ERIKSENSGLOBAL
Actuaries & Investment Strategists

MARKET PERFORMANCE AND COMMENTARY – DECEMBER 2022

MARKET PERFORMANCE

Index	Index Level/Price	1 Month %	3 Month %	1 Year %
Global Equities				
MSCI World NR	6,236.96	-5.1	7.5	-16.0
MSCI World NR (NZD)	12,626.84	-6.0	-1.8	-11.4
MSCI Emerging Markets	627.54	-2.0	6.6	-15.5
S&P 500 (US)	3,839.50	-5.9	7.1	-19.4
Nikkei 225 (Japan)	26,094.50	-6.7	0.6	-9.4
FTSE 100 (UK)	7,451.74	-1.6	8.1	0.9
DAX (Germany)	13,923.59	-3.3	14.9	-12.3
CAC 40 (France)	6,473.76	-3.9	12.3	-9.5
Trans-Tasman Equities				
S&P/NZX 50	11,473.24	-0.7	3.7	-12.0
S&P/ASX 300	84,173.60	-3.3	9.1	-1.8
Bonds				
S&P/NZX NZ Govt Stock	1,648.36	-1.5	0.1	-9.1
S&P/NZX A Grade Corporate	5,417.52	-0.8	0.2	-5.1
Barclays Global Agg (Hedged to NZD)	375.85	-1.2	0.8	-11.7
Oil and Gold				
West Texas Intermediate Crude	80.26	-0.4	1.0	4.2
Brent Crude	84.97	-1.8	-1.4	9.7
Gold	1,824.02	3.1	9.8	-0.3
NZD Foreign Exchange				
AUD	0.9326	0.6	6.0	-1.0
EUR	0.5926	-1.8	2.6	-1.6
GBP	0.5258	0.8	3.8	4.0
JPY	83.4486	-3.7	1.9	5.8
CNY	4.3758	-0.5	8.5	0.5
USD	0.6324	1.8	11.8	-7.6

Source: Nikko AM, indices are in the local currency of the asset unless otherwise indicated.

Executive summary:

- Equities and bonds sold off as Central banks raised cash rates.
- Gold rose.
- Oil fell to around $80 per barrel on recession fears.

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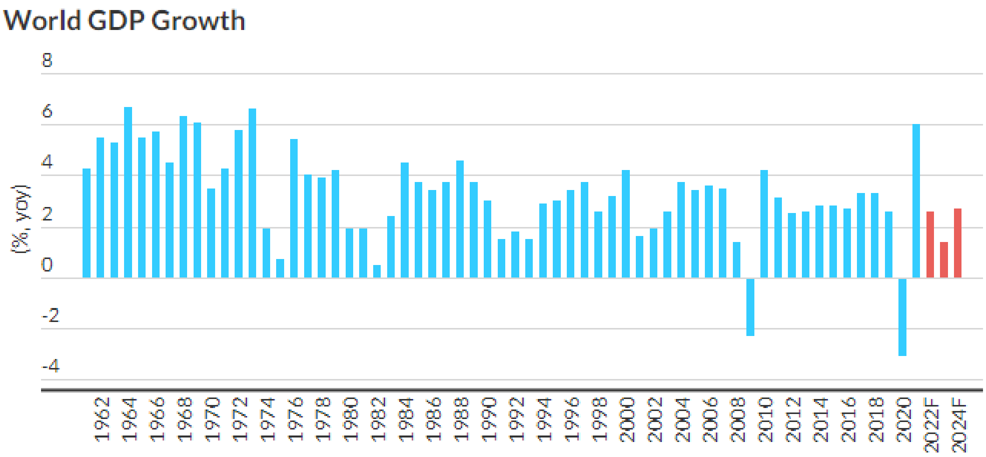
ECONOMIC COMMENTARY

GLOBAL SNAPSHOT

US stocks ended 2022 going down in December. This followed a year of significant losses caused by the Federal Reserve's rapid increase in interest rates to control inflation, fears of recession, the Russia-Ukraine conflict, and growing concerns about COVID cases in China. The three main indices on Wall Street recorded their first yearly drop since 2018 as another period of loose monetary policy came to an end. The urgent pace of rate hikes by the Federal Reserve hadn't been seen since the 1980s.

According to Fitch Ratings, over the past three months global economic activity has been more robust than anticipated - which led to increased growth forecasts for 2023. However, the outlook for global growth has worsened due to the likelihood of further monetary policy tightening and a declining outlook for China's real estate sector. The rating agency expects global growth to decrease to 1.4% in 2023. This would be the weakest expansion since 2008, excluding the impact of the COVID-19 pandemic in 2020 (Figure1).

Figure 1



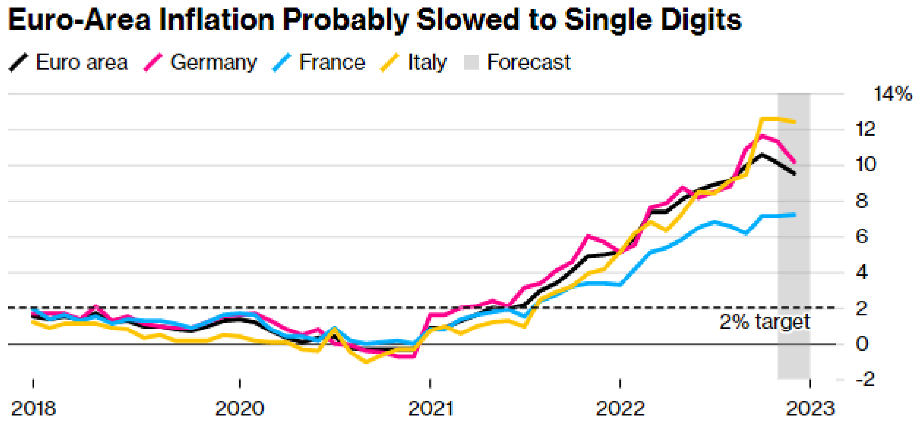
Source: Fitch Ratings' estimates, national statistical offices, Haver Analytics

Increasing unemployment could lead to more conflict in policy decision making, as governments try to protect households from economic shocks while central banks focus on controlling inflation. This increases the risk of policy 'mistakes' – i.e. policies that negatively impact growth. When fiscal policies are relaxed while central bank quantitative tightening policies increase (which add to the supply of government bonds that need to be purchased by the market), it creates an upward pressure on real interest rates. In addition, hidden leverage and inadequate liquidity management in the non-bank financial sector amplifies the effects of real interest rate shocks, as seen recently in the UK gilt market.

The European Central Bank increased its main interest rate from -0.5% in July to 2% in December. A rise in interest rates causes investors to demand a higher yield on bonds, pushing down the price of bonds already in the market.

Economists predict that the worst year of inflation in the euro-zone's history may have ended with a slight improvement, as the rate of cost increases returned to single digits. The initial reading for December is expected to show a slowdown in annual consumer price increases to 9.5% from 10.1% in the previous month, based on the median of 28 forecasts in a Bloomberg survey (median shown in Figure 2).

Figure 2



Source: Bloomberg

The Bank of Japan surprised markets by adjusting its yield curve control policy to allow the yield on the 10-year Japanese government bond to fluctuate within a range of 50 bps around its 0% target. In its policy statement, the BOJ stated that this change is meant to "improve market functioning and encourage a smoother formation of the entire yield curve, while maintaining accommodative financial conditions." However, as the only Central bank in the OECD able to influence its 10 year bond yield this too sent shock waves through global bond markets. It effectively spelt the end of negative interest rates globally.

According to BlackRock, the events of 2022 including war, high inflation, and market turmoil have shaped three key investment lessons for the new year. First, it is important to consider a wide range of potential scenarios and be aware of the dangers of inertia and other behavioural biases. Second, investors should take into account the compensation for geopolitical risk. Finally, BlackRock believes that it is necessary to develop a new approach to investing, which may involve making more frequent portfolio changes in the face of increased macroeconomic and market volatility. These lessons support our active multi-asset approach.

LOCAL SNAPSHOT

First-time home buyers have taken advantage of the drop in prices this year, with their market share increasing from about 20% in the early part of the year to 24-25% in the latter half of the year, according to recent figures from CoreLogic. However, the Reserve Bank raised the official cash rate to 4.25% and forecasted further inflation, recession, and rising unemployment, making buyers of all types less active. A net 17% of mortgage advisers reported fewer first-time buyers in the market this month, according to a survey by economist Tony Alexander.

A local recruitment agency in Queenstown has reported that 13 employees it had placed in jobs quit within the first week of this month because they were unable to find housing. These employees, who were mostly in the hospitality and construction industries, are among approximately 40 people who have had to leave town or not even go there over the past three months due to the housing crisis.

A ban on battery-cage hens has resulted in some empty supermarket shelves and rationing of egg cartons despite the plan being 10 years in the making. The Egg Producers Federation has stated that more than 75% of chicken farmers have had to change their farming methods or careers due to the ban. The shortage has exacerbated already high egg prices. There were multiple price increases in 2022, including a 27% increase in August and a 13% increase in November. Another increase is expected due to the current shortage.

WORLD FINANCIAL MARKETS

Equities

The MSCI World Index was down 5.1% and MSCI Emerging Markets returned -2.0% in December in local currency terms.

The S&P 500 fell by 5.9% in December. Growth stocks struggled due to rising yields throughout much of 2022 and have underperformed compared to value stocks, which are tied to economic performance. This reversal of the trend that had lasted for the past decade was caused by declining performance from companies such as Apple, Alphabet, Microsoft, Nvidia, Amazon.com, and Tesla, which saw decreases of 28%-66% in 2022. The S&P 500 growth index saw a 30% drop in 2022, while the value index decreased by 7.4%. Investors preferred sectors with steady earnings and high dividends, such as energy, which saw impressive annual gains of 59% due to rising oil prices. On the last day of the year, all eleven S&P sector indices fell, led by real estate and utilities.

The Euro STOXX 50 Index was down 4.3% in December. Despite slowing down inflation the new year will be challenging for European equities as the European Central Bank has indicated that it will continue to increase interest rates in the near term in an effort to combat high levels of inflation. Major stock indices were negative. Germany's DAX Index was down 3.3%, France's CAC 40 returned -3.9%. UK's FTSE 100 declined 1.6% in December.

In December, the ASX 200 experienced a 3.2% drop, resulting in a 1.1% loss for the year. Despite this, Australian equity investors performed better than their international counterparts. While the NZX 50 Portfolio Index saw a smaller decline of one third as much as the ASX 200 in December, it still recorded a loss of 14.7% for the year, the first annual drop in over a decade.

Fixed Interest

After rising to 3.88% on the last Friday of 2022, the U.S. 10-year Treasury yield fell to 3.57% in the first week of 2023 (Figure 3), after steepening significantly in the last quarter. Treasury yields and oil futures both rose as investors prepared for the new year amid concerns about recession and the Federal Reserve's rate hike path.

Figure 3

Source: Trading Economics

On the final trading day of 2022, government bonds in the euro zone fell, completing a historically poor year for European sovereign debt. The yield on Germany's 10-year government bond rose to 2.5%. The yield on Germany's 10-year bond, which is viewed as a benchmark for the euro zone, had risen by more than 260 bps in 2022. According to Refinitiv data, this marks the largest sell-off of government bonds in the euro zone dating back to the 1950s. Spain's 10-year yield rose to 3.6%. Italy's 10-year yield climbed to 4.6%.

UK 10-year gilt yields experienced their largest annual increases on record as sovereign bond markets were impacted by high levels of inflation and uncertainty about how policy makers would respond to it.

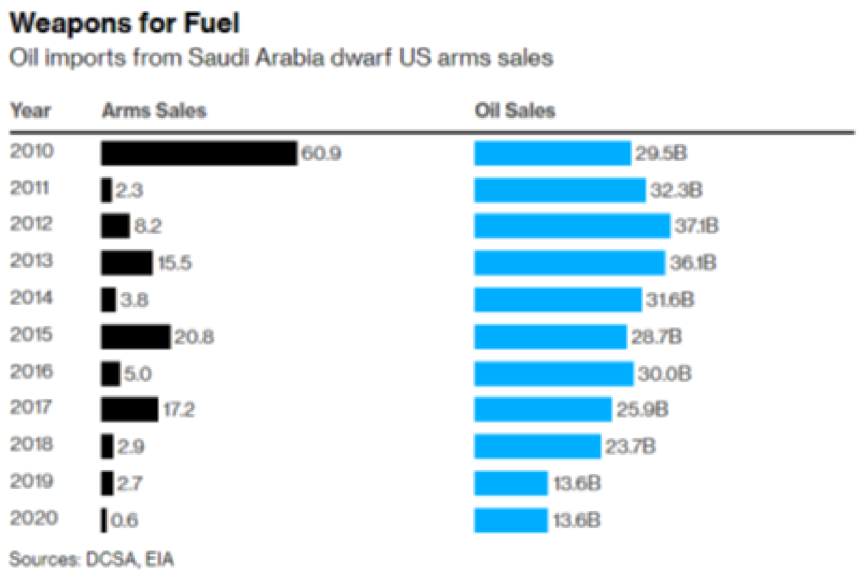
DEGLOBALISATION – PETRODOLLAR VS PETROYUAN

One of the significant influences of deglobalisation in the transition to a ‘green economy’ has been changes in Saudi-US relations, which began in the 1940s. Notably, a meeting between US President Franklin Delano Roosevelt and Saudi King Abdul Aziz Ibn Saud on the USS Quincy on February 14 1945 marked the start of a significant geopolitical alliance between the two countries. This alliance saw the US provide security in the Middle East in exchange for oil, with prices pegged to the US dollar. This alliance played a major role in global politics and security.

However, the alliance has proved fragile in the past decade. Declining most in 2015 after the Saudi invasion of Yemen and the assassination of Jamal Khashoggi (Saudi dissident) inside the Saudi consulate in Turkey in 2018. Now Saudi Arabia is no longer the leading exporter of oil to the US, having been surpassed by countries such as Canada, Mexico, and Russia. This was also the case before the US banned imports in response to Russia's invasion of Ukraine. Arms sales have significantly decreased at the same time, though over the last decade, Saudi Arabia has purchased 24% of total US arms exports.

It is likely that 2023 will be remembered as the year that the longstanding energy deal between the US and Middle Eastern countries began to change, as a new energy relationship between China and the Middle East emerges. China has purchased increasing amounts of oil and liquified natural gas from countries like Iran, Venezuela, Russia, and Africa using its own currency for some time. The meeting between Chinese President Xi Jinping and Saudi and Gulf Cooperation Council (GCC) leaders in December was the beginning of the "petroyuan," marking a significant shift in the global energy order.

Figure 4



According to Credit Suisse, China wants to change the status quo in the global energy market as part of a larger plan to de-dollarize trade between BRIC (Brazil, Russia, India, China) and other regions around the world following the use of the US dollar as a weapon after Russia's invasion of Ukraine. This means that in practice, more oil trade will be conducted using yuan. Chinese President Xi Jinping announced that over the next three to five years, China will significantly increase its imports from GCC countries and work towards "all-dimensional energy cooperation."

Analysts believe that the rise of the petroyuan will accelerate the transition to clean energy, therefore Europe should not be opposed to the Inflation Reduction Act, even though it will reduce demand for European prescription medicine and clean energy technology. The increase in use of the petroyuan should motivate both the US and Europe to move away from fossil fuels as quickly as possible.

GEOPOLITICS

According to BlackRock's analysis of 68 risk events since 1962, geopolitical events generally only have a temporary effect on markets and economies. Yet today, geopolitics are now the main known risk for markets.

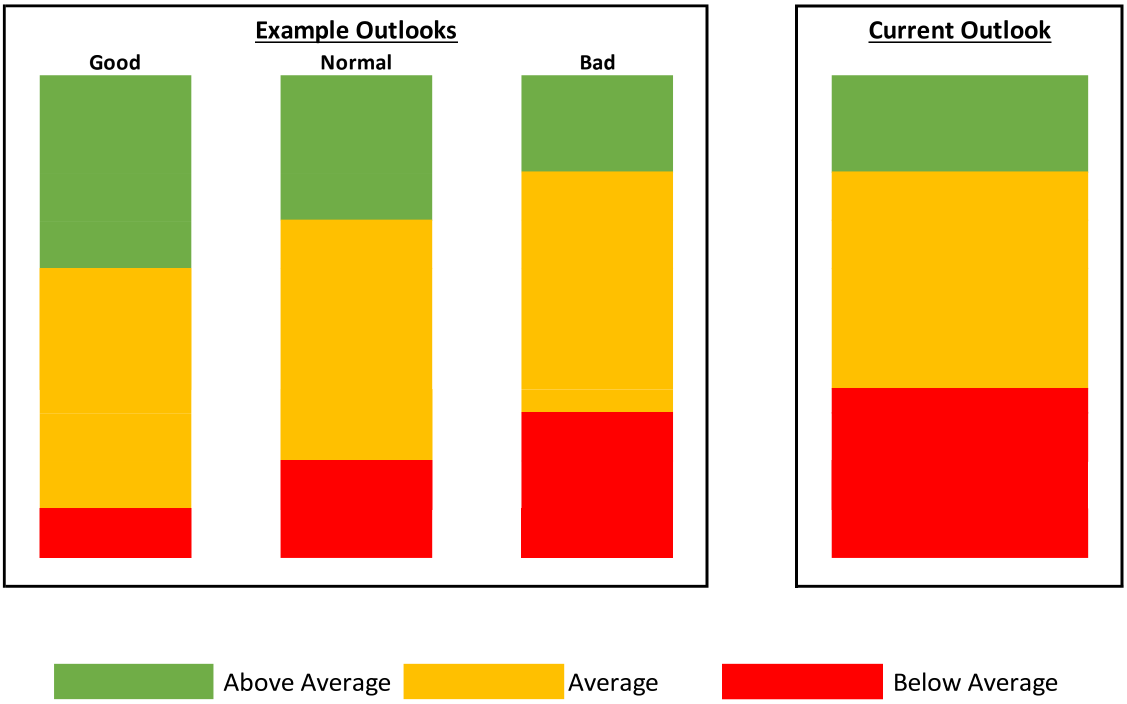
2023 started with a Ukraine strike on a Russian base in Makiivka in the Donetsk region. The blast was so severe that Britain's Ministry of Defence speculated that ammunition was being stored near the accommodation for troops in a vocational school building located around 10 kilometres behind the front line. The Ukrainian side stated that use of mobile phones (prohibited in the army) by Russian troops in Makiivka allowed them to find their location.

North Korea surprised its southern neighbour by crossing the border with five drones on 26 December. One reached the capital city Seoul and returned back. The drones caught Seoul off guard and they had to quickly mobilize various types of aircraft, including advanced fighter jets, modern attack helicopters, and propeller-engine planes. However, South Korean air forces could not intercept any of drones which raised a wave of criticism from both the population and the President. This incident showed their vulnerability against drone attacks, which remains a relatively cheap and versatile weapon.

Defence ministers of Russia, Turkey and Syria held unannounced talks in Moscow in late December. Officially the discussion was about the Syrian crisis, refugee problems and the joint struggle against terrorism. As a result of the meeting, the Turkish defence minister committed to withdraw troops from Syrian land. It is still unclear what Moscow promised to Ankara in exchange – wheat, nuclear fuel, or something else?

The newly formed government in Israel swung towards the Russian side after the Benjamin Netanyahu bloc came back to power. Foreign Minister Cohen's comments indicating that Israel would no longer publicly criticize Russia for its involvement in the war in Ukraine and his conversation with Russian Foreign Minister Sergei Lavrov, which happened soon after he took office, have raised concerns about a potential change in Israeli policy toward Russia under the new government. Israeli-Russian relations, including political and humanitarian, remain complex. Dependence on Russian support is heavy for Israel’s fight against terrorists in Lebanon and Syria. In particular trying to balance Iranian influence in the region is an issue. Approximately 15% of Israel’s population are Russian speaking (from Russia and other Soviet Republics), with ties and connections with oligarchy groups in Russia.

MARKET OUTLOOK



The current market is less likely to have an above average return (green) as a below average return (red) over the next two to three years. It is more likely to have an average return (amber).