



Episode 7: Episode Seven - Portfolio Management for the most important group of investors - SMSF and Managed Accounts

In this podcast **John McIlroy** of **Crystal Wealth** and **Nicholas Ali** of **SuperConcepts** will be discussing:

- Who is starting SMSFs and what are their motivations?
- Who is making the investment decisions once the SMSF is established?
- Relation of the SMSF strategy to the mandate for the managed account portfolios
- Incorporation of other assets into the way the portfolio is managed
- Role of ESG in SMSF portfolios
- Advantages of using managed accounts for SMSFs
- What are main assets in SMSF and what is missing?

Moderated by David McDonald, CFA - IMAP Investment Specialist

Jenny Phimleut - IMAP: 0:01

This podcast is not meant for retail investors but instead is meant for financial advisers and investment professionals advice Please refer to IMAP's website for more details www.imap.asn.au Welcome to this podcast in the IMAP independent thought series.

David McDonald - IMAP Today, we are looking at portfolio management for the most important group of investors SMFS and manage. It's my pleasure to welcome here today to talk about this John McElroy from Crystal wealth and Nicholas Ali from Super Concepts. Welcome to you both. Nick if I can start with you, can we just talk first of all, about who do you see starting SMSF at the moment? What sort of trends you're seeing there? What groups of people?

Nicholas Ali - SuperConcepts: 0:51

Yeah, thanks, David. So the groups of people that we're seeing set up a self-managed superannuation fund that 35 to 49 cohort. So it's gen X that are the ones setting up the self managed superannuation funds. I guess that my generation, that generation we've had some form of superannuation contributions, our whole lives. And at around about that age, especially if there's a spouse with a similar level of money and super... around about that age, people have enough money in superannuation to justify the costs of an SMSF.

Given that the cost of an SMSF tend to be fixed, and probably at that point in life where they're thinking about building their retirement savings. And so they're probably more engaged than they were when they're in their sort of mid to late twenties. That's the group that we see setting up self managed superannuation funds.

David McDonald - IMAP: 1:51

And do you think the, the main reason behind it is a control one or is it an interest in investment? or what do you see as the main drivers?

Nicholas Ali - SuperConcepts: 2:02

There's a couple of key main drivers. Certainly one is an element of control. They want to be able to invest in the things that they want to invest in. So that's, that's a key driver. The other is transparency. They want to be able to see what they're investing in sometimes through an APRA regulated fund, it's a little bit of a black box. You don't necessarily know exactly what you're investing in and also flexibility ...the ability to perhaps be more nimble than their industry fund or the like, and also a broader selection of investments.

David McDonald - IMAP: 2:41

Right. And John are you seeing it as a growing area for your clients more and more setting up SMSF or is it a fairly steady part of the business?

John McIlroy - Crystal Wealth: 2:53

Yeah, it's probably a fairly steady part of the business, but you know, apart from the points that Nick has made around control and transparency, I think there's also increasing numbers of people that are looking to be more aware where their super is invested. If you compare a self-managed super fund where you have complete transparency of the investments, and you compare that to someone who might have, you know, a reasonably, reasonably sizable amount of money in a industry, my super account, where they've really got not a lot of clues to where the money's invested.

We're finding that people, particularly those more interested in ESG issues, are looking to have more transparency about where their money's invested. I think the other thing for us is, we deal with some fairly complex structures in terms of more so at the retiree sort of age where you've got people, maybe husband and wife in a fund both of them with a pension account they might exceed the transfer balance cap, so they've got an accumulation account.

They might even have the need for estate planning strategies that might have multiple pensions as well. So they could have three or four different accounts each of them! And if you were doing that through a industry super fund you might have 4 or 6 different accounts.

David McDonald - IMAP: 4:30

And does the managed account help in that sort of situation? Does it makes it easier to run the SMSF?

John McIlroy - Crystal Wealth: 4:35

Yeah, because you really still end up with one pool of investments and that's, so you can cater for all of those different pension and accumulation strategies, but still do it through one of investments, and that software and managed account.

David McDonald - IMAP: 4:51

Okay. So we've seen that Nick is suggesting more of perhaps younger people getting keen to set up SMSF's, and obviously the older people are already there, perhaps. And I guess the question then is once it's set up and running, who do we see making the investment decisions generally are they outsourced or are they tending to do it themselves?

John McIlroy - Crystal Wealth: 5:14

Yeah, I think, unless they're looking at setting up a self managed super fund for a specific investment, which could be, you know, a property or something business asset it's pretty rare to find someone who then wants to be able to have full power over the investment choices and just spend a lot of time selecting which stocks to buy that sort of thing.

There's not many people that really want to do that, but, by using a managed account in conjunction with a supplement fund is when you get that control and transparency. They're not spending hours and hours and hours on the research, investment side, you know, and MDA structure, which is what we use, serves that really well.

David McDonald - IMAP: 6:02

Okay. And how do you sort of align the strategies for the different SMSF's within the, you know, the model portfolios that you might have for managed accounts?

John McIlroy - Crystal Wealth: 6:14

Yeah there is obviously a requirement for the self managed fund to have a SMSF related investment strategy document. Quite specific as to what that's going to cover, but generally speaking, those strategies are very broad. You might have an asset allocation range right from zero to a hundred. So, that you don't have to change them all the time, but the thing when you get to and MDA investment in this program, which you have to have that has to be a lot more detailed and has to be quite specific to the risk profile that the client is engaging you to, to perform.

What we do is we have the MDA investment program and the system related strategy, document points for that.

David McDonald - IMAP: 7:02

Okay. And presumably once the strategy is set up, it's not likely to change significantly, is it unless you know, that people move into retirement phase or some sort of major change

John McIlroy – Crystal Wealth: 7:14

Yeah, I think it can and in our experience that those strategies can change in the investment program and that be either you know, increasing risk or decreasing risk. So. The way that we do that is we regularly review the risk profile. Some of them, you know, may increase the risk, so they might go from a balanced strategy to a more assertive strategy or from a balanced strategy to a moderate strategy

David McDonald – IMAP: 7:42

What do you see as the main assets that are sitting in SMSF because we often read that people have Aussie shares and cash and not much else, or do you see people with generally more diversified investments than that. Or do you think there are asset classes that are often missing?

Nicholas Ali - SuperConcepts: 8:13

What we see is it's a fairly good spread. Obviously there's, there's a, a leaning towards Australian equities inside self-managed, superannuation funds, probably overweight cash as well. And as John alluded to before, sometimes the driver to set up a self-managed superannuation fund might be a medical professional, looking to get their practices into the fund or, or primary producer looking to get a primary production property into the fund, but we're seeing more and more as more people take up separately managed accounts, we're seeing a greater spread or a greater diversification across asset classes. You know, one of the key ones. International equities. People are, or trustees are taking up international equities.

And I guess that's one of the beauties of an SMA is you've got somebody that's sitting there putting together the portfolio and managing that portfolio so we are seeing a diversification of assets across the asset classes in self-managed superannuation funds away from the big three property cash and Aussie shares.

But they are probably lagging behind in the international equity space than the newer traditional model portfolios through an APA regulated fund.

David McDonald - IMAP: 9:32

Right.

John McIlroy - Crystal Wealth: 9:33

Yeah. and particularly when you see SMSFs that are directly invested in stocks, they'll be disproportionately weighted to the banks and the miners.

Nicholas Ali of SuperConcepts

John alluded to before, that sometimes the driver to set up a self-managing superannuation fund might be a medical profession or looking to get their practices into the fund or primary producer looking to get primary production property into the fund but we're seeing more and more as more people take up.

Separately managed accounts. We're seeing a greater spread or a greater diversification across asset classes. You know one of the key ones is international

equities people are or trustees are taking up international equities. And I guess that's one of the beauties of a SMA is you've got somebody that's sitting there putting together the portfolio and managing that portfolio and people like that, so we are seeing a diversification of assets across the asset classes in self-manning superannuation funds.

Away from the big 3 property cash and Aussie shares ah but they're probably lagging behind in the international equity space than the traditional. Ah, you know like model portfolios through an APRA regulated fund.

David McDonald

Right

John McIlroy - Crystal Wealth

Yeah, and particularly when you see SMSFs that are directly invested in stocks that they'll be disproportionately weighted to the banks and the miners. Um, but that's what they know like Woollies and therefore they're getting a top 10 ASX experience or top 20 I'm not getting the diversification across different asset classes and as Nick said the area where they're underweight and traditionally been underweight is in the international equities, which when you look at the statistics, international shares or US shares have been the top performing asset class at 7 out of the last ten years but yes SMSFs are typically underweight.

David McDonald

Right I mean one of the other things we hear from particularly like the industry funds and so on is they have big exposures to infrastructure Airports Toll roads and the like is that something you see in SMSFs. or is it something that's easy to put in you know alternatives private Equity Infrastructure hedge funds that type of exposures.

John McIlroy - Crystal Wealth

Yeah, there are plenty of alternatives out there to be able to invest in infrastructure funds. There's quite a wide variety of those. We currently use an infrastructure fund. In our portfolios at the moment, and also you know in the private equity space.

You know there's plenty of alternatives out there but generally you would need to be kind of a professional working in those markets or and investment markets to be able to. Identify that they exist and then be able to sort of research them to figure out you know whether they're suitable and how they fit in portfolios.

David McDonald

I guess that gets back to what you talking about earlier John with the you people setting up the fund but then handing over the professionals to look after it for them rather trying to do it themselves. Is that something you see much Nick? Exposure to those sort of other asset classes.

Nicholas Ali of SuperConcepts

I think it's an urban myth that SMSF's can't access infrastructure.

There are a lot of infrastructure investments out there and also it's not just a matter of having a particular type of fund in an SMSF when you look at a self-manned superannuation fund Client.

You're looking at the whole of the whole of their wealth wallet so they might actually have um income producing assets inside the SMSF because of you know things like franking credits or you know other exemptions on income that come with infrastructure funds and perhaps outside the superannuation fund.

They've got growth assets maybe in a family trust or held personally because they don't need the income they obviously that well they want that that capital growth so there are those assets.

Asset classes that are accessible through a self-managed superannuation fund and to John's point again, it's another urban myth that self managing superannuation fund trustees don't want help with regards to the management of their portfolio.

Most of them do want help. What they want is to be able to have that transparency see what's going on have experts that are running the SMA or an IMA managing that portfolio on an active basis and then so that's that investment aspect is taken care of by professionals by the planner by the fund manager for want of a better word and then trustees focus more on things of a strategic nature. So you know what type of contributions go in.

Nicholas Ali of SuperConcepts

Catch up concessional contributions to offset a personal accessible income in the financial year pension strategies a whole range of other things. So yeah, SMSF's are a very broad church.

John McIlroy - Crystal Wealth

Now the point David is that you know particularly for international equities by using managed accounts there's a lot more availability for self-managed funds.

David McDonald

Right

John McIlroy - Crystal Wealth

You know for instance, for the clients we have a global share model portfolio which sits under custody with direct shares, so they can access that whereas if you were trying to do that individually through an international brokering account. It will still be clunky to do it whereas you do it through a managed Account you can get exposure to those particular shares you know, very easily and at pretty minimal cost.

David McDonald

Yes, yes.

Nicholas Ali of SuperConcepts

Yeah, and that's a good point, I guess all boats rise when the tide goes up and a couple of years ago that was the case but now things are getting a bit choppy and the tides going out things like ETFs and you know your index funds, they do go down.

David McDonald

Sure.

Nicholas Ali of SuperConcepts

And what people want is somebody that's going to be able to manage that portfolio and take out the emotion and make a decision an investment choice that's based on fundamentals and data and that's what we're seeing again with that younger cohort coming through they tend to be driven along those lines and also the older generation as Australians live longer. We're seeing people having more growth assets in their self-managed superannuation fund because they need to have that growth because as a you know a 65 year old has still probably got two and a half decades to have that fund draw down in retirement.

David McDonald

Yes that's an important point I mean it used to be not long ago that they'd said once you're retired you have to put everything into something safe. But if you've got 20 to 30 years ahead of you that might not be so much the case.

I mean Nick you mentioned earlier about people putting you know, perhaps a medical practice farm or something like that into their self-managed super fund and I'm just wondering maybe John for you how would you look at incorporating things like that you know someone comes and they've got the fund but they own a commercial building or they work for a big company and they've got a huge shareholding.

John McIlroy - Crystal Wealth

Yes, the way that that we deal with that is that we can either isolate that asset from an asset allocation point of view or we can include it in the asset allocation decision and generally what we would do is say if it's a property for instance, that's an investment property. We would look at that... talk to the client about it ...see how they feel about it.

Do they think that's more of a defensive asset or was it more of a growth asset and then kind of mould the asset allocation of the fund around that. So if they had you know 50% of the fund in the property then the balance of the fund might be a little bit more aggressive than you would otherwise do because they think that's quite defensive so you know you can incorporate these things depending on you know what the client's trying to achieve and it can be done very flexibly.

David McDonald

Now I think one thing we sort of touched briefly on earlier when we talked about why people are setting up the self-managed super funds was I want you to know what's in them and having a little bit of control and I guess that gets us into the area of ESG and we very briefly mentioned that earlier and is that becoming a bigger focus for clients.

Do you think there are more people interested in the ESG criteria and wanting their super to be invested along those lines.

John McIlroy - Crystal Wealth

Yeah, look there's obviously a growing interest as we're seeing from the industry statistics in investing in responsibly invested or ESG or ethical portfolios, and it comes back to that point I was I was making earlier about people being more interested in knowing where their money is invested.

So we are seeing an increase in that, and the SMSF structure is perfect for that because you've got full transparency about everything that's in the portfolio.

You can do things such as you can either run a negative screen through an SMSF or you can use more advanced ESG processes right through to having Investments in impact investment styles. So you can do all that through an SMSF structure and obviously you've got to have a decent system to be able to sort of manage that but you can provide it and you know we've been providing that service.

John McIlroy - Crystal Wealth

we've been running responsibly invested model portfolios for clients for better than a year now and you know I found with my clients that about probably 40% of them have converted from our conventional portfolios to our responsibly invested portfolios which you know is a bit surprising. But we just provide it as a choice to the clients. So yes, the level of interest in it is high and I think you know particularly for someone who's got a self-managed super fund they've generally got a fair bit higher than the average superannuation balance so they are also a bit more interested in where the money's invested. And this kind of works perfectly for those type of clients.

David McDonald

And John how do you find what is available for screening and you know finding suitable investments is that something that's not quite there yet or yeah, there is enough out there to follow.

John McIlroy - Crystal Wealth

I think that it's evolving. There's enough out there to be able to do this adequately now and I'm sure that it'll improve a lot over the next three years so it's quite easy to do negative screens.

We have about 7 or 8 categories from alcohol tobacco gambling etc where you can just negatively screen out assets where they get more than 10 percent of their

revenue from any one of those activities. We then use this for direct stocks both locally and internationally and also for managed funds.

We use industry available data. Um, that is basically giving ratings to companies and funds across environment, social and governance sustainability scores and we've got some benchmarks so if a company produces a score above our benchmark then they are excluded from the portfolio selection. There's quite detailed things that you can use now. and it'll only get better in the future.

David McDonald

Nick is the sustainable ethical stuff something that you're seeing big growth in and more interest.

Nicholas Ali of SuperConcepts

As an administrator we don't necessarily see a specific trend in that way. But we are seeing people on a more macro level to John's point. the people that set up a self managed superannuation fund. They tend to be more engaged in their superannuation than people who don't, so they are looking for those sorts of things. But anecdotally we're not seeing a huge push in that particular space.

David McDonald

Okay.

John McIlroy - Crystal Wealth

Yeah I think it's really up to the advisory practice to develop some options for clients in this space, and then provide those choices to the clients.

Nicholas Ali of SuperConcepts

exactly yeah .

John McIlroy - Crystal Wealth

We certainly don't push it.

It's there as an option if they want to apply their personal values to what's sitting in their self managed fund

Nicholas Ali of SuperConcepts

Yeah, exactly that's the driver that that we're seeing.

David McDonald - IMAP

All right Thank you.... we've talked about who's setting up the funds and the reasons behind it and wanting to see more transparency and control perhaps and we've obviously seen that having managed accounts is an easy way to look after the money and making it easier for the trustees and the members of the funds to be more interested in ethical issues, which seems to be growing quite strongly.

Any other key points that we haven't discussed that you'd like to mention gentleman?

John McIlroy - Crystal Wealth

Look I think there's one point about using a discretionary service whether that is an SMA or MDA doesn't kind of really matter and that is the ability to do things quickly.

We operate under an MDA service. You know we could make a decision this morning to change a portfolio either take a stock out and but switch it for another stock. We can have that change applied across our all our clients' portfolios by this afternoon and their portfolio is updated when they log on tonight. Now if we weren't running a discretionary account. I mean we have no hope whatsoever of doing that. We'd need to send an ROA to the client .. then wait for it to come back.

Yeah I think that is a great advantage in terms of efficiency, and having the ability to produce a better outcome from a client than if they're not under a discretionary service.

David McDonald

Yes that's very important obviously a big advantage there John thanks for that.

Nicholas Ali of SuperConcepts

One thing we're seeing is that as the baby boomers are starting to get a little bit older, what they want is the ability to maintain their self managed superannuation fund but not have the onerous obligations - investment obligations as that's where SMA's and MDA's give them like an APRA regulated fund.

They don't need to worry about the nuts and bolts of the investing they can look at the big picture thing of going into pension mode or estate planning, binding death benefit nominations, re-contribution strategies that sort of thing while that investment process is being looked after by professionals

I think what potentially could happen and what has been happening traditionally is people set up or they're in an APRA regulated funded industry fund when they're young and they're working various jobs through university or wherever through their trade. They get to that point of 35 to 49 years old we've got a critical mass to have a self-managed superannuation fund.

They might look at having a property in there. They might look at other asset classes a core satellite approach SMA's being a core and perhaps they have some other asset classes. There's a more satellite approach then when we get to their 70's 80's..things like an SMA really take away that onerous investment decision.

So I think self-managed superannuation funds might be a fund of choice for older Australians where traditionally older Australians tend to wind up their funds because of the fact that they see those investment decisions as being a bit of a bind.

So what we're seeing is people using SMA's as a proxy for going back to "an industry fund with a third party trustee", I think that's going to be a trend that we'll see in the future.

John McIlroy - Crystal Wealth

Another aspect is that because using a managed account within this in a SMSF structure and the client retains legal and tax ownership of the assets.

So, you are capable of managing the tax outcomes of those funds in a way that you just don't get to do in pretty much any other structure, and particularly where you have some more complex strategies and where you've got pension accumulation. So, it's part tax exempt and part taxable and you can manage the capital gains particularly very well using a managed account within a self-managed super fund.

David McDonald

Excellent look I'm conscious of the time we've had a great discussion and really appreciate your inputs there. So, all that's left for me is to say? Thank you very much to **John McIlroy - Crystal Wealth** and **Nicholas Ali of SuperConcept** and we hope to have you back to one of the IMAP Independent Thought podcasts very soon. Thank you.