



Chairman's Letter 2013

Dear Member

I am pleased to provide you with an update on the management of the Government Superannuation Fund (GSF) following the release of the annual reports of the Authority and GSF (or the Fund) for the year ended 30 June 2013.

FEATURES OF THE 2013 YEAR

- A strong year in investment markets saw good returns and growth in the Fund despite cash and global bond yields barely matching inflation.
- An after tax surplus of \$493 million saw the Fund grow in size from \$3,017 million to \$3,382 million after entitlements paid and contributions received.
- On a total portfolio basis, investments returned 2.1% above the Reference Portfolio after fees. This was mainly due to the external managers out performing their individual benchmarks.
- Particularly good returns were achieved in both domestic and offshore equity markets.
- The actual portfolio has an allocation into insurance products away from fixed income relative to the Reference Portfolio. This diversifies the overall risk of the portfolio whilst seeking to improve the returns and proved valuable in the current year of flat bond returns.
- The NZ dollar strengthened against the Australian dollar but weakened against the US and Euro currencies. As at 30 June 2013 the Fund still had a higher exposure to foreign currency than its benchmark (36% v 20%).
- During the fiscal year \$853 million was paid out to members of the Schemes.

Welcome

The Authority welcomed Michelle van Gaalen as a new member of the Board with effect from November 2012. Michelle has over 15 years senior management experience in financial services. In May 2013 she was appointed as director of strategy and business performance at the Bank of New Zealand.

In July 2013 Cecilia Tarrant was elevated to the position of Deputy Chair left vacant since the retirement of David May in May 2012.

Thanks

The Board thanks the Minister of Finance and government officials for their support, and the Management team and staff for their high level of work and commitment to meeting the Authority's objectives.

I also thank my fellow Board members for their expertise and commitment during the year.

Yours sincerely

Keith B Taylor
Chairman, Government Superannuation Fund Authority Board



Investment Performance

The Fund had an excellent return for the year of 16.7% after tax especially when you take into account the very low interest rates and low global inflation.

The major reason for the Fund's success for the year is that equity markets both in NZ and overseas performed very well (+31% and +25% respectively) and about 60% of the Fund is invested in public market equities.

In addition to public equity markets the Fund has almost 20% invested in alternative asset classes such as insurance-linked assets, commodities futures, less liquid private equity and real estate funds, and skill-based trading strategies. These investments are also growth strategies that are expected to add value above fixed income over time. However, we expect they will not fluctuate in the same cycle as the public equity markets and therefore they will reduce the likelihood of excessive swings in the value of the Fund. The table below compares the Fund's investment returns against the long term expected return for periods ended 30 June 2013.

Returns to 30 June 2013 (%pa)	1 year	5 years	10 years
Fund return (after tax)	16.7	3.4	5.0
NZ Government Stock (after tax)	0.0	5.0	4.2
NZ Government Stock (after tax) plus 2.5%	2.5	7.5	6.7

The Fund return is behind its Investment Performance Measure (NZ Government Stock (after tax) plus 2.5% measured over 10 years) by 1.7% but ahead of NZ Government Stock by 0.8%.

It is important to note that the performance of the Fund does not impact on members' entitlements as these are set by the Government Superannuation Fund Act 1956.

Outlook

Heading into the 2014 financial year, the tension between global deleveraging and monetary stimulus still dominates the investment landscape. Is the 'experimental' monetary accommodation really working? Is the real burden of debt write-downs being shared equitably among bond-holders and taxpayers? Is enough being done to improve productivity and reduce inefficiencies to minimise the loss of jobs and incomes? Amidst the challenging economic environment, exciting advances in technology and reforms in developing countries are providing great opportunities for growth. Global financial markets have the job of assessing these risk and return opportunities and transferring them among investors.

Despite the rise in global government bond yields, they still appear poor value unless the debt deflation scenario unfolds. Equities are valued more reasonably relative to estimates of moderate long term earnings growth, notwithstanding the good returns in the last 12 months. In the most likely outlook scenario of persistent slow growth and low interest rates, equities are priced to deliver a return premium over bonds at least appropriate to their greater risk.

NZ assets, notably shares, and the NZ dollar look fully priced compared to global counterparts, reflecting the relative strength of the NZ economy. But high external debt levels present a risk and one of our major trading partners, Australia, is struggling. China has become our largest export destination but its growth is also likely to be subdued compared to its recent history.

Absolute returns across all asset classes are expected to be modest, creating a temptation to reach for additional yield. The downside risks are real and many factors could trigger volatility.

GSF SCHEMES

Administration

Datacom Employer Services Limited (Datacom) is the GSF scheme administrator and is responsible for the day to day administration of the GSF schemes. Datacom has approximately 30 staff dedicated to the GSF schemes and continues to perform well. For the 2013 financial year, 100% of all four weekly annuities were processed and paid on time.

New business system

Work continues on the development of a new and more sustainable business system for use in the administration of the GSF schemes. The detailed requirements for the project were completed in December 2010. Progress on the new business system has been slower than planned due to the complex nature of the Schemes. The Authority is fully committed to having a fit for purpose system which will enable the Schemes to operate efficiently and accurately.

Actuary

The role of the Government Actuary was disestablished on 30 September 2011 and on 1 October 2011 Russell Employee Benefits Pty Limited (Russell) was appointed to provide actuarial services to the Authority. The Authority's current Actuary at Russell is Emma Brodie.

Website

The Authority's website - www.gsfa.govt.nz - continues to be an important part of our communications strategy and contains comprehensive information on both the Authority and the Fund. It explains how the Authority operates and gives all stakeholders access to our quarterly investment results, as well as any changes the Authority makes to its policies, investment strategy and personnel.



GOVERNMENT SUPERANNUATION FUND AUTHORITY

Our Mission

The Authority's mission is to use best practice to manage the Fund and administer the GSF schemes, in accordance with the Act, with the prime objectives of enabling:

- returns to be maximised without undue risk to the Fund,
- the Crown's contribution to GSF to be minimised, and
- the needs and reasonable expectations of its stakeholders to be met.

www.gsfa.govt.nz

Further information

If you have any queries regarding your GSF membership or would like a free copy of the annual report, please contact Datacom Employer Services, GSF Schemes Administration, PO Box 3614, Wellington 6140, Freephone 0800 654 731.