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When most New Zealanders invest, their intention is to preserve the purchasing power of their capital against inflation and to grow their capital through the accumulation of income and capital gains for use in retirement. One asset class with the potential to deliver on all three of these fronts – inflation protection, income and capital gains – are global shares. But when faced with the daunting array of global shares available many New Zealanders give up.

Much of the return derived from owning shares is determined by the economics of the sector in which the company operates. It therefore makes sense to screen the global share market for sectors which have reliably delivered inflation protection, a steady source of income and rewarding capital gains. As well as a fourth variable which investors all too often dismiss in a rising market – stability during market downturns.

Investment returns mean revert over time. This means that if an asset class experiences a period of underperformance, at some point in the future it plays 'catch up', resulting in a period of outperformance. Historically, global shares have returned around 9% per annum. But over the past 10 years they only returned negative 0.79% per annum, which suggests that they are due for a period of outperformance.

Nevertheless, a study of historic share market returns shows that in some cases the market can take up to 20 years before it booms again. Given that we have already had 10 bad years, the probability of a strong share market run is increasing with each year.

TABLE OF SHARE MARKET RETURNS

Historical period	Market movement	Total return (after inflation)	Annualised return (after inflation)
Dec 1899 - Dec 1920	20 years sideways	-54%	-3.6%
Dec 1920 - Dec 1930	10 year bull market	174%	10.6%
Dec 1930 - Dec 1950	20 years sideways	-18%	-1.0%
Dec 1950 - Dec 1960	10 year bull market	141%	9.2%
Dec 1960 - Dec 1980	20 years sideways	-19%	-1.0%
Dec 1980 - Dec 2000	20 year bull market	394%	8.3%
Dec 2000 - Dec 2020	20 years sideways?	?	?

Source: Robert Shiller, New Zealand Funds Management

What makes it worth even a 10 year wait, is that when global shares do resume their upward trend, they are extremely hard to beat. Since 1900, the average market uptrend has lasted approximately 10 years and has not only matched inflation but delivered an additional return above inflation of on average 9.3% per annum, sufficient to increase an investor's real wealth by a multiple of 2.4x.

Some sectors of the share market participate almost equally in the upside but show more stability than others during down years. A number of these sectors also exhibit strong income generating potential through high and stable dividends and have systematically protected investors' capital during periods of high inflation. Since 1973 there have been seven periods during which the share market declined by more than 15%. Over the same time period there have been three global inflationary episodes. These episodes are defined by starting six months before consumer price inflation reached 5% per annum and ending when inflation dropped back below 5%. The following three sectors of the global share market outperformed their peers in both instances, while offering strong dividend income and market matching capital gains.

- Utility and infrastructure companies – water, power and gas companies declined by less than the market 86% of the time, while delivering inflation-beating returns 83% of the time.
- Healthcare companies – pharmaceutical companies and medical equipment manufacturers declined by less than the market 90% of the time, and beat inflation 78% of the time.
- Consumer staples companies – supermarkets and breweries have also declined by less than the market 90% of the time, and beaten inflation 73% of the time.

An investment in global shares can be daunting so many New Zealanders balk at the thought. But it need not be. Long-term investors should consider investing internationally as the local market does not offer sufficient securities in the above sectors to create a defensive, diversified portfolio.

By investing in companies from the defensively orientated infrastructure, healthcare and consumer discretionary sectors, or by accessing an index or fund which tracks the fortunes of all companies in those sectors, investors can significantly increase the probability that their portfolio will meet their original investment objectives of protecting their savings against inflation, and compounding their wealth over time.

New Zealand Funds Management's Mid-Term Growth Portfolio provides clients' with a diversified range of assets which have been specifically chosen for their capital stability and inflation beating attributes. The investments are identified and managed using New Zealand Funds Management's proprietary A.R.M.O.R. investment process.

For further information please contact:



Michael Lang Ph: 09 377 2277
Chief Investment Officer
New Zealand Funds Management

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