Lonsec

Lonsec Active (FirstChoice Managed Account Range) Structure Review

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01 Portfolio structure

Risk Profile	Asset Category	APIR Code (Super)	APIR Code (Pension)	Defensive	Conservative	Moderate	Balanced	Growth	High Growth
Australian Equities (%)				8	16	19	23	32	41
Investor Mutual Australian Share Fund	Growth	FSF0592AU	FSF0524AU	4	6	7	7	8	10
Fidelity Australian Equities Fund	Growth	FSF0833AU	FSF0827AU	4	5	6	7	7	10
Schroder Wholesale Australian Equity Fund	Growth	FSF0588AU	FSF0520AU		3	4	5	5	6
First Sentier Concentrated Australian Share Fund	Growth	FSF0595AU	FSF0527AU		2	2	2	4	4
Bennelong ex-20 Australian Equities Fund	Growth	FSF1736AU	FSF1727AU				2	3	4
First Sentier Australian Smaller Companies Fund	Growth	FSF0646AU	FSF0573AU					5	7
Global Equities – Unhedged (%)				8	16	21	26	36	47
MFS Global Equity Trust	Growth	FSF0625AU	FSF0552AU	4	4	6	7	10	13
Acadian Global Managed Volatility Equity Fund	Growth	FSF1394AU	FSF1400AU	4	4	5	7	9	12
Magellan Global Fund (Hedged)	Growth	FSF1788AU	FSF1796AU		4	5	6	9	11
T. Rowe Price Global Equity Fund	Growth	FSF0626AU	FSF0553AU		4	5	6	8	11
Property & Infrastructure (%)				4	8	10	11	12	12
Pendal Property Securities Fund	Growth	FSF0641AU	FSF0568AU	4	6	6	6	7	7
AMP Capital Global Property Securities Fund	Growth	FSF1228AU	FSF1214AU			2	2	2	2
First Sentier Global Listed Infrastructure Fund	Growth	FSF0953AU	FSF0944AU		2	2	3	3	3
Fixed Interest & Diversified Income (%)				55	40	40	30	18	
PIMCO Global Bond Fund	Income	FSF1393AU	FSF1399AU	13	10	10	9	5	
Macquarie Income Opportunities Fund	Income	FSF1040AU	FSF1030AU	12	8	9	6	4	
Perpetual Diversified Income Fund	Income	FSF1256AU	FSF1250AU	11	8	8	6	4	
Colchester Global Government Bond Fund	Income	FSF6700AU	FSF7004AU	10	8	8	6	5	
Schroder Absolute Return Income Fund	Income	FSF0649AU	FSF0577AU	9	6	5	3		
Cash (%)				25	20	10	10	2	
Cash	Income	N/A	N/A	25	20	10	10	2	
Total Income Assets (%)				80	60	50	40	20	0
Total Growth Assets (%)				20	40	50	60	80	100

* Changes in **bold**
The fund recommendations in this table should be considered in conjunction with the full Lonsec fund-specific research report, as well as each fund's Product Disclosure Statement.

02 Portfolio objectives

The Lonsec Active (FirstChoice Managed Account Range) portfolios provide investors with capital growth and income over the medium to long term through exposure to a range of asset classes and investment vehicles. The portfolios are designed to reduce overall portfolio risk by spreading investments across a number of specialist managers with complementary investment styles.

The portfolios have been designed for investors seeking a diversified portfolio aimed at generating growth.

Risk Profile	Defensive	Conservative	Moderate	Balanced	Growth	High Growth
Average exposure to growth assets	20%	40%	50%	60%	80%	100%
Average exposure to defensive assets	80%	60%	50%	40%	20%	0%
Minimum timeframe	2 years	3 years	4 years	5 years	6 years	7 years
Investment objective	+0.8 p.a. above cash	+1.6 p.a. above cash	+2.0 p.a. above cash	+2.4 p.a. above cash	+3.2 p.a. above cash	+4.0 p.a. above cash
Benchmark	Conservative	Moderate	Balanced	Balanced	Growth	Aggressive

2.1 Portfolio philosophy

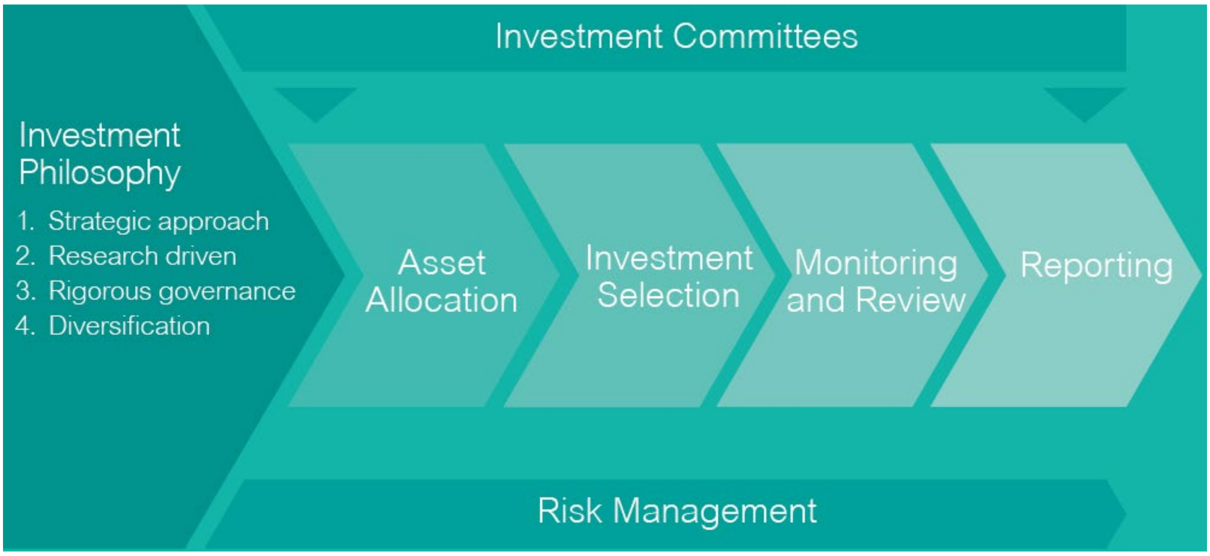
Our philosophy underpins our investment research driven approach to portfolio construction and the processes we use to build quality investment solutions. At the core of our philosophy are our four beliefs:

1. A strategic approach to portfolio management to achieve investment objectives while managing downside risk.
2. Investing in high quality investments underpinned by Lonsec's extensive research.
3. A strong risk management culture supported by a rigorous governance process.
4. A diversified approach to portfolio construction

2.2 Portfolio construction approach

Lonsec's investment process combines a strategic approach to asset allocation with active investment selection.

The chart below shows Lonsec's portfolio construction process:



Asset allocation

Lonsec begins by setting a long-term strategic asset allocation. Lonsec's process seeks to determine a neutral asset allocation framework designed to maximise return and minimise risk over the long term. Lonsec incorporates both quantitative and qualitative inputs in determining the strategic asset allocation target weights including Lonsec's proprietary forward-looking capital market assumptions, an assessment of risks, such as volatility and liquidity risk, and correlations between asset classes.

Lonsec conducts a formal review of the strategic asset allocation every two years and reassesses the inputs on an annual basis. The objective of the formal review is to ensure that the Lonsec strategic asset allocation framework remains robust and continues to be effective in achieving the stated investment objectives of the respective risk profiles in the long term.

Investment Selection

Lonsec's investment selection process has a focus on quality, diversification and risk. To be eligible for portfolio inclusion, fund managers must meet Lonsec's minimum quality criteria which includes funds rated Recommended or higher by Lonsec's investment research team.

Leveraging the knowledge and expertise of one of Australia's largest investment product research teams, Lonsec Research Pty Ltd (Lonsec Research) conducts comprehensive research across all asset classes including listed and unlisted investment structures. Investments are assessed on a forward-looking basis considering key factors such as people, philosophy, process, portfolio construction and risk management.

Investment products rated Recommended or higher are believed to exhibit competitive advantages to peers in these factors and are also believed to have a high probability of achieving their investment objectives.

Portfolio allocations take into account the role each fund will play within the portfolio.

Lonsec builds portfolios using three key building blocks:

Market exposure

Exposure to market returns either via long-only active management or passive strategies.

Risk control

Exposure to strategies that have the ability to manage downside risk. These strategies are designed to act as a 'shock absorber' for the portfolios.

Value add

Strategies that are designed to generate strong relative long-term growth or diversification from traditional asset classes. Lonsec's qualitative investment selection process is supported by rigorous quantitative analysis including holdings-based analysis, risk and return based analysis and forward-looking scenario analysis.

03 Australian Equities

3.1 Fund overview

	Investors Mutual Australian Share	Fidelity Australian Equities	Schroder Wholesale Australian Equity	First Sentier Concentrated Australian Share	Bennelong ex-20 Australian Equities Fund	First Sentier Australian Smaller Companies
Role in portfolio	Market Exposure (Value – downside protection)	Market Exposure (Growth – GARP)	Market Exposure (Core/Style Neutral with a focus on valuation)	Market Exposure (Growth - Alpha)	Diversification & Growth (Mid-Cap)	Diversification & Growth (Small Cap)
Rating	Highly Recommende d	Recommende d	Recommende d	Recommende d	Highly Recommende d	Recommende d
Target excess return	Outperform benchmark over rolling 4 years	Outperform benchmark by 2.5% over rolling 3 years	Outperform benchmark by 2 - 3% p.a. over rolling 3 year periods (before fees)	Outperform benchmark by 3-4% over rolling 3 year period (before fees)	Outperform the benchmark over rolling 3 year periods by 4% p.a	Outperform (pre fees) benchmark by 5% over rolling 5 yrs
Benchmar k	S&P/ASX 300 accum. index	S&P/ASX 200 accum. Index	S&P/ASX 200 accum. Index	S&P/ASX 300 accum. index	S&P/ASX 300 Accumulation Index excluding S&P/ASX 20 Leaders Index	S&P/ASX Small Ordinaries accum index
Style	Value	Growth (GARP)	Core/Value	Growth	Core	Style neutral
Portfolio Mandate Highlights	20-70 stock portfolio.	30 to 50 stock portfolio, aims to be sector neutral	40 to 70 stock portfolio	20 to 30 stock portfolio	20-50 mid-cap stocks. Does not invest in the top 20 of the S&P/ASX 300 Accumulation Index	40 to 60 stock portfolio.

3.2 Portfolio construction rationale

The Australian equities allocation within the portfolios is a well-diversified mix of high-quality active managers providing investors access to differing styles and investment strategies. Within the asset class, the **Fidelity Australian Equities Fund** is included as a 'beta' style exposure with the role of providing investors market like returns with the potential for further upside, or alpha.

The Fidelity fund is expected to bring robust diversification benefits to the model portfolios, with the Fund's GARP (growth at a reasonable price) investment style expected to blend well with the allocations to Investors Mutual and First Sentier funds (both Growth style and Small caps).

The **Investors Mutual Australian Share Fund** has been included to provide a level of defensiveness (or downside protection / risk control) to the portfolios.

IML focuses on identifying quality companies with recurring earnings and dividends, that are trading at reasonable valuations. The Manager's value approach also ensures that the level of stock overlap between the Australian equities managers within the model portfolios is balanced and diversified (as much as it possible within the heavily concentrated Australian market e.g. Financials and Resource sectors make up a significant portion of the market).

The **First Sentier Concentrated Australian Share Fund** has been included in the portfolios to provide a higher level of alpha potential within the portfolios (post the Covid correction). The Fund is invested using a fundamental, 'bottom-up' research approach to identify growing companies that generate consistent investment returns above their cost of capital. This 'Growth' investment style (historically described as GDP plus) has been consistently applied since the Fund's inception.

The **Bennelong ex-20 Australian Equities Fund** is the portfolios discrete mid-cap exposure, included to provide additional alpha opportunities and diversification from the relatively "top-heavy" Australian equities benchmark.

Rounding out the portfolio is the strategy that Lonsec believes adds the most potential for significant outperformance. However, it may also exhibit the highest levels of volatility. In this bucket, Lonsec has included the

Schroder Wholesale Australian Equity Fund is an active fund. The manager's investment approach focuses on long-term business quality, average earnings through a full business cycle and strong emphasis on valuation. The Fund is intended to complement the growth style managers within the portfolio, notably Bennelong and FirstSentier.

First Sentier Australian Small Companies. As the portfolios dedicated domestic small cap exposure, it provides investors access to a sector of the market that has historically exhibited a significant return premium (albeit with less liquidity) over and above its large cap counterpart, whilst also experiencing a higher level of volatility.

The equity markets at the smaller end of the market cap spectrum tend to be less efficient than large cap markets providing investors a potential information advantage, if they undertake in-depth research on these stocks.

The Fund's small cap bias also enhances stock diversification within the wider Australian equity component of the model. This diversification and higher return potential are both attributes that provide compelling reasons to include small cap managers in the portfolio.

Given the increased risks and potential for higher levels of volatility, Lonsec has only included this strategy in the risk profiles with a higher exposure to growth assets (Growth and High Growth).

Investors Mutual Australian Share

The Fund is managed by Anton Tagliaferro (25%), Hugh Giddy (50%) and Daniel Moore (25%) utilising a 'bottom-up' investment approach that focuses on identifying companies that meet its quality criteria, have a track record of recurring earnings and dividends, and that are trading at reasonable valuations.

The Managers adopts a value style, seeking to identify quality companies with sustainable earnings. Given the Manager's investment style the Fund has historically performed relatively better in down markets and will tend to underperform in markets which favour cyclical sectors, or low-quality market rallies where companies with high levels of leverage and poor-earnings quality rally.

Fidelity Australian Equities

Paul Taylor, portfolio manager for the Fund, typically employs a growth at a reasonable price (GARP) strategy, believing that stock prices are driven by a company's ability to generate better earnings and cash flow growth than the market. The fund will hold 30-50 stocks with a portfolio turnover typically in the range of 20-30% p.a.

The Fund is typically sector neutral and Lonsec expects the Fund's performance to be predominantly driven by the resulting stock positions, rather than favourable market conditions to a particular style. Therefore, the research and portfolio construction process are the critical factors influencing performance.

Taylor is ably supported by Fidelity's extensive global network and considerable research effort both domestically and globally.

Schroder Wholesale Australian Equity Fund

The Fund is managed by Martin Conlon and Andrew Fleming. Both are seasoned investment professional who have managed money across different market cycles.

The manager focuses on companies that are reinvesting in their businesses at above average rates of return on capital, believing it will be rewarded with better than average share price performance over the long-term. The Manager also views favourably companies that are willing to return capital to shareholders if there are no apparent growth opportunities.

First Sentier Concentrated Australian Share

The Fund is managed by Dushko Bajic, Head of Australian Equities at First Sentier and supported by one of the largest Australian equities team in the market.

The Fund is concentrated in a selection of the Manager's highest conviction ideas across quality Australian companies with strong balance sheets, earnings growth and high or improving returns on invested capital. The Fund typically holds 25 and can allocate up to 10% of NAV to cash. The Fund is largely security size agnostic and has experienced a heavier tilt towards higher growth stocks in recent years. The omission of capitalisation constraints enables the Manager to engage in active positioning based on industry dynamics and analysts' 'best ideas' allowing flexibility towards exposures in small, mid and large cap stocks. Although this extends the Manager's investable universe, in practice the Manager will invest in constituents of the Index.

Bennelong ex-20 Australian Equities Fund

The Fund is an actively managed, 'long-only' Australian equities strategy constructed utilising a fundamental and bottom-up driven investment process. There is no targeted bias to either growth or value stocks. The Fund does not invest in the top 20 names in the S&P/ASX 300 Accumulation Index, meaning it will not hold the big miners such as BHP and Rio Tinto, the 'big four' banks, or Telstra. The Manager seeks to identify quality companies with strong growth prospects that are considered to be underappreciated by the market or expected to meet or exceed earnings expectations. The Manager has a solid pedigree managing an ex-20 strategy, being an early pioneer of this capability, and consistently implements a high conviction investment approach

First Sentier Australian Small Companies

The small cap universe generally offers high alpha opportunities (albeit with less liquidity and more volatility), as equity markets at the smaller end of the market cap spectrum tend to be less efficient than large cap markets. The small cap bias also enhances stock diversification. Both of these attributes provide compelling reasons to include small cap managers in the portfolio.

Dawn Kanelleas, Michael Joukhador and Pavlos Totsis jointly manage the Fund. The managers seek to identify instances of market mispricing through the use of fundamental stock analysis. While the portfolio is actively managed according to a ‘style-neutral’ approach, the Fund may demonstrate mild style biases towards either ‘growth’ or ‘value’ at various stages of the market cycle.

04 Global Equities

4.1 Fund overview

	MFS Global Equity	Acadian Global Managed Volatility Equity	Magellan Global Share - Hedged	T.Rowe Price Global Equity
Role in portfolio	Market Exposure (GARP)	Risk Control (Low Volatility)	Market Exposure (GARP)	Alpha (Growth)
Rating	Recommended	Recommended	Recommended	Highly Recommended
Target excess return	2% over rolling 3-5 years	Match index with 20% less volatility over a market cycle	Above 9% p.a. (net fees) over five-to-seven year periods	MSCI ACWI ex Aust + 3% (before fees)
Benchmark	MSCI World (net) index	MSCI All Countries World (net) index	MSCI World (net) index	MSCI All Countries World ex Aust index
Style	Growth at reasonable price	Low volatility small/mid cap bias	Quality / Growth at reasonable price	Growth
Portfolio Mandate Highlights	80 to 100 stock portfolio. Maximum 15% exposure to emerging markets.	200 to 400 stock portfolios. Maximum stock limit 1% (+0.5% tolerance).	20 to 30 stock portfolio. Can hold 20% in: cash, non-index names & emerging markets.	Holds 150-200 stocks. Soft maximum exposure to emerging markets +/- 15%.
Currency hedging approach	Unhedged	Unhedged	Hedged	Unhedged

4.2 Portfolio Construction Rationale

Utilising a similar rationale and portfolio construction techniques as those employed within Australian equities, the global equities allocation provides investors access to a well-diversified mix of high-quality active managers spanning differing styles and investment strategies.

Within the asset class, MFS Global Equity is included to provide a core global equity exposure. The core, in this case, is in terms of being the largest weighting within the global equity component and provides the bedrock for this section of the portfolio.

The MFS Global Equity Trust provides an active GARP style exposure to the portfolios. Although a 'growth' style manager, MFS tends to invest in 'quality' companies that possess strong balance sheets with low levels of debt. The Manager is also conscious of valuation when seeking growth opportunities. Additionally, the MFS Global Equity Trust complements the low volatility approach of the Acadian Global Managed Volatility Equity Fund.

Acadian is included to provide an element of risk control to the global equity exposure. The strategy is explicitly designed for downside protection (a key driver for its inclusion).

Additionally, the Fund has been included in the portfolios to add an element of style diversification, with a benchmark unaware quantitative equities style strategy.

The Fund's strategy aims to exploit the 'low Beta' anomaly. The Fund is also expected to complement the allocations to the Magellan and T. Rowe Price managers, which apply a growth-at-reasonable-price (GARP) focused approach and a growth bias respectively.

The Magellan Global Fund – Hedged has been included to provide further diversification, with this index unaware, concentrated, mega cap, growth fund expected to outperform in markets where there is uncertainty or a flight to quality, and underperform in more speculative markets, and is thus expected to enhance the defensive qualities of the overall portfolios. That said, for some time the manager has been heavily biased toward both the US (as a region) and US Technology companies like the FANGs (Facebook, Amazon, Netflix and Google) reducing these defensive characteristic (and thus, in part, the lower weighting within the portfolios). The Manager's benchmark unaware, concentrated approach is also expected to reduce turnover and stock overlap within the models (especially with T. Rowe Price, which typically has a bias to emerging markets). Additionally, the heavy cash weighting Magellan has been typically running for some time is also expected to provide a buffer as markets drawdown.

Rounding out the global equity allocation is the T. Rowe Price Global Equity Fund. T. Rowe has a more diversified 130-170 stock portfolio and is fixated on companies with strong growth profiles. The Manager has typically maintained a degree of sector neutrality to allow stock selection to be the primary source of value added and, in recent times, has fully utilised the breadth of its emerging markets limit. These factors are once again something different from the other managers within this segment of the portfolio.

MFS Global Equity

The Trust is managed with a Growth at a Reasonable Price ('GARP') investment style and tends to exhibit a 'quality' bias. Further, it will typically exhibit a mid-to-large cap bias. Portfolio construction is benchmark agnostic and largely unconstrained.

MFS utilises a 'bottom-up' fundamental research approach and seeks to outperform the market by identifying and investing in companies that can grow sales and earnings at rates higher than the general economy. Such companies typically exhibit strong business franchises and sustainable competitive advantages within their industries.

The Manager has a long-term investment horizon for company forecasts / valuations, which is consistent with their 'growth' investment style. In light of this, the Manager adopts a 'buy and hold' strategy, which transcends into a portfolio that will typically experience low levels of stock turnover (<20%).

Acadian Global Managed Volatility Equity

The Fund has been included in the portfolio to add an element of style diversification and risk control, with a benchmark unaware quantitative equities style strategy.

The Fund's strategy aims to exploit the 'low Beta' anomaly. Acadian seeks to build a low-risk equity portfolio that predominantly holds low-risk stocks ('low Beta' or 'low volatility') but also adds information on the correlation structure of equities to help further reduce risk through diversification. Additionally, the Manger utilises its return forecasts from its core global equities strategy to decide between stocks that are equally low risk.

The Fund is not constructed relative to a benchmark and form a total risk as opposed to the traditional quantitative relative risk perspective. Positioning and performance are therefore likely to differ significantly to the benchmark with the potentially a high expected tracking error versus the index.

Magellan Global Fund - Hedged

The Manager applies an index unaware, concentrated approach to investing. Investment decisions are driven by in-depth financial analysis and qualitative research that aims to identify 'outstanding' companies at attractive prices that can potentially be held for a minimum of three to five years.

The Fund is expected to outperform in markets where there is uncertainty or a flight to quality, and underperform in more speculative markets, and is thus expected to enhance the defensive qualities of the overall portfolios. The Manager's benchmark unaware, concentrated approach is also expected to reduce turnover and stock overlap within the models. It should be noted that the portfolio is concentrated in the number of stocks it holds and may be skewed in its regional exposures (currently the portfolio has a material exposure to US domiciled stocks).

T. Rowe Price Global Equity

The Fund has been included to provide a diversified (by number of stocks in the portfolio) growth focus exposure to the portfolio with a reasonable emphasis on the emerging market space.

The Fund employs a growth investment style, and a bottom-up, fundamental research approach to identify companies that exhibit either growing or improving growth fundamentals. The portfolio is highly diversified (130 – 170 stocks) and will typically have a tracking error between 3-7% p.a. This is reasonably high considering the number of stocks in the portfolio. Thus demonstrating its non-benchmark (at a country level focus). Annual turnover is also high ranging between 80-100% p.a. as the team attempt to pick the winners and rotate out to the next idea.

05 Property and Infrastructure

5.1 Fund overview

	Pendal Property Securities	AMP Global Property Securities	First Sentier Global Listed Infrastructure
Role in portfolio	Listed Domestic Property exposure	Listed Global Property exposure	Listed Infrastructure exposure
Rating	Highly Recommended	Recommended	Highly Recommended
Target excess return	Benchmark +1.5% over rolling 3 years	To outperform benchmark over rolling 3 years	To outperform benchmark over rolling 3 years
Benchmark	S&P/ASX 300 AREIT Accumulation Index	FTSE EPRA/NAREIT Developed Rental Index ($A Hedged)	FTSE Global Core Infrastructure 50-50 Index ($A Hedged)
Portfolio Mandate Highlights	15 to 30 stock portfolio. Bottom up process focused on quality and intrinsic value broad investment parameters however tends to be benchmark aware.	45 to 65 stock portfolio. Top down macro & region-specific bottom up research process, quality bias.	35 to 45 stock portfolio benchmark unaware, fundamental bottom up research process, holistic quality focus.
Currency hedging approach	N/A	Hedged	Hedged

5.2 Portfolio Construction Rationale

The **Pendal Property Securities Fund** is included in the portfolios to provide exposure to the domestic listed property market. Lonsec has elected to utilise an active approach within the asset class given the relatively concentrated nature of the benchmark and believes Pendal's ability to invest in non-benchmark positions is an attractive feature that is expected to provide additional opportunities for diversified returns to that of the benchmark over the longer term.

The global REIT exposure within the portfolios is gained through the **AMP Global Property Securities Fund**. Historically, global property securities have exhibited higher returns than their domestic peers, albeit with a higher level of volatility. Despite this increased volatility, Lonsec believes the diversification benefits gained through investing globally are a positive attribute from a portfolio perspective.

Included as the infrastructure exposure within the portfolios is the **First Sentier Global Listed Infrastructure Fund**. Global listed infrastructure has historically exhibited low correlation to listed property and equities and provides an alternate source of growth within the model portfolios.

Global Listed Infrastructure was added to the Conservative portfolio at this review. No other fund changes were made to the Property and Infrastructure segment of the portfolio as part of this review.

Pendal Property Securities Fund

A domestic listed property fund allocation is included across all the portfolios to provide exposure to the competitive long term expected returns for Australian listed property, as well as the greater yields on offer compared to other growth assets.

The Fund is Lonsec's most preferred domestic listed property securities fund on the FirstChoice menu. Whilst the Fund is benchmarked to the S&P/ASX300 Property Trusts Index, it has one of the broader investment mandates within Lonsec's LPT Fund universe with the ability to invest in Infrastructure (<10%), unlisted property (<10%) and international REITs (<15%).

AMP Global Property Securities Fund

Global property securities have historically exhibited higher returns than domestic property, albeit with higher volatility.

The Fund provides regional diversification due to the broader opportunity set global listed property securities offers relative to the domestic listed property securities market.

The Manager utilises an investment process that integrates a blend of both 'top down' macro-economic inputs and region specific 'bottom up' fundamental stock analysis in a bid to exploit inefficiencies in global property securities markets.

The Manager has a large experienced investment team covering all major geographic regions.

First Sentier Global Listed Infrastructure Fund

Global listed infrastructure has historically exhibited low correlation to listed property and equities and provides an alternate source of growth within the portfolios.

The Manger uses bottom up, fundamentals-based approach and seeks to exploit situations where it believes the market underestimates the level and quality of sustainable free cash flows of these assets, due to in part to the market's limited experiences in assessing and valuing infrastructure securities.

The managers will target infrastructure companies whose assets have high barriers to entry, strong pricing power, sustainable growth and predictable cash flows.

In comparison to peers, the Manager places relatively more focus on the qualitative aspects of stocks in its coverage, in addition to valuation considerations. The Manager's quality criteria extend beyond the assets themselves and places greater emphasis on factors such as management alignment, board independence, gearing levels, sovereign/political risk and sustainability.

06 Fixed Interest and Diversified Income

6.1 Fund overview

	PIMCO Global Bond	Macquarie Income Opportunities	Perpetual Wholesale Diversified Income	Colchester Global Government Bond Fund	Schroder Absolute Return Income Fund
Role in portfolio	Global Fixed Interest exposure (primarily duration)	Source of Income & Capital Stability (via High Grade Credit Exposure)	Source of income & capital stability (via short dated credit exposures)	Global Fixed Interest exposure (primarily duration)	Diversified fixed interest (Capital protection)
Rating	Highly Recommended	Highly Recommended	Recommended	Highly Recommended	Recommended
Target excess return	Benchmark + 1% over 3 years.	Benchmark + 1-4% (before fees)	Index + 2% p.a. (before fees) over rolling 3 yr periods	Benchmark +2% (gross) over full market cycle	RBA cash rate + 2.5% over rolling three year period
Benchmark	Barclays Global Aggregate Index A$ Hedged	Bloomberg AusBond Bank Bill Index	Bloomberg AusBond Bank Bill	Citigroup World Government Bond Index A$ Hedged	RBA Cash rate
Portfolio Mandate Highlights	Diversified, benchmark unaware portfolio incorporating top down and bottom up views.	Generates income via a ‘core’ allocation to investment grade floating securities + rotates tactically into high yield, emerging market etc ‘satellites’.	Generates income stream from a core portfolio of highly quality, short dated instruments supplemented by unrated or sub investment grade trade ideas.	Diversified, benchmark unaware portfolio of sovereign bonds	Geographically diversified portfolio with a focus on downside protection. Allocates across a broad range of securities
Maximum Sub-Investment Grade Exposure	20%	25% (inc Emerging Market debt)	25%	20%	50%
Minimum Credit Quality (at purchase)	B-	CCC	Unrated	BBB-	Sub-IG
Currency hedging approach	Hedged	Hedged	Hedged	Hedged	Hedged

6.2 Portfolio Construction Rationale

In constructing the fixed interest and diversified income allocation for the portfolios, Lonsec believes the key considerations to be the protection of capital (especially given the large exposures within the defensive portfolios) and the ability to provide diversification to growth assets. Furthermore, Lonsec strongly believes in active management within the sector, particularly given the prevailing macroeconomic environment and changing attributes of the underlying benchmarks.

Lonsec has included the **PIMCO Global Bond Fund** as the portfolios global fixed interest exposure to provide further diversification characteristics to the equities allocation based on the low correlation observed between the asset classes historically.

The **Colchester Global Government Bond Fund** provides exposure to global sovereign bonds and has been included in the portfolios owing to the defensive characteristics historically exhibited by the asset class and should also perform well in stressed equity market scenarios.

The **Macquarie Income Opportunities Fund, Schroder Absolute Return Income Fund** and **Perpetual Wholesale Diversified Income Fund** have been included to provide differing levels of capital protection through accessing various securities within the asset class. All strategies employ a structurally low duration profile, with the inclusion having the dual effect of lowering the overall duration (reduced sensitivity to interest rate changes) of the portfolios whilst strengthening the defensive characteristics.

PIMCO Global Bond

Global bonds have historically acted as a good diversifier to equities, as reflected in the low correlation between the two assets. An active approach is preferred in the global fixed interest sector given the broader investment opportunity set in global bond markets, with greater scope to add value from security selection, sector rotation and country selection.

The PIMCO fund provides diversified exposure to global fixed income securities. The bulk of PIMCO's underlying investments are in highly rated securities, including sovereign bonds, corporates and mortgage backed securities. The Manager seeks to add value through duration, yield curve positioning, credit selection, country and industry sector allocation.

Macquarie Income Opportunities

The Fund is included in the portfolios as a relatively conservative diversified income fund. The Fund is expected to diversify the sources of income flowing through the portfolio, while at the same time enhancing the regularity of income through monthly distributions.

Lonsec's conviction in this fund is high, supported by very strong resources, a well-diversified portfolio and evidence that the Manager has remained true to label and delivered results in line with its stated style.

The Fund is one of the more conservative options within Lonsec's Alternative Income sector, but investors should expect low to moderate volatility in their capital price relative to cash. The core portfolio consists of highly rated floating rate notes, asset backed securities and residential & commercial mortgage backed securities, however the Fund's mandate allows the Manager significant scope to allocate to various fixed income sub-sectors including high yield (sub-investment grade) and emerging market debt.

Perpetual Wholesale Diversified Income

The Fund was added to diversify the fixed income component of the portfolio and to reduce overall interest rate sensitivity of the portfolio.

It is envisaged that the manager's focus (and design of the product) will provide a steady income stream with capital stability over the medium term, rather than tracking a benchmark, is a key appealing attribute. This is especially the case as bond benchmarks have become increasingly sensitive to changes in interest rates owing to their long duration (off the back of long dated bond issuance)

The Fund is designed to provide absolute returns. This is achieved by taking a 'bar-belled' approach to portfolio construction; i.e., blending a 'core' diversified portfolio of short-dated, relatively liquid securities with a 'plus' component offering higher returns by way of longer tenure, increased credit risk (either by way of credit rating or subordination) or liquidity risk.

The 'core' portfolio is the larger component of the Fund and consists of investment grade income producing assets such as cash, fixed interest and hybrid securities, primarily sourced from the Australian debt markets, though the Fund can (and does) purchase non-AUD securities and hedge the associated currency risk.

The 'plus' component of the portfolio tends to consist of sub-investment grade securities and higher yielding investments such as domestic residential mortgage backed securities (RMBS) (including subordinated tranches of non-conforming mortgages), asset backed securities (ABS), commercial mortgage backed securities (CMBS), private debt and other packaged loans and receivables. The allocation to this component of the portfolio tends to be more opportunistic in nature.

Colchester Global Government Bond Fund

The Fund is a global fixed interest offering that invests solely in sovereign bond markets and their associated currencies. Bond management is treated independently from currency management when deriving optimal bond and currency portfolios with the aim of generating half to two-thirds of the relative return from bond selection and one-third to a half from currency management.

The Manager is value-oriented, with a philosophy based on the belief that investments should be valued in terms of the income they will generate in real terms. The investment approach is therefore based on the analysis of inflation, real interest rates and real exchange rates, supplemented by an assessment of sovereign financial balances – fiscal, external and monetary. Portfolios are constructed to benefit from those opportunities with the greatest relative investment potential for a given level of risk (that is, Colchester seeks to own sovereign bonds with the highest relative real yields and the currencies most undervalued from a relative perspective).

Schroder Absolute Return Income Fund

The Schroder Absolute Return Income Fund is an absolute return multi-strategy fixed income fund that invests in Australian and international fixed income securities. With a focus on managing downside risks, it aims to outperform RBA Cash Rate by 2.5% p.a. (before fees), over three year periods, and to avoid negative returns over any rolling 12-month period.

The Fund actively allocates across a broad spectrum of fixed income and floating rate assets, including Australian corporate credit, hybrid securities, subordinated securities, global investment grade credit, global high yield credit, structured instruments, government bonds and cash. The Fund also aims to deliver monthly income to investors.

Construction of the Fund is guided by broad risk limits. For example, it has the flexibility to be 100% invested in cash and/or government bonds to help preserve capital during the credit cycle downturns. The Fund's duration can vary between -2 to +4 years (absolute) which is more restrictive compared to most peers. Its average duration is typically between 1 to 2 years.

Analysist Disclosure and Certification

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