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# Yovich & Co. Market Update

16th April 2023

| As at 14th April | NZX 50G | All Ords | Shanghai | FTSE | Dow | NASDAQ | NZDAUD | NZDUSD | OCR |
|---|---|---|---|---|---|---|---|---|---|
| **Previous Week** | 11870.08 | 7412.01 | 3327.65 | 7741.56 | 33485.29 | 12087.96 | 0.9386 | 0.6268 | 5.25% |
| **Week Close** | 11880.56 | 7560.39 | 3338.15 | 7871.91 | 33886.47 | 12123.47 | 0.9255 | 0.6205 | 5.25% |
| **Change** | 0.09% | 2.00% | 0.32% | 1.68% | 1.20% | 0.29% | -1.40% | -1.00% | 0.00% |

The NZ market was flat for a second week in a row last week, up 0.09%, while the Australian and UK markets increased by 2.00% and 1.68% respectively. The US market was up 0.79% over the week, with weak CPI and PPI inflation data, coupled with rising job claim numbers, supporting the market expectation that the Fed's tightening cycle should be nearly over. Market pricing suggests one more 25bps hike before the Fed ends the rate hikes.

Market volatility expectations have decreased based on the hope of an end to the tightening cycle and a slowing economy. The VIX index, measuring volatility expectations in the share market, has decreased for four weeks in a row. Bond market volatility also declined last week, with the MOVE index down 14.6%.

However, Fed Governor Waller repeated his view that monetary policy will need to remain tight for a substantial period of time, and longer than the market anticipates. Stronger than expected earnings results in the US drove US rates higher and strengthened the USD later in the week. The 2-year US Treasury rate increased by 15bps to 3.97%, while the 10-year Treasury rate was up 13bps to 3.44%. In NZ, rates increased slightly, with the 2-year swap rate up 4bps to 5.03%, and the 5-year swap rate up 6bps to 4.31%.

The US Dollar Index was down by 0.44% despite the rally late in the week, and the NZD depreciated against the USD, moving to 0.6205. The Dow Jones Commodity Index was up strongly by 1.55%, and the price of Brent Crude oil was up a further 1.61% to just above US$86 per barrel.

Stats NZ data highlights that retail card spending rose a seasonally adjusted 0.7% month-on-month in March. A survey by BDO highlights that the construction sector still has more work than it can cope with, but a significant number of building companies are worried about a future slow-down. Uncertainty about the pipeline was greatest in the residential sector and amongst smaller operators, with more than a third needing more work or having only sufficient work for the next three months.

The Cordell Construction Cost Index rose 0.6% for the first quarter, the lowest increase in more than two years, taking the annual rate down to 8.5% from 10.5%, suggesting building inflation may have peaked. The index is based on building an average three-bedroom single storey house with two bathrooms in brick and tile.

| The biggest movers of the week ending 14th April 2023 | | | | |
|---|---|---|---|---|
| **Up** | | | **Down** | |
| Pacific Edge | 14.81% | | Serko | -5.02% |
| Arvida Group | 6.12% | | Summerset Group | -4.44% |
| Heartland Group | 5.88% | | Fonterra Shareholders' Fund | -3.24% |
| Tourism Holdings | 5.22% | | Oceania Healthcare | -2.78% |
| Fletcher Building | 4.75% | | NZX | -2.52% |

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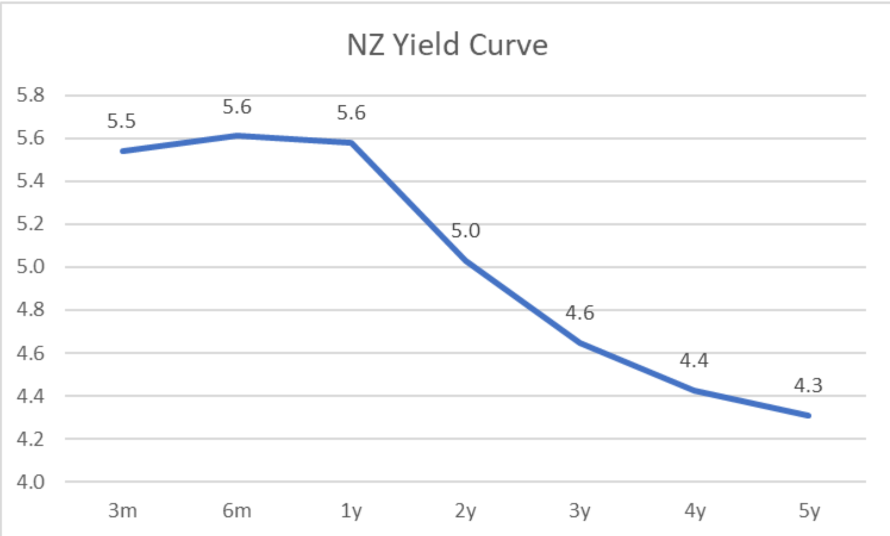
## Market Highlight – IMF Outlook for Real Interest Rates

In last week's market update, we discussed how the rising interest rate environment presents an opportunity for investors to attract a higher return from defensive assets, including bonds. The Reserve Bank of NZ has recently raised the Official Cash Rate by 50bps to 5.25%, with many seeing the higher-than-expected move as a signal to banks that their interest rates in the market have not moved high enough. However, the reaction by banks has not been commensurate with the OCR rise, and what we are seeing now is high short-term rates, but flat or falling long-term rates, as portrayed in the yield curve below. This suggests that the market is expecting a high OCR and short-term rates for the next 18 months or so, followed by a relatively quick fall after that.




**Outlook for Real Interest Rates**

Is the current increase in interest rates a temporary uptick, or a reflection of long-term structural factors? In its recent World Economic Outlook, the International Monetary Fund (IMF) provides its outlook for real interest rates globally. The real interest rate is the interest rate adjusted for inflation. The IMF's analysis shows that real interest rates have been declining since the mid-1980s at all maturities and across most advanced economies. They have found that two of the most important drivers of rates during this time have been:

- Declining productivity growth; and
- Demographic forces, e.g. time spent in retirement as the population ages.

In advanced economies, declining productivity growth and ageing populations have pushed real interest rates downwards. Countering these factors has been higher fiscal financing, which has acted to push up real interest rates, however the net effect has been a downward push.

The IMF's view is that these factors are not likely to behave very differently in the future, so real interest rates in advanced economies will likely remain low. In emerging economies, productivity growth is forecast to decline towards advanced economies' average over the long-term, and coupled with aging populations, rates in those countries are projected to decline towards advanced economies' rates over the long term. The factors that could work against this view are heightened government spending and debt, and deglobalisation forces leading to further trade fragmentation, both of which could act to increase rates in developed economies.

Overall, the IMF's analysis suggests that recent increases in real interest rates are likely to be temporary, and that when inflation is brought back under control, central banks in advanced economies are likely to ease monetary policy and bring real interest rates back towards pre-pandemic levels.

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## Investment News

### Channel Infrastructure NZ (CHI.NZ) – Conversion Project Update

Channel Infrastructure has released its quarterly conversion project update for Q1 2023. Permanent decommissioning of the refinery process plant is now in the final stages and will be completed in Q2 2023. 55m litres of private storage capacity has been commissioned, and is now available at Marsden Point, with the remaining capacity expected to be commissioned during Q3 2023. Conversion costs continue to track to budget, with approximately $145m spent on the project, and limited use of project contingency to date.
**Current Share Price**: $1.53, **Consensus Target Price**: $1.47

### Summerset Group Holdings (SUM.NZ) – First Quarter Sales Update

Summerset Group has reported 210 sales for Q1 2023, comprising 115 new sales and 95 resales. This compares to 279 total sales in Q1 2022, comprising 167 new sales and 112 resales. The CEO said that while new sales are lower, Summerset only delivered 57 new homes during the quarter. The company however continues to be on track for delivering 625 to 675 new homes in 2023, with over 75% delivered in the second half of the year. The resales were lower than expected, and this was primarily related to timings associated with residents settling and moving in.
**Current Share Price**: $8.40, **Consensus Target Price**: $13.28

### Barramundi Ltd (BRM.NZ) – Final Exercise Date for Warrants

The final exercise date for the Barramundi warrants is Friday 26th May. The exercise price of the warrants is $0.83, and the warrants are currently 'out-of-the-money', as the current price of Barramundi shares has dropped to $0.70. As such, our general guidance to investors is to do nothing.