

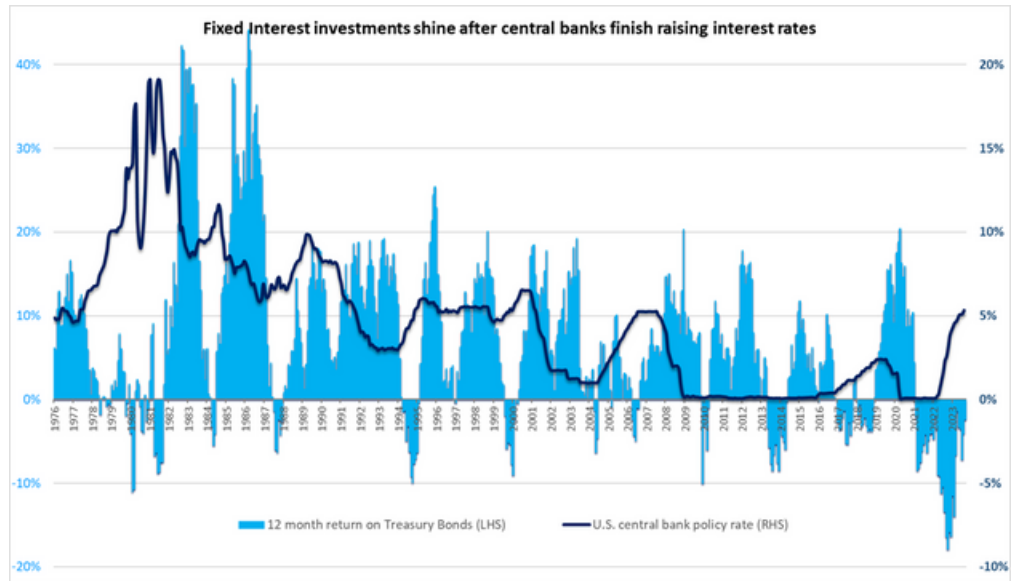
# Market Update - October 2023

*All things in their season and all things in moderation. Q3 of 2023 took back a portion of this year's gains, but as interest rates peak, income looks promising in the year ahead.*

## 'Tis the season

Retailers have Christmas decorations out already! It seems to get earlier every year. It's becoming just like the changing weather patterns where there is less of a clear line between seasons. The same has been true of investment markets these last few years. Nevertheless, there remain certain underlying principles that hold true: Christmas is on the 25th of December; Summer is warmer than Winter; and history shows that bonds perform their best after central banks have finished raising interest rates.

Central banks around the world have slowed the pace at which they have been raising interest rates, but they continue to talk tough about being ready to do more. The reason for the tough talk is to manage expectations, so that people don't carry on spending in a manner that causes more inflation. In any event, rate hikes may well be behind us with the possibility of just one more in certain countries around the world, which means that 'tis the season for bonds.



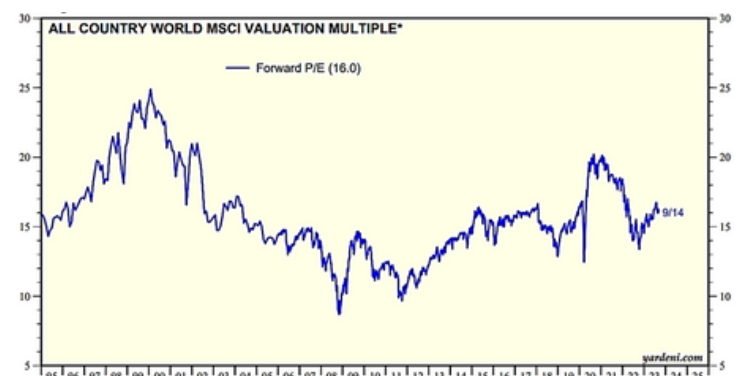
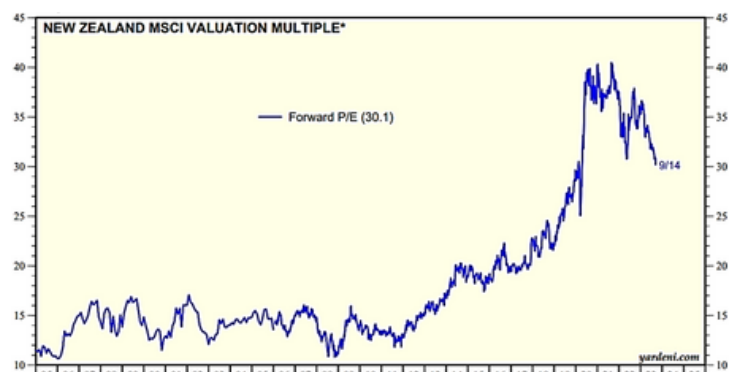
Explaining how bonds work as an investment can quickly become confusing because of the math involved. However, the following chart illustrates in simple terms, why we are entering bond season. As central banks raise interest rates, the return on bonds fall. Conversely, once central banks have finished raising interest rates and then later reduce them, returns on bonds jump. Shopping for bonds now can give the gift of good returns and spread investment cheer in the coming season of the investment cycle.

## We're for Team New Zealand

We've done our part by voting and we want the All Blacks to win the Rugby World Cup later this month because we are emotionally invested in New Zealand, but we don't want to invest here - for rational reasons.

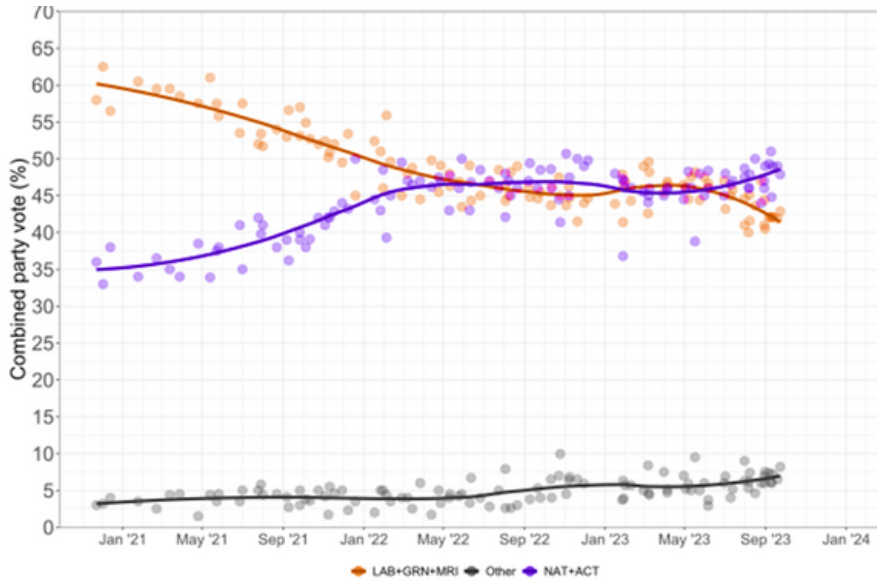
We favour a smaller allocation to New Zealand equities than usual and have done so for several years. We say this on the basis of valuation. New Zealand equities are expensive compared to the revenue they generate, considerably more so than those of other nations. Assessing P/E ratios (Price to Earnings), we see New Zealand shares are twice as expensive as global equities. The New Zealand share market has shares priced at 30 times their earnings while international shares are priced at 16 times their earnings. Such a high P/E ratio also means that any dividends received will deliver a low return measured as a percentage on the investment.

We want all things New Zealand to do well, but we must moderate our emotional attachment in favour of a well-diversified portfolio that promises better opportunity for long-term growth based upon a platform of sound fundamentals.



## The politics of New Zealand

You are receiving this Market Update around the time of the 2023 New Zealand General Election. Maybe there will be a clear-cut result on election night or maybe there will be weeks of backroom negotiations to form a government. As current polling stands, it looks like it could be a close election once we include the potential of minor parties achieving the 5% threshold (or gaining a seat in parliament) and forming coalition partnerships.



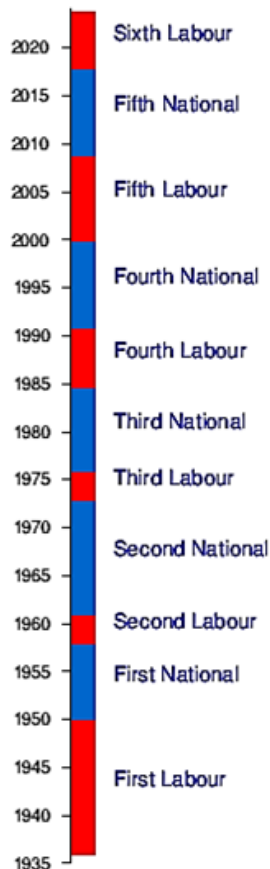
The history of New Zealand politics paints an interesting picture of how New Zealanders relate to those they elect to govern. New Zealand is a centrist nation with moderate political views. There are those among us who prefer being left of centre and those who favour the right, but the electorate as a whole never lets one side hold power for too long.

Despite not liking the extremes of the political spectrum and preferring to gather around the centre, New Zealanders do have their differences. Those differences are reflected in what actions we believe should be taken so that our society can achieve its common goals.

Politics is about policies, and policies are the path we choose to reach our goals.

We face the same challenge in our personal lives. How do we raise our families? We want to build a sense of family and create lasting memories, but we must balance that with repaying the mortgage and saving for retirement.

How we manage our money is where we most clearly see the tension between short-term needs and longer-term ambitions. As financial advisers, we help people on a daily basis in prioritising their goals and providing actionable steps, navigating often conflicting agendas.



## Gradual recovery

Investment markets paused their upward path over the quarter, moderating the gains made during the prior two quarters. Global equity markets fell back as long-term interest rates pushed higher.



We continue to favour bonds at current attractive interest rates. We also favour some currency hedging in the international equity portion of portfolios due to the New Zealand Dollar having fallen to levels only seen during previous global weakness.

## Market outlook

Economic risk remains elevated in the short-term. The impact of higher interest rates is slowing economic activity. This is causing the rate of inflation to fall back down to more normal levels, but central banks will not reduce any pressure by way of reduced interest rates until they are certain inflation is no longer a risk.



Fixed interest investments are attractive at current interest rates and the prospect of a slowing economy promises to add reasonable capital gain over the course of 2024 on top of the high rate of interest being paid.