Axiome Quarterly Update

April—June 2024

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Economic and Market Commentary

Overview

The AI boom theme continued into the June quarter. International equities again increased, but gains were concentrated in the large cap tech sector. Short-term credit also performed well, but elsewhere returns were negative or more subdued. NZ and Australian equities, global small caps and international property, for example, all fell over the quarter (see Figure 1).

As in our previous update, on the economic front the US remains a bright spot, but there are now also increasing signs of activity picking up - or at least stabilising - in other key economies and regions, including China and the EU. Inflation has also continued to trend down globally, to the extent that some central banks have begun to cut interest rates, including the ECB and Bank of Canada. New Zealand unfortunately remains a glaring exception. Data releases suggest that we remain in recessionary conditions, but despite this, the RBNZ has maintained its relatively hawkish stance.

Large cap global equities performed well again this quarter, but performances elsewhere were quite mixed.

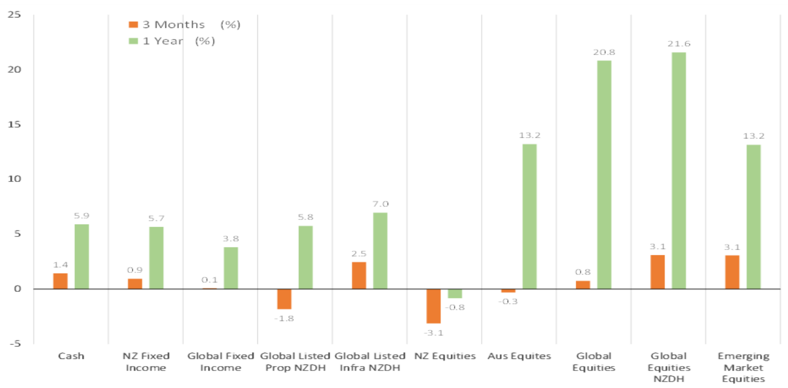

Figure 1: Mixed performances in the June quarter

Market roundup

Asset class performances were mixed in the quarter. Global equities again rose, by around 3% on an NZD hedged and local currency basis, bringing the annual returns to over 20%. Emerging markets performed in line with global equities. Under the surface equity market performances were much more mixed. Global small cap stocks fell by around 2% in local currency terms, while global value and Australian equities both fell by around 1%.

Gains were strongest in US equites over the past year, reflecting the relative strength of the US economy and the AI boom underway. NZ equities have performed poorly as rates have stayed high and corporate earnings have taken a hit.

Trailing the pack, NZ equities fell around 3% over the quarter and 1% over the year to June. Most of the largest stocks on our market are utility and infrastructure-type investments sensitive to NZ economic growth and interest rates. While rates remain high and growth very weak our market will likely continue to struggle. Figure 2 suggests that the decline in corporate earnings in our market since the post-Covid peak in early 2022 has been *larger* than falls seen over the GFC period.

Listed global property fell around 2% while global infrastructure increased by 2.5% on an NZD hedged basis. Over the year, these asset classes have returns around 6% and 7% respectively. Bond performances were also mixed. New Zealand investment grade bonds increased 0.7% in the quarter and 5.2% over the year, but within this, government bonds, which are longer duration, returned around 4.7%, while corporate bonds returned 6.3%. International investment grade bond returns were flat this quarter as they suffered from the marked-to market impact of markets pricing in delays to interest rate cuts, particularly in the US. But short-term credit and high yield performed very well, with funds that allocate to these asset classes returning around 2.5% in the quarter and in some cases over 10% (net of fees) for the year.

Diversification as always remains essential across markets and asset classes.

As always, the mixed performance of markets argues for ensuring portfolios remain well diversified. While large cap growth stocks are in vogue now, any shortfall in their earnings could well precipitate a large correction. While NZ stocks are out of favour, they are interest rate sensitive and as such they are primed to rally when the RBNZ joins its international peers in cutting rates.

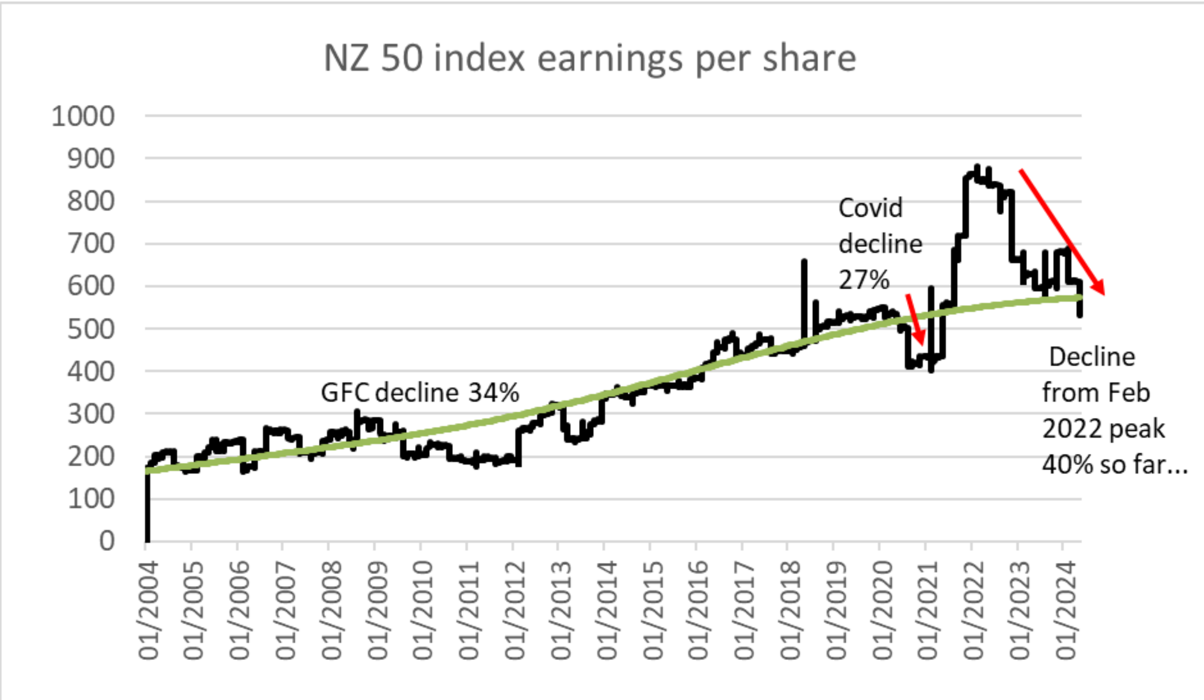

Figure 2: Large decline in NZ listed corporate earnings

Source: Schroders Asset Management

Key Market Movements for the Quarter

Quarter | Past Year

New Zealand Shares

Quarter: -3.1% | Past Year: -0.8%

New Zealand shares fell 3.1% over the quarter, giving up the gains made last quarter, and are now down around 0.8% over the last 12 months. This is a quite soft result compared to offshore equities, but our market remains a strong performer over the last decade with a return of around 9.7% per annum.

Source of Figures: S&P/NZX 50 Total Return Index with Imputation Credits

New Zealand Fixed Interest

Quarter: +0.7% | Past Year: +5.2%

New Zealand investment grade bonds returned 0.7% in the quarter and 5.2% over the year. Within this, government bonds returned around 4.7% over the year, while corporate bonds returned 6.3%.

Source of Figures: S&P/NZX Investment Grade Corporate Bond Index

Australian Shares

Quarter: -0.6%% | Past Year: +13.1%

Australian shares fell a little in the quarter, but annual results remain strong at around 13%. Australian small cap stocks were weaker, while value outperformed over the year returning around 20%.

Source of Figures: S&P/ASX 300, S&P Australia BMI Value, S&P/ASX Small Ordinaries

International Shares

Quarter: +0.8% (+3.1% hedged) | Past Year: +20.8% (+21.6% hedged)

Following the blistering pace of gains over the past several quarters, international shares posted a return of 'only' around 3% this quarter in local currency and NZD hedged terms. This brought the annual results to around 21% in NZD terms, while NZD hedged returns were around 21.6%. Small caps fell 4.5% in the quarter and returned around 10% over the year, while value stocks fell 3% in the quarter and have risen 14.5% over the year. The underperformance of small and value-oriented stocks in part reflects that the largest gains were again from large cap US growth stocks in the tech sector.

Source of Figures: MSCI World Index; Morningstar Developed Markets NZD hedged, MSCI World Value MSCI World Small Cap in NZD terms.

Emerging Markets

Quarter: +3.1% | Past Year: +13.2%

Emerging Markets rose by around 3% over the quarter and a respectable 13.2% over the year to June in NZD terms. This in part reflects investors taking advantage of their relatively cheap valuations, but also that economic growth was stronger than expected, especially in China.

Source of Figures: MSCI Emerging Markets Index

International Fixed Interest

Quarter: +0.1% | Past Year: +3.8%

Global investment grade bonds were again flat in the quarter as market conviction waned that interest rates will be cut aggressively over 2024. This reduced the annual return to 3.8%, below the current running yields on global bonds of around 6%.

Source of Figures: Bloomberg Barclays Global Aggregate Index (hedged to NZD)

International Property and Infrastructure

Quarter: -1.8% (property) | Past Year: +5.8% (property)

International property stocks fell by around 1.8% in the quarter in NZD hedged terms, while global infrastructure increased around 2.5% in NZD hedged terms. Over the year, infrastructure increased around 7% and global property 6% on an NZD hedged basis.

Source of Figures: FTSE EPRA NAREIT, FTSE Dvlp Core Infra 50/50; NZD & NZD hedged basis

The Evolution of Retirement: Adapting to a New Era

The concept of retirement has transformed significantly over the years. What once was a period of rest and relaxation after decades of labour has evolved into a more dynamic and complex phase of life.

The Origins of Retirement

The modern idea of retirement dates back to the late 19th century. In 1881, Otto von Bismarck, the conservative president of Prussia, introduced the concept of government-sponsored financial support for older citizens. At that time, the notion of retiring was revolutionary, as most people continued to work as long as they were physically able. Von Bismarck's proposal was driven by political pressure and the need to address the growing concerns of the working class. It led to the creation of a retirement system for those over the age of 70, which was later adjusted to 65.

Early Retirement Systems

The introduction of public pensions in various countries followed Bismarck's lead. For instance, New Zealand implemented its Old Age Pension in 1898, providing support for citizens over 65, albeit with a stringent means test. These early systems were designed during a time when life expectancy was much lower, and relatively few people lived long enough to claim these benefits. As a result, the financial burden on the state was manageable.

Increasing Longevity and Its Implications

Fast forward to the 21st century, and the landscape of retirement has changed dramatically. Advances in healthcare and living standards have significantly increased life expectancy. Today, a 65-year-old in New Zealand can expect to live another 23 years (for men) to 25 years (for women) on average. This extended lifespan has transformed retirement from a brief period at the end of one's life into a substantial phase that can last 25 to 30 years or more.

The Changing Nature of Work and Retirement

With people living longer, the traditional notion of retirement—ceasing work entirely at 65—has become less practical and often financially unfeasible. Many are now rethinking their approach to retirement, opting for a more gradual transition. This might involve scaling back to part-time work, changing careers later in life, or even starting new ventures. This extended working period allows for continued income, delayed withdrawals from retirement savings, and additional years for investments to grow.

Financial Planning for Modern Retirement

Given these changes, retirement planning has also evolved. It's no longer just about saving a lump sum to draw down in later years; it's about creating a sustainable plan that accounts for longer life expectancy, healthcare costs, and inflation. Here are some key strategies for modern retirement planning:

1. **Start Early and Save Consistently**: The power of compound interest cannot be overstated. Starting to save early in your career and contributing consistently to retirement accounts can significantly increase your nest egg over time.

2. **Diversify Investments**: A diversified portfolio can help manage risk and ensure growth. This includes a mix of stocks, bonds, real estate, and other assets.

3. **Consider Part-Time Work or New Ventures**: Extending your working life, even part-time, can provide additional income and keep you engaged. Many find that a second career or part-time work is fulfilling and financially beneficial.

4. **Plan for Healthcare Costs**: Healthcare expenses can be substantial in retirement. It's crucial to account for these in your retirement planning and consider options like long-term care insurance.

5. **Inflation-Proof Your Retirement**: Inflation can erode purchasing power over time. Investments that provide inflation protection, such as equities or real estate, can help maintain your standard of living.

The New Retirement Mindset

Retirement today is not just an end but a new beginning. It's an opportunity to pursue passions, explore new interests, and redefine your life's purpose. With careful planning and a proactive approach, you can ensure that this phase of life is not only financially secure but also enriching and fulfilling. The evolution of retirement reflects broader societal changes.

As we live longer, healthier lives, the way we approach retirement must adapt. By embracing this new reality and planning accordingly, you can create a retirement that is both secure and satisfying, allowing you to spend with confidence and enjoy the fruits of all your hard work.

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