FLP FINANCIAL
FAMILY • LIFESTYLE • PURPOSE

FLP Financial Pty Ltd

Investment Philosophy

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Introduction –
Our Investment philosophy

A major part of what we do at FLP Financial involves the investment of our clients' money, whilst we also spend a lot of time on tax strategy, asset protection, retirement planning and client structures — things that can be termed 'traditional financial planning' — such as the investment of accumulated assets, remains central to helping clients achieve their financial objectives.

For us, successful investing is about getting the big decisions right. This means making sure our clients are invested in the correct asset classes that correspond with their goals and objectives, their timeframe and tolerance to volatility.

There are a number of fundamental beliefs that underpin what we do:

Capitalism Works – Businesses strive to make profits and increase shareholder value. Capital markets increase in value over time.

Risk and Return are related – Risk is all about volatility. If you have a diversified portfolio, and a long-term investment horizon then the real risk is that you sell when the market is down – either investors deviate from the plan, panic and sell, or they are forced to sell. Different asset classes have different amounts of volatility (risk) and have different return profiles. Investors are rewarded for the volatility (risk) that they can tolerate.

Markets Work – Investors are rewarded for the volatility (risk) that they are willing to bear. There are short term fluctuations and volatility, but we must remain focused on the long term returns that capital markets provide.

Diversification is essential – Diversification ensures you are not "putting all your eggs in one basket". Having a diversified portfolio spreads the risk across the asset classes and investments within each asset class. This reduces the portfolio's volatility as different asset classes perform at different cycles of the economy. i.e., fixed interest may perform well when the share market is negative.

Fees and costs matter – Markets are unpredictable, but costs and taxes can be controlled. The lower the costs, the greater the investors' share of the investment returns. Research shows that lower cost investments have tended to outperform higher cost alternatives. To hold on to even more of the returns manage for tax efficiency as well.

Take a long-term view – Time in the market beats timing the market. Focus on achieving long term compounding returns without trying to time the market or pick individual 'winners'. What is really important to creating wealth is being invested for the longer term. Some periods will have negative returns. You don't need to pick the absolute best investment, average market returns are fine.

Focus on things you can control – You cannot control markets and market volatility, and nobody truly knows what is going to happen in the future. You can control how you react to volatility and world events. Ignore speculation and media noise, as well as 'hot tips' for individual stock picking. You can also control how much and what you spend your money on, as well as how much debt you take on.

Stick to YOUR plan and be disciplined. We are here to help keep you on the right course, but people tend to make poor decisions because of their emotions. Don't make the common mistakes of over-trading, chasing returns or panicking when the market falls, or of comparing yourself to 'the Joneses' (what they are doing has absolutely nothing to do with your goals or situation).

- Asset allocation drives the majority of portfolio returns and risk so it's vital to get that right first.
- Low cost index funds provide superior after-fee returns to actively managed funds engaged in stock picking or market timing.
- Markets move in cycles so after a period of strong returns in one asset it is prudent to rebalance into others to lock in profits and reduce risk.

The index/ETF approach

FLP Financials investment philosophy is a common sense investment approach that utilises the benefits of index funds — lower cost, broader diversification, tax efficiency and lower volatility

It can be difficult to continually pick winners over the long term. So instead of trying to beat the market, indexing provides a low-cost way to track market returns. Indexing offers investors two distinct advantages:

1. Investing in all or a representation of stocks in a market index can diversify your portfolio and reduce risk.

2. Buying and holding securities over the long term may reduce volatility, lower costs and taxes, and improve long-term returns.

Index funds bring greater discipline and stability when compared to an actively managed investment portfolio by:

- substantially reducing reliance on 'picking winners' or chasing fund manager returns;
- providing portfolio diversification;
- potentially improving after-tax returns by taking maximum advantage of capital gains discounts; and
- reducing overall fund management and transaction costs.

Index Funds are broad based, low cost investments that capture the overall performance of the market and form the foundation (and majority) of a stable portfolio (i.e. Index Funds) and are used to:

- capture market performance
- reduce investment costs
- create a stable portfolio foundation

Even more importantly, is that countless studies have concluded that very few managers have the ability to beat the financial market over the long term.

Low costs

Index funds usually have lower costs than actively managed funds.

1. Lower transaction costs. Index funds use a buy-and-hold approach, which means their fund managers generally trade securities less frequently than their active counterparts. This reduces brokerage, commission and other trading expenses.

2. Lower management fees. By tracking the performance of an index, index funds essentially rely on a repeatable investment process allowing for cost efficiencies, as they don't have to employ highly paid research teams to analyse and choose securities.

Potential tax efficiency

Every time you sell a stock, you’re incurring a potential capital gain. Simply, capital gains is a tax incurred by the investor as a result of selling securities. As a rule, index fund managers have lower stock turnover, which helps minimise capital gains. In contrast, actively managed funds typically trade more often than index funds so they tend to create more capital gains tax liabilities. The higher your usual marginal tax rate, the more you stand to benefit from indexing’s tax efficiency.

Long-term performance

Indexing’s buy-and-hold approach is a low-cost way to tap into the long term returns generated by investment markets.

Why we use indexing at the core of the investments

An index is a group of securities designed to represent a broad market or a portion of the broad market.

There are indexes measuring the investment results of all major markets and asset classes. An index fund invests in all or a representative sample of the securities of the index it tracks.

Investing in a broadly diversified index fund will ensure investment returns reflect the market performance of the underlying asset class. There is a low risk that returns will deviate substantially from the index benchmark and favourable odds of realising market returns over time. Simply stated, the return from indexing is market performance minus costs — and the costs of indexing are low.

With active management, the investor is seeking enhanced returns compared with the market in a disciplined fashion, after all costs. Any excess market returns can make a difference to the value of a portfolio when compounded over time.

Incorporating an index fund philosophy for a portfolio offers several benefits:

Low costs: Index funds have lower ongoing fees and transaction costs than most active funds investing in similar assets.

Lower transaction costs: Index funds have a low portfolio turnover as they tend to buy-and-hold securities for longer periods to track the index. Lower portfolio turnover results in low ongoing transaction costs. Transaction costs can include brokerage, commissions, stamp duty, custody and other expenses associated with trading securities.

Tax efficiency: An index management approach minimises portfolio turnover so investors can take advantage of available capital gains tax concessions.

Diversification: An index fund gives access to a broad spread of securities that make up a market index. Portfolio diversification means less exposure to the performance fluctuations of individual securities, moderating overall volatility.

Transparency: An index fund is designed to track an index and therefore allows greater control and transparency over a portfolio’s risks.

FLP Financial’s Index/ETF investment philosophy is a common sense investment approach that combines the benefits of index funds—lower cost, broader diversification, tax efficiency and lower volatility— with actively managed funds or other direct investments offering potential for outperformance. It can involve using index funds or exchange-traded funds (ETFs) as the core of an investor’s portfolio and selecting actively managed investments or direct shares as the satellites.

Core-satellite brings greater discipline and stability when compared to an actively managed investment portfolio by:

Portfolio rebalancing

FLP Financial’s believes that the asset allocation decision—which takes into account each investor’s risk tolerance, time horizon, and financial goals—is one of the most important decisions in the portfolio construction process. This is because asset allocation is the major determinant of risk and return for a given portfolio. Over time, as asset classes produce different returns, the portfolio weights will move from the target asset allocation. This changes the risk and return characteristics to an allocation that may be inconsistent with an investor’s goals and preferences. Portfolio rebalancing is extremely important because it helps investors to maintain their target asset allocation.

By periodically rebalancing, investors can diminish the tendency for “portfolio drift,” and thus potentially reduce their exposure to risk relative to their target asset allocation. Annual or semi-annual monitoring, with rebalancing at 5% thresholds, is likely to produce a reasonable balance between risk control and cost minimisation for most investors. Annual rebalancing is likely to be preferred when taxes or substantial time/ costs are involved.

Asset Allocation is the primary portfolio decision

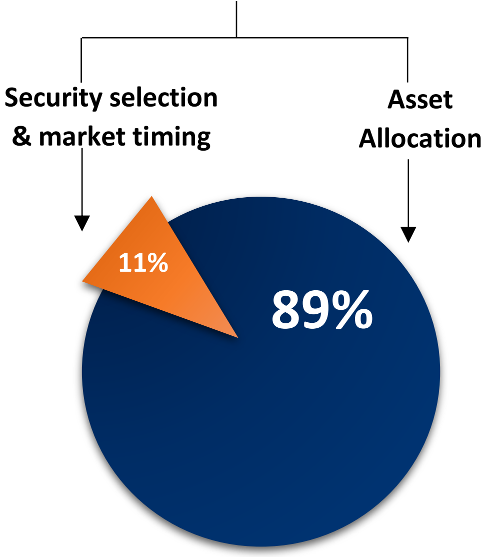
FLP Financial believes that the asset allocation decision — which takes into account each investor's risk tolerance, time horizon, and financial goals — is the most important decision in the portfolio construction process.

This is because asset allocation is the major determinant of risk and return for a given portfolio. Over time, as asset classes produce different returns, the portfolio weights will move from its target asset allocation. This changes the risk and return characteristics to an allocation that may be inconsistent with an investor's goals and preferences. Studies have shown that your chosen asset allocation is responsible for more than 90% in the variability of returns between portfolios.
The diagram opposite illustrates the results of research recently conducted which confirms strong support of that theory — Investment outcomes are largely determined by the long term mixture of assets in a portfolio.

A seminal study by the Institute of Actuaries examined the key drivers of value over an average term of a relationship — whilst it was clear that strategic advice was the predominate component of value creation, however with regard to the investment piece of the jigsaw, asset allocation formulation was the key component.

Note: Calculations are based on the monthly returns for 580 Australian funds from January 1990 through to September 2015. For details of the methodology, see the Vanguard The global case for strategic asset allocation and an examination of home bias (Scott et al., 2016). Source: Vanguard calculations using data from Morningstar

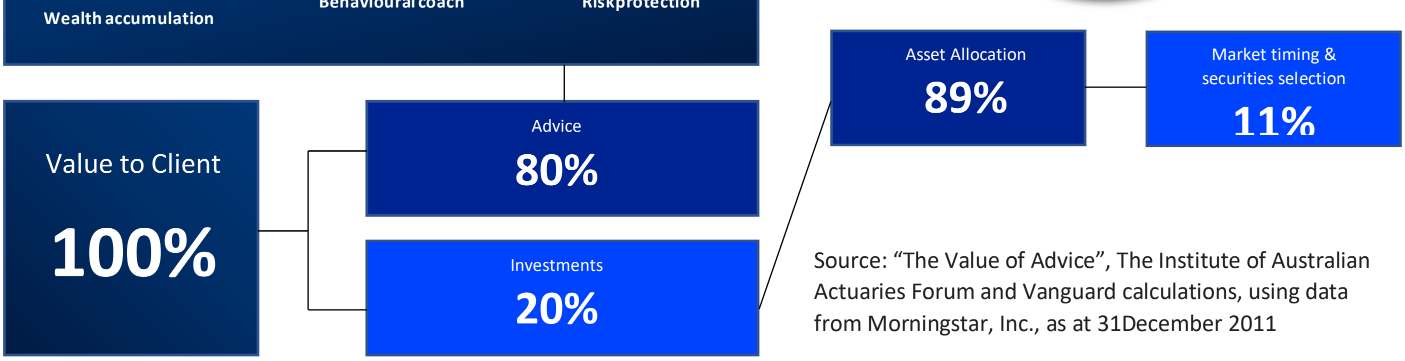
Percentage of a portfolio's movements over time explained by:



Strategy planning
Budgeting
Cash flow planning
Wealth accumulation

Estate planning
Retirement planning
Socialsecurity
Behavioural coach

Tax planning
Tax structures
Risk profiling
Riskprotection



Value to Client
100%

Advice
80%

Investments
20%

Asset Allocation
89%

Market timing & securities selection
11%

Source: "The Value of Advice", The Institute of Australian Actuaries Forum and Vanguard calculations, using data from Morningstar, Inc., as at 31December 2011

Broad Diversification is crucial

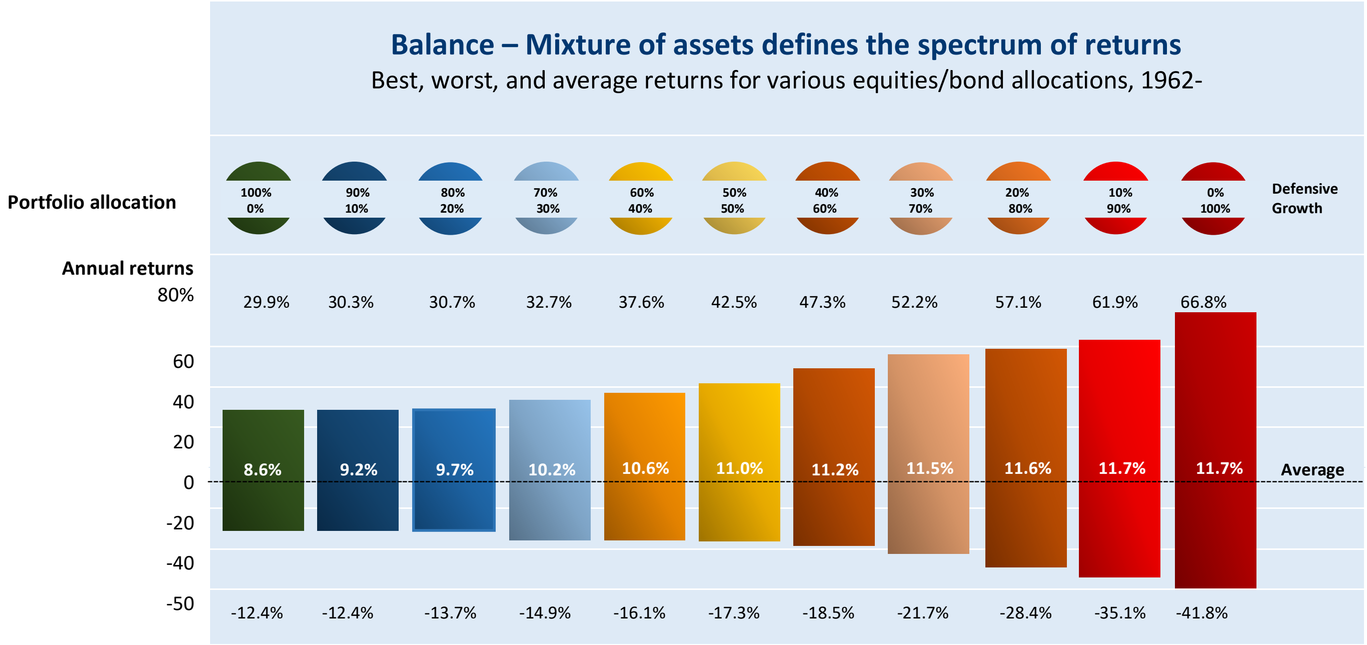
Following implementation of our investment philosophy, clients have the following diversification characteristics to help manage their investment risk in line with their tolerance:

Diversification across asset classes

The various asset classes – shares, private markets, property, bonds and cash – perform differently under different economic and market conditions. The proposed portfolio is diversified across a range of asset classes to reduce the impact of downward fluctuations in any one asset class over the short term, yet still capture the benefits of potentially higher returns from growth assets like shares over the long term.

Diversification across investment management styles

Investment management companies with different investment management styles tend to excel at different times under different economic and market conditions. The proposed portfolio combines a range of investment managers with complementary investment styles, using sophisticated techniques to neutralise unintended style biases in each asset class, and to ensure that diversification of management styles actually results in diversification of underlying investments.



Source: Credit Suisse, "Credit Suisse Global Investment Returns Yearbook 2013", data used by Credit Suisse and in our chart are originally sourced from Dimson, Marsh and Staunton, London Business School, "Triumph of the Optimists".

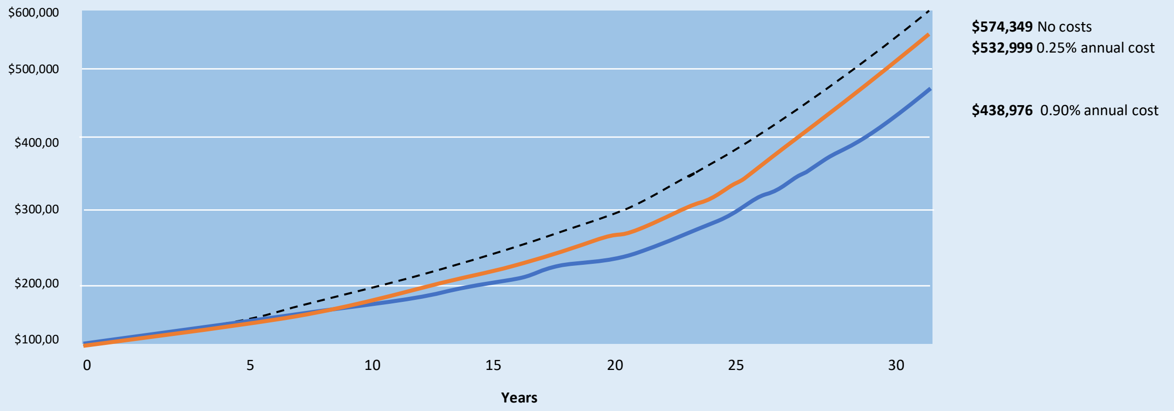
Low cost is a critical success factor

Costs are a pervasive feature of the investment management industry and can take the form of management expenses or other related fees applied to investors' capital as it changes through time. Cost is therefore a drag on net performance. In contrast to the uncertainty about future returns on securities and asset classes that characterises financial matters, minimising costs is a certain way for managers to influence investment performance in a positive manner.

Access to a manager that obtains the market return at a very low cost is an essential building block of our firm's investment philosophy. Investors can't control the markets, but they can control how much they are willing to pay. Every dollar that investors pay for management fees or trading commissions is a dollar less of potential return. In addition, our experience has been that, historically, lower-cost investments have tended to outperform higher cost alternatives in the long term.

The long-term impact of investment costs on portfolio balances

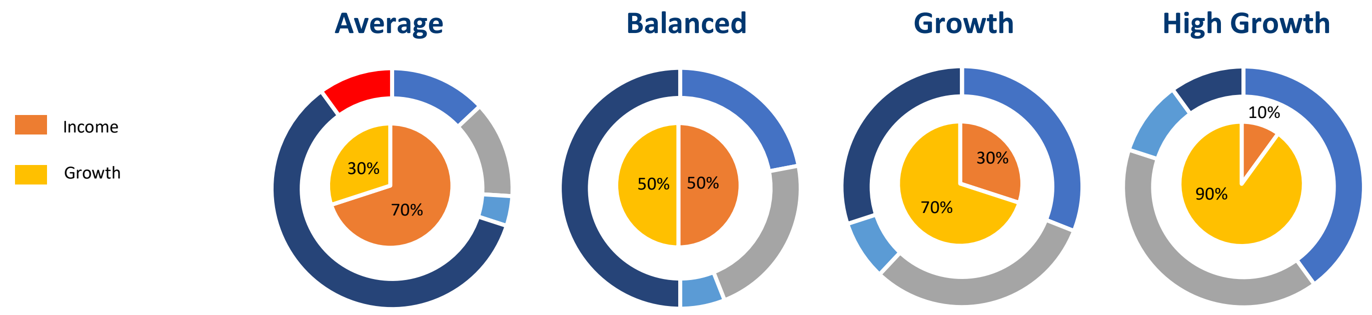
Assuming a starting balance of $100,000 and a yearly return of 6% which is reinvested



Note: The portfolio balances shown are hypothetical and do not reflect any particular investment. The final account balances do not reflect any taxes or penalties that might be due upon distribution. Source: Vanguard.

A low-cost diversified portfolio — an excellent foundation for an investment portfolio

A great way to access the full power of the asset allocation story is by holding a broadly diversified low-cost index fund. The four funds illustrated below would each commonly hold more than 7000 equity securities and over 12000 fixed interest securities giving investors the comfort of a huge amount of diversification.



Asset Allocations	Vanguard® Conservative Index Fund	Vanguard® Balanced Index Fund	Vanguard® Growth Index Fund	Vanguard® High Growth Index Fund
🟦 Australian Shares	13	22	31	40
⬜ International Shares	13	22	31	40
🟦 Property	4	6	8	10
⬛ Fixed Interest	60	50	30	10
🟥 Cash	10	0	0	0

The reasons we recommend that our clients invest in a core holding of diversified index funds are:

1. **Cost advantages:** Lower management and transaction costs.
2. **Diversification:** A broader spread of securities which means less exposure to the performance fluctuations of single investments.
3. **Ease of management:** Indexing provides consistent performance resulting in greater stability of your portfolio, making on-going portfolio management much easier.
4. **Tax Efficiencies:** Index fund managers typically turn their portfolios over less often than active managers.
5. **Risk control:** Consistent returns mean a low level of volatility.

Regular portfolio rebalancing reduces risk

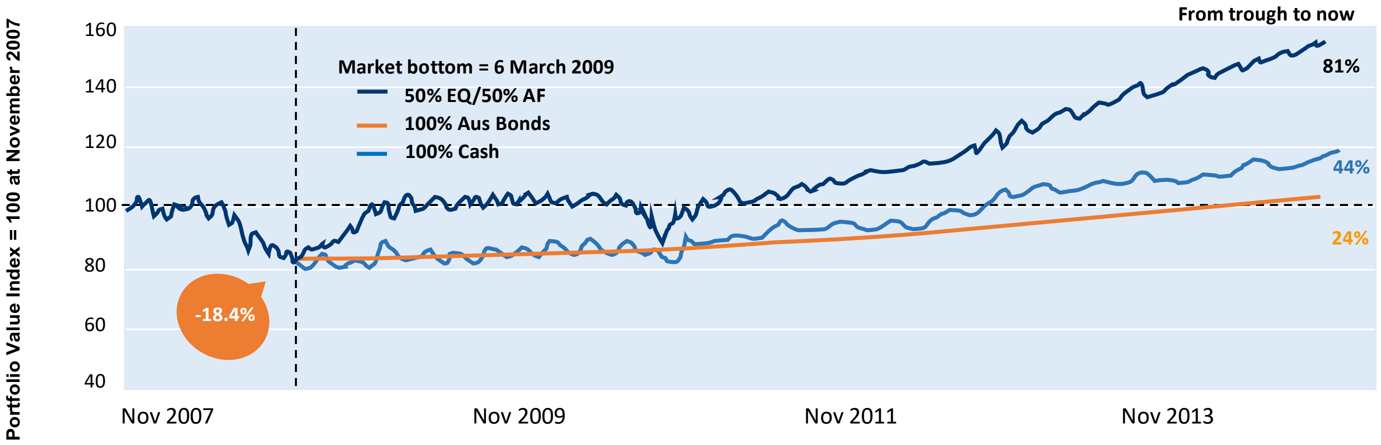
In many ways we see this as the most important function. Regular rebalancing back to our calculated asset allocation and style ensures that the plan we put in place for you initially is adhered to and given a chance to work over a long period of time.

Portfolio rebalancing helps investors to maintain their target asset allocation. By periodically rebalancing, investors can diminish the tendency for "portfolio drift," and thus potentially reduce their exposure to risk relative to their target asset allocation. Annual or semi-annual monitoring, with rebalancing at 5% thresholds, is likely to produce a reasonable balance between risk control and cost minimisation for most investors. Annual rebalancing is likely to be preferred when taxes or substantial time/costs are involved.

It is not sufficient to just set a target asset allocation. You have to constantly review and ensure the asset allocation is being maintained through time. For example, if shares perform better than the other assets in your portfolio, your actual allocation to shares will increase above your target asset allocation.

With disciplined rebalancing, an annually rebalanced portfolio provides lower volatility and a higher return. This also means you are never exposed to risks you had not agreed to when you first invested.

Your portfolio is reviewed by us on a regular basis. As part of our ongoing service offering, we undertake monitoring of the portfolio and regular due diligence of the underlying investment managers within it.



Education and a disciplined approach improves returns

One of the main reasons we have prepared this Investment Philosophy Document is so clients understand our investment philosophy, how we create the portfolios and the risks that provide the expected return. The way to capture the expected returns from the risk factors is to remain disciplined to ensure you capture the returns when they are there and to hold your nerve by staying the course when they aren't.

We write this document with the hope that our existing clients and future clients will better understand how we manage money, how we are different from the mainstream institutions and also the value of this approach. As we outlined above, this document is by no means static and we encourage clients to challenge our business on any of the decisions set out in this document because we find that only by continually challenging and evolving this investment process are we able to produce the best results for clients.

General Advice Warning & Core Disclosures

Any advice in this publication is of a general nature only and has not been tailored to your personal circumstances. Please seek personal advice prior to acting on this information. Before making a decision to acquire a financial product, you should obtain and read the Product Disclosure Statement (PDS) relating to that product.

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For more information, you can find interviews with our portfolio managers, market updates and product disclosure statements on our website at www.flpfinancial.com.au

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Frequently asked questions

Investing is for meeting long-term goals; saving is for short term goals.

Money that investors may need in the short term (2 years or less) should be kept in short term investments which protect capital. These include money market funds (a fund that invests in short term financial instruments such as cash), bank accounts, or government bonds (gilts). Clients should only consider investments in the stock market or corporate bonds when they have money to put away to help meet a longer-term objective.

Broad diversification, with exposure to all parts of the stock and bond markets, reduces risk.

If an investment portfolio does not fairly reflect the overall investment market in terms of balanced asset allocation (the process of dividing investments amongst different asset classes such as stocks, bonds and cash) and investment style (such as growth or value), we believe clients are taking additional risk. We judge that this is unlikely to pay off over the long term.

An investor's most important decision is selecting the mix of assets to be held in a portfolio, not selecting the individual investments themselves.

Deciding on the mix and proportion of stocks, bonds and cash in a portfolio is critically important — much more so than deciding on individual assets or funds. To work out the asset allocation that's best for each individual, investors need to consider factors such as their financial needs, their tolerance of risk and the length of time they want to invest.

Consistently outperforming the financial markets is extremely difficult.

Economic uncertainties, random market movements and the rise and fall of individual companies mean it is extremely difficult for anyone — including professional investors — to beat the market in the long term. An active manager buys or sells shares (or bonds) in order to meet a particular investment objective.

Therefore, actively managed funds typically have higher operating and transaction costs which can eat into returns. So we believe it makes sense to begin by considering funds that follow the index.

Minimising cost is vital for long term investment success.

Costs matter a great deal because investment returns are reduced dollar for dollar by the fees, commissions, transaction expenses and any taxes incurred. Investors as a group earn somewhat less than the market return are subtracting all those costs. Therefore, by minimising costs, investors improve their odds of meeting their investment objectives.

Investors should know how each investment fits into their plans, and why they own that particular asset.

Investors need to be clear why they own each particular investment. Knowing the characteristics of each investment and the role it plays in a diversified portfolio increases investors changes of selecting suitable investments that can be held for the long term.

Risk has many dimensions and investors should weigh 'shortfall risk' — the possibility that a portfolio will fail to meet longer term financial goals — against 'market risk' or the change that returns will fluctuate.

In the long run, what matters most is whether your investments enable you to meet your objectives. Earning enough to meet objectives is much more important than whether investments suffer interim declines or trail a market benchmark. But many investors react only to market risk. They may bulk up on stocks during when markets are doing well, taking on more market risk than they realise. Conversely, they're tempted to reduce allocations in stocks in response to market downturns. In truth, to achieve long range goals, most investors need to accept some level of risk from equities.

Market timing and performance chasing are losing strategies.

Market-timers who buy and sell frequently, hoping to 'catch the wave' as securities rise and fall, need to be very sure that their timing is right. Otherwise, they stand to lose money from market movements while also paying significant transaction costs. As many investors say; its time in the markets that counts, not timing the markets. Also, market fashions change — often very suddenly. There is no guarantee that a performance chasing strategy, asset class (a type of investment such as stocks, bonds or cash) or fund that has performed well will continue to perform well next year, next month — or even tomorrow.

An investor should not expect future long term returns to be significantly higher or lower than long term historical returns for various asset classes and subclasses.

The major asset classes (equities, bonds, cash investments) have long histories and well established risk/reward characteristics. When estimating future returns for asset classes or sub-asset classes, long term historical returns are a good place to start. Vanguard expects that returns from various subclasses of the stock market will be similar to each other over long periods. Also, Vanguard expects that long term return for equities will be higher than that for bonds, and that bond returns will, in turn, exceed returns on cash investments over long periods. However investors should always remember that no method for predicting market returns is perfect. Past performance is not a reliable indicator for future results.