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Yovich & Co. Market Update

13th February 2022

As at 11th February	NZX 50G	All Ords	Shanghai	FTSE	Dow	NASDAQ	NZDAUD	NZDUSD	OCR
Previous Week	12279.56	7418.90	3361.44	7516.40	35089.74	14098.01	0.9347	0.6645	0.75%
Week Close	12173.78	7515.81	3462.95	7661.02	34738.06	13791.15	0.9312	0.6643	0.75%
Change	-0.86%	1.31%	3.02%	1.92%	-1.00%	-2.18%	-0.37%	-0.03%	0.00%

The NZ market was slightly down by 0.86% in the last week, with 20 companies recording gains, and 29 companies recording losses. The US market was down over the week as investors sought safety in Treasuries after news from the US warning that Russia could take offensive military action against Ukraine as early as this week.
The international Brent Crude oil price continued to climb, increasing by 1.8% over the week to US$94.44. It is now up 21.17% this year, following a rise of 60.63% during 2021. These high prices have motivated a sharp rise in the number of US oil rigs brought back into production, which brings hope of oil price falls in the future.
In NZ, the minimum wage will rise from $20 to $21.20/hr, from April 1. MBIE recommended a lower rise to $21, saying larger increases "may become unaffordable for some firms, particularly those in sectors most affected by lockdowns and with high numbers of minimum wage workers".

The biggest movers of the week ending 11th February				
Up			Down	
Sanford	6.75%		Arvida	-6.40%
Westpac	5.98%		Pushpay	-5.50%
EROAD	4.18%		Pacific Edge	-5.41%

Market Theme – Interest Rates

In recent market updates we have talked about rising inflation, and the response from the Reserve Bank of increasing the Official Cash Rate (OCR). Annual inflation has hit 5.9% and the RBNZ has already increased the OCR from a low of 0.25% to 0.75% with further rate hikes signalled. The market has priced in further OCR hikes up to about 2.50% over the next year or so; what does this mean?

The OCR affects rates that are set by the market, starting with the short-term bank bill rates of 1-3 months duration. Longer term rates are based on the market's expectations of future short-term rates. The yield curve is a line chart that shows interest rates of different maturities with the same level of risk, for example government bonds from 1 year to 10 years. Typically, the yield curve is upward sloping, reflecting the fact that investors require a higher return for a longer period of time. However, sometimes the yield curve can be inverted, which usually means investors are predicting a recession in the future, and so are willing to accept lower rates for the safety of longer-term bonds.

When the market is not expecting any immediate changes in the OCR, the 3-month bank bill rate will typically be 0.05%-0.10% (or 5-10 basis points) above the OCR. Currently, the 3-month bank bill rate is 46bps above the OCR, while the 1-year swap rate is 133bps above the OCR, suggesting the market is expecting 5-6 0.25% increases in the OCR over the next year. The chart below shows the OCR since January 2021, along with the spread between the OCR and the 3-month bank bill rate, and the spread with the 1-year swap rate. This clearly shows the widening spreads due to expectations of rate rises.

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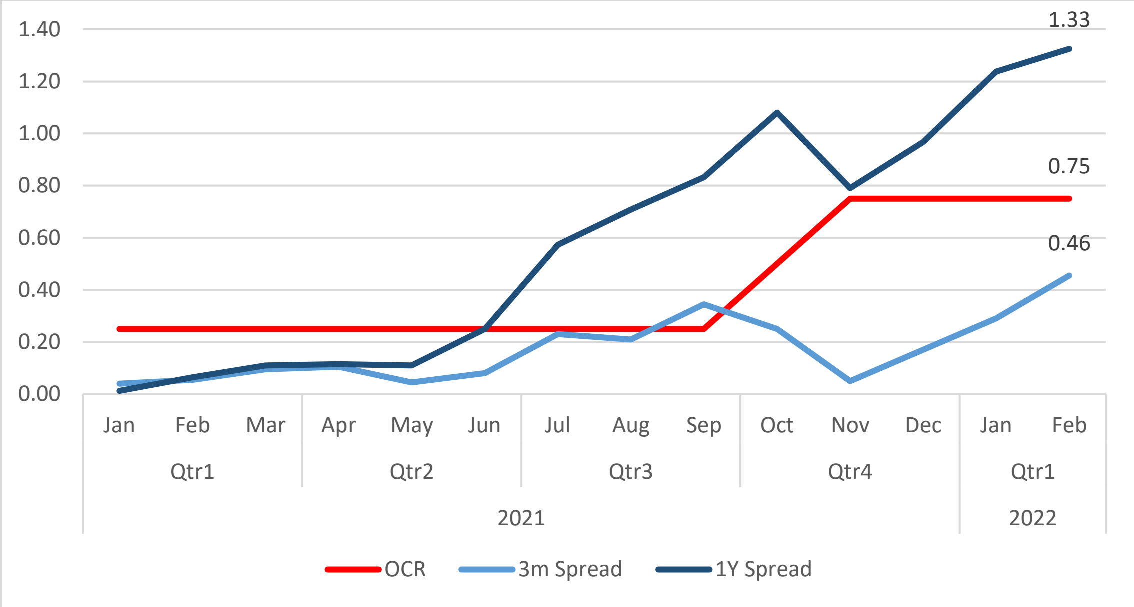

The prediction of higher rates in the future is usually a sign of predicted future growth. This is because growth means an increase in aggregate demand in the economy, which pushes up prices when the economy is at capacity, which leads to inflation and in turn forces interest rates up. In the current climate of supply chain constraints however, it is better to think of the higher rates signalling a lack of economic slack, where our economic capacity is being reached due to lack of supply as opposed to increased demand, hence the fear of stagflation.

How do interest rates affect the sharemarket? Long-term interest rates, for example 10-year bond rates, are typically used to value equities (shares), because equity investors are investing for the long-term. Share returns are balanced against the cost of money (interest rates) over the medium to long term. High dividend yielding stocks are particularly vulnerable to interest rate rises, as the dividend has less relative appeal as interest rates increase. Growth stocks are also impacted heavily, as their values are weighted for more long-term growth, and discounting those long-dated returns at higher interest rates has a sharper impact than for stocks with more modest growth prospects. This is why we have seen a sharper correction for technology stocks in the US.

With interest rates having decreased in recent years, the strong sharemarket returns we have seen have been backed by solid earnings and revenue growth, but also coupled with higher valuations. The correction we have seen in the last few months have cut out this excess in valuations, and we may see that going forward, companies' earnings forecasts will be the principal influence on equity returns.

Market Highlight – Plunge in Meta Platforms (Facebook) Share Price

Facebook parent Meta Platforms posted its quarterly earnings update in early February, revealing a modest decline in profit growth as it increased spending related to the new metaverse that CEO Mark Zuckerberg outlined late last year. The announcement prompted a plunge in the share price, dropping 26% in one day, with further declines in subsequent days. It is now down 34.73% over the year to date.
The company said users were spending less time on its more lucrative services, and also cited inflation as a weight on advertiser spending. They have estimated that ad-tracking changes introduced by Apple last year would cost the company some US$10b this year. The profit reported was US$10.3b for the fourth quarter, below analyst expectations of US$10.9b, and a small decline compared with a year ago.

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Investment News

Westpac (WBC.NZ) – First Quarter Profit Up 80%

Westpac's net profit for the December quarter was up 80% on the quarterly average in the second half of the previous financial year. The company said that primarily reflected lower expenses, and a strong contribution from the Treasury and Markets unit. This is despite the net interest margin, or NIM (the difference between what a bank pays to get deposits and what it charges to lend money) being down 8 basis points from the quarterly average of the second half of the previous financial year, to 1.91%.
Current Share Price: $24.46, **Consensus Target Price**: $26.44

Investore Property (IPL.NZ) – $75m Retail Bond Offer

Investore is offering up to $75m (with an additional $50m in oversubscriptions at the company's discretion) of 5-year senior secured fixed rate bonds. The interest rate will be the Swap Rate (currently at 2.91%) plus an indicative margin of between 1.15% and 1.30% per annum, subject to a minimum interest rate of 3.95% pa.
The net proceeds of the offer will be used to repay existing bank debt. It is expected to open on 14th February and close on 18th February, with the interest rate expected to be set on 18th February.
Current Share Price: $1.76, **Consensus Target Price**: $1.93

NZX (NZX.NZ) Completes Superannuation Acquisition from ASB

NZX, NZ's equity and debt market exchange, has completed the acquisition of the management rights of the ASB Superannuation Master Trust. The acquisition is via NZX's subsidiary and passive funds management business, Smartshares Limited, and represents a step-change in scale for Smartshares.
The acquisition adds more than $1.8b in retirement savings to Smartshares, and is being funded from cash on hand and new debt facilities.
Current Share Price: $1.76, **Consensus Target Price**: $1.88