Canopus Investments Limited

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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.international-equities.com

Investment Directions **30 September 2016**

"Analysis to action; opportunities to outcomes"

In this Issue

1. **Overview** – Multiple and divergent pressures currently driving global equity markets but US presidential election outcome the biggest unknown. "Buy rumour, sell fact" will apply if Clinton wins. An unexpected Trump victory would slam equities. RBNZ keeps OCR at 2.00%. Prospects of further OCR cuts diminish as dairy prices rise and NZ economy grows at 3.6% p.a. – amongst highest in OECD. Outlook for equity purchases in October unfavourable but may improve by end of month.

2. **Equities** – Infratil and Genesis Energy, income and growth prospects.

3. **Interest rates, bonds and debentures** – Demerging Trustpower offers complicated exchange offer for some existing bonds with cash redemption and offer of new bonds for others. Action required by existing bond holders or valuable bonds may be automatically redeemed for cash. Deposit rates stable during September. Deposit rates for major S&P-rated finance companies.

4. **Strategy** – Portfolios steady in September. US presidential election uncertainty having negative impact on equities but pressure should ease if Clinton moves ahead in polls.

Space Exploration News

SpaceX outlines plans to land humans on Mars by 2025, download presentation at [*http://www.spacex.com/mars*](http://www.spacex.com/mars)

1. Overview

Rarely have financial markets experienced so many driving pressures at one time as we see today. No sooner had the Bank of Japan moved off investors' worry lists than concern over Deutsche Bank's capital adequacy re-emerged. In a relatively mundane move, the Bank of Japan said it would target long term interest rates through purchase of government bonds to keep 10 year bond yields near zero. Japan's QE target was lowered by 80T Yen (US$788B) while the base rate was kept at -0.1%. Impact on global equities was minimal.

Germany's biggest lending bank faces a possible US$14B claim by US regulators pertaining to its sale of mortgage backed securities leading up to the Global Financial Crisis in 2008. German Chancellor Angela Merkel has reportedly ruled out a government bail-out and observers believe the bank has left it too late to conduct an effective capital raising through new share issuance as existing shareholders would see their holdings severely diluted. Restoring profitability is proving challenging in an ultra-low interest rate environment and the DBK share price has consequently dropped from over €30 in July 2015 to just over €10 14 months later. Although Deutsche Bank has denied it needs additional capital or state assistance, jitters have spread throughout European banking stocks and to the US where some derivatives clearing houses were reportedly winding down exposure to Deutsche Bank. However, Deutsche Bank has other options to remain solvent, including cancellation of high risk subordinated bonds or passing of interest payments on those bonds. In New Zealand similar high risk securities issued by banks are known as “Tier 2 subordinated capital notes” – which can be similarly converted or cancelled to support bank solvency in an emergency. Beyond the European banking sector for now though, negative impact on equities should be limited. The US banking sector is more likely to be affected by the current Wells Fargo debacle.

Oil imposes a daily variable on equity markets as OPEC tries to agree on production cuts. A reported agreement to limit production on 28 September helped equity markets into recovery mode the next day.

As always, China’s mounting debt of unknown quality, housing market and banking stability pose additional concerns – particularly for those commodity exporting nations so dependent on the giant Asian consumer. Of all “known known” risks, China has to be the biggest. What is unknown is how well Chinese authorities can contain the risk through direct intervention and market controls when needed. But China remains a command economy and, for now at least, global markets appear willing to give Chinese authorities the benefit of the doubt.

US equity, currency and credit markets are partly factoring in a December interest rate hike by the Federal Reserve after the September meeting, as expected, failed to produce a result. November’s meeting, just before the presidential election, can be ruled out – leaving December as the only remaining 2016 possibility. The move, when it comes, will be negative for equities but should not deliver the same king hit as the first rise in December 2015.

Overriding all though, is that big elephant in the cupboard - Donald Trump. All he had to do to stay in the race during the first presidential candidate’s debate was to avoid being his own worst enemy (again). This he largely achieved despite presenting nothing more than his usual blustering megalomania alongside a highly polished Hillary Clinton. Without doubt Trump is the huge enigma of our time. Just a month ago Hillary Clinton all-but had 270 Electoral College votes and the Presidency in her bag. Today she struggles to maintain just a 2 point lead over Trump in the polls and her likely Electoral College total has been cut to 188. If Trump can swing Florida’s 29 votes, it’s all on in a big way.

Of huge concern to Clinton campaign managers must be the sheer paucity of numbers turning up to Hillary Clinton’s campaign rallies. Double imaging, zero zoom or pan and selective crowd slicing all get mixed through willing media cameras to hide pitiful attendance and rows of empty seats in school gyms. In contrast, Trump draws thousands, even tens of thousands, to huge halls and stadiums wherever he goes. Normally, rally numbers give a strong pointer to the eventual outcome. According to the pollsters, this time it’s different. Maybe.

To date, equity markets have not factored in the possibility of a Trump win. Indeed, post-debate revival indicates renewed equity market confidence in a Clinton presidency. A Trump presidency, after trailing Clinton in the polls, would hit equity markets hard. A lot of water has to go under this bridge yet.

As expected, the RBNZ left New Zealand’s OCR at 2.00% at its review on 22 September.

Fonterra raised its forecast farmgate milk price to $5.25/kg MS from $4.75, a move expected to put an extra $1B into the national economy through an average $79k boost to dairy farm incomes. $5.25 is above the $5.05 calculated by Dairy NZ as the break-even price needed for the average dairy farm to reach profit. Fonterra’s new forecast came after the dairy price index rose another 1.7% at auction on 20 September. Whole milk powder, New Zealand’s single largest export, has now risen 32.5% over the past three months.

Goldman Sachs has dropped its forecast chance of a further RBNZ OCR cut in November to nil as New Zealand’s GDP growth at 3.6% is amongst the highest in the OECD and spending on household goods such as furniture, carpets and audio equipment starts to grow. Swap market pricing in of the chance for a lower OCR in November has dropped from 75% to 54%. Firming sentiment against a lower OCR has helped the NZ retain strength against both the AUD and USD although the Kiwi is off its September highs. Yields here remain highly attractive to investors from sub-zero interest rate regions. Hence any NZD weakness should be limited for the immediate future.

Australia's central bank left its OCR at 1.5% on 6 September and gave little new guidance as to future likely movements.

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

	Latest	Aug 16	Jul 16	Jun 16	May 16	Apr 16	Mar 16
3 month LIBOR (end of month) %	.85294	.83344	.75150	.6311	.67305	.63835	.62820
TED Spread (points)	.57	.51	.49	.39	.35	.42	.42
VIX equity volatility	13.12	13.12	11.87	15.63	14.19	15.70	13.95
US LEI		-0.2%	+0.5%	+0.2%	-0.2%	+0.5%	+0.1%
Japan LEI			+0.0%	-0.3%	+0.3%	-0.2%	+0.2%
Eurozone LEI		+0.0%	-0.1%	-0.1%	+0.2%	+0.0%	+0.3%
Australia LEI			+0.4%	+0.3%	+0.3%	+0.7%	+0.3%
United Kingdom LEI			+0.0%	-0.3%	-0.3%	-0.0%	-0.2%
China LEI		+0.9%	+0.6%	+0.5%	+0.4%	-0.1%	+0.3%
US Money Market Funds $T	2.670	2.724	2.715	2.718	2.733	2.709	2.765
US Gov. 10 year T-Bond (%)	1.5560	1.5680	1.458	1.488	1.834	1.819	1.786
US 5 yr inflation expectations %	1.68	1.64	1.67	1.42	1.61	1.82	1.75
US high yield-treasury spread 3-5yr %	5.16	5.10	5.69	6.21	5.97	6.24	7.05
Foreign holdings of US T-Bonds $B			6247.9	6281.0	6209.9	6238.5	6287.0
Margin debt, NYSE (US$ millions)			474,575	447,337	451,094	455,646	445,846
US M2 Money Stock (US$B)		13008.0	12891.8	12811.4	12733.5	12654.2	12572.9
Velocity of Money US M2				1.448			1.463
CNN Fear and Greed Index	45	63	82	44	77	72	64
AAII sentiment survey (% bullish)	24.8	28.6	31.3	29.0	17.8	27.4	27.2
US retail & food service sales US$B		456.321	457.669	457.409	454.135	453.397	
Insider Buy/Sell ratio (US) %	31	29	34	45	44	41	58
Brent crude oil spot price USD/barrel	48.85	46.92	43.30	49.73	49.69		
Forward P/E S&P 500 (12 month)	18.43	18.59	18.93	17.99	17.75	17.80	17.55
Trailing P/E S&P 500 (12 month)	24.81	24.71	24.87	24.22	24.04	24.11	23.53
Total Put/Call options ratio CBOE	0.99	1.01	1.20	1.23	0.93	1.15	1.08
S&P 500 Share Index	2159.93	2170.95	2173.60	2098.86	2096.95	2065.30	2059.74

Short term indicators of Fear and Greed, AAII sentiment and insider buy/sell ratio all point to an improving but still unfavourable time to be buying equities as we move from the end of September, traditionally a weak month, into the uncertainty of the US presidential election compounded by expectations of a US Fed interest rate hike in December. US interest rates do appear to be on the turn, but the pace is glacial. Any boost to equities from rising crude oil price should be limited by world ability to increase supply despite OPEC agreement to limit production.

2. Equities

Infratil (IFT:NZX) has received Foreign Investment Review Board (FIRB) approval to buy 48% of Canberra Data Centres at a cost of A$392m. Australia's Commonwealth Superannuation Corporation will also hold 48% of CDC with 4% being retained by CDC executives. CDC provides outsourced data centre services to many Federal Government agencies and private customers. Infratil reports that CDC has achieved strong recent growth with a number of growth opportunities underway, including a fourth data centre. CDC has confirmed that it is on track to deliver growth of around 30% for the full year to 30 June 2017 as the business fills existing capacity within its facilities.

Cash dividend yield at 2016 payout of 14.25cps and current share price of $3.24 is 4.40% with 100% dividend imputation credits. Analysts expect dividends of about 16 cps in 2017, giving a cash yield of 4.94% on current share price, also with 100% imputation credits attached.

Genesis Energy (GNE:NZX) currently sells on a high cash dividend yield of 7.81% with 80% imputation credits attached. Dividends per share are picked to rise to 17 cps in 2017 (from 16 cps in 2016) with 75% imputation credits attached, representing a cash yield of 8.10% at the current price of $2.10. Analysts expect net profit after tax to remain steady or increase only moderately over the next two years. Chair Dame Jenny Shipley is expected to give guidance for 2017 results at the Annual Shareholders Meeting on 19 October. Should directors forecast even a modest growth in NPAT for the current year, Genesis Energy could represent a useful yield addition to portfolios, providing both high income yield and a component of growth. Intending investors would have to be prepared to act quickly on any positive news coming from the annual meeting.

3. Interest rates, bonds and debentures

NZX-listed Trustpower is demerging into two listed entities:

1. "Tilt Renewables" to hold Trustpower's Australasian wind generation assets and solar development projects and
2. Bay Energy Limited ("New Trustpower") which will operate Trustpower's Australasian hydro generating plants and New Zealand retail businesses.

Existing Trustpower shareholders will receive one share in each of the demerged companies for each existing Trustpower share.

As part of the demerger process some existing Trustpower bond holders will be offered the opportunity to exchange their existing Trustpower bonds for new bonds to be issued by "New Trustpower" while others will be able to apply for a priority allocation of new bonds. The new bonds will carry a coupon of 4.01% with a maturity date of 15 December 2022 and are intended to be listed on the NZX Debt Market under code TPW150. Payments of interest will be made quarterly in arrears, commencing on 15 December 2016.

Existing TPW090 (15/12/16, 8.00%) bond holders will have their bonds redeemed but may apply for new shares in the priority pool.

New Zealand resident holders of TPW100 Senior Bonds (15/12/17, 7.10%), TPW110 Subordinated Bonds (15/9/19, 6.75%) and TPW Senior Bonds (15/12/21, 5.63%) are offered the options of exchanging none, some or all of their existing bonds for new bonds carrying the same maturity, ranking and coupon as their existing bonds. Applications for the exchange offers must be received by the registrar no later than 5.00 pm on 12 October 2016.

Existing bond holders, eligible for the exchange offer but who do not advise the registrar of an option prior to the closure date will have their existing bonds redeemed for cash.

Members of the general public may apply for new bonds (TPW150, 15/12/22, 4.01%) through approved financial intermediaries.

Before making any application for bonds or selecting their preferred choice of exchange or redemption, eligible bond holders and intending applicants for new bonds are strongly advised to read the Product Disclosure Statements to see full details of the offers.

No movement in term deposit rates during September but UDC has lowered on call rates.
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	2.05	2.70	3.20	3.50	3.55	3.65	3.30	3.30	3.30	3.40
UDC Finance	AA-	100,000	2.55	2.75	3.25	3.50	3.55	3.65	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

Equity markets move largely in response to expectations, not actual events. The old adage "buy rumour, sell fact" succinctly says that by the time an expected (positive) event happens, price action related to that event will have already occurred. Hence unexpected outcomes, such as the unexpected Brexit vote, exert a swift and opposite reaction on prices. Experienced investors see such moments as rare opportunities, not causes for panic.

Of all competing pressures on equity markets just now, the US presidential election holds the biggest potential for an "unexpected event". By all rhyme and reason the practised and professional Hillary Clinton should be miles ahead of rambunctious Donald Trump but even after "winning" the first debate she appears to be recovering little of her ground lost in September. Financial markets see Clinton as the steady financial hand in contrast to a Trump pushing a reversion to trade barriers and isolationist economics. Equity markets, perhaps dangerously, are going with the polls, expecting and pricing in a Clinton victory but as we have seen above, Clinton's narrow lead in the polls is not supported by rally numbers where Trump easily holds the populist momentum. Polls and rally numbers tell opposite stories. Both can't be right - hence the potential for a major upset on 8 November.

Clinton has one month with two more presidential debates to consolidate and expand her lead. Should she manage to do so, by 9 November all expectations will have been built into share prices and few, if any, opportunities will remain after a Clinton victory. In contrast, if Trump triumphs, expect a sharp sell-off in global equities deeper and longer lasting than that following the post-Brexit vote. Therein could lie real opportunities.

With other current share market drivers effectively "known knowns", only the US presidential race poses a genuine "known unknown". Hence risk during the traditionally weak month of October is high and any purchases should be limited to special opportunities and restricted attractive offers. While the NZD/AUD rate remains high and local share prices expensive, New Zealand investors should be looking to the much larger and better-priced Australian market for special opportunities. Tourism, aged accommodation and healthcare are favoured sectors but again, with expectations already priced in, attractive purchases are hard to find. Utilities, infrastructure and listed property, now well down off highs in expectation of higher US interest rates, may hold more promise.

Where applicable we intend to exercise rights to exchange existing Trustpower bonds for equivalent bonds to be issued by "New Trustpower". Given that ultra-low interest rates should be with us for an extended time, senior bonds paying a respectable income are hard to come by.

Our published personalised portfolios have held steady during September, negatively impacted by a weaker New Zealand share market but assisted by steady offshore equities and a slightly lower NZ dollar. Substantial September dividend and interest payments are still to be counted. 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.

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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