



SuperLife

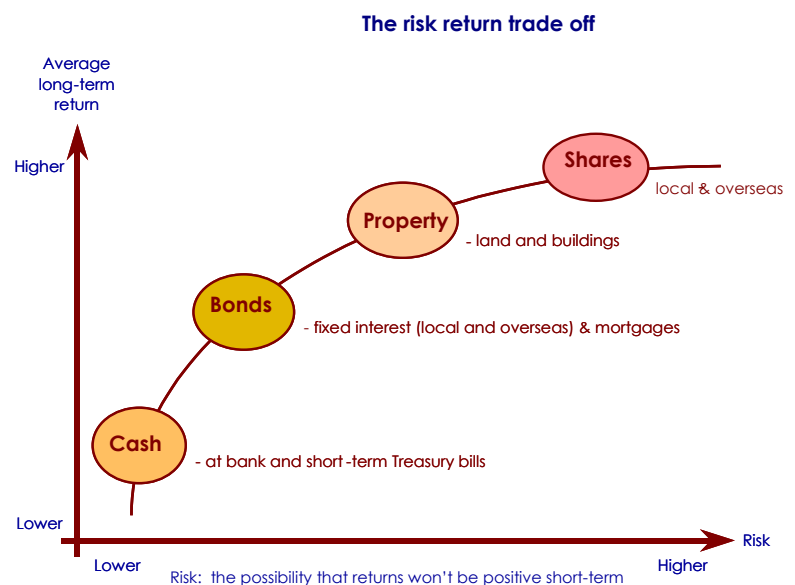
investment guide

When you invest for your retirement, or for any other purpose, you must decide on an investment “strategy”. Your investment strategy is the mix of the different types of assets (i.e. cash, bonds, property and shares), in which your savings are invested. You should also decide how it should be changed over time. Your investment strategy is a major contributor to the returns you will receive from your investments and should therefore be designed to meet your financial goals.

To determine your investment strategy, you should identify the returns you want over the short, medium and long term, and the risks you are prepared to accept. Investment “risk” refers to the volatility of returns over the short-term and in particular, the chance or likelihood of a negative return.

The general principle is that investments that expose investors to higher risk (i.e. the possibility of a negative return in the short-term) will normally compensate investors, over the long-term, with a higher average return. However, this is only on “average” and the return in any particular year may be very high or very low.

The diagram illustrates the common risk return trade-off. By combining the different asset types you can alter your risks and therefore your projected returns. If you want to focus on maximising your long-term average return (e.g. over 15 to 20 years or more) and protect yourself against the risks of unexpected inflation, you should probably put emphasis on share investments, but maintain some cash and bonds. In contrast, if you are concerned about the need for certainty of your return over the short-term, you should favour cash and bond investments, but could still have some shares. Put another way, you can increase your average long-term return with more property and/or shares, or reduce your short-term risk with more bonds and/or cash.



Ultimately, your investment strategy is up to you, and will depend on your needs and preferences. The purpose of this guide is to provide you with information. We recommend that you seek appropriate professional investment advice.

Contents

Your investment strategy	1
- the investment matrix	
- important questions	
Other investment considerations	5
Expected returns	6

For more information contact:

SuperLife
 PO Box 8811, Symonds Street, Auckland 1150
P: (09) 375 9800 or 0800 27 87 37
F: (09) 375 9801
E: info@superlife.co.nz

Balancing risks and return - the investment matrix

In deciding your investment strategy, you need to balance your timeframe and your risk profile. This should let you work out how much of your savings should be invested in shares and property and how much in cash and bonds.

Investment matrix (allocation to shares and property)

Your time horizon	Your risk profile		
	"Cautious"	"Moderate"	"Willing"
0 to 5 years	10	40	50
5 to 12 years	30	50	70
12 years +	50	60	80

Source: MCA NZ Limited

Your "best" mix of assets will combine your time horizon with your risk profile.

The number in the matrix represents the "theoretical" exposure to shares and property for different combinations of time horizons and risk profiles. For example "60" means 60% shares and property, and therefore 40% in bonds and cash.

In broad terms, the matrix tries to balance your timeframe, your likely income needs, the risk of inflation and your risk profile. You should also consider the current market outlook before making a decision.



Important questions

When you decide what investment strategy might be right, here are some questions that you should ask yourself.

- What average return, after-tax, do I want over the long-term?
- What minimum return will I accept over the short-term?
- What income do I need from my investments and when?
- Is future inflation a concern?
- If something goes wrong, how long am I prepared to wait for the markets to recover?
- What is my time frame - when and how will I spend my money?
- How involved do I want to be day-to-day?

We look at these questions next.

What average return, after-tax, do I want over the long-term?

The higher the average return you want, the higher the allocation to property and shares you should have. However, having a high allocation to property and shares does not always mean a higher average return in every period. Sometimes, over periods that can last several years, property and shares will produce low or even negative returns.

What minimum return will I accept over the short-term?

Bonds, property and shares can all give negative returns over the short-term. Also, when they happen, the negative returns are more likely to be larger from shares and property than bonds. If you always want a positive return, you need to focus on cash and some bonds with a low level of property and shares. However, if you do this, the price you pay is a lower expected average return over the long-term. You will therefore have to save more to achieve your goals.

What income do I need from my investments and when?

The higher the level of regular income that you need in the immediate future, the more you should invest in bonds and cash. Though shares and property do produce income (through dividends and rent), the level of income and certainty of receiving the income is typically lower.

Is future inflation a concern?

If you are investing for the immediate future, unexpected inflation is normally less of a concern. However, if you are investing for the long-term e.g. for retirement in 20 years' time, high inflation is more of a potential risk. To protect the value of your savings against the effects of inflation, you need to have an exposure to assets that should go up with inflation. This means some shares and property. You might also have some cash and bonds to dampen the volatility of the returns, but if inflation is a concern, the focus should be on shares and property.

If something goes wrong, how long am I prepared to wait for the markets to recover?

One thing is certain; the return from shares will sooner or later be negative and sometimes that negative return may be very large. After this occurs, the markets eventually recover, but it can take several years. We never know when the market will “crash”, so you should remain invested in shares only if you are able to wait 10 years or more for it to recover, should something go wrong.

What is my time frame - when and how will I spend my savings?

If you need all your money back in the near future - e.g. you are going to retire shortly - it makes sense to protect your assets against the risks of a sudden loss. Therefore a more “conservative” approach might be appropriate i.e. predominately cash and bonds.

If your goals are longer term (at least 7 years) and you can tolerate some years of low or even negative returns, in return for a higher expected long-term average return, a less conservative approach may be better including an exposure to some shares. This will give you a higher “average” return but you will not get a higher return every year and some years it could be negative.

If your goals are more long-term (at least 12 years) and you want a higher average return and are prepared to take some low or negative returns, you might want to have even more shares. Over the long-term, inflation protection becomes more important and you have time to ride out the highs and lows of the share markets.

The date when you will receive a benefit is important, though more often it is better to look at when you will spend your savings. If you are likely to spend your savings in the next few years (e.g. you are saving for a new car in say three years time) it is normally best to focus on cash and bonds. In contrast, if you are saving for retirement, even if it is only a few years off, because retirement will often last 20 or 30 years plus, it is normally best to have some shares and property to protect you against inflation in retirement.

This leads to the concept of aligning your investments with your expected expenditure. This is particularly important when you are close to, or in, retirement and you depend on your investments to provide you with an income.

In respect of future expenditure, appropriate investments are:

What will the money be used for?	Type of investments
Rainy day or emergency fund	Cash
Shorter term expenditure (<i>0 to 3 years</i>)	Cash
Medium term expenditure (<i>2 to 10 years</i>)	Bonds
Longer term expenditure (<i>7 years plus</i>)	Shares/property



In simple terms:

- Cash gives you certainty that the money you will spend tomorrow will be there when you want to spend it. Over the short-term, inflation is not normally a major concern. Most investors should also retain some cash to provide flexibility in case their circumstances change.
- Bonds have an expected return higher than cash, but still retain a reasonably high level of security. They are good when you can tie your savings up for a few years before you need them.
- Shares/property provide the highest expected average return but more importantly, give protection over the long-term against the risks of unexpected or high inflation. The longer your investment period, the greater is the inflation risk. However, because share returns are volatile, you need to have some cash available to meet urgent or short-term spending needs. By doing this you can avoid having to sell shares or property when the market is at a low point. You should not have to sell some of your shares to buy groceries when markets are down.

On this basis, every 2 to 3 years, you should reassess your expenditure needs and realign your strategy. Once in retirement, this will probably involve moving some money out of shares and property every few years, to top up your bond and cash holdings. As you approach retirement it might mean allocating more of your new savings to cash and bonds as opposed to switching from property and shares, to cash and bonds.

How involved do I want to be day-to-day?

In deciding on your investment strategy, you should also think about how involved you want to be in future changes. The more time you are willing to spend and the more interest you have in being involved, the more you may wish to focus on shorter term issues such as the market outlook. Making those kinds of decisions is called “market timing”. Sometimes, the market’s direction is obvious but mostly that isn’t the case. Market timing is difficult to get right over periods longer than 1-2 years.

When thinking about your investment strategy, you should also consider:

Sleep at night

No matter what strategy the experts say is best for your liabilities, you should make sure that you are happy with the likely outcome (e.g. the potential for a negative or low return) and that you can sleep at night. Knowing this gives a suitable investment strategy for you.

Don't be a forced seller

As a rule, it always pays to hold some cash for emergencies just in case your circumstances change. The best investment outcomes occur when you are not forced to sell a particular asset and can therefore sell it when you choose.

Past performance

As a rule, recent past performance is not a good guide to future performance. It is normally not the best decision to move your savings to the asset classes that have just performed the best. Be careful about chasing the markets up when it has already increased. Your risk of loss is a lot greater if you do that.

Other investments

In deciding how your **SuperLife** balances are to be invested, you should also consider your other assets. While **SuperLife** will only report the return you receive on your **SuperLife** investments, it is the overall strategy and return that is important. For example:

- if you are just starting out investing for your retirement, you can put more in shares (take on more risk) as the consequences are low. At this stage your major “asset” is your future income and future savings.
- if you own a house or a rental property you might want to have no property exposure with **SuperLife**.
- if you own some NZ shares directly you might want to have fewer NZ shares under **SuperLife**.
- if you have money in the bank, you might want to have less cash.
- if most of your assets are tied up in a single business, you might want your **SuperLife** investments to be more conservative.

Your **SuperLife** investments should therefore be looked at both individually and as part of your total portfolio.

Outlook

When deciding on your investment strategy you should also consider the current state of the markets. Is the economy growing? Are interest rates stable, rising or falling? Has the sharemarket just performed well or poorly? Are investors confident or nervous? Is the NZ dollar strong or weak?

It will normally be hard to decide what will happen next and often the professional investors get it wrong. This should lead most investors to decide on their strategy based on their timeframe and risk profile and to then stick to it. However, sometimes you may want to alter your strategy for the future, based on what you think will happen next.



No one knows for certain what returns the different types of assets will give in the future. The general characteristics of each type of investment are:

Cash returns

The returns from cash are generally small, steady and positive. The return reflects the return that you would get from your local savings bank.

Bond returns

The return from a bond depends on the current “yield” of fixed interest securities (i.e. how much a borrower will pay to borrow “new” money) and the changes in the yields. When yields rise (i.e. interest rates rise) your return is the yield less a capital loss (about 4% for every 1% rise in interest rates). If yields fall, you get the yield plus the capital gain (about 4% for every 1% fall in interest rates). Over the medium term, the gains cancel out the losses and the average return is the original yield.

Bonds provide certainty over the medium term and therefore are good for investors requiring security. However they don’t provide any additional rewards when the economy is strong or any direct protection against inflation. The best times to buy bonds are when interest rates are higher than normal (and should fall), or when you need a regular income.

Property returns

The return from property over the long-term depends on the rental income after costs and the rise or fall in property values. Generally, rental income will increase reflecting inflation and increases in the standard of living, but will be influenced by supply and demand. It should also be noted that when a property has no tenant, the income return may be negative as maintenance and other costs are still payable.

Property is a good investment when you think that the economy will grow through expansion (e.g. immigration) and for long-term investors wanting protection against inflation with less volatility than shares.

Share returns

The return from a share comes from the dividends paid and the change in the share price. The change in the share price will normally reflect changes in the company’s profitability and its dividend policy. These in turn, should reflect inflation and economic growth. Over the long-term, the return depends on the company’s profitability but over the short-term, will be driven by emotion and investor confidence.

Shares are a good investment when you can invest for a while or when you think that the economy will grow quickly. They are also good if you want protection against inflation and you don’t need to worry about the short-term return, as the returns from shares are volatile over one to two year periods.

Currency

If you invest overseas then, in addition to the return from the assets you buy, your return will be affected by the changes in the NZ dollar. If the NZ dollar falls the value of your overseas assets goes up and vice versa. The risks from currency movements can be eliminated by hedging out the risk. But hedging also removes any opportunity for a higher return from currency movements.