

Product Review

Hostplus CPIplus

ISSUE DATE: 13-05-2024

Key information

INVESTMENT TYPE	RETIREMENT OPTION
ISSUER	HOSTPLUS PTY LTD
INVESTMENT OBJECTIVE	AIMS TO DELIVER A PREDETERMINED RETURN ABOVE CPI (CURRENTLY CPI + 2.0% P.A., WITH CPI CALCULATED AS AN AVERAGE OF THE LAST 2 CPI NUMBERS.) ¹
RISK OBJECTIVE (INTERNAL)	NEGATIVE RETURNS EXPECTED TO OCCUR IN LESS THAN 0.5 OUT OF EVERY 20 YRS
INVESTMENT TERM	NO SET TERM
MINIMUM INVESTMENT	\$10,000 MIN. BALANCE TO COMMENCE HOSTPLUS ABP (MIN. 1% ALLOCATION TO ANY INVESTMENT OPTION WITHIN ABP, INCLUDING CPIPLUS)
PRODUCT SIZE	\$390M (JULY 23)
INVESTMENT PROTECTION	DAILY RETURN FLOOR OF ZERO (RETURNS CANNOT BE NEGATIVE). NO EXPLICIT GUARANTEE.
INCOME PAID	CPIPLUS RETURNS INCREASE THROUGH INCREASES TO UNIT PRICES. HOSTPLUS ABP SUBJECT TO MINIMUM PENSION DRAWDOWN AMOUNTS.
SWITCHING	YES
INFLATION PROTECTION	YES - TARGET RETURN OBJECTIVE SET ABOVE CPI
ANNUAL FEES & COSTS	ADMINISTRATION FEES AND COSTS²: \$234 P.A. + 0.0165% P.A. OF ACCOUNT BALANCE INVESTMENT FEES AND COSTS (INC. PERFORMANCE FEE): 0.89% TRANSACTION COSTS: 0.10%

1 The predetermined return is net of investment fees and costs. 2 Administration fees and costs are costs for the Account Based Pension

What this Rating Means

The 'Approved' rating indicates that Lonsec believes the financial product can generate risk adjusted returns in line with relevant objectives.

Scope of this Rating

The research process has included, but is not restricted to, the Lonsec Ratings Process for structured products. Lonsec has not sought legal advice regarding the structure of the product or engaged specialist taxation or actuarial advice.

Lonsec's rating does not represent a credit rating. Investors in the product must be satisfied with the credit worthiness of Hostplus and the regulatory oversight provided by APRA.

Using this Product

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page. Investors are advised to read the Product Disclosure Statement prior to making any investment decision.

Lonsec notes that the Manager has produced a Target Market Determination (TMD) which forms part of the product issuer's Design and Distribution Obligations for the Fund. Lonsec has collected the TMD that has been provided by the Manager and notes that this should be referred to for further details on the Target Market Summary, Description of Target Market and Review Triggers.

Lonsec sees the product potentially suiting:

- Retirees wanting an investment that offers a balance of stability and growth while safeguarding against rising inflation.
- Retirees wanting more certainty over their investment return and a pre-determined return above the level of inflation over time.
- Retirees concerned about sequencing risk or outliving their savings.
- Retirees that are members of Hostplus Pension (retirement phase).

Lonsec considers the **pension option** to have a place alongside other retirement products available to Australian retirees and to form part of an overall retirement strategy.

We strongly recommend that potential investors read the product disclosure statement

Lonsec Research Pty Ltd ABN 11 151 658 561 • AFSL No. 421 445 • This information must be read in conjunction with the warning, disclaimer, and disclosure at the end of this document. This report supersedes all prior reports.

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Risk characteristics

	LOW	MODERATE	HIGH
LEVERAGE RISK	●		
LIQUIDITY RISK		●	
CONCENTRATION RISK	●		
VOLATILITY RISK	●		

Risk categories are based on Lonsec’s qualitative opinion of the risks inherent in the product’s asset class and the risks relative to other products in the relevant Lonsec sector universe.

What is the product?

The Hostplus CPIplus option (‘the Option’) is designed to provide returns that are more certain and less volatile than those available by investing in growth assets, such as shares, while offering higher returns than those available by investing in conservative assets, such as cash.

The assets of the CPIplus option are invested in the same pool and alongside the Hostplus Balanced option in the pension phase, however the return outcome of CPIplus will be independent of the underlying investment performance. The CPIplus return formula provides for a minimum daily return floor of zero, meaning that irrespective of movements in CPI, the daily return of CPIplus will not be negative even if the CPI rate applicable to that period was negative.

Members investing in the Option should note that while returns are pre-determined, and increase the level of certainty in delivering a stated outcome, the return itself is not guaranteed.

Lonsec notes that the Option is only available to members of the Hostplus Pension (retirement phase).

Unless specified otherwise in the product disclosure statement dated 1 July 2023, all standard terms of Hostplus Pension (such as and including the opening account balance, minimum and maximum investments, investment switching) apply to CPIplus.

Lonsec Opinion of this Product

- Lonsec has initiated Hostplus CPIplus with an ‘Approved’ rating. The rating is supported by the well thought out, innovative product design that protects against inflation risk and caters towards the diverse needs of retirees in the Hostplus pension account. The option is designed to increase the consistency of investment returns while continuing to maintain the simplicity, flexibility and liquidity of an account-based pension.
- Lonsec acknowledges the product has several attractive features:
 - A predetermined return that exceeds CPI;
 - It provides retirees with a greater certainty in the balance of their retirement savings and associated comfort in the ability to plan for future spending needs;
 - Regardless of fluctuations in CPI, returns will never be below zero for any return period;
- It maintains the liquidity and flexibility associated with an account-based pension.
- While returns are not guaranteed, the Option provides a level of flexibility that is not typical in retirement products that provide greater certainty of return associated with them. For example, assets remain accessible rather than being ‘locked up’. Switches and redemptions from the Option can be requested at any time.
- The product is suitable to act concurrently with other income stream products to create a retirement income portfolio that meets several objectives.
- The product design is viewed favourably bearing similarities with a ‘swap arrangement’ where one party agrees to exchange the return of their investment with the return outcome of another party. In this relationship, the return outcome of one asset is typically fixed and the other is variable. That said, these arrangements are typically complex and come with counterparty risks, both of which are largely mitigated in the design of the Option.
- In simplistic terms, members in the Option forgo the excess return of being invested in the same pool of assets as the Balanced Option, in exchange for a certain return. This means the Balanced Option receives the benefit of any excess return while paying the CPIplus members the agreed CPI + ‘n’ return. In instances where the investment return of the underlying assets falls short of the agreed CPI+ ‘n’ return, the Balanced Option makes up the shortfall.
- While acknowledging the favourable design and overall proposition, Lonsec notes it is still in its relative infancy and further enhancements could be made with more formal asset/liability matching programmes introduced. In this regard, Hostplus may be able to leverage its relationships with external parties. Should this occur, it may make the Option more scalable into the future.
- Fundamental to the viability of the proposition is that the return of the underlying investment, the Hostplus Balanced option, is expected to be greater than the Option through time, noting it could be less in any one year. That said, not all members may be willing to accept the greater level of investment risk that comes with investing in the Balanced Option and be willing to sacrifice the potential for greater upside through time in exchange for greater stability and predictability. Lonsec suggests retirees consult with a financial adviser and consider their own personal circumstances. As with all retirement options, the use of the Option should be considered as a part of, rather than the sole, retirement solution.
- Lonsec believes that CPI linked investment options can play a legitimate role in the suite of retirement products available to Australian retirees. By providing a more certain investment return outcome, even if the underlying investment suffers negative returns, this type of product can help to alleviate concerns about sequencing risk, the potential to outlive retirement savings, or that retirement savings keep pace with inflation.

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- CPIplus's target return objective exceeds the rate of inflation, maintaining the real value of a member's investment returns. Over the long term, this objective provides a return profile that is more consistent, certain and less volatile than that offered by growth assets, such as shares, while offering higher returns than those available by investing in conservative assets, such as cash.
- As the target return is fixed (above CPI) for a specified return period (usually a year), the returns on the underlying investments do not impact the returns for the Option. Lonsec notes that the same is true in the instance of outperformance, i.e. the benefits of the underlying assets exceeding the objective are not derived by the investor.
- Lonsec notes that Hostplus has appropriate processes to provide a predetermined return investment product. Further, Lonsec believes the resourcing of the investment team overseeing investment selection and ongoing monitoring to be commensurate with requirements and further supported by an investment committee of four including one relevant external third party.
- Members of the Option should be aware that the value of 'n' may change from one year to the next, albeit Hostplus does not expect any significant variation through the cycle. That said, the value of 'n' could be lower or higher than the current 2% in future return periods. Furthermore, Hostplus may decide to discontinue the Option. Lonsec notes if the Option became too large, it would become impractical to offer given the more material risks to Balanced Option members.
- The total management fee charged to investors is a combination of Hostplus's administration fee, the investment management fee (including performance fees) and net transaction costs. Further, the return objective of CPIplus is net of investment fees and costs and performance fees. Lonsec notes the ongoing annual fees and costs are the same as the Balanced Option and pleasingly no additional fees are charged for the certainty of the return outcome. The fee is considered attractive given the nature of the Option and its overall proposition.

How does the Product work?

Hostplus CPIplus is an investment option offered within the Hostplus account-based pension. It offers members the certainty of a known rate of return in access of CPI.

Calculating the rate of return

The return of the CPIplus option is set in advance for each Return Period (currently 12 months from 1 July) and is expressed as a predetermined rate, 'n', above the average Consumer Price Index (CPI) rate. The return for each Return Period is calculated using a formula, $CPI + 'n'$, where CPI is based on the average consumer price index rate for the last two quarters (and is updated each quarter) and 'n' is a predetermined rate of return (compounded daily over the Return Period) determined by Hostplus each year as part of its annual investment strategy review. The CPIplus return formula provides

for a minimum daily return floor of zero, meaning that irrespective of movements in CPI, the daily return of CPIplus will not be negative even if the CPI rate applicable to that period was negative. Although the rate for 'n' is predetermined for a Return Period, Hostplus reserves the right to shorten the Return Period or discontinue offering the predetermined return, however if it does so, members invested in CPIplus will be notified as per the notification process.

The CPIplus return formula including the value for 'n' will be regularly reviewed by Hostplus, in accordance with existing investment strategy and policy settings, and adjusted for future Return Periods if considered appropriate or necessary.

The assets of CPIplus are invested in the same pool and alongside the Balanced option pursuant to the option's current investment strategy. Returns in CPIplus are unaffected by returns on the underlying investments. The Balanced Option receives the benefit of any excess market returns generated on the underlying assets, while making up the shortfall if the CPIplus underlying assets fall short of the predetermined return.

The predetermined 'n' rate is reviewed annually and involves balancing the interests of members in the CPIplus option (who benefit from a higher 'n') against the interests of members in the Balanced option within the accumulation phase (who benefit from a lower 'n').

The CPI rate used in the CPIplus formula is based on the average CPI rate for the last two quarters, and the rate is updated four times a year to align with the most recent quarterly release of CPI information by the ABS. For example, if the relevant CPI rate for the quarters ending March and June are 1.5% and 1.2% respectively, the CPI rate for CPIplus from 1 August will be 1.35% (the average). Each application period commences one month following quarter end, as the ABS CPI data release occurs during this month.

Illustrative outcomes of the Option vs the Balanced Option

The chart below show the performance of the Hostplus Balanced option on a rolling 12-month basis versus the hypothetical performance of Hostplus CPIplus had it been offered over the last decade and with a predetermined rate of return of $CPI + 2\%$ p.a. In most rolling 12-month periods, Hostplus Balanced has outperformed the hypothetical $CPI + 2\%$ p.a. return, however the return has been generated with materially more volatility, and on occasion realised a negative return.

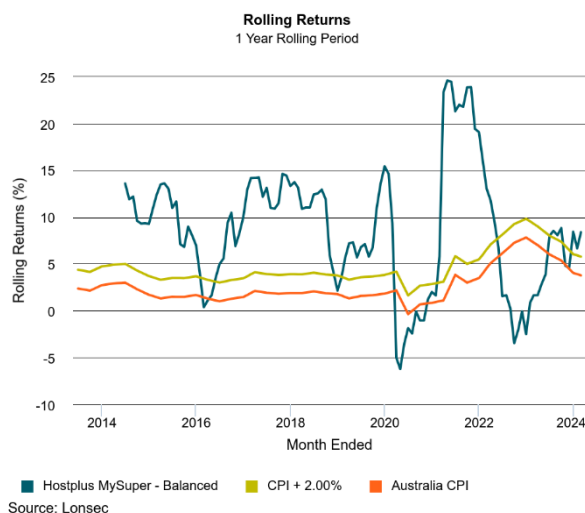
Members of the CPIplus option sacrifice the higher returns of the Balanced option in exchange for more certain and less volatile returns.

As can be seen in recent periods, the $CPI + 2\%$ return has been higher than the return of the Balanced Option

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given the volatility of markets. In these circumstances, the Balanced Option has funded the shortfall to pay the pre-determined return to CPIplus members.



Relevant Parties

The issuer of the investment linked lifetime annuity is **Host-Plus Pty Limited** ('Hostplus').

Host-Plus Pty Limited is one of the country's largest profit-to-member industry superannuation funds, managing the retirement savings of over 1.8 million members across 305,000 employers. As at 31 October 2023, funds under management stood at \$100.9bn, with strong annual cashflow.

More information on Hostplus is available from <https://hostplus.com.au/>.

People and Resources

Hostplus – Investment team key decision makers

Name	Position	Years Exp. ¹
SAM SICILIA	CHIEF INVESTMENT OFFICER	29/16
GREG CLERK	DEPUTY CIO - INVESTMENT STRATEGY & RISK	25/8
CON MICHALAKIS	DEPUTY CIO - PORTFOLIO CONSTRUCTION	31/2

1: Number of years' experience in industry / with Hostplus.

The Hostplus Investment team, led by CIO Sam Sicilia and supported by Deputy CIOs Greg Clerk and Con Michalakakis, comprises 23 professionals managing a broad diversified set of asset classes, though the Fund has a heavier focus on unlisted assets versus some of its peers.

Sicilia, who has 30 years of industry experience, is responsible for capital markets and generating

investment insights for the Fund. Clerk joined the Fund in 2016 but had a lengthy working relationship with the Fund prior to his appointment in his role at JANA where he spent 17 years, most recently as the primary asset consultant to the Fund. Michalakakis joined the Fund in May 2022 following the merger with Statewide (where he was CIO) and is responsible for leading the fund's portfolio construction team.

The senior leaders have significant tenure within the team and bring a broad range of experience in investment consulting and asset ownership. Since 2002, the Fund has exclusively used JANA for asset consulting, acknowledging JANA's extensive research capabilities. JANA is responsible for researching and monitoring the strategic asset allocation ('SAA') and dynamic asset allocation ('DAA') at the Fund. Furthermore, the Fund leverages JANA's manager research process, while the Fund's internal investment team is involved in the later stages of the manager diligence process and meets with all potential managers prior to onboarding.

The investment team is considered smaller than peers with a similar level of assets under management. That said, the Fund predominantly outsources the management of its investments to external managers, except for direct investments and co-investments in property, infrastructure, and private equity, which have grown in recent years.

Asset allocation and manager selection decisions are ultimately made by the Trustee Board with guidance and input from the investment team supplemented by JANA. JANA is responsible for researching and monitoring the strategic asset allocation ('SAA') of the Fund. JANA's asset allocation is determined quarterly by the in-house committee, then tailored to meet the objectives of the Fund.

Hostplus has been committed to outsourcing its investment requirements to external managers, except for some investments within the property, infrastructure and private equity asset classes, where the Fund has increased its direct investments and co-investments in the past few years. For external managers, mandates are predominantly used with selection focused on high conviction, boutique style managers. The Fund has historically allocated materially to unlisted assets with a soft limit of 40% of the Fund applied.

Regulatory Environment

The Fund is a registrable superannuation entity (RSE) for which Host-plus Pty Ltd is the issuer and the Trustee. APRA regulates the trustees of superannuation funds who are required to act in the best interest of their members. The Fund uses tier 1 service providers. APRA has not flagged any concerns at the time of this review.

Risk Management

The Board charter details key policies and processes the Board has in place for the governance of the Option, as well as the key roles and responsibilities of the Board.

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Separate to this, the Fund's in-house Group Executive, Legal & Compliance oversees a compliance program which includes three risk management frameworks. Lonsec considers the existing compliance structure in place at the Fund to be adequate.

The investment team conducts portfolio analytics primarily via Aladdin (integrated with eFront for private markets), which has been operational since Q1 2023. The addition of Aladdin is viewed favourably given it is viewed as a best-in-class risk management system noting that it may take time to fully implement and make the most use of its functionality. The Manager still accesses JANA's tools including Solve for top-down asset allocation. However, Hostplus has improved their investment risk and performance analytical systems in recent years which is viewed as a significant uplift and enables a much greater 'whole-of-portfolio' view.

Risks

An investment in CPIplus carries several standard investment risks associated with international investment markets. These include economic, political, legal, tax and regulatory risks. These and other risks are outlined in the PDS and should be read in full and understood by investors. Below are what Lonsec considers to be the major risks:

Product design

As the predetermined return formula (including 'n') is only set for the defined Return Period (usually 12 months from 1 July), the predetermined rate 'n', other aspects of the predetermined return formula, or terms of operation of CPIplus such as formula methodology, product rules, etc. may change in future Return Periods.

Although the Investment strategy reviews and determination of 'n' are scheduled to occur annually, Hostplus reserves the right to shorten the Return Period or discontinue offering the predetermined rate. Hostplus may conduct an interim investment strategy review if a 'risk trigger event' occurs.

Wind-up risk

Similar to other Hostplus pension investment options and while Hostplus expects to offer CPIplus to its pension members on an ongoing basis over the long term, Hostplus reserves the right and could determine to not offer CPIplus in the future.

Liquidity Risk

Investors may be exposed to liquidity risk given the illiquid nature of some investments. Investments may be difficult or impossible to sell, either due to factors specific to that investment, or to prevailing market conditions. Liquidity risk may mean that an asset is unable to be sold or the Option's exposure is unable to be rebalanced within a timely period and at a fair price, potentially resulting in delays in redemption processing, or even the suspension of redemptions.

Regulatory risk

Changes in government policies, regulations and laws could affect the value, and/or tax treatment, of any investment in the Hostplus Pension Account.

Members should review the PDS for other potential risks.

Taxation

These comments constitute 'General Advice' only and Lonsec advises potential investors to consult a taxation specialist before deciding to invest (or not to invest) based upon these taxation considerations. Investors should refer to the Taxation considerations of the PDS for further information. Contact Information

For further information:

Telephone: 1300 467 875

Web: <https://hostplus.com.au/>

About Lonsec

Lonsec Research Pty Ltd (Lonsec) is an investment research house with specialist areas of expertise, which was originally established in 1994 and the current entity was registered on 23 June 2011. From 1 July 2011, Lonsec became a fully owned subsidiary of Lonsec Fiscal Holdings Pty Ltd, a privately owned and independent entity with a multi-brand strategy of providing leading financial services research and investment execution.

Lonsec believes that professional financial advisers need informed opinions on the best investment strategies and financial products to provide real value for their clients. To meet this need, Lonsec has in place an experienced research team, which draws on a robust research process to undertake in-depth assessment of managed fund products.

Analyst Disclosure and Certification

Analyst remuneration is not linked to the research or rating outcome. Where financial products are mentioned, the Analyst(s) may hold the financial product(s) referred to in this document, but Lonsec considers such holdings not to be sufficiently material to compromise the rating or advice. Analyst holdings may change during the life of this document. The Analyst(s) certify that the views expressed in this document accurately reflect their personal, professional opinion about the matters and financial product(s) to which this document refers.

Date prepared

May 2024

Analyst

Darrell Clark

Release authorised by

Nathan Umapathy

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