

# Dare to be different

MLC Long-Term Absolute Return Portfolio



Issue date: 5 December 2005



A  **National** Company

“ If you **put money in**  
and pull it out again in the  
space of a *few months*,  
you are not investing,  
**you are speculating**. And just  
because everyone is doing it,  
**doesn't make it right.**”

Al Gore, former US Vice-President

“Gore warns against super short-termism”, Money Management, 10 Nov 2005

## Why keep up with the Jones' when you can lead them?

MLC's manager of managers investment process has helped Australians achieve their financial goals for the last 20 years. And an innovative multi-sector, multi manager portfolio, the MLC Long-Term Absolute Return Portfolio builds on this process to deliver you the potential of genuine long-term returns.

John Bogle, founder and ex-chairman of Vanguard Group, is calling for the industry to strive against short-term speculation\*, as is the former US Vice-President Al Gore. While the industry is only just beginning to challenge the idea of short-term investing, MLC has already developed an investment vehicle to meet this challenge – the MLC Long-Term Absolute Return Portfolio.

The MLC Long-Term Absolute Return Portfolio ventures into uncharted territory with an investment strategy that pays no attention to the rest of the market, has a genuine long-term investment time, and focuses on real wealth creation.

For many years we have set our investment managers free to deliver you higher returns. The MLC Long-Term Absolute Return Portfolio continues this evolution to deliver you a portfolio that lets you really invest for the long-term.

\* "Stop speculating and get back to capitalism: Bogle", Financial Standard, 14 Nov 2005.



# When you invest for the genuine long-term, you can afford to be different

The MLC Long Term Absolute Return Portfolio is a multi-sector, multi manager portfolio, adopting a true long-term investment horizon.

Due to the genuine long-term nature of the fund, the MLC Long-Term Absolute Return Portfolio is able to use strategies not available to traditional portfolios:

- 1 **accessing many sources of returns** to reduce any dependency on a single source of return and avoiding the risk of the portfolio being dominated by share markets
- 2 **gearing** to increase potential returns
- 3 applying a **'strategic overlay'** to manage risk and opportunity



# Accessing many sources of returns

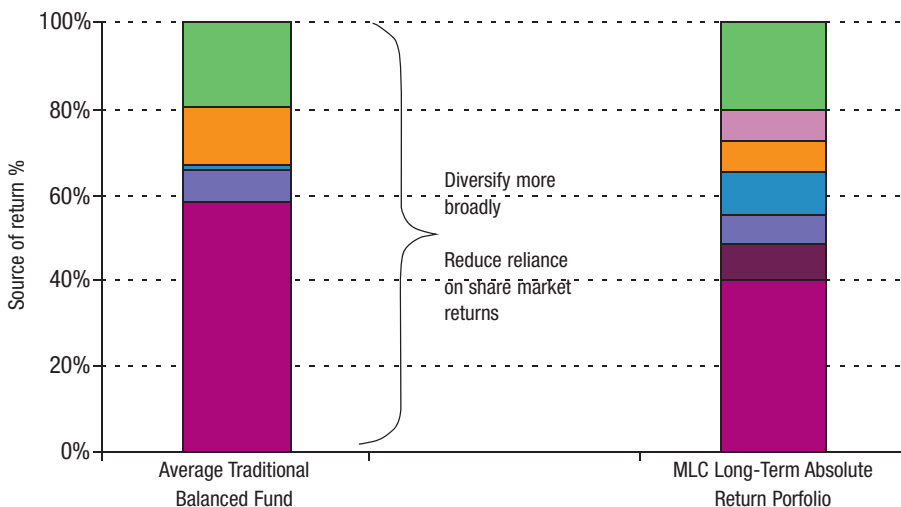
Traditional portfolios rely heavily on share markets to generate returns. This means you are relying on positive share market performance to provide the wealth you require to meet your lifestyle goals.

The MLC Long-Term Absolute Return Portfolio, however, introduces a new level of diversification to your portfolio. It accesses many sources of returns at all times. Various strategies are employed to ensure there is no domination by any single source:

- > Using investment managers who employ unconventional strategies focused on generating real returns
- > Using financial techniques to amplify the impact of investment managers' skill (see page 4 for more details)
- > Placing significant emphasis on global and emerging market shares when appropriate
- > Investing in non-traditional assets (see non-traditional assets to the right)

As we are continually researching new strategies and assets, MLC may add, vary or remove sources of returns, investment managers, strategies or assets at any time without prior notice to you.

## How the MLC Long-Term Absolute Return Portfolio improves the risk-return trade off



■ Manager Skill 
 ■ Absolute Return 
 ■ Debt 
 ■ Private Market 
 ■ Property 
 ■ Commodities 
 ■ Shares

## Non-traditional assets

- **Private Markets** - Assets, such as private companies, that cannot be traded on listed markets, and are therefore illiquid. The current target level for private markets exposure is 10%, but may change over time. The maximum exposure to these assets is 30%.
- **Commodities** – Commodities include energy, agriculture and metals – access to which will be gained through derivatives markets including the use of futures. Commodity futures are financial contracts based on the underlying physical assets – meaning transactions are in cash rather than the physical commodities. The maximum exposure to commodities is 30%.
- **High-Yield Debt** – Debt securities that pay higher rates of interest than investment grade debt because they are issued by countries or organisations that have a higher risk of default.
- **Mezzanine Debt** – High yield debt that is not publicly offered.
- **Inflation Linked Securities** – Securities whose values are linked to changes in inflation, providing a hedge against the erosion of your purchasing power due to inflation.

This is not a comprehensive list. Over time the Portfolio may invest in other types of assets, many of which cannot be anticipated today. The percentage limits mentioned above refer to the value of the Portfolio. Exposure to non-traditional assets may impact an investor's ability to transact on the Portfolio.

## Gearing

### Amplifying investment manager skill using gearing and covered shorting

With 20 years of experience in researching and selecting investment managers, MLC believes it is able to identify investment managers that can outperform the market over the long-term. This outperformance is called an additional source of returns.

Many of the investment managers with the highest level of outperformance invest in share markets. But, as indicated, the Portfolio is designed not to be dominated by such markets. It uses financial techniques to gain a significant exposure to such investment managers' potential outperformance without accepting all of the associated market exposure.

This is currently achieved by borrowing to invest in investment portfolios, then selling relevant index futures to remove unwanted market exposure - market shorting. This has the effect of increasing the differences between the investment managers' holdings and those of the market index. It is these differences in holdings that are the source of investment manager outperformance. We call this "amplifying" the investment manager's skill.

Gearing a portfolio can magnify your investment returns. It can, however, also magnify any negative returns or losses, and the volatility of returns.

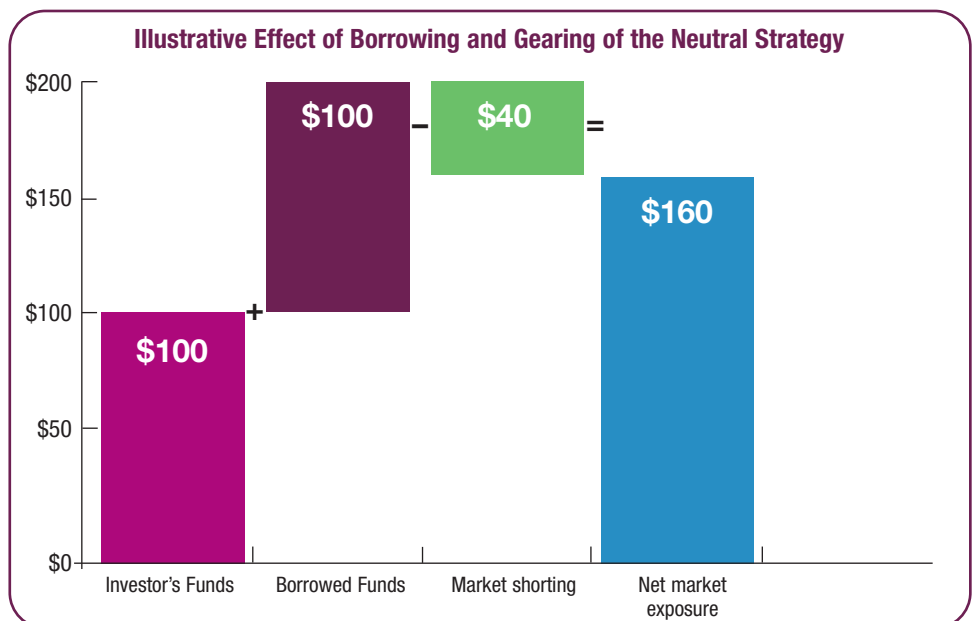
By diversifying across many sources of returns and having a long-term focus, MLC has increased its flexibility to gear the MLC Long-Term Absolute Return Portfolio's risk and return expectation to meet its investment objective.

The MLC Long-Term Absolute Return Portfolio may access investments that borrow for two reasons:

1. To increase exposure to investment markets
2. As part of the financial techniques that amplify investment manager skill (see shaded box to the left)

The current neutral strategy (discussed on page 5) involves borrowing \$100 for every \$100 you invest.\*

The graph below illustrates how borrowing to invest increases market exposure, which is then reduced by market shorting, based on the current neutral strategy. In this case borrowed funds of \$100 are added to the investor funds of \$100, and by subtracting the market shorting of \$40, results in a net exposure of \$160.



\* This amount could increase as a result of a change in the neutral strategy or the strategic overlay.

## Strategic overlay

The 'strategic overlay' process is MLC's approach to making substantial changes to the MLC Long-Term Absolute Return Portfolio's neutral strategy, altering its exposure to different sources of returns.

The current neutral strategy is set out below in terms of the net exposure for every \$100 of an investor's funds.

Strategy component	Net exposure (\$)*
Global Shares	53*
Australian Shares	14^
Private markets#	10
Debt and hybrid assets	24
Property Securities	16
Real return strategies	24
Commodities	19
<b>Total</b>	<b>160</b>

\* Represents an exposure of \$73 to physical assets, less market shorting of \$20.

^ Represents an exposure of \$34 to physical assets, less market shorting of \$20.

# The allocation to private markets is currently less than the target allocation. Further allocations will be made as and when investment opportunities arise. Until such time, the allocation will be invested in hedged global shares.

This neutral strategy may be altered over time to incorporate changes in our view, regarding the long-term relationships between assets, as well as including new sources of return.

The MLC Long-Term Absolute Return Portfolio's long-term focus, and its willingness to be different to others, allows it to be positioned for the risks and opportunities identified over a 5-8 year timeframe. For example, MLC may alter the MLC Long-Term Absolute Return Portfolio's exposure to markets in response to long-run cycles. These strategies may take several years to reward investors, and cause the MLC Long-Term Absolute Return Portfolio's performance to vary significantly from other investment options.



## The importance of a net real return

When you invest, you are trying to grow your wealth in a real sense – so you can purchase more with your money in the future than you can today. This is called a ‘real return’, and is what you receive above the rate of inflation.

However, it is not just inflation that can erode the value of your investment. For you to be able to buy more in the future, your investment needs to generate a return over and above tax, investment fees and other investment costs it incurs in achieving a return. This is called a “net real return”, which takes into account these additional factors and provides a better measure of your return.

### Return expectations

MLC’s current return expectation for the MLC Long-Term Absolute Return Portfolio, is an average of 5.5% p.a. above inflation, over rolling 20 year periods.

This expected return is a net real return after the deduction of tax for a superannuation fund, investment fees and other costs\* incurred in managing the investments of the Portfolio.

Over the length of your investment in the MLC Long-Term Absolute Return Portfolio, there may be significant periods when the return is lower than expected. And there will also be occasions when the Portfolio experiences negative returns. The return expectation of the Portfolio may change over time and is based on MLC’s current estimate of long-term returns – actual returns may differ.

Neither MLC nor any member of the National Group of Companies, or any other person, guarantees MLC’s current return expectation for the MLC Long-Term Absolute Return Portfolio of 5.5% p.a., now or in the future.

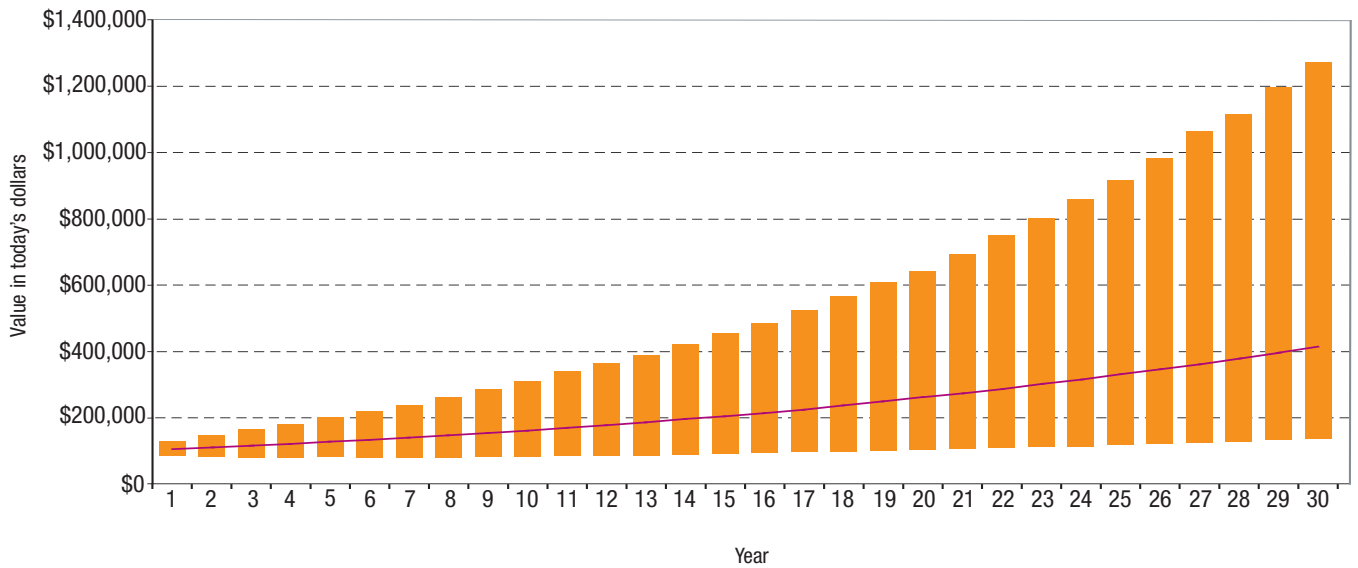
### Ranges of potential growth

The value of an investment in the MLC Long-Term Absolute Return Portfolio will vary over time. The graph opposite gives you an idea of how much a \$100,000 investment in the MLC Long-Term Absolute Return Portfolio could grow in today’s dollars. It shows the range of these values between the 5th and 95th percentiles, together with the median, i.e. 50th percentile.

We have used the MLC Long-Term Absolute Return Portfolio’s neutral strategy (outlined on page 5) to calculate the values shown in the graph. The values are based on MLC’s current forward-looking real return and volatility estimates for the various asset classes. As the MLC Long-Term Absolute Return Portfolio is focussed on achieving a net real return we then deducted an estimate for the tax that would be paid by a superannuation fund and investment costs of 1.41% p.a.

\* You may incur an additional administration fee as set by your IDPS operator. These fees have not been deducted from the net real return, as they will depend on your chosen IDPS operator.

Range of potential future values of a \$100,000 investment in the MLC Long-Term Absolute Return Portfolio



■ Range of potential future values in today's dollars
 — Median future value in today's dollars



# The MLC manager of managers investment process

Behind the MLC Long-Term Absolute Return Portfolio lies MLC's manager of managers investment process, a process based on a number of fundamental investment beliefs:

- > **skilled investing** is the best way to grow wealth
- > **deep research** is the only reliable way to identify skilled investment managers, brand and past performance are unhelpful
- > **diversification** leads to more consistent investment outcomes
- > a **long-term approach** should be used if your goals are long-term
- > **efficient implementation** reduces the costs of running a portfolio

These beliefs are continually applied by MLC's dedicated team of investment professionals to create the 4 key elements of the MLC Manager of Managers Investment Process:

## 1. A long-term approach to investment strategy

MLC has a long-term investment approach designed to provide reliable performance over different economic and market environments by broadly diversifying across investment strategies, investment managers and securities. Reliable performance is achieved by making many small investment decisions, rather than just a few large investment decisions. Small decisions would be investing in lots of securities while a large decision would be adjusting a portfolio in response to perceived short-term market trends.

## 2. Selecting excellent investment managers

When it comes to selecting investment managers, past performance tells us nothing about the future. MLC commits extensive resources to finding excellent investment managers from around the world. MLC researches a broad range of investment managers over a long period of time to form a view of their competitive edge. The investment managers we select are continually reviewed to ensure you always have excellent investment managers looking after your money. We also encourage each investment manager to be the best they can be. This often involves the investment managers creating customised portfolios for MLC.

## 3. Combining different investment managers

Because each investment manager has a different approach to investing, they select different securities. By carefully combining a number of these investment managers to manage the MLC Long-Term Absolute Return Portfolio, MLC is able to generate more consistent performance than would be possible with just one investment manager.

## 4. Implementing portfolios efficiently

MLC has 20 years of experience as a manager of managers, the scale (as the fourth largest in the world\*), decision making processes and investment structures which enable the efficient implementation of the MLC Long-Term Absolute Return Portfolio. Our team of implementation specialists carefully manage portfolio costs and taxes.

\*Cerulli Associates – The Cerulli Edge, Asia-Pacific Edition, Third Quarter 2005.



Over the last *20 years*, the S&P 500 returned an average of **12.98% p.a.** However, the average investor, focused on making short-term decisions, *earned only 3.5% p.a.\**

- that's a difference of around

**\$950,000 on a \$100,000**

investment over those 20 years!

\*Quantitative Analysis of Investor Behaviour, Dalbar, 2004

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54140 MLC 12/05



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