Why SMSF investors are beating the big boys

ANDREA SLATTERY

In the run-up to the GFC, SMSF trustees were chided for their conservative approach to investment markets. Australian Taxation Office figures show asset allocation at June 30, 2008, of 26.9 per cent in cash and 31.5 per cent in Australian equities (57.4 per cent in total), but even this conservative approach did not insulate them from the fallout from the GFC, with average fund returns down 5.9 per cent in the 2008 financial year and 6.7 per cent in 2009.

What this conservative asset allocation did do, however, was insulate them far better than their APRA-regulated cousins, with the returns for the latter dropping 8.1 per cent in 2008 and 11.5 per cent in 2009. Both SMSFs and APRA-regulated funds returned to the black in 2010.

Since then DIY investors have rebuilt their portfolios, but the bitter memories of 2008 remain part of their investment DNA. A quick look at their current asset allocation for SMSFs palpably demonstrates this, with the numbers for the September 30, 2016, quarter showing Australian shares and cash and term deposits still comprising a sizeable portion of their funds — in fact, at 57 per cent it is level pegging with June 2008.

It's not hard to understand why. As research continually shows, for the 48 per cent of SMSF trustees either transitioning to (60 to 65) or in retirement (over 65), capital preservation and income generation are the prime drivers of their investment strategies. And many trustees who are 55 plus and approaching retirement are also likely to fit this investment mould. In stark contrast, only 5.6 per cent of APRA-regulated fund members are in pension phase.

It's this critical factor of capital preservation and income generation that makes attempts to compare the investment performance of APRA-regulated funds with SMSFs an exercise in futility. At its core, it's a question of priorities. SMSFs deliberately have a more conservative approach to asset allocation to allow liquidity for pension payments, and hence have a potential for lower returns.

And it is not just an issue of liquidity. There is also an expectation by SMSF trustees, especially as they advance in years, that there will be unexpected demands on their capital, such as medical expenses — another reason to adopt a conservative approach. Yet SMSF critics remain fixated on the supposedly higher investment returns of the APRA sector to argue why most SMSF trustees would be better to return to APRA's bosom.

In a recent statement, Industry Super Australia cited ATO figures that the average net return for an SMSF in 2015 was 6.2 per cent. This compared to 8.8 per cent for an APRA-regulated fund, and, within that pool, 7.8 per cent for a retail fund and 9.7 per cent for an industry fund. Such comparisons ignore the different nature of the funds and their reporting requirements. When the ATO and APRA respectively compile statistics on an SMSF or APRA fund's return, different expenses are accounted for. APRA make it clear in their Annual Superannuation Bulletin that "expenses are generally understated" in their calculations.

This can inflate APRA fund returns compared with SMSFs. It is also noteworthy that it is standard practice for APRA-regulated funds to exclude the administration fees they charge their members outside their investment.

This small print is conveniently overlooked by SMSF detractors.

Perhaps the final word should go to the actuarial firm Rice Warner, which this week issued an updated report that included a comparison of APRA and SMSF returns over the past 12 years (2005-16).

Based on ATO data, it showed SMSFs averaging 8 per cent compared with 6.8 per cent for APRA funds over this period. No doubt that will put a smile on SMSF trustees' faces — and would certainly suggest that the Cooper and Murray inquiries were on the right track when they gave the SMSF sector a clean bill of health, investment performance included.

Andrea Slattery is CEO of the SMSF Association

New super rules could affect estate planning

MONICA RULE

SMSF members may need to revisit their estate plan because of changes to the superannuation law effective from July 1. Until now, most estate planning involved a self-managed super fund member organising a reversionary pension. This was so that upon the member's death, the surviving spouse could receive the deceased's pension and would not need to sell any assets of the SMSF to satisfy the superannuation law's compulsory payment requirement.

However, forthcoming changes not only limit the amount an SMSF member can have in their retirement pension account but also limits the amount a member can receive from their deceased spouse's pension account. This is because the deceased's pension will also count towards the surviving spouse's transfer balance cap.

In turn this means that if the total of the surviving spouse's own pension and the death benefit pension exceeds the transfer balance cap (currently at $1.6 million), the spouse will need to remove the excess above the cap from their SMSF and pay out a lump sum benefit. The surviving spouse can either remove money from their own pension account or remove money from the death benefit pension.

As death triggers a compulsory payment situation, they cannot transfer any of the deceased's superannuation to their accumulation account. This may mean that assets will need to be sold to effect the payment of a lump sum death benefit.

When a member commences a retirement pension from an SMSF, the member would normally choose a reversionary pension. This is an income stream super benefit paid to an SMSF member where upon their death the pension continues to be paid to a nominated reversionary beneficiary as though that reversionary pensioner was the original pensioner. The only thing that changes is that when the pension is paid the following financial year, the minimum pension payment requirement is calculated using the reversionary pensioner's age.

A non-reversionary pension, on the other hand, is an income stream superannuation benefit paid to an SMSF member that ceases upon the member's death. The pension stops upon the death of the SMSF member, and the deceased's superannuation will then need to be paid as either a lump sum and/or an income stream superannuation benefit.

Grace period

Now we already know that death triggers a compulsory payment situation under the law and therefore the deceased's super cannot remain in the SMSF and must be paid as a reversionary pension, a new pension or a lump sum benefit. The deceased's superannuation cannot be added to the accumulation account of the recipient member.

There may be some consolation in knowing that the government has provided a 12-month "grace" period for reversionary pensions. A reversionary death benefit pension is not counted towards a surviving spouse's transfer balance cap until 12 months after the date of death. The amount counted is also the balance of the late member's pension at their date of death even if it is paid 12 months later. If the deceased's pension is non-reversionary, then the death benefit pension is counted immediately when it is paid to the surviving spouse and the amount counted is the deceased's pension account at the date of payment.

Another area of estate planning that needs some consideration is death benefits payable to children of the deceased. Unlike a surviving spouse, a child under the age of 18, or aged up to 24 who is financially dependent on the deceased, or a child with a disability of any age can receive the deceased parent's pension regardless of how much has accumulated in the pension account. This means, even if the deceased parent's retirement account has grown above the transfer balance cap, currently $1.6m, the deceased's child can maintain the pension account until either the child turns 25, when it needs to be paid out as a lump sum death benefit, or until the pension is exhausted if it is received by a child with a disability.

The changes in the super laws affect everyone in one way or another. Understanding the changes will enable you to make informed decisions on whether changes are required for your current estate plan.

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CSL looking up, Wesfarmers looking down

DAVID WALKER

AARON FRANCIS

CSL's growth under chief executive Paul Perreault is visible and accelerating

Growth is easy to observe but risk is less apparent. As we look forward from reporting season, investors are valuing stocks based on the growth rates recently reported and guided, but valuations should also reflect whether stocks are becoming riskier.

Wesfarmers and CSL are telling case studies because the former is slowing and becoming riskier while the latter is accelerating and becoming less risky.

Wesfarmers' headline interim numbers seemed reasonable enough. Sales grew 4 per cent, operating earnings were 15 per cent higher and after-tax earnings rose 13 per cent.

But the results from supermarket chain Coles, which contributed over a third of operating earnings, were a concern. The supermarket chain's all-important like-for-like sales growth (the measure which captures sales for the same set of shelves from one period to another) decelerated to 1.3 per cent for the half and 1 per cent for the second quarter, down from 4.3 per cent in the previous half. Besides this, operating margins narrowed.

Overall, Coles earnings fell 8 per cent. These results were worse than the market expected. In particular Coles was unable to pass on increases in the cost of meat because Woolworths cut its own prices. Earlier, price inflation in produce levelled out, restraining grocery margins.

For so long Coles enjoyed buoyant margins and sales growth because Woolworths, distracted by the Masters hardware misadventure, was uncompetitive. But this period of "Peak Coles" is over now that Woolworths is resurgent. Coles is being forced to cut prices to stay competitive as Woolworths finds efficiencies to help offset its own price cuts. Meanwhile Aldi's rollout in South Australia and Western Australia continues, so Coles is losing share there.

Coles now faces a difficult strategic question: does it stick to its former strategy of supporting longer term sustainable earnings or does it fight on price and market share? Both will be costly and the outcome is unknown.

At Wesfarmers' jewel, the Bunnings chain like-for-like sales also slowed and losses in Britain will expand in the second half and into 2018. I am yet to be convinced selling DIY products in Britain will work given trade services there are cheaper than in Australia so households generally prefer to engage tradespeople rather than do projects themselves. At best a material pay-off from Britain is three years away. Wesfarmers as an investment proposition is complicated by the intended sales of the Curragh coalmines and the office supplies chain Officeworks, although both exits would "de-risk" the group.

This is because coal mining is a volatile, unpredictable game and coal prices are already off their recent peaks, while Officeworks stands to be substantially disrupted by Amazon. Wesfarmers is being prudent by attempting to sell it through a stockmarket float. Wesfarmers missed an opportunity to sell the coal business at the peak of the last commodities boom so I support the current attempt and hope it leads to a full exit at or above written down book value.

Wesfarmers is entering a new era with a new CEO and headwinds are emerging for Bunnings and Coles.

While I don't expect the strategy to change materially under new management, the outstanding takeaway is that earnings risk is higher.

On my models, the intrinsic value of Wesfarmers is $41 but the share price is nearly $44 due to optimism the mines and Officeworks will be sold. The market in its enthusiasm for the divestments could be missing the deteriorating picture at Coles, which may eventually lead to a discount in the stock.

CSL upgraded its guidance in January and interim net earnings surged 36 per cent. This week CSL is hosting analysts on a tour of its European facilities and the insights are no doubt adding to the rally as the stock at $125 continues on its journey towards our new intrinsic valuation of $143 in 2018.

CSL's growth is visible, accelerating and importantly, it is less risky than before. This is one of the few ASX 50 stocks, perhaps the only one, capable of compounding earnings at double-digit per annum.

Sales at the key CSL Behring division grew 18 per cent. Competitors underinvested in US plasma collection capacity, so CSL's expansion became a competitive advantage. It took share from competitors by meeting more of the ever-growing demand for immune therapy products known as immunoglobulins.

The derisking came from guidance that Seqirus, the loss-making vaccine business acquired from Novartis, is on track to break even in FY18. Investors will start to engage with Seqirus not as a risk but a new source of upside.

Idelvion, a new haemophilia therapy recently approved for sale in large markets, had a strong start and investors are bullish on Afstyla, another new haemophilia treatment. Both are longer-lasting than the competition and require less dosing.

The growth outlook for CSL is as attractive as at any time since the launch of the immune treatment Hizentra in 2010.

This is a company with several sources of potent margin expansion: sales growth and higher margins for Idelvion and Afstyla; increasing take-up of Kcentra, a treatment for perioperative bleeding, in US hospitals; patient conversion to CSL's Berinert and Haegarda treatments for hereditary angioedema, and ongoing growth in demand for existing immune treatments Privigen and Hizentra.

It's two different stocks that have long attracted a wide group of local investors — just now though, they are going in different directions. It's essential to consider not only the growth a company reports and guides but also whether the core business units are becoming riskier or less volatile.

David Walker is senior analyst at StocksInValue.com.au which holds stock in CSL, and does not hold stock in Wesfarmers.

FLOAT WATCH

Software service to stand up

Bigtincan Holdings
ASX code: BTH
Shares on offer: 46.2 million
Listing price: 26c
Market capitalisation: $45.9m
Listing date: March 22

SIMON HERRMANN

Internet and software company Bigtincan Holdings seeks to raise $12 million to list on the ASX this month in a $46m deal.

The "Software as a Service industry" (SaaS) is a high-growth sector but peers have performed in a mixed fashion: Wisetech Global (WTC) recently announced strong results and its stock price soared. In contrast, shares of Aconex (ACX) were sold down.

Bigtincan is focused on the North American market. It is an Australian SaaS provider focused on enterprise mobility. The group's mobility software is designed to facilitate sales and service workflows in order to increase client engagement. As at the date of the prospectus the company had about 300 paying customers with 100,000 users on its single product platform. The company was founded in 2011 with historic share capital of $22m.

Revenue is projected to rise by 38 per cent during the 2017 financial year and transition to a cash flow positive status over the medium term is a major catalyst, albeit contingent on further growth.

Income visibility is high as Bigtincan has maintained an annual client retention rate of more than 90 per cent since the 2015 financial year. What's more, recently established channel partnerships with Apple and Singtel Optus provide the opportunity to drive sales and extend the company's reach.

The company's relationship with AT&T is mature and already bringing in sales. But Bigtincan has historically been reliant on external capital while operating at a loss and there is no guarantee that a self-funding position will be achieved. Management predicts a $4.8m loss this financial year, after a $5.2m loss last year.

The IPO is valued at a modest premium to historic invested capital. However, as product investments are largely completed, management can now focus on expanding sales capabilities. The float is speculative in nature, but catalysts offer potential for upside.

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