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THE PREMIER SELF-MANAGED SUPER MAGAZINE

Capital preservation key to SMSF success

October 19, 2020
Tharshini Ashokan

Fund managers offering capital preservation following the COVID-19 pandemic will appeal to SMSFs struggling in a highly volatile market, an investment expert says.

The market volatility caused by the COVID-19 pandemic has made capital preservation a priority for SMSF investors, according to an investment expert.

Cor Capital managing director David Hood said fund managers offering capital preservation following the pandemic would appeal to SMSF trustees, and in particular trustees in retirement.

“With much of the evidence suggesting SMSFs will not enjoy the strong tailwind of equity market returns in the next decade as they did in the last, as well as having cash and bond yields at historical lows, SMSF trustees will place a premium on preserving their capital,” Hood said.

“This focus will apply particularly to those SMSFs that are in retirement (nearly 50 per cent) or those nearing retirement and can ill afford to put their retirement nest eggs at risk.”

He pointed out the pricing of risk assets did not reflect the current high-risk investment environment and this situation would eventually result in a market correction of risk assets, an outcome many SMSFs would be particularly vulnerable to.

“In the past decade, and despite historically low interest rates in recent years, these SMSFs have been ‘protected’ by their investment in fully franked ASX shares … that have provided capital growth and healthy dividend income,” he said, adding that at March 2020, these shares comprised $167 billion or 26 per cent of all SMSF net assets.

“It’s our contention that investors should not expect a similar performance from equity markets in the coming decade and that dividend income is also likely to be constrained, at least for the next few years.

“Put simply, the traditional 60 per cent growth/40 per cent defensive-type portfolios that many SMSFs rely on will, in all likelihood, fail to meet their investment objectives in the coming years.”

He noted SMSFs had a propensity for making “poor, short-term decisions” or otherwise tended to follow investment strategies that were ultimately weak without making the tactical decisions necessary to improve fund performance. This made SMSFs particularly susceptible during times of high market volatility, he noted.

“Large institutions have the wherewithal to use different investment strategies to improve returns, such as defensive option strategies. But these strategies take SMSFs into territory they often don’t understand and certainly don’t embrace,” he added.

“Knowing they will need to find alternative ways of generating growth and income while preserving capital, there will be a growing appreciation of the need to find fund managers that can achieve these objectives without the need for a high level of complexity or costs.”

In July, Challenger retirement income chair Jeremy Cooper said SMSF members who were also retirees faced a new dynamic as to how they generated retirement income due to the impact the coronavirus pandemic had had on their capital invested in equities and property markets.

In January, research by Investment Trends into investor behaviour revealed capital protection as opposed to capital growth was the priority for many individuals based on a predominantly pessimistic view about the Australian share market.