AMP CAPITAL

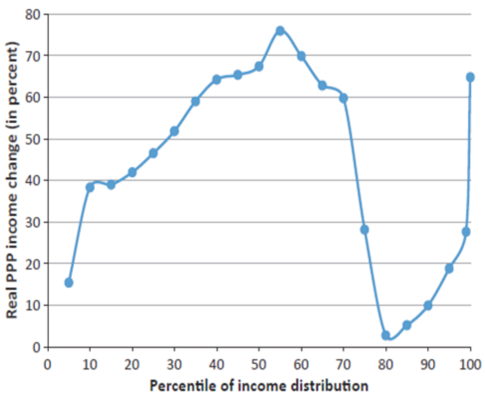
INVESTMENT BRIEF

JUNE 2016

Stock markets waxed and waned over the month as the world focused its attention on the events in Britain and the outcome of the referendum on whether they would leave the EU. The 'Leave' result took the market by surprise but markets had all but recovered their Brexit losses by the end of the month. The New Zealand share market was not immune to events in Britain ending down for the month, but remains one of the strongest performing markets globally year-to-date. New Zealand bonds rallied alongside their global counterparts over the month. As expected, the RBNZ left the OCR unchanged at 2.25% early June but retained an easing bias. The NZ dollar rallied strongly against the major currencies, strengthening 14.8% against the British pound.

1. The age of political disruption

Relative gain in per capita income by global income level 1988-2008



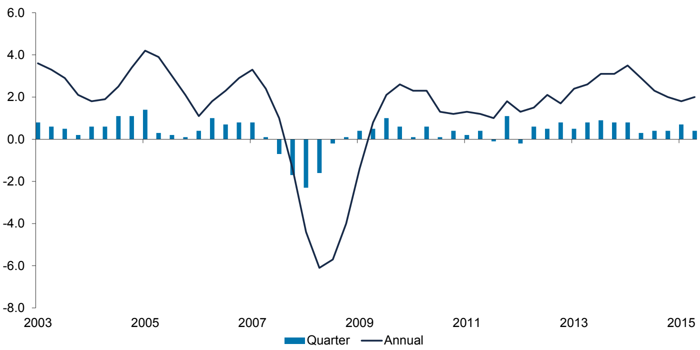
Source: Branko Milanovic – The World Bank

- Frustration about lack of economic progress, stagnant real incomes and lack of job security is manifesting as a strong 'anti' movement: anti-globalisation, anti-integration and anti-immigration.
- Establishment politicians are bearing the brunt of the backlash given a seeming lack of ability or desire to change the status quo.
- It is this frustration that has led to the rise of anti-integration nationalist political movements across Europe, the rise of Donald Trump and Bernie Sanders in the United States, the Scottish independence referendum and now Brexit.
- People are looking for change so Brexit should be a wake-up call for politicians that continuing to rely on central banks to fix all economic woes is not a credible option for increasing prosperity.

2. Brexit: Impact on the UK economy

UK GDP growth

Percent change



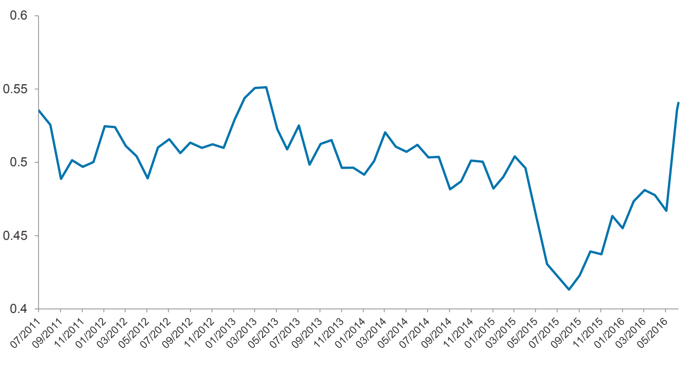
Source: Bloomberg

- While current arrangements remain in place the UK will continue to enjoy unfettered access of its goods and services into the EU, so the immediate impact on exports will be limited. In fact, given the depreciation of the exchange rate, export competitiveness will improve, assuming the depreciation is sustained.
- However, the impact on business confidence of a long period of uncertainty around future trade access will likely have negative implications for capital spending and hiring decisions. Indeed, capital formation was already weakening leading into the referendum.
- In short, the uncertainty and implications for investment and jobs could push the UK into a mild recession later this year. Key indicators to watch will be business and consumer confidence.

3. Brexit and New Zealand

NZD/GBP

Monthly



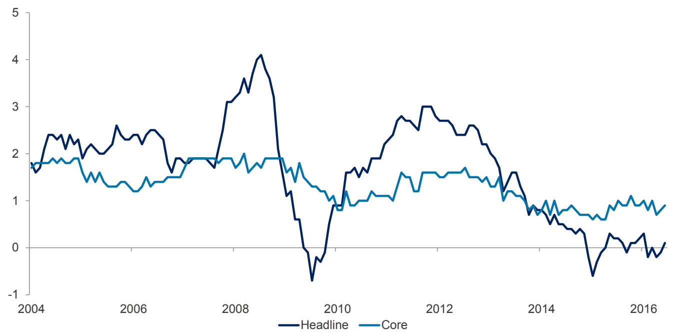
Source: Bloomberg

- The implications for New Zealand are negative in the near-term but will be manageable.
- The UK takes around 3% of New Zealand's merchandise exports (wine, lamb) and 9% of services (tourism). The sharp drop in sterling and likely decline in consumer confidence and consumer spending will be negative for trade. On the flipside, it's a great time for Kiwis to head to the UK on holiday.
- The longer term question of trade access will take time to sort out and will be a source of uncertainty for some time.

4. Brexit and Europe

Eurozone inflation

Annual % change

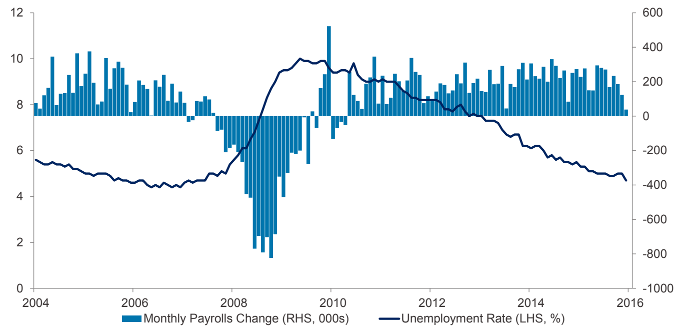


Source: Eurostat

- Brexit has negative implications for the Eurozone, though we expect these will be manageable.
- The UK is destination to around 7% of Europe's exports (Germany, Netherlands and Belgium have the greatest exposures), so any downturn there will have implications for trade flows.
- Uncertainty about the economic and political implications of Brexit on Europe could see weaker business and consumer confidence. That could see a winding back of investment and hiring plans and higher precautionary savings by households.
- Lower growth means a likely more persistent output gap and a further delay to any meaningful inflationary pressures and a more dovish sounding ECB, at least until the uncertainty begins to diminish.

5. US monetary policy

US labour market



Source: BLS

- US activity indicators are bouncing back with GDP likely to resume it's above-trend growth in the second quarter of the year. This follows a period of weakness off the back of reduced investment and higher precautionary savings as a result of the heightened uncertainty about the economic outlook at the start of the year.
- Retail spending and housing related activity have regained some upward momentum. These are the sectors we have been relying on to deliver above trend growth in 2016.
- A key factor is continued employment gains. We expect jobs growth to recover from the poor May print, though not rebound to previous levels. That said, concerns about the labour market will likely delay further interest rate normalisation to September at the earliest.

6. Hung parliament in Australia?

NZD/AUD

Daily

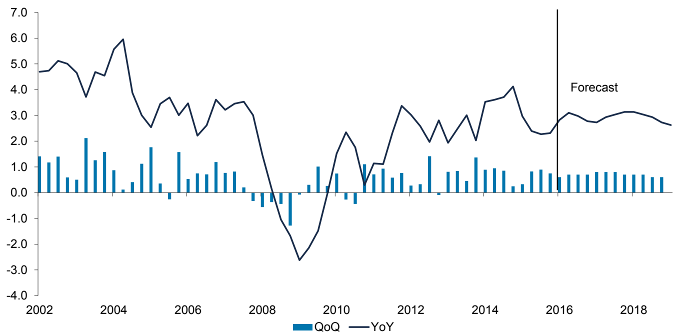
Source: Bloomberg

- In Australia, the election is finally over but it looks like another three years of de facto minority government, which is not a great outcome for the economy and investment markets.
- The Coalition looks to be slightly ahead, but even if it does win government it won't have control of the Senate with the balance of power remaining with the Greens and minority 'parties'. The result means poor prospects for the Coalition getting the budget deficit under control, implementing its policy to cut corporate taxes, and undertaking serious productivity-enhancing economic reforms.
- Alternatively, if Labor wins it will likely mean faster public spending growth via more spending on health and education, partly funded by tax increases on higher income earners, a higher budget deficit in the next few years, a royal commission into banking and greater intervention in the economy.

7. New Zealand economy looking solid

New Zealand GDP

% change



Source: Statistics New Zealand, AMP Capital

- The New Zealand economy continues to put in a solid growth performance despite the headwinds from the external sector. We expect growth of 2.5-3.0% per annum over the next two years before winding down in 2018, largely on the back of slower population gains.
- Factors impacting the external sector, such as lower dairy commodity prices, remain a drag on growth. The strength of the exchange rate, while a reflection of New Zealand's strong relative economic performance, also remains a challenge for the external sector. However, service exports remain strong on the back of tourism flows.
- Domestically the strong economic growth impetus continues to come from population growth. Sectors that are growing strongly include residential construction, retail spending and the core service areas such as healthcare.

MARKET COMMENTARY

GLOBAL SHARES

The world focused its attention on the events in Britain and the outcome of the referendum on whether they would leave the EU. Stock markets waxed and waned over the month depending on what the polls suggested the outcome would be. Equity markets rallied the week leading up to the Brexit vote as polls predicted the 'Remain' camp to win. The eventual 'Leave' result took the market by surprise with investors panicking somewhat on the day, unsure what the decision would mean for the region and financial markets. While uncertainty and volatility will remain a feature over the medium term as investors and policymakers come to terms with what Brexit means, markets had all but recovered their Brexit losses by the end of the month. The equity rally following the Brexit tumble was equally as dramatic, with UK equities posting their biggest three-day jump since 2009 after the Bank of England suggested it will probably loosen policy. A weakening pound and a rebound in commodities helped the FTSE 100 wipe out its Brexit aftermath losses in just four days. Investors appear to be looking long term and taking comfort from the expectation of continued central bank support. Prior to the UK referendum the Fed left rates unchanged. In the press conference Yellen commented that the uncertainty around Brexit was "one of the factors" underlying its policy decision. US equities ended the month up 0.3%, while developed markets eventually finished down 1.3%.

NEW ZEALAND SHARES

The New Zealand share market was not immune to events in Britain over the month and fell alongside its global counterparts following the Brexit result. The S&P/NZX 50 Index ended down 2.0% for the month, but remains one of the strongest performing markets globally year-to-date, up 9.1%. June saw Sky TV reverse its poor May performance, gaining 6.0% over the month. The company announced a merger with Vodafone NZ which would see Sky TV gain access to Vodafone's fixed and mobile internet technologies, an area that the company has struggled to deliver on.

NEW ZEALAND LISTED PROPERTY

New Zealand listed property followed the broader domestic market lower, ending down 1.4% over the month. Stride Property was the standout performer over June, rallying 7.4%. Stride's share price rally came on the back of a solid earnings result and the announcement it will split its portfolio into two distinct entities, a property portfolio and property management business.

GLOBAL BONDS

Investors turned to perceived safe haven assets in the form of sovereign bonds as global equity markets were buffeted by the UK Brexit vote. Led by sovereign bonds, global bonds, as measured by the Barclays Global Aggregate Index, gained an impressive 2.0% over the month. The Fed kept rates unchanged and the ECB launched its corporate bond-buying programme. While this will in all likelihood reduce yields for the chosen investment grade bonds, it is less clear that it will succeed in stimulating the broader economy. Yields on the US 10-year Treasury closed the month at 1.47%, down 38 basis points (bps) over the month.

NEW ZEALAND BONDS AND CASH

New Zealand bonds rallied alongside their global counterparts over the month. As expected, the Reserve Bank of New Zealand (RBNZ) left the Official Cash Rate (OCR) unchanged at 2.25% early June but retained an easing bias. There is one further cut flagged in the interest rate projections. The major discomfort will be in the level of the exchange rate that may see that cut delivered. The 90 Day Bank Bill yield ended June 1 bp lower at 2.42%, while the 10-year NZ Government bond yield ended down 26 bps at 2.35%.

COMMODITIES

It was a volatile month for risk assets and commodities were no exception. Commodities were influenced by the risk-on, risk-off nature over the month but eventually outperformed global equities, with the Bloomberg Commodity Index finishing 4.1% higher. Precious metals performed strongly benefiting from safe haven buying. Certain agriculture subsectors were also strong, such as sugar and coffee. Crude oil stock piles plunged over the month, recording the sixth-straight weekly decline. However, analysts caution that the shrinking inventories may have more to do with the summer driving season than improving oil market fundamentals.

GLOBAL LISTED PROPERTY & INFRASTRUCTURE

Global listed property and global listed infrastructure followed the broader market trend, but benefited from falling interest rates. The defensive growth asset classes returned 4.1% and 3.9% respectively over June.

NEW ZEALAND DOLLAR

The New Zealand dollar (NZD) rallied strongly against the major currencies, ending up 4.4% against the Trade Weighted Index, as the RBNZ left rates unchanged at its June meeting. The NZD ended June 5.5% stronger against the US dollar at 0.7134. The fallout after the Brexit referendum saw the British pound (GBP) tumble, and over the month the NZD strengthened 14.8% against the GBP, ending at 0.5360.

	AS AT 30 JUNE 2016	CHANGE OVER THE MONTH (%)	CHANGE OVER THE YEAR (%)
MSCI - US	8235.48	+0.3	+3.2
MSCI - UK	12611.16	+5.0	+3.4
MSCI - Germany	3035.79	-5.4	-10.8
MSCI - Japan	1563.43	-9.8	-23.4
S&P/NZX 50	6897.53	-2.0	+20.4
MSCI - World (local curr.)	4872.20	-1.3	-2.1
MSCI - World (NZD)	9006.56	-6.2	-7.3
NZ Official Cash Rate	2.25	0 bps	-100 bps
NZ 90-day bank bill yield	2.41	-1 bps	-85 bps
NZ 10-year bond yield	2.34	-24 bps	-128 bps
US 10-year bond yield	1.47	-38 bps	-88 bps
NZD-USD	0.7134	+5.5	+5.5
NZD (TWI)	76.0	+4.6	+6.6
NZD (MSCI weighted)	78.3	+5.3	+5.6

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