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In This Issue — *Page*

Steve's Soap Box

The following is yet another contentious piece of opinion Steve has written for the newsletter. As we have warned previously, these pieces are 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.

Affording Our Future: Superannuation and KiwiSaver Dilemma

Debate is again emerging regarding the future of New Zealand Superannuation (NZ Super). Often this talk emanates from persons with vested interests in the outcome of this debate, however in typical fashion the media flock to the alter of those willing to make a noise in the hope that something scandalous will emerge. Politicians especially never let the facts get in the way of a good headline, after all, it is election year.

So what is this debate all about?

1. Should we increase the age of eligibility to NZ Super, and if so to what age, and when should we start?
2. Should we also introduce some form of means test, or income test, to ensure we limit the amount of taxpayer's money that goes into providing a taxpayer funded pension?
3. Should eligibility to KiwiSaver funds stay linked to eligibility to NZ Super if the age of eligibility to NZ Super increases to 67 or beyond?

Let us have a look at these matters one at a time and try and put some facts and reason into the debate.

Should We Increase The Age Of Eligibility To NZ Super?
In my opinion, yes we should. NZ Super is universally available for all those who reach eligibility. If we as a country wish to retain a universal super entitlement then we need to ensure that it is affordable equally for all generations. Why should the generation about to retire get significantly greater benefit due to increased longevity and expect the next generation to pay for it? That is simply not fair.

Currently NZ Super takes 4.1% of GDP. Statistics tell us this grows to 6.6% of GDP by the time the next generation retires. This is in excess of what we spend on education as a country. Those supporting the argument that NZ Super is sustainable in its current form point to the OECD average currently of 9.30% and say our system is great – don't touch it if it ain't broke! In my opinion those supporting the status quo miss the point. It is not a matter of affordability, after all we can afford anything if we wish to prioritise other expenditure like education as less important. It is a matter of equality, should my children be left with a burden 50% more than we are currently paying? If we want NZ Super to be sustainable, and the best in the world, then we need to ensure each generation pays its way and does not burden other generations with their greed and waste. To what age, and when? The age should be linked equally to each generation's burden. Statistically this is around 67, and we should start now – very slowly.

Should NZ Super Be Means / Income Tested?

In my opinion, absolutely not. Have we not learnt anything from those bad old days of the early 1990's? Means testing or income testing punishes those who work hard and save, only to benefit those who don't. Means testing or income testing disincentivises saving and produces a dependant society. Do you remember Superannuation Surcharge? This was an income test on superannuitants and led to the birth of many a scheme to get around it. It even led to couples who had been together for 50 years divorcing to avoid paying tax. Like all bad legislation it was eventually conferred to the scrap heap and to revisit those days again defies belief.

Should Kiwisaver Stay Linked To Eligibility To NZ Super?

Again, in my opinion, absolutely not. If we increase the age of eligibility of NZ Super to say 67 then current KiwiSaver rules state that you cannot get access to your KiwiSaver funds until the new age of 67. This is quite simply unfair. KiwiSaver is your money, you have forsaken spending today so you could have an enjoyable tomorrow. I accept that both the employer and the government also contribute to your KiwiSaver, however don't think this is a gift. Your employer is paying you less so they can contribute, and the government is prioritising tax payer funds, they could just tax us less. No, this is your money and we should be able to access it when we retire, whenever that may be.

The debate on these matters will get plenty of media attention during election year. It is a pity politicians will make the decisions, based less on facts and reason, and more on the ideology of left or right on the political spectrum.

QUIZ

1. If you are a New Zealand superannuatant who is married, or in a civil union partnership, or in a de facto relationship, how much is your gross (before tax) New Zealand superannuation?
   A $ 12,137
   B $ 16,137
   C $ 20,137
2. What is the marginal tax rate of a New Zealand tax payer earning $ 50,000.00 p.a.?
   (Marginal tax rate is the tax you will pay on your last earned dollar).
3. Can you transfer your Australian Superannuation funds to New Zealand?

Rising Interest Rates and the Impact On Portfolios

Now that increases in the Official Cash Rate (OCR) interest rate are virtually locked in, it is time we review what this means for investors and their portfolios.

The market recently anticipated that the Reserve Bank could commence a steady increase in the OCR interest rate commencing from the March rate committee meeting. This 0.25% increase will be the first of a number of increases over the next two years as the Reserve Bank moves the OCR setting from its current stimulatory setting to a more neutral setting. The current OCR (interest) rate is 2.75% and this is expected to increase to 3.75% by the end of this calendar year, and 5.00% by the end of 2015.

Although this increase is 2.50% and appears large, an OCR of 5.00% is still low historically for New Zealand, and is still far away from the OCR of 8.25% we had leading up to the Global Financial Crisis. If we think of the Reserve Bank as being the driver of our economy, and we imagine the price of money as being the engine, then a low OCR of 2.50% would be like putting the foot flat to the floor on the accelerator. A high OCR of 8.25% would be like putting your foot flat to the floor on the brake pedal. An OCR interest rate of around 5.00% would be neither a stimulatory accelerator nor a restricting brake and theoretically lead to a stable, free wheeling economy.

What Does This Mean For Interest Rates?

If the OCR increases this year by around 1.25%, then any interest bearing product that takes its lead from the OCR will also increase approximately 1.25%. Investments such as 'on call' accounts and short term deposits are linked to the official cash rate, therefore we could expect to see a 6 month deposit, which is today around 3.50%, move up to 4.75% approximately. Floating rate mortgages are also closely linked to the OCR, therefore floating rate mortgages that are around 5.80% currently could finish this year around 7.00%. The relationship between longer term deposits and bonds, and longer term fixed rate mortgages is less direct. The rate offered for a 10 year government stock is more strongly determined by the price of 10 year money available internationally than a current rate of the NZ OCR. Therefore we could see in 12 months time short term deposit rates up 1.25% however long term deposits not up at all. This eventuality is not uncommon and leads to a flattening of our yield curve. Should this phenomenon continue into 2015 then we could end up with short term interest rates being higher than longer term interest rates. Our yield curve, which would have flattened during 2014, would then slope downwards during 2015. The market calls this an inverse yield curve.

What Should Investors Do Differently?

For several years we have recommended investors keep their investment funds mainly in bond funds enjoying the last of the older higher rate bonds on issue. This strategy proved very successful and rewarded investors with above market rates while interest rates fell or remained low. As interest rates creep up this strategy will underperform the market and investors will need to make changes. Firstly investors should be moving to shorter term deposits and 'on call' type cash funds while we wait for higher interest rate products to become available. Secondly investors should look to introduce a small percentage of other assets into the portfolio mix to reduce the reliance on low yielding bonds. In New Zealand this normally means introducing a small portion of high dividend yielding shares. A bucket of 10 or 12 high dividend yielding shares will produce an average dividend income flow of 8.00% p.a. while a bucket of deposits and bonds currently will struggle to produce 4.00% p.a.

When Will Investors Know To Move Back Into Longer Dated Products?

There has been an enormous amount of research completed internationally that helps guide us with this decision. Low capital risk fixed interest investments should produce a real rate of return of 3.00%. The real rate is the gross interest rate, less tax, and less (inflation). An investor today should therefore require a gross return of a minimum of 6.00% to induce them to commit for a fixed term of 3 years or more. (6.00% gross, less tax of say 1.00%, less inflation of say 2.00%). In recent months investors have not been able to obtain investment rated, quality fixed rate deposits at an interest rate of 6.00% or better. This has led us to recommend that funds stay invested into shorter term and 'on call' products until rates increase. As this year progresses we expect to see emerging new opportunities where investors will finally be rewarded with gross interest rates in excess of 6.00%.

New Investment Opportunities

In the last week we have seen the first signs of institutions having to pay investors a more realistic interest rate to borrow money. The following issues have just been announced and may be of interest to investors looking to add income yielding assets in excess of 3.00% real rate of return.

Sky Network Television	**6 Year Bond**	**6.25% - 6.50% p.a.**
Contact Energy	**5 Year Bond**	**5.80% - 6.00% p.a.**
Genesis Energy	**Dividends**	**8.00% - 10.00% p.a.**

To discuss the inclusion of any of these new issues into your portfolio, please contact Steve or Michael.

Key Indicators and Rates

OCR (official cash rate)	2.75%	UDC Finance Deposit – 1 year	4.30%
90 day Bank Bill	3.10%	Southern Finance Deposit – 1 year	6.00%
Enhanced Cash Portfolio	3.00%	Corporate Bond Portfolio *(estimated)*	4.49%
Income Securities Portfolio – Call	3.50%	Income Focus 18 Portfolio *(estimated)*	5.20%
Income Securities Portfolio – 3,6 & 12 mts	4.00%	Income Focus 28 Portfolio *(estimated)*	5.70%
Heartland Bank Deposit – 1 year	4.25%	Income Focus 50 Portfolio *(estimated)*	6.90%

1. B **2. 30%** **3. Yes**

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Disclosure Statements are available on request and free of charge.