

SuperViews

From the office of the
Employee Representative
SAS Trustee
Corporation Board



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| The Investment Process

The SAS Trustee Corporation (Trustee) is responsible for the four closed NSW Public Sector Superannuation Schemes, State Authorities Superannuation Scheme (SASS), State Superannuation Scheme (SSS), Police Superannuation Scheme (PSS) and State Authorities Non Contributory Superannuation Scheme (SANCS), which have combined their assets to form the Pooled Fund (“the Fund”). The Fund is administered under the Superannuation Administration Act 1996 (“the Act”), which stipulates that the Trustee must outsource all investment functions to external service providers. Therefore the Trustee has appointed a master custodian to hold the assets of the Fund for safe keeping and has appointed an asset consultant to advise on investment strategy and recommend a mix of specialist investment managers in the various investment sectors.

As the Trustee is required by the Act to seek external advice and outsource the investment functions, it has been critical to develop a robust investment process to ensure that all the externally contracted parties actively contribute towards the Trustee’s goal, which is to look after members and their retirement benefits.

The investment process consists of a multitude of layers from broad macro directions to very specific micro instructions. The emphasis in this article will be on the broad macro framework rather than the day-to-day management tools.

| The investment responsibilities of the Trustee Board

The Trustee Board consists of nine members who are responsible for the policies and outcomes of the Fund. The Trustee Board meets on a monthly basis and specifically considers investment matters each quarter.

The investment responsibilities of the Trustee Board are split into four separate areas:

a. in relation to the investment and management of the Fund:

- (i) review the investment objectives and strategies of the Fund;
- (ii) review the asset allocation for each investment strategy of the Fund;
- (iii) appoint, review the performance of and terminate the Fund’s asset consultant, investment managers and custodian;

b. in relation to monitoring investment managers:

- (iv) review the Fund’s investment portfolio results at least each quarter;
- (v) monitor the reporting arrangements of investment managers;
- (vi) monitor and deal with breaches of investment mandates;

c. monitor investment governance issues; and

d. review its own performance against its responsibilities.

The organisations involved in the investment process

POLICY DECISIONS REST WITH THE TRUSTEE BOARD, WHO ARE ADVISED BY AN ASSET CONSULTANT.



DECISIONS ARE THEN IMPLEMENTED BY THE STC EXECUTIVE, WHO COORDINATE THE ACTIVITIES OF THE CUSTODIAN AND THE FUND MANAGERS.



Asset Classes	Funds Managers
Australian Shares	Alliance Capital Australia Ltd AMP Capital Investors Limited Barclays Global Investors Australia Limited Deutsche Asset Management (Australia) Ltd GMO Australia Limited Maple Brown Abbott Limited NSW Treasury Corporation State Street Global Advisors, Australia, Ltd UBS Global Asset Management (Australia) Ltd
International Shares	ABN Amro Asset Management (Australia) Ltd Fidelity International Limited BIAM Australia Pty Ltd Capital International, Inc Wellington International Management Company Pte Ltd State Street Global Advisors, Australia, Ltd
Private Equity	Deutsche Asset Management (Australia) Ltd
Property	Deutsche Asset Management (Australia) Ltd
Australian Bonds	State Street Global Advisors, Australia, Ltd
International Bonds	State Street Global Advisors, Australia, Ltd
Cash	State Street Global Advisors, Australia, Ltd

- **Risk Objective 1:** To have monthly returns (measured over 3 year periods and longer) in the second quartile relative to the managers in the InTech Growth Funds Survey.
- **Risk Objective 2:** To target 3 year rolling returns which vary less than 1.5% from the median manager in the InTech Growth Funds Survey.

From December 2003 three additional Investment Strategies have been available to SASS contributors for their personal account balance and for deferred member accounts. These new strategies are: Balanced Strategy, Conservative Growth Strategy and Cash Strategy.

The objectives for the three new investment options are structured on the same basis. They have a return objective being a margin above CPI to be achieved over 3 – 7 years depending on the risk profile of the product. They also have a competition based objective to achieve returns that are comparable to returns generated for members of other funds. The target is to achieve this objective over periods in excess of 3 years.

While the investment objectives may not always be achieved in all time periods, they remain the long term targets for the Funds Strategies.

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Setting investment objectives

The starting point when developing an investment strategy is to define a set of objectives, which should be realistic, in line with the funding requirements and achievable over a given time horizon.

For the Growth Strategy, which was previously the only investment option in the Pooled Fund, the Trustee Board has adopted four objectives, being two return and two risk objectives.

The objectives for the Growth Strategy are:

- **Primary Return Objective:** To outperform the Consumer Price Index (CPI) by 4.50% p.a over rolling 10 year periods, with an expected probability of 70%.
- **Secondary Return Objective:** To outperform the median manager in the InTech Growth Funds Survey over rolling 3 year periods and longer.

Strategic asset allocation

With the objectives defined, exhaustive testing goes into developing appropriate strategic asset allocations for the various risk profiles.

Asset allocation is the distribution of investments among various asset classes (shares, property, fixed interest and cash). The input to the asset allocation process is long-term expected returns and historical volatility for each asset class plus a measure of how each asset class has moved historically relative to the other asset classes. The output is an allocation to the various asset classes based on long-term historical trends. As we all know history does not necessarily repeat itself every 3, 5 or 10 years, so scenario testing is an important part of this process. The possible outcomes of the asset allocation are mapped, to see how they would perform if the “unthinkable” were to happen. These test results are then presented to the Trustee Board, which adopts an appropriate strategic asset allocation.

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The good the bad and the ugly years

It is important to emphasise that a strategic asset allocation is not about picking which market is likely to out perform over the next 3 – 6 months. It is about identifying a combination of assets, which has a reasonable probability of generating CPI plus a margin over time. The objective will unfortunately not be achieved in a nice straight line of consistent returns year after year. There will be good, bad and ugly years. Because there is a high level of uncertainty in investment markets, especially in the short-term, it is very important to have a reference point and that is exactly what the strategic asset allocation represents.

Rebalancing the asset allocation

Movements in investment markets will make the weight of each asset class in the portfolio bounce around. To avoid an asset class deviating too far from its strategic target, the Trustee Board has for many years operated with a passive re-balancing program. Currently the rules are that once an asset class deviates by more than 3 percent from its target, it is automatically brought back to a 2 percent deviation. A re-balance does not happen very often, but when it happens it tends to be when a market has trended either up or down for a period of time.

The table below sets out the strategic asset allocation for each of the options available as at 2004.

	Investment Options			
	Growth	Balanced	Conservative Growth	Cash
Strategic Asset Allocation				
Growth Assets	74%	50%	30%	0%
Income Producing Assets	26%	50%	70%	100%
Target Sector Allocation				
Australian Equities	38%	25%	13%	–
International Equities	27%	18%	10%	–
Property	9%	7%	7%	–
Australian Fixed Income	12%	20%	20%	–
International Fixed Income	8%	20%	20%	–
Short Term Securities	6%	10%	30%	100%

Strategy review

The Trustee Board reviews the strategic asset allocation at least once a year. As part of the strategy review, the Trustee Board must ensure that the risk profile adopted for a strategy is maintained down to the sector and the manager level. The overall risk profile is like a risk budget and the challenge is to use that budget most efficiently by aiming to get the best possible return given the risk constraint.

In some sectors active management has on average been rewarding over the medium term. In these sectors the Trustee Board, in conjunction with their asset consultant, have put together a number of active mandates with quite specific targets for managers to achieve over a defined time horizon. By contrast, in sectors where there has been little reward for active management, the Trustee Board has chosen to be fully indexed. It means the manager basically replicates the appropriate index such as the ASX 200 and therefore performance closely tracks the index.

Managing the managers

To ensure that all managers operate in accordance with the Trustee Board's investment philosophy, each of them are given very prescriptive investment guidelines known as mandates. These documents clearly define what the Trustee Board expects of a manager, the kind of investment instruments they can use, the maximum they can invest in an individual security, sector or country in the case of an overseas mandate. These documents also convey the Trustee Board's stance on corporate governance and will request that the manager votes all shares it holds on behalf of the Trustee Board, if that is applicable for the mandate.

It is important to emphasise that the investment guidelines are not just words on paper. The Fund's custodian monitors each manager's compliance with their specific guidelines and any breaches are reported to the Investment Committee on a quarterly basis.

Monitoring manager performance

The final part of the investment process is the monitoring and evaluation of the investment managers. This process is ongoing and is discussed at the monthly Board meetings as well as the quarterly Investment Committee meetings. At these meetings, the Trustee Board evaluates the product performances, the manager combinations and the performances of individual managers. This way it is possible to quickly identify if a manager is not performing as expected and appropriate action can be taken. The first step is generally to ask the asset consultant to take a closer look at the manager. If the asset consultant's assessment of the manager is unfavourable, then the manager may be asked to present to the Trustee Board, so the Board can directly convey their concerns to the manager.

From time to time it has been necessary for the Trustee Board to terminate managers. However, it is not something the Trustees rush to do on the basis of short-term under performance. Once a manager is part of a sector's manager combination, they have a specific function to perform. That is, the manager was chosen for a reason and unless they are deemed unlikely to deliver in accordance with expectations, a manager will be given a reasonable amount of time to improve their performance.

Are we on the right track?

Finally, the Trustee Board formally reviews its own performance once a year, to make sure it is on track to deliver on its fiduciary responsibilities to members.

In summary, the Trustee Board has a disciplined investment process, which is created around realistic goals and a simple framework based on diversification. The consequence of diversification is that investments have been spread across asset classes, and managers, and therefore clear communication and team work are essential for the process to work. It is important to emphasise that both the investment process and the investment structure are evaluated on an ongoing basis. The question is constantly being asked "Are we on the right track?" to ensure the total framework is efficient and has a high likelihood of delivering solid returns for all the stakeholders of the Fund.

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Investment Update – September 2004

During the September quarter the Pooled Fund's Growth strategy continued the positive trend seen in the previous 3 quarters. The investment return was 1.6% for the quarter, and 12.0% for the year ended 30 September 2004.

Net Investment Returns	December Quarter 03 %	March Quarter 04 %	June Quarter 04 %	September Quarter 04 %
Pooled Fund (Growth strategy)	3.2	2.5	4.2	1.6

The performances for the quarter and the one year relied heavily on the strong performances generated in the Australian share market and in particular in the listed property trust sector, which returned 20.7% and 29.0% respectively. The Australian share market finished the month on an all time high, and continued its record breaking run into October. The market was benefiting from solid results during the reporting season combined with further rallies in commodity prices.

The spike in oil prices to around US\$50/barrel was good for certain segments of the share market, but as consumers it was painful whenever we had to put petrol in the car. It was this negative impact on consumers around the world and their expected future ability to consume, which combined with a strengthening A\$ resulted in poor returns from international shares during the September quarter 2004.

Over the past 5 years the Growth strategy returned 4.9% p.a., which was roughly in line with what a cash option would have returned over the same period. It means that over this particular 5 year period, investors have not been rewarded for taking risk. Another way of expressing it is to say that investors have had a growth option, which did not pay off, but did not have a big opportunity cost either.

The thing to remember is that the performance figures – even the medium to long-term ones can quickly change. In fact, they are already changing, because investment markets have been strong over the past 18 months, which has translated into a 2 year return of 9.6% p.a. for the Growth strategy. This is significantly better than the return of a cash product, which would have generated returns between 4.5 – 5.0% over the same period.

Net Investment Returns/Strategy	3 Months %	1 Year %	3 Years % per annum	5 Years % per annum
Growth	1.6	12.0	4.4	4.9
Balanced	2.1	N/A	N/A	N/A
Conservative Growth	2.0	N/A	N/A	N/A
Cash	1.2	N/A	N/A	N/A

Past performance is no guarantee of future performance. The Trustee does not guarantee the performance of any product.

Asset Sector Index Returns (before allowance for tax and fees)

	3 Months %	1 Year %	3 Years % per annum	5 Years % per annum
Australian Shares (ASX 200)	5.2	20.7	10.8	9.0
International Shares (unhedged)	-5.0	9.2	-7.1	-3.8
Listed Property Trusts	5.4	29.0	15.2	14.2
Australian Fixed Interest	2.6	5.2	5.5	6.6
International Fixed Interest (hedged)	3.6	6.9	7.7	8.1
Cash	1.4	5.5	5.0	5.3

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Life after work — Start to plan for the rest of your life

It's an interesting fact that many of us will be retired longer than we have been active in the workforce. Australians longevity continues to increase, rising to 77.6 years for men and 82.9 years for women in the 2000 – 2002 census figures. More than ever, we need to consider and plan for our future. This takes time and thought, and ideally you should be considering your post retirement options at least two to three years before you intend to leave work.

Let's look at six key issues for planning your future.

- 1. Where do you plan to live?** This decision may have a number of implications for your future plans. If you plan to downsize, this may release a significant amount of capital for other uses. Alternatively, if you plan to stay where you are, what upkeep costs will be involved and will you be able to maintain your home? Another option is the 'sea change'. If you are considering this option, think about trying rental first. Finally, are there any health or family issues that may influence where you choose to live?
- 2. What do you plan to do?** Start considering how you will fill your time in retirement. You could consider volunteer work, returning to study, hobbies or sporting activities or part time work. Whatever you are considering, practice before you commit. It may be that although a trip around Australia in the 4-wheel drive sounds like a great idea, you may not like a traveling caravan lifestyle. Experiment beforehand while you have the resources.
- 3. Do you have any planned major expenses?** Are you planning a wedding, home renovations, an around the world cruise, a new car? Large expenses mean that you need to have access to an amount of capital. This can influence your investment decisions and your planned savings ahead of retirement.
- 4. What 'money to live on' do you need?** A budget is a vital planning tool. Your current spending patterns can give you an idea of what you may need to live on in retirement. To help you get started, visit our website at www.ssfs.com.au and download our budget planning spreadsheet. All you need to do is fill in the blanks each month and by the end of the year you will be able to see not only how much you are spending, but where you spend it.
- 5. Do you understand your superannuation options?** Understanding your superannuation scheme is a vital step in planning for life after work. It is important that you understand how to make the most of your superannuation, what benefit options may be available and any opportunity you have to increase your final benefits.
- 6. Do you have a financial plan?** A financial planner can help you develop a financial strategy that will assist you to achieve your post work goals. Your financial plan will act like a road map that will guide you to retirement and beyond. And because our lives constantly change, especially in retirement, you will need to regularly review your plan to ensure that it continues to meet your needs.

Financial Planning – The choice is yours

State Super Financial Services provides a quality financial planning service exclusively for current and former public sector employees and their families.

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