DecisionMakers
Investment Advisers & Portfolio Managers

MyFiduciary
Governance & Investment Support

Economic and Market Commentary December Quarter 2021

Market performances were mixed

Performances were mixed over the quarter given different economic conditions and risks.

Market performances were mixed in the December quarter. Bonds again performed poorly, and New Zealand equities couldn't repeat their September quarter strength. Emerging market (EM) equities trod water, while developed large-cap equities performed well. At the other end of the spectrum, property and infrastructure enjoyed exceptionally strong returns.

The performance differences reflected crosscurrents in macroeconomic conditions and country or sector-specific factors. Rising inflation and the prospect of central banks increasing interest rates weighed down fixed income but provided strong support to "real asset" classes such as listed infrastructure, property, and gold. Developed market equities were propelled by solid corporate earnings and (still) strong growth conditions, while EM equities were held back by lingering concerns around Chinese risks.

Market roundup

Global equities marched higher...

Developed market equities climbed further over the December quarter, by around 8.5% in NZD terms. This resulted in an annual return of 28%, while NZD hedged shares increased around 24% (see Figure 1). Within global equities, higher-risk small caps had a weaker annual return (18.5%) while value stocks performed in line with the market.

...while emerging markets fell and Australian stocks rebounded.

Emerging markets had a softer quarter, falling by around 0.5%. This reflected ongoing geopolitical tension with China and concerns around the surprisingly heavy-handed approach that the Chinese authorities have taken to rein in "excess profits" in its tech sector and related listed companies such as Alibaba and Tencent. That said, Chinese growth has remained relatively firm and concerns around property developer Evergrande's failure severely denting this has dissipated. Australian equities reflected this diminished risk, increasing around 3.5% in the quarter and have returned 17% over the year.

Listed property and infrastructure had a standout performance.

As mentioned above, international infrastructure and property stocks had a very strong quarter. International property rose 10.5% in the quarter and around 30% for calendar 2021. International infrastructure returned around 11.5% in the quarter and 25% over the year. Both asset classes have in part benefited from rising inflation and inflation risks as they are expected to be relatively resilient to a higher inflation environment.

On the flip side, bonds are less resilient to rising inflation and interest rates. As a consequence, New Zealand investment grade (IG) bonds fell 1.4% in the quarter and 4.2% over the year. International IG bonds fared a little better, being flat in the quarter and falling around 1.4% over the year. Finally, NZ cash did better still, increasing by around 0.5% over the year.

Outlook for the years ahead

Fixed-income returns were generally poor as markets priced in higher interest rate levels, but short-term bonds funds out-performed.

We do not have a crystal ball to predict what will happen to markets in the months ahead – of course, nobody does. But we have recently updated our long-term asset class expected return forecasts, in which we take into consideration the very strong run-in growth asset classes over the past 5 years and more, and the exit we are now seeing from ultra-supportive monetary policy and interest rate levels.

A summary of our numbers is provided (see figure 2), alongside a forecast range from industry "experts" including global asset managers, investment organisations and consultants. Key points are that:

- We expect lower long-term returns from most asset classes than we have seen over the past decade, in line with our previous commentaries.
- We expect to see cash rates continue to lift towards levels that are higher than today but still quite moderate relative to longer-term history. This lift should provide some relief to savers relying on the income streams from their portfolios.
- We expect to see equities and other growth assets offer a premium (higher return) to cash over the long term. This is in line with the majority of experts and long-term financial history which suggest it is both rare and fleeting to see equity markets (across most countries) under-performing cash over two- or three-decade time horizons.
- We expect bonds to only offer a very modest excess return to cash, and there is a chance that this may be negative over a more medium-term time horizon. This reflects that while we think cash rates should, and will, head higher over the next few years or so, markets are yet to fully factor this into bond prices. For this reason, your portfolios have materially reduced their exposure to bond funds with relatively "standard" maturity terms (or duration) in favour of bonds and related instruments with relatively short duration.
- We expect reasonable returns from listed property, infrastructure, and "alternative" assets.

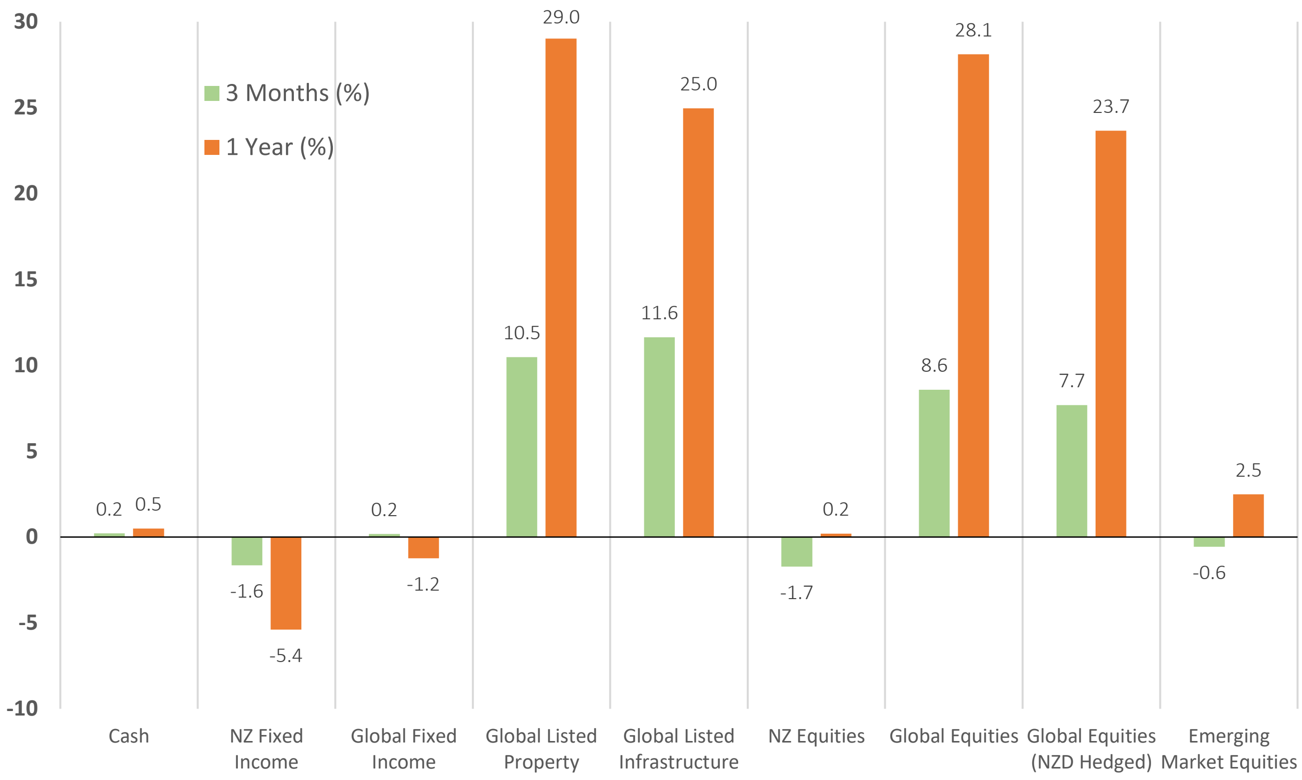
The RBNZ expects NZ's economic performance to remain robust despite the Covid restrictions.

flat to declining interest rates.

In summary, and as always, we can point to a laundry list of risks that may present challenges to markets at some stage: the ongoing pandemic, supply-chain issues, rising inflation and interest rates, geopolitical tensions between the Western nations, China and Russia, huge national debt levels, over-priced housing markets, *etc.* We can also point to the fact that global growth has remained robust through the stops-and-starts to activity and should the current Omicron wave mark an end to the pandemic, growth should bounce higher still.

Through the ups and downs, we are confident that our portfolios are well-designed to manage inflation and other risks, and that they will continue to offer a better return than cash over the medium to longer term.

Figure 1: Patchy returns over the quarter



Source: Morningstar Direct, MyFiduciary

Figure 2: Expected long term returns

Asset Class	Expected long-term return	Industry average	Industry low	Industry high
NZ Cash	3.5%	n.a	n.a	n.a
NZ Bonds	4.0%	n.a	n.a	n.a
Global Bonds	3.7%	3.3%	3.0%	4.9%
NZ equities	7.4%	6.8%	5.5%	8.0%
Australian equities	7.6%	7.1%	6.1%	7.7%
Global equities hedged	7.5%	6.9%	5.6%	8.3%
Emerging market equities	9.2%	8.0%	6.9%	10.1%
Global listed property	6.2%	6.2%	4.7%	6.5%
Global listed infrastructure	6.2%	6.5%	6.3%	8.3%

Source: MyFiduciary, various