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Investment Update – September 2016

Prepared by JMIS, investment consultant to Select Wealth Management

After a weak first half of 2016, global GDP growth should recover modestly in the second half as the large drag from inventories abates. However, the world continues to face substantial headwinds, including the impact of Brexit, continued weakness in US investment ahead of their election, a moderation in Chinese growth and the impact of the stronger yen on Japan.

US

In August, the Fed left interest rates unchanged as good news about the economy, such as the better employment data, was offset by subdued inflation and global worries. However, the Fed kept open the possibility of a rate rise later this year, saying the near term risks had now diminished. Another positive was that unemployment in July was unchanged at 4.9%.

In July, the CPI was slightly weaker than expected with a core rate of 0.1% versus 0.2% expected, new home sales rose more than expected to the highest level in 9 years and the manufacturing PMI slipped from 52.9 to 52.1 but remained in expansion mode, as it has been since 2009.

Japan

In early August**,** Japan's cabinet approved a government stimulus package that includes ¥7.5 trillion (US$73 billion) in new spending, in the latest effort by Prime Minister Shinzo Abe to jump-start the nation's sluggish economy. The spending program, which has a total value of ¥28 trillion over several years, represents not just an attempt to breathe new life into the Japanese economy but a political test for Mr. Abe, who has struggled to deliver sustained growth.

Japan's August preliminary Manufacturing PMI rose to 49.6 from 49.3, but stayed in contraction mode for the 6th straight month.

China

In July, China's macro statistics for industrial production, fixed asset investment and retail sales growth as well as new credit data all weakened.

This data seemed to suggest that the overall growth momentum of the first half of the year is wobbling a little lower in China. The yuan has continued to weaken slowly, as capital outflows persist.

Europe

The Eurozone's slow economic recovery appears to have weathered the initial shock of Britain's vote to leave the EU with the July PMI surveys of business activity reaching their highest level in seven months.

The European Central Bank has hinted at taking further action next month should economic conditions in the eurozone fail to improve, with its top policymakers saying the impact of the latest wave of uncertainty to hit the global economy needed "very close monitoring". The latest edition of the central bank's monetary policy deliberations — for the meeting on July 21 when it decided to keep rates on hold — indicated the governing council may well act to keep its ultra-loose monetary policy in place for longer when it next meets on September 8. Europe's recovery has remained on track, but aftershocks from the UK vote to leave the EU and the poor health of the region's banks risked its derailment.

The Bank of England cut its benchmark interest rate to 0.25% in July, the lowest level in the Bank's 322 years, and introduced a series of bond-buying measures to support the economy after Brexit. The rate had been at 0.5% since March 2009.

Australia

In early August, the Reserve Bank of Australia cut its official cash rate by 25 basis points to 1.5% citing low inflation. Given very subdued growth in labour costs and very low cost pressures elsewhere in the world, low interest rates will likely remain for some time.

New Zealand

As expected, in mid-August, the Reserve Bank of New Zealand (RBNZ) cut the official cash rate by 25 basis points to 2%. This was the 6th cut in the last 14 months. At the time, the RBNZ said:

"*Global growth is below trend despite being supported by unprecedented levels of monetary stimulus. Significant surplus capacity remains across many economies and, along with low commodity prices, is suppressing global inflation. Some central banks have eased policy further since the June Monetary Policy Statement and long-term interest rates are at record lows. The prospects for global growth and commodity prices remain uncertain. Political risks are also heightened.*

Weak global conditions and low interest rates relative to New Zealand are placing upward pressure on the New Zealand dollar exchange rate. The trade-weighted exchange rate is significantly higher than assumed in the June Statement. The high exchange rate is adding further pressure to the export and import-competing sectors and, together with low global inflation, is causing negative inflation in the tradables sector. This makes it difficult for the Bank to meet its inflation objective. A decline in the exchange rate is needed.

Domestic growth is expected to remain supported by strong inward migration, construction activity, tourism, and accommodative monetary policy. However, low dairy prices are depressing incomes in the dairy sector and reducing farm spending and investment. High net immigration is supporting strong growth in labour supply and limiting wage pressure.

House price inflation remains excessive and has become more broad-based across the regions, adding to concerns about financial stability. The Bank is consulting on stronger macro-prudential measures that should help to mitigate financial system risks arising from the rapid escalation in house prices.

Headline inflation is being held below the target band by continuing negative tradables inflation. Annual CPI inflation is expected to weaken in the September quarter, reflecting lower fuel prices and cuts in ACC levies. Annual inflation is expected to rise from the December quarter, reflecting the policy stimulus to date, the strength of the domestic economy, reduced drag from tradables inflation, and rising non-tradables inflation. Although long-term inflation expectations are well-anchored at 2 percent, the sustained weakness in headline inflation risks further declines in inflation expectations.

Monetary policy will continue to be accommodative. Our current projections and assumptions indicate that further policy easing will be required to ensure that future inflation settles near the middle of the target range."

Summary

We continue to expect a capital markets back-drop of low economic growth, low inflation and very low interest rates. We also expect the "high-yield "bond and share markets like New Zealand and Australia to be well supported by capital flows from the ultra-loose monetary policy countries.

In New Zealand, this buying has the tendency to inflate the value of a handful of higher capitalisation stocks whereas, below these, there are numerous shares trading on more realistic PE multiples.

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