



The Investment Book

*TOWER's guide to growing your
wealth through managed investing*



Let's get started



Introducing TOWER

TOWER has been meeting the personal financial security needs of New Zealanders for over 135 years.

With our in-house investment management expertise, proven investment performance and our comprehensive range of reliably managed investment products, we're well placed to help New Zealanders understand how to create long-term wealth by investing in managed fund investments.

Our established relationships with a wide network of financial advisers also means we can put you in touch with a professional who can discuss your specific financial situation, no matter where you are in the country.


For more information about managed investing or to select from TOWER's extensive range of managed investments, please talk to your financial adviser, call us on 0800 4 TOWER (0800 486 937) or email on investments@nz.towerlimited.com. You can also visit our website www.tower.co.nz.



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The information contained in *The Investment Book* is of a general nature only and does not take into account any individual's particular circumstances, financial or otherwise. It is not intended to provide a substitute for comprehensive or specific investment advice. Readers should obtain professional, independent financial advice relevant to their circumstances before making any decision to invest.

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Introduction

Managed investments provide you with a convenient and easy way to build your long-term wealth.

By pooling your dollars with those of other investors, and using TOWER's buying power and expertise in investing you can use managed investments to help you achieve capital growth without having to be an investment expert yourself.

In *The Investment Book*, we provide a straightforward outline of the types of managed investments available plus:

- A plain English explanation of what to look for in a managed investment
- Some tools to help you establish your financial position and goals, and your investment risk profile
- Information on the role of a financial adviser, and how you can work effectively with your adviser to achieve your investment goals.

Throughout this guide we have provided checklists, summaries of key points and places for you to record your thoughts and make notes on sections that are relevant for you. Our managed investment glossary will also help you understand key investment terms and financial jargon.

We trust *The Investment Book* will provide you with the tools, information and guidance to begin your managed investment journey.

Throughout this guide we have provided checklists, summaries of key points and places for you to record your thoughts and make notes on sections that are relevant for you.

1 Investment options and the benefits of managed investing

In New Zealand you can invest in a variety of different ways. Some of the most common include:

Bank term deposits

These are low-risk, straightforward ways to save lump sums that offer a better return than a bank savings account but generally lower returns than shares or property over the longer term. Bank term deposits are familiar and easy to establish but you will need a lump sum of money before you can invest and if you withdraw before the term is up you will typically pay some kind of exit fee.

Bonds and debentures

There are many options here ranging from very secure Government bonds to much riskier options such as small finance company debentures and capital notes. All offer a fixed rate of return that is typically higher than that offered by a bank term deposit. To minimise your investment risk, you should carefully research and review companies offering these types of investments. In addition you will need to be familiar with accounting of coupons, rolling maturities, currency risk (if investing in international bonds) and others.

Property

This is a familiar and popular form of investing for New Zealanders. Many of us own our own homes which offer potential for long-term growth. In addition, rental properties can provide a regular rental stream. The downsides include the complications associated with owning and/or renting out properties and the liquidity difficulty in selling properties should you want to change your investment strategy.

Shares

Shares can be purchased in a range of individual New Zealand and international companies. Although there can be wide variations in the value of your shares in the short-term, returns can be higher over the long-term than for other forms of investment. Dividend payments also appeal to those wanting an income from their investments. Like bonds and debentures it is important to research and review the companies that you are buying into and there will be a significant amount of paperwork to complete to establish a diversified share portfolio.

Managed investments

– combining the best of the investment options

An alternative to traditional investment options is managed funds, otherwise known as managed investments.

With a managed investment, you employ a professional fund manager (like TOWER) to invest in a variety of assets on your behalf. Your money is pooled together with that of other investors so you gain access to a much wider range of investments than you could typically invest in yourself. Your investment is professionally managed on your behalf, saving you spending time and energy on your investments and letting you get on with enjoying life.

Managed investments enable you to more easily follow some of the key investment rules:

Diversifying your investment dollars

Spreading your investments across a variety of different asset classes and diversifying within an asset class means you are less vulnerable if one doesn't perform. You can invest in a variety of single sector managed funds to spread your investment risk or invest in a balanced fund with a built-in diversified mix of assets.

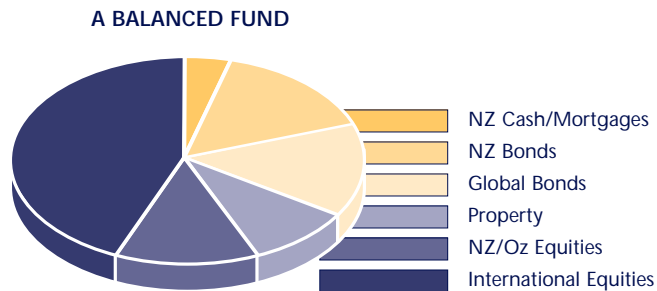
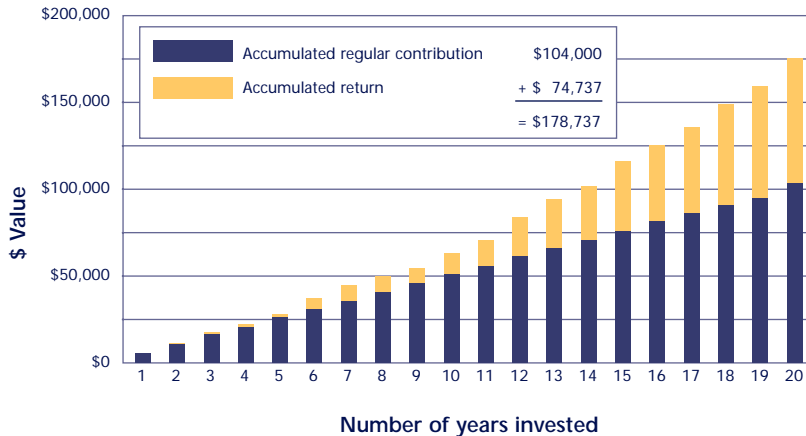


Chart is illustrative only.

Investing regularly

Small regular investments can build to a large sum over time. Most managed fund investments enable you to make regular monthly or fortnightly investments so you can take advantage of compounding returns over time as shown below.

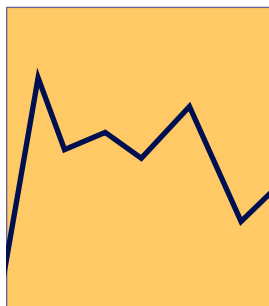


Graph assumes a regular investment of \$5,200 per year and 5% returns.
All returns are reinvested. Graph is illustrative only.

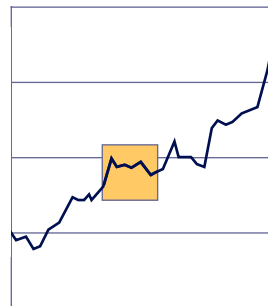
Investing for the longer term

All investments go through cycles of increasing and decreasing returns. History has shown that by remaining invested throughout these cycles investors gain more than those who try to time the market by withdrawing when fund returns are down and reinvesting when markets rise.

Managed funds are typically designed to help you achieve growth of your investments over a longer time period (typically five to seven years or more). This makes them ideally suited for those who want to invest for the longer term.



SHORT-TERM VOLATILITY



LONG-TERM PERFORMANCE

Using the expertise of specialists

A managed fund employs professionals who have the knowledge, expertise and market information to make informed and educated investment decisions.

Managed funds offered by TOWER are either managed in-house or are contracted to international specialists selected and robustly monitored by TOWER.

Record your current investments here and note how they measure up to managed investments. For example:

* *Residential property – strong, stable asset but all my investment dollars are tied into just one investment – not following the diversification rule.*



2 Types of managed investments

There is a wide variety of managed fund investments available. In chapter three of *The Investment Book* we discuss in detail what to look for in a managed fund, but key elements will be:



- Meeting your financial objectives, for example, your need for growth vs income
- Matching your attitude to risk, for example conservative or aggressive
- Matching your investing timeframe (short or long-term)
- Enabling you to invest on either a regular or lump sum basis.

Depending on your needs in each of these areas, your adviser will generally put together an investment portfolio made up of single sector, alternative or balanced funds or an appropriate mix of these types to meet your needs.

Single sector funds

Single sector managed investments invest into a single asset class but within that class offer a diversified mix of types of that asset.

Cash funds

Cash-based funds will invest in a variety of short-term money market securities such as 90-day bank bills and certificates of deposit. Returns on cash-based managed funds will typically be in line with or slightly better than what you could achieve in bank term deposits of a similar timeframe.

Fixed interest funds

These are also known as bond or debt security investments. Typically, fixed interest managed funds will include international bond products and other fixed interest securities not available to ordinary investors. Returns on fixed interest products should generally be higher than those for cash-based funds but there may be more volatility in your returns.



A fund that sits across both these asset classes is a mortgage fund. This is a fund that invests into a portfolio of mortgages on residential, commercial and rural properties. Mortgage funds may be deemed cash funds if investing in floating rate mortgages, and fixed interest funds if invested in fixed rate mortgages. Mortgage funds are typically low-risk, stable, income-generating funds.



Both cash and fixed interest funds are known as income assets because they earn a regular level of interest. Income assets are generally lower risk, offer lower returns than growth assets (see below) and are best suited to investors wanting preservation of their capital over a shorter timeframe or those who require a regular income from their investment.

Property funds

Managed funds investing in property will invest in a diversified portfolio of different property sectors including commercial, retail, industrial and others, or in a large commercial single property not normally available to individual investors.

Property-based managed funds enable you to invest in a strong and relatively stable market without the difficulties of buying and selling, and managing tenants that you may encounter with your own residential property. They also allow you to access this asset class without having to have tens of thousands of dollars or take on a mortgage in your own name.

Share funds

Also known as equity funds, share funds will include a wide variety of domestic and/or international shares. A managed share fund will employ experienced fund managers who thoroughly research information about the performance of major companies, and will make an informed selection of shares on your behalf.



Property and share funds are known as growth assets because they offer the potential for capital growth as the value of the shares or property increases. They also provide some income (by way of rent or dividends). These funds are typically more volatile than income assets but over the medium to longer term generally provide better returns. Growth assets are more appropriate to investors with longer investment timeframes.

Single sector managed funds offer the opportunity to invest in assets on a scale not normally available to individual investors. They provide expertly managed investments for individuals that offer the opportunity for both income and capital growth.

Alternative funds

Some fund managers provide managed funds known as alternative funds. There are a number of managed investments that fall into this group including venture capital, structured products, private equity funds and, one of the more common, hedge funds.

Hedge funds seek to achieve positive returns regardless of what the market is doing and use strategies such as short selling and derivatives. These funds are often high risk using borrowing to enhance returns. However, because they usually have a low correlation with equity markets, they can provide a smoothing effect on the volatility of your total managed investment portfolio.

Balanced funds

Balanced funds are a category of managed funds that include a mix of asset classes.

Balanced funds, also known as diversified, or multi-sector funds, will include cash, fixed interest, property and shares, and may even include some alternative investments.

These funds provide a cost-effective solution because they provide a researched, diversified mix of investments within a single fund.

Risk versus return

Each fund type has some investment risk associated with it. Generally speaking, the higher the risk (or short-term volatility) of an investment, the greater the potential return. The graph below shows the relationship between risk and return for each type of fund.



Graph is indicative only, not based on actual returns and risk.

Managed investment structures

It is very important to know that when you invest in a managed fund investment, you are not investing in the fund manager's company and decisions made about the funds are not impacted by the fund management company's own financial performance.

Each managed fund has its own investments which are held in a separate trust structure with its own trust deed and trustee. The trustee has a legal duty to look after the interests of all the investors in the fund and ensure all the rules and conditions of the trust deed are followed.



Each fund also has an investment manager who makes the day-to-day decision on the investments within the fund. Other parties involved in the running of a managed fund are described in chapter three of this book.

There are differences in the way managed funds can be structured. The most common structures for managed fund investment products available in New Zealand are:

- Unit trusts
- Group Investment Funds (GIFs) (category A and B)
- Superannuation funds
- Insurance bonds

Unit trusts and GIFs are both available for individuals wanting medium to long-term growth but they are governed by different legislation and tax on the funds is treated differently (see chapter three of this book for more details). You'll see a wide range of managed funds offered under each of these structures.

Superannuation funds are specifically designed as long-term retirement savings products. Only natural people or a trustee of another superannuation scheme may become a member of a superannuation fund (that is a company, organisation or family trust cannot become a member, whereas a company, organisation or family trust can invest in a unit trust or GIF). Under legislation, superannuation funds should only be used 'for the primary purpose of retirement'.

Insurance bonds are registered under different legislation again, and must have life insurance attached.

The structure that is best for you will depend on your investment goals and timeframes, your current financial and tax situation and how you want to structure the ownership of your investment. A professional financial adviser can help you determine these needs.

Master trusts and wraps

Some companies offers solutions that help investors with larger sums create an integrated portfolio of investments. These may use managed funds in one or more of the asset classes described earlier in this chapter from a range of fund managers.

Master trusts

A master trust is an investment trust set up to offer a range of different funds within a single administrative and legal structure. Like a managed fund it will have a trust deed and trustee but it will usually have several different fund managers. Employer superannuation plans are also commonly provided in a master trust structure.

Master trusts provide the benefits of a larger range of investment managers, and funds that have been combined into selected portfolios across different risk profiles. Generally the details of all the different investment options are provided in one offer document with a single application form, and reporting is generally provided in a single, comprehensive report.

The trust structure means the investment options are analysed and selected to provide a complementary and optimal mix of investment options. Simplified, hassle-free administration and ongoing monitoring and advice from your financial adviser are other key benefits of a master trust.

Wraps

A wrap is a specialised investment and administration service through which you can include both managed fund and direct investments.

Like a master trust, investing via a wrap service can save a lot of time and paperwork – the key difference is that the wrap is not in itself a managed fund, but is a platform for the administration of your investments. Unlike a managed fund or master trust where you own units in a fund, in a wrap the investments are held in your name via a custodian.

Wraps are ideal for those wanting to include both managed fund investments and a selection of shares, government bonds, debentures and other investment options within one consolidated portfolio.

Record your thoughts, comments and questions about types of managed investments here.

3 Understanding what to look for in managed investments

New Zealand law requires that all New Zealand-based managed fund investments must have an investment statement. This is the offer document that provides investors with information about the fund and the application form.

Investment statements provide a wealth of detail about your investment and we strongly encourage you to read the investment statement before making any investment decisions.

We also encourage you to seek the services of a professional financial adviser. An adviser can guide you through the wealth of detail to help you make the decisions that are best for you.

As you and your adviser put together your investment portfolio, you will need to consider how your own investment goals will be met by the fund objectives, timeframe and other features of the funds you are considering. (See chapters four and five of this book for more information on identifying your own financial needs.)


Some of the **key fund features** to consider are described in this chapter.

Fund objectives

Every managed fund established will have an investment objective and investment guidelines. This is a guide to the level of performance the fund manager aims to achieve over the recommended period and the type and range of investments included in the fund. There may be periods where the fund manager achieves performance either above or below this level, depending on a number of market factors such as the economy of the country invested in, currency rate changes, interest rate changes and others.

Some investment objectives will be expressed in terms of comparison to another type of investment vehicle, for example, 'exceeding trading bank returns'.

Others will use a benchmark to compare themselves to, such as an established, published investment index. For example, 'outperform the MSCI world index in New Zealand dollars over each five-year rolling period'.

 It is important the objective for the fund is consistent with your own investment objectives. And remember to look closely at how the objective is described – if it says it will outperform the MSCI world index over each *five-year* rolling period it is unlikely to outperform it every year.

Investment timeframes

This is the timeframe over which the fund aims to achieve its objective.

Some fund managers will provide this in years – others may just say short, medium or long term.

As a guide when you are looking at managed fund investments:

- Short-term means one to three years
- Medium-term means three to seven years
- Long-term means seven years or more

The timeframe for the fund to achieve its objective should be consistent with the timeframe you've set to reach your financial goals.

Risk indicator

A fund's risk indicator provides an indication of how volatile the returns are likely to be.



If a fund is described as having **low volatility**, returns will generally be similar from year to year.

Conversely, if a fund has **high volatility**, returns may fluctuate widely over shorter timeframes. High risk funds are more likely to include some years where returns will be negative. However, over the medium to long term, high risk funds should provide higher returns than low risk funds.

Your adviser will provide recommendations on the right balance of high and low risk funds for you. This will include considering your risk profile, your financial goals and your investment timeframe.

Fund management style

Two key styles are passive and active.

Under a **passive style** the fund manager selects assets to match a particular index and invests in the same asset proportions as that index. This means the performance of the fund will reflect that index – when the index goes up so will the fund; when it goes down again, so too will the fund. Due to the reduced management research and analysis a passive manager does, management fees will be less than for active funds. There may also be tax advantages (see the tax section later in this chapter).

An active style manager actively researches and analyses the market to determine undervalued assets to include in the fund and how many to buy and at what price. They will regularly assess the performance of the fund against the benchmarks and objectives established for it and determine what changes to make in the shares held or asset allocations.

There is a range of active management styles. Some terms you may hear include growth manager, value manager or contrarian manager (see the glossary). Some funds may also employ several different investment managers each employing a different style. This can provide another form of diversification for the fund (a multi-manager approach).

You and your adviser should discuss the impact of the fund management style on what you hope to achieve from your investment.

Portfolio breakdown

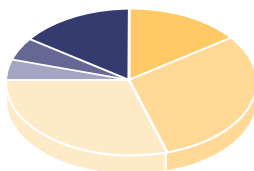
One of the key benefits of managed fund investments is providing much wider diversification than you could hope to achieve by investing directly yourself.

The fund information you receive when you invest should provide you with a breakdown of the countries, industries, mix of asset classes or other areas the fund invests into.

The portfolio breakdown often explains why seemingly similar funds may have quite different risk indicators.

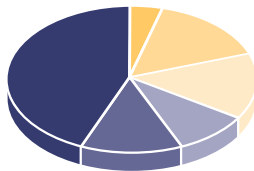
For example, balanced funds can vary from quite conservative mixes (including a lot of lower risk investments such as cash and fixed interest), through to more aggressive balanced funds (which will include a higher percentage of growth investments such as shares). This will have a key influence on the returns you will achieve from the fund.

CONSERVATIVE BALANCED FUND



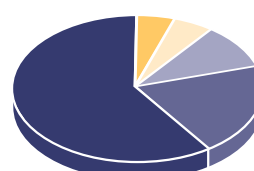
- NZ Cash/Mortgages
- NZ Bonds
- Global Bonds
- Property
- NZ/Oz Equities
- International Equities

BALANCED FUND



- NZ Cash/Mortgages
- NZ Bonds
- Global Bonds
- Property
- NZ/Oz Equities
- International Equities

AGGRESSIVE BALANCED FUND



- NZ Bonds/Cash
- Global Bonds
- Property
- NZ/Oz Equities
- International Equities

Charts are illustrative only.

Return figures

By law, fund managers must always remind investors that past return figures are not necessarily indicative of what the fund will achieve in future.

Nevertheless it is almost impossible not to be influenced by what has happened in the past. But rather than decide purely on the historical published numbers, **discuss with your adviser the following questions:**

- How do the published returns compare to the fund objective?
- How do the return figures look for the investment timeframe you are considering?
- If returns have been negative at times what would that mean for your investment dollars and could you live with that risk?

Remember, return figures for managed funds are typically net of tax and fees. They should always describe the assumptions on which they have been based (for example, annualising returns longer than one year, reinvesting distributions).



Although they provide information about what the fund has achieved in the past, they are not necessarily an indicator of what you'll achieve in the future.

Currency hedging

Many managed investments will have all or a proportion of their funds invested in overseas shares, bonds or other international investment vehicles. That can lead to investment returns being influenced by changes in the level of the New Zealand Dollar (NZD). When the NZD falls, the value of overseas investments rises – and when the NZD rises, the value of overseas investments falls.

In a perfect world you would have all overseas assets hedged against currency movements when the NZD is rising, and unhedged when the NZD is falling. However in the real world it's difficult to predict currency market movements precisely.

There are costs associated with currency hedging so an active manager will determine where the balance of risks lies and position an investment portfolio accordingly.

Fees

A range of fees apply to managed investments. Some of these are fees you pay directly while others are paid by the fund.

Investor fees

Establishment or entry fee – This fee is expressed as a percentage of your investment amount and is agreed between you and your adviser for their advice and guidance in helping you determine the appropriate investment for you. It is deducted from your initial investment and any subsequent or ongoing investments and paid to your adviser before your money is invested in the fund.

Exit fee – Some funds may also have an exit fee. This fee won't apply if you remain invested until maturity.

Fund fees

Management fee – This fee is deducted directly from the fund and paid to the fund manager (either directly or via the administration manager). It pays for the costs of investment management, administration and for the service brokerage fee the fund manager pays to your adviser for managing the relationship with you. You won't see this fee shown as a deduction against your investment as it is paid directly from the fund.

Trustee fee – This fee is paid to the trustee for the services they provide. Again, you won't see a trustee fee in your transaction statements as this fee is paid directly by the fund.

Other fees

Other fees may apply to your managed fund investment and these will be detailed in the investment statement.

In addition some advisers may charge a fee for preparing a financial plan. You pay this fee directly to your adviser for the services and advice they are providing to you.

Expenses

The expenses incurred in running a managed fund (such as audit, registry, legal, custody and other costs) are disclosed via the fund's Management Expense Ratio (MER). This is a summary of the fund expenses expressed as a percentage of the total fund size.

All managed funds that have been established for longer than a year calculate an MER but funds can calculate MERs in different ways. The investment statement will explain what expenses are included and whether they are gross or net of tax. The MER will vary slightly from year to year depending on the expenses incurred and the size of the funds under management that these expenses are spread across.

Tax

Generally speaking most New Zealand resident unit trusts and GIFs that derive category A income (eg income from equities), unless the investment is from a designated source investor, are deemed to be companies for tax purposes. That means if they derive income on their investments or realised gains (when investments are sold at a higher price than when they were purchased), they will be taxed at the company tax rate of 33%. GIFs that derive category B income (generally income from bank deposits or Government or local authority stock) or to the extent that the income is derived from investments from designated sources, differ in that the investor is taxed directly on the distributions of income from the GIF.

A designated source includes certain estates, statutory and charitable trusts who have the same trustee as that of the GIF.

To ensure investors are not taxed twice many distributing managed funds that are deemed to be companies attach imputation credits. The impact of the imputation credits depends on your own marginal tax rate as illustrated below:

	Distributing NZ unit trust or GIF A (assuming fully imputed)		
Investment income	\$100		
Tax within the fund	33%		
Investor's assessable income	\$100 (\$67 + \$33 imputation credits)		
Investor's marginal tax rate	19.5%	33%	39%
Tax payable	\$19.50	\$33.00	\$39.00
Less imputation credits	\$33.00	\$33.00	\$33.00
Balance	\$13.50*	\$0	(\$6.00)**
Net cash return	\$67.00	\$67.00	\$61.00
Effective net return assuming imputation credits are used against other income	\$80.50	\$67.00	\$61.00

*Investor may offset the excess tax credit of \$13.50 against tax on other income.

**Additional tax to pay by the investor.

GIFs that derive as category B income or to the extent that its income is derived from investments from designated sources do not pay tax on income earned provided the income is distributed during the year or within six months from year end. Instead investors pay tax directly on the income that is distributed to them. They will have either Resident Withholding Tax (RWT) deducted or income tax withheld by the trustee at their personal tax rate.

This has the following effect on net returns:

	Distributing GIF category B		
Investment income	\$100		
Tax within the fund	None if fully distributed within six months of balance date		
Investor's assessable income	\$100		
Investor's marginal tax rate	19.5%	33%	39%
Tax payable	\$19.50	\$33.00	\$39.00
Effective net return	\$80.50	\$67.00	\$61.00

Superannuation funds have different taxation implications again.

All tax on income and gains (if equities are held on revenue account) is paid by the fund at 33%. All returns are fully tax paid for the investor. No imputation credits are available for investors. There is no further tax liability for a 39% tax payer.

For investors whose employers make employer contributions to superannuation funds you can elect to match the Specified Superannuation Contribution Withholding Tax (SSCWT) deducted from the contributions your employer makes to your personal tax rate.

Those with a salary greater than \$60,000 can choose to sacrifice some or all of the amount above \$60,000 directly to their superannuation plan. Instead of paying 39% tax on the amount you sacrifice, you can elect to have SSCWT deducted at the rate of 33% instead – a 6% saving on the personal tax you pay. Note that a fund withdrawal tax may apply if you withdraw your sacrificed contributions prior to reaching retirement age, though there are some limited exceptions to this rule. The rules are complex and so advice should be sought from a competent tax adviser.

Those investors with tax rates below 33% can also elect to have SSCWT deducted at that lower rate.

Passive funds that track an index (rather than being actively managed – see the section on fund management styles), may have a binding ruling from the Inland Revenue Department that states that the gains of sale on shares are not subject to tax. Read the taxation section in the fund's investment statement to check if it has such a ruling.

Finally, some Australian unit trusts and Open Ended Investment Companies (UK or European domiciled managed funds) may also have different taxation implications.

A financial adviser will be able to guide you on the most recent tax implications of managed funds, and we also recommend you seek independent taxation advice from a qualified taxation specialist.

Investment minimums

One of the benefits of managed investing is that minimum investments are relatively low – often \$1,000 to \$5,000. You can also make regular additions to your investment, without having to set up a new investment each time.

If you have a good income but don't yet have a lump sum to invest, many managed investments provide the option of signing up to regular investments (no initial lump sum required).

Regular withdrawals to supplement income needs are another feature of some managed funds.

Investment statements provide information on the minimum investment amounts required to begin investing.

Who is involved?



When you invest in a managed fund, you are investing in a trust that is a legally separate entity to the company providing the fund.

The investment statement lists a number of parties that are involved in the running of any managed fund investment. The key parties you may see listed are:

- **Issuer** – the company that is providing the fund – that is they have developed the fund and have ultimate responsibility for the fund.
- **Promoter** – the company selling the fund.
- **Administration manager** – runs the fund, performing the day-to-day operational administration tasks.

- **Investment manager** – invests the money and makes the decisions on what assets the fund buys and sells.
- **Trustee** – looks after the interests of investors and ensures the rules of the trust deed and all relevant laws are adhered to by the issuer. They have a key role in any decisions made about the structure of the fund and any changes to the trust deed.
- **Statutory supervisor** – some GIFs will appoint a statutory supervisor whose role is to monitor trustees who may also be an issuer to ensure they are acting in the best interests of the investor.
- **Responsible entity** – applies to Australian-based unit trusts only. This role has a similar function to a combined issuer/trustee role.

It is common for one company to share many of these roles. The issuer, promoter and trustee contact details will be listed in the investment statement.

Independent research house star ratings

Companies such as FundSource provide both a star rating system and a qualitative assessment for managed funds. These rating systems look at the average historical risk-adjusted returns for the fund and other factors such as the stability of individual investment management teams.

You and your adviser need to consider elements such as how the funds you're selecting work together to create a diversified portfolio, risk profiles, investment timeframes and others.

Summary

There are many elements to take into account when developing an investment portfolio. These are summarised in the checklist on the next page.

While your adviser will provide recommendations for your investment portfolio, the final decision is up to you. Take the time to discuss and understand answers to the questions in the checklist so you feel comfortable that you are making the best decisions for your future wealth.

Checklist of points to discuss with my adviser

- What are the objectives of the funds?
- What are the investment timeframes?
- What level of risk do the funds have?
- Do the investment objectives, timeframes and level of risk fit with my goals?
- What are the fund management styles?
- What are the underlying assets?
- Do published returns reflect the objectives?
- If the funds have overseas assets, what is the currency hedging policy?
- What are the fees and expenses?
- What are the tax implications for me?
- What are the investment minimums?
- Who are the parties to the investments?
- What are the star ratings?

4 Working with a financial adviser

Throughout *The Investment Book* we have recommended you work with a financial adviser to develop an investment portfolio to suit your circumstances.

A financial adviser can help you establish your financial plans, guide you in your investment decisions and, during the course of your investment, help you stay on track to meet your goals.

A good adviser will be a long-term trusted professional who will help you achieve your investment objectives.

How to find a financial adviser

If the prospect of a long list of names in the yellow pages is too daunting, choose a trusted investment brand such as TOWER and call them to ask for a recommendation.

As well as advisers from TOWER Financial Advisory Services, TOWER has relationships with a large number of other professional financial advisers throughout New Zealand and can put you in touch with someone in your area.

Types of advisers

Many people including private bankers, financial planners, tied and independent financial advisers, trustees, share brokers, and some accountants and lawyers offer investment advice.

The key to choosing the right adviser for you is choosing someone you feel comfortable with. Later in this chapter we provide some questions you can ask to get to know your adviser and help you determine whether you will work effectively together.

Cost of advice

There are a variety of ways of paying for advice. The arrangements vary but typically they fall into one or more of the following ways:

- Establishment or entry fees – paid by you to your adviser (via the fund manager) based on an agreed percentage of each amount you invest.
- Trail commissions – paid by the fund manager to your adviser for ongoing servicing.
- Monitoring fees – paid by you to your adviser usually based on an agreed percentage of the amount you have invested.
- Initial (plan) fee – paid by you directly to your adviser for plan preparation and/or advice.

By law your adviser's disclosure statement (see questions to ask your adviser) must outline whether the adviser will receive a commission or other benefit from advising you, and you and your adviser must agree the payment method before you invest.

What to expect when you visit an adviser

During your first visit to an adviser, they will typically conduct a financial needs analysis which may include:

- Exploring your current assets, income and expenses to help you determine the amount you can afford to invest.
- Discussions about your financial goals, and helping you identify what these are.
- Helping identify your investment risk profile. This critical step helps establish your attitudes to investing so the adviser can ensure they are recommending solutions that you will feel comfortable with and will meet your needs.
- Checking you have an appropriate level of insurance to protect your assets. Some advisers also offer trustee services and these advisers would typically check that wills, family trusts and other vehicles to protect your assets are in place.

Advisers will differ in their approaches, but you may like to prepare yourself for the first meeting with the following:

- Complete our goal-setting sheet (see chapter five) to help you start thinking about financial goals.
- Answer the questions in the risk profile tool (chapter five) to give you a feel for your investment style. Your adviser will work with you to ensure the risk profile is accurate.
- Check your financial records and take along (or send beforehand) documents such as:
 - Salary and other income information
 - Copies of budgets you may have created
 - A record of expenses
 - A summary of investments you hold
 - Copies of insurance policies
 - Tax information that shows the rate of tax you are paying

The financial position and income and expenses worksheets in chapter five will help you summarise this type of information.

Useful questions to ask your financial adviser

Your adviser must legally provide you with a disclosure statement that details their experience and qualifications and will tell you:

- Whether the adviser gives advice only about particular types of investments
- Whether the advice is limited to the investments offered by one or more particular financial organisations
- Whether the adviser will receive a commission or other benefit from advising you
- Whether the adviser has any conviction for dishonesty or has been adjudged bankrupt
- The method by which the adviser receives any money or assets on your behalf.

In addition to the disclosure statement it can be helpful for you to get a feel for how the adviser prefers to work with their clients. Some of the areas to discuss might include:

- Frequency of contact with clients. When, why and how will the adviser contact you and what type of ongoing service can you expect?
- Ad hoc advice – for example, what would happen if a new investment opportunity comes up that hadn't been initially discussed?
- The size of their investment book – for example, how many clients the adviser has, how much money they have under advice, and how long they have been providing advice.
- Investment reporting – how you'll be kept up to date with the progress of your investments.

You may also like to ask for references of people to whom the adviser has given advice who have similar circumstances (the adviser will need to ask permission to provide references). You could also ask whether they are currently invested in any of the investments they recommend.

Remember, this person will need to know your personal financial details and will be responsible for helping you build your long-term wealth. Take the time to get to know your adviser and discuss how you will be able to work together.

In the case of an adviser who charges fees rather than commission ensure that you check with them at what stage in the process you are required to pay for their consultation.

What happens next?

Advisers vary in exactly how they provide their recommendations, but once you have found an adviser and provided them with information about the purpose of your investment they will usually follow these steps:

- The adviser will work on a recommended financial plan. This may take some days as the adviser researches the best options to meet your needs and prepares this in a document that fully explains what they are recommending.
- Some advisers like to present this plan in person; others will provide you with a copy first then contact you to arrange a time to go through it in detail. The types of things you can expect to see covered in the plan include:
 - A statement about your investment goals
 - A description of your agreed risk profile
 - A recommended course of action to help you achieve those goals and the appropriate products to help you get there
 - A section describing why the recommendations will fit your needs
 - All fees and costs associated with using the recommended products



The plan may also provide you with alternative strategies to consider and show you the impact of using those alternatives.

- You will go through the plan with the adviser and to ensure you fully understand and feel comfortable with what they are recommending you may want to take the material away and use publications such as this book to help you understand the structure and objectives of the products recommended.
- If you decide to make changes to the plan, make sure you get those changes made in writing and initial them to confirm that both you and the adviser agree on those changes.
- Once you are completely comfortable with the recommended actions and have read the investment statements your adviser will help you complete any necessary application forms and will process payments and forms on your behalf.
- You and your adviser will receive written confirmation of your completed investments to keep for your records.

Ongoing monitoring and advice

All fund management companies will provide you with regular statements that show transactions in your investment funds.

In addition, your adviser will provide a regular overview of your investment information, or will contact you to discuss the information you receive directly. Your reporting requirements need to be established in the early stages of your relationship.

While investment plans are typically for the medium to longer term, your adviser will contact or meet with you at least annually to confirm your plans are still on track and that your circumstances haven't changed.

If you have any concerns or questions you can also ring and talk to your adviser.

Note any questions you want to ask the adviser. Remember to take along information that will help the adviser determine your financial needs (see checklist on page 21).



5 Worksheets to get you started

Summary of financial position

Before you visit a financial adviser it can be helpful to identify your current financial position. Use this worksheet to help you identify the items to include.

Lifestyle assets	\$ Market value of assets	Debts	\$ Amount owed
House		Mortgage	
Car		Car loan	
Others		Personal loan	
		Student loan	
Investment assets		Credit cards	
Savings and term investments		Hire purchase	
Investment property		Other	
Managed funds/unit trusts			
Superannuation plan			
Shares			
Others			
Total	\$	Total	\$

Net worth	
Total assets <input type="text"/>	less total debts <input type="text"/>
	= net worth <input type="text"/> \$

In addition to the items listed on this financial position sheet, your adviser will need to know who owns your assets, your relationship status and your tax status.

After tax income	\$ Value (household income)	Expenses	\$ Value
Salary or wages		Regular savings	
Benefits or superannuation		Mortgage, rent or board	
Bonuses and commissions		Other loans	
Interest and dividends		Hire purchase	
Rents received		Overdraft	
Other income		Credit cards	
		Rates and insurance	
		Clothing	
		Phone, cellphone, power, gas	
		Groceries	
		Healthcare	
		Car expenses	
		Home repairs	
		Education, childcare	
		Entertainment	
		Hobbies	
		Personal spending	
		Holidays	
		Child support	
		Other regular expenses	
Total income	\$	Total expenses	\$

Financial goal-setting guide

Identifying your financial goals is a vital first step to successful investing. Before visiting an adviser try drafting your initial thoughts on goals – your adviser will help you make these goals more specific and show you ways in which you can achieve them.

Use the retirement calculator provided overleaf if one of your long-term goals is retirement saving.

Goals	Approximate dollars needed	Month and year needed	Monthly amount to save
Short-term (under 3 years)			
<i>Eg family summer holiday or starting an investment plan</i>			
Medium-term (5-7 years)			
<i>Eg moving to a new home or increasing your investments once mortgage is paid off</i>			
Long-term (7 years plus)			
<i>Eg retiring at 60</i>			

Retirement calculator

A standard rule of thumb when calculating how much income you would like in your retirement is to base it on 70% of your current net annual salary. Use the table below to find out how much you need to save per month to reach this amount.

Calculate 70% of your current net annual salary (i.e. the after-tax amount). This is your estimated required annual income requirement in retirement.	\$
Subtract Government NZ Superannuation rates* – in round figures: <ul style="list-style-type: none"> • Single – \$13,000 per year • Couple (both in retirement) – \$20,000 per year (i.e. \$10,000 each) 	-\$
The difference. Use this figure to calculate how much you need to save for your retirement (below)	\$
Monthly savings required (from table below)	\$

Savings table

This table shows the amount you will need to save per month to make up the difference between your estimated required retirement income and what you will receive from Government Superannuation. It assumes you will retire at 65 years of age and require 20 years of retirement income.

'The difference' amount from above	Monthly saving required depending on your current age							
	25 yrs old	30 yrs old	35 yrs old	40 yrs old	45 yrs old	50 yrs old	55 yrs old	60 yrs old
\$5,000	\$65	\$84	\$110	\$148	\$207	\$308	\$514	\$1,138
\$10,000	\$130	\$167	\$220	\$296	\$414	\$616	\$1,027	\$2,277
\$15,000	\$195	\$251	\$330	\$444	\$621	\$924	\$1,541	\$3,415
\$20,000	\$260	\$335	\$440	\$594	\$828	\$1,232	\$2,054	\$4,554
\$25,000	\$324	\$419	\$550	\$740	\$1,035	\$1,540	\$2,568	\$5,692
\$30,000	\$389	\$502	\$660	\$888	\$1,242	\$1,848	\$3,082	\$6,831
\$35,000	\$454	\$586	\$770	\$1,036	\$1,450	\$2,156	\$3,595	\$7,969
\$40,000	\$519	\$670	\$880	\$1,185	\$1,657	\$2,464	\$4,109	\$9,108
\$45,000	\$584	\$754	\$990	\$1,333	\$1,864	\$2,772	\$4,622	\$10,246
\$50,000	\$649	\$837	\$1,099	\$1,481	\$2,071	\$3,080	\$5,136	\$11,385

The figures assume returns of 4% after fees and taxes on your investment before you retire and 3% after fees and taxes after you retire. There has been no adjustment for inflation, other investment or superannuation you may have. The figures assume you will use up all your capital over the 20 years of retirement.

* Government Superannuation rates as at Nov 2004.

Risk profile tool

The shorter your investment timeframe the less tolerance to risk you will have. Therefore if your investment timeframe is less than five years irrespective of your risk tolerance, it is advisable to adopt a defensive or conservative investment approach.

The following questions about investing will help you determine what you want to achieve from your investment and select the best investment options for your plans. There are no right or wrong answers as everyone is different, so pick the answer that best fits your situation.

1. What is the main goal of your investment (eg retirement, your children's education, a new home, car or overseas holiday)?		
Given your investment goal what is your investment timeframe?		
1-3 years	<input type="checkbox"/> 5	3-7 years <input type="checkbox"/> 10 7 years + <input type="checkbox"/> 15
Please read each of the following statements and think about whether you agree or disagree with that statement (<i>tick the statement that most suits you</i>).		
	Agree	Neutral Disagree
2. It is important to me that the value of my investment does not reduce in the next year	<input type="checkbox"/> 1	<input type="checkbox"/> 2 <input type="checkbox"/> 3
3. I would be concerned if the returns on my investment fluctuated greatly	<input type="checkbox"/> 1	<input type="checkbox"/> 2 <input type="checkbox"/> 3
4. Making decisions about investments makes me nervous	<input type="checkbox"/> 1	<input type="checkbox"/> 2 <input type="checkbox"/> 3
5. Out of the following statements pick the one that best describes your attitude towards investing.		
I prefer investments with a consistent return and I am willing to accept the lower return associated with these investments		<input type="checkbox"/> 1
I am willing to accept a reasonable amount of fluctuation for better expected long term returns		<input type="checkbox"/> 2
I understand the risk associated with investing and am comfortable with market fluctuations to achieve above market returns		<input type="checkbox"/> 3
6. The percentage of my household net income spent on repaying current debt (including my mortgage) is?		
33% or more	<input type="checkbox"/> 1	10% - 33% <input type="checkbox"/> 2 Less than 10% <input type="checkbox"/> 3

Score	Investor profile	Investment timeframe
13-19	<p>Defensive investor <i>Low risk</i></p> <p>You tend to prefer investments with lower risks associated with a decline in value; for example, term deposits. You are more interested in preserving the value of your investment rather than receiving a return on your capital. You may be retired or near retirement and without a big cushion in your savings. Alternatively you could be an investor with a short investment horizon.</p>	2-4 years
20-25	<p>Conservative investor <i>Low/medium risk</i></p> <p>You tend to prefer investments with lower risks associated with a decline in value; for example, term deposits. However, you do recognise that in order to achieve higher returns, some risk must be incurred and you are prepared to tolerate some fluctuation and volatility in your investment.</p>	3-7 years
26-31	<p>Balanced investor <i>Medium risk</i></p> <p>You are willing to place reasonable emphasis on growth investments while being aware that these are liable to fluctuate in value over the short to medium term. You can tolerate some fluctuations and volatility, but you tend to stay away from dramatic or frequent changes.</p>	5-8 years
32-37	<p>Moderately aggressive investor <i>Medium/high risk</i></p> <p>You have an above-average tolerance to risk and are willing to accept a greater chance of a decline in value for potentially higher returns. You have a medium to long investment horizon and can tolerate short-term fluctuations for better than average long-term gain.</p>	8+ years
38-42	<p>Aggressive investor <i>High risk</i></p> <p>You are willing and usually eager to accept a greater chance of a decline in initial value in return for potentially higher returns. You have a long investment horizon and can tolerate short-term fluctuations for better than average long-term gain.</p>	10+ years

6 Achieving long-term wealth through managed investing

Managed investments are specifically designed to help investors grow their capital and so achieve long-term wealth.

Savings options such as bank term deposits are designed to help you achieve income but may not preserve the real value or the purchasing power of your capital over the longer term.

Some capital growth options such as directly owned property investment or direct share portfolios can be time consuming and require considerable experience and expertise to manage effectively.

Managed investments provide a way of growing your capital, enabling you to follow the basic rules of investing and take advantage of the knowledge of experts.

We trust *The Investment Book* has helped you better understand how managed investing can help you on your investment journey.

Best wishes for successful investing

Any final thoughts:



Glossary

This glossary sets out how common jargon associated with managed investments is defined.

Annual report

Each managed fund must produce an annual report showing the income and expenditure of the fund over the period. By law annual reports must be sent to every investor in the fund.

Assets

These are the shares, bonds, property or other items that the managed fund invests into.

Benchmark

An investment market index or some other market measure that fund managers use to guide their investment and performance. Fund managers will aim to match or perform better than their benchmark.

Certificates of deposit

A type of deposit where the value of the deposit varies over time before maturity date.

Contrarian manager

A style of investment management where the manager takes a different view on which securities to buy and sell from most managers.

Contribution

This is the investment you make. If you are investing regularly you may also see the term regular contributions.

Correlation

A measure of how closely two variables move together through time. For example, shares tend to have a high degree of correlation because their prices are influenced by the same forces.

Derivatives

An investment that derives its value from another investment. For example, an option is a derivative instrument that obtains value from the investment that can be purchased with the option. Futures contracts are another form of derivative.

Distributions

Some funds offer distributions. This is literally the payment of income to investors in the fund.

Diversification

Spreading your money across a number of different investment types, or within a managed investment, spreading it across a number of different assets or types of a single asset.

Equities

Shares – either New Zealand (New Zealand equities) or International (International equities)

GIF

Group Investment Fund – one of the common legal structures for a managed fund investment.

Growth manager

Growth stocks are defined as having superior long-term earnings growth and return-on-capital potential. Growth-style investment managers will focus on obtaining these stocks when assembling their portfolios.

Imputation credits

Many managed funds offer imputation credits. These are tax credits that are passed on to investors receiving distributions because managed funds have already paid tax before they made the distribution. You can use these tax credits to offset the tax liability on your income.

Indexes

A benchmark against which financial or economic performance is measured. Expressed as a data series which reflects the change in value of an underlying variable or aggregate variables. A common index for international shares is the MSCI World Index.

Insurance bond

An investment product which offers a small amount of life insurance as well (generally a set dollar amount).

Investment statement

The investment statement is the investment offer document setting out all the key information about the fund and answering a series of questions covering risks, charges, returns and other information. It also contains the application form. It is illegal to provide a managed fund in New Zealand without an investment statement for the fund.

Lapse

When you have stopped making investments and the fund has fallen below the minimum investment level required.

Liquidity

The ability of an asset to be converted into cash quickly and without any price discount.

Long position

Buying an asset in the expectation of it rising in value and selling it for a higher price in the future.

Managed fund

Where clients' money is pooled together with the funds of other investors.

MSCI world index

The Morgan Stanley Capital International World Index of international shares, a recognised industry benchmark of performance of international shares.

Portfolio

This is a group of investments, or collectively your overall investments.

Prospectus

The prospectus is a more detailed version of the investment statement and includes a summary of the trust deed and a summary of the year-end financial statements (prospectuses must be regularly updated to include updated financial information). Again every managed fund must have one and a copy is lodged with the Companies Office. Copies are available on request.

Regulars or regular investments

Making investments on a regular basis such as monthly.

Return

Usually expressed as a percentage, it indicates how much a fund has grown over a defined period.

Securities

A generic term describing any of a range of investment instruments – for example, a bond, debenture, share, option and others.

Short selling

Selling an asset in the expectation of it falling in value, and buying it back for a lower price in the future.

Singles or single investment

Making lump sum investments on an initial or ad hoc basis.

Switching

Transferring from one fund to another.

Units

The total pool of assets in a managed fund is generally divided into units. These units are owned by investors in proportion to the amount of money they have invested.

Unit price

When you invest in managed funds you buy units. The cost of each unit is the unit price. The unit price moves up and down to reflect the value of the investments of the fund. Many income funds' unit prices remain at \$1 as income is distributed.

Unit trust

One of the common legal structures for managed funds. Similar to a GIF, investors' monies from different people or organisations are pooled for a common investment purpose.

Trust deed

A written agreement between the issuer of the fund and the trustee which sets out the rules by which a fund will operate.

Value manager

Value stocks are conventionally defined as stocks trading on undervalued or underpriced stocks measured, for example, by price-to-earnings multiples or price-to-book value. Value managers tend to focus on these stocks when assembling their portfolios.

Volatility

A measure of risk. Indicates the degree of fluctuation in returns. All investments have periods of increasing and decreasing returns. These can be caused by interest rates going up and down, property and company valuations increasing and decreasing, and currency movements to mention just some of the factors influencing returns.

