SuperLife investor update

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www.SuperLife.co.nz

What is my past return?

Understanding the return you receive from an investment, or the return that you would have received had you made the investment, is often difficult. This is mostly because common market practice for the disclosure of past returns does not match an individual investor's circumstances. Published past returns rarely allow for cash flow, may not include all fees and do not always allow for tax.

In SuperLife's view, the return that is important is the net-of-tax and net-of-fees return the investor receives; ideally expressed in dollars. But market practice means that quoted past returns are often gross (or at a different tax rate to the investor's tax rate), generally ignore contributions and are shown as a percentage. Most quoted returns are on the basis of investing a single lump sum (e.g. $10,000) at the start of the period.

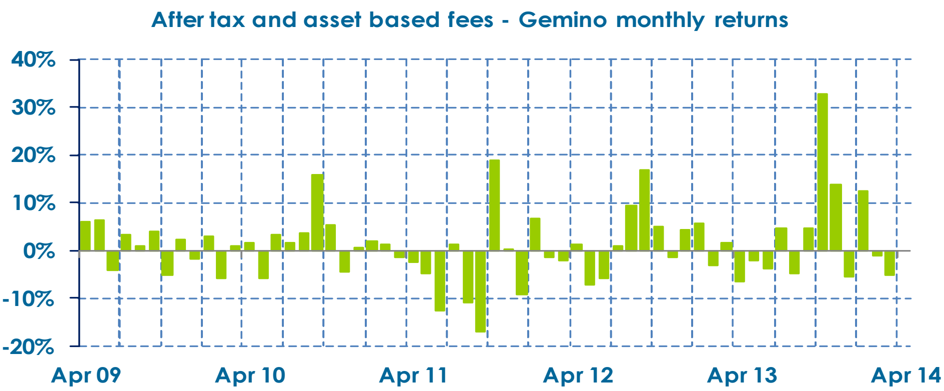
> *The important return, to an investor, is the net-of-tax and net-of-fees return, based on their cash flows and tax rate.*

To understand the potential differences, we can look at an example. We have used the SuperLife Gemino Pool as it has been the most volatile Pool over the last five years and therefore illustrates the differences well.

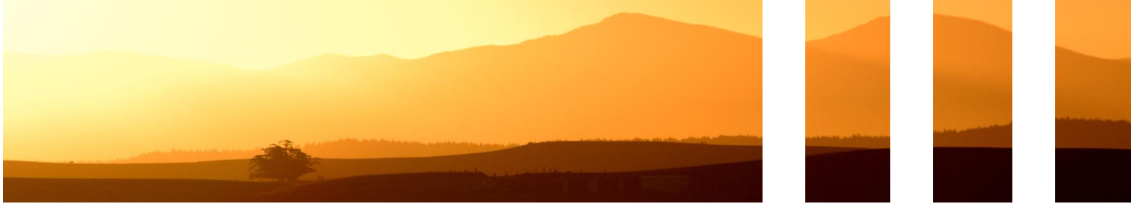
Under three common scenarios of negative cash flow (i.e. withdrawing money), no cash flow (i.e. a single investment) and saving money (i.e. positive cash flow), the average returns were 7.3%, 9.5% and 14.1% a year respectively, over the five year period. This raises the question, "what is right?"

The monthly returns, after-tax (at the highest tax rate) and after asset-based fees over the last five years, of the Gemino Pool under SuperLife's KiwiSaver scheme, have been:

Chart 1

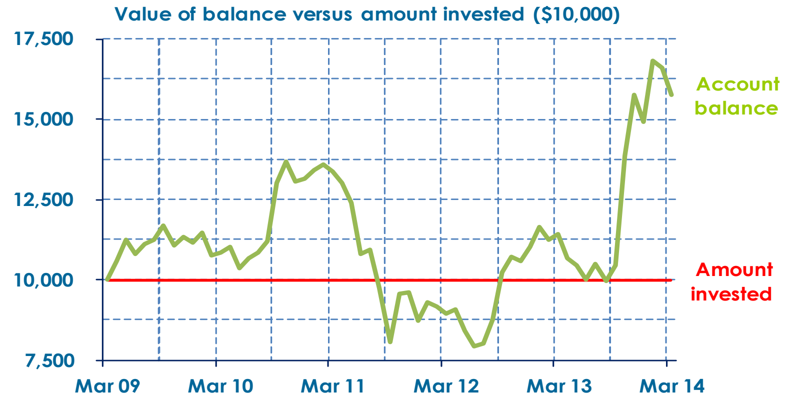


The chart highlights the frequency of the negative returns and the wide variation of returns from one month to the next.



Therefore, if $10,000 was invested in Gemino on 1 April 2009, the value of the investment throughout the five years would have been:

Chart 2



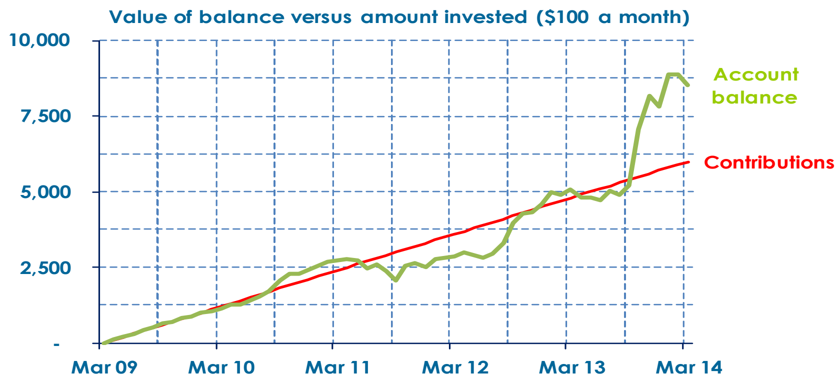
Opening value	$10,000
Investment earnings	$5,929
Fees	-$165
Closing value	**$15,764**
Net return	**9.5% p.a.**

After 5 years, the $10,000 would have been worth $15,764 or 58% higher than the original $10,000, which is equivalent to a return of 9.5% a year.

However, few investors invest $10,000 at the start of the period and make no other savings, particularly with KiwiSaver. What was more likely, was that they saved each year so that they received the employer contribution and also the annual government MTC subsidy (member tax credit).

As an alternative to investing a single lump sum at the start, if an investor saved $100 a month for the five years, the value in their account would have been:

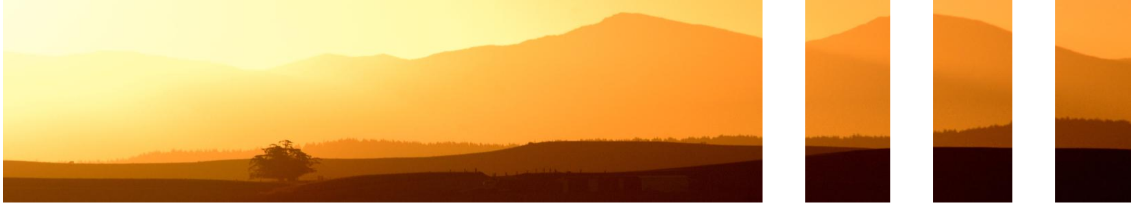
Chart 3



Opening value	$0
Savings	$6,000
Investment earnings	$2,699
Fees	-$165
Closing value	**$8,534**
Net return	**14.1% p.a.**

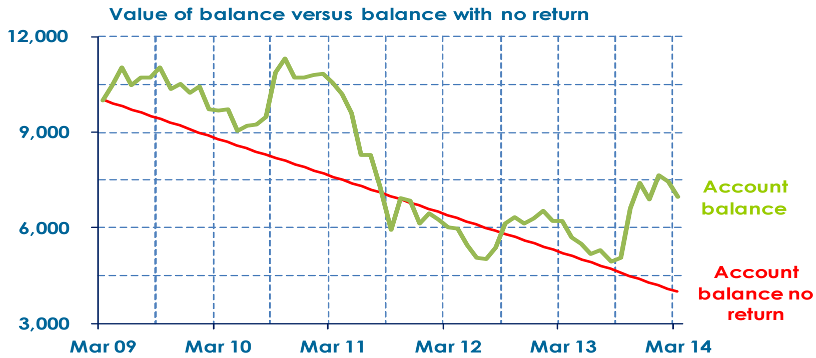
After 5 years, the investor would have saved $6,000 and would have had an account balance of $8,534. The $2,699 investment earnings was equivalent to 14.1% a year return, i.e. if you saved $100 a month and earned 14.1% each year, you would have had $8,534 after 5 years. 14.1% a year is closer to what most investors would have received, than the 9.5% a year. The difference between the two is explained by the impact of the timing of the cash flows.

However cash flows are not always positive. As investors, in retirement move from saving to spending, it is useful to look at what happens when you start making regular withdrawals from your savings.



If an investor started with a balance of $10,000 and chose to withdraw $100 a month for 5 years, the investor's account balance would have been:

Chart 4



Opening value	$10,000
Payments	-$6,000
Investment earnings	$3,153
Fees	-$165
Closing value	**$6,988**
Net return	**7.3% p.a.**

Over the five years, the account balance reduced from $10,000 to $6,988 mainly due to withdrawing $6,000. The average return over the 5 years was equivalent to 7.3% a year.

Three different returns, reflecting three different investor savings patterns; 14.1% a year, 9.5% a year and 7.3% a year. Which is right? For most investors, it will be the 14.1% because they are actively saving. However, for an investor, it will depend on their individual circumstances and a single return quoted for a particular product may not be applicable to those circumstances and could be potentially misleading.

Currently, the market practice and regulated disclosure requirements show that the historical return of Gemino to be 9.5% a year for the five year period. But the more likely return for an investor was 14.1% a year, if they were saving, and 7.3% a year if spending. Given this difference, it is important to look beyond the published returns and understand the drivers of the returns and the likely pattern of returns.

Also relevant and well illustrated by the Gemino example over the last five years, is the investors' tolerance to seeing the value of their investment going "up and down". Each of the charts highlight significant downs in the five years and investors have to decide if they are comfortable in seeing the value of their savings change so dramatically. The example shows the value of tolerating the downs to get an overall satisfactory return, but this is not guaranteed and always the outcome.

Important notes:

1. The return an investor receives depends on their tax rate and their cash flows. Two investors with the same investment strategy can have materially different returns if they have materially different cash flows. The difference arises from the volatility of the returns from one period to the other. If there is no cash flow, then volatility does not affect the average return. If there are cash flows, volatility has a material impact on the average return and particularly dependent on whether the more recent return is positive or negative. SuperLife investors can see their annual returns based on their cash flows and their tax position over the Internet, at www.SuperLife.co.nz. Returns are shown as dollars and percentages.

2. Gemino was used in this article, to illustrate the returns that different investors would have received, because it has had the highest level of volatility of the different Pools. It is not a recommendation to invest or not invest in Gemino. You can see the volatility of the returns in the charts by looking at the range of returns and the periods where the return since the start (1 April 2009) resulted in a negative return overall.

3. We think investors should choose their investment strategy based on:

   - When they are likely to spend their savings (under the "bucket" approach), and

   - The ups and downs (particularly the downs), they are willing to experience along the way. The bucket approach to investing is explained in our booklets "thinking about your retirement" and "thinking about investing" available on the SuperLife website at www www.SuperLife.co.nz.