Synergy Investments
Newsletter

FOR QUARTER ENDING 31 DECEMBER 2024

Synergy
INVESTMENTS

www.synergyinvestments.co.nz

Market Commentary

After finishing the year with another generally positive quarter for diversified investment portfolios, 2024 is set to be remembered fondly by investors.

The strong 12 month returns from most share markets sit in contrast to a global economic environment still searching for its post-Covid equilibrium. In New Zealand, for example, the local S&P/NZX 50 Index (gross with imputation) gained 12.2% for the year.

However, the environment facing workers and households was characterised by slowing growth, lingering inflation, weakening house prices, high interest rates and rising unemployment.

This apparent disconnect between markets and the real world is because long term investors consistently look to the future. That means current market prices (and returns) are not just based on observed economic conditions, they also reflect the future expectations of all market participants.

In many ways, the solid share market returns in 2024 imply a general market expectation of better economic times ahead. Hopefully, for workers, households and investors alike, this will be delivered over the coming 12 months and beyond.

Political changes and Ukraine's ongoing conflict

After a highly unorthodox contest, with sitting president and presumptive Democratic nominee Joe Biden pulling out of the race in July, Donald Trump eventually prevailed over Kamala Harris in November to win a second term as US president.

While the president campaigned on a raft of issues, including the mass deportation of illegal immigrants and imposing widespread trade tariffs, the world now watches with interest to see exactly which initiatives the incoming administration will look to prioritise.

Political instability was also a feature in Europe during the quarter, with Germany and France in the spotlight. In Germany, the three-party governing coalition collapsed in November after Chancellor Olaf Scholz sacked his finance minister. This paves the way for new elections to be held in February.

In France, Prime Minister Michel Barnier was ousted in a no-confidence vote as other parties declined to back his budget. On 12 December, French President Emmanual Macron named centrist ally Francois Bayrou as Barnier's replacement, after several days of tense political gridlock.

Further east, the Russian invasion of Ukraine will tick over the three year mark in the coming quarter and is sadly showing no signs of concluding.

Republicans returned to power in the US

We often note that the government of the day has little influence over whether investment markets go up or down. Moving from Labour to National (in NZ) or from Democrats to Republicans (in the US) typically results in minor policy tinkering, but usually not wholesale changes that could spook or energise markets.

This is what makes the result of the recent US elections more intriguing. The Republican Party, headed by President Donald Trump, secured a grip on power in Washington that is uncommon in US post-war history.

In 2025, the Republicans will control the White House, the Senate and the House of Representatives. Republican appointees already represent a majority on the US Supreme Court and heavily populate the federal judiciary. It is also highly likely that Republican political appointees will more widely and deeply populate agencies that make up the US federal regulatory system.

Such political dominance is rare. How the Trump administration responds to this opportunity will be a key element influencing market sentiment in the months ahead.

> The Republican Party, headed by President Donald Trump, secured a grip on power in Washington that is uncommon in US post-war history.

Early indicators

Initially, many global share markets responded positively to the US election result, with the S&P 500 Index in the US rising 2.5% the very next day. US share prices were buoyed by expectations that the promised policies would result in lower taxes, reduced regulation and stronger growth.

Those would potentially all be positive outcomes, but the starting point for the new administration's policies is a US economy that is already close to full capacity. Any significant increase in spending from here, due to tax cuts or increased business investment, runs an increased risk of being inflationary.

Mindful of this, the US Federal Reserve has already scaled back its projections of interest rate cuts in 2025 to just two. Of course, if inflation was to actually start heading higher again, the Federal Reserve wouldn't just slow down its rate cutting plans, it might stop cutting interest rates altogether and need to consider increasing rates again.

That outcome becomes more likely if, as promised, widespread new tariffs are imposed on imports and the large-scale deportation of migrant workers occurs. Both of these initiatives would negatively impact economic output in the US which, again, would likely result in higher inflation.

Currency markets

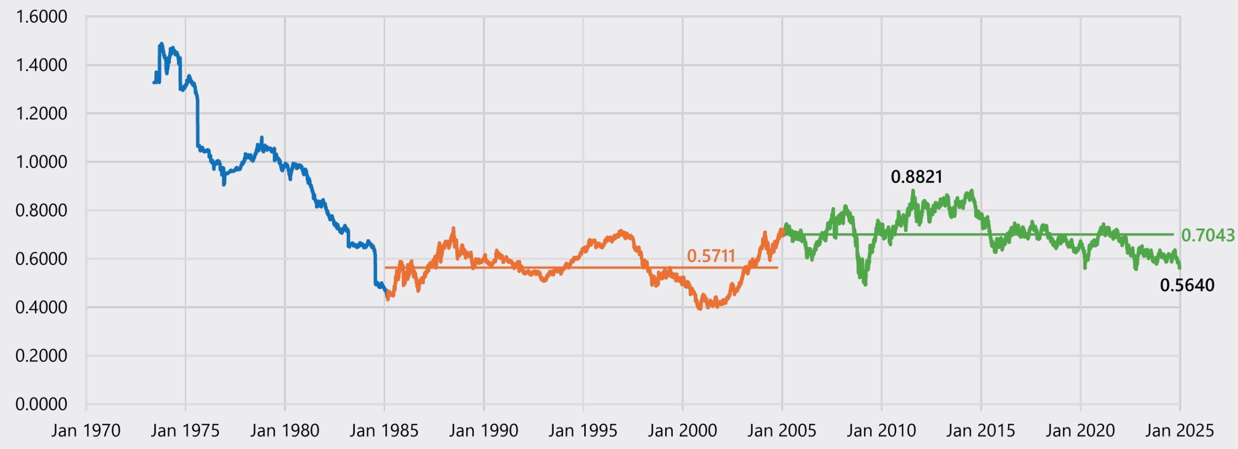
Following the Republican victory, the prospect of stronger growth, rising share prices and higher interest rates could potentially attract increased capital flows from abroad into the US. If inflows into US assets increase, this would be supportive of a strengthening US dollar.

If the US dollar does strengthen further against the NZ dollar, it will be extending a general downward trend for our own currency that began in July 2014 when the NZD/USD exchange rate touched 0.8821. At the end of 2024, this exchange rate was sitting at 0.5640, representing a decline of about 36% in nine and a half years.

That's a significant change over time but, if we take a look at the relationship between the US dollar and NZ dollar going back to 1973, it is far from unprecedented.

The fluctuating NZ dollar

The NZD/USD chart below is broken down into three time periods:



The first **(blue line)** is a 12 year period from June 1973 to March 1985, which shows the NZ dollar weakening fast against the US dollar. At the start of this period one NZ dollar was worth about US $1.40 and by mid-1985, one NZ dollar was buying less than US $0.50.

For those who remember these times, it was a period of real economic stress in New Zealand. The oil shock of 1973 caused oil prices to soar and hurt global trade, which impacted New Zealand due to our reliance on agricultural exports.

The second period **(orange line)** is the first 20 years since the NZ dollar was floated, from early 1985 to early 2005. The significant economic and regulatory reforms of the late 1980s ultimately led to a period of sustained growth in the 1990s. The NZD/USD rate averaged 0.5711 over this 20 year period (fluctuating widely) and, by the end of the period, was slightly above US $0.72.

The third period **(green line)** covers the last 20 years from early 2005 to the end of 2024. A series of crises including the Global Financial Crisis (2007 to 2009), the Christchurch earthquakes (2010/11 and aftermath) and Covid-19 pandemic (2019 to 2022) contributed different stresses to the New Zealand economy. The most recent has left a legacy of high inflation and low growth which the New Zealand government continues to wrestle with today.

What all of the above should reinforce (bearing in mind we only commented on factors from a New Zealand perspective) is the myriad of influences that can impact exchange rates. The assumed policies of the new Trump-led administration, while potentially significant, are only one of many.

Where the exchange rate may go over the next 20 days, let alone the next 20 years, is anyone's guess.

The more things change, the more things stay the same

Big changes in the US political landscape could usher in significant new policy settings and potentially lead to an altered growth profile for the US economy. This might be good for investors and give a boost to the US dollar. But it could also be inflationary. As we know in New Zealand, addressing rising inflation can lead to some less favourable outcomes like rising interest rates and higher mortgage costs.

In the short run, it's hard to know exactly what changes to expect in the US, and over what timeframe. However, what we can reasonably expect is that President Trump – first and foremost a businessman – will not be looking to derail corporate America.

While short term noise and uncertainty has increased, we can be confident that good businesses that generate returns and profits, creating employment and growth, will continue to thrive under this administration and into the future. We can expect this in the US, in New Zealand and around the world.

As always, the best investment strategy in the face of uncertainty is to be aware of your ability to take and withstand risk and to stay well diversified across good quality assets.

The long term benefit of that approach never changes.

Key Market Movements

The underlying performance of global shares were mixed during the October to December quarter. Overall, markets advanced thanks to gains in the US and Japan, while weakness prevailed throughout most of Europe.

US shares received a boost following Donald Trump's victory in the November presidential election, but other regions came under pressure amid concerns this could usher in a new era of trade protectionism. A key plank of Trump's campaign was the imposition of widespread foreign trade tariffs, with China often being singled out as a primary target. Emerging markets shares, headed by weakness in Chinese shares, were lower over the quarter.

Bond markets reflected the turbulent political landscape across Europe and the US with longer term bond yields generally rising despite many central banks cutting their cash rates, and with further rate cuts projected in 2025. Concerns about potential US tariffs revitalising inflation in America contributed to US Treasury Bonds losing ground over the quarter.

One of the notable winners was a much stronger US dollar, reinforced by the Federal Reserve suggesting interest rates may not need to be reduced as much as first thought. A stronger US dollar generally means a relatively weaker New Zealand dollar and holding a portion of unhedged foreign assets in portfolios added significantly to New Zealand investor returns in the recent quarter.

INTERNATIONAL SHARES

▲ +2.0% (hedged to NZD)

Developed market equities delivered muted returns in the fourth quarter of 2024, with escalating tensions in the Middle East and Ukraine, political upheaval in Germany and France, and uncertainty in the US economy among the risks uppermost in investors' minds.

▲ +13.6% (unhedged)

The US market continued its strong performance, with the S&P 500 Index up over +5% by early December in US dollar terms, before the Federal Reserve suggested that fewer rate cuts may be needed in 2025, leading the market to give up a large portion of the quarter's gains.

Eurozone markets were broadly down, with the MSCI Europe Index down -2.8% in local currency terms over the quarter. Political turmoil in Germany and France increased uncertainty at a time when the European Union is trying to adapt to a world where they cannot rely on cheap Russian energy and export led growth.

The UK FTSE 100 Index had a volatile path to a small decline (in British pounds) over the quarter. The UK continues to battle low growth and 'sticky' inflation, which is a combination that traditional monetary policy is poorly equipped to fix in unison.

The Japanese share market had a solid end to 2024 with the Nikkei 225 Index up over +5% for the quarter (in Japanese yen). The market environment in Japan has experienced consumption growth and increased investment driving economic growth, while inflation declines toward target levels.

Against most major currencies the New Zealand dollar was weaker through the quarter, which meant higher reported returns for investors holding unhedged foreign assets. In particular, the NZ dollar depreciated by -13.5% against the US dollar over this period.

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

EMERGING MARKETS SHARES

▲ +4.6%

Emerging markets shares generally experienced weak fourth quarter returns, with the MSCI Emerging Markets Index (gross) down by -4.2% in local currency terms. However, due to the significant weakness of the New Zealand dollar, unhedged New Zealand investors experienced a useful gain of +4.6%.

Underlying market softness was driven by continued economic weakness in China and concerns over US President Trump's trade policies. Emerging economies rely heavily on trade and foreign direct investment, and Trump's protectionist policies would, if enacted, aim to increase investment in the US by using tariffs to increase the price of other countries' exports. This could lead to a degree of product substitution and decreased demand for emerging market exports.

After delivering a strong third quarter driven by the announcement of Chinese economic stimulus, Chinese shares performed poorly in the fourth quarter. Markets were disappointed by the lack of follow through in respect of the previously announced stimulus package, and are concerned that the aforementioned (potential) US tariffs would put more pressure on an already weak economy.

While a number of smaller emerging markets - including the Czech Republic, Kuwait, Taiwan and UAE - managed to deliver positive returns, it was negative returns of the largest index constituents (China, India, Brazil and Korea) which dragged the index lower. Taiwan delivered a solid return for the quarter, driven by the ongoing positive sentiment around artificial intelligence demand.

Taiwan led this group for the year as well, and with China also advancing the emerging markets shares asset class gained +13.7% in local currency returns. This was further enhanced to +22.1% for New Zealand investors due to the relatively weak New Zealand dollar.

Source: MSCI Emerging Markets Index (gross div.)

NEW ZEALAND SHARES

▲ +5.6%

The New Zealand share market, as measured by the S&P/NZX 50 Index, extended its strong third quarter result by posting another tidy gain to end the year.

The New Zealand economy showed signs of further weakness in the lead up to Christmas, with unemployment climbing to 4.8% and retail sales volumes falling slightly, reflecting the ongoing pressure on household budgets.

With inflation seemingly now under control, the Reserve Bank ramped up its aggressive interest rate-cutting cycle to stimulate the economy, moving the OCR from 5.25% to 4.25% over the course of the fourth quarter, with further rate reductions expected in 2025.

With the beginning of the long-awaited easing in monetary conditions in New Zealand, several small consumer cyclical and healthcare firms delivered strong double digit returns over the quarter. However, of the more index-relevant businesses, it was Auckland Airport (+16.5%), Contact Energy (+16.3%) and Fisher and Paykel Healthcare (+11.0%) which were leading the charge.

Interest in Auckland Airport shares increased as it was confirmed the Auckland Council sold its remaining 9.71% stake to UBS at a price of $8.08, propelling the shares back to their highest price since April.

On the other side of the ledger, Mercury NZ Ltd disappointed by delivering a -9.3% return over the last three months.

After lagging other regions for most of the year, this quarter helped the New Zealand shares post a robust +12.2% return for the 2024 calendar year.

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

AUSTRALIAN SHARES

+0.8%

The Australian share market was slightly weaker in the final quarter, with the S&P/ASX 200 Total Return Index falling -0.8% (in Australian dollars). Weakness was evident in materials prices, affected by China's slowdown and in soft commodity prices, as relatively high interest rates continued to restrict consumer demand.

The Reserve Bank of Australia extended its interest rate pause through the fourth quarter, keeping the Australian cash rate at 4.35%. It continues to state it needs more time, and a decrease in domestic demand, to gain confidence that inflation is sustainably within the target range of 2-3% (the September measure was 2.8%, the first time it has dipped below 3% since 2021). For the moment, the economic weakening that the Reserve Bank needs to see has stalled, with unemployment holding steady at 4% and wages continuing to rise.

Continued uncertainty around China's economic stimulus package and weaker iron ore prices over the final quarter contributed to lacklustre results for materials giants BHP (-13.9%) and Rio Tinto (-9.0%).

Offsetting these was a generally strong quarter for the equally important financials sector, with the big banks all contributing positively. National Australia Bank (+1.6%), Westpac Banking Corporation (+4.3%) and Commonwealth Bank of Australia (+13.2%) all enjoyed the continuation of relatively high interest rates in Australia, which was underpinned by the resilience demonstrated by the Australian economy overall.

With the Australian dollar slightly stronger against the New Zealand dollar over the quarter, the reported returns to New Zealand investors were marginally higher than the reported index returns.

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

INTERNATIONAL FIXED INTEREST

+0.0%

The fourth quarter of 2024 saw yields in fixed interest markets exhibit considerable volatility, primarily driven by geopolitical tensions, central bank actions and fluctuating inflation rates.

In the US, treasury bond prices fell (i.e. yields rose) amid concerns over the potential inflationary impact of trade policies arising from a Republican victory in the presidential election.

While the US Federal Reserve delivered further rate cuts throughout the fourth quarter, it also adopted a more 'hawkish' tone, indicating that expected rate cuts in 2025 may now reduce from four to two. Because the US economy has shown a great deal of resilience, there is little need for the Federal Reserve to cut rates faster, especially if the potential imposition of new trade tariffs were to reignite fears about rising inflation.

The European Central Bank cut key European rates twice in the fourth quarter, the Bank of Japan maintained a steady 0.25% interest rate, while the Bank of England cut once in November to 4.75%.

The US 10-year bond yield rose from 3.79% to 4.57%, with the two year bond yield moving from 3.65% to 4.24%, maintaining a positive yield premium for longer duration bonds. Germany's 10-year bond yield lifted from 2.13% to 2.36%, while the UK 10-year yield moved from 4.01% to 4.57%. The FTSE World Government Bond Index 1-5 Years (hedged to NZD) was flat over the quarter, returning +0.0%, while the broader Bloomberg Global Aggregate Bond Index (hedged to NZD) was down -1.2%.

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

NEW ZEALAND FIXED INTEREST

+1.1%

The Reserve Bank of New Zealand (RBNZ) cut New Zealand's Official Cash Rate by 0.50% on both 9 October and 27 November, reducing the rate from 5.25% to 4.25% heading into 2025.

Short term inflation expectations are now below 3% and economic indicators broadly suggest the New Zealand economy is continuing to slow, with weaker housing data, decreased investment (as measured by building consents) and persistently lower retail sales all painting a picture of a softening economy. The question now for the RBNZ is how quickly to cut rates to ensure that the economy doesn't cool too far.

On the back of the general trend of rising bond yields internationally, the New Zealand 10-year bond yield increased from 4.28% to 4.61% over the quarter.

The S&P/NZX A-Grade Corporate Bond Index gained +1.1% for the quarter, while the longer duration but higher quality S&P/NZX NZ Government Bond Index gained +0.3%.

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

Table 1: Asset class returns to 31 December 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)	2.0%	21.6%	7.1%	11.2%	10.8%
	MSCI World ex Australia Index (net div.)	13.6%	34.5%	13.8%	15.5%	13.8%
Emerging markets shares	MSCI Emerging Markets Index (gross div.)	4.6%	22.1%	5.4%	6.0%	7.6%
New Zealand shares	S&P/NZX 50 Index (gross with imputation credits)	5.6%	12.2%	1.0%	3.4%	10.0%
Australian shares	S&P/ASX 200 Index (total return)	0.8%	14.4%	8.9%	9.3%	9.1%
International fixed interest	FTSE World Government Bond Index 1-5 Years (hedged to NZD)	0.0%	4.1%	1.4%	1.3%	2.2%
	Bloomberg Global Aggregate Bond Index (hedged to NZD)	-1.2%	3.0%	-1.0%	0.2%	2.4%
New Zealand fixed interest	S&P/NZX A-Grade Corporate Bond Index	1.1%	6.8%	2.9%	1.9%	3.5%
New Zealand cash	New Zealand One-Month Bank Bill Yields Index	1.1%	5.4%	4.5%	2.8%	2.5%

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.

When there is nothing to do, do nothing

Do you ever find yourself moving from one queue to another in a supermarket, or changing lanes on a congested motorway, only to realise you should have stayed in the one you were in?

Or do you interrupt your workflow and respond to emails when a more considered response, or none at all, may be more appropriate?

If the answer is Yes, you're not alone, because human beings have an in-built bias towards action.

Action bias, or the Do Something Syndrome as it's sometimes known, is the term behavioural psychologists use to refer to people's preference for doing something over doing nothing, even when inaction might lead to a better outcome. It can be driven by a range of psychological factors — the desire for control, social pressure, fear of regret or the illusion of productivity.

We think we're making things better

Investors display action bias in all sorts of ways. An obvious example is the compulsion you might feel to sell when markets fall sharply, thereby turning paper losses into actual losses. Similarly, you may notice that markets have risen and feel the need to buy straight away to benefit from further gains. Another example is buying, say, a stock or a cryptocurrency because you've just read in a newspaper article or heard from a colleague at work that it could be about to rise in value.

We tend to think that, just by doing something, we're somehow improving our chances of a successful outcome. Most of the time, in fact, investors are better off doing nothing at all.

"I am always hearing that people should be more engaged with investing," economist Tim Harford recently wrote in the Financial Times.[1] And up to a point that is true. People who feel ignorant about how equity investing works and therefore stick their money in a bank account or under a mattress, are avoiding only modest risks and giving up huge potential returns.

"But you can have too much of a good thing. Twitchily checking and rearranging your portfolio is a great way to get sucked into poorly timed trades. The irony is that the new generation of investment apps work the same way as almost any other app on your phone: they need your attention and have plenty of ways to get it."

Boys will be boys

Some investors are more prone to action bias than others. Men, particularly younger men, are more susceptible than women. One reason for this is that men are more likely to be overconfident. Another factor is testosterone, which, according to the neurologist-turned-investment author William Bernstein, reduces fear and increases greed. "(Testosterone) does wonderful things for muscle mass and reflex time," says Bernstein, "but doesn't do much for judgment."

In one well-known study, professors Brad Barber and Terrance Odean found that although women also trade more than they should, men trade even more frequently.[2] Between 1991 and 1997, they found that this increased trading reduced men's net returns by 2.65% per year, compared to a hit of 1.72% for women.

Warren Buffett, the owner of Berkshire Hathaway and the world's most successful living investor, has been a consistent advocate of patience and discipline. Buffett once said: "The trick is, when there is nothing to do, do nothing." He famously described "lethargy bordering on sloth remains the cornerstone of our investment style."

Buffett's business partner, the late Charlie Munger, agreed that the less investors do, the better their returns tend to be. "Our job," Munger said, "is to find a few intelligent things to do, not to keep up with every damn thing in the world."

What to do about it

So what can investors do to curb their action bias? The first thing is just to acknowledge it; feeling the need to act is part of being human.

Remember too that even if action is required, you almost certainly don't need to act straight away. So whenever you feel you need to do something, take time out. Try going for a walk, or better still, sleep on it. If you're still not sure, speak to someone about it, and actively seek out evidence to support not taking action.

Something else you can do is to keep your investment strategy simple. Every year, Morningstar publishes a study called Mind the Gap, which compares the returns that funds produce compared to the returns that investors in those funds actually achieve.[3] Time and again the researchers find that the investors who find it hardest to resist the temptation to trade are those invested in narrowly focused funds. Investors in broadly diversified funds are far more likely to ignore the noise and stay the course.[4]

It might seem counter-intuitive, but a final suggestion is simply to pay less attention to investing and the markets. Don't keep checking the value of your pension: once or twice a year is quite enough. You don't need to check the FTSE 100 or the S&P 500 either. And if you find that reading the money section of your weekend paper only makes you more inclined to act, just put it in the recycling.

As Tim Harford says, "the more attention we pay to our investments, the more we trade, and the cleverer we try to be, the less we will have at the end of it all."

It really is true: *the less you do, the better off you're likely to be.*

Originally published on: https://www.timeline.co/blog/when-there-is-nothing-to-do-do-nothing

Sources:

[1] https://on.ft.com/3Qvd2FX The lesson of Loki? Trade less

[2] http://faculty.haas.berkeley.edu/odean/papers%20current%20versions/boyswillbeboys.pdf Boys will be boys: Gender, overconfidence, and common stock investment

[3] https://www.morningstar.com/lp/mind-the-gap Mind the Gap 2024: A Report on Investor Returns in the US

[4] https://www.morningstar.com/funds/bad-timing-cost-investors-one-fifth-their-funds-returns Bad timing cost investors one fifth their funds returns

Synergy INVESTMENTS

info@synergyinvestments.co.nz
www.synergyinvestments.co.nz
0800 4 synergy

Level 4, 83 Victoria Street
PO Box 1106
Christchurch 8140