Getting the edge with managed funds

An IFSA guide to understanding managed investments

Over nine million Australians have over $1 trillion invested in managed investments. This makes Australia the fourth largest market in the world[1], not insignificant given our comparatively small population. Australia has a strong and stable managed investments industry and a world-class regulatory system that delivers the level of consumer protection that investors demand.

The increasing number of competitors and the number of new institutions offering products in Australia are strong indicators of the industry's viability and growth prospects.

What is a managed investment?

A managed investment is an investment fund made up of a pool of money that comes from many people who have similar goals. Managed investments are also known as managed investment schemes, managed funds or unit trusts.

A professional investment manager invests the pool of money in line with the goals of the investors by purchasing securities in a variety of asset classes including shares, property, fixed interest, cash, or a mixture of these. Examples of goals could be to provide a regular income while maintaining the value of the investment over the short term, or to generate growth over the long term.

There are hundreds of managed investments available to investors, each with its own risk and return characteristics. This diversity caters for an array of different investment needs.

Many Australians already invest in managed investments without realising it - through their super fund. You can also invest in managed investments outside the super system.

What are the different kinds of managed investments?

Managed investments can be divided into two categories - single sector or multi-sector funds.

Single sector

As the name suggests, single sector funds invest in a single asset class, such as Australian shares. However, they still diversify across a number of investments within the specific asset class. Examples of diversification within a single sector fund could include an Australian share fund which invests in shares from a range of different industries, such as mining, pharmaceuticals and telecommunications.

[1] International Investment Funds Association survey of investment funds for the June quarter 2003.

Multi-sector

Multi-sector or diversified funds invest across a range of asset classes, which usually include shares, property, fixed interest securities (bonds) and cash.

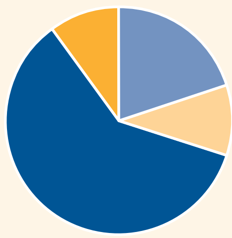
Multi-sector funds provide a choice between:

- Growth funds - which invest mainly in shares
- Conservative funds - which invest mainly in fixed interest securities and cash
- Balanced funds - which invest in a balance between investment types

Single-sector example

International Share Fund

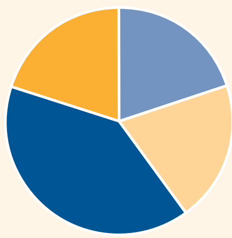
- Japan 20%
- Asia 10%
- Europe 60%
- North America 10%



Multi-sector example

Balanced Fund

- Australian Shares 20%
- Property 20%
- Cash & Fixed Interest 40%
- Global Shares 20%



The Investment and Financial Services Association Ltd ABN 82 080 744 163 represents the retail and wholesale superannuation, funds management and life insurance industries. IFSA has over 140 members who are responsible for investing over $950 billion, on behalf of ten million Australians. Members' compliance with IFSA Standards and Guidance Notes ensures the promotion of industry best practice. IFSA website: www.ifsa.com.au

How managed investments work

What are units?

When you invest in a managed investment, you are allocated units representing your interest in the fund. The number of units that you have represents your share of the fund. The number of units you are allocated is calculated as follows:

dollar value invested / unit price = number of units allocated
$1,000 / 1.0100 = 990.0990

Each unit in a fund is of equal value, but the price of a unit can fluctuate from day to day. This is because the value of your units will change over time, based on the market value of the fund's investments. So if the value of the investments in the fund rises - so will the value of your units. Similarly, if the value of the fund falls, the value of your units will also decline.

To determine the dollar value of your investment, multiply the number of units you hold by the current unit price for the fund.

number of units x current unit price =
dollar value of your investment
1,000 units x 1.1250 = $1,125.00

Who manages my investment?

A professional investment manager follows processes and procedures designed to ensure the fund's investments remain consistent with its investment objective.

Investment managers have the resources to monitor investment markets and research current trends, enabling them to act on opportunities as they arise. Usually, an investment manager will dedicate certain team members to specific markets such as Australian shares, international shares, property or fixed interest.

Where do returns come from?

Returns from managed investments generally come in two forms - income and capital growth.

Income is based on the earnings from the fund's assets over the period and may include income from share dividends, rent from property, or interest from cash investments as well as capital gains from the sale of shares or other investments within the fund.

Income is paid to the investor as a 'distribution', typically on a quarterly basis. Most funds allow investors to reinvest their distributions back into the fund in exchange for additional units.

Capital growth comes from increases in the value of the fund's assets and is reflected in changes in the unit price. Investors profit from this growth when they decide to sell their units.

How much do I need to get started?

To start investing, most managed investments require a minimum investment amount of $1,000. However, some funds accept as little as $500 if investors opt to start a regular savings plan with monthly contributions of anywhere from $100 upwards.

How are managed investments taxed?

Any distributions you receive are income and are taxed in the following way:

- Dividend component - taxed at your highest marginal tax rate. If the dividends have been franked you will receive franking credits. Franking credits represent the tax paid by companies on their earnings and can be passed on to shareholders via dividends.
- Interest and income from the sale of assets - taxed on 50% of the gain if the fund has owned the asset for more than 12 months, or 100% if less than 12 months.

You will also need to consider capital gains tax if you sell any part of your holdings in the fund.

What is a PDS and do I need to read it?

Every managed investment has a Product Disclosure Statement (PDS) which provides detailed information about the investment, its fees and objectives. You need to read the PDS before applying for units in the fund.

Visit our website www.ifsa.com.au and click on *about our industry* and then *publications* for a free copy of the guide *Model MIS PDS*.

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What are the fees? [1]

Below is a listing of some of the fees that may be charged in relation to a managed investment. Not all funds will charge all fees.

Establishment fee	This is the fee to set up your account in the fund.
Contribution fee	This is the fee for the initial and every subsequent investment you make to the fund (or that may be made on your behalf, eg by an employer).
Withdrawal fee	This is the fee charged for each withdrawal you make from the fund (including any instalment payments and your final payment).
Termination fee	This is the fee when you close your account with the fund.
Ongoing fees	This is the total of all ongoing administration, investment management, expense recovery and other fees charged by the fund.
Switching fee	This is the fee charged when you switch between investment options offered by the fund.
Adviser service fee	This is the fee charged by your adviser for advice about your investment(s) in the fund. An adviser may also receive other amounts as commission.

Source: IFSA Model Product Disclosure Statement (PDS) Managed Investment Schemes

Annual ongoing fees for a managed investment will usually fall between 1.5% and 2.5%.

You should find a similar fee structure in all PDS's issued by managers who are members of IFSA. IFSA requires that all investment managers of its member companies calculate and publish fees so that investors are able to compare funds on a cost basis. Look for IFSA member funds or for the IFSA logo when selecting a fund.

Are managed investments expensive?

To determine whether a managed investment offers you value, you need to consider the costs and benefits, when compared with other investment opportunities.

Consider investment property. When people talk about the gains they have made from a direct property investment they usually ignore costs such as the agent's commission, stamp duty, legal fees, council rates, insurance, ongoing maintenance and periods of vacancy.

Taxes, charges and levies can amount to between 13.4% and 26% of the sale price on new house and land packages in capital cities around Australia.[2] It is generally accepted by market economists that the 'yield' on residential property in Australia now averages around 3.5%.

Holding shares directly also normally entails brokerage costs. In addition, it is difficult to invest in the number and quality of shares that you gain access to through a managed fund without incurring significant costs, unless you invest large sums of money. This is particularly so if you are considering a regular savings plan.

FSRA - protecting investors

Investors can benefit from higher levels of protection when investing in a managed investment following the introduction of the Financial Services Reform Act (FSRA) in March 2002. FSRA establishes a single licensing and disclosure regime for all retail financial products and services. The key objective of FSRA is to create a streamlined framework to promote higher levels of integrity and consumer protection.

It means that anyone providing financial services must have an Australian Financial Services licence or become the representative of a licence. Applicants have to meet minimum standards surrounding educational qualifications and experience and demonstrate that adequate arrangements are in place for supervising and monitoring the conduct or representatives.

Reforms such as FSRA have cemented the reputation of Australia's financial services industry as being among the most efficiently regulated in the world. It means that investors now enjoy better protection when investing through managed funds, which are not available through other forms of investments.

Why invest in a managed fund?

Managed funds can help you make the most of your time and money - here's why.

> You don't need much to get started

An initial investment of $1,000 is enough to get you started with most funds or $500 when combined with a regular investment plan.

> Professionals manage your money

Few individual investors have the time and knowledge to research and maintain an investment portfolio. A managed investment offers investors the opportunity to tap into the fund manager's resources, investment expertise and experience.

> More investment opportunities

Because a managed investment pools the money of many investors, the fund has the buying power to access assets

[1] These fees appear in the ASIC Fee Template and will be provided by all IFSA members in their PDS's over the next 12 months.

[2] These figures take into account embedded taxes, charges and levies on new house and land packages. Source Housing Industry Association.

not ordinarily available to individuals - such as private equity, large infrastructure projects and shopping centres.

> Instant diversification

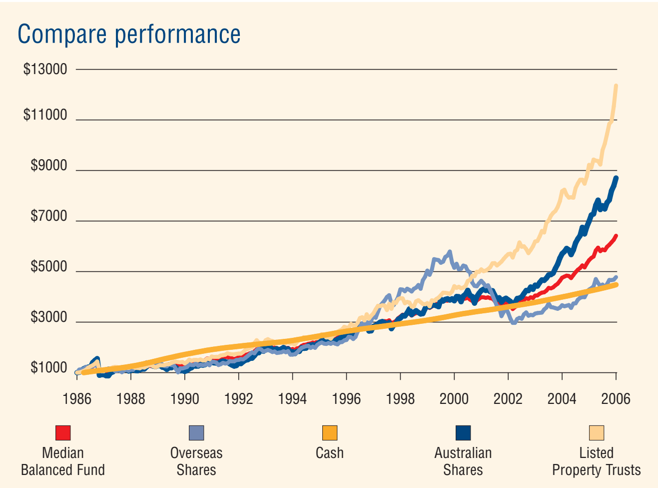
Diversification, or spreading your money across a number of different investments, reduces your reliance on the performance of any one investment. It means if one investment falls in value, others that are performing well may make up for the loss.

Through a single managed investment you can diversify across asset classes, companies, industries, sectors, countries and even investment managers. For example, through an Australian share fund, it's possible to hold up to 90 different companies - regardless of how small your initial investment may be.

Some managed investments also provide access to international investments. Given the Australian sharemarket represents just over 2% of the world's sharemarkets, it makes sense to consider offshore exposure.

> Returns to help your savings grow

The chart shows the performance of an investment in a median growth and a median balanced managed investment compared to an investment in cash and property over the last 20 years.



Source: Mercer Investment Consulting. Chart shows returns over 20 years to Dec 2006.

> A wide choice

With so many funds available, most investors are able to find one whose investment objective matches their needs.

> An easy way to save

Most managed investments offer the convenience of a regular investment plan via direct debit. Saving even a small amount each month can add up over time. Or investors can opt to reinvest their distributions and benefit from earnings on their earnings.

The chart shows the growth of an initial investment of $1,000 in a balanced fund combined with a regular savings plan of $100 a month over 20 years.

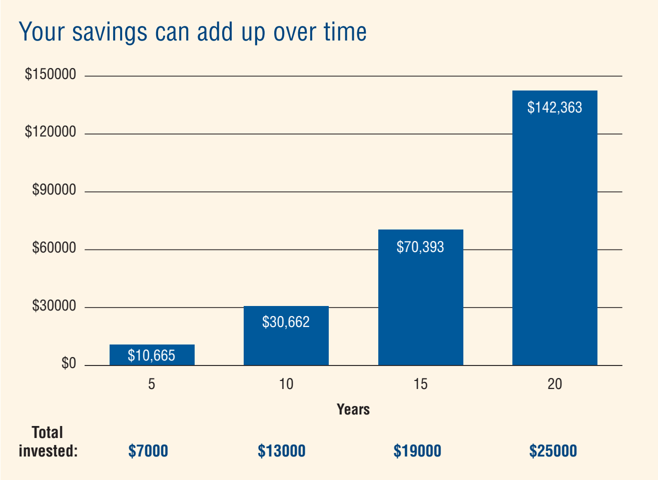


Chart shows investment into Mercer Median Balanced Fund for periods to Dec 2006. Returns are after tax and management fees.

> Access to your money

When you invest in a managed investment outside the super system, your money is not tied up - you can access your funds whenever you need them but be aware that most funds require some notice of withdrawal and may also incur exit costs depending on how long you've been invested and on your agreed fee structure. It is important to be aware though, that most managed investments have a recommended period of investment. If you withdraw your funds before this period, it may be harder to achieve your financial goals.

> Opportunities for gearing

Borrowing money to invest in a managed investment scheme is called gearing. Gearing can increase the profits you could make on your investments because you can invest more money. On the down side, there is a greater risk if unit prices fall or if interest rates on borrowed money increase. Gearing into Australian and/or international share funds may offer tax advantages for some investors.

> Information is readily available

Most fund managers provide convenient access to current information about your investments, including your account balance, transaction history, fund performance and unit prices. You can usually obtain this information via the internet, phone or through the post. Fund managers also keep investors informed about their investments through regular reports and updates.

> Investor protection

In Australia there are strict laws to protect consumers of financial service products. Ordinary or non-super managed investments are operated by a responsible entity, which protects the interests of the investors. Responsible entities are regulated under the Corporations Act 2001 and related legislation. Superannuation funds are managed by a trustee who is required to comply with the Superannuation Industry (Supervision) Act 1993.

Australia's corporate regulatory framework is regarded as one of the most stringent regulatory regimes in the world.

Managed funds and superannuation funds are regulated by the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA). These bodies take an active role in supervising the industry.

Choosing a managed investment

When deciding which managed investment is right for you, consider three key factors.

1

Investment time horizon

Time horizon is the length of time before you want to access your funds. It is important because it can influence how aggressively you invest.

Shares and property have a high risk and also the potential for higher returns over the long term. Cash and fixed interest are more stable investments. They carry lower risk and generally produce lower returns.

If you have a longer time horizon, you may choose to invest for growth as you have time to ride out the ups and downs of the market in the short term in order to maximise returns over the long term.

If you have a shorter time horizon, security may be more important and you may choose investments with a lower risk.

2

Risk tolerance

Risk tolerance is your ability or willingness to tolerate declines in the value of your investments while you wait for them to return a profit. Some people lose sleep if the value of their investment falls marginally, while others are relaxed even when their investment is moving up and down dramatically.

If your risk tolerance is high you are more likely to feel comfortable investing for growth in assets such as shares and property. If you have a low risk tolerance, cash and fixed interest may be more appropriate for you.

Risk tolerance is an individual issue, so make sure you consider how you feel about it before making any decisions.

3

Investment return

Investors need to decide if they want their investment to pay them income, if they would like it to grow in value, or if they want a combination of the two. Historically, shares and property have provided higher returns over the long term when compared to cash and fixed interest investments. However, if your goals are within reach, you probably won't need to consider taking on higher risk.

In addition to these three factors, the methodology or style adopted by an investment manager is worth considering. For example, some managers invest to achieve a benchmark, and provide cheaper fees, while others believe they can generate additional returns through active management, but tend to charge higher fees. There are many different styles available, so shop around and find a manager whose approach matches your own ideas about investing. Most managers will outline their style on their website or in other information brochures.

It's also important to select a manager with a solid reputation. Check that the fund manager, or responsible entity, is licensed and the fund is registered with ASIC. Make sure you read the Product Disclosure Statement (PDS) to ensure the soundness of its constitution and compliance plan. Make sure that you are comfortable with the purpose of the fund and that the fund is meeting its legal obligations.

How to get a managed investment

To invest in a managed investment complete the application form attached to the PDS supplied by the provider of your choice and send it with your cheque as directed. You can get a PDS directly from the fund's responsible entity/fund manager.

Or you can talk to your financial planner who will also act as your guide when you select a managed investment. IFSA's *Six easy steps* can help you find a financial planner with whom you feel comfortable.

Getting the edge...

This brochure is part of IFSA's education initiative. To learn more about managed funds and investing check the IFSA website for other fact sheets and guides.

www.ifsa.com.au

Need more information?

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- Product Disclosure Statements
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