



# Qualitative Fund Research

Castle Point Funds Management Trans-Tasman Fund

November 2018

## About the Manager

Castle Point Funds Management Limited (the Manager, Castle Point) was established in 2013 by the investment team and is built on a highly disciplined approach to identifying investment candidates which they successfully executed when at Tower Investments. Castle Point Funds Management is fully owned by Castle Point Holdings, which is owned by employee and external shareholders. The Manager has provided a brief profile available [here](#).

Castle Point believes that superior returns can be generated by investing with a long-term perspective and focusing on capital preservation. They combine this with a rigorous approach to in-depth research, and strong alignment with investors to maximise long-term investor returns.

Castle Point clearly spells out its governance and controls framework [here](#).

Castle Point manages three PIE funds:

- Castle Point Ranger Fund
- Castle Point Five Oceans Fund
- [Castle Point Trans-Tasman Fund](#)

In addition, Castle Point also manage wholesale funds and segregated accounts for clients.

All members of the investment team perform research for the underlying investments and each fund has designated dual portfolio managers. Other functions, other than investment functions, are outsourced to third parties. Public Trust provides custodian and supervisor duties, MMC provides fund administration and custodian duties. For the number of funds being managed the team, this is an adequately resourced team of well tenured and experienced personnel. Individual bios for the team at Castle Point can be found [here](#).

## Using this Fund

**This is General Advice only and should be read in conjunction with the Disclaimers, Disclosures and Warnings at the end of this document.**

The Castle Point Trans-Tasman Fund (“the Fund”) is a ‘long-only’ Trans-Tasman equity product. The benchmark for the Fund is the S&P/NZX 50 Gross Index. Although the Fund can hold higher levels of cash, typically the cash balance will be under 5%. As such the Fund, will generally sit within the growth component of a balanced portfolio, more specifically the Australasian equities sector.

The Fund is subject to equity market risk and movements (both positive and negative) in the share prices of the underlying securities in the portfolio. The ability to allocate between either New Zealand or Australian equities, as well as security selection can impact performance. Accordingly, investors should therefore be aware that the Fund may experience periods of negative returns and that there is a risk of potential capital loss being incurred on their investment. The Fund is suited to higher risk profile investors with a minimum investment time frame of five years.

The Fund may enter into forward currency and other derivative contracts to manage its Australian Dollar currency risk.

The Fund is a Portfolio Investment Entity (PIE). The Fund intends to pay quarterly distributions, however investors can elect to have those distributions reinvested in the Fund.

Question	What the Manager says	What FundSource think										
<p>What are the Manager's assets under management - in total and in this Fund?</p>	<p>As at September 2018 Castle Point (the Manager) has more than \$300 million of funds under management (FUM). Castle Point was established to provide investors with a truly differentiated investment offering.</p> <p>As at 30 September 2018:</p> <table border="0"> <tr> <td>Ranger Fund:</td> <td>\$65.1M</td> </tr> <tr> <td>5 Oceans Fund:</td> <td>\$35.3M</td> </tr> <tr> <td>Trans-Tasman Fund:</td> <td>\$0.3M</td> </tr> <tr> <td>Mandates:</td> <td>&gt;\$200M</td> </tr> <tr> <td>Total:</td> <td>&gt;\$300M</td> </tr> </table>	Ranger Fund:	\$65.1M	5 Oceans Fund:	\$35.3M	Trans-Tasman Fund:	\$0.3M	Mandates:	>\$200M	Total:	>\$300M	<p>The Manager has three retail products in the market place. This Fund is more benchmark aware than other funds offered by the Manager. The retail FUM is now over \$100M which, while growing strongly, is relatively modest and is an aspect FundSource will continue to monitor. However, it is reflective of the boutique nature of the business.</p> <p>The Trans-Tasman Fund was launched in November 2018 but continues on from a wholesale strategy that has been operating since January 2014. There is some risk of an investor becoming a significant unit holder but due to the Manager's strong FUM growth this is expected to reduce quickly.</p> <p>Overall, the Manager's total FUM is growing quickly, reducing business risk significantly with the Manager becoming a profitable operation, which combined with the ownership structure mitigates any corporate risk.</p>
Ranger Fund:	\$65.1M											
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Mandates:	>\$200M											
Total:	>\$300M											
<p>Who is accountable for managing the Fund, and how long has the investment team worked together?</p>	<p>Richard Stubbs and Stephen Bennie are Co-Portfolio Managers. Jamie Young and Gordon Sims are analysts. The four have worked together as a team for the past 9 years.</p>	<p>The investment team have worked together for a total of nine years, five and a half years at Castle Point, and previously for three and a half years at Tower, providing comfort that the portfolio management team work well together. Ultimate responsibility for the Fund lies with Stubbs and Bennie. The Fund has a long track record as a wholesale investment product, harking back to 2014. As a retail product there is no track record as such. FundSource notes the Fund is unlikely to be managed differently to the wholesale version of the Fund, however, there is a risk the Fund may not attract strong funds under management (FUM).</p> <p>Analyst functions are shared between Young and Sims, though all four investment team members are responsible for identifying opportunities and undertaking investment research on the investments that successfully pass through the proprietary filters and candidate gates.</p> <p>All the investment team are co-founders and equal equity owners in the business, which remains at 16% as at 2018. There is a mechanism in place to enable the investment team and key personnel to become larger shareholders over time.</p>										
<p>What objective is the Manager trying to achieve?</p>	<p>The objective of the Trans-Tasman fund is to outperform the benchmark S&amp;P/NZX50 Gross Index (including Imputation Credits) over periods of three years or greater, after all fees but before taxes. The fund targets a tracking error of 4-6% and will typically have less than 5% cash at any time.</p>	<p>The Fund seeks to provide investors with outperformance above its stated benchmark. FundSource notes the Fund doesn't provide specific guidance on the quantum of outperformance above its stated benchmark, which is not uncommon in the New Zealand market.</p> <p>The Fund, in retail form, has no track record. The Manager has indicated the Fund will be managed in accordance with</p>										

		<p>the wholesale strategy, which has a strong performance history. FundSource notes wholesale fees are lower than the fees charged for retail funds, this would impact the wholesale strategies performance compared to the Fund's performance benchmark if a retail fee was applied. Due to the lack of track record for this Fund FundSource is not in a position to develop a meaningful understanding of how performance and risk measures look for this Fund.</p> <p>The Manager will provide performance reports via its <a href="#">website</a>. FundSource notes that performance data will also be available on the New Zealand Government's Disclose website <a href="#">here</a>.</p>
<p>What does the Manager invest your money into?</p>	<p>The fund will hold 90-100% Australasian equities and 0-10% cash.</p>	<p>The Fund has a relatively tight constraints around the asset allocation of the Fund. However, the Fund is not restricted to the types of securities it can invest via, which includes the use of derivatives, which can introduce unintended leverage in to the portfolio. The cash allocation of the portfolio will limit the use of derivatives, as the Fund requires all derivatives position to be covered by cash. FundSource believes this is a strong risk mitigation strategy, preventing derivative's from dominating the portfolio.</p> <p>The Fund will be heavily biased to New Zealand companies, with a much smaller weighting to Australian companies. FundSource does not believe the Fund is likely to stray too far from its strategic weights of ~75% New Zealand equities and ~25% Australian equities. However, there may be periods where the Fund will experience material changes to the allocation and the type of instruments being used.</p> <p>The Fund is broken in to four discreet pools, the Alpha Pool, NZX50 Neutrals, NZX50 Underweight Pool, and Conviction Underweights. FundSource believes the Alpha, NZX50 Neutrals, and NZ50 Underweight Pools will hold the vast majority of positions, while the Conviction Underweights will be opportunistic and likely to appear for short periods in the portfolio.</p> <p>The Manager publishes the Fund's holdings on the <a href="#">Disclose website</a>.</p>
<p>What are the inherent risks imbedded in the Fund?</p>	<p><b>Market Risk</b> The returns you receive from the Fund will be affected by the performance of the Fund's investments, which may be affected by the performance of investment markets generally. This risk includes movements in the general price level and demand and supply in the market in which the relevant investments are made, the sectors in which the investments are made, and economic and regulatory conditions, including market sentiment, inflation, interest rates, employment, political events,</p>	<p>The Manager is aware of the broad range of risks and is mindful of them when constructing and managing the portfolio. The mix of fundamental bottom-up security analysis and allocation to New Zealand and Australian equities will be important in determining to the Manager's ability to achieve its stated objective.</p> <p>The Fund is expected to hold between 30-50 companies in the portfolio, providing exposure to a reasonable number of NZX listed companies, particularly if holdings</p>

	<p>environmental and technological issues, and consumer demand both in New Zealand and globally.</p> <p><b>Currency Risk</b> A portion of the Fund's investments may be invested in assets denominated in currencies other than New Zealand Dollars - e.g. Australian Dollars. Returns may be affected by movements between the New Zealand dollar and other currencies. The Fund's hedging policy is designed to control this risk (see SIPO for further details).</p> <p><b>Credit Risk</b> The risk of a counterparty to the Fund being unable to meet its payment obligations.</p>	<p>are at the upper end of the range. FundSource notes the Fund is index aware, but the actual allocation to any company maybe materially above or below that companies index weight. Rather the weight of a company in the portfolio is how the Manager intends to reflect its view. This will be most notable for the NZX ten largest companies.</p> <p>FundSource highlights the maximum position size to any one company can be higher than 15% of the overall portfolio, however, the Manager does not expect this will be a regular occurrence. The Manager is aware of the risks that both diversification across names in and size of a single position can bring to a portfolio. They are also aware of the need to ensure appropriate levels of liquidity, despite equity typically being very liquid.</p>
<p>Why does the Manager believe the future prices of the Fund's investments will vary?</p>	<p>The returns of the fund will be principally driven by two factors. The future returns that the S&amp;P/NZX 50 index delivers and the active over and underweights that the Fund takes versus that index.</p>	<p>The Manager clearly understands the dynamics between fundamental bottom up research and market mechanism that will drive the allocation to the alpha, neutral, underweight, and conviction underweight pools. The Manager has a core capital preservation ethic, embedded, which will be reflected in the number of companies in each of the pools, and size of the positions compared to the NZX50 reference index weight. FundSource understands the exposure to Australian companies is not referenced to an ASX benchmark. The weight of alpha stocks in the portfolio is mechanistic, in that each alpha stock will have a default position, based around conviction.</p> <p>The Manager employs a detailed process to arrive at a potential investment and position size for a company in the Fund. The process commences with a series of proprietary filters and other approaches to identify potential candidates.</p> <p>Each candidate company must pass through a specific gate which seeks to identify certain value and quality criteria. There are two value gates - deep value and value. Similarly, there are two quality gates; mid-cap growth and moat. The research and criteria evaluated are specific to each of these gates. This process looks to combine aspects of both value and quality investing.</p>
<p>Why does the Manager believe you should give them your money rather than to someone else or to an inexpensive index fund?</p>	<p>The Manager believes that superior returns are generated by investing with a long-term perspective and focusing on capital preservation.</p> <p>The investment strategy of the Fund is to exploit market inefficiencies resulting from a bias to short term performance by financial market investors, through investing in a range of Australasian assets.</p> <p>These inefficiencies exist because, in Castle Point's opinion, financial market investors tend to:</p>	<p>FundSource is not able to provide commentary that specifically relates to this Fund. However, does recognise the Trans-Tasman Strategy, only available to wholesale investors, does have a track record, which based on the Manager's data, has performed strongly against the same reference benchmark. FundSource points out that investors should not rely on the historical performance of wholesale strategy as an indicator for this retail Fund's future performance. What it does indicate is the Managers ability to positively</p>

	<ul style="list-style-type: none"> <li>- focus on recent past performance</li> <li>- underestimate the effect of capital flows and the resilience of poor returning companies (this is called the 'Value opportunity')</li> <li>- underestimate the length of time growth companies can earn excess returns (this is called the 'Quality opportunity').</li> </ul>	<p>execute this strategy through a strong investment market.</p> <p>As the Manager states, the Fund invests with a long-term perspective, FundSource believes potential investors should be investing with a minimum five year time horizon in mind.</p> <p>The Manager target a tracking error range of 4-6%. The Australian companies will positively contribute to the tracking error as well.</p> <p>FundSource believes that the Fund's deliberate allocation to specific pools, and core focus on long-term capital preservation could make it an attractive diversifier, in a well-diversified Australasian equity portfolio.</p>
<p>How does the Manager decide to buy or sell investments?</p>	<p>Companies are invested into based on whether they fall into one of the stock pools: "Alpha stocks", "Neutral stocks" or "Funding stocks".</p> <p><b>Alpha Stocks</b> Alpha stocks are high conviction Australasian companies, identified by a thorough research process. We research companies that fall into one of our four strict categories: Deep Value, Value, Mid-Cap Growth or Moat. Companies are researched by analysts who report their work each week in an investment meeting, attended by the investment team, that provides an official forum for wider team input into the research process. Once the investment team believes that a company has been thoroughly researched, the decision will be made around whether the research has produced an unbiased conviction that the company falls into one of the four categories and has sufficient upside with a margin of safety.</p> <p><b>Neutral Stocks.</b> These are NZX50 constituents that are close to passing our value or quality gates, but do not quite make it through the strict criteria to justify them being an "alpha stock" so they are held at benchmark.</p> <p><b>Funding Stocks.</b> These are other stocks in the NZX50 that don't fall into the "alpha" or "neutral" stock pools, so rather than holding them at benchmark, they are equally underweighted by the required proportion to fund the overweight "alpha stocks".</p> <p>Companies will be sold if they fall out of their stock pool, which could be a result of a stock being removed from the NZX50, or an "alpha stock" having no more sufficient upside, or a company ceasing to have relevant attributes. This selling decision will be made with the same thorough research process that was adhered to when buying it.</p>	<p>The buy decision for the Manager employs a detailed rigorous process, from universe filtering, in-depth research to portfolio selection and position sizing. Detailed processes should provide a clear and logical approach to determining how a decision to buy or sell a portfolio holding is arrived at. FundSource believes the strategy based around the four pools is very clear and provides an easy to understand framework that links directly to the size of a company in the portfolio.</p> <p>In principle the Fund provides additional budget to companies it wants to have a higher exposure to. This budget is taken from the funding stock, or NZ50 underweight pool. This should ensure the portfolio does not become over exposed to any of the four pools, in typical market environments.</p> <p>Fundamental, bottom up research drives investment decisions, with cash being the residual of the Fund's liquidity management and fund flow management. It is important to understand that the Manager is principally an equity manager, and this Fund is expected to be fully invested through the full market cycle.</p>

<p>Has the CIO personally invested in the Fund? If so, paying the same fees as other investors?</p>	<p>No as this is a specialist fund. The investment team are invested in other Castle Point funds which have some exposure to the same investments.</p>	<p>FundSource believes that the interests of investment personnel are better aligned to those of the investors, when investment personnel are significantly invested in the Fund, and at the same fees.</p> <p>In this instance the investment team are achieving this proxy through the Managers flagship Ranger and Five Oceans funds. While there are elements of alignment, the investment team will not be experiencing the same effect as investors in this specific Fund.</p> <p>FundSource does expect that investment personnel should to be paying the same fees as other investors, to ensure the experience of both parties is symmetrical. FundSource notes that the staff at Castle Point do pay the same fees as investors, for the funds they are invested in.</p>
<p>How much latitude does the Manager have to deviate from the weightings of the Benchmark portfolio?</p>	<p>The fund targets to have a 4-6% tracking error and will decide on the extent of overweight positions based on this, equally spreading underweight positions to fund them. Typically, the largest target overweight position is 4% relative to the index, with a 10% hard limit.</p> <p>Tracking Error: 4%-6%  Cash Allocation: 0% to 10%  Equities Allocation: 90% to 100%  Single Security Limit: 10% over benchmark weight  Sector Limits: n/a</p> <p>Regional Limits:  New Zealand: 75%-100%  Australia: 0%-25%</p>	<p>The Manager has a relatively tight risk management framework for this Fund. The Fund is focused on Australasian securities. The default position is to predominantly hedge Australian currency exposure back to NZD, though the Manager has discretion to leave positions unhedged.</p> <p>The Fund can invest into a single security, its benchmark weight plus 10% for benchmark companies. For non-benchmark companies this ranges between 0-10% as an absolute number. An individual company must not exceed 19% of the issued share capital of that security, including any derivative exposure to that company.</p> <p>FundSource highlights derivatives can introduce unintended leverage in to Fund. Investors must determine the Fund's relatively constrained approach, combined with the ability to use physical and derivative exposures to gain an exposure to a company, aligns with their needs and objectives.</p>
<p>On what basis does the Manager believe the fees they charge are justified?</p>	<p>Castle Point has a consistent track record of outperformance. The fee is competitive and transparent, being an all-in fee.</p> <p>No performance fees are charged by this Fund.</p>	<p>FundSource believes the Manager is transparent from a fees perspective, noting the annual fund charge is capped, as disclosed in the Product Disclosure Statement (PDS) available <a href="#">Product Disclosure Statement (PDS)</a>, FundSource views the capping of fees as a positive feature, noting the Manager employs this feature in its fund suite.</p> <p>FundSource notes the Fund capped fee is below the sector average for the FE Analytics NZMI Australasian Equities sector peer funds. This FE Analytics sector consists of 35 funds in total, including this Fund.</p>
<p>How would you describe the quality of your organisational and investment governance processes?</p>	<p>Castle Point strives to have best practice operating systems and procedures when accepting, investing, managing and reporting back to clients, including:</p>	<p>The Manager has increased its governance frameworks over the past 12 months. This has been achieved appointing Amanda Smith as an independent Chair of the board, and</p>

	<ul style="list-style-type: none"> <li>• Castle Point is licensed by the FMA to provide both Managed Investment Schemes and Discretionary Investment Management Services.</li> <li>• Government owned Public Trust is the independent supervisor for the fund.</li> <li>• Clients' investments are priced daily by MMC an independent party.</li> <li>• All funds are independently audited by Deloitte.</li> <li>• All funds undergo a daily check by the operations team to ensure funds are within mandate,</li> <li>• Dealing is not undertaken by the portfolio managers.</li> <li>• The board is independently chaired and contains senior compliance expertise at Board level.</li> <li>• Investment Committee meets quarterly and provides an additional layer of oversight on the portfolios.</li> <li>• The Compliance Assurance Committee meets quarterly and has an independent chair.</li> <li>• A client advisory panel meets yearly to ensure the investment team remains true to the investment philosophy and provide an additional feedback mechanism for investors.</li> </ul>	<p>introducing a Head of Operations, Jenine Briggs and a business analyst role. As expected, as the Manager's FUM has grown, the Manager has been adding additional resources. While there is progress, FundSource would view expansion of the Board with another non-executive director positively.</p> <p>FundSource views the appointment of independent members to key committees as a key aspect of strong corporate governance frameworks. In the case of the Manager, the addition of Independent Investment Committee member, Kevin McEntee, in addition to Amanda Smith ~12 months ago is a strong positive. As Castle Point continues to grow FundSource would be like to see non-executive members lead other key committees, which may include Audit and Remuneration committees.</p> <p>From a transparency perspective, the <a href="#">Our People</a> section of the website provides clear guidance on the roles of each person in the Castle Point team, across investment, sales and marketing, operations, board, and investment committee. Castle Point is one of the few managers that provides this level of transparency across the organisation.</p> <p>The Client Advisory Panel is an interesting feature, despite being a little unclear as to what purpose it serves. FundSource believes fund managers should actively seek to engage with investors directly, as well as through intermediaries.</p> <p>FundSource believe that the Manager is considered and deliberate in the decisions it makes, and with the benefit of strong ownership and advisory roles, is able to put in place a governance framework that would typically be seen at a larger fund manager. The foresight to develop the business is embedded in the Manager's thinking and culture. This is considered a strength for this Manager and the funds it operates.</p>
<p>Is there alignment of interests through; ownership of the Manager, and remuneration of the investment team?</p>	<p>The investment team have their savings outside of property invested in Castle Point's funds, the Ranger Fund and the 5 Oceans Fund.</p> <p>50% of any performance fees, the Ranger Fund generates, go into a bonus pool for the executive team.</p> <p>The executive team all have shares in the business, each having 4%.</p>	<p>To remain operational the Manager must preserve current FUM, and grow FUM by generating long term positive returns for investors. The Manager has been able to achieve strong positive FUM growth over the past 12 months.</p> <p>Being partly owned by the Investment team and aligning variable compensation to performance is a positive alignment of interests with investor outcomes. Ownership can assist with team stability; the ability for the co-founders to increase this to 50% over time.</p> <p>Corporate risk, while reducing due to growth, remains present. The shareholding of RCP Holdings and other supportive stakeholders, continues to mitigate corporate risks of a relatively young company.</p>



## Conclusion and Rating

The Fund provides investors with exposure to a risk managed portfolio of Australasian equities, benchmarked to the NZX50. The Fund is actively managed, which is reflected in the portfolio positioning around the four pools of companies, alpha, neutral, underweight and conviction underweight, combined with the position size of a company in the portfolio. Investors considering this Fund, should have a minimum investment timeframe of five years.

Castle Point's ownership, consisting of the investment teams' 4% each, and non-related well-funded entities, continues to assist in reducing corporate and personnel risk. In addition, Castle Point has had strong funds under management (FUM) growth since the initial review in November 2016. This has allowed the Manager to embark on a deliberate plan to enhance its operations, bringing in greater independence and removing some operational and compliance aspects from the investment team. FundSource views this positively as it improves the Manager's long-term sustainability.

While this Fund has no track record directly, this Fund continues on from a wholesale strategy that has a track record of over four years. While there is

some historical data, how this retail Fund reacts, and the Manager adjusts the portfolio, proactively or reactively, continues to develop. Being a new fund offering the Fund's FUM is negligible, which can represent a risk the early investors. The Fund is free of capacity issues and can readily implement its investment process.

FundSource observes the investment team has strong industry experience. The interests of the investment team are aligned to those of the investor via their shareholding, and their investment in companies that will be represented in this Fund. The degree of alignment is not as strong as it is with the Ranger and Five Oceans funds.

The Manager's basic fee is below the peer average in the FE Analytics NZMI Equity Australasian sector. FundSource notes the Fund's fee is capped, which is a strong positive.

FundSource recommends that investors carefully consider the Managers approach to security selection and ability to use a range of derivatives, matches with their risk profile, investment needs, and objectives.

### FundSource Rating: **AA**

Fund ratings are current as at the date of publication of this report. FundSource reserve the right to review and update fund ratings from time to time.

## Research Factor Weighting

Research Process Category	Model Factor Weight	Analyst Average Score
Corporate & Investment Governance	15%	4.00 / 5
Investment Philosophy & Process	20%	3.60 / 5
People	25%	4.00 / 5
Portfolio Construction & Implementation	15%	3.33 / 5
Risk Management	15%	3.40 / 5
Investment Fees	10%	3.57 / 5

Overall Average Score: **3.69 / 5**

## FundSource Rating Guide

### AAA: Highly Recommended

Funds which have excellent managers, stable senior personnel, a sound track record over a full market cycle, a clearly defined investment philosophy, and a portfolio consistent with that philosophy. The management company will also have established effective control procedures to maintain that philosophy.

### AA: Recommended

Funds will have first class, experienced managers, and a sound track record and reasonable stability of senior personnel where the management philosophy must be coherent and consistent with existing portfolios.

### A: Investment Grade

This category of funds covers most of the reasonably experienced, competent managers, but often with less stability of personnel than the higher rating trusts.

### FW: Fund Watch

There has been a material change with either the manager, this may include, but is not limited to departures, new hires, process changes, changes to the investment philosophy. This is considered to be an interim measure, to enable further investigation, re-evaluation and an appropriate course of action to be determined.

### S: Sell

This category covers previously recommended funds that are no longer recommended because of some material change. Removal from recommended status might be for a variety of reasons such as a fundamental change in the fund management company or in the manager's investment strategy, or because a fund did not meet its original expectations. The implications for ongoing service are that the fund should be reviewed on an individual client basis to ensure it still matches their original investment objective.

### NR: Not Rated – Screened/ Not Rated

Funds in the Not Rated – Screened category have provided information and/or FundSource has conducted an initial analysis of the fund, but has chosen not to provide a recommendation at this stage. FOR Not Rated funds the manager may have provided information, but no review meeting has been conducted

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Client focused outcomes are underpinned by the belief that the role of business model innovation and accelerating technological change opens up new possibilities, to put client interests at the centre of the financial services industry focus. This is based on John Hagel's work on the possibilities for "Disruption by Trusted Advisors" and John Kay's "Other People's Money: Masters of the Universe or Servants of the People".



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