



## Top investment tips for this decade

By MICHAEL LANG    Last updated 11:24 12/03/2010

When most New Zealanders invest, their intention is to protect their investments against inflation and to grow their capital for use in retirement.

What makes this challenging is that investments offering a high degree of certainty and stability in value such as cash and term deposits struggle to beat inflation after tax has been taken into account.

Also, cash and term deposits do not grow investors' real wealth or purchasing power over time.

Unfortunately, investment alternatives that do lead to a real increase in purchasing power have earned a reputation for being excessively volatile and therefore risky, particularly investments in finance companies.

The truth is that they are.

Many New Zealanders would be better off hoarding their cash in term deposits and coping with the erosive effects of inflation, than investing without taking the considerable time and effort required to understand either the investments they are making or the organisation which is making it for them.

Nevertheless, for those willing to invest the time and muster the perseverance, the rewards are substantial.

Many New Zealanders begin the year(or decade), by focusing on what might go up the most in the coming year. Such a short-term oriented investment approach is fraught with risk.

The story of Gerson Bleichroeder is worthy of consideration by investors, advisers and managers alike.

At the age of 24, Bleichroeder advised his sole client – a Prussian who went on to weld the Second Reich into an empire – to target a long-term rate of return of 4 per cent above inflation. This would enable his client to double his wealth every 17 to 18 years.

Investors would do well to adopt a similar philosophy when constructing an investment portfolio for the coming decade. The five asset classes listed below, combined in a way to reflect the conservative nature of the investor, offer considerable upside over the coming decade.\

### 1) New Zealand dividend-paying shares

Imagine if today you could buy your neighbour's house for the price it was valued at 17 years ago? Few investors would hesitate.

Incredibly, despite investments, acquisitions and expansion, the New Zealand share market does trade at the same price level as in 1993.

Because the New Zealand share market returns have been so lacklustre, the opportunity for significant capital gains in the New Zealand share market exists.

Investors also need to bear in mind that despite recent volatility in share market prices, very few New Zealand blue-chip companies actually fail in the same way that many finance companies have done. Instead, share prices tend to fluctuate.

It is very rare for stable, high-quality, listed companies to cut their dividends and, as such, the income from a portfolio of dividend-yielding shares is unlikely to fluctuate much.

Additionally, and in contrast to owing a corporate bond, most share investors have little or no tax to pay on either their capital gains or dividend income.

Currently, the top 20 dividend-yielding shares on the NZX offer an average dividend yield of 8.8 per cent. In addition, patient investors could reap a capital gain of over 50 per cent should the market revisit its previous high.

## 2) Defensive global shares

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'. This results in a period of outperformance.

Historically, global shares have returned around 9 per cent per annum. But over the past 10 years they only returned -0.79 per cent 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. When global shares resume an upward trend, they are extremely hard to beat.

However, such investing requires patience which, in turn, requires concentrated strength during years of poor returns.

Some sectors of the share market do show more stability than others during down years, but participate almost equally in the upside.

Companies in the following sectors are particularly defensive:

- infrastructure companies such as water, power and gas companies;
- healthcare companies such as pharmaceutical companies and medical equipment companies;
- consumer staples such as supermarkets and breweries; and lastly
- listed property trusts.

Investors should invest internationally as the local market does not offer sufficient securities in the above sectors to create a defensive, diversified portfolio.

Since 1900, the average market uptrend has lasted approximately 10 years and has averaged 9.3 per cent per annum more than inflation, sufficient to increase your wealth by a multiple of 2.4, and more than enough to compensate patient investors for the potential of a further five or ten years of volatile and anaemic share market returns before markets fully recover.

## 3) Agricultural commodities

Commodities are likely to be one of the best-performing asset classes over the next ten years, but they are also likely to be one of the most volatile.

The global economy is entering the 'tens' with high debt levels, both at the private and public level.

Governments facing a debt problem may decide that a little inflation is helpful in effectively devaluing the debt they have issued.

If this occurs, specific commodities have the potential to perform strongly.

Investment markets appear to have forgotten that man, despite his many accomplishments, owes his existence to a six inch layer of topsoil and the fact that it rains.

For thirty five years, agricultural prices have declined, after adjusting for inflation. Little wonder New Zealand has slumped from the 3rd wealthiest nation in the OECD, as measured by income per capita, to 22nd.

Despite the long decline in agricultural prices, the world's population has continued to grow at 1.5 per cent per annum.

Growth in emerging economies is leading to the loss of agricultural land due to water shortages and urbanisation. But more significantly, a move to protein-rich diets requires significantly more agricultural

output.

A kilogram of beef requires approximately seven kilograms of grain or rice. In eight of the nine most recent years, the world has consumed more grain than it has produced.

As a result, global inventories of grain have fallen to levels marginally above those during World War II.

Economic behaviour is conditioned by pricing. Given the multitude of competing options for capital, agriculture will need to revisit its all-time highs during the coming decade.

With the economic outlook still murky, investment in agriculture provides exposure to an industry that follows a very different cycle to the broader global economy.

This makes agricultural commodities more defensive than industrial-driven alternatives such as copper and oil.

Investors can gain a diversified exposure to agricultural commodities by buying an exchange-traded fund that passively tracks the performance of wheat, corn, sugar, soy, coffee, cocoa and related commodities.

#### **4)Gold**

Gold requires separate consideration from other commodities as it is not only a good investment during periods of inflation, but can also appreciate in value during rare moments when investors panic.

However, in the long run it does nothing more than preserve investors' capital against inflation.

The conundrum that investors face when considering whether to own gold is nicely summarised by the English proverb: "When we have gold we are in fear, when we have none we are in danger." Because gold earns nothing and yields nothing, it is notoriously difficult to value and this makes it more volatile than the share market.

But with printing presses whirring to rekindle economic growth, the outlook for gold is promising.

In the short run, the market for gold is like a voting machine that may have gotten ahead of itself in recent months and could therefore be vulnerable to a pullback in 2010. In the long run, all markets are weighing machines.

The more money that is printed to restart the global economy or repay excessive government borrowing, the higher gold will levitate.

And the coming decade could see an unprecedented rise in inflationary pressures, from which gold stands to benefit.

There is also the wild card that central banks in emerging markets such as China, Korea and Brazil (which hold less than 2 per cent of their foreign exchange reserves in gold compared to developed nations' 70 per cent) decide to increase their ownership, in which case gold might once more appreciate twenty-fold as it did in the early 1970s.

In the meantime, gold is a holding that tends to zig when markets zag, thereby improving the stability of a diversified portfolio.

#### **5) Cash and term deposits**

Over the past 12 months a number of corporates have issued bonds to the public – these include Fonterra, Contact Energy, Vector, NZ Post, TrustPower and Watercare.

Investors have fully supported these issues as they offered attractive yields in an environment where bank deposit rates were falling.

Furthermore, during the economic crisis, when most other asset classes were declining, these issuers offered both name recognition and stability.

Investing in these bonds for yield is a reasonably sound investment strategy. But investors should be cautious to lock in their capital for extended periods of time.

Interest rates are currently at depressed levels in New Zealand and around the world. In a rising interest rate environment, investors who are unwilling or unable to hold corporate bonds to maturity are likely to experience a capital loss if they sell.

This is because the new buyer will insist on a higher return to reflect the fact that interest rates have risen.

To avoid disappointment, investors should therefore refrain from using corporate bonds like ATM machines and instead hold the equivalent of two or three year's income in short-term bank deposits. As interest rates rise, so too will term deposit rates.

The difference in return between a term deposit and corporate bond is negligible, whereas the change in the value of a long-term bond, caused by rising interest rates, can be significant.

While Bleichroeder only targeted a rate of return of 4 per cent above inflation, his client's wealth grew faster than this, but only because Bleichroeder's modest initial target kept both Bleichroeder and his client Otto von Bismarck from getting caught up in the short-term manias (and subsequent panics) that regularly swept across Europe.

The coming decade will offer its own dizzying array of temptations, but today's equivalent of Bleichroeder's investment strategy is a highly-diversified portfolio of asset classes that is conservatively selected and patiently held.

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