SYNERGY
INVESTMENTS

Investment Report for Quarter Ending 30th June 2017

ANOTHER POSITIVE STEP TOWARDS POINT B

There are many important steps to formulating a sound long term investment plan, but when you boil it down to its simplest form, a financial plan is aiming to move you from the financial situation you are in today (the day you agree to the plan) to the financial situation you aspire to be in at some future date. In essence, you are creating a map and an action plan on how to go from point A to point B, where point B usually represents a certain amount of investment assets at a certain point in time. Then the focus turns to monitoring your progress along the path towards that target.

strong business confidence. In fact, most developed markets were up over the quarter in their local currency terms, but a stronger New Zealand dollar took a little gloss off some of these returns when any unhedged foreign asset values were reported back into New Zealand dollars. The Australian market swam against the tide a little by being one of the few major share markets to post a small loss over the quarter.

Supporting these generally positive equity market returns was the underlying theme of a return to a more synchronised global

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While you can measure your progress in life on many different metrics (happiness, career, family, wealth and health), the most common yardstick for measuring your progress towards point B is usually returns. On that score, almost anyone investing into Synergy at its inception should be ahead of their plan, as returns for most risk levels (the 30/70 portfolio and above) have so far exceeded our long run expectations. Even though the pace of returns was generally a little slower than in recent quarters, the April to June returns were still another positive step towards the achievement of your long term goals. Not the sizable leap forwards we saw in the first quarter of the year or in the third quarter of 2016, but definitely still heading towards that all-important point B.

Helping us down that pathway this quarter were generally good returns from global share markets.

The emerging market regions, including countries like China and Korea, delivered excellent results. When these regions do well, it is generally an indicator that global investors are comfortable taking on more investment risk. The New Zealand market was also a notable performer, reflecting a still solid economic outlook here, and

growth environment. This was reinforced on numerous fronts over the quarter:

- The US Federal Reserve raised interest rates again in June and maintained their projection for a further seven rate hikes over the next two and a half years.
- After several challenging years, all the countries in the European Union are now growing (even Greece).
- Major emerging markets nations – like China and India – never stopped growing.
- New Zealand, and to a lesser extent Australia, also maintained useful growth rates, even while global growth rates have been weak.
- There were coordinated signals from several other central banks, including the European Central Bank, Bank of England and Bank of Canada, that the global recovery is building and that attention may soon need to be given to when to consider raising interest rates themselves.

As far as share markets are concerned, this paints a generally favourable scenario. Coordinated global growth tends to be driven by increased spending, which leads to more job creation, higher incomes, higher prices and profits and, ultimately, more investment, leading to yet higher growth. It is a virtuous circle which tends to reward owners of shares.

The main blight in this picture was the result of the UK elections in June. In an attempt to shore up their position at the Brexit negotiating table, the Conservatives called for an early election in April, when holding a commanding 19 point lead in the polls. Only seven weeks later, they suffered the humiliation of seeing their previous majority reduced and having to rely on the support of Northern Ireland's Democratic Unionist Party in order to form a minority government.

For once, this news didn't appear to have any significant impact on share markets. Perhaps the markets are suffering from 'Brexit fatigue', or perhaps they have collectively decided that, in the grand scheme of things, it doesn't really matter whether the European financial centre moves from London to Paris, Berlin or Zurich. Regardless, there will still be a financial centre somewhere and life will still go on. The British (or some of them) might not be so sanguine, but then it was the British who tipped the first domino over by voting for Brexit in the first place!

As always it is difficult to look into the future with any certainty. Political issues might wax and wane. North Korean tensions might escalate or recede. Global growth might accelerate or fade. Markets might rise or fall.

If history tells us anything it's that we should expect the unexpected, and one of the best ways to protect against the unexpected is by doing what Synergy does so very effectively – keeping costs low, being extremely diversified and tilted towards sources of higher expected returns, and limiting exposures to only the more liquid and higher quality securities in both equity and bond markets.

It is this approach, consistently and persistently maintained, that will help ensure you stay on track to reaching your point B.

KEY MARKET MOVEMENTS

+5.92%

New Zealand Shares

The local market backed up a good start to the year with another strong quarter. With improving global growth expectations, still supportive credit conditions and continuing strength in overseas equity markets, the New Zealand market prospered. Leading performers included Air New Zealand (+33.4%) and Xero (+33.4%), while A2 Milk (+33.8%) and Synlait (+22.2%) also advanced on the back of recovering milk prices. Sky TV (-12.0%) was one of the worst performers, thanks in part to the cancellation of their merger with Vodafone in June.

Source: S&P/NZX 50 Index, gross with imputation credits

+1.32%

New Zealand Fixed Interest

The Reserve Bank of New Zealand maintained the Official Cash Rate at 1.75% through both its 11 May and 22 June meetings. The release of the government budget showed the nation is in a strong fiscal position, which was supported by lower than expected unemployment figures. Even so, the Reserve Bank stressed they require a high threshold (in future data) before next raising interest rates. Yields were little changed through the quarter, which meant a return in line with expectations for this asset class.

+4.43%

New Zealand Property

The domestic listed property sector followed the broad equity market up. With the Reserve Bank indicating interest rates will be on hold in the medium term, yield seeking investors returned to the relatively higher yields offered by listed property assets. Vital Healthcare Property Trust led the pack, gaining +11.04% as the market favourably priced its recent 'acquisition spree', which included the purchase of a private mental health hospital in Sydney for A$30.3 million.

Source: S&P/NZX All Real Estate Index, gross with imputation credits

-5.28%

Australian Shares

The Australian share market posted a loss for the quarter, down -1.58% in Australian dollar terms. Small capitalisation companies fared better than larger firms, with the S&P/ASX Small Ordinaries down only -0.35% relative to -1.70% from the S&P/ASX 100 (both returns in Australian dollars). Returns to unhedged New Zealand investors were further reduced by a relatively weak Australian dollar. Leading sectors included industrials and healthcare companies, whilst telecommunications shares struggled as TPG Telecom announced a decision to launch Australia's fourth mobile network, putting stress on their larger peers.

Source: S&P/ASX 200 Index (total return)

+3.16%
(hedged to NZD)

-0.33%
(unhedged)

International Shares

As mentioned previously, developed markets equities delivered generally positive returns. Europe's big players all advanced, with the French election of Macron, in particular, well received. Japan was also one of the better developed markets (even with increased North Korean tensions), with many firms reporting annual profits above expectations. A slightly stronger New Zealand dollar, against the basket of global currencies comprising the MSCI World Index, saw reported returns from hedged equities outperforming the comparable returns from unhedged investments.

Source: MSCI World ex-Australia Index (net div.)

+1.77%

Emerging Markets Shares

Emerging markets outperformed developed markets, as exporting nations such as China and Korea rallied strongly amidst signs of an improving global growth outlook. Greece was one of the best performers, with Eurozone finance ministers agreeing to provide the financial assistance required to end uncertainty about the Mediterranean nation's ability to meet upcoming debt repayment obligations.

+0.59%

International Fixed Interest

This quarter saw the release of positive economic data from both the US and Europe. However, with inflation remaining stubbornly subdued, central banks continue to provide accommodative monetary policy. The quarter concluded with several 'hawkish' comments from central banks signalling the possible need to raise rates. This caused global yields to rise steeply in the final week of the quarter, resulting in an overall small gain from the international fixed interest asset class.

Source: Citigroup World Government Bond Index 1 – 5 Years (hedged to NZD)

-2.51%

International Property

Ongoing accommodative monetary policy benefitted international property, with American and European assets generally advancing. The S&P Developed REIT Index returned +1.92% in US dollar terms, while, conversely, the Australian listed property sector was down, with the S&P/ASX 300 A-REIT Total Return Index declining -3.05% in Australian dollar terms. A weak US dollar further reduced reported returns to New Zealand investors holding unhedged investments in this asset class.

Source: S&P Developed REIT Index (total return)

All returns are expressed in NZD. It is assumed that Australian shares, emerging markets 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.

KEYS

by Carl Richards

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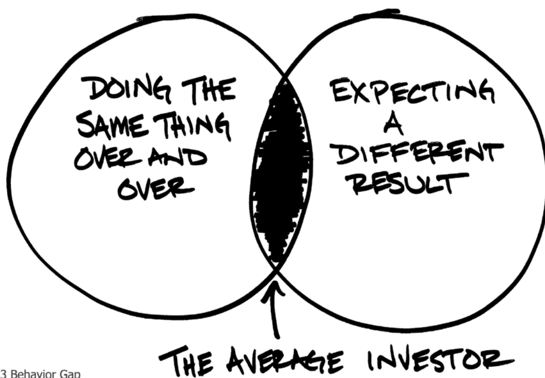

A few years ago, a friend of mine, who happens to be a really well-known journalist, had a conversation with a really well-known academic. Because the conversation was private, I'm not mentioning names. But I did want to share one fascinating part of their discussion.

They were talking about cognitive biases. A cognitive bias is a mistake we make because of a hole in our thinking. It's a sort of mental blind spot, and it's often built in to our thinking. A lot of the time we don't even know we're doing it. My friend, knowing the effect of these mistakes on our lives, wanted to know if knowing about these biases was enough to change our behaviour.

"I know what these biases are called," he said. "I've read all your books. I've read the academic literature. I can even spot these mistakes in others and myself. So my question for you, Mr. Academic, is pretty simple – knowing all that I know, can I have any hope that I'll stop making these mistakes?"

"No," answered Mr. Academic. "As I've said before, my only hope is that by reading my studies and my books, people will know what to call the mistake after they've made it."

I've heard this sentiment expressed before by people who study how humans behave with money. It makes the situation seem almost hopeless, because we have these natural human tendencies to do things that will cause us problems with money.

These cognitive biases might be good for the survival of our species, but they've been really bad in terms of our ability to behave with money. While I've heard that sentiment before, and in part I agree with it, simply knowing about these cognitive mistakes isn't going to change them. But knowing what they are called, and even identifying our tendency toward particular biases or mistakes, does help. It allows us to put in place what I like to think of as guardrails. Think of these guardrails as life hacks, or little changes we can make in our behaviour to minimise the effect of the mistakes we tend to make.

Let's assume you know that you make a particular mistake frequently. Perhaps you're like me, always misplacing your wallet. Since you've noticed this about yourself, you can now take steps to establish a habit to avoid losing your wallet in the future. Of course, you could just shrug your shoulders and say, "Well, that's a cognitive bias I have. There's nothing I can do about it," and hope something will change. But that's not a solution. In fact, it makes you the very definition of insanity, as you do the same thing over and over again and expect a different result.

What if, instead, you picked a single spot to set your wallet every time? By sticking with that simple life hack, the odds of losing your wallet drop quite a bit. Let me give you another example.

My mum comes to our house all the time, and when she leaves, she often forgets something. Sometimes it's her glasses, sometimes it's her purse. Recently, when she came to our house, she brought in a few groceries to stash in our fridge because she planned to stay for dinner. I watched her take a few steps, and I could tell she was thinking about something.

She knew that if she didn't do something to remind herself, she'd leave the groceries in the fridge. So she went back to the fridge, opened the door, and set her car keys next to her groceries. As she closed the fridge, she said to me, "Now I won't forget my groceries because I can't leave without my keys." My mum doesn't

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know about life hacks or think about this as a cognitive bias, but she intuitively knew enough to establish this guardrail to avoid forgetting her groceries.

I love this example of a life hack for a couple of reasons. First, my mum noticed a tendency she had to forget things. Second, she put a simple guardrail in place to avoid making the mistake. It's simple and doesn't require any new gadgets or checklists to work. Plus, it's repeatable. No matter where she goes, if my mum keeps her keys with whatever she needs when she leaves, she will be less likely to forget something.

Chances are we will continue to make money mistakes because of our own particular cognitive biases. But that doesn't mean we can't take steps to avoid making the same mistake again, once we notice the bias and set up guardrails to contain the damage. It starts with learning that these biases exist, and then identifying the ones we struggle with.

If you aren't sure what cognitive biases you struggle with, let me suggest something. If you have a partner, ask him or her. Trust me – they know our biases.

Once we know our biases, we can put guardrails in place. Like waiting 72 hours before buying something that we think we have to have right now, or putting your wallet in the same place every time. Whatever the hack, it's a better option than just hoping we won't make the same mistake again. We all know how that will turn out.

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