Walter Yovich (FSP 41025)
Jarrod Goodall (FSP 198885)
Nathanael McDonald (FSP 629229)
Brock Fannin (FSP 1002346)

Yovich & Co. Market Update

26th February 2023

As at 24th February	NZX 50G	All Ords	Shanghai	FTSE	Dow	NASDAQ	NZDAUD	NZDUSD	OCR
Previous Week	12144.66	7552.19	3224.02	8004.36	33826.69	11787.27	0.9077	0.6245	4.25%
Week Close	11905.75	7512.71	3267.16	7878.66	32816.92	11394.94	0.9169	0.6165	4.75%
Change	-1.97%	-0.52%	1.34%	-1.57%	-2.99%	-3.33%	1.02%	-1.27%	0.50%

Markets reversed course last week, with major indices falling following several weeks of positive movements since the beginning of this year. In the US, there was data from the personal consumption expenditures (PCE) index, with the result for January showing an increase of 0.6%, above forecasts for 0.5%. This sent the message that inflation pressure remains, and the market reacted accordingly, with the S&P 500 Index falling 2.67%. The NZ and Australian markets followed suit, down 1.97% and 0.52% respectively, while the UK market was also down 1.57%.

In NZ, the Reserve Bank of NZ raised the official cash rate by 50bps last week, in line with expectations, taking the OCR from 4.25% to 4.75%. The RBNZ governor stated that while there are early signs of price pressure easing, core consumer price inflation remains too high, employment is still beyond its maximum sustainable level, and near-term inflation expectations remain elevated. Further, the severe storms in the North Island will lead to shortages in some goods and services in the near term, and upward price pressures are likely to stay high as a result, while rebuild work will increase activity over coming years.

After two weeks of rapid interest rate rises in the US, last week saw rates flatten off, with the 2-year Treasury rate down 1bp to 4.69%, and the 10-year Treasury rate down 4bps to 3.87%. In NZ however, rates increased, with the 2-year swap rate up 30bps to 5.39%, and the 5-year swap rate up 28bps to 4.82%.

With risk-off sentiment dominating the markets, the USD strengthened against the NZD and AUD, with the US Dollar Index increasing by 1.32%. The NZD dropped further, down 1.27% to 0.6165 against the USD. The Dow Jones Commodity Index was down 0.83%, while the price of Brent Crude oil was up slightly to finish the week at above US$83 per barrel.

Core retail spending in NZ has continued to soften, with spending down 1.3% in the 3 months to January compared to the previous comparable period, despite price increases. Key areas of weakness included home building supplies, homeware & appliances, stationery, and apparel. A further source of pressure for retailers is an increase in the NZ minimum wage by 7% in April 2023.

According to a study commissioned by Channel Infrastructure, NZ is likely to reach peak petrol usage within two years. However, diesel use will remain strong for some time, and aviation fuel consumption will grow.

The biggest movers of the week ending 24th February 2023			
Up		**Down**	
Scales Corporation	7.72%	The a2 Milk Company	-10.06%
Ebos Group	5.03%	Restaurant Brands NZ	-9.02%
Port of Tauranga	2.44%	Serko	-7.41%
Summerset Group	2.11%	Oceania Healthcare	-7.23%
Auckland International Airport	1.62%	NZX	-7.09%

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Investment Topic – Bonds vs Term Deposits

An investment theme that follows inflation is higher interest rates. This theme is generally painted in a bad light due to the detrimental effect of higher interest rates on asset prices and on the economy. Contra to that however, higher interest rates present an opportunity for those with money to invest to attract a higher return, especially those investing in lower-risk fixed interest instruments.

It has been a long-term trend since the global financial crisis in 2008 that interest rates have progressively tracked downwards. This trend presented a problem for lower-risk investors who had relied previously on the fixed income provided by bonds and/or term deposits; these investors were forced to either accept a lower income, or redirect their capital towards higher-risk investments to achieve the same level of income. We saw this play out over recent years, with investors taking their money from bank term deposits, and investing into dividend stocks like property or utilities, with those stocks therefore increasing in price.

Now that interest rates are returning to a more adequate level, this should suit those lower-risk investors who can now earn a better fixed income from safer assets, and perhaps even re-balance their investment portfolios back to a level that more accurately reflects their risk profiles. With this in mind, the two main fixed interest investments are bonds and term deposits, and while similar, there are some differences to keep in mind. Both instruments offer regular interest payments, and the return of the principal investment upon maturity. Bonds are debt issued to a corporation or government, while term deposits are a type of savings account held at a bank. The major differences are interest rates, risk, and liquidity.

Interest rates and risk: While interest rates for term deposits are usually relatively similar between the various banks, interest rates on bonds vary considerably depending on the issuer. Because bonds are issued from various organisations, there is a wide range of risk levels available, from very safe government bonds, to corporations with lower credit ratings. This presents a broad range of risk vs return for investors to choose from, allowing investors to choose higher interest rates than what is available on term deposits, or achieve lower risk (and lower return) via government bonds.

Liquidity: With term deposits, funds are locked in for a fixed period of time, unless investors can negotiate with their bank to break the term deposit early, usually with a break cost. Bonds on the other hand can be bought and sold on the market, which allows investors access to their funds at the market price before the maturity date.

At Yovich & Co, our strategy for the fixed interest portion of an investment portfolio is a laddered maturity profile, with a range of credit ratings tailored to the individual investor's risk profile. This could include term deposits as well as bonds, but with term deposits generally suited better to the short-term, up to one year.

Investment News

A2 Milk Company (ATM.NZ) – First Half-Year Net Profit Up 22%

A2 Milk announced its first half-year results, with EBITDA up 10.5% to $107.8m, and net profit up 22.1% to $68.5m. The results were in line with the company's expectations, with revenue growth of 18.0%, driven by China label IMF sales with record market shares. The outlook for FY23 remains for low double-digit revenue growth.
Current Share Price: $6.97, **Consensus Target Price**: $6.90

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Property For Industry (PFI.NZ) – Annual Results – AFFO Down 5.0%

Property For Industry announced its full-year results for FY22, with net rental income of $93.5m, up 1.3% from the previous year, and Adjusted Funds From Operations (AFFO) down 4.6% to $44.6m following higher interest costs. After taking into account fair value losses on property valuations totaling $56.7m or 2.6%, this contributed to a loss after tax of $13.9m. Dividends for FY22 are 8.10cps, up 2.5% on 2021 dividends. Occupancy is at 100%, with a weighted average lease term (WALT) of 5.08 years.
Current Share Price: $2.275, **Consensus Target Price**: $2.36

Chorus (CNU.NZ) – First Half-Year Profit Down 79%

Chorus announced its half-year results, with revenue up 1% on the previous half-year to $487m, and EBITDA up 4%. However, due to higher interest costs and higher depreciation due to accelerated copper cable depreciation in fibre areas, net profit was down 79% from $22m to $9m. The guidance for EBITDA for FY23 has increased from $655m-$675m to $675m-$690m. The interim dividend is 17cps, with guidance of 42.5cps for FY23.
Current Share Price: $8.18, **Consensus Target Price**: $7.63

Freightways (FRE.NZ) – First Half-Year Profit Up 3.5%

Freightways announced its half-year results, with revenue up 25% to $552.1m, and EBITDA up 11.1% to $113.7m, with NPAT up 3.5% to $45.2m. In its outlook, the company was cautious in the short-term about the impact of a slowing economy, but remains positive about the diversification and resilience the business model offers. The interim dividend is 18cps.
Current Share Price: $9.70, **Consensus Target Price**: $10.59

Vector (VCT.NZ) – First Half-Year Profit Down 13.2%

Vector announced its half-year results, with revenue up 8.7% to $744.3m, and adjusted EBITDA up 3.9% to $274m. NPAT was down 13.2% to $100.3m, with interest costs higher than last year. Guidance for EBITDA is $515m-$525m. The interim dividend of 8.25cps is flat on the previous year.
Current Share Price: $4.12, **Consensus Target Price**: $4.26

Mercury (MCY.NZ) – First Half-Year Normalised EBITDA Up 53%

Mercury announced its half-year results, with normalized EBITDA up 53% to $451m, driven by higher hydro generation. Due to the previous year being favourably impacted by a $367m gain on the sale of Tilt shares, the half-year NPAT was down 46% versus the previous period. An interim dividend of 8.7cps has been declared, up 9% on the previous period, with guidance for FY23 of 21.8cps, up 9%.
Current Share Price: $6.35, **Consensus Target Price**: $6.34

Spark (MCY.NZ) – First Half-Year Adjusted Profit Down 7.8%

Spark announced its half-year results, with adjusted revenue up 3.2% on the previous period to $1,950m, while EBITDA was down 6.5% due to higher expenses. Net profit was down 7.8% to $165m. The interim dividend is 13.5cps, up 8% on pcp, with guidance for the total FY23 dividend of 27.0cps.
Current Share Price: $5.04, **Consensus Target Price**: $5.13