Markets Monthly

03 October 2019

Sharemarkets lift while the NZD slide continues

- Sharemarkets were volatile, but posted gains over the month of September.
- The European Central Bank and the US Federal Reserve eased policy settings during the month.
- Long term interest rates lifted slightly in September, but remain historically low. NZ term deposit rates dipped.
- The NZD slide continued, with the trade-weighted index down 0.7% for the month, and 4.2% over the quarter.

Date		30-Sep-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	1.15	-0.04	-0.49	-0.76	-2.55
Fixed	NZ 5-year gov't stock	0.89	0.05	-0.37	-1.09	-3.09
Interest	NZ 10-year gov't	1.09	0.02	-0.48	-1.53	-3.05
	AUS 10-year gov't	0.97	0.08	-0.35	-1.70	-2.52
	US 10-year gov't	1.68	0.18	-0.33	-1.37	-0.80
Australasian	NZ - NZX50 Capital (NZ$)	4709	0.8%	2.8%	12.8%	70.4%
	- NZX50 Gross (NZ$)	10893	1.3%	3.9%	16.5%	107.3%
Equities	AUS - All Ords (A$)	6801	1.5%	1.5%	7.5%	28.4%
International	JAP - Nikkei (¥)	21756	5.1%	2.3%	-9.8%	34.5%
Equities	UK - FT100 (£)	7408	2.8%	-0.2%	-1.4%	11.9%
	US - S&P500 (US$)	2977	1.7%	1.2%	2.2%	50.9%
	WORLD - MSCI (US$)	2180	1.9%	0.1%	-0.2%	28.4%
	MSCI in NZD (NZ$)	3479	2.5%	7.0%	5.2%	59.7%
Exchange	NZD/USD	0.6266	-0.5%	-6.4%	-5.1%	-19.6%
Rates	NZD/AUD	0.9271	-1.1%	-3.0%	1.3%	4.1%
	NZD/JPY	67.64	0.9%	-6.2%	-9.7%	-20.6%
	NZD/GBP	0.5100	-1.3%	-3.5%	1.1%	6.3%
	NZD/EUR	0.5730	0.5%	-2.8%	1.1%	-6.7%
	NZ TWI	69.97	-0.7%	-4.2%	-2.5%	-7.9%

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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Market News

Sharemarkets posted reasonable gains during September, despite the news flow, which at times was very negative. In the US, Democrats launched a formal impeachment enquiry to President Trump, focused on his phone call to Ukraine's President Volodymr Zelensky. The rough transcript of the call suggests Trump pushed Zelensky to investigate the activities of former Vice President Joe Biden and his son Hunter Biden. US-China trade tensions remain, although once again, investors appeared optimistic about the next round of negotiations later in October.

It's not just the US and China markets have to be worried about. According to media reports, the US is set to impose retaliatory tariffs on European goods after the World Trade Organisation's ruling on illegal aircraft subsidies to Airbus. From October 18, the US plans toimpose a new 10% tariff on aircraft imported from Europe and a 25% rate on other goods including farming and industrial items. This will likely test already strained test transatlantic trade relations.

The Brexit situation remains a shambles, with PM Johnson's suspension of Parliament deemed unlawful by the UK Supreme Court. Johnson now wants an early general election. Opposition MPs won't support an early general election until the risk of a no-deal Brexit on 31 October is removed. In early October, Johnson sent the European Union his new blueprint for a Brexit deal, where the Irish backstop would be ditched, with Northern Ireland to stay in the European single market for goods, but outside of a customs union. Responses to date have been lukewarm and time is running out ahead of the 31 October Brexit date.

An attack on Saudi Arabia's oil production infrastructure was another major concern, with around 5% of global supply temporarily impacted. Oil prices initially soared higher, but subsequently eased as the supply fears moderated.

A number of central banks have eased policy settings over the past month. As expected, the US Federal Funds rate was cut by 0.25% to a 1.75% to 2% range, "in light of the implications of global developments" and "muted inflation pressures". The European Central Bank cut one of its policy rates by 10bps to -0.50% and confirmed it would be restarting bond purchases of €20bn a month from November. The People's Bank of China announced a 50bps cut to its Reserve Requirement Ratio. The Reserve Bank of Australia cut the Australian cash rate to 0.75% on 1 October.

The RBNZ's on-hold decision at its September Review was widely expected, though a rate cut wouldn't have been a big surprise after the 0.5% cut to the Official Cash Rate (OCR) in August. Data released during the month showed the economy grew 0.5% in 2019Q2, in line with ASB/RBNZ forecasts. However, this was the fourth successive quarter that quarterly GDP growth printed below its trend rate. Annual growth of 2.1% was the lowest in six years.

Despite widespread capacity constraints, business investment has remained weak, and if it fails to improve it will likely weigh on the duration of the economic expansion. This weakness stemming from business confidence and the murky global environment remain key concerns for the New Zealand growth outlook. Against these risks, the RBNZ will be heartened by the impact its monetary easing this year has had on borrowing costs. The RBNZ expects household and business spending to pick up in response to the record low interest rates available.

However, NZIER's Quarterly Survey of Business Opinion (released on 1 October) was not encouraging. The results suggest the economy has approached stall speed over Q3, with more signs of weakening cost and pricing pressures. Both aspects will concern the RBNZ. We think it is increasingly clear that the economy needs even more stimulus to try and hold growth up in the near term and give greater assurance that momentum will firm next year. The initial sense from the just-released independent experts' review of the RBNZ's bank capital increases is an endorsement of the RBNZ's capital proposals. If there is little change to the proposed capital increases then we think it is likely the RBNZ gets surprised next year by the extent of the negative economic impact.

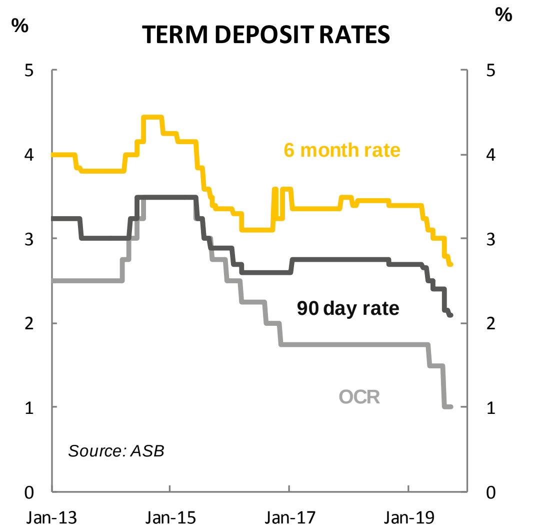
ASB now expects a further 50bp in total of OCR cuts; -25bp in November and now -25bp in February. These cuts would take the OCR to a fresh record low of 0.5%. After the mixed response to the 50bp OCR cut in August, we expect the RBNZ will revert to smaller 25bp steps. Rather than reassure that the cavalry is on the way, the 50bp August cut seems to have caused some disquiet. With the OCR at a record low, we concur with the RBNZ's view within its September OCR announcement that there is scope for more fiscal stimulus to support the economy if necessary.

Income Assets

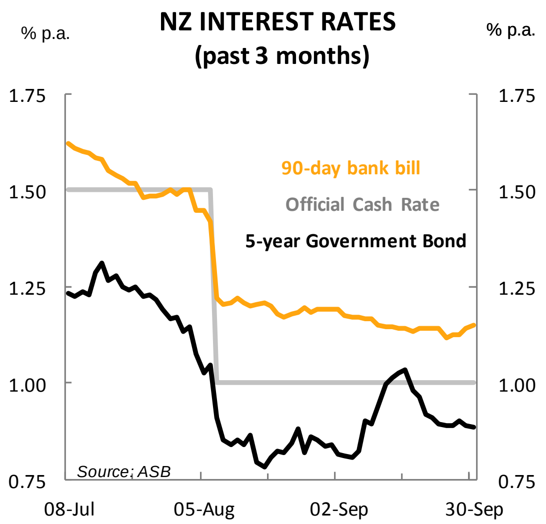
Cash

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 25 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 13 November. In addition, we think that the OCR will move even lower, to 0.5% in February 2020.

Term deposit interest rates have drifted lower since the August OCR cut, and are at their lowest levels since the mid-1960s. For amounts over $10k, term deposit rates for 2-5 years are around 2.6%. Rates for shorter 3-month terms are slightly above 2%, and 6- to 12-month rates are around 2.6-2.8%.



The wholesale interest rate curve has flattened significantly, with long-term interest rates only marginally higher than short-term rates. We think the risk for savers is that term deposit rates move even lower. The main catalyst is the OCR being 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. The initial sense from the just-released independent experts' review, which endorses the proposed significant increases in bank capital requirements and downplays their economic impact, is that higher bank capital requirements are coming.



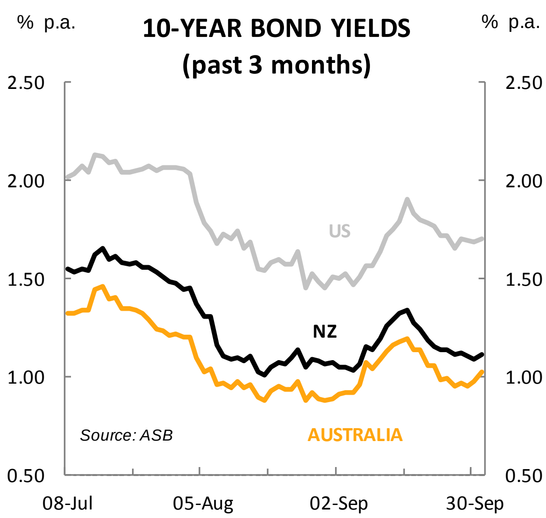
The latest ASB term deposit rates [can be found here.]

NZ Fixed Interest

The NZ 10-year Government bond yield briefly dipped below 1% in mid-August, and ended the month just above 1%. Over the first half of September yields rose in line with a global drift higher, only to decline into month end.

By the end of September the 10-year yield was 1.09% (up 2 basis points over the month). The 5-year Government bond yield closed the month at 0.89%, up 5 basis points over the month. Corporate bond yields also ticked slightly higher over the month, but remain incredibly low on a historical basis.

As we have mentioned in earlier reports, the expectation of a lower OCR, combined with the dovish sentiment from offshore central banks, 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 early 2020. We also expect global central banks to continue to ease policy settings. Our view remains that we can see lower New Zealand bond yields over the year ahead, with 10-year government bond yields dipping below 1%. European and Japanese markets show that zero is not a limit for bond yields in certain circumstances; although we think negative bond yields are unlikely in New Zealand at this juncture.

International Fixed Interest

At the end of July, the US Federal Open Market Committee's (FOMC, or Fed) delivered their first rate cut since 2008, and trimmed the Federal Funds Rate by 25bp to a 2.00% to 2.25% range. Another cut was delivered on 19 September, taking the Federal Funds rate to a 1.75% to 2.00% range. Back in July Fed Chair Powell suggested that the cut was not necessarily the start of a lengthy monetary easing cycle, but markets thought otherwise and long term interest rates in the US declined accordingly. In September, bond market movements suggested investors may be more convinced by the Fed message. The 10-year US Treasury yield did not re-test August lows (1.44%) and rose 18 basis points in September to close yielding around 1.68%. At the time of writing, the string of weak US data have pushed USD yields lower, with markets now pricing in a further 75bps of Fed cuts oved the next 12 months.

Closer to home, the Australian market followed a similar pattern to the NZ market. Having touched a record low of 0.89% at the end of August, the Australian 10-year Government bond yield rose over the first few weeks of the month to touch 1.2%, only to rally back lower again in the second half of the month. Australian 10-year yields ended the September month at around 1%.

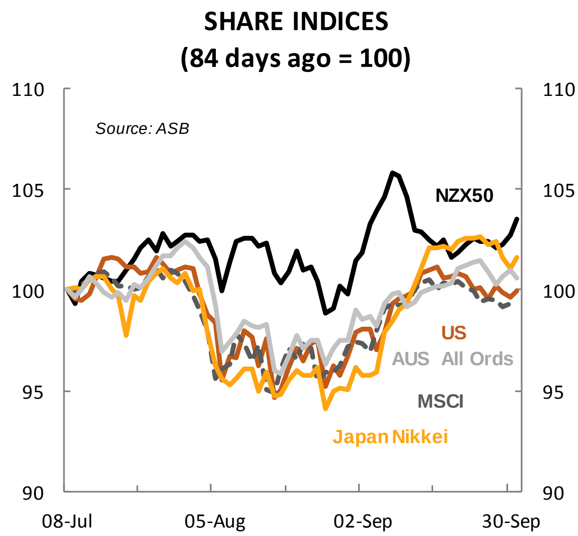
During the month the European Central Bank its retail deposit facility rate by 10bps to -0.50% and also confirmed it would restart bond purchases of €20bn a month from November. As for the US, European bond yields ended September above August lows. Negative yields continue to characterise the European sovereign debt market, with 10-year debt yields negative in France, Germany, Switzerland, Sweden and the Netherlands. Japanese sovereign yields have remained negative across much of the term structure. During the month the Bank of Japan maintained its extremely stimulatory policy settings, but appeared to be moving closer to delivering more policy support.

Growth Assets

Australasian Equities

Australasian markets recovered from the August dip, and posted gains over September. The Australian All Ords index lifted 1.5% and the NZX50 Gross index was up 1.3%. Both indices ended September around 2% below highs reached earlier in the quarter, but were significantly up on a year ago.

Two clear themes in the local sharemarket are the support being garnered from low interest rates, and strong reactions (both positive and negative) to earnings news. Kathmandu shares rose 21% in September after August's good news. Fletcher Building also had a strong month, gaining 16%, again following encouraging news.



At the other end of the scale, Z Energy shares slid nearly 12% over the month. At its latest earnings update the company said its FY 20 earnings are negatively affected by lower retail and refining margins. The largest negative influence on the overall market return was the pull back in a2 Milk shares (-8% in September), which has been under pressure due in part to concerns about the outlook for margins in the future. Across the Tasman, 13 of Australia's 22 sub-industry sectors posted gains during the month. Household and personal products rose the most (up 19%), followed by Autos and components (up by 5.1%). Banks rose 4.9%

over the month. The Telecom sector fell the most, declining 4.3%.

International Equities

International equities were volatile in September and ended the month 1.9% higher on the MSCI index (in USD terms). That partly offset the August decline, and like Australian share indices, this benchmark world share index was only down around 2% from the year's peak. The MSCI index was basically flat on a year ago (-0.2%).

The S&P 500 index of US shares gained 1.7% over the month, and was 2.2% higher than a year ago. Japan's Nikkei share index gained a whopping 5.1% in September, but larger losses in earlier months meant the index was down 9.8% on a year ago. The FT100 index of UK shares rose 2.8% in September but remained down 1.4% on year-ago.

Market sentiment continues to be heavily influenced by the prospect of "lower for longer" interest rates, changing sentiment regarding a US-China trade deal, and mounting evidence of slowing global growth. Brexit concerns have added to the mix for both UK shares and global sentiment, and this month the Saudi oil issue has been an additional source of concern. We expect volatility in global markets to continue, as many of these global challenges are expected to continue. Despite an impeachment enquiry now on the cards for President Trump, his provocative tweets are unlikely to die down. Fed caution about future rate cuts are sure to draw more criticism from the US President.

The 1.9% gain in global shares over the month shows that negative news flow doesn't necessarily lead to weaker equity market performance.   The upcoming reporting season will be important. A company's performance is ultimately a vital influence on its share price.

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

Exchange Rates:

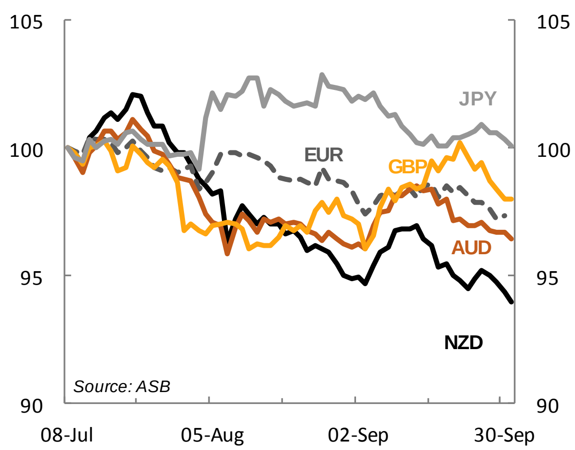
The NZD slide continues, with the trade-weighted index down 0.7% during September, and 4.2% over the third quarter.

Over the month the NZD/USD exchange rate had a 2c range, with the high of 0.6451 set on 12 September. The NZD/USD subsequently eased below 0.6300, and touched a low of 0.6250 on the last day of September.

The NZD also eased against the AUD and GBP during the month, but posted gains against EUR and JPY.

The JPY trade weighted index decreased by 1.9% in September and JPY decreased against all currencies we monitor. The EUR trade weighted index decreased by 1.1% in September. The EUR weakened against all currencies we monitor, with the exception of JPY.

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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