

Sunsuper's investment strategy

Markets started 2013 where they finished 2012, with strong returns for superannuation funds driven by share markets.

Investors have been encouraged by signs of growth in the United States. They have also been encouraged by central bank actions across a number of countries to follow the lead of the US Federal Reserve. For example, the Bank of Japan undertook monetary stimulation and the Japanese yen fell, giving potential growth in corporate earnings from both domestic consumption and exports. Japanese shares were particularly strong over the quarter, with a return of 21 per cent.

By the end of the quarter, some of the 2012 confidence gave way to caution. Renewed concerns over Europe gave reason for investors to take some profits. This time it was Cyprus that led the headlines but it seems that investors were perhaps less concerned than might have been expected. In Cyprus, bank deposits were shown to be not as safe as had been assumed. Some of the discounts being applied were extreme.

However, even in the face of such provocation, there was no broad panic in Europe. There were no reports of cash being stuffed into mattresses. There was no substantial flight to the traditional safe haven of gold. In Europe, the authorities have stated that they have the capacity to "do whatever it takes"; perhaps their willingness to do so is becoming more accepted across Europe. Or possibly those who saw bank deposits in Cyprus being taxed at rates of up to 40 per cent have become more resilient to potential losses in other assets.

The outlook

Despite another quarter of outperformance, share markets remain attractive relative to many fixed interest markets. Central banks remain committed to keeping monetary conditions loose and interest rates low. They have pumped money into their respective economies. This money has to find a home somewhere and, in this environment, market trends can continue for extended periods of time. However, uncertainties remain and there are likely to be a number of twists and turns in investment markets.

Central bank actions in Europe, the US and Japan present difficulties for other economies. A clear example of the consequences of foreign central bank behaviour is the continuing strength of the Australian dollar, presenting Australian businesses with many challenges. Continuing pressure from this source has the potential to undermine employment.

While risks remain, over the last 12 months, we saw a great example of how returns from investments are not necessarily linked to economic fundamentals over short time periods. Timing investment into and out of markets is a difficult thing indeed.

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Major asset class returns to 31 March, 2013

Returns to 31 March 2013	3 months %	1 year %	3 year % p.a.	5 year % p.a.	10 year % p.a.
Australian shares (S&P/ASX300)	8.0	19.2	5.0	2.9	10.2
International shares, local currency (MSCI AC World)	9.0	14.1	8.5	3.9	9.3
International shares unhedged (MSCI AC World)	6.6	10.9	4.2	0.4	4.6
Australian listed property (S&P/ASX 300 A-REIT)	5.3	30.5	11.6	-3.7	2.7
Australian fixed interest (UBSA Composite)	0.1	7.0	8.0	7.8	6.3
Cash (UBSA Bank Bill)	0.7	3.6	4.4	4.7	5.3

1 S&P/ASX300, 2 MSCI AC World, 3 S&P/ASX 300 A-REIT, 4 UBSA Composite, 5 UBSA Bank Bill

The role of shares in superannuation portfolios

To many, shares are scary. Over a short term period, share values can move up and down by significant amounts. Last quarter we spoke about this volatility. Volatility can be unsettling and can cause real damage to investors who need to sell assets. However, it is generally of little importance to long term investors and can actually provide some advantages to those who are able to buy good assets at cheap prices.

Shares form a major component of many superannuation portfolios. Indeed, commentators including former Australian Treasury Secretary Ken Henry have expressed views that Australians have too much exposure to shares in their superannuation funds. For some people this could be correct. However, every individual is unique. Some should have no shares; some can tolerate a superannuation portfolio that is completely invested in shares.

What are shares?

Investors who own shares own part of a company. Collectively with other shareholders, these investors can influence and in some cases direct the activities of the company. Profits earned by companies can be reinvested in the business or paid to shareholders in the form of dividends. Profits and dividends, in turn, vary over time. Successful companies see their profits increase.

What drives the prices of shares?

Over short periods of time, share prices can move erratically in response to confidence and sentiment. Pieces of news can lead to both upward and downward spikes in prices.

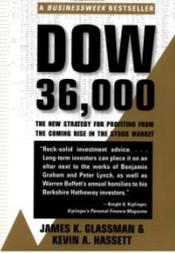
Over the longer term it is company earnings that drive share prices.

Knowing the true value of any asset is very difficult, as investors have to compare current prices with expected future cash flows and expected future interest rates, which are inherently linked to the state of the local and global economy.

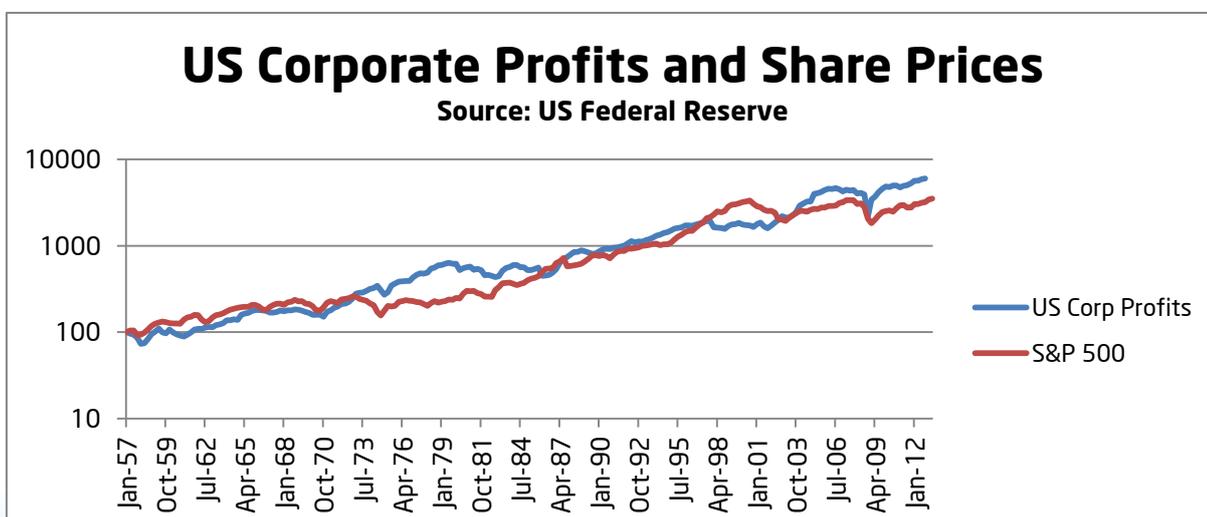
What we observe throughout history is that economic growth and other factors do fluctuate, but they do so in more gentle cycles than the prices of shares and many other investment assets.

United States share prices and earnings

The United States provides a rich source of data. In the following chart we show share price and corporate profit data from the US Federal Reserve, indexed to a common start date of January 1957. There are a number of interesting features shown on the chart.

<p>In the 1970s there was a high level of global inflation. Share prices lagged earnings as analysts took a view that the profits were not real. In 1979 there was a Business Week article proclaiming the "death of equities"</p>	 <p>1</p>
 <p>1</p>	<p>In the late 1990s technology was the answer. Companies that were not losing money were seen as not investing enough to survive in the new age. Share prices went a long way ahead of earnings and there were predictions of significant growth to come, as exemplified by the book by Glassman and Hassett</p>
<p>At the current time, the S&P has just set a new record but has effectively spent a lot of energy for no net gain since 2000. At the same time, other than the hiatus caused by the Global Financial Crisis, earnings of US companies have been strong for a long time. We need to wait to see if this relationship between earnings and share prices will once again converge</p>	

1 Pictures: BusinessWeek



What does this all mean for superannuation?

The objective of many people is to use their superannuation in retirement to provide a level of replacement of their wage.

As economies grow there are two main beneficiaries; those who supply labour and those who supply capital. Over time, if labour takes a proportion of the benefits that is too large, capital tends to be withdrawn and unemployment can result. If capital takes too much then wage pressures will tend emerge as profitable companies compete for staff. This tends to provide some natural level of balance.

When people start their working life they have very little capital. Their assets are effectively the future labour that they can supply. When they leave the workforce, their assets are mostly capital. Accumulating investments in shares over a full working life offers the potential for the return on share investments to effectively be used to provide a wage-like outcome. Shares can therefore play a useful role for superannuation funds.

But, as said before, every individual is unique.

Members face different types of risk when in different stages of their investment life. A good definition of risk for members who are still accumulating wealth is "the likelihood of not having enough income in retirement" to meet your desired standard of living. Part of managing this important risk is to start with a clear and realistic goal for your lifestyle in retirement. With this you then need to consider the interaction between your level of contributions and savings with your choice of investment option over the remaining period to your retirement. Focussing on the income that you can expect to draw from your future account balance, rather than on your current balance, can help make better decisions now.

For members without the ability to add further contributions, and in fact the need to withdraw regular amounts in retirement, a good definition of risk remains "the likelihood of not having enough income in retirement". However, during this time volatility of asset prices can have an adverse effect on your ability to draw income. This arises from the fact that taking out a regular payment is in effect the same as being a forced seller at current prices. Managing this becomes an important part of managing your retirement.

What does Sunsuper offer to help me achieve my goals?

Members who have a relatively long time before they retire and who are looking to accumulate wealth for the future may choose an investment option or combination of options that may experience some short-term volatility but expect to perform well over time.

Members in retirement are likely to have different goals for their super savings in the short and long-term.

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 Centre¹ which you can call to talk through any questions you may have. Just call us on **13 11 84**.