

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

	Aspiring Fund	NZ50G	ALL Ords Accumulation Index (rebased in NZ\$)
<u>Short-term returns</u>			
Month	0.35%	0.50%	0.72%
Last 3 Months	4.24%	4.73%	5.99%
Last 12 Months	15.07%	18.70%	21.86%
Financial Year to Date	8.91%	13.76%	6.93%

Long-term* returns and volatility

Return (annualised)	11.13%	6.61%	2.99%
Return volatility (annualised)	8.69%	11.59%	16.44%

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

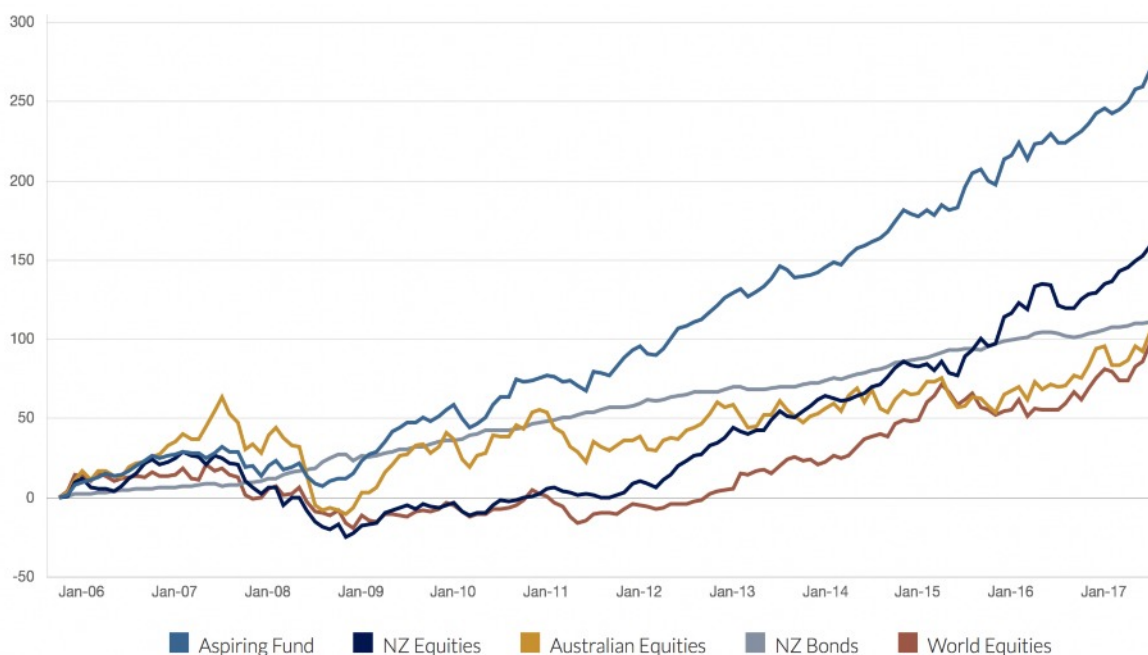
Unit Price \$3.48

ASSET ALLOCATION (approximately):

New Zealand Equities	37.8%
Australian Equities	20.9%
International Equities	14.8%
Bonds	3.2%
Total Cash	23.2%
Short Equities	-2.3%

Net Asset Value of the Fund (approximately): 375.8m

Fund Performance



The Fund returned 0.35% in November. A stronger New Zealand dollar blunted solid contribution across our equities portfolios.

The NZ market's relentless march upward continued in November with the main index, the NZX50G, up 0.5% for the month and 19% for the year. The New Zealand market has now had 11 consecutive months of positive performance, the longest winning streak in the database we have maintained since the inception of the Fund in February 2006. This is following a global trend where the MSCI World is on track for its first 'all positive months' calendar year for over 30 years. The music is playing loud, and the dance floor is packed with dancers (many of them robots).

With such stellar returns and low volatility what could possibly go wrong with a sound "buy and hold" strategy? Well, quite a lot if we ever revert to historical norms.

When we assess market valuation we calculate a NZ market price to earnings ratio (P/E), which excludes retirement village operators (whose earnings are driven largely by property revaluations), and all loss-making companies. We also calculate the P/E ratio as the average of all eligible companies rather than a market-cap weighted average. We think this is a more robust data series than a market cap weighted index which can be heavily distorted by high index concentration of a few large companies.

On this basis, the average NZ P/E has reached a record high of 16.9x (our database includes data back to 1997).

The list of previous occasions when we reached these valuation extremes doesn't make for great reading when considering market returns that followed;

- June-97 (peak pre-Asian crisis), 16.7x and subsequent correction of ~30%
- May-07 (peak pre-GFC), 16.6x and subsequent correction of ~45%

Even as recently as September 2016 when the average P/E reached 16.8x we had a subsequent peak to trough correction of 9.8% over the next 6 weeks.

Extreme valuation does not automatically self-correct and we are not predicting a market wide sell-off. However the combination of high prices and low volatility suggests a level of complacency we do not share.

Like most observers we attribute the sustained period of asset price appreciation and low volatility to the liquidity supplied so liberally by the globally important central banks. New Zealand may not have enjoyed the limitless largesse of the Bank of Japan or the ECB but we have certainly experienced the 2nd round effects from international investors looking for alternatives to negative or minimal yields in their own markets.

It seems clear that the US Fed is going to start reducing its bond portfolio gradually in 2018 and some Fed governors have publicly commented on the possibility that their actions have helped contribute to an asset bubble. However, before we get too nervous, they have shown a consistently accommodating pattern of behaviour since the GFC and investors have been well rewarded for betting that this will continue until it doesn't.

Very similar to the rewards for investors betting that an expensive New Zealand market would just keep on getting more so over the past few years.

The poster child for this phenomenon last month was Ryman which accounted for 140% of the index's return.

The Auckland housing market continues to show signs of cyclical maturity. While price evidence continues to be mixed, suburb to suburb (the leafy suburbs still recording the odd eye-watering result at Auction), an overall clear trend has been weakening auction clearance rates. The Barfoot & Thompson Auction results for November show only 33% of houses sold on Auction night. More alarmingly ~45% of Auctions did not receive a bid. The Reserve Bank (RBNZ) has acknowledged softness in the property market by lifting LVR restrictions.

In spite of underlying property softness, Ryman blew through a resistance level of the past ~2.5 years and was up 14% for the month, driven by offshore buying. We took some medicine on a mid-sized short position – we appreciate and admire the success of Ryman, however are comfortable being on the other side of the trade as its price to book ratio nears 3x in a wavering property market. That is over \$3 billion of effective goodwill on the balance sheet of a property development company.

November was a relatively busy month for company reporting and annual investor days. While the company results were a mixed bag with a mildly positive tone, it would appear there has been a quick reversal in confidence following the change of Government as illustrated by November's ANZ business confidence survey hitting an 8 year low. In some respects, the survey result should not be hugely surprising with Labour / NZ First's plans to reduce immigration and raise the minimum wage by 30% over the next 4 years.

There is an argument that more money in the pockets of lower wage earners should be supportive to the economy - one can sympathise with the idea of giving it a go when contemplating the complete failure of trickle-down economics in any developed economy. However, it does have the potential to weigh on many businesses who will find it difficult to pass the added cost on, particularly as we close in on the longest economic cycle on record. Wage inflation risk is something we are now acutely considering for the Fund's investments.

During the month we reduced our position in Z Energy, a prior top-10 holding for the fund. Despite negative commentary surrounding ongoing Government commitment to investigate retail petrol prices, and news of a new entrant's proposed development of new terminal capacity in the South Island, Z shares were up +7.1% in November. We are cautious about the sunset issues of the business and therefore trimmed our position into the strength.

On the buy side, we added to Chorus - a company we continue to track closely. Chorus shares are now down ~12% from the middle of the year, and as a result offer much more appealing risk/reward. Broker research on Chorus was mixed during the month, but was more about valuation than the underlying

investment thesis. We are attracted to very strong long-term dividend growth and debt pay-down, and a current share price supported by the expected Fibre Network's regulated asset base.

In Aussie, we had decent wins in new listings Netwealth (44%), which operates an online platform for investment management, Propel Funeral Partners (26%), and a new position in technology company Appen (32%). Following strong recent performance, we sold out of our successful Speedcast International investment, a position we took on with a strong view on valuation. On the negative side our biggest hit came from a small holding in biotech company Living Cell Technologies. Trial results for its Parkinson's disease treatment showed no efficacy and we exited the position at half its book cost.

Our international portfolio performed well in a strong market. We continue to diversify our holdings by sector and geography. Progression on Trump's proposed US tax cuts removes an element of valuation downside risk for US equities, and we continue to see better risk reward in more liquid offshore markets.

Overall our equity weighting rose in November but we have subsequently taken profits in a few trading positions. December tends to be a quieter month for local markets with the second half becoming particularly illiquid amid a dearth of company news. However, summer holidays are only a serious distraction for the 10% of the world's population who live below the equator and we will be keeping a watchful eye on developments in the wider world.

TOP 10 HOLDINGS

Google	3.0%
Precinct Convertible Notes	2.7%
Amazon	2.3%
Metlifecare	2.2%
Sanford	2.2%
Chorus	2.2%
EBOS	2.2%
Contact	2.2%
Heartland	2.1%
Woodside	1.8%

Aspiring Asset Management Limited

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