

New Zealand Equity Monthly April 2023

Picture is complex for equities, although some bright signs are emerging

By Michael De Cesare, Portfolio Manager
15 May, 2023

Strong market performance in 2023 to date masks more complex picture

New Zealand's equity market was surprisingly strong in the first four months of 2023 given the current challenges faced by the economy. Although stock prices were broadly flat in April, the market delivered a year-to-date return of approximately 4% as of the end of the month. The actual picture is more mixed, however, partly as a result of the concentrated nature of the New Zealand market. The S&P/NZX 50 Index, New Zealand's main equity market index, comprises New Zealand's 50 largest stocks by market capitalisation, making it far smaller than Australia's S&P/ASX 200 Index (200 stocks) and the US's S&P 500 Index (500 stocks). Furthermore, based on our calculation that the top five stocks in the S&P/NZX 50 Index represent approximately 42% of its size, there is further concentration within the index itself. This means that its performance depends on the fortunes of a small group of companies. The index's top five stocks were up by 9% as of the end of April, far exceeding the overall 4% gain as calculated with the market capitalisation-weighted methodology and showing that the top five drove a large proportion of the market's return. We performed a simple average calculation with equal weightings given to all 50 stocks in the index and found a year-to-date return of close to zero. This appears to be a more accurate representation of current economic conditions.

Interest rates and earnings key to outlook for market

Looking ahead, given that fundamental valuations in the market largely depend on interest rates and earnings forecasts, it is encouraging for equities that New Zealand's Official Cash Rate, which currently sits at 5.25%, appears to be close to its peak in the current hiking cycle. The beginning of an easing cycle in which rates move downward again is likely to be supportive for the market. Current conditions remain challenging, however, given that recent monetary policy has been driven by the need to respond to the inflationary crisis. Central banks have been acting to bring down inflation at any cost, even if it hampers economic growth. Against this background, we feel there is a possibility that New Zealand could enter a recession later in 2023. Investors also face uncertainty as to when the full effects of recent rate hikes will be felt in the market and how potent those hikes will be. The picture for corporate earnings is similarly cloudy. Following the February reporting season centred on companies with fiscal years that ended in December 2022, approximately 50% of the companies reporting saw their market consensus earnings downgraded for the 2023 and 2024 fiscal years. This suggests that risk is still skewed to the downside.

Top-down factors still weighing on sentiment, but bright signs are emerging

A number of top-down issues are also weighing on sentiment towards equities and other risk assets. New Zealand's latest consumers price index showed a large on-year rise of 6.7% in the March 2023 quarter, although this was down from 7.2% in the December 2022 quarter. Global issues including the high geopolitical threat level and strains in the financial system are also creating downward pressure. At the same time, signs that inflation and interest rates may be close to their peaks are sources of light at the end of the tunnel.

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