SYNERGY
INVESTMENTS

Investment Report for
Quarter Ending 31st December 2018

WHY A LONGER TERM PERSPECTIVE IS IMPORTANT

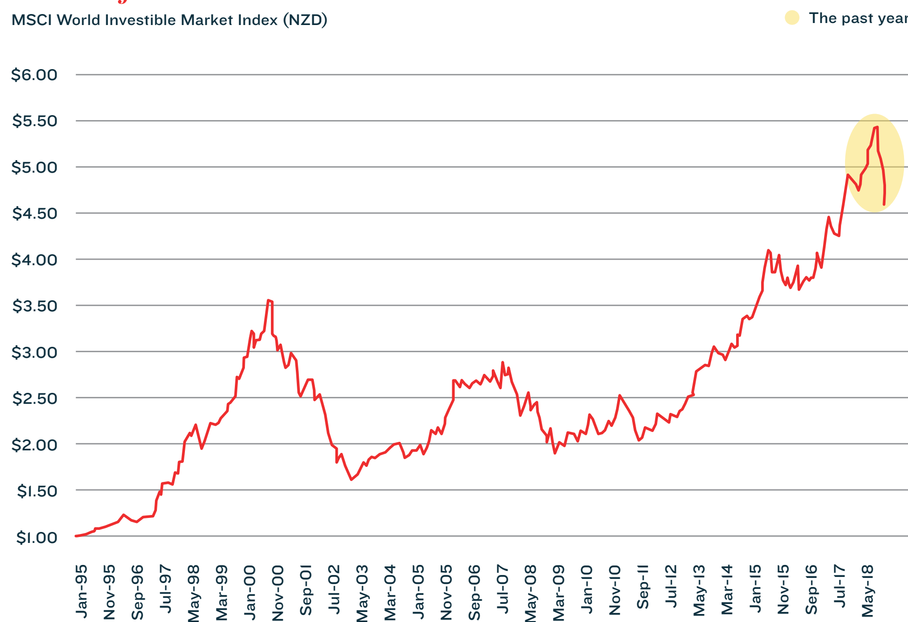
The final quarter of 2018 turned out to be a rockier time for share markets than we have seen in recent years. For the first nine months of the year most share markets were enjoying good returns, but market volatility increased sharply towards the end of the year as global share markets participated in a broad based decline. The decline was significant enough that most global markets finished the year in the red, although the New Zealand share market was a notable exception with the local NZX 50 index (including imputation credits) gaining 6.0% for the year.

It's always disappointing when markets lose ground, but it's also inevitable that risky assets will experience periods of negative performance. We have seen it frequently in the past and we will continue to see it in the future, which is why a longer term perspective shows the virtues of taking a patient approach.

The chart below shows the growth of wealth from a dollar, invested in global share markets going back to the mid-1990s. To represent the return of global share markets over this period we have assumed the return of the MSCI World Investible Market Index. The past year is highlighted towards the end of the line.

Growth of wealth: 1995 to 2018

MSCI World Investible Market Index (NZD)



Maintaining a longer term perspective is important because, as human beings, we are all prone to what is known as recency bias.

We tend to overemphasise the most recent data and extrapolate that into the future (usually incorrectly), while at the same time undervaluing long term trends. And if we allow ourselves to become hostage to that kind of behaviour, we run the risk of deciding to do the wrong thing at precisely the wrong time. Quite often, that can be far more damaging to a long term investment plan than a temporary market correction.

It's not always clear why investor sentiment changes. Long term investors had generally done extremely well since the Global Financial Crisis of 2007/08. However, they had also been getting increasingly fatigued by the prevailing uncertainties in the world. Included in that list were the simmering trade tensions between USA and China, diminishing prospects for a clean Brexit deal and concerns about US interest rate rises. Towards the end of last year, as investors increasingly sought a higher risk premium from investing in the more volatile share markets, we saw share prices generally correct lower. This wasn't positive for portfolio performance over that period, but so far this year investors have been returning to the markets to take advantage of these discounted prices.

As the new year begins, the media's focus inevitably turns to speculating about possible developments in 2019. We have already seen many opinions about the possible outcome of the trade tensions, the current US government shutdown, and the UK's tortured path towards Brexit. While it's natural to have an opinion on these issues, always remember that the views and expectations of all market participants are already built into prices. Even more important to remember is to try and shut out the media speculation 'noise' as much as possible. The media has a tendency to sensationalise and overstate, neither of which is particularly helpful (or comforting) if you are already confused about what to do.

Sound investment strategy doesn't change just because market conditions do. In our view, sound investment strategy includes all of the elements that Synergy is designed to deliver—a widely diversified and low cost exposure to high quality and highly liquid securities, along with strategic tilts towards sources of higher long term expected returns.

Of course, the best strategy in the world is only as good as the investor using it. Therefore, sound investment strategy also requires investors having a clear understanding and acceptance that changing market conditions are unavoidably part of the bargain, in order to achieve their important long term goals.

KEY MARKET MOVEMENTS

+1.21%

New Zealand Fixed Interest

The Reserve Bank of New Zealand (RBNZ) held the Official Cash Rate (OCR) at 1.75% at the 8 November update and reinforced expectations of no rate changes until 2020. RBNZ Governor Adrian Orr also stated there are both upside and downside risks to their growth and inflation projections and that the timing and direction of any future OCR change remains data dependent. This outlook, along with an increase in demand for more defensive securities, contributed to yields moving lower over the quarter, which proved beneficial for bond returns. The index delivered a +4.43% return for the year.

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

-6.63%

International Property

International property was not immune to the market volatility, although the more defensive nature of the asset class meant its returns were less negative than the broader equity market. The S&P Developed REIT Index lost -5.45% in US dollar terms and the Australian S&P/ASX 300 A-REIT Total Return Index lost -1.71% in Australian dollar terms. A weaker New Zealand dollar (relative to the 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)

-11.70%

Australian Shares

The Australian share market was hit harder by the increase in global market volatility. The ASX 200 lost -8.24% in Australian dollar terms, with large companies faring better than small companies (the ASX 100 Index was down -7.73% versus the MSCI Australia Small Cap Index down -12.38%). Defensive sectors such as utilities and real estate were among the most resilient, as were large materials firms such as BHP and Rio Tinto, which were both near flat. Conversely, consumer discretionary and telecommunications sectors were some of the worst affected, while energy was also poor as oil prices declined. Reported returns to unhedged New Zealand investors were further reduced by the Australian dollar weakening by approximately -3.7% relative to the New Zealand dollar over the quarter. The ASX 200 returned -7.39% for the year in NZD (and -2.84% in AUD).

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

-13.49% (hedged to NZD)

-14.57% (unhedged)

International Shares

Several factors contributed to heightened market volatility in the last quarter of 2018. Fears over slowing economic growth and reduced earnings expectations were fuelled by ongoing concerns about the impact of the US-China trade tariffs, the impact of continued increases in interest rates, and the uncertainty still surrounding the UK's pending exit from the EU. Britain continues to struggle to find a satisfactory pathway out of the EU, with Prime Minister Theresa May failing to gain support for her proposed EU Withdrawal Agreement. This increased concerns about the stability of the UK government, further compounding the global risks facing investors in the UK. Overall, quarterly losses were significantly negative across most developed nations including USA -13.5%, UK -10.3%, Europe -11.2%, and Japan -17.1%, making it the worst quarter for this asset class since the Eurozone debt crisis of 2011. For the year, the index declined -3.52% in New Zealand dollar terms on a currency hedged basis and -7.19% on an unhedged basis.

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

+2.34%

New Zealand Property

The New Zealand property asset class was very resilient for the quarter, delivering a gain of +2.34% which rounded out a +10.88% year. The prospect of lower interest rates for longer in New Zealand played its part in helping maintain positive sentiment towards the sector. Six of the seven largest listed property trusts delivered positive returns, led by Argosy, which returned in excess of +10% for the quarter.

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

+1.43%

International Fixed Interest

The US Federal Reserve raised rates by another 0.25% in December but also signalled that the track of regular rate rises may be coming to an end. This, and a classic flight-to-safety trade - which saw increased demand for bonds at the expense of shares during the quarter - drove government bond yields lower, which was beneficial for bond returns. This helped the index finish +2.17% higher for the year. The European Central Bank confirmed they were ending their quantitative easing (ie, bond purchasing) programme, although reduced their economic outlook forecasts, suggesting that rates will remain low for some time. The preference for lower risk assets in the quarter (bonds over shares) was also seen within the bond market, as lower risk government bonds generally outperformed corporate bonds.

Source: FTSE World Government Bond Index 1-5 Years (hedged to NZD)

-5.60%

New Zealand Shares

In a period of high volatility and, in most cases, significant share market declines around the world, the New Zealand market fell -5.60% for the quarter. On a relative basis this made it one of the better performing global share markets for the quarter and, in spite of the weak finish, completed a return of +6.04% for the year. The New Zealand share market contains a higher than average exposure to defensive sectors such as utilities (power producers) and REITs (property companies), which helped provide some insulation to the domestic market in this environment. Most companies in the index saw their share prices decline, particularly the large companies. Fletcher Building was one of the most affected over the quarter, completing a very difficult year for the company, while healthcare companies also struggled. Conversely, utilities were robust with firms such as Mercury, TrustPower and Meridian delivering gains. TradeMe was the standout, gaining 22% on the back of a $2.5billion takeover offer from a private equity firm.

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

-8.55%

Emerging Markets Shares

Emerging market equities were also down in the fourth quarter, although less so than in developed markets. This closed out a difficult -9.45% year for unhedged New Zealand investors. Chinese shares were among the worst hit, as trade uncertainty combined with disappointing earnings to drag them lower. Korean and Taiwanese shares also disappointed, with several large technology firms suffering falls amid concerns about the potential for reduced demand for these discretionary products. Nations with a dependence on oil exports (eg, Russia and Colombia) also struggled, although Brazil was a positive outlier posting a +10.8% gain on the back of a stabilising election outcome.

Source: MSCI Emerging Markets Index (gross div.)

Unless otherwise specified, 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.

SECRETS OF A HAPPY RETIREMENT

Some people who imagined they'd leave all their worries behind once they quit working are finding retirement isn't quite as blissful as they dreamed it would be. In the USA, 2018 data from the Employee Benefit Research Institute (EBRI) suggests the average retirement satisfaction of Americans is falling, regardless of whether they are wealthy or not.

Whilst we don't have comparable data for New Zealand, we do have this thing called retirement(!), so we should see whether we can learn anything from the USA data.

It's not clear what's causing the reduced retirement satisfaction, but part of the problem might be the nature of retirement is changing, and it's taking people's expectations a while to catch up. Retirements can stretch for decades, health care costs are rising, and people are more likely to want (or need) to keep a foot in the working world rather than transitioning straight to a life of fulltime leisure.

That transition from busy worker to relaxed retiree isn't always simple. Although retirement boosts happiness overall, some retirees are happier than others.

What separates the happy from the less satisfied? Perhaps it's simply that some worked out ahead of time the 10 biggest secrets of a happy retirement.

1. Don't assume it's all about the money

It's a cliché to say money can't buy happiness, but it's true when it comes to retirement. A big bank balance won't translate to stress free retirement if there are other problems lurking below the surface.

Sometimes, the problems are financial, such as debt. In other cases, they're personal. Whatever the cause, you shouldn't assume money alone will make the other problems in your life disappear.

2. But don't ignore your finances

Money might not be everything, but a steady source of retirement income can go a long way to reducing retirement stress. People with consistent sources of retirement income, such as a pension, are generally more financially confident and less likely to feel pressure to cut spending than those who rely solely on income from their investments.

3. Stay healthy

The better a person's health, the more likely they were to say they were having a happy retirement, EBRI found. 80% of retirees who rated their health as excellent said they were very satisfied with their retirement, compared to only 26% of those who rated their health as poor.

The good news is, for many, retirement offers an opportunity to refocus on health and wellness as people have more time to pay attention to nutrition, exercise and living a healthy lifestyle.

4. Find your purpose

Retirement frees up your schedule, but for some people all that unstructured time can be overwhelming. An absence of purpose can lead to boredom, depression and relationship stress. That can be especially true for people whose identity was closely tied to their career.

Think carefully about what your retirement purpose will be before you stop working. That might mean setting yourself up to start a business, looking into volunteer work, or turning a spare bedroom into an artist's studio.

5. Don't try to keep up with the Joneses

Pressure to keep up with your friends and neighbours when it comes to holidays, home improvements and hobbies can derail your retirement finances, and your happiness.

If you move in a social circle where people tend to live large and you can't handle the pressure to keep up, you might need to refocus your energy elsewhere.

6. Give back

Many people plan to dedicate time and money in retirement to giving back. That generosity doesn't just benefit those you help, but it also increases your own sense of wellbeing.

Volunteer work and other charitable activities are also a great way to find new purpose and meet new people.

7. Stay social

Not having much of a social life can be bad for your health. Studies have linked low social interaction with a greater risk of heart disease and cognitive decline.

To stay happy and healthy in retirement, make time to develop new relationships and nurture existing ones, especially if your social life previously revolved around work.

8. Communicate with your spouse

Even couples with strong relationships can find the transition to retirement is a bumpy road. Suddenly, the person you're used to spending evenings and weekends with is around all the time. Even if you're looking forward to getting to know your partner again, you might need to set some boundaries.

Sometimes, that means one person goes back to work, even part time. It also might mean sitting down and having a conversation about what you both really expect from retirement, so neither person ends up unhappy or resentful.

9. Think twice before relocating

Picking the wrong place to move is one of the biggest sources of retirement unhappiness. Choosing a location because it has a low cost of living or you loved holidaying there without considering other factors—such as whether you'll enjoy the community or have friends or family nearby—can be a mistake that's expensive to undo. Pulling up stakes without considering all the potential consequences can be one of the biggest retirement regrets.

10. Be satisfied with what you have

Your retirement nest egg might not be quite as large as you hoped it would be, but that doesn't have to mean spending your golden years in misery. Assuming you have enough to live comfortably, there are plenty of ways to enjoy your retirement, even if you can't afford all the luxuries you might have dreamed of.

The key is to appreciate what you do have —whether it's your health, family or hobbies —and not stress too much about what you might lack. Once you come to terms with your own retirement reality, you'll be well on your way to retirement happiness.

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