Synergy Investments
Newsletter

INVESTMENT REPORT
FOR QUARTER ENDING 31 MARCH 2022

Market Commentary

Headlines were dominated this quarter by the war in Ukraine and the humanitarian crisis continuing to unfold there. The implications of the Ukraine conflict quickly fed through into increasingly volatile financial markets, with share markets declining and bond yields rising further (meaning bond prices fell) over the quarter.

Market turbulence, as unpleasant as it is, will eventually ease. In fact, to the extent that lower share prices now imply a higher expected return for owning shares, current market prices could eventually be regarded as a buying signal for longer term investors.

Inflation outlook

Inflation has risen sharply over recent months and what was initially projected to be a transitory phenomenon, has become much more widespread and persistent. There are even signs that the recent acceleration in rising prices is increasingly being seen as the new norm.

That represents a real dilemma for policymakers. With inflation already much higher than forecast, central banks (including the Reserve Bank of New Zealand) are now having to prioritise policy measures aimed at containing inflation. The primary tool at their disposal to achieve this is to raise interest rates.

The repercussions of this are already apparent in New Zealand, with the Official Cash Rate (OCR) having been raised four times (by a total of 1.25%) between 6 October 2021 and 13 April 2022.

With domestic interest rates already on the rise, and debt servicing costs rising along with them, this exacerbates the cost of living challenges already faced by many New Zealand families.

However, we should be comforted by the fact that markets react significantly faster than economic indicators.

The fall in share prices in the most recent quarter is a result of market participants demanding a lower price for the known risks involved in these investments. In effect, this uncertainty and known bad news has already been 'priced in'. As we ease through this difficult period – and as long as we don't see any further big surprises – we can expect investments to deliver positive returns even if economic activity is somewhat subdued.

Central bank policy

After more than two decades of successfully implementing monetary policy to carefully manage inflation expectations within a low and narrow band, central banks are now being compelled to act to ensure that inflation expectations don't suddenly become unanchored.

The European Central Bank surprised markets during the quarter by presenting plans for a faster than expected reduction in its bond buying programme. Its policy response suggested its concerns about inflation prevailed over all other considerations, including the war in Ukraine, and the deteriorating outlook for economic growth.

The New Zealand situation is particularly acute. With inflation expectations now above the Reserve Bank's 1% to 3% target band and inflation itself still yet to peak, the Bank is currently expected to progressively move the OCR to almost 3.5% by 2024.

What remains to be seen is how the underlying economy might perform in that environment. Bearing in mind, consumer and business confidence is already at rock bottom, and household cashflow is being reduced by negative real wage growth, high inflation, and the sharp rise in mortgage rates. If economic activity slows quickly as interest rates rise, then the Reserve Bank's current interest rate projections may ultimately require a downward revision.

Is food the new gold?

Beyond the immense human suffering, the war in Ukraine and the sanctions imposed on Russia create broader issues related to global food production and supply.

At one end of the spectrum are countries with a significant dependency on essential commodities (including mineral products, chemicals, metals and soft commodities) that were imported from Russia and Ukraine.

At the opposite end, there are countries - many of them emerging markets - that could potentially position themselves to fill this gap by exporting more at higher prices.

Food prices and food availability will increasingly be a global economic and political issue. For example, the expected decrease in food production due to reduced spring plantings in Ukraine quickly lifted global wheat prices by over 15% since the start of the war.

Higher grain prices will have a disproportionate impact on low income countries, particularly some countries in Africa, and even India, where spending on food makes up a relatively high proportion of their income. Pressure will mount on these countries to either find alternate sources of supply or to ramp up their domestic production.

However, even if other regions recognise an opportunity to step up their own food production in an effort to fill the void, it can take considerable time to plan, sow, grow and harvest meaningful replacement crops. Quickly replacing the 40 million metric ton supply of Ukrainian wheat would be an astronomical feat.

What can we do?

Maintain perspective and stay patient.

Uncertainty is a constant. We don't even know what the weather will be next week, and we certainly don't know what might happen to change the current conflict in Ukraine, global travel and trade, supply chain pressures, concerns about inflation or the ongoing evolution of Covid-19.

But we do know that all these unknowns are factored into market prices. And even though we may not know when or how, history tells us categorically that conflicts always end, pandemics run their course, consumerism and trade generally flourish (on average), and inflation is more commonly able to be controlled within targeted ranges.

We don't see anything in the world to suggest that this time is any different.

In fact, if we took the Ukraine conflict out of the picture, we would have been looking at a world that was beginning to emerge from the Covid shadow, in which travel and trade were picking up and people and businesses were making longer term spending and investment plans again.

All of this will return, even if Vladimir Putin may have pushed the delivery date out a little.

While the investment returns this quarter have been disappointing, they (thankfully) bear no relation to the returns of the comparable quarter in March 2020 when Covid first arrived in the world.

It's useful to look back at that time because the best strategy then was the same as it is today – 'don't worry and stick to your plan'.

We can quickly see the outcome of that approach from the table below.

The third column shows how three key market indices performed (in total returns in their local currencies) during the first quarter in 2020.

Country	Index	3 months ending Mar 2020	27 months from Jan 2020 - Mar 2022
USA	S&P 500 Index	-19.6%	45.4%
New Zealand	S&P NZX 50 Index	-14.8%	5.4%
Australia	S&P ASX 200 Index	-23.1%	21.5%

Sadly, a number of unadvised investors chose to exit the markets at this point.

The fourth column shows the performance of those same indexes over a longer period (note: this longer period includes both the poor returns in the first three months of 2020 and the poor returns in the recent quarter).

Holding on to your investments through these periods of heightened market volatility wouldn't have felt like much fun, but the overall outcome was well worth the effort.

Key Market Movements

With the prospect of US interest rate hikes and unrest at the Russia/Ukraine border, there were few places for investors to hide in January, as bond yields spiked and share markets waned. Growth-tilted sectors such as information technology and consumer discretionary bore the brunt of the pain, while the energy sector generally performed strongly.

Following Russia's invasion of Ukraine in late February, investors became increasingly concerned. Markets tumbled as investors reassessed the potential economic impact of sanctions on Russia and on further supply chain upheavals.

With this adding further fuel to a developing global inflation problem, bond yields rose markedly over the quarter as central banks quickly signalled their intention to not let inflation expectations get out of control.

Unfortunately, with equity markets generally falling and bond yields rising (meaning falling bond prices), the first quarter of 2022 was a challenging environment.

INTERNATIONAL SHARES

-4.9% (hedged to NZD)

-6.5% (unhedged)

Russia's invasion drew widespread condemnation and elicited significant economic sanctions from democratic nations. This amplified existing concerns over inflation pressures, particularly in energy and food products.

In the USA, the flagship S&P 500 Index (total returns in USD) declined -4.6% in spite of US economic data otherwise remaining relatively stable and unemployment reducing to a low 3.6%.

Eurozone shares fell more sharply. The region has closer economic ties with both Ukraine and Russia, particularly when it comes to a reliance on Russian oil and gas. Worries over consumer spending led to declines for retailers, while the conflict also exacerbated supply chain disruptions by stifling the availability of a wide range of parts. This impacted the information technology sector in particular.

UK equities were more resilient as investors began to price in the additional inflationary shock of the Russian invasion. Large cap equities tracked by the FTSE 100 index even managed a small gain over the quarter, driven by the oil, mining, healthcare and banking sectors.

In New Zealand dollar terms, the MSCI World ex-Australia Index delivered a quarterly return of -4.9% on a hedged basis and -6.5% unhedged. This meant the rolling 12 month return for the New Zealand dollar hedged index is still a healthy +11.3% while the unhedged index has gained +10.9%.

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

EMERGING MARKETS SHARES

-8.0%

Emerging market equities were firmly down in the first quarter as geopolitical tensions took centre stage. US and its Western allies imposed a raft of sanctions on Russia and commodity prices moved significantly higher in response, raising concerns over the impact on inflation, the pace of policy tightening and the outlook for growth.

Trading in Russian companies (both inside Russia and on international exchanges) became fraught as investors sought to exit these exposures en masse and their share prices crumbled. Russia was officially removed from the MSCI Emerging Markets Index on 9 March, at a price that was effectively zero.

Egypt, a major wheat importer, was one of the weakest markets in the MSCI Emerging Markets Index, due in part to a 14% currency devaluation relative to the US dollar. China also lagged the index by a wide margin as daily new cases of Covid-19 spiked, and lockdowns were imposed in several major cities, including Shanghai. Regulatory concerns relating to US-listed Chinese shares also contributed to market volatility.

Conversely, the Latin American markets all generated strong gains, led by Brazil. Other net commodity exporters also posted sizeable gains, including Kuwait, Qatar, the UAE, Saudi Arabia and South Africa.

In unhedged New Zealand dollar terms, the MSCI Emerging Markets Index produced a quarterly return of -8.0%, contributing to a -10.4% return over the last 12 months.

Source: MSCI Emerging Markets Index (gross div.)

NEW ZEALAND SHARES

-6.8%

New Zealand was again one of the poorer performing global developed share markets over the quarter with the S&P/NZX 50 Index returning -6.8%. There was a wide divergence in sectoral returns over the quarter, with utilities and financial services firms generally outperforming, while healthcare and technology companies dominated the list of poorer performers.

New Zealand-based travel and expense management provider Serko Ltd declined -33.4% for the quarter as business travel volumes reduced during the important December and January period. This disruption, caused by the Omicron variant, impacted Serko's revenue expectations for the year. Healthcare companies Ryman Healthcare, Fisher & Paykel Healthcare and Pacific Edge Ltd all fell between -23.4% and -27.8%. With the generally lower respiratory intervention requirements of the Omicron variant, as well as a relatively mild flu season in the Northern Hemisphere, some of the tailwinds that had propelled Fisher & Paykel's strong share price performance throughout 2020 and into 2021, dissipated in the first quarter of 2022.

Although companies delivering positive returns were in the minority, utilities firms with greater pricing power performed relatively well. Contact Energy, Vector, Genesis Energy, Spark, Chorus and Meridian Energy all returned between +2.4% and +5.3%, to help prop up the local market index.

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

AUSTRALIAN SHARES

+3.9%

The Australian share market (ASX 200 Total Return Index) bucked the trend by eking out a +2.2% return for the quarter in local currency terms. Returns to unhedged New Zealand investors were higher at +3.9%, due to an appreciation in the value of the Australian dollar over the quarter.

Once again, the dispersion in sectoral returns was a feature of the market, with the energy, materials, utilities and financials sectors all performing positively, while consumer discretionary, healthcare and information technology companies were the notable laggards.

Also notable was the generally strong performance of the large capitalisation firms, with top 20 companies Woodside Petroleum (+52.5%), BHP Group (+29.7%), Rio Tinto (+25.6%) and Santos (+24.5%) all benefiting strongly from increases in energy and/or key commodities prices.

At the other end of the spectrum, Hutchison Telecommunications fell -32.5% and Reece Group, a leading distributor of plumbing products to commercial and residential customers in Australia, New Zealand and the United States, experienced a decline of -29.2% in spite of posting a solid half year announcement.

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

INTERNATIONAL FIXED INTEREST

-2.2%

The narrative that inflation was transitory began to change at the beginning of the year and central banks increasingly signalled their inflation concerns, which drove bond yields higher.

While acknowledging the uncertainties related to the geopolitical situation and its economic implications, central banks have so far suggested that unless the growth outlook were to markedly deteriorate, they view inflation as the more pressing problem.

Inflation throughout Europe was revised up to 5.9% in February and inflation in the UK accelerated to 6.2%. In the US, inflation reached a 40 year high of 7.9% and is expected to remain elevated over the coming quarters.

With this backdrop, the European Central Bank confirmed that the tapering of the pandemic emergency purchase programme will now conclude in June. President Christine Lagarde also left the door open to a first interest rate hike later this year.

The US Federal Reserve, as expected, raised the federal funds rate by 0.25%, making it clear that further increases will be appropriate. Committee members now expect seven hikes this year, and four next year, implying interest rates could end this cycle higher than the committee's perceived neutral rate of 2.4%.

After an initial rate hike in December, the Bank of England raised its policy rate by 0.25% twice in the first quarter, reaching 0.75%. At its March meeting, the bank described geopolitical risks as having accentuated its prior expectations for weak growth and high inflation this year, before noting that its monetary policy "will act to ensure that longer term inflation expectations remain well anchored".

With investors now expecting rate hikes at a swifter pace, global bond yields rose notably through the quarter. The US 10 year treasury yield increased from 1.51% to 2.35%, while the UK 10 year yield climbed from 0.97% to 1.61%.

While rising yields are a headwind for short term sovereign bond returns, corporate bonds generally performed even worse, as credit spreads widened due to a worsening economic outlook.

The FTSE World Government Bond Index 1-5 Years (hedged to NZD) returned -2.2% for the quarter, while the broader Bloomberg Global Aggregate Bond Index (hedged to NZD) returned -4.8%.

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

NEW ZEALAND FIXED INTEREST

-2.9%

The Reserve Bank of New Zealand (RBNZ) elected to increase the Official Cash Rate (OCR) by a further 0.25% on 23 February, moving this benchmark rate from 0.75% back to its pre-Covid level of 1.00%.

In making this adjustment, the Monetary Policy Committee noted that the most significant risk to be avoided at present was for longer term inflation expectations rising above the bank's target and becoming embedded in future price setting.

The committee stated that while higher interest rates are necessary, households and firms may have become more sensitive to interest rate changes as their debt levels have risen. Accordingly, the behavioural response of households and businesses in the face of higher interest rates will be important considerations in determining the pace of future interest rate tightening. For the time being, the RBNZ is currently projecting the OCR to hit 3.4% by late 2024, however, it acknowledges the pathway towards that level could well include individual rate hikes of larger than 0.25%, if deemed necessary.

Given this outlook, the New Zealand 10 year government bond yield climbed from 2.33% at the end of 2021 to 3.25% at the end of March, an increase of 0.92% over the quarter. The New Zealand 2 year government bond yield followed a similar pattern, beginning the year at 1.98% and ending the March quarter at 2.92%, a yield increase of 0.94%.

Similar to the effects seen overseas, these rising bond yields generally resulted in negative short term returns for bonds of all durations.

The S&P/NZX A-Grade Corporate Bond Index fell -2.9% for the quarter, while the longer duration but higher quality S&P/NZX NZ Government Bond Index fell -4.3%.

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

Table 1: Asset class returns to 31 March 2022

ASSET CLASS	INDEX NAME	3 MONTHS	1 YEAR	3 YEARS	5 YEARS	10 YEARS
New Zealand shares	S&P/NZX 50 Index (gross with imputation credits)	-6.8%	-2.9%	+7.9%	+11.9%	+14.4%
Australian shares	S&P/ASX 200 Index (total return)	+3.9%	+14.1%	+11.9%	+9.0%	+8.4%
International shares	MSCI World ex Australia Index (net div., hedged to NZD)	-4.9%	+11.3%	+14.1%	+12.0%	+12.9%
	MSCI World ex Australia Index (net div.)	-6.5%	+10.9%	+14.4%	+12.8%	+12.9%
Emerging markets shares	MSCI Emerging Markets Index (gross div.)	-8.0%	-10.4%	+4.7%	+6.6%	+5.5%
New Zealand fixed interest	S&P/NZX A-Grade Corporate Bond Index	-2.9%	-5.2%	+0.2%	+2.3%	+3.8%
International fixed interest	FTSE World Government Bond Index 1-5 Years (hedged to NZD)	-2.2%	-2.5%	+0.8%	+1.4%	+2.7%
New Zealand cash	New Zealand One-Month Bank Bill Yields Index	+0.3%	+0.6%	+0.7%	+1.2%	+2.0%

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.

How to feel rich

A new book by Nick Maggiulli explains how to save and invest — and how to strike the right balance between the two. But no matter how much money you are able to accumulate, most people, says Nick, never actually feel rich. Why is that? And what can you do about it?

The author addresses these questions and more in this, the second part of a two-part interview with TEBI editor Robin Powell.

RP: Saving and investing have to go hand in hand. Why do you think saving is so important? And how much should people be looking to save?

NM: Saving is important because you need to save money so you can invest. Is there a right amount? No. Rather than talking about the right amount to save, I like to say "save what you can." Let's say you have a low income and you really have to cut your spending to reach your saving target; you're going to make yourself very miserable if you're always trying to hit a certain number or metric.

So I would say to new savers, don't worry too much about your spending and your savings rate early on, but do try and focus on your income. If you can grow your income enough, your savings rate will naturally go up. It's one of the clearest correlations in the data: people who have higher incomes have higher savings rates. Of course there are exceptions. There's the rich person you know who blows all their money, but those people are rare. On average, if you look at the data, you'll see that, for most people, more income means more savings.

RP: You should obviously shop around for the best interest rate on a savings account, and if you're investing in equities, you'll want a decent return. But, realistically, it's not going to make a big difference to start with, is it?

NM: Right, it's just not going to matter that much. Imagine you have $1,000 invested. You're like, "Wow, I've got my first $1,000". But if you're going to get a 10% return in a year, that's a hundred bucks. I remember when I was 22 or 23 years old, I invested my first $1,000. But I was overanalysing it because, at the same time, I was going out in San Francisco with my friends and I could spend $100 in a night easily: drinks, dinner, Uber back home, or whatever. So I spent my entire year's investment return in one night going out. My investments didn't really matter because I didn't have enough money yet. Now, returns matter more because I have more money invested.

So it's all about figuring out where to focus. In the book I call this "the save-invest continuum". Everyone's on the continuum. The first question is, how much can you save in cash in the next year? So, for example, if you can save $500, that's $6,000 a year. And then the other question is, what can your investments earn you in the next year? You have 20 grand, say, and you're getting a 5% return. That's a thousand bucks. You have your six grand you can save, you have $1,000 that your investments can earn you. Which one is bigger? Your saving. Which means you need to focus more on growing your income, saving more, and getting that money invested, so you can raise the other number. At some point, if you do this properly, that $6,000 might go higher, but then the $1,000 return on your investments is going to start growing and growing and, eventually, your investments should earn you about the same that you could save, or even more.

I'm at a point now where, if there's a really bad year in the market, I couldn't save my way out of it. I would lose more money than I could save. Imagine someone with ten million bucks. If they lose 10%, that's a million dollars. I don't know about you, but saving a million dollars after tax is not easy for most people, even rich people. You have to have a really, really high paying job to do that. So you can see why investing matters for someone with $10 million, and saving matters for someone with $1,000. Those are extreme examples, but they illustrate my point, which is: find where to focus. Don't worry too much about your investments when you don't have a lot invested. Start thinking about it more and optimise it as that wealth grows.

RP: One point you make in the book is that people never feel rich. What do you mean by that?

NM: The example I like to use is Lloyd Blankfein, the ex-CEO of Goldman Sachs. Blankfein said in an interview, "Oh, I'm not rich, I'm just well-to-do. I'm kind of well-off." He's a billionaire, though. So he's objectively one of the richest people on the planet. There's no debate here. He's super rich, I would say, but he doesn't feel rich. Why is that? Because his friends are Jeff Bezos, David Geffen and so on — people who have ten, 15 or 100 times more wealth than he does. So if those are your friends, you're not going to feel that rich.

But it seems a little crazy. How could Lloyd Blankfein not feel rich? But think about it. Anyone reading this who has more than $93,000 is in the top 10% for wealth on the planet. I would consider someone in the top 10% of the planet to be rich. You might say, "Nick, I only have $100,000, I'm not rich. How can you say I'm rich?" Well, you're rich relative to everyone in the world. You could say that it's not fair of me to compare you, say, to a farmer in Bangladesh. Well, Lloyd Blankfein doesn't think that we can compare ourselves to him. He's saying, "you can't compare me to these regular people; you should compare me to Jeff Bezos and David Geffen." So you're making the same argument that he's making. We're just splitting hairs about where the limit is.

So my point with saying nobody ever feels rich is that it's always relative. As you start to gain more wealth, you're going to start hanging out in wealthier social circles, and you're going to think, "Wow, I'm not as rich as that person." You're always going to be on this treadmill of "I never feel rich".

For me, once you have a sufficient amount of wealth, you have to just identify as rich. I'm not a millionaire and I would consider myself rich. I'm not financially free — I still have to work, I still have to earn money — but I consider myself rich because, if I don't do that mentally, I'm going to be on this treadmill for the rest of my life. If I don't consider myself rich, I'm always going to consider myself poor, and I'm always going to have to keep chasing money. The only way to escape that treadmill is just to know that, relative to the world, I am rich. I think of it as a psychological trick that allows me to enjoy your life more.

RP: You also talk about "the most important asset". What is that, and why is it so important?

NM: It's your time. Without a doubt, it's your time. And that's the whole point of the book, at the very beginning I have a section headed "How to use this book". And I basically say that readers should feel free to jump around and figure out which area is relevant for them. I don't care if you don't read every single chapter. I just want you to find value and then use your time efficiently. I know time is precious and, because of that, I want to use as little of your time as possible.

Of course, you can read the book in order, from beginning to, end, and enjoy it. There's a lot of good stuff in there. At the same time though, if you're thinking, "I don't need help with saving — I only need to worry about investing," then skip the entire section on saving and just go to the investing section.

You need to think about how you're using your time and where you're focusing your energy. When I was in my early 20s I focused so much time on looking at my investments, and that didn't really matter. I should have focused more on building my skills, and my career. I didn't really start doing that until I was 27. I probably

should have started blogging sooner, and I should have built my skills up sooner. I was spending all that time on something that didn't matter anything like as much.

RP: Although you're now Chief Operating Officer at Ritholtz Wealth, you still see yourself very much as a data scientist. Why do you think people are so sceptical about data and evidence, even when the truth is staring them in the face?

NM: I think data can be used for good, and it can be used for harm too. The issue is that you need context. Context matters. When I give you a data point without context, it doesn't mean anything. Sometimes you need the details of how something is done.

Here's an simple example. Take a seemingly simple question like, how many uninsured drivers are there in the United States? Well, there are different ways of answering that question. How do you define uninsured? Is it someone who is uninsured for a whole year? Is it someone who is uninsured for one month during the year? So, based on your definition of "uninsured", you're going to get different numbers.

So context matters, and critical thinking matters. And it's tough today, especially because there's so much information out there. It's hard to validate and verify everything that's said, so people can use data to weave a tale that's not necessarily true because it's out of context. I think that's why people are sceptical — and they should be sceptical — about data. But at the same time, you have to think critically. It's not easy, it's not going to get easier, and it's probably going to get harder.

I know where the weak points are in my own arguments. Although I argue the case in my book for a "just keep buying" approach, I know there've been cases over the decades where it hasn't worked so well. They're rare; they do happen, but they're rare. I know the bad data. So that's the thing I would urge people to keep in mind when assessing data: be critical in your thinking.

Source: https://www.evidenceinvestor.com/nick-maggiulli-how-to-feel-rich/

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