IMAP
Institute of Managed Account Professionals

North

A guide to managed portfolios

Adviser use only

MyNorth Managed Portfolios

October 2021

Message from Edwina Maloney and Toby Potter

The numbers speak for themselves.

44% of advisers in Australia now use managed portfolios, up from 22% just five years ago.[1] Total funds under management across the managed portfolio industry in Australia is now more than $111 billion as at 30 June 2021, up from $80 billion in 2019.[2]

Why do managed portfolios continue to grow in popularity?

From an adviser's perspective the reason is simple – they make it easier to deliver high quality advice that meets clients' goals. And, in an environment where the cost of providing advice in Australia has increased markedly in recent years, this has never been more important.

Managed portfolios are a compelling proposition. They provide low-cost access to leading investment managers and portfolio construction, portfolio responsiveness to shifting markets and volatility, plus transparent reporting, among many other benefits.

As North's managed portfolio range continues to expand with equity portfolios, IMAP and the North team have worked together to develop this paper.

Its purpose is to help you better understand the ins and outs of managed portfolios, covering everything from portfolio construction, implementation strategies and their effectiveness in meeting best interest duties.

We hope it's a useful educational resource for you.

Edwina Maloney

Director
Wealth Products & Platforms
AMP Australian Wealth Management

Toby Potter

Chair
Institute of Managed
Account Professionals Ltd

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A guide to managed portfolios

PART 1

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The ups and downs of markets

For many investors, Australian equities are the first place they think of putting their money as they look for familiar companies with a long track record. But experienced investors understand there will be bumps along the way and that markets can fall as well as rise. Equity managed portfolios are responsive enough to handle this volatility and allow professional investment managers to make timely portfolio adjustments.

Shane Oliver, our Head of Investment Strategy and Chief Economist, shares his view on equity market movements.

The outlook for equities both domestically and overseas is positive with the strong rebound set to continue, albeit at a more constrained pace. Looking through the inevitable short-term noise, the combination of improving global growth and profits, further reopening globally and from later this year again in Australia on the back of vaccines and still low interest rates augurs well for equity markets in 2021–22. Despite the market lows seen last year, equities have seen a very strong rebound with US equities up 102% and Australian equities up 66% as at 30 August 2021.

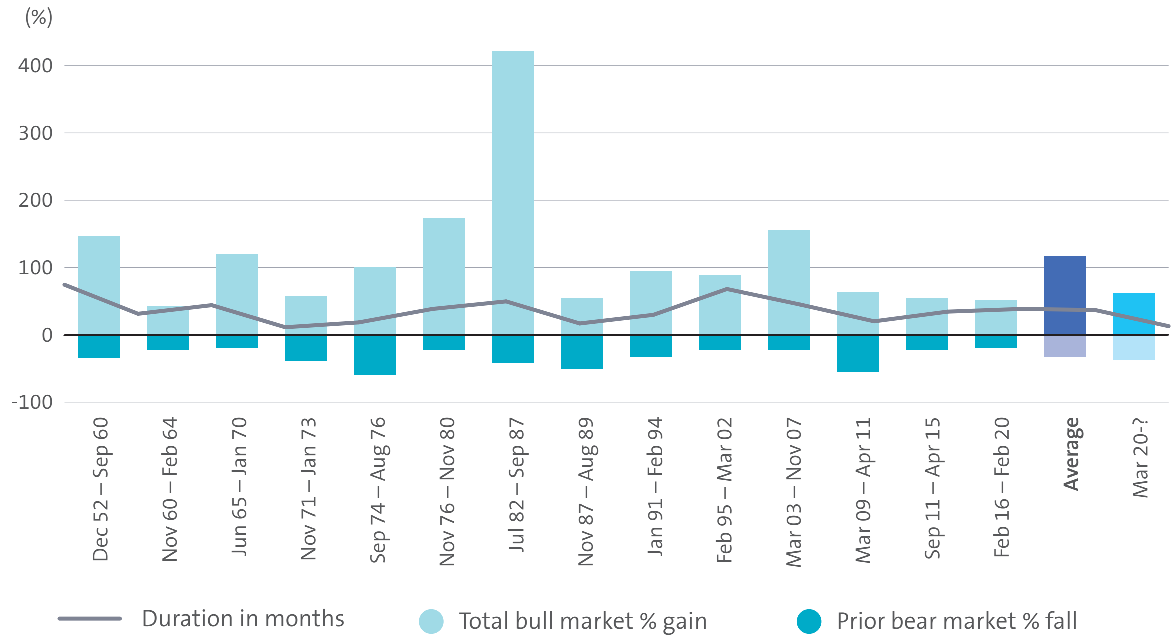
Cyclical bull market patterns throughout history suggest the current bull market likely has further to go as many of the tell-tale signs of a major market top aren't present. When thinking about this issue, it's always useful to start by looking at past cyclical bull markets in equities.

The average gain in bull markets since World War II is 116% over 46 months.

In this context, the rebound seen over the last year would be relatively short for a cyclical bull market if it were to end at this point. It's most likely that we're in the transition between the initial recovery and earnings driven growth, and we're still not seeing the sort of unambiguous overvaluation, economic overheating, monetary tightening and investor euphoria normally seen prior to the end of cyclical bull markets in equities.

However, we're likely to see a continuing shift in performance away from investments that benefitted from the pandemic and lockdowns – like technology and healthcare equities and bonds – to investments that will benefit from economic recovery – like resources, industrials, tourism equities and financials.

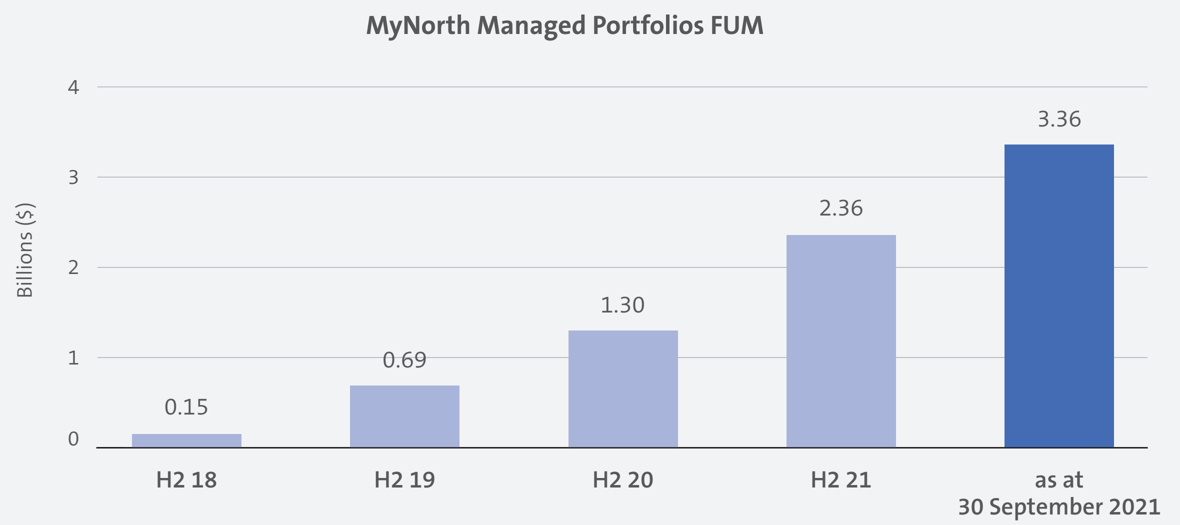
Cyclical bull markets in Australian equities since World War II



Source: Data is for the All Ords index; Bloomberg, AMP Capital

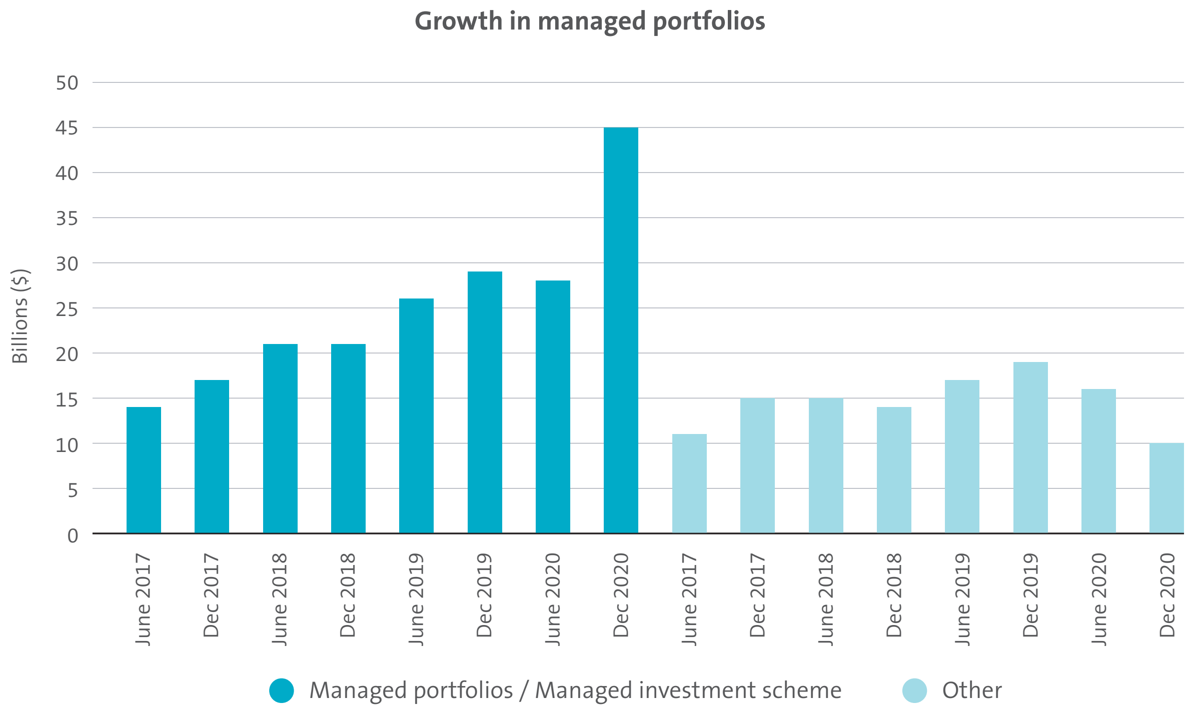
Seven reasons managed portfolios could suit your practice

Whether you call them managed portfolios, managed accounts, separately managed accounts or even managed discretionary accounts, they've become a growing part of smart advisers' toolsets, as you can see in the graph below.



Source: North 2021.

Managed portfolios are equivalent to over 10%[3] of platform investments by value, with advisers increasingly using their reporting, transaction and portfolio management capabilities to meet clients' goals.



Source: IMAP

3 IMAP Dec 2020 data and Plan for Life Dec 2020.

1. Reducing operational risk

Managed portfolios allow you to transfer some operational risk to investment professionals so you can focus on serving your clients and growing your practice. With MyNorth Managed Portfolios, all rebalancing, trading and monitoring is taken care of by the North specialised trading team. This results in more efficient trading where orders are combined with others received on the same day and trades are netted off when processed and can reduce the trade fees for clients as they benefit from institutional broking rates.

2. Simplifying advice

Once the client has agreed to investment in a managed portfolio, the investment manager takes responsibility for investment research and portfolio instructions. As a result, there are fewer steps in the ongoing advice process. Investment managers can adjust portfolios quickly within the investment mandate meaning advisers can focus on advice strategies. Using the COVID-19 market volatility as an example, most advisers rate managed portfolios as 'Very Good' (55%) or 'Good' (33%) in terms of freeing up their time during COVID-19.[4]

3. Time to focus on the client's critical issues

Managed portfolios allow you to focus on your role as steward and financial mentor. You can spend more time educating clients about your recommended advice strategies and how they're tracking against their goals as market conditions change.

4. Meeting client expectations

Clients aren't solely focused on meeting their risk/return goals.

They can also have less tangible needs. Managed portfolios can meet these needs by combining clearly articulated objectives with structured portfolio management.

I need to know my investments are managed by experts

I'm happy for someone else to make decisions so long as I know their underlying approach

I want my portfolio to reflect my values

5. Meeting best interests

An important part of your role as an adviser is to consider your clients' best interests when developing Statements of Advice. More than nine out of ten advisers who use managed portfolios say it's easy to show they're meeting best interests with managed portfolios.[4]

6. Leveraging experts

Managed portfolios can facilitate effective collaboration between the stakeholders who help clients achieve their goals – advisers, investment managers and specialised trading teams.

7. Building blocks for a whole-of-wealth solution

Research shows advisers see managed portfolios as a whole-of-wealth solution for different types of clients. Advisers who use managed portfolios say:

– 44% of their active clients hold managed portfolios, with
– an average of 62% of these clients' total investible assets allocated to managed portfolios.[4]

Managed portfolios based on broad client goals such as retirement income, asset protection or maximising accumulation can act as building blocks for advisers.

4 Investment Trends February 2021 Managed Accounts Report.

And three reasons managed portfolios could suit your clients

1. Transparent

In a world where trust is king, managed portfolios can reassure clients by keeping them fully informed about how their investments are faring. Investment managers communicate regularly about portfolio changes and their investment philosophy.

Investors also like to educate themselves online via PDFs (48%), emails (47.5%) and videos (33.5%) so MyNorth Managed Portfolios provide content in different formats to suit client preferences.[5]

Underlying investments are fully transparent (to the unit level if investments include funds) so you can communicate with your clients around how they are helping them achieve their goals. This helps highly engaged clients better understand how their money is invested, particularly when it comes to specialist investment strategies like environmental, social and governance (ESG).

2. Cost efficient

MyNorth Managed Portfolios use scale to negotiate discounts on funds that form part of a portfolio. Clients can access these funds at a cheaper rate than if they had invested outside the managed portfolio.

3. Tax effective

Compared with unitised investments such as managed funds, Australian equity managed portfolios can be an effective tax strategy. In a managed portfolio the investor is the beneficial owner of the underlying investments and this means sale or redemption of assets only occurs as a result of the investor's or investment manager's decision.

Investors aren't therefore disadvantaged by decisions of other investors to redeem units from a unitised fund which may cause the sale or redemption of assets from these funds, and may trigger capital gains tax liabilities for all investors in the fund, not just those redeeming units. Managed portfolios may also be able to provide some protection against triggering unwanted tax liabilities as, for example, when an investor wishes to prevent the sale of specific assets they may be able to transfer the asset directly to their account (eg to their individual HIN or an account they beneficially own) instead of needing to sell.

5 ASX Australian Investor Study 2020.

James Willis

Total Clarity Group

James is an adviser who has implemented equity managed portfolios.

Founder of Crows Nest, Sydney advice practice Total Clarity Group, James has been an avid equity managed portfolio user for the last 12 years and considers them a large part of his investment universe.

Although not right for every client, James appreciates the range of client circumstances that managed portfolios can accommodate, making them a desirable investment vehicle for simple wealth accumulators right through to those with more complex needs.

> “For people who are just trying to do the best they can to build their investments and super, indexes are absolutely perfect and work fantastically. For more sophisticated clients, managed portfolios can provide a better outcome in terms of ownership of the underlying equities and control over the flow of dividends.”

The transparency of a managed portfolio is valued by James’ clients as it promotes a sense of ownership and authenticity while also giving James flexibility in utilising their income from the managed portfolio to maximise their outcomes.

“When a client is having their review with us, this transparency is massively reassuring. With a managed fund you just know your fund has gone up by x% per annum. With a managed portfolio you can show them in advance what their portfolio income is going to look like.

So if you’re a 50-year-old preparing for retirement, you can see exactly how your portfolio can deliver the $50,000 or $60,000 in income you want each year in retirement. It makes the whole conversation around retirement income much more relevant.”

James believes the tax position is also generally better for clients in a managed portfolio as the risk of embedded tax positions in unit trusts is removed while also allowing flexibility in treating franking credits for each client.

“It just gives us more transparency and choice”, he says.

Professional investment expertise is also a key driver of the selection of a managed portfolio as James notes it allows him to focus on his true role as the adviser:

> “We aren’t here to try and tell people what the market’s going to do, we’re here to make sure our clients are leading the lives they’re meant to be leading.”

Approaches to portfolio building

North's guiding principles for manager selection

We know it's important to select quality investment managers for MyNorth Managed Portfolios. Advisers have an average of 13 managed portfolios on their APLs but only recommended an average of 4.8 of these to clients in the last 12 months.[6]

We look at four main areas when we select the investment managers

Business	Ownership, profitability, governance quality, business lines, strategy execution, client support.
People	Allocation of responsibilities, investment decision making, investment manager leadership, depth of resources, consultants and investment committees, analyst diversity and resources, skill set and compensation alignment with portfolio objectives.
Process	Investment philosophy, investment process, portfolio construction, risk management and monitoring, track record.
Product	Fees, client reporting, liquidity, capacity, platform interaction.

How we grade investment managers

Grading	Definition	Comments
AA	High quality	**Best in class, no weaknesses.** Very high level of confidence to meet mandate objectives.
A	Above average quality	**Strong, minor weaknesses.** High level of confidence to meet mandate objectives.
BB	Investment Grade	**Solid.** Likely to meet mandate objectives.
B	Below Investment Grade	**Not investable; flawed in several major categories.** Unlikely to meet mandate objectives

Source: Douglas Funds Consulting and North.

> "Analysis shows that there are relatively few investment managers who meet performance objectives consistently over time. However, these quality managers can be identified on a forward-looking basis by thorough due diligence using proven criteria that encompasses both qualitative and quantitative factors. This assessment involves understanding how four key areas (Business, People, Process and Product) are effectively integrated and translated into professionally managed portfolios available to your clients."

Nigel Douglas, CEO Douglas Funds Consulting

6 Investment Trends February 2021 Managed Accounts Report.

How investment managers build managed portfolios

Investment managers consider a number of factors when they're building managed portfolios.	
Investment universe	A single sector such as Australian equities or a multi-asset/diversified portfolio.
Beliefs about market returns	– Drivers of market returns. – Ability to add value. – Active vs passive.
Objectives	Goals-based or risk-based approach. For example CPI + x% or medium risk.
Environmental, social and governance (ESG)	Client ESG preferences. Stock substitution was used as an early tool to accommodate for specific preferences such as ESG, however as the managed portfolios universe has matured the industry has moved towards dedicated portfolios.
Platform investment menu	Availability of investment options – managed funds, ETFs and equities.
Strategic Asset Allocation (SAA)	Establish long-term expected holdings for each asset class together with minimum and maximum ranges (for multi-asset portfolios and some equity portfolios).
Dynamic Asset Allocation (DAA)/ Tactical Asset Allocation (TAA)	Adjusting the asset class exposure based on market developments.
Costs	The portfolio's fee budget. A more active approach is likely to generate higher transactional costs such as buy/sell spreads. Active managers need to be able to achieve returns despite their higher fees.
Responsibility for management	Decisions about the most appropriate team and resources to be involved in portfolio management.

Investment managers have a breadth of choices to build portfolios, depending on their investment approach, capabilities and desired outcome. Managed portfolios represent a growing universe of investments in a variety of structures, offering exposure to different asset classes and markets.

Managed funds

Managed funds are typically used as the core for most asset classes. They are particularly suitable and cost-efficient for assets such as bonds, property trusts, alternatives and cash trusts.

Exchange Traded Funds (ETFs)

ETFs provide a quick and efficient way to make portfolio changes, whether it's strategic or tactical. The listing of funds improves liquidity for investors.

Equities

Equities delivered through managed portfolios offer advantages compared with equity managed funds. They are available in a variety of styles (index, value, growth, core, ESG focused).

Four ways investment managers build managed portfolios

1. Managed funds and ETFs

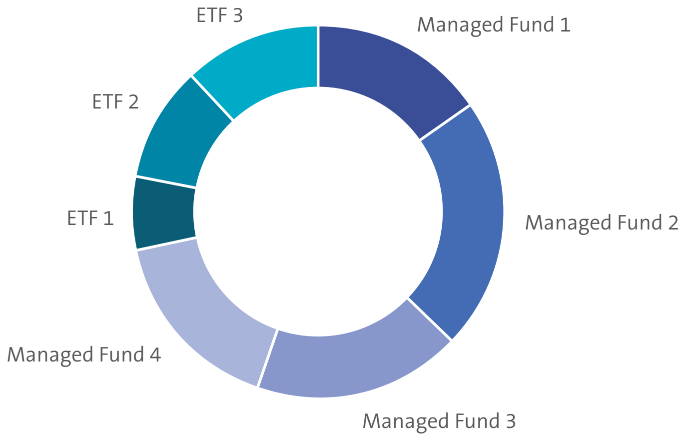
Investment managers can use listed investment products like ETFs and managed funds to build outstanding client solutions.

Managed funds are typically used as the core exposure for most asset classes, particularly those more difficult to access, such as bonds or alternatives. Including an allocation to a variable asset allocation product also enables a degree of active management of the asset allocation to be embedded into a portfolio.

Where small balances are involved, a managed fund may be simpler and avoid an excessively concentrated equity holding. One of the benefits of also holding a small allocation to ETFs is that they can be used for rebalancing and re-positioning the portfolio to implement a simple and quick asset allocation change. In addition, often it will be cheaper to trade an ETF to rebalance a portfolio of managed funds rather than crossing the buy/sell spread on a fund. Though this won't always be the case, and total costs should always be examined on a case-by-case basis.

This more efficient way of implementing active asset allocation with ETFs, enables the client to access more granular opportunities than can be achieved by simply increasing or decreasing the weighting of funds in their portfolio.

Diversified portfolio: Managed funds and ETFs



For illustrative purposes only.

Case study: Morgan Stanley

Our open architecture and rigorous selection process help drive the right outcomes for clients. Our four pillar investment approach starts with well-established asset allocation principles to reduce risk and help ensure client outcomes are within their expectations. We focus on macroeconomic and market conditions to tilt towards where we have conviction and decide whether active or passive management is suitable. We seek to identify 'best of breed' fund managers who can generate alpha and deliver value for money. Our proprietary risk models are supported by institutional grade tools to help manage portfolio risks.

The end result is a portfolio that delivers risk and return outcomes consistent with client expectations. Everybody has different needs and our approach caters for an expected range of outcomes.

> "Including an alternatives strategy with a variable asset allocation is an efficient way to incorporate active management of a managed portfolio's asset allocation. ETFs can be a very useful tool in rebalancing a portfolio. Managed funds, equities and ETFs can complement each other in portfolios."

Pendal

2. Sleeve or nested equities

Within a diversified portfolio, an investment manager may select Australian equities directly, rather than via managed funds. While trading equities directly can increase concentration risk, they can also provide benefits such as:

- lower overall cost by removing a layer of costs
- greater transparency and more timely communication
- more tax benefits
- flexibility to tailor Australian equity exposure towards specific needs, requirements and risk profiles.

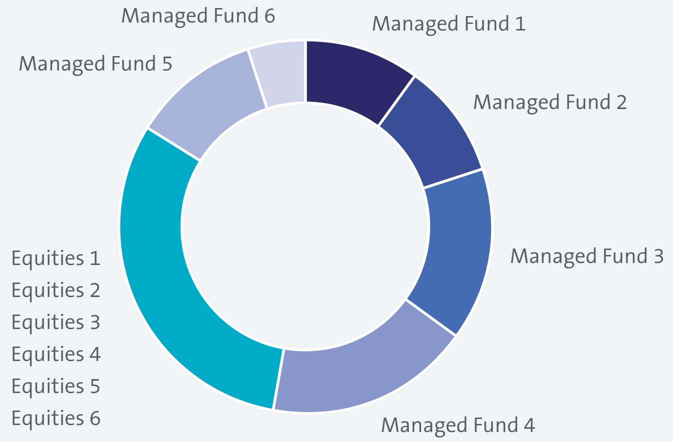
There are two main approaches to building these managed portfolios.

Sleeve

Managers can gain exposure to equities by holding a sleeve of equities. More defensive, lower risk equities can be included for conservative investors as part of a multi-asset managed portfolio built with managed funds.

A defensive investor may also have a preference for higher income, dividend yielding equities held as a portfolio sleeve. They can also design a sleeve of higher risk, high growth equities for investors with greater risk tolerance.

Diversified portfolio: Managed funds and sleeve of equities



For illustrative purposes only.

> A sleeve of directly held Australian equities combined with dedicated small-cap managers provides clients with the benefit of greater transparency, tax efficiency and reduced cost combined with active management in an area of the market where managers have demonstrated an ability to add value. This also allows us to provide more insightful and timely communication to both advisers and clients.

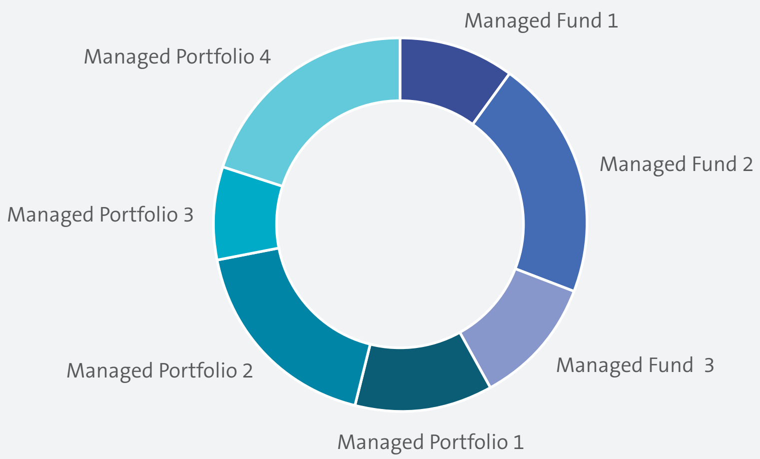
InvestSense

Nested

Managers can gain exposure to an asset class by nesting another managed portfolio within their portfolio. This example shows a diversified portfolio consisting of a number of managed funds and the use of an Australian equities managed portfolio.

Success depends not only on how effectively managers can select equities and construct portfolios but also on how they source value-adding research and manage portfolios.

Diversified portfolio: Managed funds and nested managed portfolios

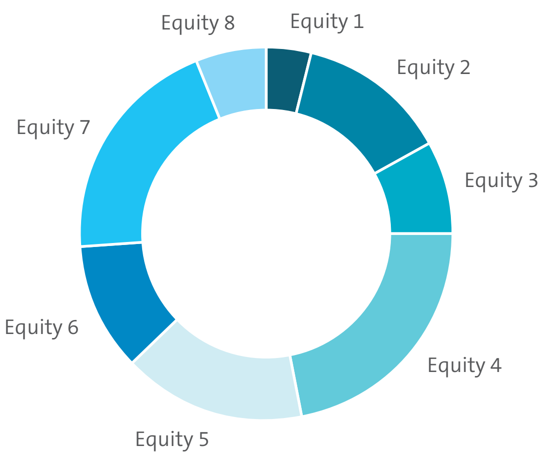


For illustrative purposes only.

3. Equities

We appoint investment managers to build managed portfolios using equities. We explore why you may look to leverage a professional manager for this capability in the 'Why outsource equities management' section of this paper.

Single sector portfolio: Equities



Here's how Blackmore Capital does it

We adopt a benchmark-unaware approach based on fundamental company and industry analysis. While the composition of the benchmark isn't a factor in equities selection, it does influence position size. We also integrate ESG in our analysis.

At the core of our investment philosophy is the belief that a high-quality business should achieve consistent earnings and generate attractive returns through the investment cycle. We believe we can identify quality businesses and purchase them with a margin of safety to generate attractive returns for investors.

We blend quality at a reasonable price, value and growth strategies to create a balanced mix of return and risks. With up to 30 equities, portfolios are relatively concentrated and while style-neutral they are biased towards quality and large caps. The portfolios are expected to show lower volatility, providing resilience in down markets.

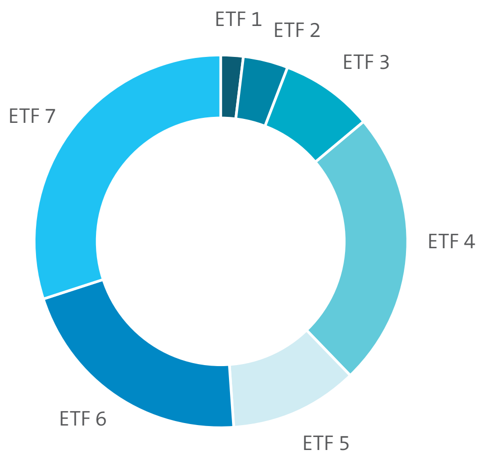
4. ETFs

Investment managers can use ETFs to build diversified portfolios with different risk profiles. They are simple to access, liquid, low cost, transparent, and offer exposure to a diverse range of asset classes and strategies. Long-term strategic asset allocation can be implemented through the use of ETFs.

ETFs are also useful for short-term adjustments to the portfolios as investment managers can easily tilt portfolios towards or away from asset classes, regions, styles or sectors as a more efficient alternative to trading individual securities or holdings.

Investment managers skilled at identifying trends can use thematic ETFs to implement their view. For example, if they believe there is more opportunity for outperformance in the US over the Australia they may invest in a US equity ETF to overweight their portfolio to the US equity market.

Single sector portfolio: ETFs



For illustrative purposes only.

Here's how BetaShares create their ETF portfolios.

BetaShares use this approach for its Dynamic Asset Allocation (DAA) Managed Portfolios as it allows us to construct multi-asset and investor profile-based portfolios that are cost-effective, highly diversified, transparent, and simple to explain to clients. Our approach also incorporates DAA allowing us to tilt asset classes to seek to either generate additional returns or manage downside risk.

The advantage of utilising ETFs for the strategy selection include low cost, transparent and more effective exposures for asset classes. Importantly also is the utilisation of some ETFs with 'smart beta' index methodologies. These aim to deliver outperformance outcomes vs both traditional indices and active managers.

How advisers can blend managed portfolios

Managed portfolios aren't tailored to individual clients. They are built to respond to the 'typical' client with a specific risk profile or goal.

As their adviser, you're best placed to take into account your client's needs across all their assets. These might include existing holdings, which affect the characteristics of the overall portfolio, individual tax considerations or ESG options.

Here are three examples of the ways you could blend equity managed portfolios to meet their needs.

High alpha blend

For clients who can tolerate higher risk and volatility, you could combine two managed portfolios with a high conviction approach focused on quality companies.

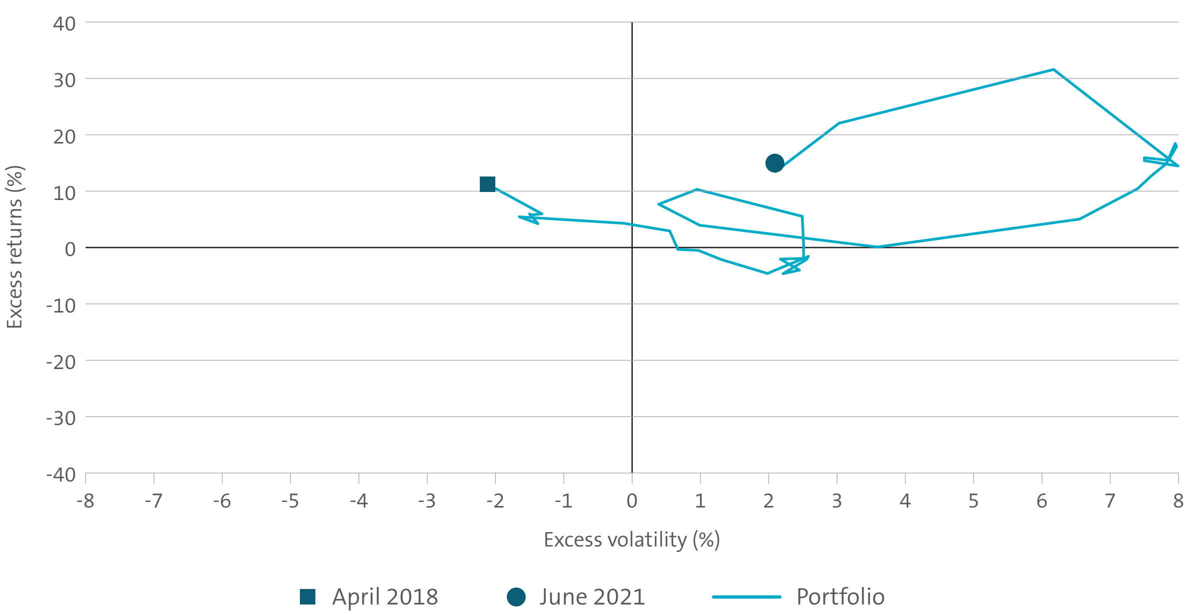
- The **DNR Capital Australian Equities High Conviction Portfolio** is style agnostic with a quality bias and aims to outperform the S&P/ASX 200 Accumulation Index by 4% pa over a rolling three-year period. It holds between 15–30 equities.
- The **Quest Australian Equities Ex-20 Portfolio** is a concentrated strategy with a bias to lower market capitalised stocks and aims to outperform the Ex-20 Index (S&P/ASX 300 Accumulation Index excluding the S&P/ASX 20 Accumulation Index). It holds between 20–40 equities.

While their approaches have some common features, the two managers employ different processes to select equities, resulting in a combined portfolio with little overlap. The combination of different investment styles can lead to more consistent performance results across various market conditions.

The combined portfolio has strongly outperformed the ASX 200 Index. Over three years, excess return net of fees was 7.5%, while in the 12 months to June 2021, it was 15%.

In the graph below we show some of the metrics of the combined portfolio based on equal weighting to each portfolio.[7] The tracking error is quite high, ranging between 4 and 11%, confirming the combined portfolio has a very different mix of equities than the ASX 200 Index. This isn't surprising as both managers have a highly concentrated, benchmark unaware approach.

High alpha blend snail trail
1 year rolling period vs S&P/ASX 200 TR Index AUD

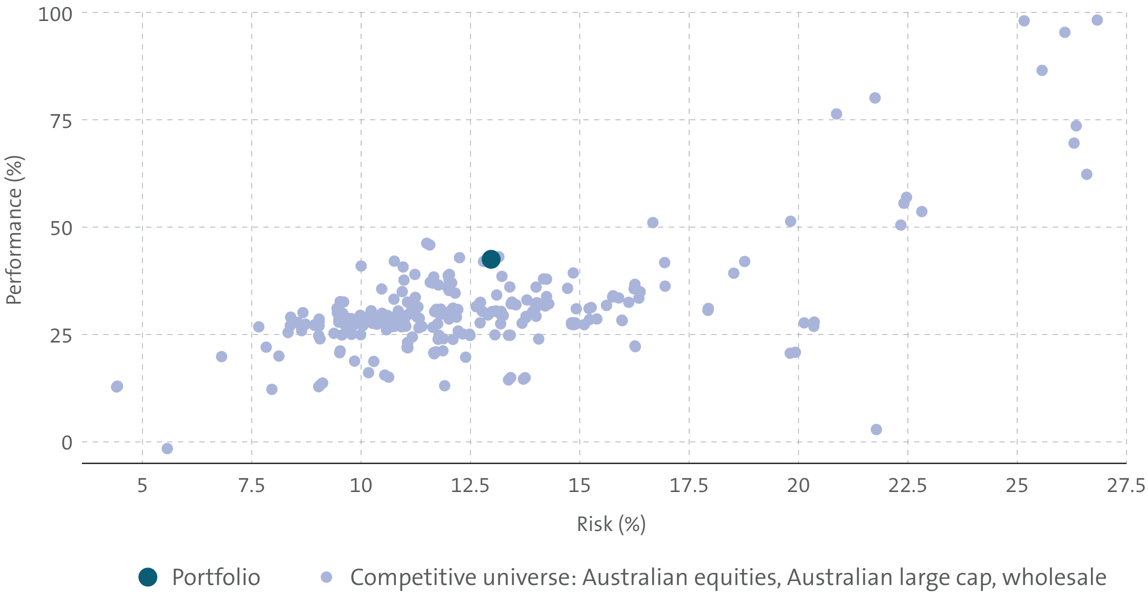


Source: Lonsec iRate powered by FE Analytics. Report generated 29 July 2021. Past performance is not a reliable indicator of future performance. Returns shown are gross of fees, costs and expenses.

7 Due to data availability, actual returns data has been used for the Quest Australian Equities Ex-20 Portfolio.

The snail trail which measures the portfolio's risk and return over time shows the combined portfolio has generally higher volatility compared to the index (culminating at excess volatility approaching 8%). This is consistent with the managers' active, benchmark unaware approach. The graph below shows the portfolio has generated higher returns compared with most similar investments, while taking on higher risk.

High alpha blend risk/return
June 2021: 1 year risk/return



Source: Lonsec iRate powered by FE Analytics. Report generated 29 July 2021. Past performance is not a reliable indicator of future performance. Returns shown are gross of fees, costs and expenses.

Income focused blend

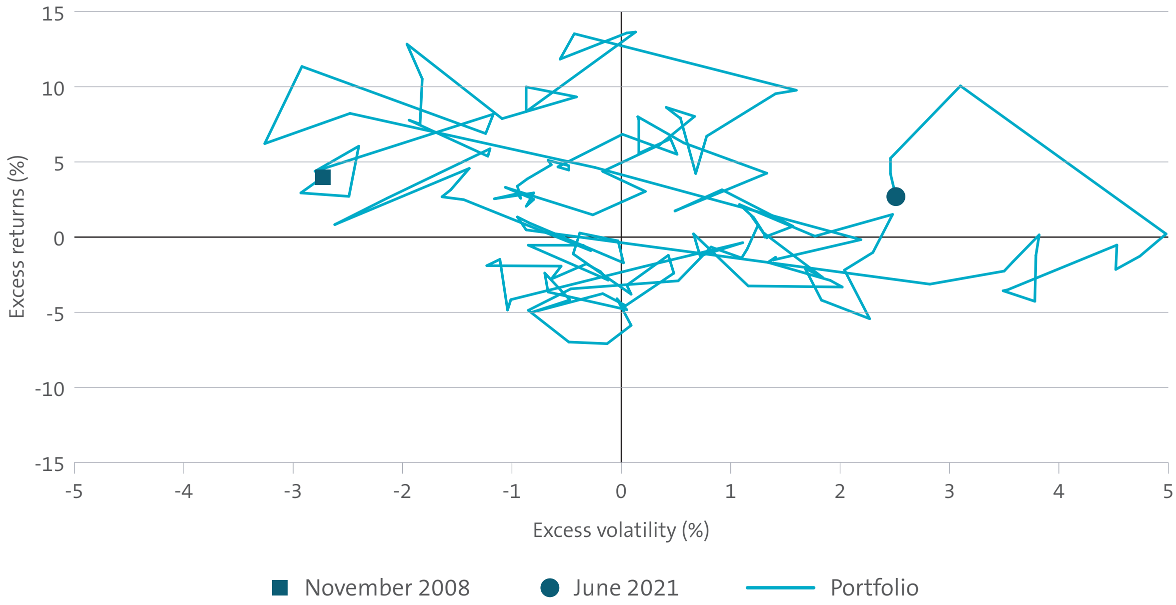
For income focused clients targeting higher dividends, you could combine two managed portfolios with different income strategies.

- The **Macquarie Income Australian Equity Managed Portfolio** is an income/value strategy with a quality focus which aims to outperform the S&P/ASX 200 Industrials Accumulation Index over the economic cycle and provide above market levels of tax-effective income (via franked dividends), with lower volatility than the broader Australian equity market. It aims to hold between 25 to 35 equities.
- The **DNR Capital Australian Equities Income Portfolio** is an income strategy with a quality focus which aims to generate outperformance vs the S&P/ASX 200 Industrials Accumulation Index and deliver higher levels of income over a rolling three-year period. It holds between 15–30 equities.

In the graph over the page, we show some of the metrics of the combined portfolio based on equal weighting to each managed portfolio.[8]

8 Due to data availability, actual returns data has been used for the Macquarie Income Australian Equity Managed Portfolio.

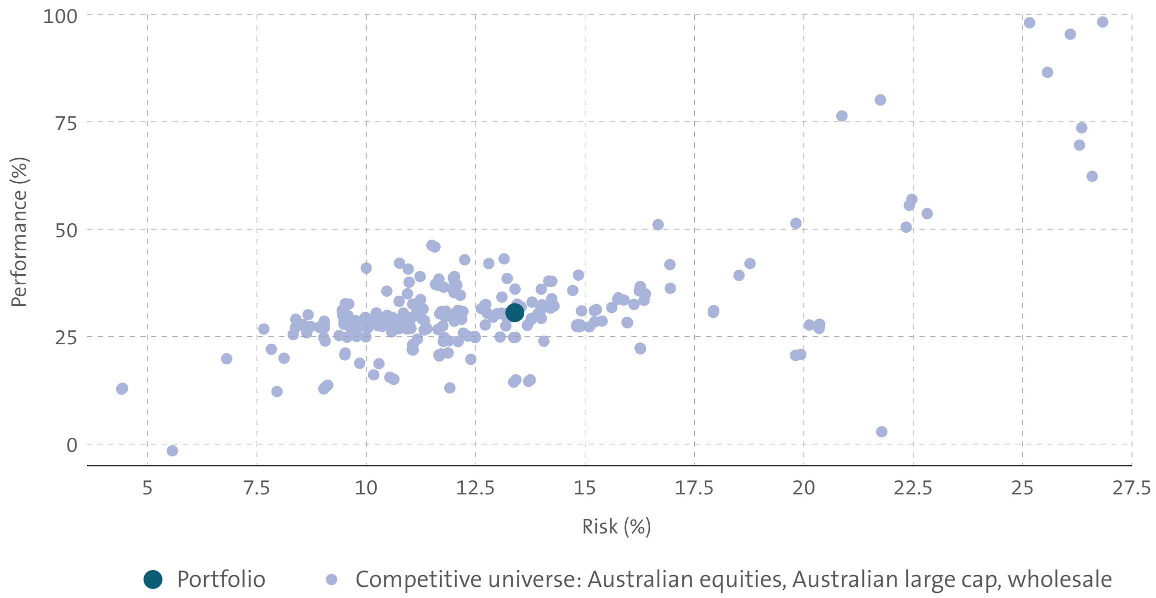
Income focused blend snail trail
1 year rolling period vs S&P/ASX 200 TR Index AUD



Source: Lonsec iRate powered by FE Analytics. Report generated 29 July 2021. Past performance is not a reliable indicator of future performance. Returns shown are gross of fees, costs and expenses.

The snail trail, while quite dispersed around the centre doesn't show a strong bias with regards to volatility relative to the index. It has moved within the volatility differential range of -3.5% to +5%. Importantly, the snail trail has been largely located in the top quadrants of the graph signifying positive excess returns.

Income focused blend risk/return
June 2021: 1 year risk/return



Source: Lonsec iRate powered by FE Analytics. Report generated 29 July 2021. Past performance is not a reliable indicator of future performance. Returns shown are gross of fees, costs and expenses.

The portfolio has delivered competitive returns, compared to the universe of similar investments, over all time periods since 2016 without taking excess risks.

The blended income portfolio would have had a dividend yield (ex-franking) of approximately 4.5% compared to the ASX 200 index of 3.7%.

Index top 20 plus Ex-20 blend[9]

For clients focused on generating strong performance while considering cost, you could combine an index, low-cost strategy for the ASX top 20 equities with an active strategy focused on the Ex-20 universe of equities.

- The **UBS ASX 20 Index Portfolio** is an indexed strategy which aims to fully replicate the ASX 20 Accumulation Index. The portfolio will typically have very small equity and sector variation from the index and a corresponding low tracking error.
- The **First Sentier Ex-20 Australian Share Portfolio** is a high conviction strategy with a bottom-up quality, growth bias that aims to outperform the S&P/ASX 300 Accumulation Index excluding the S&P/ASX 20 Accumulation Index over rolling three year periods with tracking error expected to be between 3% to 10%.

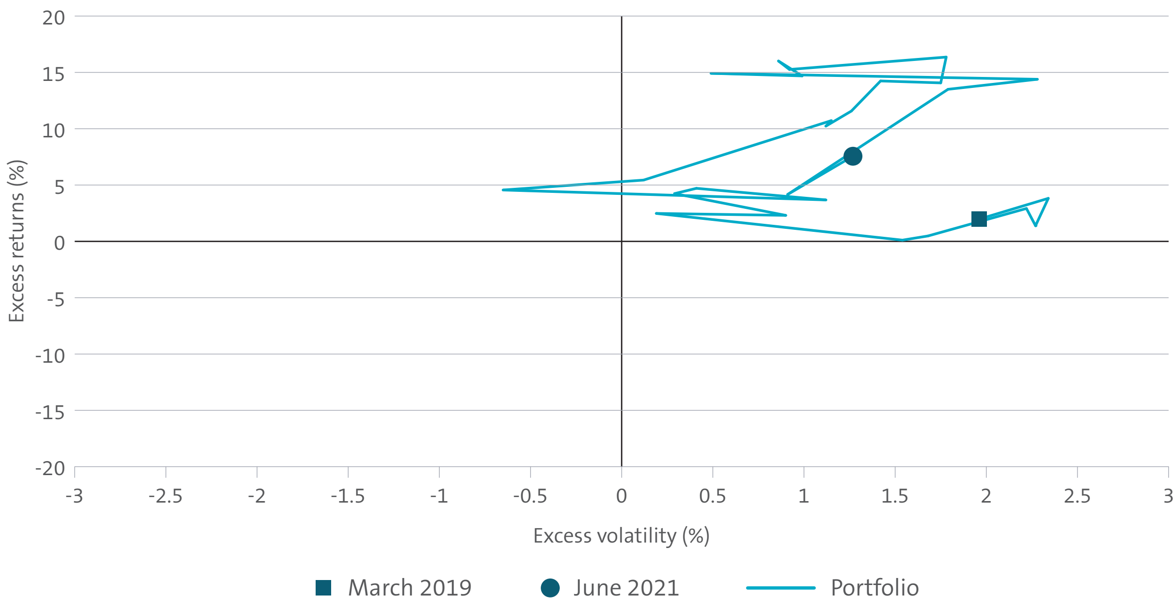
It is well understood that it can be challenging to add value through equity selection in the large cap market. The 20 largest ASX-listed equities account for almost 50% of the Australia's equity market capitalisation, they are highly liquid and well researched. Hence employing an active approach in this market segment and paying high fees may not be rewarded with positive excess returns. Equities outside the top 20 tend to provide a much more fertile ground for generating attractive risk adjusted returns.

In the graph below, we show some of the metrics of the combined portfolio based on equal weighting to each portfolio. We note that the majority of variation in the relative risk and return statistics of the combined portfolio is driven by the First Sentier Ex-20 Australian Share portfolio.

The snail trail is more compact compared to the two previous combinations, not deviating too far from the index on each side. The line has mainly resided in the top right-hand quadrant signifying higher volatility relative to the ASX 200 Index (up to 2.5%). The scale of the excess volatility axis for this combination is markedly smaller compared to the previous two combinations.

Index top 20 plus Ex-20 blend snail trail

1 year rolling period vs S&P/ASX 200 TR Index AUD

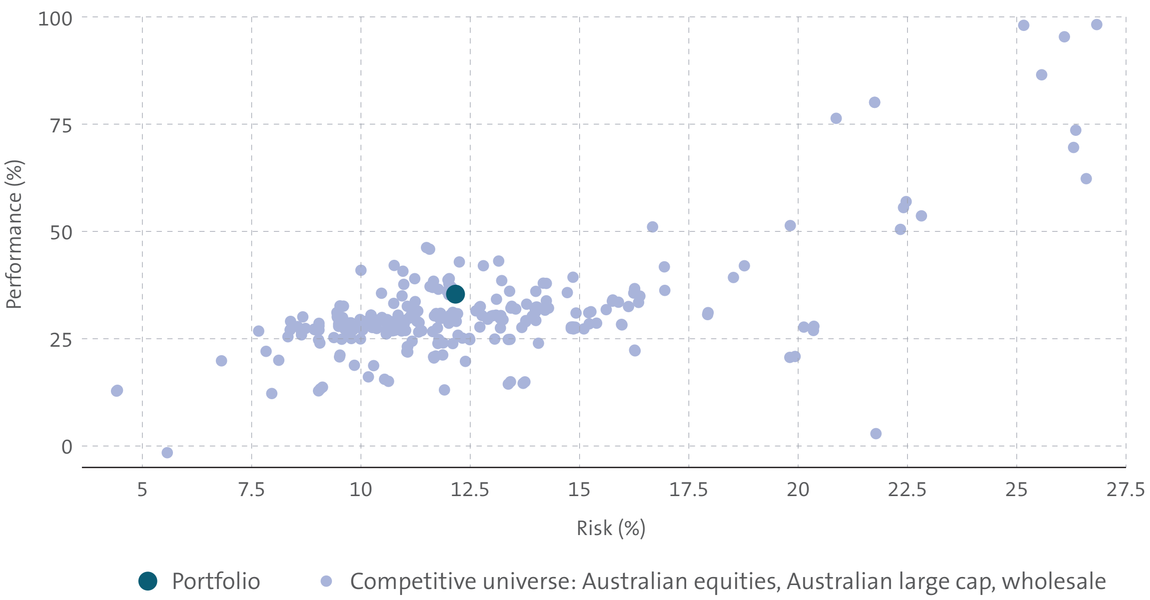


Source: Lonsec iRate powered by FE Analytics. Report generated 29 July 2021. Past performance is not a reliable indicator of future performance. Returns shown are gross of fees, costs and expenses.

The portfolio has delivered high excess returns over the 12 months to June 2021 time period. On a risk/return chart, the portfolio sits in the high return/average risk area of the diagram.

9 Due to data availability, the Index top 20 portfolio used in these graphs is indicative only and may differ from the UBS ASX 20 Index Portfolio.

Index top 20 plus Ex-20 blend risk/return
June 2021: 1 year risk/return



Source: Lonsec iRate powered by FE Analytics. Report generated 29 July 2021. Past performance is not a reliable indicator of future performance. Returns shown are gross of fees, costs and expenses.

When you're blending managed portfolios, you can use tools such as Lonsec iRate and the Morningstar Portfolio X-Ray to illustrate your recommendations.

Why outsource equities management?

Implementing investment recommendations is critical to achieving the best outcomes for your clients. But it has also been associated with many operational and investment recommendation errors. The cost of fixing issues can be substantial in both compensation and lost time.

Managed portfolios can mitigate this risk in four key ways:

- Transactions are executed centrally and in bulk, greatly **reducing the risk** of delays or loss of market positions.
- Transaction **responsibility is transferred** from the adviser to the North specialised trading team where several pre-trade compliance checks are completed and reviewed before any trades are processed. The teams confirm that the proposed weights comply with the respective mandates and that the proposed weights match the instructions provided by the Investment Manager to ensure risk is minimised.
- Reduced client interactions mean fewer steps in the advice process and **more time to spend with clients** discussing their strategic goals.
- **Responsibility for elective corporate actions**, one of the major sources of error, is handed to the investment manager.

Why is it so important to get equities right?

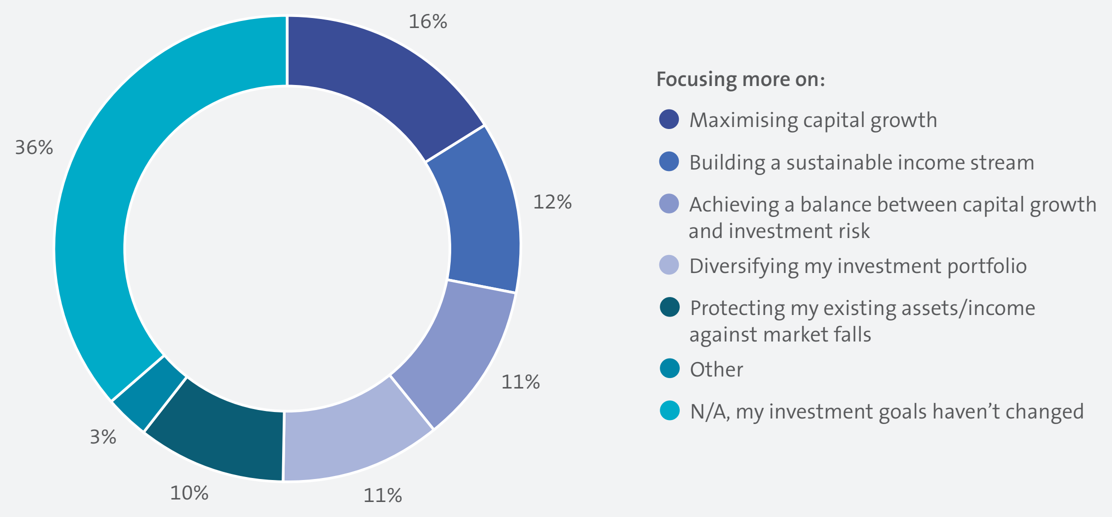
> “Despite a proliferation of investment options, the enduring appeal of property, and the growing proportion of household wealth tied up in residential property, directly owned shares remain a popular option for Australians seeking to build wealth for the future.”

ASX Australian Investor Study 2020

Investors value equities...

Australian equities are the most widely held asset class, owned by 58% of investors.[10] As you can see in the graph below, following the COVID volatility, building a sustainable income stream was a common goal for investors.

Investment goals in the wake of COVID-19
How have your investment goals changed in the last three months (March–May 2020)? (Investors)



Source: ASX Australian Investor Study 2020. Data from May 2020.

10 ASX Australian Investor Study 2020.

...but can struggle to do it themselves

While the demand for Australian equities is high, for many investors it's tough to set themselves up for success. Many Australian investors struggle with the mechanics of investing.

- How do I pick the best companies?
- How do I generate an income?
- What if losses are more than I expect?
- Is my portfolio 'diversified' so spreading the risk?
- How do I monitor my investments?
- How much will trading equities cost?

As their adviser, clients may look to you for guidance. But many advisers prefer to let a professional investment manager choose equities for a number of reasons.

Focus

Your first responsibility is to understand your clients' goals and circumstances. This is a full-time job with a large client base and leaves little time for in-depth equity analysis.

Specialist knowledge

With a huge universe of investments on the ASX, it can be hard to stay well informed. Investment managers have the skills and capacity—for example, First Sentier Investors, one of the MyNorth Managed Portfolio investment managers has eight investment professionals researching just the top 190 ASX equities.

Corporate actions

These can create significant work and risk. An investment manager can deal with corporate actions, supported by the North specialised trading team.

Distance

It's often an advantage to be one step removed from choosing equities so you're better able to engage with your clients on strategy rather than needing to justify each buy or sell decision.

Implementation on North

For many advisers, a MyNorth managed portfolio could be an efficient way of holding Australian equities that clients recognise, managed by experts.

North is an efficient, flexible and automated trading platform that can help you achieve the best outcome for your clients. Whether your clients' investments are held directly via an individual HIN or within a managed portfolio via an omnibus HIN, North supports both models.

Under an individual HIN:

- buy and sell assets simultaneously
- trade listed securities immediately.

Under an omnibus HIN:

- trades are aggregated with others submitted on the same day and netted off when processed
- typically lower trade costs.

The North platform technology enables managed portfolios to be quickly updated in accordance with the views of the investment manager so you can spend more time with your clients on their goals.

How managed portfolios can help you meet your clients' needs

Meeting your Best Interests Duty (BID) obligations

A recommendation to a client to invest using a managed portfolio has to comply with all the standard regulatory requirements for providing personal advice including:

– providing a Statement of Advice (SoA) which addresses product replacement (where relevant)
– complying with the duty to act in the client's best interests in relation to the advice (the Best Interests Duty or BID)
– providing the advice only if it would be reasonable to conclude the advice is appropriate to the client, assuming the Best Interests Duty has been complied with
– warning the client if the personal advice is based on incomplete or inaccurate information
– managing conflicts and placing the interests of the client ahead of any interests of the adviser or related parties
– addressing the requirements of the design and distribution obligations (DDO) regime.

Here's a brief summary of how MyNorth Managed Portfolios may help you comply with your Best Interests Duty. This isn't a full analysis and it's still important to consult your licensee's compliance team.

Statement of Advice and BID obligations

An SoA which recommends a managed portfolio needs to comply with the Corporations Act and ASIC Regulatory Guide RG175. When preparing SoAs, advisers need to comply with their BID obligations. When ASIC assesses compliance with the BID, ASIC will consider whether a reasonable advice provider would believe the client is likely to be in a better position if the client follows the advice.

The Corporations Act provides a 'safe harbour' standard that you can rely on to prove you've complied with the BID, by showing you've taken the steps in section 961B(2) of the Corporations Act (**Safe Harbour standard**). When you're providing personal advice, you'll need to follow the steps set out in the Safe Harbour standard to ensure the advice is complete, appropriate and compliant. A number of these steps relate directly to a decision to recommend a particular investment such as a managed portfolio.

> Relevantly, you need to have identified:
> *the objectives, financial situation and needs of the client that would reasonably be considered as relevant to advice sought on that subject matter (**the client's relevant circumstances**)*[11]

Set out below are questions that may help you identify matters that may reasonably be considered relevant to a recommendation to invest in a managed portfolio.

10 questions you should ask before recommending a managed portfolio to a client

1. **Are their investment goals likely to be met?**
   If they need a certain income, or they have an accumulation target over time, is the managed portfolio likely to meet that goal?

2. **Is their risk tolerance consistent with the potential volatility of the managed portfolio?**
   Taken together with any other investments you recommend, the client should understand and accept the potential falls and rises in the value of their managed portfolio.

3. **Is their investment time frame consistent with that of the managed portfolio?**
   Each managed portfolio has a suggested minimum investment time frame. This needs to be consistent with the client's investment horizon.

4. **Are they looking for experts to make portfolio decisions?**
   Is the client seeking a service which draws on the expertise of others?

5. **Do they have a preference for a particular investment approach, such as environmental, social or governance (ESG)?**
   Some managed portfolios are designed to cater for specific investment approaches aligning to preferences that may be held by the client.

11 *Corporations Act 2001, Section 961B(2).*

6. **Do they want their portfolio to adjust quickly when markets are volatile?**
   This is a key benefit of managed portfolios.

7. **Are they willing to delegate decisions?**
   If they want to be involved in every decision, a managed portfolio probably won't suit.

8. **Are they concerned about tax or would they prefer to receive franking credits directly?**
   A managed portfolio could help avoid any disadvantage from embedded tax positions in unit trusts.

9. **Would they prefer to hold ASX-listed securities or equities directly?**
   Holding ASX-listed equities through a managed portfolio could suit if they have experience as a direct investor or a preference for companies they recognise.

10. **Are they concerned about the cost of investing?**
    An active managed portfolio could cost more than an index-based portfolio, although the increasing popularity of managed portfolios has helped to lower their overall cost through increased competition and greater market scale.

If you recommend a managed portfolio as a replacement for any existing investments of your client, you should have a reasonable belief your client is likely to be in a better position if they adopt your recommendation. This could be for a number of reasons, including:

- The managed portfolio more closely aligns to the client's investment objectives, financial situation and needs.
- The managed portfolio offers greater flexibility to structure their investment portfolio.
- The managed portfolio includes investments that are:
  - more highly rated by research houses,
  - expected to have stronger, less volatile performance, or
  - lower cost.
- The managed portfolio offers the ability to hold ASX-listed investments directly.

You'll need to make sure your client understands the key features of the recommended managed portfolio, including what the investment manager is entitled to do on their behalf. They'll also need to understand the potential tax consequences, fees and costs and other consequences of the recommended changes.

You should also consider if there are cost savings or increases, taking into account all circumstances including replacement costs and any fees you might receive, and whether these are likely to override any benefits. The SoA should also include a summary of the costs and benefits of replacing any existing investment.

For example, if you recommend an equity managed portfolio to replace Australian equities they hold directly, you should provide a comparison of fees and costs. You must have a reasonable belief, and the client must understand, that the managed portfolio is likely to serve their needs better and ultimately put them in a better position.

Your DDO obligations: a brief guide

Under the DDO regime, issuers of certain financial products need to issue a target market determination (TMD) covering the target market, distribution, review and monitoring of the product.

DDO requirements generally apply to advisers when they provide financial advice about managed portfolios through a super fund or IDPS.

- You need to reasonably believe (after making all reasonable inquiries) that either a TMD is in place or is not required for a product before engaging in distribution conduct in relation to the product (which includes giving a disclosure document or providing advice about the product), unless you're providing personal advice.
- You must also take reasonable steps that will, or are reasonably likely to, result in distribution being consistent with the most recent TMD, unless you're providing personal advice.
- If you become aware of a significant dealing which is inconsistent with the TMD, you need to let the issuer know as soon as practicable (and by no later than 10 business days). This obligation applies even if you're providing personal advice or engaging in conduct associated with such advice.
- You also need to keep a complete and accurate record of distribution information, such as the number of complaints, and report this to the product issuer.

Les McGuire

Future Proof Wealth

Les is a financial adviser working with clients all over Australia with his head office in Ballina, NSW. He has almost 100 clients in MyNorth Managed Portfolios, mostly in Zenith Essentials.

Les believes client best interests are paramount. To achieve this objective, having reasonable costs and active management in a portfolio is critical and these portfolios have proven to be a successful choice through periods of market volatility.

Les' philosophy is "Educate, don't sell" and his advice process with new clients is to spend the first meeting conducting an in-depth fact find explaining basic investment concepts. Depending on the experience and previous investment knowledge a client has will help shape the content of the initial conversation. It is important all information is explained in a language a client can understand. At this time, it is critical that a client is not overwhelmed, and embraces the experience to learn and understand the process. "The fact-find discussion takes a long time to do properly, for us to get to know each other," he says.

"The other thing we spend time on is helping clients understand how investments actually operate. This includes the role of active and passive management, the trade-offs between cost and the potential for above-market investment returns."

It's important that clients understand the risks of investing and the mechanics of the investments in their portfolio—the differences between managed funds, managed portfolios and direct investing. "I've used portfolios managed directly by managers such as DNR and make a point of explaining the differences between all types of investments including direct, managed portfolios managed funds, ETFs or the other structures available," Les says.

> "I make sure clients understand the role of the investment manager—that they can move investments as they feel appropriate into or out of the portfolio without reference to me or to them. We make sure clients understand the risks of manager selection as well as market movement."

Understanding a client's goals is key to good, personalised advice. To determine the best investment vehicle is often determined from the client's preferences. To best understand what features a client prefers we take them through a list of various features and explain the purpose of each to ensure that they make a conscious educated decision. Clients often express a preference for one investment feature or another. "I ask them what they like about it. I'm not there to sell them a particular solution, I'm trying to find out from them why it seems relevant."

This enables Les to maintain comprehensive file notes from the meeting. "There's no guarantee these investments will outperform. We make sure they know that, and we record we've discussed this risk."

"We never talk about product at this first appointment—the role of that meeting is to uncover a client's goals and help them understand investment concepts. It's not until we present the Statement of Advice (SoA) that we deal with specific products. By this time, they understand the basic product structure and they know it's right for them."

Helping clients understand their portfolios is an important part of building their confidence. "Because I make sure they take away materials about the investments we've discussed, they often reread those and come back to the SoA meeting with specific questions."

In summary, Les believes clients can benefit from active management by experts. "We could be going into a very difficult market and clients will need professional management to navigate that, to find specific investment opportunities."

MyNorth Managed Portfolios investment menu

Managed portfolios may not be suitable for every client but for advisers looking for this investment structure, the breadth of managed portfolio solutions available through MyNorth allows increased flexibility to tailor an investment strategy to meet the unique needs of your client.

Whether it's younger clients with lower balances or retired clients looking for income, we've designed our investment menu to cater for their needs.

We offer all of the below types of managed portfolios:

- Global equities (broad based)
- Responsible investments
- Low-cost portfolios
- Multi-asset class
- Sector specific equities
- Australian equities
- Income-orientated portfolios
- Property
- Infrastructure
- Retirement-orientated equities
- Goals-based/outcome-oriented

About IMAP

The Institute of Managed Account Professionals Ltd assists advisers, licensees, investment managers, managed account providers and others to implement managed portfolios as part of their retail advice services.

IMAP's mission is:

'Education, Information and Representation of Managed Account Professionals'.

IMAP offers annual conferences which focus on advice, portfolio management and technology as well as a series of investment forums and webinars.

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A guide to managed portfolios

PART 2

AMP Capital

About the investment manager

AMP Capital is a global investment manager based in Australia. As part of the AMP group, they share a heritage that spans almost 170 years. Their home strength in Australia and New Zealand has enabled them to grow internationally, and today they have operations established in the Middle East, China, Hong Kong, India, Ireland, Japan, Luxembourg, Singapore, the United Kingdom and the United States.

Their asset class specialists, investment strategists and economists work together with the aim of delivering strong investment outcomes for clients and as at 31 March 2021 they had invested over A$52.9 billion in real estate and infrastructure assets.

Investment philosophy

AMP Capital believes that successful investment in global real estate securities requires a fluid, globally integrated approach utilising local expertise to identify attractive investment opportunities.

This philosophy centres on the belief that real estate securities supported by a sustainable business model and quality assets and, run by experienced and capable management, will outperform over the long term.

Successful property investment requires a rigorous and disciplined investment approach. AMP Capital believe successful global real estate investments require local expertise in order to anticipate trends and changing market conditions. By situating regional teams in local markets, they are better positioned to predict trends and changing market conditions.

In the short term, AMP Capital believe that the performance of real estate securities is driven by the 'marginal pricer' – the primary market participants driving the equity price at a point in time. They believe that the marginal pricer of an equity differs not only at any point in time but is also different between points in time. As a particular marginal pricer may use a different valuation technique to other investors in the market, this can lead to mispricings between regions, countries, sectors and equities.

The investment approach allows for the flexibility in choosing which valuation technique is appropriate to capture the impact of the marginal pricer today, as well as the key turning points as to when the marginal pricer changes. Further, they believe that risk is asymmetric, frequently geometric and needs to be captured at every stage of the investment process. As a result, they have implemented an end to end, systematic risk management approach.

Portfolio summary

	AMP Capital High Conviction Listed Real Estate Portfolio
North code	NTH0200
Asset class	Australian listed real estate
Investment style	Quality
Investment universe	Australian listed real estate equities
Investment objective	To deliver a total return (income and capital growth) after costs and before tax, above the benchmark on a rolling three-year basis.
Managed portfolio benchmark	S&P/ASX 200 A-REIT Accumulation Index
Minimum investment horizon	5 years
Minimum investment amount	$25,000
Indicative number of assets	12–30
Investment management fee (pa of the portfolio balance)	0.50%
Estimated investment performance fee (pa of the portfolio balance)	0.23% Calculated as a percentage of the outperformance of the managed portfolio compared to that of the benchmark selected for the portfolio over a quarterly period.

	AMP Capital High Conviction Listed Real Estate Portfolio
Portfolio income	Paid to cash account
Target growth/defensive exposure	99%/1%
Maximum cash holding	20%
Expected turnover (pa)	~25%

Portfolio construction

The investment process at AMP Capital involves every listed security being assessed and scored with a three stage bottom-up process of:

1. **Quality Score (Q)**

   This summarises the qualitative assessment of a company's fundamentals and dictates the potential active bands the manager would apply in portfolio construction.

2. **Volatility Scores (+V and -V)**

   An assessment of the factors affecting the volatility of the company.

3. **Warranted Total Return (WTR) Score (W Score)**

   The score considers the warranted total return expectation of a security derived from the valuation method which considers but is not limited to metrics across the balance sheet, cash flow, profit and loss and real estate specific indicators.

Then a top-down review is conducted through the Regional Strategy packs that bring the bottom up and top down together. AMP Capital believe this aligns well with an investor looking for a long-term real estate investment approach using local experts embedded deep into each market.

Portfolio construction is implicit in the entire investment process. The output of both fundamental bottom-up research as well as top-down macroeconomic research is used not only to identify and rank suitable investments but as a tool in determining the securities weight in the portfolio.

Case study

Goodman Group are a fully integrated global logistics property group that own, develop and manage industrial real estate in 17 countries including logistics and industrial facilities, warehouses and business parks. They have a clear focus on investing and developing high quality industrial properties in strategic locations, close to large urban populations and in major gateway cities globally, where demand is strong for E-commerce. Their own, develop and manage model is an integrated customer service offering which is at the heart of their business. They continue to be positively impacted by structural changes of online sales growth.

Investment highlights

- Delivered an operating profit of A$614.9 million, up 16% on the previous half year results.
- External AUM up 6% to A$48.5 billion, with total AUM up 5% to A$51.8 billion.
- Development workbook of A$8.4 billion; focus on high barrier to entry markets in urban areas.
- Significant liquidity and balance sheet capacity with headline gearing at 4.8% and look-through gearing at 16.6%.
- A$2.3 billion of available liquidity, A$1.3 billion in cash (with additional liquidity of A$19 billion in Partnerships).
- Awarded 'Sector Leader' for their respective peer groups in the 2018 Global Real Estate Sustainability Benchmark (GRESB).

BetaShares

About the investment manager

BetaShares is an Exchange Traded Fund (ETF) and Managed Portfolios specialist Australian fund manager. Founded in 2009, their aim is to provide intelligent investment solutions to help Australian investors meet their financial objectives.

With over 60 products, they currently offer the broadest range of exchange traded products in the market and had over A$21 billion in AUM at 20 September 2021.

Investment philosophy

BetaShares provides Australian investors with products that are tailored to their investment objectives and optimised for Australian market conditions. To do so, the BetaShares Managed Portfolios investment philosophy follows six key pillars:

1. Passive asset class exposure

Due to market efficiency, it is generally hard to achieve enhanced risk-adjusted returns beyond the ‘beta’ return of an asset class through active security section. As such, the models use passive or rules-based exposure to different asset classes.

2. Strategic asset allocation foundation

Asset classes are not perfectly correlated and have distinct risk and return characteristics. As such, risk and return can be optimised for specific investor risk profiles through a blending of exposures to different asset classes.

3. ETF focus

Due to their high levels of diversification, transparency and low cost, the most effective way of gaining asset class exposure is though passively managed ETFs.

4. Beta or ‘smart beta’

Passive or rules-based exposure to asset classes need not always imply ‘market cap’ or ‘liability’ weighting of securities. In some cases, there may be a role for alternate rules-based security weighting strategies – often termed ‘smart beta’ – where these appear to offer better risk-adjusted returns.

5. ‘Best of breed’ ETF selection

BetaShares is open to the use of external ETFs, ie a ‘best of breed’ approach to instrument selection, where deemed appropriate by the model manager.

6. Dynamic asset allocation overlay

Due to investor biases, asset classes can be subject to often significant mispricing over time. As such, dynamic asset allocation – or tilting asset class exposures relative to their strategic benchmarks – offer the opportunity for enhanced risk-adjusted portfolio returns over time.

Portfolio summary

	BetaShares Dynamic ETF Managed Portfolio Conservative	BetaShares Dynamic ETF Managed Portfolio Moderate	BetaShares Dynamic ETF Managed Portfolio Balanced	BetaShares Dynamic ETF Managed Portfolio Growth	BetaShares Dynamic ETF Managed Portfolio High Growth
North code	NTH0201	NTH0202	NTH0203	NTH0204	NTH0205
Asset class	Diversified	Diversified	Diversified	Diversified	Diversified
Investment style	Conservative	Moderate	Balanced	Growth	High growth
Investment universe	Exchange traded funds	Exchange traded funds	Exchange traded funds	Exchange traded funds	Exchange traded funds
Investment objective	Aims to match or outperform the benchmark return over a rolling three-year period.	Aims to match or outperform the benchmark return over a rolling four-year period.	Aims to match or outperform the benchmark return over a rolling five-year period.	Aims to match or outperform the benchmark return over a rolling seven-year period.	Aims to match or outperform the benchmark return over a rolling seven-year period.
Managed portfolio benchmark	Morningstar Australia Conservative Target Allocation NR AUD	Morningstar Australia Moderate Target Allocation NR AUD	Morningstar Australia Balanced Target Allocation NR AUD	Morningstar Australia Growth Target Allocation NR AUD	Morningstar Australia Aggressive Target Allocation NR AUD
Minimum investment horizon	3 years	4 years	5 years	7 years	7 years
Minimum investment amount	$500	$500	$500	$500	$500
Indicative number of assets	Approximately 7–11	Approximately 7–11	Approximately 7–11	Approximately 6–10	Approximately 4–9
Investment management fee (pa of the portfolio balance)	0.21%	0.21%	0.21%	0.21%	0.21%
Total estimated indirect costs (pa of the portfolio)	0.20%	0.19%	0.19%	0.18%	0.17%
Portfolio income	Paid to cash account	Paid to cash account	Paid to cash account	Paid to cash account	Paid to cash account
Target growth/defensive exposure	20/80	35/65	50/50	70/30	90/10

Portfolio construction

The investment process is built on seven steps, which all add incremental value to the final product:

1. **Asset class forecasts**

   BetaShares develop an expected 10-year forecast performance on asset classes, grouped as: Cash, Australian and International Bonds, Equities and Listed Property and Gold.

2. **Risk assessments**

   Once completed, a matrix is developed which places the asset classes by standard deviation and correlation.

3. **Portfolio optimisation (SAA)**

   The asset class weights are determined based on the prior analysis.

4. **DAA asset class tilts are determined**

   Using the approved SAA weightings as a base, the team utilises these weights to determine Dynamic Asset Allocation (DAA) tilt opportunities. A key element of the manager's DAA framework is the decision on whether to be over/underweight growth assets. BetaShares' strategy is based on the fact that equity markets are volatile, and attempts to reduce risk in the face of frequent market pull backs/corrections is unlikely to add value.

5. **BetaShares Investment Committee reviews DAA tilts**

   Determine if tilt is appropriate based on deviation from the SAA.

6. **ETP selection**

   BetaShares use their understanding and expertise to select ETPs considering characteristics such as tracking error, liquidity and fees.

7. **Ongoing review and monitoring**

   Necessary risk analysis reviews completed.

Case study

BetaShares' DAA portfolios managed portfolios seek to achieve capital growth and income streams though a careful blending of asset classes all using a range of cost-effective, transparent, 'best of breed' exchange traded funds. Value is added from DAA, both generating alpha and managing downside risk, utilisation of some smart beta methodologies across both fixed income and equities and lastly from the comprehensive adviser service and reporting capabilities.

Blackmore Capital

BLACKMORE CAPITAL
EQUITY INVESTORS

About the investment manager

Founded in October 2017, Blackmore Capital is a boutique offering with institutional rigour and an investment centric culture. Winner of IMAP's Australian Equities award in 2020, they have over A$1 billion in FUM as at May 2021 across the two actively managed Australian equity portfolios. The Melbourne based team credit their extensive research-based travel program and expert networks as the key drivers behind the depth of industry knowledge they have amassed.

Investment philosophy

Blackmore Capital's investment approach aims to deliver long-term, risk adjusted returns by investing in companies that are focused on generating earnings of high quality and operate in industries that exhibit favourable long-term prospects. Critical to their investment philosophy is the consideration of seven core components of assessment: earnings quality, industry, balance sheet, management and board, ESG, valuation and portfolio construction.

Through an iterative process of company and industry engagement they look to find catalysts to generate value or identify red flags which could destroy future value. The investment process encourages gathering knowledge and understanding from many sources. The process ensures that they stay focused on medium and long-term fundamentals and within their circle of competence. The investment discipline and independent analysis gathered from a wide range of sources provide insights that have enduring value.

The core of their belief is that a high-quality business should display consistency of earnings, exhibit an ability to maintain returns, possess a strong balance sheet, have large potential market opportunity, adopt sound corporate governance and be available for purchase below their estimated intrinsic value.

Portfolio summary

	Blackmore Capital Blended Australian Equities Portfolio	Blackmore Capital Australian Equities Income Portfolio
North code	NTH0206	NTH0207
Asset class	Australian equities	Australian equities
Investment style	Blackmore Capital's investment process descriptor incorporates a blended approach including value, growth and quality at reasonable price. In distilling the descriptors of value, growth and quality at a reasonable price they incorporate a bottom-up approach that is benchmark unaware but primarily focused on large capitalisation equities.	
Investment universe	ASX-listed equities	ASX-listed equities
Investment objective	To deliver long-term capital appreciation by investing in Australian listed equities. The portfolio aims to do so with lower volatility and greater downside protection relative to the benchmark.	To deliver long-term growth in both capital and income by investing in Australian listed equities. The portfolio aims to do so with lower volatility and greater downside protection relative to the benchmark.
Managed portfolio benchmark	S&P/ASX 200 Accumulation Index	S&P/ASX 200 Accumulation Index
Minimum investment horizon	5 years	5 years
Minimum investment amount	$25,000	$25,000
Indicative number of assets	20–40	20–40
Investment management fee (pa of the Portfolio balance)	0.61%	0.61%
Portfolio Income	Reinvested	Reinvested

	Blackmore Capital Blended Australian Equities Portfolio	Blackmore Capital Australian Equities Income Portfolio
Target growth/ defensive exposure	99%/1%	99%/1%
Minimum single asset position	1%	1%
Grossed up dividend yield	N/A	3.52%
Maximum cash holding	25%	25%
Expected turnover (pa)	25%	25%
Expected tracking error (pa)	4.0–4.5%	4.0–4.5%

Portfolio construction

Blackmore Capital's portfolios are constructed by relying heavily on fundamental company and industry research. They identify the attributes of earnings quality, balance sheet latency, sustainability of returns, industry position and opportunity, focused management in alignment with the Board's strategic direction and a valuation that is fair and provides a margin of safety.

The portfolio weighting ascribed to a company is determined by a risk/reward equation. For example, as risk is reduced due to the observed improvement in the performance, they state that "we aim to build on our position. In addition, as reward improves due to declining valuation we will consider buying more. Conversely, if the balance sheet or earnings quality deteriorates, we will consider divesting our position".

Case study

May 2021 | Portfolio change | Increasing CSL Limited (CSL)

Blackmore Capital saw an opportunity in CSL. CSL's underperformance relative to the benchmark has been dramatic over this period, weighed down by depressed plasma collections due to COVID-19 disruptions in its largest market in the US. Plasma disruptions have led to declines of collections of ~20% in FY 21, however, recent data suggests that foot traffic in CSL's US plasma collections has risen materially in recent weeks supported by the successful rollout of the COVID-19 vaccine.

CSL's supply of plasma is also being supported by increasing donor fees by ~30% and the opening of new collection centres to ensure that adequate supply is reaching patient demand. Overall, a recovery in plasma supply should provide greater confidence that CSL's earnings are well positioned to rebound by FY 23. Given nascent signs of improved operating conditions coupled with a depressed equity price Blackmore Capital added to the position in CSL.

DNR Capital

About the investment manager

Founded in 2001, DNR Capital is an Australian investment management company that delivers client-focused, quality investment solutions to institutions, advisers and individual investors.

It is a pioneer in the delivery of individually and separately managed accounts in the Australian market and aims to deliver investment out performance to investors.

DNR Capital is a signatory to the Principles for Responsible Investment (PRI).

Investment philosophy

DNR Capital believe a focus on quality companies will enhance returns when it is combined with a thorough valuation overlay. They seek to identify these quality companies that are mispriced by overlaying a quality filter, 'Quality Web', with a strong valuation discipline.

They define quality companies as being those companies with the following five attributes:

1. **Earnings strength (particularly improving return).**
2. **Superior industry position.**
3. **A sound balance sheet.**
4. **Strong management.**
5. **Low environmental, social and governance (ESG) risk.**

The DNR Capital Australian Equities Income Portfolio also has a preference for companies that have heightened and sustainable dividend capability, strong profit to cash conversion, and assured earnings growth. Companies that generate franking credits predominate.

The portfolios have a style neutral investment style. The equity selection process has a strong bottom-up discipline and focuses on buying quality companies at reasonable prices. Where DNR Capital are satisfied that a company possesses quality characteristics, then it is eligible for inclusion in the portfolio. However, it must also represent value and sit comfortably within the portfolio construction framework. A range of valuation methodologies are used depending on the nature of the company being assessed to identify mispriced opportunities.

Portfolio summary

	DNR Capital Australian Equities High Conviction Portfolio	DNR Capital Australian Equities Income Portfolio
North code	NTH0208	NTH0209
Asset class	Australian equities	Australian equities
Investment style	Style neutral with a quality focus	Style neutral with a quality focus
Investment universe	ASX-listed equities	ASX-listed equities
Investment objective	To deliver outperformance of the benchmark by 4% pa over a rolling three-year period.	To deliver outperformance of the benchmark and deliver higher levels of income relative to the benchmark over a rolling three-year period.
Managed portfolio benchmark	S&P/ASX 200 Accumulation Index	S&P/ASX 200 Industrials Accumulation Index
Minimum investment horizon	3–5 years	3–5 years
Minimum investment amount	$25,000	$25,000
Indicative number of assets	15–30	15–30
Investment management fee (pa of the portfolio balance)	0.80%	0.80%
Portfolio Income	Reinvested	Reinvested
Target growth/defensive exposure	99%/1%	99%/1%
Minimum single asset position	1%	1%

	DNR Capital Australian Equities High Conviction Portfolio	DNR Capital Australian Equities Income Portfolio
Maximum cash holding	20%	20%
Expected turnover (pa)	20–40%	30–60%
Expected tracking error (pa)	4–6%	4–6%

Portfolio Construction

The DNR Capital four stage investment process is outlined below.

STAGE ONE: Liquidity filter

STAGE TWO: Idea generation and quantitative screen

– Quantitative and quality screening
– Further ideas are generated via a program of company visits, communication with industry experts and top down opportunities.

STAGE THREE: Equity research

Phase 1 – 'Quality Web' assessment

– Industry structure
– Balance sheet
– Earnings
– Strength of management
– ESG review
– Income stability/growth (applied for the DNR Capital Australian Equities Income Portfolio)

Phase 2 – Fundamental bottom-up valuation and investment thesis

STAGE FOUR: Portfolio construction and management

Recommended equities considered given:

– top-down considerations
– portfolio characteristics
– equity and sector correlation analysis
– after-tax consideration
– monthly investment committee oversight.

Portfolio management

– Conclusions constantly retested
– Sell decisions based on:
  – reach target valuation
  – deterioration of quality characteristics/ investment thesis.

Case study: Portfolio Holding – Qube Holdings (October 2021)

Qube is a quality company, led by a visionary management team that has a very good track record of capital allocation. DNR Capital believe the market is currently underestimating the likelihood of more contract wins, investment opportunities and acquisitions. In addition, its balance sheet strength and healthy franking credit balance, should allow capital management, which is not being considered by the market. Whilst Qube trades on a lofty FY 22e PE this does not accurately reflect the earnings contribution from its Patrick investment and excludes the potential deployment of latent balance sheet capacity. Qube's underlying dividend yield is ~2% pa (plus full franking benefits) however we expect double-digit growth over the next 3–5 years.

Qube meets DNR Capital's quality web:

Industry strength: Qube is the largest integrated third party container logistics provider in Australia and provides a diverse range of integrated port services, bulk material handling and bulk haulage.

Earnings strength: Qube has good earnings visibility underpinned by take-or-pay contracts with robust counter parties and its strong competitive position, reflecting its innovative, competitively priced, quality logistics solutions.

Balance sheet: Post completion of Moorebank sale Qube is expected to be in a net cash position and will have balance sheet capacity to deploy into M&A opportunities and/or capital management.

Dividend sustainability and growth: Qube's underlying dividend yield is ~2% pa (fully franked), however we expect double-digit growth over the next 3–5 years. In addition, we estimate Qube will have excess franking balances that would allow it to complete an off-market buyback.

Management: Qube has a highly experienced management team with significant industry expertise and a strong track record of strategic vision and operational excellence in extracting efficiencies and maximising asset utilisation.

Environment, Social and Governance (ESG): Qube has low-risk from an ESG perspective.

First Sentier Investors

About the investment manager

Since inception in 1988, First Sentier Investors have evolved into a global fund manager with a client base that extends across Asia, Australia, Europe and North America. They invest more than A$241 billion on behalf of their clients globally, as at 30 June 2021. First Sentier Investors are a stand-alone asset management business, offering a comprehensive suite of investment capabilities across a number of asset classes. All of their investment teams – whether in-house or individually branded – operate with discrete investment autonomy, according to their investment philosophies.

Investment philosophy

The Australian Equities team's focus is fundamental, bottom-up investing with earnings growth and a return on capital focus. Their investment philosophy is based on the belief that growing companies, which generate consistent returns and can reinvest above their cost of capital, provide the best investment returns over the long run. They also keenly seek to analyse and forecast changes in company return on invested capital as catalysts for buy and sell decisions as this strongly influences valuations. The investment process is designed to deliver outperformance through the full investment cycle.

The team believe they have the resources to employ a 'full coverage' approach in their research process, covering more than 190 ASX-listed equities in detail. Their investment ideas come from bespoke fundamental research into industry dynamics, company analysis and discounted cash flow (DCF) valuation modelling. This analysis is enhanced through a comprehensive company visitation and engagement program, which also supports and incorporates their assessment of ESG risks and opportunities. The team's long-term investment horizon and focus on quality, growth companies fundamentally requires sustainability in business models and practices and is inherently well suited to strong ESG outcomes.

Portfolio summary

	First Sentier Investors Ex-20 Australian Share Portfolio
North code	NTH0210
Asset class	Australian equities
Investment style	Bottom-up, fundamental equity selection with a focus towards high growth and high-quality companies.
Investment universe	ASX-listed equities
Investment objective	To deliver higher long-term capital growth with some income by investing in the broader set of Australian companies in the S&P/ASX 300 Accumulation Index, but outside the S&P/ASX 20 Accumulation Index. The Portfolio aims to outperform the benchmark over rolling three-year periods.
Managed portfolio benchmark	S&P/ASX 300 Accumulation Index excluding S&P/ASX 20 Accumulation Index
Minimum investment horizon	7 years
Minimum investment amount	$25,000
Indicative number of assets	20–40
Investment management fee (pa of the portfolio balance)	0.75%
Portfolio income	Paid to cash account
Target growth/defensive exposure	99%/1%
Minimum single asset position	>0.5%
Maximum cash holding	4%
Expected turnover (pa)	40% to 80%
Expected tracking error (pa)	3–10%

Portfolio construction

Analysts provide an equal distribution of equity recommendations between each of the five buckets (Strong Buy/ Buy/ Hold/ Sell/ Strong Sell) relative to their universe of coverage rather than a benchmark. This approach seeks to extract the analyst's best ideas, independently of a equity's index weighting, which ensures a greater conviction of calls. In addition to the analyst's recommendation that is primarily driven by their DCF price target, the portfolio manager may take into consideration other factors in determining an equity's active weight, including:

– the strength of the investment view
– the interrelationship among different companies within the portfolio
– ESG risks and opportunities
– macro risk factors
– sectoral considerations where appropriate
– risk and active weight limits.

The key factors that may prompt First Sentier Investors to reduce or exit a position include a change in the analyst's recommendation, driven by:

– The price target being reached or exceeded. They typically would gradually reduce an equity's portfolio weight as it approaches its target price.
– A negative shift in the earnings, return and/or quality of a company.
– Company diversification into areas outside its core competency or unexpected dilution in returns.
– Management deterioration or operational targets not being met.

The decision on when and whether to sell is ultimately the responsibility of the portfolio manager.

Case study

First Sentier Investors Australian Equities Growth Team built a position in ALS Limited in late April as they were positive on the company's long-term growth prospects driven by organic and acquisitive expansion into the global Food and Pharmaceutical testing industries. By diversifying into these Life Sciences markets (now >50% of group revenue), the team believe ALS will offer greater consistency of earnings compared to its historical performance. They also have a positive outlook for ALS' commodities business, which is leveraged to the gold exploration cycle, as recent indicators suggest the cycle could be sustained for 3–4 more years. As a result, they expect the business will achieve double-digit earnings growth and increasing Return on Invested Capital (ROIC) over the next few years. The investment in ALS has been positive so far after the company reported a high-quality and strong earnings update in late May. First Sentier Investors Australian Equities Growth Team remain attracted to the business prospects and medium-term strategy, hence they continue to hold the position as at the date of publish.

Macquarie Investment Management Global Limited

MACQUARIE

About the investment manager

Macquarie Investment Management Global Limited (MIM) delivers a full-service offering across a range of asset classes to both institutional and retail clients predominately in Australia and the US. As at 31 March 2021, MIM had approximately A$367.1 billion in AUM.

The Macquarie Systematic Investments team is responsible for the management of the Australian equity managed portfolios. The team consists of 15 experienced investment professionals and has over 19 years' experience in managing managed portfolios. These Australian equity managed portfolios have received ongoing recognition in the industry with the Macquarie Australian Small Companies Managed Portfolio winning the IMAP Australian Equities Small Cap award for the past four years in a row.[12]

Investment philosophy

The investment philosophy for MIM's Australian equity managed portfolios is based on the premise that asset prices respond to the dynamic tension between company fundamentals and investor sentiment. As a result, the team holds four key beliefs on how to outperform the Australian market:

1. Typical human behaviour leads to biases that can be exploited

Investors are flawed because of their use of cognitive shortcuts. These shortcuts can lead to incorrect decision-making from an investment perspective when actions are taken that are contrary to those suggested by long-term statistical probabilities.

2. Biases can be systematically captured and combined in a portfolio to deliver a specific investment outcome

MIM considers its role as investment manager to:

- identify the biases eg cheap equities outperform
- measure the biases eg how much do value equities outperform by?
- express them in a portfolio ie positioning of the equity in the portfolio.

3. Ongoing research is required to understand changing investor motivations and behaviours, ensuring the strategy remains current

Markets are constantly changing as are investor behaviours. The way that the team captures these alpha sources therefore needs to evolve through time.

4. Systematic strategies are best implemented with awareness of market conditions

Proprietary quantitative models can provide a roadmap to navigating markets. Portfolio managers are required to determine the probability and degree of model success across varying market conditions.

To implement their investment philosophy, the team rely on a systematic process to exploit opportunities using a number of quantitative and event driven investment strategies within a style neutral portfolio construction framework.

12 The Macquarie Australian Small Companies Managed Portfolio won the IMAP Australian Equities Small Cap Award in 2018, 2019, 2020 and 2021.

Portfolio summary

	Macquarie Core Australian Equity Managed Portfolio	Macquarie Australian Small Companies Managed Portfolio	Macquarie Income Australian Equity Managed Portfolio	Macquarie Growth Ex-20 Australian Equity Managed Portfolio
North code	NTH0211	NTH0212	NTH0213	NTH0214
Asset class	Australian equities	Australian equities	Australian equities	Australian equities
Investment style	Style neutral	Style neutral	Income/Value	Style neutral
Investment universe	ASX-listed equities	ASX-listed equities	ASX-listed equities	ASX-listed equities
Investment objective	To outperform the benchmark over a rolling five-year period.	To outperform the benchmark over the medium to longer term. It aims to provide capital growth and some income.	To outperform the benchmark over the economic cycle and to provide above market levels of tax-effective income (via franked dividends), with lower volatility than the broader Australian equity market.	To outperform the benchmark over a rolling five-year period.
Managed portfolio benchmark	S&P/ASX 200 Accumulation Index	S&P/ASX Small Ordinaries Accumulation Index	S&P/ASX 200 Industrials Accumulation Index	S&P/ASX 300 Accumulation Index excluding the S&P/ASX 20 Accumulation Index
Minimum investment horizon	5 years	5 years	5 years	5 years
Minimum investment amount	$25,000	$25,000	$25,000	$25,000
Indicative number of assets	25–35	25–35	25–35	25–35
Investment management fee (pa of the portfolio balance)	0.61%	0.61%	0.61%	0.61%
Estimated investment performance fee (pa of the portfolio balance)		0.64% Calculated as a percentage of the outperformance of the managed portfolio compared to that of the benchmark selected for the portfolio over a quarterly period.		0.64% Calculated as a percentage of the outperformance of the managed portfolio compared to that of the benchmark selected for the portfolio over a quarterly period.
Portfolio Income	Reinvested	Reinvested	Reinvested	Reinvested
Target growth/ defensive exposure	99%/1%	99%/1%	99%/1%	99%/1%
Minimum single asset position	1%	1%	1%	2%
Grossed up dividend yield			5.3%	
Maximum cash holding	5%	10%	5%	5%
Expected turnover (pa)	40–50%	50–70%	40–50%	40–50%
Expected tracking error (pa)	2–3%	4–5%	2–3%	4–5%

Portfolio construction

The investment approach is based on using quantitative techniques to capture desirable equity characteristics in a robust portfolio framework. The drivers that are incorporated in the investment process are grouped into three factor families: Quality, Sentiment and Value. In essence, the portfolios aim to hold higher quality companies, with solid earnings momentum at a reasonable valuation. The team's research has shown that companies with these characteristics typically outperform in the Australian market.

An investment manager overlay is also applied, linking the managed portfolios to current market conditions, recognising that there are situations or events that may not be captured using a systematic process. The approach takes advantage of a broad range of investment themes to drive performance, whilst aiming to minimise any unwanted risks, producing a robust and well-diversified portfolio.

Macquarie Income Australian Equity Managed Portfolio

In addition to the above process, the Income managed portfolio also incorporates a proprietary grossed-up dividend yield score ranking process which seeks to identify companies offering an attractive grossed-up dividend yield, ideally with growth.

Macquarie Growth Ex-20 Australian Equity Managed Portfolio

The Growth Ex-20 managed portfolio follows the same framework as the large cap managed portfolios. However, it strips out companies that reside within the ASX 20 and uses that capital to:

- hold larger positions in high conviction growth companies; and
- incorporate select sustainable growth companies from the Ex-20 universe and the Macquarie Small Companies universe.

Case study

Global miner BHP Ltd (BHP) scores well across the three key metrics, being: Quality, Value, and Sentiment and as such is currently held as an overweight in the Macquarie Core Australian Equity Managed Portfolio.

- **Quality**: BHP holds a number of diversified, long-life, Tier 1 assets. Consistent production. Strong balance sheet and free cash flow.
- **Sentiment:** BHP has benefitted from improving commodity prices which has driven improving earnings and share price momentum.
- **Value:** BHP scores well based on its strong, free cash flow yield.

This is not a recommendation to buy, sell or hold any equity. The example is illustrative only and may not be held in any of the managed portfolios at the time of reading.

Morgan Stanley

About the investment manager

Morgan Stanley is a global investment bank founded in 1935 which operates today in 42 countries. Morgan Stanley Wealth Management Australia leverages the institutional research and wealth management research of the global investment bank to construct managed portfolios that fuse global insight with local perspective to address the needs of Australian investors. Morgan Stanley Wealth Management Australia is focused on offering quality investment options that are delivered with an unwavering commitment to client service. This has culminated in the team being awarded winner of the Licensee Managed Account and Multi Asset categories of the 2021 IMAP Managed Account awards and a finalist in the Innovation category..

Investment philosophy

Morgan Stanley's investment philosophy prizes flexibility, adaptability and dynamism. They believe that changing markets require a willingness to challenge even strongly-held views when evidence demands it. Morgan Stanley's overarching objective is to optimise risk-adjusted returns through the cycle. They are flexible in their approach to achieving this objective but always maintain conviction in the decisions they take and strategies they employ.

The investment process is built on four pillars, which all add incremental value to the final product.

1. Asset allocation

Morgan Stanley firmly believes strategic asset allocation (SAA) is the most important determinant of portfolio performance over the long term and, as a result, dedicate a significant amount of intellectual capital to the process. To capitalise on shorter-term opportunities they leverage tactical asset allocation (TAA) to add additional value.

2. Active and passive

They consider whether market conditions are conducive for active management to outperform in order to determine the right mix of active and passive investment styles to optimise fees.

3. Manager selection

Three complementary quantitative tools are applied to the process of manager selection. Fundamental analysis is used to interpret the results from these tools and assess other risks that are difficult to discover though data analysis alone. The range of fundamental factors considered are aggregated into six categories: business, people, product, process effectiveness, portfolio and risk management, and performance.

4. Portfolio construction and risk management

Portfolios are constructed and monitored using their proprietary tools and validated with third party systems.

Portfolio summary

	Morgan Stanley Wealth Management MAPS(i) Core Conservative Portfolio	Morgan Stanley Wealth Management MAPS Core Balanced Portfolio	Morgan Stanley Wealth Management MAPS Core Growth Portfolio
North code	NTH0215	NTH0216	NTH0217
Asset class	Diversified	Diversified	Diversified
Investment style	Neutral	Neutral	Neutral
Investment universe	Managed funds and exchange traded funds	Managed funds and exchange traded funds	Managed funds and exchange traded funds
Investment objective	Aims to outperform its benchmark over a rolling seven-year period.		
Managed portfolio benchmark	Morningstar Australia Fund Multisector Conservative Category Average	Morningstar Australia Fund Multisector Balanced Category Average	Morningstar Australia Fund Multisector Aggressive Category Average
Minimum investment horizon	7 years	7 years	7 years

	Morgan Stanley Wealth Management MAPS[(i)] Core Conservative Portfolio	Morgan Stanley Wealth Management MAPS Core Balanced Portfolio	Morgan Stanley Wealth Management MAPS Core Growth Portfolio
Minimum investment amount	$500	$500	$500
Indicative number of assets	15–35	15–35	15–35
Investment management fee (pa of the portfolio balance)	0.33%	0.33%	0.33%
Total estimated indirect costs (pa of the portfolio balance)	0.39%	0.49%	0.61%
Portfolio income	Reinvested	Reinvested	Reinvested
Target growth/defensive exposure	20/80	60/40	90/10
Minimum single asset position	0.50%	0.50%	0.50%
Maximum cash holding	30%	20%	15%
Expected turnover (pa)	50%	50%	50%
Expected tracking error (pa)	1–3%	1–3%	1–3%

(i) MAPS stands for Multi-Asset Portfolio Solutions.

Portfolio construction

The portfolio construction process considers all the factors in the investment process to determine the optimal portfolio.

A range of quantitative and technical indicators, macro and market factors and fundamental research drive the TAA views that inform the buy/sell decisions. Each active view is then implemented against the SAA. Each allocation is then determined by the relative return expectations of the asset class against the asset class benchmark over the defined time horizon and conviction in the analysis.

Case study

Morgan Stanley's investment philosophy principles of flexibility, adaptability and dynamism are illustrated by the following case study during the COVID-19 market crisis.

During 2020, they made 14 changes to the Core Growth Model to reflect Morgan Stanley's global research views. In early February, they observed Chinese power consumption was not rebounding post the Chinese New Year holidays and that this wasn't reflected in market expectations. As such, they reduced equities and built up cash to reduce risk from the portfolios. By March, they observed that the monetary policy responses from major central banks was sufficient to remove the firm's worst case scenario so they began to build up their equity exposure again. By June, the firm recognised that the rapid fiscal response from major governments was likely going to result in a 'V-shaped' economic rebound. From the low in March, they continued to reduce cash, added to equities and rotated to credit within their fixed income allocation. The actions taken resulted in the Core Growth Model returning 5.8% in 2020 versus the S&P/ASX 200 Accumulation Index which returned 1.4% and the Morningstar Australia Fund Multisector Aggressive Category Average which returned 1.8%.[13]

13 Past performance is not indicative of future performance.

Pendal

PENDAL

About the investment manager

Pendal follows a 'multi-boutique' business model, where teams of investment professionals focus on asset management while distribution, compliance, business and general management functions are delivered centrally. Fund managers operate in a boutique environment where they maintain full autonomy over their investment approaches and share in the economic value that they create for clients, combined with the strength of a significant institution with a strong operational platform. Pendal started offering managed portfolios in 2007 and as at 30 June 2021 manage over A$107 billion in assets for their clients.

Investment philosophy

Pendal's investment approach is based on three beliefs:

1. **A style-neutral (or 'core') approach maximises opportunities.**

   Pendal believe that any equity has the ability to outperform given the right circumstances. The portfolios include a broad range of ideas, so that performance is not hostage to a small number of sectors, styles or thematic drivers. The large team, which covers the ASX 100 and a significant proportion of the ASX Small Ordinaries, is informed by this principle.

2. **Excess returns are generated from anticipating change in a company's level or earnings.**

   The fundamental research focuses on anticipating change – either in earnings or the quality of earnings (which is reflected in the market's rating – or valuation – of an equity). They isolate specific investment triggers which underpin their thesis. This makes the investment case transparent, ensures they remain focused on the key issues, and guards against thesis creep.

3. **Portfolio construction reflects the risk they are paid to take.**

   Pendal consider that their investment edge lies in company-level insight. They build portfolios that are driven by this insight – that is, primarily by equity-specific risk – rather than style, sector or thematic exposures. They believe that this equity-driven construction will deliver a more consistent performance profile through the cycle than style-based strategies.

Portfolio summary

	Pendal Australian Share Portfolio	Pendal Sustainable Future Australian Share Portfolio
North code	NTH0218	NTH0219
Asset class	Australian equities	Australian equities
Investments style	Bottom-up, fundamental, core style	Bottom-up, fundamental, core style
Investment universe	ASX-listed equities	ASX-listed equities
Investment objective	To outperform the benchmark over a rolling three-year period.	To deliver outperformance relative to the benchmark over a rolling five-year period by investing in companies which Pendal has identified as having leading financial, ethical and sustainability characteristics.
Managed portfolio benchmark	S&P/ASX 300 Accumulation Index	S&P/ASX 300 Accumulation Index
Minimum investment horizon	5 years	5 years
Minimum investment amount	$25,000	$25,000
Indicative number of assets	15–35	20–40
Investment management fee (pa of the portfolio balance)	0.63%	0.63%
Portfolio income	Paid to cash	Paid to cash

	Pendal Australian Share Portfolio	Pendal Sustainable Future Australian Share Portfolio
Target growth/defensive exposure	99%/1%	99%/1%
Minimum single asset position	1%	1%
Maximum cash holding	10%	5%
Expected turnover (pa)	30–70%	30–70%
Expected tracking error (pa)	2–6%	2–6%

Portfolio Construction

Equity selection is focused upon anticipating change – either to a company's earnings or the valuation placed upon those earnings (ie the valuation multiple). This is done using a five factor-framework, which helps identify and focus on the key investment triggers. A team of 18 portfolio managers and analysts carries out the research. The strength of corporate relationships and experience of industry structure underpins actionable insight.

Portfolio construction is focused upon taking the risk that they get paid for. Macro and other factors are considered and play a role in portfolio construction. However, the team's key insights and competitive advantages are formed at the company and industry level. As a result, portfolios are built to reflect primarily equity-specific risk. The outcome is a portfolio which tends to be style-neutral and is designed to perform in different market environments.

Case study

A key feature of a robust portfolio construction is the ability to perform in a number of different scenarios and market environments. This was evident in 2020, when the portfolio was able to handle the sharp rotations in market drivers through each phase of the crisis.

Defensive companies such as gold miner Evolution and Metcash helped in the initial downturn from March to April. In the initial rebound, policy beneficiaries such as BHP (commodities) and Xero (growth equity, driven by falling yields) helped drive performance. Then in the rotation to value and cyclicals post-November it was companies like Qantas and Santos which came to the fore.

A key aspect of portfolio construction is to have equities with a company-specific investment thesis which can support it even if the thematic backdrop is not beneficial. For example, Telstra and Metcash, which are broadly defensive, were able to keep performing in late 2020 and into early 2021 on company-specific drivers, even as the market was rotating into more cyclical names.

Quest Asset Partners

About the investment manager

Quest Asset Partners is a boutique fund manager established in 2004 who manage active equity investment portfolios on behalf of wholesale institutional clients and individual investors. The business is wholly owned by its well-regarded investment team with an average experience of almost three decades. As of August 2021, Quest managed A$1.6 billion on behalf of their clients.

Investment philosophy

There are more than 2,000 equities listed on the ASX. When searching for investment opportunities, Quest undertakes a detailed assessment of business quality. Their aim is to identify companies that can deliver good returns on invested capital and sustain those returns through time. Quest has a long track record of investment outperformance leveraging this process.

There are three stages in the Quest investment process, being quality assessment, valuation and portfolio construction.

The first quality stage assesses the strengths and weaknesses of the potential investments across financial, management and business sustainability criteria. Quest considers the quality score as the principal risk measure in their investment process. This is an assessment formed through multiple meeting with companies together with key stakeholders.

The second valuation stage focuses on long-term net cash generation. The Quest bespoke valuation template assesses past financial performance and forecasts key future metrics with an emphasis on understanding cash flow. This second stage is known as Q-Value and through it Quest develops the understanding of each business and the key drivers of value creation.

The third portfolio construction stage is about getting the balance right between risk and return. This stage constructs a portfolio where each individual investment is appropriately sized. Portfolio risk is actively managed with a focus on capital preservation.

The portfolio will typically have a bias to companies with growth characteristics (revenue, earnings and return on equity) and can be expected to have exposure to companies not in the benchmark. Both these exposures will vary through time as opportunities arise. The portfolio will have significant exposure to mid and small-capitalised equities benefiting from Quest's proven investment process and experience with smaller companies.

Portfolio summary

	Quest Concentrated Australian Equity Portfolio	Quest Australian Equities Ex-20 Portfolio
North code	NTH0220	NTH0221
Asset class	Australian equities	Australian equities
Investment style	Concentrated, long only, quality biased	Concentrated, long only, quality biased
Investment universe	ASX-listed equities	ASX-listed equities
Investment objective	To deliver outperformance against the benchmark over the medium term.	To deliver outperformance against the Ex-20 Index over the medium term.
Managed portfolio benchmark	S&P/ASX 300 Accumulation Index	S&P/ASX 300 Accumulation Index excluding S&P/ASX 20 Accumulation Index
Minimum investment horizon	3–5 years	3–5 years
Minimum investment amount	$25,000	$25,000
Indicative number of assets	20–35	20–40
Investment management fee (pa of the portfolio balance)	0.61%	0.80%

	Quest Concentrated Australian Equity Portfolio	Quest Australian Equities Ex-20 Portfolio
Estimated investment performance fee (pa of the portfolio balance)	0.66% Calculated as a percentage of the outperformance of the managed portfolio compared to that of the benchmark selected for the portfolio over a quarterly period.	0.66% Calculated as a percentage of the outperformance of the managed portfolio compared to that of the benchmark selected for the portfolio over a quarterly period.
Portfolio Income	Reinvested	Reinvested
Target growth/defensive exposure	99%/1%	99%/1%
Minimum single asset position	1%	1%
Maximum cash holding	20%	25%
Expected turnover (pa)	60–80%	70–90%
Expected tracking error (pa)	3–5%	5–7%

Case study

James Hardie has been one of the best performers in the Quest portfolio over the last few years and highlights the Quest process in action. Importantly, the business has been well known to Quest. The team first attended a James Hardie investor day in the mid 1980s and have since closely followed the company through a progression of CEOs and through some turbulent years. From a Quality perspective, evaluation was not straight forward, as a valuable fibre cement franchise was coupled with an asbestos legacy. Investor uncertainty associated with the retirement of long-standing CEO Louis Gries and a weak US housing market provided the opportunity to build a significant holding in 2017 at a cost of $16 per equity. Since then the business has continued to improve in quality which is being recognised by the market. Recently the company has been trading well above $40.

UBS Asset Management

About the investment manager

UBS Asset Management Australia provides a comprehensive range of investment styles and strategies to institutional investors, financial advisers, wholesale and retail investors. Drawing on its 30-year heritage, UBS Asset Management strives to deliver outcome-orientated investment solutions for their clients, underpinned by a team-based approach and disciplined risk management.

With over A$53 billion of invested assets as of June 2021 in Australia and approximately 50 employees located locally, UBS Asset Management is one of the largest global asset management businesses in the Australian market.

Investment philosophy

UBS Asset Management believe index investing requires manager skill, experience and technology to achieve the best performance possible whilst closely tracking the underlying benchmark. They seek to construct a portfolio that delivers the return of the underlying benchmark by maintaining relative low risk and aiming to maximise value.

They use full replication where possible depending on the characteristics of the benchmark index, the size of fund and the desired tracking accuracy.

Optimally constructed portfolios and an efficient implementation are at the forefront of all their index and rules-based strategies. UBS Asset Management also aim to add marginal value to the index return where this can be achieved without jeopardising the tracking requirements of their clients' portfolios. The experienced global trading team and attention to the detail of equity trading patterns has allowed their clients to capture some added-value from pricing inefficiencies at the impact point of index changes with minimal impact on tracking accuracy. All activities are undertaken in a strictly risk controlled manner and monitored via their multi layered approach to risk management.

Portfolio summary

	UBS ASX 20 Index Portfolio
North code	NTH0222
Asset class	Australian equities
Investment style	Full replication
Investment universe	ASX-listed equities
Investment objective	To closely track the S&P/ASX 20 Accumulation Index.
Managed portfolio benchmark	S&P/ASX 20 Accumulation Index
Minimum investment horizon	5 years
Minimum investment amount	$25,000
Indicative number of assets	20
Investment management fee (pa of the portfolio balance)	0.24%
Portfolio income	Reinvested
Target growth/defensive exposure	99%/1%
Maximum cash holding	Target is to be fully invested with minimal cash position.
Expected turnover (pa)	7.5%
Expected tracking error (pa)	0.3%

Portfolio construction

The objective of this portfolio is to track the performance of the respective benchmark, the S&P/ASX 20 Accumulation Index, as closely and efficiently as possible, thus minimizing costs while limiting the risk of deviating from the benchmark.

In maintaining index portfolios in line with their targeted relative risk budget, they apply a combination of explicit controls on weight deviations and risk monitoring. They use both state-of-the-art risk systems and their in-house designed Portfolio Optimisation Platform (POP) to do this, providing insight to the risk generated by individual positions, sectors and factors as well as estimates of overall relative risk.

POP allows them to apply parameters to the portfolio construction process using a combination of optimisation techniques and transaction cost modelling in order to achieve the best possible balance between risk and trading costs building optimal portfolios. Their portfolio managers monitor the portfolio's risk characteristics on a daily basis.

All material investment decisions are taken on a team basis considering two key elements in order to create an efficient index portfolio. Portfolio implementation is via leading proprietary indexation and risk systems:

– Tracking indices closely (full replication and stratified sampling, maximum typical deviations and rigorous on-desk and independent monitoring pre and post trade).

– Minimising cost, adding value (lower turnover in portfolio construction considering risk and transaction costs and managing cash balances effectively, utilising consolidated global trading volumes, trading efficiently for index changes, adding value in corporate events, voting and engagement).

Case study

UBS Asset Management's aim is to construct index portfolios that replicate the underlying index. While they do not have an outperformance target as such, they aim to exploit inefficiencies and add marginal value to the index return where this can be achieved without jeopardizing the tracking requirements.

One example where value can be added is around corporate events, such as placings, where decisions are frequently required and simple mechanical analysis is often not possible. Depending on the size of the placing, the treatment by index providers will differ (eg waiting for the next scheduled rebalance for inclusion or fast tracking into the index). When analysing the opportunity set and potential valuation ranges relating to IPOs and secondary public offerings, UBS Asset Management's index portfolio managers utilise both their own research and the independent company analysis performed by 30+ equity research analysts based around the world for actively managed equity portfolios.

National Australia Bank's capital raising in the second quarter of 2020 was an example of a corporate action that offered an opportunity to add marginal value. NAB's institutional placement of A$3 billion represented 7% of their issued capital. Large placings like NAB's are likely going to be fast-tracked. Given the significant discount to the equity price, value could be added by, in a strictly risk-controlled manner, trading a part of the future weight of the stock in the index in advance of the index provider's trade date.

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Contact us

phone 1800 667 841
web northonline.com.au
mail North Service Centre
GPO Box 2915
MELBOURNE VIC 3001

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