Lifestages KiwiSaver Scheme: Income & High Growth Funds Update

As at 30 September 2016

Funds Administration New Zealand Ltd ("FANZ") is the Manager of the Lifestages range of funds.

Welcome to your Investment Commentary for your Lifestages KiwiSaver account for the period ending 30th September 2016. The quarter started with investment markets recovering from their Brexit concerns once it became obvious that any British exit from the EU will take years to put in place and may well be "watered down" in its final implementation. This positive performance was supported by investors seeking out any assets that produced a reasonable income as well as a slew of generally positive earnings out of the United States and New Zealand. This positive period then came to halt when reports started to come out of the United States that the US Federal Reserve might be considering putting up interest rates to slow down the strong performance of the United State economy together with increasing concerns about the outcome of the US Presidential election.

For investment markets world wide that had been 'mainlining' quantitative easing strategies over the last few years this came as a shock. Markets have been used to operating in an environment where Central Banks support asset prices with a low interest rate focus and a supportive monetary policy where Central Banks purchased assets to hold on their Balance Sheets.

Our own view of this development is much more relaxed. Whilst we know that higher interest rates will put up the cost of capital and may also provide some head winds for asset classes (such as property and infrastructure stocks), we should not lose sight of the reason why interest rates will rise. Fundamentally, interest rates rise as a result of strong growth rates in the economy and are used to slow down a stronger than expected rise in inflation. It means that the economy is growing and that this growth will be reflected in, over time, stronger earnings in companies which (as a result of restructuring during the GFC) now have lower debt levels. Over the medium to long term this is a good thing! The other aspect that is important to remember is that any rate of increase is likely to be much, much lower than in previous interest rate cycles.

Some of our investors may remember last year that we highlighted a piece of research for investors that the NZ Reserve Bank produced in September 2015 (refer to Reserve Bank Paper "Estimating New Zealand Neutral Interest Rates, AN 2015/05, September 2015). This research looked at where the neutral monetary policy rate was for the 90 Day Bank Bill rate in New Zealand. It came up with two conclusions:

1. That the neutral monetary policy rate for the 90 Day Bank Bill rate was approx. 4.3% (which was down from 6.0% in 2008).
2. The trend for the neutral monetary policy rate for the 90 Day Bank Bill in New Zealand was for the rate to decrease.

We conclude that even when interest rates begin to rise, the nominal rates they reach will be nowhere like they were in 2007. Structurally, we are in a new investment paradigm. For investors this means that holding a lot of cash is not probably going to deliver the income stream you may need to keep the wheels on your lifestyle and/or achieve your financial goals. Borrowers may find that the nominal rates they have to service may be far lower than at any time over the last 20 years. We recommend that you contact us to review your investment approach should this trend be of concern to you.

The other major issue over the quarter was the focus on Kiwisaver Funds that invested in companies that made items like cluster bombs. Members who live in the North Island and who read the NZ Herald articles will be aware that we did not feature in the list of impacted Kiwisaver Funds. Not with standing this result we can advise that we began a review to further tighten up on our internal processes to ensure that our funds cannot unwittingly invest in these type of companies in the future. This review is progressing well and we will let you know of the results in our next update.

The performance of the Lifestages KiwiSaver Funds for the quarter showed that a diversifed portfolio with a mix of Growth and Income Assets was the 'right way to go'. The strong equity performance for the quarter was in contrast to the weaker bond performance as global bonds struggled. Investors will recall that this result was the opposite in the previous quarter.

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KiwiSaver
Poua he Oranga

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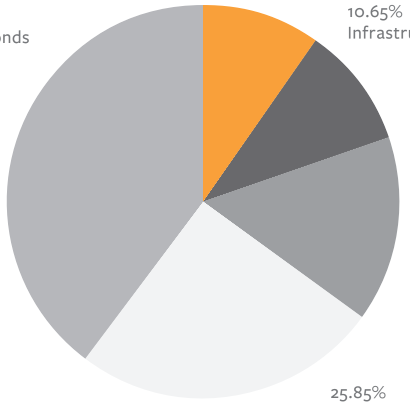
Lifestages Income Fund

The Lifestages Income Fund aims to provide a low risk investment option. It is generally suitable if you want to have a 'low risk' investment portfolio which invests solely in income producing assets.



Performance

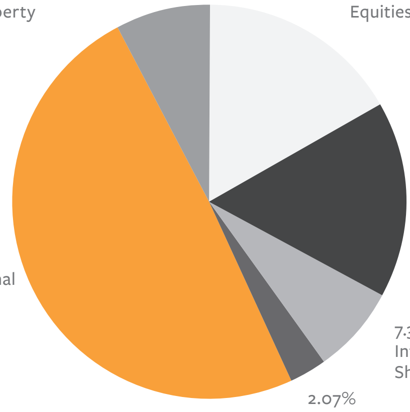
Investors in the Lifestages Income Fund will have noted that fund produced a lower result for the last 3 months. This was mainly in response to concerns about rising interest rates in the United States and growth markets responding positively to a realisation that concerns about Brexit were "over-done" in the short term. Investors will have noted that the performance trend in the quarter ending 30th June 2016 quarter was in reverse for our Income and Growth Funds.

3 months	6 months	Unit Price (30/9/16)
0.65%	3.68%	1.051383

These figures are stated before tax and after fees

Lifestages High Growth Fund

The Lifestages High Growth Fund aims to provide capital growth over the long term. The majority of the Lifestages High Growth Fund is invested in a broad spread of New Zealand and international growth assets.



Performance

Investors in the Lifestages High Growth Portfolio will have noted that fund produced a positive performance over the last 3 months and a more muted performance over 6 months. As we have previously noted diversification between income and growth assets does pay off for investors over time and the last 6 months has been an example of the positive relationship between different asset classes.

The performance trend has often been volatile as investment markets responded negatively to falling commodity markets over the last 12 months and then responded positively as Central Banks implemented a range of monetary responses. The Brexit vote also caused volatility for this fund in the June quarter, which saw markets fall only to recover over the last quarter as investors realised that initial concerns about Brexit were "over-done". This "risk on, risk off" environment has meant that markets overall have produced a positive performance albeit providing somewhat of a roller coaster type ride.

3 months	6 months	Unit Price (30/9/16)
3.83%	3.68%	1.035419

These figures are stated before tax and after fees