



RUTHERFORD REDE

# Insights

Spring 2020





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# A MESSAGE FROM THE DIRECTORS



Labour has been returned to government in an historic landslide providing the Labour Party with a clear mandate to lead.

What has been remarkable in this election is the support given to the Leader, whether you wanted your politics right, left, or centre, the majority has settled in a presidential style of wanting Jacinda to lead.

Many would reflect she has earned this position through her leadership during the events of 2019 and 2020, especially her sheer doggedness to hit Covid pretty well head-on, and whilst this has not been a perfect execution, we remain ahead of the curve.

The rest of the world is dealing with the rapid expansion of cases, perhaps a second wave, and in parts it is dire. We can be thankful that life is pretty normal again here in New Zealand. May alert level one last.

But we are far from through this pandemic. We hope that through protecting our borders that we continue to limit the impact on our economy. We are fortunate. Fortunate our population is small, and nimble, landmass relatively large, and export commodity prices are holding up well. We have a big customer in China who are likely to emerge first from this recession. They need food supplies, and we have food.

Many of us will be happier when we can at least bubble with Australia. They have been careless, following the unfortunate example set by the US, UK and much of Europe. Slow to react, indecisive policy to combat the Virus and ill-judged leadership decision-making.

Meanwhile, as investors and clients, you will note the returns achieved over the past Quarterly and six-monthly periods have been robust. Quite noteworthy when you consider the state of the world and the recession from which most are yet to emerge. But markets are smart.

They look ahead and whilst the vista is somewhat blurry, better times are seen on the distant horizon. That is good enough for markets to be perky and to value ahead of time.

We anticipate it won't all be plain-sailing. Covid may get away on us; governmental support must stop at some point, businesses will have to retool. At this time of change, holding high-quality assets, selecting managers with solid track records and being very well-diversified within New Zealand and globally are, we consider, the essential components to preserve and grow your capital.

# THE WORLD THAT WAS



## Key themes of the period

### *September 2020*

- Most markets continued their climb over the September quarter
- Global central banks remain supportive in monetary policy meanwhile
- Covid-19 is broadening its reach and will start testing local health services
- Interest rates remain bewilderingly low with no inflation concerns yet emerging

## The market rebound continued

### **Most markets continued their climb over the September quarter.**

Markets continued their recovery over the September quarter, a prospect signalled in our last update. Corporate earning announcements have been better than expected and this combined with the support both in terms of high government spending along with policies that have driven interest rates lower have supported this better than expected recovery. With interest rates so low the search for higher-earning assets has taken priority over economic risks and the resurgence of Covid cases in UK, Europe and the US.

International shares rose around 5% in the quarter in NZD terms, whilst NZD hedged shares increased around 6.5%. The very broad 'MSCI All Country World Index' which indicates the progress of world equity markets overall has reached new highs (**Figure 1**). Within global equities, higher risk 'small cap' stocks increased around 6% in NZD terms, while 'value' stocks continued their under-performance, rising only around 3%. While 'small' and 'value' stocks deliver a healthy premium over the long term they do have periods, particularly in challenging economic times, when they underperform the general market. 'Emerging Market' equities increased around 7% in NZD terms, another strong performance.



## In contrast, Australian equity market performance has lagged, as has global property.

Trans-Tasman equity markets had mixed fortunes. Australian shares were flat in AUD terms and increased around 1.5% in NZD terms. Over the year Australian shares have under-performed, with the ASX 200 Index still around 18% lower than the peak level it reached in February 2020. Concerns around bank profitability, and tensions with China impacting resource stocks, have clearly weighed on Aussie market returns. In contrast, the NZ equity market increased around 3% over the quarter, bringing the 5-year performance to around 17% per annum – an exceptional result.

'International property' stocks rose by around 1% in the quarter, but are still down around 17% over the year-to-date, reflecting ongoing uncertainty around how much lower longer-term tenancy demand may be in the post-Covid world.

## Fixed income returns were solid, but running yields looking forward are now very low.

Fixed income returns were also positive over the quarter. New Zealand investment grade (IG) bonds returned around 1.7% in the quarter and 5.5% over the year to September, while global IG bonds returned around 4% over the year. Both are materially higher than the return to cash over the period. However, running yields are now very low, at around 1% for global IG bonds and just 0.5% for New Zealand IG bonds. This implies returns from fixed income are likely to be much lower going forward.

## A tale of two Cvids

With some markets now back at all-time highs, generally driven by particular niches such as technology and healthcare sectors within these markets, questions around whether levels can be justified have not gone away. Outside of listed markets, similar questions are being

raised about the resurgence in residential property market activity in prices – a phenomena not just confined to New Zealand's shores. Nations hard hit with Covid cases, such as the UK and the US, are also seeing strong residential property gains.

FIGURE 1

*Global Equities reach new peaks*



Source: MSCI

How can asset prices be rising in an environment where overall economic activity and employment remains weak, and many businesses remain heavily reliant on policy support? In our last update we pointed to the following factors, which remain relevant:

- The fact the short-term economic data has been stronger than expected. Short-term market movements tend to be much more driven by how conditions evolve relative to expectations, rather than levels of activity per se. In the US, the data surprises are the largest ever recorded (**Figure 2**).

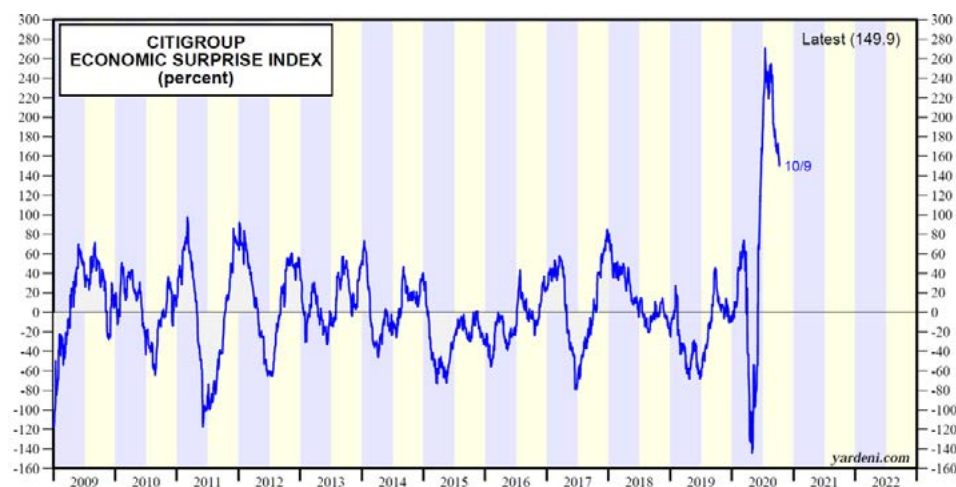
In New Zealand, economic activity and business confidence have also rebounded much more quickly than bank and public-sector economists expected. The most recent ANZ 'Survey of Business Confidence' suggest businesses are now net positive about their own activity outlook and investment intentions (**Figures 3 and 4**).

- The extremely supportive monetary and fiscal policy settings in place globally, which is instrumental in supporting lending, credit markets and asset prices.

- The fact that despite the rally, risky assets continue to offer materially higher yields than investment grade bond yields and cash yields, plus the prospect of capital gains over the longer run.
- Global mass production of Covid-19 vaccines will likely begin within a short (3-6 month) horizon. Eleven vaccines are now in conventional large-scale human trials. China and Russia have leaped-frogged this process and have begun rolling out vaccines to parts of their population most at risk (e.g. frontline healthcare workers).

FIGURE 2

*US economic bounce back surprise largest on record*



Source: Citigroup, Yardeni Research

Beneath the surface, it is also a "tale of two Covids". Part of the reason why economists have got it wrong is that they under-estimated the resilience of the business sector – in general – to lock-downs and restricted travel movements, which in turn no-doubt was assisted by the rapid deployment and usage of remote working applications (including those that support on-line sales





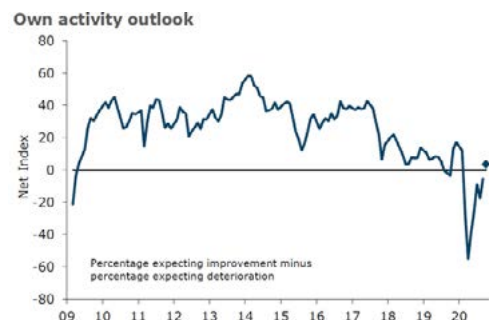
and service delivery). Given this, and the presence of wage and fiscal support mechanisms, household and business confidence has not suffered as much as feared, hence nor has employment and spending levels. Kiwis are also great travellers who spend \$10b each year on travel overseas particularly over the winter months. Money set aside for this has been spent not only on internal travel but purchases of other items. All these factors together with the presence of ultra-low financing costs has helped boost asset prices, including housing.

But businesses in sectors that depend on foreign tourists and in-person patronage (e.g. hotels and restaurants) have suffered, as have workers in these sectors, who also tend to be younger and on lower incomes. Covid-19 has hence further exacerbated the home ownership and wealth gap between the haves and have-nots. In the US, this gap has

now exceeded levels reached in the 1920s before the onset of the Great Depression. Such levels of inequality undermine notions of fairness, social mobility, and economic growth itself. This gap and mounting government debt levels will provide challenges for governments not only in the short-term but well into the future. While the short-term impact has been moderated, the long-term is much less certain. Along with the documented challenges of climate change these problems will require new thinking and new policies. The election campaigns here though have been fought with little debate on policy. Almost certainly there is more to come.

FIGURE 3

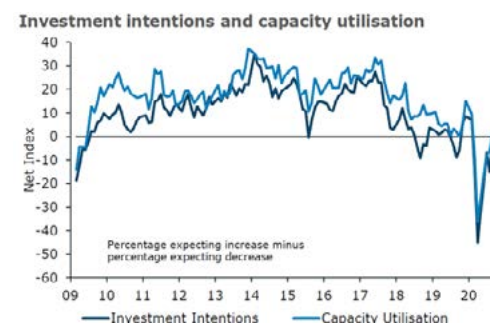
*NZ business confidence back in black*



Source: ANZ Research

FIGURE 4

*As are their investment spending intentions*



Source: ANZ Research

# 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.*

## A REVIEW OF THE QUARTER



QTRLY RETURN  
+ 2.9%  
PAST YEAR  
+ 8.3%

**New Zealand Shares:** New Zealand shares returned around 3% in the quarter, a solid result given the very strong June quarter bounce from the Covid-19 sell-off. Over the past 5-years performance remains exceptional at around 17.2% per annum. Source of Figures: S&P/NZX 50 Total Return Index with Imputation Credits



QTRLY RETURN  
+ 1.7%  
PAST YEAR  
+ 5.2%

**New Zealand Fixed Interest:** New Zealand investment grade corporate bonds returned 1.7% for the quarter and around 5.3% 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



QTRLY RETURN  
+ 1.3%  
PAST YEAR  
- 9.2%

**Australian Shares:** Australian shares mildly rose in NZD terms over the September quarter, bringing the annual return to around -9%. Within Australian equities, 'small cap' stocks out-performed returning around 7.1%, while 'value' stocks lagged with a flat result. Overall, while a strong bounce the Australian remains lower than other broad markets over the year. Source of Figures: S&P/ASX 300, S&P Australia BMI Value, S&P/ASX Small Ordinaries



QTRLY RETURN  
+ 5.1%  
PAST YEAR  
+ 4.7%

**International Shares:** International shares rose around 5% in the quarter in NZD terms, whilst NZD hedged shares increased around 6.5%. These results were sufficient to make annual returns now positive for the year-end September. Within global equities, 'small caps' returned around 6% in the quarter while 'value' stocks languished, returning around 2.6%. Source of Figures: MSCI World Index; Morningstar Developed Markets NZD hedged, MSCI World Value, MSCI World Small Cap.



QTRLY RETURN  
+ 8.6%  
PAST YEAR  
+ 12.5%

**Emerging Markets:** Emerging Market equities rose 8.6% in the quarter, bringing the annual return to 12.5%, a strong result. Returns were even stronger in local currency terms at around 30% for the year, with the difference reflecting the NZD appreciation versus EM currencies. Source of Figures: MSCI Emerging Markets Index



QTRLY RETURN  
+ 0.7%  
PAST YEAR  
+ 3.9%

**International Fixed Interest:** Global bonds returned 0.7% in the quarter and 3.9% 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)



QTRLY RETURN  
+ 0.7%  
PAST YEAR  
- 21.0%

**International Property and Infrastructure:** International property stocks rose by around 0.7% in the quarter but are still down around 21% 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 only marginally down over the past year. Source of Figures: FTSE EPRA NAREIT NZD Hedged



# THE WORLD POPULATION IN 2100







**As we reflect on a world disrupted by Covid and with our population being bolstered by returning Kiwis, and Kiwis staying home, the effect of ever-increasing people on a planet with finite resources seems worthy as a discussion topic.**

On that note, 22 August 2020 marked the point of this year known as Earth Overshoot Day. That is, from that date and for the remainder of this year, the resources consumed are beyond the earth's ability to regenerate them. They are therefore being consumed at the expense of future generations.

The number of people on the planet impact consumption of resources, but where they are and how fast they are growing, may not be as you think.

The world's population is growing at an ever-increasing rate. The following chart shows the periods that it took for the global community to approximately double.

Year	Population
1000	275,000,000
1500	450,000,000
1804	1,000,000,000
1951	2,584,034,261
1990	5,327,231,061
2020	7,794,798,739

Source: <https://www.worldometers.info/world-population/world-population-by-year/>

This appears to be out of control. According to the Institute for Health Metric and Evaluation (IHME), the world population is expected to peak at 9.7 billion in 2064 and be lower to 8.8 billion in 2100. While this seems hopeful, the impact is more on where the population is domiciled rather than how many of us there are. The population in the wealthiest countries is declining, and in the poorest countries it is increasing. The chart below points to Africa as a hot spot not only in climate but in the numbers of people.

The declines are as insightful as the increases. Equally, the demographic within declining countries point to population spikes in the elderly, which presents a looming challenge.

If we are aiming for population growth of 0% to preserve our resources and way of life, then these statistics give cause for concern. The rate of population growth seems to follow an evolutionary pattern. From 1750 to 1950 Europe was on an exponential growth path but fell away from 1950. Asia also has followed this pathway, but now is starting to fall away. Africa though, is growing fast. In 1950 they were 9% of the world population, in 2010 they were 15%, and UN predictions have them at 24% by 2050. Today 80% of humanity is living in a developing country; by 2050, we expect this to be 86%. With that increase also comes population density that brings its own set of challenges. In 1950, 30% of the world population lived in cities, now that number is 50%.

So what is going on here? If parents expect high death rates in their children, they respond by having more children.

As survival rates in Europe increased not only from lower child mortality but improvements in food availability, better healthcare and less war, then families had fewer children. This will need to be experienced in Africa before birthrates decrease.

Education, along with improvements in healthcare, have a large role to play in this progression. It may surprise you to know that Iran has one of the lowest birth rates in the world. Following the 1978 Iranian Revolution, Iran experienced improvements in education and healthcare. These lead directly to a lowering in the birth rate.

It follows that you might expect that if you could lower the birthrate, then population growth would come down quickly. It's not that simple, though, as can be seen through New Zealand's population demographics. We have two noticeable spikes in our population. The babyboomers and the children of the baby-boomers. The creation of the massive spike in baby-boomers led directly to a spike in numbers when they had children. If there is a spike on the childbearing age of the population, then it follows that there will be a further spike as that group has children. Countries that have been growing fast have a skew to younger and more fertile people.

FIGURE 5						
	2017	% Total	2100	% Total	Difference	Change
China	1,400,000,000	19%	732,000,000	7%	- 668,000,000	-48%
India	1,380,000,000	18%	1,090,000,000	10%	- 290,000,000	-21%
United States	335,000,000	4%	336,000,000	3%	1,000,000	0%
Indonesia	258,000,000	3%	229,000,000	2%	- 29,000,000	-11%
Pakistan	214,000,000	3%	248,000,000	2%	34,000,000	16%
Brazil	212,000,000	3%	165,000,000	2%	- 47,000,000	-22%
Nigeria	206,000,000	3%	791,000,000	7%	585,000,000	284%
Bangladesh	157,000,000	2%	81,000,000	1%	- 76,000,000	- 48%
Russia	146,000,000	2%	106,000,000	1%	- 40,000,000	-27%
Japan	128,000,000	2%	60,000,000	1%	- 68,000,000	-53%
Ethiopia	103,000,000	1%	223,000,000	2%	120,000,000	117%
Egypt	96,000,000	1%	199,000,000	2%	103,000,000	107%
DRC	81,000,000	1%	246,000,000	2%	165,000,000	204%
Tanzania	54,000,000	1%	186,000,000	2%	132,000,000	244%

Source: <https://www.visualcapitalist.com/world-population-2100-country/>

Curiously since the '60s, even at this extraordinary rate of growth, food production has exceeded population growth. The issue is not how much food we have; it is the question whether that food is in the right hands. Clearly, it is not. Food scarcity tends to be driven by socioeconomic inequality, lack of democracy, and war.

There are other impacts on our environment to changes in population. Increases in prosperity lead to disproportionate consumption in some resources. Without going into detail, our consumption of water and meat is running ahead of population growth. This is driven by increasing wealth in countries like China.

Migration is another consequence. As expected, the incentives to migrate from poorer countries to less densely populated rich ones are strong. This may seem like a solution, but this may exacerbate the problems of poorer countries rather than solve them. It is the more able who migrate, leaving those remaining less educated and less well-resourced.

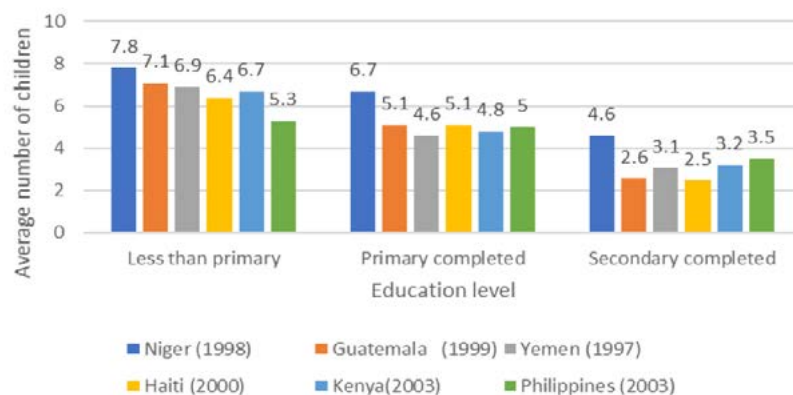
After digesting this material, the benefits of living in New Zealand seem to be further magnified. Our population growth is modest and driven by migration more than fertility factors. We have a lot of control over how fast and with what

skills we grow. Equally, we are producers of food and use the natural environment in the main to create that food. We have a great opportunity so long as we manage it well.

You may be interested in New Zealand's population characteristics. We have extracted the following material from Statistics NZ.

FIGURE 6

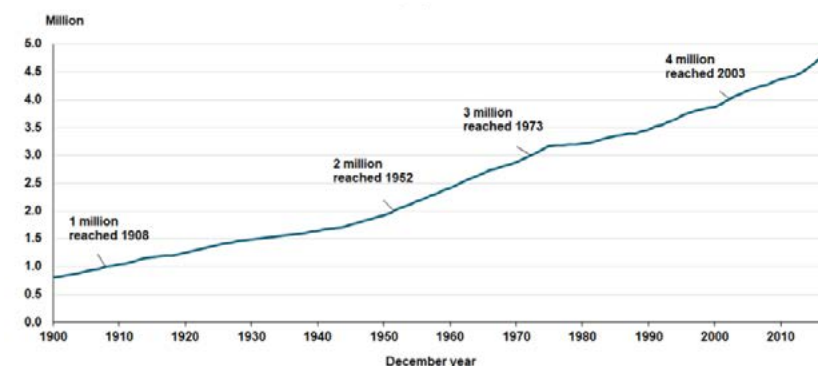
*Education impact of birth-rates*



Source: <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC3987379/>

FIGURE 7

*New Zealand Population 1900-2017*



Note: Figures for 1901-2017 are 'estimated resident population'. Figures for 1950-55 are calculated by subtracting estimated natural increase and net migration from 1901 population estimate. Figure for 2018 is projected.





More recently, migration has provided a spike to our population growth. As you can see from the chart alongside, this has not always been the case.

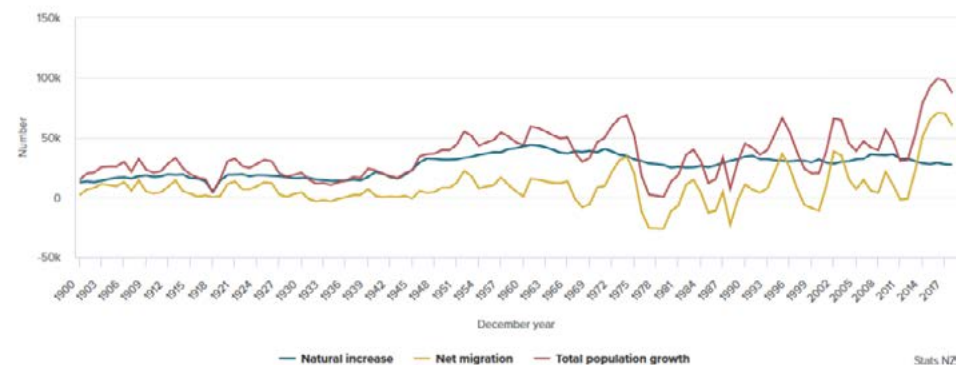
Our birth rates are interesting. Birth rates in 1961 were 4.3 births per woman, more than double the replacement rate of 2.1. In 2017 this rate was down to 1.8 births per women.

So when do Statistics NZ expect the population of New Zealand to reach 6 million? Their modelling suggests around the mid-2040s, but with higher migration, this could be achieved by the 2030s.

What is clear is that New Zealand is seen as a desirable destination in a world where overcrowding and competition for food are increasing. Without migration, our population would fall. It's no wonder migration is such a political hot potato.

FIGURE 8

*Components of New Zealand's population growth, 1900-2017*



**Note:** Natural increase is estimated births minus estimated deaths. Deaths include war deaths occurring outside of New Zealand. Net migration is total movements for 1900–95 and 'permanent and long-term' migration for 1996–2017. Total population growth is natural increase plus net migration; this is different from population growth derived from population estimates which also incorporate census counts. 2018 figures are projected.

Source: <https://www.stats.govt.nz/news/are-we-there-yet-heading-for-a-population-of-5-million>

A NETFLIX ORIGINAL DOCUMENTARY

SPECIAL FEATURE

David Attenborough  
A LIFE ON OUR PLANET



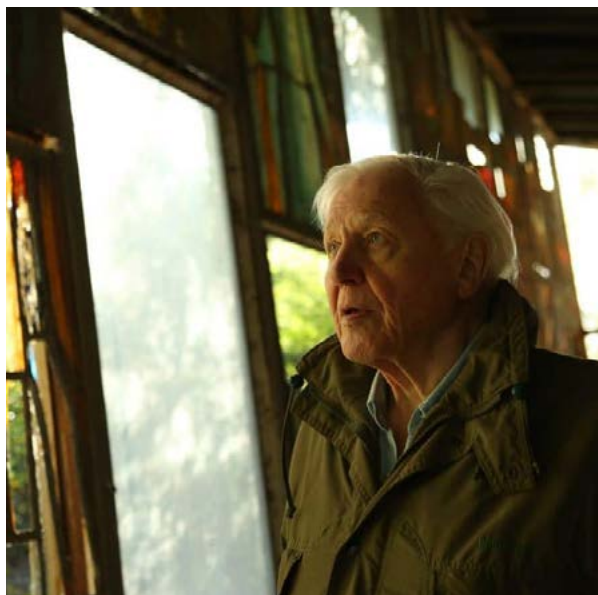
# A LIFE ON OUR PLANET

Documentary on Netflix

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David Attenborough





*Attenborough is widely considered a national treasure in the UK. In 2002, he was named among the 100 Greatest Britons following a UK-wide poll for the BBC.*



**Every once in a while, a person comes into our world who truly loves the diversity of life on this magnificent planet and seduces us with their heartfelt compassion for all living things.**

In his 94 years, Sir David Attenborough has visited every continent on the globe, exploring the wild places of our planet and documenting the living world in all its variety and wonder.

Now, for the first time, the celebrated naturalist reflects upon both the defining moments of his lifetime and the devastating changes he has seen.

Produced by WWF and the award-winning wildlife film-makers Silverback Films, David Attenborough: A Life on Our Planet is a first-hand account of humanity's impact on nature.

The documentary addresses some of the biggest challenges facing life on our planet, providing a snapshot of global nature loss in a single lifetime. With it, comes a powerful message of hope for future generations as Sir David reveals the solutions to help save our planet from disaster.

Acting as a witness statement and an urgent call to action, the documentary reveals alarming figures showing that since the broadcaster was born, the Earth has lost a staggering 31% of its wilderness. Not only that, but the planet's human population has more than tripled in less than a century, with carbon in the atmosphere increasing from 280 PPM (parts per million) to 415 PPM.

It's a shocking wake-up call, and Sir David does not mess around letting us know how little time we have left to fix our mistakes.

A timely and vital message for all of us, not only as New Zealander's but as citizens of the world.

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Sir David Frederick Attenborough (born 8 May 1926) is an English broadcaster and natural historian. He is best known for writing and presenting, in conjunction with the BBC Natural History Unit, the nine natural history documentary series forming the Life collection that together constitute a comprehensive survey of animal and plant life on Earth. He is a former senior manager at the BBC, having served as controller of BBC Two and Director of Programming for BBC Television in the 1960s and 1970s.

He is the only person to have won BAFTAs for programmes in each of black and white, colour, HD, 3D and 4K. In 2018 and 2019, he received Primetime Emmy Awards for Outstanding Narrator.

He considers his 2020 documentary film, David Attenborough: A Life On Our Planet, his personal witness statement of his life and the future.

Attenborough is widely considered a national treasure in the UK. In 2002, he was named among the 100 Greatest Britons following a UK-wide poll for the BBC.



# FINANCIAL JARGON TRANSLATED TO ENGLISH

## Quantitative easing

**What is 'QE'? There are hundreds of books written on this subject, but here we distil it down to a simple explanation.**

The process of quantitative easing has been used by the Reserve Bank of New Zealand (RBNZ) and many other central banks around the world this year as part of its strategy to keep the economy moving. This is the process referred to as printing money; although most money is created these days electronically so even though this process conjures up an image of a printing press, the process is much less dramatic.

'QE' is the process of the RBNZ buying government bonds with money it has digitally created to increase the supply of money in the economy, lowering interest rates, moving exchange rates, and stimulating the economy. The RBNZ is responsible for the supply of money in the economy and depending whether they want to speed the economy up or slow it down, they either increase or decrease the money supply.

When buying bonds, the price is set at a level where there is an incentive to sell the bonds to the RBNZ and because bonds have an interest rate (coupon) that is at a fixed price then effectively the bond is now selling at a lower yield.

### Example:

- A government bond is simply a loan to the government on the promise they will pay you back on an agreed date while paying you interest along the way.
- A bond with a par value of \$10,000 (the amount the government will repay to the owner of the bond), paying interest (Coupon) annually of 4% would produce income of \$400 per year and achieve a yield of 4%.



- If the RBNZ decides to purchase that bond at a price of say \$10,300 then holding that bond to maturity, they will achieve a yield of 3.34%
- The reason is that the \$400 per year is constant and because they have paid more than the par value (\$10,000 that they will receive when the bond matures) then the RBNZ will only receive a yield of 3.34%
- The person selling the bond is incentivised to sell because they are getting a better price than they would have before.
- But now they must find something else to invest in, and of course, bonds currently are trading at a lower yield, so they look elsewhere.

These lower yields together with the lower official cash rate (which the RBNZ sets) result in lower interest rates generally as the market, in part, sets its rates at a margin above the official cash rate and/or government bond yields.

With QE there is more money in the economy and this together with low-interest rates is an incentive for businesses to invest in productive items and for consumers to spend more; helping us grow out of a recession. It seems likely that an increase in money supply with the same amount of goods and services to purchase must result in higher prices for goods and services. In other words, inflation. To date, QE has not resulted in inflation, well not in the way it is measured.

What we are seeing is that extra money that previously had been invested in a safe government bond is now looking for another investment. The result has been an increase in shares and property as this money finds a home, but the

supply of these assets has not increased consistently with the amount of money. So, their price has increased.

Isn't inflation supposed to be bad? Well, some inflation creates the incentive to spend, and that makes economies work. Too much, of course, creates a stampede to spend, and that is not good. With all this debt, the government would like some inflation as it is easier to shrink this debt through inflation rather than paying it back. Hence the RBNZ target of keeping inflation between 1% and 3%.





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