

# BRAMWELL BROWN LTD

## INVESTMENT ADVISERS – BROKERS

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### **Bramwell Brown Limited – Newsletter – June 2019**

#### **Infratil to Buy Vodafone**

Infratil has announced that it has executed a conditional agreement to purchase Vodafone New Zealand in partnership with Canadian investment firm Brookfield Asset Management. Infratil has invited shareholders to help fund the purchase by participating in a pro-rata entitlement offer. Shareholders have the right to purchase one new share in Infratil at \$4.00 for every 7.46 shares currently held. The offer seeks to raise \$300 million.

Infratil has a very good track record as a manager of infrastructure investments and has been a good long-term investment for shareholders. It owns 51% of Trustpower and Tilt Renewables along with interests in Australian companies Longroad Energy and Perth Energy. It owns 66% of Wellington Airport and 100% of NZ Bus and Snapper. It also has various other interests in Australia including data management, retirement villages, schools, and hospitals. Infratil sees the purchase of Vodafone as an exposure to high conviction trends surrounding data growth and future communication models.

The offer is non-renounceable, which means you are not able to sell your rights to new shares to somebody else. You have three options, take up your entitlement in whole, take up your entitlement in part, or do nothing. If you do nothing your shares not taken up will be offered to eligible institutional shareholders through a bookbuild. Any premium achieved above the \$4.00 offer price will be paid on a pro-rata basis to those shareholders who chose not to take up their entitlement.

#### Timeline:

Retail Entitlement Offer opens	Thursday May 23 <sup>rd</sup>
Retail Entitlement Offer closes	Tuesday June 11 <sup>th</sup>
Results of Retail Bookbuild announced	Thursday June 13 <sup>th</sup>
Settlement of Retail Bookbuild	Tuesday June 18 <sup>th</sup>
Trading of new shares on the NZX	Tuesday June 18 <sup>th</sup>

**CONTACT THE OFFICE IF YOU WOULD LIKE TO DISCUSS YOUR OPTIONS**

## **Exchange Traded Funds**

I attended a seminar hosted by the NZ Stock Exchange in May on exchange traded funds (ETF's). We have been using ETF's in client portfolios for many years, however recently they have become increasingly popular. An ETF is an investment fund traded on the stock exchange that holds assets such as shares, bonds or commodities. They are popular due to their relatively low fees, and the diversification they offer. Most ETF's track an index, and are often referred to as index funds. For example the Smartshares Top 50 fund (FNZ) listed on the New Zealand Stock Exchange tracks the Standard & Poors NZX 50 Index. The fund is made up of the fifty largest companies listed on the New Zealand Stock Exchange, but with a 5% cap on any one holding.

What is an index? An index is a hypothetical portfolio of securities that represents a portion of a market. It is designed to be able to measure the changes in that market over time. One of the most widely recognised stock market indices is the Dow Jones Industrial Average. The Dow is made up of 30 companies trading on the New York Stock Exchange, and is widely reported when markets are rising or falling. In the UK you might have heard of the FTSE Index, which tracks the largest 100 companies listed on the London Stock Exchange. In Japan it's the Nikkei, which measures 225 large companies on the Tokyo Stock Exchange.

How does an index fund work? We can use the Dow Jones Industrial Average Index as an example. The 30 companies that make up that index at any given time is public knowledge. Companies include Apple, Boeing, Caterpillar, Coca Cola, Microsoft, and Nike. A fund manager who wants an investment vehicle that tracks the index will buy shares in those 30 companies, and then sell units to investors. Your investment in the fund is always going to mirror the performance of the index. State Street Global Advisors is one of the world's largest fund managers and operates a large number of ETF's under their SPDR brand. You can buy their DIA fund, which tracks the Dow Jones Industrial Average Index on the US Stock Exchange.

Why buy an index fund? The main benefit is the diversification they offer. When you buy an ETF you are buying a wide range of securities through that one investment. For example if you buy the NZ Dividend fund (DIV) on the NZX you are purchasing the 25 highest dividend paying companies on the New Zealand market. In addition, the administration involved with one holding must be simpler than with 25 separate holdings. Brokerage costs might also be less if you are investing small sums. Purchasing one share would be more cost effective than buying 25 small parcels of individual shares. You also have the ability to invest in a theme. For example you might be interested in emerging markets, electric vehicles, healthcare, gold or China. Rather than trying to purchase individual shares to gain exposure to those themes you could invest in an ETF that will hold many different shares matching the index that relates to that market.

Disadvantages include the management fees. All ETF's incur fees, however because most funds are passively tracking an index the fees are usually very low in comparison to actively managed funds. An active fund manager that is picking stocks to include in a fund, and buying and selling based on their view of companies and markets might charge from 1% to 2% per annum in management fees. An ETF that simply holds the stocks represented in an index will have much lower fees. The Smartshares Dividend Fund has an annual fee of 0.54%. The very large ETF's like iShares and SPDR's have fees as low as 0.02%. The iShares S&P 500 fund (CSSPX), which tracks 500 large US companies has a management fee of 0.07%.

Another disadvantage is that you don't get to choose the holdings in the fund. The fund is comprised of whatever companies are represented in the associated index. For example you may want exposure to American technology companies. You could buy IGM on the US exchange, which is the iShares ETF that tracks the Standard & Poors North American technology sector index. However you may be opposed to owning Facebook following the controversy surrounding the publication of the March 15<sup>th</sup> terrorist attack. Unfortunately you don't have the ability to exclude Facebook from the fund.

Active fund managers will always claim that you are better off to pay them 1% to 2% per annum to choose individual stocks that will perform better than the market. However, at the NZX seminar we were presented with compelling evidence that showed very rarely do active fund managers regularly beat the market after fees. Individual circumstances will dictate whether an investor is better to buy an ETF or buy a basket of shares directly. Investors with large sums of money are in a position to buy individual stocks and therefore avoid the fees charged by ETF's, however if you are wanting exposure to a sector comprising hundreds of separate holdings an ETF is a very good way to gain that exposure.

New Zealand's ETF's are run by Smartshares, a division of NZX. They are about to bring eight new funds to the market in partnership with BlackRock. BlackRock's iShares is a leading global ETF provider, with almost \$2 trillion in assets under management. Some funds will have exposure to global companies that score highly in environmental, social and governance (ESG) factors, with companies screened for exposure to thermal coal, weapons, tobacco and other controversial industries. Other funds track automation and robotics, global bond, and healthcare innovation indices.

I would encourage investors to research ETF's, and the following links should be helpful. Call the office if you have any questions.

NZX Smartshares <https://smartshares.co.nz/>

BlackRock iShares <https://www.ishares.com/us>

S&P Dow Jones Indices <https://us.spindices.com/index-literacy/>

## **Rabobank Capital Securities**

Rabobank has announced it will be redeeming its preference shares (RCSHA) at the next reset date (June 18<sup>th</sup> 2019). The preference shares were issued in 2009 and were designed to have their rate reset every five years until 2039. At the time of issue Rabobank had the right to redeem the shares on the ten-year anniversary, and they have elected to do that. Holders of the notes will be repaid in full on June 18<sup>th</sup>.

## **Mercury Bonds**

Mercury Energy has announced it will be refinancing its capital bonds (MCY010) at the next reset date (July 11<sup>th</sup> 2019). The bonds were issued in 2014 and were designed to have their rate reset every five years until 2044. Holders of the bonds will be contacted closer to the time with the opportunity to reinvest under the new terms, or have their money paid back.

## **Kiwi Capital Bonds**

Kiwi Capital Funding has announced it will be redeeming its subordinated notes (KCF010) at the next reset date (July 15<sup>th</sup> 2019). The notes were issued in 2014 and were designed to have their rate reset every five years until 2024. At the time of issue Kiwi Capital Funding had the right to redeem the notes on the five-year anniversary, and they have elected to do that. Holders of the notes will be repaid in full on July 15<sup>th</sup>.

## **Interest Rates**

With all of these fixed interest securities being redeemed investors will again be looking for a home for their funds. The three securities mentioned above are paying 8.34%, 6.90% and 6.61% respectively. Unfortunately those rates are now a thing of the past, and reinvestment rates are more likely to be between 3% and 4%. There is a tendency for investors to hold funds in cash until interest rates improve, however I would discourage this. The long-term outlook for interest rates is a continual decline, and I think investors should continue to roll over their maturing fixed interest at prevailing rates. Holding funds in cash based on an expectation that rates will improve indicates we can predict the future – unfortunately, we can't.

## **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.