

Super funds a hit at the box office

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but the sequel may disappoint

Returns, writes **David Potts**, are all a balancing act.

FOR the third year in a row, most super funds have posted a double-digit return. Like John Howard, they just have to be there and everything else falls into place. Can they do it for a fourth time? Can John Howard?

Probably not, though I don't know about Howard. The average super fund is likely to post a return of 15 to 16 per cent, which is no guarantee that yours will, and all of that occurred in the first nine months of the financial year. In the past three months the wheels, while not falling off, were definitely getting very wobbly.

Investment consultants Intech estimated super funds were running at almost 17 per cent until the end of March. Then the funds dropped an estimated 4 per cent, clawing back 2 per cent just in the nick of time by June 30.

It's also worth bearing in mind that the sharemarket's big gains were in the first half of the financial year.

Still, most funds have more than made up for the back-to-back drops in 2001 and 2002.

The benchmark

Indeed, if the figures are to be believed, your super fund should have grown 45 per cent over the past three years just from what was already in it, let alone new contributions.

I'm guessing here, but I'd say your fund hasn't grown by that at all. So what's going on?

The trouble is there's no such thing as an average super fund. Well, there are probably a lot

of super funds that are average, but that's different. The benchmark used is a so-called balanced fund, which is usually the default if you don't tick the box as to how you want your fund to invest your money.

Even then, nobody can agree on what a balanced fund is. Some experts say it's a fund that is 70 per cent in shares and 30 per cent cash and fixed interest.

Others are stricter, saying it should be a 50/50 breakdown. A conservative, risk-averse investor might even say 40 per cent shares is enough, while a risk taker might think 80 per cent shares is conservative enough to be called balanced.

The point is that this benchmark might not look like your fund at all.

You might even have a conservatively managed all share fund which would have returned 70 per cent more than the average balanced fund. Or, a conservative fixed interest fund that would have done 50 per cent worse.

Neither fund is necessarily better or worse than the published average. It could well suit what you want for your age and where your finances are at. They're just different.

In fact, the differences within funds between one supplier like BT or AMP can be greater than between each other. So if you're not getting the published benchmark and wish you were, look at the asset allocation of your fund.

The problem is more likely to be fixed by switching between funds from the same supplier, rather than changing brands altogether.

Mind you there are two exceptions to this rule.

It's well known that the returns on industry or union-run funds have been higher than retail funds offered by the BTs of the world.

That's mostly because of the difference in fees. But

don't think industry funds are always cheaper, just because they're not for profit.

Many employer offered funds at least match the low fees of industry funds and have the bonus of offering better insurance as well, research by Chant West shows.

Remember industry funds have to use professional fund managers who charge a fee, irrespective of who they're working for.

The other reason industry funds have been out-performing most well-known funds is that they've tended to stay clear of global, especially US shares, and put more into infrastructure stocks.

That advantage may be no longer. The smart money is chasing global equities, and infrastructure is being knocked by rising interest rates.

Even so, I'd put my super on any fund with low fees. Especially since a study by Morningstar which looked at how much of a fund's out-performance was due to skill, and how much to luck.

The answer is luck is more important. "At best, only 43 per cent of funds that beat the benchmark in a particular category also demonstrated skill. In some instances, none passed the test," the study said.

It also found that poor performing funds are more likely to stay that way than over performers.

Instead of comparing your fund with an average that either doesn't exist, or is the wrong fund for you, there are always indices like the All Ordinaries index for shares or the MSCI world index for international shares.

The trouble is that most super funds have a mix of shares and bonds or cash, so you're not comparing apples with apples.

Unless it's an index or passively managed fund, its job is to duplicate slavishly whatever index it is following.

Sometimes an index fund will even beat its own index. Vanguard bears the listed property trust index it follows because its clout in the market affords it discounts from trusts seeking capital, says Morningstar.

But most super funds are actively managed. As a rule super funds aim to return 3 or 4 per cent above the inflation rate, after taking out fees and the 15 per cent tax.

In a booming sharemarket with inflation below 3 per cent that hasn't been hard.

In 2005-6 they only needed 6 or 7 per cent when the sharemarket soared 24 per cent. Not that they would have tried to pull that one on the punters.

True, a 3 per cent real return a year doesn't sound all that challenging. But being super it adds up over time, especially when 9 per cent of your salary is being paid in as well by your boss.

SelectingSuper's calculator at www.selectingsuper.com.au shows that \$10,000 in super for a 20-year-old starting out on \$20,000 a year, and staying on that for the next 45 years, will grow to almost \$185,000 by then with a 3 per cent return.

As it happens, the preliminary returns for 2005-6 suggest that Australian share-only funds have beaten the index by an extra 2.4 per cent, with an average return of 26 per cent.

Volatility

Frankly, if your super fund comes anywhere near that you should be worried.

It's taken risks that might not be suitable for super, especially if you're close to retirement or you're already drawing down an allocated pension.

A well-run, share-oriented super fund - say with 80 per cent shares and 20 per cent fixed interest - will have returned about 18 per cent in the year to June 30 if First State Super in NSW, the fifth-biggest fund, is any guide.

Balanced funds, usually the default option if you haven't nominated an asset mix or were never asked, should be earning about 15 per cent.

A half and half fund, 50 per cent shares and 50 per cent bonds, will have earned about 11 per cent.

If an unusually high return isn't a fluke, it's because a fund is concentrated in one part of the market. Any fund that had a swag of resources stocks, especially the heavies BHP Billiton and Rio Tinto, would have out-performed the market.

But resources are cyclical. When commodity prices come down to earth, eventually those funds will have disproportionately bad returns.

A fund manager who trades stocks a lot is also likely to outperform. Again, this will mean a worse performance in market downturns.

I suspect most super fund members would prefer consistent, even if unspectacular, growth year in and year out.

By the way, a highly traded share portfolio could also mean a higher tax burden.

No super fund worth its salt should be paying the 15 per cent super tax. That's because blue chip shares pay fully franked dividends which come with an automatic tax break of 30 per cent. The excess 15 per cent is even refunded by the Tax Office.

Outlook

The super money trail is moving offshore, judging by recent comments by fund managers.

Both Mercer Consulting and Russell say international shares are the first preference of fund managers. There also appears to be growing interest in commercial property.

After three good years in a row they think the sharemarket can't get better than this and, in any case, there are some bargains overseas.

Whether this can bring a double digit return again is debatable. Not because it's the wrong move, but because it's a tougher global economy out there.

For one thing interest rates are higher and, in Japan's case, rising for the first time in years.

That isn't all bad for super funds, mind you. Just mostly it won't help share or bond markets, or for that matter property, but it'll boost returns on cash and short-term deposits.

Also bear in mind that 2005-6 was one of those rare years where every major asset class grew, albeit at very different rates.

Rising rates makes a repeat of that unlikely.

Having risen the most, Australian shares seem the most vulnerable to a rate rise.

Fund managers are "polarised" about the outlook, said Peter Gunning, Russell's chief investment officer for Asia Pacific.

"Approximately three in 10 managers are bullish on the outlook for domestic equities over the next year, compared with four in 10 who are bearish," he said.

The big unknown is how long the resources boom will last.

Since China is growing at a breakneck pace - and breakneck is the word for it - thanks to Americans buying its products, anything that undermines the US economy will ricochet on us.

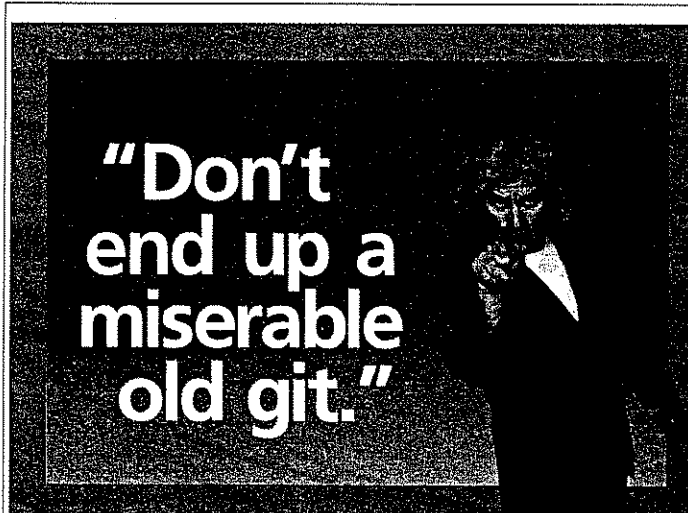
The good news is this is the same fear economists had a year ago.

The bad news is that since then US interest rates have almost doubled and oil prices have jumped more than 30 per cent.

> BLOCKBUSTERS

Fund	Type	Can anyone join?	Net performance to 30 June 2006*					
			1 year	Rank	3 years	Rank	5 years	Rank
1 NSW Bookmakers' Accumulation Fund - Accumulation	Master trust	Yes	18.8%	1	15.0%	3	13.0%	1
2 Telstra Super - Balanced	Govt fund	No	16.9%	2	14.9%	4	8.3%	4
3 Great Southern Super - Growth Strategy	Master trust	Yes	15.8%	3	16.2%	1	8.6%	3
4 Australian Meat Industry Super Trust - Balanced	Industry fund	No	15.8%	4	16.2%	2	9.9%	2
5 Perpetual WealthFocus Super Plan - Perpetual's Balanced Growth	Master trust	Yes	15.5%	5	14.8%	5	6.9%	7
6 MLC MasterKey Superannuation - Horizon 5 Growth Portfolio	Master trust	Yes	15.5%	5	14.0%	7	5.6%	10
7 AUSCOAL Super - Main Fund	Industry fund	No	15.1%	7	13.9%	9		
8 CBA Officers' Super Fund - Mix 70	Corp fund	No	15.0%	8	13.1%	13	7.3%	5
9 EISS - Diversified	Govt fund	No	15.0%	9	13.2%	12	6.6%	9
10 LGSS - Pool A - Diversified	Govt fund	No	14.7%	10	13.8%	10	6.8%	8
SelectingSuper Default Option Index			14.0%		13.1%		7.2%	

*Early released results only. Source: www.selectingsuper.com.au. Assumptions for investment performance: figures shown are net of tax, net of investment management fees and net of the maximum applicable ongoing management fees.



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