JBWere

MAS
Investment Update

17 January 2022

Markets Outlook: Transitioning

The year may only be in its infancy, but it has already been a somewhat action-packed one for financial markets as investors continue to grapple with the combination of a number of key themes and questions that emerged late last year and have carried over into the New Year. These include the rapid spread of the Omicron variant around the globe, sharply rising rates of inflation, ongoing supply chain disruptions, more hawkish signalling from central banks, the failure of the US Congress to pass Biden's latest fiscal package, and even some increased geopolitical tensions thrown into the mix. It has been a volatile start to the year across both equity and fixed income markets (and especially within these asset classes), and some see this as potentially a harbinger of what could be in store for the remainder of 2022 after a couple of years of generally strong returns across investment portfolios.

Despite the somewhat turbulent start, we generally retain a modestly positive view on global equity markets for 2022. While some of the key macro tailwinds that helped propel major equity markets sharply higher over the past two years have now waned (accelerating global growth and abundant central bank liquidity), meaning that the magnitude of returns will likely be more moderate than recent experience (a typical outcome as markets transition to a new consolidatory stage of the cycle), we continue to see the economic backdrop as consistent with further equity market upside, led by corporate earnings growth.

Supporting our generally positive view is a belief that while the strongest acceleration phase of the economic cycle is now behind us, the global economy will still record above-trend rates of activity growth this year. Still accommodative financial conditions, household pent-up saving, increased business capex spending, a gradual easing of supply chain disruptions and an eventual peak in inflation pressures should all support solid activity levels in our view. Despite the remarkable speed at which the Omicron variant has spread around the world, milder health outcomes suggest economically damaging lockdowns are likely to be avoided.

Perhaps the biggest question facing investors this year is the trajectory of inflation. The magnitude to which it emerged last year was undoubtedly the year's biggest surprise. Equity markets withstood the barrage remarkably well though, largely because corporate profit margins proved resilient. While we don't think inflation rates across the developed world have peaked just yet, we don't see elevated rates persisting, largely because a normalisation in household spending (away from trade-intensive durable goods and back towards services) will eventually take pressure off supply chains – a major reason for the sharp jump in prices seen for many products recently.

We have reasonably high conviction in our view that inflation will peak this year. Where we have lower conviction (given that it is reliant on when supply chains normalise) is how quickly inflation recedes from that peak. It is the latter that will importantly determine how aggressively central banks withdraw monetary policy stimulus, which will have a large bearing on the behaviour of financial markets this year. Some central banks, like the Reserve Bank of New Zealand, have already started that process. Others, like the US Federal Reserve, are on track to join that club very shortly, and markets have quite quickly moved to price in close to 100bps of rate hikes for the Fed this year (as well as some expectations that it will also begin to reduce the size of its balance sheet). If we are correct in our view and inflation rates recede, then that degree of monetary policy tightening is unlikely to cause too much in the way of disruption for equity markets. If inflation pressures persist for longer, and more monetary policy tightening is signalled and delivered, then there could be a few more digestion issues. Ultimately, given our positive views on the growth backdrop, we see equity markets delivering further gains, but just like the year has started, we expect it to be one with a few twists and turns.

MAS Portfolio Implications

We did not make any changes to our **Tactical Asset Allocation** positioning over the past quarter, with the funds within the MAS KiwiSaver Scheme and the MAS Retirement Savings Scheme (the MAS Funds) currently sitting at a broadly neutral position for equities versus their strategic targets. The Funds are also broadly neutral versus target in fixed interest and cash. We believe the MAS Funds are positioned appropriately for the economic and markets backdrop described above. That is, one where markets experience higher levels of volatility and the risk-reward for equity markets, while not negative by any means, is less positively skewed than it has been. We continue to maintain high levels of diversification both across and within asset classes, which should provide a reasonable buffer to returns from this modestly higher volatility backdrop that we expect to continue.

Within the Australasian equities portfolio, as was the case over the September quarter, our broad strategy was largely a selective one over the past quarter, where we added or reduced positions within the portfolio through share price volatility and/or liquidity opportunities. Of note, we took advantage of share placements in both **Ebos** and **CSL**, which both occurred at discounts. We were also comfortable adding to existing positions in **Fletcher Building**, **Oceania Healthcare**, **National Australia Bank**, **NEXTDC**, **Ramsay Healthcare** and **Xero**, among others, over the quarter.

Notably within the International equities portfolio, over the latter part of the quarter we transferred the existing legacy ETFs (exchange traded funds) and direct stocks that made up the Tilt portfolio to a new fund managed by BlackRock following an MSCI custom index specifically designed for MAS. This new Tilt is a somewhat ground-breaking solution, that has taken years of planning, and will allow MAS to access JBWere’s highest conviction medium-term thematic ideas while still being compliant with its Responsible Investment policy. Some of these thematics include, but are not limited to: **Global Clean Energy**, **US Medical Devices**, **Global Sustainable Development**, **US Software**, **Automation and Robotics**, and **US Banks**.

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