



REPORT TO THE UNIT HOLDERS IN THE ASPIRING FUND FOR THE
MONTH JULY 2017

	Aspiring Fund	NZ50G	ALL Ords Accumulation Index (rebased in NZ\$)
<u>Short-term returns</u>			
Month	1.26%	1.08%	1.83%
Last 3 Months	1.06%	4.27%	-4.33%
Last 12 Months	8.09%	4.71%	7.73%
Financial Year to Date	2.10%	6.91%	-3.75%

Long-term* returns and volatility

Return (annualised)	10.79%	6.17%	1.99%
Return volatility (annualised)	8.78%	11.76%	16.48%

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

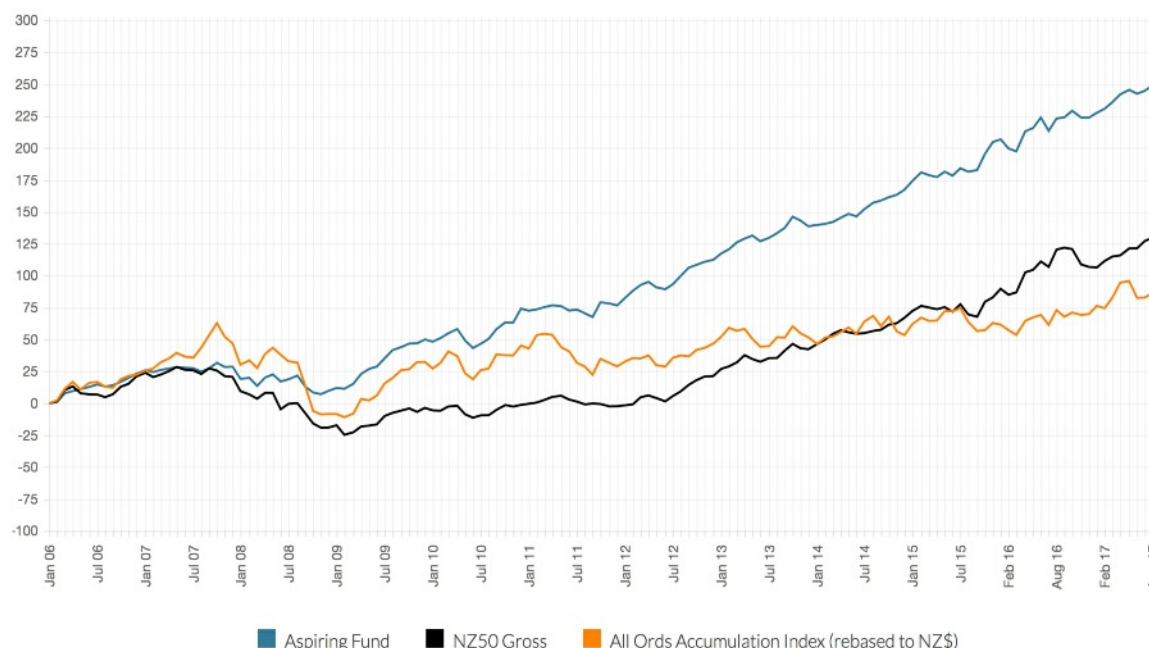
Unit Price: \$3.2655

Asset allocation (approximately):

New Zealand Equities	44.3%
Australian Equities	20.1%
International Equities	9.6%
Bonds	2.2%
Total Cash	23.8%
Short Equities	-1.3%

Net Asset Value of the Fund (approximately): 354.3m

Fund Performance



The Fund returned 1.26% in July with the NZ and International portfolios doing the heavy lifting in a fairly quiet month for markets.

NZ equities continued their relentless grind higher in 2017, with a 1.08% return in July. This marks the seventh consecutive positive month since Dec-16. Returns have been impressive over this time too- up 11.8% to July which is broadly in line with the gross performance of US equities (S&P500 +11.1% in USD). What is particularly noticeable against these metrics is the underperformance of the NZX10 index (+7.2%). This index comprises the ten largest companies in the NZ market and the stocks most held by offshore investors.

It is also worth noting the strong calendar year returns of NZ equities have largely been a recovery story, with company valuations (PE ratios) reverting back close to 2016 highs. This shows up in the market's 12-month return performance of only +4.7%, which includes a ~4% contribution from dividends. By comparison the NZX10 index has returned -3%, and the S&P500 +16% (in USD) – large cap offshore investors are now making more money at home.

With valuations back to historical highs, the outlook for future returns is tightly linked to the outlook for earnings growth. As such, the August reporting season is particularly timely and important. From the valuation starting point it is possible we see some much needed volatility in NZ and new investment opportunities emerge for the Fund. What seems more likely, if the local corporate bond market is a guide, is a resistance to material sell-offs (in the absence of a global equities pull-back) as dividend yields remain a relatively sure source of relatively high income.

There were two capital bond issues priced in May and listed in June from Genesis and Vector. Both were priced at 5.7% for an effective 5-year term. They are now trading at 4.9% and 4.8% respectively, consistent with the performance of Summerset's issue of senior debt which has traded in from 4.78 to 4.6%. The reasons for this yield compression are fairly simple. Retail investors are significantly less concerned about spreads to swap and S&P credit ratings than their advisors. They don't just want yield- they need it, and they are continuing to venture further into risky territory to obtain it whether it be in equities or corporate credit.

Global dividend yield ETF's are playing the same game. Combined with the steady inflows from Kiwi-saver via pre-set asset allocation models this means the market needs new issue or capital raising activity to act as a pressure release valve. For whatever reason this is not occurring yet but we would be very surprised if Boards and their advisors are not contemplating it.

At an aggregate market level, we have an expensive market with a high dividend payout ratio driving local and global investor interest and no obvious catalyst for this to unwind. We think the performance of Fletcher Building over the month illustrates the market's problem.

We have previously written about our expectation of 'peak cycle problems' for Fletcher Building – and this continues to play out. The company dominated headlines again in July, with the exit of its CEO, assessment of larger losses from its high risk development pipeline, and a write-down of its Australian operations. Accumulated losses of \$245m (35 cents per share) now total a decade worth of the division's normal earnings.

On the investor call, management said they have materially lowered their assessment of Australian business earnings potential, and see the NZ cycle as "clearly at peak capacity". In our view, this highlights the more important issue of the company's dismal performance across an extended period of time. We note analyst 1-year forward earnings forecasts today (FY18, 64 cents per share) are only 1% higher than seven years ago.

Despite this sorry saga the share price finished the month unchanged after an initial 8% selloff. While the company enjoys support from a loyal band of analysts, many of whom failed to see any of this coming, we suspect the share price resilience owes more to the difficulty investors constrained to NZ large caps have in finding a large cap stock which looks obviously better. Clearly there are many better businesses but whether they offer materially better value for money is much more problematic.

All of this is a long-winded way of saying that we think the market is expensive but it is likely to remain so while the alternatives are even more expensive and new issue activity remains moribund. Our persistent cash weighting is a consequence of our certainty that this will change and the difficulty of timing or predicting the catalysts for change.

Despite the difficulty of an expensive market we had a few good wins in the month with Metlifecare (+4%), A2 Milk (+10%) and Pushpay (+23%) key among them. We attended Metlifecare's investor day at its Greenwich Gardens Development which will become the country's 2nd largest retirement village once completed. The retirement operator is slowly proving out its development credentials and we continue to see value in the stock, particularly relative to the sector. It has struggled with market absorption post the Infratil sell-down but its discount to NTA provides valuable relative protection.

On the back of a slew of broker upgrades in July, A2 Milk's share price continued to soar. A2 has been an impressive earnings growth story, and channel check data suggests it is maintaining momentum. However, the recent rash of broker activity has generated a degree of euphoria among investors and we have taken some profits post month-end.

The Fund participated in a ~NZ\$35m equity raising for Pushpay - a high growth NZ technology company principally focused on providing a payments service to the US church donations market. We have been keeping a close eye on Pushpay's customer and financial performance for over a year, and deemed the \$1.51 placement price attractive for the company's industry leading growth metrics. The share price ended the month up ~40% to \$2.10 – valuing the company at \$575m.

There were three key narratives for the Aussie market's 0.44% A\$ move. A directionless Industrial sector (-1%), a 5% move in Resources on the back of rising commodity price rises, and a lift in Banks (~2.5%) after the Australian Prudential Regulation Authority eased capital requirements. Aussie economic signals were also strong with falling unemployment and rising business confidence.

Our Aussie portfolio had a weak month as it is focussed on the industrial sector, and was underweight resources and banks, although we did lift exposure to these sectors during the month.

Our non-Australasian equity exposure is predominantly stocks in the Tech sector in the US. Most of those companies reported results in line with or better than expected last month with the one exception being Amazon which modestly disappointed the market due to higher than expected costs.

Facebook announced much better results than even the most optimistic analyst forecasts and consequently rallied 15% for the month. Facebook is now up 47% for the year and the scale of the business is demonstrated by the fact it has added roughly NZ's GDP to its market capitalization during that time. Alphabet (Google's parent) and Facebook own the majority of the digital advertising space and digital advertising spend is now greater than the traditional forms of advertising. Their dominance in data analytics means no other digital advertiser can match their reach or customer comprehension. We think their effective monopoly powers justify their premium ratings but continue to monitor the political backlash they are capable of generating.

We also own Amazon - a business which will dominate and disrupt traditional forms of retail for years to come. The criticism of Amazon is that they make no money but the reality is they can turn a few levers and become highly profitable but currently prefer to spend and grow market share in the business sectors they target. They have already grown Amazon Web Services from a standing start to being the world's largest and most profitable host of cloud-based services.

Their core activity has historically been retail sales but, with the advent of Amazon Prime and its access to a huge library of proprietary digital content, they are expanding and diversifying both geographically and in product streams. Nevertheless, retail alone is a huge opportunity. The world's retail spend is currently US\$26 trillion and Amazon currently have 1% market share. All the growth in retail globally is online, an area where their strength in logistics gives them the advantage of speed of delivery and price.

The Tech sector generally operates on a winner take all basis and is even more brutal than professional sports where at least the 5th place getter does get some prize money. At the time of the tech wreck in 2001 many of the market darlings were effectively me-too suppliers of hardware which never had a chance of justifying their premium valuations as their products became commoditised. We acknowledge that, in Facebook, Google and Amazon, we hold market darlings but their businesses have much wider moats than the previous generation and their ostensibly higher valuations are a reflection of this.

So far, our strategy of holding a basket of these has delivered very good returns. It is tempting to take profits but but they were bought as long term investments in dominant players and, as long as the businesses remain dominant players, it will take extreme valuation risk for us to do so.

TOP 10 HOLDINGS

Contact	3.9%
EBOS	2.7%
Google	2.6%
Metlifecare	2.5%
Heartland	2.4%
Sanford	2.2%
Mainfreight	2.0%
Z Energy	1.9%
Xero	1.8%
Meridian	1.7%

Aspiring Asset Management Limited

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