

Wealth Weekly

Hi TINA, Meet FOMO

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The sense that "There Is No Alternative" (TINA) to equities in the face of central bank pressure on interest rates has combusted with retail investors' "Fears Of Missing Out" (FOMO). The result has been an unusually steep recovery in shares following the short sharp dip in March. We saw that again on Friday when international equities soared after positive US jobs data further boosted optimism around the pace of economic recovery. TINA and high valuations may be here to stay if inflation remains low and central banks stick to their current path. But FOMO is a volatile propellant that adds to the market risks in both directions.

Staying sober at the party

The remarkably steep recovery in financial asset prices since the slump in March has coincided with some of the worst economic data since the Great Depression. Markets are focussing on the reopening of economies, the hope for a COVID-19 treatment and vaccines, aggressive fiscal stimulus and the unconditional support of central banks for practically all asset prices.

Markets could overshoot. Share buying by retail investors has been significant since lockdowns began, both internationally and in New Zealand. In contrast, institutional investors in general, and value-oriented investors in particular, have been more cautious. Further positive economic news could drive markets and valuations higher. But FOMO behaviour raises the danger of subsequent volatility if company earnings disappoint, inflation makes a comeback, or if political risks emerge out of left field.

There remain risks ahead. Many economies will take time to recover the lost economic activity. Uncertainty and unemployment could stymie lending, borrowing, business investment and consumer spending. Tensions between the world's two largest economies, the US and China, are mounting. A trade war re-escalation would be negative for both economies. Protests in the US and Hong Kong accentuate the contrast to soaring equities. The US faces a fractious election in November, with uncertain corporate tax policy implications. Changes to working practices and consumer habits could have an impact on some businesses, the magnitude of which is still hard to judge. **Overall, we believe markets are pricing in an optimistic economic outcome.**

Balancing the outlook of recovering economies, relentless central bank support and market exuberance against the ongoing uncertainty, **we recommend a neutral allocation to equities, listed property and fixed income.**

Themes of the week

The last remaining confirmed COVID-19 patient in New Zealand has recently recovered. There still exists a small risk of new cases and outbreaks emerging. The government has moved New Zealand from Alert Level 2 to Level 1 on Monday night. **Key listed beneficiaries of this change include SKYCITY, and building sector stocks Fletcher Building, Steel & Tube, and Metro Performance Glass.**

For the first time since lockdown, the Reserve Bank of New Zealand last week didn't buy quite as much debt as the government's Debt Management Office issued, and **the NZ 10-year government bond yield has risen to be higher than the equivalent US yield for the first time in 2 years.**

Looking ahead

US Federal Reserve chairman Jerome Powell's press conference will be in focus on Thursday morning (NZ time); it will be interesting to see how markets react if his tone is either more optimistic or cautious than expected. Ryman Healthcare will report its FY20 result on Friday.

Macro Investment Perspectives

Caution and Patience

The impact of COVID-19 has been devastating, with the US alone suffering over 100,000 deaths and more than 40 million people filing for unemployment. Globally, trade in goods and services has collapsed, not helped by the seeming implosion in the US/China relationship. Yet, **the equity market has recovered to levels only slightly below the peaks in February this year**, led by sectors such as information technology, consumer discretionary, telecommunications and healthcare.

Throughout the crisis we have maintained a neutral asset allocation stance but with an active approach to portfolio management. We recommended adding to oversold equity positions during the March panic, and taking advantage of the subsequent rally to trim exposures to sectors forecast to be more at risk from the economic fallout. We now recommend a more defensive approach. **While retaining an overall neutral exposure to growth assets, we are trimming our international equities slightly and deploying the proceeds into New Zealand equities and property.**

Separating the economy from financial markets

The boom in equity markets can be attributed to two main things:

- The unprecedented amount of monetary and fiscal support provided by central banks and governments
- The fear of missing out (FOMO) on the recovery, particularly by retail investors who missed the last bull market.

By holding interest rates around zero, central banks have underpinned support for the higher yielding equity markets. Asset purchasing by central banks has also reduced the likelihood of a serious credit event, which has fuelled investor risk appetite globally.

The equity market is also pricing in the stimulus from aggressive government fiscal responses to the crisis. Wage subsidies, income support and welfare top-ups have boosted the incomes of millions of people around the world. The support may not offset the pandemic's impact on some troubled businesses and on people who lost their lives or jobs. But in many countries the aggregate positive impact of the fiscal support has more than offset the contractionary impact of job losses. This (together with lower interest rates and rising equity markets) should lead to higher savings, and possibly to some pent up consumption as economies reopen.

Pricing in the recovery

Signs that investors continue to price in a relatively sharp recovery in the economy include the recent bounce in cyclical sectors, including energy, financials, travel and small caps. Housing data has also been stronger than expected in some markets, reflecting falling mortgage rates and good liquidity in the banking sector.

China was the first country to enter a lockdown and the first to exit. An expected investment-led recovery in China's economy has been reflected in commodity prices finding a floor, with oil and copper off their lows.

The scientific effort that has been deployed to develop treatments and a vaccine for COVID-19 is unprecedented. **The market is pricing in a high likelihood that these efforts will succeed, and sooner rather than later.**

But border restrictions and social distancing carry costs

As necessary and successful as they were, lockdowns have economic consequences, and this is currently being seen in rising unemployment and the downsizing or closure of many businesses. The pandemic will also accelerate changes in consumer behaviour and working practises (such as working from home, and video conferences), which will impact some businesses.

Deflation remains a near-term risk, which will weigh on the increasingly leveraged corporate sector. Profit margins are likely to come under pressure as pricing power diminishes. Public sector intrusion or corporate tax hikes (in the US) could become a headwind.

Despite governments keeping economies on financial life support, **most businesses can't avoid responding to the increasingly uncertain outlook.** Banks will remain cautious about lending. Consumers and businesses will remain cautious about borrowing more money or investing more in growth projects – despite the central-bank-induced collapse in costs of capital. This increases the risk that the recent rise in jobless numbers becomes a more long-lasting phenomenon.

Uncertainty remains elevated for economic growth and earnings. Geopolitics (China vs USA), US domestic politics (presidential election in November) and social unrest in the US and Hong Kong add to the risks. **The current exuberance in equity markets likely reflects a best case economic outcome.**

Themes of the Week

NZ Equities

Virus Virtually Vanquished

New Zealand is moving to Alert Level 1 on Monday night, largely removing restrictions on businesses and consumers. The only major exception being border controls, which will continue to impact travel, tourism and airfreight markets. **Key listed beneficiaries of the move from Alert Level 2 to 1 include SKYCITY (OUTPERFORM), and building sector stocks Fletcher Building (NEUTRAL), Steel & Tube (OUTPERFORM), and Metro Performance Glass.**

While consumer demand has been robust in recent weeks, we are wary that some of this is pent-up, with headwinds developing given rising unemployment levels and likely business failures, particularly as the government's wage subsidy scheme partially winds down over the next four weeks.

Alert Level 1 restrictions are largely limited to border controls. Notwithstanding some easing of restrictions at other Alert Levels under the weight of pressure from business and consumer groups, we expect the government to maintain a health first approach to the border. This may mean trans-Tasman, Pacific Islands or other 'air-bridge' bubbles opening up but only if the risk of importing new cases is deemed somewhere between negligible and zero. In order to satisfy this level of risk tolerance, health related border measures (COVID-19 tests, medical passports, quarantine etc.) may dampen the rate of recovery in travel demand.

Figure 1. Impact on companies at each Alert Level

Company exposure (10 - massive/little revenue/loss making, 0 no impact or benefit). Excludes cyclical economic impact on each company.

	Level 4	Level 3	Level 2	Level 1
Auckland Airport	9	9	8	7
Air New Zealand	10	10	7	6
Tourism Holdings	10	10	7	6
Refining NZ	7	7	6	5
SKYCITY	10	10	6	2
Sky TV	6	6	4	2
Z Energy	8	6	3	2
NZME	8	7	2	2
Infratil	4	4	2	1
Spark NZ	2	2	1	1
Fletcher Building	10	4	4	0
Metro Performance Glass	10	4	4	0
Steel & Tube Holdings	10	4	4	0
NZ King Salmon	5	5	3	0
Abano Healthcare Group	10	10	2	0
Michael Hill Intl	10	9	2	0
Kathmandu Holdings	10	8	2	0
The Warehouse Group	10	8	2	0
Briscoe Group	10	8	2	0
Asset Plus	5	4	2	0
Kiwi Property Group	5	4	2	0
Stride Property	5	4	2	0
Sanford	4	4	2	0
Metlifecare	4	3	2	0
Summerset Group	4	3	2	0

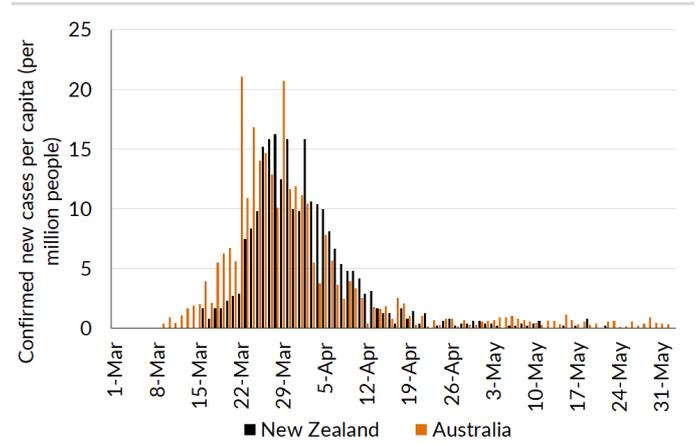
Source: Forsyth Barr analysis. NOTE: list limited to those most impacted by Alert Levels 1 & 2

Figure 2. Key beneficiaries of Alert Level changes

Alert Level 2 to 1	Alert Level 1 to no alert		
SKYCITY	4	Auckland Airport	7
Fletcher Building	4	Air New Zealand	6
Metro Performance Glass	4	Tourism Holdings	6
Steel & Tube Holdings	4	Refining NZ	5

Source: Forsyth Barr analysis

Figure 3. COVID-19 elimination in New Zealand



Source: WHO, Forsyth Barr analysis

Fixed Interest

RBNZ trims bonds purchases, yields rise

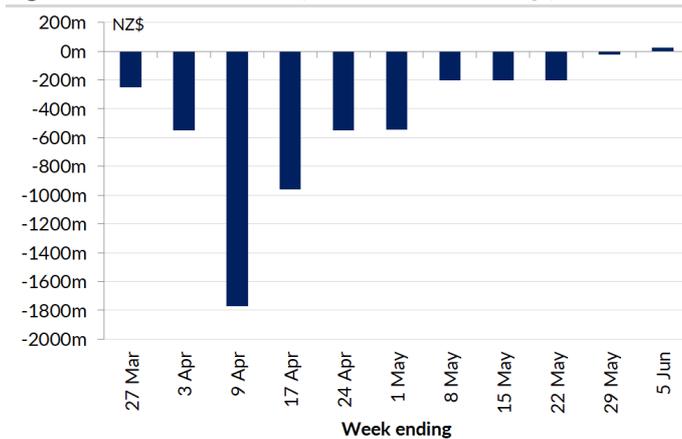
For the first time since the Reserve Bank of New Zealand (RBNZ) announced its (then) NZ\$30bn Large Scale Asset Purchase programme (now NZ\$60bn), the RBNZ last week purchased less New Zealand Government Bonds (NZGBs) than was issued by the New Zealand Debt Management Office (DMO) (Figure 4).

As part of its response to the economic fall-out from COVID-19, the RBNZ's Quantitative Easing (QE) programme saw the central bank begin buying NZGBs in the secondary market to help provide liquidity and to keep interest rates low. This was effective, with NZGB yields falling to record lows over the period between 13 May and 22 May. However, over the last week yields on NZGBs have increased as the RBNZ has begun to purchase fewer bonds than the DMO is issuing. The RBNZ had said it would front load its purchases, meaning it would do a lot more purchasing in the initial weeks to drive down market yields. As the purchasing slows down, yields are edging higher, creating the possibility that the RBNZ will have to step its purchases up again or else accept the higher market yields.

It may be a challenge to drive interest rates lower given the sheer amount of debt issuance being undertaken around the globe. Investors may require higher interest rates as a result of the choice they have now. The rise may well have something to do with a number of the central banks updating their forecasts recently. The Reserve Bank of Australia (RBA) and the Bank of Canada (BoC) both gave reasonably upbeat commentary around their respective economies. Both central banks believed that their own worst-case forecasts (made in the immediate aftermath of COVID-19) were now unlikely. The US Federal Reserve will meet this week and its subsequent statement and press conference early on Thursday (NZ time) will be keenly watched.

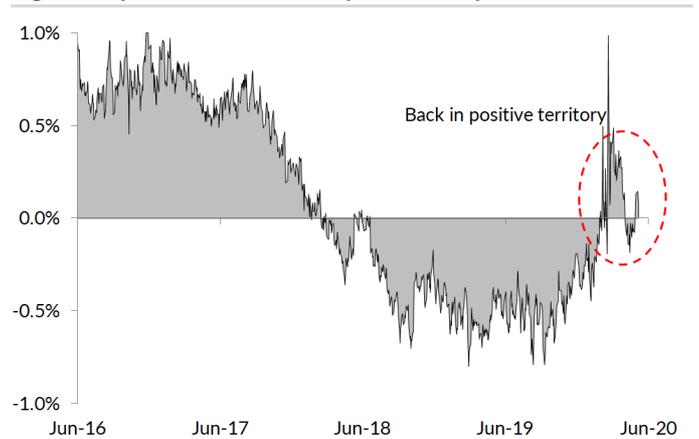
The yield on the New Zealand 10 year NZGB has now risen back above that of its US equivalent, having spent most of the last two years below it (Figure 5).

Figure 4. Net NZGBs issued (Issuance less RBNZ QE)



Source: Forsyth Barr analysis, NZ DMO, RBNZ

Figure 5. Spread between NZ10yr and US10yr



Source: Forsyth Barr analysis, Thomson Reuters, Generic 10yr

Research Worth Reading

New Zealand

Infratil (IFT) – Stretching Data Centre Growth – FY20 Result

Whilst IFT's FY20 result had two minor positive surprises, recent strong share price performance and a weaker than expected CDC Data Centre outlook has resulted in us pulling back our rating to NEUTRAL from OUTPERFORM. The positive surprises in the result were Vodafone's FY20 EBITDA being closer to the top of its guidance range than the bottom, and the decision to maintain the 2H20 dividend at 11cps. NEUTRAL (Published By Forsyth Barr)

Investore (IPL) – FY20 Result – Cashed up to go shopping

IPL reported a steady FY20 result. FY21 DPS guidance was unchanged although upside potential was tempered. IPL's appeal is its defensive supermarket based rental income which underpins its 4.5% cash yield as well as its relatively low financial gearing, providing headroom to drive better distribution growth via opportunistic acquisitions. OUTPERFORM. (Published by Forsyth Barr)

NZ Equity Strategy – Recovery Heat Map

Our real time heat map (Figure 6) of various NZ economic indicators shows the recovery of economic activity in New Zealand is in full swing (as equity markets have been suggesting for some time). Unemployment has recently been stable, but we are wary of the initial 12 week wage subsidy scheme ending this month for most claimants. Economic sentiment remains depressed but credit card spending has returned to prior year levels. Credit spreads in the bond market have fallen from their peak but remain elevated compared to pre COVID-19 levels. Mobility data suggests most New Zealanders are now back at work. International tourism remains dormant.

Figure 6. Forsyth Barr COVID-19 recovery heat map

Week ending	27-Mar-20	03-Apr-20	10-Apr-20	17-Apr-20	24-Apr-20	01-May-20	08-May-20	15-May-20	22-May-20	29-May-20
Economic sentiment	-1.2	-1.0	-1.4	-1.3	-1.0	-1.0	-0.7	-0.9	-0.4	-0.7
BBB credit spreads	249	256	198	185	214	161	188	177	173	171
Jobseeker Support recipients	15%	23%	27%	34%	38%	41%	42%	42%	42%	43%
Workplace visitation	-38%	-64%	-66%	-65%	-59%	-44%	-34%	-25%	-6%	-9%
Credit card spending	-27%	-57%	-58%	-57%	-56%	-45%	-40%	-14%	-1%	-1%
Electricity volumes	-1%	-12%	-13%	-11%	-5%	-7%	3%	4%	5%	6%
Retail fuel volumes	-36%	-75%	-74%	-74%	-68%	-51%	-41%	-29%	-19%	-19%
Commercial fuel volumes	-40%	-60%	-56%	-65%	-60%	-51%	-41%	-39%	-38%	-43%
Heavy vehicle traffic	-28%	-59%	-62%	-62%	-46%	-36%	-20%	-6%	0%	-2%
Light vehicle traffic	-44%	-81%	-82%	-83%	-78%	-56%	-47%	-27%	-6%	-4%
Domestic passenger flights	82%	19%	1%	1%	1%	2%	2%	5%	19%	29%
International arrivals	-99%	-100%	-100%	-99%	-99%	-99%	-99%	-99%	-100%	-99%
Hotel occupancy	-67%	-64%	-71%	-74%	-64%	-64%	-65%	-66%	-64%	-49%
Building consents	-80%	-33%	-57%	-56%	-9%	-32%	-33%	-21%	-16%	-26%

Source: Forsyth Barr analysis

Power Points – COVID Eliminated from Electricity – June 2020

Looking at the recent electricity statistics, the recovery from lockdown has been faster than expected. May 2020 electricity demand was up +1.9% on the prior comparison period and wholesale electricity prices were the second highest in the past 14-months. We continue to like the sector with OUTPERFORM ratings on all of the electricity stocks. (Published by Forsyth Barr)

Real Estate Reflections – The Road to Recovery

The listed property sector performed relatively well in May, up +3.1% while the broader market rose +3.3%. Tenants are now back trading, rent collections and tenant support is tracking in line with, or below, our expectations, and FY21 guidance, where provided, pointed to flat underlying earnings. That said, there are still questions around medium term rents, occupancy, and capitalisation rates. We continue to prefer Investore, Property for Industry, and Vital Healthcare Property for their defensive attributes in this time of uncertainty. (Published by Forsyth Barr)

Tourism Holdings (THL) – We remain on the bus (or should I say the RV)

The rapid rise in THL's share price represents a case of the market looking beyond the near-term earnings outlook to implied FY23 multiples. On this basis THL appears cheap relative to average forward multiples over the last five years. THL has acted proactively to control costs. BUY. (Published by Ord Minnett) [Forsyth Barr retains an UNDERPERFORM rating on THL]

Australia

Aristocrat Leisure (ALL.AX) – Land-based customers reopening, from Oklahoma to NSW

Citi expects a protracted slowdown in the US land-based business, before normalising by FY22e. The past week has seen the key Oklahoma and NSW markets largely reopen, albeit with restrictions. Aristocrat remains Citi's preference within the gaming sector. Citi expects Aristocrat to benefit from market consolidation, given its ability to utilise its secure balance sheet and liquidity position while competitors reduce investment. BUY. (Published by Citi)

CSL (CSL.AX) – Can elevated flu sales offset the decline in plasma collection?

Citi looks at the sensitivities of elevated flu vaccine sales on CSL's FY21 earnings. The analysis suggests that the potential benefits from higher flu vaccine sales in FY21 might not be enough to compensate for the potential downside from lower plasma collection. Despite these short-term risks, CSL should continue to take market share in the medium term due to its superior plasma collection position. BUY. (Published by Citi)

James Hardie Industries (JHX.AX) – US Census Bureau data

The US Census Bureau's newly released 2019 Characteristics of New Housing dataset suggests: 1) There is ample opportunity for fibre cement to continue taking share from vinyl; 2) Stucco has been gaining likely at the expense of brick – JHX could look to compete against both categories with its EasyTex panel. BUY. (Published by Ord Minnett)

Ramsay Health Care (RHC.AX) – Earnings revisions

After discussions with hospital groups last week, and with clear evidence that the COVID-19 crisis has been brought under control, Ord Minnett is confident RHC will enjoy a rapid return to profitability in FY21 as its core Australian hospitals normalise. ACCUMULATE. (Published by Ord Minnett)

Scentre Group (SCG.AX) – Vicinity capital raising implications

SCG's smaller retail peer Vicinity Centres (VCX, rated HOLD) has launched a A\$1.4 billion capital raising to shore up its balance sheet. SCG has indicated it does not intend to issue equity, although Ord Minnett believes Vicinity opting to tap the market complicates SCG's capital decisions. SCG's gearing will drift higher as devaluations are booked. HOLD. (Published by Ord Minnett)

Westpac Banking Corporation (WBC.AX) – AML/CTF compliance review findings

WBC released several reports on its own investigation into its anti-money laundering (AML) and counter-terrorism financing (CTF) compliance breaches and management accountability. None of them uncovered intentional wrongdoing by Westpac staff. Westpac set aside a \$900m provision for AUSTRAC in the first half of FY20; Ord Minnett assumes this will be topped up by a further \$100m in the second half, but a higher penalty than this can't be ruled out. HOLD. (Published by Ord Minnett)

International

Gilead Sciences (GILD) – Mega-Merger which probably does not make much sense

This weekend, Bloomberg reported that AstraZeneca has approached GILD about a potential merger. GILD reportedly does not appear interested in selling or merging. Citi sees a low likelihood of such a deal happening because its size would require a substantial equity portion, which may not be attractive to GILD shareholders at current low valuations. BUY. (Published by Citi)

PayPal (PYPL) – UBS Evidence Lab Inside: PYPL Remains Download Leader, Raising EPS and PT on Stronger Outlook

Data on app downloads shows three key trends: 1) Mobile payment apps continue to gain share against banking mobile apps in the US; 2) PYPL's apps together remain the leaders in share of downloads, but looking at individual apps, Square's Cash App is the leader on a stand-alone basis; and 3) PYPL downloads rank highly in a number of regions, including the UK (1), Mexico (5) and India (15). BUY. (Published by UBS)

Calendar

Figure 7. Calendar

Date	New Zealand	Australia	International
8-Jun		Queen's Birthday	JP: GDP QoQ (Q1)
9-Jun	ANZ Business Confidence Scales AGM	ANZ Job Advertisements (MoM) NAB Business Survey (May) NAB Business Confidence (May)	
10-Jun	Manufacturing Sales Volume (Q1) Tilt Renewables SSM	Westpac Sales Volume (Q1) Home Loans MoM Invest Housing Finance MoM	US: JOLTs Job Openings (Apr)
11-Jun	Electronic Card Retail Sales (May) NZME AGM	MI Inflation Expectations	US: Core CPI MoM (May) US: Crude Oil Inventories US: FOMC Economic Projections US: FOMC Statement US: Fed Interest Rate Decision US: FOMC Press Conference
12-Jun	Westpac Consumer Sentiment Business NZ PMI (May) FPI MoM (May) Ryman Healthcare FY20 QEX Logistics FY20		US: Initial Jobless Claims US: PPI MoM (May) UK: GDP MoM & YoY UK: Manufacturing Production (Apr) UK: Monthly GDP 3M/3M Change
13-Jun	CFTC NZD Speculative Net Positions		

Source: Forsyth Barr analysis

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