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Investment Advice ***Sharebroking*** ***Managed Funds*** ***Fixed Interest*** ***Property*** ***Company Formations*** ***Trade Mark Registration***

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Investment Directions **28 April 2015**

"Analysis to action. Opportunities to outcomes"

In this Issue

1. **Overview** – US shares resume upward momentum in April on quarterly earnings results and record margin trading. Australia attempts to follow but New Zealand falls short. NZD/AUD strong rise ends short of parity as iron ore and AUD rally. Urban NZ economy booms. China acts to limit share price bubble. Global growth rotating from US and China to Europe. Leading economic data still positive but high margin trading figures in US and China cause concern. Central bank interest rates in US, Australia and NZ likely to stay on hold until late 2015.

2. **Equities** – Fliway Group fails to fire on listing. Final payment for Meridian shares due 15 May. Spin-off of South 32 from BHP may result in tax impost for New Zealand BHP shareholders.

3. **Interest rates, bonds and debentures** – Deposit rates still falling. Best fixed term deposit rates from major deposit takers.

4. **Strategy** – High yielding shares, bonds and listed property purchased over a year ago now producing sound results but reinvestment of maturing funds difficult. Entitlement to special issues from directly held shares provide useful avenue. Best to retain cash when no suitable reinvestment opportunities available. Attention swinging to Australian small cap growth stocks. High risk capital notes being avoided. Portfolios manage positive growth in March despite higher NZ dollar and lower Australasian shares.

First pictures from Dawn, as it swings into polar orbit around Ceres, show the bright spots coming back into view. http://dawn.jpl.nasa.gov/ . Later analysis by on-board instruments should reveal if Ceres really does hold huge quantities of water.

1. Overview

US shares rose during April as fears of a poor quarterly earnings season receded. Major companies' earnings beat reduced forecasts even though S&P 500 companies saw earnings fall 4.6%. Earnings per share forecasts for 1Q15 have been reduced by 8.2% since the start of the year due to the strong US dollar and poor electronics company results. Healthcare and financial sectors are still expected to post gains but materials and energy should be laggards. Analysts expect S&P 500 earnings to recover well in 2016, forecasting a rise of US$135/US$118.75, or 13.7%, but earnings estimates often get revised downwards with time. In the short term, US economic growth is slowing. Private sector jobs grew by only 189k in March compared to 225k expected while PMI fell to 51.5 compared to 52.5 expected – the fifth month in a row of decline in manufacturing. A high US dollar impacts the ability of US manufacturers to export. Such data should push any US Fed intentions of higher interest rates further out towards late 2015 at the earliest.

The New Zealand dollar fell quickly on 23 April after RBNZ Assistant Governor John McDermott said the Reserve Bank was not considering an OCR rate rise at present. Although hardly new news, speculators took the statement as a signal to back the NZD away from parity with the AUD. The NZD/USD declined from .7625 to .7568 while the NZD/AUD fell to .9756 from a close of .9944 on 21 April. But the good times roll on – at least in the cities and despite the fall in dairy prices. In March, new vehicle registrations reached their highest since 1984 (daily, transporters choke Wairau Valley car zone streets, offloading hundreds more to add to the total) petrol is cheap as are overseas holidays. Auckland diners pack hundreds of fine dining establishments any night of the week. A $100 billion construction industry boom has seen the Building Construction Industry Training Organisation instigate an apprenticeship drive to meet skilled demand in one of the fastest growing sectors of the economy – predicted to grow at 3.2% p.a. until 2017 at least.

Strangely, although mainstream media highlights cheap holidays and cars, we hear no suggestion that individuals should use the good times and high NZ dollar to buy back assets “sold off” to wicked overseas buyers in tougher times. Keenness for repurchase is limited to certain voters and politicians coincident with the 3 year electoral cycle - and then only with other people’s money.

The Australian dollar broke out of its long downward trend to gain against major currencies on news of a 16% rally in iron ore prices over the past 10 weeks and following weak new home sales and poor manufacturing index data out of the United States. Market expectations of an OCR cut by the RBA in May have decreased from 75% a week ago to just 50%. Continuing recovery in the iron ore price may well influence the RBA to keep its OCR on hold at its May announcement. Better Australian jobs data, retail sales and higher than expected Q1 inflation, backed by booming house prices in Sydney and Melbourne, all add pressure on the RBA to leave the OCR alone at 2.25%. Should it do so, expect the AUD to post further gains against both the NZD and USD.

Gold continues to look weak as markets still await firm indications of a first interest rate rise by the US Federal Reserve. Such a rate rise, when it does eventuate, should prove negative for the non-income producing metal. Uncertainty over timing of the next US interest rate rise means expectation of the rise may not be fully built into the current gold price, leaving room for further falls once the Fed does take a more definite interest rate stance. Recent price volatility has been attributed to a US$1 billion gold sale (“Swap”) between Venezuela and Citibank with Citibank possibly then hedging its new physical holdings by selling gold futures contracts, i.e. going short in the futures market. Should the gold price fall, Citibank would lose value on its physical gold but gain on its short position in the futures market, compensating for the loss.

China’s securities regulator has reacted to the Country’s booming sharemarket by warning investors not to sell real estate or speculate on shares with borrowed money. The Shanghai Composite Index has gained 110% in 10 months with a 28% surge in just 7 weeks to 20 April. According to the Shanghai Stock Exchange, margin trading account balances reached 1.16 Trillion Yuan (US$187 B) on Thursday, 9 April. “Umbrella Trusts”, enabling margin trading and share lending by managed funds to facilitate short selling, have been banned. Chinese investors are reportedly rotating out of small caps, where P/E ratios have reached 50, into neglected blue chips where P/E for the top 50 is just 15. To help boost business lending, China’s Central Bank has lowered the Required Reserve Ratio for banks by 1% to 18.5%. China’s Flash Manufacturing PMI fell to a 12 month low of 49.2 in April. A figure below 50 signifies economic contraction.

Ongoing efforts to “internationalise” the Yuan should see China’s central bank soon relax foreign investment controls, allowing private Chinese citizens to invest up to US$2 million abroad without having to obtain regulatory approval. This follows a similar relaxation for Chines companies earlier that led to a record US$84.4B overseas investment in 2014. Chinese insurance companies were granted investment freedom back in 2012, leading to a surge in property purchases in western cities such as New York, London and Sydney. While helping China’s currency gain acceptance as a medium for international trade, relaxation of offshore investment controls also aims at taking pressure off the limited investment options of house property and shares within China itself.

Europe looks set to be a winner from a rebalancing of global economic growth with European equities rising after prospects for massive QE from the ECB slashed the Euro in value. Euro area Flash PMI rose to 54.1 in March from 53.3 in February. The Euro now looks to have found a floor as demand for European equities grows along with demand for the currency with which to buy them.

Keeping our finger on the pulse of major Leading Economic Indicators (LEI) and other leading data:

	Latest	Mar 15	Feb 15	Jan 15	Dec 14	Nov 14	Oct 14
3 month LIBOR (end of month)	.27700	.27075	.26160	.25460	.25520	.23435	.23210
TED Spread (points)	.27	.24	.25	.23	.22	.21	.22
VIX equity volatility	12.29	15.29	13.34	20.97	19.20	13.33	14.03
US LEI		+0.2%	+0.1%	+0.2%	+0.4%	+0.3%	+0.6%
Japan LEI			+0.2%	+0.0%	+0.1%	+0.6%	+0.2%
Eurozone LEI			+0.7%	+0.3%	+0.4%	+0.2%	-0.1%
Australia LEI				+0.4%	+0.3%	+0.0%	-0.1%
United Kingdom LEI			+0.6%	+0.2%	+0.0%	-0.4%	-0.4%
China LEI		+0.2%	+1.4%	+0.6%	+0.9%	+0.8%	+0.8%
US Money Market Funds $T	2.588	2.634	2.692	2.702	2.733	2.688	2.629
US Gov. 10 year T-Bond (%)	1.92	1.93	2.00	1.68	2.17	2.194	2.34
Foreign holdings of US T-Bonds $B			6162.8	6217.9	6153.7	6112.4	6058.9
Margin debt, NYSE (US$ millions)		476,381	464.933	444,836	456,283	457,106	453,841
US M2 Money Stock (US$B)		11,846	11,820	11,701	11,625	11,562	11,511
Velocity of Money US M2					1.530		
Forward P/E S&P 500 (12 month)	18.05	17.62	17.55	17.01	17.25	17.15	16.25
Trailing P/E S&P 500 (12 month)	20.98	20.52	20.53	19.71	19.67	19.27	18.43
Total Put/Call options ratio CBOE	0.76	1.13	1.01	1.10	1.22	0.99	0.775
S&P 500 Share Index	2117.69	2067.89	2104.50	1994.99	2058.90	2067.56	2018.05

Nothing in our fundamental data table indicates a sharp sharemarket reversal is imminent or even likely in the short to medium term. Figures of interest this month include strong leading economic indicators in Europe and the UK – consistent with a "global growth rebalancing" – theme, while leading economic indicators in the US and China ease off. An ever-growing level of margin debt fuels the New York Stock Exchange based on copious quantities of accessible and cheap money from past QE in the US and present QE programmes in Europe, Japan and China. High levels of margin debt hold the potential for a sharp reversal in equity prices should a sudden tightening of credit result in widespread margin calls, but for now credit is about as loose as it could be. Investor confidence in US sharemarkets is reflected in the low VIX volatility and very low Put/Call options ratio.

US M2 money stock growth was only 0.22% in March, compared to 1.02% in February and around 0.5% per month for the previous 6 months. In more normal times, high M2 money stock growth is seen as a harbinger of rising inflation but massive QE money creation programmes ensure current times are not "normal". Over the past three years, US M2 has grown 21% but consumer price inflation has increased by just 2.9% in a slow growth economy. Should growth slow further and M2 growth stagnate, the US Fed could yet be forced into another round of QE stimulus.

2. Equities

Fliway Group (NZX:FLI) made its NZX debut on April 9th easing slightly from the $1.20 issue price on the first day indicating little latent demand for the issue was held by lead broker Forsyth Barr to help shore up the price on listing . The $1.20 issue price was set by bookbuild at the low end of the indicative range implying institutional investors were less than impressed with the bulk of funds being raised in the IPO going straight into pockets of the selling shareholders. Despite the negative IPO as covered by Investment Directions last month, Fliway Group does hold some attraction and remains one to watch.

Holders of **Meridian Energy Instalment Receipts (NZX:MELCA)** as at 4 May 2015 will be required to meet the final call of 50 cents per receipt before 15 May in order to receive the fully paid shares. The MELCA price has been pushed down as the payment date approaches, so now is not a good time to be selling the partly paid shares. Before the IPO in 2013 much discussion centred on the possibility that major Meridian customer, Tiwai Point Aluminium Smelter, could close in 2017. The high New Zealand dollar and low (but recovering) aluminium price mean closure remains a real possibility but, according to analysts, the most recent contract for electricity supplied to Tiwai Point has been set at a price so low that closure would have very little effect on Meridian's revenue. Meridian produces about 30% of New Zealand's electricity, overwhelmingly from the big South Island hydro stations. Hence profitability may be subject to volatility from year to year as water inflows vary.

If MELCA holders fail to meet their final payment call, their underlying shares could be sold to meet the payment and expenses with any shortfall remaining a liability of the MELCA holder.

The key dates and conditions of the conversion to fully paid shares as well as payment methods can be seen here http://www.treasury.govt.nz/statesector/soes/meridianenergyinstalmentreceipts

Meridian has paid ordinary and special dividends above the level forecast in the IPO, in addition to which the Company is targeting a progressive return of another $625m over the next 5 years through increased dividends and/or on-market buy backs. At the theoretical ex-final payment price of $2.40, cash dividend yield should be around 5.8%. Return of capital could increase the yield further. The high dividend yield and expected reliable income of the new MEL shares should see the price rebound a little after the final payment date.

Shares in **BHP Billiton (ASX:BHP)**, Australia's big and efficient iron ore miner, jumped 12% in just one week to 27 April as iron ore recovered 21% to US$57 per tonne from a low of US$47.08 3 weeks ago. So great is BHP's global influence that the recovering iron ore price is attributed, at least in part, to the big miner's decision to defer construction of its A$2 billion Port Hedland expansion project. However, BHP is keeping to its target of producing 290 million tonnes of iron ore per year through improved efficiency of existing resources. With an historically high dividend yield forecast of around 5%, BHP shares should benefit quickly from any ongoing improvement in the price of iron ore.

The big three highly efficient global iron ore producers – BHP, Vale and Rio Tinto **-** are widely suspected of using the current oversupply and low prices to force less efficient smaller operators out of business. Atlas Iron, Australia's fourth largest iron ore producer, has already been forced to cease mining operations after its mines became untenable with the low ore price.

As reported here last month, subject to a shareholder vote, BHP shareholders will receive 1:1 free shares in South 32**,** being spun off from BHP to hold the less attractive mining divisions including manganese, silver, base metals, aluminium, alumina and coal, together valued at about A$12 billion. Apparently the issuance of shares in South 32 will be structured as a "demerger dividend" with Australian taxation franking credits attached which are not claimable in New Zealand. Hence New Zealand BHP shareholders may incur a taxation liability at their marginal tax rate even though they have received no income or theoretical increase in value – just a split in their existing capital. The New Zealand Shareholder's Association is requesting that the IRD recognise the "functional effect" of the demerger and avoid the imposition of tax. There exists at least one precedent for special tax treatment of shareholders in a specific company. In 2007, GPG shareholders received a 5 year exemption from introduction of the "fair dividend rate" method of taxing foreign shareholdings. A response to the Shareholder's Association request is expected within the week.

3. Interest rates, bonds and debentures

UDC has reduced deposit rates by 0.05% for terms 12 months and above. Fisher and Paykel Finance lowered deposit rates up to 0.5% p.a. on 30 March with the 5 year term reducing from 5.80% to 5.30% for amounts over $25k.

Heartland Bank has a special 4.50% p.a. for 12 months.

Current deposit rates, % p.a.:

Issuer	$ min	Call	3mth	6mth	9mth	12mth	18mth	24mth	36mth	48mth	60mth
F&P Finance	1000	3.65	3.85	4.35	4.60	4.85	4.90	5.05	5.25	5.45	5.65
F&P Finance	25,000	3.65	4.00	4.50	4.75	5.00	5.05	5.20	5.40	5.60	5.80
Heartland Bnk	1000	3.75	3.80	4.40	4.35	4.50	4.55	4.65	4.90	5.00	5.15
Heartland Bnk	20,000	3.75	3.90	4.40	4.45	4.50	4.65	4.75	5.00	5.10	5.25
Liberty Fin.	5,000		4.05	4.65	4.85	5.35	5.80	6.05	6.55	6.70	6.75
Liberty Fin.	20,000		4.20	4.80	5.00	5.50	5.95	6.20	6.70	6.85	6.90
UDC Finance	5000	3.45	3.90	4.20	4.25	4.35	4.35	4.35	4.35	4.35	4.40
UDC Finance	100,000	3.95	4.00	4.30	4.35	4.45	4.45	4.45	4.45	4.45	4.50

Heartland Bank occasionally offers existing depositors a small margin above normal rates for certain terms. Check with Canopus for their latest specials.

For the full range of debenture stock interest rates and credit ratings visit Debex at
http://www.debentures.co.nz/debenture_stock.html

Canopus advisory clients receive a full rebate of any brokerage paid on term deposits. This can add up to 0.5% per year to the deposit rates tabulated above.

Contact me for copies of investment statements and application forms alan@canopus.co.nz
or telephone 09 444 8055. No brokerage is payable by investors on applications made through Canopus.

4. Strategy

Of the two major opposing forces acting on global equity prices – negative expectation of US interest rate rises and positive central bank money creation – the latter dominates for now. Despite significant volatility early in the year, major global share markets have settled into a steadier upward trend at a time of year often marked by global equities weakness. Even Australia and New Zealand, positively out of sync with the US in the first quarter, seek to play catch-up as May approaches.

We stay alert for any signs of a sudden tightening of credit – especially in the US – where credit tightening coupled with an initial fall in the indices could well lead to margin calls on the record high level of margin debt employed to fund NYSE stock purchases. A rapid fall in US share prices would be the likely result.

Staying committed to higher dividend equities and fixed term bonds has proven to be a sound strategy over the past three years. Although the international search for yield continues to drive up income-producing asset prices and we have maturing funds to reinvest, such reinvestment will not be pursued where the only available investment assets lack security and a respectable return. Capital Notes, recently on offer by big household name banks, may boast a coupon of 7% p.a. but in reality are high risk instruments, exposing the investor to possible non-payment of interest or even complete loss of investment capital through cancellation of the capital note if the bank should face insolvency.

Where no suitable opportunity exists to reinvest maturing funds, those funds will be held on deposit until such opportunity appears. In a diversified portfolio of directly held securities, useful reinvestment opportunities occasionally arise through offers from existing companies already held in the portfolio such as partly paid shares, in-the-money options and warrants or preferential access to new issues of bonds and shares. In a time of low interest rates and high asset prices, these special situations do have a significant positive impact on portfolio returns.

On the surface, a high New Zealand dollar provides the opportunity to expand portfolio diversification offshore but again, little value is likely to accrue where asset prices are simply too high. Our portfolios have benefited from a few special issues by directly held Australian shares and some ASX listed securities are now cheaper in NZ dollar terms than they were six months ago. High share prices for blue chips mean we are now more likely to find value in a few under-researched growth oriented shares in the small and mid-cap range.

For investment outside Australasia we prefer to utilise listed trusts and investment companies. Such vehicles are easily purchased and sold (high liquidity), NTA value is readily available along with performance history. However, we have to accept that this asset class in our portfolios is likely to simply meet market performance over time.

Both our published diversified income and diversified growth portfolios managed incremental gains of less than 1% in March – satisfactory considering the month recorded a further 1.26% rise in the NZD/AUD exchange rate and 1% falls on the ASX and NZX.

Click this link to see charts http://www.canopus.co.nz/investment_advice.html#returns

Please note that I cannot make application for new issues of bonds or shares, trade securities on your behalf or provide personal investment advice unless you have a sharebroking account opened through Canopus.

Contact me if you would like to open an account alan@canopus.co.nz or telephone 09 444 8055.

To discuss building a diversified, low volatility personal investment portfolio designed to produce income, growth or a combination of both, contact me by email at alan@canopus.co.nz or telephone 09 444 8055.

Please note – Canopus does not pool investor funds. Each Canopus investor is treated as an individual with a personal customised investment portfolio being built to suit the investor's requirements. Investments are registered in your own name greatly enhancing returns, security and transparency while providing access to valuable special issues and minimising management fees. Individual voting rights attached to securities are retained by the investor. Uncommitted portfolio cash is held in the investor's own personal bank account with full online banking facilities. High liquidity of investments means the investor has ready access to funds if needed. Ultimately, the investor remains in control of the portfolio.

Regards,

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Financial Adviser Disclosure Statement available on request, free of charge.

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