

# The Genesys plain english guide to investment terms

November 2009

If you're a little confused by the language of investing, our guide should help you out. If there's anything you don't understand, let us know. We'd be happy to speak to you.



GENESYS WEALTH ADVISERS LIMITED ABN 20 060 778 216  
AUSTRALIAN FINANCIAL SERVICES LICENCE NO 232686  
LOCKED BAG 26 EPPING NSW 1710  
TEL 1800 066 577 (TOLL FREE) FAX (02) 9869 0842

Information in this booklet is general in nature as it doesn't take into account your particular needs and circumstances. Please do not act without personal financial advice tailored to your situation.





### absolute return fund

A type of [managed fund](#) with a focus on providing a return to investors which is independent of the general market. These [fund managers](#) use different strategies to traditional fund managers enabling them to produce gains (or losses) regardless of what the general market is doing. The risk profiles of these funds vary greatly from conservative to high risk so it's important to understand the particular strategy being used by the fund.

See [hedge funds](#).

### active manager

A [fund manager](#) who seeks to achieve higher returns than the general market index (eg. the 'all ordinaries' index for Australian shares). Instead of trying to follow the market, they actively seek out opportunities to beat the market. Opposite of a [passive \(index\) manager](#).

Investing with an active manager may involve:

- higher fees because the fund buys and sells more often
- a reliance on the particular skill of the manager
- potential to achieve returns above the benchmark and so with that, higher volatility

Common types of active fund managers are:

#### i. value managers

A value manager seeks to identify and buy stocks when they are underpriced and to take profits when they become overvalued i.e. they take advantage of situations when shares trade above or below their fair value.

#### ii. growth managers

A growth manager focuses on the expected future growth of a company's earnings. Growth managers focus less on current price and more on the potential value of an investment.

### alpha

Refers to the additional return created by a [fund manager](#) above that of the general market. Alpha is a good way to measure an [active manager](#)'s success.

### alternative assets

Alternative investments may include: [hedge funds](#), [hybrid securities](#), [gold](#) and other selected [commodities](#) and resources.

Each alternative asset type has its own growth and/or defensive characteristics so it can be difficult to classify them into a particular asset class. For example, gold can act as a safe haven during volatile markets and in this way acts as a [defensive asset](#). At the same time the price of gold can also fluctuate widely and in this way it acts as a [growth asset](#).

Alternative assets generally perform differently to the more traditional asset classes and some are highly dependent on manager skill which may introduce a different type of risk to an investment portfolio.

Because alternative assets can have unique characteristics (both conservative and risky) they should be examined closely so the true nature of the investment is understood – alternatives aren't always as they seem. Another thing to note is that some alternative investments are [unlisted investments](#) and as such there may be [liquidity](#) issues and there can sometimes be a lack of available research.

### asset allocation

The process of spreading your investments across various categories of investments known as asset classes. Your asset allocation is also known as your [investment strategy](#).

## asset class

Asset classes are the six main categories of investments – 'cash', 'Australian fixed interest', 'international fixed interest', 'property', 'Australian shares', and 'international shares'. Each asset class has its own characteristics and risk / return profile and can be broadly grouped as either 'defensive' (cash, fixed interest) or 'growth' (shares, property) style investments.

## Australian shares

One of the six [asset classes](#). An Australian share represents part ownership in an Australian company. Categorized as a [growth asset](#), they offer a mix of capital growth and potentially tax effective income via dividends with attached imputation credits. Australian shares can be expected to exhibit more [volatility](#) than most other asset classes, however they also have the potential to deliver the highest return. They are a [long term](#) investment (5yrs +). Shares can be accessed through either [managed funds](#) or by [direct](#) purchases through the Australian Stock Exchange.

# b

## basis point

A measurement equal to one hundredth of one percent. Eg. "50 basis points" = half a percent. For example, if interest rates are at 4% and the reserve bank increases them by 25 basis points, the new interest rate is 4.25%.

## bond

A type of investment sitting in the [fixed interest asset class](#). With bonds, governments or businesses essentially borrow money from you in return for a promise to pay it back with interest. Bonds can be volatile when interest rates change and the risk of the investment varies between borrowers. While they sit within the fixed interest asset class, there is the potential to lose money.

# C

## cash

Another of the six [asset classes](#). Typically, cash refers to bank accounts, term deposits, cash management trusts, etc where your money is able to be accessed easily. Cash is one of the safest types of investments although the buying power of cash can be eroded by inflation over time. Cash generally offers lower returns than other asset classes, however it is lower risk.

## commodities

Physical substances traded on an exchange eg. oil, gold and other metals. Can also be food and grains.

# d

## debt to equity ratio

The proportion of your investment which is financed through borrowed money versus your own money. A higher ratio indicates a higher proportion of borrowed funds and therefore higher risk.

## defensive asset

An asset with a focus on income rather than capital growth. Defensive assets include [cash](#) and [fixed interest](#) eg. bank accounts, term deposits and [bonds](#). It should be noted however that not all fixed interest investments are necessarily defensive.

## derivatives

Financial products whose value depends upon the performance of another investment. They allow you to gain exposure to an underlying investment without actually owning the investment eg. the right to buy or sell the underlying investment (eg. a share) at a set price at a set time.

They can be used to:

- a) reduce risk (hedging)
- b) make profit from market movements

Derivatives can be complex and also risky if used to speculate on the future direction of the market. Examples include options, futures and warrants.

## direct investment

An alternative to a managed fund as it involves buying and selling shares and other investments yourself through an exchange such as the Australian stock exchange (ASX). With direct investing, you are making the investment decisions your self (or with the assistance of an adviser) as opposed to paying a [fund manager](#) to do it for you.

## diversified fund

See 'multi sector fund'.

# f

## fixed interest

One of the six asset classes. Fixed interest investments are things such as government [bonds](#), [mortgage funds](#) and debentures.

Over time the fixed interest asset class has expanded to include corporate bonds, inflation linked bonds, emerging market debt, asset backed securities (loans and mortgages) and hybrid instruments (convertible notes) to name a few.

When hearing this term, most people think "safe". While this is true with many fixed interest options, you can still lose money, so it's important to understand the true nature of what you are investing in.

## fund manager

The investment professionals who makes the investment decisions on behalf of investors in a [managed fund](#).

# g

## gearing

See 'leverage'.

## gold

You can physically buy gold as an investment. Gold is popular when investment markets are volatile as it is considered a "safe haven".

## growth asset

An asset with a focus on longer term capital growth. They include [Australian](#) and [international shares](#), [property](#) and some [fixed interest](#) investments. By their nature they are generally more volatile than [defensive assets](#) like [cash](#). Consequently, they are suitable for investors who have [medium](#) to [long term](#) investment horizons.

# h

## hedge funds

A type of [managed fund](#). These investments seek to maximise returns by using a number of sophisticated, complex investment strategies not found with traditional managed funds. Sometimes referred to as [absolute return](#) funds or [alternative assets](#).

Nowadays it isn't accurate to assume that hedge funds all try to "hedge" their risk. In fact, because hedge fund managers can make speculative investments, these funds can carry more risk than the overall market. Some hedge funds can also have [liquidity](#) restrictions making it difficult for investors to withdraw their capital before a certain time frame.

Not all hedge funds are the same - investment returns, volatility and risk vary enormously between funds.

## hybrid securities

Hybrid securities can be complex and often classified as [alternatives](#) investments. Having characteristics of both shares and debt, hybrid securities pay a predictable rate of return or dividend for a certain period of time, usually until a maturity or conversion date. At that date the holder has a number of options including converting the securities into the underlying share or cash or roll over for another term. So they may seem like a [fixed interest](#) type of investment, however unlike fixed interest, there is an option to convert to the underlying share. More common examples include convertible and converting preference shares.

Because of the somewhat complex nature of these investments, they are for sophisticated investors only.

See [alternative assets](#).

# i

## index manager

Also known as [passive managers](#), they are the opposite to an [active manager](#). These [fund managers](#) typically invest in companies which make up the market index eg. the ASX 200 Index. They don't chase opportunities but rather follow the market itself. These types of funds are generally cheaper than active funds, with volatility in line with the particular market they are tracking.

## index fund

A managed fund run by an [index manager](#) (refer above).

## infrastructure

An investment sitting in the [property](#) asset class. Investing in infrastructure means you are investing in things like airports, roadways, etc. These investments are not listed on the stock exchange so there may be liquidity restrictions. It can sometimes be difficult to obtain research on the quality of the particular investment.

## international shares

One of the [asset classes](#), international shares represent an investment in companies and sectors outside Australia. When investing abroad, the value of capital is affected not only by the value of the shares but also by currency exchange rates. Like [australian shares](#), international shares are [growth](#) style investments and have a [long term](#) investment horizon (5yrs +).

## investment horizon

How long you have to invest. Can be either [short term](#), [medium term](#) or [long term](#).

## investment platform

Are portfolio administration services also known as [wrap accounts](#) and [master trusts](#). They offer a centralised way to keep track of your investments, manage tax reporting and perform switches between investment alternatives quickly and efficiently.

## investment strategy

See '[asset allocation](#)'.

## investor directed portfolio service (IDPS)

An IDPS is a type of administration service (or [investment platform](#)) for holding investments. They are typically marketed as [wrap accounts](#).



## leverage

Refers to the process of borrowing money to invest. Leverage can be tax effective but can also be risky because investing with borrowed money has the potential to multiply losses as well as gains.

## leveraged buyout.

See '[private equity](#)'.

## listed investments

Investments which are listed on the stock exchange (ASX). The ASX creates a market for buyers and sellers of shares in listed equities providing [liquidity](#) for investors.

Listed managed fund investments are dynamic with the price being affected not only by their performance of the fund itself but also by movements on the stock exchange in general.

Listed investments include:

### a) direct shares

As a shareholder you participate in the company's performance via dividends (income) and /or growth in share price. Company shares are available across a wide range of investment sectors such as mining and resources, financial and industrials. Australian company shares also offer tax effective income via dividends with attached imputation credits.

### b) listed managed investment schemes

These are [managed funds](#) which are listed on the stock exchange. An example here may be a listed property trust – a managed fund (which invests in underlying property investments) which is able to be bought and sold on the stock market.

### c) listed investment companies (LICs)

Listed investment companies are managed by investment professionals and invest in a portfolio of assets such as local and international shares, infrastructure assets and private equity. In this way they are similar to managed funds, but there are important differences. While managed funds are unit trusts where the units are bought and sold through a fund manager, listed investment companies are companies investing in shares that can be traded on the stockmarket through a broker. They generally have lower fees than managed funds but the skill of the manager is important and it can be difficult to get commercial research on these types of investments.

### d) exchange traded funds (ETFs)

[Index funds](#) listed on a stock exchange.

## liquidity

The ease at which you can redeem your investment. A highly liquid investment is easily converted to cash.

### loan to value ratio (LVR)

The proportion of your portfolio which is funded by borrowed versus your own money. For example if you have \$30,000 and you borrow a further \$70,000, your LVR is 70% ( $\$70,000 \div \$100,000$ ).

An **increase** in investment value results in a **decrease** in the LVR and a **decrease** in the investment value results in an **increase** in the LVR.

See also 'margin lending' and 'debt to equity ratio'.

### long term

An investment horizon of more than five years.

### longevity risk

The risk that you may outlive your money.

# m

### managed discretionary account (MDA)

An MDA is an arrangement where you provide your adviser or fund manager with the authority to make and implement investment decisions on your behalf – similar to a power of attorney. With such arrangements, you agree for somebody to act on your behalf (within rules).

The advantage of an MDA is that the person you provide the authority with can act quickly to take advantage of market opportunities. However, while there are general rules within which they will operate, you do not know what individual transactions they will make on your behalf until they are done - you appoint them to have discretion over your money.

### managed fund

A common type of investment used by financial advisers. You are sold 'units' in the fund along with many other investors. The **fund manager** invests your money in accordance with a set of investment objectives and the unit price (like a share price) changes frequently depending upon the performance of the fund. You receive either income (distributions) or capital growth (losses) through an increase (or decrease) of the **unit price** in accordance with how many units you own. There are a range of managed fund options each investing in different ways. Also called 'investment trusts', managed funds can be either superannuation or non-superannuation.

### management expense ratio (MER)

The fee charged by the **fund manager** for investing your money and represents the total cost associated with investing in a **managed fund**. Expressed as a percentage, this fee is deducted from your return - you don't pay it out of your pocket.

MERs are generally higher with **growth** style managed funds as opposed to **defensive** or **passive** style managed funds. As well as covering the running costs of the fund, the MER also remunerates the fund manager for their role.

### manager style

Fund managers differentiate themselves in the market by their approach and philosophy. While each manager and managed fund has its own unique characteristics, generally they will adopt a particular style. Combining different managers with different styles is a good way to diversify.

Refer to 'active manager', 'passive manager' for examples.

## margin lending

Refers to a type of loan called a *margin loan* which enables you to buy shares or units in a managed fund where the shares or managed fund are used as security. If the price of the share or managed fund falls below a certain level and breaches your agreed [loan to value ratio](#) (LVR), you are required to contribute more funds personally to return your LVR back to its agreed level. If you can't, the investment is sold – sometimes at the wrong time. Like all geared investing there are risks and professional advice should be sought.

See also [Loan to Value Ratio \(LVR\)](#).

## market cycle

The cycle of behaviour that investments go through. All markets are cyclical - they go up, peak, go down and then bottom. When one cycle is finished, the next begins.

The four phases of the market cycle are:

1. Boom
2. Contraction
3. Recession
4. Growth

## market risk

Investment markets are driven by supply and demand causing prices to fluctuate resulting in [volatility](#).

## market timing risk

The risk that you try to pick the [market cycle](#) and get it wrong.

## master trust

Like [wrap accounts](#), master trusts are a type of administration platform providing simplified administration, consolidated reports on your investments (making it easier to analyse performance and manage tax) and a menu of investment choices.

Generally, there are two types:

- (a) *discretionary master trusts* where the individual investor selects the underlying investment product(s) from a list drawn up by the master trust manager or promoter; or
- (b) *fund of funds*, where the investor selects a general risk profile, for example, 'balanced' and the master trust manager or promoter selects the underlying investments from among a range of products managed by one or more managers.

### *How is a master trust different to a wrap account?*

The key differences between [master trusts](#) and [wrap accounts](#) (or [IDPSs](#)) lie in the portability of the underlying investments, certain taxation aspects and the degree of sophistication offered.

- **Portability**  
In many master trusts the underlying investment options are specific to that master trust and are held by a trustee on your behalf. This means that you have to sell the underlying investments in one master trust to invest in another master trust. This potentially triggers capital gains tax.
- **Taxation**  
In most cases investment wrap accounts are a custodial service and the underlying investments are held in your own name. So, investors who have an investment in one wrap could "in specie" transfer it to another wrap without triggering a change of ownership or capital gains tax.

Another difference lies in the sophistication - wrap accounts are more sophisticated versions of master trusts offering many more investment choices. They may cost a little more however.

See '[wrap accounts](#)' and '[invest directed portfolio service](#)' and '[investment platforms](#)'.

## medium term

An investment horizon of between one and five years.

## mezzanine fund

See '[wholesale fund](#)'.

## mortgage fund

A type of [managed fund](#) within the [fixed interest](#) asset class. The money invested in a mortgage fund is lent out in the form of mortgages or is invested in other mortgage funds.

Mortgage funds are relatively conservative investments and should be viewed as a medium term investment. They are not without risk. Two key risks are:

1. liquidity – the risk that you cannot easily convert your investment to cash – this is known as ‘fund freezing’.
2. default risk – the risk that borrowers default on the underlying loans of the fund.

## multi-manager fund

Also known as a ‘fund of fund’. Rather than investing directly in shares, cash or fixed interest, the [managed fund](#) invests in a selection of other managed funds usually managed by several different fund managers. Depending on the investment objective, the multi-manager may focus on one asset class or several.

Multi-manager investments are a good way to diversify your investments without having to invest in numerous managed funds. They are good for people with lower balances who want the benefit of several different manager styles in the one investment. However, because they actively hire and fire other fund managers, they are more expensive than other “pre diversified” solutions such as single manager diversified funds.

## multi-sector fund

A [managed fund](#) which invests across a range of asset classes, not just one. These funds are good for investors with lower balances who want a pre-diversified investment without the cost of many separate managed funds.

See ‘[diversified fund](#)’ and ‘[sector fund](#)’.

# p

## passive manager

A fund manager who doesn’t seek to beat the market, but follows the market. Sometimes also called an [index manager](#). Fees are generally lower because they are not actively buying and selling. Returns are generally less volatile although they can be lower than [active managers](#) who have a different approach.

## private equity

An investment in companies not listed on the Australian stock exchange (ASX). Can be risky in nature as these companies are sometimes new and seeking funds to grow. Some private equity investments called ‘[leveraged buyouts](#)’ can also contain a lot of debt.

## product disclosure statement (PDS)

An important booklet which is provided to you at the time you apply for a managed fund. It details the key features of your investment as well as the particular risks and fees involved so it’s important you read it. Our Statements of Advice (SOAs) may also refer you to particular parts of the PDS to assist us in explaining the basis for our advice.

## property trusts

One of the six main asset classes. Property trusts offer a way to gain access to property investments without having to have a large sum or mortgage. They are [managed funds](#) which invest in a range of underlying property investments and can be [listed](#) on the ASX or [unlisted](#). Listed property trusts can be more volatile than [unlisted](#) property trusts and may also have currency risk. Unlisted property trusts are an [unlisted investment](#) and may have less [liquidity](#) and [hybrid](#) property trusts offer investment in a mix of listed and unlisted property.

Property trusts can exhibit both “[growth](#)” and “[defensive](#)” characteristics paying a combination of income and capital growth.

# r

## real rate of return

The rate of return you receive from your investments after inflation.

## retail fund

Older style managed funds accessible by investors directly from the fund manager (as opposed to being offered through an [investment platform](#) or [wrap account](#)). Retail managed funds usually have upfront and ongoing commissions payable to financial advisers and higher [MERs](#).

## risk

The chance that your investment outcome is not as expected. This can mean many things:

- a) you permanently lose your money in part or in full. Otherwise known as product failure.
- b) the returns you receive are not the returns you expected although this should not be confused with volatility which is the normal ups and downs of investment returns as the investment moves through its cycle.

There are other types of risk involved such as:

- a) longevity risk – the risk of you outliving your money.
- b) Inflation risk – inflation can cause money to lose buying power over time.
- c) Interest rate risk – interest rates go up and down depending on the economic climate.
- d) liquidity risk – the risk that you cannot access your money when you want.
- e) legislative risk – the government can change the law causing an adverse outcome for the investor.

## risk tolerance

An industry term to describe your emotional tolerance for volatility of returns. This term should actually be your 'volatility' tolerance because we define risk as the chance of losing money – and no one likes to lose money. When we talk about your comfort level, we are really talking about how much volatility you are comfortable with. We classify our client's tolerance for volatility as either: Conservative, Moderately Conservative, Balanced, Growth or High Growth.

Also (incorrectly) referred to as your risk profile.

# S

## sector fund

See 'single sector fund'.

## strategic asset allocation

Your long term strategy of spreading your investments across the various asset classes - cash, fixed interest, shares, property and alternatives. It is designed by considering your [risk tolerance](#), investment horizon and your particular financial objectives. Your strategic asset allocation refers to the [long term](#) - it's different to a [tactical asset allocation](#) which refers to the [short](#) or [medium term](#).

## short term

An investment horizon of less than one year.

## single sector fund

A [managed fund](#) which invest within one asset class only, such as international shares only. However, they still diversify across a number of investments within the chosen asset class. This means the fund manager needs to have knowledge of the particular asset class selected. Also called '[sector funds](#)'.

## supplementary product disclosure statement (PDS)

Is used to communicate a change in the original PDS given to you at the time you apply for an investment (usually a [managed fund](#), [master trust](#) or [wrap account](#)).

See '[product disclosure statement](#)'.

# t

## tactical asset allocation

The process of adjusting your long term [strategic asset allocation](#). Common reasons may be to react to the market cycle or to ensure your portfolio has the right income or growth characteristics.

See '[tilt](#)'.

## tilt

Occurs when your adviser recommends a change to your long term [strategic asset allocation](#). Reasons for "tilting" your portfolio include reacting to the general market cycle (e.g [tactical asset allocation](#)) or another specific requirement of your wealth plan eg. targeting certain investments to provide you with more income.

## today's dollars

A projected value discounted to take inflation into account. For example, the future value of \$10,000 may only be \$9,500 after it is adjusted for inflation.

## top down

A type of [manager style](#). The approach starts with forecasting broad macro economic trends. The manager then looks at how these economic trends will impact on individual investment sectors and then finally on individual assets. Investments are made into those sectors asset classes expected to provide the best returns and then into the best investments within those asset classes. The opposite of 'bottom up' investment style.

# u

## unit price

Just as the share price relates to the price of your shares, the unit price refers to the price of your units in your [managed fund](#) investments. Like a share price, the unit price fluctuates in line with the value of the assets of the fund relative to the number of units on offer from the fund. Higher unit prices mean higher returns and lower unit prices mean lower returns.

## units

In the same way you refer to the number of shares you have when talking about your share investments, units refer to the number of units you hold in your [managed fund](#) investments.

## unit trust

See '[managed fund](#)'.

## unlisted investment

Opposite to an investment listed on the Australian stock exchange. Because unlisted investments aren't traded on an exchange, there is no immediate market and this can sometimes create [liquidity](#) problems for the investor.

See '[listed investment](#)' and '[liquidity](#)'.

# V

## volatility

See 'risk'.

# W

## warrants

A type of [derivative](#) – that is they 'derive' their value from another thing. They allow you to gain exposure to an underlying investment without actually owning the investment eg. some warrants give the owner the right to buy or sell the underlying investment (eg. a share) at a set price according to the terms of the warrant. Some warrants have higher risk/return profiles than others that offer lower risk features such as capital guarantees.

## wrap account

Also referred to as an administration service, [IDPS](#) or [investment platform](#), they are similar to [Master Trusts](#). Wrap accounts combine (or wrap) all of your investments into one manageable account. They are commonly used by financial advisers as a means to manage and administer your investments. For a fee, wrap accounts offer investors:

- a selection of many investments including managed funds and direct shares
- the ability for your adviser to switch investments easily to keep your portfolio in line with your investment strategy
- internet access to view information on your portfolio
- tax and performance reports on your consolidate investments
- access to lower cost wholesale funds

With wraps accounts, you remain the beneficial owner of the portfolio and still have the discretion to make all the investment decisions.

See also '[IDPS](#)' and '[master trusts](#)'.

## wholesale fund

A wholesale [managed fund](#) generally has higher minimum investment amounts and lower costs. The larger amounts invested generally mean fewer investors and greater economies of scale in operations, and this is reflected in a lower [management expense ratio](#).

[Wrap accounts](#) and other [investment platforms](#) also access wholesale managed fund investments, although in different ways to direct wholesale investment. This affects the cost structure and the way in which the fund may be offered to investors and the MER. Managed funds accessed in this way are commonly referred to as a [mezzanine funds](#) because they offer access to wholesale funds at a cost between retail and direct wholesale rates.

Wholesale managed funds can be accessed directly from the [fund manager](#) with information on the fund available from the [Product Disclosure Statement](#).

