

Zenith fund research methodology

The below summarises Zenith's proprietary fund research methodology and process. We follow a structured ratings process that involves assessment of the following quantitative and qualitative factors.

* Please note we do not disclose the weightings of factors and sub-factors change for each sector and this should be used as a guide.

** Please note that factors for Investment Process and Portfolio Construction can change according to specialist sector being assessed.

1. Investment process

1.1. Overview

Zenith offers its clients access to the investment managers we identify as the 'best of breed' through a comprehensive, multi-dimensional selection process. The selection process is rigorous in both its qualitative and quantitative analysis and each component is equally weighted.

As a dedicated provider of managed funds research, Zenith is completely objective in its selection process. Zenith does not manage any proprietary assets and as such is able to choose investment managers with absolute independence.

Our philosophy and commitment is simple. By exploring the investment landscape in a diligent and detailed fashion, Zenith is able to uncover the best opportunities on behalf of our clients.

1.2. Screening process

An effective screening process is critically important to the overall research method. It ensures greater efficiency by directing the research team to concentrate their efforts on funds with superior qualitative and quantitative parameters.

The process begins by dividing the universe into the following broad asset class categories:

| Alternatives | Australian shares | International shares | Multi-asset | Property | Australian fixed interest |
|-----------------|-------------------|----------------------|-----------------|-----------------------|---------------------------|
| Debt strategies | Absolute return | Asian long short | Balanced | Australian securities | Bonds |
| Exchange traded | All cap | Country funds | Exchange traded | Diversified | Corporate debt |



| | | | | | |
|--|--|--|--|---------------------------------------|--|
| products - ETP | | | products - ETPs | | |
| Global macro/absolute strategies | Equity income | Emerging markets | Growth | Exchange traded products - ETPs | Exchange traded products - ETPs |
| Investment bonds | Exchange traded products - ETPs | Exchange traded products - ETPs | High growth | Global securities | Listed investment entities – LICs/LITs |
| Listed investment entities - LICs/LITs | Geared | Global (hedged) | Income | Listed investment entities- LICs/LITs | Short-term credit |
| Managed futures | Industrials | Global (unhedged) | Lifestage super | Specialist | Specialist |
| Market neutral | Large companies | Global long short | Listed investment entities – LICs/LITs | | |
| Multi strategy | Listed investment entities – LICs/LITs | Listed commodities | Moderate | | |
| Other | Long short | Listed infrastructure | Real return | | |
| Private equity | Micro cap companies | Listed investment entities – LICs/LITs | Specialist | | |
| | Mid cap companies | Regional – Asia ex-Japan | | | |
| | Small companies | Small companies | | | |
| | Specialist | Specialist | | | |
| | | Specialist – long short | | | |



| Cash | International fixed interest | Mortgages | Real assets | Retirement products |
|---------------------------------|--|--------------|-------------------------|---------------------|
| CMT | Bonds | Conservative | Hybrid funds | Fixed term annuity |
| Exchange-traded products - ETPs | Corporate debt | High yield | Infrastructure | Lifetime annuity |
| | Diversified | | Other | Other |
| | Exchange traded products – ETPs | | Real estate – Australia | Protection products |
| | High income | | Real estate - global | |
| | Listed investment entities – LICs/LITs | | | |
| | Unconstrained | | | |

Zenith considers all Australian registered managed funds and a limited number of unregistered products. To avoid entering multiple funds for each investment manager, where appropriate, a flagship fund is used as a proxy for the manager's capabilities in that asset class.

We generate fund data surveys from our extensive database. We begin with the broadest universe to avoid any selection bias at this early stage. Data is collected directly from the investment managers. The collection of in-house propriety data is rare within research houses, however Zenith considers this to be an important source of value add. This method has uncovered many opportunities prior to their coverage on commercial databases. In addition, there is a growing band of investment managers who are looking to limit growth in funds under management to remain within their target capacity limits. As a result, they are not represented on commercial databases. The early identification of quality fund managers is one of our key competitive advantages.

As the number of managed fund products offered to the Australian retail investor continues to expand, we will see offerings from the largest fund managers complemented by the growing band of smaller boutique players. Zenith believes that research groups with the necessary systems and contacts in place to act quickly will be best positioned to offer their clients access to an ever-expanding world of opportunities.

1.3. Quantitative screen

From its database, Zenith selects a list of leading contenders who pass the initial performance and risk screens. These quantitative screens include:

- Absolute return (total, income & capital gains)
- Information ratio



- Sharpe ratio
- Sortino ratio
- Consistency of Outperformance ratios (total, rising & falling markets)
- Beta
- Alpha
- Number of negative performance months
- Maximum drawdown
- Tracking Error
- Standard Deviation
- R-squared
- t statistic

All quantitative measures are examined over rolling three-year, five-year and annualised periods.

Zenith has undertaken a detailed study into the appropriateness of differently weighted time periods and believes a three-year period is generally the most appropriate minimum period. Whilst other timeframes are considered as part of the analysis, beyond this period investment team composition may be highly variable. Furthermore, annualised data may be inconsistent given its short term, possibly cyclical orientation.

1.4. Qualitative screen

Whilst the first stage of the investment process tends to focus on the manager's risk adjusted and absolute performance, the second stage incorporates an important qualitative overlay. The initial quantitative filter may identify a strongly performing manager who subsequently fails the qualitative filter given Zenith's view on the team, organisation or process. Conversely, the quantitative filter may look less attractive if the current market conditions do not suit the manager's investment style.

The use of a rolling 3-year timeframe as the benchmark review period aims to smooth out style biases which can often lead to distortions.

If the Zenith team do not have prior knowledge of the credentials of investment personnel but the manager looks attractive on the quantitative filter it will source a view from its network of industry contacts. If negative commentary does not arise, we undertake a preliminary meeting to determine the appropriateness of this manager's representation on the list.

1.5. Detailed due diligence

After a short list has been constructed, detailed due diligence is undertaken with the investment manager. At this stage we thoroughly examine every aspect of the manager, from the overall philosophy and process to the people behind it. This level of due diligence is only achieved through detailed face-to-face meetings, a thorough review of all documentation, including the



standard questionnaire, and an in-depth look at the portfolio's construction. Note that reviewed documentation does not include any assessment of advertising or promotional materials to any groups or individuals outside the Zenith Research team.

The face-to-face meeting with the investment manager is regarded as a critical component. Our process extends beyond meeting with the Head of the Asset Class; other members of the investment team, regardless of seniority, are interviewed. This promotes forthright discussions and ensures there is consistent approach within the entire team. This aspect of the interview process is an important element as it provides us with a better understanding of team dynamics, the spread of responsibility, succession planning, team depth and key personnel risk issues.

During the course of the review process an assessment is undertaken on three key attributes: organisation, philosophy & process, and personnel. This section of the review is qualitatively driven.

1.6. Responsible Investment (RI) classification

Our RI classification involves an assessment of three broad indicators:

- Does an investment strategy take into account RI and if so, to what extent is this embedded in the investment process?
- Are fund managers acting as active owners of securities?
- What is the extent to which formalised policies and procedures govern the integration of RI issues for the Fund?

To generate these outcomes, we rely on information derived during manager meetings as part of our due diligence process as well as the provision of formal documentation from managers (does not include assessment of advertising and promotional material). We may also use external information from sources such as Principles for Responsible Investment (PRI). Classifications reflect an absolute view, not a peer-relative assessment.

Products which hold a current Zenith investment grade rating (refer to Section 3) are also assigned an RI classification using our proprietary system. Funds which have not previously been rated will be assessed by the research team and assigned an RI classification on initiation of coverage. [View](#) more detailed information about our RI classifications.

How can the classification be used?

The RI classification has been added as a filter to our online tool, Zenith Mosaic. This allows users to search for funds not only on aspects such as asset classes, styles and ratings, but also on which RI category a user might prefer.

1.7. Organisation assessment

Key points we consider include:

- Ownership structure – global alliance, overseas parent, joint venture, staff equity ownership (particularly relevant for boutiques)



- Organisational structure – whether the business is solely focused on asset management or operates in broking, investment/retail banking or financial planning
- Management team structure – board composition, reporting lines (domestic, regional and/or global basis)
- Executive team analysis – CEO, CIO, Board of Directors, Asset Allocation Committee
- Organisational history – timeline of major events (acquisitions, restructures etc)
- Funds under management – total, split by wholesale, retail & asset class, history of gross inflows/outflows and decomposition of mandate and client type;
- Remuneration & contractual structure
- Administration - back office capabilities, client reporting, and
- Communication – access to portfolio managers, sales/distribution staff.

At the organisational level, we're looking for clean reporting lines, a commitment to the domestic business, an experienced & well credentialed executive team, diversified sources of funds under management, effective administration and strong communication.

1.8. Investment philosophy & process assessment

We examine the following points:

- What is the manager's underlying investment philosophy?
- How does this philosophy seek to exploit inefficiencies in the market and is it aligned with the investment process?
- Has the manager's philosophy changed over time?
- Does this philosophy differ at various stages of the business cycle and/or between sectors?
- Is the majority of the research internally or externally organised?
- What is the frequency of formal and informal meetings amongst the investment team?
- How is the universe of securities filtered to arrive at an investable universe?
- What information sources/data feeds are used?
- Is a standard template used for building stock models or is this left to analyst discretion?
- What is the level of reliance/importance placed on qualitative (Porter style analysis) and quantitative (valuation model) analysis?
- Is the qualitative assessment formally ranked or scored?
- Are analysts required to assign levels of conviction to recommendations? (i.e. target price, quantitative score or suggested over/under weight position)
- Does the process make use of model portfolios?
- What is the investment processes sell discipline?
- What is an indicative level of turnover per annum within the product?



- How concentrated is the portfolio?
- How are the portfolio stocks weights decided, portfolio manager discretion versus matrix approach?
- Is there a minimum stock weighting on entry into a portfolio?
- At what FUM size would the manager consider closing the fund or portfolio due to capacity constraints?
- Has the investment process or style changed as FUM has increased?
- How does the manager define risk?
- How is portfolio risk managed?
- Is Tracking Error actively monitored and is this formally constrained?
- Who is responsible for risk management and what is the process?

On the philosophy and process front, we're looking for a fundamentally sound investment philosophy, a consistent and discipline investment approach, transparent portfolio construction and robust risk management.

1.9. Investment personnel

- Does the investment team have sufficient resources to implement its stated investment process?
- What is the depth of experience and track record of the investment team?
- How are responsibilities split (stock, sector, mandate/portfolios, committee involvement etc) within the team?
- How many stocks does each analyst cover?
- Do portfolio managers also have stock responsibility?
- Is a succession plan in place and do any key personnel risk issues exist?
- Recent personnel changes and the reasons why?
- What is the frequency and nature of formal and informal meetings within the investment team?
- How are personnel remunerated?

On the personnel front, we're looking for a well-resourced, highly credentialed investment team with a solid track record of value add. A spread of responsibility within the team should limit key person risk, whilst an appropriate remuneration structure should incentivise all members of the team.

1.10. Quantitative portfolio attribution

In addition to the qualitative assessment undertaken as part of detailed due diligence, a more in-depth analysis is performed on portfolio attribution.



Whilst the quantitative data gathered from the initial filter process is re-examined in the detailed due diligence phase, it is the testing of the manager's portfolio which drives this part of the process.

Key information sought by Zenith to undertake this task may include:

- Full portfolio listing with accompanying benchmark weighting
- Top ten active positions
- Top ten absolute positions
- Portfolio sector exposure relative to index
- Monthly portfolio turnover data
- Listing of stocks added/deleted on a monthly basis, or
- Monthly attribution analysis dissecting portfolio performance and risk, highlighting the key contributors to both.

This data is supplied on a monthly basis and is electronically delivered to us to allow for ease of data implementation into internal database systems.

The data gathered from this quantitative review is then compared with responses from the qualitative interview process with managers on process and philosophy. During this process we are looking for consistent responses. For example, does the portfolio trading data match the manager's response to a query on an indicative level of portfolio turnover?

Important trends and themes we look for in the quantitative analysis include:

- Can the manager successfully pick winners as well as avoid the 'blow-ups'?
- Has the manager added value across all market sectors or does a sectoral trend exist, allowing for style biases?
- Has any style drift occurred over time?
- Does the manager's style favour a certain market condition? i.e. cyclical recovery?
- Has the manager been successful at timing entry and exit points on stocks/securities along with identifying undervalued opportunities?
- Does the manager need to turn the portfolio over regularly to add value?
- Does the manager hold positions which may be difficult to exit, due either to the size of the position and/or liquidity of the security?

1.11. Summary

Zenith's key competitive advantage is that we recommend only the best investment products for our clients. Initially we apply both qualitative and quantitative screens to identify funds worthy of further consideration. Detailed due diligence is undertaken on the resulting short list. This involves a highly comprehensive review process which encompasses an assessment of key criteria including the organisation's structure, the investment philosophy and process, the calibre of the



investment personnel and an in-depth portfolio attribution analysis. The best funds are added to the 'Recommended List', a list of our highest conviction products.

2. Ongoing manager evaluation

Zenith prides itself on the regularity and depth of its continual vigilance over investment managers. This extends from those managers already represented within the product and/or service to those on the 'radar screen' for possible inclusion. Whilst the same process is used in the monitoring of managers to that adopted in the initial evaluation, it often 'drills down' to specific issues that may have been identified during the month, quarter or yearly period of review.

In addition, should there be a personnel departure and/or a significant process change, Zenith will meet immediately with the manager to evaluate the impact of the change and recommend a course of action to the Investment Committee.

Below we have detailed the specific data reviewed.

Monthly

- Monthly Performance Update - all underlying managers in the database & Zenith products versus their peers
- Manager Fund Flow Information – detailing any significant wholesale mandates lost and FUM pool totals for each underlying manager & Zenith products
- Update database – flows through to the quantitative component of the investment process

Quarterly

- Monthly Data as above
- Quarterly questionnaire – detailing stock/security portfolio holdings, attribution analysis and formally confirming any compliance breaches and/or investment personnel/process changes
- Manager update, via teleconference or video-conference. Zenith will speak directly with each portfolio manager to ensure an open dialogue. This update can either be general in nature or address specific issues at hand
- Screening update – identifies any new managers worthy of further due diligence and any existing manager who now fails the initial screen
- Adjust/amend manager asset allocation weights in the diversified funds/portfolios

Annually

- Monthly & Quarterly Data as above
- Due diligence update – review existing managers and any new managers deemed worthy of addition
- Update database - flows through to the qualitative component of the investment process
- Review strategic asset allocations for diversified funds/portfolios



3. Fund ratings

Zenith undertakes thorough screening of each asset class to identify quality managed investment opportunities.

This is followed by an extensive due diligence process, where funds are assigned a rating. This rating is based on Zenith's proprietary scoring system.

The quantitative assessment is flexible in that we do not rely on a performance history of three years to positively rate a fund and may use the history of an investment manager at a previous organisation if required (eg. in the assessment of Orion Asset Management we assessed the performance history of Tim Ryan at Credit Suisse).

Each fund is assigned an overall score/rating:

| Rating | Score |
|--------------------|-----------|
| Highly Recommended | = / > 80% |
| Recommended | 70 - 79% |
| Approved | 55 - 69% |
| Not Approved | < 55% |

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