Economic Commentary

15 September 2020

Financial markets have continued to move higher over the quarter, producing strong returns for growth assets. The NZ sharemarket added nearly 10% for the three months, the Australian market around 5%, and US markets were up between 15% (S&P500) and 26% (NASDAQ). Ongoing strength in the technology and healthcare sectors is driving most of the performance, with traditional cyclical stocks falling behind. Interest rates have again declined and appear likely to fall further still. The NZ Reserve Bank has indicated that a move to a negative official cash rate next year is a strong possibility to protect the economy against the effects of Covid-19. The virus continues to spread in many parts of the world, including the United States, South America, Australia, and now again for Auckland. Portfolios have recovered much of the lost ground from earlier in the year, but ongoing volatility should be expected.

It is now clear that we are in a technical recession with negative GDP numbers for the first six months of the year. There remains significant support in place and the Reserve Bank of NZ is continuing with its "Quantitative Easing" strategy to keep interest rates low and provide liquidity to the financial system. At the moment, in NZ at least, this seems to be working. Consumer spending has bounced since the lockdown was lifted, house prices remain relatively steady, and although unemployment has increased there doesn't appear to be a huge increase in job losses yet. In financial markets, the monetary and fiscal actions are clearly giving investor's confidence that authorities are determined to avoid a long-term economic depression. In our view, the result of all these support measures may be that we are in something of a 'false dawn'. Unfortunately, it is simply unsustainable for governments to continue with these hugely expensive support packages indefinitely. The wage subsidy programme in NZ was to end at the beginning of September but is now extended again. Our borders remain closed for the foreseeable future, so it is possible that the effects of the Covid crisis will become more apparent through the third and fourth quarters of the year.

The lockdowns, low interest rates and technology have combined to create some very interesting anomalies in sharemarkets. There has been a huge increase in trading by "do-it-yourself" retail investors using online trading platforms such as Sharesies and Hatch in NZ, and Robinhood in the US. Most of these types of trades are for small volumes of shares in companies with high-profile consumer brands. In the US, this has included the large technology stocks such as Apple, Amazon, Google (Alphabet), and especially Tesla. In NZ, interest in Air New Zealand shares spiked during our lockdown, doubling the share price (despite there being little or no fundamental reason for it to increase!). The result of some of this trading activity is that there has been a major divergence between the performance of a small handful of shares compared to the remainder of the market. In the US, the top five companies on the S&P500 are up by around 35% for the year-to-date, and the remaining 495 companies are collectively down by 4% for the year! This means that valuations are stretched for the high-profile growth shares, but there is considerable value in some of the lesser-known and traditional companies.

The next quarter is shaping up to be an eventful one with ongoing developments in the pandemic globally, the NZ election now in October and the US election in early November. It appears that the popularity of Jacinda Ardern and the problems that National have encountered of late will likely drive Labour to a successful election result here. Markets will expect this and shouldn't be too affected by our local election, especially given that both major parties are proposing few significant changes in tax policy and are roughly aligned around the need for further stimulus. The US election could create stronger waves. Democratic candidate Joe Biden is currently well ahead in the polls, but this was also true four years ago when President Trump surprised everyone (there may perhaps be a percentage of Trump supporters who do not accurately report their voting intentions to the pollsters!). From our vantage point here in NZ, the US appears to be facing significant challenges from the virus, a massively divided political environment, civil disorder, and chaotic governance. China seems to be taking advantage of this 'gap' in US leadership, making strategic moves in Hong Kong and the South China Sea.

As a result of all of the factors discussed, we're sceptical about the market rally and believe that there will likely be ongoing volatility in the months ahead. Sharemarkets are being pushed and pulled by multiple competing factors – low interest rates, poor economic data, virus developments, vaccine news, chaos in the US, Brexit ructions etc etc - and remain highly unpredictable. In the first half of September we have already seen a sizeable sell off in technology shares, including Apple, Tesla, and Microsoft. This seems to have been driven by stretched valuations for these companies and investors locking in profit after the exceptional run that the tech sector has had, rather than by any particularly adverse news. However, it is a reminder that the environment that we are in is quite unique and challenging. In such times, it is more important than ever to stick to the fundamentals of good financial planning and investment practice – diversifying widely, ensuring that risk exposure is appropriate, focusing on investment time horizons, staying disciplined through volatility, and keeping an eye on medium and long-term goals.