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Colin Davidson

*Chartered accountant and
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***Managed
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FOR
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by Colin Davidson



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Wiley Publishing Australia Pty Ltd

Managed Funds For Dummies®

published by
Wiley Publishing Australia Pty Ltd
42 McDougall Street
Milton, Qld 4064
www.dummies.com

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National Library of Australia
Cataloguing-in-Publication data:

Author: Davidson, Colin.
Title: Managed Funds For Dummies / Colin Davidson.
Edition: Australian ed.
ISBN: 978 1 74216 942 2 (pbk.)
Subjects: Investments — Australia.
Pension trusts — Australia — Management.
Dewey Number: 332.6780994

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Typeset by diacriTech, Chennai, India

Printed in China by
Printplus Limited

10 9 8 7 6 5 4 3 2 1

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Colin Davidson has worked in financial services for more than 20 years, both in Australia and overseas, in London and Asia. A qualified chartered accountant, Colin worked in Hong Kong as a stockbroker selling equities to global and regional fund managers. In Australia, he has managed a major bank's online stockbroking business and Australia's largest direct managed funds broker. Currently working at one of Australia's largest full-service retail stockbrokers, Colin is RG146 accredited and a Responsible Executive managing the broker's financial planning business. He co-wrote the 2005 and 2006 editions of *Australia's Top 100 Managed Funds*.

Dedication

To the family, Louise, James, Ella, Alex, Claudia and Blossom, and to those gone but not forgotten, Jean and Marguerite, go well.

Author's Acknowledgements

Something I hadn't appreciated when writing this book was how much of a collaborative effort the whole process would be. Thanks to Bronwyn Duhigg who, before she left John Wiley, originally approached me to write the book and guided me through the commissioning process. Thanks to Rebecca Crisp for the subsequent direction and always kind words of encouragement, and to Hannah Bennett, the publishing equivalent of a footy coach, expertly guiding from the sidelines. Thanks to Kerry Davies, project editor extraordinaire, for the ever-wise suggestions, who somehow magically pulled everything together. Thanks also to Zoë Wykes in the United States for the fresh perspective with the final edits, and to Glenn Lumsden for the great cartoons!

Thanks also to Angus Robertson, financial adviser at Bell Potter Securities, for the technical review of the book. With many years' experience advising clients on superannuation and managed funds, Angus brings a tremendous amount of experience to the book. Thanks finally to Louise, who read chapters, offered advice and was given a good excuse to regularly lock me away in the study until I'd met my deadlines. I'm sure the family enjoyed the peace.

Publisher's Acknowledgements

We're proud of this book; please send us your comments through our online registration form located at www.dummies.com/register.

Some of the people who helped bring this book to market include the following:

Acquisitions, Editorial and Media Development

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Acquisitions Editors: Bronwyn Duhigg,
Rebecca Crisp

Technical Reviewer: Angus Robertson

Editorial Manager: Hannah Bennett

Production

Graphics: Wiley Art Studio

Cartoons: Glenn Lumsden

Proofreader: Catherine Spedding

Indexer: Michael Ramsden

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Introduction

When I started writing this book at the beginning of 2010, global stock markets were emerging from one of the worst periods since the 1929 Wall Street Crash in the United States. Investors' portfolios had been decimated by the global financial crisis (GFC) of 2007 and 2008. The performance of many fund managers had fallen off a cliff and the funds management industry had gone through a shakeout. The crisis highlighted the fund managers who deserved their fees and exposed the mediocre — those who had been carried along by the 2003 to 2007 bull market.

As a result of the crisis, investors who stayed in managed funds fled to safety and switched their investments into cash, earning a pittance from the lowest interest rates Australia had seen in years. Investors lost confidence in the markets and especially in the fund managers who were supposed to be growing their money. As markets recovered, investors returned slowly, not so much to managed funds but to owning shares directly and looking after their own money.

So, all-in-all, a great time to start writing a book about managed funds!

Although the GFC should make everyone more cautious, it shouldn't stop people investing. In fact, the GFC has highlighted the need for professional fund managers. In *Managed Funds For Dummies*, I look at how fund managers provide consistency of method and a disciplined approach to managing money.

About This Book

I wrote *Managed Funds For Dummies* as a plain-speaking and practical guide to managed funds. The book is aimed at anyone new to managed funds — or investing for that matter — and who might not know where to start. And just because you may use a financial planner to invest doesn't mean you won't find the book useful. This book helps you ask the right questions and, importantly, understand the answers.

Without wanting to sound like a politician, *Managed Funds For Dummies* especially targets the everyday Mum and Dad investor trying to save for a better future, for themselves and their children. Many investors want to manage their own investment decisions, and this book is a good starting point for the DIY investor — even more experienced investors who may want to brush up on their managed funds knowledge. It is certainly not meant to replace qualified professional advice!

Fund managers have a certain air of mystery about them. They're a naturally secretive bunch, but who can blame fund managers for wanting to protect the way they make money? I aim to peel away some of the mystery and show investors what they need to know about fund managers and their funds before they invest.

The book refers to a number of the major fund managers in Australia and around the world. Longevity in the marketplace and size usually dictate which managers I mention. Investors are bound to come across the names in advertising, when talking to a financial planner or even through a quick search of the internet.

The industry is changing, and none more so than in 2010. Fees and commissions are the big talking point, as is the desire to make everything simpler and easier to understand. Hooray to that! Legislation will change some of the things I've written about in this book over the next couple of years. I've foreshadowed those changes where possible and explained the likely impact for the investor.

Conventions Used in This Book

To help you get the information you need as fast as possible, this book uses several conventions:

- ✓ **Bold** words make the key terms and phrases in bulleted lists jump out and grab your attention. They also indicate the action part of numbered steps.
- ✓ *Italics* signal that a word is an important defined term.
- ✓ Monofont is used to signal a web address.

When this book was printed, some web addresses may have needed to break across two lines of text. If that happened, rest assured that no extra characters (such as hyphens or spaces) are used to indicate the break. So, when using one of these web addresses, just type in exactly what you see in this book, pretending that the line break doesn't exist.

- ✓ Sidebars, text separated from the rest of the type in grey boxes, are interesting but slightly tangential to the subject at hand. Sidebars are generally fun and optional reading. You won't miss anything critical if you skip the sidebars. If you choose to read the sidebars, though, I think you'll be glad you did.

I use some terms interchangeably in the book. So a *fund manager* can refer to the actual company that has legal responsibility for a managed fund, but can also refer to the actual person who manages the fund. The context should make it obvious which is which. The term *financial adviser* is interchangeable with *financial planner*, and refers to anyone who is legally qualified to give financial advice. *Stocks* and *shares* also refer to the same thing.

Foolish Assumptions

When I sat down to write this book, I thought long and hard about who would pick it up and read it. Here are a few assumptions I made that may apply to you:

- ✓ If you're reading this book, you have an interest in investing and, in particular, in managed funds.
- ✓ You may have no knowledge whatsoever about managed funds other than seeing the occasional advertisement and wondering what they're all about.
- ✓ You may be an industry professional taking a quick flick through the pages, maybe even a fund manager, but perhaps that's assuming too much!
- ✓ You want a book that covers every aspect of managed fund investing but can also give you the practical detail you need to go about investing. At the same time, you don't want to wade through the finance industry double-speak that can leave investors perplexed. But you do need to understand some specific terms that go with managed funds, so I clearly explain each of these, with a handy glossary at the back of the book for quick reference.
- ✓ Last but not least, you want an independent view of managed funds, one that isn't trying to sell you anything or convince you that only managed funds will do. So I give you a guide and a way to answer questions you may have about managed funds and whether they're right for you. It may even help to answer questions you didn't know you should ask until reading this book!

How This Book Is Organised

Managed Funds For Dummies covers virtually every aspect of managed fund investing, and I start by giving you an understanding of what a managed fund is and why investing in managed funds is different from investing in shares and property. When you understand that, then you can figure out what type of investor you are, do the research and then fill in the forms. The book also gives the once-over to investment strategies such as margin lending and how these strategies may have a place in your portfolio.

The book is organised in six parts, covering everything you need to know about managed funds in Australia and how to invest in them.

Part I: Coming to Grips with the Basics of Managed Funds

Part I starts with a view from the top, looking at what you need to know, the pros and cons of investing in managed funds and how they are structured. It also examines the importance of asset class and investment style, and rounds off with how much investing in a managed fund is likely to cost you.

Part II: Doing the Research for Your Peace of Mind

This part is all about you, examining what type of investor you may be and how to work out what level of risk you're prepared to take when investing. I then look at how to set your investment goals, how you can research managed funds and what you need to look out for when judging if a fund is going to help you achieve your goals.

Part III: Choosing, Buying and Selling Managed Funds

Which comes first, choosing the fund or the fund manager? If you want to get to know the fund manager before choosing a fund, then this part explains the ins and outs. It also shows how you can invest either direct with a fund manager, via a financial planner or through a managed fund broker. I also give you practical hints on how to fill the forms in, as well as how to buy and sell funds.

Part IV: Determining How Funds Are Labelled

This part looks at the many ways managed funds are categorised by the industry. Increasingly, hedge funds are going mainstream and this part demystifies some of what they do. Administering your funds may not sound particularly exciting but knowing the services offered by fund managers and administrators is worthwhile, possibly saving you time and money.

Part V: Following Some Sensible Ideas for Happier Returns

So you've chosen your funds. This part examines what other strategies you may want to use to invest, such as borrowing to invest, regular savings plans and dollar-cost averaging. But what happens if it all goes wrong? This part explains who is keeping an eye on the fund managers and who to complain to if you're not happy.

Part VI: The Part of Tens

Managed funds investing doesn't need to be complicated and, in this part, I give a rundown of what to bear in mind before taking the plunge, including ten tips for getting you on the road to successful investing in managed funds, and ten traps and pitfalls — what the fund managers may not tell you and what you should look out for.

Glossary

The **glossary** of terms explains the key investing terminology around managed funds.

Icons Used in This Book

Everything in this book is worth reading, but some paragraphs may jump out at you as being an important piece of information to remember or a useful tip on managed funds. In the margins of the book, you can find the following icons marking certain paragraphs containing that special information. Here's what they mean:



Remember items are the yellow sticky notes of the book, the ones you should highlight with your own yellow marker. You'll find these notes useful when completing a task — such as filling in an application form, or what to remember when using a financial planner.



This is the stuff that is a little bit technical — usually related to tax, fees or legal information — you don't need to know this information but may find it interesting. If you want to know a bit more about how something works, then read this icon; if not, you can give it a miss and won't be any worse off.



A tip is a specific piece of advice on a particular topic. A tip may be a shortcut or some other helpful hint that may save you time, money or possibly heartache.



Warnings are just that — a heads-up that you need to be aware of something that could get you into trouble, cost you money or affect the fund you invest in.

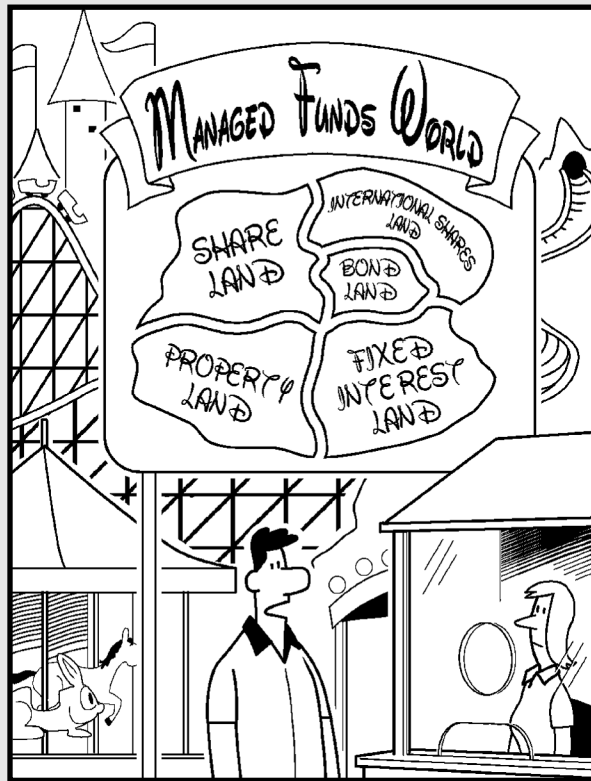
Where to Go from Here

Put the book to work for you straightaway! Thumb through the book to see what catches your eye or head to the Table of Contents or the Index to find a section or topic that interests you. Or just turn the page and dive right into Chapter 1. The choice is yours but, whichever way you go, I hope you enjoy — and benefit from — *Managed Funds For Dummies*.

Part I

Coming to Grips with the Basics of Managed Funds

Glenn Lumsden



*'Which part of the park has the
least scary rides?'*

In this part . . .

Whether you know it or not, managed funds are very likely a part of your investing landscape. Contributing to a superannuation fund? Chances are you're investing in managed funds. So, if for no other reason, getting to know managed funds could help you achieve a better retirement. Part I introduces managed funds, what to look out for and how to choose them.

As much as I'm a big fan of managed funds, you get to look at the cons as well as the pros of using managed funds here, and a dose of the legal stuff of how funds are structured, with a pinch of technical guff on top. This part also introduces some of the investing techniques used by professional financial planners and gets down to what we all want to know — how much it costs.

Chapter 1

Getting Started with Managed Funds

In This Chapter

- ▶ Understanding the basics of managed funds
- ▶ Finding out what fund managers actually do
- ▶ Doing the research before leaping into managed funds
- ▶ Making sure you know what to look out for

I'm going to indulge the accountant in me and throw around a few statistics about the size of the managed funds industry. The Australian industry has \$1.7 trillion-plus in funds under management, with 10,000 and more funds available from over 130 fund managers, making it the fourth-largest managed funds industry in the world.

All sounds pretty impressive but what does it really mean for the average investor? That lots of advisers and people in the finance industry are raking it in with all the fees being charged? Possibly, but what is important is that the numbers show Australia has a thriving and world-class fund management industry offering a wide choice for investors, despite the effects of the global financial crisis.

Australia's superannuation (often simply referred to as super) system drives much of the managed funds industry, and managing super drives much of people's investing decisions. Saving for retirement is big business and that's because it affects most of us in one way or another. Super should be front and centre of most people's investment strategies. Understanding that managed funds can make up a fair chunk of your super, the need to know about managed funds becomes important.

In this chapter, I cover how managed funds can play a part in your investment portfolio — whatever your investment plans, whether saving for retirement or for a deposit on a house. Understanding what managed funds are, how to choose one and what to look out for can help make your investment decisions a whole lot simpler.

Making a Start with Managed Funds

A *managed fund* is a way of pooling together money from many investors into one big pot, called a *trust*. Investors then buy units in that trust. The company or person looking after the money in the trust — the *fund manager* — invests the money across a host of different types of investments, from cash and property to bonds and shares. Most managed funds are *unlisted*, meaning that they're not traded on the stock exchange. However, a small number of funds are traded on the Australian Securities Exchange (ASX) as listed investment companies.

Considering managed funds beyond the GFC

The global financial crisis of 2008 to 2009 not only rocked the financial world; it also seemed to affect just about every aspect of our lives, including mine in setting out to write this book.

In investing terminology, writing a book on managed funds in early 2010 was the equivalent of buying at the bottom of the market. Things couldn't get much worse — for the industry or for investors. Many funds, especially those in the property and mortgage sectors, were badly hit, freezing investors' money. Many of these funds remain frozen while managers wait for the good times to return. So why would you even consider going back into the managed funds market after all that chaos?

The point is that markets go up and down, and the good times do return. Managed funds can and should have a place in people's investment portfolios regardless of the fallout from the GFC. The superannuation industry in Australia is worth around \$1.3 trillion and relies completely on markets that work and fund managers that perform well. As long as people and their employers are contributing to superannuation, skilled money managers and their managed funds will always be needed.

If there is a good side to the GFC, it is the lessons that might be learned by fund managers and investors alike. Poorly managed funds didn't survive. Fund managers do make mistakes and do lose money, sometimes a lot. But occasionally you come across a manager who knocks your socks off performance-wise and who can deliver again and again. As an investor, these managers are the ones you want to seek out to manage your money, because these are the guys who genuinely add value to your investments over time.

Discovering that you're probably using managed funds already

Before thinking about investing with managed funds, take a step back and look at the investments you have already. 'Not a lot,' you may think. But hold on. For many people — and I include myself in this — aside from the family home, superannuation is probably the largest, single and most important investment they have.

If you're working for a company, you're probably contributing to a super fund set up by your employer or perhaps an industry super fund. Most employer and industry funds are set up to invest mainly in managed funds, with very few offering direct share ownership. Often though, super is the forgotten investment; you have it because it's the law. Thinking about your super probably only happens around tax time, when you get an annual statement telling you what your fund has been up to during the year.



Just because your managed funds are in an employer super fund doesn't mean you can't manage them. Your super is important and managed funds are probably a big part of it. Getting to grips with some of the basics of managed funds can give you a better understanding of how to get your super working for you. See Chapter 3 for more on superannuation.

Including managed funds in your portfolio

'Portfolio' sounds like a word only the very wealthy would use, those with a private banker to cater for their every investing whim. Don't be put off, as *portfolio* is just a way of identifying the money you set aside for investing. Managed funds are generally set up to cater for three distinct uses:

- ✓ **Superannuation:** Within your super account helping you save for retirement
- ✓ **Pension:** After you've retired, managed funds in your pension account that help to provide an income
- ✓ **Investment:** Anything that is not part of (outside) your superannuation and pension



The idea of investing *inside* or *outside* your superannuation and pension is important to understand. Using superannuation and pensions can be a way of minimising tax on your investments. If investing solely to fund retirement, superannuation is invariably the best way to go, and managed funds are set up to cater for super, pensions and investments.

Examining What's Managed in Managed Funds

In the United States, managed funds are called mutual funds and in the United Kingdom they're unit trusts. So why 'managed funds' in Australia? For once, the finance industry came up with a name that says exactly what the product does — it manages funds (money). Thankfully, no committee was involved in coming up with that name or who knows what we'd be calling them!

Lifting the lid on fund managers

Managing money involves both investment decisions and administration, regardless of whether a big company or an individual is looking after the money. *Investing* is about making your money grow or producing an income. *Administration* is keeping track of your money and having the right paperwork to complete your tax return. Fund management companies spend a lot of money trying to get right both the administration and the investing sides of the business.

Fund managers may have different styles of investing. Styles can include *growth* managers investing in stocks with long-term growth prospects, or *value* managers who look for investments believed to be relatively undervalued. Hedge funds are another style all together (see Chapter 16). All have different risk and return attributes so you need to know what you're getting yourself into before you invest. Chapter 4 tells you more on investment styles.



Choosing a fund manager is as much about performance as it is about a good reputation — that the manager won't run off with your money — and good client service. Consistently good performance over a long period is the difference between a good fund manager and a great fund manager.

Finding out how fund managers earn a crust

Fund managers earn money mainly in a couple of ways. The first is charging fees as a percentage of your money. Every month the fund manager shaves off a percentage equivalent to anywhere between 0.9 per cent and over