The following material is provided by Associate Guild member Gerry Breen, Trustee of the NZ Ship Officers' Superannuation Fund. The information is not intended as financial advice. The Merchant Service Guild recommends that financial advice be sought from a professional financial advisor.

The New Zealand Ship's Officer's Superannuation Fund (NZSOS)

It is now some two years since your Trustees introduced Member Level Investment (MLI) into NZSO and the timing and implementation of that move has proved to be beneficial to those Members that have used the facility. In the period serving as introduction to MLI we expressed the view that superannuation is not a fast process, it is a process of a standard 40 years effort, i.e. from 20 years of age to 60 years of age.

The Trustees advised that members should get to feel comfortable with choices they could make about which fund or funds they would use in the 8 fund stable in NZSOS, and if they did nothing they would carry on as before in the Investment Linked Superannuation Fund (ILS) which was the anchor fund in NZSOS /MLI. Many followed our point of view but we have now reached the second stage of the MLI process whereby your Trustees will try to publish some articles of historic and / or educational nature to assist Members to be more informed in their choices. This is not investment advice, as we are not allowed to give that under the laws of New Zealand, rather they are informed articles based on information we get about our Manager, Tower Corp *www.tower.co.nz*, and from the professional managers, mainly in Tower Asset Management (TAM). Additionally some items will be based on historic lessons we have learned over the 15 years we have been involved with NZSOS.

The investment advice must come from yourself or your financial advisor. You can also visit the website of the Retirement Commission

The NZSOS record shows up in the returns we / TAM have produced over the past 13 to 14 years. Returns have averaged between 8% and 10% gross per annum, with the main vehicle being the ILS. Perhaps more important is that this return was made possible using the lowest risk / highest return corporate / wholesale superannuation fund in the industry, according to the Mercer survey of 2003. See Investment Choices for members below to find out more about what factors influence choices.

Since MLI started, some volatility has been introduced showing gross rates as high as 27% and as low as 4%, depending on the fund used. Please remember that 33% of the gross growth rate is taken in tax.

NZSOS history

In the historic context of how NZSOS came about in 1990, an 84 question survey was placed on the market in NZ in the hands of the major providers of superannuation to assess the attitudes and ideas that existed at the time. As a result of this, Tower was chosen to administer our proposed fund, and after almost 15 years that choice has served us well and continues to do so. This is not to say that problems did not arise between Tower and Trustees, but it is to say that problems were all overcome in a friendly helpful manner for the benefit of Members. But Tower Corp'n did have some problems with their new business venture in Australia after demutualisation. However, NZSOS money was never invested IN Tower. It was invested safely BY Tower, and those problems are now largely overcome.

Accordingly, NZSOS / TAM has overcome many difficult periods of market turbulence but have always stuck to their investment philosophies and come through successfully. It has been a salutary lesson for Trustees to follow TAM's philosophy based on "value" investing. **Investment influences** and the following remarks show some of the complexities and attitudes that can arise with investment management.

Investment choices for members

The pressures that Members may undergo making choices can come under many sub headings as follows:-

Disappointing returns may prompt investors to look at their investment options. Importantly they need to recognise that their choices have not really changed.

Investors can lock in a known return by purchasing a government guaranteed bond and if they want to try achieve a higher return they need to take on some risk.

This could be in the form of either market risk such as investing in equities or corporate bonds, or relying on the skill of an active manager to add value.

Gaining an exposure to market risk is easy. You could invest in index funds that track broad sharemarket indexes. As index funds are essentially a commodity the investment management fee investors pay should be very low. In fact the management fee should probably be called the administration fee because no active management takes place.

Manager skill is harder to find, but it is worth paying for. A good active manager can add considerable value.

Investor reaction to poor returns appears to be saying that they want to place less reliance on market risk and more reliance on manager skill to deliver their investment return. This is an understandable reaction, but there could be a gap between how much market risk investors want and how much they need. There may also be a gap between the amount of value added they want versus the amount that they are likely to receive.

Extra return from active management

Theory suggests that the average active manager should not add value. By definition they shouldn't because for every position that makes money there is offsetting one that is losing money. This said, there are some markets where the proposition of the average active manager not adding value is severely tested. In the domestic sharemarket, for example, the average active domestic manager has added value.

While the average active manager may struggle to add value, good active managers can add a lot. The difficulty when analysing managers to sort the good from the lucky. Good performance can be due to luck. Having faith in a fund manager's process and in the ability of the manager to implement the process is critical when choosing an active manager.

TAM and BT are active Managers in the funds of NZSOS.

Background of TAM

TOWER Asset Management Limited (TAM) is a wholly owned subsidiary of the TOWER Group. TAM has almost NZ$4 billion in funds under management and has been managing assets for wholesale clients, independent of the TOWER Group, since 1990. Since then TOWER Asset Management has grown to become one of the leading managers in New Zealand's fund management industry.

TAM has a long history of industry recognition for investment excellence, winning the IPAC Fund Manager of the Year award four times in the past decade and twice coming runner up. No other investment manager has achieved such consistent success in these awards. In 2003 TAM was the INFINZ Fund Manager of the Year and the FundSource Fund Manager of the Year runner-up. TAM also won the NZ Property Council's Supreme award.

Investment influences

The bursting of the technology bubble put pressure on the funds management industry. Consultants are under pressure for recommending asset mixes that delivered low returns. Trustees are under pressure from members who could have received a higher return by putting their money in the bank. Fund managers are under pressure from shrinking asset values and lower profitability.

Unfortunately, some investors may look at a particular 'new' strategy in isolation and fail to recognise the impact its introduction will have to their overall portfolio risk. By implication, assuming their risk tolerance has not changed, they should reduce risk elsewhere in their portfolio to offset the 'new' strategy.

Assessing the overall portfolio impact from including an exposure to alternative assets can be difficult as standard correlation analysis understates the risks involved. The only thing you can be sure of is that your investment management fees will rise.

Questioning a process after a period of poor performance is a natural reaction - it has happened before and is almost certain to happen again. During the technology bubble, value orientated managers were under scrutiny for refusing to invest in excessively valued stocks. With the benefit of hindsight this was the right thing to do.
How investors react when the process they follow is under pressure will have a huge bearing on their success. Investment markets tend to cycle and the worst thing to do is to chop and change, <u>chasing the best performing strategy over the last year or so.</u> We will try to show some of the pressures that members may undergo making choices in some of the following articles.