

## 5. How we invest your money

The information in this document forms part of the Product Disclosure Statement (PDS), dated 1 July 2011, for the LGS Accumulation Scheme. This document is dated 1 July 2011.

### Overview

As stated in the PDS, LGS offers members five investment strategies to choose from. Full details of these strategies are outlined in the tables following.

#### High Growth investment strategy

<b>Definition</b>	For high investment growth above the Consumer Price Index (CPI) over the longer term. The High Growth strategy generally invests a very high proportion of its funds in growth assets, such as Australian and international equities and property. This combination aims to earn high real investment growth above CPI over a 7 year period. Because the emphasis is on growth, you should keep in mind that there may be what financial professionals call 'short-term volatility' in this strategy. In other words, the value of the investment may fluctuate over the short term.	
<b>Asset allocation</b>	<b>Asset class</b>	<b>Asset allocation range</b>
	Australian equities	30-40%
	International equities	27-37%
	International listed property	0-6%
	Australian fixed income	0-5%
	Australian inflation linked bonds	0-5%
	International fixed income	0-5%
	Absolute return funds	3-13%
	Cash	0-10%
	Australian direct property*	0-10%
	Semi liquids*	0-10%
	Private equity*	5-15%
	Defensive Illiquids*	0-5%
<b>Objective</b>	4.5% net investment return per annum above CPI, measured over a rolling 7 year period**	
<b>Time horizon</b>	7 years	
<b>Risk profile</b>	High. There is a significant chance that the investment value may decrease in the short term. The chance of a negative return in any year is 1 in 3.	

\*Note that the combined investments in these asset classes will not exceed 25%.

\*\* Objective net investment returns is net of fees but not net of taxes.

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### Balanced Growth investment strategy

<b>Definition</b>	For real investment growth above the CPI over the medium to longer term. For investors who want a high exposure to Australian and international equities and property and are prepared to accept more risk. The emphasis is on growth so investors should be prepared for some potential short-term volatility. In other words the value of the investment may fluctuate over the short term.	
<b>Asset allocation</b>	<b>Asset class</b>	<b>Asset allocation range</b>
	Australian equities	21-31%
	International equities	20-30%
	International listed property	0-6%
	Australian fixed income	0-10%
	Australian inflation linked bonds	0-10%
	International fixed income	0-10%
	Absolute return funds	6-16%
	Cash	0-10%
	Australian direct property*	0-10%
	Semi liquids*	0-10%
	Private equity*	1-11%
Defensive Illiquids*	0-6%	
<b>Objective</b>	3.5% net investment return per annum above CPI, measured over a rolling 5 year period**	
<b>Time horizon</b>	5 years	
<b>Risk profile</b>	High/Medium. There is potential for the value of the investment to decrease in the short term. The chance of a negative return in any year is 1 in 4.	

\*Note that the combined investments in these asset classes will not exceed 25%.

\*\* Objective net investment returns is net of fees but not net of taxes.

### Balanced investment strategy

<b>Definition</b>	For real investment growth above CPI over the medium term. The Balanced strategy generally invests a proportion of its funds in growth assets such as Australian and international equities and property, semi liquids and private equity and the balance in income-producing assets, such as interest-bearing securities.  This combination aims to earn real investment growth above CPI over a 3 year period. There are more assets that produce income which makes the strategy more stable than the High Growth and Balanced Growth strategies.	
<b>Asset allocation</b>	<b>Asset class</b>	<b>Asset allocation range</b>
	Australian equities	11-21%
	International equities	10-20%
	International listed property	0-6%
	Australian fixed income	6-16%
	Australian inflation linked bonds	6-16%
	International fixed income	6-16%
	Absolute return funds	7-17%
	Cash	0-10%
	Australian direct property*	0-10%
	Semi liquids*	1-11%
	Private equity*	0-10%
Defensive Illiquids*	0-8%	

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<b>Objective</b>	2.5% net investment return per annum above CPI, measured over a rolling 3 year period.**
<b>Time horizon</b>	3 years
<b>Risk profile</b>	Medium. Although the emphasis is on spreading your investment over various asset classes, there is a possibility that the value of the investment will decrease in the short term. The chance of a negative return in any year is 1 in 5.

\*Note that the combined investments in these asset classes will not exceed 25%.

\*\* Objective net investment returns is net of fees but not net of taxes.

## Conservative investment strategy

<b>Definition</b>	For shorter term investing with good security and some potential for growth. The Conservative strategy generally invests a small proportion in growth assets and the balance in income-producing assets such as interest-bearing securities. This combination aims to earn real investment growth above CPI over a 2 year period. Although it is relatively more stable than the High Growth, Balanced Growth and Balanced strategies, the returns and the value of the investment can still fluctuate.	
<b>Asset allocation</b>	<b>Asset class</b>	<b>Asset allocation range</b>
	Australian equities	1-11%
	International equities	1-11%
	International listed property	0-6%
	Australian fixed income	8-18%
	Australian inflation linked bonds	8-18%
	International fixed income	8-18%
	Absolute return funds	11-21%
	Cash	5-15%
	Australian direct property*	0-8%
	Semi liquids*	5-15%
	Private equity*	0-6%
Defensive Illiquids*	0-10%	
<b>Objective</b>	2% net investment return per annum above CPI, measured over a rolling 2 year period.**	
<b>Time horizon</b>	2 years	
<b>Risk profile</b>	Medium/Low. Although the emphasis is more on security, returns and the value of the investment can still fluctuate. The chance of a negative return in any year is 1 in 8.	

\*Note that the combined investments in these asset classes will not exceed 25%.

\*\* Objective net investment returns is net of fees but not net of taxes.

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### Cash investment strategy

<b>Definition</b>	For investors who want exposure to investments in money market securities with a very low risk of capital loss.  The Cash strategy invests predominantly in short-term Australian money market assets. In addition, a small proportion of the assets (up to 15%) is invested in global interest type assets having a longer maximum term. This gives this strategy greater exposure to higher returns than by just investing in short-term domestic assets, with only a small increase in the overall volatility of the returns. This strategy offers investments for short-term investors or those seeking less volatile returns.	
<b>Asset allocation</b>	<b>Asset class</b>	<b>Asset allocation range</b>
	Cash and income producing assets	100%
<b>Objective</b>	0.25% net investment return per annum above the “cash” <sup>*</sup> rate, measured over a rolling 2 year period. <sup>**</sup>	
<b>Time horizon</b>	2 years	
<b>Risk profile</b>	Low. Depending on market volatility, there is a chance that this investment may experience a negative return, but this is expected to only be for periods of no more than a month. Over longer time frames, the chance of a negative return would be remote.	

\* The benchmark for the cash rate is the UBS bank bill index.

\*\* Objective net investment returns is net of fees but not net of taxes.

### Automatic Switch upon Death Notification

Upon notification of the death of a member, any of the deceased’s benefit will be moved to the cash strategy where it will remain until the death benefit is paid out.

## Sustainable investing

LGS, like other super funds, invests in a range of assets including shares, private equity and direct property, but unlike most funds LGS actively invests these assets based on a sustainable and socially responsible investment policy. This policy specifically takes into consideration environmental, social and corporate governance (ESG) issues<sup>1</sup>.

### How does the policy work?

The policy sets out the sustainability framework for all investments made by LGS. It covers the total investment portfolio, with specific policies for private equity and direct property investments as follows:

- The regulatory framework of LGS
- Selection of external asset consultants
- Selection and monitoring of investment managers, private equity and targeted investments
- Collaboration and engagement with other sustainable investing organisations
- Negative screening and replacement of investments
- Green management of direct property
- Commitment to the issue of climate change
- Proxy voting to influence companies environmental decisions
- Reporting of sustainability strategy to members and
- Corporate citizenship.

We further expand on several of the above initiatives to confirm to you the way in which the assets of LGS are invested in compliance with this policy.

<sup>1</sup> Note that third party investment managers for the underlying portfolios in the Local Investment Fund may have various policies which also take these ESG factors into account when they make investment decisions. However, these policies do not have any direct bearing on the Trustee’s investment decisions.

## How we invest your money

### Manager selection and monitoring

When selecting new investment managers, our due diligence requires a demonstration of how an assessment of ESG risks is incorporated into their investment process. The investment manager is asked to specify the resources available to analyse ESG risks, including personnel and their expertise, and their use of any external research services.

Managers are encouraged to discuss ESG and other risks in their investment reports to LGS. The LGS investment team monitors the investment portfolios of its investment managers to ensure that LGS' investment and ESG guidelines are adhered to. The LGS investment team holds discussions with investment managers who do not adhere to LGS policy to reiterate the importance of these policies. If there are continual breaches of the investment policies, LGS may withdraw the investment mandate.

### Environmental issues

LGS considers climate change to be one of the most serious environmental risks facing the long-term prosperity of the fund and its members. LGS is a signatory to the Carbon Disclosure Project which collects and distributes information that helps prevent dangerous climate change.

LGS participated in the Climate Change Investment Initiative and commits to ongoing support for this project. It assists superannuation funds to understand their climate change risks and manage them effectively. As part of this initiative, in 2010 LGS was ranked first in an Asset Owners Disclosure Project. LGS ranked first overall but also placed in top spot in six out of the 12 categories and in the top ten for the remaining categories. LGS has also joined the Investor Group on Climate Change, which has the objective of raising awareness of climate change risks and encouraging best practices in the management of these risks.

When assessing existing and future investments, LGS assesses the environmental impact the operations of the investment have on the environment and the active steps the organisation has taken to commit to environmentally sustainable operations.

The Trustee of LGS is also an active shareholder and attempts to influence proper social and environmental activities when it casts its votes at company or shareholder meetings.

### Direct Property holdings

The Trustee has adopted an environmental policy which, in part, is designed to increase energy and water efficiencies across the properties directly owned by LGS. The policy also encompasses waste reduction and recycling, indoor air quality, improving operations and maintenance, material and resources, Occupational Health and Safety and environmental risk management.

It is also now the current policy of the Trustee to source 100% of its energy requirements through green energy and requires tenants to follow suit as a condition of their lease renewal.

The Trustee will continually monitor performance in this area and is working towards an objective of 100% green energy for its commercial and industrial direct property investments within 10 years.

### Alternative investments

An alternative investment is generally one that is not one of the four traditional asset types (i.e. stocks, property, bonds and cash). As part of its sustainable and socially responsible policy, LGS invests with certain private equity managers such as Hawkesbridge and Macquarie Clean Technology, which make direct investments into clean technology companies such as the Environmental Technology Group and SolarReserve. LGS has a strong commitment to these clean technologies and will continue to explore opportunities in this sector.

## Principles of Responsible Investment

LGS is a signatory to the United Nations Principles of Responsible Investment (UN PRI) and as such undertakes to:

1. Incorporate ESG issues into investment analysis and decision making processes
2. Be active owners, vote on shareholder issues and participate in collective engagement
3. Seek disclosure on ESG issues by our investment managers
4. Promote the acceptance and implementation of the UN PRI Principles in the investment industry
5. Collaborate with other organisations to enhance effectiveness and
6. Report on our sustainability activities.

## Collaboration and engagement

LGS is a foundation member of the Australian Council of Superannuation Investors (ACSI) and utilises ACSI to assist in ensuring that there is adequate scrutiny in the governance policies of listed companies. LGS is also a part owner and subscriber to Regnan - Governance Research & Engagement Pty Limited, a company dedicated to research and engagement services that promote improved ESG performance from Australian companies.

Through these organisations, LGS is able to engage with companies using a collective voice.

## Socially responsible overlay

LGS uses an overlay based on research to exclude companies that operate in the industries and companies set out below which have been assessed to have a high ESG risk. It then replaces those stocks with companies that have high ESG ratings. This practice helps ensure that your superannuation money is invested in industries which are sustainable in the long term.

Where it is impractical for an investment to participate in the separate portfolio, LGS will consider the divestment of that investment on a case by case basis.

The Trustee has determined that LGS will not make investments in companies that are engaged in the following areas of activity:

1. Armaments
2. Gambling
3. Nuclear / Uranium
4. Old Growth Logging
5. Tobacco
6. Poor Mining Practices
7. Questionable Workplace Practices and
8. Questionable Environmental, Social or Corporate Governance Practices.

## Local Investment Fund (LIF)

The LIF is a wholesale investment trust and the majority of the assets of Local Government Super are invested through LIF. The Trustee of LIF is LIF Pty Limited which is a wholly owned subsidiary of the Trustee of LGSS.

The Trustee of LGSS, through its ownership of LIF Pty Limited, is responsible for selecting and managing the range of investment managers which collectively manage the portfolio of each strategy within LIF. The Trustee also invests a minor proportion of the assets into direct investments, namely the Property Fund.

Local Government Super adheres to the guiding principle that several carefully selected investment managers will over any reasonable period produce:

- More consistency
- Lower volatility and risk
- Better results.

Having a single investment manager is not likely to be as effective.

## **What is an investment strategy?**

An investment strategy is a set of rules or guidelines used in constructing an investment portfolio. It will usually set ranges for different classes of assets designed to target different levels of overall investment risk. The ranges for each asset class will be determined by the investment objective of that investment strategy.

In selecting an investment strategy, you are instructing the Trustee to invest the amount nominated into a pool of assets constructed by the Trustee, to give effect to the objectives of that strategy.

When making investment decisions for the investment strategies, the Trustee takes into account labour standards, environmental, social or ethical considerations in the following manner:

- Such issues that may affect an investment. Any such financial affect would influence our investment decisions.
- The investment managers for the underlying portfolios in LIF may have various policies regarding the extent to which they take into account such matters when investing but they have no direct bearing to the Trustee's investment decision. The Trustee does not consider such factors when selecting third party investment managers.

Your investment in the Scheme is not guaranteed. The value of your investment can rise or fall.

## **Diversification**

Local Government Super's assets are allocated to a range of investment managers. This is to ensure diversification of both investments and investment managers.

Please note that investment managers and/or their weightings will change from time to time and that updated details will be provided in the Local Government Super Annual Report.

## **Investment returns in recent years**

Up-to-date information in relation to the annual effective net earnings for each investment strategy for the last five financial years are set out in the latest Annual Report, along with other related investment performance information.

You should note that the net earning rate reported in the Annual Report may not be the same as the rate experienced by members because of the timing differences and the reserving policy of Local Government Super.

You should also be aware that past net earning rates are not a reliable indicator of future net earning rates.

More information regarding recent performance can also be found on the website or by contacting Member Services.

## Unit pricing

The value of your account is expressed in terms of units. When money is allocated to your account, units in a selected investment are issued to you. The number of units purchased is dependant on the unit price for that day and the amount allocated to your account.

The unit price is the net asset value of the investment on a particular day divided by the total number of units on issue on that particular Business Day. The net asset value is the valuation of assets and liabilities (including indirect management costs) determined by the market price at a valuation point after allowing for transaction costs and the deduction of taxation and expenses.

Unit prices are calculated and declared for each business day, provided that all relevant information is available to the Trustee to make the declaration. There may be times when unit prices cannot be issued and payments are temporarily suspended. This may occur in times of extreme market volatility caused by political, financial year end, economic or any other crisis.

If this were to occur, an interim valuation method may be applied or payments suspended for a period of time.

**Note:** A Business Day is a day that the Australian Stock Exchange (i.e. both SEATS [Stock Exchange Automated Trading System] and DTF [Derivatives Trading Facility]) is open for trading in Australia.

## Reserves

LGS operates the following reserves in Pool A:

### Operational Risk Reserve (ORR)

The ORR operates principally to meet any remaining self insured death/invalidity claims within Pool A and generally to protect LGS from other contingent events or the need for capital expenditure. A specific amount of \$100,000 is also maintained in the ORR at all times to satisfy one of the requirements of the Trustee's public offer licence.

The ORR may also hold a reserve up to a maximum of 0.3% of LGS's assets for the purpose of reimbursing members disadvantaged by an error or anomaly to the unit price allocated to them where such amount cannot be recovered from external sources.

### Administration and tax reserves

Deductions are made from members' accounts and investment earnings to pay for LGS's income tax liabilities and operational expenses. The administration and tax reserves are invested in cash and apply towards the expenses they relate to as and when they become payable. This information is disclosed in the Annual Reports.

## Investment of Reserves

The assets which support these reserves are held effectively in cash, either in a bank account, a cash management account or as a cash investment in a unit trust.