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SMSFs should seek 'all-weather' portfolios

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SMSFs with 'all-weather' investment portfolios could neutralise the sequencing risk caused by severe economic uncertainty.

SMSFs should build 'all-weather' investment portfolios to protect retirees from heavy losses in times of extreme market volatility, such as that experienced during the COVID-19 pandemic, an investment management expert has said.

Cor Capital director Tom Rachcoff said SMSFs should neutralise the sequencing risk caused by poor investment performance during times of severe market uncertainty by building portfolios that protect investor wealth while still providing stable growth through real returns.

"Ideally the pre-retiree and retired investors would have a portfolio that can perform well in a bull market phase, but more importantly work to protect capital within the extreme 'risk-off' environments," Rachcoff said.

He noted many SMSFs that had opted for diversified portfolios and investments in infrastructure and real estate in an effort to manage risk were unprepared for the economic impact of the pandemic and the resulting market fall across asset classes.

Investors had moved into this position due to the decade long bull market, which came to an end as a result of the coronavirus pandemic, he said.

“Investors often become complacent by long periods of high returns, only to be blinded by sudden downturns, and that’s what we saw in the first quarter of 2020,” he said.

He pointed out the fall in markets was so swift and unexpected that asset-class correlations drifted together and offset any benefits of a diversified portfolio.

“Many of these investors did not realise that they were at risk and were sitting on a roller-coaster ride through the sequencing risk zone, with a better-than-even chance of succumbing to human behaviour if markets got stressed. And they got very stressed,” he added.

He also pointed out pre-retirees and retirees were more likely to suffer the consequences of poor investment choices during times of extreme economic uncertainty than any other investor group because they had less time to recover from their losses compared to other investors.

“Sequencing risk represents the danger of experiencing poor investment performance at the worst time. While some investors have decades to ride out volatility and heavy capital losses, investors nearing and in retirement are not among them,” he said.

“They need to pay greater attention to the risk of permanent capital loss and the sequence of returns, while still attempting to maximise return.”

Last month, BetaShares senior investment specialist Roger Cohen said retirees should stay invested and avoid cashing out despite current market volatility as a result of the COVID-19 pandemic.

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