

Chair's Letter 2019



Tēnā koutou katoa

This is my first letter to you following my appointment as Chair of the Government Superannuation Fund Authority Board (the **Board**) on 1 July 2019.

On behalf of the Board, I am pleased to be writing to you regarding the activities of the Government Superannuation Fund Authority (the **Authority**) and the Government Superannuation Fund (**GSF** or the **Fund**) for the year ended 30 June 2019.

Features of the 2019 Year

- During the financial year to 30 June 2019, \$893 million was paid out to members of the GSF Schemes. The business system, used to administer the GSF Schemes, continues to perform well and to provide efficiency and stability to the schemes' administration area.
- Investment markets were volatile during the year. Equity markets fell in late 2018, amid recession fears and threats of trade wars, then rebounded in early 2019 as central banks, led by the US Federal Reserve and China, reverted to stimulus to avert a slump.
- The Fund takes a long term view when determining its investment strategy. Over the last 10 years the Fund investment return was 10.1% per annum net of investment management fees, 4.4% per annum ahead of New Zealand (**NZ**) Government Bonds and 0.3% per annum behind the Reference Portfolio we use to assess our performance.
- For the financial year to 30 June 2019, the Fund returned 3.6% per annum before tax and after investment management fees (compared to 7.7% per annum for the Reference Portfolio) as alternative investments under-performed both bonds and equities.

Investment activity

The Fund's objective is to maximise the excess return above NZ Government Bonds, before NZ tax, while limiting the chance of under-performing over rolling ten year periods.

The Fund relies largely on equities to provide the excess return above NZ Government Bond returns and is always looking for more ways to capture alternative return sources. 90% of the Fund is invested internationally. Almost 20% is invested in alternative asset classes, such as insurance-linked assets, private equity and risk factors. These alternative sources of return diversify the Fund's risk, enabling higher total returns to be achieved at similar levels of risk. Active management is also used where there is a strong likelihood of added value net of any incremental costs. Nevertheless, global equity market risk remains by far the biggest investment risk to the Fund.

In 2018, the Board approved an increase in the Fund's allocation to equities to be implemented gradually over the following two years and we are halfway through this process. This should result in a small increase in the risk and reward over a ten year horizon.



The Board also approved an increase in the exposure to an alternative fund which is not correlated to equities but is expected to provide returns in a similar quantum to equities over a long horizon.

Early in 2019 the Board extended its commitment into global private equity. Whilst the Board does not expect the actual amount invested in global private equity to increase substantially, we do expect this new commitment will extend the time period we are invested in this asset class. The private equity strategy is consistent with our long term horizon and capitalises on the known and stable cash flow of the Fund.

There has been considerable attention given to incorporating environmental, social and governance factors into investment programmes around the world. The Fund relies on third party investment firms to manage its assets and these managers all take account of such factors where they are material to expected returns and risks. The Authority also collaborates with other Crown Financial Institutions (**CFIs**), notably the Guardians of New Zealand Superannuation and the Accident Compensation Corporation.

As well as discussing common investment issues, the Authority shares the services of a global engagement service company to co-ordinate engagements with global companies that have serious issues around damage to the environment, human rights abuse and bribery and corruption. Investments in certain securities are excluded where the issuer is considered to be acting contrary to NZ law, international agreements, significant Government policies, or has breached its standards of behaviour. The Authority and other CFIs are members of the NZ Corporate Governance Forum whose purpose is to promote good governance among listed NZ companies.

Outlook

Global economic growth is expected to decelerate over the next 12 months to a below trend pace, with risks skewed to the downside. Protectionist policies are already weighing on global trade volumes and the uncertainty it brings is holding back business investment. Businesses

are meeting demand through hiring which, unlike capital expenditure, can be unwound quickly. This is supporting the labour market and incomes which, in-turn, is helping consumer confidence. In recognition of the slowdown and downside risks, and with inflation pressure easing, central banks are expected to cut rates and, in some regions, to turn again to other monetary policy tools.

Modest growth and inflation, along with easier monetary policy, is typically positive for both equities and bonds. However, a quarter of the global investment grade bond universe now comes with negative yields which will limit their returns.

Yields have also moved lower on global equities, as share prices have risen faster than company earnings over the last year, and this points to lower total Fund returns in the future.

The expected return differential between global equities and bonds is still above the long-term average, which indicates global equity investors are still being compensated for higher risk. Very low bond yields, not inexpensive equity markets, is the reason for this.

Whilst the NZ share market has had another good year, NZ equity prices are extended relative to fundamentals in other equity markets. In contrast, the NZ dollar is a little below fair value as suggested by the long-term real exchange rate, but it should continue to act as a safety valve (i.e. decline) if global risks continue to rise.

Communications

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 member booklets and policies, together with our annual investment results and investment policies and strategy.

If your contact details change, we request and encourage you to advise the scheme administrator, Datacom Connect Limited (**Datacom**), so we can contact you if required. Datacom will provide you with a personal details form



on request for this purpose. Your personal information is currently maintained and stored electronically by the Authority within a cloud service in Australasia.

Privacy and security

The Board is very aware of the need to respect members' privacy. We are required to hold personal information about you for the purposes of ongoing management and administration of the GSF schemes. Personal information is data about an identifiable individual, or information that could be used to identify you, such as your name and contact details.

We are bound by, and adhere to, the privacy provisions set out in the Privacy Act 1993.

With this in mind, please be aware Datacom will never send you a generic email asking for your personal information (for example, your bank account number and your date of birth) or ask you to provide your bank account details over the telephone.

Wherever you provide personal information – whether it's by email, letter, by completing a form or over the phone – you can be assured we will do everything we reasonably can to protect your personal information from being used in the wrong way.

The Board and Datacom will never:

- ask you for your banking PINS or passwords;
- send you a link to a GSFA website login page;
- ask you to download any software onto your computer;
- ask you to give us remote access to your computer.

If at any time you have any concerns about requests you receive, please call Datacom on 0800 654 731.

The Board

Cecilia Tarrant retired from the Board at the end of June 2019. Cecilia was initially appointed to the Board in August 2011, became the Deputy Chair in July 2013 and was appointed Chair in May 2017. Cecilia made a considerable

contribution to the Authority during her tenure and I would like to thank her for her considerable work.

Angela Foulkes joined the Board 1 November 2018. Angela has extensive public and private sector consultancy experience and has served on a range of government sector advisory and regulatory bodies, including on state sector standards, educational qualifications and government sector structure.

The Board has two permanent sub committees - an Investment Committee and an Audit and Risk Review Committee. The Investment Committee forms an important part of the investment strategy as it works closely with Management to provide comfort to the Board that due process is documented and implemented by Management prior to bringing a recommendation to the Board. The members of the Investment Committee are Alison O'Connell (Chair) and Murray Brown. The Audit and Risk Review Committee's purpose is to assist the Authority in fulfilling its responsibilities for managing and administering the Fund and the Schemes pursuant to the Government Superannuation Fund Act 1956. This committee is chaired by Shelley Cave and the other members are Michelle van Gaalen, Alison O'Connell and Angela Foulkes.

Conclusion

On behalf of the Board, I would like to thank 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.

Anne Blackburn

Chair

Government Superannuation Fund Authority Board

4 September 2019





**GOVERNMENT
SUPERANNUATION FUND
AUTHORITY**



www.gsfa.govt.nz

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.

Further information

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