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Autumn Update

January – March 2021

Investment Commentary

In the context of a long term investment plan, a single year is not a very long time. That said, it's difficult to write this particular update without reflecting, at least a little, on what an extraordinary year we have all just experienced.

Twelve months ago, we were about three weeks into our national Covid-19 lockdown, and we were all operating from home offices.

At the time, the only thing we knew for certain was that, globally, we had been unceremoniously thrust into unfriendly territory. It was certainly a worrying time from a health perspective, with a potentially fatal pandemic raging, which initially created a gigantic upheaval in investment markets. At the time, the immediate outlook was highly unsettled, and no one had any idea what was going to happen the next day, let alone the next month or year.

Apart from the age-old (but extremely appropriate) advice of not panicking, one of the points we managed to stress last year was that share markets would be a "leading indicator" of the eventual recovery. What that meant was that share markets would start to improve well before we would see any clear evidence of improvement in the world around us. And so it proved.

In a global context, we are still a long way from being "back to normal". Yes, vaccination programmes are being implemented, economic growth rates are recovering, and the recent announcement of a travel bubble with Australia are all reasons for improving optimism. But, if we scratch a little deeper, we see that unemployment rates remain elevated, global supply lines are stretched, international travel is still challenging for many, and a significant third wave of the coronavirus is currently sweeping Europe and many emerging nations.

Share markets have generally spent much of the last 12 months going from strength to strength.

Some of these issues may take months or years to settle, but forward-looking share markets are not sitting waiting - quite the contrary.

Over the three months ending 31 March 2021, the highly influential US[1] market recorded a strong gain of 6.2%. For the 12 month period from 1 April 2020, this rounded out an almost unimaginable 56.4% return.

To put this in context, it was only the second year since the end of World War II where the US market has delivered a 12 month return in excess of 56%.

This performance, along with the returns of many other global share markets over the last year, is unusually high because it includes the big bounce-back from the Covid-19 turmoil that saw markets plummet in February and March 2020. For investors who stayed committed to their long term investment plans, this at least helped provide suitable compensation for those two very challenging months.

Returns were similarly impressive across other international developed markets. Over the first quarter of 2021, Japan[2] recorded a substantial jump of 8.9%, and Europe (excluding the UK)[2] gained 8.4%. The UK[2], although continuing to be a relative laggard within the major developed market region, still delivered a solid 5.2% return.

While developed market returns were almost unanimously positive in the first quarter, the performances of emerging market nations were a little less consistent. Of the four largest emerging market constituents, China[2] was virtually flat, returning -0.2%, while South Korea[2], Taiwan[2] and India[2] posted excellent quarterly results of 6.1%, 12.7%, and 5.2%, respectively. In aggregate, the emerging markets asset class delivered 2.3%[3].

Closer to home, the returns of the New Zealand and Australian markets also diverged for the quarter. In recent years, the New Zealand share market has tended to outperform the Australian share market in local currency terms. However, in the three months ending March, Australia[4] was clearly the stronger market gaining 4.3% compared with the New Zealand[5] market return of -3.9%. This represented the largest quarterly outperformance by the Australian share market since the final three months of 2016.

In New Zealand, listed bank shares did well, and Fletcher Building, which reported strong half year improvements in margins and profits, gained 22%. However, it was quarterly weakness from other market heavyweights such as Contact Energy (-19.8%), Meridian Energy (-26.6%), and the a2 Milk Company (-28.6%), which dragged the overall market return into the negatives.

Although the performance of most share markets was generally strong for the quarter, fixed interest markets struggled as government bond yields rose quite sharply during the quarter.

Yields were lifted by the continued rollout of Covid-19 vaccinations and expectations of a large US economic stimulus. The general thesis behind these increased yields seems to be that the coronavirus will be conquered, the world will get back to "normal", and the combination of a growth surge (from economic normalisation) and ongoing significant government stimulus will lead to increased growth, increased inflation and, ultimately, higher interest rates.

It's a plausible enough scenario, but 'plausible' does not mean 'guaranteed', and history repeatedly tells us that inflation and interest rates are notoriously difficult to predict.

For any doubters, it might be worthwhile to reflect on what happened just over a decade ago.

Coming out of the Global Financial Crisis (GFC), market commentators were almost unanimous in predicting the significant inflation risk that would surely result from central banks' efforts to shore up financial markets. This consensus view was based on the dramatic easing in monetary policy, the establishment of additional central bank liquidity facilities, and the Large Scale Asset Purchase programmes that were all implemented in 2008/09.

However, in the decade that followed, despite records being set in terms of the breadth of the subsequent economic recovery and the record low unemployment rates it generated, inflation stayed persistently *below* market expectations.

According to the long term US inflation calculator, the average annual US inflation rate from 2000 to 2009 was 2.56%, but in the decade that followed the GFC it actually *reduced* to 1.77%. It was a very similar story here in New Zealand as our consumer price index rose an average of 2.7% in the decade leading up to the GFC and only 1.6% in the decade following it.

Looking back at this today, we can point to the greater utilisation of technology and the increasing transfer of production from relatively high cost producers to relatively low cost producers (e.g. relocating factories from the US to Vietnam), as two key contributors to the inflation rate persistently falling short of the bloated post-GFC expectations. But, back in 2009, reasons why inflation might stay surprisingly low weren't being widely mentioned at all. Will it be different this time? Perhaps, but we'll only find out in the future where, as we know, nothing is certain.

Even though economic growth has been strong in recent quarters (much of which can be attributed to the bounce-back from Covid-related lockdowns when economic activity stalled), the overall level of economic *activity* in most countries suggests that spare capacity still exists. This is most obviously the case in labour markets, where unemployment rates in developed economies are higher than those generally associated with full employment. When there is capacity in the labour market, new workers can be hired without necessarily impacting wages across the wider economy. This helps keep costs of production down and inflationary pressures in check.

As for the significant economic stimulus and increased money supply around the globe, we can't take it as a foregone conclusion that these will irrevocably drive inflation higher. Outside of the housing sector and the share market, the demand for money remains relatively weak. The post-GFC years already provide us with a template in which highly accommodative monetary conditions did *not* lead to persistently higher inflation.

Markets continually express their view of the future by the way they price securities every minute of every day.

That collective view generally sent government yields higher in the first quarter.

In the US, the 10 year Treasury bond yield increased by 0.82% (moving from 0.92% to 1.74% over the quarter) while the 2 year Treasury was almost unchanged. It is this 'steepening' in the yield curve that is generally an indicator of rising growth and inflation expectations. Other nations reflected a broadly similar pattern. The UK 10 year yield increased by 0.65% to 0.85%, and across Europe, where the vaccination programme is some way behind the US and UK, yields in Germany, France, Spain, and Italy also increased, although in smaller amounts.

Bond yields and bond prices have an inverse relationship (meaning bond prices *decline* when bond yields *increase*), so the rising yield environment was generally negative for the prices of fixed income assets in the quarter. As a result, the World Government Bond Index[6] and the Global Aggregate Bond Index[7] were down -0.4% and -2.5%, respectively for the quarter.

On 24 February, the Reserve Bank of New Zealand (RBNZ) held New Zealand's overnight cash rate (OCR) at 0.25%. This was the eighth successive "no change" decision since they reduced the OCR from 1.00% to 0.25% last March. In the accompanying Monetary Policy Statement, they noted they would "not change the stance of monetary policy" until they had confidence they could sustainably achieve their consumer price inflation and employment objectives. They qualified this by saying that "gaining this confidence will take considerable time and patience". In other words, the RBNZ doesn't see any overwhelming inflation pressures on the near horizon either, but of course their view, and the market's view, will continue to evolve as additional information becomes available in the weeks and months ahead.

Over the first quarter, the two year New Zealand Government Bond yields stayed largely unchanged, while the yield on 10 year Government Bonds increased by 0.82% (from 1.02% to 1.84%). In keeping with the movements internationally, this resulted in a similar steepening in the yield curve in New Zealand which was also negative for local bond returns during the quarter, as the New Zealand Corporate A Grade Bond Index[8] declined -2.1%.

Where interest rates and inflation may go from here is anyone's guess. Although the market has only a patchy record in accurately predicting future movements, it is currently pricing-in a higher inflation risk. However, the policy makers that actually decide the short term interest rate settings, like the RBNZ and the Federal Reserve in the USA, are less confident about the sustainability of the recovery. In the coming months (or years), it will be interesting to see if the market slowly adjusts towards the thinking of the policy-makers or vice versa.

In the meantime, the best strategy, as always, is to stick to your plan. It proved to be the right decision last April when the market fallout from Covid-19 was still fresh and it's very likely the right decision now.

Interest rates are already expected to gradually increase in the future. That's the expectation embedded into the upward sloping yield curves we see today, and it's also reinforced by government policies that are designed to relentlessly pursue greater economic growth. But whether these future interest rate increases happen faster or slower than the market currently expects, is really anyone's guess.

Although we can't expect another 12 months of strong double-digit share returns, well diversified portfolios nevertheless remain well placed to deliver the returns that the markets will ultimately make available.

[1] S&P 500 Index (total return in USD)
[2] MSCI Country and regional indices (gross dividend in local currency)
[3] MSCI Emerging Markets Index (gross dividend in USD)
[4] S&P/ASX 200 Index (total return in AUD)
[5] S&P/NZX 50 Index (gross with imputation)
[6] FTSE World Government Bond Index 1-5 Years, hedged to NZD
[7] Bloomberg Barclays Global Aggregate Bond Index, hedged to NZD
[8] S&P/NZX A-Grade Corporate Bond Index

Key Market Movements for the Quarter

The first quarter of 2021 saw broadly positive returns for riskier assets supported by the rollout of the Covid-19 vaccines, paired with ongoing supportive fiscal and monetary policy.

The start of the quarter was volatile, with the siege of the US Capitol Building threatening to overshadow or disrupt President Biden's inauguration on January 21. However, the 46th US president eventually took office without incident. Biden's early executive orders included rejoining the Paris Climate Agreement, directing the government to rejoin the World Health Organization, and the American Rescue Plan Act of 2021. The latter was a $1.9 trillion stimulus package to support the US's recovery from the pandemic and recession, including direct payments to most Americans, funds for vaccine distribution, and other business and healthcare support.

One of the most interesting stories of the quarter was the price action of several small US companies, most notably GameStop, a brick-and-mortar retailer of video games. An internet forum targeted GameStop's share price, pushing it up by as much as 30 times in early January. Their aim was to hurt hedge funds that were known to be betting against this firm. The initial price rise had its intended consequence as hedge funds were forced to exit their positions crystalising significant losses. However, as quickly as the price had shot up, momentum quickly turned, and the share price plummeted back towards its earlier range. The net impact on markets was negligible as GameStop, and the companies involved represented very minor weights, but it served as a reminder of the risks in holding concentrated positions. It also highlighted an understated impact that web forums can have on markets and shone a spotlight on the regulator's shortcomings in monitoring these areas.

The first quarter also saw the anniversary of the fastest market correction ever seen - during February and March 2020. The subsequent 12 month returns for many asset classes reflect the sharp subsequent recovery from those lows, providing a forceful reminder of the merits of a disciplined long term investment approach.

International Shares

+6.2% (hedged to NZD)

+8.1% (unhedged)

With global vaccination programmes underway, an improving economic outlook along with continued government support has meant improving prospects of companies' future revenue and profitability. This has been very positive for most share markets.

In the US, the flagship S&P 500 Index (total returns in USD), advanced +6.2% for the quarter for a remarkable +56.4% return over the past 12 months.

In Europe, share market performance was also very strong. The MSCI Europe ex UK Index (in local currency) gained +8.4% through the quarter and, during March, this index surpassed its highest pre-crisis level. The MSCI Europe ex UK Index gained +40.0% over the last 12 months.

British equities were also strong, although they did not increase at the same rate as their neighbours. In GBP terms, the FTSE 100 advanced +3.9% for the quarter and +18.4% for the last 12 months. Japanese equities were among the best in developed markets for the quarter, as a relatively weak Japanese Yen enhanced the revenue of exporters. The MSCI Japan Index jumped +8.9% for the quarter for a +43.5% return over the last 12 months.

Small capitalisation companies generally outperformed larger companies in the quarter and also posted higher returns over the last 12 months. Economically sensitive industries such as energy, industrials, and financials were the best performing as the prospect of strong economic growth drove their prices higher. Defensive industries such as utilities (e.g. power companies) and consumer staples (e.g. food producers) are typically less volatile and advanced at a slower rate.

Healthcare and information technology – sectors that had thrived through the pandemic – lagged through the quarter, although information technology remains near the top over the last 12 months.

The New Zealand dollar was generally weak versus foreign currencies and this meant that unhedged foreign assets outperformed. In New Zealand dollar terms, the MSCI World ex Australia Index delivered a quarterly return of +6.2% on a hedged basis and +8.1% unhedged. The rolling 12 month return for the New Zealand dollar hedged index was +49.7%, while the unhedged index gained 'just' +31.4%.

Emerging Markets Shares

+5.4%

Emerging market equities generated gains as well, albeit less than developed markets. The vaccine roll out in these nations has been slower than in developed nations, and high infection rates again meant social restrictions in some countries. Oil heavy economies such as Russia and Saudi Arabia were among the best performing nations as renewed global demand for oil pushed prices up. Taiwan was also strong, led by large semiconductor producers who produced good results.

Korea and India produced small gains while regional heavyweight, China, struggled in the face of ongoing US-China tensions, even under the new US administration.

In unhedged New Zealand dollar terms, the MSCI Emerging Markets Index produced a quarterly return of +5.4%, for a +35.8% return over the last 12 months.

New Zealand Shares

-3.9%

Although the Royal New Zealand Yacht Squadron proved to be world beaters, domestic equities took on a little water in the first quarter of 2021. It was a handful of disappointing results from the larger firms and the announcement of a 1 percent drop in our GDP during the last quarter of 2020 (worse than expectations) that knocked us right off our foils. In aggregate, the broad S&P/NXZ 50 Index declined -3.9%.

Dairy companies Synlait Milk and a2 Milk were among the poorest performers as multiple earnings downgrades soured investor demand. Synlait's largest client is a2 Milk, and a2 has seen demand for their infant powder dry up through the latter half of last year, negatively impacting both firms' reported profit expectations.

Meridian and Contact Energy also had volatile quarters, and each ended down more than -20%. Both had enjoyed a strong end to 2020 as high demand for these clean energy companies from international investors had pushed their prices up. However, during the first quarter, Standard and Poors signalled the expansion of their global clean energy index from 30 holdings up to 100, slashing Meridian and Contact's weightings. Investors tracking this index reduced their holdings in both companies which pushed each firm's price well down.

At the other end of the spectrum, Fletcher Building enjoyed another strong quarter, as did The Warehouse Group, which reported a record profit late in the quarter.

Australian Shares

+5.8%

Australian share market returns were strong over the quarter. The S&P/ASX 100 (the largest 100 companies in the Australian market) returned +4.5% in Australian dollar terms, while the S&P/ASX Small Ordinaries Index (the companies ranked 101 to 300 in the Australian share market) delivered +2.1%. Over the last 12 months, small capitalisation companies have been very strong, with the S&P/ASX Small Ordinaries Index up +52.1% versus +36.8% for the top 100 companies.

The strongest performing sector in Australia was financials, where Westpac led the rally on the back of strong profit reporting through the quarter. The market sees an improving outlook for the banking sector with a strong economy and a thriving housing market, in particular, helping profit projections.

Heavyweight miners BHP Group and Rio Tinto posted small gains, however many of the mid cap gold miners posted losses as the price of gold fell during the quarter, harming these firms' prospects.

Returns to unhedged New Zealand investors were slightly enhanced by a small appreciation in the Australian dollar over the quarter.

International Fixed Interest

-0.4%

As mentioned earlier, longer term yields broadly rose as the market priced in prospects of an improving economic growth outlook. As was the catalyst in equity markets, the vaccine rollout and continued government support drove expectations, and the market began to price in interest rate increases earlier than was the consensus at the start of the year.

The US 10 year yield – the yardstick for global yields – increased to 1.74%, effectively returning it to pre-Covid levels. These yields are now at the lower end of the broad range observed in the decade following the GFC. Many developed market government yields saw similar moves, with the 0.83% increase in the US being matched in Australia with the UK not far behind. Yields in the European union also rose, although by smaller magnitudes. The Japanese 10 year yield was relatively unchanged.

When bond yields are relatively stable, bond investors receive the bulk of their return from the bond yield and from something called the 'roll down' return, which is a valuation benefit that generally accrues to investors as the bonds they hold move closer to maturity. At the start of the period, both of these sources of return were minimal as yields were low and curves were relatively flat. In the first quarter, the prices of bonds fell as bond yields increased sharply, and the impact of the lower bond prices was far larger than the positive combined yield or roll down benefits.

Longer duration bonds were hit the hardest, while corporate bonds performed slightly better than government bonds. The FTSE World Government Bond Index 1-5 Years (hedged to NZD) declined -0.4%, while the broader Bloomberg Barclays Global Aggregate Bond Index (hedged to NZD) returned -2.5% for the quarter. These declines are among the worst seen in this asset class since the turn of the century. However, the impact of Covid-19 on both equity and bond markets has generated some short term results (both good and bad) which have been far from normal. When we look at the annualised performance of bonds over longer time periods, we quickly find returns that are a lot closer to long term expected averages, such as the Bloomberg Barclays Global Aggregate Bond Index (hedged to NZD), which has returned +4.0% pa over the 3 years to end March 2021.

It should also be noted that although the increase in yields contributed to a negative quarter for bonds, it also serves to *increase* the expected return of these same assets going forward.

The final silver lining within this period of higher volatility in bond markets is the diversification benefits we have seen in portfolios. This negative performance on fixed income assets occurred alongside another very strong performance from the riskier equities. The flipside of this was exhibited during the initial Covid-19 crisis early last year, where high-quality fixed income assets benefitted (at that time) from a drop in yields when equities were delivering large losses. This is precisely the sort of diversification benefit we expect from pairing these different asset classes together in portfolios; when one does poorly, the other will often perform well and help carry the portfolio.

New Zealand Fixed Interest

-2.1%

Yields in New Zealand followed the global trend and spiked with the NZ 10 year yield closing the quarter at 1.84%, 0.82% above its starting point. The impact was negative on performance, although generally less so here than overseas, as our market has a relatively shorter average time until maturity, and the yield changes were less amplified.

NZ Government bonds generally outperformed credit securities, and shorter maturity bonds that have less price sensitivity to rising interest rates outperformed longer maturity bonds, but generally, all parts of this asset class posted losses.

The S&P/NZX A-Grade Corporate Bond Index declined -2.1% over the quarter, and the rolling 12 month return has been +1.9%. Longer term performance remains robust, with both the 3 and 5 year annualised average coming in at +4.0%, while the 10 year return is +5.0% per annum.

The longer duration but higher quality S&P/NZX NZ Government Bond Index declined -3.4% for the quarter and has retreated -1.6% over the preceding 12 months.

Table 1: Asset class returns to 31 March 2021

Asset Class	Index Name	3 months	1 year	3 years	5 years	10 years
New Zealand Shares	S&P/NZX 50 Index, (gross with imputation credits)	-3.9%	+28.9%	+15.7%	+14.3%	+15.2%
Australian Shares	S&P/ASX 200 Index (total return)	+5.8%	+45.0%	+10.5%	+9.8%	+5.6%
International Shares	MSCI World ex Australia Index (net div., hedged to NZD)	+6.2%	+49.7%	+12.4%	+13.6%	+12.0%
	MSCI World ex Australia Index (net div.)	+8.1%	+31.4%	+14.2%	+13.2%	+11.0%
Emerging Markets Shares	MSCI Emerging Markets Index (gross div.)	+5.4%	+35.8%	+8.1%	+12.2%	+4.9%
New Zealand Fixed Interest	S&P/NZX A-Grade Corporate Bond Index	-2.1%	+1.9%	+4.0%	+4.0%	+5.0%
International Fixed Interest	FTSE World Government Bond Index 1-5 Years (hedged to NZD)	-0.4%	+0.6%	+2.6%	+2.3%	+3.5%
New Zealand Cash	New Zealand One-Month Bank Bill Yields Index	+0.1%	+0.3%	+1.1%	+1.5%	+2.2%

Unless otherwise specified, all returns are expressed in NZD. We assume Australian shares and emerging market shares are invested on an unhedged basis, and therefore, returns from these asset classes are susceptible to movement in the value of the NZD. Index returns are before all costs and tax. Returns are annualised for time periods greater than one year.

Housing affordability... where to from here?

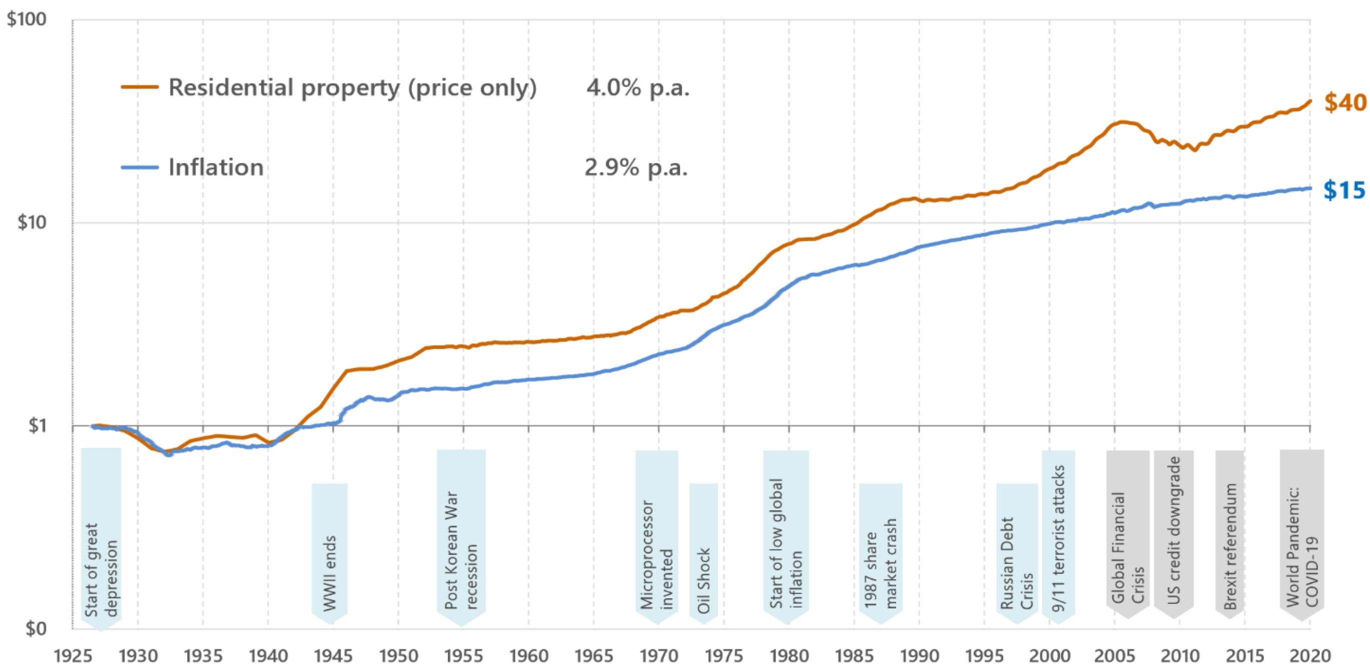
For generations, property has been the preferred investment of many New Zealanders. Those of us fortunate enough to own our own homes take great pride in doing so. But, for many, the attraction runs deeper than simply having a roof over our own heads. We *understand* property. We *trust* property. We also know that over a long period of time, investors in residential real estate have often been able to generate a very good return from property.

When we look at property markets overseas, residential property generally represents a solid if unspectacular investment. For example, in the chart below, we can see that the average price of residential property in the United States has increased by only 1.1% above the rate of inflation over the last 93 years. This price series *excludes* the effects of capital upgrades that occur when you spend additional money to maintain or make improvements to your property.

This makes intuitive sense because if the price of property (excluding capital improvements) were to increase much faster than the rate of inflation, it would eventually outpace most people's ability to purchase it!

But that's not what seems to have happened locally here in New Zealand.

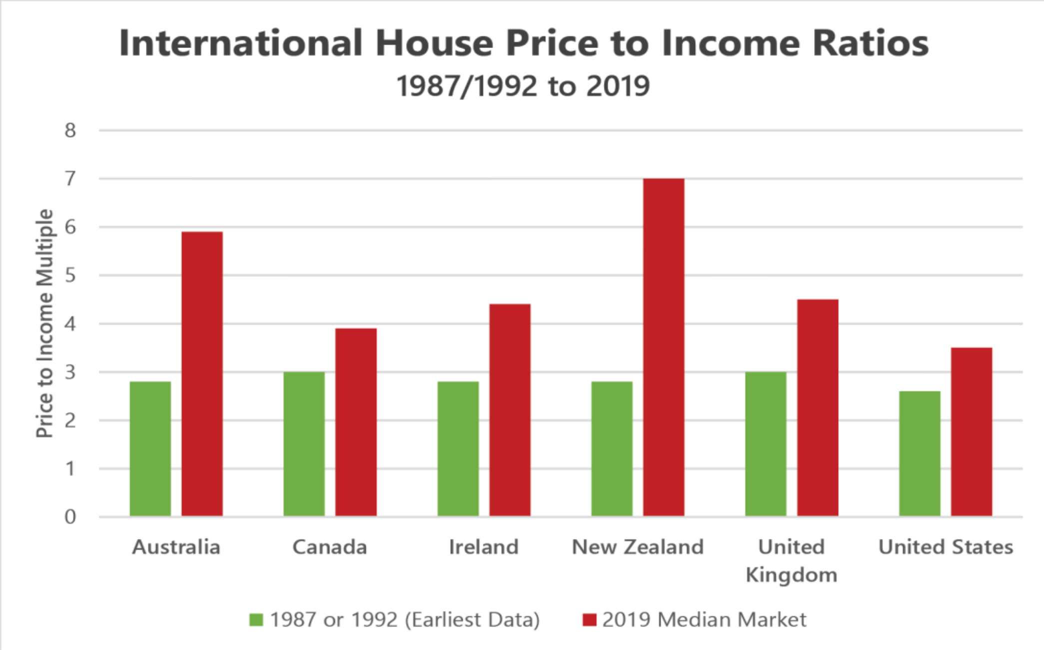
Long term growth of residential property and inflation 1927 - 2020



Analysis period is for June 1927 to December 2020. All returns are in US dollars

Sources: **Residential property:** 01/1920 to present - Shiller Home Price Index (source: Grebler, Five-CityMedian, PHCPI, FHFA, S&P/Case-Shiller). **Inflation:** US Consumer Price Index (source: Stocks, Bonds, Bills and Inflation, Chicago: Ibbotson and Sinquefield, 1986. Represented by Consumer Price Index for All Urban Consumer (CPI–U), not seasonally adjusted. The CPI is updated with a one month lag).

Note: These materials are only prepared for client education purposes. Consilium has taken every care in preparing this information. Although the data has been sourced from publicly available information and/or provided by the investment managers, we are not able to guarantee its accuracy. Past performance, whether actual or simulated, is no guarantee of future performance.



The overall result is that New Zealand housing is much more unaffordable than it was 30 years ago, and it is much more unaffordable, on a relative basis, compared to other countries.

The above chart shows data from the Demographia 2021 study on international housing affordability and compares housing affordability from about 30 years ago to today.

The measure of affordability is the national average home price as a multiple of the national average income. This measure helps us make an easier comparison between countries with different income levels.

As can be seen quite clearly above, the red bar is twice the height for New Zealand as the green bar. That means it takes almost twice the income to purchase a house now compared to 30 years ago. This chart is based on 2019 data, so with the recent strength in the housing market, it's very likely to be even worse today. We also observe that the red bar for New Zealand is higher than comparable English-speaking countries.

This probably helps explain why the New Zealand government felt compelled to introduce some changes to the tax regime faced by residential property investors.

The two main changes announced in March were:

1. The extension of the 'bright line test' to 10 years for existing residential property (maintained at 5 years for new builds). This means an effective tax on any capital gains made on properties sold earlier.
2. The removal of tax deductibility of interest expenses for homes purchased from 27 March 2021, with deductibility to be phased out entirely over the next four years.

It seems these changes have been introduced with the intention of reducing the profitability, and therefore the incentive, of investing in existing residential property. And, if it removes the incentive for property investors to purchase the existing housing stock, then it might just make more room for the ubiquitous 'first home buyer' that the government spends so much time trying to figure out how to help.

It is far too early to tell whether these policy changes will have that desired effect, because at least part of what's driving New Zealand's relatively unaffordable housing market is a supply side issue. House prices are already high; but if these high prices aren't inducing sufficient investment into new property developments, then there must be some constraint either on the supply of land, materials or labour. Solving these issues isn't anywhere near as simple as creating or extending a 'bright line test' for capital gains.

In the Demographia study, former Prime Minister Bill English is quoted as saying "*Housing affordability is complex in the detail - Governments intervene in many ways - but is conceptually simple. It costs too much and takes* *too long to build a house in New Zealand. Land has been made artificially scarce by regulation that locks up land for development. This regulation has made land supply unresponsive to demand."*

From an investment point of view, we've traditionally told clients that have wanted to pursue residential property investment that they needed to treat it like a business — their own property business.

They can hope for (but can't guarantee) that house prices will rise. Therefore, they need to ensure they have a property that makes sense from a rent and cashflow perspective. They need to consider the time and cost of capital improvement and realise that they don't own the "median house". They own a physical property that renters use and inevitably damage, and their property will depreciate and will need maintenance to improve it. Some who have undertaken residential property investment on this basis and approached it thoughtfully, like a business owner, have done very well.

But the government is now saying that investing in residential real estate is *not* a business, so interest expenses will not be an allowable deduction like it is in any other business. Additionally, turning over a property investment within 10 years might also have significant additional tax consequences. The end result is likely to be that the smaller and more leveraged investors might increasingly begin to look elsewhere to grow their wealth, like the sharemarket.

New Zealanders are unlikely to suddenly lose their love-affair with residential property. Those feelings have been nurtured by generations of New Zealanders being able to successfully gain leveraged exposure to an asset class that has, over time, steadily appreciated in value. Critically, those leveraged capital gains have historically been 'tax free' and with interest rate deductibility benefits!

However, in light of the recent tax changes, it is possible the rate of future capital appreciation in this space might slow. That's certainly what the government will be hoping. Some investors may think twice before investing and some may change their strategy entirely. But it would be a brave person to suggest that this will mark the end of residential property investing.

The bricks and mortar appeal of investing in housing has, for a long time, resonated with Kiwis in a way that better performing assets classes have never been able to match. While that might change, we wouldn't bet my house on it.