Jack Lowenstein, Morphic Global Opportunities Fund

Jack Lowenstein is Joint Chief Investment Officer and Managing Director of Morphic Asset Management, manager of the Morphic Global Opportunities Fund. He joined Hunter Hall when it had just $13m under management and played a key role in building it to a peak of just under $3 billion in FUM.
Jack is also an non-executive director of Calliden Group Limited, a general insurance company listed on the ASX and an non-executive chairman of Kontiki Capital Limited, an investment bank based in Suva, Fiji.
Prior to joining Hunter Hall, Lowenstein had careers in corporate finance and as an international financial journalist.

SMSF TRUSTEE DILEMMA: DOMESTIC VS GLOBAL EQUITIES

Jack Lowenstein

Like increasing numbers of Australians, I happen to be a trustee of my own family superannuation fund.

This means I make both the asset allocation and investing decisions, doing my best to account for risk and return and fitting this in around a fairly busy day job.

I'm not alone in this process, with self-managed super funds (SMSF) having been one of the fastest growing parts of the economy in recent years and now representing just over 30% of all superannuation fund assets.

Members of SMSF are now nearly 1 million people nationally and total SMSF assets are just under $500 billion.

Along with my many fellow Australians, I have no alternative but to take my SMSF responsibilities seriously, since regulatory authorities are watching closely.

Responsibilities of SMSF trustees

So what are my main responsibilities as a trustee, apart from complying with the mountains of paper work the position involves?

Those laid down by the Australian Tax Office (ATO) are pretty general but they do ask you to act in the best interests of all fund members when you make decisions and also to manage the fund separately from your own affairs.

For someone with experience in investment markets, these conditions are not too onerous but for those without this background, establishing the basis for responsible decision making might be a little more challenging.

We all bring differing skill sets to this job but if one were to look for an objective template for objective decision making, then it would seem reasonable when making asset allocation decisions to look at what the big super funds do.

These organisations have the funds to pay advisers who specialise in these things, who research the economic outlook and fund manager universe to determine the broad nature of product selection options in line with asset class decisions.

Where SMSF trustees feel they need external advice in making decisions, recent ASIC research has found this can be risky, with some 28% of files researched considered to be receiving poor advice, 70% receiving adequate advice and only 1.3% receiving good advice.

A feature that did disturb ASIC was that where there were pockets of poor advice, much of this involved recommendations that investors set up an SMSF to gear into real property.

Asset allocation

Given the seeming risks of actually looking for quality advice, SMSF trustees could do worse than look at what the big, professionally managed super funds do when it comes to asset allocation.

This data is reasonably easy to access, provided by the ATO and APRA, and there are interesting differences to point out as these two tables show.

There are four categories of differences worth noting:

- SMSF have higher amounts in cash and fixed interest – 29% of assets compared to 18% of assets, with big super funds additionally having 5% in international fixed interest
- Exposure to Australian listed shares is close, with SMSFs having 32% invested and big funds 28%
- SMSF's have a liking for residential property, with 15% of assets invested compared with big funds not investing at all
- The most glaring difference is for overseas shares, with SMSFs having 0.33% of assets invested, too small to be in the pie chart above, compared with 23% for the big funds

In considering asset allocation differences, it would be unfair to conclude that big super funds are the only ones that apply professionalism to decision making.

Many SMSF trustees do have the requisite skills to make these decisions, as the regulator requires, and there can also be sound reasoning behind investing in asset classes they know well, like Australian equities, residential property and preparedness to opt for safe levels of liquidity.

However, there is little doubt that big super funds, with the resources at their disposal to engage experts to advise on asset allocation and consider the risks of alternative strategies, are in a sound position to develop comprehensively thought out investment strategies.

Where expertise and research combine is in the area of risk and it is it would be fair to say the big super funds are more involved in assessing risk in relation to returns than the average SMSF.

Performance data

Since the greatest difference in asset allocation between big super funds and SMSF is in global equities, it is worth looking at the return and risk issues in this decision making process.

Regarding return, there have been periods over the past few decades when Australian equities have outperformed global but that has not been the case since the global financial crisis and especially in the current year, as the chart at the bottom of the page shows:

Given the strong argument on the return side, as shown in the chart, for having global exposure to equities, perhaps there may be other reasons SMSF cling so strongly to a home bias, such as risk considerations.

In relation to risk and investing in global equities, the issues big super funds focus on are basically diversification.

The Australian Securities Exchange (ASX) index essentially represents an exposure to banks and resource stocks, with this combination representing over half the index.

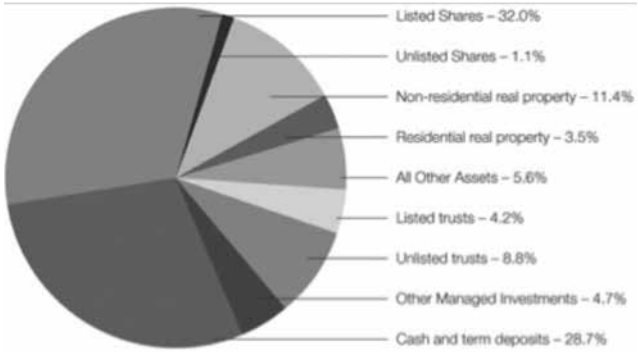
Global equities provide greater diversification across all other sectors, with important investing opportunities in information technology, healthcare, industrials and consumer discretionary.

It is exposure to this wider investing universe, and returns, that have driven the big super funds to build allocations to global equities and so if one looks for reasons for SMSF not having followed this lead, perhaps it is the mechanics that have made the process seem a little daunting.

Managed funds vs direct exposure

If SMSF are going to overcome their home bias and look to emulate the asset allocation strategy of the big funds, a few issues that

2011 SMSF asset allocation



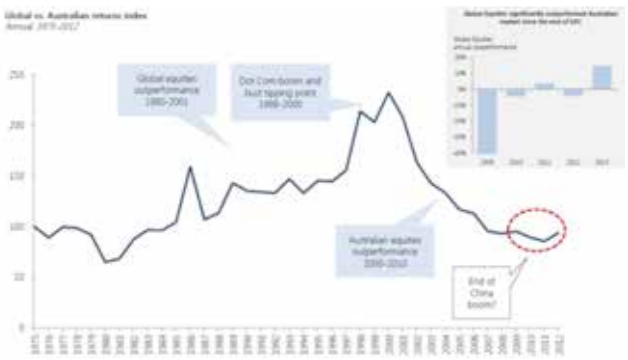
2012 Large super fund asset allocation

Asset allocation – default strategy

Asset Class	Amount ($billion)	%
Cash	35.2	9
Australian fixed interest	33.9	9
International fixed interest	21.2	5
Australian shares	108.3	28
Listed property	9.1	2
Unlisted property	30.5	8
Other assets	64.1	16
International shares	91.1	23
Total	**393.2**	**100**

Source: *APRA Annual Statistics, June 2012*

Why global equities matter to Australian investors



confront them from the beginning are currency risk, low yields on large overseas stocks and whether to invest direct in a few stocks or choose a managed fund or the ETF route.

Very few of the big funds seek to buy individual stocks since their overall risk management practices involve outsourcing the investment process to fund managers.

Many SMSF take a direct investing stance when it comes to Australian equities and probably feel qualified to pick on a few big international stocks, like Microsoft, Coke and Apple, and feel this might meet risk and return challenges.

But this would ignore a number of investing rules, since it is more oriented towards investing in past reputation and not taking account of some of the macro issues, like which are the best economies and sectors to be investing in right now, micro issues like comparative stock performances and then there are currency considerations.

If investors are to be serious about investing in global equities they have to acknowledge that currency is a separate asset class within decisions that are made so there is more to it than just stock picking on the basis of well-known names and brands.

If SMSF are to really follow the lead of the big funds, they would recognise the risks of stock picking themselves and take the managed fund route, although here too there are more decision making options.

Increasingly in recent years, investment markets have shown greater volatility than previously, which can be either a threat for those unfamiliar with how to deal with it, or an opportunity if you are structured as an investor to take advantage of market gyrations and develop strategies through them.

Having a long short capability is a distinct advantage in these times, especially if it is accompanied by specific stock research on the short side and use of ETFs and futures to manage risk on the long side, accompanied by screens to discern value on stocks in a genuinely global universe.

Decision time and outlook

Since the establishment of modern portfolio theory in the 1950s, despite huge market fluctuations since then, nothing has happened to dislodge the main tenet of the theory that diversification is the greatest contribution to achieving the best risk adjusted return.

If diversification became a guiding light to asset allocation for SMSF, they would pay closer attention to the differences between how their portfolios are made up in comparison with decisions made by the big super funds.

While it is understandable for SMSF to have an affinity with residential property, which is not the province of big super funds, it is in allocation to global equities where SMSF have a big discrepancy to address.

The weakening of the Australian dollar lends weight to the advantages of considering overseas equities alternatives, especially as the US economy shows signs of recovering, Japan being on the comeback trail, India moving more inevitably to a position of world powerhouse and opportunities continually arising in China and South Korea.

While there is no reason to think Australia will not continue as a land of opportunity, if SMSF trustees are to take their responsibilities seriously, they should be looking at placing Australia in the context of broader investing horizons.

The way big super funds go about this is a powerful template – they recognise that the diversification principle necessitates significant exposure to global equities and that expert managers offer the best opportunities for managing risk and return.

Stock picking has its merits and attractions but on a global scale requires skills and systems beyond the average SMSF manager.

I might have a day job that involves investing but when I combine what I know from that arena with my responsibilities as trustee for my family super fund, I recognise the need follow the big super fund example and bow to the skills and focus of fund managers.

Perhaps when it comes to allocating to global equities, you might understand my personal bias in choosing one particular global manager but my purpose here is really to point up what seems an anomaly in the divergence of asset allocations strategies between the big end of town and SMSF. **FS**

Further reading

Where SMSF trustees feel they need external advice in making decisions, recent ASIC research has found this can be risky.