Integrity Australian Share Fund

New boutique fund manager Integrity Investment Management has launched a new Australian Share fund that plans to deliver long-term sustainable returns through an experienced team, good risk management, shareholder activism and an after-tax focus.

Behind every great business is an even greater story. The grittier the details, the better the tale. With Australian equities boutique fund Integrity, the story centres on a group of investment experts who struck out on their own to make a case for the ordinary investor.

Former UBS analysts and fund managers, including former UBS head of Australian equities Paul Fiani, are behind Integrity. While Fiani is at pains to move away from talking about Qantas, it's worth a recap to understand why the fund he has set up, with the backing of his former colleagues, already has $400 million in mandates from new and former clients.

In a nutshell, Fiani opposed the $5.45 per share private equity bid for Qantas earlier this year because he believed the offer undervalued the company. The airline's current share price at around $6 means Qantas shareholders are $1.5 billion better off and Fiani's former clients are $100 million better off, which vindicates his view but made his role at UBS untenable.

That's all history now as Fiani and ex-UBS senior staff Shawn Burns, Marcus Truman, John Moran and Karen Thompson embark on the next chapter in their careers. With decades of industry experience between them, Fiani said their established track record distinguishes them from other boutiques.

"The fund is good for people who want exposure to the Australian market through solid companies picked by an experienced team. They can come into our fund with confidence that we are a known quantum, not only in terms of reputation, but how we manage the fund."

For example, Integrity will be run broadly the same way as Fiani ran the UBS Australian Share fund, an investment strategy which was so successful that it took the fund from a standing start to nearly $4 billion funds under management under Fiani's tenure.

After-tax investing matters

Part of the fund's formula is to focus on after-tax returns. "We explicitly value franking in our investment process" said Fiani, adding that the approach to after tax investing they are using now is similar to the one he introduced more than ten years ago. This is in contrast to the broader funds management industry that is only now focusing on after-tax investing.

Fiani explains that by adopting an after-tax focus, investors win, even when it's potentially at the expense of the fund manager's pre-tax performance. For example, since benchmarks are usually set against pre-tax returns, a fund manager might get a better performance figure picking, say, stock X over stock Y on a pre-tax level even if stock Y is the better pick on a post-tax basis.

By focusing on post tax returns, two funds with identical pre-tax performance could differ at a post-tax level by as much as 7 per cent (see illustration below).

It's this core belief of putting the investors' interests first that drove Fiani to take a stand on the Qantas deal. Or in this case, invest in shares that may not provide the best pre-tax returns, but provide higher post-tax gains and ultimately, wealth for his clients. "We still did very well on a pre-tax basis but the point is, we did better on a post-tax basis," he said.

Integrity also breaks from the pack because it regards shareholder activism as a key investment tenet. "We think we can make a real difference to our client's returns through our activism in the market."

For example, besides voting at AGMs, Integrity defines corporate governance as keeping corporates honest and accountable, which separates active managers from the passive managers.

"If the whole market was [made up of] passive investors, the Qantas transaction would have gone through without challenge."

That is why active managers such as Integrity are so important, said Fiani, because they don't just strive to give investors better than benchmark returns, but they help to ensure the benchmarks are as high as possible.

The portfolio

The group's new Australian Share fund consists of a basket of 30 to 50 stocks handpicked by Fiani, Burns, Truman and Moran. "The experience of the team is highlighted by the fact that all the market sectors have been covered by the analysts previously…Typically when you put a group of people together you'll get a lot more 'coverage gaps'. The fact that we have full coverage, experience-wise, is powerful."

The fund does not use leverage, or complex trading instruments. "We're not using colorful, exotic derivatives that increase the risks and reduce the transparency of the fund. People who invest with us know exactly what they are getting."

The portfolio, which currently includes Qantas, QBE and Sonic Healthcare, are what Fiani calls 'quality stocks' with sustainable businesses. "We're trying to build a portfolio that will maximise our client's long term wealth."

He continued, "Unforeseen events happen. New technologies such as the internet come and render once powerful companies much weaker and create valuable new businesses. That's why it's important to keep up with the times and have a diversified portfolio."

With the fund's robust and reputable investment strategy in place, a solid corporate structure was also high on Fiani's priority list. For example, the fund is a rarity in the boutique space in that it is a Responsible Entity (RE), which means it has to meet rigorous compliance standards set by ASIC, including the appointment of an external compliance committee. Integrity has also invested heavily in systems and people including a chief operating officer and compliance manager.

"If you talk to any of the institutional consultants or the retail research groups, one of the first things they focus on is the structure of the organisation. And that's for good reason. Getting the structure right allows you to get the right people on board and focused on investments, which is how you get the investment results."

Integrity Investment Management launched its Australian Share Fund on 17th October. To date, the fund already has $87 million and while it is early days, its performance is already well ahead of the ASX300 benchmark. ∎

Comparison of post tax and pre-tax returns

	Fund A – post-tax focus	Fund B – pre-tax focus
Capital invested (1/11/2006)	$100,000	$100,000
Pre-tax return	30%	30%
Post-tax return	23%	16%
Value of investment (31/10/2007)	$123,000	$116,000
Gain	$23,000	$16,000

The analysis above compares the performance of two funds that have identical pre-tax performance. Both funds have pre-tax performance equal to the return of the ASX 300 Accumulation Index over the 12 months to 31/10/2007. We then calculate post tax performance assuming Fund A's dividend component was 100% franked whilst Fund B's dividend yield was not franked. We then further assume that Fund A has held its stocks for the entire year, whilst Fund B has generated its pre-tax return by regular buying and selling of stock positions. Whilst these are hypothetical assumptions, they demonstrate the significant differences that can arise between pre- and post-tax performance depending on a manager's style.

Fund essentials – Integrity Australian Share Fund

Typical tracking error	**2–5%**
Typical number of stocks	**30–50 (currently 35)**
Typical cash level	**1–5%**
Gearing	**Not allowed**
Benchmark	**ASX 300**
Post tax focus	**Yes**
PDS available for download on website	**www.integrityim.com**
Minimum for direct investment	**$50,000**
Telephone	**(02) 8987 5400**
Current platform availability and access availability (minimum investment depends on platform. Please consult platform for details.)	**APA; Avanteos – Access 121, Symmetry; BT Wrap; Macquarie Wrap (from 1 December); ETrade; MLC MasterKey Custom Investment Service; MLC MasterKey Custom Self Managed Super. Also coming to more platforms soon. If we are not on your platform, ask your provider to add us.**