BRAMWELL BROWN LTD
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Bramwell Brown Limited – Newsletter – September 2015

China

Should we be worried about the constant flow of doom and gloom coming from China? From my understanding there is a major disconnect between the Chinese stock market and the Chinese economy, yet it's the stock market that seems to grab all the headlines. The Chinese sharemarket is a complex beast with three separate exchanges, the Shanghai and Shenzhen Exchanges in mainland China, and the Hong Kong Exchange. The sharemarket crash reported in the media relates mainly to the Shanghai Exchange which is largely closed to foreign investors and is open to manipulation by the Central Government. The Shanghai Index rose 150% in the last year and has subsequently dropped by about 40%. In comparison the Hong Kong Exchange rose approximately 20% in the previous year and has now given up all of those gains. More liberal laws around buying stocks with borrowed money meant billions of dollars was invested into the Chinese share market using margin trading.

It's the economy we should be focussed on, rather than the sharemarket. China has been the dominant driver of growth since the global financial crisis and any slowdown in their economy is going to be felt around the world. We have already seen the effect on Australia as demand for iron ore has diminished. The Chinese construction boom appears to be over, and with it comes the lower demand for steel. Other commodities are suffering the same fate as demand from China reduces. New Zealand is not immune with the dairy and coal industries affected accordingly. So yes – we should be concerned about what's happening in China but I would caution investors against a wholesale exit from the markets.

Every investor needs to constantly review their own financial position in relation to the goals they have set and the current market conditions. A twenty year old embarking on a career might see five more "China" cycles in their life-time but history tells us that so long as they hold good quality, diverse assets they will ride those cycles out in good shape. However the sixty-year old, five years from retirement, with half of their assets in shares needs to view the markets with more caution. Those with shorter time frames should be looking to take risk off the table as they near retirement, as they have less chance to make up any losses. That doesn't mean that they should bail out of shares altogether – shares is an important asset class even for those in retirement.

Bonds – New Issues

New issues of corporate bonds have been few and far between this year, and with interest rates falling those issues are becoming less and less inspiring. The ANZ and Kiwibank capital notes offered good returns (over 7%), albeit with considerably more risk. The Warehouse five-year bond at 5.30% was just enough to beat bank term deposits. The Goodman Property Trust seven-year bond offering 5.00% was marginal at best. We now have Contact Energy and Sky City Entertainment issuing six and seven year bonds with projected interest rates between 4.20% and 4.80%. Is this the new normal? Many financial commentators are predicting interest rates around the world will stay low for years, so should we be grabbing these returns while we can?

My recommendation to investors is to always draw comparisons with other investment alternatives. Are you being fairly compensated for the risk you are taking? The returns currently on offer for Government bonds is a good place to start. Government Stock maturing from 2020 to 2023 is trading at yields of 2.65% to 2.90%. In my view the extra return (around 2%) offered by Contact Energy and Sky City is adequate compensation for the risk, in comparison to Government bonds. But what about bank term deposits? If you can achieve 4.35% on a Rabobank five year term deposit I would suggest you are not being fairly compensated by Contact Energy at 4.40%. Admittedly the bond gives you liquidity that a term deposit can't; however most investors with diverse portfolios don't need every security they hold to be highly liquid.

Should we be looking to shares? Are they adequately compensating us for the risk we are taking? We can achieve 6% to 7% investing in the listed property trusts and 7% to 10% with some of the energy companies. Whether or not these returns are good enough on a risk adjusted basis is something I will explore in more depth in next month's newsletter. If in the mean time you would like a review of your investments don't hesitate to call the office.

Repairs & Maintenance

Unfortunately I have been showing my age recently and may be off work briefly over the coming month. I have just had an operation to repair a troublesome knee and will have surgery shortly to repair a recently damaged shoulder. I may be out of the office for up to a week and if Sue is unable to man the fort on a particular day I will redirect the phone to home. Rest assured phone calls and emails will be answered promptly, and hopefully the only inconvenience to you will be if you arrive at the office without first making an appointment. My home number is 3703911 and my mobile number is 0274523980 if you are ever having trouble getting hold of me. Please don't hesitate to ring.