BRAMWELL BROWN LTD

INVESTMENT ADVISERS – BROKERS

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The Global Economy

The global economy continues to be a drag on markets with Greece and Spain constantly in the headlines. Greece remains in a state of flux leading up to elections in mid-June, and doubts are surfacing over Spain's ability to pay its bills. Are we seeing the demise of the Euro? There are reports of bank runs in Greece and Spain, and some commentators believe the euro zone is about to implode. What does this mean for the global economy? The biggest threat is to the banking system – not only the contagion effect of bank runs, but the exposure banks have to sovereign debt. Banks hold large volumes of Government bonds and as individual countries run into financial difficulty those bonds lose value. The banks' assets are reduced which leads to a contraction in their lending to businesses, households and other banks. This contraction would flow through Europe and eventually the rest of the world. The ultimate outcome is another global recession (did we come out of the first one?)

What does it mean for New Zealand investors? Initially it would mean similar volatility to that we experienced in 2008. Share markets historically suffer when significant global events occur, and I would predict a Euro meltdown would cause a correction here. The direct effect of a Euro collapse on a well-capitalised, well managed, profitable New Zealand company is debatable, however that doesn't stop investors panicking and dumping their shares. All share investors should be prepared for volatility in their portfolios as the European debt crisis unfolds. I would be surprised, however, if we see a sell-off similar to that in 2008. Back then investors could sell their shares and invest in bank and Government bonds returning 7.00% to 9.00%. Those returns aren't available now, and our corporates are generally in good shape with sustainable revenues. Another factor in investors' favour is the willingness of central banks to do whatever it takes to smooth volatility and keep the financial system operating effectively. Whether that is to our long-term benefit is of course debatable.

For investors with most of their money in bank deposits and corporate bonds a Euro meltdown "might" mean a period of higher interest rates. Funding flows will stall, putting pressure on banks to raise rates to entice depositors. I would imagine it would be short-lived however, as generally in a recession interest rates drop in an effort to stimulate an economy. I think fixed interest investors can unfortunately look forward to a long period of low interest rates. The Institute of Economic Research suggests this could be as long as seven years.

Budget

Yet again the budget has underwhelmed, however all the signs leading up to the release were not to expect too much. I think considering the state of the world economy, any effort to balance the books and return to surplus should be commended. Reading the newspaper during the lead-up to the budget it struck me that many people want plenty for nothing. Paid parental leave, student allowances, early childhood education subsidies and Working for Families aren't free and must be funded by the taxpayer. It worries me that New Zealand is becoming more and more socialist, with welfare benefits and Government handouts becoming an expectation rather than a privilege. Social welfare should be the safety net that catches the minority, not a lifestyle choice. There was an email doing the rounds last year which I think is worth repeating:

- You cannot legislate the poor into prosperity by legislating the wealthy out of prosperity
- What one person receives without working for, another person must work for without receiving
- The Government cannot give to anybody anything that the Government does not first take from somebody else
- You cannot multiply wealth by dividing it
- When half of the people get the idea that they do not have to work because the other half is going to take care of them, and when the other half gets the idea that it does no good to work because somebody else is going to get what they work for, that is the beginning of the end of any nation

One thing I don't understand is the Government's blanket refusal to tackle the significant issue of superannuation. John Key is an intelligent man and has a background in finance. He knows we can't continue to fund New Zealand super at its current rate yet he refuses to acknowledge it. New Zealand's demographics suggest it is only a matter of time before hard decisions need to be made around retirement savings. Here is an excerpt from a previous newsletter:

- The average age of death has increased from 60 to approximately 85 in the last 50 years
- The numbers in New Zealand's population over 60 will approximately double by 2050
- In 2000, there were approximately nine taxpaying workers for each retired pensioner
- In 2050, there will only be three tax-paying workers for each retired pensioner
- The Government response is likely to include some of:
    - A decrease in the superannuation benefit
    - An increase in the age of eligibility
    - Means testing
    - Compulsory KiwiSaver membership

Figures released by Treasury suggest by 2060 there will only be 2.5 tax-paying workers for each retired pensioner. The Government simply cannot afford to keep paying the same amount in superannuation without a means of levying taxpayers. My preference would be to have a minimum guaranteed universal pension (at a lower level than we have currently), with tax incentives available to those who contribute to their own scheme. That way we have a choice about when, and how much, we contribute to our own retirement fund. If we decide we have a better use for our money, we are free to make that decision. If we feel the best use for our money is to fund a more comfortable retirement then so be it. If the Government gradually reduces the pension payment, and uses some of that money to incentivise saving for our own retirement, the onus moves to individuals to make choices for themselves. Unfortunately there will always be those who, for a variety of reasons, can't or won't make those choices. And there lies the perpetual dilemma for Government – Nanny State or freedom of choice? I want to be able to make my own choices, although I also don't want to see superannuitants begging in the streets – there is a compromise to be reached there somewhere.

Government policy, of course, needs to be broad-brushed. The more intricacies, exceptions and anomalies there are, the harder it is to administer. I'm certain that eventually the Government will make KiwiSaver compulsory, and will increase the minimum contributions expected from members and their employers. They will probably follow the very successful Australian model where employers are now required by law to contribute 9% of an employee's salary to a complying superannuation scheme. Australians now have more money per capita invested in managed funds than any other country. Individuals also now have better financial literacy due to the interest they take in their significant investment portfolios. Whether this alone will be enough to prevent the burden of superannuation from blowing future budgets is unlikely. Increasing the age of eligibility is the most likely option for a new Government, with means-testing a less-palatable, but possible option also.

KiwiSaver

I mentioned in last month's newsletter the upcoming anniversary for KiwiSaver investors. You need to have deposited at least $1,043 before July 1st in order to qualify for the 50% subsidy from the Government. If you are eligible the Government will match your contribution up to a maximum of $521. To be eligible for the matching contribution you must:

- Be over 18
- Mainly reside in New Zealand

Once you reach the stage where you are able to withdraw your funds from KiwiSaver, you are no longer eligible for the Government's matching contribution. So once you reach 65 (and have been a member for at least 5 years) you will not receive the 50% subsidy.

NZX Return of Capital

Shareholders in NZX could be forgiven for thinking the company had experienced a colossal fall in fortunes. Shares traded at $2.85 on May 25th and now trade at $1.25. The reason is twofold – a return of capital to shareholders in conjunction with a share split. The company cancelled one share in ten, paying $2.85 per share to eligible shareholders, and then undertook a seven-for-three share split. A portion ($1.06) of the payment made for the cancelled shares is taxable. All things remaining equal shareholders should be in a similar financial position now as they were before the return of capital and share split. Let's look at the maths for someone holding 10,000 shares:

Pre-return of capital and share split	
10,000 shares at 2.85	**$28,500**
Post-return of capital and share split	
1,000 shares cancelled at $2.85	$2,850
Less tax	45 (approximate)
	$2,805
9,000 shares remaining	
Seven-for-three share split now equates to 21,000 shares	
21,000 shares at 1.25	$26,250
Total	**$29,050**

As you can see at this stage shareholders are in a similar position after the return of capital and share split.

Fees

Over the last twelve months I have offered clients a fee-paying service for personalised financial advice. The Financial Advisers Act makes a very clear distinction between personalised and class advice. Class advice does not take into account a client's financial situation, goals, or tolerance for risk, and is only suitable for those clients seeking a transactional service. The personalised service has been offered at $250 per annum and will remain at that level for the coming year. This fee is tax deductible. Financial information is analysed and compared against model portfolios at different levels of risk and stage in life. Current clients have found the information generated a useful guide to their investment planning. This is the last year the service will remain at such a low fee so I would encourage you to consider signing up. Ring the office if you think this could be of interest to you.