ERIKSENSGLOBAL
Actuaries & Investment Strategists

MARKET PERFORMANCE AND COMMENTARY – APRIL 2023

MARKET PERFORMANCE

Index	Index Level/Price	1 Month %	3 Month %	1 Year %
Global Equities				
MSCI World NR	6,808.1	1.6	2.5	3.2
MSCI World NR (NZD)	14,173.1	3.1	7.1	8.4
MSCI Emerging Markets	646.7	-0.7	-3.3	-3.9
S&P 500 (US)	4,169.5	1.5	2.3	0.9
Nikkei 225 (Japan)	28,856.4	2.9	5.6	7.5
FTSE 100 (UK)	7,870.6	3.1	1.3	4.3
DAX (Germany)	15,922.4	1.9	5.2	12.9
CAC 40 (France)	7,491.5	2.3	5.8	14.7
Trans-Tasman Equities				
S&P/NZX 50	12,019.8	1.1	0.4	1.1
S&P/ASX 300	88,586.6	1.8	-1.0	2.1
Bonds				
S&P/NZX NZ Govt Stock	1,708.5	1.1	1.5	0.8
S&P/NZX A Grade Corporate	5,595.0	0.8	1.2	2.6
Bloomberg Global Agg (Hedged to NZD)	387.9	0.5	1.0	-1.5
Oil and Gold				
West Texas Intermediate Crude	76.8	1.5	-2.6	-26.7
Brent Crude	81.3	2.0	-4.7	-23.7
Gold	1,990.0	1.1	3.2	4.9
NZD Foreign Exchange				
AUD	0.93	0.1	1.9	2.4
EUR	0.56	-2.8	-5.9	-9.1
GBP	0.49	-2.9	-6.4	-4.9
JPY	84.10	1.0	0.1	0.0
CNY	4.28	-0.5	-2.0	-0.8
USD	0.62	-1.2	-4.4	-4.9

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

Executive summary:

- Equities (except emerging markets) and bonds posted positive returns in April.
- Gold price is hovering around $2000 per ounce.
- Oil traded above the $80/barrel level on data of low US reserves and coming into force OPEC+ oil production cuts.
- Geopolitical tensions are still high.

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

Authored by Janibek Issagulov and reviewed by the EriksensGlobal team.
5 May 2023

GLOBAL SNAPSHOT

Economic data from the US suggests that inflation in the States is slowing down. The Headline Consumer Price Index (CPI) went up by only 0.1% in March, while core inflation decreased to 0.4% from February's 0.5%. The year-on-year headline inflation rate also dropped to its lowest level since May 2021. The cost of shelter, which had been one of the primary drivers of core CPI, also moderated. The US labour market also appears to be cooling down, as the March labour report showed a smaller-than-expected increase of 236,000 nonfarm payrolls, the smallest since December 2020. The average growth rate in hourly earnings fell to 4.2% year-on-year, and the vacancies-to-unemployment ratio decreased to 1.7 from a peak of 2. There are hopes that inflation will continue to decline, with futures markets pricing the recent 25-basis-point rate hike in May and expectations the Fed to begin cutting rates before year end.

According to analysts, the Fed may encounter a rocky path to cutting interest rates this year, despite the possibility of inflation returning to its target smoothly. This is due to several factors, including an increase in US wage growth and annual job switchers rate - both measures of the strength of the labour market. Furthermore, there has been an increase in some consumer inflation expectations, with the New York Fed's survey of consumer expectations indicating a rise in one-year inflation expectations to 4.7% in March from 4.2% in February, and the University of Michigan data showing a jump to 4.6% in April from 3.6% the previous month. In addition, energy prices will play a crucial role in the inflation outlook, as OPEC+'s plan to reduce crude production by more than 1 million barrels per day from May could result in a tighter oil market. It is also worth noting that in the past eight instances where US CPI has risen above 5% since 1960, it took an average of three years before inflation fell back below 3%.

Following the potential-yet-averted worst-case scenario of SVB collapsing, another regional bank, First Republic Bank (FRC), has fallen. Regulators took control of the struggling bank and sold all of its deposits and most of its assets to JPMorgan Chase Bank to prevent further banking turmoil in the US. PNC Financial Services Group and Citizens Financial Group were among the banks that submitted final bids to compete with JPMorgan. As a result, several regional banks' shares fell on May 1, following the collapse of FRC, which is the third significant casualty of the largest crisis the US banking sector has faced since 2008.

The Bank of England, the Bank of Japan, the European Central Bank and the Swiss National Bank have decided to adjust the frequency of their 7-day US dollar liquidity-providing operations from daily to once per week, effective 1 May 2023. This decision was based on the improving US dollar funding conditions and low demand observed in recent operations. These central banks, in consultation with the Federal Reserve, have stated that they are prepared to modify the provision of US dollar liquidity if needed to address market conditions. The swap lines among these central banks are an important liquidity backstop to alleviate pressure in global funding markets, helping to reduce the impact of these pressures on credit supply to households and businesses, both domestically and internationally.

In a bid to preserve its declining foreign reserves, Argentina has decided to pay for Chinese imports in yuan rather than US dollars, according to Economy Minister Sergio Massa. From May, the country will be able to program imports worth over $1 billion in yuan, effectively replacing the use of its US dollar reserves. This announcement comes after the government accused the right-wing opposition of contributing to the peso's sharp decline against the dollar, prompting an investigation. The peso currently stands at 227 to the dollar at the official exchange rate, but it has more than doubled in the parallel "blue" market.

LOCAL SNAPSHOT

Despite expectations of solid labour cost growth, the labour market in New Zealand remains tight, with significant gains in employment and record-high labour force participation. The unemployment rate and other utilization metrics are hovering around record lows. While labour cost growth was not as strong as anticipated, it reached a record annual high with widespread increases. However, more significant labour market slack is expected to emerge in 2023 due to weaker demand and more robust supply, although the RBNZ is unlikely to shy away from further monetary tightening. It is unlikely that any OCR cuts will occur until well into 2024.

The RBNZ has released an excerpt ahead of its financial stability report, stating that NZ-based banks are not likely to be affected by rising cash rates. This follows the collapse of two US regional banks, Silicon Valley and Signature banks, due to a run on deposits that exposed them to substantial losses. The excerpt mentioned that New Zealand banks have little interest rate risk, as they use strategies such as matching the repricing maturities of assets and liabilities, interest rate swaps, futures, and forward contracts to hedge any remaining mismatches in their exposures.

WORLD FINANCIAL MARKETS

Equities

The MSCI World Index was up 1.6%, and MSCI Emerging Markets returned -0.7% in April in local currency terms.

In April, the S&P 500 Index was up 1.5%. As investors focused on the busiest week of quarterly earnings reports for the season, stocks experienced mixed returns. During the last week of April, 35% of the companies in the S&P 500 Index, representing 44% of its market capitalization, were set to release their results. On 27 April, just four stocks - Microsoft, Apple, Amazon.com, and Facebook parent Meta Platforms - contributed to almost half of the S&P 500's gains. This was the biggest gain since 6 January, and it was mainly due to Meta's 14% increase in stock value following an earnings beat.

In general, cyclical sectors had a weak performance as investors took into consideration various new indications of a slowdown in the economy, especially in the manufacturing sector. At the beginning of the last week of April, there were several measures that showed regional manufacturing activity to be significantly lower than what was expected, implying that factories reduced production in April. Furthermore, the news of a negative outlook for shipping volumes from United Parcel Service caused investors to worry, which led to a 10% drop in the company's shares.

In Europe, the MSCI Europe ex UK Index was up 2.2% in April. Germany's DAX Index increased by 1.9% and France's CAC 40 was up 2.3%. The UK's FTSE 100 was up 3.1% in April.

The S&P ASX 200 index had a positive return of 1.9% in April despite weaker US equity markets and disappointing earnings releases in the domestic materials and energy sectors.

Chinese equities closed with a mixed performance before the start of a five-day holiday, while investors remained cautious amid an uneven economic recovery. Beijing's reiteration of its supportive policy stance helped ease some concerns, and the Shanghai Stock Exchange Composite Index posted a gain of 1.6% over the month.

Fixed Interest

US Treasury yields marginally decreased at the end of April amid volatility ahead of the Fed policy meeting on 3 May. As expected, the Fed raised the cash rate by 25 bps.. Concerns increased about the approaching debt ceiling date and negotiations for raising it. The yield on the 10-year US Treasury note decreased by 14bps, down five basis points in April. The 2-year Treasury yield decreased to 4.0%.

The news of stagnating first-quarter German economic growth and a more dovish-than-expected Bank of Japan policy meeting on 28 April contributed to a pullback in yields. The yield on 10-year German bund was up 2 bps in April. Peripheral eurozone broadly tracked core markets. In the UK, yield on the 10-year gilt was up 23bps in April.

US investment-grade corporate bonds declined over the last week of April due to the disappointing economic environment. Corporate bonds issued by regional banks were particularly affected as the news of First Republic Bank weighed on the banking sector and caused renewed worries about the health of regional banks. Nevertheless, by the end of the month, corporate bonds rallied, bolstered by positive corporate earnings reports and an increase in secondary trading volumes.

GEOPOLITICS

We have entered a new world order. Two major geopolitical and economic blocs – one Western-led and one led by China and Russia – are firming up and are increasingly in competition with each other. The fragmentation that's ensued has led to a dramatic reduction in geopolitical cooperation and the rise of a group of more assertive and important multi-aligned countries.

In March 2023, Russian President Vladimir Putin was indicted for war crimes in Ukraine when the International Criminal Court (ICC) prosecutors and United Nations investigators separately found that Russian officials had carried out forced deportations of Ukrainian children. This arrest warrant for Putin puts South African President Cyril Ramaphosa in a difficult position because South Africa is obligated by treaty to support the ICC, but it will also host the BRICS summit in August, which is a bloc dominated by Russia and China. While Ramaphosa has refused to engage in diplomatic disputes with Russia over the war in Ukraine, his options with regard to the ICC warrant are limited by a South African court ruling in a separate case involving ousted Sudanese dictator Omar Bashir. In 2015, South African officials allowed Bashir to travel freely to and from Johannesburg despite an outstanding ICC warrant, and their refusal to comply with the warrant was criticized by the judiciary, who ruled that it was inconsistent with South African law.

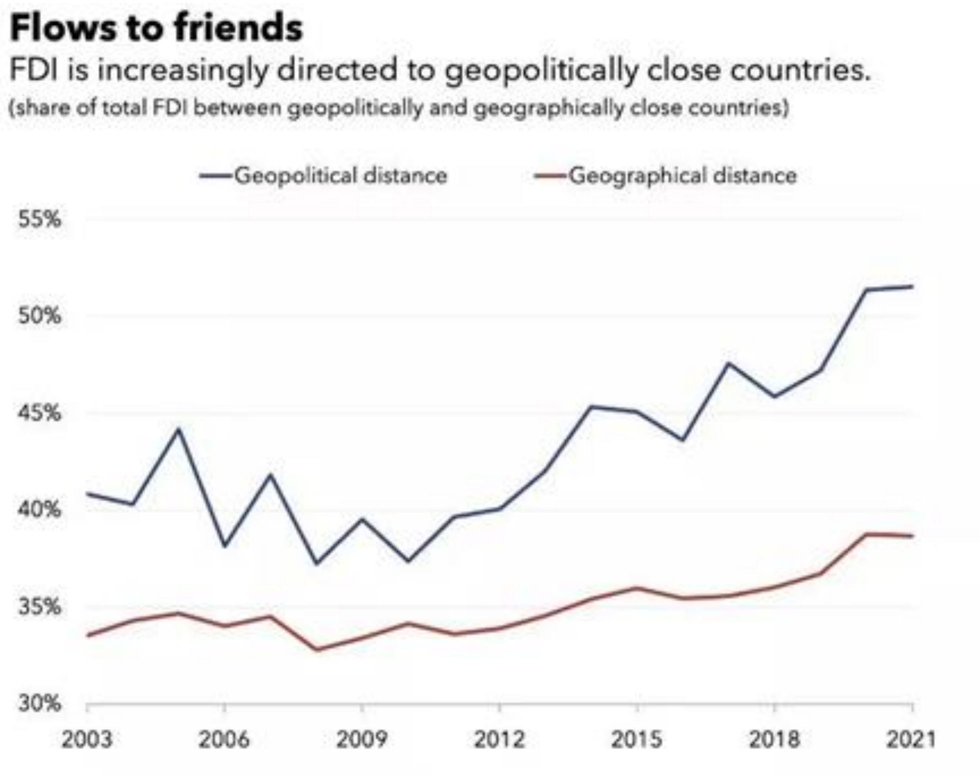
The mediator in West-Russia relations, Turkey, has entered into elections. The diaspora community, which makes up 5% of the total electorate, is eligible to vote in the upcoming elections on 14 May, and Turkish citizens living abroad have already started heading to the polls since 27 April. The voting preferences of Turkish citizens living abroad vary from country to country, with the majority of voters in Germany favouring the current President, Recep Tayyip Erdogan, while those in the UK lean towards the pro-Kurdish HDP (Peoples' Democratic Party) or the main opposition party CHP (Republican People's Party). The reason for these differences lies in the integration policies of each country, with Germany's lack of dual citizenship leading to more patriotic or religiously oriented voters supporting Erdogan. Additionally, the reason for living abroad also plays a significant role in determining the voter's decision, with a significant portion of Turkish refugees living in countries such as the UK, Switzerland, the USA, and Sweden distancing themselves from the government in Turkey, which explains the varying voter tendencies in different countries.

GLOBAL TRADE – GREEN ECONOMY AND GEOPOLITICS

The European Union (EU) has passed a significant deforestation law that will prohibit the import of commodities such as coffee, soy, and beef if they are associated with the destruction of global forests. Businesses that supply goods to the EU must provide a due diligence statement and verifiable proof that their products were not cultivated on land that was deforested after 2020. The issue of deforestation is a major contributor to global greenhouse gas emissions, accounting for 10% of them. Meanwhile, Indonesia is proposing a free trade agreement for some minerals exported to the United States. The agreement is intended to benefit US-based electric vehicle battery supply chain companies by providing access to Indonesian nickel products.

The International Monetary Fund (IMF) has reported that foreign direct investment (FDI) is increasingly flowing between countries that share geopolitical ties rather than geographic proximity (Figure 1). This trend suggests that if geopolitical tensions continue to increase and countries become more polarized along geopolitical fault lines, FDI could become even more concentrated within blocs of aligned countries. US Treasury Secretary Janet Yellen has warned against any move by Washington to disengage from China, given the potential disastrous consequences. The Financial Times has reported that China is targeting Western interests in the country following several years of US-imposed trade and technology restrictions.

Figure 1



Source: weforum.org

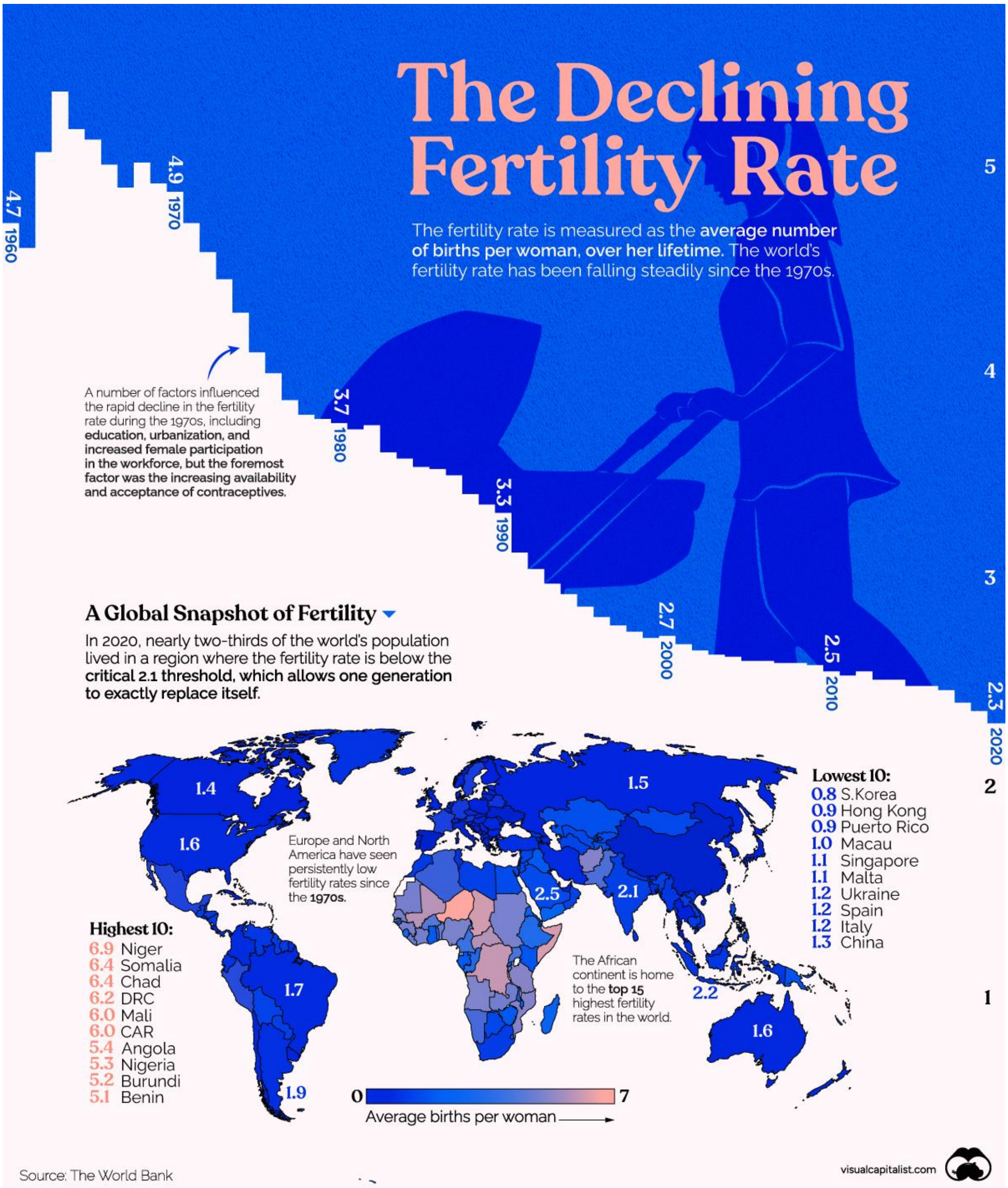
To avoid the spill over of geopolitical tensions into trade, the EU has taken steps to allow retaliatory measures against countries that put economic pressure on EU members to change their policies. The introduction of the "anti-coercion instrument" in the second half of 2023 will permit the bloc to impose higher import tariffs or restrict access to EU public tenders. Moreover, the EU has announced restrictions on imports of Ukrainian grain after Poland and Hungary banned some imports, and other Eastern European countries are considering similar action. These countries had become transit routes for grain that could not be exported through Ukraine's Black Sea ports due to Russia's invasion, causing local farmers to compete with an influx of cheap Ukrainian imports that distorted prices and demand.

Meanwhile, Brazilian President Luiz Inácio Lula da Silva has suggested that developing countries should replace the US dollar with their own currencies in international trade. He has also advocated for a new common currency for trading in South America, which has been met with scepticism from many economists.

HUMAN RESOURCE OR HUMAN CAPITAL?

While the current global population raises concerns, another set of issues arises when fertility rates decline below replacement levels. Shrinking populations and a higher ratio of elderly to working adults result from dropping fertility rates, leading to undesirable economic consequences such as increased healthcare costs and a reduced tax base. Immediate solutions, such as immigration, can help until populations are shrinking in all countries. To prevent a demographic catastrophe, common strategies such as reducing the cost of raising a child and offering better support for families with children are often employed. The world has never had to deal with declining populations on a global scale, and it remains to be seen how this will reshape human livelihoods, priorities, and expectations (Figure 2).

Figure 2

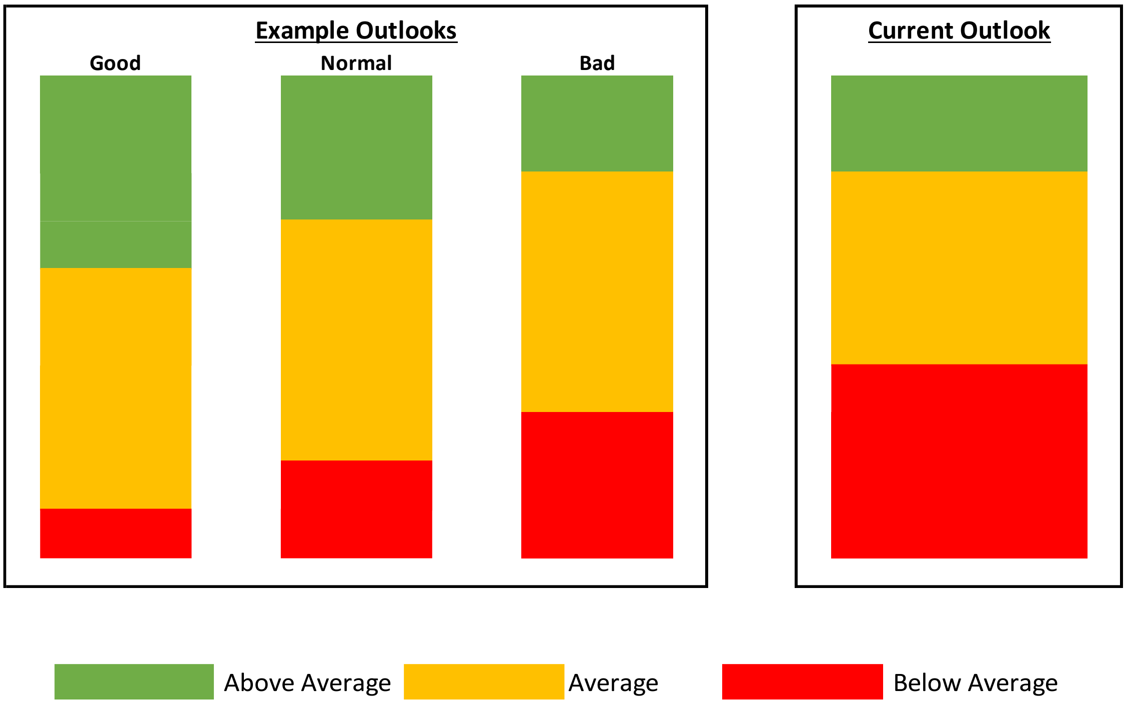


Source: visualcapitalist.com

According to Rest Less' research, British workers are increasingly likely to continue working into their 70s. The cost of living crisis has forced many older individuals to remain employed, with inadequate retirement savings leaving them with little choice but to continue working. While the current state pension age in the UK is 66 for both men and women, it is set to rise to 67 from May 2026 for those born on or after April 1960, and further increases are expected after next year's general election, which could impact millions of people born in the 1970s.

The situation in France is also tense, with plans to raise the state pension age from 62 to 64 sparking widespread civil unrest. Despite the financial necessity that may force older workers to continue working, the research emphasized the importance of ensuring they are not exploited in the workplace and receive the necessary support to remain in employment.

MARKET OUTLOOK



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