HOLM TRUTHS

Down to earth advice for savers and investors from independent investment commentator Mary Holm

WINTER 2006

Stay Away

New Zealanders' increasing tendency to travel overseas is a wonderful development. We enjoy it, we learn tolerance and we pick up ideas – ranging from what to eat to how to make a living.

The trend has made us all more aware of the changing value of the Kiwi dollar. When it rises, we perhaps take a longer or more expensive trip. But when it falls, we don't all stay home. Some of us modify our travel plans; others carry on regardless, maybe spending less on other items.

Over the years, too, we've become more likely to own international shares – directly or by investing in a world share fund or a managed fund that includes international shares.

The government has recently proposed changes that in many cases would increase taxes on share investments beyond Australia.

Many New Zealanders have responded by saying they will withdraw from international shares. Some plan to switch to Australian listed shares, which will be taxed much the same as NZ shares (but without dividend imputation). Others say they will bring their money home, investing in local shares, property or elsewhere.

But bringing your investments back to Australasia may not be a good idea, for two reasons:

ALL OVER THE PLACE

The relative volatility of New Zealand's share market becomes clear when you compare its performance with the markets in Australia, Canada, France, Germany, Italy, Japan, the UK and the US, since 1974.

- *New Zealand is the only country to switch in one year from best performer, in 1986 (111%), to worst, in 1987 (minus 44%). The crash hit us hardest.*
- *New Zealand is one of only four countries to switch from worst to best in a single year. In our case, the switch was from 2000 (minus 21%) to 2001 (16%).*
- *Our highest two returns – 129% in 1983 and 111% in 1986 – were the second and third highest of any country in the period. (Top was the UK's 151% in 1975.).*
- *Our 1987 return was the lowest of any country in the period.*

• There has been huge opposition to the proposed changes. At least wait to see if they are modified before the tax bill becomes law, probably later this year.

• Even if the bill is passed unchanged, providers are likely to set up vehicles through which you can continue to invest in international shares reasonably tax efficiently.

There are some strong reasons for keeping some of your long-term savings offshore – or, indeed, to make such investments if you don't already have them. They are:

Broader spread

One attraction of investing in international shares is diversification. If you invest in many different economies, when some are performing badly there's a good chance others will be growing.

You also broaden your exposure to different industries. Compared to world shares, the NZ share market is extremely top heavy in telecommunications and utilities, and grossly under-represented in information technology and energy.

Australia, meanwhile, is extremely top heavy in materials and very heavy in financials, and is grossly under-represented in information technology, and low in health care.

Putting half your share money in Australia and half in New Zealand will, of course, broaden your industry base. But you would still be over-weight in materials and telecommunications, and under-weight in energy and health care. And you would remain extremely underweight in information technology.

(CONTINUED PAGE 2)

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(STAY AWAY, CONTINUED)

Lower volatility

If you concentrate only on the last decade or so, the world share market has been more volatile than the NZ and Australian markets. World shares boomed in the late 1990s and crashed early this decade, while Australasian shares held to a pretty steady upward path.

But when we look at the mid 1980s to mid 1990s, New Zealand and, to a lesser extent, Australia were the boom and bust markets. The two Downunder markets experienced considerably higher volatility then than the world market has at any time in the last 30 years. (See graphs)

Looking at the maths over the 30 years as a whole, the NZ market is somewhat more volatile than the world market, while Australia is similar to the world market.

Another way to look at it: In the last 30 years Australasian markets were much more likely to record quarterly losses than the world market. In 33% of the quarters the NZ market fell and in 30% the Aussie market fell, compared with 21% for the world market. This in part reflects global market diversification.

Dominant companies

The NZ share market is heavily dominated by a few companies. That's fine when the dominant companies perform well, but not when they don't.

Telecom currently makes up 19% of our market, followed by Contact Energy and Fletcher Building, both at about 9%. Together, our top ten companies account for 65% of the market.

Australia is only somewhat better. BHP Billiton makes up 11% of that market, and the top ten companies account for 44%.

By contrast, the biggest company on the world market is Exxon Mobil, making up just 1.6% of the MSCI global index, followed by General Electric at 1.5%. The top ten companies account for only 10% of the market.

The world market is much less dependent on the performance of one or a few companies.

Returns

Over the past 30 years, the average annual return on the NZ share market, before tax and including dividends, was 15% – just above Australia's 14.6%.

And the winner is...

...New Zealand at the moment. If you invested $100 in the New Zealand sharemarket* in March 1976, and reinvested dividends, you would have about $6,600 in March this year. In Australia, you would have $5,900 and in international shares $4,500.

But much depends on the period. If we were looking in September 2000, the $100 would have grown to $3,200 in New Zealand, $3,100 in Australia and almost twice as much, $6,100 – in international shares.

The log scale graph makes it easier to compare volatility in different periods.

For example: in the top graph, the global share boom and bust of the late 1990s and early this decade looks much more dramatic than the NZ boom and bust of the 1980s. But that's just because it starts from a bigger base. In fact, as the log scale graph shows, the NZ boom and bust was more extreme.

(* We assume you invest in an index fund or a similar broadly diversified portfolio.)

The world performance was a little weaker, at 13.5%.

Just as with volatility, though, the relative performances vary depending on the period. From 1976 to 1991, for instance, the world market outperformed New Zealand and Australia, and it did so strongly again in the late 1990s.

Looking ahead, the world market is probably just as likely to beat Australasia as the reverse.

Offsetting

Predictably, the NZ and Aussie markets often move more closely together than the NZ and world markets.

If you have some money in NZ shares and some in world shares, it's much more likely that a bad performance in one market will be offset by a good performance in the other than if you have some in New Zealand and some in Australia.

Over the last 30 years, in 36% of the quarters world and NZ shares moved in opposite directions. This happened only 19% of the time with Australian and NZ shares. *(SEE "YES BUT..." ON PAGE 4)*

Footnote: While it's possible to make international share investments hedged to the NZ dollar, most people don't. So the data in this issue assume your investments are unhedged.

> ***"My wheels are running. My investments are local, regional and international."***
>
> Prince Alwaleed Bin Talal Alsaud, the world's fifth richest man.

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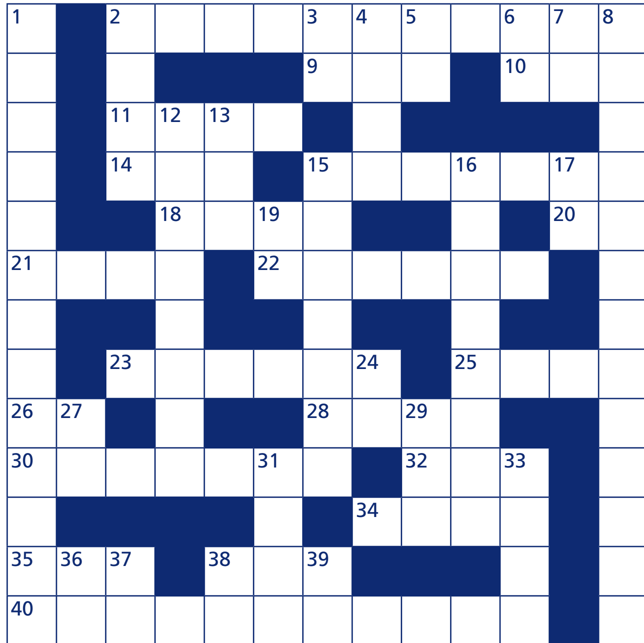
HOLM TRUTHS CROSSWORD

WINTER 2006



Solution: Back page

ACROSS

2. Go on, mind cup! (anagram) (11)
9. Finish (3)
10. Not against (3)
11. Exclamation (4)
14. Girl's name (3)
15. (and 16 down) Overseas money (7,8)
18. Repetition of sound (4)
20. Too many drugs (initials) (2)
21. Close (4)
22. Ornament with pin (6)
23. To do with veins (6)
25. Italian white wine (4)
26. Kipling poem (2)
28. Midday (4)
30. External (7)
32. To grow old (3)
34. Region (4)
35. One or some (3)
38. Use sparingly (3)
40. Deputies (11)

DOWN

1. Of many countries (13)
2. Wire or barred prison (4)
3. Youthful travels (initials) (2)
4. Annul, cancel (4)
5. US state (initials) (2)
6. Same as 26 across (2)
7. Not yes (2)
8. Offspring's offspring (13)
12. Save Rose (anagram) (8)
13. Bag in animal or plant (3)
15. Great riches (7)
16. See 15 across
17. Move, proceed (2)
19. Written on pencils (initials) (2)
24. Very (2)
27. Kung _ _ (2)
29. Paddle (3)
31. Ditch (4)
33. We hear with them (4)
36. NZ's most populous island (initials) (2)
37. You or The (archaic) (2)
38. Visitor from space (initials) (2)
39. Printer's measure (2)

Dear Mary:

I like the old idea of investing $1,000 a year for the first 20 years of a child's life and then seeing the result of compound interest when they are 65.

Nowadays you should probably invest $2,000 a year.

Unfortunately I did not do it for my grandchildren.

Dear Reader:

I like the idea, too – a lot. And I'm sure many of us also wish we had done it for family members – or for that matter that someone had done it for us!

Still, it's never too late. Perhaps you could make the savings for your great grandchildren, or start a plan now for your grandkids, at whatever their ages. Even if the compounding is over 25 years rather than 45, it can still work well.

Let's look at the numbers in our table. You might make a return of 1% after inflation and tax on bank term deposits; 4% in diversified investments; or 6% in a share fund.

- **Long-term saving for children is a great idea.**
- **The return makes a huge difference over long periods.**
- **Children can learn about money as you save for them.**

Because we've subtracted inflation from the returns, the numbers represent the value in today's dollars. In other words, if you invested at 6%, the recipient would end up with a sum that would buy whatever $506,500 buys now. Not bad!

Notice the big effect different returns have, especially over long periods.

After the 20 years of contributions, the 6% total is about 67% more than the 1% total. But after 45 more years, the 6% total is almost 15 times bigger than the 1% total.

Clearly, as long as you have the stomach to cope with the ups and downs of share investments – including losses in some years – you would be best to save in a share fund.

One more thought: When the child is, say, 15, you might want to give her or him some say in where the money is invested. Watching the savings grow could become part of the child's financial education.

P.S. You suggest investing $2,000 a year instead of $1,000. In that case, just double all the numbers in the table.

The 6% investment would grow to more than $1 million in 45 years – although it may not last that long, in the face of education and housing costs in the meantime!

If you can afford only $500 a year, halve the numbers in the table. For $100 a year, divide by ten.

Return after subtracting inflation	$1,000 now + $1,000/year for 19 years	Total if investment is maintained 25 more years	Total if investment is maintained 45 more years
1% a year	$22,000	$28,200	$34,400
4% a year	$29,800	$79,400	$174,100
6% a year	$36,800	$157,900	$506,500

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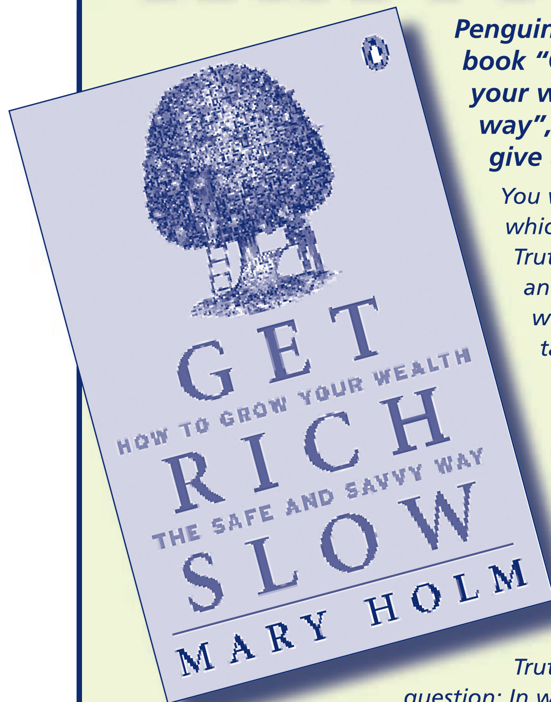
WIN A BOOK



Penguin has just published my new book "Get Rich Slow: How to grow your wealth the safe and savvy way", and I have five copies to give away to Holm Truths readers.

You will recognise much in the book, which is based on articles from Holm Truths. The material has been updated and put together in a cohesive whole, showing the steps you can take towards wealth.

For more information about the book, including the first and last chapters, see my website www.maryholm.com

To go in the draw to win one of the five copies, send me: your name and mailing address; the name of the adviser or company that sends Holm Truths to you; and your answer to the question: In what publication did most of the material in "Get Rich Slow" first appear?

Email your entry to mary@maryholm.com (please put "Holm Truths draw" in the subject line) or mail it to Mary Holm, P.O. Box 8520, Symonds Street, Auckland 1150, by Friday, August 18, 2006.
Winners will be notified directly, and listed in the next Holm Truths.

YES BUT...

Two reasons are often given for not investing in offshore shares:

1. "Dividends are lower and you miss out on dividend imputation."

Overseas companies, especially beyond Australia, do tend to pay out lower dividends than NZ companies.

They're more likely to keep profits to grow their business, which tends to boost the growth in share prices. So what you lose on the swings you gain on the roundabout.

And the lack of dividend imputation, usually on low dividends, doesn't make a great deal of difference to over-all returns.

2. "Foreign exchange movements boost risk."

Actually, they don't. Changes in the dollar's value will sometimes increase volatility but just as often they will reduce it.

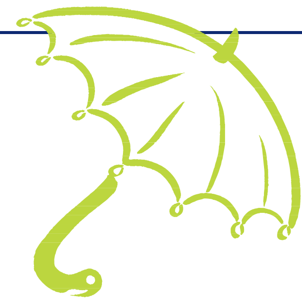
If, for example, international share markets are falling, foreign exchange movements can more than offset that, so that the value of your offshore shares still rises.

Note, too, that having overseas investments hedges you against loss if the Kiwi dollar falls. Foreign travel and imported goods such as cars will cost more, but the value of your investments will rise to help cover that.

Over all, having international investments reduces risk more than it increases risk.

"Before this century is over, the Dow Jones Industrial Average (US stock index) will probably be over one million versus around 10,000 now. So for the long term, the outlook is tremendously bullish if you buy stocks blindly to keep for a century."

Sir John Templeton, creator of some of the world's largest and most successful international investment funds.



Holm Truths Crossword Solution

I		C	O	M	P	O	U	N	D	I	N	G
N		A				E	N	D		F	O	R
T		G	O	S	H		D					A
E		E	V	A		F	O	R	E	I	G	N
R			E	C	H	O			X		O	D
N	E	A	R		B	R	O	O	C	H		C
A			S			T			H			H
T		V	E	N	O	U	S		A	S	T	I
I	F		A			N	O	O	N			L
O	U	T	S	I	D	E		A	G	E		D
N					Y		A	R	E	A		R
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L	I	E	U	T	E	N	A	N	T	S		N

You're welcome to send questions to From the Mailbox. Email them to mary@maryholm.com, or mail them to P.O. Box 8520, Symonds Street, Auckland 1150. Please include your phone number. Unfortunately, Mary can't answer all questions in Holm Truths, and cannot correspond directly with readers.

WRITER AND PUBLISHER

Award-winning journalist Mary Holm writes the *Money* column for the NZ Herald and *The Investor* column in the Waikato Times, Dominion Post, Christchurch Press and other major newspapers. She runs seminars, and is the author of *Get Rich Slow* (Penguin, $29.95, at good bookstores); *Snakes & Ladders – A guide to risk for savers and investors* and *The REAL Story – Saving and investing now that inflation is under control* (both published by the Reserve Bank). Mary holds a BA in economic history, MA in journalism and MBA in finance. Her website is www.maryholm.com

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