

Market Commentary

NO CRYSTAL BALL FOR ASSET CLASSES

NZFUNDS

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Investors risk destroying a lot of their wealth if they choose to stick to just one asset class, with analysis demonstrating that over the past 50 years, almost every asset class has had periods of strong performance and periods of disappointing performance.

New Zealand Funds Management's investment strategist, David Wilson, says since the decade ending 1969, performance of each of the different asset classes of bonds, cash, property and New Zealand and United States shares can wildly swing from being a clear outperformer to a bad investment.

"Quite clearly just as every asset class has its day, it will also have a decade during which it underperforms," Wilson says. "Investing in government bonds or fixed interest for the past two decades has been a worthwhile strategy but it was not during the 60s and 70s, when it was the worst performing asset class. A similar story can be seen for shares when the 60s, 80s and 90s were great decades but, as we are all aware, the last decade was poor."

In the ten years to 1999, United States shares were the highest performing asset class to invest in, giving investors an astounding 18% per annum return. In the following decade to the year 2009, that completely reversed to a return of -1% per annum, making it the worst asset class to invest in during that period.

"After decades of trial and error in the investment industry, two factors remain constant," Wilson says. "Firstly, if you invest in a single asset class you will either create a significant wealth during a bull market, or by sticking with one asset class, you could destroy the wealth you have saved."

This is especially the case when investing your assets in cash, which after tax, can return less than the rate of inflation. The only way to properly preserve wealth is to diversify it.

Wilson says no one knows what will be the best performing asset class over the coming decade. "Recent analysis we have completed suggests that shares are still overvalued, despite the last decade poor performance.

Government bonds also look expensive but may also continue to outperform, as they have in Japan, over the last twenty years, or it may be another asset class such as commodities that is the outperformer. Given this uncertainty, it is imperative investors have investments across several asset classes. Investors only get to throw the dice once in retirement and if you try and pick which asset class will outperform and are wrong, you don't get the chance to make that decision again."

Wilson says investors should have exposure to seven different asset classes – cash, corporate bonds, government bonds, inflation-adjusted bonds, shares, commodities, and currencies. "In all cases, except cash, there should also be a risk management strategy implemented on each asset class.

"By incorporating risk management strategies, you can limit the adverse impact if that asset class underperforms. However, if the asset class performs strongly, then you can still participate in the upside. If you are invested in all seven asset classes, you are in the enviable position of being invested in whichever asset class that will perform strongest over the coming decade. But with a risk management strategy, you will also not necessarily be exposed to poor performing asset classes."

DECADE PERFORMANCE OF EACH ASSET CLASS

Decade	New Zealand Cash		New Zealand Bonds		New Zealand Property		New Zealand Shares		United States Shares		New Zealand Inflation	
	Return pa	Rank	Return pa	Rank	Return pa	Rank	Return pa	Rank	Return pa	Rank	Return pa	Rank
60's	3% ¹	5	5%	3	2%	6	16%	1	8%	2	3%	4
70's	7%	5	7%	4	12%	1	7%	3	6%	6	12%	2
80's	13%	5	14%	4	15%	3	25%	1	17%	2	11%	6
90's	9%	3	10%	2	5%	5	7%	4	18%	1	2%	6
00's	7%	3	7%	2	8%	1	5%	4	-1%	6	3%	5

All returns are stated on a pre-tax and pre-fees basis. ¹ Estimate. Source: Reserve Bank of New Zealand, NZX, Statistics New Zealand, Quotable Value, Robert Shiller, New Zealand Funds Management's estimates.

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