Markets Monthly

05 November 2019

Long-term bond yields lift during October

- Sharemarkets were mixed in October, with US shares posting solid gains and the S&P 500 reaching a record high. Japan's sharemarket lifted an impressive 5.4%, while UK and Australasian markets were down.
- The US Federal Funds rate range was cut 0.25% lower in October, but long-term US rates lifted. Upward pressure on yields was also present down under, with long term bond yields in Australia and New Zealand moving higher.
- Conviction regarding multiple RBNZ interest rate cuts waned over the month, but ASB still expect a November OCR cut. The NZD lifted against the USD, but declined against a strengthening GBP over the month

Date		31-Oct-19	Month %	Quarter %	Year %	5-Year %
Cash	NZ Official Cash Rate	1.00	0.00	-0.50	-0.75	-2.50
	NZ 90-day bank bill	1.12	-0.03	-0.38	-0.79	-2.57
Fixed	NZ 5-year gov't stock	1.02	0.14	-0.12	-0.92	-2.84
Interest	NZ 10-year gov't	1.31	0.22	-0.14	-1.23	-2.68
	AUS 10-year gov't	1.16	0.19	-0.04	-1.46	-2.13
	US 10-year gov't	1.79	0.10	-0.27	-1.35	-0.51
Australasian	NZ - NZX50 Capital (NZ$)	4642	-1.4%	-1.9%	19.0%	64.2%
	- NZX50 Gross (NZ$)	10788	-1.0%	-1.0%	23.2%	100.2%
Equities	AUS - All Ords (A$)	6773	-0.4%	-1.8%	14.5%	23.0%
International	JAP - Nikkei (¥)	22927	5.4%	6.5%	4.6%	39.7%
Equities	UK - FT100 (£)	7248	-2.2%	-4.5%	1.7%	10.7%
	US - S&P500 (US$)	3038	2.0%	1.9%	12.0%	50.5%
	WORLD - MSCI (US$)	2234	2.5%	2.1%	10.5%	30.8%
	MSCI in NZD (NZ$)	3474	-0.1%	4.7%	12.4%	59.7%
Exchange	NZD/USD	0.6429	2.6%	-2.5%	-1.7%	-18.1%
Rates	NZD/AUD	0.9276	0.1%	-3.0%	0.5%	4.3%
	NZD/JPY	69.83	3.2%	-2.4%	-5.7%	-18.7%
	NZD/GBP	0.4970	-2.5%	-8.4%	-3.5%	1.3%
	NZD/EUR	0.5756	0.4%	-2.6%	-0.2%	-7.6%
	NZ TWI	70.73	1.1%	-2.5%	-1.9%	-7.5%

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.

Market News

Falling global fixed interest yields has been a key theme in financial markets over the past year. In late September and October we have seen a partial pullback of this move in bond markets, and yields have pressed higher. In saying that, global fixed interest yields remain incredibly low, despite the upward movements over the past month or so.

Another key theme has been the US-China trade war and related broader concerns over global economic growth. Here the story remains the same: markets swing from optimism to pessimism, moving from tweet to tweet. The mood soured in late October following reports that Chinese officials had doubts over whether a comprehensive long-term trade deal with the US was feasible. Less than a week later, on 1st November US shares lifted after Beijing's state-media Xinhua News Agency said the two economies had reached "consensus on principles" during a telephone call between their main trade negotiators (Source Reuters). The mid-November APEC trade summit in Chile was originally earmarked as the venue for signing the "phase one" part of the US and China trade deal. The summit is now cancelled due to social unrest, so negotiators are looking for a new venue to sign.

Another Brexit "deadline" has passed without resolve. Now the UK heads back to the polls for a General Election on 12 December. With the European Union (EU) providing a Brexit extension till the end of January 2020, fears of a "hard Brexit" have reduced. The pathway to a Brexit withdrawal agreement that is acceptable to all parties remains unclear.

The month was bookended by central bank rate cuts. The Reserve Bank of Australia cut the Australian cash rate to 0.75% on 1st October, and on 31st October (NZT) the US Federal Funds Rate was cut by 0.25% to a 1.5% to 1.75% range. We expect that the direction of risk for policy settings of the world's major central banks is down.

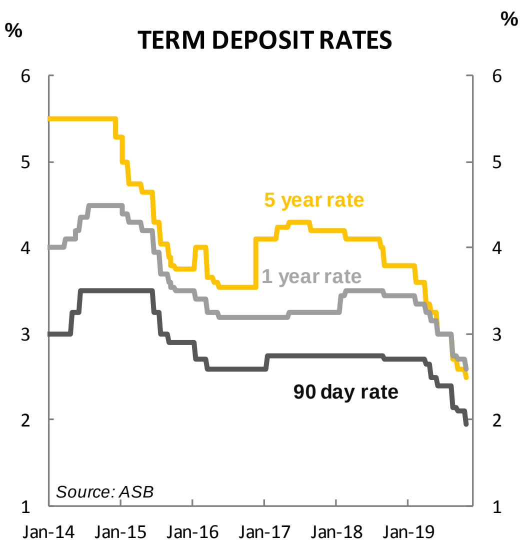
The last monetary policy decision by the Monetary Policy Committee (MPC) of the RBNZ was on the 25th September, where the OCR was held at 1.00%. Improved global risk appetite and higher yields has since seen the scaling back in market pricing for interest rate cuts by the RBNZ and other central banks. Markets are currently sitting on the fence (13bps of cuts priced in for the November 13 meeting), wondering if a 1% OCR is the trough this cycle. ASB economics continue to expect the RBNZ to cut the OCR further to support sluggish NZ growth. A 25bp cut is expected to be delivered next week (November 13), and we have pencilled in a further 25bp cut next year, taking the OCR to 0.5%.

Income Assets

Cash

The OCR was cut by 0.50% to a new record low 1.00% at the RBNZ's 7 August meeting, and then held it at this level at the 25th September review. Despite the on hold decision, we continue to think that persistently weak domestic sentiment and slowing global growth will cause the RBNZ to push the OCR 0.25% lower to 0.75% when the committee next meets on 13th November. In addition, we think that the OCR will move even lower, to 0.5% in 2020.

Term deposit interest rates have drifted lower since the August OCR cut, with modest falls over October. 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 2.8%.



We think the risk for savers is that term deposit rates move even lower if the OCR is cut further. The imposition of higher bank capital requirements for locally-incorporated banks from the RBNZ could also put downward pressure on term deposit rates (and/or upward pressure on borrowing rates). We will have to wait until December for an announcement by the RBNZ on the details of the future capital requirements for locally-incorporated banks.

A common question we have been getting asked recently is if New Zealand Bank's term deposit rates will go negative. We are not expecting this to happen within our current forecasts. Even a negative Official Cash Rate (which again, we are not forecasting at present), doesn't mean term deposit rates would have to be negative, although a negative OCR would result in term deposit rates much closer to zero than today's levels.

The latest ASB term deposit rates can be found here.

Asset	Instrument	31-Oct-19 Yield	Month %	Quarter %	Year %	5-Year %
			Yield Change			
Cash	NZ Official Cash Rate	1.00	0.00	-0.50	-0.75	-2.50
	NZ 90-day bank bill	1.12	-0.03	-0.38	-0.79	-2.57
	US 90-day bank bill	1.91	-0.19	-0.34	-0.63	1.68
Fixed	NZ 5-year gov't stock	1.02	0.14	-0.12	-0.92	-2.84
Interest	NZ 10-year gov't	1.31	0.22	-0.14	-1.23	-2.68
	NZ 10-year swap	1.42	0.22	-0.22	-1.41	-2.97
	AUS 10-year gov't	1.16	0.19	-0.04	-1.46	-2.13
	US 10-year gov't	1.79	0.10	-0.27	-1.35	-0.51

NZ Fixed Interest

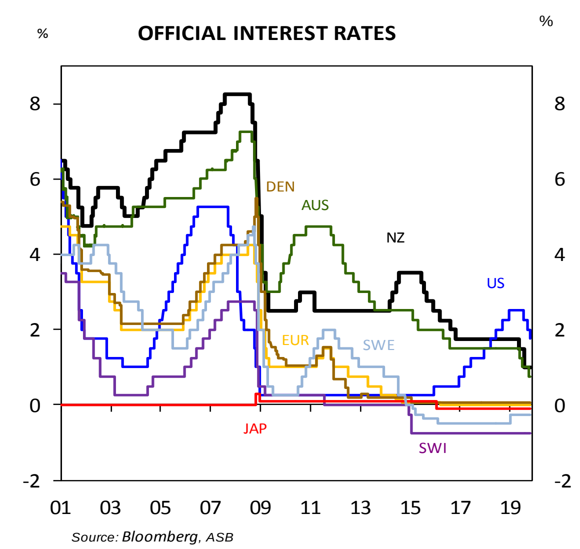
The NZ 10-year Government bond yield briefly dipped below 1% in mid-August, but then started drifting higher. That upward move picked up pace in October, and the 10-year government bond yield ended the month up 0.22% at 1.31%. The 5-year yield was also up, lifting 0.14% to 1.02%. Australian and U.S. 10-year yields also lifted over the month, up 0.19% and 0.10% respectively. The lift off the September lows, both here and abroad, has been significant. Long term corporate bond yields also lifted over the month, although the increases were smaller than the kick-up in government bond yields. Bond prices move in the opposite direction to yield, so the sharp lift in yield has been negative for bond portfolios. Despite the big October moves, NZ corporate and Government Bond yields remain incredibly low on a historical basis.

Yields are off their lows, but a likely lower OCR, weakening global growth and the associated weak inflation pulse here and abroad should maintain downward pressure on NZ fixed interest rates. We expect two further 25bp OCR cuts, taking the OCR to a new record low 0.50% by 2020. We also expect global central banks to continue to ease policy settings. Our view remains that we could see lower New Zealand bond yields over the year ahead, with 10-year government bond yields potentially dipping below 1%.

International Fixed Interest

The US Federal Open Market Committee's (FOMC, or Fed) cut the Federal Funds rate target range again on 30th October, with a 0.25% cut taking the new range down to 1.50% - 1.75%. The reasons for the cut, like in July and September, were *"global developments"* and *"muted inflation pressures"*. However, the FOMC indicated that the bar to further rate cuts has been raised, which once again led to criticism from the US President. Fed Chair Jerome Powell and Vice Chairman Richard Clarida have both commented that "monetary policy is in a good place" since the October cut.

The Bank of Japan (BoJ) made no monetary policy changes in October, but adopted an open ended easing bias like the European Central Bank in September. The BoJ changed its



forward guidance from keeping short term and long term interest rates steady *"at least through around spring 2020"* to *"at their present or lower levels as long as it is necessary*". BoJ Governor Kuroda warned that the BoJ has room to lower rates deeper into negative territory, and we think this easing bias will be acted on early next year.

Despite all this action, long term global yields were on the rise through the course of the month. US 10-year yields lifted 0.1%, and are trading around 0.3% above recent lows. 10-year yields remain negative in France, Germany, Sweden, the Netherlands and Switzerland. But in each case, yields have become "less negative" over the course of the month, lifting a similar amount to US yields. Japanese10-year yields remain near recent lows (around -0.20%). We think policy settings at the world's major central banks risk moving lower given the negative risk profile around the global outlook. And related to this, long-term interest rates could retrace recent climbs if some of these downside risks resurface, muting global growth and inflationary pressure. But right now the Fed's apparent comfort with monetary policy settings and renewed optimism about positive outcomes for global trade and Brexit are causing bonds to sell off (yields higher).

Growth Assets

Australasian Equities

Australasian markets dipped in October. The Australian All Ords index slipped by 0.4%% and the NZX50 Gross index was down1%. Both indices are a few percentage points below the peaks reached earlier in the year, but remain significantly up on a year ago.

Over the course of the month, concerns about the outlook for the Tiwai Point Aluminum smelter hung over the electricity sector. Rio Tinto (the majority shareholder of the smelter) is reviewing the smelter's future. The smelter uses over 10% of New Zealand's electricity, and the implications of its potential closure led to weakness for electricity generator stocks over October. Rio Tinto expects to complete the review in Q1 2020.

Across the Tasman, 11 of Australia's 22 sub-industry sectors posted gains over the month. Pharmaceutical & Biotechnology products rose the most (up 9.6%). Food, Beverage & Tobacco products fell the most (down by 5.0%). Banks fell by 4.1%, and Materials were down 1.9%. Commodity prices finished mostly higher in October, led by coking coal. Iron ore was an exception. Prices dropped in October on mostly an improving supply outlook.

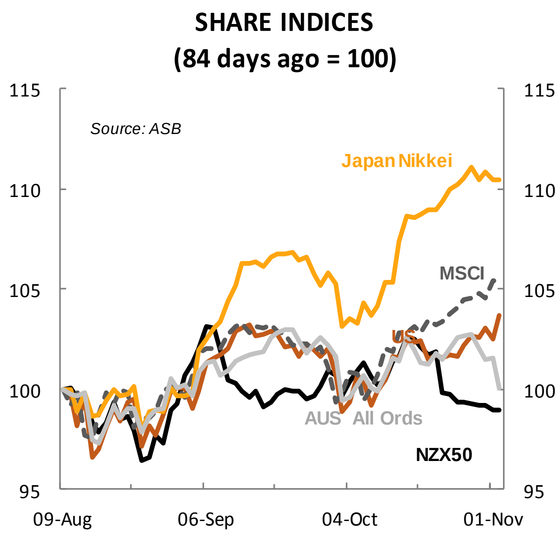
International Equities

The US S&P500 sharemarket index set all-time record highs in October (and early November) as investors became increasingly optimistic about the potential for a partial US-China trade deal and a resolution to the Brexit impasse. Adding to the positive sentiment was a number of encouraging US corporate earnings results and economic data (solid US Non-farm Payrolls in particular). The offsetting tension came from the uncertainty about the next mover for the Fed (discussed above).

The S&P 500 index of US shares gained 2% over the month, and is 12% higher than a year ago. The US September quarter corporate earnings season got off to a positive start with largely upbeat results from the big US banks and healthcare companies.

Japan's Nikkei share index gained over 5% in September, and again in October, offsetting big losses in earlier months and pushing the index back into positive territory for the past 12 months.

The FTSE100 index of UK shares dipped 2.2% in October, but was up 1.7% on year-ago. The FTSE lifted as it became clear the UK would avoid a disorderly Brexit on 31 October after the EU



agreed to a 3-month extension. However, the index then fell around 1% as the prospect of a UK general election on December 12 put investors in a more cautious mood. The drama continues….

ASB Securities has more information on sharemarkets and trading here.

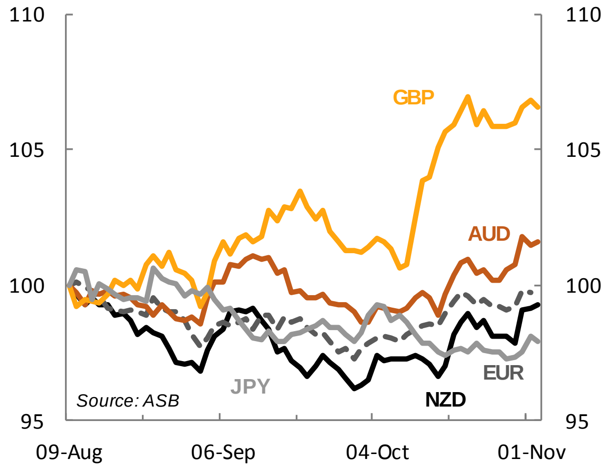
Exchange Rates:

The recent NZD slide came to a halt in October with the trade-weighted index lifting 1.1% over the month. The NZD briefly fell to a decade-long low against the USD on 1 October (0.6204) following subdued NZ business confidence data, but strengthened thereafter, ending the month up 2.6% against the USD, comfortably above 0.6400 again.

The NZD rose against all the other major currencies we monitor in this report, with the exception of GBP. GBP outperformed across the board due to favourable Brexit developments. That strength saw NZD/GBP ease 2.5% during the month, with 1 NZD under 50 pence.

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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