ETFs, LICs and Unlisted Managed Funds

What's the difference?

WealthAdviser

Contents

Before you get started

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Information in this handbook is no substitute for professional financial advice.

We encourage you to seek professional financial advice before making any investment or financial decisions. We would obviously love the opportunity to have that conversation with you, and at the rear of this handbook you will find information about our authorised representative and how to go about booking an appointment.

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Letter from the Wealth Adviser Library

Dear Reader

Welcome to the Wealth Adviser Library

This library was built specifically to facilitate the provision of sound financial information to everyday Australians.

Our mission is to build an accessible, comprehensively supported team of members who share our vision and commitment to providing tailored financial advice and a new foundation of financial understanding and security for everyone.

With a national network of likeminded experts, we have the potential to provide the financial building blocks for future generations.

Knowledge gives you a huge advantage

We believe that knowledge gives you a huge advantage in creating and effectively managing wealth; in planning to reach your goals; and in being prepared for whatever unexpected twists and turns life may present.

That's why our team of experts has created this series of digital handbooks and manuals that seek to inform you of not only the benefits but also the potential risks and pitfalls of various strategies and investments.

We trust you enjoy this publication and find it informative and professionally presented. Of course, your feedback is always welcome as we strive to continually offer content in a format that is relevant to you.

Take the next step

Wealth Adviser (a division of WT Financial Group Limited) supports more than 400 privately owned and operated advice practices around the country. We invite you to engage with one of our advisers to discuss what it was you were hoping to achieve when you obtained this handbook, and to establish if they can help you achieve your goals and objectives.

At the rear of this handbook you will find details on how to book an appointment.

Wealth Adviser Library

ETFs, LICs and Unlisted Managed Funds – what's the difference?

Exchange traded funds (ETFs), listed investment companies (LICs) and unlisted funds are all managed investment vehicles with some similarities. However, it's important to understand the differences between them to enable you to make an investment decision that suits your specific needs, goals and risk tolerance level.

In this e-book, we will explain the key differences between ETFs, LICs and unlisted funds. We will also provide answers to FAQs and outline the pros and cons of each investment option.

What is an Exchange Traded Fund (ETF)?

An exchange traded fund (ETFs) is a managed investment that trades on a stock exchange. It allows you to buy units in a 'basket' of shares or other assets (like currencies or commodities). This 'basket' of assets helps you to diversify and spread your investment risk. ETFs earn a similar return to those earned across entire investment or commodity markets.

There are two main types of ETFs:

1. passive, and
2. active.

Passive versus active ETFs

Passive ETFs are the most common type. As the name implies, a passive ETF requires minimal investment management. It simply attempts to match market indices like the ASX200 on the Australian Securities Exchange, the S&P500 on the US stock market or a commodity index like gold, iron ore or copper. Passive ETFs have low fees to reflect their low level of management.

Active ETFs on the other hand tend to have fund managers who trade their underlying assets more frequently and attempt to outperform their underlying market index. Active ETFs have higher fees than passive ETFs to reflect their more active fund management.

ETF FAQs

How are ETF units priced?

An ETF's unit price is based on the net asset value (NAV) of its basket of shares or other assets. It is monitored by a market maker who quotes daily ETF unit buy and sell prices (also known as the 'bid/ask spread') based on movements in the ETF's NAV.

The market maker's goal is to keep the ETF unit price as close as possible to the NAV. The number of ETFs units available can be increased or decreased based on investor demand.

How do share-based ETFs work?

Most share-based ETF will not buy an equal number of the shares listed in the index that it's tracking. Instead, they will generally buy a proportional volume of each company's shares to reflect the importance of each company's value to the overall index. There are some ETFs out there that employ an 'equal weighted' strategy designed to remove the impact of market capitalisations on the diversification of the ETF however these are in the minority.

For example, an ETF investing in the ASX200 index will buy more shares in the largest companies in the index than in smaller companies. Doing this will help it to match the index's returns.

What is the minimum investment in an ETF?

Different ETFs have different minimum amounts, but most will accept an initial investment of as little as $500.

Do you pay brokerage fees on buying and selling ETF units?

Yes.

Can you use margin loans to finance the purchase of ETF units?

Yes.

Do ETFs pay dividends to investors?

Yes, if the underlying assets distribute dividends.

Do ETFs provide you with franking credits?

Yes, if they invest in Australian shares and the underlying assets pay dividends with franking credits.

Do you get a product disclosure statement (PDS) with an ETF?

Yes, if it is an ETF that is listed on the ASX. The PDS must be provided to you before you invest, and it must list:

- the index that the fund's investment performance is attempting to match,
- any associated ETF fees,
- any associated ETF risks, and
- how to make a complaint about the fund.

How many ETFs are on the ASX?

There are currently over 200 and the number is growing[1].

What is a synthetic ETF?

A synthetic ETF may not actually buy the specific asset class representing (for example, a lump of gold if it's an ETF with gold as its underlying asset). Instead, it may buy a derivative contract with an investment bank that promises a return based on the market price movements of the ETF's underlying asset.

The pros and cons of ETFs

Pros	Cons
Diversification	Overall investment sector risk (for example, if you invest to match a share market index and the market crashes)
Low-cost access to markets you may not otherwise be able to access	Brokerage fees and management costs
Larger ETFs are highly liquid investments	Smaller ETFs are less liquid
Transparency – you can always see the unit market price and the underlying value of your investment	Currency risk if you invest in an ETF with underlying international assets and the denominating currency devalues
The potential for capital gains if unit prices increase	Potential for international tax obligations if you buy in an ETF that is listed on an international stock market
The potential for dividends	
The potential for franking credits if the ETF invests in Australian shares that pay dividends	
ETFs pay no income tax. All income is passed on to unit holders who pay tax at their marginal rate	

[1]https://www2.asx.com.au/markets/trade-our-cash-market/asx-investment-products-directory/etps

What is a Listed Investment Company (LIC)?

Listed investment companies share some similarities with ETFs.

- LICs operate like managed funds.
- LICs are listed on a stock exchange like the ASX.
- LICs have either internal or external fund managers who charge fees.
- LICs invest in other companies on the share market.
- They are both best viewed as medium to long-term investments.
- However, there are also plenty of differences.
- LIC investors hold shares in the company itself, not in a portfolio of assets.
- Investors purchase shares in the LIC that can be bought and sold, not units.
- LICs can only ever be actively managed. There is no passive LIC option like there is with ETFs.
- LICs don't track an index. Instead, each LIC fund manager is responsible for setting investment strategies and selecting investments. Investment strategies can range from conservative to aggressive.
- The value of an LIC investment is based on market prices rather than net asset value. The market price of an LIC could be lower or higher than its net asset value.
- LICs have a board of directors.
- Any dividends earned aren't necessarily passed on to clients, whether they are or not (and the amount) is solely at the discretion of the LIC's board of directors.
- LICs have a fixed number of shares in their initial public offering. They are 'closed- ended'. An ETF on the other hand is open-ended, meaning new units can be issued over time.
- There is no market maker like there is with ETFs, so they may not be as liquid.

New shares in an LIC aren't ever issued or cancelled (for example, when investors join or leave like they are with managed funds). The terms of LIC fund manager agreements are usually between five and ten years.

LIC FAQs

What do LICs typically invest in?

LICs tend to invest in:

- Australian and international shares.
- private equity funds
- specialised assets or sectors like technology, property or infrastructure.

How many LICs are there on the ASX?

There are currently more than 100 LICs listed on the ASX[2].

How can you invest in an LIC?

The most common ways to invest in an LIC are through an online share trading platform or broker.

Do you pay brokerage fees on buying and selling LIC units?

Yes.

Is there a famous example of a successful LIC?

Yes, investment guru Warren Buffett's company (Berkshire Hathaway) is an example of a successful LIC in the United States.

[2] https://www2.asx.com.au/markets/trade-our-cash-market/asx-investment-products-directory/lics

The pros and cons of LICs

Pros	Cons
There are a range of LICs to suit different investment strategies	Dividends may not necessarily be paid
They are easy to access	Investment manager fees are usually locked in for five to ten years and are usually higher than ETFs
They may offer dividends, giving you the opportunity for both capital growth and dividends	LIC fees associated with the company structure are passed on to investors
They can have lower fees than other types of managed funds	LICs are only required to report gross investment returns (not net returns)
Transparency – you can always see the share market price for your LIC	LICs pay 30% tax
The potential for capital gains if the LIC's share price increases	
The potential for dividends	
The potential for franking credits if the ETF invests in Australian shares	

What is an Unlisted Managed Fund?

As the name suggests, an unlisted managed fund is not listed on a stock exchange like the ASX. This is a key difference between unlisted managed funds and both ETFs and LICs, who are listed on the ASX.

Most managed funds are unlisted funds. You can buy units in an unlisted fund by applying to its fund manager. The investment terms and conditions of unlisted managed funds can vary greatly. Investors funds are pooled and invested in an attempt to generate the desired returns. Investors in the fund own units in it, but not the fund's underlying assets. Fund distributions are based on both the overall investment performance and the number of units held by an investor.

Unlisted funds can also be either closed or open-ended. ETFs on the other hand are open-ended, while LICs are closed-ended.

Unlisted managed fund FAQs

How are unlisted managed fund units priced?

Prices in unlisted managed funds are set by the fund manager and based on the fund's underlying net asset value.

What is the minimum investment in an unlisted managed fund?

Different unlisted managed funds have different minimum amounts, but most will accept an initial investment of as little as $1,000.

Do unlisted managed funds pay dividends to investors?

Yes, if the fund's underlying assets distribute dividends.

Do unlisted managed funds provide you with franking credits?

Yes, if they invest in Australian shares and the underlying assets pay dividends with franking credits.

Do you get a product disclosure statement (PDS) with an unlisted managed fund?

Yes. The PDS must disclose:

- the asset or assets that the fund is investing in,
- the target rate of return,
- any associated managed fund fees,
- any associated managed fund risks, and
- how to make a complaint about the fund.

What should you consider when evaluating an unlisted managed fund?

- the long-term investment performance of the fund matches your desired rate of return,
- how the investment risks (e.g. low, medium, or high) match your risk profile,
- the fees, and
- how quickly you can access your investment if necessary.

The pros and cons of unlisted managed funds

Pros	Cons
Unlisted managed funds can generally invest in a broader range of asset types than both ETFs and LICs (for example, unlisted property funds)	It tends to take a little longer to buy and sell units in unlisted managed funds
Like ETFs, unlisted managed funds pass all their income on to unit holders	Some funds may be less liquid than others
Unlisted managed funds pay no income tax. All income is passed on to unit holders who pay tax at their marginal rate	They do not have public disclosure requirements like ETFs and LICs do. However, they are required to report both their gross and net investment returns monthly to relevant regulatory bodies
The price of a unit in an unlisted fund can be less volatile than those in an ETF or shares in an LIC	Most unlisted managed funds are actively managed and therefore higher fees than a passive ETF
	They may have varying levels of liquidity depending on the type/s of assets they invest in

The bottom line

Ultimately, whether or not you should invest in ETFs, LICS, unlisted managed funds (or a combination of all three) depends on your individual financial situation. It's best to seek professional advice that's based on your specific needs and goals.

Take the next step

We trust you enjoyed this publication and found it informative and professionally presented. Of course, your feedback is always welcome as we strive to continually offer content in a format that is relevant to you.

We now invite you to take the next step and meet with an adviser to discuss what it was you were hoping to achieve when you downloaded this handbook and to establish if we can help you achieve your goals and objectives.

Next you will find details on how to book an appointment with one of our experts.

We look forward to meeting you soon.

Appointment booking request form

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Please nominate your preferred day, date and time to meet with us. One of our client services representatives will call you to confirm your appointment.

Preferred appointment day and time

Day ______________________________________

Date ______________________________________

Time ____________________ am/pm __________

If you would like us to contact you via email to confirm your appointment or to answer any questions you have, please provide a valid email address for our records.

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Your Details

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First name __________________________________

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Reader Notes

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Wealth Adviser

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