fisher institutional

Snapshot

Market insights for investment professionals from Fisher Institutional — October 2017

Bruce McLachlan
Chief Executive

The big unknown and what does it mean for us?

Ever wondered why many so called experts have been getting forward looking predictions so wrong in recent times? It's because most predictions and forecasts rely on learnings or analysis of our collective experiences from the past. And the world has never been in a phase like it is right now, which means much of this analysis and past experience is, well……useless.

There has been technology impacts, quantitative easing, sub-zero interest rates, all at an eye watering rate of change….there are lots of reasons why predicting the future has become difficult. Yet it remains popular as humans are innately programmed to make sense of the world around us.

But then there is China. Even the most accomplished experts have very little genuine understanding of the intricacies of the Chinese economy, and it's precise impact on the world. Decoding China could provide insight into the future for global markets due the sheer scale of the China influence. You see size is at the heart of what makes China so different, their differing political and economic models are merely red herrings. China is the clear second largest economy in the world, and since introducing market reforms in 1978 has grown at an average 10% since that time, and 7% pa in more recent times. The China economy is bigger than Germany, Japan and the UK combined, which are the third to fifth largest economies in the world. Bloomberg reports that total capital outflows from China in a single year over 2015/2016 amounted to $1.7 trillion US dollars. These dollars have poured into equity markets, property and direct acquisition of companies in every sphere of the world economy. This has distorted traditional valuation methodology and markets almost everywhere. And very few other than the Chinese themselves really understand what is happening, or whether it will endure.

In New Zealand the commentary of what a change in levels of investment from China in New Zealand property and equities might mean is laden with fear. So what is the reality for New Zealand investors? First, there is added competition to buy assets, particularly those deemed to be strategic. Second, the Chinese have proven in many instances to take very long term perspectives, and therefore will value these strategic assets in a way not replicated by many westerners. Thirdly, the New Zealand Overseas Investment Office reports that in the first 8 months of this year foreigners acquired a total of $2.7b of New Zealand assets. This is from all countries and confirms that New Zealand represents the proverbial drop in the bucket to the $1.7 trillion USD annual capital outflows emanating from China. Therefore investors, rather than worrying what a reduction in Chinese investment might mean for markets, should be conscious that a slight redirection of additional capital towards New Zealand could have dramatically more impact than what we have witnessed to date.

The lesson here is to not try and second guess the Chinese impact, the political response, nor try to get rich quick. Investment fundamentals do not require a prediction of the future, nor a following of that which is fashionable. That is called speculation. Buying quality assets at fair prices and holding for the longer term may not sound exciting, but is bound to minimise disappointments in the future. And do be careful who you get your expert advice from.

Fashionable investments — friend or foe?

Ashley Gardyne
Senior Portfolio Manager

Ecommerce is causing tectonic shifts in the retail sector — squeezing the profitability of traditional retailers, while driving growth for others. Before our recent trip to Europe we spent a lot of time researching successful European retailers like H&M and Inditex (owner of Zara) and leading online players like Zalando and ASOS (who now do free delivery and returns in New Zealand). On our trip we met a number of online and offline retailers, gaining some new perspectives and getting a better understanding of who the winners and losers may be.

> "Even in this changing world, clothing retailers can do well if they are nimble and embrace technology."

Only a few years ago retailers argued that clothes shopping was an experience people enjoyed; so much so that the need to try clothes on and get the right fit would provide protection from online competition. We now know this isn't true. First, free delivery and now more enticingly free returns, means your home can become the fitting room. This has driven the rapid growth of European online retailers like Zalando and ASOS. If online retailers can take care of delivery and returns for less than it costs to operate a store infrastructure (leases, store fitout, staff costs etc), then it is profitable for them and more convenient for customers. Fashion chain H&M already makes more than 25% of its sales from ecommerce in some of its mature markets. People will increasingly buy apparel online and retailers need to adapt.

If you have product customers want, you can choose where you sell it — potentially keeping your best product to sell on your own website, and selling the rest to department stores. This creates a challenge for traditional department store chains who essentially retail products made by others. As most of this product is now available on websites like ASOS, Zalando or Amazon, the margin for simply being a retailer is under pressure.

Even in this changing world, clothing retailers can do well if they are nimble and embrace technology. Zara is a great example of this. Unlike traditional retailers that design and manufacture most of their merchandise at the start of the season, Zara make a fraction of what they expect to sell. They wait to see what is selling well in store, what competitors are selling, and what is popular on social media platforms. Zara then designs, manufactures and ships this product to store within six weeks. This speed and responsiveness to trends results in much less discounting of unsold stock at the end of season and a higher margin on each garment. Being fast and flexible is becoming a requirement for many apparel retailers.

As consumers increasingly look online to shop for clothes, it is the online malls like Zalando, ASOS and Amazon that are attracting the most eyeballs. Consumers value the ability to access multiple brands in one place, with a wide range, fast delivery and free returns.

While the world of retail is changing, there can still be attractive investment opportunities among companies that embrace this new environment. Amazon is the largest online apparel retailer in the US, and we are increasingly seeing brands turn to them to expand their online reach.

Short term pain, long term gains

Frank Jasper
Chief Investment Officer

"Kicking the can down the road." "Never put off for tomorrow, what you can do today." "You may delay but time will not." "When there is a hill to climb, don't think that waiting will make it smaller." And my new favourite. "Stop talking. Start walking."

A quick google on procrastination will bring up hundreds of quotes imploring us to deal with the hard things today and stop putting them off. The aging of the New Zealand population and our ability, as a nation, to afford New Zealand Superannuation is one of those hard things. And it is hard. It is requires difficult trade-offs that affect people's lives but just because it's hard it doesn't mean we can put off thinking about it.

Unfortunately putting off thinking about it seems to the policy that has been universally adopted by our politicians. The recent election gave us the chance to reassess each party's position on superannuation.

Labour and New Zealand First support the status quo — no change to the entitlement age for New Zealand Superannuation. This means that New Zealand Superannuation, as a per cent of Gross Domestic Product (GDP), will rise from 4.8% in 2016 to a projected 8.4% of GDP by 2060. To put this in context we currently spend about 6.2% of GDP on healthcare. When you factor in that over the same timeframe we'll be moving from four tax payers for every superannuitant to two tax payers for every superannuitant, more tax or reduced services are on their way. There's only so many ways you can cut the cake!

National's policy is similarly anaemic with the age of New Zealand Superannuation entitlement beginning to slowly lift from 2037. This reduces the scale of the problem but is hardly a transformational solution.

The problem with not dealing with the looming superannuation challenge is that it is unsustainable for the New Zealand economy. And the problem with unsustainable things is that they are unsustainable. One day the rules on New Zealand Superannuation will be changed. The longer it's left in limbo the more disruptive that change will be for us all.

What can we do as Kiwis, tax payers and voters? Unfortunately, there are only two things we can do. Firstly, we can, and should, talk about superannuation and engage in the political process to ensure our voice is heard.

Ultimately, though, it's the decisions each of us take today with our own savings that will determine the quality of life we will have as we get older. By regularly saving into our KiwiSaver accounts or other managed funds we can be much better prepared should there be changes to New Zealand Superannuation. The politicians may procrastinate. We don't have to.
"Stop talking. Start walking."

Contact us

Mark Brighouse
Chief Investment Strategist
Phone 09 487 2632 | Email mark@fisherfunds.co.nz

Kate Meyers
Institutional Client Relationship Manager
Phone 09 487 2637 | Email kate@fisherfunds.co.nz

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Market Movements

As at 30 September 2017

Stock Markets*	Closing Values	Changes over: 1 Mth %	3 Mths %	6 Mths %	12 Mths %
S&P Developed LargeMidCap - (Local Curr)	703	2.4	4.0	7.3	18.9
S&P Developed LargeMidCap ($NZ)	N/A	2.4	6.3	4.7	20.8
S&P Global LargeMidCap ($NZ)	N/A	1.0	6.6	6.4	20.0
USA - S & P 500	4888	2.1	4.5	7.7	18.6
USA - Nasdaq	7448	1.1	6.1	10.5	23.7
Japan - Topix	2434	4.3	4.7	11.8	29.3
UK - FTSE100	6208	-0.7	1.8	2.8	11.2
Germany - DAX	12829	6.4	4.1	4.2	22.1
France - CAC40	13535	4.9	4.3	6.8	23.7
HK - Hang Seng	74184	-1.2	8.6	17.9	23.0
Australia - S & P 300	55432	0.0	0.8	-0.8	9.0
NZ-S&P/NZX 50 Gross Index (inc imp credits)	9441	1.8	4.7	10.9	9.1
NZ-S&P/NZX 50 Gross Index (excl imp credits)	7930	1.4	4.2	10.2	7.7
Market Volatility - VIX	9.5	-10.2	-14.9	-23.1	-28.4

New Zealand Property		%	%	%	%
S&P/NZX All Real Estate (inc imp credits)	1208.7	0.6	0.5	5.0	0.0
S&P/NZX All Real Estate (exc imp credits)	1181.2	0.5	0.4	4.5	-1.0

Ten Year Bonds	%	Yield Changes			
USA	2.20	-0.01	0.01	-0.28	0.57
Japan	0.06	0.06	-0.02	0.00	0.14
United Kingdom	1.36	0.32	0.10	0.22	0.71
Australia	2.84	0.12	0.24	0.15	0.93
New Zealand	2.98	0.08	0.00	-0.21	0.81

90 Day Interest Rates	%	Yield Changes			
USA	1.05	0.02	0.05	0.30	0.76
Japan	0.06	0.00	0.00	0.00	0.00
United Kingdom	0.34	0.06	0.03	0.00	-0.05
Australia	1.71	0.00	0.00	-0.08	-0.03
New Zealand	1.96	0.00	-0.02	-0.04	-0.24

Bond Indices	Closing Values	Changes over: 1 Mth %	3 Mths %	6 Mths %	12 Mths %
S&P/NZX Bank Bills 90-Day	700.12	0.16	0.50	1.01	2.09
S&P/NZX NZ Government Bond Index	1643	0.03	0.94	2.31	0.25
Barclays Capital Global Aggregate Index (Hedged NZD)	N/A	-0.40	0.99	2.22	0.93

Hedge Funds & Commodities		%	%	%	%
HFRX Global Hedge Fund Index (USD)	1257	0.6	1.8	2.7	5.6
DJ-UBS Commodity Index Total Return	172	-0.1	2.5	-0.6	-0.3
Gold (US$/ounce)	1281.50	-2.6	3.3	2.7	-2.4
Oil (US$/barrel)	56.79	7.8	20.6	8.8	17.7

Currencies		%	%	%	%
NZD / USD	0.7229	0.9	-1.3	3.4	-0.6
NZD / EUR	0.6115	1.5	-4.7	-6.4	-5.5
NZD / GBP	0.5388	-3.1	-4.4	-3.6	-3.8
NZD / AUD	0.9213	2.0	-3.5	0.5	-3.0
NZD / YEN	81.37	3.2	-1.1	4.5	10.5
Trade Weighted Index	75.85	-1.6	-2.7	-0.9	-2.6

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