

Monthly View

July 2018

Global stock returns were flat overall in June, after staging some recovery in the previous two months, but still below the peak levels reached in January. Lingering trade jitters continue to weigh on market sentiment, even though broader fundamentals still appear supportive. This recent pull back in prices has come despite continued gains in forward earnings (a measure of companies expected earnings). The weaker NZD, however, assisted returns for NZ investors.

After US markets had a weak first quarter (and indeed global markets also), most shares have had a better second quarter. The S&P 500 fell -1.2% over the first quarter and recovered +2.9% in the second quarter this year. This has been helped by data confirming that the first-quarter weakness in US consumption was a temporary blip and a strong labour market, as unemployment fell to historic low levels.

Notwithstanding the strong quarter, trade concerns continue to weigh on investor sentiment (and therefore share prices). This was true particularly in June as we draw closer to the impact of the tariffs that are implemented following US-China trade negotiations. Markets outside the US, such as Chinese and emerging market equities, have been most affected. During June the China's benchmark index has fallen 20% from its 2018 high. The Chinese yuan dropped to the lowest level this year against the US dollar as investor sentiment weakened with respect to growth in China. European equities have also been affected, with auto companies suffering on fears that US tariffs could be applied to car imports. The conclusion of this scuffle is hard to predict, but the longer this drags on the greater the risk that it starts to impact sentiment more broadly.

In addition to trade concerns, the most vulnerable emerging markets, with large current account deficits (external funding requirements), such as Turkey and Argentina, have come under significant pressure with sharp currency and equity market falls. Further US interest rate rises, or dollar strength, could put additional pressure on the most vulnerable emerging market economies.

In this period our view is to favour equity exposure in regions which have markets that are better able to withstand a higher US dollar and weaker global trade.

Overall the MSCI World Index (which is a broad representation of global equity markets across 23 developed markets countries), was down -0.2% for the month of June and down -0.7% year-to-date. This suggests that the average investor in the global sharemarket will likely be in a similar position as they were at the start of 2018 (despite the rocky ride it has been so far so far). A New Zealand investor would have had currency gains from unhedged positions however.

At home the S&P/NZX50 Gross Index advanced by +3.3% in June. This was helped by strong performances by Kathmandu (+21.8%), Fisher & Paykel Healthcare Care (+13.4%), and Sky TV (+12.1%) which were the best performers. Push Pay (-3.0%), Trade Me Group (-3.1%) and Heartland Bank Ltd (-5.6%) were the biggest detractors to the index. According to the ANZ business confidence survey, business confidence was down slightly in June, however, firms' expectations of their own activity (arguably a better gauge of future GDP growth) remains positive. Looking at activity by industry, retailers remain the least positive, while manufacturers are the most upbeat.

We remain cautious about the New Zealand share market at current valuations and continue to look for companies with strong earnings relative to their share price (i.e. low price-to-earnings ratios).

The Australian S&P/ASX200 Index was also up +3.3% for the month of June and had a particularly good second quarter (+8.7%). The large cap stocks in the mining sector generally had a stellar return for the quarter – BHP Billiton rose by +20.2% and Rio Tinto by +14.8% – while the banking sector returns were mediocre, i.e., ANZ Bank at +9.5%, Westpac at +7.1%, and National Australia Bank at +1.2%. This sector has been detrimentally impacted by the findings of the Hayne Royal Commission into banking.

We are moderately cautious about the valuations in the Australian market, however, we are seeing slightly better value compared to the New Zealand market.

The Reserve Bank of New Zealand left interest rates on hold at 1.75%, as was widely expected in June. Governor Orr repeated that the OCR will stay at the current expansionary level for a considerable period. Comparing this with the Federal Funds rate, which pushed higher in June to a target range of 1.75 to 2%, it is the first time since late 2000 that the OCR is lower than the Fed Funding rate. We are advising that the duration on clients' fixed income portfolios is kept relatively short (so not to lock in a lower interest rate for a long period).

For currency in June, the NZD depreciated against the USD by -3.33% whereas the AUD also depreciated against the USD but by the comparatively smaller amount of -2.15%. This will be a gain for investors with unhedged global exposure. We believe the gap between New Zealand and US Interest rates could put further downward pressure on the NZD relative to the USD which would continue to assist the performance of clients' unhedged global share portfolios.

Our Current view

In summary we remain neutral with our view regarding global equities. US growth appears to have rebounded strongly in the June quarter, reflecting milder weather and stronger consumer spending. That is likely to continue to support solid strength in corporate earnings. However, tempering this is the potential for US-China trade negotiations to worsen over the third quarter and we will continue to monitor risks associated with deteriorating global trade carefully to consider investment risk.

We also see New Zealand and Australia as showing signs of similarly robust economies in mature stages of economic cycles. While we are cautious that Australasian shares are currently at high valuations, we will continue to prefer value stocks. Our respective Reserve Banks continue to indicate a preference for keeping interest rates low for the medium term. Notwithstanding this, we continue to keep fixed interest securities at a short duration as long-term interest rates may potentially move higher.

Given the extended period of strength from investment markets, it is important that the share exposure levels in clients' portfolios are appropriate for their risk tolerance.

Monthly View – Continued

July 2018

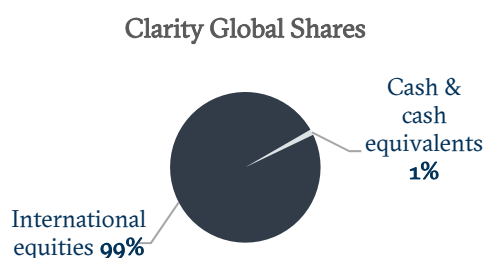
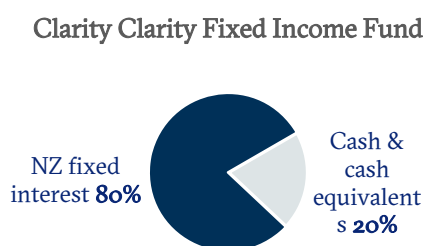
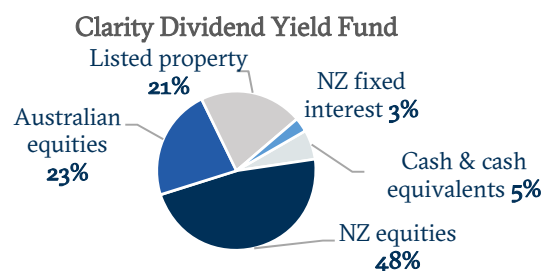
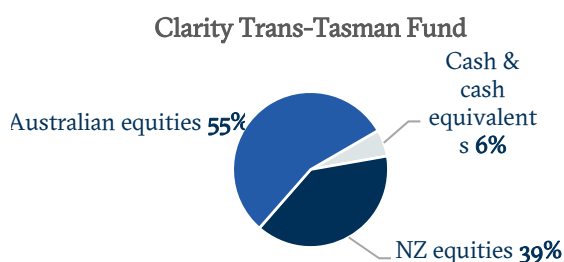
Sector	Position	Comment
Cash	Overweight	We are slowly increasing cash levels to reduce some market risk.
Fixed Interest	Underweight	We think long-term interest rates will start to increase so are keeping duration relatively short.
New Zealand Shares	Slightly Underweight	We continue to look for exposure to New Zealand companies with good dividend yields. Valuations still look high and defensive stocks are more attractive in our view.
Australian Shares	Neutral	There are some reasonably priced companies with solid growth prospects.
Global Shares	Overweight	Our preferred exposure but still wary of trade and geopolitical risks.
Property	Neutral	Attractive yields offered. An increase in cash rates could have an impact on the sector.

Clarity Fund Performance

To 30 June 2018	1 Month (%)	3 Months (%)	1 Year (%)	3 Years (p.a. %)	5 Years (p.a. %)
Clarity Trans-Tasman Fund *	+2.4%	+8.4%	+16.2%	+12.6%	+13.0%
Clarity Dividend Yield Fund *	+2.3%	+7.1%	+11.1%	+14.1%	-
Clarity Fixed Income Fund *	+0.4%	+1.0%	+4.3%	+4.2%	-
Clarity Global Shares Fund *	+0.9%	+3.4%	+14.5%	-	-

* These returns are after deductions for charges and before tax.
Past performance is not indicative of likely future performance.

Clarity Funds Investment Mix



Indices for Key Markets

To 30 June 2018	1 Month (%)	3 Months (%)	1 Year (%)	3 Years (p.a. %)	5 Years (p.a. %)
S&P/NZX 50 Capital Index	+2.9%	+6.8%	+13.3%	+11.4%	+10.3%
S&P/ASX 200 Capital Index (NZD)	+4.2%	+10.8%	+12.9%	+2.9%	+3.6%
S&P 500 Capital Index (NZD)	+3.8%	+10.0%	+21.7%	+9.6%	+14.1%
MSCI World Capital Index (NZD)	+3.2%	+8.0%	+18.5%	+6.4%	+10.8%
S&P/NZX 90 Day bank bill Total Return	+0.2%	+0.5%	+2.0%	+2.4%	+2.7%

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

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