



May 2018

Monthly View



Global equities rebounded in April, partly unwinding the declines from the previous two months. The rebound came despite a lift in global bond yields and reflected ongoing good growth in earnings.

On a month-end basis, while the MSCI Index is now down 4.0% from its January peak, April returned a positive 1.8% in local-currency terms. Most of the equity gains came from outside the US, with the S&P 500 Index returning only 0.4% in the month. A stronger US dollar boosted by higher US bond yields appears to have supported stronger gains in Europe and Japan especially.

At home, headline business confidence in the ANZ survey fell from -20 to -23.4 (net balance of optimists versus pessimists), which is a lagging economic indicator suggesting New Zealand businesses are becoming more cautious in their outlook for the economy. This was mostly driven by the slowing activity in the construction industry. Notwithstanding this, April was a positive month for local shares, with the NZX50 Gross Index lifting 1.5% over the month, to be 0.7% higher over the past three months, and 14.4% higher from the past year. The index reached a level within 2% of its all-time high recorded earlier this year. Fletcher Building lifted 6.5% over the month, trailing only Synlait Milk's 16.2% lift at the top of the board. Conversely, A2 (-3.2%) and Fisher & Paykel (-2.6%) gave up part of the strong gains recorded in earlier months.

The US geo-political concerns regarding US President Trump's trade and military policies took a back seat last month to heightened concerns of US inflation and interest rates. Indeed, fears over a trade war with China have eased somewhat with US officials engaging in talks. At the same time, tensions with North Korea have also eased with talks pending. The remaining issues which continue to trouble markets are the final number of countries to be affected by new US steel and aluminium tariffs, and the new tensions concerning Iran. The latter has caused oil prices to gain a further 5.6% over April. In summary its looking possible that, while Trump's actions make dramatic political headlines, they may not be likely to seriously change America's trading relationships.

Alphabet, Google's parent, reported its strongest sales growth in four years. Markets however looked unfavourably at its rising costs from investments in new business such as cloud computing and hardware and the share price dropped by 4.5% following the result. Facebook seems to have shaken off privacy concerns and bounced back by 9.1% after good performance in earnings growth. Amazon rose 3.6% in April also. Notwithstanding high valuations we are starting to see the emergence of headwinds for FANG stocks (Facebook, Amazon, Netflix, and Google) due to heightened risks of regulatory scrutiny and concerns over whether the high valuations are sustainable.

In Australia the 'Hayne inquiry', the Royal Commission's inquiry into the Australian banking and financial services sector, continued to weigh on

financial stocks. AMP took the brunt and was down a further -19.0%.

Despite Australia's relatively weak performance across financial stocks (+.1% for the month), the S&P/ASX 200 still managed strong outperformance and returned 3.9% in local currency terms. This was predominately due to a weaker Australian dollar and stronger iron-ore prices particularly helping resource stocks.

With respect to global bond markets, after consolidating in March, the US 10-year government bond yield rose sharply in April, to a peak of 3.05%. This proved to be a negative catalyst for the US sharemarket. Australia and New Zealand bond markets followed the US moves in April, however, the 10-year yield here lifted more modestly and yields are still down on year-ago levels and below their US counterparts. We would expect, if long-term bond yields push higher, it would negatively affect the value of current bonds held in client portfolios.

In currency markets the USD strength in the second half of the month was the key theme during April. The USD had been in a downtrend since early 2017 but rose over 3% in the second half of April which was driven by higher US bond yields. The NZD eased 1.6% against the firming USD over the month, and the USD also posted gains against EUR, GBP, JPY, and AUD. On a trade-weighted basis the NZD eased 0.7% over the month which is positive for clients' unhedged offshore holdings.

Our Current View

We believe global sharemarkets are likely to remain satisfactory in the near term as companies continue to report positive earnings growth supported by economic fundamentals consistent with a mature economic cycle. Investors are still seeing equities as offering value when compared to bond yields, which despite some consolidation, remain low. We view the significant risk to equities is if interest rates were to move sharply higher (here and abroad) as central banks attempt to curb inflation. However, in our view a 'soft landing' orchestrated by a gradual increase in rates seems more plausible and will less likely cause a sell-off in equity markets. Accordingly, notwithstanding headwinds for the sharemarket (such as increasing rates and high valuations) we remain neutral with our global shares outlook.

We continue to keep fixed interest maturities at a relatively short duration as long-term interest rates, which remain low, may potentially move higher during the year.

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

Allocation to long-term benchmarks

| 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. |
| NZ 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 | Neutral | Despite the increased volatility international exposure may be necessary as part of a balanced portfolio. |
| Property | Neutral | Attractive yields offered. An increase in cash rates could have an impact on the sector. |

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