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Invest like Buffett? Diversification, Part 2

Ashley Owen

In Part 1, I challenged the conventional notion that diversification is the key to building wealth. In Part 2, I propose that sensible diversification is indeed critical for most investors, but not for 'building wealth'. Turning wealth accumulated over a working life into reliable, regular, inflation-adjusted cash flows for the rest of a retirement when a person is no longer working is a very different goal to 'building wealth'.

As demonstrated in Part 1, building a great fortune or even a modest fortune is almost always the result of concentration and focus, not diversification. Even the father of diversified index investing, John Bogle, built his wealth by concentrating all of his time, effort and money into building one great business – Vanguard. Most great wealth comes from building businesses, while more modest wealth generally comes from people's professions and careers. Either way the wealth is built primarily from 'human capital' - the time, skill and expertise of the individual, and by focusing that human capital on a particular business, profession or career.

Building wealth requires taking risks. To build wealth you start young, put everything you have into your specialised business, profession or career. It is high risk but you have plenty of time in front of you, no dependants relying on you, no expensive lifestyle to support, the flexibility to be able to fail a few times, start again and try new things, time to spend a decade or so investing in your skills and expertise to build your chosen business, profession or career. You can afford to take big risks when you are young and just starting out.

Turn what you've built into a reliable income stream

However, after having made your money by applying your human capital to your business, profession or career, sooner or later most people want to 'retire' (or are required by legal or physical limitations). That means turning what you have built during your working life into reliable, regular, inflation-adjusted cash flows to fund living expenses for yourself and your dependents for perhaps several decades. That is a very different goal to 'building wealth', and it does require sensible diversification and disciplined risk management. The role of diversification is primarily to protect the downside and limit losses when you are no longer willing or able to return to work to replenish the losses.

The problem is that many retirees and pre-retirees have a stated goal of 'building wealth' – which usually requires a high risk of failure if they take the types of risks they can no longer afford to take.

This perceived need to build wealth often stems from a number of motivations. In many cases their lifestyle aspirations have been set at unrealistically high levels, based on unsustainable boom-time asset prices, salaries and or bonuses. They look at the returns of say 8% per year from diversified portfolios and say, 'but that won't get me the 100 foot boat or the beach house in Noosa'. Indeed it won't, and so they go off chasing then next hot stock, leveraged structured product, or forex trading scheme or scams.

Other people are inspired by stories of vast fortunes built by people such as Warren Buffett, Richard Branson and George Soros and they now want to 'invest like Buffett' to build wealth with their retirement nest egg.

Many investors want to get back the wealth they 'lost' in the global financial crisis or through other failed investments when they sold out at the bottom or, sadly, in many thousands of cases, were sold out at the bottom by their margin lender or bank. If they lost half or two thirds of their money, they see it as a perfectly reasonable goal to want to double or treble what they have left in a few short years, to 'get it back'.

Building wealth like this is possible of course but it requires taking concentrated risks they probably can no longer afford to take.

Invest like Buffett - using other peoples' money

People say they aspire to invest like Buffett but let's see what that actually means. Many books and articles have been written about Buffett, and he has written annual reports to his investors since 1957 (freely available here). Essentially his method boils down to investing in just a few great companies that you analyse and understand in intricate detail, taking controlling stakes, or at least significant minority stakes in them so you can control or influence board decisions, especially CEO remuneration and capital allocation decisions of the company.

Buffett started out in the early years applying the principles of his professor and boss Ben Graham (known as the father of value investing) and other Graham disciples like Walter Schloss. This text-book approach involves diversification across a large number of companies bought below their intrinsic value, with little regard for the quality of management and little interest in understanding each business in detail. But Buffett very quickly switched from broad diversification to focus on a very concentrated portfolio of just a few great businesses he studied and understood inside out and intended to hold forever.

Buffett's transition from text-book Graham-style diversification to extreme concentration probably came in the late 1960s or early 1970s, marked by the purchases of GEICO (1972) and Washington Post (1973), and most certainly by the late 1970s, with Capital Cities (from 1977). We can see this shift in Buffett's approach when he quoted Keynes' view that there are "seldom more than two or three enterprises" worth investing in (1991 Berkshire Hathaway Annual Report p.15).

One extreme illustration of Buffett's view is his 1992 suggestion that if you were "going away for 10 years and you wanted to make one investment" and "you couldn't change it while you're gone", then you could be confident owning just one stock – Coca-Cola (quoted in Kilpatrick, '*Warren Buffett: The Good Guy of Wall Street'*, 1992, p.123).

That's all your eggs in one just basket. At that time Coke was 40% of Berkshire's portfolio and, yes the share price did rise by 130% in the 10 years following 1992. A huge bet but it paid off.

The main influences of this shift to concentration were probably Philip Fisher (one of Buffett's main mentors who used the 'put your eggs in one basket' metaphor repeatedly, and the idea that it is *better to own a few excellent businesses you know very well*), Bernard Baruch (*one cannot possible truly understand more than a small number of businesses*), and Keynes (*investment success comes from a very small number of great investments*).

Another key influence was probably Charlie Munger, who often used the eggs in one basket metaphor and ran a far more concentrated portfolio than even Buffett. The two met in 1960 and Munger joined Berkshire in 1978.

Buffett aimed to make just 10 investment decisions over his entire lifetime (Buffett quoted in Forbes, 25 May 1992, p.298, also M. Buffett, *Buffettology*, p.174). That really does focus the mind on concentrating on just a few big decisions, as in '*A few big ideas - small ones just won't do*.' (Berkshire Hathaway 1984 Annual Report p.1).

A retiree can't invest like Warren Buffett personally

The various books and articles on Buffett and the annual reports are about Buffett investing Berkshire Hathaway's funds (and the partnership funds prior to 1969), but Buffett's experience of investing his *personal* cash is even more concentrated, and impressive.

After Ben Graham retired and closed down his firm, Buffett went out on his own. He invested just $100 of his own cash at age 25 in 1956 and seven limited partners invested a total of $105,000 in cash into Buffett's first limited partnership, with Buffett managing the money as the 'general partner'. He built his stake in the partnership via the fee structure. The fund paid the limited partners 6% interest on their money plus 75% of the profits in excess of 6%, with the other 25% of profits above 6% accruing to Buffett's stake in the partnership.

When speaking of his and his wife's wealth in 1964, he said, "all our eggs are in the BPL [Berkshire Partnership Ltd] basket and they will continue to be. I can't promise results but I can promise a common destiny." (1963 Buffett Limited Partnership Report, 18 January 1964, p.6).

By 1969 his personal share of the partnership equity, by way of the investment management fee structure, had accrued to $25 million. He liquidated the partnership and distributed the assets to the partners. One of the main assets was Berkshire Hathaway, which was transformed into the holding company and he has controlled it ever since via his shareholding. Right from his initial $100 cash investment into the first partnership he re-invested all of his earnings and so all of his personal wealth was concentrated in a single venture (Hagstrom, *The Warren Buffett Way*, p.3).

So he didn't 'invest' his cash at all (except $100). His wealth was from his human capital. He has invested Berkshire's funds wonderfully well, but his own personal wealth was built by investing other people's money – the limited partners' money in his partnerships; the cash flows from insurance premia provided by the insurance customers of Berkshire's insurance businesses; and borrowed money. The return on his own $100 cash contribution in 1956 (plus 57 years of his time and energy) has been in the order of 40% pa compound per year. It is a fantastic return over more than half a century, but how relevant this is to the goals and needs of today's retirees?

Warren Buffett	Typical retiree or pre-retiree
☐ Apart from the $100 of his own money in 1956, invested other people's money	× Will be investing own money only
☐ Investment horizon is 'forever' - he buys companies he never intends to sell	× Start withdrawing cash from next month and then every month for the rest of life
☐ Buys controlling or large minority stakes so he can control or influence critical board decisions	× Buys tiny shareholdings only - no influence over board
☐ Analyses and understands every company in intricate detail before buying	× No time to study and analyse each company and probably does not have skills anyway
☐ Buys "when there's blood on the street"	× Panics and retreats to cash when the market falls heavily
☐ After strong rises, sits on cash and waits for falls	× After strong rises, fear of 'missing out', tends to fads, hot stocks and schemes
☐ Has never received a dividend	× Needs regular dividends to live off
☐ Receives a fixed non-inflation adjusted salary of $100k per year (out of which he reimburses the company for his use of company facilities)	× Needs regular cash flow to increase with inflation
☐ Has not had a pay rise for 25 years (not even for inflation)	× Needs cash flow to rise at least by inflation
☐ Giving his wealth away to charity anyway	× Will need wealth to live off
☐ Leads a relatively frugal lifestyle	× Would like regular holidays and some luxuries – "I've earned it!"
☐ Lives in the same old house for decades	× Would like to upgrade the house and/or buy a holiday house, and/or maybe a boat
☐ Drives the same beat-up car	× Would like new car every few years
☐ Is still working full time in the office at age 83 (and Charlie Munger is 89)	× Don't want to work full time in the office into late 80s. Wants to retire!

How is Buffett anything like a 60-year-old dentist, plumber, airline pilot or teacher who either cannot or does not want to work full-time anymore? It is the opposite of Buffett's concentrated approach to investing to build wealth. I thoroughly recommend reading book and articles about Buffett, and in particular the annual reports (and from others like Soros). There are many valuable common sense lessons that can be applied to everyday investing, <u>but it's important to recognise that we're talking about completely different goals and expectations.</u>

Building wealth requires concentration and focus and full-time hard work, but turning that wealth into reliable real cash flows for decades in retirement requires sensible diversification and disciplined risk management.

It is all a question of understanding each investor's individual cash flow requirements, their willingness and ability to bear risks, and then setting realistic goals and expectations about how to invest their money in order to maximise the probability of achieving those goals to provide peace of mind for themselves and their families.

The bottom line is that you can't invest like Warren Buffett if you want to retire and focus on preservation of capital.

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Give this risk the credit it deserves

Warren Bird

I find it ironic that the fixed interest risk that most people fear is market risk. The fact that when yields go up, bond prices fall seems to scare many investors.

It shouldn't.

The risk that bond investors should be most concerned about is credit risk. Only a credit failure can result in the permanent loss of capital and, potentially, a significant negative hit to a portfolio's total return.

Market risk does not produce a permanent loss of capital. When yields rise there is an initial fall in the mark to market capital value of bonds, but higher yields result in increasing returns over time. I've written about this over the years (including in past articles in Cuffelinks), so I won't become sidetracked by it again now.

Rather, this article discusses what credit risk and credit ratings are. In part 2, I will turn to the question of how credit risk can be managed so that it doesn't wipe you out.[1] The good news is that, although credit risk is the more serious investment risk in my view, it can also be managed so that the risks are well worth taking.

What is credit risk?

The credit quality of a borrower is the likelihood that they will fail to honour their obligations to make timely payment of interest and principal. The world is an uncertain place and no bond issuer – be they a company or a government – has a 100% guarantee of never failing to pay.

There are a lot of factors that determine a bond issuer's credit quality. There are financial factors, such as the amount of leverage an issuer has on its balance sheet. Issuers with low leverage have a stronger capacity to meet their debt obligations than highly leveraged issuers with low interest cover ratios.

The management strategy of the issuer is important. For example, strong risk management policies reduce credit risk, as does a clear and robust governance framework.

Finally, the industry in which a business operates is an influence on credit quality. Some industries are relatively stable, while others are volatile; some have a small number of well-established participants, while others are much more open to new start-ups taking market share from existing players.

What credit ratings are

One of the most commonly used tools in credit risk analysis is credit ratings. Most people have heard of ratings, even if only when our politicians talk proudly of how the government still has a 'triple A' rating.

There are many different ratings scales that can be used, but the table below provides an overview of the ratings framework used by most agencies and credit analysts. In this framework, AAA ratings are assigned to borrowers with an 'extremely strong' capacity to pay. As the capacity diminishes the rating moves to AA, then A, then into the B's.

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[1] Recommended reading for those interested in delving deeper includes the fulsome information provided by Standard & Poor's on their website, http://www.understandingratings.com/ or the overview found at the Australia Ratings' website http://australiaratings.com/corporateratingmethodology

Rating band	Risk description	Corporate examples	Default rate*
AAA	Capacity to pay is extremely strong	Johnson & Johnson, Microsoft	< 1%
AA	Capacity is very strong	CBA; Toyota; Nestle; Shell; Colgate	1.5%
A	Strong capacity, but some susceptibility to changed circumstances	Boeing; Coca Cola Amatil; Telstra; Wesfarmers	2.5%
BBB	Adequate capacity, but adverse changes likely to weaken capacity	Alcoa; Nissan; Kellogg; Toshiba	5%
BB	Currently has capacity, but would face major uncertainties if adverse business or economic conditions unfold	Ford; GM; Fortescue; Goodyear	20%
B	Currently has capacity, but likely to be impaired if adverse conditions unfold	American Airlines; Nokia; Levi Strauss; Wendy's	40%
CCC, CC, C	Currently vulnerable or highly vulnerable to non-payment of obligations	Clear Channel	60%

*historical average % of issuers rated in the band that default within 10 years, based on Moody's and S&P data.

It's important to understand that credit ratings are subjective opinions about an issuer's credit quality. They are an analyst's view, after considering the sort of factors mentioned above, of the issuer. Different analysts can have different views and there is no absolute right or wrong rating.

Also, ratings aren't set in stone. As economic and business conditions unfold, some issuers improve and may receive a credit upgrade, while others deteriorate and may be downgraded. In recent years, Wesfarmers has moved from BBB to AA, while Nokia has been downgraded from BB to B.

As a guide to the likelihood of default, ratings are more of a relative guide than an absolute probability. For one thing, the average default rates shown in the table above mask a great degree of variance year to year. Years like 2008 and 2009 saw above average defaults across the spectrum of ratings, while in many years there are very few.

What credit ratings are not

Finally, ratings are not an indication of the probability of losing capital if there is a default. Some debt investments have a high probability of default, but are secured against tangible and liquid assets that can be sold so that investors recover some of their capital. Others have a strong credit risk rating, but if a default occurs the recovery rate may be quite low.

It's also important to appreciate one thing they are not. Ratings are not investment recommendations. They are an input, but don't provide sufficient information to make a decision about whether to invest or not. This works both ways. AAA rated bonds are safe, but may be poor investments if they are paying a very low yield or if the recovery rate if there is a default is very low. On the other hand, while the credit risk of BB and B rated bonds (sometimes unhelpfully called 'junk bonds') is high, they are often excellent investments because of their high yields and reasonable recovery rates if there is a default.

The returns you make from investing in fixed interest are a combination of the interest you receive and capital losses from defaults. A high-yielding portfolio may provide an investor with as much as 3 or 4% above low risk portfolios like cash or term deposits. But if you experience a default or two you can easily lose more than 3 or 4%. This can wipe out the extra income you had hoped to receive.

Part 2 will address strategies for managing credit risk effectively.

Warren Bird was Co-Head of Global Fixed Interest and Credit at Colonial First State Global Asset Management until February 2013. His roles now include consulting, serving as an External Member of the GESB Board Investment Committee and writing on fixed interest, including for KangaNews.

Not all lifecycle funds are equal

David Bell

As the dust begins to settle on the MySuper product landscape (albeit with more rolled out until the end of the year), many have adopted a lifecycle strategy. And while retail groups seem to have dominated the push down this path they are not alone, with both corporate and industry funds using a lifecycle approach. However, it will become clear that not all lifecycle funds have been created equal. There are a number of key features which distinguish the different lifecycle offerings and they can have a significant impact on member outcomes.

Previously I have been a well-informed fence sitter on lifecycle funds (see "Are lifecycle funds appropriate for MySuper products?"). If pushed harder and given only a strict choice of whether or not to take a member's age into account when designing their underlying investment exposure, I would side on doing so. My greatest reservation remains that there are so many other personal factors to consider that lifecycle funds could be the intermediate technology before we develop a superior approach (some groups are already well down this approach which I call 'mass personalisation', particularly overseas). Undoubtedly, good advice based on someone's detailed personal situation usurps all systematic approaches, but is not a realistic proposition for the entire working population.

Here is a guide to the 'Big 4' differences and their impact. These issues are not isolated to Australia – these differences also occur in the US where lifecycle funds have greater prevalence:

1. The shape of the glidepath – The 'glidepath' is a simplified summary of the asset allocation through time. A glidepath is generally presented in terms of exposure to growth assets given age and typically steps down as retirement approaches, as shown in Diagram 1 below. The timing and size of the reductions vary, and as a result, these products will produce different lifecycle outcomes for their members. There is no exact answer on what is the optimal glidepath. All we can do is assess the research and reasoning that has gone into the design of specific products. One specific issue is whether the product is designed with an accumulation objective in mind or whether it is designed to roll into a specific allocated pension product with a complementary asset allocation – this is known as the 'to versus through' debate.

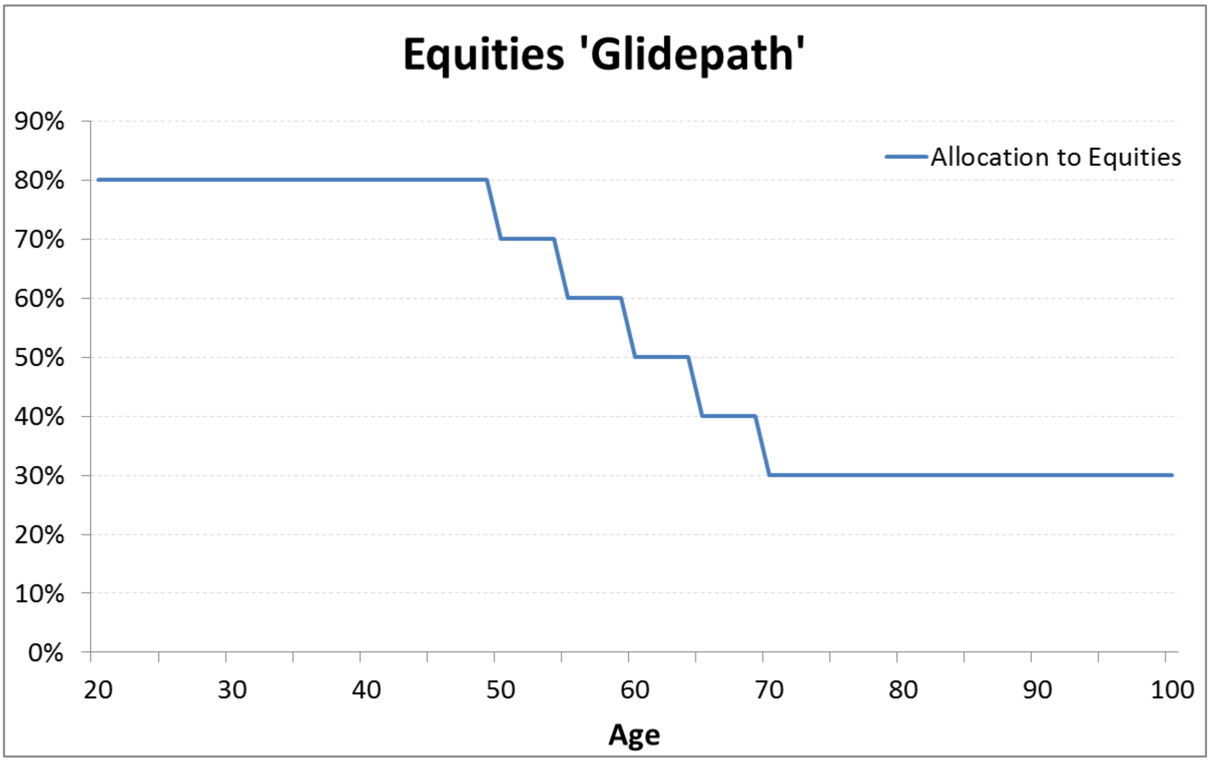

Diagram 1: Example of a glidepath.

2. Age cohorts (buckets) or personal administration – There are two options to administer the glidepath asset allocation. One is to group people into age buckets; each member of that cohort will have identical asset allocation. This is the most common approach, for example those born in the 1970's, 1980's, 1990's, 2000's etc. An alternative is to administer the lifecycle approach to each member individually. The latter approach has benefits – specifically, it avoids giving people at the extremes of a cohort group the same asset allocation. For example, in some products you may have a scenario where someone aged 51 and 60 have the same asset allocation. There is a risk that cohort or bucket administrative approaches dilute much of the complex calculations that have gone into the glidepath design.

3. Glidepath smoothness – Some glidepaths will make many small re-allocations over time while others may take a smaller number of large steps. This latter approach makes a sizable asset allocation switch regardless of the market fundamentals. Imagine a scenario where shares have fallen heavily and now look attractive but concurrently a lifecycle fund glidepath may reduce exposure to growth assets, locking in losses and removing the ability to participate fully in a recovery. This issue interacts somewhat with (2). A cohort approach with large steps can have a greater impact on lifecycle outcomes than a personally-administered approach with small increments.

4. Active asset allocation – Active asset allocation has become more prominent among super funds, particularly post-GFC where it became obvious that active management within underlying funds provided only a small buffer in difficult market environments. We can see the merit of active allocations in a lifecycle strategy where, as described in (3), transitions may occur at inappropriate times. Of course there is no guarantee that such an approach will work – not all active asset allocation capabilities are created equally either!

These are the Big 4 issues, but there other differences are emerging. Some groups are already considering how best to structure exposure to underlying asset classes through the lifecycle. Again the US provides good guidance to latest market trends. The design of lifecycle funds could be based on administrative capabilities (personally administered approaches likely cost more than a cohort approach), cost, research resources, and even a desire to keep it simple so that underlying members understand what is going on.

The design of a MySuper fund, where we have balanced funds and a range of different lifecycle fund designs, is a difficult area for an individual to assess. In front of each product there will be smart marketing messages. It is important that those groups who rate super funds are well-equipped to assess different super fund designs. They face a big challenge. Previously they compared funds, the large majority of which adopted a balanced fund approach, and this made for relatively easy performance comparisons. Now there is an extra dimension – fund design and member outcomes. Will these groups perform a deep assessment of the fund design, perhaps using proprietary tools to enable an objective comparison (and cut through the marketing materials), or will they just assess the high level issues considered in the design?

With MySuper we move into an age where the lifecycle approach is more prominent. Be aware that not all lifecycle funds have been created equal. It will be fascinating to watch advancements in this space, and how the groups which rate super funds adapt to the new environment.

Three things I've learned from Warren Buffett

Bill Gates (via LinkedIn)

I'm looking forward to sharing posts from time to time about things I've learned in my career at Microsoft and the Gates Foundation (I also post frequently on my blog.)

Last month, I went to Omaha for the annual Berkshire Hathaway shareholders meeting. It's always a lot of fun, and not just because of the ping-pong matches and the newspaper-throwing contest I have with Warren Buffett. It's also fun because I get to learn from Warren and gain insight into how he thinks.

Here are three things I've learned from Warren over the years:

1. It's not just about investing.

The first thing people learn from Warren, of course, is how to think about investing. That's natural, given his amazing track record. Unfortunately, that's where a lot of people stop, and they miss out on the fact that he has a whole framework for business thinking that is very powerful. For example, he talks about looking for a company's moat—its competitive advantage—and whether the moat is shrinking or growing. He says a shareholder has to act as if he owns the entire business, looking at the future profit stream and deciding what it's worth. And you have to be willing to ignore the market rather than follow it, because you want to take advantage of the market's mistakes—the companies that have been underpriced.

I have to admit, when I first met Warren, the fact that he had this framework was a real surprise to me. I met him at a dinner my mother had put together. On my way there, I thought, "Why would I want to meet this guy who picks stocks?" I thought he just used various market-related things—like volume, or how the price had changed over time—to make his decisions. But when we started talking that day, he didn't ask me about any of those things. Instead he started asking big questions about the fundamentals of our business. "Why can't IBM do what Microsoft does? Why has Microsoft been so profitable?" That's when I realized he thought about business in a much more profound way than I'd given him credit for.

2. Use your platform.

A lot of business leaders write letters to their shareholders, but Warren is justly famous for his. Partly that's because his natural good humor shines through. Partly it's because people think it will help them invest better (and they're right). But it's also because he's been willing to speak frankly and criticize things like stock options and financial derivatives. He's not afraid to take positions, like his stand on raising taxes on the rich, that run counter to his self-interest. Warren inspired me to start writing my own annual letter about the foundation's work. I still have a ways to go before mine is as good as Warren's, but it's been helpful to sit down once a year and explain the results we're seeing, both good and bad.

3. Know how valuable your time is.

No matter how much money you have, you can't buy more time. There are only 24 hours in everyone's day. Warren has a keen sense of this. He doesn't let his calendar get filled up with useless meetings. On the other hand, he's very generous with his time for the people he trusts. He gives his close advisers at Berkshire his phone number, and they can just call him up and he'll answer the phone.

Although Warren makes a point of meeting with dozens of university classes every year, not many people get to ask him for advice on a regular basis. I feel very lucky in that regard: The dialogue has been invaluable to me, and not only at Microsoft. When Melinda and I started our foundation, I turned to him for advice. We talked a lot about the idea that philanthropy could be just as impactful in its own way as software had been. It turns out that Warren's brilliant way of looking at the world is just as useful in attacking poverty and disease as it is in building a business. He's one of a kind.

Bill Gates is the founder of Microsoft and Co-chair, Bill & Melinda Gates Foundation.

A fundamental flaw in the Australian retirement system?

John Evans (from *The Conversation*)

Most Australians accept that during their working life, some earn more than others. But will they accept that the compulsory Superannuation Guarantee Levy system could deliver very different post retirement incomes to those who had similar pre-retirement incomes?

The Australian retirement system, consisting of the Age Pension, the SGL system and personal savings has one serious flaw that will only start to emerge once the system has matured in 2020.

Almost all analysis done on the retirement system uses 'on average' assumptions in relation to periods of contribution, investment returns, costs and period of retirement and usually concludes the system is 'adequate'. But this analysis fails to consider that over a typical working life of 40 years, a lot can vary. In particular, all SGL contributions go into some type of investment vehicle where the member's accumulated retirement benefit is a function of investment markets. Naturally, these include significant 'shocks' from time to time, such as the recent global financial crisis.

The consequence of investing SGL contributions in market-linked securities, regardless of the capabilities of the fund managers, is that workers are going to have very different retirement incomes depending on how 'lucky' they were in not being subjected to market shocks during their working life. My own research, conducted with colleagues, shows that even without any market shocks, the typical worker could end up with a replacement ratio (the ratio of post retirement income to pre-retirement net income) ranging from around 45% to almost 300%. With even a modest number of market shocks, this range could extend down to almost 35%, and that includes the Age Pension.

This range in post-retirement standards of living is highly likely to be viewed as unacceptable by retirees who have been forced to defer part of their income to retirement savings. This will not only create unanticipated demands for the Age Pension, but possibly social unrest.

The solution to this issue already exists and was a fundamental part of the industry fund philosophy when first established. The solution is to go back to the concept of the SGL contributions being invested in a common pool, but to credit the member account with an interest rate, much the same as occurs with bank deposits on a regular basis. The interest rates would reflect the underlying earnings of investments in the pool, but would be smoothed by creating reserves to balance the poor times with the good times.

This is not a new concept and has been practised in investment-related insurance contracts for many years. It is, of course, not perfect and if mismanaged can create problems and failures as it did with Equitable Life in the UK. But if properly managed, it can create much smoother returns to members of retirement funds and reduce the effect of market shocks and the impact of market volatility.

One of the reasons that industry funds abandoned this concept was that they were expanding very rapidly, and $100 worth of reserves at the beginning of a year had considerably less impact in smoothing returns during the year when assets doubled to $200. But industry funds are now much more mature and this issue can be managed.

The interest rate concept would create more significant financial risk for the Boards of superannuation funds, and greater financial skills would be required than are currently needed. But the result would be less volatile retirement benefits for members who are already pooling their contributions and are expecting some level of retirement income evaporation close to retirement. The regulation of superannuation funds would also need greater attention, but the regulator already has similar issues with the few remaining defined benefit funds.

A return to a more stable distribution of investment returns is socially desirable and will help to avoid the negative results of the current system. Without it, many people will find they reach retirement without much of the money that they thought they would have.

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