

Chairman's Letter 2018



Tēnā koutou katoa

This is my second letter to you following my appointment as Chairman of the Government Superannuation Fund Authority Board (the **Board**) in May 2017.

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 2018.

Features of the 2018 Year

- During the financial year to 30 June 2018, \$880 million was paid out to members of the GSF Schemes.
- The Fund investment return for the year was 10.5%, before tax and after investment management fees, 0.5% behind the benchmark Reference Portfolio and well above the 4.2% return on NZ Government bonds.
- Over the last 5 years, the Fund investment return has averaged 10.7% pa net of fees, 0.3% pa ahead of the Reference Portfolio and 6.1% per annum above NZ Government bonds.
- Over the last 10 years the Fund investment return was 7.3% per annum net of fees, 0.1% ahead of the Reference Portfolio and 1.5% ahead of NZ Government bonds.

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 over NZ Government Stock 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.

During the year the Board approved an increase in the Fund's allocation to equities to be implemented gradually over the next two years. This should result in a small increase in the risk and reward over a ten year horizon. The Board will also consider increasing the exposure to alternative, diversifying return sources where these can be accessed at a reasonable cost. It is also increasing its commitments to global private equity over several years, as signaled last year, and implementing a long-short strategy with one of its existing global equities managers to capture an increased return from their skill at picking stocks. This manager has a proven record of adding value. Finally, the Fund has engaged an external manager to assist with implementing its dynamic asset allocation more efficiently.



There has been considerable attention given to incorporating environmental, social and governance factors into funds' 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 (**NZ Super**) and the Accident Compensation Corporation (**ACC**). 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 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

The global economy is expected to move into its third year of above-trend growth over the next 12 months supported by rising private sector demand and higher government spending. Lower spare capacity, especially in the United States, and higher energy prices are expected to move headline inflation closer to targets in developed markets but underlying inflation generally remains low. Such a backdrop is typically positive for riskier assets like equities, but less positive for bonds.

Whilst the last two years has seen a broad-based uplift in growth, some individual economies may be at risk. The US Federal Reserve is expected to continue to lift interest rates over the coming year and, if this is accompanied by a stronger US dollar, funding pressures for some smaller emerging markets may arise. Similarly, US trade tariffs could weigh on the largest emerging market, China, but recent precautionary monetary and

fiscal easing should underpin that economy. The UK is scheduled to leave the European Union in March 2019 and there is a risk the transition will not be a smooth one.

After two years of relative calm in financial markets, volatility has returned. Periodic bouts of volatility should be regarded as the norm not the exception, especially given the expected rise in borrowing costs for the US dollar, the world's largest funding currency.

Yields remain relatively low on global equities and bonds, which points to lower total Fund returns in the future. However the expected return differential between global equities and bonds is a little above the long-term average, which indicates global equity investors are still being compensated for higher risk. This is not the case for New Zealand equities, where prices appear elevated relative to fundamentals. In contrast, the NZ dollar is near fair value, suggested by long-term real exchange rate, but it could continue to act as a safety valve (i.e. decline) if global risks 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, 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 the Board's scheme administrator, Datacom Connect Limited, 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

In June of this year, Craig Ansley and Ainsley McLaren retired from the Board. Craig spent six years on the Board and he was Chair of our Investment Committee for the last five years. Ainsley was a member of the Investment Committee for the last 3 years. Craig and Ainsley's knowledge and understanding of investments and markets will be missed. I would like to thank them both for their contribution to the Board over the years.

We are fortunate to welcome two new members to the Board - Anne Blackburn and Murray Brown. Both Anne and Murray have a broad base of skills and experience in investment and markets and they will join

the Investment Committee. Anne has a background in banking, governance and strategic advice. She returned to New Zealand in the mid-1990s after fifteen years working with international investment banks in New York and London. Anne is a director of TSB Bank, Fidelity Life limited, Fisher Funds Management Limited and Warren and Mahoney Limited and is also a board member of the Advisory Board of the Treasury Commercial Operations. Murray has previously held senior management positions at Fisher Funds Management Limited and First NZ Capital.

Dr Alison O'Connell has assumed the role of Chair of the Investment Committee.

The other permanent committee is our Audit and Risk Review Committee (**ARRC**) chaired by Shelley Cave. Michelle van Gaalen, the Deputy Chairman of the Board, is a member of this committee.

The Board has worked effectively and efficiently in 2017/18 with seven full Board meetings being held during the financial year and I would like to thank all the Board members for their expertise and commitment during the year.

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.



Cecilia Tarrant

Chairman

Government Superannuation Fund Authority Board

3 September 2018



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.