Get off the rollercoaster

Look to Future Fund for ways to see good returns with less risk

Jon Horton

We've all felt the sting of expectations failing to match up to reality.

The peeling paint and sagging sunbeds that didn't show up in the glossy brochure for the holiday resort, the once-in-a-lifetime concert experience that cost a fortune but fell flat on the night, the restaurant booked months in advance that delivered a dud meal.

But if there's one area where you don't want to come out on the wrong side of the expectations-versus-reality equation, it's your investment strategy.

For a good proportion of the population, being in the investment market can feel like getting on a rollercoaster — they're handed their hot dog and coke, strapped in and hurtle off to ride the ups and downs. While they may get to their destination, the ride can be hair-raising and the journey could see them lose their lunch.

Given the choice, it's a fair bet your average traveller would rather be on the Orient Express: ambling happily between the dining and sleeping cars, journeying in comfort with the certainty of a given outcome.

If you're an investor, and you're looking to build wealth, you should be asking yourself two key questions: what's my objective in terms of a return, and what is the probability of hitting that target in any given year?

If we look at your average balanced fund, that objective is around 3.5 percentage points over inflation, which for the past couple of years has sat at 2.5 per cent. So let's say an average target return of 6 per cent a year.

For the past eight years (that is, since the GFC hit) the average annual return of the typical balanced fund has actually been about 4 per cent. But it hasn't been smooth sailing. At their worst point in those eight years, balanced funds saw a loss of 25 per cent.

If we look at that probability question, the odds of your average balanced fund hitting its target return in any given year sits about 33 per cent.

Most financial planners use the balanced fund model, and the overwhelming determiner of the outcome are the stocks and bonds markets — and that means the rollercoaster ride is going to continue.

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Now let's look at the standard bearer of the Australian investment market: the Future Fund.

The managers of the Fund, which is made up of the taxpayers' money (all $118-odd billion) looked at what Australian asset managers were doing and fundamentally rejected their approach.

They think a 3.5 per cent over CPI return each year is too low. Instead, they target 4.5 to 5.5 percentage points over CPI, and they want to design a portfolio that has a high probability of achieving that each and every year.

To do that they've gone with the endowment model, which is used by Yale and a slew of other prestigious universities in the US and Europe.

They use a broad range of asset classes, including a high allocation to alternative investments such as hedge funds, at different levels to smooth out the ride — taking the Orient Express, rather than the rollercoaster.

And if we hark back to the probability question?

The odds of the Future Fund achieving their target 7 per cent to 8 per cent total return is around 80 per cent in any given year.

So let's add one more question to the mix: do you have the stomach, the time or the wealth to let your hard-earned investment ride that rollercoaster?

There can be a disconnect between the industry and their clients where it comes to understanding what the average investor wants, and how much risk they're prepared to take.

The likes of the Future Fund clearly demonstrate that better positioning around risk management can deliver high outcomes while mitigating the ups and downs of the market.

There are some innovative financial planners heading in that direction today. Set your expectations around the return you want and the risk you're prepared to take, go out there and find those planners, and make sure the reality marries up accordingly.

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Illustration: Toby Wilkinson

Taxing questions in superannuation death payouts

DIY SUPER

Monica Rule

High on the list of the Government's superannuation concerns is that self-managed superannuation funds are being used for estate planning purposes.

Although the main purpose of an SMSF is to provide retirement income for members, the superannuation law does allow a member's superannuation savings to be passed on to their beneficiaries upon their death.

If the trust deed of a member's SMSF allows for the payment of a death benefit, then the death benefit can be paid directly to the deceased's dependants or to their legal personal representative.

Dependant and legal representative are key terms for understanding the rules.

Under the superannuation law, people who are classified as dependant are a spouse of the deceased member (including de facto partner or a same-sex partner), any child of the deceased (including a step-child, adopted child or ex-nuptial child), a person with whom the deceased had an interdependent relationship, and a person financially dependent on the deceased prior to their death.

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An interdependent relationship is where two people have a close personal relationship and live together, where one or both of them provide for the financial and domestic support and personal care of the other.

An interdependent relationship can also exist if there is a close personal relationship, but the other requirements can't be satisfied due to a physical, intellectual or psychiatric disability. The two people can be related (e.g. a mother and son or two elderly sisters) or not related to each other (e.g. friends).

A legal personal representative is a person who has been given an enduring power of attorney over the affairs of the deceased member.

It is usually someone known to the deceased such as a family member, a trusted friend, or their accountant or solicitor.

This means, upon the death of an SMSF member, the member's superannuation savings can be passed on to their spouse, their children (including adult children) or to their legal personal representative. If it is passed on to the legal personal representative, this person will distribute the deceased's superannuation savings in accordance with the deceased's wishes stated in the will.

Now, the tax treatment of a death benefit is based on whether the beneficiaries are classified as a "death benefit dependant" under the income tax law.

If a person is classified as a "death benefit dependant", they can receive the deceased's superannuation tax free if it is paid as a lump sum death benefit. If it is paid as a pension, no tax is payable provided either the deceased or the beneficiary is over the age of 60.

You should be aware that a person who is a dependant under the superannuation law may not be a dependant under the income tax law.

To satisfy the term "financial dependent", a person would need to rely on the deceased member for financial support. The financial support must be substantial and the person would need to rely on the financial support to maintain their basic needs.

So in order for an adult child of the deceased SMSF member to receive the parent's superannuation savings tax free, they would need to either have an interdependent relationship with their parents or they would need to be financially dependant on their parents prior to the death of the parent. While very high wealth individuals might be able to support their adult children, this is out of the question for most average SMSF members.

It will be interesting to see what happens if the government does curb estate planning in SMSFs. While the "dependant" definitions under the superannuation law and income tax law do differ, clever strategists have found ways to effectively make SMSFs highly tax-effective estate planning vehicles.

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