2015 – Issue 2

STUART + CARLYON

Financial advisers for your lifetime goals

How low can they go?

We recently attended the Portfolio Construction Forum in Auckland. Experts share the latest analysis and thinking about the global economy and what constitutes the ideal investment options. This was before Greece's latest troubles, though the monetary woes of the EU were certainly a focus of the discussion.

As always there is debate on what's going to happen in the world markets, and in particular, the impact of falling interest rates. Already low in US, UK and Japan, negative interest rates are now a reality in Switzerland, a practice that has now spread to New York within the banking sector where JPMorgan Chase is currently trying to shed $100 billion in deposits. It doesn't want the money.

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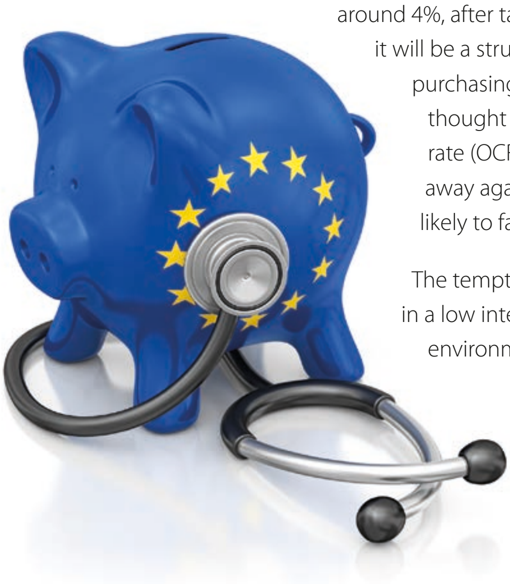
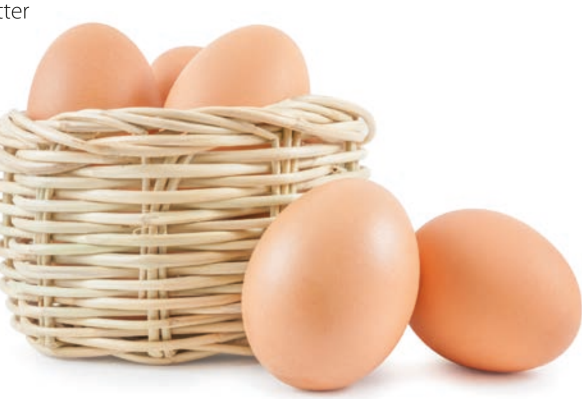
General consensus at the Forum agreed that we need to get clients used to low interest rates, maybe even forever. The "forever" part was a surprise but a middle to long-term flat spot makes sense based on underlying demographics and the world of ailing economies:

- Aging population. Older people buy less stuff.
- Lower employment growth, lower GDP growth and less demand for money all lead to low interest rates.
- With bank deposit rates now hanging around 4%, after tax and inflation it will be a struggle to maintain purchasing power. (Whoever thought the official cash rate (OCR) would drop away again in NZ and be likely to fall further?)



The temptation for investors in a low interest rate environment is to chase high credit risk; for those that are very risk averse it poses a dilemma of where to put your money so it's not losing ground.

The conclusion from the participants at the Portfolio Construction Forum is that shares paying sustainable dividends are a viable option and represent better value relatively speaking. The decision then is working out how much risk you can adopt given your risk tolerance and your risk capacity.



Our client portfolios all did well in the last 12 months: the lowering interest rates have been more than compensated by the capital growth part of each portfolio. In particular, the offshore funds in the portfolio have benefitted further from foreign exchange gains.

Lesson: It always pays to be diversified. Over the last 12 months, even our conservative risk portfolios (Risk 1) earned 7% to 8% gross; that's 5% to 6.5% net after tax and fees. Risk 3 with more shares earned 9%-12% or net 8% to 10.5%. That sure beats the negative interest returns being offered.

Our key take outs

- Don't chase higher yield via riskier debt.
- Spend less.
- Take on more shares and property stocks to benefit from a growing income stream.
- Check whether your long term objectives will still be met if markets underperform. If you are uncomfortable with downside risk, consider different strategies within your control, for example, releasing capital from your home or selling little used assets.

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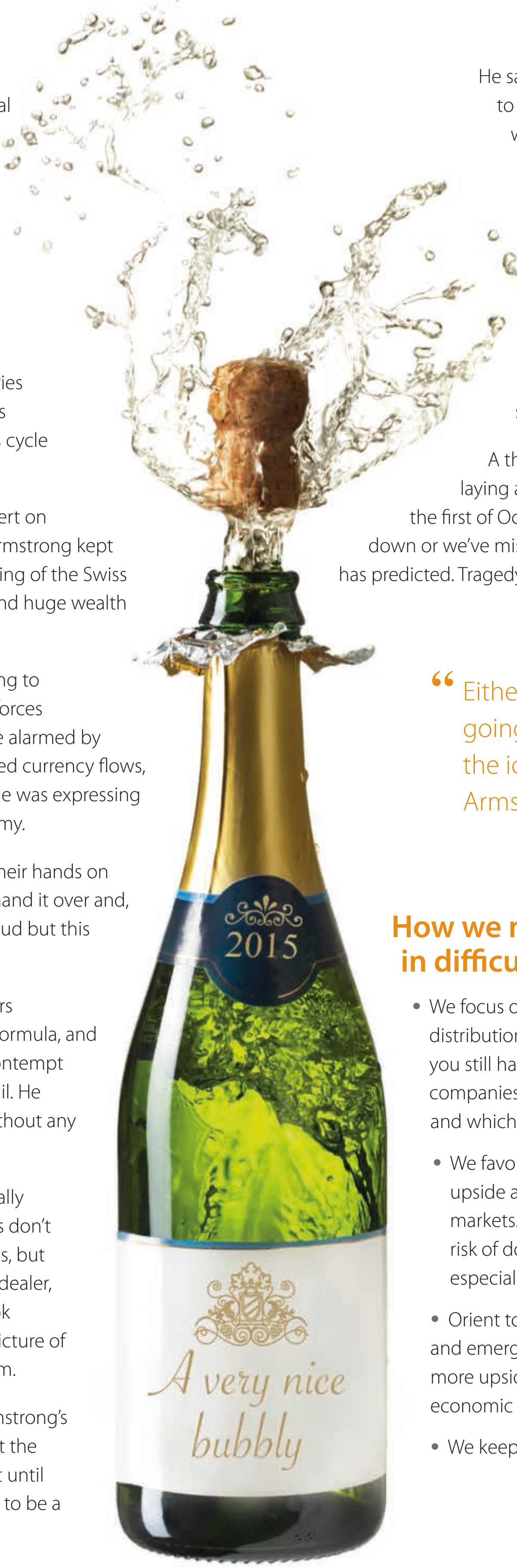
The forecaster



We saw a rather disturbing film at the recent Documentary Edge Film Festival last month. It was the story of an American fund manager, Martin Armstrong, whose company had around a trillion dollars under management.

His secret, a mysterious algorithm that he'd developed based on the Fibonacci series of numbers and the number Pi. Hocus pocus? Many theories come and go about recurrent patterns in the global markets. But Armstrong's cycle theory seemed to bear fruit.

A deep student of history, and an expert on currency cycles since Roman times, Armstrong kept getting it right (including the unpegging of the Swiss franc from Euro in January this year) and huge wealth flowed into his managed funds.

But in 1999 it all went wrong. According to the documentary, the establishment forces (Government and the Big Banks,) were alarmed by Armstrong's correct calls. He'd predicted currency flows, wars and stock market crashes. Now he was expressing serious concerns about the US economy.

As a result, the Government wanted their hands on the algorithm. Armstrong refused to hand it over and, to frame him, he was charged with fraud but this charge never resulted in a court case.

Instead, at the first hearing, prosecutors demanded Armstrong hand over his formula, and he refused. The judge found him in contempt of the Court, and sent Armstrong to jail. He remained incarcerated for 12 years without any trial.

Recently released, Armstrong is a socially difficult man, and his prognostications don't always endear himself to his audiences, but one of his many supporters, a bullion dealer, was on hand at the screening and took questions. He painted an unsettling picture of Wall Street and of the US justice system.

When asked about the veracity of Armstrong's forecasts, the dealer was adamant that the man always gets it right. "Just you wait until October 1st" he told us. "There's going to be a major crisis that day."

He said that one of Armstrong's methods is to track where the tidal flow of money is washing around the world – into and out of China, away from Wall Street. "Just look where the smart money is moving."

One shaky institution, he says, is the Governments in the western world. "Governments will be broke because of debt. They won't be able to meet Social Security, pensions etc. This is the death of socialism. Investing in sovereign bonds will be risky."

A thought provoking session. We suggest laying aside a bottle of bubbly to be opened on the first of October. Either the Western Titanic is going down or we've missed the iceberg that Martin Armstrong has predicted. Tragedy or relief, a nice bubbly can do no harm.

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How we manage your portfolios in difficult times

- We focus on investments with cash flow distributions so if your capital bumps around you still have an income stream. Also investing in companies with potential growth in their earnings and which have low debt.
- We favour sectors that are likely to have more upside and avoid being overweight in expensive markets. On balance, they say, there is more risk of downturn with interest bearing bonds; especially government ones.
- Orient to growth opportunities, namely Australia and emerging markets where there is potentially more upside. China and India are likely to be the economic powerhouses of the future.
- We keep your portfolio diversified at all times!