FORSYTH BARR

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SPECIAL REPORT
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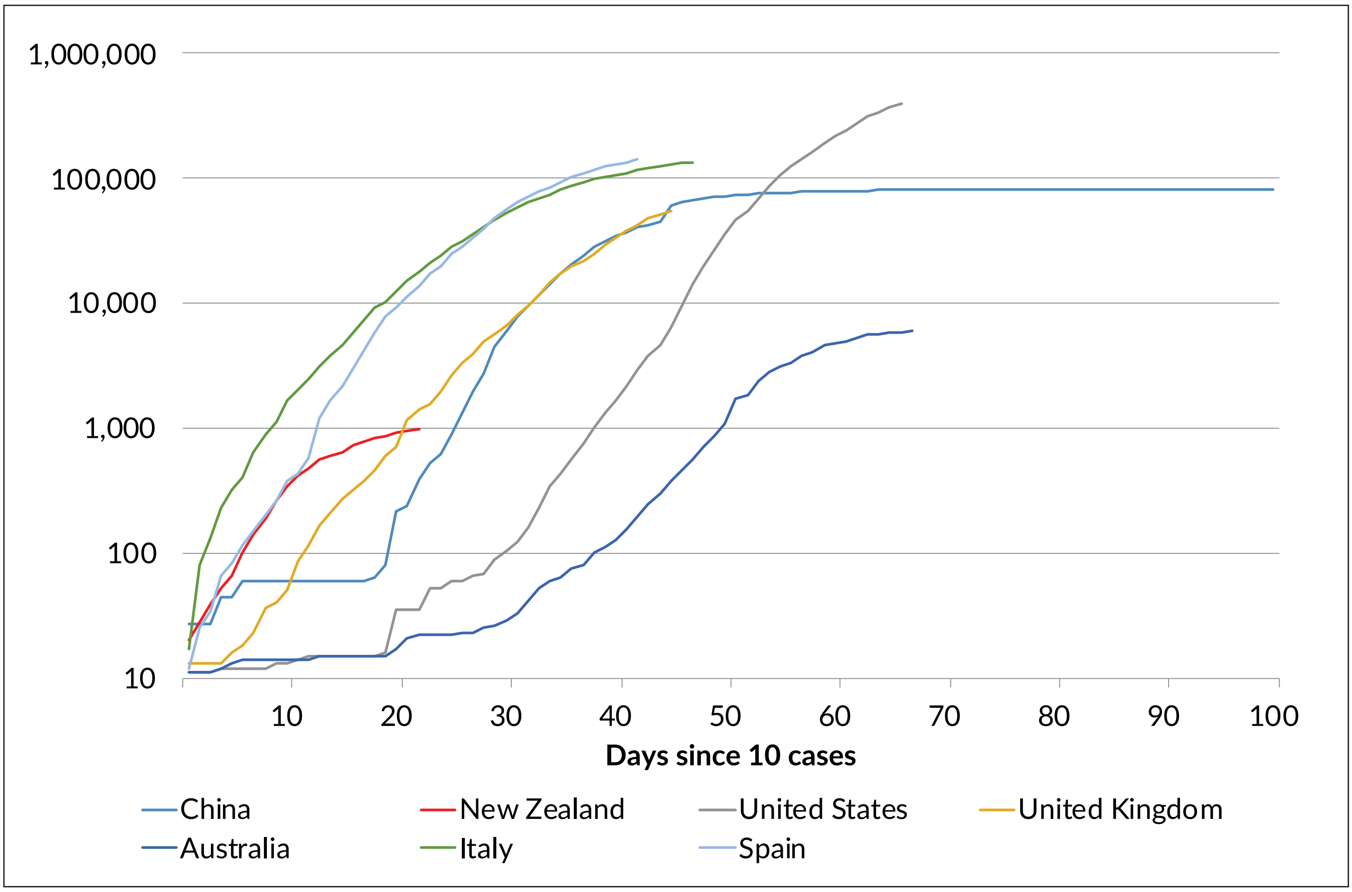
Will Tina Play an Encore?

The past week has been a good one for equity markets, responding to slowing new COVID-19 cases in hot spots like Italy, Spain, and potentially New York. Here in New Zealand it appears the lockdown is working – fingers are crossed that measures may be eased sooner rather than later.

While positive news is welcomed, the outlook for both the virus, and the resulting economic impacts, remains highly uncertain. In the near-term we expect news around the virus itself will drive markets — you only have to look at the past two months to appreciate news-flow and sentiment can swing quickly. Longer-term, the damage COVID-19 has wrought on people and economies will have ramifications for investment markets for years to come.

COVID-19 cases: New Zealand flattening the curve



Source: European Centre for Disease Prevention and Control

Legacy of the last crisis

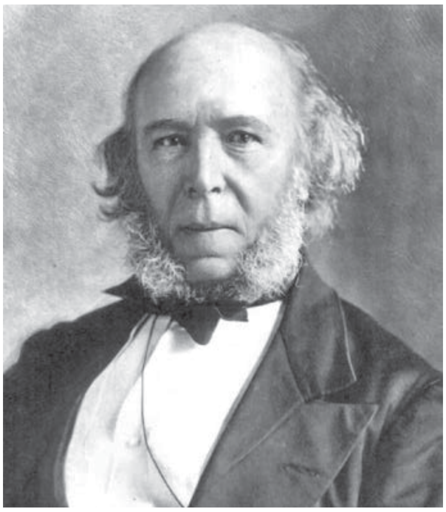
The last global economic crisis was the Global Financial Crisis (GFC) of 2007/08. It began with the crash of the United States housing market. Housing loans turning bad caused a number of banks and other financial institutions that held these loans to fail. There were fears that a domino effect, the spread of bad debts from one institution to another, could threaten the entire financial system. It led to the worst global recession since World War II.

Central banks around the world responded to shore-up the financial system with unconventional policies like negative interest rates and QE (quantitative easing, the purchasing of government bonds or other securities). A legacy of the GFC has been these "unconventional" policies have become "conventional". Ultralow interest rates have persisted around the world ever since.

Along came Tina

TINA, shorthand for "there is no alternative", was coined by British intellectual Herbert Spencer in the 1800s. In recent years, the "Tina effect" has been used to explain the behaviour of investors and markets. In a world of ultralow interest rates (and low returns from bonds and term deposits), for many investors "there is no alternative" to equities to generate an acceptable investment return.

Against this backdrop, New Zealand's high dividend yielding market (which has the additional appeal of tax efficiency through imputation credits and no capital gains tax) has been one of the top performing markets globally over the past decade. A large part of this return has been from investors willing to pay a higher price for the income generated by businesses in sectors such as utilities, telecommunications and property.



Herbert Spencer (1820 - 1903)

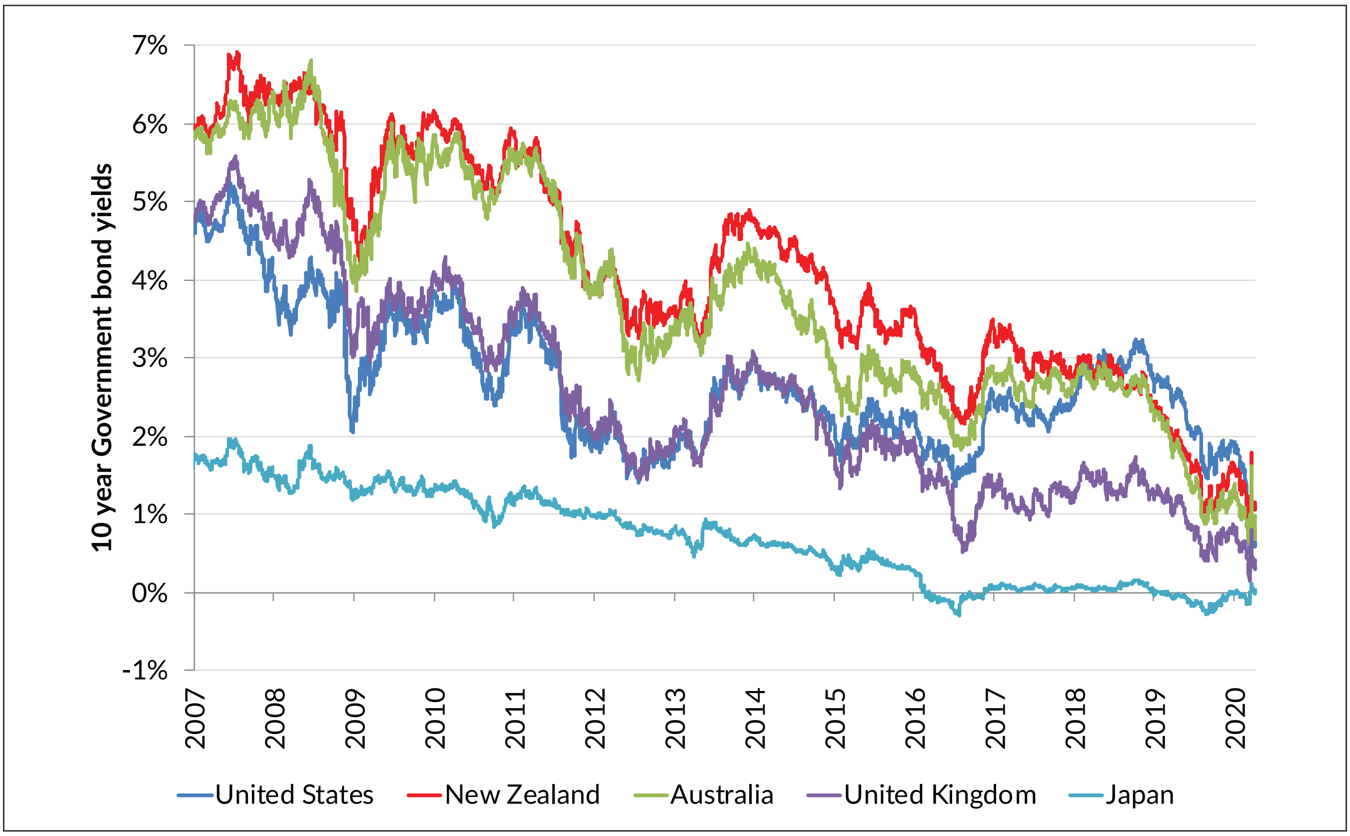
How low can we go?

Before we'd ever heard of COVID-19, central banks around the world had been telling us interest rates would remain low for the foreseeable future. Now low interest rates will be even lower.

The cost of COVID-19 for governments will be large, from the packages to protect businesses and jobs, the stimulus spend to help a recovery after the virus passes, and the lost tax revenue. Government debt around the world is forecast to jump to the highest level since the war impacted the 1940s. Back then, repayment of that debt was helped by the baby boom and strong population growth in the decades that followed. Today we face the opposite, the world's population growth is slowing, and the ageing population means higher pension and healthcare costs for governments.

High government debt levels and the desire to support economic growth could firmly ensconce low interest rates and other monetary policies like QE as the norm.

Interest rates: 10-year government bonds



Source: Refinitiv

Income will be harder to find

Like the GFC, COVID-19 will pass. But there will be legacy impacts. One for investors is that income will likely be harder to find. Not only will the interest earned from bonds and term deposits be low, but many companies will reduce or cancel dividends. There are a range of reasons. Earnings will be lower. Companies will want to be cautious given the uncertain outlook. Many will have to pay down debt accumulated to help them through the crisis. And companies will need to be conscious of being seen as good corporate citizens during this period, meaning prioritising protecting jobs and vulnerable customers over paying dividends to shareholders.

What's an investor to do?

A low income environment will create difficulties for some wanting to live off their savings. Unfortunately, there is no silver bullet solution. The options for an investor depend on individual circumstances. Whilst fewer in number, there remain some attractive income options within equities. Those who are able to increase allocations to these higher-risk/higher-return assets might be able to do so. However, taking more risk should not come with a high chance that an investor can't meet his or her essential needs — as the past few months have reminded us, avoiding "sleepless nights" is valuable. Spending less typically feels unpalatable, but is a low risk option. For some investors consuming some capital may be more favourable than bearing increased risk. The majority of investors do not consume all their capital over their lifetime. For many these will not be straightforward questions. Your Forsyth Barr Investment Adviser is here to help you to consider your options, provide advice, and ensure that your investment plan supports your present and future lifestyle needs.

Matt Henry
Head of Wealth Management Research

The Board and staff of Forsyth Barr wish you a safe and happy Easter holiday

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