THE GENERATOR

Money makes money. And the money that makes money makes more money.

Benjamin Franklin

Q3_2021

THE MARKETS THIS QUARTER

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After the first half of the year produced solid gains in investment markets, we have seen things take a pause in the latest quarter as participants begin to ponder what the next step might be.

Whilst the economic recovery is well entrenched, it has not been one way traffic as the Delta variant of Covid-19 has proven very difficult to bring under control. This has slowed the rebound in job growth in public facing roles as outbreaks emerge and has exacerbated the supply chain issues companies have been grappling with since 2020.

As well as these physical issues, we are now getting closer to the point where central bankers begin to contemplate the first steps in removing some of the emergency stimulus measures introduced last year at the start of the pandemic, that is initially slowing the rate of money-printing (tapering QE) before stopping it altogether (sometime next year in the US, already stopped in NZ). The step after that would be to increase interest rates (see inside for NZ market expectations).

The best performing sector of client portfolios in this quarter has been the Property & Infrastructure allocations, in particular Australasian property exposures, with global property also producing solid returns.

After lagging in the first half of the year, the last three months have seen a good uplift in the NZ share market, as well as continued gains in Australian shares, although these returns have been diluted as the NZ Dollar has risen strongly against its Australian equivalent (up some 4%).

After beginning the quarter well, global sharemarkets have drifted back down due to the concerns mentioned earlier as the rate of growth from the pandemic recovery appears to have peaked, whilst fixed interest allocations have provided mixed results.

Whilst this quarter might have produced a modest outcome, portfolio returns over the last year continue to be very satisfactory and we believe the outlook is still encouraging for investors.

Business as (sort-of) usual—Locked down but not out!

Given that we've had some practice now (too much some would say!) we've been able to move seamlessly to working from home since we moved into the initial lockdown on 17th August.

Thanks to modern technology, with all of our key data and portfolio management systems being "in the cloud", we can continue to do everything from taking calls to instigating transactions and managing portfolios to holding Zoom meetings with clients.

Having said that, we're all looking forward to getting back to normal operations as soon as we can!

Inside

- *Super Returns for the NZ Super Fund*
- *Changes to client portfolio structures*
- *Current market pricing for OCR changes*
- *New CV's are on their way—will they be relevant?*

Super returns for NZ Super fund

The New Zealand Superannuation Fund has recorded its strongest ever yearly investment return, bouncing back after a lacklustre return the previous year, to earn 29.63% in the year to June 2021. The previous year had seen returns of 1.73%.

The Chief Executive of the Fund, Matt Whineray, has warned that the strong returns won't last in an environment where investment has become more challenging with higher inflation and rising interest rates.

"The past year demonstrates the importance of sticking to our long-term investment strategies, which are designed to play out through market cycles" said Whineray.

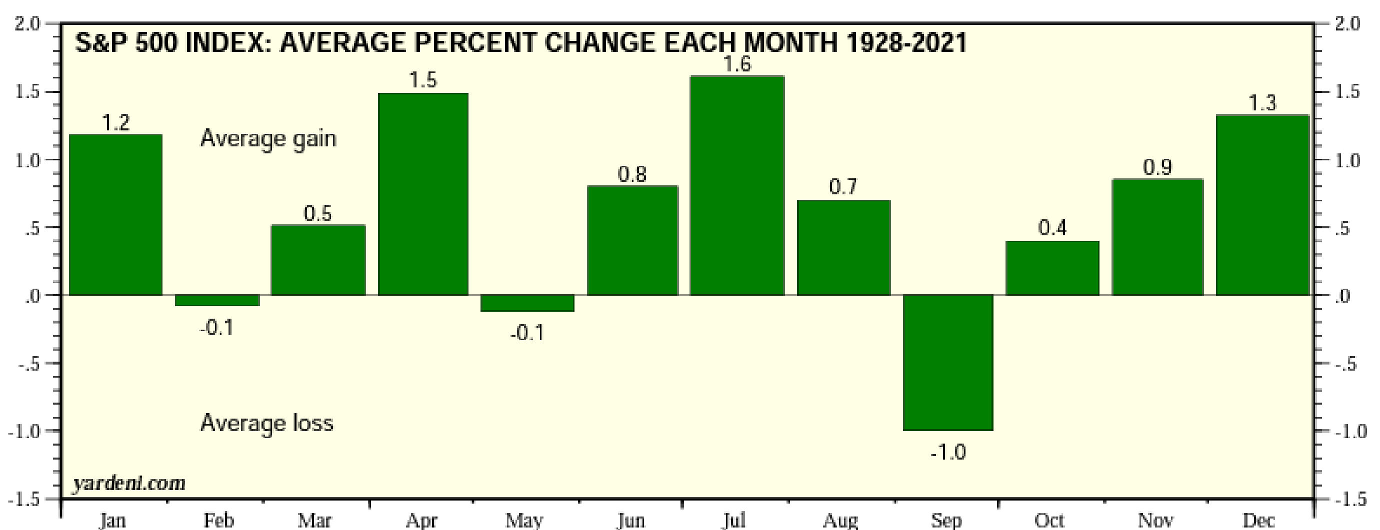
The Fund was established in 2001 to help meet the future costs of NZ Superannuation and began investing in 2003. Since that time, it has had an average return of 10.67% p.a., outperforming it's low cost indexed reference benchmark by 1.24% p.a. as the fund has grown to $59.8b. The Government has made contributions of $12.4b to the Fund since it's inception. It is projected that the Government will start making withdrawals from the fund to help pay for superannuation from the mid-2030's, but the fund is predicted to keep growing as a percentage of GDP through to 2070. Given the long time horizon, they've built a strongly growth oriented portfolio, with its largest allocation being to Global Equities at 63% of the portfolio.

"With markets continuing to perform strongly and economies rebounding, supported by accommodative fiscal and monetary policy around the world, we're possibly looking at a period of increasing inflation and rising interest rates. That combination should weigh on company returns and creates a challenging investment environment. We do not expect the outperformance of recent times to continue forever," says Mr Whineray.

"At the same time, the ongoing impact of Covid-19 and uncertainty about virus variants weighs on economic sentiment. ***It's a recipe for ongoing uncertainty we aim to tackle by focusing on the long-term performance of the Fund."***

Mr Whineray says *"these are world class results that show the Guardians has been successful in utilising the Fund's long horizon, operational independence, sovereign status and strong governance structures in order to generate above-market returns over a sustained period."*

September historically the weakest month!



*No change (0.00%) month of September 1979. Data are through August 2021.
Source: Standard & Poor's and Haver Analytics.

Summing up

- *markets are volatile and can deliver unexpected results*
- *maintain your disciplined investment strategy*
- *think of your long term goals and how they are best achieved*
- *always talk to your adviser if you are worried*

Changes to portfolio structures

Interest rate risks diminished

Core Portfolios Rebalanced

New High Net Worth Portfolios Launched

One of the investment themes likely to play out over the years ahead is that the multi-decade fall in interest rates has come to an end and we are at the start of a period of general rises in interest rates. This is in response to inflationary pressures and as the emergency measures put in place by central bankers are reversed.

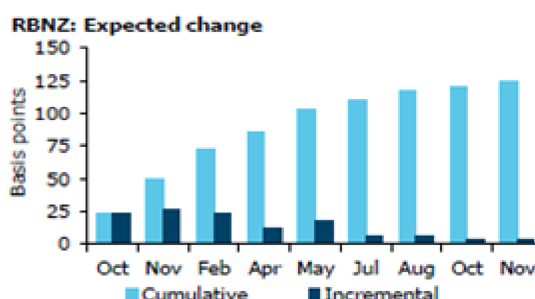
Rising interest rates can pose a risk to investment portfolios as rising bond yields mean a loss in value for existing bonds, known as interest rate risk.

In conjunction with our research providers, we have looked at options to reduce this risk and have recently completed a review of the fixed income allocations in our client portfolios. Our objective is to increase the portfolio's resilience to future interest rate or inflation increases, and its return potential if rates remain low.

As a result, we are have implemented several changes to the asset allocation of client portfolios across all risk profiles.

- Reduced standard bond holdings in favour of a higher weight to short duration and cash enhanced investments. This is to reduce interest rate risks and reflects the poor outlook for standard bond holdings.
- To also reduce standard bond holdings by allowing up to a 15% allocation to several 'alternative' asset classes. The asset classes may include gold, insurance-linked securities, private credit and trend following. Their inclusion is expected to further reduce interest rate risks in the portfolio, and also offer yield enhancement and/or diversification benefits.
- To keep the broad allocation to growth assets in line with the current portfolios' risk profiles. This means the recommended changes should not increase overall portfolio risk.
- Continue with an allocation to 'inflation-protecting' assets (listed infrastructure and global real estate). The higher weighting to inflation-protecting assets is aimed at dealing with longer-term inflation risks associated with today's very loose monetary and fiscal policies.
- Also in the last quarter, in conjunction with our research providers, we have built and implemented a range of portfolios' designed specifically for our high net worth clients. The size of these clients portfolios means that we have been able to introduce an increased range of investments within their existing allocation ranges whilst ensuring that each allocation results in a meaningful level of investment, thereby further increasing the level of diversification within portfolios.

New Zealand	Rate	*Change from current*
Current Rate¶	*0.25*	
Wed 6 Oct 21	0.48	*0.23*
Wed 24 Nov 21	0.75	*0.50*
Wed 23 Feb 22	0.98	*0.73*
Wed 13 Apr 22	1.11	*0.86*
Wed 25 May 22	1.29	*1.04*
Wed 13 Jul 22	1.35	*1.10*
Wed 17 Aug 22	1.42	*1.17*
Wed 5 Oct 22	1.46	*1.21*
Wed 23 Nov 22	1.50	*1.25*



Current-market pricing for changes to the Overnight Cash Rate

Summing up

- *••• sometimes what you see as a safe strategy can in fact be a risky one, because it won't deliver on your goals*
- *••• Seek sound advice about setting up a multi-asset, multi strategy portfolio of assets*

Will your new CV be relevant?

New Council Valuations for residential properties are due out in October

Are they a relevant price indication?

It's been four years since Aucklanders last received updated council valuations or CVs for their properties, with the majority of the region's neighborhoods rising in value by more than 20 percent.

Following the global disruption caused by the COVID-19 pandemic and ensuing economic difficulty and recession, Auckland Council deferred its revaluation of the region's properties by 12 months, noting an inability to source reliable market data given the volatile economic climate.

Traditionally updated every three years, CVs for residential property are council- commissioned estimates of a property's value, calculated to determine what proportion of rates the owners are liable for.

Working in partnership with valuation firm Quotable Value (Q.V) Auckland Council uses mass appraisals and computer-generated estimates, which despite remaining sight- unseen by council officials, determine a property's market value. These estimates are publicly available.

The council says these estimates reflect the most likely selling price should the property have sold as of June 1 during the rating year.

The estimates factor in known consented works and subdivision or zoning changes, but do not include chattels.

IMPACT FOR SELLERS

Often critiqued as outdated in a rapidly-moving market, buyers sometimes incorrectly look to CVs as a price-guide for residential property, however, Auckland Council is careful to caution against use for anything other than a guide for setting local rates.

Yet in the absence of other demonstrated sales data such as is the case for new-build homes, the influence of an outdated CV can be frustrating.

Real Estate Agents have found council valuations can often baffle buyers, with buoyant periods of the property cycle contributing to a fast-paced and changeable landscape for price setting.

Heightened buyer interest and competition for quality properties have a direct correlation to the number of properties sold by auction, a process that does not traditionally offer value indication until the auction day proceedings.

Salespeople have remarked that occasionally, in the absence of a set price, buyers will look to public information such as CVs to determine value.

However, using these figures can be inconsistent, often offering false indications of truemarket value given the fact that Real Estate Agents utilise a complex set of matrices for establishing value that extend significantly past a simple computer-generated algorithm used by Council.

As council valuations are calculated sight unseen, they fail to account for features that have a large bearing on an eventual sale price, such as a great view, the condition of a property or car parking, amongst other things.

Real Estate Agents use a combination of valuation techniques including on-site or virtual inspections to accurately understand the selling features of a home, these are contrasted with neighbourhood sales data and a depth of understanding about planned and existing local infrastructure as well as community features to deduce an accurate price expectation.

Where in the past, buyers have used CVs as a benchmark for value owing to a lack of available information, we are bombarded with sales data today.

Thanks to a hot property market that has drawn intervention from the Government and the Reserve Bank, buyers are increasingly wary of sales estimates that are light on detail and it is expected the new generation of house hunters will pay less attention to these numbers when seeking a value estimate in the current market.

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