Bramwell Brown Ltd

Investment Advisers – Brokers

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

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Mighty River Power

Well – how wrong could I be? My prediction last month of the Government forging ahead with the float of Mighty River Power proved to be completely incorrect. It has instead decided to wait until March next year, and will consult with iwi on issues raised in the Waitangi Tribunal's interim report. The tribunal has put forward a "shares plus" proposal that gives Maori particular rights in the company, above other shareholders. Prime Minister John Key has rejected the proposal and gives five reasons why:

- It is not in the national interest for any group to be given such rights
- Almost every form of redress covered by shares plus could be achieved in other ways
- Aspects such as giving Maori shareholders the ability to make decisions on strategic issues were unworkable
- It would make the company less attractive to investors and possibly lower the share price to the detriment of taxpayers
- After hui earlier this year it was decided Treaty obligations rested with the Crown, not the companies

The Maori Council has said it will mount an immediate legal challenge if the Government goes ahead with the sale of mighty River Power this year. The Government needs to be sure these issues are resolved before the company comes to the market. It needs the first sale to be a success if it is going to have any chance of bringing the other companies to the market at reasonable prices in the future. We will keep you informed as the sale process unfolds and would remind potential investors to register your interest with us. At this stage we don't need an indication of the amount you may wish to invest, but will need that detail closer to the time.

Economics

I attended a National Bank presentation in mid-September where Cameron Bagrie, the bank's chief economist spoke. Two years ago I reported on a similar presentation, and it seems little has changed in the interim. Topics included the US economy, the Eurozone crisis, China, interest rates and debt levels. Since speaking two years ago he commented that "since then the only trend is there is no trend." In the last five years the global economy has lurched from crisis to response to improvement to complacency and back to crisis again. Are we in the complacency phase now? Sharemarkets have rallied strongly over the last three months, yet if anything, debt levels have risen. Are we about to enter the next crisis stage? What might be the trigger this time?

He explained that historically it takes eight years to recover from a financial crisis, but believes the current global crisis could be a ten-year fix. There is more global debt now than there was in 2008, although more of that debt is held by governments rather than individuals, corporates or banks. Central banks are doing all they can to keep interest rates low in an effort to give struggling nations time to trade their way out of their difficulties. The European Central Bank's latest rescue package allows it to buy an unlimited amount of bonds from heavily indebted member countries in order to keep the cost of their borrowing at low levels. Of course all this is doing is shifting the debt – not solving the debt crisis. In order to solve the crisis there are a number of options:

- Default
- Austerity
- Growth
- Inflation
- Depression

I've wondered in the past whether default might be a good option. I'm not experienced enough in economics to understand all the implications of a country defaulting on its debts. Unfortunately it's not just the financial implications that governments have to take into account, but the social implications also. What is the social cost of a country being bankrupted? Probably very similar to an individual, only on a massive scale. High rates of unemployment bring all manner of social issues that are hard to manage, and any country that can't borrow money is going to struggle to grow its economy.

We are seeing most countries resort to various austerity measures, and it seems a logical first step for any individual/entity/country earning less than it spends. Growth is where Cameron Bagrie sees the solution, but "how" to grow is not so simple (more on that later). Letting inflation run rampant is one solution I put forward in June 2010, but of course it's not a solution at all. All inflation does is erode value – great if you owe a significant sum of money, but devastating for those with money in the bank.

One final point Cameron Bagrie touched on was interest rates. He warned against an expectation that interest rates can only go up from here. The Reserve Bank is already under pressure to cut rates from our export sector which is struggling with the U.S dollar at 0.82cents. The exchange rate with our largest trading partner, Australia, is equally important and he suggests anything over 0.80cents will warrant an interest rate cut from the Reserve Bank.

Resources

An interesting statistic presented at the seminar was New Zealand's place in the world in relation to resources. Wealth of Nations data from the World Bank places New Zealand at 8th in the world for natural resources on a per capita basis. Australia ranks 11th, and the top seven are all oil producing countries. New Zealand ranks 1st in the world in terms of renewable natural resources per capita. As Cameron Bagrie says, "New Zealand has the right stuff; we just have to be able to unlock it."

Is it time we started turning these resources into commercial reality? Is this how we can grow our economy and drag ourselves out of the financial crisis? I don't want our waterways polluted, or our native flora and fauna destroyed any more than the next person, but have we gone too far in New Zealand pandering to the environmental lobby groups? Were the environmental concerns at Pike River so great that the mine couldn't be open cast? Could we not have moved the snails up the road? Bathurst Resources is an Australasian coal-mining company that has spent seven years and $15 million on the resource consent process for an open cast mine at Denniston, just north of Westport. If allowed to go ahead it would provide 225 jobs. My aunt and uncle milked cows at Birchfield, and as kids we used to visit in school holidays. We once spent a day exploring the old Denniston mine site. It's a beautiful place and part of the attraction of that part of the country is the fact that it remains largely as it was one hundred years ago. But it's also a big area – thousands of hectares of bush-covered hills. Is clearing the bush from a tiny fraction of that area, digging the coal out, and then replanting it really going to "ruin the biodiversity" of the Denniston Plateau?

As I said, I don't want to see Bathurst Resources come in and lay waste to the area, pump all manner of chemicals into the waterways and leave a big ugly hole in the ground. That's what the Resource Management Act is designed to prevent. But seven years and $15 million to achieve a consent – really?

Fonterra – Trading Among Farmers

Gaining investment exposure to New Zealand's dairy industry could be only a few months away as Fonterra's Trading Among Farmers (TAF) scheme comes to the market later this year. TAF is a scheme designed to avoid the share redemption risk Fonterra faces if a large number of dairy farmers decide to exit the industry at the same time. Currently whenever a farmer sells their farm the co-operative is obliged to redeem their shares, which could potentially cause cash flow problems for Fonterra.

Fonterra's aim is to have a fund that farmers can sell their shares into rather than having to be redeemed by the company. Other farmers will be able to purchase extra shares and receive the dividend on that investment. Part of the proposal is that outside investors will be able to buy units in the fund also. No voting rights would attach to the units; therefore farmers would retain control of the co-operative. As details are finalised we will bring them to your attention through the newsletter.

Fixed Interest

Finding fixed interest products that can beat bank term deposits on a risk-adjusted basis has been difficult in the last couple of years. Historically we would look to the likes of Fonterra, Contact Energy, Auckland Airport, or some of the other power companies if we were trying to achieve rates above the banks. However all of these companies' secondary market bonds are trading at yields below bank term deposits. There are plenty of other products on the market however, and some of the resettable securities are worth investigating. Here is a list of some of the perpetual or redeemable securities trading on the secondary market.

Security	**Coupon**	**Benchmark**	**Margin**	**Next Reset**	**Price**
ANZ	9.66%	5 year swap rate	2.00%	18/04/13	100.00
BNZ	9.89%	5 year swap rate	2.20%	28/03/13	98.40
BNZ	9.10%	5 year swap rate	4.09%	30/06/14	106.00
Contact Energy	8.00%	5 year swap rate	4.55%	15/02/17	107.50
Genesis Energy	8.50%	5 year swap rate	3.87%	15/07/16	110.00
Infratil	4.22%	1 year swap rate	1.50%	15/11/12	56.50
Kiwi Bank	8.15%	5 year swap rate	2.90%	04/05/15	106.60
Origin Energy	4.47%	1 year swap rate	1.50%	15/10/12	59.30
Quayside Holdings	5.42%	3 year swap rate	1.70%	12/03/14	84.00
Rabobank	3.70%	1 year swap rate	0.76%	08/10/12	79.80
Rabobank	8.786%	5 year swap rate	3.75%	18/06/14	106.50

You can see a big difference in the price of these securities on the secondary market. I have explained in previous newsletters that the early securities were issued before the global financial crisis and had reset characteristics that are entirely inappropriate now. For example the Infratil and Origin Energy securities reset annually at a very low margin over the 1 year swap rate. At the time they were issued their coupon rates were 9.00% and 10.24% respectively, with the 1 year swap rate around 7.50% to 8.50%. Since then of course interest rates have dropped significantly, and the margins new borrowers must pay to source funds have increased.

The securities trading at a premium are doing so because they have a relatively high current coupon, whereas the securities trading at a discount have low coupons. There are all sorts of implications to consider when assessing these securities as an addition to a portfolio. What are the swap-rates currently? Are they likely to go up or down? When is full repayment likely to be made? What will my yield be if I pay the asking price? I can talk you through all of these implications if you are looking to add fixed interest products to your portfolio.