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

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Investment Directions **27 August 2015**

"Analysis to action; opportunities to outcomes"

In this Issue

1. **Overview** – Global equities hit by sharp sell-off as Chinese markets retreat but well-diversified portfolios little affected. Dow Jones Industrial Average drops 1000 points in 10 minutes. Influence of margin trading overlooked by media. More volatility expected before markets settle. Market expectations of higher US interest rates pushed out to December. Leading economic indicators of major economies declining.

2. **Equities** – Blue chip shares on sale but no hurry to invest.

3. **Interest rates, bonds and debentures** – Deposit rates still falling. Latest investment rates from major deposit taking institutions. Latest bond issues not useful.

4. **Strategy** – Sharp global equities sell-off has only minor effect on portfolio unit values and no impact on expected income. Time to consider new equity purchases but need to conserve some cash for known special opportunities.

Space News

New Em drive propulsion system has potential to revolutionise space travel, cutting travel time to planets to weeks and months instead of years. See interview with British inventor Roger Shawyer at https://www.youtube.com/watch?v=4hTdSg47h3k . A convincing demonstration can be seen at https://www.youtube.com/watch?v=Rbf7735o3hQ

Even sharper images appear of Ceres as Dawn continues its programme from the third mapping orbit at an altitude of 1470 kilometres. Still no firm analysis of the famous bright spots in Occator crater. See latest reports at http://dawn.jpl.nasa.gov

1. Overview

Followers of mainstream media could be forgiven for thinking the world as we know it had approached destruction over the past week as daily writers employed wild descriptors such as "catastrophic", "disaster", "global systemic meltdown", "calamity", "implosion" and "turmoil" in desperate attempts to wrest headlines off their peers.

The reality, although undoubtedly tough on some, was much less dramatic for those holding well constructed investment portfolios.

The Shanghai Composite Index has, as at the time of writing, dropped 22.85% in the week to 26 August giving a total 43.34% retreat from its peak on June 12.

This fall was sufficient to shake global markets with the Dow Jones Industrial Average shedding 6.2% from 17 to 21 August, closing at 16,459.75. The following Monday, 24 August, the DJIA collapsed more than 1000 points on opening, possibly the sharpest major fall in the history of the index, but then partially recovered to close down 3.6% for the day at 15,871.35. As of 27 August, NZ time, a classic "dead cat bounce" has seen the DJIA recover to 16,287, but further weakness can be expected as more margin traders get wrung out of the markets. At these levels the Dow has eliminated over one year of gains.

On Tuesday, 26 August, China's central bank hurried to support markets by lowering interest rates again, this time cutting the 1 year rate by 0.25% to 4.6%. The "reserve ratio" of cash required to be held in reserve by banks was also cut by 0.5% in a bid to spur lending and reduce capital outflows from the country. China's manufacturing output fell in the first three weeks of August at the fastest pace since the Global Financial Crisis. The latest monetary moves are unlikely to be sufficient to put China on track to achieve the 7% growth targeted by China's Government or to boost Chinese sharemarkets, so more stimulus can be expected.

Australasian share markets didn't escape: the S&P/ASX 200 losing 7% in 3 days to bring total losses to 12.25% for the month of August but a sharp rebound on Tuesday 25th clawed back 2.6%.

NZX50 losses were more moderate, down 6.8% from its peak on 3 August and still just ahead for 2015.

Reasons cited for the sudden global sharemarket collapse centre on:

- Unexpected devaluation of the Chinese Yuan on 10 August.
- Concern over China's growth and scepticism over official growth figures.
- Falling commodity prices with lower demand from China, especially for crude oil.
- Failure of Chinese Government measures to prop up Chinese sharemarkets and wider economy.
- Concern the US recovery may be stalling.
- On-again, off-again signals from US Fed over "lift-off" for US interest rates.
- Resignation of Greek Prime Minister Tsipras with implications for Eurozone stability.
- Weakening currencies and failing growth of emerging economies.

Media reports make virtually no mention of the role margin trading plays in such rapid index reversals. Margin trading reached extreme levels just before Chinese markets plunged in June and appears to have then halved over the following two months although regular data is unavailable.

In the US, historical correlation between margin trading and the S&P 500 is striking. As pointed out here last month, NYSE margin debt reached unprecedented levels during April, May and June although the run up was much more steady and extended than the mainly inexperienced investor-led spike in China. Nevertheless, we can expect a similar unwinding of margin backed speculatory positions in New York before a measure of market stability returns. Figures are only published monthly with the next set only taking us up as far as July – hence no close correlation with the August S&P plunge should be expected. Unwinding of margin debt from a peak usually takes several months.

The USD fell sharply with respect to the GBP, Yen and Euro in concert with US share markets. The broader USD index retreated from 97 on 19 August to 94 on Tuesday 25th.

Expectations that the US Federal Reserve will start to raise interest rates in September have largely evaporated with "lift-off" now majorly forecast for December – but market consensus for any rate rise at all in 2015 is fading. At this stage a December rise in the target Federal Funds Rate still seems likely on balance because:

- The US economy is still managing a recovery, albeit irregular, with employment, retail sales and industrial output all improving.
- The US Fed is eager to start the move back towards more "normal" rates.
- The Federal Reserve will be keen to show that the US is still the world's dominant economy.

- The US Fed's credibility is at stake. Having long signalled a rates rise, further deferment would call current members' judgement (and possibly jobs) into question.
- The recent US dollar fall reduces the risk of overheating the greenback with higher interest rates.

A rebound in New Zealand dairy auction prices on 19 August generated some immediate interest in the Kiwi with the NZD lifting back over A$0.90 as the Australian currency weakened. Overall though, the NZD trend remains downward against the USD and Trade Weighted Index (TWI).

The New Zealand OCR was lowered to 3.00% on 23 July as expected while the Reserve Bank of Australia kept its OCR at 2.00% on 4 August – also as expected – with further indication the rate is unlikely to move in the near future as the RBA is satisfied with the labour market, economic growth and lower exchange rate. Australian tourism and service exports have risen over the past two years and profits in the non-mining sector have increased. Low interest rates are supporting housing development and consumption. The Australian economy remains vulnerable to slower growth in China and the recent (and possible future) Yuan devaluation.

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

	Latest	Jul 15	Jun 15	May 15	Apr 15	Mar 15	Feb 15
3 month LIBOR (end of month) %	.33160	.30860	.28175	.28275	.27875	.27075	.26160
TED Spread (points)	.26	.23	.27	.27	.27	.24	.25
VIX equity volatility	36.02	12.12	18.23	13.84	14.55	15.29	13.34
US LEI		-0.2%	+0.6%	+0.6%	+0.6%	+0.4%	-0.2%
Japan LEI			+0.4%	-0.2%	+0.0%	-0.4%	-0.1%
Eurozone LEI			+0.4%	+0.3%	+0.5%	+0.6%	+0.6%
Australia LEI			-0.2%	+0.2%	-0.3%	+0.0%	+0.7%
United Kingdom LEI			-0.2%	-0.4%	+0.3%	+0.2%	+0.7%
China LEI		+0.9%	+0.6%	+1.1%	+1.5%	+0.2%	+1.4%
US Money Market Funds $T	2.686	2.648	2.618	2.615	2.582	2.634	2.692
US Gov. 10 year T-Bond (%)	2.133	2.205	2.335	2.095	2.046	1.93	2.00
Foreign holdings of US T-Bonds $B			6175.2	6134.8	6137.3	6175.9	6162.8
Margin debt, NYSE (US$ millions)			504,975	499,143	507,153	476,381	464.933
US M2 Money Stock (US$B)		12,059	11,982	11,938	11,895	11,846	11,820
Velocity of Money US M2			1.494			1.501	
CNN Fear and Greed Index	3	9					
Forward P/E S&P 500 (12 month)	17.42	17.82	17.81	17.89	18.05	17.62	17.55
Trailing P/E S&P 500 (12 month)	21.63	21.18	21.52	21.47	20.98	20.52	20.53
Total Put/Call options ratio CBOE	1.26	1.00	1.10	1.15	1.05	1.13	1.01
S&P 500 Share Index	1867.61	2103.84	2063.11	2107.39	2085.51	2067.89	2104.50

The reported strength in China's July LEI was mostly from increased bank loans while consumer confidence, manufacturing and exports were all weak. US 10 year bond yields continue to trend lower as expectations fade for a September Fed "lift off" of US interest rates.

Although not tracked in our table above, VIX futures trading on the CBOE are all trading at values below the latest VIX spot rate of 36.02 recorded above – indicating professional traders believe the current sharemarket collapse is overdone. Expecting the VIX to fall in future is essentially speculating that US share markets will rise.

US "Velocity of Money", effectively a measure of the rate at which each dollar is used for transactions, reached yet another all-time low since records began in 1959, indicating much of the money created during the massive QE programmes of 2009-14 still sits idle, failing to reach circulation in the real economy and preventing any possibility of significant consumer price inflation.

The "Fear and Greed" index has fallen yet further into "extreme fear" territory - at 3 even lower than the very low reading of 9 in July.

The latest forward S&P 500 P/E figure was as at 21 August. We can expect a drop to around 16.6 by 25 August.

Professional traders got their Put/Call options ratio right when they spiked the ratio up to an unprecedented high of 1.70 on 21 August. The ratio has since fallen back to 1.26, still a high figure by historical standards, indicating professional traders are still taking out "insurance" to protect their portfolios against more market weakness.

2. Equities

Analysts estimate **Westpac Bank (ASX:WBC)** will need to raise another A$3B before 1 July 2016 to remain ranked in the top quartile of its global peers on a tier-1 equity basis. Additional capital is then expected to be needed before the end of FY 2018, expected to be derived from dividend reinvestment, profit retention and/or additional asset sales. 2016 capital raising options include a special share purchase plan, an institutional placement, dividend reinvestment plan and asset sales. In this exercise Westpac will be following the lead of the other Australian big four. Reaction to negative press coverage of capital requirements and likely lower dividend growth has helped push bank share prices down 25% in just four months. After the latest global market sell-off, Westpac sits on a dividend yield of nearly 6% and P/E near 13. Westpac has missed the boat somewhat if it chooses to raise capital via a special share purchase plan or pro-rata cash issue to existing shareholders and will have to offer a generous discount in order to ensure success of the issue. The result could be a special opportunity for existing Westpac shareholders to add to holdings at a particularly attractive price. The high dividend yield appears sustainable for the mid-term future at least.

Although forecast growth is very modest, increased capital solidifies the big Australian banks as core portfolio holdings.

Fletcher Building (NZX:FBU) is another blue chip knocked down by negative press and the global sell-off, offering high dividend yield plus modest earnings and dividend growth at a relatively low P/E.

These are just two of a whole range of top quality shares now on sale in Australia and New Zealand.

3. Interest rates, bonds and debentures

Contact Energy and Sky City are in the process of making 6 year and 7 year bond issues respectively. Contact Energy bonds should have a coupon set in the range 4.32% - 4.42% with Sky City possibly paying a little more. The long terms and expected low coupons mean these latest bond issues are not wanted in our portfolios.

Deposit rates are still falling. Heartland knocked a further 0.20% off 6 and 9 month terms with 0.10% less for longer terms. Heartland's Cash Pie rate fell -0.25% to 3.35% on call and -0.35% to 3.85% for 12 months. Fisher and Paykel Finance reduced deposit rates by -0.25% on call and between -0.20% and -0.45% for terms across the board.

Current deposit rates, % p.a., quarterly interest payments:

Issuer	$ min	Call	3mth	6mth	9mth	12mth	18mth	24mth	36mth	48mth	60mth
F&P Finance	1000	3.15	3.50	3.95	4.10	4.15	4.20	4.35	4.45	4.55	4.65
F&P Finance	25,000	3.15	3.65	4.10	4.25	4.30	4.35	4.50	4.60	4.70	4.80
Heartland Bnk	1000	3.85*	3.30	3.70	3.70	3.85	3.85	3.90	4.00	4.05	4.15
Heartland Bnk	20,000	3.85*	3.40	3.70	3.80	3.85	3.95	4.00	4.10	4.15	4.25
Liberty Fin.	5,000		3.95	4.55	4.85	5.20	5.55	5.80	6.40	6.40	6.30
Liberty Fin.	20,000		4.10	4.70	5.00	5.35	5.70	5.95	6.55	6.55	6.45
Liberty Fin.	100,000		4.15	4.75	5.05	5.40	5.75	6.00	6.60	6.60	6.50
UDC Finance	5000	2.95	3.45	3.60	3.60	3.70	3.70	3.75	3.80	3.90	4.00
UDC Finance	100,000	3.40	3.45	3.65	3.65	3.75	3.75	3.80	3.85	3.95	4.05

*Heartland Direct Call Account

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

A lot of changes in data deserve attention this month.

Looming "tax loss" time in the US could help restrict any significant recovery in US markets during September, even though a "dead cat bounce" after the initial shock is to be expected. I see no hurry needed to take advantage of current apparent bargains.

The latest bond offers from Contact Energy and Sky City are just too low on yield and long on term to be of interest for our portfolios, despite the outlook for an even lower OCR over the next 12 months. I would expect any further bond issues this year to be similarly unattractive. We will most likely retain our current bond holdings, although market values have reached unusual heights, and examine reinvestment options on a rolling basis as each bond matures over the next 6 years. We could sell on market now at a good profit but worthwhile reinvestment options for the lower return/lower risk portion of our portfolios are extremely limited.

Signs of slowing growth in the New Zealand economy and lower dairy prices, correlating with the lower trending NZ dollar, mean we may take the opportunity to further diversify portfolios into international markets. The global share market sell-off puts many high quality equity investments "on sale" but we also have commitments coming up for known special opportunities so will continue to be highly selective in any new purchases. I would expect to continue avoiding emerging markets irrespective of apparent bargains. In these domains issuer risk, currency risk, sovereign risk and market risk are all just too high.

Our portfolios have not suffered unduly with the sharp global sharemarket falls, our income portfolio down just 2.3% for the month to date at $1.3288 and the growth portfolio unit off 3.35% at $1.4982. Income should not be affected at all with the income portfolio on track to provide 7.4% p.a. after fees and after tax at the portfolio owners prescribed rate based on the amount saved while the more aggressive growth portfolio should deliver income of 5.13% p.a. after fees and after tax at the owner's prescribed rate, based on the total amount saved. Unit growth includes income reinvested in the portfolio.

Major share indices are well down for the year, the DJIA off -8.6% and the S&P/ASX 200 down -3.1%. The NZX50 has managed a small rise of +1.38%. Even after the August sharemarket falls our income portfolio unit is up +5.93% and the growth unit is up +8.98% over the same period - since 31 December 2014.

Click this link to see charts http://www.canopus.co.nz/investment_advice.html#returns (August figures will be posted after month end as usual).

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.

Canopus does not cancel portfolio units to meet fees. In Canopus portfolios, fees are taken on the nose as a portfolio expense. Hence, if you start with 100,000 units of $1.00 and make no further contributions or withdrawals, you will still have 100,000 units years later. The number won't be whittled away and the current unit value times the original number of units will represent your true portfolio value.

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.