ASB

Markets Monthly

05 July 2018

Trade concerns rumble on

- US President Trump continues to make tariff threats, which are being met with politically-targeted retaliation.
- The US FOMC lifted the Federal Funds rate, but long term US rates remain below recent highs.
- Global sharemarket performance was mixed in June. However, NZ and Australian equities posted solid gains.

Financial markets were under a mixture of opposing forces in June. US President Trump was in the thick of it, as he threatened countries with tariffs, created drama at the G7 summit, and met with North Korean leader Kim Jong-un. Beyond politics, the monetary policy divergence between the US FOMC and other central banks, and the strengthening USD was another key theme.

The G7 summit was held on 8–9 June in Canada. It illustrated the cooling in relations between the United States and the rest of the G7. Before the summit, Trump said Russia should be invited back into the fold (Russia was suspended from the G8 over the annexation of Crimea from Ukraine in 2014). Trump left the G7 summit early to travel to Singapore for his 12 June meeting with Kim Jong-un. After leaving the G7 summit, Trump tweeted that he had instructed US representatives not to endorse the G7 communique. He also criticized Canadian Prime Minister Trudeau, calling him "dishonest & weak”. In contrast, Trump said he and Kim had developed a “very special bond” after their meeting, although the actual pledge of nuclear disarmament from North Korea remains vague.

Sharemarkets were largely positive in the early stages of the month. Investors’ response to the Trump-Kim Summit was muted, which is understandable given the lack of detail around any North Korea’s denuclearisation plan.

However, as trade tensions heated up in the second half of the month, global equities declined. The US S&P 500 share index ended the month posting a 0.5% gain, but closed the month 2.5% below its 11 June high. The Japanese Nikkei also posted a modest 0.5% gain for the month, but ended the month 2.9% below mid-June levels.

In addition to already announced 25% tariffs on $150 billion of imports from China, President Trump has threatened a 10% tariff on a further $US 200 billion of imports from China. Trump also held out the possibility of applying tariffs on even more imports if the Chinese government responded by increasing tariffs on imports of US goods.

The European Union (EU) implemented tariffs on politically targeted US products (like motorcycles and whiskey) in retaliation to US tariffs on steel and aluminium imports from the EU. Subsequently US President Trump threatened to impose tariffs of 20% on imports of cars from the EU *“if these Tariffs and Barriers are not soon broken down and removed”.*

On 14 June (NZT) the FOMC lifted the Federal Funds rate from 1.75% to 2.00%. The increase was the 7th hike in the FOMC’s interest rate tightening cycle. The majority of FOMC voters (8-7) expect to increase the Federal Funds rate by a further two times this year to 2.25–2.50%. This is more “hawkish” than the outlook provided by voters in earlier

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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meetings. Despite this, long term rates ended the month pretty much where they started. The 10-year US Government Bond yield peaked at 3.12% on 18 May, only to dip back below 3% over the following week. The US 10-year Treasury yield remained below 3% through all of June.

The European Central Bank and Bank of England both met in June, and made no changes to their policy settings. Market interest was in any forward guidance for future rate moves. The Bank of England (BoE) decision was 6 to 3 in favour of the status quo (7-2 in May) with BoE Chief Economist Haldane now voting for a further 25bp hike. The BoE also signalled that it won't start reducing its £435bn of asset purchases until the policy rate hits 1.5% (previously 2%). The European Central Bank (ECB) signalled that its policy interest rates will remain at current levels *"at least through the summer of 2019"*. Interest rates are set to remain lower in Europe than the US for a while yet.

The Reserve Bank of New Zealand (RBNZ) held the Official Cash Rate (OCR) steady at its meeting on 28 June, as expected. As a consequence of the weaker activity outlook ASB Economics pushed out its expected timing for OCR hikes by 3 months, with the next hike expected in November 2019. Risks of an OCR cut remain low, but have increased in recent months.

USD strength remained the key theme in currency markets during June, and that was a key factor behind the NZD's dip below 68 US cents. Monetary policy divergence between the US and other economies and elevated trade tensions are both supporting the USD vis-à-vis other currencies (including the NZD).

Date		30-Jun-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	1.94	-0.01	0.02	-0.04	-0.71
Fixed	NZ 5-year gov't stock	2.15	-0.11	-0.14	-0.52	-1.25
Interest	NZ 10-year gov't	2.86	0.14	0.15	-0.12	-1.28
	AUS 10-year gov't	2.65	0.00	0.05	0.05	-1.12
	US 10-year gov't	2.86	0.01	0.12	0.58	0.40
Australasian	NZ - NZX50 Capital (NZ$)	4036	2.9%	6.8%	13.3%	63.5%
	- NZX50 Gross (NZ$)	8943	3.0%	7.5%	17.3%	101.4%
Equities	AUS - All Ords (A$)	6290	2.7%	7.2%	9.1%	31.7%
International	JAP - Nikkei (¥)	22305	0.5%	4.0%	11.3%	63.1%
Equities	UK - FT100 (£)	7637	-0.5%	8.2%	4.4%	22.9%
	US - S&P500 (US$)	2718	0.5%	2.9%	12.2%	69.2%
	WORLD - MSCI (US$)	2089	-0.2%	1.1%	9.0%	45.7%
	MSCI in NZD (NZ$)	3083	2.8%	7.9%	17.9%	67.8%
Exchange	NZD/USD	0.68	-2.9%	-6.4%	-7.5%	-13.1%
Rates	NZD/AUD	0.92	-0.7%	-2.7%	-3.7%	8.9%
	NZD/JPY	74.99	-1.2%	-2.5%	-8.5%	-2.8%
	NZD/GBP	0.52	-1.5%	0.1%	-8.1%	1.1%
	NZD/EUR	0.58	-2.8%	-1.0%	-9.2%	-2.6%
	NZ TWI	72.43	-1.1%	-2.8%	-7.5%	-2.2%
Equity indices are the respective end-of-month closes. Interest rates and exchanges rates are at 5pm NZ.						

Income Assets

Cash

As was widely expected, the RBNZ held the OCR steady at its meeting on 28 June. However, the tone of the RBNZ assessment was more dovish than expected by the market, which in conjunction with soft business confidence data, helped to trigger a late June rally in NZ wholesale interest rates. ASB Economics now think that the OCR will remain at 1.75% until November 2019. Risks of an OCR cut remain low, but have grown recently. OCR settings have been stable over the last decade or so. The OCR has been at 1.75% since the November 2016 cut. Over the March 2011 and March 2014 period, the OCR was left unchanged at 2.5%.

Despite the drift down in domestic wholesale interest rates, deposit rates for all terms were broadly steady in June. This may reflect more demand for funds from local banks. Term deposit rates for amounts over $10K ranged from 2.75% to 4.1% for terms between 90 days and 5 years. Given that OCR moves look some way off, most short-term returns on term deposits are likely to stay near current levels over the year ahead. ASB Economic forecasts have been factoring in some upward pressure on longer term deposit rates over the year from lifting global rates. However, jitters in global financial markets continue to keep influential long-term global interest rates contained.

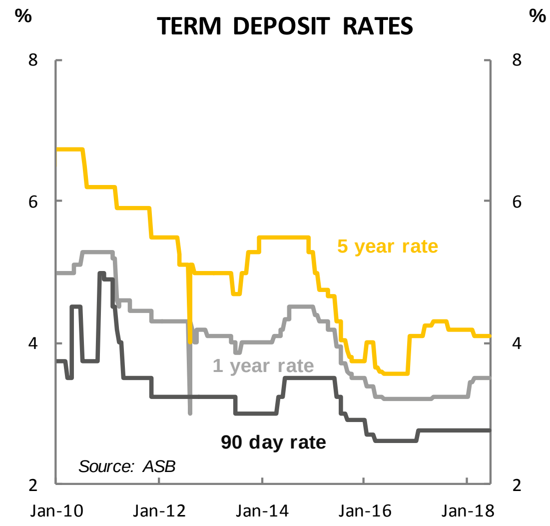
The latest ASB term deposit rates can be found here.

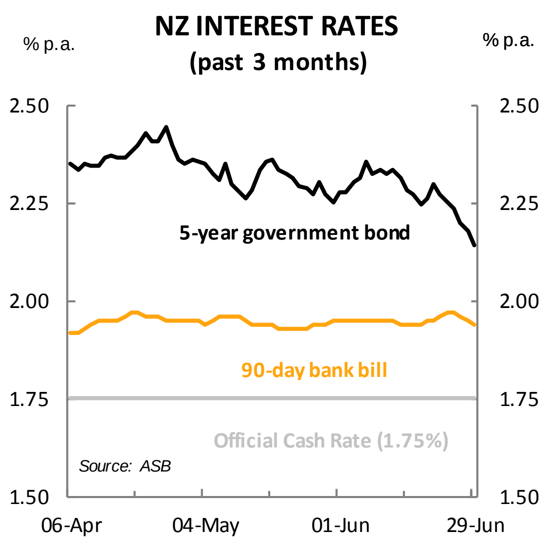
NZ Fixed Interest

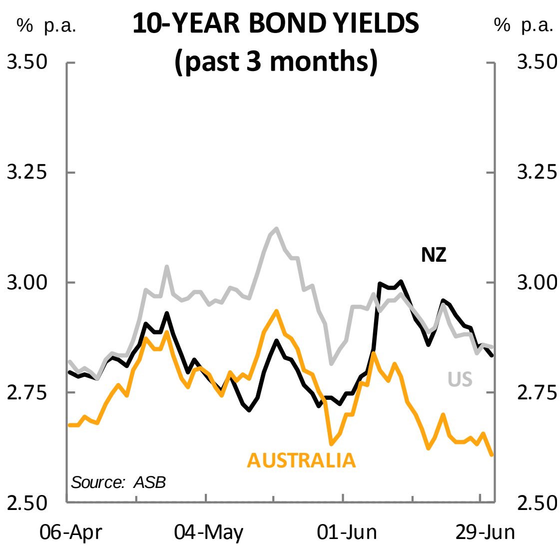
New Zealand Government bonds continued the recent pattern of trading with lower yields than their US counterparts for most maturities. The 5-year government bond yield dipped 11 basis points during the month, and rates for other terms also declined.

Note that the underlying bond used for the New Zealand 10-year benchmark changed during the month (from the bond maturing in April 2027 to the bond maturing in April 2029). This is behind the increase in the 10-year rate shown on the page 1 table. In fact, the yields on both bonds dipped during June (by 11 bps and 7bps respectively).

We continue to expect long-term local bond yields to rise modestly over the year ahead, 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 sharply in the first week of June (yields higher), only to slowly rally back over the rest of the month, with the yield back at 2.86%, only 1 basis point away from where it started. The early June rise in global yields was due to reduced geopolitical risks in Italy and the expectation of further policy tightening from the US FOMC, with the likelihood that the European Central Bank would soon tighten policy.

However, sentiment changed and key global bonds rallied (yields lower) later in the month. The ECB announced the phasing out of bond purchases by the end of 2018, but also committed to keep rates unchanged "until at least summer 2019". Escalating trade tensions during the second half of June also added to the rally in global bonds. Over the course of the month the German 10-year bund yield dipped 8 basis points to 0.30%. The 10-year UK gilt yield lifted early in the month, to trade with a yield around 1.4% on 11/12 June. However, the rally into month-end took the 10-year gilt yield back down to 1.28%, where it was at the start of June.

Growth Assets

Australasian Equities

June was another positive month for the local sharemarket, with the NZX50 Gross Index lifting 3% over the month, to be 17.3% higher over the year. Fletcher Building's share price recovery continued, as investors reacted positively to the recent rights issue and related balance sheet repair. The a2 Milk Company's share price also recovered from its dip in earlier months. Fisher & Pykel Healthcare also performed well in June, with the share price up nearly 14%. But all these stocks trailed Kathmandu holdings, which posted a share price gain just shy of 24% in June. In a company announcement, Kathmandu's Chief Executive Officer Xavier Simonet commented, "Our second half so far has been strong across both Australia and New Zealand" and the company's year to date sales are some 7.7% higher than a year ago.

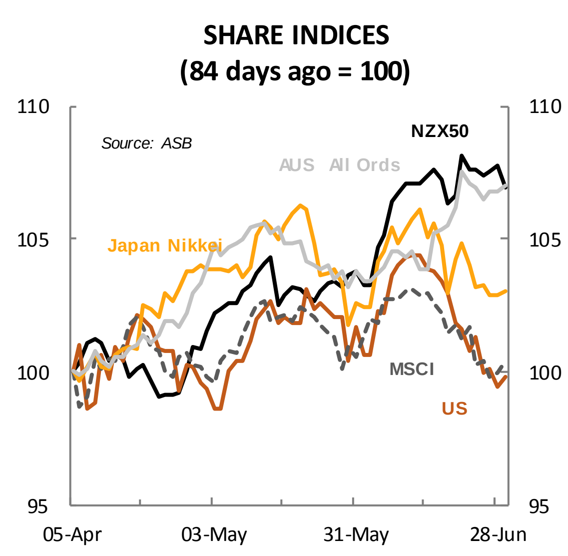
The Australian All Ords share index lifted 2.7% in June, to be up 9.1% on a year ago.

The ASX200 index reached 10½-year highs on 21 June, supported by a number of factors. A weakening Australian dollar, which fell to an 18-month low against the USD (0.7342) was positive for exporter incomes. The paring-back of interest rate expectations pushed bond yields lower, supporting Real Estate Investment Trusts (REITs) and infrastructure shares. The passing of the Turnbull government's income tax cuts plan boosted consumer discretionary stocks. Energy stocks were also supported by rising oil prices. Finally, a recovery in Australian banks' share prices led financial sector equities higher.

International Equities

Global sharemarkets had another mixed month in June. The key political influences were Trump-related, and got more negative as the month progressed. The MSCI world share index peaked on 12 June, and slid 2.6% into month-end. Chinese and emerging market equities were weaker over June, with the Shanghai Composite down 8% over the month.

Over the full month, the US S&P 500 index increased by 0.5% and the tech-heavy Nasdaq lifted 0.9%. In Europe, the German Dax fell by 2.4% and the London FTSE dipped 0.5%. In Japan, the Nikkei index of shares lifted 0.5% over the month, but closed the month nearly 3% below the 12 June peak.



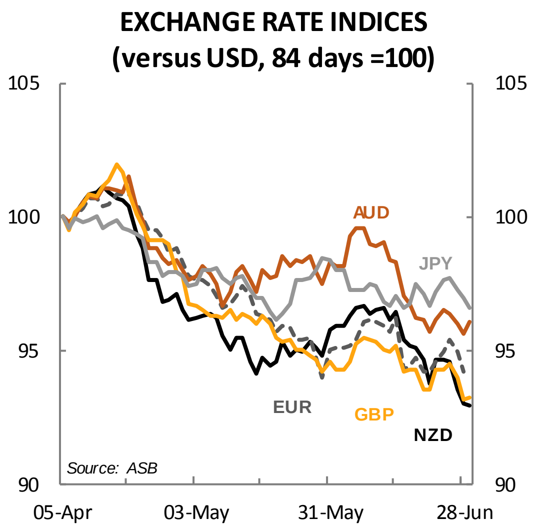
ASB Securities has more information on sharemarkets and trading [here.](#)

Exchange Rates:

USD strength remained the key theme in currency markets during June, and that has seen the NZD dip below 0.68 against the USD recently.

Monetary policy divergence between the US and other economies and the trade tensions are both supporting the USD vis-à-vis other currencies including the NZD. The USD (as measured by the DXY USD index) is trading around 7% above the lows of early 2018.

At the time of writing NZD/USD is trading around 9% below its 2018 peak of 0.7440. The NZD declined by 2.9% against the USD over the month of May, and also weakened against the other major currencies. On a trade-weighted basis the NZD declined 1.1% over the month.



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