Monthly View – October 2020

Australasian Share Markets Make Gains

Both the New Zealand and Australian share markets had a positive month. In New Zealand, companies with 30 June balance dates reported in October. Generally, earnings forecasts lifted post result reporting, as better than expected COVID recovery trading was experienced. Property and retirement sector companies share prices improved. Continuing falls in interest rates benefited these companies as low interest rates and higher relative yield attracted investors. Sentiment in the retirement sector also improved as residential property prices rose.

Electricity generators and retailers were also supported based on the yields the shares provide and the possibility that Rio Tinto will defer its decision to exit the Tiwai Point aluminium smelter. Related to the potential for Rio Tinto to delay exit was the election of a Labour Government without the need to rely on coalition partners. The share market has interpreted the election outcome positively as it is expected that Labour will continue existing economic management and companies can have confidence in respect of policy continuity.

Locally, a notable decline in price was experienced by A2 Milk, the second largest company on the NZ exchange, which declined 4.6% in October. The fall in A2 Milk can be attributed to the Victorian lockdown which disrupted the diagou supply chain out of the state. The daigou supply chain is an emerging form of cross-border exporting in which exporters from outside China purchase commodities (mainly luxury goods, but sometimes also grocery items such as infant formulas) for customers in China. This led to a downgrade in earnings growth and has led a number of Australian investors to exit or short sell the company.

Interest Rate Falls Continue

The trend of falling interest rates continued through October. Term deposit interest rates with the major trading banks are now below 1% for all maturities out to 5 years. Negative interest rates remain a prospect in New Zealand with the Reserve Bank continuing to promote negative rates as a real possibility in 2021. It is clear that the RBNZ is intent on driving investor rates to near zero and maintaining rates at this level for some time. The RBNZ intends to implement the Funding for Lending Programme next month and this will enable trading banks to lend funds at very low cost and replace term deposit funding. A consequence of low rates has been a surge in residential property values as funding is on lent at lower levels. The Reserve Bank of Australia has demonstrated a similar commitment to quantitative easing in line with other developed economies. The Australian cash rate has been reduced from 0.25 to 0.1%.

Politics and COVID Weigh on International Share Markets

With Hong Kong providing an exception, offshore share markets were weaker in October. Europe was gripped by a second wave of COVID 19 and this delayed potential economic recovery. The German share market measured by the DAX index fell by 9.4%. French and British markets similarly fell by 4.5% as these countries entered lockdowns. The United States market was a captive of politics with market movements reflecting the potential timing and magnitude of additional fiscal stimulus from Washington. As the elections approached, the prospect of immediate stimulus measures diminished, and the US share market fell. The US share market was also impacted not only by potential post-election policy but also by the prospect of increased regulation/fines or company break-up of the large technology stocks: Facebook, Google, Microsoft and Amazon. These companies dominate the US market given their capitalisations. The US Department of Justice in fact instigated a legal action against Google at the end of the period.

The initial public offering of Ant Financial was also a focus for share markets as the Ant listing, if completed, will be the largest ever. It was intended to list the company on Shanghai and Hong Kong Stock Exchanges. Ant Financial is a multifaceted Chinese financial services company providing a multitude of services including micro-finance. The offer was oversubscribed 872 times and at the offer price was equivalent in scale to the GDP of Finland. At the eleventh-hour Shanghai regulatory authorities have deferred the listing.

Conclusion

The recurrence of COVID 19 globally weighed on markets at the end of the month as the prospect of further shutdowns and economic disruption was raised. Offsetting this the current low interest rate environment that is likely to persist for the foreseeable future and the ongoing search for yield continue to support markets. Low rates of return from fixed income will underpin share values where some growth in earnings into the future is evident or the business is able to sustainably maintain shareholder distributions. Businesses with decaying revenues or disrupted business models are likely to continue to be shunned. To date economic outcomes, post the advent of COVID have been less dire than initially anticipated. If normalisation of economic activity can be achieved and international trade and travel re-established there is further upside opportunity in shares offsetting the lower income levels. For investors looking for income and return, a well-diversified investment portfolio should provide a better long-term return than holding bank term deposits.

Monthly View continued – October 2020

Indices for Key Markets

As at 31 October 2020	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.
S&P/NZX 50 Index	2.9%	3.0%	12.0%	14.0%	15.1%
S&P/ASX 200 Accumulation Index (NZD)	0.0%	-0.4%	-9.2%	2.3%	7.0%
MSCI ACWI Index (NZD)	-2.2%	0.7%	2.2%	7.3%	9.3%
S&P/NZX 90 Day bank bill Total Return	0.0%	0.1%	0.8%	1.5%	1.9%