

Setting Goals and Staying Focused

February 2009

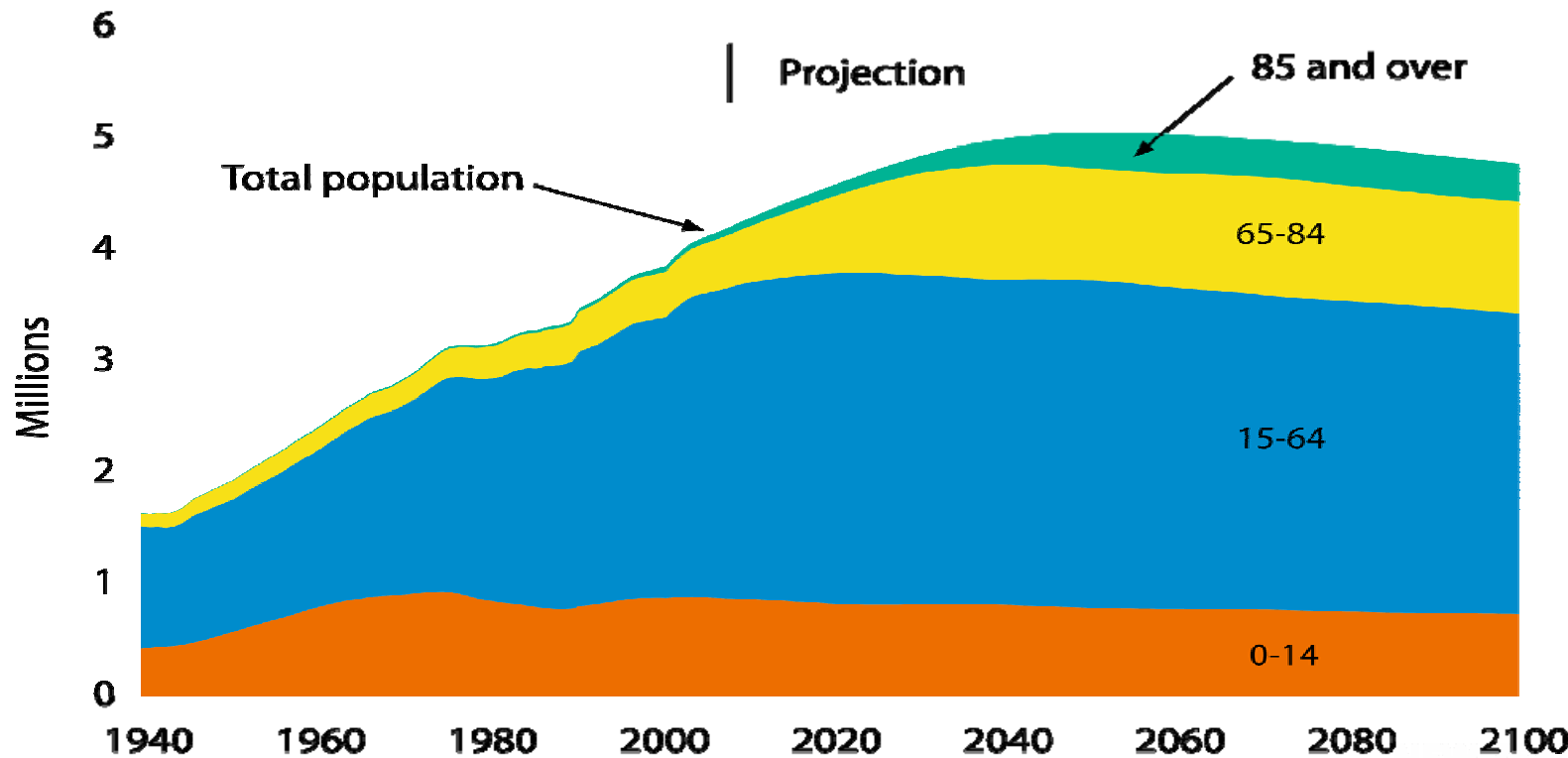
Adrian Orr
Chief Executive Officer

Being a long-term investor?

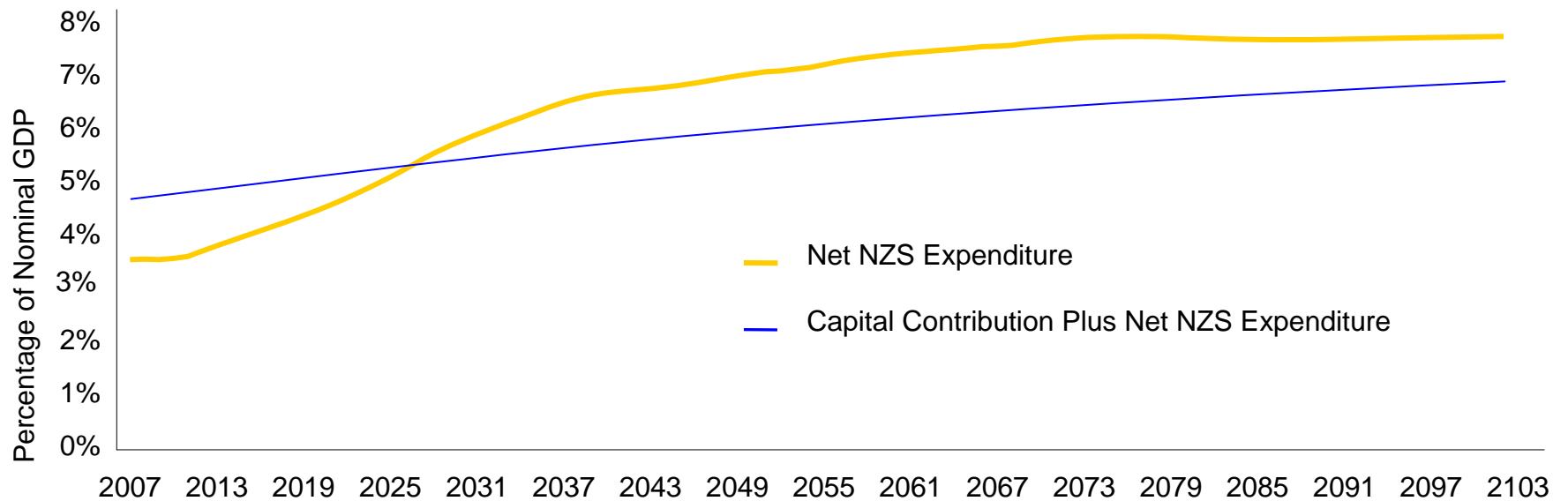
- A clear purpose
- Governance discipline to stay the course
- Selected financial exposure
- Able to communicate the challenges to key stakeholders

A Clear Purpose: the Superannuation Buffer Fund

Source: New Zealand Treasury



A Clear Purpose: Smoothing superannuation costs over time



Source: New Zealand Treasury

Discipline to stay the course

- Clearly defined portfolio of Crown financial resources
- Managed by an independent governing body

“The Guardians must invest the NZSF in a prudent, commercial basis, and in doing so, consistent with:

- Best-practice portfolio management; and
- Maximising return without undue risk to the Fund as a whole; and
- Avoid prejudice to New Zealand’s reputation as a responsible member of the world community”

Add-value by returns $>$ risk-free rate and passive alternative

Governance Budget

- The WW / Oxford research (Clark and Urwin: Best-practice investment) identifies a fund move from 'good to great'.
- Of most importance to results were these four:
 - Strong **investment beliefs** commanding Fund-wide support that align with goals and informs all investment decision-making.
 - The use of a highly investment competent management function tasked with **clearly specified responsibilities**, and accountabilities to the Board
 - Working within a **learning culture** which deliberately encourages change and challenges the commonplace assumptions of the industry.

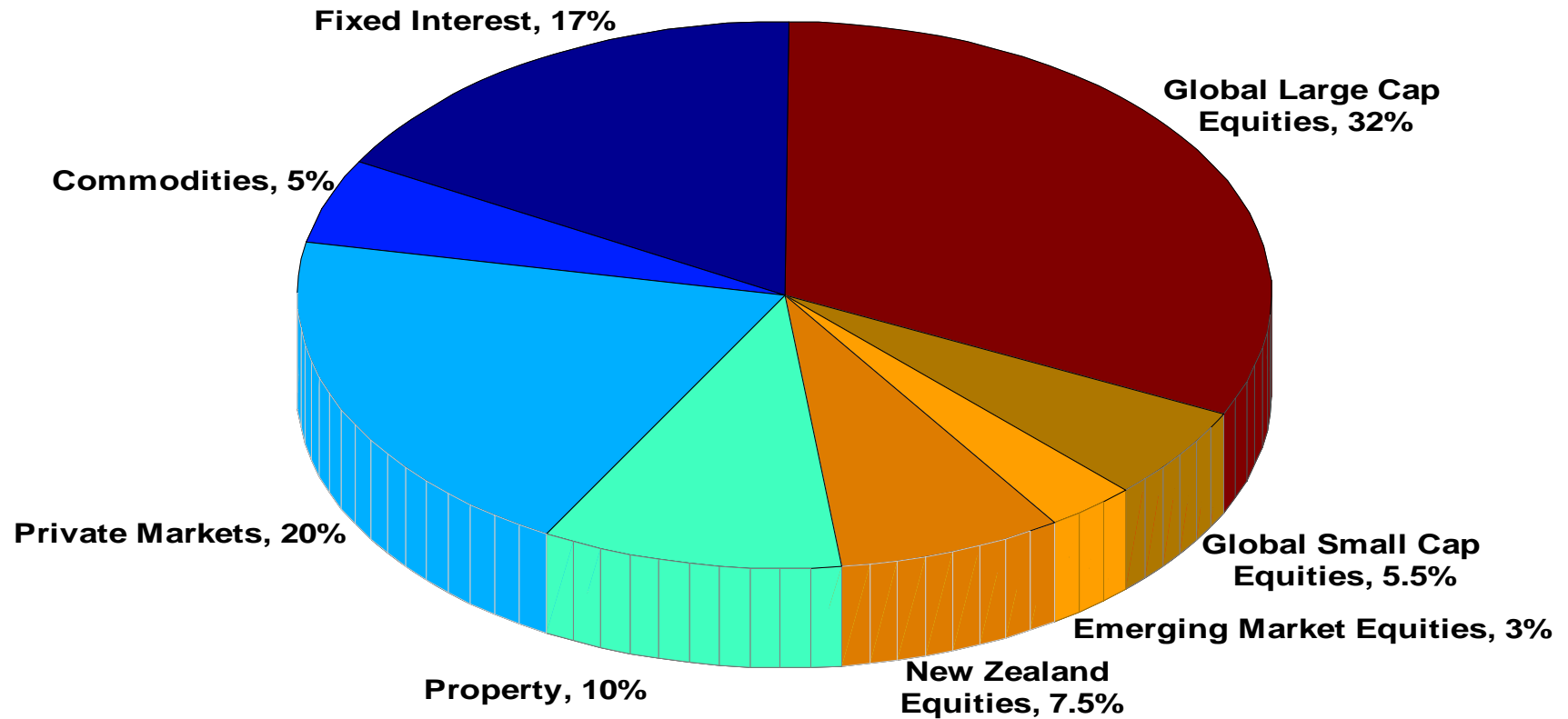
Source: Watson Wyatt Research

Deliberate Financial Exposure: Strategic Asset Allocation

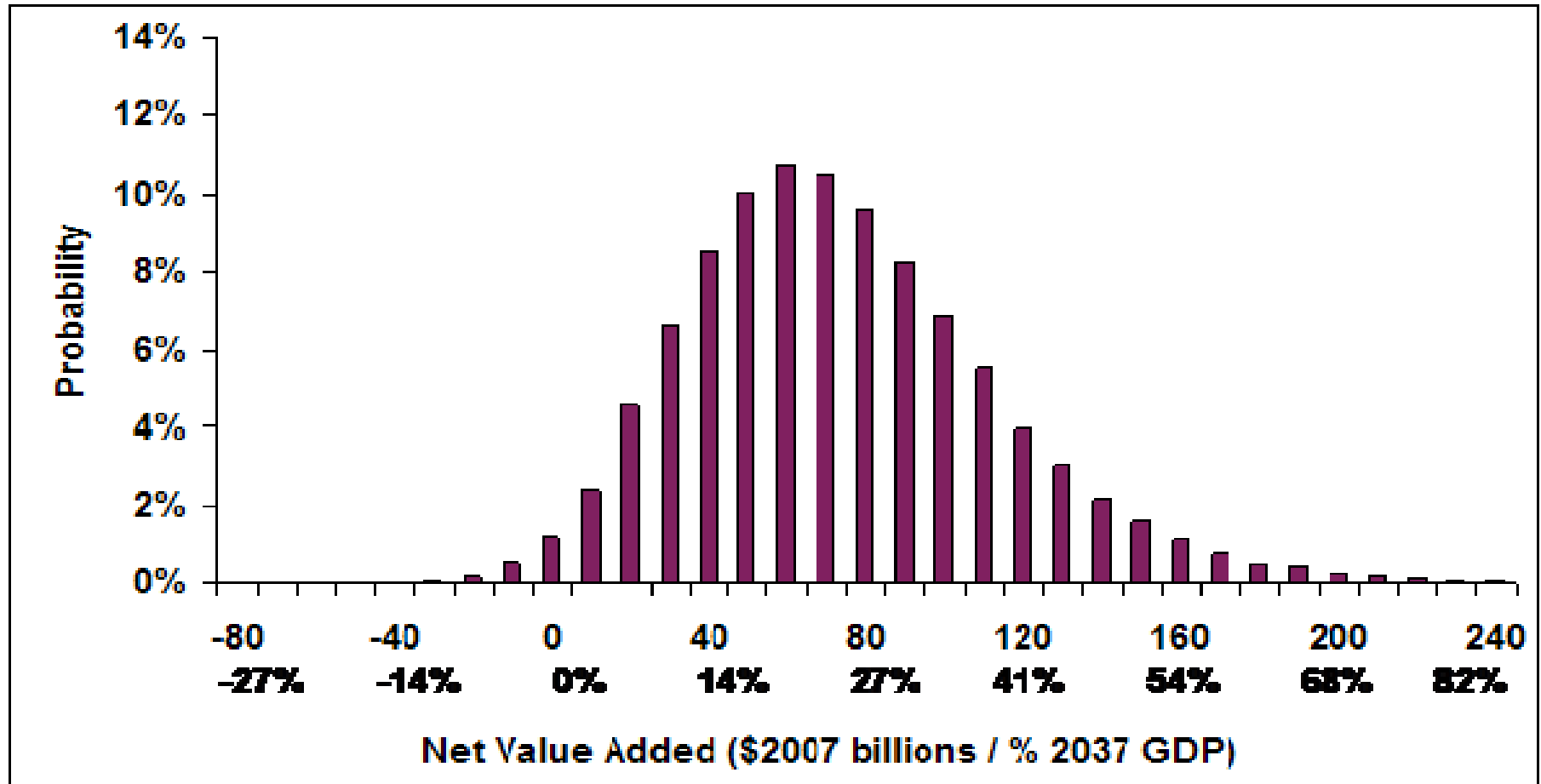
- The Guardians' endowments include their:
 - Long-term investment horizon – matching long-term liabilities
 - Ability to invest across the near full range of asset classes globally; and
 - Liquidity risk premium due to no capital withdrawals until at least 2020
- Key decision:
 - Mix of markets and assets that the Fund will on average be exposed to

Strategic Asset Allocation

Fund by Asset Class (%)



Distribution of expected returns over a 30-year investment horizon (against T-bills)



Time Horizons

- Different time horizons have different significance

Horizon Period	Why is it important?
3 months	Manager performance is measured over this period
1 year	Financial reporting interval in the Fund accounts
3-10 years	The central period for 'success' for the Fund
10-20 years	Average duration of the Fund
> 20 years	Consistent with the longer term mandate of the Fund

Financial crisis implications?

Issue	Reaction	Opportunity / Threat
Impact on financial markets	Chronically weak banking sector and systematic de-leveraging producing significant dislocation	Tactical and strategic
	Greater risk aversion growing with a flight to quality in asset allocation	Markets have repriced risk
	Banking pressure to de-leverage leads to many distressed opportunities	Distressed assets Threat issue also
	Investors favouring uncorrelated assets, with markets with appraisal values slower to re-price	Alternative assets
Risk	Risk models are not suited for financially stressed conditions,	New risk models Threat issue also
	Increasing attractions of building a macro overlay framework	New risk models
Leverage	Recognition that excessive use of leverage is big red flag	Steps to reduce leverage
Investment Managers	Increase evidence of overcrowding and capacity issues with managers	Review of quant / leverage
	Increased manager event risk from weak capital / business model or compliance or risk management disciplines	Refinement of manager profile
	Excessive 2 and 20 type cost structures represent poor value for money	Cost constraints
	Time horizon of permanent capital organisations like pension funds in demand, allowing mandates to be stretched	Long-term investor profile

Source: Watson Wyatt Research

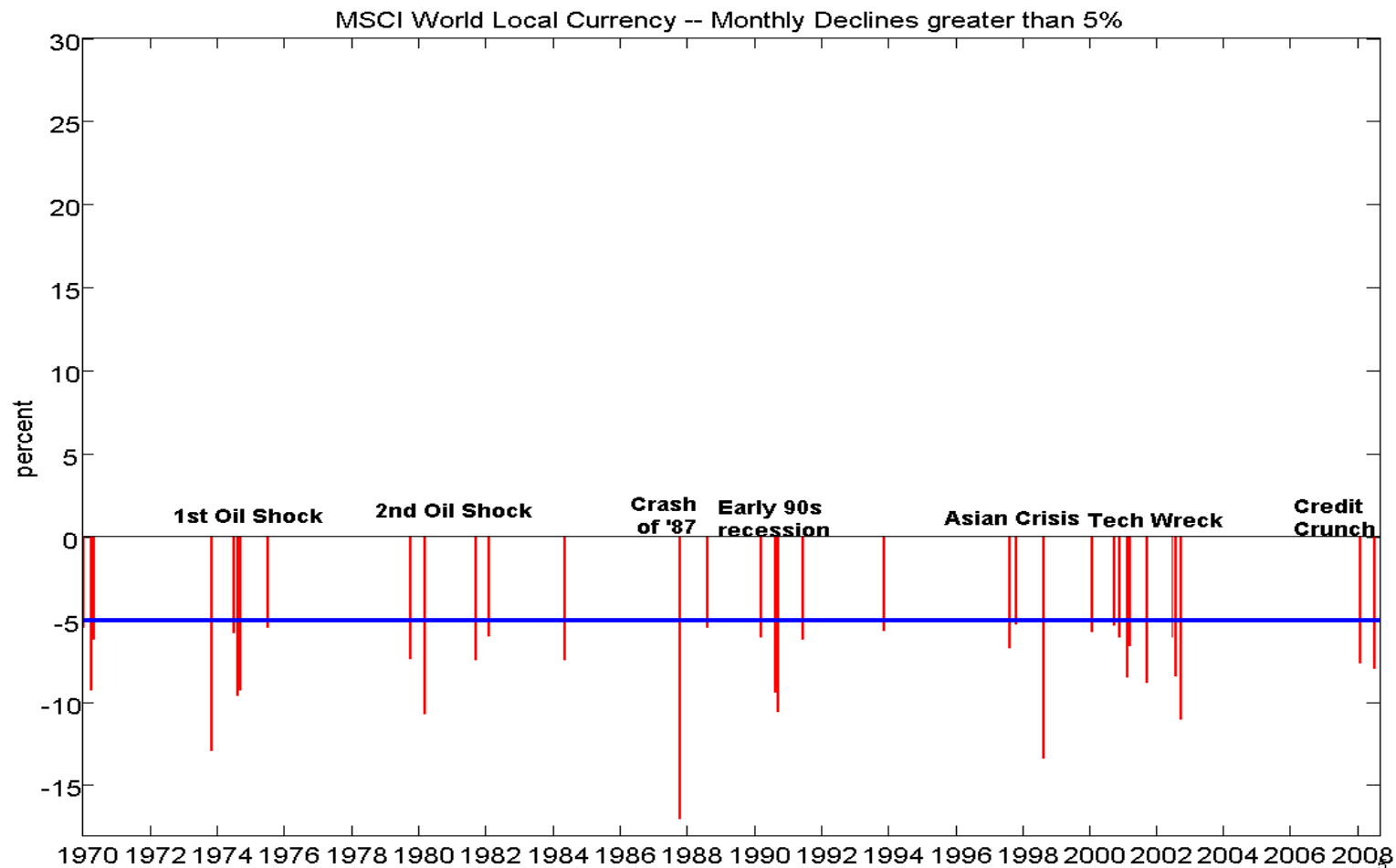
The Credit Crunch and the long-term investor

- **Opportunities**
- Potential to buy assets at attractive valuations
 - Equities
 - Private equity and unlisted assets
 - Property
 - (Distressed) Debt

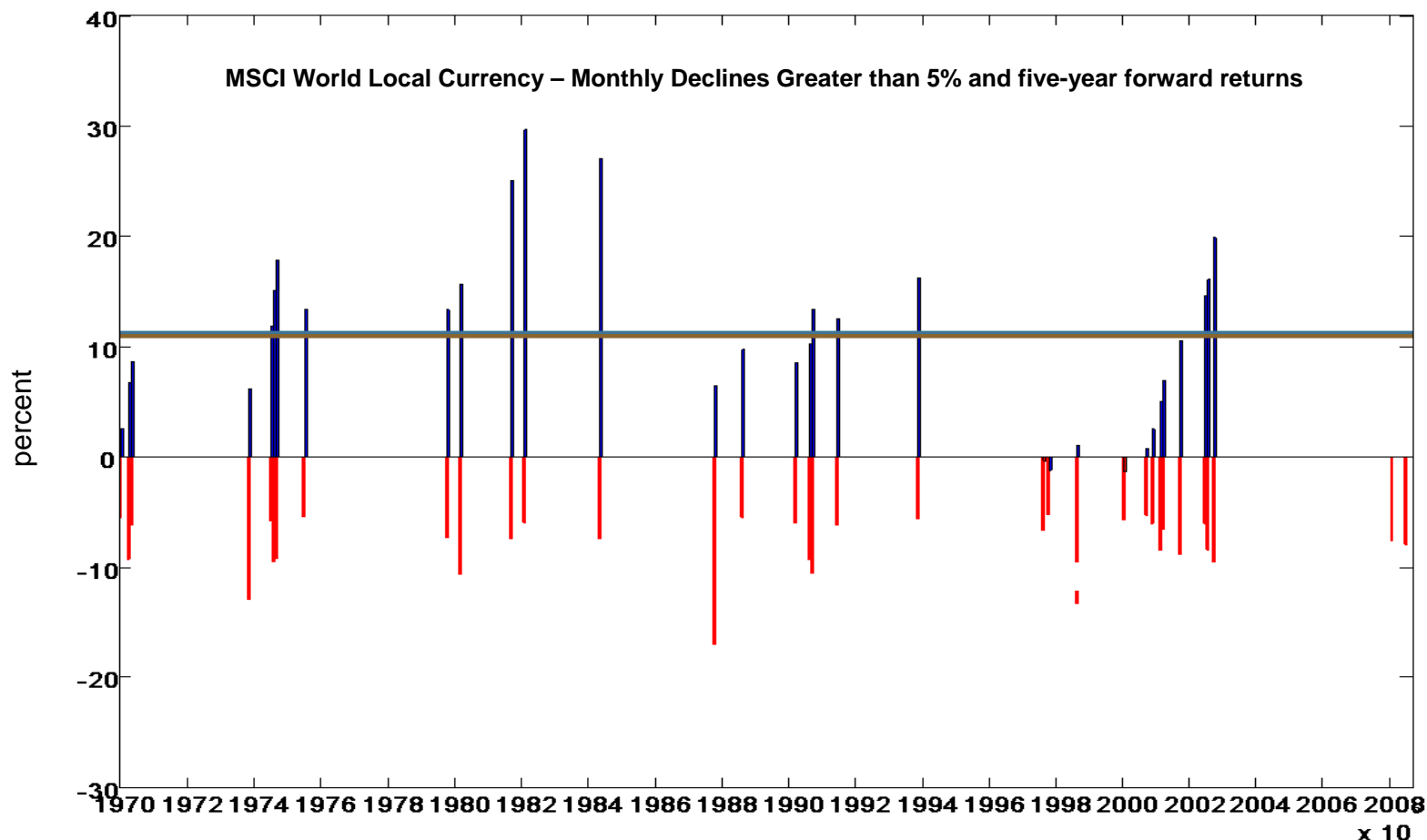
BUT..

- A challenge to maintain investment discipline in the face of likely short-term losses
- Maintain discipline in evaluating opportunities
- Remain mindful of overall risk profile and liquidity

Past shocks in perspective



Past shocks in perspective



Summary: Principles of Long-Term Investment at the Fund

- **A clear purpose:** smoothing superannuation costs over time
- **Discipline to stay the course:**
 - Well-defined organisational and accountability structure
 - Structure strategies and incentives to be invariant to short-term market-movements
- **Deliberate financial exposure:**
 - Diversification through the SAA
 - Maintain flexibility to evaluate and buy into new investment opportunities...
 - ... while undertaking thorough diligence and maintaining risk commitments
- **Communication to key stakeholders**