Managed Funds

A managed fund is one type of 'managed investment scheme' (MIS), which is a professionally managed investment portfolio that pools the money of multiple investors. Investment/fund managers are appointed to manage the money within the fund including the selection, buying and selling of the underlying investments.

By pooling money with other investors you may gain access to investments not normally available if you invested directly or enable you to achieve a greater level of diversification. The managed fund structure also allows for the professional management of your money.

If you invest money into a managed fund you will receive a number of 'units' in that fund. The number of units you receive is calculated as the amount of money you invest divided by the 'entry' unit price on that day. This is why managed funds are also often called 'unit trusts'. The unit price may increase or decrease in line with the value of the underlying assets.

Investment Options

The investment/fund manager or administrator of the fund, may offer a range of investment options that you can choose to invest in. Each option has different investment goals, timeframes, risk profiles and underlying assets.

Some managed funds may provide a diversified allocation to asset classes based on a risk level. Examples of these include a 'balanced' fund which invests approximately half of the money within the portfolio in growth assets such as share and property, with the remainder in more defensive assets such as cash and bonds.

Other funds might invest in a specific type of asset (e.g. Australian shares, international shares, property or cash). There may be different investment styles used to manage the portfolios such as value or growth investing.

When investing in a managed fund you need to choose which options are best suited to your personal preferences and financial goals. This includes consideration for:

- Your risk profile
- Your investment time horizon
- Your need for diversification across asset classes
- Your preference to invest in a particular type of investment or asset class

The Product Disclosure Statement (PDS) provides you with information on the investment options and may help you to determine the suitability.

Investment Returns and Taxation

The underlying assets of the managed fund might produce income (including interest, rental income, realised capital gains and dividends) and/or capital growth.

The fund manager will deduct any applicable fees and expenses from the income generated and the remainder is more often than not, distributed to investors (unit holders).

This income is included in the investor's own tax return and is taxed at the investor's own marginal tax rate. If franking credits have been derived these will be passed onto investors and can help to reduce tax payable.

If units are sold, this may create a capital gain or loss depending on how the fund unit price has changed since your initial investment and any investment thereafter. If a capital gain has been realised on units held for more than 12 months a 50% capital gains tax discount will apply unless the units were owned by a company.

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Benefits of Managed Funds

Managed funds have a number of advantages that allow you to select options that suit your specific needs and objectives. These benefits may include:

- Diversification: Managed funds can provide you with a diversified portfolio that may invest across a range of asset classes and securities
- Wide choice of investments: Wide choice of asset classes and diversified portfolios
- Specialists: Access to specialist investments and investment styles
- Tailored portfolio: Can have a tailored portfolio where specialist managed funds are chosen (e.g. infrastructure, emerging markets, small caps)
- Professional investment manager: Team of professional investment managers responsible for the investment selection, review and monitoring. This also includes risk management
- Active performance: Active managed funds will actively manage investments to take advantage of the changing market outlook and therefore have the potential to outperform their index
- Low level of participation: There is a low level of participation and time involvement required by you in the management of the managed fund compared to investing directly
- Regular investments: Many managed funds allow regular investments including small minimum amounts. This can assist you if you are investing using a 'Dollar cost averaging' approach and/or a regular savings plan
- Tax statements: Managed funds provide tax statements to assist with you with completing your tax returns

Disadvantages and Risks of Managed Funds

There are a number of risks and disadvantages of managed funds to be aware of. The key risks will be determined by the nature of the managed fund including the asset classes and securities that it invests in. The risks and disadvantages include:

- Market risk: The performance of the managed fund will be affected by the assets and securities that it invests into. If it invests in 'growth' assets like shares and property, it has the potential to provide higher returns over the long term but will also have a higher level of risk including the risk of capital losses compared to more secure investments like cash and bonds.
- Limited control: You have no control over the individual investments that are bought and sold.
- Tax management: You have no control over the timing of sales and purchases of assets or assets selected to be sold. This may affect the capital gains tax outcome of the managed fund.
- Capital gains in distributions: The distributions paid from a managed fund may include a return of capital which can be less tax effective for investors.
- Limited transparency: There is limited transparency of the underlying portfolio and investments. A managed fund will tend to report of the securities and assets held in the portfolio but this tends to be reported with a lag.
- Higher fees: Fees can be high due to the management and administration fees and buy-sell spreads.
- Currency risk: Movements in the relative value of international currencies can influence the value of international assets.

Gearing risk: Some managed funds may borrow funds to increase potential returns. This gearing can magnify both gains and losses.

Investment styles

Managed Funds

Growth or Value Investing

Investors must consider whether they prefer to invest in fast-growing firms or underpriced industry leaders. Each will have varying risk and return characteristics and will perform differently at different times in a market cycle. Investors must determine which strategy best suit their individual needs.

The growth style of investing looks for high-quality companies that have high earnings growth rates, high return on equity, high profit margins and low dividend yields. There are however no guarantees going forward. Companies that have all of these characteristics are often innovators within their field/industry and make lots of money. It is thus growing very quickly, and reinvesting most or all of its earnings to fuel continued growth in the future.

The value style of investing is focused on buying strong companies at reasonable prices. Their price however has fallen due to the company or industry falling out of favour with investors or perhaps the economic cycle not favouring a particular industry at that point in time. Investment managers look for a low price to earnings ratio, low price to sales ratio, and generally a higher dividend yield. The main ratios for the value style show how this style is very concerned about the price at which investors buy in. The idea behind value investing is that stocks of good companies will bounce back in time when the true value is recognised by other investors and the market.

Quality and Lower Volatility Investing

In recent years, we have noticed an increase in other styles of investing. These styles include Quality and Lower Volatility investing and, in many cases, some products will focus on both.

Investing in Quality companies is usually associated with companies with efficient management, sound balance sheets, low debt, profitability, and strong cash flows. Quality strategies seek to provide excess returns by investing in companies that are better positioned for short- and long-term growth.

Lower Volatility investing targets companies with less volatile share prices that typically fall less than the share market during share market declines.

Higher quality and lower volatility portfolios aim to deliver strong up-market participation and down-market protection. These portfolios also tend to blend well with growth and value portfolios to improve overall portfolio diversification.