

MyConsultant

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Aidan Geysen

Manager of Research

Aidan is Manager of Research, with responsibility for JANA's ongoing research programme and specific projects. Aidan's research responsibilities are focused on ensuring

JANA's best ideas are reflected in our clients' portfolios. Prior to his current role, Aidan headed JANA's Australian Equities Research Team.

Before joining JANA in 2003, Aidan spent 12 months working and travelling in Europe. During that time he worked in the Insurance area for Zurich, and then Barclays Bank in various roles. In 1997 he began his career at National Financial Management (NFM) as part of their graduate program.

Aidan holds a Bachelor of Business from Swinburne University, and a Graduate Diploma in Applied Finance and Investment from the Financial Services Institute of Australia.



Grant Mizens,
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Senior Consultant

Grant earned a Bachelor of Arts majoring in Economics from the University of Illinois, USA, and a Diploma of Financial Markets from Finsia. Grant began with MLC Investment Management in 2006.

During this time his focus was portfolio construction and manager research of domestic and global equity investment managers.

Grant is currently a Senior Consultant in JANA's Research Team focusing on Australian Equities.

Tailoring Australian Equities portfolios for post retirement

JANA has always been known for being early, so when Ken Marshman declared that 2013 would be "the year of post-retirement", it is not surprising that he was probably 12 months out.

The implementation of Stronger Super has occupied significant resources across the industry, through a wave of tailored post-retirement solutions now coming to the market, and for good reason. The last 10 years has seen a 33% increase in the population aged over 55. This change in demographic has resulted in rapid growth in the scale of post-retirement funds, facilitating tailored offerings that cater for the specific requirements of retirees. While JANA is looking at optimising the construction of each asset class and the overall portfolio for post-retirement, this piece addresses the Australian equities sector, which is a key foundation of the offering, due to the size of allocation within a portfolio, the tax treatment of the sector, and the ability to tailor outcomes within the asset class.

The three key imperatives when constructing an Australian equities portfolio for post-retirement are:

- to ensure the portfolio is structured efficiently from the perspective of a zero tax investor,
- to limit volatility relative to the optimal portfolio structured for the accumulation phase, and
- to achieve outperformance of the benchmark index.

Balancing the Objectives

It is important that the role of income in an Australian equities portfolio built for the purposes of post-retirement isn't overplayed.

Targeting higher income has some merit due to the higher value attached to franking, which is more valuable to a zero tax investor. In addition, a portfolio that has a greater portion of the total return coming from income rather than capital is likely to experience lower volatility, and it is the associated reduction in volatility that is of most importance. It should be said that there will be times when a naïve skew to income will result in unacceptable concentration risk and higher volatility, such as the skew to REIT's and Banks that may have characterised an income portfolio leading into the financial crisis. Therefore, the best results will likely come from the active management of the underlying strategies.

To explore further the merits of a lower volatility portfolio, a key question to address is whether lower volatility should be targeted within each asset class, or whether it is better managed through the overall Growth / Defensive asset mix. JANA's approach has been to seek to optimise the characteristics of tax efficiency and lower volatility at the asset class level as well as at the portfolio level. Our objective for constructing an Australian equities portfolio for post-retirement has been to seek to achieve a return in excess of the market return, while seeking to limit volatility. If too much return is sacrificed in the pursuit of lower volatility it introduces "longevity risk", which is the risk that a retiree will outlive their balance. Stated another way, the benefit of delivering an excess return of even 1% per annum can materially increase the life of a retirement portfolio.



Tailoring Australian Equities portfolios for Post Retirement

Impact of Cashflows on Return Outcomes

As an industry focussed on time weighted returns, it is easy to miss the impact that cashflow has on actual “dollars in the hand”. During the accumulation phase, adding to your investment during a market correction can be beneficial, though far less so toward the end of the accumulation phase where cash inflows are typically small as a proportion of the overall balance. Conversely, in the retirement phase, drawing off your balance during periods of market corrections can be very damaging. This is referred to as “sequencing risk”.

In Figure 1 below we have simulated the return outcomes of the Australian equities market and compared it to a portfolio where the upside / downside capture has been limited to 80%, and looked at the results over rolling 5 year periods. During periods of generally positive returns, it is expected that the lower volatility portfolio would lag, as it also produces lower returns, and with the exception of the Financial Crisis, Australia has enjoyed a prolonged period of strong returns. The analysis shows that there can be benefits that stem from lowering volatility, though it is dependent on the starting point.

The key point to draw from this is that the value of reducing volatility to a retiree during the drawdown phase is undeniable, though not if it comes at the expense of excess return. The objective therefore, is to seek to deliver a return that exceeds the market with greater downside protection – a difficult balance, and one that requires a portfolio to be constructed thoughtfully and with active management of the strategy mix.

Constructing the Australian Equities portion of a post-retirement portfolio

It is essential that an Australian Equities portfolio constructed for a post retirement solution seeks to maximise the potential life of a member’s retirement package. In considering the competing forces of volatility and return JANA has investigated strategies that can be employed when structuring tailored post retirement portfolios. The following are a selection of preferred strategies which can be blended to improve outcomes in the drawdown phase:

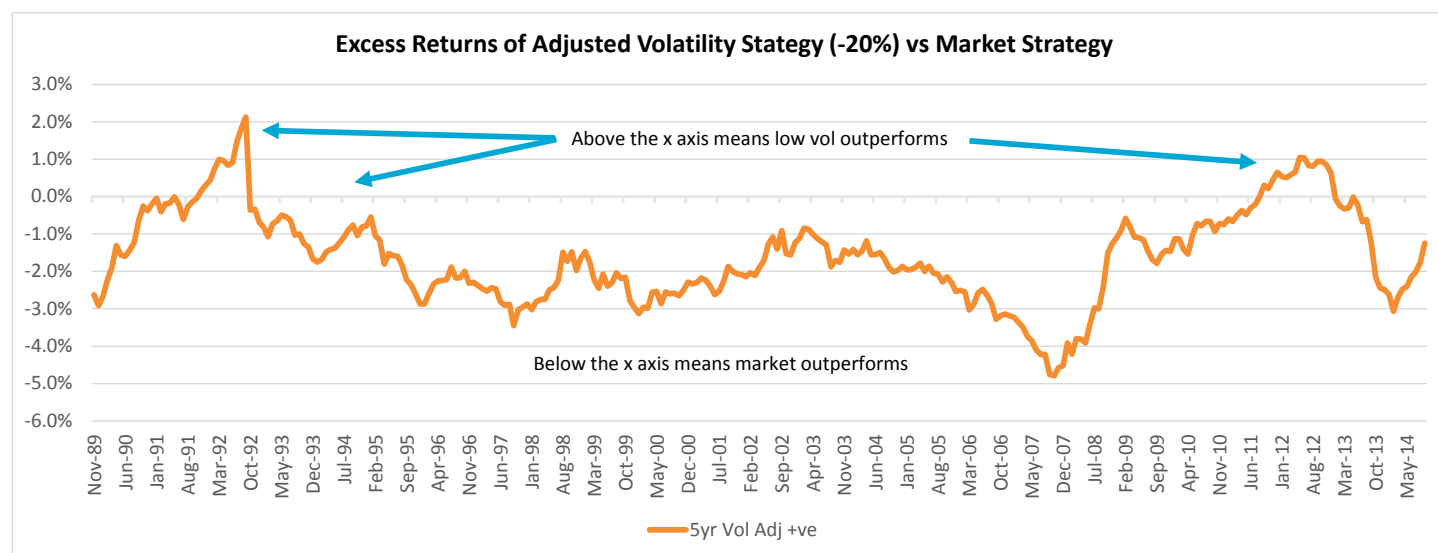
- Alpha strategies – Broad market managers in which we have conviction in their ability to deliver excess returns. Skewing more of

the total return of an Australian Equities portfolio to alpha (manager skill) provides diversification and increases the chance of delivering on objectives.

- Quality – Emphasising quality to provide downside protection during market corrections while delivering excess returns over time through the benefit of compounding.
- Low beta – Utilising exposure to low beta managers to reduce volatility and protect against market corrections.
- Income strategies – Strategies which skew more of the total return toward income, which can deliver lower volatility and a pick-up in franking.
- Buy Write Strategies – Buy Write strategies also provide a lower volatility return profile with additional income and franking.

The appropriate mix of the above strategies depends on a number of factors including scale (segregating accumulation and post retirement assets can increase costs), risk appetite, cost constraints and the interaction with other asset classes and strategies elsewhere in the post-retirement portfolio.

Figure 1



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