Markets Monthly

09 January 2020

Yields lift and sharemarkets surge into year end

- Sharemarkets were strong in December, with the main US share indices setting fresh record highs. Positive sentiment regarding a US-China trade agreement was a key driver in December. Renewed US-Iran tensions are a concern in early 2020.
- The NZ sharemarket lifted 1.4% in December, and gained 30.4% over the year (NZX 50 gross index).
- Bond yields, both here and abroad, resumed the march higher over December. Bond yields have moved significantly higher over the past three months, but remain well below year-ago levels.
- The NZD surged higher over December, lifting 4.7% against the USD, and 3.2% on a trade-weighted basis.

Date		31-Dec-19	Month %	Quarter %	Year %	5-Year %
Cash	NZ Official Cash Rate	1.00	0.00	0.00	-0.75	-2.50
	NZ 90-day bank bill	1.29	0.06	0.14	-0.68	-2.38
Fixed	NZ 5-year gov't stock	1.36	0.26	0.47	-0.50	-2.24
Interest	NZ 10-year gov't	1.65	0.36	0.56	-0.72	-2.00
	AUS 10-year gov't	1.37	0.34	0.40	-0.95	-1.47
	US 10-year gov't	1.89	0.11	0.20	-0.83	-0.31
Australasian	NZ - NZX50 Capital (NZ$)	4925	1.3%	4.6%	26.0%	69.7%
	- NZX50 Gross (NZ$)	11492	1.4%	5.5%	30.4%	107.0%
Equities	AUS - All Ords (A$)	6802	-2.1%	0.0%	19.1%	26.2%
International	JAP - Nikkei (¥)	23657	1.6%	8.7%	18.2%	35.6%
Equities	UK - FT100 (£)	7542	2.7%	1.8%	12.1%	14.9%
	US - S&P500 (US$)	3231	2.9%	8.5%	28.9%	56.9%
	WORLD - MSCI (US$)	2358	2.9%	8.2%	25.2%	37.9%
	MSCI in NZD (NZ$)	3506	-1.8%	0.8%	24.9%	60.6%
Exchange	NZD/USD	0.6726	4.7%	7.3%	0.2%	-14.1%
Rates	NZD/AUD	0.9603	1.3%	3.6%	1.0%	0.4%
	NZD/JPY	73.10	4.0%	8.1%	-1.4%	-21.8%
	NZD/GBP	0.5123	3.0%	0.4%	-3.1%	1.9%
	NZD/EUR	0.6003	2.9%	4.8%	2.3%	-6.8%
	NZ TWI	73.49	3.2%	5.0%	0.3%	-7.4%
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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Market News

Last month we suggested "where to next" for interest rates looked to be key question for financial markets to ponder. The answer in December was "long-term rates are going up", both here and offshore. Ten-year Government bond yields in New Zealand, Australia, and the US are now all significantly higher than the lows recorded a few months ago. The lift in December was particularly strong in local markets, with NZ 10-year yields up a whopping 36 basis points over the month, followed closely by a 34 basis point move higher in Australia's 10-year bond. The swift move up from the recent lows has caused some noticeable changes in bond portfolio valuations over the quarter. The FTSE World Government Bond Index (NZD hedged) declined 0.62% over December and is down 1.56% over the fourth quarter. Here, the ANZ New Zealand Government Bond index was down 1.89% over December, and 2.91% over the fourth quarter.

Earlier in 2019, many of the world's central banks were in easing mode, and a number of central banks actually cut interest rates, including the US Federal Open Market Committee (FOMC), the Reserve Bank of Australia (RBA) and the Reserve Bank of New Zealand Australia (RBNZ). This, and signs of stabilisation in the global outlook has seen markets entertain the possibility that we may be close to the trough for the global interest rate cycle. Of greatest significance for global interest rates, the FOMC appears confident that it does not need to cut rates further, and its latest set of forecasts suggest that Fed policy makers expect the Federal Funds rate to remain steady over 2020. These central bank pauses, combined with improving sentiment regarding global trade and economic growth have been catalysts for the moves higher in long term interest rates.

Over the year ahead we still think we could see further cuts from the RBNZ, RBA, the FOMC, and other central banks. However, the direction of interest rates and market sentiment is moving away from our view on central banks easing at present. The RBNZ and RBA next review their respective policy settings in February. ASB's view is that the RBNZ will hold the OCR at 1.00% in February. Tightening credit conditions posed by stricter bank capital requirements are expected to prompt a 25bp cut later in 2020. We have pencilled in May for this last rate cut, but the risks are skewed to a later move. Our CBA colleagues believe the RBA will cut the 0.75% cash rate by 25bps in February, with the cash rate hitting the RBA's 0.25% lower bound in August to support economic activity. Meanwhile, Fed Chair Powell continues to suggest that the hurdle for further rate cuts in the US is high. The upshot is a lengthy period of weakness in US economic data and/or a re-emergence of growth threats to the US or global economy will probably be needed for the Fed to cut the Federal Funds rate this year.

Sentiment regarding US-China trade was a key source of direction for sharemarkets during December. The month actually started with investors on the back foot, after US President Donald Trump said he would immediately restore tariffs on US steel and aluminium imports from Brazil and Argentina. Trump accused Brazilian and Argentinian authorities of devaluing their currencies to provide then a competitive advantage (source Reuters). At about this time Trump also said a Chinese trade deal may have to wait until after the 2020 US elections. The mood improved later in the month and global shares rebounded after the US and China announced on 13 December that an agreement had been reached for a "phase one" of a trade deal. A Chinese delegation is scheduled to travel to Washington and sign the deal in mid-January.

Improving sentiment also triggered a rebound in global yields, posing a headwind to equity market performance. However, equity market investors have (so far) been happy to shrug off recent rises to global interest rates given the reduction of pessimism on the global outlook. US sharemarket indices set record highs in December, but have pulled back modestly in early January in response to geopolitical tensions.

A US drone strike in Iraq has killed Iran's top General Qasem Soleimani as well as Abu Mahdi al-Muhandis, a commander of a coalition of pro-Iranian militias. The situation creates a difficult position for the Iraqi government because Iraq is an ally of both Iran and the US, and the US has a significant military presence in Iraq. After the attack Iraqi MPs have passed a resolution calling for foreign troops to leave the country. Trump has threatened sanctions against Iraq "like they've never seen before" if they expel troops, and separately threatened to attack Iranian sites if they carry out any retaliation against the US. Iran announced it will no longer follow the restrictions from the 2015 nuclear deal. These tensions are setting the tone in global financial markets early weeks of 2020. At the time of writing US share indices are down circa 1% in the wake of the US attack, and the MSCI world share index is down around 0.5%.

The UK General Election went the way that polls suggested in December. Prime Minister Boris Johnson's Conservatives won a decisive majority, leaving market participants more confident that an orderly Brexit can be delivered. Johnson can now fast track his Brexit deal through Parliament, with Royal Assent likely on 13 January. The UK would then be in a position to leave the EU with a transition period on 31 January 2020.

Australia's fires continued to rage over December and into 2020, tragically claiming human lives and killing thousands of animals. The loss of life should always be the centre of attention, but the financial cost and economic impact will affect businesses and financial markets. The fires are unprecedented in scale, with more than 5 million hectares destroyed. The economic impact is still to be assessed, but the financial cost of previous fires suggests the cost will be in the billions, impacting many facets of the economy including property, agriculture and tourism. On January 7 the Australian Insurance Council said: *"to date, insurers have received 8,985 claims since September from New South Wales, Victoria, Queensland and South Australia. Many more claims are expected to be lodged in coming days and weeks. Insurance losses stand at $700 million."* Beyond the fire damage, extreme drought conditions are impacting many parts of Australia, and particularly hurting the agricultural sector. The Australian sharemarket declined over December, in contrast to the strong lifts observed in other markets.

Although geopolitical risks have increased in early January due to the US strike in Iraq, other key risks to the global economy have reduced. The "phase one" part of the US China trade agreement is expected to be signed at the White House this month, the UK is on the way towards an orderly Brexit, and the Chinese economy is stabilising, with the People's Bank of China supporting growth by cutting its reserve requirement ratio by another 50bp this month. On the local data front, the year ended on an encouraging note. New Zealand Q3 Gross Domestic Product increased by 0.7% over the quarter, bang on ASB's "bullish" forecast, but stronger than both the Reserve Bank of New Zealand's November forecast and market expectations. The revised growth profile suggests that the economy accelerated in the second half of 2019 after a sluggish first half.

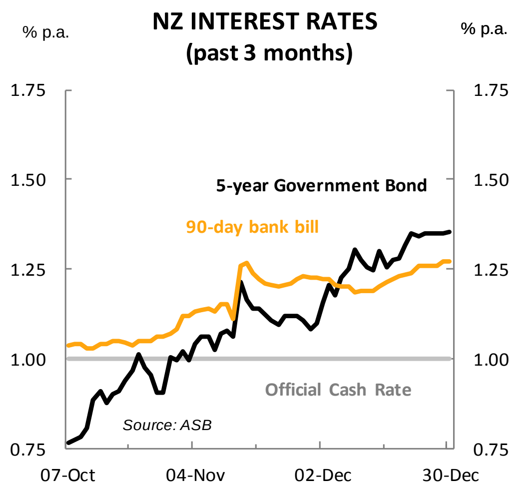
Income Assets

Asset	Instrument	31-Dec-19 Yield (%)	Month	Quarter	Year	5-Year
			Yield Change			
Cash	NZ Official Cash Rate	1.00	0.00	0.00	-0.75	-2.50
	NZ 90-day bank bill	1.29	0.06	0.14	-0.68	-2.38
	US 90-day bank bill	1.91	0.00	-0.19	-0.89	1.65
Fixed	NZ 5-year gov't stock	1.36	0.26	0.47	-0.50	-2.24
Interest	NZ 10-year gov't	1.65	0.36	0.56	-0.72	-2.00
	NZ 10-year swap	1.78	0.29	0.58	-0.87	-2.32
	AUS 10-year gov't	1.37	0.34	0.40	-0.95	-1.47
	US 10-year gov't	1.89	0.11	0.20	-0.83	-0.31

Cash

The OCR was cut by 0.50% to a new record low 1.00% at the RBNZ's 7 August meeting and finished 2019 at 1.00% after on hold decisions in September and November. The RBNZ is expected to cut the OCR by a further 25bps in 2020, in large part due to tightening credit conditions. We have pencilled in a May OCR cut, but we can't rule out the possibility that the RBNZ remains comfortable with current settings for an extended period.

Term deposit interest rates have drifted lower since the August OCR cut, posting modest falls over November. Deposit interest rates were little changed over December. For amounts over $10k, term deposit rates for 2-5 years are around 2.5%. Rates for shorter 3-month terms are now slightly below 2%, and 4- to 12-month rates are between 2% and 2.6%.



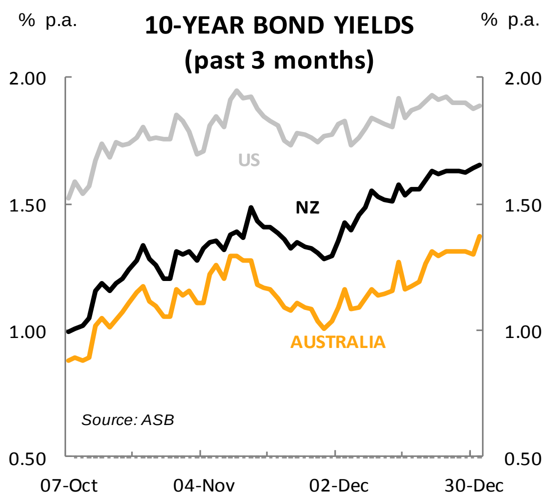
We think the risk for savers is that term deposit rates move even lower, particularly if the OCR is cut further. On 5 December, the RBNZ announced the details of the future capital requirements for locally-incorporated banks, which will be phased in over the coming years. The imposition of higher bank capital requirements for locally-incorporated banks from the RBNZ could put downward pressure on term deposit rates (and/or upward pressure on borrowing rates).

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

NZ Fixed Interest

The NZ 10-year Government bond yield dipped briefly below 1% in August and again in early October. Since then, however, NZ yields have been moving steadily higher, with 10-year Government bond yields ending 2019 at 1.65%. This is a large move, and has triggered a noticeable dip in bond valuations. Bond prices move in the opposite direction to yield, so the sharp lift in yield from the lows has been negative for bond portfolios. The ANZ New Zealand Government Bond index was down 1.89% over December, and 2.91% over the fourth quarter. The ANZ New Zealand Corporate A-Grade Bond Index was down 0.64% over the month, and 1.19% over the fourth quarter.

However, even though bond yields are off the 2019 lows, NZ corporate and Government Bond yields remain incredibly low on a historical basis, and significantly lower than a year ago, which has supported annual returns for portfolios. The abovementioned Government and Corporate bond indices are up 4.89% and 5.22% over the year to 31 December.



International Fixed Interest

As was widely expected, the Fed made no changes to the target rate settings at its December meeting. The “dot plots” of the Committee member’s forecasts showed the FOMC projected to leave the funds rate unchanged in 2020 with just 25bp of hikes for 2021 and 2022. Fed Chair Jay Powell emphasised there would need to be a “significant” and “persistent” increase in inflation before interest rates need to rise. The Fed looks happy with interest rate settings, and the bar to further cuts is high.

US 10-year yields rose 11 basis points or 0.11% over the month, and are trading around 0.4% above recent lows.

European 10-year yields remain negative in Germany, the Netherlands and Switzerland, but have lifted into positive territory (just) in France and Sweden over the past month. European yields have become “less negative” over recent months, and the major European 10-year yields are up by around 0.25%-0.5% over the past three months.

Japanese yields remain negative, but are also “less negative” than they have been earlier in 2019.

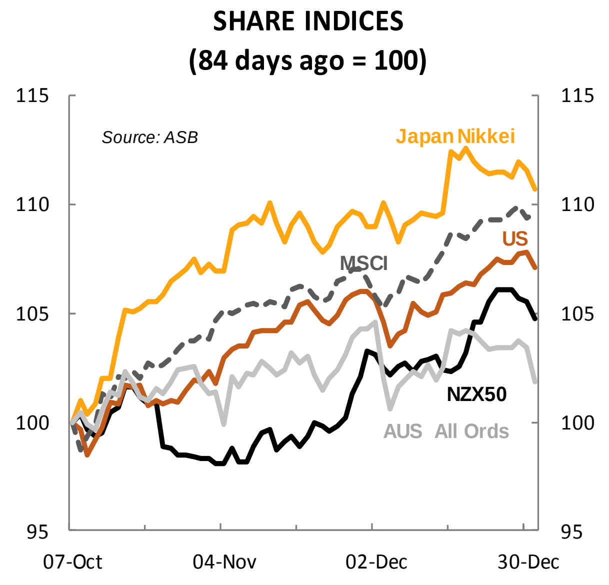
Growth Assets

Asset	Index	31-Dec-19 Level	Month %	Quarter %	Year %	5-Year % pa
			Change			
Equities	NZ - NZX50 Capital (NZ$)	4925	1.3%	4.6%	26.0%	11.2%
	- NZX50 Gross (NZ$)	11492	1.4%	5.5%	30.4%	15.7%
	AUS - All Ords (A$)	6802	-2.1%	0.0%	19.1%	4.8%
	All Ords in NZD	7084	-3.3%	-3.4%	17.9%	4.7%
	JAP - Nikkei (¥)	23657	1.6%	8.7%	18.2%	6.3%
	UK - FT100 (£)	7542	2.7%	1.8%	12.1%	2.8%
	US - S&P500 (US$)	3231	2.9%	8.5%	28.9%	9.4%
	WORLD - MSCI (US$)	2358	2.9%	8.2%	25.2%	6.6%

Australasian Equities

Australasian markets were mixed in December. The New Zealand market pressed higher, in line with global moves, with the NZX50 Gross index up 1.4% for the month. However, the Australian market weakened, with the Australian All Ords index down 3.3% in December. However, both markets posted solid gains over the 2019 year.

New Zealand stocks in the retirement sector were boosted by a takeover offer for Metlifecare from a Swedish fund manager during the month. Shares were up circa 30% on a year ago. Metlifecare shareholders will vote on the transaction at a special meeting in April. The a2 Milk Company finished December trading around $15, up $4 from where it started 2019, but still below its $18 late July peak. After a tough few years, shares for Fletcher Building rose 4% over 2019. Having peaked at $10.66 back in 2016, the share price was just above $5 in early 2020. Over December, 17 of Australia's 22 sub-industry sectors posted losses. Food & Staples Retailing fell the most (down 9.2%) followed by Telecommunications (down by 7.8%). Consumer Durables & Apparel was among the sectors to post gains, up by 1.7% (that lift comes after the double digit gains posted by the sector in the preceding month). Although the year finished on a slightly weak note for the Australian sharemarket, the 19.1% annual sharemarket return was the best in a decade.



International Equities

Global sharemarkets recorded solid gains over December. Key positive influences over the month included US-Chinese trade developments and the UK General Election. Gains were capped by thin trading and profit taking at the very end of the month, and the subsequent US-Iran tensions in early January.

The S&P 500 index of US shares gained 2.9%over the month, and posted its best annual gain since 2013, lifting 28.9%. The Dow Jones Index lifted 1.7% and the NASDAQ gained 3.6% in December. All three US indices set fresh record highs in late 2019, and are just shy of those levels in early 2020. Japan's Nikkei share index gained 1.6% over the month, and 18.2% over the year to 31 December. In Europe, the German DAX index gained just 0.1%, while the UK's FTSE 100 index of shares rose 2.7% to be 12.1% higher than a year ago.

It's been a very good year for global sharemarkets, with the MSCI index of world shares up 25.2% in USD terms and 24.9% in NZD terms over the year to 31 December.

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

Exchange Rates:

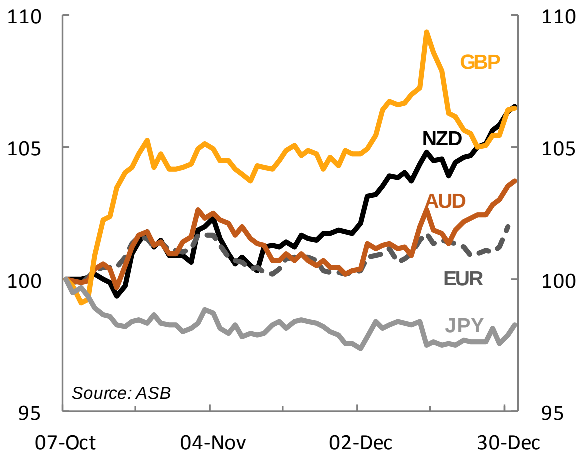
The NZD had a very strong finish to the year, lifting 4.7% against the USD and 3.2% on a trade weighted basis. The NZD gained against all the currencies we monitor in this report over the month and quarter.

Over the full year the NZD was little changed. The NZD/USD exchange rate rose 0.2% over 2019, and NZD was up 0.3% on a trade weighted basis.

The USD itself was weak over December, declining 1.9% on a trade-weighted basis. Over the 2019 year, the USD trade-weighted index rose 0.2%.

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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