# Optima Wealth Winter Update

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Whether you own a TV or radio, read a newspaper, or get your news online, it's a fairly safe bet that the bulk of the economic news you are receiving at the moment sounds fairly gloomy.

Even if we could ignore the news, which is often more noisy than informative, we can't easily ignore that the price of food, petrol and many other essential goods have been rising sharply in recent months, putting pressure on household budgets.

This comes at a time when New Zealand house prices also seem to have peaked. After having accelerated strongly throughout much of 2021, helping homeowners at least 'feel' wealthier, housing market indicators now suggest prices could be easing in many regions. And, while the housing market begins to cool, mortgage rates are heading in the other direction (higher), which will only serve to crimp discretionary spending even further.

As spending reduces across the economy, and without our border and immigration policies currently enabling enough visiting holidaymakers or migrant workers to take up the slack, the immediate economic outlook appears weaker than the post-covid global reopening world that many envisaged was awaiting us this year.

While New Zealand's official unemployment rate is at record lows, and our exporters continue to perform fairly well supplying a world still scrambling to satisfy widespread food and commodity shortages, these appear to be isolated rays of sunshine peeking out from behind a thickening bank of economic cloud.

Consumers and businesses have shown great resilience over the last few years. But the economic environment continues to be challenging and the pathway towards a sustainable economic recovery (perhaps with an initial period of low or negative growth), is unlikely to be smooth.

### Inflation pressures

One of the elements that will have a bearing on the shape and speed of the recovery will be what happens with inflation.

The roots of the current surge in global inflation can be traced all the way back to the start of the Covid-19 pandemic, when a large imbalance between the supply and demand for goods emerged.

The global economy contracted sharply in the first half of 2020 as lockdowns were imposed, but what followed was a highly unusual recession as households were largely shielded from economic pain. Many were able to continue to work from home on full pay, while others had their balance sheets protected by various government payments and employment subsidies such that, in aggregate, net savings rose sharply.

With consumers relatively flush with cash and most parts of the global economy still closed, notably the services sector, this pent-up demand was directed into the goods sector and, in New Zealand's case, the housing market.

While the supply of goods can often struggle to keep pace with demand shocks even in normal economic times, strains on production were amplified by Covid lockdowns and the simultaneous disruption to global supply chains. Shortages of goods caused supplier delivery times to lengthen, and the deteriorating imbalance between supply and demand flowed through to consumers in the form of higher prices.

More recently, the spill-over from the tragic events in Ukraine has only exacerbated these underlying inflation trends as commodity prices have soared, lifting inflation even further.

However, inflation has begun to show some tentative signs of softening, even if the official (backward looking) figures still look strong. Global shipping rates spiked during the pandemic due to supply chain constraints, and the higher freight costs were typically passed on to consumers. However, the Freightos Baltic Index (FBX) Global Container Index suggests these are now well off their highs, having fallen to around US$6,500 per container, compared with around US$11,000 per container in late 2021. It is a tangible sign that some of the recent freight congestion is finally starting to ease.

Similarly, higher oil prices have been hurting consumers at the petrol pump with the international oil price rising from around US$50 per barrel in February 2020 to around US$120 per barrel by early June 2022. However, in the last few weeks the oil price has moved steadily downwards to hover around the US$100 per barrel level. Price declines have also been seen in some other key industrial commodities such as copper, which is used in building construction and electronic product manufacturing. After more than doubling in price from March 2020 to the end of February 2022, the copper price has eased over 20% since.

All of these more recent price trends help reinforce the idea that inflation, whilst continuing to be problematic now, may begin to ease over the remainder of 2022.

**Economic growth**

As central banks have been steadily revising their inflation expectations upwards, these have been accompanied by downward revisions in projections for global GDP growth.

The recent World Bank Global Economic Prospects Report highlighted this only too clearly.

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In January, it forecast global growth for 2022 of 4.1%, but barely six months later, in its June update, this was cut sharply to 2.9%, a nearly one-third reduction from its earlier estimate.

Economic activity has so far been relatively robust as consumers have shown an ability to absorb higher prices, in part due to running down the savings they accumulated during the initial phase of the pandemic. The subsequent tight labour market and pick-up in wage growth has also helped. While these factors should remain supportive for a time, some cracks have begun to emerge on the demand side of the global economy.

With inflation outstripping wage growth in most countries, a squeeze on real incomes has started to erode consumer confidence. Some measures of consumer confidence in the US and UK have fallen to levels not seen since the global financial crisis, while confidence is declining in Europe. It's the same in New Zealand with the 'cost of living crisis' now widely recognised as the number one issue facing households.

All of this suggests that consumers may soon be less willing (or able) to tolerate higher prices in the future, and there is even a risk of outright declines in demand. In the case of recent oil, copper and other commodity price declines, this adjustment may already be underway.

Meanwhile, now that central banks are finally getting on with the job of raising interest rates and global bond markets price in additional rate hikes, there are also signs that tighter financial conditions are starting to have an impact.

In the US, 30-year mortgage rates have climbed to 5.7% in mid-June, the highest level since 2008, and this has coincided with a deterioration in US housing market.

The New Zealand housing market is also showing clear signs of having cooled from the FOMO (fear of missing out) days of late 2021/early 2022. The Reserve Bank of New Zealand was amongst the first of the global central banks to begin raising interest rates late last year, and with floating mortgage rates now nudging 5.5%, we are seeing more regular commentary suggesting a slowdown in house sales. In some regions, house prices may already be easing.

All of this makes for a very difficult environment for policymakers. Faced with widespread pricing pressures, central banks have determined that tackling inflation is their highest priority, and higher interest rates are the primary tool at their disposal to achieve it. Therefore, as long as inflation remains a concern, central banks will likely continue raising interest rates while maintaining cautionary forward guidance, in an effort to cool activity.

**Bear markets**

As if this escalating inflation and weakening economic growth environment wasn't enough, the ongoing war in the Ukraine and the drawn-out global impact of Covid, are other factors continuing to create uncertainty or unease in the minds of many investors.

In general, when investors are feeling happy and confident, they are often more comfortable allocating to higher risk investments. However, when they are lacking in confidence, they are less inclined to take higher risks. Market commentators have a specific phrase for this general investor attitude, they refer to it as 'investor sentiment', either positive or negative.

Recently, investor sentiment has been more consistently negative. And it is with this backdrop that global share markets have been struggling over recent months.

On 14 June, the main New Zealand share market (the S&P/NZX 50 Total Return Index) slipped into official 'bear market' territory. A bear market is generally defined as a decline of at least -20% from the prior market peak, which in New Zealand's case was on 4 October 2021. At time of writing, the S&P/NZX 50 had since rallied a little, reducing the size of this decline, but nevertheless it reflects a very tough period for local share market investors.

This is not an issue unique to New Zealand. The globally significant US share market has had it even worse. The headline S&P 500 Index similarly fell into bear market territory on 13 June, while experiencing its worst first half of the year since 1970. The other high profile US index, the Nasdaq 100 which includes all the large technology companies, ended June over -30% below its peak of 27 December 2021.

These returns are reflective of markets that are facing a range of uncertainties and they are therefore pricing in a high degree of caution or pessimism. But that doesn't mean that the returns outlook for the months ahead is necessarily poor.

When we review historical data (back to 1940) using the leading US share market index as our reference (the S&P 500 index), the chart below summarises the average one, two and three year performance of the S&P 500 after all previous bear market declines of -20%.

As the chart clearly shows, the average return after a decline of -20% is positive in all analysed time periods, and strongly positive over the subsequent two and three year periods. As challenging as things may seem now, this is a timely reminder that markets are always much more focused on where the economy is going, and not where it has been. After all, share markets are a leading indicator for the economy.

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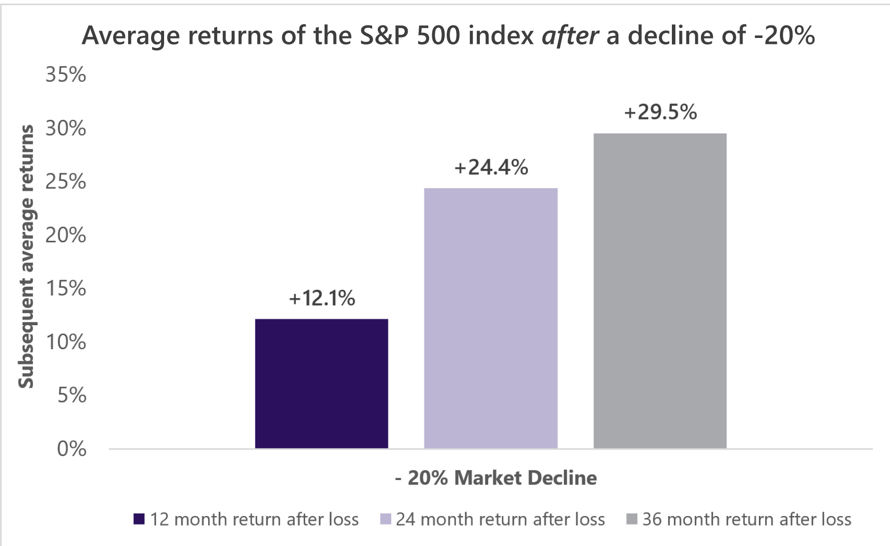


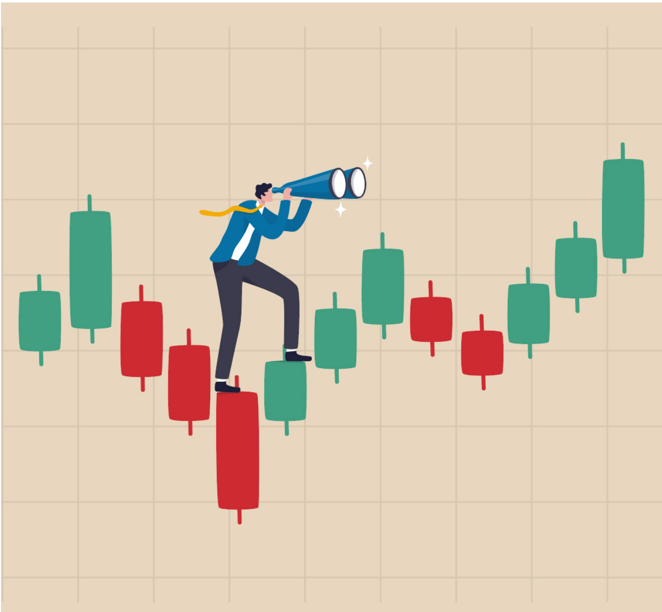

Note: The calculated returns figures (for declines and recoveries) are all based on month end pricing data.

Bond markets have also experienced a poor start to the year, with interest rates in many countries having increased and with further rate rises projected. It is a unique aspect of bond pricing that when interest rates rise, two things happen –

1. The *prices* of existing bonds go down (which happens immediately)
2. The *expected future returns* of those existing bonds go up (with these higher returns being delivered over time)

In this regard, falling bond prices are felt immediately in portfolio valuations, while the higher expected future returns are only received in the months that follow. One small comfort from this is that with current bond yields now much higher than they have been for several years, the expected future returns from bonds are looking increasingly attractive.

> Whilst it might be tempting to think that you could just sit out of the markets and wait for the current storm to blow over, the forward-looking markets will always go up, and sometimes strongly, well before the economic clouds have cleared.



**This too will pass**

Even if New Zealand or any other countries enter a technical recession this year (two or more consecutive quarters of negative growth), recessions don't tend to last for very long and don't necessarily impact asset prices. As we have already noted, if demand and inflation show more obvious signs of reducing, central bank policies can also be expected to eventually pivot from fighting inflation to supporting growth.

For now, uncertainties are elevated and these uncertainties have been fully priced into markets. While this has been a big factor in the poor share market returns year to date, it doesn't tell us anything about the returns we should expect for the remainder of this year.

Markets are relentlessly forward-looking. They don't only calibrate the information that is known today, they also calibrate all the fears, hopes and expectations of every market participant. Whilst investor sentiment has been very negative, and this has weighed heavily on market prices, we know that sentiment and markets can turn very quickly. Just as the prospect of better economic times ahead can be a catalyst that can help move markets higher, and it can happen well before the benefits are readily observable in the economy around us.

Given the current low market starting point, if sentiment was to begin to improve in the coming weeks and months around any one or more of the current uncertainties (inflation, central bank policy, economic growth, Covid or the Ukraine conflict), then share markets at these lower prices might suddenly look a lot more appealing.

As always, in periods like this where the market has been challenging, it is best not to try and 'time' your exposure. Whilst it might be tempting to think that you could just sit out of the markets and wait for the current storm to blow over, the forward-looking markets will always go up, and sometimes strongly, well before the economic clouds have cleared. And given the speed that markets can react, being on the sidelines and missing the recovery can often be far more detrimental to a long term plan, than absorbing the current lower valuations and higher volatility of returns.

The most reliable advice is always to maintain the risk exposure that you set, and considered appropriate, when the skies were clearer. Investing more when prices are cheaper is usually an even better option, but that may not be an option that is available to everybody. If it isn't, just batten down the hatches and wait this one out. The skies always clear and the markets always recover. We just don't ever quite know the timing.

# Key market movements for the quarter

Shares and bonds across the board were under pressure in the second quarter of 2022, as markets priced in further increases in interest rates as well as an increased risk of recession. Amongst equities returns, which were generally poor, the MSCI World Value index significantly outperformed its Growth counterpart, although both registered double-digit declines. The Chinese share market provided a rare highlight as prolonged lockdowns were lifted in some major cities, allowing macroeconomic indicators there to show some improvement.

Inflation rates in major economies continued to persist at multi-decade highs, with various central banks raising interest rates and others clearly signalling their intention to do so soon. The quarter also saw mounting concerns over global economic growth prospects, with the fight to tame inflation likely to result in monetary policy settings that would be less supportive than the global economy has enjoyed in recent years.

The potential for economies to experience a recession later this year became more widely contemplated and, towards the end of the quarter, economic indicators began to reflect a general moderating or slowing in economic activity.

**-15.1%**
*(hedged to NZD)*

**-6.9%**
*(unhedged)*

## International shares

In the US, investor focus was on inflation and the policy response from the US Federal Reserve. The bank enacted initial rate hikes during the quarter and signalled that there would be more to come. Even so, they admitted the task of bringing inflation down without triggering a recession would be a challenging balancing act.

While weak sentiment affected all sectors, consumer staples and utilities companies were comparatively resilient. However, there were some dramatic declines for some companies, most notably in the media, entertainment and auto sectors.

Further steep declines were common for eurozone shares, as the war in Ukraine continued and concerns mounted over potential gas shortages, with supplies to Germany a particular being a point of concern. Higher inflation also dented consumer confidence, with the European Central Bank (ECB) poised to raise interest rates in July.

UK equities also fell over the quarter, with economically sensitive areas of the market performing poorly towards the end of the period amidst rising recessionary risks.

In New Zealand dollar terms, the MSCI World ex-Australia Index delivered a quarterly return of -15.1% on a hedged basis and -6.9% unhedged. This meant the rolling 12 month return for the New Zealand dollar hedged index reduced to -12.2% while the unhedged index is down -4.2%.

*Source: MSCI World ex-Australia Index (net div.)*

**-1.6%**

## Emerging markets shares

In a quarter where global share markets generally slumped, it was somewhat against the usual trend to see the relative outperformance of the emerging markets region (as a whole). When investors are wary of exposure to higher risk assets, emerging markets are often harder hit. But not this quarter.

That said, plenty of emerging market share markets did post declines. The South Korea share market struggled, with financials, technology and energy stocks hit particularly hard amid growing fears of a global recession. Taiwan was also significantly lower, on fears that rising inflation and global supply chain problems would weaken demand for its technology products.

The Latin American markets of Colombia, Peru and Brazil were amongst the weakest in the MSCI Emerging Markets Index. A combination of rising concerns about a global recession, domestic policy uncertainty and weaker industrial metals prices later in the quarter, all contributed to the declines.

The emerging European markets of Poland and Hungary both underperformed by a wide margin, as geopolitical risks stemming from Russia's invasion of neighbouring Ukraine persisted.

The shining light for the region was China which managed to deliver a solid positive return for the quarter. With lockdown measures in certain Chinese cities being eased, this prompted a recovery in economic activity.

As the largest constituent in the emerging markets region, China's positive result was a major driver to the mild loss for this asset class in the quarter, with the MSCI Emerging Markets Index producing a quarterly return of -1.6% in unhedged New Zealand dollar terms.

*Source: MSCI Emerging Markets Index (gross div.)*

-10.2%

## New Zealand shares

The New Zealand market endured a difficult quarter with the S&P/NZX 50 Index returning -10.2%. Whilst at the individual company level there was 'red ink' almost across the board for the quarter, it was the industrials and health care sectors that contributed the largest drag on the performance of the index.

The two worst affected firms in the industrials sector, Air New Zealand and Freightways were down -27.9% and -25.9% respectively for the quarter, as the prospect of weaker economic growth weighed heavily on their prices. While building materials firm Fletcher Building fell -21.0% as sentiment around the domestic building and construction sector continued to cool.

With only six firms in the top 50 delivering a positive return in the quarter, it was software firm Pushpay that enjoyed the strongest performance, gaining 11.4%. This followed news that two existing shareholders (BGH Capital and Sixth Street) were intending to make a takeover bid for the firm.

*Source: S&P/NZX 50 Index (gross with imputation credits)*

-9.8%

## Australian shares

The Australian share market (ASX 200 Total Return Index) had a similarly tough time sliding -11.9% over the quarter in local currency terms. Returns to unhedged New Zealand investors were slightly better at -9.8%, due to an appreciation in the value of the Australian dollar over the quarter.

Once again, the dispersion in sectoral returns was a feature of the market, with the utilities and energy sectors standing apart from the rest by delivering small gains. At the other end of the spectrum, the information technology sector suffered a very poor quarter as growth company valuations came under increasing pressure due to the expectation of faster rate hikes. The real estate and materials sectors were also very weak.

With only a little over one in ten companies in the ASX 200 delivering positive returns during the quarter, infrastructure firm Atlas Arteria (+23.1%) and small energy company Viva Energy Group (+23.0%) were the clear standouts.

At the other end of the standings, there were 21 companies within the ASX 200 that delivered returns of -35% or worse for the quarter. This list was littered with small capitalisation firms in the technology and basic materials sectors, as valuation concerns and general negative sentiment during the quarter impacted these companies the most.

*Source: S&P/ASX 200 Index (total return)*

-1.0%

## International fixed interest

Global bonds saw their prices continue to decline during the quarter, with yields markedly higher due to elevated inflation data, increasingly 'hawkish' central bank statements and rising interest rates. There was a small bond rally (price gains) towards the end of the quarter as economic growth concerns began to rise.

With inflation data in major economies at multi-decade highs, the quarter was characterised by various central banks raising interest rates and others signalling their intention to do so. The quarter also saw mounting concerns over future economic growth prospects, including the possibility of a recession later this year.

In the US, the Federal Reserve implemented a series of interest rate hikes, raising the US policy rate by 0.50% in May and a further 0.75% in June, their largest single rate hike since 1994. At the same time, Federal officials cut their 2022 growth forecasts. In response, the US 10 year bond yield rose from 2.35% to 3.02% over the quarter.

European bond yields were volatile as the European central bank indicated it would end asset purchases early in the third quarter and raise interest rates soon after. With this backdrop, the German 10 year bond yield increased from 0.55% to 1.37% over the quarter.

In the UK, the Bank of England implemented further interest rate hikes, bringing the total to five in the current cycle, as well as raising its inflation forecast to a staggering 11%. This helped push the UK 10 year bond yield up from 1.61% to 2.24%.

Corporate bonds also suffered in the broad bond market sell off, and generally underperformed government bonds as credit spreads widened markedly. With mounting concerns over the economic outlook, high yield credit securities (i.e lower credit quality) were hit particularly hard.

The FTSE World Government Bond Index 1-5 Years (hedged to NZD) returned -1.0% for the quarter, while the broader Bloomberg Global Aggregate Bond Index (hedged to NZD) returned -4.5%.

*Source: FTSE World Government Bond Index 1-5 Years (hedged to NZD)*

-1.4%

### New Zealand fixed interest

The Reserve Bank of New Zealand (RBNZ) elected to increase the Official Cash Rate (OCR) by a further 0.50% on 14 April and again by another 0.50% on 26 May, taking this benchmark rate from 1.00% to 2.00% by the end of the quarter.

In its accompanying statement, the RBNZ noted that "the level of global economic activity is generating rising inflation pressures that are being exacerbated by ongoing supply disruptions driven by both Covid-19 persistence and the Russian invasion of Ukraine. The latter continues to cause very high prices for food and energy commodities."

The Monetary Policy Committee also reconfirmed it planned to continue to lift the OCR "at pace" to a level that will confidently bring consumer price inflation to within its 1-3% target range.

In effect, this confirms the expectations of the RBNZ are for interest rates to continue to rise, for the time being at least.

Given this outlook, the New Zealand 10 year government bond yield climbed from 3.25% at the end of the first quarter to 3.87% at the end of June. The New Zealand 2 year government bond yield followed an entirely similar pattern, beginning the quarter at 2.92% and ending the June quarter at 3.51%, a yield increase of 0.59%.

Similar to the effects seen overseas, these rising bond yields generally resulted in negative short term returns for bonds of all durations.

The S&P/NZX A-Grade Corporate Bond Index fell -1.4% for the quarter, while the longer duration but higher quality S&P/NZX NZ Government Bond Index fell -3.2%.

*Source: S&P/NZX A-Grade Corporate Bond Index*

***Table 1: Asset class returns to 30 June 2022***

| Asset Class | Index Name | 3 months | 1 year | 3 years | 5 years | 10 years |
|---|---|---|---|---|---|---|
| New Zealand shares | S&P/NZX 50 Index (gross with imputation credits) | -10.2% | -13.5% | +1.9% | +8.3% | +13.5% |
| Australian shares | S&P/ASX 200 Index (total return) | -9.8% | -3.7% | +5.3% | +8.0% | +7.7% |
| International shares | MSCI World ex Australia Index (net div., hedged to NZD) | -15.1% | -12.2% | +6.8% | +7.7% | +11.6% |
| | MSCI World ex Australia Index (net div.) | -6.9% | -4.2% | +9.7% | +11.2% | +12.4% |
| Emerging markets shares | MSCI Emerging Markets Index (gross div.) | -1.6% | -16.1% | +3.4% | +5.9% | +6.0% |
| New Zealand fixed interest | S&P/NZX A-Grade Corporate Bond Index | -1.4% | -6.8% | -0.9% | +1.7% | +3.4% |
| International fixed interest | FTSE World Government Bond Index 1-5 years (hedged to NZD) | -1.0% | -3.5% | +0.0% | +1.1% | +2.5% |
| New Zealand cash | New Zealand One-Month Bank Bill Yields Index | +0.5% | +1.0% | +0.7% | +1.2% | +2.0% |

*Unless otherwise specified, all returns are expressed in NZD. We assume Australian shares and emerging market shares are invested on an unhedged basis, and therefore returns from these asset classes are susceptible to movement in the value of the NZD. Index returns are before all costs and tax. Returns are annualised for time periods greater than one year.*

# What happened to bonds?

On November 15, 2020, the New Zealand Herald ran an article titled, ***'What negative interest rates would mean for borrowers and savers'***. It said that the Central Bank was seriously considering negative interest rates as an option to stimulate the economy in the post COVID recovery.

A mere 18 months later, the Central Bank raised the OCR to 2.5%, and indicted further upward moves were likely as outlined in its May Monetary Policy Statement[1].

The Reserve Bank Governor's comment at the time was succinct and accurate, "We're in a different world now."

Not unsurprisingly, financial markets had priced lower interest rates into bond prices in 2019 and 2020 and investors got higher than normal returns as a result. In both 2019 and 2020, bonds provided investors very attractive returns. The Global Sustainability Bond Trust by Dimensional earned investors 8.64% in 2019 and 7.66% in 2020.

Since those heady days, market expectations about interest rates have changed dramatically. Markets no longer consider negative rates a possibility. Now markets are focused on inflation. Supply shortages, logistics problems and workforce constraints, combined with international energy disruptions, have pushed prices higher across many goods and services. Bond markets have absorbed this information and investors are now seeking a higher return on bonds. In response, bond prices have gone down and many investors received negative returns.

It's important to point out that the poor recent bond returns are not the result of fund management or the credit worthiness of the underlying bonds themselves. Poor returns are due to investors expecting inflation and requiring a higher yield as a result.

While that explains what happened, the question remains; should you still own bonds in your portfolio?

The answer in general is yes, although we always need to consider individual circumstances. It is worthwhile to provide some context and evidence for our position, especially considering recent returns.

### 1. Bonds are still a good diversifier

Historically, bonds have been an excellent diversifier to shares. Since 1993 (as far back as we have NZ data at our disposal), there has been only one other calendar year where bond prices and share prices were both negative; in 1994 which we have circled below. By contrast we can look at 1998, 2000 and 2008 and see where bond prices went up while share prices that went down providing that diversification benefit investors are looking for.

### 2. Bonds help control volatility

Another illustration of the below chart is the narrower range of returns. While returns from shares can range from +50% to -40%, returns from bonds have never exceeded 20% in either direction. An appropriate allocation to bonds will reduce the volatility risk for your portfolio, which is especially important if you have a shorter investment time horizon.

### 3. Bonds are still credit worthy

The bond funds used in our portfolios are overwhelmingly comprised of bonds selected from

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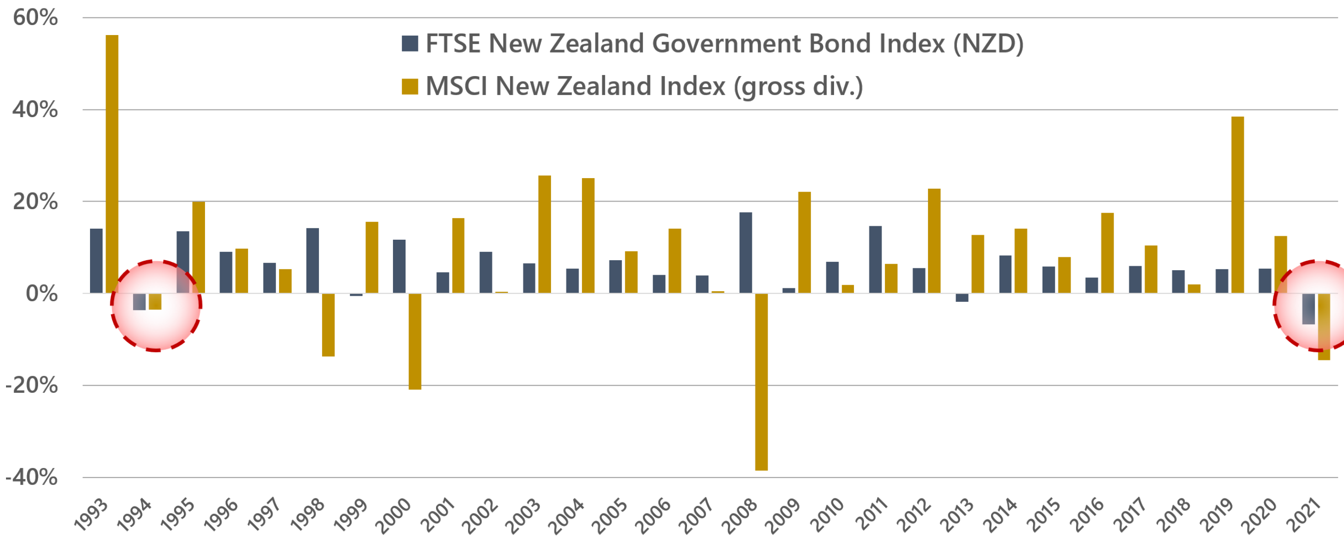
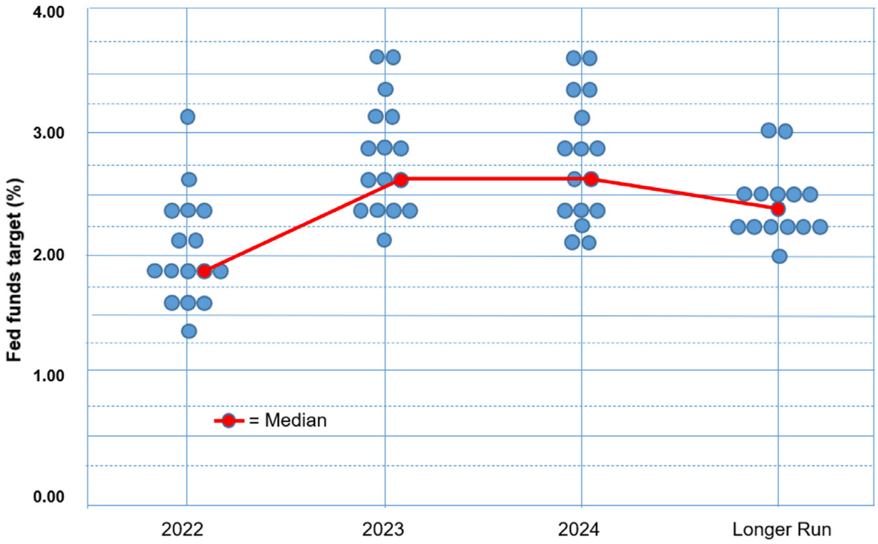
**Figure 1: Annual Returns MSCI New Zealand Index and FTSE New Zealand Government Bond Index**




*Source: Dimensional, FTSE, MSCI*

**Figure 2: FOMC's assessment of the appropriate federal funds target rate**




*Source: Federal Reserve, Summary of Economic Projections (SEP), March 16, 2022*

borrowers that are investment grade rated (BBB, A, AA, and AAA). Those borrowers, which include the New Zealand Government, are very likely to pay back the bonds. If investors hold on for the long run, they will likely receive the positive return that comes from those borrowers making their scheduled payments.

### 4. Increasing rates are priced in

But what if interest rates go up more from here? Won't that lead to lower bond returns? Not necessarily. The expectation is that interest rates will go up, and those expected increases are already priced in by the market. The reason they are priced in is because there is substantial, publicly available information about the intentions of central banks with future interest rate movements. One source is the projections made by US Federal Open Market Committee Members. Those projections are in the chart summarised below. Each dot represents the opinion of a member on where interest rates will be for the years 2022 – 2024 and then longer term.

This chart shows that some members, called 'doves', believe interest rates will be lower than the median projection, while others, called 'hawks' believe they will be higher than the median projection. The median position is plotted in a line in the chart above. The question for bond prices will not be whether rates go up, but rather how much they go up by and whether the hawks or the doves are closer to the truth. This is a question that markets adjust for everyday making the answer a 50/50 guess. After all, prices must fairly include all known expectations for both a buyer and seller to willingly trade.

### 5. The yield to maturity and thus the expected return, is much higher now

On a positive note, bonds are yielding more than in previous years. The Dimensional Global Bond Sustainability Trust, as of the date of writing, is yielding 4.77%[2]. That number was closer to 1.0% 18 months ago.

What that means for investors is that bonds now have a much higher expected return. Even if prices go down, investors could still earn a positive return because they are starting from a 4.77% yield rather that 1.0% yield.

To summarise, over the next year:

- ✔ If yields do not change, investors win.
- ✔ If yields go down, investors win.
- ✔ If yields go up, prices will fall, but investors are starting from around a 4.77%[3] return rather than a 1% return. Therefore, they could still earn a net positive return over the next 12 months.

### Conclusion

We understand that it has been a very difficult 12 months for bond holders, as markets have adjusted from the possibility of negative interest rates to watching the Reserve Bank move to fight inflation. Markets have moved quickly, as they should, to reflect this change. The way markets do that is through prices. So, while the returns over the past six months have been painful, they do make economic sense.

From here, the question is about the long-term place of bonds in investor's portfolio. We strongly believe they still have a place. They remain a good diversifier, they are issued by investment grade borrowers, interest rate increases are factored in, and yields are much higher than they were 18 months ago.

If you have any concerns, please let us know. As always, we want you to be comfortable with your long-term investment strategy.

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*1 https://www.rbnz.govt.nz/hub/publications/monetary-policy-statement/monetary-policy-statement-may-2022*
*2 https://au.dimensional.com/funds/global-bond-sustainability-nzd-class*
*3 In the global sustainability bond fund*