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Investment Directions **29 October 2016**

"Analysis to action; opportunities to outcomes"

In this Issue

1. **Overview** – Did Trump trough too soon? Has Hillary peaked too early? FBI reopens Clinton probe – unlikely to swing outcome but investors have cause to pause. US Fed rate rise in December being priced in as fact. New Zealand and Australian interest rates near or at bottom of current cycle. Data indicates US economic recovery continues but no sign of rapid inflation.

2. **Equities** – Lessons for IPO investors in demise of Wynyard.

3. **Interest rates, bonds and debentures** – Trustpower bond exchange offer to go ahead after company's South Australian wind farms return to production following severe storm that disrupted state power grid. No need for bond holders to take further action if option application already submitted. Deposit rates stable during October. Deposit rates for major S&P-rated finance companies. Standard and Poors downgrades UDC Finance.

4. **Strategy** – Portfolios steady in September, ease slightly in October but volatility low. FBI decision to reopen Clinton email investigation slam dunks US equities - but partial recovery quickly follows.

Space Exploration News

The space race to Mars is on. Boeing says it will beat Spacex.

http://money.cnn.com/2016/10/05/technology/boeing-mars-spacex-elon-musk/index.html

1. Overview

Trump managed to claw back a few points following the third debate, but later polls showed Clinton moving ahead again, albeit marginally. Given Trump's unerring propensity for self- destruction throughout the entire campaign, a Clinton lead of just 5% - 6% seems unbelievable. After troughing late in October the Trump campaign must have even dared deep thoughts of a possible upset on 8 November. Trump rallies still attract thousands while Clinton's MSM media friends have difficulty making even a school gymnasium look half full. Any half decent candidate riding the "anti-establishment" wave would have waltzed in, but the obstreperous Trump must be counted amongst Clinton's biggest advantages and, ironically, the investor's best friend. This has got to be the most bizarre presidential race in living memory.

No one has more riding on the outcome than FBI Director James Comey. After earlier reporting that the Clinton email case had been closed and then being taken to pieces before a House Judiciary Committee for failing to pursue the case while handing out immunities, on 28 October Comey wrote to Republican committee members revealing that the Clinton email case would be reopened in light of new emails coming to hand that appeared to be pertinent to the investigation.

Wall Street's reaction to the bombshell news was sharp and dramatic, The DJIA falling 150 points in a matter of minutes, but then quickly recovering half of that decline on realisation that little chance existed of any FBI action being taken prior to the election – thus still leaving Clinton a relatively free run at the White House. As of this writing, the FBI news had not entered polling, where Clinton maintains a 5.2 point lead. Comey has probably taken little enough action to save his own scalp from a Clinton presidency – but has now succeeded in making enemies in both camps.

So investor sentiment, having discounted a Trump victory entirely by mid-October, has now been forced to reconsider the real possibility of an upset in the Whitehouse race on 8 November, with all the dire consequences that a Trump reversion to isolationist economics would hold for portfolios. For now though, despite just a slim lead in the polls, Clinton holds nearly all the electoral college cards. This is one presidential election investors throughout the world will be pleased to see the back of.

Looking past Clinton and Trump, the US Federal Reserve rate decision on 14 December poses the biggest investor challenge. Since lower equities, higher bond yields and a rising US dollar have all made up their minds that a rate hike is on, the quandary for investors lies in trying to pre-guess what guidance the Fed may provide in its December release. As a December rate hike moves from "known unknown" to "known known" territory, further impact post the announcement should be much less than many currently fear, barring a major shock in Fed guidance. Further, if current signs of an end to the year- long US corporate "earnings recession" can consolidate then return of the traditional New Year rally becomes a real possibility.

On 4 December Italy holds a constitutional reform referendum on which Prime Minister Matteo Renzi has staked his future and which many observers see as a de facto vote on continued Italian EU membership. As in the UK, US and other EU member states, anti-establishment sentiment runs high, led in Italy by the 5 Star Movement, recent winners of the Rome mayoralty. Polls indicate "No" is ahead – boosting 5 Star and the anti-EU cause. However, a national election is not due until 2018 and a "No" vote does not necessarily mean resignation of the present government. Hence the referendum is unlikely to hold any immediate threat to European unity – or to equity markets. Argument continues over whether insolvent Italian banks should be rescued by "bail in" or "bail out". Only "bail in" is allowed under EU rules, forcing losses on depositors, bond holders and shareholders - and boosting anti-establishment sentiment even further. But EU bureaucrats and Italian politicians alike know they tread that particular academic path to their own demise. And when were Italian banks not insolvent anyway? Vatican officials reportedly developed a type of floating charge security as far back as the thirteenth century to protect Papal funds from "absconding merchant bankers". Don't expect any great equity market impact from Italy on 4 December whether the vote be "Yes" or "No".

New Zealand's RBNZ has adopted a policy of issuing explicit projections on expected OCR rates in contrast to just the 90 day bill rate projections made previously and from which economists had to infer the future OCR. From the new policy, economists expect the OCR to be reduced to 1.75% on 10 November and that this will be the low point of the current cycle. As usual though, the RBNZ retains an escape clause, saying OCR projections will be conditional on its assessment of current economic conditions and assumptions about future evolution of the NZ economy. Lowering the New Zealand OCR just before a US Federal Reserve rate hike in December would drive a weaker NZD/USD.

New Zealand's annual inflation rate in the September quarter was just 0.2%, down from 0.4% in June, adding strength to the RBNZ's argument for a lower OCR in November.

In contrast, new Australian Reserve Bank Governor, Philip Lowe, is not committed to a lower OCR, indicating the current 1.50% could be the lowest point in this cycle. As with the NZD/USD, the NZD/AUD looks set to continue its weaker path. Australian inflation rose 0.7% in the September quarter vs 0.5% expected, further reducing expectations of another OCR cut, although annual inflation remains well below the RBA target of 2% - 3% at 1.3% http://money.cnn.com/2016/10/05/technology/boeing-mars-spacex-elon-musk/index.html. Much lower inflation figures or a bad bout of news from China would be needed for the

1.50% OCR rate to be threatened.

Westpac reports Australia's economic outlook has improved for the second month in a row. The Westpac-Melbourne Institute Leading Index, which indicates likely pace of economic activity 9 months hence, rose to 0.58 in September from 0.15 in August, the strongest increase since December 2013. Helping must be iron ore, back up over US$60 per tonne after lows around US$30 in late 2015.

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

	Latest	Sep 16	Aug 16	Jul 16	Jun 16	May 16	Apr 16
3 month LIBOR (end of month) %	.88733	.84561	.83344	.75150	.6311	.67305	.63835
TED Spread (points)	.55	.57	.51	.49	.39	.35	.42
VIX equity volatility	16.19	13.29	13.12	11.87	15.63	14.19	15.70
US LEI		+0.2%	-0.2%	+0.5%	+0.2%	-0.2%	+0.5%
Japan LEI			-1.1%	-0.1%	-0.3%	+0.3%	-0.2%
Eurozone LEI		+0.1%	+0.2%	-0.6%	-0.1%	+0.2%	+0.0%
Australia LEI			+0.0%	+0.5%	+0.2%	+0.3%	+0.7%
United Kingdom LEI			+0.0%	-0.2%	-0.2%	-0.3%	-0.0%
China LEI		+1.1%	+0.8%	+0.3%	+0.3%	+1.9%	-0.1%
US Money Market Funds $T	2.651	2.680	2.724	2.715	2.718	2.733	2.709
US Gov. 10 year T-Bond (%)	1.8450	1.6080	1.5680	1.458	1.488	1.834	1.819
US 5 yr inflation expectations %	1.87	1.75	1.64	1.67	1.42	1.61	1.82
US high yield-treasury spread 3-5yr %	4.69	4.97	5.10	5.69	6.21	5.97	6.24
Foreign holdings of US T-Bonds $B			6196.4	6247.9	6281.0	6209.9	6238.5
Margin debt, NYSE (US$ millions)		501,125	471,231	474,575	447,337	451,094	455,646
US M2 Money Stock (US$B)		13060.9	12986.9	12878.0	12803.6	12728.8	12652.4
Velocity of Money US M2		1.437			1.448		
CNN Fear and Greed Index	33	50	63	82	44	77	72
AAII sentiment survey (% bullish)	24.8	24.0	28.6	31.3	29.0	17.8	27.4
US retail & food service sales US$B		459.821	456.976	457.849	457.409	454.135	453.397
Insider Buy/Sell ratio (US) %	31	32	29	34	45	44	41
Brent crude oil spot price USD/barrel	49.80	48.24	47.94	40.76	48.05	49.26	45.64
Forward P/E S&P 500 (12 month)	18.02	18.43	18.59	18.93	17.99	17.75	17.80
Trailing P/E S&P 500 (12 month)	24.31	24.81	24.71	24.87	24.22	24.04	24.11
Total Put/Call options ratio CBOE	0.99		1.01	1.20	1.23	0.93	1.15
S&P 500 Share Index	2126.41	2168.27	2170.95	2173.60	2098.86	2096.95	2065.30

US Interest rates up, S&P 500 down, inflation expectations up, all point to a US Federal Reserve rate hike in December - discounting the possibility of a move just prior to the presidential election in November. US consumer spending continues to grow but business investment is reportedly weak. Velocity of money fell even further in the September quarter suggesting any Fed guidance in December on future rate rises should be benign. Moderate TED Spread and a lower high yield-treasury spread indicate credit risk is low. After an extended period of relative consistency, NYSE margin debt has stepped up – a worrying trend we would not want to see develop into something bigger in the months ahead. I would prefer to see short term indicators further into "fear" territory before entering on the buy side.

While the presidential race lies open to more bombshells – on either side – easing of US share indices could continue, but underlying data doesn't suggest any significant threat to equites in the medium term.

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2. Equities

The demise of **Wynyard Group (NZX:WYN)** provides some salutary lessons for intending IPO investors:

1. Chasing up "hot stocks" can be detrimental to your portfolio health.
2. Investing in high tech software companies carries its own special set of risks.
3. Accept glowing company announcements with a big grain of salt.
4. Take extra care when investing in "one shot wonder" companies.

5. The good IPOs are the ones you can't get hold of.

Wynyard voluntarily called in administrators on 25 October - just over three years after listing, after suffering a series of increasing losses and making insufficient progress on major projects. Despite backers stumping up another $30m via a rights issue the company still needed more cash but draw down of a $10m loan facility proved infeasible thanks to a number of tough conditions imposed.

So even when a new company appears to offer "blue sky" with a potentially high demand product in a growth sector, those shares can still turn out to be a bad investment.

3. Interest rates, bonds and debentures

The demerger of Trustpower, relevant to Trustpower bond holders and reported on in this section last month, was put on hold following a severe storm in South Australia that damaged the State's transmission system and which saw Trustpower's Snowtown 1 and 2 windfarms close down temporarily when the Australian Energy Market Operator suspended the South Australian electricity market. On 17 October Trustpower reported that the electricity spot market had resumed normal operations and that the constraints on Snowtown 1 and 2 had been lifted. On 19 October Trustpower reported that the demerger process would proceed and that final court orders for the demerger process had been granted.

Trustpower bond holders who have already submitted their option applications, need take no further action to participate in the demerger as they originally intended.

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	A-	5,000	2.05	2.70	3.20	3.50	3.55	3.65	3.30	3.30	3.30	3.40
UDC Finance	A-	100,000	2.55	2.75	3.25	3.50	3.55	3.65	3.35	3.35	3.35	3.45

S&P has downgraded UDC's long term credit rating from AA- to A- as a result of ANZ bank reviewing its continued ownership of UDC. UDC remains on credit watch negative by S&P until greater clarity emerges in relation to UDC's future ownership.

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

Considering the possibility of more US election bombshells, holding fire on market purchases seems wise for now. Hot overseas money that chased New Zealand high yields up, is in the process of departing, depressing the NZX sharply and bringing some top local equities within striking distance. However, the improving Australian outlook and depressed prices there too means any powder we choose to expend will most likely be across the ditch. A high risk/high return strategy would be to purchase just a day or two ahead of the November 8 US presidential election.

Interest rate sensitive sectors in New Zealand and Australia are suffering as hot international money leaves in anticipation of a US interest rate rise in December. Expectations of a lower New Zealand dollar is helping push New Zealand listed security prices down faster than Australia, reversing the out-performance experienced by New Zealand equities on the way up. Particularly hard hit have been listed property plus high yielding infrastructure and utility sectors with limited growth projections. Where a listed entity in one of these traditionally stable sectors offers all of low price, high yield and a measure of growth, a well-priced entry should prove very rewarding.

Australian property companies with exposure to the housing market continue to languish on the ASX despite being well off their highs in August and offering high dividend yields. Surging high rise apartment approvals and construction in Sydney and Melbourne are expected to produce a large oversupply in the months and perhaps even years ahead. Restrictions placed on foreign buyers, both from within Australia and overseas, should exacerbate the situation. At some stage these listed property companies should make excellent buying but patience is needed.

Our published personalised portfolios made slight gains in September but have retreated a little in October to date after significant equities weakness on both the ASX and NZX. Preliminary assessments show our published income portfolio units as being down 1.3% in October with growth portfolio units off 1.4%. Diversification plus an eye on income as well as growth have helped reduce portfolio volatility during a month when Australasian sharemarkets have retreated more than 5%.

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

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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.

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Regards,

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