NEW ZEALAND SUPERANNUATION FUND

TITLE:

Opportunities and Challenges for a Long Horizon Investor

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Outline

- Overview of NZSF
- Investment Approach of a Typical Long Term Institutional Investor
- NZSF’s Investment Approach
  - Reference Portfolio and Actual Fund
  - Value-add Strategies
  - Investment Framework
- Relevance of Finance Theory in Practice
  - Asset Allocation
  - Market Efficiency
  - Dynamic Behaviour of Markets

NZSF: Our Purpose

- Smooth future New Zealanders' tax burden
- Investing prudently and commercially:
  - Apply best-practice portfolio management
  - Maximise return without undue risk
  - Avoid prejudice to New Zealand's reputation as a responsible member of the world community
- Long-term expected rate of return:
  - New Zealand Treasury bills plus 2.5% p.a. over 20 year rolling periods

NZSF: Quick Facts

Started investing September 2003
Withdrawals to begin 2029/30

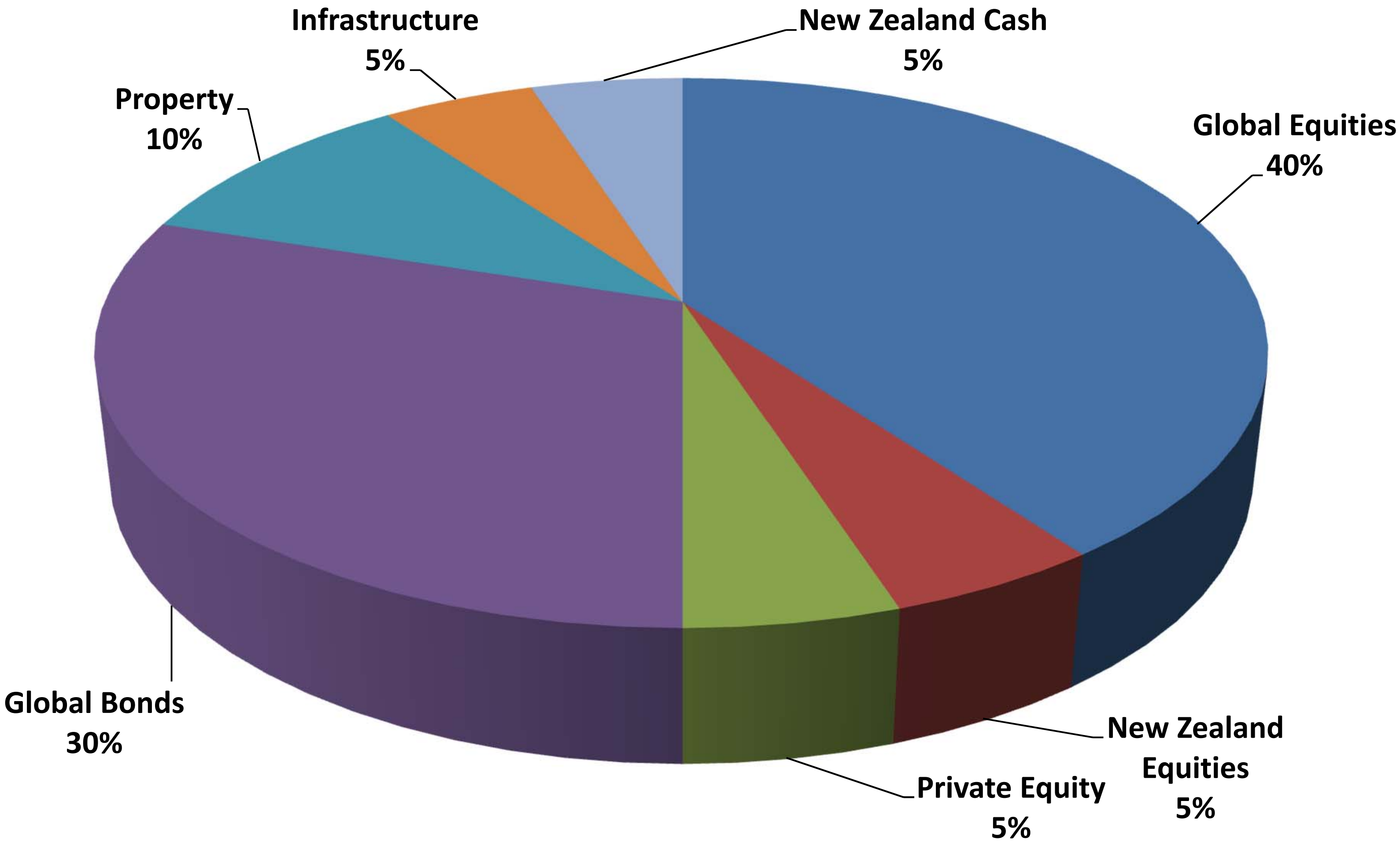
As at 31 July 2012:	
Total funds under management:	$19.15b
Investment in New Zealand assets	$3.4b*
Annualised return since inception:	7.16%
Excess return (above T-bills):	1.95%

*Excluding cash and foreign exchange hedging instruments

Standard Approach: Long Horizon Investor

- “Investing with the expectation of holding an asset for an indefinite period of time by an investor with the capacity to do so” (WEF, 2011)
- “An investor having no specific short-term liabilities or liquidity demands” (Ang and Kjaer, 2012)
- Or “long-run investors are first and foremost short-run investors. They do everything short-run investors do, and they can do more because they have ... a long horizon” (Ang, 2012)
- A long horizon is helpful.
- But we also need to consider our other endowments, our beliefs and capabilities

Standard Approach Strategic Asset Allocation (SAA)



Our Approach: Reference Portfolio

- Our Reference Portfolio
  - Low-cost, passive and implementable portfolio which is expected to achieve Fund objective
  - Degree of risk appropriate for a long-term investor
  - Chosen by the Board
- Provides a benchmark for assessment
  - Is management adding value with active strategies?

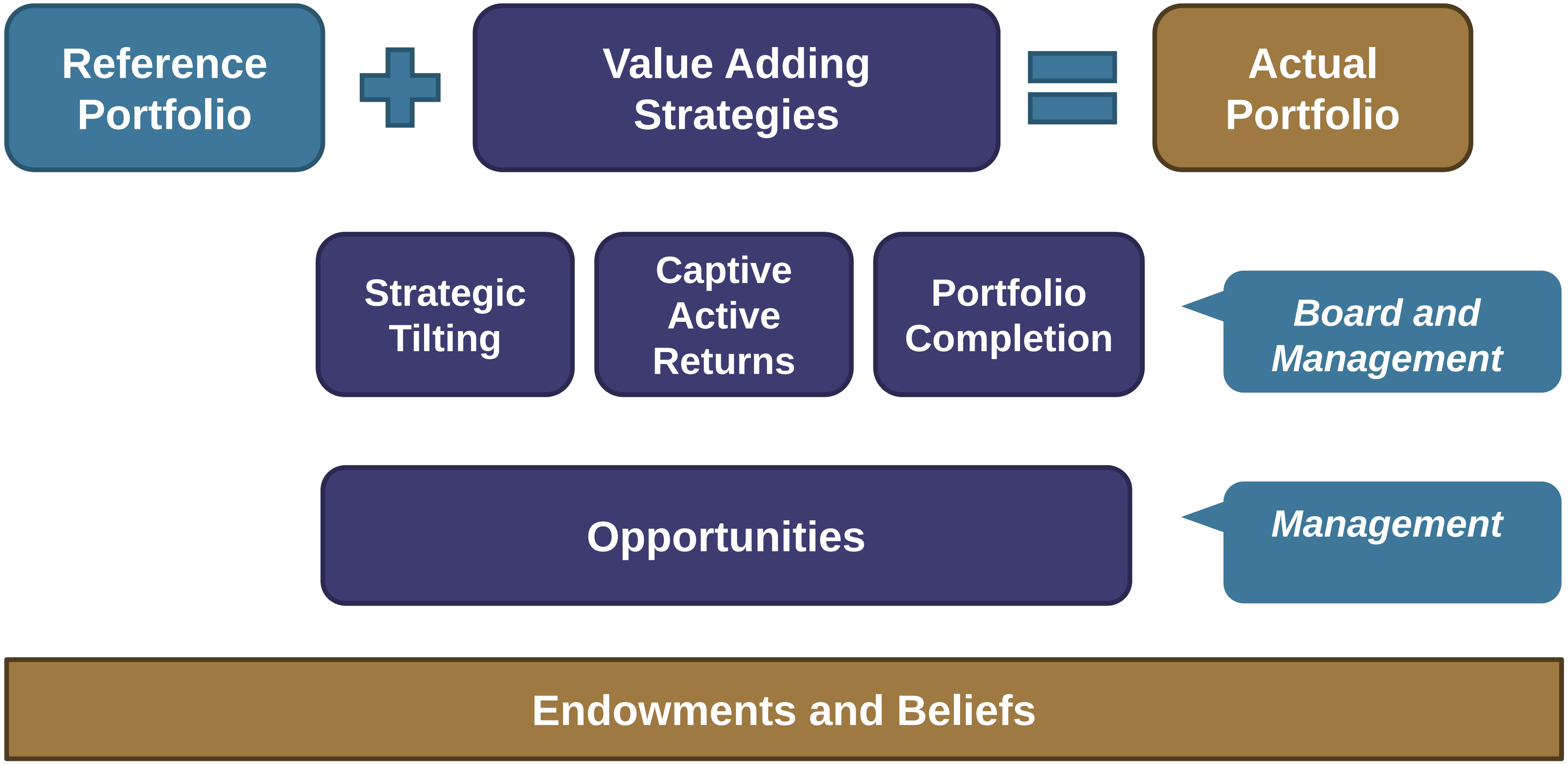
Asset class	Percentage
Global equities	70%
NZ equities	5%
Global listed property	5%
Total growth	80%
Total fixed interest	20%
TOTAL PORTFOLIO	100%
Net un-hedged foreign currency exposure	0%

Our Approach: Active Management

Our goal: To ‘add value’ to the Reference Portfolio

- Management’s mandate is to add value to the RP
- We are guided by our endowments (long horizon, liquidity profile and governance), investment beliefs and capabilities in developing activities or strategies to achieve our mandate

Our Approach: Clarity around Risk, Reward and Governance



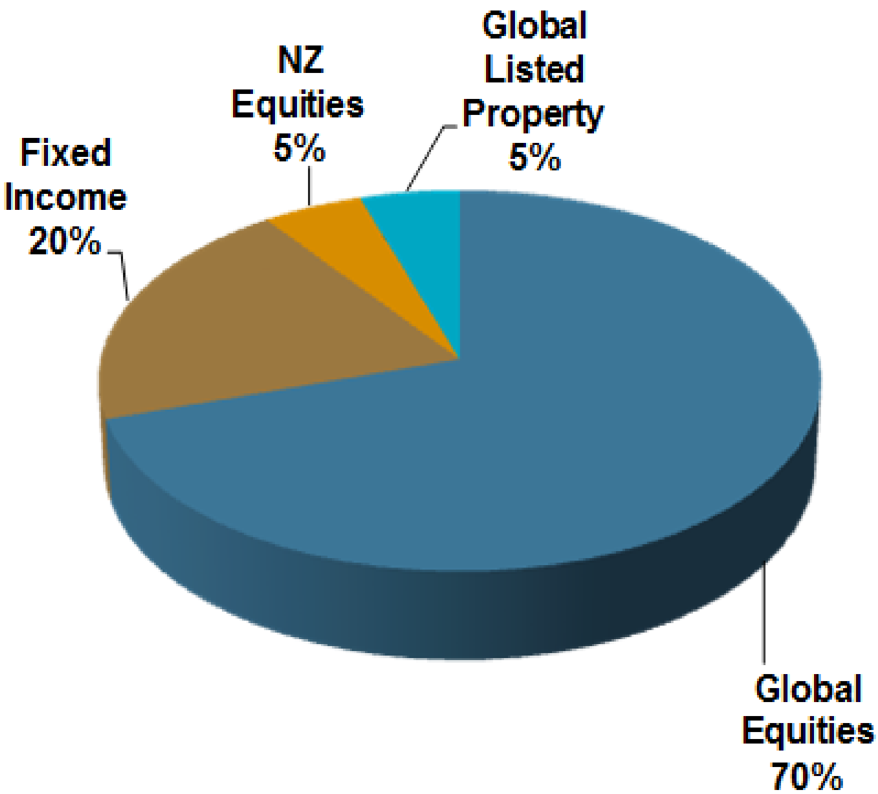
Our Approach: Opportunities and Access Points

Identify the Opportunities	Accessing the Opportunities
• Transaction efficiency	• Physical Listed - Passive vs. Active - Internal vs. External
• Diversification	• Derivatives - Passive vs. Active
• Mispricing: asset classes, markets & securities	• Physical Unlisted - Internal vs. External

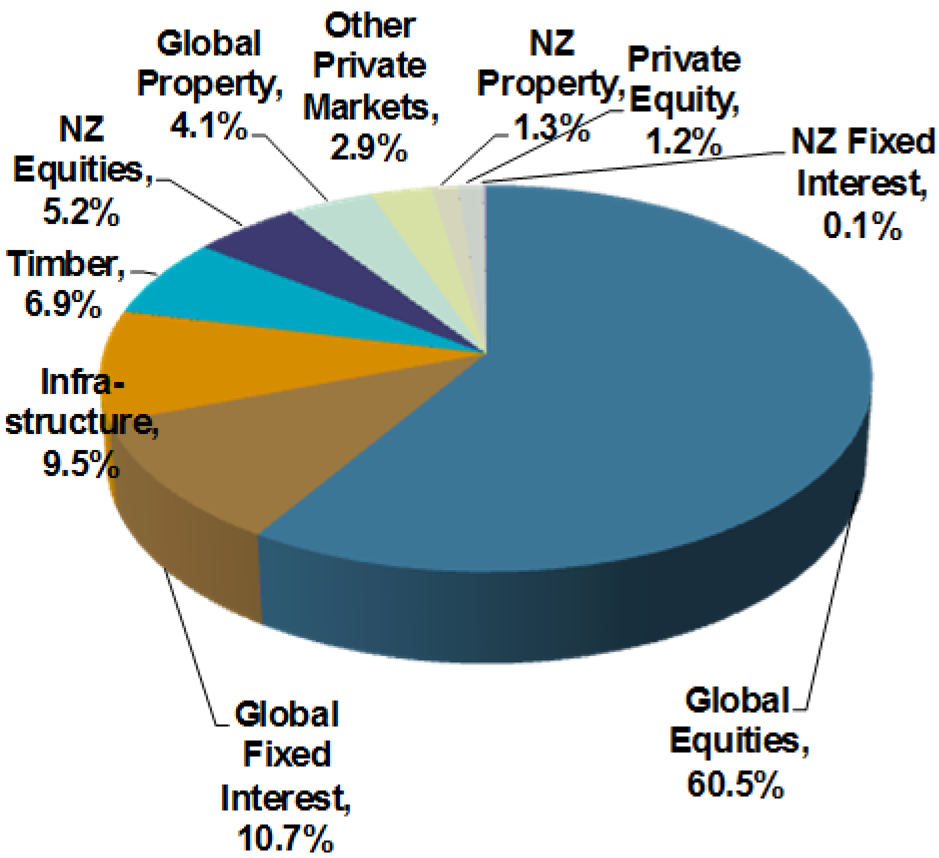
Aim for a single top down view across the widest range of investments & a consistent investment approach

Our Approach: Reference Portfolio and Actual Portfolio

Reference Portfolio



Actual Portfolio



Relevance of Finance Theory in Practice

Our investment beliefs are informed by Finance theory, and these beliefs form the basis for our strategies. For example:

Asset Allocation

What we believe in	What we are not sure about
Asset allocation is key	The exact nature of risk premiums
Portfolio Optimisation is a useful tool provided we take into account it's shortcomings	How portfolios should be constructed beyond mean variance, i.e. if and when 'fat-tail' matters
Diversification is paramount	

Relevance of Finance Theory in Practice

Market Efficiency

What we believe in	What we are not sure about
Financial markets are by and large 'efficient': ▪ Risk and return are strongly related, i.e. 'beta' is a fair reward for systematic risk ▪ Manager skill ('alpha') is rare and hard to find	Are there structural inefficiencies in the market? Examples: ▪ Are some markets (such as frontier markets) segmented? ▪ Do active manager incentives distort market pricing?
Manager fees represent a clear hurdle for active management	

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Relevance of Finance Theory in Practice

Dynamic Behaviour of Markets

What we believe in	What we are not sure about
Risk and return characteristics of financial markets are dynamic	To what extent are these dynamic changes predictable?
Empirical evidence suggests that market volatilities cluster and returns 'mean-revert' over time	If there are predictabilities in market risks/returns, what is the best investment strategy to exploit these?

Conclusion

- A long horizon investor enjoys all the opportunities a short term investor has, plus a lot more
- There are challenges in establishing the appropriate investment structure to exploit the opportunities
- Endowments
- Beliefs
- Capabilities