NEWSLETTER
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Strongbox
tailored wealth management

What should you be doing?

In our most recent newsletters we have tried to summarise the current consensus on the outlook for the global economy and therefore the stockmarkets.

The consensus has varied so much in recent months that we were just about to throw up our hands and say who knows what might happen next – given enough time and reading, we can find evidence to support pretty much any opinion as to what may happen next.

But this week we came across an interesting new positive view from Gavyn Davies writing in the FT.

His argument is that although we are now in the tenth year of a major bull market, this does not in itself imply that markets are over-valued. It has been widely thought that artificially low interest rates since the GFC have led to over-investment in equities, implying that a major correction may be inevitable.

And while Davies does not rule out the possibility of a normal bear market if/when interest rates rise and investors start to apply a higher risk premium to equities than they have been doing since the GFC, he argues that actual dividend growth rather than excess available money has driven the majority of the market's gains. His analysis shows that of the 12.5% annual return delivered by US equities in the past decade, 8.3% was underpinned by growing dividends. Given that dividends are almost always paid in real money, using cash that companies have generated from their activities, this implies that real business growth has, so far at least, been good enough to underpin most of the gains in the market.

His analysis implies that less than 1% of the past ten year's returns have been as a result of increased liquidity and monetary easing, and in fact that monetary policy recently may have been too tight . This certainly stacks up with some of the negative views we have read in recent months about the prospects for real economies. If this analysis is correct, it would imply that a correction would follow declining global economic performance, but as we are not in a huge bubble, it would most likely not be a major crash.

Equities comment

The top performing company in the portfolio year to date was Micron Technology, which was up 34%.

Micron is a manufacturer of memory and storage solutions for computers worldwide, and is one of the top three companies in this sector. It provides memory products for the cloud server, enterprise, client, graphics, and networking markets as well as for the smartphone and other mobile-device markets.

The company has strategic collaboration with BMW Group for the use of its devices in self drive cars which are expected to be a big growth area over the next 10 years.

Memory and storage have moved beyond simply holding data to now unlocking its meaning and value. They transform data into insight that people use in many different walks of life. Computing systems are achieving new levels of artificial intelligence by mimicking the connections of human neurons and this kind of processing requires vast amounts of storage and processing power.

Micron is at the cutting edge of these new developments. However, be prepared for a bumpy ride. This sector is notoriously cyclical and given to sharp sell offs, but we are hopeful that have gotten in early enough to be able to ride the wave.

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Model Portfolio

The model portfolio has picked up since the poor ending to last year, and on a 12-month basis is up 4%.
We sold a couple of stocks this last quarter - Teva and CF Industries. We were unimpressed at the slowness of the turnaround in Teva, and in the case of CF Industries – which we still consider to be a good quality company – we think the share price has run too far ahead of the underlying fundamentals.
We expect the markets to stay calm as the Fed now looks unlikely to rock the boat in the leadup to the 2020 election. However, there is still the outside risk of recession which cannot be totally discounted.

Model Portfolio
Initial value $1m **Current Value** $2.22m
Cash 36% **Shares** 64%

Performance		**Bottom Performer Shares (ytd)**		**Top Performer Shares (ytd)**	
6 months	-12%	VIXY	-39%	Micron	+34%
12 months	+4%	CVS	-20%	CNOOC	+22%
since start	+122%	Indivior	-12%	Lowes	+18%

Investment basics - So what exactly is risk?

Risk is generally defined as "The uncertainty that an investment will earn its expected rate of return", or, to put it another way, risk is the possibility that the returns on a asset will vary more widely than expected. There are many sources of risk, but the following are the most common:
(i) Business risk – the risk that a business you invest in, either directly or through it's shares or bonds, does not achieve its expected results and returns are then lower than expected.
(ii) Financial risk – the risk that, because of the way a business is financed, it may not be able to meet its obligations leading to lower than expected returns to stock or bondholders.
(iii) Liquidity risk – the risk that the asset may not be readily convertible to cash. This risk applies more to hard assets, such as real estate, artworks etc. than to financial assets, although certain kinds of financial assets, such as shares in small companies, can also carry high liquidity risk.
(iv) Exchange rate risk – the uncertainty of the return earned by an investor holding assets in a currency other than his home currency. This is particularly relevant to investors from a small country such as New Zealand who need to invest overseas in order to gain exposure to a wider range of quality assets.
(v) Country risk – the uncertainty caused by the possibility of adverse political events in a country. Developed countries such as the US have lower political risk than emerging or unstable ones.
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