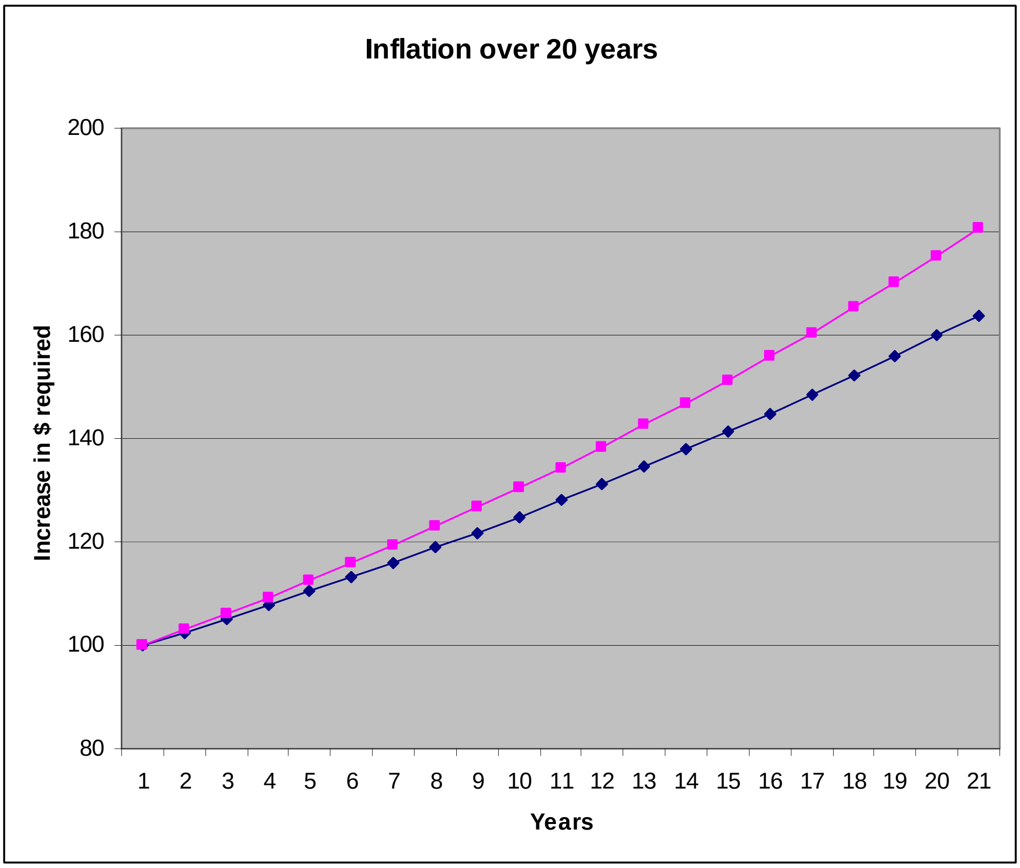
Not an Authoritative Guide to Superannuation Investment

Australia is a world leader in personal superannuation. This was not necessarily driven by altruism but probably more by the need for government to move the financial risk in supporting an ageing population from itself to the individual. Certainly generous financial incentives have sweetened the pot but, still, the risk is now with you.

What to invest your superannuation savings in then? There are two sides to this: prior to retirement and post retirement. This little missive only addresses the post-retirement phase of superannuation investment.

More than once I have heard reputable financial advisors say that the percentage of your post-retirement savings should be in cash is equal to your age. That would suggest that at 65 years old, 65% of your super should be in cash deposits. (I am including term deposits under this umbrella.) But what about inflation?



The graph above shows the increase in expenditure that would be required each year to maintain equivalent purchasing power with 2.5% and 3% inflation. This is the sort of rate of inflation the Reserve Bank is aiming to maintain.[1]

Retire at 60 and, by 80, your retirement savings will have to generate going on for twice the annual income unless you are simply drawing down on your capital.[2]

If keeping a lot of your superannuation in cash is a certain way to ensure that you will wind up on a government pension anyway before you cark it, what are the alternatives?

The obvious alternative strategies are investments in shares or in realestate.

Due to high transaction costs with realestate investments, these are by necessity long term, illiquid investments. Housing investment advisors always go on about "position" – a good house in a good suburb with good capital growth prospects. Such investments offer low or negative rates of return for many years and really only fit with pre-retirement investment.[3]

What about shares? Look at the Australian share index (graph of the ASX 200 below) over the last 10 years. If you bought in 2008, you would have been down almost 50% in 2009! However, by now, if you had been buying in 2006 or earlier, you would be up 50%.

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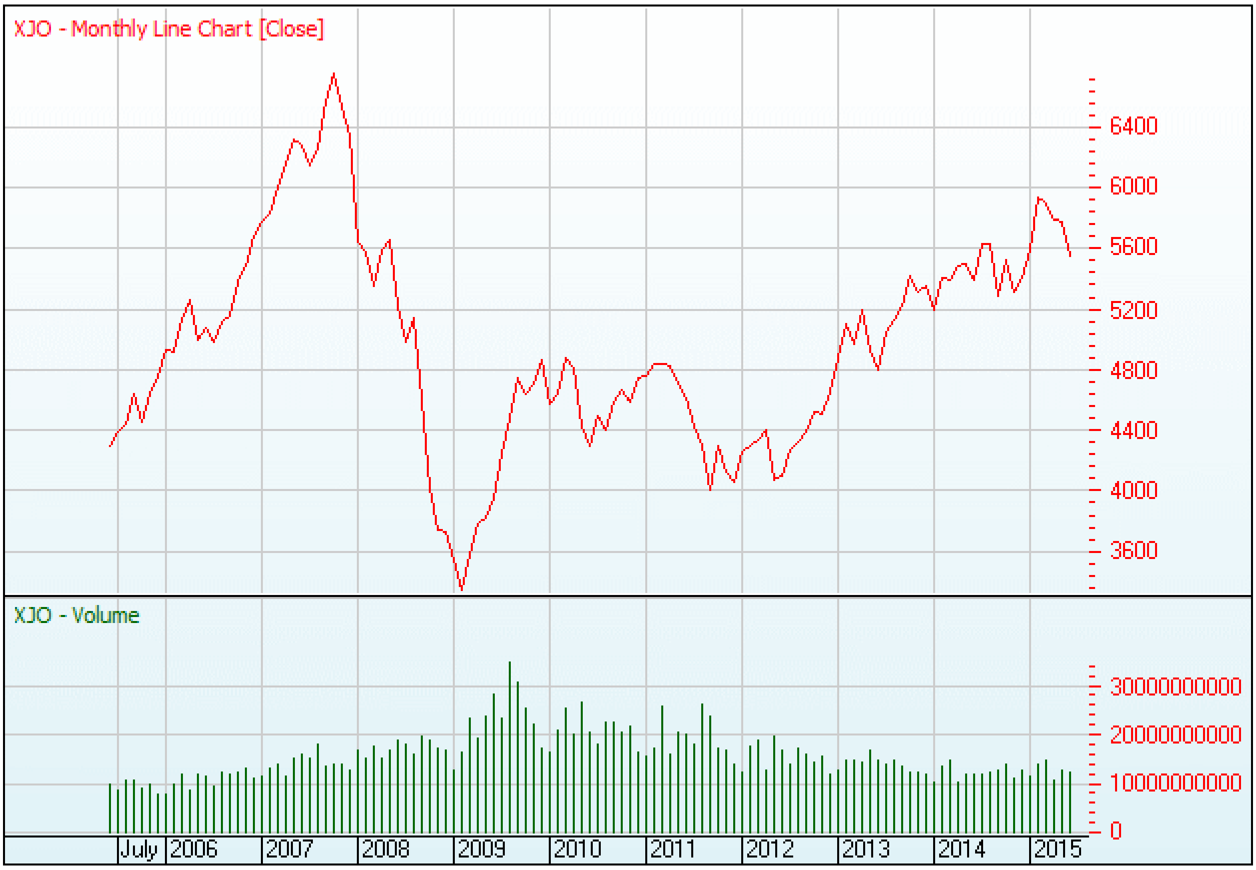
[1] Remember that central banks want some inflation. This is necessary to keep the evil of deflation at bay. If prices are deflating (reducing), consumers will rationally postpone purchases on the basis that it will be cheaper if they do it next month or even next year. Such behaviour is a sure way to kill an economy. Also, inflation reduces the real value of government debt.

[2] Keep in mind that governments want Superannuation is to provide for the retiree rather than as a mechanism of estate planning, although any amount left in superannuation is taxed at 15%, the only form of death duty remaining in Australia.

[3] Conversely, investments in slum housing (*or at least cheap flats in undesirable locations*) are the one form of realestate with good up-front returns. However, capital growth is low by comparison but, what the heck, in retirement, we need income!

Also, consider those hardy souls who bought shares late 2008 and early 2009. As the saying goes, “Fortune favours the Brave”.



(ASX top 200 stocks over 10 years, the index and trading volume – from ASX web site)

The other important point is that most Australian companies have continued to push out solid dividends on the period of the Global Financial Crisis.[4] This has kept the money rolling in for retirees with a sensible share portfolio.

There is one important thing to remember about shares. Never leave yourself in the position where you have to sell shares to provide necessary income. This will invariably be at a time when share prices are depressed and the worse possible time

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[4] However, we probably have to thank Wayne Swan for this. The IMF dubbed him “the World’s Best Treasurer” for his handling of the Australian economy over the GFC but, if we had a Treasurer like our current one, it is likely to have been very different. So much comes down to chance in human affairs.

to sell.[5] This is when having some cash becomes important. If you keep enough of your retirement income in “cash” (in the broad sense of the term) – enough to keep you going for two or even three years – this is likely to be enough to weather even a GFC-Mark Two under an incompetent government.[6] This is hopefully a lot less than the “percentage as cash equal to your age” formula of financial planners.

As to a choice of shares when you know nothing about investing, you can always buy your own “Mini-Index Fund”. An “Index Fund” is where you don’t try to pick companies but buy some of everything in a category and the biggest 20 companies on the local share index is a good place to start.[7] Remember that, in stock picking competitions run by local financial publications, the dart board is right up there with (and often well ahead of) the professional investment advisors.

So, why not buy all or most of the companies in the ASX20? Wait for panics and buy when others are selling. However, if you don’t like a company, even if it is in the ASX20, don’t buy it.[8]

Remember you cannot tip the top or the bottom of any market. If someone tells you they can, ignore their advice.[9]

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[5] Also, I would personally never buy shares on a margin loan! These will always be called in during any major financial downturn.

[6] However, don’t forget the dividend stream when calculating the amount you will need as cash. The long term average for the ASX20 is 4.9% per year (or 6.4% with franking), according to the Motley Fool Australia.

[7] It is prudent to be diversified but having shares in too many companies can lead to confusion, hence the ASX20.

[8] I personally won’t buy shares in any company with interests in betting. If people understood odds, they wouldn’t bet and those who don’t understand are those who can least afford it. Also, I would never invest in a company exporting thermal coal. This is an industry likely to suffer rapid, terminal decline and I would not want to be “left holding the baby”. Metallurgical coal is a different matter. While I have also believed for a very long time that global heating is a dire threat, I don’t see any alternative to high grade metallurgical coal in generating the infrastructure to keep civilisation afloat. You will have your own likes and dislikes. These are just some of mine.

However, remember no stratagem can provide absolute certainty against all possible events. Consider the prudent, well-off retirees in Germany at the time of the Weimar Republic. How many of these survived the rampant inflation (and later the war) with their savings intact, I wonder?

NOTE: I am NOT an investment advisor and this is NOT personal financial advice to you or anyone else.

David Woodcock

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[9] I am always reminded of the uncanny ability of some financial gurus who have predicted six of the last two downturns in the share market.