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

Unsolicited Electronic Messages Act 2007. If you do not wish to receive further issues of "Investment Directions" or other investment messages from Canopus, please reply to this message with "Remove" in the subject line.

Investment Directions 27 November 2014

"Analysis to action. Opportunities to outcomes"

In this Issue

1. **Overview** – Ultra-low global interest rates and fiat currency issuance help push up New Zealand asset prices. OCR held at 3.50% with no upside in view. New stimulus measures in Europe and Japan. US QE ends but Fed to retain inflated balance sheet. US dollar and US equities still in demand by international investors. US and Chinese Leading Economic Indicators still strong. AUD drops on lower interest rate outlook.

2. **Equities** – Portfolio shares. Kingfish issues free warrants. Medibank Private allocations heavily scaled but debut unspectacular.

3. **Interest rates, bonds and debentures** – Term deposit rates steady for November. Best fixed term deposit rates from major finance companies.

4. **Strategy** – Portfolios gain in October. Income portfolio strong but growth portfolio held back by hiccup from PIE Funds Management. Stockton bankruptcy pension judgement blow to US municipal bond holders - could pry open door to higher US interest rates despite US Fed retaining inflated balance sheet.

1. Overview

New Zealand can't isolate itself from the global influences of ultra-low interest rates and major currency debasement. The RBNZ, local analysts and the media were naïve in thinking NZ would see a steady OCR rise during 2014, reaching 4.5% or more as consumer inflation grew. Instead, mortgage and deposit rates are falling again under pressure from cheap money offshore. Consumer inflation is just 1%. Ultra-low global interest rates and fiat money creation manifest themselves here as rising asset prices (shares, property and bonds) even while consumer price inflation stalls. Calls for isolationist policies to prevent "overseas ownership" ignore reality in an inter-related global economy. The repercussions of unilateral action would be severe – but will not stop populist politicians from making such calls. "Populist policy settings" are still possible from a future government. New Zealand yields remain highly attractive to international investors. Falling oil prices mean lower NZ inflation and the OCR on hold. The RBNZ kept NZ's OCR at 3.50% on 30 October but previous pointers - that tightening would be necessary - were missing from the commentary.

The New Zealand dollar has not been debased by quantitative easing so expect demand for the currency to remain firm.

The US Fed, as expected, announced the end of QE on 29 October, also stating that it would keep interest rates low (current target for Federal Funds is 0 – 0.25%). The Fed also announced it would maintain its huge

new bond portfolio, giving the Fed a balance sheet > US$4T, by buying more bonds as existing ones mature. Earlier, the market had expected the Fed would not replace mortgage backed securities as they matured, thus reducing the grossly inflated balance sheet. Coming on top of new data showing US GDP growth moving up to 3.5% p.a., the news created another surge in US share prices.

Wall Street saw extra strength as the European Central Bank and People's Bank of China both announced new stimulatory measures during the week ended 21 November. The ECB will increase asset purchases in an attempt to raise inflation and production while China has cut its benchmark interest rates for the first time since July 2012. The one year lending rate reduces 0.4% to 5.6% as the one year deposit rate falls by 0.25% to 2.75%. More cuts are expected. Shares in Hong Kong and Shanghai rose 2% although volumes of newly-allowed cross trading between the two Chinese exchanges disappointed.

Large capital outflows are reported from Europe as interest rates reach record lows. US$240B reportedly flew the Zone in fixed income assets in the six months to August 2014 as the ECB bond purchasing programme was seen as too limited to inspire confidence in European growth prospects.

Australia has undergone a marked change in interest rate outlook with markets now pricing in a 30% chance of OCR reversal (downwards) by August 2015. The big four banks are cutting term deposit rates. The changed interest rate outlook and more "jawboning" from the RBA is depressing the AUD. Construction fell 2.2% in the September quarter with engineering down 3.2% and residential down 1.6%. The RBA hopes residential construction will pick up the economic slack left by declining construction in mining. For the year, engineering construction was down 12.1% but residential construction rose 8.6%.

In the UK, BoE Governor Mark Carney lowered UK growth and inflation forecasts on 13 November, causing investors to put off expectations of an official interest rate rise until November 2015.

New QE measures in Japan call for the Bank of Japan to increase the amount of Yen created to 80 trillion per year (US$720 billion). The Japanese economy is the World's third largest and about one third the size of the US economy, so this amount of QE is huge. Nearly all the new currency will be used to buy Japanese Government bonds with 3 trillion Yen to be spent on Exchange Traded Funds on the Japanese share market. The Japanese Government Pension Investment Fund will sell US$300B in Japanese Gov. bonds and buy US$150B each of domestic and foreign equities. The goal is to keep Japanese interest rates low while supporting the economy and sharemarket. Exporters should benefit from a lower Yen but consumers will pay more for imported fuel and food. Foreign investors face the danger of a sudden collapse in the Yen, depressing Japanese asset prices in terms of other currencies. Expensive currency hedging would be required to mitigate. Despite a strong resultant boost for the Nikkei 225, direct investment in Japan remains the preserve of specialists.

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

	Latest	Oct 14	Sep 14	Aug 14	Jul 14	Jun 14	May 14
3 month LIBOR (end of month)	.23285	.23210	.23510	.23360	.23960	.23460	.2274
TED Spread (points)	.21	.22	.23	.20	.20	.19	.19
VIX equity volatility	12.25	14.03	16.31	12.09	16.95	11.57	11.40
US LEI		+0.9%	+0.7%	+0.0%	+1.1%	+0.7%	+0.6%
Japan LEI			+0.3%	+0.1%	-0.9%	-0.8%	-1.2%
Eurozone LEI		+0.0%	+0.0%	-0.6%	+0.3%	-0.1%	+0.4%
Australia LEI			-0.3%	-0.1%	+0.6%	+0.2%	+0.2%
United Kingdom LEI			-0.4%	+0.4%	+0.1%	+0.7%	+0.5%
China LEI		+0.9%	+1.0%	+0.7%	+1.3%	+1.3%	+0.7%
New Zealand CLI (Amp adj. OECD)					-0.4%	-0.3%	-0.3%
US Money Market Funds $T	2.654	2.629	2.614	2.595	2.554	2.570	2.587
US Gov. 10 year T-Bond (%)	2.26	2.34	2.51	2.343	2.556	2.516	2.457
Foreign holdings of US T-Bonds $B			6060.4	6066.6	5998.0	6013.2	5976.0
Margin debt, NYSE (US$ millions)		453,841	463,878	463,018	460,231	464,311	438,457
US M2 Money Stock (US$B)		11,511	11,473	11,439	11,414	11,343	11,298
Velocity of Money US M2			1.534			1.535	
Forward P/E S&P 500 (12 month)	17.05	16.25	16.85	16.75	16.55	16.60	15.84

Trailing P/E S&P 500 (12 month)	19.27	18.43	19.36	19.16	19.51	19.34	18.04
Total Put/Call options ratio CBOE	0.98	0.775	1.29	0.82	0.99	0.85	0.89
S&P 500 Share Index	2067.03	2018.05	1972.29	2003.37	1930.67	1960.23	1923.57

The Total Put/Call options ratio has risen rapidly from 0.75 on 23 November to 0.98 on 25 November indicating expert traders are again moving to insure their portfolios. A daily move above 1.0 would be more convincing that the S&P 500 is about to come off recent highs.

3 month LIBOR, TED Spread and VIX equities volatility have all settled back to benign levels. Leading economic indicators for the US and China remained strong in October but the UK showed a sharp reversal. Japan consolidated its positive movement in September but has since slipped back into recession with Prime Minister Abe calling for new elections – basically as a confidence vote in his "Abenomics" strategy of boosting the economy through massive QE money creation. Abe is expected to win the election so Abenomics should continue.

Velocity of Money (US M2) has remained static at an ultra-low level for the past three quarters. I would not expect to see rising US consumer inflation and rising US interest rates until money starts circulating more rapidly at the consumer level. In the meantime, QE money creation will continue to manifest itself as asset price inflation.

NYSE margin trading positions unwound only slightly during October with the S&P 500 actually gaining for the month. Hence the potential remains for a major fall in the index if margin traders are forced to liquidate in large numbers. However, with vast amounts of QE dollars now in existence and accessible to traders, large scale forced liquidation of margin positions seems only a remote possibility. M2 US money supply continues to increase steadily. Forward P/E for the S&P 500 is up but still not excessive. The outlook must be for mildly volatile but still strong equity prices towards year end.

The US dollar remains in demand with foreign holdings of US bonds still high despite declining yields. Compared to the near zero yields available elsewhere, US yields are attractive – Australian and NZ yields even more so.

2. Equities

Kingfish Limited (NZX:KFL) has made a free issue of warrants to shareholders on the register at 12 November in the ratio of 1:4. The warrants are exercisable on 6 November 2015 at $1.29. Should the Kingfish share price be above that price on 6 November 2015 the warrants will be "in the money" and most will be exercised, giving Kingfish a major influx of new cash. Fisher Funds has made one successful issue of Kingfish warrants previously but has failed in earlier attempts to raise funds this way for its specialist listed Australian and international investment companies Barramundi and Marlin respectively. The warrants trade on the NZX with code KFLWC and traded on 26 November at 9 cents each. Theoretically the warrant price should move nearly the same amount in cents as the head KFL shares so the opportunity for big gains and losses from trading the warrants is magnified several times with respect to the head shares. KFL shares currently trade around $1.35 so the warrants are currently "in the money".

The Australian Government SOE sale of **Medibank Private Limited (ASX:MPL)** turned out to be something of a damp squib for New Zealand investors. After granting New Zealanders access to the float via broker "firm allocations", the Commonwealth then cut allocations to New Zealand brokers to about 12% of their requests, leaving some would-be investors with just the minimum holding and others with none at all. Putting the boot in the Australian Government then exercised its option to reclaim a further 20% of broker allocations, reducing new private investor shares even further. At the A$2.00 issue price to private investors, the shares were not cheap but a little below the A$2.15 price institutions paid. Expectations for a strong debut on the ASX were dashed as the shares reached just A$2.23 on the first day and have since drifted off to A$2.11.
Institutional and fund managers are reportedly upset with the high price of the float as they are effectively obliged to hold Medibank shares. As a top 50 stock Medibank will be included in many indices used as benchmarks for fund performance. Considering the financial strength, potential efficiency gains, growth

prospects and respectable dividend for Medibank Private, short-changed New Zealand investors may yet get the chance to add to small initial allocations of the potential blue chip at a reasonable price, more so as the NZD/AUD appreciates. Most will probably regard anything over A$2.00 as too expensive though.

3. Interest rates, bonds and debentures

No changes to our term deposit rate table this month

Current deposit rates, % p.a.:

Issuer	$ min	Call	3mth	6mth	9mth	12mth	18mth	24mth	36mth	48mth	60mth
F&P Finance	1000	3.75	4.10	4.60	4.85	4.95	5.10	5.35	5.60	5.85	6.10
F&P Finance	25,000	3.75	4.25	4.75	5.00	5.10	5.25	5.50	5.75	6.00	6.25
Heartland Bnk	1000	3.75	3.80	4.40	4.35	4.50	4.55	4.65	5.05	5.15	5.60
Heartland Bnk	20,000	3.75	3.90	4.40	4.45	4.50	4.65	4.75	5.15	5.25	5.70
Liberty Fin.	5,000		4.05	4.65	4.85	5.35	5.80	6.05	6.55	6.70	6.75
Liberty Fin.	20,000		4.20	4.80	5.00	5.50	5.95	6.20	6.70	6.85	6.90
UDC Finance	5000	3.45	3.50	4.25	4.40	4.50	4.85	4.90	5.15	5.40	5.65
UDC Finance	100,000	3.95	3.60	4.35	4.50	4.60	4.85	5.00	5.25	5.50	5.75

Heartland Bank frequently 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

Our diversified income portfolio unit gained 2% in value for the month of October as gains accrued across all sectors – equities, bonds and property – with Australian holdings pushed up a little further by a lower NZD/AUD exchange rate. In keeping with our "lower for longer" view on interest rates, the portfolio includes a broad range of bonds, debentures and floating rate notes with maturities spread over the next seven years. As interest rates have declined, this section of the portfolio has provided good income plus increasing market value of securities. Rising interest rates would negatively impact bond values but not the income (assuming no defaults). Rolling maturities will help reduce the overall effect of any rise in interest rates on the portfolio and allow us flexibility to examine appropriate reinvestment strategies for maturing funds at the time. We avoid perpetual bonds as these could be severely affected once interest rates do start to rise.

Our growth portfolio units gained just under 1% for October as the greater exposure to international equities underperformed. Highly rated fund manager, PIE Funds Management, recorded an uncharacteristic stumble in October as it exited a poorly performing company in Australia that had previously featured as one of its favourites. Lessons have surely been learned and I would expect PIE Funds to regain its superior performance in short order. Our growth portfolio includes investment in PIE Funds, providing strong and consistent returns over the long term - but impacting unit value growth in October.

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

Although we continue to add mid-term bonds at reasonable rates from initial issues when available, reasons are emerging that may indicate rising global rates are on the way, but still a long way off.

While announcing the end of QE3, the US Fed unexpectedly also announced an intention to retain its grossly inflated balance sheet through purchase of more Treasury bonds as existing holdings mature, in an attempt to keep US interest rates at ultra-low levels. Previous issues of Investment Directions have covered the point that heavily indebted US cities, counties, utilities and even whole states could be at risk of bankruptcy from rising interest rates, with consequent danger to numerous pension funds. A recent judicial decision to allow the City of Stockton in California to exit bankruptcy with pension benefits largely intact, but at the expense of bond holders, holds the potential to upset the enormous US municipal bond market, taking interest rate settings out of control of the US Fed. Giant US fund manager, Franklin Templeton, has been forced to take a haircut of 89%, getting just over $4 million of its Stockton debt holding of $36 million, supposedly secured by collateral of golf courses and a park. The decision throws into doubt the priority of municipal creditors and the value of collateral. Since the decision, the US S&P Municipal Bond Index has fallen slightly while other indices remain positive. This could be an important indicator to watch in early 2015 along with the US 10 year Treasury bond yield and velocity of money.

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.

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 each individual'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,

Alan King
Authorised Financial Adviser
Canopus Investments Limited
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

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

Disclosure

Canopus Investments Limited, its directors, officers and associates, may hold or apply for investments referred to in this newsletter for their own investment purposes.

Canopus Investments Limited does not bank or hold investment monies received on behalf of clients unless by special request or arrangement. When held on behalf of clients through special request, client funds will be held on trust in a separate special purpose account. In the normal course of business, investment monies will be passed directly to the securities issuer. All Canopus sharetrading account holders are issued with an individual true bank account from which share purchases are funded and to which share sale proceeds are deposited. Canopus does not pool sharetrading account funds.

Disclaimer

This newsletter does not constitute personal investment advice. Information in this newsletter does not constitute a recommendation or

advice to purchase any product or service referred to in this newsletter. Investment products or services referred to in this newsletter may not be suitable for individual investment objectives or individual financial circumstances. Information contained in this newsletter should not be relied on for making investment decisions. In compiling this newsletter, individual personal financial circumstances have not been taken into account. For personal investment advice contact Canopus Investments Limited to arrange an initial advisory interview.

To the maximum extent permitted by law, neither the owners, managers, employees nor associates of Canopus Investments Limited accept any liability whatsoever for any loss or damage resulting from reliance on, or consequent to, the use of information obtained from this communication or any other publication produced by the owners, managers, employees or associates of Canopus Investments Limited. Neither Canopus Investments Limited, nor its directors, officers and associates, guarantee the expected investment return, return of capital, or any other return from investments referred to in this newsletter. Neither Canopus Investments Limited, its directors, officers nor associates accept any liability whatsoever for financial losses that may be incurred as a result of reliance on, or consequent to, any information contained in this communication.

Information provided in this communication does not constitute an offer of securities as such offer is only made on receipt of a completed application form. Application for securities will only be accepted when made on the application form accompanying the formal offer document.

This newsletter is compiled from information believed to be accurate at the time of writing. However, no guarantee as to the accuracy of information contained in this newsletter is given, intended or implied.

Information contained in this newsletter is provided on a non-prejudicial basis only. Information contained in this newsletter is not intended to create, nor does it create, any legal obligation, responsibility or contract between Canopus Investments Limited, its officers and associates and any other party.

Copyright

Information contained in this newsletter may not be used for other than the purpose for which it is intended, that is, the obtaining of financial services information of a general or class nature only. International copyright to the material in this newsletter is held by Canopus Investments Limited. Unauthorised copying, forwarding or use of information obtained from this newsletter by any individual, entity (whether legally incorporated or not), corporate, state or representative of such entities in any manner whatsoever is prohibited and may be deemed to constitute breach of copyright.