# Markets Monthly

03 April 2019

## Bonds and shares rally as central banks get dovish

- **Sharemarkets were largely positive during the month, rising domestically and in the US and Europe, but flat in Australia and down in Japan. All the markets we monitor posted solid gains over the first quarter of 2019.**
- **With most central banks making dovish noises, higher global interest rates appear increasingly distant.**
- **Bond yields eased significantly both here and abroad in March, with NZ 10-year yields setting record lows.**
- **The NZD fell after the RBNZ's March OCR review, and ended the month down 0.3% on a trade-weighted basis.**

| Date | | 29-Mar-19 | Month % | Quarter % | Year % | 5-Year % |
|---|---|---|---|---|---|---|
| Cash | NZ Official Cash Rate | 1.75 | 0.00 | 0.00 | 0.00 | -1.00 |
| | NZ 90-day bank bill | 1.85 | -0.04 | -0.12 | -0.11 | -1.27 |
| Fixed | NZ 5-year gov't stock | 1.46 | -0.21 | -0.40 | -0.83 | -2.74 |
| Interest | NZ 10-year gov't | 1.81 | -0.35 | -0.56 | -0.90 | -2.78 |
| | AUS 10-year gov't | 1.77 | -0.33 | -0.55 | -0.83 | -2.32 |
| | US 10-year gov't | 2.40 | -0.27 | -0.31 | -0.34 | -0.32 |
| Australasian | NZ - NZX50 Capital (NZ$) | 4317 | 4.5% | 10.5% | 14.3% | 56.5% |
| | - NZX50 Gross (NZ$) | 9831 | 5.4% | 11.6% | 18.1% | 91.3% |
| Equities | AUS - All Ords (A$) | 6262 | 0.1% | 9.7% | 6.7% | 15.9% |
| International | JAP - Nikkei (¥) | 21206 | -0.8% | 6.0% | -1.2% | 43.0% |
| Equities | UK - FT100 (£) | 7279 | 2.9% | 8.2% | 3.2% | 10.3% |
| | US - S&P500 (US$) | 2834 | 1.8% | 13.1% | 7.3% | 51.4% |
| | WORLD - MSCI (US$) | 2108 | 1.0% | 11.9% | 2.0% | 25.9% |
| | MSCI in NZD (NZ$) | 3107 | 2.0% | 10.7% | 8.8% | 60.7% |
| Exchange | NZD/USD | 0.6783 | -0.9% | 1.1% | -6.3% | -21.6% |
| Rates | NZD/AUD | 0.9571 | -0.1% | 0.7% | 1.5% | 2.1% |
| | NZD/JPY | 75.10 | -1.1% | 1.3% | -2.4% | -15.6% |
| | NZD/GBP | 0.5192 | 0.8% | -1.8% | 0.5% | -0.2% |
| | NZD/EUR | 0.6041 | 0.4% | 3.0% | 2.8% | -4.0% |
| | NZ TWI | 73.66 | -0.3% | 0.5% | -1.2% | -10.5% |
| Equity indices are the respective end-of-month closes. Interest rates and exchanges rates are at 5pm NZ. | | | | | | |

Central banks continued to move towards more dovish positioning over March, suggesting higher interest rates are now a more distant prospect. As a result, global bond yields fell across the board, continuing last month's descent.

**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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The prospect of 'lower for longer' rates also provided support to a range of equity indices, with the NZX50, S&P500 and FTSE all gaining. The main exception was the Japanese sharemarket, which declined over the month, and the Australian All Ordinaries index, which was flat.

The Bank of Canada (BoC) was the first to kick things off at the beginning of the month, holding its overnight rate at 1.75% and signaling it was less certain that the its next move would be an increase rather than a cut. Since its January statement, the BoC has become more cautious about the outlook, and in March expressed "increased uncertainty about the timing of future rate increases". We expect the BoC will remain on the interest rate sidelines for now.

The European Central Bank (ECB) continued the cautious trend, pushing out the expected timing for its rate hikes and signaling further quantitative easing was on the way. At the ECB's March meeting, interest rate increases that had been scheduled for around the end of the European summer were delayed, meaning rates are now expected to remain at current record lows out to at least the end of 2019. As the month drew to a close, ECB President Mario Draghi reaffirmed his position, saying that *"adjusting our forward rate guidance"* (i.e. delaying future interest rate increases) remained an option. Elsewhere in Europe, the Bank of England left rates unchanged at 0.75% and stated the next rates move could be in either direction. With Brexit uncertainties still present, this was understandable.

Of significant importance to markets was the shift to a more neutral assessment by the US Federal Reserve. The Fed held its key policy rate (the Federal Funds Rate) between 2.25%-2.50% at the March meeting and reiterated it would be 'patient,' suggesting it is in no hurry to change interest rates. The March 'Dot Plots' signaled no hikes for 2019 and just one 2020 hike, as opposed to the two 2019 rate hike and one 2020 rate hike signaled in December. The Fed the Fed will slow its monthly sales of Treasury bonds prior to the scheduled end of its balance sheet run-off in September, and will reinvest the proceeds of sales in mortgage-backed securities in Treasury purchases after this. This should help keep longer-term US interest rates low.

The Reserve Bank of New Zealand's (RBNZ) March interest rate announcement showed another central bank making a dovish shift. The RBNZ left the Official Cash Rate (OCR) at 1.75%, but it explicitly adopted an easing bias, noting *"the more likely direction of our next OCR move is down."* ASB Economics have revised our OCR outlook, and now expect 50bps or 0.5% worth of OCR cuts. We have the first 0.25% move lower penciled into our May forecasts, followed by another 0.25% cut in August, taking the OCR to a fresh low of 1.25%. Markets expect the OCR to move lower, with around 50bps of OCR cuts expected by mid-2020.

The Reserve Bank of Australia (RBA) was slightly more resistant to the dovish trend, maintaining the cash rate at 1.5% at its March and April Reviews. An expectation in the run up to the April meeting was that the RBA might shift its policy guidance in a more dovish direction. The RBA Board stuck to its earlier mantra, stating that *"holding the stance of monetary policy unchanged at this meeting would be consistent with sustainable growth in the economy and achieving the inflation target over time".* Investors seeking a subtle hint of a change in bias will now have to wait for the meeting Minutes (due 14 April).

The Kiwi dollar fell sharply following the RBNZ's March announcement, ultimately ending the month down against the AUD and the US Greenback. The NZD was still up against both the GBP and EUR as both currencies were weighed by continuing political deadlock in the UK and soft economic data in the Eurozone. The resilience of the NZD despite local interest rates falling to record lows has been noteworthy.

Ongoing geopolitical risks will colour the outlook for the coming weeks. In recent months, markets have been optimistic that the United States and China will reach some form of trade accord, putting an end to their long-running trade stoush. However, events during March still give cause for concern. As the month drew to a close, President Trump stated that tariffs are likely to remain on Chinese goods for a "substantial period," and his economic adviser Larry Kudlow said that talks could drag on for weeks or months, dashing hopes of a quick resolution. Markets may lose patience if the two sides fail to put pen to paper. For now sharemarket participants retain a degree of optimism; and European and US sharemarket indices posted double-digit gains over the first quarter of the year.

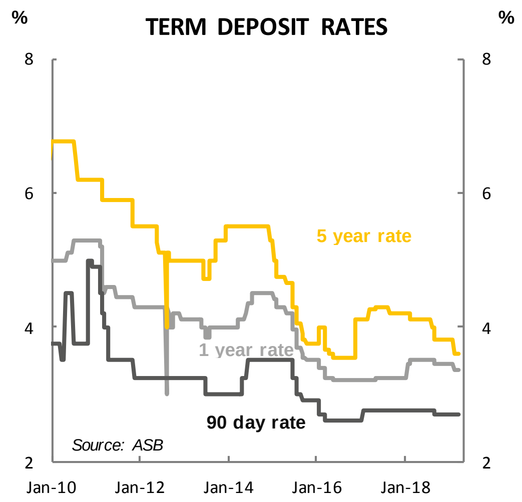
The UK's attempts to depart the European Union (EU) remained shambolic. The UK parliament rejected Prime Minister May's withdrawal agreement, forcing the UK to delay Brexit beyond the end of March. With a new deadline looming on 12th April and the UK Parliament still divided, uncertainty abounds. Recent UK employment and growth data does show the economy holding up well despite the political chaos, helping the FTSE end the month in positive territory. Nevertheless, if the UK ends up crashing out of the EU with no deal, we are likely to see more financial market volatility, as well as some significant economic upheaval.

# Income Assets

## Cash

The RBNZ kept the OCR on hold at 1.75% at its March meeting, as expected, but surprised us by its changed outlook for interest rates. At earlier meetings the RBNZ had been pushing out the length of time that it expects to retain the current 1.75% OCR setting. And at earlier meetings the RBNZ said the direction of the next OCR move *"could be up or down"*. In March the RBNZ said that *"given the weaker global economic outlook and reduced momentum in domestic spending, the more likely direction of our next OCR move is down".*

In the wake of the announcement there was a significant rally in NZD wholesale interest rates (yields lower). ASB Economics expects the OCR to be cut by 25bps in both May and August.




The change in call was prompted by the dovish RBNZ message and heightened downside risks to the short-term domestic outlook that were highlighted in the weak Q1 NZIER Quarterly Survey of Business Opinion (discussed here). Another influence on our view change is the proposed impact of higher bank capital requirements on banking funding costs, customer lending and deposit rates. These dynamics will have important implications for cash and term deposit returns. With OCR cuts a distinct possibility over the remainder of the year, ASB Economics expect most short-term returns on term deposits risk declining from current levels over 2019. For the longer-term rates, further dips also remain a risk, particularly if other long term interest rates continue to decline.

Term deposit rates have been fairly steady since September 2018, but the rates on some terms were trimmed by between 5bps and 20 bps this year. Term deposit rates for amounts over $10K range from 2.7% for a 90-day term (unchanged on earlier months), up to 3.6% for a 5-year term (down 20 bps since January 2019).

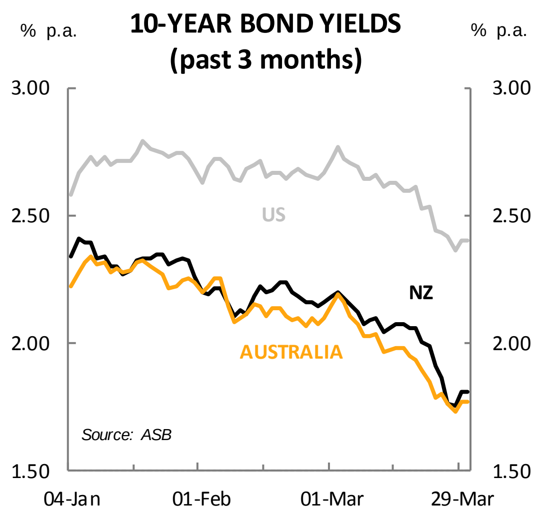
**The latest ASB term deposit rates** can be found here.

## NZ Fixed Interest

NZ Government bond yields continued their decline over the month of March across a range of tenors, with the 5-year yield ending the month down 0.21% at 1.46%. The 10-year yield ended the month down 0.35% to reach 1.81%. Whilst yields have been falling since the end of last year, the decline during March was considerably sharper than in previous few months, and yields are now at or near all-time lows.

Dovish signaling by central banks have been the primary catalyst driving yields lower and the RBNZ's OCR review was more explicitly dovish than many had anticipated.

With domestic data and forward indicators of activity (notably business confidence) pointing to subpar growth, market sentiment on NZ interest rates sentiment during the quarter shifted from 'lower for longer,' to '*even* lower for *even* longer.'




### International Fixed Interest

US bond yields remained low through February, with those for 10-year Treasuries falling to 2.40% (-0.27% across the month), with the Fed signal for no 2019 rate hikes underpinning the rally (yields lower).

Global yield curves have flattened. For US Treasuries, the "2-10 slope" (i.e. the gap between the yields on US 2 and 10-year bonds) is still narrow, with the 10-year yield a mere 17 bps ahead of the 2-year as of the time of writing. As we highlighted last month, this slope is regarded by many as a recession indicator. When the slope 'inverts' and the 2-year yield rises above the 10-year, this often signals a wider economic slowdown on the horizon. The narrow gap thus raises flags about the health of the American economy; suggesting to investors that the Fed is unlikely to hike rates any time soon.

In fact, one key US yield metric did actually invert during the month, with the yield on 3-month US government bonds briefly outstripping the 10-year yield towards the end of March. Whilst the 3m-10y spread isn't as closely watched as the 2-10, it provided markets with yet more evidence that rate hikes are a distant prospect.

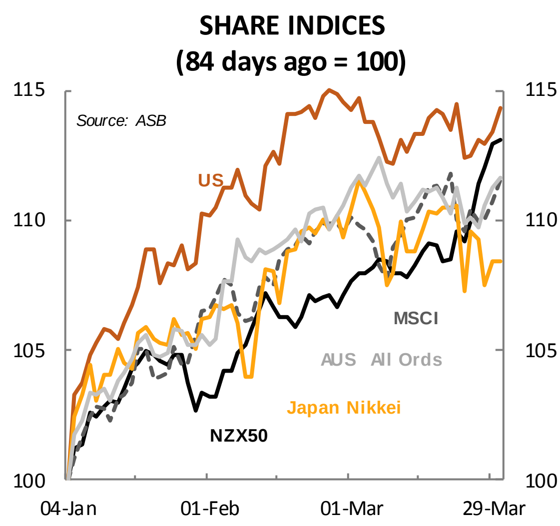
Elsewhere, European bond yields continued to slide throughout March, even though many were already in negative territory. The 10-year German bund closed out the month with a -0.07% yield, joining the 5-year and other shorter-tenor bonds, which were already in negative territory. Yields were down right across the Eurozone amid signs the ECB is likely to keep delaying a rate hikes. In France, 5-year bond yields drifted further into negative territory. French 10 – year yields were still positive, but fell over the course of the month. The UK 10-year gilt fell over the course of the month, ending March with a 1.0% yield.

Having crept up towards 0% in the first week of March, the yield on the Japanese 10-year bond subsequently fell, ending March with a -0.1% yield.

# Growth Assets

### Australasian Equities

It has been another strong month for New Zealand equities, with the NZX50 Gross index gaining 5.4%, and setting a fresh record high during March. The Australian market was more subdued during March, with the All Ords gaining 0.1% over the month. Both sharemarkets posted solid gains over the full quarter, with the NZX 50 Gross index up 11.6%, the NZX 50 Capital Index (which doesn't include dividends) up 10.5%, and the Australian All Ords up 9.7%.




The strong dividend flow from New Zealand shares has been a key support. The expectation that interest rates will remain historically low has boosted share prices for a number of defensive stocks during the month. The top four stocks over

March were Genesis Energy, Meridian Energy, Chorus and Contact Energy. Air New Zealand's share price has been under pressure this year, but it did recover off the lows set mid-month. Late in the month the company announced it will defer $750 million of aircraft orders and continue to cut costs as it faces a slower growth outlook.  Kathmandu Holdings was a laggard during the month, with the share price down around 9% for the month.

The Australian "All Ords" index remained just shy of its August 2018 peak.  Downward pressure remained on banking stocks, with falls for three of the four big bank stocks, and NAB squeezing out a small gain over the month. Rio Tinto, BHP and Fortescue posted strong gains for the month. Iron ore prices remain high, holding on to the price gains that occurred after the Brazilian dam disaster earlier in the year, supporting stocks for iron ore producers.

## International Equities

Over the March 2019 quarter all the major sharemarkets we monitor have pressed  higher. The MSCI global index was 11.9% higher in the March quarter (in USD terms), taking the year-to-date increase to 2%. The S&P500 gained 13.1% over the quarter (+7.3% yoy), with monthly gains of 7.9% in January, 3% in February, and 1.8% in March.

Having suffered the worst year since the Global Financial Crisis in calendar 2018, the March 2019 year to date has seen markets recover a lot of lost ground.    With the exception of Japan's Nikkei index, all the indices we monitor were up on year-ago levels. Japan's Nikkei 225 dipped 0.8% over the month, and is still over 10% below its 2018 peak. The aggregate performce of global shares is reflected in the MSCI world share index, which is up 8.8% over twelve months (measured in NZD terms).

However, in contrast to the fresh highs that the New Zealand sharemarket set in March, the global indices we monitor remain below their 2018 peaks.  For example, the US S&P500 is currently around 2½% below September 2018 highs, despite the strong March 2019 quarter.

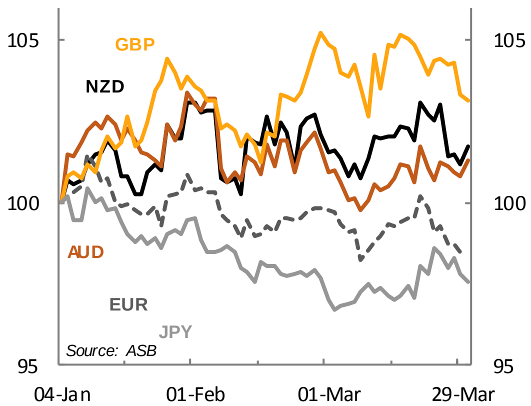
Two key drivers of the global sharemarket recovery have been increased optimism on global trade, and the dovish tone adopted by global central banks. As we saw over 2018, sentiment can shift quickly. Accordingly, we cannot rule out further bouts of volatility if these concerns over the global outlook resurface.

A "hard Brexit" is an obvious concern  over the coming weeks. However, even as the Brexit impasse continued the FTSE index of UK shares rose 2.9% over March, a 8.2% gain over the quarter.

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

## Exchange Rates:

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




The NZD eased 0.3% on a trade-weighted basis during March. The NZD fell 0.9% versus the USD, 1.1% against the yen, 0.8% against the GBP and 0.4% versus the EUR. The NZD was little changed vis-a-vis the AUD (-0.1%).

The NZD/USD low for the month (0.6745) actually occurred towards the start of the month (8 March), while the high of 0.6939 was recorded on 21 March. On 27 March, in the wake of the RBNZ's "dovish" OCR announcement, the NZD fell close to 2%, but did not re-test the month's lows. A brief rally into month end saw the NZD close the month trading near 0.6800 against the USD.

The NZD strengthened against the AUD over the first three weeks of the month, trading as high as 0.9731 on 25 March. However, the NZD lost over 1c against the AUD after the RBNZ announcement discussed earlier in this report, and the cross rate ended the month trading just shy of 0.9600, near where it was at the start of the month.

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