



Chairman's letter



NATIONAL
PROVIDENT

DEAR MEMBER

It is my pleasure to provide you with an update on the National Provident Fund (NPF) and its activities over the financial year to 31 March 2018. I was appointed to the Board in July 2015 and as the Chairman in September 2017. I would like to thank my predecessor, Catherine McDowell, who has remained on the Board after standing down as Chairman last year as a result of her relocation to Australia.

The NPF schemes are unique in New Zealand, in that payment of the benefits by the schemes is guaranteed by the Crown. This means members can be confident their retirement savings are always secure. However the investment performance of the assets of the schemes is subject to market forces in a similar manner to other New Zealand superannuation schemes. The financial year to 31 March 2018 was a good year for investment markets, with both the New Zealand and overseas share markets producing strong returns in an environment of low interest rates and low inflation.

A key piece of work this year has been the review of the asset allocation strategies for all the NPF schemes. This work has been very challenging in the current low interest rate environment, with the Board seeking to achieve the appropriate

risk-reward balance. The review was completed in early 2018 and, where the asset allocation is changing, the new asset allocations will be implemented by 30 June 2018. Each scheme has been analysed individually, taking into account its specific liabilities. For some schemes, the Board has decided to increase the allocation to growth assets (shares). Whilst this may slightly increase the volatility of the returns for those schemes, it should also increase the overall level of the returns over the longer term. The impact of the review on your Scheme is detailed in the Annual Report, together with the investment results for your Scheme.

Further information on how investment markets have performed in the past year is set out under the Investment Commentary.



review 2018

review²⁰¹⁸

RECENT LAW REFORMS

Since the Global Financial Crisis, regulators around the world have been implementing new regulatory requirements to reduce the risk of a repeat of these events. NPF is already subject to strict governance and reporting requirements and has many procedures and processes in place to ensure good practice. Some members will have already experienced the additional procedures we are required to follow, for example, the introduction of 'proof of identity' procedures in relation to anti-money laundering legislation. Improvement to processes and efficiency gains will continue to be a focus for the Board going forward.

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 NPF 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 scheme administrator, Datacom, 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 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 an NPF 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 628 776.

MISSING MEMBERS

The Board continues to devote resources to finding members for whom we do not hold a current address. All members classified as missing are listed on the Board's website – www.npf.co.nz – under Unclaimed Monies. If you have friends or family who may have been members of NPF in the past you should encourage them to check our website.

To ensure you continue to have access to your savings, and the number of missing members does not increase, please advise Datacom, the scheme administrator, in writing of any change in your contact or bank account details.

BOARD MEMBERS

As mentioned earlier I became Chairman of the Board in September 2017. Graeme Mitchell is our deputy Chairman and he very capably chairs our Audit and Risk Review Committee. Catherine McDowell continues to be on the Board and chairs our Investment Committee. Earlier this year Wayne Stechman was reappointed to the Board for a further three year term through to June 2021; Wayne is a member of the Investment Committee. The other two members of the Board are Stephen Ward, a member of the Audit and Risk Review Committee and Daniel Mussett who is on the Investment Committee.

My thanks go to my fellow members for their contributions to the work of the Board over the year. The Board also joins me in expressing heartfelt thanks to the management and staff of Annuitas Management Limited for their high level of support during the year and their commitment to the NPF members in whose best interests they act every day.



Kind regards

A handwritten signature in black ink, appearing to read 'Edward Schuck'. The signature is written in a cursive, flowing style.

Dr Edward Schuck
Chairman

Board of Trustees of the National Provident Fund
June 2018

NPF investment commentary

1 APRIL 2017 TO 31 MARCH 2018

To meet the schemes' objectives, NPF invests in a mix of cash, fixed interest and shares in line with the asset allocation for each scheme. Asset class returns, gross of expenses and tax, are commented on below.

MARKET OVERVIEW

Shares produced strong returns for the March 2018 financial year, supported by a synchronised uplift in global growth and rising corporate profits. Returns from global bonds (fixed interest) were positive but low for the year as starting yields were low and rose modestly over the year. US bond yields gained the most over the year, as growth expectations were revised up and the US Federal Reserve lifted the cash rate by 1%.

After a prolonged period of calm in markets, volatility returned with a jolt in February on concerns US inflation and bond yields will rise faster than the economy can handle. These concerns have since subsided but are likely to be a recurring theme over the coming year.

NEW ZEALAND CASH

Cash returns were 2.5% for the financial year, 0.58% ahead of benchmark. The Official Cash Rate remained at 1.75% over the year, with inflation tracking below the Reserve Bank's target of 2.0%. Inflation is expected to rise only gradually going forward so cash returns are expected to remain low for some time.

FIXED INTEREST

Global fixed interest returned 5.9% for the financial year, 2.6% ahead of benchmark. Rising global bond yields held back core government bond returns. NPF investment managers found attractive reward for risk in non-core strategies, including emerging markets and securitised credit. New Zealand fixed interest returned 3.8% for the financial year, 1.3% ahead of its

short duration benchmark with credit and yield curve strategies the main contributors. Low and rising bonds yields will continue to weigh on fixed interest returns over the coming year.

OVERSEAS SHARES

Overseas shares returned 13.1% for the financial year, 2.2% ahead of its unhedged benchmark. Strong earnings growth was the main tailwind behind the gains. Healthy earnings growth is expected over the coming year, driven by above-trend economic growth and expansionary US fiscal policy. Given the solid earnings backdrop, overseas shares valuations are only a little above the 20-year average levels. This may not be enough to prevent market wobbles over the coming year as investors digest the implications of rising bond yields, as well as the usual geopolitical concerns.

NEW ZEALAND SHARES

New Zealand shares returned 15.5% for the financial year, 1.4% behind the benchmark return. Approximately half of the index annual return was from one stock, A2 Milk. A below-benchmark allocation in this stock for one NPF investment manager explains the under-performance versus benchmark. In contrast to overseas shares, New Zealand share valuations are trading notably above their 20-year average levels. Returns seen in recent years will be harder to come by.

OUTLOOK

Global growth is expected to remain above average over the next few years, with inflation expected to increase modestly. Overseas share market valuations are not abnormally high and their valuation compared to bonds supports a benchmark allocation to shares. Volatility has returned to share markets after a long hiatus, and the return of risk should be regarded as the norm, not the exception. It is widely known, but often forgotten, that higher risk is the price of higher returns.