



# Fisher Funds

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### **Green shoots – are they sprouting?**

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We have all noticed the wave of optimistic commentaries in the financial media in response to the recent upturn in global share markets. Since hitting a many-year low on March 6<sup>th</sup>, global share markets have bounced, some by more than 20%. This rebound has been dubbed the “Green Shoots Rally”, with many suggesting it may signal the initial stages of a recovery in the global economy.

Some commentators warn that it is too early to be optimistic and call the recovery a ‘Bear Market Rally’, one that is destined to fizzle out. Their caution is understandable given that there are still a lot of areas in the global economy that are suffering; and it is certainly true that news continues to emerge about business failures and job losses on a daily basis.

But it is important to separate the economic cycle from the share market cycle. Shares can rally strongly even while the economy is performing poorly. Examples dating back many decades show strong and sustained share market rallies which began part way through an economic recession.

The share market is forward looking, and a share price today is largely based on what investors expect the company’s profits and dividends will be in the months and years ahead. Even though we are currently overwhelmed by bad news, it is reasonable to assume that in six or twelve months time, the news might get better. A small improvement in economic growth, a renewed sense of confidence among consumers and businesses, or a better than expected level of sales for a company are the sort of catalysts that can encourage investors to think more positively, even in the midst of bad news.

Have there been enough green shoots in the New Zealand share market to warrant the recent rally? The answer is most definitely yes. First of all, shares were sold indiscriminately during 2008 as investors sought to reduce risk. The shares of good companies and bad were sold down, irrespective of the company’s quality, profitability or prospects. This left a disconnect between price and value such that early this year, a number of company shares had become too cheap relative to their assets or their earnings. When the market started to rally in March, it was the undervalued shares that rallied the strongest. This is a good sign because although investors were not discerning as they sold last year, they have been discerning as they’ve bought back in.

A number of companies have reduced their dividends during the past year in order to preserve cash in an uncertain climate, others have maintained their dividends and some have lifted them. With the significant share price falls of last year, the average gross dividend yield for the New Zealand share market is now close to 8% which is reason in itself for the market to rally. In an environment of low interest rates, this competitive dividend yield means that share market investors are being paid well while they wait for capital growth to ultimately come.

Corporate New Zealand has performed relatively well in this downturn, as evidenced by the profit results released in recent months. While some high profile listed companies have needed to raise



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capital, we have seen numerous examples of companies that have weathered the difficult economic conditions well and maintained profitability. Unlike the US, we have not seen whole industries throw themselves on the mercy of the Government; rather, good companies have taken advantage of weaker competitors to grow market share or have reaped the benefits of expansion and diversification strategies undertaken in previous years.

At Fisher Funds, we have always preferred companies that have a competitive 'moat', something that gives them an edge over their competitors so that they can survive and thrive regardless of the timing and extent of an economic downturn. These 'moats' have been evident in recent profit results and have certainly justified the subsequent share price performances.

There has been much talk about falling interest rates, mainly as they affect home-owners or home buyers. Falling interest rates have also had a significant impact on those investors who rely on a regular income from their investments to fund their lifestyle. As interest rates have fallen, there has been evidence of some investors looking to the share market, and particularly to high-yielding shares, as an alternative to bank deposits. Other investors found the share market too nerve-racking in 2008 so they took their money out of shares and deposited it in the bank "for safety". Some of these investors have begun to return to the share market and have been part of the green shoots rally. The support that has been given to the numerous capital raisings of the past few months, without other shares being sold to fund them, is evidence of investors returning to the market. Just as the weight of selling drove share prices down in 2008, we could see share prices continue to be driven up by the weight of buying as investors return to the market.

In October, Warren Buffett began buying stocks in the US share market and said "What is likely... is that the market will move higher, perhaps substantially so, well before either sentiment or the economy turns up. So if you wait for the robins, spring will be over". He has previously talked about buying when other investors are at their most pessimistic. Investors have been very pessimistic, and have therefore not been prepared to look to the future with any optimism. We can be our own worst enemies as, particularly in bad situations, we often extrapolate the current environment into the future and assume that things will stay bad. In my view, there are enough green shoots in evidence to suggest that at some point the New Zealand share market will get better, and stay better. That is not to say that the economy will soar, or the whole share market will soar, or that there won't be bad days or weeks. But glimmers of hope? Sprouts of encouragement? Absolutely.

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