



RUTHERFORD REDE

Insights

Summer 2021



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THE WORLD THAT WAS

Key themes of the period

January 2021

- Equity markets continued their climb with Trans-Tasman equity markets singing from the same sheet in the last quarter
- Higher risk emerging market, small, and value stocks had a bumper quarter
- The economic 'shock' from COVID was weaker than expected



The market rebound continued

Equity markets continued their climb over the December quarter, with all growth asset classes closing higher.

Markets continued to climb over the December quarter, in line with our view that the environment, on balance, favours risk assets. Massive fiscal and monetary policy support, COVID-19 vaccine rollouts, and the search for yielding assets out-weighed concerns around a considerable surge in COVID cases in Europe and the US. Into January 2021, the rally has continued at the time of writing, as has the rotation from large-cap tech stocks to a much broader

base of cyclical, small-cap and value stocks. In part, this has reflected the US election and Georgia Senate results, which gives the Democratic Party in the US a clearer pathway to enact large scale fiscal policy support whilst COVID still rages and longer-term infrastructure spending programmes.

Higher risk emerging market, small, and value stocks had a bumper quarter.

International shares rose around 4.5% in the quarter in NZD terms, whilst NZD hedged shares increased around 11.7%. Within global equities, MSCI ESG indexes outperformed over the year principally because of their lower exposure to the oil and gas sector, while higher-risk small and value stocks outperformed in the quarter. Small caps returned

around 13.7% in the quarter, while value returned around 6.3% in NZD terms. Emerging Market equities increased around 10% in NZD terms, another strong performance.

Australian equity market performance lagged in 2020, as did global property and infrastructure.

Trans-Tasman equity markets sang from the same song sheet in the December quarter. Australian shares increased around 12.5% in NZD terms, while NZ shares rose around 11.5%. In calendar 2020, Australian shares still had a relatively weak performance returning around 4.5% in NZD terms. Concerns around bank profitability, and tensions with China impacting resource stocks, clearly weighed on Aussie market returns. In contrast, the NZ equity market returned around 14.5% over the year, bringing the 5-year performance to around 17% per annum – an exceptional result. Our market gains were also broad-based, with the NZ 50 portfolio index (which caps a company's weight at around 5%) out-performing the NZ 50 Index (which has considerable weight on A2 Milk and Fisher & Paykel Healthcare).

International property stocks rose by around 10.7% in the quarter, but are still down around 14% year-to-date, reflecting ongoing uncertainty around how much lower longer-term tenancy demand may be in the post-COVID world. International infrastructure has been more resilient, with returns broadly flat over the past year.

FIGURE 1: GLOBAL EQUITIES REACH NEW PEAKS



Source: MSCI

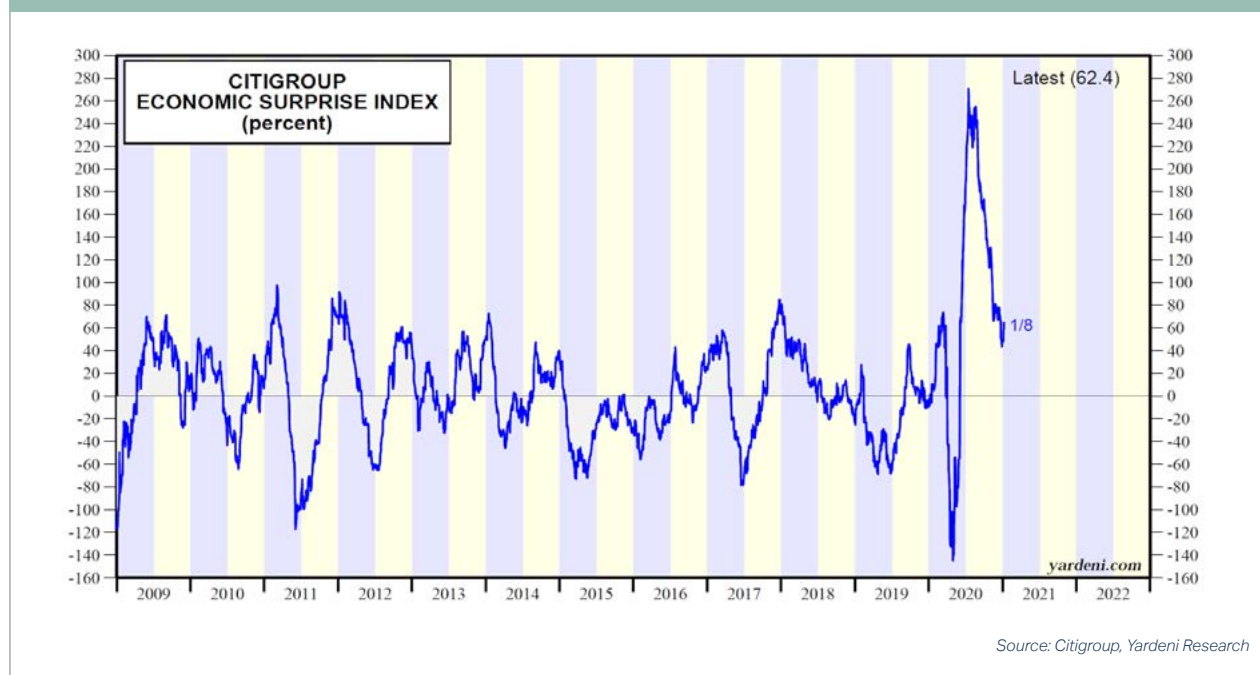
Fixed-income returns were mixed.

Fixed income had mixed fortunes. NZ investment grade (IG) bonds fell around 2% in the quarter, with government bonds declining around 2.8% and corporate bonds 1%. This reflected robust NZ economic data and a pull-back in expectations for negative rates. Despite the quarterly fall, they still returned around 5.5% over the year, which is in

line with NZD hedged global IG bonds. These returns are materially higher than the return to cash over the period. However, running yields are now very low, implying returns from fixed income are likely to be much lower in the future.



FIGURE 2: US ECONOMIC BOUNCE BACK SURPRISE LARGEST ON RECORD



2020 Vision

In our view, the 2020 rally was justified by policy support measures and economic conditions being better than initially feared.

With markets continuing to rally despite the surge in COVID and re-imposing lockdowns in many countries, questions around whether we are now in 'a bubble' have certainly not gone away.

Our 2020 view was that the rally could be justified because:

- The economic 'shock' from COVID was much weaker than expected (**figure 2**). New Zealand provides a clear example. While GDP fell over 12% in the June quarter of 2020, it rose 14% in September, and a positive gain for calendar 2020 GDP is not implausible. This is a far cry from calls that we were entering the worst economic conditions since the Great Depression! As we have highlighted in previous

commentaries, short-term market movements tend to be much more driven by how conditions evolve relative to expectations, rather than activity levels per se.

- Despite the rally, risky assets continued to offer materially higher yields than investment-grade bond yields and cash yields, plus the prospect of capital gains over the longer run.
- Markets are forward-looking and could see that global mass COVID inoculations were soon to begin, as indeed they have.
- Underneath the surface, it was also a 'tale of two COVIDS': Businesses reliant on in-person patronage suffered, as did communities reliant on, say,

international tourism. But the vast majority of businesses were able to get by with remote working, as was government and sectors such as agriculture. At the other end of the spectrum, the tech sector thrived.

- We also took some comfort from the fact that markets were applying some level of discrimination to the rally. While the tech sector boomed, those most exposed to COVID such as office property and energy underperformed, as did markets heavily exposed to cyclicals and banking such as the UK and Australian markets. Market volatility also remained higher than the low levels it reached from 2014 to the end of 2019 (**figure 3**).

In 2021, we expect much more modest returns to risk assets, with the possibility of markets pricing in interest rate increases being the main caveat to our positive view.

Our view for 2021 is that the environment still favours risk assets given their yields, on average, remain higher than on cash and bonds. We also expect that the rotation towards cyclicals, value and smaller-cap stocks will likely continue with economic life returning to normal as mass-scale inoculations are achieved over the coming months. However, we do not expect returns to be as strong as the back half of 2020.

The major caveat to this view is that it depends on inflation and interest rates remaining low. Should markets start pricing in central banks needing to raise rates in the medium term, or turn their attention to fiscal sustainability

risks, we would expect to see significant sell-offs. This risk is perhaps most material in New Zealand, where, with the benefit of hindsight, it looks like the RBNZ pushed monetary and credit conditions too loose in 2020; they may be forced to tighten financial conditions (starting with mortgage loan-to-value ratios) over the next few years.

Our overall sanguine view does not imply that all assets are priced rationally, or even consistently! Stocks like Tesla (electric vehicles) and digital currencies such as Bitcoin are likely caught in a wave of irrational exuberance (**figure 4**). At the same time, at the other end of the spectrum, government bonds in our view suffer from excessive pessimism over the medium to longer-term economic outlook. Time as always will tell.

FIGURE 3: MARKET VOLATILITY REMAINS ELEVATED

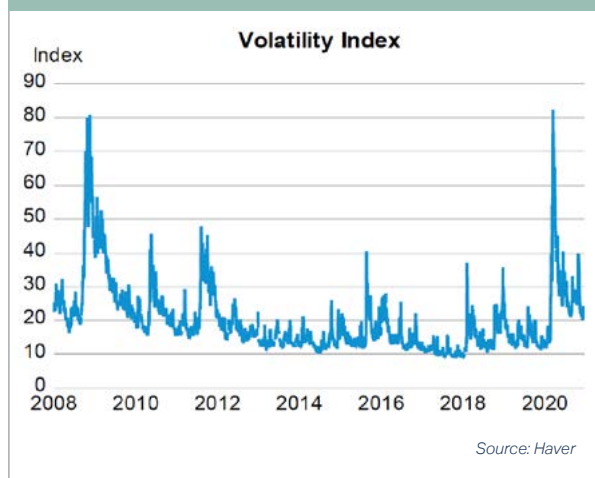


FIGURE 4: TESLA AND BITCOIN BUBBLES?



HOW THE MARKETS FARED

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
+ 11.5%
PAST YEAR
+ 14.6%

New Zealand Shares: New Zealand shares returned 11.5% in the quarter, a very strong result that boosted the calendar 2020 return to around 14.6%. Over the past 5-years performance remains exceptional at around 17% per annum. Source of Figures: S&P/NZX 50 Total Return Index with Imputation Credits



QTRLY RETURN
- 1.0%
PAST YEAR
+ 5.4%

New Zealand Fixed Interest: New Zealand investment grade corporate bonds fell 1% in the quarter and returned around 5.4% for the year. This return is both comfortably higher than the 90-day NZ bank bill and term deposit rates, showing that NZ corporate bonds have delivered a premium over the year. Source of Figures: S&P/NZX Investment Grade Corporate Bond Index



QTRLY RETURN
+ 12.5%
PAST YEAR
+ 4.5%

Australian Shares: Australian shares performed well over the December quarter, bringing the annual return to around 4.5%. Within Australian equities, small-cap stocks performed in line with large-caps, while value stocks out-performed rising around 17% in the quarter. Overall, while a strong bounce the Australian market remains lower than many other equity markets over the year. Source of Figures: S&P/ASX 300, S&P Australia BMI Value, S&P/ASX Small Ordinaries



QTRLY RETURN
+ 4.5%
(11.7% hedged)
PAST YEAR
+ 8.6%
(11.1% hedged)

International Shares: International shares rose around 4.5% in the quarter in NZD terms, whilst NZD hedged shares increased around 11.7%. These results were sufficient to lift returns into double digit territory for calendar 2020 on an NZD-hedged basis. Within global equities, higher risk small and value stocks out-performed. Small-caps returned around 13.7% in the quarter, while value returned around 6.3% in NZD terms. Source of Figures: MSCI World Index; Morningstar Developed Markets NZD hedged, MSCI World Value, MSCI World Small Cap.



QTRLY RETURN
+ 9.9%
PAST YEAR
+ 10.9%

Emerging Markets: Emerging Market equities rose around 10% in the quarter in NZD terms, bringing the annual return to around 11%. Returns were even stronger in local currency terms at around 20% for the year, with the difference reflecting the NZD appreciation versus EM currencies. Source of Figures: MSCI Emerging Markets Index



QTRLY RETURN
+ 0.8%
PAST YEAR
+ 5.4%

International Fixed Interest: Global bonds returned 0.8% in the quarter and 5.4% for the year (in line with the NZ investment grade bond return). 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)



QTRLY RETURN
+ 10.7%
PAST YEAR
- 13.2%

International Property and Infrastructure: International property stocks rose by around 10.7% in the quarter but still closed down 13% for the year. This is perhaps still a remarkable result given this asset class has been hit hard by COVID-19. International infrastructure has been a more resilient asset class, with returns broadly flat in 2020. Source of Figures: FTSE EPRA NAREIT NZD Hedged

A photograph of four people hiking on a wooden boardwalk through a dense forest. The boardwalk is made of wooden planks and runs diagonally across the frame. The hikers are seen from behind, walking away from the camera. The forest is lush with green ferns and trees. The lighting is soft, suggesting a misty or overcast day.

LIVING LONGER. LIVING BETTER.

An article in the August 2020 magazine Mindfood caught our attention. Insights that can lead to a better quality of life, particularly in retirement years, we believe are very much within the scope of the service we provide to you.

This article reinforces views we already understand and adds further context. We thought a summary might be interesting.

Trudi Case wrote the article.



Becca Levy published a study in the Journal of Personality and Social Psychology, concluding that people who had positive attitudes to ageing lived seven and a half years longer than those who did not. The study identified those who had positive attitudes by asking responses to five statements:

1. Things keep getting worse as I get older
2. I have as much pep as I did last year
3. As you get older, you get less useful
4. I am as happy now as when I was younger
5. As I get older, things get better/worse/stay the same as I thought they would be.

Remarkably, the idea of accepting ageing as a process and making the best of it does result in significantly more years on the planet.

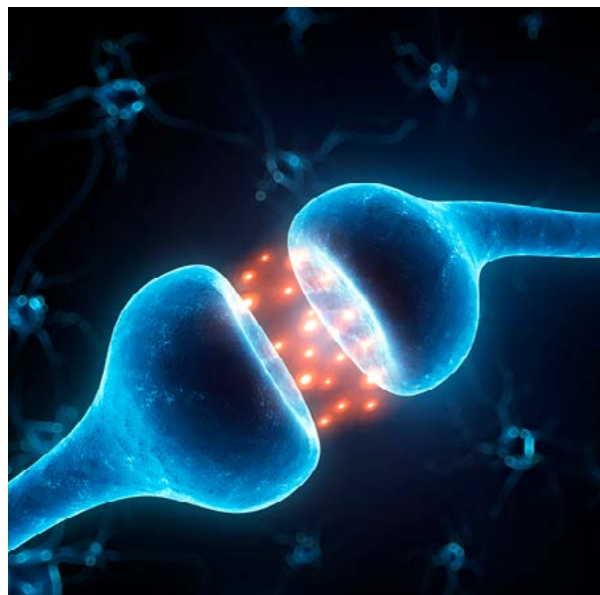
Often in our discussions on the amount of money required to fund a comfortable retirement, we suggest an assumption of living to age 95. Many say 'Let's do that, but I don't want to live that long'. Perhaps what they mean is that they do not want to be frail or lose mental capacity.

Various studies show that we live longer and there are things we can do to impact our health, so those extra years provide us with pleasure.

The standard set of strategies include:

1. Eating a healthy, balanced diet
2. Exercising
3. Seeking medical care early and proactively
4. Ensuring good sleeping habits
5. Living and enjoying being in the present
6. Being socially connected.

On this last point, it seems we are social animals who thrive on social activity. We are wired to belong. Positive experiences with family, friends and broader social networks have a role to play.



'This rewiring of our brain means we are more likely to spontaneously notice more pleasant things in our everyday life'



Retirement can mean that the contribution to society is just as valuable as when fully engaged in a career, but different.

As role models, there's an essential function in sharing a lifetime of experience with the next generation. Equally, retirement provides time for learning and joining groups that might share a passion for painting, photography, singing in a choir, or volunteering at a local charity. In their way, all of these things influence how the five questions on ageing might be answered.

On the question of being in the 'here and now', the research supports our intuition. Associate Professor Craig Hassed of Monash University says using our senses to scan our environment is a natural consequence of our curiosity, creativity, and learning. He adds that this is exercising our brain positively, and it has the effect of clearing our head. We work better, and our memory improves. In contrast, if we worry about the future, this activates the brain's stress circuits and over activation of this is associated with more rapid brain ageing.

Mindfulness is taking notice of simple pleasures, savouring them and enjoying them as life unfolds.

Hassed goes on to suggest that on your morning walk, feel the crisp morning breeze, smell the flowers, listen to the birds, notice passers-by and smile and say hello. As you turn your attention outwards life becomes more interesting, people are noticeably friendlier, and you start to feel better.

Research has found that if we tune into these experiences for ten seconds or more, we transfer the experience from our short term memory into our long term memory, and we can recall them easily later. This rewiring of our brain means we are more likely to spontaneously notice more pleasant things in our everyday life and with that, more joy and contentment.

So, a positive attitude to ageing will lead to more years on the planet. Taking the time to enjoy each moment and invest in our health and an appreciation that the wisdom that comes from age is an asset to be shared will contribute to a positive attitude to ageing. It is circular.

Enjoy each year, and consequently, you will have more of them.

Sources:

1. Mindfood, August 2020 publication
2. Becca R. Levy et al, Yale University. Journal of Personality and Social Psychology Longevity Increased by Positive Self-Perceptions of Aging

REDISCOVERING OUR BACKYARD

With a COVID vaccine still some time away, an overseas trip may not be in your plans for 2021. However, that provides us with an excellent opportunity to explore our beautiful country and discover someplace new.

We have created a timeline of events you may want to experience in the first quarter of the New Year. Combining one of New Zealand's many iconic festivals or events is another way to get the most out of a holiday.

17-21 February

Art Deco Festival in Napier

What better way to enjoy the Hawkes Bay than combining your visit with Napier's Art Deco festival. Step back in time and enjoy what life was like from 1920-1940 surrounded by the Hawkes Bay art deco architecture. With over 300 different events to choose from within the festival programme, it could be a jam-packed five days! The festival includes outdoor concerts, vintage car parades, fashion shows and aerial displays.

13 March

Wildfoods Festival in Hokitika

Explore the South Islands rugged West Coast and tick off one of New Zealand's iconic events simultaneously. Experience Hokitika's Wildfood Festival where you will be able to try such delights as local whitebait fritters or step out of your comfort zone and try huhu grubs! There will be something here for even the pickiest of eaters. Even if the cuisine does not appeal, you will enjoy the live music and fashion! While you are in the area, don't forget to visit the Hokitika Gorge. This comfortable 2km loop track will take

you through the gorge and over a suspension bridge, giving you fabulous views over the Hokitika River's blue waters.

21 March

Ripe – Wanaka Food & Wine Festival

Discover the charm of Wanaka. Whether you enjoy the outdoors, sumptuous cuisine, or breath-taking scenery, Wanaka offers something for everyone. Time your next trip there to coincide with Ripe – Wanaka's new food and wine festival, showcasing some of Central Otago's finest fare. In addition to over 30 food and wine suppliers, there will be cooking demonstrations from Nadia Lim and live music. While you are in Wanaka, make sure you enjoy some of the following activities:

A leisurely stroll along one of the many lakeside walks which will take you to Rippon Vineyard or Bremner Bay. The more experienced walkers could head up Roy's Peak or enjoy one of the walks through Mt Aspiring National Park.

Enjoy some family fun at Puzzling World!

Get out on the lake and have some fun jetboating, paddle boarding or kayaking.

Cruise across Lake Wanaka to Mou Waho Island, which has been pest free since 1995 and is now home to the rare, flightless buff weka. Enjoy the 3km round walk to the Arethusa Pool, a natural glacial formed lake at the top of the island and enjoy the spectacular views.



27-28 March

Mangawhai Walking Weekend

Only 1.5 hours north of Auckland, Mangawhai is the perfect spot to enjoy the outdoors. This laidback beach town is home to a great surf beach and an inner harbour, a safe spot for kayaking, paddle boarding and fishing. Mangawhai is also home to various coastal and bush walks, most of which are open year-round. The Mangawhai walking weekend provides an opportunity to enjoy various walks for all different fitness levels with a group of like-minded people. Each of the walks offered has limited spaces available, so it is recommended you book in advance. While you are in the area, make sure you check out the family-owned, Bennetts of Mangawhai for your handcrafted chocolate fix, or take a moment to enjoy a coffee and lunch in their lovely courtyard. If you are after a local wine, be sure to make a stop at Te Whai Bay Wines, a privately owned vineyard located at the base of the Brynderwyns.

2-5 April

Waiheke Jazz Festival

Spend Easter on Waiheke Island listening to jazz among the vines. In addition to jazz concerts, the Waiheke Jazz Festival also incorporates performance art, exhibitions, painting workshops and a range of music genres (not just jazz!), including DJ's, bands, and solo performances. Just a short ferry ride from Auckland, you will have access to unique eco-tours and an array of pristine beaches. With various festival events to choose from over Easter weekend, you could make this a day trip or stay for a few days.



Below are some of our favourite destinations that we have also chosen to highlight for their unique offerings:

Marlborough

If sipping wine while soaking up stunning vistas sounds like your ideal activity, you will not go wrong with a trip to

the top of the South Island. The Marlborough Sounds offer secluded bays, secret coves, and breath-taking peninsulas, while the prolific wine region produces the world's most sought-after Sauvignon Blancs. If you are looking to tie in your wine tastings with some exercise, explore one of the walking or cycling trails.

Here are two options:

The Queen Charlotte Track is a dual-purpose walking and mountain biking track covering 72km from Anakiwa to Ships Cove. It can be covered over 2-3 days cycling, but you can also enjoy sections of track on a 1-day ride if you have time or fitness constraints with different access points. Mountain biking (or walking) does not get much better than this!

Alternatively, you could enjoy the Nydia Track which although not as well-known as some of the other walking tracks in this area; it is no doubt still one of the most beautiful. Considered advanced by the Department of Conservation, this 27km track runs from Pelorus Sound to Duncan Bay and follows the sheltered Nydia Bay shoreline. Overnight accommodation is located halfway along the route at On the Track Lodge. Guided tours are available through Walk Pelorus.

Slipper Island

Slipper Island is located off the Coromandel Peninsula's eastern coast, near Tairua and Pauanui. This 224-hectare island is home to Slipper Island Resort and can be experienced as a day trip, or you can choose to overnight at the resort. It is the perfect spot for swimming, snorkelling,



paddling, and beach games with beautiful white sandy beaches. The island's northern and eastern sides are perfect for exploring with rocky cliffs and volcanic rock formations. The resort is off the grid and operates on solar power and rainwater creating awareness of your environment but do not worry, for those who do not want to be completely cut off from the world, there is still cell phone coverage!

Nikau Caves

Alternatively, if a day trip is more your thing, consider exploring the Nikau Caves. Only a 90-minute drive southwest of Auckland, you can experience a guided tour of a beautiful glow worm cave. You will enjoy a walk over a native farm and through the rainforest before entering the cave. The tour lasts approximately 1.5 hours, and there is a café on-site for you to enjoy pre/post tour. Accommodation options are also available.



FINANCIAL JARGON TRANSLATED TO ENGLISH

Why go negative? A look at negative interest rates.

There has been much talk about interest rates in New Zealand becoming negative. In general, it means depositors have to pay to have their deposits lodged with an institution. Japan has had negative rates for a long time, and the likes of Germany and some other European countries have more recently introduced negative rates.

There has been speculation that we are on track for negative interest rates some time this year. However, this has subsided in recent months, given the economy has

proven more resilient than expected. What we are referring to here is the Official Cash Rate (OCR). The OCR is the Reserve Bank rate that applies to overnight loans between banks as part of the money settlement process. The OCR sets a benchmark from which short-term loans are priced and longer-term loans that also reference expected changes in the OCR.

In effect, the OCR is the best indicator of interest rate levels at any one time.

The Reserve Bank uses interest rates to control the economy's speed; low interest rates are the foot on the gas, and high interest rates pump the brakes. Too fast means that inflation moves outside its targeted range (some inflation is good, too much inflation has negative effects

– think Zimbabwe as an extreme case). Too slow means that economic activity slows resulting in less prosperity and more unemployment. Together, the Reserve Bank and the Government try to keep our economy working at the right speed to be comfortable, and economic activity to be sustainable.

Currently, the OCR is 0.25%, a record low. Some economists forecast two further rate drops in 2021, bringing the OCR to -0.25%. That will mean that banks will have to pay to have their surpluses held by other banks.

While the OCR may become negative, and lead to a reduction in both loan and deposit rates, there is no expectation that customers will have to pay to have their

deposits held in the bank, i.e. term deposits or mortgage rates are likely to become negative in New Zealand. With term deposit and savings account rate anaemic already, a reduction, of course, means they will become very low if not zero.

So why does the Reserve Bank want lower interest rates? It wants to encourage people to invest and spend more and in so doing speed up economic activity. They are concerned that a significant slowdown could result in deflation and unemployment. Deflation is where the value of money increases, encouraging people to suspend their spending plans with a view that goods will be cheaper in the future. This would slow the economy and make it hard to start again; deflation can become a downward spiral as it encourages us not to spend, leading to lower prices, leading to deflation, and so on.

Of course, there has been much talk about housing prices increasing as a result of cheap money. The government has asked the Reserve Bank to take this into account. However, it is not easy for them, and ultimately it will be the supply of housing that will determine house prices. The Reserve Bank is charged with controlling inflation, unemployment, and it seems not at the expense of a runaway housing market. As Adrian Orr, the Governor of the Reserve Bank has said this is a very tough ask and the government has a large role to play in terms of its spending programme and investment in long term solutions to the housing problem. But that is another discussion.

It looks possible that interest rates will drop again in 2021, but retail customers will not have to pay to have their deposits managed by their bank. However, if interest rates drop, so will deposit and loan rates. Good news for those with a mortgage, however, this makes it hard for those who have traditionally relied on interest to provide them with some spending money. This gives even more credence to a diversified portfolio with a mix of income streams and capital growth potential to achieve your goals.





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