MARKET PERFORMANCE AND ECONOMIC COMMENTARY – FEBRUARY 2019

MARKET PERFORMANCE

Financial market behaviour over the past year is summarised in the table below:

Index	1 Month %	3 Month %	1 Year %
Global Equities			
MSCI Emerging Markets	1.1	5.6	-5.1
S&P 500 (US)	3.0	0.9	2.6
Nikkei 225 (Japan)	2.9	-4.3	-3.1
FTSE 100 (UK)	1.5	1.4	-2.2
DAX (Germany)	3.1	2.3	-7.4
CAC 40 (France)	5.0	4.7	-1.5
Trans-Tasman Equities			
S&P/NZX 50	3.8	5.7	11.4
S&P/ASX 300	6.0	9.9	6.8
Bonds			
S&P/NZX NZ Government Stock	0.6	2.3	6.4
S&P/NZX A Grade Corporate Bonds	0.6	2.0	5.2
Barclays Global Aggregate Bonds	0.1	2.5	3.7
FTSE World Government Bonds	-0.2	2.3	3.9
Oil			
West Texas Intermediate Crude Oil	6.4	12.4	-7.2
Brent Crude Oil	8.0	12.6	2.1
NZD Foreign Exchange			
AUD	0.7	1.8	3.4
EUR	-1.0	-1.3	1.1
GBP	-2.8	-4.8	-2.3
JPY	0.5	-2.7	-1.6
CNY	-1.9	-4.5	-0.2
USD	-1.7	-0.8	-5.6

Source: Nikko Asset Management

We make the following key observations:

- Continued rise in equity markets through February, particularly Australia
- Positive returns in Trans-Tasman Equities and the US equity market for the one-year period compared to negative returns in global markets elsewhere
- Low returns from bond markets
- Fall in West Texas crude oil over twelve months but rise in Brent crude
- Stronger NZD versus the AUD over each time horizon

Auckland
443 Lake Road Takapuna
PO Box 33-1318 Takapuna 0740
p: +64 9 486 3144
auckland@eriksensglobal.com

Wellington
Level 9, 111 The Terrace
PO Box 10-105 Wellington 6143
p: +64 4 470 6144
wellington@eriksensglobal.com

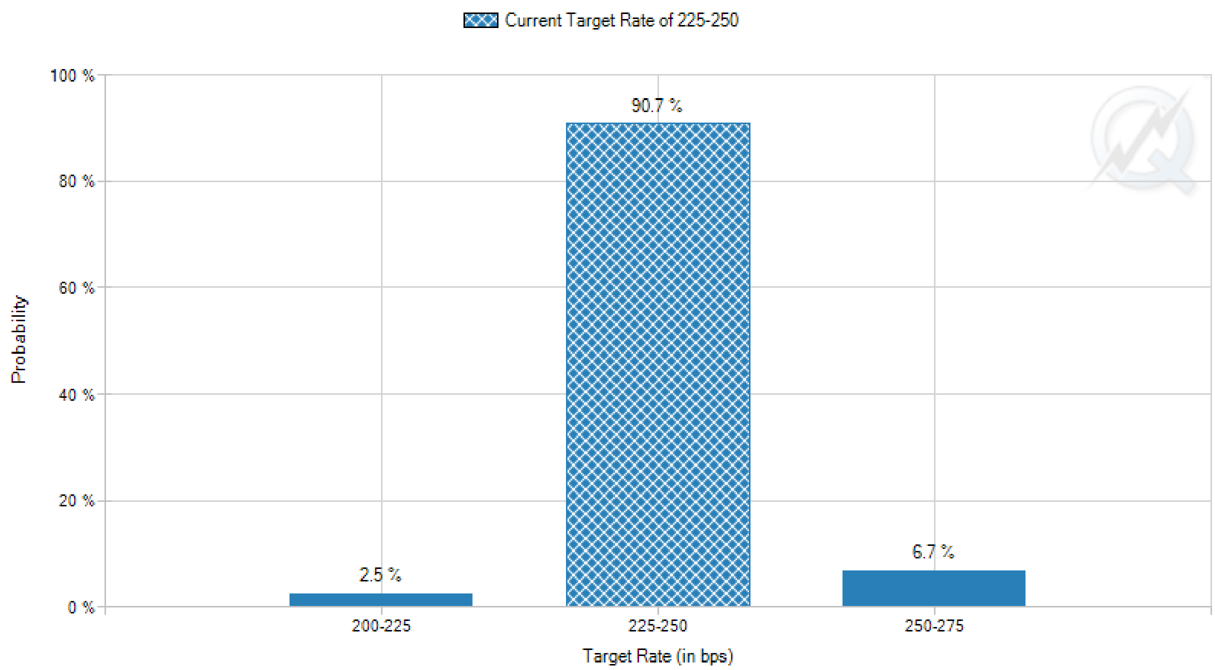
ECONOMIC COMMENTARY

Towards the end of 2018 there were three main risks at the forefront of investors' minds: (1) slowdown in global economic growth; (2) US/China trade war; and (3) continued hikes by the US Federal Reserve. Now that we are near the end of the first quarter of 2019 two of these risks have been significantly reduced, with one risk still creating doubt in the markets, that is the slowdown in global economic growth.

China's economic growth is a key concern. The National People's Congress released a report in early March with the GDP growth target for 2019 at 6.0% - 6.5%, which is lower than the point target of 6.5% last year. A survey of economists by Bloomberg saw growth forecasts at 6.2% for 2019 (down from 6.6% in 2018). This 6.2% is also what the IMF has forecast. Independent economist, Andrew Hunt, is less optimistic and is forecasting 3-4% growth.

It is now accepted that the US Fed is effectively pausing on any further hikes. The market is now pricing in a probability of around 90% that the US cash rate will remain at its current target range of 2.25%-2.50% for 2019 (illustrated in Figure 1).

Figure 1: Target Rate Probabilities for 11 December 2019 Fed Meeting



Source: https://www.cmegroup.com/trading/interest-rates/countdown-to-fomc.html

Following a decision to delay tariff hikes on $200 billion worth of Chinese goods, Trump has cited making substantial progress towards forging a trade deal. The deadline for talks has extended beyond 1 March and the prospect of the two country leaders meeting for a 'signing summit' has also been floated. There are tones of optimism that an end to the trade war could be in sight.

There is still a great deal of uncertainty surrounding the likelihood of an agreement being made. The US won't accept a 'Soybean Solution' where each country merely agrees to open their markets to exchange more goods (i.e. soybeans for aeroplanes). Ultimately Trump was elected for being a hardliner, as was US Trade Representative Robert Lighthizer who wants a deal that's enforceable and has commitments by China, especially in the areas of intellectual property rights and technology transfers. What is less clear is how much Washington is willing to compromise to avoid escalation of the trade conflict.

There are several other geopolitical events around the globe that could cause discomfort for financial markets moving forward:

- **Brexit**. Concerns over a no-deal Brexit were lessened with British Parliament voting against a no-deal exit. MPs voted in favour on extending negotiations. All 27 European Union members must agree to any extension.

  The UK is set to leave the EU on March 29, but the possible extension may clash with the European parliamentary elections in late May. The chamber is made up of lawmakers from all 28 European member countries… including the UK. The length of the extension is unknown with Theresa May stating it will be "as short as possible" but it should be before the European elections so that Britain's political mess isn't further imported to the rest of the EU.

- **Venezuela**. Hyperinflation continues to run rampant in Venezuela with the IMF anticipating the country's inflation rate will reach a staggering ten million percent in 2019. Internally, conflicts worsen as the country disputes which of its two presidents to recognise: Nicolás Maduro, who had been sworn in to a second six-year term in office or Juan Guaidó, leader of the opposition and National Assembly who declared himself acting president on January 23.

  The US, UK, France and Germany recently recognised Guaidó as the legitimate president and has the support of around 50 other countries. Maduro blames the US for the economic chaos due to sanctions and believes the US are using foreign aid to help overthrow him. Oil production and exports are plummeting, drying up revenue sources. Meanwhile creditors are demanding more than US$9 billion in overdue bond payments and Maduro repeatedly refuses international aid into Venezuela, accelerating government spending. Maduro received the support of China and Russia at a recent UN Security Council meeting.

- **Oil**. Oil is in high demand and shorter supply due to the US sanctions to Venezuela and Iran, OPEC production cuts, and optimism about US/China reaching a trade deal. This shortage was illustrated when US inventories of oil fell by 8.6 million barrels in the week ended February 22 – against expectations of a 2.8 million gain. Prices steadily increased throughout the second half of February only to take a downturn following President Trump's tweet criticising OPEC telling them to "relax and take it easy". Higher oil prices flow through to inflation figures, so any sustained increases will affect the implementation of monetary policy by central banks.

In New Zealand, the Tax Working Group has issued its report. As clearly signalled, it is recommending a broad-based capital gains tax (CGT) which, however, excludes the family home. Whilst not planned to take effect until after the next election, their recommendations will clearly stimulate lots of discussion.