# Quarterly Report
# NPDC Perpetual Investment Fund

Q3 2020

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# Contents

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# Fund Overview

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# Fund Overview

| Fund size |
|---|
| $301.2m |

Returns (after fees and taxes)

| Since inception (Nov 2004) | 5 years | 1 year | 3 months |
|---|---|---|---|
| 6.6% p.a. | 7.7% p.a. | 3.8% | 4.1% |

Distributions to Council (Release payments)

| Since inception (Nov 2004) | 5 years | 1 year |
|---|---|---|
| $223.7m | $40.8m | $8.9m |

Nb – Implementation of Guardian and Full Outsource Agent (Mercer) model took effect March 1 2017. Results and distributions incorporate TIML results for period prior to March 1.

# Financial Market Update


Global equity markets continued their strong performance in July, supported by a better-than-expected earnings season in the US and continued fiscal support for households and businesses. Emerging markets outperformed, returning +5.3% (in unhedged NZD), ahead of developed equities which finished up +3.4%. NZ equities performed well, returning +2.5%. Monetary policy intended to soften the economic impacts of the pandemic drove a month of declining yields and positive returns in the global bond market (+1.0%). Accommodative monetary policy also aided the rally in gold with spot prices reaching all-time highs, and contributed to a weakening of the US dollar.

Continued improvements in global manufacturing data during August suggested that the rebound in activity was starting to gain momentum. Combined with an indication of persistently dovish central bank policies, equity markets performed strongly. Developed equities finished up +6.3%, while NZ equities were also positive, up +1.8%. Similarly benefitting from an increase in manufacturing activity, commodities were broadly positive with Crude Oil, Copper and Iron all experiencing gains. NZ Bonds continued to deliver positive returns (+0.8%), while global bond markets slipped in August (-0.7%) as rates rose.

Equity markets took note of considerable headwinds in September, losing ground after their widespread positive trajectory from their pandemic-induced lows. The upcoming US Presidential Election, resurgent Covid-19 cases in Europe and the US, and continued economic weakness all represented uncertainties contributing to developed equities declining in September (-2.9%). Bond markets benefitted from the risk-off sentiment with both global bonds (+0.4%) and NZ bonds (+0.7%) posting positive months.

Domestically, the level of economic activity remained significantly below levels experienced prior to the pandemic disruptions. On-going virus-led activity restrictions (most notably in Auckland) continued to dampen economic activity and both business and consumer confidence, while international border restrictions significantly affected migration and tourism. Ongoing support for domestic economic activity has been provided through significant government spending, however the removal of temporary support policies (such as the Wage Subsidy scheme) has already commenced. In response to these economic challenges, the Reserve Bank of New Zealand (RBNZ) continued its commitment to prolonged monetary support. The Monetary Policy Committee agreed to continue with its Large Scale Asset Purchase (LSAP) Programme of up to $100 billion in bond purchases. Additional monetary instruments such as a Funding for Lending Programme, negative OCR and purchases of foreign assets continue to be investigated as potential options should further monetary stimulus be required.

# Market Outlook

- Moving into the fourth quarter, the predominant market driver continues to be the pandemic and the extent to which countries try to arrest the spread of the virus. With new cases of Covid-19 showing no signs of abating and fears of second waves emerging in Europe (notably Belgium, Netherlands and France), questions arise around the severity of any lock-down measures to contain the spread of the virus and their resulting economic consequences. Additionally, progress on the development of a vaccine continues to create both market optimism and increased volatility.

- Focus on the US Presidential election on 3 November continues to escalate, when voters will decide whether incumbent President Donald Trump or Democratic nominee Joe Biden will lead the nation going forward. Current polling shows Biden leading the popular vote with 50% versus the 43% of Trump. The US Federal Reserve (the Fed) released their Federal Open Market Committee (FOMC) minutes for September which reinforced the prevailing view that due to the uncertainties ahead, more fiscal stimulus would be required and that interest rates are unlikely to move in the foreseeable future. Fed officials laid out a three-part test to be met before considering raising short-term interest rates from zero, which include labour markets meeting their maximum employment goals; inflation reaching 2%; and evidence that inflation will continue to run moderately above this 2% target.

- Domestically, economic activity continues to be supressed by ongoing border restrictions, reduced incomes for both households and firms, general uncertainties with the economic outlook, and softer demand from key trading-partner economies. As government support programmes begin to wind down and economic activity remains muted, job losses are likely to continue. The Reserve Bank of New Zealand (RBNZ) is forecasting the unemployment rate to peak in December 2020 at around 8%. With the pandemic disrupting global economic activity globally, New Zealand exports have suffered reduced demand, challenging global supply chains and a stronger exchange rate (relative to the New Zealand dollar trade-weighted index of currencies). Activity has started to resume in some economies as countries which appear to have contained the virus begin to ease their restrictions. Conversely, other countries who had previously contained the virus have again re-imposed restrictions in response to new outbreaks, highlighting the difficulty in containing the virus while accommodating economic activity.

- In response to these challenges, the RBNZ agreed to expand the Large Scale Asset Purchase (LSAP) programme up to $100 billion and retain the Official Cash Rate (OCR) at 0.25%. Demonstrating that unconventional times call for unconventional policy, the RBNZ has agreed that additional monetary instruments must be actively investigated and prepared. These additional monetary policies include a 'Funding for Lending Programme' (FLP) whereby the RBNZ provides additional monetary stimulus by offering low-cost, secured long-term funding to banks in order to reduce their demand (and therefore price) of other sources of funding.


# Fund Performance

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# Fund performance

- The Fund returned 4.1% for the 3 month period to 30 September 2020 (after fees). The Fund is behind its objective of CPI+3.3% over 1 year but is still ahead over the long term.
- On a benchmark relative basis, which is the secondary objective, the Fund is also underperforming over the year and is line for the quarter.

| | 5 years (p.a.) | 1 year | 3 months |
|---|---|---|---|
| Fund return (net of fees) | 7.7% | 3.8% | 4.1% |
| Value add (total portfolio including legacy PE) | | | |
| • Relative to CPI + 3.3% | +3.0% | -0.9% | +2.6% |
| • Relative to benchmark | n/a | -1.4% | +1.0% |

# Sector Performance – (3 Months)

| Gross Returns | $ Value ($M) | Weighting % | Return % | Excess over benchmark % | Return attribution[1] |
|---|---|---|---|---|---|
| **Overseas Shares (incl. PE Proxy)** | **128.1** | **42.5** | **4.6%** | **-1.2** | **2.0%** |
| | | | | | |
| **Emerging Markets** | **15.5** | **5.2** | **7.0%** | **+0.1** | **0.4%** |
| | | | | | |
| **Alternatives[3]** | **60.5** | **20.1** | **2.3%** | **+1.7** | **0.4%** |
| Mercer Unlisted Property | 8.0 | 2.7 | 1.6% | +2.0 | |
| Mercer Unlisted Infrastructure | 15.1 | 5.0 | 6.1% | +5.8 | |
| Mercer Listed Property | 6.1 | 2.0 | 3.2% | +2.5 | |
| Mercer Listed Infrastructure | 5.8 | 1.9 | -0.4% | -1.3 | |
| Fund of Hedge Funds | 25.5 | 8.5 | 1.3% | -0.6 | |
| | | | | | |
| **Private Equity** | **46.3** | **15.4** | **6.6%** | **+5.5** | **1.0%** |
| | | | | | |
| **Fixed Interest** | **39.7** | **13.2** | **1.4%** | **+0.7** | **0.2%** |
| Mercer Overseas Sovereign Bonds | 16.1 | 5.3 | 1.0% | +0.4 | |
| Mercer Global credit | 23.5 | 7.8 | 1.7% | +0.3 | |
| | | | | | |
| **Cash** | **11.1** | **3.7** | **0.1%** | **+0.1** | **0.0%** |
| | | | | | |
| **Total Portfolio** | **301.2** | **100.0%** | **4.2%** | | **4.2%** |

1. Weighted contribution to total fund return.
2. Gross returns for all sectors except Private Equity and Fund of Hedge Funds which are net of fees
3. The Alternatives Sector has a benchmark of CPI+4%, which is the long term target. CPI is reported with a 1 quarter lag. The Alternatives sub-sectors are also shown, versus their respective benchmarks.

# Sector Performance – (12 Months)

| Gross Returns | $ Value ($M) | Weighting % | Return % | Excess over benchmark % | Return attribution[1] |
|---|---|---|---|---|---|
| **Overseas Shares (incl. PE Proxy)** | **128.1** | **42.5** | **4.8%** | **-1.0** | **2.2%** |
| | | | | | |
| **Emerging Markets** | **15.5** | **5.2** | **5.2%** | **+0.2** | **0.4%** |
| | | | | | |
| **Alternatives[3]** | **60.5** | **20.1** | **-1.1%** | **-6.6** | **-0.1%** |
| Mercer Unlisted Property | 8.0 | 2.7 | 2.4% | +2.9 | |
| Mercer Unlisted Infrastructure | 15.1 | 5.0 | 13.8% | +7.2 | |
| Mercer Listed Property | 6.1 | 2.0 | -12.5% | +5.8 | |
| Mercer Listed Infrastructure | 5.8 | 1.9 | -10.4% | -0.5 | |
| Fund of Hedge Funds | 25.5 | 8.5 | -2.7% | -0.5 | |
| | | | | | |
| **Private Equity** | **46.3** | **15.4** | **5.2%** | **+1.6** | **1.0%** |
| | | | | | |
| **Fixed Interest** | **39.7** | **13.2** | **4.8%** | **+0.9** | **0.8%** |
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# Sector Performance – (Since Inception with Mercer)

| Gross Returns | $ Value ($M) | Weighting % | Return % | Excess over benchmark % | Return attribution[1] |
|---|---|---|---|---|---|
| **Overseas Shares (incl. PE Proxy)** | **128.1** | **42.5** | **7.9%** | **-0.2** | **3.5%** |
| | | | | | |
| **Emerging Markets** | **15.5** | **5.2** | **10.3%** | **+1.3** | **0.6%** |
| | | | | | |
| **Alternatives[3]** | **60.5** | **20.1** | **4.1%** | **-2.0** | **0.9%** |
| Mercer Unlisted Property | 8.0 | 2.7 | 7.3% | +3.0 | |
| Mercer Unlisted Infrastructure | 15.1 | 5.0 | 11.8% | +6.5 | |
| Mercer Listed Property | 6.1 | 2.0 | 4.7% | +5.8 | |
| Mercer Listed Infrastructure | 5.8 | 1.9 | 4.9% | -0.2 | |
| Fund of Hedge Funds | 25.5 | 8.5 | 0.6% | +0.1 | |
| | | | | | |
| **Private Equity** | **46.3** | **15.4** | **5.6%** | **-4.9** | **0.9%** |
| | | | | | |
| **Fixed Interest** | **39.7** | **13.2** | **5.7%** | **+0.9** | **0.9%** |
| Mercer Overseas Sovereign Bonds | 16.1 | 5.3 | 5.9% | +0.8 | |
| Mercer Global credit | 23.5 | 7.8 | 5.3% | +0.2 | |
| | | | | | |
| **Cash** | **11.1** | **3.7** | **2.0%** | **+0.4** | **0.1%** |
| | | | | | |
| **Total Portfolio** | **301.2** | **100.0** | **7.0%** | | **7.0%** |

1. Weighted contribution to total fund return.
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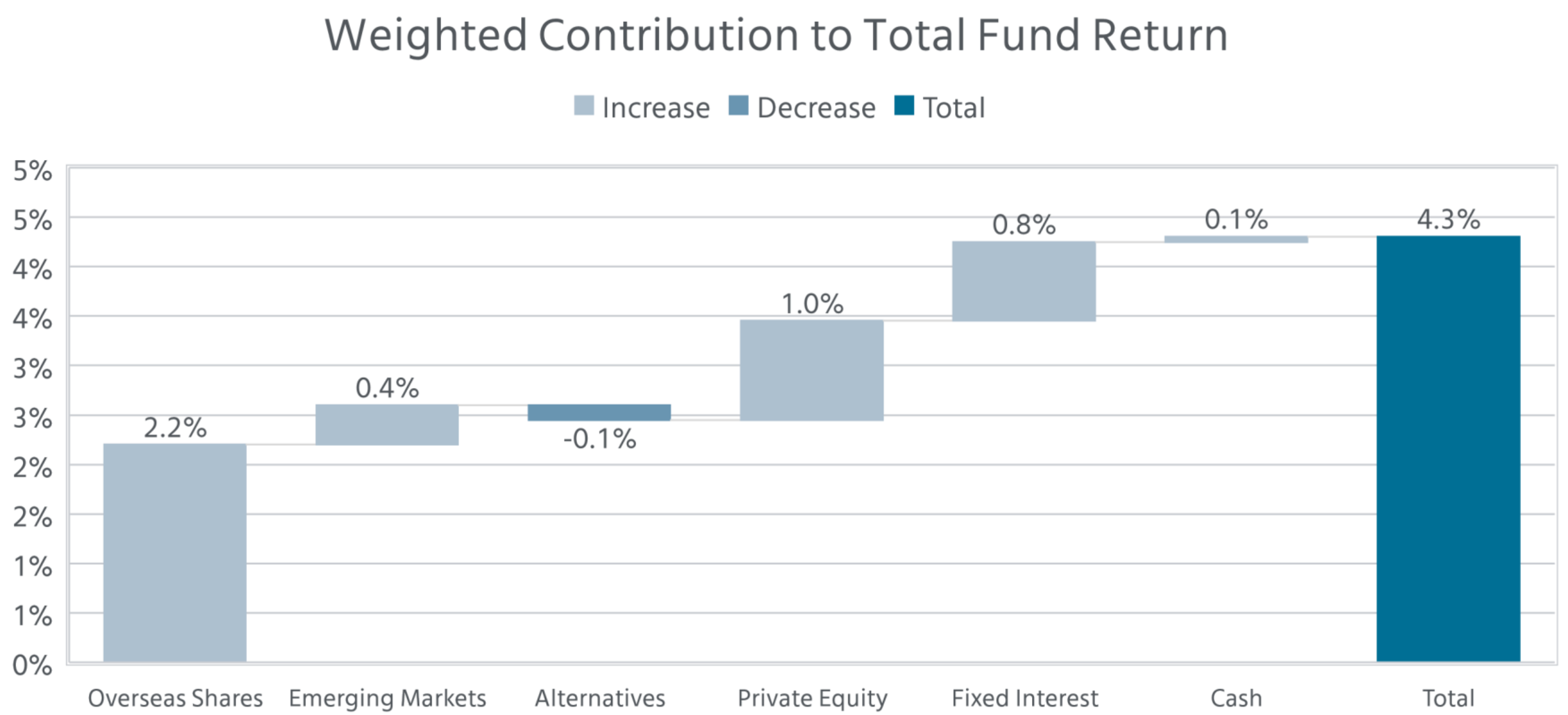
3. The Alternatives Sector has a benchmark of CPI+4%, which is the long term target. CPI is reported with a 1 quarter lag. The Alternatives sub-sectors are also shown, versus their respective benchmarks.

# Sector Performance (12 Months)




The more defensive and long-term sectors contributed positively over the 12 months.

1. Weighted contribution to total fund return.
2. Gross returns for all sectors except Private Equity and Fund of Hedge Funds which are net of fees

# Asset Allocation

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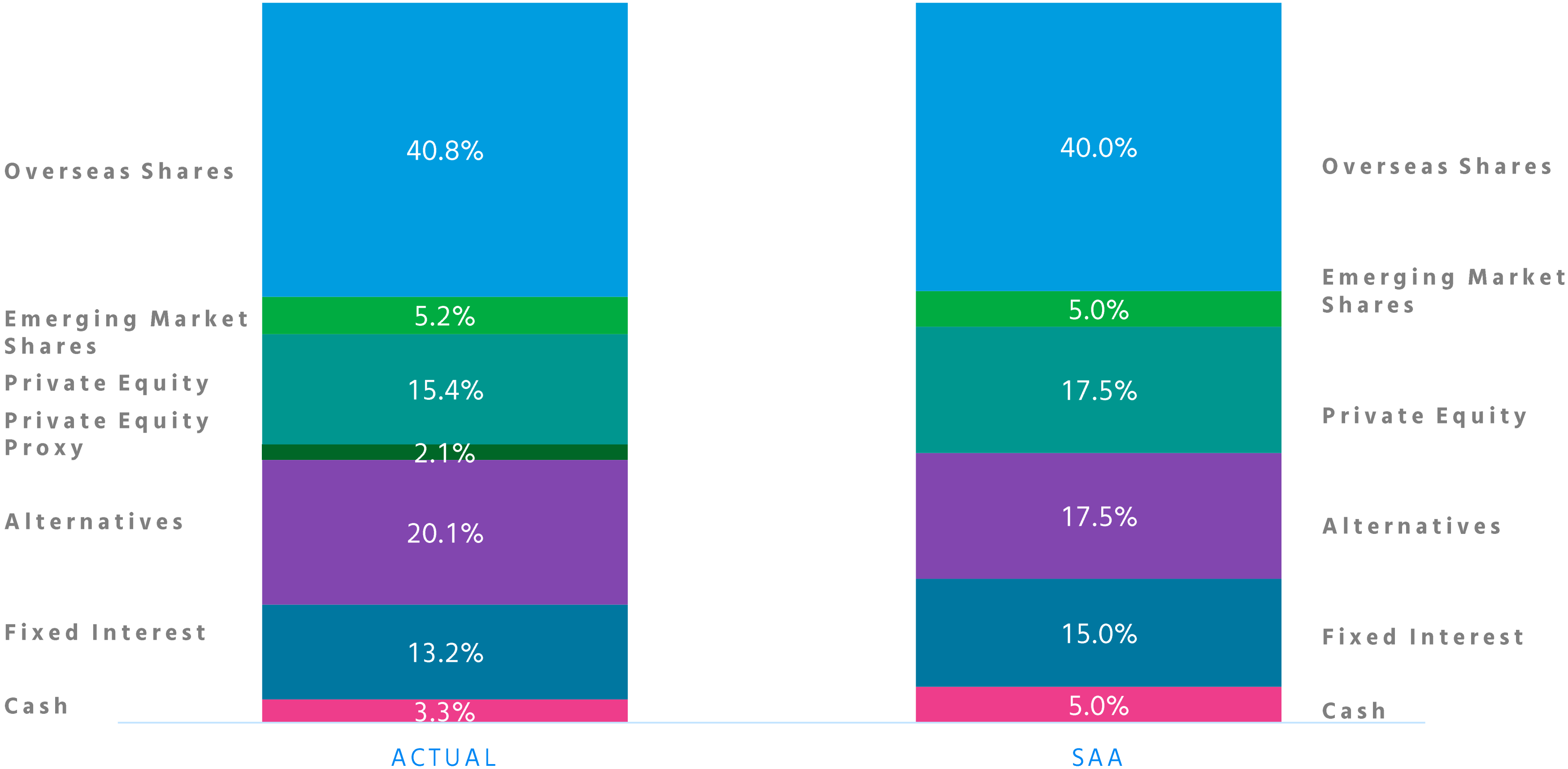
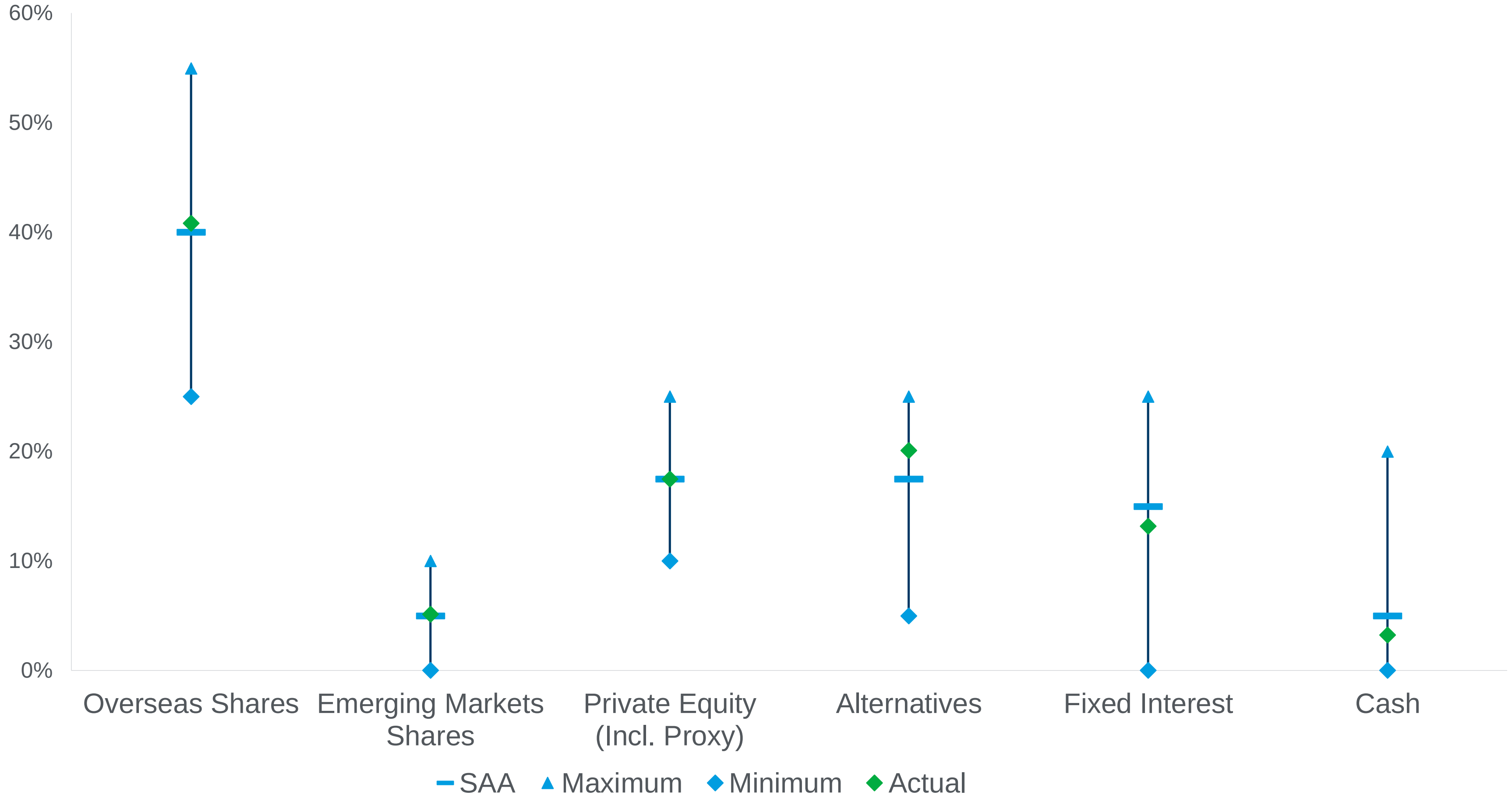
# ASSET ALLOCATION




- The NPDC portfolio continues to transition towards the long term Strategic Asset Allocation (SAA) as the Private Equity allocations are built up and the proxy is progressively reduced. The Private Equity Proxy consists of 1.7% Listed Overseas Shares and 0.4% Cash.
- The target hedging ratio for Overseas Shares is now 50% (effective 31 August 2019).

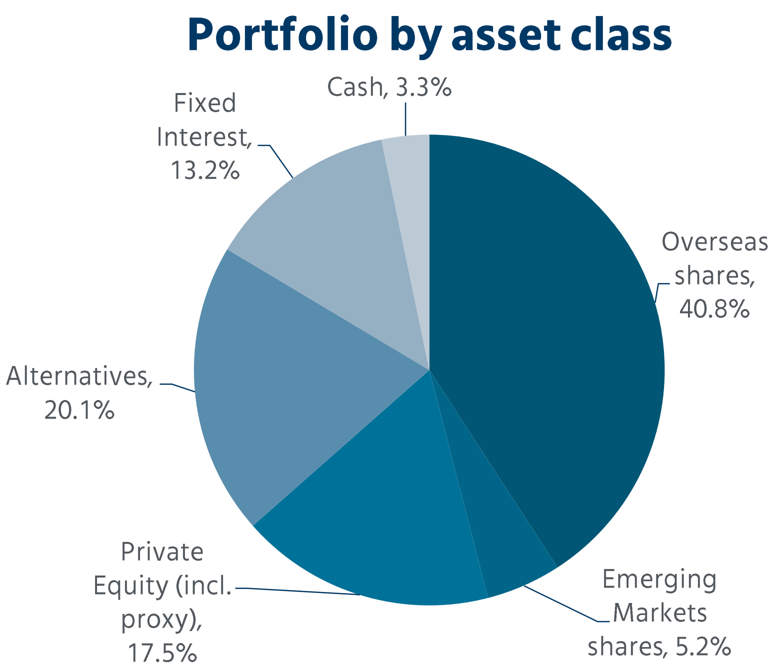
# Asset allocation
## Ranges

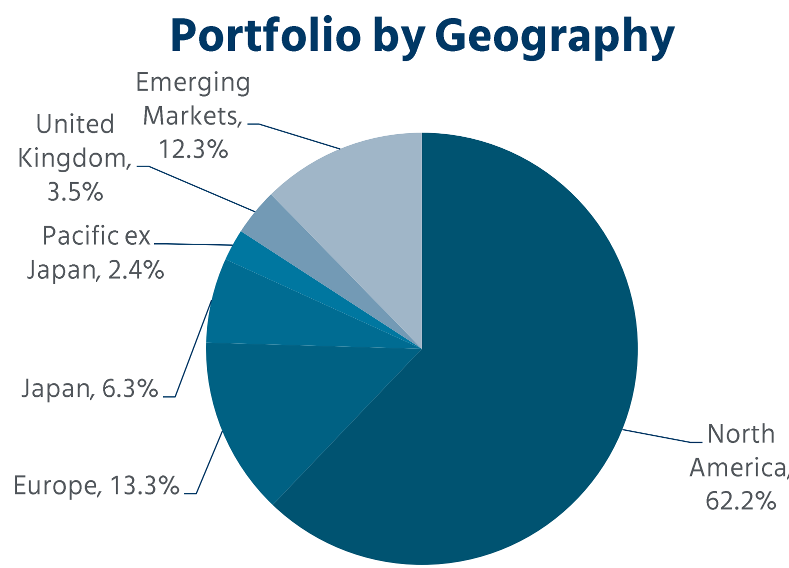



- All asset class allocations are within the ranges specified in the SIPO.

# Asset allocation

- The portfolio is well diversified by asset class, sector and region.
- Within Overseas Shares, there is an underweight relative to the benchmark in all regions; Pacific ex Japan, Japan, Europe, the UK and the North America, in favour for an overweight to Emerging Markets. Note the Portfolio by Geography graph below includes the Schroders, LGIM and EM portfolios.



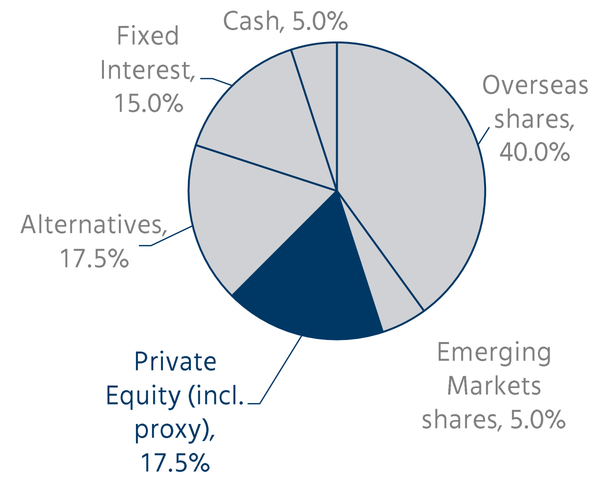
# Sector in focus
## Private Equity

- What is Private Equity? Private Equity can be defined as investments in companies that are not listed on the sharemarket. They are often held in closed-end funds (not open to new investors) with a typical term of 10 years. Private equity managers seek to add value by improving companies over the period of their ownership of them.

- Role in portfolio: The primary purpose of private equity is to provide capital growth over the long-term, taking advantage of the equity and illiquidity risk premia. They form part of the Growth Assets allocation in the portfolio.

- Allocation: The long term Private Equity allocation is 17.5% (currently 15.4%), and is diversified across a number of managers investing into companies based in NZ and around the world. The allocation is being built up over a number of years to diversify across vintages. During this phase, a proxy allocation comprised of 80% Overseas Shares and 20% Cash is used to meet the 17.5% target allocation.

- Strategies: Private equity encompasses a continuum of strategies that have specific risk/return characteristics and can be grouped along a company's life cycle in terms of cash-flow generation.




| | |
|---|---|
| **Managers** | Barings<br>Direct Capital<br>Pioneer Capital<br>Mercer PIP IV and V (multi-manager, each holding 30-40 funds) |
| **Benchmark** | CPI + 6% |
| **Diversification** | • Currently invested in 83 funds, each invested into multiple companies<br>• Invested globally across America, Europe, Asia and the Pacific<br>• Diversified across different sectors<br>• Diversified by vintage |

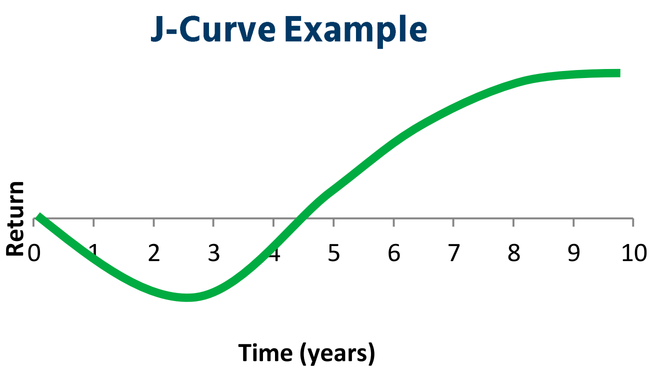
# Private Equity
## Fees and the "J-Curve"

### Fees

- Private equity tends to have higher fees than most other asset classes. A typical fund will charge management fees on committed capital during the initial investment period which is typically five years then often move to a management fees as a percentage of net asset value.

### The J-Curve

- The J-Curve represents the expected pattern of return for a private equity fund over time.
- In the early years, returns tend to be low or negative as companies are restructured and improvements are made. During this phase, the fund is often yet to generate sufficient returns to cover the investment costs and management fees.
- In the following period, the expectation is that returns will start to increase as companies start to mature and benefit from these changes, and cash inflow starts to improve.
- Then finally, the fund will look to wind up and the manager will seek to sell the investments or list them on stock market.




NPDC's Private Equity allocation is diversified across a number of vintages, so different funds are in different stages on the J-Curve, which helps to manage this impact.

# Private Equity Case Study
## Laybuy

- **Business Overview:** Laybuy is an innovative, fully integrated payment platform designed with simplicity at its core. It allows consumers to receive their purchase straight away and spread the total cost over six weekly automatic payments.

- **Valuation**
  - Total Invested: $22,270,561
  - On 7 September 2020, the holding in the company was partially sold down via an initial public offering (IPO) on the Australian Securities Exchange (ASX). Pricing was at A$1.41 per share, which was at the top of the range (average purchase price was NZ$0.35 per share).
  - This represents a 4.4x gross money multiple on total invested capital (211% IRR).

- **ESG considerations**
  - **Environment:** Low to moderate exposure to environmental risks.
  - **Social:** Key social risks include Customer satisfaction, data protection, government and community relations and marketing communications. Laybuy are acutely aware of these factors and actively manage the issues.
  - **Governance:** BNPL pay later space is exposed to a number of regulatory risks (e.g. consumer protection and credit regulations). This was investigated during the due diligence process and it was deemed that Laybuy is not overly exposed. Post-investment, the Board has been built to ensure that the appropriate levels of skill and experience are present.

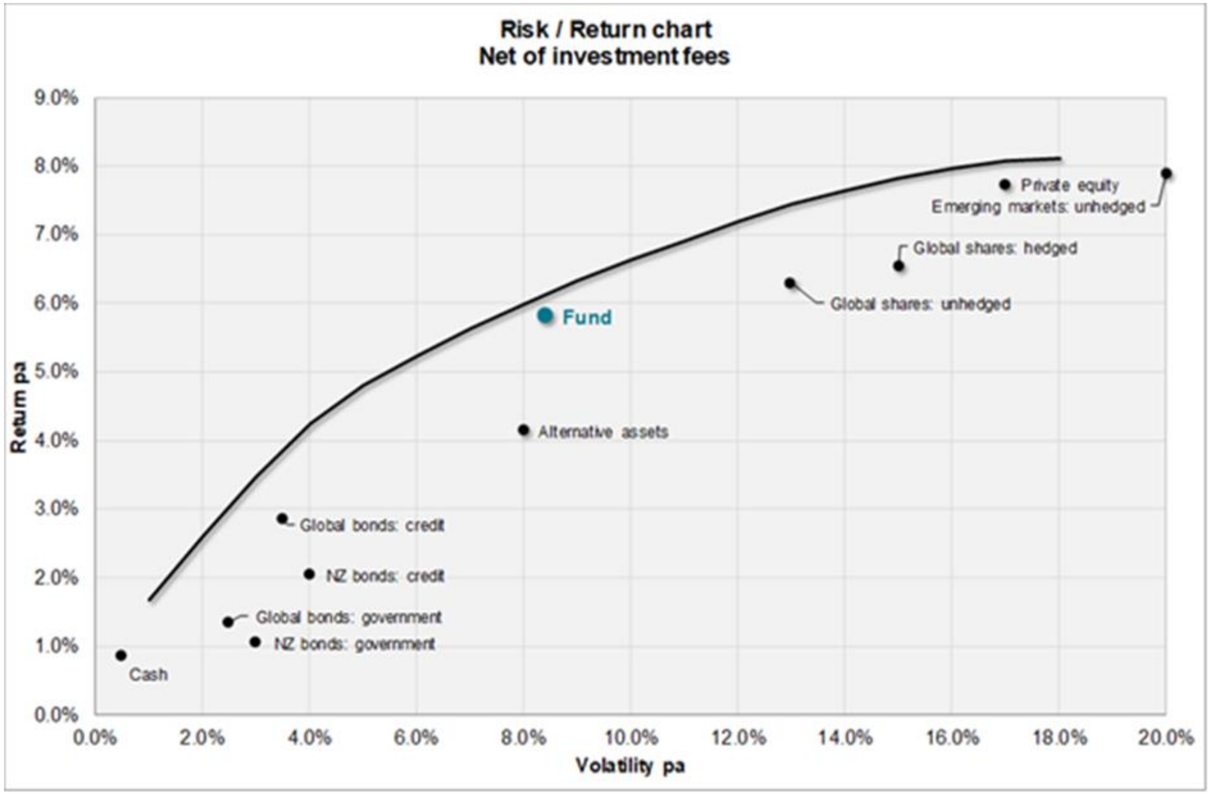
# Private Equity Case Study
## Rockit

- **Business Overview:** Rockit is headquartered in Hawke's Bay, and holds an exclusive global licence to directly and/or, via sub-licence, produce, distribute, and sell the Rockit apple variety which attracts a higher margin given it's naturally small size, high density, sweetness, and prolonged shelf life.

- **Valuation**
  - Total Invested: $26,485,873
  - Reported Value: $46,268,792
  - Gross IRR: 24%

- **ESG considerations**
  - **Environment:** Exposed to a number of environmental risks in particular; water and air pollution; water scarcity; waste management and the use of sustainable resources. It is understood that Rockit utilises industry best practice with detailed plans and operating procedures. New fully compostable tube packaging is in the process of being trialled.
  - **Social:** Health and Safety is an area of high risk and is addressed on a regular basis at Board meetings. Rockit is also considered to be an employer of choice, paying above the minimum wage.
  - **Governance:** Governance issues, with particular focus on internal controls, are being monitored at a board level.

# Asset class
## Risk /return chart



# Compliance Statement

| Document | Status |
|---|---|
| New Plymouth PIF Guardians SIPO | There were no breaches reported in the quarter |
| Mercer Investment Trusts NZ SIPO | There were no breaches reported in the quarter |
| Responsible Investment Policy | There were no breaches reported in the quarter |

| Investments held in Mercer Investment Trusts NZ | Status |
|---|---|
| Segregated mandates | There were no breaches reported in the quarter |
| Mercer managed funds | There were no breaches reported in the quarter |
| External managed funds | There were no breaches reported in the quarter |

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