



March 2018

Monthly View



Sharemarkets got off to a rocky start with the US S&P 500 index down 4.97% for the first week in February. This fed through to the NZX which was down 2.26% over the same period but managed to claw back most of that by the end of the month, to finish down -0.8%. But if we exclude the stellar performance of A2 Milk, up 42% for the month, the market actually closed closer to -4.0% down for February. The reporting season has now finished and overall it was positive with companies delivering earnings upgrades and if not holding dividends, providing small increases.

The takeout from this is that we might continue to see volatility as markets try and determine what effect potential inflation and interest rate increases might have on the economy.

While the major central banks would like to see a “soft landing” with gradual increases in interest rates, there is a risk that they may have to tighten much faster than expected. The US Fed have indicated that they expect to raise interest rates 3 times this year. If the Fed needs to raise rates by more than this, we could see markets react negatively.

But if we look at what we do know, rather than what we read in media about bloodbaths and market crashes, there are some competing forces at play. We have seen markets increase over the last 10 years; we have seen the US deliver a real stimulus to the economy in the tax cuts announced late last year; unemployment continues to move lower, and logic says that at some point wage inflation will begin to emerge. We also have the Fed indicating they will reduce the supply of money, and simple economics of supply and demand says when you reduce supply, prices are likely to go up. So, this is part of our rationale for thinking interest rates in the US are heading higher.

Offsetting this we have had the company reporting season in the US, and the results have been healthy overall. Revenues grew over the last quarter and are forecast to grow on average by 7% in 2018. Earnings growth was also strong, up 15% for the quarter, and is expected to grow by a similar amount in 2018. Earnings growth is shown to be a good driver of stock market performance which is a positive for markets.

Australia is also going through its reporting season with profit growth up 8% and about half the market delivering upgrades to forecast earnings.

Looking at Europe, the European Central Bank indicated that they are considering removing quantitative easing. Markets have been mixed with sound economic indicators being a positive, but the market is also on guard about the prospect of rising inflationary pressures.

Japan's economy also had positive announcements with exports growing for the 14th straight month and employment increasing, its best growth numbers in 11 years.

Our Current view

We have seen an increase in volatility across global markets. Investors are swinging between the optimism of strong economic/corporate fundamentals and the anxiety of rising interest rates.

Nobody knows when the market might correct but with synchronised global growth and companies reporting positive corporate earnings, there could still be more time before this upward momentum stops.

10-year Treasuries continue to trend higher and are getting close to the all-important 3% level. Rising yields mean higher borrowing costs which could slow the economy and send stock markets lower.

Closer to home we do not think we will see the same inflationary pressures (or house prices rises) which supports the view that we are unlikely to see any changes to the NZ Official Cash Rate (short-term interest rates) in 2018 and even into 2019.

We continue to remain watchful and recommend clients have a well-diversified portfolio at or close to their long-term strategy.

We continue to keep fixed interest maturities relatively short as long-term interest rates may potentially move higher during the year.

Allocation to long-term benchmarks

| Sector | Position | Comment |
|-------------------|---------------------|--|
| Cash | Overweight | We are recommending short dated term deposits. |
| Fixed Interest | Underweight | We still think interest rates will start to increase so keeping duration relatively short. |
| NZ Shares | Underweight | Still want an exposure with good dividend yields. Valuations still look high. |
| Australian Shares | Neutral | There are some reasonably priced companies with solid growth prospects. |
| Global Shares | Slightly overweight | We prefer Europe. Watch the Italian election. |
| Property | Neutral | Attractive yields offered. An increase in cash rates could have an impact on the sector. |

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