Newsletter: Summer 2008

STUART + CARLYON

Financial advisers for your lifetime goals

Talk of recession spooks world markets.

When bad news comes in double doses it has a tendency to quickly get a lot worse. The current markets are a case in point. Yes, there's been a credit squeeze, caused largely by the explosive property markets in most western countries. But with the US Presidential primary campaign seizing on the news the economy has been launched onto the front pages of the world's press.

Once Mitt Romney pledged in the rust-belt state of Michigan to do everything in his power to save American jobs, he not only found himself a credible platform (at last) but he swung the spotlight onto the falling Dow and he triggered a flurry of pledges from his rivals to come up with rescue packages for the US Economy.

Rescue packages! Are things really that bad?

Well clearly things aren't that great. Within days of George Bush's tax announcements, the world sharemarkets dropped around 4-5% in anticipation of a Wall Street slowdown. And of course last year in New Zealand we saw 13 finance companies tumble into receivership and that was followed by a residential property sales slow-down in terms of number, selling time and in price. Interest rates have further tempered the property market with mortgage rates now eclipsing 10% - up from 8% just two years ago.

If the price of credit has gone up, then fuel prices – which reached a record high over the summer break – hit consumers in the back pocket. We didn't need a presidential primary to put the economy onto our front pages.

In the USA things are no better. The over-lending in the housing market is one factor, but deeper down there have been some real structural shifts with many jobs disappearing overseas, (the auto industry is one example) and with investment banks simply running out of capital to handle the write-offs they've encountered. It has taken the Chinese and Singaporean governments as well as Middle East investors to help bail out Merrill Lynch, Morgan Stanley and Citigroup. No wonder confidence is down. The various factors have created a jittery marketplace that now even has the usually implacable US Federal Reserve worried.

What's the outlook for New Zealand investors?

The next 9 months are likely to see the negatives outweigh the positives. In our view the traditional investor perspective that puts the USA and Europe centre stage is likely to shift as we eye the booming economies of the developing world. India, for example is on a spending spree – with Indian investors buying up western automotive and steel companies.

Meanwhile the US and European economies such as the UK, Spain and Ireland, will go through a period of adjustment – a slow deflation if you like – of the property and sharemarket balloon, while they appear likely (the US especially) to introduce tax relief to help ignite consumer confidence.

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Within this "we'd better just grin and bear it" economy, there will be opportunities. One is the performance of NZ property trusts which have become undervalued (by as much as 16%) while still delivering a rich flow of rental income: some 11% before tax.

Meanwhile low risk cash and fixed interest investments are offering yields of 8.15% to over 9%.

Then there are the currency-related gains to be had if our dollar finally drops. Our dollar remained high in 2007, against all expectations, but the pressures are likely to see a fall in our Kiwi during 2008. Now is a good time to consider offshore investments while they're affordable.

Last year many people said that we at Stuart + Carlyon were lucky to have placed no clients in Bridgecorp or other similar investments. Luck had nothing to do with it – we've been in the market long enough to avoid such risks.

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But let's recap our general operating rules for our client portfolios:

- No structured credit products.
- No direct exposure to sub-prime mortgages.
- No finance companies other than UDC.
- We use fund managers with an active style. They:
  - Follow themes and select countries and market sectors.
  - Hold more in cash within their fund if they wish.
- We include listed funds which don't have to sell assets to meet withdrawals.
- Our clients are invested for the long term. Nevertheless portfolios are not immune from periods of negative market sentiment.
- The income stream from the investments continues and provides cash in hand even while the capital value may fall for a time.
- For regular savers and new investors, market downturns provide great buying opportunities.
- We remain diversified and hold sound well-managed investments.

All share sectors have had excellent performance over the past 5 years. Last year we captured gains by reducing and re-weighting in the share sectors as required. Downturns are not new to us. Over many years of advising we have guided clients through several cycles of good and bad times.

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The markets aren't looking fabulous for the start of 2008 and it is a time to be prudent while looking for the opportunities that arise whenever there's change going on.

Growing investments

The diminishing world foodbasket needs greater investment.

The world of investment can get over-complicated. Let's not forget that most investment is, in the end, about things that people want to buy – and food is the most basic commodity of them all.

Given the surge of cooking shows on western television, and the rapid growth of the populations of Asia and South America, there's plenty of activity in this sector of the market with demand for high-end products such as olive oil growing rapidly even as the supply of basic items such as rice and grain teeters on the brink of under-supply.

A recent look at world food price trends reveals some emerging crises as well as investment opportunities.

- Prices for many staple foods reached record levels in 2007.
- Global food reserves are at their lowest in 25 years.
- The world food supply is vulnerable to crisis or natural disaster and climate change – and world weather patterns are becoming more unstable.
- Globally there is a shortage of arable land, but Brazil has opportunities with 106 million hectares of potential farmland.
- In China average incomes have barely risen while food prices have soared by 17.6% (70% for pork, 30% for vegetables and 34% for cooking oil).

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Another macro-trend is the connection between soaring food prices and political instability – which in turn can cause fluctuations in prices. In March 2007, Mexicans demonstrated against the four-fold increase in the corn price. In September, Italians organized a one-day strike against rising pasta prices.

The opportunities are clear, with increasing demand for greater investment in agriculture. The sector has a compelling basis for good returns.

The overseas share funds we use have some exposure to emerging markets where there are brighter prospects for growth. These funds also own companies in the developed world who are exporting to or servicing the emerging economies with increasingly important agricultural infrastructure including bio-technology, fertilizers, irrigation and farming equipment.

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