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the advantage

Winter 2012

New York, New York...

Mark in the Big Apple

Mark Wooster, Chief Investment Officer at Caliber (Accordia's investment manager), has just returned from a research trip to the US. Keeping up to date with the latest information about portfolio construction is an essential part of Caliber's work. When Mark discovered that a seminar on Advances in Asset Allocation was being run in New York, it was a perfect opportunity for him to add it to his research trip to see some leading overseas fund managers and get an extra benefit from the travel.

Mark says the seminar was a pretty full-on affair run over three days, with over 100 slides every day presented by Lionel Martellini, a French PhD from EDHEC. EDHEC is probably little known in New Zealand but is held in high esteem in the world of portfolio management research. Set up in 2001, EDHEC-Risk Institute conducts world-class research and brings the results to asset managers. They have a team of 85 permanent professors, engineers and support staff plus 45 research associates with centres in London, Singapore and the United States.
The seminar was run in conjunction with the CFA Institute which is the world's leading professional body for investment managers and analysts.

Mark was not the only Kiwi attending. There was another there as well (from the NZ Super Fund) but the rest of the forty or so participants were from all over the world.

The seminar lived up to Mark's expectations in looking at current practices in asset allocation, the major challenges confronting investors, and advances in addressing these challenges. The material was covered in a rigorous, scientific manner with plenty of proof for any potential solution presented. Mark was happy to report that the seminar has provided very useful material for Caliber's ongoing research and analysis programme.

While in New York, Mark visited a number of managers. One of these was **Blackrock Investment Management** where Mark saw a Senior Strategist from the Alternative Strategy Group. Blackrock is a large investment manager with about US$3.5 trillion under management and operations all over the world. Mark looked at a number of Blackrock's strategies and processes including the types of assets being managed, teams involved, and their performance. He also checked out Blackrock's objectives and how global events were impacting on their strategies. Caliber will be following up with the Blackrock locally as part of its assessment of investment opportunities for Accordia.

Next it was Austin Texas which, at 32 degrees, was considerably hotter than New York. Here, Mark visited **Dimensional Fund Advisers** or DFA, Accordia's current manager for international equities. DFA has 620 people in a large building about 20 minutes from the Austin's CBD and another office in Santa Monica with around 120 people. Together, they manage about US$240 billion.

Because DFA is an existing manager, this research visit was very different from one with Blackrock. This one was about monitoring and review, checking quantitative/numerical aspects of the manager's performance and also qualitative factors like the team, processes, ownership, general management, directional changes and so forth. Before the meeting, Caliber had carried out extensive work and already had a comprehensive understanding of how DFA delivers results for

refreshingly honest investment advice

Mark in the Big Apple from front page

Accordia's clients. DFA runs a broadly diversified portfolio of more than 5,500 international shares with a focus on adding value through holding "value" stocks and bringing in small cap(italisation) stocks (by international standards) alongside the big companies like Apple, Exxon, Caterpillar etc. DFA is focused and disciplined in their approach and Mark found the morning he spent with their people very productive.

Mark's first meeting was with a Portfolio Manager who is part of the team responsible for constructing Accordia's portfolio of international equities. The Portfolio Manager provided a progress update on the fund and specific areas of interest Mark had identified prior to the meeting. For example, what did/didn't work well, performance and quantitative assessments of pure performance numbers and risk. Mark was particularly keen to focus on risk management within the portfolios and he explored this at a number of different levels. The Portfolio Manager invited Mark to view his computer screen with live trading models, holdings, risk management and performance monitoring. Mark also got the chance to speak to one of DFA's dedicated traders – one of a team of people at DFA actually responsible for executing trades on the share market.

This kind of interaction cannot be achieved without site visits by highly experienced, dedicated professionals. Mark's US trip finished with visits to managers in Los Angeles. Back at the "coal face", all of these experiences are added to the work that focuses on delivering benefits to Accordia's clients. Some of our readers have attended sessions on portfolio construction in recent months so we hope this article has provided you with some further insights.

An Investment Policy Statement is a "Must Have"

If you have nothing else on file, make sure you have an Investment Policy Statement (IPS).

An IPS, sometimes also called a Statement of Investment Policy and Objectives (SIPO), is simply the investing equivalent of a business plan.

Your IPS should cover the goals you want to achieve, how you plan to achieve them, the roles and responsibilities of all parties involved, a timeline of required activities, and how you will navigate any obstacles that arise. Just like a business plan, your IPS should be carefully constructed and re-visited regularly.

At Accordia we believe that all investors need an IPS, whether you're investing your own money or responsible for overseeing investing for others, as is the case for trustees, stewards, guardians, committee members etc.

Although first promoted by the Chartered Financial Analyst Institute in the USA in the1980s, IPSs are neither widely used in New Zealand nor well understood. However, in light of our improved regulatory environment for financial services, they've become a necessity, particularly for those responsible for investing for others.

It's just as important for individuals and families to have an IPS. It demonstrates they've given serious thought to what needs to be achieved and agreed on a strategy.

No-one can accurately predict the future, but if you're failing to plan, then you're planning to fail. Being clear about where you're trying to get to will better equip you to make decisions in times of adversity by keeping you on track.

Irrespective of the amount involved, financial matters should be considered carefully, especially when the funds belong to others in the form of a family trust, estate or an organization.

Our advice to all investors, and especially to those involved in a fiduciary role, is to start with an IPS. Only after all matters have been carefully considered can a well-planned portfolio be created and managed.

IPSs are quite different from reviews. Reviews report portfolio performance and are an essential part of the investment management process. However, it's the IPS that sets out the course whilst reviews simply identify progress along the way, not the reason for the journey or how it's going to be achieved. An IPS is a broad plan. It will refer to source documents and points of applicable law like the Trustee Act and it covers all elements that need to be considered in developing an investment strategy. It also documents processes and procedures as well as roles and responsibilities.

Renowned financial services practitioner Blaine Aiken described a well-written IPS as having:

"…sufficient detail that a competent third party could implement the investment strategy, be flexible enough that it can be implemented in a complex and dynamic financial environment, yet not be so detailed as to require constant revisions and updates."
(fi360's Blaine Aiken)

We welcome inquiries about how we can help you with an IPS, especially if you're acting in a trustee.

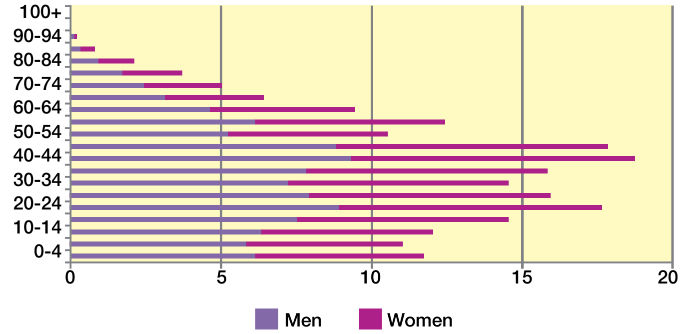
7 Billion and Counting… But…

There are now more than seven billion people in the world and that number will continue to grow - but only for a while. The world's population growth will peak in about 2050 and, after that, it's actually all downhill, a fact we sometimes don't appreciate.

These population trends, both in terms of the absolute numbers as well as their composition, are important to understand. One of the biggest concerns is how economies will cope as they try to support more elderly people who are less economically productive. Within some crucial areas of many economies, including New Zealand's, there are fewer young people to replace those who want or need to retire. Fewer people are entering the work force than are leaving and those that do leave are living longer. Governments are looking to raise the age of pension entitlements, encourage more private savings, deal with child care needs for younger working parents, provide health care for the elderly, encourage higher and wider education and, in some instances, look to their immigration policies (though immigration is unlikely to "save the day").

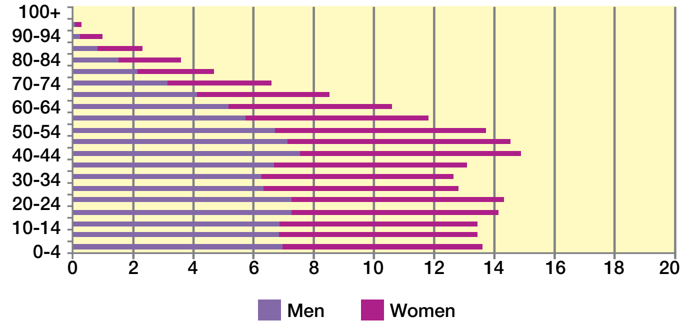
Looking at the largest population in the world, China's, population growth will peak in about fifteen years. By 2050, more than 30% will be over sixty years of age. The largest group in the Chinese population is now in its forties and, apart from a group currently aged twenty to twenty four, there are far fewer youngsters. Partly due to the one–child policy of the past, the under 14s make up an even smaller part of the whole population in China than in New Zealand.

Population of China 2012



Source - International Data Base - US Census

Population of NZ 2012

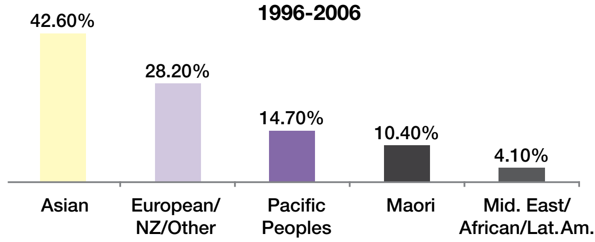


Source - International Data Base - US Census

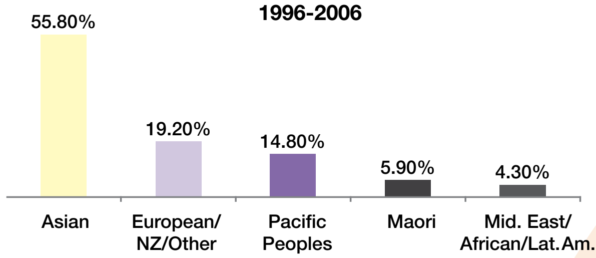
According to Professor Natalie Jackson, Professor of Demography and Director of the National Institute of Demographic and Economic Analysis at the University of Waikato, there will be "staggering shifts in the ratio of young to old" in New Zealand.

There will be more elderly (65 +) than children (under 14) in just 11 years. Most will live in Auckland and Auckland will also attract the lion's share of future population growth – all at the expense of other regions where lower growth is expected across the board.

Contribution to NZ population growth 1996-2006



Contribution to Auckland population growth 1996-2006



The ethnic mix is also changing because some population groups are growing faster than others. There are wide regional differences where, in some areas there are melting pots of various ethnic groups and, in others, little diversity.

Of particular concern to a country like ours that relies heavily on agricultural exports, is the current age structure of the farming population. Professor Jackson's figures show a very large group of grain, sheep and beef cattle farmers at 65 + years and very few being born into that occupational group. In 2006, 36.8% of all people involved in that occupational category were aged 55 years and over. That's a lot higher than for those in financial and investment services (15.6%) and property operators and developers (27.2%). Where will the farmers come from in future and how will they be able to afford to farm if there's no inheritance involved?

It's clear to most, though our current Prime Minister remains unconvinced, that the age of entitlement to New Zealand superannuation must rise. When our universal pension scheme was first introduced, life expectancy was much lower than today. Given the simple transfer of tax dollars earned to pensioners and the population changes that are already known, a rise in the entitlement age is inevitable. It's also clear that Kiwisaver needs to be compulsory and the level of contribution should rise steadily. Affordability will always be the moot point. Maybe there are lessons the older generation can teach the younger about saving.

As a country and as individuals, there are some challenges ahead. It's best that we understand the issues and prepare for them as soon as possible.

Putting it Simply

Commodities

We've chosen to write about "commodities" this time because our clients now invest in them. Commodities have been introduced into portfolios recently so it might be helpful to get an idea of what they are.

Commodities are marketable goods of some kind, covering nearly anything you can think of. Many commodities occur naturally like iron ore, copper, gold and oil or are grown like coffee, tea etc. In New Zealand we are accustomed to hearing about the commodities we produce such as milk fat, sawn logs or meat.

Prices for commodities fluctuate all the time, mostly because of supply and demand. For example, because of weather conditions in the US, there is speculation that the prices of a variety of commodities like corn will go up. Because commodities are priced on a global basis that will help producers here who are selling those same goods. Of course, if the Kiwi dollar rises, the gain might be reduced or even wiped out.

There has been an increased focus on commodities over the last 15 years as demand from developing nations increases. This increased demand has put pressure on prices, especially for hard commodities. As a result, we have seen some impressive terms of trade numbers (exports minus imports) from countries such as Australia where demand from China has been substantial, helping to develop that industry to its current state.

A significant part of the commodities spectrum is energy. The 21st Century is shaping up to be a turning point in the move away from massive reliance on fossil fuels (coal, oil etc), to more sustainable energy sources like solar, wind and bio-fuels. That transition will provide further opportunities, and challenges, for investors.

Holding commodities in a portfolio aids diversification. Commodities have proven to be useful in combating inflation and will behave in a different manner from other assets through some market cycles. Some portfolios now hold commodities and reviews for these clients will provide more information.

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