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Five steps to diversify your SMSF

October 2017

Introduction

ATO statistics show that most self-managed super fund portfolios are poorly diversified.

As at June 2017, the average SMSF held 75% of its investments in just three asset classes - Australian shares and listed trusts (35% of assets), cash holdings (24%) and domestic property (16%).

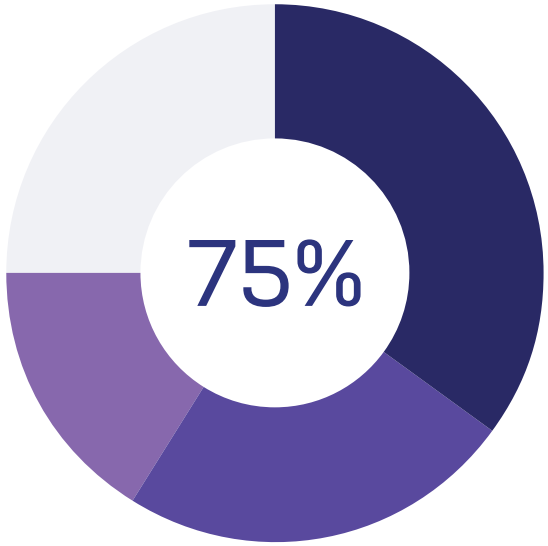
Among smaller funds, portfolio concentration was even more pronounced. On average, these funds had more than half their investable assets in cash.

It's important to note that the ATO data isn't perfect – many of the figures are estimates, and the figures don't distinguish between funds in pension and accumulation mode (which would typically have different asset allocations). That said, the overwhelming levels of portfolio concentration in the report suggests that many SMSFs are likely to have portfolios which are poorly constructed.

Like any investment portfolio, the asset allocation decisions of your SMSF should be tailored to suit your members' risk profile and objectives. For some SMSFs, having large allocations to Australian equities, cash and property may be appropriate. However, for most SMSFs, there are likely to be opportunities to improve asset allocations to enhance long-term investment returns and reduce risk.

If you manage your own SMSF investments, here are some tips to enhance the diversification of your portfolio.

Figure 1 - Asset allocation of average SMSF as at June 2017



ASSET CLASS	PERCENTAGE
Australian shares and listed trusts	35%
Cash holdings	24%
Domestic property	16%
Other	25%

Step 1: Minimise concentration to any one asset class

The notion of not having all your "eggs in one basket" should be a cornerstone consideration for any portfolio.

If your investment "eggs" are spread across a wide variety of asset "baskets", each with different characteristics and profiles, then the negative performance of some investments will tend to be offset by the positive performance of others. Over the longer term, the entire portfolio will typically yield higher and less volatile returns. Among professional portfolio managers, allocations to single asset classes are often capped at ~30% to help ensure meaningful diversification across portfolios, with lower maximum constraints (5-15%) applied to higher risk asset classes to help manage overall risk and sector exposures.

To read more about diversification, click here.

Step 2: Ensure your Australian share portfolio is sufficiently diversified

Diversification within an asset class is often just as important as being diversified across different asset classes.

This is especially the case if you hold Australian shares. A number of investment surveys have shown that the typical SMSF's Aussie share portfolio is concentrated in a small number of stocks (typically less than 20) and predominantly exposed to the financial and resources sector. This lack of diversification within this asset class can heavily impact returns. An unexpected swing in one stock/sector (for example, Telstra or Commonwealth Bank in recent years) will have a marked (and unnecessarily high) impact on overall portfolio returns. The benefits of diversification in terms of enhancing returns and lowering risk can be seen in a simple comparison of the S&P/ASX20 index (which comprises only the largest 20 stocks on the ASX) and the broader S&P/ASX200 index. Over the three years to 30 September 2017, the S&P/ASX200 has outperformed the S&P/ASX20 (7.1% % vs 3.8% per annum) and with lower volatility (standard deviation of 11.8% vs 13.2%).

Figure 2 - Comparison of returns over three years to 30 September 2017 for S&P/ASX20 and S&P/ASX200 indexes

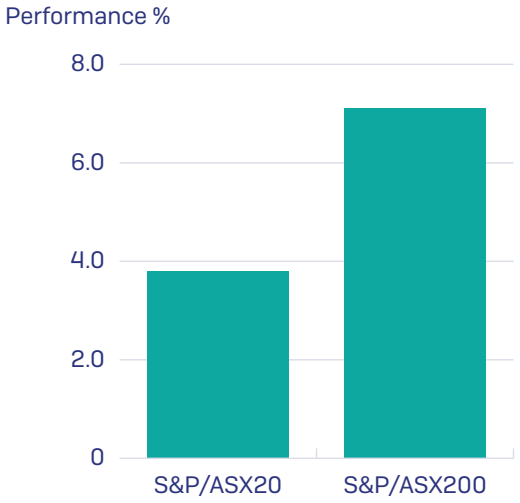
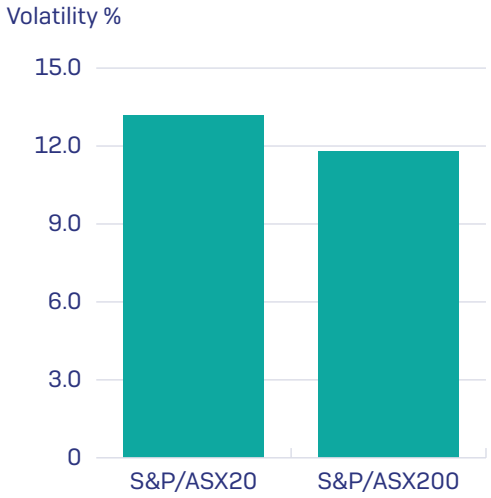


Figure 3 - Comparison of volatility over three years to 30 September 2017 for S&P/ASX20 and S&P/ASX200 indexes



Step 3: Consider the benefits of geographic diversification

The Australian share market makes up less than 2% of the world's total by market capitalisation. As such, limiting your investment pool to just Australia will inevitably limit the potential benefits afforded by the global market.

As an example, the MSCI World Index (excluding Australia) has delivered an annualised return of 8.4% per annum over the three years to September 2017, higher than the ASX200's 7.1%, and with lower volatility (standard deviation of 10.4%). The $133 billion Future Fund currently allocates just 6% of its total portfolio to Australian equities and more than 3.5 times that amount in international stocks.

Step 4: Ensure your cash allocation is appropriate

While holding cash and term deposits is one way to de-risk your SMSF portfolio (and may well be appropriate in some circumstances), the current interest rate environment naturally makes it difficult to maximise capital growth for your retirement funds.

For those investors with longer investment horizons, the benefits of a more diversified portfolio – albeit with higher risk – may be more appropriate, particularly if the asset allocation is carefully constructed to match your risk profile and objectives.

Step 5: Consider the benefits of ETFs

Exchange-traded funds (ETFs) are an ideal vehicle for SMSFs, providing immediate and highly diversified exposure to specific asset classes and having the advantage of being low-cost and readily tradeable on the stock market.

In just one or a few trades on the ASX, it is possible to invest across literally thousands of companies, sectors, asset classes and positions - instantly and inexpensively delivering a truly diversified portfolio.

To find out more about ETFs, click here.

Seek help

Ultimately, asset allocation decisions are complex. They require an understanding of one's risk tolerance level and the determination of suitable investments to match specific objectives.

This is where good investment advice can really make a difference. Your SMSF may be your ultimate responsibility to manage, but that doesn't mean you can't seek the help of others.

About Six Park

Six Park is an automated investment service backed and managed by Australia's preeminent investment experts.

While most robo-advisors are user-friendly and easy to use, Six Park is different from other services in three significant ways:

- Unparalleled investment management experience and unaligned with a bank
- Strong portfolio performance
- Lower costs than other robo-advice services

The combination of sophisticated technology, low cost and the human asset management overlay is why we refer to Six Park as "Robo Plus".

Six Park's Robo Plus provides an unrivalled value-for-money and investment return profile when compared with any other investment service in Australia.

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