NEWTON ROSS
PRIVATE WEALTH MANAGEMENT

15th April 2019

March 2019 Quarterly Report

The quarter marked a sharp recovery in investment markets as investors bought back into cheaply valued assets and as central banks globally, but particularly in the US, signalled lower interest rate policies in response to slowing economic activity.

The outlook for economic growth has certainly softened since mid-2018, but the prospects of any near-term recession are receding on recently better than expected economic data. Growth in China and the US appears to have stabilised while Europe continues to suffer from US/China trade war side-effects (falling German exports) and Brexit continues to weigh on confidence. The European Central Bank has indicated a preparedness to lower interest rates further.

At the time of writing, Brexit has been kicked down the road, while China and the US appear closer to some form of trade announcement. At home, NZ business confidence has weakened again while lower net migration and softening house prices and tighter credit conditions may impact domestic demand. On the flip-side, rising government spending and minimum wage increases will assist demand. The NZ Reserve Bank expressed concern for slower growth indicating the next interest rate move may be lower. Unless we see a marked improvement in data there is a market expectation that the RBNZ will cut rates in May.

Investment portfolios have enjoyed a strong start to the year and providing a recovery from the very difficult December quarter. While investment markets have improved as we predicted they would in January, the sharp fall then bounce is a reminder of the type of volatility we can expect through the latter part of this global economic and investment cycle. A cycle, which with easier central bank interest rates, has some way to run yet.

Kind regards,

Wayne Ross
Director Investments

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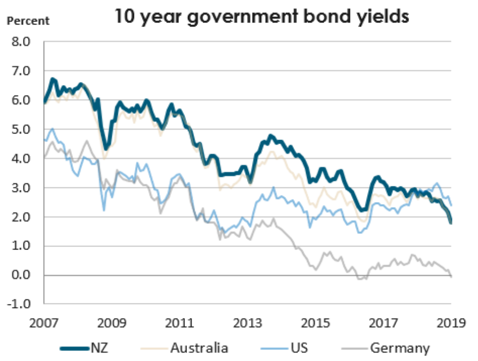
ECONOMIC AND MARKET SUMMARY

Last year's investment market correction reflected an overly pessimistic view of the global economy suggesting a near term recession was likely. Share markets retreated sharply and higher quality bond returns leapt as investors moved money into safe-haven assets. 10 Year Government bond yields came down so low they were implying an 80% chance (JP Morgan) of recession.



Source: Bloomberg

This view of recession was difficult to reconcile with what was certainly softer, though still expansionary, economic data. More than the economic data was saying, investors were reacting to the raft of negative geo-political issues in play including China/US trade tensions, US Government budget shutdown, Brexit and a US Federal Reserve dazzled by its own tighter policy headlights. Several things then happened in January. Trump provided strong indications a trade deal would be done (likely a wet blanket deal), China opened the taps on credit to stimulate growth and the US Federal Reserve finally blinked and announced rate rises were now on hold. Investors responded and moved money back into what were then very attractively priced markets including shares and higher risk bonds. Interestingly through this period, the NZ share market was one of the most resilient in the world and now stands at record highs once again.

With economic growth presently going through a dip, central banks are likely to focus on stimulating growth as opposed to worrying about inflationary pressures which remain remarkedly benign. With historically high employment levels and wages' growth starting to appear in many economies, it is difficult to see the trigger for any sustained economic contraction at this time. However, some economies are more reliant on export activity rather than domestic demand (emerging economies for example) and may have more difficult times yet.

The chart below from JP Morgan measures global economic activity intentions. It shows the run down from 2017 through 2018 but in February, and now March, there has been a bounce. We expect this bounce to be sustained with central bank encouragement, but unlikely to recover to 2017 levels. Consensus forecasts show slower (still positive) growth through 2019 and into 2020.

Global Purchasing Managers Index - Recovering

Source: JP Morgan Global PMI

With the sharp improvement in share prices and a softer background for growth what can we expect from investment markets going forward? Most global share markets are fairly valued (given weaker forecast earnings) when compared with historical pricing. The NZ share market remains one of the most expensive where the high yielding nature of our market combined with constant KiwiSaver inflows tends to underpin it despite the more challenging earnings conditions. Elsewhere, safer fixed interest or bond markets are more challenging with historically high valuations and very low yields. Bonds continue to provide some protection against volatile sharemarket conditions but at their currently very high prices, there is less room for benefit. NZ 10-year government bond yields (see chart column 1) are now lower than they are in the US and as at the end of March provided a 1.7% p.a. pre-tax yield which is a negative return after inflation! Term deposit rates are also moving lower as the RBNZ turns dovish and credit conditions tighten. Potential new bank reserving requirements may further weigh on term deposit rates through 2019. Property prices in Auckland have eased on better supply, lower net migration and tougher investment property tax rules. We expect property prices elsewhere to follow suit. As economic conditions bottom out and recover this part of the cycle, share prices should continue to improve as earnings stabilize and bond yields rise as near-term recessionary concerns abate.

The table below shows the gross returns (before tax) from the benchmark index for each asset class.

Market Returns	Mar. Qtr.	1yr p.a.	3yr p.a.	5yr p.a.
$NZ v TWI	**1.1**	0.0	0.5	-1.7
$NZ v $US	**2.3**	-5.6	-0.5	-4.7
$NZ v $AUD	**0.5**	1.6	2.0	0.4
NZ Cash	**0.5**	2.0	2.1	2.6
NZ Fixed Interest	**3.1**	7.4	4.3	5.7
Intl Fixed Interest 100% hedged to $NZ	**2.5**	4.5	3.1	5.5
Australasian Equities 50/50 Indexes	**11.1**	14.4	11.5	10.6
NZ Listed Property	**8.5**	24.0	9.5	14.2
Intl Equities 50% hedged to $NZ	**11.1**	6.5	11.2	10.0
Commodities $NZ	**4.5**	0.2	2.8	-4.4

SECURITIES RETURNS FOR THE QUARTER

The following tables show the returns from the securities recommended by NZ DIMS. Depending on your investment strategy you may hold all or only a portion of these securities and the returns for the securities held may also differ slightly depending upon cash flows and transactions in your portfolio over the quarter.

AUSTRALASIAN EQUITIES

Company	Sector	Quarterly Performance In NZ$ terms
New Zealand Equities		
Auckland Airport	Ports	15.5%
F&P Healthcare	Healthcare	20.8%
Fletcher Building	Building	3.1%
Freightways	Transportation	15.2%
Meridian Energy	Energy	24.5%
Port of Tauranga	Ports	10.3%
Stride Property	Property	6.2%
Trade Me	Consumer	1.1%
Vector	Energy	11.0%
Vista Group Intl	Software	30.9%
Australian Equities		
BHP Billiton	Resources & Energy	18.3%
Brambles	Professional Services	17.2%
CSL	Healthcare	5.4%
IAG	Financials	10.9%
National Australia Bank	Financials	4.5%
Scentre	Property	7.7%
Sonic Healthcare	Healthcare	13.4%
Westpac	Financials	3.0%

- Meridian Energy produced an excellent trading result during the period, improving both pricing and margins to wholesale buyers to increase net earnings by 18%. There was also a substantial reduction in regulatory risk as the Electricity Authority rejected a claim from retailers that electricity prices were being manipulated by generators. The shares were also in demand from investors looking for higher yields as interest rates fell to record low levels.
- Software and data company Vista International hit a 7 month high following another strong annual result. Revenue climbed 23% to $130.7m and profit was up 27% driven by a good year for the core Movio and Vista Cinema businesses. The company now employs almost 1000 people worldwide and since listing in 2014 the company has grown at 29% p.a. while the share price has increased fourfold. The company generates 32% of revenue from providing software as a service and this is a growing part of the business as they work with leading industry players such as Disney, Fox, Viacom, Odeon and Cineworld.
- Fisher & Paykel Healthcare announced they had settled all outstanding patent infringement disputes with competitor ResMed with no payment or admission of liability by either side. This helped overcome investor concerns about manufacturing delays and slowing growth in some areas of healthcare spending.
- The transformation in the BHP business continues with a raft of management changes announced during the quarter. This reflects the company exiting certain markets and focusing on conventional oil assets such as a potential bid for exploration company Bluewater.
- Brambles announced the sale of its IFCO reusable plastic crate business to Abu Dhabi Investment Authority for US$2.51bn which was an excellent sale price. The core pallet business produces higher margins than IFCO and US demand is expected to recover which will also support the share price. The company is returning US$1.95b from the sale to shareholders by way of a dividend and an on-market share buyback. This is expected to take up to a

Woodside Petroleum	Energy	14.0%
Woolworths	Consumer Staples	5.0%

- Woolworths announced an off-market buyback to return A$1.7b to shareholders from the sale proceeds of its petrol business. This will release significant franking credits for use by Australian shareholders which may make the 10-14% discounted price attractive from a tax perspective. All shares purchased by the company will then be cancelled to improve returns to remaining shareholders. The company has also completed its review of its 183 Big W stores and will close 30 of the budget department stores over the next three years in an effort to improve overall profitability. The review also recommended closing two distribution centres when their leases expire in favour of smaller centres closer to the most profitable stores.
- Trade Me shareholders have voted in favour of the $2.56b takeover offer by UK private equity firm Apax Partners. Shareholders will receive $6.45 per share which is above the independent valuation of $5.93-6.39. Trade Me listed at $2.70 per share in 2011 and has returned 188% to investors since then. Pending the final High Court approval, the company will de-list on May 5.

year to complete and will further improve their capital position.

- Sonic Healthcare posted a solid profit result as revenue increased In Australia after picking up the National Bowel Screening contract and organic growth continued in the US where hospital lab joint ventures are proving an excellent way to form partnerships with associated community labs. Competition remains tough in most markets and margins were slightly lower due to increased costs from regulation, consumables and employee wages.
- National Australia Bank announced a raft of management changes following the royal commission into the Australian financial sector which singled out the bank Chair and CEO particularly as being unwilling to own up for past misconduct. Both men resigned and have been replaced with interim management while the board searches for suitable replacements. This disruption poses a risk to the ongoing business strategy reset as management may be distracted by the search and any new CEO will need to address both immediate changes required and the future business direction.
- Woodside Petroleum announced a higher than expected dividend pay-out following a 28% rise in profit as production and prices increased. The company is aiming to double LNG production by 2027 and has set aside A$1.6b towards key development projects this year. Australia is already the world's largest LNG producer.

AUSTRALASIAN MANAGED FUNDS

Fund	Quarterly Performance In NZ$ terms	Commentary
Devon Trans-Tasman Fund	11.4%	The fund outperformed the market benchmark over the quarter due to overweight positions in Vista and Meridian and underweight positions relative to the market in Sky TV and Air NZ. The Australian property market being in the doldrums has not stopped the manager adding fibre cement board manufacturer James Hardie to the portfolio. JH operates in many different markets and the manager has taken an opportunity to build a position in the company following a period of share price weakness. China is an important driver for Australasian company growth and in a recent visit the manager confirmed that while the Chinese economy has slowed, it remains a powerful force and continues to demand commodities to address domestic capacity constraints in steel, aluminium, coal and iron ore as the government clamps down on local producers due to pollution and debt issues. Consumer confidence is slightly weaker (phone and car sales down) and there remains a large over supply in most property sectors but Government tax cuts and targeted infrastructure spending is helping to boost business confidence. The manager believes there are clear signs Chinese growth has bottomed and any US/China trade deal will cement this recovery.
Harbour Australasian Equity Focus Fund	8.9%	The fund underperformed the market benchmark over the quarter with Kathmandu, Syrah Resources and Abano Healthcare the key detractors due to short term concerns. The Kathmandu share price has fallen due to cyclical and seasonal concerns which have masked the good progress made in transforming their business from a leading Australasian retailer to a brand-led global multi-channel business. Positive contributions were made by Mainfreight, Vista Group and a new holding in Contact Energy which posted strong earnings due to higher wholesale electricity prices. An allocation to retirement provider Summerset was reduced following recent share price strength. The company has been experiencing strong unit sales but the slowdown in the NZ property market is impacting on the sector in general as many of the companies rely on property development to maintain profitability and distributions. Given the record low level of domestic interest rates the manager believes defensive stocks will continue to be supported near term by investors seeking yield. Over the medium term, equity market valuations are looking stretched and profits are likely to be taken and redirected towards companies exposed to the enduring core market influences of demographics, disruptive technologies and the rise in consumer spending in Asia.

INTERNATIONAL EQUITIES

Fund	Quarterly Performance In NZ$ terms	Commentary
Active Fund Managers		
Platinum International Fund	8.2%	The fund was up 8.4% in A$ terms for the quarter. The fund has its strongest quarter since March 2015 with holdings in the Asia Pacific region contributing the bulk of this return. The average return from long stock positions was 13% but the manager has been concerned with the valuation of some shares, particularly in the US, so has been holding cash and short equity positions which in this period combined to reduce the overall return. The manager notes that while European economic data has been soft and has dampened market returns the final Brexit outcome (whenever that may be) is unlikely to have major portfolio ramifications. Meanwhile Chinese stimulatory measures are starting to be noticed and the massive impact of China on world growth is being appreciated by more global investors. The portfolio continues to be positioned cautiously and is only 73% net invested with the manager uncertain about the disconnect between the strong rally in equity markets and the negative market signals from equity fund outflows and bond market yield curves.
Monks Investment Trust	16.9%	The fund was up 14.4% in GBP terms for the quarter which was above the market. This outperformance follows a weaker December quarter and it is a timely reminder of two important investment considerations. Firstly, a quarter is simply too short a timeframe for meaningful analysis of a long-term investment and secondly how an active manager constructs their portfolio needs to be clearly understood before reviewing their performance over any time period. Monks for example is a collection of 70-130 growth orientated companies out of a universe of 10,000 stocks. There is very little overlap with the market index (less than 10%) and companies are bought for their future (3-5 year) prospects so we expect and understand their performance will be more volatile than the market index. The manager looks to reduce risk in the portfolio in several ways. Inherent individual biases in stock selection are reduced by requiring a majority decision before trading a stock whereby at least 2 of the 3 managers agree. Portfolio holdings are diversified so that even a high conviction stock will only make up 2-3% of the total portfolio (incubator ideas are only 0.5%) and exposure relative to the broad market index is limited when compared to the region, industry and individual companies. Finally, the manager also considers how the portfolio might contain other areas of concentrated risk such as the number of companies that would be unduly influenced by movements in commodity prices and inflation.
Magellan High Conviction Fund	9.5%	The fund was up 10.0% in A$ terms for the quarter. The biggest contributors to performance came from Facebook and Microsoft. Facebook surged after higher than expected revenue numbers for the 4th quarter of US$16.9b showed users and advertisers were sticking with the social media company even though it has been troubled by privacy and other issues including live screening. Microsoft rose after releasing quarterly earnings that showed strong growth in cloud revenues. The key detractor was packaged goods company Kraft Heinz which dropped after writing down the value of underperforming brands by US$15.4b, dealing with a regulatory probe of its procurement department and being faced with rising input costs.

Passive/Index Funds		
Vanguard Intl Shares Select Exclusions Index Fund Hedged to NZD	12.3%	This fund provides passive exposure to all major developed share markets and is hedged back to the NZD. The fund is hedged to the NZ dollar which means values were not adversely impacted by the rise in the NZ dollar against the AUD (+0.5%) and USD (+2.3%). Global markets had their strongest start to the year since 1998 as the Fed indicated a lower path for interest rates which stimulated demand for equities and stimulatory measures in China gave investors confidence demand for physical goods would remain strong for some time yet. Just how long that confidence remains is the question however with debate continuing over when (or whether) these late cycle stimulus measures will peter out along with economic growth.
iShares Russell 2000 Index Fund	11.8%	These funds provide passive exposure to smaller companies in the USA and around the world. The funds are valued in USD. Not surprisingly after the disconnect of share prices from company fundamentals last quarter the weakest performers were among the strongest this quarter with growth companies beating value, and non-dividend payers outpacing dividend payers. The broad rally saw all 11 sectors of the Russell 2000 end the quarter in the black with Information Technology and Energy the strongest areas and Consumer Staples and Financials the laggards, the latter due to banks and insurance companies being negatively impacted by the US Fed deferring further interest rate hikes.
Vanguard FTSE All-World ex US Small Cap Index Fund	7.5%	
Vanguard Emerging Market Index Fund	9.2%	The fund provides passive exposure to companies listed in emerging markets and is valued in USD. Emerging markets rebounded in the quarter largely due to a stabilizing US dollar, perceived progress in US-China trade talks and recovering oil prices. The Chinese share market outperformed following tax cut announcements to stimulate growth and all markets were supported by the change in Fed policy. Lower interest rates and a lower US dollar place less pressure on emerging economies with high current account deficits or significant holdings of USD denominated debt. Despite the rebound many sources of uncertainty remain priced into emerging markets and this offers potential upside if they resolve favourably.

COMMODITIES

Security	Quarterly Performance In NZ$ terms	Commentary
iPath Dow Jones UBS Commodity Index Note	4.4%	The fund provides passive index exposure to commodities and is valued in USD. The oil price rebounded, up 25% for its strongest quarterly price gain in almost 10 years as OPEC delayed any decision to extend production cuts until June once the market has assessed the impact of US sanctions on Iran and the crisis in Venezuela. Base metals were the next best performing sector, up 11% as China and the US edged closer to a revised trade deal. Precious metals on the other hand have continued to languish with the gold price actually falling as investors switched attention to the strong equity market, and soft commodities such as grains saw falling prices as US supply increased more than expected.

NEW ZEALAND FIXED INTEREST

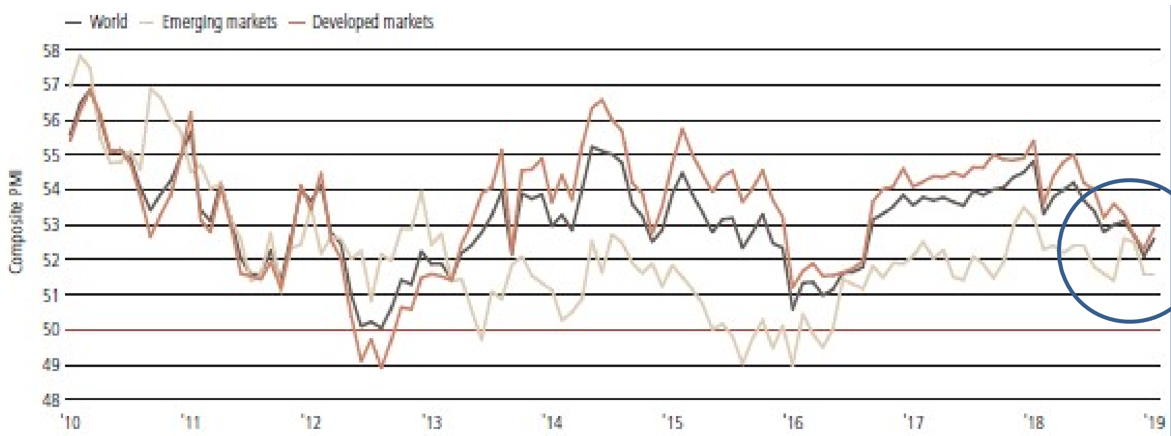
Security	Quarterly Performance In NZ$ terms	Commentary
NZ Government Fixed Interest	3.1%	After stating last quarter that the low Fed Funds rate was still far from neutral and lifting rates for the 8th time in this market cycle the US Federal Reserve. under pressure from pessimistic global share markets and sharply rising equity volatility, surprised investors by indicating they would be 'patient' on further rate hikes and 'flexible' on unwinding their balance sheet. At the same time, Brexit is still unresolved and the ECB lowered growth forecasts which saw German bond yields dip below 0% once again. The move by the Fed has become known as the Powell Pivot and rather than two more rate hikes in 2019 investors quickly priced in zero increases and even a potential rate cut. US long term rates have dipped below short-term rates which historically has been a precursor to a recession however there is much debate about whether this will happen given the structural changes which have occurred over the last 10 years. So, while US consumer spending and non-residential investment is slowing, leading economic indicators are not pointing to a US recession any time soon so the sharp drop in yields may be unwarranted. Certainly, the magnitude was not with much of the unusual price action seemingly due to investors using derivatives to quickly cover their previous bets in mortgage and low volatility trades. This buying to stem losses pushed yields much lower than fundamentals suggest (much like equites last quarter) and since hitting a low of 2.36% in late March, 10 year yields have moved back above 2.5% in early April.
NZ Corporate Fixed Interest Investment Grade Rating	2.3%	The Reserve Bank of NZ also surprised the market, explicitly introducing an easing bias by stating the more likely direction of short-term interest rates is down. This was perceived as a move by the RBNZ to 'jaw-bone' down the NZ dollar in order to stimulate the economy in line with its dual mandate. The RBNZ has not been the only factor pushing down yields, govt surpluses have reduced bond supply, fund managers have been buying longer dated bonds in line with benchmarks and there is concern that new capital requirements for banks will tighten monetary conditions. NZ 10 year bond yields dropped sharply over the quarter, down 0.6% to 1.75% and forecast rates are suggesting an OCR of 1.25% over the next 5 years which is well below the RBNZ estimated neutral cash rate. Our view is that at these low yields NZ bonds are too expensive and we note rates have since moved back above 2% in early April in line with moves offshore.

ECONOMIC COMMENTARY

Global Growth – China the Key

These days, it all seems to be about China. Whether the news is about US trade disputes, military expansion, cyber-attacks, intellectual property theft, advanced technology development, commodity demand or their "Road and Belt" initiatives and influences. And, there is a good reason for that. While China still lags the US in absolute economic size it still represents more than 55% of annual global growth. So, when China's economic data started to slow in 2018, the world particularly, key Chinese trade partners in the region, watched with increasing anxiety at China's economic prospects. At the same time, fiscal stimulus in the US is fading and Europe suffering from weaker internal demand while Germany's manufactured goods exports slid sharply lower. Meanwhile, Brexit continues to plague both UK confidence and increasingly impacting on EU economic activity as well. The recent delay for Brexit may provide some political room but will do nothing for business confidence. With the prospects for world growth easing to below long-term trend levels, investment markets reacted sharply in late 2018 building in a most pessimistic picture of likely recession. Equity markets were the hardest hit but were additionally impacted by high frequency program trading that thrives on large price movements and creates significant short-term price momentum and volatility. The wild swings were very uncomfortable for investors. It was an important time to keep an eye on long term fundamentals and to look through these market gyrations. Though cliché, sticking to strategy was critical for longer term investors over this period who would otherwise risk being caught trying to get out and then get back into such tricky market conditions. In the quarter, markets bounced sharply as two critical things happened. Firstly, the US Federal Reserve whom had been worried about inflation (with unemployment down to 3.8%) and achieving interest rate normalisation, did an about face on their tightening programme and indicated rates would be on hold and possibly continue to be so through 2019. The easier stance was not expected but provided immediate relief for share markets and sub-investment grade debt markets. Secondly, Chinese officials, increasingly worried about slowing activity went back to traditional stimulus levers releasing more capital for investment through reduced bank reserving requirements and announcing several significant new infrastructure projects. These actions also raised Chinese and global equity market sentiment. The March global Purchasing Managers Index graph above shows a small bounce over the March quarter. It is only one period but with some form of US/Chinese trade deal to be expected, Brexit moved down the road, extended monetary policy pauses and additional Chinese stimulus, the small bounce may develop into a more positive trend from here and extend the global economic cycle further.

Global PMIs are now consistent with Trend Growth (51.7) and in expansionary territory (>50)

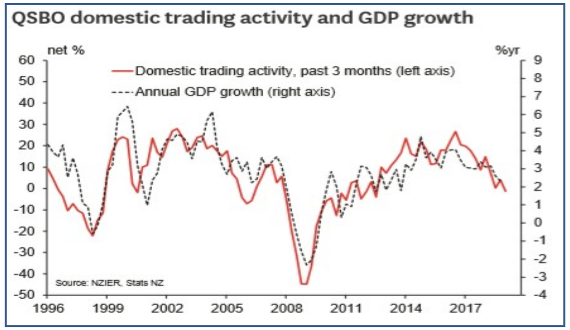


Source: UBS Asset Management, Macrobond as of March 12, 2019

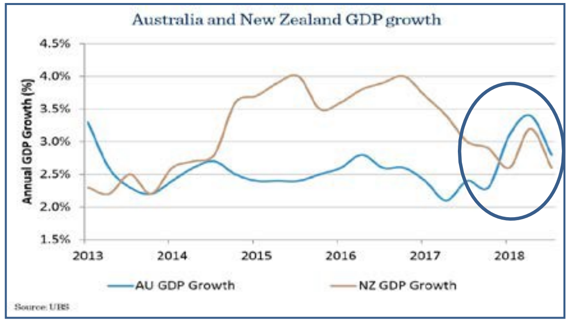
New Zealand

After a brief lift in business confidence in the December quarter (good weather and holiday prospects?), confidence (see chart opposite) deteriorated quickly again in the March quarter back to a 9 year low and worryingly the fall in confidence is broad-based reflecting weaker own business activity and falling investment intentions. Firms are seeing margins compressing on higher wages and other higher input costs which is impacting profitability. Westpac commented that rather than regaining momentum in 2019 the economy just seems to be ticking over. With inflation still contained (slightly above the 2% target), the Reserve Bank is focusing on softer global growth risks and weak business sentiment. The RBNZ announced an easier rate outlook at their recent OCR review and opened the way for an interest rate cut (probably in May). This change in policy setting provided some necessary relief for our persistently high dollar which was being underpinned by lower global interest rate settings. NZ GDP growth in the December quarter was 0.6% (2.5% annualised) and slightly better than expected. Strong retail sales, construction activity and increased Government spending also assisted. Looking ahead, higher minimum wages (from 1st April), full employment conditions, lower interest rates and further Government spending programmes should boost consumption. The lower NZ dollar should also assist terms of trade. On the negative side, lower net migration (less applicants), foreign buyer restrictions, record consent issuance, capital gains taxes (likely), tougher bright line tests, tax loss ringfencing and tighter credit conditions are combining to push house prices lower. Falling house prices will impact household confidence and spending. March consumer confidence data is lower across all income and age groups and regions and nearing 6-year lows. We expect activity will stabilise over the rest of the year as offshore conditions improve and government spending continues. With further planned rises to minimum wages some work clearly needs to be done to restore business confidence and investment.

NZ Business Outlook Weakens



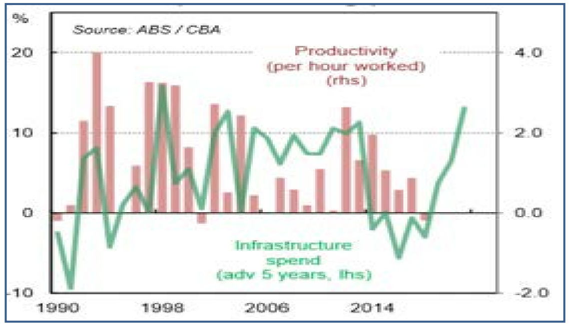
NZ and Australian Economies



Australia

The Australian economy slowed significantly over the second half of 2018 as house construction and house prices declined markedly across most major cities on much weaker credit conditions. This is impacting household confidence and spending while wages growth also stalled. The CBA Purchasing Managers Index fell below 50 in Q4 indicating a contraction in activity but then rose back above 50 in March on stronger services. Commodity prices have also recently lifted, particularly iron ore, on stronger Chinese demand and tighter global supply. With a long-projected return to budget surplus, the Australian Government (with an election now in May) has promised tax cuts and increased infrastructure spending (now booming). This would provide a fiscal lift for the economy. The RBA kept rates on hold but and has left room for easing with some commentators picking a rate cut this coming quarter as they worry about the negative wealth effect from falling house prices. A recession is however unlikely given full employment levels, upgraded business investment intentions, trading surpluses, budget surpluses and the planned fiscal stimulus. Australia enters its 28th year of consecutive growth presently forecast to come in at a slower but still solid + 2.5% in 2019.

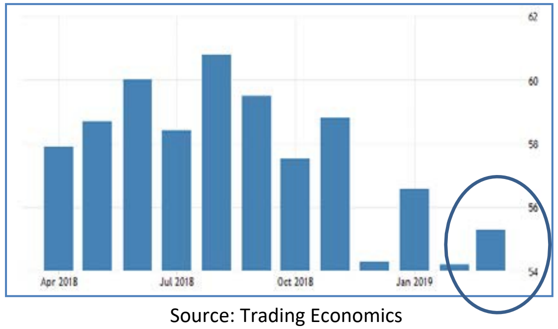
Australian Infrastructure Helping



US

The world's biggest economy clearly decelerated through 2018 and finished the year weaker. Though US macroeconomic conditions remain solid, the Chinese trade war, Federal Government budget impasse and spending shutdown, reduced global economic momentum and volatile market conditions all weighed on consumer, business and government activity. With core inflation (2.2%) and wage inflation still in check, the US Federal Reserve had room to respond to the softer conditions in January and moved to an easier stance pausing rate hikes and adjusting the bond sales programme. The easier outlook took markets by surprise and triggered a sharp rally in markets. There has been much speculation that the Fed is becoming increasingly influenced by Trump's desire to let their economy 'run- hot'. More recent March data shows activity is improving with strong job numbers, a rebound in consumer confidence, greater construction spending, better manufacturing data (ISM index 54.2) and a rise in new home sales. Personal incomes also rose in January. Other data remains mixed but generally strong to suggest a further positive bounce in activity is likely in the coming quarter particularly, should a US/China trade deal complete. The Trump tax cut stimulus has begun to fade but additional government spending - despite a record Government deficit - is very likely as Trump prepares for 2020 electioneering. The strong labour market is expected to keep the US running at above trend growth in 2019 (2.5%), the question is how the US Federal Reserve will react to greater wage inflation pressures should they arise. An additional rate rise this year may be still on the cards though this is not priced into markets.

US Purchasing Managers Index Bounce

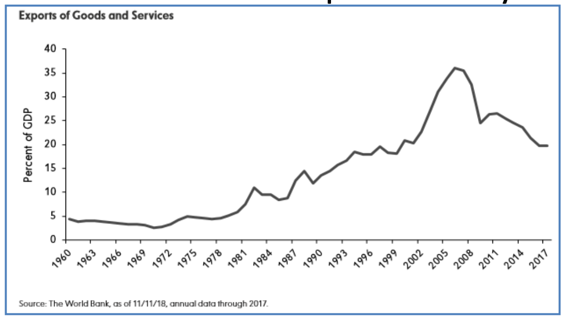


Source: Trading Economics

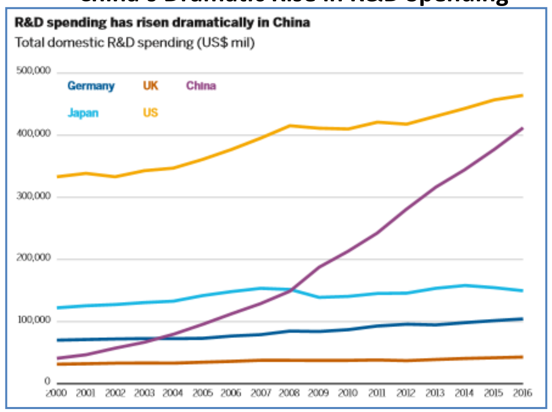
China

Growth in China slowed during 2018 from 6.8% at the beginning of the year to 6.0% by year end. However, these are official numbers and actual growth is likely to be less. While the trade dispute with the US has had an impact on activity, China's focus on financial deleveraging and their structural shift to a higher value-add domestic demand driven economy is also contracting their rate of overall activity. Much of this is intentional as they head for quality and seek to move away from inefficient (and highly indebted state-owned enterprises) and more to private sector initiatives. This includes opening up their capital markets to more transparent funding and pricing, allowing foreign access and shrinking 'shadow-banking' activities. The graphs opposite show how China is becoming less reliant on exports (less than 20% of their economy now) and how they have dramatically increased research and development in the quest for higher value activities. Significantly, low value, labour intensive manufacturing has been shifted offshore to neighbouring countries and this trend will likely accelerate. We expect some resolution in the current China/US trade dispute, but it will be a 'window-dressing' exercise only. China is now a world leader and power but also needs to move more carefully with the US (and increasingly Europe) to avoid overreaching and escalating global tensions beyond trade. The US seems to be winning more bi-partisan support to its China views as seen by the Huawei 5G roll-out concerns. More recently Chinese officials have turned the stimulus back-on through easier bank credit and targeted infrastructure spending. For the first time in four months China's Purchasing Managers' Index moved back above 50 into expansionary territory providing setting the scene for a stronger cyclical upturn this coming quarter. As New Zealand and Australia's largest trading partner, a healthy Chinese economy is important for our own.

China Less Reliant on Exports – now only



China's Dramatic Rise in R&D Spending



NEWTON ROSS
PRIVATE WEALTH MANAGEMENT

Europe

Germany has long been the key driver of Euro growth with its manufacturing exports underpinning the region. German factory orders fell sharply over 2018 as new domestic emission standards impacted auto manufacturing, orders from China dropped and global trade tensions continued to rise while Brexit stewed. The German Purchasing Managers Index (PMI) fell to a 6year low - though was still expansionary. German business confidence also fell through 2018 and even recently the Trump administration was still calling for additional tariffs on German cars. Elsewhere in Europe soft private consumption, industrial disruption, election distractions and a political and financial crisis in Italy have added to the threat of a hard Brexit withdrawal (now alleviated). Post March data has been slightly more positive with the Europe PMI moving up to 51.6 and business surveys improving (first rise in 6 months). The European Central Bank has responded to the softer conditions delivering a new round of cheap financing for Eurozone Banks but is becoming increasingly trapped by its zero-rate strategy. Europe needs a US /China trade resolution as it is directly impacting Euro exports. Despite trade headwinds, conditions should improve given relatively strong employment, a low euro and cheap financial conditions. Growth for 2019 is forecast at 1.4%, a long way from the stellar 2.5% growth rate of 2017.

German Factory Orders Fall Sharply

UK

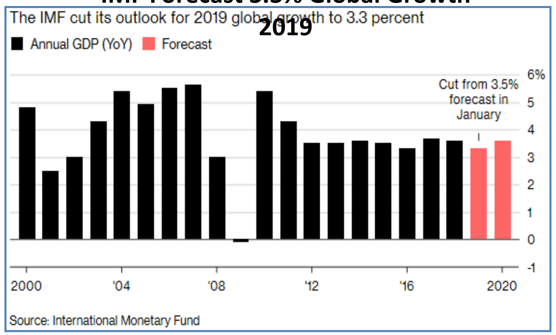
Brexit. At the time of writing May had won an EU delay to 31st October. The UK Parliament is divided into four groups, leavers, stayers, partial stayers and those wanting to ask the public again. There is no obvious way forward and with the extension granted, an election will most likely be called and possibly, though less likely, a second referendum. An election appears to be the only mechanism that can potentially reshape the power in a Parliament that has failed its people. Bank of England Governor Mark Carney said the UK is better prepared for a hard Brexit but warns the economic impact would be substantial. In the meantime, the UK economy bravely soldiers on and though services are contracting it's manufacturing was strong in the first quarter (PMI rising to 55.1 in March) ironically as businesses built up inventories ahead if a hard Brexit risk. Full employment (3.9% unemployment) is supporting consumption while exports are steady and Government spending increasing. Growth for 2019 is uncertain but tracking at 1.4%.

UK Constitutional Crisis

Japan

Following a series of natural disasters, Japan finished 2018 relatively well with a 1.9% annualised Q4 growth rate. Weaker demand from China and the US/China trade dispute impacted exports early in the quarter but there are now signs of recovery with their manufacturing PMI index rising in March. Critically, Japan is now lining up for bi-lateral trade negotiations with the US as Trump sets out to address the US90bn trade imbalance.

IMF Forecast 3.3% Global Growth 2019



Emerging Markets

Developing economies have been under pressure from the trade tensions, US dollar strength, rising interest rates, capital outflows and rising energy costs. Emerging country growth, typically more export reliant, has been markedly weaker and more impacted by the trade dispute than developed economies. A recovery in commodity prices and easier US rate outlook will be supportive. India is expected to pick-up (WEO Update) over 2019 while Asia, emerging European countries, Latin America, MENA countries and CIS states will likely moderate further over the year.

MARKET COMMENTARY

Summary

Markets recovered strongly in the first quarter following a sharp sell down at the end of 2018. The sell down was driven by concerns for economic growth and a raft of geo-political risks. Since then, more accommodating central bank policies and stimulatory fiscal action from governments has stabilised the prospects for economic activity in China, the US, Japan and Europe. Global economic growth - while slowing (currently about 0.5%) - is still forecast to be above the long-term trend at 3.5%. Recent data is again more encouraging and suggesting a 'bounce' in growth rather than the slide into recession that investment markets were predicting and pricing in late last year. From here, we expect conditions will gradually improve though market volatility will remain elevated as the various geo-political risks swing investor sentiment around as they play out. Valuations are becoming stretched again for some assets (NZ shares) and this means there will be periods of market weakness as profits are taken. While some type of recession or end of economic cycle is inevitable, we believe the present economic cycle has some way to go yet and should be supportive for investment returns.

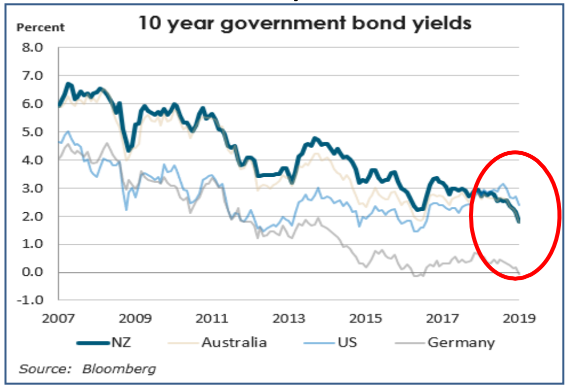
Cash & Fixed Interest

In a sudden departure from its previously hawkish language, the US Federal Reserve surprised markets by announcing a more accommodating approach to its monetary policy in January. This did not rule out additional rate rises but left the door open for a pause in 2019. They also reduced the pace and profile of their bond sales programme designed to reduce the size of their holdings which have accumulated since 2009. The change in messaging provided immediate and sharp relief for global equity markets and fixed interest markets that had both been pricing for recession. Following suit, the Reserve Bank of NZ not only kept the cash rate at 1.75% but provided a more cautious outlook for growth suggesting the next likely interest rate movement might be down. They are likely to cut the rate back to 1.5% in the May Monetary Policy Statement. The RBNZ was also trying to talk our dollar down which has been persistently strong and additionally exposed to easier offshore central bank statements. The European Central Bank, clearly concerned with softer Eurozone data and global trade risks also announced an easier stance. This saw the Euro move lower which should help with currently soft export orders. The US bond market temporarily experienced an inverse yield curve (very short-term rates higher than 10 year bond yields) in the quarter and this event has a high correlation with near-term recessions. The curve has since normalised though remains very flat. Over the quarter, long dated global bond yields fell sharply and prices rose as money sought safe haven assets, particularly sovereign bonds. More recently, bond yields have started to rise again as the prospects of recession recedes though any large rise is likely to be contained while inflation remains benign. NZ bond yields rallied down to 1.7% but have sold back up to 2.05% within 10 days of quarter end. NZ bonds remain at an abnormal discount to US bonds reflecting the ongoing demand

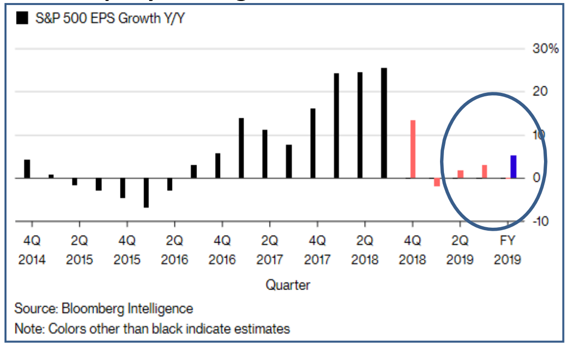
Sharp Recovery for Sharemarkets

World Indices:	31/03/2019	YTD % Change Local Currency	YTD % Change NZ Dollar
Dow	26,258	12.6%	11.1%
NASDAQ	7,829	18.0%	16.4%
SP500	2,867	14.4%	12.9%
Japan TOPIX	1,616	8.1%	5.0%
Germany	11,682	10.7%	6.7%
UK	7,317	8.8%	10.3%
China (MSCI)	97	15.2%	16.5%
Australia (ASX 200)	6,217	10.1%	9.7%
NZ 50 Gross	9,854	11.8%	11.8%

Bond Prices Rally as Yields Fall



US Company Earnings Growth 5% Forecast 2019



NEWTON ROSS
PRIVATE WEALTH MANAGEMENT

from overseas investors looking for diversification benefits. Term deposits do not provide the interest rate certainty of longer dated bonds, but with our historically low NZ bond yields, term deposits are often providing a more attractive alternative for shorter term investments and are increasingly being used for fixed interest portfolio exposure.

Equities

Sharemarket valuations became very attractive following the sharp corrections in December. Forecast price to earnings ratios at that time were at multi-year lows for many markets. As expected, funds flowed back into oversold markets in the quarter, but especially accelerated once the US Fed announced its policy pause. Even though slowing economic growth reduces earnings growth prospects (see US company earnings growth forecast graph), share markets still remain at fair to reasonable values. Global, US and Australian market PE's are now trading between 15x and 17x with European market PE's lower and around 14x on their greater earnings uncertainty. Meanwhile, our NZ market remains an expensive stand-out with PE ratios again greater than 20x at the end of the quarter. Other composite valuation models also show our market to be overvalued. Even at these elevated prices, our high dividend paying share market continues to provide an attractive yield (though far higher risk) than cash and bond yields (see chart opposite) while the steady flow of KiwiSaver funds into the market also helps to underpin prices. On paper, offshore markets look better value but the NZ market has consistently performed better over recent years despite elevated valuation levels.

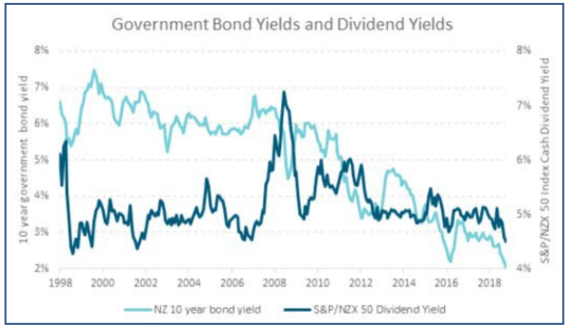
Property

NZ residential sales volumes have been falling (-9.5% yoy), but prices have been remarkably steady nationally - though weaker in Auckland (-2% yoy). Anecdotally, Auckland asking prices are now starting to appear more in advertisements and there are more reports of sales at or below CV. Better housing finance numbers in February may assist with demand but the taxation rule headwinds, foreign buyer restrictions, lower net migration and better supply will continue to weigh on Auckland house prices. Across the ditch, the important Sydney and Melbourne residential markets may be bottoming out after their large price falls in 2018 (see graph opposite). Meanwhile NZ commercial property market remains very well bid as investors continue to seek alternative yields to cash and bonds. Property capitalisation rates compressed further over the quarter on tight supply. Rents are also rising. Auckland office supply remains extremely tight (prime property at 3.5% vacancy) but should ease with many major projects completing in the CBD in 2020 while Wellington's supply has recently improved on the completion of the Deloitte and PWC buildings. Auckland industrial property is now at a record low vacancy rate (1.7%) leading to higher rent reviews.

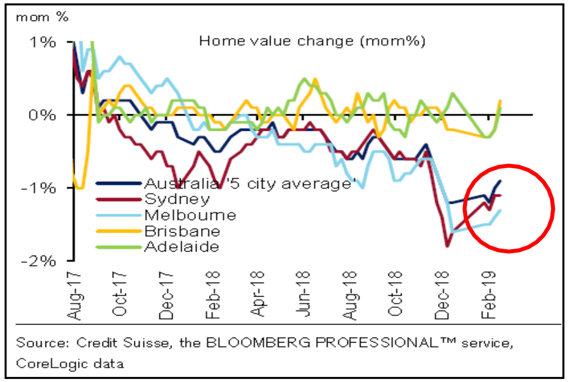
Commodities

Commodity prices are now recovering from a difficult 2018. Prices drifted down last year on weaker net global demand but supply pressures, for iron ore and copper (Vale mine closure Brazil) and lower NZ milk production has combined with recently improved Chinese demand is supporting a recovery for many commodity prices. Oil has also recently lifted on restricted supply from Libya, Iran and Venezuela while the ongoing US/China trade war is leading to stockpiling for several key US agricultural commodities.

NZ Dividend Yields vs Government Bond Yields



Australian House Market Bottoming?



Commodities Improving