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Yovich & Co. Market Update

30th October 2022

As at 30th October	NZX 50G	All Ords	Shanghai	FTSE	Dow	NASDAQ	NZDAUD	NZDUSD	OCR
Previous Week	10782.36	6869.86	3038.93	6969.73	31082.56	10859.72	0.9024	0.5750	3.50%
Week Close	11129.53	6973.52	2915.93	7047.67	32861.80	11102.45	0.9067	0.5725	3.50%
Change	3.22%	1.51%	-4.05%	1.12%	5.72%	2.24%	0.47%	-0.43%	0.00%

Markets made further gains last week, with the US market up 3.95%, the NZ market up 3.22%, and the Australian market up 1.51%. There is more speculation that the Federal Reserve is debating internally on the aggressiveness of further rate hikes, leading investors to speculate that rate hikes will not go as high. This however will not affect this week's expected rate hike from the Fed of 75 basis points. The Fed will be looking for clear evidence of a weaker labour market before loosening their current trajectory.

The Reserve Bank of Australia releases its next monetary policy decision this week, where it is expected to raise the cash rate by a further 25bps to 2.85%. The RBA has been raising rates slower than other economies, and slower than the market expected, and their latest inflation figures saw the CPI increase 7.3% over the year to September, which was higher than expected. The European Central Bank raised its cash rate last week by a further 75bps to 1.50%.

Interest rates in the US fell from their previous week's highs, with the 2-year Treasury rate down 26bps to 4.35%, and the 10-year Treasury rate down 28bps to 3.98%. NZ interest rates followed suit, with the 2-year swap rate down 33bps to 4.99%, after having jumped 38bps in the previous week to 5.31%. The 5-year swap rate also fell 36bps back to 4.71%.

Commodity prices were on average slightly up during the week, with the Dow Jones Commodity Index up 0.46%. The price of Brent Crude oil increased 2.45% to US$95 per barrel.

The ANZ Business Outlook survey for October showed business confidence fall. Pricing intentions are reportedly easing, but do not yet indicate a meaningful fall in inflation.

The biggest movers of the week ending 28th October 2022				
Up			Down	
Mainfreight	11.32%		Vista Group	-5.66%
Tourism Holdings	10.63%		Serko	-3.40%
Freightways	5.84%		Heartland Group	-2.86%

Economic News – INFINZ Conference 2022

Last week, the annual conference for INFINZ (Institute of Finance Professionals NZ Inc) was held in Auckland. Speakers at the conference included the Minister of Finance Grant Robertson, Reserve Bank Governor Adrian Orr, Former Trade Minister Tim Groser, Sir John Key, bank CEOs, and economists. Topics discussed included an update on the domestic economy, global and domestic inflation, geopolitics and trade, and international economics.

There is a lot to unpack from a full day of speakers, and there was no clear consensus on whether we are on the brink of recession, and where inflation will go next year, but three important themes from the day were:

- While it has become fragmented, we are not seeing the end of globalisation and international trade.

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- While NZ is in a tricky balancing act between China, our largest trading partner, and the increasing division between eastern and western countries, we have other opportunities such as the UK and Europe.
- Inflation is becoming sticky, and as central bankers globally increasingly ramp up rate rises, the potential for a hard landing increases. While NZ cannot escape this global phenomenon, we are better placed than most countries.

Globalisation

Globalisation in the last half of the 20th century has enabled dramatic global economic growth, especially in emerging economies such as China. The world has become more interconnected, and international trade has soared. One major effect this has had on western nations is keeping a lid on inflation: with manufacturing outsourced to low-wage countries, prices for goods have dropped. Globalisation has become more fragmented since the global financial crisis, and this fragmentation has been exacerbated by the disruption to established supply chains since Covid, and increasing geopolitical tensions, notably the Russian invasion of Ukraine, and recent trade wars and security concerns between China and the US. A major development recently has been the CHIPS and Science Act in the US, which boosts government funding for the manufacture of semiconductor chips. The US economy has become highly dependent on the supply of these chips, which are used in many industries, however recent supply chain disruptions revealed a large hole in the security of this essential supply. With the US government now subsidising the chip manufacturing industry, this also comes with stricter chip export controls to protect national security.

That said, the fragmentation does not signal the end of globalisation. A small open economy such as NZ relies on international trade, and while the playing field is changing, as long as we still produce goods and services that are in demand overseas, we will continue to export. The supply chain disruptions have provided a lesson to businesses, with the previous phrase "just-in-time" being replaced by "just-in-case", meaning businesses are prudent to hold more stock "just in case" of further disruptions to their supply.

Balancing act with China

China is NZ's largest trading partner, with trade having ramped up since signing the historic free trade agreement in 2008. This has been hugely beneficial to the NZ economy, with a rapidly increasing middle-class in China looking for higher-protein foods, happily supplied by NZ farmers. Relying on one trading partner too much however does increase the risk to our economy. Just as diversification of an investment portfolio reduces risk, so too does diversification of trading partners reduce risk. It so happens that NZ's largest trading partner is also an authoritarian regime with little regard for human rights, with President Xi Jinping looking to further enforce his power, recently changing the rules to allow him to remain in power for a third term, effectively making his term indefinite.

There is a conflict for NZ due to our historical allegiance to democratic countries, and our 5-Eyes partnership with the US, UK, Canada, and Australia. We only need to look at the Australian example to see the result of making Chinese leaders unhappy: China cut off contact with Australian ministers and slapped tariffs and restrictions on some Australian exports. While this will be a difficult path to navigate for NZ, we can take heart that we have other opportunities to develop other trading partnerships, including the UK and Europe.

Inflation

During the Covid lockdown, the actions of central banks via monetary policy, and governments via fiscal policy, worked in unison to inflate demand in the economy. With the resulting rampant inflation, there is a growing conflict now between monetary policy seeking to reduce aggregate demand, and fiscal policy seeking to support those struggling to make ends meet due to the rising cost of living. Economists seem to agree that in NZ we are now experiencing wage inflation, which can make general inflation more sticky as expectations lead to a price-wage spiral. The longer inflation sticks around, the harder the landing will have to be on the economy to get it under control.

To put NZ's situation into a global perspective however, we have one of the lowest inflation rates, and one of the lowest unemployment rates. Having started monetary tightening earlier than some, we should be able to curtail inflation long before it reaches the heights seen around the world, and with unemployment starting from such a low base, the required dampening of economic demand should see unemployment remain low by world standards.

Investment News

Fletcher Building (FBU.NZ) Reconfirms FY23 EBIT Target of $855m

In a trading and outlook update, Fletcher's CEO says that trading in the Products and Distributions divisions across NZ and Australia remains in line with expectations, and it is expected that volumes will remain at current levels for the remainder of FY23. In the Residential and Development division, house prices and margins are running 10% below the peak levels reached in December 2021. The company reconfirms their FY23 EBIT target of $855m or better. EBIT for FY22 was $756m.
Current Share Price: $4.98, **Consensus Target Price**: $6.77

Restaurant Brands (RBD.NZ)) – Third Quarter Sales Up 32.3%

Restaurant Brands' third quarter sales to 30th September increased 32.3% to $322.2m compared to the previous comparable period, as sales recovered from the impacts of Covid restrictions. Total year-to-date sales are up 15.7% on pcp to $907.1m. The company notes inflation is adding cost pressures, and is raising prices where possible in response.
Current Share Price: $7.15, **Consensus Target Price**: $10.68

ANZ Bank (ANZ.NZ) – Full-Year Profit Up 16%

ANZ has announced its full-year earnings, with profit up 16% from FY21, to AUD$7.119b, and EPS up 6% on last year. Net interest margin was 1.63%, compared to 1.64% in FY21. A final dividend of AUD74c was announced, taking the full-year dividend to AUD$1.46, up 2.8% from $1.42 in FY21. The net interest margin is expected to improve in FY23, but total expenses may increase around 5% in FY23.
Current Share Price: $27.90, **Consensus Target Price**: $29.76

SkyCity Entertainment Group (SKC.NZ) – First Quarter EBITDA Up 10%

SkyCity has provided a trading update, noting a strong start to the year, with revenue and EBITDA exceeding their internal expectations. EBITDA in Q1 FY23 was approximately 10% above pre-Covid levels.
Current Share Price: $2.79, **Consensus Target Price**: $3.53

Port of Tauranga (POT.NZ) – Full-Year Profit Up 8.7%

Port of Tauranga has announced its FY22 results, with NPAT up 8.7% on last year, to $111.3m, driven by solid bulk trade and container volumes, and increased storage revenue. Costs also rose substantially, mostly due to higher rail, fuel, and labour costs. A final dividend of 8.2cps was announced, taking the full-year dividend to 14.7cps, up from 13.5c the previous year.
Current Share Price: $6.29, **Consensus Target Price**: $6.21