



Asset Allocation for MySuper

All superannuation funds are considering the structure of their MySuper product to be introduced from July 2013. As part of this process, trustees will need to decide an appropriate asset allocation for MySuper.

Until the Global Financial Crisis (GFC), most superannuation funds had a consistent record of providing strong real rates of return on their default investment strategy. Many funds had experienced no more than one or two small negative returns in their last 25 financial years. In contrast, by the middle of this year, some funds could be advising members of their third negative annual return in the last five years.

In this environment, trustees want to know whether we have had a secular shift in investment markets with a permanent increased level of volatility or whether the current global economic turmoil is exceptional - causing outlier results which should not occur for some time again. As there is continued uncertainty, should trustees carry forward the existing default fund investment strategy or is MySuper a catalyst to consider something different?

MySuper

MySuper was promoted in the Super System Review as a mechanism (together with SuperStream) to drive down costs in the superannuation industry. It is intended to be a commoditised - low cost, low option – product designed for disengaged members. This cohort probably includes almost all people under age 40 and perhaps half of older Australians. Consequently, it will hold more than 75% of members and about half the industry's assets¹.

At this stage, MySuper does not have a retirement component. This important segment was largely ignored in the Super System Review. However, the Government has indicated that it will look to extend MySuper into retirement products at some stage.

The product must provide a *long-term* investment strategy. This can be a life cycle investment with asset allocation varying over time. Members who want to vary their investment strategy – even by putting some of their money into cash – will become 'Choice' members. Choice members can still retain some of their investments in MySuper.

Most funds will adopt the existing investment strategy for the current balanced fund (default) option – but is this the right decision?

¹ Superannuation Market Projections 2011



The World of Superannuation Pre-GFC

Before the GFC, the superannuation industry had become complacent; even poor funds provided a reasonable result for their members. Consider the environment between 1986 and 2007:

- Cash flow was strong - fuelled by the underlying mandatory employer contributions, which grew from 3% to 9% in the decade to 2002.
- Fund earnings were strong *in most years* and any negative results were quickly overcome by strong positive returns the next year.
- The industry's assets grew by nearly 10% p.a. over an extended period.
- Revenue grew through the proliferation of profitable inactive accounts as well as increased membership through employment growth (largely due to high annual migration).
- Tax concessions encouraged many to contribute significant amounts into superannuation – this drove the early flood into the SMSF segment.

However, there were already signs of hubris:

- The Commercial segment (called Retail by APRA) was complacent, satisfied to grow in real terms – which was easy to do due to expansion of the total market. However, market share dropped from 80% to 30% over 25 years (as industry funds and the SMSF segment provided innovative alternatives).
- Funds became so used to regular strong investment returns, they began to compare themselves against peers over shorter and shorter periods - the financial media now produces monthly returns, which are clearly irrelevant.

Unfortunately, many researchers suffer from the same ailment of **Measurement Irrelevancy**, so the industry tends to focus on the measurement of short-term volatility rather than looking to achieve the long-term objectives they set for the different cohorts of their members.

- The general success of the industry hid inefficiency in many areas. Many poor funds survive due to the absence of any proper measurement of their relative value to members.
- Many funds have had a lack of strategic focus. For example, some Boards spend more time on selecting managers (a relatively low order activity) than thinking about long-term investment strategies; all funds talk about retirement solutions but none has yet set out a clear path for members approaching retirement.



Impact of the GFC

The experience of the GFC and the subsequent much heightened volatility in investment markets has caused many in the global industry to question whether conventional investment principles still hold true. The financial dislocation has brought down many of the world's leading banks and destroyed several European economies, notably Greece. If we have had a major secular change, we need to consider whether it changes our long-term view of investment markets and asset classes.

The direct impact of the GFC has seen:

- Poor results over the last four years (including some years of negative performance).
- A significant increase in market volatility which has been sustained for a number of years – much longer than anticipated compared with earlier market dislocations.
- Initial stoicism (or apathy) from most members and a persistence with their investment in the long term, balanced investment portfolios provided by their superannuation funds.
- Increasing activity, especially from those approaching retirement, to switch out of these portfolios into portfolios with capital security (cash options and Term Deposits).
- Ongoing strong flows of assets to SMSFs.
- The blocking of redemptions by some illiquid funds which were unable to meet the demands for payment.

Against this background a number of commentators are claiming that Australian superannuation funds have compounded the problem by placing too high a reliance on equities, especially Australian equities. In evidence, asset allocations of Australian funds are compared to those of European and North American funds which hold lower weightings to equities.

These issues should make trustees question whether Australian funds should be realigning their investment strategies both to counter a perceived structural imbalance and to respond to a potentially secular change in investment markets.

The long-term outlook for investment markets

Before setting an appropriate asset allocation, trustees need to take a view on the long-term investment outlook. Do they have a pessimistic view of world economies and markets and concur with the view of ex-public servant leaders Ken Henry and Jeremy Cooper that funds should increase levels of debt holdings such as Bonds and reduce equities? If so, what does this mean for asset allocation and long-term investment objectives?



Or, do they agree with Sir John Templeton (US mutual fund pioneer and successful investor) - “The four most dangerous words in investing are *this time it’s different*.”

If trustees concur, then they should expect, after a lengthy period of adjustment, investment markets will get back to normal. Under this scenario, the GFC is a ‘black swan’² event, occurring in one in a hundred or more years.

Following the GFC, we surveyed a select group of investment practitioners (leading asset consultants and fund managers) seeking their expectations for long-term returns on the major asset classes. We used 10 years as a proxy for the long-term as most investment experts have little if any difference in assumptions for periods beyond that. Recently, we surveyed a slightly larger group to gain insights into whether the GFC had affected their outlook for long-term returns. The results of our surveys are summarised in Table 1³.

Table 1. Summary of Expected Long Term Returns - Surveys 2009 and 2012⁴

Asset Class	Number of Respondents		Maximum (% p.a.)		Minimum (% p.a.)		Average (% p.a.)		Median (% p.a.)	
	2009	2012	2009	2012	2009	2012	2009	2012	2009	2012
GROWTH ASSETS										
Australian Equities	7	11	9.4	13.5	8.2	8.5	8.7	9.7	8.5	9.0
International Equities (unhedged)	7	11	9.0	10.9	8.2	6.8	8.5	8.9	8.5	8.5
Listed Property	5	10	8.0	9.2	6.4	6.5	7.6	8.0	8.0	7.8
Direct Property	6	8	8.0	9.5	6.0	6.1	7.2	7.9	7.3	7.9
DEBT ASSETS										
Australian Fixed Interest	7	10	6.0	6.0	4.0	4.0	5.4	5.2	5.7	5.4

² A term popularised by finance professor Nassim Nicholas Taleb in his book of the same name – it is an event with three attributes. First, it is an outlier as it lies outside the realm of regular expectations, because nothing in the past can convincingly point to its possibility. Second, it carries an extreme impact. Third, human nature makes us concoct explanations for its occurrence after the fact, making it explainable and predictable.

³ We omitted one fixed interest fund manager which expected equities to return no more than 6% p.a. over the next decade with bonds at 6.5% p.a. domestic and 9% p.a. international.

⁴ Throughout this newsletter, returns are shown gross - before tax and investment management expenses but after overseas withholding tax. The value of imputed tax credits are added back for Australian equities.



International Fixed Interest	7	10	6.0	6.0	4.4	4.0	5.6	4.9	5.8	4.5
Cash	6	10	5.1	5.5	4.5	4.1	4.9	4.9	5.0	5.0

These results suggest that the experts do not believe the long-term outlook has changed – and, importantly, growth assets are still expected to out-perform debt assets over the long run. Much of the difference between 2009 and 2012 appears to be the base starting point for the period. In other words, Australian equities are expected to do better in the next decade because they start from a relatively under-valued position.

Many funds still have long-term objectives of earning a margin over inflation after fees and taxes. Typical targets are 3% to 4% above national consumer prices increases. The Future Fund (which does not pay tax on its investment earnings) has a target of CPI plus 4.5% to 5.5%. Given its size (which lowers costs), tax-free status, and absence of cash flow constraints, its target should exceed that of an APRA-regulated superannuation fund.

Consequently, we would expect those superannuation funds expressing their objectives in a similar way to have targets of between 3% and 4% above CPI.

Are such targets still sustainable? The views of the experts suggest that they are. Further, many experts are cautious about any shift from equities to bonds at this time. Table 2 shows the expected margin over cash for various growth asset classes – and cash is expected to stay well ahead of inflation (by 2.5% to 3%). As these growth asset classes usually provide 70% or more of the assets of the default investment strategy, the overall fund return has a high return expectation.

Table 2. Margin over Cash – Long Term Return Surveys 2009 and 2012⁵

Asset Class	Average Margin (% p.a.)		Median Margin (% p.a.)	
	2009	2012	2009	2012
Australian Equities	3.8	4.8	3.5	4.4
International Equities (unhedged)	3.6	3.8	3.6	3.8
Listed Property	2.5	3.0	2.9	2.9

⁵ Numbers in this table is averaged slightly differently to table 1, for e.g. the return of listed property over cash is calculated only for respondents who invest in both listed properties and cash.



Direct Property	2.6	3.1	2.6	3.1
Australian Fixed Interest	0.8	0.2	0.7	0.5
International Fixed Interest	0.7	0.0	0.8	0.1

Have funds got the right Asset Allocation?

The allocation of money to specific asset classes is the most important investment decision. If a fund gets this right, it swamps all other decisions. Yet, in our experience, many funds spend only a small amount of time considering or reviewing this critical decision.

A practical example of the importance of asset allocation is the difference in returns between APRA-regulated funds and those regulated by the ATO (SMSFs). One would expect that the rigorous process of large funds would lead to superior investment returns. After all, they have the input of expert asset consultants who help them select the top quartile fund managers.

Well, the results don't support this!

Table 3 shows the impact of personalised asset allocation using the latest available data from the ATO and APRA. The table shows the average return of all funds in each group (before and after fees).

Table 3. Average Return - APRA Regulated Funds vs SMSFs⁶

Year end 30 June	APRA (gross)	SMSF (gross)	APRA (net)	SMSF (net)
2005	13.2%	16.8%	12.4%	15.1%
2006	14.0%	16.3%	13.2%	14.5%
2007	15.6%	21.4%	14.9%	19.5%
2008	-7.6%	-6.5%	-8.3%	-7.0%
2009	-11.9%	-4.6%	-12.6%	-5.0%
2010	9.8%	10.8%	9.0%	10.4%
6 year average	4.9%	8.5%	4.2%	7.4%

⁶ The SMSF results for 2011 are not yet available.



Presumably, the superior performance of the SMSF segment is not based on skill, or the investment experts would achieve the same results in the APRA segment. It is probably due to three key factors:

- Asset allocation – members tend to hold equities during the accumulation phase. Many shift proportions of their assets to Term Deposits prior to and into retirement and that strategy has provided solid real returns over the last 20 years. The approach has also allowed them to meet expenditure requirements without realising depressed assets before they can recover.
- No compromise on strategy – if a member is in equities, there is often no allocation to debt assets to reduce short-term volatility (and depress returns).
- Tax – an SMSF can more easily make use of tax advantages at member level (share buybacks and the write-off of accrued CGT liabilities when shifting into pensions).

The six year period shown above will not be typical of future long-term results. For example, rates on Term Deposits are likely to fall and future share buybacks will be less lucrative than past ones. Consequently, the table should not be used to argue that SMSF funds outperform large APRA-regulated funds.

Similarly, funds with good historical performance, particularly over periods less than five years, should not use this to demonstrate future superiority – that can only come from their investment processes and asset allocation.

Clearly, the right asset allocation is critical – and it should be chosen to match the objectives set for members, recognising that membership can be placed into a number of broadly homogenous groups, some of which have different objectives and need a tailored structure to suit their circumstances.

Investment Strategies for MySuper

As the major objective of trustees is to seek a real long-term return for their members, they should start with the objective of investing entirely in growth assets, recognising that there is ample scope for diversification across asset classes. Why depress long-term returns by selecting debt assets in the mix?

Such a strategy could be justified for every member up to age 50 (as they cannot access their funds for at least 10 years) but a different strategy could be developed for those where liquidity is important (that is, those approaching or in retirement).

Having determined that a growth-oriented default strategy is required, trustees should still consider whether the traditional basis of asset allocation remains sound.



Current default investment strategy

Trustees usually want to reduce volatility as many members react badly to large negative returns on a year to year basis. As trustees cannot explain investment strategies to disengaged members, they use fixed interest investments to moderate the wild annual swings in equity values. Unfortunately, this attempt at diversification must reduce the retirement benefit of their members.

Under this logic, funds appear to converge on a mix of 70% to 80% of equities and 20% to 30% of debt assets. The allocation to specific asset classes is generally made in conjunction with an investment expert (asset consultant), in an attempt to diversify risk and reduce volatility. The total mix often appears somewhat arbitrary with peer fund portfolios having some influence! There is some consideration of the appropriate allocation between Australian and international equities, taking into account issues such as currency risk, imputation credits and knowledge of each market. Property, infrastructure and private equity are treated as separate classes due to their illiquid nature and receive nominal allocations.

Most funds tend to set a broad asset allocation and hold it over lengthy periods. The allocation is then adjusted periodically through various processes such as tactical or dynamic asset allocation.

The easy option

Many trustees will agree with the views of most investment experts that we will revert to normal investment conditions over time. This suggests (simplistically) that the current default investment strategy (typically, the Balanced fund option) can be used with little or no change. This will minimise the transition to MySuper as members will not need to be told about a fundamental change in investment strategy.

To date, those funds which are thinking of making changes are doing so to address two particular features of MySuper, namely:

- The fact that it is marketed by government as a low-cost product.
- The requirement to measure volatility using the FSC/ASFA Standard Risk Measure (SRM).

The low-cost nature of MySuper will lead to an increase in the proportion of passive investments held in default investment strategies. As an example of possible trends, when AMP changed its product structure last year, it introduced a Balanced Indexed product with an annual fee of 65 basis points (bps). This product is marketed as being competitive compared to industry funds. This is a sensible strategy given MySuper has been designed as a simple commodity product with price competitiveness dictated by government to be an important feature. Other AMP investment options have higher fees reflecting the active investment strategies used.



The other factor is the proposed APRA requirement for funds to disclose appropriate measures of risk, of which the FSC/ASFA Standard Risk Measure is an example. This measure of volatility⁷ requires funds to assess risk by showing the number of negative returns expected over a twenty year period.

While the measure is only one metric which should be taken into account, it will have more prominence as a result of being constructed under an industry guidance paper. Of course, by itself, the measure is largely irrelevant for most members and it might even encourage many to change to a more conservative (lower-return) strategy in an attempt to reduce short-term volatility.

At the extreme, members could even be attracted to put their money in cash as this will have a minimal number of negatives in 20 years. Of course, the trade-off to reducing volatility is a much lower return over that period which simply penalises the member by reducing their retirement benefit.

Some funds could even move the default option (the MySuper strategy) to a more conservative asset allocation to reduce the expected number of negative returns, which will also lead to a trade-off against long-term performance.

While the easy option will still contain high levels of growth assets, the overall asset allocation will not be chosen under any rigorous process. Allocations to broad asset classes will still be highly subjective and not linked to risk/return criteria or member objectives.

Working from First Principles

MySuper provides an opportunity to develop an asset allocation from first principles. Let us assume that trustees, in order to meet their prime objective of providing members with a reasonable retirement benefit, seek to provide a strong real rate of return – and they can choose a portfolio ignoring short-term volatility. What asset allocation would they choose?

The first step is to invest in the right sectors. Trustees should seek growing industries where returns are likely to be strong (they might, for example, choose technology, telecommunications and health) and they would exclude industries likely to be weak (which might include airlines and car manufacturing).

The second step is to decide the nature of the investment. For example, an allocation to resources could lead to investment in commodities directly (gold bullion), synthetics (derivatives in commodity prices), shares in mining companies, investments in businesses supplying services to the resource sector, or infrastructure needed in the resource sector (railways, ports).

⁷ See Standard Risk Measure, Guidance Paper for Trustees issued jointly by ASFA and FSC in July 2011.



The third step is to look at the geographical location of each investment. This takes into account various risks associated with international investments but also seeks opportunities. For example, any investment in the retail sector might look at growth in consumers – so intuitively the growing middle classes of countries such as India, Indonesia, Brazil and South Africa might present opportunities.

In this way, the fund will develop a matrix by industry, by type of investment and by region. Both private and public equity investments would be considered. In some industries (such as property and infrastructure – which go across many industries), the expected returns on unlisted assets may be higher. This is partly due to the illiquidity premium which a large institutional investor can earn. It also represents the value which can be extracted from a large investment.

If trustees took this view, they would provide different mandates to fund managers. Managers would be chosen for skill in an industry segment rather than for trading shares across an economy. It could be argued that infrastructure and property portfolios already follow this type of thematic approach to a great extent. Could it be expanded across the whole portfolio?

This approach moves away from a decision as to how much to place in Australian or international equities. Local tax positions such as Australia's favoured imputation structure on dividends would be taken into account in valuing a company against its international peers. Similarly, Australia's corporate culture of having high payment ratios for dividends would be attractive for generating stable income.

Funds choosing their asset allocation this way would not have to group investments in arbitrary ways such as making an allocation to Australian Equities.

They would still hold shares in this segment, but they would be chosen on an expected-value basis – for Australia, this would include the value of imputation credits.

Funds would be interested in private equity if it gave a sufficient premium for illiquidity and manager skill – but they would only consider an investment if the businesses concerned met the fund's requirement of being in high growth segments of the economy and the returns were expected to compensate adequately for the additional risks and higher fees.

The fourth and final step would be a top down review of the portfolio emanating from the first three steps. Up to this point, the investment process has involved allocation of assets to market segments and types of investments (equities, bonds, property, etc.) selected for their anticipated return prospects going forward. Let's call these investment "themes".



This final step involves the traditional optimisation process of modelling the return and volatility and characteristics of each theme and interactions between them over the long term and determining what proportion of the overall portfolio to allocate to each in order to optimise long term returns relative to the trustees' risk appetite.

This last step, allocation of risks to specific classes or themes, is the most important decision required from trustees. It is the area where investment experts should be able to demonstrate their value.

Changing asset allocation

If funds invest for the long-term, they will save on trading costs and earn the illiquidity premium. They don't need to chase the (often illusory) alpha to generate good returns for members. They will earn alpha simply by focusing on the right place to invest (and avoiding industries with poor long-term prospects).

Obviously, the strategy needs to be tested periodically. Industries wax and wane and funds should anticipate change. Indeed, the trustees' views of growth segments of economies around the world will change and they should respond to these with appropriate modifications to strategy.

Dealing with different time horizons

Default and other composite portfolios have delivered poor or negative returns for four out of the last five years. This has been particularly painful for those in or near to retirement who need to draw on at least some of their assets in the near term. The Baby Boomers are now aged 55 to 65 so there will be a significant increase in retirees over the next ten years and a large transfer of assets into retirement incomes (as well as large lump sum withdrawals at the time of retirement)

Many members who retired after the GFC were unprepared and they had diminished values at the time they accessed their benefits. A major contributor to this problem has been the asset allocations of those nearing retirement which remained fully committed to default and similar composite portfolios. These portfolios suffered significant falls and in many cases income can now only be generated by realising holdings in these portfolios at depressed values. The challenge for funds in the future is to determine how to better provide for those in and nearing retirement whilst still providing for the bulk of their members who remain in the accumulation phase.

Before discussing solutions for trustees, it is worth considering the primary investment needs of the different groups of superannuation fund members:



- **Younger, accumulation members** have long investment horizons and many years until they can access their accumulating assets. Their primary need is to accumulate and grow their asset base. Short term volatility is not a significant risk to them as they will have sufficient time in the market to recover from short term falls. Their regular contributions also provide a buffer against volatility through dollar cost averaging. Their biggest risk is one of inadequate long term returns.
- **Pre-retirees** face a more complex situation. They can expect to draw down some or all their accumulated funds in the short to medium term. Those with smaller balances will probably draw down their full balance on or soon after retirement and therefore need to protect these balances against volatility and negative returns. Those with larger balances will draw down some at retirement and retain some as a regular income into retirement. They have the same need for certainty for the assets they will draw down, but also have the need to grow their income in retirement to combat inflation. These members will therefore have a short to medium term requirement for asset value stability for a portion of their assets and a requirement for growth for the balance of their assets in order to meet their later, inflation affected, income requirements.
- **Retirees** are similar to the pre-retirees, except that they have an immediate need to draw down assets for income and to meet expenditure commitments. These members will therefore also have a short to medium term requirement for asset value stability for a portion of their assets to meet their income needs and a requirement for growth for the balance of their assets in order to maintain their incomes in real terms.

The common theme behind these scenarios is the need to invest members' assets to match their liabilities. This is not a new concept and is standard practice for the investment of defined benefit funds. However, to date, it has not been applied rigorously to accumulation funds. The experience of the GFC shows the concept is needed. However, it is not possible to deal with liquidity and longevity in the same investment portfolio so the concept needs to be applied to individual members rather than to composite strategies.

We discussed the concept in our Touchstone Newsletter *Investing in the Retirement Years*, July 2011. To summarise the comments and recommendations in that newsletter:

- Investments to meet short term liquidity requirements should be separated from investments to meet longer term growth requirements.
- Composite portfolios either with fixed asset allocations or with lifecycle allocations are not adequate because they can force the realisation of depressed assets following a market fall.
- The requirements of accumulation members with long periods to retirement are relatively homogenous and can be satisfied with one or a small range of growth oriented portfolios.



- The requirements of those approaching and especially those in retirement are not homogenous and individuals have a unique blend of short term and long term investment requirements which require a personalised approach.
- We therefore proposed an investment methodology that separated assets into two pools:
 - The Liquidity Pool is invested in cash and similar non-volatile assets that can be relied upon to provide a secure asset value to meet expenditure commitments.
 - The Growth Pool is invested in a composite of growth oriented assets that will provide medium to long term growth to combat inflation and support future incomes to meet lengthening life expectancies.

There is no simple approach that will properly deal with every individual member's circumstances but we believe that funds can adopt a framework that will improve the lot for all members and provide personalised solutions for those who require them. The first step would be to split the membership into broad age cohorts and to then focus on more individualised treatment within these cohorts:

Up to Age 50

This is a relatively homogenous cohort. All members have long investment horizons, are paying contributions (assuming auto-consolidation applies to inactive accounts) and have the ability to recover from short term negative volatility. A standard default portfolio is the best option for this cohort. Past experience and detailed investment modelling also indicate that there is no value to be gained from adjusting portfolio asset allocations prior to age 50.

Individual, engaged members may prefer a higher growth option either via a composite portfolio or an individually designed portfolio. However, these members will tend to exercise Choice in order to achieve this so they are unlikely to remain in MySuper.

Age 50 to 65

This cohort needs to progressively move some assets to cash or a similarly low volatility asset class over the period to retirement. The transfers should be carried out to suit individual circumstances, but these can only be determined via direct engagement and this will not be possible for all members.

Those members who can be contacted and do engage should be allowed to select:

- What proportion of their assets is moved to cash and over what period



- What proportion of their assets is invested for growth and the specific portfolios in which to invest.

For those who cannot be engaged, it will be necessary to provide a standard (default) methodology for moving a proportion of their assets to Cash.

From our experience advising funds, the most significant factor for determining the movement to Cash is the Account Balance:

- The majority of members with smaller account balances take their benefit in cash at or soon after retirement. The funds are used to meet commitments like mortgages, discretionary spending like holidays, short term income requirements and then the member reverts to reliance on the Age Pension
- A minority of members with smaller accounts transfer their benefits to another (generally larger) superannuation account elsewhere
- The majority of those with larger account balances will only take a portion of their benefit in cash and transfer the balance to a post retirement (pension) account either with their current fund or with another fund.

Therefore the standard (default) methodology for this cohort would be to progressively move the asset balance, up to some threshold, to cash over the period to age 65 (or possibly 67) with the balance (if any) remaining in the default investment option. The optimal threshold can be determined by analysing actual exits and by surveying a sample of members in this cohort.

Post Retirement

This cohort requires a proportion of their assets to be invested to meet short term expenditure requirements and a proportion invested to meet medium to long term expenditure requirements. The methodology of matching assets to liabilities by investing in a Liquidity Pool to meet short term expenditure requirements and in a Growth Pool to combat inflation and meet longer term income requirements is the appropriate methodology for this group. Investment in a single composite portfolio is inappropriate and inadequate.



How can these different time horizons be dealt with for MySuper members?

MySuper only allows a single investment option, although this can be a life cycle option. Ideally, MySuper should allow members to transfer some of their funds into cash as they approach retirement. However, members need to become Choice members for this to apply. The rules for MySuper should be modified to allow this when the product is extended to cover retirement.

It is dangerous to assume that every MySuper member at any particular age will retire at the same age and have the same expenditure pattern at and after retirement. In fact, the progressive movement to short term assets at or near retirement will, for many, **increase** the risk that they have insufficient funds to meet their needs at advanced ages.

We suggest that trustees seek to engage members as they approach retirement (from age 50 onward) and offer intra-fund advice specifically targeted at implementing a **personalised** investment strategy aligned to anticipated expenditure needs. It seems likely that funds will be permitted to bundle such advice into the standard MySuper fee. The key questions will be:

- When do you intend to retire? and
- What are your expenditure plans at and after retirement?

Clearly the conversation and subsequent advice will be more complicated than this. For example, many people will say they intend to retire as soon as their superannuation is sufficient and some will have or intend to implement Transition to Retirement strategies. However, the end result of the advice process will lead to a decision by the member of the amounts that will need to be transferred gradually into cash to meet immediate liquidity needs on retirement. The fund could then establish a personalised investment strategy involving a mix of the MySuper default and Choice (cash and fixed interest) investments designed to meet the member's stated retirement funding objectives.

The fund could also simplify the process and increase the take up by offering a standard (default) methodology on an opt-in basis.

The pricing for the Choice option used for this purpose could be set so that there are no extra fees for MySuper members. This would overcome the deficiency in the current MySuper rules while maintaining the low fee approach.

The process suggested above may be considered complex and costly. However:

- A default methodology would not be difficult to automate and implement; and
- Personalised investment option strategies will only be employed on receipt of instructions from the member and can be managed in the same way as for Choice members currently.



Conclusions

Has the long-term outlook for investment markets changed?

NO!

There is no discernible secular change in market consensus long term investment returns. The outlook for growth assets is strong and essentially unchanged. Nevertheless, funds should be prepared to make more significant tactical departures from benchmark asset allocation depending on their views regarding volatility and the patchiness of economic circumstances in different sectors and different regions.

Successful investment strategies are likely to be those based on anticipated long term strategic views of economic, social, demographic, technological, environmental and political changes around the world rather than purely traditional sector allocations and manager selection.

What funds with strong cash flow should be doing is spending time on the components of their growth assets to ensure diversity and access to projects yielding good returns from their illiquidity premium.

Should Australian funds be making fundamental changes to their investment strategies?

YES!

Traditional allocation to asset classes is flawed. Allocations do provide a form of diversification but they are monitored against peers rather than overall fund performance. Allocations to equities should follow similar processes as allocations to property and infrastructure – funds need to target growth industries and regions for their equities and not slavishly follow conventional allocations to listed markets.

This form of thematic investment will require a change in mandates for fund managers.



Should funds be changing how they deliver investment outcomes to their members?

YES!

Legislative constraints mean that MySuper asset allocations will necessarily have to be based on the retirement income needs of “average” members. However, multi-portfolio life cycle investment strategies that depend not only on age but also account balance could be developed.

In addition, funds should refine and enhance their member engagement strategies to target members approaching retirement (say those aged 50 and over) in order to implement personalised investment strategies which will combine MySuper and Choice investment options.

The net result for the average composite strategy will be to do nothing different and just let members make different selections over time. In other words – no change to the portfolios and how they are managed, but a big change to how those portfolios are used by and delivered to members

Finally, we expect post retirement assets to grow from 30% to 42% of the superannuation assets in 15 years, reflecting the long term build-up of superannuation guarantee contributions combined with the ageing population. Funds need to engage with members to ensure they are well prepared to meet the twin requirements of liquidity and longevity protection.

Restricting MySuper products to a single investment portfolio, even if this is a lifecycle portfolio, is inadequate for those approaching retirement and is entirely inappropriate for those in retirement who need to invest for liquidity and longevity. This shortcoming must be rectified with the design of the MySuper retirement product which must allow for a low cost liquid asset portfolio (Cash and/or equivalents) to be provided alongside a long term default portfolio. This structure should then also be extended to members in the accumulation phase.



Contact Us

If you have any questions, comments or you would like to use information found on this site, please contact us.

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