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Diversity Rules

At the end of January 2018, my client Marjorie Johnson (not her real name) contacted me to express her disappointment in the performance of several of the investment components in her Self-Managed Super Fund – which overall, had increased by 6.58% in the six months since the inception of her current portfolio.

My letter summarising our discussions has been reproduced below with Marjorie's permission.

Key take-out:

While the performance of some of asset classes over a given period may have produced results which are disappointing, there are generally others which will be better.

A diverse portfolio helps to protect the investor from the swings and roundabouts which are inevitable in long term investing.

The asset classes under the spotlight in this instance were global listed property and Australian fixed interest. References to the investment administration platform and specific investment product issuers have been replaced with generic references.

Good afternoon Marjorie,

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

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

As at today, the Johnson SMSF investment portfolio has achieved a total return of 6.58% since inception (17 July 2017 to 30 January 2018) a period of approximately 6 months.

Within that period, the Exchange Traded Funds (ETFs) investing in the various asset classes within your SMSF portfolio have achieved (as will generally be the case) different performance results. These are summarised in the comments which follow.

I can understand your disappointment with the performance of the global listed property ETF and the Australian Fixed Interest ETF since their purchase dates. This is particularly so when compared to the US Share market ETF and the Developed World Ex-US Share market ETF which, over the same period, have returned 13.66% and 11.88% respectively.

The performance of a particular asset class, however, should not be judged in isolation, but as part of your overall SMSF investment strategy which is based on a diversified portfolio.

Global listed property markets have struggled over the last 6 months, but since 1 November 2013, the recommended global listed property ETF has returned 10.42% per annum – providing strong returns in the medium to long term (as per the factsheet attached). Our research indicates that it is the most diversified (with 213 underlying property investment holdings) and lowest cost global listed property market ETF at this point in time.

With respect to your Australian Fixed Interest ETF, we are guided by our research which indicates that this is currently the best performing ETF in its asset class, and furthermore if/when markets become more volatile#, then this defensive asset category ETF should provide your SMSF portfolio with stability to offset any potential poor returns from share market ETFs.

It is important to note too, 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 – which is a good thing – similar to when a long-dated term deposit matures after a number of interest rates rises.

As you are aware, our Record of Advice (RoA) of 12 January 2018 contains a recommendation for the partial replacement of your Australian Fixed Interest ETF with an International fixed interest ETF. In the interest of better portfolio diversification and higher expected risk-adjusted portfolio returns, MFG's investment committee believes that 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 Jones Street investment property) has an approximate allocation of 35% 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 / bear market (whenever that may be) and ensure that it is:

a) well diversified to absorb the shocks, with
b) plenty of liquidity to maintain pension payments throughout.

Recent US share market volatility over the past week should indicate that now is a good time to take some profits.

I trust that this information reinforces why we don't try to chase performance.

As you know, our philosophy is to "Get Rich Slowly" – and stay rich!

NOTE This correspondence was in late January 2018 in the very early stages of the recent return of share market volatility.

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