Markets Monthly

05 August 2019

US Federal Funds rate cut for the first time since '08.

- **The big focus in July was the US Federal Reserve. The Federal Funds Rate was cut 0.25% on 31 July (US time).**
- **Local fixed interest yields continue to decline in anticipation of more RBNZ Official Cash Rate cuts over the coming months and in tandem with falls for global yields.**
- **New Zealand yields traded around record lows. Global government bond yields fell.**
- **Global sharemarkets lifted over July, and several indices set fresh record highs. Australasian sharemarkets were particularly strong during the month.**
- **The NZD was mixed during July, easing against the USD and JPY but gaining on the AUD, GBP and EUR. The NZD ended the month down 0.2% on a trade-weighted basis.**

Date		31-Jul-19	Month %	Quarter %	Year %	5-Year %
Cash	NZ Official Cash Rate	1.50	0.00	-0.25	-0.25	-2.00
	NZ 90-day bank bill	1.50	-0.14	-0.31	-0.41	-2.20
Fixed	NZ 5-year gov't stock	1.14	-0.12	-0.46	-1.00	-2.87
Interest	NZ 10-year gov't	1.45	-0.13	-0.46	-1.32	-2.82
	AUS 10-year gov't	1.21	-0.11	-0.59	-1.45	-2.31
	US 10-year gov't	2.06	0.05	-0.46	-0.87	-0.49
Australasian	NZ - NZX50 Capital (NZ$)	4733	3.4%	7.8%	17.6%	71.6%
	- NZX50 Gross (NZ$)	10893	3.9%	8.7%	22.0%	110.9%
Equities	AUS - All Ords (A$)	6897	2.9%	7.5%	8.3%	22.6%
International	JAP - Nikkei (¥)	21522	1.2%	-3.3%	-4.6%	37.8%
Equities	UK - FT100 (£)	7587	2.2%	2.3%	-2.1%	12.7%
	US - S&P500 (US$)	2980	1.3%	1.2%	5.8%	54.4%
	WORLD - MSCI (US$)	2188	0.4%	0.4%	1.6%	27.6%
	MSCI in NZD (NZ$)	3300	1.5%	0.9%	4.7%	63.7%
Exchange	NZD/USD	0.6628	-1.0%	-0.5%	-2.9%	-22.1%
Rates	NZD/AUD	0.9597	0.4%	1.5%	4.5%	5.2%
	NZD/JPY	71.96	-0.2%	-3.1%	-5.1%	-17.7%
	NZD/GBP	0.5359	1.4%	4.1%	3.1%	6.7%
	NZD/EUR	0.5956	1.1%	0.0%	2.2%	-6.2%
	NZ TWI	72.92	-0.2%	0.3%	-0.6%	-9.1%
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.

Sharemarkets continued to recover from May's slump, and posted further gains in July. Australasian sharemarkets were standouts amongst the major markets we monitor, with the NZX50 Gross index lifting 3.9% and the Australian All Ords up 2.9% over the month. Both indices traded around record highs during the month, but weakened slightly in the closing days of the month and into early August.

The S&P 500 index of US shares also set a record high during July, although US equities eased into month end as the focus turned to the July Fed meeting. The S&P 500 ended the month around 1.5% below its peak, but still up over the month. The weakening in US equities (and stocks elsewhere) has continued in early August, largely due to US President Trump tweeting: *"the US will start, on September 1st, putting a small additional tariff of 10% on the remaining 300 billion dollars of goods and products coming from China into our country".* US shares and Treasury yields subsequently slumped. Global oil prices also fell by 7-8% following 1 August decision to lift tariffs.

The US Federal Reserve's meeting on 30-31 July was a major focus for both bond and share markets, which have been anticipating the start of a US easing cycle. In the end the Fed delivered a 25bp cut to the Federal Funds Rate, but also tried to temper expectations about further rate cuts. President Trump was unimpressed, and continued his attack on the Fed Chair Powell, tweeting *"As usual, Powell let us down"*, and "*what the market wanted to hear from Jay Powell and the Federal Reserve was that this was the beginning of a lengthy and aggressive rate-cutting cycle".* In contrast, Chair Powell Fed stated *"it's not the beginning of a long series of rate cuts"* but added *"I didn't say it's just one …we're thinking of it as essentially in the nature of a mid cycle adjustment to the policy."* The reduction of the Federal Funds Rate came just seven months after the last Fed interest rate increase. US shares dipped in the wake of the announcement, and bond markets were choppy.

Boris Johnson won the Conservative Party leadership vote in late July, and as a result became the latest UK Prime Minister. That result was expected, but the future path for Brexit remains highly uncertain. A "hard" Brexit with no deal appears increasingly likely to occur later this year. Despite the ongoing uncertainty the UK FTSE 100 sharemarket index has performed well over recent months, and managed to gain 2.2% over July. Although the UK equity market has shown resilience over recent months, the FTSE is still down nearly 4% on the peak recorded back in May 2018, and has underperformed the other markets we monitor over the past five years.

The next RBNZ meeting is 7 August. We believe the RBNZ will lower the Official Cash Rate by 25bps (to 1.25%) at this meeting, and expect a further cut to the OCR (taking it to 1%) at the November meeting (November 13). There is the risk is that the next OCR cut is earlier, and the OCR trough is deeper if downside risks to the outlook crystalize. The RBA cut the cash rate to 1% on 2 July, and is expected to deliver another rate cut later this year (likely November).

The NZD was mixed during July, and eased 1% against the USD, and was down 0.2% on a trade-weighted basis. A lot of July's movement in NZD/USD was driven by the USD itself. The USD trade weighted index increased by 2.5% over July but was volatile as market expectations regarding the Fed's month-end meeting adjusted. On the NZD side of the equation, soft business confidence and the associated expectations of imminent RBNZ rate cuts weighed on the NZD, particularly late in the month.

Income Assets

Cash

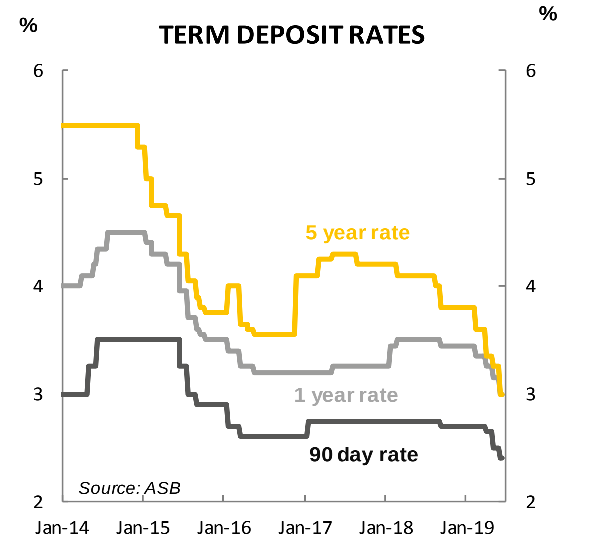
The OCR was cut 0.25% to a record low 1.50% in May, and held at that level at the June Review. The next RBNZ monetary policy decision is on 7 August, and we have another 0.25% cut penciled into our economic forecasts for then (1.25% OCR), and a further 0.25% cut forecast in November (1%).

Term deposit interest rates dipped lower over June, but were steady in July, at levels that are around the lowest they have been since the mid-1960s.

For amounts over $10k, term deposit rates for 1-5 years are largely around 3%. Rates for shorter 3-month terms have dipped towards 2%. Wholesale interest rates are almost flat across the curve as well (i.e. long-term interest rates are only marginally higher than short-term rates), in part a reflection of the lower-for-longer view on interest rates.

We expect term deposit interest rates to stay low, and the risk is they dip further if the RBNZ delivers further OCR interest rate cuts over the coming months.

The latest ASB term deposit rates can be found here.



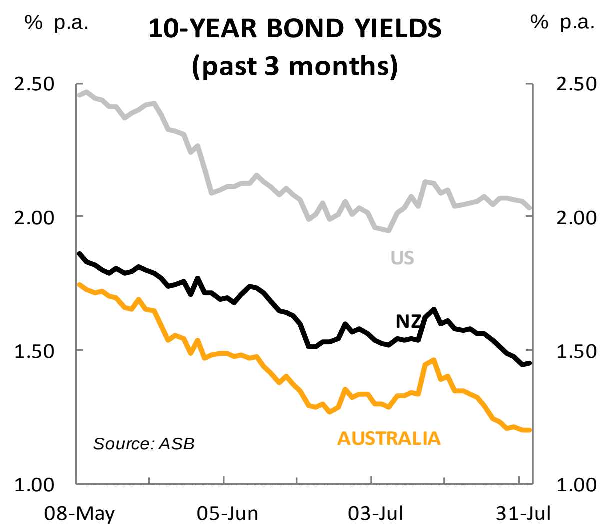
NZ Fixed Interest

Government bond yields moved even lower in July, with those for the NZ 10-year bond dropping below 1.5%, and ending the month 13 bps lower at 1.45%. Yields on 5 year Government bonds declined 12 bps, closing the month at 1.14%. The 10-year yield is down 1% on year-ago levels, and is close to 300 basis points lower than 5 years' ago. The plunge in yields over the past year has been staggering. Persistently low inflation, concerns over the global outlook and central bank interest rates (either delivered or signaled) have had a significant impact on local bond yields.

We expect a further 50bps of OCR cuts (25bps in August and November), and also expect the RBA to trim the cash rate by a further 25bps in November (0.75%). We also expect further cuts to the influential US Federal Funds rate later this year. 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 ongoing low bond yields over the year ahead.

International Fixed Interest

July's focus was all about the US Federal Open Market Committee's (FOMC, or Fed) meeting at the end of the month. The Federal Funds Rate was widely expected to be cut – the question was by how much?



During the month US market participants toyed with the possibility the Fed could cut policy interest rates by 50 basis points at the July meeting. "Fedspeak" during the month, including comments from Chairman Powell and New York Federal Reserve President John Williams, influenced expectations and bond yields significantly. Sentiment regarding the possibility of a large Fed cut waned in the second part of the month, with yields rising off the month's lows. Finally, the Fed cut the target range for the Federal Funds Rate by 25bp from a 2.25% to 2.50% range down to 2.00%-2.25%.

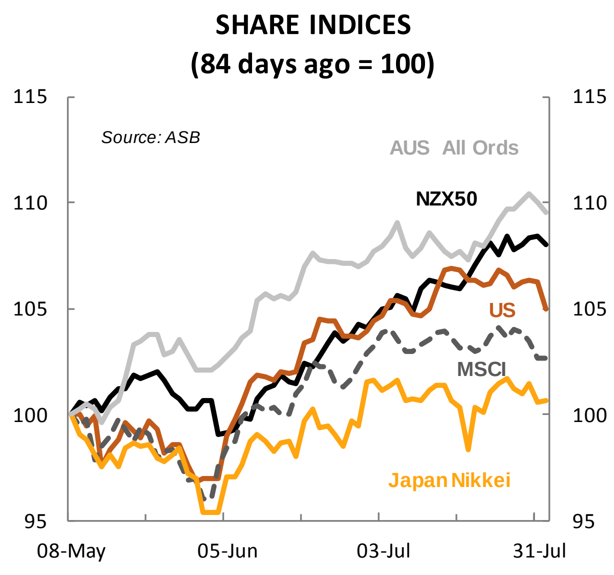
Financial markets were choppy in the wake of the announcement. Investors hoping for a more aggressive 50bp rate cut, or signaling that a significant policy easy cycle was underway were disappointed. Two FOMC members dissented and voted to keep interest rates unchanged, which likely impacted sentiment regarding the outlook for Fed policy settings. Nonetheless, we expect the FOMC to cut the Funds rate by 25bps in September and by a further 50bps in late 2019/early 2020, taking the Federal Funds Rate down to a 1.25%-1.5% range. The FOMC also decided to stop shrinking the Federal Reserve USD3.65 trillion balance sheet in August, reinvesting the proceeds from maturing mortgage backed securities (MBS's) into US Treasuries.

Over the full July month, US 10-year yields rose 5 basis points (or 0.05%), but at the time of writing in early August have fallen back to trade around 1.89%, largely due to the Trump tariff tweets discussed on page 2. US 10-year Treasury yields are still close to 60bps higher than their July 2016 lows. The key question that will be answered over the year ahead is how much more the Fed will cut the Federal Funds Rate, and this will influence whether 2016 lows get revisited. Australian10-year Government bond yields fell another 11 basis points to end the month at 1.21%. Like NZ 10-year bonds, Australian10-year Government bond yields are currently around record lows.

European government bond yields have dipped lower over the month. Ten year government bond yields are in negative territory in France (-0.2%), Sweden (-0.2%), Netherlands (-0.3%), Germany (-0.5%) and Switzerland (-0.8%). Greek (2.02 %) and Italian (1.58%) 10-year Government bond yields also pressed lower. In late July, the European Central Bank (ECB) left all key interest rates on hold, but with a strong signal that more stimulus is coming. President Draghi didn't beat around the bush, stating *"This outlook is getting worse and worse".* The ECB's concerns centre particularly on the weak international trade and global growth backdrop. The key change in language from the ECB was that the Bank now expect interest rates to remain *"at their present levels or lower"* at least through the first half of 2020. The ECB also appears to be weighing other easing options, including a new asset purchase scheme. UK 10-year gilt yields dipped down to around 0.6% during the month, and the Bank of England maintained its expansionary policy settings at its latest meeting in early August.

Growth Assets

Australasian Equities



Australasian sharemarkets continued their strong run, and were the best performing markets we monitor in this report over the month and year to 31 July. The NZX50 Gross index rose 3.9%, and the Australian All Ords index was up 2.9% over the month. Both indices were up significantly on a year ago, with respective gains of 22.0% and 8.3%. Both indices hit record highs during the month.

After dipping in June, share prices in the a2 Milk Company bounced back strongly over July, lifting circa 20% to trade over $17 per share. Sticking with dairy, Synlait shares also had a strong month, gaining nearly 9%, while share prices from the Fonterra Shareholder Fund slipped nearly 3%. Ryman Healthcare share prices bounced back from earlier weakness and lifted close to 10% over the month. The strong run for electricity generator/retailer stocks observed in recent months took a bit of a breather in July, with some of the "gentailers" eking out gains, and others easing slightly. In Australia, a key focus at the start of the month was the Reserve Bank of Australia (RBA). The RBA cut its cash rate to a record low 1.0% on 2 July, and is widely expected to move the cash rate even lower. Over July, 19 of Australia's 22 sub-industry sectors posted gains. Leading the gains was consumer durables & apparel (up by 17.5%), followed by food, beverage & tobacco (up by 14.8%). Iron ore prices remained steady in July, despite an improving supply outlook. Rio Tinto and BHP's share prices dipped over the month.

Share performance for the big Australian banks were mixed: NAB lifted over 7%, Westpac was up 1.6%, while ANZ &

CBA share prices declined modestly. NAB appointed Ross McEwan as the CEO and Managing Director during the month, and investors seemed encouraged with the share price lifting in the wake of the announcement.

International Equities

US sharemarkets continued to lift in July, although the gains were modest compared with June's surge. Expectations of pending Fed interest rate cuts, (misplaced) optimism about an imminent US-China trade deal, and encouraging earnings data all supported sentiment. The US Dow Jones was up by 1%, the broader S&P 500 increased by 1.3% and the tech-heavy NASDAQ finished up by 2.1%. The latest tariff tweets from US President Trump were a disappointing development for investors, and have caused sharemarkets to slump in early August. It was only five weeks ago that Trump and Chinese President Xi Jinping announced a trade truce at the G20 Summit in Japan, and in doing so provided a boost to markets over July.

As we noted last month, global equities are likely to remain pushed and pulled by trade developments and the "lower for longer" interest rate theme in global fixed interest markets for a while yet. In contrast to the disappointment of the trade situation, the company specific news out of the US over July has been more positive. Around ¾ of the S&P 500 companies that have reported second quarter earnings have beaten market expectations. Meanwhile in Europe, the German DAX fell by 1.7%, while the UK FTSE rose by 2.2%. And in Asia, Japan's Nikkei rose by 1.2%.

ASB Securities has more information on sharemarkets and trading here.

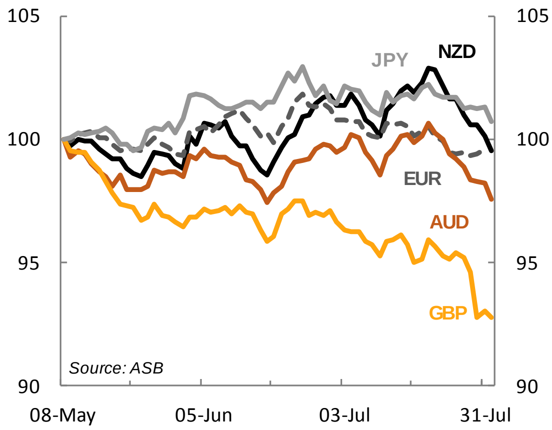
Exchange Rates:

The NZD was mixed during July, and eased 1% against the USD, and was down 0.2% on a trade-weighted basis. A lot of the movement in NZD/USD was driven by the USD side of the equation. The USD trade weighted index increased by 2.5% over July but was volatile as market expectations regarding the Fed's month-end meeting fluctuated.

On the NZD side of the equation, soft NZ business confidence and the associated expectations of imminent RBNZ rate cuts weighed on the NZD later in the month.

The fear of a "no deal" or "hard" Brexit has weighed on the GBP over recent months. GBP underperformed the other major currencies and fell against the NZD in July. On a trade weighted basis GBP lost 2.7% over the month, and NZD/GBP lifted 1.4%.

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



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

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