

2018 SMSF Insights Research Paper

Diversification in Self Managed Super Funds (SMSFs)

Prepared by Investment Trends
for BT Financial Group in partnership
with the SMSF Association



Foreword by Jo Moxey

BT is proud to be partnering with Investment Trends and the SMSF Association to bring you the 2018 SMSF Insights Research Paper on Diversification in SMSFs.



We share in the belief that a well-diversified portfolio together with the freedom of investment choice is critical to the success of your clients' SMSFs. As such we are committed to helping advisers with BT's market leading technology and tools to help achieve well-diversified SMSF portfolios for your clients.

BT Panorama's SMSF solution is designed to be simple to use and drive greater efficiency in managing SMSFs. Its comprehensive investment offering helps provide more value to your clients and your business while its collaboration tools help you work more closely with your clients and their Accountants and fund administrators.

Partnering with Investment Trends and the SMSF Association to bring you the 2018 SMSF Insights Research Paper reflects our commitment to supporting you and your clients. We know that you are the trusted partner in the wealth journey of your clients and we believe our guiding mission to help Australians 'prepare for their best financial future, forever' complements your value proposition.

We sincerely look forward to working together.



Jo Moxey
Head of Distribution
BT Financial Group

Foreword by John Maroney

The SMSF Association has always been an ardent supporter of SMSFs having well-diversified investment portfolios and has often acknowledged this is an area where many SMSFs could improve their standing.



The benefits of a well-diversified portfolio are numerous and well understood but front of mind for trustees should be the benefits of mitigating volatility and short-term downside investment risks and the long-run benefits of higher overall returns.

In addition to these benefits, it is widely understood by SMSF trustees and their advisers that legally diversification must be addressed under their investment strategy. This gives extra weight to the importance of considering diversification for SMSFs while balancing it with the freedom of choice and flexibility that is inherent to SMSFs.

This research strengthens the case that SMSF trustees and their advisers understand the importance of a well-diversified portfolio and is instructive in telling the story that achieving this important goal can be more difficult than first thought. The SMSF Association expects that the degree of diversification will improve as SMSF trustees increasingly become aware of their ability to gain exposure to different markets and asset classes through exchange traded funds and managed funds. In addition, as advisers find ways to educate their clients and bridge the gap between knowledge and taking action, we expect to continue to see SMSF portfolio diversification evolve.



John Maroney
CEO
SMSF Association

Contents

Methodology	5
Executive summary	6
Introduction	7
Section one Diversification, a top priority when selecting investments for SMSFs	8
Section two The challenges in creating a well-diversified portfolio	12
Section three The expectation of service and product providers	13
More information	14

Methodology

The SMSF Insights Research Paper on Diversification in SMSFs details the results of a short quantitative online survey of financial planners conducted between February and March 2018.

Total responses after data cleaning and validation:
n=163 financial planners, including RG146 compliant accountants and principals/business owners who personally provide advice to clients with an SMSF (referred throughout this report as 'SMSF planners').
The maximum sampling error (centre of the range) at the 95% confidence interval for this sample is +/-7.6%.

The breakdown of the total 163 respondents is as follows:

– SMSF generalists (1 to 20 SMSF clients)	110
– SMSF specialists (20+ SMSF clients)	53

Note that analysis of smaller subgroups will have a higher sampling error. Not all respondents were required to answer all questions. Some questions, therefore, have a small sample size for some segments.

Where relevant, we have drawn insights from a wealth of syndicated Investment Trends research, including research of SMSF trustees.

Unless otherwise stated, all statistics, data and graphs within this report are sourced from the Investment Trends and BT Financial Group, 2018 SMSF Insights Research Paper.

Executive Summary

SMSF trustees and the SMSF planners that support them recognise the benefits of diversification, but many SMSF portfolios do not remain sufficiently diversified.

Still, SMSF planners overwhelmingly regard diversification as a top priority when selecting investments for their SMSF clients, and many see it as a differentiator in their value proposition.

The majority of planners, however, find it challenging to create diversified SMSF portfolios.

Many SMSF planners recognise that even a portfolio containing 30 stocks may not provide sufficient diversification, and there is strong consensus that managed funds can help form the building blocks of a diversified portfolio.

Product manufacturers and service providers can assist SMSF planners alleviate barriers to greater diversification. Client-facing collateral and access to diversified portfolios are the key enablers.

Introduction

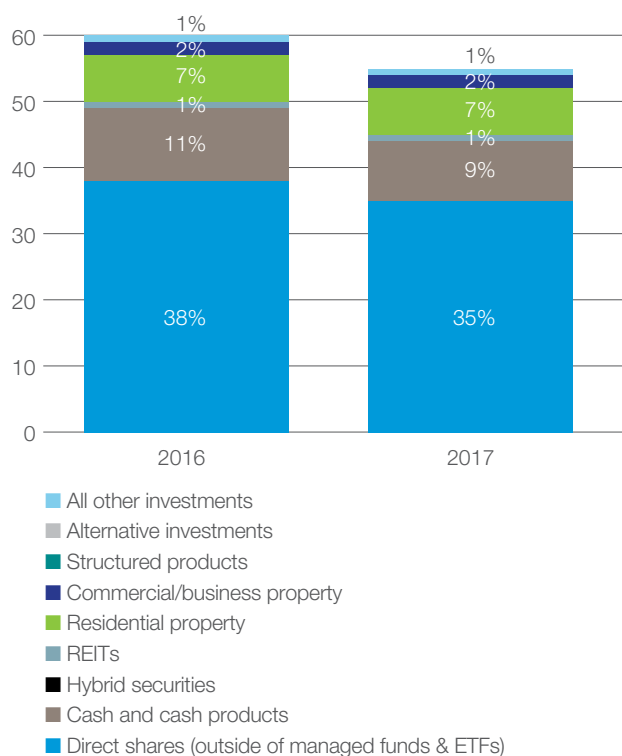
Choosing what investments to include in a portfolio is seldom an easy task. This endeavour bears even greater significance for Australians with an SMSF, since SMSF trustees are making decisions that may ultimately determine the size of their retirement nest egg and their income in retirement.

For the most part, SMSF trustees recognise the benefits of a well-diversified portfolio (83% agree that it is important to be diversified across a range of asset classes¹). But while knowing not to put all your eggs in a single basket is one thing, putting that knowledge into action is a separate matter altogether.

Individual direct shares have traditionally been a mainstay of SMSF portfolios, with the average trustee holding 18 stocks, on average, comprising 36% of their SMSF balance². But over the last five years, the allocations to managed funds and exchange-traded funds (ETFs) have gradually increased as more SMSFs recognise the benefits of attaining broad-based exposure to equities and other asset classes and markets.

Despite the reduced allocation to individual direct shares, SMSF portfolios remain highly concentrated. In fact, 55% of trustees say over half of their SMSF monies are invested in one investment type³, potentially exposing these investors to unnecessary levels of concentration risk (see chart).

Proportion of SMSF trustees who say over half of their portfolio is invested in one investment type



1, 2 & 3 Source: Investment Trends April 2017 SMSF Investor Report
 Graph source: Investment Trends April 2017 SMSF Investor Report

Section one

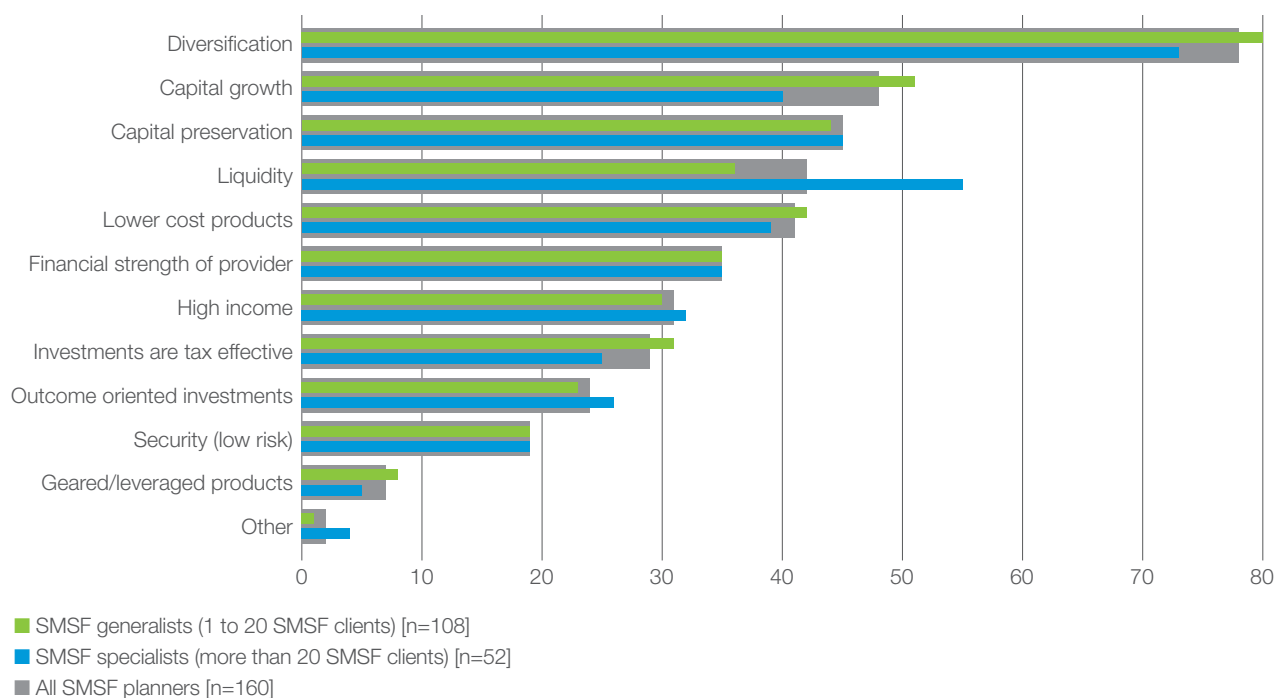
Diversification, a top priority when selecting investments for SMSFs

Financial planners overwhelmingly regard diversification as a top priority when selecting investments for their SMSF clients.

Financial planners continue to play a key role in servicing the SMSF market. Like SMSF trustees themselves, planners recognise the importance of constructing well-diversified portfolios. Across the industry, 69% of planners currently advise SMSFs in some way, shape or form, with a fifth servicing more than 20 SMSF clients each (a cohort described as 'SMSF specialists') and another half advising between 1 to 20 SMSF clients (or 'SMSF generalists').

Decades of research has consistently identified the importance of diversification in portfolio construction, and it is evident that financial planners strive to construct investment portfolios that meet their SMSF clients' needs and recognise portfolio concentration risk. Among planners who advise SMSFs, over three quarters say diversification is their top priority when selecting investments for their SMSF clients (see chart). Planners, both SMSF specialists and generalists alike, rank diversification ahead of factors such as capital growth, capital preservation, liquidity and product cost when selecting investments. This reflects the important role diversification plays in reducing concentration risk and generating returns for SMSFs.

In the next 12 months, what will be your top priorities when selecting investments for your SMSF clients?
(Multiple responses permitted) Among SMSF planners.

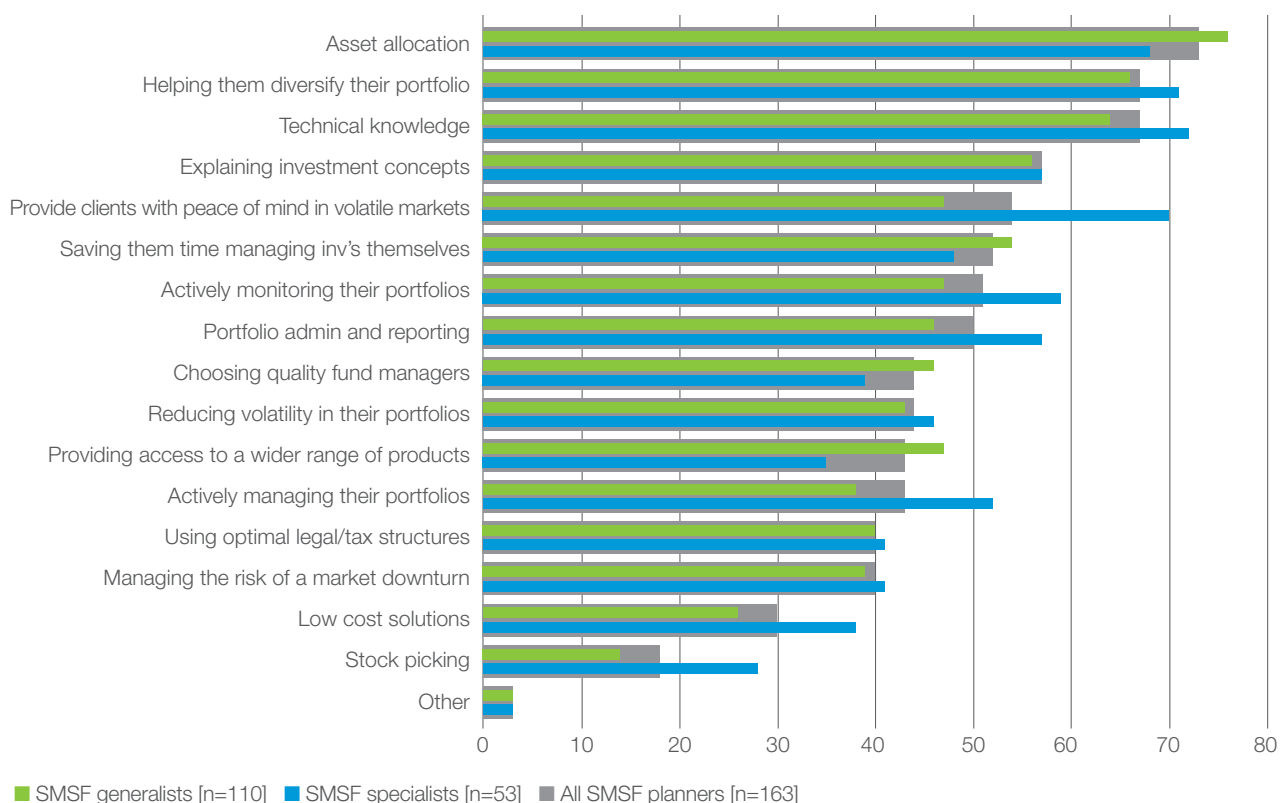


Not only do planners recognise the importance of a well-diversified SMSF portfolio, many see it as a differentiator in their value proposition.

When asked to list the most important investment-related benefits they provide SMSF clients, planners most often say they provide assistance with asset allocation decisions (73% cite this), constructing diversified portfolios (67%) and technical knowledge (67%).

Compared to SMSF generalists, specialists are relatively more likely to say they provide their SMSF clients with peace of mind during volatile markets, and assistance with actively managing and monitoring their SMSF clients' portfolios.

What do you see as the most important benefits you provide to your SMSF clients in relation to their investments?
(Multiple responses permitted) Among SMSF planners.



The majority of SMSF planners agree that managed funds form the building blocks of a diversified portfolio.

For SMSF planners, there is strong consensus of what a well-diversified portfolio looks like when presented with a range of options. Close to nine in ten (89%) consider a portfolio of managed funds, direct shares and property to be diversified, while 87% believe investments across four or more asset classes is ideal.

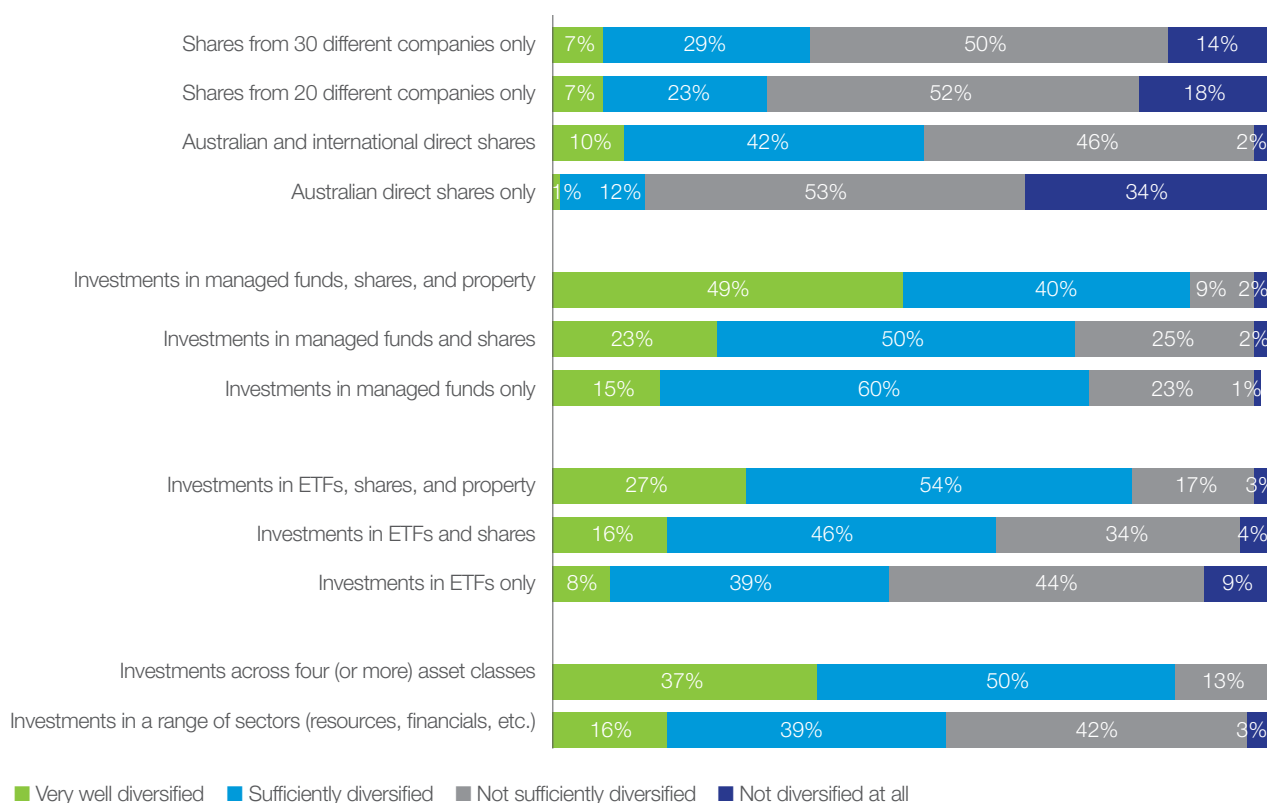
In addition, two in three SMSF planners (64%) recognise that even a portfolio of 30 individual stocks may not provide sufficient diversification. Many do, however, see the addition of international direct shares as a tool for diversifying a portfolio. Right now, currency risk and a lack of knowledge about international markets are two major hurdles contributing to a strong home bias among SMSF trustees (and retail investors for that matter).

The benefit of fully franked dividends and refundable franking credits is also an influential factor in many SMSFs favouring Australian equities, particularly those in the retirement phase.

While managed funds and ETFs can both equally provide access to a broad range of assets, under half of SMSF planners (47%) think that an ETF-only portfolio is sufficiently diversified. Conversely, three in four believe a portfolio invested entirely in managed funds meets their diversification needs. This perceived gap may soon recede as the adoption of ETFs among planners continues to rise, and the range of asset classes and strategies available through ETFs continues to broaden.

How well diversified would you say are each of the following portfolios?

Among SMSF planners [n=141].

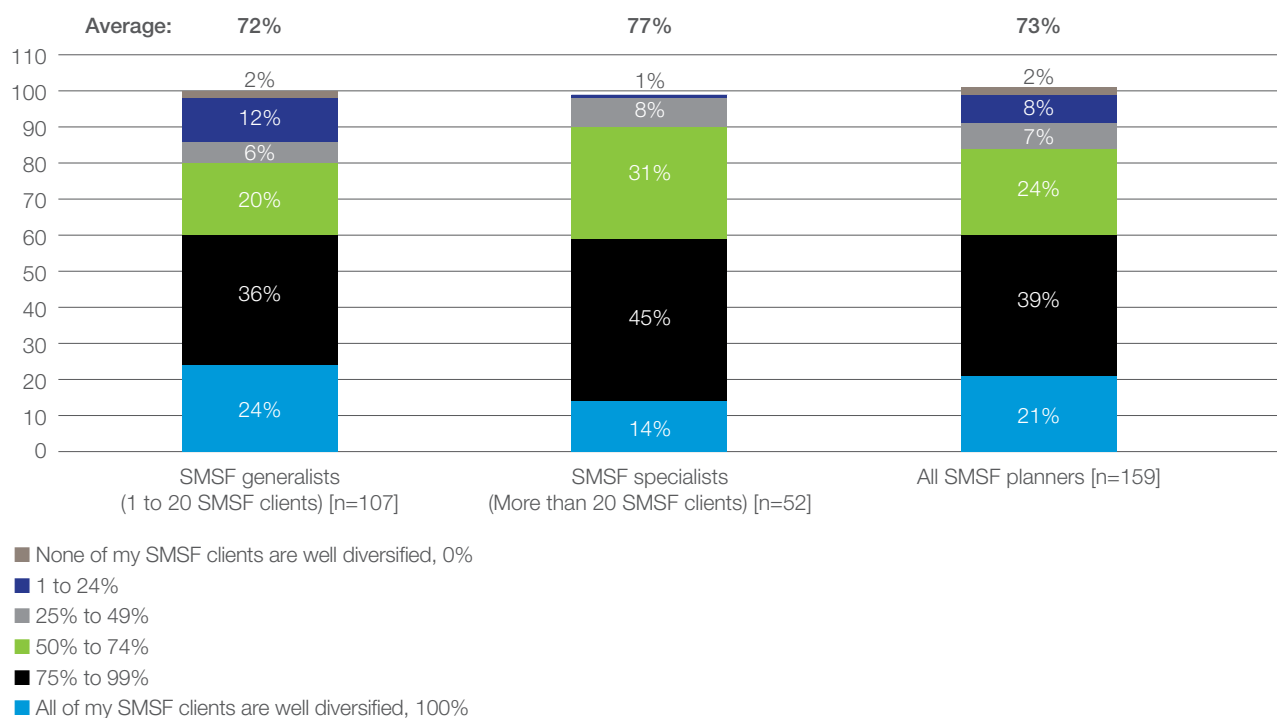


At the moment, only one in five SMSF planners consider all their SMSF client portfolios to be well-diversified.

Across their entire SMSF client base, planners believe approximately three quarters of their SMSF clients hold well-diversified portfolios (73%, on average). In other words, SMSF planners see opportunities to help the remaining 27% of their SMSF clients better diversify their investments.

SMSF generalists believe a smaller proportion of their SMSF client base hold well-diversified portfolios than SMSF specialists do (72%, on average, versus 77%).

Roughly what proportion of your SMSF clients would you consider as well diversified?
Among SMSF planners.



Section two

The challenges in creating a well-diversified portfolio

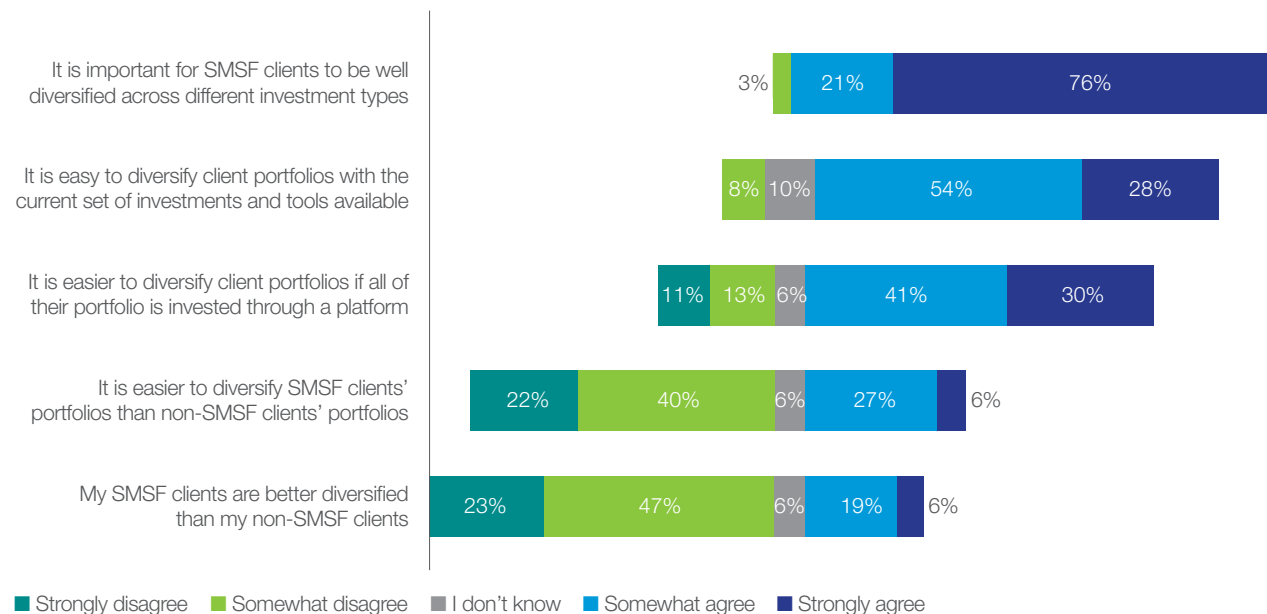
The majority of planners find it challenging to create diversified SMSF portfolios.

Almost all planners (97%) agree it is important for their SMSF clients to be well-diversified across different investment types. The vast majority, however, do not believe their SMSF client portfolios are better diversified than their non-SMSF clients.

Given that four in five SMSF planners (82%) believe it is easy to diversify portfolios using the current products and tools on offer, it appears the key perceived barriers to greater diversification in SMSF portfolios are not product-related in nature, which we will explore next.

This stems from the majority (62%) finding it more difficult to diversify SMSF client portfolios compared to non-SMSF portfolios. The role that property, especially business real property, plays in many SMSF portfolios can make it more difficult for advisers to construct diversified portfolios for many SMSF clients. Compared to specialists, SMSF generalists are more likely to find this a challenge.

Do you agree or disagree with each of the following statements?



Section three

The expectation of service and product providers

Product manufacturers and service providers can assist SMSF planners alleviate barriers to greater diversification. Client-facing collateral and access to diversified portfolios are the key enablers.

Close to nine in ten SMSF planners (89%) believe that product manufacturers and service providers can help them achieve their desired level of diversification in SMSF portfolios.

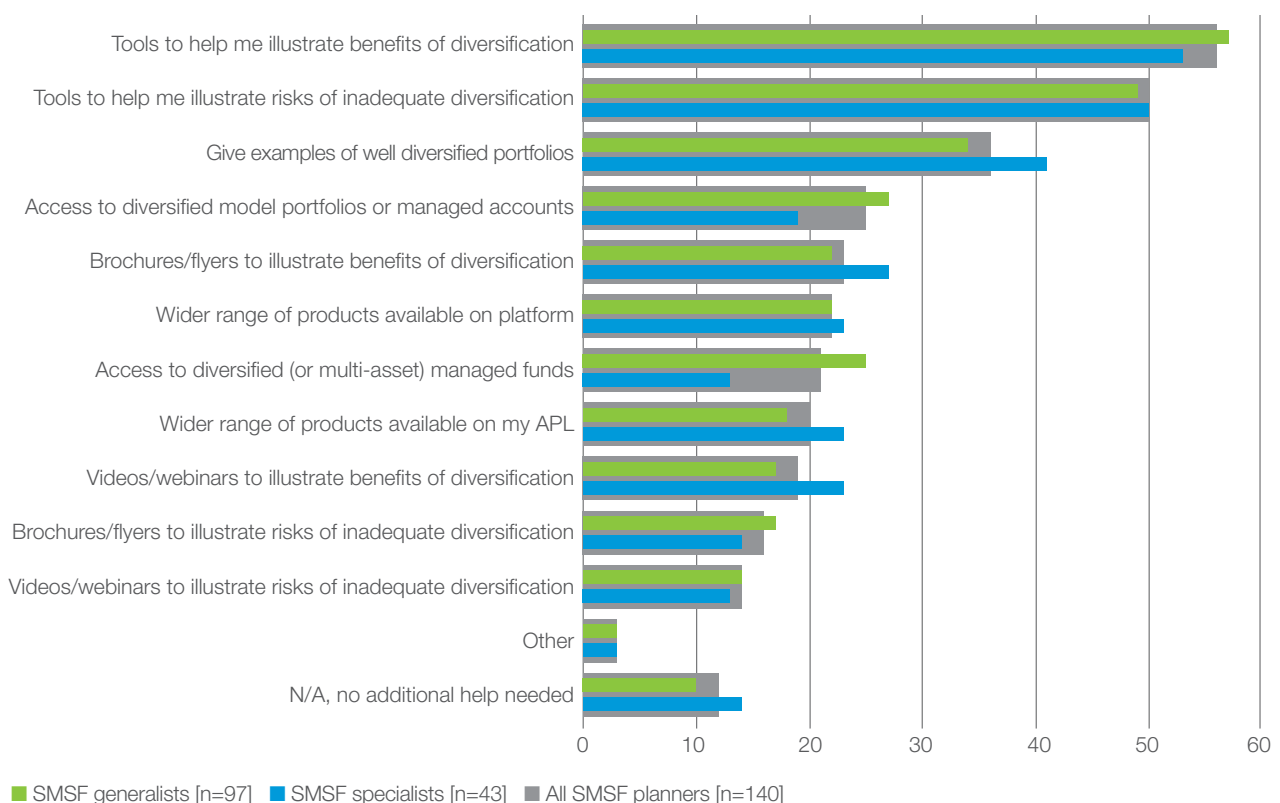
SMSF planners say that providers can assist most effectively by equipping them with client-facing collateral – illustrative tools that assist them in explaining the benefits of diversification, and risks of inadequate diversification, to their clients. In addition, many also seek examples of well-diversified portfolios and greater access to these portfolios (either through model portfolios or managed accounts). The rising adoption of managed accounts among planners further highlights their growing

priority to provide clients access to diversified, transparent and professionally managed solutions.

Actionable solutions are the key to addressing this important issue for SMSF trustees.

The vast majority of SMSF trustees understand the importance of a well-diversified investment portfolio, but they can struggle to convert this knowledge into an investment reality. SMSF planners and the service providers that support them can play a decisive role in addressing this problem by delivering products and services that help convert this knowledge into actionable solutions.

How can product providers help you achieve your desired level of diversification in SMSF client portfolios? (Multiple responses permitted) Among SMSF planners.



More information

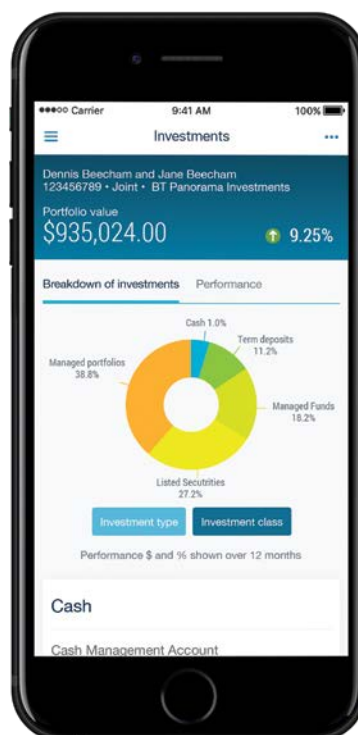
BT can help manage your client's SMSF.

The BT SMSF solution offers a smarter way to manage your clients' SMSFs more efficiently.

BT Panorama Investments is a comprehensive investment offer for your SMSF clients. Offering efficiency, simplicity, choice and flexibility. Plus a range of smart SMSF tools to help you keep your clients' SMSFs on track.

For more information

To discuss this report, your business or client needs, contact our SMSF team on 1300 784 207 or email support@panorama.com.au



For more information

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