Managed Funds vs. Individually Managed Shares. What's best for you?

Since the GFC, investors appear to have become much more sceptical of holding their investments through a portfolio of unit trusts -or managed funds, as they are better known.

Managed funds are recommended to retail investors by financial advisers whose skills are in the strategic planning of family finances rather than investment management. By pooling investments into a unit trust, the funds were designed to provide cost-effective diversification across a range of different companies skilfully selected and managed by a professional fund manager.

For a portfolio of managed funds, investors pay an annual fee to the fund known as a management expense ratio (MER), a fee to the financial adviser to cover their fund selection, asset allocation and relationship skills and also a fee to the platform on which the funds are held. In total, fees may amount to 2-3% p.a.

For this level of fees clients expect:

- The underlying managed funds to outperform the underlying market
- The financial adviser to select the better performing funds
- The financial adviser to select an appropriate mix of funds that met the client needs and risk
- The portfolio to maximise after-tax returns
- The financial adviser to be accessible to clients and offer a proactive investment service

While no adviser or fund manager could have predicted the 55% fall in the Australian market in 16 months during 2007-2009, there are many investors who felt let down by their adviser, whether they were invested in managed funds or indeed direct shares.

In cases where portfolios fell markedly in value and were sold out of fear or because they were in an inappropriate margin lending situation, it was a real tragedy. It was impossible not to feel very disappointed for retirees whose portfolios were improperly constructed, saw their retirement savings decimated, then found themselves in frozen managed funds. This did not happen with direct shares such as CBA, BHP or Woolworths.

After listening and talking to clients over the last few years, we know they want:

- Better after-tax outcomes
- Better value, after platform and advisory fees
- Better and closer access to portfolio managers with deeper knowledge and experience of investment markets

This is where an individually managed share portfolio service — called 'individually managed accounts or 'IMAs' — can provide a real alternative to those disillusioned clients.

An IMA generally has the following characteristics:

- *Independent portfolio management company*
- *Experienced portfolio managers*
- *Personalised and proactive service*
- *Successful family clients*
- *Direct Australian securities*

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Here, in a little more detail, are the benefits of an IMA which address some of the weaknesses of managed fund portfolios:

- IMAs provide portfolios of direct shares such as BHP, ANZ Bank, Ramsay Healthcare or Wesfarmers rather than sell in-house product so their advice is always independent and unbiased.
- IMAs offer personal portfolio managers, with backgrounds in institutional research and fund management, who also act as client relationship managers and provide a highly personalised service.
- Every portfolio is different to reflect clients' needs and risk profile and selects from Australian equities, Australian fixed interest, overseas securities and cash.
- IMA managers adhere to a strong stock picking research process that selects stocks according to clients' investment objectives..
- IMA managers work closely with clients' accountants to ensure that their investments are structured for maximum tax efficiency, whether in their own names, partner's name, a family trust, company name or in Self Managed Super Funds.
- As shares are held in the client's own name, the IMA manager is able to manage the portfolio for better after-tax outcomes. Through direct shares (as opposed to units in a managed fund over which the client has no tax control), the IMA manager aims to minimise capital gains by taking advantage of the 50% capital gains discount as well as maximising franking credits.
- Managed fund clients have discovered that, in some cases, their managed fund structure has meant that they inherit existing fund unit holders' capital gains. In the event of a falling unit price on their first distribution, as in say 2007-2008, new unit holders may be hit with not only a falling capital value but also a distribution with an inherited tax liability. A direct share portfolio avoids such impact on distributions.
- IMA managers agree a performance benchmark with every client, such as the ASX 200 accumulation index (accumulation is dividends inclusive), that should reflect the investment objective for the portfolio. This ensures that the IMA manager is accountable for performance relative to the agreed benchmark. Technology provided by IMAs allows clients to track this on a continuous basis, as well as daily portfolio valuations.
- Fee levels vary per IMA manager depending upon the size of the portfolio and consist of an annual management fee, including administration and reporting system. Clients incur external brokerage to buy and sell the underlying shares at institutional rates. In total, clients may pay in the region of 1.25% to 1.75% compared to 2-3% for a managed fund portfolio.

In summary, clients are attracted to IMA managers for:

- Accessibility to their own portfolio manager with whom they enjoy a strong personal relationship.
- Their own unique portfolio of hand-picked direct shares tailored to their needs and risks.
- After-tax returns through owning individual stocks in their own name, enabling the management of capital gains and franking credits.
- Fees that are markedly lower than managed fund portfolios.

Many IMA managers are equity partners in their business so focus on building close relationships with clients when managing their wealth expectations. Satisfied clients often refer new clients to their IMA manager, creating growth for the business. Accordingly a strong client focus and culture is paramount.

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1,036 words