NEWSLETTER MARCH 2015

WORDS OF WISDOM

The Sage of Omaha, Warren Buffett, produces an annual report for the shareholders in Berkshire Hathaway. It is the high point of the year for many financial people and his pearls of wisdom are always eagerly awaited.

This year has been no different. Chris Cuffe's newsletter Cuffelinks, has distilled 10 noteworthy pearls and I have repeated 2 below:-

Forget Market Timing & Forecasting

"Investors, of course can, by their own behaviour, make stock ownership highly risky, and many do. Active trading, attempts to "time" market movements, inadequate diversification, the payment of high and unnecessary fees to managers and advisors, and the use of borrowed money can destroy the decent returns that a life-long owner of equities would otherwise enjoy. Indeed, borrowed money has no place in the investor's tool kit: Anything can happen anytime in markets and no advisor, economist, or TV commentator – and definitely not Charlie nor I can tell you when chaos will occur. Market forecasters will fill your ear but will never fill your wallet".

My comment: Absolutely! Read this again and avoid the traps that catch the novices and unwary.

Difficult To Find Good Investment Managers

"There are a few investment managers, of course, who are very good, though in the short run, it's difficult to determine whether a great record is due to luck or talent. Most advisers, however, are far better at generating high fees than they are at generating high returns. In truth, their core competence is salesmanship".

My comment: Remember that the real experts know they don't know. Avoid anyone who says they can beat the odds. If it looks too good to be true it probably is.

QUO VADIS?

The Intergenerational Report has just told us what we already know, that we are living longer, having less children and grandchildren and in 30 years time there will **not** be enough taxpayers to support the pension system and subsidised health system currently enjoyed.

Our democratic political system is wonderful in that it'ss adversarial nature provides checks and balances, but it does not lend itself to providing bitter medicine. It's a bit like a dysfunctional family where the parents are so busy squabbling with each other that they forget to supervise and discipline the kids. The kids are happy to roam the streets unattended, but will suffer from the lack of education when they get older.

Anyone currently planning on retiring young, spending their super then going on the pension, or spending most of their super travelling "while they still can" can look forward to a longer old age on a decreasing pension without takeaway coffee (too expensive) and without access to timely, top quality healthcare, which will only be available to those with enough money to afford it.

The solution? – Don't leave it to politicians to plan for you, they don't. Save more (salary sacrifice for working people), spend less, plan to retire later or at least work part time (my plan).

USE SUPER TO BUY FIRST HOME?

I think it's a lousy idea, for a number of reasons.

Firstly, investment 101 and the Laws of Compound Interest teach us that, given equal contributions, the first quarter of contributions will be nearly half the eventual payout after 40 years, so using your first 10 years super to buy a home will reduce your eventual payout to not much more than half, and this is at a time when the Intergenerational Report tells us that in 40 years the poor will not get enough pension or quality healthcare.

Secondly, the increased demand for property will simply push the price of property up further, probably by the amount of the deposit which the young couple have just withdrawn from their super, so they've used the first 10 years of their super contributions to make a further unfair transfer of wealth from the young to the baby boomers, who own most of the overpriced property.

As a baby boomer owning property I can't complain. My parents' generation asked my generation to pay 2 to 3 times my annual salary for my first few homes, while we are asking our kids to pay us about 7 times their annual salaries for the equivalent property. Not very fair, but nice work if you can get it. Baby boomer property owners will be the first up to the guillotine when The Revolution comes.

WHY SPREAD INVESTMENTS?

I sometimes question my business sanity for spreading my clients' portfolios, as the more individual investments the more chance of one doing poorly and making my clients doubt my judgement and moan at me.

There are a number of reasons. The main one obviously is that if one accepts that The Future Is Not Ours To See, which I do, and some asset types will do well and some poorly in the short term, but you just don't know which will be which in advance, then the risk of putting all a client's money into one investment would be unacceptable.

So spreading between different asset types reduces risk. It also reduces the long-term return compared to having all the money in the asset type that actually does the best, but I have already accepted that I don't actually know which that is going to be.

A second reason is that if you had 2 asset types that produced the same return over time, say 10 years, but with different paths to get to that same point, then your overall risk, or volatility, has been **lower** for the **same** return.

Another benefit is that if one spreads quite broadly, say to sub-types such as small companies, that increases the chance that at any point of time at least one portion of a portfolio is doing well and is available for a drawdown, so on that basis one can have a bit less cash and bonds in reserve for drawdowns. This should increase the overall long-term return.

And you thought we were just sitting here drinking coffee and looking out the window, O.K., we do that too.

CHANGES TO ASSET ALLOCATION

I believe it is time to do some tinkering at the edges with my **standard** client portfolios.

I don't pretend to know which way investment markets are going to go, but there is clear past evidence that markets are cyclical, so if one is counter cyclical, by taking profits on what has done well and putting the proceeds into whatever has done less well, then the long-term return is better.

At the moment large companies (CBA, Telstra etc) are doing well in Australia, certainly better than small companies. On a Global basis large economies (US, China, Germany) are doing better than developing countries.

I therefore believe the time has come to add a bit to small companies and developing countries. I plan to recommend taking roughly 6% from bonds (fixed interest), 4% from Australian share index fund (mostly large companies) and adding 6% to Developing Countries and 4% to Small Australian Companies funds.

They are not big changes, but if being counter cyclical works as it has in the past, it should add some value going forward in the medium to long term.

We will attend to the change on our client accounts where we have authority, and will shortly send forms to clients where we don't currently have authority.

Kind Regards,

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Director

of a general nature and clients should take advice on their specific situation.