BRAMWELL BROWN LTD

INVESTMENT ADVISERS – BROKERS

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Bramwell Brown Limited – Newsletter – November 2011

Risk Aversion

Determining someone's tolerance for risk is a difficult task at best. As an adviser you have to be very careful you don't impose your own biases on other people. I see some investors taking risks unnecessarily. Just because modern portfolio theory suggests an allocation to shares is prudent, doesn't mean investors should take those risks if they don't need to. It is more noticeable in the low-interest rate environment we are experiencing at present. Risk-averse investors are looking to the share market in an effort to boost their returns to the level they were enjoying in 2007. But what happens when risk turns into loss? I often talk to investors about loss-aversion rather than risk-aversion, and try to impress on people that risk often does lead to loss.

The dramatic drop in the price of Fletcher Building shares in early October is an example where investors' tolerance for risk may not have matched their tolerance for loss. If you had just bought Fletcher Building at $7.94, it is understandable you might be dismayed to find them at $6.30 a week later. If you find yourself uneasy when this type of correction occurs you may need to ask whether your aversion to risk is reflected in the investments you hold. An adviser should be able to help determine a level of risk that suits you, however it is more art than science, and relies on the investor giving an accurate account of their financial position, their goals, and the level of risk (or loss) they feel they are comfortable with. Often when risk turns to loss the aversion to risk we thought we had turns out to be somewhat underestimated.

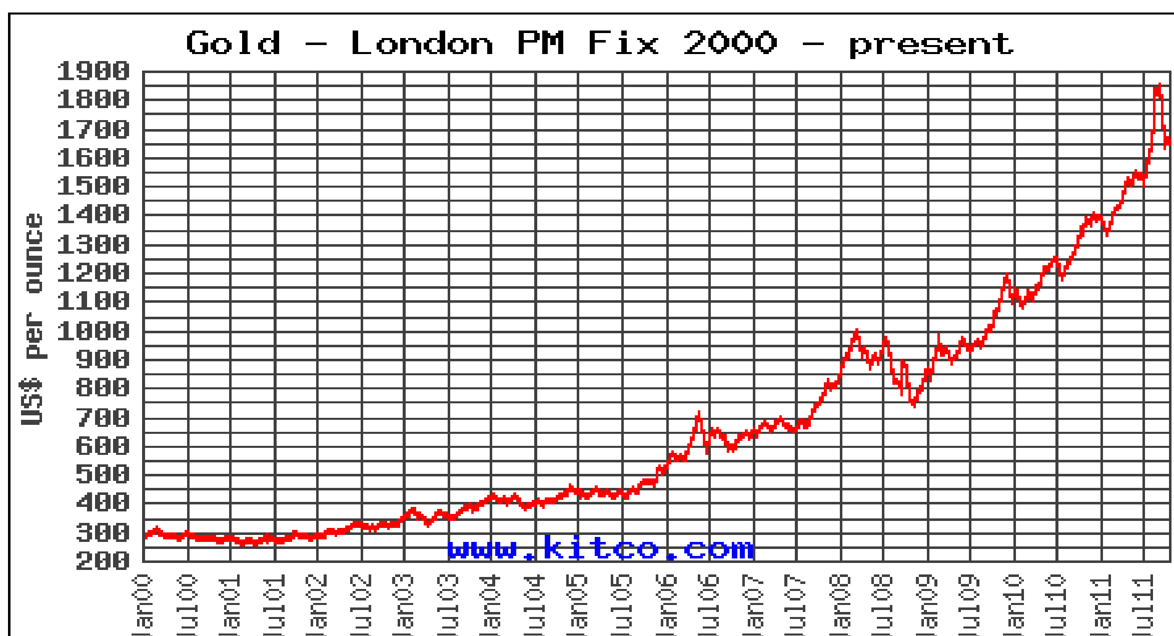
State Asset Sales

This has been widely publicised previously, and will be one of the hot topics during the election campaign. Meridian, Genesis, Solid Energy, Mighty River Power and Air New Zealand have all been earmarked for partial sale. As much as I would like to see the addition of such companies to our stock market I fail to see how selling such assets to pay down debt is good for our country.

Regardless of my opinion, if these asset sales go ahead we will endeavour to make the opportunity available to our clients. Energy companies are generally defensive assets with stable earnings, which provide a steady stream of dividends to investors. An early indication of demand would be helpful, so please contact the office if you are interested in seeing offer documents if and when they are produced.

Gold

I often have people ask me if they should include gold in their portfolio. I don't mind admitting I find the market for gold a bit of a mystery. Buying an asset that offers no source of income, other than its capital gain, puts it higher on the risk scale, and needs to be treated accordingly. It's a bit like buying a piece of art or a classic car in the hope it will increase in value over time. Yet there are plenty of very successful investors who swear by gold, so it's worth some investigation. Historically gold was used as a currency. Carrying gold around to settle accounts and pay for goods became cumbersome, leading to the introduction of paper money. The early paper money was typically a receipt for a certain amount of gold, although this was abandoned with the introduction of the Bretton Woods monetary system during World War II. Below is a chart showing the gold price since 2000.



What options are available for investors who want an exposure to gold? Three of the more popular options include buying the physical product, buying shares in a gold mining company, or buying an exchange traded fund (ETF).

<u>Buying the physical product</u>

There are a number of ways you can buy gold. Most of us probably already own some gold jewellery, and there are investors who hold their gold in this form. The main advantage of this type of investment is that you get use and enjoyment from it. The disadvantage is the fact it can be stolen, it costs money to insure, and it can wear out. You can buy gold coins, ingots or bars, but as with jewellery there are costs associated with holding them. You could bury it in the garden and run the risk of someone stealing it, or you could rent a safety deposit box at the local bank. Bullion traders will hold it on your behalf, but will

charge handsomely for the service. The New Zealand dealer's brokerage rates have also been criticised in the past as being excessive.

Buying shares in a gold mining company

This is a relatively simple way to gain exposure to gold; however other factors come into play that won't necessarily relate to the gold price. The efficiency of the particular company you buy will have a big bearing on their share price, as will the production they are able to achieve. The share price of a gold mining company that is performing poorly is unlikely to track the gold price. Oceana Gold in New Zealand (OGC) and Newcrest Mining in Australia (NCM) are two companies with direct exposure to the gold price through their mining operations.

Buying an exchange traded fund

This is possibly the easiest way to gain exposure to gold. Gold Bullion Securities is listed on the Australian Stock Exchange under the ticker symbol "GOLD." It was set up in 2003 and at that time each share represented one tenth of one ounce of gold. The shares are backed by gold bullion held at the HSBC Bank in London. The amount of gold backing the fund will diminish over time as it is used to pay the administration fees associated with the fund. At the end of August each share represented 0.0970187 ounces of physical gold. So like holding gold yourself, there are costs involved with holding an exchange traded fund that will eat into your returns. Those costs, however, are possibly less than holding the physical product yourself, due to the economies of scale.

I think anyone buying gold needs to have a basic understanding of the time value of money in order to compare returns. Is holding gold for ten years a better return than a ten-year bank deposit? The answer varies, of course, depending on the ten years in question. If you invested $1,000 in gold in 2000, it would be worth approximately $5,700 now, a compound return of 17.50% per annum. This is before costs, however, so returns would be slightly lower than this. If your ten-year period of investment had been 1990 to 2000, your return would have been negative, as the price of gold dropped over that period.

One of the main benefits of including gold in a portfolio is its low correlation to shares and bonds. What this means is that, in general, the gold price will move in the opposite direction to the price of shares and bonds. It won't happen all the time, however historically it has happened more often than not. It acts as a hedge against a drop in share prices and vice versa. You may ask, "wouldn't it be best to sell shares at their peak and buy gold, and then sell gold once it's peaked and get back into shares?" I wouldn't begin to try and predict when those tipping points might exist, and would prefer to have a portfolio of assets that I can call on that perform differently in certain circumstances.

Trade Me

The Trade Me share float is gaining momentum, and should be before investors some time in November. Fairfax plans to sell approximately thirty-five percent of Trade Me, with the proceeds going toward reducing debt and increasing dividends. Trade Me is New Zealand's leading auctions and classified business and has grown to a customer base of nearly three million New Zealanders.

Insurance Australia Group (IAG)

Insurance Australia Group Limited (IAG) advised shareholders at its annual general meeting it is considering making an offer of NZ$150 million of unsecured subordinated bonds to the New Zealand public, with the option to accept oversubscriptions.

It is expected the bonds would have a term to maturity of 25 years and be callable at IAG's discretion (subject to the prior approval of the Australian Prudential Regulation Authority) on the fifth anniversary of their issue and on each interest payment date thereafter. Interest would be payable quarterly in arrears.

An announcement of the minimum interest rate until the first call date and the margin would be made on or around the opening of the offer, expected to be in November 2011. IAG expects that the bonds would be assigned a credit rating of 'A-' by Standard & Poor's. Full details of the issue would be contained in an Investment Statement and Prospectus. No money is currently being sought and no applications for bonds will be accepted or money received until the subscriber has received an Investment Statement.

IAG is the parent company of an international general insurance group, with operations in Australia, New Zealand, the United Kingdom and Asia. Its operating subsidiaries underwrite over $10 billion of premium per annum. It sells insurance under many leading brands including NRMA Insurance, CGU, SGIO, SGIC, Swann and The Buzz (Australia); NZI and State (NZ); Equity Red Star (UK); and NZI (Thailand).

Infratil

Infratil have a tranche of infrastructure bonds maturing on November 15th 2011. They have indicated they may offer investors the opportunity to roll this bond over under new terms. New investors may also have the opportunity to invest. These bonds have historically paid interest of 8.50%. We expect confirmation of this offer over the next week.

PLEASE CONTACT THE OFFICE AS SOON AS POSSIBLE IF ANY OF THESE OFFERS ARE OF INTEREST TO YOU

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