fisherfunds

Fisher Funds IMA Model Portfolios

Quarterly Report October 2024

Contents

Overview
Turning point for interest rate cycle boosts markets 3

New Zealand Equities
Newfound optimism and company performance drive stronger returns 6

Australian Equities
Interest rate cuts supportive for equities..................................8

Global Equities
Stock market rally continues but lots going on under the hood...............10

Property & Infrastructure Fund
Electricity demand and favourable interest rates buoyed Property & Infrastructure equities 12

New Zealand Cash & Fixed Interest
Lower interest rates help create favourable conditions for a soft landing..... 14

Global Fixed Interest
Fixed interest securities continue to offer competitive yields 16

Contributors this month

Ashley Gardyne
Chief Investment Officer

Matt Peek
Portfolio Manager

Robbie Urquhart
Senior Portfolio Manager

Sam Dickie
Senior Portfolio Manager

Quin Casey
Senior Portfolio Manager

Mark Brighouse
Chief Investment Strategist

Disclaimer: The content of this publication is intended for Fisher Funds Individually Managed Account Service clients. It may not be circulated or copied without the express permission of Fisher Funds Management Limited (Fisher Funds). The information and any opinions herein are based upon sources believed reliable, but Fisher Funds, its officers and directors make no representations as to its accuracy or completeness. All opinions reflect our judgement on the date of this report and are subject to change without notice. The information contained in this publication should not be used as a basis for making an investment decision about any particular company. Professional investment advice should be taken before making an investment. Past performance is not a reliable guide to future performance. This information is current as of March 2023 and is subject to change without notice.

Turning point for interest rate cycle boosts markets

Ashley Gardyne, Chief Investment Officer

The third quarter of 2024 marked a long-awaited turning point, as central banks shifted from a singular focus on inflation, to also looking to support employment and growth. While volatility picked up in August as investors expressed concern about weaker employment data, markets pushed to new highs when the US Federal Reserve (Fed) decisively cut interest rates in September and signalled more easing ahead.

Changes in central bank policy were a major focus and driver of markets this quarter. Fed Chair Jerome Powell and RBNZ Governor Adrian Orr began the third quarter by signalling that further improvements in inflation data were needed before interest rate cuts could be considered. They got what they'd been hoping for, as inflation continued to decline during the quarter and got closer to both central banks' target ranges.

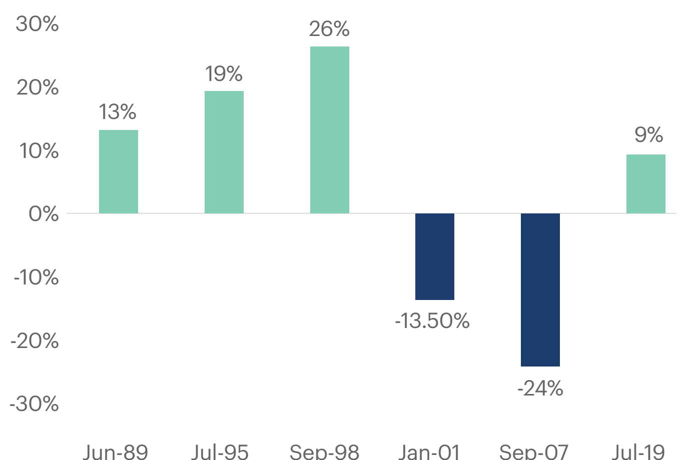
After two and a half years of interest rate hikes and restrictive monetary policy, both central banks initiated their long-awaited easing cycles. New Zealand's prolonged economic slump, combined with inflation being back under control, led the RBNZ to deliver an earlier-than-expected 25 basis point cut in August. A few weeks later, the Fed followed with a more aggressive 50 basis point cut. These moves were greeted as a decisive shift to a phase of easing and an emphasis on preventing further increases in unemployment.

Markets tend to perform well the year following the start of a rate cutting cycle. However, this performance often hinges on whether a recession follows within the next 12 months. The context of the rate cuts is critical: are we witnessing 'celebratory' cuts, where the economy is on stable ground, and lower interest rates further support growth? Or are we seeing 'desperation' cuts, where central banks are scrambling to avert a recession, as we saw in 2001 and 2007?

US CPI Inflation is in range of the Fed's target

Source: Bloomberg

S&P500 returns 1Y post the start of a cutting cycle



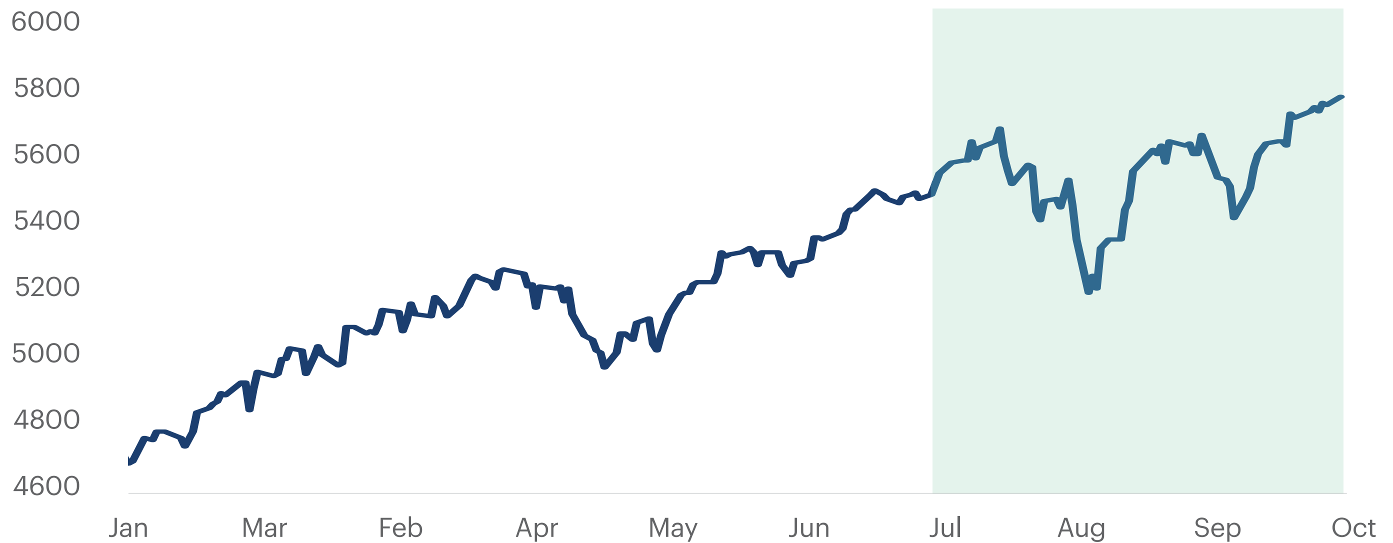
Source: Bloomberg

Not All Smooth Sailing

Despite markets reaching all-time highs by the end of the quarter, the journey was far from linear. The chart below shows the US market fell over 8% from mid-July to early-August.

Chief among the drivers of this volatility were fears of a slowing economy and whether the Fed was behind the curve in addressing the cracks that were appearing. A surprise downturn in US employment data for July contributed to this sell-off – as did an interest rate hike by the Bank of Japan, which sent the Japanese share market down sharply. However, markets quickly rebounded as central banks moved to ease monetary policy later in the quarter.

US S&P 500 Index: The path to all-time highs wasn't linear



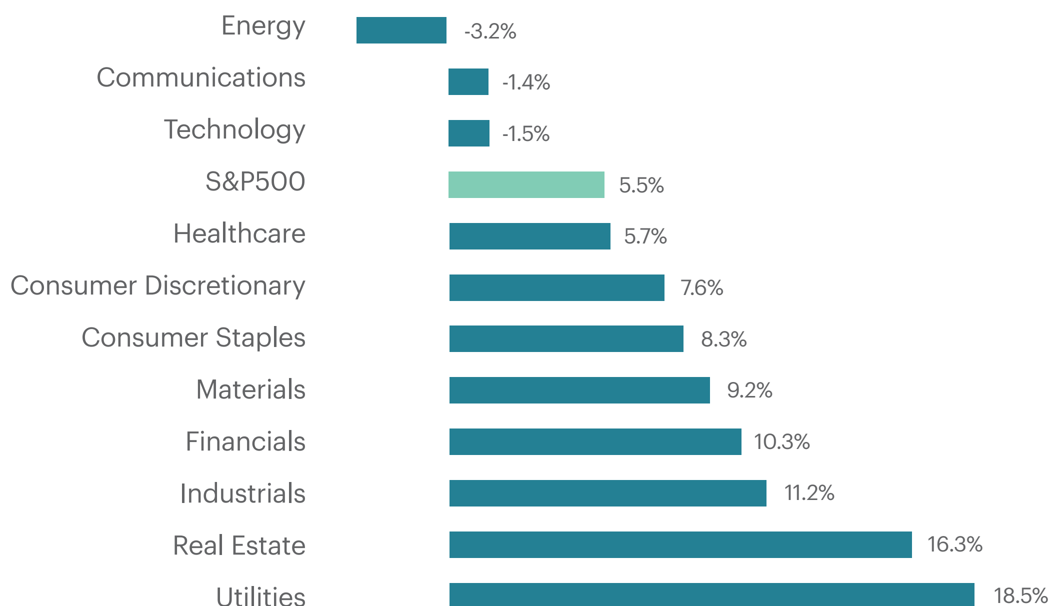
Source: Bloomberg

Spreading the love

The prospect of lower borrowing costs worked its magic on the market. Markets have surged to new highs since the Fed's 0.50% interest rate cut and the signal that it's committed to lowering rates further.

The Fed's assertive stance has also resulted in a long-awaited shift in market leadership, spreading performance beyond the large tech names that had dominated for so long. Within the 'Magnificent Seven' tech stocks, notable leaders like NVIDIA, Microsoft, Amazon, and Google ended Q3 lower than where they began. This is a positive development for the broader market, as it signals a broadening in the economic recovery and reduces the vulnerability to sharp market corrections if this narrow group of market leaders falters.

In the third quarter, eight of the S&P 500's eleven sectors outpaced the broader index, a sharp contrast to the first half of the year, when only technology and communications managed to outperform. Cyclical sectors like Utilities and Real Estate – both highly sensitive to interest rates – emerged as top performers.



Source: Bloomberg

On the home stretch for 2024

Q3 marked the long-awaited turning point, as central banks shifted from a singular focus on inflation, to a more balanced approach supporting growth. While the Fed seems close to achieving its elusive soft landing, recent market volatility has reminded investors that the march higher in markets is never a straight line.

As we look ahead, the fourth quarter may well bring more turbulence as the market tries to discern whether interest rate cuts are coming fast enough to prevent further economic harm. Event risks, including the US presidential election and escalating tensions in the Middle East, also create uncertainty.

What's encouraging, however, is that company fundamentals remain robust, with earnings growth hitting its highest level in three years and broadening across sectors – not just in the tech heavyweights that supported markets earlier in the year. As we head towards the end of the year, this combination of strong fundamentals, falling interest rates, and positive economic growth provides a solid foundation for markets.

Newfound optimism and company performance drive stronger returns

Matt Peek, Portfolio Manager, New Zealand Equities

There were several solid contributors, with holdings exposed to the local economy responding positively to the Reserve Bank of New Zealand's first interest rate cut.

In addition, the quarter again saw strong performance from **Fisher & Paykel Healthcare** (+16% total return) and cinema software provider **Vista** (+19%) off the back of positive outlook updates. The sizeable positions in Infratil (+9%), **EBOS** (+14%), and **Xero** (+10%) all performed well. Detractors from performance this quarter were **a2 Milk** (-4%) and **Contact Energy** (-7%).

The Fund's holdings generally performed well

Almost all our portfolio companies provided updates in the quarter, either through financial results or trading updates around annual meetings. The good news was that many delivered positive updates.

Fisher & Paykel Healthcare provided strong revenue and net profit guidance for the first half of its 2025 financial year and increased its full-year profit outlook. The year has started strongly across all products and regions. In the Hospital division, the key contributors included ongoing change in clinical practice in favour of the company's therapies, a good response to new product innovations, and relatively high respiratory hospitalisations. In its Homecare division, its new OSA (obstructive sleep apnea) masks continue to sell well. The company is also seeing gross margin improvements as it returns to its programme of efficiency and continuous improvement activities.

Vista reported the first half result for its 2024 financial year, with revenue impacted by the 19% weaker US box office following the 2023 writers' and actors' strikes. The strikes delayed the release of certain movies in the 'film slate', with Vista's box-office-exposed divisions feeling the impact. Positively, the company has been able to manage its cost base well following its late 2023 'transformation' and focus on operating more cost-efficiently. The company has clarified that it expects its core operating profit margin to be 13-14% for the year (versus expectations of around 12%) and aspirations of 16-18% in December 2025 (versus 15%+ previously). The company has become increasingly confident of achieving its targets in terms of Cloud and Digital customers live by the end of 2024 and is sticking by its aspiration of at least $175 million annualised recurring revenue by the end of 2025.

a2 Milk was the notable exception, as guidance for the next financial year of mid-single digit revenue growth and flat profit margins fell short of expectations. The company called out supply-chain issues, which mean it needs to air-freight stock into market at a significant additional cost ($10 million), with an impact on sales. The company also pushed out profitability targets for both its US business and Mataura Valley Milk processing facility. These unexpected negatives detracted from what has been continuing strong in-market execution from the company in the China infant formula market.

Renewed optimism despite the persistence of challenging economic conditions

As 2024 has played out, economic data has worsened. However, during the quarter share prices rebounded as investors became more optimistic that the economic outlook may improve in the next year. In July, the Reserve Bank of New Zealand (RBNZ) noted inflationary pressures were subsiding and then followed through in August by cutting interest rates by a quarter of a percent and foreshadowing further cuts.

> Share prices rebounded as investors became more optimistic.

Across the market, companies that would benefit from a stronger New Zealand economy saw their share prices lift. This extended to several portfolio holdings such as **Port of Tauranga** (+28%), courier company **Freightways** (+21%), steel distributor **Vulcan Steel** (+16%), and trucking and logistics company **Mainfreight** (+7%).

In addition, retirement operators **Summerset** (+27%) and **Ryman** (+21%) benefited as the RBNZ cuts enable lower mortgage rates, with the potential to breathe life into the housing market. A tougher environment for vendors has meant residents are having a harder time selling the family home in

advance of moving in, which has forced operators to reduce their build rates to conserve cash and match unit deliveries to demand. The business model also sees greater value accrue to operators in a rising housing market, as vacated units can be resold at higher prices. In addition, listed retirement operator peer **Arvida** (+80%) saw a Board-endorsed takeover approach at a material premium, which illustrates that share prices in the sector had become overly pessimistic, with private investors willing to pay much higher prices by taking a longer-term view.

Ryman provided two positive updates during September. Early in the month, it announced a business improvement programme. The company is recalibrating its residents fees to more sustainable levels, relative to its quality offering, which will improve financial performance. Ryman is also restructuring its team to operate more efficiently and implementing its decision to halt breaking ground on new villages until after it has delivered existing projects and recycled capital to reduce debt. Ryman also announced that it is appointing Naomi James as its new CEO. She has a sound track record, having assisted Refining NZ (now Channel Infrastructure) in successfully transforming from an oil refinery to a fuel import terminal. It's also pleasing to see that Naomi is appropriately incentivised to build value for shareholders. These updates reflect well on the new Board and provide us with increased confidence in the future strategy and performance of the business.

With the newfound optimism, we're not yet seeing tangible signs of stronger economic growth but believe interest rate cuts were a necessary first step to seeing better conditions in 2025 and beyond for our companies with local operations.

The New Zealand share market has sprung to life with share issues

The quarter saw several companies offer new shares to investors. But, in our view, not all share offers are created equal.

We generally prefer offers to fund compelling incremental growth opportunities. For instance, **Infratil** raised $1.275 billion in June to fund growth opportunities across its portfolio. Most capital is earmarked for its CDC Data Centres business, which is seeing strong demand growth. Every new dollar invested generates high rates of return. We were supportive, given the company's long-term track record of investing wisely to create value, including at CDC.

In this vein, **Auckland Airport** (-1%) raised $1.4 billion to fund the development of its new integrated terminal. We were expecting an equity issue at some point given the size of the overall project, but were surprised by the timing and quantum of the raise. While debate remains around the finer details, the existing dated infrastructure needs a material upgrade, and investors should be allowed a reasonable return on this investment. We participated, given its position as New Zealand's premier airport precinct.

Outside of the portfolio, **Synlait** raised $218 million of new equity and **Fletcher Building** raised $700 million. Both were from a position of weakness, to repair overly indebted balance sheets while earnings are under pressure. While their shares have recently rallied from their lows, as concerns around financial distress are alleviated for now, they have respectively returned -59% and -36% for the calendar year 2024. Both companies have a lot to prove given their chequered track records of allocating capital into poor investments and allowing too much debt to accumulate on the balance sheet.

While not a share issue per se, **Contact Energy** announced plans to buy near pure-play hydro generator Manawa for around $2 billion, with Manawa shareholders (including Infratil with its 51% stake) receiving a combination of Contact shares and cash. While the portfolio nicely complements Contact's hydro generation, to justify the price tag paid, it will need to execute well to deliver the anticipated portfolio benefits and cost savings. The deal also means that Contact is issuing a large number of shares to Manawa holders in lieu of needing to raise equity from existing shareholders, which dilutes upside potential to existing Contact shareholders. The deal is subject to Commerce Commission approval and comes at an interesting juncture for the sector, given recent media and political scrutiny. While it remains to be seen if the deal will get approval, it's worth noting that the deal is yet another high-value exit for Infratil, a significant position for the Fund.

Interest rate cuts supportive for equities

Robbie Urquhart, Senior Portfolio Manager, Australian Equities

Softer economic data resulted in several central banks globally cutting interest rates for the first time in years. This proved supportive for equities.

In Australia, the Information Technology (+17% in A$), Real Estate (+14%), Industrials (+9%), and Consumer Discretionary (+9%) sectors led the market higher. Only Energy (-9%) and Utilities (-3%) finished Q3 in the red.

A large dispersion of returns within sectors was driven largely by company specific factors that emerged when reporting their financial results during Q3.

Wisetech continues to widen the moat around its business

Wisetech (+40% in A$) was the standout performer for our portfolio in Q3. It delivered superb financial results for FY24. Revenue and pre-tax profit grew close to 30%. It also guided to strong revenue and profit growth again in FY25.

> Wisetech was the standout performer

Wisetech's Cargowise software product suite is becoming to freight-forwarders what Microsoft 365 is to many businesses and consumers – an indispensable tool. Cargowise now counts 14 of the largest 25 global freight-forwarders as customers. These customers are outperforming those that don't use Cargowise. This performance bodes well for further customer wins in the future.

Wisetech is the clear leader in global logistics software. It also continues to invest aggressively in broadening and improving its product range for its customers. It spent over $360m in innovation and product development in FY24 alone, adding to future growth potential.

Wisetech's shares do not trade cheaply (they rarely do). However, it has several key characteristics that we look for in companies. Its scale and its increasingly ubiquitous use across the logistics industry is a key source of its wide moat. It provides a necessary service to its customers and is less subject to economic cycles. The company is well run by a passionate founder who is well-aligned with shareholders. Founder Richard White and his team are focussed on maximising value long term. Wisetech has plenty of scope for growth.

Improving outlook is supportive for our defensive and cyclical industrial portfolio companies

Falling interest rates increased investor confidence that global economic growth would improve. This buoyed the share prices of fibre cement manufacturer **James Hardie** (+21%), and employment advertising business **SEEK** (+15%). Both benefit from accelerating economic growth.

Ansell (+22%) likewise does better in a rising economy. After a pandemic-affected few years, FY24 has seen customer activity returning to normal, leading Ansell to guide to earnings growth once again in FY25. The market has also continued warming to Ansell's acquisition of a competitor's protective equipment division. When making acquisitions, it makes intuitive sense to acquire near the bottom of the cycle when expectations are depressed. It's harder to do in practice. We support Ansell's courage in completing this deal at this point of the cycle.

Brambles (+34%), the largest pooled pallet provider globally, was another industrial shareholding that delivered a well-received financial result. Its size advantage over competitors enables it to better service its customer base. This provides it with pricing power when re-negotiating customer contracts. This advantage was evident in its financial results where, despite substantial de-stocking of pallets by customers, Brambles managed to grow earnings by 17% in the year. Brambles is producing strong cash flow and expects to sustain this, as signalled by an increase in its dividend payout rate and a US$500m share buyback.

Growing pains afflicted some of our smaller portfolio positions during Q3

Audinate (-38%), **Johns Lyng** (-33%), and **PWR Holdings** (-16%) all fell sharply after they reported their financial results.

With earlier stage, faster-growing companies such as these, the market can often have outsized positive or negative reactions to good or bad earnings results. This reaction is because the market tends to extrapolate the most recent earnings trends. This focus on the most recent trends has a larger impact on the overall valuation of faster growing companies compared to mature businesses if earnings growth reverses – even if that change is temporary.

In talking through the sources of investor disappointment with each management team, we think that the earnings growth headwinds facing each company will be resolved. As such, we have bought more shares in all three companies.

In Audinate's case, the company delivered strong growth in FY24. But it guided to a modest decline in revenue for FY25 compared to market expectations of another year of strong growth. This stems from some customers over-ordering networked audio chips in FY24 as the pandemic-related supply chain constraints eased. Once this excess inventory is sold, Audinate expects revenue to grow strongly once more. Given uncertainty over exactly how fast this excess inventory will take to clear, investor caution is understandable. However, the shift from analogue to digitally networked audio signals has a long way to run. Audinate's technology has become the industry standard in networked audio. Audinate will continue to grow and benefit from this structural shift.

Johns Lyng remediates properties damaged by insurable events (for example, weather events such as floods) on behalf of insurers. Its FY24 revenues were impacted by a period of benign weather in Australia, leading to less weather-related repair jobs. This impact was compounded by poor performance by a handful of its business units in one Australian state. This performance resulted in an insurer reducing the allocation of repair jobs to Johns Lyng. Management swiftly replaced the underperforming business partners. The insurer has since increased its allocation of work to Johns Lyng. While disappointing, we are pleased with management's speed in addressing this issue. Johns Lyng remains well placed to continue taking market share and growing strongly in Australia and the US.

In PWR's case, strong revenue growth of 25% was recorded in the year. However, PWR is spending a significant amount in FY25 to increase production capacity. It is also adding meaningfully to its highly skilled employee base. This is in anticipation of winning contracts from aerospace customers – a new avenue of growth for the company. The costs are incurred ahead of the revenue growth and hence weighs on near-term earnings growth. These steps arguably increase the scope for PWR to keep growing strongly in the future. As such, in our view, this additional spend is a good, rather than a bad thing!

Stock market rally continues but lots going on under the hood

Sam Dickie, Senior Portfolio Manager, Global Equities

While global stock markets continued their rally, plenty was going on under the hood during the quarter.

In July and August, softening US labour data and falling inflation spurred expectations of imminent interest rate cuts by the US Federal Reserve (Fed). This expectation drove a sharp change in market leadership – small companies and value stocks started outperforming growth stocks as investors piled into companies that were in more need of interest rate relief, resulting in growth stocks underperforming value stocks by 7% for the quarter.

In early August, the Japanese Topix market fell 12% – its biggest daily drop since Black Monday in 1987. This drop was driven by an unexpected interest rate hike by the Bank of Japan, flying in the face of the interest rate cutting bias other global central banks were taking.

In September, the Chinese Government fired what can only be termed a "bazooka" – a multi-pronged stimulus (monetary, fiscal, macro-prudential), at a time when sentiment was at its lowest ebb and the China market had its strongest rally in years. The Fed made its long-awaited first interest rate cut (on pause since July 2023) and cut rates 0.5%, largely as expected by the market.

Against this backdrop, the portfolio had four stock-specific issues rear their head in a short space of time (July was tough). While we expect our investment theses to change from time to time, it is rare to have four things happen at once.

Portfolio update

Perceptions of a softening consumer and US economy helped provide an opportunity in Mastercard. This, coupled with the ongoing tailwind of falling global inflation (fell 1% to 4% over the quarter) drove mortgage rates down to their lowest level in two years, spurring Floor and Decor.

Floor & Decor (+25%) was buoyed by falling interest rates (US 30-year mortgage rates have fallen from a high of around 8% to around 6%), fuelling expectations that the key lead indicator of flooring demand – existing home sales – will rebound from near 50-year lows. Key competitor LL Flooring filed for bankruptcy in August, serving as a reminder of how well Floor & Decor is doing versus competitors in a tough macro environment.

Floor & Decor was buoyed by falling interest rates.

Mastercard (+12%) was under pressure due to the combination of potentially softening US consumer demand and lingering concerns after US District Court Judge Brodie dismissed a settlement offering to a group of retailers by US Banks/Mastercard/Visa. We added to the position as these concerns were overblown. Regulation is something Mastercard has dealt with for years and the company has continued to gain market share in every major market around the world, despite most of those markets having heavier regulation than the US.

MSCI (+21%) continues to gain market share in its core index business. Customer retention rates have rebounded after temporarily falling earlier in the year following the merger of two large investment banks. MSCI is expanding its customer base and growth runway by offering more customised indexes and solutions. For example, wealth management sales grew 12% year on year and hedge fund sales grew 15% year on year in the quarter, both ahead of total company growth. Another growth avenue for the company is nascent private asset indexing and benchmarking, with MSCI announcing the launch of 130 private asset indexes.

Tencent (+19%) continues to demonstrate its ability to outgrow peers against a tough China macro backdrop. More recently, the share price was strong, in line with the Chinese stock market which was buoyed by a multipronged Government stimulus package. Monetary policy was eased, liquidity was flushed into the market, property lending restrictions were eased, and direct stock market stabilisation measures were introduced.

The backdrop for healthcare companies is challenging. The funding for biotech companies is volatile, impacting clinical research organisations like Icon. Edwards Lifesciences is facing capacity constraints in hospital operating rooms and Dexcom made some missteps in the execution of its growth strategy.

Icon (-8%) was impacted during September by the market perception that demand from large pharma customers may be weakening. The anticipated biotech recovery is also stalling, following several comments by competitors at broker conferences. The company subsequently stated that it's not seeing any incremental weakness in demand from large pharma customers and Icon is gaining share with these customers. While the biotech recovery is slower than expected, new business wins continue to grow. We think this was an over-reaction by the market and have added to the position.

Edwards Lifesciences (-29%) fell sharply as expected growth in its core transcatheter aortic valve replacement (TAVR) medical device fell below expectations. The company revised its full-year guidance from 8-10% to 5-7% growth, citing capacity constraints in the operating rooms used to perform the TAVR procedures. While not clear on timing, the company expects this slowdown to be temporary and for procedure growth to return to the target 8-10% range over time. The market took a more negative view – raising two concerns: TAVR penetration – as it is increasingly challenging to identify and treat these patients – and competition, with several competitors looking to take some of Edward's 60% global market share. While we think a long growth runway is still ahead for Edwards, we have reduced our position as we wait for more clarity on the pace of the turnaround.

Dexcom (-41%) fell sharply during the quarter as it unexpectedly lowered its growth expectations for the year, with the company guiding to 4-8% revenue growth in the second half, down from 20% growth in the first half. Unlike Edwards Lifesciences, these headwinds were somewhat self-inflicted. This is a company that has executed well, growing sales of its continuous glucose monitors (CGMs) nearly 30% p.a. over the last five years to around $4 billion globally. With a lot going on, including a major salesforce restructure; the launch of new consumer-facing CGM; and the ramp-up of two manufacturing facilities, the company has run into challenges that have impacted its growth. While we think a long growth runway is still ahead for Dexcom, we have reduced our position as we wait for more clarity on the pace of the turnaround.

Portfolio activity

We added Hermès and NVIDIA to the portfolio during the quarter

Hermès is a French luxury design brand that sells leather goods, clothes, silk scarves, homeware, and jewellery. The company is known for its iconic Birkin and Kelly bags, where resale values often exceed retail. Ultra-high-quality products, exclusivity (key leather products are hard to acquire and have waiting lists), and a vertically integrated supply chain (quality control), give Hermès a strong brand moat. And Hermès is run by a very long-term oriented management team. The luxury sector has been under pressure as Hermès' competitors 'over-earned' coming out of COVID by raising prices too aggressively. Hermès got caught up in that poor sentiment (despite the company not aggressively raising prices) and that gave us an opportunity to add it to the portfolio.

NVIDIA is a semiconductor chip designer specialising in GPUs (accelerated computing chips), of which it is the world's largest supplier (~85% market share). NVIDIA's GPUs are used in data centres (~90% of its earnings), robotics, gaming, professional visualisation, and autonomous driving. NVIDIA's ten-year head start developing its ecosystem of chip hardware, software, and networking creates a lock-in effect for customers and underpins the moat. Demand for accelerated computing will remain high for some time. The company's co-founder continues to run the company along with a highly talented management team.

While we still have concerns about too much AI hype in the market, coupled with the higher-than-normal uncertainty that comes with a brand-new revenue stream (GPUs being swapped for legacy chips/CPUs in the datacentre), the recent PE valuation de-rating vs the S&P500 by around 25% gave us an opportunity to initiate a small position.

We exited Dollar Tree and Dollar General during the quarter

The dispersion we are seeing within various sectors of the US economy is unusual. For example, new home sales are at decade highs while existing home sales are at multi-decade lows. And while the overall US consumer is robust, the low-end consumer is, in a relative sense, doing much worse than it has in decades. The COVID aftershocks continue, and the relative weakness of the low-end consumer impacted the dollar stores.

During the Global Financial Crisis, dollar stores sales growth accelerated as consumers traded down. This characteristic has not been repeated in the current environment. Low-income consumers (who make up most of the customer base) continue to reduce spending in the face of the higher cost of living, doing significantly worse than higher-income consumers. But, as higher-income consumers begin to tighten their belts also, dollar store companies are facing increased competition from large discount stores like Walmart and ecommerce retailers trying to win customers back. This is a change in thesis, so we exited the small positions.

Electricity demand and favourable interest rates buoyed Property & infrastructure equities

Sam Dickie, Senior Portfolio Manager, Property & Infrastructure Fund

This quarter was strong for property & infrastructure equities, with global infrastructure equities the standout (+13% for the quarter), outperforming global equities (+6%), US equities (+6%), and emerging markets (+9%).

Utilities drove infrastructure's strong performance, with US utilities up +20% for the quarter. Electric utilities are seeing the prospect of sustained demand growth for the first time in two decades. Datacentres, particularly those supporting artificial intelligence, are key drivers of growth in future demand for electricity in the US and several other markets globally.

> Utilities drove infrastructure's strong performance

Our portfolio has several stocks that benefit from the rise of artificial intelligence and datacentre demand, such as **Infratil** (+9%, owner of CDC datacentres), **Equinix** (+18%), **AMT** (+20%, owner of Coresite datacentres), and **Goodman Group** (+6%, where a significant portion of work in progress is datacentre properties). We have not benefitted from the emergence of a premium price for nuclear power, however, which has supported stocks we don't own such as Constellation Energy (+23%) and NextEra (+15%).

Outside utilities, property & infrastructure equities were supported by the arrival of a broad-based monetary easing cycle. This easing saw 10-year government bond yields decline meaningfully in the quarter. Yields reduced 0.62% in the US, 0.43% in New Zealand, and 0.34% in Australia. Despite Australia's hawkish central bank (no policy rate changes in the quarter), the decline in longer-term rates and the prospect of the end of the earnings downgrade cycle buoyed Australian property equities, +14% for the quarter. By contrast, New Zealand property equities were +8%.

Portfolio update

Our US tower investments **American Tower** (+20%) and **Crown Castle** (+23%) reported second quarter earnings. American Tower beat expectations and lifted full-year earnings guidance by 2%. Domestic and international towers performed well, alongside datacentre business CoreSite. Importantly, AMT is seeing an increase in leasing, potentially helped by the lack of a long-term deal with AT&T (meaning current demand impacts earnings now, rather than being smoothed over a contract term). Crown Castle's results were in-line with expectations with full-year guidance unchanged. Crown Castle's small cells business reported delays in achieving leasing targets, though the impact was modest. There was no update on the potential sale of the fibre and small cells business. Overall, the tower share prices had a strong quarter, supported by improving investor sentiment as headwinds abated and earnings remained resilient.

US utilities **CMS** (+20%) and **American Water Works** (+14%) reported second quarter earnings. Management expects full-year earnings to land at the upper end of their guidance range. CMS is also finalising a plan with regulators that will provide CMS with financial incentives to support the development of renewable energy. American Water Works maintained its outlook for full-year earnings and narrowed the range towards the upper end. The most noteworthy developments during the quarter were regulatory developments that better positioned American Water Works as an acquiror of other water businesses. Over time, these developments have proved an attractive growth opportunity for the company.

Contact Energy (-7%) announced that it plans to buy near pure-play hydro generator Manawa for around $2 billion. Manawa has significantly underperformed other electricity stocks in recent years, with earnings power eroded by its agreement to sell power to Mercury Energy on a long-term agreement at prices significantly below current market prices. Manawa's hydro assets, and lack of earnings power (relative to asset base) made it attractive to integrated Gentailers. While the portfolio nicely complements Contact's overall portfolio, to justify the price paid,

Contact will need to execute well to deliver the anticipated portfolio benefits and cost savings. Early in the quarter we increased our position in Contact as the earnings outlook had improved. However, we reversed this change after the Manawa deal was announced, given the price paid and execution risk involved.

Infratil (+9%) had a strong quarter, with transactions during the quarter supporting the value of its portfolio. The sale of Australian DC operator Air Trunk for AU$23b increased investor perception of value for other datacentre operators in Australia such as CDC datacentres, owned by Infratil. The sale of long-term investment Manawa to Contact Energy also resulted in significant value uplift, with Contact offering a 47% premium to Manawa's recent share price. We decreased our position in Infratil during the quarter because relative value became less attractive.

The September quarter was a tale of two ports, with **Port of Tauranga** (+28%) significantly outperforming **Napier Port** (-9%). Both ports have faced significant trade headwinds recently, yet the volume outlook is turning positive at both ports and prices are increasing meaningfully. The key reason for Napier Port's under performance is its heavy reliance on forestry. Key customer Winstone Pulp International (which contributes 7-8% of Napier Port's profits) has decided to shut down, citing high electricity prices.

Goodman Group (+6%) reported second-half 2024 earnings that met expectations. Guidance for 2025 was typically conservative (2024 earnings growth of 14% was materially higher than initial guidance for 9% growth). Datacentres are becoming a higher share of work-in-progress, moving from 40% currently to over 50% in the near future. Goodman can earn much higher development profits on datacentres, though timing of profit recognition can be volatile. Channel checks we made during the quarter suggested Goodman is making strong progress with datacentres, including the delivery of turnkey sites in Sydney, Amsterdam, and Los Angeles. We increased our position in Goodman as we gained increasing confidence from these channel checks.

Auckland Airport (-1%) raised $1.4 billion to fund the development of its new integrated terminal. We were expecting an equity issue at some point, given the size of the overall project but were surprised by the timing and quantum of the raise. We decreased our position during the quarter, as it has become increasingly apparent that passenger numbers in the next few years will be lower than expectations, resulting in lower profit growth. Subsequently, we participated in the equity raise given the attractive discount on offer.

Our Mexican airport investments **OMA** (flat) and **ASUR** (-6%) underperformed the benchmark during the quarter. This underperformance is in part due to the Mexican peso struggling recently, impacting the value of the holdings. Peso weakness arose as the market weighs the impact of a new President (Claudia Sheinbaum) in Mexico. A super-majority of Congress could allow the passage of reforms considered unfriendly to markets and the rule of law. Yet, fellow Mexican airport **Grupo Aeroporto Pacifico** (GAP, +22%, not in the portfolio) reported the outcome of their next regulatory regime ('MDP'), with tariffs (pricing) much higher than expected. We consider the GAP MDP outcome to be a favourable indicator of the Government's willingness to be market friendly. We don't think the market is adequately reflecting the read-across for the sector, and we increased our position in OMA during the quarter, in part funded by ASUR.

We exited three positions in the quarter: **Norfolk Southern** (+16%), **One Gas** (+18%), and **Charter Hall Social Infrastructure REIT** (+22%). All were long-term holdings yet had been moved to small positions (2% each) in recent years as our conviction in the thesis reduced. We re-deployed the capital into companies of higher quality with greater growth prospects (**AENA, Canadian Pacific, Equinix, OMA, CMS, Contact Energy**).

Lower interest rates help create favourable conditions for a soft landing

Quin Casey, Senior Portfolio Manager, New Zealand Cash & Fixed Interest

Global bond markets had a solid quarter as, in general, central banks cut policy rates and signalled further cuts in the months ahead, which lowered yields and lifted bond prices. Despite the drop in yield levels over the quarter, bonds are still generating attractive income flows compared to recent history. Given our base-case economic outlook of moderate growth and lower inflation, conditions should remain supportive for fixed-income assets – especially bonds issued by high-quality companies.

Lining up the runway

No doubt many of you have read the phase soft landing in media coverage about the outlook for the global economy.

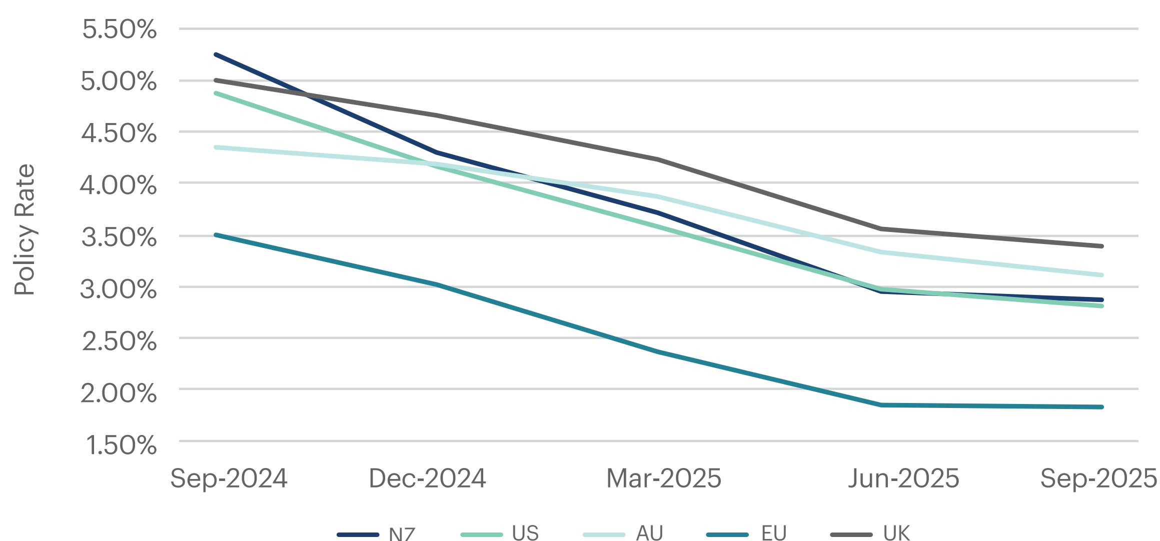
The phrase flows from the idea that the economy can be thought of as an aeroplane, and central bankers are the pilots: they adjust their policy rates to navigate their economies through turbulence with the overall aim of landing smoothly at their destination.

For most central banks around the world, that destination is price stability – usually defined as inflation stabilising around 2.0% per annum – and a balanced labour market.

With sharply rising prices following the pandemic period, central banks increased policy rates to slow demand and bring inflation back down. In general, this part of the flight path has been relatively smooth as inflation has eased over the past 12 months while economic activity, overall, has been steady.

Central bankers are now beginning the descent and have communicated to passengers that policy rates will be lowered to give the best chance of a soft landing. Markets have digested this message – the chart below shows that policy rates are anticipated to fall over the coming year.

Current and Market Implied Policy Rates



Source: Bloomberg

Indeed, during August, the Reserve Bank of New Zealand cut the Official Cash Rate from 5.50% to 5.25%. Governor Orr noted that he had increased confidence that inflation was returning to target rates, while economic indicators suggested that domestic activity was starting to slow. As shown in the chart above, the OCR is expected to be closer to 4.0% by the start of next year, which if realised, will help support demand across all sectors of the domestic economy.

Of course, there could be a few bumps as the runway comes into view, but we think central banks will continue to reduce policy rates and largely agree with market expectations shown in the chart.

In summary, lower interest rates are helping to create the favourable conditions required for a soft landing.

Up-in-quality mindset maintained

We continue to position the fund towards bonds issued by high-quality companies.

Over the rest of 2024 and into 2025, we expect steady, but not spectacular, growth and easing inflation. These two factors should be a tailwind for bonds issued by companies with strong business models and robust balance sheets. Lower quality companies are less resilient to slowing economic activity and will likely find it difficult to achieve sales growth, which is the starting point for generating healthy cash flow.

Credit spreads (the extra yield over and above a government bond) that investors are currently receiving for owning lower-rated bonds, are below historical averages.

This lower yield suggests corporate bond markets are not adequately compensating investors for taking on the extra risk that comes with lending to less-resilient businesses.

Adding a bit more Kiwi(bank) to the fund

During the quarter, we added to our existing position in **Kiwibank's** subordinated bonds, following release of its annual results for the year to June 2024. The numbers painted a healthy picture with the bank recording a net profit after tax of $202m, +15.0% year on year. Asset quality also remained solid and the bank's capital position is strong (noting the group is 100% owned by the Crown). Given the favourable result, we bought additional bonds in the secondary market, and we believe Kiwibank will continue to maintain its financial performance and strong capital position over the coming years.

Shifting gears across the ditch

Avanti Finance issued auto loan asset-backed securities during September and the fund participated in this transaction. While Avanti is known for its mortgage lending business in New Zealand, the group also offers auto finance in Australia – entering the market with the acquisition of Branded Financial Services in 2019. Since then, Avanti's Australian auto unit has been growing and performing satisfactorily, which has been supported by conservative loan underwriting criteria. Given this, and that the Australian economy is cruising nicely, we invested in the deal and look forward to Avanti accelerating further into the Australian auto finance market.

Fixed interest securities continue to offer competitive yields

Mark Brighouse, Chief Investment Strategist, Global Fixed Interest

Global bond markets had their second-best quarterly return since 2008, as many central banks began lowering official interest rates.

Consumer price have been well behaved and the central banks of Switzerland, Canada, Sweden, the Euro Zone, the UK, the US, and New Zealand have all declared success in the inflation battle and have cut rates. The US Federal Reserve cut by half a percent in September demonstrating their confidence that the economy is slowing. Central banks are now hyper-focused on avoiding a rise in unemployment rates. A so-called 'soft landing' for the economy is the goal, but historically this has been hard to achieve.

The Fund Managers remain somewhat defensively positioned, with portfolio durations shorter than the benchmark. Managers expect rates to remain higher for longer and an increased supply of government debt to keep long-term yields attractive. The prospect of budgets deteriorating in some large economies opens opportunities to benefit from market divergences.

A return to the very low level of interest rates that prevailed for the past decade seems unlikely and fixed interest securities will continue to offer competitive yields.

fisherfunds

Contact: Private Bag 93502,
Takapuna, Auckland 0740
0508 347 437
enquiries@fisherfunds.co.nz

fisherfunds.co.nz