Synergy Investments
Newsletter

FOR QUARTER ENDING 30 JUNE 2024

Synergy INVESTMENTS

www.synergyinvestments.co.nz

Market Commentary

Positive global share market momentum carried into the second quarter of 2024 for the USA, although share market returns in other regions were variable.

The outlook for interest rates remained unchanged, however there is growing expectation for a general reduction in interest rates around the globe. In June, the European Central Bank and the Bank of Canada became the first of the major banks to begin cutting rates. With local inflation heading in the right direction, it looks as though the Reserve Bank of New Zealand may soon follow suit.

In the key US market, the Federal Reserve held the federal funds rate steady at 5.25% throughout the quarter, with officials there citing the need to cool persistently high inflation.

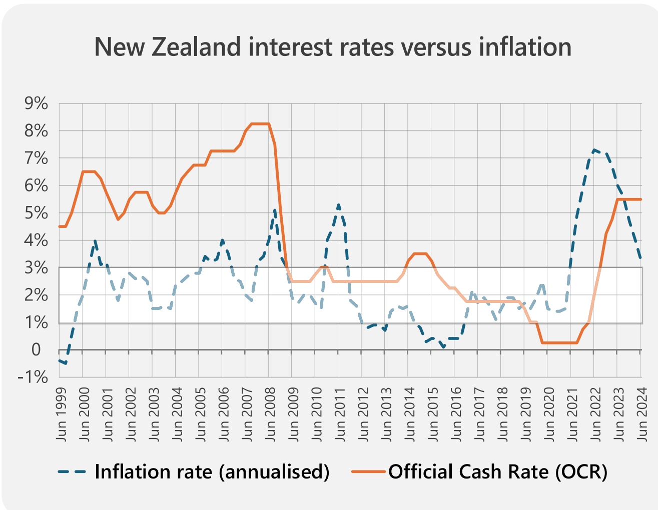
Against this backdrop, the US share market extended its bull run that began in late 2022, with the S&P 500 Index reaching all-time highs during the quarter. This performance was led, once again, by the strong performance from a handful of large capitalisation companies in the information technology sector. Unfortunately, the New Zealand share market continues to lag many of its global peers with weak economic growth, and stubborn inflationary pressures, continuing to challenge local policymakers.

On the global political stage, uncertainty and change seem to be in store in 2024. After a relatively brief campaign, the Conservatives have just relinquished Downing Street after 14 years in power in the UK. Emmanuel Macron's snap election resulted in no clear winner, leaving France without a new prime minister or government and in political chaos just weeks before they welcome the world for the Olympic Games.

Meanwhile, the lead-up to the US presidential election has been even more volatile than pundits expected, including the shocking attack on former president Donald Trump in early July and the recent exit of Joe Biden from the Democratic ticket.

New Zealand interest rates - the wait goes on

The chart below shows the annualised inflation rate (dotted blue line) plotted against New Zealand's Official Cash Rate (OCR) which is the short-term interest rate set on a periodic basis by the RBNZ (orange line).



The RBNZ aims to keep inflation within the range of 1% to 3% over the medium term (the area shaded in white). For the most part they have achieved this fairly consistently over the last 25 years. Up until 2021, there had been only occasional deviations of inflation outside this band, and most had returned back to the target range within 12 months.

However, the 'cost-of-living crisis' has been a different story. The significant 'spike' in inflation that commenced in 2021 has so far not returned to the target band. This is why the orange line is not budging yet. The length of time that inflation has stayed above target (now three years and counting) has backed the RBNZ into a corner. It is highly reluctant to reduce interest rates until it sees inflation back inside the target band. This caution has resulted in the OCR being stuck at 5.5% since May 2023.

The good news, as you can see from the chart, is that inflation is heading in the right direction, and many commentators consider that we could see interest rate reductions later this year (ahead of the RBNZ's own forecasts). Whenever it begins, it will mark the end of the most restrictive interest rate settings New Zealand has experienced in 15 years.

Does the US election matter?

We are approaching a pivotal moment in the U.S. political landscape, as President Joe Biden has officially announced that he will not seek re-election. This decision significantly alters the upcoming election, which is now likely to feature former President Donald Trump as the presumptive Republican nominee. Trump is known for being a divisive and controversial figure, and his campaign is expected to involve considerable time in courtrooms as well as on the campaign trail. He will face off against a yet-to-be-confirmed Democratic candidate, with Kamala Harris seemingly the frontrunner.

Does it matter who wins?

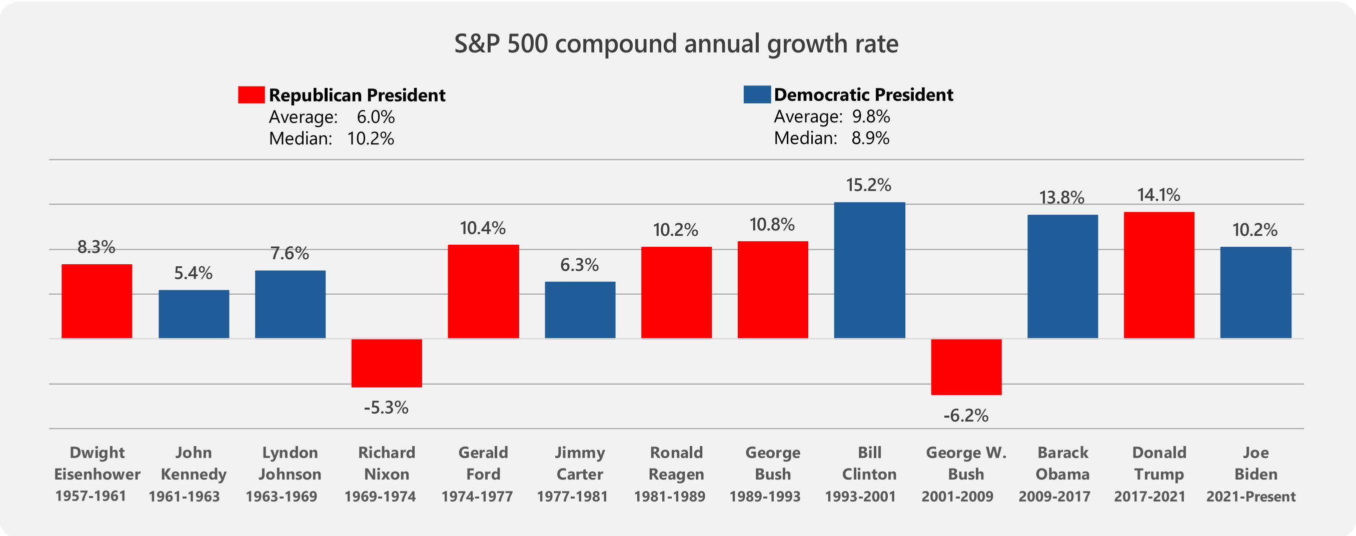
In some ways, probably not. Both the Democrats and Republicans will aim to be expansionary and will keep issuing bonds and printing money. While the Democrats might spend more, the Republicans will aim to reduce taxes more.

In some ways, almost certainly. In matters of foreign policy, we can expect a Republican presidency to renew stronger rhetoric around Europe's contributions to NATO, possibly not supporting efforts to arm Ukraine, and likely promoting greater trade protectionism, particularly in respect to China. Conversely, the Democrats have indicated they will propose extending tax breaks for those on low incomes while raising corporate tax rates, and potentially further promote renewable energy development. Clearly the outcome in November will have a significant impact on some sensitive corners of the economy.

How investment markets might perform is much less predictable, although history says that patient investors will be rewarded regardless of which political party controls the White House.

One of the reasons why is because the president has no direct control over the share market. While the president influences fiscal policy to varying degrees, it is Congress that ultimately creates the federal budget, and government spending is only one of many variables that affect the share market. Also, when considering events like the dot-com bubble, the Great Recession, and the COVID-19 pandemic - no president caused those events, but all three events caused share market crashes.

Since the inception of the S&P 500 share market index in 1957, the respective market performance under different presidencies is highlighted below.



Given the ability for statistics to be easily manipulated, Republicans (higher median return) and Democrats (higher average return) could both try to claim the share market has performed better when they controlled the presidency.

However, investors should ignore such comments. Share prices, determined by business fundamentals like revenue and earnings growth, are merely influenced (not controlled) by a president's fiscal policies.

While the winner in November may not have much of an impact on eventual market returns, this will nevertheless be a point of considerable global attention over the next 4-5 month

Tune out the noise

There is a near constant swirl of speculative opinion - both in the general news media and in the financial press - about a range of factors or events for which the outcome is, and always will be, uncertain.

Not a day goes by without a big, scary headline professing at least some level of consternation about one or more of the following:

- the timing and size of future interest rate changes
- the long-term impact of AI
- the consequences of a changing global political landscape
- whether inflation is really back under control
- whether technology companies are forming the next market 'bubble'
- when the conflict in Ukraine or the Middle East might end
- the ongoing impacts of climate change

Unfortunately, reading (or watching) the guesses of different pundits about an unknown future provides no useful benefit to long term investors.

Markets, in aggregate, are aware of the prevailing uncertainties and, to the greatest extent possible, that uncertainty is already factored into asset prices today. Yes, as information changes, prices will move to reflect that new information. But, as the exact nature of future information is usually unguessable in advance – even by so-called experts – this speculation is nothing more than an unwelcome distraction and investors should exclude it from their strategic decision-making.

The best response a long-term investor can have to uncertain events is to tune out the persistent noise about everything that is unknown or could go wrong and focus instead on the consistent behaviours that have been proven to add value over time.

Unlike the list of potential issues, which is always concerning and always changing, the list of great investor behaviours never changes.

These are – in no particular order:

- ✔ allocate strategically (not tactically),
- ✔ keep costs low, stay diversified, rebalance periodically to manage risk,
- ✔ don't engage in panic buying (or selling),
- ✔ and always consult your adviser if your circumstances or requirements change.

Mastery of these relatively simple steps means you will dramatically improve your chances of achieving your long-term investment goals and objectives.

Key Market Movements

International share markets gained overall in the second quarter of 2024, although individual country returns were mixed.

Politics was a key focus this quarter. The recent European Union parliamentary elections saw significant gains for right-wing nationalist parties. In the UK, the general election in early July resulted in a change of government. Meanwhile, President Joe Biden has announced at the last minute that he will not seek re-election, endorsing Kamala Harris as his successor. However, the identity of the next Democratic nominee remains uncertain.

Outside of this, the artificial intelligence 'theme' continued to lead markets, while policymakers continued to wrestle with how much (and when) to reduce interest rates.

With a slowing in economic activity in the US and weakening economic indicators in the Eurozone and UK, the case for interest rate reductions remains broadly intact. The only element not playing its part is inflation which is remaining a little higher and 'stickier' in some regions than the central bankers are generally comfortable with.

Emerging share markets outperformed developed share markets over the quarter (excluding any currency hedging impacts) as softer US macroeconomic data helped ease concerns about the timing of US interest rate cuts, and a welcome rebound in Chinese shares helped propel emerging market returns overall.

INTERNATIONAL SHARES

+3.2% (hedged to NZD)

+0.7% (unhedged)

Share markets in the developed economies generally delivered gains in the second quarter. The US market was again led higher by the information technology and communication services sectors. Ongoing enthusiasm around artificial intelligence continued to boost related companies, such as microprocessor manufacturers and AI software developers, amid some strong earnings and outlook statements.

European share markets were mixed in the second quarter, amid uncertainty caused by the announcement of parliamentary elections in France and dwindling expectations for steep interest rate cuts (with euro area inflation actually increasing from 2.4% in March to 2.5% in June).

The FTSE 100 achieved all-time highs as UK shares rose over the quarter. After delivering relatively strong economic growth in the first quarter, data early in the second quarter pointed to a slowdown with the economy shedding 140,000 jobs in April.

Against most major currencies, the New Zealand dollar was stronger through the quarter, which meant higher reported returns for investors holding hedged foreign assets.

The MSCI World ex-Australia Index returned +3.2% for the quarter hedged to the New Zealand dollar and +0.7% for the unhedged index.

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

EMERGING MARKETS SHARES

+3.1%

Emerging markets shares delivered more solid returns than their developed counterparts, although the stronger New Zealand dollar was a factor in reducing the size of the reported gains.

Shares in China rallied strongly over the quarter as low valuations for many Chinese companies encouraged investors to return. Optimism about the authorities' support for the housing sector and President Xi's reform rhetoric was also beneficial.

Indian shares delivered robust gains, driven by continued positive investor sentiment. Indian benchmark indices reached record highs at the end of the quarter, with media and banking stocks leading the way. Taiwan also posted a strong return against a backdrop of continued investor enthusiasm for technology companies, particularly those benefitting from the positive sentiment linked to AI-related businesses.

Brazil and Mexico were amongst the worst performers for the quarter. Flooding in Brazil's southern state of Rio Grande do Sul prompted investor concerns about economic growth, spending and inflation. Meanwhile, in Mexico, Claudia Sheinbaum's election as president and her Morena party's super majority in the lower House of Congress raises the prospect of institutional weakening if Morena is able to pass constitutional reforms, including judicial reform. The associated risks here were poorly received by the market.

It was a useful quarter overall for the underlying emerging markets group. While the MSCI Emerging Markets Index produced a quarterly return of +6.3% in local currency terms, the stronger New Zealand dollar reduced the gains to unhedged investors.

Source: MSCI Emerging Markets Index (gross div.)

NEW ZEALAND SHARES

-3.1%

The New Zealand share market, as measured by the S&P/NZX 50 Index, delivered a negative return for the second quarter, generally lagging global peers.

Hanging over the performance of the local share market has been persistent weakness in economic indicators. Forward economic activity indicators point towards a potential contraction in New Zealand's GDP for the second quarter, running with a notable decline in GDP per capita and a contraction in the services industries. The labour market is also showing signs of loosening, with a decline in job advertisements and an anticipated acceleration in the unemployment rate.

The Reserve Bank of New Zealand (RBNZ) continues to be faced with the delicate task of balancing the risk of managing current high inflation against the possibility that inflation may decline much more rapidly than expected over the medium term.

From within the top 50 companies, good results were recorded by Fisher & Paykel Healthcare (+18.2%) following the announcement of a 6% gain in annual net profit, and Meridian Energy shares (+6.4%) gained on the back of solid retail sales volumes. On the downside, Fletcher Building Ltd (-31.3%) reduced its profit guidance citing difficult housing market conditions, and SkyCity Entertainment (-29.8%) declined steadily through the quarter.

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

Key Market Movements

AUSTRALIAN SHARES

-0.6%

The Australian share market (S&P/ASX 200 Total Return Index) recorded a small decline in the second quarter, falling -1.1% in Australian dollar terms.

Returns tended to be slightly better in the larger capitalisation companies over the quarter and, breaking ranks with global peers, it was the utilities sector which was easily the strongest performing sector of the Australian market. The energy, real estate and materials sectors were the weakest in a quarter where losing sectors outnumbered winners by six to five.

Within the largest 50 firms, which is where the bulk of the ASX 200 index return generally comes from, there were notable performances from healthcare software provider Pro Medicus (+38.1%) and gold mining company Newmont Corporation (+18.7%).

However, in a period where the overall returns were weak, there were at least as many firms that struggled, including financial technology firm Block Incorporated (-25.5%) along with James Hardie Industries (-23.2%). James Hardie is the world's largest fibre cement maker and has forecast a fall in profits over the next year due to reduced demand for its products.

With the Australian dollar very slightly stronger against the New Zealand dollar over the quarter, the reported returns to unhedged New Zealand investors rose to -0.6%.

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

INTERNATIONAL FIXED INTEREST

+0.9%

The second quarter of 2024 commenced on a disappointing note for global bond markets, with renewed concerns about US inflation causing investors to reassess the likely timing of interest rate cuts. However, later in the quarter a more favourable market environment was driven by the emergence of softer labour market conditions, and encouraging news on inflation.

With US inflation easing slightly from 3.5% in March to 3.0% in June, the latest "dot plot" showing the rate forecasts of Federal Reserve policymakers indicated just one interest rate cut this year. The European Central Bank proceeded with a 0.25% interest rate cut in early June, although scope for further cuts appear limited by 'sticky' inflation readings in the region. While in the UK, despite slowing growth and encouraging inflation trends, the Bank of England left its base rate unchanged over the quarter.

The US 10 year bond yield climbed from 4.21% to 4.41%, with the two year bond yield moving from 4.63% to 4.75%. Germany's 10 year bond yield rose from 2.29% to 2.49%, while the UK 10 year yield moved from 3.94% to 4.18%.

The FTSE World Government Bond Index 1-5 Years (hedged to NZD) returned +0.9% for the quarter, while the broader Bloomberg Global Aggregate Bond Index (hedged to NZD) was up +0.1%.

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

NEW ZEALAND FIXED INTEREST

+1.2%

The Reserve Bank of New Zealand (RBNZ) left New Zealand's Official Cash Rate (OCR) unchanged at 5.50% at 10 April and 22 May announcements, extending the sequence to eight 'holds' since May 2023.

While the RBNZ acknowledge weaker capacity pressures and an easing labour market are reducing domestic inflation, it also points out that certain sectors of the economy are less sensitive to interest rates. For example, higher rents, insurance costs, council rates, and other domestic services costs are contributing to New Zealand's overall inflation figure, which is still above the RBNZ's target band.

As it has signalled for some time, the RBNZ reiterated that it wants to see inflation back in the target 1% to 3% band before moving to reduce interest rates. With unemployment having risen post the election and evidence of reduced spending across the economy, the only open question now is - how long will it take for inflation to fall back into the target band? The latest reading, for the 12 months ended June 2024 was 3.3%, suggesting it could be sometime soon.

On the back of the general trend of rising bond yields internationally, the New Zealand 10 year bond yield increased from 4.61% to 4.75% over the quarter.

The S&P/NZX A-Grade Corporate Bond Index gained +1.2% for the quarter, while the longer duration but higher quality S&P/NZX NZ Government Bond Index gained +0.5%.

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

Table 1: Asset class returns to 30 June 2024

ASSET CLASS	INDEX NAME	3 MONTHS	1 YEAR	3 YEARS	5 YEARS	10 YEARS
International shares	MSCI World ex Australia Index (net div., hedged to NZD)	3.2%	21.6%	7.8%	11.7%	10.7%
	MSCI World ex Australia Index (net div.)	0.7%	21.2%	11.9%	14.1%	13.3%
Emerging markets shares	MSCI Emerging Markets Index (gross div.)	3.1%	13.8%	-0.2%	5.5%	7.0%
New Zealand shares	S&P/NZX 50 Index (gross with imputation credits)	-3.1%	-0.8%	-1.7%	3.0%	9.7%
Australian shares	S&P/ASX 200 Index (total return)	-0.6%	13.1%	7.1%	8.3%	8.2%
International fixed interest	FTSE World Government Bond Index 1-5 Years (hedged to NZD)	0.9%	4.7%	0.3%	0.9%	2.1%
	Bloomberg Global Aggregate Bond Index (hedged to NZD)	0.1%	3.8%	-1.9%	0.0%	2.6%
New Zealand fixed interest	S&P/NZX A-Grade Corporate Bond Index	1.2%	6.3%	0.3%	1.1%	3.4%
New Zealand cash	New Zealand One-Month Bank Bill Yields Index	1.4%	5.8%	3.7%	2.5%	2.4%

Unless otherwise specified, all returns are expressed in NZD. We assume Australian shares and emerging markets shares are invested on an unhedged basis, and therefore returns from these asset classes are susceptible to movement in the value of the NZD. Index returns are before all costs and tax. Returns are annualised for time periods greater than one year.

Habits vs. Goals: A Look at the Benefits of a Systematic Approach to Life

Nothing will change your future trajectory like your habits.

We all have goals, big or small, things we want to achieve within a certain time frame. Maybe you want to make a million dollars by the time you turn 30. Or to lose 20 pounds before summer. Or to write a book in the next six months. When we begin to chase a vague concept (success, wealth, health, happiness), making a tangible goal is often the first step.

Habits are algorithms operating in the background that power our lives. Good habits help us reach our goals more effectively and efficiently. Bad ones make things harder or prevent success entirely. Habits powerfully influence our automatic behaviour.

"First, forget inspiration. Habit is more dependable. Habit will sustain you whether you're inspired or not. Habit is persistence in practice."
— Octavia Butler

The difference between habits and goals is not semantic. Each requires different forms of action. For example:

Let's say you want to read more books. You could set the goal to read 50 books by the end of the year, or you could create a habit and decide to always carry a book with you.

The problems with goals

Let's go over the problems with only having goals.

First off, goals have an endpoint. This is why many people revert to their previous state after achieving a certain goal. People run marathons, then stop exercising altogether. Or they make a certain amount of money, then fall into debt soon after. Others reach a goal weight, only to spoil their progress by overeating to celebrate.

Habits avoid these pitfalls because they continue indefinitely.

Second, goals rely on factors that we do not always have control over. It's an unavoidable fact that reaching a goal is not always possible, regardless of effort. An injury might derail a fitness goal. An unexpected expense might sabotage a financial goal. And family issues might impede a creative-output goal.

When we set a goal, we're attempting to transform what is usually a heuristic process into an algorithmic one. Habits are better algorithms, and therefore more reliable in terms of getting us to where we want to go.

The third problem with goals is keeping a goal in mind and using it to direct our actions requires a lot of thinking and effort to evaluate different options. Presented with a new situation, we have to figure out the course of action best suited to achieving a goal. With habits, we already know what to do by default.

During times when other parts of our lives require additional attention, it can be easy to push off attaining our goals to another day. For example, the goal of saving money requires self-discipline each time we make a purchase. Meanwhile, the habit of putting $50 in a savings account every week requires less effort as a practical action.

Habits, not goals, make otherwise difficult things easy.

Finally, goals can make us complacent or reckless. Sometimes our brains can confuse goal setting with achievement because setting the goal feels like an end in itself. This effect is more pronounced when people inform others of their goals. Furthermore, unrealistic goals can lead to dangerous or unethical behaviour because we make compromises to meet our stated objective.

> "Habit is the intersection of knowledge (what to do),
> skill (how to do), and desire (want to do)."
>
> — Stephen Covey

The benefits of habits

Once formed, habits operate automatically. Habits take otherwise difficult tasks—like saving money—and make them easy in practice. The purpose of a well-crafted set of habits is to ensure that we reach our goals with incremental steps. As the saying goes, the way to eat an elephant is one bite at a time. The benefits of a systematic approach to life include:

Habits can mean we overshoot our goals. Consider a person who has the goal to write a novel. They decide to write 500 words a day, so it should take 200 days. Writing 500 words generally doesn't require an enormous amount of effort assuming interest in and knowledge of the topic, and even on the busiest, most stressful days, the person gets it done. However, on some days, that smaller step leads to their writing 1000 or more words. As a result, they finish the book in much less time. On the contrary, setting "write a book in four months" as a goal would have been intimidating on final word count alone.

Habits are easy to complete. As Charles Duhigg wrote in The Power of Habit, "Habits are powerful, but delicate. They can emerge outside our consciousness or can be deliberately designed. They often occur without our permission but can be reshaped by fiddling with their parts. They shape our lives far more than we realize—they are so strong, in fact, that they cause our brains to cling to them at the exclusion of all else, including common sense."

Once we develop a habit, our brains actually change to make the behaviour easier to complete. After about 30 days of practice for a simple action like drinking water first thing in the morning, enacting a habit becomes easier than not doing so. More complex habits take longer to form, but they can still become automatic.

Habits are for life. Our lives are structured around habits, many of them barely noticeable. According to Duhigg's research, habits make up 40% of our waking hours. These often minuscule actions add up to make us who we are. William James (a man who knew the problems caused by bad habits) summarized their importance as such: "All our life, so far as it has definite form, is but a mass of habits — practical, emotional, and intellectual — systematically organized for our weal or woe, and bearing us irresistibly toward our destiny, whatever the latter may be."

Once a habit becomes ingrained, it can last for life and takes a lot of work to break.

Habits can compound. Stephen Covey paraphrased Gandhi when he explained: "Sow a thought, reap an action; sow an action, reap a habit; sow a habit, reap a character; sow a character, reap a destiny."

In other words, building a single habit can have a wider impact on our lives. Duhigg calls these keystone habits. These are behaviours that cause people to change related areas of their lives. For example, people who start exercising daily may end up eating better and drinking less alcohol. Basically, those who quit a bad habit may end up replacing it with a positive alternative.

Habits can be as small as necessary. A common piece of advice for those seeking to build a habit is to start small. If you want to read more, you can start with 25 pages a day. After this becomes part of your routine, you can increase the page count to reach your goal. Once your small habits become ingrained, the degree of complexity can be increased.

> "First we make our habits,
> then our habits make us."
>
> — Charles C. Nobel

Why a systematic approach works

By switching our focus from achieving specific goals to creating positive long-term habits, we can make continuous improvement a way of life. Even if we backtrack sometimes, we're pointed in the right direction.

Warren Buffett reads all day to build the knowledge necessary for his investment decisions.

Stephen King writes 1000 words a day, 365 days a year (a habit he describes as "a sort of creative sleep"). Olympic athlete Eliud Kipchoge makes notes after each training session to establish areas which can be improved.

These habits, repeated hundreds of times over years, are not incidental. With consistency, the benefits of non-negotiable actions compound and lead to extraordinary achievements.

While goals rely on extrinsic motivation, habits, once formed, are automatic. They literally rewire our brains.

When seeking to attain success in our lives, rather than concentrating on a specific goal, we would do well to invest our time in forming positive habits.

Source: https://fs.blog/habits-vs-goals/

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