accordia

Spring 2011

the advantage

refreshingly honest investment advice

The Crystal Ball of Investing

"How do we choose investments to avoid the turmoil?" It's a question we get asked a lot especially when news bulletins are full of stories about economic woe. The answer is short and honest: "We can't."

In uncertain times, such as we're experiencing now, the prices of all assets are affected. Our highly interconnected world means information travels instantly, so there's no escaping the hype, and nowhere to hide. As a result, sentiment changes rapidly, investors dump assets they previously thought attractive, and buy assets that had previously been out of favour. Despite the fact that little may have changed about the company or its prospects, sentiment drives their trading activity.

Unfortunately the crystal ball of investing that provides insights not available to other investors hasn't been discovered yet, although it would be a marvellous find. In addition to correctly predicting global events, it would also have to be able to recognise the complexity and outcome of all factors that impact pricing - quite a trophy indeed.

So what do we do?

Rather than frantically searching for the elusive crystal ball, we follow a systematic and pragmatic approach to investing that's served us well. It has 5 simple steps:

- We work out what you want to achieve over what time frame
- We document where you are now
- We use robust, comprehensive processes to construct your portfolio
- We manage your risk effectively
- We manage your investments in a disciplined way

The need for this disciplined approach is particularly apparent in today's environment. Concerns over European debt have hit the headlines with a primary focus on Greece, and now Italy is in the spotlight, with the cost of its debt creeping up to concerning levels.

Then there's the United States, a key world economy in sticky, low growth mode, with high levels of unemployment and its own debt issues. Although China and other emerging economies continue to exhibit strong growth, it's of little benefit if the developed economies continue to wallow.

Silver Linings

These dramatic economic scenarios are more newsworthy at the moment than the successes of some of our biggest international companies, so its easy to believe it's all doom and gloom. However, amidst the turmoil, Caterpillar, for example, has made record profits, and Apple and Google are sitting on huge cash balances poised to buy companies they've been targeting for some time.

In addition, some global corporates have effectively immunised themselves against regional risks by operating in an environment that no longer recognises country borders. For example, UK-listed Vodafone annually turns over the equivalent of NZ's GDP through its operations all over the world. Iconic US conglomerate, General Electric (GE), has more than half of its employees outside the US, and turns over around 3.5 times NZ's GDP. Companies in the so called defensive sectors also continue to perform. No matter how bad it gets, we continue to buy essentials such as toothpaste and food. As a result, companies like Proctor and Gamble, who own the Colgate toothpaste brand, can still thrive and grow their business to become a significant player in the Chinese toothpaste market.

The media rarely present a balanced world view, usually portraying the more sensational or newsworthy angles.

When Uncomfortable is Good

Sometimes good, effective investing is uncomfortable. It can mean being invested in assets that are out of favour in the short term but, over the longer term, are essential elements of a properly-constructed portfolio.

Accordia's experienced investment manager employs a robust framework for managing portfolios in turbulent markets.

- We believe in carefully understanding what the "budget" for risk should be. Is it a large or small budget?
- We intensively research and analyse the correct exposures for your portfolio, with the appropriate amount of risk assets to meet the budget.
- We carefully manage your risks, the bedrock of any effective investment management programme.
- We monitor fundamental changes to the factors driving different investments, such as the present sovereign and government debt issues.
- We're disciplined and work hard. There are no short cuts and no there's crystal ball. It's good quality research and analysis that make the difference.

So coming back to the original question, "How do we pick investments to avoid turmoil?" It's simple. We employ solid portfolio strategies through rough times and smooth.

Does Timing Matter?

You want to make sure that every dollar counts when you're investing, regardless of what the market's doing. As well as making good investment decisions, getting your timing right can also be helpful.

There's an oft-touted method of investing called Dollar Cost Averaging which merits a closer look to see how useful it can actually be.

The practice of Dollar Cost Averaging or DCA, as it's more commonly known, means investing equal amounts of money on a regular basis, over time. The aim of the practice is to buy more assets when prices are low and fewer assets when prices are high.

So for example, you may invest $100 in shares every week for 6 weeks. As the price of the shares changes over the six weeks, the number of shares you can buy for your $100 each week also varies.

In the example below, at the end of the six weeks, you own 610 shares. Because the share price is $1.02 at the end of the period, your investment is worth $622.20 compared to the $600 you invested.

	Share Price	Investment	Shares Bought
Week 1	$1.00	$100	100
Week 2	$1.05	$100	95
Week 3	$0.95	$100	105
Week 4	$0.91	$100	109
Week 5	$0.97	$100	103
Week 6	$1.02	$100	98

Now compare what would have happened if all the money had been invested as a lump sum at the start of the period. The share price at that point was $1, so you would have been able to buy 600 shares. As a result, your investment at the end of the period would be worth $612, or over $10 less than if you'd invested using DCA.

In principle, Dollar Cost Averaging appears to be a winning strategy, but in reality, there's a lot more to it than first appears.

Transaction Costs

One of the main arguments against DCA is increased transaction costs. If you have to pay a minimum transaction amount or trade fees, it will inevitably cost more for several smaller transactions than it would for a single lump-sum purchase. It's worth evaluating whether the costs are sufficiently large to erode any potential gains from using DCA before you proceed.

At Accordia, we have no upfront transactions fees, so you wouldn't have to consider that element of the DCA exercise.

Being In to Win

Another argument that needs considering is the alternate use of the money. What would you be doing with the money while you're not investing it in the market?

As the money has to be kept available to make periodic DCA purchases, the alternate investment options will be limited to lower-returning liquid ones. In reality, investing a lump sum in the market may be a better choice than facing low returns on the residual balance as the money is dollar cost averaged.

Alternatively, for an investor who doesn't have a lump sum available, but can only make periodic investments, DCA can be a good option. Rather than waiting to have a fixed sum of money available to invest, they may be better investing the money in the market when they can.

To DCA or not

The most unpredictable element of investing is market volatility, and in recent years this has increased. Although DCA is designed to help manage volatility, tests over time have shown that it only wins out under certain market conditions. If the market is falling, DCA can reduce the average price you pay. Statistically, lump sum investments are likely to generate better returns when made as a single transaction than dollar cost averaged. The exceptions to this are when the market is falling or if the investor is only able to invest smaller amounts.

The Accordia Portfolios are ideal for lump sum and DCA investing.

Putting it Simply - Hedging

With warmer weather upon us, your attention may have turned to tending your garden. We therefore thought it might be useful to explain a horticulturally-related investment term.

In addition to being something that can be used to make an attractive border for your garden, 'hedging' is important in the asset management world too.

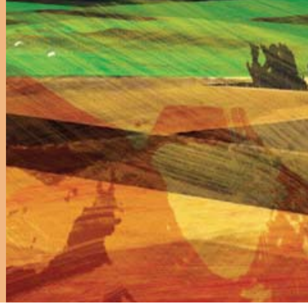
The meaning of hedging in investments is actually not dissimilar to its meaning in gardening. Just as you might plant a hedge to protect a precious plant from adverse winds, hedging an asset means making an investment to protect it from adverse price movements.

Rather than being green and leafy, an asset hedge is usually created by taking an offsetting position in a related security.

For example, if you were buying shares priced in US Dollars but were worried about the US Dollar falling, you would take out a contract that allowed you to fix the price of the US Dollars. As a result, you could purchase your shares without being concerned about a currency loss.

Of course, it would also mean that you wouldn't benefit from any gain in the US Dollar, as you'd have fixed your exchange rate at a lower level, but at least you would have been able to sleep at night!

There are many ways of hedging, and it's undoubtedly a complex business. However, you can be confident that Accordia looks after all of that on your behalf.



Avoiding the Dollar Doldrums

An isolated island in the South Pacific, the New Zealand economy is heavily reliant on exports and a narrowly-focused primary sector. As a result, investors need to reduce the risk of domestic investments by diversifying their portfolios with offshore assets.

Of course, as you'll know from travelling abroad or buying goods online internationally, they're generally priced in the currency of the local country rather than in New Zealand dollars. Investments are just the same, so if you have an investment in Vodafone, it's listed on the UK market, and the shares are priced and traded in British Pounds.

The same is true for other asset classes, such as US Treasuries (government bonds), which are priced and traded in US Dollars.

A well-diversified portfolio with a high level of international investments therefore has an exposure to many different currencies as well as to the different holdings listed in a variety of geographically-diversified locations.

This is challenging because, regardless of what may be happening with asset prices, currencies can move independently. For example, you may make 10% gain on some assets but lose 12% on currency movements, leading to a 2% overall loss. Conversely, you may also make currency gains which improve your overall portfolio returns.

Foreign exchange movements can be problematic, particularly when our domestic currency, the New Zealand Dollar (NZD), is volatile, which it has been of late. If the NZD appreciates rapidly against the US Dollar (USD), the USD investments fall in value, causing short term shocks to the portfolio. While the currency may correct in the medium to long term, the short term movements can cause concern.

At Accordia, we carefully manage your currency risk. Prior to investing in any offshore assets, extensive analysis is carried out to work out the appropriate level of foreign currency exposure in the portfolio. From this analysis, a framework is developed which is used to guide the portfolio construction. The foreign currency exposures are then constantly monitored to ensure that the portfolio stays within the boundaries set and don't expose investors to unnecessary risk.

Accordia manages currency risks in the short term while keeping in mind the medium to long term investor objectives of investors. It's an on-going activity and an integral part of our investment management process.

So next time you're watching TV and checking out the currency movements, rest assured that we're watching too, and using the information to keep your portfolio on track.

Christmas Greetings

We extend our warmest good wishes to everyone for the Christmas season. Our offices will be closed from midday on 23rd December to 9am on January 11th. The last day for arranging ad hoc withdrawals is December 14th.

Accordia Christchurch **Phone (03) 348 1689**
Accordia Hamilton **Phone (07) 855 2888**
Email **service@accordia.co.nz**

accordia

www.accordia.co.nz