

Chairman's letter



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 2019.

BACKGROUND

The payment of the benefits by the NPF 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 2019 was a volatile one for listed shares, with significant falls in all share markets in the last quarter of 2018 followed by strong resurgence in these markets in the first quarter of 2019. Overall the year produced a satisfactory return in an environment of low interest rates and low inflation.

As I mentioned last year, a key role of the Board is the review of the asset allocation strategies of all the NPF schemes. Reviews are completed every three to five years for the schemes and more frequently in some cases.

The reviews were completed in early 2018 and the new asset allocations were implemented by 1 July 2018. Each scheme was analysed individually, taking into account its specific liabilities. For some schemes, the Board 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 current asset allocation for your Scheme is described in the Annual Report, together with the investment results for your Scheme.

The Board also regularly reviews and monitors the performance of the investment managers to ensure they are in line with our expectations.

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

A large, artistic background image of red flowers, similar to the one in the top left, but larger and more prominent, with a soft focus effect.

review 2019

INVESTMENTS

INVESTMENT MARKET OVERVIEW

Asset returns were positive for the March financial year, despite intensifying global growth and trade concerns as the year unfolded. Following a solid first half for share markets, equities declined sharply in the December quarter as fears grew around US-China trade tensions, the month-long US Federal Government shutdown and a possible manufacturing recession in Europe. Share markets recovered in the March quarter as lower inflation allowed central banks to hold back on interest rate hikes. Thus far at least, the slowdown does not look as large as was expected, but that does not mean the concerns have gone away.

Asset class returns, net of fees, are commented on below.

NEW ZEALAND CASH

Cash returns were 2.4% for the financial year, 0.5% ahead of benchmark. The Official Cash Rate remained at 1.75% over the year, with inflation tracking 0.5% 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

International fixed interest returned 2.0% for the financial year, 2.6% behind benchmark for last year and 1.3% ahead of benchmark over the last three years. Lower global fixed interest yields over the second half of the year contributed to capital gains in fixed interest assets. However, NPF investment managers were underweight low-yielding developed markets which rallied the most as growth concerns rose. New Zealand fixed interest returned 4.1% for the financial year, 0.8% ahead of its short duration benchmark

with credit strategies the main contributor. Low current fixed interest yields are expected to hold back fixed interest returns over the coming year.

OVERSEAS SHARES

Overseas shares returned 7.3% for the financial year, 0.4% behind its hedged benchmark for last year and 0.9% behind benchmark over the last three years. Solid US earnings growth in the first half of the year, and more accommodative central banks in the second half, supported the gains. Global equity managers outperformed their unhedged equity benchmark whereas an allocation to alternative strategies was a drag on returns.

A new unit fund of the Global Asset Trust, in which the Schemes invest, was established in the second half of the year to hold alternative investments. The aim of holding alternative assets is to diversify away from equity and bond risk, to which the Schemes are almost entirely exposed. The alternative assets currently entail a single investment in a style premia fund.

NEW ZEALAND SHARES

New Zealand shares returned 16.4% for the financial year, 3.0% behind the benchmark return and 1.2% behind benchmark over the last three years. The share market was propelled higher by record low fixed interest yields which lifted valuations across the board, but particularly in the 'yield-play' utility and property sectors. In contrast to global shares, New Zealand share valuations are trading well above their 20-year average levels and NPF managers are finding attractive opportunities in Australian markets over the medium term outlook. However, this exposure did contribute to the under-performance over the last year.

INVESTMENT OUTLOOK

Global growth is expected to decline modestly over the next few years with inflation also a touch lower. This points to modest returns from both equities and fixed interest over this horizon. Global share market valuations are not abnormally high and their valuation compared to fixed interest supports a neutral allocation to equities. NZ equities, in contrast, are trading near record valuations and a below-target allocation appears justified. Low expected returns from traditional assets make the allocation to alternatives somewhat more attractive, though no investment comes without risk. The benefit derives from selecting alternatives with returns that do not co-move with traditional assets.

COMMUNICATIONS

The NPF website – www.npf.co.nz – is an important part of our communications strategy and contains comprehensive information on NPF and the schemes. It explains how NPF operates and gives all stakeholders access to the trust deeds and financial statements for each of the schemes.

If your contact details change, we request and encourage you to advise the administrator of the NPF schemes, Datacom, so we can contact you if required. Datacom will provide you with a personal details form on request for this purpose. Your personal information is currently maintained and stored electronically by NPF within a cloud service hosted in New Zealand.

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.

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 neither Datacom nor the Board will ever 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 phone.

Wherever you provide personal information – whether it's by email, letter, completing a form or over the phone – you can be assured we will do everything we reasonably can to protect your personal information from being used in the wrong way.

NPF and Datacom will never:

- ask you for your banking personal identification number (PIN) or password;
- 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.

BOARD MEMBERS

Later this year there will be some changes to the Board with two of our long standing members, Graeme Mitchell and Catherine McDowell, coming to the end of their terms. Graeme has been on the Board since July 2010 and has very capably chaired our Audit and Risk Review Committee since July 2015. He became Deputy Chair of the Board in July 2016.

Catherine joined the Board in August 2013, became Deputy Chair in July 2015 and then Chair of the Board until August 2017 when she moved to Australia. Since then Catherine has served as Chair of our Investment Committee.

I thank both Graeme and Catherine for their significant contributions and service to NPF over the years.

Details of the new Board members will be added to our website once their appointments have been confirmed by the Minister of Finance.

I would also like to thank my other Board members, Wayne Stechman and Daniel Mussett (also members of the Board Investment Committee) and Stephen Ward (also a member of the Audit and Risk Review Committee) for their contributions, and I look forward to working with them in the coming years.

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, reading "Edward Schuck". The signature is written in a cursive, flowing style.

Dr Edward Schuck

Chairman

Board of Trustees of the National
Provident Fund

June 2019