



Qualitative Fund Research

Pathfinder Asset Management World Equities Fund

January 2017

About the Manager

Pathfinder Asset Management Limited (the Manager, PFAM) was founded in 2009, and is built on the premise that the Manager is the custodian of a client's investment, not the owners of it. While subtle this is very much a different starting point to the client relationship. The Manager has provided a brief profile available [here](#).

PFAM's philosophy is based on the belief that "factor based", passive and/or "rules based" exposures over the long run tend to outperform most managers. They think of their strategies in terms of "active macro", "smart indexing" or enhanced beta. PFAM's approach to investing is unique in the New Zealand market, where the market is dominated by actively managed strategies.

PFAM extends this passion to transparency and good governance, outlined [here](#) and actively contributes back to the local communities, available [here](#). FundSource Ltd views corporate citizenship

and governance frameworks as extremely important foundations from which a manager starts to engage with the clients' experiences.

PFAM manages four funds:

- PFAM Commodity Plus Fund
- [PFAM World Equity Fund](#)
- PFAM Global Property Fund
- PFAM Global Water Fund

These funds are managed by a team of three investment professionals, who are generalists focused on "top down" macro research, as opposed to "bottom up" security selection. Operations consists of two people. The Board comprises two independent directors and two executive directors averaging over 20 years' experience each in financial services. For the number of funds being managed the team is adequately resourced, having well tenured and experienced personnel. Individual bios for the team at PFAM can be found [here](#).

Using this Fund

This is General Advice only and should be read in conjunction with the Disclaimers, Disclosures and Warnings at the end of this document.

The PFAM World Equity Fund ("the Fund") employs a research based investment strategy that is implemented through a portfolio of Exchange Traded Funds (ETFs). As such the Fund, will generally sit within the growth component of a balanced portfolio, more specifically within the global equity allocation.

The Fund is subject to equity market risk and both positive and negative movements in the share prices of the underlying securities in the portfolio. Investors should therefore be aware that the Fund may experience periods of negative returns and that there is a risk of potential capital loss being incurred on their investment.

The Fund intends to be fully invested, and is expected to have a minimal cash holding. The Manager does have the ability to reduce the exposure to ETFs down to 25% in certain circumstances.

To redeem units in the Fund, the Manager requires a three business days' notice period, and investors can expect to be paid within 10 business days post the notice period.

The Fund is a Portfolio Investment Entity (PIE). The Fund currently does not pay distributions to investors. This means that any income received by a Fund is retained, and is reflected in the unit price.

Question	What the Manager says	What FundSource think										
What are the Manager's assets under management - in total and in this Fund?	<p>As at 31 December 2016 PFAM has in excess of \$128 million of funds under management (FUM). PFAM manages four PIE funds with a focus on international (not domestic) assets. The funds and FUM are below:</p> <p><i>As at 31 December 2016:</i></p> <table><tr><td>Commodity Plus Fund:</td><td>\$74.2M</td></tr><tr><td>Global Water Fund:</td><td>\$10.3M</td></tr><tr><td>World Equity fund:</td><td>\$31.1M</td></tr><tr><td>Global Property Fund:</td><td>\$12.9M</td></tr><tr><td>Total in PIE Funds:</td><td>\$128.5M</td></tr></table>	Commodity Plus Fund:	\$74.2M	Global Water Fund:	\$10.3M	World Equity fund:	\$31.1M	Global Property Fund:	\$12.9M	Total in PIE Funds:	\$128.5M	<p>The Manager commenced business in 2009, and can therefore substantiate its proven longevity with a 7 year track record. For the types (and number) of strategies the business has relatively low levels of funds under management. This is, however, reflective of the boutique nature of the business and the focus on alternative assets or alternative ways to cost efficiently access traditional asset classes.</p> <p>The Fund's first units were issued on 14 November 2011. It initially commenced with separate hedged and unhedged versions of the Fund. These were subsequently converged in to a single fund which now employs an active currency overlay. This change came in to effect on 31 December 2013.</p> <p>The Fund is considered to be less than what is typically required for an institutional manager to be profitable. The size of FUM is reflective of the boutique nature of the Manager, which is profitable at current FUM levels. The Manager operates a largely rules based quantitative approach to investing across its products that typically reduces resources required and cost involved in managing the Fund.</p>
Commodity Plus Fund:	\$74.2M											
Global Water Fund:	\$10.3M											
World Equity fund:	\$31.1M											
Global Property Fund:	\$12.9M											
Total in PIE Funds:	\$128.5M											
Who is accountable for managing the Fund, and how long has the investment team worked together?	<p>Paul Brownsey is the Chief Investment Officer (CIO) of Pathfinder. The direct investment team is Brownsey, John Berry and Karl Geal-Otter. Brownsey and Berry have managed funds at Pathfinder together since May 2009. Geal-Otter joined the team in November 2015.</p> <p>An investment committee comprising Brownsey, Berry and Kent Fraser (an independent consultant) set operational limits and review overall fund strategy. Fraser has a strong background in risk, treasury and financial markets.</p>	<p>Brownsey has been the Manager's CIO for over seven years, and has strong experience, in managing index and rules based strategies. Berry is focused on the operational aspects of investing, but has a solid knowledge of the investment process and implementation of it. Each of Brownsey and Berry have over 20 years industry experience, covering a range of investment structures and products.</p> <p>FundSource notes that there is a higher degree of key person risk, with respect to the Manager. This is in part mitigated by Brownsey and Berry holding a significant equity stake in the manager.</p>										
What objective is the Manager trying to achieve?	<p>The Fund's objective is to:</p> <ul style="list-style-type: none">provide cost efficient and diversified access to global equities (across both developed and emerging markets); andachieve a return higher than the fund's benchmark (after fees but before tax) over medium to long term (3-year +) horizons <p>Monitoring whether the Fund is achieving its objective involves the following metrics measured over 3 year periods:</p> <ul style="list-style-type: none">returns after fees and before tax vs the fund benchmarkvolatility vs the fund benchmark	<p>The Fund's since inception performance history is attributable to both Brownsey and Berry.</p> <p>The use of a Vanguard ETF, USA ticker VT, as the Fund's benchmark is unusual, but shouldn't be considered as being inappropriate. As well as being a different approach the ETF reflects an index not commonly used as a reference benchmark for global or international equity funds.</p> <p>While the Manager uses ETF's to implement the strategy, the Manager can use sector, country, and regionally specific ETFs, which can lead to a portfolio that looks significantly different to the benchmark index. The Manager has a</p>										

	<ul style="list-style-type: none"> returns after fees and before tax vs the average of a sample of international equities PIE funds <p>The Fund benchmark is US listed global equity ETF (ticker: VT) applying 50% currency hedging to NZ dollars. This ETF tracks the FTSE Global All Cap Index.</p>	<p>target hedging position of 50%, but can significantly vary the hedging amount, should the Manager hold a particular view on the NZ dollar.</p> <p>The objective is to achieve a higher return than the Fund's benchmark over 3 years, net of fees, but before taxes, please refer to the Manager's factsheet.</p> <p>The expected quantum of performance over the Fund's benchmark is not clearly stated by the manager, accordingly investors should remain abreast of the Funds' performance, to ensure it still meets the investors needs and objectives.</p>
What does the Manager invest your money into?	<p>The Fund invests in exchange traded funds (ETFs) for exposure to global equities.</p> <p>The allocations reflect Pathfinder's view on (a) geographic regions (Europe, US, Asia etc.) (b) company size (small, mid, large capitalisation etc.) (c) sector (utilities, healthcare, technology etc.) and (d) other groupings (such as high dividend yielding stocks, value factor, growth factor etc.).</p> <p>Despite using ETFs as building blocks, this is not a passive fund. The manager describes the Fund style as "active macro".</p> <p>PFAM make short to medium term tactical asset allocation decisions based on its investment views. The intention is for the Fund to have a highly diversified portfolio of more than 500 underlying exposures. No single exposure can be more than 10% of the Fund.</p> <p>The Fund can also allocate to cash or use derivatives for downside protection (implemented very sparingly). This decision is based on PFAM's market valuation scoring, which in turn is derived from a series of objective measures, including (a) Market cap to GDP ratio (b) Tobin's Q ratio (c) long term market trend (d) forward PE vs 5-year average and (e) St Louis Fed Stress Index.</p>	<p>The Fund is suitable for investors who want an actively managed, benchmark unaware, global equity fund that can implement the Fund's strategy via a mix of highly focused ETFs. For example, while the basket of underlying positions in the ETFs can range from being in the 10's – 1000's, the ETF itself may be very specific in the sector, country or company size it is targeting. This approach is likely to lead to an asset allocation that can vary significantly from benchmarks typically used in performance analytics and investment performance comparisons.</p> <p>By implementing the investment strategy via ETFs an investor can expect to have exposure to a significant number of countries (approximately 50) and to over 2000 companies.</p> <p>FundSource believes the Manager's transparency, courtesy of publishing the Fund's holdings on the FMC Register, to be a strong positive. The underlying securities are predominantly long only equity positions. However, derivatives can be used to assist in hedging market risks.</p>
What are the inherent risks imbedded in the Fund?	<p>The Fund invests in a global, diversified portfolio of ETFs and the underlying assets these ETFs hold. The normal risks inherent in this type of investment apply, such as:</p> <ol style="list-style-type: none"> 1) general market risk 2) individual company risk 3) liquidity risk 4) single asset class risk 5) counterparty risk 6) currency risk. <p>PFAM believes that the role of a good investment manager includes understanding, quantifying and managing risks that may impact the Fund, and communicating these to investors.</p>	<p>The Manager is aware of the broad range of risks and is mindful of them when constructing and managing the Fund. Key decisions by the Manager are macro related decisions focusing on the region, country and sector the manager is looking to avoid or invest in.</p> <p>The currency hedging decision making process starts with the hedging level sitting at 50%. It is expected that hedging will typically remain relatively close to the 50% hedging level, unless the manager has a strong view on the NZD.</p> <p>The Fund is an active research based strategy, differentiating the Fund from the rest of the Manager product suite, at the time of writing. The change to a fully researched security selection process places greater demands on the investment</p>

		<p>team. FundSource believes that in this case the Manager would benefit from additional resources, to assist in reducing the elevated key person risk of this fund.</p>
<p>Why do they believe the future prices of the Fund's investments will vary?</p>	<p>Global equities are a key component of diversified portfolios. Prices of equities will go down as well as up, requiring a medium to long term investment horizon.</p> <p>Through broad diversification across countries and sectors, the Fund can mitigate much of the risk of individual stock price moves. However the value of the Fund's portfolio as a whole will move as equity markets globally trend up and down.</p>	<p>The Fund is a benchmark aware global equity fund, however, can make investments, via ETFs, that can lead to meaningful differences to the benchmark. The FE Analytics NZ Global Equity data indicates that the Manager has ranged from low to positive correlation with the Funds benchmark. Investors should consider the Fund as having a minimum investment horizon of at least five years. Over shorter periods, there is potential for material movement in the value of underlying shares.</p> <p>FundSource believes that there is potential for the Fund to generate returns that can deviate, both negatively and positively, from that of the index, despite the expected high number of overall stocks making up all the ETFs invested in. This is because the Managers active macro allocation process may materially overweight regions, countries or sectors.</p>
<p>Why does the Manager believe you should give them your money rather than to someone else or to an inexpensive index fund?</p>	<p><u>Inexpensive index exposures:</u> The obvious choice for cheap exposures is to select an ETF. There are, however no similar ETF exposures available which provide:</p> <ul style="list-style-type: none"> ▪ Currency: Variable NZD currency hedging ▪ Active macro allocations: Ability to implement under/over-weight positions at a macro level (PFAM implements a top down view of the markets seeking those offering the best risk adjusted return). <p><u>Other NZ PIE fund options:</u> There is a limited universe of international equity PIE funds available in NZ. Comparing to other international equity PIEs:</p> <ul style="list-style-type: none"> ▪ Fee: Pathfinder's 1.1% + GST fee (plus underlying ETF charges) is at the low end. As well, Pathfinder does not charge investors a performance fee. ▪ Currency: Pathfinder has a target 50% hedge but can deviate from this if it believes there is an opportunity to reduce risk or add value. 	<p>The Manager is providing investors with an opportunity to gain exposure, in a relatively unique way, from a PIE structure perspective. The uniqueness is in the form of using ETF's as the method of gaining exposure to regions, countries, and sectors. Of the 111 funds in the FE Analytics NZ Equity Global sector, there are only two funds who predominantly implement their strategy via index funds or passive ETFs, both are PIE structures.</p> <p>The use of macro overlay, as a core decision making process, is not widely used by global equity managers most managers prefer a fundamental bottom up, security selection approach. The top down macro driver does potentially provide some diversification benefits, in that key decisions will have a different set of inputs compared to peers. The typical exposure in the portfolio is circa 2000 stocks, which is more than most active fundamental global equity funds.</p> <p>Investors should expect the Fund to be fully invested with a targeted cash weight of 0%. With an inception date of November 2011 the current performance history is mixed as outlined on the Managers website. While the Fund's performance has lagged the Manager selected market index, however, it has above average performance and lower volatility and tracking error than the average global equity fund in the FE Analytics NZ Global Equity fund.</p>
<p>How does the Manager decide to buy or sell investments?</p>	<p>The Fund's investment style is "active macro". This means PFAM implements</p>	<p>FundSource notes that the Fund employs a structured, systematic, macro driven</p>

	<p>investment themes with a medium to long term horizon. Investment ideas are generated from either PFAM's own analysis or recommendations from a wide range of expert sources engaged by PFAM.</p> <p>Paul Brownsey will model how an investment idea is expected to impact on the Fund portfolio. An internal paper is produced to record the investment rationale.</p> <p>The Investment Committee formally reviews Fund positions each quarter. The review process involves the following steps which identify what is (and is not) performing for the Fund as well as where the key investment risks sit:</p> <ol style="list-style-type: none"> 1) High level review of portfolio returns 2) Return attribution by geography 3) Return attribution by sector 4) Review of expected tracking error 5) Current holdings 6) Scenario analysis (portfolio stress testing for a range of possible events) 7) Value at Risk (VaR) analysis <p>As well as reviewing on a portfolio basis, the Investment Committee analyses individual positions. The purpose is to challenge whether the rationale remains for continuing to hold. PFAM regards the decision to exit a position as equally as important (and often harder to make) than the initial buy decision.</p>	<p>process to categorise and rank potential opportunities for their suitability for incorporating in to the portfolio.</p> <p>FundSource believes the proprietary system employed by the manager relies heavily on the skills of Brownsey, highlighting the keyperson risk in the model. It is important to highlight that Brownsey is ultimately responsible for determining the buy and sell decisions.</p>
Has the CIO/ PM personally invested in the Fund? If so, paying the same fees as other investors?	<p>Part of the core philosophy is that managers should invest alongside their investors to align interests. The principals of Pathfinder (Berry and Brownsey) both invest in all funds managed by Pathfinder. Their investment is on the same terms and conditions (including fees) as other Pathfinder investors.</p>	<p>FundSource believes that 'eating your own cooking' should be an aspect potential investors consider, when deciding to invest in any financial product.</p> <p>Investing in funds alongside investors aligns the interests of investment personnel with those of the investors, particularly when the investment is on the same fee basis.</p> <p>The Manager believes alignment of interest is an important aspect as well, to the point that not only are Brownsey and Berry significant shareholders in the Manager, but are significantly invested in all PFAM funds. Importantly, Brownsey and Berry pay the same fees as other investors, enhancing the alignment of interest with an investors experience.</p>
How much latitude does the Manager have to deviate from the weightings of the Benchmark portfolio?	<p>PFAM takes a "top down" macro approach to building the portfolio. This means the manager can (and does) take significant positions away from the benchmark when believe to be justified. The allocations reflect Pathfinder's views on, among other things, the outlook for global markets, relative value between markets, market valuations and event risk.</p> <p>Tracking Error +/-3.0%</p>	<p>As the manager states, the top down influence can lead to material portfolio differences to the benchmark. The top down macro input does require manager insight, and accordingly increases the reliance on the investment personnel, and key person risk. The macro overlay is then complemented with a rule based quantitative filter to identify candidate ETFs.</p>

	<p>Cash Allocation: typically 0%-10%</p> <p>Single ETF Limit: <3% of market cap</p> <p>Sector Limits: n/a</p> <p>Country Limits: n/a</p> <p>Regional Limits: n/a</p> <p>There are restrictions on the types of ETFs that can be held. No leveraged, inverse or synthetic ETFs are permitted.</p>	<p>Further to the ETF restriction of 3% of market capitalisation, the Manager does not invest in ETFs that have less than \$1 billion invested in them. The Manager also has a liquidity restriction, where each ETF holding must be less than 3% of that ETF's one month trading volume.</p> <p>Setting aside the Fund's intention to be fully invested, there are few other restrictions the Manager needs to adhere to in implementing their investment strategy. Investors must be prepared to be invested in a Fund that can materially change its allocations to a specific region, country or sector at any point in time.</p>
On what basis does the Manager believe the fees they charge are justified?	<p>PFAM believe the fees are justified because they provide good value for a low fee. The base management fee is 0.89% which PFAM believe is at the lower end of management fees in NZ. In addition to this base fee, the Fund incurs costs of trustee, registry and fund accounting which are an additional 0.21%. This gives a total fund fee of 1.1% (plus GST). The total fee is capped at this level.</p> <p>Trading costs (i.e. brokerage costs) are paid by the Fund. All other costs (i.e. legal, audit etc.) are paid for by Pathfinder. PFAM do not recharge these to the Fund meaning the total expense ratio for the Fund is fixed at 1.1%.</p> <p>In addition, PFAM do not charge performance fees to the Fund. PFAM believe that true alignment of investor and manager interests comes from Pathfinder's management team investing alongside investors.</p>	<p>FundSource believes the Manager is transparent from a fees perspective, noting the administration and underlying manager fees are disclosed in the Product Disclosure Statement (PDS) available here. The New Zealand Companies Office website provides further details on fees are available here.</p> <p>Compared to other funds in the FE Analytics New Zealand Global Equity Sector, the Managers fees are below the average basic fee and investment cost ratio charged by global equity managers.</p>
How would you describe the quality of your organisational and investment governance processes?	<p>PFAM believe their organizational and governance structures are very high quality. The governance structure is led by independent directors Sandy Maier and Catherine Savage. Sandy and Catherine are both high profile, deeply experienced directors with considerable governance expertise at financial firms. For example, Catherine is Chair of the Guardians of the NZ Super Fund.</p> <p>From the inception of Pathfinder the independent directors have overseen implementation of robust compliance and risk policies. Berry has a strong legal background in financial markets. Berry is functionally responsible for ensuring the governance, risk and compliance procedures meet the standards that are required by the independent directors and are expected by investors.</p> <p>Pathfinder Asset Management Limited is licensed under the Financial Markets Conduct Act 2013 as a manager of registered schemes.</p> <p>Some functions are outsourced to reputable firms, e.g. Custodian – Public Trust, Audit – PWC (funds) and Deloitte</p>	<p>The Manager has a solid governance framework. FundSource believes this could be strengthened by increasing the number of Non-Executive Directors, and managing the tenure that non-executive personnel serve. FundSource notes that the two Non-Executive directors form the Audit Committee. Separating Committee functions is considered good governance, however, expanding this to include remuneration, would be viewed favourably.</p> <p>FundSource views the implementation of a formal Investment Committee in 2015, which includes independent member Kent Fraser, positively. This could be further improved, by expanding the number of external advisers, which would align with global best practice.</p> <p>The Manager does outsource some functions. External providers are reviewed annually which for key providers includes a face to face meeting with the Audit Committee. FundSource note that all providers are large well-resourced providers in the New Zealand Market.</p>

	(Manager), Fund Accounting and Registry – MMC, Legal – Russell McVeagh.	
Is there alignment of interests through; ownership of the Manager, and remuneration of the investment team?	<p>Aligning Pathfinder's interests with those of the client is an important focus for Pathfinder. PFAM see this as achieved through several factors:</p> <ul style="list-style-type: none"> ▪ <u>Manager ownership</u>: Berry and Brownsey own 92% of the equity of Pathfinder. The equity ownership ensures Berry and Brownsey are highly incentivised to build a successful long run track record for investors in the funds. ▪ <u>Co-investment</u>: Berry and Brownsey both invest in Pathfinder's funds. This gives the strongest possible alignment of interests with investors. ▪ <u>No performance fees</u>: Pathfinder does not charge performance fees. (Pathfinder see performance fees as generally a poor alignment of manager and investor interests – performance fees are an asymmetric reward which may skew manager risk performance and fail to align in falling markets). 	<p>FundSource observes that to preserve capital and generate a long-term positive return for investors, the Manager must remain operational.</p> <p>Being substantially owned by the Founders/Principals, including key investment personnel, there is strong buy-in from the team to work hard for the firm's long-term success. FundSource considers this a positive alignment with investors.</p> <p>This means that, unlike institutional managers, the Managers primary duty is not to an external shareholder.</p>

Conclusion and Rating

The Fund provides an investor with exposure to an ETF based strategy that uses a macro based decision process to invest in Global Equities. FundSource observes that the Managers does not focus on broad index based ETFs, rather the Manager looks to identify region, country, sector and small, medium and large market capitalisation specific ETFs. Subsequently, FundSource notes that the portfolio may have allocations that are materially different to the Funds reference benchmark.

Pathfinder have shown that by employing quantitatively focused macro based strategies each fund achieves its breakeven point at lower levels of funds under management than typically required by active fundamental based strategies. FundSource notes that despite the Funds long track record the FUM is relatively low.

Key and critical to FundSource's conviction in the manager is the significant ownership of Brownsey

and Berry. Any change in key personnel will likely have a material impact on FundSource's conviction in the Manager.

Importantly, the interests of the investment team are strongly aligned to those of the investor via the investment team's shareholding in the company and their investment in the Fund, and paying the same fees as retail investors.

The Fund takes a differentiated approach to typically index based investments in global equities. FundSource recommends that investors carefully consider that the Managers approach meets their investment needs and objectives.

FundSource Rating: **AA**

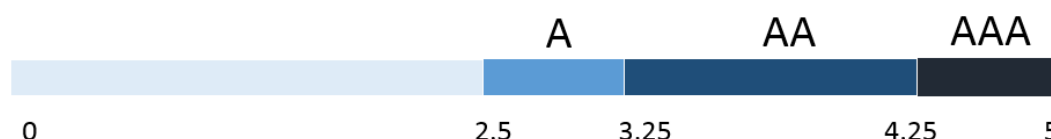
Fund ratings are current as at the date of publication of this report. FundSource reserve the right to review and update fund ratings from time to time

Research Factor Weighting

Research Process Category	Model Factor Weight	Analyst Average Score
Corporate & Investment Governance	15%	3.88 / 5
Investment Philosophy & Process	20%	3.50 / 5
People	25%	2.83 / 5
Portfolio Construction & Implementation	15%	3.25 / 5
Risk Management	15%	3.20 / 5
Investment Fees	10%	2.93 / 5
Overall Average Score:		3.25 / 5

FundSource Rating Guide

The qualitative rating of a fund is a function of the FundSource Research Factor Weighting process, which is built around the six core qualitative research process categories. The weighted scores result in an overall score, out of five, which is then matched to the following rating:



AAA: Highly Recommended

Funds that have superior average scores in all six underlying qualitative factors. This recognises aspects about the Manager and Fund in question that includes, but is not limited to, significantly experienced and stable senior personnel, a sound track record over a full market cycle, a clearly defined investment philosophy and process, and a portfolio consistent with that philosophy and process. The management company will also have established effective controls to maintain that philosophy.

AA: Recommended

Funds that have strong average scores in all six underlying qualitative factors. This recognises aspects about the Manager and Fund in question that includes, but is not limited to, experienced and stable personnel, a sound track record over a full market cycle, a clearly defined investment philosophy and process, and a portfolio consistent with that philosophy and process. The management philosophy must be coherent and consistent with existing portfolios and processes.

A: Investment Grade

Funds that have good average scores in all six underlying qualitative factors. This recognises aspects about the Manager and Fund in question that includes, but is not limited to, experienced personnel, a sound track record a defined investment philosophy and process, and a portfolio consistent with that philosophy and process.

FW: Fund Watch

There has been a material change with either the manager, this may include, but is not limited to, departures, new hires, process changes, changes to the investment philosophy. This is considered to be an interim measure, to enable further investigation, re-evaluation and an appropriate course of action to be determined.

S: Sell

This category covers previously recommended funds that are no longer recommended because of some material change. Removal from recommended status might be for a variety of reasons such as a fundamental change in the fund management company or in the manager's investment strategy, or because a fund did not meet its original expectations. The implications for ongoing service are that the fund should be reviewed on an individual client basis to ensure it still matches their original investment objective.

NR: Not Rated – Screened/ Not Rated

Funds in the Not Rated – Screened category have provided information and/or FundSource has conducted an initial analysis of the fund, but has chosen not to provide a recommendation at this stage. FOR Not Rated funds the manager may have provided information, but no review meeting has been conducted

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FundSource delivers high quality quantitative and qualitative fund research to financial advisors and the broader financial services industry. FundSource works with a number of expert providers to source this data. Quantitative data is supplied by FE Australia, while qualitative research is provided by Research IP.

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