Introduction to Passive Investing

Understand the principles, concepts and how to create a passive investment portfolio, using NZX ETFs

WHY INVEST?

"YOU, OWNER OF PROFITABLE COMPANIES ALL OVER THE WORLD"

You won't get rich working for others - or even for yourself - from 9 am to 5 pm every day.

"FREE TIME IN THE FUTURE"

To ensure a decent retirement, you need to **put your money to work for you and wait the time to act on it.**

WHY PASSIVE INVESTING?

"IF YOU CAN'T BEAT IT, JOIN IT"

In the long run, **very few investors are able to consistently "beat the market"**, with low risk.

- Studies show that in more than 80% of cases, active investment strategies - such as stock picking, day trading and timing the market - **lose to "the average market"** in the long run (5+ years).

"INVESTING SHOULD BE AS BORING AS WATCHING THE GRASS TO GROW"

Do not waste your time reading reports and balance sheets trying to find "the next Tesla". **It is the time in the market and the regular contributions that will buy you "time in the future".**

- Dedicate your hours to your current source of income (or even to develop new ones), but **put your savings (and time) to work for you.**

BEFORE INVESTING...

DO NOT HAVE LIABILITIES

It makes no sense to invest if you have critical debts, so **eliminate (or significantly reduce) them.**

DO HAVE A EMERGENCY RESERVE

If you don't have enough assets to support yourself for a few months if something goes wrong, **create an emergency reserve, 3 to 6 times your monthly cost.**

FEATURES OF A PASSIVE PORTFOLIO:

ORIENTED TO INVESTOR'S GOALS AND PROFILE

A passive portfolio is based on investor's goals and profile.

DIVERSIFIED

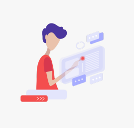
A passive portfolio is well-diversified:

- among different geographies;
- among different asset classes (preferably uncorrelated);
- over time.

BUILT WITH ETFs

A passive portfolio is built using ETFs. Advantages:

- Greater simplicity
- Lower administration fees
- Less risk
- Returns in line with the market
- Low demand for portfolio monitoring (or portfolio rotation)



IT AIMS FOR THE LONG TERM, BUT WITH AN EYE IN THE OPPORTUNITIES

A passive portfolio is for the long term but also takes advantage of opportunities, such as anticipating market cycles.

WITH FREQUENT CONTRIBUTION AND REBALANCING

A passive portfolio receives regular contributions in order to benefit from the market's rule "buy low (and sell high)".

BASED ON DATA AND ON ACADEMIC STUDIES

A passive portfolio must be built using assets with the (statistical) capability to meet investor's expectations and it explores the findings of studies from academia and from the investment industry.

EXAMPLE: A SIMPLE NZ-BASED PASSIVE PORTFOLIO, WITH ONLY 4 ETFs:

25% in New Zealand Equities

Invest in the local New Zealand listed companies.

Examples of possible assets: Smartshares S&P/NZX 50 ETF (NZG) or Smartshares NZ TOP 50 ETF (FNZ).

25% in Australian Equities

Invest in Australian listed companies.

Examples of possible assets: Smartshares S&P/ASX 200 ETF (AUS) or Smartshares AUS TOP 20 ETF (OZY).

25% in Developed Markets Equities

Invest in listed companies from developed markets: US, Europe, Japan, etc.

Examples of possible assets: Vanguard International Shares Select Exclusions Index Fund, Smartshares Global ESG ETF (ESG), Smartshares US Equities ESG ETF (USA) or Smartshares US 500 ETF (USF).

25% in Emerging Markets Equities

Invest in listed companies from Emerging Markets: China, South Korea, Mexico, etc.

Examples of possible assets: Smartshares Emerging Markets Equities ESG ETF (EMG) or Smartshares Emerging Markets ETF (EMF).

STEPS TO IMPLEMENT THE PASSIVE STRATEGY?

Step 1: Objectives, profile and portfolio

Define your **investment goals** (ex: 10% return per year) and **build a portfolio with assets that have the capacity** to achieve these goals but that also **fits your profile** as an investor (conservative, moderate, aggressive, etc.).

Step 2: Stay invested

Contribute periodically to your portfolio (**and re-balance whenever needed**), using the broker of your choice.

Step 3: Time and opportunities

Do not panic about crises or negative news: **take advantage of opportunities and market conditions/cycles.**
Let the time (ie. compound interest!) to act, protecting and monetizing your capital in the long run.

WHAT ARE THE INVESTOR PROFILES?

Conservative

The conservative investor is very risk-averse, **as he/she cannot see the portfolio balance being less than the amount invested.** The conservative investor will invest in financial assets considered very safe, such as bonds, real estate, term deposits or private pension plans.

Just as an example, in the worldwide crash of the stock exchanges during the Coronavirus pandemic, the conservative investor was "grateful" for not having investments in variable income (eg. stock market).

Moderate

The moderate investor **accepts a low exposure to the risks (and returns) of the financial market, even though this represents having (slight) declines in the amount invested.** It tends to invest in fixed income financial assets (such as treasury bond or bills) or even a not-so-large amount in variable income: stocks, mutual funds, ETFs and real estate funds.

Just as an example, in the worldwide crash of stock exchanges in March 2020, the moderate investor probably despaired a lot when the portfolio balance dropped considerably and eventually sold the assets invested on the stock market at a loss.

Aggressive

The aggressive investor lives well with a **greater exposure to the risks (and potentially greater returns) of the financial market, even though this represents significant dropdowns in the invested capital.** The aggressive investor will invest mainly in variable income financial assets both locally and overseas, such as shares, real estate funds, ETFs and cryptocurrencies.

Just as an example, in the worldwide crash of stock exchanges in March 2020, the aggressive investor probably was concerned about seeing the portolio balance dropping considerably, but remained invested and even took the opportunity to buy even more assets on the stock market.

WHAT ARE EXAMPLES OF LONG TERM FINANCIAL GOALS?

Example 1: Preservation of capital

- This financial goal is essentially aimed at preserving the capital that has already been accumulated. One can, for example, aim for a return target of around 2% per year.
- This goal is closely associated with the conservative profile.

Example 2: Protection against inflation and/or devaluation of the currency

- This financial goal aims to protect capital in terms of purchasing power over time. The aim is to reduce the negative effects of inflation and/or the devaluation of the currency. One can, for example, aim for a return target of 3 to 5% per year.
- This goal is closely associated with the moderate profile.

Example 3: Passive income

- This financial goal is aimed at obtaining passive income, ie. the periodic payment of dividends, from the invested capital. One can, for example, look for a target of 0.40% per month, similar to the returns on real estate rentals.
- This goal is closely associated with the conservative profile.

Example 4: Monetizing capital

This financial goal aims to **invest your money to make it profitable**. In other words, put your money to work for you. For example, you can set an average return expectation from 8 to 12% per year.

FUTURE VALUE FORMULA: ESTIMATE THE RETURNS OF YOUR PASSIVE PORTFOLIO

Future value: **estimated end balance**
Starting value: the **initial amount** that you are investing (if any).
Contribution: the **monthly contribution** to your investment portfolio
Return rate: the **average monthly return** of your portfolio.
Time: **duration** of your investment.

In the calculator below, we estimate the end balance of a portfolio, starting from $1000, with monthly contributions of $1000, for 240 months and returning 1% per month, on average.

$$Future\,value = Starting\,Value \times (1+rate)^{time} + \frac{contribution \times \left((1+rate)^{time} - 1\right)}{rate}$$

PASSIVE INVESTOR'S CALCULATOR

(enter the values below and find an estimate of the end balance of your investment)

Monthly contribution: 1000

Starting balance: 1000

Duration (in number of months):

1 360

Average return rate (% per month):

0 1 2 3 4 5

PS: Calculations made using the future value with regular contributions formula:
FV=StartingBalance(1+rate)^time + Contribution*[(1+rate)^time-1]/rate*

Forecasted end balance:
1,000,147.92 $

GLOSSARY:

Investment portfolio

- An investment portfolio (or portfolio) represents the set of investments made by a person (or institution).
- It usually has more than one financial asset in more than one asset class.
- It is described in terms of allocations (eg 25% in fixed income, 25% in real estate funds, 25% in shares, etc).
- It presents a variable return over time, usually measured as a percentage per year (ex: average of 12.34% per year) or over a certain period (ex: 5.78% year-to-date)

Fixed Income

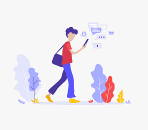
- Fixed Income is a category of investments where **it is known in advance what the final returns of the investment will be**.
- They are usually investments with fixed terms.
- Examples of fixed income financial assets are term deposits and treasury bonds/bills.

Passive Investment

- It is an investment strategy, generally **focussed on the long term, where the aim is to obtain the same average return as the main stock market indexes**, such as the S&P 500 or the NZX 50.
- It is implemented via index funds (also called ETFs) that present greater diversification (and consequently less risk) than isolated assets such as a single company share.
- This strategy requires less effort (and knowledge) to follow up, as it avoids unnecessary *buys and sells* and tends to present returns similar to active investment management in the long run, but with less risk and lower administration fees.

Variable income

- Variable Income is a category of investments where **it is not known what the final return of the investment will be**.
- As the name implies, the prices of invested assets vary (significantly) over time, and may even show negative returns.
- They are usually investments with no fixed term. Examples of variable income financial assets: shares, mutual funds, ETFs and Real Estate funds.



Deposits and Rebalancing

Contributions are investments (think of something like a deposit) made regularly in an investment portfolio. They aim to increase the volume of capital invested through new purchases. They are usually made from the savings made (or dividends received) by the investor in a given period, such as the difference between income and expenses.

Rebalancing is the activity of buying more assets that underperformed in the portfolio in order to go back to the desired allocation. It can be done through new investments or through the sale (full or partial) of assets that outperformed in the portfolio. Typically this re-balancing is periodic (eg. every January) or it is done when the portfolio deviates significantly from the desired allocation.

ETF (or index fund)

- ETF (Exchange Traded Fund) is a financial asset traded on the stock exchange. It consists of several financial assets from the same assets class and seeks to replicate the performance of a given index, either fixed income or variable income.
- ETFs are used on a large scale in the passive investment strategy because they are diversified and have lower management fees.
- In New Zealand, ETFs are not capital gain taxed and some of them do not pay dividends since they are reinvested in their own units.
- Examples of ETFs in NZX (New Zealand Exchange): Smartshares NZ Top 50 ETF (FNZ), Smartshares S&P/NZX ETF (NZG), Smartshares S&P/ASX 200 ETF (AUS), Smartshares US Equities ESG ETF (USA), etc.

WHO WE ARE:

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Made in New Zealand from important and local ingredients.

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