Bramwell Brown Ltd

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Bramwell Brown Limited – Newsletter – September 2014

Election

I have to admit it is becoming more and more difficult to come up with topics for the monthly newsletter. You would think the September election would provide plenty of material worthy of analysis, however so far the campaign has been hijacked by the "Dirty Politics" book and the Dotcom circus. It would be good to see actual policies being released and debated. Much of what is released is meaningless marketing-speak. "We are going to tackle unemployment head-on." "We are going to build a knowledge-based economy." "We will lift productivity." Wouldn't it be great to have a truly independent body analysing the various parties' policies – someone without an agenda of their own?

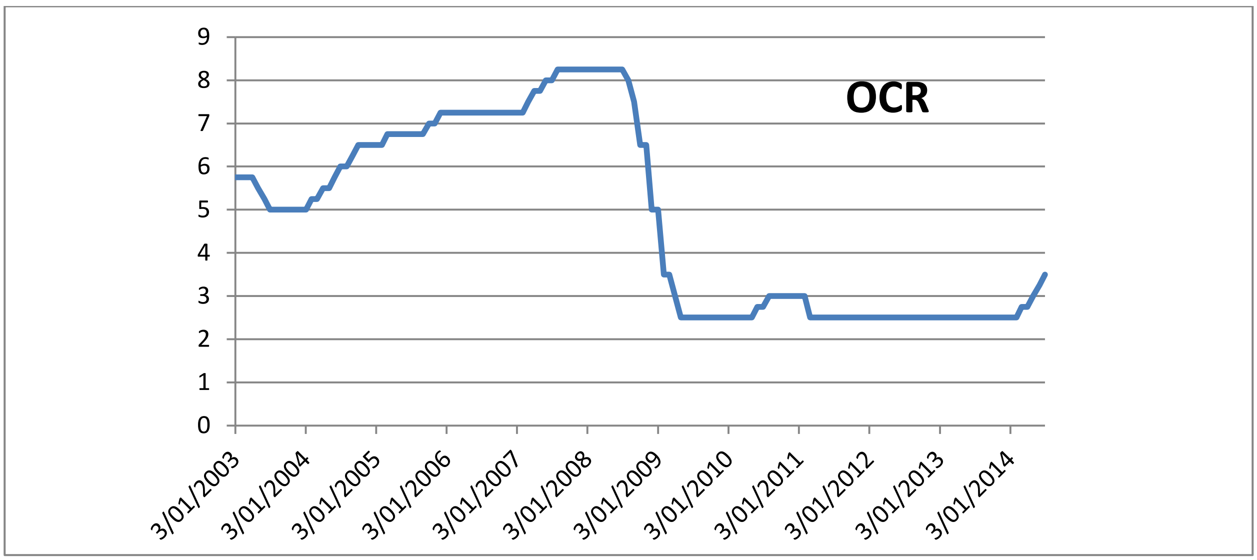
The main political parties all have worthy aspirations for the country but it would be good to know what those policies would cost to implement. I want clean rivers and beaches as much as anyone – what will it cost? Free doctor's visits for over 65's sounds great – nothing's ever free – what does it cost and how do we pay for it? Increasing the minimum wage sounds fair – who pays and what are the broader implications for small business and for unemployment? Better qualified teachers rewarded for performance or smaller class sizes – what's best? Capital gains tax – is it enough to pay for all the extra social spending? What are the long-term implications for saving and investment? How do we bridge the gap between the rich and the poor without forcing innovators out of the country because they are being taxed so highly? How do we encourage people to work for a living when they have been brought up with an expectation that the state should support them?

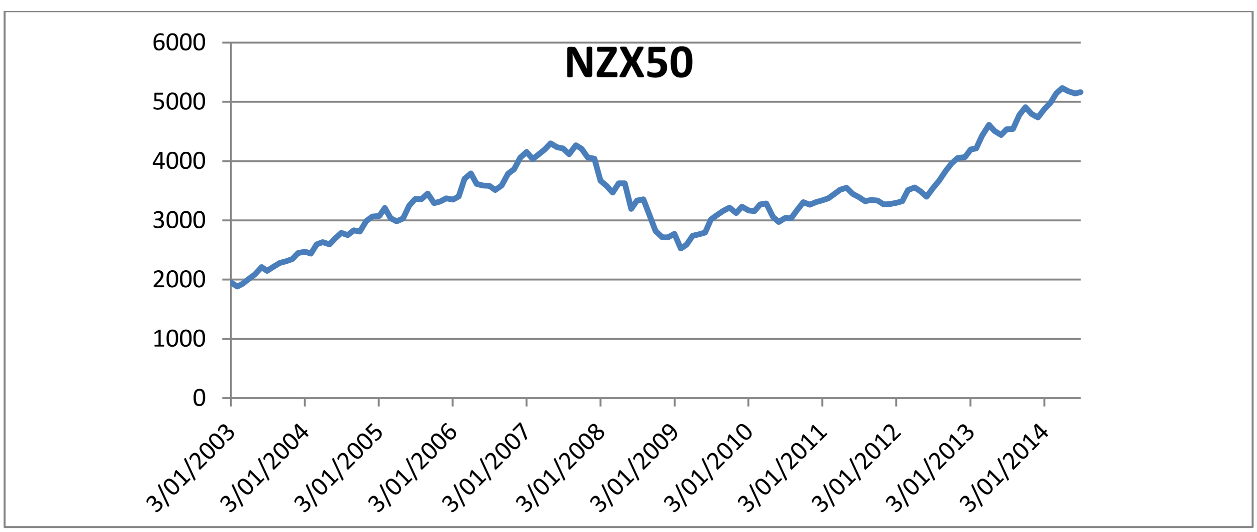
Investors in the state-owned power companies will probably be hoping for a return of the National Government. The Opposition's policy of setting up a single buyer of wholesale electricity with the ability to set prices will without doubt negatively impact the share prices of Mighty River Power, Genesis Energy, Contact Energy, Trustpower and Meridian Energy. These companies are currently trading at approximate gross dividend yields of between 8% and 11%, which is high in comparison to other listed companies. This is a reflection of the uncertainty around the sector leading into the election. Younger investors will look to the housing debate with interest. National have released details of increased subsidies for first-home buyers through the KiwiSaver scheme, and Labour has promised to build 100,000 affordable homes under their Kiwibuild programme.

Official Cash Rate

Last month's newsletter contained a piece on the Official Cash Rate (OCR). Looking at the graph started me thinking about what effect the OCR has on the sharemarket. My basic knowledge of economics would have me believe that low interest rates encourage higher share prices and vice versa. Certainly over the last few years we have seen a very strong sharemarket based on low interest rates. Investors have sought better returns than those on offer in bank deposits and have turned to the bond and share market for alternatives. This has driven yields down and prices up.

It would be simplistic to suggest rising interest rates will automatically produce a drop in share prices. Interest rates are one of a number of factors that affect company performance. You could also argue that the OCR reacts to economic activity, rather than drives it. The OCR increases from 2003 to 2008 were in response to a booming economy, and the cuts to the OCR in 2009 were due to the global financial crisis. I would suggest there are still gains to be made in the sharemarket while interest rates remain low. And even as interest rates increase, the presumption is that they are increasing due to a buoyant economy.





Fixed Interest

Here is a selection of secondary market bonds with their current yields to maturity.

Company	Coupon	Maturity Date	Yield	Price/$100
Trustpower	7.60%	December 2014	5.35%	100.63
Auckland City Council	6.28%	March 2015	3.95%	101.27
Fonterra	7.75%	March 2015	4.30%	101.77
Meridian Energy	7.15%	March 2015	4.49%	102.51
Goodman Property Trust	7.75%	June 2015	4.49%	106.60
Warehouse	7.37%	June 2015	5.25%	101.60
Telecom (Spark)	8.35%	June 2015	4.41%	102.99
Trustpower	8.40%	December 2015	5.55%	103.51
Fletcher Building	9.00%	May 2016	5.20%	106.10
Goodman Fielder	7.54%	May 2016	7.20%	100.54
Infratil	8.50%	June 2016	5.80%	104.55
Z Energy	7.35%	October 2016	5.20%	104.25
Air New Zealand	6.90%	November 2016	5.14%	103.61
Auckland Airport	8.00%	November 2016	4.30%	107.68
Trustpower	8.00%	December 2016	5.50%	105.33
Meridian Energy	7.55%	March 2017	5.13%	105.69
Infratil	8.50%	June 2017	6.40%	105.32
Manukau City Council	6.52%	September 2017	4.55%	105.59
Infratil	8.00%	November 2017	6.20%	105.19
Trustpower	7.10%	December 2017	5.50%	104.78
Z Energy Limited	7.25%	August 2018	5.60%	105.81
ANZ Bank	6.25%	March 2019	4.87%	105.55
Contact Energy	5.80%	May 2019	5.27%	102.19
Z Energy	6.50%	November 2019	5.80%	103.12
Infratil	6.75%	November 2019	6.45%	101.31
Goodman Property Trust	6.20%	December 2020	5.55%	103.40
Sky TV	6.25%	March 2021	5.77%	102.61
Wellington Airport	6.25%	May 2021	5.60%	103.58
Kiwi Income Property Trust	6.15%	August 2021	5.95%	101.12
Infratil	6.85%	June 2022	6.85%	100.00
Kiwi Bank	6.61%	July 2024	6.00%	102.53
Mighty River Power	6.90%	July 2044	6.12%	103.25

It is interesting to note that every one of these bonds (with the exception of the 2022 Infratil) is trading at a premium to their issue price in the secondary market. Investors are happy to pay more than the face value for these bonds and accept a slightly lower return. For those who need a refresher on how the secondary bond market works:

Coupon – the interest rate at which the bond was issued. In most circumstances the coupon rate does not change throughout the life of the bond. Some bonds are issued with the ability to reset the interest rate at various times.

Maturity Date – the date at which the bond matures and the initial investment is repaid in full.

Yield – this is the return a buyer of the bond in the secondary market would achieve. If you pay more than the face value of the bond your yield will be lower than the coupon, and vice versa. There is an inverse relationship between price and yield. Look at the Infratil 2022 bond. It is trading at a yield of 6.85%, which is the same as its initial coupon. Anyone buying that bond will pay the same as the initial investors (but will pay brokerage) and will achieve the same yield until maturity of 6.85%. Investors buying the Infratil (November 2017) bond are happy to do so at a return of 6.20%, instead of the initial rate of return of 8.00%. They would pay a premium (105.19/100) to get this bond, hence the lower return.

APN Media Bond

APN Media have announced their intention to repay their 2016 bond early. Investors may be disappointed to forego an investment paying 7.86% per annum, although most will be happy to receive their capital back considering the relatively rocky ride the company has experienced in recent times. Full repayment, together with accrued interest will be paid on September 22nd. They will also pay a 2% premium (as contained in the prospectus) due to the early repayment.

Rabobank Interest Rates

Term	**Rate (annual interest)**
Premium Saver (call account)	4.60%
1 year	4.95%
2 years	5.25%
3 years	5.50%
4 years	5.80%
5 years	5.95%

DISCLOSURE STATEMENT AVAILABLE ON REQUEST AND FREE OF CHARGE