What can we make of the uncertain world we are in?

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• interest rates
• inequalities
• isolationists

“What affects mankind is inevitably our affair.”

Sources: Shutterstock and Getty Images
Mad as hell
Why it’s kicking off around the world

- stagnating middle classes
- stifled democracy
- wealth concentration

Source: The Guardian Weekly
Wealth creation has been uneven

- The world’s 26 richest individuals own as much wealth as the poorest half of the global population.
- Europe & North America comprise 15% of the world’s total population; Africa & India comprise over 25%.

Source: Global Wealth Report 2018, Credit Suisse Research Institute
"I would say that the level of relationship is a 10."
Why “isolationism” has always inevitably failed ...

- appeasement emboldens aggressors
  - the “Chamberlain effect”

- technology trumps territory
  - the internet (social media) has no borders

- bilateralism accentuates inequalities
  - migration and economic refugees
• 18.9% increase in the CPI for the year to the June 1987 quarter
November Monetary Policy Statement

- **OCR unchanged at 1.00%, (minus 0.75% since November 2018)**

- **Inflation : 1.5%**

“Employment remains around its maximum sustainable level while inflation remains below the 2% target mid-point, but within our target range (1% to 3%).”

“**Interest rates will need to remain at low levels for a prolonged period** to ensure inflation reaches the mid-point of our target range”
Factors to consider

• The overlay of politics and economics make the current environment “different”
  ➢ Brexit, Middle East, South America
  ➢ Protectionism – USA versus China
  ➢ Attitudes to globalisation
  ➢ Geopolitical pressures will intensify
• Not your “normal” slowdown in growth around the globe
• Are we set to follow Japan?
• China – can they hold it all together?
• What does the world look like if monetary policy is now ineffective?
• Italy 10-year bond yields are 1% yet government debt is >100% GDP. Credit risk being ignored.
US GDP growth – longest expansion in history

SOURCE: TRADINGECONOMICS.COM | U.S. BUREAU OF ECONOMIC ANALYSIS
But the fiscal position now is worse than post WWII
Slumping manufacturing offset by strong services

Source: Trading economics

US ISM manufacturing PMI

Source: Bloomberg, WSJ

US Markit services PMI
Manufacturing recession is global

![Manufacturing PMIs graph](image-url)

Source: Refinitiv Datastream
Leading indicators suggest slowing global growth
World exports expected to follow commodity prices down
Aging demographics could be suppressing demand?

*Persons 15-64 years old. Source: United Nations*
Flat China trade only due to devalued currency

*China: Merchandise Trade*
(trillion yuan, saar, ratio scale)

*Excluding Hong Kong.
Source: China Customs and Haver Analytics.
China’s consumer has become much more cautious.
US house price growth is slowing quickly now
And US jobs growth is slowing
Trend outlook for US employment declining

Source: Federal Reserve Banks of Dallas, Kansas City, New York, Philadelphia, and Richmond.
Recessions tend to accompany negative payroll revisions
The US consumer is about to feel price pain

Source: WSJ, Daily Shot
Globalisation and technology continues to drive durable goods deflation

CONSUMER PRICE INDEXES: DURABLE GOODS
(percent change)

Fed only has 225bp of rates to cut this cycle

[Graph showing US policy rate from 1975 to 2015]

Source: Refinitiv Datastream
As activity slows, so does earnings growth

*S&P 500 Aggregate Revenues* (yearly percent change) (8.0)

Average of
M-PMI & NM-PMI (52.8)

* S&P quarterly data, not per share. Revenues are derived by multiplying S&P 500 revenues per share by the S&P 500 divisor for each quarter.
Source: Standard & Poor’s and Institute for Supply Management.
If E falls, US equity valuations harder to justify
And earnings downgrades are coming
NZ still has growth, but it’s slower paced

Why has growth slowed?

➢ Capacity
➢ Global scene
➢ End of cycle – watching structural indicators
➢ Some asset classes adjusting
➢ Lots of change which is unsettling
➢ Easing migration
➢ Weak confidence

A slower pace of growth is not a downturn – yet!

Source: Bagrie Economics, Statistics NZ
World population projections. Disruption is here for agriculture but the world still needs to eat

- The world population is projected to **9.9 billion** in 2050
- That’s up **2.3 billion** from an estimated 7.6 billion now
- Africa’s population to more than double by 2050 to 2.6 billion
- Asia will rise about 717 million to **5.3 billion**
- Europe (including Russia) will see a decline in population from 746 million to 730 million
- The population in the Americas is seen increasing to 1.2 billion from 1 billion now
- **India +309m. Nigeria +215m. Congo +132m. Pakistan +106m**
- The population of 38 countries will be smaller in 2050 than in 2018. **China -50m. Japan -25m. Russia -9m. Germany -4m**
- Australia 24 to 35m. NZ 4.8 to 6.3m

Source: Population Reference Bureau – 2018 World Population Data Sheet, Bagrie Economics
What normally drives a downturn in NZ?

- Global recession
- Asset bubble that pops / weakness in structural indicators
- Emergence of inflation drives up interest rates
- Incompetence
  - Central bank takes interest rates too far or don’t respond quickly enough
    - Tends to impact quickly
  - Government delivers poor policy
    - Tends to be take time to impact
Strong levels of building activity and high commodity prices

- Building consents issued $ million (annual)
- Commodity prices - NZD (Jan 86=100)

Source: Bagrie Economics, ANZ, Statistics NZ
RBNZ expects asset prices to lift / people to spend

Key topics to think about

➢ August / September has seen the property market lift
➢ How low can physical borrowing rates go? There is a limit
➢ Could negative interest rates come to NZ?
➢ Will people borrow and spend more?

Projected impact of interest rate changes on house prices (%) – quarterly boost

Source: Bagrie Economics, RBNZ
What are we observing

Clouds are swirling

- Banks are tightening credit availability, particularly to rural and property sectors
- House prices are falling in Auckland
- Lending to agriculture sector has hit its aggregated cap
- Increasing financial distress is evident across the dairy sector, including Fonterra

The good news

- NZ has enjoyed 18 years of excellent returns across all segments: equities, property, farming, fixed interest
- NZ has been the best performing market in the world over the past 18 years
- NZ has outperformed the Australian equity market by 100% over the past 7 years
NZ Equities vs the World

NZ Dividend yield advantage has gone

PE expansion drives NZX50 outperformance

Source: Forsyth Barr Research
Returns over time

This graph shows the range of returns (high-low) and average returns on key investment classes over the past 20 years.

Sources: Iress, Ord Minnett, Forsyth Barr Research
Past performance is not a guarantee of future performance. All returns are based in the local currency i.e. A$ for Australia, US$ for international.
Our guiding principle is “North-West”
The goal: To achieve a higher return with less risk

Expected return vs. Risk

Source: Forsyth Barr Research
Risk return: NZ equities moving South East

Blue circles:
Expected 3 year return of +7.5% (+/- 4%)

Source: Forsyth Barr Research
Dividend yields and bond rates over time

S&P/NZX Div. Yield (12m Fwd)

5 Year Bond Yield

Source: Forsyth Barr Research
Higher yields are not without risk

<table>
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<tr>
<th></th>
<th>Dividend Yield</th>
<th>5 Year Bond Yield</th>
<th>Premium</th>
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<tr>
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<td>3.4%</td>
<td>1.1%</td>
<td>+2.3%</td>
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<tr>
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<td>4.1%</td>
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<tr>
<td>Germany</td>
<td>3.1%</td>
<td>-0.5%</td>
<td>+3.7%</td>
</tr>
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Source: Forsyth Barr Research

- The prospect/impact of lower/negative interest rates accentuates investor focus on alternatives, however risks need to be carefully considered.
Consequences of listening to the Armageddonists
Thank You