Want a 25% annual return? Take a deep breath…

by Paul Rickard

Key points

- *An ASX-quoted fund is similar to an Exchange Traded Fund (ETF), except its investments are actively managed. It trades on the same platform as ETFs and complies with the same ASX rule set.*
- *The K2 Global Equities Fund (KII) is the ASX-quoted version of the K2 Global Alpha Fund.*
- *The K2 Global Alpha Fund boasts of a total return (after fees) of almost 260% since inception in November 2009, compared to the index's total return of around 99% (the MSCI AC World in AUD).*

As the debate hots up between Listed Investment Companies (LICs) and ASX-quoted funds, K2 Asset Management is the latest to launch an ASX quoted fund, the K2 Global Equities Fund (ASX Code: KII). This follows the launch last month of Magellan's Global Equities Fund (ASX Code: MGE).

What is an ASX-quoted fund?

An ASX-quoted fund is just like an Exchange Traded Fund (ETF), except that unlike most ETFs, its investments are actively managed. It trades on the same platform as ETFs and complies with the same ASX rule set.

This means that there is a high level of transparency around the fund's investments and net asset value, and market makers have been appointed to provide liquidity to ensure that units can be bought or sold on the ASX at a price that is very close to the underlying net asset value.

ASX-quoted funds use the managed investment structure and have a responsible entity. On the other hand, LICs use a company structure.

Critically, this is a closed structure with a defined number of shares on issue, while ASX-quoted funds are open-ended funds. Effectively, the responsible entity offers for sale new units on the ASX via a market maker, while at the same time offering to buy existing units (at a slightly lower price) that will be redeemed if purchased. Because this involves the responsible entity taking on market making risk, ASX-quoted funds are best suited where the underlying fund's investments can be easily hedged, or where there is not a lot of price movement during Australian market trading hours (for example, a fund investing in international shares).

For investors, the advantages of investing in ASX-quoted funds compared to LICs include:

- Increased transparency around holdings and net asset values;
- Secondary market trading should be around the net asset value – no premium or discount;
- No listing discounts – placement fees (if any) to brokers are paid by the responsible entity (out of their pockets, not unit holders), while for LICs, these are paid by the company (i.e. shareholders' pockets).

Like LICs, investors can buy units in an ASX-quoted fund through any broker, and will receive a CHESS holding statement. There is no minimum investment size (outside the normal ASX requirement of the initial $500) or application form to complete.

K2 Asset Management

K2 is a global equity fund manager based in Melbourne. The holding company is listed on the ASX under stock code KAM, 80% owned by staff and related parties, and manages $852.2 million, which is invested in five funds. Since inception in September 1999, its track record as a manager is pretty impressive, as the following table attests to:

Performance 30 June 2015 Net of all fees	1 Year %	3 Year % p.a	5 Year % p.a	7 Year % p.a	10 Year % p.a	Since Inception % p.a
K2 Global Alpha Fund	31.9%	32.5%	27.4%	-	-	25.0%
K2 Asian Fund	34.9%	23.6%	11.7%	9.0%	10.4%	11.9%
K2 Select Int Fund	31.7%	20.9%	14.1%	10.4%	12.5%	12.4%
K2 Australian Fund	11.0%	16.3%	9.5%	9.3%	9.3%	12.6%
K2 Australian Small Cap Fund	13.5%	-	-	-	-	18.0%

K2 Global Equities Fund (KII)

KII is the ASX-quoted version of the K2 Global High Alpha Fund. Its objective is to deliver superior risk-adjusted returns through the investment cycle while protecting clients' capital.

It is an absolute return, variable beta global equities fund.

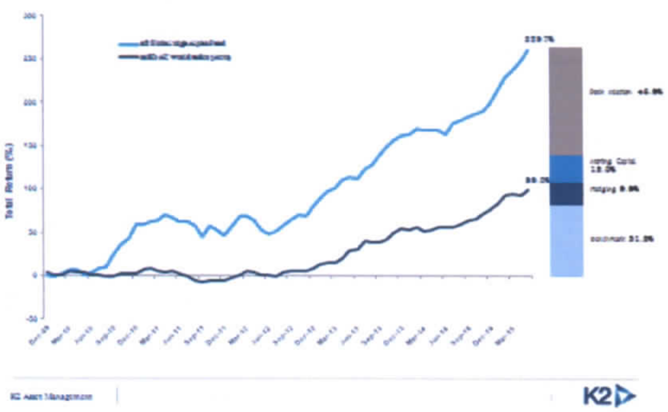
This means that the manager attempts to add value by:

- Variable beta – the fund actively adjusts its net equity exposure – potentially, it could be 100% invested in cash if the investment climate was unsuitable;
- Currency – this is a key driver of performance, so the manager attempts to position for the medium term trend; and
- Alpha – the manager is a bottom-up stock picker, identifying stocks that will benefit from structural change or other major themes or catalysts, and uses fundamental analysis to value the stock.

The manager is index or benchmark unaware, has no country or sector allocation, and allocates capital dynamically. Typically, the fund will hold 80 to 120 different stocks, but if deemed appropriate, could hold up to 100% cash. The fund can also buy long and sell short, and use derivatives in certain situations. However, it doesn't use gearing to generate returns.

The K2 Global Alpha Fund has around $57 million in funds. It boasts of the following performance record – a total return (after fees) of almost 260% since inception in November 2009 compared to the index's total return of around 99% (the MSCI AC World in AUD).

K2 Global High Alpha Fund Performance – Since Inception



The K2 Global Equities Fund will start with around $20 million in funds, and is due to list on the ASX on Monday 20 July. Initially, about 25% to 30% will be allocated to cash.

Fees

Fees on this fund are not cheap. Including GST, the total management fee is 2.70% pa – a 2.05% pa investment management fee, responsible entity fee of 0.06% pa and estimated expense recoveries of 0.59% pa. Further, the investment manager is entitled to charge a performance fee of 20.5% of the amount by which the net asset value per unit exceeds the 'high water mark'.

While admittedly the Magellan Global Fund has quite a different investment mandate, its base management fee is by contrast 1.35% pa, with a performance fee of 10% of any excess return.

Our view

It's very hard to argue with K2's track record, and we really like the style of ASX quoted funds. As in many things in life, you pay a premium for quality – so if you're interested, take a deep breath and consider K2 for a component of your offshore allocation.

Important: This content has been prepared without taking account of the objectives, financial situation or needs of any particular individual. It does not constitute formal advice. Consider the appropriateness of the information in regards to your circumstances.