NEWSLETTER

July 2018 Vol 12: Issue 3

Strongbox
tailored wealth management

What should you be doing?

Every now and again we all find ourselves exclaiming, in response to some revelation that has emerged in somebody's PhD thesis "You seriously needed to do a PhD thesis to work that out? My grandmother could have told you that!"

In that vein, but possibly of great practical use, are the conclusions of a study just published by a London-based body called The Fixed Income, Currency and Commodities ("FICC") Markets Standards Board ("FMSB").

Ridiculously long-winded name notwithstanding, this body has carried out some very interesting research into "the behavioural patterns in 390 cases of misconduct in financial markets over an extended period of time (225 years stretching back to 1792) and covering 26 countries and multiple asset classes" - including false rumours of Napoleon's death being used to play the London gilts market.

And – surprise, surprise – they have found out that there are no new tricks, just new ways of applying the same old tricks. Their work has led to four key thematic conclusions:

1. There are a limited number of behavioural patterns – the materials show 25 behavioural patterns (in 7 broad categories) evident in market misconduct cases, which repeat and recur over time.

2. The same behavioural patterns occur across different jurisdictions and countries –these behavioural patterns do not respect national or jurisdictional boundaries but are evident internationally.

3. The same behavioural patterns also occur across different asset classes –these behavioural patterns are not specific to particular asset classes. The same patterns are evident in different asset classes.

4. The behaviours adapt to new technologies and market structures –technology is not new – it has been a feature for markets for years and these same behaviours have adapted to new technologies and new forms of communication.

So – human nature does not change! My grandmother could have told you that...but this could actually be very useful research. While the conclusions are intuitive, empirical research pinpointing a limited number of damaging behaviours could be very useful to regulators. Instead of trying to legislate in microscopic detail for every possible eventuality, there are only seven behaviour types that need to be regulated and controlled. With a bit of luck, that might make market regulation at once simpler and more effective, and that has got to be good for investors in the long run.

Equities comment

The top performing company in the model portfolio year to date was Noble. It is a leading offshore drilling contractor for the oil and gas industry. The Company owns and operates one of the most modern, versatile and technically advanced fleets in the offshore drilling industry. It performs, through its subsidiaries, contract drilling services with a fleet of 27 offshore drilling units, consisting of 14 drill ships and semi-submersibles and 13 jack-ups, focused largely on ultra-deepwater and high-specification jack-up drilling opportunities in both established and emerging regions worldwide. Noble is probably the most financially robust company in this sector. Unfortunately for us, we first bought Noble when oil prices were much higher and the share price was around US$31 and soon afterwards oil prices halved! The share price now is around US$6, up 29% since the start of the year. We still expect to make our money back and more.

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The model portfolio reached another all time high at the end of the June quarter.
Before the quarter ended, we sold our long term position in Monadelphous, the Australian mining services company, realising a return of 66% on that holding.
After the close of the quarter we bought four new stocks. Our view is that while the market is fairly valued, the global economy seems to have a good tailwind behind it at the moment, although the developing tariff disputes may change this. Also, there seems to be a shift in sentiment away from the largest defensive companies to relatively smaller ones.
We have found four of these which we feel are undervalued. We think the continuing strength in the market will result in a good return on these companies and we are happy to hold them for the longer term. These companies are United Rentals (URI), Micron Technology (MU), Centene (CNC) and Lowe's (LOW).

Model Portfolio
Initial value $1m **Current Value** $2.27m
Cash 42% **Shares** 58%

Performance		**Bottom Performer Shares (ytd)**		**Top Performer Shares (ytd)**	
6 months	-2%	Alaska Air	-22%	Noble	+29%
12 months	-4%	Monadelphous	-15%	Vixy	+24%
since start	+114%	Qualcomm	-14%	TEVA	+22%

Investment basics – the risk free rate of return

Last issue we talked about that fact that investment is what you do with your savings to make them increase in value. We then went on to say that one of the reasons you need your savings to increase in value is because you are deferring until a future date consumption that you could afford today, and you need to be rewarded for this. If there was no reward for saving, people would simply accumulate enough cash or gold to protect themselves from a rainy day, hide it under the mattress, and that would be that. Not a very good basis for modern capitalism, which relies on savings to fund economic activity! The rate of return a saver requires for deferring consumption is known as the "pure time value" of money. But of course if you want to be paid, say, 5%/year just for deferring your consumption, you want your $105 to have the same purchasing power as it would have today – i.e. you also need to be compensated for any loss of value due to inflation. If inflation is also 5%, your total return for the year needs to be 10%. These two elements of your return combined are known as the "risk free rate of return", ie what you require before you even consider taking any risk other than deferred consumption. . The interest rate paid by instruments such as Government bonds is generally taken as the risk free rate because Governments (generally) do not default. Next time, we will move on to talking about risk – i.e. the further return required when we commit our savings to an investment with an uncertain outcome.

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