



RUTHERFORD REDE

# Insights

Winter 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.

# ECONOMIC & MARKET COMMENTARY JULY 2021

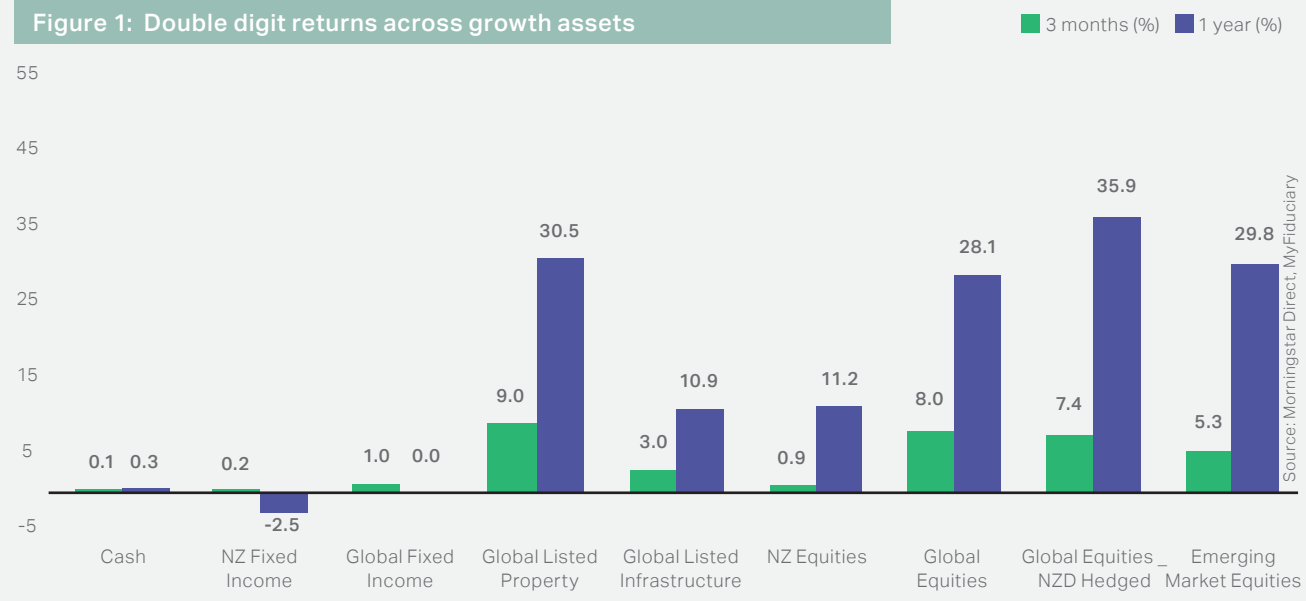
## Markets continue their climb

*Equity markets climbed to record highs over the June quarter.*

Most equity markets continued to climb over the June quarter, extending their record highs. Robust economic growth, vaccine roll outs and ongoing or newly promised stimulus programs far outweighed concerns around re-surgings of Covid cases and lock-downs in some regions and countries. However, it wasn't plain sailing across all asset classes.

Fixed income returns were again weak as cost pressures and inflation risk concerns continued to mount. As discussed at the end of this update, this is perhaps nowhere more evident than in New Zealand where there has been a complete U-turn in the RBNZ's outlook for interest rates – from cutting rates to increasing them as soon as early next year.

Figure 1: Double digit returns across growth assets



## Market roundup

*Equity market performances were solid over the quarter and year.*

Equity markets are now clearly higher than the levels reached before the Covid pandemic hit. International shares rose around 8% in the quarter in NZD terms and around 27% for the year to June. NZD hedged shares increased around 7.5% in the quarter, and over 35% for the year (see Figure 1).

*Higher risk small cap stocks had the highest annual return, while NZ equities lagged.*

Within global equities, higher risk small and value stocks mildly under-performed in the quarter, returning around 5% in NZD terms. Over the year, however, global small caps out-performed returning around 40% and value stocks

performed in line with the market overall. Emerging Market and Australian equities also performed well, with both up around 30% for the year to June.

In contrast, New Zealand shares only returned around 1% in the quarter and are up around 11% for the year to June 2021. Their performance has slipped from being ahead of the pack to slightly below global market returns over the past three and five years. This illustrates the importance of diversification within equity market holdings, and that we shouldn't expect a single market to continue to out-perform.

International infrastructure rose around 3% in the quarter while international property stocks increased by around 9%. On an annual basis returns were around 20% and 30% respectively. Concern that Covid would permanently reduce tenancy demand has clearly waned for the property sector overall,



with sub-sectors such as industrial property surging on the back of very strong manufacturing activity and low vacancy levels.

*Fixed income returns continued to languish.*

Fixed income posted small positive returns over the June quarter. New Zealand investment grade (IG) bonds rose around 0.3%, resulting in an annual performance of -1%. International investment grade bonds have fared a little better, increasing by around 1% in the quarter with flat performance over the past year

## **New Zealand is expected to tighten interest rates first**

*Economic growth has been strong as economies continue to re-bound from Covid.*

In our last update we highlighted that economic agencies are predicting growth over the next few years to be at multi-decade highs as life “gets back to normal” and as fiscal spending programs turbo charge growth. Actual data outturns over the June quarter have been broadly in line with this theme. Global manufacturing activity is firmly in expansionary mode, unemployment rates continue to fall, and consumer spending is surging. In NZ, data released in mid-June by Statistics New Zealand showed GDP in the March quarter rose 1.6%, well ahead of most forecasters’ expectations and firmly putting to rest any concern that our economy might experience a technical recession.

*Attention is now shifting to rising costs and inflationary risks*

With New Zealand’s economic recovery well established and global growth on steroids, focus has shifted to rising

costs and inflation. The big question is whether the surge in commodity, freight, construction, and a range of other costs seen this year will be temporary, or instead lead to a sustained increase in CPI inflation rates. Survey measures of business and households suggests risks point to the latter, with inflation expectation measures running at multi-year highs.

*The RBNZ is leading the pack in signalling a need for higher interest rates.*

In this environment it is perhaps not surprising that central banks have begun to change their tune. No central banker wants to win the economic battle with Covid only to fight an inflationary war. In the US, a number of senior officials at the Federal Reserve have begun to call for an explicit timeframe for rising rates. In its May update the RBNZ signalled that it will lift interest rates from mid-next year, possibly sooner, if the economy and inflation continue to run ahead of expectations. In this respect the RBNZ is leading the pack – rates are expected to lift here ahead of other major economies).

*Interest rates need to be considerably higher to make bonds an attractive asset class again.*

Will increasing rates come to pass next year? Perhaps, but perhaps not if conditions pan out weaker than the RBNZ currently forecasts. The recent lockdowns in parts of Australia are a reminder that we are not out of the woods yet. Regardless, in our view the balance between risk and reward for bonds remains poor, and one or two small changes in short-term rates is unlikely to change this. We need to see a sustained increase to make bonds an attractive asset class again. This isn’t going to happen any time soon.



# 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  
+ 0.9%  
PAST YEAR  
+ 11.2%

**New Zealand Shares:** New Zealand shares increased around 1% in the quarter, a weaker result than for global markets. Despite the soft quarter, returns were still reasonable for the year ended June 2021, at around 11%. Over the past 3 and 5 years NZ equity returns are now broadly in line with global markets.



QTRLY RETURN  
+ 0.3%  
PAST YEAR  
- 1.0%

**New Zealand Fixed Interest:** New Zealand investment grade corporate bonds increased slightly in the quarter and returned around -1% for the year ended June 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  
+ 7.2%  
PAST YEAR  
+ 29%

**Australian Shares:** Australian shares performed well over the June quarter, bringing the annual return to around 30%. This annual result is, however, flattered by the fact it is measured against the Covid sell-off, a theme we also see in the other markets as reported below. Source of Figures: S&P/ASX 300, S&P Australia BMI Value, S&P/ASX Small Ordinaries



QTRLY RETURN  
+ 8.0%  
(7.4% hedged)  
PAST YEAR  
+ 28.4%  
(35.9% hedged)

**International Shares:** International shares rose around 8% in the quarter in NZD terms, whilst NZD hedged shares increased around 7.5%. Annual results reflect 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 under-performed in the quarter, both returning around 5% in NZD terms. Source of Figures: MSCI World Index; Morningstar Developed Markets NZD hedged, MSCI World Value



QTRLY RETURN  
+ 5.3%  
PAST YEAR  
+ 29.8%

**Emerging Markets:** Emerging Market equities rose around 5% in the quarter in NZD terms, bringing the annual return to around 30%. As with developed market equities, EM equities are benefiting from the Covid pandemic recovery. Source of Figures: MSCI Emerging Markets Index



QTRLY RETURN  
+ 1.0%  
PAST YEAR  
+ 0%

**International Fixed Interest:** Global bonds increased around 1% in the quarter and had a flat return for the year. As with the NZ result, this soft annual performance 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  
+ 9.0%  
PAST YEAR  
+ 30.5%

**International Property and Infrastructure:** International property stocks rose by around 9% in the quarter and closed up over 30% for the year ended June. International infrastructure returned around 20% for the year (in local currency terms), also a strong result. Source of Figures: FTSE EPRA NAREIT NZD Hedged



Insights

# THE CHANGING MIND

By Daniel Levitin

'Aging well' is a subject that increasingly gains importance as we age. 'The Changing Mind' by Daniel Levitin caught our attention and we thought we would share some of the insights we gained from reading it. The biggest insight is that we can influence the way we age.





The widely held assumption is that as we age our memory declines. It's not as simple as that. At all ages we forget things. The trouble is that as we age, we start to associate our forgetfulness with memory loss. Some aspects of our memory actually improve. As we get older, we get wiser – or in other words, our ability to make judgements and decisions based on pattern recognition improves. This is due to the experiences we have had and the neural connections our brains have laid down through those experiences.

Another myth is that older people are past their prime. Actually many older people have become very successful at skills started in old age. An example is Anna Mary Robertson who has paintings on display at the Smithsonian and New York's Metropolitan Museum of Art. She didn't start painting until she was 75. Or Harland Sanders. At 62 he had experienced a difficult childhood and had drifted all his life

from job to job – many of which he was dismissed from. Finally at age 62, after winding up a failed business, he had run out of options. Back then a man's life expectancy was 65, just 3 years away. With one last roll of the dice he started using an old family recipe for chicken. And so the KFC empire was under way. He lived well into his 90's.

We all age differently. Some aging is genetic, some is environmental and some relates to our opportunities. Research shows that the single most important determinant of lifetime happiness is your personality. One very large influence on our personality is our experiences in childhood. Being nurtured impacts us on a chemical level. Being nurtured in childhood will reduce your stress hormones and strengthen your immune system throughout your life. We cannot change our childhood, but are we stuck with our personalities? The answer is "no", personalities can change.

Our personalities are not set totally by our neurochemistry, that is, all the physical characteristics we are born with that have over time been seen as unchangeable. Our personalities are also shaped by our environment and opportunities. A clear example is a high-risk taking personality contrasted with a conscientious less risk-taking personality. A risk taker has a lower life expectancy. Can a high-risk taker change their personality to be one of taking less risk? It seems the answer is "yes".

One remarkable feature of our brains is their ability to change through a feature called neuroplasticity. As an example: when someone is blinded by an accident, their brain is able to redirect the function of the cells in the part of the brain that used vision to instead promote other ways of navigating the world, like increased sound sensitivity and touch.





So how is it possible to change our brains in order to extend our lifespan? This is where the COACH principle comes in. Coach stands for:

- Curiosity
- Openness
- Associations
- Conscientiousness
- Healthy Practices

An example of how this might work in practice is to compare the experiences of two people that have a medical event. Both are equally disabled. One is proud, status conscious and with a lifetime of sporting and business success. They refuse to use a walking stick and spend most of their time alone. Their condition declines. Contrast this with someone who enrolls in exercise classes, joins a book club, takes up crafts and connects with new people. This is evidence of a growth mindset. The second person is high in openness, curiosity, and associations and therefore has a lowered risk of heart disease, alzheimer's, and diabetes. People with a growth mindset consistently outperform those with a fixed mindset.

Conscientiousness helps us finish the things that we start such as continuing to turn up to Pilates classes or maintaining regular exercise routines. Actually following through and creating effective habits requires conscientiousness. Interestingly this declines as we age. Perhaps that need to impress at work is diminished as our career becomes more established and we can do things simply because we want to.

Healthy practices are the last of the COACH aspects. These practices relate to diet, exercise, and sleep.

Diet fads have always been promoted as the next best thing and almost all have little scientific basis for their success. When measured success seems to be evident it can often be in fact due to other factors such as more food awareness or an increase in exercise. However there are a few principles that do seem to have strong credentials. Restricting calorie intake intuitively sounds logical and various fasting practices are supported with science. Somehow after a huge first course we always find room for pudding, but eating only when you are hungry and stopping when you feel full is a good principle. There are many "superfoods" as well as the latest hyped healthy option so it can be very confusing and easy to be cynical. What seems to be important is not what you eat but what you don't eat. Less processed foods, sugar, salt and red meat is a good rule set. The quote from Michael Pollan's 2008 book in defence of food is worthy: "Eat food. Not too much. Mostly plants."

Physical exercise, even in small doses, has the biggest impact. Simply walking – especially outdoors – has a very large impact. For example: two elderly groups were asked to walk. One group was asked to follow a rectangular path. The other was encouraged to wander off the path and explore the space. When tested on mental agility upon their return the group that

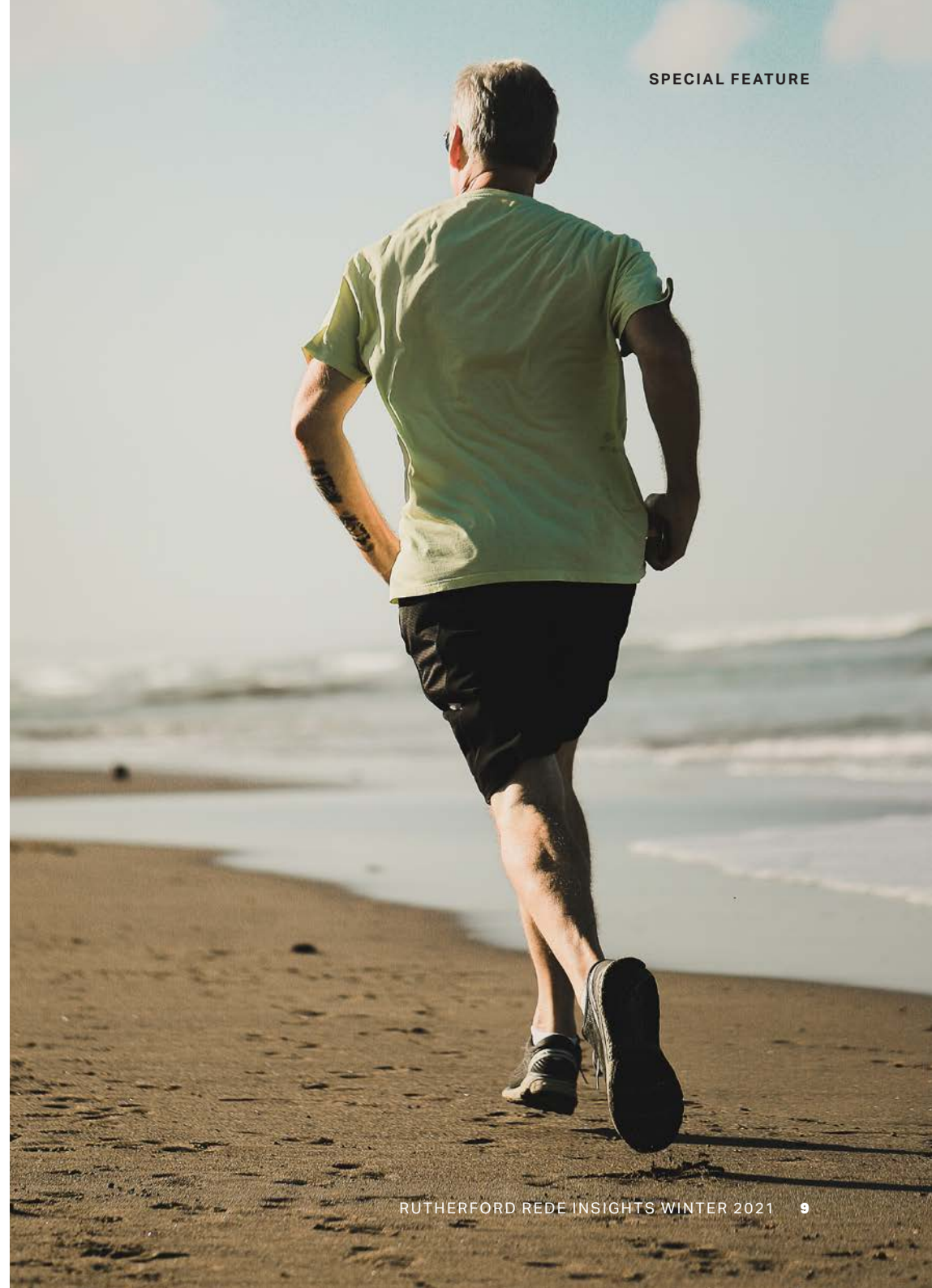


wandered had higher scores. Exercise is enhanced with exploration and variety. In fact, the studies show such strong evidence of the benefits of exercise that doctors have started to prescribe it. Interestingly, a little exercise is significantly better than none at all. An experiment compared two groups of people sitting on an exercycle. One group just sat there while the other peddled only modestly without meaningful effort. There was a material difference in mental agility in the tests conducted at the end of the bike ride.

It's a myth that as we get older we need less sleep. It's just harder to get good sleep as we age. Aching muscles and bones, as well as more frequent trips to the toilet, make uninterrupted sleep harder to get. Along with this, the part of our brains that regulate sleep, the suprachiasmatic nucleus (SCN), degrades. This part regulates our circadian rhythm, essentially signalling things like when to wake up and when to get sleepy. Studies show that 99% of people need 7 hours of sleep each night. There are various ways to support this, including restricting blue light from devices close to bedtime.

Some people see sleep as downtime and therefore wasted. One way of reframing sleep is that it's not squandered time but productive time. Sleep is restorative. While we sleep cellular repair and cleaning mechanisms kick in. It's when wounds are healed, and bacterial and viral infections fought off. It's when memories are consolidated, and emotions and problems are processed. If you are learning a new skill, that memory is encoded in your memory at night.

The key to aging well is to push yourself to remain active, to maintain and build new relationships, and to try new things, while at the same time eating well and getting enough sleep. Surveys show that older people are at the happiest period of their lives. Research indicates that we can influence this and maybe get more skilful and happier as we age.





# REDISCOVERING OUR BACKYARD

The Cook Islands and Trans-Tasman bubbles have opened up opportunities to travel overseas again, however trips around Aotearoa, New Zealand 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.



# LAKE DUNSTAN CYCLE TRAIL

**If cycling through stunning Central Otago landscapes, enjoying some of the delightful Bannockburn wines and soaking up touch of history sounds like something you would enjoy, then the newly opened Lake Dunstan trail needs to be added to your travel list.**

The Lake Dunstan Cycle trail officially opened in May this year, linking the South Island towns of Clyde and Cromwell. This 55km trail has been created for cyclists and walkers and will take you through some spectacular scenery as you pass by Lake Dunstan, the Kawarau River and the Cromwell Gorge.

The trail is divided into four sections which range between 6km to 29km in length. The track is not difficult (grade 1-2) so it can be completed in one day. The trail also links up with the Central Otago Rail Trail if you are looking to extend your adventure.

Some of the highlights of the trail include the picturesque Cromwell Heritage precinct where you can explore the cafes, galleries and retail stores. The opportunity to sample some of the locally produced wines direct from the cellar door should not be missed.

The section of the trail that takes you through the Cromwell Gorge is a huge credit to those who designed and built it and has been years in the making. Engineers designed a series of cantilevered platforms that hang off the side of the granite rocks enabling you to cycle around the sheer cliffs directly above the water.

There are several companies offering bikes for hire, including e-bikes so you don't need to take your own. Our advice is to take advantage of this new trail before word gets out and it starts to get busy.







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