Investment Report – January 2015

Usually at this time of the year, financial market comments cover the performance of the year just finished and look forward to the likely prospects and outcomes for the coming year.

The Year to 31 December 2014

This will be remembered as another strong performance year for shares, and indeed the third in a row. As inflation is historically low in most countries, real returns from sharemarkets were therefore very sound for the year too.

Even the performance from bond markets was better in 2014 than in 2013.

New Zealand had some of the best investment performance numbers for these twelve months compared with most other countries. Bonds (as measured by the NZX Corporate A Grade Index) provided a total return (income plus capital gain) of +7.4%, while shares (the NZX50 Gross Index) provided a strong +17.6% annual return to equity investors.

Beyond New Zealand, sharemarkets were likewise mainly positive. Australia was one of the better country returns at +5.6% (in Australian dollars) A stronger New Zealand Dollar (NZD) over the year reduced the Australian returns in NZD terms.

Results from other major bourses were USA +11.4%, UK –2.7% and Germany +2.7%.

The Year Ahead

In 2014, nearly all the sharemarkets provided strong returns as dividend yields offered higher yields than bonds with the ultra-easy monetary policies and low interest rates around the world.

In 2015, interest rates still look very likely to remain low for most of the year. Indeed, some commentators now feel that deflation is a growing possibility in some countries as, aside from the US, major countries like Japan and the euro zone area are struggling to generate inflation and stimulate growth. Key commodity prices like dairy, oil, gold and copper declined sharply in the latter part of 2014. Moreover, with divergence between the monetary policies of the major central banks, the preconditions are in place for larger currency deviations in 2015.

We are conscious that the bull market of the past six years has seen significant asset price appreciation and that future investment returns are likely to be more modest. In their article “2015: Looking Ahead”, JBWere has stated:

“From an asset allocation perspective, we believe equities can continue to grind higher in 2015. However, the “aging bull” market no longer warrants a significant overweight. We advise investors to trim equity holdings closer to a neutral allocation over coming months.”

As doubts begin to increase around the prospect of higher economic growth, the need for higher interest rates appears to be evaporating and even further accommodative monetary policy may be required in countries like Australia.

If US interest rates remain low and global growth fails to increase, New Zealand interest rates will also remain lower for longer.

Thus, at least in the first half of 2015, the prospects for equity markets remain benign and, surprisingly, interest rates may even fall further from current levels.

Summary

Central banks look likely to continue to support markets with easy monetary policies through most of 2015. Inflation is virtually non-existent, so interest rates need not rise in the short term.

This scenario still supports a constructive case for buying selected equities, at least until interest rates begin to rise to make bonds more attractive. However, a diversified approach to investment, as always, remains appropriate.

Moreover, as all sharemarkets have risen strongly over the last few years, we encourage investors to reflect upon their portfolios which may have drifted away from their benchmark ratios due to the exceptionally strong share returns of recent years.