

This Week's Top Articles

- **Barnaby Wiener on preserving wealth and asset allocation** *Graham Hand*
- **Franking: what's in the industry fund tax pool?** *Graham Hand*
- **How can a super fund hold no cash or bonds?** *Damien Klassen*
- **Housing prices from black hole to blue sky** *Phil Ruthven*
- **5G mobile promises to connect and speed up everything** *Michael Collins*
- **SMSF borrowing ban is a solution in search of a problem** *Chauvel and Smith*
- **A new, client-centric model of advice** *Nathan Krieger*

Barnaby Wiener on preserving wealth and asset allocation

Graham Hand

Introduction: Barnaby Wiener oversees the MFS Prudent Capital Fund in London, which targets total returns over cycles by investing in a wide range of diversified assets. He has been at MFS for 21 years and is a former Captain in the British Army. This is an edited version of our discussion.

GH: You talk about the continuous balance between wealth preservation and wealth creation. Where are you at the moment?

BW: We're at the extreme end of wealth preservation, as our book is currently positioned as defensively as it could be. It's driven by our assessment of the opportunities arising from the risk and return opportunity available to us. And that is driven by a combination of valuation and an assessment of fundamentals, both at a micro and macro level.

Right now, generally, equities are risky relative to their history, and at a macro level, there are huge imbalances that have developed over a period of decades. It seems inevitable that until we actually address those imbalances, the system will become ever more fragile.

At the micro level, we see so many sources of disruption and threat for individual business models, partly driven by new technology. It makes it a challenge to find companies we have real faith in with respect to the durability of their cash flows and business model.

GH: Why do you place such importance on the 'principal versus agent' problem? It features at the start of your investment beliefs.

BW: The only person that matters is the principal when it comes to the investment. We're all operating on behalf of a principal, whether it's a wealthy family, or an individual with a retirement plan. There are so many layers of intermediation in our industry. Someone who's directly charged with the responsibility of managing money must have the mindset of what's in the interest of principal, the owner of the money.

The background to its prominence was my frustration with the constraints of traditional relative return investing and being measured against the benchmark.

GH: You have list of attributes that you look for in a company, but you admit that no company meets all these criteria. And there's no algorithm that allows for a trade off. With great companies such as Apple and Facebook, how does your investment process balance the risks? For example, the risk of regulation for Facebook, the risk that the next iPhone model might fall behind Samsung.

BW: We all struggle with it. It's fascinating that I can have conversations with colleagues looking at the same business through a similar lens but still coming out with a different conclusion. From our perspective, we've never been able to get comfortable with the sustainability of the Apple franchise, partly because it is so dependent on the next product. The value proposition means Apple products are extremely expensive. Yet I know the extent to which people are willing to sacrifice a huge percentage of their income on an Apple product.

We believe Facebook is inherently a more durable business model than Apple, because of the extraordinary platform as well as Instagram. There are negative aspects but I think people are locked in. It's an extraordinary tool for connecting with people and for advertisers to reach that target audience. For particularly small companies who don't have the means to advertise on traditional media like TV or billboards, Facebook and Google have given them a route to market that didn't exist before.

There are obviously concerns about how the internet is regulated, not just Facebook. We're being paid to take the risk, but nothing is ever clear cut.

We try to be disciplined and rational in our approach, but all decision making involves an element of gut instinct and emotion.

GH: You say that all equity investing has an element of guesswork, and yet valuation is your primary investment tool. How do you reconcile those positions?

BW: Actually, we spend much more time focusing on our assessment of the durability of the business, because there are lots of companies trading on optically-cheap valuations which we don't go near, such as banks and energy companies or companies that have challenged business models. Valuing bonds is a pretty exact science but valuing equities is not, because you don't own any right to the cash flow. So ultimately, we take a holistic approach, with a focus on sustainability.

GH: Some prominent fund managers place great emphasis on calculating the intrinsic value of a company, but you think DCF (discounted cash flow) analysis is too much guesswork.

BW: The financial world in general has become enslaved to the Excel spreadsheet, and I don't think that is ultimately healthy. Most of the things that really matter can't be measured in a cell in a spreadsheet. One example is corporate culture. I think it is one of the biggest indicators of long-term success in a business. You can't quantify that but you know when you see it.

This is a job that involves subjective judgment, with an overlay of a rigorous approach of questioning. But ultimately, we make judgment calls.

GH: All fund managers say they think long term, but they face pressures to perform in the short term. Where is the biggest challenge to long-term thinking strongest? Is it from your clients, your own self esteem, or from your company expecting you to perform well?

BW: I don't feel it's a significant challenge with clients. We've been clear about our approach and that there's a risk that we will be defensively positioned as the market goes up. I think clients understand what we're doing. They're not buying the strategy purely as an equity strategy, the volatility is much lower and our peer group is multi asset.

The internal incentive structure is designed to reward the longer term, and it helps to have been at the firm for over 20 years. The biggest pressure is probably self esteem. I can't completely detach myself and say it's just an academic exercise. I would like to get it right. It's frustrating when a strategy is wrong for a while.

GH: Also in your guiding principles, you talk about the need to know your own weaknesses. Are you talking at a personal level or a company weakness?

BW: It's more about being aware of personal biases. One's biases can be a good thing, but you need to be conscious of one's self knowledge.

GH: For many of our readers, the biggest challenge is the asset allocation piece, deciding how much to have in each asset class. What guidance do you have for someone with say a million dollars to finance their retirement?

BW: Firstly, what is their timeframe? The shorter the timeframe, the more liquidity they need. It also depends on the valuation of financial markets. If they buy into equities at peak multiples, they can take a long time to retrieve losses. Understanding the mathematics of compounding is also really important. If they lose half their money, they have double it to get back to the start.

You could say just invest and leave it there, and that's true in theory. But we can't divorce ourselves from our emotional response, and who's really willing to endure that kind of market volatility. It's all very well say, you got a million dollars fully invested, and in a bear market, it goes to \$400,000, that's alright because we're at the bottom of the market. The reality is, you're sitting there thinking, I've lost over half my money.

I think people should err on the side of conservatism, but that doesn't mean be fully in cash. Our investment strategy is trying to manage that on behalf of the end client. It's designed to give people peace of mind.

GH: What major insight does your experience as a Captain in the British Army bring to your investing?

BW: I think it's a broader perspective on life. The financial world can be in a bubble of its own making. There are many aspects beyond investing that show what one's values are. I think some people get wrapped up in the trauma of investment decisions, and it helps to be somewhat detached. The army was a very different experience to the one I'm in now.

Graham Hand is Managing Editor of Cuffelinks, and he met with Barnaby Wiener on 20 March 2019. This article is for general information purposes only and does not consider the circumstances of any investor.

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Franking: what's in the industry fund tax pool?

Graham Hand

A reader, Ian, wrote to us:

"An AFR article on 16-17 February, page 30, by John Wasiliev called 'How franking would work on industry fund options' says a direct share option in an industry fund is not part of the overall pool and therefore cannot use excess franking credits. I can't work out if this is right."

The relevant section from the AFR said:

"But when a member elects to make their own investment choice under a direct investment option that allows them to invest directly in any shares from the top 300 companies on the stock exchange, for example, they are no longer under the "pooled" fund.

They are instead invested as an individual on a separate platform where all dividends, imputation credits and tax liabilities are applied to that individual's portfolio. A platform is an online service that collects and displays information about investments."

Clarification by AustralianSuper

Cuffelinks previously addressed this issue in June 2018 with an article by [Tom Garcia of AustralianSuper](#). This week, Tom confirmed the position in his previous paper, and anyone who wants the full context should read the original. The most relevant part for franking credits is:

"How are franking credits managed and how might Labor's proposed changes affect members?"

Based on announcements that have been made to date, the impact of Labor's proposed changes differs according to the tax-paying status of each superannuation vehicle.

AustralianSuper is a single taxpayer which pays tax at the entity level rather than the individual member level. It pays a significant amount of tax on its contributions and investment income derived from assets that support member balances in the accumulation phase.

The Fund uses its total franking credits to offset the total tax liabilities it pays. It achieves this because the assets supporting each investment option across the accumulation and pension phases are combined in the one entity. The franking credits are then allocated to the investment options that have exposure to Australian equities. For example, franking credits received in the Member Direct investment option are attributed to members in the option so they receive their respective benefit of the credits.

While the Fund remains a significant taxpayer, the proposed changes are not likely to materially impact investment returns. By contrast, other funds that have low or no investment income taxed in the accumulation phase, low or no taxable contributions and have a high exposure to Australian equities are more likely to be negatively impacted by the proposed changes."

QSuper announcement has the same outcome

As a further check, QSuper has this on [its website](#) relating to its equivalent of a 'member direct' offer, called 'Self-invest'. In answering questions on the impact of Labor's franking credit policy, QSuper says:

"Will I be impacted?"

No. The proposal impacts taxpayers who haven't paid any tax. Because QSuper pays tax each year, based on what is currently known this proposal is unlikely to impact QSuper or our members. Even if your income account is not paying income tax, QSuper is a taxpayer and can take full advantage of the franking credit.

Will I lose any franking credit benefits?

No. QSuper will still receive the benefit of franking credits when determining unit prices. Remember the proposal is not changing franking credits, rather stopping a cash refund for those who haven't paid tax.

I have Self-invest. Will I be impacted?

No, for the same reasons as above, QSuper is a taxpayer."

Graham Hand is Managing Editor of Cuffelinks. Readers should obtain their own financial advice relating to the issues in this article. As we have written in [other articles](#), not all public funds are the same.

How can a super fund hold no cash or bonds?

Damien Klassen

On 21 March 2019, [Bloomberg](#) reported:

"Australia's best-performing superannuation fund is going against the grain by avoiding cash and bonds, betting the 30-year investment horizon of its youthful members means it can ride out looming economic shocks.

Hostplus, which represents swathes of the country's baristas and restaurant waiters, had about 53 per cent of its \$40 billion invested in the sharemarket, and the remainder in unlisted assets including airports and water-cleaning plants, chief investment officer Sam Sicilia said.

Hostplus beat local peers with a 10 percent return over three years ended Jan. 31, according to Lonsec Group. It's also top ranked over five years, up 8.9 percent and outpacing the country's largest pension fund AustralianSuper Pty, the data show. Hostplus has held no cash since at least 2011 and bonds in its portfolios were effectively zero over the past three years, according to Hostplus. The firm prefers stakes in office buildings, pipelines and emerging technology.

Part of that success was due to the fund's ability to stomach less liquid unlisted assets, Mr Sicilia said."

Risk and reward

There are a few ways to read this.

The implication of the article is that the fund has done the best over the past five years because it shunned low-risk assets like cash and bonds and invested in higher-risk assets, and therefore the same strategy will work going forward. Which is why ASIC requires everyone to add a disclaimer "Past performance is not an

indication of future performance.” You need to give Hostplus credit for taking on more risk over a period where stock markets performed well relative to other assets. If it were a conscious tactical decision to allocate more to risk assets (I don’t know if that was the case) then the decision was a good one.

However, the way the article is written implies that Hostplus is taking more risk because its members are younger, which is concerning. The implication would then be:

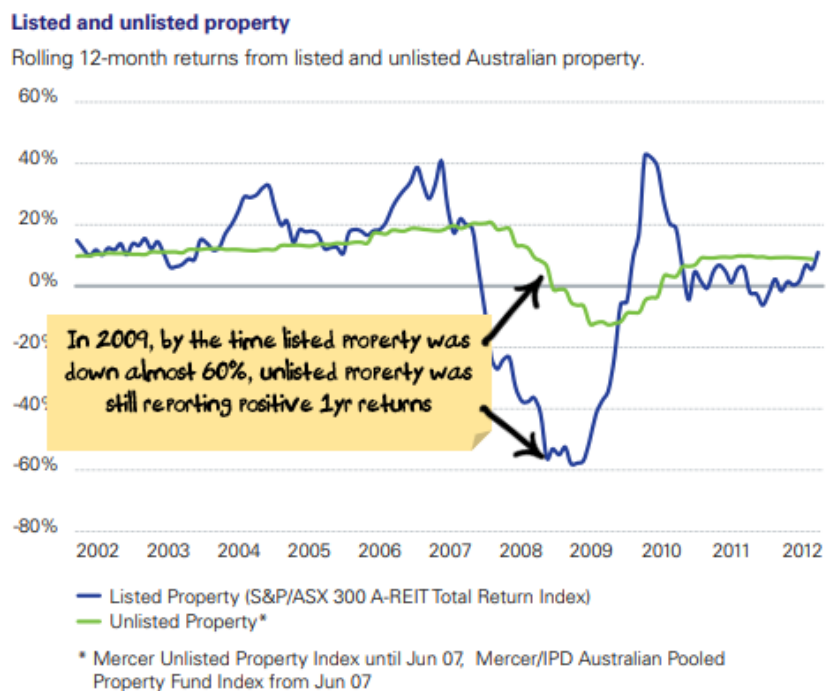
- Hostplus will go up more when markets rise and down more when they fall as Hostplus has structurally higher risk.
- You don’t want to be in this fund if you are older because they are tailoring the asset allocation for younger members.

Are unlisted assets less risky than listed ones?

Another implication of the article is that unlisted assets are similar to cash and bonds. They aren’t.

When comparing funds that invest in listed assets versus funds that invest in unlisted assets, there is no way of knowing the actual value of the unlisted assets. A good example is unlisted property funds during the financial crisis. Unlisted property funds invest in effectively the same assets as listed property funds and the underlying properties are worth the same, but the performance differs because of how the values are reported:

Do you really think that while listed property prices fell almost 60% over a year, unlisted property prices had increased slightly over the same year? Both types of funds owned buildings in the same markets, it is just that unlisted assets don’t get valued regularly and so the values being reported were the values from prior years and didn’t reflect the actual market value.



By this stage, unlisted property funds weren’t trading anyway and so you couldn’t sell your unlisted asset at the inflated prices. Who would want to buy unlisted property assets at last year’s prices when you could get listed property assets at almost 60% off?

So, this is the trillion-dollar question. Is an unlisted property trust less risky than listed property? There are a lot of people who say yes as the *reported* prices are less volatile, but my emphasis is on the word ‘reported’.

Preference for liquid versus illiquid

For me, if it is the choice between owning an asset:

1. in a listed vehicle where I can see what is happening, how much it is worth and buy or sell at any time; or
2. in an unlisted vehicle where I don’t know what is happening, the asset can only be sold at infrequent intervals and the valuation is a mix of prices from prior years and management estimates,

then I will take option 1 every time. Just because I can’t see the price move doesn’t mean that it hasn’t.

The other problem is that I can be diluted by other investors coming and going. To illustrate with an extreme example, let’s say:

- You and I are the only investors in a fund having invested \$100 each.

- The fund owns 50% in an unlisted asset and 50% cash. So, the total value of the fund is \$200 made up of \$100 in the asset and \$100 in cash.
- The asset falls 60% (\$60) in price, so our fund is now only worth \$140 (\$70 each for you and me) but the fund doesn't revalue the asset and so reports the fund still being worth \$200.
- I decide to redeem my holding in the fund.
- The unlisted asset can't be easily sold, and so the fund pays me \$100 cash being half of the \$200 that the fund is still being officially valued at.
- This leaves you with \$40 of an unlisted asset – double the loss that you should have taken.

Is now the right time to have no cash and bonds?

Assets move in cycles. Ordinarily, towards the end of a 10-year bull market in risk assets, you would want to be increasing your holdings of cash and bonds, leaning into the cycle so that when the bull market in risk assets ends you can cushion the downside and you have a war chest to look for bargains. That is my strategy at the moment, but Hostplus has taken the opposite strategy. They are suggesting that now is the time to own more risk assets and to abandon cash and bonds.

Hostplus may be right. Recessions may be avoided, central banks might hit the printing presses, growth and inflation might return and risk assets might continue to go up.

I'm hoping the Bloomberg journalist has misrepresented the Hostplus investment process. I'm hopeful that Hostplus has a more nuanced view about the value of risk assets versus cash and bonds. They are a big fund with lots of investment managers and you would expect that to be the case.

The net effect is if you are looking to replicate the Hostplus asset allocation and abandon cash and bonds, do it because you genuinely think that risky assets will continue their streak, not because you think that unlisted assets have some magical ability to provide stability while their listed brethren fall.

Editor's footnote

In September 2018, Hostplus's CIO Sam Sicilia provided insights to its investment strategy in [Investment Magazine](#).

"Our growing allocation to alternatives is to ensure we remain flexible and adaptive, given we have such a high allocation to unlisted assets."

"For us, having that strong cash flow, [about \$7 billion worth of inflows a year], disposable cash if you like, means we can take advantage of not just opportunities that arise, but each opportunity that arises. If I were the CIO of another fund, where the outflows were around the same as the inflows, I would be having a very different conversation with you."

"They (the fund members, average age 34) are not retiring anytime soon, so there is a long investment horizon. The fund itself never gets older. Why? Because the hospitality industry is always a young person's game."

"The assets themselves are very long-term assets. They have growth characteristics but, in particular, they also have defensive characteristics. They generate income, which is defensive, and capital gains, which is growth. When equity markets are volatile, our unlisted assets – such as real estate and infrastructure – provide downside protection. That is critical. If you say, 'How come everybody doesn't do that?' Well, you need to tolerate illiquidity. I'm pretty happy with the characteristics."

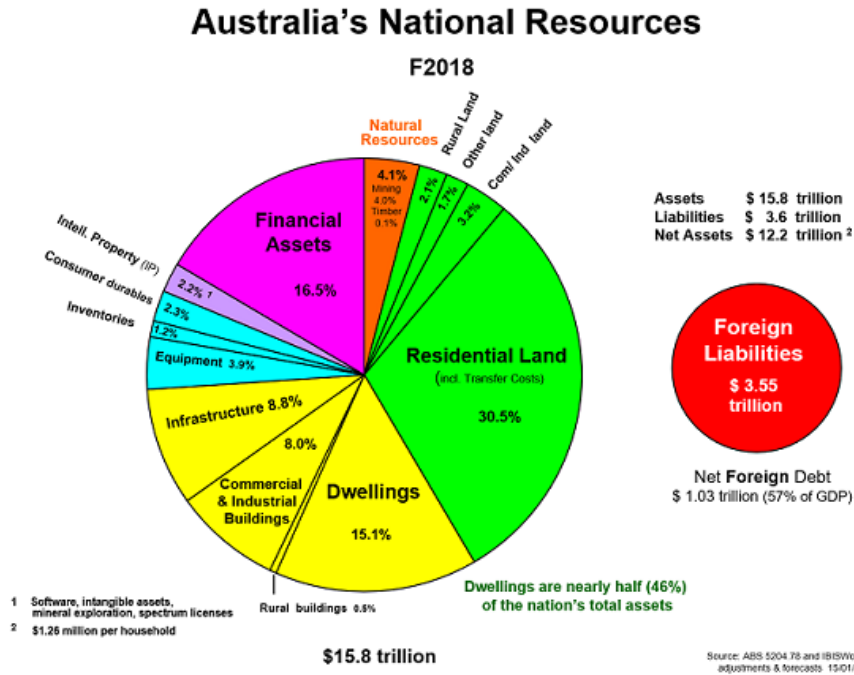
"People say to us, 'During the GFC, you must have taken action and moved things around.' It was quite the opposite, we did nothing. We made no changes to our SAA, because we have the financial cash flow and means to see through all of that volatility. In fact, when equity markets dropped, we purchased equities at a cheaper price."

Damien Klassen is Head of Investments at [Nucleus Wealth](#). This article is for general information purposes only and does not consider the circumstances of any individual. A version of this article appeared in *MacroBusiness*.

Housing prices from black hole to blue sky

Phil Ruthven

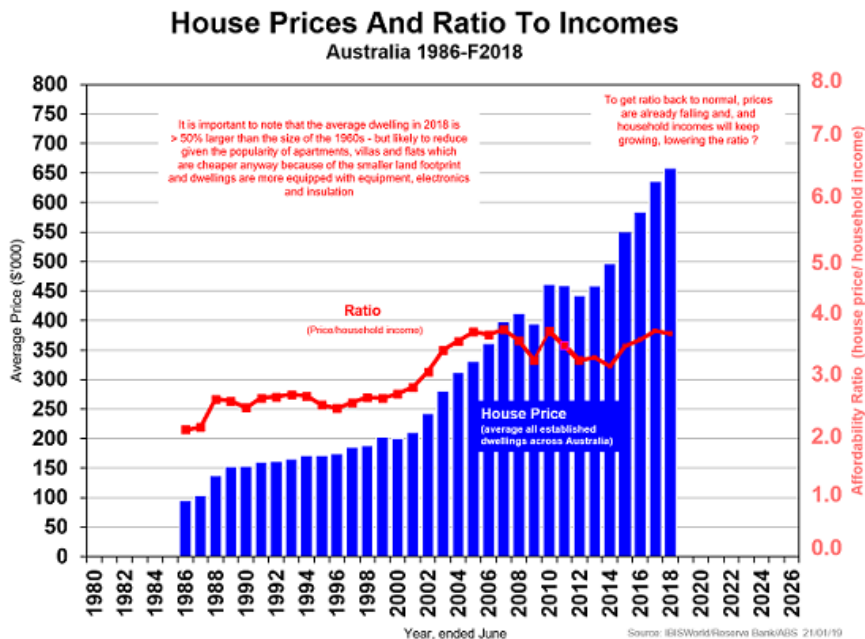
Housing in Australia is the nation’s single most important resource, accounting for 46% of the total \$15.8 trillion value of all assets in 2018. So, businesses, governments and householders get nervous when the market becomes discombobulated as it has now been for a year or more, with uncertainty the order-of-the-day.



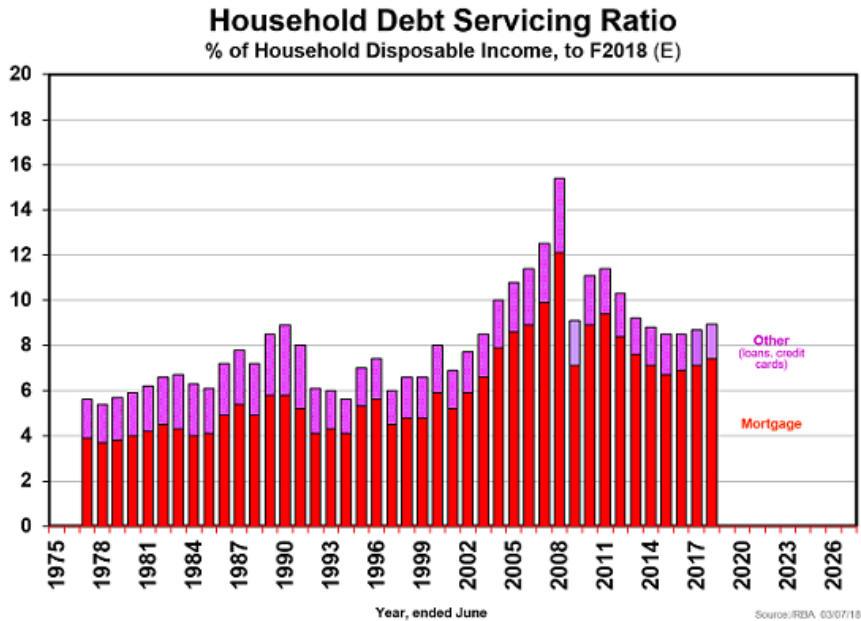
In June 2018, there were 10.6 million dwellings valued at \$7.2 trillion, an average value of \$680,400. An estimated 9.6 million were occupied, with the balance of nearly 1 million unoccupied (holiday and otherwise being interim or for sale, temporary or long-term vacancies).

Affordability of housing

The ratio of dwelling prices (the blue bars below) to disposable household income was 3.98 in 2018, a little higher than the previous record of 2007 and 2010, but now easing down due to falling prices.



In June 2018, the interest on household debt of mortgages, loans and credit cards as a percentage of total disposable household income was 9.0%, mostly comprising mortgage interest at 7.4%. This was much lower (due to record low interest rates) than the peak of 15.4% some 10 years earlier in 2008 (when mortgage interest was 12.1% of disposable household income).

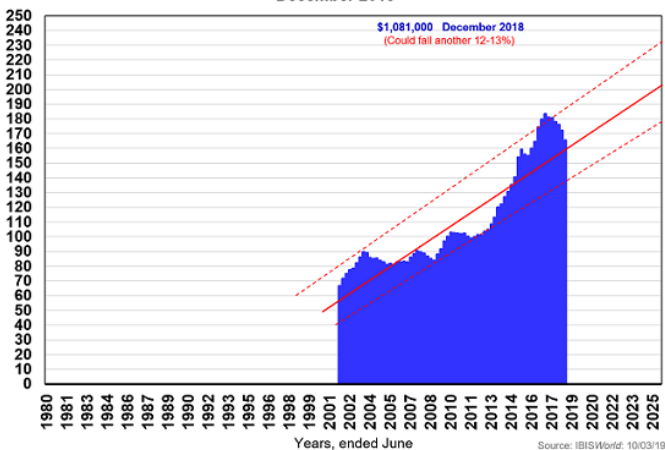


The continuing low mortgage rates is helping new home owners weather a potential affordability impasse if not disaster, although plunging dwelling prices creates the problem of debt exceeding asset value in many cases. Lenders will need to exercise patience in most of these cases, relying on debt servicing ability more than temporary negative net asset value.

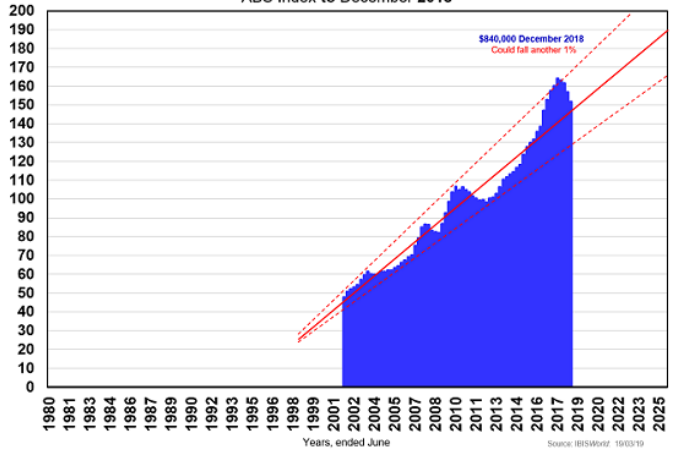
Major city house prices

The current dwelling price correction, for the nation’s near-11 million dwellings, is warranted and dramatic, and there is further to go. But only Sydney and Melbourne houses had ‘bubbles’ while other capital cities were over-trend.

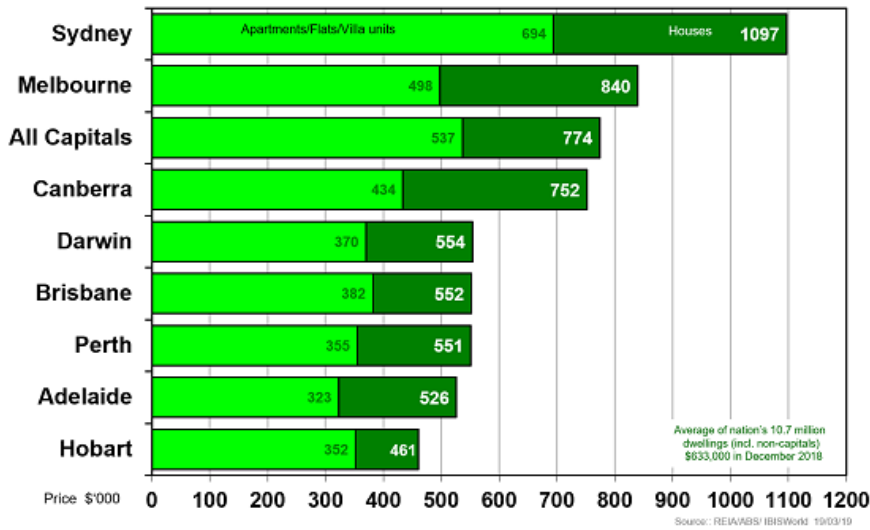
Sydney House Prices ABS Index
December 2018



Melbourne House Prices
ABS Index to December 2018



House & Flat Prices Across Australia
Capital Cities Median 2018 (December quarter)

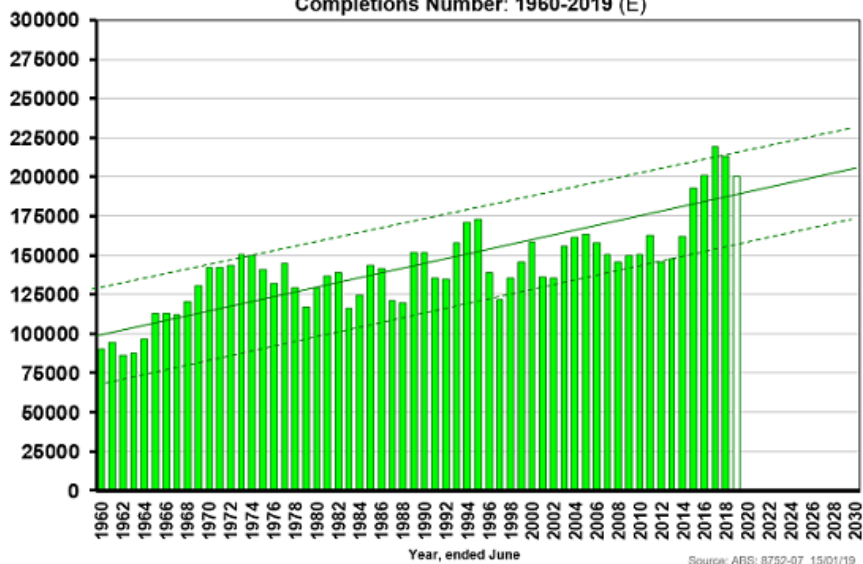


In 2019 and possibly 2020, we expect further falls of around 7 to 8% on a national average basis. This converts to a 13% national fall from the peak in December 2017. Sydney houses could fall by up to 22-23% from peak to trough, having been in a bubble. However, continuing low interest rates (eventually rising slowly), rising incomes, government incentives, and lender accommodation could minimise the dangers.

Almost \$400 billion was spent on dwelling finance over recent years, of which over a fifth was on new dwellings. This has been crowding out investment in other wealth-producing investments for growth, efficiency and competitiveness.

It is astonishing that the nation increased the output of new dwellings by almost 50% from less than 148,000 of 2013 to almost 220,000 in 2017. In just 4 years! A fall of 30% from this peak by FY2022 is now possible. NSW, having had a more spectacular rise, can be expected to have a more spectacular fall.

Australian Housing Construction
Completions Number: 1960-2019 (E)



But by a few years into the 2020s, prices and construction numbers will be on the rise again. We may have a black hole in the interim, but there is always some blue sky above that greets us as we come out of it.

Phil Ruthven is Founder of the [Ruthven Institute](#), Founder of [IBISWorld](#) and widely-recognised as Australia's leading futurist.

5G mobile promises to connect and speed up everything

Michael Collins

In Bulgaria, the country's mobile or wireless phone operator Mobitel exhibited fifth generation or 5G technology during a virtual reality demonstration. Russian telecom Megafon and Qualcomm tested 5G in Moscow while Vodafone hosted Ireland's first live 5G test. In the US, Verizon now offers 5G internet for homes in a few locations. In Australia, Telstra connected a customer with a commercial 5G device on 5G technology for the first time. These are just some of the trials completed or underway in recent months as the world prepares for a transformative leap in mobile.

5G potential to transform lives

5G's promises include vast improvements in data speeds at lower cost, much faster response times (known as 'lower latency' in industry jargon), greater connection density and lower battery consumption on devices. These benefits will arrive as beam forming and dynamic spectrum allocation, software-defined networking and the deployment of wide bands of higher-frequency radio spectrum, among other technological advancements, turn existing 4G networks into 5G networks over the next decade.

5G is expected to transform daily life because it will enable key developing technologies such as the internet of things (when everything is linked), driverless cars, smart factories, connected utilities, voice-triggered devices, remote surgery, artificial intelligence, and augmented and virtual reality, even if these advances have other challenges.

The vital nature of 5G is the mass connectivity it will foster, and the potential for 5G-enabled applications to shift data processing from the 'core' to the less-secure 'edge' of networks.

Potential for slow adoption

However, these are colliding with two forces that may slow 5G's adoption, boost its cost and make it more politically disruptive than earlier versions of mobile connectivity.

The **first** issue hampering 5G's deployment is that it magnifies the risks posed by the insecure nature of the internet. If everyone and everything will connect to the internet, 5G networks must be made far more secure than the worldwide web has proven to be so far.

The **second** challenge is that 5G is tangled up in the rivalry between China and the US. This reflects the role 5G will play in determining the next generation of giant technology companies (as 4G helped elevate Alphabet, Apple and Facebook) plus the importance nations attach to having guaranteed access to leading telecom equipment. The latter is the biggest cause of tension because China's Huawei Technologies has surpassed Western peers Ericsson and Nokia to become the world's leading telecom equipment maker over the past decade. That some regard Huawei as an instrument of the Communist Party makes it (and other Chinese companies) unwelcome in the US and some allied countries, including Australia. While the deployment of 5G will be slower, more troubled and less economical than it should be, these hurdles will hopefully lead to more secure 5G networks in time.

To be sure, even in the best of circumstances, the infrastructure required means 5G will take much time and money to be broadly deployed. Another hurdle is that the rate of 5G uptake will depend on how quickly people buy the new, more costly 5G phones capable of receiving 5G signals and the new spectrum bands in which it is deployed. The lack of security on the internet came at its birth and will be hard to overcome. The differences between the US and China are ideological, political and commercial; the new wireless technology is not the central issue in the Beijing-Washington rift.

5G thus has much to navigate for its benefits to fully materialise. But technological advancements usually hold sway in the end. The benefits of 5G are there to be widely shared in time if networks can be secured.

Michael Collins is an Investment Specialist at [Magellan Asset Management](https://www.magellangroup.com.au), a sponsor of Cuffelinks. This article is for general information purposes only, not investment advice. For the full version of this article, go to: <https://www.magellangroup.com.au/insights/>.

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SMSF borrowing ban is a solution in search of a problem

John Chauvel and Adam Smith

The case against LRBA (Limited Recourse Borrowing Arrangements) is unclear, but there could be bad news for SMSF trustees who want control over their investment strategy, regardless of whether they intend to use an LRBA or not. Treasurer Josh Frydenberg has confirmed the retention of LRBA for SMSFs, while it is [Labor Party policy](#) to ban them.

An LRBA is a borrowing whereby an SMSF can purchase a specific asset with debt. The debt is limited in recourse to the asset purchased and not the other assets of the fund. From a financial risk-return perspective, the 'economic' asset of the fund is the equity component (the purchased asset value less the limited recourse debt). LRBA can work well for property assets because they are often large value, steady annuity-like investments that are beyond the reach of the average SMSF without the borrowed amount.

What the regulators say

On 22 March 2019, the Treasurer publicly released a report prepared by the Council of Financial Regulators (CFR) and Australian Taxation Office on *Leverage and Risk in the Superannuation System*.

The report showed that 8.9% of all SMSFs have an LRBA representing 5.2% (or \$3.8 billion) of total SMSF assets. The CFR said: "Given this magnitude, LRBA are unlikely to pose systemic risk to the financial system at this time."

However, the report expressed concern with the "prevalence" of property as the main asset purchased under an LRBA, which was most common with "low balance" SMSFs with balances under \$500,000. As a consequence of "significant implications for the security of individuals' retirement saving" (supposedly those with low balance funds), the CFR concluded that their "preferred" option was to remove the exemption allowing SMSFs to access LRBA.

So, while LRBA pose no systemic risk to the financial system, a portion of self-funded retirees could be subjected to high levels of risk through a concentrated exposure primarily to residential property, particularly in the event of a general property market downturn. They argue this risk could revert back to the government via greater dependency on the government-funded pension system. However, there is no attempt to evaluate the systemic risk or why SMSFs are particularly vulnerable. Indeed, it could be the case that SMSFs are better positioned to deal with a generalised downturn due to lower leverage, less incentive to negatively gear and the protection afforded by mandatory superannuation contributions.

Borrowing by SMSFs

There is some great data on LRBA in the report compiled by the ATO from audited annual accounts prepared by SMSFs.

While the number of funds with LRBA has steadily increased to 8.9%, the value of LRBA assets as a portion of total fund assets has plateaued and even declined from 5.3% in June 2017 to an extrapolated 5.2% in June 2018 (although with current lending practices and declining property prices, the actual percentage could be lower). The portion of SMSFs in the "low balance" bracket invested in residential property has declined from 39% in 2016 to 36% in 2017.

Concentration has also been increasing amongst SMSFs with LRBA. The report found that "over 90% of the SMSF LRBA population within the \$200,001 to \$1 million fund size ranges had an LRBA concentration of greater than 50%." What is not clear is the portion of net LRBA assets (the equity) as a portion of net fund assets. This is a reasonable measure given the limited recourse structure and would undoubtedly show much lower levels of concentration across the board.

The report also paints a concerning picture with respect to leverage ratios of LRBA invested in residential property. For example, funds with leverage ratios greater than 50% increased from 68% in 2016 to 73% in 2017. However, funds with leverage ratios greater than 70% declined from 29% in 2016 to 26% in 2017, implying overall leverage is falling (and is probably much lower today).

What is also missing from the analysis is a lenders' perspective of LRBA. How do LRBA compare to other investment loan products by key measures of risk? Loan to value ratio (LVR) is a key indicator of risk: lower the LVR, the lower the risk. The data provided in the report does not provide much granularity around LVR. However, crudely dividing the average LRBA borrowing by the average LRBA asset provides a system-wide LVR

of 49% as at June 2017. By comparison, Westpac's dynamic LVR across its mortgage book at the same time was 52%, implying it is riskier than LRBA loans.

Another concern expressed by the CFR is that LRBA lending has gravitated to the non-bank sector where they have less control. This problem is not insurmountable with targeted regulation.

The politics

The report does not support the Labor case to ban LRBA's. Banning LRBA's for residential property investment is a small piece of Labor's housing affordability policy on the premise that LRBA's make housing less affordable. This premise is speculated in the report but not supported by its conclusions (or even the earlier Productivity Commission Report on superannuation). Unlike negative gearing and CGT policy announcements by Labor, LRBA's have virtually no revenue impact on the budget, so the incentive to change is not for fiscal reasons.

The current government on the other hand is taking a more pragmatic approach. It is adopting the CFR's second preferred option of targeted regulation, most of which it says it is adopting anyway as a response to the Financial Services Royal Commission. It wants to see more data, which makes sense given the tectonic changes that have occurred over the last year.

Implication for SMSF trustees

The options put forward by the CFR do nothing less than limit the investment options available to SMSFs. We have written on the subject of [SMSFs investing in residential property](#) in the past. We don't sugarcoat the risks, but we do think it is a suitable strategy for some investors at certain stages of their retirement savings journey. The CFR acknowledges that SMSFs acquire residential property "early in their lifecycle", which is a sensible strategy for an anticipated 30+ years of accumulation.

The debate needs to shift back to the quality of advice and selling techniques that influence SMSF trustees to make investment decisions. This would be the same advice a trustee should presumably receive if they thought it was sensible to invest over 50% of their retirement saving in venture capital, or a single small cap listed company or many other investments that are riskier than leveraged residential property and much more easily available and executable than an LRBA. When will the CFR contemplate a ban on those investments as well just to prevent them from happening?

Overall, the suggestion of a ban on LRBA's looks like a solution in search of a problem. The implications of a property downturn on small investors are potentially adverse regardless of the structure through which they invest, and whether through their super or not. No evidence has been presented that the implications are necessarily more adverse for SMSF investors. There is no consumer outcry for more regulation in this segment, unlike so many other aspects of the financial services industry, and SMSF trustees want greater flexibility and an end to capricious regulatory changes. The CFR found no systemic risks, and the data seems to support the proposition that the majority of SMSF property investments are soundly based.

What is missing in the proposal to ban LRBA's is a clear benefit to consumers, or to the economy, or to the housing market, or to the financial system. Absent this, we are left wondering as to who really benefits from this proposed change to limit the investment opportunities open to SMSF trustees.

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A new, client-centric model of advice

Nathan Krieger

While the spotlight cast by the Hayne Royal Commission on the worst practices in wealth management industry has deservedly dominated public attention in the past year, it's easy to lose sight of a growing global movement toward a client-centric approach.

An increasing number of advice firms in Australasia, North America, the UK, Europe and Asia are embracing a shift from transactional, sales-driven and conflicted process toward a model built upon transparency, independence and alignment with the goals of the client.

The new model of advice is showing the way forward for an industry grappling with increased regulatory scrutiny, growing compliance responsibilities, potentially disruptive technology and a challenge in finding skilled, committed and engaged staff.

Global advisers with common keys to success

Key practices common to many successful advice firms include the embrace of a consistent investment philosophy, an easily communicable value proposition, fee transparency, and a shift from commoditised tasks toward spending more time with clients.

This new model of advice effectively turns prevailing processes on their head. Instead of advice being treated as a sales process, where there is a risk of products being sold to retail investors regardless of their specific needs or risk appetites, advisers start by understanding the clients' goals and working back from there.

This is potentially a win-win situation. Clients receive advice appropriate to their needs and circumstances. Advisers in turn are energised, transformed from being facilitators to adopting a consistent philosophy and a repeatable, transparent and robust approach to capital markets.

The regulatory challenge

Of course, the evolution in advice is coming at a time when regulators in many countries are taking a much closer and more critical look at conflicts and culture in the advice sector.

In his recent Final Report, Commissioner Kenneth Hayne said that making financial advice a profession was critical to restoring public trust. He urged the ending of the practice of 'fees for no service', the reduction of conflicts pervading the industry and the introduction of a credible and coherent disciplinary system for advisers.

In New Zealand, the government is introducing a regulatory regime for financial advisers which requires all advisers to retail clients to be licensed and subject to a code of conduct setting out standards of client care.

In the United Kingdom, the Financial Standards Authority in 2013 implemented a ban on commissions for retail investment advice.

The technology challenge

The growing penetration of artificial intelligence and robo-advice platforms increases pressure on advisers to demonstrate the value of their wealth management services.

Advisers are responding to this challenge by embracing new technology themselves, both to improve the client experience and to reduce the time that advisers spend on basic processes.

So, instead of a binary choice between high-end human advice and automated advice, what emerges is a hybrid model that uses technology to save firms valuable time spent gathering data and uses it instead on real, productive conversations.

This can allow advice firms to offer a tiered fee model that improves the access of smaller clients to digitally-delivered affordable and effective advice, while continuing to offer premium services to higher-net worth clients with more complex needs.

The human capital challenge

Another challenge for advice firms, amid the call for better education standards for advisers, is in finding, engaging and retaining talent. In fact, outside of improving profitability, human capital strategy has emerged as a primary concern among the firms we talk to globally.

Of the major challenges most frequently cited by advisory firms, consistently ranking near the top are recruiting and hiring employees, finding or developing a next-generation leader, and developing employees. Advisers want better training and development, advancement opportunities and career paths, and improved communication around firm goals and performance.

Summary

The advice sector is changing globally. Putting clients first, removing conflicted remuneration, embracing new technology, delivering effective advice efficiently to a wide range of clients, and professionalising the industry to restore public trust *can* be done and *is* being done.

The new model of advice is here to stay.

Nathan Krieger heads the Australian financial adviser services business of [Dimensional Fund Advisors](#) (DFA), a US-based which manages about AUD800 billion globally, including more than AUD30 billion for clients in Australia and New Zealand. DFA is convening a global adviser conference in Sydney on April 3-4 with advisers from around the world (who meet their own travel and accommodation costs).

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