

Equity Strategy

Institutional Model Portfolio

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Similar to humans, stock markets have a tendency to overprice risk when faced with new and unexpected events. The reaction to the potential economic consequences of the coronavirus (COVID-19) outbreak has been significant, but not uniform. The hysteria and hype has created a number of opportunities in the domestic market that we respond to by making 14 changes to our portfolio. This includes adding some, but not undue, risk to the portfolio by increasing our exposure to companies directly exposed to the tourism and travel market, the share prices of which have been hit hardest. We accept that we are not experts on viral pandemics, or have a clear vision as to how the outbreak will evolve. In fact, nobody does. However, we believe the market is mispricing relative risk on a number of stocks and we are acting accordingly.

Uncertainty prevails

The one story in town has dominated for most of the past four weeks and is likely to leave market volatility higher for longer until such time that outbreak data (could be cases or mortality rates) is supportive to a path to everyday normality. In the meantime, the central bank/Government economic response is likely to be supportive to equity markets for the foreseeable future.

Portfolio changes; adding AIR and buying more AIA, SKC, and the larger gentailers

We add Air New Zealand (AIR) to the portfolio with an overweight position in light of its significant COVID-19 related price declines in recent weeks. We close our underweight position in Auckland Airport (AIA) for similar reasons. In addition, we add to our overweight positions in SKYCITY (SKC), Contact Energy (CEN) and Genesis Energy (GNE). We also reduce our underweight positions in Meridian Energy (MEL) and Mercury (MCY).

Exiting MET, TPW and MHJ, and lowering weights in SPK, CNU and FPH

On the other side of the ledger we complete the staged removal of Michael Hill International (MHJ) and Trustpower (TPW) from the portfolio and given the impending takeover, we also exit Metlifecare (MET). In addition, we take profits in both Spark (SPK) and Chorus (CNU). The latter in particular has performed strongly but lacks an obvious catalyst for at least the next 6–9 months.

Figure 1. Forsyth Barr Institutional model portfolio summary

Market breakdown	Benchmark	Active weight	Portfolio
Defensive yield	50.0%	-0.9%	49.1%
Utilities	14.4%	+1.0%	15.4%
Property	10.1%	-5.1%	5.0%
Other defensive yield	25.5%	+3.2%	28.7%
Structural growth	41.5%	+0.9%	42.4%
Aged care	9.3%	+0.2%	9.5%
Other structural growth	32.2%	+0.7%	32.9%
Cyclicals	8.5%	-2.5%	6.0%
Cash	0.0%	+2.5%	2.5%
Total	100.0%	+0.0%	100.0%

Source: Forsyth Barr analysis

Institutional model portfolio

The Forsyth Barr institutional model portfolio is outlined in Figure 2. We incorporate 26 stocks together with a ~3% nominal cash holding. All portfolio holdings are 1.0% or more, unless we are adding new positions, or exiting positions, in less liquid stocks.

Figure 2. The Forsyth Barr institutional model portfolio

Code	Portfolio weight	Active weight	12m fwd PE	12m fwd cash divi yield	Rating
ATM	14.0%	+3.0%	31.0x	0.0%	OUTPERFORM
FPH	10.5%	-2.3%	49.3x	1.3%	UNDERPERFORM
SPK	8.9%	+1.0%	21.9x	5.1%	OUTPERFORM
CEN	6.5%	+2.2%	20.1x	5.7%	OUTPERFORM
AIA	6.4%	-0.1%	36.0x	2.8%	NEUTRAL
IFT	4.3%	+1.4%	n/a	3.6%	OUTPERFORM
RYM	4.2%	-1.2%	24.7x	2.0%	NEUTRAL
MEL	3.9%	-1.2%	25.7x	4.6%	NEUTRAL
CNU	3.6%	+0.7%	64.3x	3.2%	OUTPERFORM
GNE	3.5%	+2.1%	17.4x	5.6%	OUTPERFORM
SKC	3.2%	+1.4%	17.7x	6.2%	OUTPERFORM
KPG	2.9%	+0.9%	20.3x	4.9%	OUTPERFORM
SUM	2.7%	+1.2%	15.7x	1.9%	OUTPERFORM
EBO	2.7%	+0.3%	21.0x	3.4%	NEUTRAL
MFT	2.6%	-0.1%	21.4x	1.9%	NEUTRAL
ARV	2.6%	+1.8%	14.2x	3.9%	OUTPERFORM
Cash	2.5%	+2.5%	n/a	n/a	n/a
ZEL	2.3%	+0.9%	12.2x	9.8%	OUTPERFORM
FBU	2.3%	-1.3%	15.8x	4.6%	UNDERPERFORM
SAN	2.2%	+1.8%	12.6x	3.2%	OUTPERFORM
VHP	2.2%	+1.3%	28.2x	3.1%	NEUTRAL
MCY	1.6%	-1.0%	25.0x	3.3%	NEUTRAL
AIR	1.4%	+0.5%	8.7x	10.7%	OUTPERFORM
NZK	1.2%	+1.2%	17.1x	2.8%	OUTPERFORM
TLT	1.0%	+1.0%	23.3x	0.0%	OUTPERFORM
FRE	1.0%	-0.0%	18.7x	4.1%	NEUTRAL

Source: Forsyth Barr analysis

Our portfolio is less expensive on a one year forward PE basis than the market and provides a higher level of EPS growth, whilst also providing a similar level of income (on a cash basis).

Figure 3. Portfolio characteristics vs. the S&P/NZX 50 (based on Forsyth Barr estimates)

	12m fwd PE	12m fwd cash divi yield	12m fwd EV/EBITDA	12m-24m EPS growth
FB Institutional Model Portfolio	24.7x	3.3%	13.5x	9.3%
S&P/NZX 50	25.3x	3.2%	13.6x	8.5%

Source: Forsyth Barr analysis

Key active weights

We outline our key active weights in Figure 4 where weightings are 1.5% or greater relative to the benchmark.

Figure 4. Key active weights

Code	Active weight	Rationale
Key over-weights		
ATM	+3.0%	Unique growth story with penetration still low of a large (and growing) addressable market. Strong free cash flow, high return and a large net cash position. Optionality from new products/markets.
CEN	+2.2%	Defensive characteristics, long-term steady growth outlook and strong yield. Risk of NZAS closure is low. Has one of the best development projects in the country with its Tauhara geothermal option.
GNE	+2.1%	Defensive characteristics, long-term steady growth outlook and strong yield. Provides best near-term earnings growth as long-term expensive take or pay gas contracts roll off.
SAN	+1.8%	Value strategy with upside should it execute on stated target of NZ\$1 EBIT/kg. Attractive PEG. Long-term optionality around additional aquaculture water space backed by Government support. Protein theme.
ARV	+1.8%	Strong structural growth story with robust pipeline of greenfield and brownfield sites. Defensive earnings profile a derivative of its care focus and strong geographical diversification. Attractive dividend yield.
Key under-weights		
GMT	-2.3%	Well placed Auckland-centric industrial portfolio over-priced with sector leading PE of ~34x. Balance sheet optionality difficult to flex in a property market starved for well-priced investment opportunities.
FPH	-2.3%	High quality, long-term growth story. However, we struggle to justify valuation levels (~49x PE) which are elevated against any benchmark (even when growth adjusted).
POT	-1.8%	COVID-19 risks made clear in revised FY20 guidance implying sharp slowdown in log exports. Risk to FY21 earnings also given supply chain disruption. Upper North Island study unlikely to lead to meaningful benefits for POT.
PCT	-1.8%	Office exposure increases its susceptibility to cyclical swings. Cashflow outlook muted despite subdued supply outlook for office assets in Wellington and Auckland.

Source: Forsyth Barr analysis

Portfolio Changes

We have made a number of changes to our portfolio as summarised in Figure 5.

Figure 5. Portfolio changes

Code	Portfolio move	Weighting change	New portfolio weight	Rationale
CNU	Sell	-1.0%	+3.6%	Taking profits after significant outperformance
FPH	Sell	-0.5%	+10.5%	Playing on fundamentals in light of excessive valuation
MET	Sell/Exit	-1.0%	+0.0%	De-risking takeover situation
MHJ	Sell/Exit	-0.3%	+0.0%	Margin pressure at quarterly sales will drag on earnings outlook
SPK	Sell	-1.4%	+8.9%	Profit taking after strong recent outperformance
TPW	Sell/Exit	-0.5%	+0.0%	Second sell-down in staged exit
AIA	Buy	+1.6%	+6.4%	Recent price decline provides opportunity to neutralise position
AIR	Buy/Add	+1.4%	+1.4%	Re-entering having exited in January in light of COVID-19 concerns
CEN	Buy	+0.3%	+6.5%	Upweighting gentailers after Tiwai wobbles
GNE	Buy	+0.3%	+3.5%	Upweighting gentailers after Tiwai wobbles
MCY	Buy	+0.3%	+1.6%	Upweighting gentailers after Tiwai wobbles
MEL	Buy	+0.3%	+3.9%	Upweighting gentailers after Tiwai wobbles
SKC	Buy	+1.0%	+3.2%	COVID-19 sell down creates opportunity
CASH	Sell	-0.5%	+2.5%	Working the portfolio harder; default cash position is ~3%

Source: Forsyth Barr analysis

Figure 6. Forsyth Barr Institutional model active weights relative to benchmark (priced as at 6 March 2020)

Thematic/company	Active weight	Price (NZ\$)	12m fwd PE	12m fwd divi yld*	12-24m EPS growth	Rating
Defensive yield	-0.9%					
Utilities	+1.0%					
CEN	+2.2%	\$6.83	20.1x	5.7%	3.3%	OUTPERFORM
GNE	+2.1%	\$3.14	17.4x	5.6%	20.1%	OUTPERFORM
MCY	-1.0%	\$4.80	25.0x	3.3%	8.2%	NEUTRAL
MEL	-1.2%	\$4.68	25.7x	4.6%	-3.4%	NEUTRAL
TPW	-0.4%	\$6.85	21.6x	5.0%	7.0%	OUTPERFORM
VCT	-0.7%	\$3.40	26.8x	4.9%	-2.8%	NEUTRAL
Property	-5.1%					
ARG	-1.0%	\$1.40	20.3x	4.5%	0.2%	NEUTRAL
GMT	-2.3%	\$2.43	35.3x	2.7%	3.7%	UNDERPERFORM
IPL	-0.4%	\$1.78	21.6x	4.3%	1.6%	OUTPERFORM
KPG	+0.9%	\$1.47	20.3x	4.9%	0.5%	OUTPERFORM
PCT	-1.8%	\$1.91	28.1x	3.3%	-1.5%	NEUTRAL
PFI	-1.1%	\$2.52	28.7x	3.1%	0.3%	NEUTRAL
SPG	-0.7%	\$2.22	20.1x	4.5%	2.0%	NEUTRAL
VHP	+1.3%	\$2.87	28.2x	3.1%	2.8%	NEUTRAL
Other defensive yield	+3.2%					
AIA	-0.1%	\$7.89	36.0x	2.8%	0.3%	NEUTRAL
CNU	+0.7%	\$7.61	64.3x	3.2%	-2.8%	OUTPERFORM
IFT	+1.4%	\$5.09	n/a	3.6%	n/a	OUTPERFORM
POT	-1.8%	\$6.70	44.7x	2.1%	8.2%	UNDERPERFORM
RBD	-0.3%	\$11.59	25.8x	0.0%	3.2%	UNDERPERFORM
SKC	+1.4%	\$3.21	17.7x	6.2%	9.0%	OUTPERFORM
SPK	+1.0%	\$4.93	21.9x	5.1%	3.3%	OUTPERFORM
ZEL	+0.9%	\$4.07	12.2x	9.8%	2.5%	OUTPERFORM
Structural growth	+0.9%					
Aged care	+0.2%					
ARV	+1.8%	\$1.73	14.2x	3.9%	13.1%	OUTPERFORM
MET	-1.0%	\$6.86	15.3x	1.1%	9.5%	NEUTRAL
OCA	-0.6%	\$1.07	10.7x	5.1%	7.7%	NEUTRAL
RYM	-1.2%	\$15.00	24.7x	2.0%	16.5%	NEUTRAL
SUM	+1.2%	\$7.69	15.7x	1.9%	20.4%	OUTPERFORM
Other structural growth	+0.7%					
ATM	+3.0%	\$17.21	31.0x	0.0%	21.5%	OUTPERFORM
EBO	+0.3%	\$23.81	21.0x	3.4%	7.8%	NEUTRAL
FPH	-2.3%	\$25.70	49.3x	1.3%	14.5%	UNDERPERFORM
FRE	-0.0%	\$7.41	18.7x	4.1%	10.2%	NEUTRAL
GTK	-0.1%	\$2.00	49.7x	1.4%	121.5%	UNDERPERFORM
MFT	-0.1%	\$36.70	21.4x	1.9%	10.5%	NEUTRAL
NZK	+1.2%	\$2.00	17.1x	2.8%	32.1%	OUTPERFORM
SCL	-0.5%	\$4.33	18.6x	4.9%	8.3%	NEUTRAL
SKL	-0.3%	\$2.08	13.7x	6.4%	3.0%	n/a
SML	-0.4%	\$5.69	11.8x	0.0%	18.6%	NEUTRAL
TLT	+1.0%	\$3.28	23.3x	0.0%	-2.5%	OUTPERFORM
Cyclicals	-2.5%					
AIR	+0.5%	\$2.06	8.7x	10.7%	18.6%	OUTPERFORM
FBU	-1.3%	\$5.05	15.8x	4.6%	3.8%	UNDERPERFORM
FSF	-0.3%	\$3.90	14.1x	3.5%	23.0%	n/a
HGH	-0.7%	\$1.60	n/a	n/a	n/a	n/a
KMD	-0.6%	\$2.74	9.2x	6.6%	9.8%	NEUTRAL
NZR	-0.2%	\$1.12	31.6x	0.6%	8.8%	NEUTRAL
NZX	-0.3%	\$1.30	22.6x	4.7%	7.9%	n/a
SAN	+1.8%	\$7.14	12.6x	3.2%	15.3%	OUTPERFORM
SKT	-0.2%	\$0.54	7.9x	0.0%	-22.1%	UNDERPERFORM
THL	-0.3%	\$2.64	13.4x	8.1%	32.2%	OUTPERFORM
Cash	+2.5%					
Total	+0.0%					

Source: Bloomberg, Forsyth Barr analysis *cash dividend yield NOTE: PPH (active weight -0.7%), VGL (-0.4%), ANZ (-0.4%) and WBC (-0.5%) not included in the above table.

Valuation

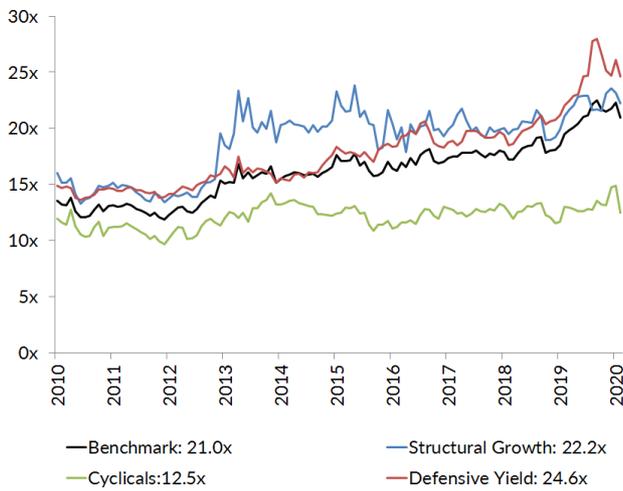
- Market valuations have fallen from recent highs with COVID-19 risks impacting recent performance.
- Lower rate outlook are supportive to defensive yield type stocks.
- Cyclical valuations look relatively cheap but beware the value trap.

Figure 7. Market valuation metrics (based on consensus earnings estimates)

Thematic	12mth fwd PE		12mth fwd EV/EBITDA		12mth fwd cash divi yield	
	Ave.	Wghtd ave.	Ave.	Wghtd ave.	Ave.	Wghtd ave.
Cyclicals	12.5x	13.0x	5.9x	5.9x	5.6%	5.8%
Defensive Yield	24.6x	25.6x	14.8x	14.3x	4.4%	4.5%
Structural Growth	22.2x	32.4x	13.7x	16.1x	2.7%	1.5%
Market	21.0x	27.4x	12.6x	14.0x	4.1%	3.4%

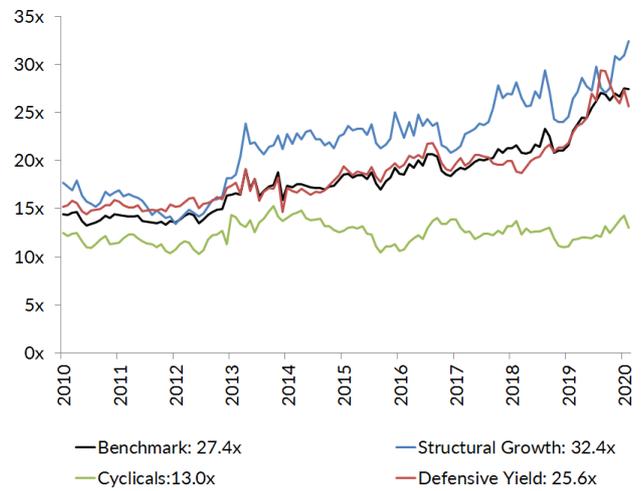
Source: Forsyth Barr analysis, Bloomberg

Figure 8. Consensus 12m fwd PE – average



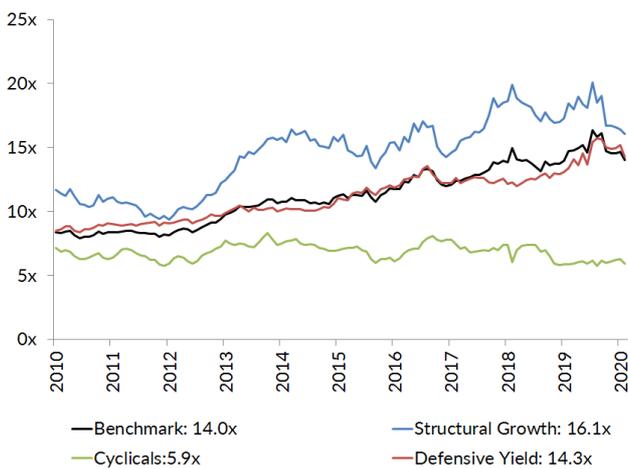
Source: Forsyth Barr analysis, Bloomberg

Figure 9. Consensus 12m fwd PE – weighted average



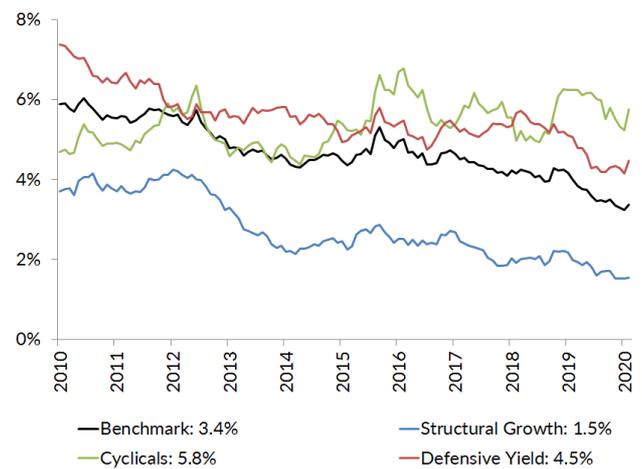
Source: Forsyth Barr analysis, Bloomberg

Figure 10. Consensus 12m fwd EV/EBITDA – weighted average



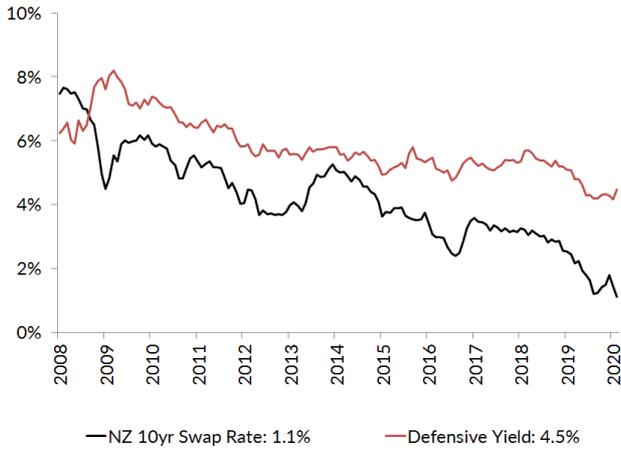
Source: Forsyth Barr analysis, Bloomberg

Figure 11. Consensus cash dividend yield – weighted average



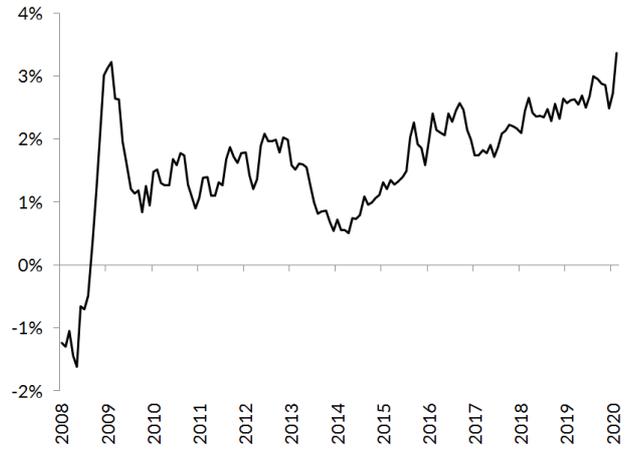
Source: Forsyth Barr analysis, Bloomberg

Figure 12. Defensive yield cash dividend yield vs. 10yr bond



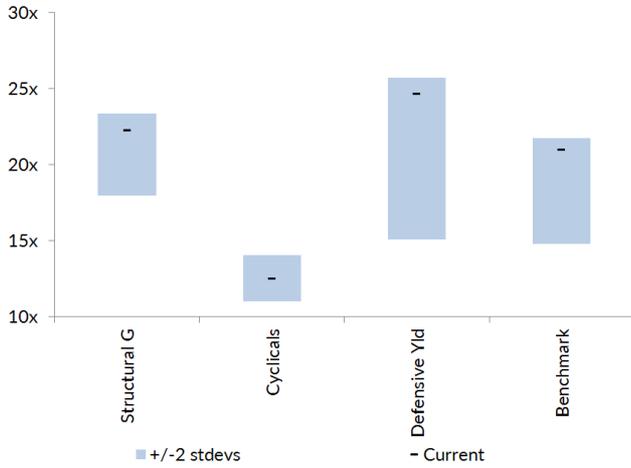
Source: Forsyth Barr analysis, Bloomberg

Figure 13. Defensive yield cash div yield and 10yr bond diff.



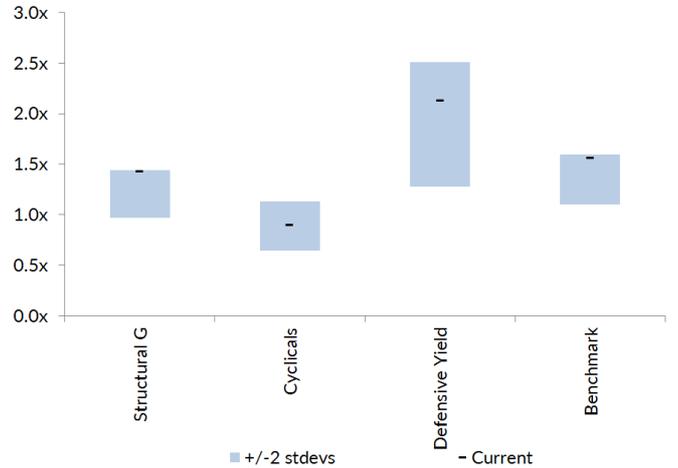
Source: Forsyth Barr analysis, Bloomberg

Figure 14. Consensus 12m fwd PE vs. historic (five year) average



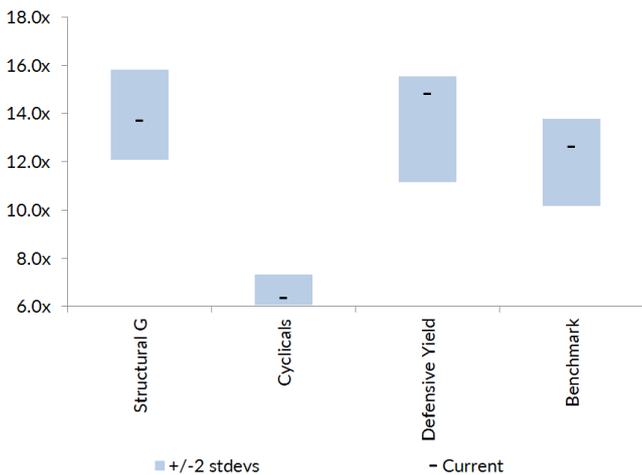
Source: Forsyth Barr analysis, Bloomberg

Figure 15. 12m fwd PEG vs. historic (five year) average



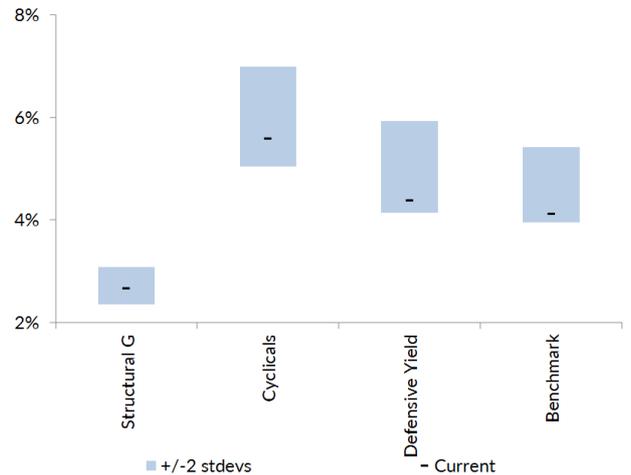
Source: Forsyth Barr analysis, Bloomberg

Figure 16. 12m fwd EV/EBITDA vs. historic (five year) average



Source: Forsyth Barr analysis, Bloomberg

Figure 17. 12m fwd cash div. yield vs. historic (five year) average



Source: Forsyth Barr analysis, Bloomberg

Earnings

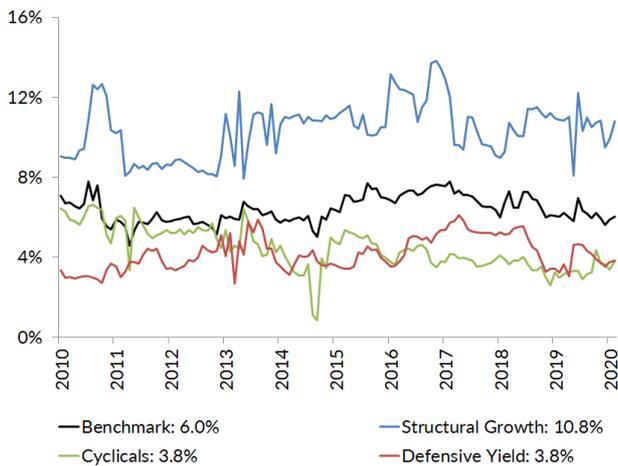
- Consensus earnings expectations are elevated despite the recent softening of cyclical conditions.
- Defensive yield earnings growth outlook remains solid.
- Margins appear to remain firm across the market broadly.

Figure 18. Market earnings estimates (based on consensus earnings estimates)

Thematic	12-24mth Revenue growth		12-24mth EBITDA growth		12-24mth EPS growth		12-24mth OCF growth	
	Ave.	Wghtd ave.	Ave.	Wghtd ave.	Ave.	Wghtd ave.	Ave.	Wghtd ave.
Cyclicals	3.8%	3.0%	8.6%	6.3%	8.3%	7.3%	9.2%	8.4%
Defensive Yield	3.8%	3.0%	5.2%	4.8%	7.2%	6.6%	4.6%	3.8%
Structural Growth	10.8%	12.6%	14.1%	14.2%	12.9%	14.9%	13.3%	13.3%
Market	6.0%	7.1%	8.9%	8.9%	9.3%	10.2%	8.5%	8.2%

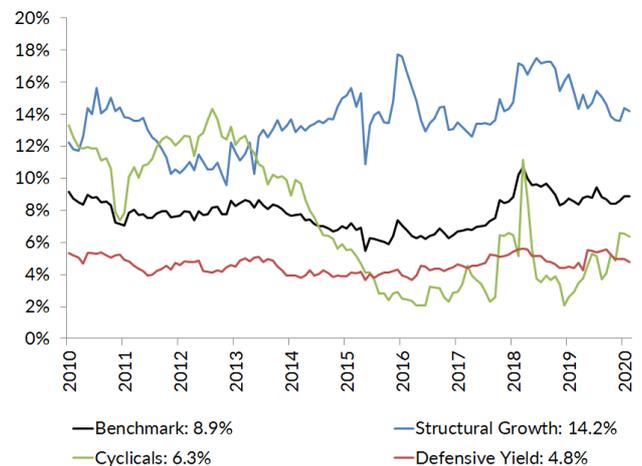
Source: Forsyth Barr analysis, Bloomberg

Figure 19. 12-24m revenue growth – average.



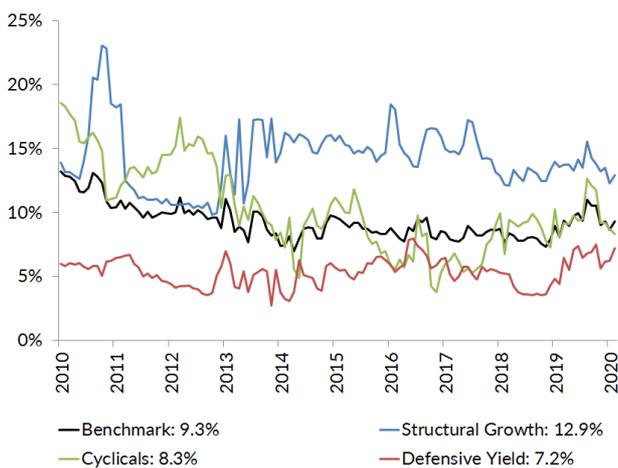
Source: Forsyth Barr analysis, Bloomberg

Figure 20. 12-24m EBITDA growth – weighted average.



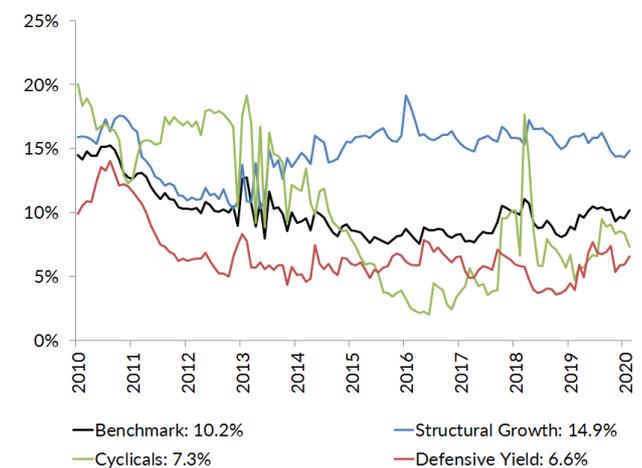
Source: Forsyth Barr analysis, Bloomberg

Figure 21. 12-24m EPS growth – average



Source: Forsyth Barr analysis, Bloomberg

Figure 22. 12-24m EPS growth – weighted average

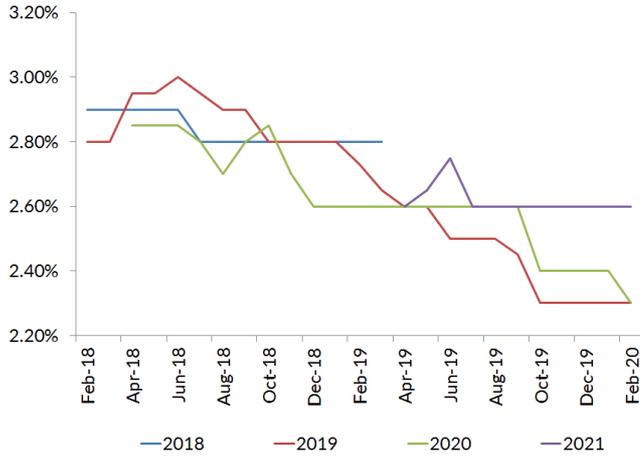


Source: Forsyth Barr analysis, Bloomberg

GDP and interest rates

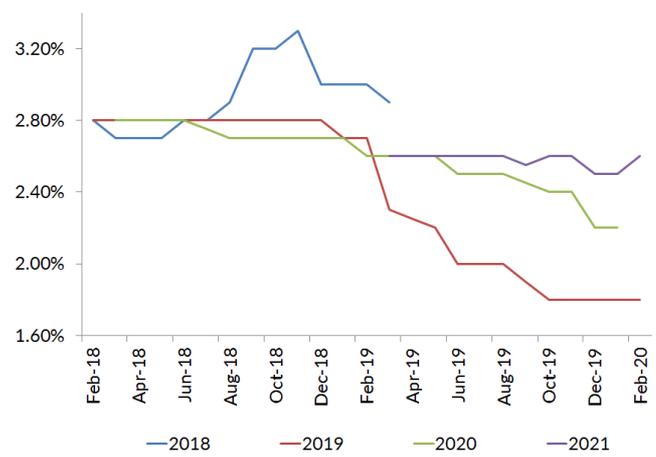
- GDP expectations have fallen for much of the past two years. However, the outlook continues to show economic expansion rather than a more severe downturn, with growth further out remaining firm.
- Bond rates have persistently fallen globally in the post-GFC period. The strengthening of rates through late 2019 has now reversed given COVID-19 concerns.
- Domestic and global inflation remains muted, affording interest rates to remain lower for longer.

Figure 23. New Zealand consensus GDP growth forecast



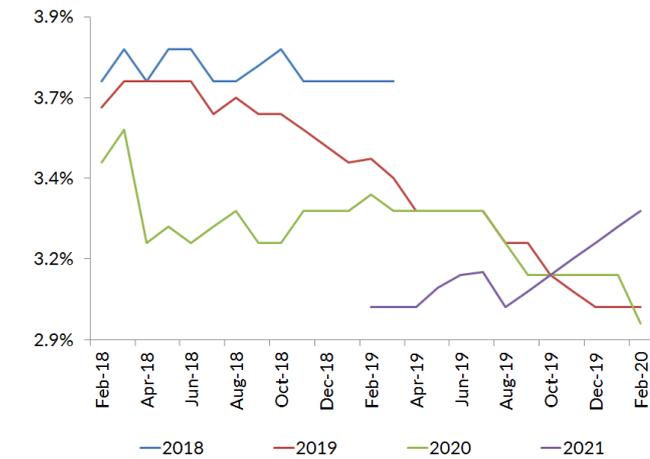
Source: Forsyth Barr analysis, Bloomberg

Figure 24. Australia consensus GDP growth forecast



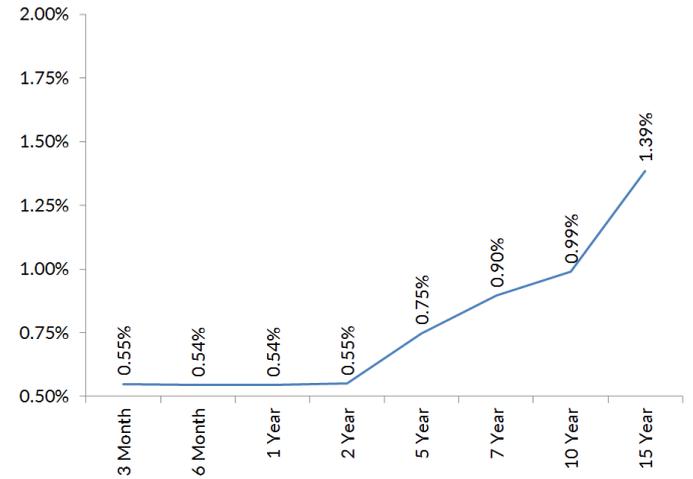
Source: Forsyth Barr analysis, Bloomberg

Figure 25. World consensus GDP growth forecast



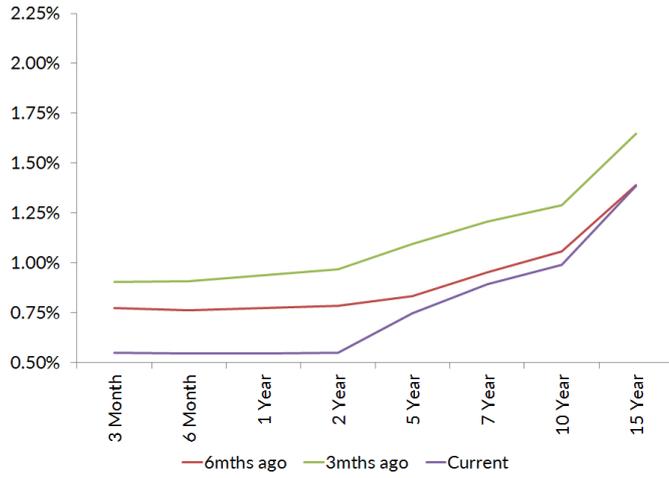
Source: Forsyth Barr analysis, Bloomberg

Figure 26. NZ yield curve – current



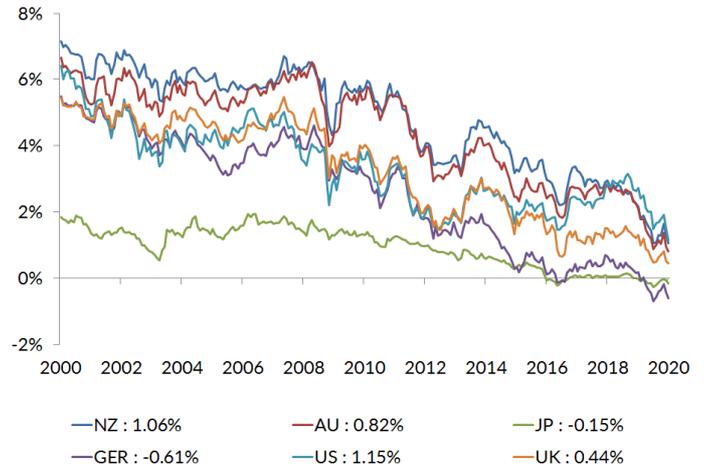
Source: Forsyth Barr analysis, Bloomberg

Figure 27. NZ yield curve – 6 month trend



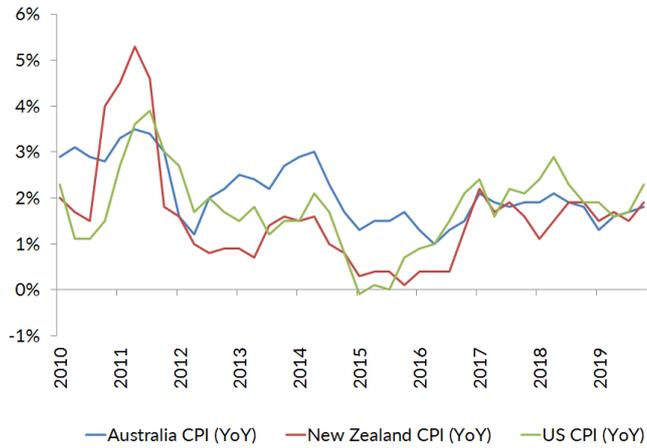
Source: Forsyth Barr analysis, Bloomberg

Figure 28. Global 10yr bond yields



Source: Forsyth Barr analysis, Bloomberg

Figure 29. Consumer price index (CPI)



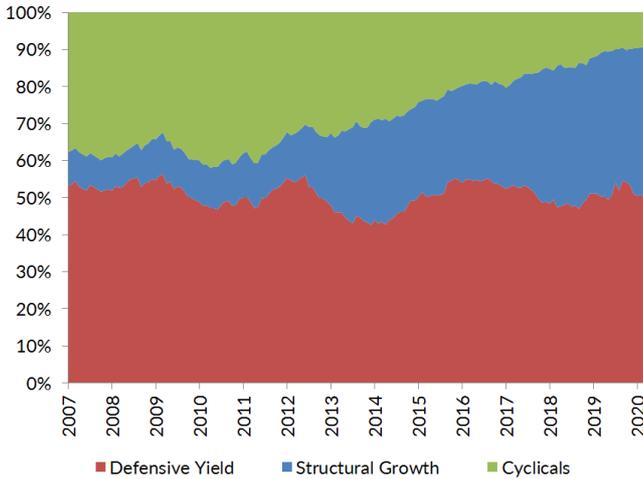
Source: Forsyth Barr analysis, Bloomberg

Other NZ market charts

- The S&P/NZX 50 has not solely been driven by large caps or MSCI NZ constituents.
- International ownership of the S&P/NZX 50 appears to have stabilised after a period of sustained growth.
- Companies across the market appear to be modestly increasing gearing in the current low interest rate environment.

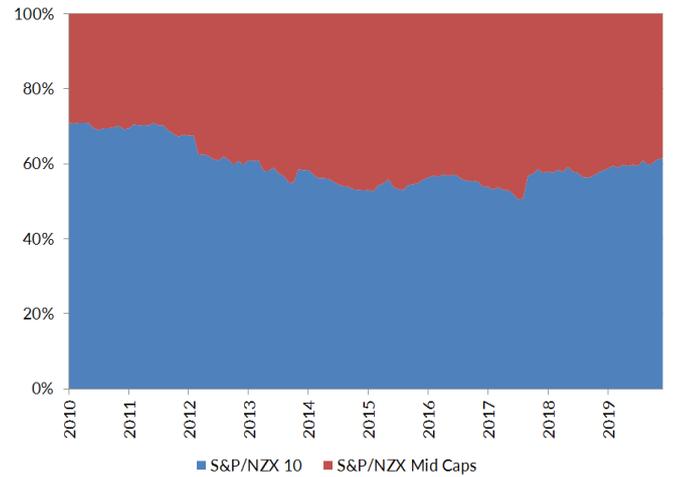
Market Structure

Figure 30. S&P/NZX 50 structure by thematic



Source: Forsyth Barr analysis, Bloomberg,S&P DJI

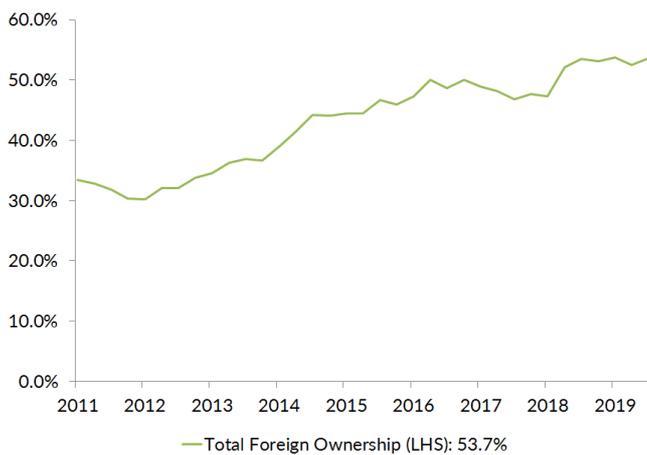
Figure 31. S&P/NZX 50 structure by size



Source: Forsyth Barr analysis, Bloomberg,S&P DJI

Market Ownership

Figure 32. Total foreign ownership of the S&P/NZX 50



Source: Forsyth Barr analysis, Stats NZ

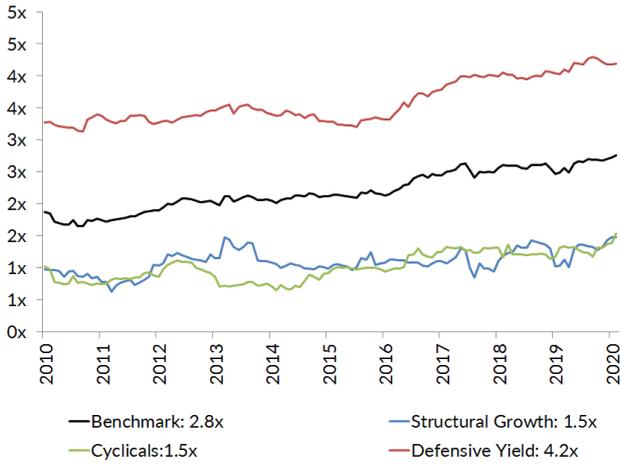
Figure 33. Australian Ownership of the S&P/NZX 50



Source: Forsyth Barr analysis, ASX

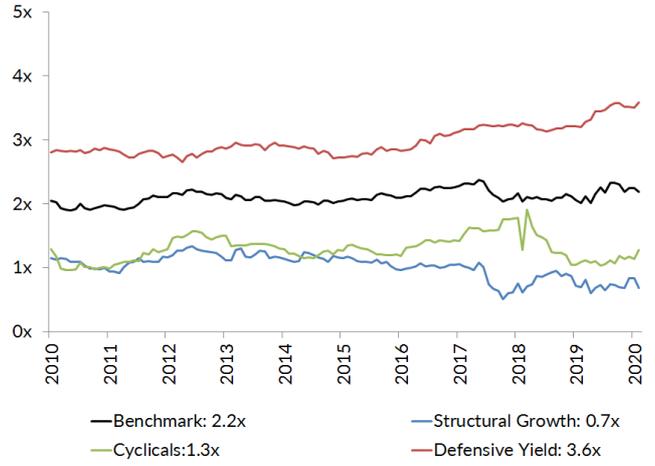
Capital Structure

Figure 34. 12mth fwd ND/EBITDA – average



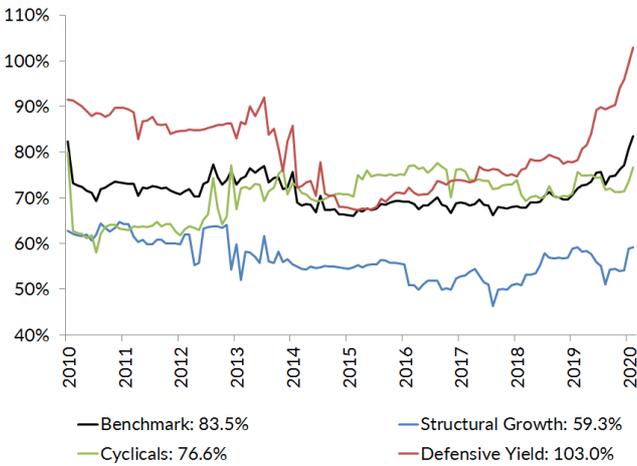
Source: Forsyth Barr analysis, Bloomberg

Figure 35. 12mth fwd ND/EBITDA – weighted average



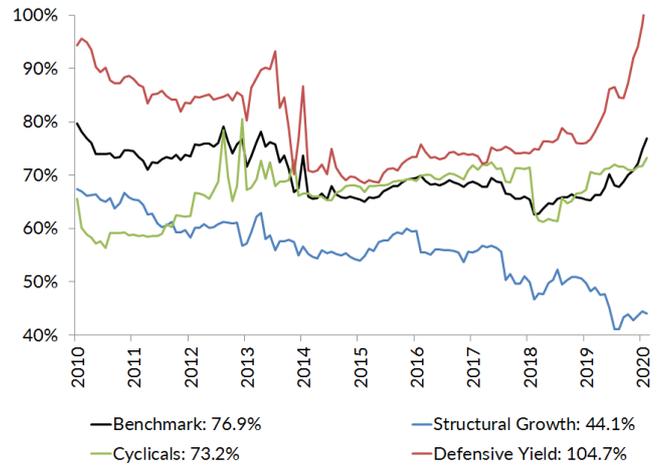
Source: Forsyth Barr analysis, Bloomberg

Figure 36. 12mth fwd EPS pay-out ratio - average



Source: Forsyth Barr analysis, Bloomberg

Figure 37. 12mth fwd EPS pay-out ratio - weighted average



Source: Forsyth Barr analysis, Bloomberg

Forsyth Barr institutional model portfolio rules

- The Forsyth Barr Institutional model portfolio is monitored on a continuous basis.
- Company ratings are factored into portfolio decisions but weightings can reflect other portfolio considerations.
- Companies with UNDERPERFORM ratings can still be held in the portfolio but will normally have portfolio weightings that would be lower than the benchmark weighting.
- Companies not researched by Forsyth Barr or associated research partners with weightings above 2%, and where no view is held, would be held at a benchmark weighting.
- The portfolio can participate in IPO and 2POs but weightings would initially be limited to the lower of the desired weighting or such holding that could realistically be obtained by bidding into the process.
- The portfolio will reflect strategic biases.
- The portfolio targets portfolio holdings of approximately 25 companies.

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