HOLM TRUTHS

Down to earth advice for New Zealand savers and investors from independent journalist Mary Holm

SPRING 2001

Taking on the World

Imagine you're at a sumptuous feast, with a huge variety of foods. You eat only lettuce, carrots and potatoes.

Or you're in a giant department store, and have money to buy a whole new wardrobe. But you stick to just one brand, even though they offer no jackets or vests and a very limited range of trousers.

Investing only in New Zealand shares – as opposed to shares in other countries – is similar. You severely limit your choice.

This might seem an odd time to be urging people to invest in international shares, or a world share fund.

Even before the terrorist strikes on the US in September, world shares had performed badly for about a year. Since then, market uncertainty has increased.

Some people have responded to this by pulling out of world shares. But that is not wise. If you're a typical New Zealander, you should probably be moving more of your long-term savings into world shares.

Note that I said "long-term." Nobody should be putting money into shares – New Zealand or offshore – if they will need the money in the next few years.

There's too big a chance that, when they take their money out, it will be less than they put in.

But over, say, ten years or more, there's very little chance the value of a diversified share investment will fall. And it's highly likely your money will be worth more than in any other type of investment.

OK, but why not stick with New Zealand shares?

As I said above, you limit your choice. Many industries aren't represented here, and others are over-represented.

Even with an investment in a broad-based NZ share fund, you're not nearly as widely diversified as in world shares.

Also, if you invest in many different economies, there's a good chance that while some share markets are performing badly, others will be booming. *(CONTINUED PAGE 2)*

HOW TO DO IT

Investing in world shares is not as simple as investing locally. There can be complications with dividend payments, taxes and estate issues.

The solution: Invest in a world share fund run in New Zealand. You'll get good diversification, and the taxes and so on will be the same as if you were in a fund holding New Zealand shares.

However, you should expect to receive much smaller dividends. Often, in fact, the dividends will be lower than the annual fees.

That's because offshore companies tend to keep more of their profits for reinvestment in the business. It means their share prices tend to grow faster.

What you lose on the dividend swings, you gain on the capital gains roundabout.

Every dog has its day in the sharemarket

Year ending June 30	Best Country	Return %	Worst Country	Return %
1982	France	31	Canada	-39
1983	Canada	85	Japan	24
1984	New Zealand	63	Canada	-5
1985	Italy	66	Canada	25
1986	Italy	107	Canada	15
1987	Australia	58	Germany	-4
1988	Japan	5	New Zealand	-28
1989	France	36	New Zealand	4
1990	Germany	33	Japan	-9
1991	Australia	11	Italy	-22
1992	France	15	Japan	-30
1993	Italy	35	Germany	-2
1994	Italy	30	US	1
1995	US	27	Japan	-26
1996	Japan	44	Australia	9
1997	Germany	46	Japan	-5
1998	Italy	70	Japan	-17
1999	US	25	Germany	-4
2000	Canada	60	UK	1
2001	Australia	10	Canada	-26

When we look at returns on shares in Australia, Canada, France, Germany, Italy, Japan, NZ, the UK and the US, we find that most countries put in the best performance at some time in the last 20 years, and most also put in the worst performance. If you're not invested in all the major share markets – probably via a worldwide share fund – you could miss out on some brilliant returns.

(TAKING ON THE WORLD, CONTINUED)

As a result, an investment in world shares is likely to be less volatile than one in just New Zealand shares (or, for that matter, NZ and Australian shares).

Less volatility means less risk. And normally, in investment, that means lower expected returns. But that's not the case when you lower your risk by diversifying.

In fact, over the last 30 years, returns have been higher on world shares than on New Zealand shares.

If you invested $10,000 in NZ shares at the end of 1970, and reinvested dividends, it would have been worth $346,000 at the end of 2000.

The same investment in world shares would have been worth almost twice as much, at $671,000.

The superior international performance is largely the result of the 1990's bull market. From 1994 to 2000, the value of world shares more than tripled. Even though they have fallen since, they're still way above mid 90's levels.

Nobody knows when there will be another bull run. But history tells us it will happen. No smart investor should risk missing out on it.

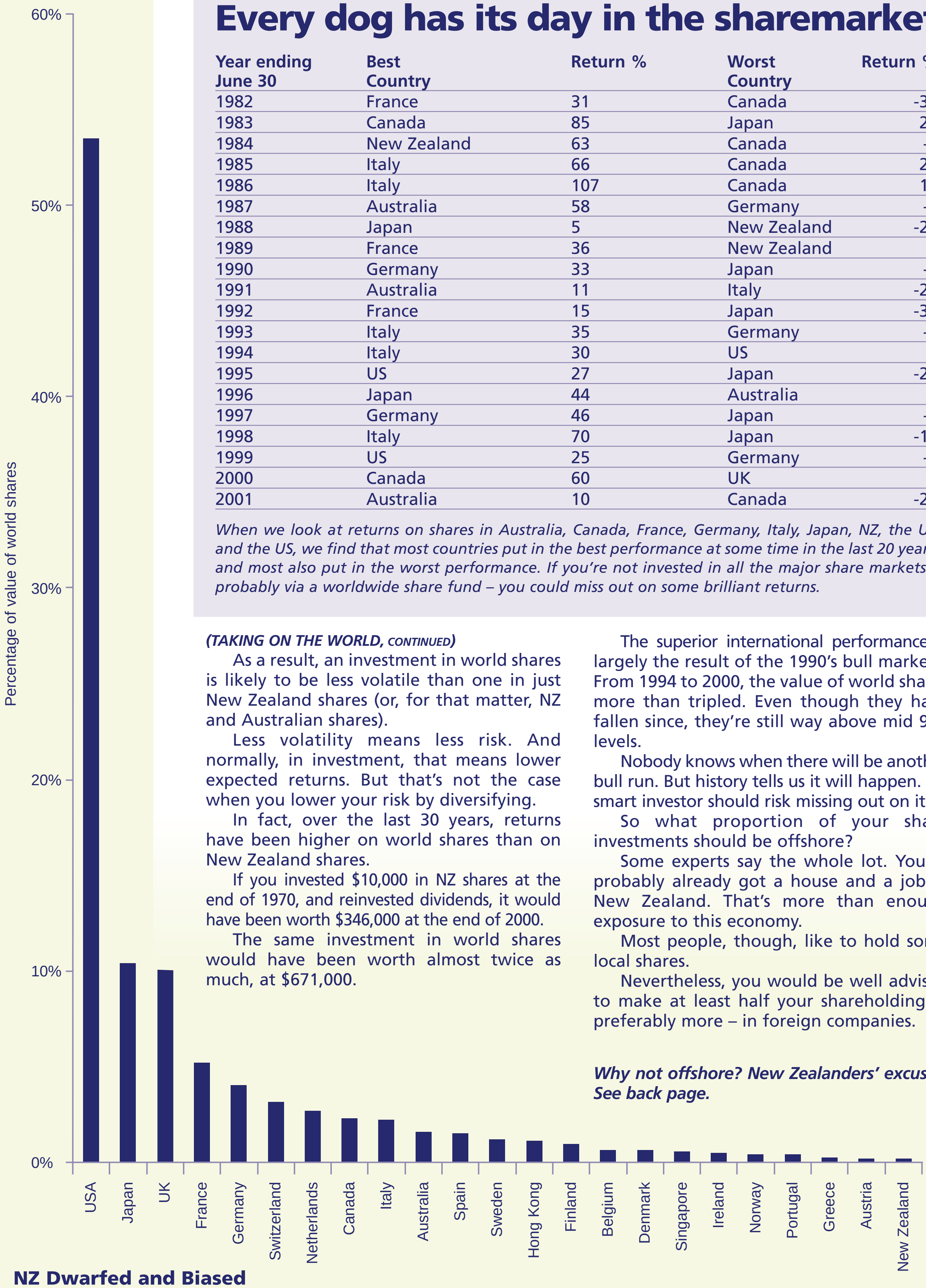
So what proportion of your share investments should be offshore?

Some experts say the whole lot. You've probably already got a house and a job in New Zealand. That's more than enough exposure to this economy.

Most people, though, like to hold some local shares.

Nevertheless, you would be well advised to make at least half your shareholdings – preferably more – in foreign companies.

Why not offshore? New Zealanders' excuses. See back page.

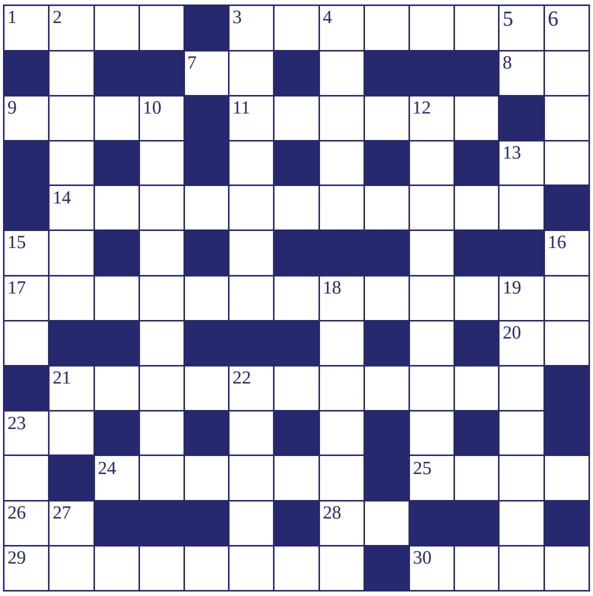


NZ Dwarfed and Biased

The total value of New Zealand shares is tiny compared with that of many countries, particularly the US. What's more, if you stick to NZ shares you narrow the range of industries you can invest in. The healthcare, information technology and utilities industries are virtually unrepresented in the NZSE40 index, but make up nearly 30% of the MSCI world share index. On the other hand, telecommunications and materials companies make up 44% of the NZSE40, but less than 12% of the MSCI.

Fortune favours the brave.

Terence, c. 195 – 159 BC



HOLM TRUTHS CROSSWORD Spring 2001

ACROSS

1. Competent, having skill (4)
3. Party decorations (8)
7. Myself (reverse of 27 across) (2)
8. Exclamation (2)
9. Walk heavily (4)
11. Common savings goal (6)
13. Not down (2)
14. What's in mirrors (11)
15. Great NZ game (initials) (2)
17. Beyond NZ borders (13)
20. Exist (2)
21. Ability to change (11)
23. Very (2)
24. Ramble or wander (6)
25. Alike (oppos. to 10 down) (4)
26. Alternatively (2)
28. Printer's measure (2)
29. Let down, was false to (8)
30. Don't _ _ _ _ shares in crises (4)

DOWN

2. Share boom time (4,3)
3. Betwixt (7)
4. Jumped (5)
5. Not yes (2)
6. Means of 11 across (4)
10. Dissimilar (oppos. to 25 across) (9)
12. Worldwide investment puts you in many _ _ _ _ _ _ _ _ _ (9)
13. Plural of 7 across (2)
15. On headstones (initials) (3)
16. A drink (3)
18. 1n 1994-2000, world shares _ _ _ _ _ _ _ (7)
19. Terrible, dreadful (7)
21. Fee Fi _ _ Fum (2)
22. Mockery, satire (5)
23. Social climber (4)
27. About (2)

Solution: Back page

GREAT DEBATE • GREAT DEBATE • GREAT DEBATE

INVESTING vs REPAYING MORTGAGE

If you've got a mortgage, you probably also have some savings to cover emergencies and to allow financial flexibility.

Is it wise, though, for you to make substantial long-term savings? Would you be better off repaying your mortgage faster than necessary?

Financially, yes. There are counter arguments. But let's look at the numbers first.

Your net worth – which shows your financial wellbeing – is your assets minus your debts. You can improve your net worth equally by adding a $1000 asset or getting rid of a $1000 debt.

If you repay a 7% mortgage, you are reducing debt that costs you 7%. That is equivalent to making an investment that brings in a 7% return, after tax.

Depending on the type of investment and your tax bracket, that's a before-tax return of between 7 and 11.5%.

The only way you can hope to make that sort of return is to take on a risky investment. And the very fact that it's risky means returns might be volatile and you might even lose your money.

Even if the investment goes well, there's a good chance average returns won't top 7%, let alone 11.5%.

What's more, you have to select and monitor your investment, and probably pay some entry and ongoing costs.

By contrast, repaying your mortgage is simple, risk-free, worry-free and usually costless. And you're moving towards getting a mortgage-free home, which gives you security.

There is, however, something to be said for making small contributions to a long-term investment, such as a share fund, while also repaying your mortgage.

You benefit from being "in the market" for perhaps a decade or two.

That gives you a chance to watch long-term trends and to decide how much volatility you can cope with, without having a lot of money at stake.

And it means you've got an investment up and running. When you finish paying off your mortgage, you can simply transfer money that used to go on the mortgage into the share fund. You're also more diversified. If the share market enters a bull run, you're part of the action, even if it's only in a small way.

A good compromise might be to put, say, $50 to $100 a month of your savings into a share fund and the rest into repaying your mortgage.

P.S. If you have credit card, a car loan from a finance company or other debt on which you are paying higher-than-

(CONTINUED PAGE 4)

INVESTING PROS	INVESTING CONS
✓ Get into the habit	✗ Risky investments
✓ Learn long-term trends	✗ More complicated
✓ Diversification.	✗ More costly.

REPAYMENT PROS	REPAYMENT CONS
✓ Risk-free 'investment'	✗ Lack of diversification
✓ Security	✗ Not as educational.
✓ Simplicity.	

> *Wealthy people miss one of life's greatest thrills – paying that last instalment.*
>
> Anonymous

(INVESTING vs REPAYING MORTGAGE, CONTINUED)

mortgage interest rates, you will always be much better off repaying that debt than saving.

P.P.S. If you've got a fixed rate mortgage, there will probably be penalties for fast repayment.

You may want to save in term deposits until the fixed rate period expires, and then transfer those savings to mortgage repayment.

P.P.P.S. How good is repaying your mortgage?

Let's say it's a $100,000, 25-year loan at 7%. If you repaid an extra dollar a day, you would save more than $13,000 in interest over the life of the mortgage. And pay it off two and a half years earlier.

If you repaid an extra $200 a month, you would save more than $51,000 in interest and pay off the loan more than 10 years earlier. That's $51,000 extra for retirement fun!

On the other hand, if you were disciplined enough to invest $200 a month, and lucky enough to earn 7% on it, your after-tax return (in the 33% tax bracket) would be 4.7%.

After 15 years, you would have accumulated $36,000.

Why not offshore?

New Zealanders often raise three objections to investing in offshore shares:

Lack of knowledge

We don't hear as much news about offshore companies as local ones.

But the corporate information in the news media is of little or no help in investing anyway.

That information reaches the big financial institutions first. If anyone can beneficially trade on it, they will.

By the time we hear about it, the price of the shares has already moved.

You may, of course, have access to insider information about a company, but it is illegal to trade on it.

Foreign exchange risk

When you invest offshore, the value of your returns in New Zealand dollars is affected by foreign exchange movements. This can add to volatility.

On the other hand, the added diversification reduces volatility. The two probably cancel out one another.

In any case, it's important to look at how you will eventually spend the money you are investing.

If it's retirement savings, and you are a typical New Zealander, you will have a mortgage-free house by the time you retire.

Quite a large portion of your retirement spending, then, may be on overseas travel, perhaps a car and imported leisure items.

And the prices of all of these items are affected by foreign exchange movements.

If, between now and the time you spend your invested money, the Kiwi dollar rises, the value of your investment won't rise as fast. But the costs of travel, cars and so on will probably fall, so you won't mind too much.

If the Kiwi dollar falls, the value of your investment will probably rise a lot. This will help you to cover the higher costs of travel and cars.

To the extent, then, that you will spend your invested money on foreign items, you lower your risk by investing overseas.

Beyond that, you can always invest in a hedged overseas share fund. The managers set up the fund so that currency risk is reduced or eliminated, and you get the returns from just the shares themselves.

Disloyalty to New Zealand

Some people feel that they are supporting New Zealand by investing in local shares, and are not if they invest overseas.

Generally speaking, though, it makes little difference to a company who its minor shareholders are.

Major shareholders, of course, have influence on how the company is run.

But, while some big foreign shareholders may have harmed NZ companies, others have made important contributions to their efficiency. Input from elsewhere is often helpful.

Still not convinced? Consider this: If you invest in foreign shares, the broader diversification will probably make you better off.

If all New Zealanders do the same, and end up better off, surely that's good for the country.

Holm Truths Crossword Solution

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

WRITER AND PUBLISHER

Award-winning journalist Mary Holm writes the *Money Matters* column for the NZ Herald and *The Investor* column for about 20 newspapers around New Zealand. She is the author of *Investing Made Simple* (Penguin, $24.95, at good bookstores) and *The REAL Story – Saving and investing now that inflation is under control* (which can be downloaded from www.rbnz.govt.nz. Click on publications). Mary holds a BA in economic history, MA in journalism and MBA in finance. She can be reached at P.O. Box 8520, Symonds Street, Auckland, or by email at maryh@pl.net

Design and Production:
Scriven Art Studios Ltd., Auckland