Investing in
knowledge

To be an investor you must be a believer in a better tomorrow.
– Benjamin Graham.

Q2/15

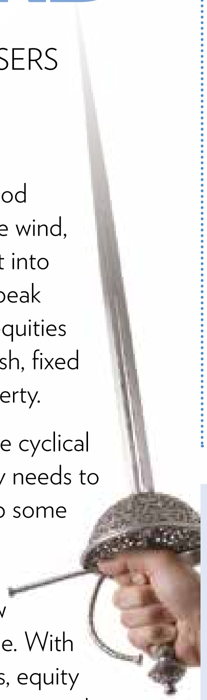
The markets are definitely
A DOUBLE EDGED SWORD

IT IS TIMES LIKE THESE THAT INVESTMENT ADVISERS GET INCREASINGLY MORE NERVOUS.

The investment markets are fantastic for one set of clients and woefully bad for another. How can the markets produce two totally different outcomes?

The stock markets, and hence equity-based managed funds, have had a fantastic run for at least the past five years. This is wonderful news for those clients who have followed our advice and invested into growth funds.

They have often received before tax investment returns of 10% or more. However, the dangers are that clients come to expect double digit returns to be the norm, or they see the consistency of these good returns, throw caution to the wind, and significantly overweight into growth investments at the peak of the market. Long term, equities will outperform inflation, cash, fixed interest and ungeared property.



However, all investments are cyclical and what goes up inevitably needs to have a breather and give up some value. The problem is we don't have a crystal ball to predict exactly when or how severe that correction will be. With historically low interest rates, equity markets tend to do well, but currently our small NZ sharemarket is looking fairly pricey and it will not be long before the inevitable correction occurs. We will get to a situation where there is too much money chasing too few shares and the company profits will no longer justify the high prices being paid for some shares.

On the flip side, times are tough for those clients wanting income to sustain their retirement. Historically low interest rates from cash and fixed interest securities mean that retired clients will need to make one of three decisions:

- Reduce expenditure expectations to reflect lower interest rates, or

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LOOKING A GIFT HORSE IN THE MOUTH?

It seems that not all Kiwisaver members are saving enough to collect the maximum $521 annual tax credit from the Government. The credit is based on 50% of the contributions each member makes up to $1,042.86 per year ending 30 June. If you haven't gotten around to maximising your contributions yet, we would urge you to do so quickly as the KiwiSaver year end is approaching fast.

This is also a good opportunity to review your KiwiSaver scheme. Please don't hesitate to make an appointment with an adviser for a free review.

Inside

••• Can you bank on your bank?
••• NZ investments are looking pricey. Is it time to take your money elsewhere?
••• The Twin Towers and your home insurance.

- Take a higher risk profile with their portfolio so as to get a longer term higher total return from their portfolio, or
- Supplement their portfolio income returns with part-time work or via a consumption of capital. For many retirees, a logical source of capital consumption could come from the sale of a rental property – especially if it is one which has seen a massive increase in value in recent years. (Rental properties are no different to shares – what goes up must also come down.)

For retirees, taking a higher risk with their investment portfolio could take three forms. The first is investing into sub-investment grade securities. These are perfectly legal investments but their quality is such that in order to attract money, they need to offer higher interest rates.

The second form is chasing higher yields from pseudo fixed interest securities such as bank capital notes or similar products such as perpetual subordinated notes or hybrid securities. These usually pay a higher interest rate and are offered by mainstream reputable companies but they are often not what they seem (see article later in this newsletter). The third risk taking strategy is to jump into the asset classes that have been performing strongly in recent years (equities and property) on the misguided belief that their strong performance will continue.

It is times just like now that all investors should be seeking impartial investment advice. There are still many ways to achieve capital growth for wealth accumulators, or provide a reliable spending stream for retirees, without taking unnecessarily high risks.

Now is the time to review your risk profile and goals with us and from there, we can talk through the options available and ensure that you achieve your financial objectives without taking unforeseen or unnecessary risks.

IT PAYS TO KNOW WHAT YOU ARE BUYING

TYPICALLY, NEW ZEALANDERS REGARD THEIR BANKS AS BEING BIG, SAFE AND TRUSTWORTHY. OVERALL, THEY DO A PRETTY GOOD JOB AND NZ HAS NOT HAD THE BANK FAILURES WE HAVE SEEN ELSEWHERE AROUND THE WORLD

However, it is often because we trust them so much that we fail to fully read and understand what they are selling us. In recent years, we have had the overcharging of credit card fees scandal, the mis-selling of mortgages scandal (mainly to farmers), the financial advice scandal in Australia by a number of Australian banks, and then in April, we had the Financial Markets Authority (FMA) warning New Zealanders about Bank Capital Notes. Some of these things were just plain wrong, but in a number of instances, the information about what the bank customer was buying was available to read – it is just that the customer either didn't read it or failed to understand what was written.

The latest FMA guide about bank capital notes is not stating they are inherently wrong or bad. What it is saying is that although you are investing into a mainstream bank using capital notes, perpetual subordinated notes or hybrid securities, you are doing so in a way that is far more risky than if you purchased a traditional bank bond which pays a lower interest rate than these other investment vehicles.

The FMA and we want to ensure you better understand the investments you have, why you have them, and the risks and benefits of each. In some portfolios, there may be a place for a small allocation to bank capital notes, perpetual subordinated notes or hybrid securities but that needs to be weighed up against the risk.

Contact us for a copy of 'Your guide to bank capital notes and similar products such as perpetual subordinated notes or hybrid securities'.

Life's tips/1

"Never depend on single income. Make investment to create a second source."

– *Warren Buffet*

Summing up

- Number crunching time? Review your risk and return goals with us.
- Thinking about investing in bank capital notes? Contact us for your free guidebook.

Time to consider an offshore holiday for some of your money

For the past 12 months, we have been advocating a number of clients increase their portfolio offshore exposure. This is increasingly important in today's juncture of investment markets.

Evidence is mounting that our economy may have peaked and the investment market is fully priced here.

The USA, Australia and other investment markets have been slower to recover and hence investment values are, in relative terms, cheaper than what they are here. With our dollar at historical highs, it means every dollar invested offshore now buys more. Nothing is guaranteed, but offshore investments in the short term have more potential for capital gain than investments here.

Combine this with history which shows that as an economy strengthens, then so too does its currency, and there is potential that an offshore investment made now, could potentially have a double gain over coming years – first from the investment itself rising in value and secondly from our dollar falling in value compared to the currency the investment was made in e.g. US dollars.

Investing offshore does not come without risk and we recommend the use of high quality managed funds which enable good diversification and investment selection. The good news is the choice of offshore investments is massive.

Talk to us about offshore investing whilst our dollar is strong.

INSURANCE – LESS FOR MORE?

MANY PEOPLE TALK ABOUT THE WORLD BEING A VASTLY DIFFERENT PLACE SINCE THE TERRORIST ATTACKS OF SEPTEMBER 11. INSURANCE IS ONE AREA THAT HAS CERTAINLY CHANGED FOREVER.

For example, in the early 90s, it was commonplace for life insurance policies to include cover against acts of terrorism and war. Since then – and particularly since September 11 – virtually no life insurer will include this cover in their standard policies. However, compared with the fire and general insurers, the exposure of life insurers is at least finite and more easily quantified. In other words, life insurers generally expect to pay death benefits on a certain proportion of the lives they insure each year. With the 9/11 US terrorist attacks, insurers paid out for people who were killed many years before they should have died, but the sums insured didn't change.

For fire and general insurers, it's a completely different ball game. No insurer ever expected to have to pay claims for the destruction of the World Trade Centre. And the frequency and magnitude of future terrorist attacks is something no insurer can accurately forecast. Consequently, insurers simply won't provide cover for these events today.

While you may think a lack of terrorism cover doesn't affect you directly, the change in insurers' thinking does.

How fire and general insurers run their businesses is largely dictated by the global re-insurers they 're-insure' their exposures with. Before 9/11, re-insurers would re-insure a set proportion of insurers' losses, which in theory meant they could never be certain just how great an exposure they had. Now, re-insurers specify the limit of their exposures, they offer insurers only closely-specified indemnities, and they have redefined what constitutes an insurable loss.

For consumers, that boils down to more tightly defined cover with more exclusions and, in many cases, higher premiums as well. The fact is, if insurers don't make money, they can't cover anyone.

Just as the insurance industry is rethinking how it manages risk, so too should consumers. For example, are you paying higher premiums because your policy has a low excess? Are you insuring only what you need to insure – or everything, regardless of whether that's cost-effective?

Finally, don't forget you also have a role in setting your premiums, in terms of the way you behave (in the car, for example) and how careful you are in protecting your property.

Talk to us about the sorts of insurance options available today and the best combination for you.

Summing up

- Consider packing your money bags and taking them on an offshore investment holiday.
- Terrorists are still making an impact – on your home insurance.

Retirement Planning

HOW MUCH IS ENOUGH?

EVEN IF RETIREMENT SEEMS A LONG WAY OFF, IT PAYS TO PLAN FOR YOUR RETIREMENT AS EARLY AS POSSIBLE.

Most people end up relying on NZ Super and their own savings for income in retirement. How much you'll need to save will depend on your own circumstances, but the sooner you start, the more you will have.

Will I have enough to fund the retirement I want?

Everyone's retirement needs are different. To work out how much you will need, think about how long you will have in retirement, what sort of lifestyle you will want, and where you will live.

You should plan on needing to fund your retirement for at least 25 years if you plan to retire at the age of 65.

People are living longer these days. On average, 65-year-old men can now expect to live until they're 86, and 65-year-old women until they're 88. In the future, we'll probably live even longer. Men reaching 65 in 2031 can expect to live until they're 88 and women until they're at least 90. (Figures based on the latest Statistics New Zealand cohort life tables.)

For many of our clients, their biggest fear is outliving their money!

What sort of retirement lifestyle do you want?

Most of us aren't prepared to lower our standard of living when we retire. Eating and drinking, taking holidays, buying clothes, maintaining our houses and cars, joining clubs, going out to dinner and shows, visiting friends and family will still be important! Some of your costs may go up (like healthcare) while others (such as education, clothing, housing, work-related travel) may go down.

Will you live in your own home or rent?

If you rent, you'll need more savings to cover the cost – but on the other hand, you won't have money tied up in a home. However, owning the place you live in, debt-free, will reduce the risk of rent increases or being asked to find a new place to live. You will have more control over your finances, but you will have to take care of maintenance and rates.

Being mortgage-free by retirement is a great goal to aim for. The reason many people currently in retirement are able to manage financially is because they no longer have the burden of mortgage repayments.

So what are the figures?

There is no magic formula as we all have different circumstances, needs and desires, but we can work out some ball-park figures. Assuming that you own your home and qualify for NZ Super, and want an annual cash income of $45,000pa (approx 75% of the average after tax net family income according to Statistics NZ).

For a married couple where both get NZ Super, they will need to find $15,000 pa from their savings. If they want to use up all their savings over 25 years (ie at age 90) they would need a lump sum of $250,000. If they wanted their capital to be maintained so that they could pass on a legacy, they would need approx $350,000 at age 65.

For a single person the answer is different as their living alone NZ Super is less than that received by a married couple. Assuming they want the same cash income, then approx $25,500 pa would have to be funded from savings. If they want to use up all their savings over 25 years (ie at age 90) they would need a lump sum of $425,000. If they wanted their capital to be maintained so that they could pass it on as a legacy, they would need approx $590,000.

Please contact our adviser if you would like to discuss this issue.

* Note all figures assume investing into a diversified portfolio with a moderate risk profile and normal financial market outcomes.

Life's tips/2

"Successful investing professionals are disciplined and consistent and they think a great deal about what they do and how they do it."

– Benjamin Graham

Next step

··· See us about the best investment and insurance options for you.

GENERATION
WEALTH MANAGEMENT