RETIREMENT PLANNING

Investment lessons from a big boy on the block

August 9, 2008

 By Bruce Cameron

If you want to double check investment advice you are receiving (as an individual or as a trustee of a retirement fund), it's worth looking at how big financial services companies go about doing the job. And if you need a lower-risk, long-term investment that will provide sound returns then there is no better comparison than a product that comes with a guarantee.

As a retirement fund trustee I was recently given a disclosure report by Old Mutual on its flagship Guaranteed Fund, which has R36 billion in retirement savings under management.

Old Mutual has been issuing the reports since 2004, but the disclosure level has been significantly improved in the latest report. The reports and the increased disclosure have followed a bit of prodding of the industry by the Financial Services Board (FSB).

The FSB encouragement of greater disclosure by life companies to investors is one of the consequences of the implosion of financial services company Fedsure. The implosion saw building industry retirement funds lose 12 percent of the assets (R600 million) invested in the Fedsure smoothed bonus, capital guarantee fund.

Old Mutual's 23-page report is well written and easy to understand, and contains useful information. (For the full report go to www.oldmutual.co.za/corporate.)

The document covers key topics such as the approach taken on the payment of bonuses (investment returns) and how much is held in a reserve account for paying bonuses when markets don't perform. What I found most interesting, from an investment perspective, was the details relating to actual asset management.

In looking at the asset management one must bear in mind that the fund has provided an average annual return of 18.6 percent over the past five years to June 30, 2008 against an average inflation rate of 5.6 percent.

This includes the latest declaration of 13 percent for the year to June 30, which is way above the returns of many market-linked balanced portfolios.

On the topic of asset management, the report looks at:

- **Asset allocation.** There is a sound balance between the asset classes. As at June 2007, total assets - both local and offshore - were spread across the following asset classes:

* Equities (listed shares): 61.5 percent (local and offshore). The portfolio must hold a minimum of 50 distinct shares with pyramid share ownership structures being counted as one company. No single investment may exceed five percent of the total portfolio.
* Interest-bearing instruments (bonds and money markets): 25.3 percent. No less than 25 percent of the portfolio must be in this asset class. This reduces volatility risk.
* Domestic property: 6.4 percent.
* Alternative investments: 6.8 percent. This will be mainly investments in unlisted shares - not high-risk speculative derivative instruments. The fund is restricted to using derivative instruments to reduce investment risk, ensure efficient asset allocation and enhance yields.

* Offshore investment: The fund, with a total of 13.6 percent invested offshore, holds close to the then maximum limit of 15 percent in offshore assets. This must be paying off well now that the rand has been taking a bit of a battering.

- Active versus passive asset management. Until this point everything was much as I suspected it would be. But then I received a big surprise.

The pleasant surprise

The Guaranteed Fund has 53.2 percent in domestic equities. Of this, 50 percent is invested in passively managed portfolios.

Over the years I have written a great deal about passive management. In my view passive investments should form the foundation of any sound equity investment structure.

In a nutshell passive investment is investing money in line with an index, such as the benchmark FTSE/JSE All Share index. In simple terms an index tracks the performance of a group of shares with the influence of each in the index being in proportion to the total capital value of all the issued shares.

A passive index manager simply replicates a chosen index by buying the proportional number of shares of each company in the index.

This is a far cheaper solution than active management where asset managers are paid excessive amounts of money to find what they believe will be the best-performing shares of the future. International research shows that very few managers get it right on a consistent basis.

When I first wrote supportively about passive investment some years ago, I was gainsaid by most financial services companies, including Old Mutual.

Active management is a lucrative business, particularly in the retirement fund arena.

Not only are there asset managers, but there are also consultants and analysts, whose existence is dependent on giving advice on which is the best asset manager to choose.

Retirement funds in particular are steered away from passive investment.

Take note

So when I see 50 percent of the local equity investments of the Old Mutual Guaranteed Fund invested in what is described as a "passive core management style", then we all need to sit up and think about our own approach to investing.

Retirement fund trustees need to have a serious look at this, bearing in mind that lower costs in the end can mean better pensions for fund members.

For individuals there is a growing selection of unit trust index funds, while exchange-traded funds (ETF) are booming both here and internationally.

An ETF is effectively a collective investment, like a unit trust fund, but one that is listed on a stock exchange, but which passively invests in other listed shares on one or more exchanges.

The best-known ETFs are the Satrix range of funds on the JSE, and the Deutsche Bank dbx range, which are rand denominated ETFs which invest on foreign stock exchanges.

In conclusion, congratulations to Old Mutual for moving strongly into passive investment and for telling us all about it.