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ECONOMIC AND MARKET COMMENTARY

OVERVIEW

Everything everywhere all at once. To borrow from the title of the 2022 Oscar winning film, almost every asset class enjoyed strong returns in the September quarter (Figure 1). The lead role in this performance was played by central bankers. The RBNZ cut the OCR by 25bps on 14th August followed by a further 50bps on 9th October. The European Central Bank also cut by 25bps on 12th September, and the US Federal Reserve cut by 50bps on 23rd September. Markets cheered and have baked in the view that the world is entering into a materially lower interest environment over the next few years.

Markets rallied across the board in the September quarter as interest rates were cut by central banks.

Playing a key supporting role was the US economy. The US equity market now represents around 65% of global equity market capitalisations. US GDP growth came in at around 3% for the year to June, and current indicators suggest that the US economy is at least maintaining this pace of growth, whilst US CPI inflation continues to trend lower and is now around 2.5%. While some commentators still think there is recessionary risk in the US, our view is perhaps the main risk now to this 'goldilocks economy' is that US rates will be cut too fast. In the meantime, the US consumer is enjoying the show (Figure 2).

The US economy has continued to perform well whilst in NZ and many other countries growth remains weak.

US economic strength is in stark contrast to home where NZ GDP growth was a miserly -0.2% for the quarter and year ended June, and NZ Bank economists do not expect a material rebound in activity anytime soon. Outside of the US economic activity in much of the world also remains patchy, and geopolitical tensions have continued to rise as the conflict between Israel and Hamas has spread.

MARKET ROUNDUP

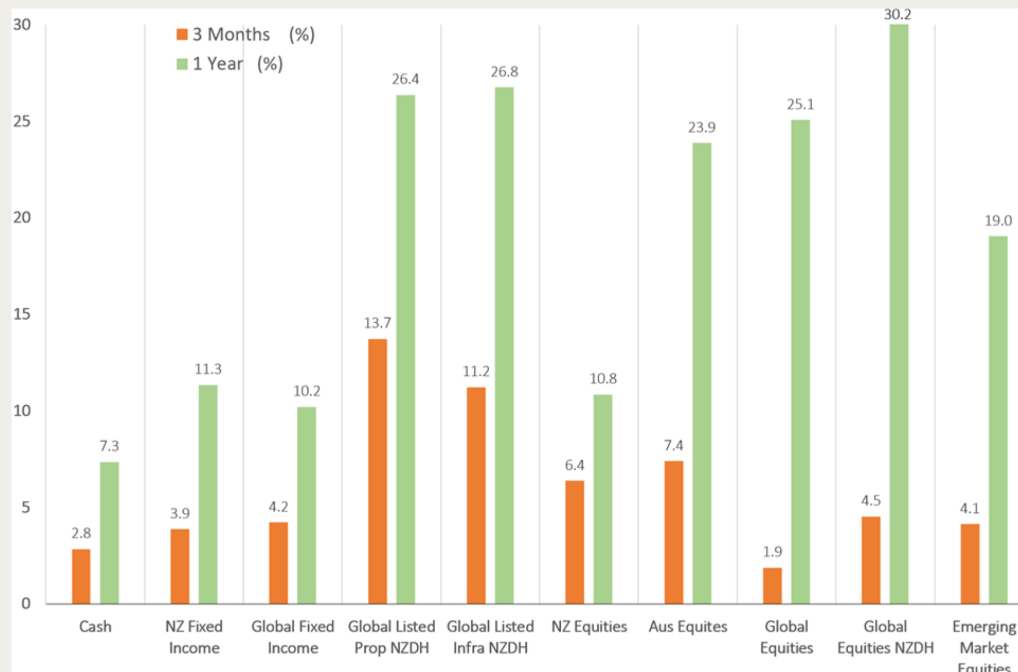


Figure 1: Strong performances in the September quarter Source: Morningstar Direct, MyFiduciary

Global equities on an NZD hedged basis had the strongest return, at around 30% in the year to June, followed by global listed property and infrastructure.

Asset class performances were strong over the quarter. Global equities rose by around 2% on a local currency and 4.5% on an NZD hedged basis, bringing annual returns to just over 30% on an NZD hedged basis, and 25% on an unhedged basis. Emerging markets outperformed unhedged global equities in the quarter, but still lag in the year to June with a return of 'only' 19%. This performance is however broadly in line with developed market equities outside of the US large cap tech sector.

NZ and Australian equities enjoyed a very strong quarter, increasing by around 6.5% and 7% respectively. Interest-rate sensitive listed property and infrastructure also performed very well, boosting their annual returns to over 26% on an NZD hedged basis, and around 22% on an unhedged basis.

Bond market performances were also strong
with returns over 10%.

Bond market performances were also strong as large rate cuts were priced in over the rest of this year and over 2025. New Zealand investment grade bonds increased 4.5% in the quarter, and around 11.5% over the year. International investment grade bond returns were slightly softer at around 4.2% in the quarter and 10.2% over the year. Last but not least, gold prices (in NZD terms) increased 8% in the quarter and 33% over the year, reaching record prices.

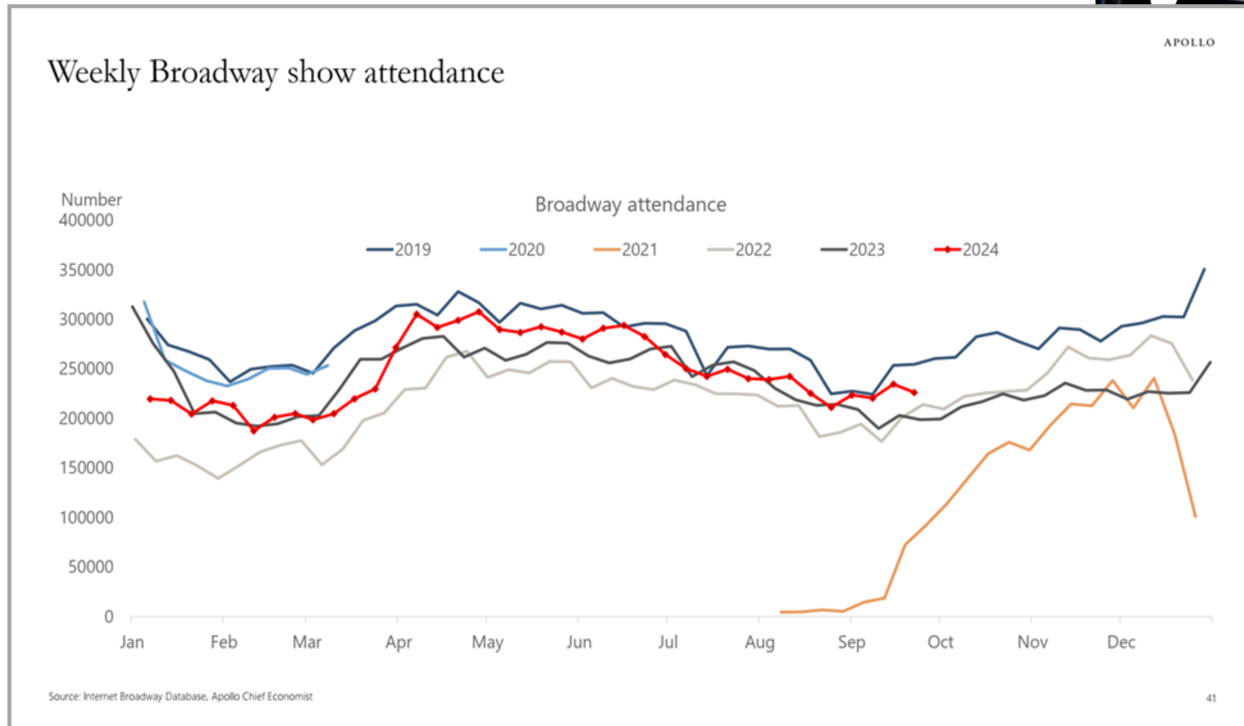


Figure 2: US consumer spending around historic averages, as illustrated by Broadway attendances

Quarter	Past Year	
+6.4%	+11.6%	**New Zealand Shares** New Zealand shares bounced strongly by around 6.5% over the quarter as our market reacted favourably to the RBNZ cutting rates in August. This lifted the annual return to September 2025 to around 11%. *Source of Figures: S&P/NZX 50 Total Return Index with Imputation Credits*
+3.9%	+11.6%	**New Zealand Fixed Interest** New Zealand investment grade bonds returned around 4% in the quarter and 11.5% over the year. This gain was driven by markets factoring in much lower interest rates over the next couple of years, boosting bond prices. *Source of Figures: S&P/NZX Composite Investment Grade Index*
+7.2%	+23.6%	**Australian Shares** Australian shares rallied in the quarter by 7.2%, boosting the annual result to around 23.5%. Australian small cap stocks had weaker performances, while value stocks outperformed over the year returning around 32%. *Source of Figures: S&P/ASX 300, S&P Australia BMI Value, S&P/ASX Small Ordinaries*
+1.9% (+4.5% hedged)	+25.1% (+30.2% hedged)	**International Shares** International shares posted a return of around 2% this quarter in local currency terms and 4.5% in NZD hedged terms as our currency appreciated versus the USD. This brought the annual results to around 25% in NZD terms, while NZD hedged returns were around 30%. Small and value stocks outperformed over the quarter, rising by around 5% in NZD terms. This reflected the rally that had been concentrated in large cap US tech stocks broadening to other countries and parts of the market. *Source of Figures: MSCI World Index; Morningstar Developed Markets NZD hedged, MSCI World Value MSCI World Small Cap in NZD terms*
+4.1%	+19.0%	**Emerging Markets** Emerging Markets also had a solid quarter, rising by around 4% in NZD terms. This lifted their annual return to around 19%, broadly in line with global equity returns ex-large cap US tech stocks. *Source of Figures: MSCI Emerging Markets Index*
+4.2%	+10.2%	**International Fixed Interest** Global investment grade bonds rose by around 4.2% in the September quarter, lifting the annual return to around 10.2%. As in New Zealand, this reflected markets discounting in lower future interest rates as evidence has mounted of slowing inflation. *Source of Figures: Bloomberg Barclays Global Aggregate Index (hedged to NZD)*
+13.7% (property)	+26.4% (property)	**International Property and Infrastructure** International property stocks increased by 13.7% in the quarter in NZD hedged terms, while global infrastructure increased around 11% in NZD hedged terms. Over the year, on an NZD hedged basis, global property rose by 26.5% and infrastructure increased around 27%. These large gains reflect central bank rate cuts and expectations of a lower interest rate environment over the next few years. *Source of Figures: FTSE EPRA NAREIT, FTSE Dvlp Core Infra 50/50; NZD & NZD hedged basis*

GEOPOLITICAL RISK AND RETURNS

OVERVIEW

Geopolitical risks and events—such as wars, terrorist attacks, political instability, and trade tensions—are a staple of our news and at times completely dominate the headlines. While such events can have profound impacts on the lives of people, communities and nations impacted, do they matter for long term asset returns? In this article we address what the empirical literature suggests in this regard, and the implications for investors.

Geopolitical risks are ever present.

GEOPOLITICAL RISK IMPACTS

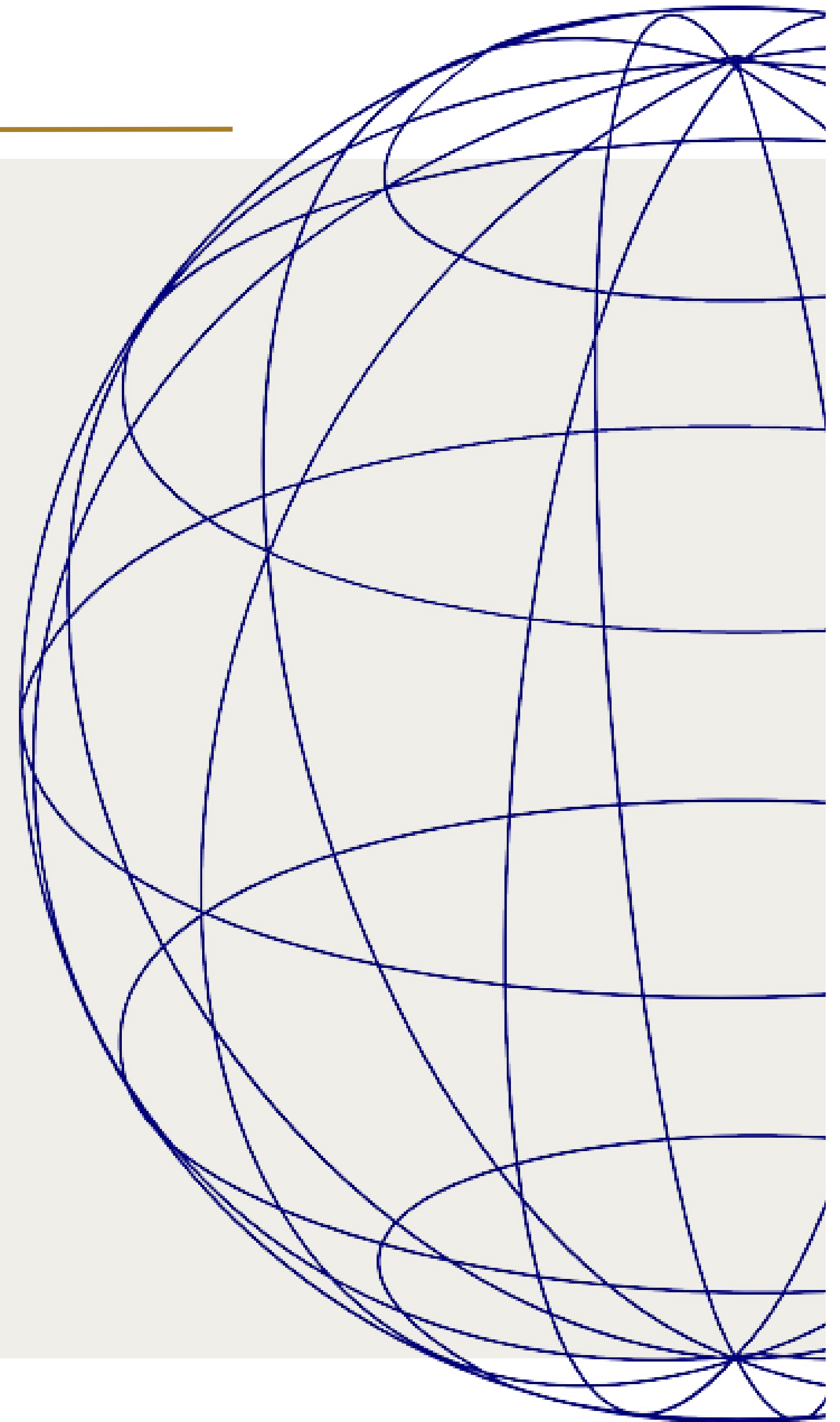
As with most things in markets it is useful to distinguish between the short and longer terms. Over the short-term the literature suggests geopolitical events can lead to abrupt equity market selloffs, and increased volatility and market risk premiums. But crucial in this is the proximity of the event to the market concerned, the magnitude of the event, and the impact across different sectors and countries.

They can cause large short-term declines in markets but are very difficult to forecast.

The literature also suggests that such events are at best coincident with volatility and short-term declines in equity markets. Or in other terms, it is exceedingly difficult to *forecast* future returns given geopolitical risks.

Over the longer-term markets recover despite the fact that there can be enduring economic and sectoral impacts.

The longer-term impacts depend on how the 'shock' is resolved and whether it has an enduring influence on economic growth, corporate earnings and profitability. In general, we can say that over time markets recover, even from the largest of such events such as the World Wars. The figure below shows the long-term march upwards of markets through geopolitical and other hits to markets. But that is not to say there aren't enduring impacts on specific companies, sectors or even countries and regions.



CASE STUDY : RUSSIAN INVASION OF UKRAINE

To illustrate with a recent example, the full-scale Russian invasion of Ukraine in February 2022 had the largest short-term impact on neighbouring countries. Poland and Hungary's equity markets fell around 40% and European equity markets overall initially fared worse than the US. But in the year following the invasion European equities had fully recovered while the US market was down around 9%, even though European economies were much more negatively impacted by rising energy prices. And now some 2.5 years on, most equity markets have reached new highs, with the US leading the pack. In contrast, Russian equity markets have become uninvestable following the dropping of their markets from indices and funds.

Russia's invasion of Ukraine had a larger initial impact on equity markets, but they have now more than recovered with the exception of the Russian market.

This is not to say there haven't been enduring impacts. Energy markets have been completely reconfigured within Europe and some commentators suggest the war has hastened the transition away from fossil fuels. Defense industry spending has rocketed. In contrast, most Western companies with Russian ties have essentially had to write-off their businesses and assets held within Russia.

IMPLICATIONS FOR INVESTORS

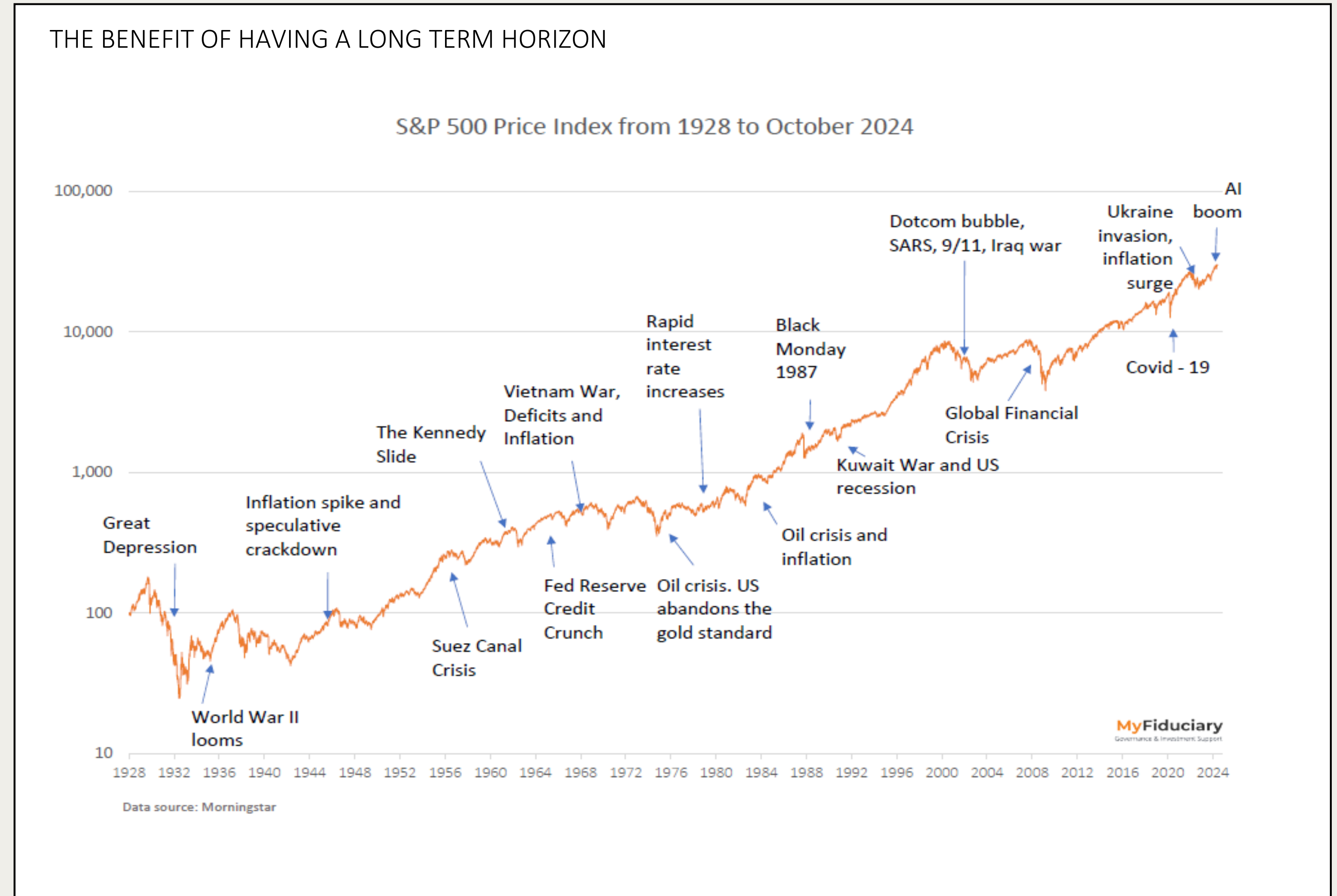
For investors, diversification across markets and asset classes is essential for managing geopolitical event risk, in line with managing market risk in general. Bonds and asset classes such as gold typically rally when there is an increase in short-term global uncertainty and equity market volatility.

A 'shock' that has an enduring negative impact on a country or sector can be mitigated by holding broadly diversified exposures across sectors and countries. And time, as always, is the ultimate diversifier. Most markets, most of the time, recover.

For investors, diversification and time are the key ways to manage geopolitical risks.

Another implication of the literature is that it is likely fruitless and potentially counterproductive to adjust portfolios in response to geopolitical risk. Markets are impacted by many forces, and as discussed above, the medium and longer run impacts are very uncertain. An investor selling European stocks after the Russian invasion to buy, say, US stocks on the view that the European economy would be hit harder would have been right on the economic impact, but wrong on the impact on markets over 2022. Defense spending has massively increased since the invasion, but defense stocks overall have not outperformed.

THE BENEFIT OF HAVING A LONG TERM HORIZON



Finally, while we caution against reducing exposure to risky assets because of concern that geopolitical risk will impact future returns, there may still be good reasons to adjust based on Responsible Investment (RI) considerations, subject to materiality and the practicality of making any adjustments. Many investors sold (or wrote off) their holdings of Russian stocks on RI grounds following the Ukrainian invasion, which in the event was facilitated by fund managers and index providers dropping these exposures in response to Western government sanctions.

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