

Fund Profile

An in-depth look at Russell Sector Funds

April 2012

Russell Australian Opportunities Fund

The Russell Australian Opportunities Fund provides investors with exposure to a diversified portfolio of Australian shares. A range of alternative and higher risk strategies are employed which are not normally available to many investors.

Fund design

The Russell Australian Opportunities Fund (the Fund) aims to provide investors with exposure to diversified portfolio of Australian shares. It seeks to significantly outperform its benchmark before costs and tax over the long term. To achieve these objectives, multiple managers and strategies are employed to reduce "scenario risk". These multiple strategies are in the form of multiple investment styles (eg. growth, value and style neutral). Managers within the Fund specialise in a diverse range of alternative and higher risk strategies and select products including active extension, small capitalisation, absolute return and concentrated portfolios not normally available to many investors.









Strategies

Strategies employed by managers in this Fund differ from more traditional Australian equities products. Currently they include strategies which fall into the following broad categories:

Concentrated: Concentrated portfolios have relatively large holdings of a small number of stocks. Holdings are typically concentrated in a manager's highest conviction ideas having the highest expected return, often with little or no regard for the benchmark's industry and stock weights. In the short term, concentrated strategies are at risk of significant short term underperformance,

Fund breakdown



Arnhem	
L1 Capital	
Allan Gray	
Paradise	
Perpetual	
Plato	
Quest	
Select Holdings	

"Multiple managers are employed within the fund, specialising in a diverse range of alternative and higher risk strategies."

Symon Parish

CHIEF INVESTMENT OFFICER,
AUSTRALASIA
RUSSELL INVESTMENTS

Quick Overview

Inception: May 2004

Benchmark: S&P/ASX 300 Accumulation Index

AUM: \$678 million (as at 31/3/2012)



Russell Australian Opportunities Fund

with underperformance of a single stock potentially having a large impact on portfolio performance. However, in the long term they are more likely to benefit from the exclusion of lower conviction stocks included in traditional portfolios as much for risk control as for their return expectations.

Benchmark independent: Benchmark Independent portfolios are constructed with little regard for benchmark weights. A traditional manager is often required to hold significant weights in the largest stocks, purely for purposes of risk control and regardless of return expectations for that industry or stock. Rather, stock weights in

step further, by borrowing and selling stocks they dislike in the expectation that they can buy stocks back to return to the lender at a lower price in the future (or using derivatives to achieve a similar outcome). This allows them to take more advantage of negative opinions than traditional managers, though introduces the risk of having to buy back at a higher price if in fact the stock goes up.

Small companies: Small companies strategies focus on listed companies with smaller market capitalisations, generally those outside the top 50 on the Australian Stock Exchange. Return expectations for smaller

Reducing risk through diversification

Individually, these strategies tend to have higher levels of risk and lower benchmark sensitivity than more traditional products. The Fund is designed to reduce risk through multiple layers of diversification:

Multi-style: Multi-style means each manager specialises in a different style, or strategy of investment. Styles and strategies are combined in an effort to reduce risk.

Multi-manager: Multi-manager means some of the world's leading investment managers are employed to manage a portion of the Fund. Selected by extensive research, they are managed and monitored on an ongoing basis.

At the total fund level, our goal is to reduce dependency on a particular economic scenario or market cycle by creating an aggregate portfolio of managers that provide opportunities to strongly outperform in most environments.

An important driver of success is to amplify those return sources we believe provide the most reliable means of alpha generation, while controlling risks we believe are uncompensated over the long term. In the case of Australian shares, we believe that stock selection provides the most reliable alpha and therefore emphasise this source of return. Stock selection is the key source of alpha for all managers in the Fund.

"The Fund is designed to reduce risk through multiple layers of diversification"

benchmark independent portfolios are often more or less equally weighted, or sometimes chosen to take into account the manager's confidence or return expectations, but are rarely held merely because they represent a large part of the benchmark. In the short term portfolios may significantly underperform the benchmark as there may be little or no exposure to the small number of stocks which dominate the benchmark return. However, in the long term they benefit from focusing on the stocks with higher return expectations without needing to hold a core of stocks for risk control.

Active extension: Active extension products differ from traditional products in their ability to "short" stocks. When traditional managers dislike a stock, they just don't buy it. An Active extension manager takes this a

companies can be much higher. Often significant value can be found in smaller companies relative to their large cap counterparts because levels of broker research and information access is much lower, or growth rates for a rapidly expanding business could be significantly higher than for larger companies which tend to have much more mature businesses.

However, risks are also higher for small companies, with companies often more reliant on the success or failure of just one or two products, and with corporate governance standard and information access in many cases arguably lower than larger corporations.

Russell Australian Opportunities Fund

The key source of risk diversification within the Fund is the use of multiple managers and multiple strategies, covering concentrated, benchmark independent, active extension and small companies strategies.

While the managers in the Fund generally have high tracking errors and lower benchmark awareness, the Fund is structured to broadly control for style bias, as well as provide broad capitalisation coverage.

No particular number of managers is targeted; the current number provides good strategy diversification and coverage of the market. Should other compelling managers be identified, we may further increase the number of managers.

The Fund invests predominantly in shares or unit trusts listed on the Australian Stock Exchange. Share price index futures are used to equitise cash holdings.

Due to the nature of this Fund, it is recommended for investors with a long investment time horizon and who are willing to accept significant volatility in returns.

Manager description and strategy

Arnhem Investment Management Growth: active extension

Arnhem's active extension investment style can be described as industry-centric relying on a deep focus on company and industry fundamentals. They seek to achieve this objective by taking both long and short positions in ASX-listed securities.

The investment style can be characterised as having a bias towards industries and companies with above-average, long-term growth

prospects, offset by under-weighting to industries and companies that have less sustainable growth prospects.

"An important driver of success is to amplify those return sources we believe provide the most reliable means of alpha generation, while controlling risks... over the long term."

Perpetual Investments

Value: quality (concentrated)

Perpetual's investment philosophy is a fundamental, conservative bottom-up approach to stock picking and active management, focusing on identifying quality companies that represent good value.

The process is based on comprehensive internal company research and portfolios are constructed by experienced portfolio managers within a pre-determined risk framework.

The research and analysis that Perpetual conduct is focused on identifying quality companies and assessing their valuation. The key criteria Perpetual target in analysing the quality of a company are: conservative debt, sound management, quality of business and recurring earnings. Perpetual then adopt a flexible approach to valuation, where analysts are encouraged to determine the most appropriate methodology for valuing a company.

Quest Asset Partners Growth: concentrated

Quest is an absolute return boutique manager that focuses on companies with sustainable and above-average returns on capital which are trading below their intrinsic value. It runs concentrated portfolios of around 20 to 25 stocks, of roughly equal weights. Quality companies are first identified by fundamental analysis on financial, business sustainability and management factors to identify those with the greatest potential to deliver a sustainable excess return on capital. Longer term valuation techniques focused on net cash flow generation and return on equity are then used to determine which of the higher quality businesses also provide good potential at current prices.

Allan Gray

Value: contrarian (deep value)

Allan Gray (Australia) is a boutique firm established in 2004. Allan Gray aims to add value by identifying the real underlying value of a company and then looking for opportunities to invest where stock prices deviate from this real value. Allan Gray takes a contrarian value approach to selecting companies.

In Russell's opinion, Allan Gray's experience in assessing the risk-return trade off for each company gives it a comparative advantage in this investment style relative to other managers.

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Plato Investment Management Style neutral: active extension (quantitative)

Plato believes that markets are less than perfectly efficient due to behavioural biases and other market inefficiencies. Plato aims to exploit these market inefficiencies by employing a disciplined quantitative process which utilises a combination of value, momentum and quality factors.

Plato's ideal investment is a stock which exhibits improving relative earnings momentum, positive price momentum, is cheap relative to similar stocks and exhibits high quality characteristics. Conversely Plato try to avoid or take underweight (or short positions) in stocks with deteriorating relative earnings momentum and negative price momentum, which are expensive relative to similar stocks and exhibit low quality.

Paradice Investment Management Style neutral

Paradice is a boutique fund manager that takes an active, yet disciplined, approach to portfolio construction. Each portfolio comprises shares in quality companies, which Paradice believe will provide the greatest potential for strong, medium to long term performance, with a focus on strong balance sheet and cash flows. This process involves actively buying and selling shares across different segments of the market. However, Paradice only buy companies which are intensively researched first. This allows Paradice to own companies which it believes will provide the greatest return with the lowest level of investment risk at any point in time.

L1 Capital Style neutral

L1 Capital (L1) is a style neutral boutique manager that focuses on bottom up stock selection, using a proprietary investment framework to identify undervalued stocks that have strong management, attractive industry structure and favourable operating trends.

L1's research is skewed towards understanding the catalysts and drivers of short term share price changes to identify trading opportunities. Consequently L1 has an intensive company visitation schedule which is strongly complemented by an extensive network of industry contacts.

Russell Select Holdings Strategy Style neutral

This innovative strategy developed by Russell Investments aims to amplify the Fund's alpha potential by accentuating the stock picking skills of our managers. Russell research has demonstrated that commonly held overweight stocks outperform uniquely held overweights. The Select Holdings strategy is designed to capitalise on this insight by concentrating exposure on a small number of commonly overweighted securities. Although this strategy results in relatively high level of risk, it can materially improve Fund performance without having a significant impact on overall risk. This strategy is implemented using an advanced quantitative model and is managed by Russell Investments.

Russell Australian Opportunities Fund: manager exposures

