

Glossary



Absolute Return: The 'absolute return' is the 'actual return'. It is the rate of return on money invested, usually expressed as a percentage.

Active management: An approach to managing investments, which aims to achieve returns above a set benchmark. Decisions about asset allocation and stock selection within the portfolio are reviewed regularly taking into account market conditions.

Active return: The difference between the return achieved by the investment manager, and the return achieved by the market movements of the assets included in the fund's benchmark.

Actuary: A person who applies statistical and financial analyses to a range of business problems. Actuaries are experienced in analysing financial transactions and assessing risks. They operate mainly in the superannuation, investment and insurance industries. Actuaries also offer advice to trustees on investment, financial projections and benefit design.

Alpha: The rate of return (ROR) earned by a security or a portfolio in excess of or below the ROR of the benchmark for that security or portfolio. A positive alpha means the investment outperformed the benchmark ROR. A negative alpha would indicate that the investment underperformed the benchmark ROR.

Asset allocation: The distribution of investments by an investment manager among various asset classes or sectors (the major asset classes are shares, property, fixed interest and cash). Asset allocation may be referred to as 'strategic' or 'neutral' (where the asset mix is appropriate to the long-term liabilities of the fund) or 'tactical' (where the asset allocation reflects the manager's view of likely short-term market movements).

Benchmark: A standard used for comparison. These are market indicators, such as the S&P/ASX 200 Accumulation Index that measures the price movement of selected companies listed on the Australian Stock Exchange. For those interested in monitoring investment performance, benchmarks are used as a measure for comparing a portfolio's return against a similar portfolio of securities.

Beta: A measure of how the return of a security or portfolio fluctuates with the market. The market has a beta of 1, therefore you would expect the returns of a security (or portfolio) with a beta of 1.2 to be around 20% more volatile than the market. That is, if the market rises by 1%, the security may rise by 1.2%. Conversely, if the market fell by 1%, a security with a beta of 1.2 may fall by 1.2%. Similarly, you would expect the returns of a security (or portfolio) with a beta of 0.5 to be half as volatile as the market.

Bond: A fixed term security usually issued by government or semi-government authorities that pays a fixed rate of interest during its life and repays the principal at maturity.

Business Day: Means a day on which banking corporations are open for business in Queensland (not being a Saturday, Sunday or public holiday).

Capital Value: Means the value of all assets of the Trust less all liabilities and provisions of the Fund as determined by QIC in accordance with the Trust Deed.

Collective investment vehicle: An investment structure such as a Pooled Trust whereby the assets of a number of investors are pooled for investment purposes. Collective investment vehicles may allow investors access to a wider range of investments and, through economies of scale, may offer lower costs, than if investing individually. Individuals however have less control of the assets and may have impacts from other investors' decisions to enter or leave the fund.

Contrarian: An investment style that takes positions counter to perceived market over-reactions to create investment opportunities. Typically this involves selling exposure to assets that are perceived to be overvalued and buying exposure to assets that are perceived to be undervalued. Contrarian behavior can be applied to short, medium and longer term deposits.

Correlation: A statistical measure of how two securities move in relation to each other. Correlation is also known as the correlation coefficient, which ranges between -1 and +1 when computed. Perfect positive correlation (a correlation coefficient of +1) implies that as one security moves, either up or down, the other security will move in the same direction and to the same degree. Alternatively, perfect negative correlation means that if one security moves in either direction the security that is perfectly negatively correlated will

Glossary



move by an equal amount in the opposite direction. If the correlation is 0, the movements of the securities is said to have no correlation. There is no direct relationship between their movements. Note that correlation does not imply one security influences the other. They may both be influenced by other factors.

Credit: A contractual agreement whereby something of value is lent by a lender to a borrower. The Agreement also includes the terms by which the borrower must repay the lender at a future date. Also, a measure of the capacity of an individual or company to borrow.

Currency forward agreement/contract: A forward contract in the foreign exchange market that locks in the price at which an entity can buy or sell a currency on a future date. Physical settlement of currencies is required at maturity.

Currency pair: The quotation and pricing structure of the currencies traded in the foreign exchange market: the value of a currency is determined by its comparison to another currency. The first currency of a currency pair is called the “base currency”, and the second currency is called the “quote currency”. The currency pair shows how much of the quote currency is needed to purchase one unit of the base currency.

Custodian e.g. National Custodian Services: A separate entity that holds assets on behalf of trustees. The custodian has the title to the fund assets, but the power of investment management remains with the trustees. A custodian provides administrative efficiency.

Derivatives: These are financial instruments such as futures and options, whose value is "derived" from underlying physical assets. Funds use derivative instruments:

- to offset the risk of price variations of securities
- as an alternative to purchasing/selling the physical security
- to benefit from any opportunities for profit which may exist in the market from time to time
- to manage currency risk and asset allocation. **Please see explanation and examples page.**

Direct or individual holdings: The ownership of an investment (e.g. shares, property, fixed interest securities) directly in the name of the investor (or its Custodian for the investor).

Discrete or discrete mandate: An investment management agreement between an investor and a fund manager whereby the assets of the investor are managed for the sole benefit of the investor.

Diversification: Investing in a variety of assets or through a number of managers in order to spread the risk. In popular terms, ‘not having all your eggs in one basket’.

Duration: A technical measure of the length of maturity of a fixed interest portfolio. A duration position different to benchmark embodies a view on the future direction of interest rates. For instance, a duration position longer than benchmark is reflective of the view that interest rates will be lower in the future.

Emerging markets: The financial markets of developing economies

Equities: Also referred to as shares. Investments in Australian and/or international companies that represent an ownership stake, or share, of a particular company. Generally, these securities are listed on stock exchanges for those who buy and sell equities. Equities are often more volatile in their returns than fixed interest and cash investments, but also tend to experience higher returns in the long term.

Ex-ante: A term that refers to forecasting events that will happen in the future. In this Information Memorandum, the ex-ante tracking error is used to indicate the risk targets over the following period.

Financial instruments: Represent a claim on a real asset.

Fixed interest: One of the four major asset classes, fixed interest securities include bonds, bank bills, floating rate notes and negotiable certificates of deposit. Interest rates on these securities may be floating but are usually fixed. The holder is paid a fixed value on a fixed future date. Predetermined interest payments may also be made throughout the life of the security. There are three primary types of fixed interest securities, classified according to the type of borrower: government, semi-government or corporate.

Glossary



Fund: A trust individually constituted under, or governed by, the Trust Deed.

Fundamentals: The basic indicators of the state of the economy, market or of an individual company. They are monitored to provide a basis for forecasting and selecting investments.

Fund manager: Invests and manages the assets of others.

Futures: A standardised financial contract, traded on a futures exchange, obligating the buyer to purchase or the seller to sell a set quantity and quality of an underlying asset, such as a physical commodity or a financial instrument, at a set date in the future and for a set price.

Futures exchange: or **futures and options exchange** is a central electronic marketplace where futures contracts and options are traded.

Global credit: These investments are essentially corporate bonds issued by predominantly foreign companies in markets other than Australia. An investment in global credit accesses a much broader range of issuers than is available solely within the Australian market.

Hedging: An investment made in order to reduce the risk of adverse price movements in a security, by taking an offsetting position in a related security, such as an option or futures contract.

Implemented management: Managing investments by allocating them to selected managers who are experts in particular markets. Implemented management involves careful selection and monitoring of the managers to ensure funds meet their investment objectives.

Investment Horizon: The period of time over which money is to be invested (e.g. 6 months, 1 year, 10 years).

Leverage: The use of borrowings which results in the magnification of potential positive or negative investment returns. That is if the return achieved on a levered investment is greater than the interest payable on borrowings, then the investment gain is greater than if borrowings were not utilised. Alternatively where an investment's return is less than the interest payable on borrowings, the total return on the investment will be less than what would have been achieved without borrowing. In the case of an investment loss, the loss will be greater than it would've been if the investment had not been leveraged. **Please see explanation and examples page.**

Long short: A portfolio construction model that can hold a negative (short) position in a stock as well as overweight/underweight position.

Long strategy or position: A long position means an investor owns more of a particular security than they have sold. Therefore, a profit is made when the value of the underlying security increases, and a loss is made when the value of the underlying security goes down.

Manager Styles: Investment managers approach the way they select investments in different ways. These are called 'manager styles'. Different styles perform differently in different market conditions so it evens out risk to include a variety of styles in a portfolio. Some of the main styles are:

- Value
- Growth
- Neutral

Modified Duration: The percentage change in price (or market value of the portfolio) for a one percent change in yield from current levels.

Non-deliverable currency forward agreement / contract: A non-deliverable currency forward contract is a foreign currency financial derivative instrument. An NDF differs from a normal foreign currency forward agreement in that there is no physical settlement of two currencies at maturity. Rather, based on the movement of two currencies, a net cash settlement will be made by one party to the other.

Glossary



Notional exposure: The total value of an investment exposed to market returns, including both capital and borrowings (leverage).

Occupancy rate: The rate at any point in time that available floor space (eg. retail or office) is occupied by a tenant.

Options: An agreement, whereby the buyer has the right, but not the obligation, to buy (receive) or sell (deliver) a specific security at an agreed price within a certain period or on a specific date.

Outperformance: Financial jargon for a fund performance above the benchmark or above the targeted return. Its opposite is under performance.

Overweight: A greater proportion than the benchmark includes. Its opposite is 'underweight', a lesser proportion than the benchmark includes.

Over the counter trading is where securities are traded via means other than on a futures or stock exchange.

Performance attribution: A process that allocates the elements of performance which make up the total return and the active component of the return. At an overall fund level, the attribution process can be broken into three distinct components:

- Contributions to, or detractions from, performance arising from TAA decisions: A positive contribution to performance will be created by investing a greater value in an outperforming asset class or conversely, a lesser amount in an under performing asset class
- Contributions to, or detractions from, performance arising from stock selection decisions
- Contributions to, or detractions from, performance arising from interaction, which jointly measures the effect of TAA and stock selection decisions.

Portfolio: Combined holding of more than one stock, bond, commodity, cash equivalent, or other asset by an individual or institutional investor. Refers to the mix of assets held for a single product/client.

Risk: The chance of variability of investment returns (volatility) or of loss. **Please see explanation and examples page.**

SAA: Strategic asset allocation. The division of assets within an investment portfolio with regards to the long-term view of the risk and return profile of those asset classes, and how to best achieve the portfolio's long-term objectives. Often abbreviated as SAA. See also Asset Allocation, TAA.

SCI: Statement of Corporate Intent. An annual performance agreement between QIC and our Shareholding Ministers.

Short strategy or position: A short position means an investor has sold more of a particular security than they own. Therefore, a profit is made when the value of the underlying security goes down, and a loss is made when the value of the underlying security increases.

Spread: The difference between the price offered and the price requested of a security or asset.

Stocks: Individual securities within a portfolio.

Stock exchange: Is a central electronic marketplace where company stocks and other securities are traded.

Structured credit: Any investment package which uses structuring techniques to transform the risk return profile of an established asset class. Examples of structuring include tranching, capital protection or tax efficiency overlays. QIC Global Fixed Interest limit Structured Credit to managed product, i.e. risk which an external manager chooses, oversees and manages.

Swaps: The exchange of cashflows related to one security or index for cashflows related to another, to change the maturity (bonds), quality of issues (stocks or bonds), or other risk exposures. Varieties of swaps include currency swaps (US Dollars to Yen), interest rates swaps (fixed to floating rates), and credit derivatives.

Glossary



TAA: Tactical asset allocation, abbreviated as TAA. Alters investments across asset classes to take advantage of short-term changes in perceived market value. With the use of TAA, QIC can increase exposure (go overweight) to assets that are expected to perform relatively well, and away from those (go underweight) expected to perform relatively poorly. See also SAA.

Tracking error: Is a measure of the extent to which a fund's return may deviate from its benchmark index based on the historical analysis of the funds volatility versus the market. ***Please see explanation and examples page.***

Underweight: See 'Overweight'.

Unit pricing: A daily process of assigning a value to the units within a managed fund. The value of a unit reflects the value of the underlying assets in the fund.

Volatility: A measure of the extent to which the value or investment return of a market or security fluctuates over a given period of time.

Wholesale market: The larger of the two investment markets. The retail market (for individual investors) is the other. The wholesale market involves large investments by institutions such as companies and superannuation funds.

Yield: The return to investors from a particular security or business venture, expressed as a percentage.

Yield curve: A diagrammatical representation of the relationship between bond yields and maturity dates. The chart plots the interest rates of bonds with equal credit quality over differing maturity dates.

Explanation and Examples

Derivatives

Derivatives are instruments, such as options and futures contracts, which derive their value from the value of an underlying security, group of securities or an index. They can be an efficient alternative to buying and selling the physical assets, derivatives can be used where the underlying asset is not owned by the party to the contract. In these circumstances, the Fund is said to be using derivatives to leverage – i.e. to generate an exposure to assets that is greater than the capital invested.

Example

A 10 year Australian bond *future* generates an exposure of \$100,000 but in purchasing this futures contract only a small amount of capital outlay is required, let's say \$10,000.

If the value of the underlying asset of this derivative, in this case the 10 year Australian Bond, rose by 1%, the value of the derivative contract would now be worth \$101,000 and if sold, a gain of 10% on capital invested would be generated. However if the underlying value of the asset fell by 1%, a 10% loss on capital invested would be realised.

Hedging

Hedging involves an investment being made in order to reduce the risk of adverse price movements in a security. This is usually done by taking an offsetting position in a related security, such as an option or futures contract

Example

Say the Australian dollar (A\$) is worth 0.70 US dollars (US\$). At this conversion rate A\$100 would buy a US\$70 investment. If the A\$ strengthened against the US\$, such that it was now worth US\$0.75, the initial A\$100 investment would now be worth approximately A\$93. If the investment was sold, this currency movement would result in a loss of nearly 7%.

To protect against this currency exposure when acquiring assets valued in foreign currencies, a hedge - in its simplest form a currency swap, foreign exchange futures contract, or foreign exchange option – could be put into place whereby we would hold the equivalent of A\$100 with a corresponding commitment to repay US\$70. In the above example, because of the increased value of the Australian dollar, we now require only A\$93 to repay our US\$70 commitment – a profit of 7%. Currency loss is offset by gains from the hedge.

The hedge has the effect of protecting the value of the overseas investment against currency fluctuations. On the other hand, if the A\$ fell against the US\$ to US\$0.65 then profits from the fall in the currency would be offset by losses with the hedge.

This is a simplified explanation - In reality the portfolio may have a basket of currencies and a variety of instruments which are applied to offset the currency risk.

Modified Duration

Fixed interest securities are purchased with a maturity date, that is, a date on which the capital is repaid.

The modified duration of a fixed interest investment is roughly equal to the average of the time until receipt of the investment's cash flows (weighted by amount). It takes into account any coupon payments as well as the final capital payment at maturity. For small interest rate changes, the modified duration is the approximate percentage change in price (or market value of the investment) for a 1% change in interest rates. To control interest rate risk within the Funds, QIC ensures that the Funds' investments are managed within strictly controlled modified duration limits.

Example

A 10 year bond with a modified duration of 6 years would fall approximately 6% in value if the interest rate increased by 1%. The value of a bond with a modified duration of 1 year, would only fall 1% with a 1% increase in interest rates. Therefore, typically the longer the modified duration, the greater the sensitivity of that security to interest rate changes.

Net leverage

When calculating the net leverage position, short positions are netted off against long positions (long exposures minus short exposures). If the maximum net leverage that the Fund could use was four times the Capital Value of the Fund, this would equate to a net long or net short cash position of 400%. If we were to assume the Fund had a Capital Value of \$10m, the maximum leverage would be \$40m.

Example

Say the portfolio has a net asset value of \$1m, the notional exposure achieved when all of the long and short positions are added together can be up to \$15m (gross leverage limit). When calculating the net leverage position, short positions are netted off against long positions (meaning that long exposures minus short exposures could equal up to \$3m under the scenario above).

Risk

Investment returns are volatile, deviating from the target return year on year, this is the inherent risk in investing.

There will be years when performance is above the return objective and years when it is below this objective and possibly the benchmark. The degree to which actual short-term returns deviate from the return objective (including negative returns and resultant loss of capital), provides an indication of the level of risk that an investor is taking.

Risk (cont'd)

Typically, the greater the volatility, the riskier the investment – that is, the greater the risk that returns will not meet expectations and/or that the investment will realise a capital loss. This is the downside of taking risk. The upside is, of course, the potential for additional returns.

It is important, when assessing an investment's performance objective, to understand what level of risk the fund manager is taking or is willing to take to achieve that objective, as this will provide investors with an indication of the volatility of returns that they can expect from the investment.

Example

Say we invest \$100 in a one-year bond yielding 5% interest. If we hold the bond for a full year, we will be paid back the initial \$100 invested, plus \$5 interest (5%). That is, if we hold the bond to its maturity, there is no interest rate risk.

If however we wish to sell the bond part way through the year, there is the risk that interest rates have risen and we will realise a loss on the sale of the bond. Lets assume that prices change and the yield on comparable bonds is now 7%. A buyer is unlikely to pay \$100 for our bond to earn 5% when they could achieve 7% buying a similar bond from someone else. Therefore we must sell the bond at a discount (and lose money). The sale price would allow the buyer to earn roughly 7% if he or she holds it until it matures.

Conversely, if interest rates had fallen, we could have sold the bond at a premium and increased our return.

Tracking Error

Tracking Error is a measure of the extent to which a fund's return may deviate from its benchmark index based on the historical analysis of the funds volatility versus the market. The risk limits for each Fund guide QIC on how to manage the inherent risks of the Fund. Take for example a fund with an average ex-ante tracking error of 3% p.a.

QIC would manage such a fund's risks so you could expect the volatility of returns to be within 3% p.a. (ex-ante tracking error) around the targeted annual active return objective. If a fund had an objective of achieving returns of 1% p.a. above the benchmark, this means that 67% of actual returns would be expected to be between 2% p.a. below and 4% p.a. above the Fund's benchmark return.