Your Fund Update

Year to 31 December 2014

STATE SUPER **Financial Services** AUSTRALIA

Welcome

Michael Monaghan
Managing Director

In this edition of Your Fund Update, we review how markets around the world performed in 2014 and take a detailed look at what's happening in the energy and oil industry, which affects all of us. We are also pleased to inform you about a new investment option that can provide you income certainty in your investment portfolio.

Despite the ups and downs in the market over the year, we are happy to report another successful year for State Super Financial Services' investment portfolios.

The majority of asset classes generated positive returns and this has helped us achieve our investment objectives of building portfolios that deliver the targeted level of return, with the lowest level of risk.

We hope this edition of Your Fund Update will help you keep up-to-date with your investments and what's happening in global and domestic markets. So please read and enjoy. And of course, just call us if you have any questions.

Michael Monaghan

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A trusted partner for your financial future

We believe quality financial planning advice changes lives. And provides you with better financial outcomes and improved wellbeing. At State Super Financial Services, we take a 'whole-of-life' approach, with financial planning tailored to the individual. Not just for your retirement, but at every stage of your life. So if you have any questions or concerns about your financial future, just give us a call.

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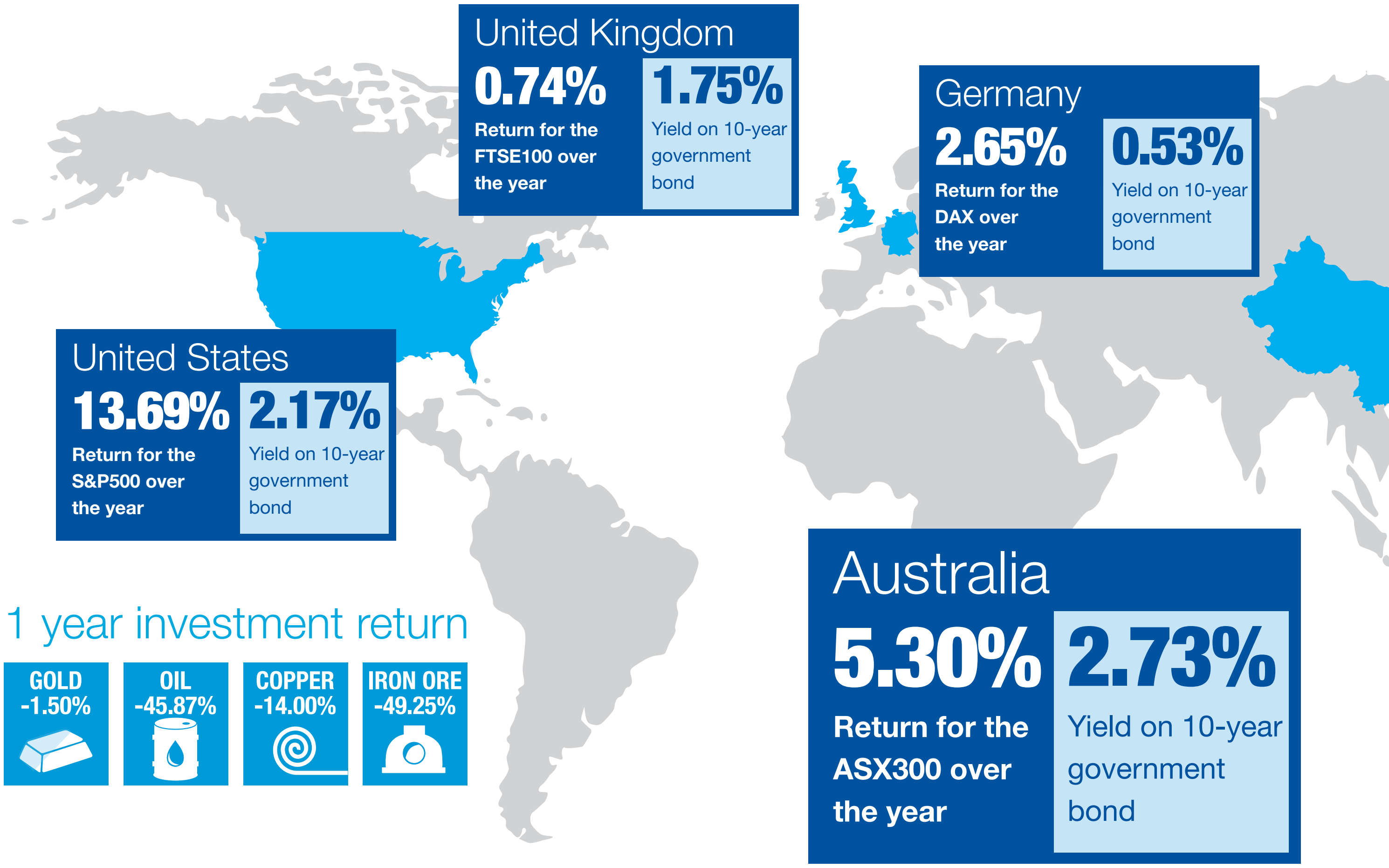
Markets Update – Year in Review

We are continually assessing markets, both domestically and globally. Here is our summary of the year just gone and importantly our outlook for the year ahead across the major asset classes.

Investment market performance from around the globe

31 December 2013 – 31 December 2014



Looking Ahead

One of our key investment beliefs is to diversify your investments across asset classes so we can effectively deal with the uncertainties that always exist when investing across the various investment markets.

Shares

Last year we saw divergence across share markets, with the Australian market up modestly for the year, while overseas share markets were generally more positive. Share markets continue to appear fairly valued. Assisting valuations is the low level of yields globally, resulting from major economic zones such as Japan and the European Union continuing to flood their economies with money to drive interest rates lower. Profitability of companies globally also remains solid, but unspectacular, and this is expected to lead to modest returns for shares in 2015. We expect that the recent moderate increase in volatility of share prices will continue into 2015 as the world continues to rebalance, with economies defining how to generate sustainable growth following the Global Financial Crisis (GFC) of 2008. The US appears to be the economy that is furthest along this path and so we continue to favour global shares over Australian shares.

Fixed Interest and Cash

Interest rates for bonds issued by governments around the world were volatile during 2014 and remain at very low levels. The prevailing theme for economies during the latter part of the year has been falls in inflation, with some major regions flirting with deflation or falling prices.

The direction of interest rates over the first half of 2015 will depend upon the ability of major economies to gain traction in fighting deflationary pressures. We expect moderate economic growth to occur that will generate low, but positive, inflation and drive interest rates slightly higher.

Bond yields represent the interest rate at which governments can borrow

US dollar vs Australian dollar

31 December 2014

81.8 USD cents

31 December 2013

89.5 USD cents

Returns from bond and cash investments will remain steady over the year ahead.

The objective of investing in bonds and cash is not just to generate returns and yield, but to also provide a safe haven in the event of a financial market crisis (such as the GFC). As such, we will maintain an exposure to bonds and cash to assist with capital preservation and liquidity in our portfolios, two key requirements for retiree investors.

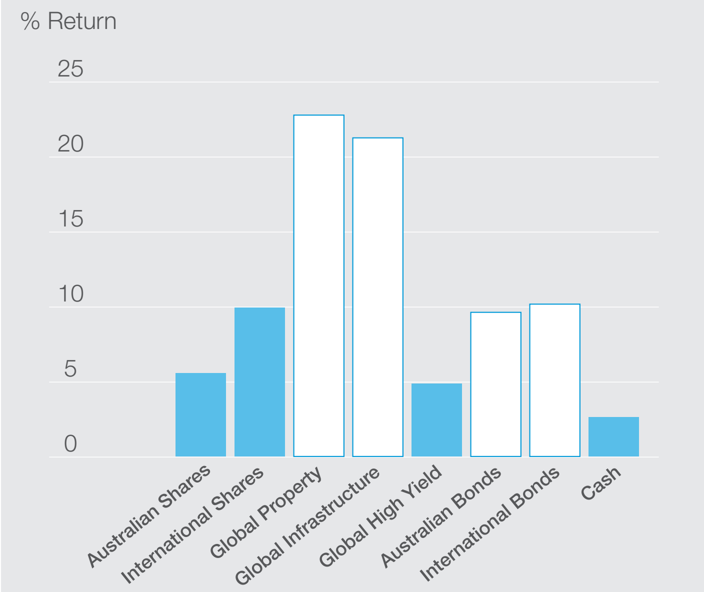
Property and Infrastructure

The so-called 'chase for yield' continues where the income provided by traditional income assets, such as bonds and cash, remains low and so investors look to other assets for this income. Property and infrastructure continued to benefit from this in 2014. We remain comfortable that the investments we hold in these areas within the State Super Financial Services portfolios will generate the income we expect, and we are also monitoring their valuations which have become relatively high.

The Australian dollar

The Australian dollar finished the year at US$0.818, down from US$0.934 in September and US$0.895 at the start of the year. Despite this depreciation, the dollar remains above long-term measures of fair value, as noted by the Reserve Bank of Australia in the minutes of their December meeting. Foreign exchange exposure continues to be a good diversifier for Australian investors, with movements in the dollar once again becoming more highly correlated to global growth expectations.

Defensive Asset Classes performed better in 2014



Benchmark returns for major asset classes in 2014

Source: FactSet

Investors started out 2014 with a generally bullish outlook for growth assets.

This view was challenged over the year, with concerns of deflation driving yields on government bonds to very low levels.

As a result, it was the defensive asset classes such as bonds, and the less volatile growth assets such as property and infrastructure, that performed more impressively.

With defensive assets now quite richly priced, we expect growth assets to be the stronger performers in 2015.

Keeping an Eye on Energy Markets

Damian Graham
Chief Investment Officer

The last quarter of 2014 saw very volatile trading in global commodity markets, but none were more volatile than oil prices.

Damian, can you give us a summary of what's happening in the global oil market?

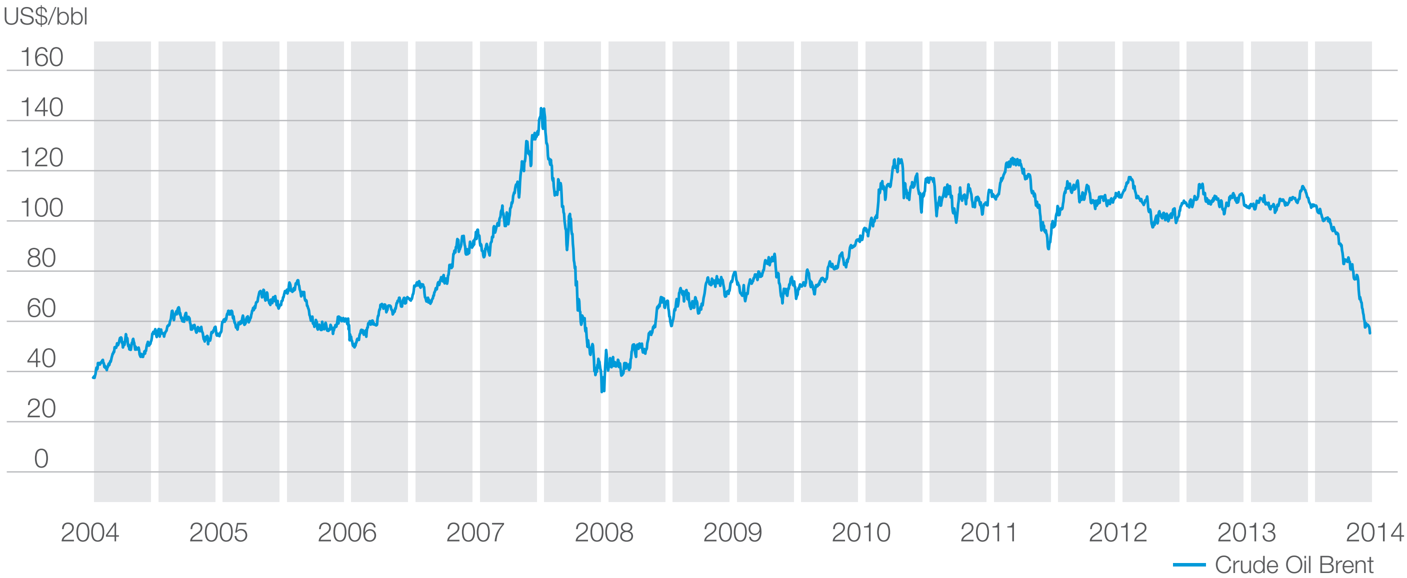
Well, it has certainly been an extremely interesting period for energy markets, with the price of oil having fallen from over US$110 per barrel, just a few months ago, to around US$55 at the New Year. The oil market has, for many decades, been somewhat of an artificial market. One group of producers, the Organisation of Petroleum Exporting Countries (OPEC), has strongly influenced oil prices by changing their production as the level of oil demanded changed in order to keep prices stable and somewhat elevated.

What has changed?

In recent years, technological advances have enabled the available supply of oil to increase. The most significant examples of this have been the development of non-traditional supplies such as oil sourced from bitumen sand – known as tar sands – primarily in Canada, shale oil, through the increased usage of 'fracking', and the injection of liquids at high pressure to stimulate production, into existing oil wells.

These changes have added approximately five million barrels per day to the potential production capacity globally. These newer production techniques are typically more expensive than traditional sources and so, have only really become mainstream in recent years, when oil prices have been elevated. With the recent fall in oil prices, there is significant risk that these non-traditional sources will become unprofitable and that production capacity will be reduced.

Oil price over the last 10 years



Why does oil matter?

Oil is only one form of energy, but it is the form that is used to produce most of the energy sources that drive the world's transportation. Oil-based products, such as petroleum or diesel, are used to power ships, trains, aircraft and road-based transport to move the goods and services that we consume, from producers to households. Energy is also a critical input to the cost of production. So it has a very strong flow-on effect to economic growth. Lower energy costs allow manufacturers to produce and ship their goods to consumers at lower prices. Consumers, not spending as much on filling up their cars, will tend to spend more on other goods and services, stimulating economic growth. Overall it is estimated that the recent fall in petrol prices will add 0.3% to global economic growth*.

*Source: Citigroup

We have typically had a moderate exposure to commodity-producing companies, including oil companies.

Top 10 Oil Global Producers

		Barrels per day ('000)	Share of Global Production
1	United States	12,343	13.7%
2	Saudi Arabia	11,600	12.9%
3	Russia	10,534	11.7%
4	China	4,459	4.9%
5	Canada	4,074	4.5%
6	United Arab Emirates	3,230	3.6%
7	Iran	3,192	3.5%
8	Iraq	3,058	3.4%
9	Mexico	2,908	3.2%
10	Kuwait	2,812	3.1%

Source: US Energy Information Administration (EIA), 2013 est.

How is State Super Financial Services managing this issue?

As an investor, we have typically had a moderate exposure to commodity-producing companies, including oil companies. This is because the value of these businesses can be more volatile, as the price of the commodity they produce can be highly cyclical. We seek to generate more stable returns for our members as they approach, or are in, retirement. This helps to reduce the potential impact a fall in the market can have on their retirement income.

Another important issue is that the previously higher energy prices had supported the development of alternative fuel sources such as solar or wind. We see ongoing progress in this area as important in managing the full range of risks that traditional energy sources can create for investors.

To ensure we understand these risks and are responding accordingly, we are currently undertaking research on the potential impacts of climate change in conjunction with Mercer, our investment consultant. The results of this research will be included in client updates over the coming year.

New Investment Option – Fixed Term Fund

We recognise that clients who are approaching, or are in retirement, have unique investment needs. So we tailor our investment and product solutions to these needs.

For many retirees it is important to set funds aside to meet income needs in the short to medium term. So we have developed a specific investment option, the Fixed Term Fund. This innovative fund pays a regular, monthly income stream and can be used to provide a greater degree of income certainty within your tailored investment portfolio.

The Fixed Term Fund has been available in the Allocated Pension Fund since January 2013 and in the Flexible Income Plan since April 2013. From January 2015 the Fixed Term Fund will also be available in the Personal Retirement Plan, Tailored Super Plan and the Investment Fund.

This innovative fund pays a regular, monthly income stream and can be used to provide a greater degree of income certainty within your tailored investment portfolio.

The Fixed Term Fund is a non-unitised investment option that provides a fixed rate of return for terms of 1, 2, 3 or 5 years. The fixed rate of return is set at the beginning of your investment so you know what you will earn over the life of the investment, assuming you hold the investment for the full term. The Fixed Funds are designed to help you plan for your short to medium term cash flow needs.

Fund Details

	Fixed Term Fund
Objective	To provide a fixed rate of return over the selected term, with the initial investment paid at maturity.
Investment strategy	Invests in fixed term and fixed rate interest bearing securities called Notes.
Standard risk measure	1 – Very low (where the investment is held to maturity)
Type of investor this option is intended to be suitable for	Designed to suit investors who wish to lock in a fixed rate of return for the selected term of the investment.
Investment timeframe	Investors can choose terms of 1, 2, 3 or 5 years.
Strategic asset allocation	Defensive assets 100% Fixed Interest Securities 100%

Reset feature

We have introduced a reset feature to the Fixed Term Fund. Broadly the effect of the reset feature is to apply a higher rate of return to your investment from a fixed 'reset date' if applicable rates are higher at that time. This is shown graphically below.

The reset feature will generally only be available on fixed term investments with a five-year term.

Risks

All investments involve some level of risk. One of the key risks is an early closure risk. The Fixed Term Fund is designed to be held to maturity. If you choose to close your investment in the Fixed Term Fund before maturity, the costs associated with redeeming the Notes early will be passed on to you. This may mean that you receive less than your original investment.

How to invest

For more information on the Fixed Term Fund, including

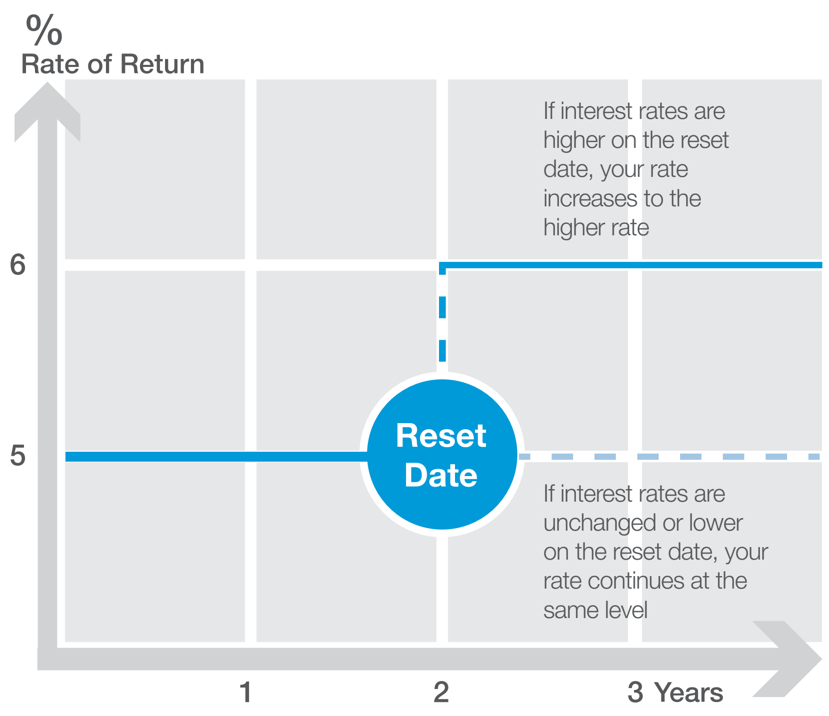
- How the Fixed Term Fund is invested
- Risks of investing
- Administrative procedures

Please see the Product Disclosure Statement (PDS) for the relevant investment product. All the PDSs are available on our website ssfs.com.au, under Investment Approach > Investment Products, or you can use the table below:

Investment Product	Website link
Personal Retirement Plan	ssfs.com.au/prp
Tailored Super Plan	ssfs.com.au/tsp
Investment Fund – Class A	ssfs.com.au/ifa
Investment Fund – Class B	ssfs.com.au/ifb

We also recommend that you consult your financial planner before making an investment decision.

Example of how the Fixed Term Fund reset feature works



The effect of the reset feature is to apply a higher rate of return to your investment from a fixed 'reset date' if applicable rates are higher at the time.

Investing in Shares

State Super Financial Services invests in shares as part of our diversified investment options.

What shares do we invest in?

Our Australian equity portfolio invests in shares of companies based in Australia that are listed on the Australian Securities Exchange (ASX). Our international equity portfolio invests in shares of companies based around the world in developed countries including the US, Europe and Asia. Our international equity portfolio also invests in shares of companies based in emerging market countries such as China, India and Brazil.

What is our objective for our share portfolios?

Our investment beliefs recognise that what is most important to you is capital preservation of your assets over time. While share returns are known to be more variable than other asset classes such as bonds, we have constructed our equity portfolios with a focus on reducing the risk of large losses.

This means that in an equity market downturn, when share prices are falling (eg the global financial crisis of 2008), we would expect our portfolio returns to fall less than the market. This also means that when the market is rising strongly, our returns are expected to go up, but may not keep pace with the market.

Over time (about five years) this is expected to provide a smoother, less volatile return stream for our clients with overall returns that are expected to be in line with market returns over the same period.

How is our approach different?

We have created our share portfolios to achieve risk and return characteristics that we believe are best suited to our clients, most of whom are approaching retirement, or are retired.

We aim to ensure a moderation of the loss of capital for clients when share markets fall. We try to achieve this by investing in shares of companies with lower price volatility and of good quality that can grow their profits in a variety of market environments.

You can learn more in our latest News and Views article that talks about our investment approach, how we construct our share portfolios, and some good quality companies that we invest in. Simply visit ssfs.com.au/news and click on the 'News and Views' tab.

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