Intelligent Investing

KINNELL & CO

We're on the Road to Nowhere…

In February we asked the question "Has TINA spread to Australasia?" The reference to TINA became common in the US after the GFC when the US Federal Reserve reduced US rates to effectively 0% and stands for 'there is no alternative' to investing in stocks. Well, TINA is here, and the only question is we don't know how long for, but it is likely for several years.

What a difference a few months makes as when we posed the TINA question in February it still appeared that the US and China might reach an amicable agreement but now that looks like the naïve hope of a couple separating their assets before the divorce lawyers get involved and relationship breakup turns toxic. Back in February the Federal Reserve had only just backed away from their 2019 rate hike track of two to three interest rate hikes and of course they have since cut rates once and will likely cut at least once more this year. Downunder the RBA has cut twice since the Australian election to 1.00% with analysts almost competing to have the lowest cash rate forecast across the ditch, and of course the RBNZ did not want to be left behind in the global rush to cut rates. The RBNZ surprised last week by cutting 0.50% to 1.00% but at least a 0.25% rate cut was a certainly so by going 0.50% they shook things up with the NZ Dollar sliding and global bond markets were seemingly spooked that such a respected, albeit small, central bank as ours would act so aggressively. The NZ share market response has been predictable with stocks that provide reliable dividends like power companies and listed property stocks surging further after several months of already strong gains. The concern is that as interest rates head towards 0% (the RBNZ even discussed the use of negative interest rates, a surreal prospect when we think about the long history of NZ interest rates being at a premium to most of the developed world) the valuation anchors for financial assets are being distorted. It all feels like we are on a road to nowhere.

Global government bond rates are melting. Over $15 trillion of sovereign debt now has a negative yield. That means you pay to lend the government money. In Germany you get the privilege of losing 0.57% of your capital each year for a decade, in Japan you only lose 0.20% a year, while in France its 0.27%, and Switzerland a hefty 0.91% a year which means after a decade of lending to the Swiss government you have 8.6% less capital. It is insanity. Despite the risks of owning equity we prefer to put that capital into businesses like **Nestle** which yields 2.4% a year and has paid a rising dividend for decades, and in another decade you will have likely received around 25% of your capital back in dividends which is a sound cushion against share price volatility compared to locking in a certain loss on Swiss government bonds. The concern is that NZ might be heading in the same direction.

The NZ 10-year government bond reached 1.10% on Friday, a record low (but at least still a positive return), and a far cry from the 2.10% area when we posed the TINA question a mere six months ago. The RBNZ's 0.50% cut to 1.00% last week is likely to be followed by a further cut to 0.75% later this year and more cuts can not be ruled out. The danger is that the RBNZ does not get what it wants. In cutting rates aggressively now, the RBNZ want consumers to increase spending, cushion a soft housing market and lower the NZ Dollar (everyone seems to want a lower currency these days and this is also a factor driving rate cuts). What happens though if the rate cuts make consumers and investors nervous about what the future holds. For every mortgage holder that borrows at a slightly cheaper rate there will be a retiree that is relying on reduced interest income to fund their retirement. The retirees, and savers generally, are being sacrificed by the RBNZ which thinks there is too much money sitting in 'lazy' term deposits and that some of those funds need to be invested elsewhere to help the economy. However, it won't help the economy to force your average retiree to buy low-growth power and property companies at ever increasing valuations in the search for a better return. And who said a 1.00% OCR would solve anything when 1.50%, or whatever higher rate hasn't so far. As we can see in Europe, years of negative rates have solved very little. It seems we are on a road to nowhere.

The companies mentioned above are named to further the discussion. This should not be construed to be personalised advice nor a recommendation to invest in these companies. Please contact Kinnell & Co. regarding how best to take advantage of the trends discussed above.

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