

Yovich & Co. Market Update

24th October 2022

As at 24th October	NZX 50G	All Ords	Shanghai	FTSE	Dow	NASDAQ	NZDAUD	NZDUSD	OCR
Previous Week	10868.09	6948.59	3071.99	6858.79	29634.83	10321.39	0.8974	0.5561	3.50%
Week Close	10782.36	6869.86	3038.93	6969.73	31082.56	10859.72	0.9024	0.5750	3.50%
Change	-0.79%	-1.13%	-1.08%	1.62%	4.89%	5.22%	0.56%	3.40%	0.00%

The US market had its best week since June, with the Dow Jones Index up 4.89% and the NASDAQ up 5.22%, as investors took heart from Federal Reserve comments suggesting the bank would slow down on the steep interest rate hikes later this year. The Fed will likely raise the funds rate by a further hike of 75 basis points in November, but may slow down after that to take stock of the economic effects into 2023. Meanwhile, the NZ market fell 0.79% and the Australian market fell 1.13% during the week.

US interest rates continued to hike aggressively against heightened inflation concerns, with the 2-year Treasury rate up 19bps to 4.61% and the 10-year Treasury rate up a massive 35bps to 4.25%, its highest level since 2008. NZ interest rates also continued upwards aggressively, with the 2-year swap rate up 38bps to 5.31% and the 5-year swap rate up 36bps to 5.07%.

Commodity prices were on average slightly down during the week, with the Dow Jones Commodity Index down 0.58%. The price of Brent Crude oil increased 1.94% to US\$93 per barrel.

Trade Me Property's rental housing figures show the number of properties listed for rent for September was up 31% compared to September last year, while the median asking rent advertised was only down \$5 compared to August.

The biggest movers of the week ending 21 st October 2022			
Up		Down	
Heartland Group Holdings	6.06%	Manawa Energy	-6.79%
Tourism Holdings	4.92%	EROAD	-5.11%
Restaurant Brands	3.12%	Oceania Healthcare	-4.55%

Market Spotlight – Exchange Rates

In recent weeks, we have discussed the high inflation rate, and the effect that has on rising interest rates. A third variable that is also highly correlated with inflation and interest rates is exchange rates. An exchange rate is simply the rate at which one currency is exchanged for another, for example, NZD/AUD and NZD/USD.

What are the main drivers of Exchange Rates?

Inflation and Interest Rates

Inflation lowers the purchasing power of a dollar, so if we have more inflation in NZ compared with overseas, this will make the NZD less valuable. Countries normally respond to high inflation by increasing interest rates, as the RBNZ has been doing since October 2021 due to rising inflation. In turn, higher interest rates attract foreign investment as investors look for higher returns. This has the effect of increasing the value of the NZD, as foreign investors buy NZD in order to invest. Inflation and interest rates therefore have opposing effects on the exchange rate, and all else being equal, higher interest rates can effectively cancel out the lowering effect of high inflation on the exchange rate.

Current Account Surplus/Deficit

If NZ spends more on imports than it earns from its exports, it has a current account deficit. In this case, there is excess demand for foreign currency (for example AUD), as NZ needs to buy more AUD to pay for the excess imports. This forces the NZD down, as people sell NZD to buy the required AUD. The lower NZD/AUD exchange rate in turn makes NZ exports cheaper for Australians, resulting in more exports, and imports from Australia more expensive, resulting in fewer imports, thereby lowering the current account deficit or creating a surplus. Alternatively, if NZ has higher interest rates than Australia, NZ can attract Australian investment to balance the currency account.

Other Drivers

The NZD is ultimately tied to the strength of the NZ economy. A stronger economy produces more and higher-value exports that are in demand overseas, leading to higher demand for the NZD.

Another driver for smaller currencies like the NZD is general risk aversion, related to the global economy. With rising global uncertainty, investors become more risk averse, preferring the relative safety of the larger USD.

Why have we seen the NZD fall?

The NZD/USD exchange rate has fallen 17.12% this year, from US\$0.6839 to now US\$0.5668. Between 2010 and 2020, NZ's current account deficit was in the range of 2%-4% of GDP. That fell to 0.8% in 2020 during Covid as we imported less. However, the current account deficit is widening this year, and the deficit was 7.7% of GDP in the year to June 2022. At the same time, US interest rates have moved higher at a faster rate than NZ interest rates. The premium that NZ government bonds offered over US government bonds at the start of the year has fallen as a result, reducing the incentive for US investors to buy the higher risk NZD. The third major factor has been rising global economic uncertainty, as the world struggles with inflation and the continuing war in Ukraine. This uncertainty means higher risk aversion, with funds flowing towards the safer USD and away from the NZD.

What does this mean for investors?

For investors with an investment portfolio that is well-diversified by geography, their international equities will have benefitted from the falling NZD, as the values of the overseas currencies have appreciated against the NZD, especially those investments in the US. This will have insulated these portfolios from the extent of the downturn of the market during 2022, and highlights the importance of diversifying your investments outside of NZ.

Investment News

Air New Zealand (AIR.NZ) Launches New 5.5 Year Fixed Rate Bonds

Air NZ has launched a new 5.5 year bond offer, with the interest rate set on 20th October at 6.61%pa. The size of the issue is \$100m; the offer having closed on 20th October. Proceeds from the issue will be used for general corporate purposes, including repayment of the AIR020 bonds.

Current Share Price: \$0.765, **Consensus Target Price:** \$0.76

Fonterra (FCG.NZ/FSF.NZ) Announces New Sustainable Finance Framework

Fonterra has released its Sustainable Finance Framework, which aligns its funding strategy with its sustainability ambitions, and reflects the evolving preferences of lenders and debt investors in this area. The Framework outlines how Fonterra intends to issue and manage any sustainable debt, which could include green bonds and sustainability-linked bonds and loans.

Current Share Price: \$3.00, **Consensus Target Price:** \$3.54

Manawa Energy (MNW.NZ) Revises Earnings Forecast

Manawa had previously issued guidance that EBITDAF for FY23 was expected to be \$140m-\$160m; it is now expecting the range to be \$127.5m-\$140m. Reasons for the downgrade include a difficult first half, increased operating expenditure for activity in relation to new developments, and repairs and maintenance driven by recent significant weather-related events.

Current Share Price: \$5.08, **Consensus Target Price:** \$6.21

Auckland International Airport (AIA.NZ) Lifts FY23 Profit Guidance and Considers Retail Bond Offer

Following a stronger than expected rebound in the aviation market, AIA has increased its FY23 guidance for underlying profit after tax from \$50m-\$100m previously to \$100m-\$130m. For the full FY23, the company is now anticipating international passengers will be between 60%-70% of pre-covid levels, and domestic passenger numbers between 85%-90%.

AIA is considering an offer of fixed rate bonds maturing in May 2028. It is expected that full details of the bond issue will be released the week of 25th October. If interested, please get in contact with your adviser.

Current Share Price: \$7.32, **Consensus Target Price:** \$7.53

Spark (SPK.NZ) Receives Allocation of C-Band Spectrum to Support 5G Rollout

Spark and the Crown have reached an agreement that will provide Spark with management rights to C-band spectrum, in return for a commitment to support the ongoing expansion of rural connectivity through the Rural Connectivity Group (RCG), and the deployment of 5G to provincial NZ. The allocation of C-band spectrum provides Spark the certainty it needs to continue investing in the rollout of 5G across NZ, while delivering further connectivity improvements across rural NZ.

Current Share Price: \$5.005, **Consensus Target Price:** \$5.26

Heartland Group Holdings (HGH.NZ) to Purchase Challenger Bank in Australia

Heartland has signed a conditional share purchase agreement to purchase Challenger Bank, subject to regulatory approvals. Based in Melbourne, Challenger Bank is an established authorised deposit-taking institution (ADI), and its system is also capable of reverse mortgage origination. Heartland's plan is for its existing Reverse Mortgage and Livestock businesses in Australia to be transferred to sit in or under Challenger Bank. Heartland's strategic objective for expansion in Australia requires the establishment or acquisition of an ADI.

Current Share Price: \$1.75, **Consensus Target Price:** \$2.13