BRAMWELL BROWN LTD

INVESTMENT ADVISERS – BROKERS

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Bramwell Brown Limited – Newsletter – November 2016

ASB Capital Notes

ASB has announced an offer of up to $250 million of subordinated, unsecured, convertible notes, with the ability to accept oversubscriptions of up to $150 million. These notes are regarded as Tier 2 capital for the purposes of the bank's regulatory requirements, and as such are complex securities and riskier than a bank deposit. They are designed to absorb losses if a bank experiences severe financial difficulties. It is essential potential investors read the investment statement carefully and understand the nature of these securities.

The notes have a term of ten years, but may be repaid earlier in certain circumstances. The capital notes could be written off or converted to shares in Commonwealth Bank of Australia (CBA) if certain non-viability trigger events occur. A non-viability Trigger Event will occur if the Reserve Bank or a statutory manager directs ASB to convert the capital notes into shares or write off the notes. This might occur if ASB encounters severe financial difficulty. Clearly these securities are more complex than term deposits or fixed-rate, fixed-term bonds. The questions investors need to ask include "does the return compensate me for the extra risk?" and "what is the chance of a major trading bank facing financial difficulty?"

The interest rate payable on the notes for the first five years will be a combination of the five-year swap rate plus the margin. The indicative margin is 2.70% to 2.85% and will be announced on or before the Opening Date. Once set the margin will not alter over the term of the notes. Based on the current five-year swap rate (2.30%) the notes should return between 5.00% and 5.15% for the first five years. If not repaid in 2021 the interest rate will be reset based on the five-year swap rate at that time, plus the margin. The notes have a BBB+ credit rating from Standard & Poors and will pay interest quarterly in March, June, September and December.

- Opening Date – November 3rd
- Closing date – November 25th
- Maturity date – December 15th 2026

<u>Call the office as soon as possible if this offer is of interest to you.</u>

Repairs & Maintenance

This time last year I had surgery on a badly damaged shoulder. Unfortunately I have torn tendons in my other shoulder and will be having it operated on this Friday. 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. Please don't hesitate to ring. On the subject of appointments could I please ask if you are coming to see me that you phone the office first to make a time that suits? I often meet clients away from the office and can't always guarantee I will be available if you drop in.

Share Values

Without doubt the consistently low interest rates have been the catalyst for rising share prices in New Zealand and overseas. As returns have decreased on bonds and bank deposits investors have sought returns elsewhere. We can see the hunt for yield reflected in the P/E (price/earnings) multiples of individual companies. The P/E ratio is a measure used to compare companies and is the company's share price divided by its earnings per share. It is a measure of the confidence investors have in the future of a company. The higher the P/E ratio the more you are paying for each dollar of earnings.

If we look at the Kiwi Property Group as an example we see their long-term average P/E is around 14. Investors historically have been prepared to pay $14 for each $1 generated in earnings. If we assume their total earnings are paid out in dividends your $14 investment would be yielding just over 7%. Kiwi Property Group's current P/E ratio is around 18, which equates to a yield of around 5.50%.

It seems logical that as interest rates drop P/E ratios will rise (all other things remaining equal). As the reference point for risk falls, the price of comparative assets increases. In theory the opposite should apply – when interest rates rise will we see P/E ratios fall (via a drop in share prices)? I think investors should be realistic – the incredible run the sharemarket has had over the last six years will not go on forever, and interest rates will play a vital role in any adjustments in the future.

Portfolio Administration

Are you having trouble with the share registries sending your financial information via email rather than post? Are you spending hours searching for financial information for your accountant at the end of each financial year? If so Bramwell Brown can help. We offer a portfolio administration service where we handle all the mail associated with your portfolio and liaise with your accountant at the end of each year. Call the office if you would like to discuss this service.