Perpetual Investments

# LISTED INVESTMENT TRUSTS – OVERVIEW

**Listed Investment Trusts (LITs) are becoming increasingly popular among Australian investors. There are various reasons for this, including an increased uptake of listed securities, partly based on a growth of new investment structures. Let's explore in more details what LITs are and what is driving their increasing popularity.**

## WHAT IS A LISTED INVESTMENT TRUST?

LITs are listed, collective investment vehicles. They are incorporated as trusts and have a closed-end structure which means the number of units they issue is fixed. Like a company issuing shares for the first time, LITs have an initial public offering (IPO) where the units are launched. Investors can then buy and sell those units on the Australian Securities Exchange (ASX). The fund manager may issue new units to increase the size of the investment pool, or units may be cancelled or bought back to reduce its size.

Like traditional managed funds, LITs might invest in Australian or global shares, property, fixed income and cash, or alternative investments.

However, unlike traditional funds, LITs are listed and investors buy and sell units in a LIT in the same way they would buy and sell shares in a company or any other listed security.

That means no lengthy application forms and importantly, knowing the price that units can be bought or sold at the point of transaction.

LITs pay out income and realised capital gains to investors in the form of trust distributions which could mean additional regular returns for investors. In addition, where a LIT invests in Australian equities, franking credits will also be passed onto investors.

### HAVE YOU CONSIDERED LISTED INVESTMENT TRUSTS?

LITs are designed for investors who:

- Use managed accounts
- Have an SMSF
- Seek an actively managed, diversified portfolio
- Want transparency and simplicity, or
- Look for administrative efficiency of their investment portfolio.

## WHAT IS DRIVING THE GROWTH IN LISTED INVESTMENT TRUSTS?

The past decade has seen substantial growth in both numbers of, and capital invested, through managed account and Self-Managed Superannuation Fund (SMSF) structures. This trend, coupled with the vast weight of money flowing into an increasing number of Exchange Traded Funds (ETFs), has increased investors' appetite for listed securities.

Many investors however, don't have the time, knowledge – or in some cases, capital – to build and manage a diversified portfolio of listed securities. Listed Investment Trusts (LITs) provide an opportunity to access an investment portfolio, actively managed by an experienced investment team.

By investing in a basket of assets, across one or more asset classes, LITs offer a diversified portfolio with just a single purchase.

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## A CLOSED-END STRUCTURE

The closed-end structure means the investment manager doesn't have to buy or sell securities following fund inflows and outflows and allows them to focus on investment selection and portfolio management instead. The number of units is fixed, so the portfolio remains stable.

Importantly, it enables the investment manager to take advantage of weak market conditions where value may be on offer, because a LIT won't need to manage withdrawals in a tough market. Conversely, when the market is strong, a LIT is not a forced buyer of expensive or overpriced assets, as can occur with other structures with a constant cash inflow.

## PRICING LISTED INVESTMENT TRUSTS

The value of a LIT's units is calculated with reference to its net asset value (NAV); the value of the trust's assets, less its liabilities. While the price of a LIT's units should be close to the value of its NAV, there will be times when it trades at a premium or a discount.

If it is trading at a premium, the LIT's unit price is trading above its NAV – which means, that if at this point of time, the investor decided to sell their units, they would receive more than if they were holding the underlying investments individually.

When the LIT is trading at a discount, its unit price is below its NAV, so if the investor would buy units at this point of time, they would pay less than if they were buying the underlying shares or assets individually.

While the NAV should be close to the value of the underlying investments, other factors can impact a LIT's price, such as:

- Investor sentiment
- Portfolio performance
- Distribution yield
- Fees, and
- Liquidity.

## BENEFITS AND RISKS OF INVESTING IN LISTED INVESTMENT TRUSTS

LITs offer many of the advantages of direct share ownership, without the time and effort that managing a share portfolio generally demands. However, as with any investment, some degree of risk exists.

| BENEFITS |
|---|
| Income from underlying investments, including dividends, interest payments and realised capital gains |
| Potential to buy at a discount to NAV |
| Access to a professionally managed, diversified portfolio |
| Active portfolio management |
| Transparency – LITs must comply with ASX listing and reporting requirements |

| RISKS |
|---|
| Some LITs may not be frequently traded and hard to sell when required |
| May need to sell at a discount to NAV |
| LITs may be affected by market volatility experienced by its underlying investments |
| Market price of LITs can be impacted by investor sentiment, independent of the NAV |
| Security specific risk, such as change in company management or the default of a bond issuer can impact the NAV |

## DECIDING WHETHER A LISTED INVESTMENT TRUST IS THE RIGHT INVESTMENT FOR YOU

When choosing investment options, there's a range of factors to consider. We've compared LITs to three common alternate investment options that also provide investors with a diversified portfolio – LICs, managed funds and ETFs.

| LISTED INVESTMENT TRUST | LISTED INVESTMENT COMPANIES | MANAGED FUNDS | EXCHANGE TRADED FUNDS |
|---|---|---|---|
| Pay a distribution that may include income and capital gains; may include franking credits | Pay a dividend which is generally fully franked | Pay a distribution that may include income and capital gains; may include franking credits | Pay a distribution that may include income and capital gains; may include franking credits |
| Listed on the ASX and have price transparency | Listed on the ASX and have price transparency | Unlisted – application via Product Disclosure Statement (PDS) – cannot see buy and sell price until it is struck for the transaction date – generally the following business day | Listed on the ASX and have price transparency |
| Active portfolio management by experienced professionals | Active portfolio management by experienced professionals | Active portfolio management by experienced professionals | Most ETFs are passive and replicate a specific market index or adopt a rules-based approach to investing |
| Because there is a finite number of units issued, fund flows do not impact the investment strategy | Because there is a finite number of shares issued, fund flows do not impact the investment strategy | Significant fund flows, particularly large withdrawals, can necessitate selling investments – this can impact all investors through realising capital gains or losses | Significant fund flows, particularly large withdrawals, can necessitate selling investments – this can impact all investors through realising capital gains or losses |
| Investors may receive returns that are higher or lower than the relevant market | Investors may receive returns that are higher or lower than the relevant market | Investors may receive returns that are higher or lower than the relevant market | Investors receive market returns, less fees |
| May trade at a premium or discount to NAV | May trade at a premium or discount to their NTA (net tangible assets) | Generally trade close to their NAV | Generally trade close to their NAV |
| Closed-end – units can only be bought if there is a seller or the trust issues new units | Closed-end – shares can only be bought if there is a seller or the company issues new shares | Open-ended – units can generally be bought and sold at any time | Open-ended – units can generally be bought and sold at any time; market makers ensure liquidity in the ETF |
| Must abide by the ASX's continuous disclosure rules | Must abide by the ASX's continuous disclosure rules | Portfolio composition is generally made available to investors on a quarterly basis | Must abide by the ASX's continuous disclosure rules, which enables investors to see the composition of the ETF's portfolio in real time |
| Operate under a trust structure and issue units | Operate under a company structure and issue shares | Operate under a trust structure and issue units | Operate under a trust structure and issue units |

## LITS VERSUS LICS

Listed Investment Companies (LICs) are very similar to LITs. Each LIC is a listed, diversified, professionally managed portfolio. Like LITs, LICs may trade at a premium or discount to their NAV. The difference lies in the entity structure – while a LIT has a trust structure, a LIC has a company structure.

### THERE ARE TWO MAIN DIFFERENCES FOR INVESTORS:

LICs pay a dividend which will include franking credits from company tax paid by the LIC, as well as those credits received from underlying investments. LIC may choose to retain the earnings and reinvest them.


LITs may either pay a distribution and / or attribute their earnings including both income and realised capital gains. Franking credits and other tax credits received by the LIT will also flow through to investors as part of the distribution.

| GLOSSARY | |
|---|---|
| **CLOSED-END** | A trust that is closed-end issues a set number of units that can then be bought and sold on ASX. |
| **IPO** | The initial public offering, or float, through which units are issued to investors who apply for them. |
| **HIN** | A Holder Identification Number (HIN) is a unique number issued by the ASX for Investors with a broker or an online trading account. |



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