



Defensive strategy pays off

Capital stable portfolio managers did a good job of capturing returns in 2010.



Back to being stable

- Capital stable funds performed poorly during the GFC.
- Managers had invested in risky, illiquid assets.
- This included high-yield corporate credit, mortgage securities and structured credit.
- For super-fund members, this was a bitter pill to swallow.
- Post GFC, managers have switched back to traditional assets.
- These include safe investments such as government bonds and term deposits.
- Morningstar's median return for fixed-income funds was 6.9 per cent.

On top ...
a review by
SuperRatings
says capital
stable
portfolios
outperformed
balanced and
growth
portfolios.

Illustration:
Karl Hilzinger



By John Kavanagh

Risk-averse super fund members who put their money in capital stable portfolios have had a disappointing few years, with their funds failing to perform at times when their supposed defensive qualities should have provided protection from market turmoil.

This was most apparent in 2008, when fixed interest was the outstanding asset class but many capital stable portfolios were poor performers.

Things were different last year. Defensive assets were, once again, the strong performers but this time capital stable portfolios passed those gains through to their members.

The Australian bond market (using the UBS composite bond index as a benchmark) was up 5.6 per cent in the year to December 31. Cash (UBS bank bill index) was up 4.5 per cent over the same period.

These defensive assets make up the core of capital stable portfolios. Bonds and cash outperformed the local and international sharemarkets (for Australian investors with unhedged exposures) in 2010.

A SuperRatings review of super fund performance in 2010 shows that capital stable portfolio managers did a good job of capturing these defensive asset returns. The median return for the capital stable portfolios the group surveys was 5.3 per cent for the 12 months to December 31.

Compared with this, the median return for balanced portfolios was 4.6 per cent over the same period and, for growth portfolios, the median return was 4.2 per cent.

SHIFT TO TRADITIONAL ASSETS

The head of global wealth management Australia at Pimco, Peter Dorrian, says the fixed interest managers did a better job in 2010 because they returned to more traditional asset management principles.

"In 2008 some managers went too far out on the risk curve," he says. "Another problem was that they bought illiquid assets. The global financial crisis reminded them of the importance of transparency, liquidity and diversification."

Russell Investments' conservative fund portfolio manager, Andrew Sneddon, says that in the years leading

up to 2008 fixed interest managers had adopted a strategy of looking for the sub-sector that would provide relative value when compared with government bonds.

In other words, they sought extra performance by going overweight in high yield corporate credit, mortgage securities or structured credit.

"In 2008 every part of the credit complex underperformed," Sneddon says. "There was nowhere to hide. The problem was compounded by serious liquidity issues."

Dorrian says Pimco had record inflows into its fixed interest funds last year, reflecting a general shift to more defensive assets in super and non-super investment portfolios. "The exposure to fixed interest in our retirement savings portfolios is still low by world standards but we have seen some shift towards holding more defensive assets," he says.

Dorrian says that for 2011, investors can expect returns in line with current yields, which range from about 5 per cent on government bonds to 9 per cent on corporate credit.

Sneddon agrees. "This year is not going to be about capturing any big capital gains from rallying markets," he

says. "It will be about capturing yield. At the moment we are re-weighting our conservative portfolio away from longer dated bonds and adding more cash. Enhanced cash yields are about the same as bonds and will get the benefit of any interest rate increases."

WHICH DEFENSIVE ASSETS?

A big decision for investors looking to add more defensive assets to their super or non-super portfolios is whether to invest via a bond fund or capital stable portfolio, or use term deposits.

With yields on six- and 12-month term deposits about 6 per cent and yields on three- to five-year government bonds about 5.2 per cent, term deposits are the better return.

An FIIG Securities analyst, Brad Newcombe, wrote in the group's newsletter, *The Wire*, in December that investors have to weigh the liquidity of bonds against the superior returns of term deposits. Newcombe's view is that the superior returns outweigh the risk of having to pay an exit fee to get out of a term deposit early.

"Term deposits have a role to play but some investors think they are the only defensive asset," Dorrian says. "Bond funds have done well through active management over the past year."

Morningstar figures back this up.

Its fund manager performance table for the year to December 31 shows that the top-performing fixed interest managers exceeded term deposit rates.

AMP Capital's Australian Corporate Bond Fund was up 10.2 per cent for the year; the Pimco EQT Australian Bond Fund was up 9.3 per cent; the Macquarie Global Opportunities Fund was up 8.8 per cent and the Zurich Investments Australian Fixed Income Pool was up 8.1 per cent.

The median return for Australian fixed income managers in the Morningstar survey was 6.9 per cent. The bond fund managers came out ahead of the term deposit rates by a nose.

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TOP 10 CASH OPTIONS

FUND INVESTMENT OPTION	FEES pa \$50,000	1 YR (%)	3 YR (% pa)	5 YR (% pa)	7 YR (% pa)
MAP - Cash Pool	\$ 875	5.6	4.9	5.0	5.1
Vision SS - Cash	\$ 121	4.8	5.0	5.2	5.1
Sunsuper Solutions - Cash *	\$ 137	4.8	4.7	5.0	4.9
NGS Super - Cash	\$ 190	4.7	4.5	4.7	4.8
Buss(O) - Cash	\$ 128	3.9	3.9	-	-
Local Super - Cash Option	\$ 197	4.7	4.2	4.4	4.5
Club Plus Super - Cash Option	\$ 83	4.7	4.6	4.9	-
Aust Catholic Super & Ret - Cash	\$ 188	4.7	4.4	4.6	4.7
AustSafe Super - Cash	\$ 163	4.6	4.7	5.0	-
HOSTPLUS - Cash	\$ 103	4.6	5.0	5.3	5.2
Cash Index Median		4.0	4.2	4.7	4.6

* Interim Returns Ranked by 1 year returns as at 31/12/2010

SOURCE: SUPER RATINGS

TOP 10 CAPITAL STABLE OPTIONS

FUND	FEES pa \$50,000	1 YR (%)	3 YR (% pa)	5 YR (% pa)	7 YR (% pa)
Local Super - Conservative Option	\$427	8.2	2.5	4.3	6.2
HOSTPLUS - Capital Stable	\$313	8.2	3.2	5.2	6.4
OSF Super - Mix 30	\$291	7.3	4.1	5.4	6.6
AUSCOAL Super - AUSCOAL Stable	\$417	7.0	2.4	4.5	6.6
LGsuper Accum - Conservative *	\$320	6.9	3.0	4.6	5.9
Telstra Super Corp Plus - Conservative	\$192	6.8	2.4	4.9	6.3
Buss(O) - Defensive	\$413	6.7	1.2	4.9	6.5
AustralianSuper - Stable	\$308	6.7	3.3	5.2	6.4
ASGARD Emp Super - SMA Defensive	\$877	6.6	4.1	5.2	-
Local Government Super Accum - Conservative	\$492	6.4	0.3	2.2	-
Capital Stable (20-40) Index Median		5.3	2.3	4.1	5.8

* Interim Returns Ranked by 1 year returns as at 31/12/2010

SOURCE: SUPER RATINGS