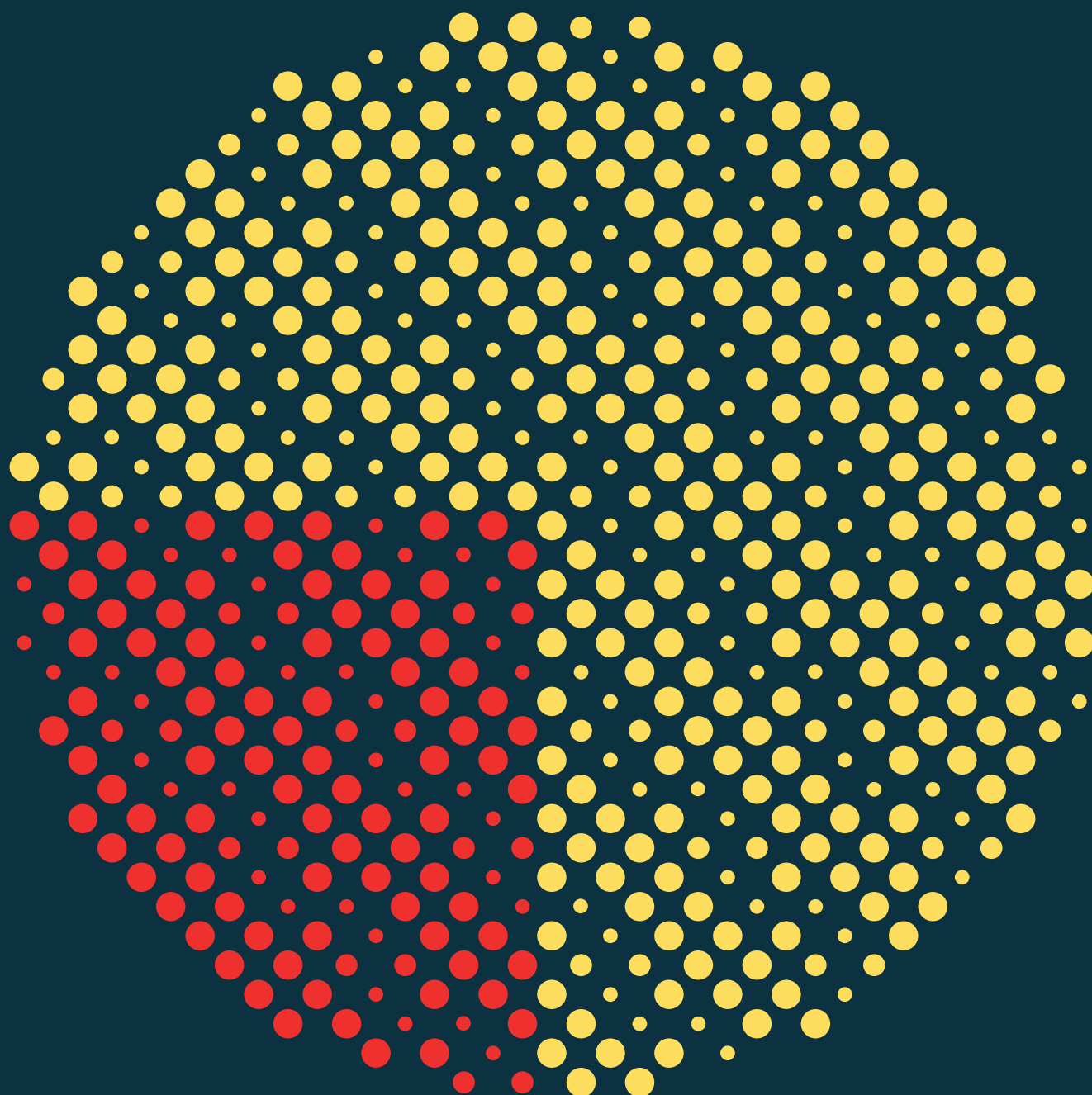




SYNERGY INVESTMENTS



*Investment Report for
Quarter Ending 30th September 2017*

NO MARKET NEWS IS GOOD NEWS

Synergy completed its second full investment year with a flourish.

Returns over the July to September quarter exceeded our long term expectations across all portfolios, as markets continued to respond very positively to signs of a growing global economy. One of the main catalysts was China, with a resurgence in Chinese growth lifting the demand for commodities and global trade in general.

For most of us surviving on a daily news diet of the morning newspaper and the 6pm TV news, however, it would have been difficult to know for sure whether markets were performing well or poorly. As we've noted previously, the mainstream media spends much more time on stories that deliver a direct and immediate emotional impact, than on less headline grabbing material like the health of markets.

And that remains an ongoing challenge for all investors. Your natural human emotions (greed, fear, excitement, anxiety, etc) are being buffeted on a daily basis by news stories, yet the best thing you can do as an investor is to find ways to prevent these from interfering with your investment decision making. In other words, make sure that your short term behavioural urges don't override a sound long term strategy.

As often seems to be the case these days, there were many troubling news stories over the quarter. Over the last three months alone these included bombings, natural disasters, mass shootings and the escalating brinkmanship between Donald Trump and his North Korean counterpart, Kim Jong-un. But in the main, these kinds of stories—as upsetting as they may be—usually don't have a significant or lasting impact on investment market performance.

Markets are much more focused on 'boring' information such as economic growth rates, interest rates, inflation, consumer and business confidence, and company profits. On a number of these measures, the July to September period scored positively, and investors who resisted the urge to trade for the wrong reasons were well rewarded as a result.

Political events often provide another high profile news source which, most of the time, lead to little lasting market impact. Significant new policy initiatives (such as government spending or taxation policies) may be an exception, as was the unprecedented Brexit vote in June, but most political news stories can be classified as largely unrelated 'noise'.

There is no better example of this than our own New Zealand elections. The New Zealand share market performed in line with major overseas markets in the third quarter, in spite of considerable uncertainty surrounding the outcome of the September election. The remarkable volatility in the pre-election polling, and the fact that no clear government was likely to be visible on election night, had no obvious impact on investor sentiment.

In our view, helping investors achieve their long term strategic plans is far more important than being right (or wrong) about an individual investment decision along the way.

Perhaps that shouldn't have been surprising. With National and Labour-led governments generally viewed as being relatively centrist by international standards, and the fact that the Reserve Bank of New Zealand would remain independent under both parties, the strong local market performance reflected that New Zealand's sound economic fundamentals mattered far more than who would ultimately end up with the keys to the Beehive's 9th floor.

Overall, the third quarter of 2017 rewarded investors who maintained their strategic investment plans. Portfolios more heavily tilted towards higher risk investments performed the best, as international and emerging markets shares were the highest returning asset classes. However, more defensive portfolios, which

allocate lower proportions to higher risk assets, also performed ahead of our long term expectations. In short, no matter what level of risk you have sought with your Synergy portfolio, it was a very good quarter to be invested.

And this is at the heart of why Synergy portfolios are structured the way they are. By building investment portfolios that are based on the most robust evidence available in financial science today, we believe Synergy represents a more reasoned—and hopefully more reliable—investment experience. Maintaining wide investment diversification and being behaviourally smart by not making knee-jerk reactions to unrelated news events are two of the hallmarks of this approach.

In our view, helping investors achieve their long term strategic plans is far more important than being right (or wrong) about an individual investment decision along the way. Time and again we are reminded that basing investment decisions on the premise of being able to accurately forecast an unknowable future is fraught with difficulty, and often layered in additional cost.

To us, that very much more speculative approach seems to imply that being right occasionally is better than being right overall. We would contend, for the vast majority of investors, this simply isn't true.

KEY MARKET MOVEMENTS



New Zealand Shares

+4.69%

The local market produced another strong quarter, as many firms reported annual revenues above expectations. Leading performers included A2 Milk (+60.6%), and its supply partner Synlait (+56.4%), who both prospered handsomely following the announcement of successful registration of their infant milk formula with the China Food and Drug Administration. NZ Refining (+7.9%) largely shrugged off the impact of the severe damage to Auckland Airport's primary jet fuel line, while the airport itself fared less well, declining by -9.7%.

Source: S&P/NZX 50 Index, gross with imputation credits



International Shares

+4.29%

(hedged to NZD)



+6.41%

(unhedged)

Developed markets equities delivered generally positive returns as macroeconomic data, in particular, low inflation and continued growth, remains in a 'goldilocks' zone (not too hot, not too cold). The US market shrugged off geopolitical uncertainty, hurricanes and the ongoing failure of the Trump administration to fulfil any meaningful policy promises, to continue to set new highs. Europe and Japan both advanced on robust economic data and neither central bank made any explicit changes to their current accommodative monetary policy settings. The European Central Bank's quantitative easing programme is only confirmed (at this stage) until the end of the year.

Source: MSCI World ex-Australia Index (net div.)



New Zealand Fixed Interest

+1.17%

The Reserve Bank of New Zealand maintained the Official Cash Rate at 1.75% through both its 10 August and 28 September meetings, and continued to signal a high threshold will be required (in future data) before even considering a potential change in interest rates. Yields were variable through the quarter but ended very close to where they started, and the spread between yields of securities with differing credit ratings was also relatively stable. Consequently, longer dated and lower rated bonds rewarded investors for both higher credit and term risk.

Source: S&P/NZX A Grade Corporate Bond Index



Emerging Markets Shares

+9.71%

Emerging markets outperformed developed markets, as steady global growth helped drive expectations that exporting nations will prosper. Brazil benefited the most as reduced political uncertainty helped stock prices record new highs. Fellow commodity producing economies such as Russia, Chile and Peru also posted strong returns. Conversely, Greek banks dragged their index into the negatives.

Source: MSCI Emerging Markets Index



New Zealand Property

+0.54%

The domestic listed property sector exhibited variation among individual names and, overall, the broad asset class returned a small gain through the quarter, lagging the broad equity market. Precinct Properties NZ Ltd led the pack, gaining +4.9% as the firm's annual report showed a significant improvement in year on year profitability. Conversely, the largest firm in the index—Kiwi Property Group Ltd—posted a -4.3% loss following the announcement that their CEO of the last ten years will step down in 2018.

Source: S&P/NZX All Real Estate Index, gross with imputation credits



International Fixed Interest

+0.60%

Within the quarter international fixed interest markets exhibited some variability, due in part to the tensions on the Korean peninsula. However, the steady flow of broadly positive economic data meant most yield curves were little changed overall. Most central banks are looking to slowly taper back their respective monetary stimuli, and, with no surprises, there was no catalyst for any significant change in yields. The UK was one exception, and yields there did move higher amid open discussions of rate rises by their central bank, and an increase in inflation.

Source: Citigroup World Government Bond Index I - 5 Years (hedged to NZD)



Australian Shares

+4.24%

The Australian share market posted a gain for the quarter, up +0.68% in Australian dollar terms. Small capitalisation companies fared better than larger firms, with the S&P/ASX Small Ordinaries advancing +4.41% versus just +0.41% from the S&P/ASX 100 (both returns in Australian dollars). Returns to unhedged New Zealand investors were further enhanced by a relatively strong Australian dollar. Leading sectors included energy and materials companies, as commodity prices advanced globally with an expectation of industrial demand returning, especially from China. Telstra (-10.6%) again struggled, hitting a five year low amid concerns the firm will have trouble adapting to a rapidly changing industry.

Source: S&P/ASX 200 Index (total return)



International Property

+2.95%

Investments into the international property sector made ground through the quarter, although returns were lower than those delivered by the broad equity market. The S&P Developed REIT Index returned +1.47% in US dollar terms. The Australian listed property sector was also up, with the S&P/ASX 300 A-REIT Total Return Index advancing +1.94% in Australian dollar terms. A relatively strong US dollar further enhanced reported returns to New Zealand investors holding unhedged investments in this asset class.

Source: S&P Developed REIT Index (total return)

THE FLAW OF AVERAGES

We all know what an average is. If you run ten laps of a running track in ten minutes, then, on average, you are completing one lap every minute. Averages are useful, but they don't always tell you the full story.

Consider two hypothetical investments. The last five annual returns of each are as follows:

ASSET A:

5%, 7%, 3%, 6%, 4%

= 5% average

ASSET B:

10%, -20%, 25%, -5%, 15%

= 5% average

Over the full five years, both assets returned an average of 5% per annum. A's returns were relatively stable, while B's were all over the place. But does that matter? The compound return to investors in asset B was surely the same as that enjoyed by investors in asset A, right?

Wrong. When you compound the returns together over the full five years, investors putting \$1 into asset A at the start of the period ended up with \$1.2757, while investors in asset B only ended up with \$1.2018. When starting with \$1 that may not sound like a lot, but if you started with \$1 million, an investor in asset B would have been \$73,900 worse off.

The reason asset B performed so much worse, even though it averaged the same overall return, was because its returns were much more volatile. When you are exposed to really volatile performance it is the occasional big negative number that can really hurt your overall compounded return.

A simple example highlights this well. If you start with \$1 and suffer a -50% return, what return do you need to get back to \$1? Well, after suffering a -50% return you only have 50 cents left. To get back to your original \$1 you need to earn another 50 cents, but this time you are only starting with the remaining 50 cents. That requires a return of 100% to get back to the initial \$1. If that happens, your average return has been 25%, but you have made exactly nothing.

Averages can also be misleading when we think of the expected returns of different investments. Consider the long term returns from the New Zealand sharemarket. If we look at the last 25 calendar years of the NZX 50 Gross Index (this is effectively the overall return of the top 50 New Zealand listed companies each year before tax and fees), the average return from 1992 to 2016 has been 10.23% p.a. It's been a very rewarding market for long term investors.

However, when we look at the returns in each individual year, we see that, in 14 years, the return exceeded 10.23%, in 11 years, the return was worse than 10.23%. The return was equal to 10.23% in exactly zero years. What this tells us is the average is all well and good, but unless you invested in this market for a very long time, your investment experience might have been quite different. If you invested in 1993 you would have felt like a genius as the index climbed 47.8% in the year. Unfortunately, if you invested in 2008, you were left feeling short changed as the index fell an eye-watering -32.8%. It's hard to feel good about an attractive long term average when you lose a third of your investment in one year.

Averages are often also considered when it comes to retirement planning calculations. At some stage, your adviser will probably sit down with you and run through some form of projection modelling. In this situation, your adviser is essentially trying to give you some idea of what your current investment funds will look like (and be able to purchase) in the future, as long as you follow the advice and the investment plan they have created for you.

Projection modelling can be an incredibly useful tool to help you determine if you are (or how you can get) on track to achieving your most important goals and objectives. But it is only a model and it relies on data estimates, which may include some combination of historical average returns or future expected returns.

Unfortunately, as we saw in the case of the NZX 50 Gross Index data, the average return over 25 years didn't necessarily tell us much about returns over shorter periods. And even if we knew exactly what the future average returns of all assets were going to be, the actual results experienced by investors would inevitably be higher or lower. That's why we call it a model. If we could tell exactly what everyone's returns would be over all time periods, we would call it a reality.

The fact that we can never know precisely is still okay, because that's where your adviser comes in. Over time, your adviser plays a crucial role in monitoring and, if necessary, adjusting your plan (subject to your agreement), to maximise the likelihood of you getting the outcome you want.

Averages are convenient and can be very useful, but the flaw of averages arises when single numbers are used to represent uncertain outcomes.

By understanding this point, we are all at least a little bit better placed to make more effective investment decisions in the future.

Disclaimer

Information contained in this newsletter does not constitute personalised financial advice because it does not take into account your individual circumstances or objectives. You should carefully consider whether the Synergy investment portfolios are appropriate for you, read the applicable offer documentation, and seek appropriate professional advice before making any investment decision.

The information in this newsletter is of a general nature only. Investors should be aware that the future performance of the Synergy investment portfolios may differ from historic performance. Details are correct as at the date of preparation and are subject to change. The investment objectives and strategies of the Synergy investment portfolios may change in the future.

While every care has been taken in its preparation, Funds Administration New Zealand Limited ('FANZ') makes no representation or warranty as to the accuracy or completeness of the information in this newsletter and does not accept any liability for reliance on it.

The capital value, performance, principal, and returns of the Synergy investment portfolios are not guaranteed or secured in any way by FANZ, its parent SBS Bank, or any other person. Investments in the Synergy investment portfolios do not represent deposits or other liabilities of FANZ or SBS Bank and are subject to investment risk, including possible loss of income and principal invested.



FANZ
Level 4, Petherwick Tower
38-42 Waring Taylor Street
PO Box 5520
Lambton Quay
Wellington

(04) 499 8430
synergyinvestments.co.nz
info@synergyinvestments.co.nz