

REPORT TO THE UNIT HOLDERS IN THE ASPIRING FUND FOR THE MONTH DECEMBER 2018

Aspiring Fund

NZ50G

ALL Ords
Accumulation Index
(NZ\$)

Short term returns

Month	-3.12%	-0.14%	-1.69%
Last 3 Months	-9.67%	-5.77%	-12.44%
Last 12 Months	-3.66%	4.92%	-7.91%
Financial Year to Date	-0.17%	5.92%	-1.09%

Long-term* returns and volatility

Return (annualised)	9.77%	6.65%	2.08%
Return volatility (annualised)	8.70%	11.35%	16.04%

* since the introduction of the PIE Tax regime, 30 Sept 2007

Unit Price \$3.40

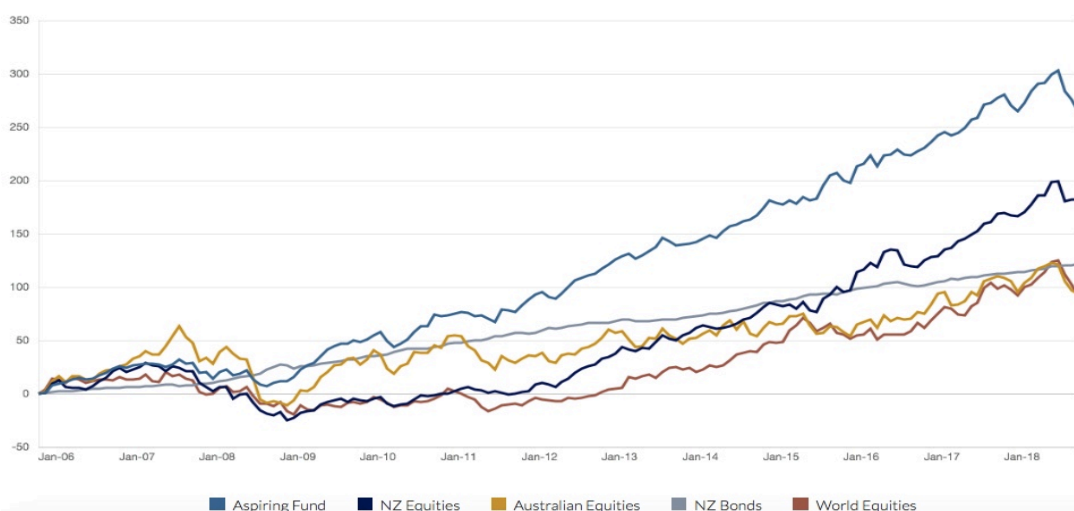
ASSET ALLOCATION (approximately):

New Zealand Equities	32.7%
Australian Equities	12.1%
International Equities	9.9%
Bonds	5.2%
Total Cash	40.2%
Short Equities	-0.3%

Net Asset Value of the Fund (approximately): 386.3m

The fund's main direct currency exposures at month end were - NZD 73%, AUD 17%, USD 9%

FUND PERFORMANCE



The Fund returned -3.12% in December, against a record setting weak December for global equities.

At their Christmas Eve low, US shares were down a staggering 14.9%. At this time they flirted with the 'down 20%' definition of an official bear market by being 19.8% off their September peak. Thanks to a post-Xmas bounce, US equities finished the month down a less bad 9% - but this still marked the worst December return since 1946!

World equities fared only slightly better, down 7.6% (in USD terms).

So why did markets suffer so badly in December?

A number of equity strategists have pointed to US-China trade tensions, investor impatience, slowing economic growth globally, and a less sympathetic US Federal Reserve.

Economists we respect, such as UBS' Chief Paul Donovan, are largely unfazed by growth trending back to more normal levels and cite no obvious negative bias of new economic data (supported by the recent very strong US jobs report). Against this, a number of corporates in Asia are now talking about a cold winter ahead, and a clear majority of US CFO's recently surveyed by Duke University now expect a recession by the end of 2020.

In our view the growth outlook is clearly softening and the market reaction can be more easily defined as a risk-off correction. It is telling that equity markets fell so hard in a month despite the theoretically supportive influence of US bond yields which dropped by more than 0.3% and ended the month on lows of 2.68%.

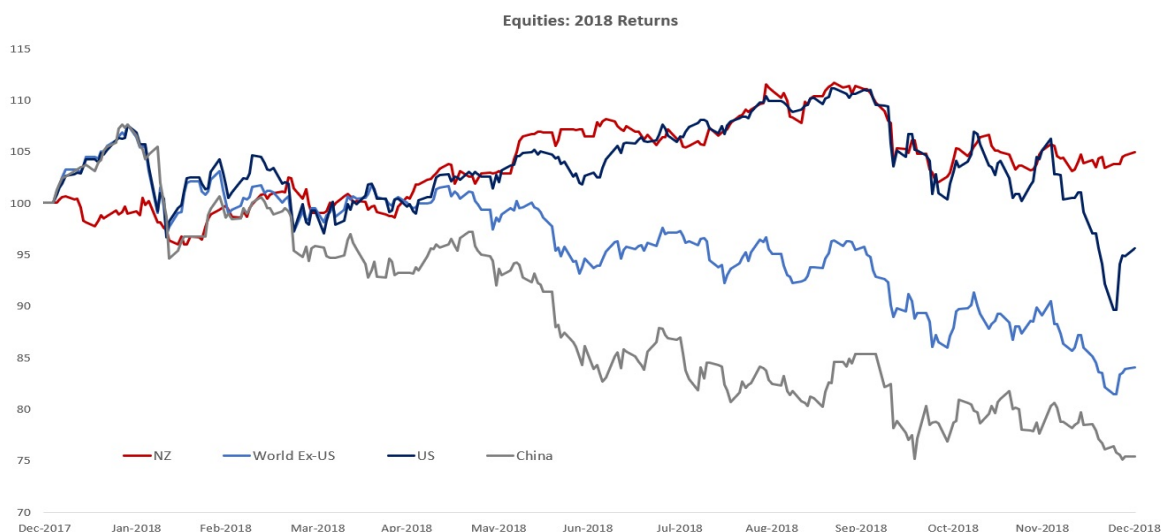
Following the well documented one directional surge of 2017, US equities finished 2018 14.3% off their highs, and the World ex-US was down 22% on the same basis.

The ex-US distinction is important in the context of how 2018 played out. Although volatility noticeably picked up, US equities largely maintained the 2017 dynamic of momentum continuing to rule with shares reaching highs late in the third quarter. The rest of the world started weak and didn't enjoy the mid-year bounce, creating a large separation in returns and valuations. The resilience of US equities was the last remaining proof point for the momentum investor bulls.

In our view the sharp selloff in US equities has opened a crack in the dam of investor confidence, and profoundly marked a turning point in the investment cycle.

Through all of this carnage NZ equities have, by and large, sailed through. The NZ50 benchmark was only down 0.14% in December, and finished the year only 6% off September highs. But what is far more remarkable is the calendar year low of the NZ50 index was back in early February.

With the US joining the rest of the World equities sell-off, NZ shares are now starting to resemble the last man standing on prom night, the lights are on, the cleaners are not interested.



Given this backdrop it is unsurprisingly that our NZ equities portfolio was our best performer, up 0.2% in December. We still favour Gentailer stocks amongst the defensives, and a2 Milk amongst the growth stocks.

While NZ positively surprised, the same cannot be said for our Australian and International portfolios which were down over 10% in NZD terms. We set up our International portfolio with our eyes wide open (Technology and Emerging markets bias) and knew that the downturn would be difficult to predict but as sharp as the previous rally. However, we were surprised by the extent to which the abrupt change in investor confidence really took its toll on a number of our Australian positions.

So what do we make of the markets we invest in, and what are we doing about it?

We still struggle with the overall valuation of NZ equities when benchmarked against global peers. However pleasingly a number of investment opportunities have re-emerged. Over the last quarter, double digit % falls in reliable and well managed businesses like EBOS, Fisher and Paykel (F&P) Healthcare and Freightways are things that we have taken notice of. However, we note that Freightways are still trading on a Price to Earnings multiple which is 4 points higher than global leader Fedex and that F&P Healthcare still looks very expensive relative to other global medical equipment manufacturers. We are proceeding with caution in New Zealand.

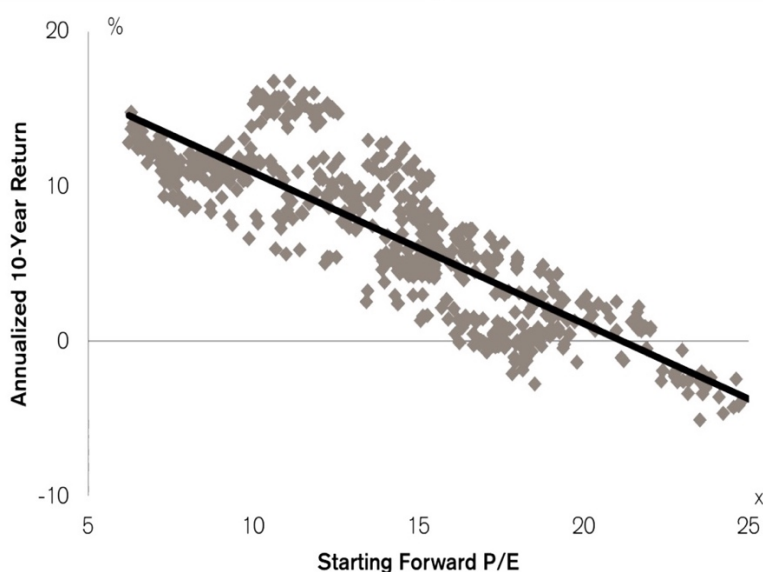
We continue to struggle with the heightened volatility of Australian shares, and the 'in the club' / 'out of the club' nature of how stocks seem to trade across the ditch. Share prices like Kentucky fried chook operator Collins Foods should not move 15% away from the broader market in a month with no material company news. We are raising the expected return hurdle for large size investment positions in Australia - it is no accident that none of our top 10 holdings are Australian apart from dual listed a2 Milk.

We expect Global shares, and particularly the bell-weather US market, to continue to set the tone and be the main directional influence for Australasian equities. And on this front, we have now become much more positive. Simply put, with long bond yields in the mid twos, a growing list of quality US firms now trade on valuations which provide an attractive risk-return trade-off. Apple is a good example. Even allowing for near term growth concerns in its hardware business, the company is currently on a 10% earnings yield, including its high growth recurring revenue platform business.

Unsurprisingly a large number of positive leaning international brokers side with this view. However, more telling, is commentary from New York's Stern School of Business which we value highly. Following the sharp rise in equities' earnings yields (profit over a lower price) and now lower (more supportive) long bond yields, they believe US equities are priced for multi-years of zero growth. And on current (likely too high) growth forecasts, since the start of their data in 1960, US equities have only looked more compelling against interest rates on three occasions (1979, 2009 and 2011).

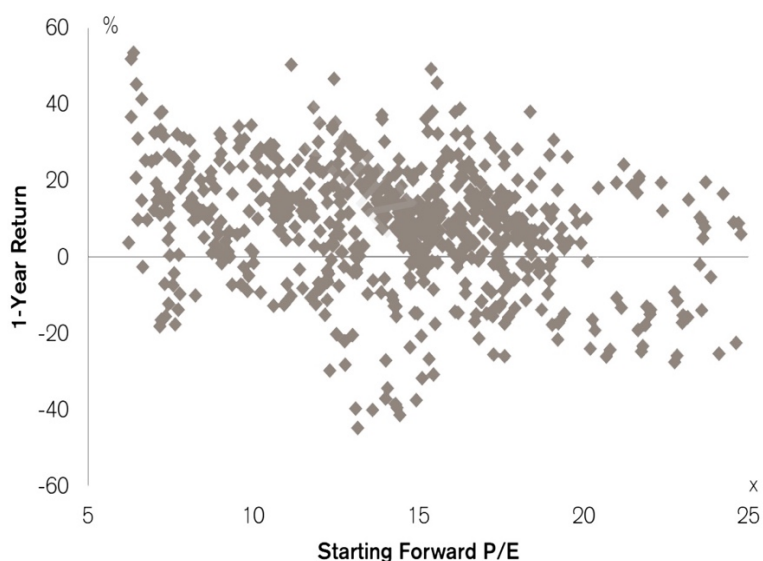
Unfortunately while valuations provide a very good read on future returns over the longer term, they provide very little instructive value over the next 12 months.

10-Year Annualized Stock Returns vs. Starting P/E Levels



Note: 1964 to present
Source: Federal Reserve, Standard & Poor's, Thomson Financial, FactSet, Haver Analytics®, Credit Suisse

1-Year Stock Returns vs. Starting P/E Levels



Note: 1964 to present
Source: Federal Reserve, Standard & Poor's, Thomson Financial, FactSet, Haver Analytics®, Credit Suisse

In the short term sentiment is an over-powering force. And on this basis, acknowledging the huge intra-day swings in markets on what is frequently unimportant news-flow, we have reduced the risk of the Fund. We are waiting for the dust to settle.

Outside key macro indicators, we will be paying closer attention to US corporate results in February - both reported growth and forward commentary will be very important. While we don't view twitter updates as reliable progress scores in US-China trade agreements, a resolution will undoubtedly be a major market event. Given the large amounts of investor flows exhibited offshore recently, we continue to be mindful of investment flows in and out of NZ equities, and also participation from local investors.

We are using the current volatility to rotate the Fund's equities portfolios more toward our higher conviction ideas. The investable list is growing and we are more encouraged in the Fund's medium term outlook today than we have been for a good while.

TOP 10 HOLDINGS

Contact	3.1%
Precinct Convertible Notes	2.6%
Meridian	2.3%
A2 Milk	2.2%
China MSCI ETF	2.0%
Metlifecare	1.8%
Z Energy	1.6%
Freightways	1.6%
Sanford	1.5%
Amazon	1.4%

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