WEALTH MANAGEMENT NEWS

FINANCIAL PLANNERS AND INVESTMENT ADVISERS 17 OCTOBER 2007

UPDATE ON INVESTMENT MARKETS

After several years, during which credit has been provided freely and risk was under priced, the recent turbulence in financial markets will result in a more cautious approach to risk, and credit will no longer be available on such generous terms.

The core problem afflicting the financial markets of late, has been a sharp rise in house mortgage defaults in the USA. This is a consequence of many adjustable rate mortgages recently having been reset, resulting in sharply higher monthly repayments. In turn this is due to the US Federal Reserve funds interest rate having risen steadily from 1.00% in June 2003 to 5.25% by May 2006. While these cheap lending rates have been available, the US housing market has been appreciating in value. Initially, this did not matter, even for non-performing loans, as the lender was able to sell the house and recover their money. However, in 2006, property values began to fall, thus highlighting some of the poorer quality loans that had been made.

In New Zealand fresh upwards pressure has been placed on short term wholesale interest rates. But medium term interest rates relevant to fixed rate borrowing costs have declined in response to a jump in easing monetary policy in the USA. New Zealand growth prospects remain reasonable over the next 2 or 3 years, but watch for a rebalancing from domestic growth towards export growth, resulting from a strengthening of our terms of trade. In the view of the Reserve Bank, the New Zealand dollar continues to be well overvalued at the current level of USD $0.76. It is becoming increasingly evident that inward capital flows, which are attracted by our comparatively high interest rate structure, rather than economic fundamentals, are driving the New Zealand dollar. The key effect of all of this on the financial markets has been volatility on many fronts and is still continuing.

COMPANY SHARES

As a consequence of a slowing New Zealand economy, pressure on profit margins and higher interest rates, it is likely that the performance of the New Zealand share market will be inhibited over the near term. Valuations still appear to be stretched. The continued high valuation of our dollar against Australia continues to provide an opportunity for New Zealand investors to diversify into Australian and other International shares where growth prospects appear to be better than in New Zealand.

FIXED INTEREST INVESTMENTS

There has been a flow-on affect in financial markets around the world resulting from the unwinding of a large amount of leverage that has built up in financial markets over recent years. In New Zealand this has been evident in the finance company debenture market with liquidity issues facing some companies with inadequate cash reserves as a result of poor management decisions and/or lending policies.

Each of the finance companies which Wealth Management Services Ltd recommends below are well managed with sound equity, adequate cash reserves and most importantly – soundly diversified lending policies. Interest rates are at their highest for several years and offer an attractive risk/reward in a diversified investment portfolio.

	12 months	18 months	2 years	3 years	5 years
Finance and Leasing Limited	10.30%	10.30%	10.50%	10.50%	10.50%
South Canterbury Finance Ltd	9.30%	9.30%	9.50%	9.60%	9.30%
Marac Finance Ltd	9.30%	9.00%	8.95%	8.75%	8.75%
Strategic Finance Ltd	9.35%	9.35%	9.50%	9.65%	9.65%
Canterbury Mortgage Trust	Current Quarterly Return 8.6%pa				

WEALTH MANAGEMENT SERVICES LTD

Ian Bell

ian_bell@wealthmanagement.co.nz

Telephone + 64 (03) 364-9338
Facsimile + 64 (03) 365-9880

First Floor, Unit 1, Amuri Park
25 Churchill Street

PO Box 27093, Christchurch
NEW ZEALAND

PIE TAX CHARGES

If you hold investments in a Unit Trust, Group Investment Fund or Superannuation Fund, you will have received a request from your Fund Manager for an elected tax rate. In future you will be taxed at this elected rate instead of a flat rate of 33%. Investors will be required to confirm their correct tax rate to the PIE entity each year. It is important that each investor has provided their correct rate, as when the investor has provided the correct tax rate, the PIE tax will be a 'final' tax and the investor will not be required to declare the PIE income in their tax return.

INFLATION - OUR NUMBER 1 ENEMY!

New Zealand has the highest interest rates in the developed world. This has unfortunately attracted overseas investors in their masses to our fixed deposits, especially from countries like Japan where deposit rates are barely 1%. This buying has driven our currency to record highs, which has had a devastating impact on our export sector. Not a good outcome for a country reliant on exports, as we are.

This situation with the currency has understandably seen calls from an increasing number of people for the Reserve Bank to stop raising interest rates, or even lower them, in an effort to bring the dollar down. While there should be continuing debate about the best way to manage monetary policy, taking the Reserve Bank's eye off inflation is dangerous ground. Our inflation rate currently stands at 2% for the year to June 2007, which looks reasonably low. However, it's accelerating, with the Reserve Bank forecasting a figure of 2.8% for the year to March 2008. We either get inflation under control, which means enduring the pain of high mortgage rates and a high currency, or let inflation rise and suffer the consequences. Neither situation is particularly attractive, but, on balance, letting inflation get out of control would make us worse off in the longer term. Inflation is quite simply enemy number one – many reading this newsletter will remember the late 1970's or early 1980's when NZ let inflation badly out of the bottle.

For those clients who have not already done so, one way of protecting your capital against inflation is to invest in real assets. Real assets are those that aren't money, such as property or shares. They have an income stream that should grow at least as fast as inflation. Companies can raise the prices of their goods and services, and property owners can raise rents. Being able to increase your income in this way protects the value of the underlying assets against inflation. And there is scarcity value as well with shares and property. The main danger with inflation is that we don't yet know all the answers about how to control it. Certainly, central bank management of inflation has come a long way since the 1970s, but the fact that inflation remains a problem is reason enough to suggest that investors should regard it as a key risk and take steps to guard against it.

Pita's comments

- Australia may have a second consecutive major drought on it's hands.
- Recently I spent time in the Murray Darling Basin where most water rights/allocations from the irrigation storage were reduced down to nil or around 10% - very difficult to deal with.
- Our dairy clients are looking forward with real confidence and our cropping clients are cautiously similar, but sheep clients really do need $65 - $70/lamb to have a business.
- Build up your financial reserves – all of us need something up our sleeve - permanently.
- Keep track of three things – where inflation is at, the price of oil and your true profitability – the trend of these three is critical.
- Don't listen to this rubbish - that is that you and I deserve an income tax reduction but the country can't afford it because it may be inflationary – there is more sense on Weet-bix packets.
- You and I need to not only rig for silent running we also need to rig for dealing with volatility – volatility is more and more looking like a regular bridge you and I need to cross every day – lets cope with it.

GENERAL ADVICE

We specialise in providing independent advice on a wide range of financial products. To obtain further advice on these recommendations and other financial planning matters or to obtain Investment Statements and Application Forms, please contact Ian Bell.

We appreciate your business – please advise your family and friends that we would welcome the opportunity to also assist them in achieving their financial goals.

Disclosure of interest: Directors and their family interests hold shares or debentures in some of the companies referred to in this newsletter. Pita Alexander is a Trustee of the Kipp Alexander Family Trust which is the principal shareholder in Finance and Leasing Ltd.

I J Bell
Managing Director

P S Alexander
Director

P R Alexander
Director