mint
ASSET MANAGEMENT

Quarterly Fund Report:
Mint Diversified Growth Fund

DIVERSIFIED FUNDS

Mint Diversified Growth Fund

Investment Objective

This is a multi-asset class Fund that offers a diversified portfolio and aims to provide capital growth over the long term. The Fund invests primarily in New Zealand and international equities (including listed property if held) but will also hold cash and fixed interest securities. The objective of the Fund is to deliver returns in excess of the Consumers Price Index (CPI) by 4.5% per annum, before fees, over the medium to long term.

Market developments

The start of the year was very strong for risk assets. The global stock market climbed 8.9%, marking its best start since 2019. The S&P500 returned 10.6% in the quarter and set a new high of 5245 at the end of March. Robust US economic data was a key driver, having surprised on the upside. While Europe, China, and Japan have seen substantial slowdowns, the US economy remained strong. As a result of strong GDP, manufacturing and employment data, markets pared back interest rate cut expectations in the US from a total of 1.75% to just 0.75% cuts by the end of the year. Yet, this has not stopped the bull market as the narrative shifted to corporate earnings and the ability of companies to grow earnings despite higher interest rates.

A mix of mega-cap tech stocks, led by AI leader Nvidia, played a pivotal role, with the stock soaring an impressive 82% during this period. Stocks from technology and communications sectors, including AMD, Oracle, Microsoft and Netflix, led the charge with double-digit gains.

The bond market presented a more nuanced picture, reflecting investors grappling with interest rate expectations and inflation uncertainties. Global bonds slid by 2.1%, impacted primarily by long-term bonds, which are more sensitive to interest rate changes. Domestic corporate bonds rose by 0.6% over the quarter.

The ongoing inversion of the yield curve, where short-term yields exceed those of long-term bonds, persisted into its sixth consecutive quarter. This unusual length without a consequent economic downturn has led many market participants to anticipate a 'soft landing', a scenario where the US Fed can bring inflation back to the range without a recession rather than an imminent recession.

The commodities market saw significant movements, particularly in oil prices, which surged amid geopolitical tensions, and production constraints, closing the quarter above $83 per barrel.

How the quarter unfolded

2024 was billed as the year that the cohort of global central bankers would collectively conclude they have slayed the inflation beast. 'Team Transitory' were dusting off the champagne flutes and preparing to celebrate the normalisation of interest rates back to palatable levels. However, the exuberance that was reached in November/December was not to be relived as noisy economic data put paid to the notion that it is going to be smooth sailing back to the target inflation range.

In the beginning of the quarter we had the spectre of sticky shelter inflation in the US rear its ugly head again with a slight upside miss to US CPI of 3.1% vs 3% on an annual basis – with the shelter component above 6% and accounting for over 1/3 of the CPI basket. Other hawkish data surprises came out in the US which moved global bond yields higher – Advance GDP estimate for Q4 were healthy at 3.3%, implying the economy could easily stomach higher interest rates. Domestically, NZ Q4 inflation reached 4.7%, a significant improvement from where it had been previously. However, reactions to the release were mixed as the non-tradables inflation basket (an RBNZ favourite) stayed uncomfortably high at 5.9%. This, plus the combination of global bond yield movements, pushed up NZ yields in January.

It was not all a washout for the dovish market watchers. In the US PCE inflation came in below expectations (the Fed's explicit inflation target). Interestingly, Australian Q4 CPI came in well below expectations, sending AUD swap rates down 0.2% on the day.

Helpfully, for the funds, equity markets in January still found ample support. However, fixed income suffered as yields started to rise in the face of increasing investor uncertainty about the path of deflation and our long-duration positioning was a detractor following the market reassessing the path of monetary policy easing over 2024.

Going into February, we focused on two key dates: the release of NZ Q4 unemployment statistics and the result of the RBNZ Monetary Policy meeting. Unemployment came in lower than market expectations, and the RBNZ forecast (4.2%) at 4%. Perversely, a low unemployment rate was 'bad news' for investors as it implied the tightness in labour markets had not dissipated, and there was less headroom for interest rate cuts. On the back of this release, one of the NZ bank's chief economists went against the grain and called for two more interest rate hikes.

We had high conviction that this was an ill-advised call given the leading indicators for the labour market and our view on economic growth and inflation in NZ. However, markets did shift initially on the unemployment news and then again on news of the revised forecast – certainly testing our conviction. All eyes were on the RBNZ – which came out surprisingly dovish and sanguine on the recent data releases; they were cognisant of the lagged effect of monetary policy and the deflationary impact of high net migration on the economy's supply side. The dovish 'tilt' was evident in revised RBNZ forecasts, which acknowledged the weaker starting point for GDP and the anticipated increase in unemployment towards the latter half of 2024. NZ yields fell, and bonds rallied as a reaction to the meeting – a helpful tailwind for the fund's fixed income performance at month end. Equities had another strong month with global market rising over 4% in February.

Going into March, attention turned to the Swiss National Bank as they became the first developed-market central bank to pivot and cut interest rates in the face of moderating inflationary pressures. Other signs that inflationary pressures were easing were the increase in US unemployment to 3.9% and Eurozone inflation coming back to the target range at 2.4% year on year. The Fed released their much heralded 'dot plots', which still showed interest rate cuts in 2024, but one less than had previously been forecast. In NZ, we had a stark reminder of the pressure the higher interest rates have on the domestic economy, with GDP coming in at -0.1% quarter on quarter, pushing the economy into recession for the second time in the last 18 months.

However, nothing is ever smooth in fighting inflation - there were some strong consumer expenditure numbers in the US, with retail spending up 0.4% month on month. There was a surprising resurgence of the manufacturing sector as the ISM manufacturing index moved from contraction to expansion in March. Within NZ, there were some punchy moves within the monthly inflation indicators, implying that there could be some upside risk to the RBNZ's pick for Q1 24 inflation – further dampening the probability of an imminent interest rate cut. Strong US consumer and manufacturing data pushed equity markets higher with the US market setting a new all-time high in the end of March.

Overall, the robust economic data resulted in a strong positive contribution from global and Australasian equities, whilst fixed income contribution was only slightly positive following markets repricing interest rates expectations.

Outlook moving forward

We have been in the 'soft landing' camp for over a year and continue to see this outcome as the most probable scenario for 2024.

Going forward, the path to interest rate cuts is still fraught with risk for all central banks. Getting inflation to the target range while allowing for lags between monetary policy and the real economy is challenging.

Our funds are still positioning for an easing in monetary policy, and the fund's long-duration positioning hopes to benefit from that movement lower in yields. However, as monthly data releases happen, there is still a high probability of volatile markets as traders try to get ahead of any central bank movement. The risk is that of re-emerging/reacceleration of inflation in that it is one of the few scenarios where equities and fixed income do not provide positive returns. We are confident that is not a likely scenario and actively monitor leading indicators and macro developments to ensure we are ahead of any inflationary pressures before they take hold.

In particular, the oil price shock remains a key risk to the "soft landing" scenario, as the price surge could result in strong inflationary pressures, stopping the Fed and other central banks from cutting interest rates later this year. Geopolitical tensions remain high, and we closely monitor the developments in the Middle East.

We remain positive on the markets going into Q2 2024. We hold growth and quality stocks, and a long-duration in bonds.

Portfolio Manager, Marek Krzeczkowski

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Marek has over 16 years' experience in the investment sector focusing primarily on quantitative analysis, investment research and financial modelling. He arrived in New Zealand in 2016 from Edinburgh where he managed the Investment Research Team at Tcam Asset Management and was responsible for helping to formulate and implement the firm's investment strategy.

At Mint, Marek is the Portfolio Manager for the Multi-asset class funds. He is also responsible for Strategic and Tactical Asset Allocation.

Signatory of:

PRI Principles for Responsible Investment

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riaa Responsible Investment Association Australasia

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