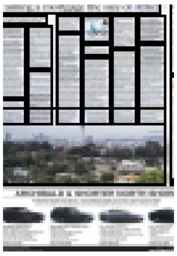

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Mary Holm

Taming a mortgage the size of Africa

A forecast property bust raises fears about negative equity

The *Herald* reported this week that there is a 40 per cent chance of the New Zealand property bubble bursting in the next two years. This sounds a lot like the roulette table, when you bet on red or black — or the flip of a coin. You could lose a lot if it goes against you.

A property bust wouldn't matter if you are mortgage-free. Your property goes down like everyone else's, so you could still sell and move if you wished. However, if you have a mortgage the size of Africa, what happens then? What would you advise?

Have a cuppa, sit tight, and in some cases watch your pennies.

The 40 per cent comes from global investment bank Goldman Sachs. It looked at the ratios of house prices to rent and house prices to household income, as well as house prices adjusted for inflation, in the countries with the 10 most-traded currencies in the world.

"Using an average of these measures, house prices in New Zealand appear the most over-valued, followed by Canada, Sweden, Australia and Norway," it said. "According to the model, the probability of a housing bust over the next five to eight quarters is the highest in Sweden and New Zealand at 35 to 40 per cent." The first thing to note is that financial forecasts are often wrong. Just this past week, Reserve Bank assistant governor John McDermott said in a speech, "More often than not, the world does not turn out as we forecast." Note that he didn't say sometimes, but more often than not.

Second, Goldman Sachs defines a bust as house prices falling 5 per cent or more after adjustment for inflation. A 5 per cent drop wouldn't be too upsetting for most of us – although of course the drop could be much bigger.

Even so, as you say, those with a low or no mortgage haven't got much to worry about. If you're planning to sell in Auckland and buy somewhere cheaper – as our next correspondent did – and prices drop more in Auckland than elsewhere, you'll be worse off.

But most people in that situation will still do pretty well.

Of course, it's more of a concern if your house becomes worth less than your mortgage, so you have what's called negative equity. But even then it's okay if you keep paying down your mortgage, preferably faster than you have to. After a while, prices are sure to stabilise and then rise again.

Our graph shows how volatile New Zealand house prices are. They have fallen no fewer than five times over the past three decades. But they always recover.

The big worry is if you can't meet your mortgage payments – keeping in mind that mortgage rates could well rise. If you're forced to sell for less than your mortgage, you'll end up with no house and a debt to the bank. Ugly.

With that in mind, owners of homes or rental properties with Africa-sized mortgages would be advised to live more frugally – perhaps cutting back on travel, cars, clothes or entertainment – and attack your mortgage. Talk to your lender about committing to larger regular payments to get that balance down.

If you're really worried, consider trading down now to a cheaper home – or selling a rental property. But don't panic. Desperate sellers do badly.

Meanwhile, let's not overlook those who are struggling to buy a house, or have given up. Finally, things might be looking up for them.

Piggybacking on Super

I am retired and still in KiwiSaver. I'm piggybacking on the wife's Super till 2019 when I'll be 65. Since I joined, in 2009, I've gone 100 per cent with a growth investment.

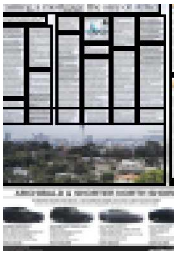
I retired in 2014 and we sold our Auckland properties and live in a small Waikato town with a couple of rentals, all debt-free.

I contribute the minimum to KiwiSaver to get the tax rebate. Since the sum I accumulate is never going to be huge (currently $28,500), should I stick with growth to maximise the amount I do get?

Most people your age would be in a lower-risk KiwiSaver fund. They plan to spend the money soon, and don't want to take the risk that, right when they withdraw their money, the markets are down.

In your case, though, I can see two possible other scenarios:

- You're getting enough income from your wife's Super and the rental properties, so you don't expect to spend the KiwiSaver



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money within the next 10 years or more.

- You might spend the money sooner, but it doesn't matter hugely if the balance has fallen. If you're short, you can always sell a rental. So you're prepared to take a punt.

If either of those applies, stick with the growth fund. There are no guarantees that will maximise your amount, but it's a good bet.

Active investing

Interesting to read NZ Super Fund chief executive Adrian Orr's recent opinion piece in the *Herald*. This must be one of the better advertisements for active investing.

He says, "The fund has also significantly outperformed a simple passive fund-equivalent (our reference portfolio) by $5.5 billion, and did so by getting more return per unit of risk than the passive alternative. The data on returns, benchmarks, and investment risk appetite is on the fund's website." Do you have any comment on Mr Orr's analysis?

Sure do. But first, to put this in context, I have for years recommended long-term investing in a passive or index fund, which invests in the shares or bonds in a market index. This is cheaper than active investing – where the fund managers choose what to buy and sell – so passive fees are lower.

Every year maybe half active managers do better than index funds and half do worse. But only a small number keep outperforming year after year. And It's practically impossible for an ordinary investor to judge in advance which they will be. Given the fee difference, it's better to stick with index funds.

More background: the NZ Super Fund was set up to help pay the rising costs of NZ Super in the decades to come. The Government put in money from 2003 to 2009, and is scheduled to restart contributions from 2020/21. The fund is worth a little more than $34 billion.

Okay, now for your question. Adrian Orr made that statement in response to comments that, "NZ would be better off managing the NZ Super Fund as a passive fund." Soon after, Orr's chief investment officer, Matt Whineray, responded to the same comments in more depth. And you may be surprised at what he says, as follows: "Active investing is difficult and not worth doing in many markets, and we agree that active investing costs more.

"This is why the majority of the fund is managed passively – two-thirds is invested in line with an index-linked reference portfolio. This is a diversified growth portfolio (80 per cent shares, 20 per cent bonds) that is fully implemented passively at a low cost." In short, most of the Super Fund is passive.

But, adds Whineray, "Active investment has some big benefits: in our case, it allows us to increase diversification and fully utilise our natural advantages. As a result, we have earned significant rewards with little additional risk." He then quotes two of the Fund's "relevant investment beliefs":

- "True skill in generating excess returns versus a manager's benchmark is very rare. This makes it hard to identify and capture consistently." As I said above, it's difficult to pick long-term active winners.
- "Investors with a long-term horizon can outperform more short-term focused investors over the long run." The Super Fund has an unusually long horizon. It's expected to supplement NZ Super payments over many decades starting in the mid-2030s. The fund's size is expected to peak in 2071.

Whineray says the fund's active investments fit into three broad categories.

- "The first contains investments that help diversify the fund's portfolio. Examples include our New Zealand timber and rural assets. These investments exploit the fund's long investment horizon and known liquidity profile."
- In the second category, "which also exploits the fund's long investment horizon", the fund buys asset classes that are relatively cheap – such as shares during the global financial crisis – and sells what looks relatively expensive.
- The third category "contains investments that rely on the ability to select individual assets that will outperform relevant benchmarks. This is what is usually referred to by detractors of active investment. We agree with the contention that picking stocks in efficient markets is a zero-sum game (what one manager gains, another loses, and everyone pays fees). This is why we use very little of this type of active investing and, where we do, it is focused on specific opportunities where there is persistent evidence of market inefficiency."

My comments? In the first category are investments that aren't available in passive funds. In the second and third categories, NZ Super Fund managers make judgments that most investors are ill-equipped to make. And even the fund gets it wrong sometimes. Note, too, that the fund does "very little" in the third category.

Whineray adds, "Active investing, within well-defined constraints, is both prudent and commercial for an institutional investor with a long horizon and the discipline to stay the course."

Many individual investors have neither. They expect to spend at least some of their money within a decade or two. And they grow uneasy when an investment performs badly, and move their money at the wrong time.

So is the Super Fund's performance "one of the better advertisements for active investing," as you put it?

If anything, it's the opposite. Most of its investments are passive. And the rest are either in assets such as timber or they are the result of sophisticated decision making by an extremely long-term, disciplined investor – a very different investor from most New Zealanders.

Forex trading woes

For your correspondent last week inquiring about forex trading, here are a few facts from an experienced trader. I have been trading real money for 3½ years and I'm not profitable yet.

There is an overwhelming amount of misleading information online, and there are many brokers ready to trade directly against their clients.

My first two years as a trader cost me plenty, and I have spent

the past year unlearning what I learnt in the previous two years.

My mentor recently wrote about trading your real money account like it was a demo account, and how you would see a big improvement in results if you take emotions out of the trade.

You may pass my details on to your correspondent, as I have spent weeks researching this subject and personally have had some bad experiences in the past.

Thanks, but I'll skip your kind offer. I'm hoping the reader has decided against trading foreign exchange after the reading I suggested for him. And your letter hardly boosts the case for trading.

You sound optimistic that you've now learnt how to trade profitably. But I doubt if anyone can trade investments – as opposed to buying and holding – without getting emotional. Please don't put good money after bad.

- Mary Holm is a freelance journalist, a director of the Financial Markets Authority and Financial Services Complaints Ltd (FSCL), a seminar presenter and a bestselling author on personal finance. Her website is www.maryholm.com. Her opinions are personal, and do not reflect the position of any organisation in which she holds office.

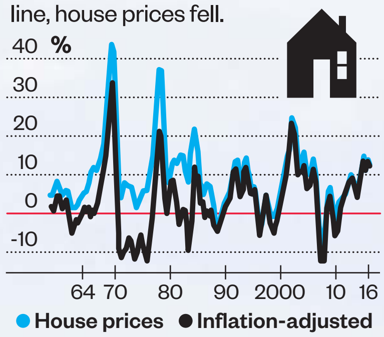
Mary's advice is of a general nature, and she is not responsible for any loss that any reader may suffer from following it. Send questions to mary@maryholm.com or Money Column, Private Bag 92198 Victoria St West, Auckland 1142.

Letters should not exceed 200 words. We won't publish your name. Please provide a (preferably daytime) phone number.

Sorry, but Mary cannot answer all questions, correspond directly with readers, or give financial advice.

Ups and downs

% change in house prices. Below the line, house prices fell.



Source: Reserve Bank / Herald graphic

In your interest
what they charge

Mortgage Rates

	Floating	Fixed (years) 1	2	5
AMP Home Loans	6.14	4.69	4.79	5.89
ANZ	5.79	4.49	4.85	6.09
ASB	5.80	4.45	4.74	5.69
Bank of China	5.75	4.85	4.89	-
Bank Direct	5.80	4.45	4.74	5.69
BNZ	5.90	4.59	4.79	6.09
China Construction Bank	5.60	5.10	5.10	-
Co-operative Bank	5.75	4.59	4.85	5.85
First CU	5.60	4.89	4.99	-
Heartland Bank	5.65	7.00	7.25	8.55
General Finance	5.95	6.25	6.50	-
Housing NZ	5.79	4.99	5.14	5.89
HSBC Premier	5.79	4.19	4.29	5.59
ICBC	5.70	4.59	4.69	5.85
Kiwibank	5.70	4.69	4.79	5.99
Kookmin Bank	5.85	5.10	5.30	-
Nelson BS	6.10	5.10	5.45	-
NZCU Auckland	6.20	-	-	-
NZCU Baywide	5.95	5.10	5.25	-
Resimac	5.30	4.86	4.94	5.48
SBS Bank	5.79	4.59	4.79	5.85
Sovereign	5.90	4.45	4.74	5.69
TSB	5.65	4.55	4.65	5.79
Wairarapa Building Society	5.70	4.85	4.99	-
Westpac	5.84	4.59	4.85	5.59

In your interest
what they offer

Term Deposit rate (%) *

	Min amnt $	6 mths	1yr	3yrs
ANZ	10,000	3.30	3.35	4.00
ASB	10,000	3.50	3.25	4.00
Asset Finance	500	-	3.40	5.75
BankDirect	10,000	3.50	3.25	4.00
Bank of Baroda	10,000	3.25	3.60	3.90
Bank of India	10,000	3.25	3.50	4.00
BNZ	10,000	3.15	3.25	4.00
Co-operative Bank	10,000	3.35	3.60	3.95
F E Investments	5,000	5.00	6.15	6.60
Finance Direct	1,000	2.25	3.95	5.50
First C U	500	3.70	3.80	-
Fisher & Paykel Finance	1,000	3.80	3.95	4.35
General Finance	5,000	2.50	4.00	5.75
GoldBand Finance	5,000	2.00	3.80	5.75
Heartland Bank	1,000	3.30	3.40	3.60
HSBC Premier	10,000	2.80	2.90	3.00
ICBC	10,000	3.30	3.40	3.85
Kiwi Bonds	1,000	1.75	1.75	-
Kiwibank	10,000	3.30	3.50	4.00
Liberty Financial	5,000	3.95	4.05	4.10
Kookmin Bank	10,000	2.90	3.10	3.35
NZCU Auckland	10,000	3.30	3.50	-
NZCU Baywide	1,000	3.80	4.00	4.25
Credit Union Central	1,000	3.25	3.60	-
Aotearoa CU	500	3.10	4.95	5.50
Nelson BS	5,000	3.50	3.70	4.05
Police C U	500	3.30	3.40	-
RaboDirect	1,000	3.40	3.40	3.95
SBS Bank	5,000	3.35	3.65	4.00
TSB Bank	10,000	3.40	3.65	4.05
UDC Finance	5,000	3.45	3.80	3.85
Wairarapa Building Society	5,000	3.30	3.40	-
Westpac	10,000	3.45	3.35	3.90

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