UniSuper

June 2013

Investment market update

UniSuper's Chief Investment Officer John Pearce provides a market update for members.

After experiencing a very good run, the Australian share market fell 4.5% in May. Notwithstanding this fall in the domestic market, our Balanced Option (where most of our accumulation members are invested) recorded a flat result for the month, demonstrating the benefit of diversification. And barring a major shock in June, our members are still looking at very healthy returns for the financial year. Read on to see returns for May, and an analysis on how the markets could have affected your super:

	% CHANGE				
	Month	FYTD	1 Year	3 Years p.a.	5 Years p.a.
Australian Shares (ASX 300)	-4.5	24.9	25.6	8.2	1.6
US Shares (S&P 500)	2.3	22.2	27.3	16.9	5.4
Asian Shares (MSCI Asia)	-0.1	13.0	14.8	5.5	0.4
Australian Dollar (AUD/USD)	-7.6	-6.5	-1.1	4.6	0.1
Australian Fixed Interest (UBSA Composite)	-0.1	3.9	3.7	7.7	8.1
Cash (UBSA Bank Bill)	0.3	3.0	3.3	4.4	4.5
Balanced Option (*)	**0.2**	**16.5**	**17.5**	**8.5**	**4.4**
Australian Equity Income (*)	**-5.7**	**29.4**	**33.2**	-	-
Global Companies in Asia (*)	**7.4**	**24.9**	**23.5**	-	-

Returns are for periods to 31 May 2013. Past performance is not an indication of future performance.

* Returns relate to our Accumulation (not Pension) investment options and are published after fund taxes and investment expenses, other than account-based fees. Returns for the Australian Equity Income Option include the value of franking credits for the Accumulation investment option.

See returns for all our investment options: **Investment options, performance and holdings**

May 2013: an improving US economy

Over the past few years May has been somewhat of a 'bogey' month, recording losses of -6.7% (2012), -2.0% (2011), and -7.5% (2010).

Unlike previous bouts of volatility, though, this recent bout has not been due to a spate of bad news. Ironically, it has more to do with the improving US economy, which has heightened expectations that the end of ultra-accommodative monetary policies is nigh.

When US Federal Reserve Chairman Ben Bernanke hinted that an adjustment to monetary policy was in the pipeline, bond yields immediately shot up, and the share market took fright. Given that many believe the rise in share markets over the past 18 months has been largely driven by ultra-cheap money, we could see further share market volatility as upward pressure on bond yields persist.

The long term investor should take comfort that the rise in bond yields is actually a sign the world is getting back to normal.

There is nothing inherently good about abnormally and persistently low (in some cases zero) interest rates.

Abnormally low interest rates indicate a sick economy, and often lead to wealth being transferred from 'savers' to 'borrowers'. It also creates many distortions in asset prices and foreign exchange rates. Don't forget how the global financial crisis started in the first place!

We should therefore ultimately welcome a return to normality, even if this implies some volatility in the short term.

Going global

In **last month's investment update** we highlighted the stellar performance of the **Australian Equity Income option**, and also cautioned that the massive capital gains experienced in the option over the past 12 months were highly unlikely to be repeated. Alas, May was a poor month for this option, down 5.7% for accumulation members.

In contrast, our **Global Companies in Asia** (GCA) option for accumulation members experienced a 7.4% gain over the month, bringing its total return since the launch of the option (in April '12) to 20.4%. Underpinning the strong performance over the past month has been the sharp selloff in the Australian dollar (AUD) from around 1.04 to 0.96 against the US Dollar (USD), although this doesn't necessarily indicate how it will perform in the future.

The Global Companies in Asia investment thesis

As is the case with the Australian Equity Income Option, the GCA option is managed by UniSuper's in-house asset management team, and is available exclusively to UniSuper members. The investment thesis underpinning the portfolio is as follows:

- The industrialisation and urbanisation of Asia will be the most important economic development for at least the next few decades, and possibly the 21st century.
- Investing directly in Asian companies may well prove to be rewarding. However, many Asian markets are still relatively under developed, illiquid, and often lack robust corporate governance frameworks.
- Therefore, a potentially less risky way of benefiting from the Asian story is to identify companies listed in developed markets. These will include many well-known global brands, deriving a significant proportion of their sales from the emerging Asian region, as is the above table.

MAJOR HOLDINGS BY REGION*

UNITED STATES	EUROPE	ASIA
Citigroup	Nestle	Samsung
Apple	Volkswagen	AIA Group
JP Morgan Chase	Unilever	United Overseas Bank
General Electric	BMW	ANZ
Qualcomm	Siemens	HSBC

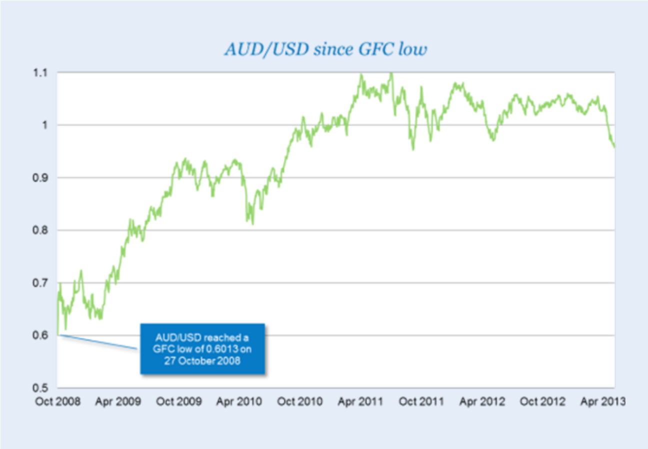
* Subject to change

Where to for the Australian dollar?

The short answer to this question is that nobody knows.

Currencies do not generate an income stream by themselves. So any notion of fair value, despite what the 'experts' say, is educated guesswork at best.

We know currency values are influenced by factors including relative interest and **inflation rates**, and terms of trade.



The problem is that we don't know with much certainty which of these factors are dominating influences at a particular point in time, and how long those influences will last.

There appears to be a reasonable consensus that the rise in the AUD to a level above parity with the USD has been mainly influenced by a combination of

- higher Australian interest rates
- high commodity prices, and
- foreign direct investment to fund our major resource projects.

We are now seeing a narrowing gap between Australian and US interest rates. Our terms of trade are declining, and capital expenditure in the resource industry will soon peak if it hasn't already. Hence, the same influences that drove the AUD up are now stabilising or reversing.

If the AUD dollar falls further then (all other things being equal) unhedged global shares could be expected to outperform Australian shares.

At UniSuper we adopt a dynamic approach to **currency hedging**, which can help protect super investments against fluctuating exchange rates. We tailor our hedging strategy depending on a range of market conditions, with particular emphasis on the level at which the currency is trading relative to its historical levels.

The hedge ratio, which is the portion of our foreign investments which we are protecting against currency movements, can actually vary from 0% to 100%. Theoretically, if the AUD was trading at its historical lows of around 0.60 USD, then the hedge ratio could be expected to be at the higher end of the range, and the converse would apply when the currency is trading at historical highs.

At time of writing the currency hedge ratio of the Global Companies in Asia option is about 15% for the USD. Therefore, the overall performance of the option would be adversely impacted by a rise in the AUD against the USD, and benefit from a falling AUD relative to the USD. Of course whether it will go up or down nobody really knows.

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