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New Zealand stocks are underperforming, but long-term prospects still favourable

The New Zealand equity market has been blessed by strong upward revisions in corporate earnings and a robust macro framework, with the country further along than its peers in a V-shaped recovery from a COVID-19-induced downturn. Yet New Zealand's main equity index, the NZX 50, has lagged its global counterparts. Equity markets in France, Germany, Australia, the UK, the US, Hong Kong and Japan are delivering positive returns in year-to-date (YTD) terms but the NZX 50 is currently down about 8%. We explain several reasons that are likely to have contributed to this underperformance, and point out factors why the market is expected to remain an attractive prospect in the longer term.

Firstly, stocks' dividend yields have declined gradually over the past decade. At the same time, the New Zealand 10-year swap rate (what an investor can earn in the fixed income market) has recently risen sharply after dropping steadily over the last 10 years. The jump by the swap rate could imply that traditional bond investors, who recently sought higher returns in equities, could begin making a return to bonds, if they haven't returned already.

The next aspect we turn to is the decline in foreign ownership of New Zealand equities. Prior to the pandemic, foreign ownership had been increasing, peaking at 43% of the NZX 50 in March 2020. But this fell to 37% of the index by the end of 2020. The decline may not be too surprising given the turbulence global markets went through in 2020. But New Zealand could be facing an uphill battle in 2021 to reclaim lost foreign ownership as other markets also prepare to re-open their economies.

New Zealand is considered to have a sound economy based on a reliable liberal democracy, producing reliable cash flows and dividends. These traits, however, are seen as bond-proxy features, with the overall yields that New Zealand offers being low relative to those of other economies. International investors, looking to tap into the global post-pandemic recovery, could be enticed by other markets that offer higher yields and less liquidity risk.

In the long term, however, we expect New Zealand to come back into vogue thanks to its strengths. The economy will fully re-open, allowing consumer spending to go from a narrow set of concentrations into wider areas such as travel and services. The sugar hit from the stimulus and accommodative policy will play out—the Reserve Bank of New Zealand in May tacitly implied that tapering lay ahead. The country will return to modest growth amid low interest rates, an environment that will again highlight New Zealand's persistent strengths mentioned above.