Synergy Investments
Newsletter

INVESTMENT REPORT
FOR QUARTER ENDING 30 SEPTEMBER 2021

Synergy INVESTMENTS

www.synergyinvestments.co.nz

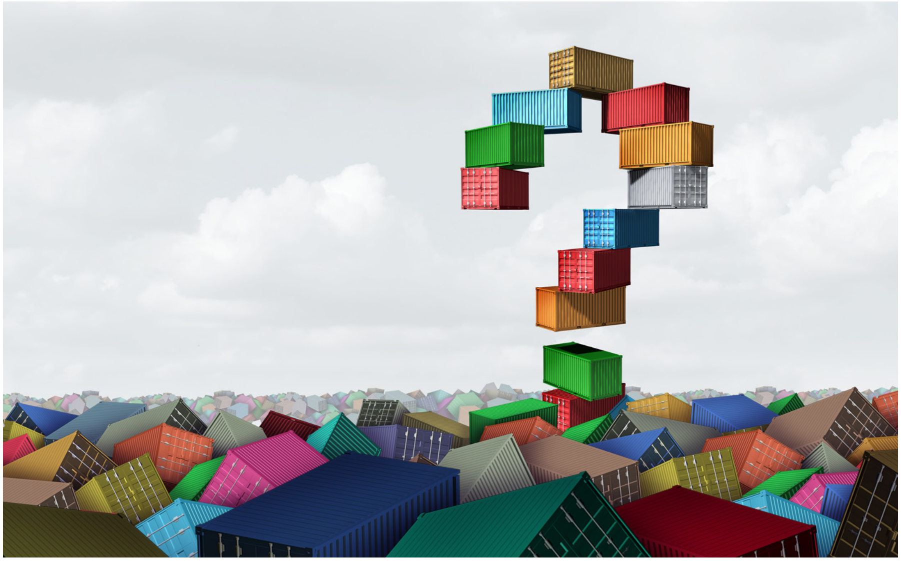
Market Commentary

While it's human nature to enjoy seeing the value of your investment portfolio increasing quickly, it's also not reasonable for us to expect large gains each quarter.

In fact, if markets ever get too far ahead of themselves, it could increase the chances of a future correction. In that context, a small positive return can sometimes be more reassuring than a large one.

Following the extended strong bounce-back from the Covid-19 market crash in March 2020, the recent quarter represented both a consolidation of those prior gains and an opportunity for the market to digest new information.

And what a considerable amount of new information there was to digest.



Chequered pathway back to normal

With much of the developed world having abandoned strategies designed to eliminate Covid-19, and instead opting to "live with it", there has been a continued reorientation underway globally whereby individuals, businesses and governments are exploring pathways back towards normal, or 'post-Covid normal'.

Increasingly, this is being reflected in many countries through a relaxation in previous social and business restrictions, and in some cases, travel restrictions.

Unfortunately, on the trade front, the pathway back to normal faces some significant hurdles, at least in the near term. Anyone who has recently tried to buy consumer goods from overseas, will already have a sense of this – shortages and delays are now commonplace – but why is this?

It's what can happen when an extremely complex system gets disrupted.

Supply chain breakdown

During the first half of 2020, when much of the global economy went into lockdown, demand for most consumer goods came to a near standstill. In short order, manufacturing capacity was cut, sailings by container ships were cancelled, and workers everywhere were furloughed or displaced.

By the second half of 2020, following massive fiscal and monetary stimulus by most central banks, consumers started flooding online retailers with new orders. Manufacturing restarted and international trade resumed. The global economic switch was suddenly turned back on.

Unfortunately, restarting the global manufacturing machine after the lockdown turned out to be anything but seamless. The vast and interconnected system that continuously moves raw materials and finished products all around the globe requires predictability and precision. But with the advent of Covid-19, both had been lost. And, when the switch did turn back on, it occurred when thousands of shipping containers were stuck in the wrong place.

Many containers that carried millions of protective face masks to Africa and South America early in the pandemic today remain empty and uncollected because shipping companies, aiming to make up for lost time and lost profitability, decided to direct their vessels towards their most profitable routes between Asia and North America or Europe.

With significantly fewer containers suddenly in circulation, this resulted in an immediate imbalance between the supply and demand for usable shipping space. Unfortunately, it is this global supply chain breakdown that is directly contributing to the spike in transportation costs we are now witnessing, as well shortages in key manufacturing components, order backlogs and frustrating delivery delays. Perhaps most obvious of all, we are seeing these effects coalesce all around us in the form of rising consumer prices.

Inflation – temporary or permanent?

And that leads to the question that policymakers and market participants are now grappling with – are these price rises likely to be temporary or something more permanent?

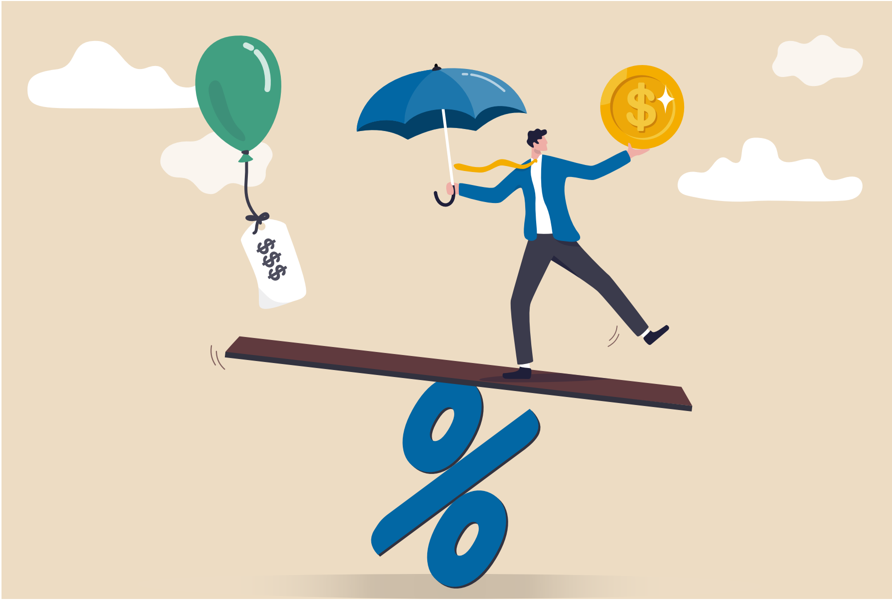
Inflation measures have certainly gone up but that only reflects what we already know – that many prices have already increased. It doesn't tell us how persistent those price rises may prove to be. In fact, if recent price rises can largely be attributed to supply chain issues, which are likely to be remedied in time, then the idea that the current inflation spike will only be temporary may have more credence.

Interest rate uncertainty

Although many of the current inflationary forces are still seen as transitory, persistent disruptions in supply chains and surging energy costs in some regions has fuelled fears that inflation might last longer than initially anticipated.

In the US, Federal Reserve Chairman Jerome Powell said they anticipate the current surge in prices, due primarily to supply chain bottlenecks, continuing into next year before fading. He said the Federal Reserve does not expect the current inflation spike to "lead to a new inflation regime, in which inflation remains high year after year."

With reported inflation rising, so too is the pressure on interest rates. However, central bankers everywhere are also



mindful that raising interest rates might not just signal their commitment to keeping longer term inflation in check, it might also threaten the recovery of the fragile global economy.

The world continues to watch developments in this space with keen interest.

But . . . not all doom and gloom

On the surface – where the media tends to search for headlines – the new information presented during the quarter seemed rather negative. It might be one explanation as to why returns during the quarter were fairly flat. However, when you scratched a little deeper, there was often better news to be found.

Globally, most countries have successfully reduced the spread of the highly infectious delta strain, via a combination of vaccines and increased mobility restrictions. And, with global vaccination rates still climbing, there is a sense of the tide slowly turning in this global fight. It is far from an immediate salve but is a brighter light at the end of the tunnel.

On this pathway towards greater personal and economic freedoms, we can begin to consider the impact this might have on trade, business profitability and economic prosperity. Taken together, the International Monetary Fund and World Bank see an average global growth rate next year of 4.6%. This may be a touch below the current growth rate, but it is still a very healthy rate of annual growth for the world economy relative to its pre-Covid pace of around 3%.

A global reopening with increasing vaccination rates may also help reduce inflation pressures as the business community consistently gets back to work. Earnings volatility should reduce as supply chain pressures ease and businesses incur less of the stop/start disruptions they have experienced with respect to operations and earnings. And while global interest rates may have commenced an upward path, they are likely to remain highly attractive (by historical standards) for quite some time, providing a significant ongoing support to share markets.

Covid-19 will go down in history as a global health disaster and an extraordinary economic disrupter. It is rare that the world is so utterly unprepared for something so seismic. But, while its health impact and implications may linger long into the future, its long term economic impact – in aggregate – may be considerably less devastating.

Key Market Movements

The quarter started on a positive note for most markets, but gains generally eased in September amid concerns of rising inflation, worries about China, and energy shortages in Europe.

The New Zealand share market performed better than most developed markets with the economic growth rate (2.8% in the second quarter) reported to be much stronger than expected. Before heading into a new lockdown in the third quarter, New Zealand's economy was enjoying high employment, relatively strong household and business balance sheets, and the expectation of ongoing fiscal support from the New Zealand government.

Key interest rates changed little internationally, although, as inflation fears strengthened, the focus returned to the likely size and timing of future interest rate hikes around the globe. Rising yields on US Treasuries in September underlined the market view that rate hikes could be brought forward in addition to an earlier tapering in their asset purchase programme.

In August, New Zealand was poised to be one of the first developed nations to commence raising interest rates; its first hike in seven years. This was only stymied at the eleventh hour as New Zealand went into another Covid-related lockdown, with the highly anticipated first move upwards in rates being deferred until early October.

INTERNATIONAL SHARES

+0.5% (hedged to NZD)

+1.3% (unhedged)

International developed share markets generally delivered low positive returns during the third quarter of 2021.

In the USA, the flagship S&P 500 Index (total returns in USD) was in line with the broad market, gaining +0.6% for the quarter. Strong company earnings supported the index through July and August, but growth and inflation concerns late in the quarter saw US shares retrace their steps in September.

European markets followed a similar pattern, with weakness later in the period due to rising energy prices and concerns that supply chain bottlenecks would drive inflation higher.

In the USA, leading performers were in the large capitalisation space, with financials and utilities sectors leading the way. In Europe, it was small capitalisation companies that generally outperformed, with the energy sector recording strong gains.

The UK market performed a little better than its European peers over the quarter, with the MSCI UK Index gaining +2.2%. Increased merger and acquisition activity helped drive market sentiment overall, while weakening economic indicators were otherwise reflected in a wide dispersion in company returns across sectors.

The MSCI Japan Index increased by +5.3% with corporate profit results, purchase orders and capital expenditure plans all looking relatively strong. The quarter also saw the surprise resignation of Prime Minister Yoshihide Suga, who was replaced by Fumio Kishida, an establishment politician considered to be a safe, if unexciting, choice to guide Japan through the next stage of its post-Covid recovery.

In New Zealand dollar terms, the MSCI World ex-Australia Index delivered a quarterly return of +0.5% on a hedged basis and +1.3% unhedged. The rolling 12-month return for the New Zealand dollar hedged index was +28.4%, while the unhedged index gained +23.4%.

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

EMERGING MARKETS SHARES

-6.8%

Emerging markets shares struggled in the third quarter, which saw a sell-off in Chinese shares, concerns over continued supply chain disruptions, and worries over the implications of higher food and energy prices in some markets.

Regulatory actions in China were the initial trigger for market weakness. These were compounded by the re-imposition of some Covid-19 restrictions, power shortages, and worries about possible systemic financial system risks stemming from the potential collapse of Chinese property developer, Evergrande.

Brazil was also weak, as above-target inflation continued to rise and the central bank there responded with further interest rate hikes, while the South Korean market was impacted by falling prices for dynamic random access memory chips (DRAM) as well as general supply chain concerns.

In stark contrast, net energy exporters generally outperformed, most notably Colombia, Russia, Kuwait, Saudi Arabia, Qatar and the UAE. India also delivered a strong gain, with investor sentiment boosted by a recent stream of initial public offerings.

In unhedged New Zealand dollar terms, the MSCI Emerging Markets Index produced a quarterly return of -6.8%, for a +13.6% return over the last 12 months.

Source: MSCI Emerging Markets Index (gross div.)

NEW ZEALAND SHARES

+5.2%

New Zealand was one of the better performing global developed share markets through the quarter, with the S&P/NXZ 50 Index returning +5.2%.

With underlying economic conditions still broadly favourable and the market 'looking through' the ongoing Covid uncertainties, it was generally the larger companies within the index which performed better than the smaller capitalisation firms. The most significant contributions came from firms in the healthcare and industrials sectors.

In the healthcare sector it was Pacific Edge leading the charge, with a gain of 24.4% following strong interest in a retail placement to help support their US growth strategy. Ryman Healthcare also performed strongly, up 15.0% after announcing record first quarter sales and continued expansion in Melbourne.

In the industrials sector, the continuation of a stellar year for Mainfreight saw its share price advance another 26.6%. On 1 September, it announced significantly improved revenue and profitability figures compared with the same 22-week period last year.

All sectors made a positive contribution over the quarter except for the consumer discretionary sector, where the increased lockdown restrictions likely had a more immediate impact. SkyCity Entertainment, down -6.8% for the quarter, was the worst affected in this sector.

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

AUSTRALIAN SHARES

-0.7%

Despite a September sell-off, the Australian share market also returned a positive quarter in local currency terms, with the S&P/ASX 200 Index (total return) in Australian dollars gaining 1.7%. In direct contrast to the New Zealand market, the largest capitalisation firms generally struggled over the quarter, while good returns were delivered by the mid and small capitalisation end of the market.

Within the large capitalisation space, it was the materials sector that caused the largest drag on performance, with market heavyweights BHP (-17.0%) and Fortescue Metals (-26.9%) delivering disappointing returns on the back of weakening iron ore prices and, in BHP's case, an underperforming energy business.

Offsetting this was a positive contribution from all other sectors, and, in particular, a good performance from the important (i.e. sizable) financials sector, where many firms recorded strong double digit returns, including Clearview Wealth (+38.0%), Challenger (+18.0%), Suncorp Group (+17.4%) and Macquarie Group (+16.4%).

Returns to unhedged New Zealand investors were slightly negative due to a depreciation in the Australian dollar over the quarter.

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

INTERNATIONAL FIXED INTEREST

+0.0%

While the US 10-Year Treasury Bond yield finished the quarter at 1.49%, only one basis point higher than it closed in June, it was the pathway to get there that interested markets. Yields fell initially, as the rapid economic recovery appeared to be moderating. However, as the market's focus turned to rising inflation and the prospect of the withdrawal of monetary policy support, yields rose back to the levels seen at the start of the quarter. The Federal Reserve also recalibrated expectations regarding its ongoing asset purchase programme, suggesting it could commence a tapering of asset purchases as early as November 2021 and completed by mid-2022, earlier than originally expected.

The UK 10-year yield increased from 0.72% to 1.02%, with the move occurring in September. As with the Federal Reserve, there was clear signalling from Bank of England policymakers that rate rises might be warranted before the end of the year. Recent economic indicators came out worse than expected, while year on year consumer price inflation rose to 3.2% in August, the highest since 2012.

The German 10-year yield was one basis point lower at -0.19%, while Italy's 10-year yield finished 0.04% higher at 0.86%. Despite worries about inflation and higher energy prices, economic activity continued at a robust pace across Europe. Having come out of lockdowns relatively late, the region appeared to benefit from a similar release of pent up demand that had been witnessed elsewhere. In August, Eurozone inflation recorded a decade high 3.4% per annum.

With little overall movement in international yield curves over the quarter, returns for high quality, low duration bonds were largely flat, while investment grade and higher yielding credit securities generally outperformed government bonds.

The FTSE World Government Bond Index 1-5 Years (hedged to NZD) made +0.0% for the quarter, while the broader Bloomberg Global Aggregate Bond Index (hedged to NZD) returned +0.1%.

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

NEW ZEALAND FIXED INTEREST

-1.3%

At its 18 August 2021 meeting, the Reserve Bank of New Zealand (RBNZ) once again elected to leave the official cash rate at 0.25% however, it was only the recent return to level 4 lockdown that deferred the anticipated increase in interest rates. The Monetary Policy Committee advised this was only a delay due to the sudden increase in health uncertainties, not a change in their planned approach. This was subsequently verified on 6 October when they announced an increase in New Zealand's official cash rate from 0.25% to 0.50%.

Faced with clear signalling about inflation concerns and higher interest rates, the NZ 10-year yield - after bottoming out at 1.49% in late July - rose steadily throughout August and September to close the quarter at 2.01%. This led to negative quarterly returns for both the corporate and government bond indexes.

Over the quarter, the movement up in yields was slightly larger for shorter duration bonds, resulting in a 'flattening' of the New Zealand yield curve. This culminated in shorter duration bonds performing a little worse than longer duration bonds.

The S&P/NZX A-Grade Corporate Bond Index fell -1.3% for the quarter, while the longer duration but higher quality S&P/NZX NZ Government Bond Index fell -1.2% for the quarter.

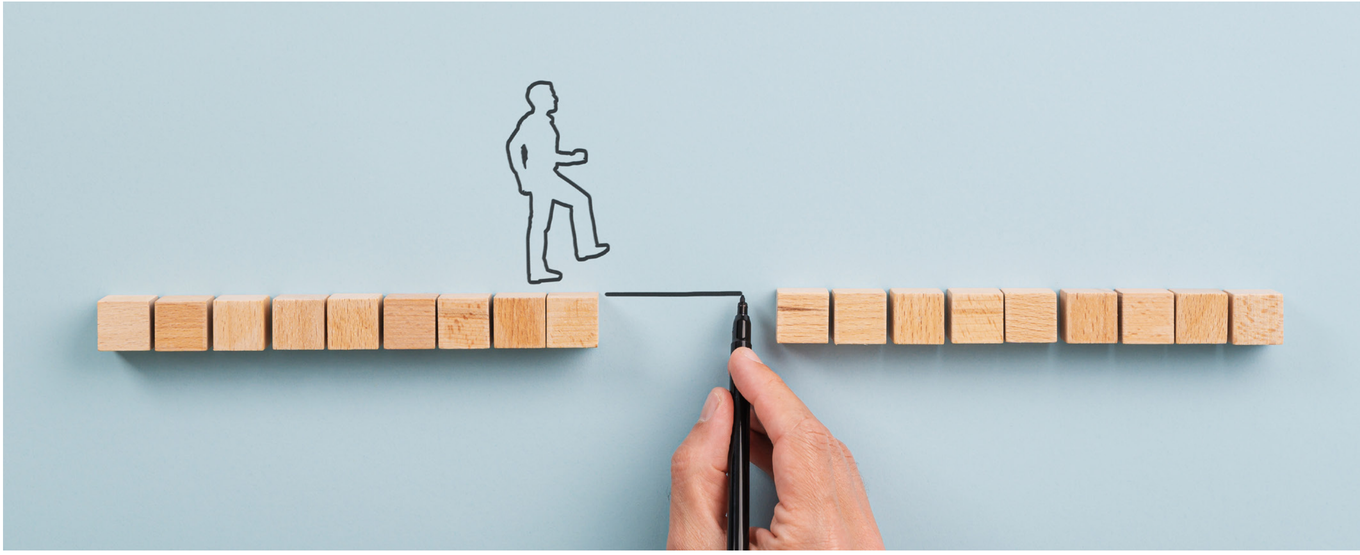
Source: S&P/NZX A-Grade Corporate Bond Index

Table 1: Asset class returns to 30 September 2021

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)	+5.2%	+13.7%	+13.2%	+13.5%	+16.1%
Australian shares	S&P/ASX 200 Index (total return)	-0.7%	+26.3%	+8.2%	+10.3%	+8.7%
International shares	MSCI World ex Australia Index (net div., hedged to NZD)	+0.5%	+28.4%	+12.0%	+13.8%	+14.7%
International shares	MSCI World ex Australia Index (net div.)	+1.3%	+23.4%	+11.7%	+15.1%	+14.0%
Emerging markets shares	MSCI Emerging Markets Index (gross div.)	-6.8%	+13.6%	+7.5%	+10.8%	+7.5%
New Zealand fixed interest	S&P/NZX A-Grade Corporate Bond Index	-1.3%	-4.1%	+2.9%	+3.1%	+4.5%
International fixed interest	FTSE World Government Bond Index 1-5 Years (hedged to NZD)	+0.0%	-0.1%	+2.5%	+2.0%	+3.2%
New Zealand cash	New Zealand One-Month Bank Bill Yields Index	+0.1%	+0.3%	+0.9%	+1.3%	+2.1%

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.

9 Obstacles to Investing—and How to Overcome Them



We've learned a lot about investing over the past 60 years, a period that has seen many breakthroughs in the world of finance.

What we know comes from studying public markets and is grounded in serious academic research. The lessons are clear: Investing in markets is an excellent plan for meeting long-term goals, like maximising your retirement income. When you develop a deeper understanding of public markets, you can cultivate a sense of optimism about investing.

Two ideas are at the heart of embracing this approach:

First, markets provide a way for both sides to win. In order to trade, both buyer and seller have to agree on a price. If either side felt the price wasn't meeting his or her needs, they wouldn't trade. This is what we mean when we say market prices are fair.

Second, markets allow all of us to invest in human ingenuity—and get paid for it. We want to help as many people as possible access what markets offer in investment opportunities and wealth generation so they can live better lives.

Even though the investment principles we run on are simple, they aren't always easy to understand and accept. Many people struggle with some of the basic concepts behind long-term, highly diversified investing—it's a matter of human nature.

Here are some of the common objections and most of us can relate to at least one of them:

1. "I don't see the point of investing in the first place."

Any decision you make with your money—even not investing—is an investment decision involving risk and rewards. You're focused on the risk involved in investing. But what are you risking by not investing? You're risking today's money having less value in the future because of inflation. You're missing out on the magic of compounding, which Albert Einstein is said to have described as the Eighth Wonder of the World. (Assuming an average 10% return, as the S&P 500 has returned historically, money invested in the stock market doubles every seven years.) You're forgetting that diversification—spreading your investments across a large number of companies—is a powerful way to minimise risk. When it comes to personal goals, everything has a trade-off. Most people don't have enough money saved to be able to live adequately in retirement without earning some kind of investment return. In the simplest terms, by not investing, you risk outliving your money.

2. "I'm too late. The train has left the station."

It's natural to feel regret about decisions you're unsure about. But it's never too late to invest. Every day, we expect the stock market to go up. Otherwise, investors would find other things to do with their money.

3. "It's too hard to figure out when to get into—or out of—the market."

Human beings have a natural urge to transact. But getting into and out of the market is gambling, not investing. If you treat the market like a casino, and you're picking stocks or attempting to time the market, you need to be right twice—in an aim to buy low and sell high. Fortunately, you don't need to time the market to have a good investment experience. Professor Eugene Fama, a Nobel laureate in economic sciences, showed that it's unlikely for any individual to be able to pick the right stock at the right time—especially more than once. (1) Once you decide to be a long-term investor, the timing debate is off the table. And that's a big relief. When you buy the whole market, you're investing in human ingenuity to find productive solutions to the world's problems.

4. "I'm afraid I'm going to lose it all."

If you're lucky enough to live a long time, you'll face big market downturns. You're much more likely to "lose it all" with concentrated investments than with a well-diversified portfolio. Individual investments may go to zero, but the modern-day market has been around for almost a century, has an average annual return of 10%, and has never lost more than 43% in a year. (2)

5. "I don't know what I don't know, and that makes me nervous."

It's OK to be nervous! If investing were a slam dunk, there wouldn't be a positive expected payoff. In order for an investment to offer the possibility of a return above money-market funds, it needs to carry risk. And when it comes to deciding how to grow your hard-earned money, the stakes are high. Uncertainty is scary, but without uncertainty, there would be no opportunity. Stock market behaviour is uncertain, just like most things in our lives. None of us can make uncertainty disappear, but dealing thoughtfully with uncertainty can make a huge difference in investment returns and quality of life. Your challenge is to stick with an established plan. A financial advisor can help.

6. "I only want to invest in companies I'm familiar with."

Stock markets contain all of the publicly traded companies out there. Every company has an incentive to do better. Investing in human potential across a broad range of companies is more likely to pay off than trying to predict which individual company is going to perform best. You can do well without having to outguess the market.

7. "I'm afraid there's going to be another financial crisis."

History shows us that there's always going to be another financial crisis—and another recovery. Every crisis has a different cause, so it feels different every time, but the market has always delivered a positive return once things settle down. Crises, by definition, are not predictable. Markets are forward-looking and remind us of the power of human resilience.

8. "I'm overwhelmed. It's just too much to think about."

Inertia is a powerful force. Thinking a little bit about it right now means worrying a lot less in the future. Inaction comes with a price, but this is where a financial advisor can really help.

9. "I don't have enough money to invest."

When it comes to investing for your family's future, there is no minimum. The first and most important step toward investing is saving. It's human nature to procrastinate. Half the battle is just getting started. This can mean "paying yourself first" by directing a small percentage of each paycheck into savings. Putting money aside regularly becomes a feel-good habit, like exercise. You can witness your own incremental progress and the boost in self-esteem it brings. You'll be surprised by how easy it is to set this in motion, and you'll feel good—for yourself, and your family. Just look at these numbers: If you invest $100 today and then $100 per month for 30 years with a 10% return, you'll end up with almost $200,000. (3)

(1) Eugene F. Fama and Kenneth R. French, "Luck versus Skill in the Cross-Section of Mutual Fund Returns," Journal of Finance 65, no. 5 (2010): 1915–1947.
(2) In US dollars. S&P 500 Index annual returns 1926–2020. S&P data © 2021 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.
(3) The performance reflects the growth of a hypothetical investment and assumes reinvestment of income and no transaction costs or taxes.

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