

# Wealth Weekly

## Big Tech Fared Well Amid Lockdowns

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Equity markets had a dream month in April, with the US market recovering +30% from its trough in late March. The resilience of large tech companies – which comprise a significant portion of the US market – was evident in the March quarter results they released last week, although even they are being more cautious about their costs to offset some of the pressures that lie ahead. Bonds also rebounded well in April.

**Tech sector growth robust despite pandemic, short-term outlook more mixed, but shares have charged ahead**

Despite the dramatic impact of COVID-19 on economies in March, **the quarterly earnings results from the mega-cap technology companies that reported this week surprised on the upside.**

- Advertising revenues at Alphabet and Facebook held up better than feared. Facebook said ad revenues were flat in April compared to the same period last year, as gaming, ecommerce and technology-related ads made up for declines in other sectors. Google reported ad declines in March which continued into April, but increased usage of cloud and other services is making up for that.
- Similarly, Microsoft reported strong demand for cloud, gaming and productivity software made up for weakness in other areas.
- At Amazon, demand for discretionary products has been weak but sales of consumer staples products have increased.
- Apple reported a modest increase in iPhone sales and robust growth in wearables and services.
- Visa's transaction volumes and revenues were better than expected, as were costs, as rising ecommerce transactions helped offset lower travel-related volumes.

While we continue to like the technology sector's long-term growth outlook, **the strong share price performance in the mega-cap stocks has probably got ahead of some of the challenges** consumers and companies are currently facing as a consequence of the pandemic. These could become more apparent in the June quarter results due in late July, as most of the pandemic lockdown impact will fall in the June quarter. Apple and Visa refused to provide guidance. Alphabet, Facebook and Microsoft are trimming their spending growth plans to help offset lower ad revenue growth. At Amazon the rising proportion of lower-margin consumer staples sales is expected to raise costs and squeeze profits this year.

**Themes of the week**

**New Zealand bonds recovered well in April after the negative returns of March.** What is more remarkable is the strong performance of bonds over the past year (NZ investment grade bonds are up +6.8%) relative to property stocks (-1.9%). These recent returns are a reminder that bonds offer capital preservation and a reliable stream of coupons, whereas property dividends are being cut or stopped altogether. Quality fixed income securities like NZ Government Bonds, Local Authority bonds and State Owned Enterprise bonds remain an important part of fixed income portfolios. Several significant bond maturities are ahead over the next few months, but there may be a bit of a wait for corporates to sort out their bank debt facilities and raise capital before they issue new bonds.

**After the fastest bear market in history in February and March, equity markets have whipsawed back up with the strongest monthly rally in 33 years during April.** There is a risk that the market's current "risk on" mood will sour if the end of lockdowns results in the pandemic resurging, or if second-round economic and earnings impacts emerge. We believe the outlook is balanced and we retain a neutral weighting to equities in our tactical asset allocation.

**This week**

Westpac on Monday announced a plunge in profits and cancelled its interim dividend; the stock was up +1.4% mid-afternoon. We expect earnings announcements from Walt Disney on Wednesday, PayPal on Thursday, and ING Group and Siemens on Friday. The Reserve Bank of Australia will announce its interest rate decision tomorrow and the Bank of England on Thursday. Locally, the March quarter labour market data will be in focus on Wednesday.

## Results better than feared, but outlook unclear

This week we had results from Alphabet, Amazon, Apple, Facebook, Microsoft and Visa. Results were largely better than expected, with COVID-19 for the most part only impacting March, the last month of the quarter. However, outlook statements highlighted that disruptions continued into April and the near-term remains highly uncertain. The tech sector, particularly companies exposed to internet themes, have proven relatively resilient, and share prices have recovered well from lows seen in March. This is likely a combination of impacts from the pandemic being brought under control, as well as a lack of alternative sectors with strong long-term fundamentals. We continue to like the technology sector, although it seems that investors' excitement may be premature as results next quarter will likely paint a clearer picture of the impact from COVID-19.

### Alphabet (GOOGL)

**Overall topline results were better than feared**, with revenue growth of +13%, and strong metrics in Google Cloud and YouTube. Management acknowledged an abrupt and significant revenue slowdown in March due to COVID-19. Google Search revenues declined in March and continued lower in April, and YouTube growth had decelerated materially by the end of March.

**Management expects COVID-19 will have a continued negative impact on 2Q advertising revenues**, and pointed to a deceleration of headcount growth starting from 3Q20 and a modest decrease in full-year capex in 2020. While the outlook for ads revenue is uncertain, GOOGL has experienced robust demand for cloud services due to stay-at-home orders, and a surge in content, apps, and subscriptions, which should support growth.

### Amazon (AMZN)

**AMZN delivered better than expected 1Q revenue**, reflecting the short-term benefits of surging e-commerce. The increase in e-commerce demand, largely from consumer staples, will likely carry through into the 2Q, bolstering sales. However, with increased sales, AMZN will also face higher costs relating to COVID-19, including the planned addition of 175k employees to meet increased e-commerce demand. While consumer staples sales were robust, demand for discretionary items declined, which could further pressure profits through the year as essential items generally have thinner margins. AWS grew +33% but didn't benefit as much as other cloud providers (such as GOOGL and Microsoft) from customers working at home.

**2Q guidance was at the midpoint of consensus expectations**. AMZN's significant increase in grocery capacity and rocketing demand for content positions the company well for market-share gains post-COVID-19, however, 2020 could prove to be a bumpy year for the company in terms of profitability given costs associated with the pandemic.

### Apple (AAPL)

**AAPL's quarterly sales and earnings were above consensus expectations**. Wearables revenue was up +23% yoy. Services revenues were up +17% yoy and now represent 23% of total revenues. During the quarter AAPL returned ~US\$22b to shareholders in dividends and share buybacks.

**AAPL did not provide guidance for the June quarter**, highlighting ongoing uncertainty in the current trading environment. As is routine during its April earnings call, Apple also updated its capital returns program, increasing its share repurchase authorisation by \$50b (versus a US\$75b increase in buybacks last year) and increasing the dividend by +6% (versus a +5% increase announced last year).

### Facebook (FB)

**FB delivered an impressive set of 1Q numbers, ahead of expectations**. Revenues climbed +18%, while global monthly active users (MAUs) increased +10% to 2.6b, and daily active users (DAUs) increased +11% to 1.7b. Management noted that advertising revenues for the first three weeks in April were roughly flat versus last year, down from the +17% growth in 1Q20, but far better than investors expected.

**A surge in gaming, e-commerce and technology driven by lockdowns is offsetting declines in FB's other advertising markets**. Similar to GOOGL, FB's forward commentary regarding advertising trends in April was better than expected. Management lowered full-year expense and capex guidance.

### Microsoft (MSFT)

**MSFT produced better than feared 3Q results**, driven by strong demand for the company's productivity software, gaming, and cloud services, which helped offset pressure on its other businesses, such as LinkedIn and Search. Azure sales grew +60% in the 3Q, with gross margins expanding thanks to improved utilisation.

Supply-chain disruptions from the COVID-19 pandemic will likely weigh on hardware sales in the near-term. However, remote working as a result of lockdowns has driven demand for MSFT's collaborative offering, Teams, which now has more than 40m monthly users, compared with just 32m in March. Management highlighted a number of COVID-19 impacts, including: softness in software transactional (non-subscription) revenues, ad revenue weakness, and volatility in long-term annuity commitments.

**4Q revenue guidance by segment was slightly below expectations**, although slower spending could offset the lower 4Q revenue outlook.

### Visa (V)

**V reported 2Q revenue and earnings ahead of expectations**, driven by higher than expected gross dollar volume and revenues, on lower than expected incentive costs and operating expenses.

V provided updated operating trends through April, which highlighted two dynamics: modest improvement off of lows for most payment volumes; and a significant acceleration in ecommerce (excluding travel) too, up approximately +30%. **V withdrew its FY20 revenue guidance**, but maintained its US\$9bn buyback authorisation (US\$5.6bn completed YTD).

## Themes of the week

### Fixed Interest

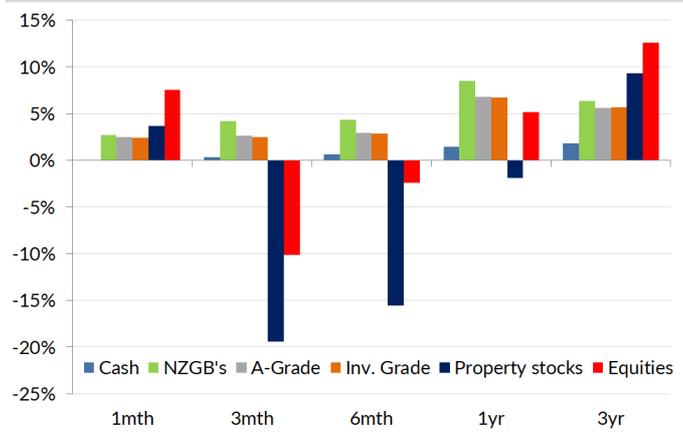
#### There is nothing like the real thing

After delivering negative returns for March (along with every other asset class), New Zealand bonds produced a stellar comeback in April. What is more remarkable is the performance of the local bond market versus its so called proxies in the equity market, the listed property vehicles. **Over the last year New Zealand investment grade bonds have returned +6.76% (New Zealand Government bonds were even better at +8.49%) compared to the S&P/NZX Property Gross Index's return of -1.87%.** Listed property stocks have often been a destination for those bond investors who want more yield than the bond market can offer but are not so keen on the extra risk that the wider equity market provides. However, **the recent returns re-emphasise that one must remember the benefits of bonds such as capital preservation and a reliable income stream in the form of coupons.** At present coupons continue to be paid on bonds, whereas dividends are being cut or stopped altogether.

#### NZGBs conquer them all (over the last year)

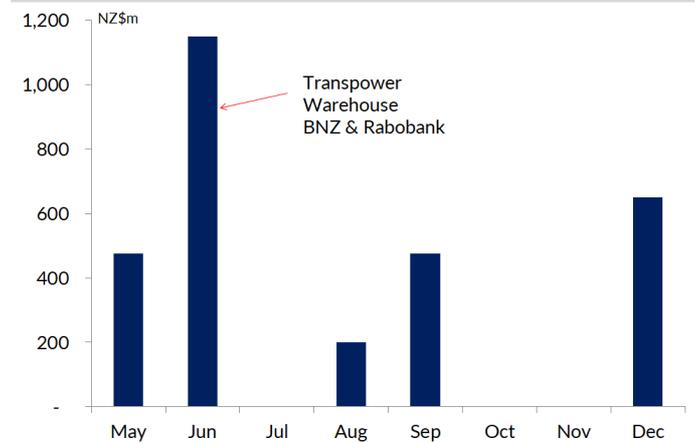
New Zealand Government bonds (NZGBs), which are now part of the Reserve Bank of New Zealand's quantitative easing programme, continued to outperform all other asset classes (Figure 1). The risk free securities even outperformed equities over the last year by +331bp (3.31%). **We continue to maintain that quality fixed income is an important part of a portfolio, whether it be NZGBs or Local Authority bonds (LGFA) or State Owned Enterprises.**

Figure 1. Index returns (NZ)



Source: Forsyth Barr analysis

Figure 2. 2020 Maturity profile



Source: Forsyth Barr analysis

#### March is almost forgotten already

Credit spreads have also contracted over April, presenting those who braved the carnage of March with some good gains. A number of bonds will mature over the next two months (Figure 2) and investors will be looking for a home for that cash. **We expect to see little in the way of new issuance in our local market for a while yet, at least until corporates have sorted out their balance sheets.** Issuance offshore is, however, booming, with corporates issuing US\$260bn in March and US\$250bn in April. With governments around the globe also having to wade into the market to fund their COVID-19 responses, the pressure on yields is likely to be around a while yet (i.e. we may not see a sharp decline soon).

## Macro

### **Greed to fear and back to greed again**

**Equity markets just had the strongest month in 33 years.** After the fastest bear market in history, in which the US equity market dropped -34% in 33 days, it rebounded just as quickly as the market's mood turned positive again. The S&P 500 index has jumped +30% over the last 38 days, to be -14% below its all-time high. The New Zealand market moves have been similar, down -30% at the peak, to be only -13% now. Australia has lagged, falling -36% at the peak, and remains down -22% currently.

**New Zealand's outperformance reflects the defensive nature of many of the leading companies in our market.** Healthcare companies like Fisher & Paykel and EBOS, consumer staples such as a2 Milk, electricity utilities and telecommunications are all likely to be more resilient through an economic downturn than most.

**The US market is similarly defensive,** dominated by large technology companies like Microsoft, Amazon and Alphabet (Google), and consumer staples like Johnson & Johnson, Walmart and Procter & Gamble. More cyclical sectors – like energy, financials, and industrials – that are more exposed to the level of economic activity have lagged.

The performance of markets over the past few months provides important reminders for investors. **The market's mood can quickly shift between positive and negative. That could happen again** if the pandemic comes back in a second wave when lockdown measures are lifted, or if the damage lockdowns have done to economies and earnings becomes more visible.

**But it's extremely difficult to time markets, which is why we don't recommend chopping and changing allocations to equities.** The maths is stark. If you put \$100 in the US S&P 500 index on 1 January 1990, today you'd have \$1,470, a healthy return of 9.5% per annum. But if you missed just the 10 best days over this 7,914 day period, today you'd only have \$620! Often the best days are when the outlook still seems bleak.

**We retain a neutral weighting to equities in our tactical asset allocation.** We believe the outlook for equities is balanced between:

- The pandemic coming under control, but with a risk of a second wave requiring further lockdowns
- Ongoing uncertainty about the length of restrictions and the resulting impact on sectors like travel
- Support for economies and markets from governments and central banks preventing the worst case economic scenarios
- Potential second-round economic effects from: a spike in unemployment; rising government debt; long-term side-effects from negative interest rates and quantitative easing
- The threat of de-globalisation as a side-effect of populist politics in the US, China and elsewhere
- Fair equity valuations on a long-term, risk-adjusted view.

The past two months are a clear reminder for investors that volatility will always be a feature of markets. The key is managing your response to it and holding the course with investments in quality companies even when the outlook is bleak or uninspiring.

## Research worth reading

### NZ equities

#### **F&P Healthcare (FPH.NZ) – Unmasking ResMeds 3Q20 Result**

ResMed's (RMD) 3Q20 result supports our view of strong tailwinds for FPH's Hospital segment, partly offset by temporary headwinds for sleep apnea diagnosis. RMD reported further market share gains in masks, but market anecdotes suggest FPH's new products have modestly improved its growth trajectory. FPH is one of the most expensive medical device companies globally (growth-adjusted and absolute) and is expensive relative to its own history and Australasian growth peers. UNDERPERFORM. (Published by Forsyth Barr)

#### **Investore (IPL.NZ) – Cashing Up to Go Shopping**

IPL announced an NZ\$100m capital raise. Post the raise IPL's NTA is NZ\$1.68 and gearing will reduce to 30.9%, providing NZ\$295m of headroom to capitalise on acquisition opportunities. IPL provided FY21 cash dividend guidance of 7.60cps. IPL's appeal remains its defensive supermarket based rental income. OUTPERFORM. (Published by Forsyth Barr)

#### **Stride Property (SPG.NZ) – March 2020 Valuations Keeping Pace**

SPG's FY20 valuations were broadly stable with a strong uplift for Industrial assets offset by weak Retail outcomes. Cost savings and depreciation benefits will be more than offset by the revenue impact of SPG's support for tenants due to the lockdown in the short term, and by vacancies and lower rental rates long-term. Our target price remains NZ\$1.75. NEUTRAL. (Published by Forsyth Barr)

#### **SKYCITY (SKC.NZ) – Another Count of the Cash**

We expect a slow demand recovery for SKC in NZ's Alert Level 2. SKC has managed costs and cash better during the closure than we initially anticipated. There is no shortage of challenges for SKC to navigate in the months ahead, but its asset base and casino licenses continue to support a valuation above the current market price. OUTPERFORM. (Published by Forsyth Barr)

### Australian equities

#### **Aristocrat Leisure (ALL.AX) – Cost savings and liquidity sufficient to withstand closures**

Following the removal of the 1H20e dividend and an additional \$136m of liquidity, Aristocrat can withstand an extended period of casino closures. Given highly-levered US land-based competitors, Aristocrat is well placed to benefit from consolidation over the medium term. BUY. (Published by Citi)

#### **Australia and New Zealand Banking Group (ANZ.AX) – Strong Lending Hurts Interim Dividend**

ANZ delivered 1H20 cash earnings ~40% below Citi's estimates as Asian bank minority stakes were written down. The 1H20 dividend will likely be foregone, but widening spreads in Institutional lending will benefit the P&L. ANZ has enough capital to withstand realistic losses. Citi believes ANZ's exposure to high grade corporates is an advantage. BUY. (Published by Citi)

#### **Carsales.Com (CAR.AX) – Not immune, but built to last**

CAR indicated lead volumes were down -25% in March and April, while fee waivers have been partly extended to May. Early signs of a recovery in lead volumes is promising, as is the resilience in traffic which points to an engaged consumer. CAR remains a critical sales channel. Ords therefore expects CAR to rebound well following the pandemic. BUY. (Published by Ord Minnett)

#### **LendLease Group (LLC.AX) – COVID-19 update and >\$1b equity raising**

LLC announced a \$950m placement and up to \$200m SPP at \$9.80/share. The raising strengthens LLC's financial position, and supports delivery of its >\$100b pipeline, or incremental investments in a less competitive environment. BUY. (Published by Citi)

#### **National Australia Bank Ltd (NAB.AX) – 1H20 Result – FX and Spreads Cause Mayhem**

NAB reported cash earnings ~7% ahead of Citi's expectations but ~19% below consensus and announced that it is raising \$3bn via an underwritten institutional placement with a \$500m SPP. BUY. (Published by Citi)

## International equities

### **adidas (ADSGn.DE) – Updating earnings post 1Q results**

ADSGn management re-iterated it will not do cost cuts that that would derail its participation in the global recovery. The success of new product launches, the recovery of demand in China and strong ecommerce sales point to robust demand post-COVID-19. The importance of exercise may have increased during lockdown, which may provide a boost to the wider industry. The pandemic should accelerate the shift to ecommerce and the winning brands, in Citi's view. BUY. (Published by Citi)

### **Alphabet (GOOG.US) – "Hey Google, How Do You Calm Fears?"**

GOOG management outlined a very strong start to 2020 (pre COVID-19), a set of commentary about March that was much better than investors' fears and reiterated long-term opportunities. BUY. (Published by UBS)

### **Amazon.com (AMZN.US) – Assessing The Varying COVID Impacts; Raising TP to \$2700**

AMZN posted mixed 1Q20 results, with revenues above consensus and EBIT slightly below. AWS revenue increased +33% y/y, a modest deceleration relative to the 34% growth in 4Q19. While investors were likely braced for weak 2Q20 operating income guidance, Citi believes the top-line guidance disappointed relative to investor expectations. BUY. (Published by Citi)

### **Apple (AAPL.US) – Results: Apple Beats but NO GUIDE**

AAPL reported March quarter sales and EPS above consensus, but provided no June quarter guidance. During the financial crisis (2008-2009), Apple had provided quarterly guidance but with a wider than normal range. BUY. (Published by Citi)

### **Baxter International (BAX.US) – 1Q Beat; Higher Demand from COVID; 2Q Still Growing; Not Providing 2020 Guidance**

BAX delivered 1Q20 sales and EPS ahead of consensus. Five businesses saw higher demand due to COVID: Acute Therapies, Renal Care, Medication Delivery, Pharma, and Nutrition, while Advanced Surgery began to decline due to elective surgery delays. UBS likes BAX's fundamental setup given good product flow. BUY. (Published by UBS)

### **Facebook (FB.US) – Showing Resilience In Turbulent Times**

FB exceeded 1Q estimates and provided initial April operating trends that showed dramatic positive rate of change vs March trends. While the forward operating environment remains in flux, FB's exposure to a broad global depth of advertisers (especially category exposure in digital/omnichannel commerce) helps offset areas of weakness. Buy. (Published by UBS)

### **Gilead Sciences (GILD.US) – COVID-19 – Positive NIAID data could mean \$5-\$10/sh upside to GILD**

GILD issued two statements on Remdesivir data. While the anticipated SIMPLE data in severe patients turned out to be inconclusive as expected, Citi thinks the NIAID trial data will likely steal the show as this trial included a placebo control arm and it appeared to deliver positive results. Although there is a wait for the data, Citi sees this as a positive step in fight against COVID-19. BUY. (Published by Citi)

### **Mastercard (MA.US) – Helpful Comments on Framing Recovery; MA Remains a Buy**

Mastercard reported a quarter that was better than expectations. There was a lot of good granularity on the progression of recent trends. Incremental data on ecommerce growth supports Citi's view of a permanent spending shift to online. BUY. (Published by Citi)

### **Microsoft (MSFT.US) – Stronger Q3 and Acknowledgement of More Uncertainty into Q4**

MSFT shares, like the sector overall, have come roaring back on a combination of fundamentals being less bad than expected as well as a lack of alternative sectors with strong fundamentals. The excitement may be premature as COVID-19 impacts have just begun in this late-cycle sector. Citi expects stock performance to hinge on Azure (cloud services) staving off deceleration (which seems a safe bet) and stability in gross margins (which is less certain into FY21). BUY. (Published by Citi)

### **Visa (V.US) – Payments Volume Declines Bounce Off Lows; Visa Controls What It Can Control; Maintain Buy**

V's weekly data on US payments volume, transactions and cross-border growth showed a bounce in the second half of April (even over the prior year's Easter period), helped by government stimulus and merchants/consumers adapting to the pandemic situation. A long multi-quarter recovery is a reasonable assumption. Citi likes V's cost controls. BUY. (Published by Citi)

## Events calendar

Figure 3. Events this week

Date	New Zealand	Australia	International
4-May	<ul style="list-style-type: none"> <li>Building Consents (MoM)</li> <li>ANZ Commodity Price Index (MoM)</li> </ul>	<ul style="list-style-type: none"> <li>AIG Construction Index (Apr)</li> <li>Services PMI</li> <li>Westpac 1H20</li> </ul>	<ul style="list-style-type: none"> <li>China Railway Construction 1Q20</li> </ul>
5-May	<ul style="list-style-type: none"> <li>Global Dairy Trade Price Index</li> <li>Labor Cost Index (Q1)</li> <li>Employment Change (QoQ)</li> <li>Participation Rate (Q1)</li> <li>Unemployment Rate (Q1)</li> </ul>	<ul style="list-style-type: none"> <li>RBA Interest Rate Decision</li> <li>RBA Chart Pack Release</li> <li>Retail Sales (MoM/QoQ)</li> </ul>	<ul style="list-style-type: none"> <li>US: ISM Non-Manufacturing PMI</li> <li>UK: Composite/Services PMI (Apr)</li> <li>Ferrari 1Q20</li> </ul>
6-May	<ul style="list-style-type: none"> <li>Inflation Expectations (QoQ)</li> </ul>	<ul style="list-style-type: none"> <li>AIG Services Index (Apr)</li> <li>Exports (MoM)</li> <li>Imports (MoM)</li> <li>Trade Balance (Mar)</li> </ul>	<ul style="list-style-type: none"> <li>US: ADP Nonfarm Employment (Apr)</li> <li>US: Crude Oil Inventories</li> <li>UK: Construction PMI (Apr)</li> <li>Walt Disney 2Q20</li> </ul>
7-May		<ul style="list-style-type: none"> <li>RBA Monetary Polict Statement</li> </ul>	<ul style="list-style-type: none"> <li>US: Initial Jobless Claims</li> <li>UK: BoE MPC Meeting Minutes</li> <li>UK: BoE Interest Rate Decision</li> <li>PayPal 1Q20</li> </ul>
8-May	<ul style="list-style-type: none"> <li>CFTC NZD Speculative net positions</li> </ul>	<ul style="list-style-type: none"> <li>CFTC AUD Speculative net positions</li> </ul>	<ul style="list-style-type: none"> <li>US: Nonfarm Payrolls (Apr)</li> <li>US: Unemployment Rate (Apr)</li> <li>ING Group 1Q20</li> <li>Siemens 2Q20</li> </ul>

Source: Bloomberg

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