Markets Monthly

04 January 2018

Sharemarket rally continues during December

- US developments in December included an interest rate hike from the FOMC and the passage of tax legislation.
- Sharemarkets were largely positive during the month, with US and NZ sharemarket indices setting fresh highs.
- Long-term bond yields lifted over December, but remain down on year-ago levels both here and offshore.
- The NZD lifted through the month, reversing a significant proportion of the post-Election slide.

Global share markets ended the year on a strong note, with most of the major markets posting gains during December. US investors were focussed on US tax legislation, the Federal Reserve meeting and rising oil prices. Republicans in the US Congress (House of Representatives and Senate) secured enough votes to pass the reconciled tax bill (Tax Cuts And Job Act) on 20 December, and President Trump signed the overhaul into law on 22 December.

The US Federal Open Market Committee (FOMC) lifted the Federal Funds rate to a 1.25% -1.50% range on 15 December, as widely expected. Short-term US yields lifted in response to the move, as well as the "quantitative tightening" that is now taking place as the Federal Reserve's huge holdings of bonds and mortgage-backed securities are slowly wound down. Longer-term yields in both here and in the US lifted modestly over the month, but are slightly lower than the levels at the start of 2017, and remain very low on a historical basis.

Across the Atlantic, uncertainty about Catalan independence continues to be an issue in Spain, and political uncertainty continues in Italy. The Italian Parliament was dissolved by President Mattarella on 28 December, and a general election will be held on 4 March. On a more positive note, during December the European Central Bank substantially lifted its aggregate Eurozone GDP growth forecasts for 2018 and 2019.

Local developments included the appointment of Adrian Orr as the next RBNZ Governor, and generally encouraging economic news. New Zealand GDP expanded reasonable 0.6% over Q3. Although the quarter's growth result was near expectations, revisions over the past three years lifted GDP growth by approximately 1% per year, suggesting the economy is stronger than previously thought. The Government's Half-Year Economic and Fiscal Update showed the Government's books remain healthy, with more surpluses and declining net debt forecast for the coming years.

A wet New Zealand spring gave way to a dry summer during December. The dry conditions prompted Fonterra to revise down its dairy production forecasts for the current season. In turn, whole milk powder prices rose 4.2% at the latest Global Dairy Trade event.

The local sharemarket ended the year on a positive note, with the NZX50 (Gross Index) gaining 2.9% in December.

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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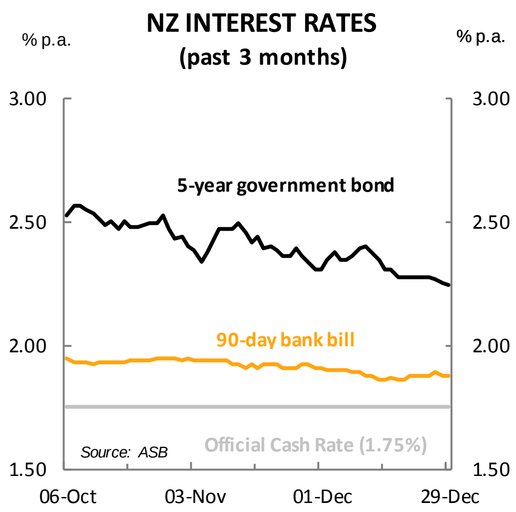
The NZD strengthened over the month, and in doing so reversed a reasonable proportion of its post-Election slide. The combination of a softening USD and positive local developments contributed to the 3.6% NZD lift against the USD.

Date	Instrument	31-Dec-17	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	1.88	-0.03	-0.08	-0.12	-0.80
Fixed	NZ 5-year gov't stock	2.25	-0.06	-0.29	-0.43	-0.69
Interest	NZ 10-year gov't	2.73	0.02	-0.24	-0.62	-0.83
	AUS 10-year gov't	2.67	0.16	-0.17	-0.10	-0.59
	US 10-year gov't	2.44	0.05	0.12	-0.04	0.74
Australasian	NZ - NZX50 Capital (NZ$)	3855	2.4%	5.3%	17.3%	66.9%
	- NZX50 Gross (NZ$)	8398	2.9%	6.2%	21.8%	106.4%
Equities	AUS - All Ords (A$)	6167	1.8%	7.4%	7.8%	32.2%
International	JAP - Nikkei (¥)	22765	0.2%	11.8%	19.1%	119.0%
Equities	UK - FT100 (£)	7688	4.9%	4.3%	7.6%	30.3%
	US - S&P500 (US$)	2674	1.0%	6.1%	19.4%	87.5%
	WORLD - MSCI (US$)	2103	1.3%	5.1%	20.1%	57.1%
	MSCI in NZD (NZ$)	2966	-2.3%	7.0%	17.9%	81.9%
Exchange	NZD/USD	0.71	3.6%	-1.7%	1.9%	-13.6%
Rates	NZD/AUD	0.91	0.8%	-1.0%	-5.5%	15.0%
	NZD/JPY	80.07	4.5%	-1.4%	-1.2%	13.6%
	NZD/GBP	0.53	3.8%	-1.9%	-7.1%	3.9%
	NZD/EUR	0.59	3.0%	-3.0%	-10.3%	-4.3%
	NZ TWI	74.15	2.6%	-2.6%	-4.5%	0.1%
Equity indices are the respective end-of-month closes. Interest rates and exchanges rates are at 5pm NZ.						

Income Assets

Cash

The Reserve Bank of New Zealand (RBNZ) held its last review on 9 November, and held the Official Cash Rate (OCR) at 1.75%. Even with some of the new Government's spending initiatives factored into its November forecasts, the outlook for inflation remains low. With this outlook in mind, the RBNZ expects to keep the OCR around the current level until late 2019. We also forecast a 2019 move, though we have the first OCR increase pencilled near the start of the year.



The RBNZ's first OCR announcement in 2018 is on 8 February. If OCR hikes are still a long way off, most short-term fixed interest returns on term deposits will likely stay near current levels over the year ahead.

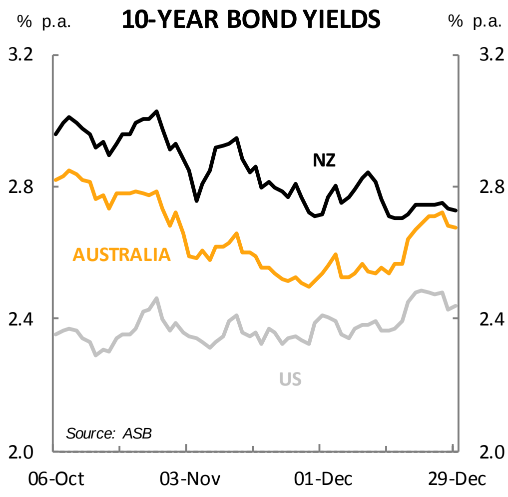
Term deposit rates for the popular terms out to 18 months barely moved over 2017, reflecting the low, stable OCR. There was some upward pressure on the longer-term deposit rates in early 2017. The upward pressure eased later in the year, and rates from 2-5 years dipped by 10bps (0.10%) in August. Term deposit rates have been stable since then.

The latest ASB term deposit rates can be found here.

NZ Fixed Interest

Demand for NZ bonds was strong during December. Demand was supported by the combination of a maturing government bond, and a lower than expected bond issuance outlook within the Government's Half-Year Economic and Fiscal Update. The demand saw the local 5-year Government bond yield dip 6bps, while the 2 bps lift in the 10-year Government bond was more modest than the equivalent bond yield increases offshore.

Spreads between NZ and US equivalents further compressed over the month, with the spread between NZ and US 10-year Government bond yields touching fresh lows, as shown in the chart to the right.



Bank and corporate bond yields are similarly low relative to historic average levels, with yields under 4% for almost all the investment-grade bonds publicly trading in the local market. And for the short-dated investment-grade bonds, yields are around 2%.

Local yields declined over the quarter and over the full year. Bond valuations move in the opposite direction to yield, so that decline in yield is a boost for valuations within bond portfolios. However, the prevailing low yields remain a constraint on overall returns on bond portfolios.

International Fixed Interest

The US Federal Open Market Committee (FOMC) lifted the Federal funds rate to a 1.25% -1.50% range on 15 December, as widely expected.

At its December meeting, the European Central Bank left its deposit and refinancing rates unchanged at -0.4% and 0.0%, respectively, while upgrading its Eurozone GDP growth and inflation forecasts for 2018 and 2019. Despite the improving outlook for Europe, interest rates remain low in the region. For example German 10-year Government bund yields are trading around 0.5% and short-term bund rates remain negative.

The yield on the US 10-year Government Bond lifted a modest 5bps over the month. Back in December 2016, US bond yields lifted far more, with the 10-year yield lifting a staggering 0.68bps over the month. That December 2016 lift now drops out of the annual calculations, leaving yields down 4bps for the 12-month period ending 31 December 2017. However, the US 10-year yield currently trades about 1.1% higher than the all-time low-point reached during mid-2016. We expect the upward drift in US yields will continue over the year ahead, and yields in other major bond markets will eventually lift too. In the long run, that expected development will help improve the running yield on global bond portfolios. But in the short term, rising yields are a headwind for portfolio valuations because of the inverse relationship between bond prices and yield.

Growth Assets

Australasian Equities:

The local sharemarket posted further gains during December. The NZX50 (Gross Index) gained 2.9% over the month, and 21.8% over 2017. Meanwhile, the Australian S&P/ASX200 index reached near 10-year highs in December, with the index lifting above 6,000 points for the first time since the start of the Global Financial Crisis. The 1.8% return over the month saw the index gain 7.4% over 2017.

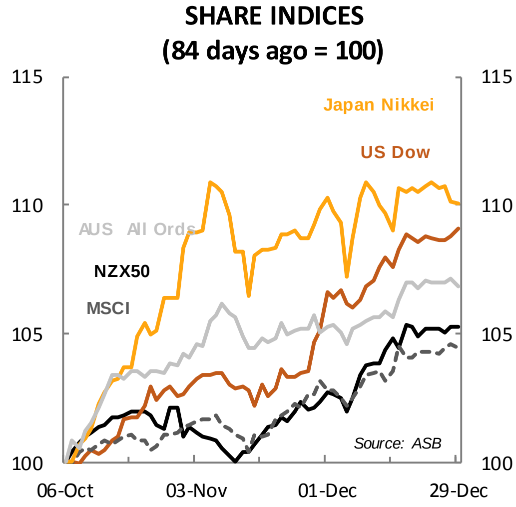
The a2 Milk Company and Xero have been standout performers on both exchanges over 2017, but the stocks gave back some gains over December. Despite their end-of-year dips, over the full year the a2 Milk Company lifted close to

280% and Xero gained nearly 80% (measured on the NZ exchange).

In contrast, shares of the 'big four' banks, which account for about a third of the Australian sharemarket, all declined over 2017.

For much of 2017, Fletcher Building investors have been nervous about the potential for further profit write-downs on the company's key construction projects. However, over December the share price did recover some of the lost ground following its recent sell off, lifting over 8%.

During the month Westfield shares lifted strongly after the group announced it agreed to a takeover by European company Unibail-Rodamco. The share price lifted 12.3% in AUD terms over the month.



A recovery in commodity prices continues to help BHP Billiton's share price. The group's main commodity exposures are oil, iron ore, copper and coking coal. The sale of BHP's US onshore gas assets is also supporting the share price, which lifted 7.2% over December.

International Equities:

Global economic growth broadly improved in 2017 and became more synchronised, helping equity markets post strong gains over the year. A supportive theme has also been the expectation of favourable US tax changes, and markets were aided in the closing month of the year by passage of those Trump tax cuts just before Christmas.

Over December, the US Dow Jones rose by 1.8%, the S&P 500 lifted 1.0% while the tech-heavy NASDAQ index rose a more modest 0.4%. In Europe, the German DAX fell by 0.8% while the London FTSE lifted 4.9%. The UK share market rose 1% on 8 December after a breakthrough in Brexit negotiations by UK and European negotiators. In Japan, the Nikkei edged 0.2% higher over the month.

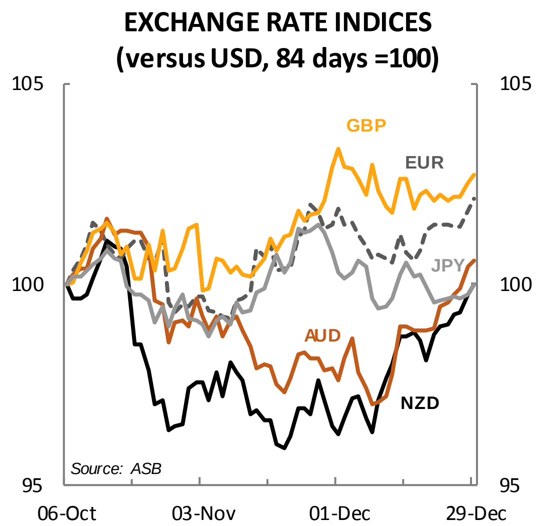
Over the full year, both the US and Japanese sharemarkets were up by nearly 20%, and the MSCI index of global shares was up 17.9% when measured in NZD terms.

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

Exchange Rates:

The NZD bounced back in December, and was the top-performing currency we monitor during the month. That recovery reversed a reasonable proportion of the NZD's post-Election slide. Part of the December move is function of a softer USD, but positive local developments also contributed to the 3.6% lift against the USD, and 2.6% lift when measured on a trade-weighted basis.

NZD/AUD lifted a more modest 0.8% during the month, because the AUD was also strengthening. The Australian trade-weighted index rose by 2% in December, with the currency supported by firmer iron ore prices and positive economic data.



For more insights into currency issues, our latest **ASB Kiwi Dollar Barometer can be downloaded [here.]**

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