# Information Sheet
# Investment Risks

This Information Sheet explains the investment risks that apply to funds held in Court. It also explains how Funds in Court (FIC) manages these risks.

Please note this document does not contain financial advice or any other type of advice. It only presents information.

We place client funds in Common Fund No. 2 (CF-2), and some clients also have funds in Common Fund No. 3 (CF-3).

You can read our 'Common Funds' Information Sheet to find out more about CF-2 and CF-3.

This is available on our website www.fundsincourt.vic.gov.au or you can call us on 1300 039 390 to get a printed copy mailed to you.

## General risks

These risks apply to funds invested in CF-2 and CF-3.

### Market risk

| Description of risk | How does FIC manage this risk? |
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| All investments include an element of market risk. Market risk relates to the market value of an investment or asset class being impacted by factors such as the stage of the economic cycle, changes in government policy and central bank policy.<br><br>When the market value falls it is possible to experience periods of negative returns, particularly in the short term. | • FIC invests in a mix of different asset classes (diversification) to reduce market risk. FIC implements a relatively conservative investment strategy and therefore the asset allocation consists mainly of defensive, income-producing assets, with a portion of the funds also invested in traditional growth assets.<br><br>• FIC adopts a long-term investment approach which aims to minimise the risk of permanent capital loss in the short term. |
| Different asset classes have varying degrees of market risk and return potential. Generally speaking, high-risk investments have the potential for the highest returns, whilst low-risk investments generate lower returns. This is known as the risk/return trade off and is applicable to all investments. | • FIC obtains specialist advice to assist in the setting of an appropriate long-term strategic asset allocation for clients. The strategic asset allocation is subject to ongoing review in order to meet the risk and return objectives of FIC.<br><br>• FIC also reviews the asset allocation of each client's account on a monthly basis to ensure consistency with the recommended strategic asset allocation and permitted tolerance range. |

# Fixed income risks

These risks apply to funds invested in CF-2.

## Interest rate risk

| Description of risk | How does FIC manage this risk? |
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| The capital value (or price) of a fixed-income security will rise or fall depending on economic conditions and movements in interest rates.<br><br>For example, when interest rates/bond yields rise, the capital value (or price) of the bond will fall. | • FIC obtains specialist fixed income advice in regard to the Fund's positioning and prior to the implementation of each individual investment (purchase or sale).<br><br>• The Fund's positioning is reviewed on an ongoing basis to ensure its appropriateness to prevailing conditions in the interest rate market and in order to meet the Fund's objectives.<br><br>• FIC primarily adopts a hold to maturity approach to investment in fixed-income securities. This approach is consistent with the conservative investment strategy of FIC and need to preserve capital. In some circumstances FIC will sell a security prior to maturity in order to realise a capital gain. There may also be times when it is required to realise a capital loss, for example, in order to reposition the portfolio due to changes in interest rates and market environment. |
| Longer-dated fixed-income securities are more sensitive to changes in interest rate risk compared to shorter-dated fixed income securities (also known as duration risk). | • The Fund is actively managed in regard to duration risk. There are also specific guidelines that stipulate the permitted duration range of the Fund compared to the relevant benchmark. |
| When interest rates fall the annual crediting rate of the Fund is likely to be lower compared to the previous year's crediting rate. This is mainly due to the lower rate of interest earned on 'at call' cash and other short-term investments in the Fund (including term deposits).<br><br>For example, maturing term deposits may need to be reinvested at lower rates of interest. | • Fund liquidity is managed daily. FIC aims to maintain a sufficient level of liquidity to meet orders for payment out, whilst any excess liquidity is invested in a mix of longer-term securities to enhance returns. FIC regularly reviews the interest rates on offer from the major Australian banks in the 'at call' and term deposit market.<br><br>• The Fund invests in a diversified range of fixed-income securities. Diversification |

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| | plays an important role in minimising the risk that one underperforming investment has on the rest of the portfolio. FIC's asset management policy establishes the permitted portfolio exposure ranges for each authorised investment. This assists in meeting the diversification requirements and the Fund's risk and return objectives. |

## Credit risk

| Description of risk | How does FIC manage this risk? |
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| The risk that an issuer of a fixed-income security is unable to meet their obligations to pay interest and principal when due (also known as default risk). | • The Fund invests only in Commonwealth and semi government securities, cash, term deposits and fixed-income securities issued by the major Australian banks, securities issued in Australia by foreign sovereigns/ supranationals, corporate securities with a minimum BBB credit rating, index linked securities, and other investments as authorised from time to time by the Senior Master.<br><br>In practice, this means that all investments in the Fund currently have a credit rating ranging between BBB to AAA by a major rating agency. AAA is the highest credit quality within the fixed-income asset class and therefore has the lowest risk of default.<br><br>In the event of a credit rating downgrade, FIC will review whether the particular security should continue to be held within the Fund. |
| Investments in securities with a low credit rating have a higher risk of default compared to a security with a higher credit rating. | • FIC seeks specialist fixed-income advice in regard to the credit rating and credit quality of securities prior to investing. |

## Liquidity risk

| Description of risk | How does FIC manage this risk? |
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| Fixed-interest securities are traded over the counter and therefore generally have less liquidity than exchange-traded investments such as listed bonds and shares. | • Fund liquidity is managed daily. The liquidity of an individual fixed-income security is also considered prior to investing. The Fund's authorised investments include some of the most highly liquid securities in the fixed-income |

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| | asset class.<br><br>• FIC regularly monitors the liquidity and market pricing of individual securities. |

## Australian shares risks

These risks apply to funds invested in CF-3.

### Equity market risk

| Description of risk | How does FIC manage this risk? |
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| The Australian share market is cyclical in nature, meaning that prices may rise and fall based upon domestic and global economic conditions. This means that it is possible to experience both positive and negative periods of performance as well as high volatility in returns. Investor sentiment may also impact on the performance of the share market. | • The Fund is actively managed relative to the benchmark. This approach differs to an index management style which aims to replicate the performance of the market. The active management approach means that there will be times when the Fund outperforms the market return and times when the Fund underperforms the market return.<br><br>• FIC takes a long-term investment time horizon when investing in this asset class in order to minimise the risk of permanent capital loss. This typically results in a buy-and-hold investment approach. |
| The Australian share market is a high-risk and high-return asset class, compared to the fixed-income and cash asset class. | • The equity asset class is specifically designed to meet the long-term capital growth requirements of certain clients and to provide some protection against the risk of inflation. FIC has established specific criteria to determine a client's suitability to invest in the Fund. Where it is determined that a client is eligible, only a portion of their total FIC assets is invested. The investment into CF-3 on behalf of clients is made over a period of 12 months in order to obtain a dollar cost average. Not all clients are invested in the Fund. |

## Company-specific risk

| Description of risk | How does FIC manage this risk? |
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| Factors that are specific to a company can have an impact on their share price and performance. Company-specific factors may include poor company management, the financial position of the company, increased competition within an industry, technological change within an industry, and changes in exchange rates for companies with international earnings. | • The Fund is actively managed relative to the benchmark. This means that the selection and weighting of shares in the Fund may differ to the composition of the benchmark, resulting in above or below market returns. This management approach differs to an index management style which aims to replicate the performance of the market.<br><br>• FIC seeks the input of experienced equity specialists in regard to the establishment of a 'model' portfolio. The 'model' portfolio is primarily determined by fundamental bottom-up stock selection. Top-down macroeconomic factors are also considered, although this is a secondary input into the construction of the 'model' portfolio.<br><br>• The Fund aims to be diversified by the number of holdings and by industry sector. There are also investment restrictions on the maximum permitted individual position size within the Fund. |

## Liquidity risk

| Description of risk | How does FIC manage this risk? |
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| The Australian share market consists of a diverse range of companies which vary in size and liquidity from large multi-divisional companies, to medium-sized (mid caps), small-sized, and 'start up' companies. Generally speaking, shares in large companies are more liquid than shares in small companies. Liquidity refers to the ability to transact on market in a timely manner and at a price that closely reflects the most recently traded market price. | • The Fund benchmark is the S&P/ASX 50 Leaders Accumulation Index. This index consists of the 50 largest and most liquid stocks in the Australian share market. Within this benchmark, the Fund primarily invests in the top 20 to 25 listed stocks and has scope to invest in companies within the S&P/ASX 100 Index. This segment of the market is considered to be more liquid than smaller-sized companies which fall outside of the S&P/ASX 100 Index. |