



## Monthly View

October 2018

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Sharemarkets continue to perform well both here and abroad, despite the global trade threats and other news. The local sharemarket had another positive month during September, with the NZX50 Gross Index lifting slightly by 0.41% over the month, up 4.56% for the September quarter. Top performers for the month included Comvita (+13.6%), Chorus (+9.1%) and EBOS (+8.1%), whilst Synlait Milk (-15.2%), A2 milk (-10.8%) and FPH (-8.2%) came back from their streak over August. We believe September showed signs of some healthy scepticism toward the expensive growth orientated stocks while value stocks returned to favour. This is also reflected by the market's one year forward Price to Earnings (PE ratio is a measure of how much you have to pay for a company to produce \$1 dollar of earnings) for the New Zealand market fell marginally from 26.6 times to 26.4 times. However local long-term bond yields were marginally up over the month which suggests that equities are still not that much cheaper relatively.

The Australian market did not fare so well for the month of September with the ASX 200 share index dipping 1.1% for the month, leaving the market virtually flat over the third quarter. The ongoing Royal Commission inquiry into misconduct in the banking, superannuation and financial services industry remains a concern for their markets. However the resource sector rallied over September, helped by recent solid earnings results and strength in iron ore and oil prices. Generally the Australian market continues to present a mix of concerns in the form of weaker house prices, trade tensions, the Royal Commission, and political uncertainty. Given this backdrop, we continue to look for value stocks which offer a 'margin of safety' (a market theory that already discounted stocks do not fall as much during market downturns). Also, with this in mind, we recommend client's exposure to Australian shares should be no more than their portfolio strategy.

For international equities, the MSCI index of global shares was up 0.4% in USD terms for the month of September, taking the global share index 4.5% higher over the third quarter. A key feature over the quarter has been the divergence of returns between regions and sectors. The S&P 500 index of US shares rose 0.4% over September, setting an all-time high during the month, and rose 7.2% over the third quarter. However, after a negative month in August, UK and European shares were mixed in September. The UK FTSE 100 index lifted 1% over the month, but the earlier weakness means the index is down 1.7% over the third quarter. The EURO STOXX 50 index of blue-chip European shares weakened early in the month, but recovered later on, to end September up nearly 1%. Over the full quarter the index was up by less than 1%.

Interest rates provided a headwind for global equities in September, the Federal Reserve lifted its benchmark interest rate by a quarter of a percentage point, to a range of between 2% and 2.25%, the third rise this year. It also hinted that rates may be approaching the level at which they no longer stimulate growth, nearly a decade after they were cut to near-zero in response to the financial crisis.

Rising interest rates can become a negative factor for equity markets for a number of reasons. Over time fixed income returns become more attractive and the cost of financing debt rises. However, when the absolute level of interest rates is low, and in that initial period when a central bank shifts to a tightening basis, the economic conditions prompting that shift, i.e. strong economic growth are conducive to corporate earnings growth. This is unusual late economic cycle conditions. The trade tensions between the US and China can't be discounted in the medium-term basis either, one Chinese official said talks could not take place as long as America "holds a knife" to China's neck.

Back to New Zealand, the RBNZ kept interest rates on hold in September. The gap between US and New Zealand interest rates continued to widen which has weighed on the New Zealand dollar. During September the NZD eased as low as 0.65 cents against the USD, which is the lowest the exchange rate had been since early 2016. For the Aussie dollar, after several months of losses, the AUD strengthened a little against the USD in September, helped by firmer iron-ore prices and a broadly steady USD. Returns for client's portfolio with international equities continue to be boosted by unhedged currency exposure.

Oil prices hit a four-year high, with Brent crude trading at around \$81.30 a barrel. Combined with a cooling housing market in New Zealand (the Quotable Value data for end-August showed that the national average house price fell 1.6% from a quarter earlier to \$672k, while Auckland was down by 0.4% to \$1.05m), concern is that if trends continue other flow-on effects, such as a drop in consumer spending, may impact markets more broadly.

### Our Current view

Politics aside, global markets have had a phenomenal run in recent times with sharemarkets around the world continuing to reach new highs. In the last 2 years the total return of the S&P 500 is over 40%, which if you asked Mr Trump, would add credence to his statement that; "less than two years, my administration has accomplished more than almost any administration in the history of our country". However, as is often only considered next to an asterisk, past performance is not an indication of future performance. Growing risks to global growth continue to give us caution. In particular we continue to monitor risks associated with rising interest rates and deteriorating trade tensions carefully to consider investment risk. We also see New Zealand and Australia as showing signs of being in the mature stage of the economic cycle. Our preference for value shares, rather than growth, in our client portfolios should provide a measure of insurance in a potential market downturn.

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.

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If you have any questions please contact us on +64 9 308 1450 or visit our website [www.jmiwealth.co.nz](http://www.jmiwealth.co.nz)

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## Monthly View Continued

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### Allocation to long-term benchmarks

Sector	Position	Comment
Cash	Overweight	We are slowly increasing cash levels to reduce market risk.
Fixed Interest	Underweight	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	Overweight	Generally our preferred exposure but still wary of trade and geopolitical risks.
Property	Neutral	Attractive yields offered.