Monthly View as at 30 September 2022

Overview

Most asset classes experienced declines over September with fixed interest, shares and property shares all experiencing a decline in value.

In late August, the Federal Reserve Bank of the United States confirmed that they will raise interest rates and keep them high until inflation was back to 2% p.a. even if this meant the United States economy experiences a recession. Since then, most developed world central banks have made similar commitments of keeping interest rates high until inflation is back to within their target range. Reflecting these comments, many economists revised up their interest rate expectations. In New Zealand, ANZ Bank revised its forecast on the peak in the Official Cash Rate (OCR) from 4.0% to 4.75% and removed any decline in the OCR within their forecast horizon. Market participants appeared to accept that this was more likely than the Reserve Bank of New Zealand's peak of 4.25% and consequently interest rates, including fixed mortgage rates, increased over the month.

Global shares declined by 8.4% over the month, reaching new year-to-date lows. The decline in global share markets was predominantly due to the higher interest rate environment, although there was also an acceptance by market participants that central banks would not come to their rescue and cut interest rates to stem any share markets losses. This has been a feature of many share market declines since 1987, when the then Chair of the Federal Reserve, Alan Greenspan, cut interest rates after the October 1987 share market crash. Greenspan was able to do this in 1987 because at the time inflation in the United States was low. Interestingly, New Zealand was one of the few economies not to cut rates post the 1987 crash as inflation in New Zealand remained high.

As at the end of September, the S&P 500 index was down 23.9% year-to-date while the technology heavy Nasdaq was down 32.4%. This begs the question of whether we will see further declines in markets?

Share markets are predictive markets, which means their value today incorporates the consensus expectation about what will happen in the future. The consensus view appears to be that the United States economy will slow and even experience an economic recession. Of note though, this is generally expected to be a shallow recession given the high current levels of employment. However, the unknowns are how long will this take and whether the slowing in demand will be enough to quell inflation.

Many of the leading economic indicators are suggesting that the United States economy is starting to slow and that some of the supply side shocks are being resolved. Container freight costs between China and the United States are falling back to their pre-pandemic levels. Commodity prices including oil and wheat have fallen back from the highs seen immediately after the start of the Ukraine War. However, labour markets around the world remain very tight and this is placing pressure on wage costs.

New Zealand Share Market

The New Zealand share market declined by 4.3% over September, reflecting international share market moves and higher interest rates. The interest rate sensitive sectors of the market were the hardest hit, with listed property shares falling 6.2% over the month. Vector and Fletcher Building also struggled over the month, falling by more than the index. Air New Zealand bucked the trend after it reported better than expected profits and commented that there is a high demand for travel, including international. While the decline was significant over the month, it was less than the declines experienced by Australia and the United States. This highlights the defensive nature of the New Zealand market.

Over the past 12 months, the New Zealand share market has fallen 16.0%. This fall predominantly reflects the rise in interest rates and the impact this had has on growth companies' valuations. In a higher interest rate environment, the value of future earnings falls.

Australian Share Market

The Australian share market also fell over the month, declining by 6.2%. Again, interest rate sensitive sectors including property and utilities experienced the largest falls. Resource, healthcare, and consumer stable companies were the strongest relative performers although these sectors still on average fell over the month.

Resource companies including BHP and Woodside have performed strongly through the current investment cycle. Unlike past cycles, this profitability has seen these companies return cash to shareholders by way of increased dividends. Over the past year the Australia share market has made its largest ever aggregate dividend pay-out of A$122 billion. This is a 27% increase from last year's pay-out.

In the 12 months to 30 September, the Australian share market has declined by 7.7% in Australian dollars. However, over the same period the New Zealand dollar has fallen from A$0.95 to A$0.87. For investors in New Zealand, the decline in the currency has offset all of the decline in the Australian share market with the annual return in New Zealand dollars coming in at 0.6%.

Global Share Markets

In September, global share markets gave back all of the gains experienced since mid-June, falling 8.4%. Concern over how high interest rates will have to rise and the impact this will have on company profitability drove market sentiment. As expected, the US Federal Reserve raised interest rates again over the month taking the Federal Reserve Funds rate to 3.15%, three percentage points higher than it was at the start of the year. They also indicated that interest rates could rise to between 4.5 – 5.0% by the end of 2023. These projections were higher than the market expected but reaffirmed the comments made in late August by Chair, Jay Powell, that the Federal Reserve would increase interest rates and keep them there until inflation fell back to 2.0% p.a.

Market participants were also starting to focus on the third quarter earnings season. To break the wage price spiral, either workers have to accept a cut in real wages or companies have to accept lower profit margins (or some combination of the two). Given the strength in labour markets it is felt that profit margins will come under pressure. Third quarter earnings, due mid-October, will provide some guidance on how much pressure there is on profit margins.

Summary

Historically, September is the most volatile month for global equity markets and unfortunately October is the next most volatile month. We would therefore not be surprised to see additional volatility this month. However, markets are now expecting high interest rates and a slowing in global economic growth. This means essentially most of the bad news is already in the market.

The upcoming United States quarterly reporting season will be watched closely but we think the major driver of both interest rates and share markets will be the labour market. Should job insecurity and unemployment start to rise, then counter intuitively, this will be seen as positive by markets. If labour markets remain tight, then it suggests interest rates may have to remain higher for longer.

Indices for Key Markets

As at 30 September 2022	1 Month	3 Months	1 Year	3 Years p.a.	5 Years p.a.
S&P/NZX 50 Index	-4.3%	2.2%	-16.0%	1.1%	7.8%
S&P/ASX 200 Accumulation Index (AUD)	-6.2%	0.4%	-7.7%	2.7%	6.8%
MSCI ACWI Index (NZD)	-1.6%	3.4%	-3.0%	7.4%	9.8%
MSCI ACWI Index (local currencies)	-8.4%	-4.9%	-16.2%	5.2%	5.8%
S&P/NZX 90 Day bank bill Total Return	0.2%	0.7%	1.4%	0.9%	1.3%