MAGELLAN EXPLAINS: Listed funds

There are a number of different investment vehicles available in listed or exchange quoted structures either on the ASX or Cboe (formerly Chi-X).

These are Listed Investment Companies (LICs), Listed Investment Trusts (LITs), Active Exchange Traded Funds (Active ETFs) and Passive Exchange Traded Funds (Passive ETFs).

COMPANY VS TRUST

The first thing to note is that a LIC is structured as a company, which means it is divided up into shares and will pay tax at the company rate before passing on any dividends to investors, which may have franking credits attached to it.

LITs, Active ETFs and Passive ETFs are each structured as unit trusts, which means that they are divided up into units and they will typically pass through income such as dividends, franking credits, capital gains.

Disclosure of the Net Asset Value is at least monthly for LICs versus a more frequent disclosure via daily or intraday indicative Net Asset Value for our LITs, Active ETFs and Passive ETFs.

CLOSED-ENDED VS OPEN-ENDED

The next difference relates to the way that the investment vehicles issue shares or units.

LICs and LITs are closed-ended investment vehicles, where the number of units or shares on the market is fixed, similar to any company that is listed on an exchange. It cannot continuously issue or redeem existing units. It can only issue new shares or units through corporate actions that include a placement, rights issue, dividend reinvestment plan, share/unit purchase plan or through a takeover of another company or trust. These closed-ended funds can reduce units via an on-market buyback facility where it has the ability to purchase its own shares or units, which are cancelled once bought back.

What this means for investors is that because the supply of shares or units in closed-ended funds is limited, investors have to trade existing shares or units with each other in the secondary market (i.e on the ASX). Therefore, they set the price of the unit or share, just like a company's share price is set by buyers and sellers on the market.

Active and Passive ETFs are open-ended. This means that the responsible entity can issue or cancel units depending on investor activity. This dynamic means that ETFs will generally trade very close to their Net Asset Value, which may be appealing to some investors. As a result, ETFs grow and contract in size based on both investment returns and investor activity.

ACTIVE VS PASSIVE

The final difference relates to the management style. Most LICs, LITs and all Active ETFs have a portfolio manager who will undertake stock research to determine which underlying securities or stocks to hold and in what weightings. They will then actively manage weightings of the stocks depending on a range of factors including stock valuations, industry trends and views on macroeconomics. They can also hold cash to manage the overall risk of the portfolio and to take advantage of opportunities when markets move.

A Passive ETF tracks an index. This can be over a broad-based stock market index, a sector index, custom-built indices or indices comprising fixed income, credit, commodities and currencies. They can either fully replicate an index by buying all the securities that make up the index or they can be optimised by buying the securities in an index that provides the most representative sample of the index based on correlations, exposure and risk.

Assets invested into by both Active ETFs and Passive ETFs can be segregated into physical and synthetic ETFs. Physical ETFs attempt to track their target indices by holding all, or a representative sample, of the underlying securities that make up the index, whereas Synthetic ETFs rely on derivatives such as swaps to execute their investment strategy instead of physically holding each of the securities in an index.

SINGLE UNIT FUND STRUCTURE

The Single Unit Fund Structure is an innovation created by Magellan that enables investors to access an open-ended fund, either off market via an application form to the responsible entity or on market via an online share trading platform or stockbroker account.

Regardless of which pathway an investor chooses, they will be investing in the same fund. Think of it as a house with two doors. You can enter via whichever door suits you and you can exit via the other door, all inside the same fund.

If an investor comes in via an application form off market, we will give them a Security Holder Reference Number (SRN) and if they come in on market via an online share trading platform or stockbroker, then the investment will be held on their Holder Identification Number (HIN).

At any time, investors can switch between holding their investment on-market or off-market depending on their preference.

For more information, please visit **www.magellangroup.com.au** to see our full range of Managed Funds.

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