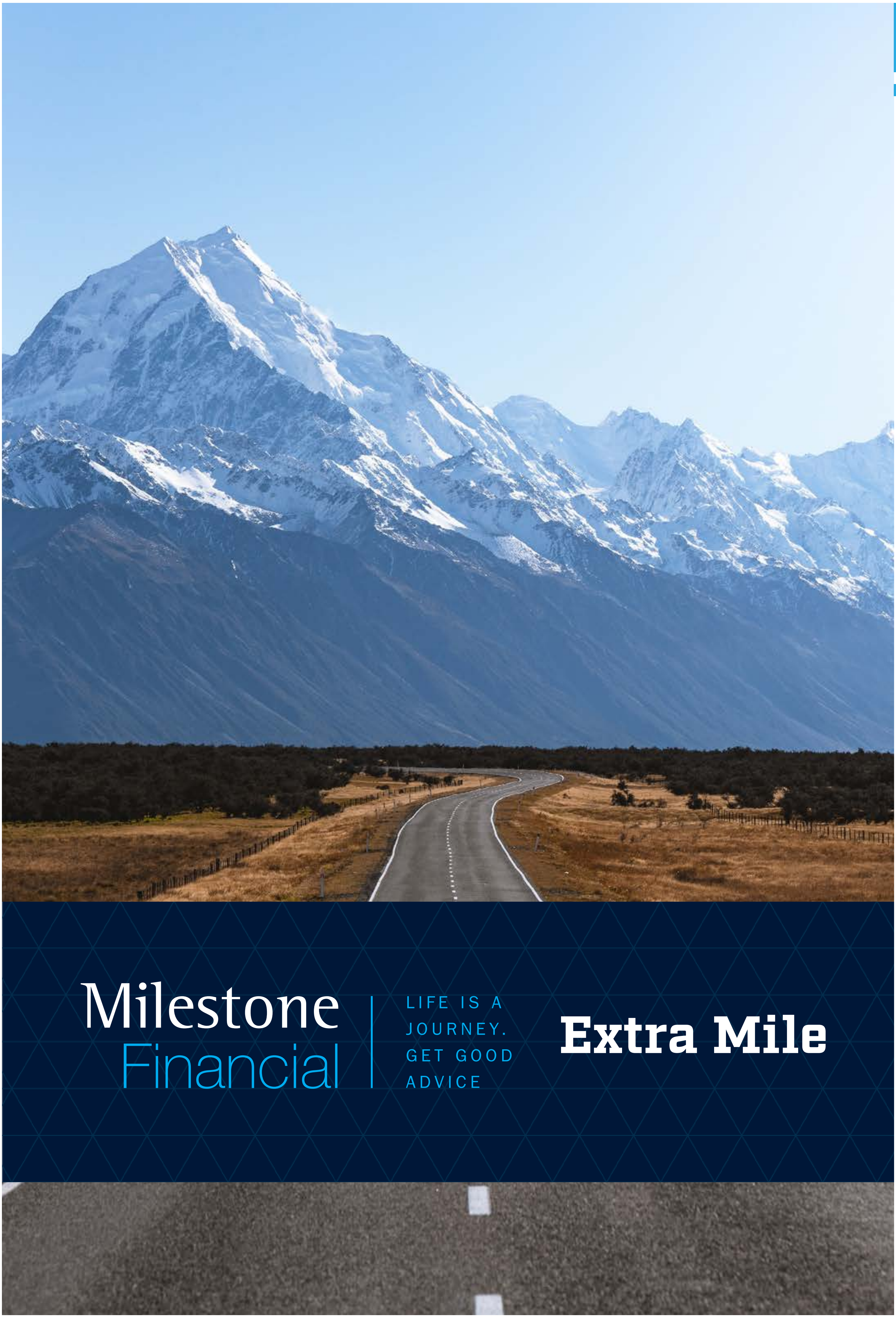
Quarter **2 / 2023**



Milestone
Financial

LIFE IS A
JOURNEY.
GET GOOD
ADVICE

Extra Mile

Insight / Guidance / Dedication

Welcome to the 5th evolution of the Milestone ExtraMile magazine

We have been rethinking what content makes for a decent read and what format makes more sense.

The issue has been to get the mix and level of information and complexity right. The mainstream media and the financial services industry produces such a large amount of information that it can be difficult to distil what is important. So, this is what we have planned for 2023.

Each quarter one of the Milestone Directors will be the guest Editor of the ExtraMile. The styles and theme may vary a bit as a result. I have asked the team to send through any articles they have read in the past quarter that may have relevance to both business and our normal day to day lives. With a small amount of added commentary, we hope to develop a resource you will find useful.

We also added some thought pieces from the investment professionals who help invest your funds, along with the latest in financial terminology, we bring you 'De-worsification'.

There will be an expose on one of the Milestone offices, this time 'Auckland,' along with the normal office chatter.

Hope you enjoy the read.

Editor
Peter Coltman

Contents

Scams

Protecting yourself in a digital world

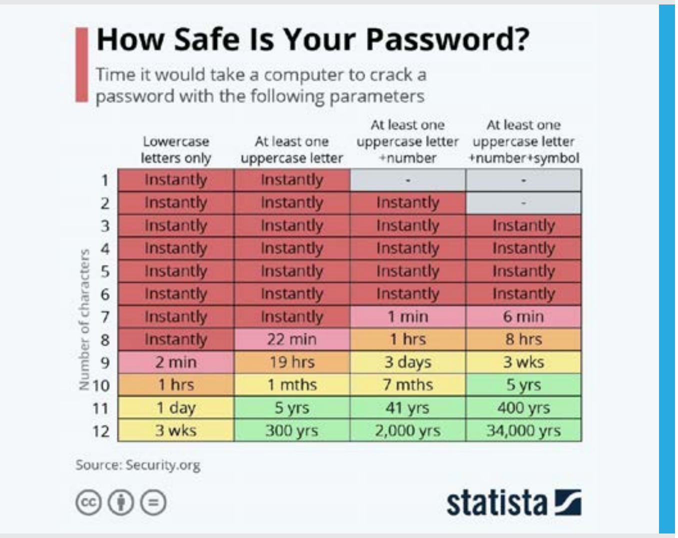
On more than one occasion in the past quarter I have read many articles about the latest scams doing the rounds. We have included an Alert from the FMA around a scam circulating at the moment. The next article is around the importance of protecting your passwords for the various websites that impact our daily lives.

In my digital existence I have 104 password protected websites and applications that I use. Some of these frequently and some not often at all, but without the password they are merely objects of frustration.

Back in the recent past the solution was to have a couple of master passwords that I could easily remember. This worked well until a number of them required changing every other month. We found a work around and the name of our first family pet and the number of our first house did the trick for a while.

But technology moves on, the number of people wanting to steal my passwords increased and they were getting smarter at how they went about their business (and it is a business). The number of characters required in a password increased and you needed to use both upper and lower case, the inclusion of numbers and more recently symbols. This is all designed to stop a computer program from cracking your password.

I am unable to confirm the correctness of the following chart, but it seeks to demonstrate the point above (thanks George Hill for supplying this). (Editor)



How Safe Is Your Password?

Time it would take a computer to crack a password with the following parameters

Number of characters	Lowercase letters only	At least one uppercase letter	At least one uppercase letter +number	At least one uppercase letter +number+symbol
1	Instantly	Instantly	-	-
2	Instantly	Instantly	Instantly	-
3	Instantly	Instantly	Instantly	Instantly
4	Instantly	Instantly	Instantly	Instantly
5	Instantly	Instantly	Instantly	Instantly
6	Instantly	Instantly	Instantly	Instantly
7	Instantly	Instantly	1 min	6 min
8	Instantly	22 min	1 hrs	8 hrs
9	2 min	19 hrs	3 days	3 wks
10	1 hrs	1 mths	7 mths	5 yrs
11	1 day	5 yrs	41 yrs	400 yrs
12	3 wks	300 yrs	2,000 yrs	34,000 yrs

Source: Security.org

When it comes to passwords, bigger is better.

With 104 passwords to remember and 16 characters a piece, that's a lot of RAM (for you IT savvy readers, brain cells for the rest of us) being taken up. How do we cope?

I use a password management system which stores these by category and site name. My master password is stored securely elsewhere and a trusted couple of individuals have authority to access it should I be indisposed. I only need to remember one password as a result, and this gets updated every 45 days.

Compare Fixed Term Deposits (CFTD) – Comparison site harvesting investor details

FMA are concerned that Compare Fixed Term Deposits (CFTD) may be operating a scam.

It operates a website claiming to offer consumers a way to compare all registered and regulated fixed income investments in New Zealand and find the highest rates. This website states that it is "fully insured and asset backed by the provider," however no such scheme is currently offered in New Zealand.

There is also no evidence to support the claim that its "recommended partners" are authorised or regulated by the Financial Markets Authority (FMA). We have seen an increase in the number of investment scam victims reporting that they have put personal details into comparison websites such as CFTD and then been contacted by individuals purporting to be from well-known banking institutions such as Citibank or HSBC.

We believe this website site is a front used to collect personal information from New Zealanders, which then enables the overseas scammers to contact them with fictitious investment opportunities. Some victims have lost hundreds of thousands of dollars to these schemes.

We recommend New Zealanders exercising extreme caution when dealing with this entity and not provide it with any personal information.
Entity name: Compare fixed term deposits
Website:
comparefixedtermdeposits.net/

Scams come in all shapes and sizes.

You have email scams with an offer too good to be true, phone calls from someone purporting to be your bank or telecommunications provider looking to solve a problem, Facebook quizzes that ask questions about first pet names, date of birth, mother's maiden name, your first street address etc. These are all designed to trick you into revealing possible passwords.

Scams are big business and have teams of people trained in client communications and the necessary skills to compromise your computers. Five main scams you need to look out for are:

Phishing Scams - Trick you into clicking on a shady link or coughing up your personal info. Outsmart these scammers by treating every unsolicited email like a mystery to be solved. Double-check sender details, resist the temptation to click on random links, and equip your device with trusty anti-phishing software.

Online Shopping - They set up ghost shops, offer ridiculously low prices, and then vanish faster than your favourite Kiwi dip at a party. Dodge these scams by sticking with well-known retailers, looking for secure website signs (like 'https' and a padlock icon in the website address bar on your browser), reading reviews, and giving the side-eye to deals that seem too good to be true. Because they probably are.

Tech Support Scams - These tech support scammers use fear to swoop in as your 'rescue team', only to ask for unnecessary fees or remote access to your device. Keep cool when this happens, remember to verify before acting, and never give remote access to your device unless you're 100% certain of the service provider's authenticity.

Online Romance - They target those seeking companionship, create false profiles, and then play the long game to earn your trust. Once the bond is formed, they'll ask for money for an 'emergency.' How to guard your heart and wallet? Keep things slow and steady, conduct a little online research of your own about the person, and never, ever send money to someone you haven't met in person, no matter how compelling the sob story.

Lottery Winnings - Scammers often announce that you've hit the jackpot, only to ask for 'processing fees' to claim the prize. Always remember real lotteries or competitions don't ask winners to pay fees or taxes upfront. If it's a lottery you don't recall entering, it's best to keep that victory dance on hold.

Always be cautious of answering calls from an 'Unknown number'. If you don't know who the caller is shortly after answering, our recommendation is to hang up.

Please note, a reputable company will never:

- Request your password.
- Request your credit card details.
- Threaten to disconnect your broadband.
- Tell you that you've already been hacked and offer to fix it.
- Request remote access to your personal computer, laptop or other devices.
- Tell you to turn all other devices and phones in your house off.

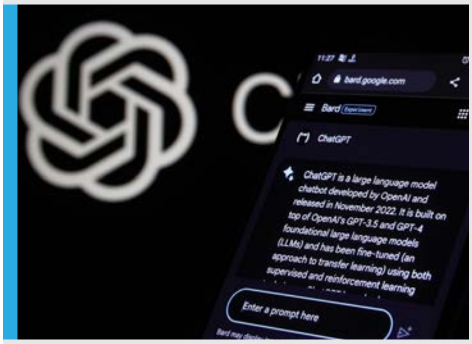
There are a number of websites that provide detail on the latest scams. For a little more information please check some of these out.

https://www.fma.govt.nz/scams/
https://www.cert.govt.nz/individuals/

Talk to a family member or someone you can trust if you think you are being scammed or are receiving calls repeatedly from unknown numbers.

Keeping the scammers at bay is all about staying informed and alert. These tricksters may be cunning, but with your common sense and these handy tips, you're a step ahead. If ever in doubt please contact friends, family or us, and we'll help keep you safe.

AI and how we view it



ChatGPT is a large language model chatbot developed by OpenAI and released in November 2022. It is built on top of OpenAI's GPT-3.5 and GPT-4 foundational large language models (LLMs) and has been fine-tuned (an approach to transfer learning) using both supervised and reinforcement learning

When I was originally given the task to produce this addition of the Ezine I thought 'great' let's jam it all into ChatGPT and get an Artificial Intelligence (AI) bot to write it up and we can pop off down the road for a long lunch. Unfortunately, it's not that simple, but its impact over time will be significant. To work well (and we are still learning) you need to set the parameters for the output you are after correctly. This includes the information, the tone, style, and length of each article. What follows is Chat GPT's opinion of itself as a part of a Financial Advisory Practice. Expansion of a single statement only. - Editor

Question: "ChatGPT as a Valuable Asset in Financial Advisory Practice: A Look at AI-Enhanced Advice"

Imagine operating as a financial adviser, dealing with a diverse range of clients – some of whom possess limited knowledge of investment principles, while others could rival the acumen of Warren Buffett. Enter ChatGPT, OpenAI's advanced language model, ready to augment your practice with its AI capabilities.

There has been a lot in the media recently about how Artificial intelligence will bring upon us the end of the world, Terminator style or will steal everyone's jobs (Thank goodness we're not Hollywood writers!) when in reality, it is just another tool, we can use to enhance the service we already provide.

1. Bridging the Informational Divide

In the realm of financial advice, it can often seem as if advisers and clients are conversing in two different languages. Fortunately, ChatGPT excels in decoding complex financial terminology and converting it into layman's terms, mitigating communication barriers.

2. Attenuating Emotional Bias

Investing can be fraught with emotional biases, which often cloud sound decision-making. ChatGPT is able to offer clear, logical reasoning behind each investment recommendation, thereby helping clients see beyond their emotions and facilitating rational investment choices.

3. Customisation: The Key to Effective Advice

ChatGPT's approach aligns with the belief that no two clients are alike. By analysing clients' prior investments, risk tolerance, and financial objectives, ChatGPT can formulate personalised investment strategies. Moreover, it can engage with clients directly to better understand their individual requirements.

4. The Champion of Research

In a rapidly changing financial landscape, ChatGPT can help maintain awareness of current market trends and company financials, presenting the data in a palatable format. This can significantly simplify the task of staying abreast with the dynamism of the financial world.

5. Portfolio Optimisation

ChatGPT has the capability to analyse portfolios for potential shortcomings and suggest diversification strategies, akin to a personal trainer for your investments.

6. Enhancing Client Communication

ChatGPT can be instrumental in explaining complex financial concepts to clients. It functions as a financial translator, ensuring mutual understanding between you and your clients.

7. A Continuous Learner

ChatGPT embodies the growth mindset, staying up to date with market fluctuations, emergent investment strategies, and technological advancements. This can keep your practice on the cutting edge of financial advising.

It is, however, crucial to note that while ChatGPT is equipped with powerful AI capabilities, it is intended to augment, not replace, human expertise. It functions as a reliable assistant, requiring your guidance for effective operation. OpenAI is committed to ethical principles, transparency, and privacy, thus ensuring a trustworthy environment.

In summary, while human advisors bring an irreplaceable value to the field, integrating ChatGPT into your practice could result in superior outcomes for your clients. The focus remains on employing AI in a responsible and ethical manner, to enhance, not replace, human capabilities.

The uses for AI across our industry are many. The article above highlights a number of potential areas and I don't disagree with any of them. We are starting to use Chat GPT to refine outbound communications. We often fall into using jargon, there is just so much of it. But the take-out from this article is to acknowledge it is here and we are just scratching the surface. The next article indicates the speed of take-up. - Editor

Financial terminology explained ‘De-worsification’

At the recent Berkshire Hathaway Shareholders AGM, 99-year-old Chief Investment Officer – Charlie Munger when being quizzed by 92 year old CEO Warren Buffett about concentrated share exposures had this to say. Thanks, Richard Paynter, for staying alert – Ed.

In early May I was privileged to be part of a contingent of New Zealand financial advisers to attend the Berkshire Hathaway AGM in Omaha, Nebraska. This was truly a bucket list opportunity and a very memorable event. Along with the other 40,000 attendees, I was regaled by the knowledge and wisdom of Warren Buffett and Charlie Munger during the Q&A session. In this session I was introduced to new financial terminology; aptly named by Charlie as de-worsification.

A question was asked around Berkshire Hathaway’s large holding in Apple stock. This was simply batted away by Warren stating that Apple was one of the best businesses that they own and his main criterion for investing is to own good businesses. The size of the holding is not the issue when it is a good business. Charlie then took over the conversation in his humble and direct way, and discussed de-worsification:

> “One of the inane things which is taught in modern university education is that a vast diversification is absolutely mandatory when investing in common stocks. That is an insane idea. It’s not that easy to have a vast plethora of investment opportunities which are easily identified. If you’ve only got three, I’d rather be in my best ideas than my worst.”

Some people can’t tell their best ideas from their worst. In the act of deciding if it’s good, they get to deciding that it is better than it is. I think we [Warren & Charlie] make fewer mistakes on that than other people and that is a blessing to us. We’re not so smart, but we kind of know where the edge of our smartness is. That is a very important part of practical intelligence. And a lot of people who are geniuses on IQ tests think they are a lot smarter than they are; and what they are is dangerous. If you know the edge of your own ability well, you should ignore most of the notions from our experts about what I [Charlie] call de-worsification of portfolios.”

A link to this is found on *https://www.youtube.com/watch?v=UpGIJG02-Mw&t=2s*

So, what is de-worsification? This is when you spread your investments over too many shares/businesses. The result is that you may only end up with an index/market type return, but at a significant fee cost.

The point Charlie is making is that diversification, spreading your risk across different shares, is a good practice as long as you are investing into good businesses and not over diversifying. Most people do not know how to, or have the resources to, identify good businesses, or even know what a good company is. Instead, they use the concept of diversification as an excuse to spread their investment funds across a whole lot of businesses and in doing so hope they will land on some good ones. This is an expensive and wasteful way to get market exposure.

Diversifying across a reasonable number of good businesses, often using carefully selected managed funds, is in my mind a prudent strategy and cannot be considered de-worsification.

Milestone Auckland

Milestone Financial Services (Auckland) Ltd (Milestone Auckland) is an interesting animal. Established in 2011 by Peter Coltman following the purchase of the family business, Coltman Investment Services Ltd, it is one of the original members of Milestone.

Over the 13 years Peter has owned the business many changes have been made. The most notable being the merger with Milestone South Canterbury, which is what makes it such an interesting animal. The principal of Milestone South Canterbury, Nigel Kerr, is retiring over the next couple of years and was looking for somebody to take over his business. Nigel had built his business up from scratch, and it is a nice fit with the Auckland clientele. Peter (and Mary), having already made the move from Auckland to Christchurch, decided that moving to South Canterbury was not such a bad idea. Therefore, Milestone Financial Services Auckland is now based in TImaru.

In addition to Peter, Mary and Nigel, Fiona McGlashan has returned to become an Adviser and lend her inquisitive mind to the development of an array of smart tools. This is an important project that aims to get people into the right KiwiSaver and improve financial literacy.

For those of you who don't know who we all are, let me make some introductions:

Peter's professional journey traversed State Insurance and AIG, amassing invaluable skills and knowledge in risk assessment and pricing. He has undertaken various roles in his career, even travelling as far as Australia before coming back to New Zealand and joining the family business, and eventually, Milestone. When he's not busy helping clients, Peter loves exploring New Zealand's hidden corners, perfecting the 'perfect' Paella, golfing, embarking on learning bowls, and enjoying family time.

Our next team member, Nigel Kerr, is a seasoned veteran of the Timaru business scene. Originally from South Canterbury, Nigel spent time working in Africa before returning to New Zealand and taking the reins at Broad Bank's Timaru branch. He's worn many hats, from director to share broker, and has contributed to various successful ventures before joining us at Milestone. Nigel's wealth of experience allows him to expertly guide a wide range of clients, from local businesses to individuals planning for retirement.

Fiona McGlashan, a proud Timaru local, found her calling in financial services following a personal shake-up after the 2010 Christchurch earthquakes. Starting as Nigel's support person, Fiona spent a decade soaking up everything about the industry, eventually earning her credentials as a Financial Adviser in 2020. Fiona's deep understanding of the industry and her genuine care for clients make her a cherished asset to our team.

Finally, we have the remarkable Mary Coltman, our invaluable support staff member. Mary's dedicated 24-year career in financial services, steadfastly supporting Peter, has been a cornerstone of our office. She ensures the smooth running of our operations and keeps the advisers' professional development on track. Married to Peter, Mary is at her happiest when spending time with their girls and wider family.

For those of the Auckland clients that don't know Timaru:

If you've been following along on TV3 and Stuff recently much has been made of Timaru as being the 'best regional town to live'. This came out in a study in March which compared 11 regions (without a metropolitan centre) based on unemployment,

housing affordability, gross domestic product (GDP) per capita, and sunshine hours.
Founded in the late 1870's Timaru is renowned for its Edwardian history and architecture. You can visit Maori rock art, surf, mountain bike or snowboard – just a few of the bountiful options you could choose in a single day.

Timaru is a port city and on the main train line. It is neatly sandwiched approximately halfway between Christchurch and Dunedin and sits just off the gateway to the McKenzie Country and Lakes.

Mary's favourite view is on leaving work in the afternoon on a clear winter's day. As we wait at the intersection of the Terrace and the Port Loop Road, we look across and can see Caroline Bay in the foreground and through to the snowy covered ranges and alps in the background. It is simply stunning.

The four-minute commute to and from work every day is a huge bonus also. That being said, we are still very much committed to servicing our Auckland clients too. Fortunately the benefits of modern technology mean we are able to do this on a day to day basis and Pete regularly jumps on a flight to Auckland to ensure he keeps in touch with everyone.

We pride ourselves on our commitment to professionalism, ongoing education, and staying up to date with industry trends and best practices. But what truly sets us apart is our genuine care for our clients. We believe in building long-lasting relationships based on trust and transparency. Our goal is to empower you with the knowledge and confidence to make informed decisions about your financial future.

Market Musings & Office Chatter

What Has Been Happening?

It's been another busy quarter with plenty going on in global markets, but most pleasingly, we have seen continued recovery in portfolios. Share markets have been broadly up throughout the quarter, with strong numbers coming out of the USA earnings season and fixed income assets now producing considerably more yield than this time last year.

The big talking point over the last quarter was the possibility of a USA default on its government debt. Since World War II the USA government has had in place a "debt ceiling". This is a self-imposed restriction on how much the government can borrow. During the quarter, the USA was at risk of hitting the "ceiling". Republicans demanded Democrats make a range of spending cuts, before they would agree to suspend the debt ceiling. Ultimately, had this not occurred, it would have led to an unprecedented USA default. This short-term uncertainty did cause elevated volatility in markets. Although avoiding the default is likely to see this volatility subside in the short term, the saga has brought into focus the huge debt levels in America and questions as to its long-term sustainability.

Changes to Trust Tax Rates

Closer to home Grant Robertson recently released the NZ Budget. One thing that has caught some attention is the increase in the Trust tax rate to 39%. The move was designed to capture high income earners utilising trusts for efficient tax structuring. However, New Zealanders have one of the highest per capita rates of Trust usage. The changes will have significant impacts on Kiwis of varying means. How people are impacted will depend on how their trusts are set up and the details of their trust deeds. But it is likely to make the use of Portfolio Investment Entity (PIE) funds even more popular. PIEs have the benefit of a maximum final tax rate of 28% on income (including when held in a trust). Sensible structuring of investments held within a trust will likely avoid paying the higher 39% rate. The new rate will likely come into effect next tax year. We will be contacting all our trust clients before then to discuss the changes. We would encourage Trustees to discuss with their accountant how they will be affected and what options are available to them.

Reduction in OneAnswer Portfolio Service Fees

Effective 1 April 2023 - we are pleased to announce that OneAnswer will no longer charge an administration fee on term deposits held within a OneAnswer Portfolio service account. Clients can access term deposits from ANZ, BNZ, Westpac, SBS, and Heartland Bank from within one account on the OneAnswer Portfolio Service. The rates available are often at a premium to standard retail rates. For clients holding term deposits outside of OneAnswer we would encourage you to speak to your adviser about the benefits of moving them into your investment account. If you have term deposits maturing and would like to compare the rates, we have available, please give us a call.

Annual Tax Reports

OneAnswer /FNZ have now released the annual tax reports. Clients should receive these in the post over the coming days. If you would like an electronic version, they can be accessed directly on the platform (in the document library) or contact us directly. We would encourage all clients to consider lodging a tax return as the administration and monitoring fees are generally fully tax deductible.

Fund Manager Contributions

We are fortunate in the financial sector to be the recipient of screeds of financial opinion pieces. On any given day there are too many to read, but I have selected a few that have passed muster for your information. The Authors of these articles are all fund managers who are likely to manage your money. I thought you might like to know what they are thinking. [Editor]

The musings of David Boyle and planning for Retirement:

I have known David for over 20 years. David became Mr KiwiSaver after having run NZ's largest KiwiSaver Scheme, he then focused on financial literacy at the Commission for Financial Capability before returning to Funds Management with Mint. David has a passion for good retirement outcomes that comes out in his articles – [Editor]

Looking back, when I was a kid my parents got me involved in a large number of activities after school, including tennis, piano lessons, elocution lessons (now called speech and drama), rugby, and last, but by no means least, cubs and scouts.

It's fair to say some of those activities didn't work out too well, but others taught me some great lessons that are still with me today. One of the key messages from my scouting days was "always be prepared" a theme taken from the founder, Lord Bayden-Powell, and which originated more around being attacked by your enemies than thinking about retirement, but it's as good an analogy as I could find for this topic.

Retirement is a funny thing. It seems far off and before you know it it's just around the corner and you are wondering how you got here. Well, as Talking Heads state, it's once in a lifetime (if you are lucky to get there at all) and being prepared for the big R is something we all need to think about, even before you are ready to do so.

Let me explain. For many Kiwis, in the past, a lot of jobs were incredibly physical and there came a time when their bodies, not their minds, were telling them to stop work. So, back in the day, many really didn't have a choice. Both my grandfathers died in their late 60s because they worked in the mines and the coal dust in their lungs eventually got to them.

While there are still a number of physical jobs here in Aotearoa, the majority of Kiwis aren't facing anything much more dangerous than the risk of paper cuts or RSI, neither of which is too life threatening. So, over the past 50 years or so, we are generally living longer, which is a great outcome for many.

We have all seen inspirational stories of people reaching into their 90s and even 100, doing exceptional things, and thinking 'wow how cool is that?'. But most of us will slow down before then – at best we might hope for 20 more summers if we retire at 65, and they might not all be sunny affairs. So, it's a good idea to plan how to make the most of them while we can.

There are a heap of checklists and plans you can follow around how much money you'll need in retirement. But have you thought about what else is important to enjoy the journey, given we are all going to the same destination no matter how rich we are?

Here are five ideas to help you start working on the other stuff:

1. Write down the things that are important for you to do now and what you want to continue doing when you stop paid work. For example, I want to play tennis into my late 70s. So, what do I need to do to achieve that? Well, keep playing for a start, maybe make time to get regular lessons again, and keep as healthy as I can along the way, without sacrificing the treats. Chocolate comes to mind for me here. It might mean I have to walk more (which I hate by the way) but, as they say, if you don't use it you will lose it.

2. How will I still maintain purpose and relevance when I leave my job/career? I have seen many incredibly successful people hit the retirement wall and struggle to get over it. Being out of sight, out of mind is challenging. When you are used to the phone ringing or people coming to you with problems or challenges at work, it can be hard to adjust when you leave. The phone stops ringing, people don't need you and your perceived value goes away.

So, before you get there, think about activities, both paid and unpaid, that you could explore or plan for when you make that decision. It could be sitting on a board or two; it might be getting involved in your local community and using your work and life skills to help others; or it could mean just working fewer days.

3. Write down a list of things you have always wanted to do but never had the time to complete. It could be as simple as driving along in the countryside and stopping off at that small town or village that you never had time to explore, or a big-ticket item like going overseas to see the northern lights in Iceland. It might mean spending more time with family and friends or taking up a new hobby. Don't forget to discuss the list with your partner or family as well. Letting them know helps them plan a little as well.

4. Have a chat with a friend, colleague or family member who has already retired. Ask them how they felt when they made that decision (or in some cases had no control), what were their fears and hopes? What did they wish they had done more of before getting there and their biggest regrets?

5. Enjoy the journey and understand the benefits of decumulation. I know I wasn't going to talk about money but, while it's not everything, (my mum always said to me if you don't have your health, you have nothing) it does provide you with choices. The key is knowing how much you need to be happy. That's like asking someone "How long is a piece of string?" So, sit down and do your own numbers, but take into account National Super, KiwiSaver and other investments, even your home or other assets you might have. Another option might be to downsize your house or live in a different area and release some capital.

The worst thing that could happen to me is I work another seven years, which would mean I would have worked 48 years without a break, only to have an accident or health issue that robbed me of all the experiences I had put off when I thought I would have more time to enjoy them.

I'm not the fittest fellow it has to be said, but I have caught myself recently thinking, while standing in the mosh pit in front of a live band at Auckland's Powerstation, how much longer will I find this enjoyable? Ages I hope, but there will come a time you might find me at the back of a concert, smiling away knowing I did it for as long as I could and not regretting a minute of it.

This article was written by a real person, with real life experiences, and uses storytelling to help make financial wellbeing interesting and, hopefully, create a smile or two along the way.

The side hustle from Grant Pearson:

Many of you may be aware that Grant was formally the General Manager of the Milestone Joint Venture. Among Grant's many talents is making difficult topics interesting. He has provided us with access to the following article from his colleagues at Insync.

Companies that thrive even in recession

Not all companies are negatively impacted during recessions, and some will actually thrive, according to Insync Funds Management (Insync).

"Some firms have such strong tailwinds, and are run by such great teams, with such strong finances, they do well even in recessions and other macro events that punish most others," said Insync CEO, Monik Kotecha.

"The important thing to remember is that stock price progress, even for these companies, isn't linear. However, longer term, the correlation between sustainable earnings growth and stock price is extremely strong."

Mr Kotecha said globally, Nvidia, Adobe, LVMH and Microsoft are great examples.

"Nvidia ramped up their GPU chip prices 10-20% recently without impacting sales and further contributing to their earnings," he said. "Adobe is another. Microsoft also recently raised prices 20% across the board and sales rose too."

He also said that, perhaps surprisingly, luxury goods company LVMH is another company that actually thrives in hard economic times. "It recorded revenue around €56.5 billion in the first nine months, up 28% compared to the same period last year."

Inflation has little impact on the production costs of these companies, he said. "The combination of high resilient margins, great brands, quality products and strong pricing power, delivers superior results even in times like now. They all possess something unique."

Mr Kotecha said their stock prices will reflect the superior position and outcomes of these companies. “It’s important not to try and time when, as this needlessly increases risk,” he said. “Instead, follow the bouncing ball - earnings growth.” Markets have already fully priced-in higher interest rates, according to Insync, thus earnings are now the market’s focus

“Investing in the highest quality stocks benefitting from megatrends delivers strong earnings growth over a full economic cycle. This is because the duration of megatrends is far longer than mere themes and are mostly impervious to events. These particular stocks benefit from the Streaming, Gaming, Enterprise Digitisation, and Premiumisation megatrends.”

Insync has identified 16 global megatrends which are providing tailwinds for growth, irrespective of macroeconomics, that also possess quality stocks within them.

“They are the reason why we remain fully invested despite market swings,” Mr Kotecha said.

Too much gloom, the evidence suggests otherwise

Despite headlines, there’s not enough evidence necessitating a decrease in portfolio exposures to equities.

Whilst things appear gloomy and may deteriorate a little further at the broad market level, that’s about the extent of it. To speculate about bottoms or bounce backs or presume the current situation will be the new normal, means loading up significant risk into portfolios.

Looking beyond the near term, we see things surprising investors and commentators on the upside. Some equity sub-sectors and many companies continue to thrive in turbulent economic conditions. Many firms (not just commodity-related businesses) have seen profits, sales and margins expand despite the prevailing macro factors. When things turn gloomy markets initially treat all stocks the same no matter their situation - until they don’t.

Many of the drivers of today’s pessimism are already shifting. What’s driving this are;

1. Recessions generally last between 12-14 months; markets look forward six months, thus price this in well in advance.

Markets respond negatively when entering times like 2022, only to perform positively once in them. Dips do correct over exuberance in some firms by punishing the financially unhealthy, yet they also temporarily penalise the strong - for a while. Since December quality companies have seen their stock prices flourish.

2. Bounce-backs occur without warning and generally when things look bleakest.

Evidence shows missing turnarounds at their beginning has a significant and permanent impact on portfolio returns longer term. The triggers are virtually impossible to time and they occur when ‘gloom’ peaks. The ensuing underperformance lasts forever unless additional portfolio risk is then added to try and recoup the impact. Almost every bounce back occurs in the opening days and weeks of a sustained rise. In this light, those trying to time when to be in/out of cash and stocks face an insurmountable task of reacting fast enough once one considers the processes behind the scenes in shifting managed funds. An investor may get the odd one right but they are faced with dozens of these over their lifetimes.

Happily, modern history shows us that expansions in businesses easily outnumber retractions, with the size and length of the expansions being far greater. This is at the heart of capitalism.

3. Inflation’s key drivers are mostly falling.

A big inflation driver are fuel prices, and they have already fallen significantly from their highs despite OPEC+ reducing output. Petrol remains high for a bit longer due to price manipulation and decade’s long, massive underinvestment in production by fuel companies. Another often touted negative are ‘logistical bottlenecks’ from COVID-19 and increased online purchasing. These have been easing for many months now. Shipping container pricing has fallen significantly with more to come as the global shipping fleet expands and facilities adapt.

The question is, what will shift inflation up significantly again, for next year’s inflation to remain even as it is now? Wage pressures are not enough to replace oil as a driver.

So, what’s fuelling present market anxieties?

The central banks. During the pandemic, central banks were initially too slow to respond to inflationary pressures and are now having to aggressively play ‘catch-up’ to reduce systemic pressure and bloating. Unemployment will rise as a result but not like it has in the past. The good news is that this too shall pass. A lot of the central banks’ negative views are already factored into bond and equity pricing because markets look forward at least six months. Interest rate rises are creating the desired slowdown in economies.

Whilst this is punishing companies reliant on easy, cheap, external capital, it has little impact on the strong ones riding global megatrends. These do well in spite of macro settings by in large. These businesses have low debt, strong cash flow, resilient margins and can maintain strong sales.

Same, same but different

Now is not the time to err. In times like this, some things are the same and a few things are, importantly, different. In recessions, earnings usually go down, yet markets are forecasting a 4% rise. Should earnings lift (and they are - surprising most), things will flip fast.

An easier way

Not all stocks follow the 'market'. Seeking stocks that do well irrespective of the macro-economic situation at hand is a good place to start as there is little need to try and time when to be in/out of markets. It's known that stock prices follow earnings per share (EPS) over time. Companies that do this and also enjoy the tailwinds of long-run global megatrends actually thrive in recessions as much as when things are fine, yet only a minority of companies globally do this (less than 300).
It is better to be in Quality growth assets now than unnecessarily load up your portfolio with timing risk by trying to gauge when the turn will occur, as up or down, these stocks go well.

Events often deceive investors

Commodity pricing today is not where most think it is. Even grain prices have fallen, along with fuel and most metals. The Russian invasion reminds us to beware of reacting to one-off, event-based dramas, and having experienced a rare 'two in a row' its distorted reality.

- Grain is a problem mostly for the least developed nations;
- Winter in Europe will pass ok like the last one;
- The Russian invasion will end, and;
- When something becomes scarce, risky, or too expensive, it gets replaced by substitutes or demand for it falls. Energy is a prime example, and a permanent decoupling from Russian energy and the acceleration to non-carbon fuel sources is well underway.

Fact versus fiction

Headlines and sentiment surveys rarely reflect reality; indeed, it's usually the reverse. In New Zealand for instance surveys are gloomy; yet our manufacturing output has risen to all-time highs, spending is up, dairy is fine, exports strong, service sectors are thriving, construction robust, tourism is rebounding, transport is going strong, government debt is ok – all despite interest rate hikes and a $2.65/L fuel price.

Property prices and construction activity are more subdued in line with all asset classes not just in NZ but globally as rate rises are producing the desired effect.

Importantly, in the US despite fuel rises and interest rate increases, disposable income has only reduced by -3.6%. This is well short of what's needed to drive harsh recessionary times.

Finally...

It's tempting to time asset allocation moves based on what has already occurred and with media headlines. Holding high amounts of cash is equally a folly. Doing either is means adding large dollops of downside risk.

Whilst inflation is peaking and is actually falling, markets are now trying to anticipate what impact higher interest rates will have on the global economy and corporate earnings. Beware of market-wide assumptions and expect a lumpy ride near term.

History proves that when investors keep focused on the growing earnings power of quality companies, they find that their stock prices follow.

John Lobb is portfolio manager at Insync Funds Management

Avoiding the mother of all default cycles

The following article is from Chris Joye, the CEO of Coolabah Capital, who also has a column in the Australian Financial Review - Ed.

Contrary to popular myth, the smart money is not found in the physical or underlying bond market, which tends to resemble Sleepy Hollow. So-called "active" bond managers are really quasi-index funds, with one or two portfolio managers overseeing thousands of individual bonds that are typically bottom-drawered and rarely turned over.

This is commonly referred to as a "beta" book given it will not furnish any "alpha", or excess returns, attributable to genuine investment skill. In this world, the focus is on yield generation rather than finding mispriced (cheap) bonds that will deliver capital gains on top of yield as they converge back to fair-value.

To drive yield, these passive investors load-up on risk via three beta levers. The first is credit default risk. Buying Credit Suisse hybrids paying 11 per cent seemed like a great idea—until you were completely wiped out. We were short-selling Credit Suisse bonds in 2022 and had a blanket-ban on long exposures in early 2021. The more default risk you take via high-yield bonds, the greater the interest rate you generally receive. A related beta lever is illiquidity. If you start adding-in illiquid loans (aka "private credit") to your portfolio, you will in theory be compensated for the inability to get out of these positions with additional yield. And there is a strong relationship between the risk of default on a bond and its illiquidity.

In the post-2008 period defined by a blind search for yield, it is unclear whether illiquid loans, private credit, and/or high yield bonds have compensated investors properly for the downside risks they are assuming. The looming global default cycle will sort that out!

A final lever is interest rate risk, known as "duration". You often get paid higher interest rates on bonds that fix their yields for longer periods as compensation for the time value of money. The downside is that a fixed-rate bond's price falls as external interest rates rise.

If you bought a 10-year US government bond paying 1 per cent in December 2021, you would have lost more than 20 per cent of your money care of the huge increase in 10-year yields to over 4 per cent by late 2022.

You often hear that the bond guys are smarter than their equity peers. This is categorically incorrect in respect of the physical bond market. It may, however, be true if one is referring to the interest rate derivatives markets.

This domain is dominated by macro hedge funds and bank balance-sheet traders that are actively competing to determine the future path of central bank policy rates. There is huge leverage and capital at stake. And investors will go to enormous lengths to find "edge" or non-priced insights. The problem is that the exchange-traded and transparent interest rate derivative markets are so price efficient it is hard for anyone to consistently win. This is why interest rate traders tend to blow-up after spectacular winning streaks.

Whereas active bond funds are surprisingly passive when it comes to their bond holdings, they will try their hand at punting interest rate derivatives. It is much easier to gamble interest rate futures on the Bank of England's next move rather than trying to assess the merits of 2,000 individual bonds, which requires an army of analysts and portfolio managers.

The reason most bond funds underperform their benchmarks over longer time horizons is precisely because this approach of seeking alpha in the most efficient and heavily contested interest rate markets rarely yields persistent results.

The irony is that the greatest inefficiencies can, in fact, be found in sleepy bond books. On the Monday following UBS's shot-gun marriage to Credit Suisse, its share price slumped an incredible 16 per cent intra-session while the spreads on UBS's ostensibly very safe, A- rated senior-ranking bonds soared by an extraordinary 110 basis points (or 308 basis points over risk-free German government bonds).

The entire world was selling UBS's equities and debt. Yet from our vantage, this was the deal of the century. UBS was buying its number one competitor for a fraction of its worth, a point subsequently highlighted by it recognising a staggering CHF36 billion of gains on the transaction.

And while we had avoided Credit Suisse long exposures for years, there was nothing fundamentally wrong with it: it was just a second-rate investment bank. The travails it experienced in March 2023 were a contrived speculative attack by hedge funds seeking to engineer a high-velocity, digital deposit run, which they did. If the Swiss National Bank had simply clarified that all Credit Suisse deposits were unconditionally government-guaranteed, this assault would never have succeeded. (But that's a tale for another day.)

UBS further secured some CHF150 billion in ultra-cheap loans from the Swiss central bank. Finally, its downside was being limited by a CHF9 billion indemnity against Credit Suisse losses from the Swiss state. If UBS was implicitly government-guaranteed before the deal, it was the singular rolled-gold, too-big-too-fail Swiss national champion after it.

On Monday UBS was imploding, my team of 12 traders and 12 analysts waded into the sluggish physical credit markets to try to hoover-up UBS's senior bonds in what was otherwise a bid-less environment.

There were meant to be more than US$100 billion UBS bonds outstanding. And yet my traders could not find an offer on a day when these securities were being obliterated. Given the nigh-on-unprecedented 110 basis point spread move, I would have thought we could pick-up billions easily. But hours later my traders reported they could only find EUR9 million. It turned out that all of UBS's global banking rivals were, in fact, short selling its bonds in such massive quantities they did not want to offer any more. They realised they were leering over their skis. It took us three sessions to accumulate a US$400 million position. Doing so actually precipitated a short squeeze, as banks swung 180 degrees and tried to buy back the bonds they had sold. Concurrently, UBS's share price started rebounding and actually ended up closing higher on the Monday after a savage initial drawdown.

UBS's credit spreads have since normalised further, bequeathing additional capital gains. Active contrarianism in high-grade bonds with robust liquidity and near-zero default probabilities is a smarter way to extract excess returns than the alternative of loading up on credit and illiquidity risk at a time when we are about to experience the mother-of-all default cycles. It is just hard work doing so.

**Christopher Joye is CIO of Coolabah Capital Investments, a global credit manager overseeing A$7.6 billion in funds.*

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