MARKET INSIGHTS

December 2022 Quarter

GRAVITY RETURNED TO FINANCIAL MARKETS IN 2022 – WHAT AWAITS IN 2023?

Ashley Gardyne, Chief Investment Officer

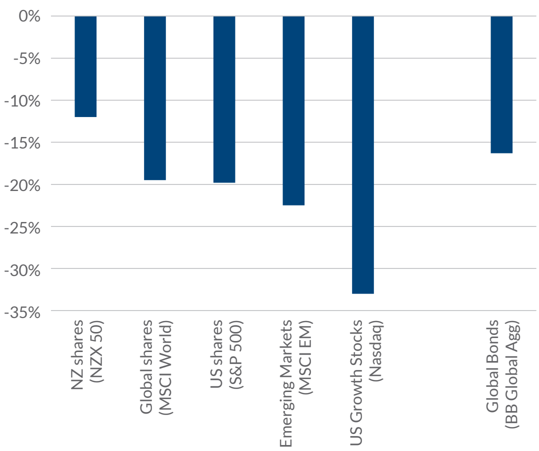
Rattled by stubbornly high inflation, rising interest rates, and the prospect of recession, 2022 was the worst year in equity markets since the Global Financial Crisis. It was also the worst year for fixed income markets in over a century. After 2022 sparked a major reset in interest rates and asset prices, what can investors expect in 2023 and beyond?

A challenging year for investors

Investors had nowhere to hide in 2022 – with share markets, fixed income markets, and property prices falling in tandem. Even cash had its value eroded by spiralling inflation.

Because bond markets fell in lockstep with equities, fixed income didn't provide its usual ballast, and even conservative portfolios declined materially in value. The scale of the bond price drop meant that balanced portfolios had one of their worst years on record, as Chart 2 shows below.

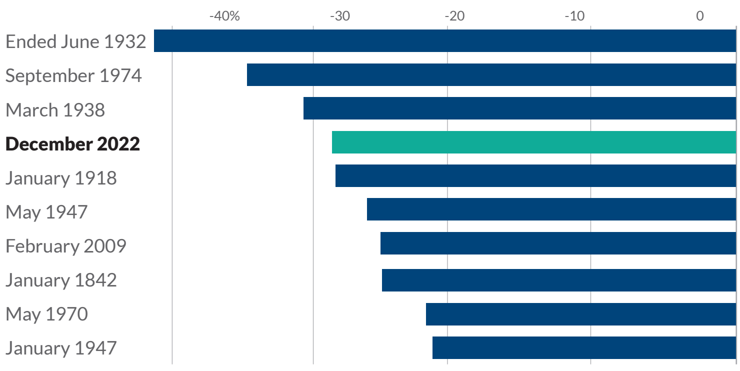
Chart 1: Markets fell in tandem in 2022



Source: Bloomberg

Chart 2: Worst year for US 60/40 portfolio in almost 50 years

10 worst 12-month returns for a 60% stock, 40% bond portfolio after inflation



Source: Wall Street Journal

It was macroeconomics that drove markets in 2022. This felt like something of a novelty after recent years, when the market-moving headlines were all either COVID-related or political (Brexit, Trump, China trade war).

[1] As measured by the Bloomberg Global Aggregate Index

Investors had to grapple with issues they hadn't encountered for decades. Inflation spiked to over 7% in many developed markets, central banks hiked interest rates at a record pace, and war broke out in Europe. After years of plain sailing, gravity returned to financial markets.

This market weakness affected the performance of our funds, which had a challenging year after more than five years of strong performance.

Focusing on fundamentals

After a year of macroeconomic turbulence, we believe it's important to focus on the micro, and the fundamentals of the businesses we invest in.

It's easy to become preoccupied with news headlines and guessing where markets may go next, but this approach is often counterproductive. Instead, investors need to screen out the noise, focus on company fundamentals, and position their portfolios in securities they believe will deliver strong medium to long-term returns.

As we do this fundamental research and review our portfolios company by company, we're becoming increasingly optimistic about the outlook for our funds.

Take the opportunities in the fixed income market, for example. With higher interest rates and wider credit spreads, investors are now being rewarded for investing in bonds. In response, we've been gradually reallocating funds from government bonds to investment grade and high-yield corporate bonds.

This time last year

US investment-grade bonds were yielding 2.5% on average in early 2022; this had increased to nearly 5.5% at the start of 2023. In some instances, we're seeing high quality investment-grade bonds yielding 7 - 8%. If you're willing to take a bit more risk and invest in high-yield bonds, the prospective returns are better still.

Woolworths Group is a good example of an investment grade bond offering far more attractive yields today than it was a year ago. Woolworths is Australia's largest supermarket chain, a stable business with predictable cash flow and a moderate debt burden that we believe it can readily service. Today, you can invest in Woolworth's bonds at a yield of around 7.3% (hedged back to NZD) – double the yield on offer a year ago.

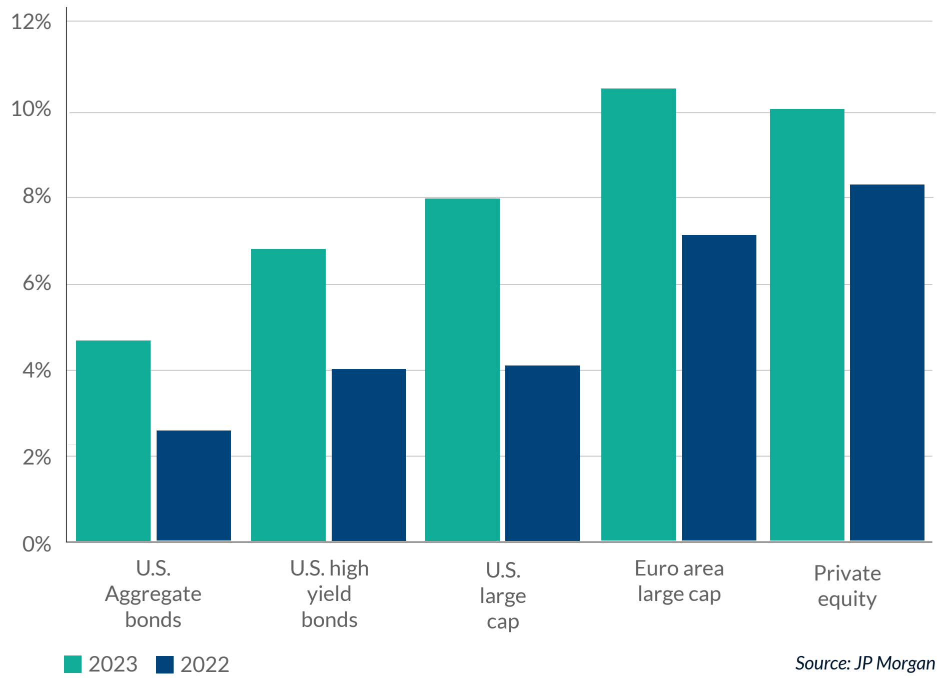
Similar attractive opportunities are available in the share market, where plenty of quality businesses have been unfairly caught up in the sell-off of lower quality businesses. We believe businesses in our portfolio like Amazon and Alphabet (the parent of Google and YouTube) have many years of growth ahead, yet they currently trade at their lowest valuation levels in over a decade. Considering individual investments helps to contextualise the current investment backdrop – which we view as attractive.

The road ahead

Last year provided a reminder that investing is always two steps forward, one step back. In times of volatility, it can be tempting to sit on the side lines and wait for the 'all clear'. But as we have seen time and again, bailing during times of volatility is usually the wrong approach. By the time inflation is back to 2%, the economy is growing steadily, and economic risks look more manageable, share markets are likely to be materially higher.

Investment bank JP Morgan has published long-term market return forecasts for the last 27 years. These are their best prediction of the return each asset class will deliver over the next 10 - 15 years. While short-term market predictions are notoriously inaccurate, longer-term forecasts are more reliable. As Chart 3 shows, JP Morgan predicts equity and fixed income returns over the next decade that are meaningfully higher than what they predicted a year ago. Their report concluded that 'markets today offer the best long-term return potential in more than a decade.'

Chart 3: After the 2022 market downturn, return projections have increased meaningfully



While the medium-term outlook for portfolio returns has improved, that doesn't necessarily mean the years ahead will be all plain sailing. Volatility is a feature of financial markets, not a bug. But, with the recent fall in asset prices, we believe investors will be better rewarded for this volatility in the years ahead.

Ashley Gardyne, **Chief Investment Officer**

NEW ZEALAND EQUITIES

Matt Peek, Portfolio Manager

The rainclouds will pass as growth shines through

2022 was a painful year for New Zealand shares but quality growth companies remain well-positioned to deliver over time.

Our growth companies are now trading at more attractive valuations

It's important to reflect on what caused the 2022 outcome.

For quality growth companies, it was largely because of elevated valuations against the backdrop of low interest rates. For instance, Mainfreight was trading at 29 times its forward earnings, versus its 10-year average of around 20 times. Today, it's trading at around 16 times. This dynamic has generally not played out to the same degree for New Zealand's defensive companies and those with lower growth prospects.

With other portfolio companies in a similar situation, the Fund now looks more attractive than it has for quite some time. Plus, history tells us that the ability of our companies to grow earnings over time will drive share prices and returns to investors.

Our companies are focused on fostering winning cultures, delivering for their customers, taking market share and becoming larger and more profitable in future years – sustainably. This came through loud and clear when we visited our companies and met their management teams throughout the quarter. These teams are certainly not pessimistic about the future.

Mainfreight is more confident than ever about fulfilling its long-term global growth potential

With its share price down -28%, you'd be forgiven for thinking that Mainfreight had a terrible year. In fact, over the course of 2022, expectations for profit in the current and next year have increased by double-digit percentages. Its share price fall comes down to a combination of the valuation becoming more attractive and general concerns about the global macroeconomic outlook.

At its investor day in October, Mainfreight discussed its ongoing strategy of growing and intensifying its network by adding new branches across all products and in all regions. This is simply a continuation of the same successful strategy that has seen its network grow to over 300 branches globally, adding around 70 over the past five years.

Investment into new facilities is improving Mainfreight's quality and efficiency. This helps to win and retain customers, boosting profitability. The new facilities include purpose-built transport cross-docks and larger warehouses, including in Europe and the US. Historically, Mainfreight has been hesitant to invest in those regions because performance lagged expectations. Now they are seeing signs of real traction in sales, customer wins, and profitability, giving them confidence to invest in those large and lucrative markets.

Mainfreight's management team and board has a fantastic track record of profitable growth. They turn up to work every day aligned and hungry to grow the business, despite a potentially tougher environment. It's encouraging to see multiple executives add to their significant shareholdings recently, underscoring how strongly they believe in the future prospects of the business. As legendary investor Peter Lynch put it, "insiders might sell their shares for any number of reasons, but they buy them for only one: they think the price will rise."

Infratil continues to benefit from strong demand for secure outsourced data centres

During the quarter, we visited the facilities of Infratil's largest business – Canberra Data Centres (CDC) – in both Sydney and Auckland. It was impressive to see first-hand the calibre of CDC's management team and their comprehensive approach to building data centres.

Their focus on offering the most secure, cost effective, and environmentally responsible data centres has seen CDC become a market leader in Australia.

CDC's new Auckland data centres have opened almost full, with 82 megawatts of capacity recently added to its pipeline in Auckland (compared to 28 megawatts currently). By leveraging their Australian experience, CDC has secured first mover advantage in the New Zealand hyperscale datacentre market.

In Sydney, CDC's CEO Greg Boorer highlighted the company's strong growth trajectory, reiterating his expectation of maintaining earnings growth at around 25% annually over the medium term. This forecast is supported by CDC's pipeline and significant customer demand. It's also backed by trends towards increasing data usage, security requirements, and cybersecurity risks.

Infratil shares were broadly unchanged over the quarter but delivered a +11% return in 2022.

The retirement sector is firmly out of favour as investors fixate on house prices

During the quarter, retirement village operators Ryman Healthcare (-37%) and Summerset (-18%) saw continued weakness in their share prices. For most prospective residents, the decision to move into a retirement village is a matter of personal circumstances and won't be delayed by house prices. However, selling their home in a soft market is taking longer, which is dragging on retirement unit sales.

Ryman raised a small amount of equity for the first time in 23 years by introducing a dividend reinvestment plan. This was in response to a surprising increase in net debt by $400 million to $3 billion at its half year result. That debt is a key reason why we've reduced our position size in Ryman over time – instead favouring Summerset (which has considerably lower gearing at 29%, versus 45%).

Summerset continues to grow its unit sales year on year as it builds out its pipeline of new villages. It's on track to increase the new units it builds annually from 600 to 800 over time. Its fledgling Australian operations will contribute to this achievement, delivering units in 2023 after years of sourcing and consenting sites.

Ageing populations and the increasing popularity of retirement living in both New Zealand and Australia will also improve Summerset's prospects over time. Construction is likely to be at the lower end of the range in 2023, but Summerset's land bank and sites already underway support its medium-term ambition.

Despite the subdued near-term outlook, we think both Ryman and Summerset are offering attractive investment value over the medium term.

Negative sentiment can turn into a positive

This year has reinforced that when market sentiment becomes particularly negative towards a company or sector, the turning point can be very powerful.

For example, a2 Milk has endured a tough time in recent years but delivered a solid performance in 2022 against low expectations. It returned +21% during the quarter and +24% for the year.

Another example is Fisher & Paykel Healthcare. Last quarter, we flagged that Fisher & Paykel's recent underperformance has largely resulted from the market's focus on short term risks. This included a transient destocking cycle that was suppressing sales of its nasal high-flow oxygen to hospitals.

We maintain that the big picture for Fisher & Paykel remains attractive. During the quarter, the company delivered its half year result ahead of expectations, as the market dynamic faded. The company's hospital consumables sales improved every month since May – an unseasonably strong result. During the quarter, Fisher & Paykel Healthcare shares returned +23%.

AUSTRALIAN EQUITIES

Robbie Urquhart, Senior Portfolio Manager

Short-term setbacks fade in a long-term lens

The Fisher Institutional Australian Equity Fund continued to rebound during Q4. Strong leadership within our portfolio companies positions them well to navigate any surprises 2023 throws at them.

Building on its positive Q3 performance, the Australian Equity Fund rose a further 5.4% in Q4. The Fund fell 13.9% over calendar year 2022.

The benchmark ASX200 index rose 7.2% in Q4 (70% hedged into NZD), buoyed by indications that China is abandoning its zero-COVID policy. This supported commodity prices, underpinning a 15% rise in the materials sector in Q4.

The ASX200 index fell 0.6% in calendar year 2022, outperforming many global share markets. This included the S&P500 index (down 18.2%), the tech heavy NASDAQ (down 32%), and the MSCI World index (down 18%). The ASX's outperformance was driven by its relatively high weighting of the energy (+40% return in 2022), utilities (+24%) and materials (+5%) sectors, which all had a good year.

It's disappointing to deliver a negative return for the year and to underperform our benchmark index. That said, our portfolio companies have performed credibly in a difficult and volatile year for global share markets.

Our portfolio companies are investing in long-term growth and building resilient team cultures. Coupled with their inherent and durable competitive advantages, this bodes well for their performance over the next few years.

Slowing global economic growth weighed on shares in Q4

Globally, central banks continued increasing interest rates to slow economic growth and combat high inflation. Higher interest rates saw companies reporting a slowdown in sales during Q4.

This effect was clearly visible in James Hardie Industries (-14.4% in AUD in Q4), a manufacturer of fibre cement siding used in housing construction. James Hardie's latest trading update fell short of expectations and it reduced earnings guidance for financial year 2023. This was primarily due to housing construction in the US (its largest market) slowing considerably.

In response to this slowdown, James Hardie reduced its workforce in December. It's pleasing to see the company move quickly to adjust its cost base and protect its profitability. However, the job cuts have left investors wondering how severe the downturn will be. These concerns will linger, but we don't think they affect the company's strong, longer-term growth prospects.

Real estate classified advertising business REA Group (-3.5%) also felt the impact of the housing downturn, induced by interest rate hikes. Its share price fell sharply in December, following a pre-Christmas profit warning by Australian competitor Domain Holdings. Domain has seen real estate advertising volumes fall faster than expected into year-end. REA is not immune to this dynamic, but we think its dominant presence makes it better placed to weather the downturn. REA will continue investing in its growth initiatives and we expect it to emerge in a stronger competitive position.

Xero's (-4.4%) share price was also weighed down by the sluggish environment in the UK, a key growth region for the company. It was impacted by a 2-year delay (announced in December) in the deadline for small businesses in the UK to digitise their tax filings. This may slow the pace of growth for its subscription products. However, we note that Xero expects some of these headwinds to fade and its growth momentum to pick up during 2023.

Don't throw the baby out with the bathwater

Concerns about inflation, interest rates, and the potential for a global economic slowdown dominated headlines in 2022. This has been reflected in company share prices, many of which are lower than they were a year ago.

As long-term shareholders, a key investment consideration for us is where a company will be in three, five or seven years' time, rather than what happens in the next three to six months. If we think a company's long-term return prospects are sound, we're more careful about how we react to near-term negative news.

The value of this approach was evident in Q4. Several of our portfolio holdings reported adequate, but not spectacular earnings. Yet their share prices rose meaningfully on this news. This highlights how much pessimism was 'already in the price'. If we had sold these shares because we were concerned about the near-term economic outlook earlier in the year, we would have missed out on these gains.

Domino's is a case in point. Its share price rebounded by 28.6% in Q4.

The company provided a tepid trading update at its Annual General Meeting (AGM) in November. Yet it reconfirmed that its same store sales growth and organic store rollout for financial year 2023 are both expected to meet their medium-term targets (+3—6% and +8—10% per annum respectively). It also raised $165 million AUD of equity to purchase shares from an option it had over the residual 33% stake in Domino's very successful German business. None of this news was transformative for the company, but it was enough to drive a sharp rebound in its share price.

Our Australian bank shareholdings – including Westpac (+16.3%), CBA (+13.1%), ANZ (+7.5%), and NAB (+7.0%) – also rose strongly over Q4. The results they delivered were in line with market expectations. However, their share prices were buoyed by the Reserve Bank of Australia's (RBA) slightly dovish decision in October to raise the cash rate by 0.25% – rather than the 0.5% the market expected. In its fight against inflation, the RBA still increased interest rates in both November and December. But merely tempering the pace of increases was enough to send bank share prices higher.

Culture is a critical ingredient in high performing businesses

As travel restrictions eased during 2022, we've valued reconnecting with companies in person for the first time since the onset of the pandemic. These meetings have reinforced how much our portfolio companies have invested in their people and culture.

Culture doesn't translate into profit growth immediately. But it's a key factor in a company's development and resilience, ultimately influencing its long-term success and value creation.

In December, we met executives from Xero, Fineos (+22%), and Audinate (+3.5%). At Fineos, we were impressed with the breadth of talent and the collegiality and cohesiveness of team members who have worked together for over 20 years. At Xero and Audinate, we met with executives who are recent additions. What stood out for us was how quickly and enthusiastically those new executives have already taken on the culture of both organisations.

Another standout for us in Q4 was spending time with a range of PWR Holdings' (+27%) management team and board members when we attended their AGM in November. The company has had a good year, and their team has done an outstanding job. PWR is having to move to larger premises to accommodate its expanding order book – a nice problem to have. Underpinning this growth is a strong culture of excellence and 'can-do' across the organisation. Touring PWR's factory, the pride across all levels of organisation is evident.

We'll likely write about team culture in future updates but suffice it to say that we believe our portfolio companies are in good hands and well-positioned to handle whatever surprises 2023 has in store.

SELECT INTERNATIONAL EQUITIES

Sam Dickie, Senior Portfolio Manager

COVID aftershocks will continue into 2023

Global market backdrop

December unfortunately finished out the year in the same fashion we saw throughout 2022: weak overall equity market performance (global equities -4% for the month, -18% for the year), technology weaker still (Nasdaq -9% for the month, -33% for the year), and global value equities (-2% for the month, -6% for the year) outperforming global growth equities (-6% for the month, -29% for the year).

As was the case all year, the Christmas grinch was the US Federal Reserve. Its December decision was more hawkish than hoped for. Bonds were sold off, interest rates went up, and equities fell. Deja vu.

As we think back on the quarter and year that was 2022, three key themes emerge: COVID's impact is continuing to reverberate, companies who saw inflated demand from the pandemic are navigating their way back to earth, and the decades of declining interest rates are at an end.

COVID's aftershocks are still being felt

Three years on, COVID is still having big repercussions. Perhaps that's unsurprising when you consider the pandemic's economic consequences: the global economy basically stopped, and the US Federal Reserve Bank flushed in five times more liquidity than it did during the Global Financial Crisis. It seems clear that COVID aftershocks are going to be felt for a few years yet.

COVID-induced demand is unwinding

COVID clearly amplified demand for many industries. Take online shopping – we all became online shopaholics during the pandemic. The market knew this demand would unwind. A lot of companies that saw abnormally strong demand during the pandemic loaded costs and investment into their businesses to service it – now they're feeling the sting in the tail.

Meta was the poster child for this dynamic, hiring 28% more people in a year. Demand can turn on a dime – but any cost you have loaded into the business is stickier. So, just as the revenue from the COVID-induced demand flattened, Meta's costs were increasing.

The good news is that companies that are further through this journey have performed strongly out the other side. Netflix, for example, saw demand for its service unwind much earlier last year – and it took its medicine and cut costs to right-size its business. The stock is up 100% from its lows. Meta seems to be taking its medicine now, too. Mark Zuckerberg has promised the market he will cut 11,000 jobs, and the stock has bounced +40% so far.

The message from the market is crystal – if you are tone deaf on costs, you will be punished. But, if you listen to the market and rein in spending, you will be rewarded.

The gravitational drag of interest rates has returned

The last two years – especially 2022 – marked the end of a 40-year trend of consistently falling interest rates.

Warren Buffet described interest rates best as 'gravity' for the stock market: as interest rates fall, they act as a smaller and smaller gravitational drag on equity valuations – and vice versa.

And, in investing, muscle memory is a powerful thing. Over 40 years investors had come to believe that they were in a gravity-free environment, which is why we had the 'Everything Bubble' last year. Pick your poison – whether you were trading crypto or second-hand boats, interest rates were near zero, money was almost free, and everything an investor touched went up. Well, gravity returned in 2022, and most of those bubbles have popped.

Portfolio update

Alibaba (+8%) and Tencent (+16%) had a roller coaster ride during the quarter. Their stocks were both down more than 20% in October.

Although President Xi's reappointment at the 20th Party Congress was expected, other surprise changes in party leadership fuelled concerns that China may prioritise state objectives over the private sector. Ongoing COVID restrictions, property slowdown, and geopolitical tensions continued to depress market sentiment.

However, China's gradual re-opening began in November and continued into December, with confirmation that China has ended its zero-COVID policy. On 26 December, China released new guidelines to significantly relax its COVID control policy, effective 8 January this year. China relaxing its COVID policy is expected to suppress growth in the near term, due to surging infections, a temporary labour shortage, and increased supply chain disruptions. But, the policy change is expected to increase full year 2023 economic growth meaningfully.

Alibaba also released earnings that provided a mixed message of slower growth, but better profitability. For both Alibaba and Tencent, resuming growth on a base of reined-in costs bodes well for stronger earnings this year.

Greggs (+1%) has been helped by easing energy costs and the five price increases the company made in the last year to offset cost inflation pressures. Price increases have had no visible impact on customer demand. This highlights the company's defensive characteristics, and shows its cheap menu is being appreciated by consumers as they become more price conscious.

Greggs' store growth strategy is tracking well, and they are on track to end 2022 with 147 new stores, making 2,328 in total. Greggs is keeping stores open for longer into the evening to drive further revenue growth, with positive early indications. 500 of its stores were operating extended hours by the end of 2022.

Meta Platforms (+2%) was up and down during the quarter. It fell 31% in October as 2023 guidance missed expectations. The volume of ads served grew strongly, but most of this benefit was offset by lower ad prices due to Apple's ad-tracking changes and mix shift (meaning a change in the make-up of ad audiences) to lower priced markets and products with fewer ads, such as Instagram Reels.

Despite slower revenue, primarily driven by the impact of a weaker macro environment on digital ad spend, the company reached double-digit cost growth and much higher than expected capital expenditure.

The increased spend reflects a combination of investments into Meta's core advertising business (Reels, AI infrastructure) as well as its non-core Reality Labs metaverse. However, the company seemed to get the message from the market and reversed course on expense growth in November. In a memo to the firm, CEO and founder Mark Zuckerberg detailed the layoff of 13% (11,000) of Meta's staff.

The company's expense growth has been a large concern for the market, so investors welcomed the expense cuts and Meta's acknowledgement that it needed to show greater cost discipline. The stock is now up 47% from its lows in early November.

In general, this cost discipline is a trend we're seeing across the tech sector. We expect to see companies in better shape to weather a macro-driven downturn in 2023.

Netflix (-4%) released a strong quarterly update, with revenue and subscriber numbers beating expectations and better-than-expected subscriber outlook for the next quarter. Netflix ended the quarter with 223 million paid subscribers.

Accounting for foreign exchange rates, Netflix's average revenue per subscriber grew strongly across three out of four regions: North America (+12% year-on-year); Europe, the Middle East, and Africa (+7%); and Latin America (+16%). These regions together contribute 88% of group revenue.

Netflix continues to be a top streaming provider in the US and UK (where data is available), with 8% share of TV viewing time. This supports the company's value proposition in our view. Netflix launched a new ad-supported tier in early November and continues to roll out paid account sharing.

We expect these options to contribute robust free cash flow growth in the long term, by monetising non-paying Netflix users (estimated at 100 million households globally), attracting new users who may have considered Netflix too expensive in the past, and reducing subscriber churn.

PayPal's (-9%) recent weakness was also driven by a subdued early read on holiday sales. At the beginning of November, PayPal reported its Q3 2022 earnings. While transaction volumes and revenue growth were slightly weaker than expected for the quarter, cost cutting measures helped protect margins and profits. Management committed to growing 2023 earnings per share by at least 15%, fuelled by buybacks and at least 100 basis points of margin expansion through cost cutting.

Paypal's revenue growth is indexed to a potential economic slowdown, and investors are grappling with what near-term e-commerce growth will look like in that environment. Investors are also assessing whether PayPal is still taking the same market share in e-commerce payment flows, as competition has increased in the space over the past 3 years.

We think Paypal's value proposition for consumers (convenience and security of payment) and merchants (higher checkout conversion rates), plus its two-sided network effect moat should see the company continue to succeed in e-commerce payments.

NEW ZEALAND
CASH AND FIXED INTEREST

David McLeish, Senior Portfolio Manager

The inflationary tide looks to be receding

In the last three months of 2022, the Fisher Institutional New Zealand Fixed Interest Fund rose by +0.3% (+0.2% above its benchmark) and the Fisher Institutional New Zealand Cash Fund rose +0.8% (-0.1% behind its benchmark).

Fixed interest assets continue to be buffeted by rising interest rates on concerns that the inflationary tide has not yet turned. But during Q4, in stark contrast to previous quarters, lower valuations allowed cash and fixed interest assets to regain many of their defensive qualities – most notably, through the attractive level of interest income now on offer.

Rising interest rates continue to put downward pressure on prices. However, the healthy level of interest income both portfolios are now generating allowed them to produce positive returns for the quarter.

Lower fixed interest asset prices have formed a solid sea wall

Rising yields and static (in the case of New Zealand cash) or falling (in the case of New Zealand fixed interest) duration have significantly lifted the breakeven point at which rising bond yields in the future can inflict negative returns on these portfolios.

In its simplest form, we can calculate this breakeven point by dividing the yield of the portfolio by its duration. All else being equal, the higher this ratio, the better a portfolio is positioned to withstand future yield rises. Today, this metaphorical sea wall is as high as it has been in more than a decade.

We have good reason to believe the inflationary tide is receding

Both global and domestic economic activity is slowing, and with the impact of previous interest rate rises yet to be fully felt, consumer demand is likely to fall further in the months ahead. On top of this, a meaningful improvement in global supply chains and reduced raw material prices should see inflation recede over the coming quarters.

In this environment, the certainty offered by cash and fixed interest assets – both in terms of more reliable income and greater security – will likely become more highly sought-after by investors. This should support prices in future.

PROPERTY AND INFRASTRUCTURE

Sam Dickie, Senior Portfolio Manager

Solid finish to a defensive year

The Property & Infrastructure Fund finished the quarter up +3.0%, underperforming its benchmark index, which was up +4.1%.

New Zealand property (-4%) significantly underperformed Australian property (+12%) and global infrastructure (+11%) over the quarter. That was driven by a combination of a more hawkish central bank in New Zealand, poor local sentiment around housing and the broader property market plus sharper earnings downgrades for New Zealand-listed property companies.

We have purposely held a significant underweight in New Zealand property as those companies typically have narrower moats and shorter growth runways than those on offer globally.

Portfolio update

Mobile tower business American Tower (-4%) and Crown Castle International (-3%) were impacted in 2022 as fixed pricing escalators couldn't compensate for increasing costs, while rising interest rates lowered cash flow and valuation multiples. To compound this, a strong US dollar decreased the value of international cash flows for American Tower.

Crown Castle met earnings expectations for Q3, but initial 2023 guidance underwhelmed expectations. Growth in tower leasing, and conversion of the opportunity in 'small cells' (smaller urban tower sites) was less than expected. Despite this, we believe the stock has been oversold. We upgraded our position following the recent market sell-off.

While both American Tower and Crown Castle International have faced cyclical headwinds from rising costs and interest rates, the structural investment thesis remains intact.

Infratil (-2%) had another busy quarter, establishing a new Australian renewables platform, halting a 'strategic review' (sale process) for Retire Australia, and updating investors through two strategy days and a half year result.

Vodafone New Zealand's update struck a positive tone, with earnings in line with expectations, a large IT project nearing completion, a re-brand underway, and a fibre review in place to unlock further value from network assets.

The investment case for Vodafone New Zealand has been significantly de-risked following the sale of its mobile towers (returning 80% of invested capital). Execution challenges remain, however, as it seeks to maintain market share and improve EBITDA margins to 30%.

We decreased our position size in US Railroad investments, Norfolk Southern (-4%) and Union Pacific (-4%) in December. Profitability has been strong recently, primarily driven by pricing increases of around 20%. However, profits bring downside risks, as volumes face a cyclical downturn, while the potential for further price increases is modest.

Pricing for trucking, a substitute transport mode, has come down significantly from its peak. Norfolk Southern de-emphasised its cost efficiency plans at its recent investor day, citing the need to improve service levels. We continue to like the US railroads in the medium term given their wide economic moats and strong pricing power.

Following strong passenger recovery for global airports in Q3, Q4 saw absolute passenger numbers level off in the seasonally quieter European winter. Relative to 2019, European airports are continuing to see an improvement in passenger levels, but the recovery is flattening. Australasian airports were later to the passenger recovery and continue to see a robust improvement in numbers relative to 2019. Auckland and Sydney airports had passengers at 67% and 71% of 2019 levels respectively in November. A key investment question is whether cost of living concerns and a global economic growth slowdown will overwrite 'revenge travel' (pent up demand to travel) as a driver of passenger recovery.

The recovery has more room to run. Airlines are alleviating capacity constraints, allowing them to better serve demand that went unmet in 2022. We are also seeing China begin to reopen its borders to the rest of the world. Chinese travellers are a key source market for most international airports, and a significant driver of duty-free revenues. These factors will support further airport revenue growth in 2023.

Auckland Airport (-3%) announced that it will move to a single duty-free operator. From September 2023 onward, Aelia Duty Free (owned by Lagardère Travel Retail SAS) will be the main duty-free retailer at the airport, after winning an extension of its contract until mid-2025. Auckland Airport will then conduct a tender for the duty-free operation, which is an important event for the airport in its most valuable business segment.

The move towards a single operator should boost profitability for both Aelia and Auckland Airport. Auckland International Airport derives a turnover-based rent with minimum guarantees. Profitability will be improved by the removal of duplicate costs, while allowing Aelia to provide a deeper product range across greater floor space.

Vienna Airport (-2%) announced plans to build a new 510 room hotel in partnership with Wyndham Hotels and Resorts. It also announced three new retail concessions, focused on food, beverage, and a news agent.

Groupe ADP (-15%) unwound a cross-shareholding with Royal Schiphol Group, the owner of Amsterdam's airport. Each company previously held an 8% stake in the other. This transaction was widely expected, after shareholders authorised it at a meeting in May 2022.

ADP will net 420 million euros from the transaction, which it intends to use for selective international airport investments and to reduce debt to 4.5—5 times EBITDA by 2025. ADP also announced that TAV Airports (a Turkish subsidiary) has been awarded a 25-year extension of its concession to operate Ankara Airport. TAV will pay rent of 475 million euros over the extension period.

MARKET MOVEMENTS

As at 31 December 2022

Stock Markets*	Closing Values	Changes over: 3 Mths %	6 Mths %	12 Mths %
S&P Global LargeMidCap ($NZ)	N/A	-1.8	0.6	-11.5
USA - S & P 500	8178	7.6	2.3	-18.1
USA - Nasdaq	12589	-0.8	-4.7	-32.5
Japan - Topix	3101	3.3	2.4	-2.5
UK - FTSE100	7657	8.7	5.7	4.7
Germany - DAX	13924	14.9	8.9	-12.3
France - CAC40	18998	12.6	9.8	-6.7
HK - Hang Seng	62782	15.0	-8.1	-12.5
Australia - S & P 200	85188	9.4	9.8	-1.1
NZ-S&P/NZX 50 Gross Index (inc imp credits)	14248	3.8	6.0	-11.3
Market Volatility - VIX	21.7	-31.5	-24.5	25.8

Property		%	%	%
S&P/NZX All Real Estate (inc imp credits)	1609.2	-3.4	-5.1	-21.8
S&P Global Infrastructure Index (70% Hedged NZD)	6511.6	5.8	-0.9	N/A

Ten Year Bonds	%	Yield Changes		
USA	3.88	0.05	0.90	2.36
Japan	0.42	0.18	0.20	0.36
United Kingdom	3.66	-0.48	1.36	2.70
Australia	4.05	0.16	0.39	2.38
New Zealand	4.45	0.15	0.59	2.07

90-Day Interest Rates	%	Yield Changes		
USA	4.42	1.09	2.70	4.36
Japan	0.06	0.01	0.00	-0.01
United Kingdom	3.87	0.53	2.20	3.61
Australia	3.27	0.21	1.43	3.20
New Zealand	4.65	0.80	1.79	3.68

Bond Indices	Closing Values	Changes over: 3 Mths %	6 Mths %	12 Mths %
S&P/NZX Bank Bills 90-Day	753.53	0.96	1.64	2.23
Bloomberg Global Aggregate Index (Hedged NZD)	N/A	0.80	-2.91	-11.75
Bloomberg NZBond Infl 0+ Yr Index	5434.12	3.31	2.32	N/A
Bloomberg NZBond Composite 0+ Yr Index	1449.81	0.09	-1.32	N/A

Hedge Funds & Commodities		%	%	%
HFRX Global Hedge Fund Index (USD)	1368	0.2	0.7	#N/A
DJ-UBS Commodity Index Total Return	246	2.2	-2.0	16.1
Gold (US$/ounce)	1819.70	9.5	0.9	-0.4
Oil (US$/barrel)	82.82	-6.8	-30.9	7.2

Currencies		%	%	%
NZD / USD	0.6325	11.8	1.7	-7.6
NZD / EUR	0.5926	2.6	-0.4	-1.6
NZD / GBP	0.5258	3.8	2.7	4.0
NZD / AUD	0.9326	6.0	3.1	-1.0
NZD / YEN	83.45	1.9	-1.2	5.8
Trade Weighted Index	72.41	5.8	2.9	-1.1

**Total Return Indices. Indices are net of offshore tax.*
Source: Thomson Reuters Datastream