Investment BULLETIN

An investment update by
NZ Funds Management

ISSUE NO. 08
AUG 2014

Features

COVER IMAGE: 'CHURCH OF THE GOOD SHEPHERD, MACKENZIE COUNTRY'
PHOTOGRAPHER: ROBERT CHURCHILL

INVESTMENT STATEMENT(S): FOR FURTHER INFORMATION OR TO REQUEST A COPY OF THE NZ FUNDS MANAGED PORTFOLIO SERVICE INVESTMENT STATEMENT OR THE NZ FUNDS KIWISAVER SCHEME INVESTMENT STATEMENT, PLEASE CONTACT NZ FUNDS OR SEE OUR WEBSITE WWW.NZFUNDS.CO.NZ

RICHARD JAMES
DIP. BUS. (FINANCE), AFA
CHIEF EXECUTIVE

Dear Clients,

As the half way mark of 2014 passes, I thought I would give you a snapshot of our progress through a numerical lens.

- Your investments with us grew by over $40 million during the first half of the year; this was due to the combination of investment growth across most asset classes, and a growing commitment by our clients toward increased savings.
- The NZ Funds KiwiSaver Scheme surpassed the 5,000 member mark, with member assets now around $75,000,000. It feels terrific to have helped 5,000 New Zealanders accumulate $75,000,000 from a standing start in November 2010 when we, rather belatedly, launched our KiwiSaver scheme.
- We have focused on working with New Zealanders who are contributing to their scheme so it is really pleasing to see that 78% of the members of the NZ Funds KiwiSaver Scheme contribute regularly to their portfolio. Your dedication to saving means that the NZ Funds KiwiSaver Scheme is now the eleventh largest in New Zealand.
- Over the 12 months to 30 June, the indicative client models we track produced annual returns of between 9.74% and 16.58% (after fees, before tax). Over the past two years in particular, investors have been rewarded for taking on a little risk with our diversified portfolio returns comparing very favourably with the rather lacklustre term deposit rates available over the same period. This is especially the case when returns are considered on an after tax basis.
- Every six months we survey a selection of you to see how you feel about us. We use a globally recognised satisfaction test called Net Promoter Score. Our most recent survey saw our results jump to +13 for Managed Portfolio Service clients and +25 for KiwiSaver clients. Rest assured that we are working on earning from you a Net Promoter Score to rival that of some of the world's most trusted brands.
- The number of companies in our Wealth at Work programme grew from 82 at the beginning of the year to 115 at the end of June. This year we expect to provide financial guidance to around 2,500 employees from leading New Zealand companies, so look out for us in the workplace.

And, while all of that is positive, for me the most exciting thing is that we continue to find ways to improve the design of your portfolios and the depth of service we can offer.

In this issue we share the outcomes of our Wealth at Work programme, provide some suggestions on how to transition from work to retirement and publish some of our research on property investing.

Thank you for continuing to trust us with your life savings. We really appreciate how much it matters to you and our own personal savings are invested right alongside yours.

Richard James
Chief Executive

How property stacks up

21%

of clients chose a flat as an investment

84%

of clients chose a house as an investment

23%

of clients chose a commerical property as an investment

9%

of clients chose bare land as an investment

SOURCE: NZ FUNDS PROPERTY SURVEY, 21 JULY 2014.
BASED ON 165 RESPONSES.

IMAGE: 'AUCKLAND CITY'
PHOTOGRAPHER: CAROLYN ARCHER

Nearly half of the NZ Funds clients surveyed own or have owned a rental property. Of the 52% who have not, about half would consider investing in property in the future.

There is little debate about the merit of owning your own home, but how does property stack up as an investment? To answer this question, we analysed investment property returns over the last 20 years. We also researched your attitude to, and experience with, property investment.

HOME OWNERSHIP IS NOT A RENTAL

68%

of New Zealanders own their own home.

Statistics New Zealand

Home held for

17 years

Statistics New Zealand, REINZ

Investment property held for

7 years

NZ Funds Property Survey, 21 July 2014

SOURCE: NZ FUNDS CALCULATIONS, STATISTICS NEW ZEALAND, NZ FUNDS PROPERTY SURVEY, 21 JULY 2014.

Home ownership

Most clients' perception of property is gained through the purchase of the family home. Despite being considered one of life's more stressful experiences, home ownership can stack up well. And so it should. As a property investment your home is tenanted for life. Not only that, but the tenant (you) willingly maintains and repairs the property free of charge. Home ownership is also unlikely to be a short-term commitment. The average New Zealander owns their home for 17 years, maximising their potential for a meaningful capital gain. Few of us can afford our first home without the assistance of a mortgage, which we diligently pay off over our working life, turning a highly leveraged investment into a wholly owned asset. By the time we come to sell, it is not unusual to have made a multiple of our initial investment tax free.

Investment property types

Investing in property can be quite different from home ownership. It is worth briefly outlining the range of property types available to New Zealanders. Each has slightly different attributes.

21% of clients chose a flat as an investment. The principal advantage of flats is that they are, on the whole, cheaper than other forms of property. The rental yield can also be quite attractive: generally up to 10% depending on condition and location. On the downside, there is generally little or no capital gain from land value appreciation, the corporate body fees and obligations can be onerous, and there is no shortage of new supply.

84% of clients chose a house as an investment. An advantage of owning a residential property is that it will be a familiar property type for most New Zealanders. The issues that arise – for example, mowing the lawns, maintaining the hot water cylinder and guttering – are all issues clients are familiar with through home ownership. The downside is that rental yields (rent after tenant and maintenance expenses, relative to the purchase price) are usually low: for example we estimate the current net yield is around 3.1% p.a.[1]

22% of clients chose a commercial property. Commercial property comes in several forms: industrial property (for example a warehouse) retail property (for example a building with a shop front) or office property (a central business district office building). Commercial property generally offers higher rental yields and longer term tenancy agreements than residential. However, the entry price is usually higher than for a flat or house. Commercial property also requires a different set of skills from that used to manage residential property. Agricultural land usually requires specialist knowledge as well, which may be why only 1% of clients held it as an investment.

Finally, 9% of clients chose bare land as an investment. If you decide to invest in land, you do not have the safety net that rental yield provides. The success of your investment depends on the price of the property appreciating over time by more than the cost of the mortgage. Such an investment is speculative in nature and often best suited to those with specialist property knowledge, such as builders and property developers.

Interestingly, between the two residential property types, flats and houses, the majority of clients reported themselves as being happy with their investment experience in a flat, whereas more than half the clients who had invested in a house reported they were either neutral or unhappy. Those who were confident enough to invest in the various types of commercial property reported themselves as being on average happy, with very few reporting they were unhappy. In contrast, the majority of investors in bare land recorded they were unhappy. There appears to be a strong correlation between the property types that offer a higher yield (flats and commercial property) and how investors feel about the investment subsequently.

Also of note is that from 1993 to 2014, Auckland property returns outperformed the rest of the country by 42.8 percentage points. Whether this continues remains to be seen. 40.7% of clients chose to invest in Auckland; 16.0% chose Christchurch; 13.6% Wellington and 44.4% other regions in New Zealand.

SURVEY RESULTS BY PROPERTY TYPE

	Flat	House	Commercial	Bare land
Pros	• Lower entry price • Higher yield	• Familiar • Comes with land	• Higher yield • Longer term leases	• Wide range of entry prices
Cons	• No land value • New supply	• Higher entry price • Lower yield	• Higher entry price • Specialist knowledge required	• No yield safety net
Client choice	20.9%	83.9%	23.4%	8.6%
Average price	$360,623	$476,346	> $1 million	n/a
Estimated yield	3.0%	3.1%	7.8%	0
Best and worst five year periods (March 1994 - March 2014)	Best 95.9% Worst 17.1%	Best 128.8% Worst 15.4%	Best 126.8% Worst 27.6%	n/a
Clients' proportion of leverage used	43.8%	51.9%	46.4%	20.9%
Clients' satisfaction level				

SOURCE: NZ FUNDS CALCULATIONS AND ESTIMATES, CORELOGIC, INVESTMENT PROPERTY DATABANK LIMITED; © IPD 2013, STATISTICS NEW ZEALAND, RESERVE BANK OF NEW ZEALAND, NZ FUNDS PROPERTY SURVEY, 21 JULY 2014.

The risks and rewards of property

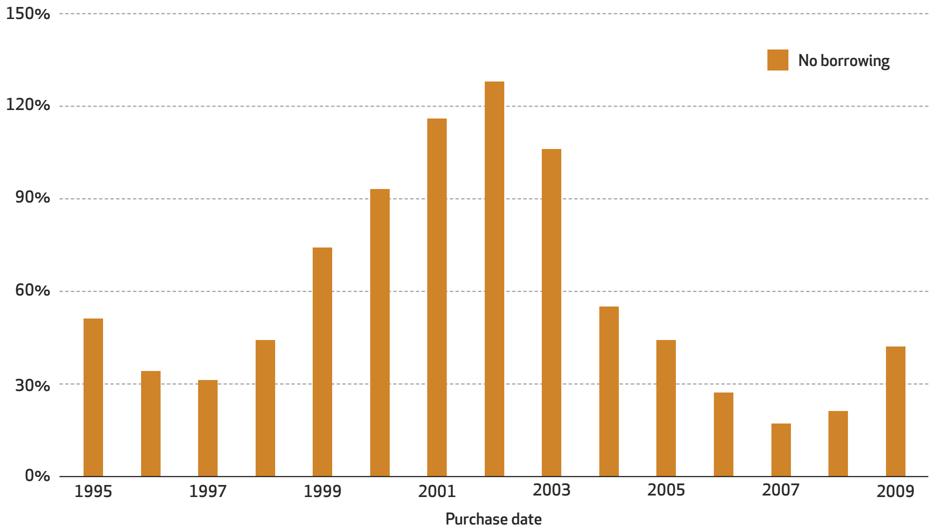
Property offers a number of attributes that can make it a highly attractive investment when managed correctly. It is relatively predictable. As well as generating an income, it offers the potential for capital appreciation. And perhaps most significantly, banks can lend against it, so it can be leveraged.

Timing the market

Property also comes with a number of risks. As with almost all investment, property is cyclical. That is, despite a long-term upward trend, property prices do rise or fall for a number of years at a time. Ideally, this would be to clients' advantage. Clients could purchase at the bottom of the cycle and sell at the top. Unfortunately, as with all investments, it is extremely difficult to have the conviction to invest in property during a market downturn. It can also be difficult to hold on to an existing property in a downturn as banks change their lending criteria and tenants and landlords alike face financial hardship. In contrast, it is all too easy to buy at the peak with little or no down-payment and the promise that it will be easily rentable later on.

Purchasing near a cyclical high does not necessarily mean all is lost. The long-term stable nature of a high-quality property should see its value recover, eventually. If clients are able to extend their holding period, a respectable increase in value is still salvageable. By way of an example, clients who purchased property around the recent peak in 2007 would have initially lost around 42% of their equity (assuming they borrowed two thirds of the purchase price), but should now be close to recovering their capital. On average, clients held their property investment for seven years. The ability to hold on for longer will often depend on your circumstances and your level of borrowing.

WHY TIMING MATTERS: FIVE YEAR TOTAL RETURN FROM PURCHASE DATE, ASSUMES NO BORROWING



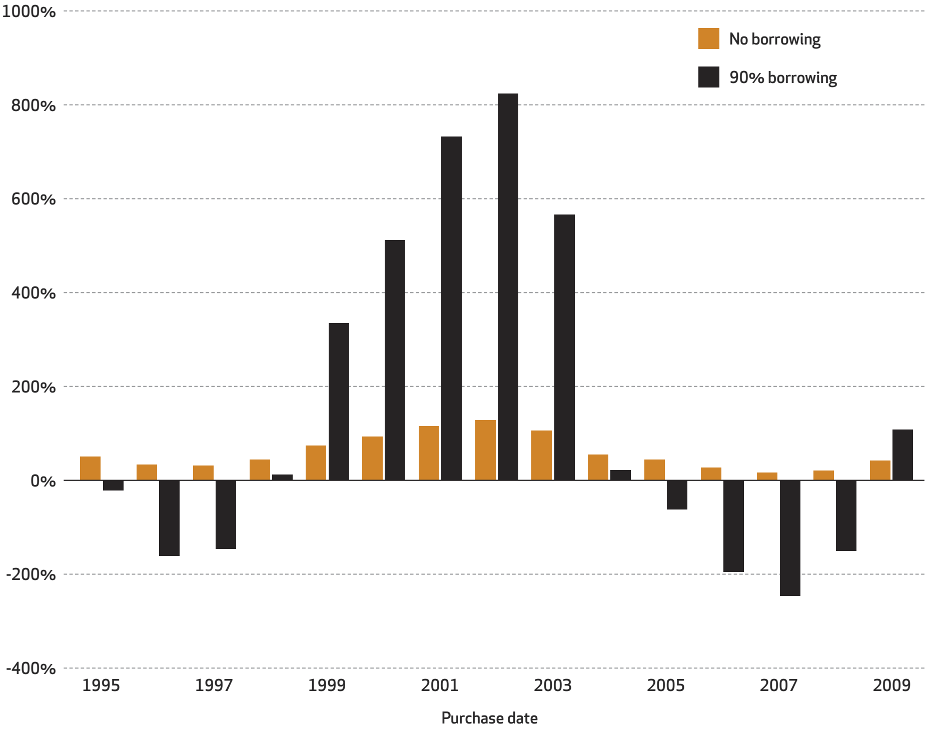
SOURCE: NZ FUNDS CALCULATIONS, CORELOGIC, STATISTICS NEW ZEALAND, RESERVE BANK OF NEW ZEALAND.

Using leverage

Borrowing, or leverage, is aptly referred to as a two edged sword. A little leverage can significantly enhance your long-term returns, while too much leverage can wipe out your deposit and, in some circumstances, the equity in your home as well.

If clients are able to service their loan safely throughout the cycle, they take the capital gain on the entire property, even though they only "paid" for a portion. Taken to the extreme this can lead to spectacular gains (and losses). Clients on average used leverage to enhance their returns: 31% borrowed between 0% and 20% of the purchase price; 20.2% borrowed between 21% and 50% and 48.8% borrowed between 51% and 100%.

LEVERAGE IS A TWO EDGED SWORD: FIVE YEAR TOTAL RETURN FROM PURCHASE DATE, ASSUMES NO BORROWING VERSUS BORROWING 90% OF PURCHASE PRICE



SOURCE: NZ FUNDS CALCULATIONS, CORELOGIC, STATISTICS NEW ZEALAND, RESERVE BANK OF NEW ZEALAND.

Property management

Maximising the probability of a capital gain over time requires work. This is perhaps the most misunderstood aspect of property ownership. A property manager can do some of this work in return for a percentage of the weekly rent, but they will not do all of it. Even with a property manager, you will need to invest your time to purchase the right property, at the right price. You will need to co-ordinate upkeep and maintenance. You will also need to manage the mortgage and bank relationship. You are responsible for deducting expenses and filing tax returns. And finally, you will also be responsible for managing the sales process to exit your investment.

66% of clients chose to manage their investment, while 33% outsourced various aspects of the relationship. Either way, managing a property from purchase to sale is more like being a small business owner than many clients realise. Making sure, at the outset, you are familiar with your obligations as a lessor and are willing to invest an appropriate amount of time and energy into your investment is essential.

THE IMPORTANCE OF PROPERTY MANAGEMENT

SOURCE: NZ FUNDS, 30 JULY 2014.

Property returns relative to alternatives

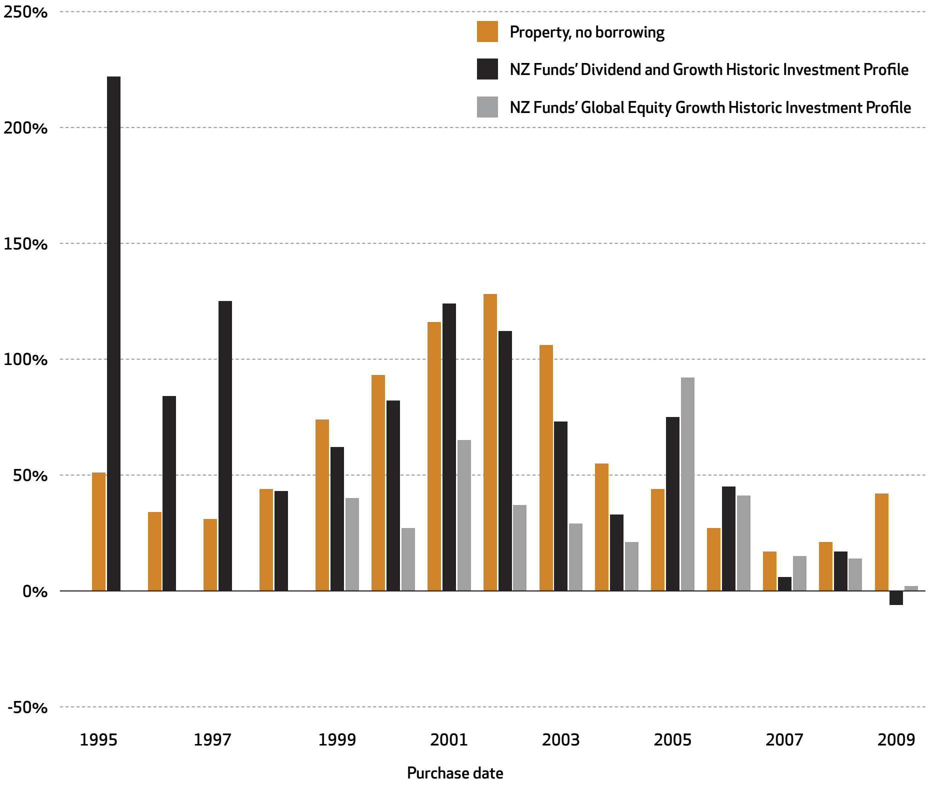
There is considerable debate about whether shares or properties make better long-term investments. In fact, both stack up well especially when patiently held for long periods of time. Interestingly, the value of a modestly leveraged property (assuming borrowing half the purchase price) does not necessarily rise and fall at the same time as New Zealand shares or international shares. This suggests that property can be a helpful source of diversification for clients. This appears to be how most clients use property. Of those clients who invested in property, 80.9% also held term deposits, 69.7% held shares or bonds; 74.2% held managed portfolios and 86.5% had a KiwiSaver or Superannuation Scheme.

CHARACTERISTICS OF PROPERTY RELATIVE TO ALTERNATIVES - LAST 20 YEARS

	Cash*	Bonds**	Residential property***	Commercial property****	Shares*****
Average yield p.a.	5.84%	5.94%	3.93%	8.72%	6.41%
Average growth p.a.	n/a	n/a	6.47%	1.59%	1.89%
Average return p.a.	**5.84%**	**5.94%**	**10.20%**	**10.03%**	**8.30%**
Largest decline	n/a	n/a	-6.10%	-3.80%	-38.70%
Liquidity	0 to 3 days	0 to 3 days	Estimated 60 to 90 days	Estimated 90 days plus	0 to 3 days
Transaction costs	0%	0%	3.00% to 4.00% (NZ Funds Estimates)	1.50% to 2.50% (NZ Funds Estimates)	0% to 1%
Tax rate	28%	28%	If held personally, marginal tax on yield, personal tax status determines tax on growth	If held in corporate structure, normal corporate tax rate is 28%	0% if dividends imputed

SOURCE: NZ FUNDS CALCULATIONS. * ANZ CALL INDEX 1994 - 2014. ** NEW ZEALAND GOVERNMENT BOND INDEX 1994 - 2003, ANZ CORPORATE BONDS INVESTMENT GRADE INDEX 2003 - 2014. *** NZ FUNDS CALCULATIONS AND ESTIMATES, CORELOGIC, STATISTICS NEW ZEALAND, RESERVE BANK OF NEW ZEALAND. **** INVESTMENT PROPERTY DATABANK LIMITED; © IPD 2013. *****NZX ALL INDEX 1994 - 2014.

BOTH PROPERTY AND MANAGED PORTFOLIO RETURNS STACK UP WELL: FIVE YEAR TOTAL RETURN FROM PURCHASE DATE, ASSUMES NO BORROWING, VERSUS NZ FUNDS' HISTORIC INVESTMENT PROFILES



SOURCE: NZ FUNDS HISTORIC INVESTMENT PROFILE CALCULATIONS, CORELOGIC, STATISTICS NEW ZEALAND, RESERVE BANK OF NEW ZEALAND. PLEASE NOTE THE NZ FUNDS HISTORIC INVESTMENT PROFILES DO NOT REPRESENT THE HISTORIC RETURNS OF THE RELEVANT PORTFOLIOS. THEY ILLUSTRATE THE HISTORIC PERFORMANCE OF NZ FUNDS' APPROACH TO MANAGING ASSETS OF THE TYPE HELD WITHIN THE PORTFOLIOS. FOR MORE INFORMATION SEE NZ FUNDS' PORTFOLIO INSIGHTS JULY 2014.

Checklist for including property in a retirement portfolio

If you are thinking about adding property to your retirement portfolio, you may wish to consider the following:

Do I have the time, energy and inclination?

If you are willing to put the time and energy into property management, the long-term rewards can be substantial. On the other hand, if you have never managed property before or do not work in a property related industry, your lack of practical experience and know-how can leave you vulnerable. If you do proceed, you may wish to start with a smaller property, and a lower level of borrowing. You can always gear it up later on if property investment agrees with you.

Does property suit my time frame?

Because transaction costs are relatively high, and leveraged property prices can fluctuate significantly over the short term, property is usually a ten or more year investment. If you are lucky enough to enjoy a short-term windfall gain, terrific, but it should not be counted on. New Zealanders purchasing a property with less than ten years to go before retirement and little or no alternative sources of savings may therefore be taking a gamble.

Does my borrowing match my risk profile?

If you wish to borrow, ensure your borrowing matches your risk profile and age. A conservative couple in their late fifties may wish to use little or no leverage, or have their mortgage payments fully covered by the rent (after taking rental expenses and tenant vacancy rates into account). In contrast, an individual in their early forties with an aggressive risk profile and a stable income may wish to borrow a higher portion of the purchase price.

Are my retirement savings diversified?

It may be unrealistic to assume the average New Zealand family will accumulate a diversified portfolio of property assets to mitigate the risk of any one property performing poorly; 55.6% of clients held one investment property. In the absence of any other forms of savings, clients' retirements may become dependent on the entry and exit and intermediate fortunes of a single property decision. It should not. There is no reason why all clients' savings should sit in the property basket. As you age, the importance of holding a growing portion of your wealth in easily accessible assets, such as bonds, shares, or a managed portfolio, grows. A useful rule of thumb for less liquid, long-term assets is to ensure that they make up no more than 100% less your age (for example 100 – 60 years old = 40%) of your retirement savings. For 43.3% of clients, property made up between 51% and 100% of their savings; for 21.7% of clients it made up between 21% and 50%, and for 34.9% it accounted for 20% or less.

Summary

Given that managed portfolios and property are both capable of growing your wealth over time, it is logical to consider whether property should be included in your retirement portfolio. There is even evidence to suggest that adding property to a managed portfolio of growth orientated assets such as shares helps dampen the volatility of returns. There is however nothing to suggest you have to own property to accumulate wealth for your retirement – there are plenty of alternatives available.

Whether property suits you will primarily depend on your personal circumstances and, in particular, whether you have the inclination and skill to be a property manager. If you do invest in property, following the simple checklist above should help you mitigate the risks and maximise the potential rewards.[2]

[1] Source: NZ Funds calculations, Corelogic, Statistics New Zealand, Reserve Bank of New Zealand.

[2] For clients who are considering a property investment we recommend **Property Investment: A Strategy for Success**, Martin Hawes and **The Truth about Property Investment**, Duncan Balmer, as unbiased practical guides to property investing for New Zealanders.

Building Wealth at Work

After several years of advising KiwiSaver clients, it became apparent that KiwiSaver on its own is unlikely to be sufficient to meet New Zealanders' retirement needs. In September 2012, NZ Funds decided to tackle the issue at its source (the workplace), by building a financial guidance programme called Wealth at Work. Since then, with the help of 115 companies throughout New Zealand, we have helped 2,952 employees with their retirement planning. This article provides an overview of the interesting array of issues faced by employers and employees.

IMAGE: 'AUCKLAND CITY FROM SKY TOWER'
PHOTOGRAPHER: CHRIS GIN

The employers' challenge

Many New Zealand companies are committed to rewarding their employees with a competitive salary and benefits programme. They work hard to ensure their rewards and employee wellbeing programmes are best in class and comply with the law. Over time, attracting, motivating and rewarding a quality workforce can make the difference between success and failure.

A rising proportion of employees' compensation is being funnelled into KiwiSaver. Five years ago employers contributed $350 million towards KiwiSaver; this year contributions will exceed $1.2 billion[1]. Despite this, KiwiSaver is likely to meet only half employees' retirement needs, and significantly less if poor investment decisions are made along the way.

Most employees welcome the offer of financial guidance. 77% of employees do not know how much they need to retire on, 69% are not confident their current arrangements would meet their retirement needs, and less than 50% feel confident their household would survive a loss of income for three months.

BEFORE WEALTH AT WORK

SOURCE: WEALTH AT WORK SURVEY, 30 JULY 2013.

The danger with leaving these issues unresolved is that they can manifest themselves in increasing turnover rates among mobile employees, who seek different reward structures, and lower retirement rates amongst elderly employees, who fear they cannot afford to retire. The feedback from two of New Zealand's largest employers was that both situations commonly occur.

Rather than continuously increasing compensation, the solution may be in ensuring employees' reward structures are better aligned to their actual financial needs. Wealth at Work seeks to do this by providing employees with access to myWealth, a simple, intuitive and personalised software programme that enables them to calculate how much they need for retirement and plot their progress. This is complemented by providing access to regulated financial advice and employer facilitated workshops.

THE WEALTH AT WORK PROGRAMME

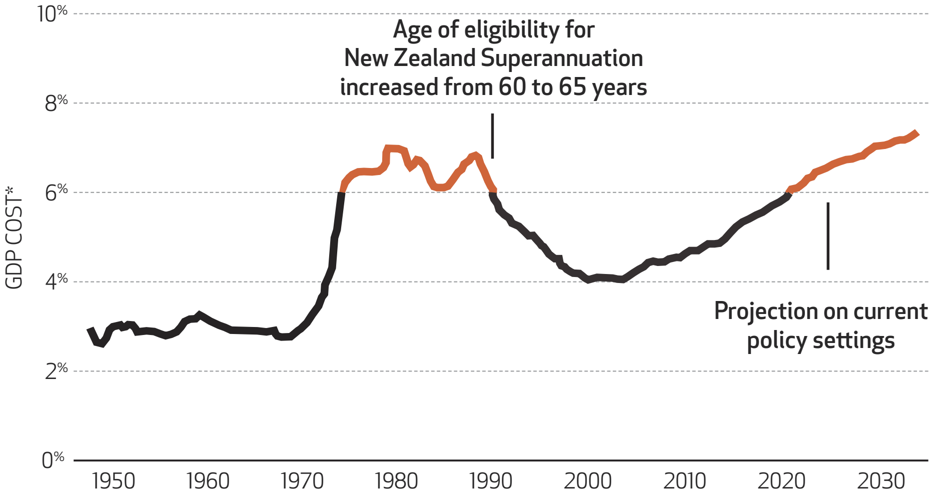
SOURCE: NZ FUNDS, 30 JULY 2014.

Why save for retirement?

A goal of the Wealth at Work programme is to address topics that are of use to employees (and management) at all levels of financial literacy. One such topic is the need to self-provide for retirement.

Like the rest of the developed world, New Zealand has an ageing population. The number aged over 65 years grew by 100% between 1976 and 2007 and will grow by another 100% by 2051 so that those over 65 years of age will make up one in four of the total population.[2] This means that, in the absence of any change, the cost of New Zealand Superannuation will nearly double as a proportion of gross domestic product. In many developed countries, the simple answer has been to increase the age of entitlement. We expect this to also happen in New Zealand. Interestingly, increasing the age of entitlement is also likely to alter when New Zealanders can access their KiwiSaver savings.

NEW ZEALAND SUPERANNUATION AND THE "UNSUSTAINABLE RED ZONE"



SOURCE: THE NEW ZEALAND TREASURY, *BEFORE TAX, AS A PERCENTAGE OF GDP.

Of more concern than the rising age of entitlement is the standard of living New Zealand Superannuation provides. At $367 a week for an individual, or $565 a week for a couple, New Zealand Superannuation is unlikely to meet employees' retirement needs. A recent study by Ashton and O'Sullivan (2012) found that New Zealand Superannuation was insufficient to fund a healthy lifestyle in retirement.

NEW ZEALAND SUPERANNUATION NEEDS SUPPLEMENTING

SOURCE: ASHTON, T. & O'SULLIVAN, J. (2012), A MINIMUM INCOME FOR HEALTHY LIVING (MIHL) – OLDER NEW ZEALANDERS, FINANCIAL SERVICES COUNCIL: HOW TO SUPERSIZE RETIREMENT INCOMES.

What do employees need to retire?

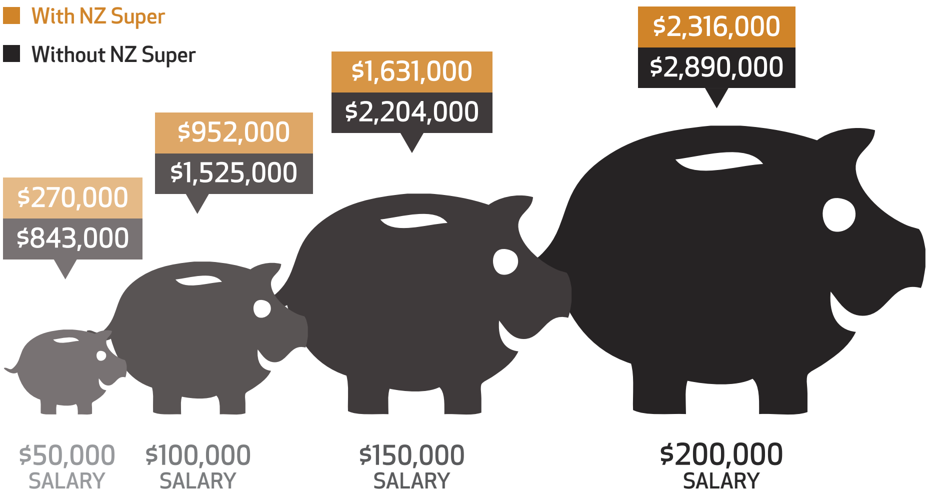
When the results of myWealth's 5,786 users are aggregated, a clear picture of what employees seek for retirement emerges. The average employee wishes to retire at 64, on 61% of their final income and expects to spend 27 years in retirement.

Most employees who had been through the workshop, "Why Save for Retirement?", chose not to include New Zealand Superannuation in their retirement calculations, signalling they see any future New Zealand Superannuation payments as a bonus. This mindset should enable them to navigate any future change in eligibility without impacting their retirement confidence.

At first sight employees' wealth targets for retirement were intimidating, but as the options employees had at their disposal were explained, the programme demonstrated that most retirement objectives are neither unreasonable nor unachievable.

Interestingly, 59% of employees modelled keeping their home rather than using the equity built up to fund their retirement. This should enable them to have sufficient funds to bridge any saving shortfall, or to fund an unexpectedly long retirement.

EMPLOYEE RETIREMENT WEALTH TARGETS

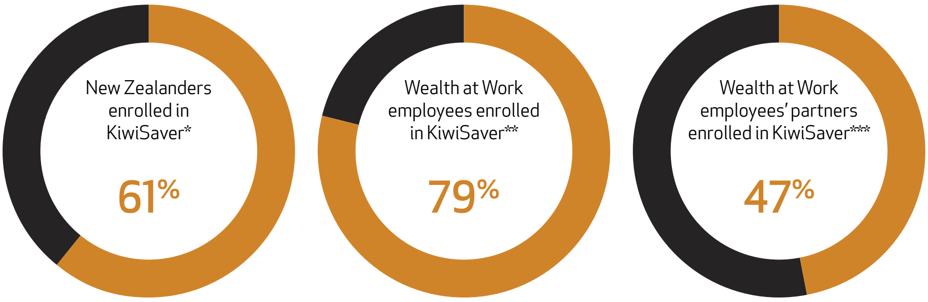


SOURCE: NZ FUNDS CALCULATIONS, BASED ON ASSUMPTIONS USED IN NZ FUNDS' MYWEALTH SOFTWARE, 7 APRIL 2014.

KiwiSaver: a great start, but not the whole solution

We had anticipated that communicating the merits of KiwiSaver would constitute a significant part of the programme. However, KiwiSaver participation rates amongst Wealth at Work companies were already significantly above the national average. Despite high participation rates, many employees were unfamiliar with the nuances of KiwiSaver, such as the ability to withdraw for a first home purchase and the flexibility of the contributions holiday provision.

KIWISAVER PARTICIPATION RATES



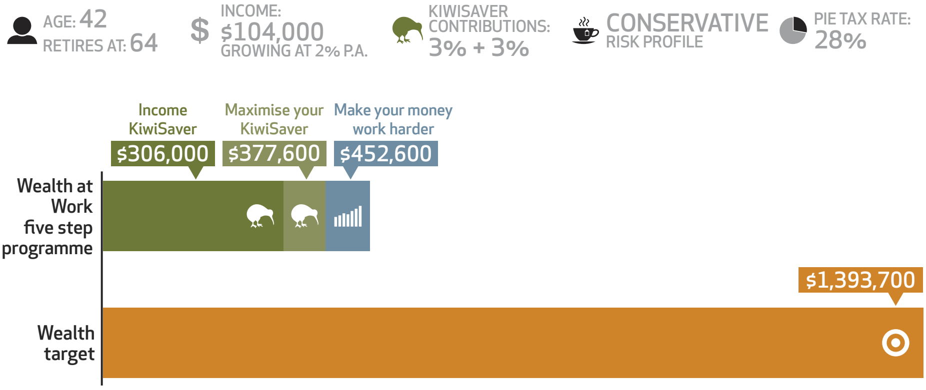
SOURCE: *INLAND REVENUE, ELIGIBLE NEW ZEALANDERS 18 - 64 YEARS, 30 JUNE 2013.
**WEALTH AT WORK PROGRAMME, 4 AUGUST 2014. ***WEALTH AT WORK SURVEY, 30 JULY 2013.

The primary misconception that needed to be addressed was that by enrolling in KiwiSaver, and paying off the mortgage, employees' retirement objectives would be met. Unfortunately, being enrolled does not mean being sorted. The programme demonstrated that for the average employee enrolled in the programme, KiwiSaver would only meet 30% of his or her retirement needs.[3]

An area where value could be added was in ensuring employees harvest member tax credits of up to $521 p.a. for partners and dependants over the age of 18. Our research found only 47% of Wealth at Work participants had done this. For a couple, with one partner not earning, this adds approximately $71,600 to their retirement saving at little additional cost.[3]

A second area where employees could get more out of KiwiSaver without having to contribute more was in asset allocation. By helping employees understand their risk profiles and the benefit of holding a portion of their KiwiSaver in growth assets, the average employee had the ability to add an estimated $75,000 to their retirement savings over a 22 year time horizon.[3]

GETTING THE MOST OUT OF KIWISAVER



SOURCE: NZ FUNDS CALCULATIONS, BASED ON AVERAGE MYWEALTH SOFTWARE USER, 7 APRIL 2014.

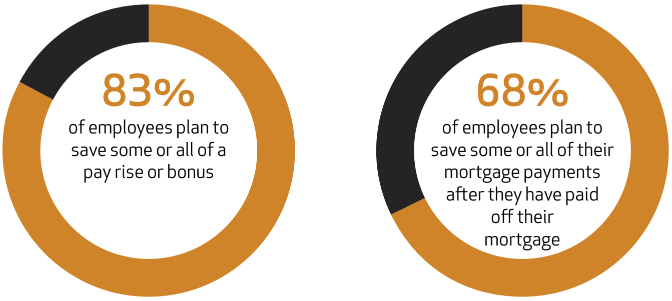
Bridging the remaining gap

For most employees the issue is not whether they are saving – almost all are in one form or another – but where to find extra dollars to save. We found the answer by listening to both employers and employees.

Employers felt they were rewarding skill and loyalty with rising rewards, but that savings rates were too low. Employees felt they needed all they were currently earning to live. However, when asked whether they would save more if their circumstances changed, most said "yes".

83% of employees surveyed said they wished to save 52% on average of any increase in compensation. 68% planned to save some (or all) of their mortgage payments after they had paid off the mortgage. In both cases, employees' existing lifestyles would not be impacted, in fact they would gradually rise, but not at the expense of their retirement wealth.

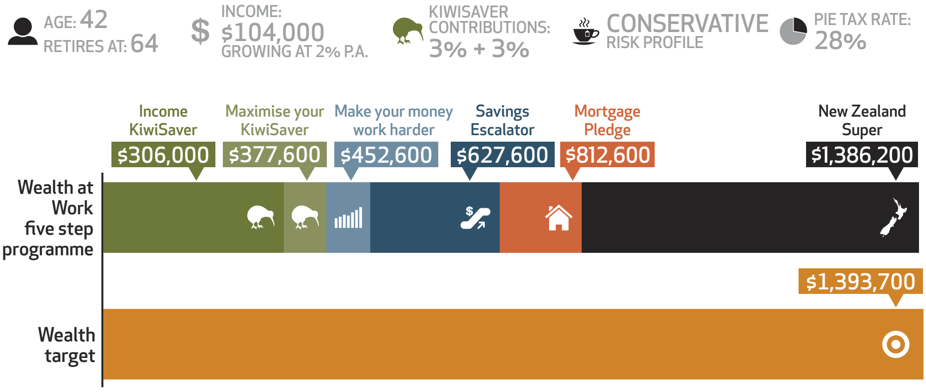
WAYS TO SAVE WITHOUT REDUCING YOUR CURRENT LIFESTYLE



SOURCE: WEALTH AT WORK SURVEY, 30 JULY 2013.

Despite their desire to do the right thing, employees must overcome an unnecessary quantum of form filling to turn theory into practice. Employers can play a valuable role by helping automate employees' retirement savings. New Zealanders will need to save approximately 10% of their income over their working life to retire on similar terms to their counterparts in Australia, the United Kingdom and the United States.[4] A work-based system where, in addition to KiwiSaver, employees can pledge to increase their savings rates if and when their remuneration increases, would be ideal.

USING WORK-BASED SYSTEMS TO BRIDGE THE GAP



SOURCE: NZ FUNDS CALCULATIONS, BASED ON AVERAGE MYWEALTH SOFTWARE USER, 7 APRIL 2014. ASSUMES SAVINGS ESCALATOR 1% OF GROSS SALARY EACH YEAR FOR FOUR YEARS.

The importance of regulated advice

The law has thrust employers into playing a prominent role in helping New Zealanders provide for retirement. It requires them to administer KiwiSaver and contribute financially. As employees become more engaged, the number and complexity of questions asked are likely to rise. Most human resource teams are ill suited to providing financial advice, and while the law provides liability carve outs, this does not necessarily protect the employer from civil action or employment disputes.

The Wealth at Work programme provides employees with access to Authorised Financial Advisers (AFAs). AFAs are able to provide personalised financial advice on all categories of financial products. They are also subject to a Code of Professional Conduct in addition to general obligations under the Financial Advisers Act 2008. AFAs are licensed and regulated by the Financial Markets Authority.

The significance of providing complementary access to an AFA should not be underestimated. It is one thing to present a concept in a workshop and quite another to help an employee apply the theory to their personal financial circumstances. Without the latter, the programme fulfils a theoretical role, not a practical one. For every workshop held, employees requested around three hours of one-on-one personalised financial advice.

WEALTH AT WORK RESULTS

SOURCE: WEALTH AT WORK PROGRAMME, 4 AUGUST 2014.

Summary

Every year New Zealand companies spend over $1.2 billion on employee KiwiSaver contributions.[1] Until recently most companies have seen this as an obligation rather than an opportunity. By being a conduit to high quality regulated advice and personalised work-based tools like NZ Funds' myWealth software, employers can now help employees meet their retirement objectives and in doing so, ensure their company is regarded as a rewarding long-term career option for the best employees in their industry.

[1] Source: Inland Revenue Department at www.kiwisaver.govt.nz

[2] Source: Statistics New Zealand, Scenario: medium fertility, low mortality, net migration 10,000 p.a.

[3] Source: NZ Funds calculations, based on assumptions used in NZ Funds' myWealth software, 7 April 2014.

[4] Source: NZ Funds estimates, source material available on request, Australia 2012 estimated average 9% increasing to 12% by 2019, United Kingdom 2012 estimated average 9.7%, United States 2012 estimated average 10%.

Wealth after Work

Thanks to the vision painted by media, experts and financial firms, for many New Zealanders retirement conjures up images of soup dinners and an inability to pay the heating bill in winter. It should not. In general, retirement has never been more attractive.

We are living longer and therefore working longer, and our retirement is also lasting longer. In general, our health is better and we are more active, so we are able to spend more time doing the things we enjoy. And while preparing for and managing our wealth in retirement can be stressful, innovative retirement plans and the increasing prominence of quality financial advice point to a richer future than many New Zealanders currently imagine.

IMAGE: 'RARANGI, MARLBOROUGH'
PHOTOGRAPHER: CHERIE PALMER

While everyone's circumstances are different, this article sets out five practical steps to manage your wealth in retirement. It also discusses some of the retirement solutions NZ Funds has developed to help New Zealanders' retirement savings last longer.

1 Make a plan

Make a lifestyle plan

Broadly speaking there are three stages to retirement: the initial active period, a semi active period and a less active period. Many clients liken retirement to taking an overseas trip: it helps to have planned ahead. For example, give some thought to where you will be retiring as the cost of living can vary markedly between different regions. Without thinking too far ahead, will you stay in the same location, or move closer to family and friends, or a warmer climate?

Many retirees list the feeling of isolation caused by a loss of social interaction that work provided as a downside of retirement. Planning a retirement activity can help. The most popular are sports, volunteering, reading, gardening and family. Consider joining a group or club before you retire. Whatever your lifestyle plan, make sure you discuss it with your friends and family. There are also an increasing number of interesting books and articles on retirement which are well worth reading.

Make a financial plan

Once you have a feel for the lifestyle you wish to lead and the activities you will undertake, it should be relatively easy to put some numbers alongside your lifestyle plan to create a financial plan. Consider breaking your estimated expenditure into the cost of your basic lifestyle and bonus activities (such as travel or one-off expenses).

You would expect that as your activity level declines, so too would the cost of living. However, our 2013 research into retirement found that most retirees spend a constant dollar amount throughout their retirement, for example $60,000 p.a. This is because, while the amount they spend on bonus activities and travel reduces over time, inflation drives up the basic cost of living filling the spending "gap". The average retiree surveyed forecast spending 63% of their pre-retirement salary, but ended up spending between 68% and 73% of their pre-retirement salary over the course of their retirement.[1]

MAKING A LIFESTYLE PLAN

SOURCE: NZ FUNDS, 1 AUGUST 2014.

MAKING A FINANCIAL PLAN

	Active 5-10 years	Semi-active 10-15 years	Less active 15-20 years
Basics	$X p.a.	$X p.a.	$X p.a.
Bonuses	$X p.a. or $XX	$X p.a. or $XX	$X p.a. or $XX
Total	A	B	C

Retirement cost = A + B + C

SOURCE: NZ FUNDS, 1 AUGUST 2014.

② Take stock

Before finalising your financial plan, understand which sources of income and what assets are available to you to fund your retirement. NZ Funds' retirement equation is an easy way to assess how you are tracking. The first input is your retirement spending, the output of your financial plan in Step 1. The second input is your source(s) of income. This will likely be New Zealand Superannuation, and may include a defined benefit pension plan.

Many investments also generate some income (for example interest, dividends or rent). However, for most retirees, that income is unlikely to be enough to bridge the gap between retirement spending and retirement income. Instead they are likely to use both their investments' income and capital value over the course of their retirement to fund their retirement shortfall. It therefore makes more sense to count income generating assets in the retirement fund. The number of spending years you can sustain your planned lifestyle for is determined by how many years of retirement shortfall can be funded out of your retirement fund.

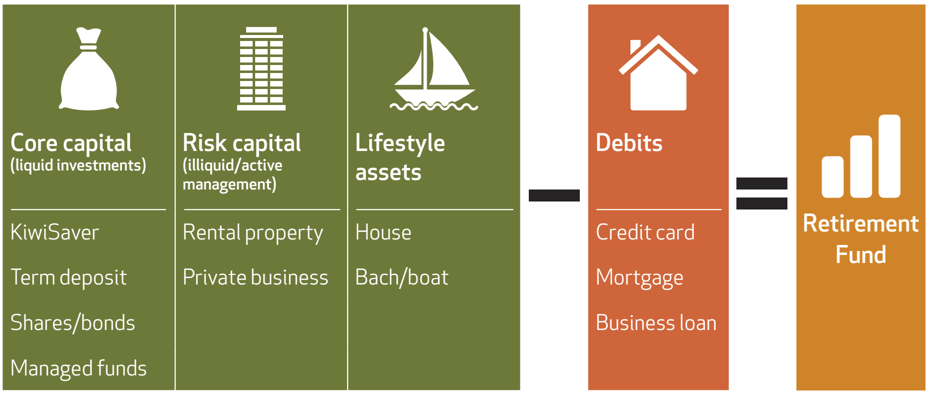
Your retirement fund

Your retirement fund is made up of your assets less any debts. It may be helpful to divide your retirement fund assets into three categories. First, those assets which do not require your active management, are easily accessible, and can be sold in part, or in whole. You should think of these as your core capital. You may wish to consider holding at least ten years of spending needs in core capital to be able to respond quickly to any adverse change in your circumstances. The types of assets retirees traditionally hold here include term deposits, shares, bonds and managed funds. Once you are eligible to access your KiwiSaver scheme, it can also be included in your core capital calculation.

Second, assets which require your active oversight, are usually only sellable as one lump sum and may take time to sell in order to realise a full price. These should be classified as risk capital. By holding a number of years of spending needs in core capital, retirees minimise the risk that they become forced sellers of assets in this category at a time when the price is depressed. Risk capital usually consists of a rental property or share of a private business, for example a farm.

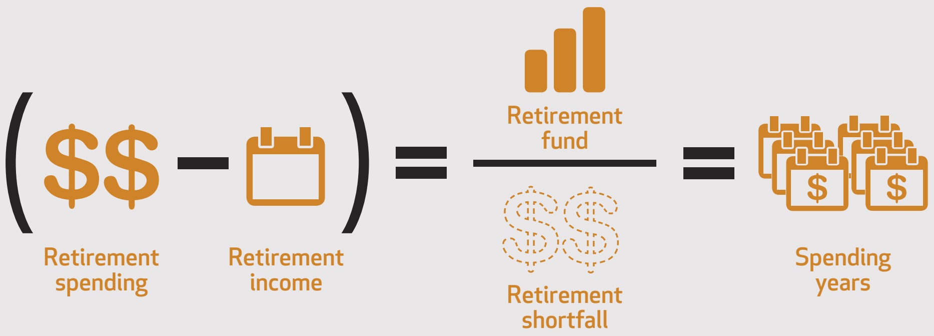
Third, you may wish to include your home, boat or bach, and other lifestyle orientated assets. While they may be in use now, as your retirement progresses you may wish to realise the value in your lifestyle assets by, for example, downsizing your home. After any debt owed, these three categories of assets represent the funds available to you in retirement.

RETIREMENT FUND



SOURCE: NZ FUNDS, 1 AUGUST 2014.

THE RETIREMENT EQUATION



SOURCE: NZ FUNDS, 1 AUGUST 2014.

Your funding options

Many retirees plan to use all the assets in their retirement fund over the course of their retirement. However, there are broadly speaking three different options: consume your savings and lifestyle assets, consume your savings and plan to leave your lifestyle assets as an inheritance, or plan to leave your lifestyle assets and a legacy to future generations or charity. The right option for you will depend on your planned expenditure and how your retirement unfolds. Many clients plan to leave some of the equity in their home to future generations, but also take it into account as a financial backstop, should they live longer than expected or incur an unexpected expense.

FUNDING OPTIONS

SOURCE: NZ FUNDS, 1 AUGUST 2014.

3 Invest simply

Ensure your retirement fund has liquidity

How you manage your retirement assets has the potential to affect not only your retirement income but also your retirement peace of mind. Many New Zealanders enter retirement with an array of assets: rental properties, one or two shares, bonds or a term deposit, a legacy superannuation scheme and (most recently) a KiwiSaver scheme. All have merit. However, preparing for retirement is a good opportunity to simplify your financial affairs. By keeping things simple and liquid, retirees minimise the chance of needing major asset restructuring during retirement.

There are four commonly occurring retirement surprises: the loss of an income which was critical to your retirement preparation, for example early redundancy, or a work inhibiting injury; an unexpected expense such as having to support a family member; higher than anticipated inflation; and a loss of retirement savings. A well structured, simple and liquid retirement portfolio may not prevent some of these things from happening, but it should help you mitigate your way through.

Ensure your retirement fund is diversified

Ensure your retirement fund is diversified. There are different levels of diversification. Owning a single bond, share or rental property is clearly not diversification. Similarly, owning a number of the same assets, for example five residential rental properties or ten New Zealand shares, offers some, but still insufficient diversification. Diversification comes from owning a variety of different asset classes, for example cash, income, inflation and growth and ideally owning them in different countries as well. Directly held shares or rental property may have a part to play in achieving diversification, but this needs to be considered against the backdrop of how complex you want to make your affairs.

NZ FUNDS' MANAGED PORTFOLIO SERVICE

Investment Category	Managed PIE Portfolio(s)	Asset classes currently held	Managers currently used	Estimated number of holdings/exposures
Cash	1	1	5*	6
Income	2	5	5	630
Inflation	3	9	7	5,500
Growth	4	9	10	5,546

SOURCE: NZ FUNDS, 30 JUNE 2014. *EXPOSURE TO: BNZ, ANZ, ASB, WESTPAC AND KIWIBANK.

ENSURE PART OF YOUR RETIREMENT FUND IS HELD IN LIQUID ASSETS

SOURCE: ESTIMATES ONLY, BASED ON NZ FUNDS CLIENT DISCUSSIONS, 1 AUGUST 2014.

Do not abandon growth

Do not assume retirement means abandoning growth. On average, a 65 year old retiree will spend 21 years in retirement.[2] Over the last 19 years, $1 invested in NZ Funds' Dividend and Growth Portfolio of predominantly New Zealand shares has snowballed into $2.81. Ensuring a portion of your retirement funds which you do not need to access in the near-term is invested in growth assets can help your retirement fund last a number of years longer. Your risk profile and age are two useful indicators of how much you may wish to hold in growth assets. As a general rule of thumb, your exposure to growth assets should be around 100% less your age, for example a 65 year old might hold: 100 - 65 = 35% in growth assets. This is subject to your risk profile and a level of volatility that you are comfortable with. Stress testing your portfolio by using historic share market or property price collapses can also be instructive.

THE BENEFIT OF GROWTH: YEARS OF SPENDING - INVESTMENT RETURNS FROM INCOME AND GROWTH ASSETS OVER THE PERIOD 1991 TO 2012

SOURCE: NZ FUNDS CALCULATIONS. *90 DAY BANK BILL RATE AND RESERVE BANK OF NEW ZEALAND SIX MONTH TERM DEPOSIT RATE (FIVE YEARS TO JUNE 2014). **RETURNS FROM MYWEALTH AVERAGE MARKET EXPERIENCE (1991-2012). ALL RETURNS AFTER MANAGEMENT FEES AND TAX, 25 JULY 2014.

4 Optimise regularly

Varying your "income" to match your portfolio will extend the life of your retirement fund. Just as you would vary your lifestyle as your income and working circumstances changed, consider doing the same in retirement. While it is possible to spend a fixed amount every year, varying your drawings, particularly if your retirement fund is temporarily depressed, is a simple way to get more out of your portfolio over time.

Significant investment market drops tend only to occur intermittently: most recently twice in the last 20 years for shares, and once in the last 20 years for property. During these periods, an adjustment in your retirement spending by, for example, 30% by perhaps postponing some of your bonus spending activities, can add one or more years of income to the life of your retirement fund.

THE BENEFIT OF ADJUSTING YOUR SPENDING TO YOUR ENVIRONMENT

SOURCE: NZ FUNDS CALCULATIONS. INCOME RETURNS: 90 DAY BANK BILL RATE AND RESERVE BANK OF NEW ZEALAND SIX MONTH TERM DEPOSIT RATE (FIVE YEARS TO JUNE 2014). GROWTH RETURNS: MYWEALTH AVERAGE MARKET EXPERIENCE (1991-2012). ALL RETURNS AFTER MANAGEMENT FEES AND TAX, 25 JULY 2014.

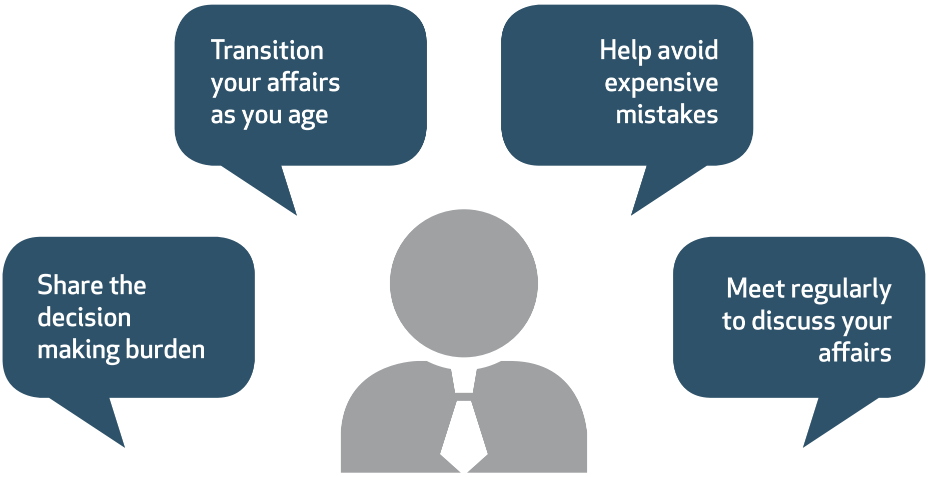
5 Consider investing in financial advice

Finally, consider the merits of investing in advice. Advice does cost, but consider it an investment. If cost is your primary concern, discuss it. Most Authorised Financial Advisers offer a range of different options and fee structures.

Investing in regulated financial advice can provide you with an alternative perspective; whether you wish to follow it is entirely up to you. It can help to have someone other than a spouse or your children to share the decision making burden with, especially during periods of change or volatility.

As with any long-term fiduciary relationship, such as a trustee, lawyer or accountant, the longer you work together, the better the mutual understanding, respect and trust. Investing in financial advice earlier, rather than later, should also help provide more continuity in your affairs, should one spouse pass away before another, or if you are no longer willing or able to actively manage your retirement savings.

MERITS OF INVESTING IN ADVICE



SOURCE: NZ FUNDS, 1 AUGUST 2014.

Summary

All of this is not to understate the challenges of retirement. It is to point out that there are a number of practical steps that anyone can take to ensure their financial affairs are more likely to fulfil their retirement expectations.

NZ Funds, in conjunction with the Authorised Financial Advisers we work with, has developed a simple, intuitive and personalised software programme for retirees, which enables them to manage their affairs in retirement. The software incorporates many of the concepts discussed in this article. If you wish to discuss any aspect of our research further, your Authorised Financial Adviser, or one of NZ Funds' team, is happy to help. Using NZ Funds' software they can also model a variety of different retirement scenarios to help ensure your retirement is more relaxing than restless.

[1] Source: NZ Funds' Investment Bulletin: Issue 6 August 2014, Researching Retirement, Paul van Wetering.

[2] Source: NZ Funds calculations, Statistics New Zealand.

NZFUNDS

NEW ZEALAND FUNDS MANAGEMENT LIMITED

AUCKLAND
LEVEL 16, ZURICH HOUSE
21 QUEEN STREET
PRIVATE BAG 92163, AUCKLAND 1142
NEW ZEALAND

PHONE - 09 377 2277
EMAIL - INFO@NZFUNDS.CO.NZ
WWW.NZFUNDS.CO.NZ

WELLINGTON
LEVEL 10
49 BOULCOTT STREET
WELLINGTON 6011

PHONE 04 473 7701

CHRISTCHURCH
UNIT 7A
9 SIR GIL SIMPSON DR
BURNSIDE
CHRISTCHURCH 8053

PHONE 03 366 9088

WANAKA
UNIT 7
12 FREDERICK STREET
WANAKA 9305

PHONE 03 443 2300

DUNEDIN
LEVEL 2
BRACKEN COURT
480 MORAY PLACE
DUNEDIN 9016

PHONE 03 477 4647

INVERCARGILL
98C YARROW STREET
INVERCARGILL 9810

PHONE 03 218 2895