



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

	Aspiring Fund	NZ50G	ALL Ords Accumulation Index (rebased in NZ\$)
<u>Short-term returns</u>			
Month	-0.88%	0.54%	-6.19%
Last 3 Months	1.96%	3.51%	-0.07%
Last 12 Months	5.77%	5.39%	7.97%
Financial Year to Date	0.14%	3.09%	-5.63%

Long-term* returns and volatility

Return (annualised)	10.77%	5.88%	1.82%
Return volatility (annualised)	8.86%	11.84%	16.62%

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

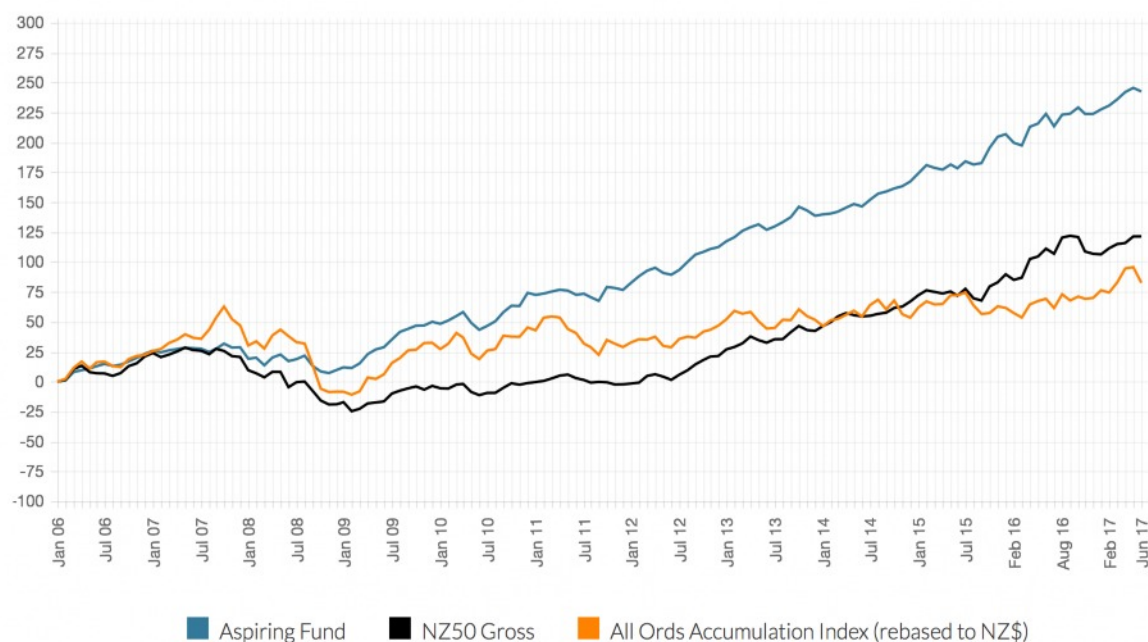
Unit Price: \$3.2028

Asset allocation (approximately):

New Zealand Equities	45.7%
Australian Equities	18.2%
International Equities	8.0%
Bonds	5.2%
Total Cash	22.9%
Short Equities	-2.3%

Net Asset Value of the Fund (approximately): 343.1m

Fund Performance



The Fund was down -0.88% in May. Our NZ and International portfolios had good months but Australia was a battle even before the effect of holding our A\$ exposure unhedged - not an inspired decision when the NZD rallied by 4% against the AUD.

Currency movements were one of the big stories for the month.

The NZD clearly benefitted from a decent month of economic news in NZ including a continuation of record immigration numbers, the 4th consecutive rise in dairy prices at the Global Dairy Trade auction, a 5% rise in the terms of trade, and a budget whose lolly scrambles were only made possible by the continued improvement in our fiscal position. Even the RBNZ's determined dovishness with its OCR review on 11 May could not dent sentiment and we finished the month up 2% on a TWI basis.

The US dollar was weaker globally, largely as a result of renewed strength in the Euro after the French presidential election and diminished confidence in the "Trump bump" to US economic growth prospects. The Pound was a casualty of increasing uncertainty about the outcome of the upcoming general election and the AUD fell in sympathy with big falls in iron ore and coal prices

The 150% rise in the iron ore price from December 2015 to March this year had the lucky country nearing a return to a current account surplus for the first time since the 1970s. However, a ~40% fall in iron ore since March put a stop to that, as the negative aspect of Australian dependence on Chinese demand was highlighted yet again.

The contrast between soft commodity strength and hard commodity weakness undoubtedly contributed to the 4% rally in the cross rate. The size of the move caught us by surprise - obviously we should have hedged if we had expected it - but our default position has always been that, in the absence of strong views, a degree of currency diversification is a desirable suppressant of volatility as long as the long run return expectation is greater than zero.

We have remarked often in recent months about the impact international flows have had on the local equity market but their buying is helping bonds outperform too. Over the past 3 months our 10 year bond has rallied 50bps in yield against 40bps for the Australian 10 year and 25 bps for the US 10 year.

However, all the good news of recent months has had plenty of time to be baked in to the currency and at some point we expect election uncertainty to become a more serious concern for investors. Our lack of hedging last month was an expensive mistake but every time we underperform due to NZD strength our investors' global purchasing power has actually improved which is another argument for a degree of currency diversification.

Our NZ portfolio performed well through the March reporting season with decent contributions from Fisher and Paykel (+6% on +18% profit lift) and Heartland Bank (+5% on good organic asset growth), with Xero (+15%) being the standout. While Xero continues to post losses as it chases growth, it is clearly doing very well in 3 of its 4 major target markets. While growth in the US has not lived up to expectations, and may have contributed to some of the well-known US tech shareholders selling down, Australasia continues to perform well and the UK is now the key growth market where the company is executing well.

Our biggest loser for the month was Metlifecare which traded back below the \$5.61 price of the Infratil sell-down a couple of months ago. Sentiment towards the sector has waned with house prices in recent months. We believe it is the cheapest exposure to the sector but for stocks which have been subject to these big deals and then fallen through the "deal price", the form book says there is a wall of selling to get through before they regain the deal price.

Another drag was one of the Fund's largest holdings, EBOS, which announced the acquisition of Australia's largest provider of outsourced pharmacy services to hospitals at a price which the company accepted was full - disappointing for a market which has always expected EBOS to buy "well". The stock price suffered further when Sigma, a competitor in wholesale pharmaceuticals, announced it had commenced legal action against a chain of pharmacies it supplies. The market marked all 3 listed pharmaceutical wholesalers down on this news but our discussions with the company leave us confident it will be substantially unaffected by this development. Nevertheless, the stock fell 5% over the month.

Like New Zealand, Australia had a budget announcement during May but it was not quite as anodyne. Biggest news for the market was the announcement of a levy, which is intended to be permanent, on banks with over \$100 billion in liabilities. The immediate reaction was to mark the banks down by about 2.5% but the more the market learnt the less it liked about this levy and the bank index fell by more than 10% over the month - quite a response to a levy which most analysts expect to cost about 3% of after tax earnings.

With the bank sector now trading at a 33% discount to Aussie industrials it is tempting to think that most of the bad news around the levy, credit cycle, housing market risk, funding risk etc. is now priced in. We are not so sure - apart from the obvious and imminent issues, global pressure on the biggest banks and their ability to exploit their retail customers is growing. The UK has recently announced plans* to give small customers more power in dealing with big banks. If it works we expect a variant to be adopted down here.

*<https://www.openbanking.org.uk/about/the-initiative-open-banking>

Another illustration of the Aussie market's ruthlessness came in the hammering of Aussie retailers as news of Amazon's arrival (in a few years time) was digested. Citi was the first broker to aggressively mark key Aussie retailers down - JB Hifi and Harvey Norman were downgraded 35% and 33% respectively due to significant hits to long-term earnings forecasts. Analysts base their views on examples of Amazon's successful entry into other markets. However Australia is unique in that it has one of the highest minimum wages in the developed world, hampering the profitability of online operations reliant on a low wage workforce. We assume Amazon have done their homework, will be patient, and will accept lower margins for the greater goal of owning the consumer's shopping choices, but we find it difficult to foresee their impact on the best Aussie retailers being quite so dire or certain.

A modest position in ANZ, our only bank exposure, was our biggest individual loser in Australia and our only retail exposure is Woolworths, which is facing more competition from Aldi than Amazon. However, across the board, Australia was a difficult market for us in May with the portfolio faring slightly worse than the 2.7% decline in the All Ords Index.

Our international portfolio had another good month with a 1.7% NZ\$ return. Google was the best performer but each stock in the portfolio was up for the month. There is no doubt that the FANG stocks (Google, Amazon, Facebook, Netflix) are becoming very crowded trades. They are widely owned by active managers and their performance means they are now the biggest beneficiaries of ETF and index buying. Some commentators are making comparisons with the nifty fifty bubble we referred to a couple of months ago.

We are not so sure. Facebook and Google are immensely profitable and, while their +25 price to earnings (P/E) ratios are certainly not cheap, their core businesses are funding a lot of currently unprofitable investment in innovation which has the potential to give them multiple legs of future growth. Admittedly these investments will have to deliver massive returns to move the needle on market caps of \$500 billion or so and Netflix and Amazon's P/E's are even more eye-watering at above 100x.

Certainly the tech names have accounted for a disconcerting share of total US market returns over 2017 as other beneficiaries of the initial Trump rally like the banks and automakers have retraced all of their gains. We are mindful of all this but we have been careful in our US stock selections and bought them all as long term investments which they remain.

We approach June perhaps more cautiously than normal as we ponder the historical weakness of the next few months – in the 11 full years since the Fund's inception, the NZ50G has registered 1 positive June month, the All Ords 2, and the Fund 2. Last week a widely-followed Australian broker noted a negative historical trend for the middle months of the year in a daily report – US\$10k invested in the S&P500 index for the months May to October in every year since 1950 would produce a negative compound return with the \$10k being worth less than \$9k today. The same \$10k invested over the same time period, but invested in the market for the months November to April only, would be worth \$607k today.

We don't have an explanation as to why these trends persist, but we acknowledge that 11 years is all the history the Fund has and 66 years is a lot of history for the US market. In any event it is some sort of justification for "sell in May and go away" as investment advice.

TOP 10 HOLDINGS

Contact	3.6%
Metlifecare	3.2%
Google	3.0%
EBOS	2.5%
Heartland	2.5%
Sanford	2.1%
Mainfreight	1.9%
Xero	1.9%
Meridian	1.8%
Spark	1.8%

Aspiring Asset Management Limited

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