BRAMWELL BROWN LTD

INVESTMENT ADVISERS – BROKERS

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Regulation

I spent a good deal of the New Year break in the office working on compliance with the new regulations around financial advisers. One of our obligations under the new laws is to have an up to date Adviser Business Statement. This is a document that shows the Financial Markets Authority (FMA) how we run our business, and how we ensure compliance with all relevant legislation. It is a document that does not have to be made public, but must be available at all times to the FMA. It's a twenty page document, which I doubt clients would be particularly interested in reading. However, updating my ABS was a chance to think about what we offer investors; and what you are signing up for when you become clients of Bramwell Brown Limited.

The main reason I was drawn to Bruce Bramwell's business was my aversion to the managed funds industry. I personally have always invested directly in the bond and equity markets with the guidance of a well qualified sharebroker. After completing my degree and financial planning papers I was looking for a job where I could provide investors with a similar service to that I had enjoyed over many years. Bruce's business was predominantly transactional, offering investors the opportunity to buy and sell shares and bonds on local and overseas exchanges. In contrast to the larger financial planning chains, once you own these shares and bonds, we don't charge you 1.50% of their value each year to tell you that you still own them! For those clients who do seek administrative assistance with their portfolio, we offer that service at very competitive rates.

A section of the ABS discusses ethics. My question to the FMA is "does legislation really influence ethical behaviour?" One of the standards in the Code of Professional Conduct for Authorised Financial Advisers is to "place the interests of the client first, and act with integrity." People (advisers) either have high ethical and moral standards, or they don't. No amount of legislation is going to change that, and I would be surprised if we don't continue to read stories in the future of financial advisers taking advantage of vulnerable investors. Ethical standards have a significant influence on conflicts of interest, of which the FMA is keen to see managed appropriately. I would suggest almost every time an investor walks into my office, a potential conflict of interest arises! You have money in the bank – you are toying with the idea of

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slightly higher returns – I have access to various homes for that money – my income depends on you investing that money – there is an instant conflict of interest. Legislation won't help me manage that conflict appropriately – my own moral compass is the only thing that will. Another section of the ABS relates to research. I think it is important that clients understand we outsource the majority of company research to third parties. Certainly I should be expected to have an understanding of any companies I recommend, however financial and economic analysis are specialised fields that are best left to professional researchers. We source our research predominantly from the brokers we use, together with various independent research providers.

Interest Rates

Interest rates continue to remain low with the world economy still in turmoil. The Reserve Bank has recently held the Official Cash rate at 2.50%, and most commentators are predicting no change to that through most of this year. Some banks have recently cut their shorter-term mortgage rates. This is keeping the majority of the secondary market bond yields at very low levels. Remember there is an inverse relationship between the yield on a bond and its price in the secondary market. As yields drop, the price will rise.

Bond	Rate	Maturity	Yield	October Price/$100	Current Price/$100
Telecom	8.20%	June 2013	5.00%	104.75	104.18
Marac	10.50%	July 2013	7.80%	104.13	103.68
Wellington Airport	7.50%	November 2013	5.25%	103.45	103.78
Tauranga City Council	7.05%	December 2013	3.49%	106.58	106.27
Auckland City Council	6.42%	March 2014	3.77%	105.75	105.41
Tower	8.50%	April 2014	6.55%	103.82	103.97
Contact Energy	8.00%	May 2014	4.95%	107.60	106.57
Fletcher Building	9.00%	May 2014	6.90%	105.94	104.36
Vector	7.80%	October 2014	4.75%	107.52	107.65
Auckland Airport	7.00%	November 2014	4.30%	106.07	107.09
Kiwi Income Property Trust	8.95%	December 2014	6.31%	105.77	107.00
Trustpower	7.60%	December 2014	5.90%	104.64	104.46
Auckland City Council	6.28%	March 2015	4.00%	105.91	106.67
Fonterra	7.75%	March 2015	4.43%	109.15	109.59
Meridian Energy	7.15%	March 2015	4.55%	107.88	107.48
Goodman Property Trust	7.75%	June 2015	5.30%	107.29	107.49
Warehouse	7.37%	June 2015	6.20%	103.14	103.50
Telecom	8.35%	June 2015	5.25%	108.11	109.46

Bond	Rate	Maturity	Yield	August Price/$100	Current Price/$100
Trustpower	8.40%	December 2015	6.90%	105.81	105.05
APN News & Media	7.86%	March 2016	11.00%	90.69	89.70
Fletcher Building	9.00%	May 2016	7.00%	107.37	107.28
Goodman Fielder	7.54%	May 2016	8.53%	97.47	96.47
Infratil	8.50%	June 2016	8.00%	101.94	101.82
Greenstone Energy	7.35%	October 2016	6.50%	104.04	103.38
Air New Zealand	6.90%	November 2016	6.65%		101.00
Auckland Airport	8.00%	November 2016	5.04%	111.50	112.44
Trustpower	8.00%	December 2016	6.30%	107.50	107.08
Meridian Energy	7.55%	March 2017	5.20%	110.80	110.44
Infratil	8.50%	June 2017	8.50%	102.27	100.00
Manukau City Council	6.52%	September 2017	5.00%	107.26	107.40
Infratil	8.00%	November 2017	8.00%		100.00
Trustpower	7.10%	December 2017	6.40%	103.56	103.40
Zed Energy Limited	7.25%	August 2018	6.90%	102.73	101.83
AMP	9.80%	April 2019	5.90%	109.35	108.01
IAG	7.50%	December 2036	7.29%		102.40
NZ Post Group Finance	7.50%	November 2039	6.50%	102.78	101.99
Genesis Energy	8.50%	July 2041	8.21%	105.63	103.20
Contact Energy	8.00%	February 2042	8.00%		100.00
BNZ Perpetual	9.10%	No maturity date		107.00	106.00
Kiwibank Perpetual	8.15%	No maturity date		103.90	102.00
Rabobank Perpetual	8.78%	No maturity date		107.10	104.80

Goodman Fielder and APN News & Media are currently the only two bonds trading at a discount to their face value.

Perpetual Reset Securities

The low interest rates continue to have an effect on the price in the secondary market for the perpetual reset securities. I have written previously about the various perpetual securities on the market, and have explained the early perpetuals had reset mechanisms that would not be acceptable if they were issued now. At the time they were issued (pre global financial crisis) their terms were in line with the rates of the day. Most of them have similar characteristics in that they don’t have a set maturity date, and they have their interest/dividend rates reset at various intervals.

The rate resets are based on a benchmark rate plus a margin. Here are some examples.

Security	Benchmark	Margin	Current Rate	Current Price/$100
Infratil	1 Year Swap	1.50%	4.97%	$53.50
Origin	1 Year Swap	1.50%	4.92%	$56.00
Rabobank	90 Day Bill	0.76%	4.21%	$76.00
Quayside	3 Year Swap	1.70%	5.42%	$87.00
ANZ	5 Year Swap	2.00%	9.66%	$100.00
BNZ	5 Year Swap	2.20%	9.89%	$97.00
Rabobank	5 Year Swap	3.75%	8.78%	$104.80
BNZ	5 Year Swap	4.09%	9.10%	$106.00
Kiwi Bank	5 Year Swap	2.90%	8.15%	$102.00

Infratil, Origin and the early Rabobank security are clearly out of favour with investors due to the very low reset rates. These companies should be mindful, however, of the reputational risk they incur by leaving these securities on issue for long periods of time at such low rates. Investors have long memories and will be less inclined to support later issues if they feel they have been taken advantage of in the past. The Quayside Holdings perpetual started to drop in value from the middle of 2010 as it neared its reset date in March 2011. We now see investors selling out of the ANZ (ANBHA) and BNZ (BISHA) perpetuals that were issued in 2008. Their reset dates are due in March 2013.

In March 2013 the ANZ perpetual will be reset for a further five years at 2.00% above the five year swap rate and the BNZ perpetual at 2.20% above the five year swap rate. If reset today their new rates would be 5.428% and 5.628% respectively. Clearly these rates are nowhere near the 9.66% and 9.89% investors are currently enjoying, but does that mean they should be sold? When these securities were marketed there was an expectation they would be repaid in 2018, if not sooner. Our fixed interest sources believe there is no new information to suggest this won’t still be the case. As mentioned above, reputational risk becomes an issue for these companies if they fail to behave in a manner that was indicated to the market at the time of issue. Selling these securities now means giving up the chance to earn close to 10% for the next year. Admittedly the following five years would see lower than expected returns; however holders of these securities have enjoyed an exceptional return through the worst of the financial crisis. Contact the office if you would like to discuss your situation.