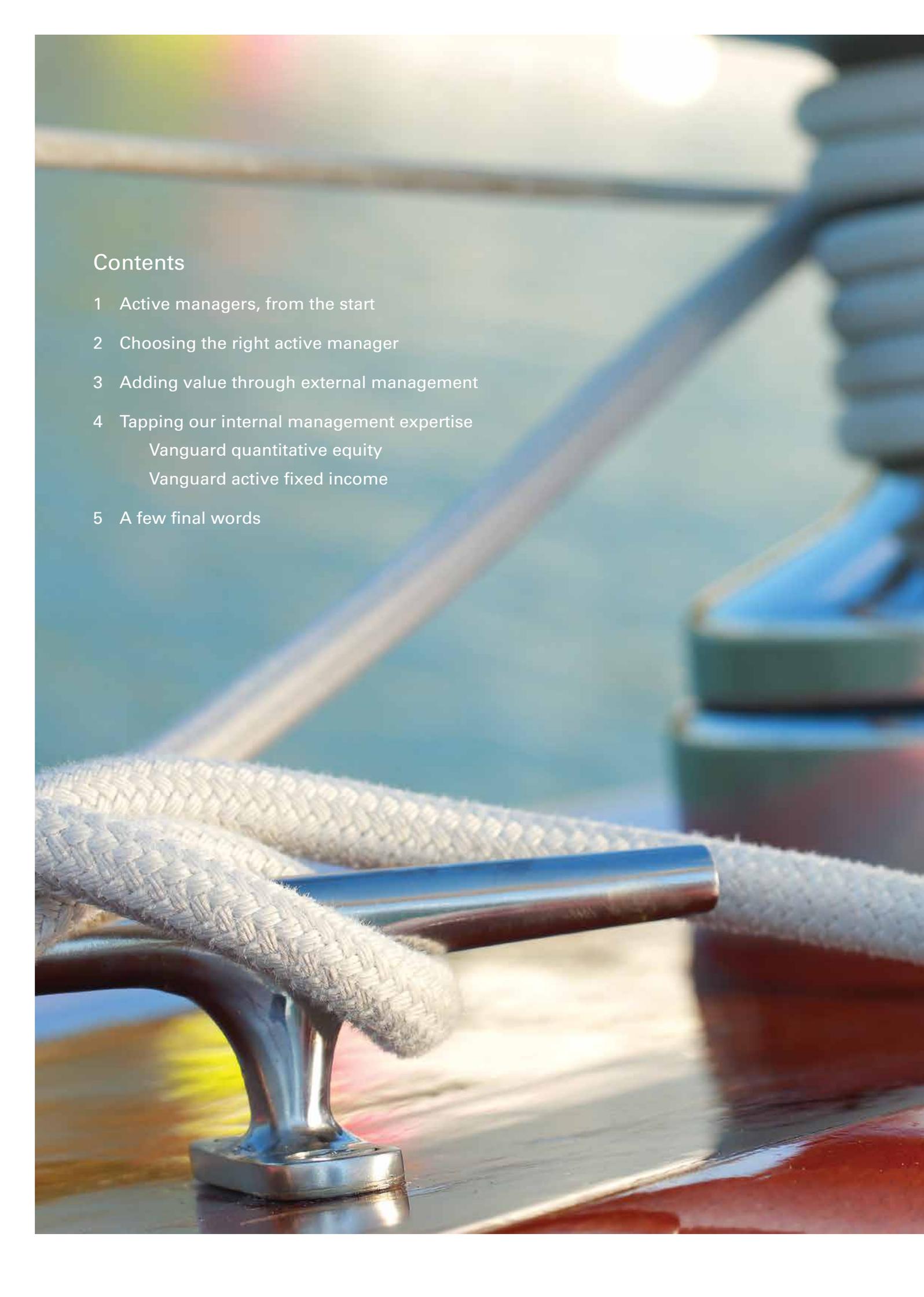


Vanguard[®]

Our approach to active investing





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Active managers, from the start

Investors know what to expect from Vanguard: stability, experience and a focus on long-term, low-cost investing.

These attributes have played a consistent role in our long history of active investing, whether managing active fixed income and quantitative equity ourselves or choosing outside managers that we're confident will add value while embracing our approach.

Our active management history goes back to our beginnings. When The Vanguard Group, Inc. started operations in the United States in 1975, our entire line-up comprised 11 active funds.

Today, Vanguard is one of the world's largest active managers, with more than \$1.7 trillion in funds under management globally. That's 25% of our total \$6.9 trillion globally in funds under management.¹

Our research supports² something we've long believed: that low costs and top talent are critical factors in improving the likelihood of outperformance using active investments.

And we've believed something else from our beginning: that managers should put investors first. We're structured in a way that allows us to do just that. The Vanguard Group, Inc., is owned by Vanguard's US-domiciled funds and ETFs. Those funds, in turn, are owned by their investors. This unique mutual structure aligns our interests with those of our investors and drives the culture, philosophy and policies throughout the Vanguard organisation worldwide.

¹ All funds under management figures in this brochure are as at 30 June 2018.

² *The case for Vanguard active management: Solving the low-cost/top-talent paradox?* The Vanguard Group, Inc., January 2013.

Note: All data throughout this brochure is shown in Australian dollars.

Choosing the right active manager

When evaluating current and prospective managers, we use a framework focusing on qualitative criteria, not short-term performance.

Sometimes our search ends within our own investment management teams. Other times we tap into the expertise of external managers that promote the Vanguard way of investing, one that emphasises low costs and a long-term perspective.

Internal versus external management

How do we decide when to use internal versus external managers?

The answer is really quite easy. Where costs are critical and strategies are highly scalable (such as with indexing and investment-grade fixed income) we manage internally. We simply think that, in those areas, we're the best in the business.

Of course, low costs matter to our external managers as well. But they're not the only parts of the mix in traditional active equity and active balanced strategies, with their greater variability in returns and opportunity for alpha generation. Skill is critical, and external management gives us access to a broader talent pool.



Adding value through external management

Before we hire an external manager, we first must have a high level of conviction in the manager's ability to add value over the long term.

A 20-member team within our Portfolio Review Department oversees existing external managers and evaluates prospective managers. It recommends external managers to a senior management investment committee that includes our CEO and that meets monthly – and annually with each of our 27 external managers. Ultimately, our board of directors has fiduciary oversight of funds and approves all external managers.

The search team emphasises qualitative factors when evaluating prospects, with four key drivers:

- **Firm.** How does the manager rate on ethics, stability and the diversity of its client base?
- **People.** How tenured and experienced are its investment professionals? How frequent is turnover among key professionals, and what is the succession plan?
- **Philosophy.** Do the manager and its investment professionals share the same beliefs about investing? Is the philosophy enduring and easily articulated?
- **Process.** Is it proven, understandable and repeatable?

Performance, you may notice, is not among the drivers. Rather, it's an outcome. We expect a firm with the right people, philosophy and process to produce a long-term history of competitive results consistent with its investment approach.

Long-term is key. While we occasionally will replace managers who no longer meet our criteria for success, our process is patient. Active managers sometimes face bumps along the road to long-term outperformance.

We use both single managers and multi-managers among our externally managed funds. We may use single managers for specialised funds or where we have a long-term strategic partnership, while we may use multi-managers with complementary approaches in an effort to increase diversification and improve performance consistency.

Tapping our internal management expertise

Our internal management draws strength not only from a deep bench of credentialed investment professionals, but also from macroeconomic viewpoints and risk management that are embedded in our approach.

The economists and investment analysts within our Investment Strategy Group in the United States, the United Kingdom, Hong Kong and Australia help us capitalise on macroeconomic effects that aren't always accurately reflected in fixed income securities prices.

Our Risk Management Group participates throughout the investment process, contributing analysis that goes into portfolio construction decisions.

This collaborative nature makes us different from many competitors, and may best be reflected by something that *isn't* present: a star manager. There's no key individual calling the shots, no one person whose eventual absence may leave investors vulnerable.

Vanguard quantitative equity

Our Quantitative Equity Group (QEG) must compete for and retain every mandate that our Portfolio Review Department awards it. In essence, with such mandates, Vanguard is hiring Vanguard.

And what does QEG have to offer? A deep, tenured investment team that for more than two decades has honed a disciplined, systematic, risk-controlled process that underlies a bottom-up, fundamental approach.

In its earliest days, QEG served only as an adviser on multi-manager Vanguard funds. But since 2005 it has handled stand-alone mandates. Today it applies its experience to multiple strategies, including market-neutral, managed payouts, alternatives and factors.

Among the group's 32 strategists, analysts and portfolio managers, 17 hold the CFA designation and 8 have PhDs. They have an average Vanguard tenure of more than 10 years and they oversee more than \$52 billion globally in 47 different Vanguard mandates.

QEG/EIG additionally leverages the best practices, low-cost execution, and index-trading expertise of more than 40 traders in multiple markets around the globe.

Vanguard active fixed income

Rather than taking aggressive positions, our Fixed Income Group aims for a consistent string of small victories over time. Our highly experienced credit research teams guide our decisions on sector overweights and underweights and issuer exposures.

Our rates team seeks to add value from sector allocation, duration, curve, security selection and other rates strategies.

And our portfolios are managed in a highly risk-controlled way across multiple dimensions of risk. This can be quite different from many active managers who take on more aggressive risk profiles relative to their benchmarks.

Fixed income, after all, is meant to play a defensive role in portfolios. Why take unnecessary risk when upside is limited anyway? Instead, we aim for outperformance compared with our benchmarks over the long run, complemented by our low investing costs.

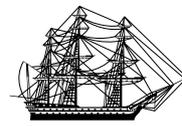
We manage more than \$561 billion globally in active fixed income, and we aim to expand upon this franchise. We have 176 investment professionals in fixed income operations in two US locations, the United Kingdom and the Asia/Pacific region. Our operations in all three regions have portfolio management, trading and credit research capacity.

Our senior leaders have more than 20 years' investing experience each, and most have been at Vanguard 15 years or longer.

A few final words

In the end, active investing, like all investing, is a zero-sum game. Half of all investor money outperforms the market and half underperforms.

High investment costs, lack of discipline and frequent personnel turnover act as headwinds to active-investing success. We work to remove these headwinds, whether through our experienced active managers or the external managers who earn our confidence.



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