ERIKSENSGLOBAL
Actuaries & Investment Strategists

MARKET PERFORMANCE AND COMMENTARY – JANUARY 2024

MARKET PERFORMANCE

Index	Index Level/Price	1 Month %	3 Month %	1 Year %
Global Equities				
MSCI World NR	7,816.27	1.8	14.8	17.7
MSCI World NR (NZD)	16,252.25	4.1	9.7	22.8
MSCI Emerging Markets	665.34	(3.5)	5.7	(0.5)
S&P 500 (US)	4,845.65	1.6	15.5	18.9
Nikkei 225 (Japan)	36,286.71	8.4	17.6	32.8
FTSE 100 (UK)	7,630.57	(1.3)	4.2	(1.8)
DAX (Germany)	16,903.76	0.9	14.1	11.7
CAC 40 (France)	7,656.75	1.5	11.2	8.1
Trans-Tasman Equities				
S&P/NZX 50	11,872.10	0.9	10.4	(0.8)
S&P/ASX 300	95,424.47	1.1	13.9	6.7
Bonds				
S&P/NZX NZ Govt Stock	1,721.38	(0.9)	6.8	2.3
S&P/NZX A Grade Corporate	5,795.95	(0.4)	4.5	4.9
Barclays Global Agg (Hedged to NZD)	399.72	(0.2)	6.2	4.0
Oil and Gold				
West Texas Intermediate Crude	75.85	5.9	(6.4)	(3.8)
Brent Crude	82.74	6.6	(6.5)	(3.1)
Gold	2,039.52	(1.1)	2.8	5.8
NZD Foreign Exchange				
AUD	0.9313	0.4	1.4	1.5
EUR	0.5667	(1.1)	3.0	(4.7)
GBP	0.4834	(2.7)	0.8	(7.9)
JPY	89.9985	0.8	2.2	7.1
CNY	4.4154	(2.0)	3.4	1.1
USD	0.6155	(2.7)	5.8	(4.7)

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

Executive summary:

- Global equities continued to march upwards in January, hitting three for three (months) since November.
- Conflict in the Middle East is intensifying with the US launching a retaliatory missile strike on Iraq and Syria.
- Oil prices again reached $80 per barrel.
- The NZD depreciated against all major currencies except the Australian Dollar and Japanese Yen.
- The rate of inflation continued to trend downwards, both here and abroad.

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ECONOMIC COMMENTARY

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13 February 2024

GLOBAL SNAPSHOT

In the final two months of 2023, a balanced portfolio consisting of 60% equities (tracked by MSCI All Country World in local currency) and 40% bonds (monitored through Bloomberg Global Aggregate indexes) delivered its third-highest return over the past three decades.

Investors are now grappling with three key themes:

1. The sustainability of upward momentum in equity and bond markets throughout 2024;
2. Strategies for navigating portfolios amid an expected shift in the interest rate cycle; and
3. Considerations of geopolitical and political risks looming ahead for passive and active investors.

Despite challenges like elevated inflation and a demanding market landscape, the US economy exhibited resilience with robust 3.1% growth in GDP in 2023, followed by continued strong consumer spending, a low unemployment rate, and new highs in the S&P 500 index. However, some have interpreted this economic strength as a negative signal. Bolstered by the strong economic backdrop, the Federal Reserve opted to leave interest rates unchanged during the first FOMC meeting of the year on 31 January. Market performance in January suggests a divergence in sentiment, with some expressing optimism about a soft landing while others adopt a wait-and-see approach to unfolding events. Questions linger regarding the potential onset of a recession, impact of geopolitical tensions, likelihood of rate cuts, trajectory of US fiscal spending, and the resurgence of inflation, all of which will significantly influence the financial markets' direction moving forward.

The Bank of England chose to keep interest rates steady, in line with market expectations, and removed previous guidance suggesting potential rate hikes. Projections from the Monetary Policy Committee (MPC) indicated a continued easing of inflationary pressures throughout the year. Governor Bailey noted that approximately 30% of the tightening impact of monetary policy is yet to affect the UK economy. Surprisingly, the vote was split into three factions, introducing a slightly hawkish tone to the message and prompting speculation about the duration of restrictive rates. Market interpretation of the announcement underwent a moderate shift, with the BoE remaining committed to a "higher for longer" approach. The central bank is likely to initially delay rate cuts but could hasten them to address decelerating economic activity. Trading in the Sterling Overnight Index Average futures mirrored Secured Overnight Financing Rate futures, suggesting a delay in monetary policy easing until late 2024 or early 2025.

The European Central Bank (ECB) is poised for an interest rate cut, although specifics regarding timing or the catalyst for action were not disclosed. Despite the ECB maintaining its key rate at a record high of 4% on 25 January, the Governing Council of the ECB expressed confidence in the containment of inflation, reinforcing market expectations of potential policy easing in the early spring. While all policymakers acknowledged promising inflation trends, there was a divergence in opinions, with some advocating for prompt action and others advocating for continued patience until further confirmation of inflation control is obtained.

The Bank of Canada has opted to maintain its key overnight rate at a 22-year peak of 5% in an attempt to curb inflation with flat GDP growth and persistently high inflation rates well above their 2% target, with inflation reaching 3.4% in December. Although the central bank is currently focused on determining the appropriate timing for rate decreases, Governor Tiff Macklem highlighted that unforeseen events (such as sudden disruptions in the supply chain) could necessitate further interest rate hikes. The BoC is awaiting signs of easing price pressures and clear downward momentum in underlying inflation before contemplating rate reductions, according to Macklem. Additionally, Macklem cautioned Prime Minister Justin Trudeau against significant spending increases in the upcoming federal budget, fearing they could impede the central bank's efforts to combat stubborn inflation.

LOCAL SNAPSHOT

The RBNZ's principal economist appears to have tempered expectations of imminent interest rate reductions. In a highly anticipated address, Paul Conway noted that the rapid increases in the OCR, starting from an all-time low of 0.25% in September 2021 and culminating to a peak of 5.5% in May 2023, have effectively curbed inflation. This was evidenced by a deceleration in the annual inflation rate, from 5.6% in Q3 2023 to 4.7% in Q4. During a presentation on 30 January, Conway remarked that monetary policy measures have been effective in slowing down the economy and reducing inflation, although he acknowledged that further progress is necessary. He deliberately avoided speculating on how the recent moderation in inflation figures and the unexpected economic contraction in Q3 2023 might influence future rate decisions, indicating that the Monetary Policy Committee will elaborate on this matter in its inaugural monetary statement of the year, scheduled for 28 February. While refraining from divulging details about the future trajectory of the OCR, Conway emphasized that the recent 0.3% contraction in the economy during the September quarter does not necessarily signify a significant reduction in demand. He also underscored that non-tradable inflation (a gauge of domestic price pressures) remains elevated, indicating the need for additional measures to address it. Despite the RBNZ indicating in its November monetary statement that rate cuts are unlikely until mid-2025, financial markets are pricing in the possibility of at least two cuts this year.

Fourth-quarter labour market data indicated a modest cooling, as the pace of hiring picked up following a decline in the third quarter, accompanied by a slight increase in the unemployment rate. Labour cost growth appears to be stabilizing at levels significantly exceeding the upper boundary of the 1-3% inflation target range, with distributional data offering minimal indication of easing wage pressures. Analysts anticipate a gradual uptick in the unemployment rate and a slowdown in labour cost growth throughout 2024.

WORLD FINANCIAL MARKETS

Equities

In local currency terms, the MSCI World Index rose by 1.8% in January while the MSCI Emerging Markets declined by 3.5%.

The S&P 500 moved 1.6% higher in January. Major US indices ended the month modestly positive amid a slew of significant earnings reports and economic data. Growth stocks outperformed their value counterparts and large caps outperformed small caps. On 31 January, both the S&P 500 and Nasdaq Composite experienced significant declines, driven by disappointing earnings forecasts from Microsoft, Alphabet, the parent company of Google, and chipmaker Advanced Micro Devices (AMD).

In January, the MSCI Europe ex UK Index rose by 1.9%. Major European stock indices were mainly softer, with Germany's DAX Index rising by 0.9% and France's CAC 40 Index gaining 1.6%. In contrast, the UK's FTSE 100 closed the month with a 1.3% decrease.

In Australia, the S&P/ASX 200 surged to a fresh all-time high, propelled by a deceleration in inflation and market anticipation of the RBA easing monetary policy. Notably, large-cap stocks outperformed their mid- and small-cap counterparts, a trend consistent with the previous year's performance. Meanwhile, New Zealand's S&P/NZX 50 Index posted a more moderate increase of 0.9% in January, similarly driven by gains in large-cap stocks.

Chinese stocks declined amid discouraging economic data and negative news from the property sector which contributed to investors' pessimism regarding future growth prospects. The Shanghai Composite Index plummeted by 6.3% in January, marking its most significant weekly drop since 2018.

Fixed Interest

Concerns resurfaced about the possibility of another regional banking crisis after shares of regional bank New York Community Bancorp fell over 60%, causing US yields to plummet on 31 January. The US 2-year yield briefly dipped below 4.20%, while the 10-year yield dropped below 4%, driven by several factors including a weaker-than-expected ADP National Employment Report , lower-than-anticipated employment costs in Q4, news that the US Treasury plans to halt the expansion of its auctions from May 2024, and apprehensions that another banking crisis could impede US economic growth, pushing the Fed to expedite rate cuts to soothe market jitters sooner rather than later.

Germany's 10-year Bund yield concluded the month at 2.16%, climbing from 2.01% in December. The nation's inflation rate stood at 3.1% in January, marking a decrease from December's 3.8%. Additionally, the HCOB German Manufacturing PMI reached 45.5 in January, a slight improvement from December's reading of 43.3.

While Australian bonds experienced an upward trend, New Zealand bonds predominantly remained in the negative zone as interest rates rose, particularly with inflation-linked government bonds falling behind.

GEOPOLITICS

On 24 January, Russia accused Ukraine of intentionally shooting down a Russian military transport plane carrying 65 captured Ukrainian soldiers destined for a prisoner exchange, labelling it a barbaric act of terrorism resulting in the deaths of 74 individuals. While Ukraine did not directly acknowledge responsibility for the downing of the plane close to the border, it did dispute several key aspects of Moscow's narrative, as officials refrained from confirming the presence of Ukrainian prisoners on board. Ukraine countered by casting doubt on the assertion that prisoners of war were aboard and presented alternative scenarios, including suggesting that the plane may have posed a threat. Despite not explicitly referencing the crash, Ukrainian military officials stated that the country would target Russian military transport aircraft suspected of delivering missiles, particularly in close proximity to the border.

Internal problems in Europe could change foreign policies as angry farmers across the EU have initiated protests ranging from a two-hour demonstration in Poland to a multi-day "siege" in Paris since the beginning of the year. Their grievances, which include overbearing EU regulations, high costs, and declining incomes, vary both between and within countries. These protests have surged across the EU, spanning from east to west, catching political leaders off guard. However, the underlying discontent among farmers has been brewing for some time, exacerbated by mounting debt, pressure from powerful retailers and agrochemical companies, volatile weather conditions, and competition from cheap foreign imports. The existing subsidy system further exacerbates the challenges faced by small-scale farmers. The conflict in Ukraine has compounded these issues, with a brief spike in crop prices quickly fading, and disruptions in trade flows leading to oversupply.

On 1 February, the European Union unanimously endorsed a $54 billion aid package for Ukraine, a decision that followed weeks of resistance from Hungarian Prime Minister Viktor Orban. The approval hinges on a pending vote in the European Parliament, which lead to the disbursement of the initial tranche of nearly $4.9 billion to Kyiv in March. European Council President Charles Michel emphasized the EU's commitment to supporting Ukraine, stating that the bloc understands the gravity of the situation. Orban, traditionally opposing the EU policy against Russia, had previously blocked additional funds for Ukraine, citing his concerns and leveraging his veto power. However, he relented after receiving assurances regarding the sensible use of the aid and guarantees that it wouldn't deplete funds allocated for Hungary. As part of the agreement, the EU will assess the aid's effectiveness annually and may renew the package in two years if necessary. Ukrainian President Volodymyr Zelensky welcomed the decision, highlighting its potential to foster long-term economic stability and growth in a country where defence expenditure consumes a significant portion of domestic revenue, leaving Western assistance to address non-war-related needs such as social security. Ukrainian Finance Minister Serhiy Marchenko underscored the substantial costs of ongoing conflict, estimating that a single day of fighting incurs approximately $136 million in expenses. But how are the EU leaders going to explain these additional budget expenses to their electorate, including already agitated farmers?

The Biden administration informed Congress on 26 January of its intention to sell F-16 fighter jets to Turkey and F-35s to Greece. The deal with Turkey was formalised following President Erdogan's endorsement of Sweden's NATO accession, with the $23 billion deal marking the culmination of over a year of intricate negotiations. Secretary of State Antony Blinken played a pivotal role in facilitating the deal, engaging extensively with Turkish officials and US lawmakers to address Erdogan's resistance to Sweden's NATO bid, which was contingent on Turkey receiving the fighter jets – a top priority for the US. Despite Turkey's initial attempt to involve the US directly in negotiations, the administration maintained leverage over the situation through the F-16s. After Turkey approved Finland's NATO accession in March 2023, Blinken worked fervently to secure Sweden's approval before the NATO summit in Vilnius, Lithuania, last summer. During a visit to Turkey in February 2023, Blinken emphasized to Erdogan that congressional approval of the jet sale was contingent upon Turkey allowing Sweden's NATO membership, underscoring the intricate diplomatic manoeuvres involved in the negotiations.

On 2 February, the US initiated strikes against Iran-backed militants and Iranian military targets in Iraq and Syria in retaliation for a drone attack on a US base in Jordan on 28 January, which resulted in the deaths of three American service members and numerous injuries to others. The drone strike targeted the Tower 22 base near Jordan's border with Iraq and Syria, prompting the US to accuse Iran of providing funding and weapons to the militants responsible, an accusation that Iran has denied. President Joe Biden swiftly issued a warning of forceful retaliation, marking a significant escalation of US involvement in the Middle East after efforts to contain regional tensions. National Security Advisor Jake Sullivan emphasized that this action was just the beginning of the US response, indicating that further steps would be taken, some of which may be visible, while others might not.

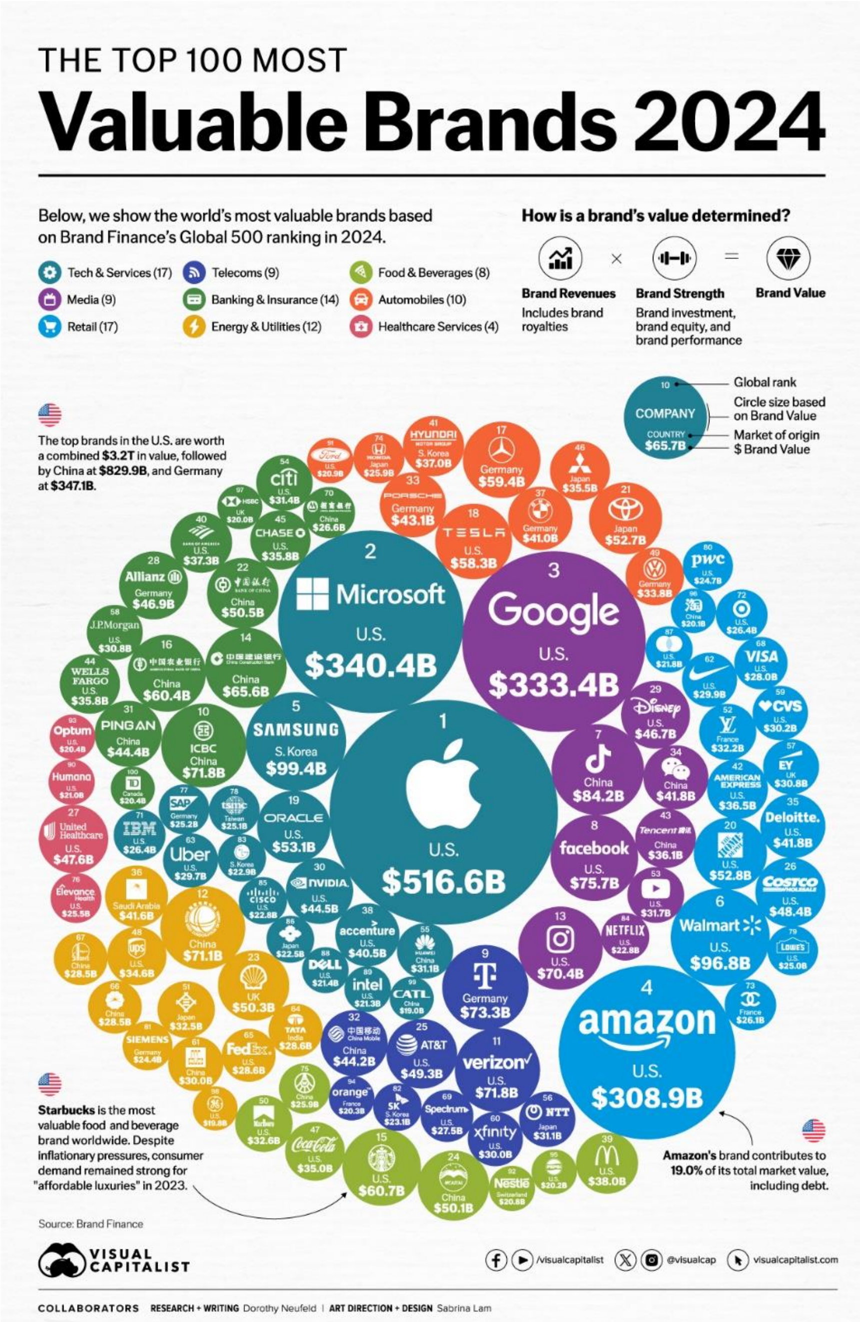
ENERGY: SWITCH COST

US President Joe Biden announced on Friday a temporary halt on approvals for both pending and future applications to export liquefied natural gas (LNG) from new projects, a move applauded by climate activists. This action could potentially postpone decisions on new LNG plants until after the 5 November election. The Department of Energy (DOE) will undertake a comprehensive review during this pause, assessing the economic and environmental impacts of projects seeking authorisation to export LNG to high-demand regions such as Europe and Asia. Energy Secretary Jennifer Granholm explained in a teleconference with reporters that this review process will span several months, with subsequent public commentary adding further time. Administration officials assured that the pause would not adversely affect allies as it includes an exemption for national security concerns, should additional LNG be required. European companies and countries rely heavily on consistent LNG supplies from the US, which became the world's leading LNG exporter last year. This dependence has grown as Europe endeavours to reduce reliance on pipelined gas from Russia following the 2022 invasion of Ukraine. Similarly, US allies in Asia are increasingly turning to LNG to mitigate coal consumption. Should we expect another spike of prices for energy resources in 2024?

HOW MUCH IS THAT BRAND WORTH?

Collectively, the top 100 most valuable brands globally surpassed a staggering $5 trillion in worth. While brands significantly contribute to shareholder value, accurately assessing their value presents challenges. Brand investments have the potential to yield dividends over extended periods, but determining their financial worth remains subjective, leading most financial regulators to typically exclude brand assets from balance sheets.

Figure 1

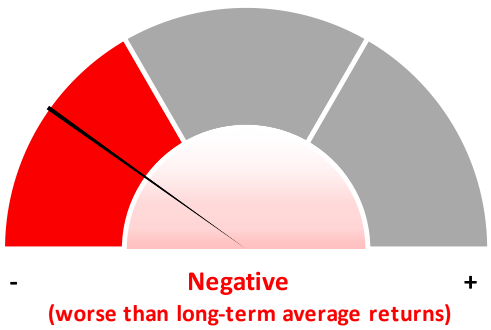


According to a report by Nielsen Media, there are approximately 500,000 competing brands worldwide, a figure that fluctuates due to the continual opening and closure of businesses. Determining an exact count is impossible given the diverse range of brands, including local, national, and international entities. But the majority of these brands are smaller businesses functioning at a regional or local scale. There are less than 1% which have over 1,000 employees and annual revenue exceeding $50 million, and the top 1% of yield incredible influence and purchasing power globally.

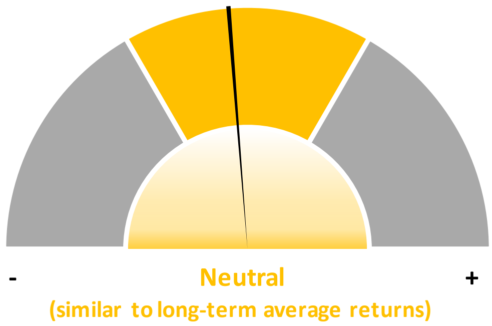
MARKET OUTLOOK

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

GROWTH ASSETS



INCOME ASSETS



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

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