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Investment Directions

17 March, 2009

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1. Overview

Bank deposit interest rates make sharp reversal upwards.

In January we listed reasons why term deposit interest rates could rise this year rather than slavishly following the Official Cash Rate down further. These factors now seem to be kicking in faster than expected, see our 2 year deposit rate chart at <http://www.debentures.co.nz/2YearDebentureStock.pdf>

See this issue's fixed interest section for more details.

On a global scale, central bank attempts to stimulate economies through rate cuts are running out of room to move.

The Bank of England continued its rate cuts in early March, now down to 0.5%, effectively expending the last of its ammunition from that box, while announcing issuance of 75 Billion new pounds for asset purchases in an attempt to combat recession. Bank of Canada made a similar cut while the European Central Bank reduced to a new low of 1.5% with more reductions expected.

Australia held its official rate at 3.25% but New Zealand lowered a smaller than expected 0.5% to

3.0% on 12 March, resulting in just a little upwards movement of Kiwi against Greenback and little immediate movement versus the AUD. Longer term, growing expectations of entrenched higher interest rates in Australia could well see the NZD/AUD slip further while both gain on the Greenback.

Japan reported a massive fall in exports, down 45.7% in the year to end of January 2009, undermining confidence in the Yen as a safe haven currency and leaving the Greenback as sole currency recourse for the risk averse. Japanese industrial production fell 10% in January 2009 alone. A whole generation is learning to live with a few years old 4WD and not-the-very-latest home theatre.

Recession intensifies in the US with durable goods orders, non-defence capital goods shipments and new house sales all falling while initial jobless claims continue to rise.

Ironically, New Zealand's frustrated attempts over many years to develop a major manufacturing sector now look more like saviour than threat as the country continues to benefit from exporting the agricultural commodities others still need. NZ terms of trade for the December quarter were better than expected at -0.9% compared to expectations of -2.0%.

On the purely financial front, TED spread has crept up, now at 109, indicating interbank lending is tightening again with the LIBOR up at 0.546% against a closing February value of 0.42%.

Although US leading economic indicators remained fractionally positive in February, those for Japan, Mexico and the Euro zone declined significantly. Australia declined marginally by 0.9%.

For equities the question remains "are we there yet?" When distraught Billionaire Warren Buffet appears on TV proclaiming doom and disaster – after advising everyone to follow his lead when buying heavily last October – the bottom can't be too far away.

AIG's enormous record quarterly loss of US\$61.7B triggered a further bout of falls to place indices at multi-year lows. No doubt we haven't seen the last of these "loss revelations" but the very worst may be past. Huge amounts of private wealth have been destroyed, partially replaced by taxpayer funded bailouts and "quantitative easing" but global money supply still lags goods and services so central banks' printing of new money should not yet be inflationary. Although anticipated to some extent, worse than expected new horror stories from the US auto industry could yet plunge indices again, adding US taxpayer losses to those of private investors gone before.

But markets are now ready to seize on any scraps of good news. Amazingly, a report that Citigroup actually traded at a profit for two consecutive months was enough to propel the DJI up by 6% in one session. How bizarre is that? A couple more good reports (or not such bad ones) saw the Dow leap 9% in a week.

Locally, investors have to reflect on a poor results season where major companies gave little useful guidance as to earnings and dividends. Logically markets should tread water until profitability of major corporates becomes clearer, but in reality direction will still be set by New York. Notably however, Australasian indices have recently been showing good resistance to Wall Street's high volatility, following in direction but not in magnitude. Earlier, DJI losses of 11% over 9 days evoked falls of 5% in Australia and just 1.5% in NZ. Conversely, on the upside, local market rallies following any overnight surge on Wall St., are quickly extinguished, dampening major recovery prospects in the near term.

2. Equities

Right now a familiar pattern of market relationships is playing out - positive volatility on Wall Street flows through into decreased risk aversion, giving “commodity currencies” such as the AUD and NZD a boost, while global sharemarkets play follow the leader. Gold declines as industrial commodities strengthen. To date all such points of inflexion have soon unwound into new bouts of desperation but each one brings the bottom closer. For the technically minded the Dow is sitting close to important moving average crossovers, near a positive channel breakout and trading at high volumes – all signs of a reversal.

Despite variable results and little future guidance, a number of major Australasian stocks maintained (or even increased) dividends during the latest reporting round, e.g. Fletcher Building, BHP, Contact, Leighton Holdings to name a few. Typically these stocks have managed a recovery or stability of sorts, but could well revisit lows under the likely scenario of a “long thin” economic recovery. In contrast, second tier shares, surprising on the downside profit-wise, seeking capital and cutting dividends, have been hit hard, e.g. Nuplex, Allied Farmers, Fisher and Paykel Appliances.

At the far end of the scale, worth mentioning, is our noted cheapie Cynotech Holdings – too small to attract attention of the major brokerages. Net profit (unaudited) for the year ended 31.12.08 was \$2,279,877, up 26% on last year’s audited figure. Profit before tax was up 106%; total assets grew 35.4% to \$35,239,430; equity increased 18% to \$13.6M and final dividend jumped 50% to 0.75 cps, giving a total dividend of 1.25 cps – a yield of 8.93% at the latest price of 14 cents. Directors consider the result satisfactory given current economic circumstances. Collection of loan receivables from distressed loan books including National Finance 2000 and Western Bay are reported as very successful with cash flows increasing. Detail is lacking in the announcement. Other trading operations of the Group are claimed to have produced satisfactory results but it would be interesting to know if any value is attributed to Cynotech’s 23% holding in Findata – an online financial information source that has failed to produce a brass razoo for its shareholders after several capitalisations under various guises over many years. Cynotech Balance Sheet shows a suspicious “Investment in Associate” valued at \$650,183. Supplementals show Findata contributed a \$99,000 loss to the Group. I sense a write-off coming but still like the overall Cynotech story.

3. Kiwisaver

It never ceases to amaze me how many parents fail to appreciate the importance of getting their children or grandchildren into this once-in-a-lifetime opportunity – not to mention themselves as well! Perhaps it’s worth repeating the main advantages. KiwiSaver is open to all permanent New Zealand residents under the age of 65.

Children under 18 receive the standard \$1000 kick-start from the Government. There is no cost to join and babies can be signed up as soon as born. Even if you or your child make no additional contributions, at age eighteen your child will be entitled to investment returns from the initial \$1000 compounding up to 18 years, plus, from age 18 on:

- Government matching contributions up to \$20 per week (\$1042.86 per year)
- Employer contribution of 2% salary minimum
- A first home subsidy of up to \$5000
- Entitlement to withdraw all their own contributions, employer contributions and investment returns to put towards their first home.
- If paying off a mortgage, after 12 months membership, the ability to divert half their own contributions towards paying off that mortgage (an option not available in all funds).

Canopus Investments Limited is an accredited agent for the Huljich KiwiSaver Fund, one of the top performing KiwiSaver funds to date in New Zealand and one that offers the mortgage diversion option. For full details of the Huljich KiwiSaver Fund, contact Canopus for a copy of the Investment Statement info@canopus.co.nz or call (09) 444 8055 for more information.

4. Current Issues

- 4.1 NZ Post Group Finance Unsecured, Subordinated Notes
- 4.2 Man OM-IP AHL
- 4.3 GoldmanSachs JBWere Trans Tasman Equity Unit Trust
- 4.4 Senior Retirement Village Trust
- 4.5 Marac Cash PIE

4.1. NZ Post Group Finance Unsecured, Subordinated Notes

NZ Post Group Finance Limited, a wholly owned subsidiary of NZ Post Limited, is offering up to \$200,000,000 of unsecured, subordinated, redeemable, cumulative fixed rate notes to the public and institutions. The Notes are a direct, unsecured, subordinated obligation of the Guarantor, NZ Post Limited. The Issuer has the right, in its absolute discretion and without notice, to amend the following dates.

Key features of the issue:

- Opening date 25 March 2009
- Closing date 22 April 2009
- Rate set date 24 March 2009
- Interest payment dates 15 May, 15 November
- First reset date and step up date, 15 November 2014
- Initial interest rate expected to be around 7.5% to 8.0%
- Maturity date, 15 November 2039
- Credit rating of "A" issued by Standard and Poors
- Minimum application is \$5000 with multiples of \$1000 thereafter
- Application has been made to list the Bonds on the NZDX, providing liquidity
- Nil application fee on applications made through Canopus Investments Limited
- **Requests for firm allocations should be with Canopus by Noon, Friday, 20 March.**

The Notes will, until the First Reset Date (15 November 2014), accrue interest at the Interest Rate announced by the Issuer on the Rate Set Date. Thereafter, the Interest Rate will, unless changed as a result of a Successful Remarketing Process, be reset on each Reset Date to be the sum of the Benchmark Rate on that Reset Date plus the Step-up Margin. The Step-Up Margin is initially set at the Margin (announced by the Issuer on the Rate Set Date) plus 1.00%. Proceeds from the issue of the Notes will be used for general corporate purposes including repayment of maturing debt and support for continued growth and development of the New Zealand Post Group.

For a copy of the Investment Statement plus application form and a firm allocation please contact Canopus info@canopus.co.nz, or telephone (09) 444 8055, fax (09) 444 8059. This is a limited offer, requests will be handled on a first in, first served basis. **Requests for firm allocations should be with Canopus by Noon, Friday, 20 March.**

4.2. Man OM-IP AHL is now open for subscription.

A blue rectangular graphic with a grid pattern. The text "Performance potential" is written in white, sans-serif font. On the right side, there is a partial view of a globe showing continents and oceans.

The Man OM-IP series of hedge funds has shown a remarkable ability to genuinely hedge and contribute to a diversified investment portfolio during the three major sharemarket downturns over the past eleven years. Based on the AHL Diversified Program which actively trades a broad range of financial markets not easily accessible to the private investor, the Man OM-IP funds have recorded mid and long term compound returns ranging from 10% to 17% p.a. - in each case backed by the security of a rising capital guarantee provided by a major Australian bank. The hedging function has been achieved through returns being uncorrelated to sharemarket gains or losses.

During the year 1 January to 31 December 2008, the underlying Man AHL Diversified program achieved an outstanding 35.1% return as sharemarkets crashed.

While the well known OM-IP 220 funds feature exposure to a second trading program aimed at providing reduced volatility, the current fund, OM-IP AHL, presents pure access to the AHL Diversified Program only, backed by a similar capital guarantee structure.

Visit the OM-IP website for full details of the issue including the Prospectus and application form:

<http://www.maninvestments.com.au/manomipahl/adv/canopus>

Alternatively, request a hard copy of the documents by emailing info@canopus.co.nz, or telephone, (09) 444 8055 or fax (09) 444 8059.

Investors pay no fees or brokerage on Man OM-IP investments made through Canopus.

4.3. GoldmanSachs JBWere Trans Tasman Equity Unit Trust

A fund with an excellent track record and well placed to achieve strong gains from a sharemarket recovery. Managed by Goldman Sachs JBWere Asset Management (NZ) Limited, based in Auckland, the Trust invests in listed companies or companies that intend to list in Australia and New Zealand with the intention of achieving capital growth in rising share markets and protecting capital in flat or falling markets. The Fund is actively managed (not an index fund) and provides access to a portfolio of carefully selected Australian and New Zealand shares which may include some of the larger listed companies such as Contact Energy, Fletcher Building and BHP Billiton.. For a copy of the latest report contact Canopus.

Key Features of the GS JB Were Trans Tasman Equity Unit Trust:

- Established September 1998
- Low minimum initial investment NZ\$2000
- Low minimum additional investment NZ\$1000 or NZ\$250 with regular savings plan
- Entry fee discounted from 3% to 1.0% by Canopus Investments Limited
- Management fee 1.0% per annum
- Fund size NZ\$30.5 million
- Fund rating, Fundssource 5 star

- Registered as Portfolio Investment Entity (PIE)
- New Zealand dollar denominated – not currency hedged
- New Zealand domiciled – no foreign investment tax complications

For an investment statement and application form contact Canopus info@canopus.co.nz or download from http://www.debentures.co.nz/TTEUT_IS.pdf

4.4. Senior Retirement Village Trust

Promoted by experienced retirement village operator, Vision Securities Limited, the Senior Retirement Village Trust aims to provide an above average and secure return by combining an investment in the surety of first mortgages over retirement villages with PIE regime tax advantages.

Key features:

- 10% p.a. yield with quarterly interest payments
- 3 year term
- First mortgage security
- Minimum investment \$5000
- PIE tax regime qualifying investment
- Nil entry fee on applications made through Canopus

For an investment statement and application form contact Canopus info@canopus.co.nz

4.5. Marac Cash PIE Fund

Two investment products utilising the PIE structure to provide investors with a competitive cash return and significant potential tax savings, depending on the individual's tax rate:

Key features:

- Marac Call PIE, 6.00% p.a. on call. Income earned daily and compounded monthly.
- Marac Term Deposit PIE, fixed 6.25% p.a. for 12 months, interest paid or compounded quarterly.
- Marac PIE fund has no fees.
- Minimum investment \$1000.
- No guarantee under NZ Government Deposit Guarantee Scheme, but the Marac PIE Fund invests exclusively in Marac Finance Limited Debenture Stock.
- No brokerage or entry fee charged on applications made through Canopus.

Contact Canopus info@canopus.co.nz for an investment statement and application form.

5. Fixed Interest and Finance Companies

Our 2 year deposit rate chart at <http://www.debentures.co.nz/2YearDebentureStock.pdf> shows the sharp upturn in bank demand for funds as they face stiff competition from numerous corporate bond issues and renewed tightening in offshore credit markets. Finance company debenture stock rates will languish until:

(a) Future of the Government Deposit Guarantee Scheme is announced. Finance companies cannot plan ahead while they face major uncertainty as to balancing asset and liability maturity

profiles. Early resolution by Government, Reserve Bank and Securities Commission is a must as the sector can play a significant role in economic recovery.

(b) Details of new finance company regulations are determined. The rules are expected to be tough but should not exclude new entrants from the sector.

(c) More top quality lending opportunities can be identified, creating at least some pressure for finance company funding.

Billions of dollars sit idle in finance companies (plus other non-bank deposit takers), contributing very little to economic recovery while future of the Government Deposit Guarantee remains in doubt. Cash reserves are being hoarded to mitigate a potential liquidity brick wall after 12 October 2010. Government needs look no further for much “low hanging fruit” to help stimulate a recovery. Of course banks are also hoarding cash and in much greater amounts, but they face a different set of problems.

The debenture stock Yield Curve at <http://www.debentures.co.nz/YieldCurve.pdf> continues to steepen as finance companies seek funds out past the scheduled Government Deposit Guarantee cutoff date but can't utilise all the short term funding on offer from investors. **Marac** has increased longer term deposit rates slightly while **Broadlands Finance** has just set a new high of 9.50% for 60 months, with quarterly interest payments. Expect others to follow while the guarantee remains in doubt.

Investors in **Mascot Finance**, placed in receivership, will be the first to benefit from the Government Deposit Guarantee Scheme. Populist press columnists and semi-literate bloggers all now claim to know that Mascot should never have been in the scheme in the first place. They just didn't know at the time. They're also short on knowing who else shouldn't be there but will be instant experts again should another failure occur.

In reality the scheme was introduced hastily to meet a vital demand in answer to conditions at the time, achieving its prime objective of preventing runs on banks and other deposit taking institutions. Expect modifications to be announced if indeed the scheme is to continue past 12 October 2010.

Any funds paid out to Mascot investors under the Guarantee should be largely repaid to Government through eventual sale of Mascot's assets. In any case the Government is still massively on the positive side of the deal with overall fees far exceeding likely payouts.

Continuation of the scheme in some form past the scheduled 12 October 2010 termination date looks likely but is not yet assured. At least we should expect to match Australia's guarantee term of an additional year – or suffer the consequences of a massive capital outflow.

Well rated corporate bond issues are proving popular. Interest rates range around the 7% to 8% p.a. range. Contact Energy has just raised \$550 million in bonds paying 8.00%. NZ Post is next in line and should prove very popular considering its Government ownership and backing. See “Current Issues” section.

PGG Wrightson Finance has reported an 82% jump in NPAT to \$4.65 M, of which \$0.96M came from International Financial Reporting Standards adjustments, for the six months ended 31 December 2008. The Company raised \$100M from a secured bond issue, the debenture book expanded by \$90M with an approximately 80% reinvestment rate and undrawn bank facilities stood at \$180M. PGG Wrightson Finance is cautiously optimistic the growth can be maintained, citing new business opportunities from declining competition and the strength to maintain lending during the financial crisis.

For the same half year, **Marac** produced a Net Profit After Tax of \$7.0M (c.f. \$13.5M last year).

Property development lending from the finance company sector has taken a small step towards recovery with minnow Priority Finance being purchased and renamed **Viaduct Capital** by interests largely associated with CEO Nick Wevers. Viaduct Capital is now listed on Debex at http://www.debentures.co.nz/debenture_stock.html and intends to increase funding through offering debenture stock over 12 and 16 month terms. As for other finance companies offering Government Guaranteed debenture stock, response to the offer has been strong and the current issue is likely to be put on hold after a couple of months. Viaduct Capital has the distinct advantage that its loan book will be constructed from valuations relevant to today's valuations – not those of last year or the year before.

Instant Finance must be the only finance company still advertising in a “business as usual mode”. The company has applied for approval under the Government Deposit Guarantee. Until approval is received, Instant Finance will continue to repay debentures as they mature, using its wholesale funding facility. Should approval be received, Instant Finance intends to issue a new prospectus offering debenture stock to the public once again. Introduction of the Government Deposit Guarantee Scheme plus a more flexible working arrangement with wholesale facility provider, Fortress, has seen the plan to repay debenture holders en bloc deferred.

6. Commodities

Crude oil and copper charts both show significant upside breakouts from long established downward sloping channels, but recent strength in oil and base metal prices could prove illusory if demand falls further as global recession intensifies. Crude oil price rises have been largely attributed to massive reserve stockpiling by China, even as OPEC cuts production and global demand falls. Huge new Chinese storage facilities are reportedly now full, with floating storage being considered, i.e. stationary oil tankers. Even more massive land based storage facilities are said to be under construction but not yet completed. Similarly Chinese stockpiling at low prices is suspected of providing base metal price support. China may eventually be in a position to control some important base metal prices through its widespread, euphemistic, “Buying in” to African resources, equity stakes in Australia and elsewhere, massive stockpiles and dominance in important metals futures markets.

For the investor this means mid term gains on energy and hard commodities are not a sure thing as volatility outweighs direction, but longer term rewards could be substantial. Exchange traded funds offer convenient access to commodities.

For further details contact Canopus info@canopus.co.nz

7. Strategy

Much is currently being heard about “bear market rallies”, an easy explanation of recent sharemarket moves, but of little help to investors – especially when some pundits pick a “bear market rally lasting several years and regaining much of what has been lost over the past year”. Just when is a bear market not a bear market? A significant market rise, bear market rally or not, is most likely to precede a tentative economic recovery by many months but that tentative recovery still looks a long way off.

So what indicators can the investor look to for guidance?

Decreased risk aversion is pivotal to both renewed share market interest and eventual economic recovery. Contrary to all predictions a year or so back of the US dollar losing its “reserve currency” status, the Greenback has demonstrated remarkable strength during the “Great Recession” as international investors sought the safe haven of US Government Bonds. Risk aversion has now come to be displayed daily as the strength of other currencies against the US dollar, particularly the (relatively) high interest commodity currencies AUD and NZD, both of which look to have found feet if not wings over the past week, breaking out of downward channels. Of course any additional and unexpected financial disaster would immediately unravel the fragile progress made but even a giant US automaker bankruptcy could hardly be classified as unexpected these days.

We will continue to monitor local currencies and US leading economic indicators for signs of economic life.

History has a habit of repeating and most investors will only return to shares once the recovery is obvious to all, thereby missing out on the real opportunities. Those bold enough to venture in now should generally confine selective buying to major corporates demonstrating strength enough to maintain reasonable profitability and dividends over the long term or special cases with which the investor is particularly familiar.

New Zealand investors should continue to diversify into Australian dollar denominated investments, both for potential currency movements and the greater range of genuine top shelf investment opportunities readily available, particularly in the equities and hedge fund asset classes.

Income seeking investors wanting to participate in high quality bond issues must ensure they apply for firm allocations early.

For all expressions of interest, investment statements and application forms, contact Canopus info@canopus.co.nz

Luck of the Irish to you.

Regards,
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