

BRAMWELL BROWN LTD

INVESTMENT ADVISERS – BROKERS

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Compliance

Since taking over this business in 2008 the compliance workload has increased exponentially. The Code of Professional Conduct for Financial Advisers placed strict (and necessary) requirements on advisers around competence and continuing professional development. The Anti Money Laundering and Countering Financing of Terrorism Act has increased our workload dramatically. The Financial Services Legislation Amendment Bill is before Parliament now and will add another level of compliance. Annual returns, audits, professional development courses, travel, and the sheer volume of reading required to keep pace with the changing compliance landscape is time-consuming and expensive. At some stage these increased costs have to be passed on. I've always attempted to absorb increased costs; however it has reached a stage where this is no longer possible. Brokerage rates will remain the same, however ongoing personalised advice fees and some portfolio administration charges will have to increase this year. I will write to those affected individually.

Fees

Having just suggested that you can expect an increase in fees I thought it would be worthwhile pointing out the level of fees that most financial planners charge. Here is a typical schedule of charges – some charge up to 2.00% per annum.

Investment Amount	Adviser Fee	Administration Fee	Total Fee
First \$500,000	1.10% per annum	0.35% per annum	1.45% per annum
\$500K to \$1million	1.00% per annum	0.30% per annum	1.30% per annum
\$1million and over	0.80% per annum	0.25% per annum	1.05% per annum

If you had \$500,000 invested you would pay \$7,250 per annum in fees, plus brokerage for the trades conducted throughout the year. These fees must come from tax-paid income; therefore the investor is giving up the first 1.80% to 2.40% of returns depending on their marginal tax rate. This level of fees is common amongst the major financial planning chains, and some justify the charges by providing twenty-page reports every quarter. I am extremely cynical about the fees charged by the financial planning firms. In most cases there is very little management required once shares or bonds are bought.

My philosophy is to buy good companies and hold them for long periods, and in most cases bonds are bought and held until maturity. Therefore we shouldn't need to be managing client portfolios on a daily or weekly basis. Furthermore the level of fees charged on large portfolios is hard to justify in my view. An investor with \$2 million in their portfolio will pay \$21,500 per annum in fees based on the previous table. It does not cost advisers twice as much to administer \$2 million as opposed to \$1 million in my opinion.

At Bramwell Brown Ltd we offer a portfolio administration service where we handle all the paperwork relating to a client's investments. We receive all communications from individual companies including interest and dividend notices, annual reports, offers of securities, and voting papers. Interest and dividends can be banked to your own account or can be processed through our trust account to call accounts we hold at the ANZ Bank in your own name. We liaise with your accountant at balance date and we report on your portfolio twice a year. We have a very reasonable upper limit on fees charged, which is attractive for those with larger portfolios. This service is ideal for those people who are away from home for long periods of time, or those who simply don't want to attend to the paperwork that goes with the investments they hold. Call the office if you would like to discuss this service.

The Secondary Bond Market

The listed bond market behaves in a very similar manner to the share market, yet still remains a mystery to many. I regularly speak at a money management course in Masterton, and the concepts around yields and prices always seem difficult to grasp for most. I'll attempt to clear things up for readers by comparing the behaviour of a bond in the secondary market to that of a share. Let's look at Argosy Property Limited. It's current share price is \$1.10 and the last 12 months dividend is 6.2 cents.

If we ignore the tax or brokerage implications we can say that at a price of \$1.10 an investor will achieve a yield (or return) of 5.64% (6.2 cents divided by \$1.10) if they invest in Argosy shares. Now let's assume that Argosy's dividend is not going to change in the next few years. I know this is unlikely, and dividends can change at any time, but stick with me for now. What happens to the return of a new investor if they have to pay a different price for the shares? The table below shows your new yield at various purchase prices.

Argosy Share Price	Dividend	Yield
1.00	0.062	6.20%
1.04	0.062	5.96%
1.08	0.062	5.74%
<u>1.10</u>	<u>0.062</u>	<u>5.64%</u>
1.12	0.062	5.54%
1.16	0.062	5.34%
1.20	0.062	5.17%

You can see that as the share price increases, a new investor's yield decreases and vice versa. This is an inverse relationship – as one goes up the other goes down. Bonds behave in a very similar manner – the relationship between the price you pay for a bond and the yield (return) on that bond is inverse.

We can relate our understanding of the returns on Argosy shares to that of a bond trading in the secondary market. The big difference between shares and bonds is the measure we use to describe their value. With shares we use price. For example, we would say Argosy has climbed 2 cents today to \$1.10. We wouldn't tend to say Argosy's yield has dropped 0.10% today to 5.64% (see the previous table), but in fact that statement describes the same 2 cent movement in the Argosy share price. And this is the method used to describe the movement in bond prices – by the change in their yield.

We will look at the Infratil bond that is maturing on September 15th 2023. It has a coupon (interest rate) of 5.25% per annum, and this does not change for the lifetime of the bond. If you had purchased this bond when it was issued you would have paid \$1 per bond and you would receive 5.25 cents per annum in interest. At maturity you receive your \$1 back. Your yield would be 5.25%. The table below shows the new price at various yields if the bond was to be traded in the secondary market (much the same as buying or selling Argosy shares). Remember whoever buys this bond, no matter how much they pay for it in the secondary market, will receive from Infratil 5.25 cents per annum in interest, and will be repaid \$1 per bond of principal in 2023.

Yield	Interest Payment	Infratil Bond Price
4.50%	0.0525	1.0340
5.00%	0.0525	1.0110
<u>5.25%</u>	<u>0.0525</u>	<u>1.0000</u>
5.50%	0.0525	0.9889
6.00%	0.0525	0.9671

Let's assume a new purchaser is happy to buy this bond but wants a return of 6%. They would only pay \$0.9671 for the bond. They would receive 5.25 cents in interest, and would receive \$1.00 in principal at maturity. Even though they receive the same interest payments throughout the life of the bond, the fact that they receive more than their purchase price back at maturity means their return is higher.

You can disregard the maths – you can't simply divide the interest payment (5.25 cents) by the price (0.9671) to work out the yield. This is because a large part of the overall return is generated by the difference between what is paid for the bond (0.9671) and what is received at maturity (\$1.00). Entire university papers are dedicated to working out a bond's yield to maturity – luckily we have bond calculators that can do it for us. The important thing to understand is that (like shares) if the yield on a bond purchased in the secondary market is to increase, then the price must decrease, and vice versa.

Secondary Market Bond Yields

Here is a selection of commonly traded bonds listed on the New Zealand exchange. Every bond is trading at a yield below its initial interest (coupon) rate. Therefore, anyone buying these bonds in the secondary market will pay more than \$1 for each bond.

Company	Coupon	Maturity Date	Yield
Goodman Property Trust	6.20%	December 2020	3.10%
Sky TV	6.25%	March 2021	4.32%
Wellington Airport	6.25%	May 2021	3.28%
Infratil	4.90%	June 2021	4.40%
Kiwi Income Property Trust	6.15%	August 2021	3.34%
Z Energy	4.01%	November 2021	3.65%
Trustpower	5.63%	December 2021	4.00%
Goodman Property Trust	5.00%	June 2022	3.52%
Infratil	6.85%	June 2022	4.20%
Heartland Bank	4.50%	September 2022	3.65%
Trustpower	4.01%	December 2022	3.80%
Infratil	5.65%	December 2022	4.37%
Meridian Energy	4.53%	March 2023	3.60%
Summerset	4.78%	July 2023	3.85%
Infratil	5.25%	September 2023	4.64%
Kiwi Property Group	4.00%	September 2023	3.75%
Z Energy	4.32%	November 2023	3.90%
Investore	4.40%	April 2024	4.12%
Infratil	5.50%	June 2024	4.90%
Kiwi Bank	6.61%	July 2024	4.00%
Precinct Properties	4.42%	November 2024	4.11%
Kiwi Property Group	4.33%	December 2024	3.97%
Wellington Airport	5.00%	June 2025	4.00%
Infratil	6.15%	June 2025	5.00%
BNZ Capital Notes	5.31%	December 2025	3.90%
ASB Capital Notes	5.25%	December 2026	3.99%
Westpac Capital Notes	4.69%	September 2026	3.93%
NZX	5.40%	June 2033	4.33%
Mercury NZ Limited	6.90%	July 2044	4.05%