Symposium 2015 - my key takeouts

Janet Natta | Smart Money Advice | 22 June 2015

As always, PortfolioConstruction Forum Symposium is the highlight of my year in terms of professional development. This year's was probably the best one to date. The expert speakers were very well researched, even if I didn't agree with all of them! In fact, we often had speakers presenting opposing view points, and it was up to us as to which speaker we thought had the more credible argument.

There were sessions on the Chinese property market, oil prices, politics and the NZ economy, a fund manager's perspective of investing in NZ, the Auckland property market, fixed interest and yield and other technical presentations. They were really interesting and contributed to the whole of the information that was being shared – but I am not sure if they are of interest, so I haven't written up specific notes!

KEY TAKEOUTS

1. Interest rates are likely to be low (at current levels or less) for a long time, if not forever

This was referenced by several speakers. One of the presenters, Tim Farrelly, had an interesting slide, looking at interest rates from 1910 up to 1980, and then from 1980 to today. Interest rates from 1910 to 1980 were roughly at the levels that we see today. His argument was that the last 30 years have been a "blip" due to globally high inflation, which started in the late 1970s and that interest rates have now actually returned to the normal.

- *What this means for you*
  Low interest rates will make it harder to get good returns for portfolios that have a large proportion of fixed interest assets (conservative asset allocations). For people entering retirement, it may mean that they will have to be open to carrying more growth assets to get the portfolio returns that they might need to make their money last through their retirement. In terms of trying to get "yield", there are other ways to get it rather than interest on fixed interest investments.
- *What am I going to do to add yield to your portfolios*

  We have already added APN A-REIT as an Australian property fund, and this fund's philosophy is to focus on generating an income from good quality property. This philosophy means that it won't shoot the lights out, but it will perform steadily and,

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if things get tough, it will perform considerably better than most other property funds.

We are in the process of adding an equity income fund into the NZ equity space to replace the AMP Capital Strategic NZ share fund. I don't want to categorise this fund as part of the fixed interest allocation, but it certainly has a strong income slant.

We are also currently researching a couple of infrastructure funds to add into the international equity space. Infrastructure funds invest in assets that generate good income through the use of essential services. Infrastructure copes really well in a downturn as people need water, power, roads, airports, telecommunications, etc, and they do not reduce their charges in an economic downturn as is the case with other non-essential spending investments.

2. It will pay to be very aware of how index hugging investment funds are, and also what their mandates are in terms of going to cash

As Jonathan Pain said, we will need to choose fund managers who are "nimble and flexible".

- *What this means for you*
  This is likely to produce better portfolio returns over the medium/long term and will also offer downside protection, in that fund managers can choose to hold cash if they can't find anything of value to buy or if they are nervous about how things are travelling in their particular sector.

- *What am I going to do to add value to your portfolios*
  We had an investment committee meeting immediately after the conference, and agreed that we will closely scrutinise the mandates that are being applied to the various managed funds that we are using, particularly in the international equities space. We may not have the option of using an index unaware fund in specific sectors like emerging markets and Asia, but it will be useful to review the mandates of the funds, especially if we have been using them for some time.

3. There are some opportunities in some specific sectors that could be very attractive for investors

There was a good presentation on investment opportunity in the technology and innovation sectors, as well as India as an investment market.

- *What this means for you*
  There may be opportunities to put some of your equity into areas that will have potential for upside over the medium/long term. The opportunities need to be weighed up against your tolerance for capital volatility in your portfolio, and need to be well researched before we start to invest money for you.

- *What am I going to do to add value to your portfolios*
  There is an interesting Indian fund becoming available in NZ towards the end of the year, and we have registered an interest in obtaining the documents when it becomes available for use in NZ. We have a reasonable technology and bio medical exposure through Platinum, and also Hunter Hall in the ethical portfolios. We may consider adding Hunter Hall into the larger portfolios purely for its technology exposure later in the year.

NOTES FROM SPECIFIC SESSIONS THAT MIGHT BE OF INTEREST TO YOU

1. **The global economy is firing on all cylinders – Jonathan Pain**

Jonathan is an international investment expert, as well as holding degrees in economics and finance. He has lived and worked in Africa, Asia, England and now lives in Australia. He is a regular speaker at PortfolioConstruction Forum programs and is always one of the most popular speakers.

These were some of his comments on the world as he sees it:

- We are witnessing secular reflation driven by central governments and it will be successful.
- The current oil prices are a game changer. They will lift global GDP by 0.5% to 0.8% per annum. Every global recession has been preceded by a sharp RISE in oil prices, so could it be that the opposite will happen? The Saudis are going to keep oil prices low because they want to keep the US Navy in the Gulf. US energy independence scares the Saudis, who need to drive fracking out of business by driving oil prices down. In doing so, they are also upsetting their enemies – China and Russia. The war in the Middle East is between Sunnis and Shias – Saudi is Sunni and Iran is Shia – and hence the need to keep the US protecting the Gulf.
- GDP predictions for 2015: China 6.75%, India 7.5%, Indonesia 6.5%, Germany 2.5%. JP is picking German GDP to be pushing 3% within 12 months and is predicting that Germany will be the surprise of 2015. Spain is also bouncing back. The USA is firing on all cylinders, and is still the greatest nation of innovation in the world. European macro economic factors are the most positive that they have been for a long time. The missing factor is the willingness of banks to lend and there are early signs that this may have turned as well.
- China – there are so many positive and exciting things happening, The Chinese market has been the best market in the world for the last 18 months. The current leadership is strong and focused on its fight against corruption and pollution. China's GDP is likely to settle between 5% to 6% over the long term. The big event for this year is when the Chinese currency becomes part of the International

Monetary Fund basket of reserve currencies and becomes a recognised trading currency. This will see the growth of capital markets in the next two years.

- India – will grow faster than China in the next decade, and its new reformist Government is making excellent progress.
- The most stable economy in the world in the last decade has been Indonesia. The reformist policies of Wadodo are driving the nation. It is the most populist Muslim nation on the planet, and is joining the rising Asian middle class.

2. **Current central bank monetary policy may cause bumps in the future – Dr Robert Gay**

This presentation focused on the actions of central banks and monetary policy, and the possibility that the current strategy may not end well.

Much of the QE to date has done little to promote sustainable growth. With interest rates at low levels globally, it will be difficult to use monetary policy to stimulate growth going forward, and low interest rates have not encouraged deleveraging (getting rid of debt). Labour productivity is declining and wages are rising. Current account balances as a percentage of GDP are all moving closer together. The largest current account balance in the world is currently Europe.

Key take out – the quality of growth matters. It is likely that credit events (in the fixed interest markets) will cause the next market downturn.

3. **Get used to low interest rates – Tim Farrelly**

GDP is likely to be lower globally going forward. GDP is a function of the number of workers and productivity growth. With declining populations, it is likely that the number of workers going forward is going to be lower, hence lower GDP. If economies slow, the demand for money drops and we get lower interest rates.

With regards to GDP and shares, there is no correlation over the long term. It is possible that valuations will go higher and stay higher in the future than they have in the past. The same may well apply for property.

Implications for NZ – NZ bonds are expected to trade between 3.5% and 4.5% going forward. The NZ cash rate could stay at 3% forever. Term deposits rates are likely to stay where they are.

Key takeouts – Investors will have to either spend less, take on more volatility exposure (shares/property) or take on more exposure to illiquid assets.

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3. Asset allocation will dominate portfolio returns – Jonathan Pain

It is possible that we have seen the low point in EU bond markets and it is likely that global inflation will move higher (a good thing). Valuations at present favour equities. China, India, Japan and Indonesia have reformist Governments in place and are doing great things for their economies.

Key take outs – Asset allocation is going to be the key driver of portfolio returns going forward. Fund selections need to made carefully. "The curse of closet indexation and relative returns will affect portfolios, where fund managers manage business risk before investment risk. Be nimble, be flexible and remember that correlations go to one in a crash!" (which means that diversification doesn't always work in a crisis). JP also said that capital preservation should dominate (a theory which we totally subscribe to) and that with higher volatility needs to come higher flexibility.

4. Harness India's growth by investing before the crowd – Mugunthan Siva

India has an amazing growth story underway. The progressive BJP party was elected in 2014 for a five-year term, with the mandate to make India business-friendly. India is the world's largest democracy and 50% of its population is aged 25 or under. The International Monetary Fund has projected that India will be the world's third largest economy by 2025 (after the USA and China) and will average 6.75% GDP growth per annum over the next 10 years. The Indian middle class is projected to grow from 21 million people currently to 91 million people by 2025. It is an economy in the early stages of growth. Many global companies are setting up joint venture businesses, or buying existing businesses to get a foot in the door.

The equities index in India is the CNX500 and India makes up 7.5% of the MSCI Emerging Markets Index. The average share in India trades at a P/E ratio of 14.5 times – in NZ, it is closer to 20 times. In India, most people have amassed their wealth in gold and term deposits (they are getting 7% for 12 months). As people become more educated, it is possible that they will seek more sophisticated investment solutions and start to invest in their own capital markets as well.

There is political risk, in that if the BJP party doesn't follow through on its anti-corruption policies, the markets may not respond favourably.

Key takeouts – The money in India's capital markets will be made in the middle layer of companies that have yet to make it into the top 500 Index. And the opportunities could be significant in the next decade.

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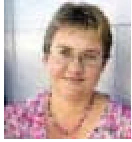

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