THE VALUE OF PROFESSIONAL FUNDS MANAGEMENT

HOW FUND MANAGERS HELP TO GROW YOUR WEALTH

Key Messages

This report outlines:

- The importance of diversifying your investment portfolio;
- The benefits of fund managers professionally managing your superannuation or investment portfolio;
- The increased access to a wider range of asset classes through a fund manager; and
- The pooling of risk when using fund managers.

What is funds management?

Funds management is the professional management of a pool of assets by an investment specialist known as a fund manager. This is generally on behalf of superannuation funds, insurance funds or individual investors such as Self Managed Super Funds (SMSFs).

The history of pooled assets (or managed investments), dates back to 1774 with the creation of a Dutch investment trust as it was believed by providing diversification it would increase the appeal and access for smaller investors with minimum capital[1]. How right they were, as managed funds and the management of these assets have become a means for investors of all sizes to access professionally managed investments. Today the asset management industry is entrusted with over $76 trillion for retail and institutional clients globally. That is equivalent to 100% of the world gross domestic product (GDP) and 40% of global financial assets[2].

> In a managed fund, your money is pooled together with other investors. An investment manager then buys and sells shares or other assets on your behalf. The value of your investment will rise or fall with the value of the underlying assets.
>
> ASIC Money Smart

An organisation that manages the investment of a portfolio of securities on behalf of individuals and organisations, subject to the directions of the investor. Fund managers offer pooled investment products and individual portfolios to a range of investors including superannuation funds, institutions, and individuals.

Funds management can be accessed through many different products and tax structures including investment trusts, superannuation funds, allocated pensions, exchange traded funds and listed investment companies.

[1] Investopedia – *"A brief history of the mutual fund"*

[2] IMF – *"the Asset Management Industry and Financial Stability"*, April 2015

What do fund managers do?

Fund managers are investment professionals who are entrusted to invest and manage financial assets on a client's behalf. Financial assets include stocks (shares), bonds, property and cash.

People invest money with fund managers to help them meet their financial goals and objectives. As examples: ensuring you have sufficient money in your retirement; saving for that special holiday overseas or purchasing a new car; or to ensure you have enough money to look after your family in the future.

Using a fund manager either directly or through your superannuation fund gives you numerous benefits including:

1. **Professional management of your superannuation or investment portfolio:** access to professional investment specialists – these experts have the knowledge and skills relating to funds management as well as the time required to research markets, economies and companies.

2. **Access to a wider range of asset classes** that individuals may find difficult to access themselves. For example, global equities (shares), emerging markets, property, alternatives or infrastructure. You can invest into managed funds which in turn invest in these asset classes on your behalf.

3. **Diversification of your superannuation or investment portfolio:** Fund managers help diversify your investments, aiming to reduce volatility of returns. This is achieved by pooling your investment with other investors in a managed fund. This allows the fund manager to invest in a wider range of securities than if you invested directly.

4. **Greater access to company research and insights:** Fund managers have access to research to help make informed decisions. As they represent large investors in individual stocks, they can gain access to senior management in companies and positively influence business decisions affecting your investment.

5. **Fund managers are continually managing your investment:** Fund managers are always monitoring portfolios so they can assess breaking news as it happens. Even when you are on holidays they are managing your investment. This could be reacting to a surprise change in interest rates to deciding on whether to participate in a rights issue.

6. **Administration and paperwork:** Owning one investment can generate a lot of paperwork, owning a portfolio of investments will multiply the paperwork. Fund managers take care of all the paperwork for the many investments they make and just send you a consolidated report.

7. **Rebalancing your portfolio:** In addition to selecting appropriate investments, fund managers also make sure the amount invested in any one investment stays consistent with the objective of the portfolio. This requires regular rebalancing, reducing exposure to investments that have done well or adding to those that may have underperformed in the short term.

How do fund managers help to grow your wealth?

1. Superannuation

Most Australian workers are required to contribute superannuation into an authorised superannuation fund. Superannuation funds will professionally manage funds for their members and/or outsource some or all of this money to external fund managers to invest and manage on behalf of their members.

The fund managers will invest this money in multiple asset classes and through various investment strategies, as determined by the superannuation fund. These asset classes include Australian and offshore shares, property, fixed income (bonds) and alternative assets such as hedge funds, infrastructure and private equity. This diversification helps lower volatility and maximise returns.

The fund manager will invest in the way that is mandated by the super fund. Superannuation funds have a fiduciary duty to allocate resources to benefit their members. Your risk profile and life stage may be taken into account depending on which strategy you belong to.

For example, you may be in a balanced fund for someone in their 40's. The assets for this fund will be very well diversified, include many asset classes, have more growth assets to focus on higher growth. On the other hand a person in their 60's may have more income assets in their portfolio to focus on yield/income.

2. Self-Managed Super Fund (SMSF)

If you run your superannuation through an SMSF, investing into a managed fund run by a fund manager can provide you with the following benefits:

a. Diversification of your portfolio;

b. Professional management of your superannuation;

c. Access to company research and insights;

d. Access to a wider range of asset classes;

e. Continual management of your portfolio;

f. Administration and paper work taken care of; and

g. Rebalancing of your portfolio if required.

3. Non-superannuation investments - investing directly with a fund manager

You can also directly invest into a managed fund in order to grow your savings and investment for future goals, outside of your superannuation.

Styles of funds management

There are many types of fund managers who employ different strategies for investing and accessing different asset classes.

Active management is where an investment team actively manages the funds' investments, and aims to beat the performance of an index (such as the ASX200 or the S&P500) by utilising its own research to determine the best securities to invest in.

Passive management is where a fund's portfolio mirrors or follows a market index and aims to provide the market return to investors. Products may include index funds or exchange traded funds.

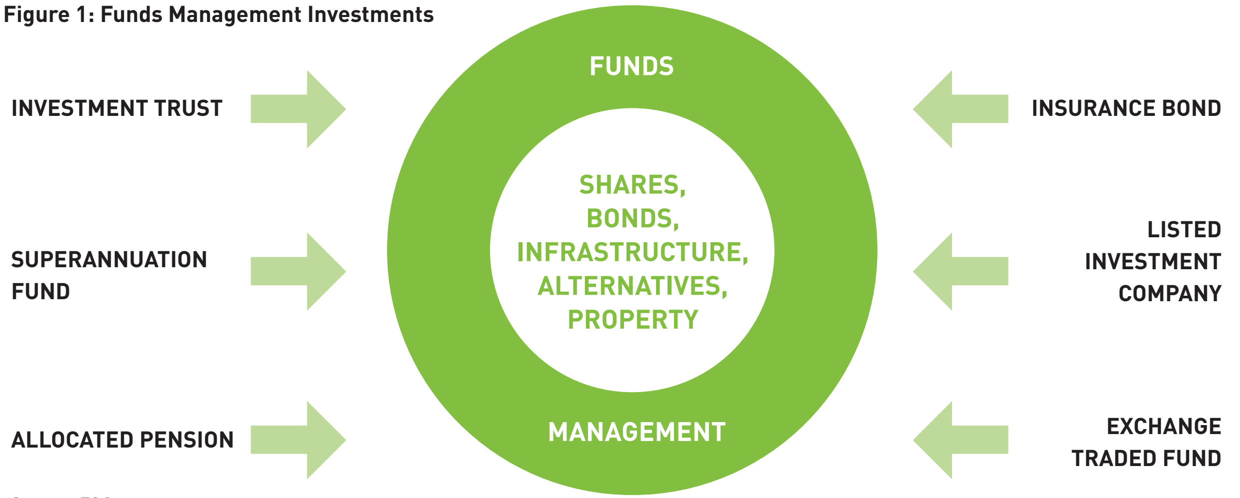
There are benefits to both active and passive management and both have a place in a diversified investment portfolio.

Asset classes include (for both Australian and offshore assets):

- Equities (shares)
- fixed income (bonds)
- cash
- property
- alternatives, including infrastructure, private equity and hedge funds.

Fund managers can help you achieve your retirement goals and specialise in creating products which are catered to these needs.

Figure 1: Funds Management Investments



Source: FSC

Stewardship and Fiduciary Duty

Stewardship is the principle that a fund manager should act at all times in the interest of the fund's beneficiaries or investors. As a manager looking after investor's money, fund managers should adhere to principles of good stewardship of that money. This includes activities of engagement and responsible investing (factoring in environmental, social and governance factors), as well as ensuring their own governance is best practice. Stewardship ensures that the investor's long term interests are taken into account in investment decisions.

Fund managers can positively influence companies and the market

As large shareholders, fund managers can engage with the companies they invest in. They have the ability to influence business practices more than an individual shareholder would be able to. In many cases, fund managers will own a large proportion of a company's shares and so can influence the running and governance of that company. They play a role in ensuring the company is run in the best interest of shareholders and that companies are held accountable for their actions.

This involves assessing how a company's activity impacts the environment, how the company treats employees and stakeholders, whether the company is being run in the best interests of all shareholders (and not just for a select few), and issues around experience and independence of the board. As a result fund managers play a very important role in ensuring companies are employing sustainable strategies for your long term investment.

Fund managers are responsible for the allocation of capital (the money entrusted to them) to productive assets. In doing this, fund managers are providing the resources needed by businesses to grow and prosper, something that benefits not only the investors but all those employed by those businesses. Allocating capital to the right businesses makes for a stronger economy.

Fund managers can also share their knowledge on investment markets and products with:

- Financial advisors;
- Individual investors and SMSF's; and
- Superannuation funds.

Fund manager websites can be a useful resource to understand the market and investing.

Fees and returns

Australia's open market and regulatory settings mean our funds management sector is highly competitive with over 400 firms – domestic and global – operating in Australia.

The pool of funds under management in Australia is over $2.6 trillion, one of the largest pools of contestable funds in the world, meaning significant efficiencies have been created in the market.

Superannuation has been compulsory in Australia since 1992, and since then the market has grown in size and sophistication. Many global companies want to manage money on behalf of Australian investors.

Figure 2: Growth of A$1 invested in Australian shares over 20 years to 30 Dec 2016

Source: Morningstar

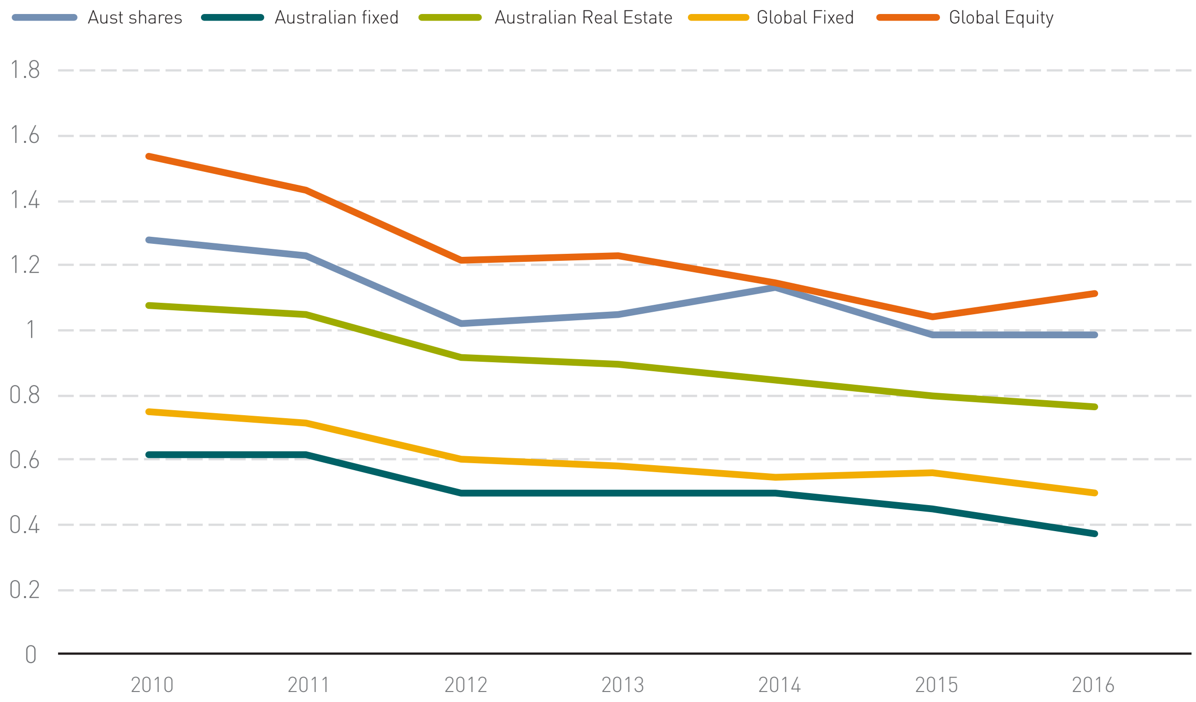
Superannuation fees in Australia are divided into several parts including administration (charged by the superannuation fund), investment (charged by the fund manager) and sometimes advice and insurance fees.

Investment fees charged by fund managers in Australia are highly competitive and are among the lowest, if not the lowest, globally. This compares with economies such as Japan, UK and USA. A survey by the FSC showed that fees in Australia were between 12% and 20% lower across asset classes as compared to these economies.

Fund managers will charge different fees depending on the asset class and the investment strategy used. Asset classes which traditionally offer higher returns tend to cost more than lower yielding asset classes. Similarly, active managers typically charge more than passive managers because they must spend more time and resource researching the market.

Fees should not be viewed in isolation. Instead it is important that you take into account both fees and returns. When combined this is referred to as the net return, which is essentially the investment return after deducting fees. It should be noted that while the cheapest funds may appear more attractive than more expensive ones, they do not necessarily result in the highest net returns.

Figure 3: Changes in Australian Investment Trust Median Fees by Major Asset Class, 2010–16



Source: Morningstar Direct™

In summary

Investing with a fund manager will:

- Allow access to the investment expertise of a professional manager;
- Enable diversification of your portfolio;
- Enable access to a wider range of asset classes; and
- Pool your risk with other investors.

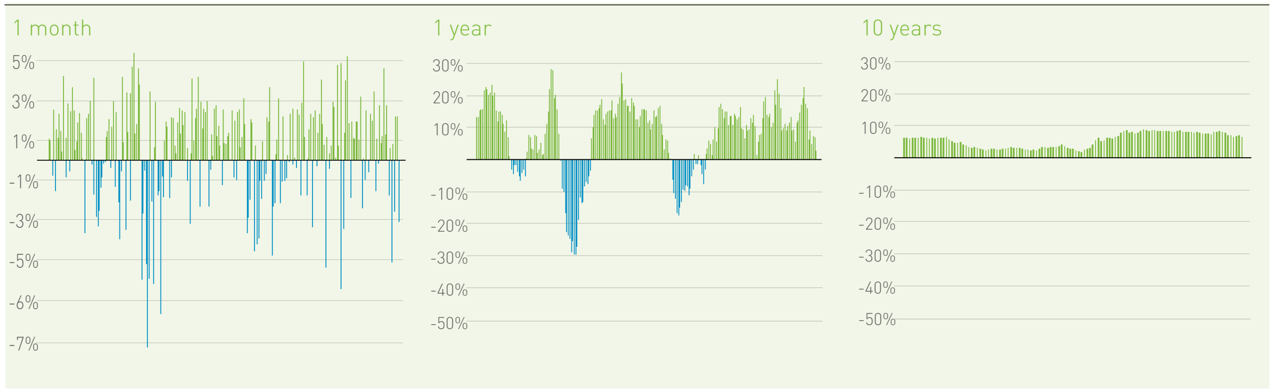
The benefits of diversification

Diversifying your portfolio and holding investments over the long term reduces risk and volatility, meaning negative returns are minimised.

Spreading investments across multiple asset classes reduces the overall risk of an investment portfolio. This is because losses made in one asset class can be offset by gains in others. The diversified portfolio is typically neither the worst nor the best performing investment in any given year. As a result, the overall return is less volatile.

A 'balanced' portfolio's returns over rolling 10-year periods show no periods of negative returns and are significantly less volatile compared with shorter term horizons. The less volatile return profile enables investors to see past the haze of short-term market movements and focus on achieving long-term investment goals.

Figure 4: Rolling returns of a balanced superannuation portfolio over varying time intervals



Source: Morningstar

For more information on funds management, please go to the ASIC Money Smart website or the Financial Services Council website. Alternatively, contact a fund manager to discuss your options.

www.moneysmart.gov.au
www.fsc.org.au

Financial Services Council
Level 24, 44 Market Street
Sydney NSW 2000 Australia
www.fsc.org.au