

Separately Managed Accounts (SMAs)

What are Separately Managed Accounts

Separately Managed Accounts, or SMAs, are a relatively new alternative to investing in direct shares or managed funds. Like a managed fund, an SMA is a portfolio of shares (or other investments) that is managed by a professional fund manager. The key difference however, is that an SMA is not a pooled trust that is sold in units. Instead, the investor has beneficial ownership of an individual portfolio of shares that have been purchased on their behalf.

The investments held in an SMA are determined by the model portfolio(s) that the investor chooses. These model portfolios are offered by various funds management companies and tend to hold up to 30 stocks. The investor can choose just one model portfolio or blend several managers, depending on their investment objectives.

The structure of SMAs confers many benefits to the investor, including beneficial ownership of the shares, the ability to view all investments in their portfolio at any time, favourable capital gains tax outcomes, cost effectiveness and transferability of share holdings between model portfolios. These advantages are explored in more detail below.

Why have SMAs evolved?

SMAs have evolved to take advantage of the changing demands of small investors, in particular the desire to own shares directly and the trend towards self managed super funds (SMSF) where the average trustee invests more than half of their portfolio in direct shares. SMAs are attractive to these investors as they offer:

- more control over investments;
- greater portfolio transparency;
- flexibility of investments;
- diversification that meets trustee objectives; and
- professionally managed portfolios.

SMAs also have the advantage of being in line with the recommendations of the Ripoll Report on financial advice reforms. They fit neatly with the “fee for service” model of adviser remuneration and they offer investors and advisers a low cost portfolio solution. In effect, they are a retail product that is available for a wholesale price.

The benefits of SMAs

Beneficial ownership

An SMA investor retains beneficial ownership of, and absolute

entitlement to, the shares held in their portfolio. This means they directly receive the dividends and imputation tax credits (franking credits) associated with these investments. This is tax effective for the investor.

Transparency

SMA investors can see exactly what shares they hold by looking at their statements or logging into their online account. This differs markedly to a managed fund where it can be hard to get accurate information on the underlying share holdings as portfolio listings tend to be abbreviated (e.g. top 10 stocks only) or months out of date.

Capital gains

Most managed funds have unrealised capital gains on their books at the time that you invest. When these capital gains are eventually realised, they are distributed to all current unit holders regardless of when they joined the fund. This means that buying into a managed fund can result in an investor “inheriting”, and ultimately paying tax on, a portion of the capital gains that were accumulated before they joined the fund. This does not occur with an SMA as the cost base of the portfolio is determined on the day that the shares are purchased by the investor’s SMA. This means the investor only pays tax on capital gains accumulated from the day they invested in the shares, not the date that the pooled fund originally purchased the shares.

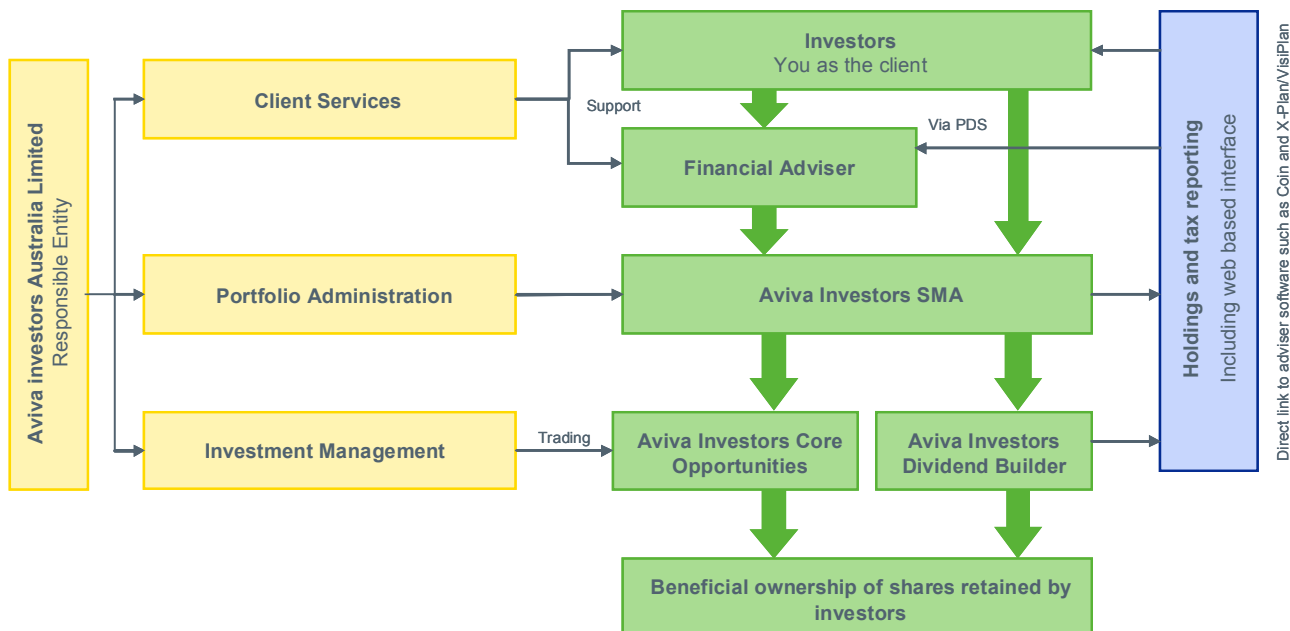
SMA investors can also minimise their capital gains tax liability when switching between model portfolios. This occurs because the SMA investor does not need to liquidate one portfolio before investing in another. Instead, the SMA can hold onto any shares that are common between the two model portfolios (trading to adjust position sizes if necessary) and just transact in the shares that are different.

Cost effective

Brokerage costs can be significantly cheaper with an SMA compared to direct shares as the SMA manager can net off your share purchases and sales with other SMA investors. This consolidation of trades saves on brokerage and other costs which can be spread over a number of investors. SMA management fees also tend to be cheaper than a comparable managed fund as an SMA does not incur the same administrative costs as a managed fund.

Transferability

If you have a direct share portfolio, you can “in specie” transfer shares into a new SMA. This minimises your capital gains tax liability, as you do not have to liquidate your direct share portfolio and then purchase the shares again for the SMA. It also prevents you from spending time “out of the market”.



Timing of income

Managed funds usually distribute on a quarterly basis and the amount paid to unit holders is a combination of the dividends and realised capital gains that have accumulated during this 3-month period. By contrast, an SMA investor receives dividend income on the day that it is earned and capital gains as soon as they are realised. This makes it easier to see which shares are providing an income return and enables the investor to reinvest or redeploy this money as soon as it is earned.

Diversification

SMA model portfolios are a good way to ensure that your share exposure is well diversified. Most model portfolios can hold up to 30 shares, covering different sectors and industries across the market. You can also diversify your exposure to investment managers by investing in more than one model portfolio. Diversification lowers the risk of your portfolio as a stock that is performing poorly can be offset by other stocks that are performing well and you are not reliant on the performance of just a couple of companies.

Professional investment management

SMA's give an investor the advantages of direct share investment (beneficial ownership, transparency, not inheriting capital gains) but with the added benefit of their portfolio being managed by professional fund managers. Investment professionals are experts in their field and have access to a wide range of resources that help them analyse developments in financial markets and at the individual company level. They also manage all corporate actions, making share investment less complicated.

Advisers and direct share recommendations

Most advisers are not permitted to give direct share advice to SMSFs and many are also reluctant to give direct share recommendations to other investors as it requires them to do a statement of advice for every trade. With an SMA, the responsibility for choosing the shares rests with the investment manager. So advisers are able to offer investors all the benefits of direct share investment without the compliance issues. SMA's are a registered MIS, hence advisers are licenced to recommend them to clients.

Aviva Investors Direct SMA

The Aviva Investors Direct SMA is unique in the market place as it does not run on a platform. Instead, the adviser deals directly with Aviva Investors and this has significant advantages, including:

- access to institutional placements;
- wholesale brokerage rates which are much cheaper than retail rates;
- no platform administration requirements; and
- direct reporting to the client via access to an online account.

By avoiding the platform model, Aviva Investors has developed a relatively low cost SMA offering. Management fees are between 46bp and 51bp, depending on the model portfolio chosen, and there are no administration fees.

Initially, there will be two model portfolios on offer – Core Opportunities which is a growth portfolio and Dividend Builder which is an income focussed portfolio. The main characteristics of these model portfolios are shown in the table below.

Model Portfolio	Key Characteristics
Core Opportunities	<ul style="list-style-type: none"> • Concentrated – 15 to 25 stocks • High conviction • Large cap focus
Dividend Builder	<ul style="list-style-type: none"> • Low turnover • Tax aware • High yielding stock focus

From a reporting perspective, clients will have online access to portfolio valuations, a history of all their transactions, tax statements (including a financial year-end tax summary) and statements detailing realised and unrealised capital gains and losses. The Aviva Investors Direct SMA is also compatible with the most popular adviser software packages, including XPLAN, Visi-Plan, Coin and BGL.

For more information on the Aviva Investors Direct SMA offering, please call your Client Services Representative.

Below are short commentaries on each Aviva Investors fund, outlining their gross performance and the main contributors to performance.[#]

Australian Equities Fund - The fund returned 5.1% for the December quarter, outperforming the benchmark S&P/ASX 200 Accumulation Index return of 4.4% by 0.7%. The main contributors to performance for the portfolio over the quarter were an underweight position in Woolworths and an overweight position in Brambles. Being overweight in CSR and National Australia Bank detracted from performance.

Australian Resources Fund - The fund delivered a return of 13.4% for the quarter, outperforming the benchmark S&P/ASX 300 Resources Accumulation Index of 13.3% by 0.1%. Positively contributing to performance during the quarter were overweight positions in Riversdale Mining and Iluka Resources. Main detractors from performance were not owning in Lynas Corporation and Sundance Resources.

Dividend Builder - The fund delivered a return of -0.2% for the quarter, underperforming the benchmark S&P/ASX 200 Industrials Accumulation Index of 0.7% by 0.9%. An underweight position in ASX and an overweight position in Tatts Group positively contributed to performance. Not owning CSL and being overweight in CSR detracted from performance.

Elite Opportunities Fund - The fund returned 7.4% for the quarter, outperforming the benchmark S&P/ASX 200 Accumulation Index return of 4.4% by 3.0%. The main contributors to performance for the portfolio were not owning Woolworths and an overweight position Alumina. Main detractors from performance over the quarter were overweight positions in National Australia Bank and Asciano.

High Growth Shares Fund - The fund returned 7.1% for the quarter, outperforming the benchmark S&P/ASX 200 Accumulation Index of 4.4% by 2.7%. Contributing to performance during the December quarter were overweight positions in Alumina and AXA Asia Pacific Holdings. Main detractors from performance were an overweight position in OneSteel and an underweight position in BHP Billiton.

Long/Short Equity Fund - The fund delivered a return of 6.3% for the quarter, outperforming the combined benchmark S&P/ASX 200 Accumulation Index (75%) and UBS Bank Bill Index (25%) of 3.6% by 2.7%. Positively contributing to performance during the quarter were overweight positions in Alumina and AXA Asia Pacific Holdings. Detracting from performance was an underweight position in BHP Billiton and an overweight position in OneSteel.

Small Companies Fund - The fund delivered a return of 17.5% for the quarter, outperforming the benchmark S&P/ASX Small Ordinaries Accumulation Index of 11.2% by 6.3%. The main contributors to performance for the portfolio were overweight positions in Tower Australia Group and Mesoblast. Detracting from performance were overweight positions in Oakton and Hastie Group.

Sustainable Investment Fund - The fund returned 4.8% for the quarter, outperforming the benchmark S&P/ASX 200 Accumulation Index of 4.4% by 0.4%. The main contributors to performance for the portfolio during the December quarter were overweight positions in Brambles and BHP Billiton. Stocks detracting from performance were overweight positions in National Australia Bank and OneSteel.

Australian Shares Fund* - The fund delivered a return of 5.2% for the quarter, outperforming the benchmark S&P/ASX 200 Accumulation Index of 4.4% by 0.8%. The main contributors to performance for the portfolio over the quarter were an underweight position in Woolworths and an overweight position in Brambles. Overweight positions in CSR and National Australia Bank detracted from performance.

Listed Property Fund - The fund delivered a return of -0.3% for the quarter, outperforming the benchmark S&P/ASX 200 A-REIT Accumulation Index of -1.3% by 1.0%. Positively contributing to performance during the quarter were overweight positions in Charter Hall Office REIT and Lend Lease Group. Stocks detracting from performance were not owning ING Industrial Fund and an underweight position in Goodman Group.

Premier Fixed Income Fund - The fund underperformed its benchmark by -0.1% over the quarter. Positively contributing to performance were overweight positions in financials and subordinated insurance. Yield curve positioning in the Australian fixed income portfolio detracted from performance, as well as a long duration position in sovereign debt markets.

[#] All returns are gross of fees. Please refer to page 4 of the Quarterly Review for a summary of returns which are net of fees.

* Closed to new investments

¹ Benchmark is 75% UBS Australia Composite Bond Index and 25% Barclays Capital Global Aggregate Bond Index (hedged into A\$)

² Benchmark is UBS Australia Composite 0-5 Year Index

Aviva Investors Investment Returns

Performance to 31 December 2010

		3 mths %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	Since Inception % p.a.
Australian Equities						
Australian Equities Fund Inception date: 03/07/1995	Gross Return	5.1	4.1	-1.5	6.8	11.4
	Benchmark Return	4.4	1.6	-5.0	4.3	10.0
	Excess Return	0.7	2.5	3.5	2.5	1.4
	Net Return	4.9	3.2	-2.4	5.9	10.4
Australian Resources Fund Inception date: 03/03/2008	Gross Return	13.4	11.7	-	-	4.1
	Benchmark Return	13.3	12.3	-	-	2.0
	Excess Return	0.1	-0.6	-	-	2.1
	Net Return	13.1	10.6	-	-	2.9
Dividend Builder Inception date: 06/09/2005	Gross Return	-0.2	-0.2	-4.2	3.1	3.9
	Benchmark Return	0.7	-2.5	-7.5	1.4	2.6
	Excess Return	-0.9	2.3	3.3	1.7	1.3
	Net Return	-0.3	-0.8	-4.7	2.5	3.3
Elite Opportunities Fund Inception date: 18/11/2002	Gross Return	7.4	5.0	1.8	8.6	14.7
	Benchmark Return	4.4	1.6	-5.0	4.3	10.4
	Excess Return	3.0	3.4	6.8	4.3	4.3
	Net Return	7.3	4.3	1.0	7.8	13.8
High Growth Shares Fund Inception date: 07/12/1999	Gross Return	7.1	3.4	0.8	8.4	14.5
	Benchmark Return	4.4	1.6	-5.0	4.3	8.2
	Excess Return	2.7	1.8	5.8	4.1	6.3
	Net Return	6.8	2.3	-0.5	7.1	12.7
Long/Short Equity Fund Inception date:	Gross Return	6.3	4.5	3.8	10.1	14.7
	Benchmark Return	3.6	2.5	-2.2	5.9	10.6
	Excess Return	2.7	2.0	6.0	4.2	4.1
	Net Return	5.9	3.7	2.5	8.9	13.5
Small Companies Fund Inception date: 19/11/1999	Gross Return	17.5	17.8	2.9	14.3	14.4
	Benchmark Return	11.2	13.1	-5.9	5.5	7.1
	Excess Return	6.3	4.7	8.8	8.8	7.3
	Net Return	17.2	16.7	1.9	13.1	13.3
Sustainable Investment Fund Inception date: 16/02/2006	Gross Return	4.8	0.7	-1.4	-	5.4
	Benchmark Return	4.4	1.6	-5.2	-	4.1
	Excess Return	0.4	-0.9	3.8	-	1.3
	Net Return	4.5	-0.1	-2.2	-	4.5
Australian Shares Fund* Inception date: 25/01/2000	Gross Return	5.2	4.0	-1.4	6.8	9.9
	Benchmark Return	4.4	1.6	-5.0	4.3	8.4
	Excess Return	0.8	2.4	3.6	2.5	1.5
	Net Return	4.9	3.1	-2.2	5.9	8.9
Listed Property						
Listed Property Fund Inception date: 28/02/1994	Gross Return	-0.3	1.8	-17.0	-5.2	7.2
	Benchmark Return	-1.3	-0.4	-20.9	-9.5	5.5
	Excess Return	1.0	2.2	3.9	4.3	1.7
	Net Return	-0.5	1.0	-17.6	-5.8	6.4
Fixed Income						
Premier Fixed Income Fund Inception date: 31/05/2000	Gross Return	-0.4	7.1	7.6	6.2	6.9
	Benchmark Return	-0.3	6.8	7.9	6.3	6.7
	Excess Return	-0.1	0.3	-0.3	-0.1	0.2
	Net Return	-0.5	6.6	7.2	5.8	6.5

* Closed to new investments

Disclaimer: All net returns are based on exit to exit unit prices for Professional Selection units, are net of fees and assume the reinvestment of income. Past performance is not a guide to or indication of future performance. At Aviva Investors' discretion, the management and/or performance fee may be partly rebated to professional, sophisticated or wholesale investors. The above information is of a general nature and has been prepared without taking account of your individual investment objectives, financial situation or particular investment needs. It is not intended as financial advice to retail clients. Before making an investment decision, you should consider the appropriateness of the information, having regard to your objectives, financial situation and needs. We recommend you consult with your financial adviser, who can help you determine how best to achieve your financial goals and whether investing in a fund is appropriate for you. Investment in the Aviva Investors Investment Funds will only be made upon receipt of a completed application form from the current PDS, a copy of which can be obtained from Aviva Investors. Aviva Investors Australia Limited ABN 85 066 081 114. AFS Licence No 234483. Level 28 Freshwater Place, 2 Southbank Boulevard, Southbank VIC 3006 GPO Box 2007, Melbourne VIC 3001 Telephone: (03) 9220 0300 Facsimile: (03) 9220 0333 Email: investorservices.au@avivainvestors.com Website: www.avivainvestors.com.au Part of the international Aviva plc group.