Tactical Thoughts – May 2020

The month of May saw equity markets continue to rebound. The impact of the Covid-19 pandemic still dominated headlines, but markets re-rated as investors reacted positively to stimulus and begin positioning for the recovery as the global economy emerges from lockdown.

The NZX50 extended its April gains with a +3.3% return as the country moved to Level 2. The Reserve Bank of New Zealand expanded its government bond purchase programme to up to $60bn from $33bn as previously announced and held the cash rate at 0.25%. The government established a $50bn Covid-19 recovery fund in the 2020 budget released on 14th May, with a focus on areas of the economy that have been impacted the most.

Australian shares continued to rebound with the ASX 200 Accumulation Index up +4.4%, +30% higher than the March 23rd low, but still 20% off February's high. Gains have been driven by multiple expansion, as investors react to stimulus measures and position for the recovery. Gold and technology outperformed in May while defensive sectors, health care and staples, lagged as investors rotated into cyclicals.

Many states in the US began some level of reopening, though the daily infection rate has only fallen to around 65% of the peak infection rate from mid-April. The S&P 500 climbed to end the month +4.8% higher and is now only 10% from its February peak. While US small caps rallied notably in May we have seen continued leadership from large cap growth stocks particularly technology companies despite the Covid-19 pandemic.

US corporate earnings reports for the first quarter of 2020 finished in May and confirmed that earnings contracted by around 14% compared to the first quarter of 2019. Defensive sectors such as consumer staples, utilities and health care were more resilient and had positive earnings growth. High demand for technology driven by people working from home helped to keep earnings in the IT sector robust. Financials, energy, and consumer discretionary have been hit the hardest.

European equity markets rallied strongly for a consecutive month as countries across the region began easing lockdown measures. The infection rate across the major European economies has fallen significantly, though the infection rate in the UK remains high relative to its European peers. Much of the investor focus in Europe has been over a European Union (EU) wide recovery plan. The plan would allow the European Commission to borrow EUR 750bn which is equivalent to around 5.4% of EU GDP.

The number of reported cases in some parts of Asia has been trending down and economies are reopening, particularly in China and South Korea. High levels of testing and contact tracing have been a key feature of their exit strategies. Falling cases in Japan are also a positive for the region. Asian equity market performance was mixed in May as US-China tensions re-escalated. A large increase in cases in India and Brazil have put pressure on their economies and weighed down returns from Emerging Market equities. To soften the impact of Covid-19, interest rates were cut in several countries, including Brazil, Mexico, India, and South Africa. Commodity prices bounced back somewhat, led by energy prices, with gold and silver also recording gains.

While global markets have rallied from their late March lows it remains unclear whether this is a bear market rally or the beginning of a new bull run. Investors' focus has shifted towards how successfully countries will be with their lockdown exit strategies. Central banks and governments have so far helped cushion the blow to the global economy, but success will be measured by the extent to which companies avoid solvency problems and workers return to employment. New Zealand has had relative success but internationally the picture is less than clear. There has been some positive news on a potential vaccine, but it is still too early to say with confidence how the public health outlook will evolve. **We continue to favour a 'quality' approach within both fixed interest and equities** with a focus on companies with strong balance sheets that benefit from an improvement in the outlook but could also survive if the health situation deteriorates.

Recommended Tactical Asset Allocation

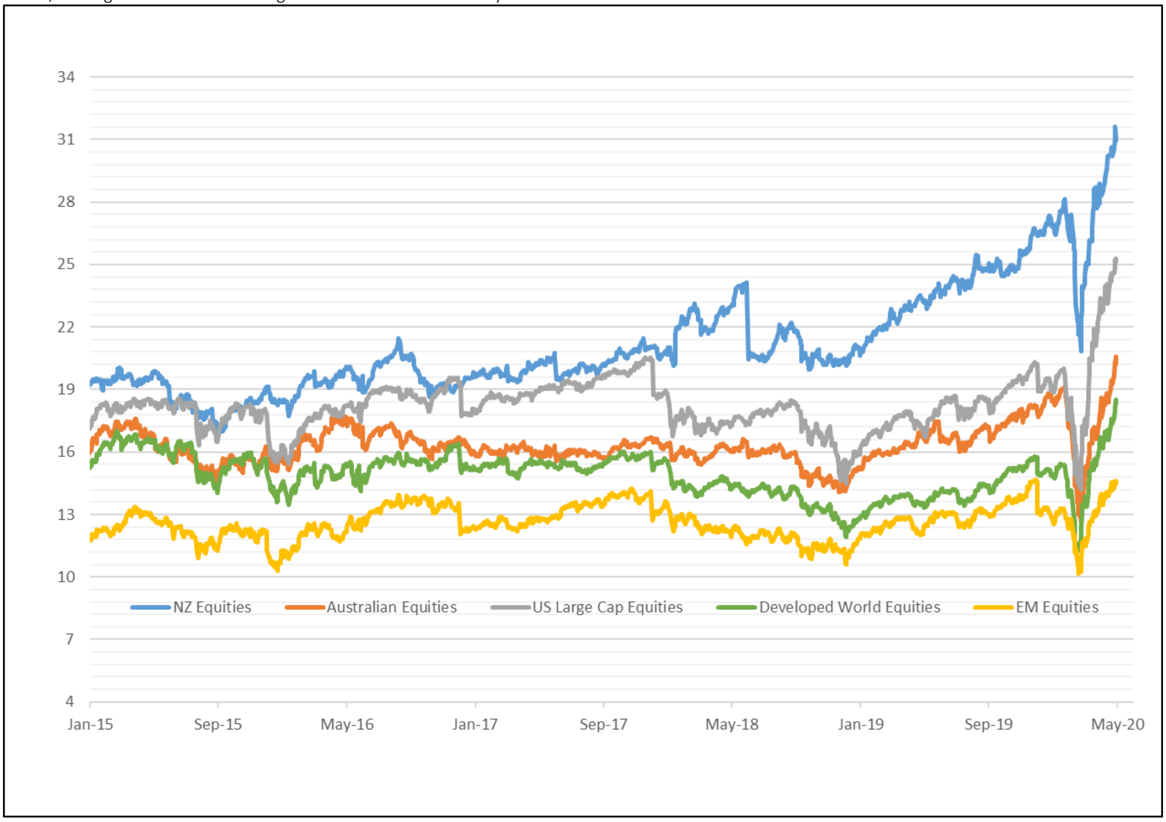
Underweight □□■□□ **Overweight**

Asset Class	Tactical	Rationale
NZ Equities	□□■□□	While NZ comes out of the health aspect of Covid-19 in good shape, we stay cautiously Neutral given the economic impact yet to play out.
Australian Equities	□■□□□	Australia has also fared well under lockdown measures and we move to Moderately Underweight. We prefer growth or yield sensitive parts of the market.
US Large Cap Equities	□□□■□	We expect continued leadership in US equities from a concentrated number of secular growth large caps.
US Small Cap Equities	■□□□□	US small caps to continue underperform their large cap peers over the mid to long term and we do not see this changing hence remain Underweight.
Developed World Equities	□■□□□	Developed markets in Europe and Japan continue to battle Covid-19 but the outlook is gradually improving. We move to Moderately Underweight.
EM Equities	□□■□□	We expect earnings to largely be flat in EM and continue to prefer Chinese stocks as authorities there have sufficient policy tools to support the economy.
NZ Listed Property	□□■□□	We upweight Listed property to Neutral. Rent relief seems to have been largely quantified, balance sheets have been shored up and people are returning to work. Low interest rates are a further tailwind.
Fixed Interest	□□■□□	Fixed Interest remains a core component to downside protection, but lower for longer interest rates have now been largely priced in.
Cash	□□■■□	We continue to upweight Cash to build reserves to take advantage of future opportunities.

Market Price Earnings ratios

Price Earnings ratios 2015 – 2020*

*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 May	30.9	20.2	25.3	73.9	18.3	14.6
10-year average	18.7	15.1	16.6	25.4	14.0	11.9
5-year average	21.3	16.3	18.3	27.6	14.8	12.6

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

FX Returns to 31 May 2020

NZ$ FX performance percentage returns to 31 May 2020

Currency Pair	1m	3m	6m	12m
NZ$/ US$	1.3%	-0.7%	-3.4%	-5.0%
NZ$/ AU$	-1.1%	-3.0%	-2.0%	-1.3%

Source: Eikon, Bloomberg, May 2020.

Index Returns to 31 May 2020

Index percentage returns in their currency

Asset Class	Index		1m	3m	6m	12m
NZ Equities	S&P/NZX 50 Gross	NZ$	3.3	-3.4	-3.8	7.6
Australian Equities	S&P/ASX Accumulation 200	AU$	4.4	-9.9	-14.6	-6.7
US Large Cap Equities	Russell 1000 Total Return	US$	5.3	3.4	-2.2	12.5
US Small Cap Equities	Russell 2000 Total Return	US$	6.5	-5.2	-13.5	-3.4
Developed World Equities	MSCI EAFE*	US$	4.1	-4.7	-12.6	-5.1
EM Equities	MSCI EM*	US$	0.6	-7.5	-10.5	-6.8
NZ Listed Property	S&P/NZX Property Gross	NZ$	3.1	-15.3	-12.7	-2.7
Fixed Interest	S&P/NZX Corporate A	NZ$	0.8	2.4	3.9	6.3
Cash	ANZ New Zealand Call Rate	NZ$	0.0	0.1	0.3	0.9

Source: Eikon, Bloomberg, May 2020 (*not total return index).

Index percentage returns translated into NZ$

Asset Class	Index	1m	3m	6m	12m
NZ Equities	S&P/NZX 50 Gross	3.3	-3.4	-3.8	7.6
Australian Equities	S&P/ASX Accumulation 200	5.5	-7.2	-13.0	-5.6
US Large Cap Equities	Russell 1000 Total Return	4.5	4.2	1.5	18.8
US Small Cap Equities	Russell 2000 Total Return	5.8	-4.5	-10.3	1.9
Developed World Equities	MSCI EAFE*	3.3	-4.0	-9.3	0.2
EM Equities	MSCI EM*	-0.1	-6.8	-7.2	-1.6
NZ Listed Property	S&P/NZX All Real Estate	3.1	-15.3	-12.7	-2.7
Fixed Interest	S&P/NZX Corporate A	0.8	2.4	3.9	6.3
Cash	ANZ New Zealand Call Rate	0.0	0.1	0.3	0.9

Source: Eikon, Bloomberg, May 2020 (*not total return index).

Macquarie Interest Rate and FX Forecasts

Rate	1Q2020A	2Q2020E	3Q2020E	4Q2020E	1Q2021E
Australia Cash Rate	0.2500	0.2500	0.2500	0.2500	0.2500
Australia 10yr govt	0.7620	0.8500	0.9000	0.9000	0.9500
US Fed Funds Rate	0.0000	0.0000	0.0000	0.0000	0.0000
US 10yr Treasury	0.6770	0.6000	0.7000	0.8000	0.8500
NZD OCR	0.2500	0.2500	0.2500	0.2500	0.2500
NZ 10yr govt	1.0600	0.9500	1.0500	1.1000	1.1500
NZ$/ US$	0.5926	0.5800	0.5800	0.5900	0.6000
AU$/ US$	0.6131	0.6200	0.6300	0.6500	0.6600
NZ$/ AU$	0.9715	0.9355	0.9206	0.9077	0.9091
EUR/ US$	1.1031	1.0500	1.0800	1.0900	1.0800
US$/ JPY	107.54	106.00	104.00	102.00	105.00
GBP/ US$	1.2420	1.2100	1.2000	1.2500	1.2500

Source: Macquarie Securities, May 2020.

Chinese companies could be heading home …

Ed Glennie – Investment Strategist

On 20th May, the US Senate passed the Holding Foreign Companies Accountable Act by unanimous consent. The legislation had been introduced to protect American investors and their retirement savings from foreign companies that have been operating on US stock exchanges while avoiding Securities and Exchange Commission (SEC) oversight.

The proposed bill states that if the SEC determines an entity has three consecutive "non-inspection years" (i.e. **unable to audit the company), the SEC "shall prohibit the securities of the covered issuer from being traded on a national securities exchange**", potentially leading to suspension or de-listing of Chinese American Depositary Receipts (ADRs) in the US. It is unclear how long the legislative process may take, but if the Act is passed into law, there could be a three-year "non-inspection" transition period starting from the date of enactment.

Chinese ADRs are seen to be the main target because according to the China Securities Regulatory Commission (CSRC) regulations, audit papers for overseas listed Chinese companies have to be held in Mainland China and cannot be examined by foreign regulators. The SEC has long raised this as an investor protection concern, but the focus of US regulators and legislators on this issue has recently intensified.

If this legislation is to be enacted, three to four years from now, the overwhelming majority of Chinese stocks listed in the US would be delisted. While headlines associated with the act is of concern, we believe the facts are less so. Firstly, China has been actively encouraging a secondary listing of some of its leading companies closer to home, be it in Hong Kong or in Shanghai. Alibaba led that process in 2019 with a listing in Hong Kong and JD.com and NetEase are in the midst of following suit. Hobson Wealth clients typically own US listed Chinese stocks that would be eligible for a Hong Kong listing so if it became an issue all could list there if needed. ADRs are also fungible between their US and Hong Kong listing.

We believe clients should continue to hold on to their ADRs at this time and if the legislation ultimately passes it can be addressed at a later date. In the short-term, however, it has led to some selling pressure on Chinese ADRs but the impact on underlying business fundamentals or stock liquidity are minimal at present. Share price action has the potential to be volatile as the law comes into effect, however, the long-term fundamentals of the potentially impacted businesses are unlikely to see any material adverse impact three to four years from now.

General Disclaimers

This document has been distributed in confidence to New Zealand resident clients of Hobson Wealth Limited (Hobson Wealth). If you are not the intended recipient of this document, please notify Hobson Wealth immediately and destroy all copies of this document, whether held in electronic or printed form or otherwise.

This document has been issued and distributed in New Zealand by Hobson Wealth, an NZX Advising Firm and a registered financial services provider. The disclosure statements for Hobson Wealth and your adviser are available free of charge by contacting us on 0800 742 737. Hobson Wealth is not a wholly owned subsidiary of Macquarie Group Limited (MGL) but MGL holds an interest in, and provides certain business and research services to, Hobson Wealth. There is also a security distribution agreement in place between MGL and Hobson Wealth.

This document contains market commentary and factual information or class advice only. It is not research. Nothing in this document shall be construed as a solicitation to buy or sell any security or product, or to engage in or refrain from engaging in any transaction. The information in this document does not take account of any particular person's objectives, financial situation or needs. Before acting on this information, investors should therefore consider the appropriateness of the information having regard to their situation. We recommend investors obtain financial, legal and taxation advice before making any financial investment decision. The views contained in this document may not constitute the views of Macquarie Group Company. While we believe the information to be accurate and any recommendations to have reasonable basis, no warranty is made as to the accuracy or reliability thereof. There are risks involved in securities trading. The price of securities can and does fluctuate and an individual security may even become valueless. International investors are reminded of the additional risks inherent in international investments, such as currency fluctuations and international stock market or economic conditions, which may adversely affect the value of the investment. The forecasts are predictive in character and therefore investors should not place undue reliance on the forecast information. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The actual results may differ substantially from the forecasts and some facts and opinions may change without notice. Hobson Wealth does not give, nor does it purport to give, any taxation advice. The taxation discussion in this document is based on laws current at the time of writing. Those laws and the level of taxation may change. The application of taxation laws to each investor depends on that investor's individual circumstances. Accordingly, investors should seek independent professional advice on taxation implications before making any investment decisions. This document is based on information obtained from sources believed to be reliable but we do not make any representation or warranty that it is accurate, complete or up to date. We accept no obligation to correct or update the information or opinions in it. Opinions expressed are subject to change without notice. Hobson Wealth accepts no liability whatsoever for any direct, indirect, consequential or other loss arising from any use of this document and/or further communication in relation to this document. Hobson Wealth, its associates, and Macquarie Group, their officers or employees may have interests in the financial products referred to in this document by acting in various roles including as investment banker, underwriter or dealer, holder of principal positions, broker, lender, director or adviser. Further, they may act as market maker or buy or sell those securities as principal or agent and, as such, may affect transactions which are not consistent with the recommendations (if any) in this document. Hobson Wealth and members of Macquarie Group may receive fees, brokerage or commissions for acting in those capacities and the reader should assume that this is the case.

Disclosures

Important disclosure information regarding MGL interest in the subject companies covered in this report is available at www.macquarie.com/disclosures.

Contacts

For more information, call us on 0800 742 737 or visit our website at hobsonwealth.co.nz

Auckland	**Tauranga**	**Wellington**	**Christchurch**
Level 4, Australis Nathan	Level 2, Suite 6, The Vault	Level 12, Deloitte Building	Level 3
37 Galway Street	53 Spring Street	20 Customhouse Quay	151 Cambridge Terrace
Auckland 1010	Tauranga 3110	Wellington 6011	Christchurch 8013