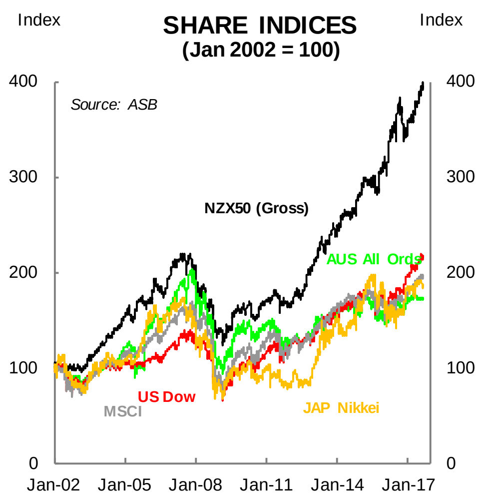
Markets Monthly

05 September 2017

Politics, uncertainty and investments

- US-North Korean tensions returned to rattle confidence in August.
- And here the General Election is a major focus, and it's turning into a much tighter race than expected.
- Despite the uncertainty, sharemarkets both here and abroad continue to be buoyant.

The run up to the 2017 General Election has proved to be far more interesting, and a closer call than what people thought only a couple of months ago. The political polls have been volatile, three political party leaders have stepped down, and a number of outcomes are possible. As the polls currently stand, either the incumbent National Party or the main opposition Labour Party could form a government with the support of the New Zealand First Party. Other combinations are also possible, depending on how well the minor parties fare on voting day. It may take until October 12 until the new government is announced, which could result in a period of uncertainty for markets.



But the reality is that markets always have to deal with uncertainty, and the general election is just one of a huge number of variables that continuously impact the perceived outlook for financial markets. Nonetheless, the election uncertainty has been used as reason for the softness in the housing market, and a number of investors have asked what a change of government would mean for financial markets. **Although investors dislike uncertainty, it's worth remembering that elections come along every three years, and although they can cause some short term volatility, they seldom alter the long-term course of financial markets.** If New Zealand does get a change in government, there will be changes in policy areas that will impact certain sectors. But the strong course the economy has been on will likely continue. That's key for sharemarkets. In the long run, the ups and downs of the New Zealand sharemarket have more to do with the broad economic backdrop and what's going on in global markets than local politics. Reflecting this, the correlation between the New Zealand sharemarket (NZX 50) and global shares (MSCI) in the chart above is 0.91 over the 15-year period, which covers five terms of government, the GFC, and a long period of sharemarket gains both here and abroad.

Addressing the housing market slowdown, we think there is more at play than some pre-election hesitation. For a start it is winter, which is always a slower period for home sales. But in addition, the slowdown reflects the RBNZ's

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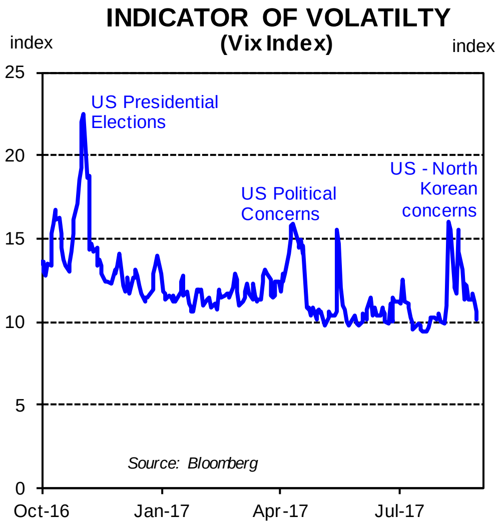
Chris Tennent-Brown – Senior Economist, Wealth (649) 301 5915 chris.tennent-brown@asb.co.nz
Nick Tuffley – Chief Economist (649) 301 5659 nick.tuffley@asb.co.nz

2016 macro-prudential measures, tighter lending policies, earlier lifts in mortgage rates, as well as affordability issues. For more information, the latest ASB Housing Confidence report [is here](#).



Turning offshore, the renewed tensions between North Korea and the US have been a concerning development during August. The US-North Korean situation is the latest of many *"low probability but high consequence"* situations Donald Trump has created during his presidency. These situations are events that are unlikely to occur, but if they do happen will be very negative. A war with North Korea is a key low-probability but high-consequence risk at the moment. When this event most likely passes, the next worry could be another standoff with Mexico over the wall, a return to protectionist trade policies, or any range of things Trump has proposed, but not done yet. And there is always the investigation into Russian influence on the election to add to the list of US dramas.

As you can see on the volatility chart above, market volatility (measured by the [CBOE's VIX index](#)) has picked up in the US as the latest situation unfolded over August, but by no more than when Trump failed to get traction with healthcare, or when the Russian political interference story started getting attention. And volatility at month end is near its lows, and significantly lower than when the market was fretting around the time of the US election last year. **The North Korean concerns did provide a headwind to further global sharemarket gains during August. The MSCI index of global shares dipped 0.1% over the month.** Nonetheless, the US sharemarket and the MSCI World Share indices remain within a percent of their respective all-time highs. Our sharemarket set another record high in August. The Japanese Nikkei share index dipped 1.4% over the month, but remains up 16.3% on a year ago. **Bond yields dipped over the month**, but remain significantly higher than year-ago levels both here and abroad. Bond valuations move in the opposite direction to yield, so the lift in yield over the 12 month period is weighing on annual returns for bond portfolios.

Date	Instrument	31-Aug-17	Month %	Quarter %	Year %	5-Year %
Cash	NZ Official Cash Rate	1.75	0.00	0.00	-0.25	-0.75
	NZ 90-day bank bill	1.96	0.01	-0.01	-0.32	-0.70
Fixed Interest	NZ 5-year gov't stock	2.48	-0.09	0.02	0.65	-0.42
	NZ 10-year gov't	2.90	-0.09	0.12	0.66	-0.61
	AUS 10-year gov't	2.72	0.02	0.33	0.83	-0.33
	US 10-year gov't	2.15	-0.13	-0.07	0.57	0.52
Australasian Equities	NZ - NZX50 Capital (NZ$)	3649.94	1.4%	4.7%	1.3%	70.9%
	- NZX50 Gross (NZ$)	7813.53	1.6%	5.4%	5.9%	113.1%
	AUS - All Ords (A$)	5776.30	0.0%	0.3%	4.5%	33.1%
International Equities	JAP - Nikkei (¥)	19646	-1.4%	0.0%	16.3%	122.2%
	UK - FT100 (£)	7431	0.8%	-1.2%	9.6%	30.1%
	US - S&P500 (US$)	2472	0.1%	2.5%	13.9%	75.7%
	WORLD - MSCI (US$)	1960	-0.1%	2.5%	14.0%	53.2%
	MSCI in NZD (NZ$)	2733	4.6%	1.3%	15.2%	70.7%
Exchange Rates	NZD/USD	0.7171	-4.5%	1.2%	-1.1%	-10.2%
	NZD/AUD	0.9073	-3.5%	-4.5%	-5.8%	16.9%
	NZD/JPY	79.23	-4.5%	0.8%	6.1%	26.5%
	NZD/GBP	0.5546	-3.0%	0.3%	0.3%	9.7%
	NZD/EUR	0.6037	-5.6%	-4.8%	-7.1%	-5.5%
	NZ TWI	75.29	-4.7%	-1.7%	-2.7%	3.4%

Equity indices are the respective end-of-month closes. Interest rates and exchanges rates are at 5pm NZ.

Income Assets

Cash

The RBNZ held its latest review on 10 August, and kept the Official Cash Rate (OCR) at 1.75%, as expected. RBNZ forecasts released in August suggest the RBNZ expects to keep the OCR around the current level (1.75%) until late 2019. We thought that weaker than expected growth and inflation data could prompt the RBNZ to signal a later start to its tightening cycle, but the interest rate outlook was unchanged from earlier forecasts. Like the RBNZ, ASB Economics expect that OCR hikes are a long way off, although our forecast has the first OCR increase pencilled in for the first half of 2019.

Term deposit rates for the popular terms out to 18 months have barely moved in recent months, reflecting the low, stable OCR. Meanwhile, the upward pressure we saw on the longer-term deposit rates earlier in 2017 has eased, and some interest rates dipped modestly in August. Term deposit rates from 2-5 years were reduced by 10bps (0.10%) late in the month.

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 next year. However, banks are continuing to offer higher “specials” on selected term deposit rates.

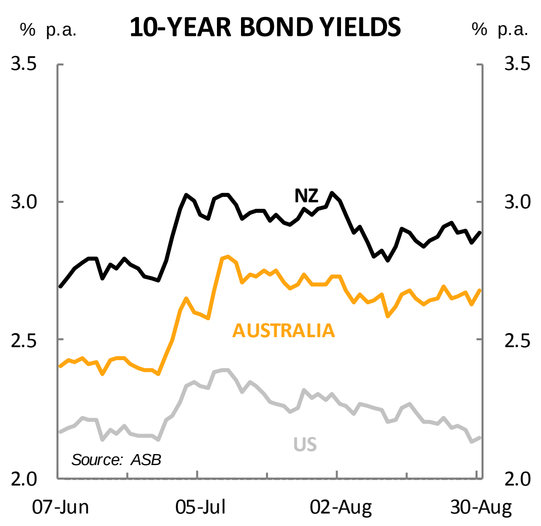
The latest ASB term deposit rates can be found here.

NZ Fixed Interest

NZ Government bond yields fell over the month. The yields on both the 5-year and 10-year bonds were down 9 basis points (bps) or 0.09% over the month, closing at 2.48% and 2.90% respectively. Fixed interest yields remain very low relative to long-run averages, but have lifted off the even lower levels recorded last year. Bond valuations move in the opposite direction to yield, so the lift in yield over the 12 month period is weighing on annual returns for bond portfolios. Bank and corporate bond yields are similarly low relative to historic average levels. During the month ANZ issued a 5-year bond which yielded 3.75%, which is around 0.5% lower than a term deposit with the same institution. The same gap can be observed with other bank bonds and bank term deposits of similar tenure at present.

International Fixed Interest

Offshore, the next Federal Open Market Committee (FOMC) meeting on 20 September is a major focus (there was no meeting in August). The FOMC has signaled the process of selling down its huge holdings of bonds purchased in the wake of the Global Financial Crisis will start “relatively soon”. We expect the specific timing of the sell-down will be announced at the September meeting, but don’t expect any fireworks. FOMC Chair Janet Yellen has already warned markets that the process will be like watching paint dry. Long-term rates remain low in the US, with the 10-year Government bond yield dipping 13bp or 0.13% over August. On top of the Korean concerns, the US Government is only funded through to September 30 (the debt ceiling was reached in March). Once again market participants are beginning to ponder a delay in Treasury bill payments. And if the US politics aren’t enough, Hurricane Harvey adds to the challenges. No wonder US bonds have been rallying harder (yields lower), as shown in the chart opposite.



Growth Assets

Australasian Equities:

The NZX50 index of local shares set further record highs during August. Although the sharemarket dipped over the closing days of the month, the Gross index was still up 1.6% for the month, and 5.9% annually. Profit results in New Zealand, and overall sharemarket performance were mixed over the month. A2 Milk's strong run of gains continued, with the share price setting record highs and gaining nearly 30% over the month. In contrast, Sky TV and Trade Me posted double digit declines. It was a good month for retirement village operators and developers, with Metlifecare, Summerset and Ryman all posting solid gains. The ongoing strength of tourism is a boost for Air New Zealand, which gained 8.2% in August.

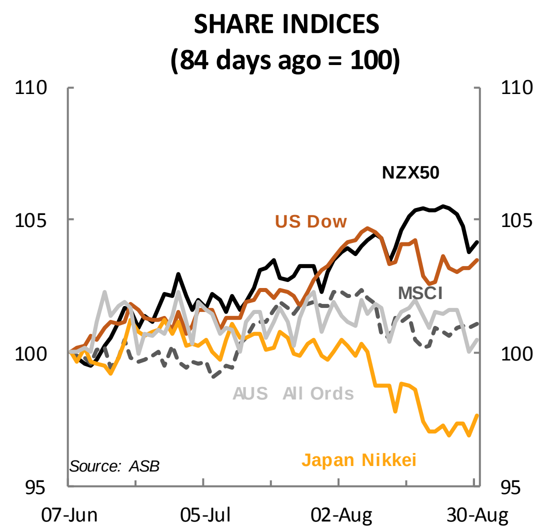
Across the Tasman, the All Ords index of shares was flat over August, to be up 4.5% over the 12-month period. The Australian reporting season dominated investor attention over August. Some 91% of the ASX 200 companies which reported full-year earnings, managed to report a profit, down from 94% in the February 2017 season. Aggregate profits were up by 63% over the year, boosted by BHP, CBA and Telstra's results.

International Equities:

International sharemarkets were mixed in August. Returns ranged from a 1.4% dip for the Nikkei index of Japanese shares, to a 0.8% lift for the UK's FTSE 100 share index. The MSCI index of world shares was down 0.1% in USD terms over the month. The key issues for investors included earnings results, the outlook for US interest rates, ongoing political uncertainty in the US and tensions on the Korean peninsula.

The month actually started positively for shares, and on the data front in the US. The strong start saw the Dow Jones Index set fresh highs. But the abovementioned concerns took their toll over the course of the month, and the US market closed down on that record peak. By month end, the investors were also assessing how the Texan floods could impact stocks. A terror attack in Barcelona added to the concerns, and weighed on European stocks in August.

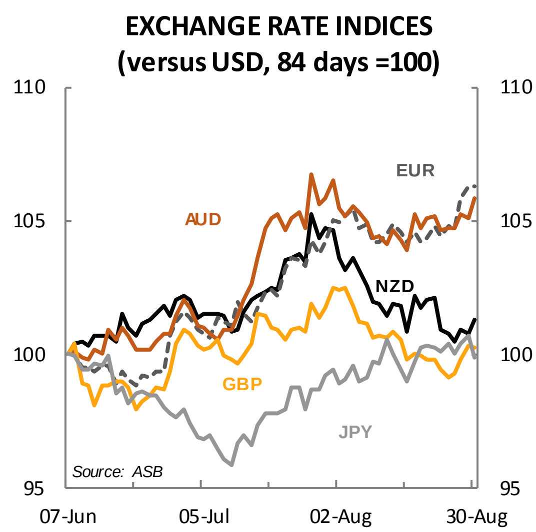
ASB Securities has more information on sharemarkets and trading here.



Exchange Rates:

In July NZD/USD strengthened, and got back above 0.7500 for the first time since early 2015. In August that move reversed, with the currency pair easing 4.5%. The NZD was also weak against the other major currencies, and declined 4.7% on a trade weighted basis. No one factor caused the NZD decline, and the currency slipped fairly steadily over the month. The RBNZ meeting, declining swap rates, Korean concerns, and the upcoming election were all cited as reasons within market commentaries over August.

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



ASB Economics & Research			Phone
Chief Economist	Nick Tuffley	nick.tuffley@asb.co.nz	(649) 301 5659
Senior Economist	Jane Turner	jane.turner@asb.co.nz	(649) 301 5853
Senior Rural Economist	Nathan Penny	nathan.penny@asb.co.nz	(649) 448 8778
Senior Economist, Wealth	Chris Tennent-Brown	chris.tennent-brown@asb.co.nz	(649) 301 5915
Economist	Kim Mundy	kim.mundy@asb.co.nz	(649) 301 5661
Data & Publication Manager	Judith Pinto	judith.pinto@asb.co.nz	(649) 301 5660

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