INVESTMENT
REPORT
FOR QUARTER
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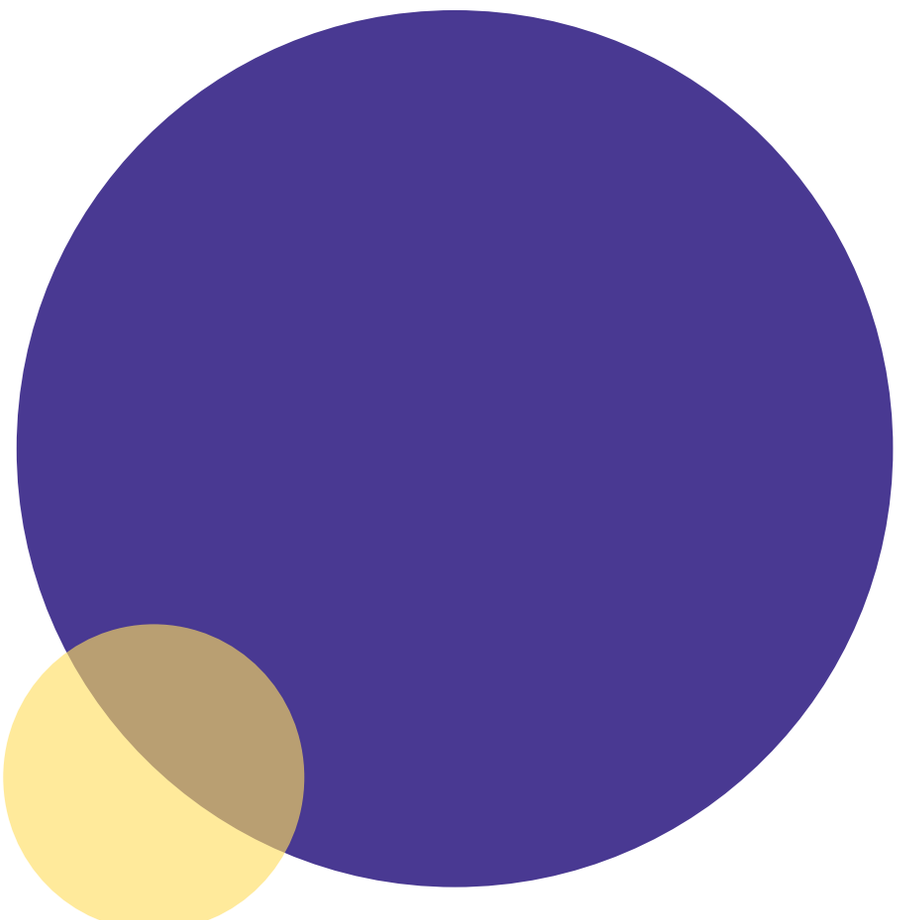

Synergy Investments

Newsletter

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Market Commentary

After an extraordinary first six months in 2020, global share markets consolidated between July and September by generally delivering more positive results.

This is a further reminder of the contradiction that exists between real world data and share market performance. We are all aware of the extraordinary impact that Covid-19 had on the world during the first quarter. With Covid-related fears reaching panic levels in late March, we saw a synchronised sell-off in global share markets unlike any other.

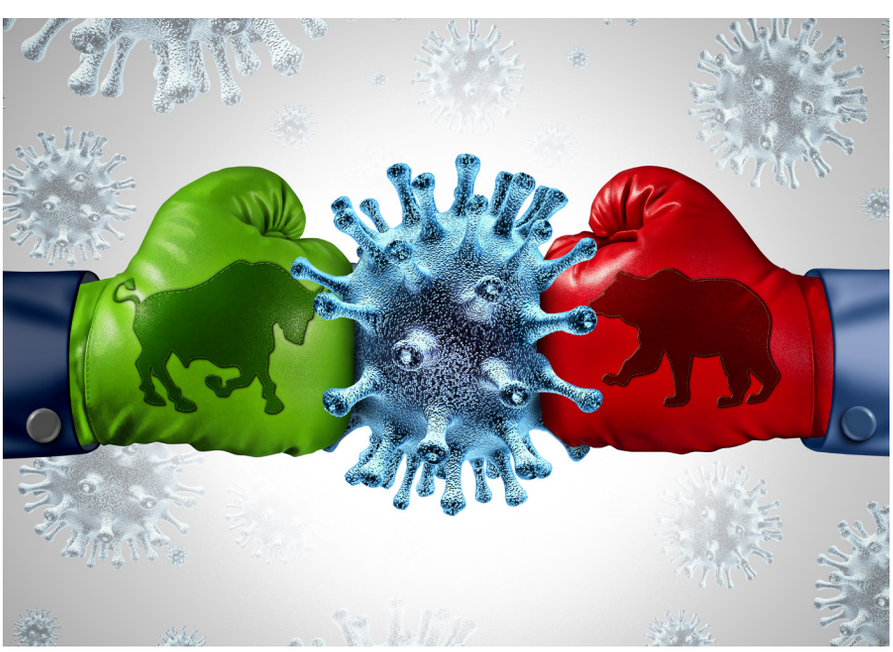
But suddenly, near the height of the panic, share markets changed course. Over subsequent months they staged a strong recovery, in some cases even exceeding pre-Covid levels.

In many ways, that too seems equally extraordinary. After all, Covid-19 has not been defeated. A vaccine remains elusive. Covid 'second waves' are being experienced by many countries, and reports of job losses are still consuming significantly more column inches than stories of job gains. International travel remains impractical for many, and numerous firms (if not industries), have yet to demonstrate they will adequately be able to cope when the wage subsidies and other central support packages run their course.

To the everyday person on the street, this does not paint an overly optimistic picture, and yet global share markets have been performing well since April. What this tells us is that share markets are not greatly concerned about what is going on in the world today. Rather, they are relentlessly looking into the future.

Global share markets

Share prices today are based on aggregate investor perceptions of each company's asset base and growth opportunities in the months and years ahead, with that projected growth being discounted back to a present day valuation. In other words, share prices today represent the market's collective expectation of the future.



And in that future, many of the issues we still see around us today may not even exist, including (we hope) Covid-19.

In contrast, many of the economic statistics used to try and help us quantify and understand the state of the world today (like GDP growth rates and unemployment figures), are backward looking. They are often calculated with a time lag of several weeks or months (meaning we generally do not find out this information until some considerable time after the fact). Even then, the data typically contains some degree of measurement error. It's therefore no surprise that a forward-looking share market can occasionally sprint ahead of our best understanding of the 'current' economic situation.

Globally, Covid-19 remained the number one news item in the quarter. This was to be expected, as it continues to have such a significant impact on matters ranging from the state of the global economy, to health and welfare, government policy, regional lockdowns, international travel and economic support measures. The ongoing build-up to the US election in November, and the near farcical state of the Brexit negotiations, were relegated to 'supporting news', and even these events were at times overtaken by stories of Covid second waves sweeping both the UK and USA.

What's happening in New Zealand

In New Zealand, one of the talking points as the quarter progressed, was the Reserve Bank of New Zealand (RBNZ) reinforcing its intentions to reduce bank funding costs. Having already signaled the possibility that short term interest rates could be allowed to turn negative in 2021 (mirroring the environment in a number of overseas countries), the RBNZ announced an alternative option to reduce bank funding costs even earlier.

The proposed Funding for Lending Programme is expected to be launched before the end of 2020 and would see

the Reserve Bank offering funding to banks at ultra low interest rates. This, in turn, would enable banks to lend at a cheaper rate, while maintaining a profit margin. This shapes as further bad news for term deposit investors, as the interest rates on these instruments would be likely to reduce as a result. However, for borrowers and, by implication, the property market, this is likely to be considered a positive.

The housing market in New Zealand appears to have rebounded in response to lower interest rates. Household loan growth has clearly picked up and house prices have recovered from declines seen in April and May. According to the Real Estate Institute of New Zealand (REINZ), New Zealand house prices (on a like for like and seasonally adjusted basis) have increased almost 3% since May and have reached new all-time highs.

Looking ahead

In what has already been a turbulent year, in many ways all we can do is shake our heads at what has happened around the globe, be grateful we live in New Zealand, and focus on the things that we can reasonably control. In the context of a long term savings and retirement plan, that might mean reviewing or updating our short, medium and long term goals and objectives. Alternatively, it might mean reviewing our budget or our savings plan; it might even mean reviewing our preferred investment risk settings.

We can, and should, focus on these things, because they are what will have the biggest positive impact on the outcomes that are most important to us. Of course, we should also exercise personal care and responsibility. But, when it comes to the big issues, we must exercise patience, and have a little bit of faith that sustainable solutions will be found. After all, we have governments wrestling with how to keep people safe, we have central banks trying to keep economies functioning and we have pharmaceutical firms who are trying to find Covid vaccines.

2020 has already delivered a resounding reminder that the interrelated world of markets, economics, health and politics reflects an incredibly complex and ever-evolving system. While that's part of what makes forecasting so difficult, we are thankfully aware of our limitations.

We know we can't predict how Covid-19 will eventually be contained or controlled. We can't predict how investment markets may perform over any short term horizon. We certainly can't predict what new information or unforeseen events may emerge tomorrow to change how we think and act today. Without a crystal clear view of the future we simply don't know how the current, complex, issues of the day will all eventually be resolved. But not knowing, doesn't mean it won't happen.

If the relative strength of the share market today is any guide, business is not expected to go out of business. In contrast to the challenging economic environment we still see around us today, the share market appears to be pricing in far more promising times ahead.

Key Market Movements

The third quarter of 2020 continued with heightened levels of uncertainty and volatility across markets, albeit significantly reduced than levels experienced in the first half of the year. There was a wide dispersion of returns across nations, industries and asset classes as capital markets continued to price in changing prospects at a global level, as well as the potential firm specific ramifications.

In 2020 we have been reminded to expect the unexpected and with Covid-19 still impacting all nations and economies, uncertainty and volatility will likely remain heightened for some time.

INTERNATIONAL SHARES

+6.6% (hedged to NZD)

+5.4% (unhedged)

International shares were generally positive in the third quarter, although it was anything but a clean sweep. The US market was very strong, as the accommodative monetary policy from the central bank continued to support businesses through the Covid induced recession. A positive factor for the US was its share market composition, which includes a higher than average allocation to technology companies which have been relative beneficiaries of the Covid-19 crisis. The S&P 500 Index (total returns in USD) advanced +8.9% for the quarter and is now up +5.6% for the year.

In Europe, the performance was more subdued and, in aggregate, the region was flat for the quarter. Covid-19 infection rates rose sharply in some nations and the rate of economic recovery was not as rapid as that observed across the Atlantic. For the quarter, the MSCI Europe ex UK Index gained +1.8% but remains down -7.4% year to date (in local currency).

Britain continued to struggle, with infection rates remaining high and the tightening of social restrictions impacting economic activity. Risks of a messy Brexit were again raised, as the end of year deadline for new rules regarding the UK-EU relationship approaches, with seemingly little progress made. In GBP terms, the FTSE 100 declined -4.0% for the quarter and is still down -20.2% year to date. Japanese equities were robust with the MSCI Japan Index advancing +4.7%, improving its year to date return to -3.2%

In New Zealand dollar terms, the MSCI World ex-Australia Index delivered a quarterly return of +6.6% on a hedged basis and +5.4% unhedged. Year to date, this asset class is now near flat with the hedged index down -0.3% and the unhedged index up +3.8%.

Source: MSCI World ex-Australia Index (net div.)

EMERGING MARKETS SHARES

+7.0%

The Emerging Markets asset class led the way in the third quarter, with the MSCI Emerging Markets Index advancing +8.8% and returning year to date performance into the black at +2.9% (gross dividend in local currency).

Chinese, Taiwanese and South Korean equities were among the best performers, as the technology heavy composition of these markets has meant they have been relative beneficiaries of this particular crisis.

Geopolitical issues were still prevalent. There is ongoing US-China tension (including President Trump banning US firms from doing business with TikTok), and the May/June Himalayan border dispute between China and India remains unresolved.

Weakness in oil prices stymied returns from significant oil exporting economies such as Russia and Brazil.

In unhedged New Zealand dollar terms, the MSCI Emerging Markets Index produced a quarterly return of +7.0%, for a +0.8% year to date return.

Source: MSCI Emerging Markets Index (gross div.)

NEW ZEALAND SHARES

+2.9%

Despite the New Zealand stock exchange suffering persistent interruptions from cyberattacks, our domestic equity market delivered a handy +2.9% through the quarter and is now positive year to date at +2.8%.

In contrast to the first two quarters of the year, it was the small and mid-cap firms that outperformed while the two largest names faltered. a2 Milk fell by over -20% through the quarter as an earnings update saw a downward revision in earnings due to disruption in direct to visitor sales due to the border closure.

Fisher & Paykel has seen increased demand for their breathing aids which helped the company's share price soar through the crisis. This quarter, however, saw some consolidation with the company returning -6%.

The delay in the New Zealand election continues to mean an ongoing lack of clarity for the future of the Tiwai Point aluminium smelter, and the potential for this large consumer of electricity to remain operational for longer helped support the utilities sector (Meridian: +5.2%, Mercury: +10.5%, and Contact: +9.9%).

Tourism related firms Tourism Holdings (+12.1%) and Auckland Airport (+10.9%) were up, while Air New Zealand (+3.8%) was relatively more reserved.

The Reserve Bank of New Zealand's (RBNZ) signalling of a likely reduction in interest rates (and therefore borrowing costs) supported the property market and the listed New Zealand real estate companies enjoyed a strong quarter after lagging through the first two. The listed real estate index advanced +13.4% in the quarter, but is still down-3.4% year to date.

Source: S&P/NZX 50 Index (gross with imputation credits)

AUSTRALIAN SHARES

+0.8%

After leading the recovery during the second quarter, the Australian share market was subdued with the S&P/ASX 200 returning -0.4% in Australian dollar terms, leaving its year to date performance at -10.8%. Small capitalisation companies outperformed their larger counterparts.

The financial sector was weak while the materials sector was mixed with most firms flat. Fortescue Metals Group was a highlight advancing +24.9% thanks in part to strong demand for iron ore from Chinese steel makers.

Melbourne was forced to endure a fresh round of prolonged lock down measures following a second Covid-19 outbreak. In part, this would have contributed to strength in the consumer discretionary sector, with Domino's Pizza, JB Hi Fi and Harvey Norman enjoying a good quarter.

Returns to New Zealand investors were enhanced by a relatively strong Australian dollar over the quarter.

Source: S&P/ASX 200 Index (total return)

INTERNATIONAL FIXED INTEREST

+0.2% The international fixed interest market was relatively quiet with central bank support holding yields low and stable.

Corporate bonds continued their trend of recovery from the second quarter, with increased economic activity and central bank support reducing the likelihood of widespread corporate default.

In aggregate, corporate bonds outperformed higher quality sovereign bonds, and longer duration bonds outperformed shorter duration bonds. The FTSE World Government Bond Index 1-5 Years (hedged to NZD) posted a +0.2% gain to take its year to date return to +3.0%, while the broader Bloomberg Barclays Global Aggregate Bond Index (hedged to NZD) returned +0.7% for the quarter, for a +4.5% year to date return.

Source: FTSE World Government Bond Index 1-5 Years (hedged to NZD)

NEW ZEALAND FIXED INTEREST

+1.7% The New Zealand fixed interest market delivered more price action than was generally seen in global markets, with the 10 year New Zealand government bond yield pushing lower to close the quarter at 0.53% - down from 0.96% at the beginning of the quarter.

Although the Official Cash Rate (OCR) was held at 0.25% at the August and September meetings, these announcements were accompanied by strong signals from the RBNZ of interest rate reductions in the short to medium term.

The decline in local bond yields was positive for bond prices, resulting in a +1.7% return for the S&P/NZX A-Grade Corporate Bond Index over the quarter, taking the year to date return to +6.5%.

Source: S&P/NZX A-Grade Corporate Bond Index

Table 1: Asset class returns to 30 September 2020

ASSET CLASS	INDEX NAME	3 MONTHS	1 YEAR	3 YEARS	5 YEARS	10 YEARS
New Zealand shares	S&P/NZX 50 Index (gross with imputation credits)	+2.9%	+8.3%	+15.0%	+17.2%	+15.3%
Australian shares	S&P/ASX 200 Index (total return)	+0.8%	-9.8%	+4.7%	+7.0%	+4.8%
International shares	MSCI World ex Australia Index (net div., hedged to NZD)	+6.6%	+7.2%	+7.4%	+10.8%	+11.5%
	MSCI World ex Australia Index (net div.)	+5.4%	+4.9%	+11.1%	+9.8%	+10.7%
Emerging markets shares	MSCI Emerging Markets Index (gross div.)	+7.0%	+5.0%	+5.8%	+8.6%	+3.9%
New Zealand fixed interest	S&P/NZX A-Grade Corporate Bond Index	+1.7%	+5.3%	+5.9%	+5.2%	+5.7%
International fixed interest	FTSE World Government Bond Index 1-5 Years (hedged to NZD)	+0.2%	+3.1%	+2.8%	+2.9%	+3.6%
New Zealand cash	New Zealand One-Month Bank Bill Yields Index	+0.1%	+0.7%	+1.4%	+1.7%	+2.3%

Unless otherwise specified, all returns are expressed in NZD. We assume Australian shares and emerging market shares are invested on an unhedged basis, and therefore returns from these asset classes are susceptible to movement in the value of the NZD. Index returns are before all costs and tax. Returns are annualised for time periods greater than one year.

Why your kids ask for financial help in their 30s

Recently, one of America's largest life insurers (New York Life) did a survey of over 2,000 people to find out what they considered to be their largest financial mistakes, and how long it took to recover from them.

The key mistakes can be summarised as:

- Not saving soon enough for retirement.
- Relying too much on a credit card.
- Not paying off credit card debt monthly.
- Taking on too much student loan debt.
- Not setting aside enough money for an emergency.

On average, these financial mistakes tend to occur in the 30s. That makes sense. The 30s seem to be the decade of life when many major financial decisions are made. We've graduated from university, have a big mortgage, we get married, we have children, and we buy a car less than ten years old (not always in that order). It's the time of life when we could really use financial discipline and guidance. Yet, ironically, it's also often a time of life when people seek help the least.

With so many major life events happening, the 30s can be a time when we spend almost every dollar we make. An income that comfortably supported two individuals now needs to stretch to three, four and even five people, and that can be compounded by the added pressure of one spouse moving out of the workforce - or at least cutting back hours - when children are younger.

Then a couple of financial surprises happen, like the car breaking down or a necessary home repair, and you solve it with a little credit card debt... We've all seen how this spiral can take hold. It is often around this time when parents get a call for some financial support. If we understand, and can anticipate, the concentration of multiple financial commitments and the associated stress at this life stage, are there steps we can take to relieve some of the pressure?

When dealing with your financial future, the most important element you can prepare for is to expect the unexpected. In other words, plan on the assumption that you'll get a couple of surprises a year.

Setting up a savings account is one way to deal with any surprise expenses that may arise. An automatic payment can be set up so, as soon as you get paid, a portion of your salary goes directly into that account. Essentially, pay yourself first, before you pay for anything else. Let that money accumulate, knowing that it isn't there for holidays or household extras, but is set aside specifically for the unexpected. Once your account is larger than about three months' wages, reward yourself with something nice for the house, or consider additional retirement savings. Either way, you'll feel a lot better knowing that you have a 'just in case' fund available.

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