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WEALTH MANAGEMENT

Yovich & Co. Market Update

27th November 2022

As at 25th November	NZX 50G	All Ords	Shanghai	FTSE	Dow	NASDAQ	NZDAUD	NZDUSD	OCR
Previous Week	11380.61	7354.74	3097.24	7385.52	33745.69	11146.06	0.9217	0.6044	3.50%
Week Close	11382.56	7447.65	3101.69	7486.67	34347.03	11226.36	0.9246	0.6246	4.25%
Change	0.02%	1.26%	0.14%	1.37%	1.78%	0.72%	0.31%	3.34%	0.75%

Global share markets had a positive week last week, with the S&P500 index in the US up 1.53%, the Australian market up 1.26%, and the UK market up 1.37%. NZ was flat however, being held back by large losses in the retirement sector. Sentiment on the housing and property sector took a blow after the Reserve Bank's Monetary Policy Statement, including a record-high increase in the OCR of 75bps. More about that below.

NZ Interest rates rose, with the 2-year swap rate increasing a hefty 27bps to 5.23%, and the 5-year swap rate increasing 14bps to 4.62%. US interest rates were relatively flat, with the 2-year Treasury rate flat at 4.45%, and the 1-year Treasury rate down 9bps to 3.67%. The NZD strengthened back to above US$0.62 during the week, a reflection of the USD Index falling and the NZD becoming more attractive due to higher interest rates. Commodity prices fell, with the Dow Jones Commodity index down 0.82%, and the price of Brent crude oil continued its downward trajectory of the past few weeks, down a further 4.52% to just below US$84.

According to interest.co.nz's Home Loan Affordability Report, the October figures show home ownership is now the most unaffordable it has been for typical first home buyers since it began compiling the report in 2004.

The biggest movers of the week ending 25th November 2022				
Up			Down	
Tourism Holdings	4.32%		Ryman Healthcare	-10.11%
Heartland Group	3.39%		EROAD	-7.81%
The a2 Milk Company	3.38%		Summerset Group	-7.08%
Sanford	3.12%		Arvida Group	-5.74%
Manawa Energy	2.98%		Serko	-3.85%

Market Highlight – Reserve Bank of NZ Forecasts Recession

Last Wednesday, the RBNZ raised the official cash rate (OCR) by a hefty 75 basis points, to 4.25%, being the largest ever OCR increase since the OCR was instituted by the RBNZ in 1999. Aggregate demand continues to outstrip NZ's capacity to supply goods and services, leading to continued price rises. On the demand side, household spending remains resilient, employment levels are high, and wages are growing. A rebound in tourism is also adding to domestic demand.

Strong demand does not normally constitute a problem, however it does when we have constrained supply. Labour shortages are constraining output, with employment currently above its maximum sustainable level, leading to wage pressure. Global growth forecasts have declined, with China's economy facing headwinds while continuing to contain the spread of Covid, which continues to cause production bottlenecks. Oil prices, despite falling from their peak, remain high, while food and fertiliser prices remain high globally because of the war in Ukraine.

Global consumer price inflation remains heightened as a result, leading the RBNZ to revise its earlier forecasts, and increase the aggressiveness in rate hikes to get on top of inflation sooner rather than later.

Changing Forecasts

The RBNZ now forecasts inflation to peak at 7.5% in the December 2022 and March 2023 quarters, before slowly dropping back to within the 1%-3% target band by the September 2024 quarter. This is an increase from their forecasts in August that inflation would fall to 5.8% by December 2022.

The new OCR path is now forecast to reach 5.5% in September 2023, and remain at that level for a year. This compares to August's forecast of a peak OCR of 4.1%. Mortgage rates will likely be in the 7%-8% range. Unemployment is now forecast to rise to 5.7% from the current 3.3% by March 2025, whereas the forecast from August was for unemployment to rise to 5.0%.

Recession

Significantly, the RBNZ has now lowered its quarterly GDP growth forecasts into negative territory during 2023, meaning recession. The peak to trough decline in the level of GDP is expected to be about 1%. The word recession is a step-up in alarming rhetoric from the RBNZ, and has gained headlines in the media, which may help to send the message to people to save instead of spend, especially just before Christmas. The recession will be a result of higher interest rates, driving a decline in spending, lowering demand for output and workers, and in turn reducing pressure on the supply capacity of the economy, and lower prices. Ideally, we would relieve this pressure through increased productivity, however this takes time and NZ does not have a good track record of productivity improvements.

Effect on the Share Market

Overall, the NZ share market declined only slightly on Wednesday, by 0.85%, as the 75bp rise was already expected by the market. The biggest movers however were property-related companies which faced significant falls. In particular, the retirement sector saw heavy falls, as their business model is based largely on the prospects of the housing market. The RBNZ's estimate is that house prices will decline by 20% in total from the November 2021 peak, having declined by about 11% already.

Potential Over-Tightening

Given that it takes some time for changes in the OCR to take effect on the economy, especially as many borrowers had fixed their rates at record lows, there is a significant chance that the RBNZ will over-do the tightening cycle at such a rapid pace. With global growth slowing, which leads to lower demand, and households suddenly faced with re-fixing mortgages at significantly higher rates, demand pressure may ease earlier than predicted, forcing the RBNZ to reverse direction earlier. However, the RBNZ have been clear that they will err on the side of taming inflation, at the cost of short-term economic pain, as sustained inflation leads to long-term economic costs.

Hopefully the strong rhetoric about recession will have the desired effect on the population to rein in spending before the RBNZ needs to carry out their aggressive forecasts.

Investment News

Argosy Property (ARG.NZ) – Half-Year Net Property Income Up 3.6%

Argosy Property's net property income for the first half of FY23 of $55.0m was up 3.6% from the first half of FY22. The increase was driven by a range of factors including acquisitions, like for like rental growth, and developments. Occupancy is at 98.9%, with a weighted average lease term of 5.5 years. The property portfolio value was $2.24b, down $23.5m as a result of property devaluation. The quarterly dividend was in line with the full-year guidance for FY23 of 6.65cps for the full year, being 1.5% increase on the prior year.

Current Share Price: $1.18, **Consensus Target Price**: $1.25

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Ryman Healthcare (RYM.NZ) Adopts a Dividend Reinvestment Plan

Ryman has adopted a dividend reinvestment plan (DRP), which offers shareholders the opportunity to reinvest their dividends by the issue of additional new shares. New shares will be issued at a 2.5% discount to the market price at the time entitlements are determined. Participation is optional, and if shareholders do not wish to participate, they do not need to do anything.
Current Share Price: $6.85, **Consensus Target Price**: $10.66

Oceania Healthcare (OCA.NZ) – Half-Year Underlying EBITDA Up 6.0%

Oceania's half-year results show underlying EBITDA of $38.7m, up 6.0% from the previous half-year, underpinned by the ongoing success of its care suite model. Total sales of 226 units included 33 new care suites. An interim dividend of 1.9cps was announced, down from the previous half-year dividend in FY22 of 2.1cps.
Current Share Price: $0.78, **Consensus Target Price**: $1.31

Serko (SKO.NZ) – Half-Year Loss of ($16.9m)

Travel booking company Serko has a focus on recovery and growth for FY23, after a tough environment during Covid-related lockdowns. Revenue of $19.4m is up 106% on pcp, however operating costs of $42.3m are also up by 70%. The half-year loss of $16.9m compares to the previous half-year loss of $11.8m. Serko is affirming its FY23 guidance of approximately doubling FY22 revenue. The company intends to return to a cashflow positive position during FY25, and has significant cash reserves.
Current Share Price: $2.50, **Consensus Target Price**: $3.61

Stride Property (SPG.NZ) – Half-Year Distributable Profit After Tax Up 21.2%

Stride Property's half-year results show net rental income of $34.1m, up 11.2% on the first-half of FY22, and distributable profit after tax of $29.3m, up 21.2% on pcp. The company had a loss after tax of ($53.1m) due to a net devaluation of investment properties of $51.8m. Occupancy is at 97.0%, with a weighted average lease term of 5.6 years. The full-year FY23 dividend guidance has been downgraded from 9.91cps to 8.00cps, with an announced 2nd quarter dividend of 1.84cps.
Current Share Price: $1.54, **Consensus Target Price**: $1.67