Standard & Poor’s View

S&P rates this fund three stars, reflecting our conviction that the manager will consistently generate risk-adjusted returns in-line with both its relevant investment objectives and its peers.

The fund has a relatively unconstrained mandate giving the team scope to identify and access a greater number of uncorrelated investment opportunities. This flexibility is required if the manager is aiming to preserve investor capital. Medium and longer term performance has been in line with the S&P peer-group median manager. Although the performance during 2008 was negative, relative to peers it was quite strong. This is the result of the manager's focus on downside risk minimisation. Performance is likely to be weaker through periods of market appreciation, which would typically generate returns for a balanced product.

SELECT has employed some experienced investment professionals including minority shareholders/business partners. However, those who are dedicated to manager research and due diligence are less experienced than their multimanager peers. This lack of experience is compensated through the tight investment committee process, which is chaired by the chief investment officer (CIO) Dominic McCormick. Additional resources would allow greater specialisation and increase both the breadth and depth of research.

The fund management fee is at the higher end of the peer group, and includes a performance fee. Although this structure includes a high water mark, S&P considers the cash performance hurdle relatively unchallenging for a manager with a long bias to the market. The majority of managers in the S&P multisector review do not apply a performance fee to the suite of funds they offer.

The ICR includes the ongoing management fee of 1.00% per year, plus expense recovery of 0.275% per year. The bid/offer spread on the fund is 0.25%/0.25%, this cost represents the investor's share of the transaction costs, incurred when the trust is purchasing or selling assets. This cost is built into the unit price.

Product Features

The investment universe includes regulated managed-investment schemes (MIS), unregulated MIS, equities and related securities, fixed interest securities, and cash. Alternatives, within the context of SELECT's multisector offerings, are defined differently with some included in more traditional sectors like property and equities, while other alternatives are categorised within the “alternatives” classification. The investment mandate has relatively broad ranges for each investment class, S&P considers this adequate to allow the manager to express its top-down views. The manager focuses on delivering absolute returns and capital preservation over the medium to longer term. S&P considers the manager's approach to risk management in keeping with this philosophy.

The fund has an indirect cost ratio (ICR) of 1.9% per year, which is approximately double the median fee for the peer group. The ICR incorporates an estimate of the performance fee. The performance fee of 10% per year is applied to any excess return over the 180-day bank bill index, less the ongoing fees. A high water mark applies to the calculation of the performance fee, which requires any previous underperformance to be recovered before a performance fee can be earned. Although this structure includes a high water mark, S&P
**Investment Style**

SELECT maintains that a portfolio consisting of purely traditional investments is insufficiently diversified, and risk-adjusted returns can be improved through a value or contrarian approach as well as diversification across markets that have a low correlation with each other. Allocation to each sector tends to be a combination of the output of bottom-up investment selection, with macro-economic or thematic overlays. The approach involves redeploying capital across time to investments that it believes will perform well over the medium term. SELECT's focus is on capital preservation and absolute returns through the market cycle, rather than on outperforming a benchmark.

There are several main differences in approach compared with a conventional multi-sector fund. SELECT seeks to diversify across investment ideas, rather than purely through an allocation to an asset class. Bottom-up investment selection influences the tactical asset allocation (TAA) weightings, and there is far more flexibility in the sector ranges than is inherent with peer mandates. The mandate has the flexibility to tilt the portfolio towards themes and sectors in which the manager has strong conviction.

While multi-sector products are increasingly offering a small exposure to alternatives, of typically up to 5% or 10% (often limited to fund-of-hedge-funds), SELECT views alternatives as a critical component of the overall portfolio and can invest up to 35% of the portfolio. SELECT classifies alternatives such as private equity and infrastructure within the more traditional asset classes of equities and properties, due to the similarity in return characteristics, therefore when included with the other. Most alternative investments have a low correlation to traditional asset classes; hence they are an ideal complement to a balanced portfolio. While the volatility of some alternatives, such as commodities, can be relatively high, a group of low correlated alternatives is combined so that a particular investment should not dominate performance.

Risk management is linked into the investment process. Analysis of a manager's risk exposure serves the primary purpose of separating minor acceptable risk from major risks, with a focus on the potential consequences and the likelihood of these occurring.

| Passive TAA | Passive Stock Selection | Active TAA | Active Stock Selection |

**Investment Team**

CIO, Mr. McCormick has overall responsibility for investment strategy and research of SELECT's range of diversified portfolios. Having worked within the financial services industry for more than 25 years, Mr. McCormick has broad experience which has been gained in various research roles. He previously worked in an investment consulting capacity before establishing SELECT as a co-founder in 2002.

David Yale is director of risk and technology, and sits on the investment and research committees. Mr. Yale has 20 years' experience in the financial services industry, specialising in computer software and technology, he has instigated and led the development of the software currently used for risk management at SELECT, and is responsible for managing risk across all portfolios.

Michael Winchester has been with SELECT for six years and is the portfolio manager for the Select Listed Investment Fund. For four years previously, he worked at Macquarie Equities in a research capacity, responsible for managed investments, hedge funds, and structured products. Mr. Winchester is the head of research with overall responsibility for the fund manager due diligence, and the valuation framework for the listed securities research.

Robert Graham-Smith commenced in August 2004 as portfolio manager for the Select Alternatives Portfolio and is responsible for research, and has recently been promoted to head of portfolio management. Mr. Graham-Smith has 16 years' industry experience, including working as a senior hedge fund analyst, investment specialist, and quantitative specialist for Deutsche Bank's absolute return strategies business, a valuable background for his current role.

Brendan Foley, managing director, oversees all aspects of SELECT's business, and plays an active role in the investment strategy (IS) meetings. Mr. Foley has 26 years' experience in the financial services and technology industries, and was previously treasurer of Man Group Plc's funds management division.

Manager research is conducted by all members of the investment team, including Stephanie Sarantis and David Matiesic. Ms. Sarantis joined SELECT in 2003 as a member of the operations team, moving across into the investment team as a manager researcher in 2007. She joined from an insurance company, where she had been working for four years. Mr. Matiesic joined in 2007, from Aon Consulting, and prior to this he had worked at Aspect Huntley. Mr. Matiesic has five years' industry experience.

SELECT has also developed relationships with experienced consultants in specialist capacities that sit on the IS meeting and advise on fund selection. Sam Armstrong is a managing partner of Barwon Investment Partners with 20 years' involvement in alternative investments, and was the joint managing partner of a specialist private equity fund-of-funds group, Quay Partners Pty. Ltd. Dr. Bartholomew Dowling has a broad range of experience as economist, strategist, global asset allocator, and absolute-return manager.

The current primary exposure to alternative investments is through one of Gottex's funds-of-hedge-funds and Aspect's diversified managed futures program. Exposure to precious metals is gained largely through Baker Steel's gold fund offering. Up until recently, SELECT had been marketing the stand-alone products offered by business partners and minority shareholders, Gottex, Aspect, and Baker Steel.

With a generous remuneration structure, which offers incentives for staying with the manager, such as a profit-share arrangement with long-dated options and deferred bonuses distributed over three years, “key person” risk is somewhat alleviated. Nevertheless, Mr. McCormick, in particular, would be a loss if he left SELECT, given his breadth of knowledge and substantial financial markets experience.

The investment team has been stable since the last S&P review, although two sales roles were made redundant in early 2009.

<table>
<thead>
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**Portfolio Review**

SELECT's investment process is transparent, with flexibility to invest in a variety of diverse investments, further enabled by broad strategic asset allocation (SAA) ranges. TAA and manager selection decisions are
interdependent, with market themes and views on underlying managers driving the portfolio construction process.

The broad SAA framework is set with regard to the fund objectives and the nature of the investments. While alternatives are categorised as a separate asset class, long/short and other less mainstream strategies can be contained within the equities, fixed interest, and property exposures.

SAA ranges are highly flexible and provide a wide band of discretion in selecting underlying investments. Ranges are not determined by optimisation or historical back testing, but are rather the result of more subjective views on appropriate risk allocations. Individual investment exposures are limited to 10% of the portfolio.

SAA ranges are intended to be formally reviewed by the SELECT research and investment committees on a three- to four-year basis. On July 1, 2008, the manager reduced the fund's equity exposure range to 10%, from 50%. These ranges provide a guide, but are not hard limits; individual sector allocations can be temporarily exceeded. Investment weightings are determined in the weekly research meeting with input from other meetings including the monthly investment strategy (IS) meeting.

SELECT predominantly conducts its own due diligence on all managers it invests in; however, there is reliance upon Gottes for hedge-fund manager selection. The team currently meets approximately 30-50 new unlisted managers and 30-40 listed managers per year, which incorporates the listed investment company universe within Australia - and a significant number within the U.K. New investment ideas are sourced largely through industry networks, referrals from fund managers relationships, and global partners. A range of external data sources and information systems are used to access manager data and to supplement other means of identifying possible candidates for further research. SELECT tends to favour boutique investment houses and specialist managers.

In assessing managed investments, the team initially identifies vehicles that have attractive assets or are considered likely to perform well in the short to medium term. The quality of the individuals responsible for managing these vehicles is also taken into consideration. Most conventional funds are screened out, which reduces the investable universe to a more manageable size. The types of managers that are examined tend to have a more absolute-return investment approach, which includes long/short managers.

For listed assets, vehicles trading at abnormal discounts to net tangible assets (NTA) are identified - and there must be an identifiable catalyst for that discount to narrow.

The check list of qualitative criteria examined includes specific issues within the broad categories of resources/people, philosophy/approach, research process, portfolio construction and risk management, and product features/operational issues. For unlisted vehicles, the review process can take between two months and a year, involving several face-to-face meetings in addition to electronic and phone contact over the period. SELECT will not always meet the manager of a listed fund before investing if it is already familiar with it and has a higher degree of comfort due to the continuous disclosure requirements of the Australian Stock Exchange. Once invested, there is at least quarterly contact with a manager.

Operational due diligence is also conducted by the investment team. Some of the key potential problems the team is seeking to identify are the existence of fraud or negligence and possible conflicts of interest. A limited track record in focusing on a particular strategy is not necessarily a reason for excluding a manager from investment, but more extensive examination is usually required to justify a position. Reference checks of key investment staff are undertaken for smaller unlisted funds, and there is a review of middle and back-office operations, such as the procedures for handling transactions.

Each manager added to the portfolio must provide complementary exposure to existing investments within an asset class. Portfolio holdings and weightings are not formulaic, but rather are determined by a combination of both relative and absolute valuation analysis, long-term sentiment evaluation, and medium-to-long-term macro-economic assessment. Underlying correlations and potential overlap of diversified fund investments are also taken into account to ensure active risk is intentional. Within the equities category, there is likely to be a mix of traditional and long/short managers, with a bias towards concentrated portfolios and managers with a value or contrarian approach. Managers that employ a value investment philosophy buy stock based on its discount to intrinsic value. This discount to intrinsic value is commonly referred to as the manager’s “margin of safety”. The margin of safety protects the investor from both poor decisions and downturns in the market. Because fair value is difficult to accurately compute, the margin of safety gives the investor room for error. This is the central thesis of “value investing” philosophy which espouses preservation of capital as its first rule of investing. S&P considers this style of investment approach suitable for a manager who has an absolute-return focus.

A top-down thematic view is the pre-eminent determinant of TAA decisions and is the major consideration before actual underlying investment decisions are made.

TAA shifts tend to be incremental and established for the medium term, unless there is a large movement in valuations or a change in investment fundamentals. For listed funds, the approach is more opportunistic, and SELECT continually monitors the trading activity, shareholder changes, and particularly the discount/premium to NTA, enabling a quick reaction to market movement.

Performance during periods of market stress is tested, and liquidity may be critical if the manager tends to exhibit highly volatile performance and where a quick exit might be required. Liquidity guidelines are strict and the portfolio will be rebalanced as the limits are reached. Rebalancing generally takes place on a monthly basis, however, it may be agreed at the weekly investment committee meeting if required.

Between 25 and 50 investments are generally held in the portfolio. Although promoting a broad cross-section of views and critique of investment ideas, the committee-based approach to portfolio construction may become inefficient and result in less accountability as the team grows. However, Mr. McCormick is ultimately responsible for fund performance.

The triggers for termination of a manager include a negative six-to-12-month view of the investment strategy, which will entail a reduction in the allocation and part or total redemption of the underlying managers. Manager-specific reasons for termination are poor performance, style drift, change in investment terms, and a significant change in staffing. Often, a concern regarding an issue such as poor performance will involve a more in-depth examination of a manager to evaluate why this occurred: if market conditions did not suit the manager at that time and performance is likely to improve, or whether it is more symptomatic of a lack of skill, which will result in divesting the manager.

The manager may make an allocation to its internally managed funds. At present, a significant portion of the manager's allocation to alternatives will be through the Gottex funds, two of which have had redemptions suspended by the manager due to the abnormal level of investor redemption requests. The manager is conscious that the more liquid assets would need to be sold down to meet these redemptions which
effectively leaves remaining investors with an altered risk and liquidity profile. S&P has subsequently placed 'On Hold' ratings on the Select Gottex Enhanced Market Fund and Select Gottex Market Neutral Fund. The allocation to the Gottex strategies is between 8% and 10% depending on the diversified fund.

The manager has also allocated assets to the Select Future Fund via Aspect Capital and the Select Gold Fund through Baker Steel. These allocations are between 2% to 4% of the diversified portfolios.

An allocation to the Select Listed Investment Fund makes up between 2% and 3% of the diversified portfolio.

The portfolio invests primarily in funds that take an active or hedged approach to currency. If required, additional currency positions for currency hedging purposes are put in place. Ongoing assessment of the currency position is an integral part of the investment process. S&P considers the manager's quantitative and qualitative assessment and monitoring of investments robust and relevant for the types of investments held.

Performance

The fund aims to produce a positive absolute return and preserve capital over the medium to long term. For the purposes of peer relativity, the fund has assessed relative to peers with similar asset allocation strategies, which are based on the aggregate allocation to growth assets.

Over the 12 months to Dec. 31, 2008, the fund produced a net-of-fees return of negative 16.17%, which was in line with the median manager. Negative returns were posted across most of the manager's investments, with the exception of Australian large-cap equity, property and infrastructure, fixed interest and cash, all producing very modest positive returns.

Better performance was achieved by the fund over the medium and longer term. The fund produced a strong relative result for the three years to Dec. 31, 2008, with an annualised net-of-fee return of 0.54%, compared to negative 1.17% for the median manager in the peer group. Fund volatility, as measured by the standard deviation metric, was 8.4% per year, compared to 7.62% per year for the median manager.

Over the five years to Dec. 31, 2008, the fund achieved an annualised return of 4.35%, which was in line with the median manager return for the peer group.

Taking the effects of 2008 out of the analysis, over the past five calendar years the fund has produced returns of between 9% and 11%, with the exception of calendar year ending December 2008, where the fund produced a return of negative 16.17%. Although all funds in the peer group posted solid positive returns over discrete years from 2004 to 2007, they have typically outperformed the Select fund during these bull market years. That said, they have underperformed the Select fund during the bear market years of 2007 and 2008. This performance outcome is not surprising given the manager's greater allocation to vehicles that include hedging strategies, relative to peers.

Risk Management

SELECT believes that traditional portfolio theory does not accurately represent real market behavior deeming a value and contrarian approach to diversification across low correlated markets more appropriate.

SELECT's risk-management framework is thoroughly embedded into the manager selection and asset allocation process thereby managing risk throughout all key stages of the investment cycle. Operational due diligence is a significant component of manager-risk management, which incorporates a critique of the manager's own risk systems and processes and business continuity plans.

Qualitative assessment also incorporates capacity risk; this is a critical issue for managers and one difficult to quantify because it can vary vastly according to a range of factors, including the manager's investment style, market conditions, and growth. In general, allocations to a strategy will be curtailed if there is considered to be limited liquidity, and consequently less capacity. Liquidity risk is an aspect of portfolio risk management that has become increasingly important for fund managers to monitor. The manager has divided the portfolio into liquidity buckets ensuring monthly liquidity remains adequate.

The qualitative assessment focuses on individual investment, style, and market risk, which collectively form the basis of SELECT's quantitative risk management approach. Within the risk-management framework there is an emphasis placed on proprietary systems. Value at risk (VaR) is one of the key ongoing risk controls accompanied by Monte Carlo simulation which is used for stress testing the portfolio and simultaneously used within the portfolio construction process. Correlation analysis is regularly conducted and helps to determine sector allocation and overall diversification levels.

Regular analysis is conducted on each manager, including return, volatility, drawdown, downside deviation, Sortino, and Sharpe ratios, and the correlations of the investments are monitored. Compliance and risk reporting is automated which minimises human error, and consequently improves accuracy and timeliness.

S&P has recently reviewed the manager's risk-management process and considers there to be a very disciplined and rigorous framework in place.

Management Group Profile

SELECT Asset Management is a specialist Australian fund manager with an absolute-return philosophy and a core focus on alternative investments and diversified portfolios. SELECT believes that the key to long-term wealth creation is to achieve attractive compounding rates of return above cash, and limiting major losses of capital in difficult market conditions. The manager aims to provide a steady rate of compounding returns with lower volatility than traditional managed portfolios over the long term, being three to five years.

SELECT was founded in 2002 by Mr. McCormick, Mr. Foley, Mr. Yale, Clayton Freind, and Roger Campbell. SELECT has relationships with leading international investment partners with large funds under management (FUM): Gottex Fund Management (US$9.0 billion), Aspect Capital (US$3.8 billion), Baker Steel Capital Managers (US$626 million), and Barwon Investment Partners (US$7 million). Select will also target investors for direct investment into the overseas investment vehicles of these partners.

Equity ownership in the SELECT business is divided into 33% of employees and executives directors, 34% non-executive directors including Gottex directors, 19% Officium Capital, 4% Aspect Capital including directors, and 9% past employees. The SELECT team comprises 22 people, covering such divisions as investments, operations, accounting and finance, and sales and marketing.
Market Share
At Dec. 31, 2008, SELECT manages assets of around A$550 million across its range of funds and portfolio solutions, of which the Select Growth Portfolio holds A$137 million, and the Select Defensive Portfolio holds A$147 million. Five clients hold 93% of the diversified assets under management, with the largest client holding 61% of the assets under management. This represents a significant “key investor” risk for the manager. The manager’s clients are predominantly retail platforms. The fall in assets under management from A$750 million at the time of the S&P review 2007, was due to some outflows, but mainly reflected the result of market declines.

Analyst(s): Rodney Lay; Justine Gorman.
Release authorised by: Mark Hoven.
S&P Fund Rating Reference Information

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<th>S&amp;P Fund Rating</th>
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Reference Material

- Sector Reports
- Reader’s Roadmap
- Glossary
- Guide to S&P Qualitative Fund Ratings
- Fund Rating Team Biographies
## Fund Rating Peer Groups by Sector

<table>
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<tr>
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## Fund Rating Philosophy

A star rating is a forward-looking qualitative assessment of a manager's ability to consistently generate risk-adjusted fund returns (net of fees) in excess of both its relevant investment objectives and its peers.

## Fund Rating Process

In assigning a star rating to a fund, Standard & Poor's evaluates: the size, skill, and stability of the manager's investment team; the clarity, implementation, and risk management of the investment process; the fund's objectives, fee structure, and portfolio characteristics; and the manager's business management.

## Fund Rating Definitions

- **5 Stars**: Standard & Poor's has very high conviction that the manager will consistently generate risk-adjusted fund returns in excess of its relevant investment objectives and relative to its peers.
- **4 Stars**: Standard & Poor's has high conviction that the manager will consistently generate risk-adjusted fund returns in excess of its relevant investment objectives and relative to its peers.
- **3 Stars**: Standard & Poor's has conviction that the manager will generate risk-adjusted fund returns in-line with its relevant investment objectives and relative to its peers.
- **2 Stars**: Standard & Poor’s has conviction that the manager will not generate risk-adjusted fund returns in-line with its relevant investment objectives and relative to its peers.
- **1 Star**: Standard & Poor’s has high conviction that the manager will not generate risk-adjusted fund returns in-line with its relevant investment objectives and relative to its peers.
- **Hold**: Issues that may affect the fund's management have emerged; and the fund rating is temporarily suspended, pending clarification.
- **Sell**: Significant issues exist that potentially will adversely affect the fund’s performance. Investors should consider obtaining advice on switching or redeeming funds.

## Fund Rating Subscript

- **New**: The investment process, fund manager, or the fund has a relatively short history, or the analytical team has changed significantly, but a relevant and demonstrable track record is shown on similar funds.
Select Growth Portfolio

Analysts: Rodney Lay; Justine Gorman

Products Facts

<table>
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<th>Manager</th>
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Fund Objectives

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<td>Target return (% p.a.)</td>
<td>Outperform cash rate + 5% - 6% pa net of fees</td>
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<tr>
<td>Target volatility (% p.a.)</td>
<td>standard deviation of 6% - 7% per year</td>
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</table>

Product Features

The investment universe includes regulated managed-investment schemes (MIS), unregulated MIS, equities and related securities, fixed interest securities, and cash. Alternatives, within the context of SELECT's multisector offerings, are defined differently with some included in more traditional sectors like property and equities, while other alternatives are categorised within the "alternatives" classification. The investment mandate has relatively broad ranges for each investment class, S&P considers this adequate to allow the manager to express its top-down views. The manager focuses on delivering absolute returns and capital preservation over the medium to longer term. S&P considers the manager's approach to risk management in keeping with this philosophy.

The fund has an indirect cost ratio (ICR) of 2.0% per year, which is approximately double the median fee for the peer group. The ICR incorporates an estimate of the performance fee. The performance fee of 10% per year is applied to any excess return over the 180-day bank bill index, less the ongoing fees. A high water mark applies to the calculation of the performance fee, which requires any previous underperformance to be recovered before a performance fee can be earned. Although this structure includes a high water mark, S&P considers the cash performance hurdle relative unchallenging for a manager with a long bias to the market. The majority of managers in the S&P multisector review do not apply a performance fee to the suite of funds they offer.

The ICR includes the ongoing management fee of 1.00% per year, plus expenses recovery of 0.25%. The bid/offer spread on the fund is 0.25%/0.25%, this cost represents the investor's share of the transaction costs, incurred when the trust is purchasing or selling assets. This cost is built into the unit price.
**Investment Style**

SELECT maintains that a portfolio consisting of purely traditional investments is insufficiently diversified, and risk-adjusted returns can be improved through a value or contrarian approach as well as diversification across markets that have a low correlation with each other. Allocation to each sector tends to be a combination of the output of bottom-up investment selection, with macro-economic or thematic overlays. The approach involves redeploying capital across time to investments that it believes will perform well over the medium term. The manager's focus is on capital preservation and absolute returns through the market cycle, rather than on outperforming a benchmark.

There are several main differences in approach compared with a conventional multi-sector fund. SELECT seeks to diversify across investment ideas, rather than purely through an allocation to an asset class. Bottom-up investment selection influences the tactical asset allocation (TAA) weightings, and there is far more flexibility in the sector ranges than is inherent with peer mandates. The mandate has the flexibility to tilt the portfolio towards themes and sectors in which the manager has strong conviction.

While multi-sector products are increasingly offering a small exposure to alternatives, of typically up to 5% or 10% (often limited to fund-of-hedge-funds), SELECT views alternatives as a critical component of the overall portfolio and can invest up to 35% of the portfolio. The manager classifies alternatives such as private equity and infrastructure within the more traditional asset classes of equities and properties, due to the similarity in return characteristics; therefore when included with the alternatives weighting of 25%, this can boost the overall allocation to as much as 40%.

Most alternative investments have a low correlation to traditional asset classes; hence they are an ideal complement to a balanced portfolio. While the volatility of some alternatives, such as commodities, can be relatively high, a group of low correlated alternatives is combined so that a particular investment should not dominate performance.

Risk management is linked into the investment process. Analysis of a manager's risk exposure serves the primary purpose of separating minor acceptable risk from major risks, with a focus on the potential consequences and the likelihood of these occurring.

**Passive TAA** | **Active TAA**
---|---
**Passive Stock Selection** | **Active Stock Selection**

**Investment Team**

CIO, Mr. McCormick has overall responsibility for investment strategy and research of SELECT's range of diversified portfolios. Having worked within the financial services industry for more than 25 years, Mr. McCormick has broad experience which has been gained in various research roles. He previously worked in an investment consulting capacity before establishing Select as a co-founder in 2002.

David Yale is director of risk and technology, and sits on the investment and research committees. Mr. Yale has 20 years’ experience in the financial services industry, specialising in computer software and technology, he has instigated and led the development of the software currently used for risk management and is responsible for managing risk across all portfolios.

Michael Winchester has been with SELECT for six years and is the portfolio manager for the Select Listed Investment Fund. For four years previously, he worked at Macquarie Equities in a research capacity, responsible for managed investments, hedge funds, and structured products. Mr. Winchester is head of research with overall responsibility for the fund manager due diligence, and the valuation framework for the listed securities research.

Robert Graham-Smith commenced in August 2004 as portfolio manager for the Select Alternatives Portfolio and is responsible for research, and has recently been promoted to head of portfolio management. Mr. Graham-Smith has 16 years’ industry experience, including working as a senior hedge fund analyst, investment specialist, and quantitative specialist for Deutsche Bank's absolute return strategies business, a valuable background for his current role.

Brendan Foley, managing director, oversees all aspects of SELECT’s business, and plays an active role in the investment strategy (IS) meetings. Mr. Foley has 26 years’ experience in the financial services and technology industries, and was previously treasurer of Man Group plc's funds management division.

Manager research is conducted by all members of the investment team, including Stephanie Sarantis and David Matesic. Ms. Sarantis joined SELECT in 2003 as a member of the operations team, moving across into the investment team as a manager researcher in 2007. She joined from an insurance company, where she had been working for four years. Mr. Matesic joined in 2007, from Aon Consulting, and prior to this he had worked at Aspect Huntley. Mr. Matesic has five years’ industry experience.

SELECT has also developed relationships with experienced consultants in specialist capacities that sit on the IS meeting and advise on fund selection. Sam Armstrong is a managing partner of Barwon Investment Partners with 20 years’ involvement in alternative investments, and was the joint managing partner of a specialist private equity fund-of-funds group, Quay Partners Pty, Ltd. Dr. Bartholomew Dowling has a broad range of experience as economist, strategist, global asset allocator, and absolute return manager.

The current primary exposure to alternative investments is through one of Gottex's funds-of-hedge-funds and Aspect's diversified managed-futures program. Exposure to precious metals is gained largely through Baker Steel's gold fund offering. Up until recently, SELECT had been marketing the stand-alone products offered by business partners and minority shareholders, Gottex, Aspect, and Baker Steel.

With a generous remuneration structure, which offers incentives for staying with the manager, such as a profit-share arrangement with long-dated options and deferred bonuses distributed over three years, "key person" risk is somewhat alleviated. Nevertheless, Mr. McCormick in particular would be a loss if he left SELECT, given his breadth of knowledge and substantial financial markets experience.

The investment team has been stable since the last S&P review, although two sales roles were made redundant in early 2009.

**Portfolio Review**

SELECT's investment process is transparent, with flexibility to invest in a variety of diverse investments, further enabled by broad strategic asset allocation (SAA) ranges. TAA and manager selection decisions are
interdependent, with market themes and views on underlying managers driving the portfolio construction process.

The broad SAA framework is set with regard to the fund objectives and the nature of the investments. While alternatives are categorised as a separate asset class, long/short and other less mainstream strategies can be contained within the equities, fixed interest, and property exposures.

SAA ranges are highly flexible and provide a wide band of discretion in selecting underlying investments. Ranges are not determined by optimisation or historical back testing, but are rather the result of more subjective views on appropriate risk allocations. Individual investment exposures are limited to 10% of the portfolio.

SAA ranges are intended to be formally reviewed by the SELECT research and investment committees on a three- to four-year basis. On July 1, 2008 the manager reduced the fund's equities exposure range to 40% to 80%. These ranges provide a guide, but are not hard limits; individual sector allocations can be temporarily exceeded. Investment weightings are determined in the weekly research meeting with input from other meetings including the monthly investment strategy (IS) meeting.

SELECT predominantly conducts its own due diligence on all managers it invests in; however, there is reliance upon Gottex for hedge-fund manager selection. The team currently meets approximately 30-50 new unlisted managers and 30-40 listed managers per year, which incorporates the listed investment company universe within Australia - and a significant number within the U.K. New investment ideas are sourced largely through industry networks, referrals from fund managers relationships, and global partners. A range of external data sources and information systems are used to access manager data and to supplement other means of identifying possible candidates for further research. SELECT tends to favour boutique investment houses and specialist managers.

In assessing managed investments, the team initially identifies vehicles that have attractive assets or are considered likely to perform well in the short to medium term. The quality of the individuals responsible for managing these vehicles is also taken into consideration. Most conventional funds are screened out, which reduces the investable universe to a more manageable size. The types of managers that are examined tend to have a more absolute-return investment approach, which includes long/short managers.

For listed assets, vehicles trading at abnormal discounts to net tangible assets (NTA) are identified - and there must be an identifiable catalyst for that discount to narrow.

The check list of qualitative criteria examined includes specific issues within the broad categories of resources/people, philosophy/approach, research process, portfolio construction and risk management, and product features/operational issues. For unlisted vehicles, the review process can take between two months and a year, involving several face-to-face meetings in addition to electronic and phone contact over the period. SELECT will not always meet the manager of a listed fund before investing if it is already familiar with it and has a higher degree of comfort due to the continuous disclosure requirements of the Australian Stock Exchange. Once invested, there is at least quarterly contact with a manager.

Operational due diligence is also conducted by the investment team. Some of the key potential problems the team is seeking to identify are the existence of fraud or negligence and possible conflicts of interest. A limited track record in focusing on a particular strategy is not necessarily a reason for excluding a manager from investment, but more extensive examination is usually required to justify a position. Reference checks of key investment staff are undertaken for smaller unlisted funds, and there is a review of middle- and back-office operations, such as the procedures for handling transactions.

Each manager added to the portfolio must provide complementary exposure to existing investments within an asset class. Portfolio holdings and weightings are not formulaic, but rather are determined by a combination of both relative and absolute valuation analysis, long-term sentiment evaluation, and medium-to-long-term macro-economic assessment. Underlying correlations and potential overlap of diversified fund investments are also taken into account to ensure active risk is intentional. Within the equities category, there is likely to be a mix of traditional and long/short managers, with a bias towards concentrated portfolios and managers with a value or contrarian approach. Managers that employ a value investment philosophy buy stock based on its discount to intrinsic value. This discount to intrinsic value is commonly referred to as the manager's "margin of safety". The margin of safety protects the investor from both poor decisions and downturns in the market. Because fair value is difficult to accurately compute, the margin of safety gives the investor room for error. This is the central thesis of "value investing" philosophy which espouses preservation of capital as its first rule of investing. S&P considers this style of investment approach suitable for a manager who has an absolute return focus.

A top-down thematic view is the pre-eminent determinant of TAA decisions and is the major consideration before actual underlying investment decisions are made.

TAA shifts tend to be incremental and established for the medium term, unless there is a large movement in valuations or a change in investment fundamentals. For listed funds, the approach is more opportunistic, and SELECT continually monitors the trading activity, shareholder changes, and particularly the discount/premium to NTA, enabling a quick reaction to market movement.

Performance during periods of market stress is tested, and liquidity may be critical if the manager tends to exhibit highly volatile performance and where a quick exit might be required. Liquidity guidelines are strict and the portfolio will be rebalanced as the limits are reached. Rebalancing generally takes place on a monthly basis, however, it may be agreed at the weekly investment committee meeting if required.

Between 25 and 50 investments are generally held in the portfolio. Although promoting a broad cross-section of views and critique of investment ideas, the committee-based approach to portfolio construction may become inefficient and result in less accountability as the team grows. However, Mr. McCormick is ultimately responsible for fund performance.

The triggers for termination of a manager include a negative six-to-12-month view of the investment strategy, which will entail a reduction in the allocation and part or total redemption of the underlying managers. Manager-specific reasons for termination are poor performance, style drift, change in investment terms, and a significant change in staffing. Often, a concern regarding an issue such as poor performance will involve a more in-depth examination of a manager to evaluate why this occurred: if market conditions did not suit the manager at that time and performance is likely to improve, or whether it is more symptomatic of a lack of skill, which will result in divesting the manager.

The manager may make an allocation to its internally managed funds. At present, a significant portion of the manager's allocation to alternatives will be through the Gottex funds, two of which have had redemptions suspended by the manager due to the abnormal level of investor redemption requests. The manager is conscious that the more liquid assets would need to be sold down to meet these redemptions which
effectively leaves remaining investors with an altered risk and liquidity profile. S&P has subsequently placed 'On Hold' ratings on the Select Gottex Enhanced Market Fund and Select Gottex Market Neutral Fund. The allocation to the Gottex strategies is between 8% and 10% depending on the diversified fund.

The manager has also allocated assets to the Select Future Fund via Aspect Capital and the Select Gold Fund through Baker Steel. These allocations are between 2% to 4% of the diversified portfolios.

An allocation to the Select Listed Investment Fund makes up between 2% and 3% of the Australian equity allocation within the diversified portfolio.

The portfolio invests primarily in funds that take an active or hedged approach to currency. If required, additional currency positions for currency hedging purposes are put in place. Ongoing assessment of the currency position is an integral part of the investment process. S&P considers the manager's quantitative and qualitative assessment and monitoring of investments robust and relevant for the types of investments held.

Performance

The fund aims to produce a positive absolute return and preserve capital over the medium to long term. For the purposes of peer relativity the fund has also been assessed relative to peers with similar asset allocation strategies, which are based on the aggregate allocation to growth assets.

Over the 12 months to Dec. 31, 2008, the fund produced a net-of-fees return of negative 26.76%, compared to the peer-group median manager return of negative 33.74%. Negative returns were posted across most of the manager's investments, with the exception of Australian large-cap equity, property and infrastructure, fixed interest and cash, which all produced very modest positive returns.

The fund produced a strong relative result for the three years to Dec. 31, 2008, with an annualised net-of-fee return of negative 3.27%, compared to negative 5.78% for the median manager in the peer group. Fund volatility, as measured by the standard deviation metric, was 7.7% per year, compared to 13.3% per year for the peer-group median manager.

Over the five years to Dec. 31, 2008, the fund achieved an annualised return of 2.79%, which was in line with the median manager return for the peer group.

Taking the effects of 2008 out of the analysis, over the past five calendar years the fund has produced returns of between 8% and 14%, with the exception of calendar year ending December 2008, where the fund produced a return of negative 26.76%. Although all funds in the peer group posted solid positive returns over discrete years from 2004 to 2007, they have typically outperformed the Select fund during these bull market years. That said, they have underperformed the Select fund during the bear market years of 2007 and 2008. This performance outcome is not surprising given the manager's greater allocation to vehicles that include hedging strategies, relative to peers.

SELECT's risk-management framework is thoroughly embedded into the manager selection and asset allocation process thereby managing risk throughout all key stages of the investment cycle. Operational due diligence is a significant component of manager-risk management, which incorporates a critique of the manager's own risk systems and processes and business continuity plans.

Qualitative assessment also incorporates capacity risk; this is a critical issue for managers and one difficult to quantify because it can vary vastly according to a range of factors, including the manager's investment style, market conditions, and growth. In general, allocations to a strategy will be curtailed if there is considered to be limited liquidity, and consequently less capacity. Liquidity risk is an aspect of portfolio risk management that has become increasingly important for fund managers to monitor. The manager has divided the portfolio into liquidity buckets ensuring monthly liquidity remains adequate.

The qualitative assessment focuses on individual investment, style, and market risk, which collectively form the basis of SELECT's quantitative risk management approach. Within the risk-management framework there is an emphasis placed on proprietary systems. Value at risk (VaR) is one of the key ongoing risk controls accompanied by Monte Carlo simulation which is used for stress testing the portfolio and simultaneously used within the portfolio construction process. Correlation analysis is regularly conducted and helps to determine sector allocation and overall diversification levels.

Regular analysis is conducted on each manager, including return, volatility, drawdown, downside deviation, Sortino, and Sharpe ratios, and the correlations of the investments are monitored. Compliance and risk reporting is automated which minimises human error, and consequently improves accuracy and timeliness.

S&P has recently reviewed the manager's risk-management process and considers there to be a very disciplined and rigorous framework in place.

Management Group Profile

SELECT Asset Management is a specialist Australian fund manager with an absolute return philosophy and a core focus on alternative investments and diversified portfolios. SELECT believes that the key to long-term wealth creation is to achieve attractive compounding rates of return above cash, and limiting major losses of capital in difficult market conditions. The manager aims to provide a steady rate of compounding returns with lower volatility than traditional managed portfolios over the long term, being three to five years.

Equity ownership in the SELECT business is divided into 33% employees and executives directors, 34% non-executive directors including Gottex directors, 19% Officium Capital, 4% Aspect Capital including directors, and 9% past employees. The SELECT team comprises 22 people, covering such divisions as investments, operations, accounting and finance, and sales and marketing.

Market Share

At Dec. 31, 2008, SELECT manages assets of around A$550 million across its range of funds and portfolio solutions, of which the Select Growth Portfolio holds A$137 million, and the Select Defensive Portfolio holds A$147 million. Five clients hold 93% of the diversified assets under management, with the largest client holding 61% of the assets under management. This represents a significant “key investor” risk for the manager. The manager's clients are predominantly retail platforms. The fall in assets under management from A$750 million at
the time of the S&P review in 2007, was due to some outflows, but mainly reflected the result of market declines.

*Analyst(s): Rodney Lay; Justine Gorman.*

*Release authorised by: Mark Hoven.*
S&P Fund Rating Reference Information

Multi-sector - 100 (at June 25, 2009)

Reference Material

- Sector Reports
- Reader's Roadmap
- Glossary
- Guide to S&P Qualitative Fund Ratings
- Fund Rating Team Biographies
Fund Rating Peer Groups by Sector

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Fund Rating Philosophy

A star rating is a forward-looking qualitative assessment of a manager’s ability to consistently generate risk-adjusted fund returns (net of fees) in excess of both its relevant investment objectives and its peers.

Fund Rating Process

In assigning a star rating to a fund, Standard & Poor’s evaluates: the size, skill, and stability of the manager’s investment team; the clarity, implementation, and risk management of the investment process; the fund's objectives, fee structure, and portfolio characteristics; and the manager’s business management.

Fund Rating Definitions

- **Five Stars**: Standard & Poor’s has very high conviction that the manager will consistently generate risk-adjusted fund returns in excess of its relevant investment objectives and relative to its peers.
- **Four Stars**: Standard & Poor’s has high conviction that the manager will consistently generate risk-adjusted fund returns in excess of its relevant investment objectives and relative to its peers.
- **Three Stars**: Standard & Poor’s has conviction that the manager will generate risk-adjusted fund returns in-line with its relevant investment objectives and relative to its peers.
- **Two Stars**: Standard & Poor’s has conviction that the manager will not generate risk-adjusted fund returns in-line with its relevant investment objectives and relative to its peers.
- **One Star**: Standard & Poor’s has high conviction that the manager will not generate risk-adjusted fund returns in-line with its relevant investment objectives and relative to its peers.
- **On Hold**: Issues that may affect the fund's management have emerged; and the fund rating is temporarily suspended, pending clarification.
- **Sell**: Significant issues exist that potentially will adversely affect the fund’s performance. Investors should consider obtaining advice on switching or redeeming funds.

Fund Rating Subscript

- **New**: The investment process, fund manager, or the fund has a relatively short history, or the analytical team has changed significantly, but a relevant and demonstrable track record is shown on similar funds.