Options in a Low Interest Rate Environment

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The unprecedented experience of Covid-19 has seen monetary policy used like never before. Central banks around the world have thrown billions and billions of dollars into trying to stimulate economic demand.

The Reserve Bank of New Zealand has cut the Official Cash Rate (OCR) to 0.25% and have been buying bonds faster than the government have been issuing, forcing interest rates lower. The theory being that low interest rates entice people to spend surplus funds.

While borrowers and home buyers have benefitted from the falling interest rates, it has been a tough time for savers. In 2007 term deposit interest rates were about 8% p.a. They are now less than 1.5% p.a. a fall of some 80%.

Lower rates may be something that we all need to adjust to as they could be this way for some time to come. Due to this we are seeing more and more clients approach us asking "how can I maintain my level of income?". While everyone will have a different outlook, we really see only a couple of options:

1. You can take on more risk. This will not suit everyone, but the reality is that in the medium term, fixed income assets (in particular term deposits) will return close to 0% after fees, tax and inflation. If you were to purchase shares in companies that pay a reasonable dividend such as the electricity 'Gentailers' or listed property companies, you will take on more risk that the value of your investments may fluctuate in value, but you may be able to sustain the income you require.

2. You can modify the nature of shares you hold in your portfolio. A shift to higher yielding shares, such as the 'Gentailers', is a good starting point with a forecast average 12-month gross yield of about 5.0%. You could draw on the capital in your portfolio to maintain income requirements. People often balk at this idea; however, it is important to view your portfolio with a total return lens (dividends + share price appreciation) and not just focus on the dividend income.

It is important to be aware that share price appreciation and dividends are not guaranteed. We saw in March share markets around the world fall and many companies reduce or defer their dividends for 12 months or more.

In summary, interest rates are lower than we have experienced before. The OCR is tipped to go negative next year and although we don't expect to see 0% return on term deposit rates, it will be very close to this, especially after taxes and charges.

It is important for clients and advisors to be forward looking in these times and think about the positioning of a portfolio 12 months from now. Will income requirements continue to be met 12 months ahead?

If you have any question please contact us on +64 9 308 1450 or visit our website www.jmiwealth.co.nz