



RUTHERFORD REDE

# Insights

Autumn 2021



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## REMINDER

Under NZ tax law all trusts have an obligation to declare any beneficiary that received a distribution during the year.

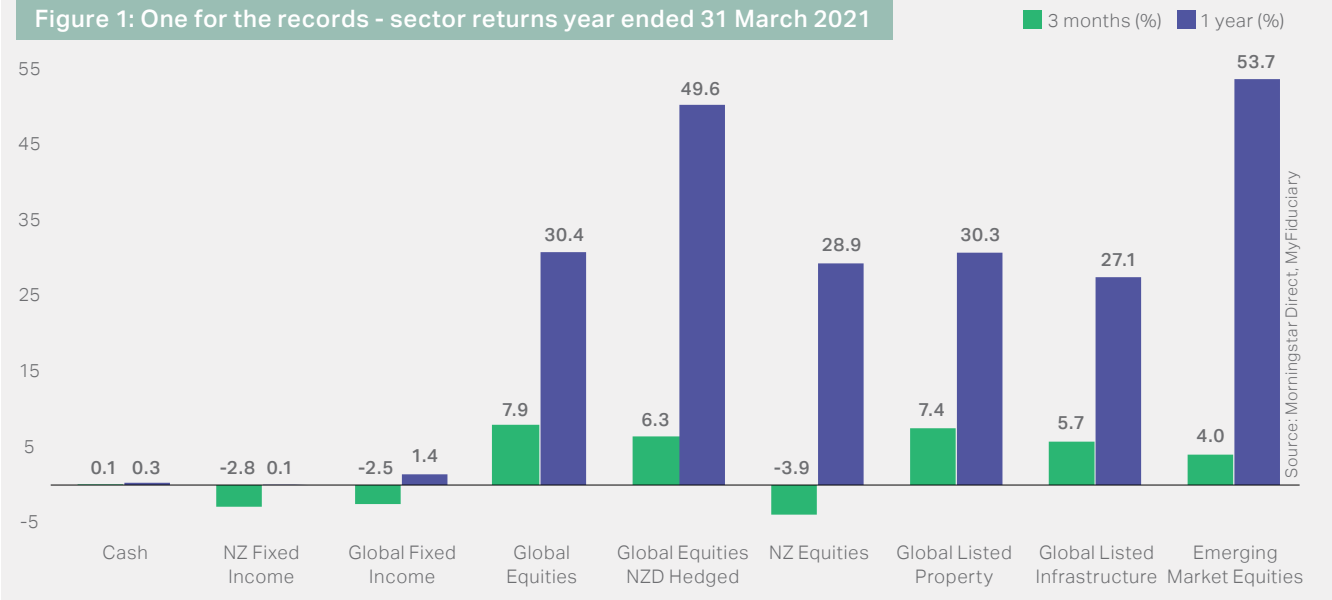
If you have a trust and it distributed to anyone other than the main beneficiaries (usually Mum and Dad) then give us a call to talk through any obligations you may have. The most common occurrence of this would be distributing to one of the children identified as beneficiaries.

# THE WORLD THAT WAS

## One for the record books

The end of March 2021 marks roughly a year from when Covid-19 became a global pandemic. The pandemic is still raging in many parts of the globe, and sectors such as tourism remain in the doldrums. Anyone presented with this picture a year ago would have been accused of having rocks in their head if they had predicted equity markets to rally 50%. But that is what has transpired, with the broad MSCI World Index up over 50% in the year. The three broad lessons (or reminders) to take from this are:

Figure 1: One for the records - sector returns year ended 31 March 2021



1. No one has a crystal ball. A large part of the reason markets are higher today is because economic conditions and earnings were not hit anywhere near as hard as feared. In New Zealand, the Treasury predicted GDP would shrink over 10% in 2020. It instead fell around 2%. Businesses proved much more resilient to coping with the 'shock', and the massive fiscal and monetary policy support measures put in place also played a key role in propping up demand and employment.
2. Markets are forward-looking. The very large decline in February 2020 reflected uncertainty around how the pandemic would impact growth and earnings. Markets rallied from around April 2020 as it became clearer that the shock to economic conditions would not be as large as feared, as some sectors, such as health and tech, would thrive. More recently, as discussed below, value and cyclically sensitive stocks (including airlines!) have started to out-perform. Here markets are factoring in the fact that with vaccination programs well under-way (NZ and Australia excepted) in much of the industrialised world it won't be too long before we see earnings for affected corporates recover too.
3. It pays to be contrarian. Investors who took the opportunity to at least rebalance portfolios in response to last-years sell-off (by selling bonds to buy equities) experienced better returns than investors who sat on the fence, or worst of all, de-risked and effectively locked in losses. Unfortunately, KiwiSaver data suggests a significant number of people did the latter with their "long-term" savings plans.

## Our advice in March 2020 was:

*We don't know whether the lows reached in the 3rd week of March will prove to be the bottom, or if instead markets will suffer further large declines given the dire immediate economic situation. But we are confident that the long-term reward for bearing market risk remains intact, and that this 'shock', like other large shocks markets have faced, will pass. As such sticking with long-term investment strategies, and re-balancing through the volatility as necessary, remains the best course...*

We have also re-iterated over the past year that the reward for bearing risk – in general - remains intact. This hasn't changed, although with the large rally we have seen we do expect returns to lower going forward. We also see very little reward for bearing interest rate (long duration) risk, and have been positioning your portfolios to reduce their interest rate sensitivity.

## Market roundup

International shares rose around 8% in the quarter in NZD terms, whilst NZD hedged shares increased around 6.3%. These results were sufficient to propel global markets to new highs and report spectacular double digit returns for the year ended March 2021 (see figure 1) – although it should be noted that returns are flattered by the fact that we are comparing to near-Covid lows. A 25% decline in markets – which was around levels experienced in early 2020 - requires a 33% bounce just to get back to even. The strong performance was particularly the case for NZD hedged international equities (up around 50%), which benefited from the recovery of the NZ dollar as well as equity markets.

Within global equities, higher risk small and value stocks out-performed in the quarter, both returning around 11% in NZD terms. Emerging Market and Australian equities also performed well, increasing over 5% in NZD terms. In contrast, New Zealand shares fell around 4% in the quarter. That said, their returns were still very strong at around 29% for the year ended March 2021.

International property stocks rose by around 7.5% in the quarter and are up 30% over the year to March 2021. This brings the level to around 10% lower than was the case pre-Covid. International infrastructure has been more resilient, with returns broadly flat over the past year.

Fixed income had negative returns over the March quarter. New Zealand investment grade (IG) bonds fell around 2.8% in the quarter, with government bonds declining around 3.5% and corporate bonds 2%. International investment grade bonds also declined by around 2.5%. Over the year their returns were around 1.5%. These outcomes are the flip-side of what has happened with growth assets. The weak annual result in part reflects that the March 2021 outcomes are measured relative to the very strong returns bonds had in March 2020 as investors "fled to safety". The weak quarterly outturn reflects markets pricing in higher interest rates over the medium-term on the back of higher economic growth expectations.

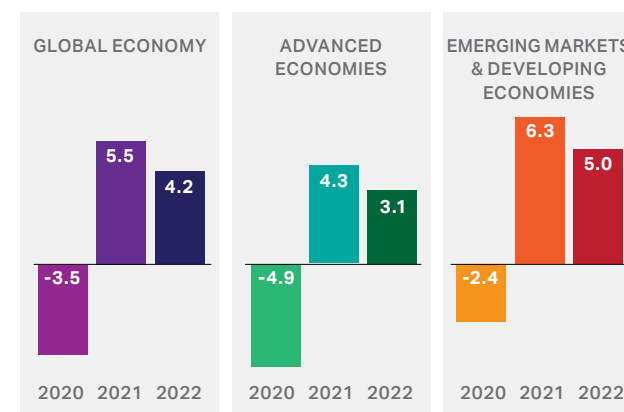
## Crystal Ball Gazing

Economic agencies, with appropriate caveats and hand-wringing around risks aside, are predicting exceptionally strong growth over the next few years as mass scale inoculations roll-out and life "gets back to normal". The IMF

estimates that global GDP fell 3.3% in 2020, but will expand 5.5% this year and 4.2% in 2022. US growth, which is being turbo-charged by high fiscal and infrastructure spending, is expected to increase 6.4%. Investment bank Goldman Sachs goes further, predicting US GDP growth to rise 8%. To put these numbers in perspective, if realised it would mark the strongest growth in generations, and at the global level the strongest growth since the recovery from World War III! Closer to home, the RBNZ predicts growth to be around 4% and the BNZ over 5%.

You could be forgiven for taking these numbers with a grain of salt. Economic agencies were far too pessimistic last year, and may prove too optimistic looking forward. On the other hand, forecast errors made by agencies usually show they are too conservative, particularly around recoveries. Time will tell.

Figure 2: IMF Predicts Strong Growth Ahead



Source: IMF World Economic Outlook, January 2021

# 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  
- 3.9%  
PAST YEAR  
+ 28.9%

**New Zealand Shares:** New Zealand shares fell around 4% in the quarter, a poor result compared to global markets. Despite the soft quarter, returns were still very strong for the year ended March 2021, at around 29%. Source of Figures: S&P/NZX 50 Total Return Index with Imputation Credits.



QTRLY RETURN  
- 2.0%  
PAST YEAR  
+ 2.1%

**New Zealand Fixed Interest:** New Zealand investment grade corporate bonds fell 2% in the quarter and returned around 2% for the year ended March 2021. The soft result reflected NZ and global markets starting to price in higher rates and inflation over the medium-term, which causes bonds to suffer a short-term capital loss. Source of Figures: S&P/NZX Investment Grade Corporate Bond Index.



QTRLY RETURN  
+ 5.7%  
PAST YEAR  
+ 46%

**Australian Shares:** Australian shares performed well over the March quarter, bringing the annual return to an extremely strong 46%. This annual result is, however, flattered by the fact it is measured against the lows shares suffered in the Covid-19 sell-off over February and March 2020, a theme we also see in the other markets as reported below. S&P/ASX 300, S&P Australia BMI Value, S&P/ASX Small Ordinaries.



QTRLY RETURN  
+ 7.9%  
(6.3% hedged)  
PAST YEAR  
+ 30.4%  
(49.6% hedged)

**International Shares:** International shares rose around 8% in the quarter in NZD terms, whilst NZD hedged shares increased around 6.3%. Annual results were exceptionally strong reflecting the bounce from the Covid-lows, 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 outperformed, both returning around 11% over the quarter in NZD terms. MSCI World Index; Morningstar Developed Markets NZD hedged, MSCI World Value.



QTRLY RETURN  
+ 5.2%  
PAST YEAR  
+ 34.0%

**Emerging Markets:** Emerging Market equities rose around 5% in the quarter in NZD terms, bringing the annual return to over 34%. Returns were even stronger in local currency terms at around 53% for the year, with the difference reflecting NZ dollar appreciation versus EM currencies. Source of Figures: MSCI Emerging Markets Index.



QTRLY RETURN  
- 2.5%  
PAST YEAR  
+ 1.4%

**International Fixed Interest:** Global bonds fell around 2.5% in the quarter and returned around 1.4% for the year. As with the NZ result this 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).



QTRLY RETURN  
+ 7.4%  
PAST YEAR  
+ 30.3%

**International Property and Infrastructure:** International property stocks rose by around 7.5% in the quarter and closed up 30% for the year. This is perhaps still a remarkable result given this asset class has been hit hard by Covid-19. International infrastructure had a similar annual return. Source of Figures: FTSE EPRA NAREIT NZD Hedged.

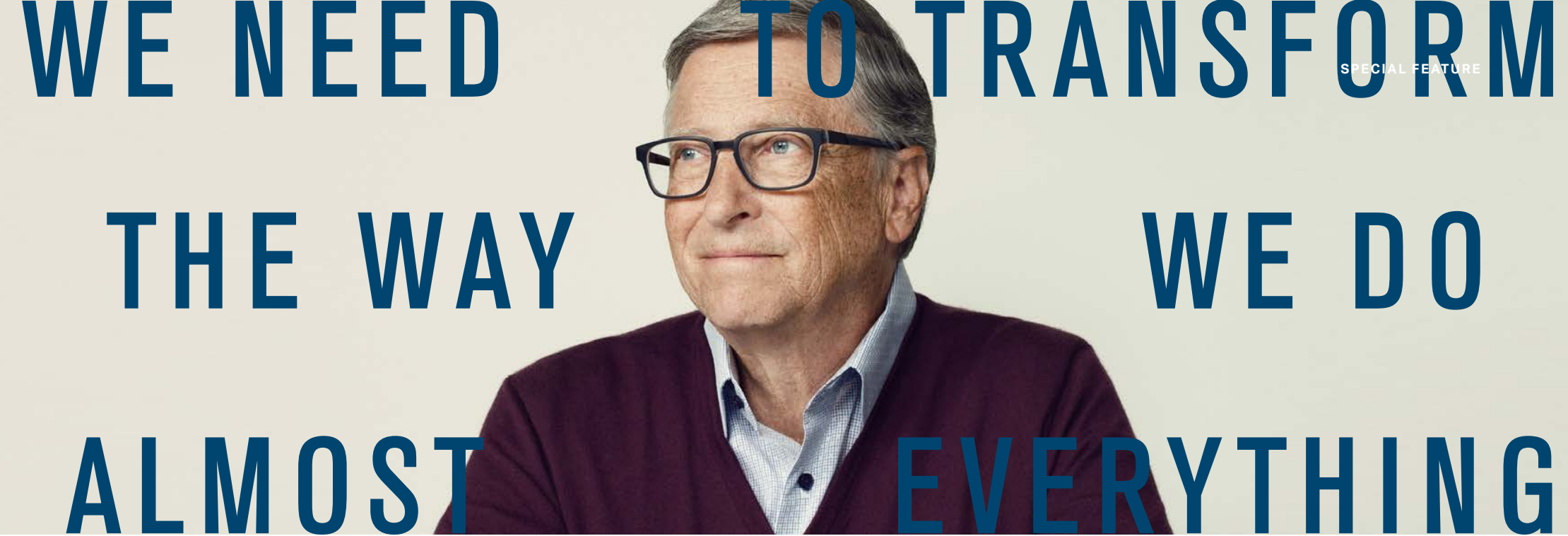


A Book Review

# HOW TO AVOID A CLIMATE DISASTER

By Bill Gates

This time last year we were in lockdown. At that time you might have viewed a TED talk given by Bill Gates in March 2015 warning of the threat of a pandemic and recommending steps to mitigate its risk. We know now that almost nothing was done to prepare and consequently the pandemic was much more severe than it needed to be. Bill Gates works full time with the Gates Foundation, using his billions to improve life on the planet. His involvement is very direct, consequently he gets to see first-hand the challenges for third world countries. It was this experience that informed him of the threat of a pandemic.



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Like pandemics, climate change is something that impacts third world countries disproportionately. This perspective has led Bill to conclude action is required, action that is well considered and focused on the biggest problems. It is with

this goal in mind that he has written "How to Avoid a Climate Disaster".

We highly recommend you read this book. It leads to some different perceptions as to the largest causes of climate change and provides a comprehensive view of the problem, its causes, possible solutions and things we must do in the future.

This review is intended to provide a summary only. The data has been taken directly from the book where it has been referenced. This is not about despair and inevitability. This is about a problem, some solutions we have and those we have yet to develop. And most of all faith that mankind will innovate to create the solutions we need.

## The case for zero carbon.

Each year we send into the atmosphere 51b tons of carbon. This has been growing exponentially since the 1970's and unchecked will continue even faster as developing countries become more mechanised. This is a problem because carbon in the atmosphere causes a greenhouse effect. That is, heat can pass through the carbon layer but most of it cannot pass back out - the heat is trapped. Carbon stays around for thousands of years, so unless we capture the carbon it will be there for a very long time.

Because of this greenhouse effect our planet will warm up. Small changes in temperature matter a lot - the ice age was

only 6 degrees colder than today! A rise from 1.5 degrees to 2 degrees is not a 33% change in terms of impact - it is a 100% change. Our aim is to limit the increase to 2 degrees by 2050. That amount of climate change is not trivial, but it is deemed possible. It could easily be worse and without significant action it will be.

The case for zero carbon is that because the carbon stays in the atmosphere for thousands of years even little bits contribute to climate change, it all accumulates. Unless we get to zero, continuing global warming is inevitable and will eventually create an environment where mankind cannot survive.

### Where does this carbon come from?

Making things (Cement, Steel, plastic)	<b>31%</b>
Plugging in (Generating electricity)	<b>27%</b>
Growing things	<b>19%</b>
Getting around (planes, trucks, ships)	<b>16%</b>
Keeping warm and cool	<b>7%</b>

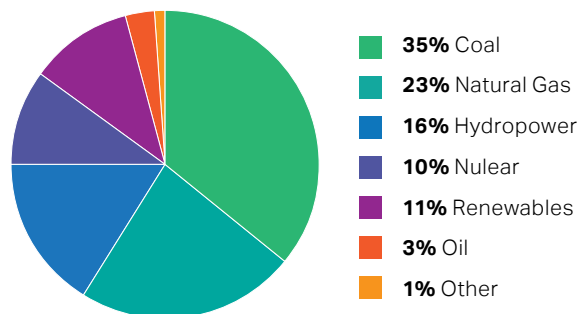


## Electricity is the key (27% of emissions)

Not only is the generation of electricity a big part of the problem, it is also a bit part of the solution.

### This how electricity is generated worldwide:

#### Sources of World's Electricity



Nearly 60% of the world's electricity is generated by coal and natural gas. The need for electricity is likely to double or even triple by 2050. Here are some of the challenges:

1. Hydro expansion is limited and creating lakes does emit carbon.
2. Solar and wind generation is intermittent and may not be close to where the electricity is needed. Storage in large quantities is not yet possible.
3. 1/3 of the cost of electricity is transmission.

4. By 2050 the US will need more than three times their current electricity supply. Developing countries will require multiples of this.

These sources of energy are examined as possibilities for providing renewable, clean carbon energy on the scale required:

1. **Nuclear fission.** The process of splitting atoms apart. It can be generated close to where it is needed and is continuous. Its problems are well documented, but all of these problems have been solved in a lab environment. France already generates 70% of its electricity from nuclear fission. Almost certainly this will be a big part of the solution.
2. **Nuclear fusion.** Instead of splitting atoms it joins them together or fuses them. It is still at least 10 years away. It is much safer than nuclear fission and its raw material could be seawater. However it requires enormous amounts of energy as its process heats to 50 million degrees.
3. **Offshore wind turbines.** Off shore wind is more constant and most cities are located near the coast. The US could satisfy all its needs from this source. The challenge is the bureaucratic processes involved.
4. **Geothermal.** The process of digging a bore down to hot rocks beneath the earth's surface and putting water down to create steam. The energy generated is not high and this process could be expensive.



## What about storing electricity?

1. **Batteries.** Current lithium batteries are at a stage where improvement is becoming more difficult. Hopefully development may be able to create better or different batteries, but this requires research.
2. **Pumped Hydro.** Using surplus wind to pump water up a hill into a reserve to be used later. This requires a hill and a reservoir, preferably close to where the electricity is required. It really has not gained any momentum because these things are not easy to find.
3. **Thermal storage.** Capturing heat when it is surplus and releasing it later. This has possibilities but will need further research.
4. **Cheap hydrogen.** This could displace the need to store energy either by storing hydrogen or creating a fuel cell battery that produces energy from the reaction between hydrogen and oxygen. There are challenges; it is not easy to produce hydrogen without producing carbon, hydrogen is lightweight therefore needs to be stored under pressure and then can leak through the cylinders, and the process also requires expensive electrolyzers.

Bill sees electrifying as being key to solving the crisis. Many of the solutions to other problems is through electricity, therefore being able to produce electricity without producing carbon is critical. Not all of these ideas will need to happen, as collectively they can do more than is required

to solve the problem. There will be winners and losers but the candidate list needs to be wide.

But what of the other two largest generators of carbon?

## Making things. (31% of emissions)

The two largest generators of carbon are cement and steel manufacture. Not only do they require a lot of energy to create, but carbon is also released as a by-product of the manufacturing process. Even if renewable energy can be used to manufacture these products there is still the problem of carbon being a by-product. Carbon can be captured more easily through technology, sucking it out at its point of origin rather than generally through the atmosphere, and while technically possible it is still very expensive. Innovation is required to change the way these products are made, especially as demand for cement and steel is growing and will continue to do so as countries like China and India mechanise and urbanise.

## Growing things (19% of emissions)

If we reach 10b people on earth by 2100 we will need 40% more food. And as we grow richer we eat a higher protein diet, so the need is even greater. Consider this:

To get a calorie of chicken meat you need to feed 2 calories of grain.

To get a calorie of pork you need to feed 3 calories of grain.

To get a calorie of beef you need to feed 6 calories of grain.

Not only will more land be required but ruminants (e.g. cows) belch methane as well as poop giving off gas. All this adds to the problem. Methane generates much more greenhouse gas impact than carbon but does not stay around in the atmosphere for as long.

In addition, the process of producing and transporting fertilizer produces carbon. This fertilizer is integral to our agricultural systems.

And what about waste? In the US 40% of food is thrown away, in Europe and parts of Asia it is 20%. An obvious strategy for combating climate change is to create less waste.

70% of the carbon from growing things comes from animals and producing fertilizer and the remaining 30% comes from the process of deforestation.

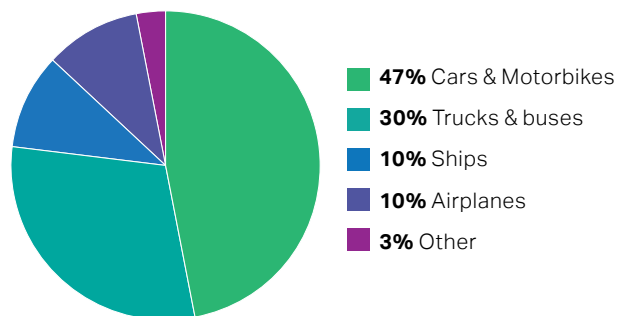
A tree over 40 years will capture 4 tons of carbon, but it does depend on where it is growing. Trees in the tropics produce so much more than in very cold areas. The average American would need to plant 20 hectares of trees to be carbon neutral. 50% of the earth's surface would need to be in trees for this to be the answer alone.

So the solutions will lie in sustainable agricultural

techniques, eating less meat, creating less waste and preserving and growing forests.

## How we get around. (16% of emissions)

### Source Transport Related Emissions



Petrol is cheap and very efficient at generating energy. There is nothing that matches it. Bill describes something called a green premium that is the difference between the cost of petrol, diesel or avgas and a green equivalent. While there is no charge for emitting carbon the cost advantage for fossil fuels will persist.

It is expected that all cars eventually will be powered by electricity. Electricity can work for cars but not other transport such as trucks and planes. Larger vehicles require more and lasting power that batteries simply cannot deliver, and increasing batteries would dramatically add to the weight of the vehicle.

There are two types of alternative fuels:

#### 1. Second generation bio fuels made from waste.

These substitute the need to grow crops for fuel (competing with food production) and are developing but are not there yet. They are around two times the cost of conventional fuels.

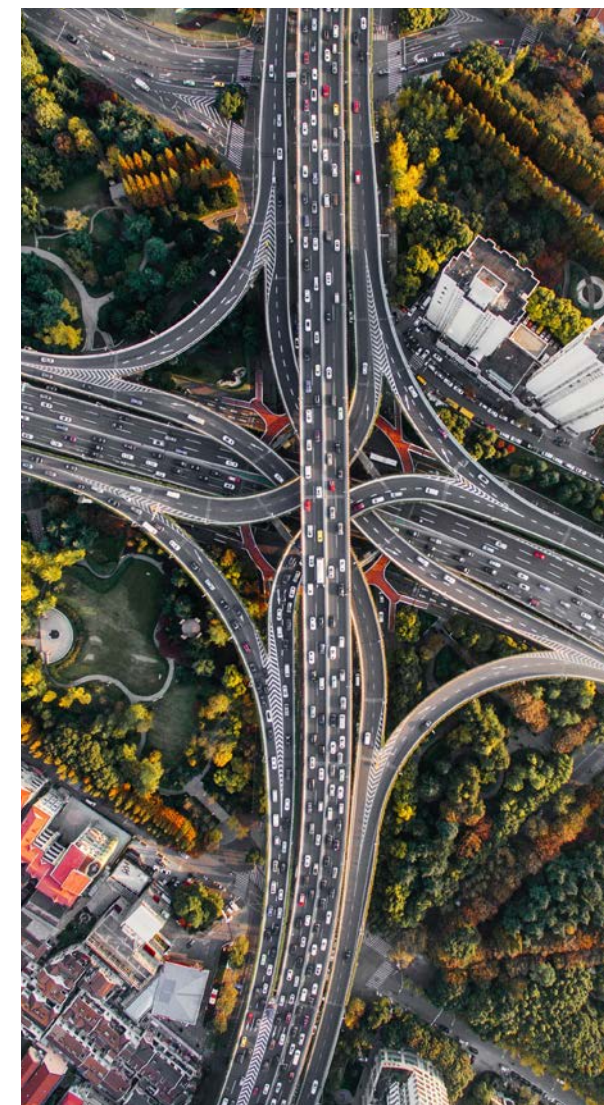
#### 2. Hydro carbon fuels. These require combining hydrogen in water with CO<sub>2</sub>. It is expensive, costing around 2 ½ times the cost of conventional fuel.

For buses, trucks and planes, bio fuels and hydrocarbon fuels look to be the answer but two things need to happen. Alternative fuels need to be less expensive and conventional fuels need to reflect their true costs. For ships this is even more so. The green premium for ships' bunker fuel is very high at up to 600% as bunker fuel is so cheap.

Bill's view is simple. Electrify where possible and use bio and hydro carbon fuels where this is not possible.

There is more to the book but we have given you the key elements. Other aspects covered include alternatives for keeping warm, how we must adapt to at least a 2 degrees warmer climate and the ways politically to assist with making these changes. Innovation is key as some of the solutions we have and some we do not. Bill makes a very big point that getting to zero in 2050 is an absolute. He sees one big risk that governments will demonstrate progress by 2030, but in so doing miss hitting zero in 2050. An example might be converting oil to natural gas to get quick wins but

avoiding investing in the technology that will achieve zero carbon emissions. Thirty years is not long!



# REDISCOVERING OUR BACKYARD

The Trans-Tasman bubble provides a realm of possibilities when thinking about their next holiday destination but now that we're used to staying home, trips around Aotearoa still hold their appeal. In this issue, we continue to review places within our beautiful country, in the hope that you will discover them for yourself.

## Exploring the Hauraki Gulf

**Auckland's Hauraki Gulf is a national taonga, dotted with islands waiting to be explored. Waiheke provides a close destination with beaches, restaurants and shops on offer. However there are three great alternative, less populated options to consider visiting.**

### Tiritiri Matangi

Tiritiri Matangi is a well known wildlife sanctuary. The island is predator free and is home to over 71 species of birds including many endangered and rare birds including the Takahe and the little spotted kiwi. It is also home to many other species including the reptile Tuatara.

From 1984 to 1994, over 280,000 trees were planted on the island, regenerating 60% of the island's forest. Now the island is made up of 60% forest and 40% open grassland, providing a mix of habitats for the island's species.

Tiritiri Matangi is a perfect day trip for a nature fix and is a 75-minute ferry ride from Auckland's ferry terminal or a 20-minute ferry ride from Whangaparaoa's Gulf Harbour. Strict biosecurity precautions ensure the protection of the wildlife so the island remains pest free. There is no food for sale, so pack a picnic and please take your rubbish with you. Guided walks are timed to connect with the arrival of the ferry. Led by the supporters of Tiritiri Matangi, the 90-minute walk takes you to some of the best places to see local wildlife.

People can explore the island at their leisure with many walking tracks available, with a walking map for purchase at the island shop. Beautiful beaches make great spots to enjoy a picnic or swim in the warmer months. Overnight stays on the island are possible but need to be booked in advance. [tiritirimatangi.org.nz/home](http://tiritirimatangi.org.nz/home)

### Rotorua Island

Located an hour's ferry ride from Auckland is the beautiful Rotorua Island. It is the perfect spot to escape the hustle and bustle of the city.

Rotorua Island has an interesting history. It was originally opened in 1911 by the Salvation Army as a rehabilitation facility for alcoholics. During its time as a treatment facility, it was largely self-sustainable with working vegetable gardens, farms and orchards to feed the island's occupants. This facility was closed in 2005 and four years later the Rotorua Trust was established. The trust along with volunteers have worked hard to restore the island and open it to the public as a wildlife sanctuary.

Ferries operate from Auckland's Downtown Ferry Terminal, but you can also reach the island by private boat, water taxi, helicopter, sea plane or if you are feeling adventurous you could kayak! A landing fee of \$5 per adult and \$3 per child is appreciated and is put towards the island's restoration and conservation programmes.

Explore the island by foot, with several walking tracks ranging from 20 - 75 minutes and cater to all fitness levels.

The tracks will take you through wetlands and forest to some beautiful beaches and picnic spots. Guided 90-minute walks are also available and this is a great way to see the island's wildlife and learn the island's natural history.

Rotorua Island is a photographer's dream with its stunning scenery and abundant wildlife. If you fancy yourself as a bit of a photographer then consider signing up for the Astro Photography Experience on 8-9 May 2021. The package cost includes transport to/from the island from Downtown Auckland, dormitory accommodation for 1 night, a guided nature walk and a night under the stars learning how to capture the Milky Way.

For more details on Rotorua Island and the Astro Photography Experience visit the Rotorua Island website at: [www.rotorua.org.nz/](http://www.rotorua.org.nz/)

### Rakino Island

Rakino Island is off-grid with no shops or services, making it the perfect place to really unwind and get away from it all. Located North East of Motutapu Island, it is home to only 18 permanent residents and approximately 75 dwellings. The island's isolation and self-reliant lifestyle is what attracts many of its holiday homeowners and residents.

The island has been pest free since 2002, so please be aware of the biosecurity restrictions before you head there. You can take a 45-minute ferry to Rakino Island from Downtown Auckland. Ferries do not operate every day so your trip will need to be thought out in advance.

The island was originally bought by Governor Sir George Grey back in the 1860's. However, he soon found Kawau Island and decided to build his house there instead. In 1874 he leased the land to Albert Sanford, who ended up buying it. Sanford founded his fishing business from there and he and his descendants lived on the island for 80 years.

These days Rakino is well known as a great fishing spot, an ideal place for boaties to go to in the summer where they will often stop in at the Woody Bay Pizzeria and a place to enjoy the outdoors, unwind and relax.

## The Catlins

Looking to head down South to enjoy the beautiful autumn colours and before the winter weather really sets in?

The Catlins is located on the South Islands southern coast between Balclutha and Invercargill and is known for its rugged natural beauty. It is made up of high cliffs, deserted beaches, hidden lakes, native forests and stunning waterfalls.

Some of the natural highlights of The Catlins include:

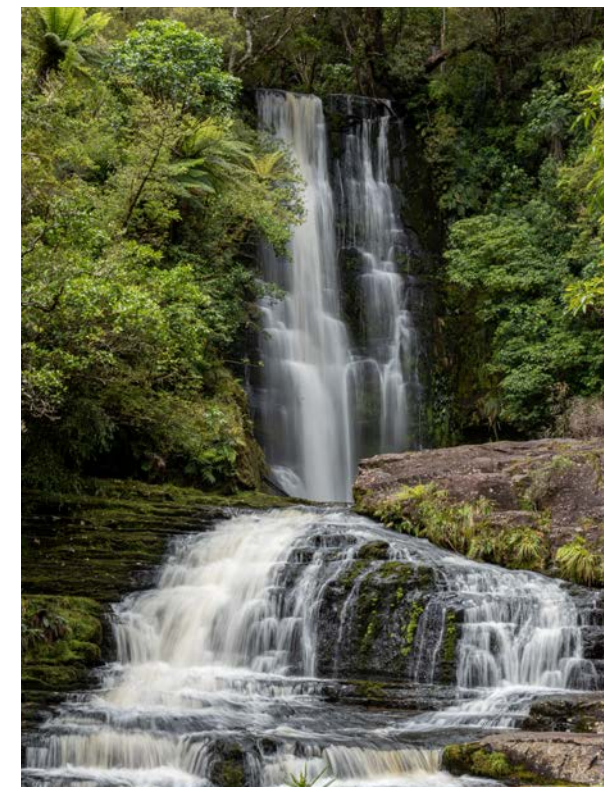
- **Waterfalls** – The Purakaunui Falls and the McLean Falls are a must see if you are in The Catlins. The Purakaunui Falls cascade 20 metres over three tiers and are among the most photographed waterfalls in NZ. They are easy to access on a 20 minute return walk from the carpark, 17kms south of Owaka. The McLean Falls are 12km south of Papatowai and the 40 minute return walk is well worth the effort to enjoy this 22m cascading waterfall.

- **Curio Bay** – If you enjoy history, Curio Bay is a must see. It's home to a petrified forest dating back to the Jurassic period (one of only three in the world), best viewed at low tide from the viewing platform. You can also walk through the living forest walkway and see how the petrified forest may have looked millions of years ago.
- **Nugget Point** – This iconic point got its name from the wave eroded rocks that look like gold nuggets. These can be seen from the viewing platform at the Lighthouse. There is a walkway out to the Nugget Point Lighthouse which is approximately a 20-minute return walk from the carpark. The lighthouse was built in 1869 and is situated 76 metres above sea level. Look out for wildlife on your way to the Lighthouse as the area is home to fur seals and a variety of seabirds.

If you have made it this far then consider also checking out Roaring Bay which is home to the yellow eyed penguin, one of the rarest penguin species in the world.

- **Cathedral Caves** – Enjoy a 1-hour return walk through the bush and along the beach at low tide to enjoy the Cathedral caves. Aptly named because of their resemblance to European cathedrals, the caves soar more than 30 metres high. The best time to enjoy the caves is an hour either side of low tide. Be prepared for wet feet as you walk from one cave to the next. Please be aware that the caves are only open between late October – May and there is a small charge for use of the carpark and access to the track.

There are several options for accommodation in the Catlins including motels, camping sites, bed and breakfasts and farm stays. We have heard wonderful things about the Greenwood Farmstay located within walking distance of Purakaunui Falls. The hosts there will treat you to a 3-course dinner, bed and breakfast. Allan and Helen-May take great care of their guests, with pricing including the option of a 3 course dinner as well as bed and breakfast. While there you can enjoy their in house library, play the piano or you can explore the farm with Alan. As their website states, you arrive as a guest and leave as a friend.



# FINANCIAL JARGON TRANSLATED TO ENGLISH



## Diversification

**Put simply diversification means not putting all of your eggs into one basket; it is described as the one free lunch in investment. In investment terms there are many eggs and many baskets. Diversification as it relates to investment is still a very simple concept but with a few extra layers thrown into the mix.**

Why would an investor want to diversify? Mostly because we cannot predict the future; diversification done well actually reduces the risk while increasing the return. By diversifying, the objective is to get exposure to all the

known sources of investment return. This follows the assumption that at some point they will all perform and in the long run they are likely to produce their long-term average premium. And because we know what those premiums are, we can plan for the long term with a lot of certainty.

Ultimately that is the end game. Plan with confidence. Spend as much as you can but not more than you can afford, so that you live your life to the full knowing once the race is run you have neither wasted the opportunity nor prematurely run out of money. The key though is to have the confidence to sleep at night knowing the plan is in hand. At the heart of that confidence is diversification.

So what is diversification?

1. Having lots of assets in each class of assets. For example there are over 200 companies listed on the New Zealand Exchange (NZX). 'Enough' is a number large enough where the performance of your holdings will mirror the performance of the NZX.
2. Having asset classes in proportion to their world share. There are many asset classes. An asset class is a bunch of shares, bonds or instruments that behave in a similar way. These asset classes vary in size. For example, global shares outside New Zealand are a much larger pool than New Zealand shares. Diversification means holding a representative sample

of each. For example the US share market makes up around 50% of the total world share market. Therefore diversification means holding that same proportion within your investment portfolio. That is, 50% of your share allocation will be US shares.

3. The third aspect of diversification is recognising that some asset classes work together better together than others. The traditional view of this has been that putting bonds and shares together provides less highs and less lows for a given average return. This is called lowering volatility. This impact seems to be less in a low interest rate environment, but it is still there.

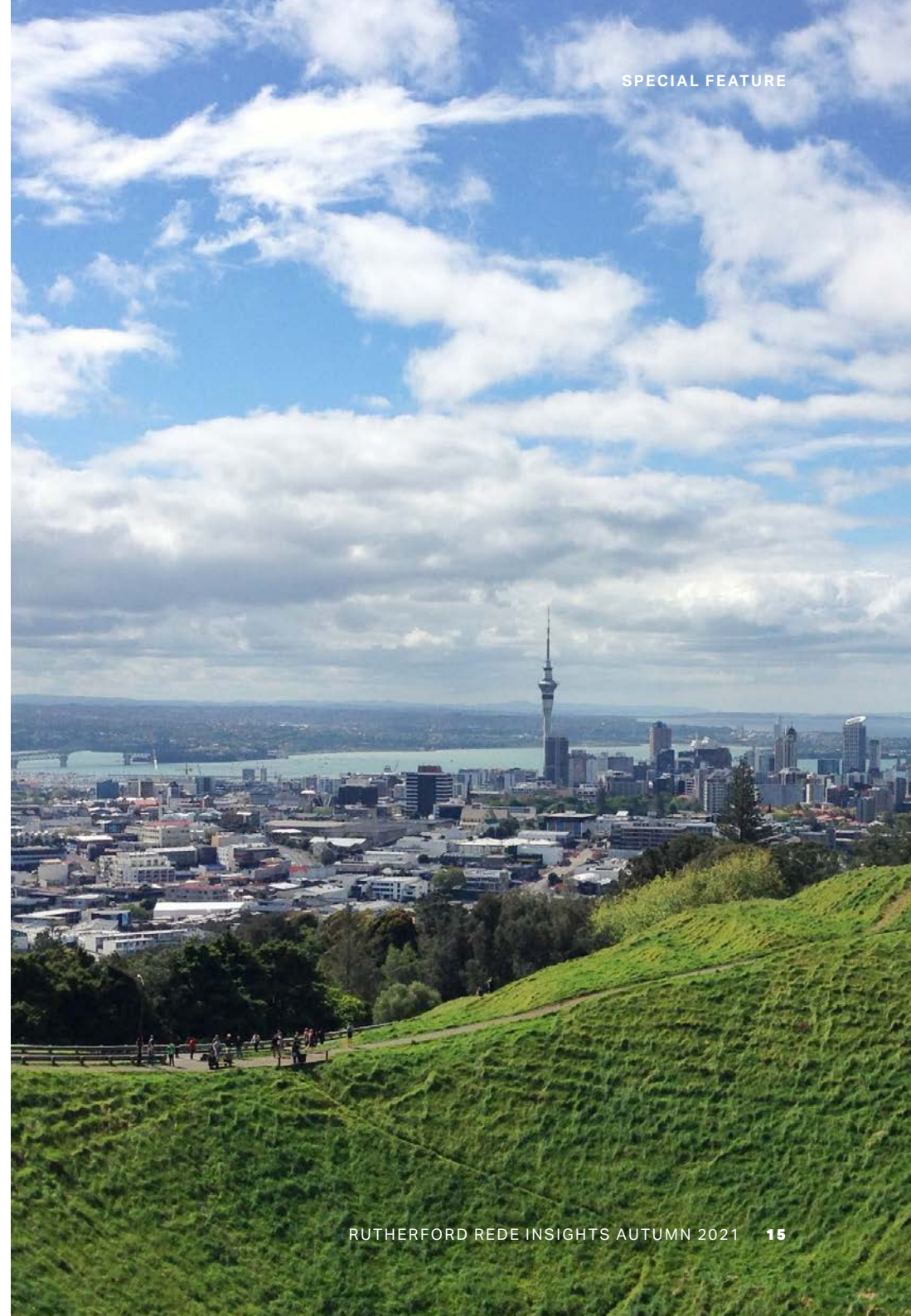
What isn't diversification? The best example here in New Zealand was in 2007 when the finance companies collapsed. Investors attracted by the higher interest rates thought that holding lots of finance companies would protect them. But the same risks applied to them all. Once the New Zealand building industry came under stress so did all of the finance companies and they all suffered.

Diversification is putting together asset classes that work well together, holding asset classes in their representative proportion and holding sufficient shares, bonds or properties so that the performance mirrors that of the asset class. Diversification increases the odds of getting an outcome you can plan for. You may miss the highs that you might achieve by picking a 'winner', but you certainly diversify away the risk of your 'winner' actually turning out to be a loser, and overall you achieve a better outcome with higher probability.

In practical terms investing your money involves a strategy that has diversification as one of its core elements. Funds that rely on forecasting the future in terms of picking outperforming shares and timing the market do risk winning and losing outcomes. In practice many more lose than win. We do not believe this strategy gives you the highest chance of achieving your objectives.

Our Investment Committee builds model portfolios that are a construction of different asset types that achieve desired risk and return outcomes. It then provides funds that will deliver the prescribed asset performances. All funds employed have strong diversification and do not rely on picking winners or timing markets. Much of the work of the Investment Committee is reviewing and finding funds that achieve returns that line up with their asset class as efficiently as possible.

If you want a high degree of investment certainty, then diversification is your friend.





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Portfolio assets are held on your behalf by the nominee and custodian, Aegis, a 100% owned subsidiary of MMC. MMC is a New Zealand outsourced fund and investment administration business. Assets are held via bare trust structure with ownership being retained at all times by the owners of the portfolio. Valuations are independently sourced and recorded by Aegis.