ERIKSENSGLOBAL
Actuaries & Investment Strategists

MARKET PERFORMANCE AND COMMENTARY – JULY 2023

MARKET PERFORMANCE

Index	Index Level/Price	1 Month %	Quarter %	1 Year %
Global Equities				
MSCI World NR	7,388.99	2.9	8.5	12.7
MSCI World NR (NZD)	15,263.93	1.7	7.7	14.3
MSCI Emerging Markets	697.51	5.3	7.9	8.6
S&P 500 (US)	4,588.96	3.1	10.1	11.1
Nikkei 225 (Japan)	33,172.22	(0.1)	15.0	19.3
FTSE 100 (UK)	7,699.41	2.2	(2.2)	3.7
DAX (Germany)	16,446.83	1.9	3.3	22.0
CAC 40 (France)	7,497.78	1.3	0.1	16.3
Trans-Tasman Equities				
S&P/NZX 50	12,056.15	1.2	0.3	4.9
S&P/ASX 300	90,381.95	2.9	2.0	11.1
Bonds				
S&P/NZX NZ Govt Stock	1,662.93	(0.2)	(2.7)	(3.7)
S&P/NZX A Grade Corporate	5,585.23	0.2	(0.2)	0.1
Barclays Global Agg (Hedged to NZD)	386.32	0.1	(0.4)	(2.7)
Oil and Gold				
West Texas Intermediate Crude	81.80	15.8	6.5	(17.1)
Brent Crude	85.09	12.4	4.6	(21.2)
Gold	1,965.09	2.4	(1.3)	11.3
NZD Foreign Exchange				
AUD	0.9236	0.3	(1.2)	2.8
EUR	0.5644	0.5	0.9	(8.2)
GBP	0.4837	0.4	(1.6)	(6.1)
JPY	88.4074	(0.2)	5.1	5.5
CNY	4.4450	(0.3)	3.9	5.0
USD	0.6223	1.6	0.8	(0.8)

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

Executive summary:

- Equities rallied over the month.
- Bonds hovered as central banks either pasued or tightened.
- Geopolitical mosaic intensified by events in Asia, Europe and Africa.
- Oil prices returned to over $80 per barrel.
- The NZD appreciated against most major currencies except the Japanese Yen and Chinese Yuan.

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 Eriksens team.
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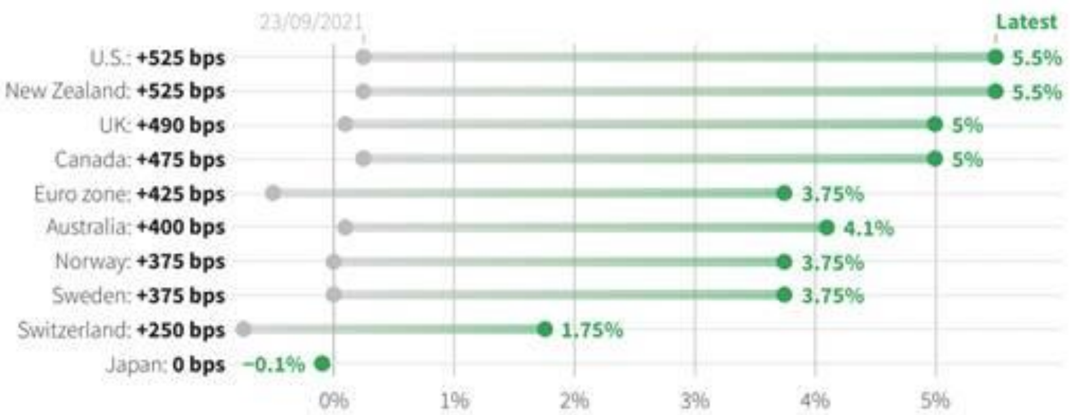
GLOBAL SNAPSHOT

The Federal Reserve raised interest rates by 25bps at its July 2023 meeting, bringing the target range to 5.25%-5.5%. This was the 11th rate hike since March 2022, as the central bank seeks to combat high inflation. In a press conference following the decision, Fed Chair Jerome Powell said that the central bank is "strongly committed" to bringing inflation back down to its 2% target. He also said that the Fed is "prepared to move more aggressively" if needed. The rate hike was widely expected by economists and the broader financial markets, which were liittle affected by the rates shift. However, the decision will lead to higher borrowing costs for businesses and consumers, which should slow economic growth. The Fed is scheduled to meet again in September. Another 25bps hike is possible.

The European Central Bank (ECB) also increased interest rates by 25bps in July, but signaled a potential pause in future meetings due to concerning economic indicators within the 20 eurozone countries (Figure 1). The benchmark rate for the euro area now stands at 3.75%, matching its highest level since the introduction of the euro currency in 1999. This record high rate has only been reached once before, in October 2000. Despite declining inflation, the central bank asserted that it still expects inflation to persist at levels deemed excessively high for a prolonged period.

Figure 1

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, July 27, 2023 | By Vincent Flasseur

On the last Friday of July, the Bank of Japan (BOJ) announced a significant shift in its approach to monetary stimulus, indicating a gradual departure from its long-standing practice of capping the 10-year bond yield. The central bank will now allow interest rates to rise more freely in response to increasing inflation and economic growth. This move is seen by some analysts as potentially transformative for global financial markets, as the BOJ has made its bond yield control policy more flexible and relaxed its defense of a long-term interest rate cap. This aligns Japan with other major central banks that have taken a more aggressive stance in tightening monetary policy to combat surging inflation, moving away from decades of robust stimulus aimed at reviving economic growth. Despite keeping interest rates at ultra-low levels and emphasizing the importance of supporting the economy, the BOJ's adjustment to its bond yield curve control scheme (YCC) is intended to enable it to react swiftly to various risks, including the threat of rising price.

On 1 August, the Fitch rating agency caused surprise among investors and elicited an angry response from the White House by downgrading the US government's top credit rating. This move occurred despite the resolution of the debt ceiling crisis two months ago. In response to the downgrade, traders immediately sought safety by shifting from stocks to government bonds and the dollar. Fitch's decision to downgrade the United States from AAA to AA+ was based on concerns about the country's fiscal condition deteriorating over the next three years and the repeated, last-minute negotiations on the debt ceiling, which raised doubts about the government's ability to meet its financial obligations. Rating agency S&P downgraded the US government’s credit rating in 2011, with similar impacts.

LOCAL SNAPSHOT

In its July monetary policy review, the RBNZ opted to keep the OCR unchanged at 5.50%, putting an end to nearly two years of continuous rate hikes. The central bank stated that the current interest rate level was fulfilling its intended purpose of curbing spending and containing inflation pressures, as previously anticipated and required. Economists and traders were in agreement that the benchmark interest rate would remain steady during the July meeting, as it was already foreshadowed in the May Monetary Policy Statement. Prior to this decision, the Monetary Policy Committee had consistently raised the OCR in each review since October 2021, resulting in a cumulative increase of 525bps across a dozen consecutive decisions, leading to the OCR reaching its highest level since late 2008 of 5.50%.

Despite robust employment growth, the rise in the number of newcomers to the labour force led to an increase in the unemployment rate, reaching 3.6%. While wages showed strength, they did not meet market expectations. The labour market surveys for the June quarter indicated significant employment expansion, yet it proved inadequate to accommodate the influx of new entrants. Wage growth remained high, reflecting previous labour market tightness, but it now seems to have reached its peak.

WORLD FINANCIAL MARKETS

Equities

The MSCI World Index was up 2.9%, and MSCI Emerging Markets returned 5.3% in July in local currency terms.

The S&P 500 closed the month with a gain of 3.1%, notable for the Dow Jones Industrial Average’s notching its 13th consecutive daily gain on 26 July, marking its longest winning streak since 1987. However, trading was relatively subdued, as the summer vacation season diverted some of the focus on a slew of important data releases, a Fed policy meeting, and some high-profile corporate earnings reports. Growth stocks outpaced their value counterparts, with the technology-heavy Nasdaq Composite leading the gains, rallying 4.0% over the month.

The MSCI Europe ex UK Index added 6.2%. Despite the Fed and the ECB announcing interest rate increases, investor sentiment appeared to receive a lift from the dovish tone struck by policymakers. Reports from China earlier, which suggested that authorities are considering further support to boost the world's second-largest economy, also encouraged investors. Germany's DAX Index gained 1.9%, France's CAC 40 Index advanced 1.3%, and UK's FTSE 100 Index climbed 2.2% in July.

Chinese equities rallied on the last week of July after Beijing signalled it will provide more stimulus to support the economy. The Shanghai Stock Exchange Index went up by 0.1%. At least it was positive!

Australian large caps started the second half of the year on a high note, extending their YTD gains by 2.9% to end up by 7.5%. Mid caps and small caps did even better, with the S&P/ASX MidCap 50 up 4.4% in July. S&P/NZX 50 turned in a more modest performance, closing up 1.2% for the month.

Fixed Interest

Latest reassuring inflation data helped push down US Treasury yields somewhat, but the yield on the benchmark 10-year note still ended the week up by 4%, backed by strong growth signals. The two-year US Treasury yield increased to 4.9%.

Eurozone bond yields climbed on concerns that the prospect of higher Japanese yields could prompt an exodus of Japanese investors from that market, but yields steadied in the last week of July. The yield on the benchmark Bund (10-year German government bond) increased 2.5%.

Spreads tightened throughout the week in the US investment-grade corporate bond market, led by mid-tier banks. Investment-grade securitised credit, including asset- and commercial mortgage-backed securities also outperformed, thanks to light new supply and a very active market in collateralised loan obligations.

Bond indices rallied in Australia while they slipped slightly in New Zealand. All reported fixed income indices in the region are holding on to their robust YTD gains so far.

GEOPOLITICS

Africa is becoming a psychological battlefield of Western and Eastern diplomacy. Russia held its second Summit of Russia-Africa Economic and Humanitarian Forum in St. Petersburg in late July. Speaking at the Summit, Russian President Vladimir Putin attempted to rally support for his country amid its war in Ukraine by offering free grain and debt write-offs to African leaders. Free grain would help Africa overcome the food crisis stemming from the war's disruption to global grain exports.. He also said that Russia was willing to write off the debts of African countries that are struggling to repay them. Putin's promises were met with mixed reactions from African leaders. Some welcomed the offer of free grain and debt relief, while others expressed concern about Russia's motives.

Russia has been courting African leaders for years, and the war in Ukraine has given it a new opportunity to make inroads. Russia's offer of free grain and debt relief is likely to be seen as a way to win over African leaders who are struggling with the economic fallout of the war. However, it is also possible that Russia is using these offers to gain political and military influence in Africa. It remains to be seen whether Putin's promises will be enough to win over African leaders. However, his presence at the Summit in St. Petersburg is a sign that Russia is serious about expanding its influence on the continent as Niger is now signalling.

A military coup in Niger resulted in the detention of senior politicians, despite international appeals for a return to democratic governance. The military takeover, which ousted President Mohamed Bazoum, has caused significant tensions in West Africa, leading to a division between Niger's former Western allies and other junta leaders in the region, including Russia. The African Union, UN, European Union, and other major powers have condemned the coup, which marks the seventh military takeover in less than three years in West and Central Africa, exacerbating the challenges to democratic progress in one of the world's most impoverished regions. Regional bloc ECOWAS (the Economic Community of West African States, a union of 15 countries) has imposed sanctions, including financial transaction halts and a national assets freeze, and has raised the possibility of using force to reinstate Bazoum, who remains confined to his palace. However, neighboring Burkina Faso, Mali, and Guinea have expressed their support for the leaders of the coup, issuing a joint statement warning against any military intervention in Niger, deeming it a declaration of war against their own countries. Amidst this situation, the US, France, and Germany have suggested that the coup's success is not yet fully guaranteed, holding out hope for the possibility of reinstating President Bazoum. Niger is the biggest supplier of uranium for French nuclear plants. It is possible Paris will use its power to restore democratic order and secure supply of its key nuclear resource, but more likely it will make a deal with the new government and avoid engaging in conflict.

Aside from Russia, China has remained politically active in Africa this year. Former foreign minister Qin Gang visited Ethiopia, Gabon, Angola, Benin, Egypt, and the headquarters of the African Union and Arab League in January. China has reaffirmed its dedication to the continent by offering debt relief and reconstruction assurances to Ethiopia, as well as extending calls to support the new administrations in Kenya and Nigeria. These commitments were made during a tour of four African nations in July by new “old” senior Chinese diplomat Wang Yi. During an unexpected stop in Addis Ababa, Wang expressed China's backing for Ethiopia's recovery efforts following the devastating Tigray war to rebuild infrastructure and bolster the economy.

The Global West has also been active in Africa, with French President Emmanuel Macron visiting Senegal, Niger, and Mauritania in February andGerman Chancellor Olaf Scholz visiting Senegal, Niger, and South Africa in June. US Secretary of State Antony Blinken visited Kenya, Nigeria, and Senegal in July with an aim to prevent Chinese and Russian influence. The French President also tried to gain access to the BRICS Summit (Brazil, Russia, India, China and South Africa) to be held in South Africa over 22-24 August, but was excluded by the host country.

Kim Jong Un held meetings with the Russian defense minister and a high-ranking Chinese delegation in Pyongyang in July, marking the first time he has received foreign guests since the outbreak of the Covid-19 pandemic. During their visit, Kim and the Russian defense minister, Shoigu, attended a weaponry exhibition, where they were shown various "new-type weapons and equipment," including intercontinental ballistic missiles and new unmanned aerial vehicles (UAVs). Some experts in Seoul observed that the showcased

UAVs bore resemblance to the American-made Global Hawk, a high-altitude surveillance aircraft, and the MQ 9 Reaper, a hunter-killer UAV.

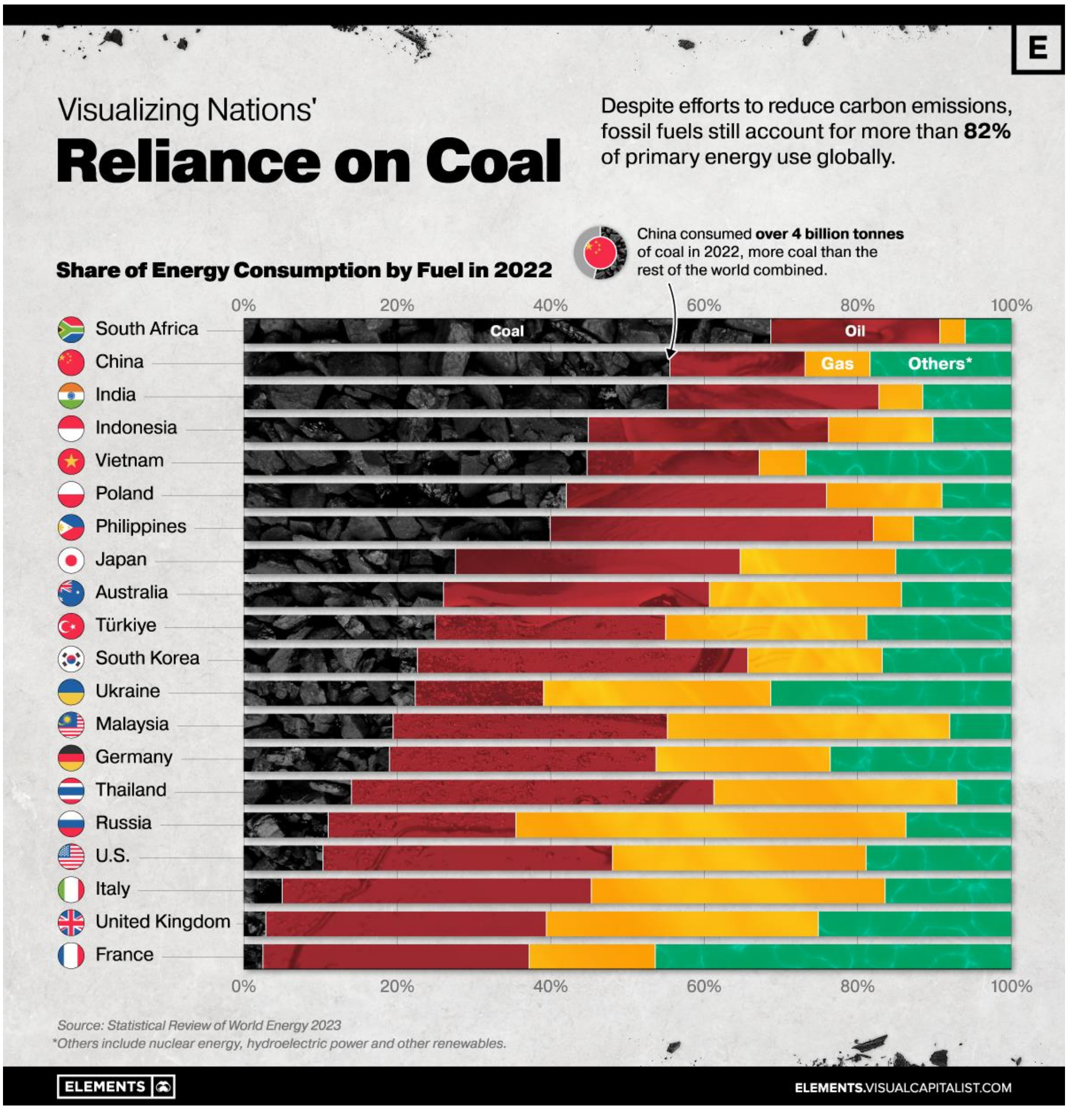
North Korea's state broadcaster reported that Kim expressed confidence in Russia's ability to achieve significant successes in their pursuit of becoming a more powerful nation. Before meeting with Kim, Defense Minister Shoigu also had discussions with his North Korean counterpart, focusing on further strengthening the strategic and traditional relations between their two countries. Although no explicit indication of a new weapons deal emerged, any potential agreements would likely remain discreet. In our view, a deal is likely, based on who accompanied Defence Minister Shoigu: Andrey Kartapolov, Chief of the General Staff of the Russian Armed Forces and Vladimir Kozhin, Deputy Minister of Industry and Trade. Kartapalov's main responsibilities are to procure military equipment and further develop military doctrine and the procurement of military equipment. Kozhin is responsible for a wide range of issues, including foreign trade policy.

A GREEN ECONOMY SUPPORTED BY COAL

In recent years there has been a strong emphasis on decarbonising the global energy system, in the pursuit of achieving net-zero emissions. However, despite efforts to curb carbon emissions, fossil fuels remain the dominant source of primary energy use worldwide, constituting over 80% of total usage. Notably, coal, which is both affordable and widely available, stands as the leading contributor to energy-related CO_2 emissions.

Coal holds a significant role in various aspects of the energy landscape, serving as the primary source for electricity generation, as well as fueling essential industries such as iron, steel, and cement production. Consequently, it remains a focal point in discussions concerning climate change and energy strategies. This is particularly evident in emerging economies where coal remains a crucial and rapidly expanding energy source due to its affordability and abundance. As an example, South Africa stands out as the world's most coal-dependent nation with coal accounting for 69% of its primary energy consumption in 2022 (Figure 2).

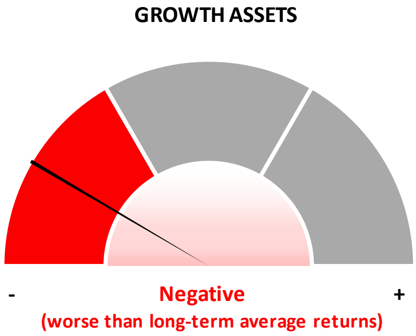
Figure 2

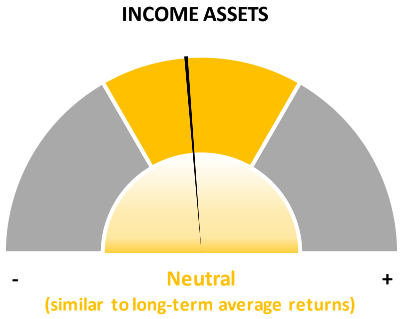


Source: visualcapitalist.com

MARKET OUTLOOK

Our investment outlook expectations over the next 12-18 months are:





Growth Assets Include:
- Global equities
- Australasian equities
- Property

Income Assets Include:
- Global and Australasian bonds
- Cash and term deposits
- Other debt instruments