Markets Monthly

10 January 2019

Bonds rally and sharemarkets suffer in December

- **Sharemarkets around the world slumped over December, as a number of concerns troubled investors.**
- **The local sharemarket fared better than most in December (-0.4%) & remained in positive territory for 2018.**
- **In contrast, global sharemarkets were down for the month, quarter, and year ending 31 December 2018.**
- **Sharemarket volatility looks to have staged a comeback with large movements evident in most major markets.**
- **Long term bond yields declined both here and abroad, boosting valuations, while the NZD eased.**
- **Oil prices declined further, falling around 10% over the month.**

Date		31-Dec-18	Month %	Quarter %	Year %	5-Year %
Cash	NZ Official Cash Rate	1.75	0.00	0.00	0.00	-0.75
	NZ 90-day bank bill	1.97	-0.01	0.06	0.09	-0.87
Fixed	NZ 5-year gov't stock	1.86	-0.15	-0.12	-0.39	-2.36
Interest	NZ 10-year gov't	2.37	-0.20	-0.25	-0.36	-2.34
	AUS 10-year gov't	2.32	-0.27	-0.35	-0.35	-1.93
	US 10-year gov't	2.72	-0.31	-0.33	0.28	-0.26
Australasian	NZ - NZX50 Capital (NZ$)	3907	-0.4%	-6.4%	1.4%	51.6%
	- NZX50 Gross (NZ$)	8811	-0.1%	-5.8%	4.9%	85.9%
Equities	AUS - All Ords (A$)	5709	-0.7%	-9.7%	-7.4%	6.7%
International	JAP - Nikkei (¥)	20015	-10.5%	-17.0%	-12.1%	22.9%
Equities	UK - FT100 (£)	6728	-3.6%	-10.4%	-12.5%	-0.3%
	US - S&P500 (US$)	2507	-9.2%	-14.0%	-6.2%	35.6%
	WORLD - MSCI (US$)	1884	-7.7%	-13.7%	-10.4%	13.4%
	MSCI in NZD (NZ$)	2807	-5.6%	-15.1%	-5.3%	38.7%
Exchange	NZD/USD	0.6711	-2.3%	1.7%	-5.4%	-18.2%
Rates	NZD/AUD	0.9504	1.3%	3.9%	4.5%	3.3%
	NZD/JPY	74.10	-4.8%	-1.1%	-7.5%	-14.0%
	NZD/GBP	0.5289	-1.5%	4.8%	0.3%	6.3%
	NZD/EUR	0.5867	-2.6%	3.5%	-1.2%	-1.3%
	NZ TWI	73.30	-2.0%	2.2%	-1.1%	-6.7%
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.

December news highlights

US President Trump played a part in many of the developments that impacted confidence in financial markets during the month. Trade tension between the US and China has been a key issue for a while now, and this has continued. At a meeting at the 30 November-1 December G20 Summit, Presidents Trump and Xi agreed to a 90-day ceasefire, which avoided the imminent implementation of more tariffs. This was a positive sign to start the month, but sentiment soured soon afterwards when Huawei's CFO Meng Wanzhou was arrested in Canada. The arrest was due to allegations she violated US sanctions against Iran. Meng was subsequently released on bail and remains in Canada while the US tries to extradite her.

The ongoing Special Counsel investigation of the 2016 US election was in the news in December, and looks set to make further headlines. The probe, headed up by Robert Mueller, has the scope to investigate possible links between Donald Trump's presidential campaign and the Russian government, *"and any matters that arose or may arise directly from the investigation."* The latest casualty from the investigation is ex-Trump lawyer Michael Cohen, who was sentenced to 3 years in prison during December.

The US Federal Funds Rate was lifted again during the month to a 2.25%-2.5% range. Trump's criticism of Fed Chairman Powell, who Trump picked for the job, has intensified, and this look set to continue. Trump appoints the Fed chair (along with Senate advice and consent) but cannot simply fire them. The Federal Reserve forecasts show it expects to lift interest rates again in 2019, and when Powell was asked if he would resign if Trump asked him to the answer was a clear "no."

US political concerns peaked with the partial US Federal government shutdown. The partial shutdown began on 21 December and has occurred because of Trump's demand for over US $5 billion of Federal funding to pay for a new border wall between US and Mexico, and Congress not agreeing to the funding. Political concerns also included the resignation of the Secretary of Defence Jim Mattis, whose resignation letter highlighted the difference between his world views and Trump's. Mattis resigned the day after Trump made the unexpected announcement to withdraw US troops from Syria.

UK Prime Minister Theresa May postponed the 11 December UK House of Commons vote on the Brexit Withdrawal motion. May said she was deferring the planned vote because *"the deal would be rejected by a significant margin".* A key concern is the issue referred to as the Northern Ireland backstop. This is a policy to ensure there is no hard border in Northern Ireland whatever the outcome of future trade talks between the UK and the EU. The UK sharemarket did respond positively when May survived a leadership challenge, but major hurdles lie ahead. Over mid December PM May had to try to convince European leaders to provide reassurance to UK members of parliament on the backstop issue. UK MPs remain concerned about being trapped inside the EU indefinitely under the proposed arrangement. A UK parliamentary vote on the current Brexit deal is scheduled for the 15th January in the House of Commons.

Another European issue over recent months has been the disagreement between the European Union Commission and Italian politicians regarding the Italian fiscal deficit. In late December Italian politicians agreed to lower deficit targets for the next three years, which in turn saw the Commission approve Italy's 2019 Budget. The European Central Bank (ECB) announced the conclusion of its €2.6 trillion bond purchase scheme in December. However ECB President Mario Draghi said *"the balance of risk is moving to the downside"* in Europe.

These issues all matter because the tensions and uncertainty they create are collectively weighing on the economic growth outlook that plays a significant part in driving markets. Recently the World Bank downgraded its 2019 GDP growth estimate, in part because of the rising trade tensions and the associated weakening manufacturing activity. However, to keep things in perspective, the World Bank still expects the global economy to grow 2.9% in 2019 (down from 3% forecast last June). That's not too different from the World Bank's 3.0% estimate of 2018 growth, and the 3.1% rate recorded in 2017.

Snapshot of how markets reacted

The US S&P 500 index of shares was down 9.2% in December. Other major sharemarkets suffered even more over the month. Germany's DAX was down 18.3%, the UK FTSE shed 12.5% and Japan's Nikkei fell 12.1%. It all contributed to what turned out to be the worst year for global sharemarkets since the Global Financial Crisis.

Despite the Fed's December interest rate hike, US bond markets reflected the "risk off" tone that impacted shares, and long-term yields pressed lower over the month. And Fed Chair Powell's comments that he is *"listening carefully"* to financial markets and remains *"patient"* have had a significant influence on market expectations for future Fed action. Other key global interest rates remained low during the month.

The records weren't all negative. On Boxing Day the Dow Jones Industrial Average posted its largest points gain ever, lifting 1,086 points. The S&P 500 index of shares rose 5% on the same day and the S&P500 retailing index lifted 7.4% after MasterCard data showed holiday sales were the best in 6 years. Amazon rose nearly 10% after selling a record number of items. Oil prices remained under downward pressure, falling another 10% over the month, to be around 40% below October highs. Whilst this isn't great news for energy producers, it is a welcome sign for energy consumers, here and abroad.

Smoother sailing in the Land of the Long White Cloud

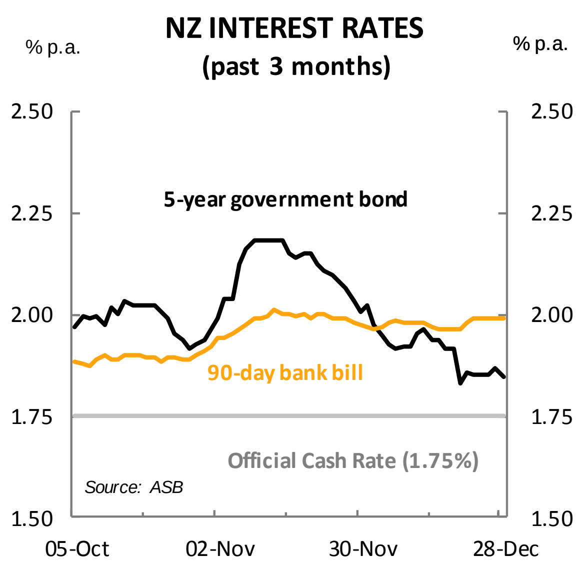
In New Zealand the news was more encouraging, and the sharemarket ended the month down by only 0.1%, to end up 4.9% higher over 2018. Data released late in the month showed that NZ economic growth was weaker than expected over the third quarter, but the level of economic activity was revised up. The Government's books also remained healthy. The question now is whether economic momentum picks up over 2019. Business confidence will be an important barometer. As we move into 2019 some positives include declining fuel prices, low borrowing costs, solid population growth, and the elevated Terms of Trade.

Income Assets

Cash

The RBNZ kept the OCR on hold at 1.75% at its November meeting, and reiterated its expectation to keep the OCR at this level into 2020. The RBNZ's next meeting and announcement is in mid-February. ASB continues to expect the OCR will remain on hold this year and next, with the first OCR move (up) expected in the second half of 2020.

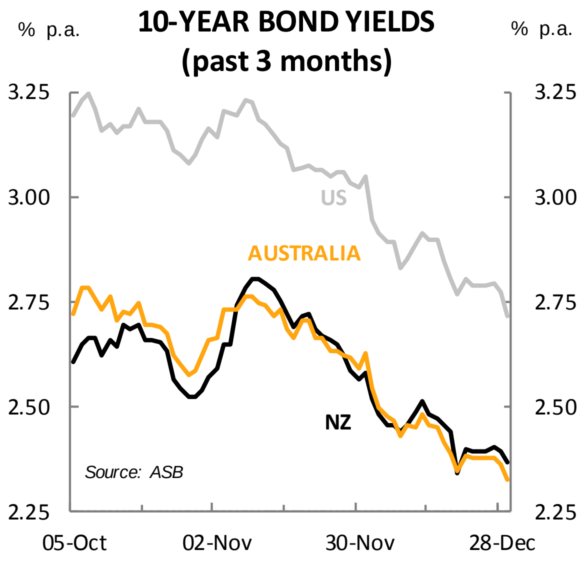
There were no major changes for term deposit rates in late 2018. Since September rates for amounts over $10K have ranged from 2.7% for a 90-day term, up to 3.8% for a 5-year term.



With OCR hikes a way off, ASB Economics expect most short-term returns on term deposits will likely stay near current levels over 2019. Further dips cannot be ruled out, particularly if other long term interest rates continue to decline, or the RBNZ decides to cut the OCR.

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

NZ Fixed Interest



NZ Government bond yields have been steadily declining since early November, and ended 2018 with both the 5-year yield and 10-year yield around 2018 lows. Both tenors were around 65 bps off their respective 2018 highs set during the first quarter of the year. The 5-year Government bond yield ended 2018 trading around 1.86%, and the 10-year yield ended around 2.37%.

The decline in yield provided a boost to the capital value of the respective bonds held over the course of the year. NZ corporate bond yields were also dragged lower during the month.

The US 10-year Treasury yield eased around 30 basis points over the month to approach 2.70%. The NZ 10-year Government bond yield declined fell by roughly 20 basis points over the month. However, yields on NZ Government bond bonds and interest rate swaps have remained below US equivalents, and this looks set to continue given the expectation that the US policy rate will remain above that of NZ for a while yet.

International Fixed Interest

US bond yields ended the month lower. The US 10-year Government bond (or Treasury) yield peaked at 3.25% on 7 November, just a basis point below the October peak of 3.26%, which in turn was a seven year high. Since then it has been a steady decline through to the end of the year, with 10-year yields declining to 2.72% at the end of the December, over 0.5% off the multi-year highs that were reached early in the quarter.

The Federal Open Market Committee (FOMC) lifted the target for the Funds rate to 2.25 - 2.50% at the December meeting, which was consistent with the rhetoric from Policy makers' speeches, earlier forecasts, and market expectations. However, Fed Chair Jay Powell's subsequent comments that he is *"listening carefully"* to financial markets and remains *"patient"* have had a significant influence on market expectations for future Fed action. The Fed still forecasts more rate increases (two in 2019, one in 2020), but financial market pricing for hikes has been significantly pared back, to the extent that the risk of Fed rate cuts are being priced into the future.

The European Central Bank (ECB) announced the conclusion of its €2.6 trillion bond purchase scheme in December. The ECB expects to reinvest the principal payments from maturing securities purchased under the asset purchase scheme *"for an extended period of time past the date when it starts raising the key ECB interest rates"*. And on this front, the ECB continues to expect to hold its policy interest rates at their current levels *"at least through the summer of 2019"*. This means the ECB's balance sheet will remain large (about €5 trillion) for the foreseeable future.

European bond yields generally eased lower over the month. German Bunds rallied (yields lower) over December, and the 10-year yield briefly dipped below 0.2% in early January. Italy's budget challenges had seen Italian 10-year bond yields as high as 3.69% during November, but now yields are back below 3%, reflecting the progress by the new Italian Government and EU Commission. However, a degree of risk is still priced into Italian yields – the 10-year yield was around 1.75% before the Italian election earlier in 2018. UK gilt yields remained in the lower part of recent ranges and the 10-year note traded with a yield between 1.2% and 1.3% for most of December. Japanese 10-year yields ended the month in negative territory having peaked at 0.16% in October. The declines in yield around the world's major bond markets provided a boost to the capital value of the respective bonds held over December.

Growth Assets

Australasian Equities

Australasian sharemarkets held up far better than the major global sharemarkets, but still recorded small declines in December. The NZX50 Gross index of shares dipped 0.1% while the Australian All Ords index was down 0.7% over the month. The local sharemarket was the only market monitored in this report that remained positive over the full year. The global concerns discussed earlier in this report had an impact on local markets, but the wide range of returns and the better overall market return relative to offshore markets also reflects a number of local catalysts and supports.

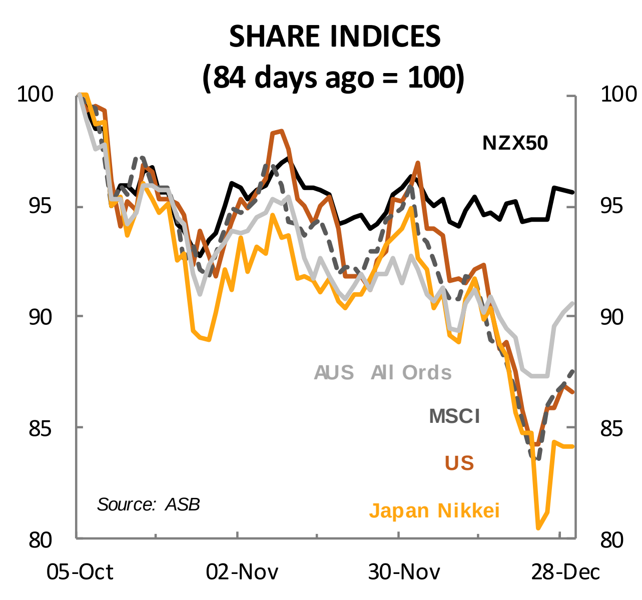
Significant falls were registered for local stocks - including Z Energy and Fletcher Building - that presented disappointing corporate earnings. This was despite Fletcher Building announcing the sale of its global Formica business in December. The NZ listed retirement village stocks Ryman, Summerset and Metlifecare, all saw share price weakness, and this was in part a reflection of concerns over the outlook for the Auckland housing market.

In contrast, takeover announcements have provided an offsetting boost to some share prices and the overall market. Apax Partners entered a formal arrangement in December to purchase 100% of Trade Me for $6.45 per share. Defensive stocks have also held up relatively well within the local market.

The Australian banking sector continues to be significantly impacted by a number of challenges. The Royal Commission inquiry, proposed RBNZ increases in capital requirements for banks in NZ, and the Australian housing market slowdown were all headwinds over 2018. On a positive note, BHP lifted over December and is up 21% over the year. Investors are encouraged by the company's divestments and associated capital return. BHP will return US$10.4bn to investors from the sale of its US onshore assets.

International Equities

A plethora of issues discussed earlier in this report all weighed on sentiment, and contributed to the worst year for global sharemarkets since the Global Financial Crisis. The US Dow Jones Industrial Average share index fell by 8.7% and the S&P 500 index of shares was down 9.2% in December. These were the biggest monthly losses for these indices since February 2009.



Other major sharemarket indices were also down over the month. Germany's DAX was down 18.3% and the UK FTSE shed 12.5%. In Asia, the Nikkei fell 12.1%.

Turning to the outlook, it is important to remember that although there are a number of threats to growth at present, many economies, including the US are enjoying decent economic conditions at present. The combination of high employment, contained inflation and historically low interest rates observed in the US and elsewhere (including New Zealand) is encouraging. Corporate earnings growth has slowed but remains respectable for many companies.

A key missing ingredient right now is confidence, and that is understandable given the range of unpredictable global issues that businesses and investors are grappling with. Reflecting the uncertainty, sharemarket volatility remains high. But that volatility has been in both directions, including the remarkable sharemarket bounce back on Boxing Day. Increased volatility looks set to be a key market theme for 2019.

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

Exchange Rates:

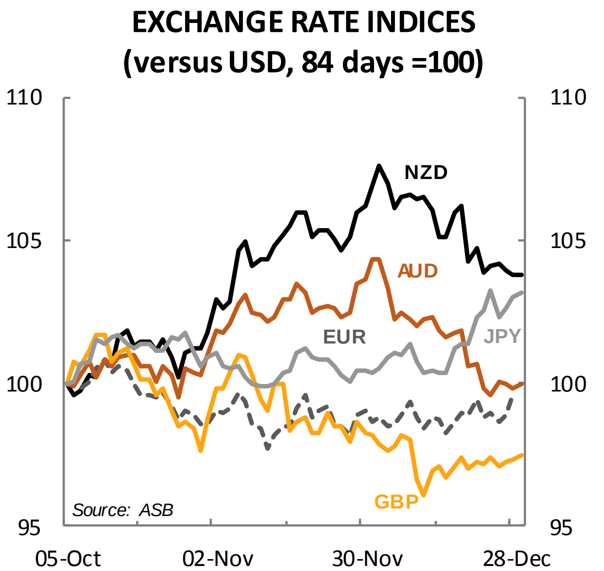
The NZD rose during November, but eased back in December vis-a-vis the major currencies.

The AUD also weakened over the month, and fell against the NZD, which saw NZD/AUD lift 1.3%.

The JPY strengthened significantly over the second half of the month, and NZD/JPY eased 4.8%.

In sum, the NZD was down 2% on a trade weighted basis for the month, and was down 1.1% over the full year.

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



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