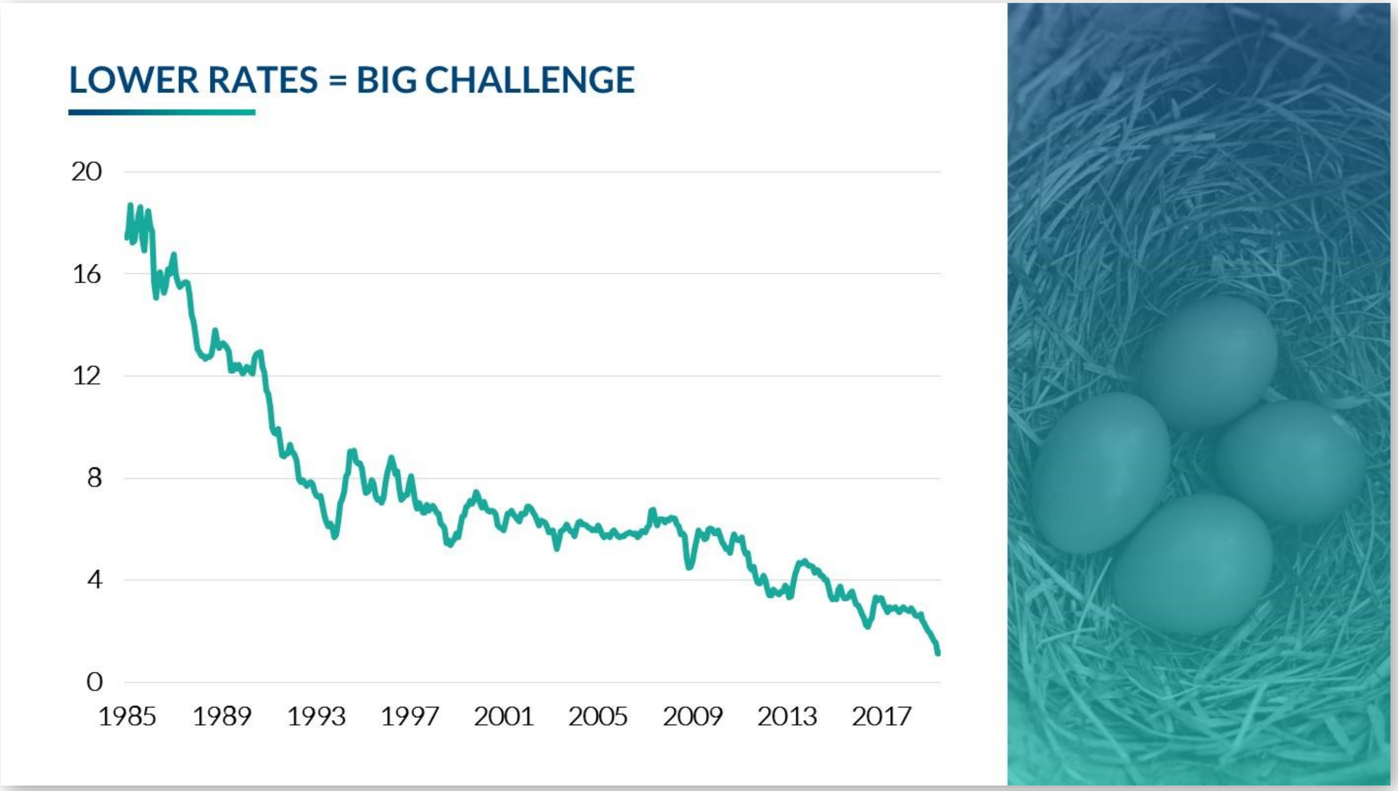
Smart Investor 2019



Interest rates are falling and have been falling for many years now. Low rates present stern challenges for all of us. It makes it harder to save towards our retirement nest egg and harder to live off that nest egg in our retirement.

To meet the challenge of low rates we need to change both how we build wealth for retirement and how we make our money work harder when we are retired.

For many of us we need to adopt a longer-term perspective and become investors not savers.

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ADDRESSING THE CHALLENGE

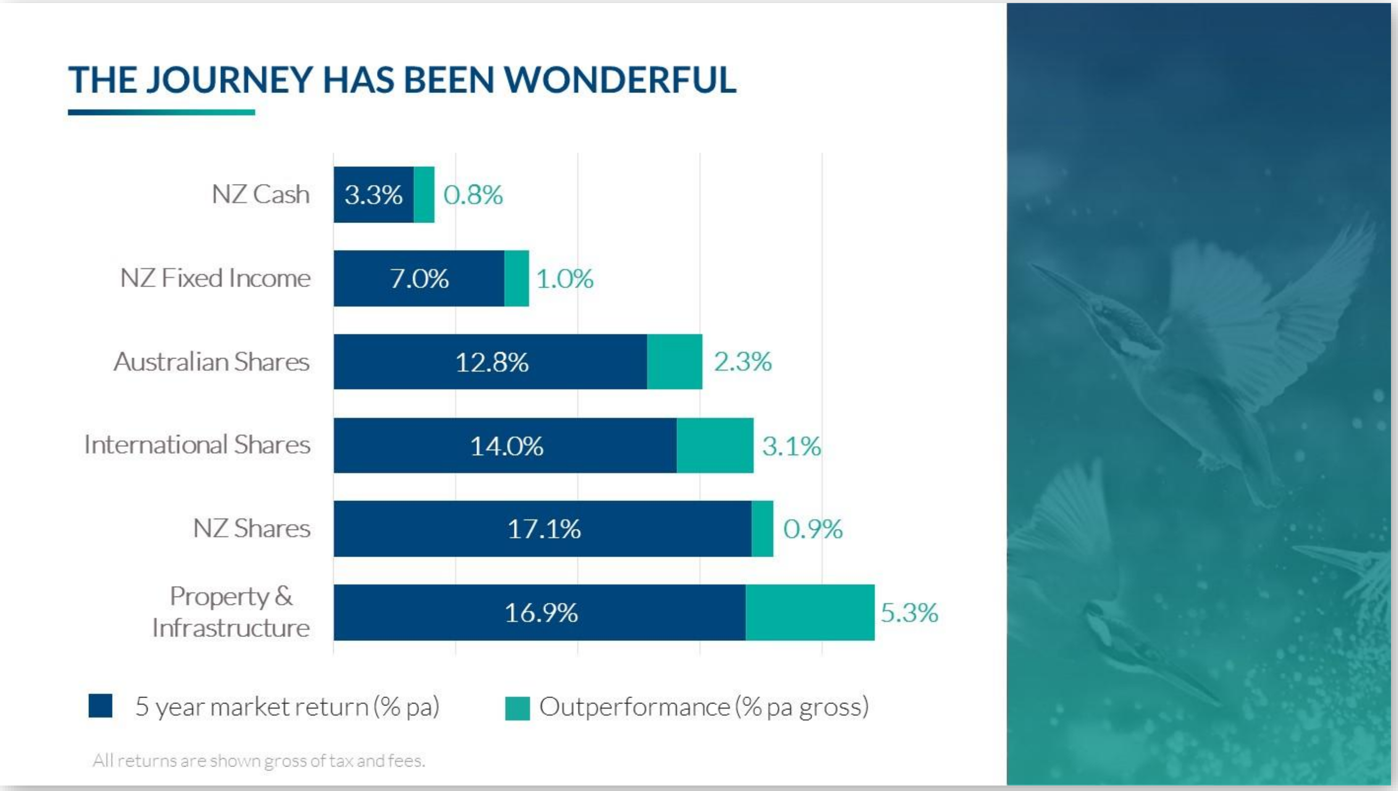
Build a match fit strategy	**Develop an investor's mindset**	**The role of active management**

While the low interest rate environment is making life more challenging, we think there are clear and actionable steps we can make to address this challenge. That is the focus of the roadshow.

Specifically what can we do as your fund manager and what decisions can you make that help adjust to low interest rate environment?

We believe there are three areas investors need to focus on:

By having a match fit investment strategy, the right mindset to live with this strategy through good and bad times and by earning enhanced returns through active management we believe you can meet today's investing challenges.



Before stepping into the future, it is worth looking back at the recent investing past. Markets have been strong and we, as an active manager, have been able to deliver returns in excess of the strong market.

This has meant it has been a wonderful journey for investors getting double digit returns on shares and solid high single digit returns on New Zealand fixed income.

THE DESTINATION LESS SO

Fixed income yields low or negative

Asset prices extended

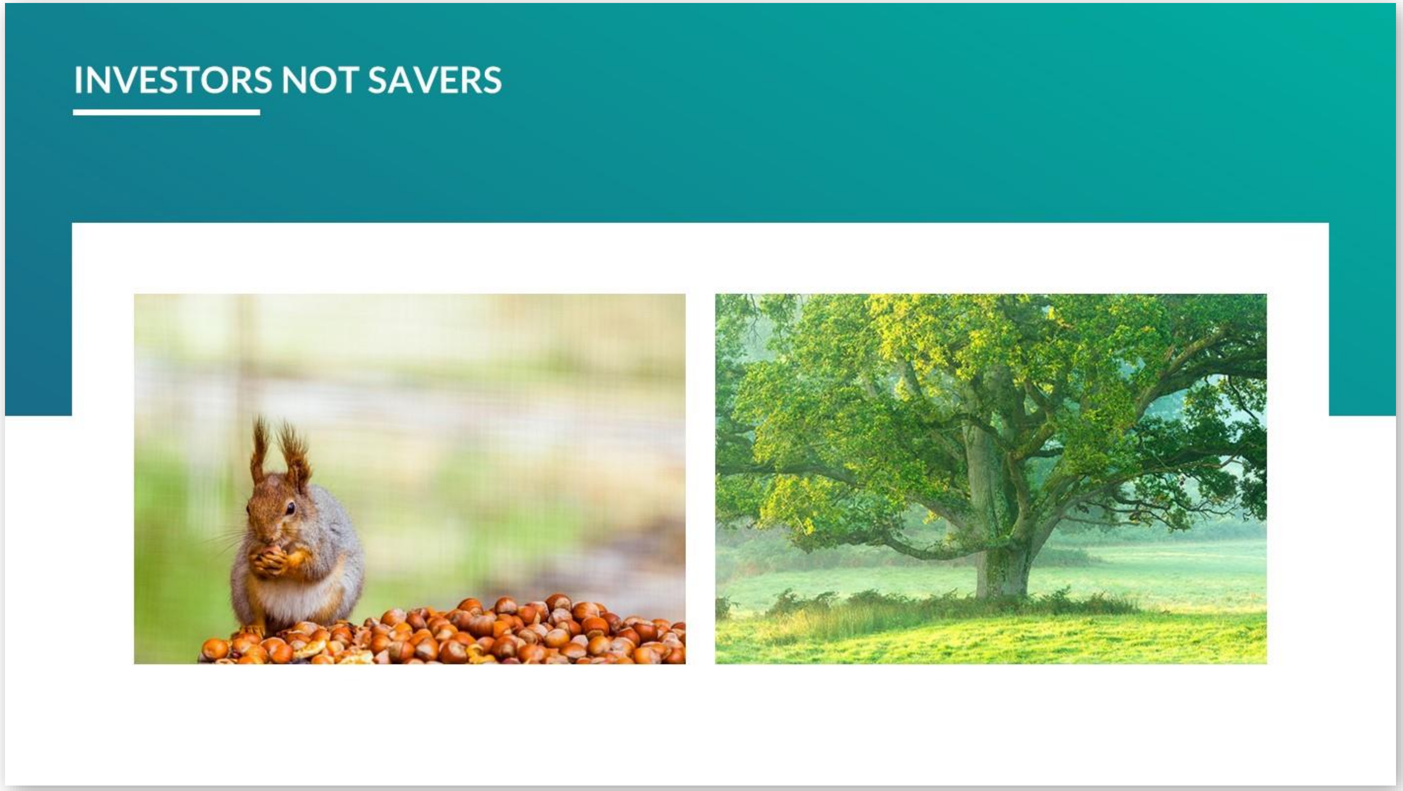
Economic expansion middle aged

Unfortunately while the journey has been wonderful the destination is less so.

Today interest rates are low. In many parts of the World, they are negative. There is something like $15 trillion dollars of government bonds with negative interest rates around the World today. In Denmark, government interest rates have been negative for seven years. This is not a new thing for many people around the World.

At the same time asset prices, the prices for things like shares and property are not exactly cheap. This is typical after a long bull market like the one we have enjoyed since the global financial crisis of 2008. Extended prices mean investors need to be much more selective than they have had to be in the past.

Last, but not least, the economic expansion, like the bull market, is middle-aged. Middle-aged expansions, like those of us who have reached those milestones, can be a little creaky from time to time and we are seeing that right now in the global economy.



If there is one key takeaway from our presentation it is that we all need to be investors not savers.

That means not squirreling our money away in low return funds or accounts – that approach is exactly like sitting on a pile of acorns – it will never grow.

Instead, in our view, we all need to be investors. That means planting an acorn and watching it grow. This comes with some risk. There will be years that will be cold and your tree won’t grow much but over time the good years tend to outnumber the bad years. Your tree, your wealth in this metaphor, will grow.

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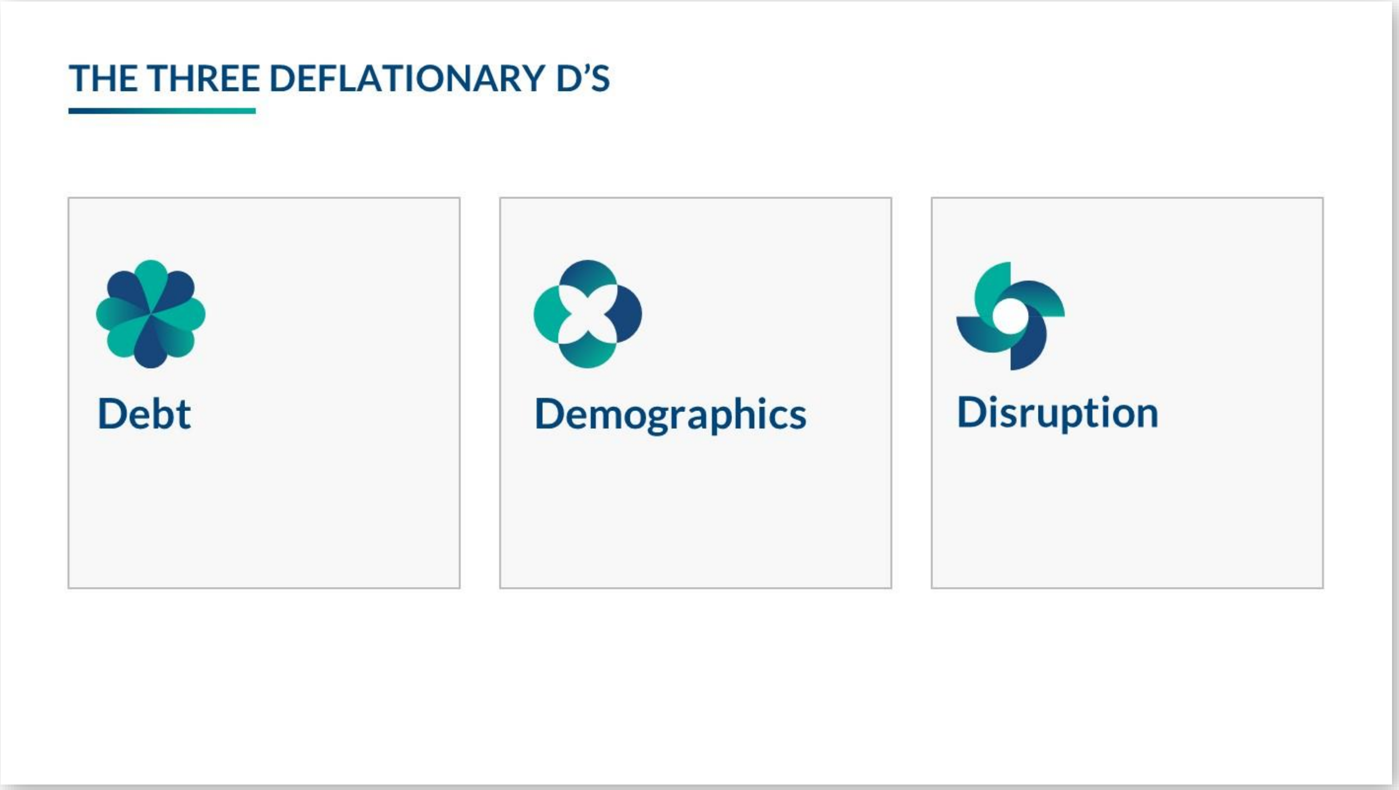
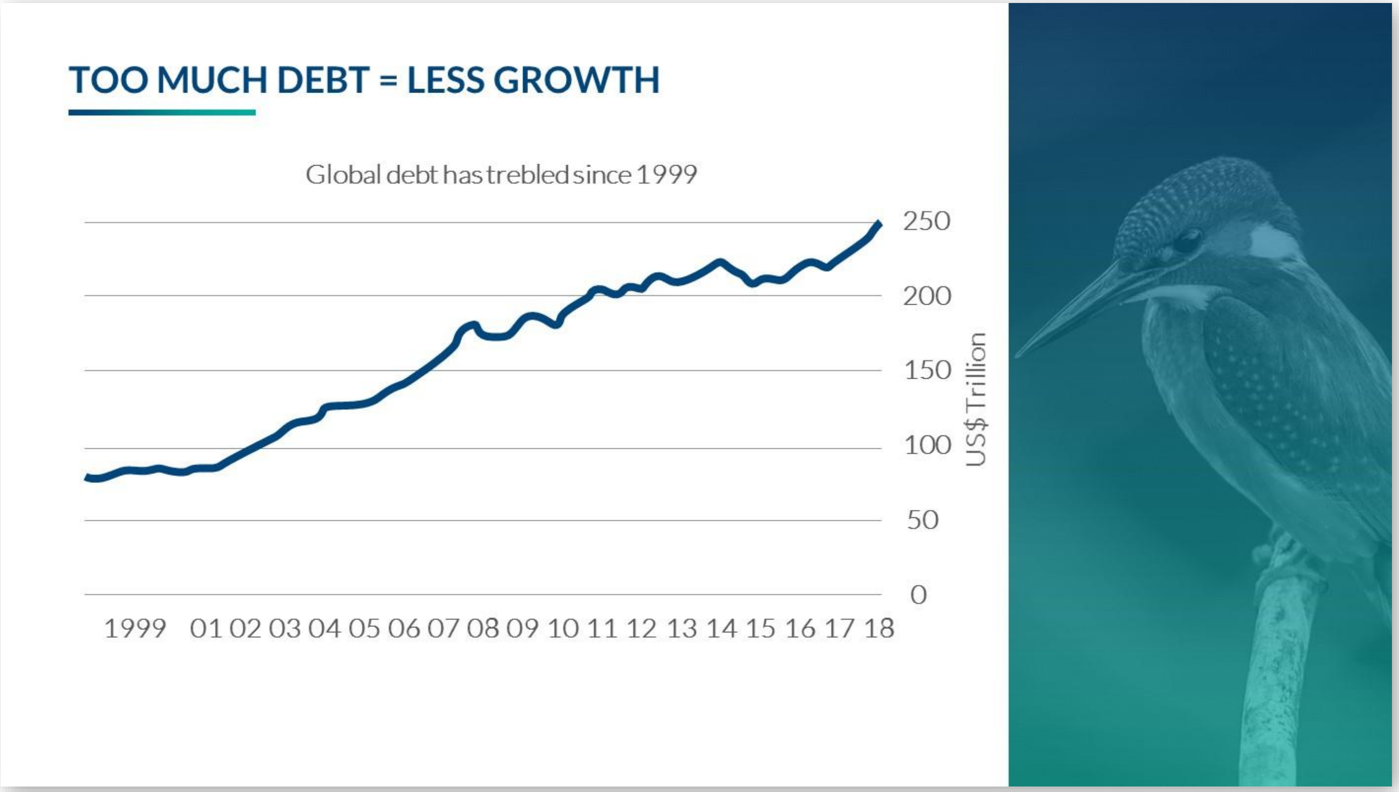
The question of whether interest rates will stay lower for longer is important. If they won’t then we probably don’t need to change how we invest. If they are going to stay low we will need to adjust.

To answer this question we first need to understand what determines the level of interest rates in an economy. That boils down to growth and inflation.



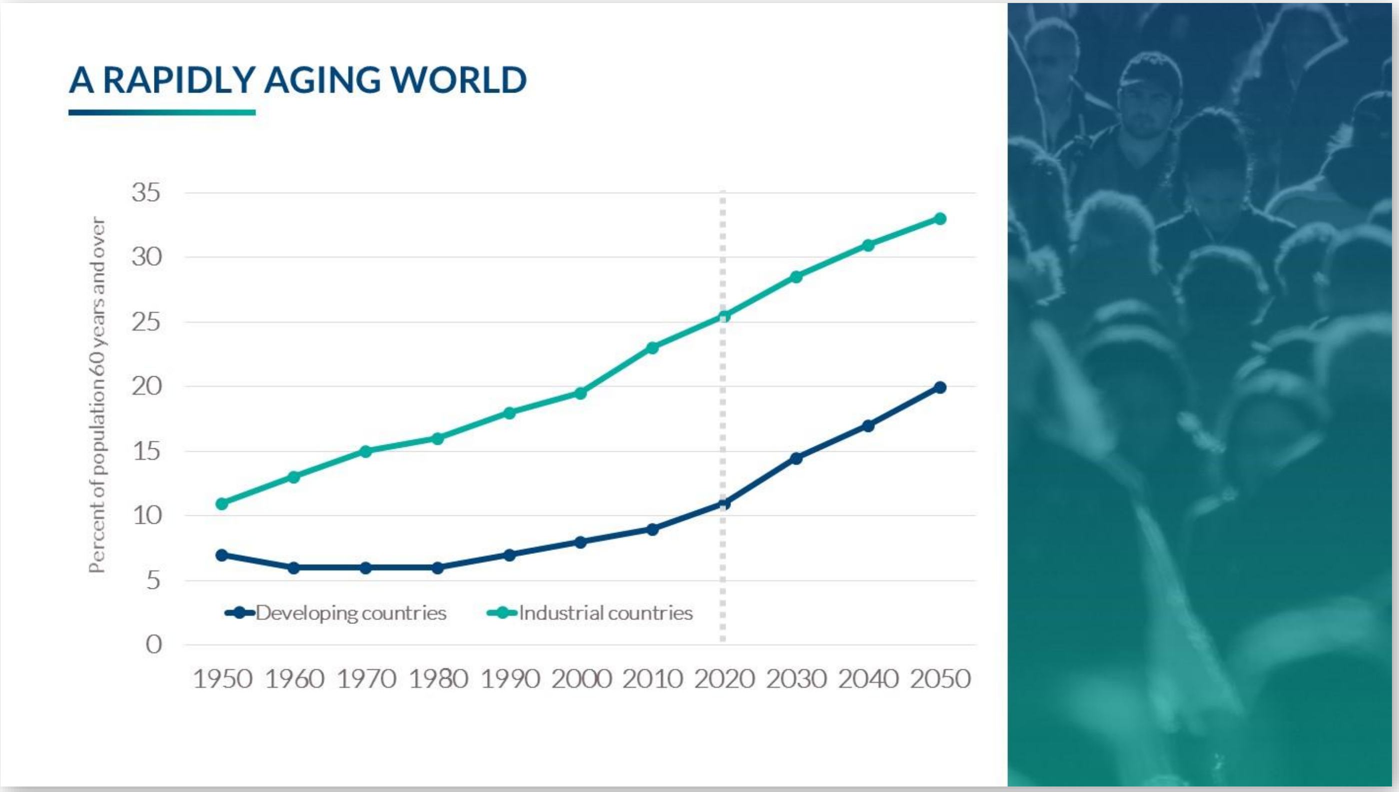
If growth is low and therefore the demand for "things" keeps their price from rising much, then the natural rate of interest will also be low. So the real question we should ask is "why do I think growth and inflation are going to stay low".

There are three key structural reasons we believe this will be the case.



1. Debt – debt is what results from bringing forward tomorrow's spending into today. That's fine if this borrowing is for productive means. Because if it is it will create economic growth in the future. The problem is that when you get to the levels of debt we now have, some $250 trillion worldwide, each incremental dollar of debt is now resulting in much less growth. Those who studied economics may have heard of this, it is the law of diminishing marginal returns.

The evidence is quite clear in this regard. The world's rapidly growing debt burden is now creating a bigger and bigger handbrake on economic growth.



2. Demographics - the world is rapidly aging and this trend is set to accelerate. This matters because, when people enter and enjoy their retirement, their spending may fall. Not just by a little bit either. It can fall quite dramatically.

Baby Boomers are the largest generation to reach retirement age in history. We are going from a situation where the largest generation in history has gone from dramatically boosting consumption to the one that will hold it back. That is a very big deal.

3. Disruption - satellite logistics, robotics, and cloud computing are just a few of the many huge technological advancements that are driving down the cost of "things". The picture in the presentation is of a 3D printer building a house. The most basic 3D printed houses in the U.S now cost as little as $4,000 to build and take less than 48 hours to construct. Automation and efficiencies like this that are happening across the globe in almost every industry.

Vanguard recently estimated that technology trims inflation by about 0.5% in the United States each year. That's a quarter of the typically rate of inflation!

We believe that interest rates will stay lower for longer. That is an investment challenge that we all must grapple with. We are of the view that building a match fit investment strategy is the first step in meeting the challenge.

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PANEL DISCUSSION

1 **Build a match fit strategy**

2 Develop an investor's mindset

3 The role of active management

The first step in developing a match fit strategy is seeking out opportunities to enhance returns without taking unnecessary or unanticipated risk.

For many clients this means investing more of your portfolio in growth assets like shares or property.

It is important that investors are thoughtful about doing this.

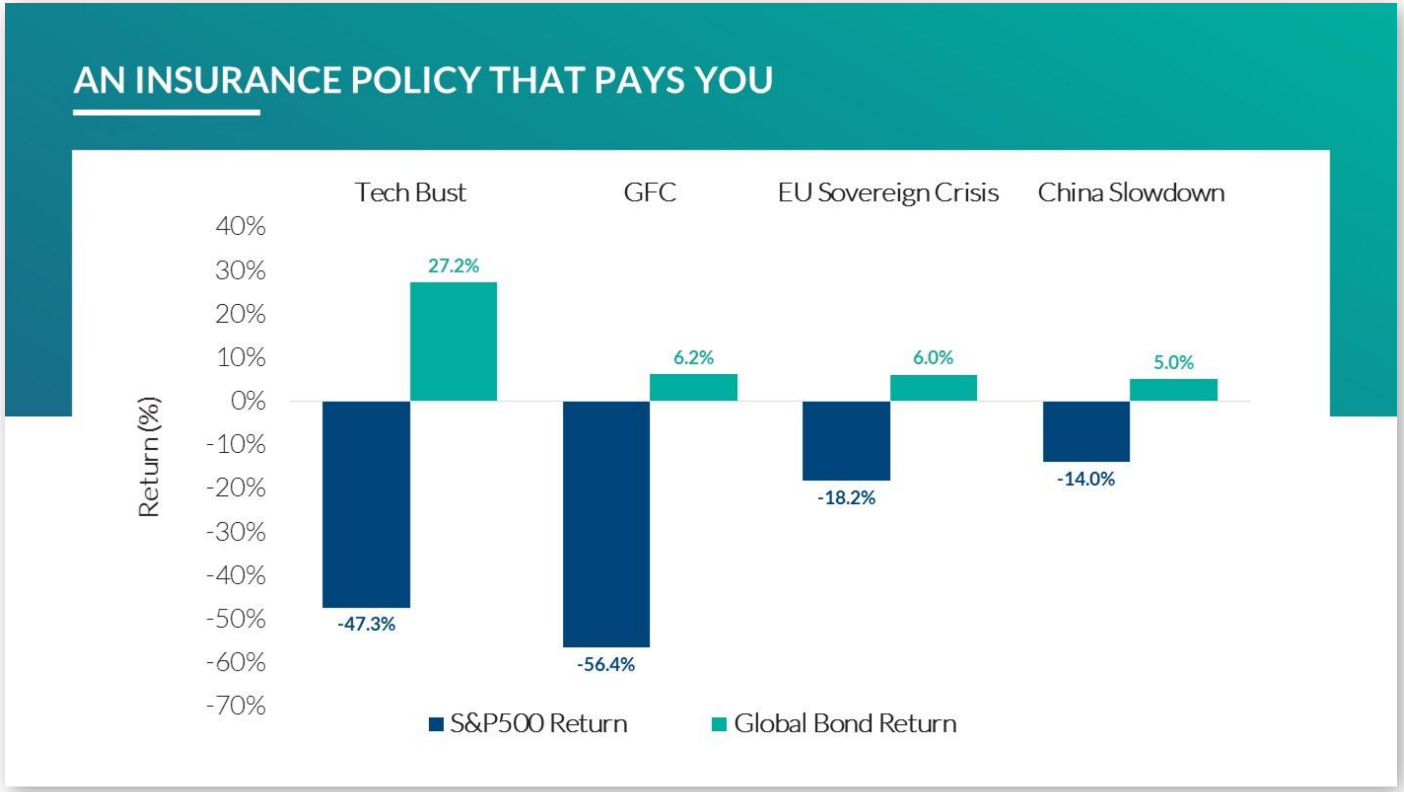
There are traps out there (hence the picture on this slide). We have seen these hurt investors in the past. The finance company disaster post the GFC was an unfortunate example of this. We would hate to see investors hurt again. Things that look too good to be true invariably are.

The other area where we believe returns can be enhanced is through carefully selecting the right companies to invest in. Low growth environments tend to accentuate the differences between winning and losing companies.

A classic example of this is the demise of traditional advertising mediums such as TV (just think of TV3 sale underway right now) versus the rise of online media like YouTube that are capturing more advertising expenditure.

We believe a well-managed allocation to fixed income has an important role to play in protecting you in the tough times that will invariably come. The really interesting thing is that not only does fixed income play this role in our portfolio, but you get paid a positive return while it's there to help in times of need.

That's almost like having an insurance policy that pays you for the privilege of protecting you.

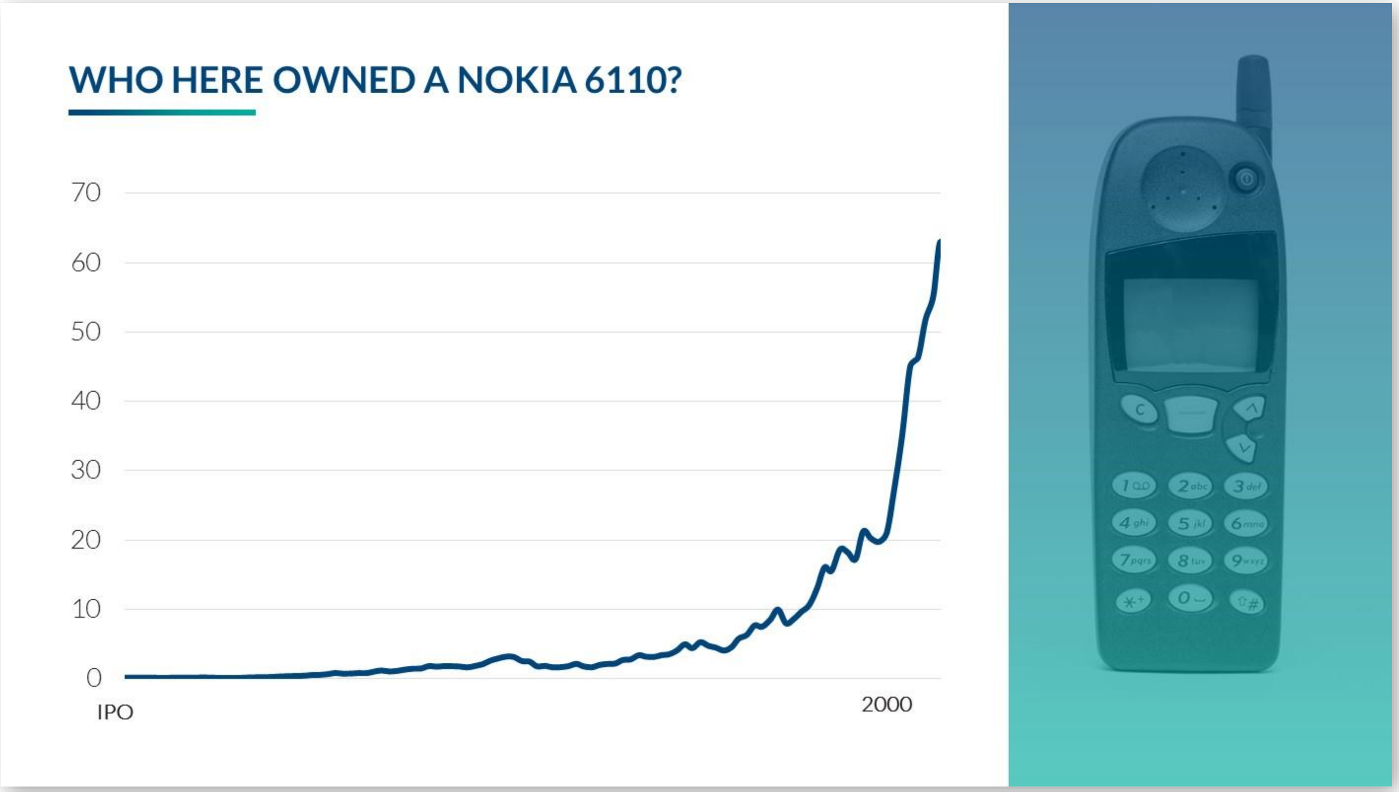


This slide shows how effective fixed income is at protecting your portfolio when share markets fall. This shows the last four material falls in the US share market. On each occasion, fixed income investments made capital gains somewhat offsetting the loss of value in shares.

The typical advice we have been given in the past is "buy and hold" or "set and forget." Get the right long term strategy and stick with it through thick and thin and you will come out ahead. We are not so sure this is the right strategy for the environment we are in.

In our view, investors will need to be more dynamic in managing their wealth, adjusting strategy as you reach long term objectives or changing spending or saving as circumstances changes.

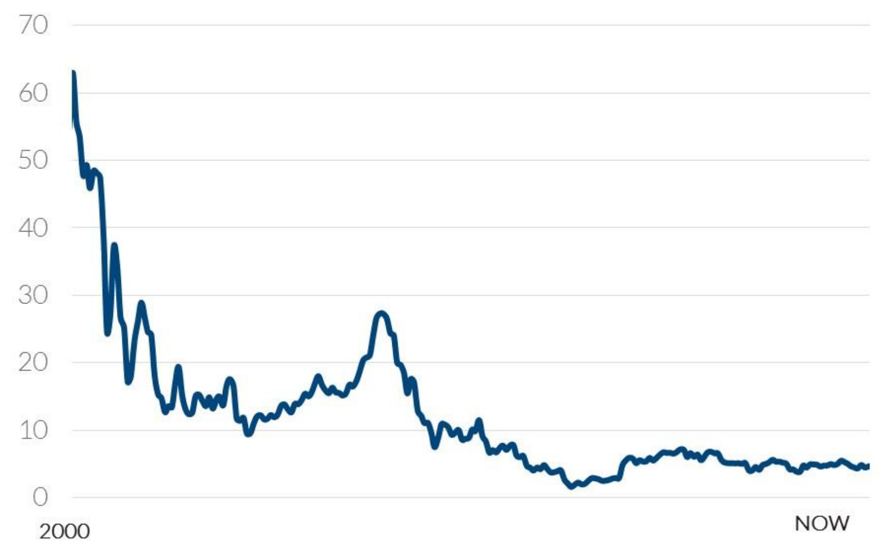
Working closely with your adviser, we think, is more important than ever.



This is true at an individual company level, as highlighted in the Nokia example we share, but even more relevant at a total portfolio level.

Here we see a dramatic rise in Nokia's share price, some 40,000% as it went on to dominate the global cellular market only for its fortunes to be dashed as disruption, the Apple iPhone, changed the playing field.

WHOOPS!



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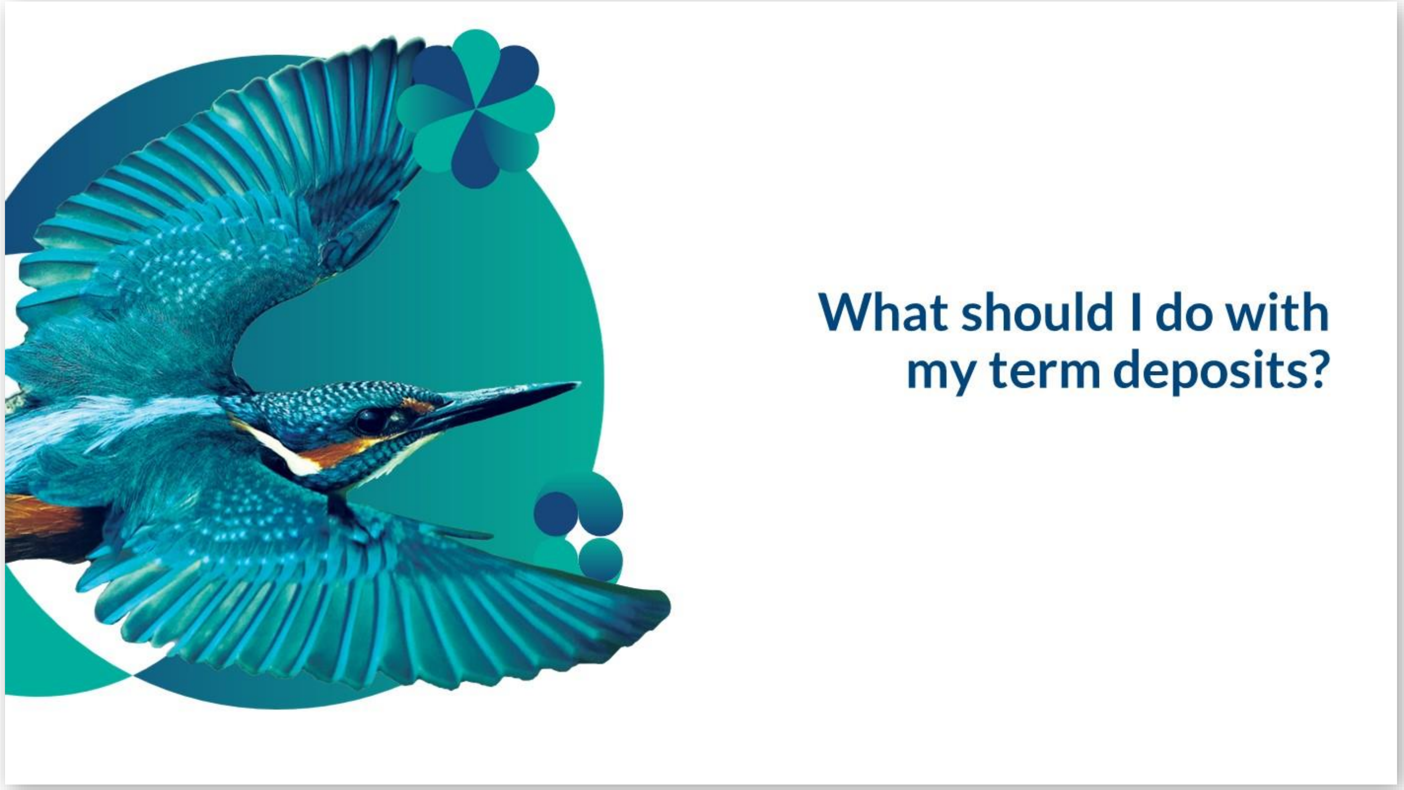
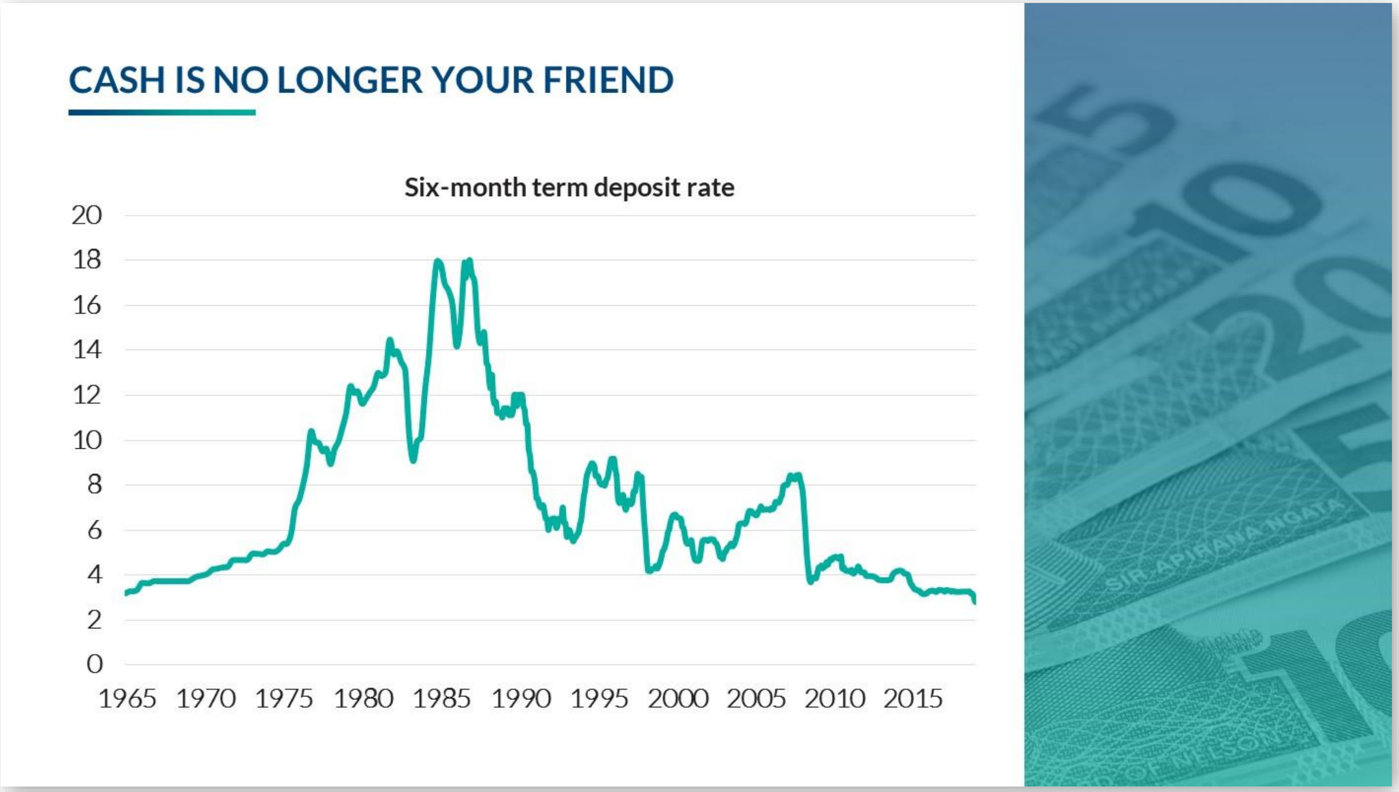


Cash is no longer your friend. In the past term deposits provided a healthy return on your savings with interest rates comfortably higher than inflation.

Today this is no longer the case. If inflation continues to average 2% many bank term deposits will suffer a real decline in value – that is after paying tax and allowing for inflation the purchasing power of your bank term deposit will fall.



This makes it harder to save for your retirement and makes living off your retirement nest egg more difficult.

In many ways this is a return to normality. Risk free, or close to risk free, investments like bank term deposits shouldn't provide strong real returns. We have been spoilt over the past few years.

For most of us we will need to reconsider if TDs remain the right investment. Talking to your adviser is a good first step in making that decision.

Of course making that first step away from the Bank and investing more of your portfolio in growth assets is a tough decision. In particular, many clients struggle with timing. Is now the right time to make the leap?

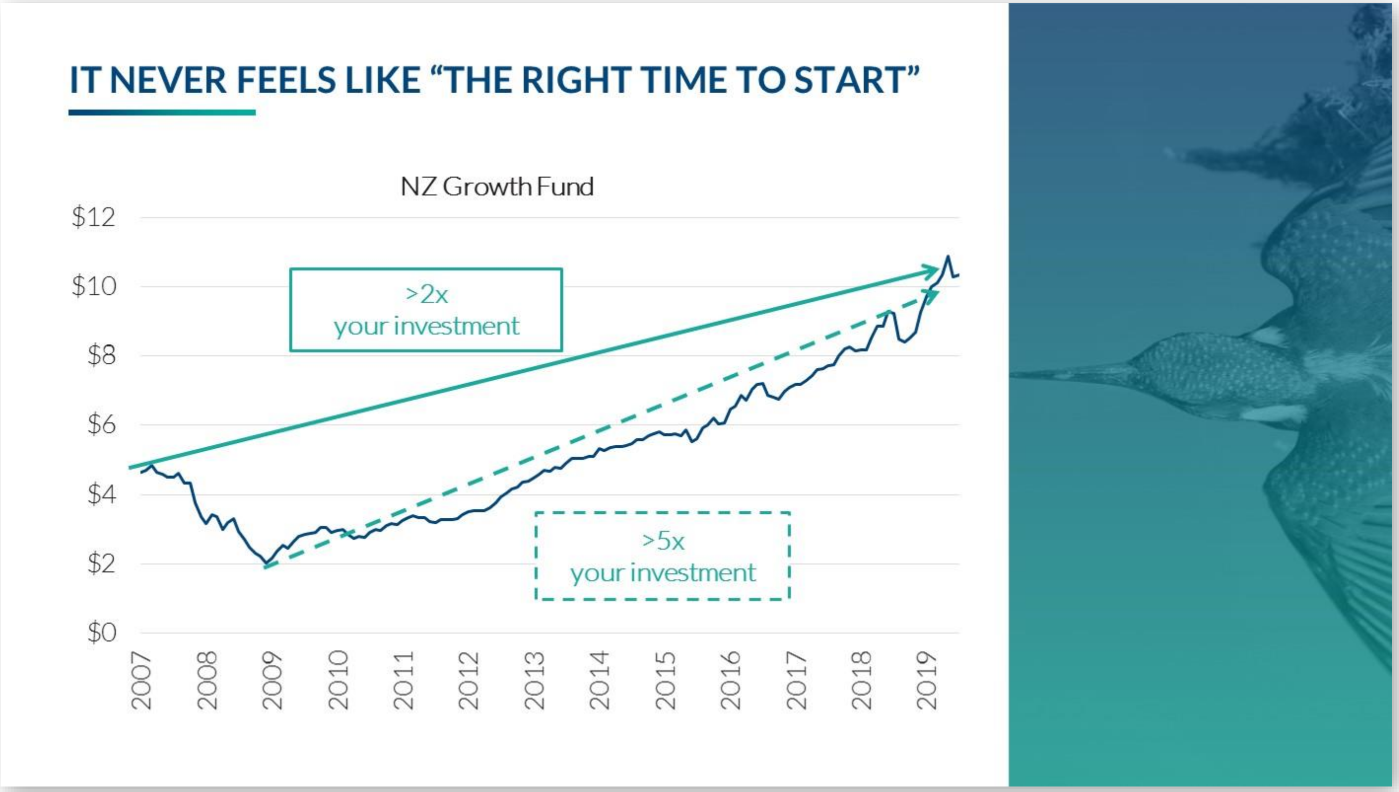
It is always difficult to make the leap because there are always worries in financial markets.

Today, market concerns include:

- the US/China trade relationship,
- an economic slow down in Europe,
- President Trump's potential impeachment,
- Brexit.

These are all legitimate worries that investors have.

Rather than letting these concerns get in the way of making decisions, we think that clients are better served by acting now and beginning their investing journey.

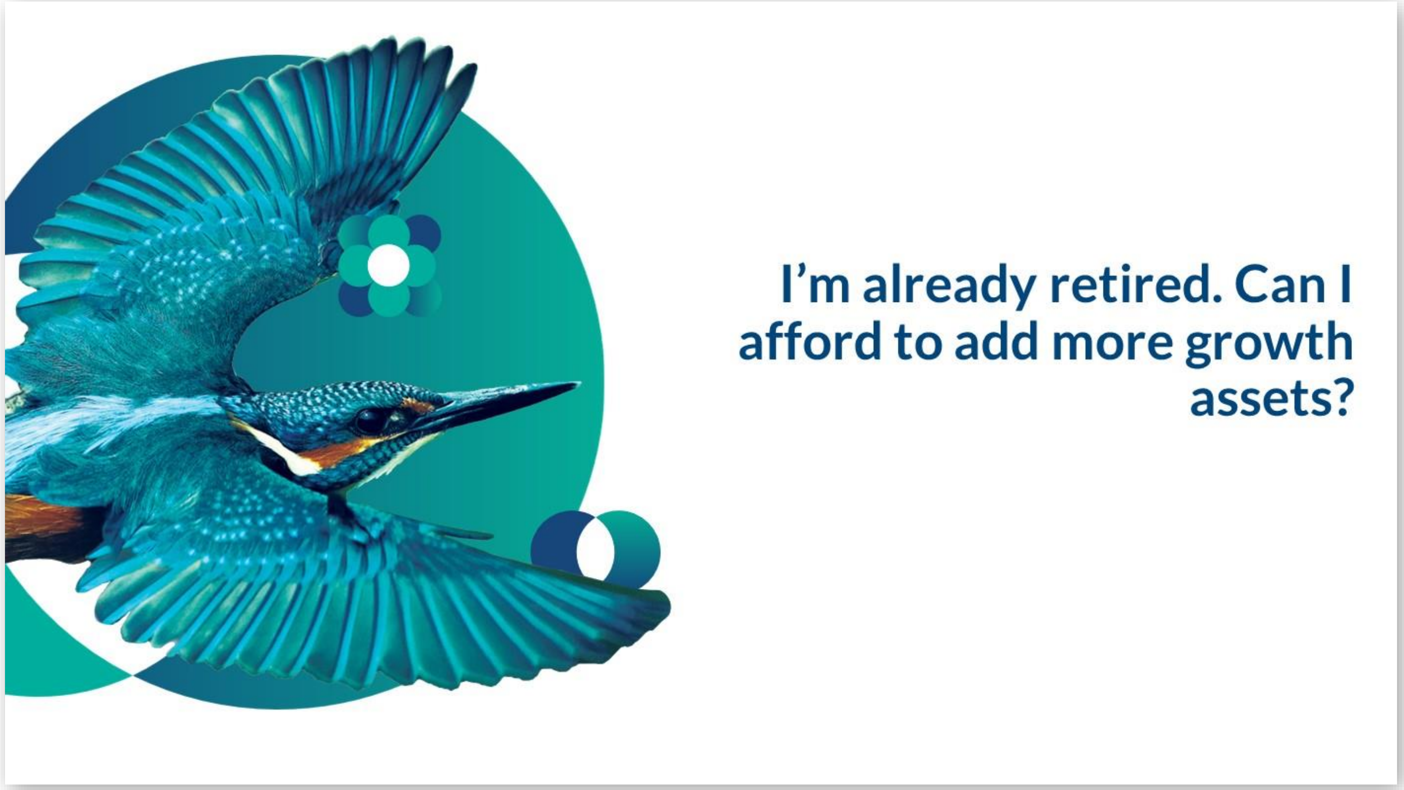


Peter Lynch, the famous manager of the Fidelity Magellan Fund in the 1990s, sums it up best, "Far more money has been lost by investors in preparing for corrections, or anticipating corrections, than has been lost in the corrections themselves." Trying to be cute on timing is a very tough and probably destructive exercise.

One way of considering this is looking at the performance of the Fisher Funds New Zealand Growth Fund. Had your timing been terrible and you had decided to invest in this fund just before the Global Financial Crisis in 2007 you would have doubled your money over the subsequent decade. This is a healthy return despite experiencing one of the worst financial crises since the great depression within a year of making your investment.

If you had picked the bottom, and very few investors did, most were too nervous at the time, you would have made five times your money over a similar time frame.

The key is to get started and put an investment programme in place that works for you.

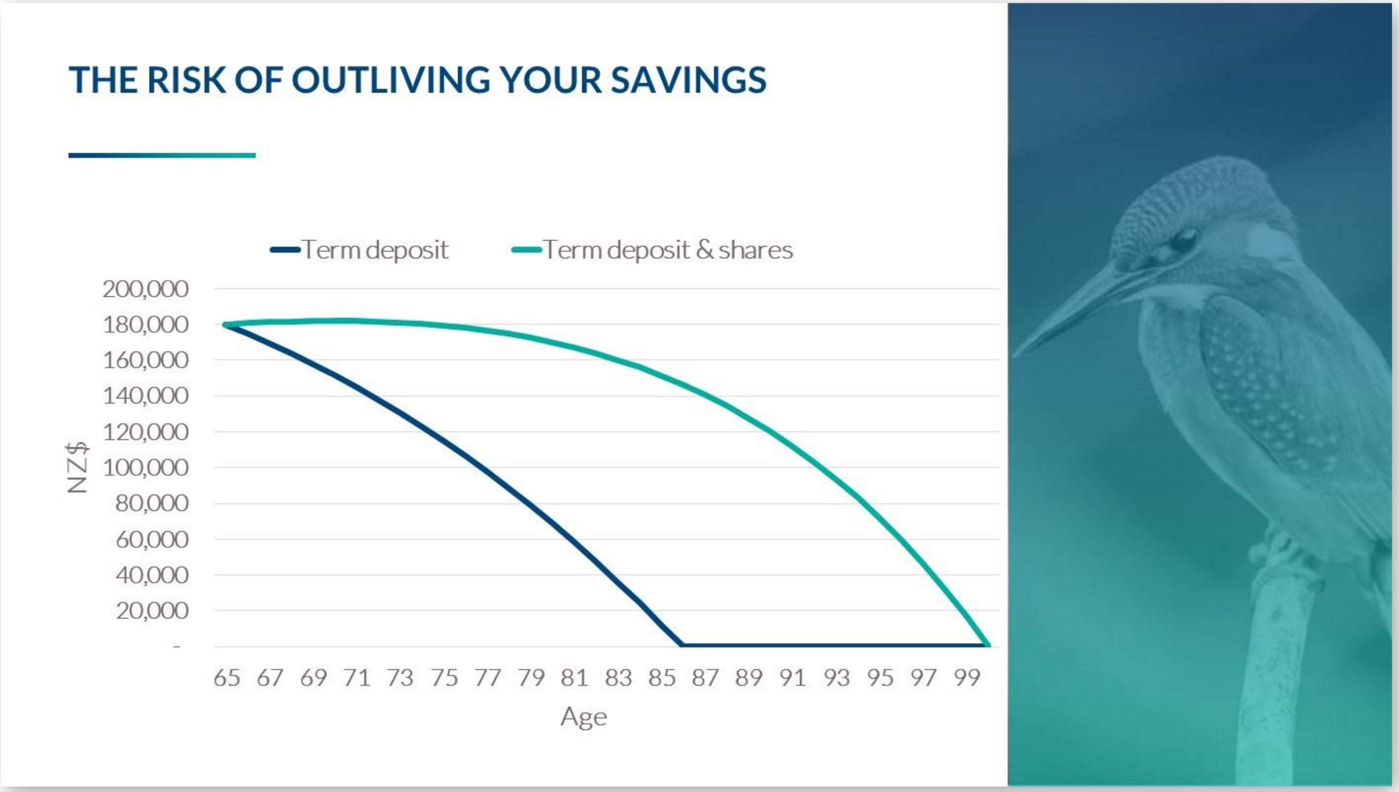


Many of our clients grapple with this difficult question. We believe that one way of considering it, is around how we define risk.

The risk that gets the most focus is the risk of our portfolio balances fluctuating with market movements. This is a real risk, and seeing market movements impact our savings is definitely enough to make the bravest investor nervous.

But this certainly isn't the only risk that people should be thinking about. For many investors it is making their money last through their retirement that is probably the risk that should be focussed on.

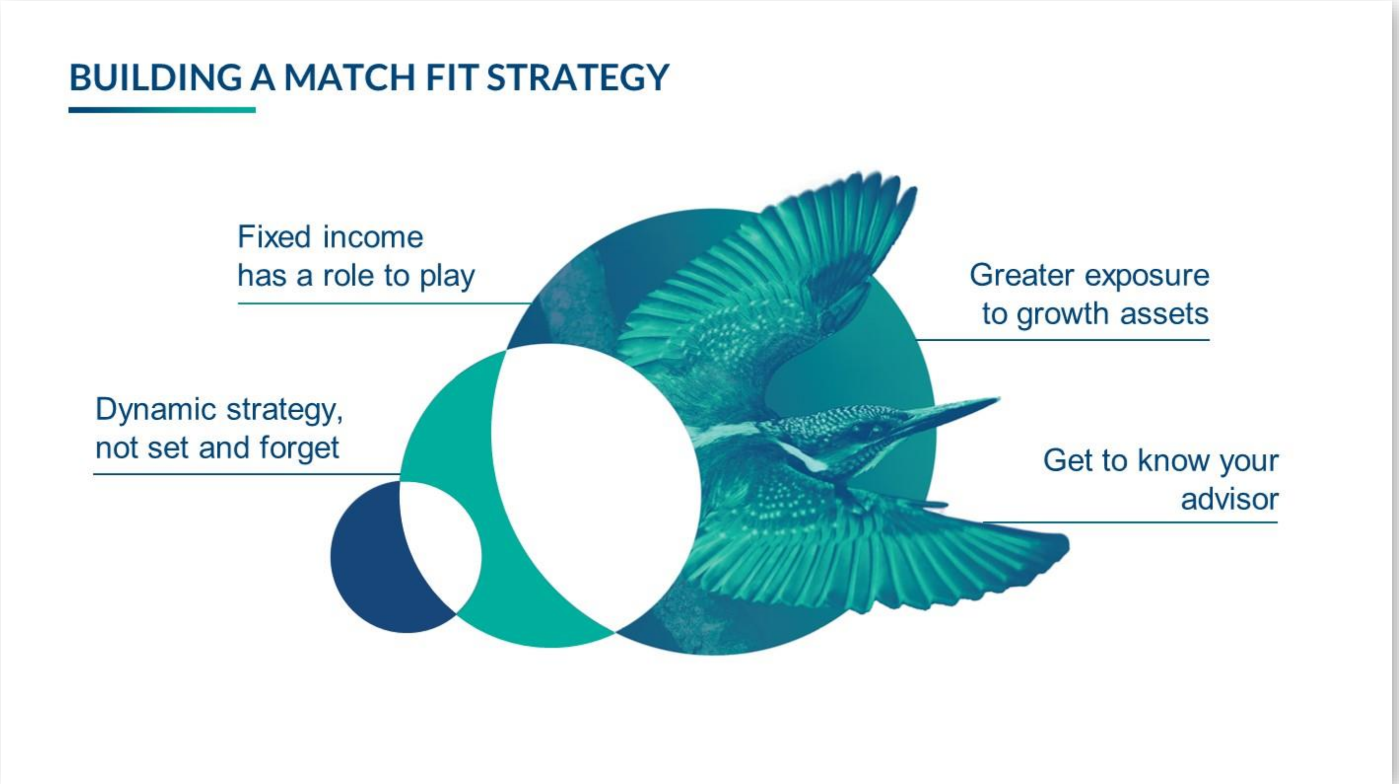
While sticking all of your money in a term deposit may mean that the value doesn't fluctuate, it may also guarantee that the balance dwindles and potentially runs out.



To illustrate this we cite a Massey University study from two years ago that estimated that for a ‘no-frills’ retirement (as they called it), the average retired couple needed another $170 per week on top of NZ Super. To provide this extra $170 a week they estimated the couple would need a $180,000 retirement nest egg on top of owning their own home.

The chart on this slide shows that if you took this $180,000 today and stuck it in term deposits then your money would run out by the time you were 85.

But by putting half of this money in shares and the other half in term deposits - then we would expected the nest egg to last all the way to the age of 100.



We believe there are solid steps investors can take to build portfolios that will thrive in a low interest World. Most likely, this will involve investing more in growth assets while not forgetting the important role that fixed income plays in ensuring your portfolio is well positioned in different environments. We will also all need to be more dynamic in how we build portfolios ensuring our money is working hard for us.

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PANEL DISCUSSION

1

Build
a match
fit strategy

2

**Develop
an investor's
mindset**

3

The role
of active
management

Investing more in growth assets means your returns will be more variable week by week, month by month but, over time, your returns should be better.

This variability in returns can be challenging. It is great when it is working for you but not so much fun when markets fall.

This is where an investor's mind set can help. By investor's mind set we mean having clear expectations about how the returns on your investments might vary over time.

Well-informed means well-armed to avoid unpleasant surprises. It is also important to have a clear process for managing our emotions through difficult market environments.

Our match fit investment strategy won't work if we cash out every time the market falls!

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Of course, it is easy talking about an investor’s mind set but it can be hard not selling when others are fearful.

Using the example of A2 Milk, the chart on this slide shows 4 occasions where the share price has fallen materially over the past 6 years. If you had panicked and sold you would have missed out on a ~1,600% return.

To avoid knee jerk, emotional responses we focus on process while in the midst of a share price pull back. We ask ourselves two questions:

- “Is the reason we invested still valid?” and
- “Do the customers of the company still love its products?”

If the answers to the questions are still yes then we grit our teeth and retain the investment. In fact, sometimes we will add to it.

It can be hard, but process and discipline help.

DEVELOPING AN INVESTOR'S MINDSET

Understanding risk and what it really means

Help yourself to make decisions under stress

Think of Fisher Funds as your financial coach

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The role
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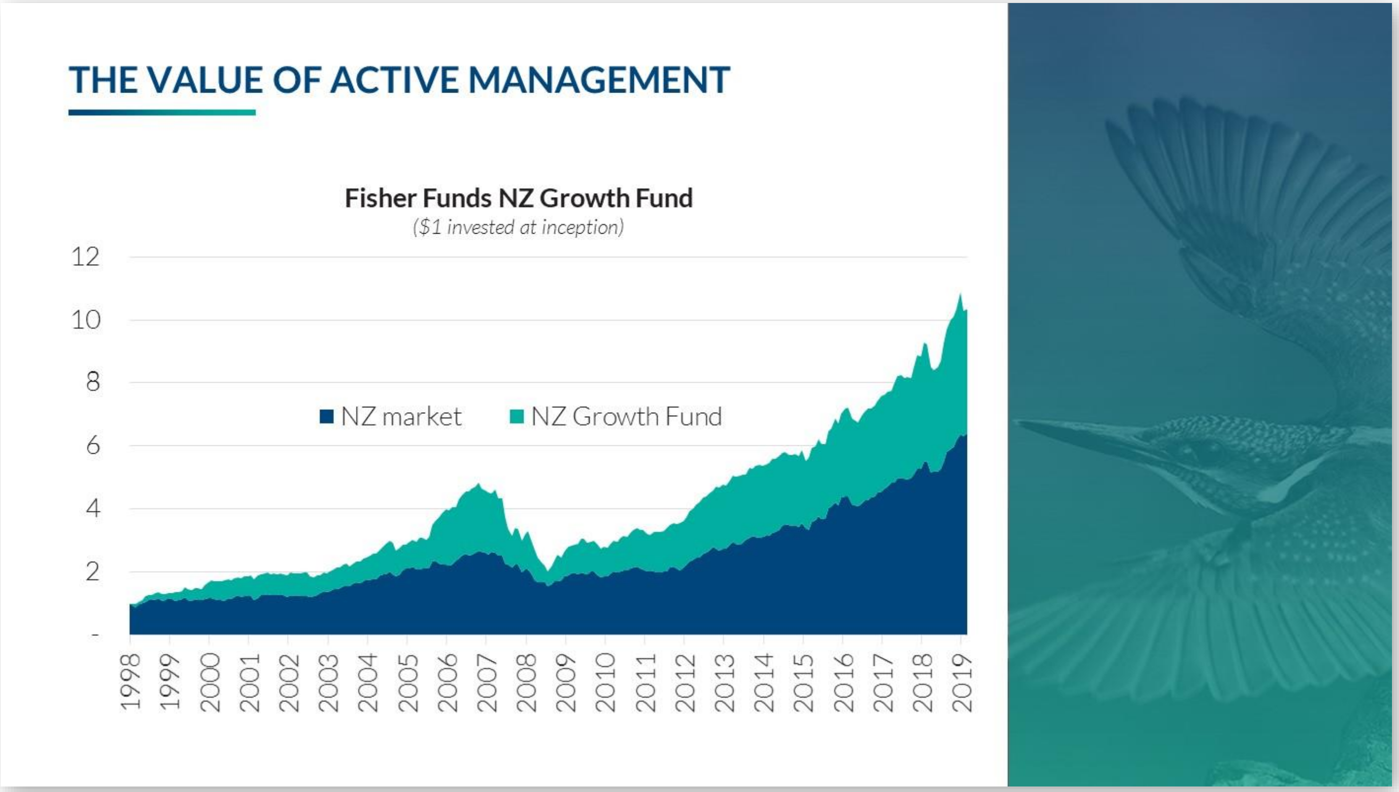
The third step in managing your wealth in a low interest rate, low return World is active management. Active management is at the heart of what Fisher Funds does as an investor. We seek to hand pick individual companies and fixed income investments that will do better than the market average.

We have been successful in doing this for over twenty-one years. Active management has made a real difference to our clients' returns and their wealth over that time.



This slide aptly demonstrates how an investment of $100,000 into Fisher Fund's New Zealand Growth Fund twenty years ago has performed (after taxes and fees).

If an investor just got the market return, they would have done well with their portfolio worth around $600,000 today. The extra return generated by Fisher Funds over the past twenty years has meant our investors have done a lot better than that, with active management adding a further $400,000 over this time – meaning an investor would now have around $1,000,000 in their investment.

Active management is going to be even more important over the next 21 years.

In fact, it goes from being the cream on the cake to being most of the cake in our view.

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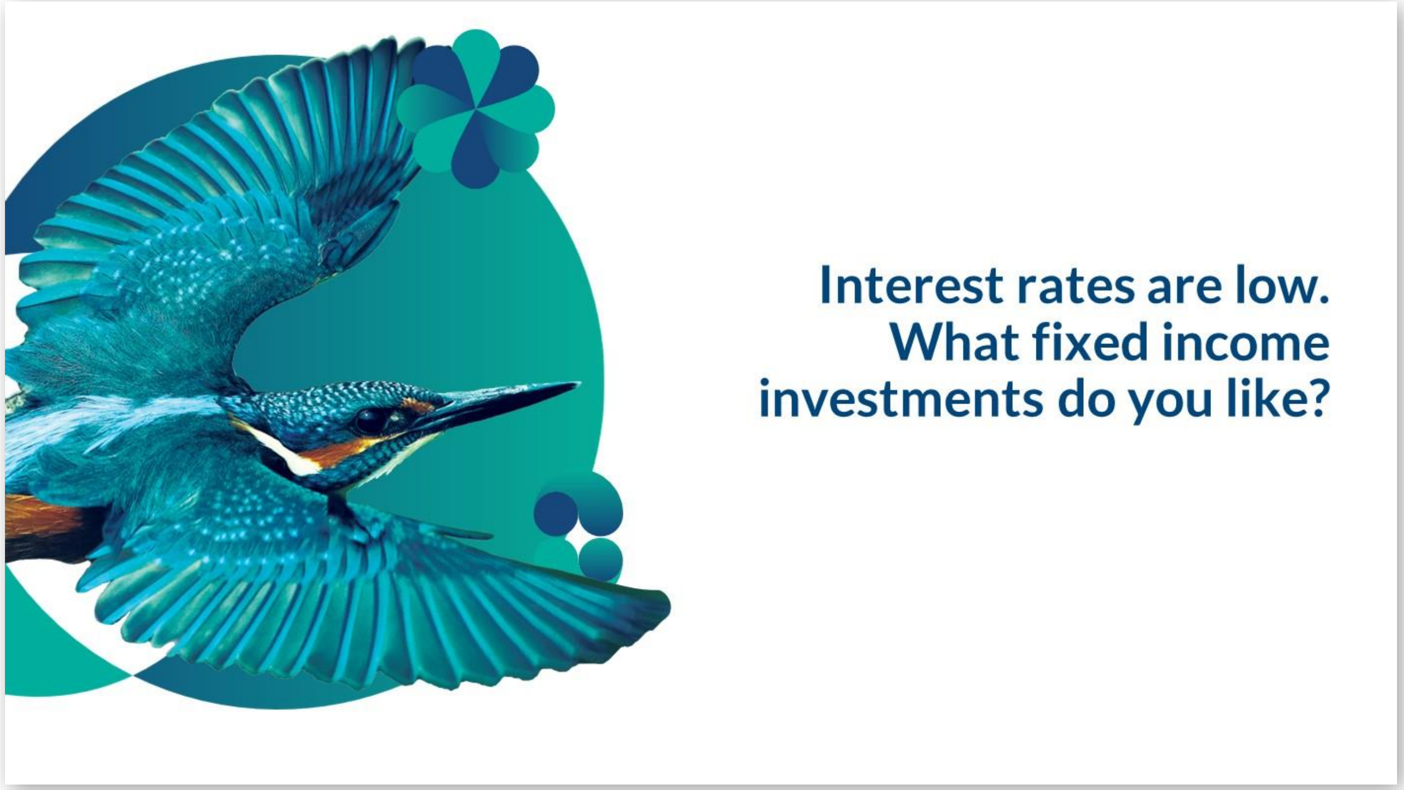


The great thing about being an active manager is that it allows us to look for opportunities where many traditional or passive bond funds simply do not go.

The low interest rate environment doesn’t really impact this all that much.

Instead, we have found over the years that often the best investment opportunities come from situations where something or someone has created a dislocation in the market, which we can take advantage of.

The New Zealand corporate debt market is one of these and, in our view, one of the more attractive fixed income markets in the world now.

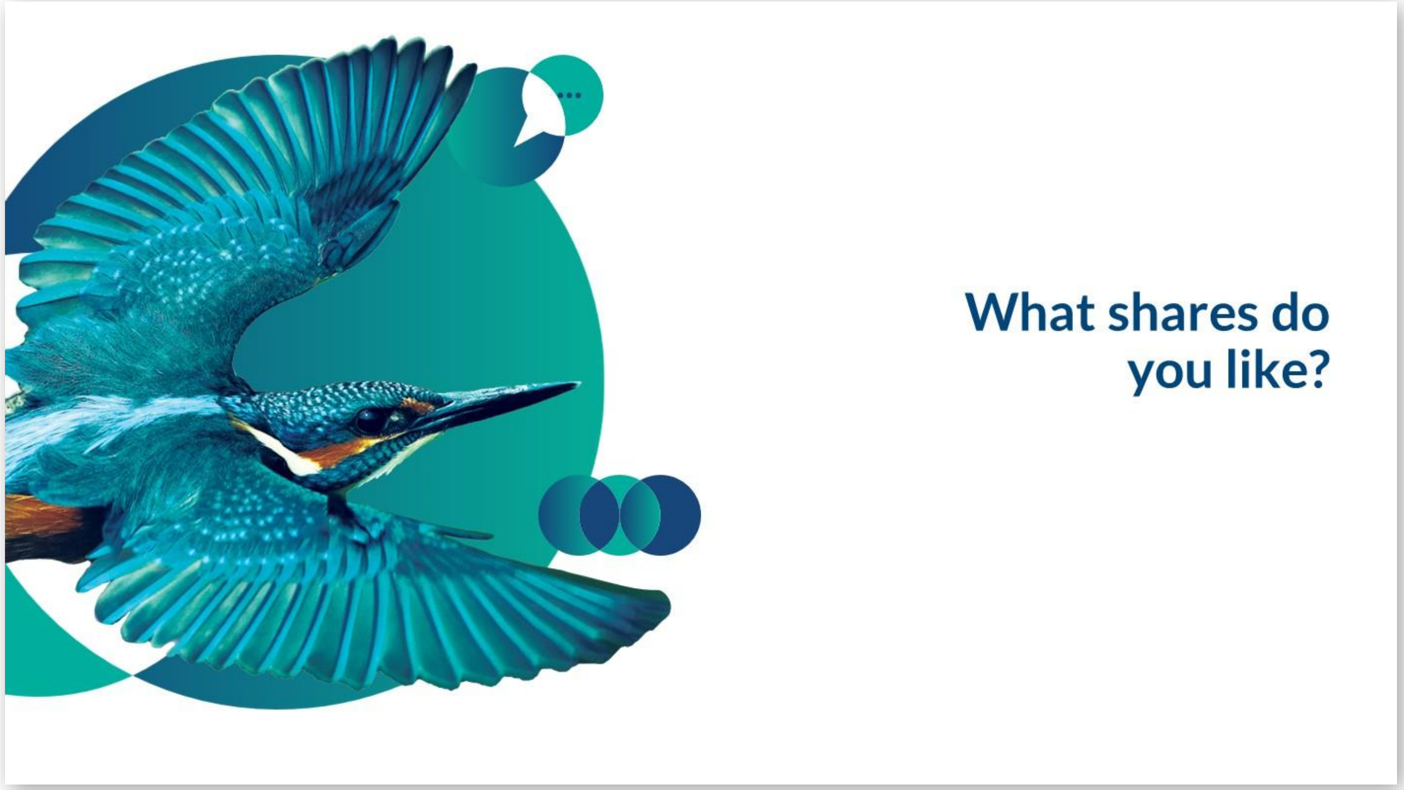
The void that typical lenders, the banks, have created by stepping back from the corporate lending space is a notable development. This has provided us an opportunity to step in and provide these new entrants to our market with the capital they are looking for – at the right terms for us of course.

An example where we have been able to take advantage of this is lending to TR Group. TR Group helps design and build fit-for-purpose heavy vehicles for their clients. Once the vehicles are built, they then typically offer their clients 5-7 years lease terms on the vehicle. They also offer service and maintenance options as well as specialised driver training.

So what was it that we liked about the company to lend to them?

In short, this is a company that is both operationally and financially well-managed. Their mantra is “always growing, learning, and improving”. Having spent time with Andrew Carpenter, the founder, and his team we got a strong sense of a culture similar to another great kiwi business we know a bit about, Mainfreight.

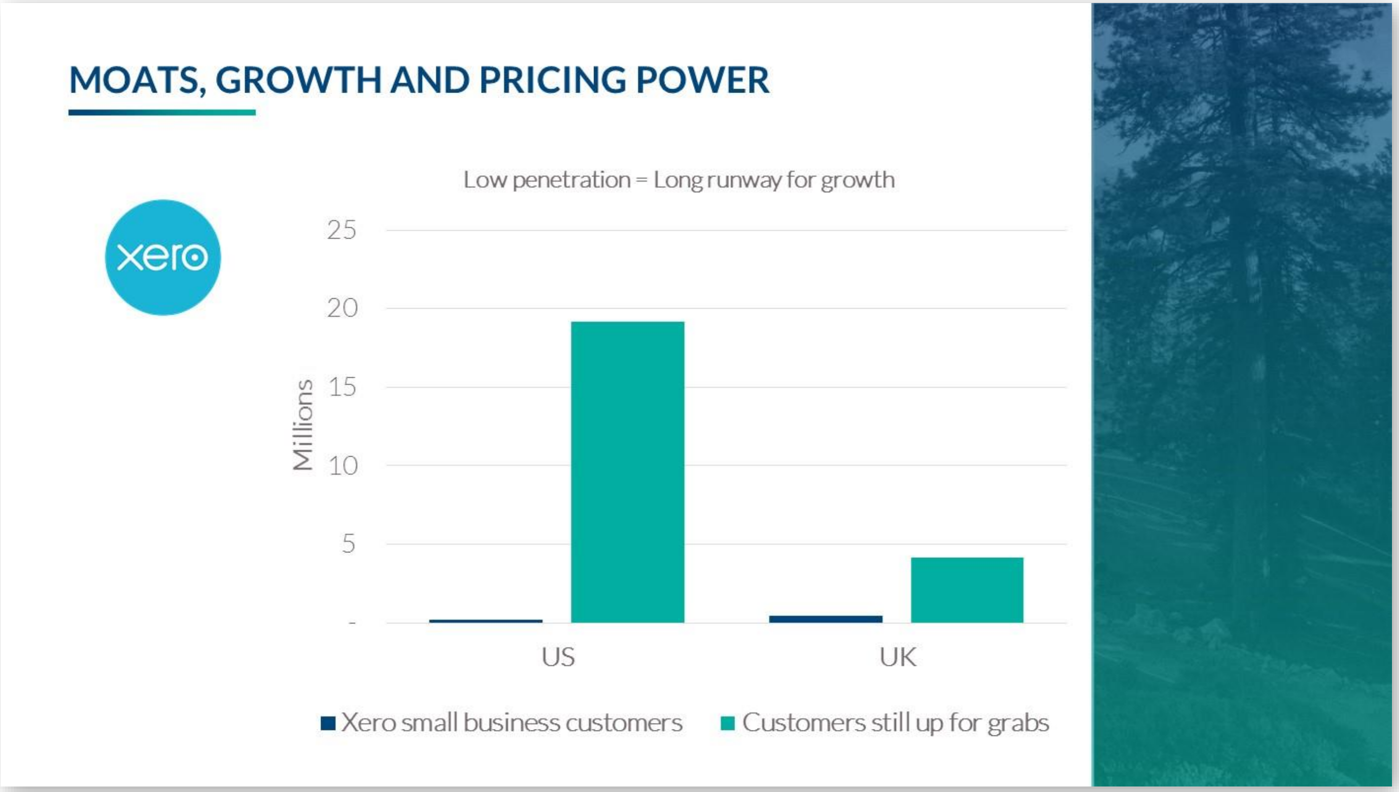
Then finally, a number of our peers are what we would characterise as traditional bond fund managers. Their sometimes-restrictive investment guidelines preclude them from investing in opportunities like this – which is great. More for you!



We strive to build all weather portfolios with companies that will thrive in any economic backdrop. This has always been central to our investment process and, if anything, continues to be even more important.

Specifically we seek companies with:

1. Pricing power and that are able to increase selling prices even in a low inflation environment.
2. High quality management who take a long-term perspective, managing the company responsibly with sound governance and regard for both society and the environment.
3. Wide moats well positioned to stave off the negative impacts of too much competition.
4. Long runways for growth enabling the firm to grow earnings for many years into the future.



A great example of a company that believe meets these attributes is cloud based accounting software provider Xero.

Xero has a very long runway for future growth. All up we see Xero well placed to compete for another 80-100 million clients across the UK, the US and rest of the world. Growth tail winds like this are powerful and should fuel the company's momentum for years to come.

Almost as exciting is the fact that Xero clearly has pricing power. Average revenue per user (ARPU) is a simplistic measure of pricing power. Australian and NZ ARPU in particular have been growing strongly – ARPU in both countries has been growing several multiples faster than inflation.

Pricing power like this is rare. Why is Xero able to achieve this? It is testament to the company's moat (sustainable competitive advantage) and superior customer proposition. Xero benefits from high customer switching costs. It is difficult and costly for customers to move away from Xero, making them sticky over time.

The long-term perspective of Xero's management team also excites us. One illustration of this is the recently announced "Net Zero @ Xero" programme. In this the company is seeking to offset 100% carbon emissions back dated to last year and forever looking forward. This is a smart move given the focus on carbon usage and shows clarity of long-term vision.

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Active management isn't easy. We know that. But we have been successful in beating the marketing in multiple asset classes and different countries over the past twenty-one years. We are very focussed on making sure the next twenty-one are just as good.

We believe that success, as an active investment manager is not about one or two heroic things; taking a big bet against the market or identifying one or two great companies. Instead, success builds slowly, by doing many things a little bit better each and every day. This is a much more measured way to grow capability.

By combining the right team with the right process and wrapping them up in a culture that strives to learn and improve, we believe we can continue to get better as an active manager.

The next twenty-one years will be just as exciting!

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WE ARE UP FOR THE CHALLENGE

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