

# Investing in knowledge

Cash combined with courage in a time  
of crisis is priceless – Warren Buffet.

## Q4/16

## LOWER EARNING RATES

*are now the norm*

IT IS LESS THAN TWO YEARS  
AGO THAT WE WERE USED  
TO SEEING DOUBLE DIGIT  
RETURNS FROM INVESTMENT  
FUNDS – INCLUDING  
KIWISAVER SCHEMES. TODAY,  
WE HAVE MUCH LOWER  
INTEREST RATES, RAPIDLY  
FLUCTUATING EXCHANGE  
RATES AND LOWER  
EARNINGS FROM SHARES.



This leads to overall portfolio returns being significantly less than in the immediate past. This is just a sign of the times in which we are currently living. Portfolios and investors need to adapt to changing times and increasing risk.

Two natural human reactions are to:

- Sell those investments that are underperforming and put the proceeds into those doing really well.

- Cash up your investments and wait until everything is doing well again.

The key dangers associated with investing into something that appears to be outperforming are:

- Taking on more risk within a portfolio. After all is said and done, higher returns normally come with higher risk.
- Concentrating the portfolio into fewer stocks or bonds and then concentrating on specific countries and industry sectors. We call this 'concentration risk'. The undesired consequence of this is that if one of the investments under-performs then it can significantly impact upon the entire portfolio.

History shows that diversification within a portfolio is a prudent measure when times become uncertain. Additionally, markets rise and fall and those who do well tend to remain invested when markets fall and find additional cash to invest into undervalued assets when cheap.

*Give us a call. We are happy to  
talk through any issues or concerns  
you may have.*

**GENERATION**   
WEALTH MANAGEMENT

### Albany Office

PO Box 64001, Botany, Manukau 2163

**TEL.** 09 448 5083

**EMAIL.** [albany@generationwealth.co.nz](mailto:albany@generationwealth.co.nz)

### Botany Office

PO Box 64001, Botany, Manukau 2163

**TEL.** 09 272 9030

**EMAIL.** [botany@generationwealth.co.nz](mailto:botany@generationwealth.co.nz)

### Pukekohe Office

PO Box 66, Pukekohe 2340

**TEL.** 09 238 3322

**EMAIL.** [pukekohe@generationwealth.co.nz](mailto:pukekohe@generationwealth.co.nz)

## WISHING YOU A MERRY CHRISTMAS

With another year rapidly drawing to a close, all of us at Generation Wealth would like to wish you and your families a Merry Christmas and a prosperous New Year.

### Christmas hours

We will be closing our offices to give everyone a well-earned rest to refresh and spend time with their families and friends. Our last day will be Thursday 22nd December and we will be re-opening on Monday 16th January.

We look forward to another successful year together in 2017.

## Inside

- ... 67 is the new 65. Will the pension age increase?
- ... When perceptions and financial reality conflict
- ... Crooks, terrorists and you. The implications for AML/CFT.

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# EMOTION VS LOGIC

FINANCIAL SELF-HARM IS COMMON AMONGST INVESTORS BUT IS RARELY DISCUSSED.

Too frequently, we see people make irrational investment decisions based on fear, greed or lack of correct information about a situation. Often, financial decisions are made based upon media commentary, advertising or what a friend has done.

As financial advisers we are constantly

dealing with situations where clients' perceptions and short-term desires are often contrary to what they should be doing at a particular point in time.

Each one of these potential mistakes can cost thousands in long-term lost income and capital gain.

## Life's tips/1

"We don't have to be smarter than the rest.

We have to be more disciplined than the rest."

– Warren Buffet

INVESTOR THOUGHTS/DESIRES	THE REALITY
"I have lost money in managed funds over the past year. They are no good; I should withdraw my money."	Managed funds are simply a vehicle to gain access to investment markets. When they lose money, it means the price of buying-in becomes cheaper so assuming you are in a quality managed fund, it makes sense to put more money into your managed fund(s) so that when markets recover (which they always have done), the value of your investment rises.
"The world is less stable now than ever before and I should sit in cash until things settle down and become safe."	There is always instability in the world. Improved communications make us more aware than ever before about these events. However, markets adapt to all situations over time. You need to be invested to take advantage of future opportunities.
"My current KiwiSaver provider has good performance and offers online access to view my investment balance. I will stay put."	KiwiSaver is a long-term investment and it is important to invest with a proven fund manager who has consistently performed well through good times and bad. We have access to the latest research from Morningstar (a global research company) on KiwiSaver funds of various KiwiSaver Scheme providers and hence can identify those funds which over time have a higher probability of outperforming and providing a consistently good risk-adjusted return. A consistent long-term good return is often better than the rollercoaster ride we sometimes see from fund managers who are consistently advertising how good they are today. All the funds in the KiwiSaver Schemes we recommend provide you with the ability to view your fund balances online.
"I will leave my money in the bank as there is no risk."	The days of getting high interest rates from term deposits is long gone. Bank accounts are a good place to store money that is required in the short-term. The big risk of leaving your money in a New Zealand bank is that over time, the real cost of living increases at a faster rate than the interest earned on your money, and so you effectively go backwards from a purchasing power perspective. If investing for the medium- or long-term, then we need to take some risk with our money and that involves investing into growth assets such as shares and property. This can easily be done via regular savings into a diversified portfolio or into a high quality multi-sector fund.
"Property has increased in value in recent years. Let's put our money into another property."	In certain areas, property values have increased excessively, meaning a period of consolidation is likely at some point. There are parts of New Zealand where property values have fallen or at best remained static for the past few years. We encourage all our clients to purchase their own home to live in provided it is economically feasible to do so. However, property is only one investment asset class and it is important to be diversified and not have all your eggs in the one basket. Having money invested into managed funds will help provide that diversification.
"As I get older, I should move all my money into lower risk investments."	This makes sense if you are planning to take all your money out of your KiwiSaver account or investment portfolio and spend it at a certain date. However, this rarely happens. It is now common for people to spend 20 or more years in retirement and having all your money sitting in low risk investments means it will not have the opportunity to grow to meet your future spending needs. We can structure your portfolio at retirement so that a portion of your money is in lower risk investments to provide you with income for the short-term while the rest remains in higher risk investments to provide growth for your future spending needs.

## Summing up

- ... Do you love your job enough to keep doing it after 65? Talk to us about other income strategies.
- ... Are you facing the new realities of finance? We are happy to discuss them with you.

# WHAT IS HAPPENING ON 1 DECEMBER?

All fund managers need to be licensed and operating under the Financial Markets Conduct Act by 1 December 2016. This requires them to replace Investment Statements with Product Disclosure Statements, provide standardised ways of disclosing fees and performance, plus all provide the same level of detail relating to their respective investment products.

The amount of work to become licensed and keep compliant is huge. This has triggered a number of managers to assess the viability of some of their investment products. There are numerous instances where employer superannuation schemes, and UK pension schemes have moved to 'restricted' or 'legacy' status. This means they have closed to new members and will preserve the benefits of their members and continue to operate under the old legislation. A number of smaller schemes have been wound up or merged with larger schemes to obtain economies of scale in the face of increased operating costs resulting from the Financial Markets Conduct Act.

The larger schemes continue to operate but now have Product Disclosure Statements. There may also be changes to their websites and the way they report their earnings.

*Give us a call if you have any questions regarding your investment portfolio and how the underlying investments are transitioning to the new legislative regime.*

## AML/CFT: we all have to GRIN AND BEAR IT

OUR GOVERNMENT SIGNED UP TO INTERNATIONAL AML/CFT\* PROTOCOLS, RESULTING IN GREATER EMPHASIS ON PROVING THE IDENTITY AND RESIDENCE OF THOSE WHO HOLD INVESTMENTS, OPEN BANK ACCOUNTS OR BORROW MONEY.

Money laundering and terrorism financing are global problems. A recent report indicated money laundering via NZ companies is around \$1.5 billion a year and globally, the figure is estimated to be between US\$590 billion and US\$1.6 trillion.

The main implications for you are:

- We, and all financial institutions you deal with, need to have certified copies of your photographic identification – preferably a passport, NZ driver's or firearms licence. You also need to prove your place of residence through documents such as rates demands, utility bills and bank statements.
- You need to provide these forms of identification whenever you open a bank account, make a new investment, withdraw money, obtain a loan etc. We recommend you hold copies of these

documents at home, or electronically so they are quick and easy to print out.

- If you invest via a family trust, we need proof of identity for all the trustees plus a copy of the trust deed showing who the beneficiaries, or classes of beneficiaries, are.
- If you no longer have a passport or driver's licence, to prove your identity you will need a copy of your birth certificate and to obtain an '18+ Card' with your photo on it.

*This legislation is not something you or we can avoid. It is now part of normal life and we will work with you to ensure it is as painless as it can be.*

\* AML/CFT stands for anti-money laundering and countering financing of terrorism.

## IS 67 GOING TO BE THE NEW RETIREMENT AGE?

New Zealand doesn't have an official retirement age. For many people, 65 years is the target as it's the age when most superannuation plans (including KiwiSaver and government-funded NZ Superannuation) begin to pay out.

The Commission for Financial Capability is reviewing retirement income policies, and will make recommendations to the government. Diana Maxwell, the Retirement Commissioner, wants the age of eligibility for New Zealand Superannuation (Super) to be slowly increased to age 67, possibly by increasing the age of eligibility by three months a year over a 10 year period to a final age of 67.

The Commissioner has said Super is not affordable. In the next 20 years the number people aged 65 plus will double, the cost of Super will triple, and our dependency ratio (the number of people of working age relative to retirees) will go from 4.4 to 2.4 people of working age to every one retiree.

Also being considered is increasing the number of years (currently 10 years) that people must be in NZ before qualifying for the pension.

These are just concepts being considered, however they align with what is occurring in other OECD countries, many of which have already increased the age of eligibility to 67 years and beyond. It may be that for the 2017 election, the issue of retirement age will once again become a political issue.

### Summing up

- ... Terrorism and organised crime threats are real, we must guard against them.
- ... The financial advice industry is evolving to meet new challenges.

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# What's the right asset allocation for YOUNG INVESTORS?

HERE ARE A FEW THOUGHTS ON MANAGING MONEY AS A YOUNG PERSON WITH MULTIPLE DECADES AHEAD OF YOU TO INVEST.

- Probably the best course of action you can take, with years and years of future savings to put to work, is to dollar cost average into the markets over time. It's not a perfect strategy but, if put on auto-pilot with automated contributions, it's likely to be one of the best investing decisions you'll ever make.
- Personal finances will matter more than your portfolio, especially when you're young. Create good personal finance habits and you can be set for life.
- When you're young you have the assets (human capital) and time horizon to potentially accept huge amounts of volatility in your long-term investment accounts. This is a blessing and a curse depending on your experience with the markets and how you approach investing.
- Every investor needs a basic understanding of financial history so they can realise how manic the markets can be at times. History is littered with examples of the madness of crowds. Don't try your hand at investing

## Life's tips/2

"In the long run, it's not just how much money you make that will determine your future prosperity. It's how much of that money you put to work by saving it and investing it."

– Peter Lynch

without the realisation that there have always been cycles that eventually reach a point of too much optimism or pessimism. Whatever asset allocation you chose, you have to remember that rebalancing back to your original target weights will almost always mean going against the crowd.

- Stock markets around the globe lost nearly 60% of their value in the latest financial crisis. Could you handle seeing your hard-earned savings cut in half, or worse, with a stock-heavy portfolio? Would you have the discipline to stay invested and keep buying all the way down while the shares are effectively on sale?
- Investing is a constant tug of war between feeling safe now and feeling safe later. If you want safety now you're going to have to accept low returns: if you want safety later you're going to have to accept occasional losses. That's the trade-off.
- Live within your means. Avoid lifestyle creep. Stay out of credit card debt. Save at least a double digit percentage of your income. Increase the amount you save each year. Keep your investment costs low. Diversify. This is simple advice. But even the best advice doesn't matter if you can't follow it. Humans just aren't designed to deal with risks that are far out into the future. Take this into account when creating your plan.
- Avoiding huge mistakes at the wrong times is half the battle. Try to learn from the mistakes of the previous generations who have come before you. Everyone

has someone in their extended family that has made huge mistakes with their money.

- Once you have a plan in place and have most of your good decisions automated, benign neglect should be the hallmark of your strategy going forward. Allow compound interest to do its thing and try not to get in the way.

The majority of the advice you read these days tells millennials that they're far too risk averse and need to be taking more risk with their portfolios. This is true in a general sense, especially with retirement assets, but we always have to remember that good advice and human nature are often in conflict with one another.

A portfolio comprised of 100%, 95% or 90% in stocks for a young person should make sense, but in reality only makes sense for those who know what they're getting themselves into. Whether you had 5% or 10% of your portfolio in bonds during the great financial crisis wouldn't have made a huge difference one way or another in terms of losses. That's still a stock-heavy portfolio regardless of 5% here or there.

What really matters is how prepared you are to deal with losses as an investor. One of my favorite quotes by Fred Schwed in his book *Where are the customers' yachts?* sums this up nicely:

*"Like all of life's rich emotional experiences, the full flavor of losing important money cannot be conveyed by literature. You cannot convey to an inexperienced girl what it is truly like to be a wife and mother. There are certain things that cannot be adequately explained to a virgin by words or pictures".*

I've spent years studying asset allocation strategies and my takeaway is that there are many solid allocation choices investors could make and still be successful. The biggest obstacle is not the allocation itself, but forcing yourself to stick with the one that you choose.

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