

QUARTERLY STRATEGIC OUTLOOK

EXECUTIVE SUMMARY

A relatively stable global growth outlook belies an underlying divergence in prospects, especially among the key developed economies. Following a period of synchronised upward momentum through 2017, mid-way through 2018 it is only the United States with continued momentum.

After a typically weak start to the year, US GDP growth appears to be bouncing back in the second quarter. Stronger growth continues to be underpinned by a tightening labour market, strong productivity-enhancing investment and easier fiscal settings.

The US Federal Reserve is well into its tightening cycle. They hiked interest rates for a second time this year in June while flagging they intend to hike twice more in 2018. Everything is falling nicely into place for the Fed, though rising trade tensions are the biggest downside risk to the growth outlook. This is not so much from a direct impact on trade or consumer behaviour, but the indirect impact on business and consumer confidence of the rising protectionist rhetoric and concern of an escalation into a full-blown trade war.

The political tension is palpable and was plain to see at the fractious June G7 meeting in Canada. Tensions were also high at the June summit of the European Union as Italy's new Prime Minister demonstrated a willingness to take the establishment on. We continue to believe an Italian exit from the Eurozone is unlikely, but there are battles looming on fiscal policy.

Political drama is also playing out in the United Kingdom with some high-profile resignations and a leadership coup within the Conservative Party. Prime Minister May's Brexit strategy is in disarray and tensions are high ahead of the self-imposed October deadline to secure a firm exit deal with the European Union.

The European Central Bank (ECB) surprised no one in announcing a final tapering and end to their asset purchase programme at the end of the year. While growth may have passed its peak, it is still expected to remain ahead of potential and absorb spare capacity. However, core inflation appears stubbornly stuck at 1%. Meanwhile, the Bank of Japan continues to struggle with meeting its inflation objective. We are not negative on the outlook for Japan and Europe, but both are likely past the peak in their respective cycles.

Emerging markets are being challenged by a stronger US dollar, higher interest rates and a significant rise in oil prices. However, conditions are generally more positive across the emerging market complex than they were five years ago, with stronger GDP growth, lower inflation and current account balances in better shape.

There was a strong negative reaction in China's share market to the ramping-up of tariff announcements by the US Administration, though this was not accompanied by concern about risks of a Chinese growth collapse. China now appears on track for additional economic reform and further transition toward services and consumption.

Global equity markets have generally struggled for direction during the first half of 2018. The key question is whether the nervous range-bound movement that has prevailed since the February correction in the US market is going to persist, or whether a strong new directional trend will succeed it. There is also the issue of whether persistent weakness in trade-dependent emerging markets is a harbinger of a broader global market decline

Regional markets in the Asia Pacific have shown weak performance that suggests a regional chill across manufacturing exporters is developing, as the tension between China and the US mounts. But, soft equity market performance has also been apparent in other regions that are not directly exposed to US trade policy. The New Zealand and Australian markets have been unaffected by deteriorating regional sentiment, suggesting these markets are still being driven by local factors and are awaiting a major global trend shift.

In New Zealand, continued weakness in business confidence surveys are raising questions about the robustness of economic growth in the period ahead. While March quarter growth was weaker than expected, our view is that growth will be stronger in the second half of the year, but the downside is risks are rising.

At the beginning of this year, we introduced some caution in our outlook for markets in 2018, and feel this has been justified by events. We expect continuation of the dominant market trends, though with a higher risk of bouts of volatility as interest rates rise and geopolitical disruptions continue. This adds up to a finely balanced outlook for markets.

Asset outlook and positions

ASSET CLASS	NEAR TERM VIEW	MEDIUM TERM VIEW	BIAS
Global equities	Remain broadly positive on a 6 month horizon on fiscal easing and US economic optimism lifting corporate earnings. However, no strong immediate catalysts for further gains from record index levels. An incipient euphoria was deflated with Q1 market volatility, which is healthy as interest rate risk is priced more realistically.	Valuations are still positive for this asset class relative to bonds and cash but US is extended compared to its historical fair value and cyclically-adjusted P/E. Earnings and M&A supportive for now, but risks clearly rising.	NEUTRAL
Emerging market equities	EM countries with external funding needs remain vulnerable on debt levels. As US trade policy becomes more discriminatory, there would be grounds to move defensively on this volatile asset class.	Medium-term fundamentals remain attractive on an absolute and relative basis. Short-term country and currency risks do not yet justify active EM positions.	NEUTRAL
Australasian equities	NZ should underperform global shares as global sentiment improves. Australian shares offer better value but require more certainty on banks and domestic corporate earnings track. Fragility to continue given banking enquiry, housing market softness etc.	Australasian shares are reasonably priced given current financial and economic conditions. However, regulatory and debt-quality issues affect the banks.	NEUTRAL
Listed property	Should track global equities in the near term with risk of underperformance if longer-term US interest rates continue to rise and if the yield curve steepens. However, demand levels are high.	From an absolute return perspective, the low real yield global environment should provide support over the medium term. Accelerated tightening risk rising, particularly in US but not yet a threat in Australasia.	NEUTRAL
Alternative Growth	Infrastructure can benefit from US administration part-funding projects, but interest rate rises challenge the yield of utilities. Commodity prices are in a period of consolidation. Some upside if inflationary sentiment mounts, but oil is close to its 3-year highs.	Cyclical price lows and improving demand are positive factors but the energy oversupply issue is expected to constrain upside in prices for some time.	OVERWEIGHT
Global bonds	Yields moved upwards in H1 18. Core inflation pressures remain contained around the world so upside from current levels is limited. Fed balance sheet trimming proceeding, ECB may accelerate too.	Global bonds are still poor value, with yields remaining artificially suppressed by central bank activity. US Federal Reserve will likely continue normalizing its balance sheet throughout 2018.	UNDERWEIGHT
New Zealand bonds	Expect long-end and returns to take lead from US but relatively robust fiscal outlook could maintain decent demand for NZ bonds.	As with global bonds, upward pressure on yields foreshadows low returns over the medium term.	UNDERWEIGHT
Cash	The Official Cash Rate is 1.75%. We believe this is the low for this cycle. Interest rates likely on hold until late 2019.	We forecast similar returns from cash and bonds over the medium term but cash has lower risk of capital loss than bonds.	OVERWEIGHT
Foreign currency	USD back in favour, Diverging monetary policy between the US Fed and RBNZ suggests NZD risks are still skewed to downside on a 12 month horizon. NZ economic policy shifts are impacting confidence and growth is likely to soften.	The NZD no longer overvalued on a MSCI weighted basis. Domestic growth lacks catalysts beyond migration at present. Dairy prices forecast lower.	OVERWEIGHT

ECONOMIC OUTLOOK

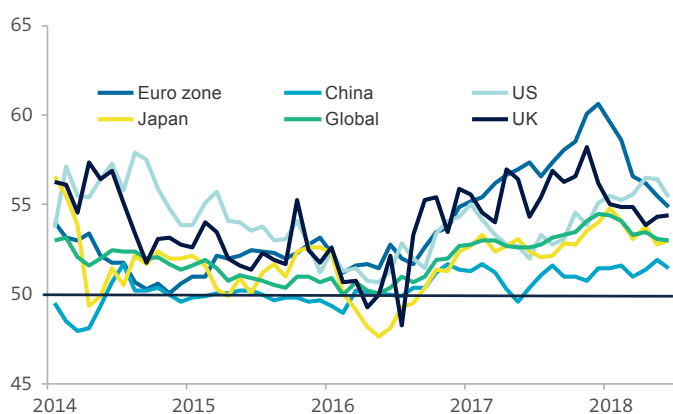
Unsynchronised developed market growth

A relatively stable global growth outlook belies an underlying divergence in prospects, especially among the key developed economies. Following a period of synchronised upward momentum through 2017, mid-way through 2018 it is only the United States with continued momentum.

After a typically weak start to the year, US GDP growth appears to be bouncing back well in the second quarter. Stronger growth continues to be underpinned by a tightening labour market, strong productivity-enhancing investment and easier fiscal settings. We expect 2018 calendar year growth to come in at close to 3.0%, up from 2.3% in 2017.

Manufacturing PMIs

Index



Source: Markit, Caixin, Nikkei, JP Morgan

We are not negative on the outlook for Japan and Europe but, as we alluded to in the April edition of Quarterly Strategic Outlook, both are likely past the peak in their respective cycles. That said, we expect growth in both will remain ahead of its non-inflationary potential, spare capacity will continue to be absorbed and inflationary pressure will emerge in time.

In Europe, consumption is holding up well as employment has recovered, though net export growth has moderated. Business sentiment surveys have softened and the composite PMI (services and manufacturing) has moderated, though has stabilised more recently. This is consistent with a shift down in growth momentum from around annualised 3% in the second half of last year to 2.0-2.5% currently.

Growth in Japan has likewise moderated. After heralding eight consecutive quarters of growth in our last report, the economy put in a mild contraction in the three months to March.

We don't expect a recession (ie a second consecutive quarterly contraction). Strong global growth is expected to continue to support the export sector, household spending will be supported by the strong labour market, and investment will continue to be supported by monetary and fiscal stimulus and strong corporate balance sheets.

While there are a number of positives for the economy, we expect the pace of annual growth to moderate from 1.7% in 2017 to around the economy's non-inflationary potential, which we put at a pinch under 1.0% per annum.

	2017	2018	2019	2020
United States	2.3	2.9	2.8	2.0
Euro area	2.5	2.3	1.9	1.7
Japan	1.7	1.2	1.0	0.9
United Kingdom	1.8	1.4	1.3	1.5
Canada	3.0	2.2	2.0	1.9
Australia	2.3	2.7	2.8	2.5
New Zealand	2.9	2.7	3.1	2.3
Developed*	2.3	2.3	2.1	1.8
China	6.9	6.5	6.2	6.0
India	6.6	7.2	7.8	8.0
Brazil	1.0	2.2	2.5	2.5
Mexico	2.0	2.5	2.0	2.0
Russia	1.5	2.2	2.8	2.7
Indonesia	5.1	5.2	5.0	5.0
South Africa	1.3	1.8	2.0	2.5
Emerging*	4.7	4.8	4.8	4.7
World*	3.8	3.9	3.8	3.5

Source: IMF and AMP Capital

We are not negative on the outlook for Japan and Europe but, as we alluded to in the April edition of Quarterly Strategic Outlook, both are likely past the peak in their respective cycles.

Escalating trade tension the biggest downside growth risk...

Rising trade tensions are the biggest downside risk to the growth outlook. This is not so much from a direct impact on trade or consumer behaviour; the impacts are thus far relatively small and manageable. But we do worry about the indirect impact on business and consumer confidence of the rising protectionist rhetoric and concern of an escalation into a full-blown trade war.

We expected a ramping up of President Trump's populist 'America First' rhetoric in the lead up to the US mid-term elections in November, but we didn't expect things to go this far. We see no let-up in the strategy, so the noise is likely to only intensify over the next few months.

So far we have seen tariffs on steel and aluminium implemented, and also on the tranche of Chinese imports in the United States. Retaliation and escalation remain real risks.

It remains to be seen whether factors such as rising consumer prices and the decisions of companies such as the iconic Harley Davison to move some production offshore to avoid the EU levy tempers the approach. We think not.

Our base case remains that a negotiated settlement will be reached. But the noise is likely to get louder before that becomes clear. Markets will remain sensitive to developments on this front.

On NAFTA (the North America Free Trade Agreement) we expect a revamped agreement to be in place by next year, but uncertainty will remain high until then.

...and causing political tension

The political tension is palpable and was plain for all the world to see at the fractious June G7 meeting in Canada. America first clearly does mean America alone.

Tensions were also high at the June summit of the European Union. Italy's new Prime Minister Giuseppe Conte demonstrated his willingness to take the establishment on. We continue to believe an Italian exit from the Eurozone is unlikely, but there are battles looming on fiscal policy.

One of the major issues up for debate at the Summit was immigration. This issue continues to cause problems at home for German Chancellor Angela Merkel within her coalition government. A workable solution appears to have been reached, though details were scant.

Disappointingly, only modest progress was made on the more vexed issue of the institutional arrangements to safeguard the common currency.

And as we write, political drama is playing out in the United Kingdom with the resignation of David Davis as Brexit Secretary followed swiftly by that of Foreign Secretary Boris Johnson. The UK seems destined for a new Prime Minister with a leadership coup within the Conservative Party likely, if not fresh elections being called, if the negotiations with Brussels in the European autumn fail.

Prime Minister May's Brexit strategy is in disarray after she adopted her party's pro-Brexit faction's more aggressive amendments to a crucial piece of customs legislation. This upset the more moderate 'soft Brexit' Tories and Mrs May needed three rebel Labour Party votes to pass the amendment.

Tensions are high ahead of the self-imposed October deadline to secure a firm exit deal with the European Union, so technical issues can be viably addressed before the formal exit on March 29 next year. As the UK Parliament will go into recess for the long summer vacation in a matter of days, re-establishing some degree of unity appears crucial.

Monetary policy

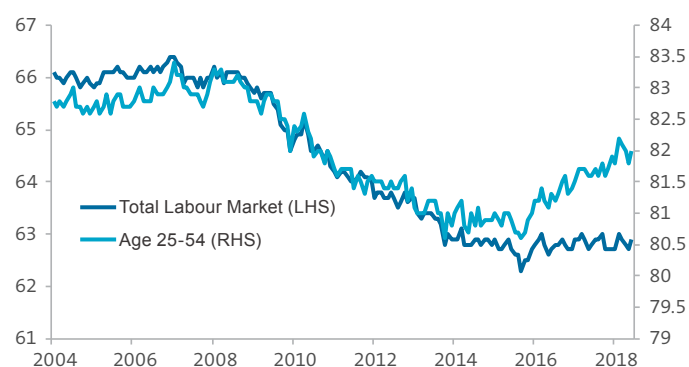
The US Federal Reserve (the Fed) is well into its tightening cycle. They hiked interest rates for a second time this year in June while flagging they intend to hike twice more in 2018.

Everything is falling nicely into place for the Fed. Headline inflation reached 2.9% in June and the core Personal Consumption Expenditure deflator (the Fed's preferred inflation measure) is at 2.0%, bang on target. Furthermore the economy is growing ahead of potential, the unemployment rate is below NAIRU (Non-Accelerating Inflation Rate of Unemployment) and while wage growth remains subdued, it is nudging ever so gradually higher.

The unemployment rate moved up in June, but we are not reading too much into this. This was mostly due to job openings being at a cyclical high and the pool of available workers is dwindling. The participation rate for prime age (25-54 years) workers is over halfway back to its pre-GFC peak.

US participation

Percent of the Labour Force



Source: US Bureau of Labor Statistics

The reality is, the labour market continues to tighten as the pool of available workers dwindles. That means wages rise faster as firms have to encourage workers away from competitors to or back into the labour market.

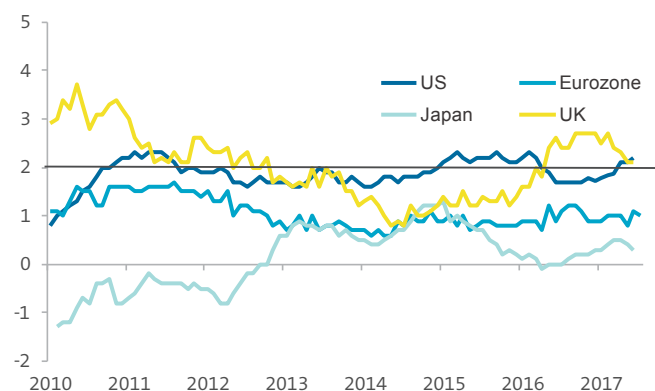
So its full steam ahead for the Fed. The uncertainty is how bad the trade situation gets and what impact that might have on the growth and inflation outlook. They will be watching developments closely.

US monetary policy gets more interesting as we get closer to the Fed's estimate of the neutral rate which currently sits just under 3%. We have been at pains to point out in the past that in the post-GFC world this is just an estimate. No one knows where neutral is anymore. For now, the best estimate of the likely path for the Fed funds rate is the Fed's own guidance which has Fed funds peaking at 3.4% in 2020. Don't fight the Fed.

The European Central Bank (ECB) surprised no one in announcing a final tapering and end to their asset purchase programme at the end of the year. While growth may have passed its peak, it is still expected to remain ahead of potential and absorb spare capacity. The unemployment rate is continuing to trend lower. In that regard, emergency monetary policy settings are no longer required.

Core Inflation

Annual Percent Change



Source: BLS, Eurostat, MIAC, ONS

However, core inflation appears stubbornly stuck at 1% or half of the ECB's mandate. While it is appropriate for quantitative easing to end, the governing council will remain cautious in lifting rates. Higher interest rates are unlikely before the end of next year.

The Bank of Japan (BoJ) continues to struggle with meeting its inflation objective. Core inflation had been trending higher in recent months before the dip lower of the last two months to 0.3%, well short of the BoJ's 2% target.

We are mildly optimistic the upward trend may resume. The labour market is tight and wages have started to move higher. That said, we expect inflation to remain well below target for the foreseeable future and for the BoJ to be true to their commitment to "pursue powerful monetary easing with persistence".

Emerging markets under pressure

The recent increase in the US exchange rate and interest rates has put pressure on emerging market assets. Our sense is these stresses are idiosyncratic to particular emerging economies rather than systemic.

Financial markets seem programmed to believe that a rising US dollar and rising interest rates are bad for emerging economies. Remember the 'taper tantrums' in 2013 and the anointing of five key emerging economies (India, Indonesia, Turkey, South Africa and Brazil) as the 'fragile five'?

A similar dynamic is playing out in 2018 as emerging markets are being challenged by a stronger US dollar, higher interest rates and a significant rise in oil prices. Higher oil prices are good for emerging economies on average but bad for the oil importers.

Add to that considerable uncertainty with respect to trade policy, particularly in the US, and the scene appears to set for a challenging period ahead. Debt levels are also higher but this is not just an emerging market phenomenon.

But this is not 2013. This year conditions are generally more positive across the emerging market complex than they were five years ago. On average, GDP growth is stronger, inflation is lower and current account balances are in better shape.

Furthermore, one of the key concerns around emerging market vulnerabilities is the stock of USD debt held by these countries. Compared to other countries (particularly advanced nations), emerging economies tend to borrow in foreign currency (especially in US dollars (USD) because it is the global reserve currency) rather than in their domestic currencies. This is because emerging market currencies tend to be more volatile given vulnerabilities to changes in capital flows.

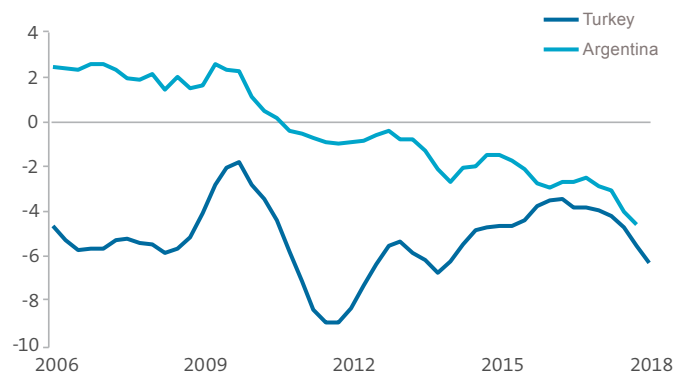
USD debt makes averages around 30% for the key emerging economies and, more generally, less than 50% of total debt outstanding. This is manageable (if the USD rises) against a backdrop of better economic fundamentals compared to a few years ago.

However, it is not a universally 'better' story. The current environment has been most challenging for Argentina and Turkey, both of which are experiencing a trend deterioration in their external imbalances, making the required offsetting capital inflows vulnerable to negative shifts in sentiment. Indeed, both currencies have suffered considerable weakness this year.



Current Account Balances

Percent of GDP



Source: IMF

The reality is structural weaknesses in individual economies will still be punished and rightly so. The Argentine government of Mauricio Macri made a bold start in 2015, aiming for a gradual reduction in the primary budget deficit and an ambitious target of bringing inflation down to a single digit rate in three years. More recently, the Macri administration has pinned its political hopes to a large infrastructure programme.

But Argentina was recently forced to negotiate a US\$50 billion standby facility with the International Monetary Fund (IMF) which brought with it conditions on the fiscal deficit, inflation and the exchange rate. The most notable part of the agreement is that the central bank is now forbidden to finance the fiscal deficit. This had been a key source of recent market consternation.

Turkey has also come under pressure, particularly in the lead-up to the recent Presidential elections. The Turkish lira has depreciated significantly, inflation has spiked higher and the political uncertainty brings with it uncertainty about the future operation of monetary policy.

As a whole, the emerging market complex is in better shape than it was in 2013. While equity markets are likely to be challenged to repeat last year's outstanding 31% average gain, and will likely remain volatile in the immediate future, bear in mind that the main emerging market share index is still yet to fully regain its 2007 (pre-GFC) highs and is not in overvalued territory.

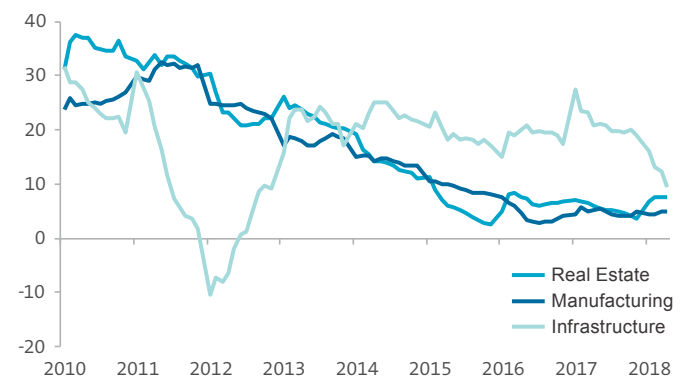
As ever, three words sum up the best advice for emerging market investment: "selectivity is key". Despite positive demographics, a growing middle class and a proliferation of investment vehicles that allow savers around the world to finance emerging country growth, many countries still face structural challenges of varying magnitudes. The key message to the politicians is those structural challenges need immediate attention. Lack of attention will be punished accordingly.

China

Economic activity in China has held up better than we expected in the first few months of 2018, though May activity data was on the soft side of market expectations. That said our expectation of continued slowdown in fixed asset investment offset by stronger consumer activity remains our central scenario as the economy slows to more sustainable levels.

China Fixed Asset Investment

YoY Percent Change (Cumulative)



Source: National Bureau of Statistics

We expect consumer spending will continue to be underpinned by the expanding middle class and the impact of rising incomes off the back of a strong labour market with the unemployment rate of 3.86%.

The cloud on the horizon is of course the escalating trade dispute with the United States. The US is China's main export partner with the US taking 21% of Chinese merchandise exports. That said, while trade is an important part of the Chinese economy and will remain a key contributor to growth, exports now account for 20% of GDP, down from just under 40% in 2006.

Escalating tit-for-tat imposition of tariffs will undoubtedly harm the Chinese economy, but the Chinese authorities have considerable policy fire-power to direct at any negative economic impact.

Inflation remains well contained at 1.8%, allowing monetary conditions to remain supportive as the authorities continue to focus on deleveraging and the management of financial risks.

The key policy interest rate continues to be raised, while the People's Bank of China continues to ensure ample liquidity by cutting the required reserve ratio. At the same time, the authorities have been keen to curb lending from the shadow banking sector while also ensuring that key growth sectors have ample access to funding.

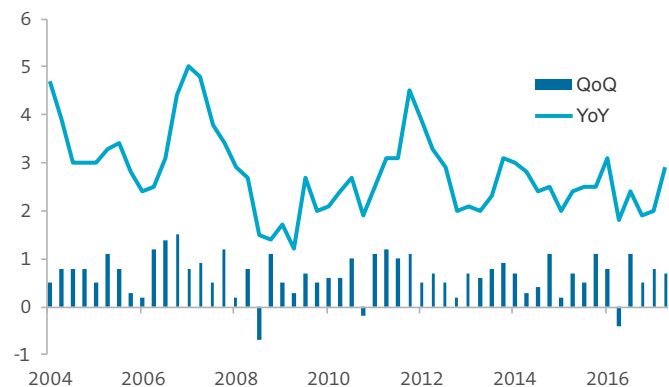


Australia

The Australian economy started the year strongly. GDP grew 1.0% in the March quarter of 2018, with the annual growth rising to 3.1% from 2.4% previously. But the strength in GDP growth over first quarter is unlikely to be repeated again in the June quarter.

Australia GDP

Percent Change



Source: ABS

Australian GDP has had a tendency to run hot and cold lately. Looking back at history, the last three strong GDP prints (around 0.9% or 1.0%) have been followed by a weaker outcome in the following quarter, which is often caused by 'one-off' impacts like strong net exports or an inventory build that are then unwound in the following period.

That said the Australian economy is still expected to hold up over the near-term and there is little risk of a recession. The GDP data also shows a slow trend up in productivity growth, which is positive for living standards.

While the year has started well, we still expect Australian growth in 2018 to be a little below the RBA's forecast of "a bit above 3%". That's largely due to a constrained consumer and a slowing housing market.

And while non-mining business investment is rising, public infrastructure spending is surging and the labour market is strong, there are few signs of noticeable cost pressures. The economy is still running below its capacity as indicated by high levels of labour market underutilisation. Growth needs to be stronger on a sustained basis to work through this spare capacity and lift wages and inflation.

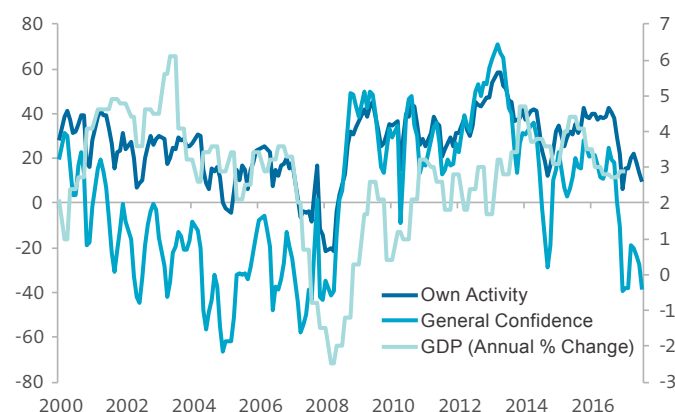
We remain of the view that the constrained inflation backdrop will keep the Reserve Bank on hold until early 2020 at least. But given the weakness in home prices and the negative wealth effect that will flow from that, it's premature to rule out the next move in official rates being a cut.

What's the chance of a rate cut in New Zealand?

Continued weakness in business confidence survey is raising questions about the robustness of economic growth in the period ahead. That makes the interest rate outlook even more uncertain than it already was. The Reserve Bank of New Zealand (RBNZ) has recently signalled that they hold a balanced view as to whether their next move is an interest rate hike or a cut.

New Zealand Business Confidence

Index



Source: ANZ Bank, Statistics NZ

Our earlier take on the rationale for business pessimism was the inevitable policy uncertainty that followed a change of Government. We also noted that the longer businesses stayed pessimistic, the more likely this was to generate pessimism about their own firms' outlook, and thus have a deleterious impact on hiring and investment intentions and economic activity more generally.

While we still hold to the latter point, the reasons for the pessimism have become broader based. Policy uncertainty lingers, but there are also now more specific concerns about rising costs and the impact on profitability, rising capacity constraints and the strength of demand, especially in light of the recently softer-than-expected March quarter GDP out-turn.

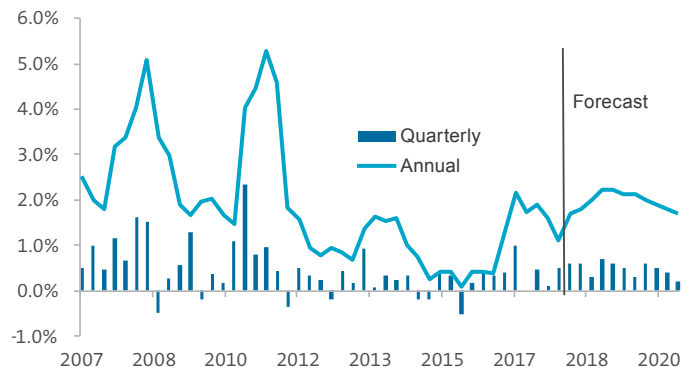
Furthermore, that combination of concerns is leading to a deterioration in expected profitability. Investment intentions were softer, though hiring intentions have held up better. Importantly, an increasing number of firms expect costs to rise in the period ahead and to pass those higher costs on.

While the year has started well, we still expect Australian growth in 2018 to be a little below the RBA's forecast of "a bit above 3%"



New Zealand Inflation

Percent Change



Source: Statistics New Zealand and AMP Capital

Furthermore, with respect to the growth outlook, the RBNZ is not as concerned about the absolute level of growth as they are about the path of growth relative to its non-inflationary potential. If business investment falls, growth falls, but so too does potential growth. Lower growth can still be consistent with higher inflation in a capacity-constrained economy.

While the focus is on business confidence it's important to also note that consumer confidence has moved a little lower in June and is slightly below its long-run average. All the same, another reason the RBNZ is unlikely to ease the OCR is that doing so could easily provoke a round of 'mortgage specials' from the banks, which would risk undoing the lending moderation the RBNZ seems to have achieved via the macro prudential toolkit. Households' propensity to save is still trending down, so rate cuts now risk encouraging another bout of leveraging up.

That said, the odds of a cut have risen in recent weeks and the RBNZ has certainly signalled a willingness to cut should the outlook warrant it. And it's certainly the case that if they do anything soon, it's more likely to be a cut than a hike.

Despite the RBNZ's balanced view as to whether their next move is a hike or a cut, we still think the next move is a hike, but it's a long way away. Critical to that view is that the growth outlook remains okay and that key capacity constraint measures (most importantly the unemployment rate) remain consistent with higher inflation in time.

So what does this mean for growth, inflation and the RBNZ?

While March quarter growth was weaker than expected, some of that will prove transitory (delays in the importation of motor vehicles, the timing of Easter). More generally, population growth remains strong, the government's Families Package came into being on July 1st, global growth is the strongest since the GFC and the terms of trade are close to a record high.

For now we remain happy with our view that growth will be stronger in the second half of the year than it was in the first half, but the downside risks are rising. Much will depend on the balance of reasons behind the weaker confidence (particularly capacity constraints) and how firms respond to that.

As for inflation, we expect headline inflation will be at the mid-point of the target band by the end of the year. The key word in that sentence is 'headline'. Reasons for the recent lift in or inflation forecasts include exchange rate weakness, higher petrol prices and increased excise taxes.

The RBNZ is more interested in core inflationary pressures. We expect core inflation to eventually begin to tick up assuming the unemployment rate remains below NAIRU (which it currently is) and wages move higher.

Wage growth is already looking solid given planned increases in the minimum wage and the size of public sector wage claims currently under negotiation. They will also be mindful of the upward pricing intentions trend in recent business surveys.

AUTHOR



Bevan Graham
NZ Chief Economist



ASSET STRATEGY

Global equity markets have generally struggled for direction during the first half of 2018. The key question for investors as the third quarter unfolds is whether the nervous range-bound movement that has prevailed since the February correction in the US market is going to persist, or whether a strong new directional trend will succeed it?

Allied to that question is the issue of whether persistent weakness in trade-dependent emerging market equities this year is a harbinger of a broader global market decline. Or is it simply more of a re-adjustment of investor expectations after emerging markets posted exceptionally-strong gains in 2017?

There has certainly been a strong negative reaction in China's share market to the ramping-up of tariff announcements by the US Administration. This has built on rising acceptance that the Chinese government is serious about reining in excessive domestic credit and speculation before disruptive defaults or insolvencies become a problem. Yet, it has not been accompanied by concern about risks of a Chinese growth collapse. China now appears on track for additional economic reform and further transition toward services and consumption.

However, other regional markets in the Asia Pacific have also shown weak performance, with Japan, Korea, Malaysia and Singapore, Indonesia, Thailand and Vietnam all in negative territory for the year to date (as at July 15th). That suggests that a regional chill across manufacturing exporters is developing, as the tension between China and the US mounts. But, soft equity market performance has also been apparent in other regions that are not directly exposed to US trade policy.

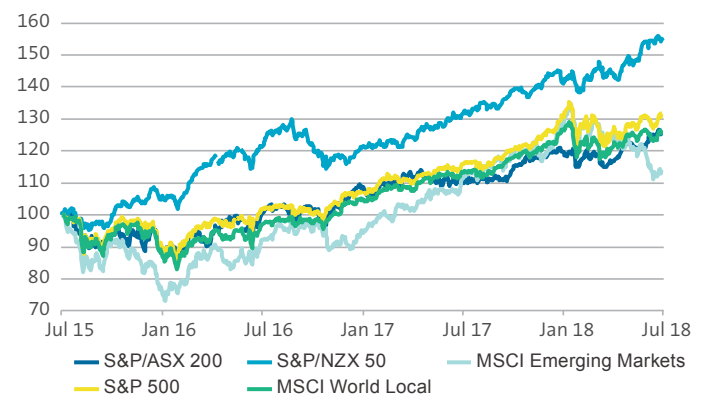
In Central Europe, the Polish and Hungarian markets have declined by more than 10% this year, while stocks in Turkey have fallen by in excess of 20%. The Nordic and Baltic economies have seen reasonably positive equity performance, whereas the more industrially-sophisticated Swiss, Austrian and German markets have had difficulty gaining traction this year. In Latin America, the Argentine and Chilean markets have dropped by between five and ten percent, while those of Brazil and Mexico are little changed.

Canada, which has been singled out by President Trump for less advantageous NAFTA access to US consumers, has nonetheless logged a small positive equity market return so far this year of around 2% – similar to the gain recorded on the Taiwanese stock index, which would normally be much more sensitive to capital outflows from other emerging Asian economies or problems in China.

The New Zealand and Australian markets have been unaffected by deteriorating regional sentiment, logging strong first half returns. This suggests that markets are still being driven by local factors and are awaiting a major global trend shift.

Emerging markets have recently dropped while others rebounded

3-Year performance of selected equity markets



Source: Bloomberg, AMP Capital

The trend is your friend (when it's around)

These are examples of the currently erratic pattern of global asset returns, particularly within the 'growth' assets of equities, property, infrastructure and commodities. Market performance in individual economies have frequently diverged (often sharply) from the returns delivered by neighbouring, or structurally similar, countries.

Translated into statistical terms, we are observing the outworking of a slump in correlations between markets. This is no surprise, as the initial signs of the 'ending of trending' could be seen in early 2017. However, because the current bull market is the second-longest in postwar history (9½ years so far) the increased divergence between asset returns is adding to investor concern that the global economy is now at a very late stage in the cycle and that a slowdown may be imminent.

If 2019 were indeed to prove the year that world growth trends downwards while inflation moves upward, it is likely that investment returns will move lower across the board in anticipation. Our current estimate for the timing of this for this is late in 2018, or in the first months of next year.

However, there is one major barrier at present to such a shift in perceptions. The US economy is operating at full throttle, with strong corporate profits, a buoyant information technology sector, a super-tight labour market and an abundance of merger and acquisition opportunities presenting themselves both at home and internationally. The strong US dollar makes imported goods cheaper (potential tariffs notwithstanding) and wages are showing signs of sustainable increase. Although orthodox economics argues that the recent corporate and personal tax cuts are unneeded and inflationary at this point in the cycle, they do represent an activity boost for 'Main Street' and thus, consumer confidence is at a historically-high level.

The pattern of US investor reaction to negative international news in recent months has been to initially sell equities, but when the limited impact on domestic conditions is taken into consideration, markets have quickly recovered. Thus, it seems unlikely that the US equity bull market will be derailed by an international shock. A domestic catalyst will probably be needed to puncture the current market optimism. With economic fundamentals remaining robust, we need to look at heightened geopolitical risk at present, with more brinkmanship likely particularly before the November US Congressional Mid-Term elections.

Bank earnings reflect interest rate dynamics, and the US yield curve is extremely flat at present, meaning that bank profitability from lending faces continuing challenges.

Will value investing rise again?

As the first major global companies start reporting their profits for the second three months of 2018, investors have been a little more willing to reward good results. The early-reporters are financial companies and banks, whose earnings can be volatile and prone to one-off boosts or drags.

Bank earnings reflect interest rate dynamics, and the US yield curve is extremely flat at present, meaning that bank profitability from lending faces continuing challenges. Somewhat better-than-expected results from the big US banks are also due to the tax cut impacts. However, there are some early signs that equity investors may be re-balancing their portfolios by taking profits on the growth sectors that have so strongly outperformed (information technology being the stand-out example), and looking to acquire the less-overvalued parts of the market where the level of dividends is still decent and future cash flows are less dependent on a continuing economic expansion.

Though the signs of this are still only incipient, a shift back to the value approach in anticipation of a US economic downturn at some point in the next two years seems to be building momentum. Over the last five years, global growth stocks have outperformed global value companies by a cumulative 40%. Since July 2015, the outperformance margin has been 20%.

In large part, this reflects the widespread enthusiasm for information technology, internet retail and associated companies, which tend to perform well under bull market conditions. Value stocks, which are often found in the healthcare, consumer staples, Industrials, or telecoms sectors, have been market laggards on the whole, particularly in the last two years. These stocks, whose steady cashflows and established industrial position appeal during unstable or economically-weaker periods, have not kept up, whether in the US or globally. Value investors such as Warren Buffett's Berkshire Hathaway have consequently lagged recently. This could well be interpreted as a signal that some investors are getting carried away with the various temporary boosts to corporate revenue expectations, and that the more conservative investment style of a 'buy-and-hold' investor like Buffett is due for resurgence.

Growth versus value returns

5-year performance of global growth and value stocks



Source: Bloomberg, AMP Capital

We think this is a healthy sign, on the whole. An investor rotation into the defensive market sectors and those (few) pockets of value that remain around the world would assist wealth preservation in the event of a more severe economic slowdown. For now, supports for gradual further gains in equity markets remain in place. At the same time, it is clear that the risks to the bull market are now higher. The market weakness in February and March, in our view, pointed to a transition to a more fragile period for growth assets. All the same, major markets could well exceed their January peaks once again – as the technology-heavy US NASDAQ Index has already – before succumbing once US growth turns down and moving beyond a correction phase into more sustained downward momentum (a ‘bear market’).

There is no recession currently on the horizon, such as would be the usual accompaniment to a sustained period of negative returns. But, history also holds occasional examples of equity market slumps of 20% or more happening well ahead of an economic recession (for instance 1982, 1987, and 2000). We are not anticipating this order of decline, but are considerably more cautious given that valuations have not improved sufficiently after the first quarter sell-off, political risk has risen on many fronts, and fixed income securities have not displayed their traditional safe-haven features – which suggests interest rates could spook the markets more seriously if another spike upwards occurs.

With more serious trade war measures being proposed and rolled out, and tightening conditions in the US, we are most concerned that the new trend for investors to move into cash rather than bonds at moments of market stress suggests a nervous market, and we allow for the more elevated risk that disappointments or shocks could generate a deeper correction.

Strong earnings persisting in the US, but cost pressures noted

Following very strong first quarter US corporate earnings, second quarter earnings are also on track to support the market’s current valuations, with early indications of a 20%+ annual gain. So far, as the reporting season begins, the blended earnings growth rate for the S&P 500 is 19.9%. If when all companies have reported, 19.9% is confirmed as the actual growth rate for the second quarter, it will mark the second highest earnings growth since Q3 2010 (34.1%).

At the sector level, the information technology and healthcare sectors have the highest number of companies issuing positive earnings per share (EPS) guidance at present. Gains in oil prices will lift the annual profit growth from the energy sector above most others, given that compared to its sub-USD50 level during the second quarter of 2017, oil was trading at USD68 this year (+40%).

Interestingly, in statements by US CEOs connected with the earnings updates, more companies in the S&P 500 are experiencing or expecting a drag on profits from the strong US dollar, than are expecting a significant impact from tariffs – at least so far. The other negative factors cited for the profit outlook are consistent with an economy running at full capacity, namely increasing cost pressures from raw materials, transportation, energy and labour compensation.

These developments have lifted US earnings growth toward an eight-year high. The question is, whether this excellent profit outcome is already reflected in high equity valuations. The

correction that began in the first quarter lowered the degree of overpricing on a P/E (price/earnings ratio) basis, but markets remain expensive by historical standards. The 12-month forward P/E ratio for the S&P 500 is now 17.6. This is above the five-year average (16.2) and well above the 10-year average (14.4).

Tax cuts in the US are, on the other hand, providing a near-term fillip to corporate income, as will President Trump’s deficit-funded military and infrastructure spending initiatives. Inflation pressure is rising, and if the full suite of US tariffs are introduced, companies will begin passing through the additional costs to consumers, which will be of concern to the Federal Reserve. The central bank is looking forward to 2020 when setting monetary policy, and will need to offset price pressures if they become structural (ie through a fixed import tariff) rather than cyclical.

This adds up to a difficult investment environment, with some growth assets running ‘more on fumes than on fuel’. However, while global demand remains strong and interest rate rises remain well-telegraphed, the 2018 mid-year period is broadly being resolved to the positive side, with more enduring difficulties potentially emerging before early 2019.

Some additional market gains are possible, but investor confidence (especially in the US) is increasingly hostage to Congress and the fate of the Trump economic stimulus and deregulation legislation package. We have noted that profits still have the upper hand over politics, despite a range of simmering risks discussed in our ‘Themes for 2018’. It is now fair to say that profits and geopolitics are in a ‘tug-of-war’ to dominate investor sentiment. In the absence of an economic slowdown, the good earnings track buffers equity optimists and discourages interest in the bond markets (where finding value is even more elusive).

Sovereign bonds yielding more than equities in the US

As interest rates gradually grind higher, the attractiveness of equity markets compared to fixed income assets over the medium-term diminishes. This is most evident in the challenges facing dividend yield-seeking investors.

In the US, the dividend yield on the S&P 500 Index has in the last nine months fallen well below the yield on ‘risk-free’ US Treasury securities. As of 15 July, the trailing S&P Index dividend yield is only 1.85%, a full percentage point below the US 10-Year Treasury Bond yield.

In order to be comfortable taking on equity market risk, investors need to expect further gains in the price the market is willing to pay for companies’ future earnings. Over multi-decade periods like the last forty years, a dividend yield that sits below the Treasury yield is the normal pattern, because most investors are seeking capital gain, rather than income, from their equity holdings. However, since the GFC in 2008, US stocks have yielded more than Treasuries as the Fed held interest rates artificially low to encourage risk appetite and ultimately, inflation.

Now, in a late-stage economic expansion, the probability of further increases in P/E multiples has fallen. Investors who have bought riskier assets to receive a better portfolio yield during the last decade now have alternatives, as interest rates move up. All the same, if inflation also exceeds forecasts, corporate profits would see a short-term benefit from pricing power gains.

Volatility ahead as market complacency is building up again

This all adds up to a finely balanced outlook for markets. The benign case is one where growth supports valuations because realised earnings keep justifying markets' anticipation of better profit news, disappointments remain in the minority, mergers and acquisitions news boost confidence, and inflation is sufficient to lift companies' pricing power while remaining too tame to require a more aggressive central bank policy response. The risk case is that bond yields rise further and undermine the credibility of future profit gains.

For now, we remain cautiously constructive on growth asset classes, but are increasingly concerned at diminishing global liquidity. Another substantial upward shift in US bond yields or the US dollar would elevate the chances of a sustained weak period, as would further gains in activity levels which drain the artificially-easy global money supply. As evidence for either the bullish case or the risk scenario develops this year, more sharp swings in investor sentiment are likely. This is typical of the late stages of a bull market cycle, and we continue to believe a prudent course is to remain at neutral weightings in portfolios' growth assets.

NZ equities more vulnerable as domestic economy slows

New Zealand equities have been the endurance champion among developed markets, with world-leading gains in 2018 even as the business confidence outlook has consistently deteriorated. While GDP growth should be somewhat stronger in the second half of this year, the domestic share market could be affected disproportionately in the event of the negative (rising) interest rate scenario prevailing offshore.

The market is very expensive on traditional measures and has been seen as a suitable destination for global yield-seeking investors. Cuts to the dividends paid by major New Zealand corporations would only risk re-enforcing the signal that critical fundamentals are changing, and so NZ equities are unlikely to continue outperforming their International counterparts over the next three years.

The defensive, dividend-focused nature of much of the local market has helped it outperform global equities throughout the second quarter

New Zealand fixed income assets have the advantage of strong fiscal underpinnings and a shortage of sovereign supply, but our economic forecasts see this gradually eroding as spending demands mount. At present, we have neutral exposure to NZ equities and a small underweight tilt in NZ fixed income, mainly due to their susceptibility to international rate rises rather than to domestic factors for now. We would now consider moving our NZ bond holdings closer to neutral in the event of any internationally-driven yield increase across the domestic interest rate curve.

Valuations of NZ equities rising while the market dividend yield sinks

NZX 50 PE Ratio and Dividend Yield



Source: Bloomberg, AMP Capital

The defensive, dividend-focused nature of much of the local market has helped it outperform global equities throughout the second quarter – though the dividend yield on the broad New Zealand index as a whole has been slipping and is now slightly lower than the yield on the Australian Stock Exchange (ASX 200).

In addition, the rapid rise of A2 Milk toward the top of the New Zealand market table by capitalisation provided a value-added commodity export narrative many investors find attractive in uncertain times. While individual New Zealand corporates have faced significant operating difficulties and instituted major restructures, investors have remained tolerant. This may be in part because of the regular inflows into the New Zealand market provided through KiwiSaver funds being invested. It may also be because listed New Zealand exporters are not active in industries likely to be hurt by tariffs or trade wars, while the New Zealand government remains a determined proponent of multilateral trade agreements.

Weakness in the New Zealand dollar (NZD) throughout the second quarter has also added buoyancy to the New Zealand companies sourcing much of their earnings internationally. With the domestic economy now on a slightly slower growth path, it is not expected that corporate earnings outcomes will improve across the board in the next six months, though there will doubtless be concentrations of strength – particularly among exporters.

In sum, the last three years' strong returns from New Zealand equities has been an unanticipated benefit to portfolios, but we are not anticipating the large performance differential ahead of International equities (which is approximately 30% as at mid-July) to be so marked in the next period. Rather, we would anticipate a return to comparable returns from New Zealand and international shares next year, with a risk being that New Zealand actually begins to slightly underperform the markets it has previously led.

Returns by asset class

ASSET CLASS	30 JUNE 2018	QUARTER	YEAR
CASH AND FIXED INTEREST			
NZ cash	2.00%	0.5%	2.0%
NZ bonds	2.85%	1.0%	4.2%
Global treasuries	3246	0.2%	2.7%
Global aggregate	388	0.2%	2.2%
DOMESTIC AND GLOBAL SHARES			
NZ shares (NZX50)	8943	7.5%	17.5%
Australian shares (AUD)	63015	8.5%	13.0%
Global shares (local)	4527	3.6%	10.9%
Emerging markets (local)	572	-3.5%	10.5%
REAL ASSETS			
NZX listed property	1281	5.9%	8.9%
Global property	1998	8.5%	7.4%
Global infrastructure	227	5.2%	4.3%
Commodities	69	0.4%	7.6%
CURRENCY			
NZD / USD	0.677	-6.1%	-7.5%
NZD / GBP	0.513	-0.2%	-9.0%
NZD / AUD	0.916	-2.5%	-4.0%

Source: Bloomberg, AMP Capital

World financial markets recovered some impetus in the second quarter

- > After global equity markets' sharp declines in February and March, the second quarter saw a stabilisation in sentiment and resumption of optimism, with good corporate earnings and economies running near-capacity.
- > Global bond markets reflected higher inflation concern, with most major government bond yields climbing.
- > US and global corporate bonds recorded negative total returns and underperformed government bonds, while the Global Aggregate Index was again flat for the three months to June, underperforming domestic cash from the New Zealand investors' point of view.
- > Over the June quarter, there was a dispersion of equity returns, as the US market rose but Japan and emerging markets weakened sharply, having overshot in 2017 when they were the strongest asset class.
- > In Australia, the S&P/ASX 200 Accumulation Index rallied strongly in the June quarter rally, gaining 8.5%.
- > The New Zealand equity market also proved robust, gaining 7.5% for the quarter. The S&P/NZX 50 Gross Index returned 17.5% for the year. The domestic market has resumed its upwards direction in the last three months, in spite of political policy uncertainties and the lower business confidence now prevailing.

- > The Bloomberg Commodities Index posted a modest return in the June quarter. This was driven by weakness in industrial metals, amid rising global trade tensions and concern that further escalation could impact demand. However, the oil price has rallied and supports the energy component of the sector.

While we continue to acknowledge that equity and bond markets remain close to full valuation levels, and are vulnerable to a wide array of risks, we are also giving weight to factors like the strong global economy and corporate earnings picture, and the fact that evident catalysts for an imminent end to present bull market conditions are few. Risks are rising, all the same, and investors are more alert to danger signals and more prone to moving their assets into cash at moments of market stress, re-investing only once the 'coast is clear'.

Volatility (upwards as well as downwards) is therefore likely to persist in the months ahead. Many institutional investors are now deploying derivatives to hedge the downside risk in their portfolios given the uncertainties and current extended valuations.

In our view, this makes our present neutral positioning in international, Australian and New Zealand equities still the prudent course.

Rising global bond yields, while New Zealand yields prove resilient so far

Since their record low in mid-2016, the yield on US government bonds has been in an erratic rising trend. Our strategy to prefer cash to international fixed interest was sporadically successful last year, but the failure of longer-maturity bond yields to sustain their highs and push upwards toward 3.0% until recently has meant that overall, our cautious stance proved disappointing. We still believe that interest rates are on the path upwards and expect their track to resemble a ‘staircase more than a ski-slope’, with periodic surges and extended sideways movements.

The first half of 2018 has been rewarding in terms of seeing higher US and global yields, but this has only partially translated to New Zealand sovereign yields, where we have a smaller underweight exposure. While US yields have now moved up 0.5% above their year-ago level, domestic long-term bond interest rates are proving more resilient, and remain around the levels they were in mid-2017. This is due in part to our better fiscal outlook and economic resilience, as well as to quite tame domestic inflation by historical standards. In an unfamiliar development, New Zealand government bonds have for several months, sustained yield levels close to or below the US Treasuries level, for securities of equivalent maturities.

One of the key implications of this is that the long-familiar ‘hedge premium’ return provided to New Zealand investors holding hedged International fixed income assets has been eroded away. As there seems to be limited domestic inflation risk and no more international risk premium for New Zealand government debt (with our AAA sovereign credit rating re-affirmed by Moody’s), returns in the fixed income sectors are set to be lower for the foreseeable future.

The proportion of New Zealand government securities owned by non-residents has declined from 61.5% one year ago to 58.1% currently, and additional foreign demand may be limited, if there is no real interest rate advantage available in holding New Zealand bonds. The latest New Zealand inflation data, for the second quarter of 2018, matched the RBNZ’s expectation of a 0.4% quarterly rise (1.5% year-on-year) while more importantly for monetary policy, the sectoral factor model of core inflation rose 1.7% which is the largest annual gain in seven years.

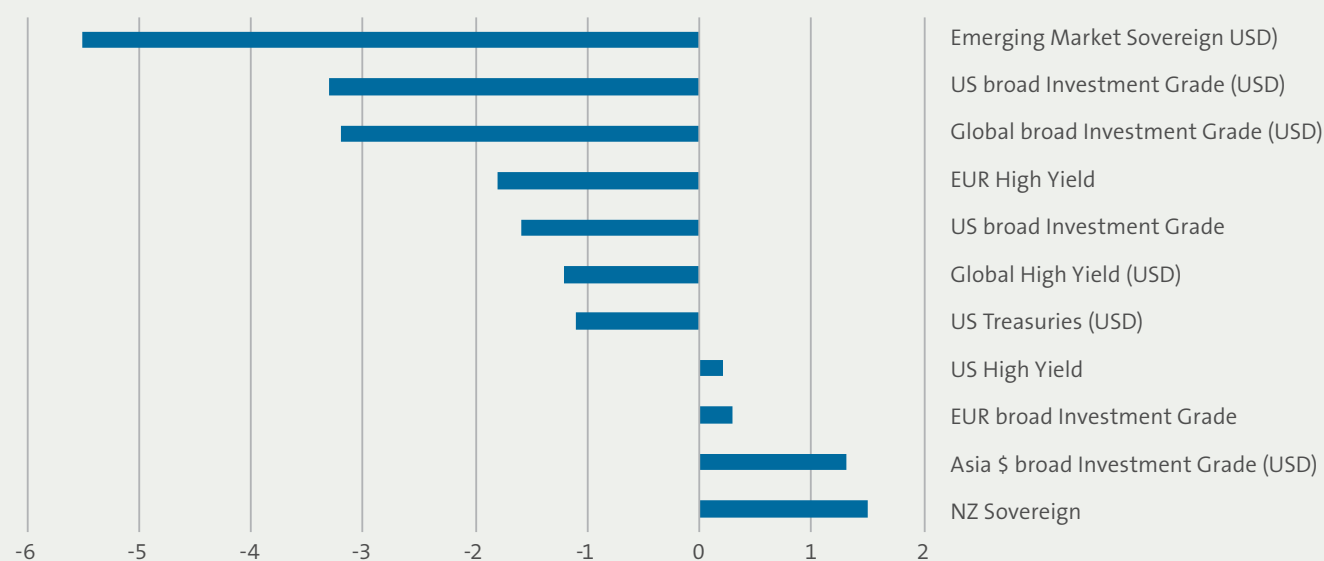
There is still a large global demand for global sovereign bonds. This buying power (whether from central banks building reserves or institutions shoring up capital) means that when yields do jump, the increase still attracts strong investor interest, which restrains the scale of the rise.

Analysis suggests that US 10-year yields would need to reach around 3.5% – another 0.65% above mid-July levels – and stay there, before interest rates could begin affecting the attractiveness of the broader equity markets. That said, the consensus view of short-term traders (which can be a contrary indicator) is still clearly extrapolating the recent rise in US yields and economic strength in data such as the July retail sales report into further yield gains in months ahead. We expect global bonds to therefore remain a weakly-performing asset class for the rest of this year, and in the absence of a significant NZD hedging pick-up we are not seeking additional exposure.

In the immediate term, it is important to remember that the US 10 year yield has now more than doubled from its 2016 bottom of 1.35% to 2.87% at the time of writing. Arguably, were yields to sustainably exceed 3.0%, that may represent the bulk of what can be expected of the immediate bear trend, at least until higher actual inflation emerges in the world economy. We would not be surprised to see US 10 year yields reach 3.25% in the course of this year, if growth and inflation continue gaining momentum.

Bond performance has been weak for key countries and market segments

Percent 2018 YTD bond performance (total returns)



Source: Morgan Stanley, AMP Capital

The question is, whether such a move up would present any insurmountable problems for the growth asset classes? Not necessarily. The current environment could well prove positive for several quarters to come, with real interest rates being pushed higher, after many years near the policy-induced zero bound toward a more neutral level (wherever that lies).

US Federal Reserve estimates implied by the Governors' forward projections (the 'dot plot') suggest 2.85% is a potential neutral target rate for the short policy (Fed Funds) interest rate. The fact that the current 10-year yield sits at that level while the US three month LABOR rate is half a percent lower at 2.34% bears out our prediction last quarter that the yield curve would flatten further. The difference between 2-Year and 10-Year US Treasury bond yields is now at a post August 2007 low of 0.25%, having been 0.75% as recently as February.

Where are the key risks?

At the beginning of this year, we introduced some caution in our outlook for markets in 2018, and we feel this has been justified by events. We are of the view that while we expect moderately positive returns for growth assets overall, there are risks that could push the market further down sufficiently to restore some value.

It is important, though, to separate two quite different sets of risks, which commentators frequently confuse:

- 1) Risks that can cause a sharp correction of between 7%-12%. This is what occurred in February /March. Possible catalysts include:
 - > a more aggressive Federal Reserve responding to politically-motivated US fiscal stimulus
 - > an unanticipated geopolitical shock such as military engagement, Trump indictment, Middle Eastern flare-up or some sort of environmental shock triggering inflation fears
 - > a flow-through from weakness in another asset, such as emerging market debt, the Chinese renminbi, bitcoin, or a more dramatic reversal in commodity prices due to tariff etc.
- 2) Risks arising from fundamental shifts in the cycle, which would signal the end of the bull market. These could arise from a variety of sources and are only likely to develop slowly, potentially by early 2019. Potential 'bull-slayer' developments are likely to be some combination of:
 - > rising corporate default rates due to excessive debt-fuelled activities in the past, or industry disruption
 - > a slowing in Chinese economic momentum as the government's credit constraints trigger risk aversion
 - > central banks being perceived as 'behind the curve' and fears of accelerated tightening
 - > tight developed market labour markets finally engendering sustained wage gain
 - > excessive fiscal stimulus triggering offsetting monetary policy tightening
 - > corporate earnings growth stalling due to margin compression or higher input costs.



Implications for investors

We expect continuation of the dominant market trends, though with a higher risk of bouts of volatility as interest rates rise and geopolitical disruptions continue. This has the following implications for investors:

- > Improving economic growth around the world will generally support equities and challenge bonds, because this growth is more 'traditional' in nature – arising from better employment and demand and thus allowing prices and, potentially, profits to rise. An additional traditional growth source – capital spending and business investment – should also kick in over the next year. Growth opportunities are now a key focus for our investment selection.
- > However, the diminishing 'artificial' component of growth – the part generated in recent years by extreme monetary stimulus, both via interest rates and quantitative easing – means that global interest rates need to rise further. Central banks are unwilling to buy up additional large tracts of the bond market to keep credit ultra-cheap, and will where possible gradually move to unwind their current holdings.
- > Yield enhancement is still a valid approach, but a high degree of selectivity about avoiding undue credit risk is vital. Rising bond yields diminish the attraction of yield plays, particularly for agile international funds.
- > The path to higher rates has begun in the US, and eventually (over the next 18 months) the UK and Australasia will follow suit. This path can be interrupted from time to time by market shocks, but a jagged upward course for yields is now the dominant trend. Caution is therefore warranted in investments that rely on low interest rates, particularly property but also debt-funded corporate mergers.
- > New Zealand and Australian assets and industries that benefited from Chinese capital outflows and 'offshoring' of wealth will need to adapt to a high degree of regulatory restriction and scrutiny.
- > Growth-oriented shares that earn profits from consumer demand and demographic, technology or medical trends (aging, migration, IT security, internet retail, healthcare reform) can perform better than defensive shares with high dividend yields. Those 'bond proxy' shares will become less attractive as the yields on government bonds progressively rise. Governments adopting substantial fiscal stimulus at a time of high existing sovereign debt will add to the upward pressure on interest rates and reinforce this trend.
- > The global oversupply of commodities will slowly diminish, so expect raw materials prices to move in a band, rather than to rally strongly. Sentiment on China is currently resilient but any more trade friction or sharp move in CNY/USD could undermine industrial metals. Credit restrictions could trigger asset weakness.
- > There is still too much debt in the world, contributing to sluggishness. Governments (especially those with unorthodox leaders or facing new situations like the US and UK) may be tempted to deploy inflation-boosting policies as a means of lowering the future debt-servicing burden. We could be in store for a challenge to the set of assets that are conventionally viewed as risk-free (developed country government bonds).
- > However, the yield on US government bonds has already risen in a short space of time and there may not be major further upward pressure while realised inflation remains low, granting the Fed the luxury of time.
- > Holding an uncommitted cash buffer is of considerable value because of the scope it allows for re-entering markets at those (inevitable, if not imminent) moments of distress. While cash yields remain low, the yield premia available for taking on bond duration risk is barely adequate, and the income benefit available from hedging international portfolio returns back to New Zealand dollars while still positive, is shrinking.

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