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How a Balanced Fund Could Leave You Teetering

Theo Marinis delves into what really constitutes a balanced fund and finds that it's worth demanding more clarity.

By Theo Marinis
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To the ordinary investor, the term 'balanced' might suggest a secure and thoughtful place to invest – but you need to look beyond the labels.

The superannuation industry has been made deliberately opaque by marketers scrabbling to attract funds under management – with the consequence that investors are often put into unsuitable asset exposures for their risk profile by advisers failing to unpack the components of a fund.

Superannuation funds, whether industry or retail, invest within the same broad asset classes, but evaluating performance and the associated risks is not as simple as ranking percentage returns for a given period. There are no meaningful rules governing the way in which funds justify how their asset allocation fits their marketing labels, nor are there guidelines around the disclosure of their risk diversification strategies (or lack thereof) – or the underlying valuation methods used in the declaration of returns.

This lack of comparability fosters misrepresentation.

Proper Labelling

As a consequence, many industry super funds labelled 'balanced' – traditionally defined as funds which have a 70/30 ratio to growth versus defensive assets – often have an 80 per cent to 90 per cent exposure to growth assets after allocations of as much as 30 per cent to 40 per cent to direct and unlisted property (but presented as defensive assets or 'alternative' assets) are taken into account. But property is not a 'low risk' asset class; it is a growth asset and should not be mis-categorised.

Funds with a higher exposure to growth assets will obviously perform better in good times than one which has, for example, a 65 per cent exposure. But when the market corrects, as it always does, the fund with the highest exposure will be subject to the highest falls – leaving investors in that fund to wonder why their 'balanced' portfolio has been so adversely affected.

In other words, one alleged 'balanced' fund with very high risk/growth can shoot the lights out when compared with a more conservative (and true to label) option. Putting both in the same category is highly misleading and begs to be addressed.

Spreading Risk

Similarly, investing across the top 300 stocks of the ASX (for example, using an Australian share index fund) spreads investor risk via stock diversification. But, when an active fund manager selects just 20 or 30 stocks which they believe will be outperformers, then there is a need to explain the risk to those who trust them. For example, if the fund manager had bought into the pre-GFC hype around ABC Learning Centre or Babcock and Brown – despite being two of the top 300 companies on the ASX – the cash would be gone.

Experience also tells me that many industry super funds (whose 10-year returns in their 'balanced' options have dominated the performance charts on the basis of the inflated valuations applied to their direct and unlisted assets) are very likely to have a performance reversal in the next financial year.

Required by law to be marked to market, these asset valuations will reflect the COVID-induced economic changes (e.g., working from home, increased online shopping) and the looming slowdown driven by Reserve Bank interest rate hikes – pre and post the current interest rate increase cycle. As a result, the returns of exposed 'balanced' fund members (who are often unwittingly in growth asset allocations) will be adversely affected. We are already beginning to see these results being played out in returns on unlisted property trust holdings.

Mandated Definitions

Rather than getting carried away with pointless measurements to create an APRA 'My Super' comparison table, and the frustrating practice of hiding behind percentage returns and selective timelines, the government should mandate the definitions and asset

allocations for the labels 'Defensive', 'Moderate', 'Balanced', 'Growth' and 'High Growth' super fund investment options. This would be a far more sensible and useful way to assist with comparing any pair.

The fundamental rule of investing, gambling, and hunting remains the same: There is no high reward without a higher level of risk. The difference is that investing has another fundamental rule – the rule of diversification – the ability to spread risk by selecting good quality assets from a broad range of classes.

A successful diversification strategy is only achievable if there is clarity around asset allocations and valuation methods. Make sure you understand what you are buying.

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