



What should you be doing?

Despite the strong run up in the markets over the past month, we remain pessimistic regarding the mid-term future. There are too many problems on the horizon, Italy, Greece, the Euro, the US deficit, the US presidential election etc. We have cut our clients equity exposure in the face of this uncertainty. We feel that asset protection has to be a priority over the next few months until we have a clearer picture regarding a possible second recession in the US. However, as the picture remains cloudy, and as the markets often move in a contrary manner (as we have seen over the last month) we would not suggest completely getting out of equities. We think that taking advantage of the current strength of the market to cut existing weightings by around 50% is the prudent course. That way, should disaster strike, all assets are not at risk, and should the markets rally strongly, one will not totally miss out.

Markets – 1 year

US S&P 50	1263+1.95%
ASX S&P 200	4353-9.80%
Nikkei 225	9050-1.820%
FTSE 100	5702-5.70%
NZX 50	3326+4.80%
Oil WTI	\$93.25 +12.54%
Gold	\$1,724.20 +19.53%
NZD/USD	0.8112
NZD/AUD	0.77692
Model Portfolio +29%	

Bond comment

We have made a change in the model portfolio this month, selling the CBA Capital RPS (purchased April 2009 at 0.79 – sold Oct 2011 at 0.931) and invested \$55,000.00 into Prime Infrastructure bonds at a price of 0.99823. These securities mature on 30 November 2012, and have been purchased at a yield to maturity of 13.10%, and cum 5 months accrued interest. We are attracted to them as they are a senior secured bond, whose ultimate parent company Brookfields Infrastructure Partners (BIP) LP is a large publicly listed fund on the NYSE. In October 2011 BIP successfully raised US\$500mn in a placement of shares for new investment opportunities and working capital, and is well positioned with substantial available liquidity to repay these securities upon maturity in November 2012. BIP owns a number of assets in Australasia, including a significant shareholding in Powerco in NZ.

Equities comment

A stock that we recently identified as good value is Admiral Group. Admiral is one of the main car insurance companies in the UK. Its principal business is selling, administering and underwriting UK private car insurance through four brands: Admiral, Bell, Diamond and Elephant. It also has car insurance businesses in Spain, Italy, France and the United States. It owns one of the key insurance comparison web sites in the UK called Confused.com. Admiral, through its non traditional business model is a story of amazing growth and inspired innovation. Admiral launched in January 1993 with just one brand, zero customers and 57 members of staff. However, at December 2010, the Group had over 2.75 million customers insured and over 4500 members of staff worldwide. During that time, they managed to avoid the growing problem of large personal injury claims for whiplash during car crashes. This has become the bane of insurers profits in the UK. Unfortunately, their luck or judgment seems to have run out on this score as recent figures show that these claims are well above historical levels of experience, and profit for the year will be at the lower end of expectations. This news has caused a collapse in the share price. This savage response to a piece of disappointing news is another example of the markets extreme skittishness.



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Model Portfolio

Based on our view that the US will most likely go into recession next year, we have decided to sell down a number of our holdings in the model portfolio. This, we feel, will give us ammunition to invest when we get close to a bottom, and will also help protect a good portion of the capital. This is a bit of a two way bet on the future of the market next year. So we will sell all our holdings in General Dynamics (20%) and Garmin (20%) and we will reduce our holdings in Hansen (120%), CEO (40%), Monadelphous (60%), LabCorp (20%), JoyGlobal (60%) and AstraZenica (-3%). The figures shown in brackets are the approximate profit we made from the holding in these shares. We will keep the cash raised on deposit, but if we see some good bond opportunities in the meantime, we may avail of those. Thus, the make up of the portfolio may well change from the original intended 50% bonds and 50% equity.

The model bond portfolio received 5 coupon payments from its portfolio holdings in October. Despite risk assets having a strong rally during the month, the bond portfolio performed well, with over half the constituent holdings making interest payments. With global growth concerns continuing to be at the front of mind of politicians and investors alike, interest rates now appear destined to remain lower for longer. Consensus views in NZ for the next increase in the OCR have now been pushed out to the middle of 2012. Accordingly, we have decided to sell CBA Capital Redeemable Preference Shares out of the model portfolio, and purchase Prime Infrastructure Bonds. This will deliver the model portfolio a significant step up in income, and due to their short duration to maturity, will likely allow us to repurchase the CBA Capital RPS this time next year at a similar price to this month's sale price.

Model Portfolio

Initial value \$1m Current Value \$1.29m

Cash 3% Bonds 47% Shares 50%

Performance Top Performer Bonds (1 m) Top Performer Shares (1 m)

6 months	-3%	GPG +1%	JoyGlobal	+40%
12 months	+9%	Rabo +0%	CEO	+23%
since start	+29%	CBA +0%	Noble	+22%

Investment basics re-visited: The risk premium

Considering all of the sources of risk we examined last month, it is very likely that the return on any investment will deviate from what might have been forecast when the investment was made. Because of this, investors will demand that the likely return from an investment be high enough to compensate them not only for the real time value of the money invested, but for the additional risk arising from a particular asset class or particular investment situation. This additional required return is known as the risk premium, and it can differ widely between different investments. In general, for example, equity investments i.e. shares, would be regarded as higher risk than property, which in turn would be regarded as higher risk than, say, Government bonds. Of course this is a generalisation – every news bulletin these days seems to talk about the likelihood of Government bond defaults - but it is a good rule of thumb, and one that is relied on heavily when designing an investment portfolio, i.e. deciding exactly how an investors available money should be spread (diversified) between different asset classes and countries. Every investor's circumstances – their age, income expectations and risk tolerance – are different, and will all be very important in the structuring of their portfolio and deciding on the appropriate level of risk.



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