



The buck stops – where?

Retirement clearly isn't what it used to be. It's becoming increasingly difficult to qualify for a pension. We're being asked to stay at work longer. We're being told we must be financially self-reliant for life. Nowadays, investing is less an option, more an edict - but we've all heard the stories about stock market crashes, lost fortunes and decimated businesses. How can we be sure we're choosing the right investments for a prosperous future?

Australia's favourite investments

The top three choices for Australian investors are property, shares and managed funds.

Property is a block of land or, in the case of an apartment, airspace above the land. It can be acquired directly or by purchasing units in a property trust, where a number of purchasers pool their funds to invest in one or more properties. Popular for decades, property makes up the bulk of many individuals' wealth.

A share, or equity, is a partial ownership of a company. If a company had 100 shares on issue and you owned one of them, you would own one per cent of that company. You would also be entitled to one per cent of the company's profits, which are paid twice a year as dividends. Bought and sold on the stock exchange, the value of shares can vary from day to day.

A managed fund is a trust which can invest in almost any asset class. Funds can be sector specific, investing solely in cash, fixed income, mortgages, property, Australian shares or international shares, or they may invest across several of these sectors. Managed funds generally hold a diversified portfolio of assets in order to disperse the investors' risk.

A love affair with property

"I believe that the investment culture within Australia is very property-centric," says Carlo Cossalter, Authorised Representative of Professional Investment Services.

“Residential property has seen tremendous returns over the past ten years and the interest rate environment has been very conducive to that type of investment.

“Property is also a very visible, physical asset. If someone buys a property they can go and visit it. They can stand in it. On the other hand, shares and managed funds are more mysterious. Because you can’t physically touch them, they tend to be less understood. They also have their prices published every day, so their volatility or risk is a lot more visible. The price of a property is not really known until it is sold, and that means investors can’t see the day-to-day fluctuations.

“I believe that Australians need to be cautious about residential property investments over the next few years,” he adds. “People tend to think they don’t need to worry about rental returns because they are always going to make a capital gain out of the property, but this is very similar to the way people were talking about technology stocks before the 2000 crash. Then they were saying, ‘don’t worry if the company doesn’t make money, we will still make a capital gain’. It wasn’t true then, and it may not necessarily be true now. With the heavy gearing people use for property investments and the rising interest rate environment, it’s not hard to envisage a lot of investors losing their entire savings should a property correction occur.”

Sound principles

So how can you predict which investments will perform best?

"Prediction doesn't come into it - a good financial adviser doesn't speculate," says Josephine St George, from Mercer Wealth Solutions. "The easiest investment to sell is one that rose by 20 per cent in the past year - but past performance is never a guide to what will happen in the future. Professional advice is about an effective strategy, not how an investment will perform in the short term.

“A good investment is based on a sound philosophy, equally sound principles and a willingness to ride out inevitable periods of poor performance. Except in very unusual circumstances, the worst time to sell is generally when share prices have fallen – but, again, your overall strategy should be the driver.”

Professional help

With a growing number of ‘easy’ investment tools and products on the market, should we be tempted to go it alone?.

“Business owners could educate themselves and put their own investments in place,” says Cossalter, “but the education must be ongoing. Investment companies and banks are constantly introducing new products, and the legislative environment is constantly changing. This is why we, as advisers, are required to undergo continuing professional development.”

“A business owner needs to be the steward and leader, and to focus on the skills and strengths he or she brings to the business,” says Kim Fairleigh, Authorised Representative of AMP Financial Planning Pty Limited. “That means acknowledging where your time can best be spent, and bringing in experts wherever they’re needed.

“When it comes to investments, it’s not just a question of choosing a few managed funds and forgetting about them,” he continues. “They need to be actively monitored, and you need to be ready to act on the outcome. It’s a very time-consuming business, even for a professional.”

“It’s like learning to fix your car because you don’t want to pay a mechanic,” adds St. George. “Not many time-pressured business people would see value in that.”

What would you do with \$75,000?

You’ve had a windfall of \$75,000 and you want to invest it. What should you do? We asked our three advisers to recommend strategies for aggressive, balanced and defensive investors.

The aggressive investor – Josephine St George

“Normally, an adviser would take into consideration variables such as life stage, lifestyle, financial situation and objectives when tailoring investment solutions.”

Assumptions Notional couple “Tom” and “Suzanne” are aggressive investors with a long investment time frame.

Comments An aggressive portfolio typically has 100 per cent invested in growth assets such as shares and property generating returns through capital growth. We would anticipate a high degree of capital volatility, particularly over the short term, which means there is potential for negative returns and capital losses. A negative return is expected, on average, once in every four years. Since the effects of adverse volatility usually become less consequential over time, the minimum suggested investment time frame for this portfolio is seven years.

Property Generally, managed investments specialising in listed property securities offer greater liquidity than managed investments with direct property holdings.

Australian and International Shares A mix of value and growth management styles will reduce the overall level of volatility. Depending on the value of the Australian dollar at time of investment, currency hedging could have the same effect. For example, when the Australian dollar is at the lower end of the spectrum there is an argument for fully hedging the international share sector.

Hedge Funds Traditional managed funds are organised around investment styles, for example value or growth. Hedge funds are organised around strategies such as equity market neutral, convertible arbitrage and event driven. They attempt to achieve absolute returns and tend to have a lower correlation to the traditional market, providing another way of reducing volatility.

Investment objectives We expect an aggressive portfolio to provide a target rate of return (after investment management fees) that exceeds inflation (CPI) by at least four per cent pa over a rolling five year period. In this case, the initial investment of \$75,000 would be worth at least \$200,000 in 15 years’ time.

Recommendations

Asset Class	Managed Investment	Benchmark Allocation
Australian Shares	Barclays Australian Share Fund	15.00 per cent
	IOOF Perennial Value Shares Trust	15.00 per cent
	Perpetual's Wholesale Australian Fund	15.00 per cent
	Schroder Australian Equity Fund	15.00 per cent
International Shares	BNP Paribas – MFS Global Equity Fund	10.00 per cent
	AXA Wholesale Global Equity – Value Fund	10.00 per cent
	Vanguard International Shares Index Fund (Hedged)	10.00 per cent
Hedge Fund	Port Part Prof High Growth Shares	10.00 per cent
Grand Total		100.00 per cent

The balanced investor – Kim Fairleigh

“Investing is not just about what you do with your money, it’s about how you live your life.”

Assumptions Paul and Rhonda are in their mid thirties and have three children at private school. Breadwinner Paul has a successful business with four employees. He maintains a cash balance of \$50,000 in his business account for emergencies and cash flow smoothing

Comments

They have a balanced attitude to risk. They want a diversified portfolio that will manage the effects of tax and inflation and help them reach medium to long-term financial goals. They are prepared to take calculated risks.

Investment objectives

They would like to grow the business further and support their children through university.

Recommendations

If they had a mortgage, I would recommend using the \$75,000 to reduce this. This would effectively provide an instant return of around 7.05 per cent tax free. If they didn't have a mortgage, I would suggest a "multi-manager" approach using a range of investment managers to provide diversification. The objective is to deliver more stable returns by using a blend of managers with complementary investment styles.

I would also make some recommendations for taking control of their financial position. This would include working with an accountant to prepare an annual business plan and other supporting plans, and with a solicitor to prepare a will. They may also want to consider a business coach to help them establish goals and strategies, create opportunities and manage problems as they arise.

Paul should ensure he and Rhonda both have realistic life insurance cover, and he should consider Income Protection Insurance at 75 per cent of current earnings. I would also recommend \$100,000 each in trauma cover.

While Paul imagines his business will fund his superannuation, a business doesn't always achieve the sale price that the owner hopes for. I would recommend that he start making contributions into either his own super fund or an industry fund.

The defensive investor – Carlo Cossalter

"I don't see too many defensive investors but there are a few very easy strategies which they can utilise without having to enter unknown territory"

Assumptions

Bob runs his business as a sole trader rather than a company and has a low tolerance for risk.

Comments

The cash, fixed income and mortgage trust sectors would be the only sectors we could consider. Property and shares would be too volatile for someone who does not want risk capital loss.

Investment objectives

We would see this more as an efficiency-driven exercise than an investment decision. For the defensive investors, the interest rates they pay on their debts would generally exceed any returns they got from a defensive investment so we would suggest paying of any debt first, ensuring that the funds remain readily accessible should they be required in the future. If there were still funds available we would seek out the best possible low-risk returns

Recommendations If Bob had an overdraft or credit card, we would first recommend paying them down as they would be attracting the highest rates of interest. If he had no overdraft or credit card but a mortgage on his home, we would probably recommend setting up an offset account and placing the cash into that. Generally interest rates on mortgages sit at around 6.5 per cent pa and are not tax deductible.

The offset account would have the effect of saving 6.5 per cent pa in after-tax dollars while still giving him access to the funds. If he had neither an overdraft nor a mortgage, we would look at other suitable cash investments.

Generally I would be paid a commission for placing an investor into a cash management trust, a fixed interest fund or a mortgage trust. However, these investments are currently delivering relatively low returns. At the moment there are several banks trying to buy a customer base by offering great returns on online accounts. The best in the market is BankWest, whose TeleNet Saver account is offering a 6.00 per cent return. This includes an introductory bonus of 0.75 per cent for the first 12 months when the rate drops back to 5.25 per cent - we could readdress the investments then. This rate is higher than the official cash rate, the 90 day bank bill rate and both the three and 10 year government bond rates. It is also higher than most retail mortgage trusts with none of the risks. The only mortgage trust which may be considered would be the LM Mortgage Income Fund which has consistently outperformed its peers over the past five years.

If Bob were making relatively good money from his business and couldn't envisage needing the funds prior to retirement, a contribution to superannuation, which is tax deductible, would be the best saving strategy. However, being self-employed, only the first \$5,000 of annual contributions would be tax deductible. Any additional contributions would be 75 per cent deductible.

Which investment?

Property

Pros

- An emotive investment – see it, touch it, live in it.
- Historically, property has made good capital gains.
- Good security if you want to borrow for other investments.

Cons

- Low liquidity – it can be hard to sell and turnaround costs are high.
- Vacancies and maintenance costs can eat into your capital.
- The yield on an investment property can be very low relative to other growth assets.

Shares

Pros

- Over the long term, shares have outperformed all other sectors.
- Liquid assets – you can sell in small parcels and know exactly how much you will receive.
- Low cost investment.

Cons

- Can be difficult to understand and, if you're not using a broker, need extensive research and attention.

- Can be very volatile over the short term.
- Influenced by many external factors such as other markets and economies

Managed Funds

Pros

- Highly diversified – risk is spread across several investments which can include some not available to retail investors.
- Access to very experienced, highly professional investors as the managers.
- Units can be purchased and sold in small parcels.

Cons

- Ongoing management fees.
- There is a huge range of funds offering very different aims, objectives and returns – it isn't easy to choose.
- Price can fluctuate significantly over the short term.

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