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Capital preservation the need of the hour for SMSFs

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From **Cor Capital**

Self-managed super funds (SMSFs) will be increasingly attracted to fund managers offering capital preservation post COVID-19, says Davin Hood, Managing Director at Cor Capital, a Melbourne-based investment manager.

“With much of the evidence suggesting SMSFs will not enjoy the strong tailwind of strong 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.

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

Hood says the investment scene, both domestically and globally, is high risk, whether it’s assessed from a geopolitical, economic or health viewpoint.

“Although that’s the investment reality, it’s not reflected in the pricing of risk assets. But that day of reckoning must come – the markets can’t continue to defy economic reality forever.

“SMSFs will not be immune to any market correction of risk assets. In fact, many will be particularly vulnerable for several reasons.

“Failing to get good advice either because of its rising cost (this has been accentuated by the ongoing exit of advisers from the industry post the Financial Services Royal Commission) or a misplaced confidence in their ability to make the right investment decisions are one of the top reasons for disappointing investment returns in our opinion.

“Further, 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 (at March 2020, they comprised $167 billion or 26% of all SMSF net assets, a number depressed by the sharp sell-off in the second half of that quarter) that have provided capital growth and healthy dividend income.

“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 60/40 type portfolios (60% growth/40% defensive) that many SMSFs rely on will, in all likelihood, fail to meet their investment objectives in the coming years.”

Hood says the combination of weaker, and, just as importantly, more volatile markets for risk assets, and lower dividend returns, will be compounded by investors often failing to be able to articulate long-term investment strategies and stick to them.

US research house Dalbar publishes quantitative analysis of investor behavior and has shown individual investors consistently underperform mutual funds because of poor decisions on when to buy, sell or switch out of mutual funds. With an expectation of

increased volatility, investors holding higher allocation to risky assets will probably make more poor investment decisions under stress.

“SMSFs, which, by law, must have an investment strategy, are still prone to make poor, short-term decisions, or, alternatively, are so locked into their strategy that they fail to make tactical decisions that can enhance their fund’s performance.

“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.

“But 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 high level of complexity or costs

“After the GFC, SMSFs increasingly shied away from fund managers that had failed to deliver during that crash and charged high fees for the privilege of doing so, with the bull market in equities in the past decade rewarding that strategy. [At 31 March 2020, managed fund assets stood at $39 billion or 6% of total net SMSF assets.]

“But in the wake of the COVID-induced recession they may no longer have that luxury if analysts are correct in predicting much lower returns in the next decade, opening the door for fund managers with investment strategies that aim to protect their capital, maintain purchasing power and provide alternative sources of return not tied to high allocations to equities.”

Against its peers the Cor Capital Fund is placed in the top decile over one, three and 5-year timeframes on the Netwealth platform; and in Morningstar’s Australia ‘multi asset – balanced’ database of 131 funds (the Cor Capital Fund was the #1 performer over 1 and 5 years, as at 31 July 2020.)