



RUTHERFORD REDE

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ECONOMIC & MARKET COMMENTARY

MARCH QUARTER 2024

Overview

Large cap global equities performed very strongly again over the quarter despite the soft global economic environment.

International equity markets rallied strongly again over the March quarter as the tech rally rolled on, lifting other parts of the market with it. Hot on the heels of the so-called “magnificent seven” US-based tech stocks which have been firing on the AI boom (up around 50% since Jan 2022) we now have the European “granola”¹ stocks. These are up a mere 43% over the same period and comprise mainly large cap pharmaceuticals and luxury brands, as well as Dutch-listed ASML, the only company that can make the machines required to manufacture the most advanced chips being used for AI applications. Elsewhere, performances have been more subdued. NZ equities is an example. Fixed income in general had a flat quarter (see Figure 1).

As in our previous update, on the economic front the US economy remains a bright spot with around three-quarters of US companies’ earnings beating analyst estimates. Europe and the UK remain weak. The New Zealand economy has been in mild recession over much of 2023, and on a per-capita basis its performance was amongst the worst in the OECD (see Figure 2) over the second half of 2023. Unfortunately, indicators suggest conditions are getting worse rather than better. On the other hand, Chinese economic data has been better than expected of late and this, along with the ongoing Russian occupation of Ukraine, has helped underpin a range of commodity prices.

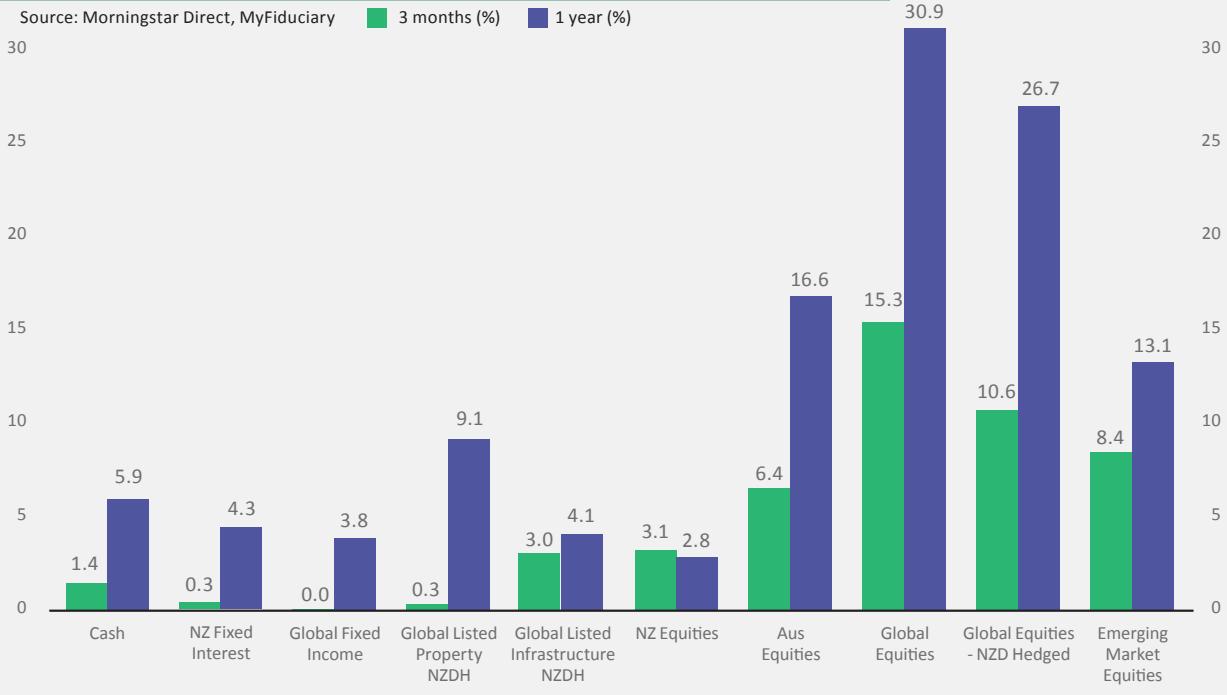
Market roundup

Gains were strongest in US equites over the past year, in part reflecting the relative strength of the US economy and the AI boom underway.

All asset classes enjoyed positive returns in the quarter. As mentioned, global equities led the pack with a 10.6% return on an NZD hedged basis, and a 15.3% return in NZD terms, given the 4.5% or so fall in the value of the Kiwi over the period. Australian and emerging market

Figure 1: Some very strong performances in the March quarter

Source: Morningstar Direct, MyFiduciary



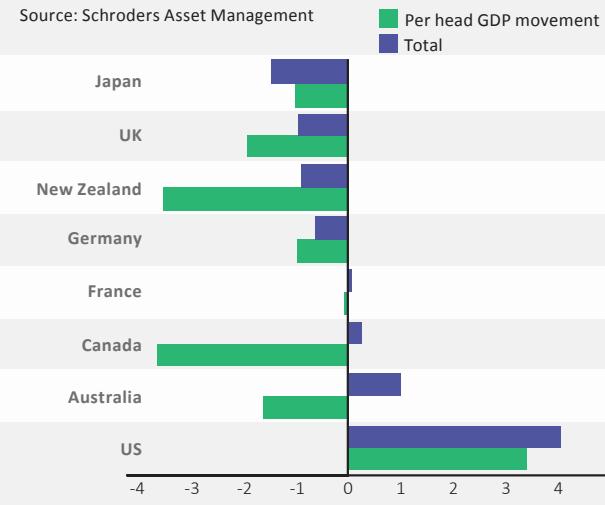
equities also had a strong quarter, with returns of around 6.5% and 8.5% respectively. Trailing the pack, NZ equities returned only around 3% over the quarter and year to March, given most of the largest stocks on our market are utility and infrastructure-type investments, sensitive to NZ economic growth and interest rates.

Listed global property on an NZD hedged basis was top of the pack last quarter but was flat in the March quarter. Global infrastructure fared a little better returning 3% over the quarter. Similar to property, while fixed income had very strong returns in the December quarter, they were flat over March as markets backed-off in their conviction that interest rates will be aggressively cut over 2024, causing marked-to-market declines in bond prices.

Global investment grade bonds returned 3.8% for the year to March, below their current running yields of around 6%. In contrast, short duration global investment grade bonds have fared much better, returning from 6 to over 8% over the year, depending on their geographic exposure.

Figure 2: Real GDP Growth – 2H23, 6 month annualised

Source: Schroders Asset Management



¹GSK, Roche, ASML, Nestle, Novartis, Novo Nordisk, L'Oréal, LVMH, Astra Zeneca, SAP, Sanofi

BENCHMARKING PERFORMANCES

Benchmarks are tools used to assess the performance of portfolios that we offer.

Benchmarks are crucial tools to enable the investor to tackle the following key questions:

1. Is my investment strategy delivering the long-term returns required to meet my core financial goal?
2. Is my portfolio performing well?
3. Are the individual funds in my portfolio performing well?

Below we provide an overview of the different benchmarks we use to address these different questions.

Different benchmarks are used to answer different questions.

Meeting core financial goals

An investor's allocation to growth (risk) versus defensive (less risky) assets is a function of the long term return they require to meet their financial goals and spending needs. In general, three benchmarks are commonly used for this long-term requirement:

- I. **A fixed return**, e.g. an expected long-term return of 7% net of fees. This expectation is calculated by estimating expected returns for all asset classes that the investor has funds in, then weighting these asset class returns by the investor's Strategic Asset Allocation (SAA).
- II. **Cash + X%**, where x% is estimated as the SAA weighted expectation of each asset class return versus cash over the longer term. For example, for a balanced portfolio we expect a return of 2.5% p.a. better than cash return over the longer term.
- III. **CPI inflation + X%**. For example, assuming inflation is 2% over the long term, we expect X to be around 4.5% p.a. for a balanced portfolio.



The most important benchmark for an investor is the long-term return requirement.

Which benchmark is used above usually depends on the type of investor. A CPI inflation + x% benchmark makes sense for most charities and foundations because their aim is to maintain the real or inflation adjusted value of their portfolio after costs and making distributions and grants. Cash + X% benchmarks are more often used by investors with relatively high spending needs whose focus is seeking to add value over and above holding cash. In contrast, a long term expected return number is most often used by investors building their portfolio to meet future spending needs.

The importance of a longer term lens.

Actual performance of a portfolio should be compared against these benchmarks over a medium-term time horizon as given the volatility in markets it is unrealistic for the benchmark to be met or exceeded every year.² A common industry practice is hence to compare the performance of a portfolio over rolling 3 to 5-year periods.

Benchmarks used to assess portfolio performances

As with assessing how a portfolio is meeting its long-term financial goals different benchmarks can be used to assess how our portfolios are performing, with each giving different information. Below we outline the benchmarks we use to assess portfolio performances in our quarterly review processes:

- I. **Reference portfolio benchmark** – Popularised in New Zealand by the NZ Superannuation Fund, this very simple benchmark comprises low-cost passive exposures to global and NZ equities and bonds only, with weights corresponding to the growth versus defensive mix of a portfolio. Comparing this return to actual portfolio performances enables us to see whether the combination of our asset allocation and fund manager selection choices are adding value.
- II. **SAA weighted benchmark** – This is calculated from benchmark asset class returns and their SAA weights in a portfolio. The difference between this return and actual portfolio returns reflect the value-add of our fund manager selections. In contrast, the difference between the Reference portfolio and SAA weighted benchmark returns let us know how our asset allocation choices are performing.

III. **Peer group benchmark**- We also compare performances of the portfolios we offer against a comparable ‘peer group’ average in the marketplace. Unfortunately, the data does not exist to enable us to compare performance of the portfolios we offer against portfolios that other Adviser firms offer. Instead, we use the next best alternative, which is to compare performance of each portfolio we offer against KiwiSaver and other multi-asset class funds in the marketplace with a similar risk profile.

All of these benchmarks are used in our review processes to test the value-add of our asset allocation and fund manager selection choices.

As with assessing performance against long term financial goals, the time horizon also matters here. We do not expect to add value every quarter, but we do aim to add value over a medium-term (3 to 5 year) time horizon. Any area where this is not occurring sets our agenda for further scrutiny and debate.

Benchmarks used to assess individual fund manager performances

Individual fund manager benchmarks mirror what we look at for portfolio level benchmarking.

Our approach to benchmarking individual fund manager performances mirrors the approach we take to look at overall portfolio performance. We compare performance of each fund manager against an appropriate asset class benchmark, and a peer group of similar funds. Funds that fail to perform at least in line with peer group averages and their asset class benchmarks over the medium-term are placed on ‘watch’ in our quarterly review process. Such a fund will likely be replaced if we lose conviction in their ability to turn around the under-performance.

²Ideally benchmark returns are adjusted for capital inflows and outflows of the investor so that the timing of investment flows does not impact on relative performances. In practice this is often difficult to calculate, so time rather than money-weighted returns are used for performance calculations.



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	
	3.1%
PAST YEAR	
	2.8%

New Zealand Shares: New Zealand shares increased 3.1% over the quarter, and 2.8% the last 12 months. This is a quite soft result compared to offshore equities, but our market remains a strong performer over the last decade with a return of around 10% per annum.

Source of figures: S&P/NZX 50 Total Return Index with Imputation Credits



QTRLY RETURN	
	0.6%
PAST YEAR	
	5.6%

New Zealand Fixed Interest: New Zealand investment grade corporate bonds increased 0.6% in the quarter and 5.6% over the year, a slightly soft result that reflected markets pricing in less cuts to the OCR this year than they had previously thought were required.

Source of figures: S&P/NZX Investment Grade Corporate Bond Index



QTRLY RETURN	
	6.6%
PAST YEAR	
	16.6%

Australian Shares: Australian shares rose 6.6% in the quarter, lifting the annual return to a very solid 16.6%. Australian small cap stocks had similar performances, while value outperformed over the year returning around 23%.

Source of figures: S&P/ASX 200, S&P Australia BMI Value, S&P/ASX Small Ordinaries



QTRLY RETURN	
	15.3%
(10.6% hedged)	
	30.9%
(26.7% hedged)	

International Shares: International shares had another very large rally over the quarter, by around 15% in NZD terms and 10.6% in NZD hedged terms. This brought the annual results to around 31% in NZD terms, while NZD hedged returns were 26.7%. Small caps returned 10.5% in the quarter and 21.2% over the year, while value stocks returned 13.8% in the quarter and 24.2% over the year. The under-performance of small and value-oriented stocks in part reflects that the largest gains were from large cap US growth stocks in the tech sector, with NVIDIA (a chip maker) being the standout performer.

Source of figures: MSCI World Index; Morningstar Developed Markets NZD hedged, MSCI World Value MSCI World Small Cap in NZD terms.



QTRLY RETURN	
	8.4%
PAST YEAR	
	13.1%

Emerging Markets: Emerging Markets rose by around 8.4% over the quarter and a respectable 13.1% over the year to March in NZD terms. Within EM stocks Indian and Latin American companies had very strong performances, but Chinese stocks continue to lag given weak Chinese growth and ongoing geo-political tension with the West.

Source of figures: MSCI Emerging Markets Index



QTRLY RETURN	
	0%
PAST YEAR	
	3.8%

International Fixed Interest: Global investment grade bonds were flat in the quarter as market conviction waned that that interest rates will aggressively be cut over 2024. This reduced the annual return to 3.8%, below the current running yields on global bonds of around 6%.

Source of figures: Bloomberg Barclays Global Aggregate Index (hedged to NZD)



QTRLY RETURN	
	0.3%
PAST YEAR	
	9.1%

International Property and Infrastructure: International property stocks rose by around 0.3% in the quarter in NZD hedged terms (4.5% unhedged), while global infrastructure increased around 3% in NZD hedged terms (around 7% unhedged). Over the year, infrastructure increased around 4% and global property 9.1% on a NZD hedged basis.

Source of figures: FTSE EPRA NAREIT, FTSE Dvlp Core Infra 50/50; NZD & NZD hedged basis



Q&A WITH CHRIS TRAN

Insights introduces people that we work closely with so that you can understand the wider team that provides our services.

Tell me about your life growing up and some of the jobs you did while studying.

I was born in Thailand to a Kiwi/Irish mother and a Vietnamese/Thai father. We moved back to New Zealand when I was 4 so the first language I spoke was actually Thai, not that I can speak it at all now (outside of ordering food).

I grew up in Wellington and thoroughly enjoyed my time there. Growing up in Days Bay and then Karori meant that friends were always close by.

I had a few jobs whilst I was studying, the first one of which was working for the document destruction company shuffling papers onto the conveyor belt to be shredded. Whilst the pay was good and the job certainly wasn't difficult, my coworkers wouldn't change the radio from the local Samoan station. I don't think I heard one word of English come over that radio over the school holidays that I worked there.

I've also delivered pizzas which (at the time) paid minimum wage plus \$2 per delivery. A king's ransom for a 16 year old boy who was using his mother's car to make the deliveries!

Interestingly enough my favourite job (apart from Rutherford Rede of course) was when I painted houses over summers whilst at university. My Dad worked in his father's factory from the age of 14 and always placed a high value on those days he spent welding. He hated the job but later in life it made him realise how much it had taught him in terms of work ethic, doing things right and realising how much he didn't want to work there forever.

He encouraged me to get a job that involved at least some manual labour which led me to painting houses over my university summers. I had a great time with the painting crew which consisted of five Christian Iraqi guys. We had a lot of laughs, drank a lot of traditional Iraqi tea and painted quite a few Wellington homes.

The days were long, 10 hours during the week and then 6-8 hours on Saturday depending on job progress but working there over summer meant I didn't have to work during the university term which was a huge bonus. When you paint your own house there's a satisfaction you feel when you near completion but when you're painting other people's houses, approaching that same milestone doesn't have the same satisfaction. That's because as soon as you've finished there's another home that you'll need to prep which is easily the worst part of the job.

I still keep in touch with the guys from the painting crew and look back on it fondly. It certainly taught me that preparation for any task is critical to its overall success and that there's no substitute for putting in the hours.

What has been your worst and best investment experience?

I bought my first share when I was in high school using my grandmother's brokerage account. I received a worrying lack of guidance from the adults in my life at the time, perhaps if they had paid more attention, they would've warned me off purchasing such a dog.

Kirkaldie & Stains, a Wellington institution of a department store promptly began its slow demise, and I cashed out a measly 20% of my original investment.

The best investment experience is one that I hope hasn't happened yet.

What learnings do you take from these experiences that you apply in your role as a financial adviser?

This foray into amateur stock picking made me realise at a young age that it wasn't as easy as the movies made it look. Through my studies it became clear that academia is resolute that active management isn't an effective way



to grow or preserve wealth when compared to a low-cost well-diversified strategy. After working for Westpac I began looking for a firm who's investment philosophy aligned with my own values and the academic principles I'd learnt.

What do you like least about your job?

The hardest part of my role is when clients pass away. You become so close to the majority of your clients and end up knowing more about their situation, their history and them as people than basically any non-family member (sometimes even more than family).

The average age of a financial adviser in New Zealand is somewhere in their late fifties and we are seeing more people ask for succession plans in their professional team. Nobody wants to turn up to their review meetings and

find a different face looking at them every time! It has become clear that clients want to work with the same person/team for an extended period of time and for those entering retirement that means working with someone younger.

What that means for me is (hopefully) becoming close to all of you!

Tell us about your partner Martha

Martha and I met when I moved to Auckland where she was my neighbour. She has an incredibly creative mind and has a small business where she buys & sells vintage clothes. Needless to say, these clothes spend a reasonable amount of time in her own wardrobe before they are actually sold.

Being from the UK she is a huge football fan having played for most of her life. Up until recently she was playing in a women's rep team in Auckland.

What are your holiday plans this year?

Martha and I are heading to Croatia for a few weeks and then over to the UK to visit her family. We'll spend just under a week in 'Stone', a canal town on the outskirts of Stoke-on-Trent, where Martha's family lives and then head to the Glastonbury music festival.

What is your favourite thing to do when not at work?

Our social life and travel are at the top of our to-do list outside of work. We spend most weekends with friends or out and about enjoying the relatively carefree lifestyle that one has in the 'pre-children phase'.



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