



Investment options and risk

Issued 2 June 2016



The information in this document forms part of the Product Disclosure Statement for the Australian Defence Force Superannuation Scheme (ADF Super), first edition, issued on 2 June 2016. ADF Super is available from 1 July 2016.

The decisions you make now about your super can help you reach your retirement goals. Take the time to understand your options, taking your personal objectives, financial situation and needs into account. For example, you should consider the:

- > amount of time your money will be invested before you need it for retirement;
- > level of investment performance that you are expecting; and
- > level of risk and fluctuation in the value of your investment that you can tolerate.

Commonwealth Superannuation Corporation (referred to as CSC, we or us) offers, and is responsible for all aspects of ADF Super, including the investment strategy. CSC pools your super with that of other members in a pooled super trust and invests it according to the investment options you choose.

You have the choice of investing in one or more of four investment options – **Cash**, **Income Focused**, **MySuper Balanced** and **Aggressive**. If you do not choose an investment option, your super will be invested in the default option, **MySuper Balanced**.

CSC's framework for portfolio construction

CSC constructs a portfolio for each investment option by categorising assets according to their risk profile and their role in diversifying portfolio-level risk. To this end, investments rest within one of five broad categories, classified by their diversifying role in the portfolio. The five broad categories (corporate

equities, debt, real assets, sovereign assets and alternative strategies) are described below:

- > **corporate equities** comprise Australian shares, international shares and private equity (investment in a company not listed on a stock exchange) investments. These investments earn a real return (ie return above inflation) by financing corporations through public and private equity markets.
- > **debt** comprises corporate credit investments in developed and emerging countries. These investments earn a real return (ie return above inflation) by financing corporations through public and private debt markets.
- > **real assets** comprise property and infrastructure investments. These investments earn a real return by financing the building, maintenance, management and trading of real assets, accessed through public and private equity and debt markets.
- > **sovereign assets** comprise government bonds and cash investments. These investments earn a real return by financing sovereigns and banks, through the holding of government bonds and Australian cash, respectively.
- > **alternative strategies** comprise investments not included in the traditional asset classes listed above, forming part of the 'other' category of assets disclosed within target asset allocations. Examples include investments in hedge funds and multi-asset diversified funds. These investments can have differing levels of risk depending on the actual strategy employed.

Each of the asset classes that make up the above categories are described in more detail on the next page.

Your ADF Super in Action

Any financial product advice in this document is general advice only and has been prepared without taking account of your personal objectives, financial situation or needs. Before acting on any such general advice, you should consider the appropriateness of the advice, having regard to your own objectives, financial situation or needs. You may wish to consult a licensed financial advisor. You should obtain a copy of the ADF Super Product Disclosure Statement (PDS) and consider its contents before making any decision regarding your super.

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Description of asset classes

The following is a general description of asset classes that make up the investment options.

Cash

The cash investment option and other options invest in cash (deposits with a bank) and money market securities (such as bank bills and promissory notes) that are issued or guaranteed by a government, bank or corporate entity. These securities must have a minimum credit rating of A1 (or its floating rate equivalent) for short-term securities and a minimum credit rating of A1 for long-term securities. Standard & Poor's (or the equivalent from Moody's or Fitch if no Standard & Poor's rating is available) determine these ratings. Interest rate futures, swaps and repurchase agreements are also investible securities in this sector.

Fixed interest

Government bonds

Investing in government bonds basically means your money is lent to governments wishing to raise capital. Generally, in return, you receive a fixed rate of interest until the bond matures and the amount invested is repayable. CSC invests in both Australian and international government bonds (such as inflation-linked and nominal, government and semi-government bonds issued by developed and emerging markets). This is generally considered a moderate risk investment as the predominant exposure is to sovereign credit risk (that is the risk that a government cannot or will not honour its existing obligations) and interest rate risk.

Corporate credit

Investing in corporate credit means your money is lent to corporate organisations wishing to raise capital through the issue of corporate bonds. Generally in return, you receive a fixed rate of interest, until the bond matures and the amount invested is repayable. CSC invests in Australian and international corporate credit. This is generally considered a moderate risk investment as the predominant exposure is to credit risk (that is the risk that a borrower cannot or will not honour its existing obligations) and interest rate risk.

Equities

Australian shares

Investing in Australian shares means you are investing in companies listed on the Australian Securities Exchange. The return on your share investments is your part of the companies' profits which is paid to shareholders in the form of dividends, and any capital gains or losses from share price fluctuations. Australian companies are exposed to both local and global market fluctuations and as the companies' fortunes fluctuate, so will the value

of any shares. Share prices are affected by market forces and are considered to be one of the more risky investments, but over the longer term may offer relatively higher returns.

International shares

Investing in international shares is like investing in Australian shares except that the companies are selected from those listed on international stock markets rather than the Australian Securities Exchange. In addition to being exposed to global stock market fluctuations, investment returns can also be influenced by currency movements. Foreign currency exposure is managed through hedging against the Australian dollar. The level of hedging is determined by CSC and may vary from time to time.

Private equities

Investing in private equities involves investing in companies that are not listed on a stock exchange. These companies are located both in Australia and internationally. They provide access to sectors or segments of economic growth that may not be accessed efficiently through listed markets (eg information technology and health care sectors). The private companies are managed by teams with operational expertise in the industries in which these companies operate.

Property

Property includes investments in established buildings and properties, for example shopping centres, or buildings under construction. We also invest money in property trusts and property companies, which means we pool your money together with that of other investors, in order to have the scale to purchase a share of very large properties. The investment returns on property come from rent and changes to property values over time. Our property portfolio generally has lower returns than Australian shares as its risk profile is more moderate.

Infrastructure

Infrastructure includes investments in essential public works facilities and services in Australia and overseas, for example, toll roads, airports, schools, water systems and power supply. We also invest money in trusts and infrastructure companies, which means we pool your money together with that of other investors, in order to have the scale to purchase a share of very large infrastructures.

Other

CSC also allocates capital to investment strategies that exploit price discrepancies between markets and between securities. These strategies provide a stream of returns that are less dependent on the actual direction of equity markets. In this way, these returns hedge the portfolio against episodes of negative equity market returns.

Investment options

Cash

Objective

To preserve its capital and earn a pre-tax return close to that of the Bloomberg AusBond bank bill index by investing 100% in cash assets.

Risk profile and investor suitability

This investment option may be suitable for those who prefer less risk. The minimum suggested timeframe for holding this option is one year or more. With a very low risk rating (band one), it is estimated that the option will have a negative return (ie will lose value) in less than six months of any 20 year period.

Bloomberg AusBond bank bill index

The Bloomberg AusBond bank bill index is a market accepted index that is commonly used to benchmark the performance of short-term cash investment portfolios. The index composition reflects a basket of 13 generic bank bills that range in maturity from one week to 13 weeks. Each week the shortest dated bank bill matures and is replaced by a new 13 week bank bill. In this way, the index has an average maturity of 45 days and is turned over every 90 days.

Income Focused

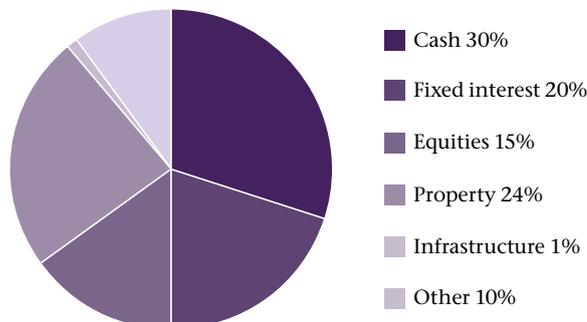
Objective

To outperform the Consumer Price Index (CPI) by 2% per annum over 10 years.

Risk profile and investor suitability

This investment option may be suitable for those who prefer less risk. The minimum suggested timeframe for holding this option is five years. With a low-to-medium risk rating (band three), it is estimated that the option will have a negative return (ie will lose value) in one to two years of any 20 year period.

Target asset allocations



MySuper Balanced – the default option

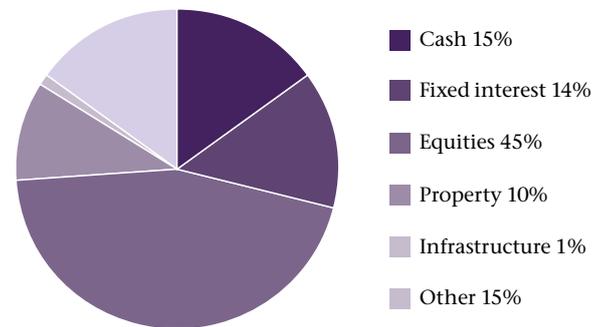
Objective

To outperform the Consumer Price Index (CPI) by 3.5% per annum over 10 years.

Risk profile and investor suitability

This investment option may be suitable for those prepared to take more risk in exchange for potentially higher returns on their investment over the medium-to-long-term. The minimum suggested timeframe for holding this option is 10 years. With a medium-to-high risk rating (band five), it is estimated that the option will have a negative return (ie will lose value) in three to four years of any 20 year period.

Target asset allocations



Aggressive

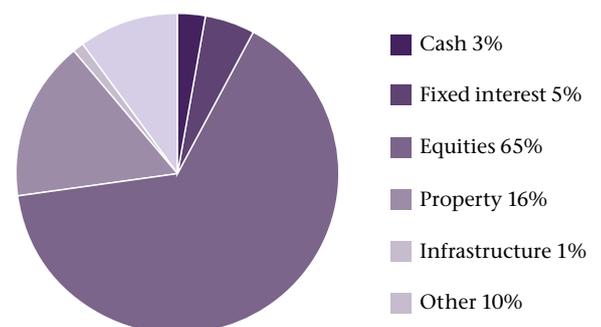
Objective

To outperform the Consumer Price Index (CPI) by 4.5% per annum over 10 years.

Risk profile and investor suitability

This investment option may be suitable for those prepared to take more risk in exchange for potentially higher returns on their investment over the long-term. The minimum suggested timeframe for holding this option is 15 years. With a high risk rating (band six), it is estimated that the option will have a negative return (ie will lose value) in four to six years of any 20 year period.

Target asset allocations



Target asset allocations

The **Income Focused**, **MySuper Balanced** and **Aggressive** investment options have a specific target asset allocation to each asset class which are monitored for market movements within the following target asset allocation ranges.

| Investment | Income Focused | MySuper Balanced | Aggressive |
|------------------------------|----------------|------------------|------------|
| Cash | 10–100% | 0–65% | 0–35% |
| Fixed interest | 10–100% | 0–65% | 0–35% |
| Equities | 0–40% | 15–75% | 20–95% |
| Property | 0–35% | 5–25% | 0–50% |
| Infrastructure | 0–35% | 0–20% | 0–50% |
| Commodities | 0–15% | 0–15% | 0–15% |
| Other | 0–70% | 0–30% | 0–70% |
| Foreign currency hedge ratio | 0–100% | 0–100% | 0–100% |

Target asset allocation ranges show, on average, the allocations each investment option is expected to hold over the long-term. These allocations may be changed by CSC without notice, for example in periods of extreme market conditions, and this may affect the amount of fees you pay.

To manage the level of short-term volatility of returns and maintain appropriate levels of liquidity, target exposures to private assets (private equity, private debt and real assets) are limited to around 25%, with a rebalancing range of $\pm 10\%$ around that target.

Investment risk and standard risk measure (SRM)

Investment risk is determined using the SRM. The SRM is a guide of the likely number of negative annual returns expected over any 20 year period. The purpose of the SRM is to provide members with a label to assist in comparing investment options.

The SRM is not a complete assessment of all forms of investment risk, for instance it does not detail what the size of a negative return could be or the potential for a positive return to be less than you might require to meet your objectives. Further, it does not take into account the impact of administration fees and tax on the likelihood of a negative return.

You should still ensure that you are comfortable with the risks and potential losses associated with your chosen investment option(s).

The following table demonstrates the estimated number of negative annual returns over a 20 year period applied to determine the risk band and label.

| Risk band | Risk label | Estimated number of negative returns over a 20 year period |
|-----------|----------------|--|
| 1 | Very low | Less than 0.5 |
| 2 | Low | 0.5 to less than 1 |
| 3 | Low to medium | 1 to less than 2 |
| 4 | Medium | 2 to less than 3 |
| 5 | Medium to high | 3 to less than 4 |
| 6 | High | 4 to less than 6 |
| 7 | Very high | 6 or greater |

For more information on the methodology applied to calculate the SRM, go to adfsuper.gov.au

Significant risks

Super, like any investment, has risks. Significant risks include:

| Risk | Description |
|-----------------------|--|
| Inflation | Inflation may exceed the return on investment. |
| Asset investment risk | Individual assets we buy can (and do) change in value for many reasons, such as changes in the internal operations or management of a fund or company we invest in, or in its business environment. |
| Market risk | Economic, technological, political or legal conditions, and even market sentiment, can (and do) change, and this can affect the value of investments. |
| Interest rate risk | Changes in interest rates can have a positive or negative impact directly or indirectly on investment value or returns. |
| Currency risk | We invest in assets located in other countries and if their currencies change in value relative to the Australian dollar, the value of investments can change. |
| Derivatives risk | We may use derivatives to reduce risk or gain exposure to investment markets when we think it appropriate. Risks associated with these derivatives include the value of the derivative failing to move in line with the underlying asset, market or index. |
| Counterparty risk | Counterparty risk is the risk that the other party to a contract cannot meet its obligations under the contract. This may have a negative effect on the value of investments. |
| Fund risk | Risks particular to the Fund include that it could cease operation, fraud against CSC could occur, Board restructure and that our investment professionals could change. |
| Liquidity risk | Assets that we invest in can become difficult to trade under certain market conditions. |
| Super laws | Changes are frequently made to superannuation law and may affect your investment and your ability to access it. |
| Changes to tax | Changes can occur to taxes on investments or super generally, which may affect the value of your investment or benefit. |

Investment risk management

Investment risk can be managed and even minimised, but cannot be eliminated. No matter how skilled the investment manager, or how strong performance has been in the past, there is always a chance you could receive less than you invested.

Ways we manage investment risk include:

- > diversification across asset classes, individual assets, investment styles and investment managers;
- > a focus on understanding the inherent risks of any particular type of investment;
- > systematic compliance and fraud control programs;
- > a continuous program of research and analysis, including environmental, social and governance (ESG) analysis; and
- > continuous monitoring of market performance, investment manager performance and relevant legislation.

Our investment governance focuses on managing risk and is driven by our primary investment objective, which is to maximise long-term real returns within strictly defined risk limits. Professional investment managers make day-to-day investment decisions, within agreed parameters, which are regularly reviewed.

We use a number of governance advisory services to support our proxy votes in the Australian and international companies in which we invest.

Environmental, social or ethical considerations

An integral element in our investment risk management processes is the active monitoring of environmental, social and corporate governance (ESG) risks within the companies in which CSC is invested. Our ESG policy focuses on pro-active and constructive engagement with companies in which our members are shareholders. To this end:

- > CSC engages and works collaboratively with a diverse group of investment managers, advisers and shareholder groups. We believe that by collaboratively influencing companies to adopt sound ESG practices, we can reduce financial risk and potentially bring about positive value changes for our members.
- > CSC takes proxy voting responsibilities seriously, where possible, voting on matters brought to shareholders by the companies in which we invest.
- > CSC is a signatory to the UN Principles for Responsible Investment – a framework for global best practice in responsible investment. This association includes a commitment to explicitly consider ESG issues in our investment policies and practices.
- > CSC is a member of the Investor Group on Climate Change, Australia/New Zealand and an investor signatory to the Carbon Disclosure Project. These collaborative industry initiatives address the business and shareholder value implications of climate change.

- > CSC is a founding investor in Regnan, the corporate engagement and governance research body that now services a number of institutional investors and clients. Reflecting CSC's philosophy, Regnan focuses on a constructive engagement process that aims to reduce portfolio risk exposures, including those relating to environmental risk.

Keeping track of your investments

Once you have made your choice of investment options, you also need to keep an eye on your investments, particularly if you have created your own portfolio combining different investment options.

Market movements may take your individual asset class proportions away from the point at which you started. As this happens, your fees and risk level may change and you will need to decide if you want to rebalance them by changing the amounts you invest in your selected investment options. We rebalance the individual asset class allocations within the **Income Focused**, **MySuper Balanced** and **Aggressive** investment options regularly.

Switching between investment options

You can switch to a different investment option(s) any time:

- > login to your account or
- > complete an **Investment choice** form available at adfsuper.gov.au, or call us on 1300 203 439 for us to email or post you a copy.

Your first investment choice, if made within 30 days of joining ADF Super, is free. You also have two free switches each financial year. Additional switches are \$20 each.

If you decide to change your investment strategy for future contributions, and you do not switch the investment strategy for your existing account, then we consider this as a first choice and switch fees will not apply.

You will receive confirmation when we have processed your investment switch.

ADF Super performance

Performance information can be found at adfsuper.gov.au. Please note that super is a long-term investment and past performance is no indication of future performance – investment markets are volatile, and it is not possible to predict when they will go up or down or how quickly this will happen.

How your investment in the ADF Super is valued

Your investment in ADF Super is valued in units. We use the amount that you invest in ADF Super to buy units in the investment option(s) you choose.

We keep a record of all units you hold. You can estimate the balance of your account on any business day by multiplying the number of units you hold in each investment option by the relevant 'sell' unit price. Unit prices fluctuate in line with investment performance – which may be either positive or negative. We generally publish unit prices on our website each business day.

We generally deduct fees, management costs and taxes before we calculate the unit price. Where fees are payable directly from your account – for example, switching fees and administration fees – units in your account are sold to the extent required for payment.

How we calculate unit prices

The unit price for an investment option reflects the total value of assets in the investment option (less fees not deducted directly from your account, expenses and taxes), divided by the number of all units issued in the investment option.

Generally we base our calculation of the value of assets in each investment option on the latest available market value at the end of each business day. Using these values, we will generally calculate the unit price for a given business day on the next business day. For example, we will generally calculate the unit price for 1 September (if a business day) and make it available on 2 September (if a business day).

If we are unable to determine a unit price for a business day on the following business day due to an unforeseeable event, such as a trading suspension in relevant markets, we will take all reasonable steps to recommence unit pricing as soon as possible.

The costs associated with the purchase or sale of Fund investments are reflected in the unit price for the relevant investment option through a buy-sell spread. For further information, refer to the **Fees and other costs** booklet available at adfsuper.gov.au

Operational risk financial requirement

All trustees of super funds are required to establish and maintain an operational risk reserve. The purpose of a risk reserve is to provide a source of financial resources to help protect members' interests should an operational risk event occur, such as the use of an inaccurate unit price to process a transaction that results in losses to the Fund or to members.

A target amount of 0.35% of funds under management (which, at the Australian Prudential Regulation Authority's direction, includes 0.10% for ADF Super assets held in the ARIA Investments Trust, a pooled superannuation trust through which ADF Super invests the assets of the fund) has been set for the operational risk reserve for ADF Super. This target amount has been reached.

At this stage, maintaining the target amount will not impact ADF Super members, but this could change particularly if an operational event occurs which requires use of the reserve. The operational risk reserve is monitored on a quarterly basis to ensure that it remains on track. An update will be provided if there are material changes to the operational risk reserve.

Changes to investment options

You should note that we can add, change or remove an investment option. We will contact you should this occur.

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