Understanding why Kiwi Wealth invests globally

Kiwi Wealth is proud to be a New Zealand owned and based fund manager. We take care to provide a quality investment service to New Zealanders, at a reasonable cost, to help people achieve their future financial goals. We also retain profits and specialist investment expertise in New Zealand, which benefits our domestic financial industry and economy.

Given our commitment to New Zealand, why is it we invest mostly in overseas shares and rarely invest in the local share market?

Why do we invest globally?

The simple answer is that over time investing predominantly offshore is likely to achieve better investment outcomes for our customers. There are three key reasons for this:

- greater selection of shares in quality companies,
- better diversification, and
- more liquid markets.

What does our global investment strategy involve?

Greater selection of shares

New Zealand's share market is small by world standards: only around 0.2% of total OECD share market capitalisation[1]. That's on a par with the Austrian share market and a bit smaller than Ireland's. World share markets have thousands of quality companies listed that sell hundreds of millions of different goods and services to different demographics, preferences, countries, regions, and industries. With modern communications, Kiwi Wealth can easily and cheaply research and invest in overseas shares from New Zealand.

Better diversification

The New Zealand share market is relatively concentrated in a few industries, notably utilities (power generators and retailers, and telecommunications), transportation, and the construction industry. Buying overseas shares allows Kiwi Wealth to thoroughly diversify its portfolios, not just across different regions and countries, but also across different sectors and industries. Good diversification makes it more likely that portfolios are not vulnerable to the whims of relatively few areas of the market and enhances the returns that can be achieved for a given level of risk.

In addition, most New Zealanders have most of their wealth and incomes tied up in the New Zealand economy – their homes, bank savings, and wage and salaries. If a large shock adversely affects New Zealand's economy, then all of these will be affected at the same time. A pool of savings invested in offshore shares that are immune from domestic events helps protect their overall wealth.

[1] World Bank World Development Indicators July 2016

Greater liquidity

Liquidity is the ability to quickly buy and sell shares in individual companies without significantly affecting the price of those shares. Liquidity in shares is important to Kiwi Wealth because we can immediately action decisions to buy or sell shares in a particular company and don't have to wait several days or more to completely transact.

Most of the large overseas markets Kiwi Wealth trades in are very liquid. There is little risk that our transactions will affect prices given their relatively small size compared to the market. In normal market conditions, we could sell most of our share portfolio within a day and the rest within a few days. In contrast, the typical shareholding in Kiwi Wealth portfolios would represent a large chunk of the volume of shares traded daily on the New Zealand market. To sell New Zealand share holdings of the quantity we would likely have in our portfolios would take weeks, if not months.

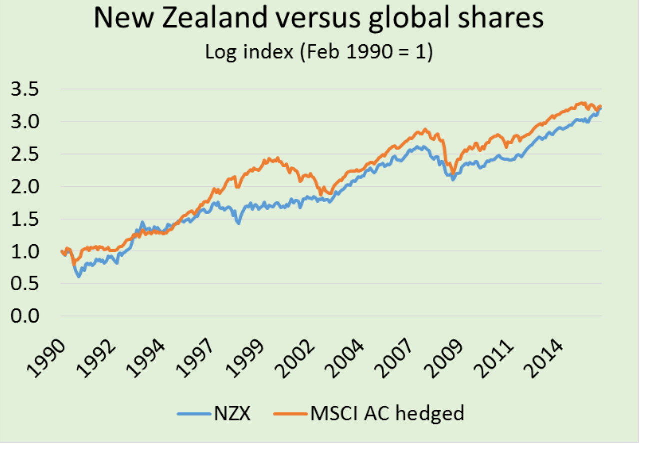
Aiming for the best outcomes for clients

We consider that, for a New Zealand fund manager like Kiwi Wealth, with large share portfolios, the most pressing objective is to deliver investment outcomes that are the best for our customers. For us, the variety of opportunities, diversification, and liquidity of offshore share markets enables us to do this.

We do currently invest in New Zealand companies through the fixed interest market, investing in companies such as Mighty River Power, Transpower and Spark. We will also invest in any New Zealand share that meets our investment criteria and stacks up on a global comparison to offer the best risk-adjusted return for our clients.

What does this mean for performance?

Some may point to the generally good performance of the New Zealand share market in the past 15 years as a reason for investing in this country. On the face of it, the New Zealand share market, represented by the S&P/NZX 50 Gross Index (NZX), has performed well since 1990, as shown in the chart below. It has delivered an average annual return of around 8.7% in that period.



As the chart above shows, hedged New Zealand dollar returns on global shares, represented by the MSCI All Countries Index, have fared well in comparison to New Zealand shares since 1990, returning an average of 8.9% per annum since 1990. While the returns have been similar on average, the path taken has been different, with some years favouring global shares and some New Zealand shares.

In our view, achieving this return through global shares is preferable given the better choice, diversification and liquidity.

Naturally, after tax returns on investments are what matter most, and there is an advantage for domestic shares, particularly for investors with higher tax rates. We have looked at the difference that tax could make to the comparison when dividends are included, and are satisfied that the advantage enjoyed by domestic shares is unlikely to sufficiently compensate for their extra risks associated with lower diversification and lower liquidity