Affluence FUNDS MANAGEMENT

A Guide To Finding The Best Listed Investment Companies

Issued By Affluence Funds Management Pty Ltd
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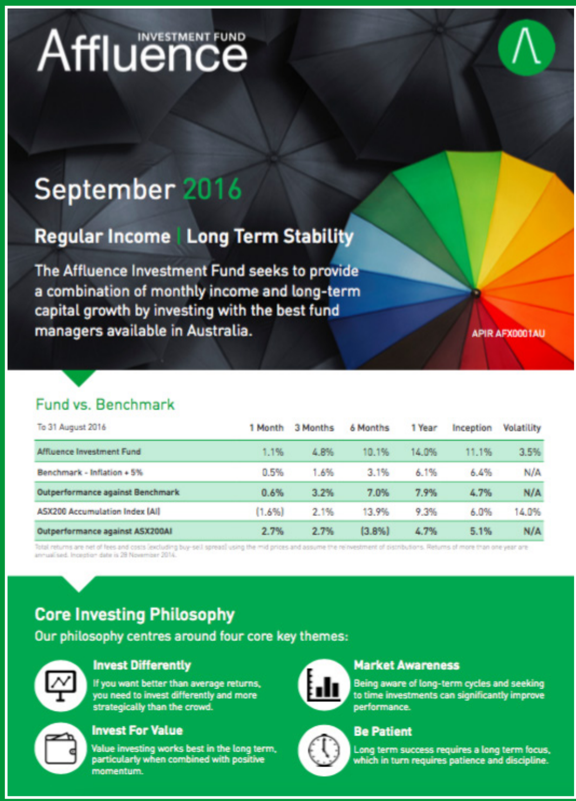
About Affluence Funds Management

Affluence Funds Management was founded in 2015 to provide investors with a better investment solution. Our focus is on delivering superior long-term investment performance and in providing quality education and investment ideas for our members.

At Affluence, we believe in doing things differently. We are contrarian, value focused, and invest for the long term. We aim to offer our investors only the very best quality investments from the top 1% of fund managers.

We are patient investors. We focus not only on finding the best investments, but on being aware of market cycles and on diversifying investments across all types of assets in our search for consistent, positive long term returns.


Affluence INVESTMENT FUND

September 2016

Regular Income | Long Term Stability

The Affluence Investment Fund seeks to provide a combination of monthly income and long-term capital growth by investing with the best fund managers available in Australia.

APIR AFX0001AU

Fund vs. Benchmark

To 31 August 2016	1 Month	3 Months	6 Months	1 Year	Inception	Volatility
Affluence Investment Fund	1.1%	4.8%	10.1%	14.0%	11.1%	3.5%
Benchmark - Inflation + 5%	0.5%	1.6%	3.1%	6.1%	6.4%	N/A
Outperformance against Benchmark	0.6%	3.2%	7.0%	7.9%	4.7%	N/A
ASX200 Accumulation Index (AI)	(1.6%)	2.1%	13.9%	9.3%	6.0%	14.0%
Outperformance against ASX200AI	2.7%	2.7%	(3.8%)	4.7%	5.1%	N/A

Core Investing Philosophy

Our philosophy centres around four core key themes:

Invest Differently

If you want better than average returns, you need to invest differently and more strategically than the crowd.

Market Awareness

Being aware of long-term cycles and seeking to time investments can significantly improve performance.

Invest For Value

Value investing works best in the long term, particularly when combined with positive momentum.

Be Patient

Long term success requires a long term focus, which in turn requires patience and discipline.

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Welcome

There are now over 80 Listed Investment Companies (or LICs) available for you to choose from on the Australian Stock Exchange (ASX). In recent years there has been a mini-boom, with a number of fund managers bringing new products to the market.

Through LICs you can now gain exposure to Australian and International Shares, as well as a number of other asset classes.

Many LICs are run by exceptional managers, using differentiated investment strategies that can help you to diversify your investment portfolio.

At Affluence, we recently undertook a year-long project to assess the best LICs and managed funds. This guide contains hints on how we did it, what we looked for, and what we found. We hope you find it useful.

While our process is designed to identify the best, we have not included a list of the best LICs because our views change over time. This is based on the performance of the manager, our opinion of the value of the underlying market the LIC invests in, and their trading price relative to NTA. You can access an up to date list of our key investment holdings by registering as an Affluence Member on our website.

Our methodology requires us to identify the top tier of LICs based on various criteria, and then to try to buy them at the best price we can. They key tool we use to identify whether an LIC is expensive or cheap is its trading price on ASX, relative to the value of the underlying assets it holds. This is known as the premium or discount to NTA.

Many of the top tier LICs we admire the most are too expensive much of the time. And so we patiently wait until we can buy them at the right price.

We hope the information in this guide is of value to you in your own investing journey.

As with all our publications, we value feedback, so please let us know if there is anything we can improve upon.

Introduction to LICs

What is a Listed Investment Company?

A Listed Investment Company, or LIC is a specialised type of investing fund.

An LIC (pronounced "lick") is a company that pools together shareholders' money and invests it under an approved investment strategy.

LICs are listed and traded on the Australian Stock Exchange (ASX) and other securities exchanges around the world.

In many ways LICs are similar to managed funds, exchange traded funds and other collective investment vehicles, but there are also some important differences.

Why invest in a LIC?

There are many reasons why people invest in an LIC, but the most common are:

- To achieve better diversification in your investment portfolio;
- To access the skills of a high-performing manager;
- To get exposure to a particluar market, asset class or investment strategy;
- To access the benefits of an unlisted managed fund with the ease of trading and liquidity of traded shares.

Types of LICs

We use the term listed investment company because almost all LICs are companies. However, there are some which are trusts.

The main difference between these two structures is in the tax treatment. Companies pay tax on their earnings and pay dividends to their investors (which are usually taxable to them but include franking credits). Trusts pay no tax directly, but instead must distribute their taxable income to investors, who then pay tax on it at their own tax rates. These distributions usually do not include significant franking or other tax credits.

How do LICs work?

Like other companies, an LIC is overseen by a board of Directors. But the day-to-day investing activities are carried out by specialist investment managers. These managers are appointed or employed by the Directors of the LIC.

Most LICs are externally managed. This means the investment manager is an external company appointed under a formal contract. The appointment usually lasts for a fixed term of 5 years or more and may be terminated or extended at the end of that period.

The investment manager charges a fee to the LIC, usually calculated as a percentage of the assets of the LIC. There may also be an additional fee payable where performance of the investment portfolio exceeds a certain return benchmark.

In most cases where the performance of the investment manager has been acceptable and their fees are reasonable, they will be asked to continue on at the end of the management contract period.

An alternative structure is an internally managed LIC. In this case, investment staff are employed by the LIC directly. Instead of paying an external manager a fee, the company pays the employment and associated costs of the investment staff.

Internal management can be a more attractive proposition for a large LIC because the cost of managing the investments can be more efficient and this can improve returns. However, for most LICs external management makes more sense because the size and scale of activities is not sufficient to make it efficient to manage internally.

LICs have low minimum investments. LICs can be bought and sold daily on the ASX. So long as you have an account with a stockbroker, you can invest in a LIC on the ASX for as little as $500. Brokerage costs usually mean it's better to buy a larger parcel than this to average out the transaction costs.

LICs can issue and buy back shares, but generally this only happens at certain times.

How do LICs generate returns?

All LICs have an investment strategy. Generally, the investment strategy will define:

- the asset class or classes the LIC invests in (e.g. Australian shares);
- the return targets the LIC is aiming to achieve and the timeframe for achieving those targets (e.g. to outperform the ASX200 accumulation index over 3 years); and
- any investment limits or ranges that will be adhered to (e.g. maximum level of cash holdings, maximum level of investments outside Australia).

All funds within the LIC are pooled together and invested in accordance with the investment strategy.

As an investor in a LIC you will receive returns in two ways.

Firstly, most LICs pay regular dividends. These dividends usually include at least partial franking credits and are generally paid from underlying profits generated by the LIC over time.

Secondly, the share price of a LIC will increase or decrease over time.

The price at which LICs trade on the ASX is set by market forces and is impacted by many factors. Some of these factors may include:

- Market conditions and investor confidence;
- The attractiveness of the investment strategy;
- Dividend yields;
- Performance of the investment manager;
- Costs of running the LIC, including fees to the investment manager;
- How large the market capitalisation of the LIC is;
- What asset class the LIC invests in;
- How well the LIC markets itself and communicates with current and potential investors.

There are also many other factors that can impact the price an LIC trades at. In order to have the best chance of achieving above-average returns over time, it's important for you to consider a range of factors and to try to buy at an attractive price.

How do LICs compare to other types of investments?

LICs are a listed managed fund. But there are several very important differences between LICs, exchange traded funds and unlisted managed funds that you should be aware of.

Below we compare features of these three types of investment products.

	Listed Investment Company	Unlisted Managed Fund	Exchange Traded Fund
Listed on ASX	Yes	No	Yes
Minimum Investment	Set by broker. Can be $500 or less.	Varies, but usually $10,000 or more.	Set by broker. Can be $500 or less.
Eligibility	Anyone with a broker account.	Some are restricted to certain types of investors.	Anyone with a broker account.
Pricing	Set by market forces. Can vary substantially from value of underlying investments.	Usually priced based on the value of their underlying assets (NTA or NAV) +/- transaction costs.	NAV +/- a margin, facilitated by market maker.
Legal Entity	Normally a company, but can also be a Trust (e.g. REIT's)	Trust	Trust
What does an investor own	Investors own shares in the company.	Investors own units in the trust.	Investors own units in the trust.
Buying and Selling	Investors buy or sell existing shares from another investor on the ASX. The LIC can also issue new units or buy-back units from time to time.	The trust issues units to investors who wish to enter the trust and redeems (buys back) units from investors who wish to exit.	Investors buy or sell existing shares from another investor (or the market maker) on the ASX.
Liquidity	Traded on ASX between 10am and 4pm most business days. Smaller LICs can be less liquid, with lower trading volumes.	Liquidity varies. May be priced daily, weekly, monthly or less often depending on the size of the fund and the type of assets it holds.	Fully liquid. Employ a "market-maker" who is required to ensure trading price is close to NAV.
Minimum size of investment entity	ASX sets the minimum size and number of holders for new LICs.	Unrestricted	ASX sets the minimum size and number of holders for new ETFs.
Investment Manager	Can be internal or external, but normally external unless very large.	Can be internal or external, but normally external.	External
Investor Returns	Pay dividends which are usually taxable to the investor and may have franking credits attached. These credits can be claimed by the investor in their tax return.	Pay distributions. Can be taxable, tax deferred or tax free. Can include some franking and other tax credits that can be claimed by the investor in their tax return.	Pay distributions. Can be taxable, tax deferred or tax free. Can include some franking and other tax credits that can be claimed by the investor in their tax return.
Income Tax	LICs pay tax on income. Attaching franking credits to dividends allows investors to receive some "credit" for tax paid by the LIC.	Do not pay tax but distribute taxable income to investors, who pay tax on it. Therefore, distribution returns are pre-tax.	Do not pay tax but distribute taxable income to investors, who pay tax on it. Therefore, distribution returns are pre-tax.

	Listed Investment Company	Unlisted Managed Fund	Exchange Traded Fund
Capital Gains Tax	Pay tax on capital gains. Attaching franking credits to dividends allows investors to receive some "credit" for tax paid by the LIC. Generally, investors pay capital gains tax on difference between cost and sale value of investment when sold.	Do not pay tax but distribute capital gains to investors who pay tax on it. Generally, investors pay capital gains tax on difference between cost and sale value of investment when sold. Any tax deferred distributions received may increase this capital gain.	Do not pay tax but distribute capital gains to investors who pay tax on it. Generally, investors pay capital gains tax on difference between cost and sale value of investment when sold. Any tax deferred distributions received may increase this capital gain.
Investment Strategy	Normally active. Tries to beat a market return.	Normally active. Tries to beat a market return.	Normally passive. Tries to replicate a market index, less management fees.
Management Fees	Normally higher than ETF's but lower than managed funds. Can include performance fees.	Normally higher than LICs and ETFs. Can include performance fees.	Normally lower than LICs and managed funds. Usually does not include performance fees.
Annual General Meeting	Yes	No	No
Governance	Appoints a Board of Directors, who monitor strategy and the investment manager.	Managed by a Trustee or Responsible Entity. May be the same as the investment manager or independent.	Managed by a Trustee or Responsible Entity. May be the same as the investment manager or independent.
Buy/Sell Spread	Difference between the price sellers offer their shares (sell price) and the price buyers are prepared to pay (bid price). Will be variable and dependent on market conditions and liquidity.	Set by manager. Based on costs of buying and selling underlying investments.	Usually a market maker makes sure that costs of transacting are within pre-set limits and approximate to underlying asset value.
Transaction Costs	Brokerage costs set by broker.	There is usually a buy/sell spread set by the manager.	Brokerage costs set by broker.
Investor disclosure	Announcements on ASX. May be supplemented by other reporting.	Continuous disclosure rules – normally periodic reports plus ad-hoc disclosure on website or by email.	Announcements on ASX. May be supplemented by other reporting.

Finding the best LICs

What are you looking for?

Choosing and investing in an LIC is a personal decision and will be heavily influenced by your personal circumstances, your investing philosophy and your portfolio goals.

At Affluence, we assess LICs on two broad criteria:

Price & Value

How expensive or cheap the market price of the LIC is, relative to the market and to the value of the underlying assets the LIC owns

Quality

The quality of the manager and their potential to deliver above average returns on the underlying assets

Put simply, we seek to buy high quality LICs when both the LIC and the market they invest in are cheaper than average. This requires a consistent strategy, patience and discipline.

There are many factors which determine the attractiveness on an LIC investment. Below we have explained some key things we consider to be important when assessing an LIC. There are also many others which can be taken into account.

Understanding the Strategy

For each LIC, we like to develop a detailed understanding of the investment strategy being employed. This is key to understanding how an LIC might fit into your existing portfolio.

This information can be found in a number of places, but most commonly in the Annual Report, on the LIC website (if it has one) or in regular investors reports lodged with ASX.

Some key information you might want to know is:

- What types of assets does the LIC invest in (e.g. shares, property, diversified)? Does the LIC focus on a small, niche market (e.g. microcap ASX stocks) or does it invest more broadly?
- What geography does the LIC invest in? Is it focussed just on Australia, in one or a combination of overseas markets, or both?
- What are the LICs return objectives? Has it managed to achieve those objectives? What should the LICs performance be measured against? (e.g. if the fund invests mostly in large ASX listed stocks, the ASX200 accumulation index may be the best benchmark);
- How much discretion does the fund manager have within the asset allocation strategy? (e.g. can they hold a large amount of cash if they cannot find compelling investment opportunities?) Some of the best LIC performers historically have tended to be those which have the most discretion, particularly around cash holdings. They also tend to have less volatile performance, particularly in down markets;
- How does the LIC aim to beat the market? What is the advantage they have that will allow them to beat the market average?
- How will the LIC compliment your investment portfolio? Are they doing something or investing in something that is different to what you currently hold. If so, this can allow you to achieve greater diversification.

If you have time, it may make sense to review the last 3-5 years ASX announcements, particularly those marked as price sensitive. This may assist to provide additional background on the LIC and to understand if the Board or management have deviated from, or changed strategy during that period. Past ASX announcements for all LICs are available from your broker or direct from the ASX website at http://www.asx.com.au/asx/statistics/announcements.do.

Assessing performance

It is said (and in fact ASIC demands all investment managers make it clear) that historical performance is no guarantee of future performance. While that is true – historical performance can be a great indicator of the potential for future performance, provided it is looked at in the right way.

The right way to assess performance is not by looking at just the historical returns generated, but by comparing those historical returns to a fair benchmark.

LIC managers may publish two different types of performance history to assist you, and both are useful.

Firstly, they will almost always publish the performance of the underlying investment portfolio the LIC owns. Portfolio performance, if possible, should be assessed after all fees to the manager but before tax. This result should then be compared to an appropriate benchmark. Assessing performance in this way will assist to understand how the manager has performed relative to the market or asset class they are investing in.

Looking at performance this way allows you to understand the historical performance of the manager of that portfolio. Importantly though, it doesn't take into account changes in the share price of the LIC over time.

For this reason, a second and just as important measure of performance is the returns of the LIC itself. This is measured for any time period by adding the change in the price of the LIC over a given period (the closing price less the starting price) plus any dividends paid. This amount is then divided by the opening price to derive a percentage return. Quite often this data is published by the LIC but if not if is usually available from your broker. This represents the total returns received by shareholders of the LIC for that period.

Ideally performance should be measured in both ways over a reasonably long period (e.g. 5 years or more). In fact, in a perfect world it should be measured over a full investment cycle - which can be 7 years, 10 years or longer. The longer the period you have data for, the better.

In particular, you may find it's important to look at how the LIC performed in down markets as this will give you some idea as to how aggressive or conservative the strategy is. For example, an LIC which invests in small cap stocks may outperform others over a very long term, but severely underperform in negative markets. That may be OK if you are comfortable with that level of volatility, but if not you may be susceptible to selling at the worst possible time.

Watch for, and avoid, these negative signs and influences when assessing performance:

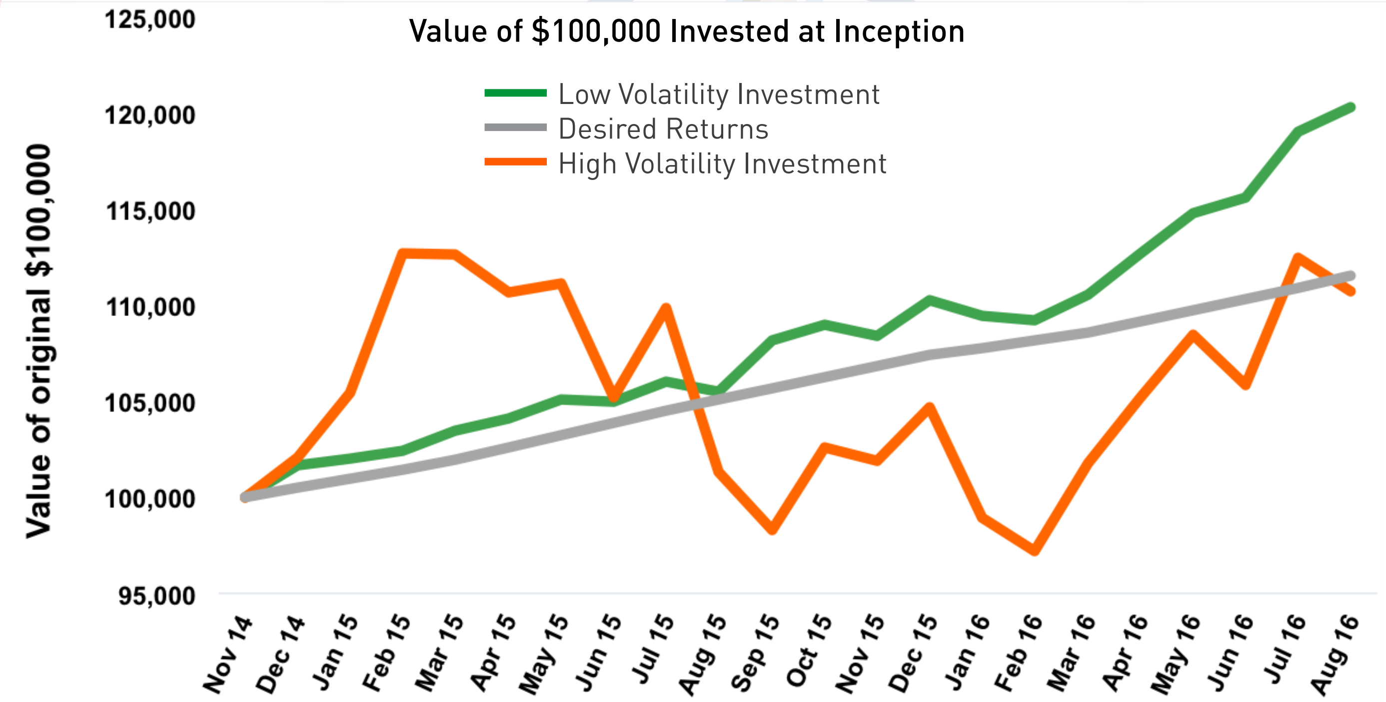
- Performance should be stated after all fees and costs. Performance before fees is irrelevant;
- Stating just a total return accumulated over a long period can be misleading. Performance should be annualised for all periods over 1 year. The industry publishes standards on how to assess performance and most managers follow them;
- Is there a long enough timeframe to assess performance? Performance data for periods of less than one year is largely irrelevant;
- Is the benchmark fair? A fair benchmark is one which reflects the average return you might expect from the types of assets the LIC invests in. For example, is it an accumulation index (does it include income of the underlying assets). Does it represent the underlying assets of the fund, or a fair long term return? Does it include franking credits, if the performance numbers do? Most managers do a good job of setting a benchmark, but some do not, and you could end up measuring performance against an inappropriate yardstick.

Finally, remember that while assessing performance can be useful, it is entirely historical in nature and doesn't necessarily reflect the future. Even good managers can go through bad periods. More importantly, asset prices can move in cycles, so you should never assume the last 2 or 3 years' performance will be repeated in the next 2-3 years. Your only aim in measuring performance is to understand how well the manager has performed relative to what they are investing in.

Volatility

Performance by itself is great, but to get a full understanding of the fund's credentials, it is also important to understand volatility, or how returns vary over time. The holy grail for an investor is the delivery of their targeted returns with very low volatility.

High volatility investments are inherently more dangerous and risky because they can prompt a much wider range of decisions from investors. For example, consider the following two investments:



Most investors would prefer to achieve the reasonable consistent, green line over time. If you held the investment represented by the orange line, it may cause significant angst as values fall and lead to a decision to sell at an inopportune time.

If volatility is an important factor for you, it is important to remember over time:

- Listed investments tend to be more volatile (but obviously more liquid) than unlisted investments;
- Smaller listed stocks (including LICs) tend to be more volatile than larger stocks;
- Sectors such as resources, IT and biotech tend to be more volatile than sectors such as health, telecommunications and industrials. The first group of industries may include a higher proportion of early stage businesses which may not be profitable or consistently so, whereas the second group are more likely to contain established businesses;
- Assets such as bonds and property (when held directly) tend to have much lower volatility than listed stocks;
- Cash, theoretically, has no, or very low volatility.

Volatility can be measured in number of ways but is generally not well understood by most investors. It can also be difficult to obtain sufficient data to calculate it properly over time. However, there are some things you can do to assess volatility.

Start by looking at a chart of the LICs performance against the index or benchmark. For example, if the LIC invests in stocks, you may look at performance against the ASX 200 index. Most online brokers will make this information readily available. Study the chart, particularly during a time when the market has corrected. Did the LIC move down more, less or about the same as the market?

Returns from the LIC itself can rise and fall more rapidly or more often than the underlying investment portfolio that the LIC owns. This is particularly the case for small and medium size LICs which tend to trade at higher prices, relative to their NTA in good markets, and at lower prices relative to their NTA in poor market periods. This has the effect of widening the actual range of returns an investor in the LIC can receive.

Some LIC managers publish a historical graph showing the discount or premium to NTA over a number of years. You may find this a very useful tool for understanding how volatile an LIC has been, relative to the market.

Some managers also publish volatility data. Measures such as standard deviation, up vs. down months, and ratios such as the Sharpe and Sortino ratios can be useful tools to assess volatility. They are most useful if they can be obtained for long periods of time and preferably contain at least one period where a significant market correction occurred.

Management - The People

Performance must be evaluated in light of the stability of the team generating it. The people managing the investments for each LIC (not the Directors or the management company) are the most important factor in delivering long term returns.

It is important to know how long an investment management team has been together when assessing the performance of an LIC. If the LIC has existed for longer than the current key investment managers have been in place, it would be wise to discount or even ignore any performance data from earlier periods, since performance is very much influenced by the team running the portfolio and making to day-to-day investment decisions. Likewise, if a key investment manager leaves a team, it is important to understand who will replace them and how that might impact returns going forward.

Stability in the investment team can increase your faith in their ability to deliver above average results. Some key factors you can look for which may indicate a strong alignment of interest include where key investment managers:

- Own part of the investment management company;
- Have a significant personal investment in the LIC, or another fund which is substantially the same and which they manage;
- Have a long history with the management company.

Holdings of non-executive or independent directors are usually less important, as it is the investment management staff who ultimately add the value and have the greatest influence on your long term returns.

This is how we screen for potential investments:

1 QUANTITATIVE ASSESSMENT OF THE MANAGER'S HISTORICAL PERFORMANCE

We prefer managers who:

- Have outperformed a fair benchmark over a reasonably long timeframe.
- Have outperformed to a greater degree in down markets compared to an appropriate benchmark.
- Have delivered acceptable total returns over a reasonably long timeframe.

+

2 QUALITATIVE: MANAGER OPERATES IN THE RIGHT ENVIRONMENT

We prefer managers who:

- Are operating in a boutique area
- Are investing in a niche asset class
- Have a wide asset allocation discretion
- Are capacity constrained
- Have fair fee structures which reflect intensity of strategy and are aligned to out-performance
- Have a stable team around them.

+

3 QUALITATIVE: ASSESSMENT OF MANAGERS PERSONAL INVESTMENT STYLE

We prefer managers who:

- Have a strong risk management focus
- Have a significant personal investment in the strategy
- Are cycle-aware
- Are value-focused
- Have a low turnover/high conviction mindset
- Display appropriate personal traits (humble, realistic, analytical, risk aware, passionate and competitive)
- Are honest about the current value of what they are investing in (i.e. acknowledge when assets are expensive)

Size and liquidity

Size matters. The ideal LIC is not too big and not too small.

LICs with a relatively small amount of investment assets (say less than $20 million) are likely to suffer from a high cost load, which can negatively impact returns. This is because many costs of managing an LIC (for example the cost of arranging an AGM) are basically the same regardless of size.

When these fixed costs of running the LIC are only able to be spread over a relatively small amount of capital, the cost in percentage terms can be high. It is not uncommon for some smaller LICs to have fixed costs equivalent to 3% or more of the value of their assets. This can represent an unacceptably large drain on returns.

The other issue with smaller LICs can be the limited liquidity, or the value and volume of their shares traded on the ASX. You may well be able to trade in relatively small parcels and you can buy and sell lower liquidity LICs much more easily than larger investors.

However, the bid/ask spread (the difference between the buy price and sell price on the ASX) can still be quite wide and you may have to be patient to be able to buy or sell at your target price.

Although very large LICs have a cost advantage, they can find it more difficult to outperform substantially over the long term. The large amount of capital they have means they must make quite large investments. This, in turn limits their investment universe (the list of potential opportunities they can hold) to the largest and most liquid investments available.

In general, Affluence prefers to invest in medium size LICs. The flexibility afforded from having a smaller pool of capital and greater investment opportunities for these LICs can outweigh the slight cost advantage that the larger LIC has.

Other things to take into account

The above factors are the key attributes we believe you should consider when researching an LIC, however they are not the only ones which can be important. Other features which can be important include:

- Capital management - how and when they have raised capital? Have they raised below NTA? Generally, you should be wary of any LIC which has raised equity at a substantial discount to NTA;
- Liquidity of the assets they invest in – LICs that invest in illiquid assets (e.g. private equity funds) should command a larger than normal discount to NTA. Valuations of these assets tend to lag the listed market and to be out of date and less reliable when markets are moving up and down rapidly;
- Internal vs external management – arguably internally managed LICs have less of a conflict of interest, however this does not necessarily lead to a performance advantage;
- Substantial holders – Details of substantial holders (those investors who own more than 5% of a LIC) are usually found in the annual report. If the fund manager or another investor you rate highly is a substantial holder, and is holding or increasing their investment, this can be a good indicator. However very large substantial holders can also be a problem, as their interest may not be aligned with yours. They can unduly influence strategy and/or delay/frustrate or even prevent transactions occurring;
- Marketing and communications - Good, consistent communication to shareholders can go a long way to limiting any discount to NTA. How often the manager communicates, how they communicate and how open and honest they are about their performance can be key factors that influence long term price fluctuations;
- Taxation – remember LICs deliver after tax returns. They pay dividends. Those dividends are usually franked, although if they are investing in assets outside

Australian shares this may not be the case. Franking credits are able to be claimed by most investors and offset against other tax liabilities or even refunded in some cases. We believe it is important to factor in franking credits when considering an LIC investment;

- Borrowings - A few LICs borrow directly and some invest in underlying assets that are themselves geared. In general, the higher the borrowing level, the higher the risk and volatility is likely to be. Because of this, you should demand a higher level of return from a geared LIC, compared to an ungeared alternative;
- Types of securities on issue – In addition to ordinary shares, many LICs also have options on issue which are also generally traded on the ASX. It is important to understand how many options are on issue and their terms (strike price and expiry date), because they can dilute NTA values over time if they are exercised. Some LICs also have some form of debt securities on issue, which is effectively a form of gearing;
- Other alternatives from the same manager - Some managers also run unlisted funds which exactly, or very closely mimic what the LIC is doing. This brings into play a very important potential for risk management. When LICs are trading at, or above their NTA, it may be a better strategy to invest in an unlisted fund and to wait for a more opportunity time to "switch" to the LIC or to top up your investment through the LIC when it is trading at a discount;
- The management company - Most LICs are externally managed and have a management contract in place for a fixed period of time. It is unlikely the manager would be terminated or voted out during or even at the end of that period, unless they had severely unperformed and a competitor or other party wanted to aggressively pursue management of the vehicle. Such circumstances are rare;
- Distributions – We believe this is one of the least important things you should consider. In particular, we suggest never to buy a LIC based solely on it having a high distribution yield. In fact, a high distribution rate can be a sign that the distribution is not sustainable and the LIC is therefore not an attractive investment;
- Earnings – We believe published earnings are basically irrelevant as far as an LIC is concerned. Reported earnings are derived from distributions received from investments, less costs, plus/minus changes in the value of the investment portfolio. Long term performance is a much better measure than short-term accounting earnings;
- Management fees - In our view, management fees are less important than you might think, unless the LIC is very small. Would you rather have a 4% management fee and 15%pa returns, or a 0.5% management fee and 2%pa returns? We know which one we'd prefer. If you look at performance net of fees and costs (as we do), management fees in isolation become much less important.

The process we use

Having looked at the quality of an LIC, and determined that you would like to own it, the next part of the equation is making sure you buy at the right price. At Affluence, we do this by applying a four stage process:

- Is the underlying market the LIC invests into trading at an attractive price?
- What is the current NTA value per share;
- How does the current ASX buy price compare to the NTA; and finally
- What is the price at which we would like to buy?

Buying at the right price

Underlying market value

Before investing in an LIC, you need to consider whether the asset class the LIC invests in (e.g. Australian shares) is cheap, reasonable value, or expensive. If the underlying investments are very expensive, the LIC is likely to produce a lower investment return.

This can be a very difficult assessment to make, but one of the questions it may be useful to ask is "would I be happy to own these investments directly?"

If you believe the asset class is expensive, then it may be prudent to be patient and wait until you believe there is more value before considering the LIC, or to make a small investment now, and monitor for signs of greater value in the future.

Net tangible asset value per security

NTA per security is the key variable (along with the share price on ASX) to determine whether an LIC is good value. ASX requires the NTA per security to be published by all LICs at least monthly, and this must be done by the 14th of the following month. Some LICs will provide NTA data more often (weekly or even daily), but the majority still only report monthly.

Because the NTA data is usually out of date, it needs to be considered in light of market movements since the last NTA date. For example, if the LIC invests a diverse portfolio of ASX stocks and the ASX 200 index has fallen 5% since the end of the last month (when the NTA per security was last reported), it is likely the NTA of the LIC will also have fallen during this period. It is difficult to estimate with certainty the exact NTA between reporting dates, but you can broadly estimate it if you understand what the LIC is investing in.

When reporting an NTA, an LIC may provide more than one NTA value. There are up to three NTA calculations that are commonly provided:

- NTA before tax. This calculation does not make any allowance for tax on current years' income and profits and therefore does not reflect the tax that will be paid/payable by the LIC for the current tax year;
- NTA before tax on unrealised gains/losses. This calculation allows for income tax and also for capital gains tax on any investments sold in the current financial year. It does not allow for tax that would be payable if all current investments were sold;
- NTA after tax. This calculation takes into account tax on income and realised capital gains and also allows for tax that would be payable if the entire investment portfolio was sold.

In most cases, we believe the most appropriate value to use is the NTA before tax on unrealised gains/losses. This reflects the position after allowance for tax payable on current year earnings and capital gains, but before any deferred tax on the remaining investment portfolio.

If the LIC has stated an intention to wind-up or otherwise dispose of all or a substantial portion of its portfolio, you may prefer to use the NTA after tax.

Calculating discount/premium to NTA

We believe the price you pay for an LIC relative to the value of its investments (the discount or premium to NTA) is the most crucial thing to get right when buying LICs.

The discount or premium is calculated by the following formula:

$$\frac{\text{(Buy price on ASX - Estimated NTA)}}{\text{Estimated NTA}} \%$$

A positive number is a premium. A negative number is a discount. For example, if the buy price is $0.90 and the NTA is $1.00, the discount is 10%, calculated as follows:

$$= \frac{\$0.90 - \$1.00}{\$1.00}$$

$$= \frac{-\$0.10}{\$1.00}$$

$$= -10\%$$

What is the right price to pay?

It is fair to say we prefer to buy LICs at a discount to their NTA. But in our view, there is no one rule which determines the right price to buy an LIC, relative to its NTA value. There are a whole range of factors to consider.

One of the key factors we take into account is the price and NTA history. If we can, we prefer to study how an LIC has traded historically relative to its NTA. This data is sometimes published by the LIC itself, or may also be available through your broker research.

If you can buy at a price below the average discount/premium, calculated over a reasonably long period, this can be a good indicator of value. Other factors which you might wish to take into account when considering your preferred buy price are:

- Historical performance – LICs which have performed very well tend to trade at a premium, or at a lower discount than comparable LICs. In some case it's worth it, but it will depend on the extent of the premium you are paying. By and large, we prefer to be patient and wait for an opportune entry point. Conversely, periods of short-term underperformance by an otherwise excellent manager can provide opportunities to buy in at a good price;
- Size – Larger, more liquid LICs tend to trade at higher prices relative to NTA, whereas smaller LICs are more likely to trade at a discount;
- Underlying assets – LICs that invest in offshore markets or unlisted investments tend to trade at bigger discounts than those who invest in larger, more liquid Australian stocks;
- Portfolio concentration – Some LICs have very concentrated portfolios, where one or a few investments make up a large proportion of the portfolio. These tend to trade at bigger discounts because of the additional concentration risk in the portfolio;
- Investor confidence and market performance – in times when confidence is low, which tends to be during market corrections, LICs can trade at larger discounts. When confidence is high and/or markets are fully valued, LICs tend to trade at higher prices, relative to NTA.

These are just a few of the many variables which can impact the price at which a LIC trades, but we have found over time that they tend to be the most prominent.

Summary

Like all investments, it's best to do your homework properly before buying any LIC.

We suggest you consider only quality LICs with proven managers who have performed well in the past.

Ensure those LICs hold assets you like and have an investment strategy you understand, with an appropriate management structure in place.

Understand how an LIC will fit into your portfolio and how you expect it to assist you in achieving your investment goals.

Most importantly, try to buy at the best possible price you can, relative to the value of the underlying assets and the trading history of the LIC.

We wish you the very best in your investing endeavours.

About the Affluence Investment Fund

The Affluence Investment Fund aims to find the top 1% of investment managers available in Australia. We then invest with them in a way that we believe balances maximum returns with low volatility.

The Funds' investment philosophy is based on six key investing beliefs:

- To achieve better than average results, you must invest differently;
- Value investing works best in the long run;
- Investing in markets where there is less competition makes it easier to achieve above average results;
- Quality income carries much lower risk than uncertain capital growth;
- Unlisted investments can deliver better returns and lower volatility than listed investments;
- Being aware of long-term cycles and seeking to time investments can significantly improve performance.

The Affluence Investment Fund aims to invest using this philosophy and to provide its investors with:

- Access to a diversified portfolio of investments;
- A minimum distribution yield of 5% per annum, paid monthly;
- Annualised returns of at least inflation plus 5% over rolling 3 year periods; and
- A total return at least 5% better than the S&P/ASX 200 accumulation index ("ASX200 Index") in any year the ASX200 Index posts a negative return.

The Fund invests in a range of opportunities across many different types of assets, managers and investment strategies, but will not invest in any asset unless we believe it can achieve our target investment returns. This should allow the Fund to take advantage of what we believe are the best opportunities at any given time.

The Fund aims to provide a regular income stream, while preserving and growing the capital value of your investment over time. We also seek to lower volatility of returns by combining investments across multiple asset classes and seeking out managers and investment strategies which can outperform in down-markets. We may also elect to put limited portfolio protection measures in place where we feel markets are overvalued.

Distributions to investors are paid monthly and Fund applications and withdrawals are processed monthly.

To limit the costs of administering the Fund, investment is initially only available to Eligible Investors. Over time, AFM Intends to expand the availability of the Fund.

The key risks of investing in the Fund are typical of the risks associated with managed investment schemes. It is important that you understand the value of your investment will go up and down over time, the Fund's returns will vary over time, future returns may differ from past returns, and returns are not guaranteed. All of this means that there is always the chance that you could lose money on your investment.

Fund Overview

Status	Open to Eligible Investors
Investment Class	Diversified
Minimum Investment	$20,000
Suggested Timeframe	At least 5 years
Target Returns	Inflation + 5%
Distribution Yield	5.0% p.a.[1]
Distribution Frequency	Monthly
Applications	Monthly
Withdrawals	Monthly
Fees	Performance based
Buy/Sell Spread	0.35%/0.35%

Get in touch

For the answer to any questions regarding this guide, the Fund, or to order an IM and Application Pack, please contact your financial adviser or Affluence via the details below:

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Invest Differently