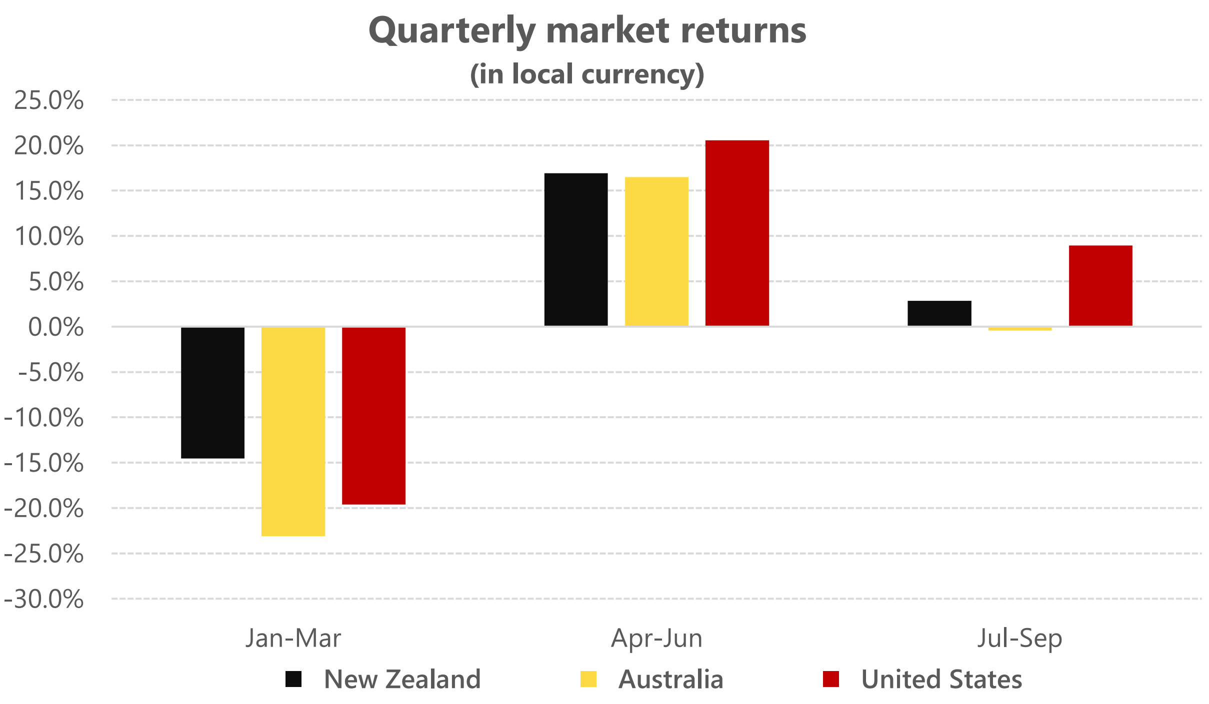
Market Commentary

The year to date can clearly be broken into three very distinct and different quarters. After the outsized market movement downward (January to March) and back up again (April to June), the July to September quarter generally delivered more modest returns.

We get a sense of this from looking at the chart below, which highlights the quarterly market returns so far in 2020 of the New Zealand, Australian and US share markets.



The above graph highlights major index returns in their local currency. The respective indices used were: New Zealand (S&P/NZX 50 Index (gross with imputation), Australia (S&P/ASX 200 Index total return), United States (S&P 500 Index)

Source: Dimensional Returns 2.0

This is again a reminder of the contradiction that exists between real world data and market performance. We are all aware of the extraordinary impact that Covid-19 had on the world during the first quarter. With Covid-related fears reaching panic levels in late March, we saw a synchronised sell-off in global share markets unlike any other.

But look at what has happened since. Share markets have changed course. In many ways that too seems equally extraordinary. After all, Covid-19 has not been defeated. A vaccine remains elusive. Covid 'second waves' are being experienced by many countries, and reports of job losses are still consuming significantly more column inches than stories of job gains. International travel remains impractical for many, and numerous firms (if not industries), have yet to demonstrate they will adequately be able to cope when the wage subsidies and other central support packages run their course.

To the everyday person on the street, this does not paint an overly optimistic picture. Which brings us back to the chart above. Share markets are clearly not looking at what is going on in the world today, they are relentlessly looking into the future.

Share prices today are based on aggregate investor perceptions of each company's asset base and growth opportunities in the months and years ahead, with that projected growth being discounted back to a present-day valuation. In other words, share prices *today* represent the market's collective expectation of the *future*. And in that future, many of the issues we still see around us today may not even exist, including (we hope) Covid-19.

In contrast, many of the economic statistics used to try and help us quantify and understand the state of the world today (like GDP growth rates and unemployment figures) are backward looking. They are often calculated with a time lag of several weeks or months (meaning we generally don't find out this information until some considerable time *after* the fact). Even then, the data typically contains some degree of measurement error. It's therefore no surprise that a forward-looking share market can occasionally sprint ahead of our best understanding of the 'current' economic situation.

In what has already been a turbulent year, in many ways the most constructive thing we can do is shake our heads at what has happened around the globe, be grateful we live in New Zealand, and focus on the things that we can reasonably control. In the context of a long-term savings and retirement plan, that might mean reviewing or updating our short, medium and long-term goals and objectives. Alternatively, it might mean reviewing our budget or our savings plan; it might even mean reviewing our preferred investment risk settings.

We can, and should, focus on these things, because that's what will have the biggest positive impact on the outcomes most important to us individually. Of course, we should also exercise personal care and responsibility. But, when it comes to the big issues, we must exercise patience, and have a little bit of faith that sustainable solutions will be found. After all, we have governments wrestling with how to keep people safe, we have central banks trying to keep economies functioning and we have pharmaceutical firms trying to find Covid vaccines.

2020 has already delivered a resounding reminder that the interrelated world of markets, economics, health and politics reflects an incredibly complex and ever-evolving system. While that's part of what makes forecasting so difficult, we are thankfully aware of our limitations.

We know we can't predict how Covid-19 will eventually be contained or controlled. We can't predict how investment markets may perform over any short-term horizon. We certainly can't predict what new information or unforeseen events may emerge tomorrow to change how we think and act today. Without a crystal clear view of the future we simply don't know how the current, complex, issues of the day will all eventually be resolved. But not knowing, doesn't mean it won't happen.

This is where the aggregate information contained in markets today might at least be a source of some reassurance. If the relative strength of the share market today is any guide, business is not expected to go out of business. In contrast to the challenging economic environment we still see around us today, the share market appears to be pricing in far more promising times ahead.

Key Market Movements
for the six-month period ending 30 September 2020

The last six months continued with heightened levels of uncertainty and volatility across markets, albeit significantly reduced from levels experienced at the start of the year. There was a wide dispersion of returns across nations, industries and asset classes as capital markets continued to price in changing prospects at a global level, as well as the potential firm specific ramifications.

In 2020 we have been reminded to expect the unexpected and with Covid-19 still impacting all nations and economies, uncertainty and volatility will likely remain heightened for some time. Below are summaries of the various investment asset classes, together with a breakdown of historical market returns.

International Shares

International shares were strong over the period, although this was not consistent across all markets. The US market was very strong, as accommodative economic policy from the central bank continued to support businesses through the Covid-induced recession. A positive factor for the US was its share market composition, which includes a higher than average allocation to technology companies which have been relative beneficiaries of the Covid-19 crisis.

In Europe, performance was more varied. In aggregate, the region was up 15% for the June quarter while flat for the September quarter. Covid-19 infection rates rose sharply in some nations and the rate of economic recovery was not as rapid as that observed across the Atlantic.

Britain continued to struggle, with infection rates remaining high and the tightening of social restrictions impacting economic activity. Risks of a messy Brexit were again raised, as the end of year deadline for new rules regarding the UK-EU relationship approaches, with seemingly little progress made.

Emerging Markets Shares

The emerging markets asset class led the way over the period, albeit in the face of increasing infection rates in many emerging nations such as Brazil and India.

Chinese, Taiwanese and South Korean equities were among the best performers, as the technology heavy composition of these markets has meant they have been relative beneficiaries of this crisis.

Geopolitical issues were still prevalent. There remains ongoing US-China tension (including President Trump banning US firms from doing business with TikTok, and continuing to blame China for the pandemic), and the May/June Himalayan border dispute between China and India remains unresolved.

Weakness in oil prices stymied returns from significant oil exporting economies such as Russia and Brazil.

New Zealand Shares

Despite the New Zealand stock exchange suffering persistent interruptions from cyberattacks, our domestic equity market delivered strong returns, including the largest quarterly gain since 1998 (gaining 16.9% in the June quarter).

In contrast to the first two quarters of the year, it was the small and mid-cap firms that outperformed while the two largest names faltered. a2 Milk fell by over -20% through the September quarter as an earnings update saw a downward revision in earnings due to disruption in direct to visitor sales due to the border closure.

Fisher & Paykel has seen increased demand for their breathing aids helping the company's share price soar through the crisis.

The delay in the New Zealand election continued to mean an ongoing lack of clarity for the future of the Tiwai Point aluminium smelter, and the potential for this large consumer of electricity to remain operational for longer helped support the utilities sector (Meridian, Mercury and Contact).

Tourism related firms Tourism Holdings, Auckland Airport and Air New Zealand have bounced back significantly following relaxing of lockdown restrictions for kiwis after a horrendous start to the year.

The Reserve Bank of New Zealand's (RBNZ) signalling of a likely reduction in interest rates (and therefore borrowing costs) supported the property market and the listed New Zealand real estate companies enjoyed a strong last quarter after lagging through the first two.

Australian Shares

After leading the recovery during the June quarter, the Australian share market was subdued with the S&P/ASX 200 returning -0.4% in Australian dollar terms, leaving its year to date performance at -10.8%. Small capitalisation companies outperformed their larger counterparts.

The financial sector was weak while the materials sector was mixed with a strong rebound to June and then mostly flat. Fortescue Metals Group was a highlight thanks in part to strong demand for their iron ore from Chinese steel makers.

Melbourne was forced to endure a fresh round of prolonged lock down measures following a second Covid-19 outbreak. In part, this would have contributed to strength in the consumer discretionary sector, with Domino's Pizza, JB Hi Fi and Harvey Norman enjoying a good period.

Returns to New Zealand investors were enhanced by a relatively strong Australian dollar over the quarter.

International Fixed Interest

The international fixed interest market was relatively quiet with central bank support holding yields at or near zero and stable. This was achieved by continuing to provide liquidity through asset purchasing programmes. This low interest rate environment is expected to continue for many years as reflected in 10-year Government bond rates of just 0.68%.

Corporate bonds had a strong period of recovery, with increased economic activity and central bank support reducing earlier fears of widespread corporate defaults.

In aggregate, corporate bonds outperformed higher quality sovereign bonds, and longer duration bonds outperformed shorter duration.

New Zealand Fixed Interest

The New Zealand fixed interest market delivered more price action than was generally seen in global markets, with the 10 year New Zealand government bond yield pushing lower to close the period at 0.53%, after moving as low as 0.51% and as high as 0.96%.

Although the Official Cash Rate (OCR) was held at 0.25%, these OCR announcements were accompanied by strong signals from the RBNZ of interest rate reductions in the short to medium term. The RBNZ has also significantly expanded their Large Scale Asset Purchase programmes with a commitment to purchase up to $60b of NZ Government Bonds, Local Authority Funding Agency Bonds and now, Government Inflation Linked Bonds on the secondary market.

Asset Class Returns to 30 September 2020

Asset Class	Index Name	3 months	6 months	1 year	3 years	5 years	10 years
New Zealand shares	S&P/NZX 50 Index, (gross with imputation credits)	+2.9%	+20.3%	+8.3%	+15.0%	+17.2%	+15.3%
Australian shares	S&P/ASX 200 Index (total return)	+0.8%	+21.8%	-9.8%	+4.7%	+7.0%	+4.8%
International shares	MSCI World ex Australia Index (net div., hedged to NZD)	+6.6%	+26.1%	+7.2%	+7.4%	+10.8%	+11.5%
	MSCI World ex Australia Index (net div.)	+5.4%	+16.1%	+4.9%	+11.1%	+9.8%	+10.7%
Emerging markets shares	MSCI Emerging Markets Index (gross div.)	+7.0%	+16.9%	+5.0%	+5.8%	+8.6%	+3.9%
New Zealand fixed interest	S&P/NZX A-Grade Corporate Bond Index	+1.7%	+5.2%	+5.3%	+5.9%	+5.2%	+5.7%
International fixed interest	FTSE World Government Bond Index 1-5 Years (hedged to NZD)	+0.2%	+0.8%	+3.1%	+2.8%	+2.9%	+3.6%
New Zealand cash	New Zealand One-Month Bank Bill Yields Index	+0.1%	+0.1%	+0.7%	+1.4%	+1.7%	+2.3%

Unless otherwise specified, all returns are expressed in NZD. We assume Australian shares and emerging market shares are invested on an unhedged basis, and therefore returns from these asset classes are susceptible to movement in the value of the NZD. Index returns are before all costs and tax. Returns are annualised for time periods greater than one year.