



FUNDS MANAGEMENT  
**Affluence**

# A Guide To Investing in Managed Funds

Issued By Affluence Funds Management Pty Ltd  
ABN 68 604 406 297 | AFSL 475940



# Contents

	Page
Introduction	3
What is a Managed Investment Fund?	4
Why invest into a Managed Fund?	4
Types of Managed Funds	5
How do Managed Funds work?	8
How do Managed Funds generate returns?	9
How Managed Funds compare to other types of investments?	10
Choosing a Managed Fund	12
What should you look for?	12
Assesing quality - key factors	12
Risks of Managed Funds	20
Is it the right time to buy?	21
Summary	22
About the Affluence Investment Fund	23
About the Affluence Funds Management	24

## Disclaimer

The information in this publication has been prepared by Affluence Funds Management Pty Ltd ABN 68 604 406 297 AFS licence no. 475940 (Affluence) as general information only in relation to listed investment companies and the Affluence Investment Fund (Fund). It does not purport to be complete and it does not take into account your investment objectives, financial situation or needs. This publication may contain statements, opinions, projections, forecasts and other material (forward looking statements), based on various assumptions. Those assumptions may or may not prove to be correct. None of Affluence, its respective officers, employees, agents, advisers or any other person named in this report makes any representation as to the accuracy or likelihood of fulfilment of the forward looking statements or any of the assumptions upon which they are based. The information in this publication is not a recommendation by Affluence or any of its officers, employees, agents or advisers and potential investors are encouraged to obtain independent expert advice before making any decision to invest in any Listed Investment Company or the Fund.

Prospective investors in the Fund should also read the information memorandum (IM) offering units in the Fund before making an investment decision. The IM was issued by Affluence as trustee of the Fund on 8 September 2015. Offers to invest in the Fund are only available to persons who qualify as Eligible Investors as defined in the IM. Affluence will not issue units in the Fund to a person unless it is satisfied the person is an Eligible Investor. The IM contains important notices and disclaimers, important information about the offer, as well as investment risks. Any forecast or projected information, including financial, is not guaranteed and there is no guarantee of any investment return or repayment of capital. This publication is dated November 2016.

# Introduction

There are now over 15,000 managed funds available to choose from in Australia, and this number continues to grow each year. The sheer number of funds, managers, structures and strategies mean it can be daunting to find the ones that suit your investment needs.

Through managed funds you can now gain exposure to the four major asset classes (property, shares, cash and fixed interest) as well as many types of alternative investments such as commodities, infrastructure and currencies. You can gain access to investments in Australia and overseas. Some funds invest broadly across many different markets and geographies, while others are very specific, targeting a specific subsector, location, or investment strategy.

Affluence estimates that around 90% of managed funds fail to beat the underlying market in which they invest over the long term, after fees and costs. While this can be disheartening, there are still a great number of funds run by exceptional managers, using differentiated investment strategies, that can help to deliver great returns while also diversifying your investment portfolio.

At Affluence, we recently undertook a year-long project to assess the best managed funds. This guide contains insights on how we did it and what we looked for.

We have not included a list of the best managed funds in this guide, because our views change over time, based on the performance of the manager and our opinion on the value of the underlying markets they invest in. You can access an up to date list of our key investment holdings for our flagship Affluence Investment Fund at any time, by registering as an Affluence Member on our website ([www.affluencefunds.com.au](http://www.affluencefunds.com.au)).

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.





# What is a Managed Investment Fund?

A managed investment fund or managed fund is a specialised type of investing entity. It is a special type of trust that pools together investors funds and invests them under an approved strategy. The fund has a trustee, who oversees the investing activities and acts in the best interests of the investors. The trustee must obtain and maintain an Australian Financial Services License (AFSL) issued by the Australian Securities and Investments Commission (ASIC). Qualified professional investment managers will then buy and sell investment assets on behalf of the pool of investors.

Managed funds are not usually listed or traded on the Australian Stock Exchange (ASX) or any other similar securities exchanges around the world. Instead, units are issued to fund investors (called unitholders), based on the value of the underlying investments that the managed fund holds.

To provide an extra layer of investor protection, many managed funds appoint a custodian to hold the investments and other assets of the fund on behalf of fund investors. The custodian (or the trustee, if no custodian is appointed) must meet certain financial requirements.

## Why invest into Managed Funds?

There are many different reasons why people invest in managed funds, but the most common reasons you might consider it are:

- To achieve better diversification by investing in a fund which holds many underlying investments;
- To access the skills of a high-performing manager;
- To get exposure to a market, sector or asset class which you do not already own; or
- To access investments that are too large for you to purchase by yourself (for example commercial property).

# Types of Managed Funds

## Wholesale vs Retail Funds

**Wholesale managed funds** are only open to certain types of investors, who are deemed to be able to understand, assess and monitor these types of investments. To qualify to invest in these types of funds, you must meet one of the following criteria:

- Invest at least \$500,000;
- Provide a certificate from a qualified accountant that you meet either an income test (\$250,000 or more gross income for each of the past 2 financial years) or an assets test (you and your fellow investors control net assets of at least \$2.5 million);
- Be deemed a sophisticated investor, which requires you to be assessed as having the requisite skills, experience and/or qualifications to properly assess and understand the investment; or
- Be deemed a professional investor, which is generally restricted to people working within the funds management industry.

Wholesale funds may be registered with ASIC but are not required to be. The trustee of the Fund issues a special type of document, normally called an Information Memorandum which is provided to potential investors and contains all relevant information about the fund, investment strategy and how it works.

Retail managed funds are open to all investors, and provide some additional features designed to better protect investors. They are managed

by a responsible entity, which is a special type of trustee. The responsible entity is a company and is governed by a board of directors.

**Retail managed funds** are required to be registered with ASIC, to prepare audited annual accounts and to lodge them with ASIC. They are also required to have a compliance plan, which governs how they intend to meet the various requirements of being a managed fund, and to have this compliance plan audited annually. Investors in retail managed funds invest through a Product Disclosure Statement (PDS) which must be issued by the responsible entity and has a higher standard of disclosure than an Information Memorandum.

## Open Ended vs Closed Ended Funds

The most common type of fund is an open-ended fund. This allows investors to buy and sell units in the fund at regular intervals. The manager may issue new units in the fund to new and existing investors when they make an application. Likewise, they may redeem (buy-back and cancel) units if they receive withdrawal requests from investors. This process of issuing and cancelling units is usually described in the IM/PDS, and can happen daily, weekly or monthly.

A closed-ended fund offers the opportunity for investors to apply to purchase units in the fund when it first opens, but the fund is only open for investment for a specified amount of time. The fund then stops accepting any new applications for a predetermined investment period, normally several years. If you want to sell units in the fund during this period, you either must

wait until the investment period has expired or seek to find a buyer (either by yourself or with the help of the fund manager). Closed end structures are most often used when the underlying assets of the fund are not easily tradable or saleable in a short period, or cannot be divided into small amounts, such as property or infrastructure. This “liquidity risk” can be a very important factor to take into account when investing in closed ended funds.

## Active vs Passive Managed Funds

For asset classes such as Australian shares, global shares, REITS, cash and bonds, there are both actively managed funds and passively managed funds.

**Passively managed funds** (including index funds) aim to replicate the overall performance of a benchmark (for example the ASX 200 index) less fees. They achieve this by buying the index, or each individual stock that forms part of the index. For example, an ASX 200 index fund may seek to own all 200 shares in the index with the same proportionate weighting as the index. The managers of these funds typically charge a much lower fee than for an actively managed fund. Proponents of this type of fund believe that there is little chance of an active investment strategy outperforming the market over the long term, and investors would therefore be best to find the fund with the lowest fees.

**Actively managed funds** (which Affluence offer and invest in) do not track a benchmark or index, but instead are relatively unconstrained in what assets they purchase and their weightings in the fund. Therefore, whether the fund outperforms the relevant benchmark is down to the skill of the investment manager. Active funds have the potential to significantly outperform a passive fund, and likewise to significantly underperform as well.

S&P Dow Jones Indices publish a regular report which attempts to measure the performance of active versus passive funds. The following is from the SPIVA Australia Scorecard from 30 June 2016:

*“There is no consistent trend in the yearly active versus index figures, but we have consistently observed that the majority of Australian active funds in most categories fail to beat the comparable benchmark indices over five-year horizons,”*

and

*“As of June 2016, the majority of Australian funds in all categories, except Australian mid and small cap funds, were outperformed by their respective benchmarks over the one-, three-, and five-year period”*

The following table is from the latest report and shows the percentage of funds outperformed by the index:

**Report 1: Percentage of Funds Outperformed by the Index**

Fund Category	Comparison Index	One Year	Three Year	Five Year
Australian Equity General	S&P/ASX 200	59.66%	65.69%	69.18%
Australian Equity - Mid & Small Cap	S&P/ASX Mid-Small	61.32%	51.55%	38.00%
International Equity General	S&P Developed Ex-Australia LargeMidCap	80.73%	91.35%	91.89%
Australian Bonds	S&P/ASX Australian Fixed Interest	89.47%	92.16%	88.68%
Australian Equity A-REIT	S&P/ASX 200 A-REIT	87.50%	93.06%	92.41%

Source: S&P Dow Jones Indices LLC, Morningstar. Data as of 30 June 2016. Table is provided for illustrative purposes. Past performance is no guarantee of future results.

While there are plenty of active funds that have not outperformed the index, there are still a lot that have!!! At Affluence, we try to search out the top 1% of fund managers, as the best managers can significantly outperform the market. Investing this way, if you can do it consistently well, can provide much better results than passive investing.

The best category for active managers according to the SPIVA report is small and mid-cap Australian equities, with only 38% of funds being outperformed by the index over 5 years.

It is no accident that many funds Affluence invests into are in the small and mid-cap Australian equities category.

S&P only include long only funds in the comparison, thereby ignoring many other investment strategies (for example there are many outstanding long/short and market neutral funds and managers). The Affluence Investment Fund has substantial investments in these types of funds as we believe they can offer good returns, reduce portfolio volatility and increase diversification.



# How do Managed Funds work?

A Managed Fund is governed by its trustee (or responsible entity), which appoints a board of directors for this purpose. .

All managed funds have a defined investment strategy. Generally, the investment strategy will outline:

- the asset class or classes the fund invests in (e.g. Australian shares);
- the return targets the fund is aiming to achieve and the timeframe for achieving those targets; and
- any investment limits or ranges that will be adhered to.

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

The investing activities for the Fund are normally carried out by specialist investment managers (usually companies). These investment managers are appointed by the board of the trustee. The investment manager may be the same as the trustee, or may be a separate entity. If separate to the trustee, the investment manager must also be licensed by ASIC. The investment manager appoints one or more investment staff (usually known as fund managers or portfolio managers) who undertake the day-to-day investing activities for the Fund.

In return for running the investment fund, the investment manager and/or trustee charge a fee to the fund for their services. Fee structures can vary considerably, but typically include a management or base fee (usually a fixed percentage of the Fund net assets).

Investment managers may also charge a performance fee (usually a percentage of the returns above a target level). Performance fees are usually subject to a high-water mark, which means any underperformance against the target returns must be regained in the future before any further performance fees can be charged. The fund will typically also pay administration and running costs, although in some cases the manager will agree to pay these out of their management fees.

When an investment is made into a managed fund there is typically a buy spread applied, and when a withdrawal is made there is typically a sell spread applied. The purpose of the buy/sell spreads is to ensure that those investors transacting in the fund's units at a given time bear the cost of the fund buying and selling assets because of their transaction. This helps to ensure existing investors in the Fund are not impacted by investors entering or leaving the fund. The buy and sell spreads are not paid to the manager but are retained by the Fund.





# How do Managed Funds generate returns?

Investors in managed funds receive returns on that investment in two ways.

Firstly, most funds pay distributions to unitholders. These distributions are usually determined and paid just once or twice a year, but some Funds, for example property and fixed interest funds, can pay more regularly. There are important differences between distributions paid by managed funds and dividends paid by companies:

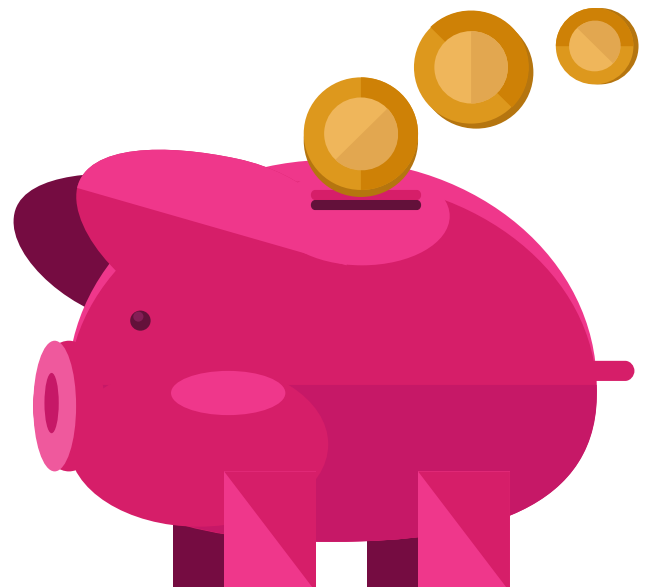
- Managed funds do not pay any tax directly. Instead, a share of the income and capital gains that would otherwise be taxable are “distributed” to unitholders in proportion to their share of the fund. The investor must then include that income in their own tax return each year and pay tax on it themselves;
- Distributions are taxable when the investor is entitled to receive the payment (the record date), not when it is paid. Distributions can also include some franking or other tax credits if the Fund has received these from the investments it makes;
- The minimum amount to be distributed each year is normally the taxable income of the Fund;
- Companies pay tax on income and capital gains. They are then able to pay dividends to shareholders from those profits. They can attach to those dividends a franking credit, which is a credit for the tax previously paid by the

Company on that amount. Investors include both the cash dividend and the franking credit in their tax return, and can usually offset the franking credit against tax payable on other income;

- Dividends are taxable when the investor is paid, not when they are entitled to receive the payment; and
- There is no minimum amount of dividends that must be paid.

Secondly, the unit prices of managed funds will increase or decrease over time based on changes in value of the underlying investments the fund holds. When the value of the funds’ underlying investments rises – so will the unit price of that fund. Similarly, a fall in the value of the underlying investments will lead to a fall in the unit price.

So the returns to an investor in a managed fund will consist of the distributions they receive during the investment term, plus or minus the change in the price of the fund units.



# How do Managed Funds compare to other types of investments?

Managed Funds are often compared to Listed Investment Companies (LICs) and Exchange Traded Funds (ETFs). But there are several very important differences between these types of investments that you should be aware of.

	Managed Investment Fund	Listed Investment Company	Exchange Traded Fund
Listed on ASX	No, unlisted.	Yes.	Yes.
Minimum Investment	Varies, but usually \$10,000 or more.	Set by broker. Can be \$500 or less.	Set by broker. Can be \$500 or less.
Eligibility	Retail funds with a PDS are available to everybody. Wholesale funds are restricted to certain types of investors.	Anyone with a broker account.	Anyone with a broker account.
Pricing	Usually priced based on the value of their underlying assets (NTA or NAV) +/- buy/sell spread.	Set by market forces. Can vary substantially from value of underlying investments.	NAV +/- a margin, facilitated by market maker.
Legal Entity	Trust.	Normally a company, but can also be a Trust (e.g. REIT's).	Trust.
What does an investor own	Investors own units in the trust.	Investors own shares in the company.	Investors own units in the trust.
How bought and sold?	The trust issues units to investors who wish to go into the trust and redeems (buys back) units from investors who wish to exit.	Investors buy existing shares from another investor on ASX. The LIC can also issue new units or buy-back units from time to time.	Investors buy existing shares from another investor (or the market maker) on ASX.
Liquidity	Liquidity varies. May be priced daily, weekly, monthly or less often depending on the size of the fund and the type of assets they hold.	Traded on ASX between 10am and 4pm most business days. Smaller LIC's can be less liquid, with lower trading volumes.	Fully liquid. Employ a "market-maker" who is required to ensure trading price .
Minimum size of investment entity	Unrestricted.	ASX sets the minimum size and number of holders for new LIC's.	ASX sets the minimum size and number of holders for new ETF's.
Management	Can be internal or external, but normally external.	Can be internal or external, but normally external unless very large.	External.
Investors Income	Pay distributions. Can be taxable, tax deferred or tax free.  Can include some franking and other tax credits .	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.

	Managed Investment Fund	Listed Investment Company	Exchange Traded Fund
<b>Income Tax</b>	Do not pay tax but distribute taxable income to investors, who pay tax on it. Therefore, distribution returns are pre-tax.	LIC's 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.
<b>Capital Gains Tax</b>	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.	Generally, investors pay capital gains tax on difference between cost and sale value of investment when sold.	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.
<b>Investment Strategy</b>	Normally active. Tries to beat a market return.	Normally active. Tries to beat a market return.	Normally passive – tries to replicate a market return, less fees.
<b>Management Fees</b>	Normally highest. Can include performance fees.	Normally higher than ETF's but lower than managed funds. Can include performance fees.	Normally lowest. Usually does not include performance fees.
<b>Annual General Meeting</b>	No.	Yes.	No.
<b>Governance</b>	Managed by a trustee (if a wholesale fund) or responsible entity (if a retail fund). May be the same as the investment manager or independent.	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.
<b>Transaction Costs</b>	Set by manager. Buy/sell spread based on costs of buying and selling underlying investments the fund holds.	Buy/sell spread on ASX. Will be variable and dependent on market conditions and liquidity. Brokerage is payable.	Usually a market maker makes sure that costs of transacting are within pre-set limits and approximate to underlying asset value. Brokerage is payable.
<b>Investor disclosure</b>	Continuous disclosure rules – normally periodic reports plus ad-hoc disclosure on website or by email.	Announcements on ASX. May be supplemented by other reporting.	Announcements on ASX. May be supplemented by other reporting.

# Choosing a Managed Fund

## What should you look for?

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

At Affluence, we assess managed funds on three broad criteria:

- The quality of the manager and their potential to deliver above average returns;
- The investment strategy of the fund and how its performance will compare to other investments in our portfolio; and
- How expensive or cheap the underlying assets the fund invests in are, relative to long-term market cycles.

Put simply, we seek to invest into high quality funds with outstanding managers when the assets they invest in are cheaper than average. This requires a consistent strategy, patience and discipline.

## Assessing Quality – Key factors

There are many factors which can determine the attractiveness on a managed fund investment. Below we have set out the key factors we consider. There are also many others which can be taken into account.

## Understanding the Strategy

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

This information can be found in several places, but most commonly in the PDS or Information Memorandum, on the fund or managers' website (if it has one) or in regular investors reports.

Some key questions we ask, to help us understand the investment strategy of a managed fund are:

- What types of assets does the fund invest in (e.g. shares, property, diversified)?
- Does the Fund focus on a small, niche market (e.g. microcap ASX stocks) or does it invest more broadly?
- What market or geography does the Fund invest in? Is it focussed just on Australia, in one or a combination of overseas markets, or both?
- Is the fund long only (e.g. it only purchases assets and holds cash), or does it also short assets or borrow to invest (known as leverage or gearing)? Gearing and shorting has the potential to enhance returns, however also has the potential to magnify losses;
- What are the investment managers return objectives for the fund? Have they managed to achieve that so far?;
- What should the funds' performance be measured against? (For example, 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 performing funds 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 fund manager aim to beat the market? What is the advantage they have that can allow them to do so?;
- How will the fund compliment your investment portfolio? Is the investment manager 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 few years' fund reports and other continuous disclosure announcements. This may assist to provide additional background on the fund and to understand if the trustee/ investment manager have deviated from, or changed strategy during that period. Past announcements for funds are usually available from the fund or managers' website.

## Assessing Performance

It is said (and in fact ASIC demands all investment managers make it clear) that historical performance is no guide to the future. 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 the absolute returns generated, but by comparing those returns to a fair benchmark and measuring how the fund (and the manager) has performed relative to that benchmark.

The manager will almost always publish the performance of the underlying investment

portfolio. This represents their performance as a manager of that portfolio. Portfolio performance, if possible, should be assessed after all fees to the manager. 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. Returns are typically expressed as a percentage, and are annualised for periods longer than one year. Usually they will include returns from both distributions and increases in the unit price.

Ideally performance should be measured 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. So, the longer the period you have data for, the better.

It's very important to look at how the fund has performed in down markets, as this will give you some idea as to how aggressive or conservative the strategy is. For example, a fund which invests in small cap stocks may outperform others over the very long term, but may severely underperform in negative markets. That may be OK for you if you can handle that level of volatility, but if you cannot, you may be susceptible to selling at the worst possible time.



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

- Is performance stated after all costs and fees to the manager? Performance before fees and costs is irrelevant;
- Stating just total returns accumulated over a long period can be misleading. Performance should be annualised for all periods over 1 year;
- Is there a long enough timeframe to assess performance? While most managers publish performance data for less than one year, it is largely irrelevant for your purposes;
- Is the benchmark fair? A fair benchmark is one which reflects the average return you might expect from the types of assets the fund 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

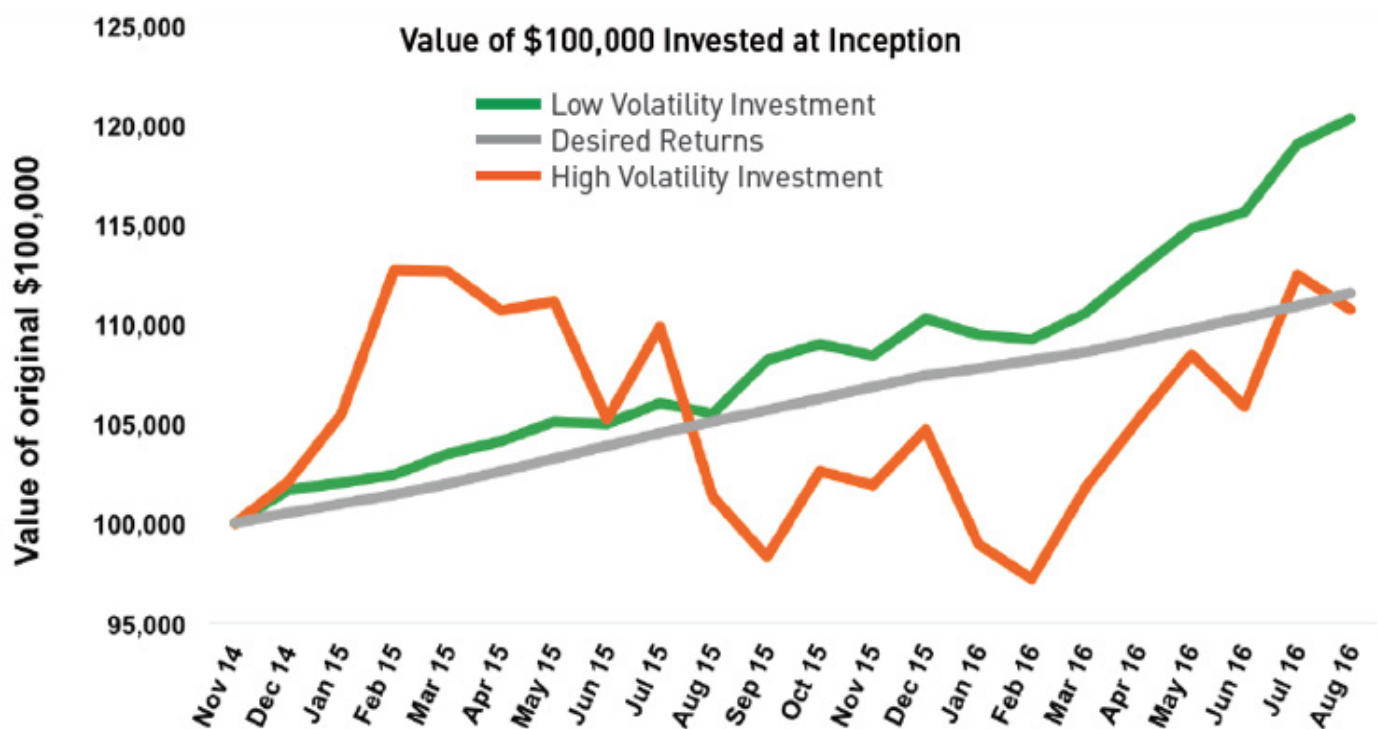
end up measuring performance against an inappropriate yardstick.

Finally, when assessing performance, remember that while it can be useful, it is entirely historical in nature and doesn't necessarily reflect the future. Good managers can have bad periods, but 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 aim in measuring performance is to understand how well the manager has performed relative to the market 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 performance 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 3 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.

In this regard, over time:

- Listed investments tend to be more volatile (but obviously more liquid) than unlisted investments;
- Smaller listed stocks 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;
- Sectors such as bonds and property (when held directly) tend to have much lower volatility than equity based businesses;
- 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 basic things you can do to assess volatility.

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

Some managers also publish limited volatility data. Measures such as standard deviation, up vs. down months and ratios such as the sharp and sortino ratios can be useful tools to assess volatility but generally only 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. We consider the fund managers or portfolio managers for each fund (not the directors) to be the most important factor in delivering long term returns.

It is important to understand how long an investment management team has been together when assessing performance of a fund. If the fund has existed for longer than the current key fund 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 fund manager leaves a team, it is wise to understand who will replace them and how that might impact returns going forward.

We like to see stability in the investment team and faith in their ability to do the job. Some key factors which may indicate a strong alignment of interest include:

- Where fund managers own part of the management company;
- Where fund managers have a significant personal investment in the Fund;
- Where a fund manager has a long history with the investment management company.

We are less interested in the holdings of non-executive or independent directors, as it is the investment management staff (particularly the fund managers) who ultimately add the value and have the greatest influence on long term returns.

We also like to see the managers to display good personal traits; humble, realistic, analytical, risk aware, passionate and competitive. It is also important that they are honest about the value of what they are investing in (i.e. they tell you when it's expensive).





## 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. In general, a bigger fund will find it more difficult to outperform compared to a smaller fund. For example, a talented equities fund manager may find many great opportunities if they only have \$100 million to invest. At this level a 5% portfolio allocation is \$5 million and allows a very wide investment universe. If the same fund manager had to invest \$2 billion, the same 5% portfolio allocation is now \$100 million, and they are constrained to only investing in the biggest equities (and thus have a much more limited number of potential investments). We like our managers to impose capacity constraints on themselves in order to preserve their ability to outperform. The capacity (level of funds they can comfortably manage) is dependent on the market they invest in, the strategy they use and the liquidity of those assets.

There is one drawback with smaller funds. Many costs of running a managed fund are relatively fixed. A fund with a smaller amount

of investment assets is likely to suffer from a high cost load, because the fixed costs must be spread over a smaller asset pool. This can negatively impact returns. Many investment managers limit the percentage of costs to net assets that they will seek to recover from the Fund, in order not to negatively impact funds that are relatively small.

Liquidity in managed funds can vary considerably depending on the manager, underlying assets, and stage of the cycle. All other things being equal, we prefer funds with at least monthly liquidity, however for funds that invest in assets such as direct property, this is not always possible, because the underlying assets are not able to be sold in parts, or over a short period. Most of these types of Funds have a set termination date when the asset is sold and net proceeds returned to investors.



## Other things to take into account

The above factors are the key attributes we consider when assessing the quality of a manager, however they are not the only ones which can be important.

Other features which can be important are:

- **Capital management** - how and when they have raised capital. Have they raised below NTA? Generally, you should be wary of any fund which has raised equity at a substantial discount to NTA;
- **Taxation** – Managed funds are normally trusts with distribute all taxable income. The amount of taxable income produced each year, and the level of taxable income passed onto the investor, will depend on the strategy and performance of the manager. How important this is to you will depend on your own tax position and tax rate;
- **Borrowings** – Some funds do 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 will be. Given that, an investor should demand a higher level of return from a geared fund, when compared to an ungeared alternative;
- **The management company** - Most funds are externally managed, which means the manager is being paid a fee by the fund investors. It is unlikely the manager would be terminated or voted out unless they had severely underperformed and a competitor or another party wanted to aggressively pursue management of the vehicle. Such circumstances are rare;
- **Distributions** - This is one of the least important things we look at. We would suggest never to buy a managed fund based solely on the distribution yield, but to consider the total returns instead;
- **Earnings** – This is also basically irrelevant as far as a managed fund is concerned. Earnings are reported as being derived from the distributions received from investments, less costs, plus/minus changes in the value of the investment portfolio. However, reviewing long term investment 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. Would you rather have a 4% management fee and 20%pa returns, or a 0.5% management fee and 2%pa returns. We know which one we'd prefer. If you look at performance after fees and costs, management fees in isolation become much less important.



# Risks of Managed Fund

Like all investments, managed funds carry certain elements of risk and an investor should be aware of the risks of any managed fund they are looking to invest in. Some of the risks associated with managed funds are:

- **Market risks** - the major source of risk and volatility with managed funds comes from the underlying assets held by the fund. If for example the ASX 200 drops by 10% over the course of 12 months, then an Australian equity fund may fall by a similar amount (it could fall by more or less than 10% depending on the skill and strategy of the fund manager);
- **Liquidity risks** - managed funds are relatively liquid with most funds providing regular liquidity (often daily, weekly or monthly). In times of severe economic downturns, however, these funds can reduce this liquidity, and potentially even freeze all redemptions for a period of time, so as to protect the holdings of the fund and not disadvantage investors who wish to stay invested. In addition, some funds offer no liquidity during the investment period and investors only receive their investment back when the fund sells its assets;
- **Key person risks** - the performance of the fund may be affected by the skill or reputation of the fund manager. This may give rise to 'key person risks' should the particular fund manager leave the organisation;
- **Investment horizon risks** - All managed funds have various recommended time

horizons. Some are short time frames (0-3 years) and others are longer time frames (5-10 years). It is important a fund's timeframe is aligned with an investors desired investment horizon, as investment returns rarely occur in a straight line. Markets and investments move up and down, and if an investor is forced to sell early for a loss, they lose the ability to generate a longer term positive return.

The PDS or Information Memorandum for each managed fund should clearly outline the types of risks most likely to impact investors in that Fund. It is important to read this information carefully as it can be helpful to understand whether an investment in the fund matches your risk tolerance.

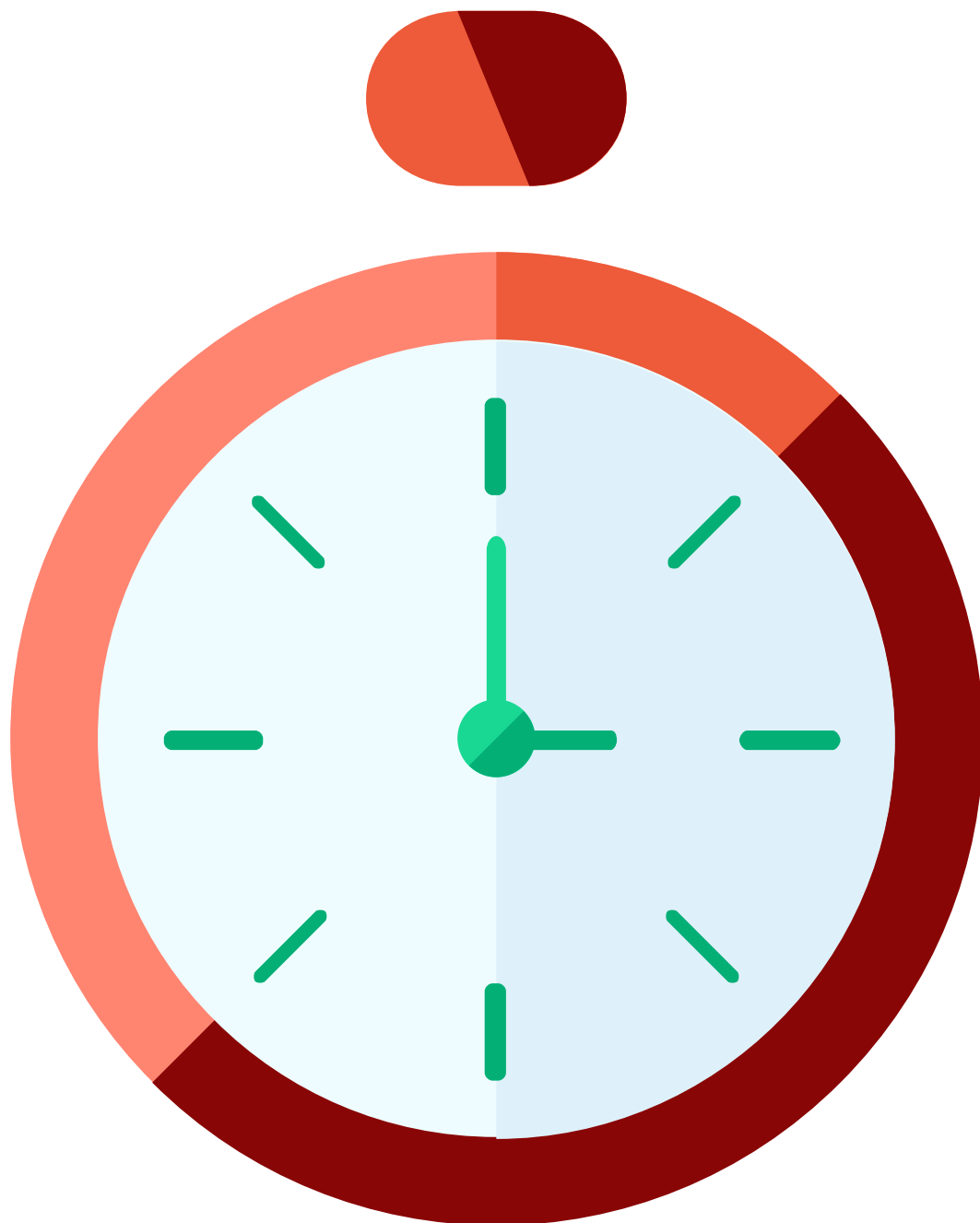




# Is it the right time to buy?

You may have found a great manager and a fund with the right strategy, that has performed above an appropriate benchmark. But there is a final step before you invest. Are the underlying assets trading at your assessment of fair value? For example, while there will always be individual assets in a particular asset class that trade above and below fair value, if an overall asset class is considered

to be overvalued, there is much less chance of achieving a satisfactory return. Remember the old adage “buy low and sell high”. There is where patience comes in. It may be necessary to wait months or years until the funds underlying assets are at a value you are happy with. There is little point entering an investment at the top of the market, even if it is with the best manager.



# Summary

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

Buy only quality funds with proven managers you can trust, who have performed well in the past.

Invest in funds which own assets you like, using an investment strategy you understand, with an appropriate structure in place.

Most importantly, make sure you understand how each managed fund fits into your overall portfolio and how it can add value over your investment timeframe.



# About Affluence Investment Fund

The Affluence Investment Fund aims to provide Eligible Investors with:

- Access to a diversified portfolio of underlying 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 aims to achieve this objective by finding 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 a formula we have developed over many years:

- To achieve better than average results, you must invest differently;
- Value investing works best in the long run, particularly when combined with positive momentum; 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 Fund began investing in December 2014 and was opened to investors for the first time in September 2015. 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 allows for diversification across all asset classes and should allow the Fund to take advantage of what we believe are the best opportunities at any given time.

The Fund aims to provide investors with a distribution yield of at least 5%pa. We also target total returns of at least 5% above inflation over rolling 3 year periods. In this way, we seek to provide a regular income stream, while preserving and growing the capital value of your investment over time. The Fund also aims to outperform the Australian stock market (as measured by the S&P/ASX 200 Accumulation Index) by at least 5% in any year in which that index delivers a negative return. We seek to achieve this 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.

## 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:

**P:** 1300 233 583  
**E:** [invest@affluencefunds.com.au](mailto:invest@affluencefunds.com.au)  
**W:** [www.affluencefunds.com.au](http://www.affluencefunds.com.au)  
**A:** Level 7, 320 Adelaide Street,  
 Brisbane QLD 4000

## About Affluence Funds Management

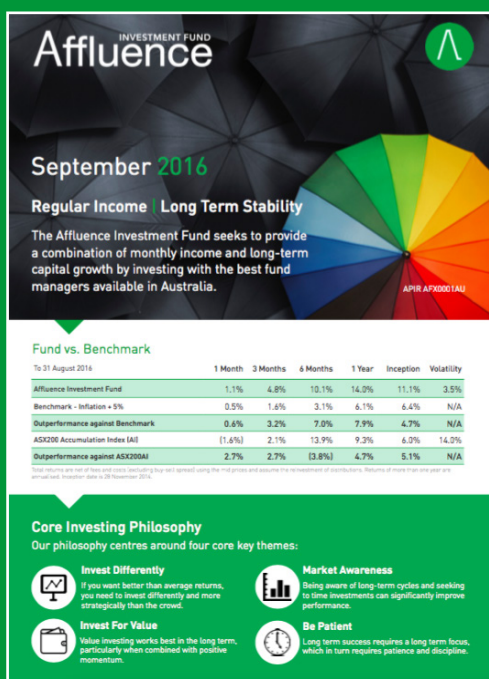
Affluence Funds Management was founded in 2015 to provide investors with a better investment solution. Our focus is on delivering superior long-term investment performance and in providing quality education and investment ideas for our members.

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.

## Core Investment Philosophies:

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.



### Invest For Value

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



### Market Awareness

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



### Be Patient

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

