From: [redacted]
To: [redacted]
Bcc: [redacted]
Subject: RE: The Future Fund and Eureka Report Article
Date: Thursday, 16 February 2012 1:24:00 PM
Attachments: image002.png
image005.png

Dear Readers,

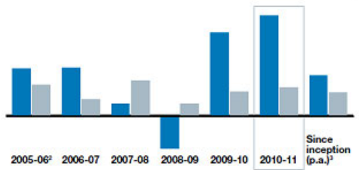
I recently received an unsolicited copy of an article from the Eureka Report covering aspects of the Future Fund s operations and performance since its inception. With your indulgence, I would like to provide a belated response and critique to not only Eureka s analysis of the Future Fund, but also cover aspects surrounding their commentary of "purchasing power" and "inflation". *(For the reader that did not see the original email with attachments then, and in order to protect the sanctity of Eureka's copyright, may I respectfully request that you access the original article **here**).*

On review of the article concerned, I must say that I was a little disappointed to see financial commentary (from what is generally considered by most to be an expert source) that proved to be somewhat superficial and lacking in rigour. Whilst I am not personally a subscriber, I am sure this is not typical of Eureka and that perhaps rigour gave way to a deadline in this instance (??). In any case, and in order to broaden the reader s perspective, let me first provide you with a quick glimpse of what has occurred over time with respect to the FF s performance (ex-Telstra); as illustrated in the FF s 2010-2011 Annual Report.

Nominal return[1] and CPI

Year	Nominal return %	CPI %
2005-06[2]	6.0	4.0
2006-07	6.2	2.1
2007-08	1.5	4.5
2008-09	-4.2	1.5
2009-10	10.6	3.1
2010-11	12.8	3.6
Since inception (p.a.)[3]	5.2	3.0

Nominal return CPI



[1] ex Telstra
[2] Represents annualised return for the period from initial contribution on 5 May to 30 June 2006 only.
[3] 5 May 2006

Source: 2010-2011 Future Fund Annual Report, page 5

What is not overly evident on review of this table; is the fact that FF did not receive its performance mandate and its initial seed funding (i.e. $18 billion) from the Howard Government until the 3rd and 5th of May 2006 respectively. Therefore, and given the time and space involved, any return for this financial year should be discounted outright. Following on from this, the FF received further contributions of $18.6 billion in January 2007, with an additional $3.6 billion together with the receipt of 2.1 billion Telstra shares (valued at transfer at $8.9 billion) in February 2007; but with this transfer it inherited prohibitive escrow limitations, which as history would show, clearly exposed the Fund to increased market volatility and risk that it could not easily negate. What is also important to note here is that as at 30 June 2007, the Fund had only established, in addition to its Telstra holding, an exposure to Australian equities of $1.85 billion and to international equities, $2 billion. The remaining assets or 91% ($38.73B) remained in cash with the RBA. The primary reason? Because the FF was still in the process of formulating its investment mandate strategies in order to comply with the Commonwealth s key performance indicator (i.e. to provide an annual minimum return of 4.5% above inflation).

In 2007-2008 the FF received further contributions from the Government of $7 billion in August 2007 with another $3.9 billion in June 2008. At 30 June 2008 the FF had approximately $55.7B in funds under management, with an additional $8.5B in escrowed Telstra shares, totalling $64.18B. However, but luckily, 62.1% or $34.5B of the Fund was still held in cash at this point when the onslaught of the GFC took hold. Irrespective of its cashed up nature, the FF still recorded a negative return of 4.3% (including Telstra) in 2008-2009; a return resulting (in part) because Telstra alone took a substantial hit of -11.4%.

As some readers would be aware, in June of 2009 I forecasted, during all the doom and gloom and to the astonishment of many, that the FF would emerge from the ashes of the GFC and post double digit returns in excess of 10% at financial year s end and into the foreseeable future. Based upon the projections within the forecast I suggested that these returns would substantially extinguish the Commonwealth s Superannuation liabilities (i.e. encompassing Parliamentary, Judicial, Commonwealth and Military defined benefit schemes) by 2016-2017 as measured and projected against the then "Target Asset Level". This forecast, which was underpinned by external forecast parameters as well as my own non-disclosed proprietary methods, was formalised in the *'Net Cost Analysis'* paper, which was formally released in November of that year.

As history would attest, the FF did indeed seize the moment and drew down on its remaining cash reserves to increase its holdings of good quality distressed assets, which in turn and in part, helped to produce a healthy nominal return (ex-Telstra) in 2009-2010 of 10.6%; and another 12.8% nominal return (ex-Telstra) in 2010-2011. Whilst the first 2 quarters of 2011-2012 would suggest a negative annualised return for this FY, I remain confident (irrespective of the European financial contagion) that the FF will again post a positive but lower inflation adjusted return at year s end. In addition to this, I would also contend (contrary to Eureka) that the FF s portfolio balance seems just about right particularly if it s international holdings are predominately held and/or valued in US denominated currency. The reason? Because once the China and /or commodity bubbles burst (and they will); then the $A will be dumped severely rendering substantial positive net returns where US dollar denominated assets are held. On this basis, and given that I believe many commodities are on the precipice of significant falls from here on in, it would seem prudent to me that the FF continues to reduce its exposure to Australian based equity holdings; particularly equity interests that are underpinned significantly by raw commodities. If it follows this course of action, which it appears to be doing anyway, then I believe we will see positive annual returns well in excess of what we have already seen in recent years.

I believe the 5 year average inflation adjusted net return figure stated by Eureka (i.e. 1.2%) and its associated commentary seriously misrepresents the historical management performance and the longer term prospects for the FF. I would contend that the 5 year inflation adjusted return (ex-Telstra) was in fact 2.04% as at 30 June 2011. But as illustrated above, a 5 year average return is very misleading because most of the fund was sitting in cash collecting dust with the RBA over the bulk of this time. I believe that a 3 year average return (at best) would better reflect the fund s actual management performance to date, and on this basis, the Fund has performed reasonably well by comparison to most in producing an inflation adjusted net return of 3.67% over the last 3 years. I remain confident that the FF will extinguish the Commonwealth s superannuation liabilities as measured by the “Target Asset Level” (that was calculated originally by Dr. Knox) well before 2020. I might very well be wrong in my analysis and longer term perspectives here .... I guess only time will tell.

In addition to the foregoing, I wanted to also raise another very important point that emerged from the article with respect to the interpretation and the interchangeability of terms such as “purchasing power” and “inflation”. Whilst Eureka s commentary in this area was not technically incorrect per se ; I nevertheless feel that readers who are unaccustomed to such terminology could be easily lead into believing that “purchasing power” equates directly to “inflation”. So let me be very clear here: “inflation” as measured by the Consumer Price Index IS NOT a measure of “purchasing power”; it is purely a price inflation index ONLY!

So, what is “Purchasing Power?” Well, in simple terms, it is a specific measure that reflects the net impact on material living standards when INCOME and WEALTH increase / decrease more rapidly than prices (i.e. after inflation has been taken into account). The reader doesn t have to take my word for it, here is an authoritative link that spells it out in black and white!

When you consider that purchasing power in Australia has increased by approximately +3% p.a. in real terms over the at least the last decade, then no Government or Parliament should underestimate or equivocate over the dire situation and anguish that many Commonwealth and Military retirees find themselves in because their former employer has failed to live up to its end of the bargain (i.e. because employees retirement incomes have only been indexed by a factor of a manipulated CPI). As such, let me leave this indelible imprint on the minds of all readers, particularly that of Politicians, by saying that:

“Purchasing Power” and therefore “Material Living Standards” can only be maintained and protected by an indexation regime that has (in addition to inflation) an **INCOME** component included!

Finally, the Government and the Parliament as a whole, should stop dodging the issue about fair indexation for its former employees and seriously consider my advice not least from the *Net Cost Analysis’* (as well as the qualified advice of others also); that incremental access to the FF would be the most economically responsible and sustainable way to ameliorate the retirement pay indexation woes of Military and Commonwealth retirees. If the Government / Parliament quarantined just a small portion of the remaining $10.1B sitting in the Fund s cash holdings (as at 31 Dec 2011), then this portion (which on the whole would still be earning interest) could then be slowly drawn upon over time without significantly affecting the longer term performance of the broader fund in general. In fact, the successive draw down on excess earnings that would be required above and beyond the Commonwealth s already extant CPI liability, which is drawn separately from Consolidated Revenue, would amount to less than 1% of the FF s current $73.1B account balance over the forward estimates. This is such a small price to pay in order for the Commonwealth to meet and honour its legal and moral obligations to 600,000 current and prospective retirees .... it makes you wonder why the Parliament have not already instigated this sound strategy (???) ..... oh yes ... because they continue to be hoodwinked by budget projections that are underpinned by rubbery data* and bogus actuarial assumptions emanating out of the hallowed halls of the Dept of Finance and its subsidiaries!

I hope this helps ....

Kind regards

Peter Thornton
Retiree and Independent Commentator
[redacted]

“All for One ... and ...One for All”

* FOI data received by the author that was generated by COMSUPER as at 30 Jun 2011, illustrated that: instances of retirement pay were still being recorded against deceased recipients; some retirees apparently joined their respective schemes long before they were even born (e.g. -75 years); and some scheme recipients miraculously lived anywhere up to 125 years of age; breaking new world records in life expectancy. How many 10 of Millions of dollars are we paying for all this wholesome data and the supposed irrefutable but irrepressible DoFD budget projections? Enough I suspect, to help pay for a substantial part of the improved indexation that is required.

SCHEME	FUND ENTRY DATE	AGE AT FUND ENTRY	AGE CURRENT	LAST DAY OF SERVICE	PEN COMM DATE	PENS ANNUAL GROSS PEN 2011	PENSION STATUS	PENSION TYPE	PENSION REASON	TERMINATION DATE	TERMINATION REASON
1922Act	1/01/1922	4	94	2/01/1974	30/06/1988	0	Terminated	Death	Spouse of Contributor	24/10/2001	Death
DRDB	17/02/1947	23	87	2/10/1961	1/07/1988	0	Terminated	Death	Spouse of Contributor	9/01/1995	Death
DRDB	17/04/1939	24	96	30/12/1961	1/07/1988	26107.64	Terminated	Retirement	Contributor	2/07/2007	Death
1922Act	1/01/1922	8	97	18/05/1972	19/05/1972	26346.32	Terminated	Death	Spouse of Contributor	19/12/2006	Death
DRDB	9/08/1949	26	88	15/02/1968	1/07/1988	25464.66	Terminated	Retirement	Contributor	16/05/2009	Death
1922Act	1/01/1922	11	101	20/04/1975	21/04/1975	0	Terminated	Retirement	Contributor	6/06/1998	Death
DRDB	29/09/1939	23	95	27/11/1957	1/07/1988	0	Terminated	Invalidity	Contributor	21/04/1991	Death
1922Act	1/01/1922	11	101	23/03/1975	24/03/1975	0	Terminated	Retirement	Contributor	2/09/1990	Death
DRDB	29/09/1939	25	97	27/11/1957	22/04/1991	17435.6	Terminated	Death	Spouse of Pensioner	22/12/2006	Death
DFRDB	1/10/1972	39	78	7/06/1974	1/07/1988	33301.06	Terminated	Retirement	Contributor	10/12/2004	Death
1922Act	1/01/1922	8	97	23/03/1975	3/09/1990	33496.06	Terminated	Death	Spouse of Pensioner	6/02/2007	Death
1922Act	1/01/1922	-75	14	15/08/1961	16/08/1961	0	Terminated	Invalidity	Contributor	27/01/1989	Death
1922Act	1/01/1922	35	125	8/03/1949	9/03/1949	0	Terminated	Death	Spouse of Contributor	31/01/1989	Death
MSBS	8/10/1992	52	70	19/08/1995	20/08/1995	33861.36	Terminated	Retirement	Contributor	7/08/2004	Death
DFRDB	5/06/1973	-6	32	25/05/1981	1/07/1988	0	Terminated	Death	Child Student	29/03/1996	Terminated
DFRDB	5/06/1973	-7	30	25/05/1981	1/07/1988	0	Terminated	Death	Child Student	7/11/1997	Terminated
PSS	1/07/1990	50	71	30/06/1999	21/08/2002	8285.16	Terminated	Retirement	Contributor	31/01/2007	Death
PSS	24/11/1997	52	65	31/08/2006	1/09/2006	19045	Terminated	Redundancy	Contributor	23/09/2008	Death