QUARTERLY REPORT: June 2008

axiome

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Market Commentary

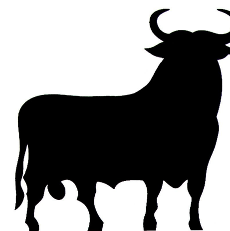
The June quarter began with markets bouncing back from the first quarter's dramatic falls. However, by quarter end, early gains (at one point the US S&P 500 index was up 8.5% from the 1 April opening level) were somewhat dampened by further global market declines.

The depreciation of the New Zealand dollar (NZD) especially against the Australian currency (AUD) has eased the pain of the drop in offshore equity market values. In fact when reported in NZD terms, a net positive return resulted for most offshore assets.

The NZD has fallen against the major currencies, reversing the trend of recent years. The table below shows that over the quarter the New Zealand dollar fell almost 9% against the Australian dollar and 4% against the US dollar and Trade Weighted Index (TWI).

Exchange Rate movement over the quarter			
	31-Mar-08	**30-Jun-08**	**Change**
NZD / AUD	0.8661	0.7918	-9%
NZD / USD	0.7935	0.7619	-4%
TWI	70.4	67.70	-4%

Economies and markets are complex things. At any one time there is any number of influences pushing them in different directions. Rising oil and food prices, both domestically and around the globe, have impacted negatively on financial markets. Stock market falls in many parts of the world now exceed 20%, which is the threshold when the term 'bear market' is often used. However, there are also positives to reflect on including: continuing extraordinary growth in China and India; and concerted action by the US Federal Reserve and other central banks to guard against the worst effects of slowing growth. Whist the rapid stock market rise of the past four years (exceeding 20% p.a. regarded as 'bull market' territory) is undoubtedly past, the surge in share prices early in this volatile quarter demonstrate compelling reasons for maintaining a balanced outlook in these uncertain times.



Asset Class Returns

A summary of the gross returns in New Zealand dollars (NZD) for the key asset classes we track and which form the core of most client portfolios, are listed in the table below.

Overall returns for the June quarter were modestly positive, reflecting the impact of the falling NZD on returns. NZ Equities were the worst performing asset class for the quarter. The NZX 50 portfolio index fell a further 7.3% during the quarter, making an overall fall of 24% over the past year.

New Zealand Property, often regarded as a stabilising influence within a portfolio has also performed poorly despite high occupancy levels and rising rents and being relatively advantaged under the new PIE taxation regime.

NZD Returns to 30 June 2008

	3 months	1 year	3 year (p.a.)
International Shares			
Australian Core Equity	4.3%	(6.2%)	n/a
Australian Large Companies	7.0%	(0.1%)	16.5%
Australian Value Companies	7.4%	(2.9%)	16.3%
Australian Small Companies	7.7%	(0.4%)	22.0%
International Core Equity	0.5%	(13.0%)	n/a
Global Large Companies	1.1%	(9.7%)	5.5%
Global Large Companies (NZD Hedged)	0.2%	(12.2%)	9.4%
Global Value Companies	(1.8%)	(17.3%)	5.3%
Global Small Companies	0.9%	(16.2%)	3.9%
Emerging Markets Companies	(0.6%)	0.4%	20.2%
International Fixed Interest			
Diversified Fixed Interest (AUD class)	10.2%	22.9%	10.1%
Diversified Fixed Interest (NZD class)	2.1%	9.2%	6.8%
New Zealand Assets			
NZ Share Portfolio	(7.3%)	(24.1%)	1.8%
NZ Property Companies	(1.3%)	(16.9%)	6.8%

Notes:
* Returns are reported after fund management expenses and are pre-tax.
** Past performance is not necessarily an indicator of future performance.

Using our emotions the best way…

Over the years we have mentioned to clients that many investors do not receive the returns available from the markets because they tend to buy and sell at the wrong time. Recent research indicates that the chemical make-up in our brains might be partly responsible for this.

We live in a complex world and to help make sense of it we are constantly making decisions and taking action. Many of our actions are based on our expectations about the future. Behavioural research has discovered that our brains produce a powerful chemical called Dopamine when we make predictions and anticipate the future. This helps to produce strong feelings of hope and euphoria which we all crave.

The seductive effect of Dopamine helps to explain why many people get a “buzz” when attempting to forecast future investment returns, even though the accuracy of these predictions is doubtful. It might also explain why media publications quoting ‘expert opinion’ about the future are so popular.

While Dopamine is likely to make us feel over confident when investing, our brains can also produce Serotonin when we are fearful or anxious. Therefore our decision making process is influenced by the brain’s current balance of these chemical forces, which can cause us to react impulsively.

We need to be very careful to resist the strong forces of Dopamine (over-confidence) or the warnings of Serotonin (anxiety) when it comes to investing. Dopamine is likely to make us buy and sell at inappropriate times based on forecasts while Serotonin could

cause us to sell an asset at a lower price when the odds are that it could recover from that lower price and return a good profit.

We suggest the following:

1. Be careful not to let fear, greed, recent past returns, or forecasts of future events dominate investment decisions.

2. Review your portfolio strategy (asset allocation) after you have had a good break from the newspaper and television. Base your decisions on your long term needs and objectives.

3. Instead of letting our emotions affect our investment decisions, with unpredictable results, let them help us to lead more satisfying lives. Quality of life will be more influenced by a focus on enjoying the best about the present, not over-concern on what cannot be predicted about the future.

Family Trust check-up

This is the time of year that many of us are filing tax returns and for those of you who are Trustees it is also an appropriate time to meet and review, amongst other things, the purpose of the Trust, the needs of beneficiaries and the Trust's assets.

It is also worth noting that if income is produced by the Trust and it is to be distributed to a beneficiary, this needs to be completed by 30 September.

It is also important to ensure that your Trust is adequately administered so that it will fulfil the intended asset protection and succession planning objectives. The following check list, whilst not exhaustive, may be a useful prompt towards ensuring basic duties are managed appropriately.

Check List:

- Have all Trustees received and read copies of Trust documents in the last year?
- Has there been a meeting of Trustees in the past year?
- Have all Trustees been involved with decision making?
- Have these decisions been recorded in writing?
- Have financial statements been compiled and is tax compliance up to date?
- Should the gifting programme be continued? If so, ensure timely filing of gift statements with the IRD.
- Is there a written investment policy in place?
- Is administration intact to ensure Trust transactions are not intermingled with personal finances?

DIY and Poor Advice set landscape for Finance Company losses

Extract from an article written by Axiome Consultants Director Philip de Lisle and published in the NBR on June 13, in conjunction with the New Zealand Institute of Chartered Accountants.

Why do we hear so many sorry stories where a life time of savings is caught in one or another finance company failure? I suggest the issues are: a DIY attitude, poor advice driven by commissions, and a general lack of financial literacy.

New Zealanders' 'DIY' attitude still influences the investment decisions of many Mum and Dad investors in the 55yr + age group. Consequently many are oblivious to the inherent risk in the products they invest, failing to understand the fine print or not even reading it.

Anecdotes abound of investors being advised to invest in a spread of several finance companies with a similar underlying risk exposure. The high front loaded commissions and trail fees usually paid to some advisers is outrageous. Conflict of interest is embedded in commissions as a form of remuneration – the financial interests of the commissioned adviser are aligned to the institution that pays them rather than the investor. Worse, the highest commissions are often paid as an incentive to sell the worst quality investments. Contrast this with a 'fee only' independent adviser, who is paid only by the client and has no vested interest to recommend one investment over another.

The 55yr + age group of investors have been through a number of cycles that has no doubt psychologically framed they way they see markets. The '87 crash, which was more pronounced in New Zealand than major overseas markets, deterred a generation from re-entering the stock market. Some who eventually did re-enter, after years of being on the sidelines watching the US stock market boom through the '90s, invested in global shares just in time to suffer the 'tech bubble' burst in 2001 and have since had years of an appreciating New Zealand dollar, which has inhibited further prudent offshore diversification.

These events have left a distorted view of risk – where shares are perceived as risky and fixed interest as safe irrespective of the credit worthiness of the issuer or their underlying application of funds. Disciplined and prudent investment gives healthy returns over time, but failure to secure quality independent advice has cost many who can ill afford it dearly.

Credit risk can be likened to a submerged reef. Your boat has a high probability of safe passage while the tide is in, but the risk of foundering increases dramatically when the tide goes out. The change in the tide of economic circumstance affecting finance companies lending to the property development and consumer finance markets is evident. This, coupled with the loss of debenture holder confidence in the overall finance company sector wrought by the initial failure of the most vulnerable finance companies, and consequent dwindling of new fund inflows, has left an increasing number of depositors exposed.

Decades of academic research have established what is required for prudent investment. Essentially: ***(1) Asset allocation*** (where you broadly spread your funds) determines returns; not picking individual winners or timing the market; ***(2) Risk and return are related***, make sure you can quantify the risk exposure and that you get paid for the risk you take; ***(3) Diversify, diversify, diversify*** – by asset class, geographic region and security numbers; and ***(4) Fees, tax and other costs matter*** – identify all the layers of costs deducted from your returns in both good and bad years.

Constructing an efficient and meaningful portfolio in today's sophisticated investment marketplace is not a DIY job. Be prepared to pay appropriate professional fees for independent advice – the cleanest way to achieve this transparently is via a 'fee only' adviser, rather than a commission driven salesperson.