



REPORT TO THE UNIT HOLDERS IN THE ASPIRING FUND FOR THE MONTH MAY 2019

<i>All returns are in NZ\$</i>	Returns			Return volatility	
	31 May 19	3 months	12 months	Since inception pa ⁱ	Since inception pa ⁱ
Aspiring Fund	-1.59%	3.83%	3.11%	10.87%	8.41%
New Zealand Equities ⁱⁱ	1.04%	8.50%	16.85%	8.64%	11.25%
Australian Equities ⁱⁱⁱ	2.39%	6.89%	8.93%	6.33%	15.59%
World Equities ^{iv}	-3.59%	3.35%	7.33%	5.92%	12.71%

ⁱ February 2006, ⁱⁱ NZX50 Gross, ⁱⁱⁱ ASX All Ordinaries Accumulated, ^{iv} MSCI World Equities Total Return

Unit Price **\$3.70**

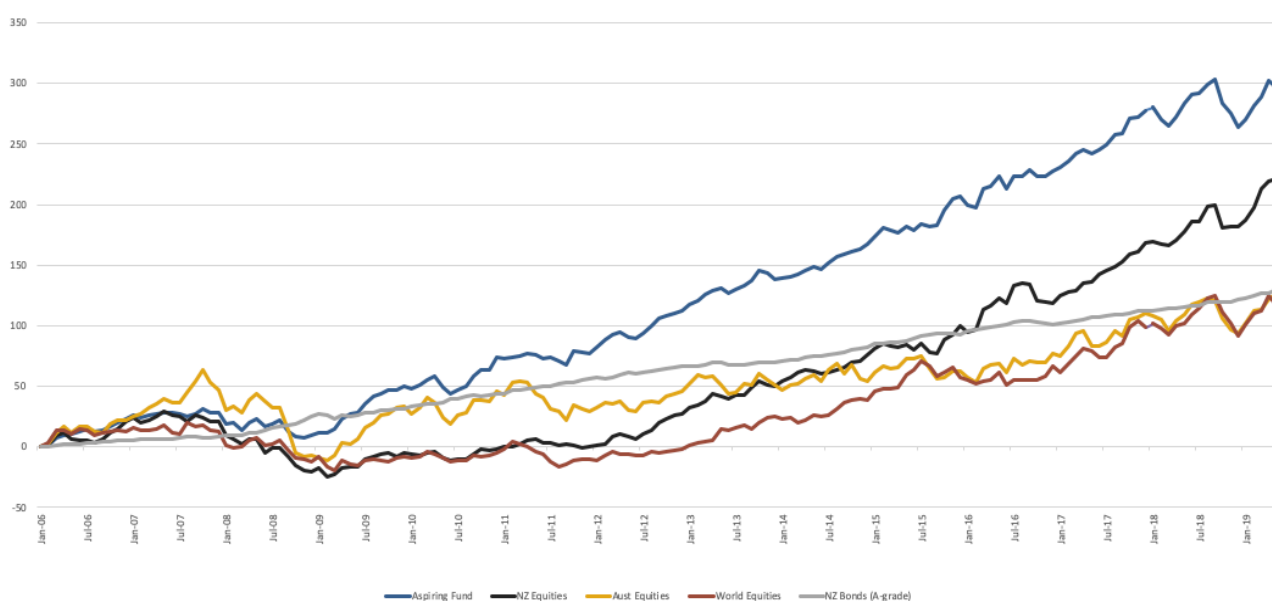
ASSET ALLOCATION (approximately):

New Zealand Equities	40.4%
Australian Equities	19.3%
International Equities	19.2%
Bonds	5.4%
Total Cash	15.7%
Short Equities	-0.4%

Net Asset Value of the Fund (approximately): **\$413.5m**

The fund's main direct currency exposures at month end were - NZD 59%, AUD 20%, USD 18%

PERFORMANCE



Aspiring Fund returns include all charges but are before tax expense, and exclude New Zealand tax credits. The returns of market indices shown above include capital returns and cash distributions, but reflect no deductions for trading and transaction costs, applicable tax, and other expenses. All return data is shown in NZD.

The Fund was down 1.59% in May, essentially giving back half of the strong returns carded in April.

At the start of April, Trump announced that the US were “getting very close to a trade deal with China”, adding that the agreement would be the “biggest deal ever made” and “good for both countries”. Roll forward four weeks, and the positive investor sentiment created by these comments was eroding fast as Trump declared negotiations had stalled, with political tension further escalating from bans placed on Huawei by the US.

International equity markets took a hammering; World Equities were down -5.8%, Nasdaq -7.6%, Emerging Markets -6.6%, and China Equities down -12%. Unsurprisingly, our International portfolio suffered losses, with particular pain coming from our Asian investments.

UBS economist Paul Donovan noted during the month, that “more significant than the tariffs themselves, is the risk of uncertainty. The US economy and the global economy has become dependent upon long and complicated supply chains. If the security of those supply chains is questioned, then companies will need to rethink their business models”. A prolonged pause on corporate investment decisions, coupled with higher prices for US consumers, would significantly raise employment and recession risks.

He goes on to point out that given this uncertainty, current “economic data releases assume less importance, most numbers are telling a story of what might have been, a better world, several tweets ago, when hopes of stabilisation in trade meant a stabilisation of economic growth”. This highlights how the macro environment had positively changed since the deep macro concerns late last year – but also by inference, how conditions could turn again.

It would seem highly unusual for a leader of a democracy to spur a recession going into an election year. However Trump is clearly not a normal president.

The Reserve Bank of NZ (RBNZ) cut the official cash rate (OCR) to 1.5% during the month. We viewed the decision as predictably supportive of their prior dovish signalling, but arguably unnecessary. The OCR garners a lot of attention by economists, but interest rates that matter more to households are mortgage rates.

The economy has already seen significant stimulus from mortgage rates falling by over 1.5% over the last two years. We have recently heard of two year rate offers as low as 3.65%. To get a sense of the magnitude of this, using figures from the Reserve Bank website - if New Zealand's total household mortgage debt of \$260bln was reset to this rate annual interest payments would reduce by around \$4bln (equivalent to +1.3% of GDP).

At these rates the interest costs of home ownership are close to parity with renting. Outside Auckland the average rental yield is 4.0%. Absent material deterioration in the job market we find it hard to see much downside risk to house prices while this situation persists.

Despite signalling heightened risks for future earnings growth, the RBNZ rate cut provided more fuel to the fire of investors forced to accept record low returns for risk assets. The TINA - there is no alternative (to equities because cash returns are so low) thesis is proving to be so dominant in New Zealand that equities valuations are becoming increasingly detached from the uncertainty priced offshore. With Vector 6 year bonds trading just over 3.0% annualised return for six years, it would appear that many investors are persuaded that Auckland Airport looks attractive on a 3.6% dividend yield.

It is noteworthy that despite global uncertainty and a weak May reporting season, NZ shares rose to an all-time high valuation in May, with an average price to earnings ratio of a quite astonishing 19.5x! World Equities are on 14.7x. NZ's current +30% premium is something we have not witnessed before.

To further highlight the high price paid for NZ earnings, Chinese (iShares China ETF) equities are on an average multiple of 9x. If earnings in China, a country which accounts for +25% of total global growth, suddenly fell by 50% overnight in isolation, share prices for those companies would still be on a lower multiple of earnings than NZ equities. This is making long-term focused investing increasingly challenging for us locally.

The future dividend prospects for NZ companies are not improving (in fact earnings have been sequentially downgraded for the last 36 months on First NZ Capital estimates) so higher share prices (lower yields) today are simply reducing future returns.

Against this backdrop we have made some pleasing changes to our NZ equities portfolio, increasing our investment levels in Infratil (now a top-10 Fund holding) and Spark (now the Fund's largest position).

The Fund participated in Infratil's \$400m equity raising to fund their 50% share of the acquisition of Vodafone New Zealand. While we view the price paid as fair (~7.5x operating earnings), fair valuation is increasingly hard to find and we are confident the new owners of the business can achieve double digit leveraged returns by managing capital effectively.

We believe the Infratil share price has absolute value support, and provides a very compelling investment thesis when considering management quality, and when compared to how defensive assets are being priced in the broader market.

Vodafone represents 20% of Infratil's investment portfolio, with the remainder evenly split between listed stocks Trustpower and Tilt Renewables, and unlisted positions including Wellington Airport and Canberra Data Centres. In our view, these types of quality assets are in the sweet-spot of long-duration investor appetite. Auckland Airport and Port of Tauranga are local examples with shares trading over 35x net profit after tax. It is worth highlighting, buying 'quality at any price' has been one the best investment strategies in this investment cycle.

On our estimates, Infratil shares have recently traded 10-15% below valuation. While this level of discount is consistent with what we have observed since the middle of 2015, the average PE ratio of NZ equities has increased from 15x to a record 19.5x over this time.

We view Infratil's commitment of a large amount of capital into the NZ telecommunications market as supportive of the Fund's top position, Spark. We concur with Infratil and Vodafone management that scope exists for the two companies to better utilise their infrastructure, and the merits of promoting new technologies such as mobile broadband for households.

Another positive read-through for our investment in Spark, is Vodafone's debt levels at ~3x earnings. Spark has well under half this level of gearing. With this balance sheet capacity we believe it is highly unlikely that the Board will feel the need to cut the dividend, especially given the seamless strategic transition of former CFO Jolie Hodson to CEO.

Despite this, we estimate the market is currently pricing in risk of Spark dividend cut. Importantly, Spark has traded on the same dividend yield as Telstra for almost 20 years. For this to be the case today, Spark's share price would have to be \$5.40, or its dividend would have to fall by 30%. At the time of writing, Spark's share price of \$3.69 is the same as Telstra, but it pays a 25 cent dividend compared to 16 cents for Telstra.

The highlight for the month in our NZ equities portfolio was a 9.8% return for our once favoured value play, Contact Energy. Contact is now up over 25% in 2019, patience has finally been rewarded. We also were quick to act on a number of large institutional deals, including a capital raise for EBOS and block trade in Z Energy – both purchased at valuations we deemed to be attractive.

While we posted a positive performance in our Australian portfolio over May, our lack of Bank holdings cost us in a relative sense. Banks gapped up on the open on Monday immediately after the Liberal Coalition's 'miracle victory'. They were up 8% on average on the opening bell as Labour's policies around negative gearing and imputation rebates were taken off the table. To compound the rally, the regulator then sanctioned looser bank lending standards later that week. This was again a major surprise to us, coming only 3 months after the Royal Commission's scathing review of lending practices.

An expanded investment team evaluating more investment opportunities abroad has strengthened our view that more attractive returns are available outside New Zealand. For now, Trump's twitter feed and actions are controlling markets. While current uncertainty has not changed our view on the merits of offshore diversification long-term, we are increasingly favouring companies less reliant on trade with the US.

Top 10 Holdings

Spark	4.1%
A2 Milk	3.6%
TILT	3.3%
Z Energy	3.1%
Amazon	2.6%
Contact	2.6%
Google	2.0%
Infratil	1.9%
EBOS	1.7%
Treasury Wines	1.5%

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