ERIKSENSGLOBAL
Actuaries & Investment Strategists

MARKET PERFORMANCE AND COMMENTARY – OCTOBER 2023

MARKET PERFORMANCE

Index	Index Level/Price	1 Month %	3 Month %	1 Year %
Global Equities				
MSCI World NR	6,807.45	(2.6)	(7.9)	9.5
MSCI World NR (NZD)	14,811.62	0.3	(3.0)	10.3
MSCI Emerging Markets	629.46	(3.6)	(9.8)	9.8
S&P 500 (US)	4,193.80	(2.2)	(8.6)	8.3
Nikkei 225 (Japan)	30,858.85	(3.1)	(7.0)	11.9
FTSE 100 (UK)	7,321.72	(3.8)	(4.9)	3.2
DAX (Germany)	14,810.34	(3.7)	(10.0)	11.7
CAC 40 (France)	6,885.65	(3.5)	(8.2)	9.9
Trans-Tasman Equities				
S&P/NZX 50	10,757.69	(4.8)	(10.8)	(5.1)
S&P/ASX 300	83,789.95	(3.8)	(7.3)	2.5
Bonds				
S&P/NZX NZ Govt Stock	1,611.97	(0.5)	(3.1)	(3.1)
S&P/NZX A Grade Corporate	5,546.54	0.1	(0.7)	2.8
Barclays Global Agg (Hedged to NZD)	376.27	(0.7)	(2.6)	1.2
Oil and Gold				
West Texas Intermediate Crude	81.02	(10.8)	(1.0)	(6.4)
Brent Crude	88.51	(8.1)	4.0	(5.1)
Gold	1,983.88	7.3	1.0	21.4
NZD Foreign Exchange				
AUD	0.9187	(1.3)	(0.5)	1.1
EUR	0.5503	(3.1)	(2.5)	(6.4)
GBP	0.4794	(2.6)	(0.9)	(5.0)
JPY	88.0945	(1.8)	(0.4)	2.0
CNY	4.2702	(2.5)	(3.9)	0.3
USD	0.5816	(3.2)	(6.5)	0.1

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

Executive summary:

- Equity and bond markets were red again in October.
- The price of gold rose as investors sought safety and protected capital.
- The NZD fell against all major currencies, providing a boost to unhedged investment returns for NZ investors.
- Inflation has likely peaked. Central banks now risk overshooting with interest rate hikes.

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ECONOMIC COMMENTARY

Authored by Jonathan Eriksen and reviewed by the Eriksens team.
10 November 2023

As this commentary is being prepared in the second week of November, investors remain bullish, stock markets are going up and long-term bond yields are coming down (a bit). But for how long?

GLOBAL UNREST

The media are still focused on war coverage for the continuing conflict between Israel and Hamas in Gaza, since tensions erupted on 7 October. The war between Russia and Ukraine, which started in 2014 with the takeover of the Crimea, charges on into another winter with very little progress by either side. The relative peace the world mainly enjoyed post the Korean and Vietnam wars seems unlikely to return.

And what about China's aspirations towards Taiwan?

INFLATION

Earthquakes, floods and forest fires occur more frequently with the effects of global warming, yet the planet's dependency on fossil fuels increases due to constraints on supply, primarily from Saudi Arabia and Russia. We therefore expect the price of oil to remain around the $80-$90 per barrel mark, with pressure on the upside. This suggests, along with the strong demand for labour in many countries (apart from China), that inflation will remain higher for longer.

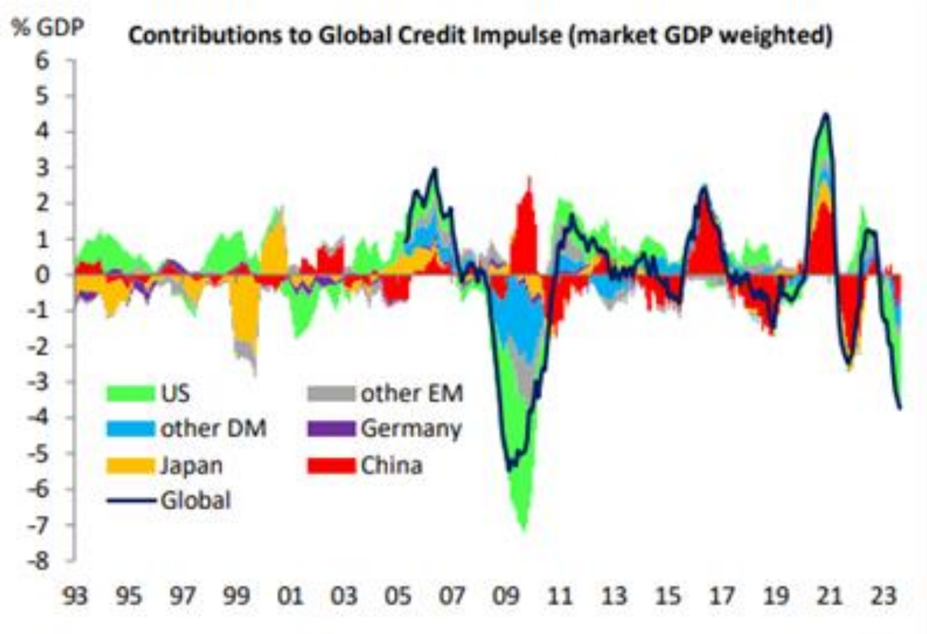
This begs the question: has inflation peaked yet? – probably. But will central banks start reducing cash rates next year? – maybe, but not if they stick to their target of trying to get inflation down to 2%-3%. Although there is a presidential election in the US next November.

Australia and the UK may have one more 25 basis point interest rate raise to go, but most other central banks (except Japan) are probably done with rate hikes.

LIQUIDITY

Part of the juggling act by central banks is managing the massive oversupply of credit provided by governments to support people throughout COVID. Although most central banks are withdrawing credit from their balance sheets and raising cash rates, the major players including the US, China and Japan, still need to support their economies by issuing bonds. Figure 1 below shows how successful they are at restricting credit: the Global Credit Impulse measures the change in new credit issued as a percentage of growth (GDP).

Figure 1: Contribution to Global Credit Impulse – Various Markets



Source: Jarden.

BOND MARKETS

The problem with bond markets is still the flat or inverse yield curve, yet the US and other Western governments have to issue government bonds to fund their growing fiscal needs. Most discerning investors, and indeed all rational investors, expect a higher rate of return for locking their savings away for longer. So, in theory, the yield curve should steepen with duration.

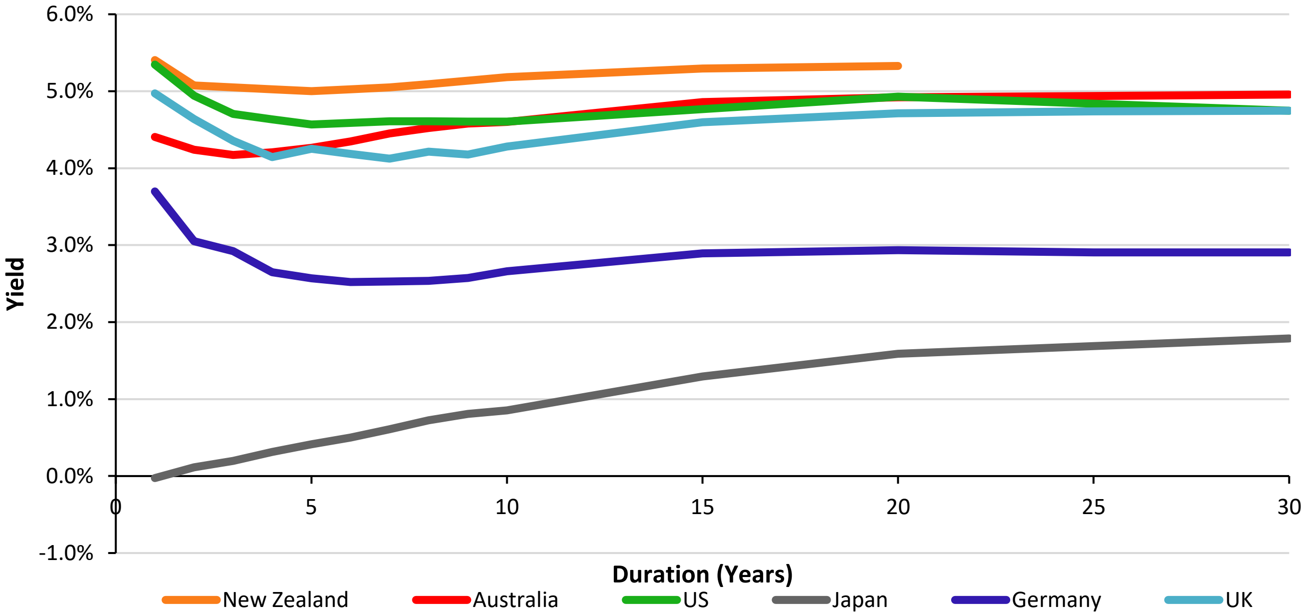
The biggest question today for markets is will the yield curve in most major markets steepen further from here? We think it will.

Bond markets are paying reasonable, but still historically low, longer-term yields. Hence their running yield can offset mark-to-market losses on longer duration bonds if interest rates rise further. However, the margin between cash and bonds is relatively modest. See Figure 2 (overpage) of various countries' government bond yields with duration (out 30 years).

This relatively benign environment, with high equity prices and reasonable bond yields, masks the incredible changes in market conditions since the beginning of the Global Financial Crisis in 2007. The severe tightening by central banks who rapidly increased their cash rates saw an unprecedented sell-off of both bonds and equities in 2022 which pushed less confident investors to the sidelines.

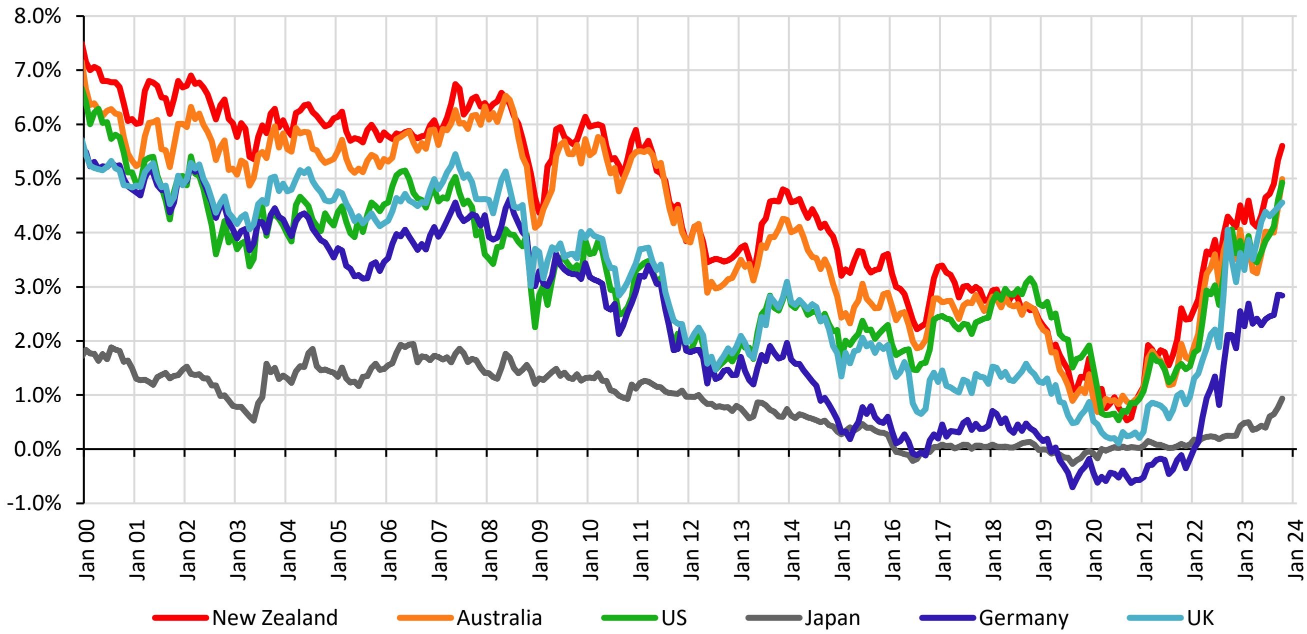
Returns for September and all but the last days in October were reminiscent of the sell-off, with 10-year US Treasury yields rising to over 5% before dropping back.

Figure 2: Government Bond Yield Curves: as of 8 November 2023



Source: WorldGovernmentBonds.com

Figure 3: 10-Year Bond Yields: 1 January 2000 to 31 October 2023



Source: Investing.com

We expect the 10-year Treasury yield to be between 4.5%-5% at the end of this calendar year. That suggests the 10-year NZ government bond yield should be between 5%-6%.

RISK PREMIUM

Until cash and bond yields rose from late 2021 onwards, investors seeking returns had to invest in equities – does anyone remember TINA (There Is No Alternative)?

Now that one-year term deposits yield around 6% in New Zealand, equity investors should seek a higher equity risk premium to invest – why take the risk otherwise? In our view, equities are modestly over-valued given the higher level of interest rates and the growing geopolitical risks.

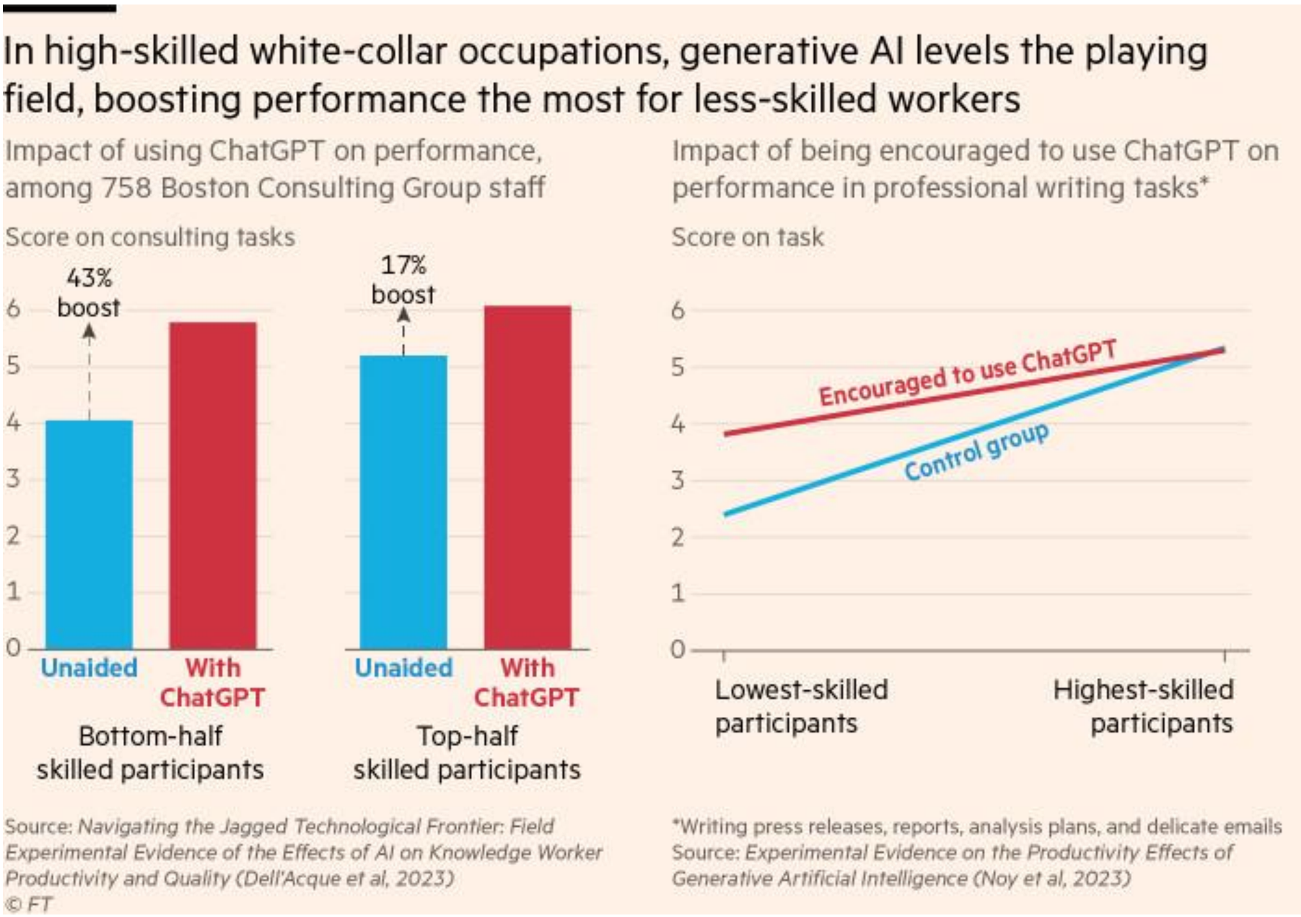
We wish the new Aotearoa New Zealand government well in its deliberations and hope the three parties involved, together with the opposition parties, can make wise, constructive decisions going forward. Both Poland and Portugal appear to be seeking a potential change of government too. It's tough at the top.

Whilst optimistic, we are not sure governments and their central banks can successfully engineer soft landings for their economies, without causing social unrest or recessions by overshooting in the next year or so. We anticipate ongoing market volatility and note there are (always) some unknown and hence unexpected risks still out there.

GREEN SHOOTS OF PRODUCTIVITY AMIDST JOB LOSSES

The Financial Times reports that generative AI has already reduced earnings and freelance jobs in some sectors by 3% in a few months. But at the same time it is improving the productivity and performance of less skilled workers in white-collar roles, as well as improving the performance of highly skilled workers. We see generative AI as boosting human potential, though note the potential for market manipulation in the financial services sector which will require ongoing regulation.

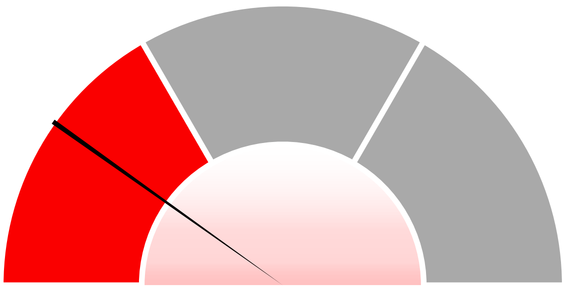
Figure 4:



MARKET OUTLOOK

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

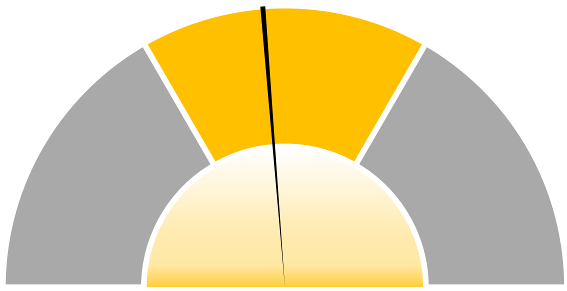
GROWTH ASSETS



\- **Negative** +

(worse than long-term average returns)

INCOME ASSETS



\- **Neutral** +

(similar to long-term average returns)

Growth Assets Include:

- Global equities
- Australasian equities
- Property

Income Assets Include:

- Global and Australasian bonds
- Cash and term deposits
- Other debt instruments