fisher institutional

Snapshot

Market insights for investment professionals from Fisher Institutional — November 2017

Brent Buchanan
Head of Direct Property

Property Prices: The new national sport?

In New Zealand monitoring house pricing is virtually a national sport. Even a minor change can create as many media headlines as an All Black match result. The response is equally emotive with rising values and talk of an affordability crisis creating alarm and dismay to those on the sidelines, while having the homeowners watching their net worth soar. Of course any fall results in equal alarm. It's no surprise given that Kiwi's love their houses.

You might not know it but at Fisher Funds we enjoy the talk of property as much as you do. As well as having exposure to listed property assets though our Property & Infrastructure Fund, we have direct interests in commercial property. This forms part of the diversified portfolio for our KiwiSaver members and wholesale investors.

Like we do when we invest in shares, we take a long term approach investing in property; owning a number of high quality retail, office and industrial properties that are occupied by well-known companies on long term leases. Our in-house team actively manages these properties. While our investment decisions are based heavily on physical factors such as location and quality; we also place great emphasis on quality of earnings from the properties we own. We avoid exposing ourselves to tenants who may not pay their rent dependent on discretionary spending, preferring instead suppliers of essential items such as food and clothing. This is to mitigate against the risk of a consumer spending fall that would impact retail sector, and flow on to industrial (including manufacturing and logistics).

So what's the current outlook for the commercial property market and how does this relate to our beloved residential properties? Recent releases from Quotable Value have confirmed what those of us living in Auckland can see for ourselves, prices are soft and have fallen over the past year. The same can be said for the commercial sector. In fact we believe the slow down was seen in the commercial sector first. Regardless of which market ran out of steam first, for both markets a slow down changes the focus of the game.

At the height of the market, capital gains were the player of the day. With prices appreciating rapidly, the focus on rental yield tended to take a back seat. So with capital gains likely to hit the bench for a while it is the rental income that will provide the primary return for investors.

This is where it gets interesting as for a time it seemed as though the run on residential property prices was as unstoppable as an All Black forward pack. Of course rents did not rise proportionately to values, meaning yields have suffered.

This is where there is a key difference between the residential and commercial rental markets. Commercial property currently delivers a 5-7% yield depending on the specifics of the property where many residential properties are yielding closer to 2-3%. If we are right and capital values remain flat, that materially changes the outlook for the residential property market. Some caution is warranted.

Within our commercial property portfolio our focus is on ensuring the quality of our tenants and finding ways to add value to our existing portfolio. In a more challenging environment this will help us generate attractive returns. We remain comfortable with our game plan.

More than milk driving A2's share price

Sam Dickie
Portfolio Manager
— New Zealand

A2 Milk has been ripping, up 390% since the start of the year.

The strong share price performance partly reflects a very impressive earnings upgrade cycle on the back of A2's highly successful entry into the Chinese infant milk formula market.

However more recently, the daily volume traded in the stock has exploded, especially the Australian listing. A2 was dual listed in Australia in March 2015. Initially the volumes traded were tiny. More recently the volumes transacted on the Australian bourse have been three times those traded in New Zealand.

This culminated on 1 November when the daily traded volume in Australia was more than six times the volume traded here. More importantly, the value of A2 Milk shares changing hands across both listings was almost NZ$300m. That equates to more than 5% of the company traded in a single day on basically no news flow. CLSA, a Hong Kong based broker, had downgraded the stock to underperform and the NZD rallied a little but apart from that, there was no actual news.

> "Looking back shows no other NZ listed company has traded as much as NZ$300m in a single day. This is unprecedented."

We looked back over history to see if there has ever been another NZ listed company that has traded as much as NZ$300m in a single day. In the absence of some sort of capital raise or placement of a block of shares we couldn't find one. This is unprecedented.

This was intriguing to us so we dug a little deeper. When we look through which brokers traded the majority of the stock, it is dominated by low cost online or retail stock brokers in Australia and Asia. These brokers are the go to trading houses for day traders, high frequency traders and algorithmic trading. In other words, very fast money traders that are much less focussed on fundamentals than they are on momentum.

The point here is that even in New Zealand hot stocks are increasingly trafficked in by offshore fast money, day traders and algorithms. This significantly heightens risks and volatility both to the upside but also to the downside.

Our response to this type of fast money, hot stock trading, is to stick to understanding the fundamentals of the businesses we invest in. We will continue to invest in high quality companies with high quality management teams and sustainable competitive advantages that are trading at prices we believe are sensible. We'll leave the day trading to the computers.

Major turning point

Bruce McLachlan
Chief Executive

We are all guilty of it. Delaying buying or selling something today because we hope it will be cheaper (or dearer) tomorrow. The trend is our friend we hear. These thought processes are what drive many markets, in that many trades are driven by either fear or greed, rather than intrinsic value. "I must buy that house today as it will be more expensive tomorrow", has been a major driver of the last five year expansion in Auckland house prices — when in effect it is still the same asset. It will be interesting if house prices fall 10% in the next year, whether buyers celebrate because houses are cheaper, or hold off because they think prices might fall further. Markets, you have to love them as an insight into human behaviour.

> "The outcome of the New Zealand election has investors trying to guess whether the time is right to buy or sell."

As investors, the decision to buy or sell is in the forefront of everyone's minds right now given global share markets are enjoying close to the longest bull run in history. The outcome of the New Zealand election similarly has investors trying to guess whether the time is right to buy or sell. Many will answer that they will wait to see the trend that emerges, and get on the back of it. Others will do nothing, but feel immensely pressured and tense by whatever trend emerges.

The New Zealand election certainly ended up being a far more engaging process than almost all pundits predicted at the beginning of the campaign, and in the end had all of the drama and theatre that only Winston Peters can deliver in forming the new coalition. But what now for investors? What should I do with my KiwiSaver account? Should I stay in growth assets? Should I move my assets offshore?

We believe investors should consider three things when making these decisions.

The first thing to remember is that long term investors should ignore short term market goings on. It is pure luck trying to pick the top or bottom of markets. There are plenty of studies that prove time in the market and making sure you get the full benefit of compounding returns over the course of years is key. The best advice is to ignore all of the noise in between.

The second thing to consider is that markets are quite efficient at processing existing information, however it is the unexpected or the contra view that is often mispriced and drives the major market moves. Don't think you can beat the market if you get your information from the newspapers — you have the same information as everyone else.

The third thing is that rather than fear the big market swings, embrace them. Make sure your investment selection matches your true risk profile and investment horizon, and view every market move as a real opportunity.

So what should you do as a result of the New Zealand election? With certainty we can say that there is going to be an elevated level of political, social and potentially economic change. That represents risk and this risk is not yet priced into markets, as we still don't know the exact policy direction of the new government. This risk is most likely to be seen through movements in the value of the New Zealand dollar. For us that means focussing on our currency management and hedging strategies while this uncertainty exists. New Zealand economic growth, long term interest rates and inflation are strongly influenced by global factors and volatility in these is less likely as a result of the election.

The key message though is to resist the natural human bias to act. This is especially important when the newspapers are full of advice about what is going to happen. We know that the future is rarely that clear. Instead, we believe that patience is truly a virtue. Don't try and predict the future, but prepare for it by having the right long term investment strategy in place. That way as markets go up and down, governments change and the unexpected happens, you can relax knowing that your strategy is right and your investment goals will be met. A clear strategy allows you to enjoy your investing experience rather than live in fear. This is all way easier said than done.

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Market Movements

As at 31 October 2017

Stock Markets*	Closing Values	Changes over: 1 Mth %	3 Mths %	6 Mths %	12 Mths %
S&P Developed LargeMidCap - (Local Curr)	722	2.7	5.3	8.8	22.8
S&P Developed LargeMidCap ($NZ)	N/A	2.7	9.3	3.3	21.5
S&P Global LargeMidCap ($NZ)	N/A	7.8	14.5	10.9	29.4
USA - S & P 500	5002	2.3	4.8	9.1	23.6
USA - Nasdaq	7717	3.6	6.3	11.8	31.1
Japan - Topix	2567	5.4	10.0	16.4	29.4
UK - FTSE100	6321	1.8	2.8	6.1	12.1
Germany - DAX	13230	3.1	9.2	6.4	24.0
France - CAC40	13982	3.3	8.2	6.9	26.0
HK - Hang Seng	76144	2.6	4.5	18.4	28.0
Australia - S & P 300	57658	4.0	4.8	2.2	15.9
NZ-S&P/NZX 50 Gross Index (inc imp credits)	9703	2.8	6.4	11.2	18.5
NZ-S&P/NZX 50 Gross Index (excl imp credits)	8146	2.7	5.9	10.4	17.0
Market Volatility - VIX	10.2	7.0	-0.8	-5.9	-40.3

New Zealand Property		%	%	%	%
S&P/NZX All Real Estate (inc imp credits)	1205.9	-0.2	0.9	3.4	4.4
S&P/NZX All Real Estate (exc imp credits)	1178.4	-0.2	0.8	2.9	3.3

Ten Year Bonds	%	Yield Changes			
USA	2.36	0.16	0.04	0.06	0.60
Japan	0.06	0.00	-0.01	0.05	0.12
United Kingdom	1.33	-0.03	0.10	0.25	0.19
Australia	2.67	-0.17	-0.01	0.09	0.33
New Zealand	2.92	-0.06	-0.07	-0.16	0.34

90 Day Interest Rates	%	Yield Changes			
USA	1.09	0.04	0.00	0.28	0.76
Japan	0.07	0.01	0.01	0.01	0.01
United Kingdom	0.44	0.10	0.15	0.11	0.04
Australia	1.69	-0.02	0.00	-0.05	-0.05
New Zealand	1.94	-0.02	-0.01	-0.04	-0.20

Bond Indices	Closing Values	Changes over: 1 Mth %	3 Mths %	6 Mths %	12 Mths %
S&P/NZX Bank Bills 90-Day	701.24	0.16	0.49	0.99	2.05
S&P/NZX NZ Government Bond Index	1652	0.52	1.05	2.03	2.14
Barclays Capital Global Aggregate Index (Hedged NZD)	N/A	0.50	1.10	1.95	2.31

Hedge Funds & Commodities		%	%	%	%
HFRX Global Hedge Fund Index (USD)	1265	0.7	1.6	3.0	7.0
DJ-UBS Commodity Index Total Return	176	2.1	2.4	3.1	2.3
Gold (US$/ounce)	1267.00	-1.1	0.0	0.1	-0.4
Oil (US$/barrel)	60.89	7.2	17.1	23.1	31.8

Currencies		%	%	%	%
NZD / USD	0.6851	-5.2	-8.6	-0.2	-4.2
NZD / EUR	0.5881	-3.8	-7.5	-6.7	-9.9
NZD / GBP	0.5159	-4.3	-9.3	-2.8	-12.0
NZD / AUD	0.8934	-3.0	-4.9	-2.7	-5.0
NZD / YEN	77.84	-4.3	-6.0	1.7	3.5
Trade Weighted Index	74.73	-1.5	-4.7	-1.7	-2.8

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