MARKET PERFORMANCE AND ECONOMIC COMMENTARY – OCTOBER 2019

MARKET PERFORMANCE

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

Index	1 Month %	3 Months %	1 Year %
Global Equities			
MSCI Emerging Markets	3.0	1.9	11.4
S&P 500 (US)	2.0	1.9	12.0
Nikkei 225 (Japan)	5.4	6.5	4.6
FTSE 100 (UK)	-2.2	-4.5	1.7
DAX (Germany)	3.5	5.6	12.4
CAC 40 (France)	0.9	3.8	12.5
Trans-Tasman Equities			
S&P/NZX 50	-1.3	-0.6	23.3
S&P/ASX 300	-0.4	-0.8	19.5
Bonds			
S&P/NZX NZ Government Stock	-1.1	1.0	8.0
S&P/NZX A Grade Corporate Bonds	-0.4	1.0	6.9
Barclays Global Aggregate Bonds (Hedged to NZD)	-0.2	1.5	9.9
FTSE World Government Bonds (Hedged to NZD)	-0.5	1.7	10.6
Oil			
West Texas Intermediate Crude Oil	0.2	-7.5	-17.0
Brent Crude Oil	-0.5	-7.1	-19.4
NZD Foreign Exchange			
AUD	0.1	-2.8	1.0
EUR	-0.1	-3.0	-0.3
GBP	-2.6	-8.1	-3.0
JPY	2.3	-3.3	-5.9
CNY	0.9	-0.7	-0.8
USD	2.3	-2.8	-1.8

Source: Nikko Asset Management

We make the following key observations:

- Weak NZD over the past 3-12 months, primarily due to the RBNZ cut in August
- Positive returns of global equities (excluding UK due largely to Brexit uncertainty) for the month following positive news on a possible US/China trade deal
- Fall in trans-Tasman equity markets over the one and three-month periods
- Negative returns from bond indices over the month as longer-dated bond yields increased

Auckland
2 Burns Avenue 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

The main risks driving markets through October were (1) central bank decisions, and (2) geopolitical risks.

The US Federal Reserve reduced the federal funds target range by 0.25% (down to 1.5%-1.75%). This was the third reduction for 2019. A major reason cited by Chair Powell was the ongoing risks posed by the US/China trade war. The market is now effectively pricing in a pause to any further cuts over the next 12 months. The Fed will patiently await incoming data, with a careful eye on inflation which is still below the 2% target. US economic growth data shows a slowing economy – annual GDP growth was 1.9% to the end of Q3, down from 2% (Q2) and 3.1% (Q1).

Whilst the trend in cash rates by central banks is clearly downwards, longer term interest rates appear to have stabilised and have begun to rise slowly again. Ultimately, the key interest rate risks are at the long end of the yield curve if they rise too quickly.

Figure 1: 10-year government bond yields over the last three years[1]

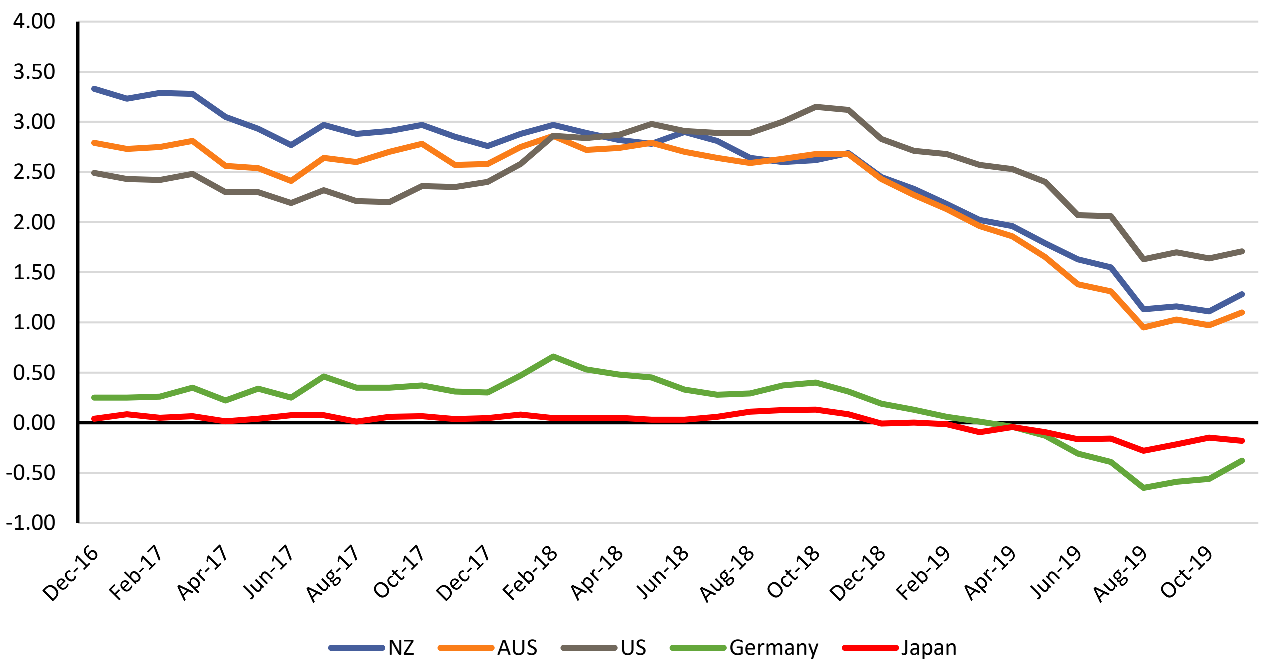

Figure 1 shows the movement of the 10-year government bond yields over the past three years. There are two observations to point out in this graph:

(1) the trend has been downwards for most of 2019, which is largely due to the switch that was flicked at the end of 2018 by the US Fed on monetary policy, but also risks from the US/China trade war; and,

[1] Organization for Economic Co-operation and Development, Long-Term Government Bond Yields: 10-year: Main (Including Benchmark) for the selective countries, retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org, November 10, 2019

(2) the slight tick up on yields in September and October following optimism on a potential 'Phase 1' agreement between the US and China.

The optimism surrounding a trade deal should be taken with definite caution. The erratic nature of President Trump could mean a very quick move back to the negotiation table if there is something he doesn't like.

News of potential impeachment of President Trump affected markets through the month. If this turns from bad to worse for President Trump then one aspect of this that should be considered is what happens on the Democratic side. More specifically, what is the likelihood of Elizabeth Warren becoming the Democratic nominee in the 2020 Presidential election?

Warren has become a leading contender to be the Democratic nominee. This is likely to be harmful to financial markets given her policies which rely heavily on protectionism and regulation. The Economist lists a few of her policy stances:

"Banks would be broken up, split between commercial and investment banking. Tech giants such as Facebook would be dismembered and turned into utilities. In energy there would be a ban on shale fracking (which, for oil markets, would be a bit like shutting down Saudi Arabia), a phase-out of nuclear power, and targets for renewables. Private health insurance would be mostly banned and replaced by a state-run system. Private-equity barons would no longer be shielded by limited liability: instead they would have to honour the debts of the firms in which they invest."

The market has not priced any significant risks in regards to Warren at present, though this may come in early February 2020 when the first Presidential primary elections begin in New Hampshire and Iowa.

Two other geopolitical risks affecting markets through October were news of another extension to Brexit (to 31 January); and protests in Hong Kong to sustain democracy. The protests have continued despite the withdrawal of the extradition bill, which was the original cause of the protests. The continued unrest in Hong Kong increases the risks to capital flight from the region.