THE SMSF REVOLUTION:
WHY IT MIGHT NOT BE RIGHT FOR YOU

PART 4 OF THE SERIES:

"Can you really afford to retire?"

MUIRFIELD

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Chapters covered in this series:

1. How big should your nest egg be?
2. The impact of inflation and living longer.
3. Reducing the risks of inflation and outliving your nest egg.
4. The SMSF Revolution: Why it might not be right for you.
5. Can you afford NOT to be an investor?
6. How to sack the tax man and live a tax-free retirement.

Letter from the author

Dear Reader,

I am glad you have chosen to receive our 6-part email series ‘Can you really afford to retire?’.

We certainly live in interesting times, both financial and social, and the advance in technology and turmoil of investment markets have made long term decision making very difficult. This is especially the case as you embark on the transition from a stable and dependable employment income to the unknown realm of retirement.

We are hearing more and more from our clients that the most important and influential decision they have made in both the final stages of their working lives and into their retirement was finding someone they can trust. After all, you are relying on someone to guide you through the confusing maze of options and strategies available and not to mention you need to know that your superannuation investments are safe. Finding that person is becoming more difficult in Australia.

The aim of this 6 part email series is to provide you with the knowledge of what strategies are available, how much super is enough to retire comfortably, how to replace your income in retirement and much more. We hope that after reading the complete series you are better armed to make the important decisions that will shape your retirement.

It is important to note that this guide is for general illustrative purposes only and for personal advice you should find a trusted adviser and work with them to develop a plan specific to your own situation.

Hopefully we get a chance to meet at some stage so I can outline why our clients have trusted Muirfield Financial Services with their retirement plans since 1989.

Regards

Melinda Planken
CERTIFIED FINANCIAL PLANNER®
Employee Representative
Partner

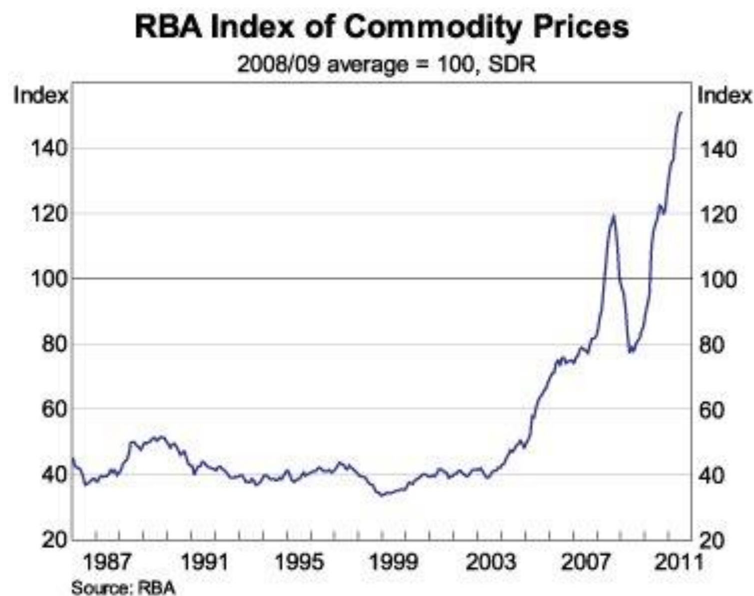
The SMSF Revolution: Why it might NOT be right for you.

Many aspiring investors will seek to have direct control of their superannuation funds. After all, they have seen funds offer them paltry returns over the past 5 years and don't feel confident that fund managers can do any better than the averages – and then they hive off fees each year to boot!

No wonder more than $600 billion and 700,000 SMSFs* have been formed.

The number is growing at a faster rate than funds under management for the whole of industry. Investors however, if they really want to control their own destiny, need to do SOMETHING. This belies what is actually happening and tells us a lot about the inertia of many investors and traders who want to accelerate their wealth.

There are so many conflicting views on investment choices. You have all the US deficit worry, the Euro Zone fiscal debacle and you have this massive boom in resources and an expanding terms of trade, creating this picture in Australia:



The real give away from the SMSF data is that investors are too frightened to do anything – and that's despite the boom in commodities. Investors with self-managed superannuation funds (SMSFs) say they will continue to hold a big proportion of their portfolios in cash despite improvements in the Australian economy.

A survey of SMSF investors who have term deposits linked to their funds found that 34% held more than half of their portfolios in cash, while 33% said their cash allocation was between 25 and 50%.

The survey also revealed that 54% of the 170 surveyed had no plans to alter their cash allocation, while 19% said they would invest more in cash.

The majority (66%) said the global financial crisis had influenced the level of cash they decided to hold in their portfolios, with the primary motivation for investing in cash being "guaranteed returns", followed by "low risk".

Almost a third of respondents said they were optimistic about the performance of their super this year, while 26% said they were still cautious.

The survey, conducted in late January 2011, also found that many Australians were seeking greater control of their financial destiny amid caution about the economy. That caution is also reflected in the fact that people are reluctant to reduce the cash component in their SMSF.

According to 75% of the respondents, control was the main reason for setting up a SMSF. A significant proportion said the fees and returns of the large super funds had also influenced their switching over.

In reality, there are approximately 75,000 SMSF's (in 2013) that are non-compliant according to the Australian Tax Office. There have been concerns from some parts of the superannuation industry that do-it-yourself super can be much more time consuming and complex than many investors realise.

The DIY paradox

The DIY paradox is that once investors take control of their nest eggs, they tend to sit on cash or real estate. Many are being attracted to strategies which offer compelling reasons for the SMSF to buy property. The premise behind such schemes is that the fund, which normally cannot borrow money, can use leverage when it is personally guaranteed. Property investing is generally a sign of long term security but is no guarantee of superior returns.

Historically SMSFs have had a disproportionate amount of their funds sitting in terms deposits, government bonds and fixed interest securities. This may be fine at a snapshot in time but over the long term, a yield on funds of less than around 5-6% is going to mean very little long term growth and is, in any case, below benchmarks for managed funds.

Consider this: The major share fund managers recommended by many professional advisers have the expertise to buy, sell and hold shares with much greater success than the average investor.

Is it any wonder that Warren Buffett, hailed as the world's most successful investor, advises the average investor to invest in shares through index funds mirroring the total stock market, rather than attempting to pick winning shares individually?

Readers should note that the self managed superannuation fund option may not be suitable for all individuals. They should, prior to making any financial action in this regard, seek the advice of a properly authorised and independent financial planner or adviser.

Can you simplify SMSFs via investment choice?

It is no wonder that over 90% of Australians make no changes whatsoever to their superannuation fund choice other than to do nothing, leaving their funds at the discretion of the fund managers and trustees.

It is also no surprise that despite the name, SMSFs tend to have most of their invested funds in cash or fixed interest securities. That might be smart in the short term but it is incredibly troublesome to do nothing for the long term.

Consider the case of Exchange Traded Funds (ETFs) as a case in point.

ETFs are surging in popularity around the western world. They have become a favourite product for investors; the question is are they popular because there are more promoters of the funds around selling more products or are they popular because they are such a good 'solution' for DIY investors?

After all, the products meet the growth in demand from intermediaries such as fund managers, advisors and investors seeking increased diversification and lower costs.

This has seen the ETFs get to around 4% of total capitalisation of the stock market in Australia. And that's only after a few years on the market.

The latest data available suggest that around 50,000 investors are directly involved in ETFs and possibly another 500,000 through pooled funds such as listed equity funds. This has multiplied in activity by about tenfold since mid-2005.

The early version of ETFs, was simply a plain-vanilla tradeable index funds in the US, but now account for more than $US1 trillion worth of investments in the US.

Paradoxically, despite the fact that such funds would not necessarily be used as high leverage trading vehicles, they are considered to be one of the reasons behind a sizeable stock market correction last year – once again exposing a real risk of such products – when a falling market triggered a series of automatic stop loss sell orders.

This is reminiscent of the 1987 stock market crash when heavily margined accounts cascaded stop loss selling on Wall Street and similar also, to the wave of selling that commenced in October 2007 and went through to April 2008.

The myth that ETFs are a “safe” product when compared to individual shares which are often heavily leveraged is troubling given that such risks are not always properly disclosed at the sales side of marketing of the investment products.

Notwithstanding the marketing hype behind ETFs, it seems that most investors in Australia have not encountered a problem with the product. The investors, made up of self-managed superannuation funds with relatively small amounts ranging from $5,000 up to $100,000, suggests that they are inexperienced, smaller investors looking for a ‘safe’ solution for where to put their super dollars coming into their accounts each month.

It is entirely likely that the diversification theme is the principle reason, which when combined with low cost and the avoidance of the risk that comes via individual stocks is a compelling case for ETFs. Liquidity and ease of selling are also reasons to buy them. Increasingly, the ability to access specific overseas markets would be appealing (on paper at least) to a number of investors.

An abundance of investment products are both a curse and an opportunity for investors. The mistake that new investors make is that the bells and whistles that sparkle and tinkle in the dark are not the reasons that they should be buying ETFs or other products (such as “guaranteed” cash flow investment property or 15% mortgage trusts). **What investors want are assets that protect them from the ravages of inflation and which offer them some protection from the volatility of markets.**

Ultimately this can only be achieved by adopting an asset allocation model that satisfies the individual age, stage and risk profile and which also gives the investor a sense of control over their future. ETFs may have a place in such a model, but there may also need to be an appropriate mix of directly owned shares, real estate and fixed interest investments.

The new investor cannot plunge unwittingly into this without first doing some homework in the form of self-education. ETFs are a new product but they should not be bought without first having regard to the best asset allocation for the investor.

Take care of the marketing hype and always take note of the number of new promoters coming into the markets. They are the false prophets.

Many DIY investors make the simplistic assumption that ETFs are the answer to the challenge of being a DIY investor. When considering the latest ETF statistics, it is probably worth thinking about how investors use ETFs to rapidly rebalance their portfolios.

In fact July 2011 was the second month when the market capitalization of ETFs fell – attributable largely to the share market's contraction. The figures include Exchange Traded Commodities. In the same month, the S&P/ASX 300 fell by 3.8% and the MSCI World ex Aus was down 2.6% in local currency terms.

Investors commonly use ETFs tracking a broad index to rebalance their portfolios following a rise or fall in share prices. But don't think that by diversifying across different equity markets that ETFs somehow give protection consider the following international markets: First China:

-- What about India? It looks much like China's one-year performance.

-- Is Brazil any better? Yes, it's recouped all of Augusts' losses. No doubt helping things along is the decision by the central bank to cut interest rates by 0.5% to a still hefty 12%.

Sorry for all of the charts but I have included them to show how difficult it can be to decipher all of the information needed to make investment decisions – and this is only the 'tip of the ice berg'.

Investors are looking for transparency and simplicity when evaluating investments and ETFs are proving to be an efficient product to deliver low-cost, passive strategies to investors, but do not protect an investor from large falls in assets such as shares and commodities.

This can only be achieved when you have a well-diversified investment across all asset classes and one that is constantly monitored to ensure it remains appropriate.

I have used ETF's as an example only to explain that when investing within an SMSF you are responsible for the investment decisions and outcomes of your fund.

Whilst funds such as ETF's are a great way to achieve diversification across shares and asset classes the complexities of picking the right fund for your investment mix is just as crucial as when selecting Term Deposits, Direct Shares, Managed Funds, Fixed Interest Funds etc.

Making one wrong decision when handling the investment of your retirement savings can mean the difference between a happy retirement and a ruined retirement.

So whilst SMSFs might be flavour of the month at the moment you need to ask yourself – "do I really want that level of complexity and burden in my retirement and is a SMSF really for me?"

Where to get advice?

Another problem for individuals is that seeking advice for a financial problem is like seeking advice for a sore knee.

- See a surgeon and he'll want to operate on it.
- See a chiropractor and he'll want to manipulate it.
- See an acupuncturist and he'll want to needle it.

Similarly, the advice provided by many financial advisers is biased towards selling you a particular investment category. Stock brokers would like you to put all your money into shares. Real estate agents are licensed only to sell real estate.

Right away, you can see a disconnection here. If you want to invest in both shares and property, for example, who can you turn to for advice on the best combination of share and/or property investments to meet your own specific needs and objectives?

The answer is an independent financial planner who has no vested interest in any of the products on offer in the market and is not aligned to any dealer group, bank or financial institution.

An investor wants to be dealing with professionals who are focussed on finding money-making opportunities and who understand the risk parameters thoroughly; who have proven methodologies for handling all market conditions and can alleviate the worries of managing your finances in retirement.

About the author:

Melinda Planken is a Certified Financial Planner® with Muirfield Financial Services, AFSL 243287. Muirfield have been the trusted finance professionals in Geelong since 1989 with specialist knowledge of retirement planning strategies and advice. As a Partner of the firm, Melinda is well positioned to guide you through the process of retirement and into the next phase of your lives.

This guide is one section out of the 6-part series 'Can you really afford to retire?' We wrote this series to outline the most important issues facing retirees in Australia and how you can avoid the most common mistakes made by many retirees before you. It is intended to get you thinking more pro-actively about your retirement.

I encourage you to book your complimentary retirement strategy session with me to discuss your specific retirement goals. The best way to take advantage of the information you have learned so far is to speak with a CERTIFIED FINANCIAL PLANNER® practitioner about strategies specific to your personal situation. This guide has armed you with the knowledge to know what questions to ask so please click here to book your free appointment and I look forward to meeting with you.

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