Australian Government

Commonwealth Superannuation Corporation

# Alison Tarditi Transcript
# CSC Annual Members' Meeting
# Tuesday, 16 March 2021 – 5.30pm AEDST

## *Start of Transcript*

## *Introduction*

Alison Tarditi: Now, the reason you've joined us this evening rather than going out for dinner or watching your favourite program on television, is that financial independence in retirement is important to you, as it is to me. So if I leave you with just one key takeaway this evening, I hope it's this - it isn't how much money you make on paper at any point in time along the journey to retirement that matters but how much of that wealth you're able to keep and realise as purchasing power to spend on the things that matter to you when you do retire.

My super, and that all of my senior investment team, is invested alongside yours. Tonight, let me demonstrate not only how we build, but also how we steward our investment portfolios so that they remain robust and capable of delivering to this purpose, as the world around us evolves and sometimes shifts quite dramatically. Any successful investment strategy that is capable of converting ideas into enduring net wealth must start with clarity of objective and of time horizon. This enables portfolios to be purpose built, opportunistic and robust to the many manias and speculative whims that episodically distract market prices away from their fundamental value.

## *Investment objectives*

Our investment objectives and our measures of success or failure are very clear, and there are just three of them - generate sufficient real returns after fees and costs to ensure that we can all retire to a comfortable standard; avoid assets that have a material risk of permanent capital impairment; and build a carefully curated selection of robust investment options to enable all of us to confidently choose the right portfolio for our personal circumstances. Let's go through each of these in turn.

Our first objective is to generate sufficient real returns after fees and costs. But what does sufficient actually mean? We use the highest standard recommended by the Association of Superannuation Funds of Australia, or ASFA, highlighted in green in the first two rows of this table, because it is an independently derived measure of what is required to be financially comfortable in retirement in Australia. For a couple, this equates to a lump sum $640,000, or an income of around $62,500 per annum.

This is our primary measure of success, because it relates directly to what you can expect to spend in retirement. It might surprise you to learn that today, this is a standard that only 25% of Australians are on track to achieve. ASFA projects that this will increase to 50% by 2050, and that's still below the 71% of our full-time defined contribution and more than 90% of our contributing defined benefit customers, who are all on track to retire above this standard, assuming that we are your only source of superannuation savings. Indeed, our average full-time defined contribution customer is on track to accumulate 32% more than this standard by retirement.

Our second objective, which is to avoid assets that have a material risk of permanent capital impairment, recognises the very important difference between suffering a temporary paper loss on the journey towards retirement, what is commonly referred to as volatility, versus a permanent write-down in the principal value of your savings that cannot be recouped before you retire. We measure our capacity to avoid such risks with three metrics. The first is a comparison of our realised investment returns against their targets, as set out in the product disclosure statements for each option and calculated over multiple time horizons that roll through the course of your working life.

The return targets for each option are not random, and they're not driven by what everyone else is doing. They are precisely calculated to define what must be achieved on average over your working lifetime to deliver you financial comfort in retirement. As you can see from these charts, all three of our investment options are generating real returns after all fees and costs above their objectives across all time horizons greater than three years. Shorter-term measures of performance, either below or above targets, reveal more about the vagaries of markets than the enduring value of your savings, because as US stock investor Philip Fisher once said, the stock market is filled with individuals who know the price of everything but the value of nothing.

But returns only tell you about the past. The future of your savings will be determined by the risks you're carrying in your portfolio today and how they pay off or don't pay off in the future. Risk management, not just at the point of an investment, but also over its lifetime, is critical to ensuring that wealth is created and sustained. This is the focus of our second group of metrics, which I'm proud to say show that our public sector accumulation customers have never suffered any material write-off of their principal capital.

This is also true for members of the MSBS and ADF funds post-merger with us in 2012. By way of example, you had no exposure to highly complex leveraged debt instruments, or CDOs, as they were known, that hurt many investors through the global financial crisis. You had no exposure to any hedge fund liquidity or fraud events, nor have you suffered any material rise in private company bankruptcy rights, either through the financial crisis or earlier recessionary episodes, and certainly not through the COVID pandemic period to date.

Now, costs matter, too. They particularly matter when they don't pay off. We hunt to find value for money, rather than lowest-cost assets. We also want to be able to pay for the best operators and managers of our assets, so that their value is underwritten throughout their life in your portfolios. So our third set of metrics support us to operate with full transparency on all costs and fees and on the payoff we do or do not generate in your portfolio as a result of incurring them.

So compared to a lowest cost, passive implementation of each options' investment strategy, we have generated after fees and costs an additional 0.7% per annum for the balanced options, with 12% less variation in your savings balance, 1.8% per annum for our aggressive options, and over their shorter, five-year history, 1.5% per annum more for our income-focussed options. So by incurring costs above a passive strategy, we've generated higher average returns after those costs and reduced a risk of capital loss.

Our third and final objective is to build you a carefully curated selection of robust investment options as opposed to a me-too smorgasbord, so that you can be confident to make choices that can maximise your chances of achieving retirement adequacy, given your personal circumstances, because we're all unique. Unnecessarily complex or long lists of investment options are one of the greatest impediments to sound investment choices. They just shift the retirement risk from the super fund back to you, the customer, and they feed the natural bias we all have towards giving way too much attention to short-term factors that may not align with the time horizons relevant to achieving financial adequacy.

Each of our three pre-mixed options are tailored to take the type of investment risks you need to bear through the different stages of your working life in order to accumulate sufficient savings for retirement. We also offer a simple, pure cash option for normal capital preservation. Our aggressive option, which you can see in this table, is designed for customers who are a long way from retirement and can afford to remain focussed on capital appreciation over the duration of their working life. Our income-focussed option is designed for customers who want to reduce the risk of their accumulated wealth being eroded by poor market conditions in the approach to retirement but who still require growth in their savings to outpace the corrosive impact of inflation.

Both of these pre-mixed options take a comparable level of risk to similar products offered by other super funds and are consistently ranked among the top performers on their net real returns across all time periods. Importantly, as shown in the last column of this table, all of our options rank very highly across the industry in terms of the amount of net real returns they can generate per unit of capital at risk. This means that our competitive outperformance is driven by the quality of the assets we select and how we steward them as active owners through time, rather than by simply taking on more and more exposure to risky assets with the hope that this will pay off.

Our balanced option, into which you are defaulted if you do not make an active choice, generally takes lower risk than comparable products available through other super funds. This is because our balanced options are explicitly designed firstly to ensure a high probability of delivering a comfortable financial retirement to our customer base, not to the average Australian employee who has a lower probability of achieving retirement adequacy and therefore needs to bear greater risk. And secondly, to be true to label. By this, I mean to balance the risks of insufficient capital growth against the risks of capital impairment that might arise due to unexpected adverse market conditions.

As a result of this and as our Chairperson has already described, we expect that relative to other balanced funds, our option will capture most of the upside in robust markets. Historically, this has been between around 87% and 93%, and avoid much more of the downside when markets fall, historically, between 39% and 50%. This pattern is an important part of our investment strategy, because it recognises the asymmetric impact on your savings from losses. For example, if your savings fall by, say, 30%, a level comparable to losses experienced by balanced funds through the global financial crisis, you would have to earn 43% just to get back to where you started prior to the loss. And so our strategy borrows from the rather pithy wisdom of Nobel Prize Winner Paul Samuelson, who said, investing should be more like watching paint dry, watching grass grow. If you want excitement, take $800 and go to Las Vegas. In the end, investment strategies are a lot like buildings. Their ability to endure the elements depends on the construction of their foundations.

## *Governance*

The term used to describe investment foundations is governance, not to be confused with its less able but much faster propagating cousin, compliance. For our investment team, governance means having very strict and transparent risk budgets, a well-defined investment universe, robust valuation and macro toolkits, delegated authorities with precise accountabilities, early failure detection controls and a ruthless self-awareness of evolving and comparative advantage and disadvantage.

Our processes have been recognised with independent international awards for both governance, and much more importantly, in my view, for what good governance enables, namely, innovation and first mover advantage. But don't take my word for it. Let's look at some real examples of what this has allowed us to do for you. CSC was the first Australian super fund to implement a fully integrated portfolio-wide risk system. This is foundational to our ability to consider the complex interactions between assets, their tangible, and importantly intangible, attributes and the evolving world in which they operate.

We have been proactively triangulating corporations' financial value with their exposure to long-term and often slow to manifest governance, environmental and social risks for more than two decades, work recognised by the United Nations Innovation Award for Sustainability in 2003 and still acknowledged as global best practice today. We use these measures and others to actively engage with public and private companies that we own on your behalf when the potential to monetise better practices is material, and we vote all shareholder resolutions proposed by all of our public companies.

When engagement is futile and the risks to franchise value are material, we will exit our shareholdings, as we have done with undiversified thermal coal production and generation companies in 2020/2021, single entity producers of tobacco in 2013 and of cluster munitions and landmines back in 2011, and [of Forestry Enterprise, Guns Limited 53:05], approximately two years prior to the company being placed into administration in 2012.

## *Climate Risk*

Now, climate risk is number one on the World Economic Forum's Risk List this year, but we initiated transparency on this risk to your future savings back in 2009, when we invited the Climate Institute to measure our portfolio's carbon footprint. We were the first Australian super fund to do so by quite a long interval. Our investments in renewable energy have reduced our carbon emissions by 460 tonnes in 2020 alone, versus a listed energy index, and our public equity carbon footprint is 16% lower than it would have been had we maintained a passive benchmark exposure to climate risks.

In 2015, we acquired half of the largest wind farm in the Southern Hemisphere at that time, being Macarthur Wind Farm. This investment has generated strong returns of 14% per annum to December 2020, not in small part because we recognised the structural tailwinds to renewables before others did and were therefore able to make a very low risk investment at a relatively low price per megawatt of generation capacity. Our competitors who have followed us into renewable energy have been assuming greater risk and paying up to 68% more than we did. For us, sustainable investing is not just about renewable energy. To mitigate the risks arising from the global population's challenging demands on natural resources, our most

recent initiative has been to actively reduce our exposure to companies that misuse scarce natural resources.

Compared to the standard passive International Equity Index, this has efficiently halved water use and waste produced by companies in that particular segment of your portfolios. Our focus on structural changes and their implications for value creation and destruction extend well beyond ESG. Trends in technology and consumer preferences, for example, which I'm sure you're all aware of, have been formidable drivers of corporate and industry disruption. Motivated by our assessment that the infrastructure required for economic progress was less about traditional assets like toll roads and assets and rather more about digital infrastructure, like datacentres and fibre networks, we acquired a joint controlling interest in the Canberra Data Centres in September 2016.

As the first Australian super fund to directly invest in a datacentre, we were able to generate exceptional investment returns to you of 51% per annum from this asset since its purchase. In December 2019, we sold half our interest to lock in profit at almost two times our total cost, whilst retaining the remaining interest, which has continued to perform very strongly. In the interests of time, I have only been able to provide a very few tangible examples of our track record in hunting for high-quality assets ahead of the pack, and how that has enabled us to build high-quality portfolios robust to a myriad of market conditions and potential future states of the world.

The uncertain circumstances of our time, including the lowest interest rates in 800 years and unprecedented fiscal policy responses to the COVID-19 pandemic mean that we have been preparing your portfolios for resilience by building greater geographic diversity into our defensive assets and currencies, financing innovation, building new asset management businesses with revenue sharing arrangements, hedging against long-term inflation risk, maintaining our focus on the fundamental value and quality of assets, rather than their current prices, and being mindful of the fact that conditions are now conducive to creating extreme bubbles in some segments of financial markets, though with no certainty on timing.

I look forward to answering your questions about financial markets and our portfolios in the time remaining this evening, but remember what matters isn't how much money you make on paper at any point in time, but how much of that wealth you're able to keep and realise and spend on the things that matter to you in retirement.