PHWM Spring Update

P1 Market commentary

P4 Key market movements for the quarter

P5 Why women make better investors

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From July to September 2017 diversified portfolios again performed above our long run expectations, as global investment sentiment strengthened.

After several years of unconventional monetary policy around the globe (including multiple quantitative easing programmes and negative cash rates in a number of countries), improving and synchronised growth seems to have returned to the global economy. As the global growth pendulum has moved, albeit slowly, from sluggish to a visible expansion, it has enabled central banks to finally reconsider their pathways back towards more 'normal' interest rate settings.

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In recent months, central banks in Europe, the UK and Canada have either changed the tone of their monetary policy statements, or hiked interest rates. Following such a lengthy period of subdued growth and low global interest rates, the movement towards higher growth expectations has been well received by most share markets.

Also contributing to this budding global growth story has been the resurgence in Chinese growth as a result of both fiscal and monetary stimulus. Chinese gross domestic product provided a positive surprise in the second quarter of 2017, which in turn helped lift commodities demand and global trade.

Of course, there was also no shortage of unsettling news over the quarter. This included the increasing unrest surrounding a possible secession of Catalonia from Spain, the London tube bombing, escalating brinkmanship between Donald Trump and "little rocket man" Kim Jong-un, the destruction wrought by hurricanes Harvey and Irma, and the Las Vegas mass shooting.

However, in spite of how emotionally challenging some of this was, share markets typically don't react significantly to these kinds of events. Markets care much more about general economic conditions, including growth rates, inflation, interest rates and unemployment as well as associated factors such as consumer sentiment and business confidence.

On a number of these measures, the July to September period scored positively.

Global equities markets posted a solid quarter. The USA, Eurozone and Japanese markets all posted gains against backdrops of positive and improving economic data. In local currency terms, the S&P500 (USA) was up +4.5%, the CAC40 (France) and DAX (Germany) gained +4.3% and +4.1% respectively, and the Nikkei225 (Japan) advanced +2.3%.

The Australasian share markets also performed creditably. In Australia the S&P/ASX200 index returned +0.7%, while the New Zealand S&P/NZX50 index (gross with imputation) posted +4.7%. With the New Zealand market performing in line with major overseas markets, it appears to have been relatively unaffected by September's general election. The considerable volatility in the pre-election polling, and the fact that no clear government was obvious on election night, had little impact on investor sentiment.

Perhaps that shouldn't have been a surprise. With National and Labour-led governments generally viewed as being relatively centrist by international standards, and the fact that the Reserve Bank of New Zealand will remain independent under both parties, the markets have remained relatively calm. All that is left now is for Winston Peters and his New Zealand First party to conclude negotiations with either National or Labour/Greens to finally confirm the make up of the government for the next three years.

With the theme of synchronised global growth continuing in the third quarter, emerging markets regions in particular enjoyed some very strong gains. The MSCI Emerging Markets Gross Index jumped +7.7% over the quarter, with double digit gains posted by Brazil, China and Russia.

Brazilian shares led regional results gaining +17.4% in an improving inflationary environment, while Chinese shares delivered +14.8% on signs that domestic growth was picking up momentum. After a difficult start to the year, the Russian market rebounded +15.3% following an improvement in crude oil prices, and lower inflation opening the door for further interest rate cuts. At the other end of the spectrum, the Greek share market fell -15.2%, eroding most of their previous gains in 2017 with domestic banking stocks leading the index down.

Although global bond yields oscillated over the quarter - with the exception of the UK, which sold off sharply in September - they were ultimately little changed against a backdrop of gradually improving economic data. There was a marked escalation in tensions between the USA and North Korea, which led to a temporary rotation into lower risk assets in August and bond yields moving lower. However, this reversed course in September, as tensions eased and risk appetites quickly returned.

US ten year yields began the quarter at 2.31% and finished at 2.33%, while German ten year yields were similarly flat, moving from 0.47% to 0.46%. In the UK, the ten year gilt yields rose 0.10% to 1.36% by the end of the quarter. In these relatively benign conditions, the Citigroup World Government Bond Index 1-5 Years (hedged to NZD) gained +0.6%, while the slightly longer duration Bloomberg Barclays Global Aggregate Bond Index (hedged to NZD) advanced +1.0%. These were both satisfactory results, given the still compressed global yield environment.

New Zealand fixed interest returns were broadly aligned with those offshore, with the S&P/NZX A-Grade Corporate Bond Index returning +1.2% while the longer duration S&P/NZX NZ Government Bond Index returned +0.9%.

Listed property assets also delivered positive returns, but generally lagged the performance of company shares as investors preferred risk exposures more directly leveraged to global growth. The idea of a normalising interest rate environment presents something of a headwind for property companies that have previously enjoyed strong demand over the last three to five years, from investors seeking to maintain their ability to generate a consistent level of portfolio income in the face of a (previously) declining interest rate environment. In this quarter, the international real estate market as represented by the S&P Developed REIT Index (total return) delivered +1.5% in US dollar terms, while the local S&P/NZX All Real Estate Index (gross with imputation) returned +0.5%.

Overall, the third quarter of 2017 rewarded investors who maintained their strategic investment plans. Growth oriented portfolios performed the best as international and emerging markets shares were the highest returning asset classes. However, income oriented portfolios, which allocate lower proportions to higher risk assets, also performed ahead of our long term expectations.

And this is at the heart of why we invest. Achieving our long term strategic plans is far more important than being right (or wrong) about an individual investment decision along the way. Time and again in recent years we have been reminded that basing investment decisions on being able to accurately forecast an unknowable future has been fraught with difficulty. To us, this much more speculative approach seems to imply that being right occasionally is better than being right overall. We would contend that, for the vast majority of investors, this simply isn't true.

Note: Unless otherwise stated, all index returns are quoted on a home currency returns basis.

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Key market movements for the quarter

+4.69%

New Zealand shares

The local market produced another strong quarter, as many firms reported annual revenues above expectations. Leading performers included A2 Milk (+60.6%), and its supply partner Synlait (+56.4%), who both prospered handsomely following the announcement of successful registration of their infant milk formula with the China Food and Drug Administration. NZ Refining (+7.9%) largely shrugged off the impact of the severe damage to Auckland Airport's primary jet fuel line, while the airport itself fared less well, declining by -9.7%. *Source: S&P/NZX 50 Index, gross with imputation credits*

+1.17%

New Zealand fixed interest

The Reserve Bank of New Zealand maintained the Official Cash Rate at 1.75% through both its 10 August and 28 September meetings, and continued to signal a high threshold will be required (in future data) before even considering a potential change in interest rates. Yields were variable through the quarter but ended very close to where they started, and the spread between yields of securities with differing credit ratings was also relatively stable. Consequently, longer dated and lower rated bonds rewarded investors for both higher credit and term risk. *Source: S&P/NZX A Grade Corporate Bond Index*

+0.54%

New Zealand property

The domestic listed property sector exhibited variation among individual names and, overall, the broad asset class returned a small gain through the quarter, lagging the broad equity market. Precinct Properties NZ Ltd led the pack, gaining +4.9% as the firm's annual report showed a significant improvement in year on year profitability. Conversely, the largest firm in the index - Kiwi Property Group Ltd - posted a -4.3% loss following the announcement that their CEO of the last ten years will step down in 2018. *Source: S&P/NZX All Real Estate Index, gross with imputation credits*

+4.24%

Australian shares

The Australian share market posted a gain for the quarter, up +0.68% in Australian dollar terms. Small capitalisation companies fared better than larger firms, with the S&P/ASX Small Ordinaries advancing +4.41% versus just +0.41% from the S&P/ASX 100 (both returns in Australian dollars). Returns to unhedged New Zealand investors were further enhanced by a relatively strong Australian dollar. Leading sectors included energy and materials companies, as commodity prices advanced globally with an expectation of industrial demand returning, especially from China. Telstra (-10.6%) again struggled, hitting a five year low amid concerns the firm will have trouble adapting to a rapidly changing industry. *Source: S&P/ASX 200 Index (total return)*

+4.29% (hedged to NZD)

+6.41% (unhedged)

International shares

Developed markets equities delivered generally positive returns as macroeconomic data, in particular, low inflation and continued growth, remains in a 'goldilocks' zone (not too hot, not too cold). The US market shrugged off geopolitical uncertainty, hurricanes and the ongoing failure of the Trump administration to fulfil any meaningful policy promises, to continue to set new highs. Europe and Japan both advanced on robust economic data and neither central bank made any explicit changes to their current accommodative monetary policy settings. The European Central Bank's quantitative easing programme is only confirmed (at this stage) until the end of the year. *Source: MSCI World ex-Australia Index (net div.)*

+9.71%

Emerging markets shares

Emerging markets outperformed developed markets, as steady global growth helped drive expectations that exporting nations will prosper. Brazil benefited the most as reduced political uncertainty helped stock prices record new highs. Fellow commodity producing economies such as Russia, Chile and Peru also posted strong returns. Conversely, Greek banks dragged their index into the negatives. *Source: MSCI Emerging Markets Index (gross div.)*

+0.60%

International fixed interest

Within the quarter international fixed interest markets exhibited some variability, due in part to the tensions on the Korean peninsula. However, the steady flow of broadly positive economic data meant most yield curves were little changed overall. Most central banks are looking to slowly taper back their respective monetary stimuli, and, with no surprises, there was no catalyst for any significant change in yields. The UK was one exception, and yields there did move higher amid open discussions of rate rises by their central bank, and an increase in inflation. *Source: Citigroup World Government Bond Index 1-5 Years (hedged to NZD)*

+2.95%

International property

Investments into the international property sector made ground through the quarter, although returns were lower than those delivered by the broad equity market. The S&P Developed REIT Index returned +1.47% in US dollar terms. The Australian listed property sector was also up, with the S&P/ASX 300 A-REIT Total Return Index advancing +1.94% in Australian dollar terms. A relatively strong US dollar further enhanced reported returns to New Zealand investors holding unhedged investments in this asset class. *Source: S&P Developed REIT Index (total return)*

All returns are expressed in NZD. It is assumed that Australian shares, emerging markets 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.

Why women make better investors

When it comes to industries, the investment industry is one of the more male dominated around. Because of this, many people just assume that men are better investors.

They would be wrong.

According to data from US financial services giant Fidelity Investments, women are actually superior investors. At least, that's what US data appears to show.

In sifting through more than 8 million US investment accounts, Fidelity discovered that women not only save more than men (approximately 0.4% more per annum on average), but their investments also earn an average of 0.4% more per year.

Those differences may seem too small to matter, but, extrapolated over a lifetime of saving and investing, the disparity at retirement age is anything but minor.

For a 22 year old starting out with a salary of $40,000 a year, a female investor that both saved more and achieved a higher investment return would see her eventual retirement savings significantly outstrip her 22 year old male counterpart.

What is it, exactly, that makes women better investors?

According to Fidelity, there are three main factors:

1. **Planning with purpose** - women tend to think much more holistically about their investments, and build their financial plans around life goals rather than trying to beat the market.
2. **Taking less risk** - in this context, taking less risk means generally managing risks better. For example, women tend to make fewer overtly risky bets, such as putting all of their money in a handful of shares, which would be prone to suffering larger price swings and bigger losses in turbulent markets. Consistent with taking less risk, women are also more likely to pick investments that are appropriate for their age and time horizon.
3. **Patience** - women generally place fewer trades and are much more diligent at carrying out a long term, buy and hold strategy. Men are 35% more likely to make trades than women, and that extra trading is costly.

Men can also be prone to becoming overconfident that they understand with great precision the value of a share, and this confidence encourages them to trade more.

Unfortunately, many men regard their share investments as a sport that comes with bragging rights, and that is what ends up getting them into trouble. Sometimes their trades will be right, and other times, they will be wrong, but they'll always pay the costs of trading, and that impacts performance over time.

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The data in New Zealand is less revealing. That's not because the attributes of female investors in New Zealand are necessarily any different, but, absent a New Zealand version of the Fidelity study, it's very hard to isolate trends in the limited New Zealand savings data available.

While the average KiwiSaver balances of New Zealand females are lower than males, this may have more to do with gender pay inequality than being the result of different savings and investment habits.

Overall, women - at least in the Fidelity study - tend to be more successful investors than men because they do the simple things better. Women have long term goals, and they are better at sticking to their plan. They focus on saving and investing for retirement or a university fund, and are less likely to adopt high turnover strategies attempting to outsmart the market.

However, while women tend to be better savers, they also tend to be more concerned about the risks inherent in the share market. In general, women lack a degree of confidence about investing, despite a growing body of evidence that they may be naturally better at it.

Another inescapable statistic is that around 90% of women, at some point in their lives, are also likely to be the sole decision maker in financial matters, due to divorce, death or other circumstances. In that event, having naturally good investment habits will be particularly valuable.

We think the biggest takeout from the Fidelity study is that these observed behavioural differences between men and women can, over time, lead to different investment outcomes. And, as the study found, those behavioural differences tended to result in better average investment performance by women over men.

That resonates with us. Not because we necessarily agree that women are superior investors, but because our investment philosophy and our carefully crafted investment strategies are based on some of the same favourable investment attributes referred to above (managing risk well, patient trading, etc).

However, in addition to these, we also incorporate significant academic evidence into our portfolio construction, and we focus on smart diversification and cost minimisation. When delivered within a well managed portfolio, these attributes provide additional benefits to all investors.

The end result, and the really good news for readers of this article, is that anyone (male or female) can adopt our investment strategies to become a significantly more effective investor.