IOOF

INVESTMENTS

An introduction to investing

Contents

Introduction

The principle of saving is well known. Money is put away in a savings account or a term deposit, generally achieving a fixed rate of interest with minimal risk. Unfortunately, a savings account can offer returns little better than inflation. In real terms, that means you may end up losing money on your initial investment.

Investing, on the other hand, is the commitment of money today which, with an appropriate level of risk, comes with the expectation of realising your future financial goals.

It's about making your money work harder for you than just saving alone can.

With its rewards, however, investing can also be challenging and confusing. Whether you dream of a new house or an investment property, money for your children's education or the comfort of security and freedom in retirement – understanding the principles of good investing is the foundation of achieving your financial goals. Achieving these goals shouldn't be luck. It requires commitment, research and patience, to ensure the outcome will be anything but uncertain. And, as with most things, you should plan ahead before you start.

This guide aims to build your understanding of the basics of investing and help get you started today on the path to securing your financial independence tomorrow. However it is just one part of understanding your investments. We strongly recommend engaging with a financial adviser to develop the strategies you need to reach your financial goals.

Understanding risk

Risk and investing are intrinsically linked. Risk is defined as the chance you will lose money on an investment – however, crucially it is also the driver for making money.

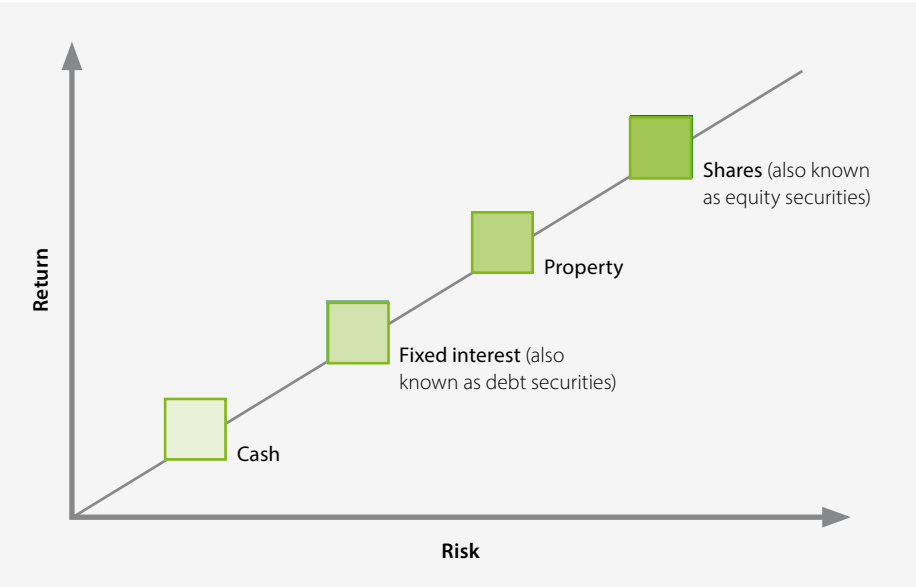
While every investment carries some risk, your appetite for risk will probably be very different to the next person. For some, crossing the road against the lights might seem risky, while others wouldn't think twice about skydiving. Risk is a perception based on your unique experiences and personality.

As all investments come with varying degrees of risk, it is important to recognise your appetite for risk and build a portfolio that suits your risk tolerance. There are several factors that, when considered wholly and in line with your goals, will measure your risk tolerance.

- **Desire to take risk** – some investors enjoy the inherent uncertainty of investing and are inclined to take on high-risk investments. More common however is an aversion to the stress that a large fall in an investment's value can produce. As a test, ask yourself how you would feel if you woke up and the value of your investment had fallen by 10%? 20%?
- **Financial capacity to take risk** – a couple with a new baby and a mortgage will have a considerably different capacity to take risks than a single person just starting out in the workforce.
- **Your need to take risk** – this is tied to your investment time frame. If you are 30 years old and planning 35 years ahead for retirement, you will probably be happy to accept greater risk (as short-term volatility is smoothed out), to achieve your goals. On the other hand, if you are nearing retirement, you'll probably not want to risk losing your money as there isn't the luxury of time to recover from losses.

Risk and return comparison

Risk and return comparison



With greater risk, there is the opportunity for greater returns. Different types of investments, as shown in the graph to the left, have greater risk – and the possibility of higher returns.

Your financial adviser is there to help you understand your risk profile and help you build a portfolio of investments which matches your risk profile and your investment objectives.

Types of risk

The most common types of risk are:

Business risk – this is the risk that a company's value will decrease or even go bankrupt. This may be unique to a company, or even a sector of the economy, however if you are invested heavily, your portfolio can face significant losses.

Market risk – also known as systematic risk. This is the risk that market-wide downturns will diminish your portfolio.

Currency risk – this is risk that arises from the change in value of one currency against another. For example, if your investment is in US dollars, a stronger Australian dollar will diminish your returns when the investment is repatriated to Australia.

Political risk – changes in government, or government policy, can significantly affect the returns on an investment. While this affects foreign investment in volatile developing countries, in Australia legislative changes, such as taxation law, can still pose a risk to investment returns.

Interest rate risk – if your investment is tied to the interest rate, such as property or bonds, then changes in the interest rate can affect your investment returns.

Liquidity risk – this is the risk that an investment may be difficult to sell at the time you want to sell. While shares are usually very liquid, assets such as property may take longer to sell, creating liquidity risk.

Inflation risk – this is the risk that your investment will not keep pace with inflation – and will lose money in real terms.

Avoiding risk

While risk is an unavoidable part of investing, there are steps you can take to minimise your exposure to unintended risk.

Diversification

As the saying goes, don't put all your eggs in one basket. Typically, different types of investments such as shares and bonds, perform well at different times. With a mix of investments, if one part of your portfolio suffers losses, other investments may remain steady or even appreciate. Over time this will smooth out the returns of your portfolio and protect against the risk of catastrophic losses.

There are different levels of diversification to properly manage risk:

Between asset classes

Diversify across different asset classes – cash, fixed interest, property, shares

Within asset classes

Diversify across market sectors, such as cyclical (eg mining stocks) or defensive (eg healthcare, consumer staples)

Within market sectors

Diversify across different companies within sectors (eg Westpac and Commonwealth Bank within the financials sector)

Long-term investments

While your age, investment goals and financial situation will affect where you put your money, generally speaking longer-term investments present smoother returns as short-term volatility is smoothed out.

Research

The more you understand about an investment and the financial markets, the less likely you'll be to make an investment which doesn't match your financial goals.

Investment concepts

Compound interest

Compound interest is your money working for you. You earn interest on the money you deposit, and in time you earn money on this interest. When you are earning interest on your interest that's compound interest, and it's one of the most important principles of investing and a great reason to start investing as early as possible.

Compounding interest can have a big impact on your final portfolio value. Here's an example of how it works. You invest an initial sum of **$50,000 at 8%** interest and have the choice to have this interest paid out to you – or you can re-invest it.

	Interest paid out		Interest re-invested	
End of year	Investment Amount	Interest amount	Investment amount	Interest amount
1	$50,000	$4,000	$50,000	$4,000
2	$50,000	$4,000	$54,000	$4,320
3	$50,000	$4,000	$58,320	$4,666
4	$50,000	$4,000	$62,986	$5,039
5	$50,000	$4,000	$68,024	$5,442
6	$50,000	$4,000	$73,466	$5,877
7	$50,000	$4,000	$79,344	$6,347
8	$50,000	$4,000	$85,691	$6,855
9	$50,000	$4,000	$92,547	$7,404
10	$50,000	$4,000	$99,950	$7,996
		$40,000		**$57,946**

After 10 years, with interest paid out, you would have received $40,000 in total interest payments. Meanwhile if you chose to re-invest the interest instead, you would have $57,946 in interest – that's nearly $18,000 or 45% more at the end of 10 years.

And just as with most investments, time invested makes all the difference. Starting early can leave you with a larger balance at retirement than investing more money later in life.

In the following example, sisters Jane and Jenny invest $1,000 each year at 10% interest. Jane starts on her 18th birthday – but invests nothing after her 25th birthday, for a total $8,000 investment. Jenny, on the other hand, starts on her 25th birthday, investing every year until she retires at 65 – a $40,000 investment. Despite this, at 65 Jane will have nearly $31,000 more in her portfolio.

Investment examples Jenny and Jane

Jenny's Investments

Jenny invests:

$1,000 every year at 10% from her 25th to her 65th birthday.

At 65, her investment is worth nearly $487,000 or more than 12 times her initial investment.

Jane's Investments

Jane invests:

$1,000 every year at 10% from her 18th to 25th birthday only.

At 65, her investment is worth nearly $518,000 or more than 64 times her initial investment.

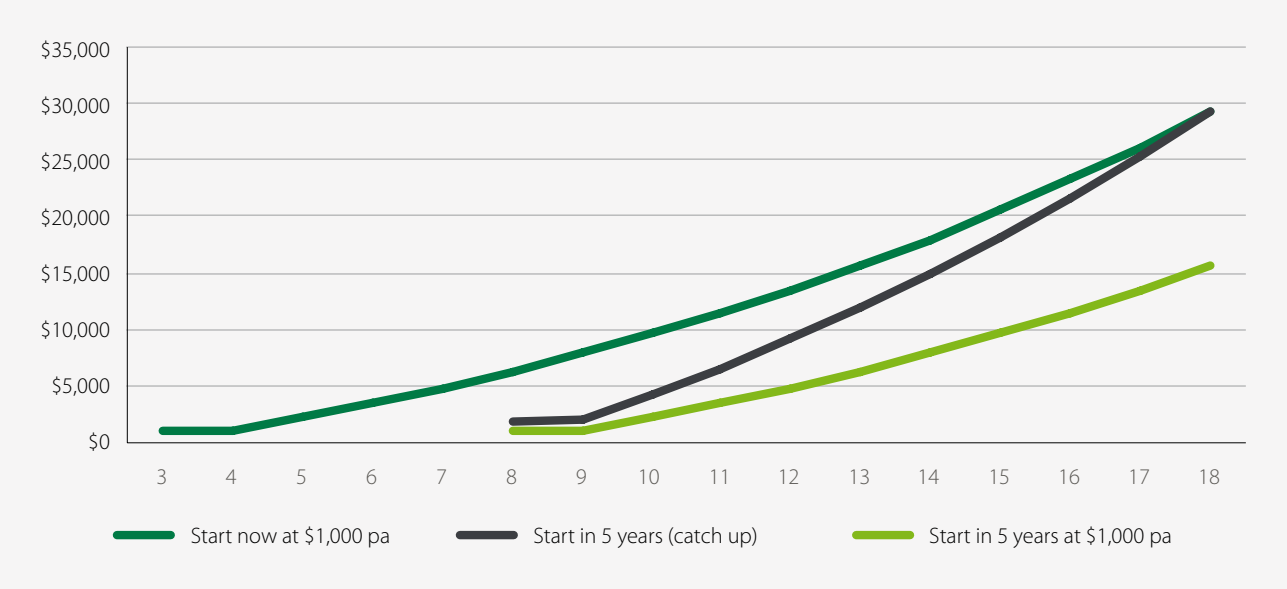
It's about making your money work harder for you than just saving alone can.

Case study

It's never too early to start

Peter and Karen have a son, Mark, aged 3. After reviewing their budget they realise they can afford **$1,000** each year to put towards Mark's university education. As Mark will likely start university when he is 18, their investment time horizon is **15 years**.

The following chart indicates the difference between starting to invest now, or waiting 5 years until Mark is 8 before starting to invest.



Assume a return of 8% pa and dividends reinvested.

By waiting 5 years Peter and Karen will need to invest $1,874 every year to reach the same final balance of $29,324.

Dollar cost averaging

Dollar cost averaging (DCA) is the strategy of investing regular, incremental amounts into your portfolio – such as setting up automatic deposits from your regular pay. As the same amount of money buys you more of something when the price is low, regular deposits over time (for investments such as shares which rise and fall in value over time) could lower the average cost of your investment.

This method of investing also lessens the down-side risk of investing a large lump sum right before a market fall.

DCA is most effective in falling markets, however predicting when a market will rise or fall is never simple. This strategy lets you take the emotion out of investing and frees you up from watching the market every day.

A steady, regular contribution plan to your investment portfolio should lower the overall cost of your investment and ultimately increase your returns.

Case study

John chooses to invest a regular amount of $1,000 each month. As the unit price rises and falls over the course of the year, by investing each month, John is investing at different unit prices and achieves a lower unit cost than if he had invested from April to September.

To find the average cost per unit John achieved over the last twelve months we look at the total amount invested divided by the amount of units John bought:

$12,000 / 417 = $28.78

Over the whole period of twelve months, the average cost per unit was $28.78, so not the lowest or the highest price that the units were purchased at during that time.

Additionally, if John had invested $6,000 in each of June and July, he would have only been able to buy 338 units, against 417 by investing steadily over the whole year.

	Amount invested	Unit price	Number of units
January	$1,000	$22	45.45
February	$1,000	$24	41.67
March	$1,000	$27	37.04
April	$1,000	$32	31.25
May	$1,000	$31	32.26
June	$1,000	$36	27.78
July	$1,000	$35	28.57
August	$1,000	$34	29.41
September	$1,000	$32	31.25
October	$1,000	$27	37.04
November	$1,000	$26	38.46
December	$1,000	$27	37.04
Total amount invested	**$12,000**		**Total units: 417**

Borrowing to invest

Borrowing to invest, or gearing, is an investment strategy usually considered by more experienced investors and those with a higher risk appetite. This is because, while gearing can increase the value of your portfolio faster than otherwise possible, it will also magnify your losses in a market downturn.

The principle behind a successful gearing strategy is that the value of your investments will increase faster than the after-tax cost of servicing the debt. However in volatile markets a loss on the investment may mean you are unable to service the debt and can be forced to sell the investment at a loss.

The following tables show the benefits and risks of gearing an investment in Australian shares:

If the share price doubles

		5-year term
Chris' own capital	**$100,000**	**$100,000**
Loan	$0	$75,000
Total initial investment	**$100,000**	**$175,000**
Total income received[1]	$10,000	$17,500
Less interest costs[2]	$0	-$26,250
Increase in portfolio value	$100,000	$175,000
Total return	**$110,000**	**$166,250**
Less loan amount	$0	-$75,000
Net value of shares	**$200,000**	**$275,000**

If the share price halves

		5-year term
Chris' own capital	**$100,000**	**$100,000**
Loan	$0	$75,000
Total initial investment	**$100,000**	**$175,000**
Total income received[1]	$10,000	$17,500
Less interest costs[2]	$0	-$26,250
Decrease in portfolio value	-$50,000	-$87,500
Total return	**-$40,000**	**-$96,250**
Less loan amount	$0	-$75,000
Net value of shares	**$50,000**	**$12,500**

1. 2% pa yield from investment
2. 7% pa interest rate on loan

Note: The examples above assume interest costs of 7% p.a. and income from the shares of 2%. For simplicity income is not reinvested in the above. The example does not consider tax or franking credits.

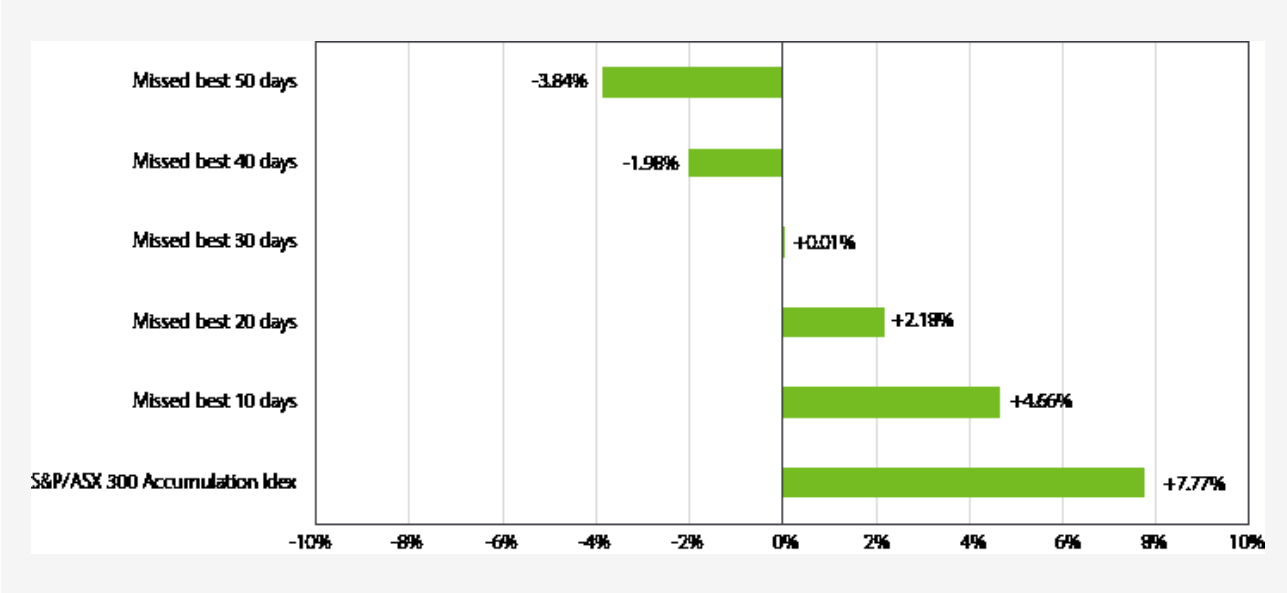
Time in – not timing

'Timing the market' by consistently selling high and buying low is very difficult. Unfortunately, markets are unpredictable and taking this strategy leaves investors prone to missing out on relief rallies – not to mention the tax implications on profit-taking.

As you can see from the graph on the next page, missing out on just 10 of the best trading days in Australia over the last 10 years virtually erased any gain you made.

That's why it's important to remember 'time in the market is more important than market timing'.

Australian Share Market annualised total returns (Dec-09 to Dec-19)



Sources: FactSet, IOOF calculations

Past performance is not a reliable indicator of future performance.

Tax-effective investing

When you receive money from most investments, or crystallise a capital gain by selling an asset, you are generally required to pay tax on that income or gain. It's important to consider the impact of tax on your investment and how tax-effective investments can improve your returns.

A tax-effective investment is one which offers a taxation benefit to you and could include investment bonds, negative gearing, superannuation and pensions, and Australian shares.

Investment bonds (see page 24)

Simply put, an investment bond is a tax paid investment. This means that the tax on investment earnings is paid by the investment bond issuer at the current company tax rate of 30%.

While funds are invested, there is no need for the investor to include any earnings in their tax return.

After ten years from the start date of the investment, or when the life insured passes away, (regardless of the time invested), the growth and earnings are free of any personal tax liability to the investor upon withdrawal.

Negative gearing

If you borrow to make an investment and the expenses of owning that asset (including depreciation and interest on the loan – but not capital repayments) are greater than the income the asset produces, you may be able to claim a tax deduction for interest costs against other assessable income.

While many investors are familiar with negative gearing on property, it is also available on shares purchased where costs such as interest and bank fees associated with the loan may be tax deductible.

Superannuation and pensions (see page 20)

To encourage people to contribute to their super and build their retirement nest-egg, the Government has provided a series of generous tax concessions making super one of the most tax-effective investment strategies available. Some of these concessions include:

- Super contributions – either salary sacrificed through your salary or from the employer superannuation guarantee (up to certain limits) contributions are taxed at just 15%[1] not your marginal tax rate.
- Money you earn on your investments is taxed at just 15%, or effectively 10% for capital gains on assets held more than 12 months
- If you are over 60, for most people, money taken out of super is tax-free.
- In a retirement phase pension, investment earnings are tax-free (on assets up to your individual transfer balance cap).

Australian shares

Australian shares potentially offer the lowest effective tax rate of all the investment asset classes. This is due to franking credits associated with share dividends.

Investment spotlight

Dividends and franking

As owning shares represents ownership of part of a company, it also entitles you to a share in profits. Companies can reinvest some or all of the profits back into growing the company (known as retained earnings) or alternatively distribute profits through payments to shareholders. These payments to shareholders are known as dividends. Dividends can be taken as cash or, in some circumstances, automatically reinvested to buy more shares in the company.

In Australia, if you receive a dividend from a company, this is considered a form of income and you may be required to pay tax. However because the company also pays tax, this is a form of double taxation.

For this reason when you receive a dividend, they often come with franking credits. Also known as dividend imputation this means you only pay the difference between the company tax rate (usually 30%) and your marginal tax rate.

1 An additional 15% tax applies for high income earners, where the total of their taxable income plus super contributions exceeds $250,000.

Returns on investments

Generally speaking, returns on your investments come in the form of either **income** or **capital** growth.

Income assets

Income assets provide a cash flow to meet living expenses or save. In some instances, such as with some shares, they can be reinvested to grow your portfolio. However, the income will likely be taxed, while the returns may be subject to inflation and interest rate risk. The return from assets in the form of income, whether reinvested or not, is known as the yield. Income includes:

- rental income on properties
- dividends on shares
- interest on cash deposits and fixed interest.

Growth assets

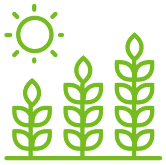
Growth assets are those that can be expected to increase in value – such as property or shares. As growth assets are intended to generate a rise in the underlying value of the asset, they are popular for general wealth accumulation. However they can be more volatile than income assets and face the risk of significant capital losses. While they don't have tax payable while the asset is in your possession, capital gains tax may be payable on disposal of the asset.

Returns on your investments come in the form of either income or capital growth.

In reality, many investments have both capital growth and income attributes, and your total investment returns are often a combination of both:

Capital growth

+



Yield (dividends, rent, interest etc)

=

Total return on investment

Asset classes

Types of asset classes

An asset class is simply a type of investment and they are the building blocks of your portfolio. There are four main asset classes:

Property	Shares (equities)
Cash	Fixed interest

Each asset class has individual characteristics and carries a different level of risk and return to suit a range of investor types. A diversified portfolio – an important risk mitigation strategy – contains investments across these different asset classes. Asset classes fall into two main groups: **defensive** and **growth**.

Defensive characteristics	Growth characteristics
Focused on preserving capital	Can produce income, however focus is on capital growth
Generate income for investors	Usually longer-term than defensive assets
Considered less volatile and safer than growth assets	Higher risk than defensive assets
Cash and fixed interest are usually considered defensive	Property and shares are usually considered growth

Cash

Investments in cash include bank deposits, term deposits, savings accounts and cash management trusts. While cash is considered the safest investment type, the returns are usually low and investors run the risk over the long term of returns being less than the rate of inflation.

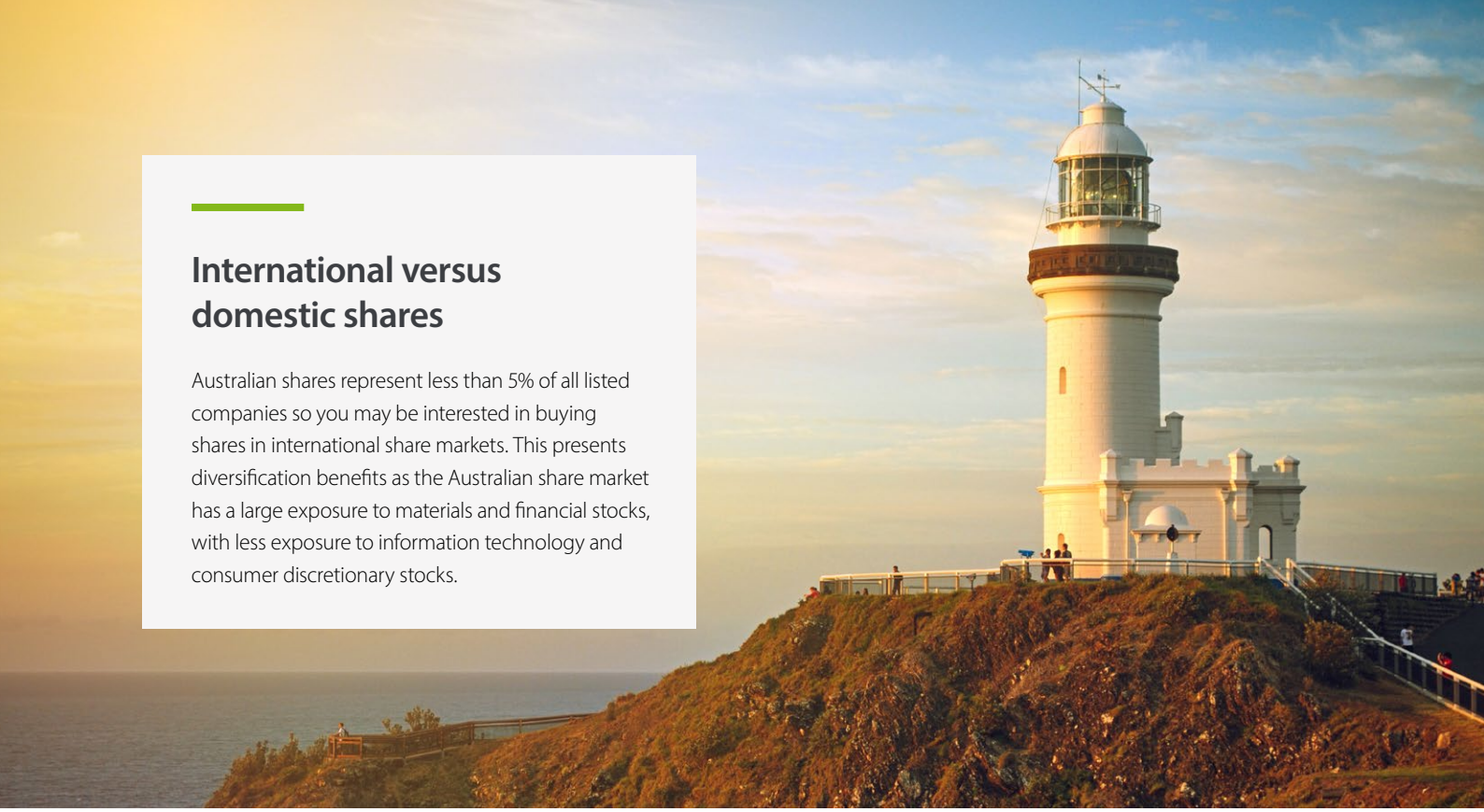
Fixed interest

Fixed interest assets, also known as bonds or debentures, are agreements where the investor is paid fixed amounts of money at pre-determined dates in the future – usually twice a year, plus the original amount repaid at the end of the term. Bonds can include the debt issued by government, banks or corporations both internationally and within Australia. Like cash, they are considered a safe investment with moderate returns over the longer term.

Property

Generally, there are three ways to invest in property:

Direct property	Listed property trusts	Unlisted property funds
Direct property involves the investor buying the property directly. For retail investors these are usually residential properties. Income can be in the form of rental returns or capital growth. There are also tax considerations, such as negative gearing, which can reduce the cost of ownership for investment properties.	A listed property trust (LPT), commonly known as real estate investment trusts (REITs), involves pooling your money with other investors, which is then used to buy and manage property, such as industrial properties, shopping centres, office buildings or hotels. As an investor you own units – similar to shares – of the trust, which can be bought or sold on the ASX. As units in LPTs are easier to buy and sell than unlisted property funds, they are usually more volatile.	Unlisted property funds are similar to REITs, however your investment is not traded publicly on the stock exchange. As a result the investment is usually more illiquid, but less volatile than listed property trusts.



International versus domestic shares

Australian shares represent less than 5% of all listed companies so you may be interested in buying shares in international share markets. This presents diversification benefits as the Australian share market has a large exposure to materials and financial stocks, with less exposure to information technology and consumer discretionary stocks.

Australian shares are bought and sold on the Australian Securities Exchange (ASX). Within the ASX there are different sectors:*

Sector	Examples of companies within the sector
Materials	BHP Group Limited, Rio Tinto, Amcor, Boral, CSR
Financials	IOOF, Commonwealth Bank, QBE Insurance Group, Medibank Private Limited
Information technology	Afterpay Limited, Computershare, NEXTDC
Health care	CSL, Cochlear, Fisher & Paykel Healthcare, ResMed Inc
Energy	Woodside Petroleum, Whitehaven Coal, Oil Search, Origin Energy
Industrials	Transurban Group, Sydney Airport, Reece Limited, Qube Holdings
Consumer discretionary	Wesfarmers, JB Hi-Fi, Tabcorp Holdings, Harvey Norman
Real Estate	Goodman Group, Mirvac Group, LendLease Group, Stockland
Communication services	Telstra, Carsales.com, Seek, REA Group
Consumer staples	Woolworths Group, Coles Group Limited, Coca-Cola Amatil, Blackmores Limited
Utilities	AGL Energy, APA Group, Spark Infrastructure

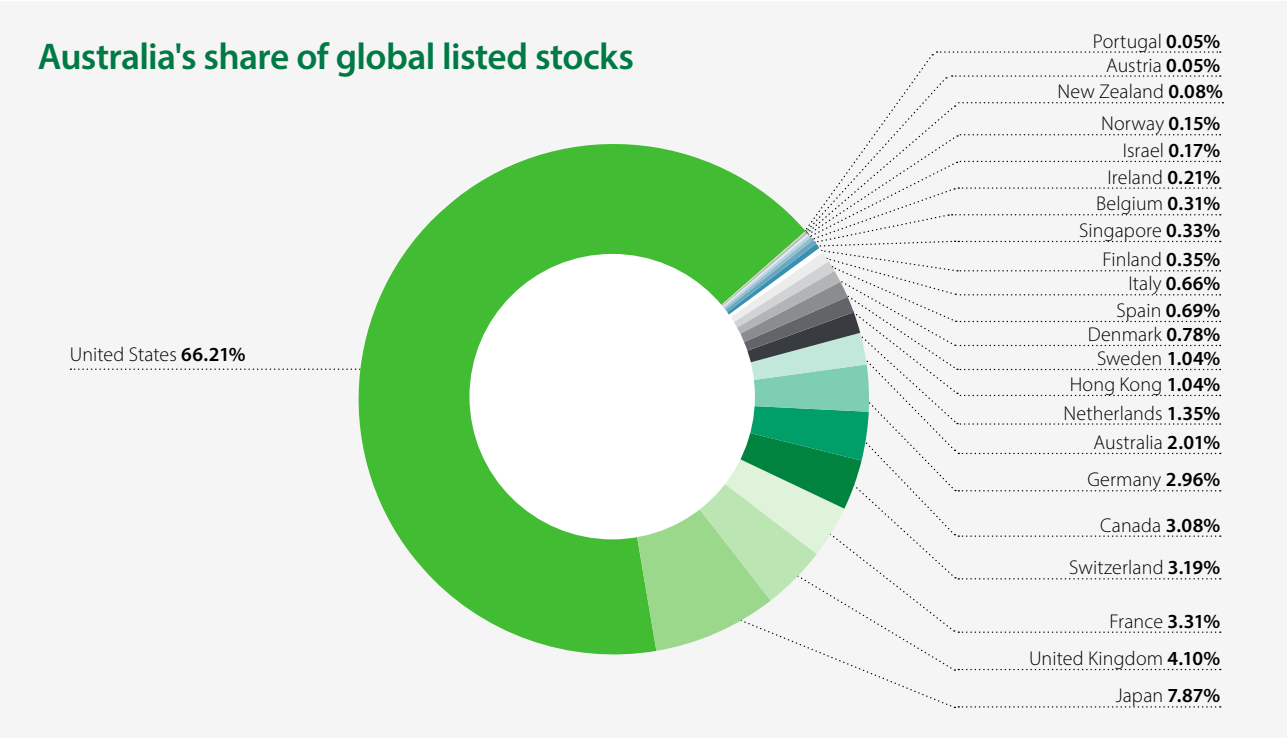
* The companies listed in the table above are examples only and should not be considered advice.

Ways to own shares

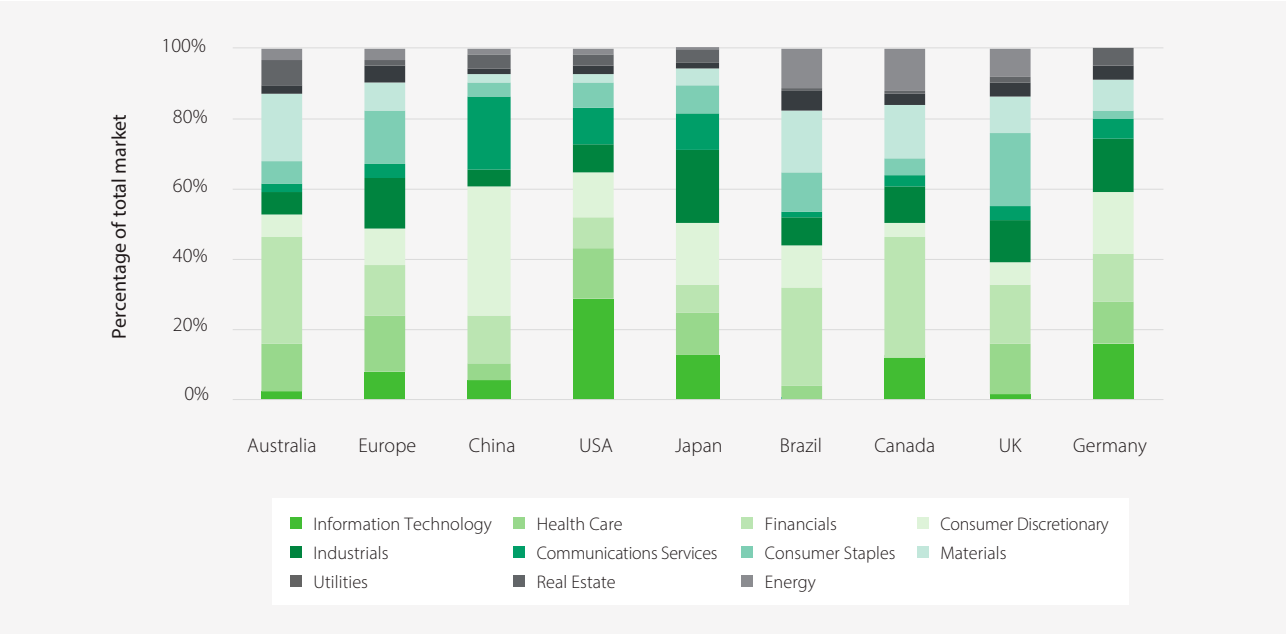
There are a number of ways to own shares, four of which are mentioned below:

Direct ownership	You have total control to choose the company and the quantity of shares purchased. They are usually purchased through a stockbroker.
Managed funds	An investment manager pools the money of all the investors, then researches and buys and sells shares on your behalf. In this case you own 'units' of the managed fund rather than the shares in the companies themselves. Managed funds allow for greater diversification across different types of shares, or even different asset classes, however usually have a fee structure associated with the service.
Listed Investment Companies (LICs)	An investment that is incorporated as a company and listed on a stock exchange. LICs operate similar to a managed fund as there is a fund manager who chooses and manages investment choices. Shares in LICs are first issued through an initial public offering (IPO) and can be bought and sold on the market.
Exchange Traded Funds	A listed investment that follows a stock market index such as the Dow Jones, S&P or ASX. ETFs are predominantly passive as well as open ended as shares are issued when there is demand from investors.

As purchasing international shares directly can be difficult, many investors hold international shares through managed funds. It's also important to remember international shares represent a range of new risks to consider, including currency risk (losing money moving into and out of Australian dollars) or political risk (the government of that country could pass laws affecting your investment).



Source: MSCI# as at October 2020



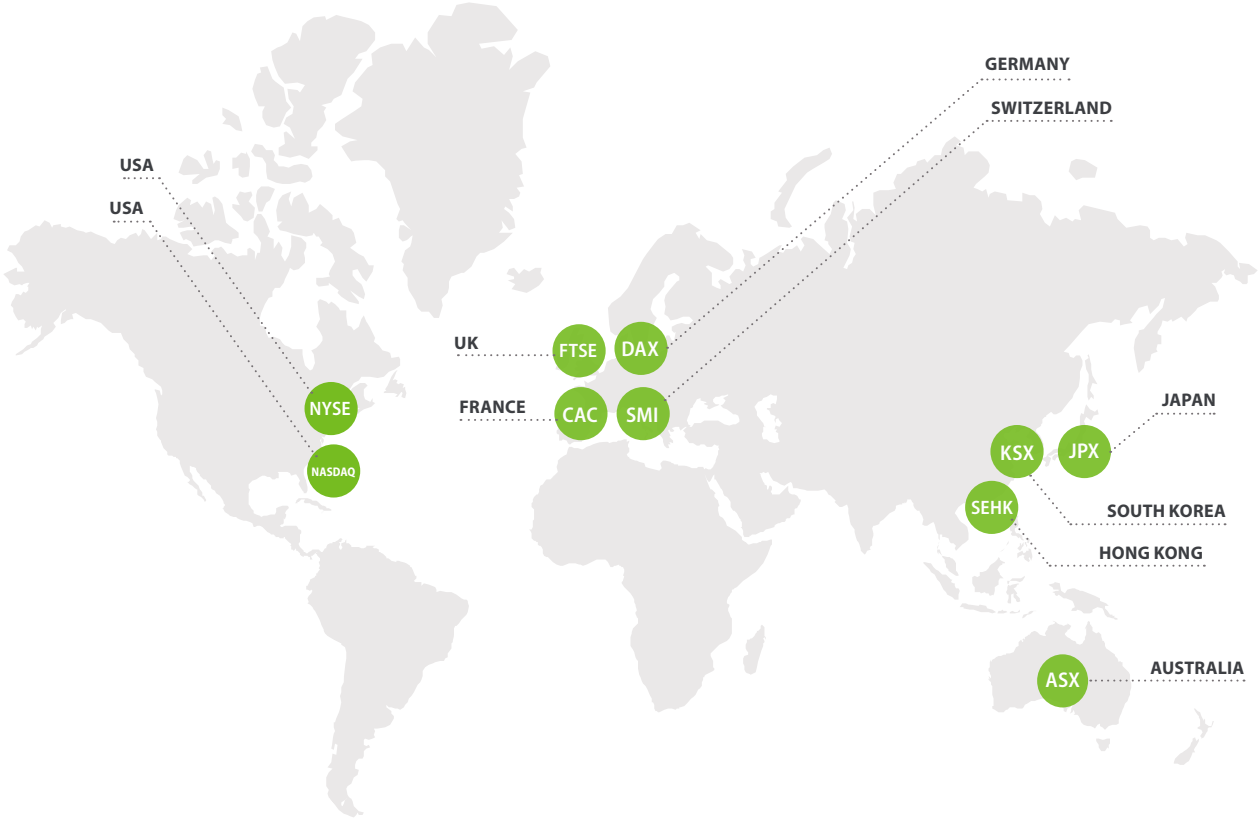
Investing globally also allows you to diversify your exposure to market sectors. The table on the next page shows that the Australian market is dominated by financial and materials (including mining) companies. However, the US has a higher proportion of healthcare and IT companies represented in their market.

Source: MSCI# as at 30 September 2020

#MSCI indices source: MSCI. Neither MSCI nor any other party involved in or related to compiling, computing or creating the MSCI data makes any express or implied warranties or representations with respect to such data (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of such data. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in or related to compiling, computing or creating the data have any liability for any direct, indirect, special, punitive, consequential, or any other damages (including lost profits) even if notified of the possibility of such damages. No further distribution or dissemination of the MSCI data is permitted without MSCI's express written consent.

International share markets

The map below highlights various international share markets and their locations.



Many well-known brands are actually listed on overseas share markets, so they are really not that foreign to you after all. Here are some examples:

USA

Microsoft Corp
Microsoft Office, Windows, Xbox

Alphabet Inc.
Google, YouTube, DoubleClick

Estée Lauder Companies
Clinique, MAC, Aveda

The Coca-Cola Company
Fanta, Mount Franklin, Vitamin Water

Europe

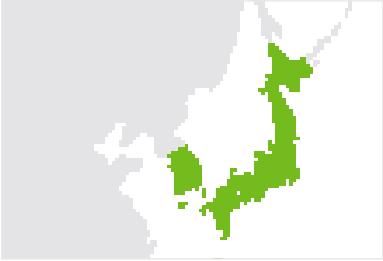
LVMH (France)
Bvlgari, Louis Vuitton

Unilever (United Kingdom)
Magnum

Adidas (Germany)
Adidas, Reebok

PRADA SPA (Italy)
Prada, MiuMiu

Nestle SA (Switzerland)
Nescafe, Milo, Peters



Asia Pacific

Hitachi (Japan)
Televisions, Air conditioners

Samsung electronics (South Korea)
Galaxy phones, Televisions

Asset class returns

Different asset classes have, over time, produced different returns on investment and many investors consider changing asset classes to chase the next return. But as you can see from the table below, it's very difficult to predict which asset class will perform strongest in the following year. **This year's winner may not necessarily be next year's.**

	Australian Shares (% pa)	International Shares (% pa)	International Shares - Hedged (% pa)	Australian Listed Property (% pa)	Australian Fixed Interest (% pa)	Cash (% pa)
2005	**22.5**	16.8	18.7	12.7	5.8	**5.7**
2006	24.5	11.5	17.5	**34.1**	**3.1**	6.0
2007	**16.2**	-2.6	6.0	**-8.4**	3.5	6.7
2008	-38.9	-24.9	-39.1	**-55.3**	**14.9**	7.6
2009	**37.6**	**-0.3**	26.7	9.6	1.7	3.5
2010	1.9	**-2.0**	**13.1**	-0.7	6.0	4.7
2011	**-11.0**	-5.3	-1.9	-1.6	**11.4**	5.0
2012	19.7	14.1	18.7	**32.8**	7.7	**4.0**
2013	19.7	**48.0**	32.3	7.3	**2.0**	2.9
2014	5.3	15.0	12.6	**26.8**	9.8	**2.7**
2015	2.8	11.8	3.8	**14.4**	2.6	**2.3**
2016	11.8	7.9	10.3	**13.2**	2.9	**2.1**
2017	11.9	13.4	**20.0**	6.4	3.7	**1.7**
2018	-3.1	1.5	**-7.6**	3.3	**4.5**	1.9
2019	23.8	**28.0**	26.8	19.6	7.3	**1.5**
Annualised Return (% p.a.)	**7.9**	**7.7**	**8.9**	**4.9**	**5.7**	**3.9**

Highest year - Highest yearly return Lowest year - Lowest yearly return

Source: Bloomberg. Please note that past performance is not a reliable indicator of future performance. All returns shown are in Australian dollar terms and include dividends, assuming that these are reinvested. Performance of International shares both hedged and unhedged is shown in AUD terms.

Indices used: Cash – Bloomberg AusBond Bank Bill Index; Australian Fixed Interest – Bloomberg AusBond Composite 0+ Yr Index; Aust. Listed property – S&P/ASX 300 A-REIT TR Index; Aust. shares – S&P/ASX 300 Accumulation Index; Int. shares – MSCI World ex Aust Net TR Index (AUD); Int. shares (hedged) – MSCI World ex Aust Net TR Index (hedged to AUD).

Asset allocation

Asset allocation in its simplest form is deciding how you will allocate your investments across different asset classes, such as cash, fixed income, shares or property.

Asset allocation is a way to diversify your portfolio recognising that different asset classes perform differently in different circumstances. As some asset classes carry more risk than others, asset allocation is also a way to reflect your risk level in your overall portfolio construction.

Types of asset allocation

There are several different ways for asset allocation to be applied to a portfolio:

Strategic asset allocation	Tactical asset allocation	Dynamic asset allocation
Strategic asset allocation involves deciding what proportion of your total portfolio you would like in each asset class. For example, you may decide to have 20% in cash, 40% in property and 40% in shares. For strategic asset allocations this involves periodically rebalancing your portfolio (that is, buying and selling assets to ensure your overall asset allocation matches, as much as possible, your original investment allocations) as different investment gains on different assets change this balance.	Moving assets tactically means moving assets to take advantage of better performing asset classes.	Dynamic asset allocation involves highly active management of the portfolio that involves rebalancing a portfolio to bring the asset mix in line with a long-term target. This involves selling down outperforming asset classes and adding to any underperforming asset classes.

Managed Funds

Unlike direct investing, in a managed fund your money is 'pooled' with other investors to buy assets. Each investor in the managed fund owns 'units' of the managed fund, the value of which rise and fall with the value of the underlying assets in the fund.

Each managed fund will have a profile which outlines the objective of the fund and the asset allocation, allowing you to decide whether the fund matches your investment goals and risk tolerance. An investment manager will make the decisions of what to buy and sell based on the fund's profile.

Types of managed funds

Single sector funds

A single sector fund invests in just one asset class, such as cash, shares or bonds. Single sector funds may also specialise within the fund, for example small cap companies or resource companies.

Multi-asset funds

Multi-asset funds invest across more than one asset class. Diversifying across different asset classes reduces the risk of investing solely in an equity fund, however may have more risk – and return – than a bond fund.

Multi-manager funds

A multi-manager fund is a fund comprised of more than one specialised fund. Each fund has a separate fund manager, with different investing styles. Multi-manager funds work on the premise that investment managers operate differently in different environments and by diversifying across fund managers, risk is reduced.

Active versus passive funds

A passive fund (also known as an index fund) is a fund which is built to mimic an index, such as the S&P/ASX 100 or the US S&P 500. The fund manager makes no decisions on individual stocks – either good or bad – instead accepting the average performance of all stocks in the index. Periodically the fund manager will buy or sell shares to reflect the weighted changes in the index the fund is designed to copy.

Actively managed funds, on the other hand, involve the fund manager actively making decisions to try and invest in the best performing assets classes and investments. The intention of the active fund manager, by being able to make individual investing decisions, is to outperform the broader market.

As the fund manager doesn't make as many decisions in passively managed funds, usually the fees are lower than in actively managed funds.

Other types of funds

Exchange traded funds

An exchange traded fund (ETF) is similar to an index fund. While they can track a basket of assets like an index fund, they can also track commodities, such as oil or gold, or even bonds. Unlike managed funds their share price actively changes through the day (managed fund prices are calculated at the end of each day). Furthermore, ETFs usually have higher liquidity (easier to buy and sell) and lower fees than managed funds.

Hedge funds

Hedge funds are similar to managed funds in that they pool investors' funds to invest. However they usually have little or no restrictions on how and where they invest. They also use a wide range of financial instruments, including derivatives and futures. Many hedge funds are 'absolute return' funds which means they aim to make money in falling or rising markets.

Advantages of managed funds:

1. Managed funds allow an investor with a relatively small amount of money to invest in assets that may otherwise be out of reach, for example international shares or commercial property.
2. Trying to invest directly may not leave enough money to adequately diversify your portfolio.
3. Managed funds are, as the name suggests, managed by professional investors with the skills, experience and research resources not generally available to individual investors.
4. It can be relatively easier to change your investment profile – say from income to growth assets – than to change a portfolio of individual assets.
5. Some managed funds can take a regular payment plan from your salary, however this is not generally the case with individual investments in shares.

Master trusts and wraps

Master trusts

A master trust is an administrative service that lets you hold a portfolio of investments, usually managed funds, under one umbrella. As your investments are held in one place, master trusts present a simpler way for you and your financial adviser to manage your portfolio.

Features of master trusts include:

- A trustee operates the master trust and holds the clients' investments on their behalf.
- The clients' investment is determined by a 'unit price' calculated by the master trust and based on the value of the underlying investments.
- Income is paid to the trustee and distributed to the investors.
- The 'unit price' usually has fees, taxes and franking credits bundled into it.
- Your investments are specific to each master trust, which means to move your investments to another master trust you will need to sell, possibly incurring a tax on any profits.

Wraps

Similar to master trusts, a wrap is a product which allows you to hold your investments in one centralised place. Wraps usually hold a more diverse range of investments including managed funds, direct shares and term deposits. As wraps hold more than just managed funds, they usually have more powerful reporting and tax management functionality.

Features of wraps include:

- Like master trusts, a trustee or service operator operates the wrap. For individuals the investments are held in the clients/individuals own names giving them beneficial ownership in the underlying assets. For super and pension wrap accounts the super fund owns the asset and there is no beneficial ownership for the member.
- One central cash account into which interest and dividends are paid and from which fees are taken.
- When investments are sold the proceeds are paid into the cash account, and equally when investments are bought the money is taken from the cash account.
- Investments don't need to be sold to move to different wrap products.

Fees

Previously this guide talked about taxes associated with your investment earnings – such as capital gains tax – as well as some things to consider regarding tax-effective investing. As well as taxes levied by the Government, there may be other charges which may affect your investments. To help understand the true cost of investing, here are some key terms associated with the fees on managed funds:

- **Entry/establishment fee** – this is the cost of setting up an account.
- **Performance fee** – if your investment performs well, or at least beats a benchmark, the fund manager might take a proportion of the outperformance.
- **Redemption fee** – this is a charge when you exit a fund.
- **Switching fees** – this is the fee charged to move from one investment to another.
- **Indirect cost ratio** – the fees above however don't necessarily include all the costs involved in running a fund – such as legal and regulatory compliance and auditing. These indirect costs are attributed to all members on a proportional basis and are known as the indirect cost ratio or ICR.
- **Administration fee** – this represents the fees and costs charged for operating and managing your account.
- **Buy-sell spread** – this may be incurred when managed investments are bought or sold and reflect the brokerage and other transaction costs incurred by the relevant investment manager.

Of course, with different investments and with different fund managers, any number of these fees may be reduced or waived.

Your financial adviser will be able to advise on all the costs associated with an investment.

Superannuation

For most Australians, superannuation (super) will be the second largest asset you own, behind the family home. It will also be the foundation of your retirement nest-egg. That's why it's important to understand how your super works and make the right financial decisions to reach your retirement goals.

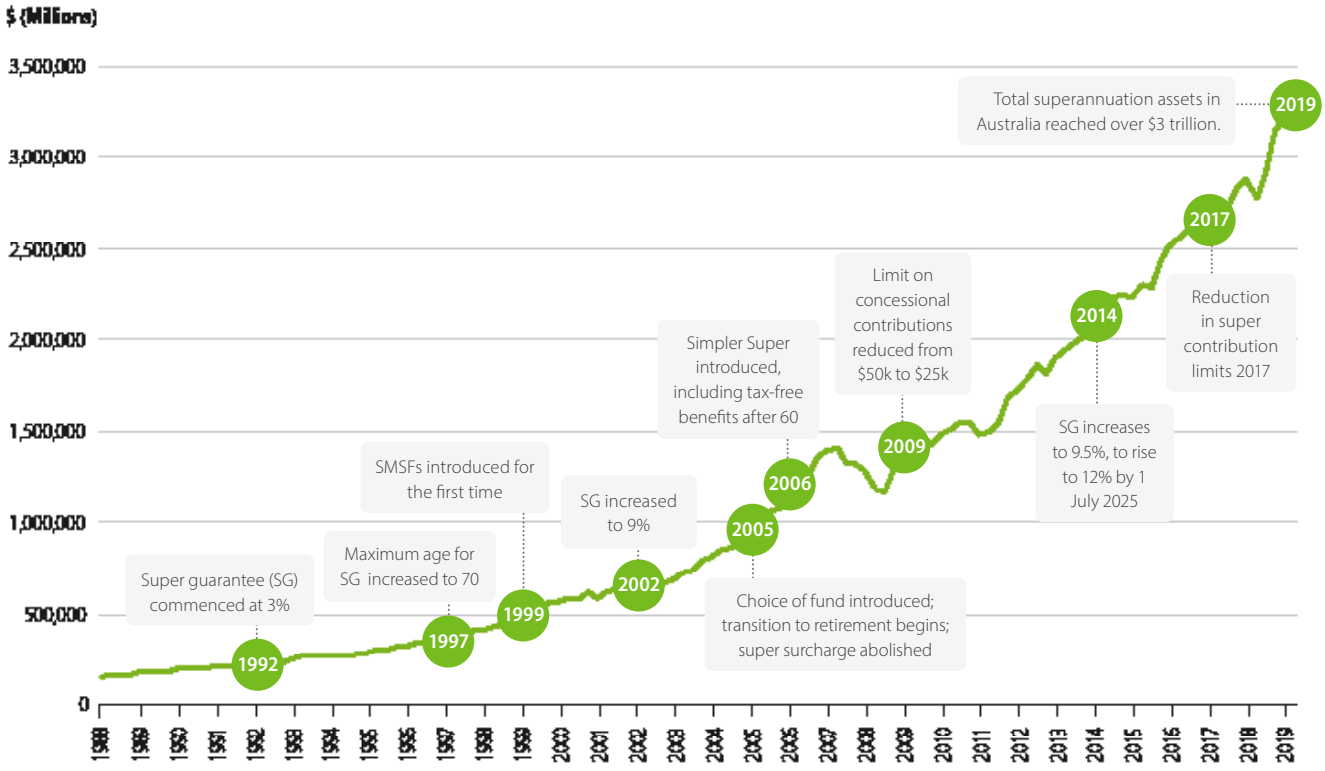
Super itself is not an investment, it is a vehicle that can provide tax benefits in exchange for restricting your access to funds. Saving in super isn't just about what you put in – with the right investments it can grow.

You can choose from different types of investments inside super which can have a big impact on your balance in the years ahead. Some people may opt to invest in the default options provided by their super plan while others may choose to invest in a variety of different investments including Australian and international shares, term deposits and cash.

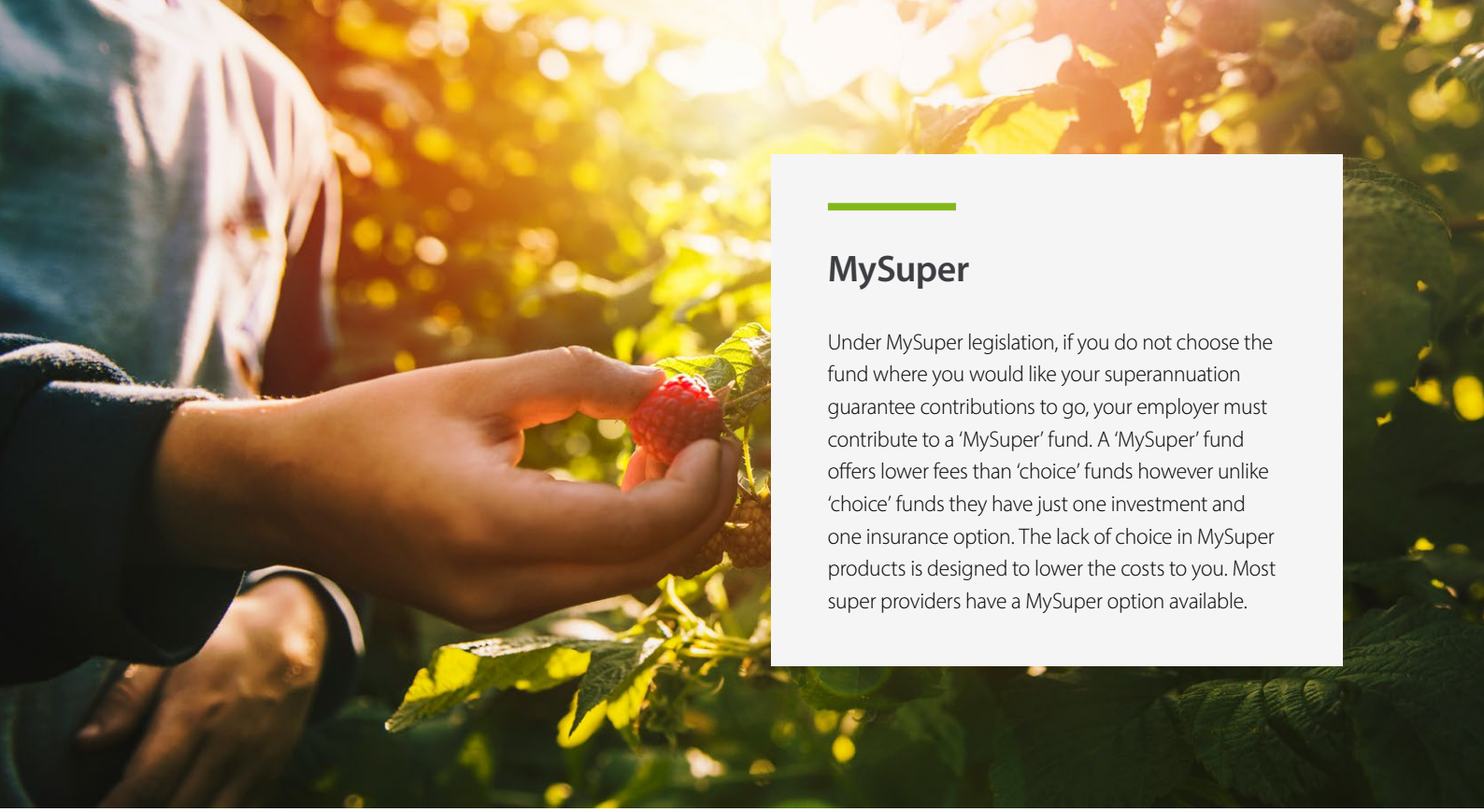
This suits people who are more comfortable investing in ready-made portfolios where investment managers do the work as well as those who want to select options that match personal investment risk tolerances and goals.

Super isn't just an investment for retirement either. Your super can be used to protect the financial wellbeing of you and your family now. You can pay for different types of insurance cover through your super which means your future can be protected with the added benefit of not having to make extra out-of-pocket payments.

Australia's big investment pool



Source: Australian National Accounts: Finance and Wealth, ABS Cat. No. 5232.0



MySuper

Under MySuper legislation, if you do not choose the fund where you would like your superannuation guarantee contributions to go, your employer must contribute to a 'MySuper' fund. A 'MySuper' fund offers lower fees than 'choice' funds however unlike 'choice' funds they have just one investment and one insurance option. The lack of choice in MySuper products is designed to lower the costs to you. Most super providers have a MySuper option available.

Types of super funds

There are four main types of super funds:

1. Corporate funds

A workplace super fund can be set up and run by a company 'in-house' solely for employees (and sometimes their spouses).

These are often referred to as corporate super funds, and are usually the preserve of Australia's largest companies, such as Telstra and BHP.

2. Retail funds

Retail funds are a type of fund set up and run by large financial services organisations. Retail super funds are available for anyone to join and often have a wide range of investment options available.

3. Industry funds

Industry funds are often set up by a particular industry or unions to provide super for people in those industries, however they are usually open to employees of any industry.

4. Government super funds

Also known as public sector funds, these are super funds set up by governments – Federal, State or local – and are similar to corporate 'in-house' super funds.

Other types of super funds

Self-managed super funds (SMSFs)

An SMSF is a super fund you run for your own benefit. Generally speaking, you can choose where your money is invested, however there are strict rules and compliance regulations, including:

- regular audits (including the costs of doing so)
- acting as a trustee or director
- only using the money invested for your retirement benefit.

Types of contributions

Superannuation guarantee

If you are over 18 and earning more than $450 per month your employer must generally contribute at least 9.5% of your salary into your super fund. This is known as the superannuation guarantee or SG. If you don't nominate a fund, your employer must make contributions to a MySuper default fund. The employer is obliged to pay you super whether you are working full-time, part-time or on a casual basis. The SG rate is set to increase to 10% in 2021, rising to 12% by 1 July 2025.

Government super co-contribution

Subject to certain conditions, if you are earning less than $54,837 in the 2020/21 financial year, the Government super co-contribution is one way to boost super balances. For after tax contributions of $1,000 or more you make into super, the Government will make a co-contribution of up to $500. The $500 maximum applies for those earning less than $39,837 in the 2020/21 financial year and reduces by 3.333 cents for every dollar of income over $39,837, before phasing out completely once you earn $54,837.

Don't lose your Super

If you've had more than one job there's every chance you have more than one super account, and if you do, you could be paying on average more than $500[2] every year in fees and insurance premiums you don't need to.

If you know where all your super is held, many super funds have easy consolidation tools that let your roll your balances into one account. However if you think you may have lost track of some super, the Australian Taxation Office (ATO) has made it easy to find lost and unclaimed money and to consolidate super. All you have to do is register with MyGov at my.gov.au and request a report of your super held by the ATO and other funds.

Please ask your financial adviser for more information.

Salary sacrificing

One way to top up a super balance is to use salary sacrificing to take advantage of the concessional tax rate of 15%[3] on pre-tax contributions (which can be lower than your marginal tax rate). Salary sacrificing, particularly for those who have spare cash flow can be particularly effective. This is shown in the table below which assumes an individual earning $50,000 has the choice to salary sacrifice $1,000 or receive the same amount as income:

	Taken as salary	Salary sacrificed into super
Gross contribution	$1,000	$1,000
Marginal tax rate*	34.5%	15%
Tax payable	$345	$150
Net benefit	$655	$850

* Includes Medicare levy

If you are on a marginal tax rate of 34.5% (including Medicare levy), you may be $195 better off for every $1,000 you choose to salary sacrifice. Depending on your salary, this benefit can be even greater, however it's important to remember that salary sacrificing doesn't make sense in every situation.

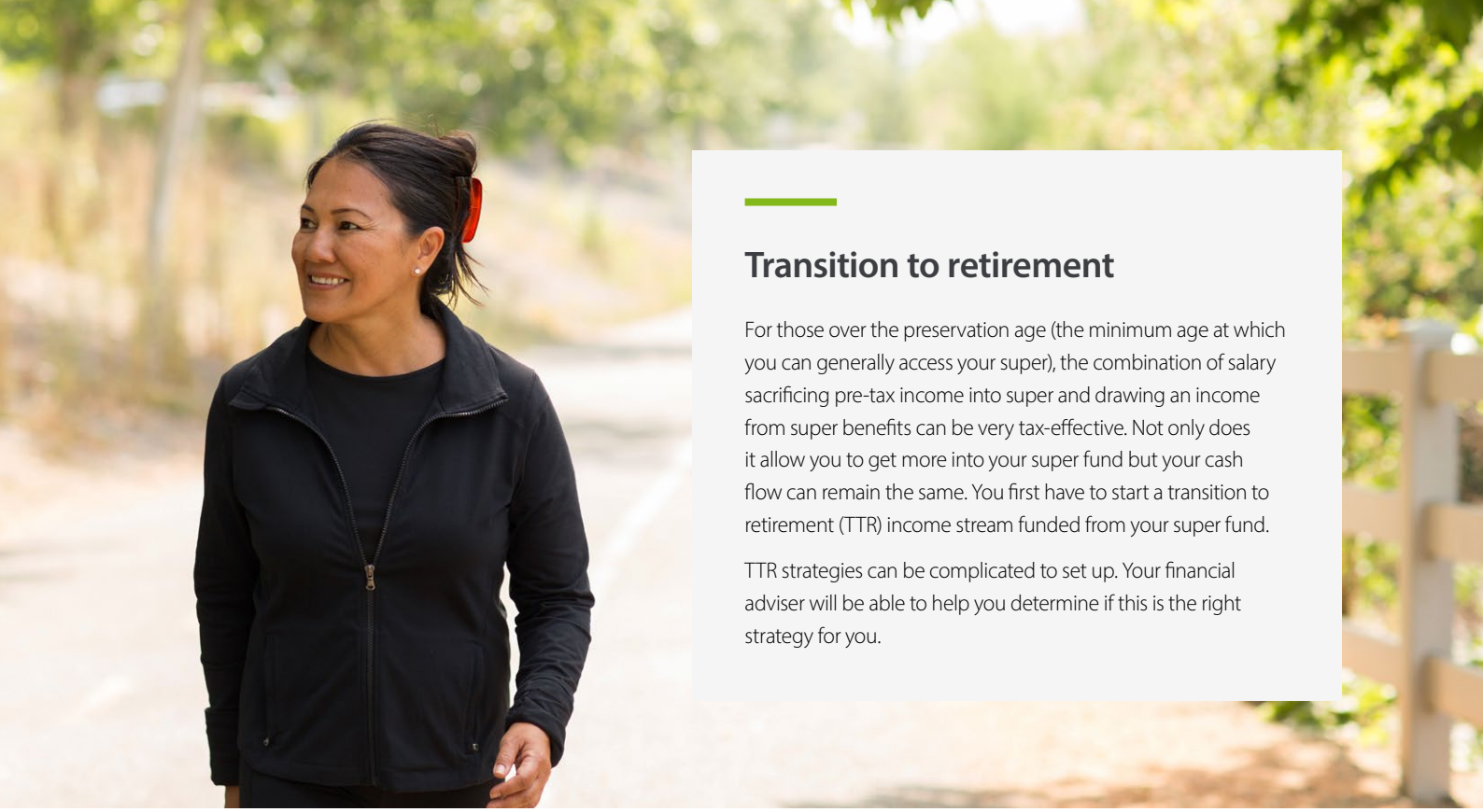
Taxable income and benefits	Marginal tax rate* (%)	Contributions tax rate (%)	Net savings on contributions (%)
$0 to $18,200	0	15	Negative
$18,201, to $45,000	21	15	6
$45,001 to $120,000	34.5	15	19.5
$120,001 to $180,000	39	15	24
$180,000 to $250,000	47	15	32
Over $250,000	47	30	17

* Includes Medicare levy

Remember – concessional contributions are capped at $25,000. Please note SG contributions are included in this amount.

2 ATO media release: Australians losing thousands in super fees annually, March 2015.

3 An additional 15% tax applies for high income earners, where the total of their taxable income plus super contributions exceeds $250,000.



Transition to retirement

For those over the preservation age (the minimum age at which you can generally access your super), the combination of salary sacrificing pre-tax income into super and drawing an income from super benefits can be very tax-effective. Not only does it allow you to get more into your super fund but your cash flow can remain the same. You first have to start a transition to retirement (TTR) income stream funded from your super fund.

TTR strategies can be complicated to set up. Your financial adviser will be able to help you determine if this is the right strategy for you.

Nominating beneficiaries

Unlike directly owned property or shares, super doesn't form a part of your estate. Nor does it automatically transfer to your estate after death. Instead, your super is held 'in trust' by the super fund. Usually the fund trustee will distribute it in accordance with superannuation law and the trust deed. Nominating your beneficiaries for your super allows you to have more control over who gets your super if you die.

A binding death benefit nomination is one of a variety of nominations – outlined in the table below – which legally allows a member to advise the trustee who is to receive their super benefit when they die, provided they meet certain eligibility criteria.

Type of nomination	Description	Positives	Limitations
No nomination	Your benefit will be dealt with in accordance with the rules of the super fund. This could mean a payment to your Estate or the trustee having discretion.	No need to renew nominations.	There is a chance super benefits could go to someone the member didn't intend them to go to.
Non-binding nomination	A member can tell the trustee whom they want their benefits to go to. It will be considered by the trustee, but is not binding.	The trustee can still exercise discretion if a member's situation has changed.	The trustee will make the decision on your behalf.
Binding nomination	The trustee must pay benefits to the dependants and in the proportions set out.	The trustee must pay benefits in accordance with the member's wishes.	The definition of an eligible dependant can be restricted for different super funds. The nomination must be renewed every three years to remain valid.
Reversionary benefit nomination	This applies when opening a pension account. The member nominates who will automatically get their pension after they die.	A pension can continue with very little interruption.	The reversionary nomination can only go to an eligible dependant. A reversionary benefit nomination cannot be changed once a pension starts.

There are rules around who can receive a superannuation benefit – it's not solely at a member's discretion. The beneficiary must be a 'dependant'. A dependant includes:

- a spouse (including de facto or same-sex)
- children of any age, including step-children, adopted or children from previous relationships
- someone who is financially dependent on the member
- someone in an interdependency relationship with you, such as a close living arrangement
- a legal personal representative, that is the Estate of the member.

Investment bonds

Investment bonds (otherwise known as insurance bonds) are investment vehicles which may offer tax efficiency for investors.

In an investment bond, investors contributing either a lump sum or regular deposits, benefit from 'tax paid' returns while funds are invested. The income from the underlying investments is taxed at the current company tax rate of 30% and does not need to be included in the investor's tax return. The investor may be an individual (up to three individuals holding the one investment), a trust or a company. The following example assumes the investor is on the top tax rate, including Medicare levy.

Investment bond		Managed fund	
Investment earnings	$10,000	Investment earnings	$10,000
Tax paid by bond manager	$3,000	Tax paid by fund manager	$0
Net return (at maturity)	$7,000	Assessable income	$10,000
Assessable income	$0	Tax paid by investor	($4,700)
After tax return	$7,000	After tax return	$5,300

Access to funds

One of the best features of an investment bond is that they are accessible. Not only is there no limit on the amount you can invest in the first year, but the investment is accessible at any time. There are no preservation requirements or the need to meet a condition of early release. There are, however, different implications on personal income tax liabilities that are dependent on the year the investment is withdrawn. We have outlined the various scenarios below.

0-8 years*	8-9 years*	9-10 years*	10+ years*
Withdrawals before the eight year anniversary date	**Withdrawals during the ninth year**	**Withdrawals during the tenth year**	**Withdrawals after the 10 year anniversary date**
Investment earnings are subject to personal income tax. A tax offset of 30% of the assessable amount applies to reflect the tax already paid within the investment bond.	Two thirds of investment earnings are subject to personal income tax at the investor's marginal tax rate. A tax offset of 30% of the assessable amount applies to reflect the tax already paid within the investment bond.	One third of investment earnings are subject to personal income tax at the investor's marginal tax rate. A tax offset of 30% of the assessable amount applies to reflect the tax already paid within the investment bond.	There is no personal income tax liability for withdrawals made after the end of the tenth year from the start date.*

* From the start date for tax purposes, which may be different to the date of initial investment.

A wide range of managed fund investment options are available within an investment bond structure, including diversified funds, multi-manager funds, Australian and international share funds, property funds, fixed income funds and cash funds.

Investment bonds may be suitable for investors:

- who need an alternative tax structure outside of super
- wishing to save in a tax effective structure
- with specific estate planning needs
- wishing to lower their taxable income.

Of course, an investment bond has many more features and benefits for all types of investors. Your financial adviser will be able to help you more if you are unsure if an investment bond is the right investment vehicle for you.

A financial adviser can keep your portfolio under review and recommend appropriate changes.

Investments are not 'set and forget'

Once you start your relationship with your financial adviser, establish your goals and build your portfolio to meet these goals. It's important to remember that your investment is not a set and forget proposition. There are number of reasons why your investments might change:

The investment value may change

The markets may change

Your needs may change

You may need to rebalance

The value of advice

There's a lot to consider when trying to secure your financial future. Should I pay off the mortgage or put money into super... but what about renovations? When can I stop work? How do I afford the children's education?

At IOOF, we believe in the value of financial advice. In today's complex and everchanging financial world, it's never been more important to seek qualified and experienced guidance to help you secure a successful financial future.

A financial adviser can help you:

- identify your lifestyle goals and put a plan in place to achieve them
- understand your current investment profile, your attitude towards risk and help you select the most appropriate investment strategy for you
- protect your assets and loved ones with appropriate insurance
- prepare for retirement and make the most of your super
- transition to retirement

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