BRAMWELL BROWN LTD

INVESTMENT ADVISERS – BROKERS

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

Bramwell Brown Limited – Newsletter – June 2018

Official Cash Rate

Yet again the Reserve Bank has left the Official Cash rate (OCR) at 1.75%. Recently appointed Reserve Bank Governor, Adrian Orr, gave his first monetary policy statement on May 10th. Here is his address:

“The Official Cash Rate (OCR) will remain at 1.75 percent for some time to come. The direction of our next move is equally balanced, up or down. Only time and events will tell. Economic growth and employment in New Zealand remain robust, near their sustainable levels. However, consumer price inflation remains below the 2 percent mid-point of our target, due in part to recent low food and import price inflation, and subdued wage pressures.

The recent growth in demand has been delivered by an unprecedented increase in employment. The number of willing workers continues to rise, especially with more female and older workers choosing to participate. Likewise, net immigration has added to the supply of labour, and the demand for goods, services, and accommodation. Ahead, global economic growth is forecast to continue supporting demand for New Zealand's goods and services. Global inflation pressures are expected to rise but remain contained.

At home, ongoing spending and investment by both households and government is expected to support economic growth and employment demand. Business investment should also increase due to emerging capacity constraints. The emerging capacity constraints are projected to see New Zealand's consumer price inflation gradually rise to our 2 percent annual target. To best ensure this outcome, we expect to keep the OCR at this expansionary level for a considerable period of time. This is the best contribution we can make, at this moment, to maximising sustainable employment and maintaining low and stable inflation.”

Market reaction included a drop in the New Zealand dollar, as Orr signalled that he would consider cutting the OCR further if conditions warranted such a move. All other things remaining equal I think investors are in for a long period of low interest rates. These low rates also provide the basis for the sharemarket to remain on the course it has been on for the last decade.

NZX Capital Notes

NZX Limited has announced an offer of up to $40 million of unsecured, subordinated capital notes. The offer consists of a priority offer of up to $5 million which is open to NZX shareholders, and a general offer which is open to members of the public who are resident in New Zealand. The general offer is only available through primary market participants, or their intermediaries – there is no public pool.

The notes have a fifteen-year term, however NZX can elect to repay the notes at their five year and ten-year anniversaries (election dates). At those dates NZX will provide notice of its decision to either redeem the subordinated notes or run an election process offering new conditions. Noteholders can then choose to continue to hold some or all of their notes subject to the new conditions or choose to have their notes redeemed in full. The interest rate payable on the notes is a combination of the five-year swap rate plus the margin. The rate for the first five years has been set at 5.40%.

I think it's important that investors understand the terms 'unsecured' and 'subordinated.' Unsecured means that the notes are not secured against any assets of the NZX Group. When you take out a mortgage it is usually secured against the property you purchase. If you fail to make your mortgage payments the bank has the ability (through its legal security) to sell your property to claim its money. In this case NZX is not offering security for the money you are lending them – you rely on their goodwill to repay you. Subordinated means the notes will rank behind other financial obligations of the NZX Group. If NZX runs into financial difficulty your notes will rank ahead of shareholders, however will rank behind other liabilities and borrowings. The interest rate of 5.40% is a reflection of the unsecured, subordinated nature of these notes.

- Interest rate (for the first five years) – 5.40%
- Maturity date – June 20th 2033
- Election dates – June 20th 2023 and June 20th 2028
- Quarterly interest paid March, June, September and December
- General offer closing date – June 15th

CALL THE OFFICE AS SOON AS PSSIBLE IF THIS OFFER IS OF INTEREST TO YOU

Portfolio Administration

Are you having trouble with the share registries sending your financial information via email rather than post? Are you spending hours searching for financial information for your accountant at the end of each financial year? If so Bramwell Brown can help. We offer a portfolio administration service where we handle all the mail associated with your portfolio and liaise with your accountant at the end of each year. Call the office if you would like to discuss this service.

KiwiSaver

The KiwiSaver anniversary (July 1st) is not far away again. Any members who have been in the scheme for a year or more should ensure they have deposited at least $1,043 with their provider before the end of June. This will ensure you receive the maximum Government matching payment of $521.43. Up until July 1st 2011 this matching payment was dollar for dollar and equalled $1,042.86, however the rules were changed and the subsidy has been cut in half. It is still worth having however, and I would encourage all members to contribute at least $1,043. If you contribute less than $1,043 from your wages you can make voluntary contributions that top it up to the desired amount. Your provider can inform you how to make voluntary contributions. Alternatively, you can lodge funds directly to the IRD online or with deposit slips available at Westpac Bank. You need to provide your IRD number and use "KSS" as the payment code.

You will receive the 50% Government matching payment up until the date you are eligible to withdraw your savings. You become eligible to withdraw your savings when you qualify for NZ Super (currently at the age of 65), or when you have been in the scheme for five years (whichever is later). So if you join KiwiSaver when you are 62, you would have to wait until you are 67 to be able to withdraw your funds. You would receive the 50% subsidy ($521.43) for each of those five years – not just until you turn 65. A number of our clients have been in the scheme for the required five years, and have reached 65. They are now eligible to withdraw their savings. As soon as you reach this point you are no longer eligible for the Government subsidies, and your employer (if you are still working) is under no obligation to continue contributing to your account.

Now is also a good time to review the type of fund you are in. Is a Growth fund still appropriate for your circumstances? Young investors may have been encouraged to opt for the growth fund because of their time frame and tolerance for risk. But what if you are a young investor considering applying for a first home deposit subsidy, and subsequently about to withdraw your funds from KiwiSaver? I would argue that taking risk out of the equation would be appropriate in these circumstances, therefore moving to a more conservative fund should be considered.

Budget

Grant Robertson's first budget lacked any real surprises, and largely delivered on the promises made in the lead-up to the election. Health, education and housing gained their usual increase in spending, and it was good to see the Government sticking to its commitment to run surpluses and reduce debt. Treasury's projection of 3% growth over the next five years was ahead of expectations, and if successful, may give the Reserve Bank cause for a change of heart on the OCR. However, since the budget release, the mycoplasma bovis outbreak has taken centre stage, and could end up being this Government's "Christchurch earthquake."

Australian Banking Royal Commission

The Royal Commission of Enquiry into Australian financial institutions has had a flow-on effect in New Zealand. The Financial Markets Authority (FMA) and the Reserve Bank have sought assurances from our banks and insurance companies that conduct such as that uncovered in Australia is not occurring here. As reported in last month's newsletter, there have been some appalling practices revealed in Australia's financial services firms. Allegations of bribery, significant conflicts of interest and blatant dishonesty have seen our regulators swing into action.

The major trading banks and insurance companies have been asked to report back to the regulators outlining:

- The actions they, their Board and their senior teams have taken to identify and address conduct risk
- Any specific plans and actions they have taken (or have underway) to respond to the issues and themes arising from the Royal Commission
- Any other work they have underway or that is planned to proactively identify and address potential conduct and culture risk
- Any work underway to remediate any identified issues where bank conduct has resulted in detrimental outcomes for customers

In a similar vein the FMA released a report recently documenting the huge incentives paid by New Zealand's insurance companies to advisers. Nine life and health insurance companies spent $34 million over a two-year period on non-financial incentives such as holidays, business support and conferences. Much of the financial regulation introduced in the last decade has been designed to facilitate the development of fair and efficient markets, and to promote consumer confidence in those markets. The payment of incentives to advisers to push financial products seems to me to go against all that the regulators have been trying to achieve. During the two-year period, one insurer stopped offering overseas trips to advisers. As a result their sales dropped by a third. This supports what the FMA found in other reviews, that soft commissions directly influence adviser behaviour. The recent FMA report into adviser conduct when replacing insurance policies found a direct connection between incentives like overseas trips and switching policies to reach volume targets.

Hopefully the Financial Services Legislation Amendment Bill might address some of these issues. I'm sure that in time the payment of commissions on financial products will be phased out, as is happening overseas at present.