Markets Monthly

02 August 2018

Sharemarkets perform well over July

- Solid corporate earnings support a lift in major global sharemarket indices over July.
- However, there were some large share price falls for companies that didn’t expectations, including Facebook.
- US bond yields rose, while NZ bond yields declined over the month.

US President Trump continued to hog plenty of the global headlines in July. The US is continuing to pursue tariffs as a solution to the country’s large trade deficit, and each week the latest development was one of the key focuses in markets. Last month he was meeting with North Korean leader Kim Jong-un, this month it was Russian President Putin’s turn for a major summit. Trump shocked even staunch supporters when he initially appeared to side with Russia rather than the FBI’s view regarding interference in the 2016 Presidential election. He also raised eyebrows when he departed from tradition and criticised the Fed’s interest rate tightening cycle saying it *“now hurts all that we have done [with the economy]”*. Trump also warned that a stronger dollar takes away US competitiveness and that *“China, EU, others have been manipulating their currencies”.*

US tariffs on US$34 billion worth of Chinese goods imports took effect on 6 July. China’s government retaliated by imposing tariffs on US$34 billion worth of US goods imports, mainly agricultural and auto. At the extreme, Trump has threatened to impose tariffs on all US imports from China (which totalled US$523 billion in the year to May 2018).

On a more encouraging note, in late July the European Union (EU) and U.S. agreed not to implement additional tariffs on bilateral trade during trade negotiations. In a joint statement, the US-EU agreed “*to work together toward zero tariffs, zero non-tariff barriers, and zero subsidies on non-auto industrial goods. We will also work to reduce barriers and increase trade in services, chemicals, pharmaceuticals, medical products, soybeans”.*

Meanwhile, data showed that over the second quarter the US economy grew at a 4.1% annualised rate, the strongest growth since Q3 2014. Growth was driven by consumer spending, business investment, net exports and government spending. But the combination of tax cuts and increasing government spending in the US does have a catch – the US Federal Deficit is widening. It printed at 3.7% of GDP in June, continuing its widening trend from its low of a 2.2% of GDP back in early 2016. Amongst it all, the US sharemarket posted solid gains, supported by strong economic data and positive corporate earnings. The S&P 500 US share index gained an impressive 3.6% over July.

The International Monetary Fund (IMF) released its latest projections of global growth in its World Economic Outlook Update. The IMF made no changes to its earlier global growth projections, and still expects the world economy to grow at an above trend pace of 3.9% in 2018 and 2019. But the organisation warned that escalating and sustained trade frictions could derail the global economic recovery.

New Zealand economic points of note over the past month include ongoing weakness in business confidence (down to around10 year lows according to the latest ANZ survey), modest inflation pressure (annual CPI inflation printed at

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click here for ASB Investment Funds. More information on ASB Securities is here.

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1.5% for Q2) and ongoing strength in the labour market (annual employment growth of 3.7% for Q2).

The local sharemarket rose a solid 3% in June, and the momentum continued in early in July. However, the sharemarket did give up those early gains by month end, with the NZX50 Gross index easing 0.2% over July. The market is up a very robust 11.7% on year ago levels on a capital basis, or 16% by the gross measure (which incorporates the impact of dividends).

USD strength has been a key theme in currency markets since April, but the greenback softened modestly against the NZD, euro, pound and Australian dollars in July. The NZD rose 0.8% vis-à-vis the USD and 1.1% against JPY.

Date		31-Jul-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	-0.10	-0.12	-0.04	-0.76
Fixed	NZ 5-year gov't stock	2.14	-0.01	-0.23	-0.43	-1.41
Interest	NZ 10-year gov't	2.77	-0.09	-0.06	-0.22	-1.47
	AUS 10-year gov't	2.67	0.01	-0.12	-0.03	-1.07
	US 10-year gov't	2.94	0.08	-0.02	0.65	0.33
Australasian	NZ - NZX50 Capital (NZ$)	4026	-0.3%	5.1%	11.8%	59.6%
	- NZX50 Gross (NZ$)	8928	-0.2%	5.7%	16.0%	96.7%
Equities	AUS - All Ords (A$)	6366	1.2%	4.9%	10.3%	26.4%
International	JAP - Nikkei (¥)	22554	1.1%	0.4%	13.2%	65.0%
Equities	UK - FT100 (£)	7749	1.5%	3.2%	5.1%	17.0%
	US - S&P500 (US$)	2816	3.6%	6.4%	14.0%	67.1%
	WORLD - MSCI (US$)	2153	3.1%	3.2%	9.8%	42.8%
	MSCI in NZD (NZ$)	3153	2.3%	7.0%	20.7%	66.8%
Exchange	NZD/USD	0.68	0.8%	-3.6%	-9.1%	-14.4%
Rates	NZD/AUD	0.92	0.1%	-1.8%	-2.3%	4.0%
	NZD/JPY	75.81	1.1%	-1.9%	-8.6%	-3.1%
	NZD/GBP	0.52	0.6%	1.2%	-9.1%	-0.8%
	NZD/EUR	0.58	0.2%	-0.1%	-8.9%	-3.2%
	NZ TWI	73.33	1.2%	-0.3%	-7.2%	-3.8%
Equity indices are the respective end-of-month closes. Interest rates and exchanges rates are at 5pm NZ.						

Income Assets

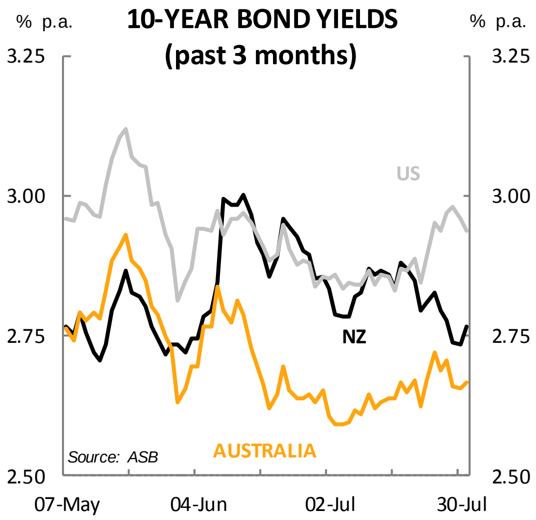
Cash

Domestic wholesale interest rates drifted modestly lower for terms out to a year over July (by 5-10bps, or 0.05-0.1%), while wholesale (swap) rates for 2-5 year terms were flat to 3bps higher. Term deposit rates for amounts over $10K ranged from 2.75% to 4.1% for terms between 90 days and 5 years. These rates have been stable since February.

The RBNZ's record-low 1.75% Official Cash Rate setting is a key factor behind the low and stable wholesale rates and term deposit rates. ASB economists continue to expect that the next move on the OCR is probably up, but not until late 2019. With OCR moves some way off, most short-term returns on term deposits are likely to stay near current levels over the year ahead. Deposit rates, however, are higher in relation to wholesale interest rates than has historically been the case. Upward pressures on bank funding from offshore markets could see deposit rates higher as banks compete for domestic funding. ASB Economic forecasts have been factoring in some upward pressure on longer term deposit rates from an eventual lift in key global rates. However, over recent months influential long-term global interest rates have remained stubbornly contained, and that pressure has not materialised.

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

NZ Fixed Interest



New Zealand Government bonds continue trading with lower yields than their US counterparts for maturities out to 15 years. The 10-year government bond yield dipped 9 basis points (0.09 percentage points) during the month, and rates for other terms also declined.

The Government is running operating surpluses, and accordingly reducing net debt. The New Zealand Debt Management Office projects net issuance of NZ Government bonds over the current 2018/19 program to be NZ$-3.2b (after projected maturities and buybacks are taken into account). This reduction is a key factor behind the "tight" local bond market which is keeping yields low.

We continue to expect long-term local bond yields to rise modestly over the year ahead in line with global counterparts, which will eventually boost the income for investors receiving income from fixed interest investments. However, the return on NZ fixed income investments over the year ahead is expected to remain lower than long-term averages.

International Fixed Interest

The US 10-year Government bond sold-off steadily over July, sending yields back to the top end of the recent 2.8-3.0% range. The 10-year yield peaked just below 2.99% towards the end of the month. The US Federal Reserve appears to be on track to deliver more increases in the Federal Funds Rate, with the next move widely expected in September. Ongoing Fed interest rate hike expectations are an upward force on US bond yields, but long term bond yields are being capped by strong demand, concerns about the long-term economic outlook, and low inflation expectations. US President Trump's trade threats continued to add to financial market nervousness over July

The yield on 10- year Japanese government bonds (JGBs) slumped from 0.10% to 0.05% late in the month after the Bank of Japan retained its target of buying ¥80 trillion JGBs per year to guide the yield on 10 year JGBs to "around zero percent". The Bank of Japan formally introduced forward guidance "to maintain the current extremely low levels of short and long term interest rates for an extended period of time". The 10-year yield was negative back in 2016, but has been between 0% and 0.11% over 2017 and 18. Shorter term JGB yields (out to 7 years) are still negative. Swiss yields are similarly negative (all the way out to 10 years). Other major markets in Europe have negative yields out to at least 2 years. The 10-year German bund yield ended the month at 0.44%, up from 0.3% at the start of July.

The European Central Bank (ECB) left its refinancing and deposit rates unchanged at 0.0% and -0.4% respectively at the July meeting. ECB President Mario Draghi reiterated the ECB's desire to keep interest rates at their current rates through the summer of 2019, and beyond if necessary. Historically low yields in Japan and Europe are likely to persist for a while yet, and are a headwind for global bond fund performance.

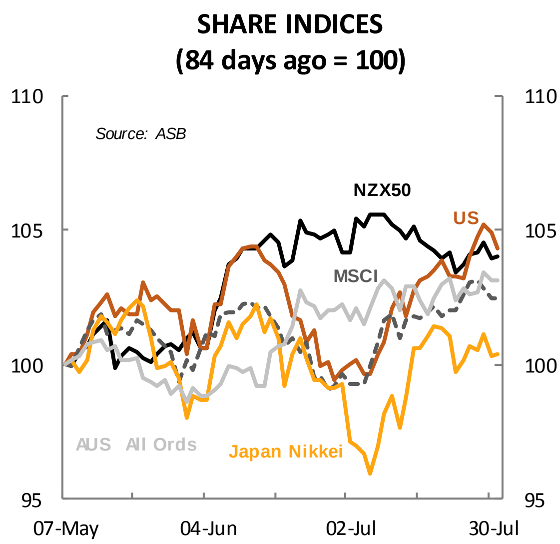
Growth Assets

Australasian Equities

The local sharemarket took a breather over late July, after trading at record levels early in the month. The NZX50 Gross index eased 0.2% over July, but is up a very robust 16% on year ago levels by the gross measure which incorporates the impact of dividends. Stock performance was mixed. Last year's stand out performer a2 Milk saw further falls, with the share price back near $10, having traded above $14 earlier in the year. The 10% slide over the past month had the stock at the bottom of the table in terms of monthly performance. Fonterra and Synlait shares declined during the month.

In contrast, medical product provider EBOS was at the top of the list, gaining more than 13% since the start of the month. The upward momentum continued for Kathmandu, which gained nearly 6% over the past month. Fletcher Building's share price lifted above $7, up nearly 28% from the year's lows at the time of writing. A number of listed property companies also posted respectable gains over July.

The Australian All Ords share index lifted 1.2% in July. This was the fourth consecutive monthly increase, with the index now up 10.3% on a year ago. The Telecommunications sector performed well (the sector was up by 7.9%), led by gains from TPG Telecom (up by 11.4%). At the opposite end of the scale, Consumer Durables & Apparel was down by 7.6%, with well-known company Michael Hill International down by 2.1% over the month.



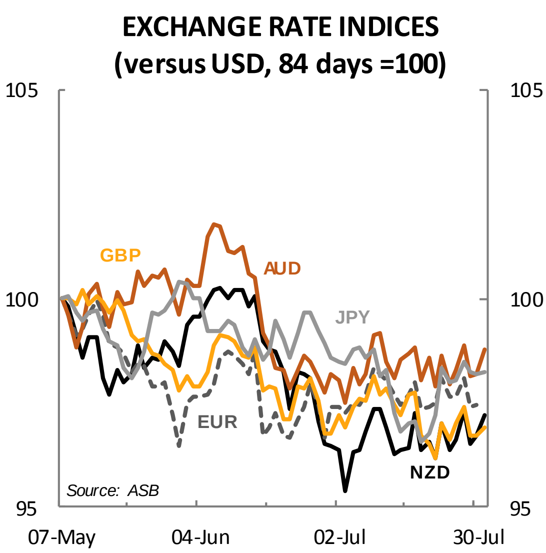
International Equities

Global sharemarkets had a strong month, despite the range of concerns that have dominated the news headlines. The latest earnings reports and encouraging economic data were supportive. As at July 31, 60% of the companies in the S&P 500 had reported their results with 82% of companies reporting Earnings Per Share (EPS) growth above estimates. However, there were some large sell offs for companies that didn't meet high investor expectations, including Facebook. Shares in Facebook fell by 19%, wiping around $110 billion off market capitalisation, in response to its latest results. Facebook wasn't alone - shares in Twitter were down around 25% and the Intel stock price initially fell around 10% after the markets digested their respective Q2 reports. Other major shares have risen in response to generally encouraging earnings news. Shares in Amazon rose to record highs after its results were released. Apple was another company to beat market expectations in its latest quarterly report released in late July, and its share price is trading just shy of an all-time high at the time of writing. Over July the US Dow Jones share index rose by 4.7%, the S&P 500 index rose by 3.6%.and the Nasdaq lifted 2.2%. Asian and European markets also posted solid gains in July, with the UK FTSE index of shares lifting 1.5%, Germany's DAX index rose 4.1%, and Japan's Nikkei share index is up 1.1%. The MSCI index of world shares rose 3.1% in USD terms, or 2.3% in NZD terms, due to the appreciation of NZD against the USD.

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

Exchange Rates:

The New Zealand trade weighted index rose by 1.2% in July, while NZD/USD traded largely within a 0.6700-0.6850 range. NZD/USD set the months low of 0.6688 early in the month, given the recent weakness of the Chinese yuan, reduced risk aversion, and softer NZ commodity export prices. The dovish RBNZ late June assessment also weighed on the NZD at the margin. A softer USD helped the NZD/USD cross rate get above 0.68000 at times during July. The latest print of the RBNZ 'sectoral factor' core inflation estimate caused a temporary NZD/USD spike towards 0.6850 when it unexpectedly lifted to an annual pace of 1.7% in Q2. NZD gained 0.8% vis-à-vis the USD and 1.1% against JPY over the month. The NZD was little changed against the AUD, but made modest gains against the euro and pound sterling over the month.



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