



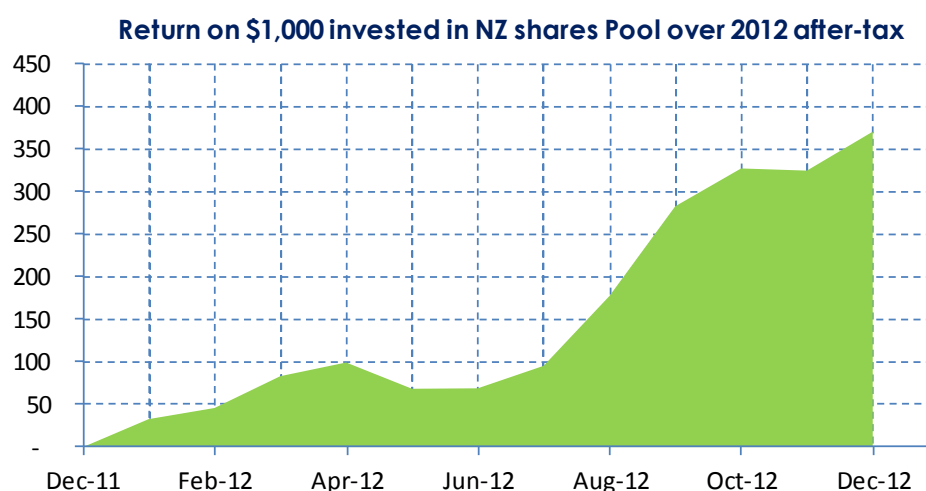
When you invest in a fund, it is often hard to reconcile the published return with the return you receive. This is because, among other things, the return is affected by cash flows (i.e. when you put money into the fund). It is also made complex by the treatment of tax and fees. Few managers show investors their individual net returns on the basis of their actual cash flows.

With KiwiSaver, the returns calculated based on actual cash flows are probably more relevant to an investor, as most people save regularly. Such returns give a better picture of what is happening to their savings.

Typically managers show the return that applied for the period, on the basis that you put your money in at the start and kept it there for the whole period. In contrast, many savers save a little each month and the timing of their cash flow is important. Often the returns allowing for cash flows and those ignoring cash flows are similar or very close. At other times, they can be 5% or 6% different and either higher or lower.

We can illustrate the differences, by looking at a real example; SuperLife's NZ Shares Pool. SuperLife's NZ Shares Pool returned 37% for the 2012 year. This was after-tax and after fees. This was an exceptional return. The 37% was the return if you invested a single lump sum at the start of the year. For example, if you invested \$1,000 on 1 January 2012, at 31 December 2012, it was worth \$1,370 after-tax and fees; an increase of \$370 on \$1,000. Over the year, the accumulated return at different times was:

Chart 1



In 2012, there were four distinct periods. In the first 4 months, the returns were steady and consistent. In the second 3 months, the return was such that the value on 31 July was similar to that of 30 April. Most of the spectacular growth occurred in August and September.



The good returns of August and September stand out when the returns of the individual months are plotted.

Chart 2

Monthly NZ Share Pool returns (after-tax at 28% and after fees)

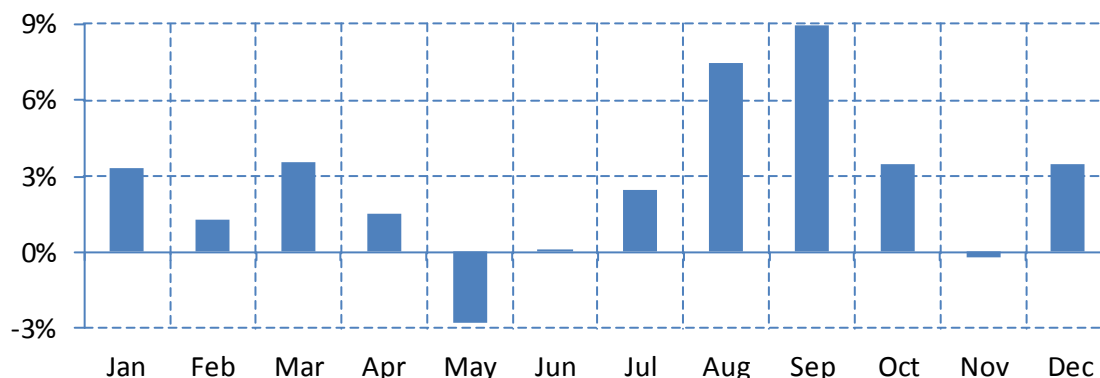
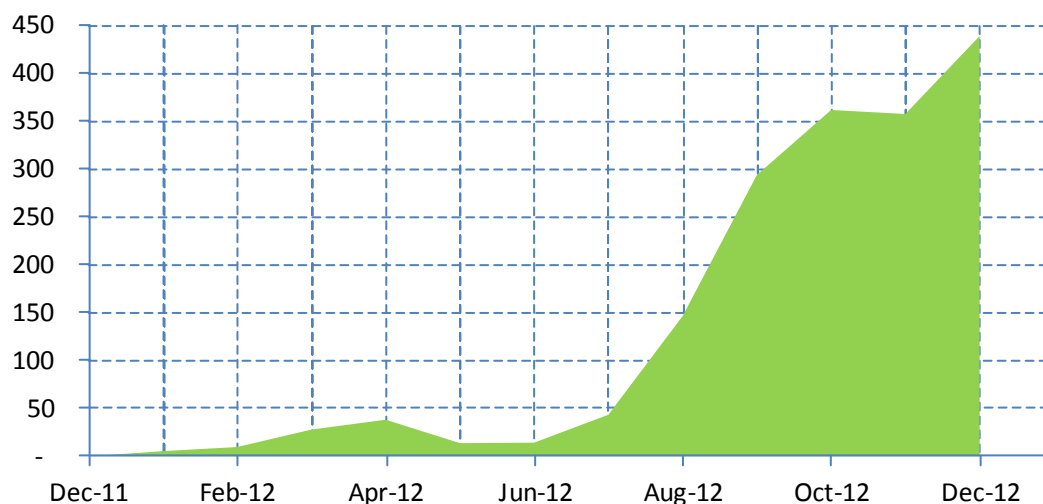


Chart 1 showed the return on a single \$1,000 investment at the start of the year. What if, instead you saved \$167 a month, over the year and therefore \$2,000 in total. This means that on average, you had \$1,000 invested for the year; less at the start and more at the end, but \$1,000 on average. The \$167 was chosen so that it allowed a direct comparison to the rate of return on the \$1,000 investment at the start of the year.

Under this regular investment scenario, the investor ended the year with a return of \$438. Allowing for the timing of the cash flows, the return on the money invested was 43% after-tax and after fees (see Chart 3).

Chart 3

Return on \$167 a month invested in NZ shares Pool over 2012 after-tax



To understand why it was higher, we need to look at the pattern of the returns (Chart 2) and the pattern of the cash flows. In the first half of the year, when the returns were lower (including the negative in May and zero in June), the investor making regular savings had less invested and so did not suffer as much. When the higher monthly returns occurred in August and September, the investor had more invested.

In 2012, the pattern worked in favour of the regular saver. In other years, the reverse could happen. Had the pattern of returns been reversed (i.e. higher at the start of the year and lower



at the end of the year), the investor would have still got a very good positive return. However, the overall return would have been lower than the 37% made on the \$1,000 (invested on a complete year).

Lessons from 2012

The experience of the NZ Shares Pool in 2012 highlights three important principles:

- The timing of returns is important when you are saving;
- It is hard to predict when the good and not so good returns will happen; and
- It is often a good idea to reduce risk as you get closer to when you will spend your money.

As a rule, when you get closer to wanting to spend your money, the impact of a negative return can be significant. It is often a good idea to reduce risk and therefore reduce the chance of a negative return, as you approach retirement.

The legal stuff

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