

Learn the basics

# LISTED INVESTMENT COMPANIES (LICs).

An introductory guide for first time investors

Listed Investment Companies (LICs) are managed funds that trade on the stock exchange similar to any other listed security. They offer investors an opportunity to gain exposure to an actively managed and diversified portfolio of securities in a single trade.

LICs are easily accessible, offer high levels of disclosure, competitive fee structures, and a long and demonstrable record of delivering out-performance after realised tax, fees and expenses. LICs can be used to gain varying active market exposures including domestic and international equities, specialist strategies, fixed income and private equity.

## How a LIC works

A LIC is a closed-end fund which trades on the ASX. It physically holds the underlying investments within a company structure. The benefit of the LIC structure, in comparison to an Exchange Traded Fund (ETF) or an unlisted Managed Fund, is threefold:

- There will be no unexpected inflows/outflows within the fund, which allows a LIC to take a long-term approach to investing;
- LICs are able to smooth out dividends as underlying distribution and capital gains are not required to be distributed within that same financial period;
- And given a LIC is a tax paying entity, there is an emphasis on delivering fully franked income.

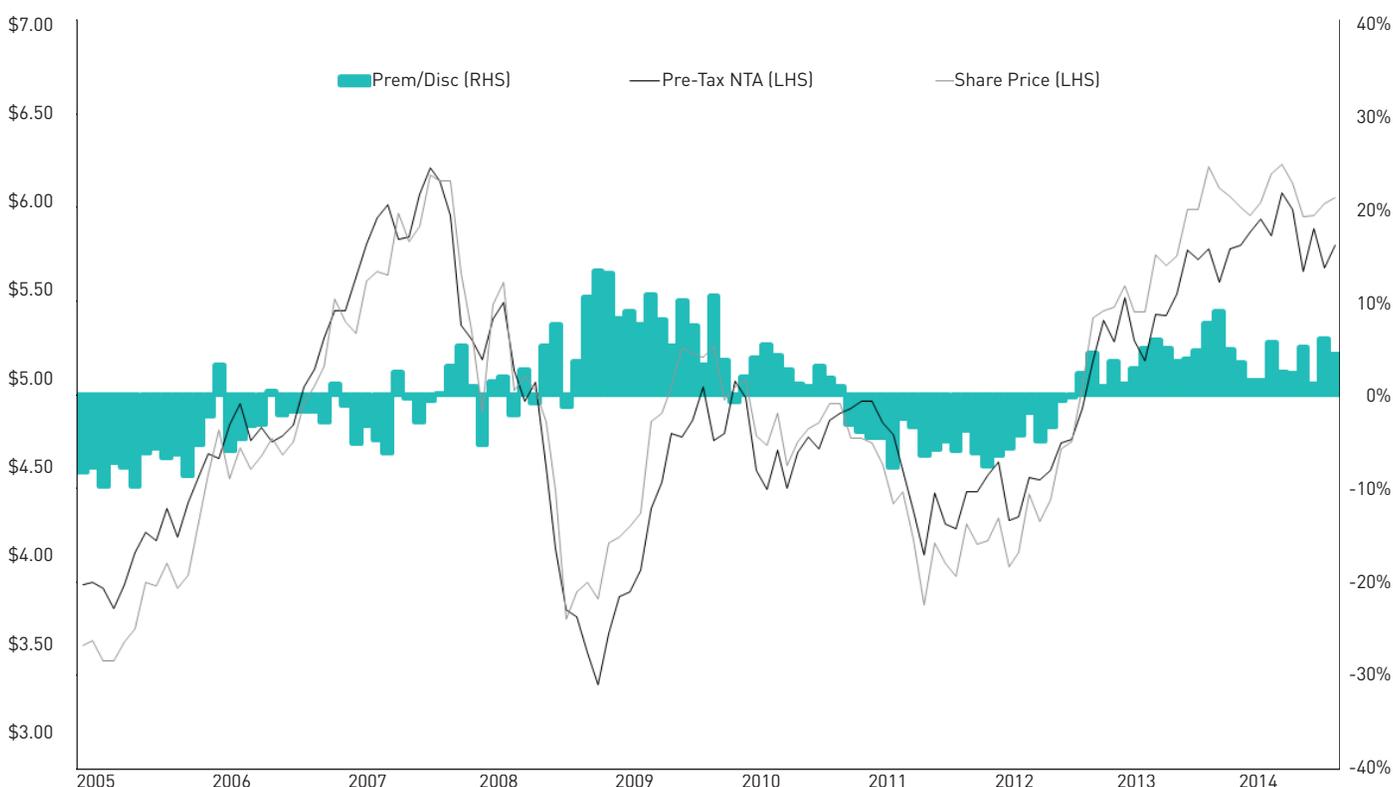
Similar to other listed securities a LIC cannot be redeemed for its underlying value, and a LIC usually trades away from its underlying pre-tax net tangible asset (NTA). At its most basic, when demand exceeds supply we usually see the pre-tax NTA discount contract, and when supply exceeds demand it usually expands.

However, through the cycle, LICs have a tendency to revert to their historical long-term average which may be at a discount or premium to its pre-tax NTA depending on the LIC. Therefore, it is suggested not to trade a LIC just on the discount & premium premise.

### Other

LICs have a Board of Directors that oversee the investment decisions of the fund, and generally employ a professional fund manager and analysts to facilitate portfolio construction and analysis. LICs offer a substantial degree of corporate governance with a requirement to meet ASX rules and regulations, deliver Annual and Half Yearly reports and release NTA on a monthly basis. Industry best practice is to release the Top 20 investments on a monthly basis, alongside fund

**FIGURE 1: LIC- AN EXAMPLE OF SHARE PRICE AND NTA DIVERGENCE**



# How you can use a LIC in your portfolio

## Instant diversification

A LIC provides exposure to all the stocks in the underlying fund, giving you instant diversification, no matter how small your investment. Thus, decreasing your overall risk.

## Building blocks

LICs can be used as 'building blocks' to build a robust investment portfolio. For instance, if your portfolio already consists of mainly ASX Top 100 companies, you can purchase a LIC that covers ASX Small Cap stocks or International Stocks.

## Generating 'Alpha'

There may be a possibility to trade the premium/discount oscillation throughout the cycle.

## Adjust asset allocation

LICs enable you to easily adjust your asset allocation in one transaction – for instance, buy a LIC to increase your exposure, selling to decrease it.

## Key benefits and risks

### KEY BENEFITS

#### Experienced management

LICs have professional investment managers who make investment decisions on behalf of the portfolio.

#### Net tangible asset (NTA)

The value of the underlying assets held by a LIC on a per share basis is referred to as NTA. LICs are required to report their NTA monthly.

#### Transparent

LICs offer high level of transparency with NTA & Top 20 investments published monthly, as well as half-year and full year accounts.

#### Franking

LICs with domestic mandates usually pass on their franking credits to investors.

#### Liquidity

LICs are listed entities and positions can be effectively valued intraday and liquidated throughout the trading day, similar to other listed securities.

#### Cost

LICs have very competitive Indirect Cost Ratio (ICR). Fees are generally lower than managed funds, index funds and some ETFs.

#### Structure

LICs are close-ended funds, meaning the underlying fund is not subject to withdrawals. As such, management are able to take a medium to long term investment focus – without the possibility of unexpected inflow/outflows.

### RISKS

#### Active management

LICs are actively managed securities and seek to outperform the broad market. This is no guarantee that the investment manager is able to meet this objective.

#### Liquidity

LICs are listed securities with finite number of units on issue that are supported by market supply and demand. This can make it difficult to enter and exit large positions, particularly for less liquid LICs.

#### Price certainty

LICs cannot be redeemed for their underlying NTA and may trade away from this value.

#### Currency risk

LICs investing in offshore securities are subjected to fluctuations in the Australian dollar against other currencies, which may erode or magnify returns.

## Five deciding factors

### 1. Start with the manager

Assess the Manager's after fee performance, preferably over at least a ten year period, and compare it to its relevant benchmark and other similar LICs.

### 2. Investment style

Have a good idea of the Manager's investment mandate and style.

### 3. Asset allocation

Compare your investment beliefs with the LICs asset allocations – i.e. if you believe resource stocks will rise; seek an LIC that concentrates on investing in resource stocks.

### 4. Fees

Look at the LIC's fee structure and compare it with similar LICs.

### 5. NTA

Understand that just because the LIC is trading at a discount to its pre-tax NTA, does not make it an instant buy. Compare it to the LICs average premium or discount over at least a ten year period.

## Know the difference

	LISTED INVESTMENT COMPANIES (LICs)	MANAGED FUNDS (MFs)	EXCHANGE TRADED FUNDS (ETFs)
INVESTMENT STRATEGY	Active	Active	Passive
TRANSPARENCY	Monthly/Weekly	Daily/Monthly/Weekly	Daily
PRICING	Supply and demand	NAV + Margin	NAV + Margin
DIVIDEND/DISTRIBUTION	Dividend	Distribution	Distribution
TAX	Tax as a company	Tax as a trust	Tax as a trust
STRUCTURE	Closed	Open	Open
LIQUIDITY	Intraday	Daily	Intraday
<b>FEES</b>			
TRANSACTION COST	Standard Brokerage	Varied	Standard Brokerage
MANAGEMENT FEE	Low	High	Low
DIVERSIFICATION	High	High	High

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