GLOBAL
ECONOMIC AND INVESTMENT NEWSLETTER
3rd May 2021 Issue No.253

## Introduction

- Canadian research company Bank Credit Analyst (BCA), has commented on prospects for the NZ dollar:

  - The outperformance to date from the Kiwi has been due to a global supply shock in commodities and an impressive rebound in the NZ economy.

  - Strong export growth (led by China) has boosted the NZ trade balance, increasing demand for the currency. There has been a boom in agricultural commodity products and demand for food should remain resilient.

  - Allowing housing prices to be increasingly unaffordable is politically and economically unsustainable.

  - The NZ share market is over-weighted with defensive stocks in a recovering global economy… and is therefore vulnerable.

  - The RBNZ will need to tighten monetary policy - due to a recovering labour market, "burgeoning inflationary pressure" and an economy open for business. It will cause interest yields to rise, providing a further (limited) boost to the NZ dollar.

  - Countries with easier monetary policy, such as Australia, could fall against the NZD.

  - However, based on purchasing power parity models, the NZD is 10 percent overvalued against the USD (shown adjacent). The currency is expensive and will start to impact on NZ trade.


  - BCA believe that over the balance of the year, NZD/USD could hit $0.75, but will probably underperform other developed market currencies against the US.

## Coronavirus

- The US is leading other major nations in the vaccination rollout and is expected to have vaccinated 70 percent of adults by mid-June. To date, the number of Americans fully vaccinated is greater than 100 million.

  Transatlantic leisure travel is now to be restored. The EU has advised that vaccinated American tourists can visit the continent during the Northern Hemisphere summer, with all 27-member countries unconditionally accepting the protocols. The ruling will be welcomed by hard-hit, tourist-oriented economies like Greece, Spain, Italy and Portugal.

  The EU has begun issuing its own citizens with "digital green passports", advising whether travellers have been vaccinated against Covid-19, have recovered from the virus, or have tested negative in the previous few days.

- The Indian "Double Mutant" variant of the coronavirus is considered the most lethal version discovered to date - and is causing a wave of infections and chaos in India. Although little is known about the double mutant, it is believed to be much more contagious than the original version.

  The double mutant has 13 mutations, and its name is due to the detection of two mutations previously found in separate variants. One of the mutations has shown signs of being able to sidestep immune responses.

  The double mutant virus has already established itself in 21 countries. In Australia, the double mutant made up 40 percent of the samples collected over the week ended April 15, compared with 16.7 percent a month earlier.

  In mid-February, daily cases in India were around 10,000… but are now up to 400,000 - as the virus tears through the community, with the authorities unprepared and in disarray. The double mutant, the contagious UK variant, as well as Brazilian and South African variants, have all been detected in India.

- The UK authorities have advised that rare blood clotting from the AstraZeneca vaccine mainly affects young people. It is considering changing recommendations so that people under the age of 40 receive an alternative vaccine.

  Scientists are investigating why AstraZeneca, which uses another (harmless) virus (an adenovirus) as a carrier, can cause the clotting disorders… while the mRNA vaccines from Pfizer and Moderna do not have this problem.

- New Zealand Covid Response Minister Chris Hipkins has announced an expansion of the "temporary travel ban" placed on travellers from India. The new banned list is now India, Brazil, Papua New Guinea and Pakistan. All travellers from very high-risk countries will require evidence of a negative PCR test from an accredited laboratory within 72 hours of travel.

## Equities

- The US share market was slightly weaker on Friday, despite strong quarterly earnings results from Apple, Alphabet and other large technology companies.

The Financial Times said (30/04/21):

*Big Tech this week reported a surge in growth and profits that stunned Wall Street, delivering powerful evidence that the digital dependence forced on a large part of the world's population over the past year could have an enduring effect.*

*The outsized figures amount to a reset in the business world, some tech investors and analysts said. According to this view, the leading digital powers have consolidated their gains from the past 12 months and made themselves an even more indispensable part of work and personal life.*

However, their share prices have not advanced accordingly.

Barron's said (30/04/21):

*The lukewarm reception to these blowout numbers continues the pattern of the past eight months. Apple, Microsoft, and Amazon have been growing by leaps and bounds, but their stocks have trailed the S&P 500 by large amounts.*

The S&P 500 index, which hit at an all-time high of 4,200 on Thursday, fell 0.7 percent on Friday. Investors are cautious and increasing their holdings of cash, in spite of stellar earnings results for the first quarter. Over 300 companies in the S&P 500 have now reported earnings, with 87.1 percent exceeding analysts' expectations.

- Volatility in US equities markets has hit its lowest level since the onset of the covid-19 pandemic.

  The 'Vix' ("fear") index, which measures implied volatility in S&P500 index options, has dropped below its long-term average of around 20 and has stayed low, despite a rocky period for equities recently (chart adjacent).


The reasons include more subdued trading by retail investors and the greater willingness of traders to navigate the market without safety nets (such as put options).

## Investment Strategies

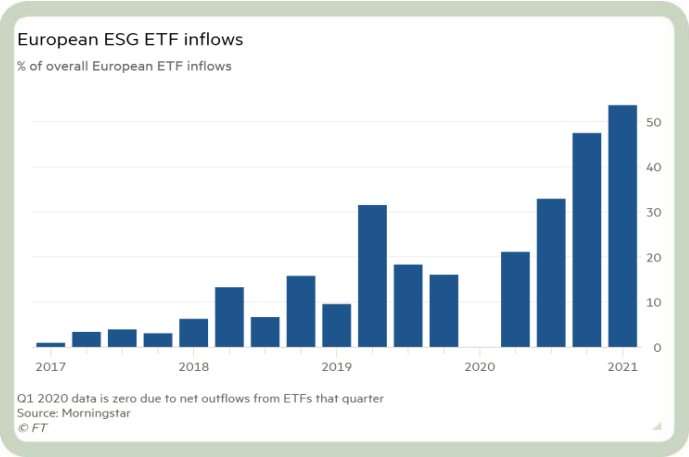
- The dividend yield on the S&P 500 is just 1.4 percent and valuations are at their highest levels since the dot.com era, which led to a crash in 2000. Therefore, any expansion in equity prices needs to come from a growth in earnings. This is expected in the current US earnings quarter, but the question remains as to how long they can continue to accelerate for before tailing off. US analysts expect final earnings growth for the first quarter to come in with growth of about 25 percent, the second highest one-quarter jump in forecasts from analysts on record… setting a high bar for the future.

The Australian Financial Review said (30/04/21):

*There's no precedent for sustained growth of this magnitude. S&P 500 earnings have grown on average by about 4 percent a year since the 1870s and slightly more in recent decades, and about 5 percent since 1990. Also, earnings grew about 10 percent a year in just two earlier decades, the 1940s and the 1970s, and both times the decade that followed was a lot more subdued.*

- Money flows into "sustainable" exchange traded funds (ETFs) surged in Europe during the first quarter of this year (chart adjacent), surpassing flows into all other ETFs.

  Investment in passive funds tracking sustainable indices – those focusing on environmental, social and governance areas and opportunities – boomed to $174 billion in 2020, from $59 billion in the prior year.



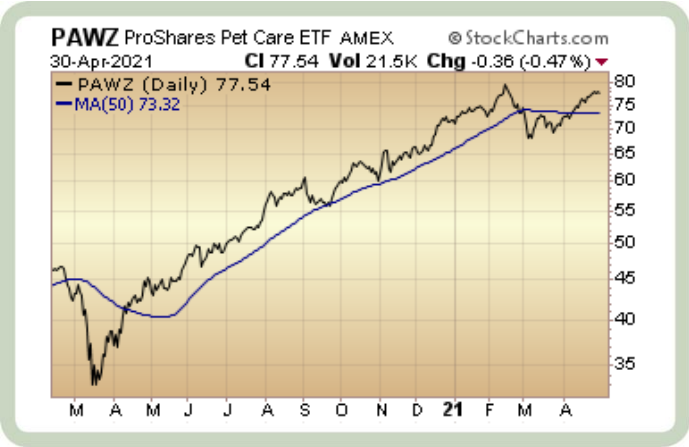

- The issuance of previously hot "Special-Purpose-Acquisition-Companies" (SPACs) screeched to a halt in April in the US. Only six new SPACs have been created so far this quarter – markedly down from 55 in the last quarter.

  Recent announcements from regulators appear to have lowered interest in the financial vehicles. In March, the Securities and Exchange Commission (SEC) issued a statement expressing concerns over disclosures and governance related to SPACs and earlier this month they indicated that they would tighten accounting oversight.

- While much has been made of "pandemic winners", such as video conferencing software, fitness equipment and television streaming, little has been made of another big winner – pets (and associated industries). People are spending more time at home and have focused on their pets (there are about 3 million in UK households alone).

  There are apparently no limits on how much can be spent on family animals, with US households allocating in total around $104 billion on pet products in 2020… forecast to rise to $110 billion this year.

  Also, pet-related equities have flourished. Shares of UK company 'Pets at Home' are up 75 percent in the last year, while US-listed 'Chewy' shares have



gained 77 percent.

Investors can gain widespread exposure to the theme by investing in exchange-trade-funds, such as the ProShares Pet Care fund (chart above - US:PAWZ).

- A new Exchange Traded Fund (ETF) will soon be launched in the US that invests in all of the latest "hot trends". Called the Amplify Thematic All-stars ETF, it will target technology, healthcare, sustainability and stocks in other highflying sectors. The aim is to provide an easy instrument for investors to participate in innovative equities with (supposedly) significant upside, such as electric cars, rockets and robotics.

  Thematic ETF's (based on exciting or innovative themes) have surged in popularity in the last year, due to investors eager to find investment sectors that can deliver returns well in excess of the market average. These US funds attracted $42 billion in investment last year and have already pulled in $30 billion this year, so far.

## Inflation, Interest Rates and Debt

- US corporate earnings reports for the first quarter of 2021 are coming through and the dominant message is that prices are in the process of being significantly increased - indicating higher inflation overall. The number of mentions of "inflation" in earnings calls has tripled per company, compared to the same time last year. Transportation, raw materials and labour were the major drivers cited.

  According to the Financial Times (26/04/21):

  *Procter and Gamble's Chief Financial Officer said the increase in commodity costs the company was experiencing was one of the largest he had seen in his career, and he expected the pressure to grow.*

  They added:

  *For the roughly 25% of companies in the S&P 500 that have reported their first-quarter results so far, the rise in commodity prices has become one of the most-cited headwinds to what is otherwise shaping up to be a lavish earnings season.*

  Commodity prices have been rocketing. Since the beginning of the year, lumber prices in the US are up nearly 60%, while copper, aluminium and Brent crude have risen by around 20%.

  However, the Federal Reserve continues to maintain that price increases are temporary, are arising from a low base… and that this should wash through.

- US investors spent a net $1.2 billion on Inflation-protected Treasuries (TIPS) in the week ending 21st of April, the 29th consecutive week of inflows into this investment instrument. TIPS are a treasury security issued by the US government, that is indexed to inflation in order to protect investors from a decline in the purchasing power of money

  The solid demand is despite the recent decline in regular treasuries yields, illustrating that investors still have concerns about the impact of strong economic growth on the trend for future interest rates.

- Eurozone government bonds have recorded their worst monthly performance relative to US Treasuries in a year. The yield premium of US Treasuries over the equivalent German bonds (bunds) – often used as a gauge of relative economic outlook – contracted in April by the most since last March. They have also underperformed the equivalent Australian, British and Japanese bonds.

  Investors appear to be bracing for a larger bond sell off (and higher interest yields) in the coming months, as the vaccine rollout and economic growth start to accelerate. Yields of German bunds, versus the US and UK, are still low (with ongoing potential to rise).

## Currencies

- Research company Bank Credit Analyst (BCA) said the following about cryptocurrencies (30/04/21):

  *Widespread adoption of cryptocurrencies, if it were to happen, would erode the purchasing power of traditional money, while robbing governments of billions of dollars in seigniorage revenue. Governments have already begun to take steps to thwart such an outcome. Restrictions on the use of cryptocurrencies will only increase over the coming years.*

  *The rollout of Central Bank Digital Currencies (CBDCs) represents an existential threat not only to cryptos, but potentially to credit card companies and online payment processors such as PayPal, Square, Venmo, WeChat Pay, and Alipay.*

  They say that online scammers, smugglers, and terrorists have been drawn to cryptocurrencies to avoid detection. Cryptos have also been used to evade capital controls and conceal wealth from the tax authorities.

  On the environment side, Bitcoin mining now consumes more energy than entire countries as large as Sweden, Argentina, or Pakistan. Also, about 70 percent of Bitcoin mining currently takes place in China, mainly using electricity generated by burning coal.

  The price of Bitcoin was $57,098 on Friday and is up 105.9 percent from the year's low of $27,734 (on Jan. 4).

## Economies

- The US recovery from the Covid-19 pandemic is gaining momentum… and assisting the developed world to exit the recession. The economy grew at an annualised rate of 6.4 percent in the first quarter, according to the latest report from the US Commerce Department. This was slightly higher than expectations and much greater than the 4.4 percent recorded in the final quarter of 2020.

  In March, US employers added 916,000 jobs — the largest increase in hiring since August 2020. However, another 553,000 workers applied for unemployment benefits, more than double the pre-pandemic level. The economy still has a long way to go, as more than 8 million jobs remain lost to the pandemic.

- US consumer confidence reached a 14-month high in April. The Conference Board's consumer confidence index spiked to 121.7 in April, up from 109.0 in March - the highest level since February 2020, just prior to the Covid-19 pandemic. The share of consumers

expecting an increase in income over the next six months rose to 17.9 percent, from 15.4 percent in March. Those anticipating a drop fell to 10.9 percent, from 12.6 percent last month.

- Economists have been increasing their forecasts for GDP growth in the UK economy for 2021, due to the efficiency of the country's vaccine rollout. Previous predictions in February were for about 4.2 percent GDP growth, but this is being upgraded by economists to between 5.4 percent and 7.2 percent. If these predictions are realised, then it would be the fastest GDP growth since 1989. Anything over 6.5 percent would be the fastest pace since the Second World War.

  There are strong prospects for social distancing restrictions being lifted in the UK earlier than for any other European country, leading to expectations of strong consumer spending and a buoyant economy (particularly in the third quarter).

- The EU economy contracted by 0.4 percent in the first quarter, compared to the previous quarter… and was down 1.7 percent on the same period in 2020. The region is lagging behind the US economic recovery because of administrative issues in rolling out vaccines and unlocking economies. A heavy reliance on tourism is also an issue. However, the economy overall is now showing signs of recovery and economists believe it will experience a strong rebound.

  Research company IHS Markit said that business activity in April across the 19 countries that use the Euro grew at its fastest pace since last July. Major German bank Commerzbank said they expect the Euro area economy to return to its pre-crisis level by the end of the year.

## Business

- The electronics industry continues to reel from a global shortage of computer chips, which is affecting smartphones, television sets and home appliances - right down to toasters and washing machines. The situation has also been affected by US sanctions on Chinese companies, which have been hoarding chips in order to continue with production.

  The Financial Times said (25/04/21):

  *Samsung began to reduce orders for some smartphone components this month, two of its main parts makers said, after the world's largest computer chipmaker warned in March of a "serious imbalance in supply and demand" for semiconductors.*

  The company may have to delay the launch of its higher end smartphones until next year.

  The most important chipmaker in this space is Taiwan Semiconductor Manufacturing Company (listed on the New Your Stock Exchange – US:TSM) which is investing $100 billion in new plant capacity, but it will take three years to ramp up to full production. Last year the company made an operating profit of US$20 billion, on revenues of US$48 billion. The company has been described as the "Hope diamond of the semiconductor industry" – and astutely manages geopolitical differences between China and America.

## Politics

- There is widespread belief that America is not just involved in a seething political turmoil (such as Donald Trump and Black Lives Matter) but is also going downhill economically.

  However, consider this:

  - Based on share market valuations (not the only measure) the US has 7 of the 10 most valuable companies in the world.

  - America has 12 of the top 20 technology companies, including giants like Apple, Microsoft, Google parent Alphabet, Facebook, Amazon etc. China has two - Tencent and Alibaba. Leading the US pack is Apple, with a valuation greater than US$2 trillion, followed by Microsoft (just under US$2 trillion), Amazon US1.7 trillion and Alphabet US$1.5 trillion. They have strong earnings and huge cash reserves.

    The Financial Times said (30/04/21):

    *The combined revenue of Alphabet, Amazon, Apple, Facebook and Microsoft, jumped 41% in the first three months of this year, to $322 billion. That points to a rapid acceleration in growth that the leading tech companies have not seen in years, even as they have become some of the world's biggest companies.*

  - In the life sciences area, the US has 7 out of the top 10 global companies and 11 of the top 20.

  - The UK based Financial Times says that America also has 10 of the top 20 universities in the world.

  The nation still has influence.

- In his first speech to Congress and on the eve of his 100th day in office, US President Joe Biden last week declared that America was in competition with China and others to "win the 21st century", warning that Chinese leader Xi Jinping was in "deadly earnest" about turning his country into the "most significant, consequential nation in the world".

  He said that both Russia and China expect America to falter under the weight of internal divisions and believe that democracy cannot compete with autocracies because it takes too long to get consensus. Ben Bernanke, Chairman of the US Federal Reserve during the Global Financial Crisis said that his biggest problem was the paralysis of US politics.

  The Economist (1/05/21) has judged Biden's presidency to date as being successful, comparing him to Franklin D Roosevelt… and saying:

  *The theory of the Biden presidency thus far is that extraordinary levels of spending, only partially matched by raising taxes on corporations and the rich, can enrich America indefinitely without triggering inflation. And that direct government intervention, not creative destruction, is a powerful force to spur innovation. This is a remarkable gamble.*

## Commodities

- Commodities are buoyant, with the Bloomberg Commodities Index returning to levels not seen since 2015. The index gained 8 percent in April and has increased by 15 percent for the year-to-date. It has been a long time since the last index peak, which was in 2011. The sector is being boosted by a surging economic global recovery and pandemic related supply disruptions - leading to a "commodities squeeze". In a time of increasing demand there is a lack of ability to speed up supply (it takes time), leading to price increases. Mounting concerns over inflation have also attracted investors into the sector.

  The Financial Times said (01/05/21):

  *Booming demand for oil, lumber, food crops and industrial metals such as copper and iron ore shows little sign of slowing at the moment, with buoyant economic growth in both the US and China leading to significant demand for commodities.*

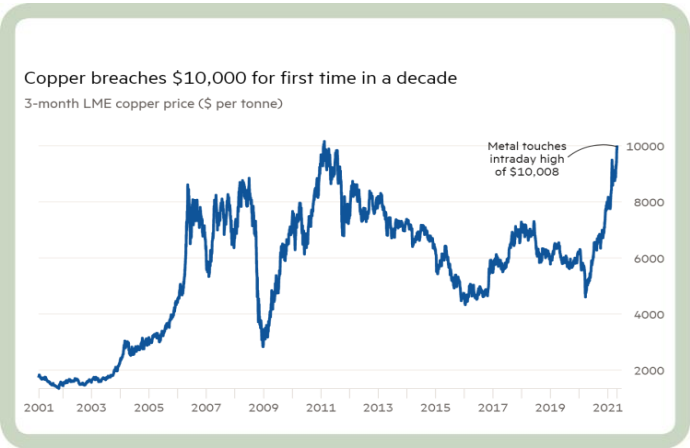
- Iron ore prices reached US$193.85 per tonne last week, a record high - according to S&P Global Platts. They commented:

  *"What we are witnessing is the continuation of a demand-driven trend that began exactly a year ago, when China saw a fast rebound in economic activity following its rapid exit from lockdown, which was immediately matched by a sudden spike in steel prices… And as the world turns to infrastructure to stimulate its post Covid-19 recovery, and as other industrial metals show comparable rises, it could indeed be reasonable to ask how much further this rally could go."*

- Copper prices continue to rise, lifting above US$10,000 per tonne last week - for the first time since 2011.

  The price is up 11 percent since the beginning of April and is nearing the all-time high of $10,190 set in 2011.

  The surge in the price of copper reflects a coronavirus-induced supply and demand imbalance that analysts believe could result in a 500,000-tonne reduction in refined copper stockpiles.




  Escondida, which is the world's biggest copper mine, recently reported an 8 percent drop in production (to 821,000 tonnes) in the nine months to the end March, due to difficult operating conditions in Chile from rapidly increasing coronavirus infections.

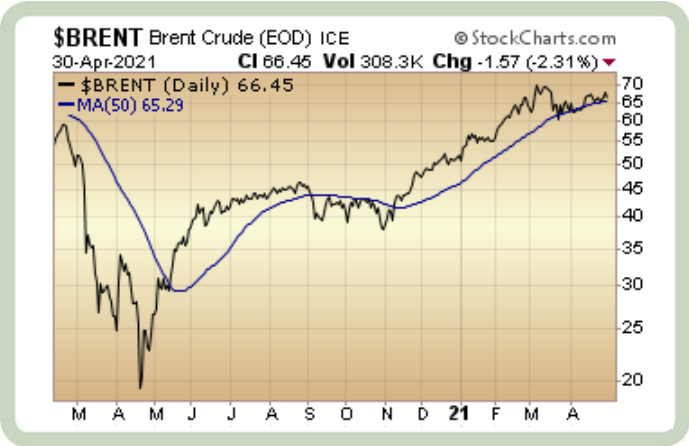
- Surging Chinese imports of a wide range of commodities have caused an increase in bulk-shipping rates, as industrial production underpins strong demand for inputs.

  China is the world's biggest commodity importer, making up roughly 45 percent of the seaborne dry-bulk market.

The Baltic Dry Index (shown adjacent) – an index tracking the costs of shipping commodities by sea – has reached a ten-year high of just over 2,800.


Daily freight rates for "Capesize" ships – the largest class of bulk carriers – have spiked to an 18-month high of around $35,000.

- Oil prices surged higher on Thursday, with Brent crude rising 1.8 percent to US$67.64, its highest level since mid-March and then slipped back on Friday.




The increasing trend is despite falling demand in India (which accounts for almost 6 percent of oil demand) as the country is engulfed in a massive Covid-19 outbreak. Furthermore, OPEC and its allies are preparing to increase oil supply from May onwards.

However, a bullish research note from Goldman Sachs said that there should be *"a significant rebound in global oil demand in coming months".*

Key to their opinion is a forecast improvement in daily Covid-19 cases for Brazil, China and Europe, as well as evidence of higher people mobility in countries with advanced vaccination rates… such as the US, Israel and UK.

## Real Estate

- Australian residential real estate prices are surging at their fastest rate in 33 years, according to CoreLogic. Reasons include expanding consumer confidence, super low interest rates, low housing inventory, government stimulus… and expectations of a strong economy leading out of the pandemic.

  However, auction clearance rates are moving lower and there were signs of a slowing in the market during March. But with the RBA unlikely to move interest rates until 2024 the outlook still remains positive.

  Meanwhile, the Australian rental market in the first three months of 2021 has seen rents rise by 3.2 percent – the fastest quarterly increase since 2007.

- Apartment prices in Australia's two largest cities - Sydney and Melbourne - have been lagging behind the residential real estate market. While the median growth in house prices for the year ended 31st March was 7.4 percent, for apartments it was just 2.3 percent. The

gap was the largest in Sydney, followed by Melbourne. In Sydney, the median apartment value rose by just 0.2 percent (to $755,360), while Melbourne's price lifted 0.9 percent (to $593,121).

The main reason is the restrictions on entry to Australia of overseas students and foreign workers.

- According to a recent paper by the New Zealand Ministry of Housing and Urban Development, 37 percent of property investors (107,530 people) reported an annual property loss to the Inland Revenue of an average of $9,000, because rents received did not cover outlays. This was a small decrease from the 116,000 people who declared a loss in 2016/17.

  However, interest rates have fallen from an average of 4.75 percent to 2.58 percent - which should have made a greater difference.

  Recent NZ government changes on interest deductibility may cause some investors to re-evaluate their investments.

**John Ryder and Devon Ashby**