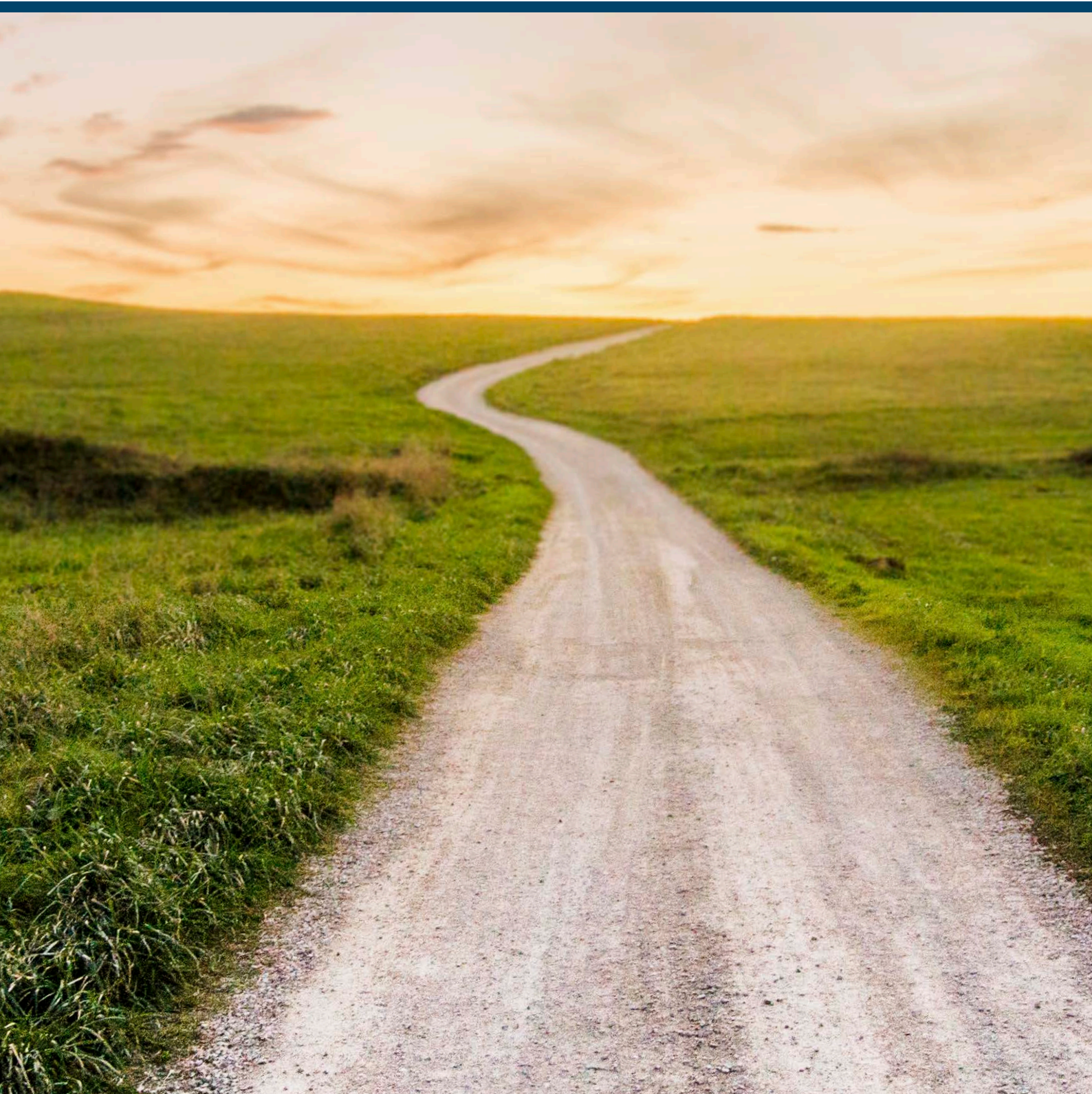


Investing the Future Fund

How we invest for the benefit of future generations of Australians.



The Future Fund is Australia's sovereign wealth fund, investing for the benefit of future generations of Australians.

Our organisation was established by the Australian Government in 2006.

Today, we manage a number of special purpose funds on behalf of the government.

The largest fund we manage is the Future Fund itself.

Over its first decade, the Fund has exceeded the long-term benchmark rate of return in its Investment Mandate, and in doing so, more than doubled its value.

The core characteristics of our investment model underpin our investment approach and are critical to our future success.

This document takes a closer look at how we invest the assets of the Future Fund and, in doing so, strengthen the Australian Government's long-term financial position.

In addition to the Future Fund, we also manage additional public asset funds on behalf of the government, including the Medical Research Future Fund.

While this document is focused on our largest fund, the Future Fund, we apply a consistent investment process across all of the funds, tailored to their individual investment mandates.

Further information about the other funds we manage is available on our website at www.futurefund.gov.au

Australia's sovereign wealth fund

**The Future Fund
invests historical
contributions from
the Australian
Government.**

**It is not a
superannuation fund,
it does not have
any superannuation
liabilities to manage
nor does it receive
any superannuation
contributions.**

**No individual has a
claim on, or is entitled
to a payment out of,
the Fund.**

Investing the assets of the Future Fund



The basics

The Future Fund was established at a time when Australia's aging population was placing increasing pressure on the government's finances.

It was set up to strengthen the government's long-term financial position.

The Fund was seeded with contributions from government valued at \$60.5bn. No contributions have been made since then.

The Fund's Investment Mandate is to achieve a return of Consumer Price Index plus 4% to 5% per annum over the long term without taking excessive risk.

Legislation permits drawdowns from the Fund from 1 July 2020. However, the government has indicated its intent to refrain from doing so until 2026-27.

Withdrawals from the Fund, when they are made, will help the Australian Government to meet its obligations out of Consolidated Revenue (including defined benefit pensions) and thereby ease the pressure on Government finances.



Balancing risk and return

The Australian Government has given us a clear mission – to invest for the benefit of future generations of Australians. This gives a real sense of purpose to what we do and it inspires our people to do the very best job they can.

'Every dollar that we make is a dollar that adds to Australia's wealth and contributes to its future.'

This purpose also requires us to be prudent in investing the assets of the Future Fund.

While every dollar we make benefits Australia, every dollar we lose is a dollar taken away. It is a dollar that is either not available or has to be found from somewhere else in the government's budget.

This perspective has a very real impact on how we build and manage the portfolio. It means that not only do we seek to generate strong long-term returns, but that we try to protect the portfolio when markets weaken. We have to take risk but we have to be thoughtful about how we do that.

'We are sharply focused on our long-term objective. Everything we do, every decision we make is focused on investing for the benefit of future generations of Australians.'



One team, one purpose

Our investment approach is based on one team working together for the benefit of the portfolio as a whole. We call this our 'one team, one purpose' philosophy. It drives our culture and the way we work.

Our team collectively channels its best ideas, irrespective of asset class, up to the total portfolio to achieve the Fund's investment objective.

The intention is to uncover the best investment opportunities across all sectors, rather than the best opportunities in each sector, and then to act with conviction on these opportunities at a total portfolio level.

Sector teams don't try to create individually balanced portfolios. Instead, we pursue diversification at a total portfolio level.

'We invest across all asset classes: listed equities, private equity, property, infrastructure, timberland, debt, alternatives, cash and overlays.'

To support our one team, one purpose approach we have created a culture that supports effective multi-sector and cross-organisational decision-making. Discussion forums and cross-team meetings, together with a focus on building a collaborative and open culture, play an important role in sharing perspectives that feed into the formal decision-making process as we seek to maximise returns.

'We have a breadth of skills and experience within the organisation and we seek to combine these into a collaborative whole. We think that gives us a material comparative advantage.'

Joined-up investment approach

When constructing the portfolio we bring together the top-down and bottom-up views – we call this being joined up. It is the cornerstone of our investment philosophy, and we further consider it a key comparative advantage that significantly improves our prospects of meeting the Future Fund's Investment Mandate.

Our top-down people look at the global economy, financial markets and political risk, and think about how this will impact the portfolio. Our bottom-up people look across the world for great assets, thinking about whether they are rewarded for the risk they are taking.

So what does being joined-up look like in practice? Our top-down team might have a view on the economic conditions in a particular country and they will test that with the sector teams to see whether local conditions support that view. By setting the big picture against local insights we generate a rich and nuanced view of the opportunities and outlook.

This process, together with our whole of portfolio approach, challenges our people to think broadly, to test and challenge their views and the thoughts of their managers, and to compare the merits of any one investment versus another.

As a result the investment team regularly meets to debate market views. Team members are encouraged to challenge and to be challenged robustly. The result is a fluid and iterative process with ongoing collaboration, comparison and communication right across the investment team and the organisation more broadly.

Joined-up investing



Dynamic investment process

In line with our whole of portfolio approach, we don't set a fixed strategic asset allocation from the top and then require those allocations to be filled across each of the investment sectors. Prospective returns and risks change through time, so we manage the portfolio dynamically.

' We aim to build a highly diversified portfolio that is as robust to as many future outcomes as possible.'

Our dynamic investment process seeks to extract the best possible return adjusted for the level of risk in markets and individual investments. We expect to increase risk levels when the expected reward for taking risk is high and to reduce risk levels when the expected reward for taking risk is low.

The key elements of our investment process are:

Foundation inputs: Our core investment beliefs inform our interpretation of each fund's investment mandate and its objectives and help us to determine our appetite for the types and levels of risk we are prepared to take in each of the funds.

Analysis of the investment environment: We develop a deep understanding of the investment environment we are operating in at any one time, along with regularly analysing a range of plausible future scenarios over multiple time horizons so that we can better understand how our portfolios might behave if conditions change.

Risk management and budgeting: Our investment policy framework helps us to clearly and effectively manage the risk of our funds at what we consider to be acceptable – rather than excessive – levels. Given our assessment of the environment and consistent with our investment policy framework, we then choose appropriate and mutually consistent risk settings for each of our portfolios, which are informed by their mandates. These risk budgets are dynamically managed.

Investment analysis and selection: Once we have decided on an appropriate risk budget for a given fund, we allocate and implement that budget through underlying investment activity. Our ongoing assessment of the investment environment provides us with insight into the behaviour of the investments we make and how they interact with each other in portfolio construction. We assess appropriate risk levels on a total portfolio level using a range of factor lenses.

Long-term investment horizon

The Future Fund has a long-term investment horizon, with performance measured against a rolling 10 year period.

We seek to benefit from the Fund's long-term investment horizon in a number of ways. First, by maintaining meaningful exposures to riskier assets, given the higher expected long-term rewards. Second, by searching hard for opportunities to extract strong excess returns for locking capital away in less liquid investments. And finally, by managing the portfolio risk dynamically to reflect substantial changes in conditions.

' We keep our long-term investment objective front of mind and seek out the best investment ideas for the targeted risk and return objectives in a given investment environment.'

While the Fund's investment strategy is under regular review and adjusted as the relative attractiveness of different sectors changes, meaningful changes to the Fund's risk profile are only expected when there is a substantial change in external conditions. One aim of this dynamic approach is to have capital ready to deploy into areas of market weakness.



A global search for the best ideas

As a global investor, we search across the world for the best opportunities to deliver strong, risk-adjusted returns.

The investment world around us is constantly shifting and changing and we need to be able to respond to that as quickly as we possibly can.

We are broad and creative in our search. We seek to be as nimble as possible in terms of how we implement the opportunities we find.

' We look for the best ideas wherever they are. Working collaboratively, we bring the best ideas from our investment managers and from across our team together.'

The way in which we access investments varies depending on the nature of the opportunity.

We typically adopt an outsourced model, where the selection and execution on individual investments is outsourced to our investment managers. At the same time, our internal investment team actively monitors and manages the sub-sector strategic exposures, so the model is far from a typical 'manager of managers' approach.

' We are not afraid to be different. We are prepared to forge new paths where that makes sense.'

We use a hybrid model, pulling on all the levers available to us for accessing the market. In addition to delegating management to our external managers, we pursue co-investment opportunities.

By co-investing alongside our managers, not only do we understand their processes better but we can find the assets that fit our portfolio well. Our team can sit alongside our managers as partners, not competitors, and work with them and inform them to find the best opportunities to bring back to the Fund.

We also make direct investments in private assets and partner with managers as needed.

We assess investment opportunities on a net-of-fees basis. If we believe an investment opportunity will deliver sufficiently strong returns, and/or reduce risk through effective diversification, we are willing to incur higher costs to access it. In saying that, one of our core investment beliefs is that the management of costs is very important to maximising returns. We seek to lever our scale and market standing to reduce costs.



Partnering for success

We partner with external investment managers who execute investment strategies on our behalf.

We consider these managers to be an extension of our team and they are some of the best thinkers in the world.

' We aim to leverage off the best in the world. We put considerable effort into taking on our partners' insights and information and factoring that into our decision making.'

They have a detailed understanding of our investment strategy and our internal investment team works closely with them to seek out the best investment opportunities around the globe.

We prefer fewer, more meaningful, relationships with external managers. We select managers for their ability to generate information and insight, their willingness to genuinely collaborate and share knowledge, and for the breadth of their collective coverage.

Our focus on alignment and building relationships has improved the quality of investment opportunities available to us, and also helped to make our dynamic investment process more efficient.

Using investment managers also aligns with our preference to keep our internal investment team as small and nimble as possible, while being as large as is necessary to cover our investment universe. This allows the team to focus on key investment decisions rather than being drawn into day to day asset management.

Integrating ESG into the process

We believe the effective management of environmental, social and governance (ESG) risks and opportunities will support our requirement to maximise returns.

In particular, we believe that there is a positive relationship between good governance and investment value. We actively exercise our ownership rights, including voting rights where relevant, across the broad range of our investments.

In undertaking our investment activities, we incorporate ESG issues into our consideration of all new investment proposals and investment manager appointments.

This integrated approach is, in our view, fundamental to being an effective long-term investor. For us, ESG issues do not sit separately from our investment function but are integrated into it.

A strong governance framework

One of the key contributors to the success of the Future Fund has been a clear and robust governance framework underpinning our operations as we pursue our investment objective.

There are clearly defined roles for the Australian Government, the Future Fund Board of Guardians and the Future Fund Management Agency.

Through the Fund's Investment Mandate, the government has given us a clear purpose and investment objective. We spend time clearly defining investment beliefs, our long-term time horizon and our risk tolerance.

Legislation establishes the independence of the Board of Guardians and ensures that investment decisions and activities are conducted at arm's length from government. The Board is responsible for deciding how to invest the assets of each fund, in line with the legislation and the investment mandates.

Our staff, the Future Fund Management Agency, are responsible for making recommendations to the Board on the Fund's investment strategy and how it should be implemented. We have a robust investment decision-making process and clearly defined points of accountability.

While our investment managers are external to our organisation, we consider them an extension of our team. We focus on achieving strong alignment with them, ensuring they have a shared understanding of our long-term objectives, investment beliefs and our culture, so they are able to act in our interests, and reflect our beliefs in their decision making.

Our commitment to good governance and driving alignment through the investment value chain is reflected in our membership of a range of industry groups.

We are also a founding member of the International Forum of Sovereign Wealth Funds (ISFWF), a global network that facilitates an understanding of sovereign wealth fund activities and of the Santiago Principles, which establish a framework for governance, accountability and transparency for sovereign wealth funds.

Investment in long-term themes: disruptive innovation

The world is currently experiencing a period of profound technological innovation. Through rapid adoption and convergence, these technologies are reshaping the way we live and work. They are also changing the way investors operate and disrupting the business models of the companies in which they invest.

The Future Fund benefits from disruptive innovation as active investors in companies of the future. Our multi-billion dollar venture capital program gives us access to innovative, high potential companies as well as insight into the disruption trends that are impacting the way societies and economies operate, and how those trends may play out in our portfolio.

While we aim to harness the opportunities disruptive innovation offers, we are equally cognisant of the risks it poses to our portfolio. For example, the introduction of autonomous vehicles may have implications for our infrastructure investments, just as the increasing influence of e-commerce may impact our retail property assets. Accordingly, we are integrating these thematics into our investment decision making frameworks with the aim of more thoughtfully evaluating their impact on long term investment performance and portfolio construction.

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