

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

	Aspiring Fund	NZ50G	ALL Ords Accumulation Index (rebased in NZ\$)
<u>Short-term returns</u>			
Month	3.42%	2.72%	7.31%
Last 3 Months	6.31%	5.88%	10.30%
Last 12 Months	14.64%	17.03%	21.49%
Financial Year to Date	8.54%	13.19%	6.16%

Long-term\* returns and volatility

Return (annualised)	11.18%	6.62%	2.94%
Return volatility (annualised)	8.72%	11.64%	16.50%

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

Unit Price \$3.47

**ASSET ALLOCATION (approximately):**

New Zealand Equities	36.7%
Australian Equities	18.8%
International Equities	12.4%
Bonds	3.5%
Total Cash	28.6%
Short Equities	-2.5%

**Net Asset Value of the Fund (approximately):** 369.7m

# Fund Performance



The fund returned 3.4% in October. We enjoyed positive contributions from all our equity portfolios and a significant boost from our 30% unhedged currency exposures as the biggest immediate impact of the election outcome was a much weaker NZ\$.

Equity markets were the place to be in October as all major global indices posted strong returns. We took a slightly unusual step for us and built our Australian equity exposure by about 5% early in the month explicitly as a short-term trade. This briefly took our aggregate equity weighting to slightly over 75%. The decision proved to be correct and timely and we spent the rest of the month taking profits. The consequence of all this was month end weightings of 65% net equities and close to 30% cash (vs October starting point of 70% net equities and 24% cash).

While we can't identify any new immediate dangers on the horizon, markets remain at inflated levels, with plenty of risk still looming around interest rates, politics, and geo-political issues.

We also think there is a much bigger danger looming for equity markets generally - the rising popularity of ETF's and passive investment strategies which assume that the price of any individual equity is set by rational economic agents looking at the conventional metrics of valuation, prospects, risks etc. However, the influence of these pools of price-indifferent capital frequently swamps the influence of old-fashioned stock pickers meaning prices are being set by people or computers who are uninterested in valuation or risk. This will work fine until it doesn't but the longer it persists the more certain and spectacular the unwind is likely to be.

The big story in NZ was of course Winston's decision to push National out of Government in favour of a coalition deal with Labour, with the Greens providing confidence and supply. The NZ\$ fell sharply on the news and ended the month down 3% and 5% v the AUD and USD respectively. The NZ economy has shown signs of peaking for some time, and with the new government's immigration policy, we are due to lose at least part of our key economic growth component of the past few years – rampant population growth. Business confidence surveys have weakened, however the new government has set itself an aggressive plan focussed on spending, a turnaround from National's conservative fiscal policy setting.

Outside of a few key growth stocks, the NZ market continues to drag its feet, perhaps reflecting an

economy that has lost some steam, and perhaps more due to attractive opportunities being offered up offshore for the international investors which own a sizeable (~50%) chunk of our market. The NZ50G's 2.7% print reflects a continuance of 2 divergent story lines - weak large cap stocks (top 10 stocks by market cap up just 0.1% and 4% over the past 12 months), and a small group of growth stocks which continued their remarkable run in October.

While we like these growth companies, we also can't ignore the price to be paid for them – in terms of price / earnings multiples, Xero, which remains unprofitable, is trading on 63x FY2019 profit (consensus estimates), with A2 Milk and Fisher and Paykel at ~40x and Synlait at 23x FY2018 profit (far above Synlait's historical average PE of 15x).

A2, by itself, delivered over 67% of the New Zealand market's 2.7% return for the month but the modesty of our holding meant a proportionately modest contribution to fund performance. By month end we had trimmed our exposure to what is now a very small holding for the Fund. Contact Energy, our largest position, was up 5% and we also had a decent win in NZ King Salmon which was up 27%.

The biggest hit to the NZ portfolio's performance came from Green Cross Health which was down 10% on news that Aussie discount pharmacy retailer Chemist Warehouse is opening its first store in Auckland imminently. Green Cross has fallen 35% from a high of \$2.95 in mid-2016, seemingly from competitive threats in the form of the Chemist Warehouse and Amazon, and the potential for deregulation of the pharmacy industry. While we are attracted to the company's strategic positioning being a major player in Pharmacy, Medical Centres and Community Health, we appreciate it will take time to extract value out of this position and the current price reflects the more imminent competitive threats on the horizon.

We were pleased to outpace a strong Aussie market as our portfolio again showed strength across the board, up ~7% in A\$ v the market return of 4%. Key contributors were Bluescope Steel (17%), Fairfax (16%) and Mantra (22%). Our collection of mining services stocks continued their strong run as the major miners extended period of deferred capex comes to an end. Bluescope appears to be playing catch up after being sold off, we think too harshly, after its result, and the market is now paying for the significant growth opportunities in front of it.

Fairfax is in favour as it prepares to separately list its online real estate portal Domain, the growth component of its business. Fairfax will continue to hold a majority stake in Domain post-separation and much of the recent push up in Fairfax's price will be a result of investors ensuring they hold a piece of Domain on listing. We think the price more than compensates for this opportunity and have since exited what has been a very good trade.

As noted, we had a good win in Mantra due to the takeover bid from French hotel group Accor at a 23% premium, at which point we banked our profits and exited the stock with the outcome of the bid not being decided until next year.

Our international portfolio had another very strong month with Amazon (15%) and Google (6%) both reporting strong quarterly numbers. As with the Aussie portfolio, the strength however was largely across the board with our collection of payment providers and Facebook all continuing on with their upward march as growth stocks in general continue to be rewarded by the market. The biggest drags on the international portfolio were Baidu which fell 10% on a result which did not meet the market's lofty expectations (it was down only 1.5% for the month) and Gogo which is being sold aggressively by short-sellers. However both of these positions are much smaller than our larger exposures - Google's price appreciation and the NZ\$ weakness against the US\$ made it the Fund's biggest holding by month end with Amazon also in the Top 10.

As our month-end asset allocation suggests, we are still struggling with the ratio of risk to reward in equity markets generally and New Zealand specifically. It is early days for the new government but the policies announced so far signal a more significant move to the left than we had expected.

November is a busy time for us as it is a significant month for company results. We always hope to find new investment opportunities through this process but current valuation levels mean we should probably be grateful to get through the month without any major disappointments.

## TOP 10 HOLDINGS

Google	3.0%
Precinct Convertible Notes	2.9%
Contact	2.8%
Metlifecare	2.3%
Sanford	2.2%
EBOS	2.2%
Amazon	2.2%
Heartland	2.0%
Mainfreight	1.9%
Z Energy	1.8%

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