SYNERGY
INVESTMENTS

Investment Report for
Quarter Ending 31st December 2015

SYNERGY INVESTMENT APPROACH

Synergy investment portfolios are designed to be consistent with an asset class investment philosophy.

Key features of this investment approach are:

1

Wide diversification across different asset classes and individual securities so that the returns of markets can be consistently achieved

2

Portfolios are actively tilted towards securities which a growing body of academic and empirical evidence suggests can deliver higher long term expected returns

3

Total investment costs are kept as low as possible

4

Investments are restricted to only high quality and highly liquid assets

Synergy focuses on robust portfolio construction and consistent low cost management rather than attempting to base investment decisions on forecasts of the future.

Investing successfully requires doing the simple things well. One of the biggest handicaps facing private investors is the tendency to make important investment decisions based on limited or short term information.

When markets go up (or down), our natural human reaction is often to buy (or sell) at exactly the wrong time. We get more confident after prices have gone up (buying more when prices are higher) and more fearful after prices have gone down (selling when prices are lower). Clearly, buying high and selling low is a poor strategy.

Unfortunately investment markets are volatile and, if this behavioural response to volatile prices is repeated often enough over the long term, investors will ultimately end up with an investment outcome that falls well short of their expectations. This is especially true given the risks they have usually taken and the costs (time, emotional effort and actual dollars) they have spent along the way.

An investment in Synergy eliminates common behavioural inefficiencies because the underlying portfolios are structured to be held and rebalanced in line with what is best for the portfolio, and not in response to short term news headlines.

Synergy focuses on robust portfolio construction and consistent low cost management rather than attempting to base investment decisions on forecasts of the future.

Not only is successfully forecasting the future an almost impossible task, but investment strategies based around this approach tend to be much more expensive to implement and maintain. It is also more difficult for investors to know what sort of investment outcome they should reasonably expect as this investment approach is subject to almost continual change.

The strength of Synergy's approach is to help investors look through all the uninformative market and media noise and to focus instead on delivering sound, long term investment strategy.

MARKET REVIEW

The last quarter of 2015 saw some divergent performances from different asset classes and markets. A summary of these asset class returns is as follows:

New Zealand Shares

+13.07%

The NZX 50 rebounded strongly in the December quarter. The Reserve Bank cut the Official Cash Rate (OCR) again in December, which helped reinforce the relative attractiveness of dividend paying shares. Selected companies also achieved outstanding returns on the back of company specific news - shares in a2 Milk rose 166% over the quarter after faster sales led to earnings upgrades. Other notable returns came from Moa Group (+97%) and Chorus (+46%).

Source: S&P/NZX 50 Index

Australian Shares

+3.33%

After a good start to the quarter, by early December the Australian share market was in danger of delivering a negative return for the quarter before rallying strongly over the second half of the month. Banking shares along with consumer discretionary companies led the late December gains.

Source: S&P/ASX 200 Total Return Index

International Shares

+6.49%
(hedged to NZD)

-1.49%
(unhedged)

Although rebounding well in October after a poor third quarter, investors remained wary throughout November and December with the global outlook continuing to be clouded by low commodity prices, migration issues in Europe, emerging markets uncertainties and ongoing geopolitical risks. Hopes likely rest with the US economy, which is growing, to reclaim its position as global market leader in 2016. In contrast to recent quarters, a stronger local currency saw hedged New Zealand dollar returns clearly outstripping returns from comparable unhedged investments. Emerging markets equities generally delivered negative returns given the heightened uncertainty surrounding the economic consequences of a faster China slowdown.

Source: MSCI World ex-Australia Index

International Property

-1.36%

Global listed property returns were positive in USD terms over the quarter (+5.52%), mainly due to the October rebound, but the stronger New Zealand dollar turned sector returns negative for unhedged New Zealand investors. With the long awaited commencement of the US interest rate normalisation process, investors will be naturally watchful about how rising US rates may begin to impact this asset class in the future.

Source: S&P Developed REIT Index

New Zealand Fixed Interest

-0.12%

On 10 December the Reserve Bank confirmed their fourth cut in 2015 of the OCR, which ended the year at 2.50%. With the Reserve Bank's base case now that rates will remain at these levels at least until 2018, a minor selloff occurred in thin pre-Christmas trading which nudged this index into the negatives, the first quarterly decline in the index since March 2009.

Source: S&P/NZX A Grade Corporate Bond Index

International Fixed Interest

+0.59%

The US Federal Reserve finally raised interest rates in the December quarter, the first increase in the Federal Funds rate since February 2006. Globally the fixed income reaction was relatively muted, however, as this move had been much anticipated. Major bond yields exhibited little change in the quarter, although international credit spreads generally widened towards the end of December which impacted credit based returns.

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

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.

MARKET TIMING

A picture is worth a thousand words

They say a picture is worth a thousand words.

We could easily write a thousand words on market timing.

We could start by explaining how all trades involve a willing buyer and willing seller; each with equal interests, and exactly the same access to information.

We could mention the fact that, over about 85 years, the S&P 500 has only gone up 51.02% of the days.[1]

We could talk about the concentrated nature of returns. We could show that being out of the market, and missing the best month each year, drops returns by about 7% per year.[2]

We could quote a psychologist from Berkeley, named Philip Tetlock, who studied over 82,000 varied predictions, by 300 experts, from different fields, over 25 years and concluded that expert predictions barely beat random guesses. Ironically, the more famous the expert, the less accurate his or her prediction tended to be.[3]

We could refer to Nobel Prize winner Bill Sharpe's contention that market timers need to be right 74% of the time, to overcome the frictions and costs of their additional trades.[4]

We could point to magazine covers, like "The Death of Equities"[5], that featured just before five years of 14.44% average compound returns for the S&P 500.

We could explain how studies - ranging from the landmark paper by Brinson, Beebower and Hood[6], to the most recent study on NZ managed funds - have found that the average contribution of market timing to returns is negative.[7]

We could highlight a study of 1,557 managed funds and 210 institutional funds, where the author concluded the market timing ability of managers is, on average, negative.[8]

We could show that the majority of market timing newsletters underperform the market.[9] We could further explain how, on average, market timing newsletters underperform the market by over 4.00%.[10]

We could note how the market timing gurus whose calls are tracked, have less than 50% accuracy.[11]

We could discuss evidence that shows economists can't time markets either.[12]

We could reveal how the predictive power of last year's return, to correctly forecast this year's return, is 0.01%.[13]

We could relate the wise words of Warren Buffett, who said, "The only value of (share) forecasters is to make fortune tellers look good."[14]

We could explain the logic that all market timing calls precisely offset each other. If you buy, someone must sell. If you sell, someone must buy.

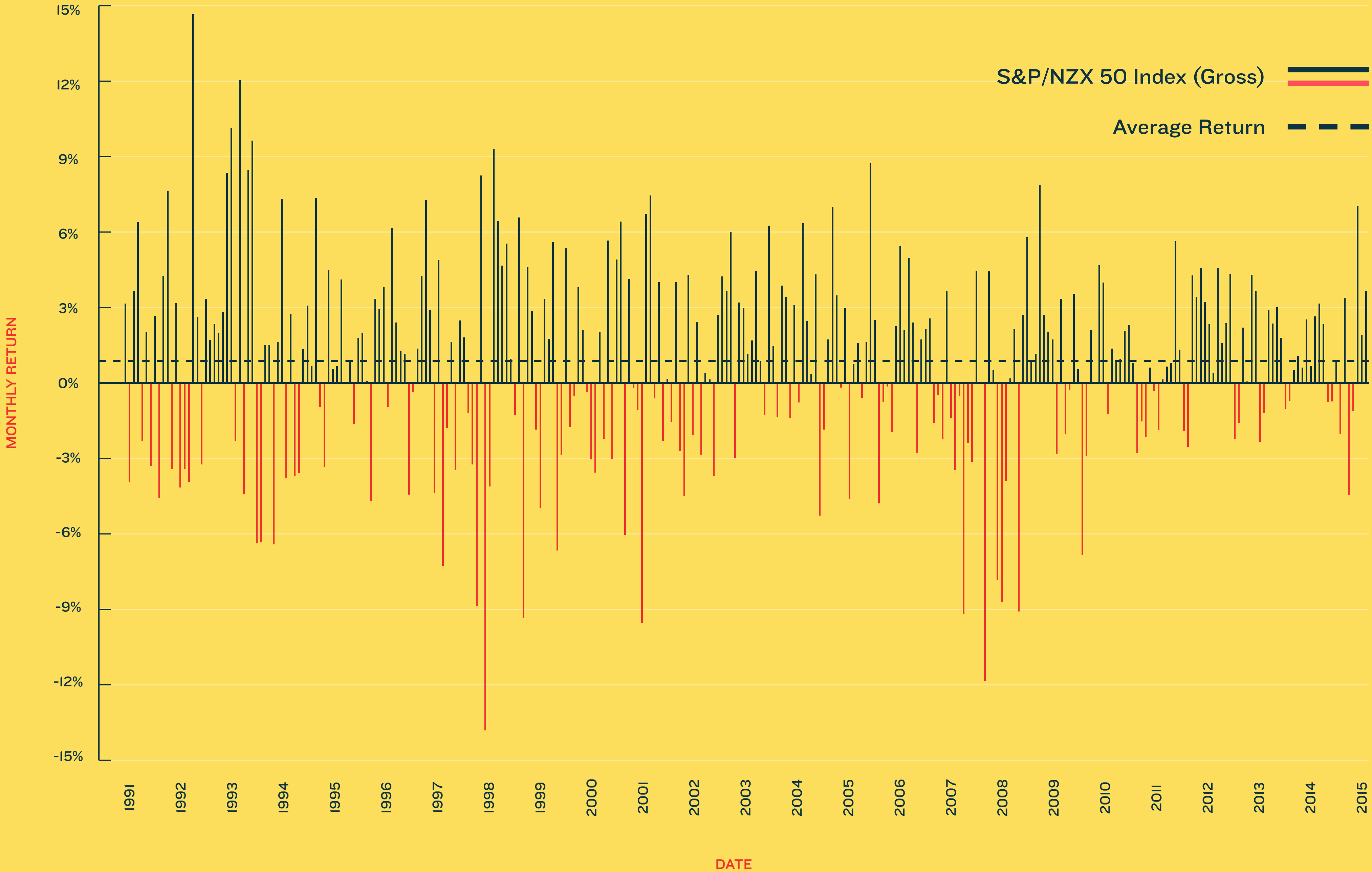
We could write about a lot of things.

OR

We could show you this picture of monthly returns and simply ask you to find the pattern.

MONTHLY RETURNS

24.5 Years: July 1991 - December 2015



Disclaimer

1) www.ifa.com, "Positive vs. Negative Returns in Various Time Periods", 85 Yrs, 5 Mths (1/1/1928 – 5/31/2013); S&P 500

2) NZX 50 Gross Index returns Jan 1991 to Dec 2015. Returns are gross of all fees and taxes

3) Burton Malkiel and Charles Ellis, "The Elements of Investing"

4) Sharpe, William, "Likely Gains From Market Timing", Financial Analysts Journal, March – April, 1975

5) www.bloomberg.com "The Death of Equities" August 13 1979

6) Gary P. Brinson, L. Randolph Hood and Gilbert L. Beebower, "Determinants of Portfolio Performance", Financial Analysts Journal, July-August 1986, pp. 39-44; and Gary P. Brinson, Brian D. Singer and Gilbert L. Beebower, "Revisiting Determinants of Portfolio Performance: An Update", 1990, Working Paper.

7) Rob Bauer, Roger Otten, Alireza Tourani Rad, "New Zealand mutual funds: measuring performance and persistence in performance," Accounting and Finance 46 (2006) 347–363

8) Wei Jiang, "A Nonparametric Test of Market Timing." Journal of Empirical Finance 10 (2003) 399– 425

9) Hulbert Financial Digest, Businessweek 9/3/1998

10) Market Timing Ability and Volatility Implied in Investment Newsletter Asset Allocation Recommendations" National Bureau of Economic Research Paper #4890

11) www.cxoadvisory.com/gurus/

12) SMH/Age Economists' Survey, Jan 6, 2008; Jan 3, 2009; Jan 2, 2010; Dec 31, 2010;

13) http://www.ifa.com/12steps/step4/step4page2.asp#ChartFlashID86

14) http://www.cbsnews.com/8301-505123_162-37841089/the-smartest-things-ever-said-about-market-timing/

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