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# Advice on building an investment portfolio whatever your life stage

How you want your rebuilt portfolio to look is a matter of individual preference. **Marina Oliphant**

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by **Jeremy Chunn**

The model portfolios featured in *Smart Investor* over the past six months have been a varied bunch. Apart from the obvious differences attributable to the investor's risk profile – young, old, working, retired – there has been a distinction between those investment professionals who favour active funds management and those who take the passive route, using low-cost exchange-traded funds.

It's sometimes hard to work out if the preference is about investment beliefs, simple probability of outperformance, or some sort of professional alignment.

The unavoidable bald fact, of course, is that no one will know which portfolio is best until 10 or 20 years down the track, and only if it has been thoughtfully rebalanced along the way.

The financial advisers and investment consultants whose portfolios we feature aren't wallies, however. The steady monotone they invariably hold on the phone and the detail of their written communication indicates they take portfolio construction very, very seriously.

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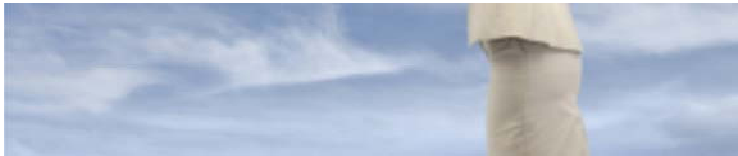


Looking into the future for a good return.

To lighten things up, we asked three of them to pump out model portfolios for some made-up clients. Just for a bit of fun.

If you can see yourself in these client profiles, it will be worth having a close look at these strategies.

**CLIENT: Woman, 30, earns $80,000 a year, no children, $100,000 in savings.**

**PORTFOLIO BUILDERS: Richard Livingston and Annika Bradley, founder and head of SMSF services, eViser.**

**Recommended asset allocation**

| Asset class | Allocation (%) | Sub-asset class | Allocation (%) |
| --- | --- | --- | --- |
| Australian equities | 45 | Large cap | 25 |
| | | Broad cap | 20 |
| Global equities | 55 | Not currency-hedged | 40 |
| | | Currency-hedged | 15 |

Recommended asset allocation for a woman making $80,000 a year with no children.

Our key objective for this client's portfolio is growth – aiming over the long term to significantly outperform the cash account in which she's currently invested. She needs high-quality investments generating earnings that will grow over time, which means investing in Australian and global shares.

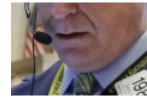
Diversification (spreading risk) is important to reduce the potential impact of company-specific or macroeconomic risks. But at such a young age, she will continue to save and is able to bounce back from setbacks, so we don't want to go overboard on the diversification front.

For larger portfolios we'd consider investing in infrastructure, property or alternatives. However, given the size of her portfolio, she wouldn't end up investing enough in these asset classes to bother. We'll reconsider once her portfolio grows to $250,000.

Our recommended asset allocation is a 45/55 per cent mixture of Australian and global shares.

**Recommended portfolio**

| Investment | Allocation (%) | Annual management cost (%) |
| --- | --- | --- |
| Schroder Wholesale Australian Equity Fund | 25 | 0.92 |
| SGH ICE | 20 | 1.18 |
| Templeton Global Growth Fund | 20 | 1.25 |
| Platinum Global Fund | 20 | 1.54 |
| Magellan Global Equities Fund (Hedged) | [illegible] | [illegible] |



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Recommended portfolio.

The client doesn't have much of an appetite for owning direct shares so we've suggested several high-quality actively managed funds and a listed investment company (LIC). We've also recommended she reduce her overall currency exposure by investing some of her international allocation in a currency-hedged fund.

The cost of active management and its impact on performance is a constant bugbear for investors. However, the fees (roughly $1200 a year) are good value given the expertise and service the client will receive. Besides, each investment in her portfolio has since inception delivered returns (after fees) above the market.

A practical issue she faces is the minimum investment for wholesale managed funds (typically $20,000 to $25,000). It's crucial that she can invest wholesale, as retail funds (those with smaller minimums) are often absurdly expensive. However, it puts a practical limit on the number of funds we can choose and the level of diversification she can achieve.

For Australian shares we've chosen SGH ICE and the Schroder Wholesale Australian Equity Fund. SGH ICE focuses on companies (typically small to medium) that are expected to deliver earnings growth through competitive advantage. The Schroders fund is a more traditional fund focused on larger Australian companies.

Global exposure will come through a mix of Templeton Global Growth – an LIC currently trading at a discount to its net asset value – and managed funds from international share specialists Platinum and Magellan.

Each managed fund is available through ASX mFunds. That means the client can trade everything through her brokerage account, giving her a portfolio with strong growth prospects that's simple to execute and manage.

**CLIENT: Married couple, mid-50s, combined income $140,000, plans to retire at 65, low super balance.**

**PORTFOLIO BUILDER: Sulieman Ravell, managing director, Wealth Focus**

The real issue for these clients is a lack of savings. Whether they achieve an 8 per cent or 10 per cent per annum return, it's going to make very little difference to their retirement.

The temptation is borrow to invest and take more risk. They either need to get comfortable with working until a later date, reducing their expectations in retirement ,or save some money.

They should:

- Pay off debt if they have any (5 per cent interest on a home loan is the equivalent of 7.4 per cent a year taxed at 32.5 per cent).

- Put most of the remainder into a super fund (beneficial taxation).

- Both maximise their concessional contributions of $35,000 a year. If this is unaffordable, use a transition-to-retirement strategy which redirects tax savings into their super.

Advisers often need to charge a minimum fee in order to monitor and manage a client portfolio. The value add on a portfolio below $200,000 is likely to be negligible and I would be tempted to recommend a generic multimanager such as Ibbotson, then tell them to come back to me when they have more money and I can add some value with their portfolio.

The benefit of multimanagers is that you are paying a manager to provide oversight within the portfolio as to the asset allocation and risk and they subsequently allocate out accordingly to the managers they feel most suited.

My preference for Ibbotson has been the widening of their mandate, allowing them to take large positions in cash and/or hedge if they feel risks have been rising in the market.

The key difference is a focus is on providing a return above inflation, rather than just trying to beat their competitors, and I think this is more aligned with investors' needs.

**CLIENT: Widow, 75, no income, $800,000 net worth.**

**PORTFOLIO BUILDER: Stephen Romic, principal and head of research, DFS Advisory**

We believe our Conservative portfolio is most appropriate for the client as it carries the lowest level of risk. The objective of the portfolio is to maintain a low risk level across all market conditions. Portfolio risk fluctuates when changes in market conditions occur, so we change the asset allocation to stabilise the risk. The asset allocation prescribed is based on the current observed volatility levels of the major risk factors that dominate portfolios. These risks, which we review monthly, include equity, yield, currency, and inflation.

| Asset Class | Allocations (%) | Active (%) | Passive (%) |
|---|---|---|---|
| Australian cash/enhanced cash | 34.3 | 31.1 | 3.2 |
| Australian fixed interest | 19.0 | 0.0 | 19.0 |
| High-yield fixed interest | 13.1 | 6.6 | 6.5 |
| Alternatives | 10.0 | 10.0 | 0.0 |
| Australian equities | 7.5 | 4.7 | 2.9 |
| International equities | 6.5 | 4.8 | 1.7 |
| Asia ex-Japan equities | 2.8 | 2.8 | 0.0 |
| International listed property | 2.3 | 2.3 | 0.0 |
| Listed infrastructure | 4.4 | 2.2 | 2.2 |
| **Total** | **100** | **64.5** | **35.5** |

We invest in a broad range of asset classes to ensure the portfolio is well diversified. Currently 76.4 per cent is invested in defensive assets that offer relatively low variation in returns. The exposure to equity risk is also low. This means that the portfolio should be well-buffered against equity market falls. In response to current market conditions, the portfolio has taken the following positions:

- 7 per cent underweight growth assets: risk in equity markets has recently been higher.

- 18 per cent underweight sovereign bonds: they offer little return above cash and are exposed to the risk of rising interest rates.

- 22 per cent overweight cash: especially enhanced cash, which forms the bulk of our allocation.

- 10 per cent allocation to alternatives: the diversification benefits act to reduce overall portfolio risk.

- Underweight US equities: of the equity asset classes, it looks to be most overvalued and hence most at risk should we experience further market volatility.

While the portfolio is expected to generate an income of around $50,000 a year under normal market conditions, the current (historically low) market yields have compressed the income expectation to about $30,000 a year. Consequently, our client may need to access some capital to support her annual income requirement and she would likely be more sensitive to capital losses.

Indeed, the riskiness of many defensive assets has also considerably increased and growth assets are (arguably) exposed to a greater level of uncertainty than they have been in some time. The need for a rigorous risk-based investment approach has never been greater than it is under current market conditions.

Our dynamic asset allocation approach seeks to generate better portfolio outcomes for investors by explicitly managing portfolio risk. Protection from capital losses during volatile equity markets is further incorporated through additional equity risk-management overlays. Our risk-based approach serves to reduce investor angst.


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