



RUTHERFORD REDE

insights



SPRING 2021
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ECONOMIC & MARKET COMMENTARY SEPTEMBER 2021

With spectacular performances for growth type investments over the last year it is little wonder that a pause occurred in the typically volatile month of September.

Vaccines are providing a pathway to a gradual recovery to normal policy settings albeit with the odd hiccup as outbreaks occur. Interest rates have been falling for seven years so eventually this trend would need to reverse. While the returns of the last year have probably been consigned to the history books the global outlook is far from dire.

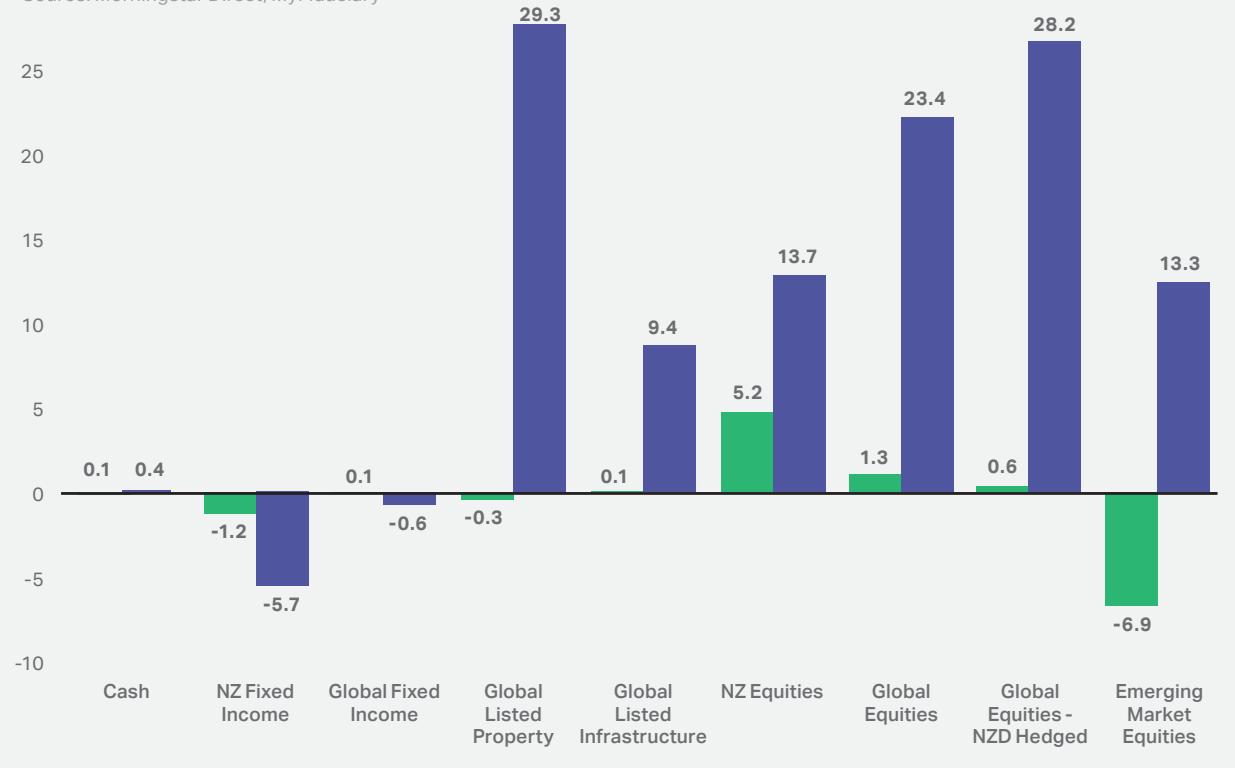
Overall, the outlook for the global economy remains encouraging, but it is important to also acknowledge concerns. Central banks are moving toward tightening policy positions, uncertainty over the US debt ceiling and the prospect of higher taxes in America are weighing on investors minds. There was also ongoing global supply constraints and rising inflation pressures, the developing energy crisis in Europe and China, and the financial crisis surrounding Chinese property developer Evergrande.

Although global economic data was mixed over September, it generally pointed to a weakening of economic activity over the last few months.

In contrast to the global trend, New Zealand continued to record better than expected economic data. The New Zealand economy grew 2.8% over the second quarter, well ahead of

Figure 1: Patchy returns over the quarter

Source: Morningstar Direct, MyFiduciary



market and Reserve Bank of New Zealand's expectations. The domestic economy was on a strong footing, with likely higher excess demand and underlying inflationary pressures than expected, heading into the current lockdown.

News in relation to the Covid virus has improved in recent weeks. Global virus cases declined over September, after rising dramatically in July and August. Declining cases across Asia and the cresting of cases in the southern states of America helped reverse the global case numbers. Around 47% of the global population has now had at least one dose of the vaccine, 72% in the developed world and 56% in the developing world.

Market performances

Performances were mixed over the quarter given different economic conditions and risks.

Market performances were mixed in the September quarter. Bonds performed poorly, particularly in New Zealand, yet New Zealand equities enjoyed a very strong performance. Emerging market equities had a less-than-stellar quarter, but developed large cap equities performed well.

The performance differences reflected cross-currents in macroeconomic conditions and country or sector specific factors. Global growth is still strong, but rising inflation and the prospect of central banks increasing interest rates weighed down fixed income. Emerging market equities were hit by concerns around the solvency of one of China's largest property developers, Evergrande, its ability to meet its debt obligations, and the flow-on effect to markets and Chinese growth. This also impacted Australian stocks. In contrast, and despite our Covid outbreak, New Zealand's economic conditions are expected to remain firm and inflation risks are to the upside. As discussed below, the RBNZ lifted the OCR in early October, ending a seven-year period of easing.

Market roundup

Global equities marched higher...

Developed market equities climbed further over the September quarter, by around 1.5% in NZD terms. This resulted in a return of 23% for the year to September, while NZD hedged shares increased around over 28% (see Figure 1). Within global equities, higher risk small and value stocks mildly under-performed. Value stocks returned around 0.4%, and small caps fell slightly in NZD terms. Over the year, however, global small caps out-performed returning around 35%, and value stocks also outperformed returning 26%.

...while emerging markets fell and Australian stocks treaded water.

As noted earlier, Emerging markets had a poor quarter, falling by around 7%. At the time of writing the Chinese property developer Evergrande is likely to declare bankruptcy and bond holders are expected to suffer large losses, but it is not expected that this "shock" will transmit

to a full-blown financial crisis. On the other hand, the Chinese government willingness to let one of its largest developers' fold is seen as a strong signal that they are serious about curbing rampant property development and construction, which has long been an important driver of Chinese growth. This in turn led to falls in iron ore and a range of other commodity prices. This negatively impacted Australian equities which declined around 1% in the September quarter.

NZ shares had a stand-out performance, largely due to replenishment of hydro lakes.

In contrast, New Zealand shares increased around 5% in the quarter and are up around 14% for the year to September 2021. This out-performance occurred despite the Chinese growth risks, New Zealand being moved to alert level 4 on the 17th August (and Auckland remaining at 4 until the 21st September), and a firm market consensus that the RBNZ will lift interest rates. A large contributor to the out-performance was from the energy sector, which increased 25% in the quarter! This sector benefited from high electricity prices, and from high rainfall levels replenishing hydro lake catchments.

Fixed income returns were generally poor as markets priced-in higher interest rate levels, but short term bonds funds out-performed.

International infrastructure and property stocks were flat in the quarter, but on an annual basis returns were around 10% and 30% respectively. In contrast, fixed income returns were poor. New Zealand investment grade (IG) bonds fell 1.2% in the quarter and 3.8% over the year. International IG bonds fared a little better, being flat in the quarter and falling around 0.5% over the year. Finally, NZ cash fared better still, increasing by around 0.5% over the year.



In previous commentary we have highlighted our concern around raising interest rates and the risks that this present to bonds. For this reason, your portfolios have materially reduced their exposure to bond funds with relatively "standard" maturity terms (or duration) to bonds and related instruments with relatively short duration. These bond and "cash enhanced" funds have performed relatively well over the quarter and year, being comfortably ahead of both standard bond fund returns, and the returns from cash.

New Zealand the first OECD country to lift rates

The RBNZ expects NZ's economic performance to remain robust despite the Covid restrictions.

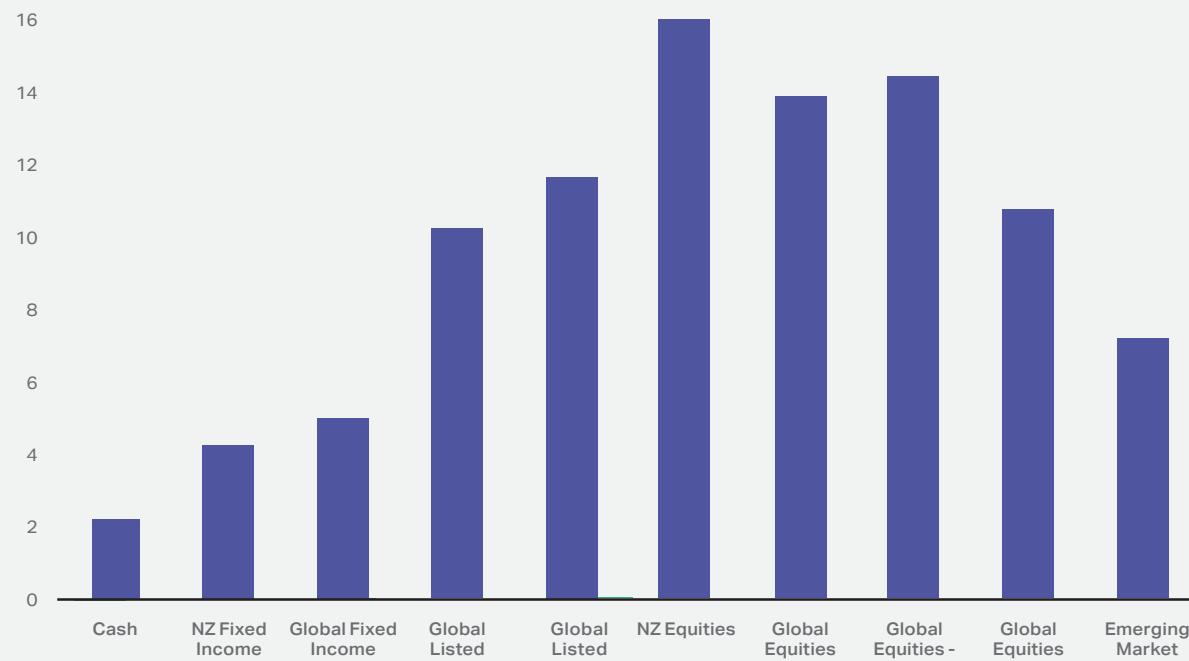
Despite the current covid outbreak New Zealand's economic recovery is seen as well-established and the RBNZ's focus has shifted to inflation. As mentioned in our previous update, the big question is whether the surge in costs seen this year will be temporary, or instead lead to a sustained increase in CPI inflation rates. Survey measures suggests risks point to the latter, with inflation expectation measures running at multi-year highs. Since our last update, while growth prospects have dimmed (particularly in China), unfortunately cost-pressures have not. Supply chain issues have become more acute, with the fuel shortages in the UK being just one notable example

The lift in the OCR marks a turning point in the support that asset prices have enjoyed from flat to declining interest rates.

In this environment it is perhaps not surprising that the RBNZ lifted the OCR from 0.25% to 0.5%. This marked the first increase in the OCR since June 2014 – ending a seven year period of easing. The RBNZ's view was that the current COVID-19-related restrictions have not materially changed

Figure 2: But very strong returns over the past decade █ 10 Years (%)

Source: Morningstar Direct, MyFiduciary



the medium-term outlook for inflation and employment, and as such further rate rises will be forthcoming.

Interest rate levels in NZ and globally of course remain extremely low by historical standards, but in our view the OCR change marks an important turning point. Markets have enjoyed a long period of flat or declining rates, which tends to support asset values through for example lower discounting of their future cash-flows, and enabling higher levels of leverage. Figure 2 provides longer term market performances.

These drivers of course have also mattered for the huge run up in house prices since the GFC slump in 2009.

Will the seven years of plenty be followed by seven years of famine? No one knows, but in our view, it is very unlikely that the feast will continue another seven years. And one thing we are confident about is that well-diversified portfolios will continue to offer a better return than cash over the medium to longer term

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
+ 5.2%
PAST YEAR
+ 13.7%



QTRLY RETURN
- 1.2%
PAST YEAR
- 3.8%



QTRLY RETURN
- 0.8%
PAST YEAR
+ 26.4%



QTRLY RETURN
+ 1.3%
(0.6% hedged)
PAST YEAR
+ 23.4%
(28.2% hedged)



QTRLY RETURN
- 6.9%
PAST YEAR
+ 13.3%



QTRLY RETURN
+ 0.1%
PAST YEAR
- 0.6%



QTRLY RETURN
- 0.3%
PAST YEAR
+ 29.3%

New Zealand Shares: Bouncing back from a soft June quarter, New Zealand shares enjoyed a strong performance in the September quarter, increasing around 5%. This lifted the annual return to around 14%. Source of Figures: S&P/NZX 50 Total Return Index with Imputation Credits

New Zealand Fixed Interest: New Zealand investment grade corporate bonds fell around 1% in the quarter and returned around -4% for the year ended September 2021. The soft result reflected NZ markets pricing in materially higher interest rates and inflation, which causes bonds to suffer a short-term capital loss. Source of Figures: S&P/NZX Investment Grade Corporate Bond Index

Australian Shares: Australian shares had a soft September quarter, reflecting concern around the Chinese growth outlook and demand for commodities. The broad market fell around 1%, although the annual return to September remained strong at over 26%. Within Australian equities, value and small cap stocks mildly out-performed. Source of Figures: S&P/ASX 300, S&P Australia BMI Value, S&P/ASX Small Ordinaries

International Shares: International shares rose around 1.3% in the quarter in NZD terms, whilst NZD hedged shares increased around 0.6%. Annual results reflect the bounce from the Covid sell off, particularly for NZD hedged equities which also benefited from the strong performance of the NZ dollar over the year. Within global equities, higher risk small and value stocks under-performed in the quarter. Value returned around 0.4% and small caps fell slightly in NZD terms. Source of Figures: MSCI World Index; Morningstar Developed Markets NZD hedged, MSCI World Value

Emerging Markets: Emerging Market equities were weighed down with concerns around the solvency of one of China's largest property developers, Evergrande, its ability to service its debt obligations, and the flow-on effect to Chinese growth. EM stocks fell around 7%, reducing the annual return to around 13%. Source of Figures: MSCI Emerging Markets Index

International Fixed Interest: Global investment grade bonds increased were flat in the quarter and fell around 0.6% for the year to September. As with the NZ result, this soft annual performance reflected bonds being re-priced lower as longer-term interest rates rose on the back of increasing global growth and inflation expectations. Source of Figures: Bloomberg Barclays Global Aggregate Index (hedged to NZD)

International Property and Infrastructure: International property stocks slightly fell in the quarter but still closed up around 30% for the year ended September. International infrastructure returned around 10% over the year (in local currency terms). Source of Figures: FTSE EPRA NAREIT NZD Hedged, FTSE Dvlp Core Infrastructure TR USD



Insights

TO EV OR NOT TO EV?

To EV or not to EV? That is the question that has been on the minds of many a prospective car buyer in recent years. So, with EVs possibly on your mind too, we thought we'd try to bring together some of the latest information.



EVs – an old new thing

Elon Musk has made it clear: electric vehicles – EVs – are the revolution in motoring that's needed to combat climate change. What you mightn't know is that it is a revolution that has been a long time in the making.

Rudimentary electric vehicles were developed as far back as the 1830s, and in the early 1900s EVs were outselling petrol driven cars. There were even electric cabs operating in New York and other major eastern cities in the United States.

The brakes go on

From around 1915 and through most of the rest of the 20th Century, however, EVs were literally and figuratively overrun by internal combustion engine vehicles. Reasons included: Big Oil (the low cost of petrol, and the infrastructure of petrol stations just about everywhere); technology (the rapidly developing speed, power and range of these vehicles, and ironically the development of the electric starter motor); and Henry Ford (his production line and the Model T that brought cars to the masses).

Irrespective of the rights and wrongs, EVs couldn't compete on utility or on cost.

Why EVs? Why now?

At a macro level, it is acknowledged that the transition to electric vehicles, as the dominant form of personal transport, is happening and that the pace of change will accelerate over time. But when is the right time for an individual car owner to 'join the revolution'?

Globally, the reasons for the transition to EVs are obvious. Countries are committing to carbon emission targets related to mitigating the effects of climate change. They are putting a price on carbon, and that price is only going up as it's seen as a mechanism to change behaviours.

In New Zealand, transport makes up 21% of the country's carbon footprint, and most of that comes from the light vehicle fleet – cars, vans and utes.

It is estimated that switching to an EV could lower a driver's carbon footprint from 3000kg CO2 to 300kg CO2 per annum.

That's the biggest single contribution to emissions reductions a person, or a household, could make beyond not driving at all and/or lowering their red meat consumption, says Kathryn Trounson, chairperson of Better NZ Trust, a community of EV drivers and enthusiasts.

Then there's the noise advantage. They are so quiet! And there are no tail-pipe pollutants.

What's holding us back?

A survey of EV buying intentions published this year identified that, of those who wouldn't consider buying an electric car or weren't sure, 72 per cent were put off by the cost. Battery life was the second largest deterrent, followed by a lack of charging stations.

Other identified concerns included 'range anxiety' (fear of insufficient range or supporting fast charging infrastructure to comfortably get drivers from A to B) and the limited vehicle choices.



Trounson says prospective buyers just need to either do their research or experience an EV, and many if not all their concerns will fall away.

"It's about getting people to overcome their long-held assumptions and the myths. Bad news seems to stick in peoples' minds far more than the good news. It's human nature but we can refute just about every objection that people have about EVs," she says.

"Most people who buy EVs report back that, no matter what they have purchased, they wish they had purchased it earlier."

The Better New Zealand Trust, the AA, EECA and numerous other organisations have good information about buying new or used EVs. They all share stories from EV drivers too, including those who have driven long distances, which can give confidence that for the gains you get, you are compromising very little.

Here some questions are addressed:

Charging

All EVs have a charging cable with a standard New Zealand three-pin plug available, so you can simply plug the car into the mains from your house. A Ministry for the Environment study last year found that more than 85 per cent of homes have off-street parking, allowing for simple overnight home charging.

Charging this way is called 'trickle charging' and can take anywhere from 7 to 14 hours for a complete refill. The cost of charging is currently equivalent to paying around 40c a litre of petrol.

Faster home charging stations are available. A bespoke charging point can be installed in a home for less than \$1000. Some let you choose a delayed start time to take advantage of low night rates offered by many power companies. You'll need an EV-savvy electrician to check your home's wiring, let you know what might suit your needs

and safely complete the installation.

Key to conveniently travelling long distances around the country, however, is the availability of rapid charging stations. These can charge four to five times faster than AC charging from the grid.

A Nissan Leaf will charge from flat to 80% capacity in 30 minutes. The new Porsche Taycan is equipped with a new charging technology that allows the vehicle to gain a range of up to 100 kilometres, in five minutes, and with a charging time from 5 to 80 percent in less than 23 minutes.

The news here is good. Waka Kotahi New Zealand Transport Authority's goal, nearly achieved, is to have a rapid charger every 75km along New Zealand's main state highways.

Apps are available to direct you, so realistically, all you need to have is a little bit of patience when it comes to charging, and do a bit of planning.

Range

This is related to charging: how far can you go without needing to stop to plug in?

With EVs there is a close correlation to range and price. For example, at the top-end, the \$159,990 (+ORC) Tesla Model S Long Range is capable of 663km on a full charge. However, one of the lowest priced current model new EV's for sale in New Zealand - the MG ZS EV (from \$48,990 +ORC) - offers a range of up to 263km from a single charge. Even with a used second-generation Nissan Leaf you should be able to achieve around 100km, however check with the dealer.

To put that in perspective, transport data suggests drivers in New Zealand cover on average 30km per day. Most people drive much less.

Dependability

Our friends at Better New Zealand Trust share this:

Plug-in cars are the most dependable vehicles on the market. They will last as long or longer than a comparable petrol vehicle, with much less regular maintenance required.

Since there are significantly fewer moving parts in an electric motor compared to a traditional combustion engine (in fact the electric motor has about 10% of the components), less ongoing preventative maintenance is needed.

An electric motor requires no oil changes, tune-ups, or new spark plugs. An electric motor will also outlast the body of the vehicle.

Brake life is extended on EVs since the motor is used to slow the car down once you take your foot off the accelerator, thus recapturing the kinetic energy and storing it back in the battery -

this is called regeneration.

Batteries

All automakers also offer good warranties on the life of the batteries. AA notes, for example, the Nissan Leaf has been so reliable thousands of people are happy to import them used from Japan and UK without much in the way of warranty cover and that, in Consumer NZ's 2017 survey of car owners, the Nissan Leaf rated highest in terms of reliability and owner satisfaction.

Models

It's no secret that New Zealanders have been let down in terms of choice of EVs. That is starting to change, partly driven by demand, and there are more and more used imports coming in. And business fleets that have been leading the EV charge are flowing many of their very functional EVs, such as VW e-Golfs and BMW i3s, into the used car market too.

As well as models you will be familiar with, some new EV's are coming. Watch out for, or ask about, the Audi e-tron GT quattro; the Peugeot e-208, the KIA EV6, the Hyundai IONIQ 5 or the Polestar 2 (from the former Volvo performance division).

There's news just in from MG too with an upgrade to its offering. From next year sometime new battery options will be available, one rated for 440km of range, the other for 320km of range. They will charge faster too.

Note however, that there are waitlists and significant Covid-related supply disruptions impacting vehicle imports. Delays in delivery of vehicles might have to be factored in if you are hunting for something specific.



Cost

The world is changing here too. From July 1, there has been a new incentive to buy a car that is better for the environment. It is called the Clean Car Discount.

Anyone purchasing an EV or plug-in hybrid EV is now able to claim a rebate of up to \$8,625 for a new vehicle and \$3,450 for a used vehicle. The vehicle must have been purchased for less than \$80,000, (including GST and on-road costs). It must have been registered on or after 1 July 2021 and it must have a safety rating of 3 stars or more on the Rightcar website (www.rightcar.govt.nz).

To receive the rebate, buyers of an eligible car simply have to visit Waka Kotahi – the New Zealand Transport Agency (www.transact.nzta.govt.nz/v2/apply-clean-car-rebate) and supply relevant details.

Recommendation

For an individual buyer, it would seem that earlier barriers and concerns have largely been addressed. The systems to support EVs on the road are now becoming well-established.

The benefits are clear – and they do present a new form of quiet-driving pleasure.

You will still need to do your research to identify a model that meets your particular needs. And depending on your needs you may have to wait to get what works for you. Utes and larger models that Kiwis have become accustomed to might be your thing, but options are currently limited in that regard.

There are options, though, to ease you into this new world. Do you currently have a second car? When you change that, consider an EV.

Trounson says many who do that then find that it is the traditional vehicle that ends up sitting unused in the garage.

There are also plug-in hybrid vehicles. They don't have the same benefits in terms of overall running costs because they retain combustion engine technology that requires the associated maintenance. But they are a popular half-step into the future.

In conclusion, good and growing EV options are here now. It may be time to start considering your options seriously.



REDISCOVERING OUR BACKYARD HINEWAI RESERVE

Exotic gorse might be a hated weed of pastoral farmers, but not on Hinewai Reserve where under the guidance of Dr Hugh Wilson, it has helped to develop the natural re-establishment of native flora and fauna as part of an ecological restoration project.

Hinewai Reserve started off as 109 hectares of farmland purchased by the Maurice White Native Forest Trust back in 1987. Trained as a botanist, Wilson has been kaitiaki (guardian) of the reserve from the beginning and always had a vision in mind of "allowing nature to reassert itself". Located on Banks Peninsula, just east of the town of Akaroa, this private nature reserve is now over 1250 hectares and is freely accessible for the public to visit on foot.

The primary aim of Hinewai Reserve is to foster the natural regeneration of native vegetation and wildlife. When Hugh Wilson first made the local community aware of his plans back in 1987 to allow the introduced weed, gorse, to grow as a nurse canopy to help regenerate farmland into native forest, people were not only skeptical, but angry. These days, however, he is considered a local hero! The property is managed under a strategy of minimal interference, allowing vegetation to grow naturally. Sun-loving gorse is permitted as it provides a natural, protective covering for young native trees. As the trees grow and push through the gorse, they create shade and the gorse dies off. Today, Hinewai Reserve is home to native forest in various stages of development and includes trees such

as totara, matai and kahikatea, it is also home to over 60 species of fern.

The secondary goal of the reserve is to provide a network of walking tracks which are regularly maintained and easily accessible from Akaroa. The walks range from 10 minutes to several hours depending on how much time you have, and are all clearly signposted. The Stony Bay Peak walk is a popular option offering beautiful panoramic views over Akaroa Harbour, and taking you past waterfalls, through native bush and providing you with the opportunity to spot some of the native birdlife along the way. The only rule for walkers is that they respect and follow the conservation goals of the reserve.

Hugh Wilson is now in his mid-70's and still lives and works on Hinewai Reserve. He regards many new technologies with suspicion, he has no TV, computer or mobile phone. He communicates from his home phone in the evenings and by writing letters. He gets around largely on foot or by bike, only taking the bus when he needs to travel further afield. A documentary has been made on him, called *Fools & Dreamers: Regenerating a Native Forest* and it is a great insight into what this man has achieved.

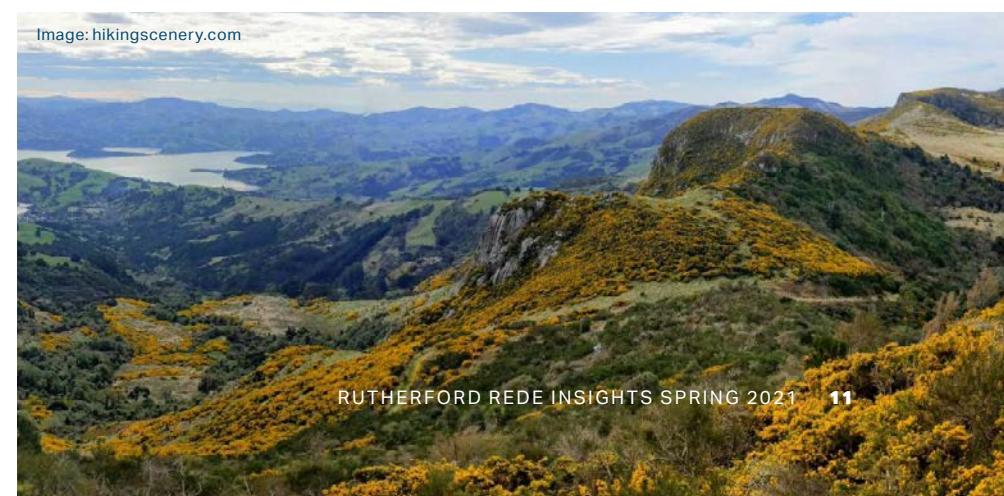
So next time you are on Banks Peninsula, maybe enjoying some of what Akaroa has to offer, contemplate taking the 15-minute drive over to Hinewai Reserve and enjoy one of the many walking trails through the native forest that Dr Hugh Wilson has worked tirelessly to develop.



Image: Michal Klajban



Image: jonas805 on wikiloc.com



RUTHERFORD REDE INSIGHTS SPRING 2021 11



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