RUTHERFORD REDE

Insights

Summer 2019

In this issue

THE WORLD THAT WAS

Key themes of the period

December 2018 – February 2019

- Markets were mauled over the quarter
- Small cap stocks were hit particularly hard
- NZ equity market did not suffer as large a decline as global stocks
- Despite the selloff the US economy remains strong and NZ is growing around trend

Markets get mauled in the December quarter

The very strong returns markets have enjoyed since around 2011 came to a crashing halt in the December quarter. Large declines occurred in equity markets in the month of October and then again in December as markets grappled with interest rate increases (in the US), Brexit deadlock, ongoing trade tensions between the US and China, a partial US government shutdown, some weaker than expected corporate earnings for bell-weather stocks such as Apple, and last but not least, the potential for global recessionary conditions to emerge over the near future.

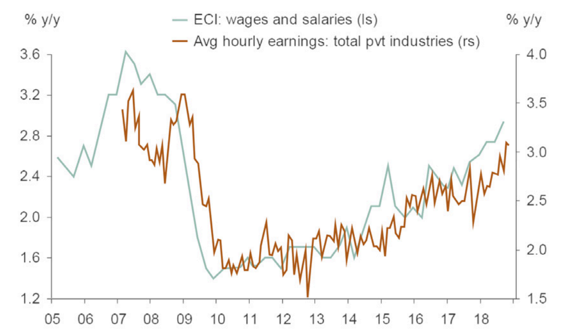
International developed market equities fell by around 14.5% over the quarter (in NZD terms), implying a -3.2% return for the 2018 year. Within global equities, value stocks fell by a lesser amount, reflecting that the decline was concentrated in 'growth' stocks which are more sensitive to changes in perceptions of the global growth environment. In line with this sensitivity, global small cap stocks also suffered larger losses, falling by around 18.5% in the quarter. In contrast, emerging markets, which are also normally more sensitive to a major downturn, fell by 'only' 8.7% in the quarter. This partly reflects that emerging markets, particularly the Chinese equity market, had borne the brunt of the trade war fears earlier. But it may also reflect a view by many equity analysts than emerging markets now offer particularly good-value for investors.

Trans-Tasman equity markets did not escape the carnage. Australian equities declined around 11.5%, with small caps being hit harder in line with the international experience.

New Zealand equities were relatively robust to the global sell off, falling by around 6%. This left the 2018 calendar year return for the NZ equity market at around 5% - a strong result compared to most other equity markets. Global property was also relatively resilient, declining by 5.6% in the quarter and 3.7% over the year.

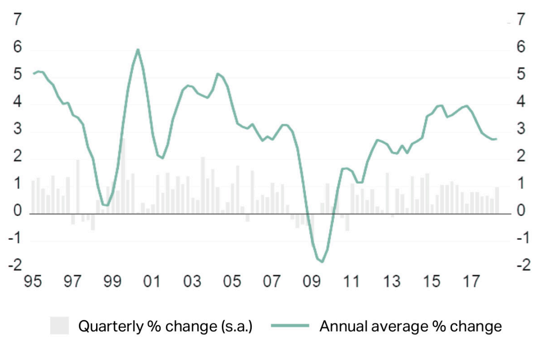
Bonds offered some respite to the equity markets sell off, as should be expected given their defensive nature. NZ investment grade bonds returned around 1.5% for the quarter and 4.6% for the year. This return is well ahead of short-term cash rates and term-deposits, indicating that NZ bonds have offered a good premium. International bonds also returned 1.5% over the quarter. Over the year, however, returns have been weaker than the coupon bonds, reflecting the fact that interest rates have risen ahead of market expectations, causing bonds to re-price lower.

FIGURE 1: US WAGES ON THE UP



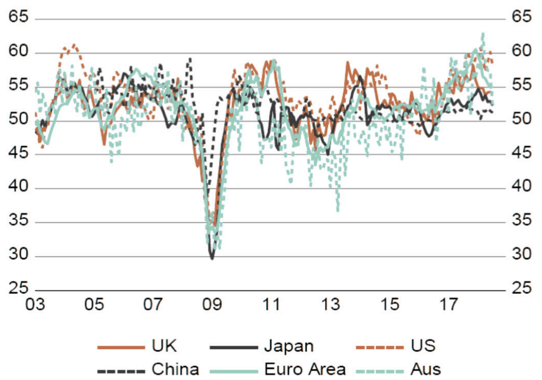
Source: Haver Analytics, DB Global Research

FIGURE 2: NZ GDP AROUND TREND



Source: Statistics New Zealand

FIGURE 3: GLOBAL PURCHASING MANAGER INDEXES ARE STILL EXPANSIONARY



Source: NZ Treasury, Haver Analytics

Global economy moves from hot to lukewarm

Through the lens of the rear-view mirror economic conditions appear lights years away from recession in much of the world. In the United States, the Federal Reserve increased short-term interest rates to 2.5% in December, despite the ongoing market weakness, given the strength it sees in the US economy. While this move was heavily criticised by President Trump and many market commentators, recent data has been very much in line with the Federal Reserves' assessment.

The US economy added over 300,000 jobs in the December quarter, far exceeding the expectation of around 175,000. The US unemployment rate is now under 4% and US wages are expanding at their faster pace in around a decade (Figure 1). US businesses would hardly be taking on staff at such high rates if they were worried about a recession around the corner!

Annual GDP in New Zealand is running around 3% according to the figures released by Statistics New Zealand just before Christmas, and our employment rate is now at a 30-year high (Figure 2). Despite weak business confidence levels, businesses are still hiring at a high pace. And upside growth potential remains in New Zealand given the huge backlog of housing and infrastructure spending that is in the pipeline.

Economic indicators elsewhere continue to suggest conditions are mildly expansionary (Figure 3). European growth continues to bobble around trend levels with the domestic strength being tempered by slowing in global trade. Indian growth remains very strong at around 7.5% as its development juggernaut continues unabated. In contrast, the Chinese economy, which has felt the full brunt of the trade wars, has had growth clipped to 'only' around 6.5% per annum (on official figures).

This is the weakest reading since the GFC, but still very strong compared to developed market economies. Australian growth has also been slowing as drought and falling house prices have hit exports and household spending. But the Australian labour market remains strong, and the most recent economic growth reading was still one of the highest in the OECD, with annual GDP around 2.8%.

Overall, the rear-view mirror suggests that the global economy has been cooling from red hot to lukewarm levels. Looking ahead, despite the risks, macro forecasters expect global growth to remain healthy at around 3.5% over the next two years (Figure 4). This is the level that has been achieved over the past two decades and hence can be considered a reversion of growth to trend levels from the very high pace that has occurred in recent years.

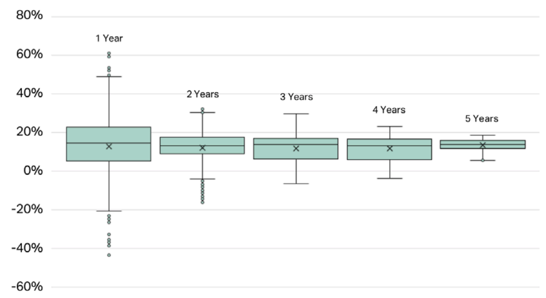
Within this headline figure developed markets are expected to slow to around 2%, while emerging markets are expected to grow more than double this pace at around 4.8%, despite a continual slowing of the Chinese economy. This is key. High EM growth (excluding China) implies that these markets will make a large and increasing contribution to global growth rates. A global recession is hence very unlikely unless there is a large slowdown in EM economies.

FIGURE 4: GLOBAL GROWTH EXPECTED TO REVERT TO TREND LEVELS OVER NEXT TWO YEARS

GDP growth (%)	2017	2018	2019F	2020F
Global	3.8	3.8	3.6	3.5
US	2.2	2.9	2.7	2.1
Eurozone	2.5	1.9	1.4	1.3
Germany	2.2	1.6	1.3	1.4
France	2.3	1.6	1.4	1.3
Italy	1.6	0.9	0.7	0.9
Spain	3.0	2.5	2.4	2.1
Japan	1.9	0.7	0.7	0.2
UK	1.7	1.3	1.6	1.4
China	6.9	6.6	6.3	6.0
India	6.2	7.5	7.0	7.6

Source: DB Global Research

FIGURE 5: US EQUITY RETURNS SINCE 1972 OVER DIFFERENT HOLDING PERIODS SHOW LONG TERM INVESTORS ARE REWARDED



The box and whisker charts in this figure illustrate the distribution of equity returns over different time horizons. The average returns are shown by the X marks. The edges of the boxes show the range of outcomes occurring between % and % of the time. The vertical lines extending outside the boxes show the worst % and best % of outcomes. Finally the dots show outliers of the % range of outcomes.

Source: Morningstar Direct, MyFiduciary

The recent sell off and long-term equity returns

The key question now is whether the sell-off is justified given the risks or, if instead, whether it has been an over-reaction to recessionary fears? History would suggest that the latter is more plausible – as the saying goes markets have predicted 9 out of the past 5 recessions.

As noted above, many analysts now see equity markets offering good-value, and in January 2019 so far markets are up. However, that is not to say that the bottom has been reached, or that the current economic conditions won't deteriorate further.

Reading the tea leaves is hard and often futile. What we do know for sure, through many cycles in economies and markets, is that investors with long term horizons get amply rewarded for bearing equity market risk (See Credit Suisse Global Investment Returns Yearbook, 2018).

As an illustration, Figure 5 shows that over the short-term returns are very volatile, and the weak December quarter is not statistically unusual in this respect. What the figures also show is that as equity holding horizons are increased equity returns are more stable and offer a more certain premium to cash.

We also know that often the strongest equity market returns are experienced in a so-called 'bear market' and we have no reason to believe this time will be any different.

STAY TUNED

The Tax Working Group's Final Report – Due February 2019

After nearly 14 months since its set up, the Tax Working Group is expected to release its report recommending changes. Hopefully, areas to clarify:

- Application of Capital Gains Tax to assets not already being taxed
- Any changes to tax rates and thresholds
- Family home tax exemption – are there exceptions?

Stay tuned for our summary of the Tax Working Group's report in the next communique to you.

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	PAST YEAR	ASSET CLASS
↓ -5.8%	↑ +4.9%	**New Zealand Shares:** The New Zealand market fell 6% in the quarter, reducing the calendar 2018 return to around 5%. However this a relatively strong performance when compared to offshore equity markets. Source of Figures: NZX 50 Index
↑ +1.2%	↑ +4.5%	**New Zealand Fixed Interest:** New Zealand investment grade bonds returned 1.2% for the quarter and around 4.5% for the year. This return is both comfortably higher than 90-day NZ bank bill and term deposit rates, indicating that New Zealand corporate bonds delivered a good premium over 2018. Source of Figures: NZX A Grade Corporate Bond Index
↓ -11.7%	↓ -7.2%	**Australian Shares:** The Australian share market returned -11.7% in the quarter and -7.2% in the year in NZ dollar terms. This very poor return was partly due to a strengthening of the NZ dollar against the Aussie. Returns were around -3% in Australian dollar terms in 2018. Within the Australian equity market, value stocks mildly outperformed over the quarter and year, while small cap stocks suffered larger losses. Source of Figures: S&P ASX 100
↓ -14.4% -13.5% hedged	↓ -3.2% -7.3% hedged	**International Shares:** International equities fell 14.4% in the quarter, whilst NZD hedged equities fell 13.5%. These poor returns reduced the annual return to -7.3% on a NZD hedged offshore currency basis, and -3.2% on an unhedged basis. The latter were stronger as our currency declined against major developed markets in 2018. In line with this performance, value stocks mildly outperformed while small cap stocks suffered larger losses. Source of Figures: MSCI World Index; Vanguard international equity index funds data to proxy hedged returns
↓ -8.7%	↓ -9.4%	**Emerging Markets:** Emerging Market equities fell 8.7% in the quarter, reducing the 2018 return to -9.4%. This is weaker than developed markets and reflects capital outflows as the US has tightened interest rates, and that the Trump Adminsitration's trade war has had quite a negative impact on the large Chinese equity market. Source of Figures: MSCI Emerging Markets Index
↑ +1.4%	↑ +1.6%	**International Fixed Interest:** Global bonds returned 1.4% in the quarter and 1.6% in the 2018 year. The annual return is still lower than the coupon on international bonds, and reflects bonds being re-priced lower over the year as interest rates increased more than markets expected. Source of Figures: Bloomberg Barclays Global Aggregate Index (hedged to NZD)
↓ -5.6%	↓ -3.7%	**International Property:** International Property stocks declined 5.6% in the quarter and 3.7% over the year. Australian property stocks fell by a similar magnitude in the quarter. In contrast, NZ property stocks bucked the trend, increasing 2% over the quarter. Source of Figures: Morningstar DM REITS (NZD hedged), S&P REIT indexes

THE COST OF CLUTTER

Reclaiming your time and space by getting rid of clutter and simplifying your life.

The New Year is a time for reflection, for change, for making plans. This is the best time of year to reflect on what's been going on and what you would like to do differently. It can be a very dynamic time with shifts and changes taking place.

It's also a great time of year to get out a note pad and start writing down, or drawing, what your goals and dreams are (without holding back) and getting clear about what you really want in the year ahead. It's with this theme in mind that our Summer Insights focuses on starting the New Year on a positive, stress-free, and 'lighter' note.

Resolving to getting organised

It's been said that life mirrors our environment. So, at this time of year having a big clear-out in our home, office, garage, or storage unit, is a great way to 'lighten the load'. It seems that a de-clutter in our personal space corresponds with a de-clutter in our mental space. Getting rid of all that clutter is a liberating experience that points us toward a less stressful and more rewarding lifestyle.

Reflecting on the high price of clutter

People keep things for all sorts of reasons. According to the National Association of Professional Organisers, the average person spends one year of their lifetime looking for lost things. Clutter makes every job more difficult. Chores take longer because we spend more time getting ready (finding a clear spot in the garage, hunting for the tools) than actually doing the job. Clutter steals time.

Then there's the financial impact of clutter. Bills are paid late because we lose them, improper storage results in damage and loss of valuable items, and when we can't find what we need – we buy another one. On the subject of storage, self-storage unit prices vary greatly depending on which city you're in, as well as it's features and size.

As an example, a two-cubic metre storage unit which contains fewer items than a one-bedroom apartment will set you back approximately $1,200 per annum. And that's not factoring in your transportation to and from the storage unit plus you won't have the flexibility to grab things out of your unit on a whim or at odd hours.

Retaining only those things that matter to you most

Remember that now-regretted impulse buy? An easy place to start with determining the cost of clutter is its initial outlay. Then you need to consider also the cost of upkeeping the items after the initial outlay and use, and the maintenance and storage costs once the items become obsolete.

Millions of people around the world have been turning to a Japanese organising consultant to help de-clutter their homes, and for Marie Kondo, the tidying expert and eponymous star behind Netflix's 'Tidying Up with Marie Kondo' there's nothing that 'sparks joy' more than seeing people take ownership of their belongings – and their lives.

While most tidying methods advocate a room-by-room or little-by-little approach, which doom you to pick away your piles of stuff forever, Kondo, according to her website, developed The KonMari Method™ which promotes tidying by category – not by location. Kondo encourages us to keep only those things that speak to the heart, and discard items that no longer spark joy. We thank them for their service – then let them go.

People around the world have been drawn to The KonMari Method philosophy not only due to its effectiveness, but also because it places great importance on being mindful, introspective, and forward-looking. In the words of Kondo, "tidy your space, transform your life".

Reclaiming your time and space

Embracing a clutter-free life will keep costs down. Consider for a moment that living a clutter-free life is to start by recognising your physical and mental clutter so you can avoid or minimise bringing it into your life from the start.

Regularly decluttering your physical space helps you to identify what you have and need for its utility, comfort and/or beauty. It can also free up your schedule as you spend less time searching frantically for your keys, wallet or purse on your way out the door.

Eliminate old paperwork and files you've been carrying around for years. While there are some documents you should maintain, most can be shredded or digitised.

Admit you will never wear that outfit again. We all have that 'favourite' item in our closet because someday we will fit into it again. And it's been 10 years. With too many 'goals' clothes, our closet may be stocked with excess to the point where we need to consider letting them go.

Cancel subscriptions you don't use. Not all clutter is physical. From gym memberships to gaming subscriptions, purging unused subscriptions can add more money to your wallet and relieve you of the guilt you experience paying that monthly fee.

Should it stay or should it go? When it comes to your important documents it's all about timing.

We hope you are inspired and encouraged by this article to start the New Year in a light and positive manner. To kick-start your de-clutter process, here's a guide to organising your essential documents.

1 MONTH

- Receipts
- Deposit ATM slips
- Reconciled bank statements

7 YEARS +

- Income tax returns
- Medical bills and statements
- Contracts
- Receipts used as tax deductions
- Cancelled cheques
- Mileage records
- Real estate tax forms and records

1–3 YEARS

- Mortgage statements
- Expired insurance records
- Charitable contributions
- Business & income related documents
- Proof of deductible purchases
- Receipts for charitable donations
- Payslips

FOREVER

- Birth certificates
- Matrimonial papers
- Passports
- Financial planning documents
- Investment statements
- Contracts
- Wills
- Medical records
- Education records
- Motor vehicle titles
- Mortgage agreements
- Property agreements
- Home improvement receipts for insurance purposes from major purchases

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