# Investment Philosophy

Last Updated: 18 July 2023

# Index


## Section 1 Fiduciary Responsibilities

- Fiduciary ethics
- Conflict avoidance
- Legal obligations
- Continuously challenge
- Never stop pursuing better
- Long term service commitment

## Section 2 Investor Behaviour & Managing Emotions

- Historical biases
- Rational mind set
- Irrational behaviour
- Belief in predictions
- Excessive trading and impatience
- Risk profiling, risk tolerance and risk need
- Values, aspirations and goals
- Matching asset allocations to investor needs

## Section 3 Investment Beliefs

- Six step approach to investment planning
- Capitalism & financial markets
- Investment discipline
- Risk & return are related
- Modern portfolio theory
- Efficient market theory
- Indexing is the best starting point
- Managed investments versus individual assets
- The odds are against market timing
- Individual asset selection is likely to fail
- Active management ...less than a zero sum game
- Fixed interest ...credit and term risk matter
- Equities ...size, health and profitability matter
- Hedging international assets
- Property ...direct or listed
- Understanding and managing risks
- Costs really matter
- Accumulators and retirees are different
- Black swan events do occur

## Section 4 — Managing Investor Expectations

- Past performance of asset classes
- Risk premium identification and understanding
- Setting investment projection rates

## Section 5 — Investment Portfolio Construction Process

- Three cost components
- Macro investment asset allocation
- Model portfolios
- Investment selection
- Investment due diligence
- Portfolio re-balancing
- Small account compromises

## Section 6 — Investment Protection

- Robust portfolio administration
- Independent custodians
- Secure capital transfers
- Clients retain control

## Section 7 — Portfolio Implementation Controls

- Clarity of communication
- Investment applications
- Completing the client's investments

## Section 8 — Investment Process Review

- Macro process results review
- Unending quest for improvement

# Purpose

The overarching purpose of the FYG Investment Philosophy is to guide FYG advisers on how to utilise evidence-based investment processes to most reliably pursue the achievement of client goals.

# Executive Summary

The Investment Philosophy utilised by FYG Planners Pty Ltd ("FYG Planners") are defined by the eight key themes noted below.

### Fiduciary Responsibility

FYG advisers adopt the ethical position of a true fiduciary. We act free from conflicts and willingly meet & exceed all of our legal obligations. We continuously challenge our processes & never cease looking for better ways to invest. We are 100% committed to the long-term service of our clients. *See Section 1 that follows.*

### Investor Behaviour & Managing Emotions

Many investors struggle with biases and emotions. Biases can be derived from personal experiences and lack of knowledge. Emotions tend to compound these issues. It is a reality our minds are attuned to a 'fight or flight' response. Something incredibly valuable during the stone age, but a handicap when investing in modern times. Uncontrolled emotions have the potential to be financially harmful.

We believe investors start with good intentions. To maximise profits at the lowest degree of risk they perceive. This is quite rational. However, due to biases and emotion, irrational behaviour can rear its head throughout the investment experience.

Without an understanding of what they can and can't control, many investors find their focus on the uncontrollable elements. The belief they need outguess the market and make successful predictions. This leads to a belief they need to consistently be 'doing something', such as frequent trading. History has shown both of these beliefs are futile and financially damaging. *See Section 2 that follows.*

### Investment Beliefs

FYG Planners has developed a six-step process for aligning our client's values, aspirations and goals with portfolios specifically designed to deliver their desired lifestyle outcomes. *See Section 3 that follows.*

We believe markets work and history has shown financial markets have rewarded long term investors for their supply of capital with an above inflation rate of return. We embrace modern portfolio theory including the key features of risk & return, broad diversification as being core to our investment beliefs. We embrace market pricing relying on information contained in pricing mechanism provided by publicly listed markets.

We avoid market and security forecasting. We avoid illiquid, unlisted assets, or non-traditional assets such as precious metals, commodities, and opaque expensive hedge funds. Instead, we focus on known academic research which has identified specific 'drivers of returns' to design our investment portfolios.

We look to design portfolios at the lowest possible cost while taking advantage of tax efficiency.

## Managing Investor Expectations

We believe it is essential to truly understand a person's most important values, aspirations and goals in order to deliver quality investment and financial advice. Every client's portfolio and asset allocation should be matched to their specific values, aspirations and goals.

Advising investors means using our expertise to help them understand the history of financial markets and the risk & reward characteristics of each asset class. This guidance ensures investors focus on the factors they can control, and the specifics shown to add value to the investment process.

This includes the use of forward investment projection rates. The use of such rates is done judiciously to ensure a client's future financial expectations are fairly and reasonably established. *See Section 4 that follows.*

## Investment Portfolio Construction Process

Portfolios are designed to meet a client's specific needs. Our model portfolios are prioritised whenever possible. We make completely clear the three cost elements involved in managing a portfolio for clients. These are: investment management, transaction, portfolio administration and advice.

The managed investments that comprise FYG Planners model portfolios are subject to detailed scrutiny. Client portfolios are reviewed and re-balanced regularly. *See Section 5 that follows.*

## Investment Protection

Portfolio administrators or custodians who hold client portfolios are subject to rigorous scrutiny and we utilise the latest available security measures to protect client portfolios from fraud.

Clients retain ultimate control of their portfolios. Advisers in the FYG group do not operate discretionary accounts and none of FYG Planners firms' staff have access to any client funds. *See Section 6 that follows.*

## Portfolio Implementation Controls

Client portfolios are implemented by trained support staff under the supervision of the client's primary adviser and/or secondary adviser. Only client authorised transactions may be completed.

Ongoing reviews and portfolio amendments are also undertaken under the supervision of the client's primary adviser and/or secondary adviser. *See Section 7 that follows.*

## Investment Process Review

FYG Planners model portfolio results are regularly reviewed against benchmark indices, constructions and peer groups over multiple time periods. The performance of the individual managed funds used within our model portfolios are also regularly reviewed. *See Section 8 that follows.*

# Section 1: Fiduciary Responsibility

## 1.1 Fiduciary Ethics

FYG Planners adopt the ethical position of a true fiduciary. We provide investment advice, oversight and management of client portfolios from a unique position of trust and legal obligation. We believe it is also a fiduciary duty to adhere to a portfolio construction process that is evidence based. This eliminates any speculation from the investment process.

Client interests are always placed first. Adviser interests and institutional entities who provide administration platforms and investment products are always secondary to the client.

FYG advisers only offer advice in areas where we have genuine expertise. Our communication is straight forward and transparent. We do what we say, and we finish what we start.

At every level we treat clients as we would expect to be treated.

## 1.2 Conflict Avoidance

FYG Planners does not allow conflicts of interest. If a conflict of interest is unavoidable, it is documented and managed.

Since 2005 FYG Planners has operated on a strictly fee for service basis and not accepted commissions from investment product providers or portfolio administration service providers.

## 1.3 Legal Obligations

FYG Planners meets and exceeds all of the standards required under the following Australian legislation:

- Corporations Law
- Life Insurance Act
- Better Advice Act
- Trade Practices Act
- Anti-Money Laundering Act
- Privacy Act
- Financial Planners and Advisers Code of Ethics

We commit to abiding by all future legislation that impacts the clients we serve.

## 1.4 Continuously Challenge

Whilst our investment processes are evidence based and thoroughly tested, there is still an obligation to challenge and assess. We continuously review our model portfolio results, and question whether they deliver outcomes clients should expect against the performance of financial markets.

FYG Planners choose to design and implement model portfolios with the intention of most reliably targeting the risk return characteristics that best suit the individual client. It is our view that clients with a similar risk appetite, or risk need, should have consistent portfolios implemented on their behalf.

Model portfolios are tested against market equivalents on a monthly basis.
*See Annexures 1.1*

Only after detailed analysis proves the ongoing results to be sound, are the model portfolios allowed to remain unchanged.  As can be seen from each of the Annexure noted above, the long-term data is supportive of FYG Planners model portfolios.

### 1.5 Never Stop Pursuing Better Strategies

Research to benefit clients is a priority. Commercial and institutional research, along with academic papers, are regularly reviewed as we investigate any new strategies that might benefit clients.

Evidence and theories provided are scrutinised and tested thoroughly to decide if they are worth adopting within our model portfolios.

### 1.6 Long Term Service Commitment

FYG Planners commenced business in 2001. We intend to remain in business for the long term. The business is not for sale and it is the director’s goal to serve our advisers and their clients long into the future through prudent succession planning.

Our guiding business philosophy has always been that *“we expect no reward until we first create value for our clients”.*

# Section 2: Investor Behaviour & Managing Emotions

## 2.1 Historical Biases

Investor behaviour is well understood as a potential Achilles heel to investment success. On practical basis, most financial advisers have experience with, or stories to tell, about investor behaviour. Many investors have acquired some form of investment bias. Biases are acquired in many ways. A positive or negative experience with an asset class. An opinion shaped by the media. Alternatively, they may have been influenced by a parent, friend, or mentor.

An 'anti sharemarket investor' often has experience with loss. This can be a personal or shared experience, possibly a family member who lost substantially. Usually speculation gone wrong.

A positive bias is often exhibited by Australians towards property. Not surprise. Long term ownership of domestic property in a market that has produced strong gains over the last half century.

Biases can dictate behaviour. Avoiding financial markets due to volatility, despite the fact those markets have offered strong long-term returns. In contrast, heavily concentrating assets where the bias favours a particular asset.

Prospective clients should be thoroughly questioned to establish any biases. This allows for education and awareness on the latent risks in their biases.

## 2.2 Rational Mindset

Irrespective of any biases, most investors will admit a desire for the highest possible return with the lowest possible level of risk. This is a rational starting point.

Faced with a choice of multiple term deposits, most investors will choose the term and institution that offers the greatest return, subject to their assessment of the institution's financial strength and security. Again, quite rational.

Most Australian investors will only invest in shares and property because they expect a higher return than if they invest in term deposits.

## 2.3 Irrational Behaviour

Despite this rational starting point, history repeatedly displays how irrational investor behaviour can be. In the short-term emotions can drive investment decisions. For example:

- Fund flows show money floods into financial markets towards the end of a strong rally.
- Fund flows also show money flooding out of financial markets near the bottom of each bear market or correction.
- In March 2009, Australia's largest superannuation fund, Australian Super saw a record volume of switches from diversified portfolios to cash. History showed this was the market bottom.

- In March 2020, at the peak of the COVID-19 selloff, Statewide Super saw a similar phenomenon. As world equity markets bottomed, member switches from diversified portfolios to cash spiked.

- US studies by Dalbar Inc. routinely show investors in managed funds achieve substantially lower returns than their benchmark. Between 1998 and 2017, the average US stock market investor in managed equity funds achieved returns of 1.91% less than the market.

- According to Dalbar, for bond fund investors, the actual results achieved were even worse, some 4.22% per annum below the market index.

- A separate study by Dalbar for the period 1984 to 2002 (18 years) reaffirmed the above results by showing that individual investors in the US stock market earned 9.6% per annum less than the S&P 500 Index.

- Borrowing for investment properties in Australia grows dramatically after property prices have skyrocketed. In reality, the best capital growth generally follows periods of market weakness.

Overconfidence is another source of irrational behaviour. Immediate investment success without any track record can provoke feelings of skill, dwarfing the true reality of luck. Conversely, an investment failure will have investors ascribing ‘bad luck’ as the reason for their poor outcome.

Without the benefit of evidence, investors often use a psychological process called heuristics. Essentially mental short cuts, using short term data or patterns they believe they have identified to extrapolate a long-term outcome or decision. In reality, no patterns exist, and the process reflect poor investment decision making. This issue was well documented by academics Brad Barber and Terrence Odean in 2011.

Attempting there is a way to outsmart others, or outguess the market, is another unreliable investment behaviour. Investors will trawl through massive amounts of data hoping to identify companies with a more prosperous future. University of Chicago student Michelle Clayman’s 1987 paper highlighted the futility of this behaviour.

Clayman analysed returns between 1981 and 1985 for investors who purchased the 29 ‘most excellent’ companies portrayed in the Tom Peters and Bob Waterman book “In Search of Excellence”. Using the Peters-Waterman assessment criteria, Clayman also analysed the 29 least excellent companies in the S&P500 index using the same measures.

The ‘unexcellent companies’ collectively earned 115.9% more for investors over the 5 years!

### 2.4 Belief in Predictions

A common myth is that investment success is based upon stock picking or market timing. This explains why the media almost exclusively focuses on ‘hot stocks’ or short-term market direction.

In truth, most forecasters and stock pickers fail miserably. As Warren Buffett said: *“I never have the faintest idea what the stockmarket is going to do in the next six months, or next year or the next two.”*

## 2.5 Excessive Trading and Impatience

A belief in forecasting leads to the flaw of trading too often. Investors never know which parts of the market will outperform year to year and more actions can mean more mistakes. Excessive trading inevitably higher costs and taxes, while a lack of patience may mean missing a recovery or the next outperformer when it appears.

Many investors mistakenly believe they and their advisers must be 'doing something' or reacting regularly in response to news. History shows the reverse is the case. To again quote Warren Buffett: "*Our preferred holding period is forever*".

## 2.6 Risk Profiling, Risk Tolerance and Risk Need

Investment professionals generally consider risk in terms of the mathematical concept of standard deviation. Mathematical analysis remains important in portfolio construction, but when dealing with individual investors, deeper risk assessment is required.

No investor risk profiling questionnaire will be perfect. It is not an exact science. It is an attempt to capture as much relevant information in forming an understanding of an investor as possible. Advisers use a risk profile questionnaire utilising research completed by Monash University Finance School, research firm Investorweb (now part of Iress Ltd) and AM Corporation (now part of the IOOF Group).

Risk profiling has four main areas of focus:

- Age and life stage
- Financial affluence
- Financial knowledge
- Specific portfolio characteristics

Questions are given weightings by the FYG Planners investment committee.

The questionnaire produces a score out of 100. This score aligns with the percentage of growth assets recommended for a client's portfolio, subject to their investment time frame. If their investment time frame is shorter than considered ideal, the growth assets portion is reduced to suit the investment time frame.

The questionnaire includes red flags. These intend to seek out inconsistencies in the respondent's answers. If inconsistencies are identified, the prospect is questioned more thoroughly until the adviser is satisfied that an appropriate risk profile has been identified.

In particular, the questionnaire targets risk tolerance. It starkly portrays the quantum of potential losses across portfolios, along with the frequency of negative results. The client and adviser can vary the assessed score by mutual agreement to ensure client comfort, or to better pursue the client's goals and needs.

Advisers discuss any potential mismatch of a client's risk profile and the risk required to pursue their lifetime financial goals. Clients are always advised to take the lowest amount of risk that still allows for the achievement of their goals.

## 2.7 Values, Aspirations and Goals

These three key aspects of a client's life are critical to understanding variances in investor behaviour.

Without fully considering short term aspirations and goals, a portfolio may be too heavily weighted toward growth assets. This could prove disastrous in falling equity market if an investor requires capital for short term spending.

Similarly, a person's health and potential longevity need to be considered when assessing the appropriate asset allocation.

In 1994 a FYG adviser transitioned two clients into retirement after long careers. Both were 66 years old, affluent, with substantial investments. One wanted safety and the highest possible income immediately (he had a heart condition and died just 2 years later). The other wanted growth so his capital would last as long as possible (everyone in his family lived to 90, he passed away aged 91 in 2018).

## 2.8 Matching Investment Plan to Client Needs & Risk Tolerance

Factoring client cash flow and capital expenditure is critical when assessing a client's asset allocation.

An investor portfolio may have a more growth orientated risk profile, but if short term spending is forecast within a 2-year time frame, portfolio construction needs to incorporate additional cash and short dated fixed interest investments.

Accounting for one off spending and short-term impacts means target asset allocation for clients will vary over time. A long-term target asset allocation for every client should exist, but short-term needs should dictate the short-term asset allocation chosen.

# Section 3: Investment Beliefs

## 3.1 Six Step Investment Planning Process

Our circular visual explains our planning process from a client perspective.

Firstly, **clarity**. We help clients define their values, aspirations, and goals. We then assess the key features of their current investment portfolio.

Secondly, **insight.** We assess what is getting in a client's way. Excessive fees, poor investment strategy, inappropriate asset allocation, sub-optimal tax outcomes, etc. We highlight what the client can do better and how much better their future could look.

Lastly, **confidence.** Through regular reviews, we highlight the prudent and successful management of their investments, adhering to their best interests, ensuring their values, aspirations and goals are being pursued effectively.

## 3.2 Capitalism and Financial Markets

FYG Planners accepts that capitalism is not a perfect economic system, it may be aptly described as 'the worst economic system, except for all the others'! However, it has proven resilient and reliable. Investors have long been rewarded for the capital they supply with returns above the rate of inflation. Put simply, this can be summed up with the term 'markets work'.

We insist our clients accept that financial markets have long been drivers of creating wealth. Our belief remains markets will continue to work. This forms the basis for their investment portfolios.

## 3.3 Investment Discipline

Having accepted the core idea that 'markets work', we continually counsel clients to remain disciplined. This involves trusting their portfolios are managed according to their investor risk profile, and in accordance with their investment policy statement.

Investors unable to manage their emotions will inevitably cause significant financial harm to themselves. Remaining disciplined through market dips and swings remains as important as any other evidence-based principle.

Para-phrasing the co-founder of Dimensional Fund Advisers, David Booth from a 2014 address; "the most important thing about an investment strategy is to have one and then to be patient".

## 3.4 Risk & Return are Related

William Sharpe won a Nobel Prize for his Capital Asset Pricing Model (CAPM) which said, "for an investment to deliver higher returns, it must experience higher risk".

Whilst the CAPM model has been criticised and superior models have been developed from it, there remains a universally held belief that to pursue a higher return an investor must increase their risk. Clients are educated clients to understand there are no high return/low risk investments.

Academic research has as identified the drivers of return. The most prominent remains the equity premium. Equities compensate investors with a higher long-term return than fixed income due to their higher risk.

Australia's main equity market has produced both volatile and strong returns since Federation. Note the following table.

**Australian Sharemarket 123 Year History**

| Year | Return | | Year | Return | | Year | Return | | Year | Return | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 1900 | 16.1% | | 1930 | -28.1% | | 1960 | -7.3% | | 1990 | -17.5% | |
| 1901 | -1.7% | | 1931 | 20.0% | | 1961 | 16.0% | | 1991 | 34.3% | |
| 1902 | 17.7% | | 1932 | 26.5% | | 1962 | 5.0% | | 1992 | -2.8% | |
| 1903 | 23.9% | | 1933 | 27.1% | | 1963 | 28.6% | | 1993 | 40.5% | |
| 1904 | 9.4% | | 1934 | 24.6% | | 1964 | 6.6% | | 1994 | -8.8% | |
| 1905 | 16.4% | | 1935 | 11.4% | | 1965 | -7.1% | | 1995 | 20.7% | |
| 1906 | 11.8% | | 1936 | 18.8% | | 1966 | 10.2% | | 1996 | 14.3% | |
| 1907 | 10.2% | | 1937 | 6.2% | | 1967 | 42.9% | | 1997 | 11.4% | |
| 1908 | 18.8% | Avg | 1938 | 1.0% | Avg | 1968 | 42.5% | Avg | 1998 | 8.5% | Avg |
| 1909 | 15.1% | 13.8% | 1939 | 7.2% | 11.5% | 1969 | 14.7% | 15.2% | 1999 | 20.9% | 12.1% |
| 1910 | 8.2% | | 1940 | 5.3% | | 1970 | -16.2% | | 2000 | 3.6% | |
| 1911 | 12.3% | | 1941 | -3.8% | | 1971 | 4.3% | | 2001 | 10.1% | |
| 1912 | 10.4% | | 1942 | 20.4% | | 1972 | 26.4% | | 2002 | -8.1% | |
| 1913 | 10.7% | | 1943 | 10.5% | | 1973 | -23.3% | | 2003 | 15.9% | |
| 1914 | 13.4% | | 1944 | 9.6% | | 1974 | -26.9% | | 2004 | 27.6% | |
| 1915 | -1.9% | | 1945 | 15.5% | | 1975 | 62.9% | | 2005 | 21.1% | |
| 1916 | -1.7% | | 1946 | 14.8% | | 1976 | 5.2% | | 2006 | 25.0% | |
| 1917 | 17.6% | | 1947 | 18.0% | | 1977 | 20.2% | | 2007 | 18.0% | |
| 1918 | 11.6% | Avg | 1948 | 3.6% | Avg | 1978 | 22.2% | Avg | 2008 | -40.4% | Avg |
| 1919 | 18.4% | 9.9% | 1949 | 9.6% | 10.4% | 1979 | 46.3% | 12.1% | 2009 | 39.6% | 11.2% |
| 1920 | 10.0% | | 1950 | 32.9% | | 1980 | 48.9% | | 2010 | 3.3% | |
| 1921 | 22.4% | | 1951 | -3.3% | | 1981 | -12.9% | | 2011 | -11.4% | |
| 1922 | 23.6% | | 1952 | -11.8% | | 1982 | -13.9% | | 2012 | 18.8% | |
| 1923 | 18.3% | | 1953 | 14.8% | | 1983 | 66.8% | | 2013 | 19.7% | |
| 1924 | 17.1% | | 1954 | 20.6% | | 1984 | -2.3% | | 2014 | 5.0% | |
| 1925 | 18.5% | | 1955 | 12.1% | | 1985 | 44.1% | | 2015 | 3.8% | |
| 1926 | 16.2% | | 1956 | 10.3% | | 1986 | 52.2% | | 2016 | 11.6% | |
| 1927 | 19.8% | | 1957 | 18.3% | | 1987 | -7.9% | | 2017 | 12.5% | |
| 1928 | 14.6% | Avg | 1958 | 22.8% | Avg | 1988 | 17.9% | Avg | 2018 | -3.5% | Avg |
| 1929 | -3.6% | 15.7% | 1959 | 47.1% | 16.4% | 1989 | 17.4% | 21.0% | 2019 | 24.1% | 8.4% |
| | | | | | | | | | 2020 | 3.6% | |
| | | | | | | | | | 2021 | 17.7% | |
| | | | | | | | | | 2022 | -2.96% | |
| | | | | | | | | | Worst Decade | | 8.4% |
| | | | | | | | | | Best Decade | | 21.0% |
| | | | | | | | | | Annual Average | | 13.0% |

For detailed information please refer to Sources and Descriptions of Data.

**Source:** Historical returns are based on the All-Ordinaries Accumulation Index which includes dividends. April 2000 - Present: S&P/ASX All Ordinaries Index (Total Return), Source: S&P. January 1980 - March 2000: ASX All Ordinaries Accumulation Index, Source: ASX. Data from 1900 - 1979 supplied by AXA/AMP is constituted using regional indices with different methodologies to record share price index movements. Returns in AUD. Copyright 2022 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.

Returns range wildly returns over individual years, from a high of positive 66.8% to a low of negative -26.9%, yet decade long results narrow, remaining more consistent.

The table below shows performance and standard deviation across four different model portfolios with varying allocations to growth and defensive assets. 30-year time period to 31/12/2022.

| | 50/50 | 60/40 | 70/30 | 80/20 | 90/10 |
|---|---|---|---|---|---|
| Ave Annual Return | 7.88% | 8.19% | 8.47% | 8.67% | 8.88% |
| Standard Deviation | 6.05% | 7.08% | 8.20% | 9.39% | 10.58% |

Source: Dimensional Returns Web. NB: the first number is the defensive assets percentage of the portfolio and the second number is the growth assets percentage. While there is industry conjecture around the status of growth and defensive assets, we believe their status to be clear. Growth assets are equities and listed real estate, along with all their sub asset classes. Defensive assets are fixed interest and cash. There is no scope for synthetic or hybrid securities as defensive assets.

Both the annualised average return and standard deviation increases as growth assets in the portfolio increase.

## 3.5 Modern Portfolio Theory

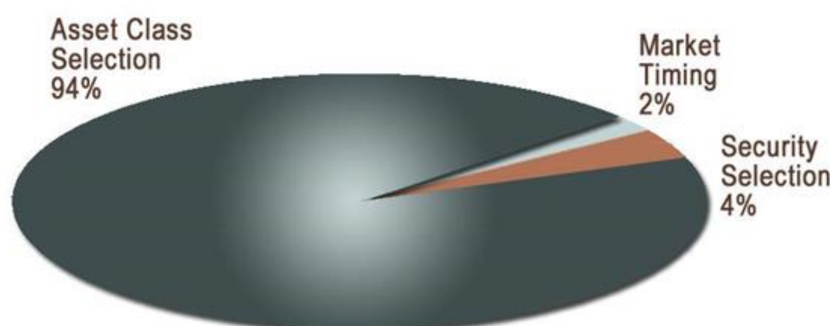
Harry Markowitz won a Nobel Prize for his pioneering work on Modern Portfolio Theory. Markowitz's work focused on diversification and its impact on portfolio risk reduction, as measured by volatility. Markowitz showed different asset classes experience very different return correlations.

Often referred to as a mean reversion model, the Markowitz model gave rise to the term the Markowitz Efficient Frontier. This predicts the highest level of return for any given level of risk based on the assets chosen within a portfolio.

We pursue the most efficient and broadly diversified portfolios we can identify for each client. They aim to achieve the highest long-term return possible for each level of risk or volatility experienced.

We believe asset allocation remains the greatest determinant of long-term investment returns.

Brinson, Hood and Beebower's 1986 study reinforces this belief. Determinants of Portfolio Performance showed only 6% of total returns achieved by 91 large US pension funds over a 10-year period could be attributed to asset selection and market timing. 94% of returns could be attributed to asset allocation.




Source: Study of 91 large pension plans over 10 year period.
Gary P. Brinson, L. Randolph Hood and Gilbert L. Beebower, " Determinants of Portfolio Performance", Financial Analysts Journal, July - August 1986, pp 39 - 44: and Gary P. Brinson, Brian D. Singer and Gilbert L. Beebower, "Revisiting Determinants of Portfolio Performance: An Update". 1990, Working Paper.

Roger Ibbotson and Paul Kaplan reinforced this belief in their paper 'Does Asset Allocation Explain 40, 90 or 100 Percent of Performance?'

### 3.6 Embrace Market Pricing

Eugene Fama Snr published his influential paper, 'Efficient Capital Markets: A Review of Theory and Empirical Work' in 1970.

Fama's research indicated all known information about any particular asset or security is quickly reflected in the current market price. In today's electronic age, this seems even more self-evident. It is best to embrace current market pricing when purchasing an investment. There will be very little benefit to be gained by attempting to time a perfect entry or find a mispriced security.

While the concept has not been without question, Fama has noted that even if markets are not completely efficient, any advantage to be gained by an investor, to the extent that markets are not perfectly efficient, will be eroded away by trading and other costs. Therefore, investors should embrace market pricing as being correct.

Other notable investment and academic voices lend weight to the belief investors should embrace market pricing. America's first Nobel Laureate Paul Samuelson wrote, "the best estimate of the true value of a security is the price that is set in the market every minute of the trading day".

The father of fundamental analysis Benjamin Graham said *“I doubt whether extensive efforts will generate sufficiently superior selections to justify their cost ….I’m on the side of the efficient market school of thought”.* Finally, Burton G. Malkiel of Princeton University in his 2003 paper “Passive Investment Strategies and Efficient Markets” also found in favour of market pricing.

## 3.7 Indexing is the Best Starting Point

History shows a broad market index fund will deliver the average return received by all investors, irrespective of the value of the capital invested or the timing of when their investments made. Essentially, an investor can receive the average return, without any work required from that investor.

Index funds also have a reputation of the lowest cost funds available in the investment marketplace.

Ongoing studies highlight that more than 50% of professional investment managers routinely fail to outperform their benchmark indices after fees on an annual basis. As this timeframe increases, using 3, 5, 10- and 15-year periods, so does the percentage of managers failing to outperform their benchmark. Similar studies highlight broad market index fund managers routinely finish in the top half of managed fund performance tables.

See the Morningstar and SPIVA studies that appear in Annexure 3.1, 3.2 and 3.3.

## 3.8 Managed Investments versus Individual Assets

For consistency of performance, ease of administration and breadth of diversification, our advisers and their clients should use professionally managed investments, in preference to directly owned assets.

We accept some clients may hold a few direct shares or an investment property, but for their serious ‘long term’ capital and for the protection of the significant portion of their wealth, we should structure and implement a globally diversified portfolio. This will leave clients best positioned to capture returns and managed risk as they pursue a successful investment experience.

## 3.9 Avoid Market Timing

As the Brinson study showed, only 2% of returns could be attributed to market timing.

In a 2008 paper, Javier Estrada from the IBESE Business School in Barcelona, concluded “the odds against successful market timing are staggering”. See Annexure 3.4. From another angle, fund manager, Dimensional looked at the potential to time size, value and profitability premiums of the Australian market using valuation ratios. They found little evidence of being able to time using these premiums. See Annexure 4.2.

There is no rhyme or reason to which asset classes will outperform or underperform year to year, as the following mosaic shows. A globally diversified portfolio is best positioned to capture the gains when they appear, while also managing risk.

## Annual Returns by Market Index

Australian Large
Australian Small
Australian Value
Cash
Emerging Markets
Fixed Interest
Global Large + Mid
Global Small
Global Value
Property

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Highest Return | 9.2% | 57.4% | 13.1% | 10.5% | 22.2% | 54.3% | 34.3% | 13.1% | 17.4% | 27.5% | 5.8% | 28.6% | 9.2% | 40.6% | 3.2% |
| | 7.6% | 40.9% | 11.0% | 5.0% | 21.6% | 48.0% | 15.3% | 12.6% | 13.8% | 20.0% | 2.0% | 27.0% | 8.1% | 30.3% | 1.3% |
| | -24.2% | 38.8% | 9.3% | 1.7% | 21.0% | 47.8% | 14.2% | 12.1% | 13.8% | 14.0% | 1.9% | 24.7% | 6.1% | 29.9% | 1.0% |
| | -24.9% | 36.2% | 8.3% | -4.9% | 17.1% | 24.5% | 11.9% | 10.2% | 13.2% | 13.9% | 1.6% | 24.1% | 6.1% | 23.3% | 0.6% |
| | -26.5% | 12.2% | 4.7% | -5.0% | 16.7% | 21.5% | 10.4% | 7.9% | 12.1% | 11.0% | -0.1% | 22.9% | 5.1% | 19.8% | -11.8% |
| | -30.8% | 8.0% | 4.6% | -8.7% | 15.1% | 19.3% | 7.3% | 3.3% | 11.7% | 10.5% | -2.4% | 21.4% | 0.8% | 17.7% | -12.3% |
| | -37.2% | 3.6% | 1.7% | -9.8% | 15.0% | 13.4% | 7.0% | 2.3% | 8.7% | 9.2% | -2.6% | 19.7% | 0.4% | 16.9% | -12.5% |
| | -41.0% | 3.5% | 0.8% | -9.9% | 9.7% | 2.9% | 6.1% | 2.1% | 7.4% | 3.7% | -3.9% | 19.1% | -2.2% | 3.8% | -13.9% |
| | -41.2% | 1.4% | -1.4% | -18.2% | 6.6% | 2.3% | 2.7% | 0.5% | 5.2% | 1.7% | -4.7% | 7.2% | -9.2% | 0.0% | -18.1% |
| Lowest Return | -53.2% | -1.0% | -3.7% | -21.4% | 4.0% | -0.8% | -3.8% | -3.9% | 2.1% | 0.6% | -8.7% | 1.5% | -16.3% | -1.5% | -18.4% |

### 3.10 Individual Asset Selection is Likely to Fail

The Brinson study also showed that asset selection contributed only 4% of the results over 10 years across 91 large professionally managed US pension funds.

In their 2010 report to the Library of Congress, the US Federal Research Division concluded reasons for investor failure included: under diversification, momentum investing, noise trading, familiarity bias, active trading. See Annexure 3.5.

### 3.11 Active Investment Management – Less Than Zero Sum Game

Nobel Laureate William Sharpe published his paper, 'The Arithmetic of Active Management' in 1991. Sharpe highlighted that of all participants in investment markets ( amateur and professional) if the index managers do achieve index results (assuming they are efficient), then all others who try to outsmart the market must also achieve, in aggregate, the index result. However, when costs are considered, the active investor must achieve less than the buy and hold index investors 'on average'.

If active management were not a less than zero sum game, investors would still face the challenge of identifying successful managers ahead of time. No reliable indicator exists for this purpose. Selecting funds based on past performance is not a substitute. Very few active managers persist with long term outperformance. For most its more luck than skill. See the Morningstar Reports in Annexures 3.2 and 3.3.

### 3.12 In Fixed Interest Markets Credit Risk and Term Risk are the Key Drivers

Debt securities, essentially loans to third parties by investors, have two major risk factors for investors to consider: Credit Risk and Term Risk. Each risk factor can vary over time.

An investor may wish to lend their money to an AA rated company with a term of 5 years. The borrowing company agrees to pay X% per annum for 5 years, but between the date of lending and the end of the loan term, the company's credit rating may change. While their credit worthiness may decline, the loan term (or bond) is already set. The value of the bond to another buyer may be lower.

The figure below highlights how corporate credit risk rewarded investors to a greater extent than those who invested in Government bonds. Time period: 1/1/1976 to 31/12/2022.

| | US Government | | US Corporate | |
|---|---|---|---|---|
| | 1 to 3 years | 1 to 10 years | 1 to 3 years | 1 to 10 years |
| Annual Return | 5.49% | 6.06% | 6.17% | 6.96% |
| Standard Deviation | 2.65% | 4.00% | 2.64% | 4.88% |

Source: **US Government Indices:** Bloomberg U.S. Government Bond Index 1-3 Years; Bloomberg U.S. Government Bond Index Intermediate. **US Corporate Indices:** Bloomberg U.S. Credit Bond Index 1-3 Years; Bloomberg U.S. Credit Bond Index Intermediate.

Similarly, the term of bond may be fixed at the outset, but with each subsequent day the term (duration) is shortening. The bond will be revalued based on the remaining term and the prevailing interest rate climate for bonds, with that credit rating and the term remaining.

The 'safe or defensive' part of a client portfolio should only be invested according to these two risk factors. Accordingly, we only use investment grade securities. We do not support hybrid investments, collateralised debt securities or other synthetic fixed income securities.

### 3.13 Factors that Drive Equity Portfolio Returns

Nobel Prize winner Professor Eugene Fama from the University of Chicago and Professor Ken French from Dartmouth College, (building on the work of Nobel Laureate Paul Samuelson and Rolf Banz from the University of Chicago), have identified a series of factors that are known 'drivers of returns' within an equity portfolio.

Investors can pursue higher expected returns by structuring their portfolio around these factors. These factors will not always be present, and any superior investment performance tends to emerge over the longer term.

The identified drivers of returns are:

1) Company size - a higher exposure to small cap shares than the whole market
2) Relative price - a greater exposure to shares with a high book to market ratio
3) Profitability - holding an excess of shares that generate reliable cash profits
4) Momentum - stocks continue to go in the same direction longer than expected
5) Investment – a company's re-investment of profits influences future performance

FYG Planners target these drivers of returns with specifically targeted managed funds and ETFs when building client portfolios. This is due to economies of scale that drive cost efficiencies, diversification benefits and consistency of implementation across all clients.

History shows the long-term effect of combining these factors results in higher returns accompanied by similar and sometimes lower levels of volatility (as measured by standard deviation). Refer to 1992 paper by Fama & French (Annexure 3.8) and (Annexures 1.1)

Nobel Prize winner Merton Miller developed theorems in the 1950's that laid the groundwork for the idea that low priced shares should have higher overall returns. Miller's work reinforces Fama & French's value effect theories.

In 2001, academic James Davis wrote the paper "Explaining Stock Returns …A Literature Survey". Davis also strongly found in favour of the factor-based equity investment process.

### 3.14 Hedging International Assets

Australian clients generally invest in Australian dollar denominated assets. The Australian dollar has fluctuated widely since floating in 1983. The three-decade average is near US$0.75, but it has been as high as US$1.08 in 2014, and as low as US$0.48. These swings are around 40% either side of the US$0.75 average. Such volatility forms our view when hedging, along with different strategies for fixed interest and equity investments.

Australian – US Dollar Exchange Rate (AUD USD) 1991-2022

Currency fluctuations can greatly influence results over shorter periods and investors make investments at different times. If they invested when the A$ was historically high, it may deliver a poor outcome if the currency reverts to the mean. If they invested when the A$ was historically low, it may deliver a positive outcome if the currency reverts to the mean.

Fixed interest securities sit within the 'defensive' allocation of an investment portfolio. To avoid potential large currency swings, a client's fixed interest portfolio is hedged to the Australian dollar.

Global equities sit within the 'growth' allocation of an investment portfolio. Here volatility is expected, but we are informed by the academic view. This suggests hedging is not likely to add value to a portfolio result over the longer term.

Our standard practice is to use a 50% hedging strategy on global equities. This aims to reduce the impact of currency volatility on the global shares held within client portfolios. However, if a client has a specific view on the $A, we may accommodate them within the existing fundamentals of our portfolio construction process.

### 3.15 Property – Direct Ownership and Listed Trusts

Very few investors can build a genuinely diversified property portfolio due to the limitations of their own investible wealth. In addition, a large portion of their wealth may already be allocated to their family home. This provides residential property exposure. For these reasons we are not significant supporters of direct property as an investment asset class.

Some investors have enjoyed positive investment experiences from directly owned property. Either from strong commercial rental income or significant capital growth from buying the right domestic property, in the right place, at the right time. These stories are abundant. Less discussed are the failures. We have been privy to many poor property outcomes. Clients, or prospective clients, who purchased in the wrong location, wrong time, wrong property type or overdid the leverage. All resulted in a significant capital loss.

Experience has shown us that property investors often use mental arithmetic until accurate valuations or sales occur. This can overestimate success or minimise failure. Transaction costs, holding costs, refurbishment costs and their own time imposition are ignored when considering their success.

Anecdotal evidence suggests rental income from commercial property in Australia has averaged around 8% since Federation. In contrast, domestic property rents have been around 5% before holding costs and 3.5% after local government rates, insurance, land tax, etc. The low rental yield is another reason why we do not support domestic property as an investment asset class.

Very high prices in Australia's capital cities appear to be driven by low interest rates, lax lending standards and overseas investors. Stagnation and population decline appear to plague regional areas. An investor cannot successfully diversify against various location risks. Their capital will remain exposed to the risks of local conditions, and the behaviour and liquidity of a single tenant.

Commercial, industrial, and retail properties via listed property trusts are the most prudent way to gain property exposure. Listed property trusts are liquidity, offer stronger net rental yields and remain diversified. Property exposure can come via well managed low-cost property trust index funds.

## 3.16 Managing Risk is Vital

Investment risks should only be pursued where evidence has shown there to be an identifiable and compensated reward. Synthetic investment products such as hybrids, CDO's, options trading, venture capital funds or hedge funds, do not fit this criteria.

Investors should only take the risks they need to take or wish to take. These risks are in pursuit of lifestyle goals & objectives, or for specific personal gain motives. Regardless of the reason, investors must fully understand the risks they are taking.

Risk comes in many forms. Taking a risk doesn't mean a reward should be expected. It just means a reward may be forthcoming if successful. The reverse is also true. Investors who accept high concentration risk may be successful, but the alternative outcome can also be catastrophic. A single share price plunging on new bad news, or tenant troubles with a property are terrible and stressful outcomes. Both can be avoided by diversification.

Conservativism, relative to goals, can also present a risk. If an investor limits themselves to cash in a low rate environment and their spending matches the income earned, then inflation will prove to be their nemesis.

Not retaining adequate liquid defensive assets can also be a major risk to a retiree. Ensuring certainty of spend if unforeseen expenditures arise is important. It can also help manage emotions and investor discipline.

## 3.17 Managing Expenses and Taxes

All investments have implementation and ongoing costs. Such costs are unavoidable yet should be minimised where possible. Self-directed investors may encounter be brokerage, administration and personal time costs. Adviser clients will see administration and investment costs, along with adviser fees.

An investor may incur various other costs. Crossing the buy/sell spread when buying shares. Stamp duty and legal costs when buying property. Interest charges when using gearing or leverage. Currency buy/sells when investing internationally.

Taxation can also be a major drag on investment returns. Whether it be income tax or capital gains tax, or GST. Every tax liability reduces the investor's net return.

A fiduciary should fully understand the costs their clients might incur and ensure they are minimised. A client's tax obligations should be minimised by all legal and practical means.

We achieve cost and tax minimisation by the following means:

- Using FYG Planners $3bn buying power to negotiate administration fee discounts for clients
- By being part of a $5bn buying group to achieve further administration fee discounts
- By researching and using only managed funds with low management fees relative to peers
- By using only managed funds with proven records in block trading, not crossing asset price spreads, patient trading and low turnover

- We submit to national and international surveys to ensure FYG adviser fees are market competitive
- Remaining up to date with Australian taxation law

We conducted a portfolio administration platform tender in 2001. This lowered client administration costs by around 15%. Subsequent negotiations in 2005 and 2010 have seen further discounts. Clients now see a discount up to 49% less than standard administration fees. Our commitment is to pursue administration cost savings for clients through ongoing negotiations.

Engaging with new entrants into the portfolio administration market is part of this process. This ensures we take advantage of new technologies and pricing advantages for clients.

The impact of fees cannot be underestimated. For example $1m invested with a gross return of 8% per annum for 30 years will grow to $4.321m if total costs are 3% per annum; but it would grow to $5.743m if costs are only 2% per year and $7.612m if costs are only 1% per annum.

### 3.18 Working Accumulators and Retiree Investors are Different

Working accumulators' most valuable resource remains their human capital. Their earning capacity multiplied by years of prospective work offers a guide to current capital value.

For accumulators our preference is to automate portfolio rebalancing as this has been shown over long periods to deliver more reliable and consistent results for those not drawing from their portfolios.

Working accumulators can choose to delay retirement if investment markets are unkind in their pre-retirement years. They may choose to work part time to reduce the draw upon their investment assets. They can benefit from dollar cost averaging by regularly investing into growth assets during their working lives, taking advantage of market declines to buy when prices are lower.

Retirees, having exited the work force, no longer have their human capital available as a financial resource. They are now reliant on their financial capital. This leaves retirees susceptible to sequencing risk. This is true in the years, pre-retirement, and the initial years, post retirement.

We attempt to mitigate sequencing risk for retirees using the following strategy:

Building block components utilised for each asset class within a portfolio. This is instead of 'all in one' diversified funds. At the establishment of a retiree's portfolio, we prefer to have no less than five times the client's first years anticipated drawings from their portfolio in cash and fixed interest asset classes. No less than 2 years anticipated drawings should be in cash.

All distributions from each portfolio component are directed to the central cash account. By taking these actions, we aim to assure the retiree that their first six years spending is catered for and their growth assets have a reasonable period to deliver expected capital growth. Our basis for this is history, since 1900 there has not been a period of seven consecutive years where Australian shares have delivered a negative return. See the AXA chart in section 3.4. The same can be said of US shares viewed from 1926.

If client portfolio experienced higher than expected capital growth in the early years of retirement, we would harvest some gains and recommence the '7 year virtually assured drawings' period. This concept is communicated to retiree clients before we commit to working with them.

If share markets fall heavily during the early years of retirement, we would the growth side of the portfolio remains unaltered. Neither selling down, nor buying more. We ensure they remain disciplined through the dip and help them manage their emotions. The goal is to remain invested and able to benefit from any ensuing recovery.

The retiree's portfolio would likely become more aggressive before any rebalancing took place. This is communicated to retiree clients before we commit to working with them.

### 3.19 Accepting 'Black Swan' Events Do Occur

With several hundred years' advice and investment experience across the investment committee. The have dealt with thousands of clients during that time, many of whom we stewarded from careers and businesses into successful retirements. In our observation, most people receive close to average market returns in the long term.

Some clients are extremely fortunate, they invest large amounts at low prices or retire pre a market boom. Other clients are extremely unfortunate with their investment outcomes due to 'black swan' events.

Financial market collapses like those of the Great Depression from 1929-1932, the Global Financial Crisis of 2007-2009, the OPEC Oil Crisis of 1973-74, or the two World Wars can have a catastrophic impact on investor's portfolios.

An investor who implements a diversified retirement portfolio immediately prior to one of these events, can be described as very unlucky, especially when one considers the average returns achieved since 1900. Advisers should explain to clients we can do little to avoid such events. We cannot reliably predict these events in advance, nor their impact on financial markets.

Similarly, an investor who has had a liquidity event and implemented an investment portfolio subsequent to one of these events can consider themselves very fortunate.

# Section 4: Investor Expectations

## 4.1 Past Performance of Asset Classes

The term 'past performance is no guarantee of future performance' reflects that active management is inherently unreliable.

In contrast, markets have long rewarded investors for the capital they supply, while academic research points to the differences in expected returns. Both history and academic research highlight an equity premium. In Australia, shares have outperformed cash and fixed interest securities since 1900. Recent 20-year Australian studies by Russell Investments have shown property has finished between shares and fixed interest.

History has shown sharemarkets have outperformed fixed interest securities over the longer term by around 5%. That has been the risk premium available to investors who have been willing to accept the volatility experienced by owning shares. This informs our belief that shares (higher risk) will deliver higher future returns than cash & fixed interest investments (lower risk). We expect property to return somewhere in between the two.

In 'Statements of Advice' to clients, we are careful to include long run data showing the historical return risk and return characteristics of an index portfolio of their risk profile. This includes the inflation adjusted average returns of their risk profile. See Annexure 4.1.

## 4.2 Drivers of Returns

In the USA, reliable financial market data exists back to 1926. The data available shows a number of key trends over the long term:

- Small cap shares have delivered higher investor returns Large cap shares
- Out of favour or unloved shares have outperformed popular or glamour shares
- Shares have outperformed fixed interest securities
- Long dated fixed interest securities have outperformed cash

In Australia, we have reliable data going back to 1990 and the identifiable key trends are the same:

- Unhealthy Value shares have outperformed healthy Growth shares
- Shares have outperformed fixed interest securities
- Long dated fixed interest securities have outperformed cash

Annexure 4.2. shows US, non-US, Emerging Markets and Australian date across various starting points. The charts further reinforce validity of the size and value in driving returns.

All clients are provided with data that highlights the historical evidence showing the drivers of returns in the various sub assets classes before they invest.

### 4.3 Investment Projection Rates Setting

Our expertise helps clients understand their potential financial prospects through comprehensive financial modelling. Asset class projection rates are applied within the FYG endorsed financial planning software.

When setting forward projection rates we are mindful and conservative. This sets reasonable client expectations. Projections are set well below the historic returns achieved by each asset class.

Our projection rate for Australian shares is 7.5% per annum (@ 31/03/2023) compared to the 13.0% historical return achieved by the ASX since the year 1900 (@ 31/12/2022).

The FYG Investment Committee sets the asset class projection rates. They determine portfolio projection rates the following way:

- The committee compares the average of past 60 months projection rates for each asset class as supplied by our research firm Lonsec. The average is the rate.

- Each six months the FYG Investment Committee checks to see if the moving average has not changed by more than one tenth of the prior value used or a return difference of 1%, if not, we continue to use the existing projection rate. If the rate has changed by more than one tenth of the prior value or 1%, then FYG Planners change the projection rates and our advisers adhere to the new FYG Planners set rates. See Annexure 4.3.

# Section 5: Investment Process

## 5.1 Three Portfolio Cost Components – Administration, Funds Management & Advice

Clients are educated in the differences between the three portfolio roles, along with their respective costs.

Clients are left under no doubt which party keeps records of their portfolio, and who holds custody of the investment assets within the portfolio. Clients understand that portfolio administration and record keeping is a specific role. It is separate to funds management and advice. Clients are counselled to understand portfolio administration has an identifiable and ongoing cost.

Investment funds are almost always separate to the administration service provider. Clients are educated that funds management is separate from portfolio administration and our advice. Funds incur a separate cost, specific to each fund within a portfolio.

Finally, clients who engage an adviser are generally looking to delegate their financial affairs. They are expected to pay for the ongoing expertise, advice, and service. Our ongoing fees may be based on a percentage of assets or a fixed annual dollar-based fee. We ensure our fees are clearly itemised as separate from administration and investment management.

## 5.2 Macro Investment Asset Allocation

As noted in Section 2.8, we strive to match our client's macro asset allocation with their risk profile, risk appetite and their need to take investment risk. We use a thorough risk profiling questionnaire to identify a client's appropriate portfolio asset allocation.

As a client's risk profile becomes more aggressive, their portfolio is tilted towards growth assets and some different sub-asset classes, while other subtle adjustments are made on the defensive side.

In the defensive allocation of a portfolio, Credit Risk and Term Risk are adjusted as the client's risk profile becomes more aggressive. The Term Risk factor is adjusted most in our model portfolios.

For clients with a risk profile above 70, we gradually introduce Global Emerging Markets into their Global equity exposure. Shorter dated fixed interest securities are reduced & eventually eliminated as portfolios become more aggressive.

See the investor risk profile example that appears in Annexure 4.1

## 5.3 Model Portfolios in Each Investment Administration Platform

We have developed an excel based system housing our portfolios across each risk profile, on every investment administration platform. The system completes the cost analysis for each model portfolio chosen while comparing that cost with a client's existing portfolio (if applicable).

The model portfolios on some platforms are ‘our best of breed’ portfolios; whereas some less used platforms include portfolios that are FYG Planners ’best compromise’ because our first-choice portfolio components are not available. See the tables of examples that appear in Annexure 5.1 and our further comments at Section 5.7.

## 5.4 Investment Selection

The cash option selected is generally the cash hub of the investment administration platform.

The fixed interest products chosen must best target FYG Planners Term risk and Credit risk factors.

In the property asset class, we prefer to use a reliable low-cost index managed fund provider.

In Australian shares, we use a Large companies fund based on the ASX100 index.

In the Value component of our Australian shares model portfolio, FYG Planners use managers whose funds target stocks with:

- High book to market ratios,
- High earnings to price ratios
- High cash flow to price.

The Australian value component of our model portfolio has over 140 shares in the portfolio.

In the Australian Small cap sector, we use managers who diversify very broadly and apply a cash profitability filter to eliminate small cap stocks with little history of genuine cash profitability. Some of FYG Planners’ preferred funds have over 200 shares in the portfolio and some may only have 40 stocks in the portfolio.

For global equities we prefer to utilise both hedged and unhedged versions of global equity managed funds or ETFs to pursue the same factors noted in the Australian equities description.

Some of our preferred funds and ETFs have over 6000 shares in the portfolio. For global emerging markets, we again prefer to use broadly diversified funds with a strong value bias. Our preferred managed funds and ETFs can have over 1000 shares in the portfolio.

## 5.5 Investment Due Diligence

The investment committee must meet with senior staff from the fund manager prior to adding any new investment fund to our model portfolios. This ensures a clear insight into the following:

- The investment process used
- The consistency of process application
- The filters applied to eliminate undesirable assets
- The historical inflows and outflows of the managed funds
- Reliance on key people
- History of key people retention
- Product costs and tax management
- Stability in the organisation

A new product can only be added to model portfolios after investment committee approval.

### 5.6 Investment Re-Balancing

Re-balancing portfolios has significant merit. Numerous studies have highlighted extra value can be created for investors through disciplined re-balancing.

Client portfolios are rebalanced according to specific client needs and life stages.

For most retirees (noted Section 3.18), we re-balance manually, only with client approval, based on their specific cash flow needs. This ensures growth assets aren't sold in a declining equity market. Equally, we look to harvest strong gains with the aim of funding future drawings after equity markets have been consistently strong.

For younger accumulating clients we will likely establish automated re-balancing each quarter or annually, subject to the client agreement. This ensures the accumulator continually takes advantage of low prices in growth assets, even when equity markets are depressed.

For non-retiree and non-accumulators, we will undertake half yearly or yearly reviews and re-balance based on actual and expected cash flows.

### 5.7 Small Accounts: Best Compromises

Many advisers service legacy clients with smaller accounts. For these people, advisers may choose to use a particularly cost-effective investment platform. Here they have no choice but to undertake modest compromises from our ideal portfolios.

For smaller portfolios on infrequently used platforms, we maintain model portfolios that are our best attempt to access the various investment risk factors we prefer to pursue and the investment portfolio framework we prefer to adopt. The investment compromises, whilst not ideal, are often outweighed by the cost reductions achieved for the client.

## Section 6: Investment Protection

### 6.1 Robust Administrators

Reliable portfolio administration services are non-negotiable.

The leading administration services are offered by Australia's leading banks such as ANZ, CBA, Macquarie, NAB & Westpac or their subsidiaries. All have the financial resources necessary to meet the challenges of doing business in an ever changing legislative, digital and market environment.

Each portfolio administration platform has a demonstrated strong record of service and capability.

### 6.2 Independent Custodians

Each portfolio administration platform engages an independent custodian to hold client investment assets. This separation of record keeping and assets holding provides valuable protection for client assets. The administrator does not actually hold the client's funds. They merely keep records.

### 6.3 Secure Capital Transfers

All client deposits and withdrawals are made according to very strict protocols to minimise any chance of fraud.

Client deposit funds may only be transferred by "not negotiable" cheque or direct deposit to the bank of the investment administration platform recommended.

Client deposit funds may not be banked into the account of any adviser or AFSL. No business operates a trust account and do not accept any investment funds in cash from any clients.

Client withdrawals may only be paid to the client's nominated bank account. Client withdrawal instructions may only be accepted in writing or by email, after they have been confirmed verbally by the client's adviser. This stance is taken to minimise the risk of cyber fraud.

If written instructions are received with altered bank details, these requests will not be met. The client's adviser and the client will need to speak directly prior the withdrawal processing.

### 6.4 Clients Retain Control

All client accounts are run on an investor directed basis. FYG Planners does not run discretionary accounts and as such FYG adviser clients always retain 100% control of their investments.

## Section 7: Implementation Process

### 7.1 Clarity of Communication

Advisers strive to communicate investment concepts to clients in plain language. While some clients can understand the complexities of investing, many do not.

We adopt an 'iceberg' approach to our investment process communications. Clients are supplied with investment documentation in line with their specific demands and requirements. All clients receive an 'executive summary' of FYG Planners investment process and some are provided this full philosophy to pursue.

Our Investment Policy Statement (IPS) documents are deliberately kept simple, in line with the Australian Securities and Investment Commission guidelines for clear and concise communications. However, each IPS also includes significant detailed investment theory information in the Annexure sections.

### 7.2 Investment Applications

After advisers receive a client's authority to proceed with investment recommendations, client services staff prepare all investment applications for clients to sign.

The applications are checked by the client's adviser and the client prior to execution to ensure all details are correct.

All signed applications are sent by a trackable mail service (Australian Express Post) directly to the portfolio administration service provider or lodged online through secure portals.

### 7.3 Completing the Client's Investments

Two days after sending the application(s), the portfolio administration service provider website is checked to confirm the account is opened (if prior email confirmation has not been received) and the funds have arrived into the portfolio cash account.

Then client services staff will undertake the transactions as noted in the client's IPS and the adviser will check the transaction record to ensure 100% accuracy.

Three days later the client's account will be checked to ensure all managed investment have been successfully purchased and correctly allocated to the clients account.

Confirmation is then sent to the client.

## Section 8: Investment Process Review

### 8.1 Macro Process Results Review

We produce a monthly report 'Asset Class Investment Report'. (Annexures 1.1). This report compares FYG Planners model portfolios to market index portfolios and a selection of relevant peers. *(NB: These reports all use a common end date for their data series).*

Each quarter FYG Planners produces a report on the performance of preferred fixed interest funds. This report compares the results of various indices, index funds and those funds we utilise in FYG Planners model portfolios. See Annexure 8.2.

Additionally, the Asset Class Investing process FYG uses, including the use of the managed funds most often used in FYG Planners model portfolios has been twice critiqued from the perspective of 'prudence', in 2004 and 2006 by respected Australian investment research analyst Michael Walsh and later in 2010 by Australian research house Paragem.

In each instance the process was independently found to be 'prudent'.