Newsletter: Summer 2013

# STUART + CARLYON

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## Market gazing

Who would have thought that 2012 would turn out so well for share market investors? With the global economy on the ropes, and the US Government backing itself closer and closer to their fiscal cliff, the picture didn't look too great. But 2012 proved a very positive year for investors and the question is: will this carry on?

Let's go around the traps and find out how fund managers and economists see 2013 shaping up.

**Brian Gaynor of Milford Active Growth on NZ & Australia shares**
*The current situation - low interest rates and slow but steady economic growth – is ideal for sharemarkets. With this in mind we are aiming to achieve a return in the 8% to 15% range in 2013 although our proactive management approach will allow us to make adjustments if market prospects change.*

**Morningstar's Economic Update on international shares**
*The signs of improvement in global economic activity continue to be favourable for international shares. On the economic front, the news has been getting better. US housing starts rose 12.10 percent in December alone, the most robust level since July 2008, and were up a very strong 36.90 percent on a year ago.*

*The US still faces some risks: fiscal negotiations between the Obama administration and Congress could hit potholes, and even if a political deal is reached, it will still mean some degree of fiscal policy tightening. Overall, though, the US looks set for a gradual acceleration in business activity.*

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*Business conditions in the Eurozone remain grim, however. Only Germany of the four large Eurozone economies looks to be recovering, slowly, from falling output in the December quarter, while the other three –France, Italy, and Spain – look to be continuing in recession.*

*The past four years have repeatedly shown that financial market squalls – or storms – can materialise with little warning. Even so, a combination of more sharemarket-friendly buying demand from investors and better economic prospects suggest that the broad outlook for international shares continues to remain positive.*

**Keith Poore Head of Investment Strategy at AMP Capital on bonds (fixed interest)**
*2012 could mark the end of the 30 year bull market for bonds and 2013 could see a rotation out of fixed interest and into equities. There could also be rotation out of the more defensive equity sectors and markets, which have been supported by low bond yields, into those more exposed to the global recovery. While the expected return from bonds is low, they*

*should continue to perform well when equities decline. Therefore, bonds still have an important role to play in diversified portfolios.*

In an interview by Money Observer, **Bruce Stout, senior investment manager of Scottish based fund, Murray International Trust**, talked about his outlook for 2013. Here are some of his messages:

- Governments are printing money as a way to address their country's financial woes but this is inflation-inducing so for investors, owning equities is a better hedge than bonds and cash.
- Stout prefers investing in companies that have transparent growth and dividends.
- When investing in Asia and emerging markets, picking the right companies is the key.
- Murray International Trust invests in both bonds and shares but at this point, bonds are expensive so the weighting is at its lowest in 20 years.
- The huge public sector debt will continue to make investors nervous and sentiment will drive markets. Hence, Stout sees capital preservation as a priority.

**What does this mean for your portfolios?**
Obviously we can't predict what will happen in 2013 but we remain committed to making sure your portfolio has exposure to all sectors – albeit the proportions will reflect whether one sector is better value than another. When we construct portfolios we ensure there is a mix of styles – passive funds (which accept the market pricing is right) and active funds (which rely on manager expertise in stock picking and timing). The views above are from active managers. Passive funds like Dimensional, or iShares do not involve forecasting and will instead track a prescribed broad range of shares, for example, the S&P 500 index (largest 500 US companies) or other criteria such as small companies.

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## Housing. What goes up and up... might come down.

There's been a lot of talk lately about the booming housing market and the affordability of houses. What's going on?

Three things have been driving prices upwards. First, interest rates are at their lowest in recent memory, and banks seem happy to lend, so they are creating plenty of demand (and ready cash) for potential home buyers.

Second; the slow economy saw new house start figures collapse over the past 3 years thus reducing housing stock. This has been compounded by the sheer time and cost of getting any new building consent through wary City Councils.

The third factor is the land squeeze, most especially in Auckland caused by a desire of the new Super City to effectively ring fence Auckland's sprawling style of growth. They want to intensify housing, thus making public transport and other infrastructure more affordable and practical, but there's no getting around it: you can't build a new home on a subdivided city section for anywhere near as cheap as you can slap a Keith Hay onto a green fields site on the urban fringe.

All three factors are pushing demand, and prices, and as recent headlines have highlighted: houses are now selling for far in excess of council valuations.

Stratospheric prices suit only two groups: real estate agents and those who are selling up and getting out.

If you already own a mortgage-free house, you are still not sitting pretty because your rates will be going up as quickly as your property value. So soaring property prices can put a squeeze on retired people who have limited financial resources.

At the same time, soaring prices put houses out of reach of young people; and this is one reason for the exodus of young workers. Why strive in New Zealand when you can earn more in London – and pay less for a home?

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How do we define housing affordability? Houses should cost no more than 3 times gross median household income, before tax. Prices have been able to increase so much since the 1980s because in many families, both parents work to cover the mortgage so median household incomes have indeed risen. But house price rises since 2001 have far outstripped this income growth.

The ninth Annual Demographia International Housing Affordability Survey released in early 2013 found housing in New Zealand remains unaffordable with median house prices now 5.3 times the median income. This is well above the "3-times" affordability water line.

All eight of New Zealand's property markets are deemed in the report to be "seriously" or "severely" unaffordable. If you think big cities are the same the world over, just note that London, New York and Los Angeles are all ranked *more affordable* than Auckland.

Auckland continues to be New Zealand's least affordable market, with a median multiple of 6.7, followed by Christchurch at 6.6, Tauranga-Western Bay of Plenty (5.9), Wellington (5.4) and Dunedin (5.1) all severely unaffordable.

The NZ government recognises the need for change, and aims to override Council planning to grow land supply and reduce costs and delays due to regulatory processes. Providing infrastructure and improving construction sector productivity are also on the agenda.

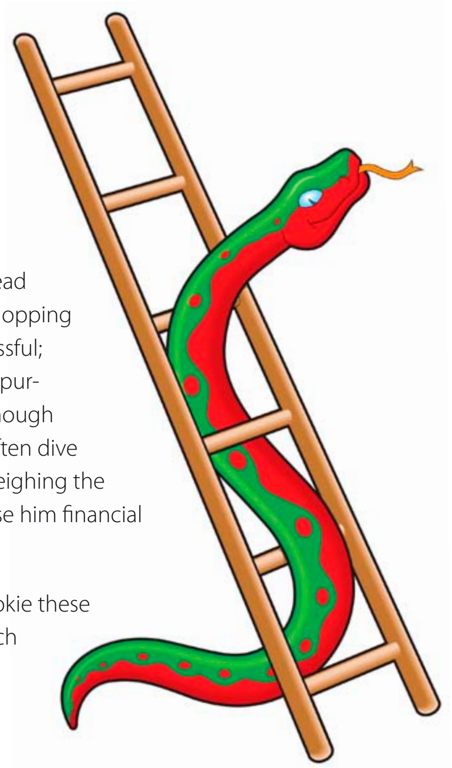
The Reserve Bank is meanwhile exploring fiscal regulations to take the heat out of mortgage lending.

There is also talk about capital gains tax and higher standards for rentals – a housing Warrant of Fitness. With different rules, fewer people may become landlords. Again this could affect housing demand.

With all these changes afoot to bring housing back into the affordability zone, don't count on high property price gains indefinitely.

## Snakes and Ladders

What can we expect in this, the Year of the Snake? No we are not turning to Chinese Horoscopes in order to forecast your returns though let it be noted that Wall St pundits have always been happy to talk animals – even if a lot of it is Bull. However we thought we'd look up the significance of the Snake.



Here's the prognosis. A Snake's worst nightmare is jumping head first into a financial deal or a shopping spree. The Snake can be successful; but only so long as he avoids spur-of-the-moment spending. Although he is intuitive, the Snake will often dive right into decisions without weighing the consequences, which can cause him financial ruin.

Hmmm. Like every fortune cookie these days, the words are not so much a prediction as a general truth. Avoid snake oil salesmen.

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