Intelligent Investing

KINNELL & CO

RBNZ crushes savers... again

There has been a lot of talk about higher interest rates in recent months making term deposits a potentially more attractive option for savers again after years of enduring quite pitiful returns on invested capital. And to be fair term deposit rates from 6 months to 2 years have edged up around 0.3-0.5% since mid-2016. However, this does not look like a return to the good old days of earning a relatively risk free 5, 6, even 7% from leaving your money in the bank. The best generally available two-year deposit from a major bank is 3.80% while you have to fix for three years to achieve a 4.00% gross return (2.68% after tax at 33%). Hardly the stuff to write home about. It was against this backdrop that we heard from the RBNZ last week with their latest Monetary Policy Statement and they did not fail to disappoint…. if you're a saver that is.

The RBNZ left the official cash rate at 1.75% maintaining the OCR at a record low. That aside they sounded more upbeat about the world – they spoke of a recovery in commodity prices, improving business and consumer sentiment leading to an improved outlook in advanced economies, and they noted slightly higher inflation and recent moves higher in global interest rates. That all sounds rather encouraging if you are wanting higher deposit rates in NZ. But alas they ended with the statement that monetary conditions will remain "accommodative for a considerable period". So, what does that mean? Well the answer is in the RBNZ's projections which show the potential for one rate hike of 0.25% in late 2019 or early 2020. So, if you're a saver hoping for higher deposit rates the next two to three years don't look great. A cash rate of 2.00% in three years' time is unlikely to see term deposit rates budge from the 3.00-4.00% range they are currently stuck in for 6 months-3 year terms. Just this week a major bank cut its one-year mortgage rate to 4.39% as recent increases in wholesale interest rates look to have petered out for now. So, what are the alternatives if you want a higher return on your capital?

- High quality New Zealand Corporate Bonds offer yields of 4.30-4.80% but you will likely need to be investing for a period of 5-7 years;
- Many listed New Zealand Property stocks offer yields in the region of 7.50-8.50% but that does entail taking some risk of changing share prices;
- Like-wise sound New Zealand listed companies can offer yields of 5.0-8.0%, a few even higher, but that also comes with some investment risk as do Australian and Global shares which have the added layer of exchange rate movements.

We think the answer for those investors who have a medium-term view, say 7-10 years or more, as most retirees should (the average 65-year old will live well into their 80's – men 84, women 87, and hopefully in reasonably good health for most of that time), is to build a diversified portfolio of assets capable of providing an annual income return of 4.0-5.0% (net of taxes and fees). That translates to $40,000 to $50,000 a year of retirement income from a $1,000,000 portfolio, rather than maybe $20,000-$25,000 from leaving that investment capital in term deposits. Of course, you can also start to use up investment capital as you get older as inflation matters less once you're 80. All investment returns in the world we live in are lower than they were a decade ago but you can build an investment portfolio that will double your retirement income. At age 65 there is still likely 20 years before what you don't spend on living and travel will form part of your estate. Ample time to maintain a medium-term investment horizon.

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