



RUTHERFORD REDE

# Insights

Winter 2019





# In this issue

---

## **A REVIEW OF THE QUARTER**

The world that was 02

How the markets fared 05

## **SPECIAL FEATURE**

Brain fitness: What you can do 06





# THE WORLD THAT WAS

## Key themes of the period

### *June – August 2019*

- Central banks have changed course to easing, boosting equity markets for the quarter
- Global economic growth is slowing, and central banks have limited ammunition to arrest downside risks
- The NZ economy is favourably placed to weather any slowdown

### Markets rally further in the June quarter

An old investment mantra is “Don’t fight the Fed”. The Fed in this case is the US Federal Reserve, who sets monetary policy and interest rates in the United States. Historically, investors in the US and globally, given the dominance of the US market, have done well when they have invested in a way that aligns with how the Fed sets its monetary policy. This pattern has been repeated over the past 6 months. The Fed has now completely backed-off increasing rates in response to a slowing global economy and heightened Trade War risks. Markets forecast instead that they will cut interest rates, in line with cuts that have already taken place in New Zealand and Australia. In response, markets have rallied strongly across all asset classes, including government and corporate bonds, property and infrastructure stocks, and equities. Investors and active fund managers who reduce risk allocations in response to the slowing economy – those “fighting the Fed” have missed out on this rally.

Many equity markets, including the New Zealand’s market reached new highs in the quarter (figure 1). International developed market equities increased by around 5.5% over the quarter (in NZD terms), implying around a 7% return for the year ended June 2019. Within global equities, value stock and small cap stock returns were a little weaker returning around 4% for the quarter. Emerging market (EM) equity returns were weaker at 2% over the quarter, but this was sufficient to turn their annual return to a small (2%) positive figure. These markets have borne the brunt of the Trade War, and on the flip side have the most to gain should growth recover. Trans-Tasman equity markets also

FIGURE 1: EQUITY MARKETS REACH NEW HIGHS

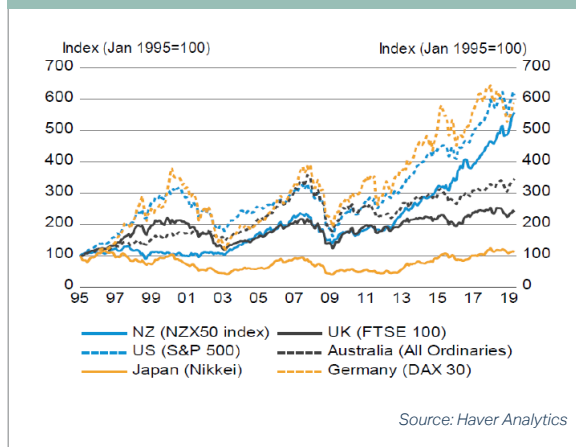


FIGURE 2: GLOBAL GROWTH & TRADE IS SLOWING

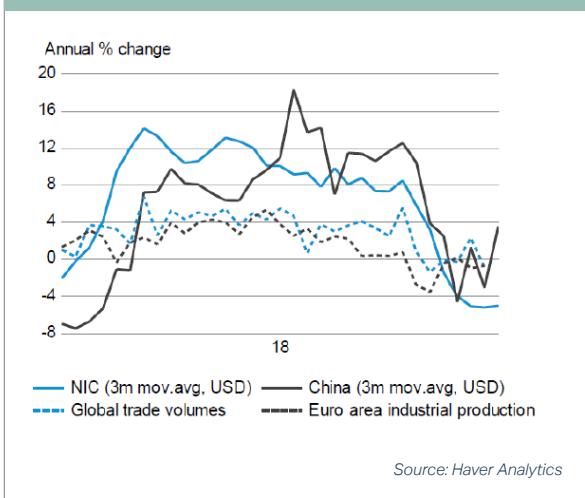
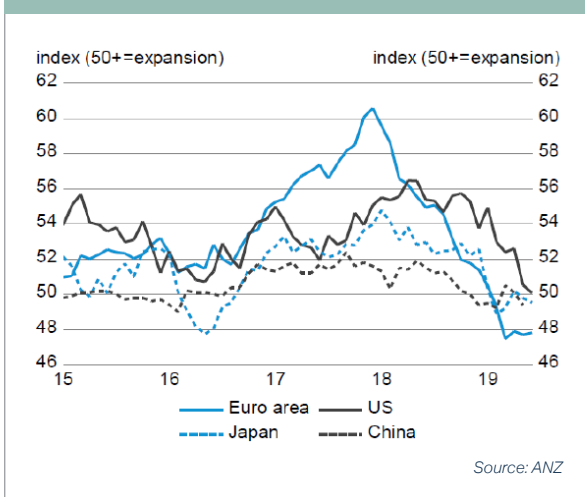


FIGURE 3: GLOBAL MANUFACTURING IS DECLINING



enjoyed a strong quarter. Australian shares returned 8.3% for the quarter and New Zealand shares returned 6.7% for the quarter. These markets in particular have benefited from RBNZ and RBA rate cuts, with the Aussie market also boosted by the surprise re-election of Scott Morrison and the Liberal Party.

Global bonds returned 2.7% in the quarter and 7.3% in the year to June 2019, while New Zealand investment grade bonds returned around 7% for the year. These returns are much higher than the running yield on bonds (around 3.5% or so) and bonds have repriced higher as interest rate expectations have declined. This also boosted “bond like” property and infrastructure stock returns, which have experienced double-digit gains over the year across New Zealand, Australia and global markets in general.

The rally in markets has, however, been accompanied by significant volatility as markets have grappled between contrasting forces. The slowing global economy reduces corporate sales and profitability. In contrast, lower interest rate reduces borrowing costs and how much investors discount corporate earnings (boosting asset prices). Errant tweeting by the Commander In Chief have added to the volatility as threats on further tariffs (including on Mexico, China, the EU and India), trade restrictions (e.g. on Huawei) and military action (Iran) have gone on and off the radar. In the event, at the time of writing the Trump Administration has backed down from the worst of the threats, and market fears of an escalating Trade War have been soothed.

FIGURE 4: MORE RATE CUTS TO COME?

|                  | Current Policy Rate | Expected Rate (Year End) | Change |
|------------------|---------------------|--------------------------|--------|
| <b>US</b>        | 2.38                | 1.61                     | -0.77  |
| <b>Eurozone</b>  | -0.37               | -0.50                    | -0.13  |
| <b>UK</b>        | 0.75                | 0.65                     | -0.10  |
| <b>Australia</b> | 1.25                | 0.71                     | -0.54  |
| <b>NZ</b>        | 1.50                | 1.08                     | -0.42  |

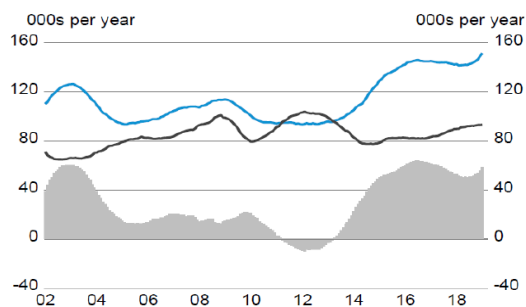
Source: ANZ Bank

### Economies still likely to muddle through

Despite the Trump Administration backing off (for now) escalating the Trade War the damage has clearly been done to global trade and growth (figure 2). World trade volumes before the Trade Wars were running around 5% per annum, and global growth around 3.5%. Today global trade volumes are flat and global growth has fallen closer to 3%. In addition, a range of short-term economic indicators such as manufacturing activity and confidence levels have fallen (figure 3).

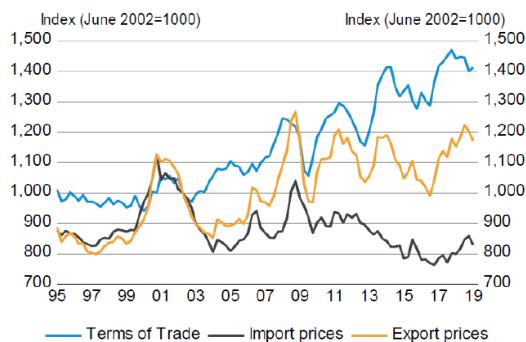
The key question is where do things go from here? The ANZ, in line with the market ‘consensus’, thinks that the environment warrants further interest rates cuts. It forecasts that the RBNZ and RBA will cut rates twice more within the year (reducing the OCR by around 0.5%), while

FIGURE 5: NZ NET MIGRATION REMAINS STRONG



Source: Statistics New Zealand

FIGURE 6: NZ TERMS OF TRADE ON A HIGH



Source: Statistics New Zealand

the Federal Reserve will cut three times (figure 4). Our view remains that whether or not this happens, markets and the global economy are likely to muddle-through the current cyclical slowdown. But this hinges on the Trade Wars not re-surfacing, or a crash Brexit plunging the UK and Europe into recession. We are also mindful that while central bank easing rates has clearly boosted asset prices and market confidence, the impact on actual economic activity may be more limited given rates are already extremely low and there is debate whether further cuts will achieve much.

Currently macro forecasters expect growth to be around 1.7% in developed markets over the next year, with US and Australian growth around 2.5%, and EU growth lagging at a little over 1%. In contrast, growth in the emerging world is expected to hold up over 4% over the next year - more than double the pace of growth in the developed world. This is key. High EM growth implies that these markets continue to make a large and increasing contribution to global growth rates. Global growth can remain reasonably firm at around 2% even if most economies are mildly slowing given the EM growth contribution. A global recession hence remains very unlikely unless there is a large slowdown in EM economies, with China and increasingly India being the linchpins in this regard. Both economies are still forecast to experienced growth rates of around 6% over the next year or two.

In New Zealand the slowing global economy and downside risks should be seen as less of a concern. Current annual growth is running around 2.5% and the RBNZ in its latest Monetary Policy Statement expects this rate to pick up to around 3% over the next year as its rate cuts kick-in. Even

if this is limited, with commodity prices at mostly attractive levels, high tourism inflows and net migration, and a large pipeline of construction projects, growth is likely to hold up well (figures 5 and 6). In addition, the move of the NZ government debt target to a range in the so-called Wellbeing Budget provides a mechanism to boost fiscal spending further should it be judged necessary to cushion our economy from a global downturn. Compared with most OECD economies, our fiscal debt levels are very low and fiscal policy is a critical lever to pull in an era where central banks have exhausted most of their ammunition.

“  
*In New Zealand the slowing global economy and downside risks should be seen as less of a concern. Current annual growth is running around 2.5% and the RBNZ in its latest Monetary Policy Statement expects this rate to pick up to around 3% over the next year as its rate cuts kick-in.*  
 ”

# 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                     |
|-------------------------------|-------------------------------|
| ↑<br>+6.7%                    | ↑<br>+17.4%                   |
| ↑<br>+1.9%                    | ↑<br>+6.9%                    |
| ↑<br>+8.3%                    | ↑<br>+6.8%                    |
| ↑<br>+5.6%<br>+3.4%<br>hedged | ↑<br>+7.2%<br>+6.5%<br>hedged |
| ↑<br>+2.2%                    | ↑<br>+2.0%                    |
| ↑<br>+2.7%                    | ↑<br>+7.3%                    |
| ↑<br>+1.6%                    | ↑<br>+11.0%                   |

## ASSET CLASS

**New Zealand Shares:** New Zealand shares returned 6.7% in the quarter and 17.4% over the year to June 2019. This continues the very strong run our market has had over the past five years or so. Source of Figures: S&P/NZX All Total Return Index

**New Zealand Fixed Interest:** New Zealand investment grade corporate bonds returned 1.9% for the quarter and around 6.9% 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

**Australian Shares:** Australian shares returned 8.3% in the quarter, bringing the June year result to 6.8% in NZD terms (11.5% in AUD terms). Within the Australian equity market, value stocks mildly outperformed over the year. In contrast, small cap stocks, which suffered large losses in 2018, returned around -2.5%. Source of Figures: S&P/ASX 300, S&P Australia BMI Value, S&P/ASX Small Ordinaries

**International Shares:** International shares rose 6.5% in the quarter, whilst NZD hedged shares rose 3.4%. This good quarterly performance boosted the annual return of global shares to 7.2% on an unhedged basis, and 6.5% on a hedged basis. Unhedged returns over the year were boosted by a fall of the NZ dollar against the US dollar. Within global equities, value stock returns were mildly lower over the year, whilst small cap stock returns were relatively weak at around -2% despite returning 3.5% for the quarter. Source of Figures: MSCI World Index; Morningstar Developed Markets NZD hedged


**Emerging Markets:** Emerging Market equities increased around 2% in the quarter and over the year to June 2019 (in NZD terms). This performance is weaker than developed markets and reflects that the Trump Administration's Trade War has had a more material negative impact on emerging markets. Source of Figures: MSCI Emerging Markets Index

**International Fixed Interest:** Global bonds returned 2.7% in the quarter and 7.3% in the year to June 2019. The return over the quarter and year was boosted by bonds being re-priced higher as longer-term interest rates fell. The latter was driven by central banks reversing course on tightening rates as concerns over Trade Wars and slower global growth have risen. Source of Figures: Bloomberg Barclays Global Aggregate Index (hedged to NZD)

**International Property:** International property stocks increased by around 1.6% in the quarter and 11% over the year. Australian and New Zealand property stocks also enjoyed strong quarters. This asset class benefited over the quarter both from the lower interest rate outlook, and the general bounce in equity markets. Source of Figures: Morningstar DM REITS (NZD hedged), S&P REIT indexes



# BRAIN FITNESS: WHAT YOU CAN DO



This month we bring you a summary of a radio interview that we thought would be of interest.

*Jude Walter an accredited Brain Fit Coach was interviewed by Newstalk ZB on the subject of brain fit. Jude was interviewed on Sunday 26th May 2019. The interview deals with the brain and strategies to improve its performance, particularly as we grow older.*

 Listen Online

<https://www.newstalkzb.co.nz/the-health-hub/jude-walter-how-to-combat-alzheimer-s-and-dementia/>



Jude Walter works with an organisation called Brain Fit.

They run a series of programmes to help strengthen memory and look after its cognitive reserve (brain power) to make the brain more durable though events such as aging and disease.

Jude makes the point that there are many types of memories, in fact *as many as 49* but there are *six key memories* that are important to our daily lives.

- 1 *Verbal memory*  
Remembering things you read or hear.
- 2 *Non-verbal memory*  
Remembering shapes and patterns. Recall of maps is an example of this or, "will this item of furniture fit in this gap?".
- 3 *Short term memory*  
This memory is only 30 seconds long and can only hold seven pieces of information at one time.
- 4 *Working memory*  
When transferring information from the short term to the long-term memory, the working memory brings all this together.
- 5 *Faces & Names*  
Recall of people's faces and names.
- 6 *Prospective Memory*  
Remembering something that needs to be done in the future.



### Memory is affected by age

Working memory and prospective memory are affected by age. Jude makes the point that the short-term memory can be improved with work. She also says that faces and names cannot be remembered without taking the time to focus. This requires at least 2 to 3 seconds of clear focus when being introduced. The brain is designed to forget things. If it remembered everything that it took in then it would very soon run out of capacity. Therefore focus is required to prioritise the brain for the things that need to be retained.

Contrary to popular belief the brain never stops growing. It is possible to train your brain to function at a high level, even as we age. The concept of training for our bodies to be fit is now accepted, but the idea of training our brains is very new. Stress in particular is very unhelpful to the brain. Memory is impacted negatively by the presence of stress. An example of this could be looking for lost car keys when you are already late for an important meeting and not being able to think straight. Curiously, calming down and taking it slowly are likely to speed up the process.

“

*The brain keeps growing, it is us who stop stimulating it.*

”

### Techniques to assist with memory

Jude also provided some techniques that can assist with memory.

**Names and faces.** Encoding helps here. That is when being introduced to someone note a physical feature, or association with their name such as a mind picture of a burger if their name is MacDonald. In other words, you attach a code to a particular thing that links to their name.

**Pegging.** This is where physical queues are linked to the things we want to remember. For example, there may be a requirement to remember three tasks required that day. Buying some butter, then weeding the garden and finally posting a letter. The technique involves tapping your nose and visualising buying butter, rubbing your ear and visualising weeding the garden and putting hands on hips and visualising posting a letter. This should be done a few times, and then when recall is required, tapping your nose will recall the task of buying the butter and continuing to use these physical queues to recall each specific task.

Most of us have heard that doing things like the crossword or Sudoku are helpful for stimulating memory. Jude indicated that stimulating the brain is much broader than that. First a good diet is helpful. A healthy body is likely to assist with a healthy brain. What constitutes a good diet is now well understood, with a balanced diet including lots of nuts, seeds, vegetables and some fruit being very supportive to brain health.

### Exercising the brain

Exercising the brain involves exposing it to stimulus in the form of new experiences that challenge the brain. As we age, our lives tend to become simpler. We tend to socialise with the same group of friends, shop and visit the same places and have the same routines. The brain keeps growing, it is us who stop stimulating it. What we can do is provide stimulation through things like meeting new people, visiting new places, doing new things, driving to the same place a different way, trying a new skill, opening the door with our other hand, parking in a different car park at the super market, walking a different route. These activities are new and fresh and require the brain to work rather than relying on habit and memory. Coming back to the crossword, if the same type of crossword is repeated day after day then the brain settles into a pattern. What is better for brain health is to try different crosswords that operate in a different pattern. Another exercise is to walk into a room and see how many things you can remember seeing in the space of 30 seconds. It seems making your brain work hard supports its development and this can continue all of your life.



Rutherford Rede Limited  
91 College Hill, Ponsonby, Auckland  
PO Box 147246

+64 9 361 3670

**[rutherfordrede.co.nz](http://rutherfordrede.co.nz)**

Portfolio assets are held on your behalf by the nominee and custodian, Aegis, a 100% owned subsidiary of the ASB Bank. Assets are held via a bare trust structure with ownership being retained at all times by the owners of the portfolio. Valuations are independently sourced and recorded by Aegis.