NEWSLETTER
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Strongbox
tailored wealth management

What should you be doing?

In our most recent newsletters we have written about the interesting political times we find ourselves living in, but we are not going to dwell any further on that for now!

We are also living – for better or worse – in interesting economic and investment times. The changes in monetary policy and the ultra-low interest rate environment ushered in by the the GFC are still impacting on global markets in ways that result in the usual rules of investment and asset allocation breaking down. For example, it used to be that equities and bond markets countered each other's performance, but with pretty much zero interest rates, there is nowhere left for bonds to go but down, while equity markets are also holding up well. This is a development that The Economist attributes to Central Banks interventions in the bond markets, but whatever the real reason, the result is an environment that makes investment planning and asset allocation much more difficult for investors and asset managers.

And this is far from being the only unforeseen consequence of the low interest rate environment in which we find ourselves. From banks struggling to maintain margins in an environment where borrowing is so cheap for clients – Deutsche Bank has been trying to blame the ECB for its current troubles (a strategy that does not seem to be working well for them!) – to the inevitable impact on both private and public pension schemes in most developed countries, this environment poses challenges for every investor and future pensioner – as we discuss on the following page, everybody now needs to save a lot more money for their retirement.

Equities comment

The top performing equities in the model portfolio year in the six months to end September were Paragon (up 590%); S32 (up 125%); Indivior (up 63%) and Weir Group (up 57%).

The first three of these four were spin-offs from various companies and while all but Paragon are likely to survive in the long term, they are all too small to make any difference to the portfolio.

So, this month we will focus on Weir which has returned us 57% in a very short period of time. Weir designs and manufactures highly-engineered products and services for the minerals, oil & gas, and power industries.

Weir's expertise allows natural resources to be processed on the world's mine sites. It helps release oil and gas from some of the most challenging operating environments, and their critical components and services assist in providing the safe and effective generation of power across the world. Their products and services can be found in many industries, including water and waste-water, chemicals and fertilisers, agriculture, food and beverage, pharmaceuticals, pulp & paper and steel & marine engineering. They are probably most famous for their high quality pumps.

The company employs around 14,000 people operating in more than 70 countries, serving markets that management sees as having good long-term prospects. However, despite offering fundamentally good long term growth prospects, many of these markets follow the ups and downs of the economic cycle. This can lead to quite a volatile share price, and we bought when sentiment was very low, but value was high – exactly as we like to do!

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Model Portfolio

The model portfolio continues to do well – it was up 5.8% in the quarter to end September – but like the rest of the market, it is running out of steam somewhat. We have not hesitated to take profits where we have seen individual stocks becoming overvalued and we expect this trend to continue for some time. However, we will continue to search out stocks where we find special situations of low sentiment and high value.

Just after the end of the quarter we liquidated the bond portfolio to reflect the fact that we no longer offer new clients an active bond management service. We realised $615.6k from the portfolio, giving us a capital gain of 20% since inception in March 2009 as well as a regular annual yield in the 4-7% range. This performance was significantly boosted by the fact that we started the portfolio shortly after the GFC – you would not normally expect a gain of that magnitude in a bond portfolio – but we also did some smart bond-picking.

Model Portfolio

Initial value $1m **Current Value** $1.99m

Cash	22.8%	**Bonds**	31%	**Shares**	46%
Portfolio		**Top Performer Bonds (ytd)**		**Top Performer Shares (ytd)**	
6 months	3%	ANBHA	1%	Paragon	+755%
12 months	8%	GPFLA	0%	S32	+44%
since start	+99%	RSCHA	0%	Weir	+36%

Financial Planning Basics 9

We've calculated that if you wanted to retire on an income of $100k gross AND wanted to keep your capital intact, you would probably need a starting capital of around $4.1m (apart from the value of your house/car/boats etc.) But what difference would it make if you were willing to spend your capital? Well, of course first you have to make some guesstimate of how many years you have left. Let's say, for the sake of argument, that you expect to live to be 83 – that's the life expectancy for a Kiwi woman born today, so may be a little optimistic for many of us, but it should be in the right ball park. So if you want to retire at 60, take a gross income of $100k/year for twenty three years, and are happy to have little or no capital left when you die, you could start with as little capital as about $1.5m, assuming that you could manage to make a real net return across the portfolio of 3.5% annually. If you think that $100k/year is too modest, and you want, say, 150k/year so you can go to Europe every Summer, then you would probably need about $2.3m to start with.

In practice of course there are many variables to be managed, and this is an ongoing process, but the point of these examples is to underline the difference arising from different decisions about use of capital. If you are willing to spend it, you can retire on a lot less – and given the current low interest rate environment, we may all need to reconcile ourselves to either saving significantly more or leaving a lot less behind when we go!

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