

Back to Basics – Understanding Managed Funds

By Michael Lannon

Last year was a good year for investors in the share market. However it is important to not lose sight of the basics of investment. This month we look at managed funds. From young investors starting out to seasoned investors that are running their own super fund managed funds can be a key ingredient in a well diversified investment portfolio. Many Australian investors need to increase their exposure to International shares and managed funds are the ideal vehicle to achieve this diversification goal. The following should help you to understand the key facts about managed funds.

What is a managed fund?

A managed fund is a pool of money invested by many people who have similar investment goals. A professional fund manager invests the fund's money on behalf of its many investors according to stated investment goals. For example, a share fund's objective may be to outperform the overall share market over five years, while a fixed income fund might aim to provide investors with regular monthly income that offers a higher return than the current interest rate.

Note: Managed funds can be either **superannuation funds** (managed funds in which you invest your super contributions) or **ordinary or non-super funds** (managed funds in which you invest money from other financial resources). Each type has different investment features and tax consequences.

What are the key benefits of managed funds?

Investing in managed funds has many benefits, including:

- **Access to a wider range of investments.** Pooling your money with other investors means you have access to investments that are not normally affordable or available, such as commercial property or international shares.
- **Diversification.** Managed funds can invest in a large number of investments across a wide range of asset classes. This results in a level of diversification that would be difficult to achieve on your own.
- **Funds that suit you.** There are a large number of superannuation and ordinary managed funds available, and each follows a carefully selected investment strategy. With the help of a financial adviser, or through your own research, you should be able to find managed funds that suit your personal financial goals.
- **Expert management.** Fund managers use a range of investment resources, skills, and experience to protect your money. This means you can rest easy, knowing your money is in good hands.
- **Regular investment option.** Most managed funds offer the convenience of a regular investing option, such as automatic withdrawals from your bank account. This feature makes it easier to achieve your investment goals with less time and effort. – **Why not consider investing your new tax cut this way?**
- **Investor protection.** Ordinary or non-super managed funds are operated by a *responsible entity*, which protects the interests of all investors. Responsible entities are regulated under the Corporations Act and administered by the Australian Securities and Investments Commission (ASIC). Superannuation funds are managed by a *trustee*, who protects investors' retirement savings and is subject to regulation under both the Superannuation Industry (Supervision) Services Act and the Corporations Act.

How do managed funds work?

When you invest in a managed fund, you buy units of ownership in that fund, which is similar to buying shares in a company. As the value of the fund's investments rise or fall, the fund's unit price moves accordingly. So this means the value of your investment will rise and fall as well, and you may achieve capital growth (or loss) when you sell your units.

Managed funds also generate income in the form of **distributions**, which are paid on a regular basis – normally monthly, quarterly or half-yearly. Each distribution is based on the earnings of the managed fund, which can come from share dividends, rent from property, interest from fixed income investments and any capital gains realised on these assets.

Investors in an ordinary or non-super managed fund can either accept the income from distributions as cash or reinvest it in the fund. However, superannuation funds will always reinvest distributions, as they are designed to help build your retirement savings.

Which funds may be right for you?

If you decide that managed funds can help you achieve your investment goals, the next step is to choose the funds in which you should invest your money.

Investment Tips

- Managed funds can be a cost-effective way of diversifying your investments while gaining access to professional investment management skills.
- By choosing to reinvest the income from your managed fund, you can benefit from the effects of compounding returns.

How do managed funds differ?

The primary distinction is between superannuation and ordinary or non-super funds. Managed funds can also differ in their asset allocation strategy, or how their assets are invested in order to achieve their investment objective.

The role of the fund manager

Before looking at other differences between managed funds, it's important to explain the important role fund managers play in whether funds achieve their investment objectives. Not only does a fund manager ensure that a fund's assets are invested in the type of individual investments that fit the fund's investment strategy, they must also keep an eye on the overall asset allocation of the fund. This requires the fund manager to focus both on individual investments in the fund, as well as maintain a big picture view of the funds holdings.

Multi-asset class funds

Multi-asset class funds invest across a range of asset classes, rather than one. This means the fund manager needs to be an expert in the range of asset classes selected or in many cases today these multi-asset class funds employ several fund managers that are specialist in specific asset classes.

While different investment managers offer different products, the following table contains examples that demonstrate how multi-asset class funds work.

Multi Asset Class Funds

Growth Fund

Higher risk and potential returns
Investment timeframe is 5+ years
Generates returns through capital growth from shares over the long term, and income from share dividends

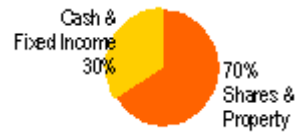
Typical Asset Allocation



High risk /return

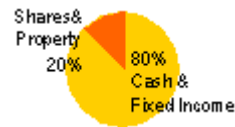
Balanced Fund

Medium to high risk and potential returns
Investment timeframe is 3 to 5 years
Generates returns through capital growth from shares & property over the medium to long-term, and a moderate level of income from share dividends and fixed income investments



Managed Income Fund

Lower risk and potential returns
Investment timeframe is 1 to 3 years
Generates regular monthly income from share dividends and fixed income investments, with limited capital growth



Low Risk /return

Single-asset class funds

Single-asset class funds invest within one asset class, such as international shares only. However, they still diversify across a number of investments within the chosen asset class. This means the fund manager needs to be an expert in the particular asset class selected.

The following table shows examples of international and Australian single-asset class funds.

Product type	Target market	Minimum investment
'Retail' Managed Funds	Individual retail investors	The minimum investment is usually \$1,000 - \$5,000 (depending on the investment manager).
'Wholesale or Mezzanine' Managed Funds	Investors with a degree of knowledge and understanding about investment markets.	Minimum investment is usually \$100,000. Mezzanine funds normally have lower fee structures than retail funds because the average minimum amounts invested are much larger. This means you pay lower management fees for a wholesale or mezzanine managed fund than for a retail managed fund.
'Wholesale' or 'Institutional' Managed Funds	Individuals deemed to be "professional" or "sophisticated" investors or organisations.	Minimum investment is usually \$500,000. Wholesale funds generally have the lowest fee structure. This means you pay lower management fees for a wholesale / institutional managed fund than for a retail or PIF managed fund.

Putting the pieces together

Now that you are familiar with the different types of managed funds available, you need to identify which types of funds best suit your investment goals. The first step to doing this is to answer the following questions:

1. **What is your investment goal? Generating income, capital growth, or a mix of both?**
2. **What is your timeframe, or how long do you have to invest?**
3. **What is your risk tolerance, or how much risk are you willing to take?**
4. **How much can you afford to invest, taking into account your immediate and anticipated expenses in the future?**

I hope that this overview of managed funds has highlighted the importance of this type of investment. Next month we will look at how you go about choosing a managed fund that suits your goals and objectives. We will highlight the research tools that are available in the press and on-line and outline educational resources that are readily accessible to help you make smart investment choices.

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