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

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Investment Directions **27 January 2017**

"Analysis to action; opportunities to outcomes"

In this Issue

1. **Overview** – Trump's first days push Dow Jones above 20,000 for first time but improved outlook for global earnings also plays a part. US kills TPP but other members seek a replacement. Australia's economic outlook improves. US and NZ market interest rates could decouple from official rates on the high side. Equity markets solidly in "overbought" territory.

2. **Equities** – Forward earnings revisions turning positive in US and Australia. Forward P/E figure down for S&P 500 but still above long term average.

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4. **Strategy** – Equities soundly "overbought" and interest rates on the rise means we are content to stand aside both share and bond markets. Published portfolios reach five year term with sound compounding results, after fees and tax.

Space Exploration News

SpaceX returns to space with successful multi-satellite launch and perfect landing of reusable booster stage on floating ocean barge. Leap in SpaceX technology and skills brings a journey to Mars closer.

https://www.youtube.com/watch?v=NT3iiSVKbcQ

1. Overview

Donald Trump hit the ground running as 45th President of the United States, outlining his plans for lower corporate and personal taxes, higher infrastructure spending, less regulation and more jobs to company chiefs and union bosses at separate Whitehouse meetings within days of taking office. Presidential support for the long-stalled Keystone and Dakota Access oil transport pipelines further helped boost the Dow Jones Industrial Average to close above 20,000 for the first time on 25 January. Investor caution, evident earlier and centering around possible international backlash to renewed American protectionism, seemed forgotten.

Boosting equities too is the prospect of immediate earnings recoveries. S&P 500 earnings are forecast to rise by

6.8% in 1Q17, the highest quarterly figure in two years with US financial stocks doing particularly well on expectations of greater margin-based earnings as interest rates rise.

For now, monetary policy as set by the US Federal Reserve, has ceased to dominate equity market direction. US interest rates could well decouple from the target Fed Funds rate by rising ahead of the official Fed view.

Trump's decision to withdraw from the Trans Pacific Partnership leaves remaining members without the prospect of tariff-free access to the huge American consumer market – forcing a major rethink by those wanting to pursue a deal in some form or another.

As trading nations, Australia and New Zealand will be keen to seek a workable pact with a broad range of complimentary economies if possible, but without the world's largest consumer nation at its core, construction of any TPP replacement will be a big ask. Japan could partially fill the role but doesn't have the economic power – and possibly not the political will - to anchor a major free trading bloc. China, touted in some quarters as a viable US replacement, does not yet have the level of consumerism needed. Hence we can expect to see the TPP idea live on but any replacement is a long way off and likely to be quite a different beast on arrival,

Trump has expressed a willingness to pursue bilateral free trade agreements with individual TPP members but the existing agreement was already seen as favouring the US, so any such individual agreements would, presumably, have to favour the US even more and thus be unpalatable to the much smaller partner.

As New Zealand's third largest export market, imposition of US import tariffs could be harmful. However, at this early stage, the target of Trump's tariff proposals look to be cheap labour countries and especially US companies setting up in those locations to take advantage of the cheap labour resource. New Zealand and Australia may be little affected.

Despite Trump's "America first" mantle along with a dead TPP, success or failure of US economic policies should continue to lead global equity and interest rate markets in the short term at least. For now that means positive equity and negative bond price movements.

Australian and New Zealand OCRs remain on 1.5% and 1.75% respectively with economists picking no change in either for 2017 although, as in the US, we could see some decoupling of the market from official rates on the high side. New Zealand's consumer price inflation reached 1.3% for the year to 31 December 2016 after the December quarter came in at 0.4%, due mainly to falling fuel prices in Q415 dropping out of the calculation.

To the end of November '16, New Zealand government accounts (OBEGAL) showed a much smaller deficit than expected, -$768m vs -$1.7B, on greater than expected GST and corporate tax while core Crown expenses declined 0.8% to $31.7B.

With inflation edging back up towards its 2% target and the economy in relatively good shape the RBNZ has little need or incentive to change its OCR in the near term at least. The easing bias expressed at releases in late 2016 should disappear in early 2017.

Australia recorded its first trade surplus for three years in November '16 at +A$1.2B, well ahead of market expectations of +A$500m. Hard commodity prices have soared, particularly oil, iron ore and coal, while production is still high. The weaker AUD/USD has improved receipts further and boosted the service sector – notably tourism. LNG exports are ramping up and a bumper 2016 winter wheat crop is due to be harvested and exported in 2017. Australia's trade surplus is expected to stay positive throughout 2017.

In Europe, 2017 may be the deciding year as to whether the European Union and/or the Euro have a future. Although on the rise, anti-EU parties in France, Italy, Germany and smaller member states still appear not to have sufficient support to win power anywhere. After the shocks of Brexit and Trump though, pundits will tread with extreme caution.

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

	Latest	Dec 16	Nov 16	Oct 16	Sep 16	Aug 16	Jul 16
3 month LIBOR (end of month) %	1.03789	.99789	.93067	.88594	.84561	.83344	.75150
TED Spread (points)	.51	.50	.45	.54	.57	.51	.49
VIX equity volatility	10.81	14.04	13.33	17.06	13.29	13.12	11.87
US LEI		+0.5%	+0.1%	+0.2%	+0.3%	-0.2%	+0.5%
Japan LEI			+0.2%	+1.1%	+0.0%	-0.8%	-0.2%
Eurozone LEI			+0.3%	+0.3%	-0.1%	+0.5%	-0.6%
Australia LEI			+0.5%	-0.4%	+0.3%	-0.1%	+0.2%
United Kingdom LEI			+0.0%	+0.1%	-0.2%	0.0%	-0.2%
China LEI		+0.8%	+1.3%	+1.0%	+1.0%	+0.5%	+0.2%
US Money Market Funds $T	2.666	2.729	2.719	2.677	2.680	2.724	2.715
US Gov. 10 year T-Bond (%)	2.523	2.446	2.368	1.834	1.6080	1.5680	1.458
US 5 yr inflation expectations %	2.06	2.19	2.11	1.87	1.75	1.64	1.67
US high yield-treasury spread 3-5yr %	4.02	4.21	4.67	4.91	4.97	5.10	5.69
Foreign holdings of US T-Bonds $B			5944.3	6038.9	6154.9	6196.4	6247.3
Margin debt, NYSE (US$ millions)			500,442	483,978	501,125	471,231	474,575
US M2 Money Stock (US$B)		13249.2	13223.2	13137.5	13060.9	12986.9	12878.0
Velocity of Money US M2					1.439		
CNN Fear and Greed Index	62	66	70	43	50	63	82
AAII sentiment survey (% bullish)	43.6	45.6	43.8	23.6	24.0	28.6	31.3
US retail & food service sales US$B		469.092	466.167	465.321	462.284	457.722	457.849
Insider Buy/Sell ratio (US) %	27	35	36	32	31	29	34
Brent crude oil spot price USD/barrel	55.48	56.78	47.95	46.2	48.24	47.94	40.76
Forward P/E S&P 500 (12 month)	17.45	19.04	18.45	18.02	18.43	18.59	18.93
Trailing P/E S&P 500 (12 month)	24.71	24.95	24.35	24.31	24.81	24.71	24.87
Total Put/Call options ratio CBOE	0.725	.975	0.90	1.06	1.02	1.01	1.20
S&P 500 Share Index	2298.37	2238.83	2198.81	2126.15	2168.27	2170.95	2173.60

China again sold US treasuries in November 2016, lowering its holdings by US$66.4B to US$1049.3B to defend the Yuan, accounting for 69% of the overall reduction. Japanese holdings fell too, by US$23.3B to US$1108.6B. Russia increased holdings by US$12B. Big reductions in foreign holdings through Belgium from August to October have levelled off in November. These holdings could include significant components from Russia and China.

Rising US equity markets are widely matched by positive short term indicators: low VIX volatility, Fear and Greed in the "greed" zone, AAII sentiment still highly positive, forward P/E falling on higher profit expectations, a high crude oil price and low put/call options ratio (professional investors see less reason to insure portfolios).

Notably the insider Buy/Sell ratio has fallen quite sharply, indicating that those "in the know" are acting with more caution – staying away from an overbought market.

New Zealand and Australia both have major interests in China's attempts to protect the Yuan. China's central bank has little scope to defend the Yuan with higher interest rates – to do so would simply exacerbate the serious impaired loan situation of its already-stretched banking sector and place bond markets under more stress where liquidity is already low. January has seen the Chinese currency regain some ground against the US dollar, bought at the cost of foreign reserves. Serious depreciation of the Yuan would inevitably lead to decreased demand for commodity exports from both Tasman states. Levelling off in China's US treasury sales would signal good news from a New Zealand point of view.

2. Equities

New Zealand and Australian share markets have shared some of America's January Trump rally – but not all. To date the S&P 500 is up 2.59% at 2297 since closing out 2016 at 2239. Similarly the Dow Jones Industrial Average has gained 1.7%, topping 20,000 for the first time, while the tech-heavy NASDAQ beats all, up 5.05% to 5655.

In contrast the S&P/ASX 200 is effectively flat around 5670 while the NZX 50 has managed a 3.15% gain.

A comparison since the shock Trump win on 8 November is more favourable – the S&P/ASX 200 up 10.14%, the S&P 500 up 10.17%, DJIA up 12.3% and the NZX 50 up 6.62%.

However, not all the recent rally should be ascribed to Trump. After a long night, global earnings momentum is turning positive. For so long we have come to accept negative earnings revisions as the norm but that is no longer the automatic case. Perhaps surprising to some, positive Australian corporate revisions are to the fore. In the US, from our data table above, forward S&P 500 P/E has dropped to 17.45 – still above the long term average but a significant move in the right direction.

3. Interest rates, bonds and debentures

ANZ is in the process of selling UDC finance to HNA Group for $660m, one of the world's largest asset financing and leasing companies. HNA does not currently operate in New Zealand. The sale is subject to certain closing steps and conditions, including replacement of the secured investments program. This appears to mean secured deposits will no longer be available through UDC and existing deposits could be repaid early. S&P has lowered UDC's long term credit rating from A- to BBB-.

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	2.00	2.95	3.65	3.85	3.95	4.00	4.10	4.20	4.35	4.35
F&P Finance	BB	25,000	2.00	3.10	3.80	4.00	4.10	4.15	4.25	4.35	4.50	4.50
Liberty Fin	BBB	5,000		3.30	3.85	4.10	4.40	4.80	4.95	5.15	5.40	5.65
Liberty Fin	BBB	20,000		3.40	3.95	4.15	4.65	4.85	5.00	5.40	5.55	5.75
Liberty Fin	BBB	100,000		3.50	4.05	4.25	4.75	5.00	5.20	5.50	5.60	5.80
UDC Finance	BBB-	5,000	1.85	2.70	3.45	3.75	3.80	3.75	3.75	3.85	4.05	4.15
UDC Finance	BBB-	100,000	2.35	2.75	3.50	3.75	3.80	3.80	3.80	3.90	4.10	4.20

Deposit rates are liable to change at short notice. Check before investing.

Canopus advisory clients receive a full rebate of any commission received by Canopus on term deposits used in portfolios.

Contact me for copies of product disclosure 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

With so many indicators telling us that equity markets are currently overbought we prefer to stand aside unless a particularly attractive opportunity comes along. Fixed term interest rates and bond yields are rising but not sufficiently as to entice us back into the market yet.

Our two published portfolios have now been tracked for five years. These are real portfolio results for which I have portfolio owner permission to publish. Over that time our diversified growth portfolio unit value has grown by 10.82% p.a. compounding per annum, after all fees and tax at the investor's prescribed rate on portfolio items. Our more conservative income portfolio has given a unit value growth of 6.96% p.a. compounding over the same term, also net of fees and tax.

Income on actual savings for the income portfolio is now running at about 6.5% p.a. after fees and tax. Income on savings from the growth portfolio is about 5.8% p.a. after fees and tax. Income on savings should grow in future as our portfolio companies increase dividends and bond yields recover.

High liquidity of portfolio items means portfolio owners have access to funds whenever required.

No leverage at all has ever been used in either of these two portfolios.

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

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