RUTHERFORD REDE

Insights

Autumn 2020

In this issue

A MESSAGE FROM THE DIRECTORS

An updated look at the world from our respective bubbles.

This is a little different from the usual Insights format but then we are in different times. The cause of the extreme volatility warrants a Scotland Yard interrogation – how was the world caught so short and ill-prepared? Books will be written, documentaries will be aired and grandchildren will be asking, "what happened in 2020, Gran, when you were locked in your homes for your protection?", "is it true?".

It is astonishing that the global economy was badly rocked by a virulent disease that emanated from our most significant trading partner. Fortunately, we were relatively well-prepared. Without doubt the world that we will move to will look to prevent a recurrence. It has to. The cost of disruption and uncertainty has been eye-watering.

While the event has been different, the volatility in portfolio values has been just another blip in the progress of your portfolios. As Directors and owners of our own portfolios, we have seen these periods of uncertainty and volatility on a cycle of almost once every seven years. The fact that we have been through them before makes it no easier when we are faced with another decline. However, we know to expect them. It would be impossible to generate the returns we have forecast for you without factoring in the occasional period of misery.

You have ALL held to the strategy that was set out for you on Day 1. That was smart. The only way to achieve those forecast returns is to ride through the storms.

We acknowledge it is never much fun at this phase of the cycle, but it has been a spectacular eleven years running up to it!

On this occasion, as the circumstances call for it, we want to say "thank you" for being clients of Rutherford Rede. We are on this journey together, through thick and thin.

THE WORLD THAT WAS

Key themes of the period

April 2020

- The impact on markets as COVID-19 became a global pandemic
- Emerging Markets and New Zealand Equity Markets perform relatively well
- From Corona-coma to Corona-exit

Markets fell as COVID-19 became a global pandemic

COVID-19 morphed into a global pandemic in February… plunging markets into bear territory.

In our last report, we highlighted the exceptionally strong returns in 2019, with markets registering gains of 25% or more. The good run continued into January 2020, but cracks started in February as concerns mounted that COVID-19 was spreading to other parts of the world. Central banks started to cut interest rates, which initially supported markets rallying further. But from around the 20th February, a very large and rapid sell-off began as the true scale of the global pandemic became apparent, and governments started to implement social distance measures and close borders.

Policy measures and signs of reducing COVID-19 transmission has led to a large market bounce since late March.

The sell-off from late February was also accompanied by extreme volatility and various stresses in financial market conditions (including reduced liquidity, longer trade settlement time frames, and increased credit spreads on bonds). In response, central banks were quick to deploy the 'toolkit' they developed in the GFC in 2008/9. Interest rates were cut to zero in countries where they were still above this level (notably, the US, Australia and New Zealand). Quantitative easing programs were also re-started or kicked into life, including in New Zealand for the first time.

Central bank action, along with the unprecedented scale of financial support measures that governments have put in place, were successful in arresting the free fall in markets that began in late February. To provide some context, the

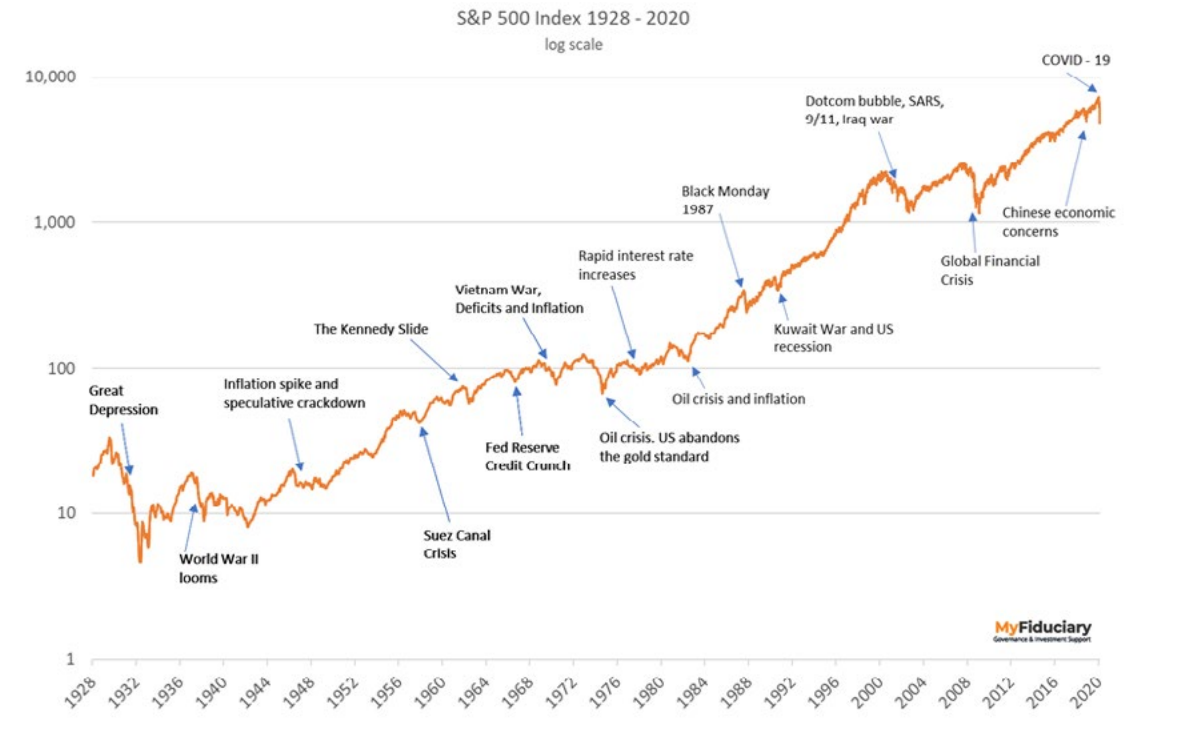
US bell-weather S&P500 index level peaked at around 3386 on 19th February. By March 23rd it had fallen around 33% to 2237 – it's the fastest descent into "bear territory" (a decline of over 20%) ever. But since that point, it has recovered around 25%, to a level of 2790 (as at the market close before the Easter break).

In our view the long-term reward for bearing risk remains intact.

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 (see figure 1). As such sticking with long-term investment strategies, and re-balancing through the volatility as necessary, remains the best course in our view. We are also optimistic that a GFC-styled financial crisis, or a Great Depression scenario, is largely off the table given:

1. The economic and financial market policy measures that have been put in place to tide banks, businesses and households over.
2. The increasing health successes in curtailing COVID-19 transmission, particularly in New Zealand, but also in US and European epicentres of the disease.
3. The accelerated timelines for the development of antiviral treatments and vaccines, which ultimately means life can "get back to normal".

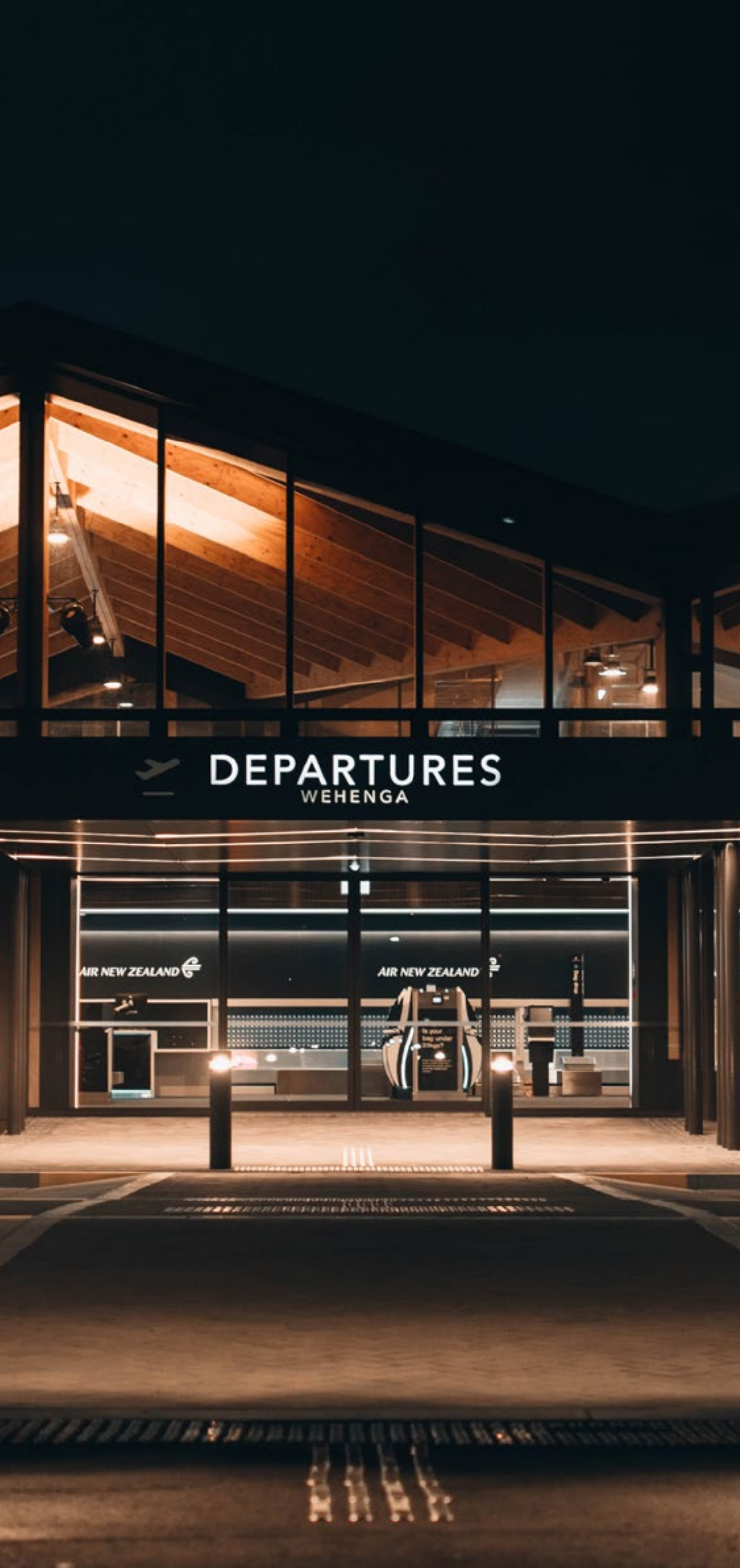
FIGURE 1: EQUITY MARKETS EVENTUALLY RECOVER FROM SHOCKS



Source: Datastream, MyFiduciary

Fixed income returns were a bright spot, cushioning the decline of equity markets in portfolios.

Turning to the quarterly market results, fixed income returns were a bright spot, with benchmark international investment grade (IG) bonds returning around 1.5% over the quarter and 6% over the year. Shorter duration global IG bond returns were lower at around 2% over the year, reflecting their lower level of risk, and NZ investment-grade bonds returns were also positive at around 4.2% over the year. But under the surface results were more disparate. In the quarter government bond returns were much stronger as long-term rates fell over the quarter and investors "fled to safety".



Investment-grade corporate bonds returns were weaker, materially so until the central bank interventions started reducing credit spreads.

The NZ dollar decline also helped cushion the blow from declining global markets.

International shares fell around 10% in the quarter in NZD terms, whilst NZD hedged shares fell around 21% - mirroring the decline in global market terms. The NZD tends to fall in the time of stress, and this time was no different, which significantly helped cushion the blow from the global market decline.

Within global equities, higher risk sectors such as small-caps and value stocks underperformed. In contrast, "growth stocks" performed relatively well, in part reflecting that this sector has a higher exposure to tech and the health care companies, which have been better able to continue business under the COVID-19 environment. Looking forward, we remain confident that value and small-cap stocks will deliver a premium, and we note that often the best returns from these factors arise when markets start recovering from a large sell-off.

Emerging markets performed relatively well, as did New Zealand's equity market.

Emerging Market equities fell around -13% in the quarter, reducing the annual return to around -5%. While this is a poor absolute outcome, it is better than what we would normally expect in a market sell-off given emerging market stocks (like small-cap and value stocks) are typically seen as riskier than large developed market stocks. The better performance likely reflects that key Asian emerging markets - China, South Korea and Taiwan - are further ahead in their management of the COVID-19 pandemic.

Australian equity markets and listed property returns were in contrast hit very hard.

Trans-Tasman equity markets had mixed fortunes. Australian shares fell around 23%, slightly larger than the international market decline. In contrast, the NZ market 'only' fell by around 15% over the quarter, and is still up around 12% over the past three years. The differences largely reflect the make-up of our markets. Amongst New Zealand's largest listed companies are Fisher & Paykel Healthcare, A2 Milk, Spark and Contact Energy, which are in sectors that are less impacted by COVID-19. In contrast, Australia's largest listed companies include banks and mining stocks, which are much more affected by the current economic conditions.

The current global slump in activity is the largest on record, with recovery time frames uncertain.

Rounding out the return picture, infrastructure and property stocks also had mixed fortunes. International property stocks fell by around 28% in the quarter (-39% on a hedged basis), reflecting large uncertainty around when commercial buildings can be re-occupied, and what tenant demand might be post-COVID. International infrastructure has been more resilient, returning around -10% over the year.

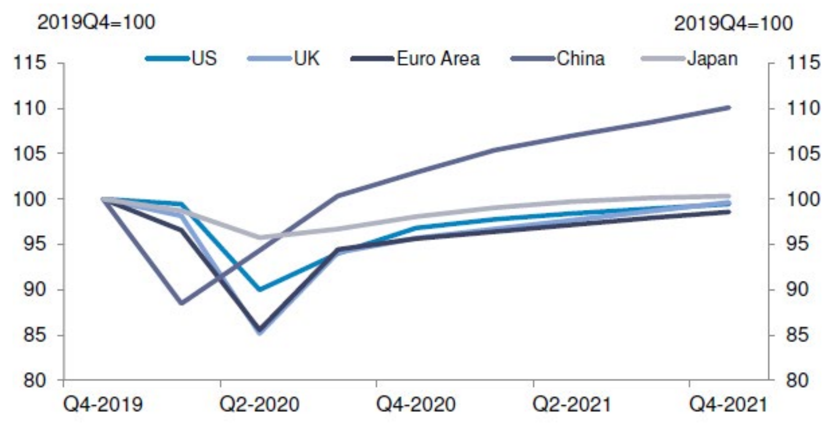
From Corona-coma to Carona-exit

But the shock will eventually pass, and New Zealand should fare relatively well.

Current economic readings are dire. Various measures of activity and employment are showing the largest declines on record. The New Zealand Treasury, for example, forecasts GDP will decline at least 13% in the year to March 2021. Pre-COVID global growth was bobbing slightly below trend. Now there is no-doubt most economies are in a recession, and the debate is over the recovery picture and whether some impacts (e.g. to tourism and commercial property) will be permanent. Current market pricing is consistent with a Nike "swoosh" pattern. Global activity will stay very depressed for the next few months but should start bouncing back from the September quarter forward (Figure 2). The uncertainty around this is very large - economic forecasts should be taken with an even larger "pinch of salt" than normal given a lot depends upon public health risks. Given the uncertainty, markets may see further bouts of volatility. But ultimately, as vaccines and better treatment protocols are developed, the pandemic will pass.

Qualitatively, we remain relatively positive about New Zealand's prospects. COVID-19 will have a larger short-term economic impact given the stringency of our lock-down measures, and our greater reliance on tourism than most OECD counties. But we are a relatively flexible economy, with much greater scope to use fiscal policy to help re-deploy resources to "plug the gap" in activity (e.g. to domestic construction, as the government has already signalled). Also, our largest trading partners (China, East Asia and Australia) will likely be the amongst the first countries to re-bound given their progress in managing COVID-19. This is crucial in the context of New Zealand being a small open economy whose prosperity is tightly linked to its trading partners.

FIGURE 2: ECONOMIES WILL RECOVER TOO, DESPITE THE UNCERTAINTY

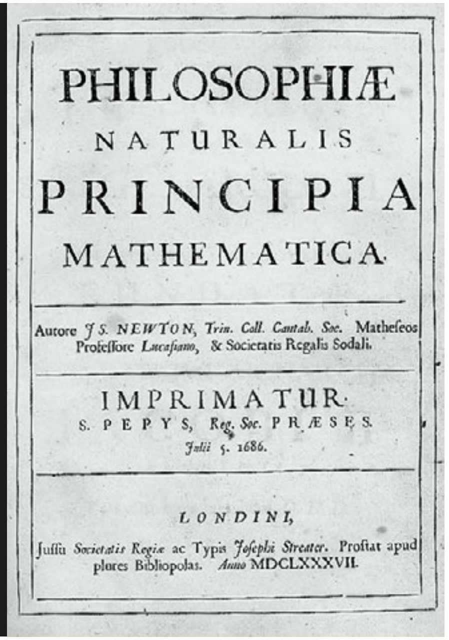


Source: Deutsch Bank Research, April 2020 Forecasts

Food for thought

Sir Isaac Newton was isolated to a farmhouse in Northern England during the plague in 1665. How he passed the time there may provide some inspiration during our period of lock-down.

First, Newton invented the mathematical system called Calculus.



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
-14.5%	+0.5%	**New Zealand Shares:** New Zealand shares returned -14.5% in the quarter and around 0.5% over the year to March 2020. The decline in NZ equities in response to the COVID-19 pandemic, while large, was still smaller than many other markets. Over the past 3-years performance remains strong at around 12% per annum. Source of Figures: S&P/NZX 50 Total Return Index With Imputation Credits
+1.2%	+4.2%	**New Zealand Fixed Interest:** New Zealand investment-grade corporate bonds returned 1.2% for the quarter and around 4.2% for the year. This return is both comfortably higher than 90-day NZ bank bill and term deposit rates, showing that NZ corporate bonds have delivered a premium over the year, and through the COVID-19 sell-off. Source of Figures: S&P/NZX A Grade Corporate Bond Index
-23.7%	-14.5%	**Australian Shares:** Australian shares returned -23.7% in the quarter in NZD terms, reducing the annual return to around -14.5%. Within Australian equities, small-cap stocks and value stocks under-performed returning around -27% and -30% for the quarter respectively. The large decline in Australian equities reflects their large exposure to the energy and commodities sectors, which have been particularly hard hit both by COVID-19 and an oil-price war between Russia and Saudi Arabia. Source of Figures: S&P/ASX 300, S&P Australia BMI Value, S&P/ASX Small Ordinaries
-10.2% (-21.1% hedged)	+3.1% (-11.1% hedged)	**International Shares:** International shares fell around 10% in the quarter in NZD terms, whilst NZD hedged shares fell around 21% - mirroring the decline in global market terms. The NZD tends to fall in time of stress, and this time was no different, which significantly helped cushion the blow from the global market decline. Within global equities, small caps returned around -20% in the quarter while value stocks returned around -17%. Source of Figures: MSCI World Index; Morningstar Developed Markets NZD hedged, MSCI World Value, MSCI World Small Cap.
-13.1%	-5.3%	**Emerging Markets:** Emerging Market equities fell around -13% in the quarter, reducing the annual return to around -5%. While this is a poor absolute outcome, it is better than what we would normally expect in a market sell-off given emerging market stocks (like small-cap and value stocks) are riskier than large developed market stocks. The better performance likely reflects that key Asian emerging markets are further ahead in their management of the COVID-19 pandemic. Source of Figures: MSCI Emerging Markets Index
+1.4%	+6.0%	**International Fixed Interest:** Global bonds returned 1.4% in the quarter and 6.0% for the year. The annual return remains strong given their low-income yields and reflects bonds being re-priced higher as longer-term interest rates fell on the back of global growth concerns. Source of Figures: Bloomberg Barclays Global Aggregate Index (hedged to NZD).
-28.0%	-24.5%	**International Property:** International property stocks fell by around 28% in the quarter (-39% on a hedged basis) and 24.5% over the year. This asset class has been hit hard by COVID-19, reflecting large uncertainty around when commercial buildings can be re-occupied, and what tenant demand might be post-COVID-19. International infrastructure has been a more resilient asset class, returning around -10% over the year. Source of Figures: FTSE EPRA NAREIT, S&P REIT indexes

WHAT YOU TRULY VALUE

In the face of a crisis, people often find they attain greater clarity about what is important to them. There is more space for reflection and an opportunity to work on absorbing projects. It's an incredible opportunity to find an activity that lets you move past fear and panic, to reconnect with what gives your life meaning. All change brings opportunity.

Some change gives us the opportunity to pause and ask: what can we do better?

Our devotion to our values gets tested in the face of a true crisis. But it's also an opportunity to reconnect, recommit, and sometimes, bake some bread.

*This article has been reproduced in part from the **Farnam Street website.***

The recent outbreak of the Coronavirus is impacting people all over the world — not just in terms of physical health, but financially, emotionally, and even socially.

As we struggle to adapt to our new circumstances, it can be tempting to bury our head and wait for it all to blow over so we can just get back to normal. Or we can see this as an incredible opportunity to figure out who we are.

What many of us are discovering right now is that the things we valued a few months ago don't matter: our cars, the titles on our business cards, our privileged neighbourhoods. Rather, what is coming to the forefront is a shift to figuring out what we find intrinsically rewarding

When everything is easy, it can seem like you have life figured out. When things change and you're called to put it into practice, it's a different level. It's one thing to say you are stoic when your coffee spills and another entirely when you're watching your community collapse. When life changes and gets hard, you realize you've never had to **put into practice** what you thought you knew about coping with disaster.

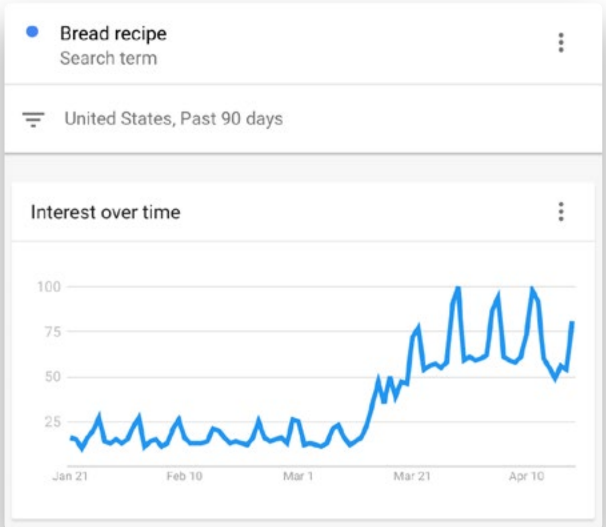
But when a crisis hits, everything is put to the real test.

The challenge then becomes wrapping our struggles into our values, because what we value only has meaning if it's important when life is hard. To know if they have worth, your values need to help you move forward when you can barely crawl and the obstacles in your way seem insurmountable.

In the face of a crisis, what is important to us becomes evident when we give ourselves the **space to reflect** on what is going to get us through the hard times. And so, we find renewed commitment to get back to core priorities. What seemed important before falls apart to reveal what really matters: family, love, community, health.

"I was 32 when I started cooking; up until then, I just ate." – Julia Child

One unexpected activity that many people are turning to now that they have time and are more introspective is baking. In fact, this week Google searches for bread recipes hit a noticeable high.



Baking is a very physical experience: kneading dough, tasting batter, smelling the results of the ingredients coming together.

It's an activity that requires patience. Bread has to rise. Pies have to cook. Cakes have to cool before they can be covered with icing. And, as prescriptive as baking seems on its surface, it's something that facilitates creativity as we improvise our ingredients based on what we have in the cupboard. We discover new flavours, and we comfort ourselves and others with the results. Baked goods are often something we share, and in doing so we are providing for those we care about.

Why might baking be useful in times of stress? In **Overcoming Anxiety**, Dennis Tirch explains "research has demonstrated that when people engage more fully in behaviours that give them a sense of pleasure and mastery, they can begin to overcome negative emotions."

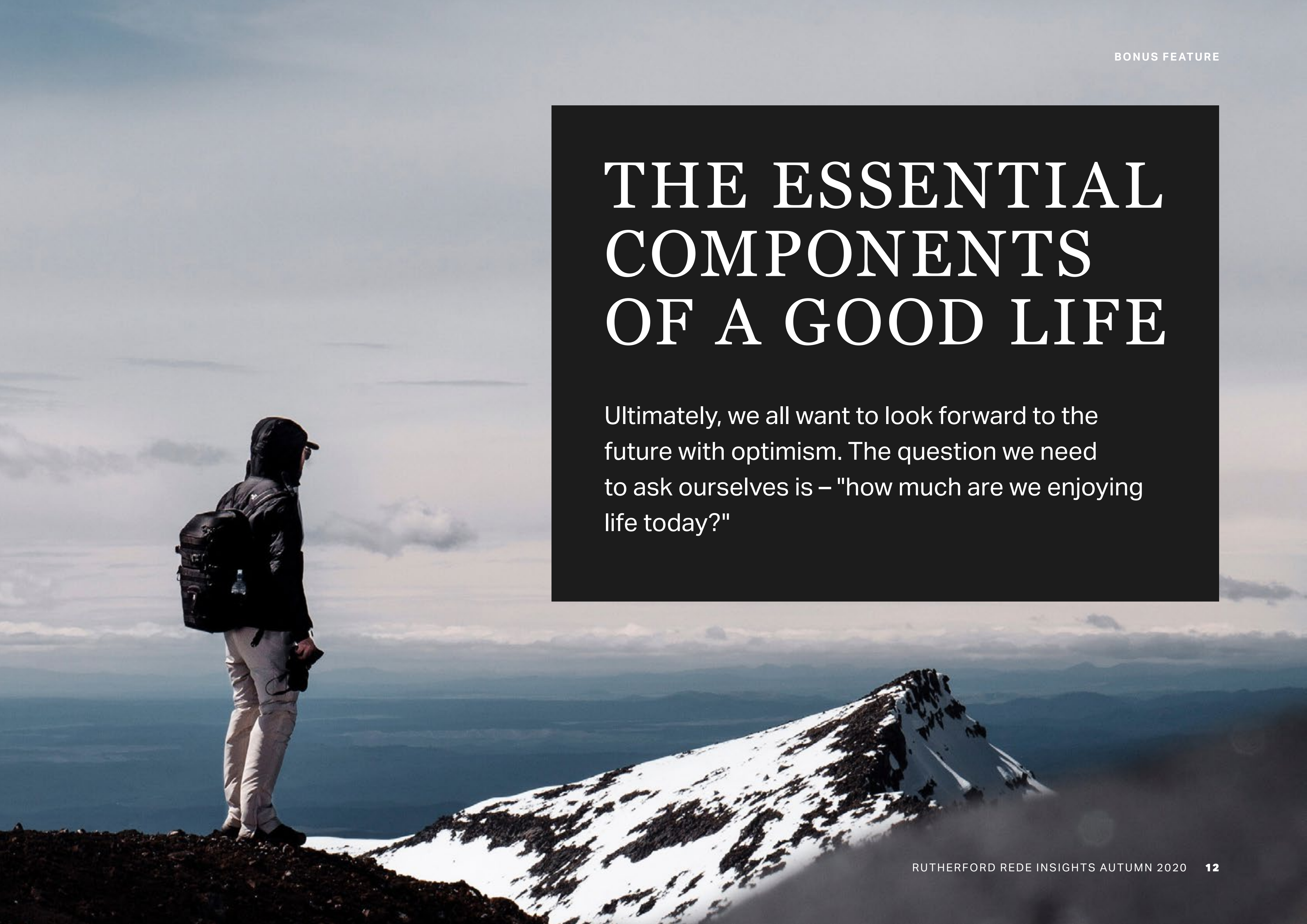
At home with their loved ones, people can reconsider what they value one muffin at a time. Creating with the people we love instead of consuming on our own allows us to focus on what we value as the world changes around us. With more time, slow, seemingly unproductive pursuits have new appeal because they help us reorient to the qualities in life that matter most.

Giving yourself the space to tune in to your values doesn't have to come through baking. What's important is that you find an activity that lets you move past fear and panic, to reconnect with what gives your life meaning. When you engage with an activity that gives you pleasure and releases negative emotions, it allows you to rediscover what is important to you.

Food for thought

More on how Newton passed his time.

Second, he drilled a hole in his bedroom shutter and held a prism up to the beam of light that came through it - and discovered the white light is made up of every colour



THE ESSENTIAL COMPONENTS OF A GOOD LIFE

Ultimately, we all want to look forward to the future with optimism. The question we need to ask ourselves is – "how much are we enjoying life today?"

As we go through life we all experience ups and downs. The scariest thing of all isn't going through the challenging times, but simply going through life without truly enjoying it.

A lot has been said and written about living a good life, and with some 7.3 billion people on this planet, there are quite possibly just as many opinions on what it constitutes.

So, what are the essential components of a good life? We've pulled together a list of our personal preferences. You will likely have your list, and it may be that some of the following items will resonate with you too.

1. **Your health:** Treat your body with the respect it deserves. The ancient philosopher Virgil had it right when he said: "The greatest wealth is health". Avoid bad habits and invest in preventative care such as regular check-ups and a balanced diet.
2. **Your family:** Your spouse, parents, children and grandchildren come first – period. If you have the blessing of a loving relationship with your family, protect it. The joy and satisfaction of loving and being loved by your family are not only priceless; it is fragile. People with strong family ties live longer and adapt better to health setbacks.
3. **Your friends:** Spending time with friends is key to our emotional well-being. Take a few minutes out of your day to catch up with them. Besides being one of the joys of life, real friendships are an excellent form of mutual insurance. In times of crisis, whether emotional, spiritual, or financial, real friendships are invaluable.
4. **Gratitude:** In the words of the Dalai Lama: "The seed of goodness is found in the soil of appreciation." Appreciate the miracle of life. It's easy to focus on the challenges of life and forget the gift of life. One small action of gratitude makes more of a difference in someone's life than we probably realise.
5. **Your education:** We typically view education as an age-based activity – something the young do to become adults and start a career. It is so much more. As well as being fun and keeping life exciting, lifelong learning reduces cognitive decline.
6. **Life experiences:** Invest more in life experiences. Adventures don't have to be expensive to be memorable. Learning a new language, taking part in a group walk, or going to dance lessons may seem frivolous when compared to the more practical and urgent things competing for our time. Yet, the rush of experiencing something amazing, new, and fun is what life is about.
7. **Your community:** Be part of something greater than yourself. Invest in the future of your community. Donate your most precious asset – your time – and mentor young people in your community.
8. **Kindness:** Kindness to others is a habit that supports and reinforces the quest for a good life. Helping others gives a sense of satisfaction that has two beneficiaries—the beneficiary, the receiver of the help, and the benefactor, the one who provides the help.

Living a good life, it seems, has many different aspects to it. It's about participating, exploring, and discovering new sources of delightful pleasures.

You simply have to think about the following activities:

- Parenting or caring for loved ones and reassuring friendships
- Teaching and nurturing our children and grandchildren
- Creating art, music, dance
- Building community connections
- Preserving the environment
- Looking after your health and well-being

What these activities add up to is what some of us might call a normal life, a well-rounded life of care and character, rich with community and creativity and balance. We might think of these activities as making up the essential components of a good life.

Food for thought

More on how Newton passed his time.

Third, he watched apples falling from trees and theorised about a force called gravity - a force that keeps the moon revolving around earth.

This spawned his famous and now very relevant quote - "I can calculate the movement of heavenly bodies, but not the madness of people".

THE 30 DAY DECLUTTER CHALLENGE

We don't all have the time to drop everything, empty our house completely and sort every item down to its true value. There are people to feed and dogs to walk! With this in mind, you can make great gains on decluttering your house if you can just do one little thing each day for a month.

YOUR DECLUTTER CHECKLIST

*The 30-day challenge has been sourced from the website article 'The Ultimate Guide to Decluttering Your Home". The original article can be found **here.***

- [ ] Meditate for 15 minutes. Imagine your life without clutter
- [ ] Find a kitchen utensil you have no use for. Give it away
- [ ] Look for something that's out of date in your kitchen cupboard. Get rid of it
- [ ] Sort through that pile of letters and bills in the kitchen. Recycle or shred them
- [ ] Pick out a piece of clothing that fits no more. Give it to charity
- [ ] Find a piece of jewellery you haven't worn for a year. Gift it to someone
- [ ] Find something, anything, in your house you don't want. Sell it and count the money
- [ ] Pick out a cookbook. Make something from it or give it away to charity
- [ ] Clean out the junk from inside your car. Spend any money you find
- [ ] Go through your old medicines. Throw away anything out of date or take it to your local chemist to destroy
- [ ] Find a stack of old magazines. Recycle them or give to an art teacher
- [ ] Open the junk drawer. Throw away items until it closes properly
- [ ] Go through the kid's cupboard. Donate clothes they have grown out of
- [ ] Pick out all the socks that don't have pairs. Throw them out

- [ ] RELAX! This is your day off. You deserve it
- [ ] Clear off the dining room table. Enjoy a proper family meal on it
- [ ] Look through your phone. Remove any apps you don't use
- [ ] Buy a functional storage item. Commit to using it
- [ ] Find a worn and broken pair of shoes. Throw them away
- [ ] Search through your freezer. Use or throw away old food past its date
- [ ] Congratulate yourself! Doing something for 21 days creates a new habit
- [ ] Go through your emails. Delete as many from your inbox as possible
- [ ] Find old and half-burned candles. Melt them down or throw them away
- [ ] Start a loose change jar. When it's full, treat yourself to something special
- [ ] Sort through old greeting cards. Unless they make you cry, get rid of them
- [ ] Organise your drinks cabinet. Pour away any old alcohol you don't like
- [ ] Download a decluttering app. Make the most of the good advice it gives you
- [ ] Pick up five things, and find a place for them. This is where they should stay
- [ ] Promise to not buy any clutter for 30 more days. Stick to this plan
- [ ] Marvel at your personal transformation. Enjoy your simpler home and life!

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