

# Monthly View

November 2018

Stock markets ended October on a positive note, however, that was not enough to stop the month from being one of the worst for equities since the global financial crisis. Markets were weighed down by investors' jitters over rising interest rates, the slowing Chinese economy and uncertainty about global trade tensions. Some \$5trn was wiped off the value of shares globally. The sell-off in tech shares was particularly bad. The tech-heavy US NASDAQ Composite posted its worst monthly decline since November 2008, down -9.2%.

The New Zealand market was hit in similar fashion with the S&P/NZX 50 Gross index falling -6.4% in October 2018, the largest monthly fall since May 2010. With the exception of Mercury, Sky TV and Restaurant Brands (Restaurant Brands' share price was lifted by a takeover bid), local stocks were all negative. The largest fallers in October were Summerset -14.7%, Kathmandu -19.0% and Synlait -20.1%. Up until the end of the September quarter, these 3 stocks, with the exception of A2 Milk, were the biggest rises for the Index, with each experiencing over +35% gains over the first 3 quarters of 2018. This suggests that in the current environment momentum stocks (stocks with share prices that show upward trends) are more likely to be worse affected during market sell offs.

Across the Tasman, the Australian All Ords share index recorded its biggest percentage monthly drop since August 2015, with a -6.5% fall in October, which left this index -1.1% lower for the October 2018 year. In other markets, Japan's Nikkei fell by -9.1%, which reversed a solid third quarter performance, the German DAX fell by -6.5% and the UK's FTSE index of shares declined by -5.1% during the October month.

In seemingly contradictory fashion, while markets were falling, recent data relating to economic growth, low unemployment and solid corporate earnings supported the view of a healthy US economy. Annualised US economic growth was up by +3.5% in the September quarter and the US unemployment rate fell to a 48-year low of 3.7%. Many US companies reported earnings during the third quarter of above the mean market estimates. Investors breathed a sigh of relief after Facebook reported a solid net profit of \$5.1bn on revenues of \$13.7bn in the third quarter. This was after a previous downbeat assessment it issued in July which wiped billions from its stock market value. Morgan Stanley and Goldman Sachs reported profits better than market expectations while health care companies Johnson & Johnson and UnitedHealth also recently posted better than expected earnings. Notwithstanding the good news, it did not stop investors reassessing risks and S&P 500 sold off, losing -6.9%,

its biggest monthly fall since September 2011. Again, seemingly contradictory, some argue that evidence of a strong US economy of late has hurt share prices because it supports the path of the Fed to continue to raise interest rates (share prices suffer from rising interest rates as investors see returns from bonds become relatively more attractive and the discount applied to future company earnings becomes higher). Clients should be aware that volatility in their share portfolios is likely to continue as markets get to grips with the significance of these emerging risks.

There was little movement of note for NZ interest rates but clients with a fixed interest holding found it provided some insulation from the equity market sell off. The NZD traded between 0.6425 and 0.6632 against the USD over October, ending the month near the middle of this range. Investors should be aware of their foreign currency exposure and that potential for further NZD depreciation will support returns from unhedged positions in their global share portfolio.

## Summary

This recent period of volatility is not something we should ignore. Markets have had an exceptional run as the world has enjoyed steady growth with non-existent inflation and the lowest interest rates in history.

However, the drop in the S&P 500 and S&P/NZX 50 Gross index (-6.9% and -6.4% respectively for the month of October) needs to be put into some context. The S&P 500 and S&P/NZX 50 have risen 5.8% and 7.4% for the last 12 months and 29.8% and 46.2% respectively for the last 3 years to the end of October. We consider it is still too early to assess whether recent events are the start of a shift in market momentum or a short-term correction. What it does suggest is that investors are starting to factor in some of the headwinds that have been known for some time (rising interest rates, trade tensions, a potential slowing Chinese economy) and that may slow global growth. On a positive note, recent US reporting has showed continued strength of corporate earnings growth.

At this stage we see no cause for alarm but suggest that it is a good time for investors to reflect on their long term strategic asset allocation. Given the length of the economic recovery and period of strength from investment markets, it is important that clients' portfolios are no more growth orientated than their long term strategic asset allocations.

## Allocation to long-term benchmarks

Sector	Position	Comment
Cash	Overweight	We are keeping cash at higher than normal levels during this period of volatility.
Fixed Interest	Neutral	We think long-term interest rates may increase so are monitoring duration.
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 lower risk in our view.
Australian Shares	Neutral	Despite the risks to the economy there are some more reasonably priced companies potentially offering value to investors.
Global Shares	Slightly Overweight	Generally our preferred exposure but still wary of trade and geopolitical risks.
Property	Neutral	Attractive yields offered.

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