SPECIAL REPORT | Friday 17 June 2022

focus

More Than Ever,
Focus Matters

Investors in financial markets have experienced a turbulent week in expectation (and experience) of increasing inflationary pressures and rising interest rates in many economies. Over the course of this week, for the first time since 1994, the US Federal Reserve increased the federal funds rate by 75 basis points, while the S&P 500 index of US shares has fallen more than 20% from the high reached in January this year, signifying a "bear market". Given heightened market volatility and investor anxiety, now more than ever, focus matters.

FORSYTH BARR

When the COVID pandemic began, central banks around the globe reduced interest rates to unprecedented low levels, accompanied by quantitative easing programmes (printing money) to cushion the economic blow created by disruption to our daily lives.

As the world begins to reopen, those measures are being withdrawn. However, with so much money from those extraordinary measures creating strong consumer demand for goods exceeding supply, and the combination of lockdown-related supply-chain disruptions in China and the economic impact of Russia's war in Ukraine, inflation levels not seen for several decades are being experienced in most developed countries. This is forcing central banks (who are tasked to keep inflation low) to raise interest rates.

As interest rates begin to rise, the immediate impact on economies is negative. Rising interest rates lead to higher borrowing costs for businesses and homeowners. A reluctance by businesses to borrow, when combined with a decline in consumer confidence (and spending) weighs heavily on any economy. Like many other parts of the world, New Zealand's inflation outlook is not favourable at the present time.

Looking forward, some of the supply issues should dissipate in due course as the world returns to normal but how far interest rates and inflation rise before that happens is challenging to forecast and hence the uncertainty in financial markets at present.

In terms of equity markets, we've been here before. History has repeatedly shown that this is a time to stay disciplined with a focus on investment quality and fundamentals. No one can predict when the current period of volatility will end, but in our view, the risk/return prospects of leading global companies appear attractive at current prices and valuation fundamentals.

In addition to those noted above, there are a range of factors negatively impacting equity markets including high commodity prices, cost pressures, slowing economic conditions, and falling house prices. From our long-term perspective these risks are being more than priced into current weak share prices.

If we look out six months or so, we believe the outlook is likely to be more positive should inflation pressures ease, monetary policy and interest rates stabilise, house prices bottom out and the economic outlook improves. At some point, the anticipation of this turning point in the outlook will become a catalyst for markets to respond positively.

The correction in equity markets is graphically presented in Figure 1 below, which shows eight leading global companies and their respective share price performances for this year, up to Friday 17 June.

Visa is the most resilient of this group with a -9% decline, whereas Walt Disney has been the worst performer, down -38%. The average decline for this group of eight leaders is -26%, while the very broad MSCI World index is down -19% (in US dollars). The Australian ASX 200 benchmark is down -10% (in Australian dollars) and the NZX 50 is down -18%. New Zealand investors in offshore assets have had some reprieve from the stronger US dollar (+7%) and AU dollar (+4%) relative to the NZD.

Financial markets comprise investors with many and varied investment goals. Some invest for short-term opportunities and use market volatility as a way of achieving their goals by actively trading on market sentiment and emotion. This strategy is not without speculative risk. Others, who are focused on longer-term wealth creation, will look across market cycles preferring to focus on fundamental factors which drive sustainable business profitability and long-term capital growth.

There are multiple factors on which asset prices are based that, when combined with prevailing market sentiment, can temporarily result in values becoming misaligned with long-term assumptions. With the benefit of the research-based advice of your Investment Adviser, you can be assured that your portfolio continues to align with your specific investment goals.

It's often only at times of heightened market volatility, that an investor's tolerance for investment risk comes into clear focus. At these times, your Investment Adviser is available for you to confirm that your investment portfolio continues to be structured to meet your investment objectives over your investment time horizon.

However, if your circumstances have changed, or if you are feeling anxious or uncertain, we strongly encourage you to contact your Investment Adviser and review your tolerance for investment risk relative to your investment goals. In doing so, we can ensure that our focus on achieving your goals, continues to be clearly aligned with yours.

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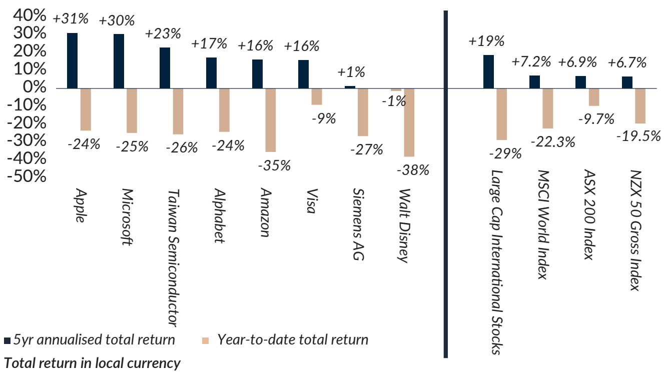
FIGURE 1. GLOBAL LEADING COMPANIES HAVE A BAD START TO 2022



Source: Forsyth Barr Analysis / Refinitiv

Understanding that sudden changes in financial markets can cause concern or indicate opportunity, your Forsyth Barr Investment Adviser is available to provide you with advice and assistance at any time.

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