FUNDAMENTALLY SPEAKING

A simple explanation of the finance terms we all hear about but don't really understand

with **Rowan Jones**

Attitude towards risk a key calculating factor

If you've ever met a financial planner you'll know that within the first few meetings they'll have you answering a range of questions to determine what your attitude towards risk is. After this they'll probably categorise what type of investor you are. You might be classed a conservative, balanced, growth or even an aggressive investor.

Not only does your attitude towards risk determine what category you fall into, other factors such as your financial goals and investment time frame also come into it.

But when you start investing what is the actual difference between the categories? The answer lies in the asset allocation of your portfolio.

Asset allocation is the proportion of your total portfolio that you invest in different asset classes. Asset classes are things like cash, bonds, shares and property.

Importantly each asset class has different risk and return expectations. As always, the bigger the potential return the greater the risk.

Generally speaking the bigger your appetite for risk the higher your allocation to growth assets such as shares and property will be. On the other hand, if you have an aversion to risk you may invest a higher portion of your investments in defensive assets such as cash and bonds.

There is no perfect formula to work out what asset allocation is appropriate for you, because everyone is different. One thing most people tend to agree on is that the asset allocation you select is one of the most important decisions you make, even more important than the individual selection of securities you invest in.

Rowan Jones is an adviser with Entrust Private Wealth Management

Illustration: Don Lindsay

A super time to ask . . .

Q&R

with Nick Bruining

Q I am interested to see that the industry super funds are opposed to being included in the recently announced commission of inquiry and hope you might be able to answer the following queries. For the super funds that sponsor sporting teams such as AFL clubs and the like, who gets to party in their corporate boxes and how are these people selected? Given that the operation and investment decisions are ultimately being directed by the board of trustees, why don't super fund members have a say in who sits on those boards and their remuneration in the same way a shareholder has a say about company directors? Given that industry superannuation funds have grown to be worth $545 billion and technology has improved so much, why aren't the economies of scale and cost savings due to technology being passed onto members in the form of reduced fees? How can we be certain that the valuations used on some unlisted assets which support their supposedly superior earnings are in fact completely accurate?

R These are excellent questions but I can't answer any of them. I'd love to be able to consider taking clients to invest in what may well be some of the better performing industry funds. But their lack of transparency makes it difficult to other funds, including those operated by those dastardly banks and AMP.

Industry Super Australia's foxes in the hen-house advertisement.

The big boys have some duds that charge huge fees and provide bugger-all value, pushed by product floggers who deserve the full scrutiny of the royal commission. But the big boys also give us access to some really good Australian and international fund managers, with decent fees and really good, transparent investment choices. They are subject to warts and all disclosure.

With industry funds, what we generally have to rely on are half-baked comparisons from cheer-leading groups who create rankings based on the performance of funds with very different levels of risk.

A fund with more than 75 per cent of its assets in a growth setting is generally far higher risk than one with 60 per cent growth assets, but they both can still be described as balanced. They are compared like pears when they are really apples and oranges.

We are expected to have complete faith that the appointees of industry groups and unions are not themselves the foxes in the hen-house.

We're the last ones to begrudge Armani socialists and industry suits enjoying a day at the footy, but it is questionable whether this should be done with the savings of working Aussies.

This is not a real Q&A. It was a rhetorical question and answer by small-l liberal Nick Bruining, turned into a rant by union apparatchik and Your Money hack Neale Prior

Diversify – or be dammed

Wayne Leggett

We have a number of clients who would love to sell their rental properties at a price that didn't represent a substantial loss. If they had their time over again, almost every one of them would not have bought the investment property.

When asked what prompted the decision to buy, many say they acted on the advice of an investment property specialist.

Of course, what was lacking in this advice was a critical element — the objectivity of the adviser.

Asking someone in real estate if they would recommend property as an investment is like asking a stockbroker if they would recommend you invest in shares.

This is not to say that real estate is a poor investment; far from it. If you compare the long-term performance of residential real estate indices with their sharemarket counterparts, there's little in it.

This makes sense when you consider that, by and large, they're both driven by the same factors, supply and demand.

Where they differ significantly is liquidity. Unlike the share market, you can't decide to sell a property today and have your money in the bank two days later. What's more, you know what you're going to get for your shares before you offer them for sale.

With property, they say there are only two days when you know what a property is worth; the day you buy it and the day you sell it, with all in-between pure conjecture.

The liquidity of shares can be a big advantage in a pinch.

If you have $500,000 in shares, the equivalent of an average Perth house, you can sell a part of that portfolio almost any day you like.

However, you can't sell the third bedroom of your rental property if you need funds in a hurry.

A share portfolio never called its owner to complain that the toilet was blocked. And a share won't "stiff you for the rent" (dividend).

Another big difference between the two is diversification. Look at how most people invest in property.

Typically, they borrow 100 per cent of the aforementioned $500,000, usually secured by a mortgage on their own home, as well as over the rental property, and invest it in one piece of real estate in the same town in which they live and already own property.

Sometimes, they even buy in the same suburb as their own home. This breaks the first rule of investing; diversification.

So many people are not only happy to invest in this manner, for a lot of them, it's a goal, in itself.

Yet, somewhat paradoxically, if you were to suggest to them that they use a similar strategy to invest $500,000 in the share market, they'd think you were crazy, because to do so would be way too risky.

Every investment portfolio should contain a component of every asset class, with property being one. But there are easier, smarter ways to invest in property than borrowing $500,000 to buy a rental near where you live.

Wayne Leggett is principal at Paramount Financial Solutions