

Wealth Weekly

Australian Bushfires — Tragic but Don't Overstate Economic Impact

Australian bushfires to weigh on tourism and retail spending

The Australian bushfires have attracted worldwide attention. They are a human, ecological, and environmental tragedy. Investors, however, need to be careful not to overestimate the economic effects. The impact has been concentrated in rural areas, albeit smoke haze and a damping of consumer confidence have also been felt in major cities. Damage estimates of c.A\$3.5b equate to 0.2–0.3% of GDP. To put that in context, that compares to damage from the Christchurch earthquakes of NZ\$40b, more than 15% of NZ's GDP. Tourism is likely to be the most impacted sector with the Australian Tourism Export Council estimating a -10–20% reduction in international tourism revenue in 2020. Smoke haze will also weigh on retail spending and construction through lost work days, adding to the pressure in these already soft sectors.

Themes of the week

After eighteen months of a bruising trade war in which the US and China levied billions of dollars in tariffs on each others' imports, the two countries have reached a 'phase one' agreement. There will be some reduction in tariffs by the US, although most will remain in place to be addressed in the more complex phase two negotiations. China has committed to purchasing an additional US\$200b in goods and services from the US, over and above the baseline volumes reached in 2017, before the trade war started. This may see US farmers benefit to the detriment of those in NZ and Australia.

The spread of the Wuhan coronavirus has reignited memories from the H1N1 and SARS epidemics in the 2000s. So far the new virus seems to be less deadly than SARS was, but the timing of its emergence around Chinese New Year, when many people travel, may help its spread. Fears about the virus could reduce demand for travel, hurting airlines, airports and hotels in particular. That said, when the SARS epidemic ended, the rebound in demand was quick. Looking back to the 2003 epidemic, we found that the earnings and valuation impacts on NZ companies were generally immaterial. This time fundamentals are more stretched so there could be more profit-taking amid the current uncertainty, but ultimately this will probably create buying opportunities in the most affected stocks and markets.

The World Economic Forum ended without significant incident last week. This year's theme of "Stakeholders for a Cohesive and Sustainable World" highlighted two of the big challenges of the coming decade. Sustainability is becoming an increasingly prominent theme in the capital markets as more investors take into account the environmental, as well as economic impact, of their portfolios.

Last week we sat down with a manager of a large global technology fund. The tech sector delivered outstanding returns in 2019. Can it repeat in 2020? The manager's view is probably not to the level of the +47% the global tech index returned last year, but the sector's growth outlook remains strong and, with valuation levels generally reasonable, they expect returns from the sector should be solid.

Looking ahead

A large number of international companies report results over the next week including global tech heavyweights Apple, Amazon, Google and Microsoft. Markets will look for the US Federal Reserve to affirm its commitment to asset buying on Wednesday. And next Monday, 3 February, the US Democratic Party holds its Iowa caucus, the first step in its presidential candidate selection process.

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In this week's report...

- Australia's bushfires look likely to affect the Agriculture, Tourism, Retail and Construction sectors the most
- The US looks like the winner from its trade war with China, while Australasian farmers might lose from the deal
- The deadly Wuhan Flu has begun to spread. Past pandemics cut travel demand for a short time, but that quickly recovered
- The global technology sector probably won't repeat last year's outstanding performance this year, but the outlook is still positive

Australian Bushfires

The effect of Australia’s bushfires on people, animals and the environment is substantial, and the fires raise further concerns about long-term climate-related risks. It has been reported that, since September 2019, over 17 million hectares have burned including close to 5 million hectares in New South Wales alone. While the financial impact is difficult to quantify, at this stage over 2,000 houses have been destroyed and the current estimate of losses from the Insurance Council of Australia stands at roughly A\$1.3bn. The damage incurred is likely to increase with the bushfire risk period ending 31 March.

The total damage estimate from the fires is around A\$3–5bn or 0.2–0.3% of GDP. Additionally, our Australian research providers believe the bushfires could drag on GDP by 0.25% per quarter in 4Q19 and 1Q20. To put this in perspective, the 2009 Australian Black Saturday bushfires burned 450,000 hectares, destroyed 2,000 houses and resulted in ~\$2bn in insurance claims, while the damage from the Christchurch earthquake was approximately NZ\$40bn, or ~15% of New Zealand’s GDP.

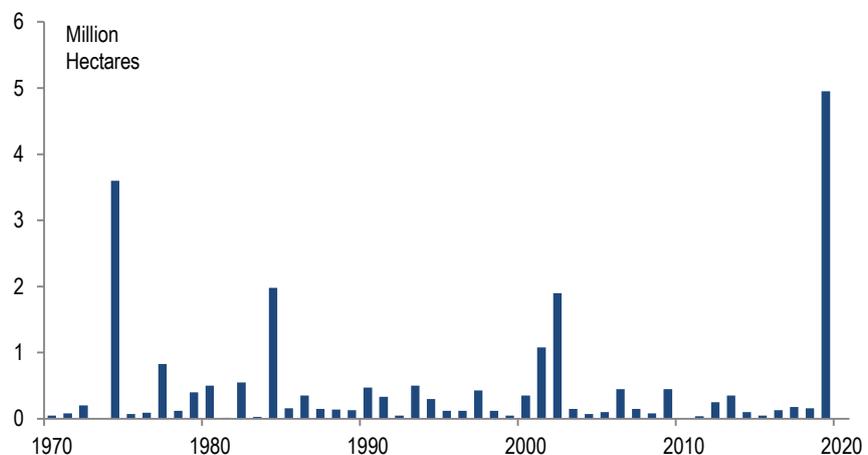
The effects of the bushfires have largely been felt in rural areas; however, the indirect impacts of the smoke haze and weaker consumer confidence have also been felt in major cities. Agriculture, Retail, Tourism and Construction are likely to be the worst off, but the actual impact across each sector is hard to estimate. Global inbound tourism could be significantly impacted, with the Australian Tourism Export Council estimating a -10–20% reduction in international tourism revenue in 2020. Furthermore, the smoke haze will drag on retail and construction with lost work days and lower retail spending, putting further pressure on already weak sectors.

ASX listed stocks we follow that have highlighted impacts from the bushfires, include:

- **Treasury Wine Estates** — Potential damage to 2020 vintage, although impact unlikely to be known until FY21 or later.
- **Bapcor** — Weakness in auto sales flagged by Super Retail Group.
- **Webjet** — Weaker domestic travel intentions is negative but this could be offset by Australians travelling offshore. Wuhan Flu presents an additional risk.
- **Viva Energy** — Potential disruption to regional locations and demand for commercial fuel (travel / transport).
- **Sydney Airport** — May see a decline in international tourists (~10–20% of passenger volumes), potentially compounded by spread of Wuhan Flu.
- **BHP Group** — Possible impact to NSW Energy Coal production due to smoke and reduced air quality.

With the February reporting season coming up, companies impacted by the bushfires will have the opportunity to update the market.

Figure 1. Total area burned by wildfires in New South Wales by year



Source: Forsyth Barr analysis, UBS

Themes of the week

Macro

Round one of the trade war ends — who won?

The key details of the 'phase one' trade agreement between the US and China are as follows:

- **Tariffs:** Before the deal, US tariffs included 25% on US\$250 billion and 15% on US\$120 billion of imports from China. Combined, the tariffed imports represented nearly 70% of the US\$540 billion in total Chinese imports to the US.

Upon signing the deal, the US agreed to reduce tariffs on the US\$120 billion from 15.0% to 7.5% within about a month and agreed not to implement any further planned tariffs (although this undertaking is not in the deal text).

- **Intellectual property and tech transfers:** The agreement includes a short section on the contentious intellectual property and technology transfer issue, asserting that any transfers and licensing of technology will be based on market terms that are voluntary and reflect mutual agreement. China is not obliged to change any laws or regulations to fulfil this issue, but did agree to more stringent protection of trade secrets.
- **Addressing the trade deficit:** China agreed to increase its imports from the US by approximately US\$200 billion (from a baseline of 2017 exports). The planned purchases are split into US\$77 billion in 2020 and US\$123 billion in 2021.

This is where things will get interesting. In 2017, the US exported US\$130 billion and US\$56 billion of goods and services, respectively, to China. So the planned purchases represent an unprecedented +107% increase over the baseline. How this will be implemented is unclear, because it is private companies — not the US Government — that control supply of these goods. In some cases the committed increases in purchases are greater than Chinese demand growth, so China will probably import less from other countries.

- **Opening market access:** As well as agreeing not to devalue its currency or intervene regularly in its currency market, China has agreed to open up access to financial services firms. Companies such as Mastercard, Visa, and American Express are expressly listed in the deal, which requires China to quickly accept applications from bank cards and payments systems looking for access.

US farmers may win big at the expense of New Zealand farmers.

Over the past eighteen months, China's imports from the US have collapsed causing it to source goods and services from other countries. New Zealand and Australia have benefited, with both respective terms of trade back near record levels by the end of 2019. Besides the trade war, African swine fever in 2019 decimated China's hog population, causing pork shortages and soaring food prices. This boosted demand for imported beef, poultry, and seafood which contributed to the export strength enjoyed by New Zealand and Australian farmers over the past year.

Of the US\$200 billion additional goods and services China has agreed to purchase over the next two years, agriculture goods make up US\$32 billion. This includes an additional US\$12.5 billion in 2020 and US\$19.5 billion in 2021. That's 52% more purchases of agricultural goods this year and 81% more next year than in 2017 when there was no trade war. To put this in context, New Zealand's terms of trade surged last year as China purchased an additional US\$3.5 billion in goods from us in the year to September 2019, compared to the same time in 2017.

To satisfy the agreed increase in imports from the US, China is likely to have to divert purchases away from other markets, possibly including New Zealand. But the initial implication of much stronger Chinese demand from the US for agricultural goods is more likely to be an increase in global soft commodity prices — a benefit to New Zealand farmers, but a cost to global consumers.

We will have to wait and see how China manages this unprecedented increase in purchases of agricultural goods from the US, and whether US farmers can actually satisfy the demand. But what is clear is the US shift from multi-lateral to bi-lateral trade agreements. Small exporting nations may get buffeted in the cross winds.

Equities

Wuhan Flu — Implications for transport stocks

The new coronavirus that was first detected in the central Chinese city of Wuhan has now spread beyond China's borders to 14 other countries including Australia, Canada, France, Japan, Singapore, South Korea, Thailand and the US. With Chinese New Year celebrations underway, a large proportion of the Chinese population is undertaking domestic and international travel, which could lead to a more rapid spread of the virus. The Chinese government over the weekend stopped tour groups from leaving the country and stopped the sale of future tours. The World Health Organisation (WHO) has yet to declare it a global health emergency. The most recent declarations by WHO were for Kivu Ebola (2018), Zika (2016), Ebola (2014), Polio (2014), and H1N1 swine flu (2009).

What are the implications for travel markets? We make a number of observations below based on the SARS (severe acute respiratory syndrome) pandemic in 2002–2003 given it also emerged from China and spread internationally. There were around 8,000 confirmed SARS cases that resulted in 774 deaths across 37 countries.

- The Wuhan coronavirus appears to have a lower fatality rate than SARS, however, it is still early days in this outbreak.
- Passengers may fear possible disease transmission through air travel. The SARS outbreak caused a short sharp shock on global travel markets. Asian air travel demand declined -8% in 2003 but recovered in 2004.
- While there were no reported SARS cases in New Zealand, inbound passengers from Asia declined by -34% in the June quarter of 2003.
- Once contained (SARS was contained in July 2003, having emerged in late 2002), travel markets recovered quickly.

Sentiment for both airline (Air New Zealand) and airport (Auckland Airport) stocks will be negatively impacted by the Wuhan coronavirus. It is not clear how the situation will evolve. If it escalates the impact on passenger travel could be material for a period of time, as was the case for SARS.

Funds

Polar Capital Technology funds — what lies ahead?

Polar Capital's technology fund managers are positive on the sector's outlook in 2020. Innovation is continuing, earnings expectations look achievable, and (with the exception of some very high-growth software stocks) valuations generally look moderate. Polar Capital's managers aim to invest in companies with technologies that are beyond the phase where teething issues prevent broad uptake, and which can, therefore, benefit from rapid increases in market penetration, revenue and earnings. The themes they currently favour, and prominent companies driving or benefiting from these themes, are the following:

- Online Advertising/eCommerce: Alphabet, Facebook, Tencent, Alibaba, Amazon
- Payments/Fintech: Visa, Mastercard, PayPal, Square, Alibaba, Tencent
- Data Economy/Artificial Intelligence: Samsung, AMD, Amazon, Microsoft, Alphabet, Illumina
- Cloud Infrastructure/Security: Amazon, Microsoft, Alphabet, Arista, AMD, Synopsys, Splunk
- Software/SaaS: Microsoft, Salesforce, ServiceNow, Zendesk, RingCentral, 8x8
- Digital Entertainment: Tencent, Activision, EA, IAC, Dolby, Spotify, Apple
- Industry 4.0/Automation: Keyence, Cognex, Harmonic Drive, Yaskawa, Fuji
- Connectivity/5G: Apple, Samsung, Qualcomm, TDK, Cognex

Research Worth Reading

New Zealand

Gentrack (GTK) — Getting a Feel for the Floor

GTK has substantially cut its EBITDA guidance following last week's warning that it faced challenging market conditions and that a key UK utilities customer had suspended deployment of a major contract. Consequently, there is a reasonable chance it generates a post-tax underlying loss in FY20. Drastic times call for drastic measures, and contra to its growth ambitions, the company is now undertaking a cost-out programme. While the company's earnings may now have found their floor, its medium term growth profile may be at least partly compromised by the scars of the headcount reduction. We retain an UNDERPERFORM rating.

Oceania Healthcare (OCA) — 1H20 Result — Rising Tide

OCA has reported a solid 1H20 result, slightly ahead of our expectations in most areas, and delivered +15% EPS growth that was boosted by new sales volumes and margins. OCA continues to make progress in terms of its development activity and the transition of its older care portfolio; meanwhile, sentiment continues to lift on the back of an improved housing market. Our rating remains NEUTRAL.

Australia

Bushfires — Sector and Stock Exposures

Since September 2019, over 17m hectares have burned nationally and the value of insurance claims is approaching those from the 2009 Black Saturday bushfires. The Federal Government has announced a \$2bn relief package over three years with an indicative \$500m to be spent this financial year. Stocks with exposure to Retail, Insurance, Food & Beverage, and Transport are likely to have the largest negative effects, while Resources, Building Materials, and Infrastructure sectors are only likely to be mildly affected. (Published by UBS.)

Australian Banks — Looking More to Rates than Fundamentals

As underperformance accelerated in 2H19 for the major banks, many analysts attributed this to the fundamentals. However, our analysis indicates the relative de-rating is attributable to the collapse in interest rates. The absence of a further fall in rates sees the stretched valuation dynamic evident in the market unlikely to be supported, positive for the Banks in a relative sense. Our key BUY idea is **National Australia Bank**, where consensus is too bearish as AUSTRAC and restructuring fears hit overdrive. (Published by Citi)

Australian Building Materials Sector — 2020 outlook

Trading multiples across the building materials sector have surged over the past 12 months, along with broader ASX indices, helped by falling interest rates. Against this backdrop, we can still see selective value across the building materials companies. Our key sector preferences are **James Hardie Industries** (JHX, ACCUMULATE) and **Reliance Worldwide** (RWC, ACCUMULATE), while our least preferred are **Boral** (BLD, LIGHTEN) and **CSR Ltd** (CSR, LIGHTEN). We take a more neutral stance on **Adelaide Brighton** (ABC, HOLD). (Published by Ord Minnett)

Aristocrat Leisure (ALL.AX) — US land-based performance – December 2019

Aristocrat has a sizable lead across each of the three key gaming machine segments in the US. Market figures for December show that Aristocrat's games accounted for five of the top 10 games in two key categories, suggesting Aristocrat is well placed to make further market share gains over the next twelve months. BUY. (Published by Citi)

Lendlease Group (LLC.AX) — Services business update

Press reports, including the Australian Financial Review, suggest Lendlease has been unsuccessful in finding a buyer for its services business, with both John Holland and Service Stream withdrawing from the process. With this latest news regarding the services business, and Lendlease retaining its exposure to Melbourne Metro, the balance sheet takes on additional importance, in our view. We believe the shares are still undervalued, but reliability of earnings is somewhat reduced. BUY. (Published by Ord Minnett)

International

Comcast (CMCSA) — Streaming to Where Video Is Going with Peacock

Comcast shared its strategy and financial objectives for its new streaming service Peacock at a well-attended launch event. We believe Comcast has an opportunity to expand its addressable market for viewership and monetisation by offering the platform for free and then creating up-sell opportunities for premium and ad-free options. We continue to recommend Buying Comcast shares as our top cable pick. We like the underlying operating and financial trends for cable and believe both NBCU and SKY are poised to perform better in 2020. We also like valuation on a consolidated and sum-of-parts basis. BUY. (Published by Citi)

China Strategy — 2020 Index Target Forecasts; Sino-US Trade Deal Implication

If history recurs, we expect the returns of the Heng Sang Index (“HSI”) and the HSCEI in 2020 (the last year of China’s five-year plan period), to be less than the average annual rises in the previous four years (2016–19). This historical trend might be due to less policy stimulus during the last year. We see more upside from communication services, consumer, healthcare and insurance sectors. Top picks are Alibaba, Sino Biopharm, TAL Education, Sun Art, AIA Group and ENN Energy. Chinese companies that look set to gain from the China-US phase 1 trade deal could include JD.com, Inovance, Han’s Laser, AIA, Sinopec Kantons, ZTE, ENN, China Gas and China Resources Gas. The companies that are likely to suffer under the US–China trade deal are Tencent, Ping An, China Mobile, Haier Smart Home, and Sinopec. (Published by Citi)

China Strategy — Lesson from SARS; Forecasts on Wuhan Coronavirus

We believe major indices such as Hang Seng Index and HSCEI, which dropped up to -15% and -8% respectively during the SARS epidemic in 2003, will have less downside from the Wuhan coronavirus, given its lower fatality rate than SARS so far.

Share prices of Chinese companies in the tourism, hotel, airlines, airports, online travel, casino and insurance industries could be vulnerable near term due to the outbreak whereas online gaming, healthcare and utility sectors could benefit.

We expect the share price impact from the outbreak of Wuhan coronavirus to trough on or before 25 April if the number of daily reported cases peaks on or before 10 March, 21 days after the end of the “Spring festival travel rush”. (Published by Citi.)

Calendar

Figure 2. Calendar

	New Zealand	Australia	International
27-Jan	Auckland Anniversary Day	Australia Day	CN, HK, SG, SK: Chinese New Year US: New home sales Dec-19
28-Jan		Oil Search FY19 result Credit Corp Group 1H20 result	HK: New Year's Day CN: Spring Festival US: Durable goods orders Dec-19 US: S&P Corelogic 20-city index Nov-19
29-Jan	Abano 1H20 result	Consumer price index 4Q19 Iluka Resources December quarterly review OZ Minerals December quarterly report Northern Star Resources Dec quarterly report Evolution Mining Dec quarter result	CN: Spring Festival US: Pending home sales Dec-19 JP: Consumer confidence Jan-20 3M FY19 result Visa AGM Starbucks 1Q20 result LVMH FY19 result Apple 1Q20 result eBay FY19 result
30-Jan	Trade balance Dec-19	Newcrest Mining December quarterly results ResMed 2Q20 result	CN: Spring Festival US: Fed interest rate announcement US: GDP data 4Q19 US: Initial jobless claims 4Q19 EU: Unemployment data Dec-19 EU: Economic confidence Jan-20 PayPal Holdings FY19 result Novartis AG FY19 result General Electric FY19 result Mastercard FY19 result McDonald's FY19 result AT&T FY19 result Facebook FY19 result Illumina FY19 result Microsoft 2Q20 result Mondelez International FY19 result Samsung Electronics FY19 result
31-Jan	Consumer confidence Jan-20 Property transfer statistics 4Q19	Private sector credit Dec-19	UK: BoE interest rate announcement EU: GDP data 4Q19 US: PCE deflator Dec-19 CN: Manufacturing PMI Jan-20 JP: Retail sales Dec-19 Unilever PLC FY19 result Thermo Fisher Scientific FY19 result Coca-Cola FY19 result Amazon.com FY19 result Walgreens Boots Alliance AGM Flex 3Q20 result Visa 1Q20 result
1-Feb			Colgate-Palmolive FY19 result Caterpillar FY19 result

Black – company news; Red – economic news; Blue – market holidays
Source: Forsyth Barr analysis

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