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INTERNATIONAL SHARE FUNDS – PART 2

This is the second in a two-part series of articles that analyses the characteristics of professional international share funds (unlisted) used in our client portfolios.

The aim of the second part of this two-part series is to provide you with a better understanding of three 'best of breed' international share funds – Antipodes Global Fund, Magellan Global Fund and Franklin Global Growth Fund. This includes the following:

- List and interpret the key characteristics of each international shares fund (investment objective, investment style, volatility of total returns, market capitalisation bias, number of stocks held in the portfolio, currency hedging and short selling).
- Investigate how to diverse into these international managers 'intelligently' based on their specific characteristics.

How to interpret the International share fund characteristics

Below are the key characteristics for the three International share funds - Antipodes Global Fund, Magellan Global Fund and Franklin Global Growth Fund. These characteristics were explained in the previous article which can be viewed here.

Investment benchmark/objective

As previously explained, the objective or benchmark of a fund is the basis for performance measurement. In the case of Magellan Global Fund, the fund is benchmark unaware or has an absolute return target of 9% nominal p.a. after fees. Similarly, Antipodes is benchmark unaware and aims to achieve an absolute return above a global benchmark. On the other hand, the Franklin Global Growth Fund aims to outperform a global benchmark by 2 - 3% after fees over the medium to long term.

Volatility of total return (tracking error)

As previously explained, the tracking error indicates how closely a fund follows the index. Tracking error is a measure of risk, the higher the tracking error the more risk the fund takes on. Franklin, Antipodes and Magellan don't target a certain level of tracking error, but history has shown they exhibit a medium to high level of tracking error which you would expect from benchmark unaware, active managers.

Investment style and market capitalisation

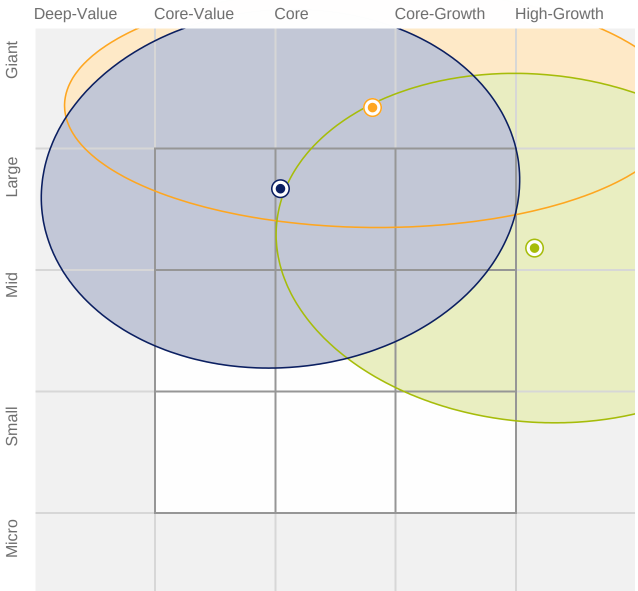
As previously explained, the style of a fund (value, growth and neutral/core) refers to the stock selection process a fund manager uses. Franklin Global Growth is a growth manager, Magellan Global is a value/neutral (core) manager and Antipodes Global is a true value manager.

As previously explained, the market capitalisation size bias of a fund indicates what type of stock/company a fund manager tends to invest in. Franklin predominantly has a bias of mid to large cap, Magellan mega cap and Antipodes mid to large cap.

The holdings based style map diagram below illustrates the investment style and market capitalisation of the Franklin Global Growth Fund, Magellan Global Fund and the Antipodes Global Fund.

The dot on the map indicates the aggregate market capitalisation and style of the relevant international share fund. For example, the green dot confirms that on aggregate the Franklin Global Growth Fund has a mid to large cap bias with a growth bias. The shaded area around the dot indicates the universe of companies in the relevant international share fund portfolio. For example, the Franklin Global Growth Fund contains stocks that vary from small to mega cap and have core to growth style characteristics.

Holdings-Based Style Map



Investment Name	Date
Antipodes Global P	31/08/2016
Franklin Global Growth (Inst)	30/06/2016
Magellan Global	30/06/2016

Centroid

Number of stocks held

All three international share funds hold concentrated portfolios. Magellan will hold 20 to 40 stocks in their portfolio, Antipodes 20 to 60 (including short sold stocks) and Franklin 40 to 45.

Currency management

The Franklin Global Growth Fund and the Magellan Global Fund are unhedged international share funds. That is, all companies are owned in their domiciled currencies. On the other hand, Antipodes will hedge currencies if they believe market conditions will adversely affect international equity investment returns.

Short Selling

Antipodes have the ability and mandate to short sell stocks (that is profit from a company dropping in value) while Franklin and Magellan do not.

To view and compare each fund's key characteristics within a table format click here.

How to build an International Share Portfolio 'intelligently'?

Client Objective: The client needs to focus on long-term capital growth, is prepared to accept negative returns in the short to medium term and has no reliance on consistency of investment income.

Consider which mix of international share funds has the following characteristics:

- Investment style diversification
- An allocation to medium and high tracking error funds
- Diversification of market cap bias
- Sufficient currency hedging capability
- Diversification of regional exposure

The following table is a possible combination of international share managers that may meet the need of the client.

Characteristics	Franklin Global Growth Fund	Magellan Global Fund	Antipodes Global Fund
Tracking error	Medium to high	Medium to high	Medium to high
Investment style	Growth	Value/Neutral	Value
Market cap	Predominantly mid - large cap	Concentrated in mega caps	Mid - large
Stock held	Low	Low	Low
Currency hedging	No	No	Low to medium
Regional exposure	Overweight Greater Europe	Overweight Americas	Overweight Greater Asia

Summary

It is important to analyse the fund objectives and seek funds that meet your long-term needs. You must look at the specific fund characteristics and ensure it matches your objectives. For example, a medium to high risk international share fund would include exposure to small and mid-capitalisation stocks, low number of stocks and funds that have a medium to high tracking error. You must always evaluate the funds, trading off the characteristics with the inherent risks of the fund.

It is also important to note that this article centres on three actively managed, specialist investment funds (unlisted). This is because, in our opinion, it currently offers the best approach in these economic and market conditions. However, as a non-aligned, independently owned practice, we will also look to other options such as Exchange Traded Funds (ETFs), Listed Investment Companies (LICs) and direct shareholdings on foreign exchanges, as when we feel circumstances dictate.

If you can combine a portfolio of international share investments 'intelligently' it should provide more consistent and superior risk adjusted returns over the medium to long term.

To view and compare the key characteristics of alternative international share investments click here.

BANK PARLIAMENTARY INQUIRY

Steve Blaker
Certified Financial Planner and
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As most people would be aware, the CEO's of Australia's 4 big banks have recently faced a special House of Representatives economics committee hearing/grilling. There were 10 members on the parliamentary committee, made up of 6 government members of parliament (MP's), 3 Labor MP's and 1 Green MP.

The banks were being questioned over a series of scandals including giving negligent and often completely flawed financial planning advice to customers, restricting payouts for disability insurance claims and allegations of rigging the bank bill swap rate. However, the final spark for the parliamentary questioning came when the banks didn't pass on to home loan customers the latest cut to official interest rates in full.

All 4 bank CEO's offered apologies for past behaviour and assured the committee that steps were being taken to improve it.

At Logical, we can only really comment with authority on their financial planning methods. By way of background, in Australia, financial planning can be broken down into two categories – Institutionally aligned and non-aligned.

Institutionally aligned would be practices with a corporate parent as the licensee (and possibly owner) i.e. the four banks, Macquarie, IOOF and AMP….and lately some of the big industry funds.

Non-aligned practices are generally independently 'owned' practices operating under an independently 'owned' licensee. There are varying reports about the split between the two, but most would concede it is probably close to 85% aligned and 15% non-aligned.

Logical has been in the camp of the latter since our origins of early January 1993. We have always been of the firm belief that institutionally aligned practices will have a high probability for conflicts of interest (implicit or not) between their client and their owners/shareholders. This certainly doesn't mean that there are not some excellent and highly skilled planners in institutionally aligned practices, but many operate within a very confined set of guidelines with sales targets at the forefront at all times.

A bank CEO disclosed in these committee hearings that all client-facing staff would have sales and referral targets that are linked to a potential annual bonus. Which begs the questions: How many bank customers own products that they either do not need or may be inappropriate for their circumstances? How many receive tailored, bespoke advice both initially and on an ongoing basis?

The opposition is calling for a Royal Commission because they believe (we suspect politically motivated) that there are fundamental systemic problems within the bank's financial planning networks. We would absolutely agree with those assertions and have done for 20 plus years. Those of our clients, who have known us for longer than a decade, would know of our continual frustrations at poor behaviour and practices that ultimately reflect badly on the profession as a whole.

Maybe naively, we are hoping that these economic committee hearings and increasing public outrage will force a change of behaviour, and importantly for the non-aligned fraternity, force full disclosure on whether an advice practice is aligned or non-aligned. This is preferable than an expensive Royal Commission but who knows….it may become the only solution!

AGE PENSION ASSET TEST CHANGES

Kate Cramsie
Financial Adviser

The social security assets test thresholds are changing from 1 January 2017. We previously wrote about this change and provided a case study in our September 2015 newsletter.

As a refresher, the level of assets you can have whilst receiving the full age pension (i.e. lower asset threshold) is increasing. In addition, the rate that pension entitlements reduce will increase to $3.00 for every $1,000 of assessable assets above the lower asset-test threshold from 1 January 2017. This is called the 'taper rate' and it is currently $1.50 for every $1,000. The effect is that the level of assets which can be held whilst still being entitled to a part age pension (i.e. the upper asset threshold) will reduce significantly.

Centrelink has now released the actual thresholds that will apply, and they are lower than originally estimated. The following tables show the current assets test thresholds as well as those that will apply from 1 January 2017.

SINGLES				
	Current Thresholds (20 September 2016 to 31 December 2016)		**Thresholds from 1 January 2017**	
	Lower	**Upper**	**Lower**	**Upper**
Homeowner	$209,000	$793,750	$250,000	$542,500
Non-homeowner	$360,500	$945,250	$450,000	$742,500

COUPLES				
	Current Thresholds (20 September 2016 to 31 December 2016)		**Thresholds from 1 January 2017**	
	Lower	**Upper**	**Lower**	**Upper**
Homeowner	$296,500	$1,178,500	$375,000	$816,000
Non-homeowner	$448,000	$1,330,000	$575,000	$1,016,000

***Lower** – recipients with assets at or below this level will be eligible for full age pension (subject to the Income Test).*

***Upper** – recipients with assets at or above this level will receive no age pension.*

The changes will not affect those currently receiving the full pension or for whom the income test is most dominant.

Centrelink have advised that impacted clients should receive a letter in October 2016 advising them of the likely impact. Asset values used in the calculation will be as at September 2016.

The following table estimates the reduction in Age Pension based on various levels of assets, assuming that the Income Test does not impact on the entitlement. Remember that the value of your home is excluded unless you are on over 2 hectares, in which case a portion may count as an asset.

	Level of Asset	Current Age Pension	Estimated Age Pension after 1 January 2017	Reduction
SINGLES				
Homeowner	$300,000	$19,256	$18,905	$351
	$400,000	$15,355	$11,105	$4,250
	$500,000	$11,456	$3,305	$8,151
Non-homeowner	$550,000	$15,414	$15,004	$410
	$650,000	$11,514	$7,205	$4,309
	$730,000	$8,394	$965	$7,429
COUPLES				
Homeowner	$500,000	$26,446	$24,632	$1,814
	$650,000	$20,596	$12,932	$7,664
	$800,000	$14,746	$1,232	$13,514
Non-homeowner	$750,000	$22,604	$20,732	$1,872
	$850,000	$18,704	$12,932	$5,772
	$1,000,000	$12,854	$1,232	$11,622

In terms of reducing assessable assets, there aren't many opportunities available and the strategies that exist may not always be suitable as they involve giving money away or locking money into inaccessible options. However, some choices to consider include:

- Check the asset values Centrelink have recorded are accurate and are based upon a fair estimate of immediate sale value (not to be confused with a replacement or insured value). Centrelink updates asset values for all Age Pension recipients every March and September. This means that the revised Age Pension estimates will be based on September 2016 values. You can submit updated asset values to Centrelink at any time.
- Gifting within the allowable limits - a couple or a single person can gift up to $10,000 a year but no more than $30,000 over a five-year period. Gifts within these limits reduce assessable assets.
- Purchase a funeral bond or pre-pay funeral expenses - individuals can either purchase a funeral bond for up to $12,250 or pre-pay funeral costs, but not both. These amounts are excluded from the assets test provided all requirements are met.

- Purchase a lifetime annuity or a term certain annuity with a term longer than five years – whilst the initial amount invested will count as an asset, if the annuity meets certain conditions, the asset value of the annuity will reduce every 6 months as income is paid.
- Use superannuation under age 65 - retirees with a spouse who is still under age 65 (or age 60 if a veteran) can transfer savings into that spouse's superannuation for exemptions under both the income and assets test.
- Upgrade or renovate the family home – the family home is an exempt asset, so any money used on upgrades or renovations will reduce assets.

When the assets test changes were originally announced the Government stated that those clients whose pensions were cancelled on 1 January 2017 would automatically receive a health care card that is not subject to an income (or assets) test. Centrelink have subsequently confirmed that:

- All pensioners will be automatically issued with a Low-Income Health Care Card, and
- Pensioners over age pension age will **also** be automatically issued with a Commonwealth Seniors Health Card.
- Department of Veterans Affairs pensioners who lose their pension will automatically be sent a Commonwealth Seniors Health Card and can claim a Low-Income Health Care Card if required.

If you receive a letter from Centrelink outlining changes to your entitlement, please forward a copy to us so we can discuss the impacts with you.

Looking for

Financial Advice?

In an ever increasingly complex financial and legislative world, our mission is to provide you with clear, concise and tailored strategic advice.

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