Russell Investments

SEPTEMBER 2016 // QUARTERLY MARKET OVERVIEW

Market Overview

Australasian equities

The New Zealand equity market rose 7.3%, as measured by the S&P/NZX50 Index. The local market benefited from a solid profit reporting season with the majority of firms exceeding profit expectations. Fletcher Building, Auckland Airport, Spark, Trade Me and Ebos led the market up. Orion Health, Tower, Chorus, Tegel and Comvita held market returns back reflecting stock-specific issues.

The Australian market, as measured by the Russell Australia Index, rose 5.5%. The reporting season failed to meet analyst expectations, with large capitalisation stocks generally disappointing. However, the Australian mining and metals sector outperformed, reflecting leverage to firmer iron ore and metallurgical coal prices.

Global equities

Global equities, as measured by the Russell Global Large Cap Index, rose 5.5% in NZ dollar hedged terms. Global markets rebounded following the surprise decision of the UK in June to leave the European Union (EU), as lower bond yields, expectations of additional monetary accommodation, and stable global economic data soothed investor concerns.

The US market climbed 4.0%, as measured by the Russell 1000 Index. A mixed bag of economic data saw the US Federal Reserve (the Fed) leave interest rates unchanged at its September meeting but strongly signal that "the case for an increase in the federal funds rate has strengthened". The decision to hold rates steady, positive economic news and strong quarterly earnings reports from several companies, buoyed the market.

European markets rose sharply, with the Russell Eurozone Index returning 6.2%. Over the quarter, markets came to terms with the UK's decision to leave the EU while, domestically, concerns surrounding the health of the Italian banking sector subsided. However, uncertainty about the health of Deutsche Bank weighed on the sector towards the end of September. Meanwhile, the European Central Bank (ECB) maintained its accommodative monetary policy. This dampened sentiment towards the end of the quarter, with some investors disappointed that policymakers had not discussed any extension of asset purchases beyond March 2017.

The UK market jumped 8.6%, as measured by the Russell UK Index. After the referendum to leave the EU in the second quarter, an element of political certainty was provided by the installation of Theresa May as the new Prime Minister in July. This was followed in August by the expected interest rate cut by the Bank of England. The central bank also launched a £170 billion stimulus package in an effort to support the UK economy post-'Brexit'. These programmes, alongside continued economic uncertainty as a result of the June vote, saw sterling continue to depreciate.

The Japanese equity market rebounded from two consecutive quarters of losses, rising 6.9%, as measured by the Russell Japan Index. The Bank of Japan kept interest rates unchanged at -0.1% while also committing itself to expanding the monetary base until inflation exceeds and stays above its 2% target. Prime Minister, Shinzo Abe, announced plans in July for a ¥28 trillion fiscal stimulus package, shortly after his ruling coalition won a majority of seats in Japan's upper house.

Emerging markets rose 7.4%, as measured by the Russell Emerging Markets Index. The market was buoyed after the Fed failed to increase its interest rate in September. The subsequent weakening of the US dollar was a tailwind to emerging markets. China (+13.9%) was the best-performing country as positive economic data increased investor confidence in the economy. Brazil extended its strong run of healthy returns, as commodities rebounded and Michel Temer took over the country's presidency after the official impeachment of Dilma Rousseff.

Global fixed interest

The Barclays Global Aggregate Bond Index rose by 1.0% in NZ dollar hedged terms. The Fed left interest rates unchanged at 0.5%. However, in so doing it strongly signalled that “the case for an increase in the federal funds rate has strengthened”. While signalling that a rate hike is likely in the months ahead, Fed officials lowered their economic growth forecast and trimmed the number of rate hikes they foresee in 2017 from three to two. On the back of these developments, the benchmark 10-year Treasury yield rose 12 basis points (bps) to 1.59%. Across the Atlantic, UK gilt yields fell 0.12% as the Bank of England cut its benchmark rate and unleashed a new round of easing. The Bank of Japan also introduced its own new form of policy easing while the ECB’s decision to leave its current range of support measures unaltered meant that Bund yields barely moved.

Global investment-grade credit spreads tightened 20 bps while corporate issuance remaining robust. One of the most notable deals came from Microsoft, which issued nearly US$20 billion in order to fund its acquisition of LinkedIn.

NZ fixed interest

The New Zealand fixed interest market rose 0.9%, as measured by the S&P/NZX NZ Government Stock index. Yields on New Zealand bonds edged lower during the quarter. As expected, the Reserve Bank of New Zealand reduced the official cash rate (OCR) to 2.00% (a drop of 0.25%) at its August meeting. While the OCR was held constant at its September meeting, it noted that “monetary policy will continue to be accommodative” and that “current projections and assumptions indicate that further policy easing will be required…”

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