Markets Monthly

05 September 2019

Bonds have more fun in volatile August

- Risk aversion and volatility escalated in August as slowing global growth, elevated trade tensions, Brexit risks, and wider geopolitical tensions weighed on risk sentiment.
- Global equities posted sharp falls at the start of the month, with more sizeable falls in UK and Japanese indices.
- August was generally a better month for global bond investors, with lower yields and flatter curves. US 30-year Treasury yields hit record lows, with some European yields falling further into negative territory.
- New Zealand yields traded around record lows after the RBNZ cut the official cash rate by 50bps in August.
- The NZD fell close to 3% on a trade-weighted basis in August, with larger falls against the USD, JPY and GBP.

Date		30-Aug-19	Month %	Quarter %	Year %	5-Year %
Cash	NZ Official Cash Rate	1.00	-0.50	-0.50	-0.75	-2.50
	NZ 90-day bank bill	1.19	-0.31	-0.48	-0.72	-2.51
Fixed Interest	NZ 5-year gov't stock	0.78	-0.35	-0.60	-1.12	-3.14
	NZ 10-year gov't	1.01	-0.44	-0.71	-1.53	-3.05
	AUS 10-year gov't	0.89	-0.31	-0.58	-1.64	-2.41
	US 10-year gov't	1.51	-0.55	-0.67	-1.35	-0.83
Australasian Equities	NZ - NZX50 Capital (NZ$)	4670	-1.3%	5.5%	11.4%	67.6%
	- NZX50 Gross (NZ$)	10757	-1.2%	6.3%	15.4%	106.1%
	AUS - All Ords (A$)	6698	-2.9%	3.2%	4.2%	19.1%
International Equities	JAP - Nikkei (¥)	20704	-3.8%	0.5%	-9.5%	34.2%
	UK - FT100 (£)	7207	-5.0%	0.6%	-3.0%	5.7%
	US - S&P500 (US$)	2926	-1.8%	6.3%	0.9%	46.1%
	WORLD - MSCI (US$)	2139	-2.2%	4.5%	-1.7%	22.3%
	MSCI in NZD (NZ$)	3395	2.4%	8.0%	3.7%	62.4%
Exchange Rates	NZD/USD	0.6299	-4.5%	-3.2%	-5.2%	-24.7%
	NZD/AUD	0.9375	-1.9%	-0.4%	2.4%	4.8%
	NZD/JPY	67.01	-6.4%	-5.6%	-9.1%	-22.9%
	NZD/GBP	0.5169	-4.7%	0.1%	1.3%	2.5%
	NZD/EUR	0.5702	-3.5%	-2.5%	0.2%	-10.2%
	NZ TWI	70.46	-2.9%	-1.9%	-2.0%	-11.1%
Equity indices are the respective end-of-month closes. Interest rates and exchanges rates are at 5pm NZ.						

For the latest performance information on ASB's funds click here for ASB Kiwisaver Scheme,

click here for ASB Investment Funds. More information on ASB Securities is here.

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Please refer to the important disclosures at the end of this document.

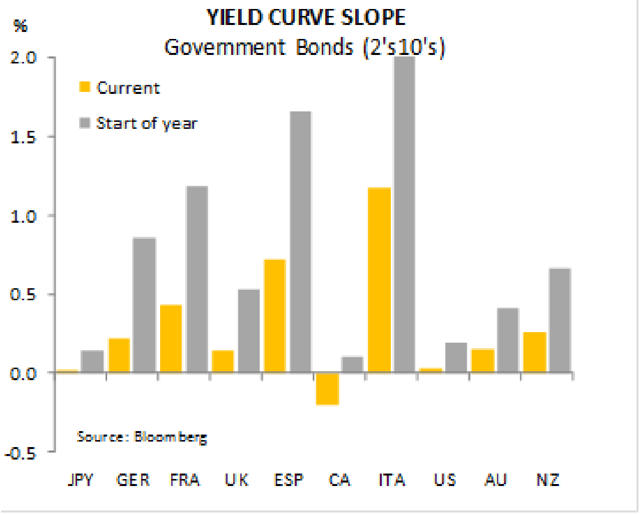
Global markets were volatile in August and a risk-off tone predominated as US-China trade hostilities, ongoing Brexit drama, rising geo-political tensions and concerns about a potential global slowdown weighed on risk sentiment.

August was not a great month for equities, with heavy falls at the start of the month for various global indices followed by a period in which they oscillated around a flattish trend. The MSCI global index (-2.2%) suffered its largest monthly fall since May, as did the major US indices, Japanese Nikkei, German DAX and UK FTSE 100. Australasian equity bourses were not immune, with the first monthly falls in the ASX and NZSE for 2019. Equity markets were also volatile, with the VIX measure of implied volatility in the S&P500 index hitting its highest level for 2019 (24.8) in early August.

Equities started the month on the back foot as the worsening trade war weighed on sentiment. US President Donald Trump announced an additional 10 per cent tariff on the remaining US$300bn of Chinese imports from September 1. China retaliated by pledging not to buy US agricultural products, with the devaluation of the yuan to post 2008 lows against the USD, called "currency manipulation" by US President Trump. A less dovish than expected message from US Federal Reserve didn't help equity market sentiment after Fed Chair Powell dampened rate cut expectations after the 25bp August cut by referring to the move as a "mid-cycle adjustment" and not necessarily the start of a lengthy monetary easing cycle. There was another downward leg in equities later in the month after China announced that it will be imposing 5% to 10% tariffs on USD75bn of US exports from September. President Trump struck back, imposing an additional 5% duty on some USD550bn in targeted Chinese goods from October, but announced that the US and Japan would agree 'in principle' to a trade deal in which Japan will cut tariffs on US agricultural exports.

Political tensions in Europe have added to the list of concerns facing equity investors. Brexit uncertainty likely added to the downward impetus and it has been a rocky road for investors. Prime Minister Johnson became UK Prime Minister in late July about one month later suspended the UK Parliament from 12 September until 14 October 2019. In early September, Johnson subsequently lost his majority in the House of Commons with the defection of 20 Conservative MP's. Opposition MP's passed a bill to prevent a no-deal Brexit (this has to pass the House of Lords before it can become law) and also voted in favour of forcing PM Johnson to ask the EU to delay Brexit by three months until 31 January if he can't get a deal with the EU or persuade Parliament to leave without a deal. Prime Minister Boris Johnson's call for a snap general election was defeated in parliament, with support well below the two-thirds majority required. Italian equities fell and yields on Italian 10-year bonds dipped below 1% in mid-August after Giuseppe Conte resigned as Italy's prime minister following fallout with a coalition partners. In early September Conte formed a new left wing coalition government has seen Italian stocks firm and bond yields ease.

August, however, was generally a good month for bond investors, with lower yields and flatter curves. Dormant inflation and slowing global growth, weak manufacturing activity and global trade has reinforced fears of a global slowdown. Investors were also spooked in mid-August by the first inversion of the Treasury yield curve (2s10s) since 2008, with US 30-year Treasury yields touching record lows in late August (1.90). Trade tensions overshadowed commentary from central bankers at the Jackson Hole symposium (August 22-24) where US Federal Reserve Chair Jerome Powell highlighted a long list of downside risks to the US economy, promising to "act as appropriate" to prolong the expansion. Rising geo-political risks in Argentina, Italy and Hong Kong also contributed to the strong bond market rally as investors sought refuge in safe-haven assets.



Bond investors seem to have ignored some of the messages coming from central banks. At Jackson Hole, Fed Chair Powell suggested that the Fed was limited in its ability to counteract Trump's trade policies. RBA Governor Lowe also warned of the limits that monetary policy could cushion the global economy, and called upon more of the heavy lifting to be done by fiscal policy. RBNZ Governor Orr was the notable exception, noting that the RBNZ and Treasury were looking at non-conventional policy option and that "it is easily within the realms of possibility that we (the RBNZ) might have to use negative interest rates".

NZ yields fell to a record low after the RBNZ surprised markets and front-footed policy easing by cutting the OCR by 50bps to a new record low of 1.00% in August. This was in response to weak business sentiment data, with the QSBO and ANZ surveys pointing to weak investment, employment and economic activity, and contained inflation pressure. NZ 10-year government bond yields briefly fell below 1% in August. Australia's Reserve Bank kept interest rates on hold on August 6, but economic forecasts in its quarterly

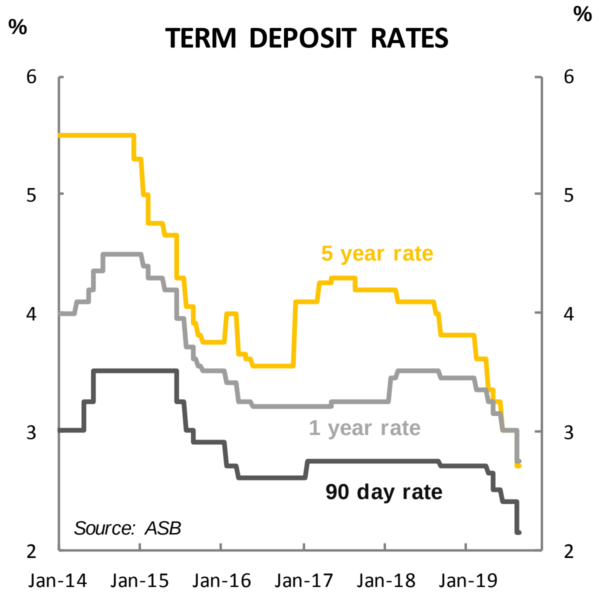
Statement of Monetary Policy (August 9) implied additional policy easing was likely in the coming months. The RBA left the cash rate on hold again in September, but retained an easing bias, preparing to "ease monetary policy further if needed ".

The gloomier global scene, RBNZ interest rate cut, and subdued domestic business confidence contributed to a weaker NZD. The NZD was close to 3% lower on a trade-weighted basis and ended the month at close to 4-year lows, with larger falls against the yen, pound and USD. Falls against the AUD and CNY were more modest.

Income Assets

Cash

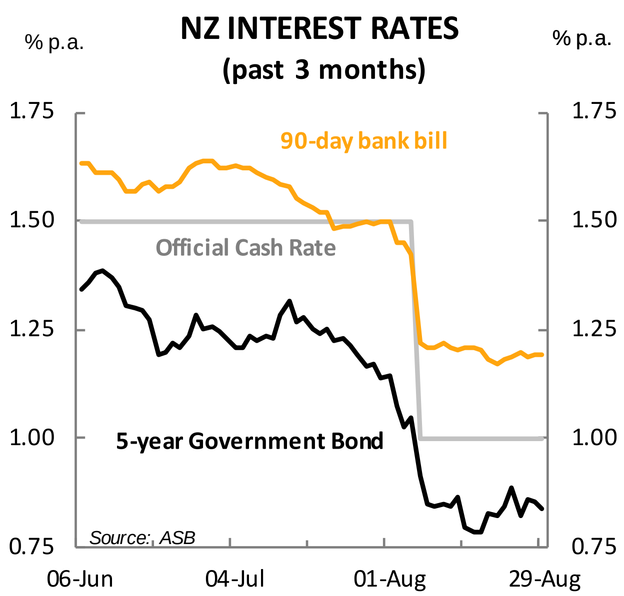
The OCR was cut by 50% to a new record low 1.00% at the August 7 Monetary Policy Statement. The next RBNZ monetary policy decision is on 25 September, where we expect the OCR to be held at 0.75%. However, persistently weak domestic business sentiment and slowing global growth is expected to push the OCR lower. Our economic forecasts have a 25% cut in November (0.75%), with the risk that the OCR moves even lower over 2020.



Term deposit interest rates have drifted lower since the August OCR cut, and at their lowest levels since the mid-1960s. For amounts over $10k, term deposit rates for 1-5 years are around 2.7%. Rates for shorter 3-month terms are slightly above 2%. These rates, while down, are high in relation to the 1% OCR and circa 1% (lower) wholesale interest rates. The wholesale interest rate curve has flattened significantly, with long-term interest rates only marginally higher than short-term rates.

We expect term deposit interest rates to move lower as the OCR is cut further. We will also have to wait until December for an announcement by the RBNZ, but the imposition of higher bank capital requirements from the RBNZ could move also deposit interest rates lower over 2020.

The latest ASB term deposit rates [can be found here.]



NZ Fixed Interest

The RBNZ OCR cut, softer tone to domestic and global data, and increased risk aversion saw NZ yields hit record lows across the curve in mid-August, with a modest lift by the end of the month. Over August, yields 5 year Government bonds declined 35bps, closing the month at 0.78%. NZ 10-year Government bond yields fell below 1% in mid-August and ended the month just above 1%. The plunge in yields and flattening in the yield curve has been substantial. Persistently low inflation, concerns over the global outlook, increased risk aversion and central bank interest rate cuts (either delivered or signalled) have all played their part.

Following sizeable fall in yields, the question must be asked, where to from here? We expect a further 25bp OCR in

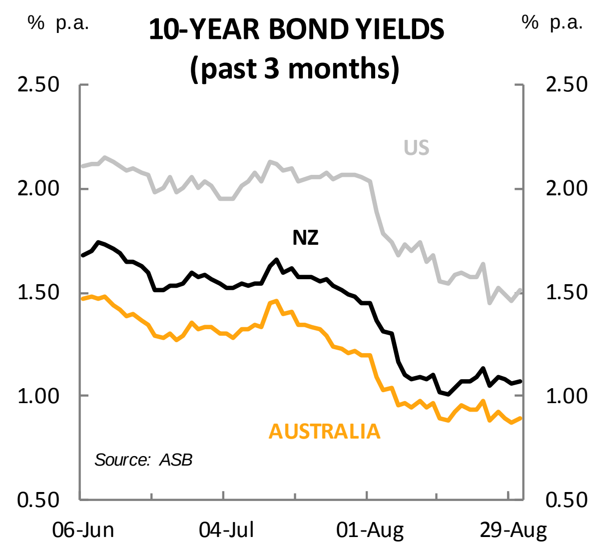
November, taking the OCR to a new record low 0.75%. Further deterioration of the domestic and global outlook is likely to see more OCR cuts over 2020 and a lower OCR trough. We also expect global central banks to continue to ease policy settings. The US Federal Reserve is expected to trim the Federal Funds rate by 25bps in September, with a total of 75 bps in cuts by 2020. We expect 50bps of cash rate cuts by the RBA (November and February 2020). Monetary policy easing is also expected by the Bank of Canada and the European Central Bank in the next month or so. The expectation of a lower OCR, combined with the dovish sentiment from offshore central banks should maintain downward pressure on NZ fixed interest rates. Our view remains that interest rates will remain 'even lower for even longer', and we expect lower bond yields over the year ahead.

International Fixed Interest

At the end of July, the US Federal Open Market Committee's (FOMC, or Fed) delivered their first rate cut since 2008, trimming the Federal Funds Rate by 25bp to 2.00% to 2.25%. Despite the assertion by Fed Chair Powell that the cut was not necessarily the start of a lengthy monetary easing cycle, fixed interest investors have thought otherwise. The move to lower yields and flatter curves has been commonplace for global fixed interest markets. Over the full August month, US 10-year yields plummeted 55 basis points (-0.55%), with yields dipping to as low as 1.44% in late August before lifting to 1.50% by the end of the month. US 30-year Treasury yields fell to a record low 1.90% in late August. The US yield curve (2s10s) was inverted for much of the latter part of the month.

Australian10-year Government bond yields fell another 31 basis points to end the month at 0.89%. Like NZ 10-year bonds, Australian 10-year Government bond yields are currently around record lows. European government bond yields fell in August. Italian 10-year bonds ended the month below 1% after starting the month above 1.50%. UK 10-year gilt yields troughed at record lows in mid-August (0.40%). German, French, Swiss and Dutch yields moved further into negative territory out to (and including) the 10-year tenor. From being unthinkable a generation ago, negative yields are becoming increasingly commonplace. According to Bloomberg estimates, at the end of August the global stock of negatively-yielding debt reached USD17 trillion, with 30% of all investment grade securities now bearing sub-zero yields. This is inflating fears of a global bond bubble.

The issue for markets is how low can yields go? There is scope for yields to move lower, but this will depend on the global outlook, the appetite of investors and the willingness of global central banks crank up the printing presses humming. Lower yields may be a boon to borrowers, but they trim returns to savers.



Growth Assets

Australasian Equities

The strong run for Australasian equities came to an end in August, with falls for the Australian All Ords index (-2.9%) and the NZX50 Gross index (1.2%). Despite the August pullback, annual gains from the major NZX indices remained in double digits and close to record peaks.

Performance of individual NZ stocks was mixed. Stronger than expected earnings saw Katmandu shares surge 22.5% over the month to their highest level this year. The RBNZ cut continued to support demand for stocks offering reliable dividends. Mercury Energy (13.6%) and Contact Energy (10.6%) were also supported by solid results. The OCR cut likely supported interest rate sensitive stocks, with property-related stocks posting gains over the month, most notably Precinct Properties (4.5%). Shares of retirement village operator Summerset rose 8.1% over the month, but at $6, the stock was well down on its $8 peak last August. The lower NZD looks to have provided a boost to stocks, with Air NZ (5.5%), the Port of Tauranga (+3.7%), Auckland International Airport (3.4%) posting gains. There were also a number of notable falls. Weaker sales growth and a scaling back in their outlook for revenue growth saw shares for cinema software firm Visa group plummet 35% over the month to a seven month low. The Sky Network share price was down 13.5% over the month and fell to a record low after a large write-down in the value of assets and lower subscriber numbers hit the stock. Although reporting record net profits and an impressive set of financial results, share prices for a2 milk were down close to 20% in August. The stock has had a stellar run, and has increased twentyfold compared to just four years ago. The Fonterra Shareholders' Fund share price was down more than 12% over the month, and touched a record low of $3.15 on the 28th of August. Fletcher Building was another underperformer, with the share price down 7.4% on increased investor caution over further cost over-runs within the beleaguered Building and Interiors division.

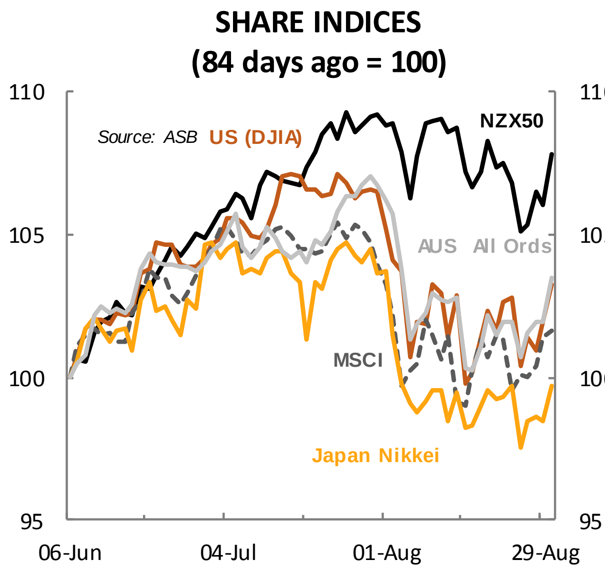
Over August, 16 of Australia's 22 sub-industry sectors posted losses. Household and personal products (down by 19.6 per cent) fell by the most, followed by Consumer durable and apparel (down by 15.4 per cent) and Materials (down by 7.9 per cent) as the iron ore price fell sharply. Pharmaceutical & Biotech shares lifted by the most, up by 4.5 per cent. Of the size categories, Small Ordinaries led declines, down by 4.2 per cent, below the ASX mid-cap 50 index (down 2.9 per cent), large cap ASX50 and ASX100 indexes (both down 2.8 per cent). The Australian corporate reporting season continued to produce mixed results. Retailer JB-HiFi and materials company James Hardie surprised on the upside, but packager Orora and Blackmores disappointed.

International Equities

US equities were volatile in August and ended the month 2.2% lower on the MSCI index. Previous optimism over more Fed interest rate cuts and (misplaced) optimism about an imminent US-China trade deal gave way to pessimism as mounting evidence of slowing global growth, the deteriorating global trade backdrop and worsening Brexit situation prompted equity investors to head to the hills at the start of the month. Global markets have consolidated after initial August weakness and volatility has abated, although the glow from the trade truce announced at the late June G20 Summit in Japan has well and truly faded.

We note that global equities are likely to remain pushed and pulled by developments pertaining to the global growth backdrop, trade, and Brexit headlines. The looming Federal Reserve decision (September 19) is likely to be pivotal for markets as will political developments in the UK and elsewhere.

ASB Securities has more information on sharemarkets and trading [here.](here)

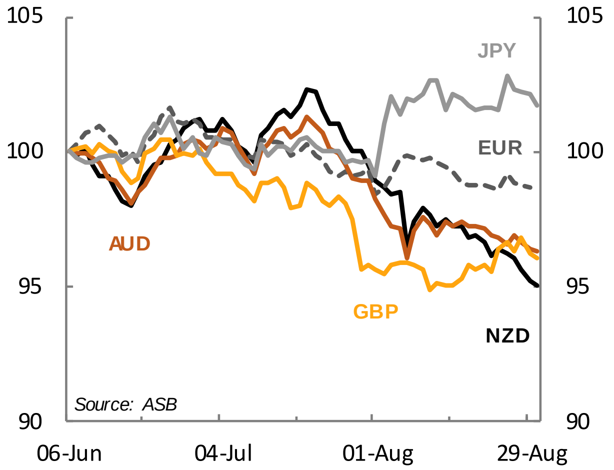


Exchange Rates:

August was characterized by the weaker NZD, which fell by close to 3% on a trade-weighted basis. Increased global risk aversion, the impact of the 50bps OCR cut and the weaker Chinese yuan were likely catalysts, with the NZD posting larger falls against the yen, USD, pound and Euro. Following the sharp fall following the RBNZ cut on August 7, the NZD drifted lower against most crosses as the weaker domestic and global outlook weighed on the NZD. The trajectory of the NZD mirrored that of the USD index, which firmed towards the end of the month, with the Chinese yuan closing the month at close to post-2008 lows against the USD (7.15).

More information about currencies is available in ASB's weekly economic report which can be downloaded here.

EXCHANGE RATE INDICES (versus USD, 84 days =100)



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