MARKET PERFORMANCE AND COMMENTARY – JANUARY 2023

MARKET PERFORMANCE

Index	Index Level/Price	1 Month %	3 Month %	1 Year %
Global Equities				
MSCI World NR	6,642.5	6.5	6.8	-5.9
MSCI World NR (NZD)	13,231.6	4.8	-1.4	-5.9
MSCI Emerging Markets	668.6	6.5	16.6	-8.4
S&P 500 (US)	4,076.6	6.2	5.3	-9.7
Nikkei 225 (Japan)	27,327.1	4.7	-0.9	1.2
FTSE 100 (UK)	7,771.7	4.3	9.5	4.1
DAX (Germany)	15,128.3	8.7	14.1	-2.2
CAC 40 (France)	7,082.4	9.4	13.0	1.2
Trans-Tasman Equities				
S&P/NZX 50	11,967.7	4.3	5.6	0.7
S&P/ASX 300	89,466.0	6.3	9.5	11.6
Bonds				
S&P/NZX NZ Govt Stock	1,683.2	2.1	1.2	-6.2
S&P/NZX A Grade Corporate	5,527.5	2.0	2.5	-2.5
Barclays Global Agg (Hedged to NZD)	384.2	2.2	3.4	-8.3
Oil and Gold				
West Texas Intermediate Crude	78.9	-1.7	-8.9	-10.5
Brent Crude	85.4	0.5	-8.5	-6.1
Gold	1,928.4	5.7	18.0	7.6
NZD Foreign Exchange				
AUD	0.9	-1.6	1.0	-1.6
EUR	0.6	0.4	1.2	1.5
GBP	0.5	-0.2	4.0	7.2
JPY	84.0	0.7	-2.7	11.0
CNY	4.4	-0.2	2.5	4.2
USD	0.6	2.2	11.2	-1.6

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

Executive summary:

- Equities and bonds rallied on expected pivot of central banks.
- Gold prices rose.
- Geopolitics and climate change uncertainty is increasing.

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ECONOMIC COMMENTARY

GLOBAL SNAPSHOT

Following a challenging 2022, the S&P 500 enjoyed a strong start to the year with a 6.2% increase in January. Decreasing inflation and stable economic data means markets are optimistic again for a ‘soft landing’ by the US economy. The Federal Reserve is expected to reduce the rate of interest rate increases during its upcoming policy meeting this week, from 50bps in December to 25bps per raise.

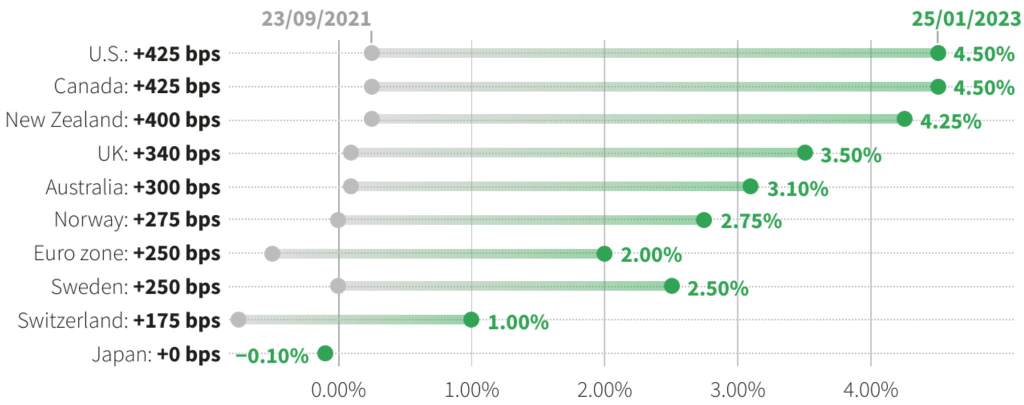
Despite some optimism that the worst of the recent economic crises may be over due to slowing inflation, Kristalina Georgieva, the head of the IMF, warns that the world economy is still struggling. At a panel in Davos, she stated that conditions are "less bad" than previously anticipated, but the potential for further pain remains. The interest rate hikes by major economies have not yet had a full impact and could lead to higher unemployment, which may prove difficult for already cash-strapped governments to handle.

On 25 January, the Bank of Canada raised its key interest rate to 4.5%, the highest it has been in 15 years, and announced that it would likely refrain from additional hikes at this time, making it the first significant central bank battling global inflation to pause (Figure 1).

Figure 1

The race to raise rates

Change in policy rates by central banks overseeing the 10 most traded currencies since the start of the interest rate tightening cycle in September 2021.



Source: Refinitiv Datastream | Reuters, Jan. 25, 2023 | By Vincent Flasseur

On February 1, the Federal Reserve raised its benchmark interest rate by a quarter percentage point, bringing the federal funds rate to a target range of 4.5%-4.75%, the highest it has been since October 2007. This hike marked the eighth increase in the process, which began in March 2022. The Federal Open Market Committee, responsible for setting rates, did not give any indication that this hiking cycle is near its end. The federal funds rate sets what banks charge each other for overnight borrowing, but it also affects many consumer debt products.

The ECB and the Bank of England increased their benchmark interest rates by half a percentage point, bringing the rates to their highest levels since 2008. The ECB stated that they plan to raise interest rates even further with the intention of hiking them by another half a percentage point in March. Although inflation has slowed in the 20 countries that use the euro, it still remains well above the bank's target of 2% at 8.5%.

LOCAL SNAPSHOT

The surprise resignation of Jacinda Ardern as Prime Minister in January shocked not only the opposition but some Labour party members. Chris Hipkins has been sworn in as New Zealand's 41st Prime Minister.

The Auckland Business Chamber (ABC) released the results of a survey showing that 78% of Auckland businesses do not want more "transformational" policies. ABC's CEO Simon Bridges held a roundtable discussion with the new Prime Minister to present these results and convey the message that the business community wants the government to focus on the basics such as tackling crime, controlling inflation, reducing living costs, and relaxing immigration policies. The survey also shows that 36% expect the Prime Minister to pursue a more economically focused agenda – and the same percentage do not. The business community wants the Prime Minister to abandon controversial policies such as the TVNZ-RNZ merger, compulsory unemployment insurance, Three Waters, and Fair Pay Agreements.

Auckland and Northland experienced a record-breaking downpour that caused at least four fatalities and significant damage across the city and the North Island. Around 350 people required emergency shelter, according to Prime Minister Hipkins. He also emphasized the impact of climate change on the extreme weather event, stating that it was a 1-in-100-year event, but after significant floods were seen in Auckland in 2016, they are happening more frequently.

The transport temporary relief package has been extended until June, which includes a reduction of 25 cents per litre of petrol excise tax, saving an average of $17.25 for a 60-liter tank. The Road User Charge discount will also be reinstated and will remain in effect until June. Additionally, the half-price public transportation fares have been extended until the end of June 2023, saving an average of $25 a week for a person who pays two $5 fares a day.

WORLD FINANCIAL MARKETS

Equities

The MSCI World Index and MSCI Emerging Markets both returned 6.5% in January in local currency terms.

The S&P 500 added 6.2% in January. Stocks resumed their winning streak, as investors appeared to welcome some hopeful signals that the economy might skirt a recession in 2023. Consumer discretionary stocks were especially strong, thanks partly to a big jump in Tesla shares over the week following a favourable outlook from CEO Elon Musk. The typically defensive consumer staples, health care and utilities segments lagged. Relatedly, value stocks underperformed growth shares, and small capitalisation stocks finished behind large ones.

The Euro STOXX 50 Index was up 9.8% as some encouraging economic data points helped to overcome concerns about the pace of monetary policy tightening. Major stock indices were positive. Germany's DAX Index was up 8.7%, France's CAC 40 returned 9.4%. UK's FTSE 100 gained 4.3% in January and has subsequently achieved record highs.

In December, the ASX 200 rose 0.6%. Despite hotter-than-expected inflation in the fourth quarter, Australian shares finished the week higher, supported by encouraging US economic and earnings data releases and early data from China showing a strong rebound in New Year holiday travel, accommodation and box office sales. Australian government bond yields, especially shorter-term yields, shifted notably higher after the CPI release.

Fixed Interest

The yield on the benchmark 10-year US Treasury note was almost flat over the month closing at 3.5%.

French and Swiss bond yields rebounded from midweek lows after ECB Governing Council member Klaas Knot called for 0.50% interest rate hikes at the next two policy meetings.

In the UK, 10-year gilt yield hovered near recent highs ahead of a Bank of England policy meeting, decreasing five basis points, down from 3.37% to 3.32% (down 34bp YTD).

It was a great month for fixed income. Inflation-linked bonds provided the highest returns in both Australia and New Zealand with the S&P/ASX Government Inflation Linked Bond 0+ Index climbing 5.0% while the S&P/NZX Inflation-Indexed Government Bonds Index gained 3.6% in January.

GEOPOLITICS

The beginning of the year is usually a quiet period for events – but not so far in 2023. The war in Ukraine is going into its eleventh month and neither side intends to negotiate a truce. The West is increasing military support to Ukraine and agreeing to send battle tanks – German Leopard, British Challenger, and American Abrams. Ukrainian troops were in the UK at the end of January getting training to use Challengers.

Russia has sent conflicting messages regarding the recent announcements of Western military hardware being sent to Ukraine. While the Kremlin downplayed the strategic value of the hardware, they also warned of the growing risks of the war expanding into a regional conflict as NATO countries increase their involvement. The spokesman, Dmitry Peskov, stated that the sending of weapons systems by NATO and the US is perceived as direct involvement in the growing conflict. A former Russian President, Dmitry Medvedev, who now serves as deputy chairman of the Security Council, warned that the defeat of a power with nuclear capabilities in a conventional war could trigger a nuclear response.

According to Ukraine's officials Russia is preparing for a new offensive in February-March. Russian troops are expected to move across all borders including Belarus territory. Whether the promised tanks reach the battlefield in time or not is the big question.

Iranian military facilities were attacked by drones on 28 January. Iran accused Israel of being behind the attack. Later the Iranian authorities stated that some parts used in drones entered the country with the support of Kurdish opposition groups. Iran bombed a Kurdish opposition position based in Iraqi Kurdistan. A Russian version of the drone attack news depicted the US as orchestrating the attack as retaliation for Iran's supply of drones to fight in Ukraine.

Apart from tensions with the US, Israel and Kurdish groups, Iran saw strained relations with Azerbaijan after an armed attack on the Azerbaijani embassy in Tehran caused one death and two people injured.

AI AUTHORS

Artificial Intelligence (AI) has greatly impacted economic commentary writing and content writing by providing new and innovative ways to analyse and interpret data. With machine learning algorithms, content can be generated quickly, with less human error, and often with more insights than a human alone would be able to generate. In the field of education, AI is being used to create personalized learning experiences, to grade written assignments and provide feedback, and to help teachers and students access and analyse educational data. However, despite these advancements, it is important to note that AI is not meant to replace human writers, teachers, or commentators, but rather to augment their abilities and improve the overall quality of their work.

Of course we couldn't resist using AI to write about itself, so that last paragraph is courtesy of ChatGPT from OpenAI. AI content generation will likely change the way we use search engines and certainly pose an issue for educators and marketers, but we will continue to write all our economic commentaries ourselves. There is no substitute for an experienced and professional team of humans from different socio-economic and geographic backgrounds who spend their days analysing investment information, especially when it comes to writing about the potential economic impacts of the most significant issues for Australasia to date, and devising investment strategies that will stand the test of time.

CLIMATE CHANGE

Climate change is a critical issue that has been affecting the planet for decades. According to NASA, the average surface temperature of the Earth in 2022 tied with 2015 as the fifth warmest on record, with global temperatures being 0.89 degrees Celsius above the average for NASA's baseline period of 1951-1980. This warming trend has led to a series of negative impacts, including increased intensity of forest fires, stronger hurricanes, droughts, and rising sea levels. NASA called the warming trend "alarming" and announced that the agency is committed to addressing the issue by providing state-of-the-art data and analysis through its Earth System Observatory. The last nine years have been the warmest since modern recordkeeping began in 1880, with Earth being about 1 degree warmer than the average of the late 19th century.

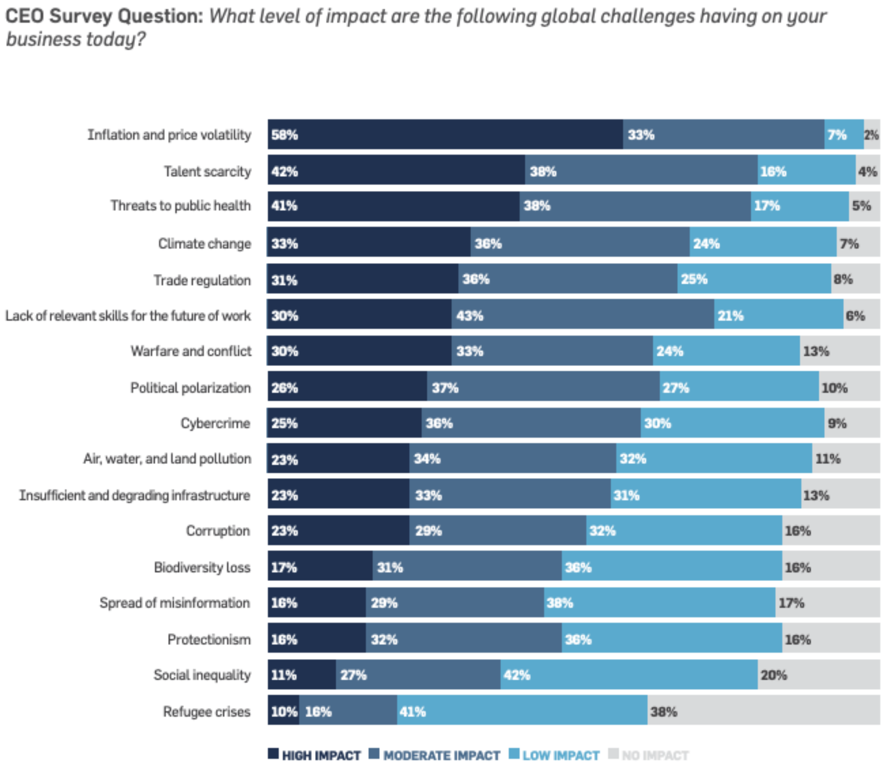
The report "Counting the Cost 2022: A Year of Climate Breakdown" highlights the significant impact that natural disasters caused by climate change have had on economies. The report lists the top 10 costliest extreme weather events of the past year, with damages estimated to have exceeded $3 billion, compared to the $1.5 billion listed in 2021. These events include Hurricane Ian in the U.S. and Cuba with damages over $100 billion, European drought with over $20 billion, flooding in China with over $12.3 billion, drought in

China with over $8.4 billion, flooding in East Australia with over $7.5 billion, flooding in Pakistan with over $5.6 billion, Storm Eunice in Europe and the UK with over $4.3 billion, drought in Brazil with over $4 billion, Hurricane Fiona in the Caribbean and Canada with over $3 billion, and flooding in South Africa with over $3 billion.

Meanwhile in the Philippines a shortage of onions means they are now more expensive by weight than many meats. This situation in the Philippines is directly connected to climate change. Harsh weather, including two powerful storms, has affected the production of crops, including onions, leading to a widespread shortage. This is a clear example of how extreme weather events, which are becoming more frequent and intense due to climate change, can disrupt food supplies and cause food prices to rise. This highlights the need for nations to invest in building resilience to the impacts of climate change, including by improving agricultural practices and infrastructure, and preparing populations to be flexible, in order to protect food security.

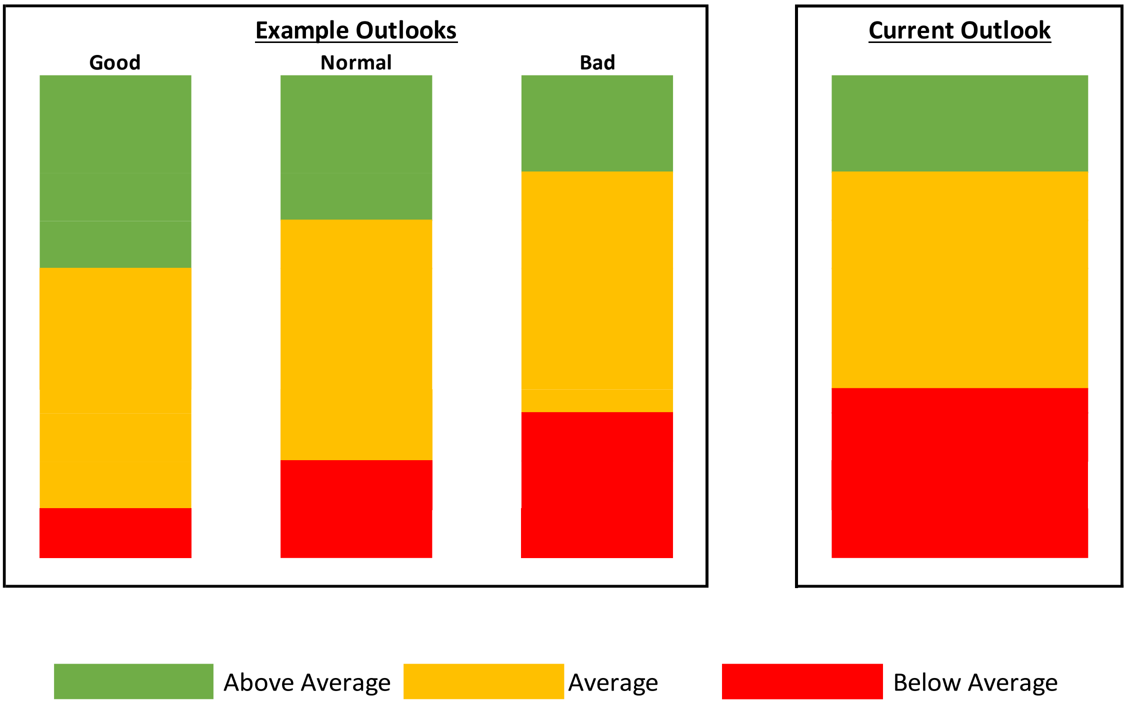
Climate change is now recognized by many CEO's based on The United Nations Global Compact-Accenture CEO Study and sits at 4th place for problems faced by businesses daily (Figure 2). The study, based on the insights of over 2,600 CEOs from various industries and countries, reveals that progress towards meeting the Sustainable Development Goals by 2030 remains far behind where it needs to be.

Figure 2



Source: www.accenture.com

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).