Lifestages KiwiSaver Scheme: Income & High Growth Funds Update

As at 30 September 2017

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

Welcome to your report for the period ended 30th September 2017. The last six months was noted for markets surprising investors, mainly on the upside. In other communications, we have previously stated we thought that economic and earnings growth would drive financial markets performance into the future. The last six months has seen the S & P 500 Index (the top 500 shares in the United States) reach new highs as well strong performances in Europe and Emerging Markets equity bourses.

At the same time, bond markets have stabilised, despite communication from the US Fed that, at some stage, interest rates would rise and "QE" would begin to be wound back.

At the start of the year analysts and investors played their usual ritual game where they opined various investment outcomes i.e. Bonds are terrible value and that, accordingly, this must be the year when yields will rise (and prices fall). And then they get mugged by reality!

2017 is playing out to be a "goldilocks" year for investors (not too hot, not too cold!). Global stock markets have been recovering since February 2016 on hopes of faster economic growth. This has been delivered in several areas especially in Europe and in the United States. This has translated into earnings growth for listed companies, especially technology and energy companies. Because many US companies derive significant earnings from their off-shore operations this too has also supported many US company profit results. The "goldilocks" scenario is playing out because although growth forecasts are increasing, there is little sign yet of any rebound in inflation.

Inflation rates in China, Japan and the Euro zone are all under 2%. In the US, the core inflation rate for personal expenditure declined to 1.5% in April. This is translating into little pressure for wage increases. Labour is in demand because it is cheap which is also bringing down the US unemployment rate to 4.3% which is also assisting the US economic performance. The other reason why bond yields are not rising yet in the US is that President Trump's fiscal stimulation package is a long way from being approved. Since the stimulus was expected to push up the budget deficit (and require the issuance of more bonds) any news is good news for bond investors.

Closer to Home

New Zealand has presented a similar picture. The 2017 Budget painted a picture of a solidly growing economy underpinning a strong fiscal outlook and that's important in today's world. Treasury expects growth to peak at 3.8% in 2019, with growth slowing thereafter as the cycle matures and capacity constraints emerge. Treasury expects growth to average 3.1% over the next five years. This solid growth underpins rising budget surpluses and falling debt as a percentage of GDP. We expect this will also support company earnings growth and market performance.

Although we expect interest rates to be under pressure to rise in 2018 we caution against investors expecting to see high nominal interest rates in the future. Some of our long-term investors will recall we highlighted a piece of Reserve Bank (RBNZ) research in 2015 which raised the idea of a lower neutral monetary rate in the future. In July 2017, the RBNZ issued a press release where they noted that they thought that the neutral monetary policy rate was now below 4%. What this means is that when we do see interest rates rising you should not expect interest rates to be anywhere near like they were prior to the GFC. That's great news for borrowers; not so good for investors!

If you live in a home with teenagers like the writer does, you may have had a teenager at home that was obsessed with the TV Show, "The Block". Anyone with an interest in property will have watched the auction of the houses in the final show with interest. The auction was held against a backdrop of;

1. An election one week later
2. Falling sales in Auckland
3. Lower credit availability as the RBNZ's Loan Valuation Ratio Policy limits the supply of loans.
4. Barfoot & Thompson housing data in July which showed:
    a. Auckland house prices fall amid weakest July sales since 2010
    b. Average price falls 4.6% m/m to NZ$908,319
    c. Median price falls 4.1% in past three months
    d. Sales drop to 747 — weakest July volume since 2010

Surprised at the results of Block Auction? Given the above, you shouldn't be. One must feel sympathy for the contestants though for all that hard work given their meagre reward. The results are better news for the RBNZ, given its stated objectives.

At the time of writing while the initial results of the election were known (subject to special votes) the final shape of the government was not known. Perhaps the one result of the election to note was the strong performance of National's party vote in Auckland relative to the rest of the country. Concerns about the possibility of "new" taxes appeared to drive many voters' thinking in Auckland and indeed nationwide in the election. The 2017 result also saw the collapse of National's coalition partners with the Maori Party losing its two seats, Peter Dunne withdrawing from his electorate campaign and Act's vote reduced. The Centre Left (if one were to include NZ First, making a three-party coalition) could just put together a majority on election night. This result made some New Zealander's agitated.

Relax. After almost 20 years of MMP we should not be alarmed or concerned by this result. MMP is all about the "art of the deal". Whatever the final shape of the government will be, the overall direction, speed and, narrative for the economy is in place.

The final government may have other agenda items (such as equality, immigration and social issues) to pursue, but the scene is set for New Zealand's economy to continue to produce a steady performance.

Funds Administration New Zealand Limited is the issuer of the Lifestages Kiwisaver Scheme.
The product disclosure statement for the Lifestages Kiwisaver Scheme is available at www.companiesoffice.co.nz/disclose (search for 'Lifestages Kiwisaver Scheme').

Disclaimer

This information is of general nature only and has not been prepared with regard to the needs of any investor. Investors should be aware that future performance may not reflect the historic performance of either fund, and that repayment of any capital or any particular rate of return are not guaranteed. Details are current as at the date of preparation and are subject to change. For further information visit www.lifestages.co.nz, phone 0800 727 2265 or contact your financial adviser. You can also write to the manager at C/- PO Box 835, Invercargill. A disclosure statement for each of our authorised financial advisers is available, on request and free of charge.

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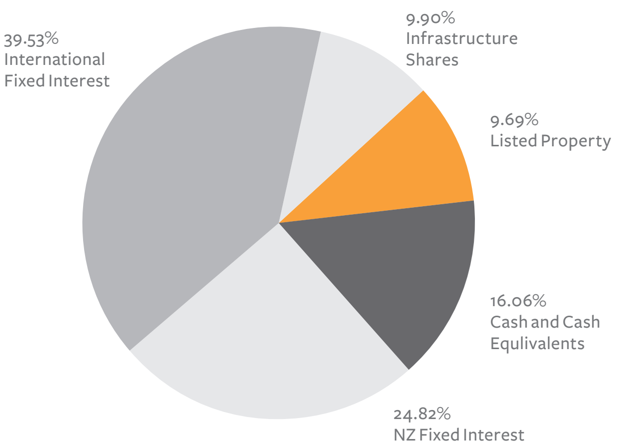
Lifestages Income Fund

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

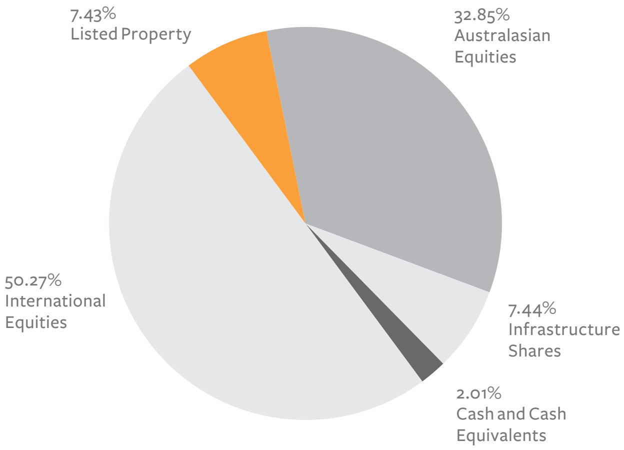
Investors in the Lifestages Income Fund will have noted that the Fund produced a positive performance over the last three months but flat for the previous nine months. This is due to rising interest rates October 2016 to June 2017 negatively offsetting income from the fixed interest securities. The positive aspect of that trend was that now the Fund's higher running yield is providing a higher return going forward.

3 months	6 months	12 months	Unit Price (30/9/17)
1.08%	1.36%	1.08%	1.0628

These figures are stated before tax and after fees

Lifestages High Growth Fund (is also the Auto Option 0 – 34)

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 Fund will have noted that the Fund produced an excellent performance over all parts of the reporting period. This performance trend has been in spite of volatile periods due to political uncertainty and a long term rising interest rate environment in the United States and in New Zealand. The prognosis for the next 12 months appears a little more uncertain and will be dependent on the United States' economy's growth promise being delivered and a reduction in world political uncertainty.

3 months	6 months	12 months	Unit Price (30/9/17)
4.25%	4.43%	13.52%	1.1730

These figures are stated before tax and after fees

30/70 (High Growth/Income) mix
Auto Option age 55+

50/50 (High Growth/Income) mix
Auto Option age 45 – 54

70/30 (High Growth/Income) mix
Auto Option age 35 – 44

30/70: 3 months	30/70: 6 months	30/70: 12 months	50/50: 3 months	50/50: 6 months	50/50: 12 months	70/30: 3 months	70/30: 6 months	70/30: 12 months
2.03%	2.28%	4.81%	2.66%	2.90%	7.30%	3.30%	3.51%	9.79%

These figures are stated before tax and after fees