

# SELECTING THE CORRECT “THREE BUCKET” COLONIAL FIRSTCHOICE WHOLESALE PRE-RETIREMENT PENSION FUND



A comparison of Colonial Wholesale fund options currently recommended by BL&A

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## GEARING OR NO GEARING?

**The first decision that the investor must make, relates to the decision to utilise internal gearing or not. Under the BL&A model, our 3rd bucket options incorporate funds which offer:**

- no internal gearing; and
- internal gearing.

Detailed information on internal gearing can be found in our document titled *Inside the 3rd Bucket – a generic look at the impact of gearing*.

In making this decision there is no right or wrong choice. It is more about what makes the investor “sleep at night” and their investment objectives. It is also true to say that “one size does not fit all”, in that an investor may choose to mix and match funds within their portfolio, having (say) 70% of their 3rd bucket in a non-gearred fund, and 30% in one with gearing. It is also possible to change the mix over time, as share markets and the cost of borrowing changes. It should not be forgotten that the 3rd bucket is about investing for the long term, and there will naturally be good and bad cycles over this period. It is therefore unlikely that an investor’s strategy will be set in stone for that entire period.

## CATEGORY ONE – COLONIAL FUNDS WHICH HAVE NO INTERNAL GEARING

### First Sentier Wholesale TTR Geared Share Fund

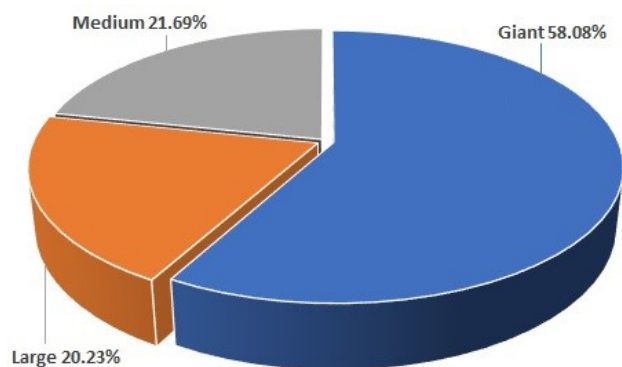
This is the only geared share fund offered by the Colonial FirstChoice fund for Transition to Retirement Pensions.

This fund has existed since 1997 (under the name Colonial First State) and hence is one of the few geared share funds to have a long term track record. Colonial utilise a concept known as dynamic gearing where the gearing ratio can be increased or decreased depending on market conditions. The gearing ratio cannot

exceed 55% and is usually around 50% meaning that it borrows \$100 for every \$100 invested.

The investment strategy of this fund is known as “GDP Plus”. It focuses on the shares of Australian companies that have strong balance sheets and whose earnings are expected to grow at a greater rate than the Australian economy as a whole. The strategy focuses on larger companies, with very small or no exposure to small companies.

This is seen in the graph below.



Within the fund (as at 31 August 2021) 58.08% of funds were held in shares in 'giant' Australian companies, 20.23% in 'large' Australian companies with none held in what would be considered 'small' or 'micro' companies.

Having said that this fund has a “blue chip” focus, it is also important to appreciate that the fund will rarely have more than 35 shares in the portfolio. Additionally, the “GDP Plus” investment approach will focus on “growth based” stocks, rather than those that (for example) pay consistent dividends.

The published list of the top ten stocks in the portfolio and their respective weightings as at 31 May 2021 is:

BHP Group Ltd	9.62%
Commonwealth Bank of Australia	8.49%
CSL Ltd	8.06%
National Australia Bank Ltd	5.96%
Westpac Banking Corporation	5.35%
Woolworths Group Limited	5.02%
James Hardie Industries NV	4.07%
Afterpay Ltd	3.23%
Goodman Group	3.19%
Domino's Pizza	3.10%
<b>Total</b>	<b>56.09%</b>

## ADJUSTING THE GEARING LEVEL OF YOUR 'COLONIAL 3RD BUCKET PORTFOLIO'

The choice of gearing in the 3rd bucket is not black or white (that is, to be geared or not geared). Where a client does not wish to have internal gearing, the third bucket will be comprised of an Australian index fund and a global index fund.

You may also use a combination of Australian non-geared and geared Bucket 3 options to adjust your level of gearing for .

- Colonial First State Wholesale TTR Index Australian Share (non-geared)
- First Sentier Wholesale TTR Geared Share Fund

With no International geared options available for TtRAPs through Colonial, international exposure in your 3rd Bucket will be with the Colonial First State Wholesale TTR Index Global Share.

For example, if the investor selected an even distribution across these two funds, the 3rd bucket would have approximately 34% of gearing which lies some way between electing (all) geared or (all) non-geared options. If they chose a 70/30 weighting, the gearing ratio would fall to around 24%. This arrangement may also suit the investor who wishes to gradually build up exposure to a geared investment, thereby reducing the possibility of entering the fund on the “wrong day”.

As another option, the third bucket could initially be invested 100% in the (non-geared) index funds and then gradually moved (say at 5% every quarter), towards the geared mix.

For further information on this, refer to the document titled *Inside the 3rd Bucket – a generic look at the impact of gearing*.

## 1ST AND 2ND BUCKETS

In the past, the investment strategy and performance of the first and second buckets have generally not differed greatly from fund to fund. It is for this reason that we have recommend the fund be selected on the basis of the third bucket, with the funds for the first and second buckets merely “going along for the ride”. With an environment of very low interest rates, some Bucket 2 “diversified” funds have moved to a higher level of growth assets. This gives the opportunity to further tweak your portfolio to enhance returns albeit at the “cost” of a higher risk level.

With this in mind, the Colonial options for the first and second bucket are:

Buckets	Colonial FirstChoice Funds
1st	FirstRate Wholesale TTR Saver (100%)
2nd	Colonial First State Wholesale TTR Multi-Index Diversified; and/or Colonial First State Wholesale TTR Multi-Index Growth

In accordance with our bucket approach, the 1st bucket must be 100% conservative as this is the part of the fund from which any payments will come. This must be invested in cash, accepting that this will not provide any sort of dynamic return. Its job is to be stable, to

allow the rest of the fund to seek the higher returns.

The role of the second bucket is to provide income 4-7 years from now. It must have enough in it to cover any withdrawals during this time, and must be invested appropriately until these funds are required.

The Colonial First State Wholesale TTR Multi-Index fund has a traditional diversified fund mix of 50% growth assets and 50% defensive assets. The Colonial First State Wholesale TTR Multi-Index Growth fund has a mix of about 80% growth assets and 20% defensive.

The growth assets of these funds are predominantly shares. The key thing about shares is that they produce relatively low levels of dividends (around 4-5%), so we are reliant on capital gains to increase their value.

## COLONIAL FIRSTCHOICE WHOLESALE PRE-RETIREMENT PENSION FEES

For as long as you are a member of the fund, the fund will charge you an ongoing fee. This fee covers the fund's ongoing role in the area of investing and administration. Logically, the more complex a fund is, the higher the fee will be.

Investment option	Admin Fees (pa)	ICR	Invest Fees (pa)	Total Management Fees (pa)	Cost (pa) \$10,000 Invested
FirstRate Wholesale TTR Saver	0.35%	Nil	Nil	0.35%	\$35
FirstChoice Wholesale TTR Multi-Index Diversified	0.20%	0.14%	0.49%	0.83%	\$83
FirstChoice Wholesale TTR Multi-Index Growth	0.20%	0.23%	0.56%	0.99%	\$99
Colonial First State Wholesale TTR Index Aust. Share	0.20%	0.00%	0.14%	0.34%	\$34
Colonial First State Wholesale TTR Index Global Share	0.20%	0.00%	0.15%	0.35%	\$35
First Sentier Wholesale TTR Geared Share – net	0.20%	0.56%	2.07%	2.83%	\$283
– gross	0.09%	0.25%	0.97%	1.31%	

The net rates are calculated as a percent of your own investment. The gross rates are on your investment plus borrowings.

### Impact of gearing on fees

In order to compare “apples to apples”, the administration fees and buy/sell spreads on Page 5 reflect both a gross and a net amount. By using a geared fund the size of the investment increases by virtue of the gearing, accentuating long term returns. The administration fees and buy/sell fees will also increase, based on the level of gearing involved.

For example, if there was no gearing in the First Sentier Wholesale Geared Share fund, the cost would be 1.31% or \$131 for \$10,000 invested. With the estimat-

ed \$11,603 borrowed, the cost is increased by \$152 (1.31% of \$11,603) for a total cost of \$283 per annum. By using a geared fund, the size of the investment increases by virtue of the gearing, accentuating long-term returns. The increase in fees will be based on the level of gearing involved, in this case about 54%.

### Indirect Cost Ratio (ICR)

The Indirect Cost Ratio (ICR) shows investment-related costs – that is, any amount not already disclosed as a fee that directly or indirectly reduces the return of an option. The ICR is expressed as a percentage of the

average net asset value of the fund. The ICR may include costs incurred in underlying investment vehicles.

This can include any or all of the following components:

- Expenses paid out of the fund's assets
- Legal, accounting, auditing fees
- Costs linked with derivatives and other investment vehicles
- Transaction costs such as brokerage fees

### Fee Rebates

Colonial First State FirstChoice will apply a fee rebate of 0.05% on the portion of the balance that exceeds \$100,000 but is under \$500,000, a fee rebate of 0.10% on the portion of the balance that exceeds \$500,000 but is under \$1,000,000 and a fee rebate of 0.20% on the proportion of the balance that exceeds \$1,000,000. Note that no fee rebate is payable on Colonial First State Wholesale TTR Strategic Cash and FirstRate Wholesale TTR Saver investment options although they are counted first in the portfolio balance bands.

The following table shows the rebate applicable if you had invested \$1,500,000 in the fund with \$200,000 invested in the FirstRate Wholesale TTR Saver option.

Portfolio balance – Colonial FirstChoice	Rate	Management Fee Rebate
First \$100,000 (All FirstRate Saver)	\$100,000 x 0.00%	\$0
Next \$400,000 (\$100,000 FirstRate Saver)	\$100,000 x 0.00% \$300,000 x 0.05%	\$0 \$150
Next \$500,000	\$500,000 x 0.10%	\$500
Over \$1,000,000	\$500,000 x 0.20%	\$1,000
<b>TOTAL:</b>		<b>\$1,650</b>

### FirstRate Saver TTR Account

From 3 September 2021, Colonial will introduce a Management Fee of 0.35% p.a. from on their FirstRate Saver TTR account. The interest rate to be offered initially will be 0.55% p.a. for a net return of 0.20% p.a. (an increase of 0.10% p.a. on the current rate). The Management Fee is variable and can range from 0.35% to 0.50% p.a.. The interest rate offered is also variable which means the net return may, at some time, be negative.

### Buy/Sell Spreads

When buying or selling the underlying assets of each investment option, transaction costs are incurred. This is often referred to as the Buy/Sell spread.

The fund makes an allowance for transaction costs incurred for each investment option by calculating an Entry unit price and an Exit unit price which are re-

spectively higher and lower than the actual unit price. New investments (including switches in) are made using the Entry unit price. Withdrawals (including switches out), fees and taxes are made using the Exit unit price. The table below shows the Buy/Sell spreads for each of the recommended fund options.

For example, a member makes a \$10,000 contribution to the Colonial First State Wholesale TTR Multi-Index Diversified option when the unit price is \$10.00. Entry transaction costs are 0.10% of the contributions. An allocation of 999 units is made to the member's account (\$10 is paid to cover entry transaction costs). If the member withdraws \$10,000 when the unit price is \$10.00, the 1,000 units would be redeemed using the Exit unit price of \$9.99 and the withdrawal amount would be \$9,990 (another \$10 is paid to cover the exit transaction costs).

Investment option	Buy/Sell Fees	Cost per \$10,000 traded
FirstRate Wholesale TTR Saver	Nil/Nil	Nil/Nil
FirstChoice Wholesale TTR Multi-Index Diversified	0.10%/0.10%	\$10/\$10
FirstChoice Wholesale TTR Multi-Index Growth	0.10%/0.10%	\$10/\$10
Colonial First State Wholesale TTR Index Aust. Share	0.05%/0.05%	\$5/\$5
Colonial First State Wholesale TTR Index Global Share	0.05%/0.05%	\$5/\$5
First Sentier Wholesale TTR Geared Share – net	0.20-0.50%/0.20-0.50*	\$20-\$50/\$20-\$50*

## BL&A Adviser Service Fee

When the client is on a “product and service” arrangement, they are charged an Adviser Service Fee. This ongoing Adviser Service Fee is charged in recognition of the ongoing role that BL&A will continue to have regarding the investment, monitoring and moving the buckets, etc.

Details about this service are contained in the separate documents *Investing through BL&A* and *Fees and Ongoing Service*. The Adviser Service Fee (inclusive of GST) charged by BL&A on your own invested funds (i.e. net and not the borrowed funds) is deducted by Colonial First State and is shown in the table below.

Investment option	Admin Fees (pa)	Adviser Service Fee (pa)	Total Admin/ Adviser Service Fee (pa)	Cost (pa) \$10,000 Invested
FirstRate Wholesale TTR Saver	0.35%	0.66%	1.01%	\$101
FirstChoice Wholesale TTR Multi-Index Diversified	0.83%	0.66%	1.49%	\$149
FirstChoice Wholesale TTR Multi-Index Growth	0.99%	0.66%	1.65%	\$165
Colonial First State Wholesale TTR Index Aust. Share	0.34%	0.66%	1.00%	\$100
Colonial First State Wholesale TTR Index Global Share	0.35%	0.66%	1.01%	\$101
First Sentier Wholesale TTR Geared Share – net	2.83%	0.66%	3.49%	\$349

## Companion documents:

*Inside the 3rd Bucket – a generic look at the impact of gearing*

*Investing through BL&A*

*Fees and Ongoing Service*

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