QUARTER 3 2015 NEWSLETTER

Financial Freedom

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Planning For The Unpredictable

Preparations for the US presidential election are in full swing, and at this stage there are some surprises

For the Republicans, John (Jeb) Bush was expected to hold a commanding lead, but is presently being outscored by an outsider, Donald Trump. For the Democrats, Hillary Clinton was seen as the presumptive nominee, but is embroiled in ongoing scandals (or media beat ups depending on your political leanings) and may face a harder time than expected.

Away from the US presidential election, we've seen closer to home predictions can also look dubious after a relatively short period. Most of us will remember the "rock star economy" quote that was bandied about in 2014, and it has been re-used as recently as mid-2015[1].

Now in August 2015, mere months after the economy was reaffirmed as a "rock star", the collapsing dairy prices have seriously impacted dairy farmers, and the flow on effects are being seen through the economy. Serious concerns are held that New Zealand could face a dismal economic future, far from the rock star prediction.

Internationally we have seen other countries face unexpected economic headwinds. China saw massive growth in its sharemarkets until June 2015, when prices crashed by up to 30% in a few weeks, with loses estimated at US$4 trillion.

In light of these sudden changes, how well have your plans held up? For most of us, we still expect about the same income and expenditure over the foreseeable future. If you haven't yet retired, you probably are still aiming to retire at the same time. Your goals are probably relatively unchanged.

So does that mean planning is redundant? Is achieving your goals just a matter of luck and circumstance?

1 Paul Bloxham: NZ's economy still moves like Jagger, NZ Herald, 18 June 2015

Following the US presidential theme, perhaps this sums up the best approach:

"*Give me six hours to chop down a tree and I will spend the first four sharpening the axe*" - Abraham Lincoln

When making your financial plans, make sure you have considered the sorts of risks mentioned above, unforeseen events. If the risk is that the New Zealand economy is badly affected by falling dairy prices, make sure that your investments are not concentrated in a single sector (such as farming) or country (such as New Zealand). If the risk is that the Chinese sharemarkets fall rapidly, make sure that you are not overexposed to that volatile market.

The goal is to ensure that you do not have all your eggs in one basket - otherwise known as diversification. You want to limit your exposure to downside risks, but also to ensure that you are positioned to benefit from any positive developments.

This provides investors with lower volatility (the rises and falls in their portfolio are not as extreme), but greater certainty about their ability to achieve their goals.

Planning for unpredictable events does not mean knowing the future, but a good plan prepares you for future uncertainty, in part by seeing how others have dealt with unforeseen events. Whilst you cannot do much about dramatic changes in the dairy prices or international sharemarkets, you can see how these events are affecting your goals. A qualified financial adviser can help you establish your goals and provide a plan to achieve them. They can advise you as to whether action is required to ensure you achieve your goals, and what options you have. This avoids making unnecessary changes to a perfectly good plan, or failing to make changes when they are necessary.

Article by IOOF New Zealand Ltd

G3 Financial Freedom Editorial from the desk of Cathy Fletcher (G3 Office Manager)

I am hoping we are now through the worst of winter with spring here and the weather slightly warmer. The days are already noticeably longer. Roll on summer!

With so much communication happening by email I thought it timely to remind you all to be extra vigilant with the scams that come via email. Some of them are so obvious that they are almost funny, that is unless you are caught out by them. Others are quite worrying because they could entice you to click on to that link to "your bank website" to check an internet banking message or improve the security on your account. I must receive at least two or three a day and some of these look like they come from the bank I bank with. However, they have trojans imbedded in them. I think we all need a reminder that things aren't always what they seem. Tell anyone you think could be vulnerable to this sort of thing, especially our older generation or those not in the workforce who might not be exposed to it very often that an email just like that could be sent to them. I was just reading about scammers phoning up purporting to be Microsoft employees saying that your computer has a virus and by giving them the computer login details and your credit card details they would sort it all out for you. I know it sounds obvious but it is not to everyone so do remind all our generations that this sort of thing goes on.

It is because of this very sort of thing that we sometimes might sound like we are going over the top in asking for identification or forms to be signed. We are here to look after your investment and to make sure that it stays safe from fraud.

If you ever have any doubt that it is us that has emailed you or phoned you please call the office here to check, we will not think you are being paranoid!

Your Children Might Thank You For This

Our job as parents is to inspire our children to take control of their own financial well being, rather than simply educate them about money. The more we get children excited about the potential and importance of their financial futures the more they will take charge responsibly - you hope.

If any of your children are coming up to the end of their education years and moving out into the big wide world in the next few months then they are about to become adults. You will be there for advice going forward but they will be financially independent - you hope.

There are financial realities in their life that they will face that, coming to grips with now might save tears and heartache down the track for everyone.

1. Having savings control their spending habits will turn out better than if spending determines how much they save

One of the areas kids today have it harder than we did, is controlling their spending and developing good habits around that. They are bombarded 24/7 with advertising aimed at getting them to spend money, their own or their parents. We had to go to a store between Monday and Friday with cash to spend. Today shopping is 7 days, online and with cards. Not that there is anything wrong with spending, it just shouldn't drive all other decisions.

All too often we only save what is left after all that spending instead of putting the savings away first and spending an allowance.

2. Age is an opportunity

The more years compound interest has to work its magic, the less the catch up is required at the other end. Although compound interest sounds like it refers only to bank deposits, it also works for investing in funds; only there it is the dividends reinvesting. They will thank themselves more for starting early the closer they get to retirement.

3. Get rich quick is elusive; diligent effort typically adds up to more

As my grandparents always said 'look after the pennies and the pounds look after themselves'. You may have to translate that for your young adult. Paying attention to every day spending costs adds up to big dollars over time.

4. Paying off student debt

Whilst the debt has to be repaid, and at the very least the minimum payments met, it could be more prudent to use extra funds to reduce higher interest debt like credit cards or overdrafts first. Start putting some away as emergency money then zero in on that loan.

5. They survive emergencies by being prepared

I know, emergencies only happen to other people! Various problems will crop up, they always do, cars, dentists, bonds for flats and other big ticket items, jobs could be lost or unexpected bills when things break down. Set aside a small amount every payday for things out of the blue.

6. Believe you can do it and then work to make it a reality

You will get that debt paid off and you could own your own home. Work for it. Protect it.

Two great things you can give your children: one is roots, the other is wings

Hodding Carter

The Benefit Of Diversification

Always keep your portfolio and your risk at your own individual comfortable sleeping point

Mario Gabelli

The topic of diversification has been described in many ways. One of our favourites is "protection from ignorance". Another is the famous "don't put all your eggs in one basket."

But to truly get to the heart of why investors should diversify, it's helpful to illustrate the benefit.

First, a little history. Harry Markowitz won a Nobel Prize in Economic Sciences for the novel concept that investors care about **more** than simply a great investment return. They also care about the **certainty** of getting that return. The more certain investors are, the lower the expected return they are willing to accept.

But how can we measure certainty? Markowitz suggested that an acceptable method was standard deviation. It is a simple measure that calculates, essentially, the typical difference between a series of numbers and its average. A series of numbers all bunched up around the average has a low standard deviation. A series of numbers that vary widely around the average has a high standard deviation.

For investors, the concept is perhaps even more intuitive. How consistent have their returns been? Have they been up and down like a rollercoaster (high standard deviation) or have they tracked at a consistent rate (low standard deviation). All things being equal, an investor would prefer to have a nice, consistent return. A return like that gives them a lot more certainty about the near future.

Markowitz found something extraordinary in his research that most of us now simply take for granted. He found that if an investor held all the investments in a market (such as the NZX 50), they got about the same average return but at a much lower standard deviation as those picking their favourite shares. Believe it or not, that was an industry shattering discovery. If you can get the same benefits (returns) with more certainty (lower standard deviation), it could be a bit foolish to not take advantage.

That background takes us to our chart below, where we show all the companies in the NZX 50 that have been listed for at least 10 years (as reported by Morningstar), compared o the NZX Portfolio Index that simply invests in all 50 companies. The chart perfectly illustrates Markowitz's conclusion.

Here are some facts about this chart.

- Morningstar suggests there are 28 securities currently in the NZX 50 which have been listed publically for 10 or more years
- The NZX 50 Portfolio Index has **higher returns than 57%** of the individual components
- It also has **lower volatility than 93%** of the individual components
- Based on the Sharpe Ratio (a commonly used gauge to measure if investors are being compensated for risk), the **risk adjusted returns of the NZX 50 Portfolio Index are better than 70%** of the individual components.

In plain language, that is the benefit of diversification. The irony of all this benefit is that it is less expensive to access than an under diversified alternative.

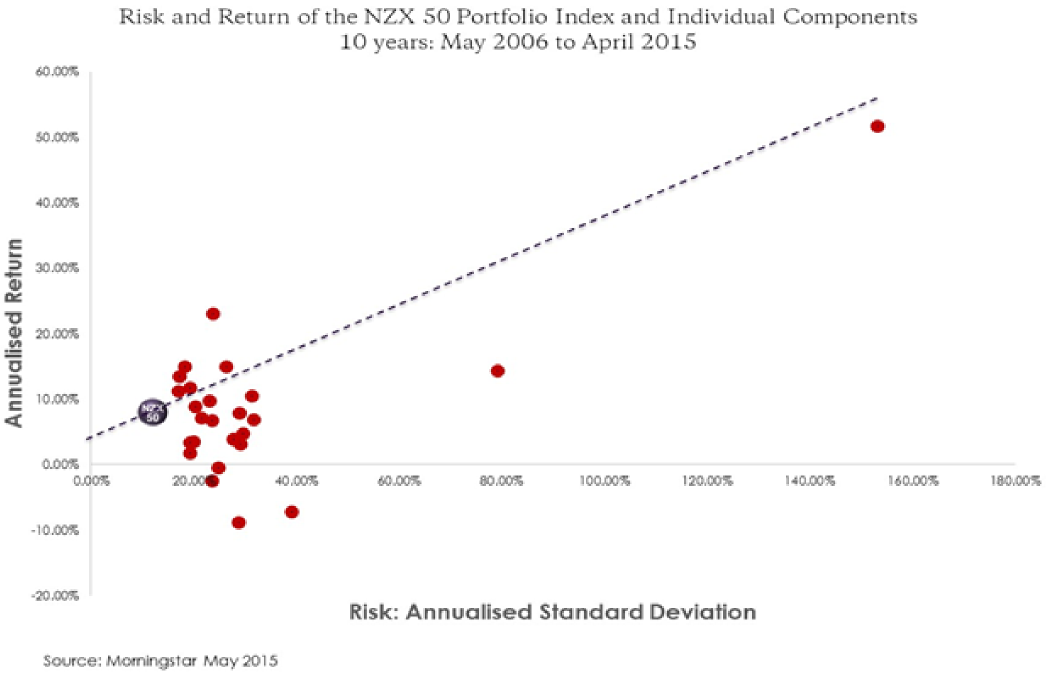
Accessing a fund that invests in the NZX 50 Portfolio Index is less costly than investing in a fund where the manager selects a few of the bunch in an attempt to try to beat the index.

With diversification, investors are the real winners. They get higher returns, greater certainty, and pay less for it.

Who wouldn't want that?

Article by Ben Brinkerhoff Of Consilium

Returns are on the vertical axis - the higher, the better. Standard deviation is on the horizontal axis - the lower, the better. The dotted line illustrates that, as you increase standard deviation, you should expect greater returns, although that isn't always the reality.



What Is Happening to Markets?

The recent sell off in markets resulted from concerns about Chinese growth and its recent devaluations. Earlier in the year the Chinese stock market had a large rally increasing 60% since the start of 2015. After such a large and quick increase it was nearly inevitable that there would be a sell off. The decline from the peak is now over 40%, having lost all the earlier gains, and is now back to late 2014 levels.

In size terms the Chinese stock market is not that big or important - rather it is the signal and possible contagion effect upon other markets. Just like Greece impacted world markets, China is impacting the important US and European markets. The US market is now technically in a correction (10%+ fall) with all major US indices falling over 10%. At one point on Monday night August 24th 2015 the Dow was down over 1000 points, but then bounced back.

Information is the resolution of uncertainty

Claude Shannon

How is this different to the 1987 stock market crash?

Whilst the point declines are now larger than in the past and seem large, compared to the percentage declines of the past they are much smaller. For instance, on Black Monday in 1987 the Dow declined over 22% and the Australian equity market declined over 40% in that period. The decline in the Dow has been around 5% to 6% or lower taking into account bounce back. It should be remembered that the US market is up around 200% since the GFC, being one of the longest stock market rallies in history. Along the way we have had a number of corrections, which have all been buying opportunities.

Could this time be different?

Nearly all markets and asset classes have been at elevated levels as a result of the massive monetary stimulus after the GFC. Some sort of correction was long overdue and markets need to find a new equilibrium level where valuations are not as elevated and prices are supported by fundamentals. In the short-term a lot will depend upon the policy response by Governments and policy makers. If markets fall much further some sort of coordinated policy response is likely.

There are a number of negatives and positives to come out of the recent volatility.

On the negative side, China is the second largest economy in the world and a slowdown here will have a much larger impact than the Greek crisis. China has been responsible for over 50% of world economic growth over the last few years and has been an important source of revenue for many multinational companies.

The China slowdown is severely impacting commodity prices such as iron ore, coal and now oil which is negative for Australia and its terms of trade and currency. Resource stocks are likely to remain in the doldrums for the foreseeable future.

On the positive side, inflation remains well contained due to lower prices, there will be no incentive to increase interest rates (the Fed may remain on hold now) and lower oil prices will be stimulatory for world economic growth. Thus, with a reasonably benign macro environment, lower prices for assets, possible policy responses and still a lot of cash on the sidelines, a case can be made for a stabilisation of markets.

Going forward, markets are likely to be volatile and investor confidence has been impacted (maybe a reality check we needed to have) but it is still too early to call an end to the bull market.

Article courtesy of Steve Merlicek
IOOF, Chief Investment Officer

G3 FINANCIAL FREEDOM
Goals + Guidance = Growth

G3 Financial Freedom Ltd
55 Eighth Avenue
PO Box 13563
TAURANGA 3141

Phone: 07 571 5333
Fax: 07 571 5339
Email: admin@g3freedom.co.nz

G3 Financial Freedom Ltd - We Make Every Day Count

We are the financial advice company that can help you create the financial future you desire with peace of mind, security and confidence. We operate under the rules of the Financial Markets Authority and abide by the Financial Advisers Act 2008. We are voluntary members of the New Zealand Institute of Financial Advisers.

We are all Certified Financial Planners, Chartered Life Underwriters, Accredited Investment Fiduciaries and we are all Authorised Financial Advisers. Talk to us about your financial future now. It is never too late to begin.