



RUTHERFORD REDE

Insights

Winter 2020



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THE WORLD THAT WAS

Key themes of the period

July 2020

- Market performance was very strong over the June quarter
- Equity markets had double-digit gains and listed property, infrastructure and fixed income were also robust
- While further market falls can't be ruled out, we remain optimistic about NZ's economic prospects

Markets are back in black!

Markets performed very strongly over the June quarter.

In our March update, markets were at the start of the recovery from the Covid-19 sell-off. At the time, our view was that markets were likely over-sold and, therefore, rebalancing portfolios towards risky assets where necessary was the best course of action. We were confident that the long-term reward for bearing market risk remained intact, and that the Covid-19 'shock', like other large shocks markets have faced, would pass. However, you will recall we cautioned that further volatility could occur given the dire economic conditions, and we certainly did not expect the recovery in equity markets to be as strong as it transpired.



The global bell-weather US S&P 500 Index closed the quarter at December 2019 levels, only around 10% off the all-time highs it reached in early February this year. The gain for the quarter was around 20%; which was the biggest quarterly gain since 1998.

Equity markets had double-digit gains in local currency terms, with the NZ market continuing its stellar reign.

Global equities had similar fortunes. International shares rose around 10% in the quarter in NZD terms, whilst NZD hedged shares increased by around 18% mirroring the increase in global market terms as shown in **Figure 1**. This is a reversal of last quarter's pattern where NZD hedged returns significantly lagged unhedged NZD returns. The NZD tends to fall in times of stress and quickly rise when risk appetites improve. This time was no different.

Within global equities, higher-risk small-cap stocks increased around 15% in NZD terms, while value stocks continued their under-performance, rising only around 4%. Emerging Market equities increased by around 9% in NZD terms, broadly in-line with developed market stocks. Trans-Tasman equity markets also fared well.

Australian shares increased by around 20% in NZD terms reflecting, in part, out-performance of the Aussie dollar versus the Kiwi. NZ markets increased around 17% over the quarter, bringing the 5-year performance to around 16% per annum – an exceptional result compared to most other equity markets and our markets' longer-term history.

Listed property, infrastructure and fixed income returns were also robust.

While international property stocks climbed by around 9% in the quarter, they are still down around 17% over the year to date, reflecting ongoing uncertainty about how landlords will manage with lower short-term rental income, and how much lower longer-term tenancy demand may be in a post-Covid world. International infrastructure has been more resilient, with returns broadly flat over the year.

Fixed-income returns were positive over the quarter, driven by credit spreads continuing to decline as central bank

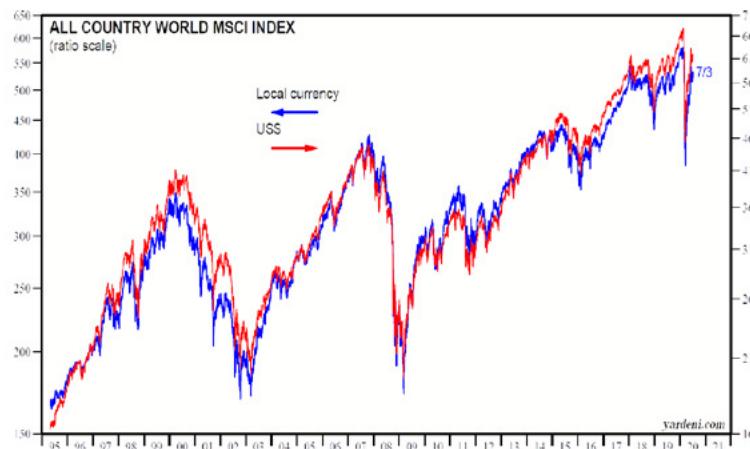
asset purchase programmes restored confidence to the market (Figure 2).

The market rally has occurred despite a weak economic environment.

New Zealand and global investment-grade bonds returned around 5.5% over the year to June, which was materially higher than the return to cash. The latter is now near-zero (or even negative in some markets) given the dropping of central bank policy rates to the lowest levels ever reached.

FIGURE 1

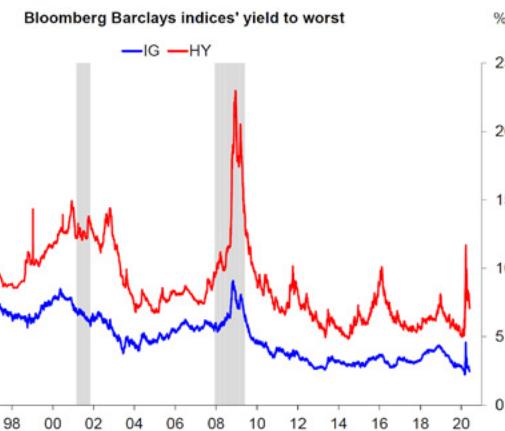
Equity markets bounce back and currency effects wash through in time



Source: MSCI, Yardeni Research

FIGURE 2

Corporate credit spreads back down. Credit spreads are the margins that are priced into bonds of differing risks. In times of trouble, they grow.



Source: DB Global Research

The strong rise in markets has led to much debate over whether the increase is justified. Is it too much too soon? As is always the case in markets, there are opposing views and no-one can accurately predict what will happen next.

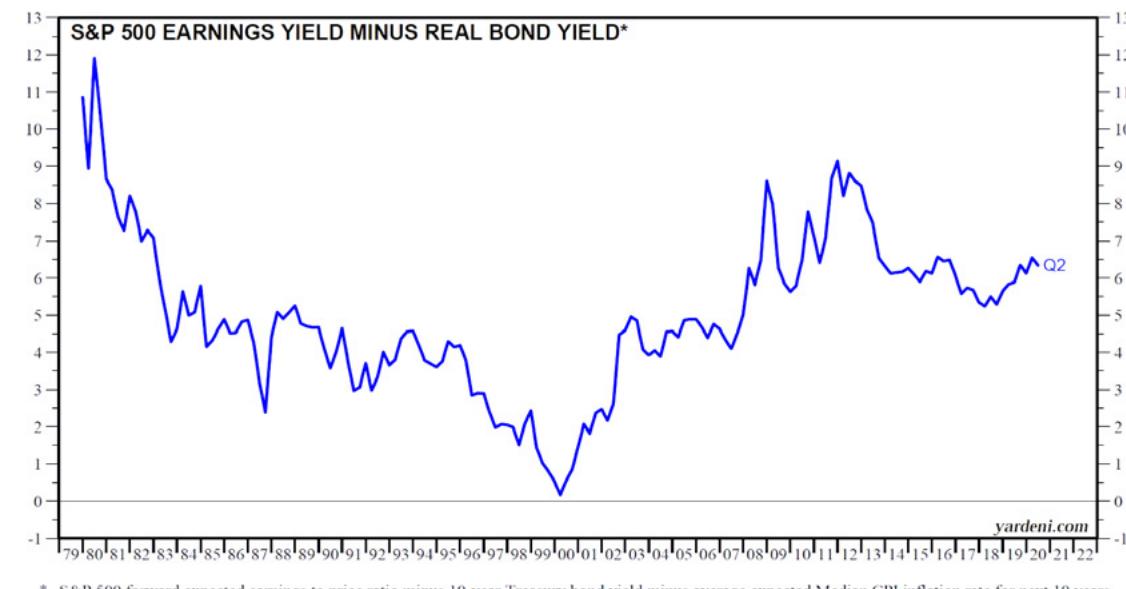
This in part reflects that economic conditions have been better than expected.

On the positive side of the ledger we can point to the following factors supporting the market increase:

- The fact that short-term economic data has been stronger than expected. This is not to say that economic conditions are strong – they are weak. Rather, economic outturns have not been as bad as feared. Short-term market movements tend to be driven by how conditions evolve relative to expectations, rather than levels of activity per se.
- The extremely supportive monetary and fiscal policy settings now in place globally. This has been instrumental in supporting lending, credit markets and asset prices.
- The fact that despite the rally equities (and risky assets in general) still offer reasonable value for investors compared to cash and bonds. Dividend yields are now materially higher than investment-grade bond yields and cash yields. They are likely to remain so given central bank rate rises are off the table for the foreseeable future while global inflation is extremely low. Also, the US equity risk premium remains well above long-term average levels (**Figure 3**), as do risk premiums in other markets.

FIGURE 3

US equity risk premiums remain high, i.e. the increase in yield that equities produce over 10 year US government bonds rate.



Source: US Federal Reserve, Yardeni Research

- While the public health management of the spread of Covid-19 has been patchy globally and poor in nations such as the US and Brazil, what has been impressive is the level of international scientific co-operation in developing treatment protocols and vaccines. Currently, there are over 145 vaccines in development and 21 in human trials. Expectations are that mass production of vaccines and immunisation will occur sometime next year.

Downside risks remain high, and further market falls can't be ruled out.

Those who believe markets to be inflated turn to these arguments to support their view:

- The fact that the current economic downturn is worse than at any time since the Great Depression (or outside of major wars). In this environment, there is undoubtedly

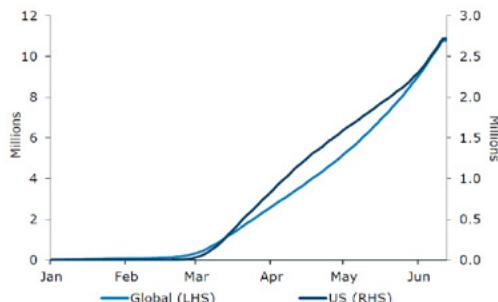


an elevated risk of 'trigger events', such as high-profile corporate bankruptcies, and these may result in another large market sell-off.

- With corporate earnings being slashed due to Covid-19, the price-earnings (PE) ratios for markets are now elevated. This conventional valuation metric is at least flashing orange and cause for caution.
- Optimism that earnings will recover is misplaced. Covid-19 cases continue to march up globally (**Figure 4**), raising the risk that at some point governments will have to re-impose strict lock-down measures.
- There will be a 'day of reckoning' for the huge debt build-up that has taken place over the past decade. Bond term premiums are set to rise, and this will cause asset prices to be re-set at lower levels.

FIGURE 4

The Covid-19 global curve has not been flattened. Cases are still growing.



Source: Johns Hopkins University, ANZ Research

But we remain more optimistic about New Zealand's economic prospects

Our view leans more to the positive side of the ledger, but of course, we can't rule out further volatility.

We note in particular that trailing PE ratios have not been reliable indicators of future returns and, instead, markets appear to have been driven more by the premium on offer relative to cash.

In New Zealand's case we remain more optimistic still given how much better Covid-19 has been managed to date, the recovery in short-term activity levels (**Figure 5**), large scale infrastructure spending in train, the resilience of our agricultural sector, and the prospect that the hard-hit tourism sector will face some relief perhaps as soon as September as a Trans-Tasman travel bubble opens up.

FIGURE 5

A composite indicator of activity reflecting NZs recent recovery.

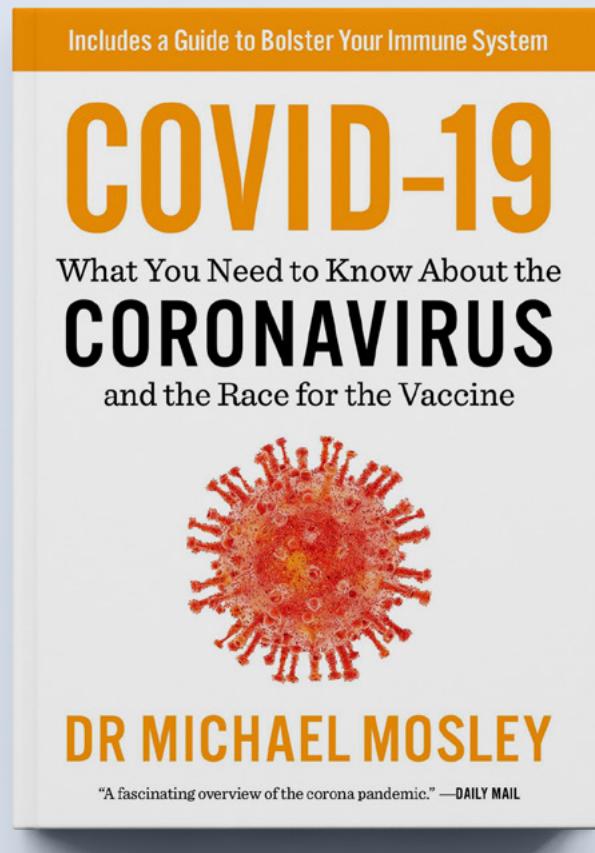


Source: RBNZ, Treasury, Statistics New Zealand

HOW THE MARKETS FAARED

*All returns are expressed in NZD.
We assume Australian Shares and International Property are invested on an unhedged basis, and therefore returns from these sectors are susceptible to movement in the value of the NZD.*

QTRLY RETURN	PAST YEAR	ASSET CLASS
 +16.9%	 +9.9%	New Zealand Shares: New Zealand shares returned around 17% in the quarter, bouncing strongly from the Covid-19 lows reached in late March. Over the past 5-years performance remains exceptional at around 16% per annum. Source of Figures: S&P/NZX 50 Total Return Index with Imputation Credits
 +3.5%	 +5.8%	New Zealand Fixed Interest: New Zealand investment-grade corporate bonds returned 3.5% for the quarter and around 5.8% for the year. This return is both comfortably higher than 90-day NZ bank bill and term deposit rates, showing that NZ corporate bonds have delivered a premium over the year, and through the Covid-19 sell-off. Source of Figures: S&P/NZX Investment Grade Corporate Bond Index
 +20.1%	 -5.7%	Australian Shares: Australian shares returned around 20% in the quarter in NZD terms, reducing the annual return to around -5.7%. Within Australian equities, small-cap stocks and value stocks out-performed returning around 28% and 23% for the quarter respectively. Overall, while a strong bounce, the Australian remains lower than other broad markets over the year owing to its higher sensitivity to global growth conditions. Source of Figures: S&P/ASX 300, S&P Australia BMI Value, S&P/ASX Small Ordinaries
 +9.9% (18.2% hedged)	 +7.3% (1.2% hedged)	International Shares: International shares rose 10% in the quarter in NZD terms, whilst NZD hedged shares increased around 18% mirroring the increase in global market terms. The NZD tends to rally in a market recovery, and this time was no different, boosting hedged returns. Within global equities, small-caps returned around 15% in the quarter while value stocks languished returning around 3.5%. Source of Figures: MSCI World Index; Morningstar Developed Markets NZD hedged, MSCI World Value, MSCI World Small Cap
 +8.7%	 +0.8%	Emerging Markets: Emerging Market equities rose 8.7% in the quarter, bringing the annual return to June back in the black at around 1%. Returns were stronger in local currency terms at around 17% for the quarter, with the difference reflecting the NZD appreciation over the past quarter. Source of Figures: MSCI Emerging Markets Index
 +2.4%	 +5.7%	International Fixed Interest: Global bonds returned 2.4% in the quarter and 5.7% for the year. The annual return remains strong given their low income yields and reflects bonds being re-priced higher as longer-term interest rates fell on the back of global growth concerns. Source of Figures: Bloomberg Barclays Global Aggregate Index (hedged to NZD)
 +8.9%	 -17.0%	International Property: International property stocks rose by around 9% in the quarter but are still down around 17% over the year. This asset class has been hit hard by Covid-19, reflecting large uncertainty around tenant demand. International infrastructure has been a more resilient asset class, with returns broadly flat over the past year. Source of Figures: FTSE EPRA NAREIT NZD Hedged

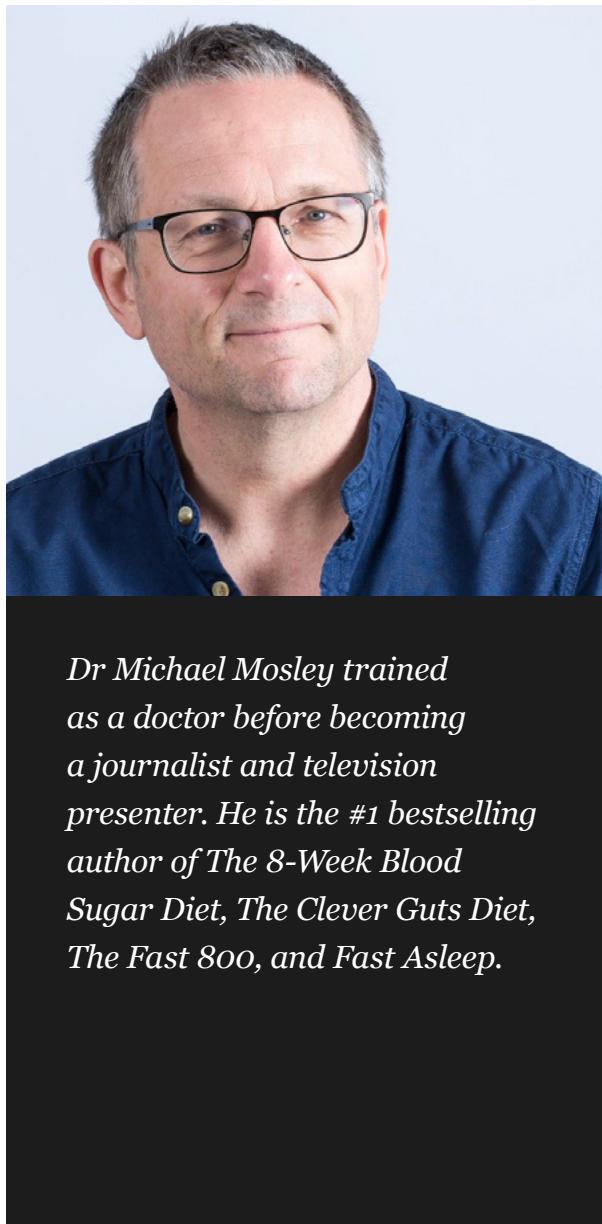


BOOK REVIEW

Covid-19: What you need to know about the coronavirus and the race for the vaccine

Author: Dr Michael Mosley

Publisher: Simon & Schuster



You would probably have needed to be in a Coma for the last three months not to have read much on the subject of Covid-19. We think there is a possibility that perhaps you just don't want to hear any more...

We recently read the book by Dr Michael Mosley titled 'Covid-19: What you need to know about the Coronavirus and the race for the vaccine' published by Simon & Schuster. Amongst other interesting aspects, Dr Mosley talks about our immune systems. Specifically, how coronavirus infects our body and how our immune system tries to fight back. He says it is those with declining or compromised immune systems who are most vulnerable. But it is possible to improve our immune system and those who do will be in a better position to protect themselves and their family as the world begins to open.

We found the book interesting and in tune with the theme of investing in your health and happiness and, at the risk of touching too much on the Covid subject, we thought you might be interested to read what he wrote.

Practising these seven things will enhance your immune system:

1. Shrink your waist
2. Try intermittent fasting
3. Eat a more Mediterranean-style diet
4. Boost your microbiome
5. Sleep more soundly
6. Be more active
7. Reduce stress

Shrink your waist

According to Dr Mosley, it's the fat around your waist that seems to make the most difference. People with excess abdomen fat tend to have a less efficient immune response, even to the point where vaccines are less effective. This could lead to raised blood sugar levels that in turn could lead to being more prone to getting infections.

Try intermittent fasting

Intermittent fasting is where you cut your calories a couple of days a week or when you only eat in a 10-hour window each day. A review paper in December 2019 published by the New England Journal of Medicine concluded that both fasting approaches lead to improvements in blood pressure, resting heart rate, levels of HDL and LDL cholesterol, triglycerides, glucose and insulin resistance. Also, there were indications that inflammation markers were reduced. Widespread inflammation is a sign of a malfunctioning immune system.

Eat a more Mediterranean-style diet

Like any army, the soldiers of your immune system responds to being well fed. A Mediterranean diet, one that is rich in natural fats, nuts, fish, vegetables and legumes are rich in disease-fighting vitamins and legumes. Movement in this direction usually involves cutting back on (or eliminating) sugary and processed foods that feed the bad pro-inflammatory microbes that live in the gut. There is a lot of information available on this diet so we will not bore you with the detail.

Boost your microbiome

Microbiome are microbes found in your gut. Enhancing the good microbes can have an important role in your bodies immune system. A Mediterranean diet helps achieve this as does introducing fermented foods like sauerkraut into your diet.

Sleep more soundly

One reason a good night's sleep is important is that while you are in deep sleep your body is generating the proteins that start and co-ordinate your immune response to viral infections. Good quality sleep is also important for the production of infection-fighting antibodies and T-Killer cells. At least seven hours of sleep seems to create some sort of threshold, but it is the deep sleep phase that is most important.

Be more active

Twenty minutes of exercise is enough to reduce tumour necrosis factor(TNF) a cytokine that drives chronic inflammation. There are other benefits of exercise of course but the key is to be active. Active does not necessarily need to be extreme. Taking the stairs and vacuuming are examples of being active.

Reduce stress

Chronic stress boosts the levels of the hormone cortisol which leads to chronic inflammation. It also reduces the level of some white blood cells that help fight off infection. Points 1 to 7 above have an effect of reducing stress, and simply being present is a further strategy that is helpful.

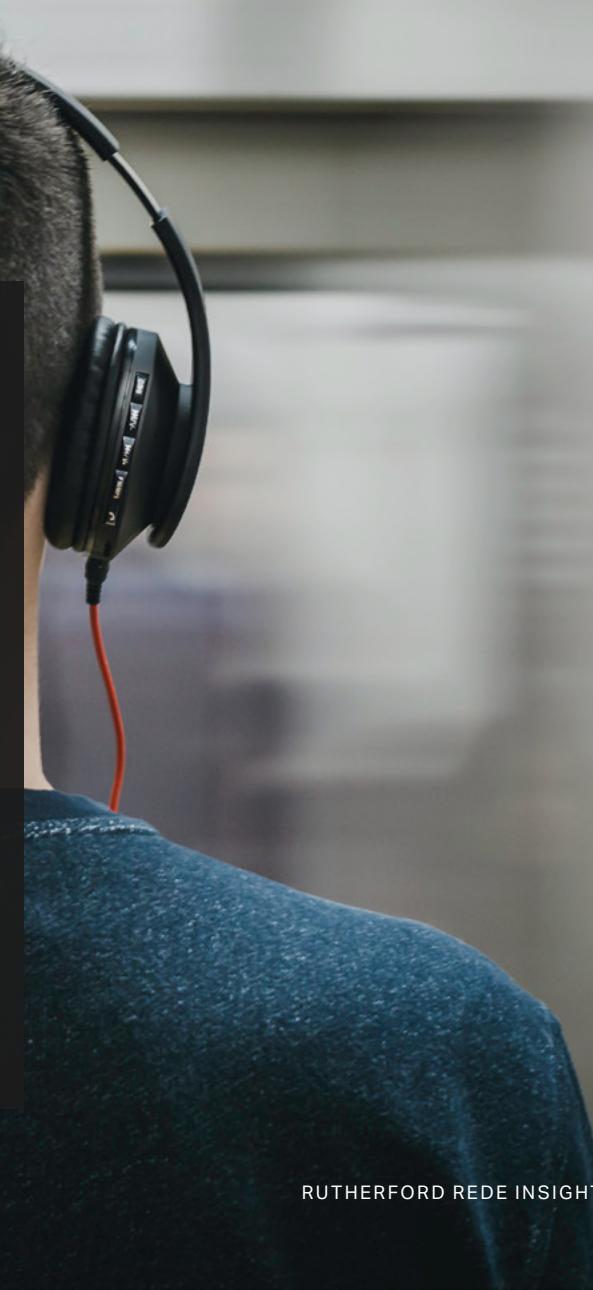


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MEDIA NOISE AND INFORMATION HYGIENE

Your Essential Toolkit





We are all overloaded with information today. The growth of the internet, the ubiquity of social media, the explosion of mobile technology and ever-faster download speeds can lead many of us to feel overwhelmed and not knowing whom to trust.

This brief guide from Jim Parker provides practical tips and suggestions to help protect your privacy, spot fake or manipulative information and identify reliable sources.

Ultimately, of course, when it comes to your finances, your most primary trusted source should be your Rutherford Rede adviser, who has the advantage of knowing you and your family, your circumstances, your goals and your capacity for risk.

Six Practical Steps:

1. Understand how the 'attention economy' works.
If you're not paying for the information, you're not the customer, you're the product. It is your attention that is most valuable.
2. Exercise particular discretion with 'news' you see on social media. These are advertising platforms, not publishers and they have no agreed editorial standards.
3. Tighten your privacy settings on Facebook – go to 'settings', 'privacy' to limit who can see your timeline; stop your profile being searched; use two-factor authentication.
4. Do not click on 'personality surveys' or download software via social media; remove third-party plug-ins – go to apps and websites settings.
5. Exercise scepticism with social media material that purports to be 'news':
 - Who is being quoted?
 - What facts are there to back up the claim?
 - Check out the author; go to the original source for verification.
 - Are more reliable sources reporting this? Do a Google news search.
 - Be careful with images. Do a Google reverse image search.
6. Red flags to watch out for:
 - Being asked to supply your email address for the full content.
 - Being asked to download a particular app to access the content.
 - Fake celebrity endorsements or promises of high returns and low risk.

How To Limit Your Social Media Use:

- Unplug for several hours a day
- Turn off notifications in settings
- Download a usage or filtering app
- Unsubscribe from groups you no longer want to be part of
- Block and report trolls; do not 'feed' them

Recommended News Sources:

Global Financial News Sources:

- [Reuters \(free\)](#)
- [Bloomberg \(part-subscription\)](#)
- [Financial Times \(subscription\)](#)
- [Wall Street Journal \(subscription\)](#)
- [The Economist \(subscription\)](#)

NZ Financial News Sources:

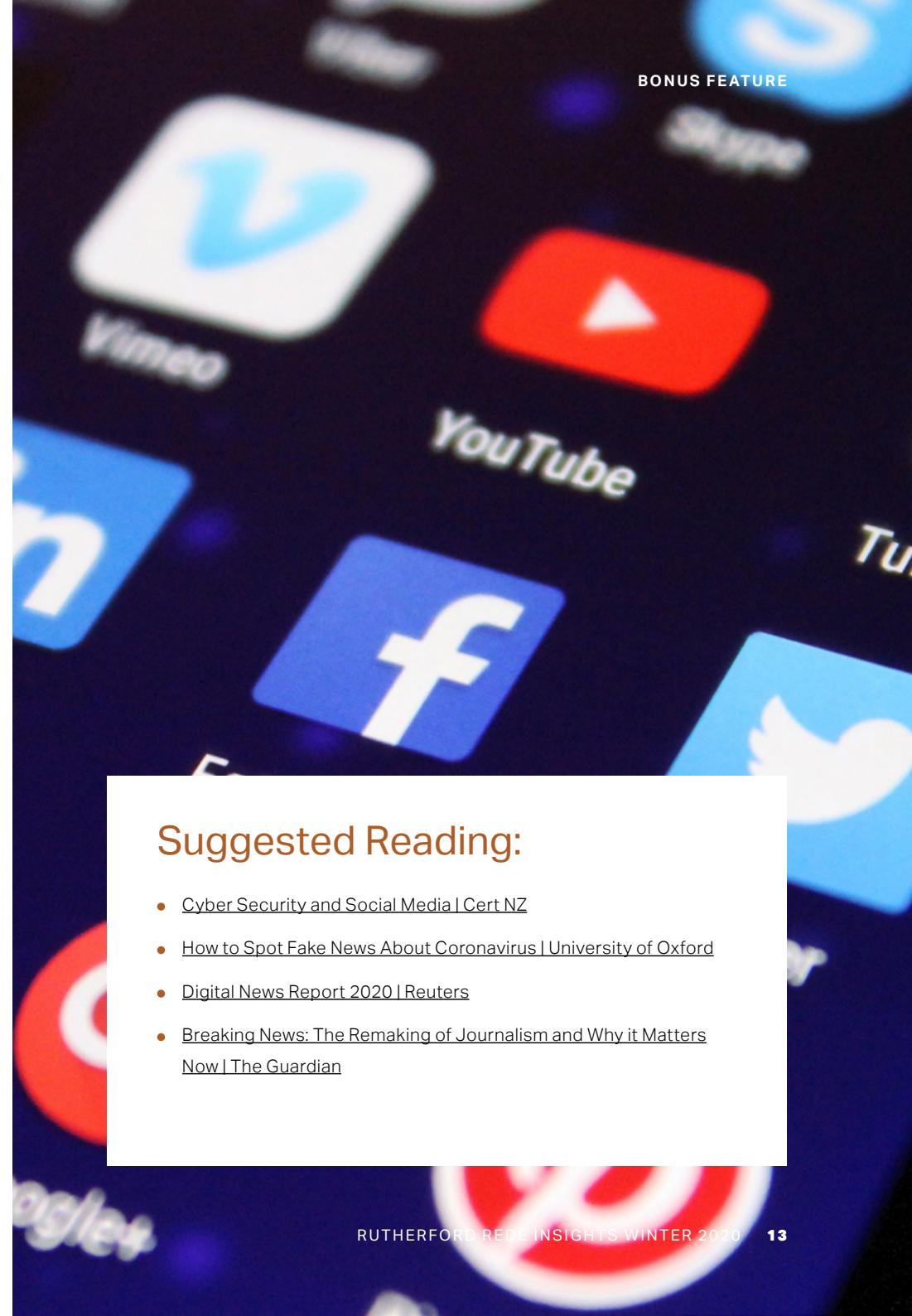
- [National Business Review](#)
- [Business Desk](#)
- [Interest.co.nz](#)
- [NZ Herald Business](#)
- [Stuff Business News](#)

Global General News Sources:

- [Reuters](#)
- [BBC](#)
- [CNN](#)
- [New York Times \(part-subscription\)](#)
- [Washington Post \(part-subscription\)](#)
- [The Guardian](#)

NZ General News Sources:

- [New Zealand Herald](#)
- [Stuff](#)
- [Newsroom](#)
- [Scoop](#)
- [The Guardian NZ](#)



Suggested Reading:

- [Cyber Security and Social Media | Cert NZ](#)
- [How to Spot Fake News About Coronavirus | University of Oxford](#)
- [Digital News Report 2020 | Reuters](#)
- [Breaking News: The Remaking of Journalism and Why it Matters Now | The Guardian](#)

RUTHERFORD REDE EVENTS



Media Noise

How to work out what's real and what's not!

We kept safe in the pandemic by observing the rules around hygiene and social distancing. But what about our media consumption? Unreliable, distorted and manipulative information is rife on the web, often tempting people into bad decisions.

We look forward to you joining our webcast at **5pm on Tuesday 21 July**, when former New Zealand journalist and funds management professional, Jim Parker, provides us with practical tips on how to safely navigate the barrage of social media, and the role of trusted advice.

If you're keen to learn how to spot fake or manipulative information, then we encourage you to register for this event.

Please note: The session will not be recorded.

About Jim Parker

Born in New Zealand and based in Sydney, Jim is Regional Director of Communications with Global Fund Manager, Dimensional. Previously, Jim spent a quarter of a century in journalism in New Zealand, Australia, Asia, and the UK specializing in financial markets and economics. Jim is a graduate in Economic History from Deakin University, Geelong, and in Journalism from Auckland University of Technology.

Market Update: Richard Knight and Noah Schiltknecht

Rutherford Rede Director and Adviser, Richard Knight, recently interviewed Noah Schiltknecht, founder of Makao Investments. A recording of the summary points covered during the interview is available for downloading. Please request a copy of the link from your Adviser.

The topics covered during the interview included:

1. What is happening to the world and how do you think it will play out?

- NZ economy – relatively better space
- Global economy
- Stimulus packages
- China as a leader in the recovery space
- Recession vs. depression
- Property market – remembering that not all of our clients are Auckland based

2. How long until we move to some sort of normality?

- What gets us there?
- What is normal? The new normal
- Digital transformation

3. What does this mean for investment? Are there some things that have changed fundamentally that will have a lasting effect.

- Markets are behaving as would be expected – pricing in information instantaneously, forward looking
- Volatility going forward
- Diversification
- Factor outcomes
- Bonds – low interest rate environment, they did their job over the last 3 months, still have a role to play.
- Infrastructure – income like qualities with added volatility. Behaves differently from rest of equity market
- Media – bad news sells



About Noah Schiltknecht

Before founding Makao in 2019, Noah was head of the institutional team at Russell Investments in New Zealand, advising a broad range of large institutional clients in New Zealand on investment strategy, asset allocation and manager selection. With two decades of financial services experience, Noah gained experience in infrastructure valuation at Vector Limited, and in capital management and structuring of insurance risk transfer solutions at Swiss Re in Switzerland. He is a New Zealand, Swiss and French citizen and lives with his wife and three children on the Hibiscus Coast.



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Portfolio assets are held on your behalf by the nominee and custodian, Aegis, a 100% owned subsidiary of MMC. MMC is a New Zealand outsourced fund and investment administration business. Assets are held via bare trust structure with ownership being retained at all times by the owners of the portfolio. Valuations are independently sourced and recorded by Aegis.