Lessons from 2020

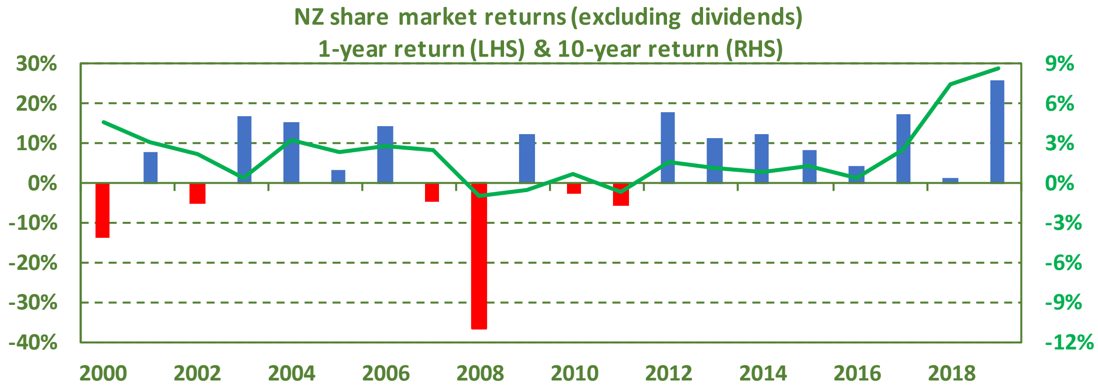
December 2020

As the end of 2020 nears, it is worth reflecting on what is important when investing in shares and the lessons that have been relearned. It is also useful to think about the investment outcomes for 2020, in the context of what was reasonable to expect based on what has happened before.

In 2020, the NZ share market initially rose 5.0%, then fell 30.2%, over February and March, before recovering to be up 7.6% year-to-date. This is not unusual and is higher overall than what is normal.

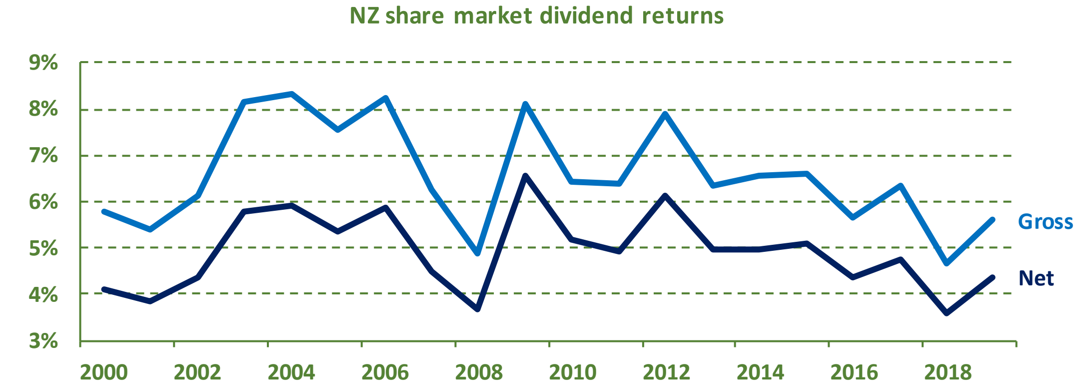
Also, net dividends of 2.4% were received, with more to likely come by 31 December 2020.

In the 20 years leading up to 2020 (ie 1 January 2000 to 31 December 2019) the change in the value of the New Zealand share market for each calendar year was:



Source: S&P/NZX 50 Index, Nikko AM, MCA

In addition to the market movement, the dividend yields, both gross and net of imputation credits, were:



Source: S&P/NZX 50 Index, Nikko AM, MCA

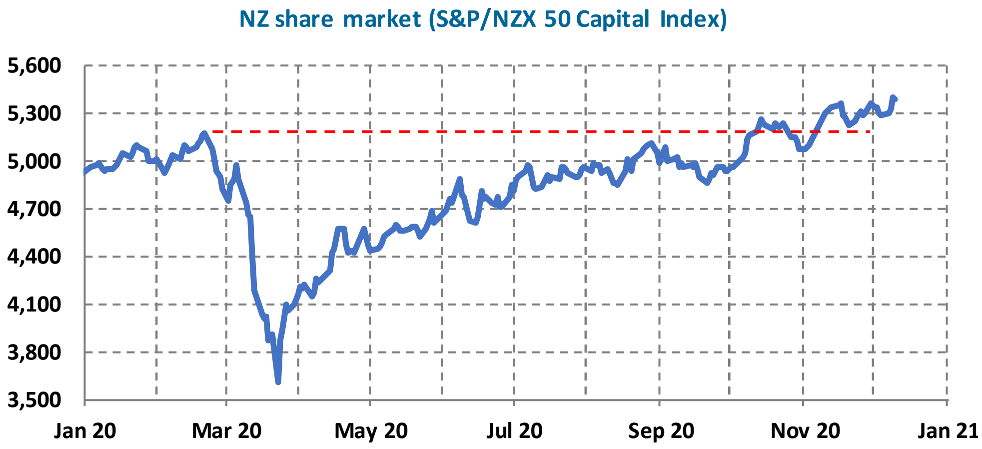
Therefore, at the start of the year (ie 1 January 2020), we could observe:

- Over the 20-year period, the market-movement return was 120% (4.1% a year annualised).
- The average net dividend yield was 4.9% a year.
- On an annual basis, about 30% of the time (6 of the 20 calendar years) the market went down. Over shorter periods, eg a quarter, the market went down about 40% of the time (33 of the 80 quarters).
- It was 8 years since the market had gone down, but only 1 year since the return was near 0%.
- In 9 of the 20 years, the market went up by more than 10%, ie about 45% of the time.

- Over the 10-year periods to 31 December 2009 and 2011, the market was down, as the good years were not sufficiently "good" to offset the "bad" years, particularly 2008, but mostly the average returns over 10 years were positive.
- In 2008 and 2018, the "bad" years from a dividend perspective, net of imputation credits (ie the cash dividend), was about 3.5%.

Therefore, going into 2020, it was normal to expect the dividend yield would probably be at least 3.5%, irrespective of what happened to the value of the shares. Also, the change in value would most likely be positive, but that a negative return over one of the four quarters or over the year, would not be out of the norm. Not "knowable", if there was a negative return, was what the driver of that return would be.

The market movement over 2020 year-to-date has been:



Source: S&P/NZX 50 Index, Nikko AM, MCA

Based on the year-to-date position (to 10 December 2020), 2020 looks like a year where:

- The market return is positive (up 9.44% year to date) and higher than the recent average (5.06%) and with 3 of the 4 quarters (ie 75%) being positive (normally 60%).
- The net dividend yield at 2.47% year-to-date and likely to end just under 3%, will be lower than the previous "bad" year (3.57% in 2018) reflecting that many companies cut their dividend due to the uncertainty COVID-19 created and their need to preserve cash.

2020 therefore reminds us that:

Overall, 2020 reminds us that shares are good investments for long-term investors and less appropriate for shorter term investors.

1. Share markets often go down and the timing of a down is not predictable, and the cause of the down is not always investment related. After such a decline, the share markets eventually recover. Most of the time, they recover within the year, but sometimes it takes 10 to 12 years. Successful investors always position themselves, so they are not forced to sell shares when the market is down. They know that to sell shares after a decline, converts what is expected to be a temporary loss into a permanent loss. The key question is "if the markets halved tomorrow, will I be financially embarrassed?" The better investment policies stop investors reacting to bad news and have a risk management plan in place.
2. From the peak on 21 February to the low on 23 March, the market went down 30.2%. The markets then went on to recover and returned to the 21 February level on 12 October. From 23 March to 12 October, the markets went up 43.8%. Successful investors understand that if a market goes down by 50% (ie halves) it has to go up from the low by 100% (ie double), to get back to breakeven.
3. Dividends are expected but not guaranteed. Successful investors hold cash and other investments to manage the risk that dividends (ie the natural income) fall short of the immediate cash requirements.