Bramwell Brown Ltd

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Global Financial Crisis

Are we through the worst of the global financial crisis? It appears any piece of good economic data is seized upon by the markets to generate another rally. The pessimism shown through most of last year has been replaced by a sense of cautious optimism. How confident can we be that it is sustainable? The Euro crisis seems to have been averted in the meantime with the Greek sovereign bondholders accepting a 53.5 percent write-down of the face value of their bonds. This has wiped €107 billion off the country's national debt, and allows Greece to receive billions more in rescue loans from the IMF and other euro zone countries. One wonders about their ability to work their way out from under the remaining mountain of debt, with more than 1 million people out of work (20 percent of the workforce). I think Greece and austerity will be words we hear used together for decades. Spain, Portugal, Italy and Ireland are apparently in a similar position.

The European Central Bank has launched a second financing package which allows banks to borrow at one per cent for three years. This has significantly reduced the risk of a banking collapse in the Euro zone. Data from the US continues to improve with the Federal Reserve indicating it will keep interest rates near zero percent at least until the end of 2014. Employment rates are improving, as are housing starts and sales.

Much of this recovery, however, is based on the massive amounts of money being pumped into the financial system from the IMF and various governments. As I've said in previous newsletters, I'm no economist but surely this must eventually lead to high inflation. Increasing the supply of money doesn't make us wealthier – instead it tends to raise prices and wages, which means our money buys less than it did in the past. This is always bad news for those on fixed incomes and those with most of their wealth in cash, bank deposits and fixed interest securities. The value of those types of investments doesn't rise with inflation. In contrast owning physical assets like shares or property probably will rise in value with inflation. My advice is to have at least some of your wealth in shares and property so that if we experience a significant inflationary event in the future you have some protection against its effects. Holding only cash and bank deposits exposes you to the erosion of your wealth by inflation.

Exchange Rates

I had an interesting conversation with my son last night about foreign exchange. My older children are reaching the stage in their lives where they are contemplating career and travel. My daughter has just moved to Melbourne after six years of university study and my eldest son is contemplating a move to France once he has finished his degree. This all seems far more glamorous than my choice at their age to milk 130 cows in an old walk-through cow shed out of Palmerston North. Anyway, moving out of New Zealand brings the inevitable questions around money, taxes, foreign exchange and superannuation. My son's question was whether he would be wise to buy Euros now rather than wait until the end of the year (he had noticed the NZ/Euro exchange rate had moved from 55 cents to 62 cents in the last four months). My response was that he was asking me to predict the future. His reply was "shouldn't you know this stuff?"

This led to a conversation around the relative price of goods here and overseas. Does the movement in exchange rates open the opportunity for financial gain? For example would there be a clear advantage in buying Telecom shares on the Australian Stock Exchange, rather than on the New Zealand Stock Exchange (Telecom are listed on both). There is a financial theory called the efficient markets hypothesis that says investors can't consistently achieve returns in excess of average market returns given the availability of information at the time. Whether or not the efficient markets theory is relevant has been debated for many years, but in this case I think it's fairly obvious. The difference in the price of Telecom shares on each exchange "should" simply be a function of the exchange rate at the time. As the exchange rate fluctuates, so to should the difference in price. If exchange rate information is freely available to investors there should be limited opportunity to profit from buying one and selling the other. As soon as there is an opportunity it is acted upon and the prices come back to equilibrium.

So, back to the question of buying Euros. Buying and selling foreign exchange is not an area that I propose to know a great deal about. I've dabbled in it myself a few years ago when the US exchange rate went over 80 cents. My rationale was that it was at an historic high, and therefore it must drop at some stage. Looking back it was a ridiculous presumption; however I got lucky and managed to make a bit of money. You would need a very sound reason to buy foreign currency today rather than in a year's time. Buying today indicates you believe our exchange rate will fall in the future, meaning you would be forced to pay more for your Euros at a later date. What are you basing that information on? How confident are you in your theory? What happens if the exchange rate continues to climb? There are so many factors in play that determine an exchange rate that I think it's impossible for the layman to really predict future events with any certainty. Also don't forget the influence interest rates have on exchange rates. Part of the reason our dollar is at historically high rates is due to our (relatively) higher interest rates. As soon as you convert your New Zealand dollars into Euros you are giving up the opportunity to earn 5% interest in favour of earning only 1% or 2%. So, instantly you need to make a gain on your foreign currency gamble just to offset the loss of income in the meantime.

Considering my son was talking about a small sum of money I don't think converting his funds into Euros now is necessary. If you were dealing in large sums (hundreds of thousands of dollars) you would consult a foreign exchange dealer and look at hedging your position with a futures or options contract. It's a bit like an insurance policy where you may have to pay a premium, but you take the risk of adverse movements out of the equation.

Ex Dividend/Cum Dividend

I'm often asked for an explanation on various terms used when dealing with shares. With many companies paying dividends in March I have people asking for the meaning of "ex dividend" and "cum dividend." There are certain rules listed companies have to abide by, and informing the market of their intention to pay a dividend is one of them. When a company announces that it intends to pay a dividend, it gives a series of dates that relate to that payment. They are the record date, the ex-dividend date and the payment date.

The record date is the date the company uses to determine which shareholders are entitled to be paid the dividend. The company will close its share register on that date, and anyone holding shares at that point will be entitled to the dividend. The company must allow at least two weeks between when it announces its intention to pay a dividend and the record date. If a company makes an announcement to pay a dividend you have time to buy shares in that company and receive the payment. The shares are said to trade "cum (with) dividend" after the company has made their announcement. You will see some shares listed in the newspaper with "CD" next to them from time to time.

In New Zealand a share will begin trading "ex-dividend" three days before the record date. This allows for the three-day trading settlement of any share purchases. Anyone who already holds, or subsequently buys shares in the company up until the ex-date will receive the dividend. If you purchase a share after it has gone ex-dividend you are not entitled to that dividend. More often than not the share price will drop the day the share goes ex-dividend. All other things remaining equal it should drop in price by the amount of the dividend being paid. Other factors are always at play of course, and it's never as clear-cut as that. We can look at Fletcher Buildings' recent dividend to get an idea of how it works. Fletcher Building announced their intention to pay a dividend of 17 cents on February 22nd. From this date the share traded cum-dividend. They nominated a record date of March 30th. It went ex-dividend on March 28th and the payment date will be April 18th. Leading up to the ex date of March 28th the share was trading around $6.95, and on March 28th it traded between $6.70 and $6.83.

Mighty River Power

The Government appears set on following through on the partial sale of state owned assets. Whether or not we agree on the philosophy shouldn't stop us weighing up the merits of investing when the opportunity presents itself. The Government has indicated that Mighty River Power will be the first to be sold, probably in the latter part of this year. What do we know about Mighty River Power?

Mighty River Power was established along with Genesis Energy and Meridian Energy when the Electricity Corporation of New Zealand was broken up in 1999. They are one of the larger generators and retailers of electricity in New Zealand. They have nine hydro-electric power stations on the Waikato River, and four geothermal stations in the central North Island. They also operate the gas-fired Southdown Power Station in South Auckland and own the Marsden A plant at Marsden Point. They have consents to operate a wind-farm at Turitea, just out of Palmerston North, and have lodged consents to operate a wind-farm at Puketoi, east of Pahiatua. They are also a shareholder in GeoGlobal Energy which is a company developing geothermal opportunities in the United States, Chile and Germany.

Their retail side of the business is spearheaded by Mercury Energy, which has over 370,000 customers. They also owns Tiny Mighty Power which services some provincial towns including Masterton. They own Metrix, which is a company providing metering and associated services to New Zealand's major electricity retailers. Six-month financial results to the end of 2011 look good with earnings of $254 million. We would expect plenty of analysis closer to their listing date when we get an idea of the value being attributed to the company and the price expected for the shares. As with other new offers I would ask all clients who think they might be interested to call the office so we have good understanding of the demand.

Stock & Share

Stock and Share have recently made offers to buy shares in PGG Wrightson and Heartland; both at significant discounts to their current trading price. This is in addition to their offer to Strategic Finance debenture holders to buy their debentures at four cents. These offers are generally only any good for the rubbish bin but please don't hesitate to ring the office and check with me first.

GPG Capital Notes

GPG Finance's capital notes that were due to mature in December 2013 were repaid in full on March 15th. For those investors looking for a home for the money the secondary bond market provides limited opportunities. Bank deposits are still providing a better return for risk, especially when you consider the 1% brokerage payable on bonds. Phone the office if you would like to discuss your situation.