THE MARKETS ARE NOT THE ECONOMY

The world feels very different to what it was just months ago. And although we are very privileged in New Zealand to be sitting closer to the 'normal' end of the spectrum, almost everyone we know has had their lives influenced by this virus. In fact, it was not until March that some of us had even heard the word "staycation" to describe an exotic holiday taken…at home.

We know people in Australia that routinely travel 150 days in a year, who have been homebound for months. We know others in Europe that are working from home now as a way of life and cannot foresee when that will change. We hear stories from people in the United States who report that the most common vehicles on the roads these days are delivery trucks.

With this shifting landscape in mind, it should not be surprising that some companies have prospered during this upheaval while others - especially travel-related firms like Air New Zealand - have struggled. From its record high on 21 February 2020, the NZX 50 fell 29.6% in less than five weeks, as the news headlines grew more and more concerning. But the recovery was swift as well. From its low on 23 March, the NZX 50 Index jumped 13.3% in just three trading sessions, one of the fastest momentum swings ever. As at 1 October, the NZX50 Index had recovered to about 99% of its record high.

Many individuals are puzzled by this turn of events. For those under the age of 75, the news headlines are likely the grimmest in memory. Thousands have found themselves suddenly unemployed or only employed by virtue of an emergency government package. The International Monetary Fund[1] projects that unemployment will approach 10%. In the United States, famous retailers such as Neiman Marcus and JC Penney have entered bankruptcy proceedings, yet share prices in the US have recovered just as strongly as New Zealand and they are still in the midst of uncontrolled community transmission of this deadly virus.

How can share prices be close to new highs when the news is so discouraging? The New York Times observed that the stock market "***looks increasingly divorced from economic reality***."[2]

[1] https://www.ceicdata.com/en/indicator/new-zealand/forecast-unemployment-rate

[2] https://www.nytimes.com/2020/05/10/business/stock-market-economy-coronavirus.html

The stock market is a mechanism for combining opinions from millions of global investors and reflecting them in prices they are willing to accept, when buying or selling fractional ownership of a company. Share prices represent a claim on all future earnings and dividends. As a result, current prices incorporate not only an assessment of recent events, <u>but also</u> those anticipated to occur in the distant future. In some sense, the share market has always been divorced from reality, since its job is not to report today's temperature, but what investors think it will be next year, and the year after that, and the year after that, and so on.

That's a difficult job. The fact that it's so difficult is the reason share prices go up and down so much when new and unanticipated information hits the markets.

It's also true that the universe of shares does not march in lockstep. At any point in time, some firms are soaring while others are crashing. This year's wrenching economic turmoil has inflicted great hardship on some firms while opening new opportunities for others (such as health care and electronic retail firms). Below we show the 12 month returns, to 30 September 2020, of the best and worst NZX 50 performers. Based on this admittedly abbreviated list, it appears the share market is doing just what we would expect - reflecting new information in share prices.

Company	Sector	Market cap 2020 ($m)	Growth year to date (to 30 Sep)
Top 5 performers:			
Pushpay Holdings Ltd	IT	$2,440	166.10%
FP Healthcare Corp Ltd	Healthcare	$19,165	90.20%
Chorus Ltd (NS)	Telecommunication	$3,849	71.10%
Investore Property Ltd (NS)	Real estate	$814	62.90%
Summerset Group Holdings Ltd	Healthcare	$2,057	36.00%
Bottom 5 performers:			
Z Energy Ltd	Energy	$1,425	-35.80%
ANZ Banking Group Ltd	Financials	$52,980	-39.30%
Synlait Milk Ltd (NS)	Consumer staples	$983	-40.40%
Westpac Banking Corporation	Financials	$65,660	-41.00%
Air New Zealand Ltd (NS)	Industrials	$1,538	-51.80%

No one could have predicted the tumult we have seen this year in financial markets. Investors would do well to ***focus on what has NOT changed***:

Markets are forward-looking, so focusing on today's economic data is akin to looking in the rear view mirror rather than at the road ahead.

Broad diversification makes it more likely that investors capture market returns that are there for the taking - including companies that do far better than expected.

News is unpredictable, so a strategy designed to weather both expected and unexpected events will likely prove less stressful and easier to stick with.

Bottom line = read the newspaper to be an informed citizen, not for advice on how to navigate the financial markets!