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The information in this document is factual information, and is not financial advice. The information is objectively ascertainable information and is not tailored to your personal circumstances. You should obtain financial advice before making a decision in relation to this information. All examples are provided for illustrative purposes only.

Investments

Investing refers to the purchase of an asset or item with the hope it will generate income or appreciate in value. Types of investments can vary significantly but can include: cash, shares, managed funds and property (direct and indirect).

Link between return and risk

Investment assets expected to produce higher overall returns also generally have a higher chance of producing negative returns. Reducing the risk of negative returns by investing in lower risk investment assets can be expected to produce lower overall returns. All investment assets have an element of risk.

An investor's tolerance to risk is applied when developing and maintaining a diversified investment portfolio.

The graph below illustrates the level of volatility (risk) and returns traditionally experienced by the major investments asset classes.

Diversification and strategic asset allocation

The most widely recognised method for managing investment risk is through diversification of investments and investment management. In order to reduce the volatility and risk of an investment portfolio, it is prudent to ensure that it is sufficiently diversified against over exposure to:

- a single asset,
- asset sector,
- geographical region or
- investment manager.

No one asset, asset class, geographical region or investment manager provides the best performance over all time periods. A diversified portfolio of investments should reduce the risk of the portfolio experiencing drops in performance across the board simultaneously, as one asset class or manager may perform well to counter the poor performance of another.

There are two common types of portfolio diversification:

1. Macro diversification

Macro diversification is achieved through diversifying an investment portfolio into different asset classes such as:

- Cash
- Fixed interest
- Property
- Domestic equity (Australian listed shares)
- International equity

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2. Micro diversification

Micro diversification is achieved by further diversifying an investment portfolio to include exposure to:

- Different market sectors
- Different companies
- Investments with different characteristics (e.g. value investments, growth investments)
- Different styles of investment management (e.g. value, growth, absolute return, blend)
- Different geographical regions (e.g. Australia, Asia, Europe, U.S.A.)
- Different fund managers.

Investment returns

Investment returns are received through income provided by the investment asset and capital movements over time.

Income can come in the form of interest from cash and fixed interest investment assets, dividends from equity investment assets or rentals from property investment assets.

When comparing interest income investments with those potentially producing capital growth it is important to compare total return from each.

Interest income investments

Interest income investments include bank accounts, term deposits, mortgages and debentures with major finance companies. These investment assets generally maintain the original capital value invested and pay a defined income return for a specified period.

The interest income received is taxable income and tax will be levied at the applicable tax rates.

Dividends and dividend imputation

Dividends from Australian companies are distributed to investors after the company has paid tax on their profits. Under the dividend imputation system investors receive a credit for the amount of tax that the company has already paid.

An example of how the dividend imputation system works is provided below:

Company profit	$1,000
Tax paid by company (30.0%)	($300)
Net after-tax income	**$700**
Cash component received by shareholder	$700
Franking credit	$300
Gross dividend received	**$1,000**

Taxation implications of dividends

An example of the taxation implications of dividends and the dividend imputation system is provided below:

	21%* Tax Rate	34.5%* Tax Rate	39%* Tax Rate	47%* Tax Rate
Assessable income *(Gross dividend)*	$1,000	$1,000	$1,000	$1,000
Tax assessed	$210	$345	$390	$470
Less: Franking credit	($300)	($300)	($300)	($300)
Additional tax payable (refund)	**($90)**	**$45**	**$90**	**$170**

* Including Medicare Levy.

Property and depreciation allowances

Property investments, either directly or through a unit trust structure provide rental income. Any expenses or losses incurred in generating that income is deductible.

Depreciation allowances may be available for building fixtures and fittings, and depending on the age of the building, capital allowances may also be available. This can reduce the assessable income of the property, without reducing the cash flow generated.

Any net income received is taxable income and tax will be levied at the applicable tax rates.

Depreciation and capital allowances may reduce the taxable income and tax payable on the rental income, however these amounts may also reduce the cost base applied when calculating the assessable capital gain when the investment is sold. Therefore, tax may only be deferred to the point of sale and not eliminated.

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Overview of investment types

Direct shares

A share represents an interest in the financial performance of that company. A shareholder in a company has the right to benefit from profits generated by the company, which are paid through dividends.

Returns generated by direct shares include movement in the share price. The share price represents the value of the company at any time.

Returns are not guaranteed. If performance of the company experiences poor performance, dividends may not be paid to shareholders. This may also affect the market price for the company's shares.

Real Estate Investment Trusts (A-REITs)

Real Estate Investment Trust investments (REIT) are investments listed on a stock exchange which allow an investor to purchase an interest in a professionally managed real estate asset or portfolio of properties.

Returns generated by REIT investments are generated by movement in the underlying property investment and regular rental income generated from the properties. As these investments are listed on a stock exchange they are also subject to general price movements.

The manager of the investment trust selects the investment properties held within the REIT and is responsible for all maintenance, administration, rentals, and improvements. Most property trust managers include properties diversified across geographic regions, lease lengths, and tenant types.

Managed funds

A managed fund is an investment that pools the money of many individual investors. This money is then invested by a professional fund manager in different asset classes (e.g. shares, property and fixed interest). How much is invested in each asset class will depend on the fund's investment goals.

Each unit in a managed fund represents an equal share of the market value of the underlying investment portfolio held within the fund.

Investment income is generated by the investment portfolio held within the managed fund. This is then distributed to unit holders and forms part of the investment return. Movement in the value of the underlying investment portfolio also contributes to investment returns of managed funds.

A managed fund is required to issue a Product Disclosure Statement (PDS). This is a document that contains information about the managed fund, including any significant benefits and risks, the costs, and the fees and charges that the managed fund issuer may receive.

The fund manager charges a fee for investing funds within the managed fund and reviewing the underlying investment portfolio. Transaction fees incurred by the fund manager when transacting on the portfolio may also be payable by unit holders. These fees are deducted from the portfolio before the unit price is calculated.

The Management Expense Ratio (MER) is the total of these fees charged during a year, expressed as a percentage of a fund's average net assets for that year.

Listed Investment Trusts (LIT)

A Listed Investment Trust (LIT) is a managed fund investment which is listed on a stock exchange. Units are able to be purchased and sold through a broker and do not require applications and redemptions to be provided to the fund manager.

An MER is charged on LITs, in the same way as a managed fund.

LITs can be open ended, where the units are purchased and sold on market and the fund manager provides the liquidity to ensure the unit price remains closely aligned with the value of the underlying portfolio. An open ended LIT is also required to have a Product Disclosure Statement.

LITs can also be closed ended. This is where an investor purchases units from an existing unit holder looking to sell their units. Closed ended LITs are not required to issue a Product Disclosure Statement. Closed ended unit trusts may trade on the stock exchange at a different value then the underlying Net Tangible Asset (NTA) value of the underlying investment portfolio. A premium to NTA is where the unit price is trading above the market value of the underlying portfolio. A discount to NTA is where the unit price is trading below the market value of the underlying portfolio.

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Listed Investment Companies (LIC's)

A Listed Investment Company (LIC) is similar to a closed ended LIT, however the investment is incorporated as a company. New shares in a LIC are issued through a capital raising or share purchase plan. The fund manager holds an investment portfolio within the company. The shareholders has the right to benefit from the investment portfolio. LICs are not required to issue a Product Disclosure Statement.

The returns on LICs are generated from the dividends paid by the LIC. Where an LIC pays tax on the income generated by the portfolio, this can be used to provide franking credits attached to the dividend paid.

Returns generated by LICs also include movement in the share price. Like closed ended LITs a LIC can trade at a premium or discount to the NTA.

An MER is also incurred on LICs, in the same way as a managed fund or LIT. The MER is deducted from the portfolio before the NTA is calculated.

Exchange Traded Funds (ETFs)

An Exchange Traded Fund (ETF) is a listed investment that tracks an index, sector, commodity, or other asset, but which can be purchased and sold through a broker and do not require applications and redemptions to be provided to the fund manager.

ETFs are generally open ended investments, where the units are purchased and sold on market and the fund manager provides the liquidity to ensure the unit price remains closely aligned with the underlying index, sector, commodity, or other asset it is designed to track. An ETF is also required to have a Product Disclosure Statement.

An MER is charged on ETFs, in the same way as a managed funds, LITs and LICs.

Separately Managed Account

A Separately Managed Account (SMA) is an investment portfolio composed of individual investments overseen by a professional investment manager in line with a specific investment style or discipline and administered on an approved platform.

Unlike a managed fund, where money is pooled with that of other investors, an SMA allows an investor to directly own the underlying investments within the portfolio. All investment income, including franking credits is received by the individual SMA portfolio and not pooled and distributed with other unit holders.

When investing via an SMA, all investment decisions and changes are made by the professional investment manager. The account holder is not consulted or required to approve any investment changes within the SMA portfolio. This allows the professional investment manager to respond to changes in investment and market conditions quickly by adjusting underlying holdings and weightings as deemed appropriate.

An SMA provides transparency over the underlying investments held within the portfolio at any time.

An SMA can also be structured to exclude certain investments from the portfolio due to existing concentrated single stock positions i.e. large parcel of shares held in a company outside of the SMA or to avoid investing in specific sectors or investments. Any changes made to the SMA portfolio are reflected in increased exposures to the other investment holdings within the underlying portfolio.

An SMA must have a Responsible Entity (RE) to review the investment performance and ensure the investment manager is meeting the stated investment objectives of the SMA.

An RE must be an Australian public company, with a level of net tangible assets which aligns with the value of the scheme's assets. Furthermore, the RE must:

- Act honestly
- Exercise a reasonable degree of care and diligence
- Act in the best interest of members of the investment scheme
- Treat all investment scheme members equally.

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