

Monthly View

September 2018

August was another positive month for the local sharemarket, with the NZX50 Gross Index lifting an impressive 4.4% over the month. A2 Milk (+20.7%), Synlait Milk (+17.6%), and Ryman Healthcare (+15.8%) led the charge and were the top performers, whilst SKY Network Television (-20.7%), Fletcher Building Limited (-9.5%) and Tourism Holdings limited (-8.2%) performed the worst. A2 Milk continues to be the dominant force when considering performance of the New Zealand market and it alone contributed an imposing +1.6% to the index for the month.

In support of the local sharemarket's impressive gains were solid profit announcements from the recent reporting season and a weaker New Zealand dollar (which makes our markets comparatively more attractive to offshore investors). A number of companies posted solid profits despite the low level of confidence reported in business confidence surveys. The Australian reporting season has also been encouraging, although the Australian market's 1% gain trailed the 4.4% gain for local shares in August.

Global equities rose in August, with encouraging economic data offsetting global trade tensions and emerging market concerns. To date, US equity investors have not been deterred over politics and trade tensions. Healthy company earnings results have supported US shares and late in the month the S&P 500 set a fresh all-time high. The tech-heavy NASDAQ index was also strong reaching 8,000 points in late August. Amazon made a strong contribution to the indices as its share rose 13% for the month helping it to become the second company to reach \$1 trillion in market capitalization (Apple being the first earlier in July). In contrast, the UK FTSE 100 and German DAX share indices shed 4.1% and 3.4% respectively in August. Brexit uncertainty was the major headwind for UK shares. European sharemarket weakness was in part attributable to the sizeable Eurozone bank exposures to Turkish debt. A weak NZD assisted returns from unhedged global shares.

August is also consistent with the recent theme of 'growth' stocks outperforming 'value' stocks. Growth stocks are companies, like A2, that are anticipated to grow at a rate significantly above the average for the market and generally focus on reinvesting any earnings to fund growth. These stocks are typically more 'expensive' because investors are prepared to pay more for earnings because they believe the long-term prospects of the company and its potential earnings are very bright. Value stocks are companies that provide more

earnings relative to their price, making them 'cheaper' and tend to return a greater portion of their earnings to investors in the form of dividends. Growth stocks tend to outperform in bull markets (when markets are up - think horns) as the market supports the investors' optimism about the company's prospects but underperform in bear markets (down - think paws) when investors tend to favour stable earnings over speculation on future earnings. We are currently, and have been for some time, a bull market.

In a surprise move the RBNZ signalled that the OCR could remain low for even longer than earlier signalled (now 2020) and the NZD weakened. In response, long-term bond yields and the NZD declined across the board during August, the latter easing 2% on a trade weighted basis over the month.

At the end of the month Fonterra lowered its forecast for the 2018/19 season milk price from \$7.00 to \$6.75 per kg MS. This has the potential to soften terms of trade (the ratio between a country's export prices and its import prices) and could encourage further NZD weakening. Continued downward pressure on the NZD will assist the performance of clients' unhedged global share portfolios.

Our Current view

In summary, we remain neutral with our view regarding shares. Positive macro indicators and robust US growth will lend support to continued solid strength in corporate earnings. However, tempering this is the potential for US-China trade negotiations to worsen. We will continue to monitor risks associated with inflation and deteriorating global trade 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. Our respective Reserve Banks continue to indicate a preference for keeping interest rates low for the foreseeable future.

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.

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 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	There are some reasonably priced companies with solid growth prospects.
Global Shares	Overweight	Generally our preferred exposure but still wary of trade and geopolitical risks.
Property	Neutral	Attractive yields offered.

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