Week 5 – Investment Strategy, Structure and Risks

Investment Strategies

Core plus satellite approach: A core plus satellite approach involves anchoring the core part of a portfolio to one or few broad-ranging investment products so as to provide a diversified component to the portfolio

Advantages	Disadvantages
Can apply to clients in their various life stages, including accumulation and pre- and post-retirement	The financial planner has the responsibility to actively research, select and monitor the satellites to suit the client's needs – time
It can apply to the entire portfolio or to a single asset class within the portfolio, such as the Australian share component	Each of the financial planner's clients may have different portfolios due to different satellites, may require monitor and reviews
The core component of the portfolio provides the portfolio with reasonable degree of diversification across asset classes, sectors and securities. This acts as an anchor for the portfolio	To the extent that ETFs are used for the core, the same potential drawbacks that apply to ETFs will also obviously apply
The satellite can be varied and tailored to the client's specific requirements and preferences – good for life stages/risk level	
The portfolio biases can be adjusted by varying the satellites and maintaining the core exposure – ensures diversified anchor	
The client's other investments can be taken into account in selecting the satellites.	

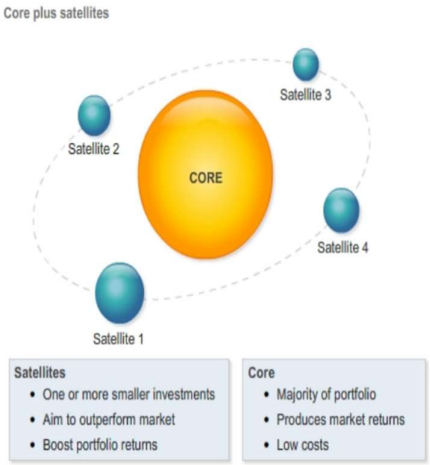
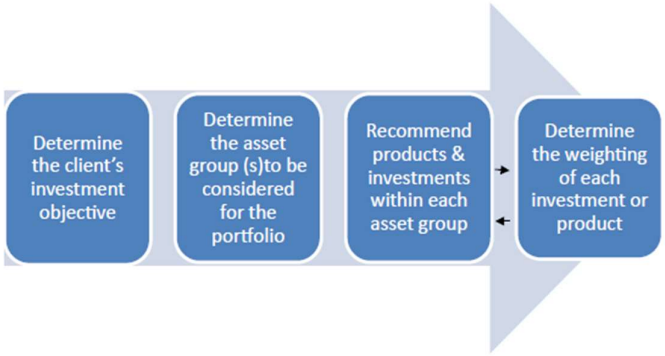


FIGURE 3.4: Process for constructing portfolios at an asset class level

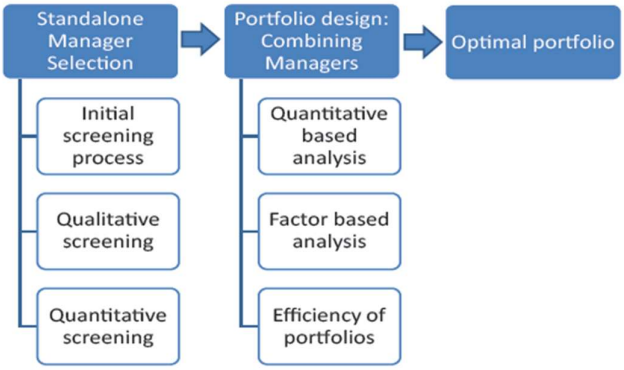


Source: Strategy Steps Pty Ltd.

Multi-manager investment strategy: A multi-manager investment strategy involves the fund manager and/or organisation appointing external investment specialists to manage a specific portfolio. The process often involves the fund manager employing a combination of investment specialists with different characteristics, such as investment styles, number of stocks in their portfolio and investable universe

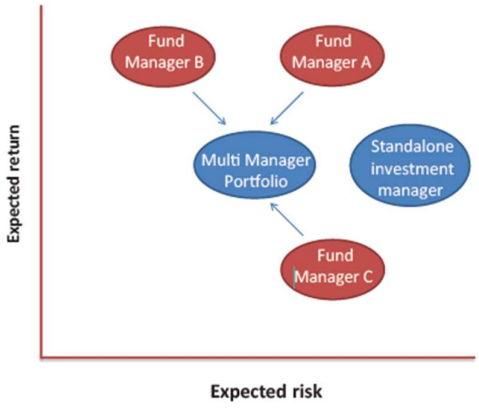
Advantages	Disadvantages
A client with minimal amount of funds can invest in a multi-manager fund that provides diversification across investment styles, market capitalisation and sectors through one vehicle	The multi-manager fund is overdiversified due to the number of managers in the portfolio – too many managers means the views are diversified to offset each manager's beliefs
No one fund manager house can realistically claim to be the absolute best in the market in every area – best suited based on conditions	Management fees for multi-manager funds are typically higher than other standalone managers that have a similar objective
Multi-manager funds allow convenient access to a range of managers with complementary investment styles and approaches via a single fund – allows the financial planner to spend more time developing and servicing the client's needs	Multi-manager funds offer less flexibility in choosing the underlying managers and assets to be included in the portfolio
A skilful multi-manager investment specialist can scour the countless number of global managers across a broader range of assets and sub-asset classes to find the best of breed managers which may include hedge funds and emerging markets	Less transparency of the underlying managers' assets held in their portfolios
Multi-managers can gain access to hedge fund strategies whereas it is difficult for investors – multi-manager funds often used when investing in hedge funds due to high minimum investment	

FIGURE 3.13: Steps in constructing a multi-manager portfolio



Source: Strategy Steps Pty Ltd.

FIGURE 3.12: Multi-manager portfolio principles

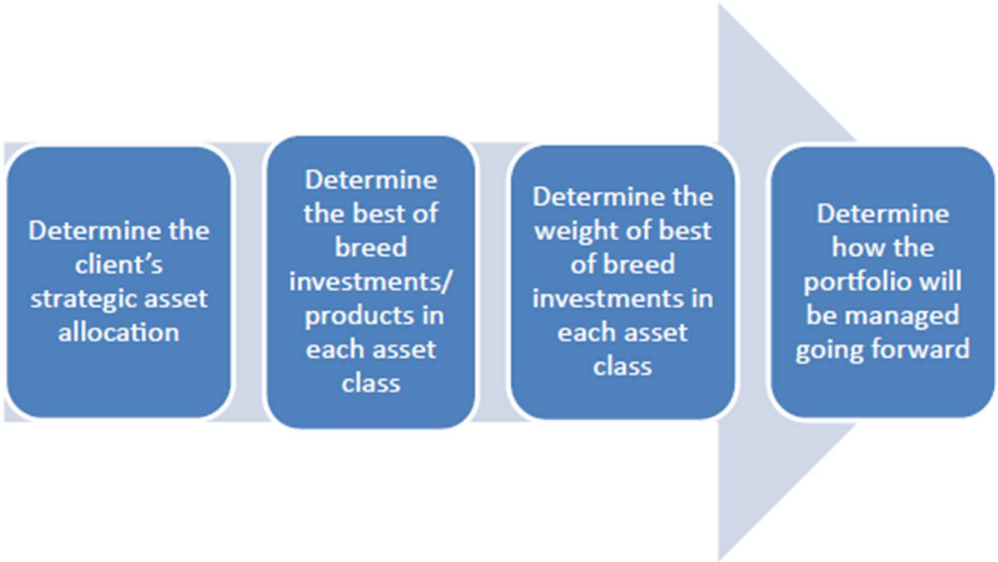


Source: Strategy Steps Pty Ltd.

Model portfolio approach: A model portfolio approach is based on selecting highly rated 'best of breed' funds and investments within each asset class or asset category such as managed funds, direct securities, listed investment companies and ETFs and using these to construct the client's overall portfolio

Advantages	Disadvantages
Model portfolios tend to be a guide for financial planners and there is the ability to change the investments included in the portfolio based on the client's circumstances and financial planner's preferences. Greater flexibility provided	When using sector specialist managers, it is important to be able to invest amounts that are economic from a fee perspective.
The client's portfolio consists of the most highly rated managers of different investment styles and approaches within each asset class – different styles perform differently in various market conditions	Rebalancing the portfolio's asset allocation on a regular basis is critical for ensuring that the portfolio remains in line with the client's needs which may incur tax consequences, transaction fees etc.
It can allow the client to form a portfolio with a combination of specialists, structured direct equities and broad-based funds within asset classes	The planner or investor must undertake all transaction to set up the portfolio initially and make changes which may be time consuming

FIGURE 3.15: Model portfolio approach



Source: Strategy Steps Pty Ltd.

Investment Structure

Legal obligations:

- A managed investment scheme (MIS) must have a constitution setting out the rules such as:
    - Cost of buying interest in the scheme and the rights of investors to withdraw from the scheme
    - The investment powers of the RE complaints resolution process.
    - A compliance plan provides operational details of how
- The MIS will meet its regulatory and constitutional compliance obligations
- Product Disclosure Statement (PDS)

Cost structure:

- Direct cost
- Indirect cost
    - Indirect cost ratio
    - Management expense ratio

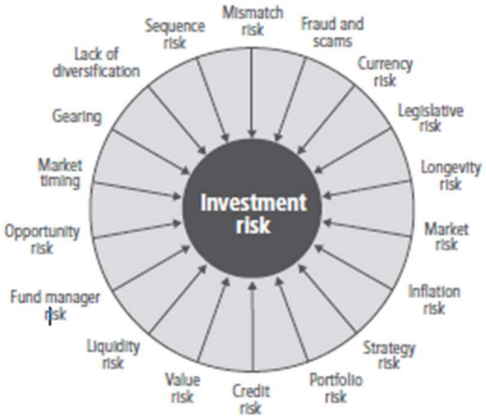
Types of managed funds:

- Listed v unlisted
- Sector v diversified
- Retail v wholesale

- Passive v active

Investment Risk

FIGURE 2.14: Types of investment risk



- **Market risk:** all markets and asset classes are subject to volatility of price and return
- **Security risk:** individual assets may cause issues for funds invested in many assets
- **Currency risk:** risk of exchange rate movements
- **Liquidity risk:** risk that you may not be able to sell your assets due to no buyers
- **Beta risk:** unsystematic undiversifiable risk
- **Taxation risk:** unpredictability of government laws which may affect taxation of assets

FIGURE 2.15: Strategies that can be used to reduce risk