ERIKSENSGLOBAL
Actuaries & Investment Strategists

MARKET PERFORMANCE AND COMMENTARY – JULY 2020

MARKET PERFORMANCE

Index	Index Level/ Price	1 Month %	3 Month %	1 Year %	3 Year % p.a.	5 Year % p.a.
Global Equities						
MSCI Emerging Markets	638.51	8.1	16.0	10.7	5.5	7.7
MSCI All Country World Index	264.88	4.0	11.5	6.2	7.4	7.4
S&P 500 (US)	3,271.12	5.5	12.3	9.8	9.8	9.2
Nikkei 225 (Japan)	21,710.00	-2.6	7.5	0.9	2.9	1.1
FTSE 100 (UK)	5,897.76	-4.4	-0.1	-22.3	-7.2	-2.5
DAX (Germany)	12,313.36	0.0	13.4	1.0	0.5	1.7
CAC 40 (France)	4,783.69	-3.1	4.6	-13.3	-2.1	-1.2
Trans-Tasman Equities						
S&P/NZX 50	11,727.63	2.4	11.4	8.0	15.1	14.6
S&P/ASX 300	64,488.29	0.6	7.8	-9.7	5.4	5.2
Bonds						
Bloomberg NZBond Govt NZD	4,626.16	0.9	0.4	5.8	6.2	5.1
Bloomberg NZBond Composite NZD	1,667.93	0.7	0.7	5.3	5.7	4.9
BBgBarc Global Aggregate Hdg NZD	444.82	1.0	1.9	6.0	5.3	5.1
FTSE WGBI Hdg NZD	3,746.97	1.0	1.1	6.8	5.7	5.3
Oil						
West Texas Intermediate Crude	40.27	2.4	66.4	-55.6	-20.0	-19.4
Brent Crude	42.81	5.2	71.3	-33.6	-6.3	-3.7
NZD Foreign Exchange						
AUD	0.9289	-0.7	-1.4	-3.0	-3.2	-4.1
EUR	0.5633	-1.7	0.0	-5.0	-6.3	4.3
GBP	0.5075	-2.6	3.8	-5.8	-0.3	6.2
JPY	70.4321	1.4	6.8	-1.7	-3.9	10.0
CNY	4.6479	2.2	6.7	2.2	-1.1	10.6
USD	0.6662	3.5	8.0	0.9	-1.3	12.4

Source: Morningstar, Nikko

We make the following key observations:

- Geopolitical risks in China, US, Lebanon
- Reintroduction of Covid-19 to New Zealand
- Upcoming elections in NZ, US creating uncertainty
- Unemployment and jobless claims figures in US reducing although the headline numbers don't tell the whole story

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ECONOMIC COMMENTARY

COVID

A second wave of COVID is perhaps the largest risk to economies in the near term. It is currently sweeping through Victoria, Australia where the state went back into lockdown in July and Auckland had its first case of community transmission from an unknown source after 102 days. A second wave to economies could be devastating for businesses that were only just able to get through the first wave of COVID lockdowns. The focus on a vaccine will therefore continue to be at the forefront of any market-moving news in the months ahead. Until there is any effective vaccine it is likely that technology stocks and quality stocks will continue to outperform other parts of the equity market that are more closely tied to the “real” or “tangible” economy.

Getting COVID-free bubbles with our Pacific Island neighbours would stimulate tourism, boost the airline industry, and support short-term migrant workers for the next fruit picking season. However the time frame for this is likely to be extended given NZ has stepped back up the Alert Level ladder.

Elections

In the US, the democrats look to have a strong hold on polling numbers for this presidential campaign. Democratic candidate Joe Biden’s quest for higher taxes and closing the ever-increasing wealth gap is charging ahead. The evolution of the pandemic will shape the process ahead of the presidential election.

The risk of changing governments is high, despite tensions continuing to rise with President Trump’s anti-China rhetoric in full swing, pandering to voters in the hope it will help his bid for re-election. The US closed the Houston Chinese consulate in July amidst fears of spying. Beijing retaliated by ordering the close of the US consulate in Chengdu.

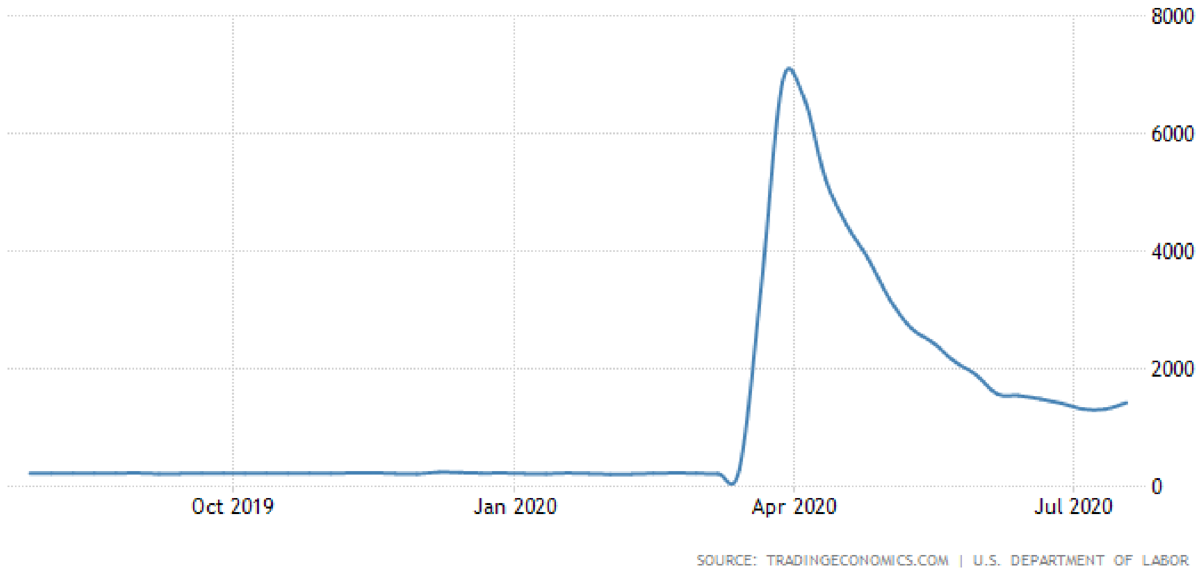
In New Zealand, Labour lead the polls with over 50% of the votes at present. This would be the first time since 1951 that a party achieved a 50% majority. The need for a coalition is still real under MMP. The Greens and NZ First polling numbers are not encouraging for either party. This is a critical election because of COVID and the resulting recession. Individual voters need to decide whether they want to see jobs be created or see them go overseas: whether we want a hand-out or a hand-up.

Over the next few months in both New Zealand and the US we will see if politicians play too much politics, overshadowing the needs and well-being of each respective countries inhabitants, or will they keep their country’s best interests at heart?

Markets

The US initial jobless claims data released in mid-July showed an increase in claims for the first time since March. This follows the increase in cases across the US as some states reopened their economies earlier than they perhaps should have. The US Manufacturing PMI figure increased to 49.8 in June which is almost neutral and a significant increase from 39.8 in May. These are only a couple of data points but should be a reminder that the economic recovery will not be a smooth one and will most likely be prolonged and largely dependent on containment of the pandemic, medical treatments and potential vaccines.

Figure: US Initial Jobless Claims



A relief package was passed in Europe, impressive since there is no fiscal union there. The €750 billion package shows solidarity within the Eurozone, notably the UK was absent from meeting. The next few months of uncertainty will show the Brits' resilience. The future trajectory of the UK will be decided by the pandemic resurgence, a flood of business failures and redundancies, and a no-deal Brexit.

Geopolitical Risks

Although the financial stability of the Eurozone was strengthened, other parts of the world are volatile. The Government in Lebanon has fallen of the tragic explosion at the port. China is exercising its new powers in Hong Kong and threatening the sovereignty of Taiwan and the South China Seas. President Trump is sanctioning Chinese officials and disrupting Chinese tech companies who use US technology.

New Zealand

Rio Tinto announced the closing of the New Zealand Aluminium Smelter in just over a years' time, causing large sell offs in the energy sector. The closing of the smelter will result in the direct loss of around 1,000 jobs and a further 1,600 indirectly connected to the smelter. The move to more renewable energy sources will see many families, schools and small businesses suffer because of the decision. With global supply chains at risk, New Zealand has the opportunity to broaden and deepen its manufacturing capacity. This will have the effect of retaining and/or generating jobs and broadening the economy, thus it makes sense to keep essential manufacturing going in NZ.

The NZ CPI index fell during Q2 and unemployment fell from 4.2% to 4.0%. Despite this the number of people not in the labour force rising by 37,000, the number of people employed fell 11,000 and the number of hours worked fell 10.3%. These latter figures give a better picture of how the economy has reacted to the

COVID-19 pandemic than unemployment percentages alone. We are effectively underutilising our workforce.

This should not come as a surprise as the Treasury anticipated that we would be seeing 8.5% unemployment at this point of the year given our lockdown scenario. This points to NZ having a better recovery than anticipated, but we still have a very long way to go. We need to stay vigilant.

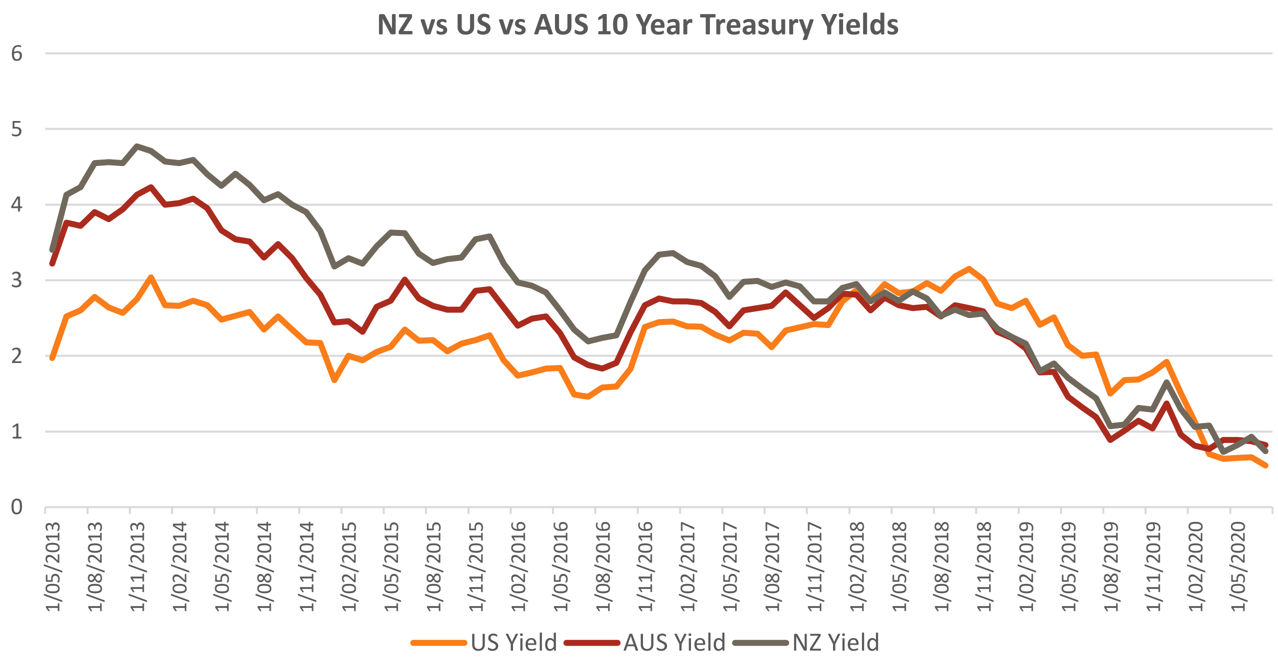
The end of the fiscal and monetary support packages in New Zealand may see this unstable and volatile bullish run of equities come to a halt.

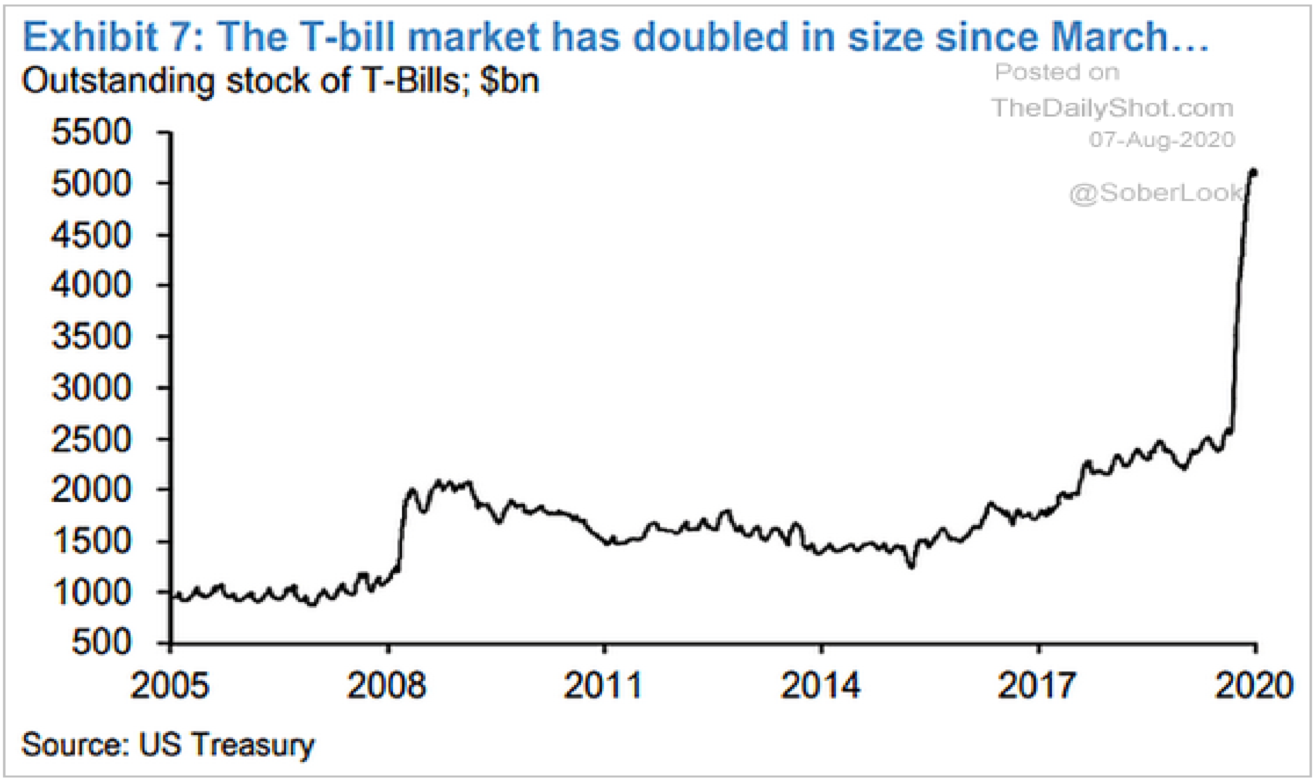
Long Term Interest Rates in NZ

Although the current ultra-low interest rates could well continue for years, they are causing difficulties for conservative investors and financial modellers alike. How can you quantify the risk premium?

In our view the 20-year plus duration Government nominal bond yields should be between 4% - 5% per annum. This would imply a cash rate of 2% - 2.5%, inflation around 2% p.a. and a 10-year yield of 3.5% - 4%. Doesn't that remind you of the good old days?!

Contrast these expected returns with US 30-year mortgages at 2.98% interest rate; the lowest they have been since 1971. The Treasury Bill market in the US has doubled in size since March because of quantitative easing. This gives a good indication of the extent of the Fed's intervention.





Source: TheDailyShoot.com