ERIKSENSGLOBAL
Actuaries & Investment Strategists

MARKET PERFORMANCE AND COMMENTARY – MARCH 2023

MARKET PERFORMANCE

Index	Index Level/Price	1 Month %	3 Month %	1 Year %
Global Equities				
MSCI World NR	6,700.7	2.5	7.4	-5.5
MSCI World NR (NZD)	13,750.9	2.1	8.9	3.4
MSCI Emerging Markets	651.3	2.2	3.8	-6.6
S&P 500 (US)	4,109.3	3.5	7.0	-9.3
Nikkei 225 (Japan)	2,8041.5	2.2	7.5	0.8
FTSE 100 (UK)	7,631.7	-3.1	2.4	1.5
DAX (Germany)	15,628.8	1.7	12.2	8.4
CAC 40 (France)	7,322.4	0.7	13.1	9.9
Trans-Tasman Equities				
S&P/NZX 50	11,884.5	-0.1	3.6	-1.9
S&P/ASX 300	86,979.7	-0.2	3.3	-0.6
Bonds				
S&P/NZX NZ Govt Stock	1,689.8	2.3	2.5	-2.6
S&P/NZX A Grade Corporate	5,549.5	1.5	2.4	0.1
Bloomberg Global Agg (Hedged to NZD)	385.9	2.2	2.7	-4.8
Oil and Gold				
West Texas Intermediate Crude	75.7	-1.8	-5.7	-24.5
Brent Crude	79.7	-3.4	-6.2	-25.2
Gold	1,969.3	7.8	8.0	1.6
NZD Foreign Exchange				
AUD	0.93	1.7	0.2	0.9
EUR	0.58	-1.4	-2.9	-7.9
GBP	0.51	-1.1	-3.8	-4.2
JPY	83.24	-1.3	-0.3	-1.4
CNY	4.30	-0.1	-1.8	-2.7
USD	0.63	1.0	-1.1	-10.1

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

Executive summary:

- Equities recovered from the selloff caused by Silicon Valley Bank, Signature Bank and Credit Suisse's collapse.
- Bond performance was mixed.
- Gold prices surged as China and Russia scrapped volumes from the market. Oil is climbing back over the $80/barrel level.
- Geopolitical tensions are increasing.

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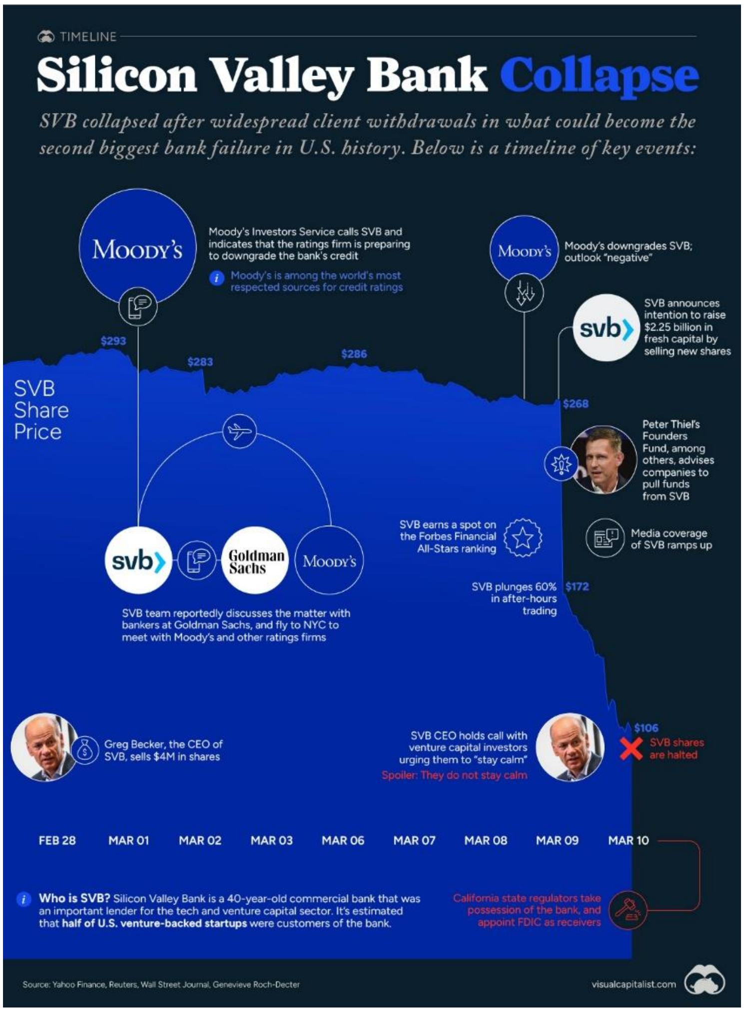
ECONOMIC COMMENTARY

Authored by Janibek Issagulov and Amy Lewis
12 April 2023

GLOBAL SNAPSHOT

The collapse of Silicon Valley Bank and Signature Bank in the US and Swiss bank Credit Suisse has caused concern in the banking sector, leading to comparisons with the global financial crisis. However, despite recent headlines, the S&P 500 index remains closer to its six-month high than its six-month low. While SVB had received positive reviews from Wall Street analysts and had recently been added to Forbes' Financial All-Stars list, signs of trouble emerged when the bank announced the need to raise over $2 billion to bolster its balance sheet on 8 March. This news, coupled with influential venture capitalists such as Coatue Management, Union Square Ventures, and Peter Thiel's Founders Fund moving to limit exposure to the bank, sparked a bank run. Additionally, SVB had the highest percentage of uninsured domestic deposits among the big banks, totalling nearly $152 billion or 97% of all deposits, further influencing decision making. By the end of the day, customers attempted to withdraw $42 billion in deposits (Figure 1).

Figure 1



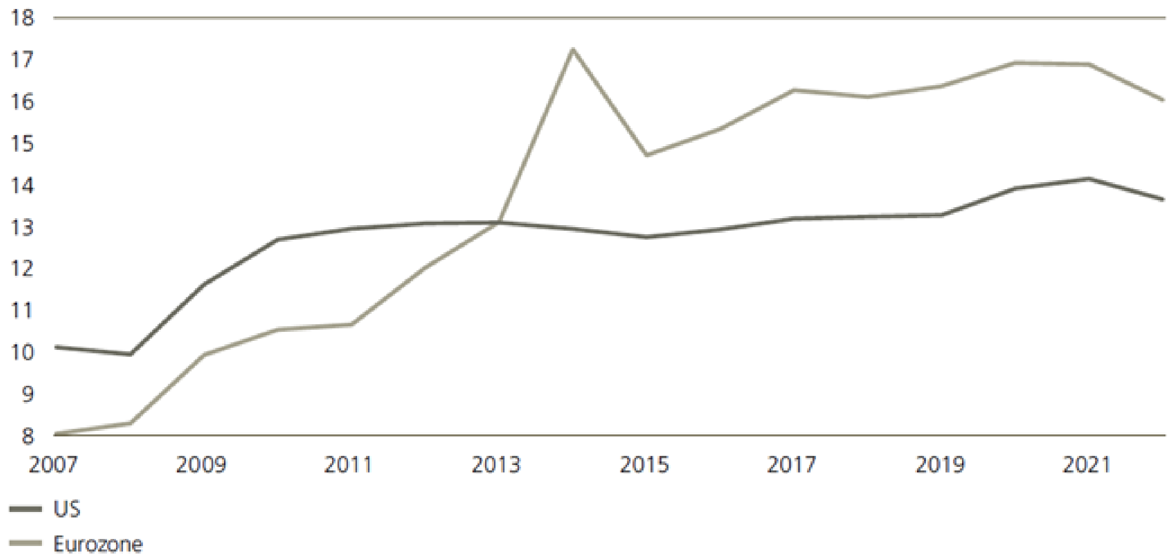
Source: visualcapitalist.com

Central banks and regulators have acted quickly and resolutely to restore confidence in the banking system, and their actions so far have prevented disorderly bank failures and improved investor confidence. However, in 2008-09, depositors and investors only regained their faith in banks once they believed they were both solvent and liquid. The current crisis raises whether the actions taken are sufficient to contain the situation. Although some banks may have suffered losses on their investment portfolios, this does not represent a widespread solvency issue, unlike in 2007. The US banking system is much better capitalised than it was before the global financial crisis, with an aggregate Tier 1 risk-based capital ratio of 13.65% at the end of 2022 compared to 10.11% at the end of 2007 (Figure 2). The mark-to-market losses are likely to be temporary. High-quality government bonds are expected to be repaid in full at maturity, unlike many of the collateralised debt obligations (CDOs) banks held in 2007.

Figure 2

The banking system is far better capitalized than before the GFC

Tier 1 capital ratio for US and euro area banks, in %



Source: FDIC, ECB, UBS, as of March 2023

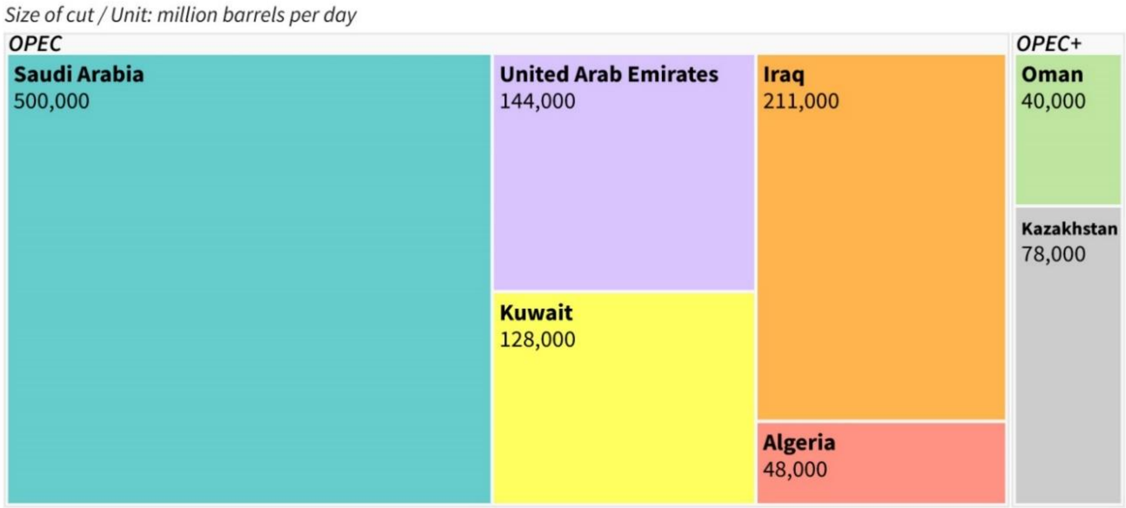
As inflation rates continue to rise, central banks face the challenge of balancing their fight against inflation with growth risks and financial stability risks. However, analysts see three options: continue to hike rates, stop hiking and evaluate the impact of banking sector stress on financial conditions, or cut rates and rely on the banking system deleveraging to control inflation. The Fed is opting for option one, while a pause in rate hikes is more likely than an immediate switch to rate cuts. Although the Fed's recent statement said the US financial system is "sound and resilient," it also noted that banking sector stress is likely to result in tighter credit conditions, which could weigh on economic activity, hiring, and inflation.

OPEC+ members, led by Saudi Arabia, have announced unexpected cuts to oil output of approximately 1.15 million barrels per day, which analysts believe will cause an immediate increase in prices (Figure 3). The decision brings the total volume of cuts made by the group to 3.66 million bpd, equivalent to 3.7% of global demand. The announcement was made one day before a scheduled virtual meeting of an OPEC+ ministerial panel that had previously intended to maintain existing cuts of 2 million bpd until the end of 2023. The US has criticised the move, calling it unwise.

Figure 3

Surprise production cuts

OPEC+ alliance on April 2 announced voluntary cuts to their production amounting to around 1.15 million barrels per day in a surprise move they said was aimed at supporting market stability.



Source: Reuters Reporting | Reuters, April 2, 2023 | By Pasit Kongkunakornkul

Iran and Saudi Arabia announced a deal brokered by China to restore their relations after decades of enmity and a formal cutting of ties in 2016. The rapprochement has been hailed as a momentous development in the region. However, the impact of this deal on the Middle East remains uncertain as the two countries are still fighting a proxy war in Yemen and supporting opposing sides across the region. Against perceived US retrenchment from the Middle East, the deal is a significant diplomatic win for China. It highlights the increasing role of China in the global political arena as it seeks to present an alternative vision to the US-led global order.

LOCAL SNAPSHOT

The Reserve Bank of New Zealand raised the Official Cash Rate by 50bps at its April monetary policy review. While many central banks around the world have been slowing the pace of interest rate hikes, the RBNZ took a different approach in a move aimed at reducing inflation to within the target range over the medium term. The RBNZ's decision to increase interest rates sharply contrasts with the Reserve Bank of Australia's decision to pause, signalling that further tightening "may well be needed" instead of the previous statement that tightening "will be needed." The RBNZ's decision appears to be motivated by two factors. Firstly, a "stitch in time" approach to get the OCR to the level needed quickly rather than drawing it out, and secondly, a desire to prevent premature pricing of OCR cuts by the market, thus maintaining the current lending rates for businesses and households.

Since the February policy statement, the economic landscape has become more uncertain, with the collapse of several regional banks in the US and Credit Suisse Bank in Europe, causing jitters in global financial markets. Although New Zealand's financial institutions remain in good health, the RBNZ will closely monitor offshore developments and the potential impact on global sentiment. Furthermore, New Zealand's GDP fell by 0.6% in the December quarter, much lower than the RBNZ's forecast of a 0.7% rise. These developments may influence the RBNZ's future policy decisions.

According to the international relations expert University of Otago politics professor Robert Patman, New Zealand's relationship with the NATO military alliance has strengthened. The country's Foreign Affairs Minister, Nanaia Mahuta, is attending a NATO Foreign Ministers Meeting in Brussels following a recent visit to New Zealand by a NATO military delegation. During their visit, the NATO director of the Cooperative Security Division met with important military leaders from the Defence Force and Ministry of Foreign Affairs and Trade.

The New Zealand Government has announced that over 25% of the population will benefit from changes to the minimum wage, benefits, and Superannuation, among other initiatives starting from 1 April. The changes are tied to inflation, which was at 7.2% annually in the December quarter. The government believes that increasing them accordingly will help to tackle the cost of living crisis. The minimum wage is set to rise in line with inflation by $1.50 per hour to $22.70 per hour. The government says that even with a 7% increase in the minimum wage, it would only have a small impact on the inflationary rate. However, the Employers and Manufacturers Association has strongly criticised the recent rise in the living wage, citing its detrimental impact on already struggling businesses. The increase in living wage is a response to the rise in the cost of living and is in line with the raises in the minimum wage and other benefits that came into effect on 1 April.

WORLD FINANCIAL MARKETS

Equities

The MSCI World Index was up 2.5%, and MSCI Emerging Markets returned 2.2% in March in local currency terms.

In March, the S&P 500 Index increased by 3.5%, as major equity indexes experienced significant gains in a week with relatively few economic data releases and financial news. Small-cap stocks outperformed large-cap stocks, and value stocks outperformed growth stocks. The energy sector, which makes up a substantial portion of value indexes, benefited from rising oil prices, with Brent crude oil rising to USD 80 per barrel.

The first quarter of 2023 ended with the Nasdaq Composite, heavily focused on technology stocks, increasing by 17%, and the broad market S&P 500 Index rising by 7%. However, the large-cap Dow Jones Industrial Average saw only marginal gains.

Global stock indexes had mixed results, with the Euro STOXX 50 Index declining by 0.1%, Germany's DAX Index increasing by 1.7%, France's CAC 40 increasing by 0.8%, and the UK's FTSE 100 declining by 3.1%.
In Australia, the S&P ASX 200 increased by 0.2% in March, with Australian shares rebounding as volatility decreased due to low volumes and a lack of news in the banking sector. The risk sentiment improved as contagion risks were avoided, and the Australian dollar saw a modest gain.

The NZX 50 Index had a negative performance in March and was down 0.1. Microcaps continued to underperform, with the S&P/NZX Emerging Opportunities Index declining by 3.7% in March and 4.3% in the year's first quarter.

Chinese stocks advanced in the last week of the month as strong economic data coupled with supportive comments from Beijing boosted confidence in the country's growth outlook. The Shanghai Stock Exchange Index returned -0.2% in March.

Fixed Interest

Although US Treasury yields increased, they eased from the heightened volatility that had dominated the market for US government debt since the sudden collapse of SVB triggered concerns about banking system turmoil leading to a recession. While the difference between the two- and 10-year Treasury yields became more negative, with short-term rates increasing more than longer-maturity yields, the yield curve remained less inverted than in early March, and the 10-year Treasury yield declined by 45 basis points in March.

In Europe, government bond yields rose broadly as investors processed strong core inflation data and hawkish comments from ECB policymakers. The German 10-year bund yield declined by 36 basis points in March. The demand for perceived haven assets weakened as concerns about the global banking sector eased, which pushed French and Swiss bond yields higher. The UK 10-year gilt decreased by 34 basis points in March due to increasing expectations of another interest rate hike in May.

The relatively stable US Treasury yields improved sentiment across the broader US investment-grade corporate bond market. However, some real estate investment trust (REIT) bonds weakened due to emerging concerns about commercial real estate. Bonds issued by riskier office REITs remained under significant pressure and underperformed the broader market. High-yield corporate bonds benefited from the improving sentiment and saw modest new issuance. Higher-quality issuers are expected to refinance bonds with near-term maturities, leading to some new deals.

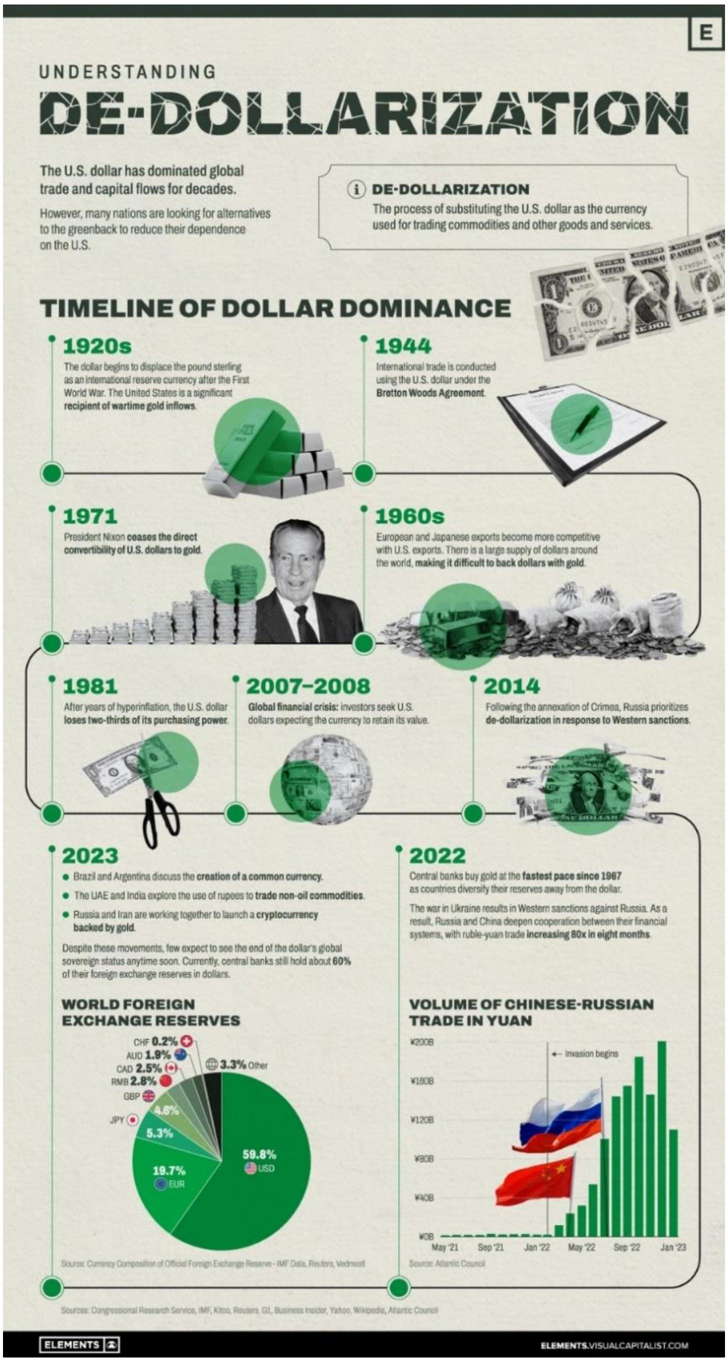
Australia and New Zealand saw a stellar month and quarter in fixed income, with linkers performing the best in both countries. The S&P/ASX Government Inflation-Linked Bond 0+ Index and the S&P/NZX Inflation-Indexed Government Bonds Index increased by 7.0% and 4.3% in the first quarter.

GEOPOLITICS

The world is undergoing significant changes due to several factors, including the ongoing conflict in Ukraine and the rivalry between the United States and China. These developments have led to increased fragmentation and the formation of geopolitical blocs, as cooperation between major powers has decreased substantially. Analysts predict that strategic competition among major powers will intensify in the coming year, with economic and energy ties shifting along geopolitical lines. Countries use energy, technology, and financial networks to achieve strategic objectives, which can negatively impact economic efficiency and pose challenges for global investors.

The increasing dominance of the United States over the global financial system and its ability to use it for strategic purposes has prompted other nations to seek alternatives to reduce the dollar's hegemony. Since the imposition of economic sanctions against Russia in response to its invasion of Ukraine, Russia and China have been cooperating to reduce their reliance on the dollar and to establish a financial system independent of Western powers. One example is the dramatic increase in the rouble-yuan trade since the invasion. De-dollarization efforts are also underway in other parts of the world, such as Brazil and Argentina, where discussions have taken place about creating a common currency for the two largest economies in South America. However, despite these movements, the dollar's global sovereign status is unlikely to end soon, as central banks still hold about 60% of their foreign exchange reserves in dollars (Figure 4).

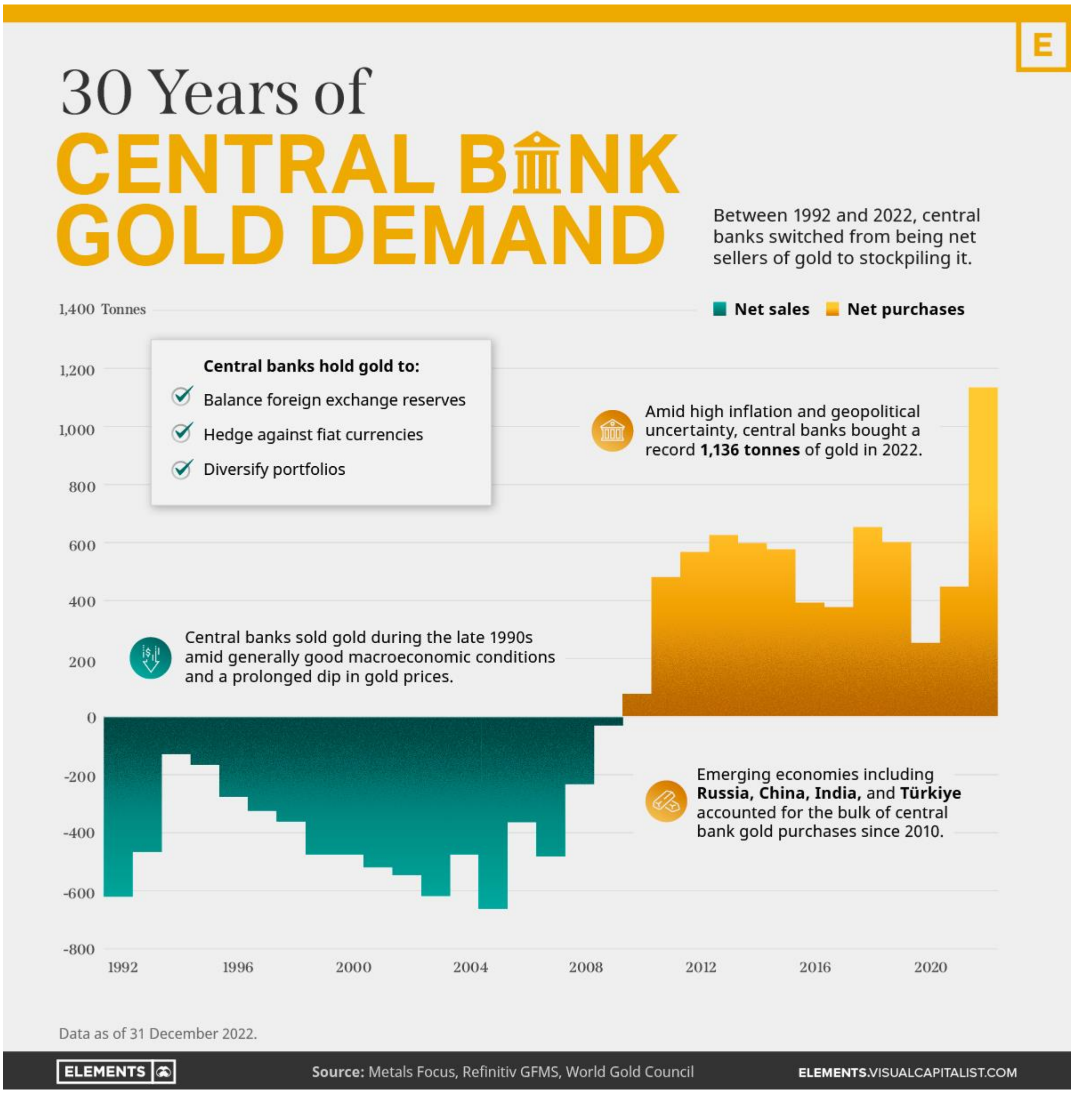
Figure 4



Source: visualcapitalist.com

In addition, central banks, especially in Russia and China, have been buying gold at the fastest pace since 1967 as countries seek to diversify their reserves away from the US dollar (Figure 5). Between the end of 1999 and the end of 2021, Central banks' top 10 official purchasers of gold accounted for 84% of all gold bought. Russia and China, two of the United States' main geopolitical competitors, were the largest buyers of gold during this period, with Russia accelerating its purchases after Western sanctions were imposed following its annexation of Crimea in 2014. Most of the countries on the list are emerging economies. They have probably stockpiled gold to hedge against financial and geopolitical risks, particularly those affecting currencies like the US dollar. China has also reduced holdings in the US Treasury securities by 20% from $1 trillion to $827 billion over the last twelve months.

Figure 5



Source: elements.visualcapitalist.com

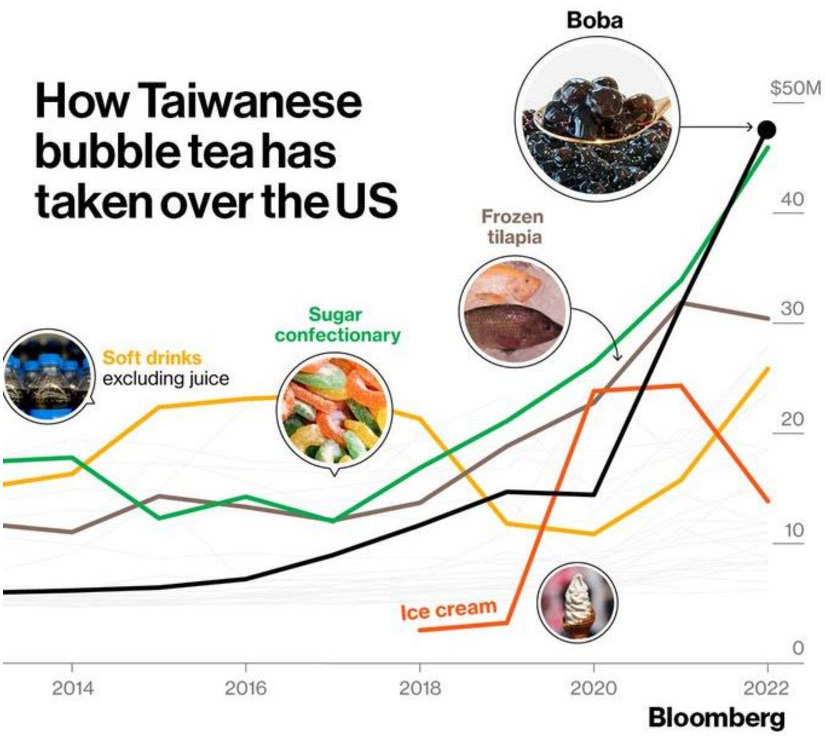
The possibility of using Russia's central bank reserves to aid Ukraine had raised concerns about the attractiveness of the US dollar. Additionally, the increasing reliance on sanctions by the US and its use of the dollar as a weapon has led to discussions of alternative currencies. The recent banking failures in the US have further highlighted the vulnerability of its financial system to destabilising crises. In the meantime, China's growing relationship with Saudi Arabia has fuelled speculation about the emergence of a petro-yuan that could replace the petrodollar.

China has taken two significant steps forward in its long-term effort to reduce the power of the US dollar. The first step was an announcement by the Brazilian government that all bilateral trade between Brazil and China will now be settled in their local currencies instead of the dollar. This move is not unexpected given China's emphasis on this issue in recent years and the fact that China is Brazil's largest trading partner. The second step was the news that China's national oil company CNOOC and France's TotalEnergies had completed China's first LNG trade settled in yuan. Further moves in this direction may be on the horizon.

IS BUBBLE TEA A NEW BUBBLE?

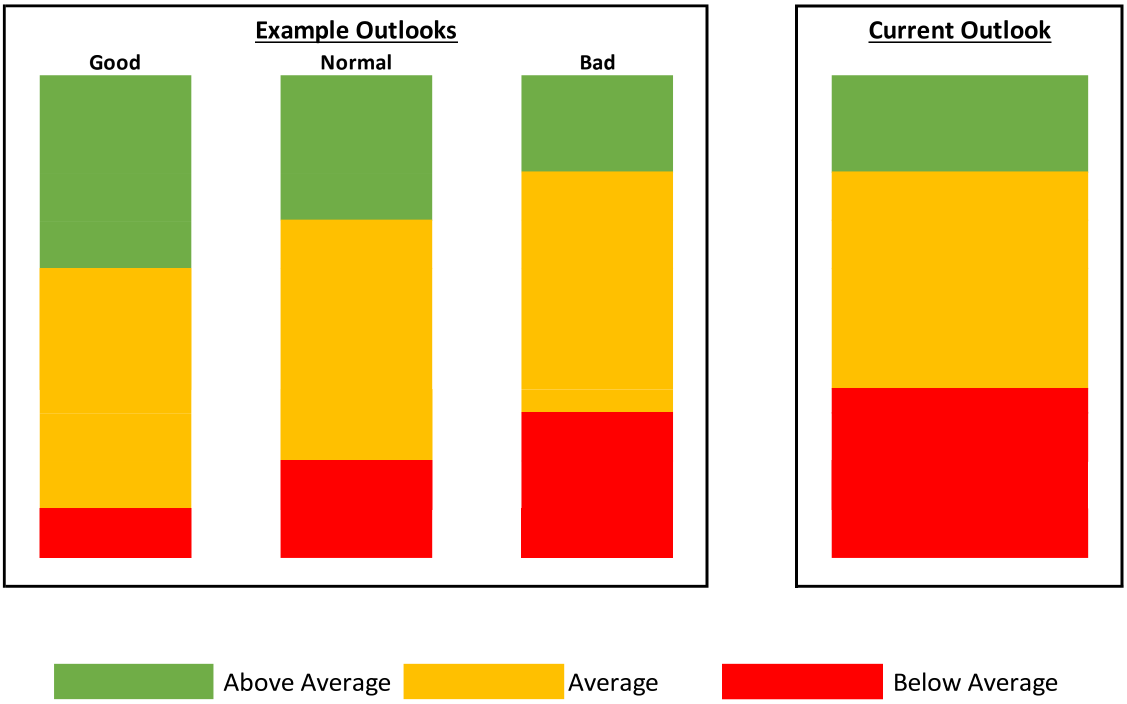
Bubble tea was first created in Taiwan during the 1980s and has been present in the US for decades, mainly sold in smaller stores catering to the Asian community. However, the market has been rapidly expanding in recent years, with the $640 million US bubble tea market predicted to reach $2.2 billion in 10 years, according to Future Market Insights. Yelp reports that between 2019 and 2022, seven US city clusters, mostly with large and growing Asian populations, saw over a 60% increase in bubble tea shops. The US imported 30.5 million kilograms of tapioca and substitutes in 2022. Taiwanese sellers hold 69% of the market share by value, despite their boba being 64% more expensive than those from Thailand on average. Bubble tea has become mainstream in the US, being sold in popular stores like Costco and incorporated into other products like ice cream, as people have embraced the unique drink (Figure 6).

Figure 6



Source: Bloomberg

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).