Utilising Managed Accounts to build more efficient portfolios

Over recent years, Managed Accounts have become far more popular and accessible due to improvements in technology.

In some ways, a Managed Account is the new version of a 'fund of funds' managed fund but with several key benefits to the client.

At Cardena Private Wealth, we are constantly endeavouring to review and critique how portfolios are constructed and managed. Our aim is, where possible, to continually enhance this process, thereby leading to better client outcomes.

What is a Managed Account?

A Managed Account is an investment vehicle that allows an investment specialist to efficiently manage an investor's portfolio in line with a set of investment objectives. The objective of the Managed Account is determined initially, and may be based upon the achievement of a return objective such as CPI + 4.5% per annum.

How does a Managed Account work?

The investor retains direct or beneficial ownership of the individual underlying investments in their portfolio rather than taking a share of a pool of assets via issued units. This potentially benefits the investor as they have more control over tax management as a result of direct ownership. Once the initial strategy is determined, the investor then hands discretion to their adviser to manage the portfolio within pre-agreed parameters to achieve the stated objectives over time.

What happens once discretion is handed to my adviser?

Subject to how the Managed Account is implemented and the philosophy adopted, the underlying investments will then vary depending upon the asset allocation decisions made. For example, a portfolio targeting a return of CPI + 4.5% per annum will invest in cash, fixed interest, Australian and international equites (both direct and via managed funds), property, infrastructure and alternative investments. The asset allocation will vary over time as the investment manager seeks to maximise the probability of achieving return objectives in an environment of changing asset class risks and return expectations.

What is the difference between a Managed Account and a Managed Fund?

A Managed Account may sound like a Managed Fund, in that the underlying assets are actively managed by a professional manager, but they differ materially in a number of ways, and arguably provide a better investment experience.

The defining difference is the ownership structure. The underlying assets in a managed account are generally held by the investor so they are visible and portable, as if the investor had purchased the assets directly. For example, an investor can hold direct shares in a managed account where they retain direct and beneficial ownership in those shares. In a managed fund, the investor owns a unit in the fund and is provided with a single unitised price.

The following table summarises the difference between a Managed Account, Managed Funds and investing directly in shares.

Feature	Managed Account	Managed Fund	Direct Equities
Professional investment management	✓	✓	
Ongoing rebalancing to ensure portfolio reflects ongoing investment manager's position	✓	✓	
Investor retains beneficial ownership of underlying assets	✓		✓
Transparency to view underlying assets	✓		✓
Ability to exclude stocks from the portfolio	✓		✓
Tax reporting	✓	✓	
Avoid embedded capital gains tax	✓		✓
Ability to net-off trades in your account	✓		

How do Managed Accounts fit with Cardena's portfolio construction philosophy?

Cardena is part of the new post-GFC approach to investing where consistency of performance and preservation of capital are paramount.

- The best way to make money is not to lose it in the first place;
- Risk should be used as efficiently as possible at all levels of the investment program;
- Forward-looking investment processes are essential; and
- Dynamic asset allocation has the flexibility necessary to manage portfolio risk & reward

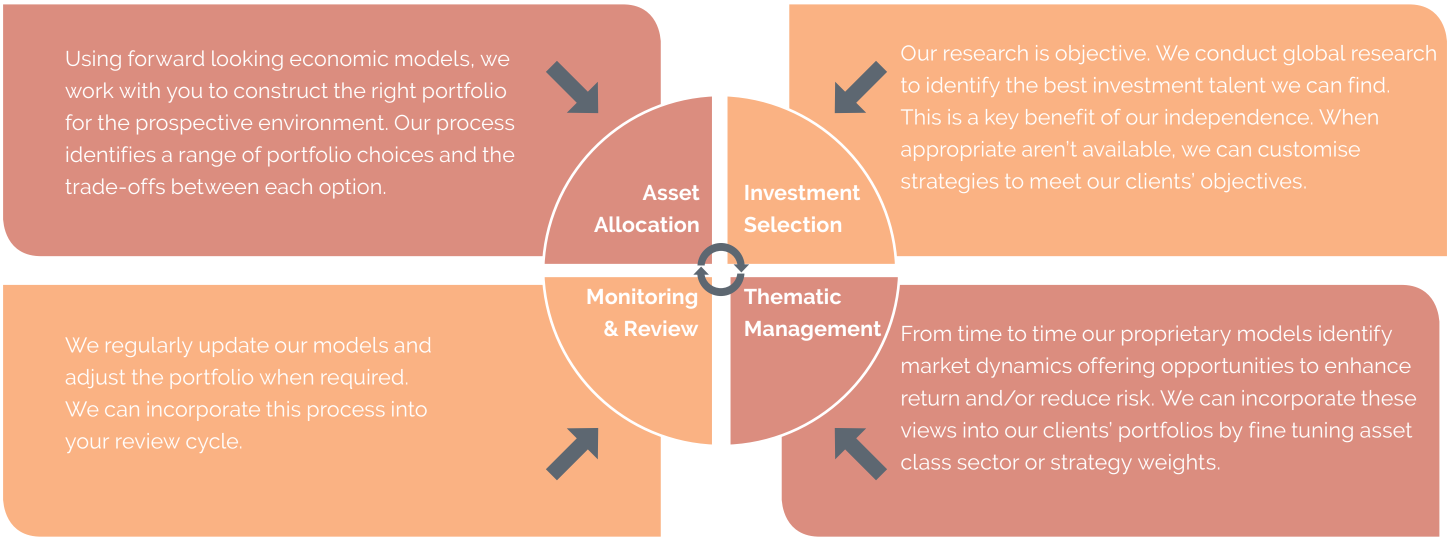
Cardena's portfolios use wider ranges within which to set asset class exposures, including the ability to have zero exposure if necessary to assets which are expected to perform poorly over a particular period. We manage exposures pro-actively using our proprietary scenario-based dynamic asset allocation process.

Cardena's approach is especially important in the aftermath of the GFC where investors are facing an extended period of low interest rates and investment returns. Cardena believes its more flexible and dynamic approach is better suited to managing the challenges of this environment than the old style of portfolios.

Cardena recommends clients invest in a suite of real return, multi-asset class, multi-manager portfolios subject to our client's objectives and willingness to accept risk and volatility.

We firmly believe that asset allocation is a key driver of portfolio returns over time. As such, portfolios need to be actively managed through a dynamic asset allocation and investment manager selection processes.

The following diagram depicts the process our investment committee follows when constructing and managing portfolios for our clients.



The technology supporting Managed Accounts allows us, as your adviser, to implement this philosophy far more efficiently than ever before.

What are the benefits of a Managed Account?

This ownership structure of a managed account leads to a number of important benefits to the investor:

1. Investment discretion supports more frequent portfolio reviews

   Traditional portfolio management and advice means that implementing changes across portfolios can be difficult and often is not done in a timely manner. The reality is that the traditional approach results in portfolios being reviewed six monthly or annually in a number of cases.

2. The investor can see exactly where their money is invested, and what investment decisions have been implemented on their behalf. Where direct assets are held this is even more transparent.

3. It is easier to see the performance of specific assets which make up the portfolio and how each asset contributes to investment performance.

4. The investor may be able to set investment parameters and rules around how their portfolio is managed, including investment exclusions and substitutions, trade sizes and tax preferences (for example an investor can choose to substitute Rio Tinto for BHP).

5. The investor may get better tax outcomes

   An investor holding investments via a Managed Account gets the same tax benefits as if they held them directly as well as being able to access professional investment managers.

6. When buying growth assets directly, the investor does not buy into any embedded tax liability that may exist in a Managed Fund.

7. Transaction and management costs can reduce.

   The application of specialist expertise and wholesale investment mandates opens up the opportunity to access brokerage at institutional rates and also to negotiate with investment managers with regard to their ongoing management expense ratio (MER)

Implementing portfolios using Managed Account technology

Whether a portfolio is constructed from direct equities, hybrids, ETFs or managed funds, a Managed Account can provide a highly efficient investment solution which benefits our clients, delivering value all-round.

The act of rebalancing is one of the driving reasons for this.

Rebalancing is when the investment manager (e.g. Cardena Asset Management) chooses to change the asset allocation or the underlying assets in the investment model, providing instructions to the Managed Account provider to buy or sell those assets for each investor who holds that model.

Rebalancing is the process that implements all necessary changes across all assets the adviser's clients or investors hold in that investment model. A rebalance will take into account the rules and exceptions that may be specified by the investor or the adviser (on behalf of their clients).

These may include for example: minimum trade size, minimum holdings and CGT rules, as well as individual exceptions such as excluding particular assets from purchase or sale.

The benefit of this process for our clients is that investment models and underlying assets are constantly monitored by the investment manager and changes are made as and when appropriate. All investment portfolios are updated by the managed account provider without the need for investor or client authorisation. The benefit to our clients is that it saves delays in implementation.

The benefits of the Managed Account become even more evident when wanting to combine multiple investment models or when using models with a large number of underlying assets which need to be rebalanced regularly.

Technology is important to ensure smooth implementation

To be truly beneficial to our clients, it is important that the Managed Account provider has a simple yet robust procedural and administration structure.

Specifically, the Managed Account provider must be able to:

- Manage the calculation and implementation of numerous investment models which contain hundreds of underlying investments and are utilised by thousands of investors;
- Make investment options available that include a broad variety of asset classes;
- Offer the ability to blend several investment models;
- Be tailored for individual clients with rules and exceptions;
- Have capability to report on performance of assets across the Managed Account and non-Managed Account assets (for example if BHP is held in the Managed Account and outside the Managed Account);
- Have efficient trading to ensure that transaction costs do not adversely impact on performance; and
- Must be available within superannuation accounts.

It should be noted that models provided by an individual model manager may have very differing performance between Managed Account providers, depending on the technology and administration employed by the providers.

Execution is thus a key factor to ensure returns are as close as possible to the investment manager's model. Speed of implementation, quality of algorithms, trading costs and timing can all have a significant impact on actual outcomes.

The advanced technology, appropriately sized administration team and the right legal structures provided by full service technology providers ensure the proper delivery of Managed Accounts for our clients.

In Conclusion

Managed Accounts are not brand new but they are growing rapidly. They are the next iteration of portfolio construction and are now able to be more easily implemented for clients given the new technology available in the market place.

A Managed Account provides you access to:

- A professionally managed investment portfolio;
- A range of investment 'models' which are managed by experts;
- The ability to customise your portfolio to meet your individual preferences;
- Certain tax advantages over traditional Managed Funds – particularly relevant to directly held Australian shares; and
- The convenience of managing all your investments or super in one account.

Get in touch

To find out more about Managed Accounts and how a Managed Account may help you grow your wealth, get in touch with a Cardena adviser:

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Source: netwealth Investments Limited Philo Capital Advisers Quilla Consulting