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sunsuper

April 2012

Sunsuper's investment strategy

Good fortune, it is said, is something to be expected in the Chinese year of the Dragon. Well, the "Tech Wreck" of 2000 led to a fairly unhappy year of the Dragon for many investors but the previous year of the Dragon in 1988 did offer some recovery from the 1987 Stock Market Crash. While Chinese astrology, therefore, is not something to rely upon, China is nevertheless an important influence on investment outcomes. And 2012, the current year of the Dragon, has certainly begun with a roar. Sunsuper's Chief Investment Officer, David Hartley shares his views on the start to 2012.

2012 off to a roaring start

Not even the default on its government bonds by Greece could quell market strength during the first quarter of 2012 … for long. Yes the financial markets did pause to mark the passing of a few hundred billion euros of bonds across the River Styx, never to be seen again, but the mourning period was brief. The event had been anticipated for such a long time that, by the time it arrived, there was relief.

Relief came from the relatively orderly process that was finally adopted for Greece's default and the strong commitment demonstrated by the Euro countries to the future of the common currency. It also arose from the fact that the insurance that some had bought to offset the effects of the default was honoured.

By the end of the quarter, the Australian share market had posted a return of just under 9 per cent. In their own local currencies, the international share markets averaged a return of almost 12 per cent. Emerging market shares did even better.

In contrast, government bond markets took a well-earned breather. Other than notable exceptions such as Greece, they had been so strong in 2011. In doing so, they had priced in almost all the positives that could be imagined for bonds. In a number of countries, the dividends being offered by very strong companies were far in excess of the interest rates being offered on government bonds.

As a result, during the first quarter of 2012 some investors started to switch from bonds to shares. Government bonds suffered some mark downs in prices that were, in some cases, too large to be offset by the regular interest payments. On the basis of marking valuations to market, some bonds provided investors with negative returns for the quarter.

Major asset class returns to 31 March, 2012

	3 months %	1 year % p.a	3 year % p.a	5 year % p.a	10 year % p.a
Australian shares (S&P/ASX300)	8.6	-6.3	11.4	-2.1	6.9
International shares, local currency (MSCI AC World)	11.6	0.8	19.1	-0.4	4.5
International shares, unhedged (MSCI AC World)	10.9	-0.4	6.2	-4.5	-1.0
Australian listed property (S&P/ASX 300 A-REIT)	7.1	1.7	14.8	-13.6	1.3
Australian fixed interest (UBSA Composite)	0.8	10.0	6.5	7.3	6.6

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The extension of the recovery in equity markets that started at the end of 2011 was not just simple relief. It also reflected more positive economic news from a number of major economies.

In the United States for example, data from the Federal Reserve Bank indicates that people have opened their wallets again. The proportion of income that Americans are saving, as opposed to spending, has now moved down to 3.7 per cent. This is the lowest level it has been over the last four years and much lower than the recent high point of 8.3 per cent seen in May 2008. One of the beneficiaries of this additional spending was the motor vehicle industry, with new light vehicle sales pushing past the temporary peak that came from the "cash for clunkers" scheme in 2009.

Australians also have been spending more than they did at the height of the Global Financial Crisis. We are, however, generally a bit tighter with our money than those in the United States. The Australian Bureau of Statistics' has calculated that Australians are still saving about 10 per cent of their incomes.

Undoubtedly for many investors the rise in share prices over the last few months is very welcome. However, just as it is important not to become too despondent when investment markets fall, it is also important not to become too euphoric when markets rise.

Central banks have been doing their best to prevent wholesale bankruptcy of businesses, households and even governments, and allow for an orderly reduction of debts over time. This reduction of debt is commonly referred to as "deleveraging" and it can occur through a combination of mechanisms:

- debt being repaid by borrowers
- debt being written off by lenders
- lenders taking over assets that have been offered as collateral as a substitute for repayment
- underlying assets generating cash flow and appreciating in value to give lenders more comfort.

The global deleveraging is expected to go on for a long time, until collective debt levels get to a point where they can be serviced on a sustained basis.

As we have said previously, the world is still and will continue to be affected by the crisis that began unfolding in 2007/2008. Confidence in the role that share markets can take for investors took a severe beating. This is not unprecedented. The "Death of Equities" has been proclaimed before.

Continuing volatility is likely to remain an obvious feature as investors reassess their strategies. This volatility will provide opportunities but will also unsettle those who are unable to take a long term perspective.

As is always the case, members should think of their superannuation in terms of the assets they effectively own, the underlying earnings being achieved on these assets, and what value the market places on these assets, now and in the future. And it is important to remember that reported "returns" reflect income as well as changes in what buyers and sellers in the market ***would*** pay for assets today. In times of heightened uncertainty, prices can easily fluctuate significantly over short periods of time.

The outlook for 2012

Our outlook for 2012 remains one in which we expect continued market volatility and high levels of uncertainty about a number of economic regions. It is also a year where a large number of political leadership changes are either going to or may happen. This includes two large economies: the US and China.

While US growth has been stronger than many had expected, China is showing some signs of moderating economic growth along with some reduction in its huge trade surplus. In this light it is interesting to observe over the last few months that the Australian dollar has lost some of its strength.

Central banks are cautious but are expected to continue to provide liquidity to support governments and institutions that are “too big to fail”. Not to do so would have dire consequences for people around the world.

In keeping with our previous Investment strategy update we again highlight that the capital markets, where Sunsuper buys and sells assets such as shares, bonds, real estate and currencies on behalf of our members, are markets where investors continuously consider the future. Thus the views on what may happen to the world economy are mostly already reflected in current prices.

We noted at the end of 2011 that shares generally looked cheap by historic standards and bonds generally looked expensive. Some of this relativity has been reversed over the last quarter but shares still appear to offer reasonable value, particularly if companies are able to maintain their earnings. In the meantime the high dividend yields on shares are giving a solid base level of returns until share values are able to sustain a broad recovery.

What is Sunsuper doing?

In this deleveraging environment we have seen a number of owners who have been forced to sell assets at bargain prices. The managers that we have appointed on behalf of our members have been positioned to take advantage of these opportunities as they emerge across the world.

In listed shares we employ a number of managers with different styles investing in Australian shares, international shares and emerging markets. In fixed interest we supplement government bond investments with higher yielding bonds issued by companies.

Our unlisted market exposures include both bond investments and share investments. Infrastructure assets such as airports, and property investments such as office buildings, shopping centres and caravan parks are examples of some of the investments that we hold on behalf of members. Private capital investments that have been in the portfolios have included Kathmandu and Dun & Bradstreet. Our hedge fund managers continue to seek anomalies to exploit in the volatile markets.

Investing in such good assets does not guarantee higher returns over short periods of time. However the diversified approach that we have adopted does provide our members with a firm basis on which to expect higher long term returns.

It is worth reminding yourself also that the dollar figure on your annual statement is not "cash" sitting in, for example, your Balanced Fund account. It is a figure that represents the current value of the underlying assets, which include quality businesses, properties and loans across the globe. This value is only a cash value if you decide to sell on the day the values were calculated. We expect the value of these assets to grow faster than cash over the future.

To be clear, this does not mean that we cannot experience further declines in the prices that buyers would be prepared to pay should the world be subjected to further shocks. But that scenario would be a potentially good buying opportunity for us all, and one advantage of our superannuation system is that contributing members continue to receive cash every year to pursue such opportunities.

Our experiences have shown us that investing in assets with high expected returns does require a long term view, and a process that is not subject to fear or greed in order to improve the chances of success. And "long-term" has shown itself to be longer than some of the conventions that we became used to.

This is why if you know you will need to spend some of your savings inside of, say, a five-year period that you carefully select the right option for that portion of your savings.

Sunsuper has a range of options that seek to meet a number of different investor needs – these options and their intended purposes are described in more detail on our website, and in our Product Disclosure Statements. We also have a Member Advice Centre which you can call to talk through any questions you may have. Just call us on **13 11 84**.