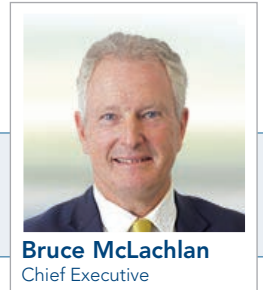


Snapshot

Market insights for investment professionals from Fisher Institutional — March 2018

Trade wars: what next for NZ?



Economics 101 is a first year course that many University students have to suffer and endure. The course is a prerequisite for many Business degree courses, whether interested in Economics or not. In my time, the subject matter was mostly very dry, and subsequently many of the concepts have been outdated by the impact of technology and a better understanding of human behaviour. Some economic principles are changing, but some have also endured.

One of the most basic principles that has endured is that free trade lifts the incomes of all participants. If resources are directed to the most efficient producers then everyone wins, notwithstanding some fallout during the change process of reaching that point.



Despite the unequivocal nature of the free trade principle, getting countries around the world to agree and implement free trade policies has been a long drawn out process. Countries have been getting there however, as shown by the continued proliferation of new free trade agreements.

Recent moves by the president of the USA to implement tariffs on steel and aluminium imports into the USA is a significant step against this progress and could be a first step in more significant trade barriers being implemented globally. The first losers will be US consumers who will end up paying a higher price for products containing steel and aluminium. The second losers will be alternative industries in the USA who feel

the retaliation from other countries. Already Europe is threatening tariffs on Jim Beam Whiskey and Harley Davidson motorcycles in retaliation! The third losers will be countries more dependent upon trade than the USA.

The interesting fact is that the US produced less than 5% of world steel production in 2016, and less than 2% of world aluminium production. This shows it is not as if the President's actions are designed to protect large volumes of domestic jobs in the USA. This proposal has political motives and potentially far greater ramifications.

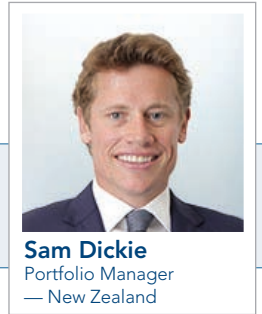
The underlying problem is that the US trade deficit widened to \$56b in January 2018, the widest this gap has been for 10 years. The US does have a significant structural problem, however there are very few commentators that believe that tariffs on selected products and a potential trade war are the answer to the problem.

Why should we even be bothered by these changes? Exports make up nearly 30% of New Zealand's annual \$250b GDP and so for all of us our livelihoods are dependent upon New Zealand being able to trade with the world. Many of our better companies listed on the stock exchange are dependent on exports. In a world of increasing tariffs and reduced trade New Zealanders incomes will fall.

It is way too early to predict where this may all lead to, but let's all hope common sense and reflections on first year university courses prevail.

Chairman

On 5th March Sir John Wells retired as Chairman of Fisher Funds. Sir John has been on the Board a total of 18 years, and has overseen the success of the company over that time. All of us at Fisher Funds wish Sir John well for the future. The new Chairman is existing Non-Executive Director David Clarke. David has been on the Board two years and brings a wealth of experience in financial services in Australia and New Zealand to the position.



The a2 Milk success story

The a2 Milk Company cracked another major milestone in February, eclipsing a range of well-known businesses to become the largest listed company in New Zealand by value.

The result announcement that catapulted it to the top of the heap contained just about everything a shareholder could want — revenue and earnings beating expectations, strong growth in market share in the lucrative US\$20 billion Chinese infant milk formula market, and progress in newly-entered markets.

The cherry on top was a brand new agreement with dairy heavyweight Fonterra, allowing a2 to accelerate entry into new global markets and launch new products. On the back of the result and the Fonterra deal announcement alone, the share price jumped, almost 40%, from \$9.29 to over \$13 at the time of writing.

But what exactly is the a2 Milk Company and how has it grown so quickly?

In a nutshell, the company currently sells 'a2'-branded fresh milk and infant milk formula internationally. Its products contain only A2 beta-casein protein. This is believed to be more comfortably digested than normal milk (which contains a mix of both A1 and A2 proteins). The company has developed and patented a range of IP which tests whether cows produce A1-free milk. More importantly the science behind a2 the company has developed a leading, highly trusted brand in Australia and China in particular.

Despite the recent success, it has been a long rags-to-riches story for early shareholders. The company has been listed since 2004 and with limited ability to commercialise its IP made losses until 2011. From there, the company started gaining traction selling fresh milk through the supermarket and food service channels in

Australia, with brand strength and awareness growing from a small base. Over the next few years a2 Milk grew share and became the leading branded fresh milk in Australia. This in itself was not highly profitable — the company only made \$9 million in operating profit before tax on \$94 million of sales in fiscal 2013.

Where the company grew in leaps and bounds was infant formula. It launched its a2 Platinum brand in Australia in late 2013 and quickly gained share, courtesy of its strong position in fresh milk.

From there, growth exploded as 'daigou' (personal shoppers) latched on to this new desirable brand and began re-exporting it for consumption in China.

a2's management have done an excellent job of managing the nuances of this channel, where others, like Australian firm Bellamys, have failed. They have also successfully grown Chinese distribution into conventional channels including key eCommerce websites and 6700 physical stores.

This move to grow distribution and a2 growing brand strength in China have led to the latest step-up in market share and earnings. Annual sales are now approaching \$1 billion. This is an incredible story of recognising opportunity and having the strategic vision and operational smarts to take advantage of it.

The Fonterra deal is the first step in the next phase of a2's global growth story — New Zealand's global dairy giant has acknowledged a2's global potential and is now on board. As Kiwis, it also means we can expect to see local supermarket shelves well stocked with a2 milk in the future!

The a2 Milk Company is owned in all Fisher Funds NZ based portfolios.

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Market Movements

As at 28 February 2018

Stock Markets*	Closing Values	Changes over:			
		1 Mth %	3 Mths %	6 Mths %	12 Mths %
S&P Developed LargeMidCap - (Local Curr)	742	-3.5	1.2	8.1	14.4
S&P Developed LargeMidCap (\$NZ)	N/A	-3.5	-6.1	4.6	11.8
S&P Global LargeMidCap (\$NZ)	N/A	-1.8	-2.2	8.4	19.7
USA - S & P 500	5308	-3.7	3.0	10.8	17.1
USA - Nasdaq	8375	-1.7	6.0	13.7	26.2
Japan - Topix	2575	-3.7	-1.2	10.4	17.6
UK - FTSE100	6175	-3.4	-0.5	-1.2	3.4
Germany - DAX	12436	-5.7	-4.5	3.2	5.1
France - CAC40	13559	-2.9	-0.7	5.1	13.0
HK - Hang Seng	83430	-6.0	6.0	11.1	34.8
Australia - S & P 300	59692	0.3	1.8	7.7	10.3
NZ-S&P/NZX 50 Gross Index (inc imp credits)	9986	-0.8	2.3	7.7	18.2
NZ-S&P/NZX 50 Gross Index (excl imp credits)	8374	-0.8	2.3	7.1	16.8
Market Volatility - VIX	19.9	46.6	76.0	87.4	53.6

New Zealand Property		%	%	%	%
S&P/NZX All Real Estate (inc imp credits)	1229.5	-3.2	-1.6	2.3	6.2
S&P/NZX All Real Estate (exc imp credits)	1198.0	-3.2	-1.9	1.9	5.2

Ten Year Bonds	%	Yield Changes			
USA	2.87	0.15	0.52	0.66	0.51
Japan	0.05	-0.03	0.02	0.05	0.00
United Kingdom	1.50	-0.01	0.17	0.47	0.43
Australia	2.78	-0.01	0.28	0.07	0.06
New Zealand	2.95	0.04	0.22	0.05	-0.29

90 Day Interest Rates	%	Yield Changes			
USA	1.65	0.19	0.40	0.62	1.12
Japan	0.69	0.62	0.62	0.63	0.63
United Kingdom	0.58	0.06	0.06	0.30	0.23
Australia	1.80	0.04	0.05	0.09	0.01
New Zealand	1.92	0.03	0.01	-0.04	-0.08

	Closing Values	Changes over:			
		1 Mth %	3 Mths %	6 Mths %	12 Mths %
Bond Indices					
S&P/NZX Bank Bills 90-Day	705.76	0.15	0.48	0.97	2.00
S&P/NZX NZ Government Bond Index	1664	0.08	-0.06	1.31	4.12
Barclays Capital Global Aggregate Index (Hedged NZD)	N/A	-0.20	-0.57	-0.26	2.41

		%	%	%	%
Hedge Funds & Commodities					
HFRX Global Hedge Fund Index (USD)	1275	-2.4	0.7	2.1	4.3
DJ-UBS Commodity Index Total Return	180	-1.7	3.2	4.8	1.6
Gold (US\$/ounce)	1315.50	-1.8	3.3	-0.1	5.0
Oil (US\$/barrel)	64.71	-4.5	1.9	22.8	21.3

		%	%	%	%
Currencies					
NZD / USD	0.7223	-2.4	5.2	0.8	-0.1
NZD / EUR	0.5922	-0.3	2.9	-1.7	-13.0
NZD / GBP	0.5242	0.7	3.4	-5.7	-9.8
NZD / AUD	0.9269	1.4	2.5	2.6	-1.5
NZD / YEN	77.07	-4.6	0.4	-2.2	-4.8
Trade Weighted Index	75.09	0.2	2.7	-2.6	-4.7

*Total Return Indices. Indices are net of offshore tax.

Source: Thomson Reuters Datastream

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