# ERIKSENSGLOBAL

Actuaries & Investment Strategists

## MARKET PERFORMANCE AND COMMENTARY – OCTOBER 2021

### MARKET PERFORMANCE

| Index | Index Level/Price | 1 Month % | 3 Month % | 1 Year % |
|---|---|---|---|---|
| Global Equities | | | | |
| MSCI Emerging Markets | 756.50 | 0.9 | 0.3 | 16.2 |
| S&P 500 (US) | 4605.38 | 6.9 | 4.8 | 40.8 |
| Nikkei 225 (Japan) | 28892.69 | -1.9 | 5.9 | 25.7 |
| FTSE 100 (UK) | 7237.57 | 2.1 | 2.9 | 29.8 |
| DAX (Germany) | 15688.77 | 2.8 | 0.9 | 35.8 |
| CAC 40 (France) | 6830.34 | 4.8 | 3.3 | 48.7 |
| Trans-Tasman Equities | | | | |
| S&P/NZX 50 | 13099.82 | -1.3 | 4.0 | 8.4 |
| S&P/ASX 300 | 83921.48 | 0.1 | 0.8 | 28.6 |
| Bonds | | | | |
| S&P/NZX NZ Govt Stock | 1786.87 | -3.3 | -5.6 | -10.0 |
| S&P/NZX A Grade Corporate | 5654.08 | -2.3 | -3.6 | -6.4 |
| Barclays Global Agg (Hedged to NZD) | 424.09 | -0.2 | -1.4 | -0.8 |
| FTSE WGBI (Hedged to NZD) | 3653.17 | -0.2 | -1.7 | -2.2 |
| Oil | | | | |
| West Texas Intermediate Crude | 83.57 | 11.4 | 13.0 | 133.5 |
| Brent Crude | 83.92 | 6.5 | 11.3 | 127.4 |
| NZD Foreign Exchange | | | | |
| AUD | 0.9528 | -0.2 | 0.3 | 1.2 |
| EUR | 0.6184 | 3.9 | 5.1 | 9.0 |
| GBP | 0.5221 | 2.0 | 4.0 | 2.1 |
| JPY | 81.6020 | 6.0 | 6.5 | 18.1 |
| CNY | 4.5821 | 2.9 | 1.6 | 3.5 |
| USD | 0.7157 | 3.7 | 2.5 | 8.3 |

Source: Nikko

Executive summary:

- Equity markets rose except New Zealand and Japan
- Bond markets are down
- Interest rates rose as inflation pressures continued
- NZ dollar strengthened against major currencies except AUD
- Investors are cautious but central banks are less so



**Auckland**
2 Burns Ave, 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

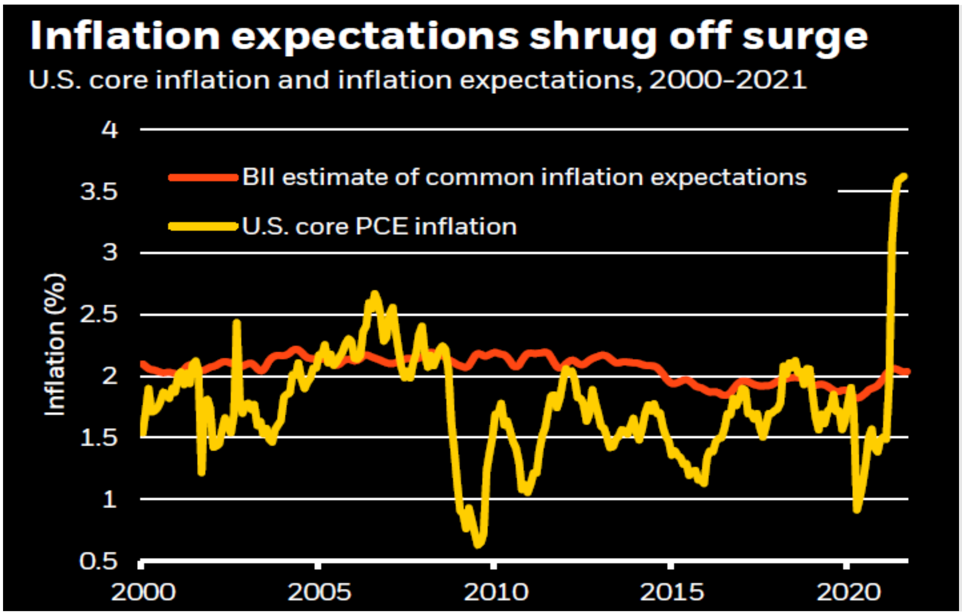
## ECONOMIC COMMENTARY

### GLOBAL SNAPSHOT

The main theme of October was inflation. Elevated energy prices, rising labour costs for service sector workers, and supply chain disruptions continue, and if inflation expectations move higher, it could force the Fed and other Central Banks to raise cash rates sooner to control it. But what is the markets' expectation?

Inflation expectations can be estimated by combining financial market data and information from surveys of consumers, businesses and professional forecasters into a single index. By comparing this index against actual inflation outcomes, we can see that although inflation expectations have risen in the US, the change in expectations is far smaller than the change in real core inflation data. Inflation expectations remain very close to the Fed's 2% target, (Figure 1), while the rate of PCE inflation is at a 30-year high.

***Figure 1***




Source: BlackRock

To counter, the Fed has signalled that it will start tapering its stimulus payments around the end of the year. Additionally, the Bank of Canada (quite abruptly) ended its quantitative easing program, reducing bond purchasing from $C2 billion per week to $C0 at the end of October. These are sensible moves from North America to control inflation. But is Europe following suit?

Initial estimates from Eurostat pegged the headline eurozone inflation rate at 4.1% in October – the highest level in 13 years. Higher energy costs were of course a prominent factor, yet core inflation, which excludes volatile energy and food prices, still ticked up to 2.1% from 1.9%. The European Central Bank (ECB) stated it would continue buying assets under the auspices of its Pandemic Emergency Purchase Programme (PEPP). ECB President Lagarde acknowledged that inflation could "take longer to decline than initially expected" but insisted the rate of consumer price increases should slow to less than 2% by 2023. Lagarde also said she expected the ECB's PEPP activities to end in March 2022, although she suggested the central bank would decide in December whether to expand on a different asset purchase programme… Can they have it both ways?

Another prominent theme is climate change and clean energy. There has been massive investment in clean energy – an average of US$1 trillion a year between 2016 and 2020 according to the International Energy Agency (IEA). But the IEA states to reach net zero emissions by 2050 there needs to be global annual investment of around US$4 trillion. More clarity on climate policies will encourage the private sector to invest in clean energy and related technologies. Clear commitments should result from the UN Climate Change Conference (COP26). Emerging markets are already in urgent need of funding for low carbon investment, and small island nations are some of those most impacted by climate change.

While increasing investment in clean energy will be modestly inflationary, the transition creates investment opportunities in both public and private markets. We will be looking towards strategic opportunities in the deep tech and forestry space that contribute to reaching net zero.

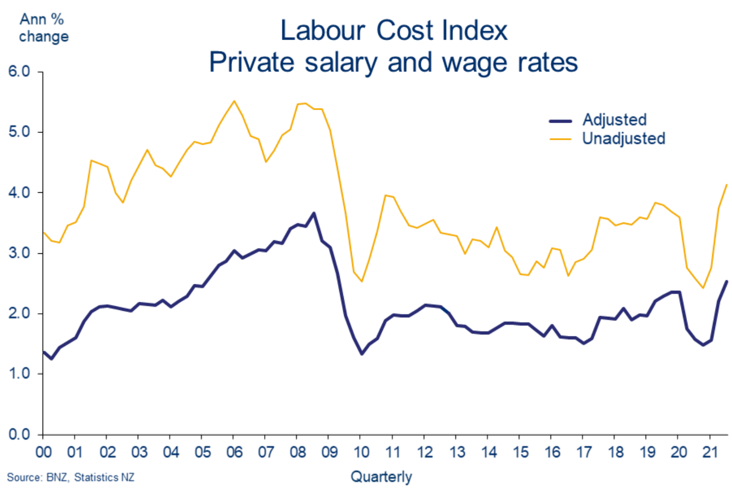
## LOCAL SNAPSHOT

Annual inflation surged 4.9% compared to a rise of 3.3% in the previous quarter, the biggest annual movement since Q2 2011. This beat the 4.1% forecast of the Reserve Bank of New Zealand (RBNZ).

The main driver was housing-related costs, such as construction of new houses and local authority rates. Vegetable prices was the second major driver, along with increased transport costs and fuel prices.

The labour market remains extremely tight and there appears to be no reduction on labour demand despite COVID community outbreaks and lockdowns. Those who are employed are also seeing good wage growth, as annual wage inflation lifted from 2.2% to 2.5%. The Labour Cost Index (LCI) showed that 18% of the surveyed workforce had pay increases in excess of 5.0% over the last twelve months (Figure 2). Clearly employers are keen to retain talent, but are also optimistic about future cashflow. The LCI itself rose by 0.7% to an annual 2.5%, well above the 2.0% considered consistent with the RBNZ meeting its inflation targets. With annual CPI inflation pushing up towards 6.0%, and the labour market as tight as it is, pressure on wages can only intensify. With all these factors in play, it's likely the RBNZ will make another cash rate rise of 25bps in November

***Figure 2***



## WORLD FINANCIAL MARKETS

**Equities**

In the US, the S&P 500 returned 7.0% in October, and 22.6% since 31 December 2020. Most of the major indexes also recorded gains and reached new highs. Consumer discretionary shares fared best within the S&P 500, boosted by a jump in Tesla following news that rental firm Hertz Global agreed to buy 100,000 of its electric vehicles. Energy shares underperformed on expectations as oil prices fell back from multiyear highs. Supply chain problems are still in play, with both Amazon.com and Apple reporting lower growth forecasts because of labour and input shortages.

Around a quarter of S&P 500 companies have reported 3Q results and 83% have beaten profit expectations. In financials, where almost 60% have reported, 88% have beaten forecasts. From a revenue perspective, 79% of S&P 500 companies that have reported have surpassed consensus expectations. This is good news and boosts the value of a very expensive equity market.

More locally, Australian equities cooled off at the end of October, with the S&P/ASX 200 selling off around 2% of its month to date gains in the final two days, closing just 0.1% up. Meanwhile, the S&P/NZX 50 closed for the month with a drop of -1.3%. Given the past couple of years this is still cream off the top.

**Fixed Interest**

Slowing growth helped drive a retreat in intermediate- and long-term US Treasury yields. Hawkish signals from both governments and central banks drove long-term yields lower and contributed to flattening the yield curve by bringing short-term rates higher. Over one week, the US 10-year Treasury yield decreased by 7bps to 1.56%.

Germany's 10-year bund yield fell lower early on, in sympathy with US Treasury yields, and fell further midweek after growth worries and concerns that central banks would commit a policy error by tightening too early. But core eurozone yields rebounded after ECB President Lagarde continued to be dove-ish, contrary to expectations. UK gilt yields fell, as the Debt Management Office reduced the amount of gilt issuance for the rest of the fiscal year by a much larger-than-expected amount. The UK 10-year gilt yield ended the month 11 bps points lower than the previous week, going down from 1.14%.

Fixed income in Australia fell dramatically, with the S&P/ASX Australian Government Bond Index declining 4.3%. Since the RBNZ increased rates by 25bps at its last announcement, there remain mounting expectations of a hike from the Reserve Bank of Australia in 2022, and potentially an end to bond purchases.

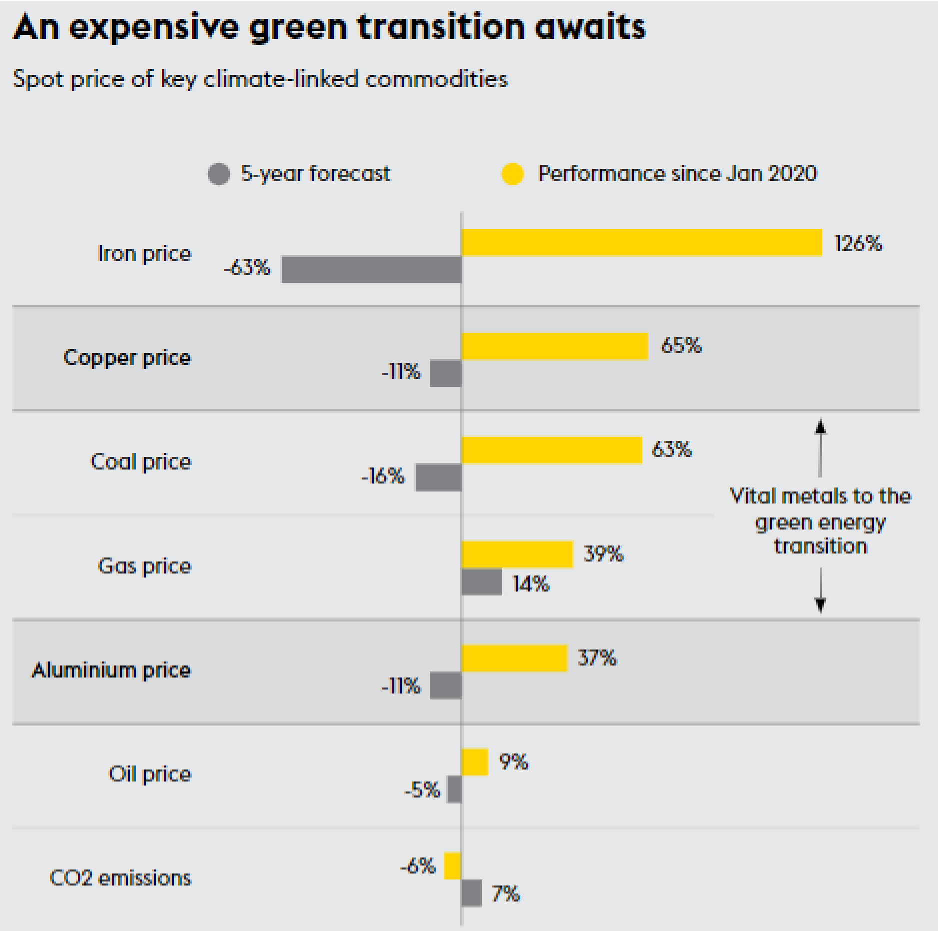
## ONE STEP FORWARD, TWO STEPS BACK FOR CLEAN ENERGY

Demand for raw materials diminished when the pandemic first struck, and so did commodity prices. The largest annual drop in global CO2 emissions since WWII was also recorded in 2020, which showed what city air and city health outcomes might look like in a net zero world.

But the rebound in both demand and price has been fierce. The Commodity Research Bureau's (CRB) Commodity Index is 35% higher year to date with rallies in the price of key raw materials such as copper, lumber, and iron ore to all time highs. Oil prices rose from record lows during the pandemic, and today demand in 2022 is expected to outpace planned supply. Meanwhile, there is increased demand for renewable energy sources and industrial metals such as copper, aluminium, lithium and cobalt, which are key to the clean energy transition. The CRB shows the impact of both current drivers of commodity prices like COVID related supply and demand disruptions, and the long term green transition that will boost demand for particular commodities.

As we mentioned earlier, the increased demand and funding for renewables will be modestly inflationary. Currency fluctuations are likely to occur for those countries reliant on (or flush with) certain commodities from either the 'old order' or necessary for the transition to clean energy.

**Figure 3**




*Source: Western Union*

Meanwhile, governments around the world are publicly ramping up investments in sustainable projects to meet the goals of the Paris Agreement on climate change, but just 2% of reported governments' $16 trillion of recovery spending is going to clean energy transitions. We wonder if COP26 will result in anything other than impassioned talk. The IEA has already warned that 2022 could see some of the world's biggest increases in energy-related carbon emissions in history amid this stimulus-fuelled economic rebound.

The stimulus is even coming up against nature's limits. After electricity supply has limited production in several key cities, China's Zhejiang province brought in its first shipment of thermal coal from Kazakhstan. China is now seeking imports of coal from Indonesia, Russia and Mongolia, to satisfy demand.

India's top power producer, NTPC Limited, is also seeking to import coal for the first time in two years. The fuel will mainly be used at power plants located far from domestic coal mines, to improve power resilience.

Not to be left behind, coal fired electricity generation in the US is also expected to be higher this year compared to 2020 due to high natural gas prices versus relatively stable coal prices. The US Energy Information Administration (EIA) said it expects 22% more US coal fired generation in 2021 than in 2020, marking the first year-on-year increase since 2014. But although rising natural gas prices have resulted in more US coal-fired generation than last year, the increase in coal generation will most likely not continue, the EIA added.

## GEOPOLITICS

In October Turkey was in geopolitical headlines. Turkey's President Erdogan, ordered his foreign minister to declare ten foreign ambassadors (from United States, France, Canada, Finland, Denmark, Germany, the Netherlands, New Zealand, Norway and Sweden) persona non grata after their calls to release the jailed philanthropist Osman Kavala. For background, the European Court of Human Rights' directed Turkey two years ago to release Kavala, who was accused of instigating the 2013 Gezi Park protests. Kavala himself was jailed over four years ago, acquitted once and then immediately rearrested to 'await trial.'

It couldn't have come at a worse time, as Erdogan has already publicly threatened to stop trade with several key trading partners and NATO allies. Relations between Turkey and its NATO allies have been taut since Turkey's involvement in the conflict between Azerbaijan and Armenia (namely the Nagorno Karabakh war). The use of Turkish drones undermined the position of the US and was a major step in challenging the US' monopoly over the sale of combat drones globally. Poland is set to become the first NATO member to buy Turkish armed drones – and they are also one of the few countries that refrained from any public statement regarding Kavala.

Canadian defence firm Telemus Systems Incorporated is another victim of ongoing political issues with Turkey and has now filed for bankruptcy after Canada cancelled export permits for military goods and technologies to Turkey in April 2021 in response to Turkey's role in the Nagorno Karabakh war. The decision prevented the electronic warfare systems manufacturer from completing existing deals with Turkish Aerospace Industries Incorporated. Hopefully the net result of these political moves is less conflict instead of more.

However, despite drones and other military technology, it remains the humble gas pipeline that is the most effective weapon, especially in winter. The EU currently depends on Russia for more than 40 per cent of its gas imports. While Gazprom (the largest supplier of natural gas to Europe and Turkey) has met its obligations under long term agreements, it has not sold additional gas on the EU spot market, instead filling Russia's domestic storage. Some European politicians allege that Russia is withholding gas deliberately to pressure EU authorities into speeding final regulatory approval for the Nord Stream 2 pipeline. Alexander

Novak says it will ‘cool off the current situation.’ But Biden’s administration continues to be cautious of increasing Russian influence over the EU.

Meanwhile in China, a government press release urged local authorities to ensure there was adequate food supply during winter – encouraged people to stock up on essentials. Social media lit up, causing international stockpiling by the nervous and in-touch. State media subsequently stated the message was due to possible quarantines due to COVID – but we wonder if this was to throw suspicion off a potential move on Taiwan.

## PEAK CONVENIENCE?

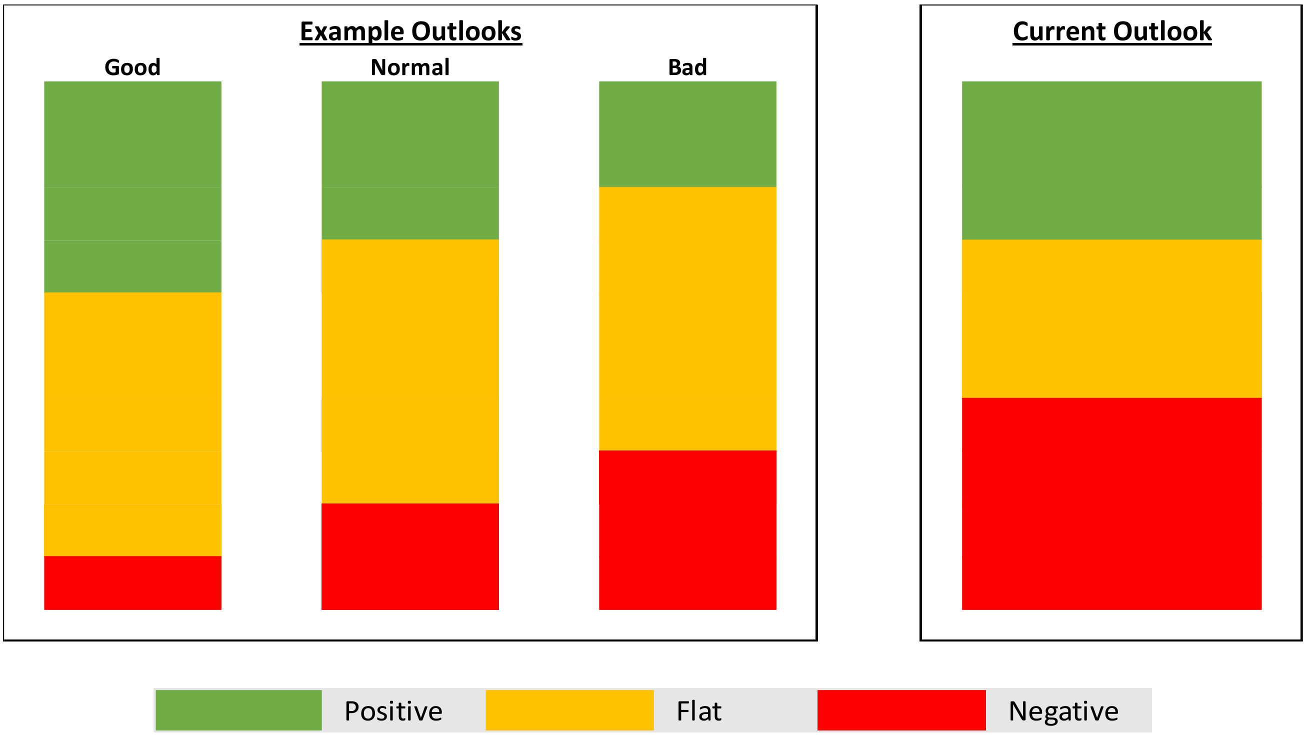
Zepto, which raised $60 million initially and competes in India's grocery delivery market, aims to deliver groceries in less than 10 minutes. This is one example of a fast delivery grocery start up, and others like it have received over $14 billion of investment since the start of 2020, in a sector turning over $2 trillion annually. Now valued at $225 million, Zepto uses small warehouses known as “dark stores” stocked with essentials that are delivered by employees rather than gig workers. In the UK, Zapp is a similar grocery delivery start up that also operates with dark stores and employees. In Paris, Uber has partnered with Carrefour, to make its own 15 minute grocery delivery service called Carrefour Sprint, partnering Carrefour employees and Uber gig workers in a hybrid model.

Despite all this growth, the ultra fast delivery model is challenged by consumer expectations meeting the reality of logistics. Turkish company Getir, valued at $7.5 billion, admits operations are the key challenge and to compensate for wastage and other inefficiencies the platform generally charges 5% to 8% more than supermarkets. However, the recent partnership of UK grocery chain Tesco with Berlin-based Gorillas grocery delivery service, along with similar ambitions of retailers like Kroger, point to future consolidations and acquisitions. As supermarkets continue to acquire these start ups it presents an easy exit for early stage investors, and in the future it could make fast groceries the new standard – at a cost.

## AND FINALLY, A HI-TECH BANDAID FOR THE US HEALTH SYSTEM

Amazon has announced two innovative programs to integrate virtual assistant technology Alexa into hospitals and senior living facilities for more efficient care and communication. In hospitals, the Alexa Smart Properties program can bring the nurse's voice directly to a patient’s room with an intercom-like device. In 2022 Amazon Care will expand its virtual and in-person ‘telehealth’ appointments as well as its prescription drug delivery service. In the future, digital health could transform patient care, from AI tools to determine vital statistics to technology that can fully integrate all hospital services. While we don’t look forward to communicating via intercom in our own twilight years, it’s great news for frontline workers and creaking health systems.

## MARKET OUTLOOK




The current market is less likely to have a good return (green) as an average return (amber) over the next two to three years. It is a little more likely to have a bad return (red). The risk of a correction is increased marginally compared to the last one we had.