Investing in
knowledge
Q1/16

Give me six hours to chop down a tree and I will spend the first four sharpening the axe – Abraham Lincoln.

IT'S A FICKLE WORLD
in which we live

2016 HAS ALREADY GOT OFF TO A VERY ROCKY START WITH SHAREMARKET FALLS IN MANY COUNTRIES AND CONCERN RISING ABOUT THE FINANCIAL SITUATION IN CHINA.

Around the world, many traders were spooked by the Chinese stock market falls and have been predicting the worst. The reality is that China is not a basket case. Its economy is still growing – albeit at a slower rate than over recent decades. However, the new reality is that China is a major economic player and if it slows down, then nervousness inevitably kicks into the markets. The good news is that the largest market (the USA) is growing and showing many positive signs. This along with a small European recovery may help offset weakness out of China.

So, what can investors expect from 2016?

- NZ bank interest rates continuing to stay at historic lows. Therefore, keeping large sums of money on term deposit will not make you rich.
- The NZ dollar may weaken against the US dollar, particularly if the USA economy continues to recover and our dairy commodity prices remain low. This means that if you already have money invested in unhedged international managed funds, you could be rewarded with a currency gain.
- Auckland house prices may stabilise. What this actually means is anyone's guess – but the likelihood of continued double digit growth in Auckland house prices is low and a small fall in prices in some areas is possible.

GENERATION
WEALTH MANAGEMENT

Albany Office
PO Box 64001, Botany, Manukau 2163
TEL. 09 448 5083
EMAIL. albany@generationwealth.co.nz

Botany Office
PO Box 64001, Botany, Manukau 2163
TEL. 09 272 9030
EMAIL. botany@generationwealth.co.nz

Pukekohe Office
PO Box 66, Pukekohe 2340
TEL. 09 238 3322
EMAIL. pukekohe@generationwealth.co.nz

MARKET CORRECTION

Sharemarkets started 2016 poorly as investors back away from riskier assets. For some it is worries about the slowing pace of growth in China, for others it is the need for banks in Europe to raise more capital, and if not that then worries about Europe, the Middle East, the spread of radical Islamism, collapsing commodity prices, emerging market debts and US monetary policy.

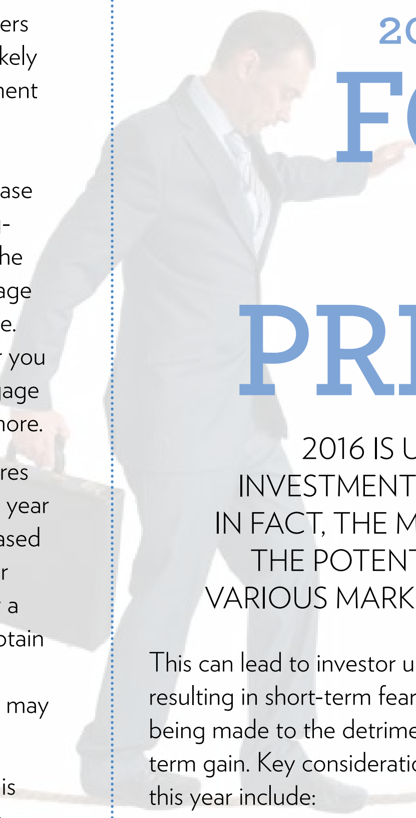
Patient investors can reflect on the fact that nothing above is new, yet the S&P500 index has grown 249% from it's trough in 2009 through to the end of 2015!

Inside

The good news is that house prices in areas that Aucklanders may wish to relocate to will likely go up. Purchasing an investment property in Auckland is now considerably more risky than over recent years. Any purchase should be regarded as a long-term decision, and factor in the implications of higher mortgage interest rates in years to come. Do your budgets on whether you can afford to service a mortgage at an average rate of 7% or more.

- Much lower returns from shares and possibly even a negative year for some shares and share-based managed funds. This is a year when active management by a quality fund manager may obtain better returns than a passive investment in an index which may make a loss.
- An increasing focus on what is happening with commodities. For us in NZ, this particularly applies to the global dairy trade prices. If these prices fall further, and the projected farmer pay-out levels are not achieved, then many dairy farmers will be under even worse financial pressure and this will have a negative impact on many sectors of our economy. Therefore, our investments need to be sufficiently diversified so we are not overly exposed to local and international businesses dependent on rising commodity prices.

Give us a call if you have any questions about the market and your investments.



2016 will be a year to

FOLLOW KEY PRINCIPLES

2016 IS UNLIKELY TO PROVIDE THE HIGH LEVEL OF INVESTMENT RETURNS WE HAVE SEEN IN RECENT YEARS. IN FACT, THE MARKET IS LIKELY TO BE QUITE VOLATILE WITH THE POTENTIAL FOR SIGNIFICANT UPS AND DOWNS IN VARIOUS MARKETS, SECTORS AND INDIVIDUAL INVESTMENTS.

This can lead to investor unease – often resulting in short-term fear-based decisions being made to the detriment of longer term gain. Key considerations for investing this year include:

- **Quality pays:** High quality investments have historically withstood economic downturns and negative investor sentiment better than their poor quality cousins.
- **Ignore the short-term market noise:** Do not react to all the market noise that will inevitably surround the short-term ups and downs in the market. Modern media likes to trot out commentators and statistics to show how things have performed in the last few hours, days or months. This sells media – especially if it is negative news. However, the markets live on and quality investments inevitably recover and go to new highs. Panicking and selling at the bottom does not help you achieve those longer term goals.
- **Diversification is key:** A well-structured portfolio will be diversified across multiple asset classes, sectors, investments and managers. This avoids having "all your eggs in the one basket". If a specific market, (e.g. the New Zealand sharemarket), fell hypothetically 10%, then there is usually some other part of the portfolio that would have made a positive return to help compensate for that loss.
- **Take care if using term deposits and some high yielding savings products:** In 2015, a number of banks changed the rules relating to their term deposits and high yielding savings products. What was a simple product is now much more complex assuming you wish to obtain the return you signed up to. Check the fine print to identify when you are eligible to withdraw your funds without losing all the interest. We are seeing an increasing number of people becoming frustrated with losing the expected interest or not being able to access their funds due to failing to notify the bank within the due timeframe of their intention to access their funds.
- **Take advantage of market downturns:** The market will rise and fall over the year. Talk to us about using your surplus cash to buy when things are cheap.
- **Stick with the plan:** If you have medium- and long-term financial goals and you do not need to use all of your money right now, then stick with the plan and stay invested. If you have a well-diversified portfolio of high quality investments managed by a reputable fund manager, then they will be taking advantage of the market opportunities and buying when things are cheap. Additionally, indices may fall but the cycle lives on and things recover.

Life's tips/1

"On taking risk, never test the depth of a river with both your feet."
– *Warren Buffet*

Summing up

- 2016 could be a volatile year. Keep your head and keep to the rules.
- Ask for your free smart planning checklist.

SMART PLANNING FINANCIAL CHECKLIST

THIS MAY BE THE BEST EVER USE OF 5 MINUTES!

Achieving your financial goals is all about doing the little things right on a consistent basis. Our 'Smart planning financial checklist' is designed to cover all the key areas of your financial fitness. It is jam packed with questions you may have never thought of. It is quick and easy to use – only five minutes for an initial overview. Share it with your family and friends and use it to identify areas which may need addressing.

Give us a call to discuss the issues that the checklist may identify for you.

THE CHANGING FACE OF INVESTMENT DOCUMENTS

New Zealand will be completing the transition to the Financial Markets Conduct Act in 2016. This regime is designed to provide greater investor protection. Fund managers will need to be licensed with the Financial Markets Authority and meet heightened standards. Fund managers are phasing out their glossy investment statements and introducing bland product disclosure statements (PDS). A consequence of this is that not all the information that you may want to know about an investment will be in one document.

We have extensive research on the products and services that we recommend so make sure you ask about anything you are not sure about. We are here to help.

Life's tips/2

"In the short run, the market is a voting machine, but in the long run it is a weighing machine."
– Benjamin Graham

Apathy is costing Kiwis MEGA BUCKS

Apathy around what asset allocation one uses for KiwiSaver is potentially costing some Kiwis tens of thousands of dollars in lost potential capital growth over the longer term. Higher risk growth and aggressive KiwiSaver funds traditionally produce higher returns over a 10 year period than lower risk funds, such as conservative or defensive funds. The difference in long-term performance is usually due to how much of a portfolio is in shares and property.

KiwiSaver is a long-term investment for most New Zealanders and this means that if the funds cannot be accessed for 10 or more years, then consideration should be given to having a higher risk portfolio. Sadly, there are too many investors sitting with their KiwiSaver money in default or conservative funds and failing to fully appreciate the ramifications of this.

Every investor will have a different risk profile based on when they plan to access their money, their knowledge and experience of investing, and how comfortable they are to accept a short-term loss to achieve a long-term gain.

We have various calculators and questionnaires to help all New Zealanders identify the best risk profile to achieve their long-term goals.

Give us a call and we can work through what is the right fund for you, your family and friends.

Summing up

- Before you invest in something new, ask us about the research available.
- Knowing your risk profile is the foundation of all your investing decisions.

Why does pessimism sound so smart

ESPECIALLY WHEN THINGS ARE SO GOOD?

HISTORIAN DEIRDRE MCCLOSKEY WAS QUOTED IN THE NEW YORK TIMES RECENTLY AS SAYING "FOR REASONS I HAVE NEVER UNDERSTOOD, PEOPLE LIKE TO HEAR THAT THE WORLD IS GOING TO HELL".

It's hard to argue. Despite the record of things getting better for most people most of the time, pessimism isn't just more common than optimism, it also sounds smarter. It's intellectually captivating, and paid more attention to than the optimist who is often viewed as an oblivious sucker.

It's always been this way. John Stuart Mill wrote 150 years ago: "I have observed that not the man who hopes when others despair, but the man who despairs when others hope, is admired by a large class of persons as a sage."

Matt Ridley wrote in his book The Rational Optimist: "If you say the world has been getting better you may get away with being called naïve and insensitive. If you say the world is going to go on getting better, you are considered embarrassingly mad. If, on the other hand, you say catastrophe is imminent, you may expect a McArthur genius award or even the Nobel Peace Prize."

In investing, a bull sounds like a reckless cheerleader, while a bear sounds like a sharp mind who has dug past the headlines – despite the record of the S&P 500 rising 18,000-fold over the last century. Wharton Professor Jeremy Siegel is often chided as a perma-stock-bull, blindly cheering for a higher market every time he goes on TV. But he's done it since the early 1980s, a period in which the market increased in value 40 times over. Alas, few care about past results when someone else is warning about The Next Great Depression.

This goes beyond investing. Harvard professor Teresa Amabile shows that those publishing negative book reviews are seen as smarter and more competent than those giving positive reviews of the same book. "Only pessimism sounds profound. Optimism sounds superficial," she wrote.

Why? There's clearly more at stake with pessimism. Daniel Kahneman won the Nobel Prize for showing that people respond stronger to loss than gain. It's an evolutionary shield: "Organisms that treat threats as more urgent than opportunities have a better chance to survive and reproduce," Kahneman once wrote.

Here are a few other reasons I've observed for why pessimism gets so much attention:

1. Optimism appears oblivious to risks, so by default pessimism looks more intelligent. Most optimists will tell you things will get ugly, that we'll have recessions, bear markets, wars, panics, and pandemics. But they remain optimistic because they set themselves up in portfolio, career, and disposition to endure those downsides. To the pessimist a bad event is the end of the story. To the optimist it's a slow chapter in an otherwise excellent book. The difference between an optimist and a pessimist often comes down to endurance and time frame.
2. Pessimism shows that not everything is moving in the right direction, which helps you rationalize the personal shortcomings we all have. Misery loves company, as they say. Realizing that things outside your control could be the cause of your own problems is a comforting feeling, so we're attracted to it.
3. Pessimism requires action, whereas optimism means staying the course. Pessimism is "SELL, GET OUT, RUN," which grabs your attention because it's an action you need to take right now. Optimism is mostly, "Don't worry, stay the course, we'll be alright," which is easy to ignore since it doesn't require doing anything.
4. Optimism sounds like a sales pitch, while pessimism sounds like someone trying to help you. And that's often the truth. But in general, most of the time, optimism is the correct default setting, and pessimism can be as big a sales pitch as anything – especially if it's around emotional topics like money and politics.
5. Pessimists extrapolate present trends without accounting for how reliably markets adapt. That's important, because pessimistic views often start with a foundation of rational analysis, so the warning appears as reasonable as it is scary, however current conditions won't last forever.

Article by Morgan Housel.

Life's tips/3

"It's only when the tide goes out that you learn who's been swimming naked."
– Warren Buffett

Next step

••• See us about the best investment options for you.

GENERATION WEALTH MANAGEMENT