Market Update - July 2023

It has long been the subject of Hollywood sci-fi blockbusters, but in the first half of 2023, the rise of Artificial Intelligence has led to a rise in stock markets, the recession was announced and a positive return for the quarter across all major asset classes.

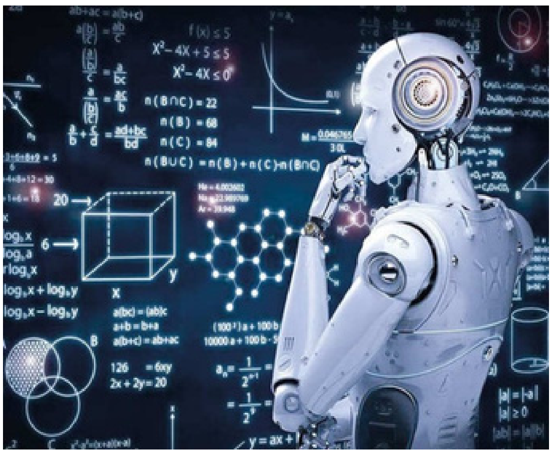
Artificial intelligence

Seven mega-cap stocks, dubbed 'The Magnificent Seven' have accounted for virtually all the gains in global equity markets this year, as per the graph below. Part of the reasoning for this equity-market rally is due to investors' expectations of the future earnings potential of these seven stocks due to their exposure to structural megatrends like the adoption of Artificial Intelligence (AI).

In the few short months since ChatGPT started making waves and entering the public consciousness, AI has taken off. Its advance has been so rapid that the potential impact of the technology has caused concern among tech sector leaders who have asked developers to enter a self-enforced moratorium to allow for the development of safety protocols.

This technology will change our way of life. Already, school students are using AI to generate their subject assignments and teachers are running software that checks their work for being AI-generated, so students are using software to 'knock the edges off' their AI-generated output to make it look more human and age-appropriate.

Like any technological advancement, AI can improve our lives, but it requires us to recognise its strengths as well as its risks.



A primary risk is its power to be used to dupe people for fraudulent purposes and to generate deep-fake content that appears to be from a legitimate source or authority and is intentionally misleading.

However, perhaps one ironic change the technology may bring is a strengthening of human relationships which includes increased face-to-face meetings.

People want to ensure that they are getting the real thing produced by informed people, rather than relying on something sourced online that is of unknown origin and potentially unreliable but put together in a manner that appears credible.

The R word - Recession

New Zealand entered a 'technical' recession in early 2023 after posting a second quarter of negative GDP growth and was the only developed country in the Pacific region to do so. This situation includes the impact of multiple weather events and industrial action. This may also reflect the increase in the number of borrowers feeling the pinch as the interest rate on their loans are reset at significantly higher levels and the worst current account deficit in the developed world - meaning we are importing far more than we are exporting.

Our central bank, like others around the world, are still focused on inflation and will maintain an upward bias on interest rates until they are certain the risk of a rising wage spiral has abated. This is the reason that we have little exposure to New Zealand shares which will have a reaction to the current local recession. On the flip side, Term Deposit rates appear attractive, however as we reach a peak in the interest rate cycle, short term rates will only come down from here, so we remain focused on the higher rates that longer term bonds offer.

Market outlook

Economic risk remains elevated in the short-term despite the surge in share markets. The impact of higher interest rates is slowing economic activity. This is causing inflation to fall back down to more normal levels, but central banks will not reduce any pressure via 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 is likely to add reasonable capital gains on top of the interest they pay throughout the remainder of 2023 and 2024.

Our team - human relationships

Investment team at RIVAL Wealth

We are your boots on the ground in the investment world, available to meet face-to-face or chat on the phone about any questions you have. Our team is always welcoming our clients to offer advice on all aspects of financial planning.

The portfolios results saw some recovery over the quarter and we are positioned for further recovery across the portfolios. We have continued with the addition of bonds not available to the retail market and seen an uptick in sentiment towards growth stocks. Our philosophy to add to proven investments when times are tough and take profits when others are buying, continues to be our long-term strategy.

New Zealand's journey to carbon neutral has hit a snag

The current Emissions Trading Scheme settings don't provide sufficient incentives for businesses to reduce their emissions at source and instead encourage emitters to rely on carbon offsets generated through planting of forests. New Zealand is one of only a few countries in the world that does not place a limit on the quantity of carbon credits that can be generated from forestry plantations. As the price of carbon credits steadily increased over the last couple of years, there was a significant rise in the hectares of pine forests submitted into the ETS. That wasn't the intention when the ETS was designed.

In December of 2022, the Government rejected the advice of the Climate Change Commission (CCC) about the path forward, which resulted in the price of carbon credits falling. In June 2023, the government announced a public consultation process and a range of options for revising New Zealand's ETS. The consultation process and the range of options have been considered vague, which has increased uncertainty and further reduced the price of carbon credits. The ETS needs fixing in order to deliver the best long-term outcomes in line with New Zealand's climate change objectives and Paris Agreement commitments, however, that is resulting in short-term disruption. Current reduced carbon prices do not provide enough incentive for corporations to reduce their emissions. The Government and CCC need the carbon price to rise, but they don't want this to result in excessive planting of pine forests that make it easier and cheaper to buy carbon credits than in reducing emissions.

A group of lawyers sued the Government for breaking its own laws in relation to achieving New Zealand's carbon emission objectives, which has forced an admission of error by the Government when it rejected the CCC's recommendations without justification. This has resulted in the price of carbon jumping higher, recovering much of its latest fall. Interestingly, the recent EU – New Zealand trade agreement made specific mention of New Zealand having a robust and forward looking ETS. So we know that whatever the Government's decision in the coming months, an ETS will be at the centre of decision making.