Portfolio Comment

Financial
Prosperity Partners

Welcome to the Quarterly Portfolio Comment, designed to inform you about the performance of our preferred Integral Master Trust portfolio and the unique way it is structured. Read on.

Portfolio Returns to 31 December 2023

IMT Portfolio	3-mth	6-mth	1-year (pa)	3-years (pa)	10-years (pa)
Defensive Fund	1.97%	3.41%	5.77%	-0.05%	2.14%
Diversified 40 Fund	3.69%	4.36%	12.51%	4.52%	5.55%
Diversified 60 Fund	4.38%	4.58%	15.61%	6.53%	7.12%
Global Equities Fund	5.74%	5.16%	21.29%	10.72%	10.03%
Focused Growth Fund	8.90%	4.30%	24.88%	N/A	N/A

Portfolio returns are calculated gross of tax and fees and gross of all management costs, but include the underlying investment fees and expenses. Returns for greater than one year are "per annum". Further information about returns can be found in the quarterly Fund Updates located at nzbritannia.co.nz. Before making any decision to acquire any product offered by the Integral Master Trust, you should consider the information contained in the Product Disclosure Statement. Past performance is no guarantee of future performance. The Focused Growth Fund adopted its current investment strategy in July 2021.

Other funds adjusted their asset allocations in July 2021 to take great account of environmental, societal and governance aspects. This has resulted, for example, in those funds down-weighting to large global emission producers, without detrimental effects to returns. In addition, the asset allocations have been adjusted to more accurately reflect market weightings around the world.

World Indices	As at 31 December 2023	As at 30 September 2023	As at 30 June 2023
Dow Jones Industrial Average	37,689.54	33,507.50	34,407.60
S&P 500	4,769.83	4,288.05	4,450.38
NYSE Composite	16,852.89	15,398.21	15,875.91
Russell 2000 Index	2,027.07	1,785.10	1,888.73
FTSE 100 Index	7,733.24	7,608.08	7,531.53
S&P/ASX 300	7,535.90	6,999.10	7,157.40
S&P/NZX 20 Index	7,296.85	6,965.72	7,499.52

Indexes are presented for illustrative purposes to demonstrate how the markets have generally performed recently. You cannot invest into an index. Past performance is not illustrative of future performance and the indices shown above are not the official benchmarks of the Integral Master Trust funds.

Market update

While 2023 was a hard year for investors and economies in general, we are starting to see a few green shoots emerging with investors who have maintained a consistent investment strategy reaping the rewards.

We started 2023 still a bit shellshocked from a harsh 2022 that saw both equities and supposedly "safe" defensive asset classes like bonds being hit hard - in short there was nowhere to hide. Inflation was still rampant and central banks, including our own Reserve Bank, were raising interest rates to bring inflation back down to acceptable levels.

Increasing interest rates acted as a handbrake on the economy by (1) making it harder for businesses to borrow and (2) taking cash out of the hands of borrowers like mortgage holders, reducing their ability to spend. Over the year this had the intended effect of reducing demand which led to lower inflation, albeit happening very slowly and at a high cost to the economy.

Like children impatiently awaiting Christmas gifts, markets have been eagerly awaiting news that inflation is being brought under control and interest rates wouldn't increase further (and maybe hoping that they would be lowered soon). Around the middle of the year, investors thought that point had been reached. The markets surged even as the central banks continued to warn against being too optimistic. Facing the prospect of all their progress being undone prematurely, central banks doubled down on their rhetoric and investors took this warning to heart. Markets rapidly fell and the following few months saw investor portfolios punished.

Then in November and December, data started showing that inflation was trending down globally. It became clear that most central banks had reached the peak of their interest rate rises. In December, the US Federal Reserve even hinted that there may be interest rate cuts in 2024. The ever-eager investors took this signal very positively and again markets surged. This left investors with a positive end to 2023.

Strong economic news, particularly out of the United States, has contributed to positive market performance and there is talk of the world's largest economy avoiding a recession. Domestically the news is not as positive. Despite a huge influx of immigrants, the economy shrunk in the September 2023 quarter, and although inflation is trending downwards it remains too high.

And so 2023 ended on a much more positive note than it began. While inflation has not been defeated, the signs are getting stronger that the harsh medicine inflicted by central banks has begun to work and the potential for a happier 2024 and beyond has grown.

The lesson for investors is that patience is rewarded. Investors who were sitting on the sidelines would have missed out of these surges. There was no warning of the good news, and the speed at which markets reacted meant it was very hard, if not impossible, to get back into the markets in time to participate in the gains.

Against this positive tone, we need to remember that investor sentiment can turn rapidly and there are still a range of potential headwinds including:

- Inflation remaining stubbornly high.
- Poor economic news.
- US presidential election.
- China facing slowing growth and ongoing debt and housing crises.
- No end in sight for the Ukraine/Russia war.
- Trouble in the Middle east.

Investors may be optimistic about 2024, but they should be aware there are many uncertainties ahead.

To do or not to do

The uncertainty facing investors in 2024 raises the question of whether or not to do something. When faced with uncertainty, people can make unexpected choices. If a person is faced with too much choice, they can suffer from "analysis paralysis" – being overwhelmed by the difficulty of identifying the best option from a wide range of choices, and end up making no decision at all.

The other risk is that people feel the need to "do something". There is quite a rich vein of research on this phenomenon – it is called Action Bias and refers to situations where we have a tendency to choose to respond with action even if there is no solid rationale to support that choice. Think of it as an automatic response based on impulse, not on logic.

"Inaction breeds doubt and fear. Action breeds confidence and courage." Dale Carnegie

"Do you want to know who you are? Don't ask. Act! Action will delineate and define you." Thomas Jefferson

Looking at the quotes above shows how taking action is viewed favourably. Taking action is not just advantageous – it is character defining and morally correct! The academic theory behind this position is that we tend to rationalise that an outcome would be worse if we'd done nothing (even if this isn't the case). The underlying assumption is that people can more easily imagine the alternative to action than to inaction.

We will elaborate on this bias with an example.

Researchers[1] investigating action bias took to the football (soccer) fields, and in particular how goalkeepers reacted to penalty kicks. The researchers analysed 286 penalty kicks made in championships and top leagues worldwide. Given the speed that the ball is kicked, the goalkeeper needs to choose their action before they know which way the ball is going. This is similar to investors who need to make a decision before all the facts are clear.

The researchers were able to determine that most kicks were aimed at the centre of the goal (which makes sense because it is the largest target). However instead of staying in the centre, goalkeepers almost always chose to jump to the left or right – in fact they dove left or right 93.7% of the time. As the expectation is for goalkeepers to actively defend their goal, they usually chose to take action. A primary reason for this was because the goalkeeper felt worse when they conceded a goal if they didn't take action. This was because the goalkeeper believed they would be judged less harshly if they made an attempt to stop the ball.

Let's look at the goalkeeper's decision in a bit more detail. The goalkeeper is an elite professional – they are playing in topflight games and are very experienced. They are also highly motivated, well compensated and are well aware that the wrong choice is highly likely to affect the outcome of the game and their own professional fortunes. You would expect given these factors, goalkeepers would make a choice based on what has the highest odds of success. It appears this is not what happens. The choice is affected the goalkeeper's emotions, particularly how they emotionally handle conceding a goal.

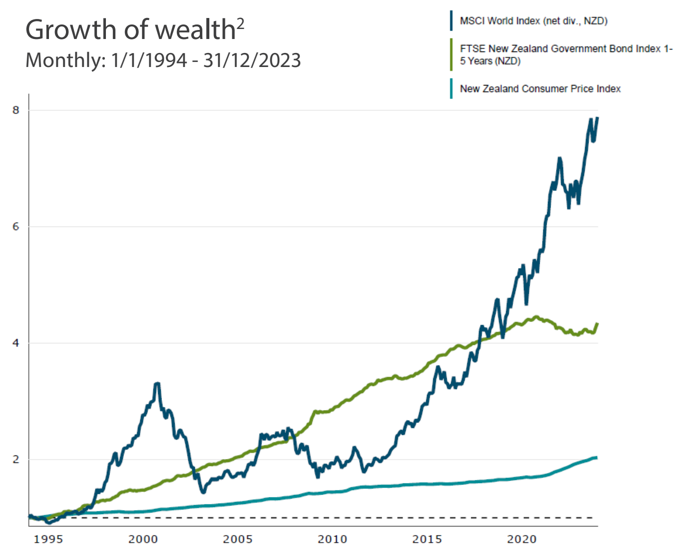
If we extend this logic out to investors who are either saving for or are in retirement, they too are highly motivated to make a rational decision that maximises their portfolio return. They have access to good advice, and there is plenty of research (including this article!) available to help. However, time and time again investors make sub-optimal choices like selling long-term investments at a loss during times of market volatility, or failing to invest when markets would have rewarded them well for doing so. These decisions can have a permanent impact on their ability to fund their retirement – and this is the financial equivalent of losing the football game. Remember, the decision to do nothing is also an action, not always a useful one when it comes to investing.

So indecision can be bad, and when to take action - what is the right decision?

The key is to get the right advice so that you avoid impulsive decisions. (1) Identify and address your most important concerns and goals, (2) implement a choice that addresses those concerns and goals, then (3) stick with the decision until the facts materially change. Here are a few examples of situations that investors face.

Concern: **Fixed interest returns look stable while share returns are volatile.**

Solution: You need to have an asset allocation that is based on your particular attitude and tolerance to risk, the level of risk/return needed to achieve your personal goals and your investment time horizon. If you are investing for the long term, keep in mind what the long-term returns of the asset classes are. **High quality fixed interest can be included in your investments to significantly minimise the volatility from shares.**

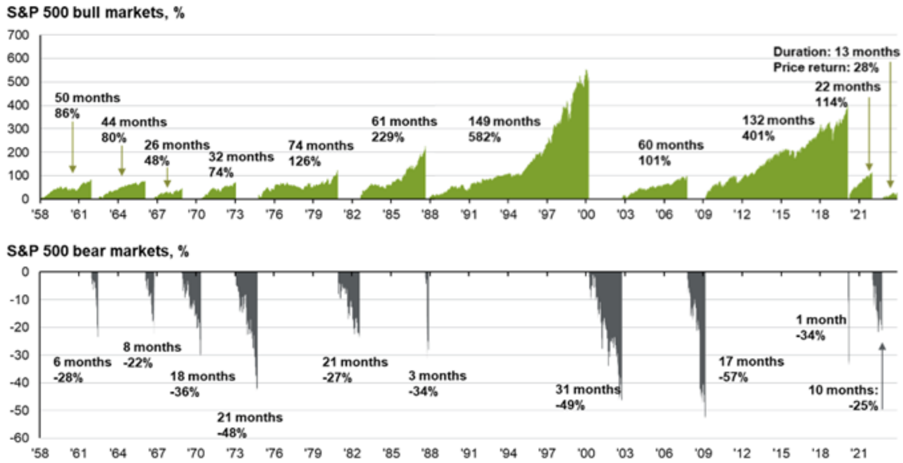


Concern: Share markets could crash.

Solution: Historically share markets have had more and longer periods of growth than decline. You need to be able to ride out the periods when markets fall so you can enjoy the gains. Remember that the **markets are very adept at transferring wealth from the impatient to the patient.**

You can see from the graph below that that although there have been some negative times – the longest being 31 months and -49% return, they have been hugely outweighed by positive times – the longest a massive 149 months (over 12 and a half years!) and a + 582% return.

US bull and bear markets



Concern: Could you get better performance by timing the market?

Solution: Chasing "winners" consistently is very hard, arguably impossible. You need to sell at the right time and also buy again at the right time. It can be an expensive lesson if you get one of these wrong, doubly so if you get both wrong. Ideally you want to be buying when prices are low, and selling when they are high. Investment managers we use have consistent and stringent policies of rebalancing portfolios, buying when prices are low and selling when they are high, as necessary.

Reacting can hurt performance

Performance of the ASX/S&P 300 Index, 2001-2022

Annualised compound return

At times it can be hard to know what the right decision is, but that is why having a financial adviser is a key to achieving your long-term financial goals. Whether you need to take action or just need to be patient, we are here to help and guide you in this key area. We are here to help you with these important long-term decisions and actions, for your financial future and well-being.

Kind regards

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[1] "Action bias among elite soccer goalkeepers: The case of penalty kicks", Bar-Eli et al, Journal of Economic Psychology (2007)
[2] DFA Returns Web. Monthly returns from 1 January 1994 to 31 October 2023