JMI Wealth

Monthly View

September 2021

Reporting Season Strong

August is a key reporting month for listed companies and did not disappoint. The anticipated rebound in earnings was evident and results broadly exceeded expectations. This was reflected in share price movements.

New Zealand companies made up lost ground and the S&P/NZX Gross index improved 5% for the month. Z Energy was the recipient of a conditional offer at $3.78 per share and was the best large cap performer. Retirement villages operators rode the tailwind of house price growth with Summerset and Ryman both up over 17% for August. Mainfreight appears to be a beneficiary of the current logistical challenges and continued its upward trajectory. A2 Milk's report again disappointed investors and the share price continued to weaken. The outlook for tourism stocks continues to be muted as trans-Tasman travel was halted.

Australian shares were weaker than the New Zealand market in August but were still able to provide a sound monthly result despite the large mining companies losing some shine. BHP and Fortescue both lost around 15% as the iron ore price rapidly declined but the companies produced hefty dividends. BHP also announced a restructuring which will result in the company having a single share class collapsing the long-standing dual share structure. The overall Materials sector, which these companies are part of, declined 7.3% in August. Information Technology continued to lead the Australian market with the sector up 17% for the month. Afterpay, Australia's largest buy now pay later stock, announced an agreement for the company to be absorbed by US payments company Square for A$39 billion. Dividends and capital distributions into the Australian market will be very significant in the next few months exceeding A$32 billion. CBA alone will return A$10 billion in dividends and buybacks.

The US share market continued to rise in August with the S&P500 up 3% in local currency. The S&P 500, Nasdaq and Dow made new all-time highs. In aggregate company earnings are above those prior to the Covid 19 epidemic by approximately 30%. The large technology companies continued their momentum and Information Technology as a whole was the best performing sector. Alphabet, owner of Google, has increased 65% plus year to date. Microsoft and Facebook also appreciated through August. Financials made gains also in August as markets anticipated scope for expansion of interest margins. Energy stocks remained in the doldrums.

New Zealand Interest Rates to Rise

Prior to the commencement of the lockdowns New Zealand interest rates were poised to increase. The RBNZ meeting in the immediate aftermath of the lockdown announcement decided to defer an increase in the Official Cash Rate (OCR). A "no change" in interest rates was not the main talking point from the meeting as the Reserve Bank strongly suggested that the next move in the OCR will be up. Provided that inflation persists at current levels, employment remains tight and house prices continue to rise, the Reserve Bank's dilemma is the extent to which rates will rise and the timeframe over which an increase will be implemented. A worsening of the Covid 19 outbreak appears to be the main obstacle to an increase in the OCR at the RBNZ's October meeting. As always, the Reserve Bank will need to walk a narrow path between controlling prices and maintaining employment. As the economy is acclimatised to low rates the magnitude of increases is likely to be limited so as to not further disrupt economic activity. If New Zealand is one of the first countries to raise interest rates, we can expect a higher NZD which will be negative for the New Zealand export sector. An important factor in the move to higher interest rates will be the communication from the RBNZ and the market understanding why and feeling comfortable with the move higher. We have seen markets react negatively to interest rate rises before but it does not always have to be a negative for share markets. Currently economists anticipate the rate increasing by 1% over the next 12 months with the RBNZ itself forecasting a 2% OCR longer term.

Australian and US Interest Rates to Lag

The Australian and US central banks are under less pressure to respond to inflation. The Reserve Bank of Australia has again at its most recent policy announcement proposed that Australian interest rates remain "low" until 2024. US Federal Reserve Governor Powell in his most recent Jackson Hole speech has indicated that the Federal Reserve will look to taper monetary stimulus into the end of this year but does not anticipate directly increasing rates until post 2022. If interest differentials do realign this potentially has implications for relative exchange rates.

Conclusions

The immediate outlook is dominated by New Zealand's success in controlling the Delta strain in terms of time taken to do so, degree of disruption (restriction levels and geographic extent) and the extent to which the population can be vaccinated. Covid 19's disruptive impact on business continues to be uneven and it will be sometime until travel and leisure stocks recover. The disruption is damaging to company profitability, but companies are better equipped to respond than the first outbreak. Unless the lockdown is prolonged, further challenges will arise such as labour constraints, availability of supply inputs and price rises. Equally these conditions are providing favourable conditions for some business activity such as logistics and construction.

Locally, interest rates need to rise substantially to provide investors with a positive real rate of return. The initial stages of a rate increase cyclical are generally supportive for shares. In the current circumstances it seems unlikely that local rates will rise to an extent that investors should tilt back to defensive assets. It remains relevant to retain fixed income assets consistent with risk profile, but the introduction of global fixed income may preserve defensiveness while mitigating the effect of locally rising rates.

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Allocation to long-term benchmarks

Sector	Position	Comment
Cash	Underweight	Reduce cash, negligible return
Fixed Interest	Underweight	Returns expected to be low in short to medium term
Australasian shares	Overweight	Slight overweight preferring Australian cyclicals
Global Shares	Overweight	Slight overweight relative to strategic asset allocation
Property	Neutral	Monitor exposure to interest sensitive investments

Indices for Key Markets

As at 31 August 2021	1 Mth	3 Mth	1 Yr	3 Yrs p.a.	5 Yrs p.a.
S&P/NZX 50 Index	5.0	7.3	10.7	12.4	12.3
S&P/ASX 200 Accumulation Index (NZD)	1.0	3.5	21.5	8.2	11.0
MSCI ACWI Index (NZD)	1.5	8.2	23.8	12.5	15.6
S&P/NZX 90 Day bank bill Total Return	0.1	0.1	0.3	1.1	1.5

If you have any questions please contact us on +64 9 308 1450 or visit our website www.jmiwealth.co.nz