

CORE/SATELLITE INVESTING

What is core/satellite?

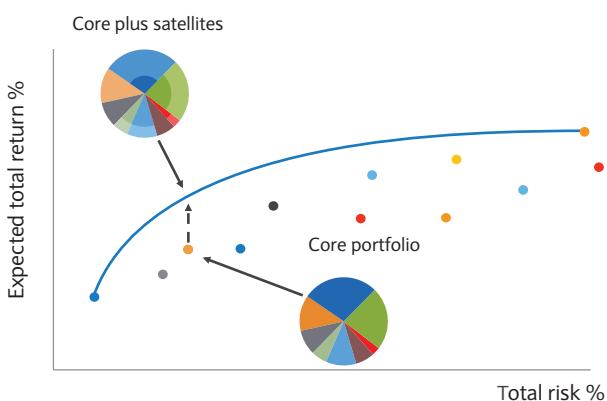
Core/satellite builds on the concept of Strategic Asset Allocation (SAA). A core/satellite strategy combines passive “core” investments with active “satellites” that seek outperformance, within the asset allocation model. It involves balancing risk and return, asset class by asset class, to meet an investor’s risk/return profile.

Core/satellite is based on the simple concept of splitting the portfolio into two segments:

| | |
|-------------------|--|
| Core | The core forms the foundation of the strategy and represents the basic SAA, providing market returns (or <i>beta</i>) at low risk for low fees. The core investments achieve broad diversification across asset classes and allow the overall portfolio to achieve the basic objectives set out by the SAA. |
| Satellites | Satellites are typically more targeted and designed to outperform the core portfolio. These investments are chosen by the investor in the expectation they will provide additional returns (or <i>alpha</i>) above the market returns of the SAA. As such, will usually incur more risk. |

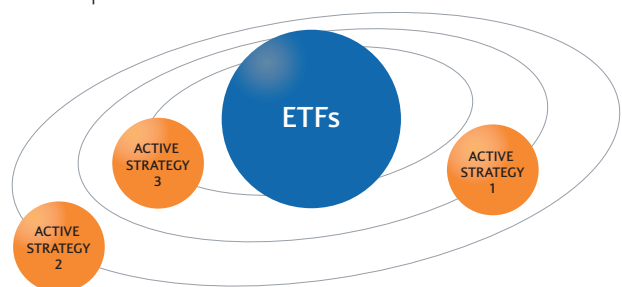
Efficient portfolio theory

Efficient portfolio theory hypothesizes that any portfolio along the frontier (curved line) represents a combination of assets that collectively offer the highest expected return for any given level of risk, or, the lowest risk for a given expected return. Core/satellite investing may help increase a portfolio’s expected returns while keeping risk constant, moving the portfolio closer to the efficient frontier, thereby attaining the best possible return for a particular risk tolerance.

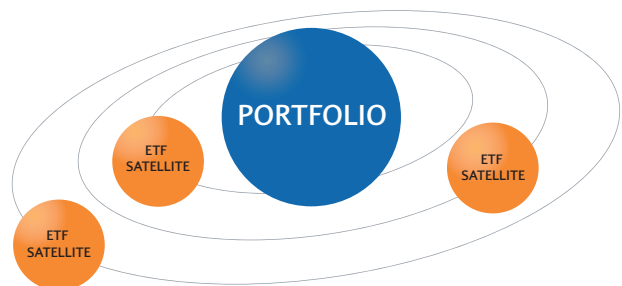


How can core/satellite investing be implemented?

Core portfolio holdings can be implemented using low-cost, risk-controlled index vehicles. Exchange traded funds (ETFs) are an ideal, flexible vehicle for core exposures.



Exposure to satellite strategies can be gained in several ways, depending on whether the satellite seeks active security selection, such as managed funds or direct securities, or targeted market exposures, which ETFs can provide.



ETFs enable investors to execute specific investment themes (e.g. small cap US equities or the global healthcare sector), or provide targeted exposure to individual countries or regions outside the broad SAA categories (e.g. China or BRIC).

Until recently, accessing the more granular or hard-to-reach markets was difficult for most investors. For example, exposure to emerging market equities was limited to the largest, most sophisticated investors or products were often costly, illiquid, and lacked transparency. Now with the broad array of ETFs listed on the ASX, exposure to many asset classes, regions and individual countries can be attained through a single trade on the ASX. Access to international markets has never been simpler.

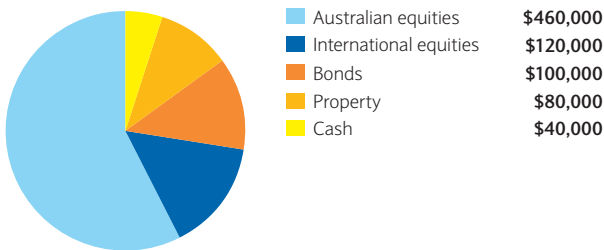
Client case study – John and Fiona

- **Age:** 30s
- **Portfolio:** 80% Australian, 20% international
- **Interests:** travel, fitness
- **Goal:** include China in their portfolio

Meet John and Fiona

John and Fiona have a diversified portfolio consisting of Australian and international equities, property, bonds and cash. After reading the research provided by their financial adviser, John believes China will continue to grow over the next five years and represents a good long-term investment opportunity to add to their portfolio.

John and Fiona's portfolio



Factors important to their decision:

- **Timing:** they want to implement their view as quickly as possible
- **Market return:** They expect the Chinese market as a whole to grow and will build wealth over the long term
- **Cost:** the investment needs to be in line with the cost of their current international equity investments.

Working with a financial adviser

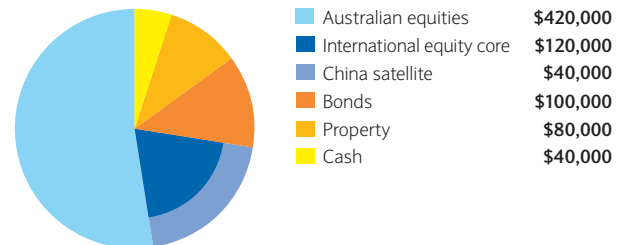
Their adviser schedules their six-monthly review, and explains that by incorporating a core/satellite approach, John and Fiona can meet their financial goals by maintaining their existing solid international core, but can express their view on China.

Their adviser recommends either a managed fund or an ETF as the best product to achieve exposure to China. Given the transparency, cost and ease of entry and exit with ETFs, John and Fiona decide to use iShares Exchange Traded Funds.

After using the International Allocation Tool on iShares.com.au, John and Fiona select the iShares FTSE/Xinhua China 25 (ASX: IZZ). With the fees totalling 0.74%* per annum, this investment is cheaper than some of their current domestic assets.

Taking tax considerations into account, their adviser recommends they sell \$40,000 of their current Australian equities to purchase the China iShares ETF. This represents a 75:25 core-to-satellite ratio. Their adviser confirmed the trade in the standard ASX T+3 settlement.

John and Fiona's core-satellite portfolio



The outcome

Good for the client:

- ✓ Able to implement their view on China quickly and simply.
- ✓ They like the flexibility of the iShares ETF and feel comfortable that if they want to exit early, they can.
- ✓ Fees are significantly lower than expected, and even cheaper than domestic managed funds.

Good for the adviser:

- ✓ Client is happy with the solution.
- ✓ This good experience may encourage the use of more ETFs for their core international holdings.
- ✓ Provides a differentiated offering to express international views.

For more information visit [iShares.com.au](https://www.ishares.com.au) or call 1300 iShares (1300 474 2737)

* Management costs: Total fund management fees and expenses as a percentage of average net assets, and is equivalent in calculation to the indirect cost ratio ('ICR') and the management expense ratio ('MER').

Important Information

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