Grow @ Marinis Group

From:	grow@marinisgroup.com.au
Sent:	Friday, 12 April 2019 9:30 AM
To:	Alex Wiedenmann | Marinis Group
Cc:	Stacey Truran | Marinis Group
Subject:	What should you do before the election?
Attachments:	2018 10 01 _ Creating a fairer superannuation balance _ EUREKA published.pdf; April 2018 eGrow for website.pdf; Media Release No 85 _ 2018 09 06 _ A Super Mess with Attachement.pdf; Media Release No. 79 _ 2018 04 04 _ Addicts Abound in Investment.pdf

Dear Friends,

What should you do before the election?

A few of you have raised concerns with me about the upcoming federal election – in particular, by asking whether significant changes to your retirement strategies are required.

This concern (as usual) has been driven by media reports of some listed investment companies paying dividends ahead of time.

As always, my attitude is that we should not jump at shadows.

Firstly, we don't know what the outcome of the election will be. And while the polls at the moment are pointing to a Labor win (notwithstanding the recent NSW state election result) they are not an indicator of the make-up of the senate.

Secondly, we don't know what the actual law will look like.

Thirdly, who knows what (if any) 'sweeteners' or 'grandfathering' will occur. Let's wait and see what the reality is.

Bear in mind too, that the impact of any of the proposed tax changes will be mitigated by an appropriately diversified portfolio.

In line with our investment philosophy, your exposure to shares (in line with each individual investment risk profile) is split 50/50 between Australian and international shares, and this is as it should be in a properly diversified portfolio.

As a consequence, in the last ten years or so, your portfolios have already benefited from that overseas exposure – refer to the attached April 2018 eGrow "Horror Headlines" and Media Release No 79 4 April 2018 "Addicts abound in Investment").

For this reason, the impact of the proposed Labor changes to franked dividends on Australian shares will also be limited.

It is also another reason why I always 'harp on' about diversification

As you know, our business model is based on providing strategic advice, with product (investment or insurance) advice being just a component part – rather than the sole focus – of our advice. As a consequence, I will never recommend anything to my clients that I would not, or am not currently doing myself – and I have not been making any changes to my superannuation plans!

It is my recommendation that you also do not make any changes until we know exactly what we are dealing with. That is in fact IF we need to do something!

Many of you will also have noticed the recent fanfare and publicity about the superior benefits of Industry superannuation funds.

I have always advocated for cost effective funds, so I decided to compare what our clients pay with the five 'best' industry funds as identified by rating agency Canstar in February 2019.

This is not as easy as it sounds, as there are no strict rules governing how funds describe asset allocations and / or (often the LACK of) strategies for diversifying investment risk.

Tabled below is a comparison of the total costs and performance of '***balanced funds'*** over a seven-year period based on an investment of $500,000.

Fund	Accumulated Value – 7 years ($)	Return on investment (%)	Investment Management cost pa (%)	Growth Assets exposure (%)
Catholic Super	$922,269	9.14%	1.17%	85%
Host Plus	$998,799	10.39%	1.40%	93%
CBUS	$979,952	10.09%	1.07%	85%
Australian Super	$982,447	10.13%	0.88%	78%
Sun Super	$956,518	9.71%	0.73%	81%
Non-industry fund balanced portfolio *	$969,408	9.92%	0.50%	65%
Non-industry fund growth portfolio *	$1,061,210	11.35%	0.50%	80%

diversified portfolio constructed using MFG researched investment options, managed via an MFG approved investment platform.

It is an interesting comparison, particularly in light of my comments above and my comments last year about the difficulty of comparing apples with oranges!

For more background information, I refer you to the attached Media Release No 86 28 September 2018 "The Super Mess we need sorted" and Eureka InvestSMART article 1 October 2018 "Creating a fairer Superannuation Balance"

As a separate issue, I am disappointed by the Federal Government's announcement that it will not accept the Hayne Royal Commission's recommendation on the immediate abolition of trailing commissions – instead referring it to a three-year review. I believe that this is the result of pressure from the mortgage broking industry and the self-interests of the life insurance industry.

I had hoped that the government would refocus on putting the client first… sadly, it has buckled to external pressure, as governments of ALL political persuasion too often have and do!

And one more thing:

If you would like to review my latest media articles, including correspondence to the federal government and the opposition on the need to act on trailing commissions, please visit our website www.marinisgroup.com.au

As always, if you have any questions or comments, please do not hesitate to get in touch with me or any of our team.

Kind Regards,

Theo Marinis B.A., B.Ec., CPA., FPA®
Financial Strategist
Authorised Representative

grow with MARINIS

GROW @ Marinis

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Media Release No: 79 **4th April 2018**

Addicts abound in investment

By Theo Marinis

- Investment exposed 100% to one stock is fundamentally flawed
- Dopamine overrides logic for the vulnerable
- Wall Street and other indices (and asset classes) are fundamentally different

Over the course of a career, I've marvelled at how many investors are prepared to commit to schemes which can be shut down at the whim of a government minister.

These investors are likely to be the same people who have held time share apartments on the Gold Coast for the last two decades waiting for them to boom like the agent said they would...or have 50 acres of trees just waiting to be harvested when the tax treatment changes, again!

That said, much has recently been written post the Shorten announcement of the ALP's plan to eliminate the refund of excess dividend imputation credits (apparently at the moment, to all BUT age pensioners!).

There are so many 'ifs' around this story that it doesn't really warrant the air-time it has already been given, but what it does point to is one of the flaws the Howard government created in taxation policy, and the vulnerability of investors who have become addicted to the 'dopamine hit' provided by tax driven investments.

Perhaps I'm more than a bit old fashioned, but the old principle applies here: 'If it sounds too good to be true... then it probably is'.

Like any drug of dependence, dopamine (the naturally occurring 'feel good' hit when we do something we think is particularly clever) will ultimately end in a downward spiral.

An example of the impact of this dependency was played out for me some time ago, in the form of an approach by a potential client seeking to maximise Transition to Retirement opportunities (not an uncommon request) as he and his partner moved from accumulation to draw-down phase.

My brief was to provide 'technical/strategic only' advice. The client, a professional his early 60s, had specifically requested not to receive investment advice on an SMSF portfolio valued at $2m, invested 100% in Telstra shares. The investment allocation rationale was based solely on Telstra's high dividend payment track record and accompanying dividend imputation credits.

The scope of the terms of my engagement expressly excluded the provision of investment advice; this did not mean, however, that my professional obligations to flag the risks associated with not addressing related advice areas (in this case, an appropriate investment strategy) could be similarly 'scoped' out.

The risks – primarily the serious lack of diversity in the portfolio and the fact that it was not in line with the clients' identified investment risk profile – formed the subject of some lengthy discussions, as well as part of my formal written advice.

But the estimated income yield delivered by the transition to retirement strategy (including the ***full*** refund of Telstra's imputation credits) was the hook. Warnings highlighting the serious risks involved in *not diversifying the portfolio were happily dismissed.*

A few years later, due to some circumstantial changes, I was again approached by the same individual to provide additional technical strategy advice. By this time the portfolio had been 'diversified'; the Telstra holdings had been diluted to just a quarter of the portfolio – fortunately before the corporation had lost 40% in capitalisation. The proceeds from the sell down had been applied to buy shareholdings in the big four Australian banks, plus one of the smaller ones... with *investment allocation continuing to be driven by the 'siren song' of dividend policies and imputation* credits.

The portfolio now held six stocks, representing 94% of the SMSF investment exposure, held entirely in the local market.

Concerns regarding the risks associated with exposure to a handful of stocks in a single market, the portfolio's vulnerability to the ebb and flow of global capital (notwithstanding the fact that a retirement income strategy based on 94% growth and 6% defensive asset exposure was not a rational or recommended approach) were raised.

An offer of investment strategy advice was again deemed unnecessary, on the basis of what I could only conclude to be the same dividend driven 'dopamine hit' overriding logic.

In the expectation that this case will be dismissed by some as a 'one off, extreme example' broader evidence of the impact of chasing imputation credit refunds can be found in the aftermath of the GFC.

To use an expression by Warren Buffett, many pension funds (both SMSF and non SMSF) "were caught naked when the tide went out". For a number of years, due to severely impaired dividend payments, the prescribed ABP pensions could not be paid from income without selling shares at a significant loss.

The reason? An overexposure in 'pension phase' super funds to Australian shares, and an addiction to their associated imputation credits (not to mention a home equity bias – another cognitive distortion) following the sudden and synchronised 50%+ fall in world share markets in 2008/09. The resulting post GFC fall in profits also saw large falls in dividends.

As a result, for a number of financial years, that famous duo, Howard and Costello were forced to halve the prescribed minimum percentage payments for account based pensions. It could be said that this rule change was necessitated in the wake of the distortion caused by their previous imputation credit policies – a distortion which continues!

Diversify and avoid having to go cold turkey

Post GFC, NONE our clients were forced to live off 50% the normal ABP minimum amounts, which meant that their retirement incomes were not compromised. There were two reasons why this was the case:

Their investment portfolios were all fully diversified, with adequate cash and fixed interest buffers to ride out the storm; they also had 50% of their share exposure overseas, as a volatility reduction strategy.

During the GFC, when ALL share markets fell around 50% or more, the $A fell more than 50%. This meant losses on overseas share market investments were more than made up for on the exchange rate movement on their overseas investments. This strategy worked exactly as it was designed to do.

Sticking to investing ONLY in shares at home – without having some global exposure – for example, the US market – is a major flaw in any investment portfolio.

There are some massive structural differences and investment exposure in the two indices which provide the astute investor the opportunity for significant capital gains in the US, and robust dividends in Australia. Similarly, Asia offers enormous potential.

Instead of treating your investments like a punt at the track, always follow the first three rules of Investment: diversify, diversify and diversify!

That means diversifying within all asset classes and across all asset classes and doing it with low cost index funds. In the long term, you will always get a better and less volatile outcome and a happier retirement!

If you think you might be a dopamine addict, act quickly. Go and see your broker or financial adviser and take the 12-step plan… to diversification.

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Media Release No 85 **6th September 2018**

A Super Mess

By Theo Marinis

The flaw in the superannuation system revealed by the Royal Commission is the fact that few people actually understand the complexities or issues of what we have. And what we have is a mess which allows marketing spin and self-interest to distract long-term investors away from the sole purpose of superannuation – to provide funds for retirement.

The mess starts at the top. The very senior bureaucrats in Canberra who are advocating significant change to the industry are the people who invented the system we are suffering under. Now they are advocating new ways of looking after savings by appointing the Productivity Commission to a new oversight position.

Appointing the Productivity Commission to be the arbiter of the Top Performing Funds 'hit parade', or League Table, is mind-bogglingly foolish.

For a start, there is an absolute conflict of interest for these public servants, who along with our politicians, are entitled to a defined benefit pension in retirement, whilst the rest of us 'civilians', are left trying to decide which 'fund' performed best.

Instead of developing a league table, the Productivity Commission should be creating a clear understanding of superannuation terminology - and publishing that information. We need to compare with apples.

Industry funds, retail funds and Self-Managed Super Funds (SMSFs) are just tax structures which allow us to invest in the same underlying assets. Some structures cost more and some cost less – and some have different functionality – but that is a minor issue. The major issue is that Canberra senior bureaucrats should not be cheer leading for any structure, super fund or super sector.

What is vitally more important is for superannuation members to clearly understand how their money is allocated – but I haven't heard anything from the Commission or its proponents about this.

If it is to really add value to society, the Productivity Commission should actually set specifications for the various asset allocations labelled 'Defensive', 'Conservative', 'Moderate', 'Balanced', 'Growth', and 'High Growth' by a) asset class and b) their appropriate weightings to Growth vs Defensive assets allocations for each defined profile.

At the moment, there are no clearly defined benchmarks for these so-called asset allocation profiles – which means they are used more as marketing terms than as indicators of the level of investment risk and appropriate investment timeframes. As such, these labels are fundamentally misleading – and perhaps conveniently so.

To demonstrate this farce, leading Industry super fund and Productivity Commission hero HostPlus is currently able to market a fund as a 'balanced' portfolio when the asset allocation has a ratio of 90-98% growth asset exposure. *

Small wonder then, with markets booming, that the HostPlus 'Balanced' fund was the best performer in 2018!

In actual fact, this fund is a 'high growth' wolf, masquerading in sheep's clothing - designed to give members a false sense of security for a VERY aggressive portfolio.

This scenario also brings to mind the example of the MTAA Super Fund, which in 2008, just before the GFC, was ranked the best performer in 2008 (no doubt the Productivity Commission would have placed it top of the table as one of the best performing funds if it were charged with the proposed responsibility at the time).

Unfortunately for MTAA and its members, when the GFC hit, the fund lost $1.5 billion of members' cash because of being too heavily weighted in growth assets when the market cracked. *

This is often what transpires, when higher and higher returns are the focus with little regard for the associated risk.

It is my contention that if the Productivity Commission is given these 'League Table' ranking responsibilities, we will find ourselves wading through a new Royal Commission in the next decade as those who were burnt by the top 10 league chart put pressure on politicians to answer questions about why their investments underperformed. The Productivity Commission will replace APRA and ASIC in the 'frame'.

There seems to be a collective 'take-out' from the Royal Commission that somehow Industry super funds are 'good' and that Retail super funds and SMSFs are 'bad'. Recent media reports state that Industry Funds are currently recipients of transfers from Retail funds, which all plays well to a narrative that there is good and bad amongst the various methods of superannuation funding.

If we are to be black and white, Industry Funds are not the cheapest form of super fund available. Industry Funds are not the most flexible and they don't have the best insurance options. But they are still good. The same can be said for Retail funds and SMSFs.

What we need to consider is the make-up and investment approach ALL funds adopt and look across the same skyline. In other words, use a mandated description of what constitutes a certain style of investing. We need appropriate benchmarks, so we can ALL really compare the performance of a particular fund to the right benchmark for a designated risk profile. And we don't need self-interested senior bureaucrats trying to pick the winning superannuation fund of the future!

NO ONE can do that, least of all the senior bureaucrats and their masters in Canberra.

Theo Marinis is Managing Director of Marinis Financial Group

* Read here: Stockspot Blog 'How super funds play the ratings game' by Chris Brycki

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How super funds play the ratings game (Part 1)

📅 31 July 2018 (https://blog.stockspot.com.au/how-super-funds-play-the-ratings-game/) Chris Brycki (https://blog.stockspot.com.au/author/chris/) Financial advice (https://blog.stockspot.com.au/category/financial-advice/), Investing (https://blog.stockspot.com.au/category/investing/)

It's that time of the year again when super funds release their annual performance. This blog looks at how the funds twist their performance relative to other funds and indexing. The funds' PR is parroted by the ratings agencies whose tables and good news story are accepted at face value by the media.

Firstly, we look at how funds manipulate their inclusion into the categories set by the ratings agencies.

Defensive assets

ASIC defines defensive assets as cash or government bonds.

Cash is defensive because when market fall it holds its value.

High grade bonds can do one better and rise when share markets fall. History backs this up too; in each of the 6 times Australian shares had a down year in the past 20, bonds rose to cushion the impact.

Can other assets be defensive?

This very much depends on the opinion of the fund manager and there is strong history to demonstrate why their opinions might not end up as fact.

High income stream and low growth assets

Just because an asset delivers a big income stream does not make it defensive. Take Telstra. Most of Telstra's returns come from regular fully franked dividend income but its share price has dropped 60% since 2015.

Infrastructure and property assets

Much infrastructure and property is held in unlisted vehicles which raises 3 concerns:

- The value of the investment is the opinion of the fund manager and there is no way of knowing whether that value is credible given that there is no open market for the asset.
- The financial structure may see a return of capital reported as an income distribution.

- The investment is very illiquid and a sale is often extremely constrained by agreements with co-investors, including first right of refusal and so-called 'tag-and-drag' conditions. One critical characteristic of a defensive asset is to be able to sell it in a deep and open market.

The inherently risky nature of these investments is usually exposed towards the end of each market cycle when too much debt is loaded in to beef up returns. In 2008 the Real Estate Investment Trust (REIT) sector fell by a whopping 75% globally because these funds had created income which couldn't be sustained under high debts and falling prices.

During the Financial Crisis some super funds stopped members from transferring money out because they were unable to sell illiquid unlisted assets. One fund, MTAA super, lost $1.6 billion due to poor hedging of unlisted assets (https://www.theage.com.au/business/super-fund-controversy-highlights-the-need-for-greater-transparency-20110609-1fuvw.html). MTAA super lost its spot as one of the best performing funds in 2008 to become the second worst according to *Super Ratings*.

Creative definitions of defensive assets

In recent times many super funds have invented their own definition of a defensive asset which has helped to push them up the ratings.

Let's look at this year's top performing fund, the Hostplus default balanced fund which claims a 24% allocation to defensive assets.

The Hostplus website (https://pds.hostplus.com.au/5-how-we-invest-your-money) explains that in addition to cash and fixed income "some asset classes, such as infrastructure, property and alternatives may have growth and defensive characteristics".

Their self-defined defensive assets include infrastructure, credit, property and alternatives. These makes up 22% of the 24% portfolio allocation to defensive assets. Government bonds make up just 2% and there is zero cash!

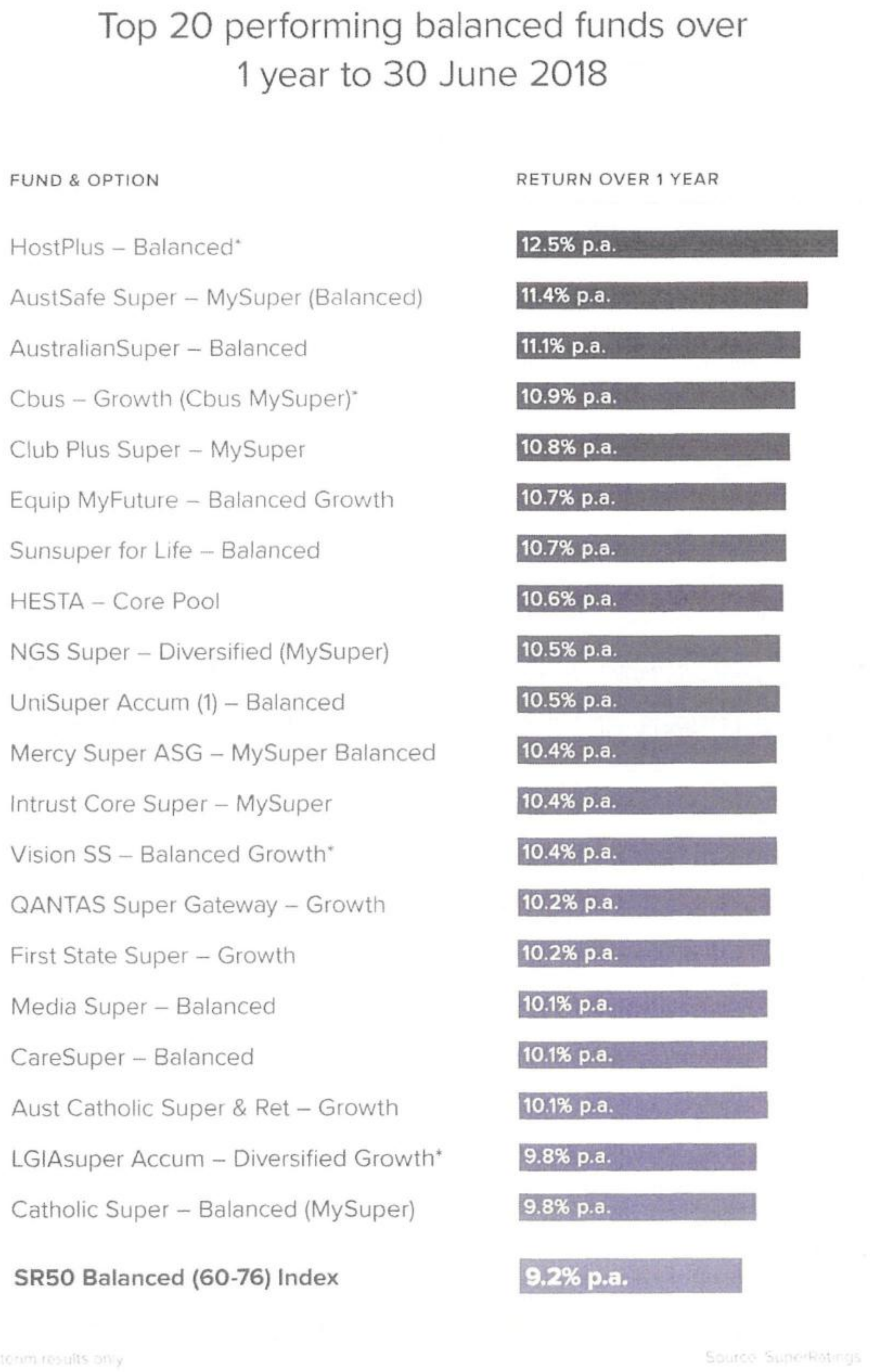
Hostplus default balanced fund

DEFENSIVE ASSET	PORTFOLIO ALLOCATION
Infrastructure	5%
Credit	6%
Property	9%
Alternatives	2%
Fixed income	2%
Cash	0%
Total	**24%**

Source: Hostplus

This has enabled Hostplus to claim top gong in its chosen category.

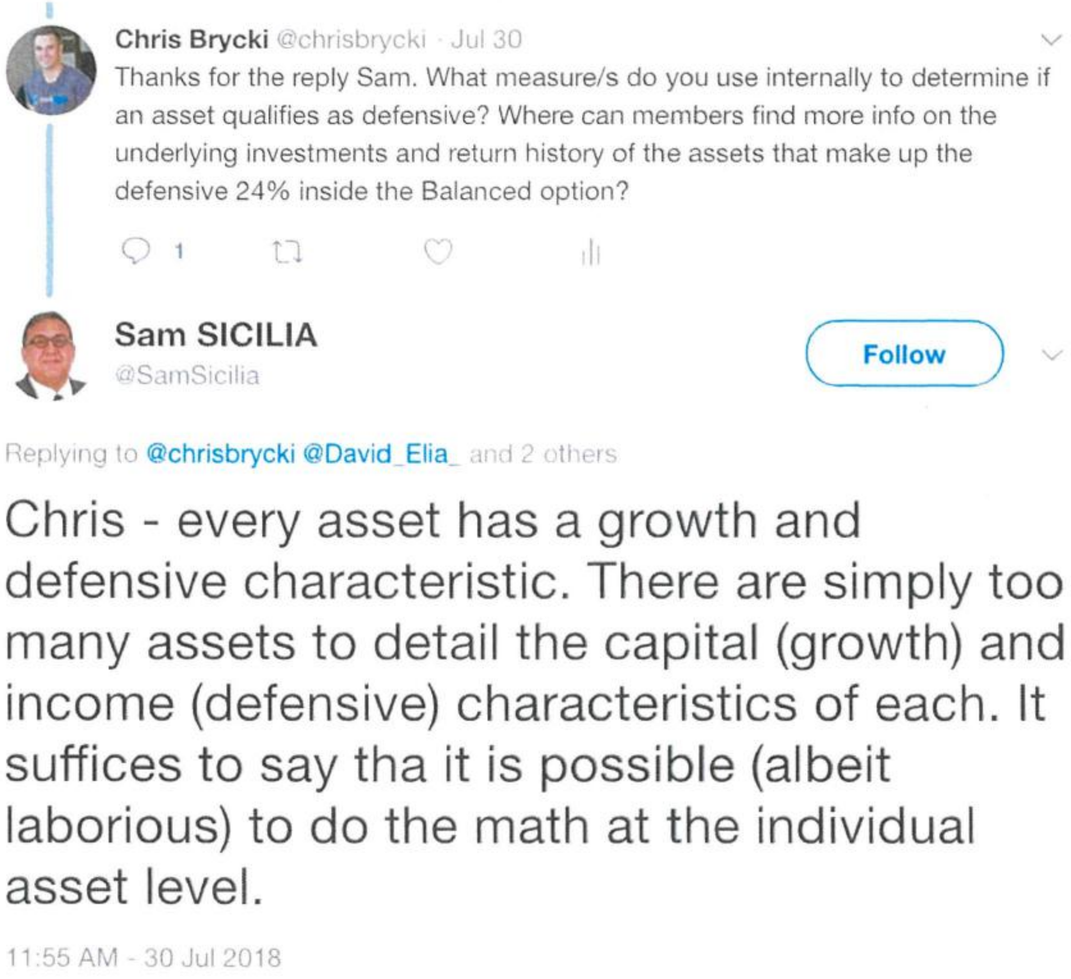
Hostplus isn't the only one. Many of the top funds on this list have counted some other assets as defensive to make the *Balanced fund* weigh-in.



*Interim results only

Source: SuperRatings

This prompted me to ask Hostplus CIO Sam Sicilia the following question:



Chris Brycki @chrisbrycki · Jul 30

Thanks for the reply Sam. What measure/s do you use internally to determine if an asset qualifies as defensive? Where can members find more info on the underlying investments and return history of the assets that make up the defensive 24% inside the Balanced option?

1

Sam SICILIA
@SamSicilia

Replying to @chrisbrycki @David_Elia_ and 2 others

Chris - every asset has a growth and defensive characteristic. There are simply too many assets to detail the capital (growth) and income (defensive) characteristics of each. It suffices to say tha it is possible (albeit laborious) to do the math at the individual asset level.

11:55 AM - 30 Jul 2018

The Productivity Commission got a similar response from many super funds when asking about returns for individual assets. Only 5 of 208 funds were prepared to disclose them.

Unfortunately, super funds aren't required to disclose how they classify their investments on their website or to anyone. Not to members, to the Australian Prudential Regulation Authority (APRA) or ASIC! They also aren't required to share how each asset has performed or even what it is. This allows funds to play the ratings game without anyone holding them to account.

By all means Hostplus and other funds should be free to invest in illiquid unlisted infrastructure, alternatives and property assets.

Just don't call them defensive!

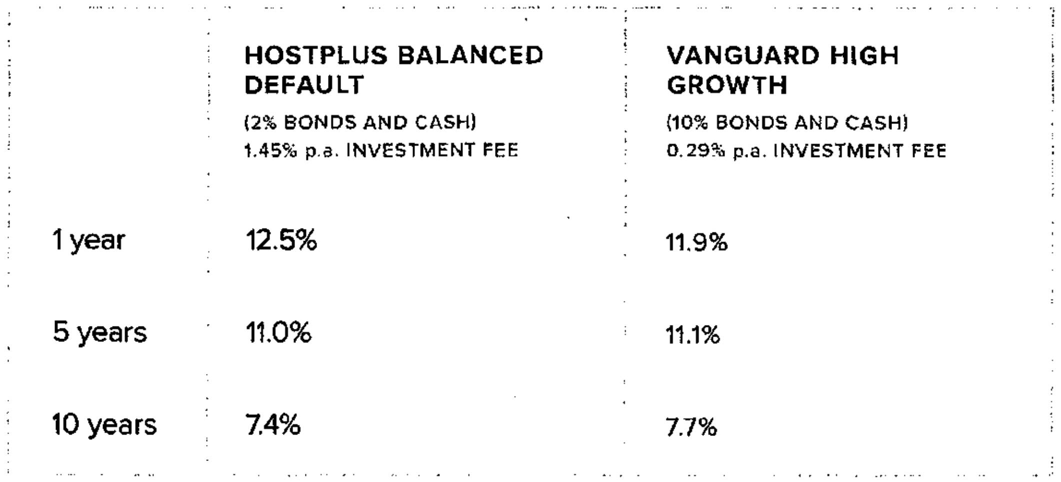
How Hostplus sells the 'success' of its balanced default fund

Hostplus chief executive David Elia puts the performance down to **active management (https://www.afr.com/personal-finance/find-your-super-fund-in-the-top-performers-20180725-h1340k)**:

"Over the past three years our balanced option did 10.16 per cent, while the index balanced option did 7.29 per cent, so that's almost a three percentage point differential. The [active] balanced option has outperformed across every time horizon" he says.

It's absurd that Hostplus compares its indexed balanced option which has 25% cash and bonds to its default balanced option with just 2%.

It would be fairer to compare it to an index fund with a similar amount of risk. For example, the Vanguard High Growth Fund has a 10% allocation to cash and bonds and generated the following returns over 1, 5 and 10 years after fees and taxes.



	HOSTPLUS BALANCED DEFAULT (2% BONDS AND CASH) 1.45% p.a. INVESTMENT FEE	**VANGUARD HIGH GROWTH** (10% BONDS AND CASH) 0.29% p.a. INVESTMENT FEE
1 year	12.5%	11.9%
5 years	11.0%	11.1%
10 years	7.4%	7.7%

Performance is net of investment fees and tax. Vanguard returns are for a super fund paying tax in accumulation stage.

Source: Chant West, Vanguard

When comparing much more similar funds, Hostplus performed **just below** an index fund over 10 years. That's not bad, most funds did a lot worse!

How ratings agencies support the misleading self-reporting

The ratings agencies don't properly query the allocations reported by the funds. This provides no check as to the real risk of the self-reported defensive assets.

In addition, the ratings agencies have a few additional problems of integrity which we discussed in what fund ratings won't tell you (https://blog.stockspot.com.au/what-fund-ratings-wont-tell-you/). To recap:

- Most ratings businesses only publicly announce the top performers and not the worst. This is because they are typically paid by the funds who they rate. Anyone who has seen The Big Short (https://blog.stockspot.com.au/lessons-i-learned-from-the-big-short/) would understand how problematic this conflict of interest is. It's why we publish the Fat Cat Funds Report (https://www.stockspot.com.au/fatcat/) to shed a light on the best and worst funds.
- Performance over 1 and 3 year periods is meaningless yet it becomes the major focus each year. You need to see how a fund has performed over a full market cycle (around 10 years) to have any idea how it performs in good and bad times.

Active or indexed super?

By our analysis (which we'll share in Part 2 of this series), over 90% of active super funds **underperformed an index fund of similar risk** over 5 and 10 years after fees and taxes.

Expensive fees for active management is precisely what causes most super funds to underperform. For every active winner there has to be an active loser (https://blog.stockspot.com.au/why-you-wont-beat-share-market/) and management fees drag down net returns.

There are always going to be a small number of funds who beat the index but that group is always changing. Many funds in the top lists this year have also spent time near the bottom when markets weren't as kind to them.

Winners always change. Fees are with you every year.

How to pick the right super fund

For those looking for a super fund with a low allocation to defensive assets, Hostplus might be one to consider. Let's be clear, Hostplus and other Industry funds are making some good investments including into venture capital and infrastructure projects that will benefit Australia.

However what shouldn't be making headlines and driving members to switch is how the fund performed compared to lower risk options in a rising market.

Chasing the latest returns harms investors

Over the last 10 years Hostplus has been one of the very few funds to **almost** generate enough extra returns to match an index fund of similar risk. Vanguard's high growth fund still beat it by 0.3% per year after fees and taxes over 10 years.

Compared to the disastrous bank owned retail super products (https://blog.stockspot.com.au/fat-cat-report-5-years/), industry funds consistently come out ahead. However that doesn't mean some stakeholders aren't massaging the truth about what drives returns and therefore what's in the best interest of members.

Will Hostplus be able to keep up with an index fund over the next 10 years? Maybe, maybe not. Based on history, the odds of a fund that charges 1.45% per year beating a low cost index fund across the market cycle is not high. Warren Buffett proved this when he recently won a 10 year bet that a Vanguard index fund would beat 5 expert-selected active fund managers.

Buffett backed the index fund which won by a massive 77%.

Look out for Part 2…

In Part 2 of this series we look at how to pick a super fund based on the 2 factors within your control and proven to drive return: risk and costs.

Each year our Fat Cat Funds Report (https://www.stockspot.com.au/fatcat/) shows that these 2 factors are by far the most important. Focusing on risk and cost rather than ratings and fund manager storytelling will help you cut through the spin and find a fund with the best chance of success.

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Main image: Aaron Burden on Unsplash (https://unsplash.com/@aaronburden)

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CHRIS BRYCKI (HTTPS://BLOG.STOCKSPOT.COM.AU/AUTHOR/CHRIS/)

April 2018 eGrow:

Horror Headlines

Dear Friends,

"Methinks thou doth protest too much..." with apologies to Bill (Shakespeare)

Having spent more than the last decade and a half engaged in media debate about financial services, it always amazes me how the 'Horror Headlines' can be so misleading, and how polarised any attempt at a rational debate based on logic has become.

As you know, I firmly believe in getting the best for my clients – but I demand that this is done in a way which is sustainable. **I hate the thought of passing on economic problems to our kids.**

Following the recent announcement by the Opposition of a proposed change to dividend imputation, I am dismayed by how many commentators (who should know better, given their qualifications, training, knowledge and experience) are falling into line, protesting "class warfare" or "a hit on low income earners" depending on which side of the political divide is expedient for them.

They sound to me about as rational as drug-addicts!

I describe the current hysteria to my walking group buddies (and anyone else who will listen) as "the commentariat being blinded by their need for the dopamine hit ***their*** imputation credit refunds provide...."

As many of you will be aware, I love an arbitrage opportunity, but not if this is delivered by poor policy, which is what our political system seems to be dishing up.

Sir Winston Churchill does, however, wisely remind us: "... democracy is the worst form of government ...except for all those other forms that have been tried from time to time."

The 'horror headlines' were generated when Bill Shorten announced that if elected, a Labor government will stop the ATO paying tax refunds on shares which have a dividend imputation benefit attached.

There are so many IFs with this announcement...

- **if** they get elected,
- **if** they get it passed in the senate; and
- **if** the public backlash does not change minds or force them to water it down.

Former Liberal opposition leader John Hewson snatched defeat from the jaws of victory when he couldn't explain how his signature 'Fight Back' policy, introducing a GST, would impact on buying a cake. As a result he lost the 'un lose-able' election. This may well be Bill Shorten's 'Fight Back' moment – or perhaps, a flash of political genius in burying a potentially unpleasant announcement in the run-up to the Batman and SA Elections.

Imputation policy changes may well not see the light of day – and if they do, they have a strong chance of being severely watered down (for instance capping imputation credit refunds at $1,000 per person is currently being 'floated'.)

The reason we are having this discussion stems from the former Howard government's tinkering with the imputation credit system which in turn, created a tax anomaly. Basically, it was a political fix to shore up a section of the electorate during a time of economic plenty.

Those days are over, for now.

Now I should declare my hand here. I actually agree with this policy as announced!

Any rational thinking person who has the professional knowledge to fully understand the current tax and long-term savings system will know that the current approach distorts behaviour in investment markets. *In terms of the Australian share market, it actually has had a negative effect.*

The US share market, in comparison, has no imputation credit system and companies pay very low cash dividends as a result. My investment hero Warren Buffet pays little or NO dividend to his shareholders but retains and reinvests profits in Berkshire Hathaway, which has the effect of boosting the price of the stock.

When asked what action his investors are able to take if there is need for cash from their investment, he advocates selling a small parcel of their shares to realise some capital gains.

Compare that to the 80% dividend payout the banks are currently bragging about in their (investor funded) ads at the moment, to remind us to not pick on them!

Naturally, they pay high dividends to satisfy the imputation credit drug to which many of their investors are addicted.

Here's proof of how the 'drug' distorts reality:

US share market

Dow Jones Low point in early 2009	6,443 points
Dow Jones 16 March 2018	24,946 points

This represents an ALMOST 300% Capital gain over the last 9 years

Australian share market

ASX 200 Low Point in early 2009	3,297 points
ASX 200 16 March 2018	5,947 points

Not even a 100% capital gain ....and we have yet to even reach our pre GCF high of approximately 6,600 points.

"Why is this so?"….. (to quote the late great, Professor Julius Sumner Miller).

It is due largely to the VERY HIGH dividends paid by Australian companies… to provide the imputation credits to which their shareholders are addicted. You could say that this is the equivalent to a 'dopamine high' when they receive their cash from the ATO – it makes them feel great, without considering the long-term impact on their investments and the country.

These investors would have done MUCH, MUCH better to ignore the imputation credit drug that is currently available …and diversified their portfolios 50% to Australian shares and 50% to international shares to reduce risk/volatility, **exactly as we do with YOUR portfolios!**

The background is simple.

Dividend imputation was originally introduced so that shareholders did not pay tax twice - which is logically fair. But returning excess imputation credits as tax refunds distorts the system and costs everyone – (and future budgets) too much.

The following example demonstrates how the imputation credit system was designed to work when introduced in 1987:

Pre-imputation credit regime

Company Profit	$100		
Taxed at 30%			
Company tax rate -	$30 paid to ATO	Paid to shareholder	$70.00
		Taxed in his/her tax return at say 34.5% MTR	
-	$24.15		

Total tax paid by the company and shareholder $30 + $24.15 = $54.15 or 54.15% TOTAL TAX RATE

Post imputation credit regime

Company Profit	$100		
Taxed at 30%			
Company tax rate -	$30 paid to ATO	Paid to shareholder	$ 70.00
		PLUS Imp Credit offset	$ 30.00
		GROSSED UP AMOUNT	$100.00
		Taxed in his/her tax return 34.5% MTR -	$34.50
		LESS Imputation Credit	$30.00
		NET Tax paid by shareholder	$4.50

Total tax paid by the company and shareholder $30 + $4.50 = $34.50 or 34.5% TOTAL TAX RATE

Imputation credits were NOT refundable at the inception of this system.

The Howard Government then brought in a very generous benefit which allowed those who did not pay tax themselves to not only NOT pay tax on their share income BUT to also receive a cash refund of the tax paid by the company on its profits!

Obviously, that was a significant benefit for a small but growing group ... **but at a great cost** in terms of tax revenues for governments and capital gains to the shareholder (as mentioned above) and **eventually to our children!**

Which brings me to the clarification that this is NOT a superannuation or a SMSF change. It is tax proposal to take one of many distortions out of the system.

To demonstrate this point, the headlines scream "200,000 of 600,000 SMSFs will be hit!" In other words, 400,000 of 600,000 SMSFs not addicted to imputation credit refunds are going about their business and doing very well without them.

It is true that if the Opposition's policy is introduced, dividend income will fall – but I believe that balance and logic in the overall tax system will begin to be restored. Companies will, as a result withhold more profits and invest them, employ more people and grow their shareholders wealth.

Remember too that Capital Gains are VERY favourably treated (another of those tax distortions) and remain tax free in account based pensions whether in an SMSF or not!

We need the commentators, the media and the politicians to stop protesting about these proposed changes and to think about them logically.

While the proposal will probably blow up in Bill Shorten's face, he actually has a point. We broke the dividend imputation system and someone needs to fix it – but shouting about it does not achieve anything.

If you are interested in further technical information with respect to this Imputation Credit debate, please also read my attached Media Release No 79 titled 'Addicts Abound in Investment' - as attached for your convenience.

And one more thing:

I usually recommend that people 'tidy up' the number of superannuation funds they have - but as part of that process, I also look at their age and the insurance benefits available under each fund.

Sometimes it is worth keeping as much as $8,000 - $10,000 in a super fund just to retain access to the cheap and broad insurance coverage which may be available within that fund. We have a client (just diagnosed with multiple sclerosis) for whom we had recommended this course of action. As a result, that client will now be able to make a claim from both superfunds (the new fund, and the fund retained).

And by the way, you might be interested in seeing our refreshed website marinisgroup.com.au and/or while you are there, please feel free to have a look at my recent media activity here.

If I or any of my staff can be of assistance, please don't hesitate to call (08) 8130 5130.

Kind Regards,

Theo Marinis B.A., B.Ec., CPA., FPA®
Financial Strategist
Authorised Representative

GROW @ Marinis

Media Release No: 79 **4th April 2018**

Addicts abound in investment

By Theo Marinis

- Investment exposed 100% to one stock is fundamentally flawed
- Dopamine overrides logic for the vulnerable
- Wall Street and other indices (and asset classes) are fundamentally different

Over the course of a career, I've marvelled at how many investors are prepared to commit to schemes which can be shut down at the whim of a government minister.

These investors are likely to be the same people who have held time share apartments on the Gold Coast for the last two decades waiting for them to boom like the agent said they would...or have 50 acres of trees just waiting to be harvested when the tax treatment changes, again!

That said, much has recently been written post the Shorten announcement of the ALP's plan to eliminate the refund of excess dividend imputation credits (apparently at the moment, to all BUT age pensioners!).

There are so many 'ifs' around this story that it doesn't really warrant the air-time it has already been given, but what it does point to is one of the flaws the Howard government created in taxation policy, and the vulnerability of investors who have become addicted to the 'dopamine hit' provided by tax driven investments.

Perhaps I'm more than a bit old fashioned, but the old principle applies here: 'If it sounds too good to be true... then it probably is'.

Like any drug of dependence, dopamine (the naturally occurring 'feel good' hit when we do something we think is particularly clever) will ultimately end in a downward spiral.

An example of the impact of this dependency was played out for me some time ago, in the form of an approach by a potential client seeking to maximise Transition to Retirement opportunities (not an uncommon request) as he and his partner moved from accumulation to draw-down phase.

My brief was to provide 'technical/strategic only' advice. The client, a professional his early 60s, had specifically requested not to receive investment advice on an SMSF portfolio valued at $2m, invested 100% in Telstra shares. The investment allocation rationale was based solely on Telstra's high dividend payment track record and accompanying dividend imputation credits.

The scope of the terms of my engagement expressly excluded the provision of investment advice; this did not mean, however, that my professional obligations to flag the risks associated with *not* addressing related advice areas (in this case, an appropriate investment strategy) could be similarly 'scoped' out.

The risks – primarily the serious lack of diversity in the portfolio and the fact that it was not in line with the clients' identified investment risk profile – formed the subject of some lengthy discussions, as well as part of my formal written advice.

But the estimated income yield delivered by the transition to retirement strategy (including the ***full*** refund of Telstra's imputation credits) was the hook. Warnings highlighting the serious risks involved in not diversifying the portfolio were happily dismissed.

A few years later, due to some circumstantial changes, I was again approached by the same individual to provide additional technical strategy advice. By this time the portfolio had been 'diversified'; the Telstra holdings had been diluted to just a quarter of the portfolio – fortunately before the corporation had lost 40% in capitalisation. The proceeds from the sell down had been applied to buy shareholdings in the big four Australian banks, plus one of the smaller ones... with investment allocation continuing to be driven by the 'siren song' of dividend policies and imputation credits.

The portfolio now held six stocks, representing 94% of the SMSF investment exposure, held entirely in the local market.

Concerns regarding the risks associated with exposure to a handful of stocks in a single market, the portfolio's vulnerability to the ebb and flow of global capital (notwithstanding the fact that a retirement income strategy based on 94% growth and 6% defensive asset exposure was not a rational or recommended approach) were raised.

An offer of investment strategy advice was again deemed unnecessary, on the basis of what I could only conclude to be the same dividend driven 'dopamine hit' overriding logic.

In the expectation that this case will be dismissed by some as a 'one off, extreme example' broader evidence of the impact of chasing imputation credit refunds can be found in the aftermath of the GFC.

To use an expression by Warren Buffett, many pension funds (both SMSF and non SMSF) "were caught naked when the tide went out". For a number of years, due to severely impaired dividend payments, the prescribed ABP pensions could not be paid from income without selling shares at a significant loss.

The reason? An overexposure in 'pension phase' super funds to Australian shares, and an addiction to their associated imputation credits (not to mention a home equity bias – another cognitive distortion) following the sudden and synchronised 50%+ fall in world share markets in 2008/09. The resulting post GFC fall in profits also saw large falls in dividends.

As a result, for a number of financial years, that famous duo, Howard and Costello were forced to halve the prescribed minimum percentage payments for account based pensions. It could be said that this rule change was necessitated in the wake of the distortion caused by their previous imputation credit policies – a distortion which continues!

Diversify and avoid having to go cold turkey

Post GFC, NONE our clients were forced to live off 50% the normal ABP minimum amounts, which meant that their retirement incomes were not compromised. There were two reasons why this was the case:

Their investment portfolios were all fully diversified, with adequate cash and fixed interest buffers to ride out the storm; they also had 50% of their share exposure overseas, as a volatility reduction strategy.

During the GFC, when ALL share markets fell around 50% or more, the $A fell more than 50%. This meant losses on overseas share market investments were more than made up for on the exchange rate movement on their overseas investments. This strategy worked exactly as it was designed to do.

Sticking to investing ONLY in shares at home – without having some global exposure – for example, the US market – is a major flaw in any investment portfolio.

There are some massive structural differences and investment exposure in the two indices which provide the astute investor the opportunity for significant capital gains in the US, and robust dividends in Australia. Similarly, Asia offers enormous potential.

Instead of treating your investments like a punt at the track, always follow the first three rules of Investment: diversify, diversify and diversify!

That means diversifying within all asset classes and across all asset classes and doing it with low cost index funds. In the long term, you will always get a better and less volatile outcome and a happier retirement!

If you think you might be a dopamine addict, act quickly. Go and see your broker or financial adviser and take the 12-step plan… to diversification.

For further information please contact:

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Media Release No 85 **6th September 2018**

A Super Mess

By Theo Marinis

The flaw in the superannuation system revealed by the Royal Commission is the fact that few people actually understand the complexities or issues of what we have. And what we have is a mess which allows marketing spin and self-interest to distract long-term investors away from the sole purpose of superannuation – to provide funds for retirement.

The mess starts at the top. The very senior bureaucrats in Canberra who are advocating significant change to the industry are the people who invented the system we are suffering under. Now they are advocating new ways of looking after savings by appointing the Productivity Commission to a new oversight position.

Appointing the Productivity Commission to be the arbiter of the Top Performing Funds 'hit parade', or League Table, is mind-bogglingly foolish.

For a start, there is an absolute conflict of interest for these public servants, who along with our politicians, are entitled to a defined benefit pension in retirement, whilst the rest of us 'civilians', are left trying to decide which 'fund' performed best.

Instead of developing a league table, the Productivity Commission should be creating a clear understanding of superannuation terminology - and publishing that information. We need to compare with apples.

Industry funds, retail funds and Self-Managed Super Funds (SMSFs) are just tax structures which allow us to invest in the same underlying assets. Some structures cost more and some cost less – and some have different functionality – but that is a minor issue. The major issue is that Canberra senior bureaucrats should not be cheer leading for any structure, super fund or super sector.

What is vitally more important is for superannuation members to clearly understand how their money is allocated – but I haven't heard anything from the Commission or its proponents about this.

If it is to really add value to society, the Productivity Commission should actually set specifications for the various asset allocations labelled 'Defensive', 'Conservative', 'Moderate', 'Balanced', 'Growth', and 'High Growth' by a) asset class and b) their appropriate weightings to Growth vs Defensive assets allocations for each defined profile.

At the moment, there are no clearly defined benchmarks for these so-called asset allocation profiles – which means they are used more as marketing terms than as indicators of the level of investment risk and appropriate investment timeframes. As such, these labels are fundamentally misleading – and perhaps conveniently so.

To demonstrate this farce, leading Industry super fund and Productivity Commission hero HostPlus is currently able to market a fund as a 'balanced' portfolio when the asset allocation has a ratio of 90-98% growth asset exposure. *

Small wonder then, with markets booming, that the HostPlus 'Balanced' fund was the best performer in 2018!

In actual fact, this fund is a 'high growth' wolf, masquerading in sheep's clothing - designed to give members a false sense of security for a VERY aggressive portfolio.

This scenario also brings to mind the example of the MTAA Super Fund, which in 2008, just before the GFC, was ranked the best performer in 2008 (no doubt the Productivity Commission would have placed it top of the table as one of the best performing funds if it were charged with the proposed responsibility at the time).

Unfortunately for MTAA and its members, when the GFC hit, the fund lost $1.5 billion of members' cash because of being too heavily weighted in growth assets when the market cracked. *

This is often what transpires, when higher and higher returns are the focus with little regard for the associated risk.

It is my contention that if the Productivity Commission is given these 'League Table' ranking responsibilities, we will find ourselves wading through a new Royal Commission in the next decade as those who were burnt by the top 10 league chart put pressure on politicians to answer questions about why their investments underperformed. The Productivity Commission will replace APRA and ASIC in the 'frame'.

There seems to be a collective 'take-out' from the Royal Commission that somehow Industry super funds are 'good' and that Retail super funds and SMSFs are 'bad'. Recent media reports state that Industry Funds are currently recipients of transfers from Retail funds, which all plays well to a narrative that there is good and bad amongst the various methods of superannuation funding.

If we are to be black and white, Industry Funds are not the cheapest form of super fund available. Industry Funds are not the most flexible and they don't have the best insurance options. But they are still good. The same can be said for Retail funds and SMSFs.

What we need to consider is the make-up and investment approach ALL funds adopt and look across the same skyline. In other words, use a mandated description of what constitutes a certain style of investing. We need appropriate benchmarks, so we can ALL really compare the performance of a particular fund to the right benchmark for a designated risk profile. And we don't need self-interested senior bureaucrats trying to pick the winning superannuation fund of the future!

NO ONE can do that, least of all the senior bureaucrats and their masters in Canberra.

Theo Marinis is Managing Director of Marinis Financial Group

* Read here: Stockspot Blog 'How super funds play the ratings game' by Chris Brycki

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Creating a fairer superannuation balance

Creating performance league tables won't rectify the super mess.

Summary: The Productivity Commission will play a central role in the development of superannuation fund performance league tables.

Key take-out: The bigger issue is creating standard definitions for the different asset allocation terms being marketed.

The flaw in the superannuation system revealed by the Royal Commission is the fact that few people actually understand the complexities or issues of what we have.

And what we have is a mess which allows marketing spin and self-interest to distract long-term investors away from the sole purpose of superannuation – to provide funds for retirement.

The mess starts at the top. The very senior bureaucrats in Canberra who are advocating significant change to the industry are the people who invented the system we are suffering under. Now they are advocating new ways of looking after savings by appointing the Productivity Commission to a new oversight position.

Appointing the Productivity Commission to be the arbiter of the top performing funds 'hit parade', or league table, is mindbogglingly foolish.

For a start, there is an absolute conflict of interest for these public servants, who along with our politicians are entitled to a defined benefit pension in retirement, while the rest of us 'civilians' are left trying to decide which 'fund' performed best.

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In other words, use a mandated description of what constitutes a certain style of investing. We need appropriate benchmarks, so we can all really compare the performance of a particular fund to the right benchmark for a designated risk profile.

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Theo Marinis

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