accordia

the advantage

Spring 2018

Research update.

The publishing of the Spring 2018 edition of Accordia Advantage has been deferred in order that we could bring you a current update on the latest research trip to the United Kingdom, New York, and Toronto.

Mark Wooster and Michael Gray at Caliber have recently returned from a major research trip to the Northern hemisphere.

The focus of this offshore research programme was to undertake a review of existing managers currently used in the Accordia Portfolios, and to undertake research on new opportunities with potential new investment partners.

A comprehensive programme on updating research processes around various strategies currently employed in the portfolios was also conducted.

In addition, this trip was a valuable opportunity to update on Macroeconomic issues, and to attend a BCA (Bank Credit Analyst) Research Investment Conference in Toronto, with the focus on investing in a late cycle environment.

To start the trip, Mark and Michael flew to London on the 10th of September, where they had an extensive programme of visits such as MAN, a long-standing Specialty manager at Accordia.

A significant meeting was held with Schroeder's, a very large institution with US$593 billion dollars under management. The focus of this meeting was to discuss their Emerging Market Strategies that they are running at the present time, and their possible application within the Accordia portfolios going forward from here.

Of note in the U.K, was the high degree of uncertainty surrounding the future environment post Brexit for the financial services sector. At this stage, the managers and financial institutions based there are covering their bases by ensuring that there are more resources on the ground in Europe. In view of the potential disruption, the major concern is whether the new post Brexit regime will mean that some of their investment funds can't be distributed across borders.

There were several other financial institutions visited while they were in London before they flew on to New York, where they had meetings arranged with leading managers that we currently use in the Accordia Portfolios.

They visited AQR, (Applied Quantitative Research) who are located about 45 minutes north of New York city at Greenwich. They are a substantial hedge fund manager, with about $180 billion dollars under management. We have used AQR for a number of years as one of the specialty holdings in the portfolio. This visit was to review their current strategies, and to speak to their key analysts about issues driving their decisions at this stage of the economic cycle.

Another significant visit was to Blackrock, another specialty manager in the portfolios. Mark and Michael had a very good discussion with two of their senior strategists around not just the current underlying risk management strategies, but also how they are being applied within portfolios by other investors.

Mark and Michael then moved on to Toronto to the BCA Investment Conference.

This was a key meeting of some very influential senior people within the financial services sector in the world. The following speakers were of particular interest:

Day one of the conference working sessions commenced with a keynote presentation by Dr. Janet Yellen, the former chair of the Board of Governors of the Federal Reserve Bank of the United States. She is a widely respected economist and academic. The focus on her presentation was on the outlook for monetary policy in the United States, the new Fed leadership during the Trump presidency, and what the 2020 elections could mean for the future of an independent Federal Reserve.

Following on from Dr Yellen was Stephen King who is a senior Economic Adviser at HSBC Bank. He discussed the potential threat of inflation, and the timing of the next recession in the current environment. He also discussed the odds of policy mistakes that could have significant consequences at this stage of the economic cycle.

Another presentation of interest on day one of the conference was by Greg Valliere, Global Chief Strategist at Horizon Investments Inc, a very large U.S based investment advisory firm.

He is of the view that the US mid-term elections will be the most important in decades for the economy and financial markets. The big question that he posed to the conference attendees was whether the Republicans will maintain control of both houses allowing them to pursue their agenda of deregulation and America first trade policies, or will the Democrats win control of the house, which will inevitably set the scene for major confrontation with the Trump Administration.

On Day two, a presentation of interest was a discussion by Dr Walter Scheidel, Professor, Department of Classics, Stanford University.

Walter Schiedel has specialised in detailing an historical analysis of social inequality over many years. He concludes that all major cycles of inequality end in significant social disruption and violence. His view is that the current cycle of wealth inequality should be no different than that experienced in the past. His presentation was centred on presenting an understanding of the social forces that will inevitably shape the future economic and financial environment into the latter part of the 21st century.

Leland Miller, Chief Executive Officer, China Beige Book presented on China, and the importance of really understanding what is going on in the second biggest economy in the world.

His company specialises in surveying thousands of Chinese companies every month, which provides unique insights into Economic and Financial issues that bypass often questionable official data. This valuable information assists greatly for institutional investors requiring accurate research and data on which to base investment decisions around Chinese economy.

There was a presentation from Julie Coronado. She is a former U.S Federal Reserve Board member, and founder of Macro Policy Perspectives Inc.

Her presentation covered the cycles of economic expansions and equity bull markets, along with rising inflationary pressures and the resultant effect on interest rates. Her background in the Federal Reserve provides her with a very good perspective on the probable direction of monetary policy, and how it will affect financial markets going forward from here.

There were other speakers who covered topics such as emerging market opportunities, future oil pricing, the effect on global inflation, and the current Geo political environment.

The trip proved extremely valuable for Mark and Michael this year, with good research and key insights on different strategies. Information gathered from this trip will be utilised to review the positioning of various investment Strategies used in the Accordia portfolios.

Both Mark and Michael found the BCA research conference was excellent and provided access to some of the world's foremost authorities on economic and investment issues.

They now have a project back in Auckland working their way through documenting and incorporating all material from the trip for the purpose of incorporating new research into portfolio management processes where appropriate.

Bank Of England, London

The Gherkin, London

Credit Suisse, New York

What investing is really all about. Staying on board through market cycles.

This is a subject that we have written about in the past, but it is always worth reflecting on why staying on board through all market cycles is critical. There has been a lot of publicity around heightened geo political risk and other global economic issues that are influencing portfolios at the present time. The legendary investor Warren Buffett describes investing as the act of laying out money now for the purpose of receiving more money at some point in the future.

Contrary to popular opinion, it is not a speculative process, rather a long-term strategy for significantly increasing the likelihood of being able to achieve future lifestyle goals and objectives. Investing is all about determining priorities for your money.

By definition, risky speculation is a short-term activity with an inherently uncertain result. Investing is a long-term activity with a much more certain outcome. Like the process of seeing a tree grow, an investment portfolio's full potential is realised over a long time. It is an investment truth that a longer investment horizon or holding period actually increases certainty of a much less risky and more probable outcome.

It is a discipline, and one that sadly, many investors fail at. The study of Behavioural finance documents the actions of thousands of people who have rushed into financial markets without a plan or strategy, with little or no understanding of risk management or time horizon, only to be disillusioned when markets fail to deliver to their quite often unrealistic expectations. This usually results in a badly timed decision to sell, and yet another investor not wanting to re-enter the markets again due to a negative experience. This behaviour was very much in evidence here in New Zealand when the share-market crashed in 1987. That event alone put a generation of New Zealanders off investing in shares again.

Many people do not fully understand the relationship between risk and return. Put simply, it is not possible to obtain a return on capital without assuming some degree of risk. Of critical importance to any prospective investment client is understanding what risk means for them personally and in financial terms, before deciding to invest in a diversified portfolio.

We have many clients who have been invested with us for well over 20 years. Over that time, they have encountered a substantial list of global political and economic events that have significantly influenced financial markets.

Here is a sample of some of the more noteworthy events since 1997:

- **a.** The Asian Financial Crisis in 1997
- **b.** The Russian financial crisis in 1998
- **c.** The September 11th, 2001 terrorist attacks in the United States
- **d.** The 2002 Share-market Downturn
- **e.** The 2007 Great recession
- **f.** The Global Financial Crisis commencement in 2008
- **g.** The 2011 Share-market fall

All of these events created investment portfolio volatility and falls in value. But for long term portfolios, these events also presented big opportunities for our portfolio management team as we were able to purchase high quality assets at discounted prices over many of these cycles. When markets recovered, the benefits accrued to clients who stayed invested over these periods, with their financial wellbeing preserved and significantly enhanced as a result.

The old adage "There is no such thing as a free lunch" is very appropriate in the context of the process of investing over the long term.

Christchurch team update.

In July, the Christchurch office farewelled Sarah Oberholster our Office Manager, who had been an integral part of our team for 16 years. We wish her all the very best for the future.

We are delighted to welcome Belinda Gwilliam (pictured) who has joined us as our new Office Manager. Belinda, her partner Ian and daughter Jessica have recently moved to Christchurch from the North Island and are really enjoying all that the Canterbury region has to offer. Many of you will already have had contact with her. She will be only too happy to assist you with any inquiries that you may have.

What is the long term outlook for interest rates in New Zealand from 2019?

There has been a lot of speculation as to when we can expect interest rates to rise in New Zealand. After the global financial crisis, interest rates fell to the lowest levels experienced in over 40 years. A by product of this environment is that there is a new generation of home purchasers who have never known mortgage interest rates to be more than 6%. Depositors on the other hand, have had correspondingly significant falls in returns, with record low deposit rates since the global financial crisis, when the Reserve Bank lowered the *official cash rate from a high of 8.25% in 2008 to 1.75% in 2016. This had a direct follow on effect to the interest rates on offer from the leading retail institutions, where many depositors have experienced falls in returns of well over 45% from 2008 to the present day. In the present environment, the outlook for a return to those halcyon days of 8+% term deposit rates are highly unlikely for the foreseeable future.

**Many people are unsure as to what the official cash rate in New Zealand is. It is an interest rate set by the Reserve Bank. It influences all other interest rates and is in effect, the wholesale price of borrowing or lending money in New Zealand. It allows the Reserve Bank to meet its primary goal of ensuring price stability in New Zealand.*

Currently, New Zealand is experiencing a significant fall in business confidence. This has not been seen since the global financial crisis, and while there has been no significant impact so far, there are growing concerns that it could impact on investment intentions within the economy. This could manifest itself with a decrease in business strategic planning and financial decision making.

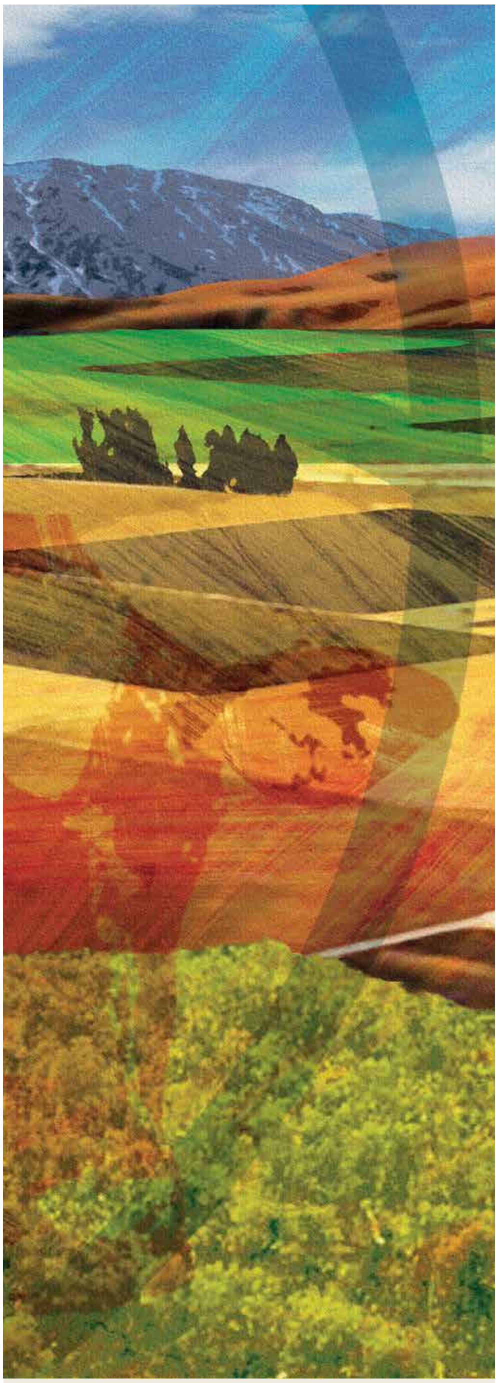
This has come at a time when there are signs that inflationary pressures may be re-emerging in New Zealand. This has the potential to complicate the Reserve Bank's view for interest rates going forward from here. Already, there are rising fuel prices, higher minimum wages, and a weaker New Zealand dollar driving up the price of imported consumer products.

At this stage, the Reserve Bank's August monetary policy statement signalled that the expectation for a rise in interest rates is still some time away, as inflation is still well within the bank's 1 to 3% range, and therefore it has signalled that it is unlikely to raise interest rates until 2020. This had the effect of sending the New Zealand dollar sharply lower against the currencies of our major trading partners.

This will present a significant problem for people with term deposits. If inflation starts to rise, the low interest rate environment is going to treat them harshly. Assuming a two year term deposit is paying 3.40% gross per annum today, and Resident Withholding Tax is 17.5%. This provides a return after tax at 2.8%. Assuming inflation is running at around 1.7%, this will leave an investor with a real (inflation adjusted) return of only 1.10% per annum.

This reinforces the importance of "not having all eggs in the one basket". For people who have had money parked in bank term deposits over the last 10 years, the loss of return opportunity for not having diversified over this time has been substantial.

The Accordia portfolios are well diversified and have captured returns from having exposures to other assets that have achieved additional risk adjusted returns over and above cash over the long term.



Christmas hours.

The offices will close for Christmas on Friday the 21st of December, reopening on Monday the 14th of January 2019. Emails and phone messages will be checked regularly over the break, so you can still contact us if you need some urgent assistance.

Our very best wishes for Christmas and 2019 from the whole Accordia team and our Investment Managers at Caliber.

Andrew, Selwyn, Belinda, Rodney, Mark, Michael, Jason, Kim, Trudy, Gemma, Zoe and Peter.

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