Monthly View as at 31 October 2022

Overview

Inflation and increasing interest rates still remain an issue for the developed world, but despite this equity markets were positive over October with most markets reporting strongly positive returns. It is difficult to explain exactly why equity returns were so positive during October, except perhaps to note that everyone was expecting the worst and all the bad news was already fully factored into share prices.

During periods of weak market environments, it is not unusual to experience greater than normal market volatility. This year we have seen share markets fall sharply in April and June, only to recover in July and then to fall again in August and September before rebounding in October. In five out of the last ten months, monthly moves in the United States S&P 500 have been more than 5% up or down. In the previous ten years, this would occur on average only twice a year (and this included during the pandemic).

This heightened volatility is why the best strategy is to remain invested during these inevitable downturns and focus on long-term returns. Trying to calculate when to come out of the market and then when to re-enter requires two correct decisions. Getting one right is hard enough.

Looking forward, we think that we will continue to see heightened volatility in financial markets. Interest rates have now risen to levels not seen for the last ten years. These higher interest rates are now feeding through into higher mortgage rates. This will have an impact on consumer spending as mortgage holders, who are typically the young with a higher propensity to spend, cut their spending.

As we write this update, the United States market is in the midst of their corporate reporting season. In general, companies have beaten market expectations, but we are seeing some initial signs of changing spending patterns. Technology companies reported lower than expected earnings with on-line advertising spending declining. A lot of the negative news has already been priced into share markets and the increase we saw in share markets in October shows there is a lot of cash to be deployed which is looking for some good news prior to investing.

Investors and economists are looking for signs that higher interest rates are slowing the economy. There can be long and indeterminant lags between changes in interest rates and how the economy is impacted. We are seeing some signs that economic growth is slowing, but this is yet to feed through into either labour data, with wage growth still high, or prices.

Markets are forward looking so typically before the data shows that an economy is in a recession, the market has already responded to what the future may look like. We feel it might be too early to call the bottom but in a perverse way, negative data will be positive for markets. If the economy was to go into a recession, we believe it is likely to be shallow given the low level of unemployment.

New Zealand Share Market

The New Zealand share market appreciated by 2.5% over October, as investor sentiment moved from being overly negative to positive. A better-than-expected earnings update from Mainfreight helped the change in sentiment. At the end of the month, Pushpay announced that they had received a takeover offer and recommended that investors accept this offer. This helped the index to close the month on a high. Other companies to experience strong performance over the month included Tourism Holdings (+32%), Chorus (+9.3%) and Air New Zealand (+9.1%). The rise in both Tourism Holdings and Air New Zealand reflected the return of tourists to New Zealand.

Over the past 12 months, the New Zealand share market has fallen 12.7%. This fall predominantly reflects the rise in interest rates and the impact this has had on the interest rate sensitive parts of the market (this includes listed property companies and the electricity gen-tailers - including Meridian and Mercury)

Australian Share Market

The Australian share market also rose over the month, appreciating by 6.0%. At the start of month, the Reserve Bank of Australia (RBA) surprised the market by only increasing interest rates by 0.25% when a 0.50% increase was widely expected. This decision by the RBA reflected a view that the Australian economy was less vulnerable to a wage / price spiral given the high migration settings and the expected fiscal restraint. The banking sector rallied strongly after this move with loan defaults expected to remain low under this more cautious approach. Qantas (+16.3%) also had a good month as airline patronage returned to pre-pandemic levels. Resource companies including BHP and Rio Tinto were amongst the weakest performers over the month as concerns over China growth weighed heavily on the sector.

In the 12 months to 31 October, the Australian share market has fallen 2.0%. This decline is significantly less than most other developed countries. The relative robustness of the Australian market has been due to the strength of the resource sector (including oil and gas exporters such as Woodside Energy) and low valuation multiples. Looking forward, valuation multiples in Australia remain favourable and these should support the market. The biggest risk remains the slowing China economy, its largest trading partner.

Global Share Markets

October was a near reversal from September. Share markets rose sharply from the lows experienced at the beginning of the month. The MSCI World index was up 7.1% with the United States Dow Jones Industrial Index leading the pack, up 14.1%. This was the best monthly rise since January 1975. This increase was led by Caterpiller (up 32%). Of the 30 companies in the index, only two experienced declines; Microsoft (-0.3%) and Verizon Communications (-1.6%).

The decline in Microsoft echoed weak earnings announcements from a number of high-profile technology companies. Alphabet (Google), Amazon and Meta (Facebook) reported lower than expected earnings. These companies suffered sharp falls over the month, but despite these falls the technology heavy NASDAQ index was still up 4.0% over the month.

The relative performance of the Dow Jones and the NASDAQ index highlights that market leadership is moving away from the technology sector and more towards the 'old economy' companies. In the year to October 2022, the Dow Jones is down 6.7% while the NASDAQ index is down 27.5%. This change in leadership is due to the higher interest rate environment and an awareness that technology companies are just as vulnerable to economic factors as other companies. Historically, they had traded at a premium as they were considered recession-proof.

Summary

October was a better month than expected but the rise in share prices may prove to be temporary. Central banks are focused on getting inflation back to within their target ranges. This is likely to result in higher interest rates. Unfortunately, the path to lower inflation will be painful for some sectors of the economy. In New Zealand mortgage rates have already risen nearly threefold from the lows experienced in 2021. House prices are now falling.

This will have a negative impact on both discretionary spending and consumer confidence. The full impact of the higher interest rate environment is yet to fully feed through with, for example, a number of mortgage holders still paying significantly lower rates. Despite this, households' budgets are already under pressure from higher food and fuel costs. Looking forward, we therefore expect economic growth to slow in the coming months.

However, financial markets are forward-looking and the prognosis above is no surprise to market participants. We are currently experiencing the third bear market in shares in 25 years. In the previous two episodes, markets recovered well before economies recovered. We therefore continue to recommend that clients focus on their long-term goals while acknowledging that in the short-term returns may be volatile.

Indices for Key Markets

As at 31 October 2022	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.
S&P/NZX 50 Index	2.5%	-1.0%	-12.7%	2.4%	7.7%
S&P/ASX 200 Accumulation Index (AUD)	6.0%	0.7%	-2.0%	4.8%	7.2%
MSCI ACWI Index – Global Shares (NZD)	2.7%	-0.4%	-1.5%	8.3%	8.7%
MSCI ACWI Index – Global Shares (local currencies)	6.1%	-5.8%	-15.4%	6.6%	6.5%
S&P/NZX 90 Day bank bill Total Return	0.3%	0.8%	1.7%	0.9%	1.3%