Markets Monthly

02 November 2018

Sharemarkets slide over October

- Having taken almost everything in their stride over mid-2018, investors worried about a lot in October.
- Sharemarkets around the world dipped significantly, but US bond yields still ended October higher.

Global sharemarket investors have taken a number of things in their stride over earlier months, but saw the same issues as a reason to sell in October. The significant weakness in sharemarkets has been attributed to rising US interest rates, trade tensions and associated growth concerns, political concerns as well as high equity valuations. These issues are all important, but none of them are new. The US-China trade tensions have been ratcheting up for months, Italy's worries have been going on for a while too, and the Fed has been lifting US rates for a few years now. For whatever reason, these issues were troublesome for investors in October, as they were in February, when sharemarkets also has a significant dip.

Date		31-Oct-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	1.91	0.00	0.00	-0.04	-0.77
Fixed	NZ 5-year gov't stock	1.94	-0.04	-0.20	-0.50	-2.16
Interest	NZ 10-year gov't	2.54	-0.07	-0.23	-0.37	-2.01
	AUS 10-year gov't	2.62	-0.05	-0.04	-0.06	-1.43
	US 10-year gov't	3.14	0.09	0.20	0.77	0.60
Australasian	NZ - NZX50 Capital (NZ$)	3899	-6.6%	-3.1%	3.8%	45.2%
	- NZX50 Gross (NZ$)	8756	-6.4%	-1.9%	7.5%	78.3%
Equities	AUS - All Ords (A$)	5913	-6.5%	-7.1%	-1.1%	9.1%
International	JAP - Nikkei (¥)	21920	-9.1%	-2.8%	-0.4%	53.0%
Equities	UK - FT100 (£)	7128	-5.1%	-8.0%	-4.9%	5.9%
	US - S&P500 (US$)	2712	-6.9%	-3.7%	5.3%	54.4%
	WORLD - MSCI (US$)	2022	-7.4%	-6.1%	-0.7%	26.1%
	MSCI in NZD (NZ$)	3091	-6.6%	-2.0%	3.9%	59.0%
Exchange	NZD/USD	0.65	-0.9%	-4.2%	-4.5%	-20.7%
Rates	NZD/AUD	0.92	0.9%	0.5%	3.5%	6.3%
	NZD/JPY	74.06	-1.2%	-2.3%	-4.4%	-8.8%
	NZD/GBP	0.51	2.0%	-1.0%	-0.7%	0.0%
	NZD/EUR	0.58	1.8%	-1.0%	-2.0%	-4.1%
	NZ TWI	72.09	0.5%	-1.7%	-0.7%	-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.

US political developments and President Trump remain at the heart of a lot of the themes. The risk of still-elevated trade tensions morphing into an all-out trade war has clearly rattled investors. China had earlier postponed trade negotiations until likely after the November US elections, but the protectionist trade rhetoric from President Trump continued during October as mid-term election campaigning stepped up.

The China-US tensions eclipsed the more positive development on the last day of September where **Canada and the US agreed to a new North American trade agreement** called the US-Mexico-Canada Agreement. It was also notable that trade-sensitive industrial stocks helped push US equity indices higher on 30 October when President Trump said he expected a *"great"* trade deal with China. President Trump also tweeted that he had a *"long and very good conversation"* with Chinese President Xi Jinping on trade. Both leaders are attending the G20 meetings in Argentina this month, and are set to meet.

The US Midterm Elections are also a source of uncertainty, but that will be resolved very shortly, with voting taking place on 6 November. In keeping with recent behaviour, many of President Trump's latest thoughts come via a tweet, including some advice to US voters that *"If you want your stocks to go down, I strongly suggest voting Democrat".* Trump also reminded voters that the *"Stock Market is up massively since the election but is now taking a little pause - people want to see what happens with the Midterms."* Opinion polls have suggested Republicans could lose their majority in the House but maintain it in the Senate. That result would be challenging for President Trump implementing his policies. But US companies and in turn sharemarkets have often operated with a similar backdrop in the US (where the President, the House, and the Senate do not align along party lines).

Although the US Federal Reserve didn't meet during the month, President Trump took more pot-shots at rate hikes during the month, saying *"I think the Fed is making a mistake,"* adding *"They are so tight. I think the Fed has gone crazy."* The Fed has been projecting the current cycle of interest rate increases for several years now, and is widely expected to lift the Federal Funds Rate again in December. Policy makers' forecasts and financial markets expect the Fed to deliver further increases over 2019, so this tension between Trump and the Fed looks set to continue. US bond yields ended October higher, and it was a volatile month for fixed interest markets.

Italian bonds were volatile over the month. The European Commission (EC) officially rejected Italy's draft 2019 Budget and ordered the Italian government to submit another draft this month. This is the first time the EC has refused to endorse a European Union member state's draft budget. If Italy does not comply it could face fines of up to 0.2% of Italian GDP under the EU's excessive deficit rules. European Central Bank President Draghi stated he is *"confident an agreement will be found"* but added *"I didn't say very confident".* Draghi commented that spill-overs to other countries from the Italian tensions are "limited".

Beyond the trade tensions, rising interest rates and politics, investors were understandably negative about some major companies' latest results and reacted strongly. Examples of the negative reactions to earnings include:

- General Electric fell by 8.8% after cutting its dividend.
- Lufthansa fell 8.1% after the German airline missed profit estimates.
- Amazon was down 7.8% and Alphabet (Google) was down 1.8% after disappointing earnings.

Towards the end of the month there were some equally strong reactions to several very good results and markets lifted into month-end, in the case of the US market partially clawing back earlier losses. Highlights include:

- General Motors jumped 9.1% on strong truck sales, & higher prices boosting profits.
- Facebook gained 3.8% after the social media giant said it would boost investment next year and announced plans to build products, including Facebook Watch and Instagram TV.
- Yum! Brands rose 4.6% as strong KFC sales drove results.
- HSBC rose by 4.8% after it reported a 28% rise in third quarter profit.

The local sharemarket also ended the month lower, with the NZX50 down by 6.6% (measured by the NZX Capital Index). The Australian market was down by a similar amount for the month, which took the All Ords index into negative territory for the year.

Commodity prices finished mostly lower in October as weaker market sentiment and concerns over global demand weighed on prices. Dairy prices softened in October and Fonterra cut its 2018/19 milk price forecast to a range of $6.25-6.50/kgms from $6.75/kgms. Oil prices declined over 10% in October on demand concerns and oversupply fears. Saudi Arabia and Russia have led production higher, in hopes of offsetting lower production in Iran and elsewhere. For Australia the news wasn't all bad though, with Iron ore, coking coal and gold prices bucking the trend.

The NZD eased against the USD and JPY over the course of the month, but gained against the AUD, GBP and EUR to be up 0.5% on a trade weighted basis.

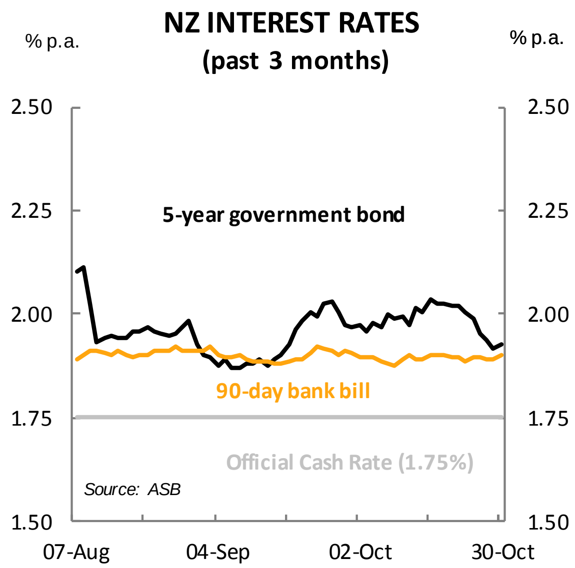
Income Assets

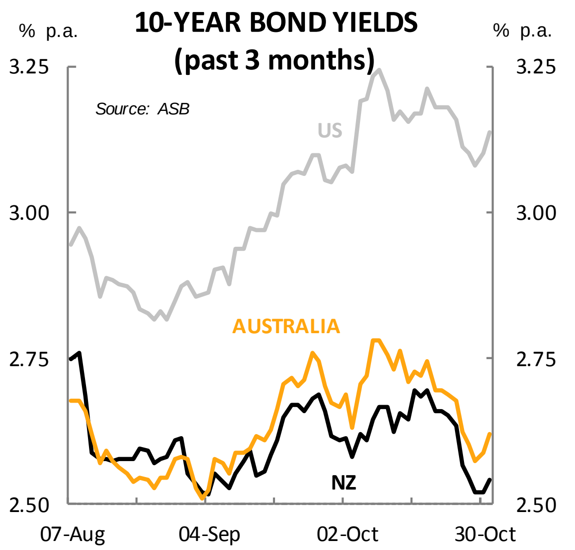
Cash

The RBNZ next meet in November, and are expected to retain a similar "watch and wait" approach to the Official Cash Rate (OCR) outlook. ASB continue to expect the OCR will remain on hold at 1.75% this year and next, with the first OCR move (up) expected in 2020. However, the risks through to mid-2019 are tilted to an OCR cut primarily if economic growth and in turn the outlook for inflation do not live up to RBNZ expectations.

During September term deposit rates eased, with rates for amounts over $10K now ranging from 2.7% for a 90-day term, up to 3.8% for a 5-year term. There were no changes in October. With OCR hikes a way off, ASB Economics expect most short-term returns on term deposits will likely stay near current levels over the year ahead. Further dips cannot be ruled out, particularly if the RBNZ decides to cut the OCR.

The latest ASB term deposit rates can be found here.





NZ Fixed Interest

NZ government bond yields eased over the month, and yields are back to around late August's lows. Improved equity markets sentiment towards the end of the month saw yields lift off earlier lows, with the 10-year government bond yield ending the month at 2.54%, 7 basis points below the levels at the start of October.

By contrast, US 10-year Treasury yields lifted 9 basis points to 3.14% by month end. NZ corporate bond yields also declined during the month, keeping most local long-term investment grade bonds trading with yields significantly below 4%.

International Fixed Interest

US bond yields ended the month higher, and markets were choppy over the month. October started with yields on the rise, followed late September increases in the Federal Funds Rate (to 2% to 2 ¼%) from the US Federal Reserve. The US 10-year Government bond (or Treasury) yield peaked at 3.26% on 9 October, which is the highest it's been since 2011. That peak came after US Federal Reserve Chairman Jerome Powell signalled that US interest rates "may go past neutral" (neutral being the level at which interest rates neither support or slow economic growth). For the rest of the month US Treasury yields were choppy, and declined as low as 3.05% around 26 October, when US equities were at their weakest. In the closing days of the month, yields rose once more as share market sentiment improved. The 10-year Treasury yield was back at 3.14% by month end, up 9 basis points on where it started. Although the Federal Reserve didn't meet during the October month, President Trump took more pot-shots at the Fed's rate hikes during the month, saying "I think the Fed is making a mistake," and went as far as saying "I think the Fed has gone crazy." The Fed has been projecting the current cycle of interest rate increases for several years now, and is widely expected to lift the Federal Funds Rate again in December. Policy makers' forecasts and financial markets also expect the Fed to deliver further increases over 2019, so this tension between Trump and the Fed looks set to continue.

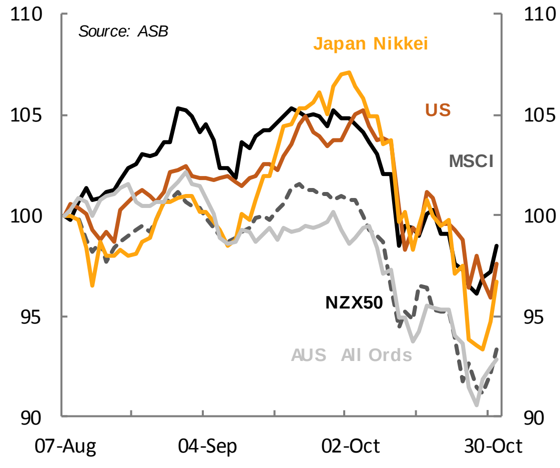
In Europe the focus was on Italy's budget woes. The Italian 10-year bond yield got as high as 3.69% during the month. These yields had been around 1.75% earlier in the year, before the Italian election. In contrast, German Bunds rallied (yields lower), with the 10-year yield dipping from 0.57% on 5 October down to 0.35% in late October, when share markets were at their weakest. UK gilts followed a similar pattern, with the 10-year yield at a peak of 1.73% on 10 October, and a low of 1.38% on 26 October. The Bank of Japan left its policy balance rate at -0.1%, kept its 10-year bond yield target at 0%, maintained its forward guidance and left its asset purchases unchanged. The Japanese 10-year yield peaked at 0.16% last month.

Growth Assets

Australasian Equities

It was a negative month for local equities, with the NZX50 Gross Index down 6.4% over the month. With the exception of Mercury, Sky TV and Restaurant Brands, local stocks were generally lower. Across the Tasman, the Australian All Ords share index recorded its biggest percentage monthly drop since August 2015, with a 6.5% fall in October, which left this index 1.1% lower for the October 2018 year. Equities in all 22 sub-industry sectors of the All Ords fell in October. The largest percentage drop was for the media sector (down 16.2%) while transportation was the best performer, although shares in this sector were still down 2.5% over the month.

SHARE INDICES
(84 days ago = 100)



International Equities

In recent months Global sharemarket investors have taken a number of potential headwinds in their stride. October, however, marked a change in tune. Catalysts for the sizeable and globally synchronised falls to equities over October are likely fourfold. These include, the impact of rising US interest rates, trade tensions and associated global growth concerns, political developments as well as high equity valuations.

Right from the start of the month, global equities appeared to be on the back foot, with the new US-Mexico-Canada trade agreement overshadowed by rising global bond yields and rising China-US trade tensions. Also weighing on sentiment was the downgrading of the global growth outlook by the IMF, its first in two years. US interest rates hitting multi-year highs at the start of the month likely heighted concerns for investors worried about the impact of rising borrowing costs on economic activity and company profits. Previously high-flying tech shares came under pressure after investors appeared to scale back their expectations for continuing high revenue growth.

There was some respite from the negativity mid-month after banks Morgan Stanley and Goldman Sachs' profits beat market expectations. Health care companies Johnson & Johnson and UnitedHealth also posted better than expected earnings at this time.

Sharemarkets weakened further after the release of the weakest annual Chinese economic growth data in 9½ years in the September 2018 quarter (a still-respectable +6.5% yoy). Annualised US economic growth remained reasonably strong, up by 3.5% in the September quarter. Other US economic data releases were also positive during the month, supporting market expectations for a Fed rate hike in December. The US unemployment rate fell to a 48-year low of 3.7% and annual average hourly earnings rose by 2.8% yoy.

At the time of writing almost half of the companies in the US S&P 500 have reported earnings for the third quarter. Around three quarters of these companies have reported actual earnings per share above the mean market estimate. Although some of these results supported shares in the closing days of October, the S&P 500 still lost 6.9% – its biggest monthly fall since September 2011. And the tech-heavy US NASDAQ Composite posted its worst monthly decline since November 2008, down by 9.2%. Japan's Nikkei fell by 9.1%, which reversed a solid Q3 performance. In Europe, the German Dax fell by 6.5% and the UK's FTSE index of shares declined by 5.1% during the month.

ASB Securities has more information on sharemarkets and trading here.

Exchange Rates:

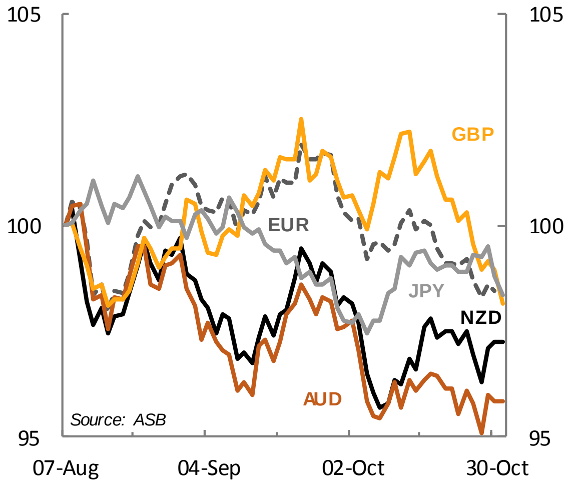
The NZD traded between 0.6425 and 0.6632 against the USD over October, ending the month near the middle of this range.

The NZD eased against the USD and JPY over the course of the month, but gained against the AUD, GBP and EUR to be up 0.5% on a trade weighted basis.

Solid US economic activity and expectations of ongoing interest rate increases supported the USD over the month, and the USD gained against all the major currencies apart from JPY. The NZD eased 1.2% against the JPY over October.

Softer Eurozone economic activity, benign inflation pressures and concerns over Italy's fiscal standoff with the European commission all weighed on EUR during the month. EUR declined against the NZD and all the other major currencies.

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



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