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Australia and New Zealand. How similar are the two countries?

There is no doubting that in spite of recent tensions between the two countries over immigration policy, citizenship rights and access to tertiary education for New Zealanders living in Australia, there are a great many similarities between the two countries. It could be argued that culturally, both New Zealanders and Australians are more closely aligned than most other countries in the world today.

In many ways however, despite the obvious differences in geographic size, population and economic scale, both countries also have very similar economic and structural challenges. The one significant difference between the two countries is that Australia has not had a recession for 26 years. However, many economic commentators are of the view that this statistic masks serious flaws in the country's economic model.

Firstly, there has been a lot of publicity around key economic drivers in both countries that have highlighted significant vulnerabilities. In Australia, recent commentary about the economy being far too dependent on "houses and holes", outlined how national income and prosperity are driven primarily by exports of iron ore, LNG, and coal, all extracted from holes in the ground. The domestic housing market has also boomed, with many commentators stating that a significant portion of the housing market is speculative. Low interest rates and easy credit have boosted house prices there. This all sounds very familiar to us here in New Zealand. In comparison, the New Zealand economy could be identified as being far too dependent on "houses, cows and tourism". The New Zealand economy has been touted as the rock star of the south pacific in recent years, having grown at an annual rate in excess of 3%. Tourism is now the country's largest export earner, followed by the agricultural sector. As in Australia, easy credit conditions and low interest rates have had a similar effect on the housing market in New Zealand in recent years, with a speculative wave of buying and selling activity, particularly in the greater Auckland region.In both countries, by looking at any accepted measure of housing affordability, the housing markets look to be significantly overvalued.

Interestingly, both Australia and New Zealand have experienced significant population growth rates in recent years. Australia has experienced 1.5% annual growth and New Zealand over 2%. For both countries, this is record-setting population growth compared to the rest of the developed world. Both countries have been “importing” economic growth via immigration but actual gross domestic product per capita, is largely stagnant or statistically insignificant.

In Australia, there is much concern over the manufacturing sector. Once a significant employer, and an important part of the economy, this sector has been hollowed out. A good example is the motor industry, which has seen all local vehicle manufacturing cease now that General Motors closed their Holden plant in Adelaide, South Australia this year. Again, New Zealand is facing the same problem, with high cost structures and low productivity problems hindering meaningful investment and growth in this sector of the economy.

Both countries face ageing infrastructure. Even more significantly, inadequate investment over the medium to longer term means that both countries are unable to cope with the demands of a rising population. In New Zealand this has been an acute problem, with Auckland, the largest city facing insufficient housing, congested roads, inadequate public services, and ballooning living costs. Many large Australian cities face similar problems, with Melbourne forecast to grow bigger than Sydney within the next few years.

Secondly, a household debt problem is growing in both countries. In Australia, total household debt is around 136% of GDP, an increase of around 50% since 2010. New Zealand is not so exposed, but there is no room for complacency as household debt is around 94.3% of GDP and growing.

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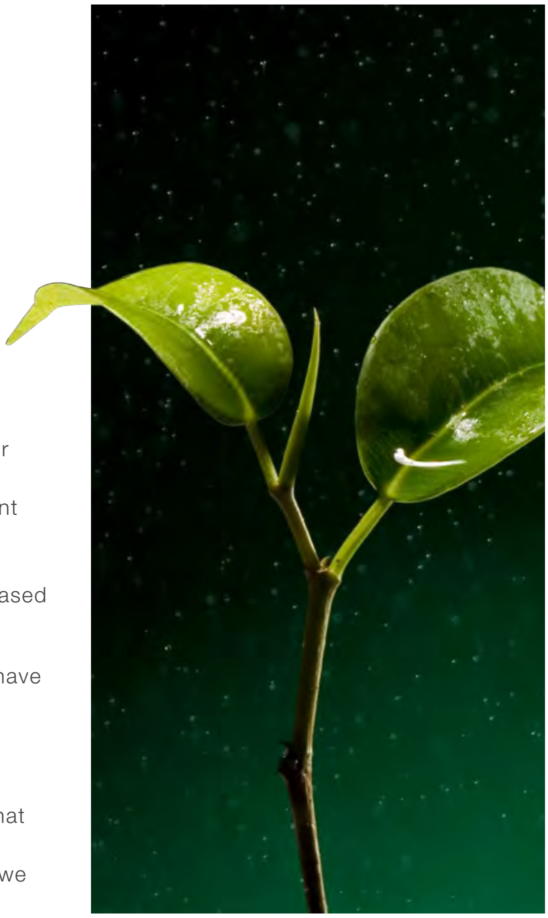
Both countries rely on access to foreign capital, much of it borrowed by the banking sector to cover the shortfall between loans and domestic deposits. In this context, both countries can ill afford a substantial fall in house prices sparking problems in the banking sector with mortgagee sales.

Both countries central banks have the delicate task of managing a gradual rise in interest rates going forward from here. This could adversely impact house values, and put undue stress on households with high mortgages. A fall in the exchange value of both the Australian and New Zealand currencies could also affect the ability of both countries to borrow internationally, and reduce the demand for Australasian denominated financial securities (Sovereign Bonds, Corporate Bonds and Equities). Devaluation would also drive increased inflation, potentially putting pressure on interest rates.

Given the issues addressed, it will be a significant challenge for both countries going forward from here to ensure that a climate can be created for innovative thinking in the 21st Century. It will require the governments in both countries to overcome policy inertia, and start educating the populace in both countries about the need for far reaching reforms. These will need to include a supportive environment to encourage productive investment, entrepreneurship, innovation, and research and development to create more high paying jobs. In both countries, there needs to be a significant adjustment in thinking to discourage the quick buck speculative mentality that seems to predominate in both countries.

Both Australians and New Zealanders need to reflect on the German economic model, where housing is regarded as a social need, not a surrogate household piggy bank, and where entrepreneurship, and a focus on productive investment has resulted in a country that represents 1% of the global population, but represents 10% of global economic output. Where Australia has been regarded as the “lucky country”, and New Zealand the country with the “rock star” economy, Germany has demonstrated over many years that it takes more than luck and rock star status to generate sustainable long-term prosperity and wealth for its citizens.

An update on the proposed new Trust Act in New Zealand.



We have written in the summer 2017 edition of Accordia Advantage about changes to the trust act, and implications for trustees and beneficiaries. We advised that when we had additional information available, we would update you on developments.

At a recent Accordia adviser briefing day, we had a presentation by Andrew Logan, a Partner at Mortlock McCormack Law in Christchurch, regarding changes to Trust legislation. By way of background, Andrew was involved in working with the law commission on behalf of the Ministry of Justice in a reference group of legal practitioners. The purpose of the group was to provide the Minister of Justice practical feedback on the bill, and to test what is proposed in the Act is reasonable in practice. As such, Andrew has a comprehensive knowledge of how the Act will impact on trusts in New Zealand.

It will be very important for the trustees to make sure that the trust is properly managed. Trustees will need to have a good knowledge of the trust deed, and to observe the conditions contained in it. The trust deed is effectively the "road code" for a trust, telling the trustees about what the trust is for, and how it should be run. For many discretionary family trusts, the trustees often comprise a husband and wife or partners, along with a friend or relative as the independent trustee.

Under the new proposed act, trustee actions will be judged against accepted industry or professional standards. Trustees will be expected to perform to the same standard as an expert in their field. It will therefore be very important for trustees to understand Management and Governance responsibilities, and to determine what professional advice around these areas needs to be obtained, and where appropriate, the engagement of specialists for specific advice.

The emphasis in the new Act is on disclosure, with increased awareness for beneficiaries of their right to hold trustees accountable.

Up to now, it has not been the norm for beneficiaries to question or challenge the decisions of trustees. The significant point to understand is that when the Bill is passed into legislation, the Bill's architecture will pave the way for increased accountability and transparency.

For those of our clients who currently have a family trust, or who act as a trustee, this is indeed an opportune time to evaluate roles.

There are a number of key questions that you as a trustee should be asking. Are we running the trust correctly and, do we understand the key components of it?

There are three groups of behaviors that the Trusts Bill codifies.

The first are the mandatory duties which a trustee must follow and are set out in the act. They are as follows:

- **A trustee must know the terms of the trust.**
- **A trustee must follow the terms of the trust.**
- **A trustee must act honestly and in good faith.**
- **A trustee must act for the beneficiaries of the trust.**
- **A trustee must exercise the powers they have for a proper purpose.**

A second group of behaviours are governed by "default" duties for a trustee to act with reasonable care and skill, to invest prudently, and not to do things for their own benefit, and to act impartially towards beneficiaries.

The third group of duties are about the information trustees must keep, and which must be made available to beneficiaries.

These include records of trust assets, trustee decisions, any changes to the trust, and to make them available to nominated beneficiaries.

A key checklist for trustees would be to start with the following:

1. **Do you know what's in your trust deed?**
2. **Do all the trustees meet at least annually?**
3. **Do the trustees keep an up to date minute book?**
4. **Is your 'Memorandum of Wishes" up to date?**
5. **Are all trust assets held in the name of the current trustees?**
6. **Does your trust have its own bank account?**
7. **Have all trustee decisions been formally recorded, and reflect documents executed?**
8. **Do the trustees have a full set of annual accounts prepared?**

At Accordia, we act for a large number of family and charitable trusts. Trustee clients will already be aware of how we work with them in establishing a proper mandate for the prudent management of trust investment portfolios.The establishment of an Investment Policy Statement which is the governing document for trustees is reviewed at least annually or more often if circumstances require it. We establish an appropriate portfolio of investments that meets that mandate and regularly report back to the trustees. This establishes a sound, transparent and prudent process for trustees. This process is also an excellent framework for the management of trustee assets within the proposed new Trust Act framework.

There is believed to be approximately 500,000 trusts in New Zealand. Of these, it is estimated that 40% many not be run properly.

One of the common problems is that settlors and trustees of family trusts often see the trust assets as their own property, and treat it accordingly. This is known as an alter ego or sham trust. If you are a trustee and you are uncertain about your role and obligations in the new environment regarding trust management procedures, we recommend that you consult your solicitor. If needed, we are happy to refer on to a specialist legal firm that will assist you.

Managing Portfolio Risk.

In times such as these, where recent portfolio returns have been very strong, it is important to keep focused on the long term. While we have been reporting strong shorter term returns, this is only one year in an investment time horizon of over 20 years for most of our clients, and in many cases considerably longer.

In strong market cycles, as in more challenging times, Caliber, the manager for the Accordia portfolios maintains a very disciplined investment management process that does not change materially throughout the market cycles. There is a continuous programme to closely monitor financial markets and underlying investment strategies.

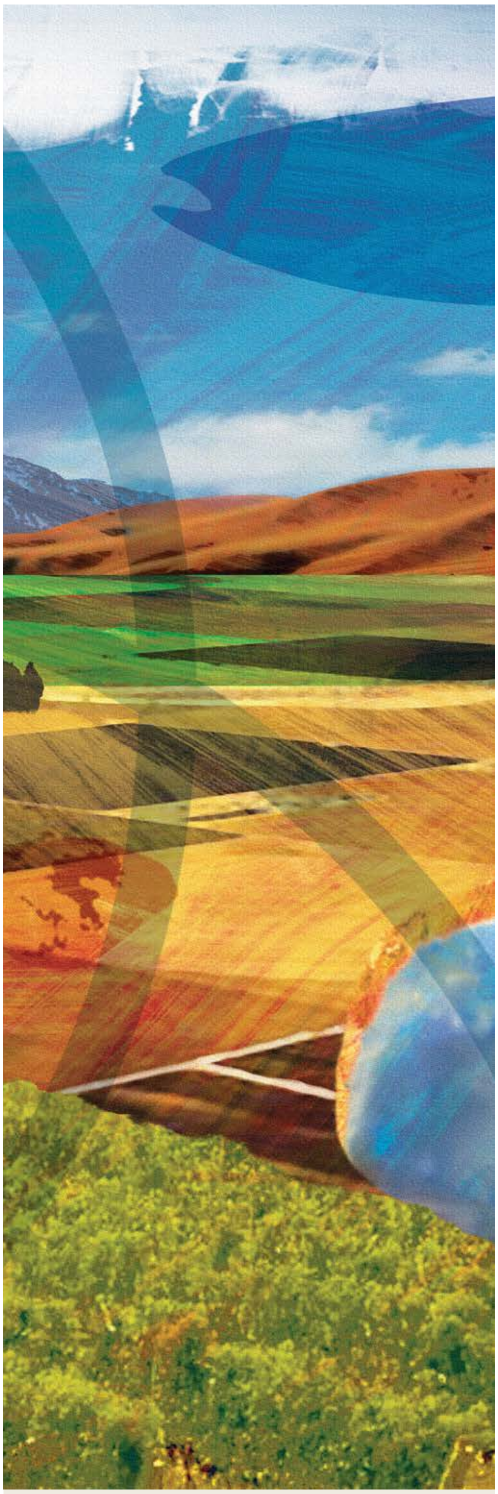
The focus on markets is critical in understanding where risks are building up in portfolios, or alternatively, if there are opportunities to add value when markets are challenging. We are just as interested in understanding good market performance as we are in a poor market environment.

In this context, the process of ongoing monitoring of the underlying investment strategies is a critical component of the work.

It provides a thorough understanding that they are performing as expected given market conditions, and that they remain appropriately invested given their stated investment objectives.

Lastly, there is active implementation of our rebalancing policy. As portfolio exposures move away from long-term strategic allocations, we rebalance our client portfolios back towards target as a means to manage portfolio risk. For example, we recently reduced the International Equity over-exposures in portfolios due to strong recent outperformance. A disciplined portfolio rebalancing policy can add significant value over time, and is an integral part of any professionally managed investment portfolio.

This is a crucial part of the risk budgeting process where we do not allow portfolios to become unbalanced, and therefore exceeding portfolio risk budgets. It's all about staying focused, with a long term view, as our clients have long term needs which need to be maintained in line with personal lifestyle objectives in good times as well as more difficult cycles.



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