SMA MODEL PORTFOLIO ★★★☆☆

Ralton High Yield Australian Shares SMA

STANDARD & POOR'S

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Standard & Poor's View

S&P Fund Services rates the Ralton High Yield Australian Shares SMA (the model portfolio) as three stars, reflecting our conviction that the manager can generate risk-adjusted fund returns in line with relevant investment objectives and relative to peers.

Specialist boutique manager Ralton Asset Management manages separately managed account (SMA) model portfolios. The business was established in 2005, but has run managed account mandates since 2001 through a previously associated investment advisory business, Ralton Group Ltd.

The model portfolio reflects a moderately concentrated portfolio of predominantly Australian large- to mid-cap equities with a yield focus. The target yield is 100 basis points above the benchmark index. It is managed according to an active, value-oriented investment strategy in which the manager exercises high conviction within the constraints of targeted tracking error of 2% to 5%. Portfolio turnover is low to moderate, reflecting a long-term fundamental investment view.

S&P regards the investment team as capable with its members exhibiting broad sector and stock-specific knowledge. Interaction between members is high, and each person actively contributes to stock selection. There is very strong alignment of interest, with executives and the team owning 74% of issued shares. However, the team is small relative to peers, with only three members who each cover a significant number of stocks.

Ralton is at the forefront of development in the Australian SMA sector, both in terms of the availability of its various model portfolios as well as educating advisers and SMA providers on aspects of SMA investment vehicles. The manager is a recognised participant in the sector.

S&P regards the model portfolio as suitable to an SMA environment. Transaction cost inefficiency, a major risk for SMA model portfolios, is mitigated by relatively low turnover, a concentrated portfolio, and absence of risk that can stem from managed fund cash flows. Operational processes are very strong, reducing the risk of a material difference in the stock composition of the SMA investor's portfolio with the actual investment decisions of the manager.

Investor Suitability

- The model portfolio would suit investors who want access to a value-oriented Australian-equity offering that predominantly comprises top 100 stocks.
- The model portfolio is well balanced, with the ability to perform throughout the cycle. However, it may underperform during periods of extreme market movements.
- As an SMA the model portfolio is relatively tax effective, and may be relatively better suited to higher marginal tax rate investors. It provides investors empowerment through portfolio transparency.

Key Strengths

- We regard the investment team as capable with members exhibiting a broad level of sector and stock-specific knowledge.
- There is a very strong alignment of interest between the investment team and investors, with the three team members owning approximately 60% of the shares on issue.
- The investment process is clear, and allows the portfolio manager reasonable flexibility in setting the portfolio.
- Strong SMA suitability, with suitable turnover and concentration.
- Strong process in relation to monitoring SMA performance and reconciling performance differences on SMA platforms.
- The assurance that stems from a well-regarded and trusted manager in the SMA sector.

Key Weaknesses

- The team is small relative to peers, with only three members who each cover a significant number of stocks.
- The manager is highly susceptible to the loss of investment personnel, particularly Andrew Stanley and Roger Walling.
- Team has not had the opportunity to demonstrate its ability over a full market cycle.
- Model portfolio updates are conveyed on a weekly basis to SMA platforms and not on a more timely basis. However, this is a relatively minor issue given the low turnover of the portfolio.

Risks

- Key person risk with Mr. Stanley and Mr Walling.
- Significantly lower FUM growth than expected, with a consequent effect on financial performance.
- Risk that the FUM of the model portfolio remains low on any particular platform.
- All SMA model portfolios incorporate risks not present in managed funds, including high brokerage and the portfolio not representing a true reflection of the investment thinking of the manager.

Sector:	Australian Equities – Large Cap	**Size (A$ m):**	Platform dependent
Investment manager:	Ralton Asset Management	**Tracking error:**	2% to 5%
Years managing asset class:	9	**Performance target:**	3% alpha
Benchmark:	S&P/ASX 300 Accumulation Index	**MER:**	Platform dependent
Inception date:	February 2008	**Min. investment (A$):**	20,000

Investment Objectives And Fees

The target number of stocks in the portfolio is 30 to 35. Portfolio turnover is low to moderate, with an expected level of 30% to 50% per year, reflecting the buy-and-hold style as well as ensuring SMA suitability.

The manager is targeting a cash yield of around 100 basis points above the benchmark index. In selecting stocks, there is a focus on both yield and the level of franking credits.

The model portfolio is moderately benchmark aware, with a tracking error range of 2% to 5% relative to the S&P/ASX 300 Accumulation Index. The manager targets 3% excess returns (gross).

With respect to portfolio exposures, individual stock weights are subject to active weight limits. Active sector weights are constrained at +/-6%.

The MER of the model portfolio is 0.8% per year. Investors should note that the total cost of investing in the model portfolio will vary according to the particular SMA platform where the model portfolio is available. Investors should refer to the SMA platform's product disclosure statement for fees.

Investment Philosophy And Style

Ralton is an active value manager that seeks long-term investment opportunities through a fundamental bottom-up, top-down overlay research process. The manager seeks to invest in companies with strong fundamentals and high quality management that are trading at least at a discount to valuation, and where the investment team has a high degree of conviction.

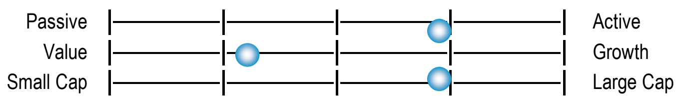
Ralton will generally seek to add a stock to the portfolio when it is trading at a 30% to a minimum 15% discount to valuation. To ensure the portfolio stays true to our "value" label, the manager reviews various measures periodically, i.e. PE, yield, price/book value (BV) to ensure the portfolio has a PE and price/BV lower than the market and a yield that is higher.

The manager recognises that markets may be driven by different styles at certain times, such as "growth" or "value". To accommodate this, the manager may position the portfolio to be "more value" in a value market and "less value" in a growth market. However, the manager ensures that the portfolio is trading at a discount to the market and the yield exceeds the market as a whole.

The objective of this dynamic process is to ensure the prospect of outperforming the benchmark across a full market cycle.

Capital preservation is a key consideration in stock selection. In addition to the focus on quality business and conservative valuation metrics, the manager avoids high-risk sectors and companies with significant specific downside risks.

While the investable universe is the S&P/ASX 300, the majority of the portfolio represents stocks within the top 100. Generally, relatively illiquid and lesser-known stocks are avoided.



Investment Team

➨ Structure

The investment team is small, comprising three members, and each member has significant sector and stock coverage responsibilities. The fund-management experience of the team is generally limited. However, S&P also recognises that while the length of the fund-management experience is relatively short, each individual member has benefited by joining an investment-management firm with developed processes and systems and a track record dating back to 2001. This is likely to have accelerated the development of the team. However, S&P views the team members as capable in their respective roles.

Key Investment Personnel

Name, Position	Years*	Experience#
Andrew Stanley, director, head of investments	5	20
Roger Walling, investment manager	4	9
Nick Loftus, investment analyst	3	5
Damian Holland, managing director, head of distribution	4	16
Analyst pool average tenure	4	12.5

**Years with current firm. #Years of relevant industry experience.*

➨ Portfolio Managers

Mr. Stanley is responsible for developing the economic and thematic top-down strategy, constructing and managing the model portfolios, and the investment analysis of particular stocks and sectors, in addition to general investment team managerial duties.

Mr. Stanley joined Ralton in January 2006 and took over full portfolio management responsibilities in late 2007. He spent the first two of his nearly four years with the manager being mentored in fundamental analysis and portfolio management and strategy by the previous portfolio manager. He was also responsible for modifying the investment process to incorporate a greater focus on risk-adjusted and index-aware returns, further developing analytical and risk-management systems, as well as managing the portfolio in a way that is efficient in an SMA environment.

Before joining Ralton, Mr. Stanley was engaged in developing structured solutions for clients in the investment banking, fixed income, and equities areas. The roles involved analysing accounting, tax, legal, and regulatory issues. Mr. Stanley held senior positions with a number of major investment banks, including UBS, Deutsche Bank, and Macquarie Group in Australia, U.S., Tokyo, and Hong Kong. His last position before joining Ralton was executive director in the UBS financial structuring group in Asia. Mr. Stanley also spent three years tutoring macroeconomics at Monash University, which has particular relevance to the top-down, thematic aspect of the investment process.

S&P recognises that Mr. Stanley has demonstrated his ability to add value in what has been a challenging market environment over the past 31 months. However, it must also been recognised that 31 months does not constitute a full market/economic cycle. As such, his ability to achieve the manager's performance targets over the long term remains untested.

However, S&P recognises the relevance of certain aspects of Mr. Stanley's prior experience. Specifically, the detailed analytical process, the degree of interaction and contact with company management, and his general finance industry experience are all highly relevant to his current role. Mr. Stanley holds a 44% stake in the management company.

➨ Research Team

Mr. Walling is responsible for the investment analysis of certain sectors and stocks. Currently, he covers six sectors and has responsibility for 38 stocks on the recommended list.

Mr. Walling was previously employed for four years in the position of senior analyst at Cinnabar Equities, a value-driven, long-biased global health care fund and an associated vehicle of the Portland House Group. Here he had subsector and stock investment decision responsibility and was a member of the investment committee, which had a portfolio-construction role. Prior to this, he practised as an optometrist. He has now spent eight years engaged in fundamental securities analysis. His interests are strongly aligned with investors through an 11% stake in the management company.

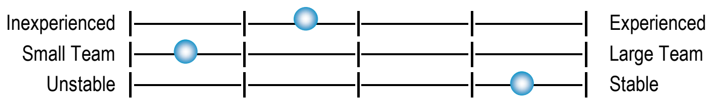
Mr. Walling has worked closely with Mr. Stanley since joining and also benefited from 15 months' mentoring from the prior portfolio manager. In addition to his stock and sector responsibilities, Mr. Walling also assists Mr. Stanley in the portfolio-construction process

Nick Loftus is responsible for the investment analysis of certain sectors and stocks and for managing the team's quantitative investment models. Before joining Ralton in November 2007, Mr. Loftus spent three years with a global mining consultancy firm where he built detailed models for scenario analysis, budgeting, and forecasts for resource companies including BHP Billiton Ltd. Mr. Loftus currently covers eight sectors and has responsibility for 32 stocks on the recommended list. He holds a 5% stake in the management company.

While not directly involved in the investment process, Damian Holland has more than 15 years of direct fund-management experience across various business activities. He has been an important contributor to the development of the model portfolios.

➨ Alignment And Accountability

There is a very strong alignment of interest between the investment team and investors, with the three team members owning approximately 60% of the shares on issue. Mr. Stanley (head of investments) owns the majority.



Investment Process

➨ Overview

The investment selection process is orthodox and sufficiently comprehensive in what it addresses. The efficiency and consistency of the investment process is facilitated by the use of in-house financial modelling and valuation templates and database tools. This is particularly important given the size of the investment team.

The manager uses both primary and secondary sources of information. It emphasises the importance of company contact and estimates around 350 management meetings per year through company presentations, site visits, one-on-one meetings, and telephone conversations. This is an impressive level given the limited resources. The team is endeavouring to increase its contact with secondary sources of information (competitors, suppliers, etc.), but its ability to do so will always be constrained given team numbers. The manager draws heavily on broker research and industry contacts as a source of market views, analytical input, investment views, and financial expectations.

The analytical depth, focus, and transparency across all stocks in the portfolio is generally less than that of larger fund managers due to limited resources and consequently the greater number of stocks and sectors each of the three analysts must cover. The relatively low turnover nature of the portfolio assists in building the detail.

➨ Research Process

The process is based on a three-stage process. The first stage defines the investment universe by screening out relatively illiquid and small market capitalisation stocks as well as those that operate in high risk sectors (exploration, early stage technology, etc.).

The second stage involves fundamental company research which, in turn, comprises several phases. The first stage further refines the investment universe to approximately 100 stocks through an assessment of qualitative, quantitative, and valuation factors. The qualitative assessment is based on "Porter-style" factors as well as a focus on management quality. The quantitative assessment gauges the financial strength, stability, transparency, and growth prospects of the company. A high-level valuation determines if the value criteria is satisfied.

The second step involves maintenance of an investment thesis and financial modelling for each company in the investment universe. The investment thesis is a live document that addresses key drivers, risks, consensus, financial position, and catalysts.

Financial modelling is based on a template that efficiently enables the analyst to establish and maintain a base model. The extent of modelling varies depending on the quality of information available, including from market analysts.

Company valuations are typically based on at least two preferred methodologies and use in-house, consensus, or an analyst's specific forecasts, or a combination of these.

The analytical outcomes are then subject to peer review with the investment thesis, models, and valuations discussed at investment team meetings. Flowing from the discussion, an approved list is created.

➨ Portfolio Construction

The third and final stage of the investment-selection process is portfolio construction and management. The stocks on the approved list are ranked according to the scoring outcome of the quality of business assessment and discount to company valuation. Stock selection and portfolio weighting is a function of ranking, analyst conviction, stock and sector portfolio limits, and top-down economic and thematic views. The portfolio is reviewed monthly.

The sell discipline can be one of four scenarios: the stock reaches fair value; the assumption underlying the purchase decision no longer applies; a better alternative investment becomes available; or the stock position is trimmed when it becomes overweight, due to its relative outperformance.

➨ Risk Management

Assessment of business quality is an integral part of the manager's overall approach to risk management as is the focus on preserving capital and the exclusion of riskier stocks and sectors.

The final portfolio is moderately well diversified, holding between 30 and 35 stocks. Single stock weights are subject to varying limits, being the higher index weight of a stock, ranging from a minimum 1% to a maximum of generally 10% at the time of purchase. Portfolio sector weightings are compared to market sector weightings on a monthly basis and any required adjustments are made.

Shares in any single stock cannot exceed more than 10% of that company's issued capital. The use of derivatives is not permitted.

Actual tracking error for the underlying fund has been in the range of 4.5% to 5.5% since inception, in line with the targeted range. The manager has recently transitioned to using Bloomberg data to estimate the expected tracking error of a proposed portfolio. Volatility has been marginally below the benchmark.

Risk Constraints

Typical number of stocks	30 to 35
Active stock limits (%)	Subject to index weight
Active sector limits (%)	+/-6
Maximum cash holding (%)	2 to 10
Targeted tracking error (%)	2 to 5
Active country limits (%)	N/A
Average portfolio turnover (3yrs) (%)	30 to 50

Performance

The performance track record of the model portfolio is short and does not cover a full market/economic cycle. As such, historical performance may be less indicative of potential performance than may otherwise be the case.

Since its establishment, the model portfolio has outperformed its benchmark, specifically by 3.6% per year to May 31, 2010 pre-fees. On a rolling annualised basis, the model portfolio has also generally outperformed the benchmark, although S&P notes that most of the relative gains were generated over the first nine months of operation.

Historical volatility is marginally below the benchmark index (annualised standard deviation of 18.5% compared to 19.8%) and the model portfolio has recorded an expected tracking error of 4%, which is consistent with the guidelines of the model portfolio.

Portfolio Review

Relative to the benchmark at the end of May 2010, the fund had overweight holdings in materials, consumer discretionary, and industrials. Underweight holdings included real estate trusts (REITs). Over the past 18 months to the same date, the fund has achieved positive attribution from a majority of sectors, with financials the only meaningful detraction. The manager's avoidance of REITs has held the fund in good stead, as the fund escaped the sharp sectoral sell-off.

The Ralton model portfolios have been positioned for a cyclical recovery domestically and internationally. The manager's view is that sustained solid economic growth will show through by the fourth quarter of 2010. In the interim, the manager expects the recent market volatility to continue in the domestic and international equities markets.

SMA Suitability

Ralton has been at the forefront of the development of the Australian SMA sector. Managing director, Mr. Holland is a prominent proponent of the sector and an important source of information for both users and providers of SMA services. The manager has developed a strong profile and this is beginning to convert into increasing adoption of its model portfolios and FUM growth.

Ralton's SMA models are now available on five SMA platform services: BlackRock Customised Portfolio, AMP Personalised Portfolio Service, Linear Managed Accounts Service, the OneVue Managed Account service, and most recently Hub24..

As an SMA specialist, the manager is well aware of the risks specific to an SMA model portfolio and manages its portfolios in a manner that serves to mitigate these risks. This can be viewed as a competitive advantage relative to some of the less SMA-aware model portfolios available in the market.

Relative underperformance risks endogenous to the fund (due to high brokerage) are minimised by moderately low turnover and a long-term investment horizon. As a dedicated SMA model portfolio, the fund inflow issues that relate to other model portfolios that mirror unit trusts are not present.

SMA Platform Availability

SMA Platform	FUM (A$ mil.)
BlackRock Customised Portfolio	16.6
AMP Personalised Portfolio	10.1
Linear Managed Accounts Service	23
OneVue Managed Account	0.5
Hub24	0

The performance of SMA model portfolios is subject to particular risks not present in managed funds. These risks relate to various portfolio attributes, which we address through the issue of SMA portfolio suitability, as well as the manager's operational processes. These processes relate to the level of communication of portfolio and trading information to the platform provider and also to the monitoring of performance in the model portfolio.

➨ SMA Portfolio Suitability

The suitability of a portfolio to the SMA template is broadly a function of portfolio turnover, portfolio concentration, average trade size, market capitalisation and liquidity. Also considered, where applicable, is the manner in which fund flow into a unit trust version is implemented in the model portfolio.

Advisers should note that some of these risks inherently derive from the SMA platform. Where a platform incorporates a minimum brokerage charge (a minority), the effective brokerage charge that applies to the model portfolio may be relatively high. Where an SMA platform incorporates a minimum trade value (the majority), smaller trades may not be executed in the model portfolio, which generates differences in stock composition to that of the investment decisions of the fund manager.

These risks may be significantly higher while the FUM of the model portfolio is low (less than several million dollars). S&P notes that the current FUM of the model portfolio has sufficient scale on three of its platforms, but not on the OneVue platform.

Portfolio Turnover

Turnover increases the potential degree of relative underperformance (due to excessive brokerage) and tracking error relative to a unit trust version (in circumstances where the manager delays trading instructions to the platform). It can also create the perception among investors that the investment manager lacks long-term stock-specific conviction given the stock transparency of model portfolios. Turnover also increases taxation events, which generally runs contrary to a key attraction of the SMA in taxation efficiency.

SMA model portfolios may incur a higher effective level of brokerage than the managed fund equivalent if a minimum brokerage fee applies to trading. The risk is a function of trade value: the lower the value of a trade, the greater the risk the minimum brokerage will apply and the higher the effective brokerage charge. This is a particular risk while the FUM within the SMA model portfolio is low.

S&P regards the model portfolio as efficient from a portfolio turnover perspective, with turnover expected to be around 30% to 50% per year. This serves to reduce the risk that the model portfolio may incur a high effective level of brokerage charges on those SMA platforms where a minimum brokerage fee applies.

The efficiency is somewhat offset by the fact that the manager may implement investment decisions gradually by accumulating or divesting stock. This creates a lower average trade size for a given level of turnover, increasing the risk of higher effective brokerage charges. This is a particular risk while the FUM in the model portfolio is low.

Portfolio Concentration

Portfolio concentration introduces similar risks as turnover. The less concentrated a portfolio, the greater the potential for stock-specific trades and a lower average trade size. Additionally, with portfolio transparency, "early adopter" SMA investors appear to have a preference for fewer but larger, better-known stocks.

The model portfolio typically has between 30 and 35 stock holdings. While this is at the higher end of the SMA peer group, S&P does not believe it to be a concern given the low degree of portfolio turnover and long-term buy-and-hold investment style.

Market Capitalisation And Liquidity

Market capitalisation and liquidity is relevant in two respects. For those managers of unit trusts that delay trading instructions to the SMA platform provider (the majority), so as not to compete on the same stock, liquidity at least permits a relative rapid execution in the unit trust. Consequently, the delay between the implementation in the unit trust and conveying the information to the platform provider may be relatively short. Market capitalisation typically corresponds to whether a company is well-known or not, and as noted above regarding portfolio transparency, "early adopter" SMA investors have a preference for larger, well-known companies where the investors' general understanding and comfort may be higher.

Generally, the model portfolio comprises large market capitalisation stocks, with relatively high liquidity. Furthermore, while trade execution can vary depending on the stock, the manager will typically move in or out of a stock over a relatively short period of several days.

Managed Fund Flows

Where a model portfolio is based on an existing managed fund, fund flows into or out of the managed fund create turnover risks in the model portfolio. A fund manager applies fund flows by either transacting in particular securities (thereby changing portfolio weights) or transacting in an entire slice of the portfolio (portfolio weights are unchanged).

Where the manager undertakes the former, every stock within the model portfolio must be traded to realign with the weights of the manager's model. In doing so, the issues of excess brokerage, minimum trade value thresholds, and higher degree of trading come into play again.

The issue of fund flows into a unit trust version is not a risk in the case of the Ralton model portfolio as it is run solely as an SMA model portfolio.

➨ SMA Management Processes

S&P believes there are two important processes from the investment manager side that may affect specific SMA performance risks. The first is the frequency and timeliness of communicating trading and portfolio composition details to the SMA platform provider. The second is monitoring model portfolio performance on each particular platform and identifying, understanding, and reconciling any material performance differences between either a unit trust version (where applicable) or a theoretical model portfolio maintained by the manager.

In undertaking the sector review it has become clear that there is a wide variation in the way and degree to which managers undertake the two processes. Findings range from managers who seek to convey trading information on a very timely basis and diligently monitor, understand, and reconcile performance differences to those that delay trading information for extended periods and undertake little performance monitoring, or none. Ralton sits firmly in the former category.

Portfolio Communication

The frequency with which managers communicate trading and portfolio information ranges from daily to weekly, and occasionally monthly. Managers who communicate on a delayed basis typically justify doing so out of concern for competing in the market for the same stock and disclosing their "IP", or intellectual property.

Many managers choose to delay communicating trading information until the unit trust and institutional mandate versions are fully invested or divested in a particular stock. This is particularly prevalent for smaller, less liquid stocks or where the manager is investing or exiting over several days and there is a concern about the price effect of an additional buyer or seller in the market. In some cases, the delay may be up to two weeks. However, many managers will simply delay as a matter of course, even in the case of highly liquid stocks where there would appear little justification for doing so.

While S&P understands the issue, the fact remains that investors are disadvantaged and not treated equitably by this practice. S&P also questions how real is the risk to investment managers, given the generally low FUM and the fact that the majority of constituent stocks in SMA model portfolios are generally large and liquid.

The longer the communication delay, the greater the portfolio and performance variation risk. The risk is greater when the following factors are greater: the trading activity/turnover of the model portfolio, the volatility of the market, and the price sensitivity of the information the manager is acting on in trading a particular stock.

While most managers delay trading instructions (typically by a week) the risks of doing so to investors will come back to the various portfolio and investment style attributes: turnover, liquidity, concentration, and fund flow management.

Delayed communication also distorts the manager's investment views, it represents inequitable treatment of the SMA investor relative to unit trust and mandate investors, and arguably is more broadly indicative of an indifferent attitude to the SMA investor.

Ideally, a manager executes its own trades and S&P acknowledges that many would prefer to do so. Unfortunately, at this point in time, the ability to do so is constrained by the SMA platforms, with only one SMA platform provider, Investment Administration Services (IAS), providing this option to investment managers.

Ralton has adopted best practice in the sense that it communicates portfolio information on a daily basis to all platforms.

Monitoring

There are three levels of monitoring SMA performance. The first is the theoretical, non-executed performance maintained by the investment manager. This should be based on the price of traded stocks on the day instructions were conveyed to the SMA platform provider. It may or may not incorporate an assumed brokerage rate. The second is the aggregated, executed performance on the SMA platform. The third is the performance at the individual investor level, which may differ from the above primarily due to fund inflows or outflows.

It is necessary for the manager to maintain a theoretical model portfolio to identify, understand, and reconcile any material variations in performance and avoid unintended trades. Many investment managers currently do not do so.

Ralton maintains reliable theoretical model portfolios and checks performance of the model portfolio on each particular SMA platform on a regular basis. The manager has been proactive in addressing any issues that have arisen to date and in encouraging platform providers to implement certain processes where the manager judged it necessary.

Management Group Profile

Ralton Asset Management Ltd. is a boutique fund manager specialising in SMA model portfolios that is majority owned by its investment and executive team. Ralton was formally established in 2005 as a sister company to Ralton Group Ltd. (RGL), an investment advisory business with a focus on direct share management, including the provision of a managed discretionary account (MDA) service.

In July 2008, an equity restructure occurred which effectively separated Ralton from RGL. The restructure was partly driven by the desire to remove a potential conflict of interest between a provider of direct share model portfolios and an adviser of such investments.

The restructure involved the injection of cash by a number of team members and private investors as well as an ongoing injection from investment team members and executives by forgoing a degree of salary. Following the recapitalisation, the latter group of equity investors owns about 75%, and the balance is held by two private individuals.

➨ Funds Under Management

On April 30, 2010, Ralton Asset Management had A$50 million in FUM.

Funds Under Management (as at May 31, 2010)

Current fund/pool size (A$ mil.)	50.2
Total FUM in strategy (A$ mil.)	16.2
Estimated capacity for strategy	N/A
Total FUM across all asset classes (A$ mil.)	50.2
Net strategy flows over past 12 months (A$ mil.)	29.1

**Source: Ralton Asset Management.*

SMA MODEL PORTFOLIO ★★★☆☆

Ralton High Yield Australian Shares SMA

STANDARD & POOR'S

Fund Rating Philosophy

A star rating is a forward looking assessment of a manager's ability to consistently generate superior risk-adjusted fund returns, net of fees, relative to relevant investment objectives and peers.

Fund Rating Process

In assigning a star rating to an SMA model portfolio, Standard & Poor's evaluates: the size, skill, and stability of the manager's investment team; the clarity, implementation, and risk management of the investment process; the SMA's objective, fee structure, portfolio characteristics, trade execution, trade execution structures and suitability for an SMA; and the manager's business management.

The S&P Fund Services SMA (separately managed account) model-portfolio rating is based on an assessment of two separate, but interrelated components: the quality of the fund manager (rated in the usual way by S&P Fund Services), and the suitability of the portfolio construction and management process for an SMA environment.

The rating is platform neutral. It applies irrespective of the platform where the model portfolio is, or may be, available. Rather, the assessment is based on the underlying assumption that all SMA platforms incorporate certain structures. Should the structure of a particular SMA platform differ from those assumptions, then the actual level of risk may differ from the S&P assessment. Investors should refer to the body of the report for a detailed explanation of the assumptions used by S&P.

Fund Rating Definitions

SMA MODEL PORTFOLIO ★★★★★	Standard & Poor's has very high conviction that the manager will consistently generate risk-adjusted fund returns in excess of relevant investment objectives and relative to peers.
SMA MODEL PORTFOLIO ★★★★☆	Standard & Poor's has high conviction that the manager will consistently generate risk-adjusted fund returns in excess of relevant investment objectives and relative to peers.
SMA MODEL PORTFOLIO ★★★☆☆	Standard & Poor's has conviction that the manager can generate risk-adjusted fund returns in line with relevant investment objectives and relative to peers.
SMA MODEL PORTFOLIO ★★☆☆☆	Standard & Poor's has conviction that the manager will not generate risk-adjusted fund returns in line with relevant investment objectives and relative to peers.
SMA MODEL PORTFOLIO ★☆☆☆☆	Standard & Poor's has high conviction that the manager will not generate risk-adjusted fund returns in line with relevant investment objectives and relative to peers.
SMA MODEL PORTFOLIO ON HOLD	Issues potentially affecting the management of the fund have emerged, and the fund rating is temporarily suspended, pending clarification.
SMA MODEL PORTFOLIO SELL	A manager with significant issues that have the potential to adversely impact performance. Existing investors should consider obtaining advice regarding switching or redemption.
— NEW —	**Fund Rating Subscript.** Where the investment process, fund manager or analytical team has changed significantly, or where the fund has a relatively short history, but a relevant and demonstrable track record can be shown on similar funds.

Glossary of Terms

Benchmark	The standard (e.g. an index) by which an investment is measured against to evaluate performance.
Excess Return	Return of an investment relative to its benchmark.
FUM	Funds Under Management—The total value of the funds managed by an asset management firm.
High Water Mark	The highest net asset value (NAV) of a fund achieved to date. If the NAV of a fund falls below this level, no performance fee will be payable to the investment manager until this level is subsequently exceeded.
Hurdle Rate	A minimum rate of return that a fund should achieve before a performance fee can be charged.
Performance Fees	A fee payable above the ICR that rewards the fund's investment manager for performance in excess of the hurdle rate.
ICR—Indirect Cost Ratio	This is the ratio of indirect costs to the total investment in a particular fund expressed as a percentage. It includes the MER, expense recoveries, and other costs associated with running the fund.
Information Ratio	Is a measure of the relative reward for the relative risk taken (excess returns of an investment (above the benchmark) divided by the tracking error). A positive information ratio would indicate efficient use of risk by the manager.
MER-Management Expense Ratio	This ratio is a calculation of investment management, marketing, trusteeship, legal, accounting and auditing costs of a managed investment fund expressed as a percentage of a fund's net asset value. It is the ongoing charges for managing a fund.
Peer Group Return	The average return of the funds in the relevant S&P peer group.
Sharpe Ratio	Is a measure of risk-adjusted performance, measuring the absolute reward for the absolute risk taken (return of the investment less the risk-free rate (e.g. bank bills) divided by the standard deviation). The higher the Sharpe ratio the greater the efficiency produced by the manager.
Standard Deviation	Measure of the variability or volatility of the monthly returns of the fund.
Tracking Error	How closely a portfolio follows or "tracks" an index to which it is benchmarked. (the standard deviation of monthly excess returns against the benchmark).
Ex Ante Trading Error	Predicted or forecast of tracking error.
Ex Post Trading Error	Historical or actual tracking error.