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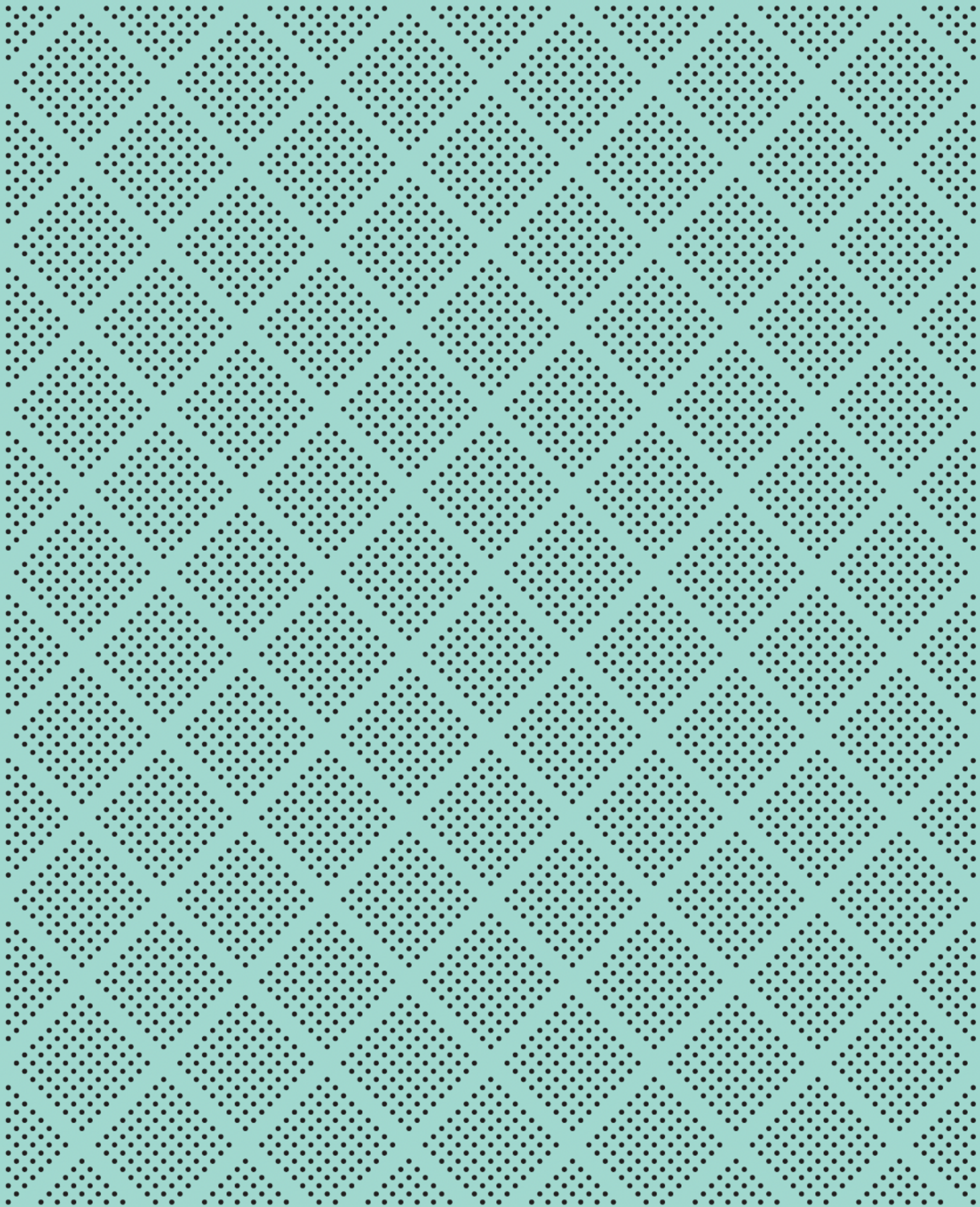
Quarterly Fund Report:
Mint Diversified Income Fund



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DIVERSIFIED FUNDS

Mint Diversified Income Fund

Investment Objective

This is a multi-asset class Fund that offers diversification by investing across a number of asset classes both in New Zealand and internationally. The objective of the Fund is to deliver a total return (through a combination of income and capital growth) in excess of the Consumers Price Index (CPI) by 3% per annum, before fees, over the medium to long term.

Market developments

It was a strong quarter for equities and bonds, but risk assets faced a more turbulent environment than in Q2. The key driver of solid performance were central banks' decisions and a shift in global monetary policy. After a long wait, The Federal Reserve initiated its rate-cutting cycle in September. A larger-than-expected move of 0.5% was a pivot after months of hawkishness. In addition, further monetary easing across major global economies, including the ECB and Bank of England, coupled with China stepping up with a stimulus package set the stage for a rally across both equity and fixed-income markets.

The S&P 500 posted a robust return of 5.9%, pushing its YTD gains above 22%. After a long stretch of dominance by growth stocks, the baton was finally passed to small caps and value stocks, with the Russell 2000 Growth Index leading at 9.5%, followed by a remarkable rally in global REITs, up 16.2%. Domestically the NZX also had a strong quarter up 6%, benefitting from the easing of interest rates.

Sector rotation was a major theme this quarter for global equities. In the US, Utilities (+19.4%), REITs (+17.2%), and Industrials (+11.6%) outperformed, with value finally making a long-awaited comeback. Tech lagged slightly, up only 3.5% as the AI hype simmered down, leaving big names like NVIDIA and Tesla on the back foot. The energy sector was the only major underperformer, with crude oil prices falling by 17% amid mounting concerns about global demand.

On the bond side, the Global Bond index posted a solid 7% return, led by a steepening yield curve as markets digested the first in what is likely to be a series of rate cuts. Credit spreads tightened, benefiting both investment-grade and high-yield issuers, and the US Treasury market returned 4.7%. NZ investment grade corporates also had a strong return at 3.9% for the quarter.

How the quarter unfolded

The third quarter wasn’t all smooth sailing. Within NZ, we had some extremely weak economic sentiment to kick July off. This started with the QSBO showing continued weakness in the business sector and prospects bottoming out with pricing intentions falling and plans to reduce employment increasing. The RBNZ changed its (uber) hawkish tone from May and acknowledged the weakening economy, excess capacity emerging and increase in labour market slack, this led to a rally in fixed income as interest rates dropped. CPI later in the month came in lower than

the RBNZ and the market expected, adding momentum to the fixed income rally and giving investors confidence that the next print would be within the target range.

During August, we saw some sunlight through the clouds, firstly with a slight bounce in Business Confidence from the doldrums in July. Unemployment was relatively well-behaved hitting market and RBNZ expectations at 4.6%, albeit a 1% increase from the previous 12-month lows. The big event that the whole market was watching was the August RBNZ meeting, with markets roughly 50/50 on whether a cut would happen. The RBNZ duly delivered a 25-basis point cut, but also shared their updated economic forecasts which showed a significant (dovish) difference in their view of NZ moving forward, with 75bps shaved off their YE24 OCR track, CPI hitting target by Q3 24 and unemployment now expecting to peak at 5.4% (previously 5.1%). This move continued the rally in NZ bonds that started in July.

Finally, in September the biggest piece of news for Kiwi investors was a small, surprising beat to Q2 GDP, showing the economy had not contracted as much as market (or RBNZ) believed. Whilst the annual number was still negative (-0.5% vs -0.6/-0.7% expected by market/RBNZ respectively), there were some surprising green shoots within manufacturing and private consumption. If, however, Q3 GDP comes in negative (released December) then it will be the 3rd technical recession for the economy in just over 2 years.

Globally, investors grappled with mixed signals on inflation and growth. As a result, volatility increased - particularly in August, when limited summer liquidity, reversal of Yen weakness and successive downside beats on US employment knocked the markets off balance for a few weeks. Non-farm payrolls was weak with only 114,000 jobs added in July, far below what markets expected, and unemployment ticked up to 4.3%. Along with the poor US employment figures and the Yen appreciating (due to BOJ hiking rates) all happening within a short period, it led to markets speculating on the reversal of the Yen carry trade reverberating around risk assets.

Against this backdrop, the Fed's decision to cut rates in September was met with relief and the size of the cut was higher than expected by most of markets participants. Chair Jerome Powell essentially told markets, that “we didn't come this far to only come this far” changing the narrative from fighting inflation at any cost, to more dovish tone and a commitment to shifting the focus to the labour market and the sustained ‘soft landing’ for growth in the US. The 0.5% rate cut was followed by other major global central banks. In addition, China’s stimulus measures propelled emerging markets and small caps alike.

However, the Fed wasn’t entirely off the hook. The market, ever the sceptic, still frets about inflation’s stubborn persistence. This was despite the Fed’s dot plot showing a more conservative path for the future path of rate cuts (and its long-term average), with only one expected in 2024, while markets priced in much more aggressive easing. Meanwhile, geopolitical risks, in particularly the escalating conflict between Israel and Iran added to the uncertainty in September. In particular, the escalation of the conflict and the war in the Middle East (with other countries getting involved) could be a risk for oil prices which could then reignite inflation.

Despite these headwinds, corporate earnings in the US are holding strong. S&P 500 companies posting 4.3% YoY growth in Q3. This has validated our long-held view of the US economy doing well and the recession risks remaining

low at this point. Encouragingly, small caps and value sectors showed renewed strength, suggesting the market's breadth is finally expanding after months of narrow leadership by the 'Magnificent Seven'.

As the quarter drew to a close, investors looked ahead to the election, expecting further clarity on US fiscal policy and potential tax changes to lead to the next wave of market momentum. But as always, nothing in the markets is linear, and with the looming US presidential election. Whether it is Harris or Trump, markets do not like uncertainty. As such, we would expect more volatility until the results of the race are known.

Outlook moving forward

Our market outlook hasn't changed from last quarter. If anything, we see macroeconomic data in the US getting stronger supporting our long held no recession view. The base case for "soft landing", a scenario where for the US economy avoids the contraction in 2025 is still the most likely scenario in our view and has largely played out as we have expected for the last 12 months.

The US presidential election should remove significant uncertainty in November. If the US data remains strong with low unemployment and low inflation as we expect, we could see markets resume their uptrend. We expect that both equities and bonds will perform well heading into 2025, supported by the strong US economy and the global easing of monetary policy.

In New Zealand, we anticipate the recovery will gather steam following the eventual rate cuts from the RBNZ. The spectre of inflation will soon be in the rear-view mirror and with further interest rates cuts, we expect a rebound in business confidence and growth. Particularly construction and retail should see some relief when interest rate cuts feed through to the consumer directly with mortgage and loan rates, supporting personal incomes and consumption.

On the portfolio side, we remain optimistic and have recently increased our allocation to equities. Both bonds and our equity exposure should benefit from softer monetary policy environment. We remain focused on high-quality growth stocks and took profits in fixed income and reduced our portfolio duration closer to neutral reflecting the fact that markets have already priced in a path of interest rates aligned to our view.

Risks, of course, remain. The biggest risk to our "soft landing" scenario is that the inflation could reaccelerate. The geopolitical risks, in particular a full-blown war in the Middle East, could push oil prices higher.
Another wildcard is the US election. Depending on the outcome, we could see policy shifts that may alter the accommodative stance that markets are currently pricing in. However, we think that as long as we have a clear winner, markets will see through it. Harris would be seen as a continuation, and whilst Trump talks about tariffs and protectionism, the equity markets performed well during his previous term.

In summary, we continue to see the global macroeconomic environment as supportive for equites and bonds for the remainder of 2024 and into 2025. With central banks shifting towards easing, and inflation back below 3% in most economies by the end of the year, we believe the groundwork is being laid for a favourable investment climate across both equities and fixed income.

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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:

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