

NZ Funds happy with hedge



David Chaplin, Wednesday, 16 June 2010 17:35

New Zealand Funds Management's (NZFM) share hedging strategy has proven its worth over the course of the global financial crisis, according to a new paper published by the group, and should guard client portfolios at a time when markets appear over-valued.

The NZFM paper said its growth portfolios "did not suffer as severe a drop as they might otherwise have done" because of the share hedge which it began implementing at the onset of the crisis in October 2007.

NZFM's growth portfolio hedge, which is based on signals given by moving average sharemarket valuations, was fully implemented by December 2007 and remained at maximum levels until March 2009.

The NZFM research paper, titled 'A defensive strategy for share market investing', says while the hedging strategy worked well when share markets were clearly rising or declining it could give "false signals" at other times.

"However, over time the cost of these false signals was more than offset by the benefits of protecting investors' capital when the market was falling, or participating in the market when it was rising caused them to sell their investments at the wrong time in an attempt to protect themselves from further losses," the study says.

"The share hedging strategy's benefit may be summarised by saying that in most cases the strategy resulted in a similar level of return to the share market, but with significantly less volatility. The attribute of lower volatility is especially important for individuals, families and trusts as it smoothes the investment journey and thereby increases the probability that they will stay invested and achieve their long-term return objective."

The NZFM paper suggests the hedging strategy - in conjunction with the group's active management and asset allocation policies - will remain relevant for the years ahead with data indicating share markets are currently expensive.

However, the study says while equity markets do look over-priced now, indicating forward-looking returns will be "somewhat muted", it could take some time for a correction to emerge.

"Historical analysis also demonstrates that markets can become more expensive than they currently are and that they can remain expensive for an extended period," the NZFM report says.

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