

# A smarter way to index

Realindex Funds combine the proven benefits of index investing with the potential for superior performance.

## Realindex Investments

Realindex Investments is an investment management subsidiary of Colonial First State, managing approximately A\$2.5 billion in assets as at 31 December 2010.

Realindex uses the Fundamental Index™ methodology in the construction of its portfolios. Realindex currently manages five underlying funds:

- Realindex Australian Share – Class A
- Realindex Australian Small Companies – Class A
- Realindex Emerging Markets – Class A
- Realindex Global Share – Class A
- Realindex Global Share Hedged – Class A.

## Why invest in Realindex Funds?

### 1 Capture the benefits of index investing

Realindex Funds differ to traditional index funds, but aim to preserve the essential benefits of index investing:

**Competitive pricing** – generally lower ongoing management costs for investors relative to actively managed funds.

**Lower turnover** – may reduce the realisation of capital gains and mean a higher proportion of any capital gains attract a CGT discount.

**Broad exposure to the market** – diversification across the market.

**Less constrained by capacity** – lower turnover and broad exposure means the Funds can be managed with larger funds under management.

### 2 A smart way to index

Realindex Funds are based on the Fundamental Index™ methodology which aims to overcome the shortcomings of traditional market capitalisation indexes.

Realindex Funds select and weight companies according to their economic footprint defined by fundamental measures of company size such as sales, cash flows, book value and dividends.

As they are based on a company's economic footprint, Realindex Funds are not reliant on price and not as vulnerable to market noise. Therefore by adopting this methodology, the funds aim to produce superior long-term performance, eliminating the potential return drag of traditional cap weighted portfolios.

### 3 Academic rigour

Realindex uses the Fundamental Index™ methodology in the construction of its portfolios, which is the result of rigorous research from some of the most respected names in modern investment research.

The underlying methodology was developed by Research Affiliates whose Founder and Chairman Rob Arnott is renowned as a thought leader in investment research.

Research Affiliates' panel of advisers includes luminaries in the fields of finance and investment management such as Harry Markowitz, Nobel Prize winner and father of modern portfolio theory, Jack Treynor and Burton Malkiel, author of one of the most respected books on investing *A Random Walk Down Wall Street*.

### Using the Realindex Funds – Class A

The Realindex Funds aim to outperform traditional market capitalisation weighted index funds over the long term (5–7 years). They aim to do this while maintaining the key benefits of index funds being lower cost, broad market exposure and lower turnover. For all these reasons they can be used to either replace or complement/diversify traditional index funds and/or active funds as a core part of a client's portfolio.

## Fundamental Index™ funds – the next generation of index funds

Fundamental Index™ funds incorporate the benefits of traditional index funds while minimising their inherent flaws.

Traditional index funds generally track market capitalisation weighted (cap weighted) indexes, such as the MSCI World Index. In these indexes, price determines a company's weight in the index. Price is the market's estimation of a company's value. It is often largely attributable to the market's forecast of a company's future earnings.

The problem with the market capitalisation methodology is that markets often irrationally react to speculative 'noise' as it is extremely difficult to forecast future earnings many years ahead. There are many examples throughout history of price bubbles caused by irrational exuberance, such as the technology bubble leading up to 2000. There are equally as many examples of markets excessively selling companies.

Traditional index funds participate fully in these market bubbles or distortions – and the inevitable correction as share prices return to their intrinsic value. This problem is further compounded as, by definition, cap weighted funds overweight overvalued companies and underweight undervalued companies.

The Fundamental Index™ methodology, on the other hand, selects and weights companies according to their economic footprint defined by fundamental measures of company size – sales, cash flows, book value and dividends. This is further enhanced by applying additional factors such as quality of earnings and debt coverage.

As they are based on a company's economic footprint, Fundamental Index™ funds are not reliant on price and not as vulnerable to market noise and the potential performance drag this may cause. Realindex Funds use the enhanced Fundamental Index™ methodology with the aim of producing superior long term performance while at the same time preserving the benefits of index funds (outlined on the previous page).

Globally over US\$45 billion in assets are managed using the Fundamental Index™ methodology (as at 31 December 2010).

### Fact box

#### Realindex Funds – Class A

Fund	Management cost	Benchmark	Representative universe
Realindex Australian Shares – Class A	0.46%	S&P/ASX 200 Accumulation Index	Australian listed companies
Realindex Australian Small Companies – Class A	0.66%	S&P/ASX Small Ordinaries Accumulation Index	Australian listed companies outside the top 100 companies by fundamental measures
Realindex Emerging Markets – Class A	0.79%*	MSCI Global Emerging Markets Index	Emerging market companies
Realindex Global Shares – Class A	0.58%	MSCI All Countries World ex Australia Net Index	Global listed companies
Realindex Global Shares Hedged – Class A	0.58%	MSCI All Countries World ex Australia Net Index AUD Hedged	Global listed companies currency hedged

#### Platform availability

- Asgard
- BT wrap
- FirstChoice
- FirstWrap
- Macquarie Wrap
- Oasis
- IOOF

#### Want more information?

To find out more about the Realindex Funds – Class A, please contact your local Business Development Manager or visit our website at [realindexinvestments.com.au](http://realindexinvestments.com.au).

\*Estimated management cost as fund has not been in existence for 12 months.

Fundamental Index is a trademark of Research Affiliates, LLC and is used with permission. Patent pending: WO 2005/076812, WO 2007/078399, WO 2008/118372.

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