Many crappy returns

Is the New Zealand Stock Exchange really worth investing in? Barely, finds MARK STORY

By Mark Story, Auckland

Issue 7 / Thursday, 1 July, 1999

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Economists and capital market analysts keep reminding us that New Zealand's prosperity is inextricably wired to the fortunes of offshore markets. So, ahem, why is our share market trading only marginally up on where it closed last year (2065 points) while share markets in the United States and Australia have been trading at all-time highs?

Equities are supposed to out-perform all other asset classes over time. But Don Turkington, managing director of brokering firm Cavill White, says that truism, believed by financial advisers around the world, just doesn't seem to apply here. The way he sees it, our share market is the classic drifter — it has lost any real sense of direction. "Much of this has to do with the structure of the New Zealand market. While it follows world markets down, it's not so good at tracking the upside."

Bugger. So what's the problem? Turkington says high interest rates, coupled with New Zealanders' risk-averse hangover from the crash of 1987, mean term deposits have commanded an unprecedented slice of the total investment pie — $45 billion worth.

But Turkington says that's only half the story. He says the thin composition of quality stocks on the New Zealand Stock Exchange (NZSE), with little or no representation in strong growth sectors like banking, technology, pharmaceuticals and IT, means the market lacks core growth drivers. We rely hugely on the top 40 companies, and more acutely the top 10, to perform: yet these, bar Telecom, are mostly commodity stocks which remain seriously out-of-the-money. Recent negative returns of stocks on the NZSE10 include: CHH (-28%), FCL Paper (-41.6%), FCL Forests (-33.9%), FCL Energy (-43.8%), FCL Building (-21.8%) and BIL (-60.6%). Even Telecom, arguably the country's only blue-chip stock, comprising half the value of the NZSE10 (52%), hit a purple patch. Doubts about its $200 million buy-in to Australian phone company AAPT punished the share price severely this month.

It gets worse. Turkington says the recent share price rally by forestry stocks on the back of improved global earnings forecasts is running out of puff. And small companies like Tourism Holdings, Hallenstein Glassons and the Pacific Retail Group received a major kicker during the fourth quarter last year on the back only of private client demand. Without foreign participation to move the big cap stocks, quantum growth for the share market is not going to happen.

"New Zealand hasn't been flavour of the month with overseas investors since the first economic slowdown hit in 1996. Since then, the market's just lost its way," says Turkington.

So is there any wisdom to be gained from our share market slump? Turkington has three gems:

1. There ain't nowhere to hide

"With Telecom dropping below $8.00 a share, it's getting harder to identify a defensive stock. It's no longer safe to assume that a high yield is sufficient to hold gains," says Turkington.

2. Go west, go east — just go

“A well diversified portfolio should include an exposure to overseas markets, either direct, via a managed fund or through one of the publicly listed index funds like WiNZ or Tortis Ozzy.” Apart from sentimentality and Winston Peterism, why feel tied to New Zealand, when you could bag a Yahoo?

3. Only brains will improve it

Lower interest rates should spur the migration to equities and offerings like Contact Energy will bring new investors to the share market. But Turkington says without steady economic growth and entry of new-style, high-tech, high-growth companies such as biotech and IT stocks that give the US market its shine, our rally to 3600 points leading up to the 1987 crash will never be repeated. Only brains can save us now.

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