



Tactical Thoughts – September 2019

Equity markets recoiled in August as President Trump left investors across the globe wondering what his next move would be. The MSCI World Index fell -2.2% on the month as the trade tensions rose to a new high with China retaliating against US measures while at the same time the new British Prime Minister, Boris Johnson, proposed suspending the UK Parliament as he paves the way for the possibility of a no-deal Brexit.

On our shores, headline business confidence tumbled again in August with a net 52% of respondents reporting that they expect general conditions to deteriorate in the year ahead, the worst result since April 2008. Employment, investment and export intentions all fell to 'dismal levels' according to ANZ's monthly Business Outlook survey. The NZ dollar weakened almost -4% against the US dollar over the course of the month. Despite this, exporters remain increasingly nervous and may not be capitalising on the more favourable exchange rate.

The outlook for the local economy appears to be deteriorating despite easier monetary conditions, supportive commodity prices and currency tailwinds. With the recent bout of nervousness, many local investors seem to have forgotten that the NZ equity market has had an incredibly strong run so far this year. The benchmark NZX 50 Gross Index is up +22.1% to the end of August but the risk now is that negative sentiment starts to feed on itself. The decline in inflation expectations from 1.8% last month to 1.7% will be of particular concern to the Reserve Bank Governor. The corporate earnings season has come to a close on what has been somewhat of a mixed bag. We liked the results from the gentailers, property companies and infrastructure owners but commodity and primary producers such as Fonterra, NZ King Salmon and even market darling, a2 Milk, undershot expectations.

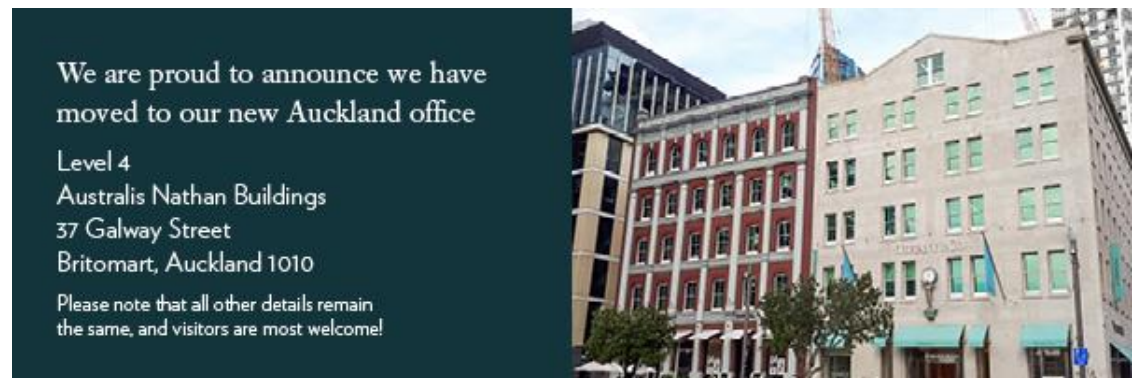
The end of August also marked the end of the Australian 2019 reporting season. According to Macquarie, there were more misses than beats within their research coverage universe. Capital management was again a prevalent theme and understandably popular with investors, especially following significant falls in term deposit rates over the past year. The miners (mainly the iron ore producers) reported profit growth in August but nevertheless sold off due to heightened nervousness among investors. Retailers reported pleasingly better than expected results, bucking concerns over slowing property prices eroding household wealth. In the words of the Reserve Bank of Australia, "there are some signs of a turnaround" in new data on home loans and house prices.

North American equities closed out their first monthly decline since May, as consumer sentiment slid and a tariff deadline in the US-China trade war loomed. The benchmark S&P 500 had a tumultuous month finishing August -1.8% as concerns over the US yield curve inverting which sparked fears a recession might be around the corner. Data on the world's largest economy showed personal spending accelerated in July, exceeding forecasts. Household consumption remains solid but the Federal Reserve's preferred measure of underlying inflation continues to fall short of its goal. The Fed is likely to remain cautious particularly as President Trump continues to goad Jerome Powell, demanding he reduces the benchmark rate further.

We maintain our positive view on US equities, in particular large caps on the back of encouraging fundamentals. We think there is upside for the S&P 500 which is likely to be driven by earnings growth and a rebound in valuation support.










Turmoil continues in Europe and the British pound seems to bear most of the brunt. The currency slipped as lawmakers lost a bid to block Prime Minister Boris Johnson's plan to suspend parliament. The Euro also dropped below US\$1.10 for the first time since May 2017 as traders closed out their positions at month's end and data showed inflation remained stubbornly low. Asian markets also struggled in August as there seems to be no end to the trade tensions in sight.

September 1 marks the opening of the new Hobson Wealth office and our fabulous new workspace at the Australis Nathan Buildings, 37 Galway Street in Auckland. If you're at Britomart, please stop by to see your adviser who can show you around.



Recommended Tactical Asset Allocation

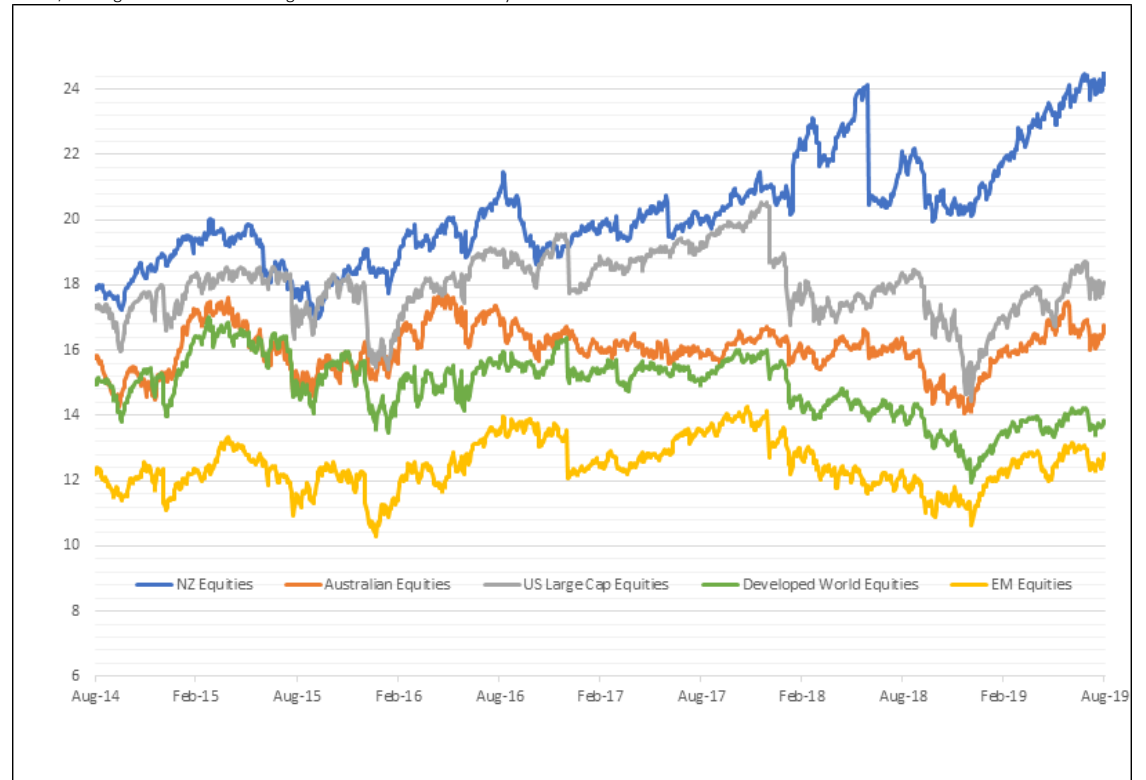
Underweight  Overweight

Asset Class	Tactical	Rationale
NZ Equities		While earnings season produced mixed results, valuations remain stretched. We continue to like the yield story so remain Neutral. The RBNZ's 50bp cut and possibility of more, reinforces this view.
Australian Equities		While the Morrison government has bought with it some positives, we still perceive the Australian economy to be muddling along so have opted to remain Moderately Underweight.
US Large Cap Equities		US corporate earnings growth is likely to remain resilient. While arguably late in the cycle, we still see a supportive back-drop for large cap equities.
US Small Cap Equities		Fundamentals in the US remain encouraging but we feel small caps may continue to lag large caps in terms of performance, hence we downgrade to Neutral.
Developed World Equities		As the possibility of a no-deal Brexit looms, we stay Underweight Europe and the UK. Japanese equities have suffered from trade tensions.
EM Equities		China's decision to retaliate against increasing tariffs and the deteriorating situation in Hong Kong sees us reduce our call on Emerging Markets to Neutral.
NZ Listed Property		Revaluation gains, tight occupancy and lower debt servicing costs underpin our robust view on NZ listed property.
Fixed Interest		While we value bonds for all client portfolios, we favour new issuance. We are forced to look further afield for ways to mitigate declining bond yields.
Cash		With the RBNZ continuing to lower the OCR we see little benefit in holding large quantities of cash.

Market Price Earnings ratios

Price Earnings ratios 2014 – 2019*

*Price/Earnings Ratios are Bloomberg Best estimates for forecast year one.



Price Earnings ratios versus average*

Price Earnings*	NZ Equities	Australian Equities	US Large Cap Equities	US Small Cap Equities	Developed World	EM Equities
As at 31 August	24.6	16.7	18.1	26.5	13.8	12.8
10-year average	17.9	15.1	16.3	25.8	14.0	12.0
5-year average	20.2	16.0	18.0	26.7	14.9	12.5

*Price Earnings ratios are Bloomberg Best estimates for forecast year one.

FX Returns to 31 August 2019

NZ\$ FX performance percentage returns to 31 August 2019

Currency Pair	1m	3m	6m	12m
NZ\$/ US\$	-3.5%	-3.1%	-7.0%	-4.4%
NZ\$/ AU\$	-1.9%	-0.3%	-2.1%	2.1%

Source: Eikon, Bloomberg, August 2019.

Index Returns to 31 August 2019

Index percentage returns in their currency

Asset Class	Index		1m	3m	6m	12m
NZ Equities	S&P/NZX 50 Gross	NZ\$	-0.9	6.3	15.4	15.5
Australian Equities	S&P/ASX Accumulation 200	AU\$	-2.4	4.2	9.3	9.0
US Large Cap Equities	Russell 1000 Total Return	US\$	-1.8	6.7	5.7	2.5
US Small Cap Equities	Russell 2000 Total Return	US\$	-4.9	2.4	-4.4	-12.9
Developed World Equities	MSCI EAFE*	US\$	-2.9	1.4	-1.7	-6.1
EM Equities	MSCI EM*	US\$	-5.1	-1.4	-6.3	-6.8
NZ Listed Property	S&P/NZX Property Gross	NZ\$	3.2	12.9	25.3	35.3
Fixed Interest	S&P/NZX Corporate A	NZ\$	1.5	3.0	5.4	7.9
Cash	ANZ New Zealand Call Rate	NZ\$	0.1	0.3	0.8	1.7

Source: Eikon, Bloomberg, August 2019 (*not total return index).

Index percentage returns translated into NZ\$

Asset Class	Index		1m	3m	6m	12m
NZ Equities	S&P/NZX 50 Gross		-0.9	6.3	15.4	15.5
Australian Equities	S&P/ASX Accumulation 200		0.0	5.0	12.1	7.3
US Large Cap Equities	Russell 1000 Total Return		2.8	10.7	14.4	7.7
US Small Cap Equities	Russell 2000 Total Return		-0.4	6.3	3.4	-8.5
Developed World Equities	MSCI EAFE*		1.7	5.2	6.4	-1.3
EM Equities	MSCI EM*		-0.6	2.4	1.3	-2.0
NZ Listed Property	S&P/NZX All Real Estate		3.2	12.9	25.3	35.3
Fixed Interest	S&P/NZX Corporate A		1.5	3.0	5.4	7.9
Cash	ANZ New Zealand Call Rate		0.1	0.3	0.8	1.7

Source: Eikon, Bloomberg, August 2019 (*not total return index).

Macquarie Interest Rate and FX Forecasts

Rate	2Q2019A	3Q2019E	4Q2019E	1Q2020E	2Q2020E
Australia Cash Rate	1.00	1.00	0.50	0.50	0.50
Australia 10yr govt	1.32	1.05	1.10	1.20	1.25
US Fed Funds Rate	2.00	1.75	1.50	1.50	1.50
US 10yr Treasury	2.01	1.80	2.00	2.20	2.20
NZD OCR	1.00	1.00	1.00	1.00	1.00
NZ 10yr govt	1.57	1.65	1.65	1.65	1.65
NZ\$/ US\$	0.6718	0.6400	0.6400	0.6500	0.6600
AU\$/ US\$	0.7020	0.6800	0.6900	0.7000	0.7100
NZ\$/ AU\$	0.9570	0.9412	0.9275	0.9286	0.9296
EUR/ US\$	1.1373	1.1200	1.1300	1.1500	1.1600
US\$/ JPY	107.85	104.00	103.00	102.00	100.00
GBP/ US\$	1.2696	1.2400	1.2500	1.2800	1.3100

Source: Macquarie Securities, August 2019.

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