Investment choices

There are many types of investment vehicles to choose from, with managed funds one of the most popular choices in Australia. Here are some of the reasons for investing in managed funds, direct shares, bonds and exchange traded funds to help you work out which combination is right for you.

Types of investment vehicles:

- Managed funds
- Direct shares (listed equities)
- Exchange traded funds
- Investment bonds

What is a managed fund?

Managed funds pool the money of many individual investors. This money is then invested by a professional fund manager in different asset classes (eg shares, property and bonds) in line with the fund's stated investment objectives. When you invest in a managed fund, you are allocated a number of 'units', rather than shares. Each unit represents an equal portion of the market value of the portfolio of investments. Each unit has a dollar value, known as the 'unit price'. The unit price will vary according to changes in the market value of the investment portfolio or the total number of units issued for the fund.

What types of managed funds are available?

Growth funds	Focus on long term capital growth rather than income and are suitable for investors with a time horizon of more than five years. They mainly invest in Australian and/or international shares and property securities.
Single sector funds	Invest in just one asset class – either cash, fixed interest, property, Australian shares or international shares. Some also specialise within an asset class – for example geared share funds or global resources funds.
Diversified funds	Also known as multi-sector funds, these tend to diversify across a number of asset classes.
Index funds	Also known as passive funds or ETFs, these funds aim to achieve performance returns broadly in line with a selected market index (for example the S&P/ASX 200).
Active funds	These funds are actively managed and aim to outperform a particular index. The fund manager researches the market and buys and sells assets based on the fund's objective.
Income funds	Focus on generating an income stream with a lower risk of capital loss. These funds tend to invest primarily in cash and fixed interest investments.
Multi-manager funds	Sometimes referred to as 'fund of funds'. Rather than investing directly in shares, cash or fixed interest, this type of fund invests in a selection of other managed funds across a range of different investment managers.

What are the advantages of managed funds?

For some investors, managed funds provide the right amount of control without the time-consuming hands-on management required by direct investing.

The advantages of investing in managed funds include:

- **Access to sophisticated investments:** investing in a managed fund gives you access to a range of investments that may not ordinarily be available or affordable to you as a single investor.
- **Diversification:** through managed funds, you can access different fund managers, asset classes, companies, industries, sectors and countries. To achieve this level of diversification when investing directly, you would need large sums of money to invest.
- **Your money is managed by experts:** the qualified investment professionals managing your money have access to information, research and investment processes not readily available to individuals.
- **Regular investment plans:** many managed funds offer the convenience of a regular investment plan – deducted straight from your bank account – so you can add to your investments on a regular basis.
- **Select your investment style:** you can choose whether to invest in a managed fund designed to deliver income, or one focused on capital growth.
- **Distribution reinvestment:** managed funds make it easy to reinvest your earnings. This allows you to purchase more units with no additional cash outlay and take advantage of compounding over time.

Investing in shares

A shareholding is part ownership of a listed company. The shareholder receives dividends or income from their share investment and the company is able to raise valuable equity capital to fund its growth and operations. The shares can then be sold on the stock exchange and a potential capital gain realised if the share price rises – creating an opportunity for both income and capital growth.

What are the advantages of shares?

- **Flexibility and liquidity:** shares offer real-time pricing, this means you can buy or sell your shares easily and quickly at any time whenever the market is open. This allows greater transparency plus the flexibility to invest over the long or short term and pick your stocks.
- **Low cost:** shares are typically a cheaper investment option to manage due to lower operating costs and management fees.
- **Capital growth and dividends:** shares offer capital growth and maximum control over capital gains realised, as you can make the decision when to sell. Shares held by individuals or trusts for more than 12 months qualify for a 50% discount on any capital gains tax (CGT) payable, in addition complying super funds can qualify for a 33.33% discount. Shares also offer income paid as dividends.
- **Franking credits:** Australian shares often include franking or imputation credits, which means where the company has already paid the tax on their profits, you can use these franking credits to offset tax payable on your other income.

Investing in exchange traded funds

An Exchange Traded Fund (ETF) is an investment fund traded on stock exchanges, much like shares. An ETF can hold assets such as shares, commodities or bonds. ETFs usually track the performance of an index, giving investors access to an instantly diversified portfolio. ETFs are open-ended funds, meaning investors have the flexibility to buy or sell shares at any time. The premise of an ETF is that you are buying into a selection of companies in one hit, rather than individually picking each company to invest in. The value of your investment is driven by the underlying asset value and general market sentiment.

What are the advantages of ETFs?

ETFs can be managed as a passive investment, which is cost effective and your returns will more than likely match the market. Alternatively using ETFs as part of an actively managed portfolio can assist with reducing costs and enhancing portfolio diversification. Finally ETFs are a good way to gain exposure to international shares and foreign currencies. For an investor looking to avoid volatility, the risk from currency movements needs to be understood before proceeding with an ETF. You should speak to a financial adviser to ensure your investment portfolio suits your requirements.

Investment bonds

Investment bonds can provide you with a simple, tax-effective, long term investment. They are also known as insurance bonds, and are 'tax-paid' life policy investments. This means the life company pays the tax on the investment earnings, making them potentially a tax-effective way to invest.

What are the advantages of bonds?

Tax effective investing

One of the most significant benefits of investing in bonds is the tax advantages, particularly for investors on a marginal tax rate greater than 30% as this is the maximum rate the life company pays on its investment earnings. Another benefit is provided you hold your investment bond for 10 years, there is no tax on investment withdrawals (as long as contributions each year do not total more than 125% of the previous year's contributions). You can switch between investment options without tax consequences.

Investing for children

Bonds can be used as an investment vehicle for children without incurring a penalty tax rate. A bond can be set up in a child's name (ages 10–16) or you can invest on a child's behalf (under 10 years of age) and transfer the ownership when the child reaches a certain age.

Estate planning benefits

Bonds are an attractive investment for estate planning as proceeds can be paid to any beneficiary (not just dependants) tax-free. Bonds are flexible as you can nominate more than one beneficiary and stipulate the percentage paid to each upon your death.

Increased Age Pension

The amount of your Age Pension depends on your family circumstances, income and assets. A bond, held through a family trust, may provide significant advantages by maximising Age Pension payments if they're calculated under the Centrelink Income Test. They may also reduce aged care facility costs.

Ways your adviser can help

As with any investment, periods when markets are down or volatile are generally not a good time to make hasty decisions. If the value of your investment has fallen due to current market conditions, remember that you are only making a loss on paper. Selling your investment would make those losses real and irreversible.

If you are ever concerned about your investments, the best thing to do is talk to your financial adviser. They can provide clear, objective advice on how market movements may affect your investments and help to rebalance your portfolio and minimise your tax liability.