Advice on getting rich slowly, and staying rich

- By Theo Marinis
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A letter, and lesson, on diversification.

Summary: It’s uncommon for every asset class in a given portfolio to outperform over the same period of time. But it isn't particularly important that they do.

Key take-out: There will usually be some disappointments in an investor's portfolio, and it's rarely a reason to look harshly upon that particular asset class.

At the end of January 2018, my client Marjorie Smith (name has been changed) contacted me to express her disappointment in the performance of several of the investment components in her self-managed superannuation fund. Overall, it had increased by 6.58 per cent in the six months since the inception of her current portfolio.

Marjorie was particularly unhappy with the return of her investments in global listed property and Australian fixed interest over that period of time.

My letter summarising our discussions has been reproduced below with Marjorie’s permission. References to the investment administration platform and specific investment product issuers have been replaced with generic references.

Dear Marjorie,

Thank you for your follow-up queries regarding your overall portfolio and the specific investments you highlighted.

In addressing your queries, I have included some reports which are also available to you through your investment administration platform.

As at today, the Smith SMSF investment portfolio has achieved a total return of 6.58 per cent since inception in a period of approximately six months (July 17, 2017 to January 31, 2018).

Within that period, the funds investing in the various asset classes within your SMSF portfolio have achieved different performance results. This will generally be the case.

I can understand your disappointment with the performance of the global listed property fund and the Australian fixed interest fund since their purchase dates. This is particularly so when compared to the US share market fund and the developed world ex-US share market fund which, over the same period, have returned 13.66 per cent and 11.88 per cent respectively.

Asset classes, however, should not be judged in isolation in these cases, but as part of your overall SMSF investment strategy, and this is based on a diversified portfolio.

Global listed property markets have struggled over the last six months, but since November 1, 2013, the recommended global listed property fund has returned 10.42 per cent per annum. This has provided strong returns in the medium to long term.

With respect to your Australian fixed interest fund, when markets become more volatile this defensive asset fund should provide your SMSF portfolio with stability to offset any potentially poor returns from funds tracking share markets.

As well, it is important to remember that bond investments can temporarily fall in value if bond interest rates rise faster than market expectations. Note that if/when interest rates do rise over time, this also means that future bond investments will generate higher levels of income – a good thing, similar to when long-dated term deposits mature after several interest rates rises.

Our recent Record of Advice contained a recommendation for the partial replacement of your Australian fixed interest fund with an international fixed interest fund. In the interest of better portfolio diversification and what's expected to be higher risk-adjusted portfolio returns, our investment committee believes it is time to adjust the current bias to Australian bond investments in favour of an increase in exposure to international bond investments.

Generally speaking, the recommendations are designed to ensure your portfolio (excluding your investment property) has an approximate allocation of 35 per cent to defensive assets (cash and fixed interest). This will give your portfolio sufficient ammunition to take advantage of bargains in the next share market correction, or bear market, whenever that may be.

It's always important to ensure your portfolio is well diversified to absorb the shocks, and has plenty of liquidity to maintain pension payments throughout.

It's about getting rich slowly, and staying rich.

Theo Marinis

https://www.investsmart.com.au/investment-news/advice-on-getting-rich-slowly-and-staying-rich/142256