Bramwell Brown Ltd

Investment Advisers – Brokers

Director: Brett Dymond – AFA, BBS, GradDipBusStud (Personal Financial Planning)

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Ross Asset Management

It's disturbing to see yet another mass destruction of investor wealth in New Zealand. Only last month I wrote about the dangers of handing over large sums of money to an adviser, and since then we have seen the demise of the Ross Asset Management business. The losses I spoke of last month from a dishonest Auckland currency trader pale into insignificance compared to the apparent losses incurred by David Ross. How do you lose $440 million before you realise things aren't going so well? I have heard some investors had their entire life savings with David Ross. We are all experts in hindsight; however there are a number of things investors should have done to avoid losing all their money.

The first mistake in my view was to invest in the "person" rather than the underlying investments. David Ross apparently had a very good reputation as a fund manager and was authorised under the new laws to provide a "discretionary investment management service" or DIM's. This allows an adviser to have complete discretion over an investor's portfolio. It's something I could only recommend in very limited circumstances and I would only recommend it for a portion of your overall wealth. There are times when it is useful to be able to act on behalf of investors; however I believe Powers of Attorney are perfectly adequate. We often have situations where clients are overseas and need someone to act on a rights issue or a share offer. A Power of Attorney gives me the right to act on the investor's behalf in that regard. It's specific to that type of transaction however does not give me carte blanche over their wealth.

A mistake that some Ross investors made was to put their entire savings with him. This is fine so long as your funds are spread across all the asset classes – bank deposits, Government bonds, corporate bonds, property, domestic and international shares. In Ross's case it appears he had a very narrow focus on small (and volatile) mining stocks. Investing in such a sector is perfectly legitimate; however I would suggest a five-percent exposure would be more than enough. So the combination of giving Ross 100% discretion to do as he sees fit with their money, handing over "all" their money, and the fact those funds were invested solely in risky assets has proved to be a very poor strategy for some.

Other questions investors can ask is "can I independently verify the investments I have made?" and "can I liquidate those investments independently of the adviser I am using?" It appears the Ross assets were held under a nominee arrangement rather than in the investors' own name. Again this is a quite legitimate practice, and is something we sometimes do when investing in overseas shares. However you have to question the ability of a one-man practise to adequately administer the investments of over 900 clients. A business of that scale should be employing the services of an independent trustee/nominee acting on behalf of those investors.

Because I encourage investors to invest directly in the financial markets (rather than through managed funds) you should be able to liquidate those investments with any broker in the country in the time it takes them to set up an account for you. If I was hit by a bus tomorrow it should not affect your ability to carry on conducting business. Your Common Shareholder Number and FIN (SRN for Australian investments) should allow you to independently confirm your holdings, and conduct business with a registered broker.

One last mistake Ross investors made was to be sucked in by the promise of high returns. Returns of 20% to 30% were mooted, which should have sounded alarm bells for any potential investor. The old adage "if it sounds too good to be true, it probably is" should be heeded by all investors.

FMA Audit

The Financial Markets Authority (FMA) is the body responsible for licensing financial advisers in New Zealand. They conduct periodic checks on adviser businesses, and I was subject to such a check recently. I'm happy to report that after submitting my Adviser Business Statement (ABS) Bramwell Brown Limited was given a clean bill of health by the FMA. The Adviser Business Statement is an 18-page (in my case) document that sets out in detail exactly how an adviser runs their business. It covers topics such as:

- Business relationships
- How we derive our income
- The type of clients we have
- What products we advise on
- What services we offer
- How we manage any conflicts of interest
- How we handle client money
- How we handle complaints
- Our skills, competency and ongoing professional development

I hope our clients can take some comfort from the fact we are running our business in full compliance with the new regulations.

Fonterra

Unfortunately we were unable to satisfy the demand for units in the Fonterra initial public offer. Investors have the opportunity to buy units on the NZX from Friday November 30th, and at the time of publishing this newsletter they had risen by $1.30 to $6.80. The unprecedented demand is clearly putting pressure on the price and I would suggest those investors wishing to gain exposure to our dairy industry might be better to wait until the hype has settled down. At $6.80 their dividend yield drops from a proposed rate of 5.80% to around 4.70%, which is relatively low for an NZX listed company.

Fixed Interest

The ability to achieve better-than-bank return remains a challenge. Money is now flowing into the sharemarket seeking higher yields, but I would caution investors to ensure you aren't taking on more risk than you are comfortable with. Ask yourself how you would feel if the risk turns into loss. I've discussed the reset securities previously, and look at them again here as an alternative fixed interest investment.

Security	Coupon	Benchmark	Margin	Next Reset	Price	Yield to Next Reset
ANZ	9.66%	5 year swap rate	2.00%	18/04/13	98.40	17.50%
BNZ	9.89%	5 year swap rate	2.20%	28/03/13	99.00	19.10%
BNZ	9.10%	5 year swap rate	4.09%	30/06/14	106.90	5.56%
Contact Energy	8.00%	5 year swap rate	4.55%	15/02/17	107.50	6.07%
Genesis Energy	8.50%	5 year swap rate	3.87%	15/07/16	107.50	6.52%
Infratil	3.97%	1 year swap rate	1.50%	15/11/13	56.50	70.90%
Kiwi Bank	8.15%	5 year swap rate	2.90%	04/05/15	106.10	5.72%
Origin Energy	4.02%	1 year swap rate	1.50%	15/10/13	60.50	74.70%
Quayside Holdings	5.42%	3 year swap rate	1.70%	12/03/14	83.80	21.40%
Rabobank	3.32%	1 year swap rate	0.76%	08/10/12	80.40	31.07%
Rabobank	8.78%	5 year swap rate	3.75%	18/06/14	108.50	5.71%

The price is each securities current price in the secondary market per $100. So if you bought 10,000 Genesis Energy bonds it would cost you $10,750 (before brokerage). The yield to next reset needs to be treated with a word of caution. That yield assumes you receive full repayment at the next reset, yet in most cases we know that's not going to happen. I put it in for illustrative purposes only. Some of these securities are perpetual, therefore we don't know when they will be repaid; hence we can't work out an accurate yield. What we can do is calculate your yield to the next reset date, and then estimate your yield for the next period.

If we look at Genesis Energy again we can calculate that if you pay 107.50 for it you will achieve a yield of 6.52% until July 2016. What you achieve for the next five years is determined by its reset characteristics. If it repays in 2016 you have achieved a return of 6.52%. If it is rolled over for a further five years it will reset at the five-year swap rate (a moving target) plus a margin of 3.87%. It will also add a step-up margin of 0.25% if it doesn't repay in 2016. We don't know what the five year swap rate will be in 2016, however if it was reset today the new coupon rate would be around 7.18%. This is made up of the current five year swap rate (3.06%) plus the margin (3.87%) plus the step-up margin (0.25%).

All of these securities have varying characteristics which I am happy to discuss with anyone looking for additions to their fixed interest portfolios.

Stock & Share

Stock and Share have increased their activity in offering investors ridiculously low prices for their shares and bonds. Trustpower, Steel and Tube, Tower, Barramundi, and Fletcher Building are the latest targets. The reason for this increased activity may have something to do with the new unsolicited offers regulations being introduced from December 1st. The regulations introduce new processes and disclosure obligations for most unsolicited offers, and also give the right to investors to cancel an agreement to sell shares or bonds during a ten day cooling off period, after accepting an offer. These offers are nothing but scams, and should be treated accordingly. Please feel free to contact the office if you are in any doubt when receiving unsolicited mail in regard to your investments. If you have received these offers from Stock & Share make sure to return the envelope they provide with no stamp and nothing inside.

Bank Profits

Much has been written about the large profits our banks are achieving, however I for one am happy to see it continue. We need a strong bank sector, particularly in an uncertain environment such as we are in at present. The headline profit figures look huge; however you have to remember the size of the businesses in question. ANZ achieved a profit of A$6.01 billion to the end of September 2012. This is a large number in anyone's language, but as a percentage of ANZ's assets it's no different to the returns other companies are achieving. I would far rather see our banks posting these profits than struggling as some other banks around the world are. For those who feel the banks should be passing on some of that profit in the form of higher deposit rates perhaps an option is to buy their shares instead. At current prices the dividend yield on ANZ is between 5% and 6%. If the banks continue to remain profitable shareholders receive returns in the form of dividends, together with any increase in the share price.