Snapshot

Market insights for investment professionals from Fisher Institutional — September 2017

Bruce McLachlan
Chief Executive

Will you spring into retirement?

To me, spring is the best time of the year. No question. Spring represents life, a new beginning and a feeling of hope and optimism. There is a scientific reason for this. Increased exposure to sunshine (vitamin D) improves our liver functions and reduces the risk of many illnesses and diseases. We are healthier, which makes us all feel better emotionally and more optimistic.

This in turn makes us all more likely to make more decisions, undertake more economic activity and basically live life more to the full. It's called *UV economics*. I have always believed in this phenomenon, because of what I have witnessed in New Zealander's attitudes during spring and early summer. Our focus quickly becomes the beach, BBQ's, family, holidays and doing positive things. No business (or politician for that matter) should ever get in the way of a Kiwi and this mindset!

With the onset of spring, there's no better time for New Zealanders to make some bold decisions about their future.

You see we think we are doing a better job than before of preparing for the future, after all we have $42 billion in KiwiSaver now. The reality is New Zealanders remain grossly underprepared financially for retirement. On a like for like basis, Kiwis have around 20% of the pension type assets of other western nations. This is exacerbated by the very low inflation, low interest rate environment that we now live in. Interest rates are relevant because it means it takes more savings to generate a satisfactory income in retirement.

The size of the problem we face is evident in the population statistics which show New Zealand is now a country of 4.7 million people (that last million has arrived quickly!) and 47% of these are over 40 years of age. Collectively we are underprepared, and while there is individual responsibility, there has to be a collective response. Our children and grandchildren shouldn't have to pay excessive taxes in the future to keep previous generations in a basic lifestyle in retirement.

So how can you turn the wave of spring optimism into retirement renewal? For those in KiwiSaver, a simple step that can be done right now is to increase contributions from the minimum (3%) up to 4% or 8%. It's a small change that can have a big impact and it is amazing how quickly spending patterns can be quickly adjusted to the new level required. Many savers have made this adjustment, but we need a lot more to take this step.

For those who have a portfolio of investments or are already on the maximum KiwiSaver contribution, this is the right time to ask if you have invested wisely. New Zealanders have 55% of their pension assets in relatively low yielding cash and bond funds, whereas Australians only have 30%, Canadians 35%, the Swiss 42%, British 37% and US citizens only 24%. New Zealand investors' natural conservatism have cost them billions of dollars of lost returns in recent years. Have you reviewed your investment strategy lately?

For those relying on trading down the size of their family home as a way of funding retirement this may not be as easy as you think. While residential property has been a stellar performer in recent years that is a huge bet, particularly when you consider the largest population group (baby boomers) are all going to be looking to sell down at the same time, to a new generation that largely cannot afford to buy homes. Making that change earlier and diversifying investments beyond just the family home makes a lot of sense.

The Government, of whatever colour, is unlikely to change any of the above situations. It is time for us all to be bold and use the optimism of spring to take control of our own retirement savings and our retirement lifestyle. Soak up that warming sun, absorb the vitamin D, and then make the decision. The team here is ready and waiting to help you make these decisions. We are with you all the way.

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Frank Jasper
Chief Investment Officer

Numbers are only half the story

Remember the days of the schoolyard. Exam results. Sweaty palms, a beating heart, the thrill of success, the worry of failure. For our Portfolio Managers, the "reporting season" has echoes of exam results. Reporting season is that time of the year when companies announce profit results for the past six months.

When we invest in a company we develop a clear road map of where we think that company is heading. We look at this primarily from a strategic perspective. What is a company doing to beat its competition, how will it sell more goods and services and can it improve profit margins? The litmus test of strategy is profitability. A good strategy means over time a company earns higher profits and higher profits mean a higher share price and happy investors.

Reporting season is one of those litmus tests. It helps us assess if a company remains on the road to investment success or if things are beginning to stray. This is often a time that we make active changes to our portfolios.

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While the media commentary on company results often looks at the headline numbers the real insights may be buried much deeper. On the surface **Freightways**, the New Zealand based courier and document storage company, downgraded earnings expectations for next year. In a knee jerk reaction the market sent Freightways shares down. For us this was an opportunity. Freightways profitability next year is impacted by investments the

company is making in more airfreight and warehouse capacity. These will fuel future growth and result in a more valuable business.

Australian producer of four wheel drive vehicle accessories and components, **ARB**, is a great example of a company that has gone through an investment phase opening up new warehousing capacity in export markets, new stores in Australia and adding to sales capacity. This investment was at the heart of why we recently invested in the company and is now beginning to pay off. Export sales, in particular, were up a pleasing 14.3% over the year. The share market loves growth and ARB was rewarded with a nice share price jump.

Overall it was a good reporting season, with more passes than fails. That said, where managing a portfolio is different than the old schoolyard is that we get to retake the exam over and over again. Each results season is a chance to actively manage our portfolio and to drive for even better results next time. Great results are the best way to slow that beating heart.

David McLeish
Senior Portfolio Manager
— Fixed Interest

The name's Bond ...

A recent survey conducted by the Financial Markets Authority suggests New Zealanders are still very much in the dark about one of the world's largest financial markets — the bond market. This is despite a majority of assets held in KiwiSaver default schemes being made up of fixed interest assets such as these. So let's shed some light on the situation.

When trying to grasp a new concept I often find drawing comparisons with something I'm more familiar with helps build my understanding. I'm going to adopt the same strategy here. I hope it works as well for you as it does me.

I've chosen the humble term deposit as the closest and most familiar comparable. It may surprise you just how similar the two really are.

In just the same way that you lend your money to the bank when you take out a term deposit, a bond is also a type of loan. But instead of lending your money to just one bank, the bond market allows you to lend to any number of borrowers anywhere in the world. As you might imagine, the list of would-be-borrowers at any one time is huge. They could be companies (that might want to expand their footprint), they could be governments and councils (who need to fund necessary services that taxes can't currently cover), or they could be specific entities (trying to fund a project such as building a new road, a power plant, or pipeline). The list of potential borrowers is so long I could never cover them all here. But I think you get the picture.

The similarities to a term deposit don't end there. In return for lending out your money, the borrower pays regular interest amounts and, all going to plan, your money is returned at the end of the term. In much the same way as the bank is obliged to meet this promise to you, borrowers through the bond market also have a similar obligation. They are largely non-negotiable. This makes them far more reliable than say a dividend paid on a share investment which could be cancelled at any point without notice.

Another similarity is that term deposits and bonds both typically have a pre-determined maturity date, or term, assigned to them. Knowing when and how much you are expected to be paid makes the return on these investments far more certain, lowering the associated risk. It is the combination of these characteristics that affords the highest rated bonds their enviable title of safe-haven assets.

Like most investments, not all bonds are created equal though. Our job is to assess the credentials of all these bonds and identify those that will perform best when combined into a portfolio — allowing you to spread your investments out and not put all your eggs into one basket (the bank). The sheer size of the global bond market gives us lots of choice, and the flexibility to mix and match different terms and interest rates of the many different borrowers relative to the risks they present.

Interest rates are at historic lows. So getting the right mix of bonds is important as movements in interest rates can and do influence the value (or price) of bonds — a key difference between them and term deposits as bonds can be sold before maturity and therefore have a tradable price.

So next time you read about bonds, hopefully you will rest easy rather than being shaken or stirred.

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Market Movements

As at 31 August 2017

Stock Markets*	Closing Values	Changes over: 1 Mth %	3 Mths %	6 Mths %	12 Mths %
S&P Developed LargeMidCap - (Local Curr)	686	0.2	1.7	5.9	16.4
S&P Developed LargeMidCap ($NZ)	N/A	0.2	-3.7	2.2	12.6
S&P Global LargeMidCap ($NZ)	N/A	5.1	2.8	10.4	19.4
USA - S & P 500	4789	0.3	3.0	5.7	16.2
USA - Nasdaq	7366	1.4	4.0	11.0	24.7
Japan - Topix	2333	0.0	3.3	6.5	24.3
UK - FTSE100	6250	1.6	0.0	4.7	14.0
Germany - DAX	12056	-0.5	-4.4	1.9	13.8
France - CAC40	12898	-0.2	-3.3	7.5	18.3
HK - Hang Seng	75062	3.1	11.5	21.3	26.7
Australia - S & P 300	55413	0.7	1.0	2.4	9.5
NZ-S&P/NZX 50 Gross Index (inc imp credits)	9271	1.7	5.6	9.8	7.1
NZ-S&P/NZX 50 Gross Index (excl imp credits)	7817	1.6	5.4	9.1	5.7
Market Volatility - VIX	10.6	3.2	1.7	-18.0	-21.1

New Zealand Property		%	%	%	%
S&P/NZX All Real Estate (inc imp credits)	1201.3	0.5	1.5	3.7	-2.0
S&P/NZX All Real Estate (exc imp credits)	1175.6	0.5	1.2	3.2	-3.1

Ten Year Bonds	%	Yield Changes			
USA	2.21	-0.11	-0.09	-0.15	0.65
Japan	0.00	-0.07	-0.04	-0.05	0.07
United Kingdom	1.04	-0.19	-0.01	-0.04	0.50
Australia	2.71	0.04	0.33	-0.01	0.89
New Zealand	2.90	-0.09	0.12	-0.34	0.78

90 Day Interest Rates	%	Yield Changes			
USA	1.03	-0.06	0.13	0.50	0.73
Japan	0.06	0.00	0.00	0.00	0.00
United Kingdom	0.28	-0.01	-0.02	-0.08	-0.11
Australia	1.71	0.02	-0.02	-0.07	-0.02
New Zealand	1.96	0.01	-0.01	-0.04	-0.32

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Bond Indices	Closing Values	Changes over: 1 Mth %	3 Mths %	6 Mths %	12 Mths %
S&P/NZX Bank Bills 90-Day	699.01	0.17	0.50	1.02	2.12
S&P/NZX NZ Government Bond Index	1643	0.50	0.16	2.77	0.05
Barclays Capital Global Aggregate Index (Hedged NZD)	N/A	1.01	1.19	2.67	1.46

Hedge Funds & Commodities		%	%	%	%
HFRX Global Hedge Fund Index (USD)	1249	0.3	1.4	2.1	5.6
DJ-UBS Commodity Index Total Return	172	0.4	2.5	-3.1	3.0
Gold (US$/ounce)	1316.20	3.9	3.5	5.1	0.7
Oil (US$/barrel)	52.80	1.6	6.9	-1.0	10.1

Currencies		%	%	%	%
NZD / USD	0.7162	-4.5	0.9	-1.0	-1.3
NZD / EUR	0.6024	-5.3	-4.6	-11.5	-7.5
NZD / GBP	0.5558	-2.3	1.1	-4.4	0.3
NZD / AUD	0.9030	-3.8	-5.3	-4.0	-6.5
NZD / YEN	78.82	-4.9	0.4	-2.6	5.0
Trade Weighted Index	77.08	-1.7	2.1	-2.2	0.4

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

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