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Dear Client

Investment Market Update - May 2022

Many of you will be aware that financial markets are currently going through a period of turbulence and are now well off their peaks from the end of last year. The last two years have been an incredibly unusual period for the world in so many ways – a global pandemic, historically low interest rates, central banks printing money, governments spending this money at almost unprecedented levels and now a war on the borders of Europe. Many of these factors individually would contribute to inflationary pressures but, when added together, we have seen the fastest spike in inflation rates in over 50 years. Inflation is now tracking at 6.9% in NZ, 5.1% in Australia and 8.5% and 9.0% in the USA and the UK respectively.

In hindsight, and these things are always easy to see in the rear-view mirror, central banks and governments overreacted to the economic impact of Covid and flooded the system with too much stimulus. Consequently this "free" money chased assets pushing many valuations into bubble territory. This included assets like cybercurrencies, housing, speculative shares (particularly many tech companies) and new inventions like Non-Fungible Tokens (NFTs). Now, to counter these inflationary forces, before they become too deeply imbedded, central banks globally are raising interest rates. The withdrawal of "free" money has resulted in a correction in asset values, with the following falls occurring since markets peaked:

Asset	Fall from peak	Date of peak
NZ Bonds[1]	-13.5%	Sep 2020
International Bonds[2]	-9.1%	Jan 2021
New Zealand Shares[3]	-16.4%	Jan 2021
Global shares[4]	-15.1%	Jan 2022
Nasdaq 100	-25.3%	Dec 2021
Bitcoin	-54.5%	Nov 2021

Source: Bloomberg, decline as at 10 May 2022.

Fortunately, our diversified investment portfolios have generally performed much better than the above headline figures would suggest. This is due to several factors including:

- Our conservative investment style which focuses on valuation and quality.
- Many of our underlying investment managers have navigated the declines relatively well.
- We have avoided highly speculative assets (e.g. cryptocurrencies, highly valued technology companies and NFT's).

This sell off has been somewhat unusual in that there have been few places to hide. Usually bonds do well when equities fall, but that has not been the case this time as they have fallen as interest rates have increased. But there is some light at the end of the tunnel for investors.

1. Markets are always forward looking. This means, in all probability, markets have already factored in higher interest rates.
2. Higher interest rates mean that the income an investor receives from bonds is now a meaningful contribution to the portfolio return.
3. The NZ dollar has fallen which has cushioned the negative return for investors offshore holdings that are unhedged.

While it is always painful to go through these periods of market volatility, history shows that quality investment markets always recover. **An investment of $1000 in US share markets in 1980 would be worth about $70,000 today, but a nervous investor who sold on downturns and bought back in later on 10 occasions, would have just $20,000.** It is difficult to pick when to enter a market when you have exited - and chances are you will miss the recoveries when you re-enter.

It is also healthy for a periodic repricing of investment assets to occur – free money leads to asset bubbles which often cause a lot of pain when they pop. To be a successful investor, patience is required. Over the long term, a well-diversified portfolio of quality investments will inevitably do well.

As always, please contact me if you want your portfolio reviewed, or if you have any queries or concerns.

Best Regards

Greg McGlynn BMS / Director

Financial Adviser
FSP 711032
greg@prospectwealth.co.nz
www.prospectwealth.co.nz
027 278 7656
09 449 2736.

Prospect Wealth.

If you have any questions please contact us on +64 9 449 2736 or email to: greg@prospectwealth.co.nz

Prospect Wealth, PO Box 33-371, Takapuna, Auckland 0740, New Zealand, 09 449 2736