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Fisher Funds Market Insights

June 2024 Quarter

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The rising tide of global markets – lifting some boats more than others

Ashley Gardyne, Chief Investment Officer

Global markets have risen significantly in 2024, extending last year's gains and lifting many markets to record highs. While gains in the first quarter benefited a range of countries and market sectors, a handful of tech companies (including market darling NVIDIA) have driven the increases in the second quarter. This divergence is starting to create both risks and opportunities for investors.

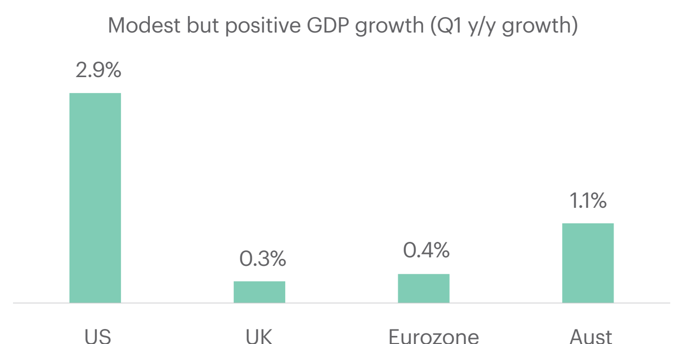
A rising tide

'A rising tide lifts all boats' is a favourite saying in financial markets, and the rising tide has benefited investors again this year. The US has had one of the strongest starts to a year on record – and the second-best start to an election year in the last century. The US S&P 500 has gained 14.5% in the year to date, while the broader MSCI World Index has gained 10.8%.

The surging tide has been driven by waning inflation and a global economy that has continued to grow, despite decade-high interest rates. Lending further support, some central banks have seen fit to cut interest rates amidst easing inflationary pressures. The European Central Bank was the first major bank to cut rates – following the lead of its smaller peers in Canada, Sweden, and Switzerland.

Inflation has fallen materially across the globe

Major economies continue to grow, despite higher interest rates



Source: Bloomberg

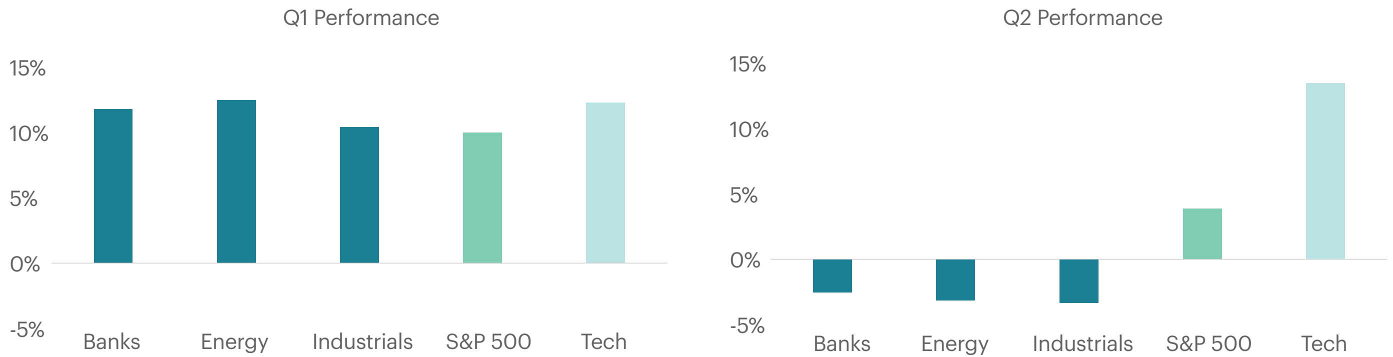
Two-speed market

This economic resilience drove a first quarter rally in cyclical sectors (like banking and energy), when they outperformed the wider share market. As shown below, however, this trend reversed in the second quarter – as incoming data suggested that interest rate cuts may finally be starting to bite.

While the rising tide was lifting 'all' boats at the start of the year, that dynamic has changed. Now, there are two very different parts of the stock market, running at different speeds.

After a strong rebound in

The outperformance of cyclical sectors in the first quarter proved to be fleeting

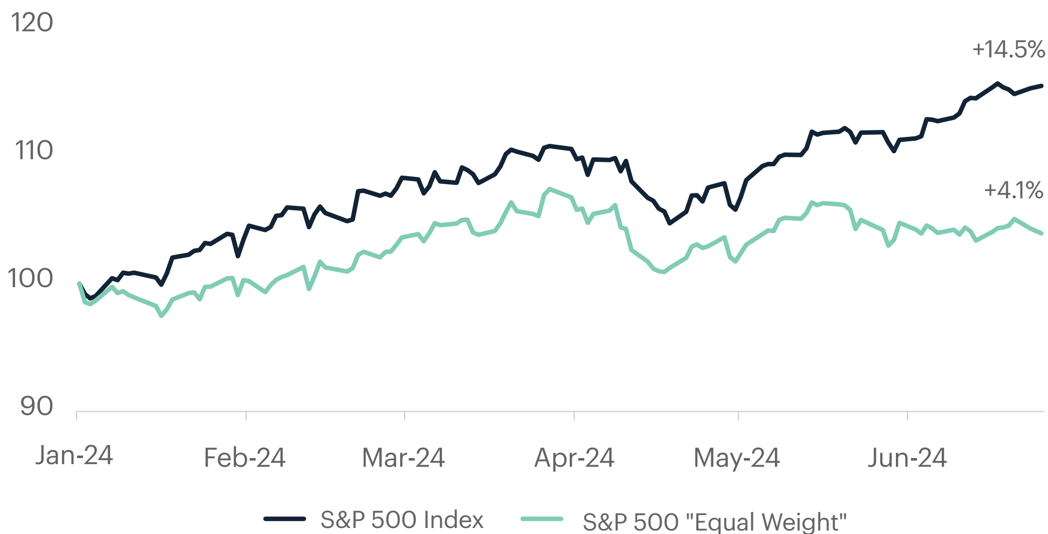


Source: Bloomberg

The US share market illustrates this two-speed dynamic well. While, as I mentioned, the US S&P 500 is up 14.5% this year, over 60% of this gain has been driven by just six big tech stocks: NVIDIA, Amazon, Microsoft, Meta, Alphabet and Apple. These stocks, and particularly AI-chip-maker, NVIDIA (+149% this year), have all benefited from the current market frenzy around artificial intelligence (AI).

The chart below shows that if we ignore the size of these big tech stocks (which together make up over 25% of the index) and instead assume that all stocks in the S&P 500 Index have the same weight, the index is only up 4.1% year-to-date (and down 3.1% in the second quarter). Viewed this way, there are clear winners and losers in the corporate sector.

The average company in the S&P 500 has gained only modestly in 2024

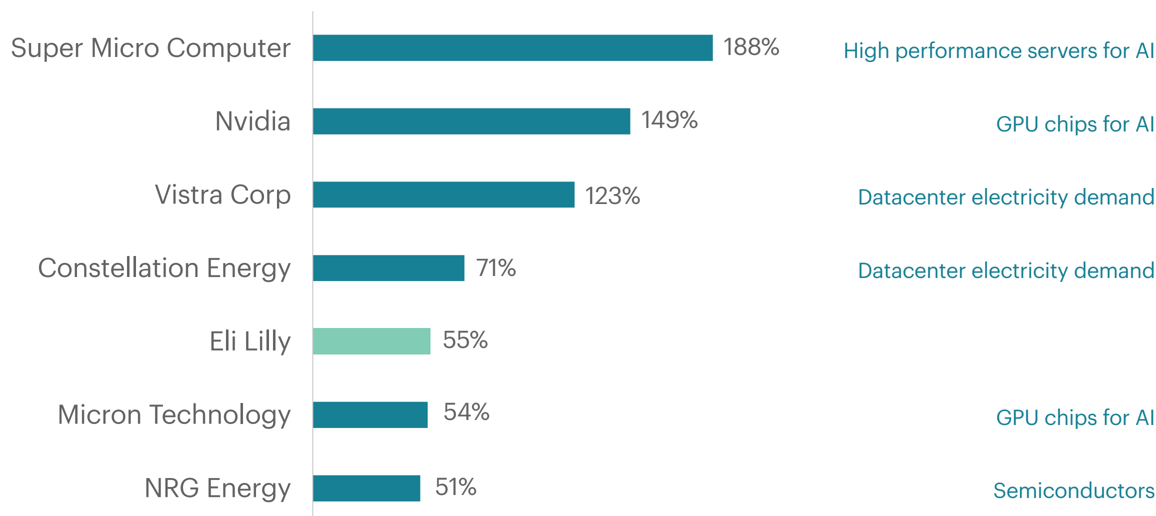


Source: Bloomberg

Companies with structural growth linked to AI – including silicon chip manufacturers, datacentres, and electricity generators – stand out among the top performers in markets this year. Six of the seven largest gainers in the S&P 500 so far in 2024 have benefited from AI-related themes.

That's either by producing silicon chips, building servers, or providing clean and reliable power (for example, nuclear) for the booming build-out of datacentres.ate cuts before our economy sustains further damage.

Six of the seven biggest market gainers in Q2 benefited from AI-related themes



Source: Bloomberg

The excitement around these themes has benefited investors materially over the last 18 months. The question now is whether these parts of the market are overhyped.

The US has also been running at a different speed to other markets

It's not just sectors operating at different speeds – the same is true of different markets, too. The US market has been powering ahead, while others (including emerging markets and our own) have been treading water.

This divergence in performance across markets is leading to an increasing valuation discrepancy. The US market is again trading at elevated valuation levels, while valuations in the UK and Europe look more reasonable. The New Zealand share market is one of the few that has yet to recover to its 2020 highs. With our economy still under significant pressure, selected companies are starting to look oversold.

Diverging share market performance over last three years

Source: Bloomberg

Where to next?

A prolonged divergence in performance across different markets and sectors can create both risks and opportunities. Companies and markets that outperform for long periods often become overhyped, while those that underperform can become unfairly beaten down.

At times of market divergence like these, it's important to be selective. While a handful of large US companies seem to be hitting record highs daily, plenty more businesses haven't yet rebounded from the 2022 sell-off. These businesses are still trading on relatively attractive valuation multiples. Many are high-quality businesses with years of growth ahead – they just happen to be in less trendy parts of the market.

As you'll read in the individual commentaries from our portfolio managers, we've seen this divergence in performance across companies, sectors and markets in many of our portfolios. Our team have been busy identifying new investment opportunities and positioning our portfolios accordingly.

New Zealand shares stay wrapped up tight during the economic winter

Matt Peek, Portfolio Manager, New Zealand Shares

The quarter's performance was led by Fisher & Paykel Healthcare (+18% total return) and cinema software provider Vista (+13%), supported by another solid return from Infratil (+4%). Performance detractors included wine maker Delegat (-20%), which announced a low 2024 harvest outcome, and Summerset (-17%), which declined as the broader New Zealand housing market remained soft through the quarter.

The local economic environment has not yet improved

New Zealand economic data has not improved as the year has played out, and negative updates from New Zealand companies came thick and fast in the quarter.

> New Zealand economic data has not improved.

Many of the most acutely impacted companies are those that rely heavily on discretionary consumer spend with most retailers releasing weak trading updates that underwhelmed already low expectations. This led to savage share price reactions: The Warehouse in general merchandise (-32% total return), Kathmandu in outdoor apparel (-36%), and Michael Hill in jewellery (-32%). Other consumer-facing companies have seen similar weakness including casino operator Sky City (-30%), Air New Zealand (off the back of weaker than expected domestic travel) (-12%), and campervan rental company Tourism Holdings (-44%) – particularly in relation to sales of ex-fleet vehicles.

Fortunately, none of these are portfolio companies.

Cyclical companies that rely on customers making large capital investments have also been impacted. For example, Fletcher Building (-31%) has seen lower than expected building activity. Metals distributor Steel & Tube (-17%) saw a deterioration in its activity levels. Telecommunications company Spark (-13%) even provided an unexpected profit downgrade, largely due to unexpectedly low demand in IT services from government and enterprise customers.

Among portfolio companies, those most acutely impacted by the New Zealand economy include Vulcan Steel (-23%), Freightways (-13%), and Mainfreight (-3%). We still think their business models will perform well longer-term —in fact, they're performing credibly compared to other consumer and cyclical exposed companies mentioned earlier. We did modestly reduce our position in Mainfreight, as we now think it will take the company longer to crack transport in the US market . However, the balance of the business is performing satisfactorily, and ongoing market share gains in Australia are particularly encouraging.

Offshore-focused companies with tailwinds were the biggest portfolio gainers (again)

The brightest spots in the portfolio are companies exposed to structural growth trends, primarily outside New Zealand.

Fisher & Paykel Healthcare (+18%) provided maiden revenue ($1.9 – $2.0 billion) and net profit ($310 – $360 million) guidance for its new financial year in line with expectations. All key areas of the business are demonstrating solid revenue growth momentum. In particular, anaesthesia (off a small base) and Obstructive Sleep Apnea masks are delivering outstanding growth. The outlook for ongoing growth is supported by management's confidence in a strong product development pipeline.

Xero (+2%) delivered a good financial result in May, with ongoing strong revenue growth and much better than expected cost containment. It exceeded the 'Rule of 40', with free cashflow margin (20%) plus constant currency revenue growth (21%) totalling 41%. Xero only recently introduced this aspiration, and it was expected to be a medium-term target. The result further builds the credibility of the heavily refreshed senior leadership team and their strategy for both balanced growth and profitability.

Infratil (+4%) raised $1.15 billion to fund organic investment opportunities in its portfolio, with the majority earmarked for Australia-based CDC Data Centres. CDC has won the confidence of large government and hyperscale customers (the likes of Microsoft) and has doubled its built capacity every two years or so. CDC expects to sign contracts on 400MW+ of capacity in the near term. Best-in-class water cooling systems and modular design make CDC well placed to support new artificial intelligence (AI) workloads –a key driver of this growth. A new Sydney site at Marsden Park will deliver around 720MW of capacity when fully built, making it one of the largest data centres globally. CDC has been part of Infratil's portfolio since 2016 and has increased in value tenfold over this period.

Vista (+13%) saw Australian private equity firm Potentia emerge with a 19.9% shareholding acquired from some of the company's other large shareholders. The stake was acquired at $2.10, which was a modest premium to the prior close of $1.84 – although the shares had recently traded as high as $2.00 after the release of the company's 2023 result in late February. We see Potentia's interest as a further sign that Vista is at a positive inflection point in the rollout of its next generation cloud-based cinema software products to customers.

The saga concludes: long-awaited certainty for the New Zealand electricity industry

On 31 May, electricity companies Meridian Energy (+6%) and Contact Energy (+4%) announced that they had signed long-term agreements to supply power to the Tiwai Point aluminium smelter. The smelter consumes around 12% of New Zealand's electricity, and its long-term future has been in doubt since owner Rio Tinto announced plans in July 2020 to shut it down.

The new 20-year contracts mean the companies will likely be able to commit to a higher level of dividends, supported by the certainty of higher earnings. The contracts also provide for 'demand response', allowing Meridian and Contact to free up electricity from the smelter when it's needed most, and when they are able to sell at high prices. Overall, the deal was widely expected – given the smelter's financial position has improved vastly from 2020 – but nonetheless a positive for the companies, as the tail risk of an unexpected shut down has been removed.

Long-term investment vision is key in a challenging Australian market

Robbie Urquhart, Senior Portfolio Manager, Australian Shares

Wide dispersion of share price moves provided us with attractive investment opportunities in Q2.

Returns were dispersed widely across sectors within the market, and across our portfolio during Q2. We saw economic themes weighing modestly on the broader share market. However, this dispersion of returns speaks largely to company-specific factors, rather than those broader economic trends. We elaborate on these factors below and we've been excited by the opportunities that certain share price moves have presented.

The 'higher for longer' interest rate environment weighed on shares in Q2

Inflation in Australia registered a 4% increase in May, stubbornly above the Reserve Bank of Australia's target band. This result, coupled with low unemployment (4.1%), and rising house prices, has pushed market expectations of an interest rate cut out to 2025.

This contributed to softness in sectors of the share market linked to the domestic economy, such as real estate (-7%), communication services (-5%), and the consumer discretionary sectors (-3%). In contrast, financials, which benefit from higher rates, rose +2%. The information technology (+2%) and healthcare sectors (+1.4%) — which are not as tied to the domestic economy – also performed better.

> Our investments in financials performed well overall.

In line with these trends, our investments in financials performed well overall. National Australia Bank (+6.6%), CBA (+4.9%), and ANZ (-0.9%) all delivered pleasing earnings results in the period. Modest credit growth and low levels of bad debts bolstered earnings for the banks. After a period of softer financial performance, Macquarie Group (+4.1%) highlighted in its financial result that FY24 is likely to be a tough year for earnings in its more cyclical divisions – its earnings are expected to grow in FY25.

Long-term earnings growth – a key driver of share price returns

Our investment process focuses on companies that can grow their earnings. As part of our research, we specifically focus on how prudently companies are either reinvesting profits or money raised (either through equity or debt issuance) in order to fund this growth. We prefer investing in companies that can grow by investing capital in their core, existing business.

We'll also back companies that acquire other businesses to bolster earnings growth – but only if those acquisitions are sensible and provide an adequate return on the cost of the investment.

During Q2 we participated in equity raisings for three of our companies to support them in accelerating their earnings growth. Pleasingly, the equity raisings were well received by the market, with the shares trading well above the issuance price in each case:

- In April, glove manufacturer Ansell (+7.2%) raised A$465 million to fund the acquisition – at a reasonable price – of a Kimberley-Clark business that designs and markets differentiated safety products, including gloves, protective apparel, and eyewear, bolstering Ansell's presence in the US life sciences industry.
- Data centre operator NEXT DC (-0.7% in Q2, but +13% from the issuance price) raised A$1.3 billion to accelerate the development and fitout of existing and new data centres across Asia – taking advantage of the exponential growth in data centre demand, partly driven by AI.
- In May, insurance broker AUB Group (+5.7%) raised A$200 million to partly fund the acquisition of a majority stake in underwriting agency Pacific Indemnity which focuses on specialty financial lines of insurance. Although the acquisition price looked relatively full, this acquisition aligns with AUB's stated intention to add scale in speciality agencies. It adds to the strength of the overall business.

In raising this capital, Ansell, NEXT DC, and AUB have all added to their longer-term earnings potential, which we think will benefit us as shareholders.

Share price weakness can be an opportunity for investors

We also invest in companies with a view of being business owners. As such, we're much more interested in what a business can achieve for its shareholders over 5 – 10 years than we are in the things affecting it over the next 2 – 3 months.

Part of our competitive advantage in investing is time. We constantly cross-check the investment theses underpinning our investment in a company. If the thesis remains sound, and we believe the underlying business will deliver good returns for shareholders over the long term, then share price gyrations predicated on shorter-term market concerns can create good buying opportunities.

In this vein, Audinate (-25.2%), fibre cement siding manufacturer James Hardie (-23.2%), employment classified advertising business SEEK (-13.5%), insurance repair business Johns Lyng (-12.3%), and software developer Atlassian (-13.2%) all provided us with attractive buying opportunities in Q2.

Networked audio products company Audinate had seen its share price rise sharply during Q1, as the company was added as a constituent to popular share market indices. But as incremental buying subsided, the share price pulled back. It fell sharply following the resignation of their CFO, who will hand over the reins to his successor later this year. We don't see anything sinister in his decision and expect Audinate will make a smooth transition to a new CFO in the coming months.

> The company showcased a number of new software products.

From a business perspective, we were pleased with what we saw when we attended Audinate's investor day in Sydney. The company showcased a number of new software products that are currently in development, which will enhance its earnings potential in both the networked audio and video markets. This adds to its long-term earnings potential.

James Hardie provided lower near-term FY25 earnings guidance than the market expected, given a cyclical slowdown in the US housing market. Yet it continues to invest heavily in its distribution channel and in growing its market share. When the housing market rebounds, it will do well.

Investors are concerned that SEEK's employment advertising will suffer as unemployment in Australia edges higher. Well run, SEEK continues to improve its product and service offering for its customers (businesses and recruiters), and should grow earnings strongly in time.

Johns Lyng's earnings are being negatively impacted by a lower level of 'catastrophe' weather events in Australia this year. Investors have also dampened expectations of how rapidly it can grow earnings in the US – a key growth market for the company. We visited Johns Lyng's management team in the US in April. We're impressed by the robust, methodical nature of their investment in that market, and how they're resourcing their US team. This positions them to grow strongly in the US in coming years.

Finally, Atlassian's share price has been similarly weighed down by near-term earnings concerns. In attending Atlassian's investor day, as with Audinate, we were impressed with the calibre of the team and the product development they're delivering to their clients.

The long-term potential in each of these businesses remains sound. We added to our positions in each of them during Q2.

Decelerating economic growth narrows the global stock market rally

Sam Dickie, Senior Portfolio Manager, Select International Shares

We've become used to seeing bond yield gyrations as the primary driver of shares in the last few years, but this quarter it was the sharp moves in economic growth expectations that pushed shares around.

After a broad rally in the first quarter of 2024, driven by accelerating global economic growth expectations, the second quarter rally was much narrower. Key economic growth drivers shifted from surprising positively in April to surprising negatively today. As a result, 2024 US GDP forecasts that were being lifted all year are now being trimmed slightly. This drove a sharp underperformance of cyclical sectors like transport and housing, which are typically more sensitive to shifts in economic expectations. The S&P500 equal weighted index (removing the disproportionate influence of large tech) was down -2%.

> We have exposure to the AI thematic via our 'picks and shovels' to the AI boom.

While we remember last year's Magnificent Seven (Meta, Amazon, Google, Microsoft, NVIDIA, Apple, Tesla) driving most of the stock market gains, that narrowed in this quarter to The Famous Four (Google, NVIDIA, Apple, Tesla). The ongoing rally in a narrow subset of AI-related stocks drove companies like NVIDIA, Apple, and perceived AI power winners, like Constellation Energy.

We have exposure to the AI thematic via our 'picks and shovels' to the AI boom – cloud providers like Microsoft, Google and Amazon. And we have exposure via the biggest users of AI technology (such as Meta), and via ASML – which has a near monopoly on the manufacturing equipment that makes the AI chips. But these stocks didn't keep pace with NVIDIA and Apple in the quarter.

Portfolio update

Tencent (+24%) benefited from the improved sentiment in China. Tencent is one of the highest quality companies in China, with its Weixin mobile app used daily by over 1 billion people. Tencent is in the early stages of monetising this userbase through highly profitable revenue streams, like advertising and financial services.

Alphabet (+21%) delivered a strong earnings result. An unexpected acceleration in Search revenue growth helped put AI disruption concerns to bed for the time being. Alphabet's new AI product, Search Generative Experience (SGE), has had positive initial results – consumers are using more searches, which potentially increases the revenue pie. Google Cloud, YouTube, and operating income margins all outperformed expectations. We took some profits during the sharp outperformance.

Two of our medical device companies, Boston Scientific (+10%) and Intuitive Surgical (+9%) launched new technologies that will drive material revenues over the next few years. Boston Scientific's market-leading FARAPULSE device helps correct an irregular heartbeat while minimising the damage to nearby healthy tissues, with an addressable market in the billions of dollars. Intuitive Surgical announced its next-generation surgical robot, the Da Vinci 5, with significant improvements over its decade-old predecessor.

Amazon (+7%) also delivered a solid earnings report. AWS, Amazon's cloud computing unit, continues to reaccelerate growth as optimisation headwinds recede, growing 17% (versus an expected 15%). AWS's operating margin is at 38% was well ahead of consensus at 30%, and management is confident in finding more upside to its overall operating margin. At the end of the quarter, it was reported that Amazon plans to introduce an ultra-low-cost section on their eCommerce platform. This helped address concerns around low-cost competition from the likes of Temu and Shein.

Mastercard (-8%) was a laggard on the back of a mixed earnings result and a softening US consumer spend. More recently, US District Court Judge

Brodie dismissed a settlement offering by US Banks/Mastercard/Visa to a group of retailers. The case, relating to an alleged overcharge on card swipe fees, dates back to 2005. We continue to monitor this case.

Salesforce (-15%) reported weaker than expected earnings. While software subscription revenue was largely as expected, the guidance for expected key growth metrics was below expectations. Additionally, management couldn't calm nerves about a potential large-scale acquisition it might do soon. Salesforce rebounded after its stock price fell in May, as investors saw the move as over-done. We reduced our weighting given the ongoing headwind to sales cycles and customers shifting spend from digital transformation towards AI initiatives.

Glucose monitoring manufacturer Dexcom (-18%) struggled during the quarter, despite reporting a solid earnings result. The fact that the company barely lifted full year revenue and earnings guidance – coupled with rekindled concerns about the effect on the business of GLP-1 agonists (like Ozempic) – impacted the price. We have added to our position into this weakness.

Dollar General (-17%) and Dollar Tree (-21%) underperformed in the quarter. A tough backdrop for low-income consumers overshadowed the tailwinds from higher-income consumers trading down, and specific store improvement initiatives. While customer traffic grew at both stores, customers reduced their spend per visit and reduced spend on more profitable discretionary items. Shoplifting, too, continues to be a headwind – not just for the Dollar Stores, but for retailers globally. We reduced our target weights, as ongoing headwinds are causing both companies to underperform our expectations.

Floor & Décor (-23%) was impacted by soft earnings, weakening existing home sales (a key driver of flooring sales), and ongoing high mortgage rates. While same-store sales growth was down -11% for the first quarter, the market expects this was the trough. With US 30-year mortgage rates still hovering around 7%, homeowners are reluctant to move house and trigger a refinance to the higher mortgage rate. This has kept existing home sales near GFC lows during Q2.

Portfolio activity

In May we added ASML to our portfolio. ASML is the leading manufacturer of lithography machines used to produce semiconductor chips. ASML has 100% market share in the cutting-edge lithography machines that are used to manufacture the most advanced semiconductor chips, such as those used in smartphones and laptops.

Advances in areas like AI and autonomous driving will require even more of these advanced semiconductor chips, which will drive ongoing demand for ASML's lithography machines. While the AI spotlight is currently on companies like NVIDIA and AMD, who are generating AI revenues today, ASML's AI revenue is currently minimal. However, this growing structural demand for increased computing power will underpin ASML's revenue growth over the medium-to-longer term.

Quality is king for bonds riding out high interest rates

David McLeish, Senior Portfolio Manager, Cash & Fixed Interest

The bond market had a choppy quarter, starting on a weaker footing due to 'soft landing' economic optimism, before recovering as US activity data worsened – led by the recently red-hot services sector. None of this, however, changes our overall positive view of high-quality fixed income assets: bonds are currently producing attractive levels of income, and we expect our baseline economic outlook – of moderate growth and lower inflation –to be supportive for the asset class.

The path ahead is towards lower, not higher, interest rates

Under the current 'tough on inflation' modus operandi, we believe central bankers will be slow to reduce overnight interest rates from here. If interest rates remain this high, the downside scenarios (of rising interest rate expectations) become less likely. This is because persistently high interest rates would continue to weigh on growth and inflation, reducing the need for central banks to lift interest rates further.

Moving the fund up in quality

Our baseline expectation for (at best) moderate growth and inflation – edging lower over the remainder of 2024 and into 2025 – is likely to benefit higher-rated bonds over lower-rated alternatives.

That's because lower-rated bonds are typically issued by less resilient businesses. These businesses tend to have a tougher time in high interest rate and slow growth environments. What's more, the extra yield (or credit spread) investors are currently receiving for holding lower-rated bonds is well below its long-run average.

This suggests that markets are not appropriately compensating investors for taking on the extra risk of lending to less resilient businesses. And it's why our fixed interest investment team continue to move the fund towards a higher-than-usual quality setting.

We're not crying over spilt milk

On a less positive note, the fund was adversely impacted this quarter by its investment in Synlait Milk Limited bonds.

Synlait manufactures and sells dairy goods, with an emphasis on branded infant formula products destined for Chinese households. The growth profile of the China market was disrupted by COVID, which has left Synlait with excess manufacturing capacity and too much debt.

The Board, executive team, and the company's cornerstone shareholder (Bright Dairy Limited) are currently working on a solution to reduce debt that's likely to involve a future equity raise. This process comes with execution risk, and the bonds traded lower during the quarter to reflect such uncertainty.

Nevertheless, we remain confident Synlait can and will attract new capital into the business – especially given the company's asset base includes its Dunsandel facility, which is a world class dairy processing plant.

The near-term path will be bumpy, but we expect to see a solution that will place the business on a firmer footing to pursue long-term growth opportunities – and that should help the price of their bonds recover.

Increasing demand for power and datacentres were the highlights as economies softened

Sam Dickie, Senior Portfolio Manager, Property & Infrastructure shares

After a broad rally in the first quarter of 2024, driven by accelerating global economic growth expectations, the second quarter rally was much narrower. While global shares were up for the quarter, many regions were down (including New Zealand, Australia, and Japan). And the S&P500 equal weighted index (removing the disproportionate influence of large tech) was also down 2%.

Key economic growth drivers shifted from surprising positively to surprising negatively. As a result, 2024 US GDP forecasts that were being lifted all year are now being slightly trimmed. This drove a sharp underperformance of cyclical sectors like transport (rails) and housing, which are typically more sensitive to shifts in economic expectations.

The ongoing rally in a narrow subset of AI-related stocks drove perceived AI power winners, like Vistra and Constellation Energy. We have exposure to the AI thematic via Infratil, and, to a lesser extent, Equinix and CMS. But these stocks didn't keep pace with companies like Vistra and Constellation Energy in the quarter.

Portfolio update

Infratil (+4.1%) raised $1.15 billion to fund investment in its portfolio – primarily CDC Data Centres. Infratil invested in CDC in 2016, and its investment has since increased in value by ten times. CDC has won the confidence of large customers in the government and 'hyperscale' (such as Microsoft) segments, leading the business to double its capacity every 2 years.

Infratil's capital raise was well-supported by the market and overshadowed some challenges in other parts of its business – such as a flat profit outlook for key investment One NZ. One NZ is facing headwinds in the New Zealand's enterprise and government telecom market, as customers tighten budgets. We participated in the equity raise, which was attractively priced at $10.15; Infratil's share price closed the quarter 10.3% higher.

NZ electricity 'Gentailers' Contact Energy (+4.0%), Meridian (+6.4%), and Mercury (not owned) announced long-term power purchase agreements with NZAS (owned by Rio Tinto) to support the aluminium smelter at Tiwai Point, Bluff. The 20-year contracts are fundamental for the construction of new power generation in New Zealand. Pricing is widely acknowledged to be at a material premium against the old contracts, and the market expects to see increased dividend payout ratios as a result. Meridian also hosted an investor day during the quarter, where they highlighted expectations for higher long-term power prices and a material earnings growth opportunity from demand response within its wider customer base.

> AENA operates a monopoly on 46 airports in Spain.

We added Spanish airport operator AENA (6.7%) to the portfolio this quarter. AENA operates a monopoly on 46 airports in Spain, the #2 tourist destination globally. AENA has one of the widest moats among global airports, with a sensible regulatory regime and best-in-class return on capital, supported by high margins and low relative capital intensity. Like many European businesses, valuation levels are currently relatively cheap. We think the market underappreciates AENA's runway for growth – particularly the commercial business, which has ample opportunity for optimisation within retail formats.

The Australia and New Zealand property sectors had a tough quarter, down -8.7% and -5.6% respectively. Financing costs are challenging dividends, and we saw several New Zealand operators reduce dividends during the May reporting season. We reduced our position in Goodman Property Trust (-11.2%) during the quarter. Several data points

globally and in New Zealand indicate slowing demand for logistics property, which the company is only just starting to observe.

We also exited our position in Australian office operator Dexus (-15.4%) during the quarter. Dexus's moat has been narrowing, with structural challenges in its key office segment combined with a stretched balance sheet. Dexus's office portfolio is high quality, but the overall market is soft, with tenant incentives dragging on cashflow and the dividend. We have been steadily reducing our position since February 2021, and the recent exit proceeds partially funded our investment in AENA.

Slowing economic growth impacted our cyclical investments, particularly North American freight railroads. Investor hopes of a near-term inflection in pricing were met with flat outcomes at best during 'bid season'. The railroads were more resilient than trucking stocks, and rail gained share of freight from truck – yet the overall demand environment was weak.

Canadian Pacific Kansas City (CPKC, -10.5%) missed expectations for first quarter earnings, and management highlighted the risk to earnings from a potential strike in Canada. Despite this, CPKC maintained full-year guidance for double-digit growth in earnings per share. Union Pacific (-7.5%) showed significant margin improvement despite soft volumes, and surpassed earnings per share estimates by 7%. Norfolk Southern (NSC, -15.3%) missed earnings expectations, driven by softer pricing and coal headwinds. Its ongoing productivity challenges and recent management changes are a source of uncertainty. We have steadily reduced our position in Norfolk Southern to fund investment in CPKC.

Our New Zealand port investments are also facing cyclical headwinds, with the subdued New Zealand economy weighing on performance. Port of Tauranga (-12.6%) has observed declining trade volumes due to both the economic environment and a decline in market share. Port of Auckland is re-taking market share as service levels improve, while higher rail costs are making Port of Tauranga less competitive for Auckland imports. We decreased our position in Port of Tauranga as we reconsidered the strength of the company's pricing power.

Finally, Napier Port (+2.4%) had a better quarter, as it begins to put the impact of Cyclone Gabrielle behind it. Despite container volumes falling, profits for the half-year rose 25% – largely due to price increases. We think Napier Port's pricing power has been underappreciated by the market, and it remains on track to meet 2025 profit targets set by management in 2021, despite the headwinds from Cyclone Gabrielle and a sluggish New Zealand economy.

Market Movements

as at 30 June 2024

Bond Indices	Closing Values	Changes over:		
		3 Mths %	6 Mths %	12 Mths %
S&P Global LargeMidCap ($NZ)	N/A	1.3	16.1	20.8
USA - S & P 500	11907	4.3	15.3	24.6
USA - Nasdaq	21589	8.5	18.6	29.6
Japan - Topix	4779	1.7	20.1	25.6
UK - FTSE100	8916	3.7	7.9	12.8
Germany - DAX	18235	-1.4	8.9	12.9
France - CAC40	23253	-6.6	1.9	4.2
HK - Hang Seng	59714	9.0	6.2	-2.2
Australia - S & P 200	99808	-1.1	4.2	12.1
NZ-S&P/NZX 50 Gross Index (inc imp credits)	14734	-3.1	-0.1	-0.8
Market Volatility - VIX	12.4	-4.4	-0.1	-8.5

Property		%	%	%
S&P/NZX All Real Estate (inc imp credits)	1564.3	-8.6	-8.4	-7.7
S&P Global Infrastructure Index (70% Hedged NZD)	7244.9	3.7	6.3	10.9

Ten Year Bonds	%	Yield Changes		
USA	4.36	0.16	0.48	0.55
Japan	1.06	0.34	0.45	0.67
United Kingdom	4.15	0.21	0.61	-0.26
Australia	4.31	0.35	0.36	0.29
New Zealand	4.67	0.08	0.30	0.01

90-Day Interest Rates	%	Yield Changes		
USA	5.48	0.02	0.08	0.05
Japan	0.31	0.05	0.23	0.24
United Kingdom	5.30	0.00	-0.02	-0.09
Australia	4.45	0.11	0.10	0.08
New Zealand	5.62	-0.02	-0.02	-0.09

Market Movements

as at 30 June 2024

Bond Indices	Closing Values	Changes over:		
		3 Mths %	6 Mths %	12 Mths %
S&P/NZX Bank Bills 90-Day	816.60	1.41	2.83	5.80
Bloomberg Global Aggregate Index (Hedged NZD)	N/A	0.08	0.06	3.82
Bloomberg NZBond Infl 0+ Yr Index	5943.05	1.23	1.36	8.84
Bloomberg NZBond Composite 0+ Yr Index	1555.63	0.80	0.99	6.75

Hedge Funds & Commodities		%	%	%
HFRX Global Hedge Fund Index (USD)	#N/A	#N/A	#N/A	#N/A
DJ-UBS Commodity Index Total Return	238	2.9	5.1	5.0
Gold (US$/ounce)	2327.70	5.0	12.9	21.2
Oil (US$/barrel)	84.99	-1.4	9.4	14.1

Currencies		%	%	%
NZD / USD	0.6093	1.9	-3.8	-0.5
NZD / EUR	0.5686	2.7	-0.8	1.2
NZD / GBP	0.4820	1.8	-2.9	0.0
NZD / AUD	0.9124	-0.5	-1.7	-0.9
NZD / YEN	98.02	8.3	9.8	10.7
Trade Weighted Index	71.97	2.1	-0.9	1.6

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

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