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

Yovich & Co. Market Update

19th June 2022

As at 17th June	NZX 50G	All Ords	Shanghai	FTSE	Dow	NASDAQ	NZDAUD	NZDUSD	OCR
Previous Week	11136.28	7145.16	3284.83	7317.52	31392.79	11340.02	0.9006	0.6379	2.00%
Week Close	10589.19	6663.29	3316.79	7016.25	29888.78	10798.35	0.9104	0.6316	2.00%
Change	-4.91%	-6.74%	0.97%	-4.12%	-4.79%	-4.78%	1.09%	-0.99%	0.00%

Global sharemarkets were down heavily last week due to central banks hiking rates, coupled with fears of recession. Starting with the US, the overall market was down 5.79%, as the Federal Reserve raised the cash rate by 75bps. In the UK, the market was down 4.12%, while the Bank of England raised its cash rate by 25bps. The local market followed global momentum, falling 4.91%, while the Australian market took a 6.74% hit. The NZ and US markets are now in bear market territory, down more than 20% from their peaks.

Higher cash rates pushed bond yields higher, and shares lower. Coupled with the higher interest rates was the rising fear of recession globally, causing sentiment to turn negative on shares and commodities, including oil. The price of oil dropped 6.8% over the week to US$113.46 per barrel, while iron ore was down 11.7%. The Australian dollar was softer as a result, with the NZD/AUD rate up by 1.09% to 0.9104.

In NZ, the 2-year swap rate increased by a massive 51bps to 4.52%, while the 10-year swap rate was up 38bps to 4.53%, resulting in an almost inverted yield curve, with the long-term 10-year rate only just above the short-term 2-year rate. In the US, the 2-year Treasury rate increased by 35bps to 3.18%, while the 1-year Treasury rate was up 21bps to 3.23%, flattening the yield curve.

The NZ GDP result for the March quarter was lower than expected, growing just 1.2% annually, compared to expectations of 2.4%. The Real Estate Institute of New Zealand (REINZ) released its May housing market report, which saw house prices across the country fall 5.0% from their peak, while Auckland house prices have fallen 11.7% from their peak. Auckland tends to lead the rest of the market, so we may see further weakness across the country. Tighter credit conditions, higher mortgage rates, and increased housing supply have all contributed to the weaker market.

The biggest movers of the week ending 17th June 2022				
Up			**Down**	
Sanford	3.70%		Skellerup	-15.85%
Vector	3.50%		Tourism Holdings	-13.01%
Fonterra Shareholders' Fund	1.91%		EROAD	-12.56%

Economic News – Federal Reserve Hikes Rate 75 Basis Points

Inflation in the US hit 8.6% in the year to May, the highest increase in consumer prices since December 1981, and higher than the expected rate of 8.3%. The big movers that contributed to the increase were housing (called shelter in the US), food, and energy prices.

The Federal Reserve had previously raised its benchmark federal funds rate by 25bps during March, signalling further increases throughout the remainder of the year. At the time, market expectations were for the Fed to raise rates by multiple 0.50% increases, with the market pricing in a 50% chance of a 75bps hike in June. With inflation coming out higher than expected for May, the Fed has decided to raise the funds rate by the higher 75bps.

This comes as the Reserve Bank of Australia has increased its cash rate by 50bps from 0.35% to 0.85% to curb inflation, while the Reserve Bank of NZ has already moved with aggressive rate hikes.

Federal Reserve Chair Jerome Powell was keen to send the message that the Fed is not intending to tip the economy into recession. The aim is to achieve 2% inflation with a strong labour market. He expects a 50 or 75 basis point rate hike will be most likely at the next policy meeting, noting that the current 75bp hike is an unusually large one, and he does not expect moves of this size to be common. Mr Powell also noted that higher unemployment may be a worthwhile tradeoff for a healthy economy; getting inflation down to 2% while unemployment goes up to 4.1% (currently very low at 3.6%) would be a successful outcome.

Recession Fears

Normally the market reacts negatively to higher than expected increases in interest rates. This is because companies are generally valued on their expected future cash flows, discounted at an appropriate discount rate. The discount rate used generally moves with long-term bond rates, plus a margin. Higher interest rates therefore translate into lower share prices. If we think about this in terms of the P/E Ratio, which we introduced in last week's market update, P/E ratios reduce as interest rates go higher.

But share prices have taken more of a tumble than could be expected from a 75bps rate hike. Why? It is because rampant inflation is causing the market to now fear a recession in the US economy. In a recession, companies' earnings fall, or at least fail to reach target growth. If we again refer to the P/E Ratio, not only is the ratio falling due to interest rates rising, but the fear is that earnings ('E') will be less than expected. So applying a lower P/E multiple to smaller earnings is a double-whammy.

In fact, such is the fear that recession is the bigger threat to investors, the market actually rallied the day of the Fed announcement. Investors took comfort that the Federal Reserve was serious about fighting inflation, and getting on top of it quickly to ensure a soft landing for the economy, as opposed to the alternative stagflation (stagnant economy coupled with high inflation).

Bear Market

With recent falls in share prices, the US market is now in a bear market, generally considered to be a 20% fall from the peak. The US market is down 23.9% from its peak in January this year, however, with the market having increased 26.9% during 2021, the market is back at levels seen in January 2021.

The NZ market has also recently reached bear market status, with the market down 25.8% from its peak in January 2021. The market was previously at this level during March 2020 when the pandemic first hit us, and prior to that the market was at current levels in the first quarter of 2019. The NZ market delivered a 26.0% return in 2019 and 11.4% in 2020.

The VIX (CBOE Volatility Index) has increased over the past two weeks, closing at 32.95, indicating heightened market expectations for volatility in the US sharemarket in the next 30 days.

In April, we looked at the yield curve, and discussed the 2-year to 10-year spread being a forward indicator of a recession when the spread turns negative. With the US 2-year Treasury yield currently at 3.18% and the 10-year Treasury yield at 3.27%, the spread has narrowed to 0.09%, so we are not yet at an inverted yield curve in the US.

With both the US and NZ economies at record low unemployment, both central banks have room to aggressively target inflation and aim for a soft landing.

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What Should Investors Do?

Keep to your long-term investment plan. Reacting to short-term volatility is poor strategy; as the investing mantra goes: it is not about timing the market, it is about time in the market. Periods of high volatility and recession are the reason for implementing a diversified portfolio. If you have the ability to hold extra cash and wait for some good opportunities in the market, two sectors to look out for are healthcare and consumer staples, which tend to be the most resilient to recessions. Options in NZ and Australia include Coles, Woolworths, Ebos Group, Fisher & Paykel Healthcare, CSL Ltd, and Resmed.

Investment News

SkyCity Entertainment Group (SKC.NZ) Provides Earnings Guidance for FY22

SkyCity advises that it is now in a position to provide earnings guidance for the year ending June 2022, following stronger than expected recent trading, especially in NZ. The company expects normalised EBITDA of between $135m-$140m and normalised NPAT of between $3.5m-$7.0m.
Current Share Price: $2.71, **Consensus Target Price**: $3.45

Ryman Healthcare (RYM.NZ) Plans New $220m Village in Taupo

Ryman has purchased a 9.79ha site on Acacia Bay Road in Nukuhau, near the town centre, with views of Lake Taupo, with plans to build a new $220m retirement village. Chief Development and Construction Officer Chris Evans said Ryman had been looking for a location for a Ryman village for some time, and noted that Taupo has a large retire population and a shortage of living options for older people.
Current Share Price: $9.05, **Consensus Target Price**: $12.22

Sky TV (SKT.NZ) Not Proceeding with MediaWorks Acquisition

Further to its announcement on 7th June addressing media speculation, Sky TV has advised that has ceased discussions to evaluate the possible acquisition of MediaWorks. Sky remains committed to restoring regular dividends, having returned to revenue growth and achieving sustainable levels of free cash flow.
Current Share Price: $2.30, **Consensus Target Price**: $3.12

Pushpay Holdings (PPH.NZ) – FY22 Profit Up 7%

Pushpay Holdings announced its FY22 financial results, with revenue up 13% on pcp to US$202.8m, breaking through the US$200m milestone, and net profit up 7% on pcp to US$33.4m. Guidance for FY23 was for operating revenue growth of between 10% and 15%.
Current Share Price: $1.28, **Consensus Target Price**: $1.57