
This paper sets out **details of the investment environment over the quarter to 31 December 2015, longer term historical data and the outlook of various statistics for the immediate future.**

1. Investment market conditions - headlines

Over the quarter

Overall

- **Share markets end higher:** The December quarter was an above average quarter for the share markets around the world, but most remain lower than their historical highs.
- **OCR cuts:** The RBNZ cut the OCR by 0.25% to 2.50% at its December Monetary Policy statement. The RBNZ highlighted the below average growth and low inflation globally, despite highly stimulatory monetary conditions and any further cuts would depend largely on the emerging economic data. In contrast, the US Federal reserve raised the federal funds rate by 0.25% during the quarter.

Economic

- **Inflation:** The annual rate of inflation for the year to December 2015 was 0.08% (-0.50% for the December quarter).
- **NZ interest rates:** Short term rates fell, in line with the OCR cut to 2.5%, while the long term rates increased during the quarter.
- **Global sovereign interest rates:** The long-term interest rates rose across most major markets.
- **Currency:** The NZ dollar appreciated against all major currencies during the quarter.

Investment markets

- **NZ bonds:** The NZ government and corporate bond markets posted negative returns in the December quarter as bond yields rose.
- **Overseas bonds:** Both overseas government and non-government bond markets posted flat to negative returns for the quarter, as long term yields across all major markets increased. In New Zealand dollars, hedged indices outperformed the unhedged indices significantly, as the dollar appreciated against major currencies.
- **Shares:** Global share markets posted positive returns for the December quarter. The New Zealand share market was the best performer for the December quarter with a return of 13.1% followed by the German share market with a return of 11.2%. The UK share market posted the lowest returns in relative terms with a return of 3.0% and was closely followed by France with a return of 4.1%. The US share market was up 7.0% during the quarter.

- **Property:** Both the NZ and the Australian listed property market increased during the December quarter with returns of 9.5% and 4.3% respectively.

Environment

In terms of the current environment:

- Future returns from cash will continue to be low relative to historical levels.
- Expected returns from bonds are likely to be lower than normal, as the starting yields remain low, but will continue to be volatile as interest rates move up and down.
- The risks surrounding the share markets are likely to remain elevated reflecting the consequences of low interest rates, high debt levels and ageing demographics. The focus should continue to be on choosing investments consistent with your time horizon and with the right income/growth/certainty mix.
- The general environment of low interest rates, low inflation and low economic growth is likely to continue until 2023/2025.

2. Investment market conditions – summary statistics

2.1 NZ interest rates (p.a.)

	31 December 2015	3 months ago	12 months ago
OCR (official cash rate)	2.50%	2.75%	3.50%
90 day bank bill yield	2.75%	2.84%	3.68%
10 year government bond yield	3.58%	3.27%	3.67%

Source: Reserve Bank of New Zealand

2.2 NZ economic indicators (annual rate to)

	31 December 2015	3 months ago	12 months ago
CPI	0.08%	0.42%	0.76%
GDP growth	n/a	2.90%	3.30%
NAW increase	3.15%	3.12%	2.46%
Unemployment level	5.30%	6.00%	5.70%

Source: Statistics NZ

2.3 Quarterly market returns in periods ending

	31 December 2015	3 months ago	Average over last 5 years
Cash	0.74%	0.81%	0.74%
NZ bonds (govt)	-0.39%	2.23%	1.42%
NZ bonds (Corporate A grade)	-0.12%	2.04%	1.50%
OS bonds (govt) currency hedged	0.75%	2.68%	1.62%
OS bonds (govt) unhedged	-7.70%	7.53%	0.74%
NZ property (gross)	9.47%	0.06%	3.57%
Australian property (ASX200 A-REIT)	4.31%	0.19%	2.28%
NZ shares (gross)	13.07%	-2.33%	3.41%
Australian shares (ASX200 gross \$NZ)	3.08%	-9.76%	0.88%
OS shares currency hedged (gross)	6.35%	-7.61%	2.64%
OS shares (unhedged) (gross)	-1.42%	-3.21%	2.70%

Source: Nikko Asset Management

Note: the above returns are quarterly and average quarterly returns. They are not annual rates.

3. Investment market conditions – December 2015 quarter

3.1 This section provides an overview of the investment market conditions and environment for the quarter.

Inflation

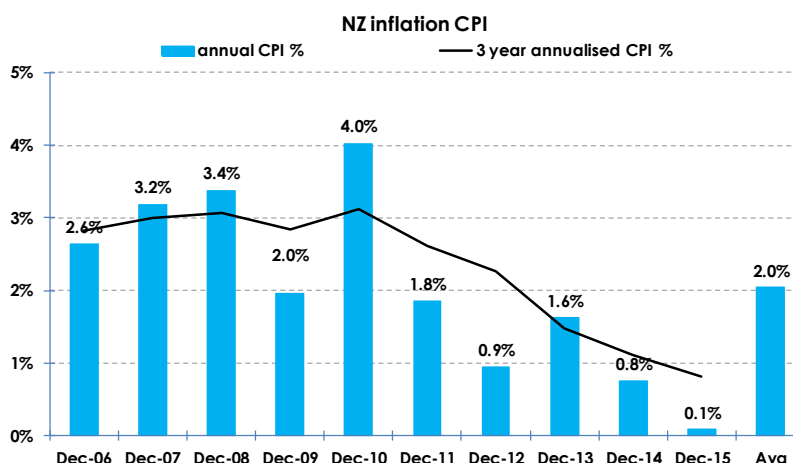
3.2 The inflation rate for the December quarter was -0.50%; down from 0.33% for the previous quarter. The annual rate to 31 December 2015 was 0.08% against 0.42% for the September quarter.

3.3 At 0.08%, the annual CPI remains well below the 1% to 3% p.a. target band.

3.4 The fall in the quarterly CPI was attributed mainly to lower petrol prices (down 7 percent) and seasonally lower vegetable prices (down 17 percent). The groups that offset the groups that fell were: International airfares (up 5.5 percent) followed by new build housing (up 1.2 percent) and rental rates (up 0.6 percent).

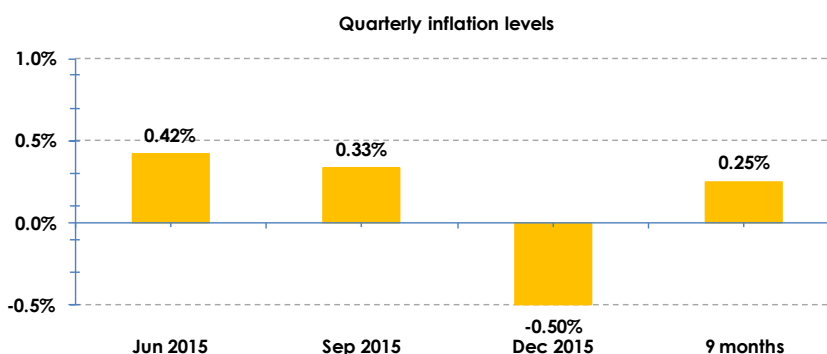
3.5 While the 10-year average (2.04% p.a.) is within the target range, the 3-year average inflation level (0.82% p.a.) is below the target band.

3.6 The recent history of annual inflation rates, for the decade ending December 2015 is:



Source: Statistics NZ

3.7 The inflation rate for the 9-months ended 31 December 2015 stood at 0.25%. Therefore, if the inflation rate for the March 2016 quarter is below -0.17%, the annual rate will fall for the year to 31 March 2016.



Source: Statistics NZ

Interest rates

- 3.8 Both short and long term interest rates declined during the December quarter in line with the RBNZ's 0.25% cut in the official cash rate. In general, rising interest rates reduce bond values and increase the expected future return (and vice versa).

Official Cash Rate (OCR)

The Reserve Bank reduced the Official Cash Rate (the Reserve Bank's tool to target inflation through interest rates) by 0.25% during the December quarter. The OCR is now 2.50%.

Short-term (90 day)

Short-term NZ interest rates began the quarter at 2.84% p.a. and finished the quarter lower at 2.75% p.a. Against this falling interest rate backdrop, a portfolio invested in short-term "cash" assets should have returned 0.74% for the quarter (before tax). The return over the last 12 months was 3.41% (before tax).

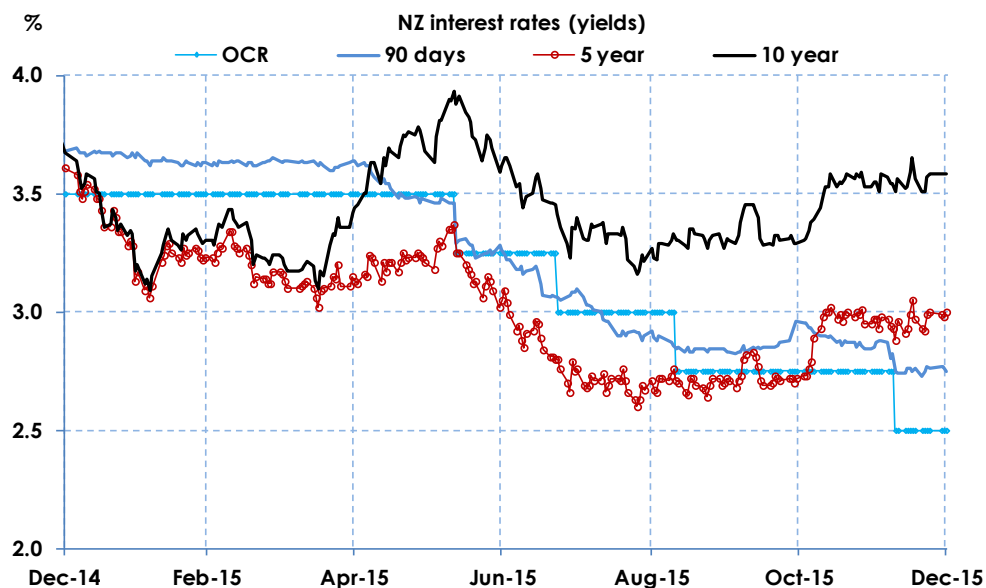
Long-term (10 years)

Long-term NZ interest rates increased during the quarter from 3.27% in September to 3.58% at the end of December. The 5-year rate also increased over the December quarter ending at 3.00%, against 2.70% at the start of the period. A portfolio invested in S&P/NZX NZ Government stock should have returned -0.39 for the quarter. The S&P/NZX A-Grade Corporate Bond index returned -0.12% for the quarter. Over the last 12 months, the returns were 5.45% and 5.81%, respectively.

Source: Reserve Bank of New Zealand, Nikko Asset Management

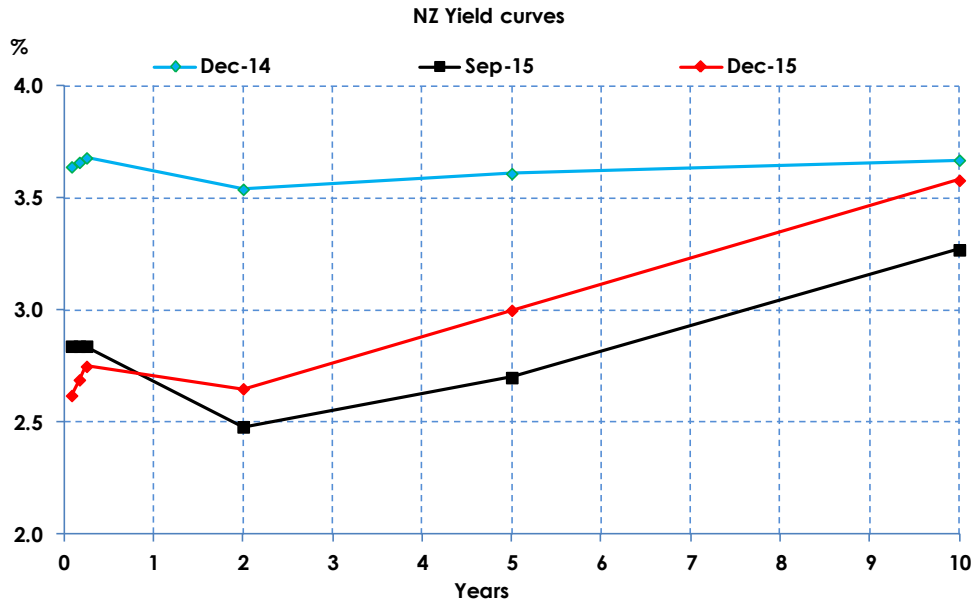
- 3.9 Overall, we believe that the global interest rate environment is likely to remain low for the next few years as most central banks continue with their low interest rate policies, and the macro issues of demographics and debt levels are supportive of low rates. Investors should however develop plans to cope with the consequences of a sudden rise in interest rates, as there is a potential for this to occur should the European debt challenges or the China shadow banking sector create a major bank failure.

3.10 Graphically, the short-term and long-term NZ interest rate movements over the last 12 months were:



Source: Reserve Bank of New Zealand

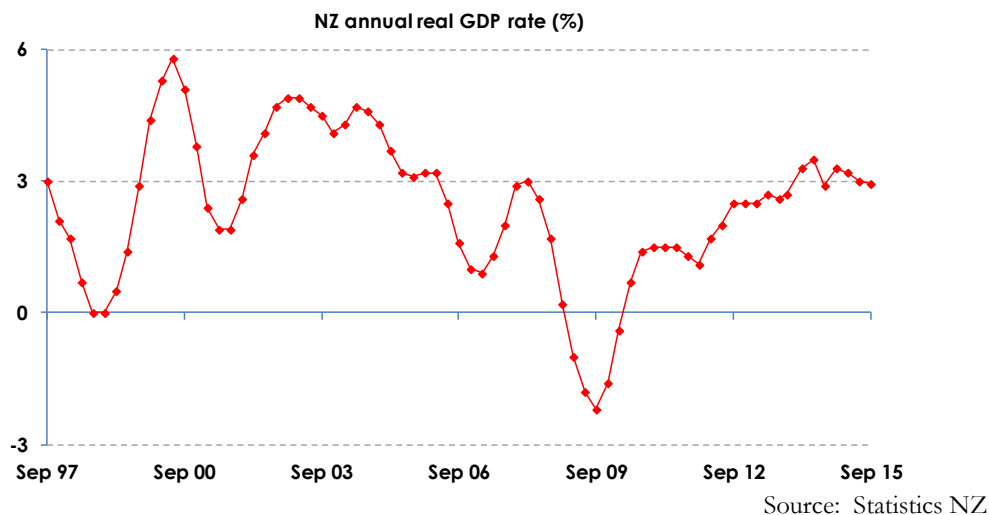
3.11 The movements in the NZ yield curve over the quarter and the last 12 months were:



Source: Reserve Bank of New Zealand

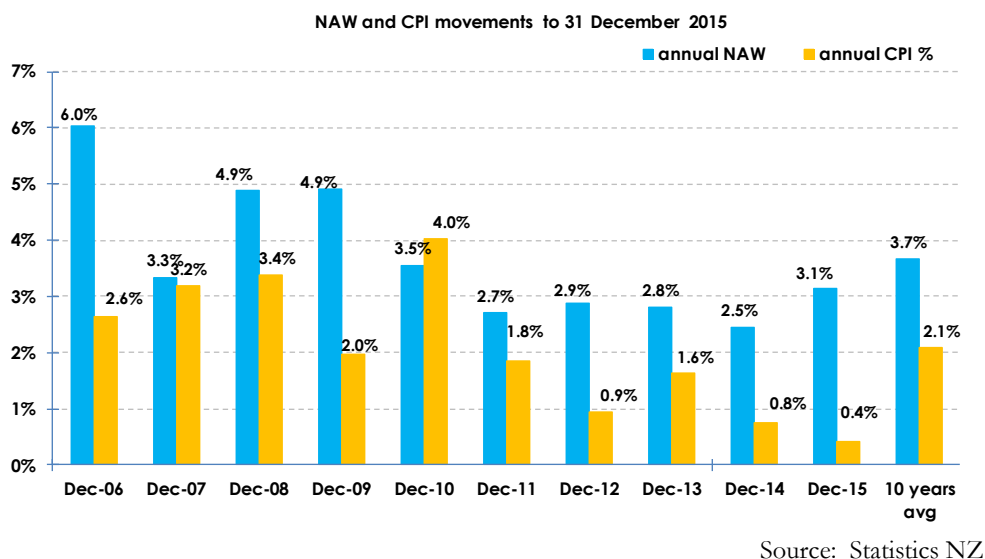
Economic growth

3.12 The official economic growth for the quarter will not be published for several months. The latest published annual GDP figure, to September 2015, was 2.9%. The historical GDP growth has been:

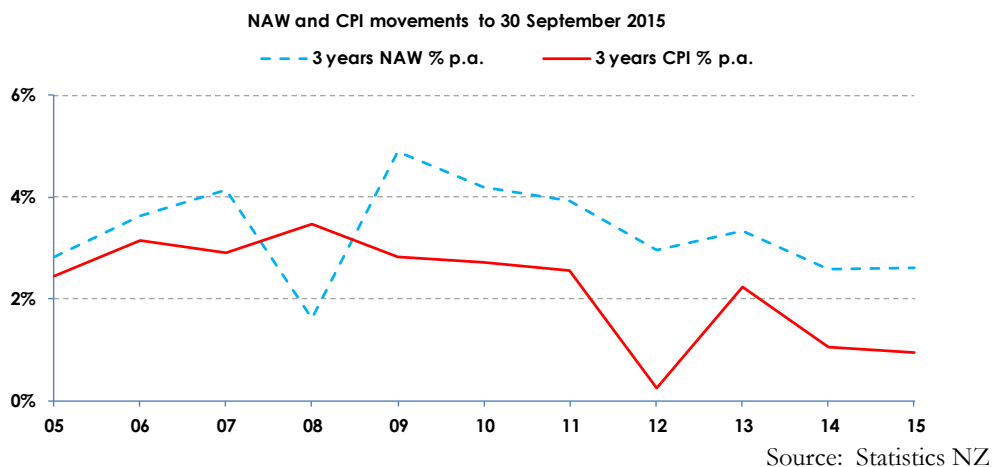


Wage growth

3.13 The latest published annual national average wage (NAW) at December 2015 shows an annual increase of 3.15% for the last 12 months. The annual movements relative to inflation over recent years have been:

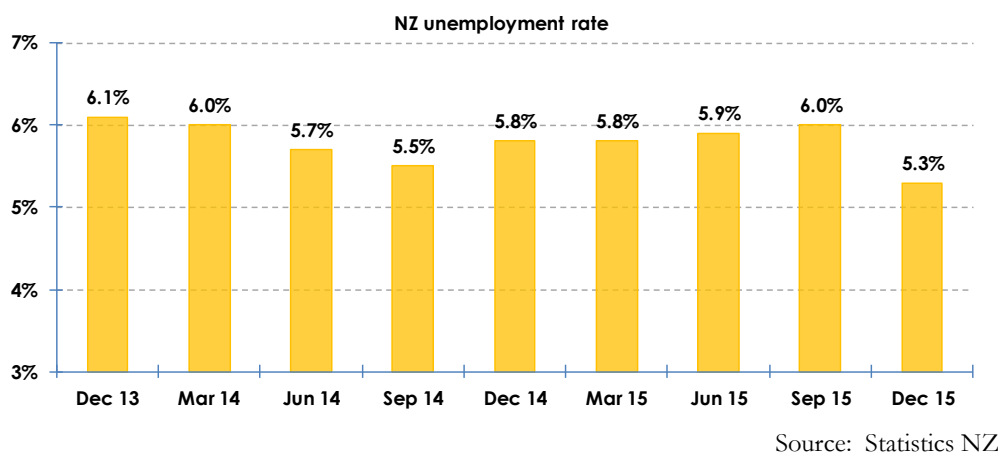


3.14 The 3 year annualised moving average of the NAW growth versus CPI has been:

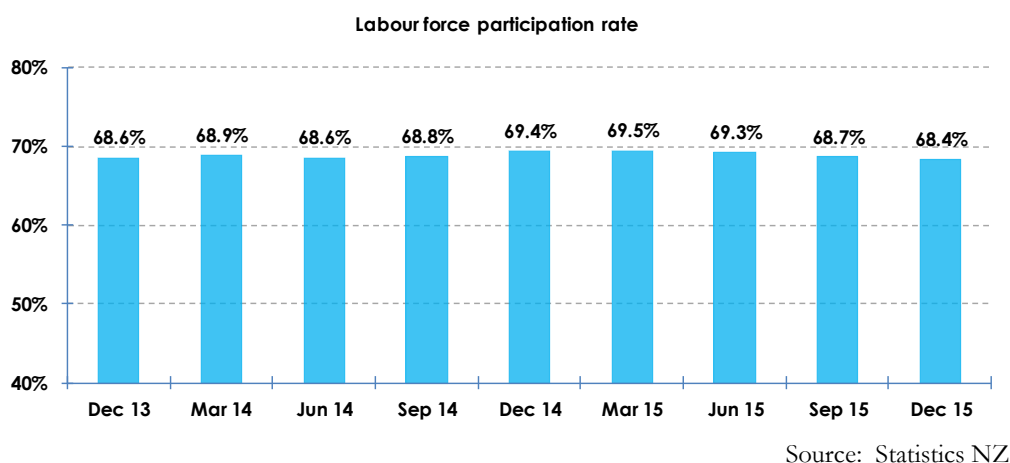


Unemployment

3.15 The latest published annual unemployment rate was 5.3% for the quarter ended September 2015. The movement of the annual unemployment level over recent quarters has been:



3.16 Also relevant is the participation rate, i.e., the percentage of working age population that are working. The recent percentage rates were:



Currency

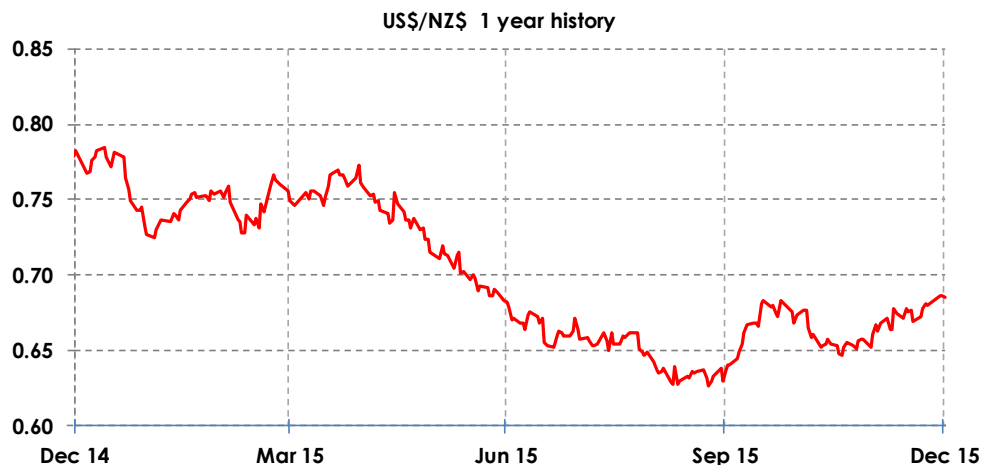
- 3.17 The NZ dollar strengthened against all major currencies during the December quarter. When the NZ dollar rises, the value in NZ dollars of overseas owned assets falls and vice versa.
- 3.18 Details of the NZ dollar movement, relative to the major currencies over the period, were:

	NZ\$ appreciation / (depreciation)	NZ\$1 equals		Historical Average ¹	Historical normal range (± 1 std dev)
		30-Sep-15	31-Dec-15		
US dollar	7.44%	0.6374	0.6848	0.6355	0.5241 to 0.7468
UK pound	9.84%	0.4207	0.4621	0.3863	0.3195 to 0.4530
Euro	10.50%	0.5666	0.6261	0.5398	0.4793 to 0.6003
Japanese Yen	7.87%	76.47	82.49	71.30	59.55 to 83.05
Australian dollar	3.32%	0.9094	0.9396	0.8348	0.7742 to 0.8955

¹The historical average and normal range are the statistics since 1986 when the NZ dollar was floated.

Source: Reserve Bank of New Zealand, MCA

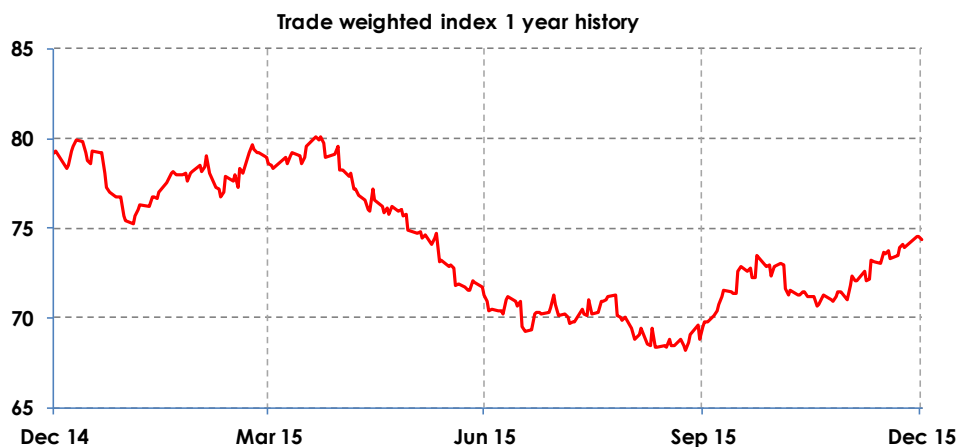
- 3.19 Graphically, the daily movement between the NZ dollar and the US dollar for the last 1 year was:



Source: Reserve Bank of New Zealand

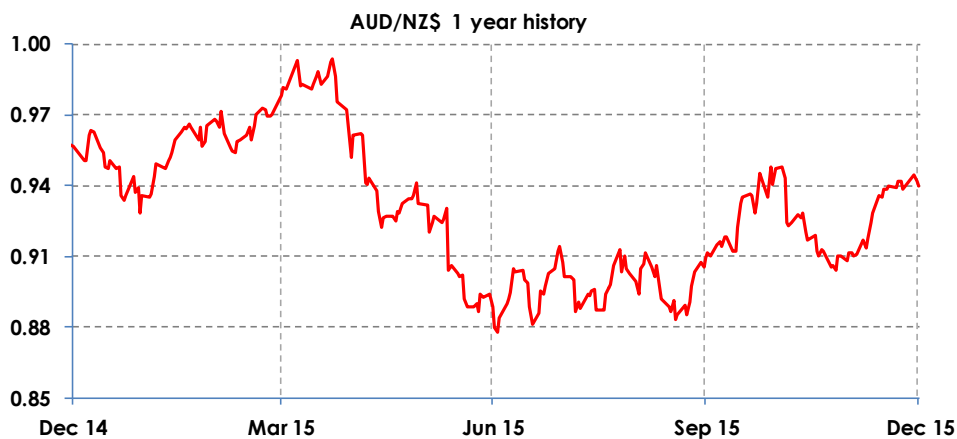
- 3.20 The above graph should be interpreted relative to the long-term average exchange rate of 63.55 cents. The average for the last 12 months has been 69.89 cents.

3.21 While the US dollar has the most significant individual impact (directly and indirectly) on global portfolios, also relevant is the trade-weighted index (TWI). The TWI is a measure of the value of the New Zealand dollar (NZD) relative to the currencies of New Zealand's major trading partners. For the past 12 months, it fell 6.2% from 79.30 to 74.40.



Source: Reserve Bank of New Zealand

3.22 For many New Zealand investors, also relevant is the Australian dollar. Graphically, the daily movement between the NZ dollar and the Australian dollar for the last 1 year period was:



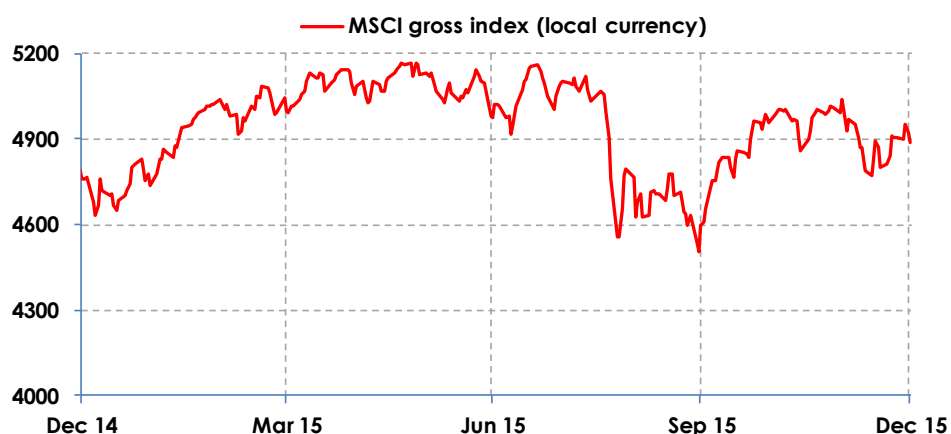
Source: Reserve Bank of New Zealand

3.23 The above graph should be interpreted relative to the long-term average exchange rate of 83.48 cents. The average for the last 12 months has been 92.89 cents.

4. Growth sectors

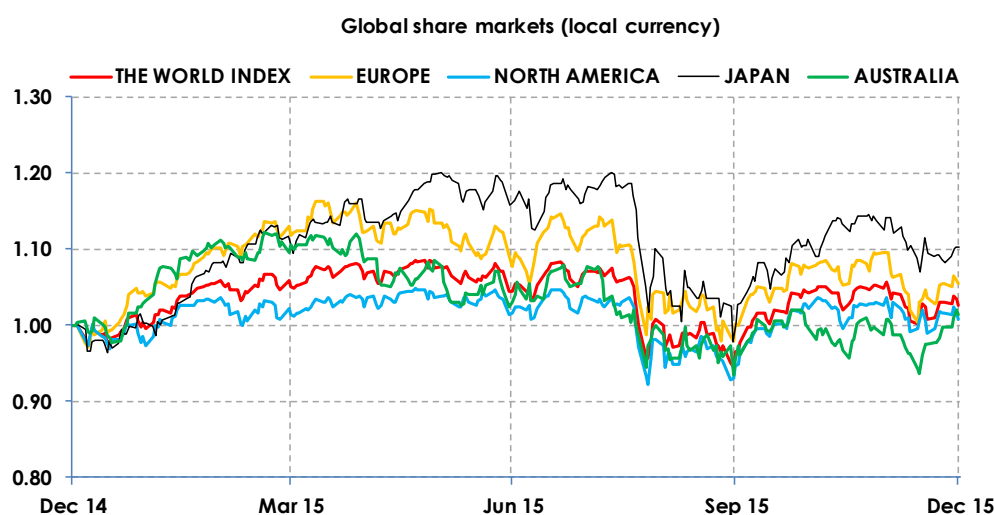
Overseas share markets

- 4.1 Global share markets remained volatile over the quarter. The overall return for the quarter, before the impact of currency, was 6.35% (MSCI gross local currency), compared with the September 2015 quarter return of -7.61%.
- 4.2 Graphically, the movement of the global share market index (i.e. the Gross MSCI index in local currency) over the last 12 months is below. The graph highlights the significant volatility (sudden movements up and down) over the quarter.



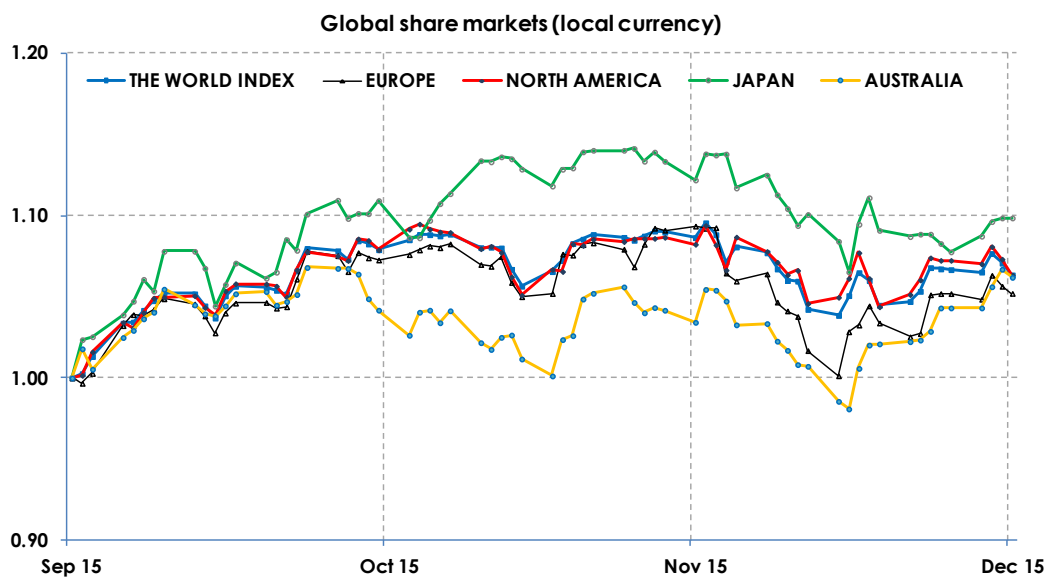
Source: MSCI Barra

- 4.3 On a local currency basis (i.e. with the impact of currency movements removed), the relative performances of North America, Europe, Japan and Australia, based on \$1 invested on 31 December 2014, were as follows:



Source: MSCI Barra

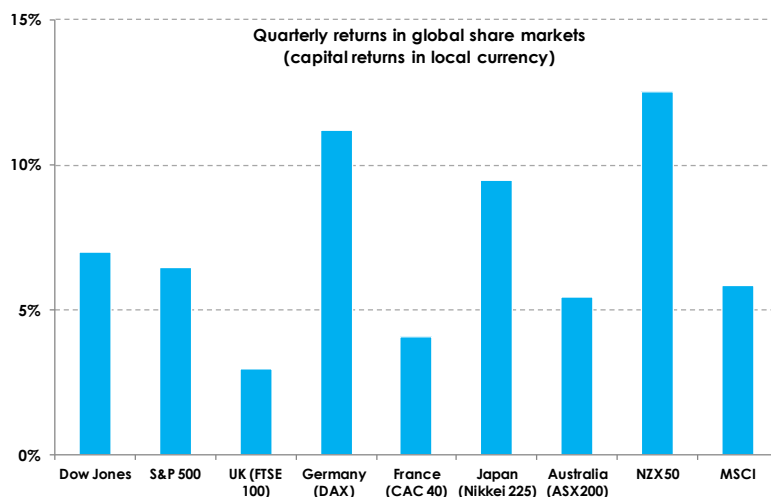
4.4 On a local currency basis (i.e. with the impact of currency movements removed), the relative performances of North America, Europe, Japan and Australia, based on \$1 invested on 30 September 2015, were as follows:



Source: MSCI Barra

4.5 Details of the capital returns of the major share markets over the quarter, before the impact of currency movements, were:

	Capital return (December 2015 quarter)
US	
Dow Jones	7.00%
S&P 500	6.45%
UK (FTSE 100)	2.98%
Germany (DAX price)	11.21%
France (CAC 40)	4.08%
Japan (Nikkei 225)	9.46%
Australia (ASX200)	5.46%
NZX50	12.52%
MSCI (local currency)	5.83%



Source: Nikko Asset Management

Comparable index performance

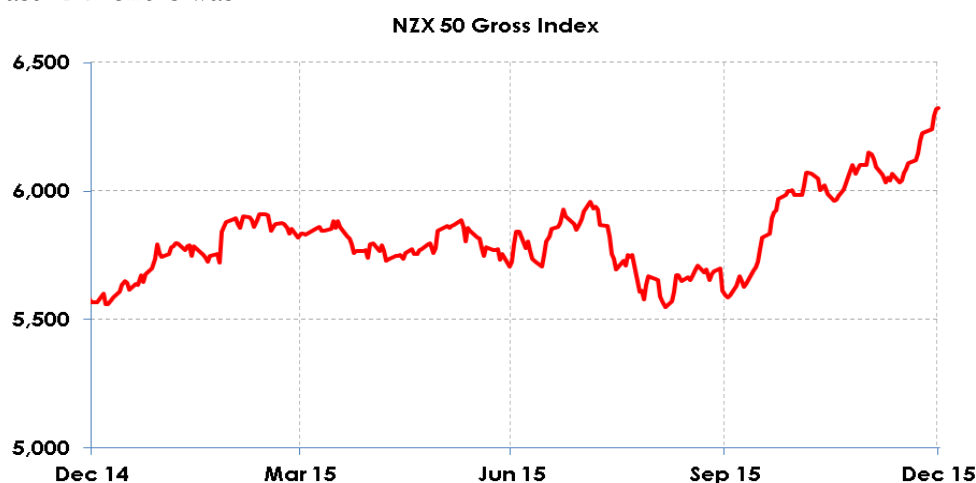
4.6 The overseas gross returns of the main indexes as at 31 December 2015 were.

Index	3 months	1 year
MSCI unhedged (gross)	-1.42%	13.17%
MSCI unhedged (capital)	-1.78%	11.04%
Dividend	0.36%	2.14%
MSCI currency hedged (gross)	6.35%	2.65%
MSCI currency hedged (capital)	5.83%	0.15%
Dividend	0.51%	2.49%

Source: Nikko Asset Management

NZ share market

4.7 The December quarter with a return of 13.07% saw the S&P/NZX50 Gross (net of imputation credits) outperform significantly the global share market return of 6.35% (MSCI Gross in local currency). Graphically, the performance over the last 12 months was:



Source: Yahoo Finance

4.8 The breakdown of the S&P/NZX50 Gross (net of imputation credits) return for the quarter and year is:

	Quarter	Annual	
Dividends	0.55%	5.11%	(net of imputation credits)
Capital movement	<u>12.52%</u>	<u>8.47%</u>	
Total return	13.07%	13.58%	

Source: Nikko Asset Management

- 4.9 The top 5 performing NZ shares in the S&P/NZX50 index over the quarter were:

Share	Gross return
The A2 Milk Corporation	165.7%
Chorus Limited	46.4%
Xero Limited	32.0%
Metro Performance Glass	27.4%
Fisher & Paykel Healthcare Corporation	26.7%

Source: Forsyth Barr

- 4.10 The bottom 5 performing NZ shares in the S&P/NZX50 index over the quarter were:

Share	Gross return
Steel and Tube Holdings Limited	-16.1%
Coats Group Plc	-14.5%
Tower Limited	-5.0%
Orion Health Group	-4.8%
Contact Energy	-4.2%

Source: Forsyth Barr

- 4.11 The top 5 performing NZ shares in the S&P/NZX50 index over the year were:

Share	Gross return
The A2 Milk Corporation	220.7%
The NZ Refining Company	73.6%
Nuplex Industries Ltd.	71.6%
Z Energy Limited	55.2%
Summerset Holdings	49.0%

Source: Forsyth Barr

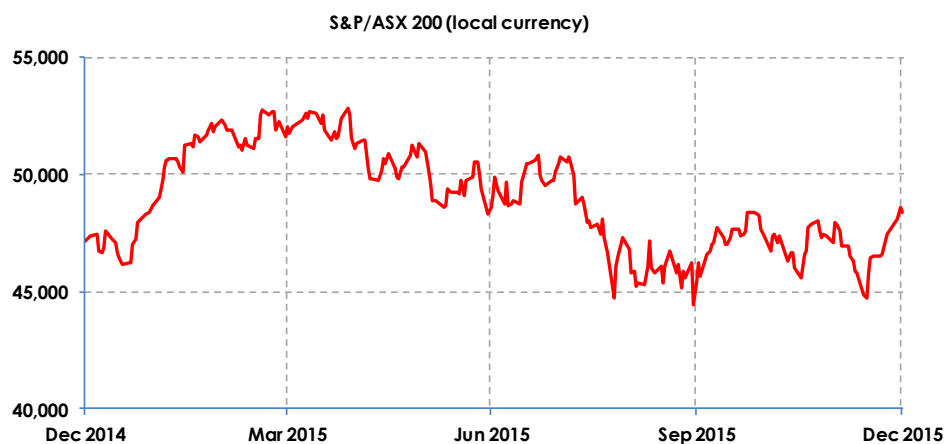
- 4.12 The bottom 5 performing NZ shares in the S&P/NZX50 index over the year were:

Share	Gross return
Orion Health Group	-46.3%
Kathmandu Holdings Limited	-22.3%
Sky Network Television	-18.0%
Steel and Tube Holdings Limited	-15.3%
Contact Energy	-11.1%

Source: Forsyth Barr

Australian share market

- 4.13 The December quarter, with a return of 6.48%, saw the S&P ASX 200 Gross (local currency) outperform the global market return of 6.35% (MSCI Gross in local currency). Graphically, the performance of the S&P ASX 200 Gross was:



Source: Standard & Poor's

- 4.14 The breakdown of the return of the Australian share market (in local currency) for the quarter and the year ended September are:

	Quarter	Annual
Dividends	1.02%	4.69%
Capital movement	<u>5.46%</u>	<u>-2.13%</u>
Total return	6.48%	2.56%

Comparable Index performance

- 4.15 The following table sets out the returns of the main indexes as at 31 December 2015.

Index	3 months	1 year
Index – S&P/NZX50 Gross with imputation credits	13.20%	15.06%
Index – S&P/NZX50 Gross	13.07%	13.58%
Index – S&P/NZX50 Capital	12.52%	8.47%
Index – ASX200 Gross	6.48%	2.56%
Index – ASX200 Capital	5.46%	-2.13%

Source: Nikko Asset Management

NZ property market

4.16 The S&P/NZX All Real Estate Gross index increased 9.47% for the December quarter.

4.17 The breakdown of the return for the quarter is:

Dividends	1.77%	(net of imputation credits)
Capital movement	<u>7.70%</u>	
Total return	9.47%	

Source: Forsyth Barr

4.18 The returns of the individual shares that make up the S&P/NZX All Real Estate Gross Index over the quarter were:

Share	Quarter gross return
National Property Trust Limited	12.4%
Precinct Properties NZ Limited	11.4%
Argosy Property Limited	10.9%
Vital Healthcare Property Trust	10.6%
Property for Industry	10.0%
Stride Property	9.0%
Goodman Property Trust	8.5%
Kiwi Property Group Limited	8.2%
Augusta Capital Limited	3.4%
CDL Investments	-7.7%

Source: Forsyth Barr

4.19 The breakdown of the return for the year is:

Dividends	6.81%	(net of imputation credits)
Capital movement	<u>8.90%</u>	
Total return	15.71%	

Source: Forsyth Barr

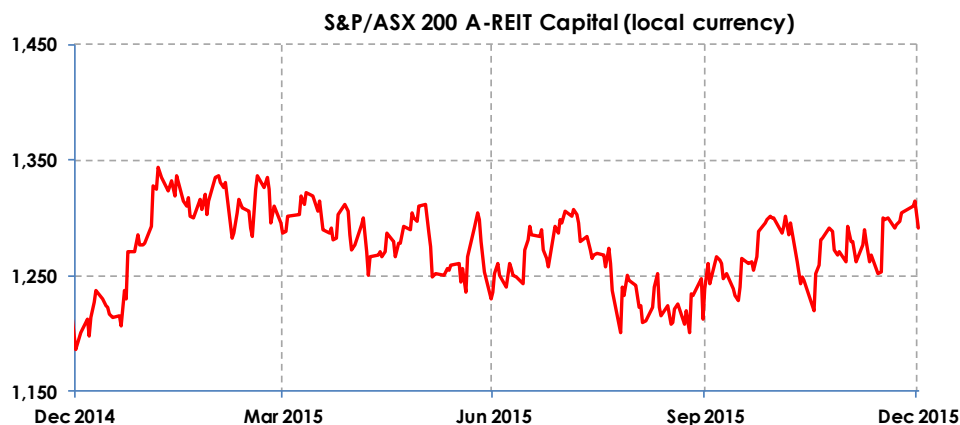
4.20 The returns of the individual shares that make up the S&P/NZX All Real Estate Gross Index over the year were:

Share	Annual gross return
Vital Healthcare Property Trust	25.4%
Stride Property	21.8%
CDL Investments	16.5%
Goodman Property Trust	16.2%
Kiwi Property Group Limited	16.0%
National Property Trust Limited	15.9%
Argosy Property Limited	13.3%
Property for Industry	12.6%
Precinct Properties NZ Limited	12.1%
Augusta Capital Limited	10.1%

Source: Forsyth Barr

Australian property market

4.21 The Australian property market increased during the December quarter with a return of 4.31%. Graphically, the performance of the S&P ASX 200 A-REIT (Capital) was:



Source: Yahoo Finance

Comparable index performance

4.22 The returns of the main listed property share indexes as at 31 December 2015 were:

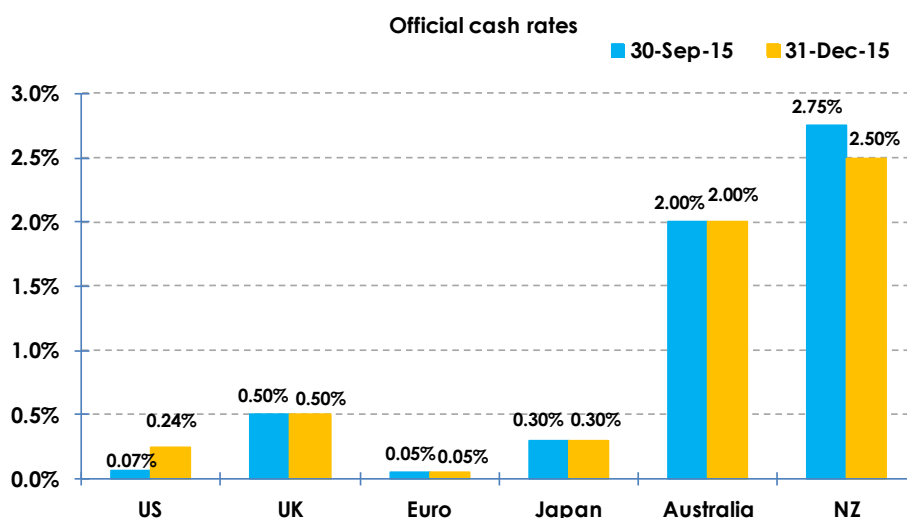
Index	3 months	1 year
Index – S&P/NZX All Real Estate Gross (with imputation)	9.5%	15.7%
Index – S&P/NZX All Real Estate (net imputation)	9.2%	14.5%
Index – S&P/NZX All Real Estate Capital	7.7%	8.9%
Index – S&P/ ASX 200 A-REIT Gross	5.9%	14.3%
Index – S&P/ ASX 200 A-REIT Capital	4.3%	8.9%

Source: Forsyth Barr, Yahoo Finance

5. Income sectors

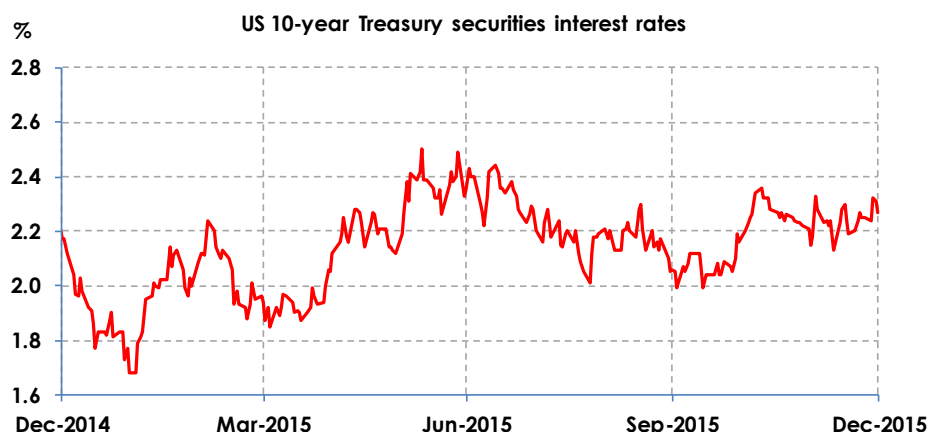
Global bond markets

- 5.1 The Citigroup World Government Bond Index, currency hedged to NZD, produced a return of 0.75% for the quarter, compared to the return of 2.68% in the previous quarter.
- 5.2 The Citigroup World Government Bond Index, unhedged, produced a return of -7.70% for the quarter as against 7.53% in the previous quarter on continued weakness in the NZD.
- 5.3 Cash rates remained at the same level as the previous quarter for the following central banks:
- Bank of England’s “Official Bank Rate” at 0.5%;
 - Bank of Japan’s “The Basic Discount Rate” at 0.3%;
 - European Central Bank’s “Main Refinancing Operations Rate” at 0.05%;
 - Reserve Bank of Australia’s “Target Cash Rate” at 2.00%.
- 5.4 Cash rates decreased from the previous quarter for the following central banks:
- Reserve Bank of New Zealand’s “Official Cash Rate” decreased by 0.25% to at 2.50%;
 - Federal Reserve’s “Federal Funds Effective Rate” increased by 0.17% to 0.24%.



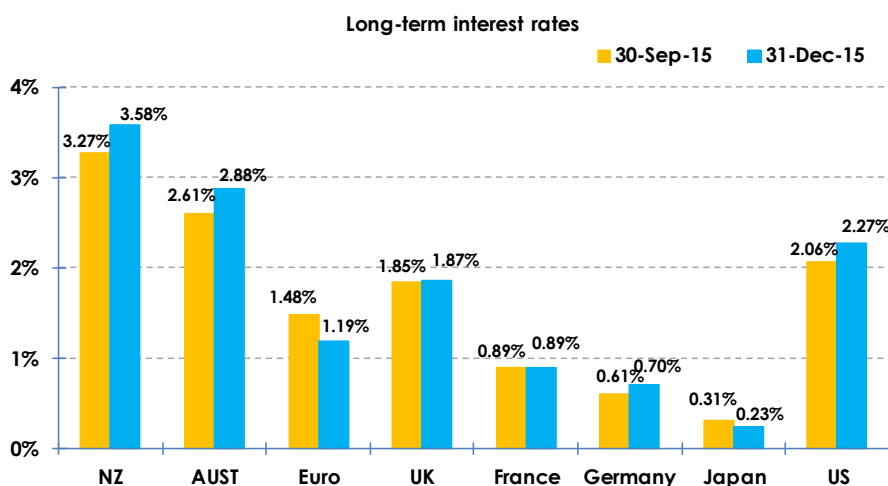
Source: Central Banks of the featured countries

5.5 Long-term US interest rates increased to 2.27% as at 31 December 2015 from 2.06% at 30 September 2015. Graphically, the movements in long-term US interest rates were:



Source: US Federal Reserve Bank

5.6 The quarterly movements in long-term interest rates are further highlighted by the change in the 10-year bond yields of each country.



Source: Central Banks of the featured countries

5.7 The returns of the main global bond indexes to 31 December 2015 were:

Index	3 months	1 year
Index – Citigroup OS Govt bonds currency hedged	0.75%	4.62%
Index – Barclays Global Aggregate bonds currency hedged	0.79%	4.46%

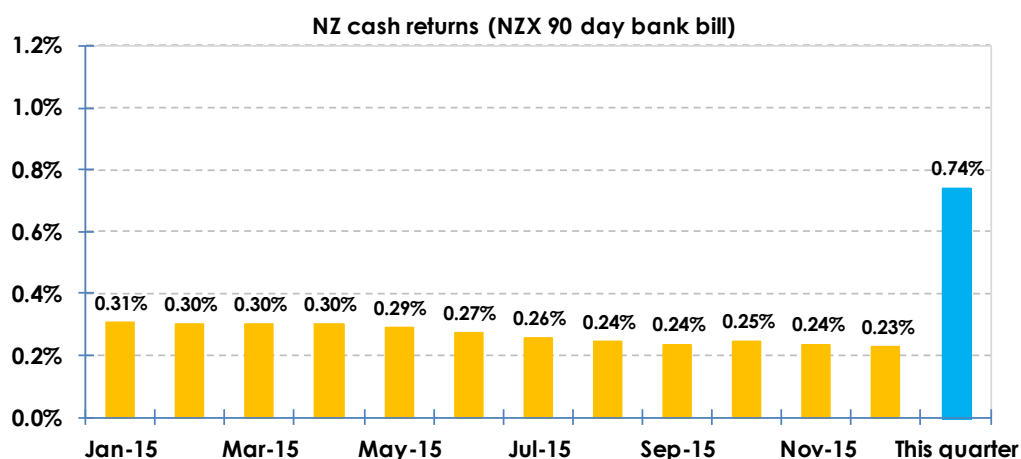
NZ bond market

- 5.8 The NZ government bond market (S&P/NZX NZ Government Stock Index) produced a return of -0.39% for the quarter, compared to 2.23% for the previous quarter.
- 5.9 The NZ corporate bond market (S&P/NZX A Grade Corporate Bond Index) produced a return of -0.12% for the quarter, compared to 2.04% for the previous quarter.
- 5.10 The returns of the main NZ bond indexes to 31 December 2015 were:

Index	3 months	1 year
S&P/NZX NZ Government Stock Index	-0.39%	5.45%
S&P/NZX A Grade Corporate Bond Index	-0.12%	5.81%

Cash returns

- 5.11 The official cash rate decreased by 0.25% to 2.50% during the December quarter and short-term interest rates followed by declining 0.09% from 2.84% to 2.75%. A portfolio invested in “cash” assets should have returned 0.74% for the September quarter.
- 5.12 Graphically, the individual monthly returns were:



Source: Reserve Bank of New Zealand

- 5.13 The returns of the main NZ cash index to 31 December 2015 were:

Index	3 months	1 year
Index – 90 day bank bill gross	0.74%	3.41%

Source: Nikko Asset Management