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

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Investment Directions **28 February 2016**

"Analysis to action; opportunities to outcomes"

In this Issue

1. **Overview** – US economic data still mixed. Possibility of more upward movement in Federal Funds rate for 2016 fades as wider global economy stalls. New Zealand economy turns to tourism and immigration to maintain some growth as dairy prices slide further. Australia has 4th largest trade deficit on record in December quarter but ekes out growth at "sub-trend" rate. RBA says door open to further OCR cuts. Short term economic indicators point to return of confidence in equity markets.

2. **Equities** – BHP Billiton slashes dividend as expected to help protect balance sheet. Sky City Entertainment and Stockland Group Properties post sound results, offer good yields and some growth in low-growth environment. Australian banks look to be oversold, offer high yields.

3. **Interest rates, bonds and debentures** – Deposit rates for major S&P-rated finance companies. Deposit rates stable for February.

4. **Strategy** – Still looking for blue chips and international equities offering high yield, low P/Es and reasonable growth.

Space Exploration News

Search for a ninth planet in our solar system gains momentum after orbits of recently discovered minor planets appear to be roughly aligned by gravitational influence of a larger, unknown and very distant body.

http://space.about.com/od/kuiperbeltobjects/fl/The-Search-for-the-Ninth-Planet.htm

1. Overview

After leading global equity markets into a sharp New Year correction that reached nearly -11% on 11 February, US equities spent the last half of the month breaking out on the upside, reducing index losses for the year to about 7%. A poorer-than-expected US jobs report on 5 February sparked off early February losses even though unemployment edged below 5%. Australian indices mirrored the US as oil weakened to under US$30 per barrel, hitting resource stocks again, but the NZX S&P 50 Gross fared better, down just 1% for the year as at 25 February despite another round of falling dairy prices.

A number of massive sovereign wealth funds, especially those of oil-producers such as Norway, Saudi Arabia and Abu Dhabi, are reported to be selling or planning to sell billions of dollars' worth of listed equities, limiting any near term recovery.

A move to safe haven bonds saw 10 year T-note yields fall to 1.86%. Money market funds grew to US$2.757T on 27 January, up from US$2.734T at month start.

Although US economic data remain mixed, corporate results in the latest reporting round failed to match the collapse predicted by some analysts - and the number of doomsayers flogging expensive "last chance" newsletters and books. However, several major NASDAQ firms shocked the tech sector with severe guidance downgrades, well below market expectations. US construction spending in 2015 reached its highest since 2007 at US$1.1T (+10.5%) as home and government projects outweighed declines in shopping centres, office buildings and hotels. Consumer spending was flat for 2015 but savings were up at 5.5% of after-tax income in December, the highest since 2012, helping drag down measured economic growth to a 0.7% annual rate for 4Q15. Improving employment and wages are expected to produce stronger consumer spending in 2016 leading to economic growth recovering to over 2%. On the negative side, US manufacturing contracted for a fourth straight month in January although the ISM index rose from 48.0 to 48.2, still below the expansion indicator level of 50.0.

Visitors to New Zealand reached a new record of 444,900 in December with China being the biggest contributor, +43%. Also, the net gain in immigration of 64,900 set a new monthly record.

The NZ OCR remains on 2.50%. Governor Wheeler says cuts to the OCR will not be mechanical just to push inflation back into the 1% -3% target range. CPI was only 0.1% in the December quarter. The Policy Targets Agreement includes other considerations: asset prices, efficiency and soundness of the financial system as well as stability of output, interest rates and the exchange rate. Although the OCR easing bias remains, further cuts are not "written in". The Governor's remarks helped NZ's currency regain strength against those of its major trading partners.

NZ unemployment fell to 5.3% in 4Q15, from 6.0% in 3Q even as record immigration boosted potential workforce numbers by 0.5% to 3.66 million. The participation rate fell slightly from 68.7% to 68.4% but employment grew 1.3% in 2015 to 2.37 million. Firms are expecting to hire more staff in 2016 but say they are having difficulty in finding skilled employees.

In Australia the RBA left its OCR at 2.00% on 2 February but said continued low inflation may leave the door open to further cuts. Governor Stevens expects inflation to remain low over the next year or two. Australia's economy is experiencing steady growth but at a "sub-trend" rate. The easing bias made no impact on the AUD where the multi-year long slide in value looks to be steadying although a reversal upwards has yet to be identified. Australia recorded a trade deficit of A$3.5B in December, the 4th worst on record. Exports fell 5% in value as imports declined only 1%. Iron ore returns were -16% for the month, coal -8% and rural goods -9% overall. Wheat and other cereals provided a part counter, up 15% each.

Threats to global economy recovery later in 2016 persist with perennial concerns over China and crude oil being joined by a strong possibility of disorganised default on loans by Venezuela as the once oil-rich state runs out of money with no orderly default process in place. High crude oil prices of the recent past have been squandered on socialist ideology rather than used to help apply common sense in any economic restructuring. Economic implosion is the result, leaving the nation heavily dependent on imports for which it can no longer pay. Potential gains to peasant farmers from compulsory land redistribution have been negated by heavy subsidies on imported food prices and government decreed price controls on local produce, wrecking a small agricultural sector that once boasted at least some export capacity. With the collapse of crude oil prices, traditionally about 95% of Venezuelan exports by value, lack of access to foreign currency for fertilizer, equipment and even seeds have left the country facing major food shortages along with a lack of other basic imported consumer items. At least Venezuela's default should be a "known known" by the time it occurs.

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

	Latest	Jan 16	Dec 15	Nov 15	Oct 15	Sep 15	Aug 15
3 month LIBOR (end of month) %	.63460	.61560	.61270	.41620	.33410	.32500	.32900
TED Spread (points)	.32	0.29	0.45	.20	.25	.34	.27
VIX equity volatility	19.11	20.20	18.21	16.13	15.07	24.5	28.43
US LEI		-0.2%	-0.3%	+0.5%	+0.5%	+0.0%	0.0%
Japan LEI			-0.5%	+0.1%	+0.0%	-0.8%	-0.2%
Eurozone LEI		+0.1%	+0.2%	+0.7%	+0.4%	-0.3%	+0.3%
Australia LEI			-0.2%	+0.3%	-0.1%	-0.3%	-0.7%
United Kingdom LEI			+0.4%	+0.4%	+0.4%	+0.2%	+0.1%
China LEI			n/a	+0.6%	+0.3%	+1.6%	+0.9%
US Money Market Funds $T	2.778	2.756	2.759	2.741	2.717	2.669	2.694
US Gov. 10 year T-Bond (%)	1.697	1.931	2.269	2.218	2.151	2.060	2.200
US 5 yr inflation expectations %	1.57	1.63	1.77	1.88	1.86	1.75	2.00
US high yield-treasury spread 3-5yr %	8.17	7.77	6.95	6.40	5.90	6.62	5.70
Foreign holdings of US T-Bonds $B			6165.8	6125.7	6046.3	6101.7	6098.7
Margin debt, NYSE (US$ millions)			461,200	472,772	471,922	453,896	473,412
US M2 Money Stock (US$B)			12,331	12,288	12,201	12,187	12,138
Velocity of Money US M2			1.480			1.493	
CNN Fear and Greed Index	54	17	44	53	69	18	3
Insider Buy/Sell ratio (US) %	66	58	53	49	48	70	68
Forward P/E S&P 500 (12 month)	15.75	15.38	17.19	17.55	18.41	16.45	17.42
Trailing P/E S&P 500 (12 month)	21.82	20.69	22.65	23.18	22.07	20.59	21.63
Total Put/Call options ratio CBOE	0.93	0.91	1.00	1.07	0.95	0.97	1.20
S&P 500 Share Index	1951.70	1940.24	2043.94	2080.41	2079.36	1920.03	1972.18

US 5 year inflation expectations reached a minimum of 1.42% on 11 February but have since recovered to 1.57%, still well below the 1.80% applying at the beginning of the year. US Federal Reserve hopes of raising the target Federal Funds Rate again this year must be fading.

Chinese holdings of US T-bonds were down only 1.5% in December '15 and only down 2% from their peak of US$1271.2B in June 2015, despite news reports of "wholesale liquidation" by China of foreign assets to support its own currency. If China has indeed spent in three months US$300B of its foreign reserves on propping up the Yuan, it hasn't come from a major sale of US T-bonds. The other big holder, Japan, decreased holdings by 2% in December with holdings then at 9.4% below their peak in January 2015 of US$1238.6B.

Latest velocity of money (rate of circulation) is 1.48, another record low since figures were first kept in 1959, showing money created under the various quantitative easing programs has yet to reach the real US economy.

The CNN Fear and Greed Index reached a major low of 9 in early January but has now recovered to a respectable 54 (neutral). No sign of an imminent equities collapse here.

Lowering of analyst expectations and corporate guidance decreases have seen both forward and trailing P/E values for the S&P 500 rise slightly, telling equities investors not to get hopes up for an overall strong rise in returns this year, although individual stock picking could bring favourable results. Passive ETFs could well stagnate.

Technically the S&P 500 has broken out of its five month downtrend, reaching a minimum of 1829.08 on 11 February. Short term indicators are saying the sharp falls in January and February were overdone but the decline in US Leading Economic Indicators and rising P/E values urge caution for later in the year.

2. Equities

BHP Billiton (BHP:ASX), as widely predicted, cut its interim dividend severely to help preserve an A grade credit rating which the company sees as essential to maintain throughout the commodity cycle. Underlying profit for the six months to 31 December 2015 was US$412 million, down from US$4.9B in 2014. Net loss was US$5.7B compared to a net half year profit of US$4.3B in 2014. Interim dividend will be 16 cents per share compared to 62 cps in 2014. BHP is to adopt a minimum dividend payout ratio of 50% of underlying attributable profit in future.

BHP expects oil to recover first of BHP's four core commodities (oil, copper, coal and iron ore) but when high cost production from competitors will cease is unknown. Weak prices and high volatility across commodity markets are likely to persist for longer than the company expected. BHP is always on the lookout for high quality resource buying opportunities but even in the current period of commodity price weakness, tier 1 assets are hard to find so significant acquisitions are unlikely.

Along with other large miners, BHP is decreasing capital expenditure, slashing dividends, reducing staff and selling assets to conserve cash flow during the commodities downturn. A nascent share price recovery was largely snuffed out by the dividend news although the latest price at A$15.59, remains above the minimum of A$14.27 reached on 3 February.

Recovery of the hard commodities sector could take several years but when that recovery comes, BHP Billiton should be in excellent shape to take advantage.

Sky City Entertainment (SKC:NZX) was the first NZX company to report first half results in the current round to 31December 2015. Fickleness of the market was clearly demonstrated. Net profit improved 30% to 12 cps, totalling $71m compared to $54.6m in the previous comparable period, at the top end of guidance. Earnings rose 14%. SKC benefitted from a tourism boost, especially from high rollers, and lower funding costs. Interim dividend was up 5% to 10.5 cps. Despite the good result and encouraging outlook the company's shares immediately fell 7 cents to $4.30, but have since recovered to around $4.50. Sky City is favourably positioned to benefit from increasing tourism, demand for accommodation, a growing Auckland population and a monopoly of Auckland gaming licenses. Sky City's new convention centre will add a whole new dimension to operations as it becomes New Zealand's primary resource to meet this type of demand. The major risk in future would appear to be the possibility of increased regulation from a future government. SKC looks poised for steady growth and increasing shareholder rewards. Projected cash dividend yield for 2016 at a $4.50 share price is 4.7%.

Stockland Group Properties (SGP:ASX) reported a first half profit up 51% to A$696m. With one-off items stripped out the result was up 8% to A$313m, mostly due to strong residential construction (+45%) in Sydney and Melbourne. Commercial property increased 4% with the retirement division up 9%. CEO Mike Steinert said 1H16 ended with a record number of residential contracts on hand. Low interest rates and modest economic growth should provide favourable conditions for future organic growth. The interim dividend was raised slightly to 12.2 cps but the security price fell after the announcement to A$3.95. Belated recognition saw the price jump to A$4.38 on 22 February but has since drifted back again to A$4.20. Stockland offers access to the construction and operation of retirement accommodation and the broader Australian residential housing construction industry plus retail centres, office blocks and logistics centres. Negativity towards the sector stems from reducing demand in Queensland as mining declines and likely further housing price falls in Perth for the same reason. However, Stockland appears well positioned to deliver a steady if modest increase in profitability and dividends over the next three years. Dividends for 2017 are projected to be approximately 25 cps giving a cash yield of 5.95% at A$4.20 and 6.25% at A$4.00. Stockland offers a high income from the relatively stable Australian REIT sector in a time of ultra-low deposit rates and bond yields.

Australian banks are the companies many love to hate –from populist TV current affairs reporters and politicians to even some fund managers. Criticism usually centres around too much lending to the mining sector, too much exposure to the housing market, irresponsible lending to those who can't pay back, making too much profit, need for more capital, lack of growth opportunities, threats from technological disruption, reliance on overseas funding and the rest. Is it no wonder the share prices suffer, yet the banks still form valuable core holdings in many portfolios, providing current cash income yields exceeding 6% during a time of ultra-low deposit returns.

Following a series of capital raising exercises in response to Basel III ratios imposed by regulator APRA, intended to strengthen the banks against any rise in mortgage losses, three of the big four banks have achieved APRA-measured Common Equity Tier 1 levels of over 10%, with ANZ just a little below as at 31 December 2015. The targeted range is 8.75%-9.25% to put Australia's banks in the top quartile of major world banks for capital strength. Any further need for capital in the mid-term is likely to be met through dividend reinvestment plans rather than the large asset sales and direct requests to shareholders for more cash through entitlement issues as seen in the recent past.

Despite their strong capital positions and positive if modest growth outlooks, Australian banks have been caught up in a worldwide sell-off of the banking sector, largely based on reports of several European banks facing significant headwinds rather than any real concern for the local big four. Global equities weakness has been exacerbated in the Australian banking sector to a level that appears overdone. One plausible part-explanation claims that, with unexpected global equities weakness from the start of 2016, many large index tracking Exchange Traded Funds have been forced to liquidate at least part of their heavy bank positions. Also, the whiff of a sector weakness can bring a sudden surge in shorting – creating negative positions that may need to be covered by repurchasing of the same stock just as quickly when values start to rise again.

Latest data reveals that significant numbers of home loan borrowers are taking the opportunity afforded by low interest rates to get ahead of their mortgage repayment schedule – with 10% of Westpac home mortgage customers said to be ahead by two years! The other big four report similar, if not quite so spectacular, trends. These figures hardly form the basis of a loan book asset quality problem within the sector.

Major analysts are generally forecasting modest growth in bank profits and no reduction in dividends over the next three years, resulting in cash yields in the 6% - 8% range on today's share prices, along with undemanding P/E values. Investors currently underweight in the banks and seeking high yields with a growth component could well consider purchases around current prices.

3. Interest rates, bonds and debentures

Current major S&P rated finance company deposit rates, % p.a., quarterly interest payments:

Issuer	S&P rating	$ min	Call	3m	6m	9m	12m	18m	24m	36m	48m	60m
F&P Finance	BB	1000	2.85	3.15	3.65	3.75	3.85	3.95	4.10	4.25	4.35	4.45
F&P Finance	BB	25,000	2.85	3.30	3.80	3.90	4.00	4.10	4.25	4.40	4.50	4.60
Liberty Fin	BBB-	5,000		3.45	4.05	4.15	4.70	5.05	5.25	5.85	5.75	5.65
Liberty Fin	BBB-	20,000		3.60	4.20	4.30	4.85	5.20	5.40	6.00	5.90	5.80
Liberty Fin	BBB-	100,000		3.65	4.25	4.35	4.90	5.25	5.45	6.05	5.95	5.85
UDC Finance	AA-	5,000	2.45	3.05	3.40	3.45	3.75	3.45	3.50	3.55	3.65	3.75
UDC Finance	AA-	100,000	2.95	3.05	3.45	3.50	3.75	3.50	3.55	3.60	3.70	3.80

Canopus advisory clients receive a full rebate of any brokerage paid on term deposits.

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

We continue to look for regional blue chips and international equities offering high dividend yields, low P/E ratios and reasonable growth. Only the very best prospects will even be considered for addition to portfolios.

In US markets we are starting to see some measure of "buying of troughs" rather than "selling of peaks" giving the Dow Jones Industrial Average and S&P500 minor gains in February. Once NYSE margin debt figures for January are posted we should see some decline in borrowings used to finance equity purchases. A large decline would boost confidence that a recovery in US equities could be underway.

Short term data indicates market sentiment has improved markedly since the "extreme fear" of January, but fundamentals point to a limited upside potential for the extent of any near term recovery.

Our diversified growth portfolio has retraced about 2.4% in February thanks mainly to weakness in international equities, the Australian financial sector and a slightly stronger New Zealand dollar. Offshore exposure was countered to some degree by returns on New Zealand equities as the NZX 50 Gross Index headed for a 1% gain over the month but sits at a loss of 1.5% for the year to date. The S&P/ASX 200 is down 2.5% for February and nearly 8% for the year.

Our more conservative diversified income portfolio is down 1.75% for February to date. February is not a big month for income receipts so dividends and interest have added little to portfolio values.

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

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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 portfolio owner remains in control of the portfolio.

Regards,

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