REDE ADVISERS
PROFESSIONAL FINANCIAL ADVICE

Newsletter
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Steve's Soap Box

The following is the first of a number of opinion pieces Steve will be writing for the Newsletter. These pieces will be on current issues affecting New Zealand and will be hard hitting and sometimes controversial. Steve is not known for his diplomacy and political correctness, and he has given himself licence to say it as he sees it. The opinions stated in these pieces will be his own and not necessarily those of the company or other staff members.

We hope you enjoy them as much as Steve enjoys writing them.

Public Enemy Number One – The Banks

In recent weeks we have seen two, but connected matters relating to banks being reported in the media:

1. Banks are reporting record profits only a few short years after the G.F.C.
2. The Reserve Bank moves to reduce the amount of mortgage lending by banks in excess of 80% of the security valuation (commonly referred to as the loan-to-value ratio, or LVR)

The first matter was reported very briefly and buried in the business pages. The second matter received saturated media attention and has been front page news.

Bank profits announced this year have been record in size and obscene when we consider the privileged position they hold in this country. Over 90% of lending in New Zealand is completed by the big four banks (ANZ/National, ASB, BNZ and Westpac), all of which are owned by the Aussies.

New Zealand Big Banks Record Profits

• ANZ	$1,370,000,000	- up 8%
• ASB	$ 705,000,000	- up 3%
• BNZ	$ 695,000,000	- up 19.5%
• Westpac	$ 770,000,000	- up 9%
Total	$3,540,000,000	

When banks lend money to kiwis for residential purposes the loans fall under the category of Tier One Capital. Tier One Capital lending requires only minimal amounts of shareholder capital for every dollar lent. Tier Two and Tier Three Capital is used for commercial and business lending and requires considerably more shareholder capital for every dollar lent. Banks can therefore lend twice as many Tier One Capital loans than Tier Two or Tier Three Capital loans, making residential mortgages considerably more profitable (especially if

you have bucket loads of cheap deposit money available). Banks would even prefer to lend on risky residential mortgages than prime, secure commercial mortgages because of the amount of shareholder capital required.

Tier One loans where the banks lend up to 80% of the security valuation (LVR) are referred to as “Prime” lending. When the banks exceed the 80% LVR this lending is referred to as “Sub Prime”. In New Zealand during 2012-2013 bank lending in total has grown a modest 5%. This compares to the 15% average lending growth of those crazy days leading up to the G.F.C. However, when we look at the types of lending the banks are doing, we begin to see a different picture. Prime lending, and Tier Two and Tier Three lending show either negative or only slightly positive growth. The percentage of risky Tier One loans however has increased to over 30% of all new lending. This tells us that bank management are reaching their 5% growth targets, not by lending more Prime mortgages or business loans, however by lending more Sub Prime mortgages to an ever increasingly stretched first home market. This smells increasingly like the same conditions that led to the G.F.C. in 2008.

The Reserve Bank has seen the danger and has recently applied a speed limit of 10% of new lending having a LVR of over 80%. The Reserve Bank has also signalled they will increase interest rates early if house price inflation does not fall from its current unsustainable level. They are concerned for the following reasons:

1. Banks with a growing exposure to Sub Prime borrowers are at greater risk of collapse if there is a housing market downturn.
2. The increase in Sub Prime lending is seen as an important contributor to the high house price inflation that we are currently seeing.
3. First time borrowers are especially at risk if the over priced houses they have borrowed in excess of 80% to buy, suddenly suffer a price collapse.

The media has gone overboard in its attack on the Reserve Bank limits. Their comments invariably have been biased and naïve, financed significantly by the banking and real estate sectors who have much to lose if the policy is successful in lowering house prices. In my opinion the LVR restrictions should be praised. Although poor bank lending is not the only reason we have high property inflation (over 10% nationwide in 2013 and 20% in Auckland) it is certainly a contributor. Do we really think that the pimply faced bank moguls in Sydney really care about house affordability in New Zealand?

Summary

Banks in New Zealand hold a privileged position of an implied, but not guaranteed, bail out by our government, yet the profits gained by exploiting Sub Prime borrowers are being paid out as multi million dollar bonuses across the Tasman. The irony is not lost on those of us who wonder about such things.

Key Indicators and Rates

OCR (official cash rate)	2.50%	UDC Finance Deposit – 1 year	4.50%
90 day Bank Bill	2.45%	Southern Finance Deposit – 1 year	6.25%
Enhanced Cash Portfolio	3.00%	Corporate Bond Portfolio *(estimated)*	4.50%
Income Securities Portfolio – Call	3.50%	Income Focus 18 Portfolio *(estimated)*	5.20%
Income Securities Portfolio – 3,6 & 12 mth	4.00%	Income Focus 28 Portfolio *(estimated)*	5.70%
Heartland Bank Deposit – 1 year	4.35%	Income Focus 50 Portfolio *(estimated)*	6.90%

Retirement Does Not Equal Old

UBS Bank recently completed a comprehensive study of investors. Following is a summary of their findings.

As we are living longer our definition of "old" is changing. Investors surveyed feel that for their parents generation 62 was the age when someone became old. However today, most people do not feel old until they are in their 80's. Being "old" is not just defined by a number. You are old when:

- You can no longer remember things and your health deteriorates.
- You can no longer live in your own home.
- You can no longer drive.
- You can no longer spend your money in a manner which provides satisfaction and enjoyment.

If 80 is the new 60, and retirement does not equal old, then what does retirement look like for pre-retirees now? Nine out of ten working investors surveyed believe they will go through a number of distinct phases of retirement, which added together may last as long as 30 years. The three phases are:

1. **'Transition' phase** – you will still work, but in a reduced or different capacity
2. **'My Time' phase** – focused on travel and leisure
3. **'The Last Waltz' phase** – lead a relaxed, simple life with health issues becoming the focus.

Investors surveyed expect to have very different financial needs across the three phases. Transition phase retirees generally expect to only require 55% of their pre-retirement income. This is due to part time, or reduced employment income. My Time phase retirees generally expect to require almost 67% of their pre-retirement income as travel and leisure activities dominate this period. The Last Waltz phase retirees generally expect to reduce their income requirements back to around 50% of their pre-retirement income as they slow down and reflect on their life and their legacy.

These survey results are not surprising, and generally reflect the behaviour of our client base. The differing requirements for income pose a number of problems for a financial adviser. In recent years we have produced a number of articles in our newsletters regarding what is a sustainable income in retirement. What this survey has emphasised is the sustainable income figure may need to change during the three phases. Should a pre-retiree investor have a pre-retirement income of $100,000 ($75,000 net) then the following will apply.

1. **'Transition' phase** – would require 55% of $75,000 being $41,250
2. **'My Time' phase** – would require 66% of $75,000 being $49,500
3. **'The Last Waltz' phase** – would require 50% of $75,000 being $37,500

The Sandwich Generation:

The most revealing result from this survey concerns pre-retirees nearing retirement (Baby Boomers). Pre-retirees are increasingly finding themselves preparing for longer, more complex retirements with three distinct phases, and are often also providing financial support and guidance to their aging parents and / or adult children. The majority of pre-retirees surveyed (in excess of two thirds) have either adult children or aging parents to support and in a sizeable number of cases they have both. The survey asked pre-retirees to best describe the role they play in their children's financial decision making. Only 16% said they were rarely or never consulted.

This is not a surprise to us and is reflected generally amongst our client base. Issues we are often consulted on by our investors, which are not directly related to themselves include:

- Rest home care for elderly parents.
- Licence to Occupy and home ownership issues for elderly parents.
- Medical insurance and state benefit care for elderly parents.
- First home ownership and assistance for children.
- KiwiSaver and savings plans for children.
- Trust and estate distributions for children.

Retirement May Last 30 Years:

Although we were surprised at the survey results regarding the amount of pre-retirement income needed in 'The Last Waltz' phase, what was not surprising was the length of the retirement years. Pre-retirees parents retired on average in their early sixties and expected to have 10 years in retirement. Pre-retirees themselves expect to retire in their mid sixties and to have 30 years in retirement. This dramatic change occurred within just one generation. For pre-retirees parents, retirement was easier to plan for and inevitably didn't result in spending capital. For pre-retirees themselves retirement is significantly more difficult to plan for and inevitably results in having to spend capital.

For the financial planner, retirement planning is the area of greatest need and the area we can add the greatest value.

Economic Update – summary from presentation by David Beattie

(Chief Investment Officer and Joint CEO, Grosvenor Financial Services Group)

- Performance – market returns for the last two years have been strong with equity investments dominating returns from cash and fixed interest. NZ shares returned 21.4%, Australian shares 10.3% and Global shares 20.7% (although due to the currency this reduces to 16.7% in NZD). Cash return of 2.5% reflects low OCR and NZ Fixed Interest returns were weaker at 4.6%.
- Portfolio Returns – net returns, after fees and 28% tax from core portfolios over 2 years have been strong:

Conservative Portfolio	7.2% p.a.	Corporate Bond Portfolio	3.5% p.a.
Balanced Portfolio	9.4% p.a.	Income Focus 18 Portfolio	5.3% p.a.
High Growth Portfolio	16.8% p.a.	Income Focus 28 Portfolio	6.5% p.a.

- Recovery Roadmap – global share markets have followed previous post-recession recoveries, with the recovery over the last couple of years stronger than expected. The recovery in markets is now complete and we are in uncharted territory with the manipulation of markets by central banks printing money (Quantitaive Easing, or QE).
- Growth Outlook – while global growth is below long term averages, it is heading in the right direction, trending upwards. It is being lead by developed nations, including US, UK and Europe. With central bank support (i.e. printing money / low interest rates), equity markets continue to be supported for some time.
- "**Don't Fight The Fed**" **(the key message)** – central banks, including the US Federal Reserve, will do whatever it takes to keep the recovery on track. They are also being very open and clear with their statements, leaving no room for analysts to interpret something else. For example, the Fed has said that US interest rates will not rise until inflation is above 2.5% (currently 2.0%) and unemployment is below 6.5% (currently 7.5%). This is not expected until 2016.
- Income Yields: Shares v Bonds – the gap between income from US shares (dividend yield) and US bonds (bond yield) has converged following a rise in long-term interest rates. Bond yields have remained strong with company earnings growing in line with rising share prices.
- Roadmap: The Next Few Years – based on Grosvenor's analysis, they have devised a roadmap for the next few years to use when managing and protecting client portfolios:
    - Now to March 2014 – QE will continue to support asset prices and the NZ dollar.
    - Rest of 2014 – small market correction possible as tapering starts (i.e. reducing money printing)
    - 2014 to 2015 – equity recovery and then some volatility as market digests the change post-QE
    - 2016 – bond and equity markets could be negatively impacted as interest rates and inflation rise.
    - 2017 to 2018 – equities march higher

Taxman Attacks Overseas Pensions – new rules and amensty

There has been much confusion regarding the tax treatment of overseas superannuation schemes held by NZ tax residents. Gains on these schemes have been taxable under the NZ foreign investment fund (FIF) rules since 2007. However taxpayer treatment of these schemes has been inconsistent due to the complexity of the rules (e.g. Australian superannuation schemes are exempt).

What are the new rules?

From 1 April 2014, any lump sums withdrawn from overseas superannuation schemes will be taxable in New Zealand using one of following methods:

1. **FIF Method**: assessable income = 5% of opening value each year or the actual gains made. This is only available if you have been declaring gains on overseas schemes in your tax return using this method.

2. **Schedule Method**: assessable income = amount withdrawn x 'schedule year fraction'
   (eg. 5 years in NZ = 23.07%, 10 years = 44.39%, 15 years = 64.08%)

3. **Formula Method**: assessable income = actual investment growth between time of withdrawal and start of assessable period (i.e. 48 months after becoming a NZ resident)

To illustrate lets consider an example of a taxpayer who has been in NZ for 15 years, who withdrew $100,000 from a UK superannuation scheme in 2010. They haven't previously returned their UK super for NZ tax purposes and it has grown by 50% since 2002.

Taxable income under the new options will be:

- Schedule Method $100,000 x 64.08% = taxable income of $64,080
- Formula Method $100,000 x 50.00% = taxable income of $50,000

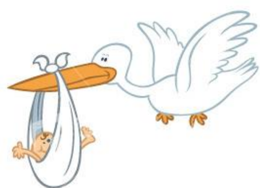
Amnesty Period

If taxpayers have made withdrawals from their overseas super schemes between 1 January 2000 and 1 April 2014, and haven't declared it as income, IRD are offering an amnesty until 1 April 2014. The amnesty allows taxpayers to pay tax on 15% of any amounts withdrawn from overseas superannuation schemes.

- Under the amnesty, taxable income on a $100,000 withdrawal would only be $15,000.

These new rules are therefore clearer but may also result in some very large tax bills (and penalties) if rules are not followed. If you have funds in an overseas superannuation scheme, these rules are likely to affect you. Please call Michael or Steve to discuss your situation. Time is very short with the amnesty period expiring on 1 April 2014.

Maternity Leave - Jasmine



Yes it is true – Jaz is pregnant and is due to give birth mid January. We all wish both her and her husband Enda well for the coming event. Jaz has become an important and integral part of the Rede team during the last 2½ years. We know that many clients will miss her cheery voice and helpfulness. Jaz is planning to be back in some capacity in 6 months and in the interim we have employed a fantastic replacement.

Ona Mackonyte has recently arrived in Christchurch from the UK, where she completed a Masters degree in Management with Finance. She is originally from Lithuania and already shows signs she will be able to keep both Steve and Michael firmly in line. Ona officially joins the team on Monday 13th January.

Holiday Season Trading and Cash Withdrawals

Withdrawals guaranteed to be paid out before Christmas:

- Where cash is available – 5pm Friday 20th December
- Where trading of securities is required – 2pm Wednesday 18th December

Deposits for Investments in Grosvenor portfolios prior to Christmas:

- Personal cheques – Thursday 12th December
- Direct Credit – Wednesday 18th December

The first trading day for the New Year will be Tuesday 7 January. All regular withdrawals and direct debits direct from Grosvenor portfolios that are due between 24 December and 31 December will be processed and paid on 31 December. All payments from BNZ Cash Manager Accounts will be processed as usual, or on the next business day.

Christmas Office Hours

Our office will close for the Christmas break at 12.00pm on Friday, 20 December 2013 and re-open on Monday, 13 January 2014.

As always, both Michael and Steve are available in the event of an emergency on their mobiles. If you require urgent assistance, please call and leave a message and they will get back to you as soon as they can.

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Check out our website at www.rede.co.nz

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