

# Wealth Management Adviser

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## Do you have commodities in your portfolio?



Commodities are the fundamental raw materials vital to manufacturing, transportation and infrastructure as well as the food we eat, clothes we wear and the energy we consume.

Therefore the supply and demand of these resources are critical to the world's economic welfare.

Commodities can provide tangible benefits for investors also, acting as a useful hedge against inflation, adding to portfolio diversification (commodities act differently to shares and bonds) and most importantly, providing the opportunity for solid returns over time. Given the vast amounts of money that have been pumped into the global financial system, it is our view that inflation will become a major concern for all investors within the next two to three years, and investors will need exposure to quality growth assets including commodities to protect their portfolios.

There are several fundamental drivers of commodity prices, some already exist whilst others will become evident over the next few years.

- The global recession has deflated prices, which has led to production cuts and a reduction in supply.
- The industrialisation of emerging economies such as India and China continues at a strong pace.
- There is a wall of infrastructure and energy spending as economic stimulus packages take effect and global demand rebuilds.
- Growing wealth in emerging markets opens up new consumers for meat, grain and milk products.
- There is a long term trend of world population growth.

As the recession eases, and the demand for goods return, the demand for oil is also forecast to rise. Indeed many prospecting and production rigs are now being re-commissioned to meet that future demand in two to four years time. That does not mean the growth path will be a smooth one. Short term it seems as though world stockpiles have increased (as demand has been less than predicted) and oil prices could easily retreat between now and the end of the year.

Although starting from low bases, other commodities have had strong rallies recently. Copper prices have already doubled this year, Aluminum is at a nine month high and Nickel is now

at a one year high. Gold has also just reached more than USD\$1,000 an ounce.

There are at least four locally based commodity funds available to investors, all with different features. Some feature capital guarantees, while others have mechanisms enabling the managers to revert back to cash to reduce volatility and protect investor returns. A "basket" approach accessing a number of leading commodities through a suitable specialist commodity fund is a sensible way to approach this sector. Single commodities can be very volatile and a diversified "basket" can help offset that volatility and provide a smoother return.

The NZ Super Fund holds an allocation of 5% to commodities, and many investment advisers would recommend weightings of between 5%

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- 10% to personal portfolios. Overseas investors tend to hold higher allocations than in New Zealand, where commodity exposure is a relatively new asset class.

Previous commodity bull markets (1906-20, 1933-49 and 1968-82) have each lasted at least 14 years. If we use history as a guide then this one should run for some time yet.

New Zealand is a leading producer of high quality agricultural products, yet unless investors own or farm the land themselves, getting exposure to the

agricultural sector can be difficult. There have been several attempts to provide specialist agricultural investment funds in the past, but few have been of real success so far. This has left investors wanting exposure to the sector with only a small number of agriculturally focused companies listed on our sharemarket.

#### Money in the bank long-term

##### - not an option

With typical deposit rates as low as 4.50% these days, investors must seriously reconsider if their plan is to

leave their money in the bank long-term. Simply, its just not an option. By the time you factor in tax and inflation you are left with a net return of less than 1%. Even the risk averse can't afford these nominal returns.

#### The effect of inflation on current deposit rates of return

|                                |             |
|--------------------------------|-------------|
| Typical Term deposit rate      | 4.50%       |
| Less tax (average) 25%         | 1.10%       |
|                                | 3.40%       |
| Less inflation                 | 2.5%        |
| <b>Net real rate of return</b> | <b>0.9%</b> |

# Global Growth - the case for emerging markets

There is no doubt that a well balanced investment portfolio should include some exposure to emerging markets, and we are bullish on China, despite what the critics have to say. Some say that the China market is only strong due to the Governments stimulus package while others suggest that you can't trust the numbers coming out of China. But with the ongoing implementation and development of worldwide accounting standards this is becoming a less reasonable argument. There is no denying, that many investors are making significant profits from their China investments.

**Warren Buffett – one of the world's leading investors believes that "China is going to be a greater and greater force in the world's economy in every way," and that "There's no question that [China's] economy is booming like we haven't seen in the United States for a very, very long time, if ever."**

An analysis of historical GDP combined with GDP forecasts for 2009 & 2010 produces some interesting

numbers and strengthens the case for portfolio exposure to emerging economies. When you remove Japan (who arguably have been in recession for some 25 years) from the Asia mix, a forecasted 14.3% GDP should capture the attention of even the greatest skeptics, especially when compared to the USA at -0.6% (2009-2010).

A real advocate of the China markets Keith Fitzgerald, Investment Director of New China Trader believes the real secret of investing in Chinese companies is that "stock prices almost always follow state investment cycles. The government invests and then the profits come. Find out what the government thinks is important to China's future... and put your cash to work there".

If you are considering emerging markets we encourage you to consider investment opportunities in China. There are some pitfalls and nothing is ever quite as simple as it seems, but don't be put off, seek expert advice and reap the returns

| Real GDP Annual %  | 2007        | 2008       | 2009       | 2010        | 2007-2010   |
|--------------------|-------------|------------|------------|-------------|-------------|
| New Zealand        | 3.2         | 0.2        | -1.4       | 2.7         | 4.7         |
| Australia          | 4.0         | 2.3        | 0.5        | 3.0         | 10.1        |
| US                 | 2.1         | 0.4        | -2.6       | 2.0         | 1.8         |
| Europe             | 2.9         | 0.8        | -3.6       | 1.4         | 1.4         |
| Japan              | 2.3         | -0.7       | -5.2       | 1.5         | -2.3        |
| UK                 | 2.6         | 0.7        | -4.2       | 1.9         | 0.9         |
| India              | 9.0         | 6.7        | 5.8        | 7.8         | 32.6        |
| <b>China</b>       | <b>13.0</b> | <b>9.0</b> | <b>9.4</b> | <b>11.9</b> | <b>50.8</b> |
| Advanced Economies | 2.8         | 0.6        | -3.2       | 1.9         | 2.0         |
| Emerging economies | 8.8         | 6.2        | 2.8        | 7.1         | 27.2        |
| Asia (ex Japan)    | 10.00       | 6.7        | 5.6        | 8.7         | 34.7        |

Chart supplied courtesy of Goldman Sachs.

Forecasts in italics



A disclosure statement is available on request, free of charge. If you require further information on any of these topics please contact:

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