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Snapshot

Market insights for investment professionals from Fisher Institutional — April 2017

Carmel Fisher
Managing Director

Once upon a time

Humans love stories. In ancient times, the only way to share knowledge was through story-telling, person to person and generation to generation. Stories help us visualise, understand concepts and build an emotional connection.

Investors particularly like investment stories. A tidy narrative can help us feel comfortable, and make something otherwise random seem logical and rational.

There are stock stories, like "the new CEO is going to turn the company around" or "the company is about to win a big contract" or "the business is ripe for a takeover".

Then there are market stories: "stocks are overvalued and ready for a correction" or "the Federal Reserve is going to end quantitative easing" or "the market has broken through 20,000 on its way to 21,000".

Once upon a time there was a Trump rally…

This has been the story of 2017 so far. It's been quite an exciting story, with enough emotional drama to keep a large audience interested. And it has been handy in explaining why stocks that were supposedly poised to fall this year have instead gone from strength to strength.

However, the problem with this narrative is that it doesn't really bear scrutiny. It belongs firmly in the fiction section.

The basic storyline is that the election of President Donald Trump will result in sweeping changes in trade, tax, infrastructure and spending that will benefit the US economy enormously. The US stock market has rallied with every page turn.

The kink in this storyline is that it doesn't explain why France, Germany, Japan and other developed markets have also rallied since the presidential election in November. Trump's policies shouldn't drive the French or Japanese share markets higher, especially given that he is threatening a global trade war.

Then there's the inconvenient fact that despite Trump's struggles to put any of his significant promises into effect, markets have rallied anyway.

The story also falters when you consider that most global equity markets had been rallying in the months leading up to the November election, so calling it a Trump rally is a bit of a stretch.

But really, what's wrong with fabricating a story if it makes you feel good?

Well if enough people opt for comfort over reality, they won't be prepared when the storyline eventually turns. If it is not a Trump rally but rather crowd momentum, animal spirits or blind faith with no fundamental basis, then someone will be left with the wrong investments when such behaviour stops.

Emotional stories can get in the way of intelligent investing. We've all seen strategists and economists get their forecasts wrong, only to offer a series of excuses for why. We've seen investors rationalising why they were right and the market was wrong. We've seen people prefer to put good money after bad, rather than admit they got it wrong.

The narrative that we've been following on your behalf is that politics are not the driving force behind markets or economies anymore.

It is quite possible that US politics will be dysfunctional and irrelevant for the next few years, and that Trump's utterings neither hinder nor help business and consumer sentiment. Instead, the US economy will recover on its own at its own pace, and the Federal Reserve will do everything it can to support that economic recovery. Other economies will stage their own recoveries, and many ships will be lifted by the rising tide. But not all ships will rise, and not all tides will either.

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Mark Brighouse
Chief Investment Officer

Are you a collector or a constructor?

Like Lego bricks, investments come in a wide range of shapes, sizes and colours. After a few years of investing you may find that you've accumulated quite a variety. While you may be happy to own a large collection, it may resemble a bin of loose bricks rather than having a cohesive design.

If an investor adds to their portfolio with every new share offer or bond issue they can end up with a collection that has lots of duplication, too much concentration and a lack of overall cohesion. Inevitably there will be a lot of very similar pieces and for an investor, this is a real problem. A jumbled collection means that you are more likely to get caught out by market turmoil, lose sight of your original investment plan, or abandon it at the worst possible time.

Every investor benefits from being methodical and organised.

The most successful investors are those who build well planned portfolios rather than collections of investments. They see themselves as "constructors" rather than "collectors".

The first step is to sort out your collection. This can be achieved by classifying investments into categories or, to use a market term, "sleeves" of similar securities. Typical sleeves are NZ Shares, Australian Shares, International Shares, Property and Infrastructure, Cash and Fixed Interest.

You should place each piece in its relevant sleeve and measure the size of each sleeve. It is likely that most people will find that the largest sleeves by far are New Zealand shares or bank deposits. In contrast, a well balanced portfolio will have a healthy weighting to international investments and to fixed interest assets.

There is not going to be a single allocation that suits everyone. It has to be matched to your individual risk tolerance and objectives.

The tough part is that inevitably you will have to throw some pieces out. This can be hard with Lego — ask any parent — and may be even harder with investments; but it has to be done if you want to create something great.

Bear in mind that in a diversified portfolio not every sleeve will be as colourful or exciting as others. The very nature of a well balanced, diversified portfolio is that some sleeves will be going strongly while others are going sideways; but that's the aim of a long term portfolio.

The construction process is not a one-off. It requires ongoing adjustment to stay on course and ensure that the end result is solid.

Constructing a well balanced portfolio is like turning a pile of Lego bricks into an amazing castle. Become a constructor rather than a collector!

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How did Fletchers get it so wrong?

Sam Dickie
Portfolio Manager
— New Zealand

You may have heard about how one of New Zealand's largest listed companies, Fletcher Building, issued a profit warning in March, just a month after its first half result, surprising the market and leading to a share price fall of 10%. We are underweight Fletcher Building in our Trans Tasman Fund.

To put it in context, Fletcher Building has grown rapidly and now has more than 20 separate divisions. What was once a quality NZ focused building materials and construction company is now a global building materials and construction conglomerate. Maybe it's the scale and magnitude of growth that has led the company astray?

Fletcher's construction backlog (which is the crux of the company's problems) is three times the size it was at the previous cycle peak. This scale must add complexity and be significantly more difficult to manage than the business of old.

The rationale for Fletcher having a construction division at all has been to exert control over a key channel so it can market its significantly more profitable building materials. It is concerning that this division has grown so rapidly and is now causing unexpected losses.

The company completed a review of around 55% of the backlog in its construction division. The result was a 15% downgrade to earnings guidance for the 2017 financial year. What might be discovered when the other 45% of its construction division is reviewed?

In stark contrast to Fletcher's woes, the privately-owned NZ civil construction firm, Fulton Hogan lifted first-half pre-tax profit 13% as its NZ (and Fijian) operations tracked ahead of expectations. Fulton Hogan achieved this in a period that MD Nick Millar described as a "challenging environment" where multinational firms were competing more aggressively for large projects in New Zealand and Australia.

As anyone who drives around Auckland will attest, there are plenty of civil and commercial construction projects underway. However, with increasing competition, the challenges of pricing long dated construction projects with volatile commodity input costs, and already thin construction margins, you need everything else in your business to be absolutely nailed.

Shrewd Lew strikes again

Manuel Greenland
Senior Portfolio Manager
— Australian Shares

Retail department store Myer has struggled against increasingly difficult trading conditions. Its department stores have lost market share to specialist retailers. The entry of international players like Zara and H&M into Australia, and the imminent arrival of internet colossus Amazon, has increased competition.

Myer's investors have had a torrid time, with the share having never traded above its 2009 initial offer price of $A4.10. None of this stopped the respected rag-trade billionaire Solomon Lew from making a surprise purchase of 11% of Myer's shares in March. Based on the sheer weight of Lew's reputation, Myer's shares jumped almost 20% on the news.

Some investors may have thought that Lew intended to buy all of Myer. Given his retailing acumen and financial muscle, Lew is well positioned to turn Myer's fortunes around and return it to growth. There would be superb returns to anyone who could buy it while it is performing poorly and sell it later as a success. Among the brands in his listed retail business Premier Investments, Lew already has a successful niche retailer in Smiggle which itself has demanding growth ambitions. Would Lew really want to turn around a poor performer with an out-dated customer proposition when he is building Smiggle for the future? We think not.

Lew is not just a great retailer; he is also a master strategist. In 2014 Woolworths of South Africa needed his co-operation in their acquisition of Australian retailer David Jones, because he owned 10% of David Jones at the time. It would seem that Woolworths had to buy Lew's stake in another retailer, Country Road, in order to win that co-operation. In one fell swoop Lew gained on two separate deals.

Given Myer's challenges, it would be far easier to turnaround as a private company, outside the view of public shareholders. Anyone wanting to buy, delist and turn Myer around now needs the co-operation of Mr. Solomon Lew; and if the Woolworths acquisition of David Jones is anything to go by, that co-operation will come at a price.

Contact us

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Market Movements

As at 31 March 2017

Stock Markets*	Closing Values	Changes over: 1 Mth %	3 Mths %	6 Mths %	12 Mths %
S&P Developed LargeMidCap — (Local Curr)	655	1.1	5.5	10.9	17.8
S&P Developed LargeMidCap ($NZ)	N/A	1.1	1.8	11.5	13.1
S&P Global LargeMidCap ($NZ)	N/A	4.8	6.8	12.8	14.9
USA — S & P 500	4538	0.1	6.1	10.1	17.2
USA — Nasdaq	6741	1.6	10.1	12.0	22.9
Japan — Topix	2177	-0.6	0.6	15.6	14.7
UK — FTSE100	6037	1.1	3.7	8.1	23.3
Germany — DAX	12313	4.0	7.2	17.1	23.6
France — CAC40	12675	5.6	5.6	15.8	21.2
HK — Hang Seng	62946	1.7	10.1	4.3	20.6
Australia — S & P 300	55870	3.3	4.7	9.9	20.2
NZ-S&P/NZX 50 Gross Index (inc imp credits)	8514	0.8	5.1	-1.6	7.9
NZ-S&P/NZX 50 Gross Index (excl imp credits)	7197	0.4	4.6	-2.2	6.6
Market Volatility — VIX	12.4	-4.3	-11.9	-6.9	-11.3

New Zealand Property		%	%	%	%
S&P/NZX All Real Estate	1151.2	-0.6	1.6	-4.7	0.1

Ten Year Bonds	%	Yield Changes			
USA	2.48	0.12	-0.01	0.85	0.59
Japan	0.06	0.01	0.03	0.15	0.12
United Kingdom	1.14	0.06	0.04	0.49	-0.28
Australia	2.69	-0.03	-0.06	0.78	0.20
New Zealand	3.19	-0.04	-0.08	1.02	0.26

90 Day Interest Rates	%	Yield Changes			
USA	0.75	0.22	0.24	0.46	0.45
Japan	0.06	0.00	0.00	0.00	-0.04
United Kingdom	0.00	-0.36	-0.37	-0.38	-0.59
Australia	1.79	0.01	-0.02	0.05	-0.50
New Zealand	2.00	0.00	0.00	-0.20	-0.34

Bond Indices		%	%	%	%
S&P/NZX Bank Bills 90-Day	693.11	0.17	0.50	1.07	2.29
S&P/NZX NZ Government Bond Index	1606	0.48	1.39	-2.02	0.96
Barclays Capital Global Aggregate Index (Hedged NZD)	N/A	0.05	0.77	-1.26	2.63

Hedge Funds & Commodities		%	%	%	%
HFRX Global Hedge Fund Index (USD)	1223	0.0	1.6	2.8	6.2
DJ-UBS Commodity Index Total Return	173	-2.7	-2.3	0.3	8.7
Gold (US$/ounce)	1247.30	-0.4	8.5	-5.0	1.1
Oil (US$/barrel)	53.47	0.2	-2.7	10.8	45.5

Currencies		%	%	%	%
NZD / USD	0.6991	-3.3	0.3	-3.9	0.7
NZD / EUR	0.6536	-4.0	-1.1	1.0	7.3
NZD / GBP	0.5590	-3.8	-0.9	-0.1	15.7
NZD / AUD	0.9164	-2.6	-4.8	-3.6	1.5
NZD / YEN	77.90	-3.7	-4.2	5.8	-0.2
Trade Weighted Index	76.06	-2.9	-2.6	-2.3	5.4

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