



# MLC MasterKey Investment Service

## MLC MasterKey Unit Trust

End of year pre-distribution commentary, 2018 financial year

25 May 2018

### Background

On Thursday, 31 May 2018 the last distribution for the 2018 financial year (FY2018) will be made to investors in the funds that comprise the MLC MasterKey Unit Trust, including those in the MLC MasterKey Investment Service (MKIS)<sup>1</sup>.

As the final distributions for FY2018 won't be known until 31 May, we've provided commentary using recent years' distributions as a reference point. Appendix 1 provides the full financial year (1 June to 31 May) distributions for the last seven years.

Investors who have their distributions paid into their bank account, rather than reinvested into their fund, can expect the income in their account within two weeks after the distribution.

### Commentary for expected full year distributions for FY2018

Commentary on the final distributions we are generally expecting, compared to recent years' distributions is provided in Table 1.

Table 1 – Commentary on expected distributions for FY2018

MLC MasterKey Unit Trust fund	Expected full year distribution for FY2018* commentary
MLC Horizon 1 – Bond Portfolio	Significantly lower than FY2017. Please refer to page 4 for the factors that affected 'Fixed income' this year.
MLC Horizon 2 – Income Portfolio	Significantly lower than FY2017 because of: <ul style="list-style-type: none"><li>• lower non-assessable capital gains – please refer to page 3 for information on 'Distributions of non-assessable capital gains', and</li><li>• reduced income from fixed income and Australian shares investments – please refer to page 4 for factors that affected 'Fixed income' and 'Australian shares'.</li></ul>
MLC Horizon 3 – Conservative Growth Portfolio	Significantly higher than FY2017 due to an increase in realised capital gains. The Fund no longer has carried forward capital losses which have significantly reduced the distributions in previous years. Please refer to page 5 for information on 'Carried forward capital losses'.

<sup>1</sup> MLC MasterKey Investment Service Fundamentals also invests in MLC Wholesale funds, which have a June year end. The MLC Inflation Plus–Assertive Portfolio, MLC Diversified Debt Fund, MLC Global Property Fund and MLC Hedged Global Share Fund in MLC MasterKey Investment Service are accessed through the MLC Wholesale funds, so they also have a June year end. As a result, this commentary does not cover those products.

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MLC MasterKey Unit Trust fund	Expected full year distribution for FY2018* commentary
MLC Horizon 4 – Balanced Portfolio MLC Horizon 5 – Growth Portfolio	Significantly lower than FY2017 because of lower non-assessable capital gains. Please refer to page 3 for information on ‘Distributions of non-assessable capital gains’.
MLC Horizon 6 – Share Portfolio	<p>There were three main factors that effectively offset to produce a similar distribution to FY2017:</p> <ul style="list-style-type: none"> <li>• lower non-assessable capital gains – please refer to page 3 for information on ‘Distributions of non-assessable capital gains’</li> <li>• an increase in realised capital gains as the Fund no longer has carried forward capital losses which have significantly reduced the distributions in previous years. Please refer to page 5 for information on ‘Carried forward capital losses’, and</li> <li>• an increase in foreign income.</li> </ul>
MLC Horizon 7 – Accelerated Growth Portfolio	Significantly lower than FY2017 because of lower non-assessable capital gains. Please refer to page 3 for information on ‘Distributions of non-assessable capital gains’.
MLC IncomeBuilder	<p>The total distribution is expected to be lower than FY2017 mostly due to a decrease in capital gains which were higher in FY2017 as the industrials sector of the Australian share market rose strongly in FY2017. The Fund’s underlying income, comprising dividend and other income but excluding capital gains, is expected to decrease slightly. Almost all of the underlying income is franked dividends which provide investors with a tax-efficient income stream.</p> <p>For more information about the distribution of MLC IncomeBuilder please refer to the MLC IncomeBuilder annual distribution commentary, which will be available mid June 2018.</p>
MLC Australian Share Fund	Significantly lower than FY2017 because of:
MLC Australian Share Value Style Fund	<ul style="list-style-type: none"> <li>• lower non-assessable capital gains – please refer to page 3 for information on ‘Distributions of non-assessable capital gains’, and</li> </ul>
MLC Australian Share Growth Style Fund	<ul style="list-style-type: none"> <li>• reduced income from Australian shares – please refer to page 4 for factors that affected ‘Australian shares’.</li> </ul>
MLC-Vanguard Australian Share Index Fund	Significantly lower than FY2017. Investors in this Fund may recall we revised the taxation components for FY2017. Compared to the more ‘normal’ distribution in FY2016, the Fund is expected to have a slightly higher distribution due to higher realised capital gains as a result of solid returns from the Australian share market in recent years.
MLC Property Securities Fund	Lower than FY2017 because of lower non-assessable capital gains. Please refer to page 3 for information on ‘Distributions of non-assessable capital gains’.



MLC MasterKey Unit Trust fund	Expected full year distribution for FY2018* commentary
MLC Global Share Fund	Significantly lower than FY2017, potentially a zero distribution, because of lower non-assessable capital gains. Please refer to page 3 for information on 'Distributions of non-assessable capital gains'.
MLC Global Share Growth Style Fund	
MLC Global Share Value Style Fund	Significantly lower than FY2017 because of lower non-assessable capital gains. Please refer to page 3 for information on 'Distributions of non-assessable capital gains'.
MLC-Platinum Global Fund	Significantly higher than FY2017 due to an increase in capital gains.

\* This commentary may be materially affected by factors including:

- investment market movements
- investment manager trading activity
- differences in the tax treatment, and
- realisation of gains and losses between now and 31 May 2018.

## Key factors affecting distributions in FY2018

The MLC Horizon portfolios are a range of multi-asset class funds tailored to meet the needs of investors with different return expectations, time frames and tolerances for volatility. The income distributions for these funds are largely based on the income from the underlying asset classes described below (ie shares, property and fixed income). The allocations to the asset classes are different for each of the MLC Horizon portfolios.

MLC's share funds (except for MLC IncomeBuilder), and the MLC Horizon portfolios with high allocations to shares, are designed to provide capital growth. Although many of these growth-focussed funds make frequent distributions, their main objective is to increase the value of their assets for investors, rather than to deliver a regular income stream.

Here are the key factors affecting distributions in FY2018.

## Distributions of non-assessable capital gains

When we sell securities in our funds (such as shares and property securities), we 'realise' a capital gain or loss. The capital gain (or loss) is the difference between the price we sell the security for and the cost of the security, and any costs associated with buying or selling the security.

Capital gains made from the sale of securities that have been held for more than a year are entitled to a 50% capital gain discount which reduces the amount of the fund's taxable capital gains. The non-assessable part of the 'discount' on the capital gain is included in the fund's distribution and has previously been referred to as a concessional capital gain because it has concessional tax treatment for investors.

In recent years many of our funds have distributed high levels of non-assessable capital gains. In some funds, all the capital gains we've distributed have been non-assessable capital gains. They've been a large part of the distributions because funds with capital losses have been able to pass through to investors the non-assessable capital gains distributed from underlying funds; preserving the concessional tax treatment of the gains.

The tax rules have changed from FY2018 so that the non-assessable capital gains a fund distributes, which exceed the 50% capital gain discount, will no longer retain concessional tax treatment for investors. We'll therefore accumulate excess non-assessable capital gains in our funds instead of distributing. These amounts will be reflected in a fund's unit price. As a result many of our funds' distributions will be lower in FY2018 and future years.

The funds most impacted by these changes are shown in Table 2. We've compared last year's cents per unit (cpu) distribution to the cpu after removing the non-assessable capital gains that would have exceeded 50% of the funds'

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realised capital gains. After removing the excess non-assessable capital gains the distributions are much lower but are also more 'normal' and therefore comparable to this year's distributions, as explained in Table 1.

Our approach is in line with industry practice.

**Table 2 – FY2017 distributions for funds most impacted by lower levels of non-assessable capital gains**

MLC MasterKey Unit Trust fund	Cpu distribution for FY2017	Cpu distribution for FY2017 after removing the 'excess non-assessable capital gains'
MLC Horizon 2 Income Portfolio	2.35	1.72
MLC Horizon 3 Conservative Growth Portfolio	2.33	1.19
MLC Horizon 4 Balanced Portfolio	3.76	1.36
MLC Horizon 5 Growth Portfolio	3.55	1.04
MLC Horizon 6 Share Portfolio	3.29	0.76
MLC Horizon 7 Accelerated Growth Portfolio	3.64	0.17
MLC Australian Share Fund	11.43	3.55
MLC Australian Share Value Style Fund	4.78	2.19
MLC Australian Share Growth Style Fund	6.24	2.64
MLC Property Securities Fund	3.30	2.19
MLC Global Share Fund	4.83	-
MLC Global Share Value Style Fund	1.97	0.66
MLC Global Share Growth Style Fund	3.81	-

The above amounts are historical distributions and are not indicative of future distributions.

## Australian shares

Many Australian companies have trimmed their dividends. Resource companies have generally had good growth in earnings but many industrial companies haven't eg the banks' profits haven't been as strong as expected and Telstra reduced its dividend significantly.

## Fixed income

Income from fixed income investments produced lower levels of income this year than in FY2017 due to rising bond yields. In the long run, higher bond yields and interest rates should result in higher distributions of interest income. However, when the interest rates and yields are increasing the value of the fixed income securities generally decreases, which flows through to lower returns and reduces the income distribution that year.



Additionally, the funds' exposure to overseas fixed income investments is largely hedged to the AUD and the AUD decreased in value this year. Currency movements therefore resulted in lower distributions of currency gains this year.

## Carried forward capital losses

Capital losses significantly reduce the level of distributions. During the GFC of 2008-9 and the first few years afterwards, markets were weak and volatile. Most funds suffered large capital losses when they sold investments. Capital losses are kept in the fund and are carried forward until they can be offset against future capital gains.

The funds we expect to have carried forward capital losses at the end of FY2018 are:

- MLC Horizon 2 – Income Portfolio
- MLC Horizon 4 – Balanced Portfolio
- MLC Horizon 5 – Growth Portfolio
- MLC Horizon 7 – Accelerated Growth Portfolio
- MLC Australian Share Fund
- MLC Australian Share Value Style Fund
- MLC Australian Share Growth Style Fund
- MLC Property Securities Fund
- MLC Global Share Fund
- MLC Global Share Value Style Fund

## Next steps

As the distribution is on 31 May 2018, there is a month before the end of the Australian taxation year on 30 June so you can assess the impact on your portfolio.

If you have questions, please speak to your financial or tax adviser.

In the week following the distribution we'll update this commentary with the final cpu distribution. The tax components will be available mid June 2018. This information will be available on [mlc.com.au](http://mlc.com.au).

More information on the performance of each fund is available on the Fund Profile Tool on [mlc.com.au](http://mlc.com.au) and is updated monthly.

## Appendix 1: Financial year distribution history

Table 3 shows the full financial year (1 June to 31 May) distributions for the last seven years. As the final distributions for FY2018 won't be known until 31 May, the commentary provided in this communication uses recent years' distributions as a reference point.

To illustrate the impact of the lower distributions of non-assessable capital gains (outlined on page 3) we've also included FY2017 cpu with the excess non-assessable capital gains removed. After removing the excess non-assessable capital gains the distributions are much lower but are also more 'normal' and provide a better comparison to this year's distributions, as outlined in Table 1.

**Table 3 – Distribution history**

Fund	Cpu distribution for FY2017 after removing the 'excess non-assessable capital gains'	Full year cpu (yield) <sup>2</sup>						
		2016/17	2015/16	2014/15	2013/14	2012/13	2011/12	2010/11
MLC Horizon 1 – Bond Portfolio	1.62	1.63 (1.6%)	1.15 (1.1%)	0.76 (0.8%)	1.53 (1.5%)	2.27 (2.3%)	2.15 (2.2%)	4.67 (4.9%)
MLC Horizon 2 – Income Portfolio	1.72	2.35 (2.1%)	3.29 (2.8%)	2.36 (2.2%)	1.77 (1.7%)	2.98 (3.0%)	2.86 (2.9%)	4.65 (4.8%)
MLC Horizon 3 – Conservative Growth Portfolio	1.19	2.33 (2.3%)	5.38 (5.1%)	2.53 (2.6%)	1.50 (1.6%)	1.95 (2.3%)	1.85 (2.2%)	3.98 (4.9%)
MLC Horizon 4 – Balanced Portfolio	1.36	3.76 (2.7%)	9.52 (6.4%)	4.86 (3.5%)	2.36 (1.9%)	2.49 (2.3%)	2.45 (2.2%)	5.44 (5.0%)
MLC Horizon 5 – Growth Portfolio	1.04	3.55 (2.9%)	9.33 (7.0%)	4.10 (3.4%)	2.04 (1.9%)	1.75 (1.9%)	2.42 (2.5%)	5.06 (5.4%)
MLC Horizon 6 – Share Portfolio	0.76	3.29 (3.4%)	8.78 (8.2%)	3.10 (3.2%)	1.55 (1.8%)	0.76 (1.1%)	1.04 (1.4%)	4.13 (5.8%)
MLC Horizon 7 – Accelerated Growth Portfolio	0.17	3.64 (3.5%)	10.60 (9.0%)	2.62 (2.6%)	1.28 (1.5%)	0.13 (0.2%)	0.19 (0.3%)	3.77 (5.4%)
MLC IncomeBuilder	17.15	17.19 (6.9%)	16.54 (5.9%)	23.25 (8.6%)	13.80 (5.6%)	19.48 (9.8%)	8.34 (3.9%)	7.88 (3.6%)
MLC Australian Share Fund	3.55	11.43 (6.6%)	8.58 (4.7%)	7.92 (4.5%)	6.12 (3.8%)	3.58 (2.7%)	4.46 (2.9%)	4.82 (3.2%)
MLC Australian Share Value Style Fund	2.19	4.78 (4.9%)	4.41 (4.2%)	4.61 (4.6%)	2.67 (3.0%)	3.40 (4.5%)	4.09 (4.5%)	2.83 (3.2%)
MLC Australian Share Growth Style Fund	2.64	6.24 (5.2%)	4.37 (3.5%)	4.82 (3.9%)	2.54 (2.3%)	1.59 (1.8%)	1.76 (1.7%)	2.95 (3.0%)
MLC-Vanguard Australian Share Index Fund	55.26	55.48 (24.0%)	9.94 (4.0%)	13.23 (5.4%)	12.62 (5.6%)	8.88 (4.8%)	9.19 (4.3%)	6.62 (3.3%)
MLC Property Securities Fund	2.19	3.30 (3.4%)	3.11 (3.6%)	3.00 (4.2%)	2.29 (3.2%)	1.54 (2.7%)	2.40 (4.3%)	1.97 (3.7%)
MLC Global Share Fund	-	4.83 (3.0%)	24.45 (13.1%)	2.01 (1.3%)	1.16 (0.9%)	0.13 (0.1%)	0.02 (0.02%)	0.03 (0.03%)
MLC Global Share Value Style Fund	0.66	1.97 (1.7%)	1.80 (1.5%)	0.82 (0.8%)	0.89 (1.0%)	0.31 (0.5%)	0.17 (0.2%)	0.05 (0%)

<sup>2</sup> The distribution yield for a fund is the annual cpu divided by the unit price released the day after the final distribution for the previous financial year.

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Fund	Cpu distribution for FY2017 after removing the 'excess non-assessable capital gains'	Full year cpu (yield) <sup>2</sup>						
		2016/17	2015/16	2014/15	2013/14	2012/13	2011/12	2010/11
MLC Global Share Growth Style Fund	-	3.81 (3.0%)	23.83 (15.9%)	3.20 (2.7%)	1.49 (1.5%)	-	-	-
MLC-Platinum Global Fund	10.41	10.41 (5.7%)	20.73 (9.5%)	30.52 (15.3%)	-	-	-	-

The above amounts are historical distributions and are not indicative of future distributions.

## Important information

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