Canopus Investments Limited

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

P O Box 101 662
North Shore Mail Centre
Auckland
New Zealand

Phone: +64 9 444 8055
+64 9 444 8056
Fax: +64 9 444 8059
Websites: www.canopus.co.nz
www.debex.co.nz

Investment Directions **30 June 2016**

"Analysis to action; opportunities to outcomes"

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2. **Equities** – Brexit puts focus on international equities for New Zealand investors. Various options examined.

3. **Interest rates, bonds and debentures** – Deposit rates stable during June. Chance of another OCR cut in August rises. Deposit rates for major S&P-rated finance companies.

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Space Exploration News

The Large Synoptic Survey Telescope, currently under construction in Chile, will enable fast, wide angle imaging of the sky. Comparison of images will allow changes in position and brightness of faint objects to be detected.

The new telescope features a revolutionary main primary mirror of 8.4metres diameter within which is concentrically formed a 5.0 metre diameter "tertiary" mirror of shorter focal length. Completion of the LSST should lead to discovery of many more asteroids in our own solar system besides providing new information about distant galaxies. See http://www.lsst.org

1. Overview

UK voters shocked pollsters, politicians, markets and all by voting to leave the EU on 23 June. Even leading "Leave" proponent, UKIP's Nigel Farange, tacitly admitted his belief that "Remain" would win as polls closed. Early results from Scotland provided the expected "Remain" result north of the border, firstly bolstering markets above previous closes, but from there on it was all downhill for the stay camp and British Pound as unexpected electorate votes for leave mounted, including major cities outside London. From a previous close of US$1.4842 the Pound collapsed to US$1.33 down 11%, in just 5 hours - said to be the fastest collapse in the currency's long history. By end of trading the Pound had recovered somewhat to US$1.3666, limiting its loss to 8%. Equity markets felt the pressure too with the Dow Jones Industrial Average taking a fast 4% hit from the morning's optimism of 18,100 down to nearly 17,300 over the same timeframe and finishing at 17,401 for a loss of 3.39%. Sovereign bond rates fell in the rush to security with the US 10 year T-bond rate reaching down to 1.579% from its previous close of 1.739%. Hardest hit equity markets were those where existing negative interest rates severely restrict central banks' ability to intervene with more stimulus, notably Europe and Japan.

In the US, a further Federal Funds rate rise this year looks increasingly unlikely as yield on the 10 year T-bond fell further to 1.46% from 1.74% after Brexit.

The NZX 50 Gross Index fared better than most with losses limited to just 2.24% while the S&P/ASX200 shed 3.18%.

Investors shouldn't panic. Despite "catastrophe and carnage" headlines from main stream media, it's not the end of the world as we know it. A significant amount of the initial equity and currency market routs will almost certainly have been due to highly leveraged speculators getting caught on the wrong side of market movements, having to front up with huge margin calls, buying back losing contracts or seeing their positions closed out with massive losses. Super-fast electronic trading algorithms just speed up the process. Although markets could settle around new levels more quickly than many believe, some volatility should persist as potential knock-on effects in Europe and America come under detailed scrutiny.

By Wednesday 29 June, less than a week after Brexit, London's FTSE 100 index had more than regained all its losses, closing above pre-Brexit levels at 6360, sparked at least partially by the realisation that a much lower Pound can hold benefits for British industry and hopes of lower interest rates from the Bank of England. Expect more volatility to come.

The successful "Brexit" campaign can be attributed to widespread dislike of the burgeoning EU bureaucracy and regulation, increasing concern over wages and jobs plus fear of massive uncontrolled immigration. Prime Minister Cameron, leader of the "Bremain" camp, will be gone before October. By a small majority, UK voters chose to ignore the fear campaign mounted by stayers. The result will boost Euro-skeptic movements throughout the European Union – notably in the Netherlands, Denmark, Austria and Italy where anti-establishment parties have recently made big gains. In Greece the membership argument will no doubt surface again. Greece is unique in that its calamitous financial situation effectively ties it into the EU – but Russia's Mr. Putin, delighted with Brexit, could possibly offer the Greeks a financial helping hand to leave as well. On the back of his military and political successes in Eastern Europe and the Middle East, a rising oil price has helped Mr. Putin preside over a 25% rise in the Russian Rouble against the USD since its low in January this year. Carving Greece out of the EU would mark another success. Don McKinnon suggests he could even try for ex-Soviet bloc EU members such as Romania and Bulgaria as well.

Mr Putin has moved swiftly to exploit the chaos in Europe, quickly restoring good relations with Turkey – aimed at keeping it out of the EU and into a more constructive role in the fight against ISIS. Syrian Kurds could be the losers, the obvious sacrificial lamb, as Assad and Russia consolidate control. The Kurds can forget about any meaningful support from President we-don't-have-a strategy - as Mr Putin knows full well. Recent direct negotiations with Mr. Netanyahu will have been aimed at avoiding accidental conflict between Russia and Israel while giving the green light to Israel's continued occupation of the Golan Heights. Mr Putin prefers to hold Assad on a short leash.

However, further break-up of the European Union is not guaranteed. Despite growth of "independence" groups throughout, Euro enthusiasts still hold the power and could implement major changes needed to save the Union if the will exists. So far though, demonstration of any such will has been absent. A few smaller states dropping out would hold little fear for investors. A possible exit by Italy would be the only one of consequence currently on investors' radar.

The Brexit impact on America's presidential campaign will also be closely watched. To date Trump has successfully recognised and tapped into widespread frustrations similar to those in the UK but dismissed by the US political and financial elite. However, Trump remains his own worst enemy – self destructing at every opportunity. All recent polls put Clinton well ahead for the presidency. Any significant move towards Trump would cause another bout of uncertainty to hit global financial markets in the lead-up to November's presidential election. That doesn't look at all likely from here.

Apart from equity and currency volatility, Brexit could impact New Zealand investors through our interest rate outlook growing ever more "lower for longer". Some economists now pick a further OCR reduction, to 2.00%, as almost a certainty in August with some also predicting a further decrease to 1.75% later this year. Increased offshore funding costs for banks may mean OCR reductions will not simply be passed on to mortgagors. In addition, more self-imposed restrictions on lending to property investors by banks should limit pressure on house prices. With a high overnight cash rate of 2.25%, the RBNZ is in a strong position to counter any Brexit effect on the New Zealand economy if needed. Only 3% - 5% of New Zealand's exports now go to Britain.

New Zealand posted a bigger than expected trade surplus in May of $358m (cf $164m expected). Exports grew 5.1% to $4.57B while imports increased 5.7% to $4.223B. Logs, timber and timber articles to China were up 42% at $373m. Fruit exports rose 22% to $539m. New Zealand's annual trade deficit to 31 May 2016 was less than expected at $3.63B.

New Zealand produced a current account surplus of $1.3B in 1Q16 cf a deficit of $2.69B in 1Q15 as imports fell faster than exports and the services sector produced a surplus of $2.8B.

NZ's dairy industry remains a major risk. OM Financial believes farm insolvencies could explode if farm prices fall further than the -24.1% year-on-year recorded to the end of April 2016. OMF calculates an average LVR for dairy farms at 65% in 2016/17, up from 47% in 2014/15 based on a 10% fall in land prices and greater "credit off-take".

Amongst all the Brexit drama, the Australian federal election this weekend seems to have been overlooked by New Zealand media. Polls say it's too close to call. A further term for PM Malcolm Turnbull should see recent share losses recovered and a return of some stability. A Labor win could also see a partial rebound and greater stability on removal of uncertainty.

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

	Latest	May 16	Apr 16	Mar 16	Feb 16	Jan 16	Dec 15
3 month LIBOR (end of month) %	.62710	.67305	.63835	.62820	.63310	.61560	.61270
TED Spread (points)	.37	.35	.42	.42	.30	0.29	0.45
VIX equity volatility	16.64	14.19	15.70	13.95	20.55	20.20	18.21
US LEI		-0.2%	+0.6%	+0.1%	-0.5%	-0.2%	-0.3%
Japan LEI			+0.3%	+0.1%	-0.3%	-1.2%	-0.5%
Eurozone LEI		+0.1%	+0.1%	+0.3%	-0.2%	+0.1%	+0.2%
Australia LEI			+0.5%	+0.1%	-0.5%	-0.5%	-0.3%
United Kingdom LEI			+0.0%	+0.0%	+0.1%	+0.2%	+0.4%
China LEI		+0.2%	-0.1%	+0.3%	+0.3%	-0.2%	+0.5%
US Money Market Funds $T	2.703	2.733	2.709	2.765	2.807	2.756	2.759
US Gov. 10 year T-Bond (%)	1.461	1.834	1.819	1.786	1.740	1.931	2.269
US 5 yr inflation expectations %	1.41	1.61	1.82	1.75	1.61	1.63	1.77
US high yield-treasury spread 3-5yr %	6.57	5.97	6.24	7.05	7.75	7.77	6.95
Foreign holdings of US T-Bonds $B			6238.5	6287.0	6236.2	6183.1	6165.8
Margin debt, NYSE (US$ millions)			455,646	445,846	435,814	447,681	461,200
US M2 Money Stock (US$B)		12731.2	12651.3	12,568.6	12,472.8	12,420.3	12,331
Velocity of Money US M2				1.459			1.482
CNN Fear and Greed Index	57	77	72	64	51	17	44
AAII sentiment survey (% bullish)	22.0	17.8	27.4	27.2	32.0		
Insider Buy/Sell ratio (US) %	45	44	41	58	65	58	53
Forward P/E S&P 500 (12 month)	17.99	17.75	17.80	17.55	15.75	15.38	17.19
Trailing P/E S&P 500 (12 month)	24.22	24.04	24.11	23.53	21.82	20.69	22.65
Total Put/Call options ratio CBOE	1.15	0.93	1.15	1.08	1.20	0.91	1.00
S&P 500 Share Index	2070.77	2096.95	2065.30	2059.74	1932.23	1940.24	2043.94

Big movers on our data chart, post-Brexit, have been US inflation expectations down sharply and a big swing upwards in the total Put/Call options ratio as traders move to increase insurance of their portfolios. Despite widespread MSM horror stories, the CNN "Fear and Greed" index only moved down into "neutral" territory from the "greed" state it held early last week. By 29 June it was back up to "greed"

The effect of Brexit on NYSE margin debt will be interesting to note once we have the end of June figure. Theoretically it should have dropped sharply as speculators got caught on the wrong side of equity market movements, being forced to close out open positions or meet big margin calls.

VIX spiked at 24.76 on the day of Brexit but has since quickly retreated.

2. Equities

Individual shares and funds with large exposure to the UK and Europe clearly took the brunt of valuation falls post Brexit. But even London's FTSE index has staged a big recovery since media predictions of "carnage" mixed with leveraged algorithm trading exploded into early panic selling. Volatility should continue for a while yet, decreasing as panic fades.

NZX-listed **Bankers Investment Trust (NZX:BIT)** is a large international-equities trust based in the UK and holding a large proportion of UK listed shares but also with holdings spread across the globe including a very small allocation to emerging markets. A sharp fall of the British Pound vs the NZD mixed with uncertainty over the UK economy saw BIT sell off in New Zealand from $11.80 down to $10.80. Bold contrarian investors could do well at that price – but it's unlikely to last. Holding BIT in a portfolio gives access to a wide range of international equities diversified across all sectors and continents. Unit price growth from end of the GFC in 2009 to mid-2015 was impressive, more than doubling from $7 to $15, but the units have retreated since then with Brexit hammering the price back below $11. At that price the dividend yield is a reasonable 3.2%. Bankers Investment Trust has a long history of steadily increasing dividends, which would be impacted to some extent in NZ dollar terms should the Pound stay weak. On the positive side though, a much weakened Pound may well see British exporters doing well as their products become cheaper on the international stage and BIT's foreign currency earnings stand to gain when translated back into the British currency.

Carmel Fisher's **Marlin Global (NZX:MLN)** offers investors access to a diversified portfolio of international equities at a useful discount to net tangible asset value. The unique Fisher Funds' dividend policy of distributing 2% of average NTA per quarter makes Marlin a special case through which private investors can derive a high dividend income from international equities. Being a PIE entity, MLN provides tax advantages for some investors. Originally intended as an investor in smaller global companies, Marlin lost its way in the early years after listing in 2007 with a number of injudicious investments, notably in China. Since then, focus has shifted to holding a portfolio including some major household names such as Alibaba, Alphabet (Google), eBay, Adidas, Mastercard and Nike. Marlin has very limited exposure to the UK but holds five companies in Germany. Total shareholder return since early 2012 has been impressive with the majority of gains coming from the high dividends. Given any recovery in global equities, purchase of MLN at current knocked down levels locks in a very high dividend yield with the prospect of some capital growth as well, provided present dividend policy can be maintained. Reported profit can fluctuate widely as changes in portfolio value are taken directly to the top line. Ability of MLN to maintain its exceptional dividend policy over the next couple of years may depend on increasing portfolio values and some realisations as cash holdings have decreased significantly during the latter half of 2015.

For investors wanting passive access to global share markets as a whole (excluding Australia), ASX-listed **Vanguard MSCI Index International Shares ETF (ASX:VGS)** provides an easy solution. The ASX-listed fund represents a class of units within the Vanguard International Shares Index Fund which, in turn, invests in approximately 1500 large and mid-sized companies diversified across all regions and a wide range of asset classes. The fund may pay out a small dividend giving an annual yield of about 2%.

3. Interest rates, bonds and debentures

Very little movement in deposit rates during June. F&P Finance reduced its on-call rates slightly. Should Brexit lead global interest rates even lower, expect finance company deposit rates to move down again too. NZDX-listed bonds would see reduced yields and higher market values.

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	2.50	2.95	3.65	3.70	3.75	3.80	3.85	3.90	3.95	4.05
F&P Finance	BB	25,000	2.50	3.10	3.80	3.85	3.90	3.95	4.00	4.05	4.10	4.20
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	AA-	5,000	2.20	2.70	3.20	3.15	3.45	3.25	3.30	3.30	3.30	3.40
UDC Finance	AA-	100,000	2.70	2.75	3.25	3.20	3.45	3.30	3.35	3.35	3.35	3.45

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

Depressed equity values post Brexit mean contrarian investors have been offered an opportunity to add some top international equities to portfolios at reasonable prices. Depending on one's objectives and risk tolerance any one of a number of holding structures may be more appropriate than others. Evaluation of international equities can be difficult for the private investor and direct holding plus brokerage can be expensive. We prefer to hold international equities through listed investment companies or listed funds. Exceptions can be made where an unlisted fund manager shows outstanding ability. Through a listed entity purchase of a broad portfolio may be possible at a discount to net asset value and daily market liquidity allows exit when desired at a known price. Research and currency hedging are the responsibility of the company or fund manager. Listed investment companies are "closed end" meaning the number of shares on issue is limited by company management. Importantly, shares cannot be sold back to the company, obviating any necessity for the company to sell assets to meet redemption requests during a market downturn.

Our published portfolios have not been immune to Brexit although income should be very little affected. After share revaluations and income are all summed up it looks as if our growth portfolio will be off about 4% during June with the income portfolio down about 2%. Published returns are after fees and tax at the investor's prescribed rate on portfolio investments.

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 an ASB Securities 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 portfolio owner remains in control of the portfolio.

Regards,

Alan King
Authorised Financial Adviser
Canopus Investments Limited FSP31002
Email: alan@canopus.co.nz
Mob: 0274 718 253
Tel: +649 444 8055

Postal address:
PO Box 101662
North Shore Mail Centre
Auckland 0745
New Zealand

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