

Newsletter



New Zealand Universities' Superannuation Scheme

February 2009

Welcome to the first Scheme newsletter of 2009. Last year was characterised by turbulent financial markets, which took their toll on most major economies. Unfortunately this year's forecast is also gloomy, with most experts predicting significant losses to continue into 2009.

What's the latest in the financial markets?

Sharemarkets plummeted as the financial crisis intensified leaving several countries sliding into recession in its wake ...

There are a number of benchmarks by which a recession can be determined, but the standard indicator tends to be when a country's gross domestic product (total output of goods and services) falls for at least two consecutive quarters. Simply put, it's a continued period of decline in economic activity, which is what many economies around the world are currently experiencing.

The October 2008 newsletter outlined how the US sub-prime mortgage crisis quickly snowballed into an economic crisis on a global scale. The big news at that stage was the downfall of a number of well known financial institutions at the hands of the sub-prime crisis, and the US government's US \$700 billion bail out package.

By November the US government had pumped a further US \$800 billion into the US financial system and major financial institution, Citigroup, had received government assistance.

Similarly, governments around the world have developed multi-billion dollar rescue plans in an attempt to alleviate pressures and restore consumer confidence.

Has this been enough?

Despite recent efforts to restore confidence and stability, sharemarkets remain unstable. Following on from the many financial institutions crippled by the financial crisis, one of the latest victims appears to be the US auto industry.

Two of the 'Big Three' US automakers, Chrysler and General Motors, appealed to US Congress for multi-billion dollar bailout loans, saying they would go under without an immediate cash injection. In December they won approval for a combined US \$17.4 billion government loan to avoid collapse. Ford is in a better position, and has forgone seeking a loan from the government, but has requested access to a \$9 billion credit line in case the situation worsens significantly.

Against the backdrop of such an intense global financial downturn, unemployment figures have also soared. By the end of 2008, the US economy had lost a net 2.6 million jobs. Economists have predicted that at least another 2 million jobs will be lost this year despite newly elected President Barack Obama's latest US \$827 billion recovery package of increased government spending and tax cuts, which is designed to create new jobs.

Economists in New Zealand have predicted a net loss of around 50,000 jobs through 2009, which will push the unemployment rate to above 6%.

Slashing interest rates to ease pressures

New Zealand joined policy makers around the world cutting interest rates in a bid to lower the cost of borrowing and encourage economic activity to stimulate the flagging economy. The New Zealand Reserve Bank has cut its official cash rate by almost 5% over the last six months.

The most recent cut was 1.5 points, to a record low of 3.5%. This prompted major banks in New Zealand to cut their interest rates, after Reserve Bank Governor Alan Bollard appealed to banks to slash their rates as well.

The impact of the financial crisis on the Scheme

Superannuation funds, including the NZUSS, have been deeply and severely affected by this significant slump in the markets. When you receive your annual report this year, you are likely to be faced with something the Scheme's annual report hasn't shown for a few years – negative returns.

The Scheme has faced a challenging year. As you can see from the following table, the financial crisis has impacted different investment options to varying degrees. Hardest hit were those options with a higher percentage of investments in growth assets (shares and property), which have been on a rollercoaster ride over the past 12 months.

Investment Option	Returns (after tax and expenses) to 31 December 2008	
	3 months	Scheme Year
Cash	1.24%	5.61%
Conservative	-2.64%	-5.54%
Balanced	-8.11%	-15.94%
Growth	-13.79%	-25.72%

Note:

The rates for the year to 31 December 2008 are not final and are likely to change.

Interest is applied on a daily basis throughout the year. The actual interest rates applied to your account balances may vary from those shown above.

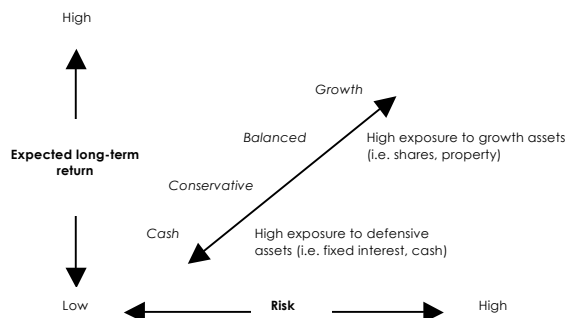
Past performance is not necessarily a guide to future performance and care should be exercised not to make decisions based on past performance only.

The Cash option, with a 100% investment in cash, provided the only positive return. So significant has this downturn been that even the Conservative option, with minimal exposure to growth assets, posted negative returns.

The Trustees' response

The Trustees are closely monitoring the financial crisis and its impact on the Scheme. The Trustees actively evaluate the performance of each fund manager, who reports monthly to the Trustees and periodically meets with them. At each Trustees' meeting during the year the investment adviser provides a report on the performance of all funds and at their first meeting each year the Trustees undertake a formal review of the performance of all funds under investment.

Asset allocation is the key factor behind your investment option's performance. The diagram below illustrates the relationship between exposure to growth assets and the effect a downturn in the markets will have. Growth assets are considered higher risk, because of their vulnerability to volatility.



As you can see, the risk of a negative return varies according to the asset allocation of your investment option – the more growth assets you invest in, the greater the chance of a negative return.

The Trustees aim to manage the Scheme's risk profile so that the rate of a negative return meets the benchmark set for each investment option. The table below shows the frequency of a negative return that you can expect for each investment option.

Investment option	Frequency of a negative return
Cash	Very unlikely
Conservative	Once every 8.6 years
Balanced	Once every 5.1 years
Growth	Once every 4.1 years

Remember though, investment options that invest in growth assets will generally post significantly higher returns in the long term than options investing heavily in defensive assets.

Understanding your investment returns

For a full understanding of your superannuation's performance, it's important to understand how each asset class has been affected by the financial crisis.

Returns for global property were the hardest hit, reflecting difficulties with debt financing. Central to this is the reluctance of banks to lend money and the consequent freezing of credit markets. Because debt financing is critical to most major property developments, the credit crisis has had major implications for global property.

Trans-Tasman property encountered similar problems, with a number of building projects put on hold due to the difficult market developers are facing. However, some analysts anticipate that the major interest rate cuts prompted by the financial crisis may start to have

noticeable positive effects on the property sector as loans become more affordable.

Global sharemarkets also suffered, with financial institutions particularly affected, reflecting investors' concerns about asset write downs and exposure to sub-prime lending.

The New Zealand sharemarket followed the trend of overseas sharemarkets, although the steep fall in the New Zealand dollar to some degree offset the effect of the downturn.

International fixed interest was also hit by escalating global credit concerns. In a bid to alleviate pressure in the market, government and global central banks have intervened but this has not been enough to quell worries around further collapses of financial institutions and inflation.

On the other hand, New Zealand fixed interest produced sound results, benefiting from investors moving away from riskier investments and lower interest rates. (Fixed interest investments benefit when interest rates fall because the security retains the interest rate applicable at the time of issue.)

Despite interest rate cuts, cash also continued to provide sound returns as banks held extra cash and ceased to lend to each other as freely as previously.

Thinking of changing your chosen investment option?

It's always hard watching the value of your investments drop, and feeling powerless to stop it. If you're thinking of moving your investments into a 'safer' option there's a number of issues you need to consider to ensure you make a rational decision, not an emotional one.

Before you make any decisions about your savings, it's suggested you talk to an independent professional financial adviser to help you make a well informed decision tailored to your individual circumstances. Such an adviser can offer financial expertise and an in-depth understanding of the various investment options and the associated risks and returns, and help you develop an investment plan that best suits your needs.

Outlined below are a number of factors you may also like to consider.

The strength of the Scheme's performance in previous years. Sometimes when faced with such drastic losses it's easy to forget the strong returns of previous years. The Scheme has enjoyed positive returns for all investment options over the past few years, which is helping to offset the impact of the global financial crisis to a certain extent.

Volatile markets can work to your advantage. Keep in mind that when the underlying value of investments is low, your superannuation contributions have greater buying power.

Investment losses are only realised when you sell. While on paper the value of your superannuation accumulation is decreasing, it only becomes a reality if you elect to cash in your investments, as you are allocated the value of each unit at the date you sell.

Switches need to be planned. Studies have shown many investors make a move to other investment options at precisely the wrong time and miss a significant part of any market recovery. The biggest market gains tend to be over a short period of time so any switches you make could mean you miss a major surge in the markets.

If you do decide to switch investment options, you may want to think about the following when making your decision...

- When you plan to retire
- How much you will need on retirement (check out www.sorted.org.nz for useful calculators)
- The amount you currently have invested
- Your tolerance to risk
- Your new investment strategy

Legislative changes to tax rates and KiwiSaver

The new government is implementing further tax cuts and changes to KiwiSaver. The changes are outlined below.

Change to the fund withdrawal tax

The earning threshold for fund withdrawal tax has been increased from \$60,000 to \$70,000. (Refer to page 18 of your Super Guide for further details of fund withdrawal tax.)

Key changes to KiwiSaver

Changes to KiwiSaver take effect from 1 April 2009:

- The minimum member contribution rate will reduce from 4% to 2%;
- Compulsory employer contributions will be capped at 2% of salary. These were scheduled to increase by 1% each year and to be capped at 4% from 1 April 2011;
- The exemption from employer superannuation contribution tax will be capped at the compulsory employer contribution rate of 2%. Previously the exemption was capped at 4%;
- The KiwiSaver Act has been amended to make it clear that if an employee joins KiwiSaver, his or her gross pay cannot be reduced to take account of any compulsory employer contributions.
- The member fee subsidy of \$40 p.a. will be discontinued;
- The employer tax credit of \$1,042.86 will be discontinued.

The member tax credit of up to \$20 a week, \$1,000 kick-start, mortgage diversion, home deposit subsidy and the first-home withdrawal provision will all remain as they currently are.

Subsequent changes to the NZUSS

The Trustees have amended the NZUSS to reflect the changes to the minimum contribution rates to KiwiSaver. A detailed explanation of the changes is set out in the Variations Notice included with this newsletter. The following is a brief summary and should be read in conjunction with the Variations Notice.

The minimum contribution to the NZUSS continues to be 4% of a salary. However, provided that legislation applicable at the date this newsletter was prepared continues to apply, the complying fund rules permit and certain other technical requirements are met, the minimum contribution may in part be made up of employer contributions.

From 1 April 2009, to make up the minimum contribution of 4% of salary:

- Unsubsidised CFA members may reduce their contribution to the NZUSS to 2% of salary (which will be directed to their Locked In No.1 Account) and have the balance made up by their compulsory employer contributions of 2% of salary;
- Subsidised members may reduce their own contributions to 3% of salary and have employer contributions of 1% of salary make up the minimum;
- Subsidised CFA members may reduce their contribution to their Locked In No.1 Account to 2% of salary and direct the balance to their Member's No.1 Account;
- CFA members may change their contribution rate to their Locked In No.1 Account (to either 2% or 4% of salary) at any time by completing and returning a 'Change of Member Details' form one month before they wish any change to take effect;
- CFA members may direct voluntary contributions to their Locked In No.1 Account. This allows a member whose contributions to his or her Locked In No.1 Account are less than \$1,042.86 (for a 1 July to 30 June year) to make a lump sum contribution and receive the full matching member tax credit of \$1,042.86.

Trustee changes

Wayne Morgan has been re-appointed as a Trustee of the Scheme for a further three years.

Jonathan Blakeman resigned as a Trustee, effective 24 December 2008. The Trustees wish to welcome Adrienne Cleland, Director of Administration at the University of Auckland, as Jonathan's replacement.

Adrienne has been with the University of Auckland in her previous role for nearly three years and has a wealth of management experience in the tertiary and finance sectors. Previously Adrienne has been Registrar at Massey University and a director of Kiwibank.

Looking for more information about the Scheme?

- Call **0800 UNIScheme** (0800 864 724)
- Visit www.superfacts.co.nz
(employer number 900106)