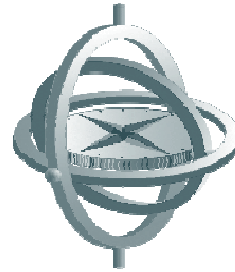


$\sigma_p = \sqrt{(w_A^2 \sigma_A^2 + w_B^2 \sigma_B^2 + w_C^2 \sigma_C^2 + 2w_A w_B \text{Cov}_{AB} + 2w_A w_C \text{Cov}_{AC} + 2w_B w_C \text{Cov}_{BC})}$ CAPM: $E(r_i) = r_f + \beta_i (E(r_M) - r_f)$ $\beta_i = \rho_{i,M}$ $f(x_i) = e^{-((x_i - \mu)/\sigma)^2 / 2}$ $\frac{1}{\sigma \sqrt{2\pi}} \sum_{i=1}^n (x_i - \mu)^2 (n-1) \sigma_p = \sqrt{(w_A^2 \sigma_A^2 + w_B^2 \sigma_B^2 + w_C^2 \sigma_C^2 + 2w_A w_B \text{Cov}_{AB} + 2w_A w_C \text{Cov}_{AC} + 2w_B w_C \text{Cov}_{BC})}$ CAPM: $E(r_i) = r_f + \beta_i (E(r_M) - r_f)$ $\beta_i = \rho_{i,M}$ $f(x_i) = e^{-((x_i - \mu)/\sigma)^2 / 2}$ $\frac{1}{\sigma \sqrt{2\pi}} \sum_{i=1}^n (x_i - \mu)^2 (n-1)$



PHILO CAPITAL ADVISERS

INVESTMENT MANAGEMENT
IN A MANAGED ACCOUNT WORLD

Disclaimer

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Presentation overview

1. Who are Philo and what are our MDA credentials?
2. Why MDA investment management is different
3. Are MDA's better suited to some investment styles than others?
4. What size portfolio do you need for an MDA to make sense?
5. Can using an MDA improve investment outcomes?
6. The stakeholders whose needs must be met
7. Who should do what in MDA investment management?
8. The revenue opportunity associated with MDA investment management
9. Conclusions

$\sigma_p = \sqrt{(w_A^2 \sigma_A^2 + w_B^2 \sigma_B^2 + w_C^2 \sigma_C^2 + 2w_A w_B \text{Cov}_{AB} + 2w_A w_C \text{Cov}_{AC} + 2w_B w_C \text{Cov}_{BC})}$ CAPM: $E(r_i) = r_f + \beta_i (E(r_M) - r_f)$ $\beta_i = \frac{\text{Cov}(r_i, r_M)}{\sigma_M^2}$ $f(x_i) = e^{-((x_i - \mu)/\sigma)^2} \frac{1}{\sigma \sqrt{2\pi}}$

Who / what is Philo?

An independently owned portfolio construction and management service for long term investors - focused on capital protection, sustainable real growth, and disciplined risk management

Philo Capital Advisers

Vision:

- To make a real difference in helping Australians achieve long term financial security

Values:

- To be true fiduciaries – free from conflicts, independent of product providers
- To charge purely on the basis of assets managed / advised, not on products sold, turnover, brokerage, rebates, trail commissions, etc
- To receive no benefits from any product providers or suppliers
- To attract the best people in the market who share our values and are motivated by a desire to contribute to and share in our success in achieving the vision

Differentiators:

- Un-conflicted – independence from product pushers – can offer investors the best solutions without fear or favour
- Scale – to develop unique processes in an unconstrained, conflict-free environment
- Independent thinking – not constrained by the dominant theory-of-the-day – have the freedom and resources to think independently and focus on what is best for investors
- Long term perspective – not driven by monthly fund flows or short term noise
- Integrated solution spanning investment, portfolio admin, portfolio construction policy, client communications, advice process, training, compliance

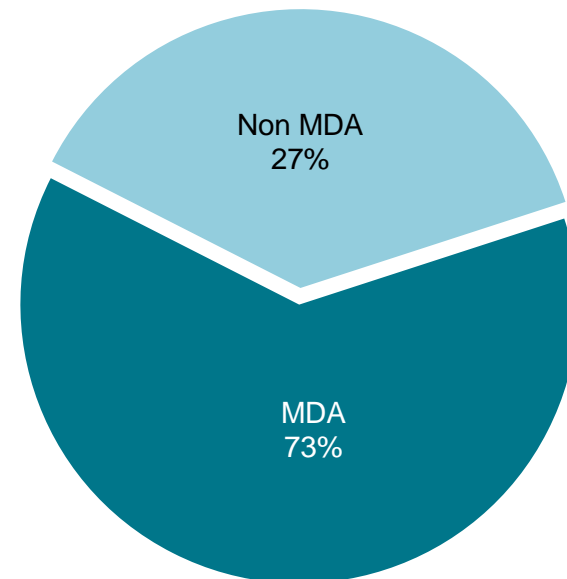
Philo services and investment philosophy



Some basic facts...

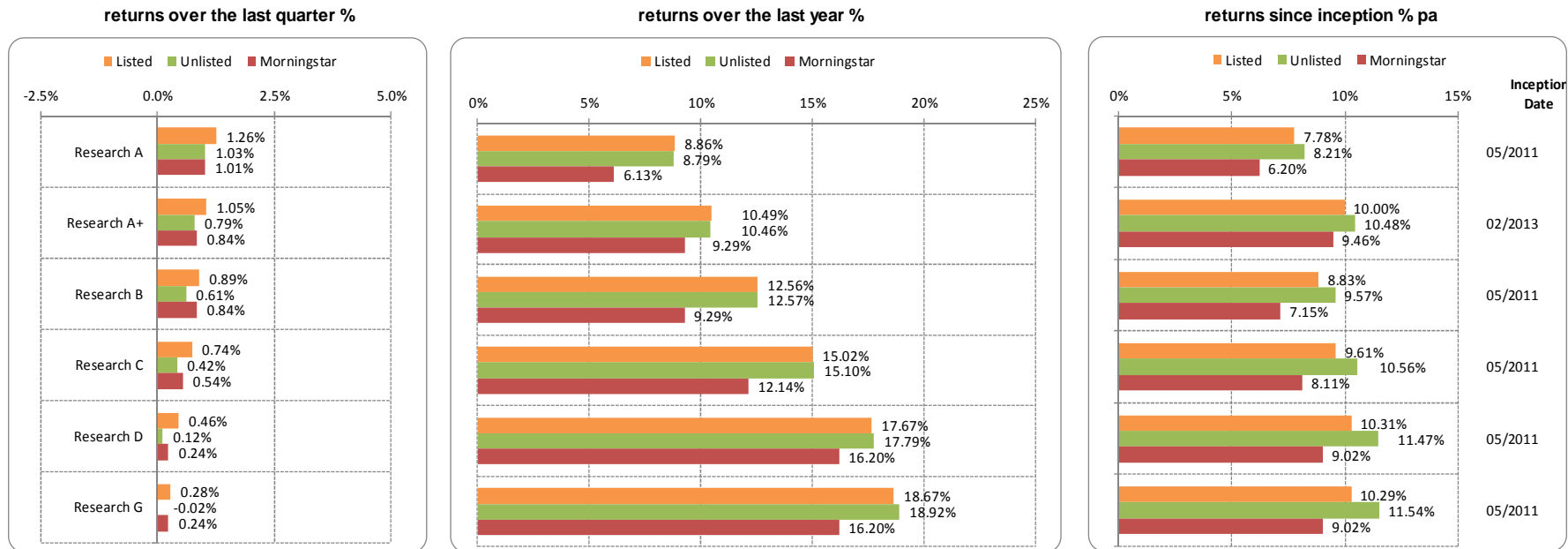
- Independent, growing business
- Sydney CBD office location
- 12 full time staff
- Adviser for approx. \$4 billion in investor funds
- Philo Portfolios administers \$2.9 bn in MDA funds
- Listed and unlisted, active and passive investments. Manager of large book of term deposits.
- A senior team with significant experience in financial services and markets
- Strong performance record for both asset allocation and fund / security selection
- Have developed extensive intellectual property re practice management as it pertains to investment

FUA - Approx. \$4bn



Philo Portfolios -v- Morningstar rating universe

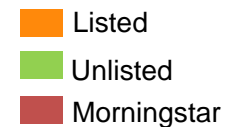
Research Portfolio performance *



* As at 31 March 2014

Note: Morningstar Composite Mapping

- Research A – Moderate (20-40% Growth Assets)
- Research B – Balanced (40-60% Growth Assets)
- Research C – Growth (60-80% Growth Assets)
- Research D – Aggressive (>80% Growth Assets)
- Research G – Aggressive (>80% Growth Assets)



Source: Morningstar Australia. Returns are to end March 2014

Past performance is no guarantee of future performance

Philo Research Portfolios -v- Morningstar multi sector funds

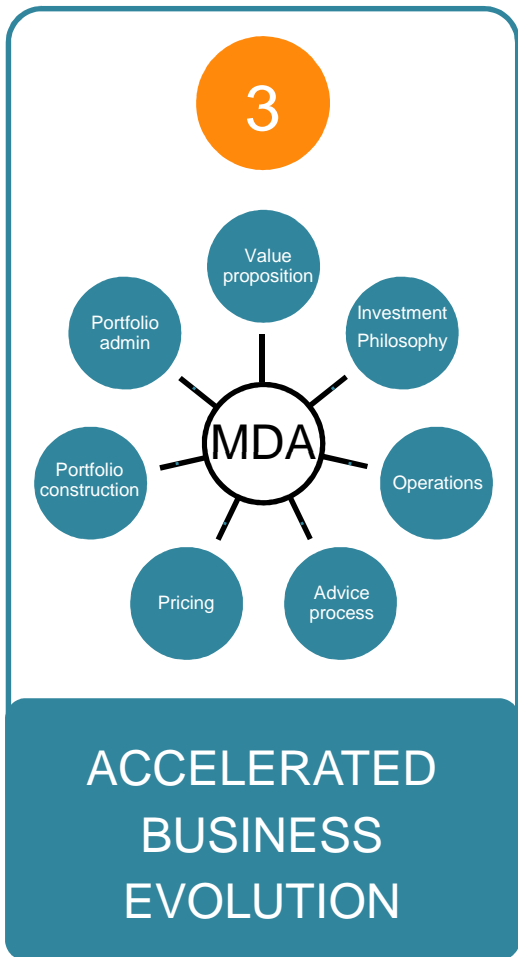
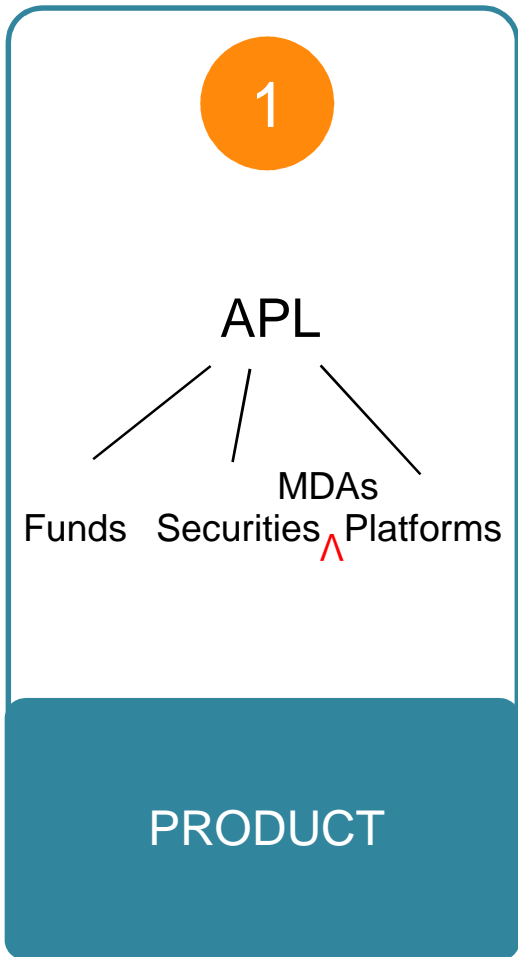
Many portfolios are top quartile + a number are top decile

Peer % Ranks

	Last quarter		Last year		Since Inception	
	Listed	Unlisted	Listed	Unlisted	Listed	Unlisted
Research A	67	44	95	94	88	93
Research A+	62	31	63	63	46	60
Research B	38	13	90	90	83	92
Research C	47	22	84	84	75	89
Research D	57	19	72	74	81	98
Research G	34	13	83	83	79	98

Note: The top attainable peer rank is 100

How do planning firms think about MDA's?



MDA Investment Management is different

- Implications of direct ownership of investments
 - Tax benefits to investors
 - Look mum, no unit price! (managing equity amongst investors requires focus, specialist processes and systems)
 - Managing liquidity
 - How to manage asset allocation processes when the portfolio includes illiquid / frozen investments or investments sensitive to turnover levels
 - Managing transparency
 - Investors see every trade and don't hesitate to ask questions
 - Tailored, yet scalable
 - Extent to which this is true varies significantly by MDA systems provider – a key consideration when introducing an MDA to your business
-
- These are portfolio management issues – not just execution issues
 - Running an MDA portfolio (properly) requires materially more thought and planning than a comparable unit trust portfolio

Are MDAs better suited to some investment styles than others?

- All styles benefit, but not equally
- MDAs particularly suit:
 - Active asset allocators with frequent reweighting (multi asset class portfolios)
 - Direct security portfolios (more frequent trading required)
 - Investments that can be readily traded and valued (even if they are notionally long term holds)
- Philo offers active / passive, listed / unlisted, bank deposits
- MDAs less suited to
 - Direct property
 - Over the counter securities
 - Privately held equity
 - Collectables

These investments can be accommodated in some MDAs, but there is not the same scalability or efficiency.

Minimum portfolio sizes for MDAs

- Minimum sizes are a function of:
 - The cost of “knowing the client” to produce an annual statement of investment program suitability (assuming MDA is not offered under a PDS)
 - “Optics” on individual holdings size
 - Any minimum transaction fees
- Where the circumstances are favourable, MDA portfolios can go as low as \$100K

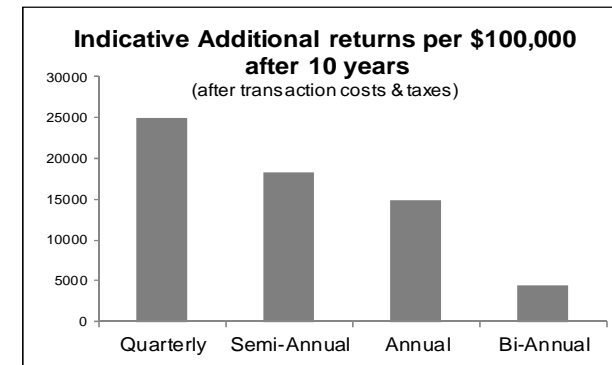
Can using an MDA improve investment outcomes?

(Based on Philo asset allocation models – past performance no guarantee of future performance)

Impact on indicative portfolio outcomes of different re-balancing frequencies

Re-balancing frequency	Out-performance of passive benchmark pa	Impact on \$100,000 compounded over 10 years
Quarterly	2.25%	\$24,920
Semi-Annual	1.70%	\$18,361
Annual	1.39%	\$14,802
Bi-Annual	0.44%	\$4,488

Incremental impact over passive re-balancing to benchmark		
Increase in portfolio turnover	Increase in transaction costs	Increase in taxes
23%	2 bp pa	7 bp pa
17%	2 bp pa	4 bp pa
10%	1 bp pa	2 bp pa
8%	1 bp pa	1 bp pa



(The indicative returns shown are after transaction costs and taxes)

Assumptions

Portfolio size: \$100,000

Weighting adjustments using quarterly multi-factor model

Benchmark = 50% cash/shares

Transaction costs = 10bp per side per trade

Tax rate = 15%

Returns are after transaction costs and taxes

Re-balancing frequency is applied to both Active and Passive portfolio

**Value added = 50 – 100bps p.a.
(Indicative)**

Key Stakeholders

Investors



Advisers



Staff



Referral Sources



MDA Investment Management – Stakeholder needs

- **Investors** – Arguably an MDA manager has no more power than a unit trust manager but.....the MDA operator is asking for discretion over their whole portfolio... Investors need strong reasons to believe that their portfolio will be managed successfully
 - **Advisers** – Need a credible role. If they are not credible in the client's eyes, neither is the planning firm or the firm's value proposition
 - **Business owners / principals** – need a business case encompassing return on capital, business risk, operational risk, brand impact and risk
 - **Staff** – want to believe in the business they work for
 - **Referral sources** – Need to see coherence, competence and consistency
-
- Does appointing a panel of well credentialed managers address all needs?
 - Does internalising investment management address all needs?
 - **Almost all MDA implementations get this wrong**

To investors

“Your life savings will be managed to world class standards by professionals who focus on nothing else”



To advisers

“Working together we will deliver an outstanding service that meets the needs of every client and will enhance your relationship with them”



To staff

“The company you work for does not compromise on quality of investment services”



To referral sources

“We will provide your clients with the most sophisticated and robust investment service in the market”



Should the planning firm be the investment manager?

- A new generation of consumers demands deep expertise
- The competitors are specialising
- The existing generation of investors are not buying the notion that financial planners are investment experts - massive formation of SMSF's, low market penetration of advice services, industry growth has stalled
- Referral sources do not want to be exposed to planners' investment decision making
- For most planning firms it is more credible in the eyes of clients, staff, referral sources that they are not the investment manager

BUT

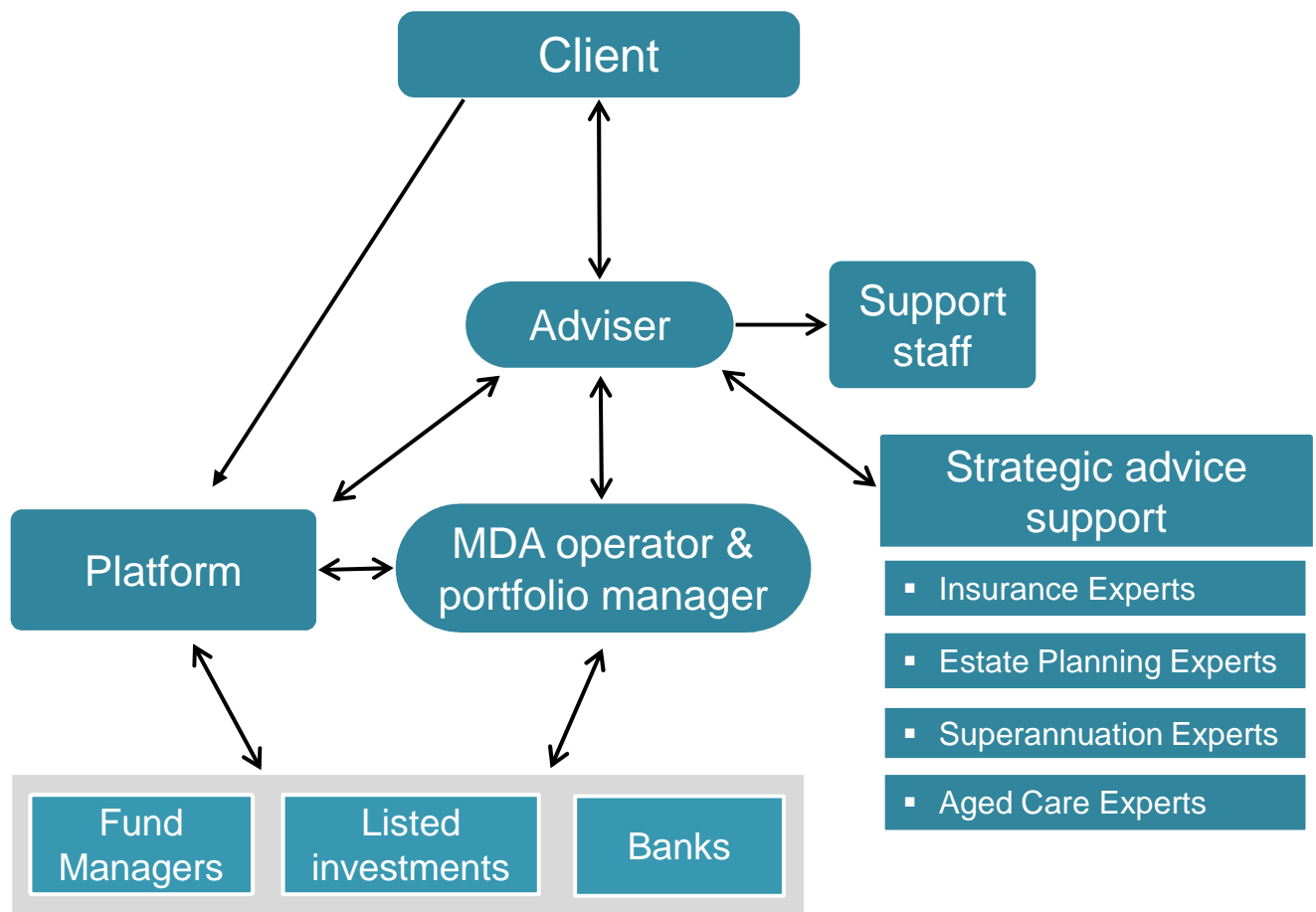
- *This does not mean that investors won't pay their planner for portfolio construction & management*

Who should do what in MDA investment management?

4 sources of quantifiable value add	Ave potential p.a.	Who
1. Right Portfolio for each purpose		
<ul style="list-style-type: none"> Portfolios not products – based on investors whole situation and goals Maximise the probability of achieving each investor’s required outcomes with minimum acceptable probability of falling short There is no perfect portfolio mix that will achieve all required outcomes for all investors (not “1-size-fits-all”) 	+/- 240 bps p.a.	Adviser (with right tools and support)
2. Dynamic Asset Allocation – across asset classes		
<ul style="list-style-type: none"> Can’t set and forget – conditions are constantly changing (static theory assumes straight line extrapolations) Avoid over-priced markets (static theory assumes markets are always “fair”) Adjusts portfolios with changing conditions, pricing, outlooks 	50 - 100 bps p.a.	Asset allocation specialist
3. Better performance – within asset classes		
<ul style="list-style-type: none"> Dynamic management of asset types within asset classes Better process to select, monitor, combine stocks/funds/sectors Access to ideas, asset types, funds not widely available 	20 - 80 bps p.a.	Stock/fund Analyst + Portfolio Manager
4. Better execution, implementation, administration		
<ul style="list-style-type: none"> Better execution + lower cost – scale, brokers competing More responsive review and re-balancing, tighter risk control Lower cost, better admin and reporting – to enable better decisions Specialists specialise in what they do best 	30 - 80 bps p.a.	Full-time MDA administrators with specialist systems & relationships

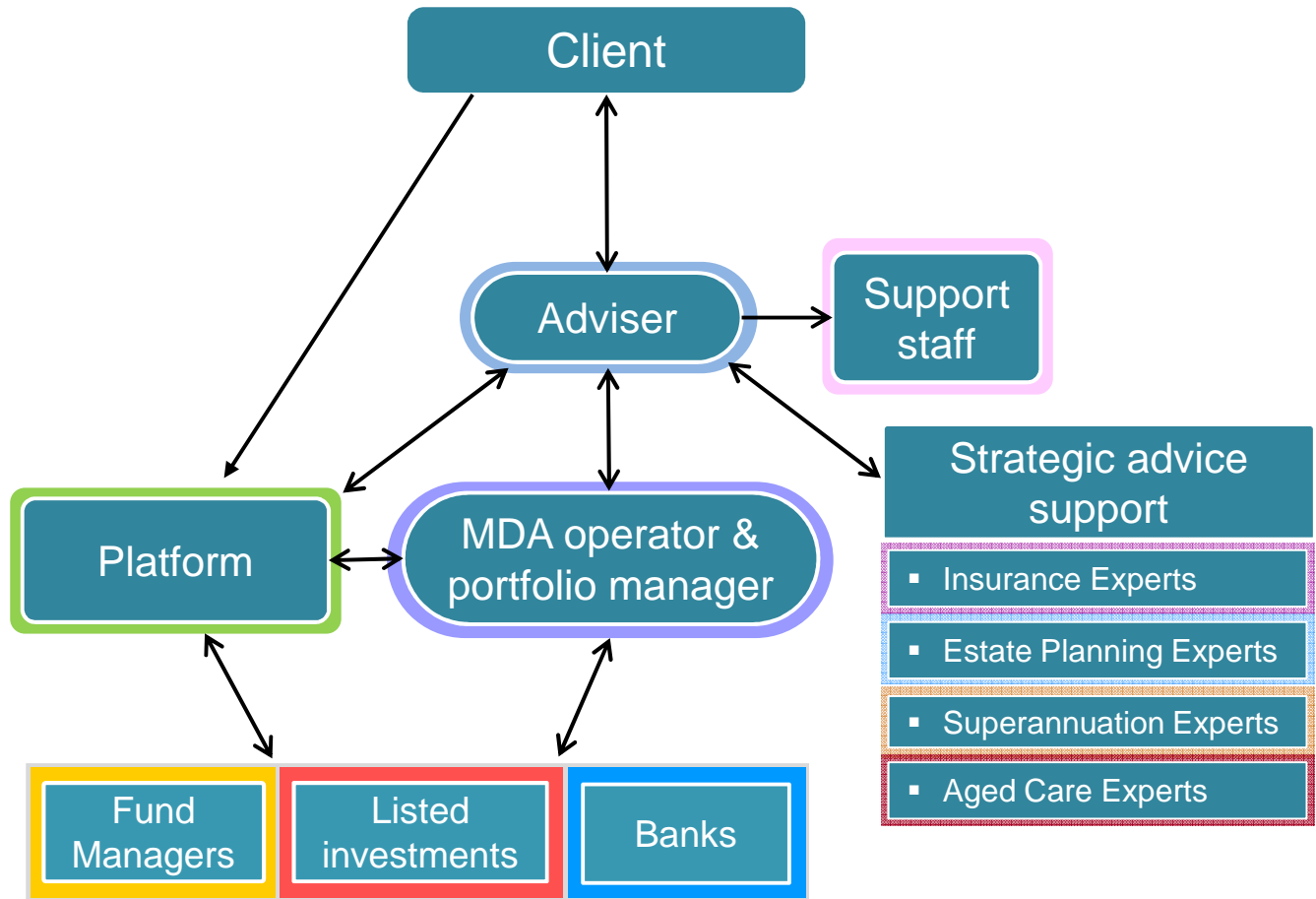
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Investors happier to pay for coherent assembly of experts



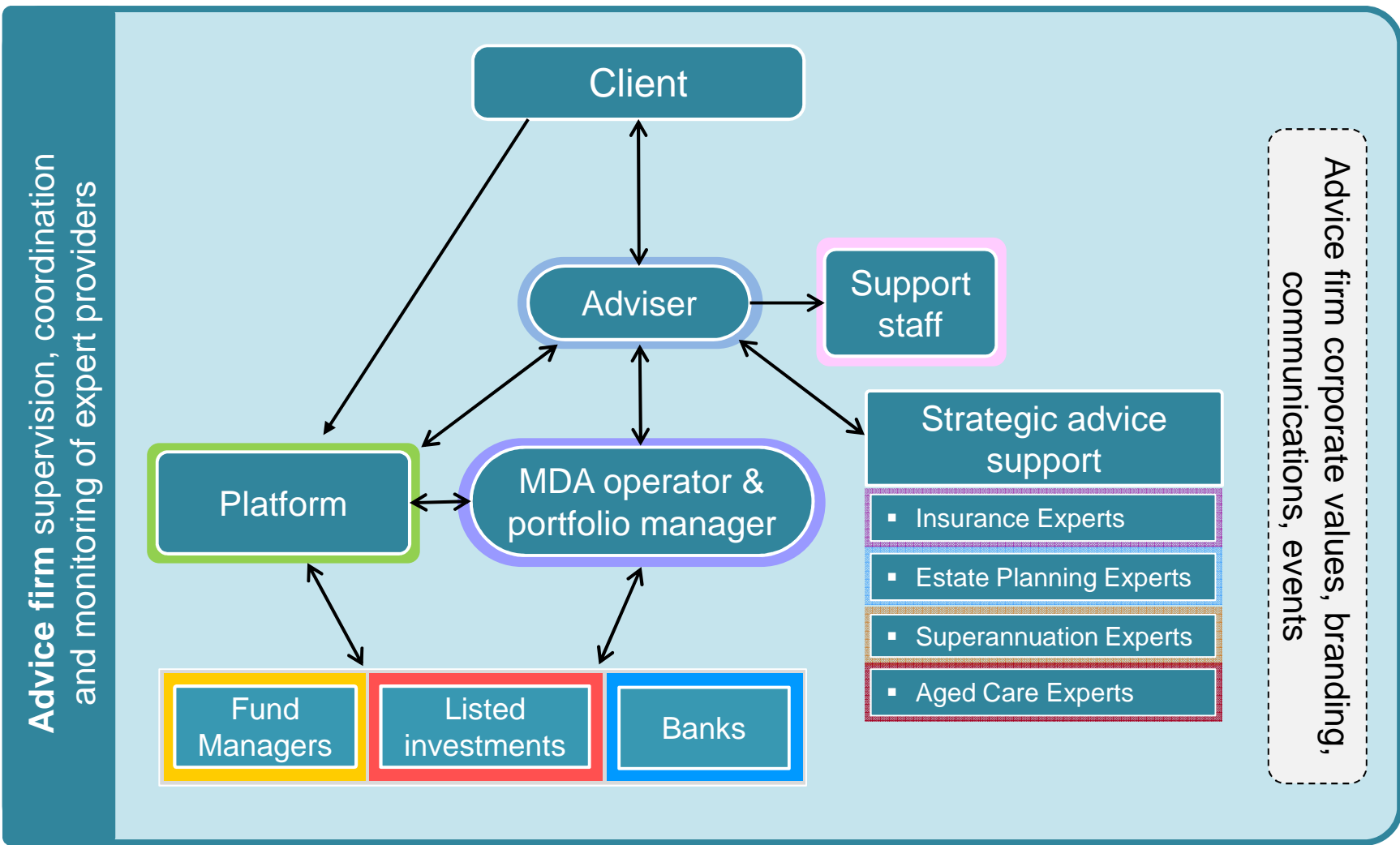
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$\sigma_p = \sqrt{(w_2A \sigma_2A + w_2B \sigma_2B + w_2C \sigma_2C + 2wAwB CovAB + 2wAwC CovAC + 2wBwC CovBC)}$ CAPM: $E(r_i) = r_f + \beta_i(E(r_M) - r_f)$

Investors happier to pay for coherent assembly of experts



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 $(E(r_M) - r_f) = \frac{1}{n} \sum_{i=1}^n (E(r_i) - r_f)$ $\beta_i = \frac{\text{Cov}(r_i, r_M)}{\text{Cov}(r_M, r_M)}$ $f(x_i) = \frac{1}{\sigma \sqrt{2\pi}} e^{-\frac{(x_i - \mu)^2}{2\sigma^2}}$
 $\pi \sum_{i=1}^n n_i = 1$ $(x_i - \mu)^2 (n-1) \sigma^2 = \sqrt{(w^2_A \sigma^2_A + w^2_B \sigma^2_B + w^2_C \sigma^2_C + 2w_A w_B \text{Cov}_{AB} + 2w_A w_C \text{Cov}_{AC} + 2w_B w_C \text{Cov}_{BC})}$

In the market for investment expertise?

This

or

This?



Q. Do you have to be the MDA investment manager to charge for MDA investment management?

A. No, that's a dangerous thinking trap to fall into. For most firms, your margins, operating risks, business risks and sales messaging will be better if you are not the investment manager.

Q. What are the typical revenue streams achievable for planning businesses for MDA investment management?

A. This is variable based on the nature of the service, how much customisation, nature of the assets, level of external funds management, what fees are already being charged for strategic advice etc. As a generalisation, we would say 50 to 100 basis points is achievable. Importantly this is a more sustainable revenue stream with a bigger valuation impact than most alternative revenue streams.

Q. What drives sustainability of different investment management revenue strategies?

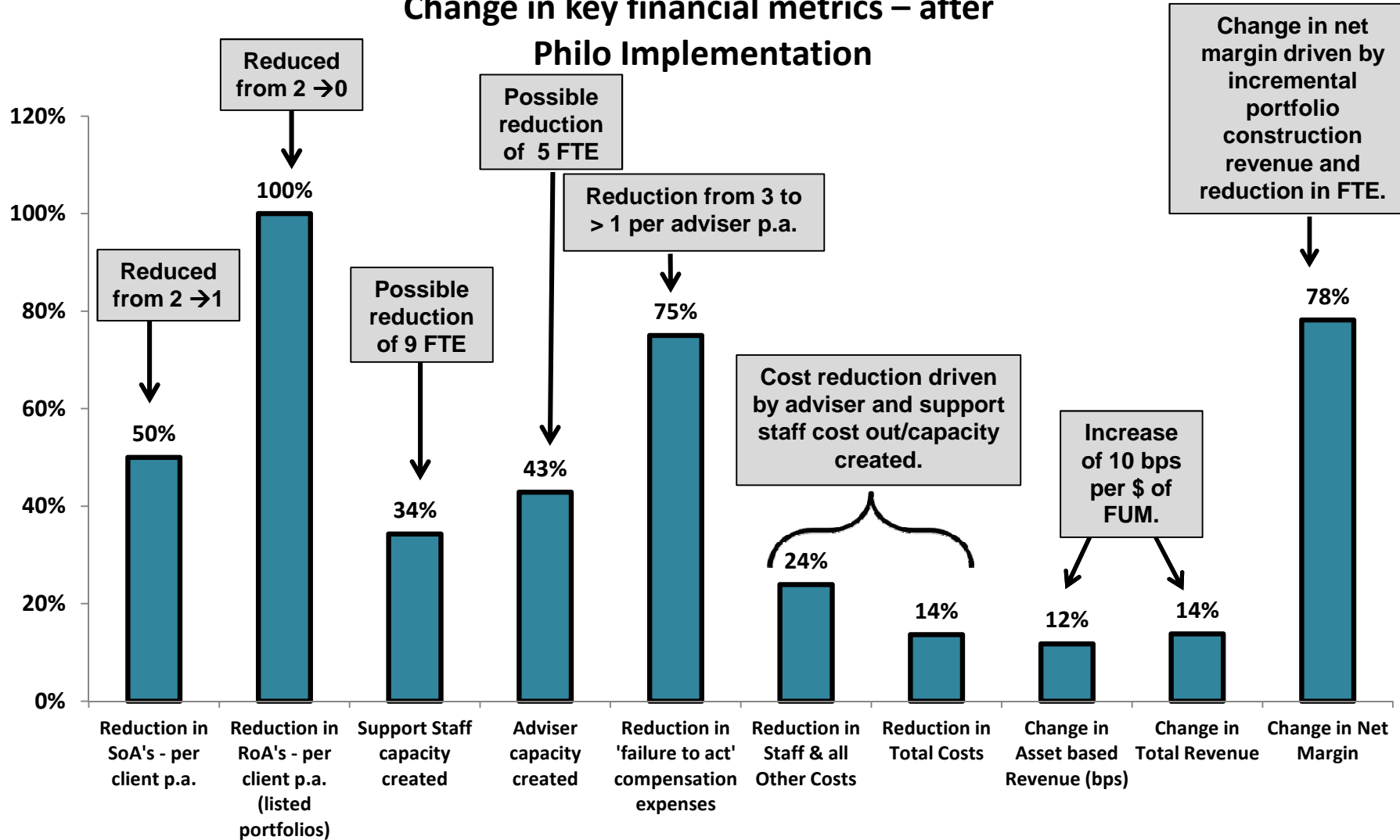
A. Value, delivery and trust. It is important, over a market cycle to be able to deliver value add from an investment standpoint. It is important that service delivery is reliable and that the investors experience is consistent with the promises that have been made. It is also important that there are no surprises along the way and that interests are aligned. Fees on transactions, related party product revenue etc can erode trust if they are not reasonable / explained in advance etc.

Q. Will using MDAs for investment reduce risk and internal costs?

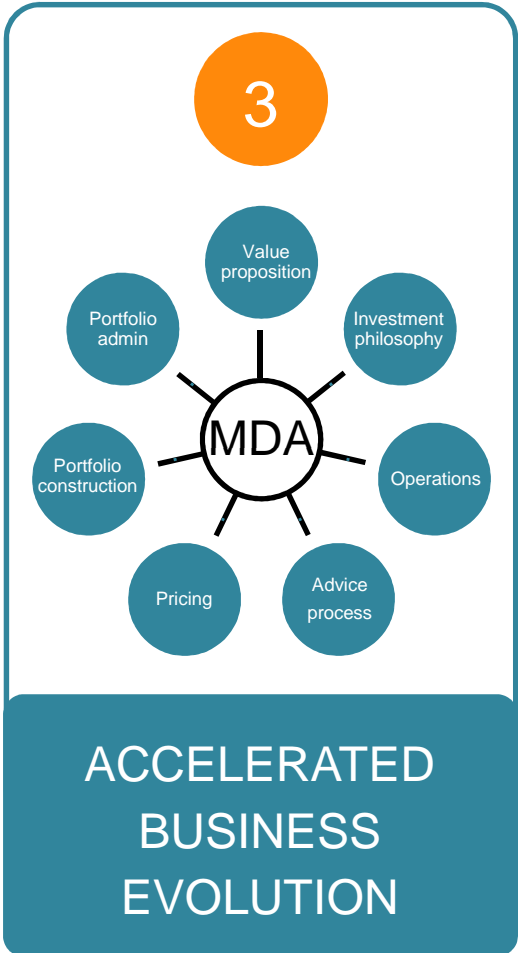
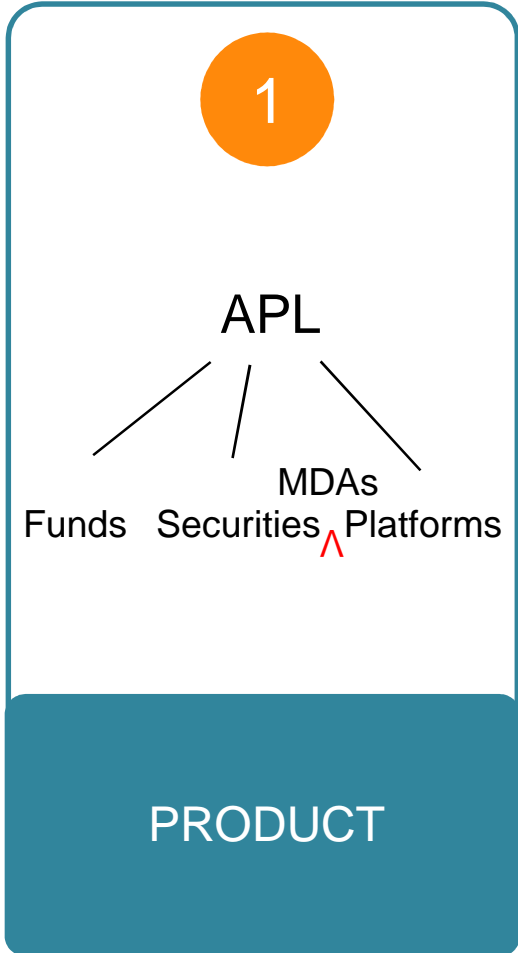
A. Done properly, the level of operational risk reduction is significant. There is also material operational cost reductions available if MDAs are used as a practice wide way of doing business.

AdviserCo business metrics – after Philo process implementation

Change in key financial metrics – after Philo Implementation



How do planning firms think about MDA's?



Conclusion

- Investment management via MDA is a superior approach for vast majority of investors
- Technically, it requires more skill in execution, not less
- Implementation amongst advisers and staff also requires significant effort and skill to be successful
- MDA is a massive win / win / win for investors, advisers, FP business owners - when done properly
- MDAs can now manage relatively small portfolios
- A material opportunity to create more sustainable revenue & reduce internal operating costs and risks
- Not all MDA's are the same. Some are just more efficient ways to deliver old style services, including old style investment management, some offer so much more.
- Outstanding investment management is at the heart of any successful MDA service – if you don't have a compelling investment story, you don't have a service people will pay a discrete fee for.

$\sigma_p = \sqrt{(w^2_A \sigma^2_A + w^2_B \sigma^2_B + w^2_C \sigma^2_C + 2w_A w_B \text{Cov}_{AB} + 2w_A w_C \text{Cov}_{AC} + 2w_B w_C \text{Cov}_{BC})}$ CAPM: $E(r_i) = r_f + (E(r_M) - r_f) \beta_i = p_i, M$ $f(x_i) = e - ((x_i - \mu) / \sigma)^2 / 2 \pi \Sigma_{n=1} (x_i - \mu)^2 / (n-1) \sigma_p = \sqrt{(w^2_A \sigma^2_A + w^2_B \sigma^2_B + w^2_C \sigma^2_C + 2w_A w_B \text{Cov}_{AB} + 2w_A w_C \text{Cov}_{AC} + 2w_B w_C \text{Cov}_{BC})}$ CAPM: $E(r_i) = r_f + \beta_i (E(r_M) - r_f)$ $\beta_i = p_i, M$ $f(x_i) = e - ((x_i - \mu) / \sigma)^2 / 2 \pi \Sigma_{n=1} (x_i - \mu)^2 / (n-1) \sigma_p = \sqrt{(w^2_A \sigma^2_A + w^2_B \sigma^2_B + w^2_C \sigma^2_C + 2w_A w_B \text{Cov}_{AB} + 2w_A w_C \text{Cov}_{AC} + 2w_B w_C \text{Cov}_{BC})}$



Wadhera

Thank you

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