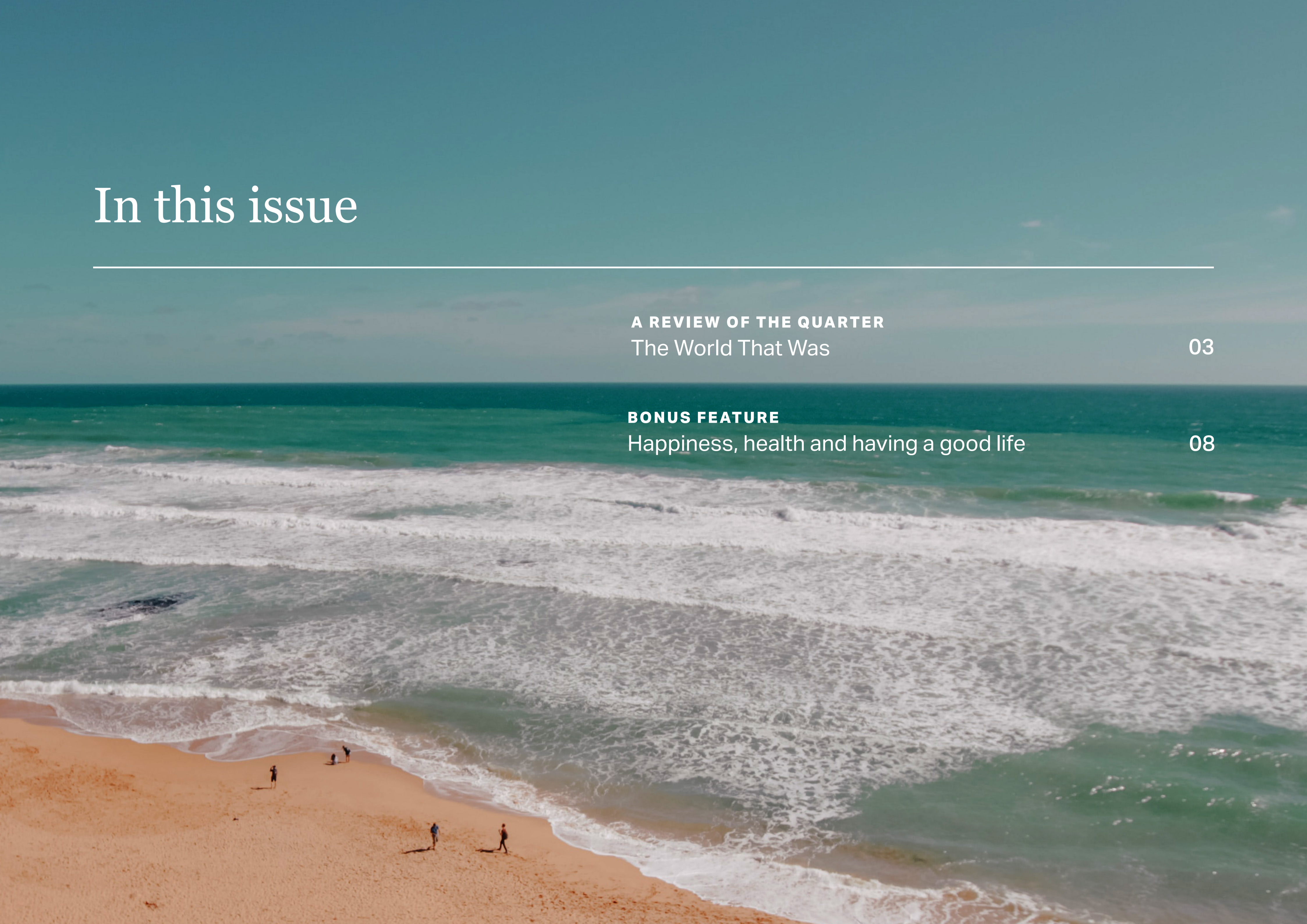
RUTHERFORD REDE

Insights

Summer 2020



In this issue

THE WORLD THAT WAS

Key themes of the period

December 2019

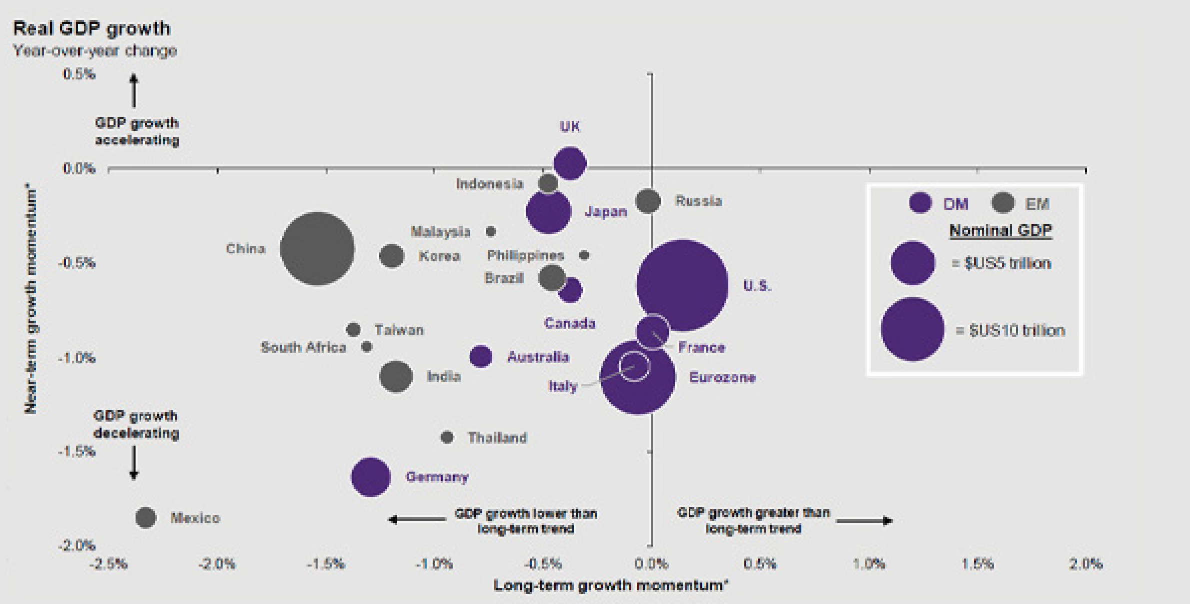
- 2019 was an exceptional year for asset returns.
- International shares had a strong quarter, particularly in Emerging Markets.
- New Zealand equities also continued their dream run.
- Interest rates are tracking lower with no inflationary pressures.
- US/China trade conflicts gradually settling

2019 ended strongly for most asset classes

What a difference a year makes! At the beginning of 2019 equity markets were treading water following a 15% decline over the end of 2018. Our view at the time was that markets were over-pricing economic recession risks, and the best course of action was to remain fully invested. We did not, however, expect that the year would close with equity, property and infrastructure returns of 25% or more in many markets!

Over the year economic growth and corporate earnings did in fact materially weaken as the trade war took hold **(figure 1)**, but what is key for markets is how this compared to what was expected. Much of the bad news in 2019 was concentrated in business confidence surveys and global manufacturing and trade. The fear was that this would spill-over into the rest of the economy, in particular denting the services sector, employment, and household spending in key economies such as the US, the Euro Area and China.

FIGURE 1: AS ECONOMIC GROWTH FALTERED



Source: JP Morgan Economic Research, IMF

But to a large extent this didn't happen. The services sector remained robust, and unemployment rates have remained exceptionally low in New Zealand, the US, the UK and most other OECD nations. As such, household spending and investor confidence remained high.

Instead, what clearly did happen in 2019 was a reversal by central banks - from tightening to easing interest rates and monetary conditions **(figure 2)**. This was likely by far the single most important reason why asset class performances, across bonds (defensive assets) and equities (growth assets), were so strong in 2019. More than 15 global central banks cut interest rates in 2019, including the RBNZ cutting the OCR to a record low of 1%. In addition to this support, fiscal spending ramped up in some countries, most notably in China.

Turning to the quarterly market results, international shares rose around 1% in the December quarter in NZD terms, but returns were much stronger in NZD hedged terms at around 7.5% given the strong performance of our currency. It increased from around 63c to 68c versus the USD as markets backed off from the view that NZ rates were on course to join the zero rate club (discussed further below).

Over 2019, NZD currency impacts on returns have evened out, with both hedged and unhedged international equity returns at around 27%. Within global equities, small caps returned around 25% for 2019, while value stocks returned 'only' 21%.

International shares had a good quarter.

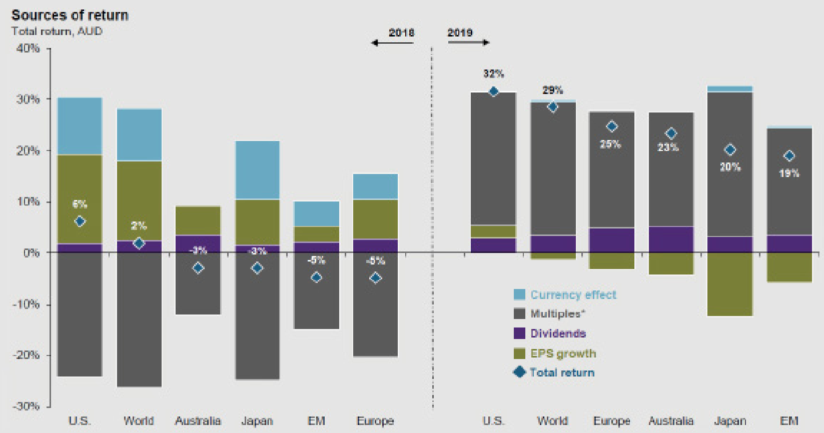
Emerging markets had a strong quarter, returning 4% (in NZD terms) as the trade war between China and the US finally showed signs of resolution (or at least a pathway to this). This brought the 2019 annual return to around 18%,

FIGURE 2: CENTRAL BANKS CUT RATES

Note: Central banks/countries considered are ECB, Fed, BoE, Australia, Canada, Chile, Denmark, Hungary, Iceland, Israel, Japan, South Korea, Mexico, New Zealand, Norway, Poland, Sweden, Switzerland, and Turkey.

Source: Central Banks, DB Global Research

FIGURE 3: BOOSTING EQUITY RETURNS VIA MULTIPLE EXPANSIONS



Source: JP Morgan Asset Management

a good result but weaker than developed markets given emerging markets have felt the brunt of the trade war.

New Zealand equities also continued its dream run.

Trans-Tasman equity markets fared better. Australian shares returned around 23% for the 2019 year, and last but by no means least, the New Zealand market returned around 32%. This very strong performance for our market boosted the return for the decade to around 15% per annum - implying an exceptionally strong 400% total return over the decade.

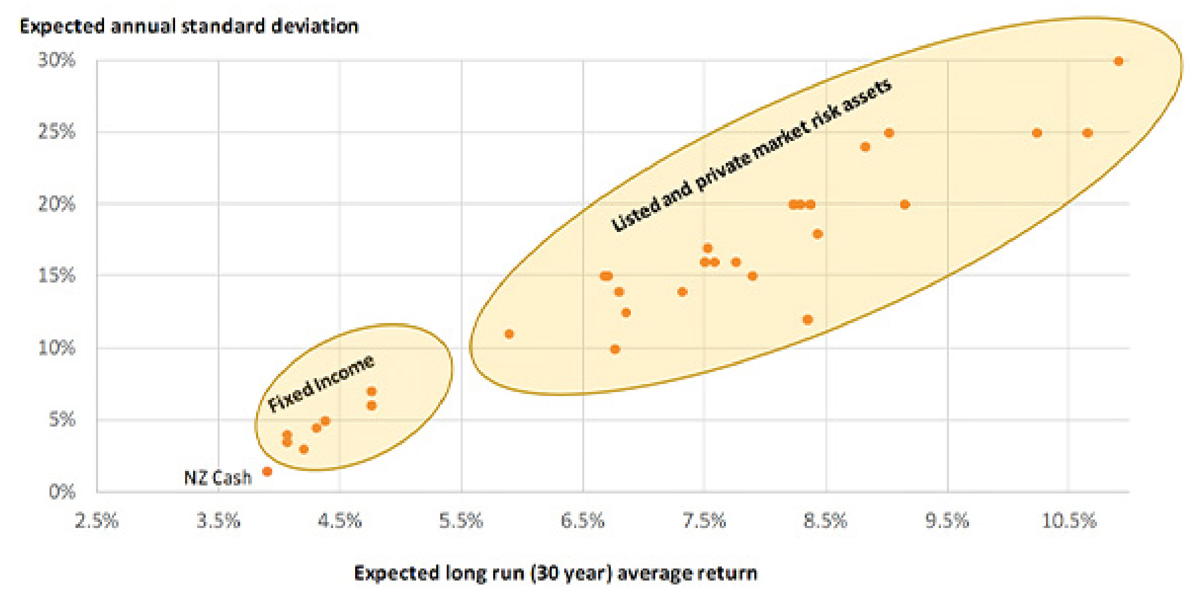
Global investment grade bonds returned around -0.5% in the quarter and 7.5% for the year. The annual return is a very strong outcome given the low running yields on bonds, and reflected bonds being re-priced higher over 2019 as longer-term interest rates fell on the back of central banks easing discussed above. However, markets backed slightly off the view that rates need to be lower for longer in the December quarter, as the global growth picture moderately improved. This change of view to a stronger (less negative) outlook was even more the case in New Zealand, where markets backed off the view that rates were headed to zero. As such, investment grade bonds returned -2.3% for the quarter and 5% for the 2019 year (Corporate bond returns were stronger at 5.5%).

Rounding out the return picture for 2019, infrastructure and property stocks have also had a banner year - benefitting both from the lower interest rate settings, and the general bounce in equity markets from the low point at the beginning of 2019. International property stocks returned around 22% in 2019, while Aussie REITs were a touch weaker at around 19%. In contrast, NZ property stocks were very strong returning around 31% for the year. Finally, global listed infrastructure stocks returned around 25% in 2019.

2020 vision - economies will likely muddle through, markets are more vulnerable.

We continue to expect that economies will muddle through given exceptionally supportive monetary conditions, easing trade frictions, and the fact that there remains a

FIGURE 4: BUT THE LONGER RUN REWARD FOR BEARING RISK REMAINS INTACT



Source: MyFiduciary capital market assumptions as at December 2019 lot of in-built momentum in the global growth picture. This is because there is a structurally higher rate of growth in emerging markets, while the services sector (comprising around 70% of GDP in the OECD) remains resilient in developed markets.

Steady growth in the global economy is expected.

The OECD's latest forecasts are that global growth will bobble around 3% over 2021 and 2022. This is weaker than the 3.5% average growth rate that had been experienced since the bounce from the GFC, but it is by no means alarmingly weaker. In addition, they (along with other forecasters) expect emerging market growth to remain much stronger at 4% or more. Global growth can hence remain positive even if most developed economies slow mildly given the EM growth contribution.

We remain more positive about New Zealand's growth prospects. Along with very low (in our view too low) interest rates, our economy will face a significant fiscal boost over coming years as the Government (finally) ramps up infrastructure spending. In addition to this, we continue to enjoy high commodity prices and commercial construction activity, and strong net migration levels. The last quarterly GDP release for the September quarter was 0.7%, stronger than the RBNZ and most bank forecasters expected. As a consequence, expectations of further rate cuts have been pulled back.

Markets may pull back given their strong run...

Even if economies muddle through as we expect, and downside risks do not materialise, (e.g. from a re-start of the Trade War, or the new risk of war between the US and Iran) it is important to recognise that market volatility can still resurface. With the exceptionally strong 2019 year, many equity markets have become more over-valued and this itself may cause a correction at some point **(figure 3)**. In addition, should global growth prospects pick-up, we could paradoxically see a sell-off in risk assets as interest rate expectations rise again.

But we still expect long run returns to earn a premium.

That said, we can't forecast such sell-off events and our longer term expected asset class returns still suggest the reward for bearing risk remains intact **(figure 4)**, in line with most institutional asset managers and investors. We are also mindful that any correction is likely to be short-lived in an environment where rates are low, and there is ample liquidity sitting on the side-lines waiting for any such event to occur.

HOW THE MARKETS FARED

All returns are expressed in NZD. We assume Australian shares and international property are invested on an unhedged basis, and therefore returns from these sectors are susceptible to movement in the value of the NZD.

QTRLY RETURN	PAST YEAR	ASSET CLASS
+5.3	+ 31.6%	**New Zealand Shares:** New Zealand shares returned 5.3% in the quarter and 31.6% over calendar 2019. This is an exceptional performance for our market, which also helped boost the return for the past 10 years to almost 15% per annum – a 400% return for the decade. Source of Figures: S&P/NZX 50 Total Return Index With Imputation Credits
-1.2%	+5.2%	**New Zealand Fixed Interest:** New Zealand investment grade corporate bonds returned -1.2% for the quarter and around 5.2% for the year. This return is both comfortably higher than 90-day NZ bank bill and term deposit rates, indicating that NZ corporate bonds delivered a good premium over the year. Source of Figures: S&P/NZX A Grade Corporate Bond Index
-2.4%	+22.8%	**Australian Shares:** Australian shares returned -2.4% in the quarter in NZD terms, which reflected our currency strengthening (in Aussie dollar terms the return was around 0.7%). The annual return was still very strong at around 23% in NZD terms. Within Australian equities, small cap stocks performed in line over the quarter and year, while value stocks have had a weaker performance, returning around 19% in 2019. Source of Figures: S&P/ASX 300, S&P Australia BMI Value, S&P/ASX Small Ordinaries
+0.9% (+7.5% hedged)	+26.9% (+26.8% hedged)	**International Shares:** International shares rose around 1% in the quarter in NZD terms, whilst NZD hedged shares rose around 7.5% given the strong performance of our currency. Over 2019 the currency impacts have evened out, with both hedged and unhedged returns at around 27%. Within global equities, small caps returned around 25.5% for 2019 while value stocks returned 'only' 21%.Source of Figures: MSCI World Index; Morningstar Deveeloped Markets NZD hedged, MSCI World Value, MSCI World Small Cap.
+4.0%	+17.7%	**Emerging Markets:** Emerging Market equities increased 4% in the quarter as the trade war between China and the US finally showed signs of resolution. This brought the annual return to around 18%, a still weaker peformance than developed markets given that the trade war has had a more negative impact on emerging markets. Source of Figures: MSCI Emerging Markets Index
-0.6%	+7.5%	**International Fixed Interest:** Global bonds returned -0.6% in the quarter and 7.5% for the year. The annual return remains a very strong outcome for bonds given their low income yields, and reflected bonds being re-priced higher over 2019 as longer-term interest rates fell on the back of mounting global growth concerns. This reversed course slightly in the December quarter as the growth picture moderately improved. Source of Figures: Bloomberg Barclays Global Aggregate Index (hedged to NZD)
+0.7%	+21.5%	**International Property:** International property stocks increased by around 0.7% in the quarter and 21.5% over the year. This asset class has benefited over the year both from the lower interest rate settings, and the general bounce in equity markets from the low point at the beginning of 2019. International Infratructure also had a good year, returning around 25% in 2019. Source of Figures: FTSE EPRA NAREIT (NZD hedged), S&P REIT indexes

HAPPINESS, HEALTH AND HAVING A GOOD LIFE!

If you are like most people, you want to be happy and feel satisfied with your life. The search for happiness is universal. We plan holidays, seek partners, buy the latest gadgets, purchase cars and houses, and obtain tickets to the most coveted shows or sporting events, all with the hope that these choices will make us happy.

This year, you may have made a variety of New Year's resolutions to improve your mind, your finances, or your health. Despite these noble intentions, many people lose focus on their goals, and the promises made on the first day of the year soon forgotten. The reality is that you don't need to make a resolution to improve your life. There are many simple changes you can make at any time. And to be happy and healthy doesn't require a lot of money or time – just a little desire and motivation!

What makes us happy?

In his article *The World Happiness Report and the science of personal happiness'*, Money and Consumer Affairs Reporter, Rob Stock says there is no hard and fast set of rules on how to be happy but if there were, a good one to include would be to live in New Zealand.

The World Happiness Report provides an insight into the science of what makes people happy. According to the Report, we are in the World top 10 of happiest countries, beaten only by the Scandinavian five (Sweden, Norway, Denmark, Finland and Iceland), Canada, the Netherlands and Switzerland.

Some of the key findings to come out of the Report clearly show there are things that make us happier, and things that detract from our happiness:

1. **Having money is good for happiness and reduces stress levels.** Money brings choices and best of all it allows people to buy time and experiences, which are better than things. Money isn't only of value for itself.
2. **Social connection and warm, intimate relationships** are the most important prologue to a good life.
3. **Health** is one of the most influential predictors of happiness. In April 2019, the Journal of Happiness Studies did a literature study of research into the link between exercise and happiness. It concluded that all observational studies reported positive associations between physical activity and happiness. As little as 10 minutes of physical activity per day or 1 hour of exercise per week might result in increased levels of happiness.
4. **Freedom is an important factor.** The Applied Research into Quality of Life agrees that the freedom to be master, or mistress of your own destiny is happiness-inducing. Once you have enough money to make basic choices, political freedom becomes important to happiness.
5. **Giving makes people happy.** It is an expression of support. Or as the authors of the World Happiness Report put it: 'It [generosity] is clearly a marker for a sense of positive community engagement, and a central way that humans connect with each other.' Summer Allen from the Greater Good Science Centre at the University of California, Berkeley, says 'some studies have found that people are happier when spending money on others than on themselves, and this happiness motivates them to be generous in the future.'
6. **An absence of violence**, no restrictions on the ability to live your culture or sexuality, access to nature and reasonable commutes are also all predictors of happiness in humans.

Can being happy make you healthier?

'Happiness is the meaning and the purpose of life, the whole aim and end of human existence.'[4]

The ancient Greek philosopher Aristotle said these words more than 2,000 years ago, and they still ring true today. Scientific evidence suggests that being happy may have major benefits for our health.

Being happy may:

1. **Promote a healthy lifestyle.** It may also help combat stress, boost your immune system, protect your heart and reduce pain. What's more, being happier may also improve sleep habits and practices, which is important for concentration, productivity, exercise performance and maintaining a healthy weight.
2. **Help keep your immune system strong.** This may help reduce the risk of developing colds and chest infections. And while the effects of happiness on the immune system are not completely understood, research suggests happy people are more likely to take part in health-promoting behaviours that play a role in keeping the immune system strong. These include health eating habits and regular physical activity.
3. **Help reduce stress levels.** Normally, excess stress causes an increase in levels of cortisol, a hormone that contributes to many of the harmful effects of stress, including interrupted sleep, weight gain, type 2 diabetes and high blood pressure. Studies demonstrate that cortisol levels tend to be lower when people are happier.
4. **Protect your heart** by lowering blood pressure, which may decrease the risk of heart disease. However, further high-quality, well-designed research is needed in this area.
5. **Improve physical functioning in people with arthritis.** Happiness may also help reduce pain in other conditions. Researchers have suggested that happy people have lower pain ratings because their positive emotions help broaden their perspective, encouraging new thoughts and ideas. They believe this may help build effective coping strategies that reduce their perception of pain.

Bringing it all together

Emerging research shows there are a number of ways to increase your happiness, and that being happy may have major benefits for your health.

For starters, getting active, expressing gratitude, and eating well are all ways to help improve your mood. Being happy promotes a healthy lifestyle. It may also combat stress, boost your immune system, protect your health, and reduce pain.

While further research may be required to understand how these effects actually work, there's no reason why you can't start prioritising your happiness now. Focusing on the things that make you happy will not only improve your life – according to the research, it may help extend it too!

1. https://www.stuff.co.nz/business/113898613/the-world-happiness-report-and-the-science-of-personal-happiness
2. https://www.healthline.com/nutrition/happiness-and-health

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