



REPORT TO THE UNIT HOLDERS IN THE ASPIRING FUND FOR THE  
MONTH OCTOBER 2018

	Aspiring Fund	NZ50G	ALL Ords Accumulation Index (in NZ\$)
<u>Short-term returns</u>			
Month	-4.84%	-6.40%	-6.99%
Last 3 Months	-2.08%	-1.90%	-6.45%
Last 12 Months	3.27%	7.44%	-0.05%
Financial Year to Date	5.17%	5.21%	5.07%

Long-term\* returns and volatility

Return (annualised)	10.45%	6.69%	2.67%
Return volatility (annualised)	8.64%	11.44%	16.09%

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

Unit Price \$3.58

**ASSET ALLOCATION (approximately):**

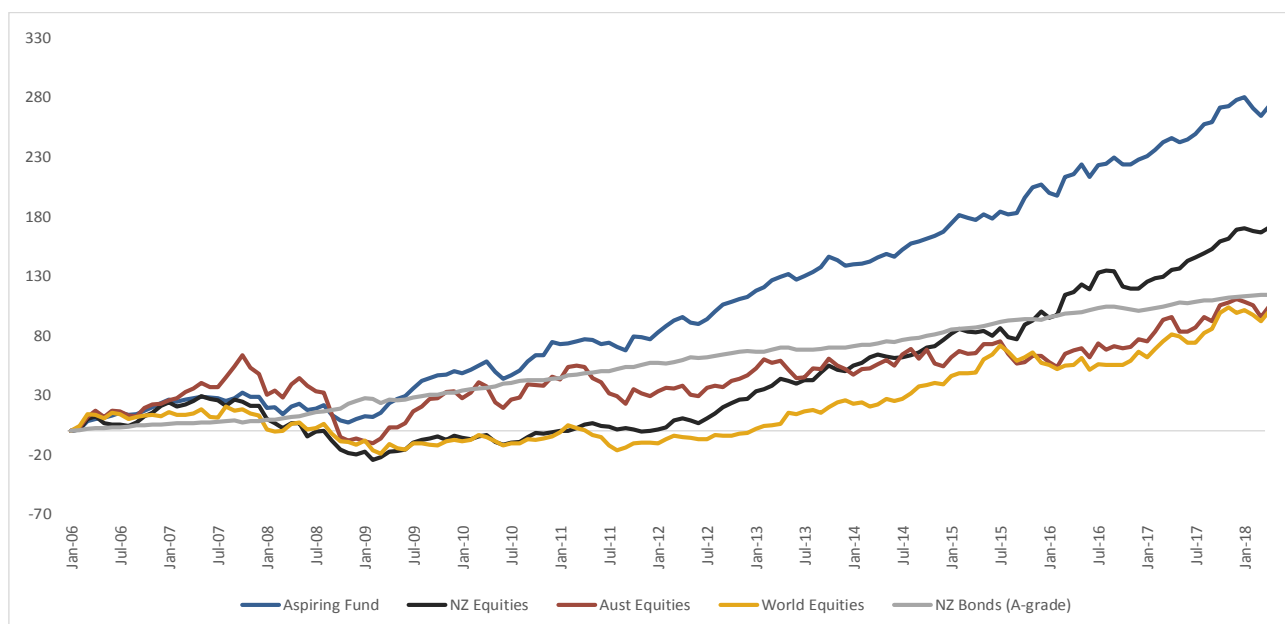
New Zealand Equities	34.7%
Australian Equities	20.0%
International Equities	8.9%
Bonds	3.3%
Total Cash	33.0%
Short Equities	-0.6%

**Net Asset Value of the Fund (approximately):** 409.5m

*The fund's main direct currency exposures at month end were - NZD 63%, AUD 23%, USD 14%*



# Fund 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 returned a very disappointing -4.84% in October.

It was a month to forget for share investors across the globe. The benchmark MSCI World Index fell 7.3% in the month, its largest monthly decline since May 2010. Although we had positioned the Fund with a lower equities holding, every dollar of risk invested was a dollar too much.

The New Zealand share market was not spared, the benchmark NZ50 index was down 6.4%. The average stock fell 5.6% putting average year to date returns at a meagre 2%.

While initially attributed to the short lived rise in US bond yields, the sell-off more simply can be defined as a broad-based global risk off correction. The tide went out. Defensive sectors outperformed but still fell (Property - 3%). The riskier end, including the momentum epicentre of Large Cap US Tech, suffered double digit declines. Very strong US third quarter results with stimulus induced year on year earnings growth of over 20%, was overshadowed by more conservative company outlook statements.

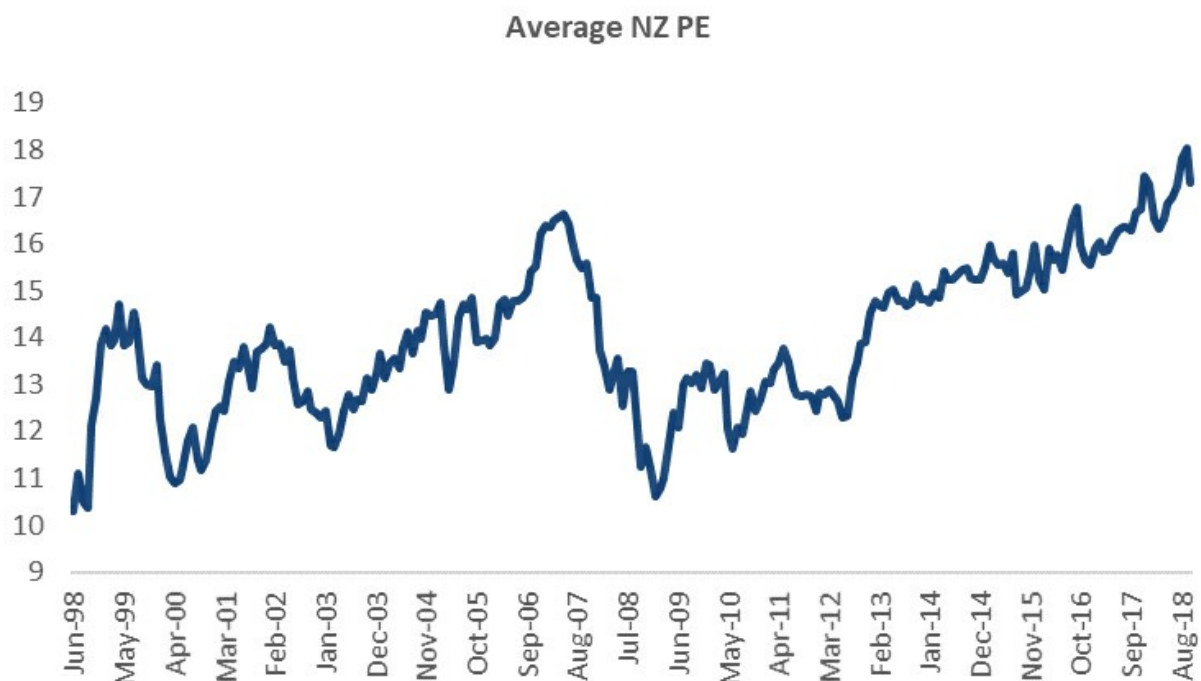
At monthly lows; Asian Equities (ex-Japan) were down 11.8%, US Equities fell 11.3%, World Equities and NZ shares were down 9.6% and 9.3% respectively.

Further reinforcing our view the low volatility of recent years is behind us, the US benchmark S&P500 had very large performance swings. Average daily trading ranges of 1.6%, were 3x the average of 2017. Moreover, the index had 9 days with greater than 2% moves, bringing the year to date total to 25 - a level not seen since 2011.

Just as investors were fearing the end of TINA (there is no alternative), equities turned higher at month end. Importantly Bloomberg data shows retail investors remain astonishingly resilient - with no clear evidence of net selling of exchange traded funds (ETFs). While TINA lives on, we remain wary of the pick-up in volatility, signs of slowing earnings momentum, and threat of higher interest rates.



Despite the down-draught few new opportunities emerged in NZ given high valuation starting points. This is best demonstrated in the chart below.



The average price to earnings ratio (PE) of NZ equities started the month at record highs (+18x), and ended at levels seen only 3 months ago (which at ~17x was then at near record highs). This contrasts to World Equities which fell to 14.1x, importantly crossing its historical average of 15.5x despite today's supportive low interest rate environment.

Outside the lack of absolute and relative valuation comfort, we remain increasingly concerned with the apparent low turnover of NZ shares across the trading day. While not directly visible in monthly trading statistics, we believe the underlying quality of NZ liquidity has deteriorated this year. With offshore led investment markets and high overseas ownership of NZ shares, we will continue to keep an eye on global ETF movements.

The Nasdaq, down 9%, registered its worst month since November 2008. A combination of caution and luck saw us sell half of our international portfolio early in the month, taking advantage of the massive liquidity in this portfolio and relatively low trading cost to de-risk the Fund. In risk off mode, the market took no prisoners for stocks that have enjoyed the upside of markets. Mastercard was down -17% at its lows after beating both consensus revenue and earnings estimates (profit growth topped 30%). Amazon had a quarter of its value wiped off during the month. It reported a strong result, well beating on earnings and only slightly missing revenues. But more cautious forward guidance fueled investor sentiment looking for reasons to sell.

Local investors were in a similar mood with high multiple Australian stocks - Kogan -50%, Corporate Travel -34%, Afterpay -30%, Wisetech -27% and Appen -24%. Fortunately, we have avoided this space by largely containing our higher risk growth holdings to our international



portfolio - where we see more quality and scale, and better investor and analyst coverage.

Our Australian portfolio fared worse than the market, weighed down by our three housing and construction related exposures which in total cost the Fund 0.54%. Aussie bank credit tightening is clearly weighing on the sector. Sydney house prices were down 7.4% year on year in October, and Melbourne down ~5%. UBS data shows current housing sales (as share of total housing stock) are now approaching 30-year lows. More domestically focused developers were down double digit, and unfortunately our three more diversified stock holdings were hit hard. Waste management company, Bingo, was down 24%. We rate the management team and view the company as attractively priced for its medium-term growth opportunities. Despite maintaining FY earnings guidance, Boral was down 19% in the month. James Hardie was down 10% and continues to closely track its US listed counterparts.

Our NZ equities portfolio, despite having no holdings in the lower risk property sector, performed significantly better than the benchmark return. This was borne out by 1) less exposure to New Zealand's high multiple/momentum large caps, and 2) a bias toward more defensive high dividend payers. The first leg of this strategy worked well, and we in fact took the opportunity to upweight A2 Milk. The second leg, was impacted by our position in Z Energy – which negatively impacted the Fund's October return by 0.4%.

Marked down following the Prime Minister's claims that the NZ public were being "fleeced" by fuel retailers, Z Energy shares sank to near 3-year lows following the release of disappointing quarterly volume data. The only bright spot was market share losses to independent operators supporting the company's assertion of a competitive market.

The Z price has taken a further step down after it lowered FY19 profit and dividend guidance. Despite a number of current one-offs impacting profitability, Z's elevated gearing after the successful Caltex acquisition has provided them with limited ability to smooth the near-term dividend. We believe the share price has over reacted given the significant amount of cashflow the company generates (when debt payments fade, this surplus cashflow will likely result in much higher dividends). But dividend yield stocks can have the tendency to look out only as far as the current dividend payment.

On a positive note, the Fund's bet on Tilt Renewables was further justified by ongoing progress with their Australian Development portfolio. Since the announcement of the current takeover offer, Tilt has released a stream of good news. This has seen a number of broker valuations creep up near the Infratil takeover offer price, with further upside scope from yet to be factored-in development options. We came away from our post result meeting with Tilt management comfortable with their ability to execute over the medium term.

It is difficult to be optimistic in an environment where sentiment turns sharply on a tweet. Against this, the October global selloff has cleaned-out a lot of the valuation premium we have observed building this year. In fact, there are now pockets of genuine value emerging. A number of quality US industrial stocks have de-rated to levels not seen for a number of years. China equities are now trading on a median PE ratio of 8.5x, which is quite extraordinary when considering growth, and the relative prices accepted for similar companies in more institutionalised markets.

Despite the late October rebound, we see no reason to change our outlook for markets. Namely; ongoing elevated volatility, and challenging near-term returns. We expect to maintain the Fund's cautious level of equity exposure until the risk/reward trade-off improves. History shows that markets can quickly move from being expensive to cheap.



## Christchurch Office Closure / Auckland Office Consolidation

We closed our Christchurch office in October and have now consolidated our operational function into our Auckland office with both Marian Crookbain and Liz Jackson relocating to Auckland. Stephen will be available for meetings in Christchurch. Please use the following contact details for all queries going forward:

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### Top 10 Holdings

Contact	3.3%
Precinct Convertible Notes	2.5%
Meridian	2.5%
A2 Milk	2.2%
Z Energy	2.1%
Sanford	2.1%
Metlifecare	2.1%
Fletcher Building	1.7%
Apple	1.6%
Cleanaway	1.5%

If you have any questions or feedback in relation to the newsletter, please [email the team](#).

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For further information please read/request a copy of the Product Disclosure Statement for the Aspiring Fund (available at [www.aaml.co.nz](http://www.aaml.co.nz)) or contact Aspiring Asset Management..

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