Investor Handbook 2019

Welcome

Every year we write about a range of investing topics on our blog at blog.stockspot.com.au. This year we published over 50 articles, as well as our annual Fat Cat Funds Report and annual ETF Research.

We wanted to share a selection of the most popular articles from the last year so that you can catch up on any that you may have missed.

By far our most popular article this year was our 'Best Australian Share ETFs', part of the ETF research that we conduct every year. Following on from that, the recent interest rate cuts also proved to be a very popular topic as well as some research on property investing and self-managed super fund strategies.

We hope you learn something new. Feel free to share these articles with friends or family!

Thank you for your ongoing support and we look forward to continuing to help you on your investing journey in the years ahead.

Regards,

Chris Brycki
Founder and CEO, Stockspot

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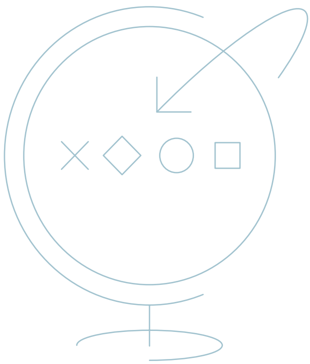
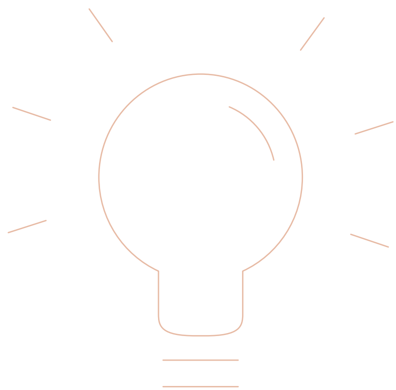


What are ETFs?

ETFs track a market index rather than taking bets on individual companies. For this reason, their management fees are much lower than typical 'active' fund managers. Tracking a market 'index' also offers the benefits of transparency and potential tax efficiency.

ETF investors directly benefit from share capital gains, dividends and franking credits paid by shares contained within an ETF. The majority of funds compared in this article are index ETFs, only the Magellan fund is an active fund which sits inside an ETF-like listed structure.

We have included the Magellan fund because of its size and popularity however, investors should understand that this is an actively managed fund.



Active vs Index investing – what's the difference?

Active investing and index (or passive) investing are 2 different ways to grow your wealth.

BY CHRIS BRYCKI, AUGUST 29, 2016

Actively managed funds aim to beat the returns of a given investment market. Passively managed funds, on the other hand, are designed to mimic the returns of a specific market as measured by a particular index like, for instance, the S&P/ASX 300. This is why they are also known as 'index' funds.

Most of the money being invested in Australia is managed by active funds but passive - or index - investing has been growing fast, particularly since 2008. We look at some of the key differences and why index investing has been growing in popularity.

How active and index investing work

Active investing

Active investing involves trusting your money to a fund manager who uses their investment skills to try and beat the market return. Active funds give you the chance to beat the market return if your fund manager gets their market timing and stock selection right.

Over the past 10 years, active investing has become less popular because fund managers are finding it harder and harder to beat each-other. It's not because active fund managers are getting less skillful but rather because funds management is extremely competitive. As more fund managers have joined the industry, it gets more difficult for them to beat the market because active managers **are** the market.

Investing is a 'zero sum game'; in the long term fund managers in aggregate can only earn the market return minus their fees. Since they tend to charge relatively high fees, about 75% of active fund managers do worse than the market after fees are taken out!

Of course some fund managers will beat the market over a given period and some will underperform. Unfortunately there's no magic formula to picking the fund managers likely to beat the market in the future.

In fact, managers who recently beat the market tend to underperform in the future. Most top-performers can't maintain superior returns over even a couple of years. Of the 664 U.S. active funds in the top 25% in 2012, only 3 of them remained in that top 25% in the following 4 years!

Index (passive) investing

Instead of buying and selling regularly, passive index funds buy and hold investments that track the performance of a particular market or index. For example, the S&P ASX/300 index tracks the largest 300 companies listed on the Australian Securities Exchange (ASX) or the S&P 500 index tracks 500 of the largest companies listed in the United States.

Index investing has several benefits over active investing:

- Fees tend to be lower than active funds, so historically passive investors have earned higher after-fee returns.
- Passive funds tend to be more tax efficient as they turn-over their portfolio less, so realise less taxable capital gains.
- They're generally less risky since they aren't focused on a particular investment style like active funds do.

Billionaire investor Warren Buffett agrees that passive investing is the smartest way to invest. He has gone on record saying that if his wife survives him, his estate plan will recommend keeping 90% of her inheritance in a passive index fund, with the rest in government bonds.

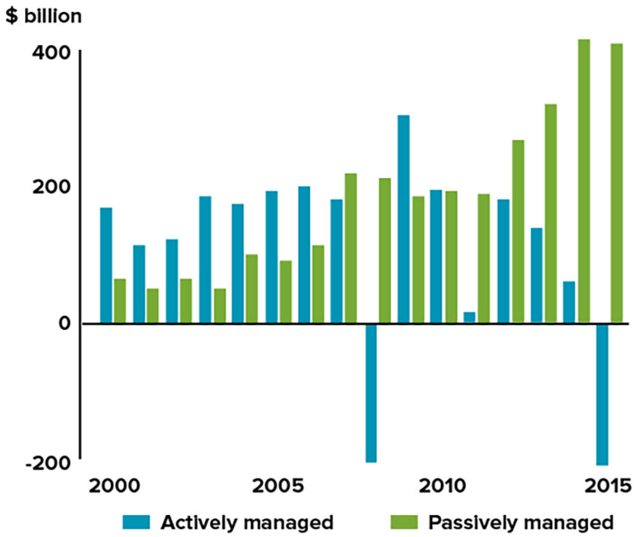
Perhaps not so surprising given Warren Buffett's own portfolio company Berkshire Hathaway, which charges no fees, has underperformed the US stock market index for 5 of the last 6 years. Mr Buffett understands how difficult beating the market really is!

Passive investing is becoming more popular as investors realise most active funds aren't worth their cost. It is why hundreds of billions of dollars have been moving out of active funds and into passive index funds.

We expect this trend to continue as passive index funds still only make up a small percentage of the overall funds management market. In Australia, passive exchange traded funds (ETFs) make up only about 1% of the $2 trillion in investable savings.

No investment strategy can guarantee returns, but you can have better control over the risk you take and the fees you pay if you adopt a passive approach.

Flow of funds from active to passive management



2019 ETF Research highlights

(conducted July 2019)

The Australian ETF market grew 26% over the past year to $45.8 billion in March 2019. Stockspot predicts that ETF FUM will hit $100b by 2022 driven by the combination of Australians having an increased focus on fees and transparency of their investments, continual underperformance of active funds, regulatory change around best interest duty, a shift in brokerage and advice models, product innovation and increased financial awareness of asset class diversification.

The best performing ETF over the last year was the ETFS Physical Palladium (ETPMPD) returning 52.4% as the demand for this precious metal continues to grow. Active ETFs struggled with the K2 Australian Small Cap Fund (KSM) taking the crown for the worst performing ETF (excluding leveraged ETFs) returning -14.3%.

ETFs are saving Australians over $300m per year in fees compared to active fund managers who typically charge 1% p.a. Sadly many advisers still recommend high cost active investing strategies despite the overwhelming evidence that low cost index ETFs are in the best interest of clients based on their diversification benefits and performance.

Bond ETFs attracted almost a third of all new money into ETFs last year, almost doubling its FUM. Bonds were one of the few asset classes that performed well in 2018, serving their purpose as counterbalances when shares fell, and have also benefited from recent interest rate falls.

Vanguard and iShares continue to dominate the ETF market in Australia. Combined, they account for 56% of all money invested in ETFs. This year BetaShares knocked off SPDR to become Australia’s 3rd largest ETF issuer.

Despite ETFs putting increased fee pressure on active funds, average ETF fees in Australia have been increasing over the past few years, primarily due to higher cost active ETFs and new 'sexy' smart beta ETFs coming to market.

Australian share ETFs charging less than 50bps (basis points) in fees had double the returns of ETFs charging more than 50bps over the last 5 years. Low cost ETFs returned 7.2% p.a. vs expensive ETFs which returned 2.9% p.a. This is one of the reasons Stockspot continues to focus on using low cost index ETFs and avoids expensive active fund products.

The 5 most common mistakes that DIY investors make when using ETFs include trying to time the market, listening to short term media news, not paying attention to asset allocation within their portfolio, not doing due diligence on ETF products and bad trading practices.

Australians have a home country bias choosing to invest in our own backyard with 75% of investors choosing to hold only Australian shares, yet the Australian market only makes up 2% of the global market. Global share ETFs are becoming increasingly popular as Aussies realise they need to diversify and reduce their reliance on the local economy, with $21b now in global share ETFs vs $17b in Australian share ETFs. Aussies now have access to ~100 global share ETFs, with 17 out of the 24 new ETFs launched over the last year being Global Share ETFs.

The ETF industry surpassed the LIC market for the first time in September 2018. The first LIC was launched 65 years before the first ETF was launched in 2001. ETFs, at the tender age of just 18, beat the 82 year old LIC! ETFs are superpassing LICs due to their lower costs, greater tax efficiency, better transparency, no conflicted remuneration and not trading at a premium/discount to their true value.

Ethical ETFs continue to gain popularity, increasing 69% to almost $1b in FUM in March 2019. ETF uptake in ethical products has continued due to perceived outperformance, investors preference for 'impact investing', and moral and ethical values being a more important consideration when choosing investments. Ethical ETFs provide a 'feel good' alternative to investing in the broad market, however we believe investors should consider the extra costs and risks, and that performance may be driven by their tilts to different market sectors (like technology and financials), rather than the underlying ethical factors.

What are the best Australian share ETFs?

We road test 5 popular Australian share ETFs, comparing them across 6 factors.

BY CHRIS BRYCKI, OCTOBER 1, 2019

Australian share ETFs continue to gain in popularity. As of September 2019 there is over $20 billion invested in ETFs tracking Australian shares, up 29% from the previous year.

Each year we compare all 200+ ETFs in our Australian ETF Report. Here we road test 5 popular Australian share ETFs, comparing them across 6 factors:

1. Size
2. Costs
3. Slippage
4. Liquidity
5. Returns
6. Track record
7. Stockspot's verdict

ETFs track a market index rather than taking bets on individual companies. For this reason, their management fees are much lower than typical 'active' fund managers. Tracking a market 'index' also offers the benefits of transparency and potential tax efficiency. ETF investors directly benefit from share capital gains, dividends and franking credits paid by shares contained within an ETF.

Size

ASX CODE	ETF NAME	SIZE ($M)*
STW	SPDR S&P/ASX 200 ETF	3,886
VAS	Vanguard Australian Shares Index ETF	4,277
IOZ	iShares Core S&P/ASX 200 ETF	1,516
MVW	VanEck Vectors Australian Equal Weight ETF	996
A200	BetaShares Australia 200 ETF	728

**Total fund assets under management at 30 September 2019*

VAS and STW are the largest Australian share ETFs managing $4.3 and $3.9 billion respectively. MVW has been growing fast and now manages $996m while the newly launched A200 ETF from BetaShares debuted in May 2018 with $50m under management and has since grown to $728m.

Size is important because ETFs must reach a certain size to become viable. As ETFs gather more assets it becomes easier for them to cut their expense ratios (fees) to continue attracting more funds. On the other hand, ETFs which haven't achieved critical mass sometimes shut down and return investor funds or increase their fees to cover their costs.

STW is the most profitable ETF of this group: $3.9b charging 0.19% p.a. which earns them $7.4 million in revenue per year, more than enough to be sustainable. If anything this product is likely to come under pressure to reduce its fees again, especially in response to both Vanguard and iShares reducing their fees in July 2019.

On the other hand the recently launched A200 is earning ~$500,000 p.a. in fees based on its $728 million AUM. BetaShares will be hoping it can continue to amass significant funds so that fee revenue allows this product to be financially viable for them.

Costs

ASX CODE	ETF NAME	MER (% P.A.)
STW	SPDR S&P/ASX 200 ETF	0.19
VAS	Vanguard Australian Shares Index ETF	0.10
IOZ	iShares Core S&P/ASX 200 ETF	0.09
MVW	VanEck Vectors Australian Equal Weight ETF	0.35
A200	BetaShares Australia 200 ETF	0.07

ETF expense ratios are becoming more competitive in Australia. In 2015 STW lowered its MER from 0.29% to 0.19% in response to competitive pressures from VAS and IOZ which were gaining market share with fees of 0.10% and 0.09% respectively. Since then STW has continued to lose share to Vanguard.

Both ETFs have been undercut by BetaShares when they launched A200 at 0.07% p.a. This sent a strong signal from BetaShares that it intends to compete with State Street, Vanguard and iShares in this category.

The 3 lowest cost ETFs are now within 0.03% p.a. of each other on fees. That's great news because costs are one of the only factors you can fully control when investing in Australian shares. The less you pay a fund, the more of the returns you keep in your pocket.

That said, costs have converged to the point where investors need to carefully consider other factors including the funds commercial viability, liquidity and track record.

Slippage

ASX CODE	ETF NAME	% SPREAD
STW	SPDR S&P/ASX 200 ETF	0.03
VAS	Vanguard Australian Shares Index ETF	0.03
IOZ	iShares Core S&P/ASX 200 ETF	0.06
MVW	VanEck Vectors Australian Equal Weight ETF	0.09
A200	BetaShares Australia 200 ETF	0.06

Slippage refers to how much you lose by crossing the spread when buying or selling an ETF. It's calculated by the average percentage difference between the best buyer and seller during market hours.

It has more of an impact if you're trading an ETF or making regular contributions because you'll need to cross the spread more often to get invested. STW and VAS currently have the lowest slippage at 0.03% (three hundredths of one percent).

By comparison the average Australian Equity managed fund offered on the ASX mFunds platform charges a bid/ask spread of 0.55% which is more than 18x more than STW or VAS! ETFs have much lower slippage than most active funds which means investors aren't starting behind the 8 ball when they invest.

Liquidity

ASX CODE	ETF NAME	DAILY TRANSACTED VALUE ($)
STW	SPDR S&P/ASX 200 ETF	27,093,595
VAS	Vanguard Australian Shares Index ETF	21,874,658
IOZ	iShares Core S&P/ ASX 200 ETF	10,828,056
MVW	VanEck Vectors Australian Equal Weight ETF	2,080,144
A200	BetaShares Australia 200 ETF	11,389,206

Liquidity refers to the amount of turnover (or available turnover) in an ETF. We measure it by average daily volume on the ASX. Volume is a measure of market making activity and trading interest which makes it a reasonable estimate of liquidity.

It's worth mentioning that it may not reflect liquidity in the underlying stocks which is typically much deeper for broad Australian share ETFs. However in times of crisis investors may not be able to rely exclusively on market makers for liquidity, so daily volume is a relevant figure.

STW has the highest liquidity with over $27 million of traded value per day in September 2019. VAS and A200 are close behind followed by IOZ and MVW.

Returns

ASX CODE	ETF NAME	3 YEAR TOTAL RETURN P.A.
STW	SPDR S&P/ASX 200 ETF	11.73%
VAS	Vanguard Australian Shares Index ETF	11.76%
IOZ	iShares Core S&P/ ASX 200 ETF	11.65%
MVW	VanEck Vectors Australian Equal Weight ETF	11.75%
A200	BetaShares Australia 200 ETF	–

Total return to 30 September 2019

The 3 largest ETFs all generated similar returns over the last 3 years with IOZ the lowest at 11.65% p.a. and VAS the highest at 11.76%. A200 recently listed so doesn't have 3 years of performance yet.

MVW failed to outperform VAS over 3 years, falling short by 0.01% per year, stemming from its index composition. Where STW, VAS, IOZ and A200 are market-size weighted indices, MVW is an equal-weight index. This leads MVW to take weight out of the largest 10-15 shares and spread it across smaller companies.

The performance of these smaller shares relative to the largest companies is a key driver of differences between MVW and market-size based ETFs. Over a 12 month period, MVW has underperformed VAS, STW and IOZ due to smaller companies underperforming over the last year (MVW falling short by almost 2%) .

Track record

The longer a track record of an ETF and the index it mirrors, the better understanding you have of how an index reacts to different market conditions as well as how closely the ETF is tracking its index.

Most of the broad Australian share indices like the S&P ASX/200 and S&P ASX/300 have existed for some time so you can see how they performed through boom times like 2003-2007 as well as periods of market stress like 2008.

Also important is the 'tracking error' which measures how well an ETF has done at mirroring its index. For example over the last 3 years VAS has generated 11.76% p.a. in returns compared to the benchmark (S&P ASX/300) which has delivered 11.85% p.a.

Tracking error is rarely zero because there are various factors that prevent an ETF from perfectly mirroring its index including fees. In the case of VAS, the difference roughly equals its fees (0.10%), which means it's doing its job right.

BetaShares' A200 fund tracks the newly created Solactive Australia 200 Index. It will take some time not only to see how the index performs, but also how closely A200 tracks the index.

ASX CODE	ETF NAME	INDEX HISTORY
STW	SPDR S&P/ASX 200 ETF	19 years
VAS	Vanguard Australian Shares Index ETF	19 years
IOZ	iShares Core S&P/ASX 200 ETF	19 years
MVW	VanEck Vectors Australian Equal Weight ETF	16 years
A200	BetaShares Australia 200 ETF	1 year

Stockspot's verdict

Since 2014 we've invested on behalf of our clients into the Vanguard Australian Shares Index ETF (VAS).

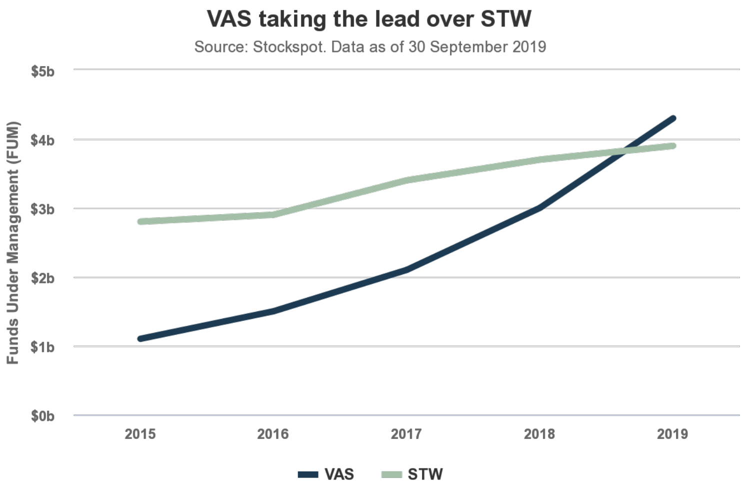
What we originally liked about this fund was its low costs (0.10% p.a.) and that Vanguard has a consistent track record of lowering its fees, not just in response to competitors, but simply because it can.

We continue to favour VAS for a few reasons:

- VAS' low expense ratio (0.10% p.a.) and global track record of reducing costs. By comparison, the largest Australian share ETF (STW) waited 7 years before it lowered its costs from 0.29% to 0.19% in December 2015. It is not surprising that VAS overtook STW in July 2019 this year, as the largest Australian share ETF VAS's broader ASX/300 exposure compared to STW and IOZ which track the ASX/200

- VAS' large size ($4.3 billion) and liquidity ($22m per day)

- VAS' low tracking error and slippage (0.03%)



- VAS' consistent return history and the 19 year track record of the S&P ASX/300 index

While MVW has had some periods of good relative performance over the last 5 years, we aren't compelled by the equal-weight strategy or other non-market cap weighted strategies for reasons we explain in another blog 'Should you buy into smart beta ETFs?'

Where our clients want more exposure to smaller shares we recommend adding a pure small cap tilt using the Vanguard MSCI Australian Small Companies Index ETF (VSO) as a Stockspot Theme. The VSO fund charges 0.30% p.a. and returned 9.77% p.a. over the 3 years to 30 September 2019.

BetaShares' recently launched A200 has received a large take up over it's first year. If it can continue to grow assets to become commercially sustainable while also increasing fund liquidity and building a performance track record, it will become an attractive Australian share ETF option.

For now we continue to be confident in recommending VAS to our clients due to its size, commercial viability, liquidity and track record.

As a final note it's great to see the original Australian share ETF (STW) as well as global ETF giants (VAS and IOZ), different index strategies (MVW) and local disruptors (A200) all have broad Australian share ETFs available.

The Australian ETF ecosystem continues to grow at a rapid pace which is fantastic news for investors.

What are the best Australian Bond ETFs?

We'll show you why and what we look out for when selecting a bond ETF.

BY MARC JOCUM, OCTOBER 1, 2019

There seems to be an important investment asset that many Australians have forgotten. This particular asset has proven time and time again to have great diversification benefits and provide steady, reliable income.

What asset is this you may ask?

The name is Bond…Fixed Income Bonds, and much like 007's martini cocktails, when markets are "shaken, not stirred", bonds can be a valuable part of your portfolio.

In this article we'll show you why and what we look out for when selecting a bond ETF.

What is a bond?

A bond (also known as fixed income) is a loan made by investors to a company or government. Bondholders lend money to the bond issuer for an agreed period (until maturity) and in return for that, they are paid a regular income in the form of interest.

At the end of the agreed period investors also receive their principal back. Historically Australian investors have preferred to invest in the share market, so bonds haven't made it into most people's portfolios.

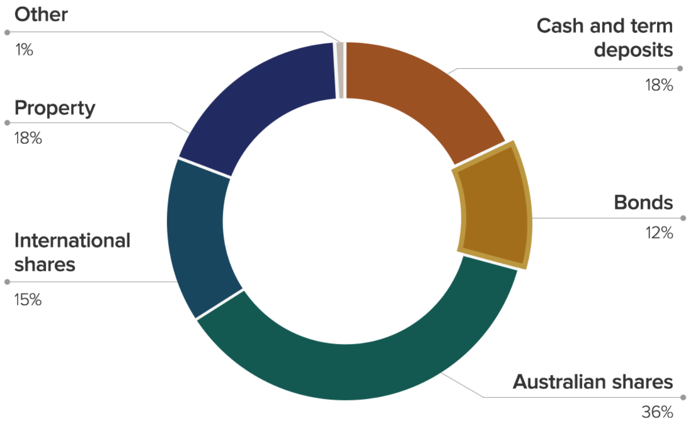
According to SuperConcepts, self managed super funds (SMSFs) only have 12% of their portfolio in Bonds. This is incredibly low given the need for defensive income for those in drawdown and retirement phase, and a cushion to share market falls.

Bonds are considered by many to be boring, but at Stockspot, we believe that boring is brilliant!

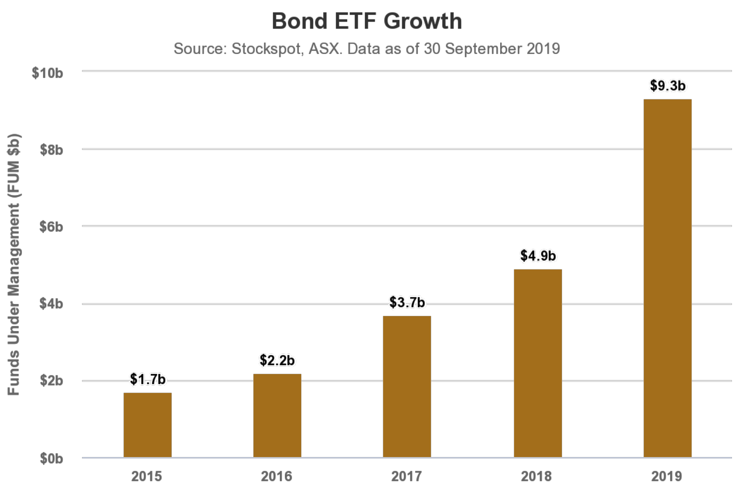
Until recently it has been difficult for everyday investors to access bonds due to high minimum investment amounts, lack of diversification and costs. However, with the rise of Exchange Traded Funds (ETFs), investors now have a solution to easily access bonds and make them a part of their portfolios.

The growth of bond ETFs

Bond ETFs have started to enjoy strong growth over the last 5 years, growing at a rate of 54% per year to ~$9.3b and now make up 17% of the overall ETF market.



Source: SuperConcepts Investment Pattern Trends September 2018.



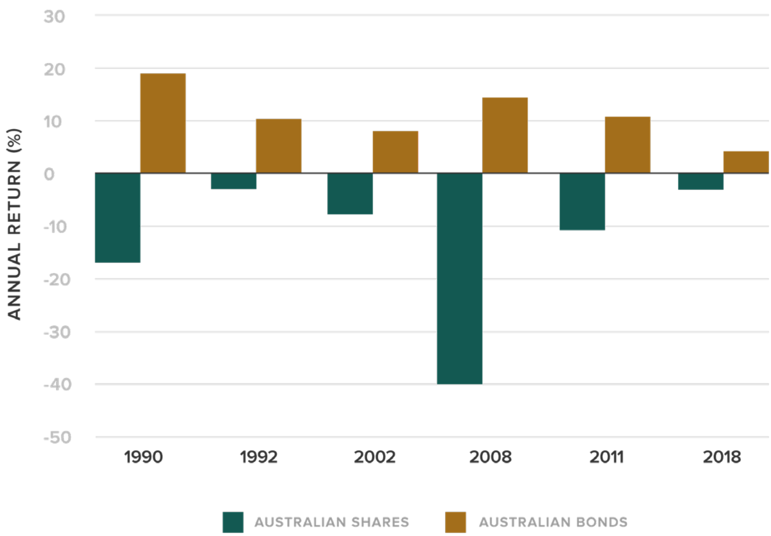
We believe this will continue to rise as ETF issuers release more bond ETFs, and investors demand more defensive assets to smooth out the returns from investing in shares.

Over the past 30 years, it is clear that when shares fall, high grade bonds do their job as a portfolio cushion and rise. Australian bonds were one of the few asset classes with a positive return in 2018 when share markets fell.

Whilst the actors playing James Bond may change overtime (Connery, Moore, Brosnan and Craig), bonds are resilient when share markets fall which has happened 6 times since 1990.

Bond ETFs offer a few key advantages over buying individual bonds:

- **Diversification** – Bond ETFs hold a basket of bonds which improves overall portfolio diversification and reduces the chance of you lending a large amount to a dud company.
- **Transparent pricing** – Bond ETFs are tradeable on the ASX whereas most individual bonds trade in more complex markets with pricing that is not very transparent and there are higher costs to getting in and out.
- **Performance** – Bond ETFs track time-tested indexes, which continually do better than active bond fund managers. The 2018 SPIVA Report showed that 98.4% of active Australian Bond managers underperformed the index benchmark over 5 years.



Source: Stockspot, Vanguard.

- **Yield** – believe it or not, dividends are not the only form of income you can get. Bonds can provide regular, consistent and predictable income, with less volatility than shares.

For more information about the basics of bonds as an asset class and the benefits they can provide, see our blog on 'Why Bonds Belong in Your Portfolio' at blog.stockspot.com.au.

Bond ETF Road Test

Each year we compare all 200+ ETFs in our Australian ETF Report. Here we road test 3 Diversified Australian Bond ETFs:

- iShares Core Composite Bond ETF (IAF)
- SPDR S&P/ASX Australian Bond Fund (BOND)
- Vanguard Australian Fixed Interest Index ETF (VAF)

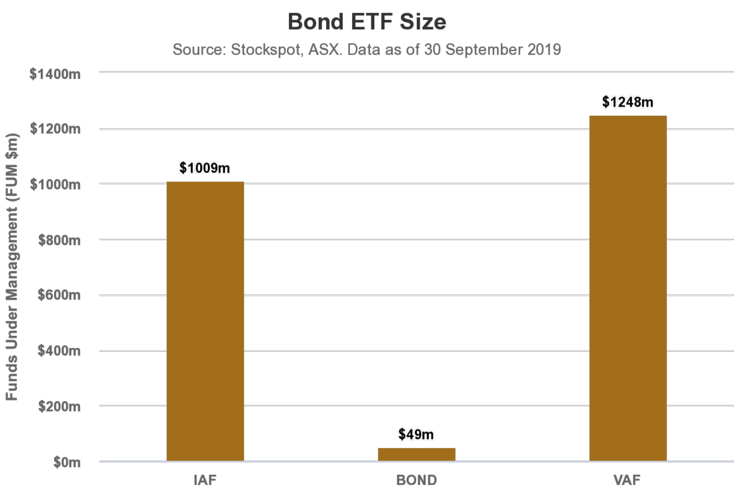
We compare them across 5 factors:

- Size
- Costs
- Liquidity
- Track record
- Other factors

Size

IAF and VAF are the 2 largest Australian Bond ETFs managing $1b and $1.2b respectively. BOND has struggled to gain traction despite being listed at a similar time to its peer group.

This is likely due to a number of factors including BOND having higher costs, lower liquidity, less diversification (only holding ~120 bonds), and it tracking a less widely known benchmark.



Costs

When it comes to cost, the headline management fee (known as the Management Expense Ratio [MER]) is not the only thing investors should pay attention to.

Unfortunately, some ETF and Fund Managers bury all hidden costs in their Product Disclosure Statements. Think very tiny writing and lots of pages.

This is why it is important to consider the Indirect Cost Ratio (ICR), which incorporates all necessary transactional and operational costs to run the fund.

We also like to examine the slippage (buy/sell spreads) of each of the ETFs. This refers to how much you lose when buying/selling the ETF.

It is calculated as the average percentage difference between the best buyer and seller during market hours.

ASX CODE	COST (INDIRECT COST RATIO)	BUY/SELL SPREADS (AKA SLIPPAGE)
IAF	0.20%	0.04%
BOND	0.24%	0.08%
VAF	0.20%	0.03%

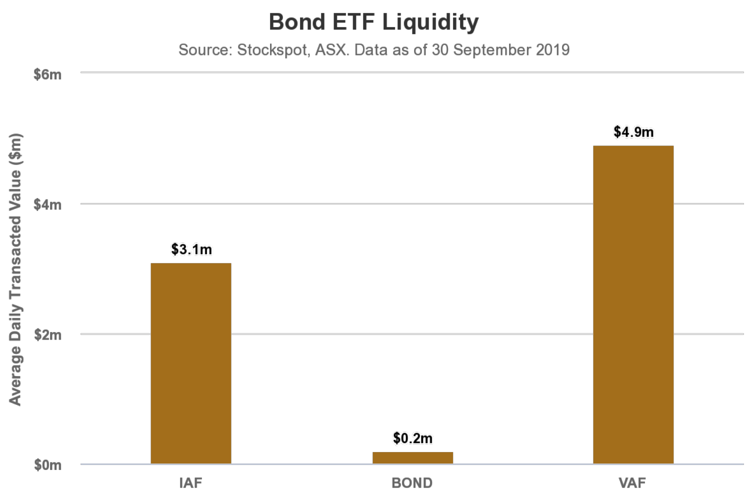
Source: ASX Fund Statistics September 2019

Both IAF and VAF have the lowest fees charging 0.20% per year. BOND is on the more expensive side charging 0.24% per year and incurring double the slippage of IAF and VAF.

Liquidity

ETFs have 2 layers of liquidity – the liquidity of the ETF, and the liquidity of the underlying bonds within that ETF.

One measure of liquidity is measured by the average daily volume on the ASX. Volume is a measure of market making activity and trading interest which makes it a reasonable estimate of liquidity. IAF and



VAF both have ample liquidity with average daily volume of ~$3-$5m.

Greater trading volumes make it easier to buy and sell an ETF and reduces the spread/ slippage involved.

Performance track record

ASX CODE	1 YEAR TOTAL RETURN	3 YEAR TOTAL RETURN (P.A.)	5 YEAR TOTAL RETURN (P.A.)
IAF	11.23%	4.45%	5.10%
BOND	12.37%	4.61%	5.28%
VAF	11.29%	4.43%	5.10%

The 3 Australian Bond ETFs have generated similar returns over the past 1,3 and 5 year periods. This is because they track a similar underlying portfolio of bonds.

Given the performance of the funds are likely to be similar, we place a greater importance on other factors when assessing these ETFs.

The longer a track record of an ETF and the index it mirrors, the better understanding you have of how an index reacts to different market conditions as well as how closely the ETF is tracking its index.

Also important is the 'tracking error' which measures how well an ETF does at mirroring its index.

ASX CODE	INDEX	INDEX HISTORY (INCEPTION DATE)	ETF HISTORY (INCEPTION DATE)
IAF	Bloomberg AusBond Composite 0+Yr Index	September 1989*	March 2012
BOND	S&P/ASX Australian Fixed Interest Index	October 2011	July 2012
VAF	Bloomberg AusBond Composite 0+Yr Index	September 1989*	October 2012

**Bloomberg acquired UBS Australia's Bond Indexes in April 2014, and subsequently rebranded. The original UBS index was created in September 1989.*

ASX CODE	5 YEAR ETF PERFORMANCE (P.A.)	5 YEAR INDEX PERFORMANCE (P.A.)	TRACKING ERROR
IAF	5.10%	5.27%	-0.17%
BOND	5.28%	5.54%	-0.26%
VAF	5.10%	5.27%	-0.17%

IAF has the longest track record (albeit marginally), having been listed for over 7 years, and tracks the widely used Bloomberg AusBond Composite Index. It's had strong performance since inception and also had low tracking error to its underlying index.

Other factors

We look at a few others factors when selecting a bond ETF:

- **Duration** – A measure of how sensitive a bond is to changes in interest rates. Bond prices and interest rates have an inverse relationship (i.e. when interest rates go up, bond prices fall).
- **Credit Quality** – this is a measure of how likely a bond is to default (not pay its investors back). The scale ranges from the highest quality (AAA) to the lowest (D), with a rating of BBB- considered to be "non-investment grade" and is more risky.

  For example, Australia has a rating of AAA whereas a country like Mozambique is rated D. The lower the credit quality, the higher the risk of defaulting. Bonds with worse credit quality tend to pay a higher interest rate to compensate investors for taking more risk.
- **Yield to Maturity** – The rate of return an investor can expect if they hold the bonds until their maturity date. This does not factor in the price return, only the income return (known as coupon payments).

Bonds with shorter durations and better credit qualities provide a better diversification cushion when share markets fall. Poorer credit quality bonds can give you a higher yield but have a more similar correlation to shares so aren't as helpful as a portfolio diversifier.

ASX CODE	DURATION (YEARS)	YIELD TO MATURITY (%)
IAF	5.6	1.14%
BOND	6.1	1.13%
VAF	5.6	1.14%

Source: ETF Product Provider as of 30 September 2019

Stockspot's verdict

James Bond chooses the Aston Martin as his choice of wheels. Stockspot adopts the same high quality approach when selecting a bond ETF. We've selected IAF for the Stockspot portfolios due to its size, liquidity, track record, high credit quality and relatively short duration.

It is an effective diversifier for the Stockspot portfolios due to its ability to cushion against share market volatility. Thanks to owning IAF and GOLD, all of the Stockspot portfolios had positive returns in 2018 despite a negative year for share markets.

We also offer international bonds using the Vanguard International Fixed Interest Index (Hedged) ETF (ASX: VIF) as part of our Stockspot Themes range. VIF invests in a diversified range of high credit quality and income generating bonds issued by governments around the world (such as the USA, Japan, France and the UK).

What are the best Global Share ETFs?

We road test 12 popular Global share ETFs, comparing them across 5 factors.

BY CHRIS BRYCKI, OCTOBER 1, 2019

International share ETFs and U.S. share ETFs have had a huge increase in popularity for individual and SMSF investors in Australia.

As of September 2019 there is almost $25 billion invested in ETFs tracking global shares on the ASX, representing almost half of the Australian ETF market. The largest and most popular track either a broad global index or the U.S. share market which is considered to be a proxy for global shares.

Each year we compare all 200+ ETFs in our ETF Report. Here we road test 12 popular Global share ETFs, comparing them across 5 factors, as well as summarising our favourites.

- Size
- Costs
- Slippage
- Liquidity
- Returns
- Stockspot verdict

Size

There are 6 global share ETFs with over $1 billion under management (IOO, IVV, MGE, VGS, VEU and VTS). The S&P 500 ETF (IVV) has been the most popular, attracting $3.2 billion on the ASX.

The US share market has outperformed other global markets over the last 5 years so investors have gravitated to this market for their global exposure. The unhedged global ETFs (IOO, IVV, MGE, VGS and WXOZ) have drawn in more funds than their hedged equivalents.

This would suggest that Australian investors are comfortable with the addition of currency diversification when they invest in global shares. A falling Australian dollar has also made the unhedged ETFs more attractive over the last 3 and 5 years.

Overall there is $12.8 billion invested in the 12 largest global ETFs. For the Stockspot Portfolios we have invested our clients into the S&P Global 100 ETF (IOO).

ASX CODE	ETF NAME	SIZE ($M)*
IOO	iShares S&P Global 100 ETF	1,687
IHOO	iShares S&P Global 100 ETF (AUD Hedged)	45
IVV	iShares S&P 500 ETF	3,191
IHVV	iShares S&P 500 ETF (AUD Hedged)	237
MGE	Magellan Global Equities Fund (Managed Fund)	1,518
MHG	Magellan Global Equities Fund (Managed Fund) (AUD Hedged)	112
VGS	Vanguard MSCI Index International Shares ETF	1,898
VGAD	Vanguard MSCI Index International Shares ETF (Hedged)	676
WXOZ	SPDR S&P World ex Australian Fund	198
WXHG	SPDR S&P World ex Australian Fund (Hedged)	92
VEU	Vanguard All-World ex US Shares Index ETF	1,509
VTS	Vanguard US Total Market Shares Index ETF	1,727

**Total fund assets under management at 30 September 2019.*

Our clients also have the option to add the S&P 500 ETF (IVV) for extra US shares or the All-World Ex-US ETF (VEU) for extra non-US shares as part of Stockspot Themes.

You can skip ahead to 'Stockspot verdict' to see why we've selected these funds for our clients and how they've performed.

Costs

ASX CODE	ETF NAME	MER (% P.A.)
IOO	iShares S&P Global 100 ETF	0.40
IHOO	iShares S&P Global 100 ETF (AUD Hedged)	0.43
IVV	iShares S&P 500 ETF	0.04
IHVV	iShares S&P 500 ETF (AUD Hedged)	0.10
MGE	Magellan Global Equities Fund (Managed Fund)	1.35
MHG	Magellan Global Equities Fund (Managed Fund) (AUD Hedged)	1.35
VGS	Vanguard MSCI Index International Shares ETF	0.18
VGAD	Vanguard MSCI Index International Shares ETF (Hedged)	0.21
WXOZ	SPDR S&P World ex Australian Fund	0.30
WXHG	SPDR S&P World ex Australian Fund (Hedged)	0.35
VEU	Vanguard All-World ex US Shares Index ETF	0.09
VTS	Vanguard US Total Market Shares Index ETF	0.03

Management fees for this group of ETFs varies widely, from 0.03% for the Vanguard and iShares US share ETFs to 1.35% for the Magellan active fund.

The pricing for the index funds have been driven by competition, with new ETFs tending to be launched at lower pricing than previously listed similar funds to gain new flows and switching.

The Vanguard products will continue to put fee pressure on iShares and SPDR, particularly where similar Vanguard funds exist. WXOZ and IOO have higher fees than VGS although WXOZ and IOO have performed better even on an after-fee basis.

Slippage

Slippage refers to how much you lose by crossing the spread when buying or selling an ETF. It's calculated by the average percentage difference between the best buyer and seller during market hours.

It has more of an impact if you're trading an ETF or making regular contributions because you'll need to cross the spread more often to get invested.

Slippage tends to be higher for global ETFs when compared to Australian ETFs since many global markets are closed when the Australian Securities Exchange (ASX) is open.

ASX CODE	ETF NAME	% SPREAD
IOO	iShares S&P Global 100 ETF	0.08
IHOO	iShares S&P Global 100 ETF (AUD Hedged)	0.11
IVV	iShares S&P 500 ETF	0.07
IHVV	iShares S&P 500 ETF (AUD Hedged)	0.09
MGE	Magellan Global Equities Fund (Managed Fund)	0.29
MHG	Magellan Global Equities Fund (Managed Fund) (AUD Hedged)	0.43
VGS	Vanguard MSCI Index International Shares ETF	0.05
VGAD	Vanguard MSCI Index International Shares ETF (Hedged)	0.07
WXOZ	SPDR S&P World ex Australian Fund	0.14
WXHG	SPDR S&P World ex Australian Fund (Hedged)	0.22
VEU	Vanguard All-World ex US Shares Index ETF	0.13
VTS	Vanguard US Total Market Shares Index ETF	0.06

This leads market makers to maintain a wider 'spread' during ASX hours. VGS currently has the lowest slippage at 0.05%. By comparison the average Australian Share ETF also has a bid/ask spread of 0.05%.

Index ETFs generally have lower slippage than active funds which means investors in index funds aren't starting as far behind the 8 ball when they invest.

For example, a round-trip of buying, holding and selling the Magellan Global Equities Fund (MGE) over the last 3 years would have incurred 2 buy-sell spreads plus management fees which totals 4.63% of costs (that's before performance fees).

The fund has generated net returns of 64.6% which means that an investor holding for 3 years would have paid away over 7% of their net return in costs.

By comparison an investor in IVV over the same time period would have round-trip costs of 0.25% compared to a net return of 65.2% so only paid away 0.4% of their return in cost.

That's one fifteenth of the Magellan fund costs paid by the index ETF owner including getting in and out!

It shows why active funds management as an industry is much more lucrative for the fund managers than the end investors. Fred Schwed wrote about this timeless concept in one of the best investing books of all time 'Where are all the customers yachts?'.

Liquidity

ASX CODE	ETF NAME	DAILY TRANSACTED VALUE
IOO	iShares S&P Global 100 ETF	$1,817,721
IHOO	iShares S&P Global 100 ETF (AUD Hedged)	$122,559
IVV	iShares S&P 500 ETF	$10,517,542
IHVV	iShares S&P 500 ETF (AUD Hedged)	$6,020,211
MGE	Magellan Global Equities Fund (Managed Fund)	$3,343,404
MHG	Magellan Global Equities Fund (Managed Fund) (AUD Hedged)	$457,614
VGS	Vanguard MSCI Index International Shares ETF	$4,789,401
VGAD	Vanguard MSCI Index International Shares ETF (Hedged)	$1,671,975
WXOZ	SPDR S&P World ex Australian Fund	$114,010
WXHG	SPDR S&P World ex Australian Fund (Hedged)	$181,374
VEU	Vanguard All-World ex US Shares Index ETF	$3,330,195
VTS	Vanguard US Total Market Shares Index ETF	$4,146,323

Liquidity refers to the amount of turnover (or available turnover) in an ETF. We measure it by average daily volume on the ASX. Volume is a measure of market making activity and trading interest which makes it a reasonable estimate of liquidity.

It's worth mentioning that it may not reflect liquidity in the underlying stocks which is typically much deeper for broad global share ETFs.

However in times of crisis and during ASX trading hours investors may not be able to rely exclusively on market makers for liquidity so daily volume is a relevant figure. Liquidity closely matches up with ETF size.

Eight of the largest global ETFs turn over more than $1 million dollars worth of volume per day.

Returns

ASX CODE	ETF NAME	3 YEAR TOTAL RETURN (P.A.)
IOO	iShares S&P Global 100 ETF	17.14%
IHOO	iShares S&P Global 100 ETF (AUD Hedged)	13.34%
IVV	iShares S&P 500 ETF	18.23%
IHVV	iShares S&P 500 ETF (AUD Hedged)	12.90%
MGE	Magellan Global Equities Fund (Managed Fund)	18.07%
MHG	Magellan Global Equities Fund (Managed Fund) (AUD Hedged)	13.94%
VGS	Vanguard MSCI Index International Shares ETF	15.19%
VGAD	Vanguard MSCI Index International Shares ETF (Hedged)	11.44%
WXOZ	SPDR S&P World ex Australian Fund	14.82%
WXHG	SPDR S&P World ex Australian Fund (Hedged)	10.94%
VEU	Vanguard All-World ex US Shares Index ETF	10.99%
VTS	Vanguard US Total Market Shares Index ETF	17.85%

Total return to 30 September 2019.

ETFs with more U.S. share market exposure (IVV and VTS) have produced the best 3 year returns while the funds with the lowest U.S. exposure (VEU) have underperformed.

U.S. shares have had strong 3 and 5 year returns thanks to the performance of shares like Apple (AAPL), Amazon (AMZN), Microsoft (MSFT), Alphabet (GOOG), Berskhire Hathaway (BRKB) and Facebook (FB).

The outperformance of US shares vs the rest of the world has historically been cyclical so is likely to reverse at some point in the market cycle.

In recent months European, Australian and Asian share markets have started to perform better than the US and tech shares which have slumped.

Of the broad global ETFs without a specific US focus, IOO (18.23%) has performed better than VGS (15.19%) and WXOZ (14.82%). The unhedged versions of each of these ETFs have beaten the hedged versions due to the Australian dollar falling.

The Magellan active fund (MGE) has performed well compared to the broad global ETFs, but many other active managers in this space have underperformed the S&P500 ETF (IVV).

It shows again why the benefit of active funds management generally accrues to the manager rather than the end investor. It's no wonder 92% of US active fund managers underperformed the index over the last 15 years.

This is the key reason we avoid active funds for our clients. Indexing tends to do better than active management due to investing being a zero sum game.

Stockspot's verdict

Since 2014 we've invested on behalf of our clients into the S&P Global 100 ETF (IOO).

The fund invests in the largest 100 companies in the world so provides great diversification across the world's largest and most successful businesses which are predominantly located in the US, UK, Switzerland, France, Germany, Japan and Korea.

Despite slightly higher fees than other options, this fund's focus on large companies has been the driver behind IOO outperforming the similar broad global ETFs: VGS and WXOZ.

This has meant our clients have earned an extra 2.2% over 1 year and 9.4% over 3 years by being in IOO rather than VGS.

Broad global share ETFs

ASX CODE	ETF NAME	1 YEAR TOTAL RETURN (P.A.)	3 YEAR TOTAL RETURN
IOO*	iShares S&P Global 100 ETF	9.71%	60.72%
WXOZ	SPDR S&P World ex Australian Fund	7.60%	51.39%
VGS	Vanguard MSCI Index International Shares ETF	8.42%	52.85%

Total return to 30 September 2019.
** Selected Stockspot fund*

We continue to favour IOO for our clients due to its size, track record and exposure to the world's largest 100 companies. However we expect iShares and SPDR will need to be more competitive on fees or risk losing funds to the more competitively priced Vanguard funds.

For clients who want to add extra U.S. shares to their portfolios we offer the iShares S&P 500 ETF which can be added as a theme. It's currently our most popular theme, likely because of its strong recent performance.

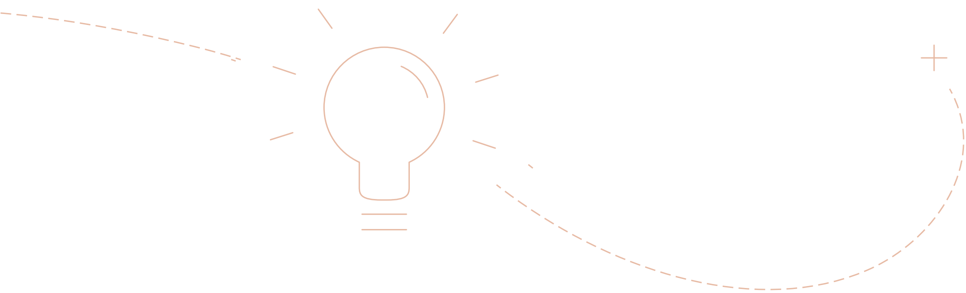
For those looking to invest globally but who would prefer to avoid U.S. companies, we offer the Vanguard All-World ex US Shares Index ETF. It hasn't performed as well over 5 years but is more insulated if tech shares or the U.S. economy falter with more even diversification across Japan, the UK, China, France, Germany, Switzerland and Canada.

ASX CODE	ETF NAME	1 YEAR TOTAL RETURN (P.A.)	3 YEAR TOTAL RETURN	5 YEAR TOTAL RETURN (P.A.)
IVV*	iShares S&P 500 ETF	10.64%	18.23%	16.49%
VEU*	Vanguard All-World ex US Shares Index ETF	4.75%	10.99%	8.69%

Total return to 30 September 2019.

** Selected Stockspot fund*

It's wonderful to see such a broad range of Global ETF options available for Australian investors. We'll continue to review the global ETF universe to ensure our clients get access to the best options available based on our careful analysis.



How are ETFs taxed?

Everything you need to know about tax on ETF investments in Australia.

BY CHRIS BRYCKI, APRIL 25, 2019

One of the reasons exchange-traded funds (ETFs) have gained popularity with Australian investors is because they are highly tax efficient. Compared to managed funds and Listed Investment Companies (LICs), ETFs tend to have lower turnover and pay out fewer capital gains.

This is great news for investors in ETFs who typically inherit a lower tax bill during their holding period compared to other fund structures which need to distribute regular capital gains from redemptions or frequent rebalancing.

If you've invested in ETFs on your own, through a broker, or with the help of an automated investment service like Stockspot, here are some tax issues to consider. Keep in mind that this article is general information only and doesn't consider your personal circumstances.

Important considerations

- Best to own ETFs in your own name
- Australian share ETFs can pass on franking credits
- Capital gains on ETFs
- Tax on ETF distributions
- Tax on foreign ETF income

Why ETFs are tax efficient

- Lower capital gains tax compared to most active managed funds
- ETFs are tax efficient compared to unlisted managed funds

What you need to lodge your tax return

- What you need to lodge your tax return via eTax or an accountant
- Ask your accountant or seek personal tax advice if your situation is complex

Important considerations

It is best to own ETFs in your own name

Whether you're managing a portfolio of ETFs on your own, or using an automated investment service like Stockspot, you should check how the ETFs are owned.

If you own ETFs through an Australian online broker or Stockspot, the ETFs should be owned legally and beneficially in your name on a Holder Identification Number (HIN) at the CHESS subregister.

From a tax perspective it is the safest and most simple way to own ETFs as it is clear what income and capital gains you have made through the year. Owning ETFs in your own name means you get full access to franking credits and don't need to pay other people's tax.

If you own ETFs through an online broker, you'll need to calculate your tax liability each year using the Annual Tax Statements from each of the ETFs you own.

How Stockspot calculates tax

Stockspot makes life easier by combining the statements from all ETFs you own. It means that you or your accountant only need to use a single document to do your tax.

Income from the individual ETFs as well as any capital gains will be summarised in your annual investor statement from us.

We send all clients their annual investor statement in August after we receive and process the Annual Tax Statements from all of the ETFs that our clients hold.

We get this information directly from the ETF registries like Computershare and Link Market Services. Stockspot clients also receive the full benefits of franking credits on Australian ETF income.

In addition to franking credits, Stockspot calculates the 15% withholding tax benefit on your overseas income and the 50% capital gains discount on investments held for 12 months.

What to check with other brokers and investment services

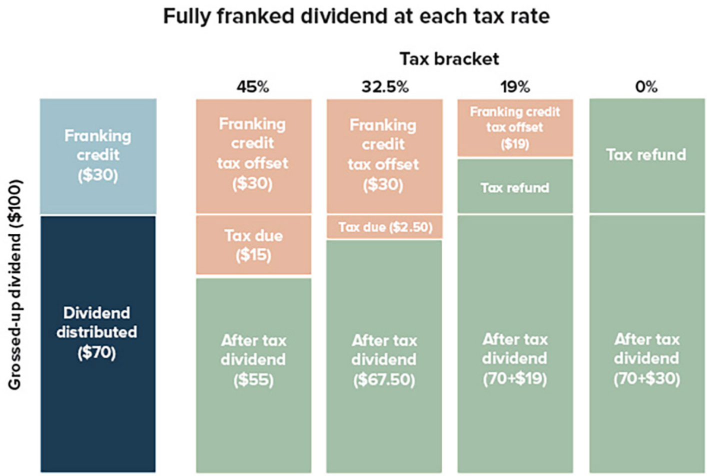
If you invest in ETFs via another investment service, overseas based stock broker, Separately Managed Account (SMA), or a managed investment scheme which uses a custody or trustee structure, tax can get more complex. You may or may not get the full benefit of franking credits.

Before investing it's important to find out what tax information they'll provide to you at tax time each year. It will differ service to service and some won't provide a comprehensive summary to help you prepare your tax.

You or your accountant will have a fair amount of tax work to complete each year, especially if you own a few ETFs. It's also crucial to ask if you're receiving the full benefits of:

- franking credits on your Australian ETF income
- the 15% withholding tax benefit on your overseas income
- the 50% capital gains discount on investments held for 12 months

Platforms and investment services which use an overseas custodian or a managed investment scheme structure may not be able to pass on all of these important tax benefits to you. These tax benefits can add up to over 1% per year in extra returns so you don't want to miss out on this tax value.



Source: PwC and State Street Global Advisors, 31 December 2013
Note: Data does not take into account Medicare levy.

Australian share ETFs can pass on franking credits

The dividend system in Australia can offer important advantage for investors in ETFs. If Australian company taxes are already paid by the companies within an ETF, then investors do not need to pay those taxes again at the personal level. The corporate taxes paid are passed down to the Australian investor through tax credits (often known as franking credits).

With ETFs you receive the benefit of franking credits but are generally less reliant on them because your portfolio will be diversified across different sectors and asset classes. For example, the Stockspot portfolios returned 0.270% to 0.685% in franking credit value in 2018.

The benefits of franking credits

Franking credits can be used to reduce an investor's total tax liability to account for the taxes on dividends already paid by companies. For individuals or complying superannuation entities, any excess franking credits can be refunded at the end of the year if the investor's tax liability is less than the amount of the franking credits.

The dividends investors receive will only be taxed at their marginal tax rates. This is a big benefit for those on lower tax brackets including self managed superannuation funds (SMSFs).

Within the Stockspot core portfolios Vanguard Australian Shares Index (VAS) distributes franking credits which we summarise for clients in their annual investors statement. This makes it easy for you or your accountant to claim the full value of franking credits on your tax return.

Capital gains on ETFs

If you sold any ETFs during the year, you will be required to calculate your Capital Gains Tax (CGT) liability (if any) with respect to those ETFs. ETF issuers won't send a Capital Gains Tax Statement by default so it's up to you to calculate any capital gains and put it in the correct place on your tax return.

Where you've owned an ETF for 12 months, the law allows the taxable capital gain to be reduced by 50% for individuals. This means that tax is only paid on half of the capital gain.

For Stockspot clients, we calculate your tax liability for you including any ETFs that were sold or rebalanced during the year. This will be summarised in your annual investor statement from us.

Tax on ETF distributions

A distribution from an ETF represents your share of the income earned by a fund. Each ETF may earn different types of income, for example dividends, realised capital gains or interest. Also, the income may be Australian or foreign.

ETFs can be a bit complex because they are structured as unit trusts, not ordinary shares. This means the types of income earned by an ETF can be split across different categories when they are distributed to you.

If you manage your own ETF portfolio, the income components required to complete your tax return will be shown in the Annual Tax Statement posted to you or available to download from the registry website associated with each particular ETF.

In 2016 the ATO changed the rules around trusts by creating the Attribution Managed Investment Trust regime or AMIT. This has added further complexity to ETF tax. For Stockspot clients, we calculate the total distributions received from all the ETFs you owned during the year. It will be summarised in your annual investor statement.

Tax on foreign ETF income

Where an ETF invests in overseas companies, some of the income distribution may be withheld from investors. This is known as withholding tax. The level of withholding tax varies depending on where the company resides and the tax rules in place between Australia and the residing country.

For example, Australian investors who buy ETFs domiciled in the United States will incur a 30% withholding tax on any distributions. Australian investors are generally eligible to reclaim some of this back as a foreign tax credit.

US-domiciled ETFs available on the ASX require that investors completes a W 8BEN form to reclaim a 15% foreign tax credits. In 2018 Blackrock converted 14 of their iShares US domiciled ETFs to Australian domiciled ETFs.

This removed the annoying W8BEN form for investors in the following ETFs: IAA, IEM, IEU, IJH, IJP, IJR, IKO, IOO, IRU, ITW, IVE, IVV, IXI, IXJ and IZZ.

Within the Stockspot core portfolios, iShares Global 100 ETF (IOO) and iShares Emerging Markets ETF (IEM) previously required that investors complete a W-8BEN form to claim back tax.

We make it easy for clients by completing the form for you so all you need to do is print, sign and send to a reply-paid address for the 15% saving. These ETFs have since been re-domiciled so no longer require a W8BEN form.

Why ETFs are tax efficient

Lower capital gains tax compared to most active managed funds

Generally, ETFs have low portfolio turnover as they track an index rather than buying and selling stocks regularly. It makes them tax efficient as there is rarely a capital gains tax (CGT) liability being passed to individual investors.

Constant trading by actively managed funds means an investor will pay much more in CGT while they're invested in the fund. For this reason, ETFs incur lower CGT compared to most active managed funds.

ETFs are tax efficient compared to unlisted managed funds

ETFs are also more tax efficient than managed funds because they trade on stock exchanges, such as the Australian Securities Exchange (ASX). Unlike unlisted managed funds, ETF portfolio managers do not need to sell the shares they've invested in to raise cash to pay investors who redeem or sell the fund.

For unlisted managed funds, this redemption process can lead to a capital gains tax (CGT) liability for all investors, regardless of how long they have owned the fund. One ETF investor's sell decision has no impact on other investors.

Lodging your tax return

What you need to lodge your tax return via eTax or an accountant

If you own ETFs through an online broker, you need to calculate your tax liability each year using the Annual Tax Statements from each ETF you own.

To do this combine the totals provided by each ETF as well as calculate any capital gains (or losses) that you've made during the financial year.

Stockspot combines the statements from all ETFs you own. It means that you or your accountant will only need to use a single document to do your tax. Income from the individual ETFs and any capital gains will be summarised in your annual investor statement from us.

If you own ETFs via a platform, another robo-adviser, Separately Managed Account (SMA), or managed investment scheme you need to find out what tax information they'll provide to you.

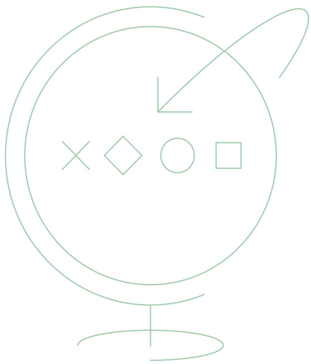
It's also important to find out if you're receiving the full benefits of franking credits on your Australian income, the 15% withholding tax benefit on your overseas income and the 50% capital gains discount on investments held for 12 months.

Ask your accountant or seek personal tax advice

Keep in mind that this article is general information only and doesn't consider any individual's personal circumstances. ETFs offer a range of tax advantages for Australian investors, however everyone's individual circumstance are different. Each ETF can also have a different tax treatment.

You should consult with your accountant to learn more about the tax consequences of owning ETFs and how it may impact your overall tax. This is particularly important if you are a non tax resident of Australia or are investing via a Trust or Self Managed Super Fund.

The Australian Taxation Office (ATO) also has a helpline for personal tax enquiries, which is 13 28 61. In addition, the ATO has a number of publications which will help you understand what you need to do to complete your return.



Seven myths about ETFs

Are ETFs causing a market bubble? We debunk this and other myths pedalled by active fund managers about indexing and ETFs.

BY CHRIS BRYCKI, OCTOBER 14, 2019

The hero of The Big Short, Michael Burry, has placed ETFs on his 'bubble' watch list. The collective groan from the ETF industry was audible. It's no coincidence that those most threatened by ETFs and index investing (active managers) are also its most vocal opponents.

This isn't new.

The active funds management industry has rallied against index investing ever since the first index fund was launched in the 1970s.

A poster by Wall Street Investment firm Leuthold criticising index investing during the early days of the Vanguard Group (1975)

Despite this, S&P Dow Jones estimates that indexing has saved investors US$287 billion in fees since 1996.

In this article I'll explain;

- What led me to index investing;
- Why active investors play a vital role in the market (and why you should avoid them!);
- Finally, I'll dismantle seven popular myths pedalled by active fund managers about indexing and ETFs and explain why Burry is wrong.

Part 1: What led me to index investing

My background is not what you'd expect for a strong advocate of index investing. I was an active investor since buying my first share at the age of 11.

I was fortunate to be mentored by some truly brilliant investors and traders during my career. However, working in the funds management industry made something very clear to me.

Firstly, the vast majority of fund managers **do not beat the market** after their fees are subtracted.

Picking winners in either individual stocks or in fund managers is difficult for the same reason: beating the market is a zero sum game, meaning for every winner there's a loser.

Because all active fund managers charge significant fees it is a mathematical certainty that as a group **they must underperform the market**. Fewer than 20% of Australian share market fund managers beat the market over 15 years.

The results are even worse for global fund managers with less than 8% beating the market. For other asset classes, like Australian bonds, only 2% of managers beat the market after costs.

The Pensions Institute compared 516 active share market funds over 10 years and found that only 1% of active funds were able to produce enough returns to offset their costs.

Incredibly, 99% delivered no outperformance after costs. The report also found that it's "incredibly hard to identify" which fund managers are going to do well in the future. [i]

One reason for this is that active fund managers who do well in one period tend to do poorly in the next. It takes 22 years of performance data to be 90% confident a fund managers' performance is actually due to skill and not luck.

In reality, only a tiny percentage of investors consistently beat the market and they fall into one of two groups:

1. they don't need your money to invest because they're already independently wealthy from their skill; or
2. they'll take your money, charge a management fee and reward themselves for any outperformance.

All of this is why you are better off earning the market return through an indexed fund or ETF.

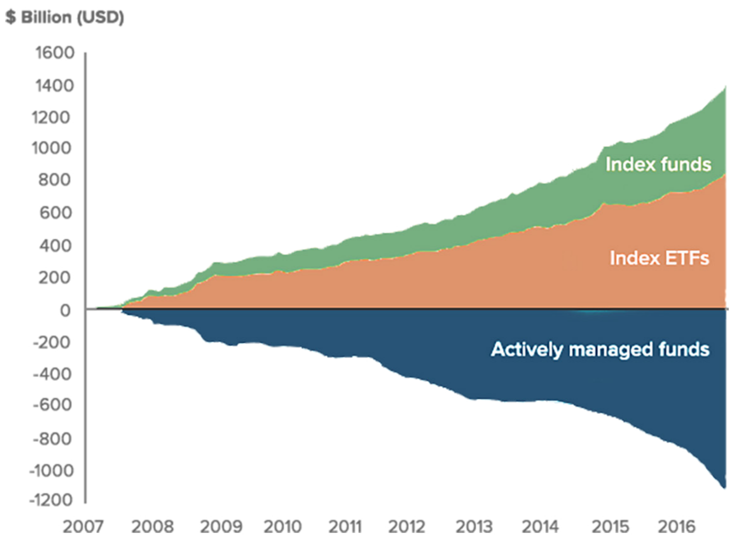
The trend out of active funds has been accelerating since the Global Financial Crisis when they provided no protection from the financial bloodbath.

Contributing to this trend has been regulatory change requiring advisers to act in the best interests of their clients and awareness of the benefits of low-cost investing.

Currently the 200+ ETFs on the ASX have a market capitalisation of $54 billion, or 2% of the share market size. In the US, ETFs comprise 16% of the investment fund market while in Canada and Europe they equate to 5% of the total market.

Globally ETFs are estimated to save investors $20 billion a year in costs and taxes. They continue to grow in popularity because they are a convenient and transparent way to invest into a large range of shares and because most fund managers can't justify their fees.

Flows from active to passive funds in US shares



Source: Investment Company Institute, Simfund, Credit Suisse

Part 2: What's the role of active fund managers?

Active fund managers do perform a vital role in setting the price of shares because they participate in almost all market trades and determine prices. This means that one active fund manager sells to another.

If the share price goes up the buyer outperforms the seller. If the share price falls the seller outperforms the buyer. In practice the seller is taking a bet that the price of the shares that he sells will not perform as well as the shares he has just bought.

For every active winner there has to be an active loser. There are thousands of active investors engaged in this every day – and the sum of their efforts amounts to the market price of each share and the market index level.

An indexed fund or ETF doesn't buy and sell any shares in response to a fund managers' opinion about future prices or dividends. Instead it owns all of the securities within an index.

The performance of the index fund is therefore the performance of the market as a whole. When you invest in an index fund you're letting other informed investors set the fair price level – and you benefit from investing at that price.

As more money goes into indexing it becomes harder to beat the market because the less capable active fund managers are being weeded out.

Think of it like buying avocados at Woolworths. Behind the scenes informed people are setting the equilibrium price level. When you walk into the store you don't need to 'bid' for an avocado, you just get the 'market price'.

Index investors do need active investors to set market prices. But as an investor you don't need to pay a high fee to the people setting prices when you can simply take the price they've set for a much lower fee.

This is the beauty of indexing.

Part 3: Demolishing a few myths about indexing and ETFs

Here are seven common myths peddled about ETFs and indexing and why they're wrong.

Myth 1: Indexing makes all shares move together

ETFs do not pick stocks and therefore cannot set prices. Rather, they buy the companies within an index at their relative 'market weights'. They have no influence over what shares come in or out of an index. All of that is determined by active buyers and sellers.

This year AMP shares have fallen 20% while CSL shares have risen 30%. Money coming into index funds would buy both of these shares in their relative index weights set by active investors.

ETFs don't actively buy and sell often, so they only contribute a small amount of the overall trading volume, in most of the world it's less than 5% of volume and even in the U.S. trading by indexed funds only accounts for around 15% of volume. [ii]

Myth 2: Indexing misprices shares

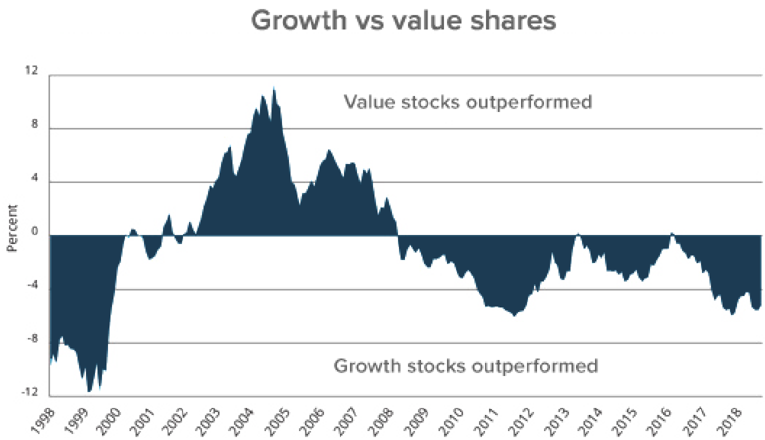
This rumour seems to originate from fund managers who have underperformed and looking to excuse their poor performance. Index funds cop the blame for causing the shares they own to be ignored and undervalued.

ETFs cannot influence prices in any meaningful way. Furthermore, if indexing did cause shares to be mispriced this would create opportunities for active investors to beat the market. Active fund managers would be celebrating, not bemoaning indexing.

The more money that gets indexed, the less 'dumb' money is left for active fund managers to beat. This is known as the Paradox of skill.

Myth 3: Indexing has harmed returns from 'value' shares and 'small company' shares

Throughout history there have been many periods where small companies have done better or worse than large companies, and when value shares have



The value of S&P500 Value Index's returns minus S&P500 Growth Index's returns.
Source: Morningstar, Hartford Funds

done better or worse than growth shares.

This has nothing to do with indexing and everything to do with normal market cycles. Sometime 'value' shares do well, sometimes 'growth' shares do well. It is hard to profit from this because nobody really knows why, how long it will last or when the paradigm is about to flip.

A more likely reason value fund managers have done poorly over the last 10 years is too many value fund managers! Warren Buffett's right hand man, Charlie Munger, says it best:

[Value fund managers] are "like a bunch of cod fishermen after all the cod's been overfished. They don't catch a lot of cod, but they keep on fishing in the same waters. That's what's happened to all these value investors. Maybe they should move to where the fish are."
Charlie Munger

Myth 4: Indexing is a bubble – or is causing a market bubble

Booms and busts are not caused by indexing, it is the herd mentality of investors chasing or leaving markets. Markets have gone through booms and busts since the start of time due to economics, governments, wars, monetary policy and a whole host of other factors.

There have always been sectors of the share market which have shown incredible volatility. In the 1630s it was the Dutch Tulip mania. In 1720 the South Sea bubble and in the 1970s there was the infamous minerals boom led by Poseidon in Australia. 1999 was the year of the largest flow of funds into US tech shares ever. This was well before the growth of ETFs, yet there was no shortage of active fund managers eager to buy tech stocks at the peak.

At Stockspot we believe the safest way to avoid the risk of falling into the herd mentality trap is to provide a portfolio which provides a balance between assets, countries and sectors.

We are very wary of sector bubbles and allocate funds to safe havens such as gold to smooth returns. This and our much lower fees are the main reasons why our portfolios have outperformed more than 90% of similar investment funds over the last 5 years.

Myth 5: Active funds protect you in down markets

In the market falls of 2000 and 2008 active managers performed on par with the index. Jason Zweig provides an historical appraisal in Sorry stock pickers, history shows you underperform in down markets too.

The reason for this is that for every active investor who beats the market, there's one who hasn't. Active investing is a zero sum game versus the index.

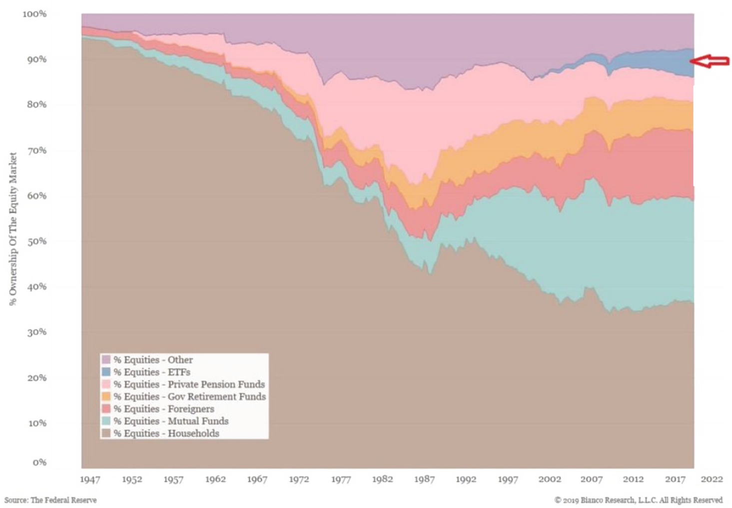
Investors in actively managed funds are in aggregate certain to underperform the market by the fees charged by these funds in both up and down markets because active investors are the market.

As more money goes into indexing it becomes harder to beat the market because the less capable active fund managers are being weeded out.

Myth 6: Indexing could cause everyone to sprint for the exit when markets are stressed

Human nature applies equally to active

Who owns the equity market?



The ownership of the US share market over time. ETFs make up around 16% of the U.S. share market. Source: The Federal Reserve, Bianco Research.

and index funds. If more people want to sell than buy, both active and index investors are impacted equally. In any event, indexed funds still only comprise 2% of the Australian share market.

Even in the U.S. ETFs still only make up a small amount of the overall market and are much better equipped to handle situations where a lot of investors want to sell at once, whereas 'closed' active funds may 'lock up' investor funds.

A recent example of this is the active Woodford Equity Income Fund in the UK – once a star fund manager it has now gone into administration and frozen redemptions (sales). Investors in this fund can't get their money out.

Myth 7: Indexing is the idiots guide to investing

A stockbroker recently told me that 'buy and hold indexing is dumb' and their clients were much more sophisticated because they 'traded often'. However, an active investor trades on the assumption they're better informed than other participants. An ETF investor benefits from the prices determined by active investors who are taking bets against each other.

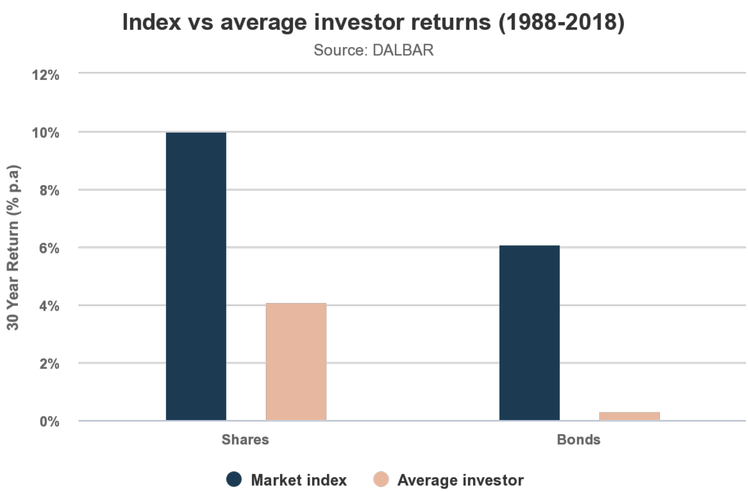
Investing is one of the few places in life where the evidence shows that the more you do, the less you get.

For 30 years the DALBAR research has shown that people who make fewer decisions, both advised and unadvised, earn higher returns.

The truly sophisticated clients are the ones investing into index funds and doing nothing else.

The upshot of all this

It's strange that some people think it's a bad thing that people are moving money out of active funds that have high costs, high turnover, poor performance and are tax inefficient into indexing and ETFs which have lower costs, are more tax



efficient and perform better as a whole.

Indexing is also easier to understand and more transparent.

The rapid growth of index investing and ETFs over the past decade is here to stay and reflects the ‘deflating’ of the active investing boom of the 1980s to early 2000s.

Investors have rightly given up on the ‘star’ power of active fund managers.

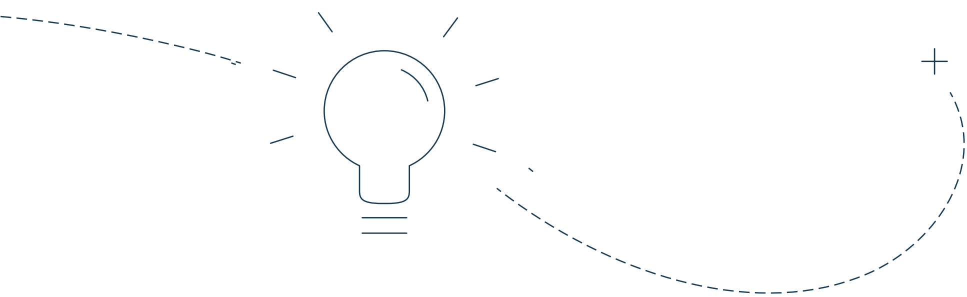
I believe financial advisers should stop trying to pick whether prices are ‘too high’ or ‘too low’ (where they have no edge) and instead encourage clients to be disciplined to their investing plans and to stick with them.

For those who rely on active stock picking for their careers and businesses, indexing remains the easy punching bag because livelihoods are at stake. This raises some ethical questions around whether self-serving arguments are being put ahead of investors and clients.

Meanwhile there is one group you won’t hear complain about low-cost index funds and ETFs – the people who invest in them.

[i] Pensions Institute Discussion Paper PO-1404 “New Evidence on Mutual Fund Performance”

[ii] The implications of passive investing for securities markets, BIS Quarterly Review March 2018



We compare LICs vs ETFs, which is best?

Our comparison of popular ASX listed LICs to index ETFs.

BY MARC JOCUM, AUGUST 5, 2019

Listed investment companies (LICs) used to be one of the best ways for an investor to gain access to a broad range of shares in one transaction.

Throughout the 1900s, ASX listed LICs became more popular with everyday Australians because of the diversification they offered across sectors and countries.

Fast forward to 2019 and the case for LICs no longer stacks up for investors when you compare them to exchange traded funds (ETFs). Our analysis reveals ETFs are superior in every measure; transparency, liquidity, certainty, fees, tax efficiency and most importantly, returns.

When you look at the data, this becomes even more shocking:

- **95% of Australian share LICs failed to beat a market index over 5 years**. You would have **20% more money** had you invested in an Australian index ETF 5 years ago rather than one of the 3 largest Australian share LICs.
- **Not one** LIC tracking broad global markets was able to beat a global market index ETF over the past year.
- The average management fee of a LIC is over 1% p.a. (**5x a typical ETF**). This doesn't even include performance fees and the tax drag of a LICs higher portfolio turnover.
- LICs regularly trade at a **discount** to their asset value (on average 7%). Investors have no certainty they'll be getting fair value when they buy and sell. LICs can also issue new shares which dilute existing investors, making this even worse.

Why are LICs still popular?

Unfortunately for investors, many stockbrokers and financial advisers continue to recommend LICs instead of lower cost index ETFs. This baffles us since ETFs have clear benefits over LICs, not least their lower fees, greater transparency and better performance.

As with most aspects of the finance industry, the motivation is largely self-interest. Stockbrokers and financial advisers are paid a healthy commission to recommend new LICs to their clients via a 'stamping fee'.

Once the LIC is listed and the

stockbrokers and advisers have collected their commissions most LICs trade well below their net asset value (NAV).

LICs are another excellent example of a loophole in the Aussie investment industry that puts financial remuneration of the people selling investments over the financial wellbeing and best interest of their clients, everyday Australians.

Stockspot has long campaigned about unfair fees in superannuation and managed funds. LICs are no different.

Given there is now $45 billion trapped in LIC products we think government needs to urgently act to ban commissions on all new LIC issuances so Australian consumers start to get better advice from their advisers and stockbrokers.

- What is a LIC?
- Why is the share value of a LIC different from the underlying value of its assets?
- Compare LICs vs ETFs
- Performance of the largest Australian share market LICs vs ETFs
- Performance of the largest global share market LICs vs ETFs
- Best performing LICs for 2019
- Worst performing LICs for 2019
- Stockspot's view
- LIC Performance tables

What is a LIC?

A listed investment company (LIC) is an actively managed fund listed on the Australian Securities Exchange (ASX). Like a managed fund, LIC money is pooled together from investors to buy a range of investments.

Unlike managed funds, LICs have a company structure, so shareholders own shares in the company (as opposed to units in a fund). Investors buy and sell shares in the LIC to each other. This means no one can sell shares in a LIC unless someone is willing to buy them at the offered price.

LICs pay company tax (currently 30%) on earnings and can choose to pay distributions to investors in the form of dividends, including any attached franking credits.

There are 114 LICs on the ASX, worth $45.1b. The LIC market has grown by 10% over the past year, much slower than the 30% growth in ETFs over the same period.

Nearly two thirds of LICs invest only in Australian shares, with the remainder investing in global shares and bonds, and a small number in infrastructure and property.

Most LICs trade at a discount to their Net Asset Value or NAV (average discount is 7%). For example if the investments inside a LIC are worth $1, a typical LIC would trade on the ASX at $0.93.

Here in lies one of the main problems with LICs: investors rarely get what they pay for as they rely on other investors in the same LIC to buy off them when they decide to sell.

This discount has increased over the last few years which has hurt their overall performance. These discounts may never close, trapping investors in LICs that have both underperformed and trade at a discount to their asset value.

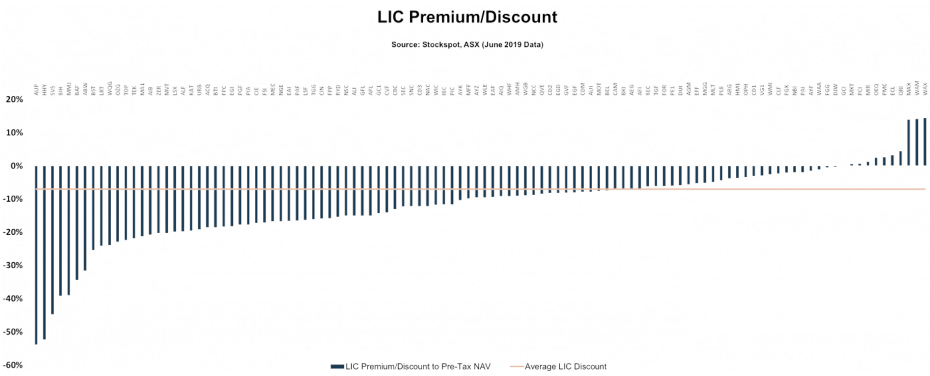
Why is the share value of a LIC different from the underlying value of its assets?

One reason for this difference is the shareholders' view of the additional value brought by the fund manager. If LIC shareholders think that the fund manager will provide no additional value the LIC will trade at a discount to the value of the underlying assets.

The size of the discount depends on the management fee – which is a drag on future returns. For example, if the underlying assets are expected to produce a 10% p.a. return and the management fee is 1% p.a. the shares are likely to trade at a 10% discount (given the total return after fees is 9%).

If shareholders think that management can deliver an additional 1% p.a. return and the management fee is 1% p.a. then the shares will trade at the value of the underlying assets.

Most LICs trade at a discount to their Net Asset Value (NAV) as shown in the following table of all the LICs listed on the ASX. Note that the average discount to NAV is around 7%.



However, many LICs trade at discounts much greater than just taking into account their management fee. This is partly because investors have formed the view that management will underperform the market and partly because of the liquidity of the LIC itself. A seller of an unloved and ignored LIC may have trouble finding buyers at any price.

Comparing LICs vs ETFs

We recently discussed the key differences between ETFs and LICs and also provided some context as to why ETFs have been growing faster.

	ETFS	LIC
Transparency	ETFs must disclose their portfolio at the end of each trading day.	LICs do not disclose their portfolio until a reporting deadline, generally monthly. The portfolio which is disclosed is already out of date.
Liquidity	ETFs have market makers which stand in the market to buy or sell at prices very close to NAV. Indicative NAV (iNAV) is updated every 30 seconds allowing the market makers to trade at close to real time values.	LICs rely on buyers and sellers for liquidity.
Tax	ETFs put taxable income in the hands of the unitholder and there is less turnover of underlying assets and therefore lower realisation of capital gains.	LICs are taxpaying entities which pay dividends. The investor is therefore at the mercy of the LIC dividend and franking credit policy as well as realisation of capital gains.

Tax differences between LICs and ETFs

LICs pay company tax on their income before distributing it to shareholders. This means LIC investors are entitled to receive fully franked dividends.

However, LICs tend to have much higher portfolio turnover than index ETFs, which creates an ongoing ‘tax drag’ from realising more capital gains each year.

ETFs distribute income on a pre-tax basis and pass on any franking credits received by Australian companies they’ve invested in. Distributions from the Vanguard Australian Shares Fund (VAS) are about 80% franked.

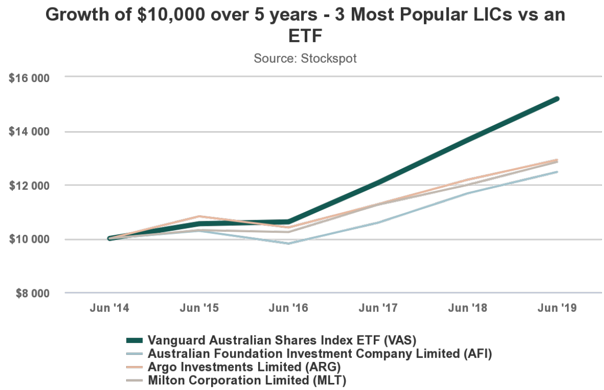
The creation and redemption process for ETF units is also tax efficient since there is no asset sale and no capital gains when units are created or redeemed. The ETF issuer can select which shares to use, so it will pick those with a low cost base, reducing the ETF’s tax burden.

The reason most LICs underperform is high fees

On average LIC costs are 5x more than a typical index ETF and that’s before the LICs costs of buying and selling shares, performance fees, tax impacts of high portfolio turnover and the dilution impact of LICs issuing more shares.

The impact of high costs becomes more apparent with each passing year as LICs find it more and more difficult to generate sufficient returns to make up for the drag of their costs.

The below chart shows that $10,000 invested in one of Australia’s largest LICs 5 years ago would be worth roughly $12,500 today including dividends and capital growth. That same amount invested in the Vanguard Australian Shares Index ETF (VAS) would be worth over $15,000.



This is one reason why we have advised clients since 2014 to invest in the Vanguard Australian Shares Index ETF (VAS) rather than use LICs that invest in Australian shares.

Performance of the largest Australian share market LICs vs ETFs

Many Aussie investors would be familiar with the Australian Foundation Investment Company Limited (AFI), which is by far the largest and most popular LIC with $7.5b in FUM. It's also the oldest LIC in the market having listed in 1936.

Argo Investment Limited (ARG) comes in a close 2nd in popularity after building up FUM of $5.8b, listing over 70 years ago. Milton, WAM and BKI are also all over $1 billion in size.

TICKER	NAME	FUM ($B)	1 YR RETURN	5 YR RETURN (P.A.)
	S&P/ASX 200 Accumulation (market index)		**11.6%**	**8.9%**
AFI	Australian Foundation Investment Company Limited	$7.5b	6.8%	4.5%
ARG	Argo Investments Limited	$5.8b	6.0%	5.3%
MLT	Milton Corporation Limited	$3.2b	7.1%	5.1%
WAM	WAM Capital Limited	$1.2b	-9.0%	7.7%
BKI	BKI Investment Company Limited	$1.1b	8.9%	3.7%
	Average LIC Return		**4.0%**	**5.3%**
VAS	Vanguard Australian Shares Index ETF	$3.9b	11.4%	8.7%
STW	SPDR S&P/ASX 200 ETF	$3.9b	11.4%	8.5%
	Average ETF Return		**11.4%**	**8.6%**

Returns as of June 2019 (Source: ASX)

Research by S&P/SPIVA that shows that 80% of active Australian share funds have underperformed over 15 years and this is also evident with LICs with almost all of them underperforming the index and ETFs.

89% of Australian share LICs underperformed the Vanguard Australian Shares Index ETF (VAS) over the last year. The figure is even worse over the long term, with 95% (19 in 20) of broad Australian share LICs failing to beat the ETF over 5 years.

Performance of the largest global share market LICs vs ETFs

It's similar story for global share LICs. Not a single one of the 18 broad global share LICs beat the Global 100 ETF over the last year. Worse still, 62% of global share LICs had **negative** returns while the Global 100 ETF had a positive year returning +14.6%!

TICKER	NAME	FUM ($B)	1 YR RETURN
	MSCI World Ex Australian Index Unhedged (market index)		**12.0%**
MGG	Magellan Global Trust	$2.2b	13.6%
MFF	MFF Capital Investments Limited	$1.6b	9.8%
VG1	VGI Partners Global Investments Limited	$1b	6.6%
LSF	L1 Long Short Fund Limited	$0.9b	-25.3%
FGG*	Future Generation Global Investment Company Limited	$0.5b	-2.2%
	Average LIC Return		**0.5%**
IOO	iShares S&P Global 100 ETF	$1.6b	14.6%
VGS	Vanguard MSCI Index International Shares ETF	$1.7b	11.5%
	Average ETF Return		**13.1%**

**HM1 was the 5th biggest global share LIC with $0.6b in FUM but does not have a 1 year performance track record yet. FGG was used instead in the table for comparison purposes. Returns as of June 2019 (Source: ASX)*

We've published articles in the past about Australians preference to invest in Australian shares. For investors wanting exposure to shares in global markets like the USA, Europe and Asia, ETFs have more consistent performance and are a better, transparent way to access these markets.

Sometimes a LIC will perform well but performance tends to come and go. According to S&P, only 1 in 10 U.S. share funds have beaten the index over 15 years.

This is why we advise clients to invest in the iShares S&P Global 100 Index ETF (IOO)

rather than use LICs that invest in Global shares.

Best performing LICs in 2019

Only one third of all LICs on the ASX had a positive 1 year return to 30 June. The average LIC return was -4% compared to the average ETF return of +8%. The returns within asset classes tell the same story.

The best performing LIC was the Bailador Technology Investments Limited (BTI) delivering a return of 42% return over the year. The LIC invests in a range of tech startups and private equity deals.

A strong year for assets like infrastructure meant Argo Global Listed Infrastructure Limited (ALI) and URB Investments Limited (URB) returned a total of 29% and 20% respectively.

High dividend yielding strategies such as Clime Capital Limited (CAM) rounded out the top performers over 1 year but have underperformed the market benchmark over longer periods with a 5 year return of just 5.9% p.a.

ASX CODE	LIC NAME	1 YEAR RETURN
BTI	Bailador Technology Investments Limited	41.9%
ALI	Argo Global Listed Infrastructure Limited	28.8%
CAM	Clime Capital Limited	21.6%
URB	URB Investments Limited	19.9%
PL8	Plato Income Maximiser Limited	19.7%

Worst performing LICs in 2019

The worst performing LIC was the 8I Holdings LTD (8IH) which lost 52% over the year. Its fellow value manager, the Forager Australian Shares Fund (FOR), also had a poor year, falling 39%. Forager was previously a star fund with top quartile returns.

Lowell Resources Fund (LRT) lost 39%

over the year, despite many resource ETFs being up almost 15%. Cadence Capital Limited (CDM) was the fourth worst performer, declining 36% over the year and -6.4% p.a. over the last 5 years.

Finally, the HHY Fund (HHY) lost 35% and may soon be shutting down after a proposed change of investment manager and responsible entity. A fund closure or merger due to poor active performance is another risk of owning a LIC.

ASX CODE	LIC NAME	1 YEAR RETURN
8IH	8I Holdings Ltd	-52.0%
FOR	Forager Australian Shares Fund	-39.4%
LRT	Lowell Resources Fund	-39.3%
CDM	Cadence Capital Limited	-35.9%
HHY	HHY Fund	-34.8%

Stockspot's view

Every year a couple of LICs perform well, but fund manager performance is inconsistent and almost impossible to predict. Of the top 25% of active Australian share funds in 2014, only 1.3% remained in the top quartile by 2018. Zero active Australian small cap fund managers remained in the top quartile from 2014 to 2018.

LICs served a purpose about 20 years ago but the investment world has moved on. In a country like Australia it is incomprehensible that stock brokers and financial advisers are not regulated to act in the best interests of their clients. If this were the case LICs would no longer continue to operate or be forced to modernise.

We urge the government to ignore the loud voices and deep pockets of the LIC lobby groups. It should move to act in the best interest of investors and close the LIC loophole by banning stamping fees and commissions.

How to build an awesome investment portfolio

Clients sometimes ask us how we built the Stockspot portfolios, and why we selected 5 assets.

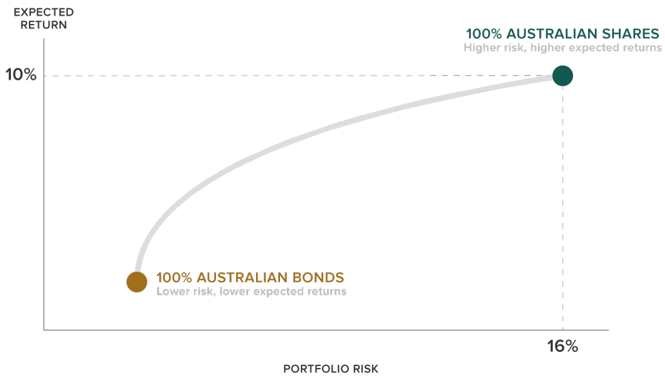
BY CHRIS BRYCKI, NOVEMBER 9, 2018

Clients sometimes ask us how we built the Stockspot portfolios, and why we selected 5 assets. It comes down to the purpose of the Stockspot portfolios which is to **maximise returns for each level of risk**. Five assets allows us to give clients the best possible combination of returns, risk and costs.

To do this we leverage the benefits of diversification. Diversification simply means that by combining investments with different characteristics you can improve the quality of returns in your portfolio.

Quality of returns is measured by how much risk you need to take to earn a certain return. Since all investing involves taking some risk, the aim is to minimise the risk you need to take to earn the return you want. Diversification across assets enables you to take less risk to earn better returns.

Let's start with a investment portfolio of 100% Australian shares. Assuming it's a



balanced portfolio with, say 25 stocks across different sectors, you're likely to earn a return of about 10% per year over the long term. Great right? Well... not really.

The risk of that investment portfolio (measured by standard deviation of returns) is about 16% per year. That means you can expect your portfolio to go up or down by about 1% **per day**! That's not so awesome.

In layman's terms, that's like cycling down a freeway, in rush-hour, without a helmet – sounds quite scary right? Lots of risk and not much protection. It means on years when the market suffers a crash or correction, your portfolio falls by that full amount. In 2008 that was about -35%! Ouch!

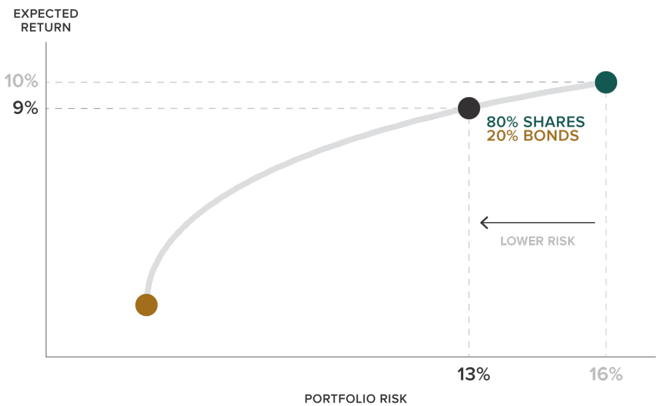
Bonds are beautiful...

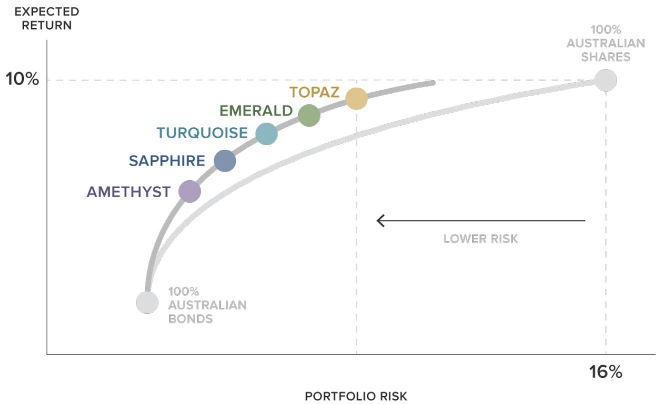
Now let's say you add a second asset – bonds. This is where the benefits of diversification start to kick in.

Based on a portfolio of 80% shares and 20% bonds you can expect to earn a return of about 9% per year – with risk of about 13%. Compared to the 100% shares portfolio it means you're sacrificing about 1% per year in returns but getting a benefit of 3% less risk!

This is a **more efficient investment portfolio** because you take on significantly less risk and don't need to give up much return.

Revisiting our analogy, the cyclist has decided to turn off the freeway onto a designated cycle lane. It's a little less hairy... and much less accident prone. In 2008 during the financial crisis, a portfolio of 80% shares and 20% bonds would have been down less than -25%, which is a lot better than those entirely invested in shares who lost -35% in one year!





Five is the magic number

Now let's look at the benefit of adding 3 more asset classes to Australian shares and bonds. The 3 other assets included in the Stockspot core portfolios are global shares, emerging market shares and gold.

By adding these 3 assets to the investment portfolio, expected returns improve by 0.5% to 1.0% per year based on the same level of risk as portfolio of only Australian shares and bonds. Higher returns without higher risk is the magic of diversification. It's possible because the 5 assets tend to move in different directions – this helps to smooth the portfolio peaks and troughs.

> Now our cyclist is happily cruising along the cycle lane, has picked up a quality helmet, a high-vis vest AND a set of lights – clever cyclist. The point is, you can never eliminate risk from your investment portfolio, but diversification adds safety and reduces the risk of a 'portfolio fatality'.

Beyond the 5 assets it is difficult to improve a portfolio further especially when you incorporate transaction costs. Our analysis suggests that adding more assets could increase returns by a small amount per year, but the benefit would be eroded entirely by the additional transaction costs needed to periodically rebalance those additional investments.

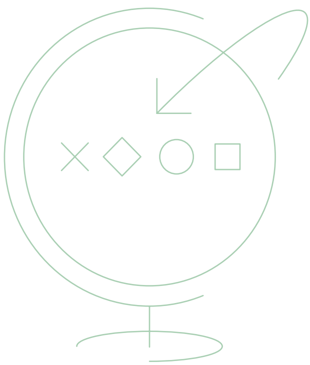
We believe that the 5 asset Stockspot core portfolios offer the best possible balance of risk, reward and cost for our clients. We recently published the 4-year performance of the portfolios and it's clear they provide a much smoother path than just owning Australian shares.

We continue to research other asset classes that could be added in a low-cost way to improve the quality of returns in our core portfolios. For clients who invest more than $50,000, we now also offer a selection of investment themes which can be added for additional diversification benefits.

A note on small accounts

Stockspot accounts can be as small at $2,000, which doesn't always provide enough cash for a meaningful exposure to the 5 asset classes. Therefore for small accounts we use a process of gradual optimisation to add ETFs that best match the expected performance of the target portfolio allocation while minimising the "drag" from any uninvested cash.

This process typically results in portfolios with a smaller number of asset classes, but similar historical performance to the target core portfolio. As these accounts grow in size they automatically transition towards our typical 5 asset portfolio allocations.



Dollar-cost average or go all in?

Everything you need to know about dollar-cost averaging, what it is and how it works.

BY SARAH KING, APRIL 12, 2019

In this blog, we uncover all you need to know about dollar-cost averaging, what it is and how it could help you gain more of life's most valuable asset – time.

Dollar-cost averaging sounds quite technical doesn't it? As with most things finance related it's another jargony term for quite a simple investment strategy that involves making small, regular, contributions to your investments.

The sophistication doesn't come from the strategy itself, but how it could help you gain more time, sleep and peace of mind. Whether you're new to investing or a professional, the decision of when to invest your money can be a challenging one.

Should you invest everything at once or dip your toes in by investing smaller amounts over time? Often we get caught on the hamster wheel trying to work out which is better. This procrastination can paralyse us from making any decision – which is the worst decision of all.

The truth is, both strategies have their own merits and limitations, but often our choice of one over the other is linked to our desire to reduce our sense of short-term regret.

So, what is the best approach?

In this blog we'll cover:

- Dollar cost averaging: How it works
- Lump sum vs dollar-cost average
- Is Dollar Cost Averaging a good idea?

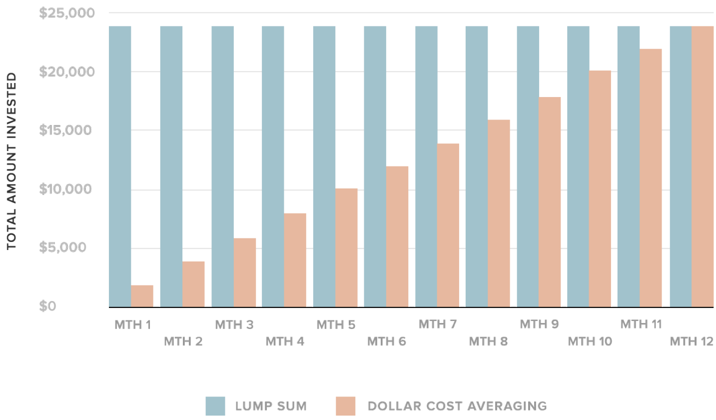
Dollar cost averaging: How it works

Let's say you have a lazy $24,000 in your bank account earning a low interest rate. In the back of your mind you're thinking "I should really be doing more with my money".

Now let's assume you've taken the next step and decided to invest that money. What next? You broadly have two choices:

- **Lump sum:** invest the whole $24,000 in one go; or
- **Dollar-cost average:** Divide the $24,000 into smaller amounts and drip-feed it into the market over a period of time. Say $2,000 per month over 12 months or $1,000 per fortnight.

When you dollar cost average you purchase some investments at higher prices when markets are up and at a lower



Lump sum (all-in) or dollar cost averaging?

price when markets are down. The aim is to 'average' out the purchase price for your investments over a set period and calm your nerves along the way.

The chart shows how much you have invested in markets each month based on investing $2,000 over 12 months compared to investing $24,000 upfront. A good question to ask yourself is how comfortable you'd feel investing the full $24,000 straight away compared to small, regular amounts each month.

How would you feel if the market kept going up? How would you feel if markets fell? These questions can help you decide where you'd feel the biggest regret and if it's better for you to dollar cost average.

Lump sum vs dollar-cost average

Vanguard found that Australian investors achieve better returns investing as a lump sum 66% of the time.

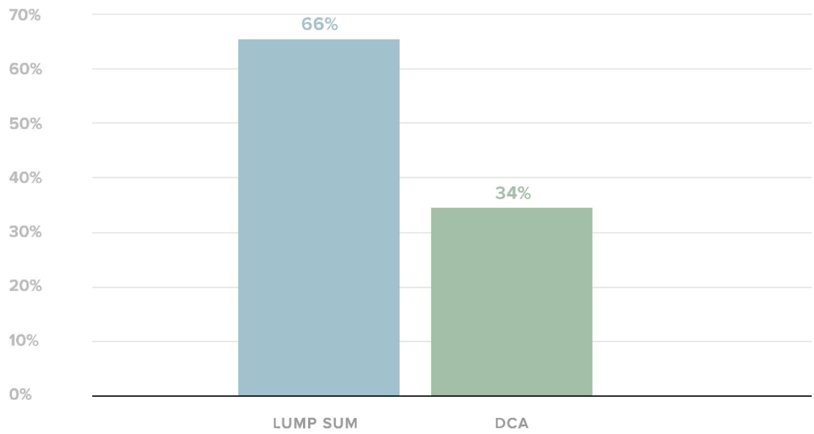
This makes sense because markets tend to go up most of the time, so you'll usually be better off investing now rather than leaving money on the sidelines. Dollar cost averaging really just delays when you start to take investing risk and earn investing returns.

So why would you dollar-cost average if research shows investing as a lump sum leads to better results most of the time?

Having some money waiting on the sidelines can be appealing because it helps us avoid regret on the small chance the market has a temporary fall.

If markets fall and you're dollar cost averaging you get to top-up up at the lower prices. Investing smaller amounts regularly can help you feel less nervous, even if it can also mean buying at higher prices.

One reason for this is because humans feel the impact of losses about twice as much as gains. The real appeal of dollar cost averaging is it helps you spend less time procrastinating about investing and can help you sleep better at night as you get started.



Which strategy works better for Australian investors (1984 – 2011)?

Pros and cons of lump sum vs dollar-cost averaging

	PROS	CONS
Lump sum	Most of the time you'll be better off since markets trend up.	Occasionally if markets fall you'll have to stomach an initial fall in your portfolio.
Dollar-cost averaging	May help you sleep better and minimise regret along the way. On the chance markets fall you'll be better off.	Most of the time worse off since you'll be buying at higher prices later on.

Is Dollar Cost Averaging a good idea?

What kind of investor are you? If your emotions make you nervous about what markets may do over the short-term then a dollar-cost averaging plan could be right for you.

It will help keep you disciplined, patient, and reduce any anxiety along the way – everything you need to be masterful investor!

On the flipside, if you're confident to invest it all today, then go for it! Just try not to lose sleep at night over your decision and make sure you plan to invest for at least a few years to give you the best chance of success.

When is the best time to invest in the share market?

One of the more common questions our clients ask us is ‘when is the right time to invest?’

BY CHRIS BRYCKI, JUNE 12, 2019

As an investor your aim is to make money, which happens when markets rise. So naturally it’s tempting to try and time your entry point to ‘*buy low and sell high*’.

The problem with this strategy is that nobody really knows where markets are headed next. Australian shares have returned around 11% per year over the last 100 years but those returns aren’t spread out evenly.

Over short periods of time like a week or a month it’s actually a flip of a coin whether markets will be up or down. Short term movements in markets are random ‘noise’ around the long term uptrend.

You can ignore the professional fund managers and TV commentators too. Most of them get their market timing calls wrong. This is one reason 80% of them do worse than simply buying and holding the Australian share market index and doing nothing.

When is the right time to invest?

If you wait for prices to fall to grab a bargain you’ll need to get two decisions right – when to be out and when to get back in. That’s easier said than done!

Even if markets do fall in the first place, if you wait too long to buy back you’ll miss out on returns as they go back up. Then if you’re completely out of the market you have no way to benefit from the gradual increase in share prices over time.

Thankfully, there is a way you can avoid the anxiety of investing everything at once! It’s a simple investment strategy called dollar cost averaging.

The best time to invest is… regularly.

Dollar cost averaging is one of the most powerful ways to get ahead when you invest. Instead of waiting for the ASX to fall to time your next investment, dollar-cost averaging is a strategy to invest your money gradually over a few weeks or months.

If you invest small amounts regularly over a period of time you'll buy your investments at an average price over time. That way you get to take advantage of any market dips (and pay a lower price) or gains if markets rise.

Procrastination is the enemy of investment returns

Trying to time the market is fraught with psychological barriers. When markets fall and it seems like everyone is abandoning the investment ship it's extremely difficult to pile in. That's why most people who wait on the sidelines for the next market correction end up waiting too long and missing out all the way back up!

Take December 2018 as an example. The S&P ASX/200 (Australian share market) had fallen 15% in 3 months and most people were sitting on their hands. Fast forward six months and the share market is up 20% from its December lows.

Those who held off from investing in December 2018 because of either: a) fears of further market falls or b) hope of even cheaper prices; missed out on dividends and capital growth.

We spoke to Clancy Yeates, a finance journalist at The Age and the Sydney Morning Herald about the influx of people we've seen investing since December 2018. Some of those people probably held off in 2018 because the market was volatile.

If you wait to save up large lump sums to invest you potentially risk:

a) Missing out on compound returns while you wait and,

b) Being more impacted by short term market movements once you're invested.

Ultimately, if you have a long-term investment mindset dollar cost averaging can reduce anxiety about losing money while you invest. Even if markets don't dip, you'll end up buying as markets rise and be making a profit on your earlier purchases.

How do I dollar cost average?

A dollar cost averaging investment strategy is easy. Simply make a plan of how much you want to invest and set up a regular top-up. The easiest way to do this is by setting up an automatic transfer from your bank account. Our Head of Client Care and Advice, Sarah King recently wrote this guide on how to dollar cost average.

Checklist before you start investing

At Stockspot we believe you should only consider investing once you have:

1. 3-6 months worth of expenses saved as a 'rainy day fund'
2. A minimum of $2,000 to invest. It could be from savings, a bonus or tax return
3. A time horizon of at least 3+ years to give you the best chance of great results

Since Stockspot's portfolios are spread across a mix of Australian, global and emerging market ETFs as-well as some bonds and gold to cushion market falls, you don't need to worry about timing the market.

Top questions from the ASX Investor Day

The 5 most common question I got after my presentation at the ASX Investor Day.

BY CHRIS BRYCKI, JUNE 19, 2019

I had the pleasure of presenting at the ASX Investor Days this year – its been a great chance to meet investors from around the country. From students investing for the first time to octogenarians with decades of experience behind them.

These were the 5 most common questions I got after my presentation...

Q. Markets seem expensive so I've been sitting on cash for the last few years. Should I invest now or wait to buy lower?

Markets are difficult to time, even for the experts. They can stay expensive (or cheap) for a long time. Meanwhile procrastination will harm your ability to enjoy any investing returns. If you're worried about short term market movements consider dollar cost averaging.

Investing into markets gradually and regularly will help you minimise both kinds of possible regret:

1. the regret of buying just before a market fall
2. the regret of not being invested at all and missing out on returns as markets rise.

Q. Why should I rebalance my portfolio? Aren't you supposed to hold onto your winners?

It's great that some of the investments in your portfolio have posted better returns than others. However as 'winning' assets become a larger part of your portfolio, they also make your portfolio more risky. Assets that are today's winners can just as quickly become tomorrow's losers.

Portfolio rebalancing is about making sure your portfolio doesn't become too risky over time. Harvesting profits from assets that have done well and grown bigger than they started, and investing that money into other assets that haven't performed as well.

Many people struggle with rebalancing because it requires keeping a close eye on markets and doing the opposite to your instincts – to *not* chase what's hot. That's why we automate rebalancing for clients – to remove the emotional biases that can get in the way of smart portfolio management.

Note that rebalancing in this way works for *whole asset classes* and **not** for individual securities. Individual shares can go to zero so rebalancing into losing shares is a sure-fire way to lose money.

This is one of the reasons we recommend owning entire asset classes via index ETFs rather than picking shares. Index ETFs regularly rebalance **out** of falling shares to protect your capital.

Q. XYZ share seems cheap. What do you think?

Most people think the shares they own are cheap or undervalued. In fact I've never seen anyone say they try to buy 'overvalued' shares!

But prices reflect the collective wisdom of every buyer and seller in a market including the thousands of professionals looking for opportunities every day.

I've never seen anyone say they try to buy 'overvalued' shares!

The chance you know something that no one else does is low. Even if you do have some extra knowledge, your 'undervalued' share could stay 'undervalued' for years or even decades because others mightn't agree.

Prices of shares are rarely perfect (stock pickers would call this trading at intrinsic value), but the market is still hard to beat because prices can stay imperfect for a very long time.

The good news is you don't need to try and beat the market. By simply *owning the market* via an index ETF you can benefit from the collective research and wisdom of everyone.

Q. How can I generate X% yield in my portfolio?

Something I've noticed is that Aussies seem to have an unhealthy obsession with income.

There's no free ride with investing so where you're earning higher income than the interest you earn on cash in the bank, you're always going to be taking on higher capital risk. Income focused portfolios e.g. high dividend shares like banks and Telstra, hybrids and high-yield debt are **riskier** than a diversified portfolio. What you get in one hand (income) you could just as easily lose from the other (capital).

My advice is to always to focus on your total return (income + capital growth) rather than just your income or dividend yield.

Today a well diversified portfolio of Australian and global shares and bonds should be able to give you income of 2-3% p.a. plus capital growth of 3-6% p.a. (total return of 5-9% p.a.) The capital growth component of returns will vary year to year but that's just the nature of investing.

When you only focus on boosting income it comes at the expense of growing (and preserving) your capital. Even if you're at pension stage you shouldn't be afraid to draw down from income and from capital growth.

Trying to 'juice up' the dividends in your portfolio is riskier than you may think which is why we don't recommend yield chasing strategies to our clients.

Q. Why do I need bonds in my portfolio when I have cash?

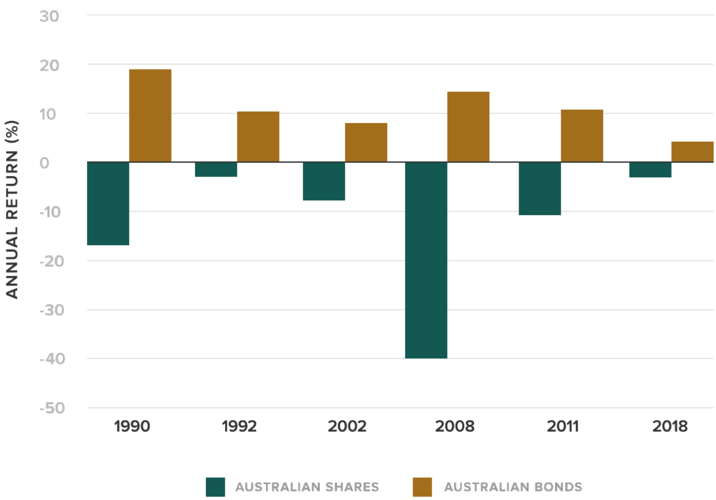
They may sound similar but there are actually some big differences between cash and bonds. When you deposit cash at the bank you're taking almost zero risk.

Because of that you'll only earn a low return in the form of interest, which will fall if interest rates are cut.

Bonds (also known as fixed income) are a different beast.

As interest rates fall, bond prices **rise** in value because their fixed coupon payments become more valuable. Bonds have historically been a much better cushion for falling share markets than cash and also earned higher long term returns.

Over the last 30 years, Australian shares have had a negative year 6 times and on each of those occasions **bonds have risen**. That's why we recommend clients have an allocation to high quality investment grade bonds in their portfolio rather than cash.



Are Australian shares expensive?

There are always active fund managers who say shares are expensive. But are they really? And does it even matter?

BY CHRIS BRYCKI, JULY 23, 2019

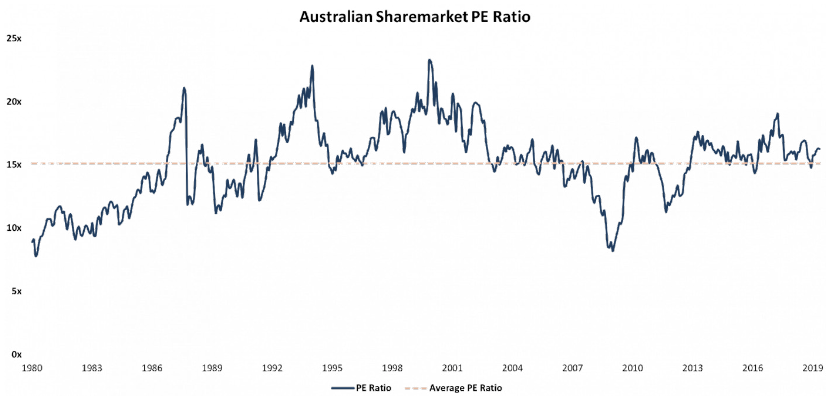
At the ASX Investor Day's where we presented over the year, one of the most common questions we received was "should I wait until markets become cheaper to buy?".

Our simple answer is that nobody has a crystal ball into what is going to happen over the short and medium term, so trying to time the market is not a useful approach to investing.

There are no shortage of fund managers and market commentators who have been saying shares are expensive for the last decade. Yet, markets have kept rising and proving them wrong.

Australian shares compared to history

Compared to history, the Australian share market looks quite 'normally' priced at the moment based on its 'earnings multiple'. The market price/earnings multiple (also known as it's P/E ratio) measures the market index divided by market earnings.



All Ordinaries Accumulation Index PE Ratio. Source: Stockspot, Market Index.

It's a quick and easy way to see how much people are prepared to pay for earnings.

A higher P/E means people are willing to pay more for earnings. That could be because they're confident in those earnings growing or simply because other alternative investments (like cash or bonds) don't offer much of a return.

The Australian market is currently near its long term historical average of 15x earnings. By comparison at the peak of the tech boom in 2000 shares were trading as high as 23x. That would translate into a share market that's 50% higher than today!

Even if markets do become expensive, they can stay expensive for a long time. 'Hoping markets fall' is not a sensible or repeatable investment strategy.

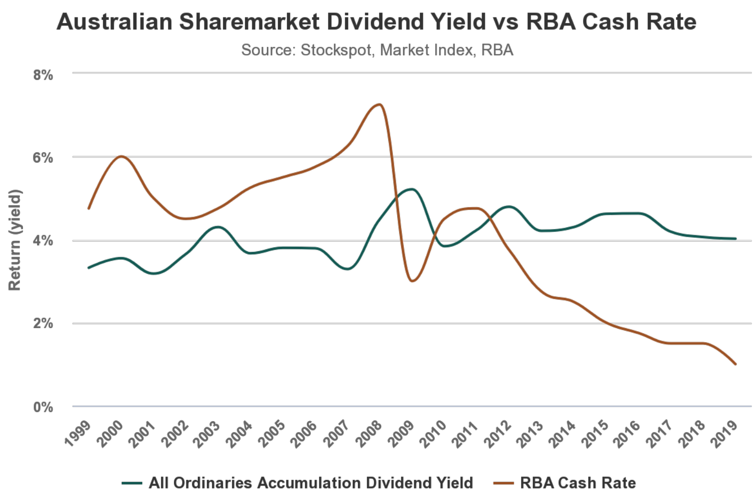
Our advice is the best time to invest in the market is regularly. That way you benefit from the long term uptrend and have the opportunity to buy more when markets occasionally 'go on sale'.

Australian shares compared to other assets

Compared to the income returns of other investments available to Australian investors, Australian shares look fairly attractive at the moment.

- Cash, term deposits and Australian government bonds only give you a return of 1-2% p.a.
- Residential property rental yields in major Australian cities aren't much better at 2.5%-3.5% p.a.
- Most global share markets are only paying 1-2% in dividend income.

The Australian share market has a relatively attractive dividend yield of 4.2% which increases to over 5% with franking credits. Of all of the investment options out there it actually offers one of the higher income returns an investor can get right now.



In fact the extra dividend return you get from investing in shares compared to the RBA interest rate hasn't looked better for the last 20 years.

In a world where everyone is searching for assets that generate income of more than zero in the bank, it's certainly possible that investors will be willing to pay much more for the Australian share market in 5 or 10 years time. Even if company earnings go nowhere.

More than earnings or any other factor, the attractive 'yield' of the Australian share market compared to cash has probably been the biggest driver of the market performance this year.

Shares can be expensive relative to history but cheap relative to other asset classes. Neither are relevant for your investing because markets can stay 'expensive' or 'cheap' for a very, long time.

Focus on what you can control

The longer you stay invested, the more you benefit from company earnings rising over time, which they do. The longer you stay invested, the less the market earnings multiple (P/E) matters.

Rather than try and time the market which is totally out of your control, we recommend focusing your attention on the 3 areas that are within your control as an investor; the risk you take (through asset allocation and rebalancing), the costs you pay and your own behaviour.

Why you need more defensive investments

High grade bonds and gold can reduce how much you lose when markets fall. But how much of them should you own in your portfolio?

BY CHRIS BRYCKI, JUNE 26, 2019

Warren Buffet loves index funds. He's sung their praises dozens of times in his annual investor letters since 1993. He's recommended investors use index funds only rather than pick stocks or pay active fund managers.

He famously won a million dollar bet that a simple S&P500 index fund would beat 10 of the brightest fund managers.

In fact Warren Buffett loves index funds so much he's instructed that his estate should be invested 90% into a shares index fund and 10% into a bond index fund.

That's right, no property, no infrastructure, no hedge funds. Just indexed shares and bonds. Buffet said it best in his 1993 Berkshire Hathaway Shareholder Letter:

"By periodically investing in an index fund, the know-nothing investor can actually outperform most investment professionals. Paradoxically, when 'dumb' money acknowledges its limitations, it ceases to be dumb." – Warren Buffett

This should tell you a couple of things – first of all that the best regarded investor in the world believes that index funds are the only ingredient you need to grow your wealth.

Secondly, that there's no need to over-complicate it. Buffett thinks that if your time horizon is infinite you only need two index funds (shares and bonds), and your portfolio should be weighted heavily towards shares.

How much of my portfolio should be in shares?

Unfortunately for most of us, our time horizon is shorter than Buffett's 'forever' so plonking 90% into shares is too risky. Over the last 100 years 90/10 allocation between shares and bonds would have earned you an annual return of 9.7% p.a.

Although, you would have had to ride some big ups and downs along the way including one 39% fall. Even for many growth investors that's tough to stomach and stay invested through!

Defensive assets to the rescue

The good news is that increasing defensive assets like bonds and gold can significantly reduce how much you lose when markets fall.

But how much of them should you own?

This was answered best by Chicago-school economist Harry Markowitz who won the 1990 Nobel Prize in Economics. He showed how to achieve the best return potential by combining growth assets like shares with defensive assets like bonds and gold.

His seminal work, Modern Portfolio Theory (MPT), continues to be the best regarded theory for managing portfolios, and is what we use at Stockspot. We combine index ETFs to generate the best possible potential for returns while taking the lowest possible risk.

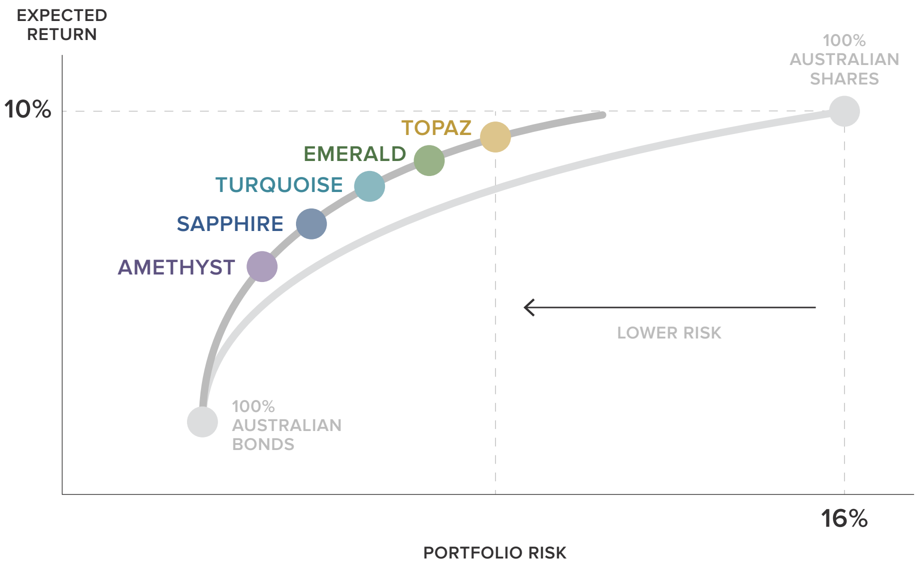
Why defensive assets have become less defensive

One of the most important factors to consider when using Modern Portfolio Theory is the relationship *between* assets which is known as their *correlation*.

Ideally you want a mix of assets that have a low correlation because this means they are less likely to lose money at the same time. This is just as important as understanding an assets risk and returns.

Low correlation assets give your portfolio a smoother path – in finance speak we call it better 'quality' returns.

Over the long term, the *correlation* between bonds and shares has usually been negative. That's why they work so well together – bonds help to cushion any



short term dips in share markets. Over the last 30 calendar years, every time Australian shares have fallen in value, bonds have risen.

But like a chameleon, correlations are always changing colour. Over the last few years the negative correlation between shares and bonds has weakened – and become positive. This is significant.

Australian shares and bonds correlation

This change of tune has happened across the developed world – driven by interest rate policy. With interest rates near zero, people have been forced out of cash into both bonds **and** shares to earn a return.

So they're both rising together. Today there is a record US$13 trillion of government bonds around the world with negative yields. i.e. you need to **pay** the government to borrow your money!

Gold is also benefiting from this world of negative real yields (when bond yields are lower than inflation) because you don't miss out on any interest by holding gold instead of bonds or cash.

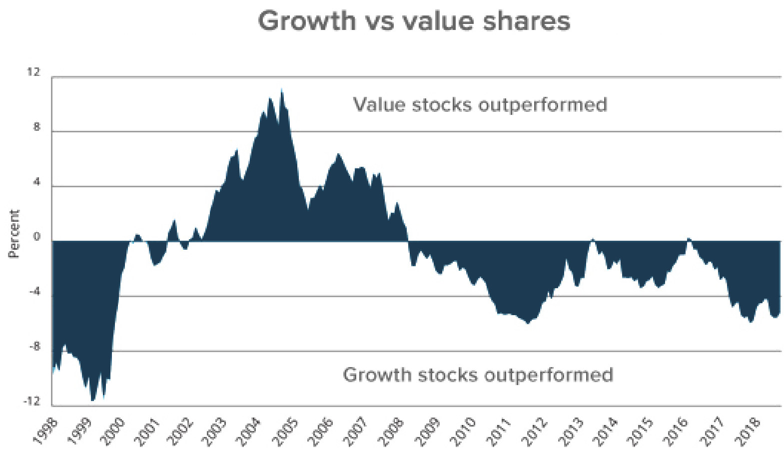
It's worth noting Buffett isn't a big fan of gold – but other renowned investors like Ray Dalio think you need it.

Total returns – shares vs bonds

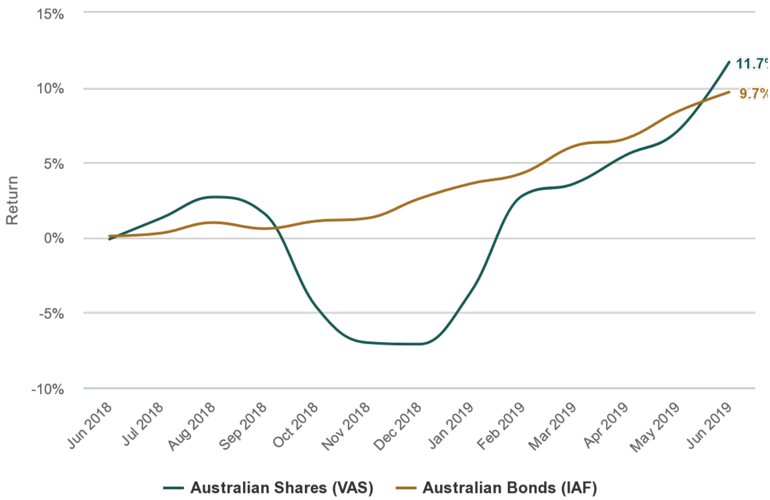
Why we made portfolio changes in 2017

The current environment where assets like shares, bonds and gold are all moving in the same direction has led to a situation where it makes more sense to have a **higher allocation to bonds and gold** than you may normally expect for a 'growth' focused portfolio.

It simply gives you the best mix of risk and return based on the current relationship



We increased our allocation to bonds and gold in November 2017 as the negative correlation between Australian shares and bonds (below zero) weakened and went positive.



between these asset classes.

This is what led us to increase the allocations to bonds and gold in all of the Stockspot portfolios in November 2017. Importantly we increased the bond and gold allocation in the Growth and High growth portfolios because it gives you the best of both worlds.

Think of it this way...

- If markets rise over the short term, defensive assets are more likely to participate in gains at the moment. Over the last year bonds are up 9.7% and gold is up an impressive 18.8%
- On the other hand if share markets fall over the short term you'll need a larger amount of defensive assets as a cushion.

So far this has played out as we anticipated. Correlations between assets have remained positive and the higher allocation to bonds and gold hasn't detracted from performance, it's helped.

Gold has been the best performing asset in our portfolios since we made the portfolio changes, up 23.6%. This has helped all of our portfolio strategies – from conservative to high growth – deliver after-fee returns of at least 10% over the last year.

PORTFOLIO	1 YEAR PERFORMANCE (AS OF 30 JUNE 2019)
Topaz (Aggressive growth)	11.4%
Emerald (Growth)	11.2%
Turquoise (Balanced)	11.0%
Sapphire (Moderately conservative)	10.8%
Amethyst (Conservative)	10.5%

Our higher allocation to bonds and gold has helped portfolio returns and risk.

At the same time the higher defensive allocation also helped to cushion market falls. When the Australian share market dipped 14% at the end of 2018, the Stockspot growth portfolio (Emerald) only dipped by 7%, helping our clients stay cool, calm and collected.

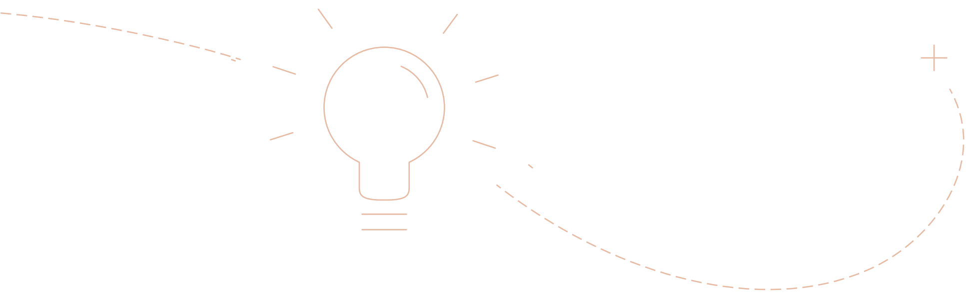
The more conservative strategies fell by even less.

All of the portfolios quickly recovered in early 2019.

Why growth investors need more defensive assets today

When shares and bonds are moving in the same direction it makes sense to maintain a higher allocation to defensive assets.

An allocation of at least 30% invested in high grade bonds and gold for growth investors gives the best of both worlds right now – participation in market gains and more protection in any temporary falls.



What the interest rate cut means for your investments

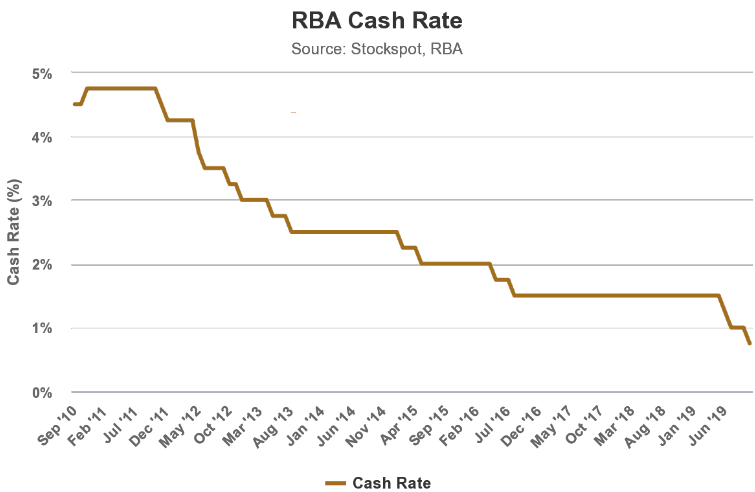
The RBA has cut interest rates to a record low of 0.75%.

BY CHRIS BRYCKI, OCTOBER 1, 2019

The RBA has cut interest rates for the third time this year, to a record low of 0.75%. Weak loan growth, low inflation, the global trade war and under-employment all contributed to the move.

For the regular person trying to get their head around what the cuts actually mean, it can be difficult to understand if you need to be worried or not and what you need to do. After all, interest rates and the economy are complex beasts.

Broadly speaking when a country cuts its interest rates the goal is to spur on economic activity, hiring and investment. Central banks do it when the economy isn't firing. If you're not watching you could be caught out by some serious knock on effects.



So what does this mean for investors, savers and property owners? Who are the winners and losers? Does it even matter?

Here's how the cuts will impact your back pocket.

The winners

Investors in Australian shares and bonds

Investors in Australian shares and high grade bonds have already been beneficiaries from the first two interest rate cuts, and will continue to benefit as cash becomes less attractive to hold.

Australian shares have risen 24% in 2019 and bonds up by 9%.

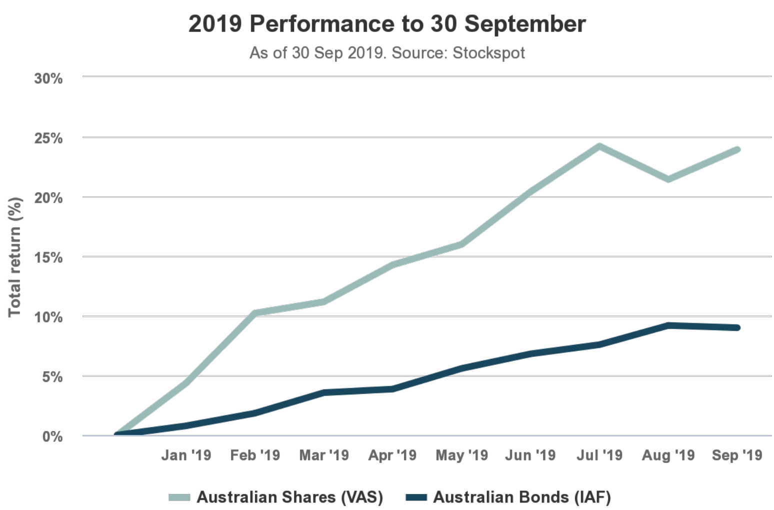
Some of this reflects the two previous rate cuts in June and July – as well as expectations of further cuts. We recently wrote why Australian shares aren't expensive relative to other times in history or compared to other investments.

The Australian share market has been one of the best performing globally in 2019, which has helped to boost the Stockspot portfolios by 13.8% (Amethyst – conservative) to 18.4% (Topaz – high growth) since the start of the year.

Shares typically rise because lower rates lead to consumers and businesses increasing spending and investment. Lower interest rates also make share dividend yields and fixed bond coupons more attractive compared to leaving your money in the bank.

An interest rate cut also leads to the cost of borrowed money falling. What does this mean? Businesses can borrow at a cheaper rate and they can invest more in their business. Consumers with loans and mortgages can now pay the interest more easily and have more income left over to spend.

Now you might be thinking 'this isn't me, I haven't borrowed any money'. However,



that doesn't mean your neighbour hasn't or your kids' teacher. If they've suddenly got more money and choose to spend it on goods and services they'll help spur on the economy.

Rather than spend, these same people can also choose to save their extra money or pay off more of their mortgage. Given the high indebtedness of Australian mortgage holders, Aussies might use the cut as an opportunity to boost their savings rate and pay down their mortgage debt. If this happens the economy might not see much of a jolt.

What should investors do?

If you are investing make sure your strategy suits your financial goals and willingness to ride out short term ups and downs in markets. We recommend clients combine different investments like shares, high grade bonds and gold to reduce risk. Don't forget the market is smart and some of the rate cut has probably been baked into prices already!

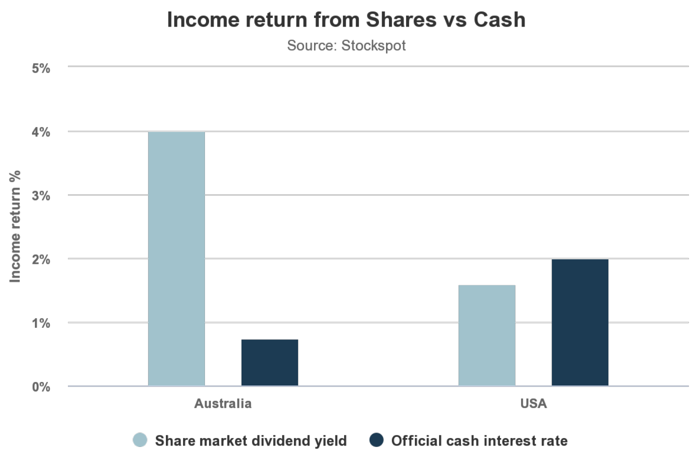
The losers

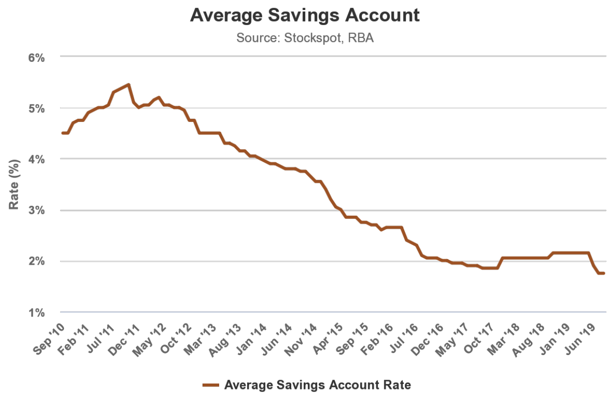
Savers in savings accounts and term deposits

The biggest losers will be people who leave all their money in cash savings accounts and term deposits (TDs). Banks will be swift to cut the cash rates on offer. Already eye wateringly low, savers can expect even lower interests on savings accounts.

That 2.2% you get on your ING Savings Maximiser or UBank USaver is almost certainly set to fall below 2% for the first time. The average return you can get in your savings account are at record lows, yielding a measly 1.75% (and that's before inflation!).

Leaving all your money in cash savings or a TD means your money is actually going backwards compared to the prices of goods and services: if you earn 0.6% interest from your bank (a typical standard variable rate today) and the inflation rate is 1.6%, the real rate of return on your money is actually negative 1%. This means you're





pedalling backwards every year. And that's even before taxes on your interest earned.

What should savers do?

We tell all clients to keep some money in cash savings for short term expenses. But for money you don't need in the short term, savers should consider investing. Exchange Traded Funds (ETFs) offer great diversification and low fees for longer term investors. They're lower risk and lower stress than buying shares in a few companies.

The inbetweeners

Homeowners and investment property owners

A rate cut is usually great news for property owners. Lower interest and higher borrowing capacity work together to lift prices. The first two rate cuts have helped to boost capital city house prices since June.

Property rental yields are still at all-time lows and despite some price falls, residential property in most cities remains expensive as a 'growth' asset. This is compounded with the extra supply of new apartments in the capital cities and increased scrutiny lenders are placing on borrowers.

What should property owners and property investors do?

The best course of action for property investors is to shop around and avoid the lazy person tax and find the best mortgage interest rate. If you have a high amount of mortgage debt, use the lower rate as a chance to pay off more of your principal. Don't expect a quick or sharp reversal in prices.

Those with most of their money tied up in property but low debt may want to consider diversifying into other investments. An investment portfolio of just Australian residential property is a high-risk strategy because you're concentrated in a single asset class.

You might be better off spreading your money across a mix of different investments to reduce the risks to your personal wealth if there's a prolonged downturn in property prices.

Why to buy gold as a portfolio diversifier

Three reasons we advise clients to buy gold to diversify their portfolios.

BY CHRIS BRYCKI, JULY 20, 2019

With the exception of perhaps Bitcoin, there are few investments as polarising as gold. Warren Buffet has avoided it since it has no utility value. Ray Dalio of $175 billion Bridgewater Associates preaches the opposite.

"If you don't own gold... there is no sensible reason other than you don't know history or you don't know the economics of it." – Ray Dalio

Views on gold as an investment are generally more a matter of philosophy rather than fact. Gold is a difficult asset to value and market commentators love to speculate what is causing the daily moves.

As a result of the fixation by many people on short-term gyrations, little discussion seems to go into the value of owning gold as part of a long-term portfolio.

Unlike shares and bonds which generate dividends, gold doesn't generate regular cash-flows so investors in gold can only benefit from capital returns.

Unlike other commodities like iron ore or oil, there's little industrial use for gold. It doesn't power our smartphones or enable the production of steel for buildings. Gold can't be depleted or destroyed either.

The majority of the demand for gold in the world comes from either jewellery or investment. So when investors buy gold they are investing in an asset whose major use is simply as 'an investment' – and not much else.

We've advised Stockspot clients to have an allocation to gold via the GOLD exchange traded fund (ETF) since 2014. The GOLD ETF is physically backed by gold bullion which is stored in a vault in London. It's unhedged so investors benefit from a falling Australian dollar.

In late 2017 we increased the GOLD ETF allocation from 10% to 12.3% for all client portfolios because we identified the need for more exposure. The negative correlation between shares and bonds had weakened which meant that bonds may not provide as much of a cushion in a share market correction scenario.

The yellow metal has since performed better than most asset classes including Australian and global shares, notching up

a return of 25%. Over the past year gold has outperformed shares too.

There are three reasons we continue to advise clients to maintain an allocation to gold in their portfolios:

1. As a diversifier

Harry Markowitz won the 1990 Nobel Prize in Economics by showing how to achieve the best return potential by combining assets with a negative relationship to each other (correlation).

His seminal work, Modern Portfolio Theory (MPT), continues to be the best regarded theory for managing portfolios, and is how we approach building portfolios.

Gold has a very low or negative correlation with most other investment assets which is why it typically moves in a different direction to shares. This is a rare quality for an asset and it means that gold has the ability to reduce the risk of a portfolio.

In finance-speak, gold helps to improve the quality of the portfolio returns which means you can earn a similar return with less risk.

2. As an insurance policy

Gold has historically been an effective way to preserve the real value of your wealth since it acts as an insurance policy against currency devaluation.

This is when your home country currency loses its global purchasing power either because of economic factors or monetary policy. While gold in US dollars is well below where it traded in 2012, in Australian dollars it trades at an all-time high due to our weak currency.

3. As a safe haven

Government bonds have historically been one of the safest places to park your money. Today however there is a record US$16 trillion of government debt issued by creditworthy governments that trades on negative yields. In countries like Japan, Switzerland and Germany you need to *pay the government* to borrow your money.

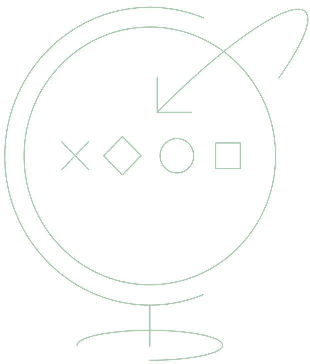
While gold doesn't have a yield, it's still a more positive yielding asset than negative yielding government bonds which penalise owners. As the amount of negative yielding government debt increases, so too does the attractiveness of gold.

Why now is the time to own some gold

We continue to see gold as an important portfolio diversifier regardless of your investment horizon or risk capacity. It's even more important for growth focused investors right now since shares and bonds are dancing to the same tune.

Gold has historically been able to maintain its purchasing power and provide portfolio insurance in times of need. It will continue to benefit from the swelling pool of negative yielding government debt.

Like insurance, it's the part of your portfolio you'll be glad you have when the rest of the investment world isn't shining.



The dangers of dividends

Dividend strategies come with their own set of risks that are often ignored.

BY CHRIS BRYCKI, SEPTEMBER 2, 2015

Three of the most common questions we get about the Stockspot portfolios are "Why does Stockspot invest in gold?", "Can I access more international shares?" and "Can I focus my portfolio on high-dividend shares?".

Having covered the first 2 questions in earlier chapters, we wanted to address the third question on dividends.

The dividend theme has become increasingly popular over the past few years and we've noticed a growing number of investors seem to be solely focused on dividend yield without considering total return.

This has been partly fuelled by the media and product issuers who have promoted high-dividend strategies as a way to cope with historically low interest rates. However, such strategies come with their own set of risks that are often ignored.

What are dividends?

Dividends are payments that companies make to their shareholders (if they choose to) from retained profits and are usually paid once or twice a year around when financial results are announced.

Companies have several choices of what to do with their profits – they can chose to re-invest them in their business, buy back their own shares, buy other companies, or pay dividends. The decision on what to do with profit is collectively known as their **capital management strategy**.

Some companies choose to pay out a majority of their profits in dividends. For example in 2015, Telstra (TLS) had earnings per share of 34.5c and paid a dividend of 30.5c per share.

The percentage of profits that are paid out to shareholders is known as the **payout ratio**. In the Telstra example this was about 90%. Mature businesses will often have high payout ratios because they don't need the profits to invest back into their business.

On the other hand, growth businesses and companies with a high level of R&D costs tend to re-invest profits in their business with the aim of growing future profits.

The Exchange Traded Funds (ETFs) that we invest in include many hundreds of companies, each with their own dividend policy. Our ETFs receive dividends from many different companies and then combine them before passing them on to investors via distributions a few times per year. Some of our ETFs pay distributions quarterly (VAS) while others pay half-yearly (IOO).

Dividend yield represents the dividend amount as a percentage of the share (or ETF) price.

For example, if the Vanguard Australian Share Fund ETF (VAS) is currently trading at $65 and it has paid annual dividends of $3.00 over the last year then its dividend yield was $3/$65 x 100 or 4.6%. Equally if you own a property worth $500,000 and earned rent of $23,000 last year then your ***rental yield*** *was 4.6%.*

Keep in mind that these are both examples of **historical yield** because they are backward looking (we'll get to that later).

Both **return** and **dividend yield** are used to describe the performance of an investment, but they are not the same thing. Dividend yield represents just the income earned on an investment that is paid out as a dividend or distribution in cash. It ignores changes in capital value – also known as capital gains (or loss).

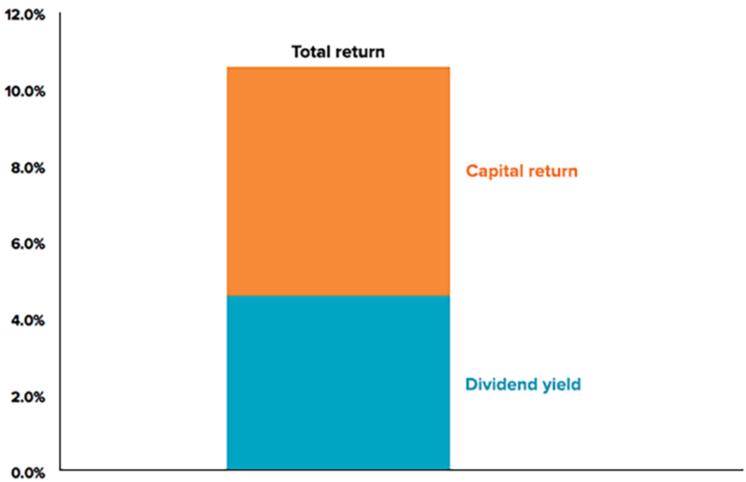
Total return includes both the dividend received and the capital gain (loss) earned on an investment.

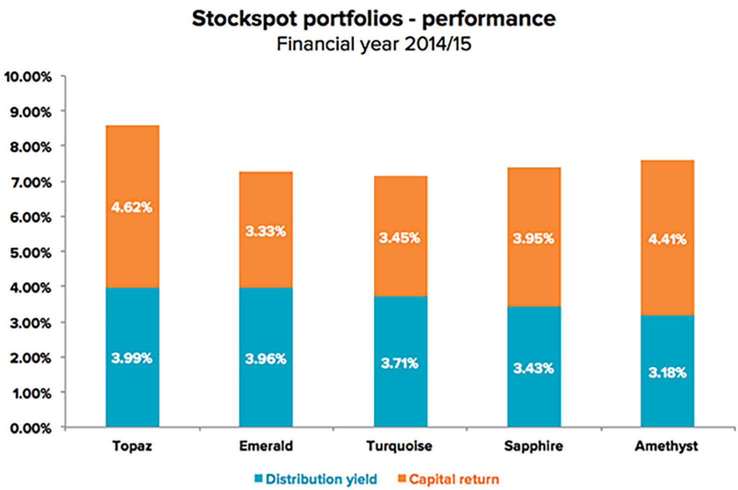
i.e. Total return = dividend return + capital return

Using the above examples, if VAS has risen from a purchase price of $61.00 to $65.00 it has generated a capital gain of $4 or 6% and if the property has risen in value from $470,000 to $500,000 it has generated a capital gain of 6%.

Therefore, the total return would be 10.6%.

Total return is the figure investors should be concerned with when making any investment – not dividend yield. For instance in the last financial year our Turquoise portfolio generated a total return of 7.2% and this was made up of dividends and distributions of 3.7% and a capital return of 3.5%.





** Performance after ETF and management fees*

Why have dividends become so popular?

With low interest rates, investors are naturally searching for higher yields than the interest on offer in savings accounts or term deposits. Shares, ETFs, property and hybrid investments that pay out streams of income lead some investors to chase this yield rather than focus on total returns. However it's important to understand that focusing on income or yield can mean you are ignoring the risk of a negative capital return.

Dangers of ignoring capital returns

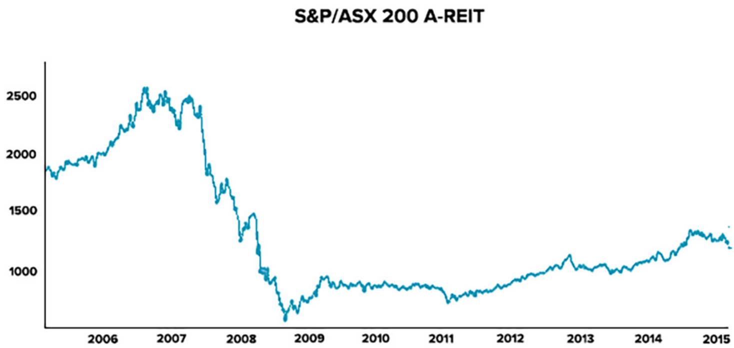
It's critical when making investment decisions to distinguish between yield and total return. An investor just focused on yield may have a negative total return despite a positive yield because of a capital loss. Our 'Buy vs Rent' post showed the devastating effects that a negative capital return had on the US property market. This fall in prices occurred despite US property appearing to have a positive yield.

Historical dividends are not future dividends

Looking only at the historical yield of an investment may lead an investor to concentrate their portfolio in high yield, low quality assets.

At the start of 2008, the historical dividend yield of many Real Estate Investment Trusts (REITs) listed on the ASX started to rise as their share prices fell. At first glance this would indicate that they were more attractive investments.

However, some REITs were highly leveraged and their historical yields were not sustainable going forward once tenants stopped paying rent and the realisable value of their property assets fell.



Many REITs drastically reduced or completely cut their distributions in 2008/2009. As a result, their share prices collapsed. In this instance, rising historical yields were signalling that the businesses were in trouble.

As the Global Financial Crisis (GFC) showed, dividend yields are by no means guaranteed – even by large, seemingly stable businesses like REITS. The REIT index in Australia fell by 77% between 2007 and 2009 and hasn't recovered yet.

Concentration risk

Another downside to chasing dividends is concentration risk. The top-yielding shares on the ASX are concentrated in sectors like banks, property (REITs) and utilities, which tend to grow less in rising markets. They are also sectors which tend to underperform the broader market when interest rates rise.

Dividends bring forward your tax bill

The impact of taxes can further reduce the attractiveness of focusing on dividend yield for tax-paying Australian investors.

Many of our clients re-invest dividends back into their Stockspot portfolios. Investing a larger amount in 'high dividend paying stocks' would increase the tax bill they have each year.

Therefore any dividend yield more than what is required for spending or pension drawdown is essentially slowing their total portfolio growth. All else being equal, and depending on your circumstances, delaying taxes and letting untaxed returns compound can be a more tax-efficient strategy.

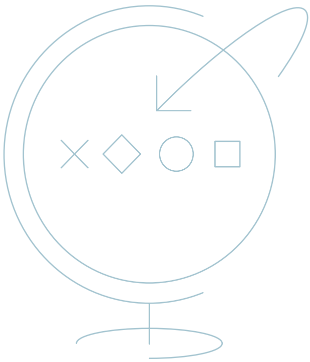
High dividend does not equal low risk

Companies that issue dividends have decided that there are not better opportunities to deploy their cash by investing in new projects or acquiring other companies.

Paying dividends in itself does not provide any certainty about a company's financial well-being or ability to sustain future dividends. All a dividend shows is that the company had nothing better to do with the cash so decided to give it back to shareholders who can choose themselves.

Investors have a long history of chasing the latest investment fad and getting burnt when the risks of that strategy become apparent. We believe that investors ignoring total return and focusing solely on dividend yield are underestimating the importance of capital returns in the investment equation.

That's not to say that we don't believe yield is important. Historically yield has contributed a significant portion of our portfolio returns. However rather than focusing on a single theme like dividend yield, we believe long-term investors should seek diversification across asset classes, countries and industries — as well as buying shares with a range of different dividend yields to generate long-term wealth.



Kids invest for free

We all want the best for the little ones in our life, so we've made investing for children free!

BY LAUREN FRANZE, AUGUST 15, 2018

We all want the best for the little ones in our life. So naturally as investing evangelists we believe children should be able to benefit from investing in the same way adults can.

Which is why clients who invest on behalf of a child will no longer be charged fees for portfolios up to $10,000^.

Why are are we doing this?

We believe that saving and investing are incredibly important topics that children miss out on learning at school. If more children get first-hand experience seeing the benefits of regular saving and compound returns, it will be one of the most valuable financial lessons they'll get in life.

Invest in their future

Stockspot is a simple low-cost way to invest for your children and teach them about the power of long-term compound growth. Investing early is also a powerful way to help them gain financial independence.

We know raising children in Australia is not exactly an exercise in frugality.

Everything. Costs. Money.

From school uniforms, three nutritious meals a day, clean underwear and music lessons. Yes, they are costly critters! The average Australian child costs around $406,000 to raise.

By investing slowly over the years you can help them to afford those bigger ticket items they'll need or want in the future. It might be their education, a car, a house deposit or traveling the world, investing can help get them there.

Hear why our client Diana invests for her children

Kids need a better way to save

There are plenty of children's savings accounts offered by the banks. Some are decent but many have all sorts of terms and conditions applied to the introductory rates. Plus we all know the banks will be sending them credit card offers as soon as they reach the right age.

Then there are the old fashioned investment bonds and managed funds that come with old fashioned high fees. And you never really know what your money is invested in.

In the 4 years we've been up and running, Stockspot's portfolios have returned on average 5.7% p.a. to 7.9% p.a, and we're completely transparent about what you own and the fees you pay.

How do I get access?

It's really easy. Simply sign-up online and select 'investing for a child'.

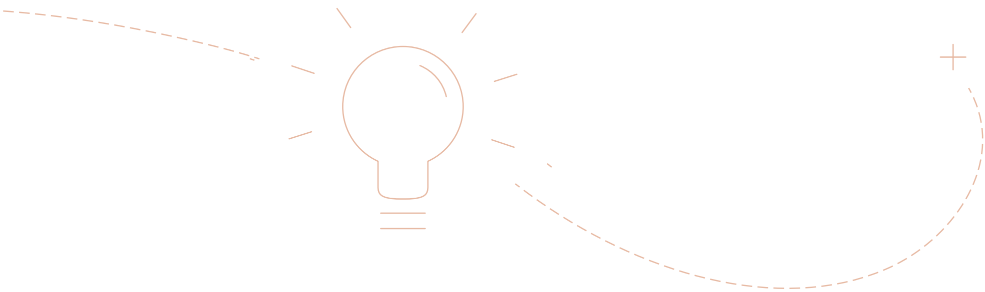
Answer a few questions about your goals and investment timeframe and we'll recommend a suitable investment portfolio.

The minimum investment to get started is $2,000.

You can also start with smaller amounts and when your balance reaches $2,000 we'll invest it for you.

Find out how Stockspot makes it easy to grow your wealth and invest in your future.

^ Full terms: To qualify you need to select 'Investing for someone under 18' when you join. Stockspot's minimum investment amount is $2,000, however you can make smaller deposits that will be invested when your balance reaches $2,000. Stockspot management fees will be waived until your child's portfolio reaches $10,000 after which Stockspot's regular fee tiers apply. The ETFs that we invest in have their own management fees which are included in the unit price. To invest in Australia it's a legal requirement to be 18 years or over. We offer two options for parents or relatives to invest for children: a) You can invest as an individual client. The investments are held in your name from a legal and tax perspective, but we can add your child's name to the account which acts as an identifier. Or b) You can invest on behalf of a child if you are a trustee of a Family Trust or Discretionary Trust and your child is a beneficiary. From a legal and tax perspective the assets are held by the Trust. Before investing on behalf of your child you should speak to a tax adviser or accountant to be aware of the legal and tax consequences.



Best SMSF investment strategies for income and capital growth

These are the 3 most asked for investment strategies from our SMSF clients.

BY CHRIS BRYCKI, JULY 15, 2019

SMSF investors have had a tough few years. The returns on term deposits have been dwindling, making it harder to earn an income from the bank.

Lenders have pulled back on SMSF loans for investment properties – now one less investment class to choose from. Meanwhile the most popular shares owned by SMSFs like Westpac and Telstra have had a forgettable decade, generating negative capital returns.

There has been one shining light for SMSFs which are exchange traded funds (ETFs). These ASX listed funds which track broad market indices rather than pick stocks have ballooned in popularity with SMSFs.

ETFs in Australia have grown from around $12 billion to $50 billion in just 5 years. According to Investment Trends, around half of that growth has come from SMSFs adopting ETFs in their portfolios. Over 120,000 SMSFs own ETFs in their portfolios today and that's growing each year.

These are the 4 most asked for investment strategies from our SMSF clients and how they can be achieved using ETFs:

- Best SMSF investment strategy for income
- Best SMSF investment strategy for capital growth
- Best SMSF investment strategy for capital protection
- Getting your SMSF asset allocation right

Best SMSF investment strategy for income: Australian share ETFs

Like owning shares, Australian share ETFs pay great dividends and pass on franking credits. But because ETFs are better diversified they're much lower risk than picking a portfolio of stocks.

We recommend the Vanguard Australian Shares ETF (VAS) which currently has a dividend yield of 4.2%. That increases to around 5% once you add in franking credits, a lot higher than the prevailing interest rate!

For SMSFs who want a little more income in their portfolios we recommend the Vanguard Australian Shares High Yield ETF (VHY) which has a tilt towards dividend shares and has a dividend yield of 5.5% and grossed up yield of 7.5%.

This ETF is one of the more popular investment themes we see for SMSFs. It delivered returns of 14.2% over the last financial year thanks to a rebound in financial shares.

SMSF tip:

It may be tempting to focus on yield, particularly as an SMSF in pension stage. We caution our SMSF clients not to be too focused on dividends. When you only focus on boosting income it can come at the expense of growing (and preserving) your capital.

SMSFs should focus on total return (income + capital growth) rather than just your income or dividend yield. Even if you're at pension stage you shouldn't be afraid to draw down from income and from capital growth. Over the last 12 months our Balanced strategy (Turquoise) generated a total return of 11% after costs, this included income of 3.2% and capital growth of 7.8%.

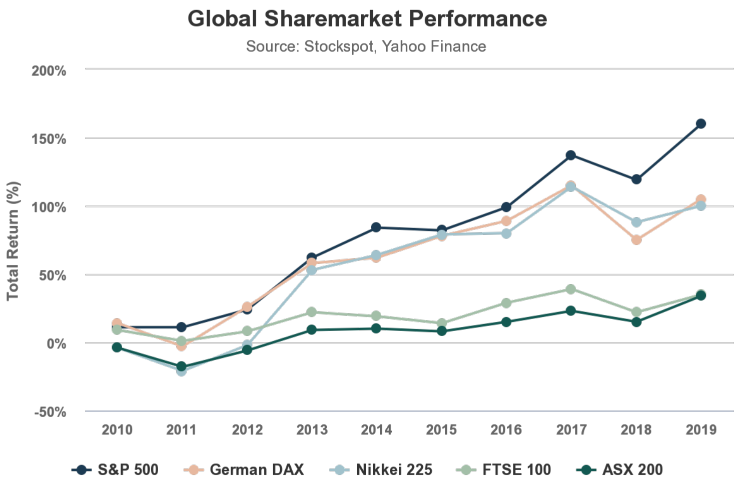
An SMSF in pension stage requiring a minimum withdrawal of 5% could have taken the 3.2% from dividend income, 1.8% from capital returns and still be left with 6% in capital returns for the 2018/09 financial year.

	1 YEAR RETURN	3 YEAR RETURN (P.A.)	5 YEAR RETURN (P.A.)
Vanguard Australian Shares ETF (VAS)	11.4%	12.8%	8.7%
Vanguard Australian Shares High Yield ETF (VHY)	13.8%	11.1%	5.7%

Best SMSF investment strategy for capital growth: global and emerging market share ETFs

Australian shares have generated lousy capital growth over the last 10 years. Fortunately SMSFs now have a wonderful array of global focused ETFs to choose from. Global share ETFs can help you to keep earning a decent return even when your Australian shares are performing poorly.

ETFs give you better sector diversification



The Australian share market is heavily geared towards the financials and materials (mining) sectors. Owning some global share ETFs helps combat over exposure to these sectors as they tend to have more technology and healthcare stocks. This has helped markets like the US, Germany and Japan do much better than Australia since 2010.

We recommend the Global 100 ETF (IOO) which invests in the largest 100 companies in the world like Apple and Google. This ETF generated phenomenal growth of 16.3% p.a. over the last 3 years.

We also recommend an emerging markets ETF (IEM) – even though emerging market shares can be smaller and more volatile, they give you access to faster growing economies and future growth. Emerging markets have returned 12.2% p.a. over the last 3 years.

Our research shows that over a full market cycle, a 45% allocation to global shares (both top 100 and emerging markets) has been the 'sweet spot' – the perfect balance between risk, return and diversification. Stockspot portfolios currently have 30 – 50% allocated to overseas markets – which helps SMSFs capture capital growth opportunities.

SMSF tip:

While you may be tempted to pay an active fund manager to access global markets, we've found that low-cost global share ETFs tend to do better over the long run because of their lower fees. This is why we only recommend low cost indexed investments and avoid higher cost active funds.

	1 YEAR RETURN	3 YEAR RETURN (P.A.)	5 YEAR RETURN (P.A.)
iShares S&P Global 100 (IOO)	14.6%	16.3%	13.5%
iShares MSCI Emerging Markets ETF (IEM)	6.3%	12.2%	8.0%

Best SMSF investment strategy for capital protection: high grade bonds

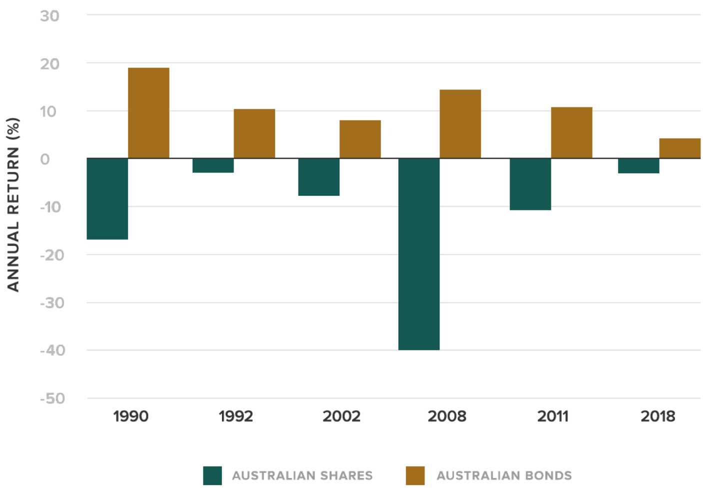
Any SMSFs who owned shares during the financial crisis will appreciate the importance of capital preservation. While shares are a great long-term investment, they can also have some stomach churning dips along the way which is why we advise all SMSF clients to own some high grade bonds as insurance.

High grade bonds have historically risen when share markets fall so can provide some insulation when markets become volatile. Over the past 30 years, whenever shares fell, high grade bonds did their job as a portfolio cushion and increased.

Australian bonds were one of the few asset classes with a positive return in 2018 when share markets fell, as they also did in 2008.

It has been difficult for everyday investors to access high grade bonds due to high minimum investment amounts, lack of diversification and costs. However, with the rise of ETFs, investors can now access bonds and make them a part of their portfolios.

We recommend the iShares Core Composite Bond ETF (IAF) which gives SMSFs exposure



to around 500 high quality government, semi government and corporate bonds. This ETF has a yield of 2.3% and it generated a total return of 9.6% over the 12 months to 30 June 2019.

As interest rates fall, bond prices rise in value because their fixed coupon payments become more valuable. This is what makes bonds a much better cushion for falling share markets than cash or term deposits.

For SMSF clients who want also want some global bonds we advise the Vanguard International Fixed Interest ETF (VIF) which has a yield of 2.0% (a bit lower than Australian bonds) and 12 month returns of 6.9%. This ETF gives you access to bonds issued by the US, Japanese, French and UK governments as well as some other countries.

	1 YEAR RETURN	3 YEAR RETURN (P.A.)	5 YEAR RETURN (P.A.)
iShares Core Composite Bond ETF (IAF)	9.6%	4.1%	4.9%
Vanguard International Fixed Interest ETF (VIF)	6.9%	2.5%	–

Learn more in our previous chapter: Best Australian Bond ETFs

Getting your SMSF asset allocation right

Rather than focus on a single strategy (income, growth or capital preservation), we recommend SMSF clients diversify across a range of ETFs to get exposure to all three. The right mix of ETFs should be based on the SMSF members' investment horizon, lifestage, risk capacity and cashflow needs.

Getting your SMSF asset allocation right will help your portfolio deliver more consistent performance whether share markets rise or fall. Stockspot offers a free assessment and will suggest the right investment mix of low-cost ETFs for your SMSF.

The strategies we recommend have experienced much lower volatility (risk) than only owning Australian shares and have had consistent returns over 1, 3 and 5 years.

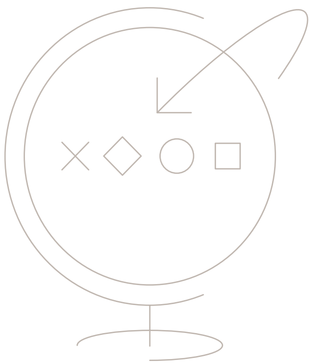
	1 YEAR RETURN	3 YEAR RETURN (P.A.)	5 YEAR RETURN (P.A.)
Topaz (aggressive growth)	11.4%	11.5%	9.2%
Emerald (growth)	11.2%	9.8%	8.2%
Turquoise (balanced)	11.0%	8.8%	7.7%
Sapphire (moderately conservative)	10.8%	8.2%	7.3%
Amethyst (conservative)	10.5%	7.2%	6.8%

Once your portfolio is set up, SMSFs should put into place threshold based rebalancing to make sure that the investments don't move too far away from their target weights.

This keeps your portfolio nicely balanced over time and takes the emotion out of your investment decisions. We do this automatically so SMSF clients don't need to watch their portfolio day to day and can get on with their lives.

Finally, a big benefit of ETFs is that they can help simplify your SMSF audit and tax. You can get your SMSF tax as automated as possible to keep costs low and make sure more returns are leftover for you.

If you pay more than $2,000 per year for SMSF admin there are ways you can reduce your costs. Stockspot recently launched a new service for SMSF admin, audit and tax starting at $660 per year.



How SMSFs can beat the best super funds in Australia

How to get better returns and spend less time – and money – managing your SMSF investment portfolio.

BY MELANIE NOVACAN, AUGUST 28, 2019

Are you one of the thousands of SMSFs that are unhappy with high fees and poor service from your adviser or accountant?

Are you unhappy because some of the larger Industry super funds perform better than your current SMSF?

A common myth is that you can't get better returns for the hassle – the time and cost – of running your SMSF. In fact, the latest survey by Investment Trends showed that investment advice was the biggest unmet need of SMSFs with 315,000 citing they need more advice.

But before you consider closing or transferring your SMSF to an industry fund, find out how Stockspot can help you get better returns and spend less time managing your SMSF portfolio, while also keeping your costs low.

Save time – and money

Simply investing in a diversified portfolio of Exchange Traded Funds (ETFs) can take the pain out of managing your SMSF. A big benefit of ETFs is that they give you more reliable returns than picking shares, as well as help simplify your SMSF audit and tax.

Using an online investment advisor like Stockspot to select the right ETFs for your SMSF portfolio helps even more by automating a lot of tasks like rebalancing and revising your investment mix as your needs change and you near retirement.

No more having to monitor the stock market or adjust your investment mix yourself. This not only helps you save precious time, it also helps you save money on things like brokerage fees and auditing at tax time.

The golden rule – low fees

Just as importantly, you want to keep the fees you pay for an advisor to manage your investment portfolio as low as possible. Stockspot's Fat Cat Funds Report 2019 Report has once again found that fees make all the difference when it comes to your retirement savings.

If you are paying more than 1% per year in fees, you could be $200,000 worse off when you retire. So our number one golden rule is: less than 1% in fees.

That includes any advice fees, subscriptions and brokerage. Stockspot's low monthly fee is all inclusive and we don't charge brokerage when we buy, sell or rebalance your portfolio.

We also help you claim any franking credits owed to boost your total return. Once your Stockspot investment portfolio is set up, you can also take advantage of our SMSF admin service, with fees starting at just $660 per annum.

The secret weapon – ETFs!

Stockspot's investment strategy of sticking to a mix of low-fee ETFs (think global and Aussie shares, bonds and gold) has delivered better returns than most industry and retail funds in Australia.

Our Topaz (growth) portfolio did better than about 90% of growth and balanced super funds over the last 5 years, including the largest retail and industry funds in Australia.

And the more conservative Stockspot portfolios have done better than every moderate fund! Well diversified, low cost ETFs are the secret to better returns.

		5 YEARS (P.A.)	TOTAL 5 YEAR RETURNS
Growth	Average super fund	7.0%	40.3%
	Stockspot Topaz portfolio	**8.6%**	**51.1%**
Balanced	Average super fund	5.6%	31.1%
	Stockspot Turquoise portfolio	**7.2%**	**41.6%**
Moderate	Average super fund	4.5%	24.6%
	Stockspot Amethyst portfolio	**6.8%**	**38.9%**

The key to diversification

Lack of diversification can expose SMSFs to unnecessary risk if a significant investment fails. With the ATO just announcing they are concerned that many SMSFs might not be diversified enough, now is the perfect time to review your investment mix.

Global shares represent only **15%** of many SMSF portfolios in Australia. However, recent research^ shows a portfolio with a mix of **48% global shares** and 52% Australian shares has given the best mix of risk and return over the last 20 years. At Stockspot, our portfolios are currently split between 30-48% in global shares and 52-70% Australian shares.

All Stockspot portfolios also include a mix of defensive assets such as **bonds and gold**.

You may be familiar with bonds, but why gold you ask? The negative correlation between shares and bonds has weakened recently. This means that bonds may not provide as much of a cushion in a share market dip. Think of gold as like your last line of defence if this happens.

What's the right asset allocation?

Getting your SMSF asset allocation right will help your portfolio deliver more consistent performance whether share markets rise or fall.

Stockspot offers a free assessment and will suggest the right investment mix of low-cost ETFs for your SMSF. Find out more about different SMSF strategies for income and capital growth or protection.

Plus the strategies we recommend have experienced much lower volatility (risk) than only owning Australian shares and have had consistent returns over 1, 3 and 5 years, as you can see in the table above.

Our top tip: stay in control of your retirement fund

Before you think about closing or transferring your SMSF to an industry fund, it's worth considering how Stockspot can help save you time and money.

Plus you can tailor your SMSF investment portfolio by adding extra assets, countries or market sectors to your portfolio with Stockspot Themes. You might want to choose areas of the market you want a greater focus on in your portfolio.

For example you might want additional exposure to certain geographic regions (such as China or the U.S.), asset classes (global property or bonds), or market factors (small companies, dividend shares or socially responsible shares).

And we ensure that your investment strategy stays balanced based on your goals and investment horizon.

^Vanguard: Approach to Constructing Australian Diversified Funds (2017)

Should you pay off your mortgage or invest?

The recent fall in interest rates has reignited the debate. Should you invest or pay down your mortgage?

BY CHRIS BRYCKI, OCTOBER 22, 2019

The appeal of owning your home outright is top of the financial priority list for most people. Indeed, it's usually better for homeowners to pay down a mortgage until they are comfortable with covering monthly repayments and have a significant buffer in their offset account.

However, with mortgage interest rates now around 3% and likely to go down further, mortgage repayments are becoming less of a financial burden on homeowners who have already paid down a large chunk of their mortgage.

The simple math

A good example is if you have a mortgage of $100,000 and are paying $3,000 per year in interest (3%), you would need to find an investment that earns a higher return than 3% per year to be better off investing than paying down the mortgage (or adding to the offset account).

Should I buy a term deposit?

The short answer is no. It may seem like the safe option to put the extra money you have into savings or a term deposit, but you'd be worse off compared to paying down your mortgage (or adding to your mortgage offset account).

Term deposits currently pay around 2%, this is less than a typical mortgage rate of 3% so you'd be locking in a loss of 1% per year. Plus the interest earned on a term deposit will be taxable income, whereas there is no tax deduction for interest on owner occupied home loans.

What investments should I consider?

If you want to invest instead of paying down your mortgage (or adding to the offset account), it only makes sense to consider investments which can achieve at least the same return as your mortgage interest rate.

Investments like Australian shares, international shares and high grade bonds have all exceeded the average mortgage interest rate over the long run. Compare their returns below against the your current mortgage interest rate (on average between 2.8% and 3.8% p.a.).

	1 YEAR (2018/9)	5 YEARS (P.A.)	10 YEARS (P.A.)
Australian shares	11.0%	9.0%	10.0%
International shares	11.9%	13.2%	12.4%
High grade bonds	9.6%	5.1%	6.0%

Source: RBA, Vanguard, LMBA, S&P/ASX All Ordinaries Accumulation Index, MSCI World ex-Australia Net Total Return Index, Bloomberg Composite Bond Accumulation Index

Note: that the after tax return on these investments will vary based on the level of franking credits and concessional capital gains as well as your tax position.

Investing is a long-term play

You should only consider investing if you can do it for the long-term. The day-to-day share market movements become much less relevant over time, so the decision to invest should be based on a long-term horizon.

As we always say at Stockspot, the longer you invest, the better your chance of success. Also, because some of these asset classes do well at the same time that others do poorly it is a safer strategy to invest in a balanced portfolio with a mix of different assets.

A diversified investment portfolio with Stockspot has earned 7-10% over the long run and is much less risk than just owning Australian shares.

STOCKSPOT PORTFOLIO RETURNS*	5 YEARS (P.A.)	TOTAL 5 YEAR RETURNS
Amethyst (conservative)	7.5%	51.9%
Sapphire (moderately conservative)	8.2%	56.8%
Turquoise (balanced)	8.5%	58.5%
Emerald (growth)	9.1%	63.1%
Topaz (high growth)	10.0%	72.7%

**Returns are after-fees as at 30 September 2019. Past performance of financial products is no guarantee of future performance.*

We believe low-cost ETFs are best and safest way to diversify your money across investments. It’s also important to keep your costs low when you invest as everything you pay in fees nibbles into your returns. This is particularly pertinent if you also have a mortgage.

Should I buy an investment property?

Q: What's better than one property?

A: Two properties!

In Australia it's almost seen as a right of passage into true adulthood to own a rental property. You might consider using your 'excess' savings to invest in another property.

The tax advantages of negative gearing can be attractive. It's been a popular strategy in Australia but it's risky as it concentrates your assets into one investment class and increases your debt as you're likely to take out another mortgage.

Negative gearing means that more of your cash is spent on interest and maintaining a property than the rent received. According to SQM Research gross yield (rent income) received for houses in Australia is 3.2% and for units 4%.

Even in a low interest rate environment it is easy to see how maintenance costs can exceed rental returns. There are other factors to think about such as your lifestyle, your risk tolerance and of course your marginal tax rate.

The appeal of owning your home outright asap may be more important to you than earning a better return by investing.

Factors to consider

If you're lucky and your mortgage repayments are no longer a difficult financial burden, and you have spare savings available, there are options available to you.

Rather than paying off the mortgage as quickly as possible, it may be a smart strategy to diversify your wealth across different investments.

Both paying down your mortgage and investing will result in increasing your savings so both are going to be positive for your overall wealth.

The main difference is that paying down your mortgage will reduce your debt (borrowing) whereas investing will diversify your overall wealth and income.

There are other factors to think about such as your lifestyle, your risk capacity and of course your marginal tax rate. The appeal of owning your home outright as soon as possible may be more important to you than earning a better return by investing so it's really a personal decision.

Invest or pay down your mortgage checklist

Here's some of the key factors to consider:

FACTOR	PAY DOWN MORTGAGE / ADD TO OFFSET ACCOUNT	INVEST EXTRA SAVINGS
Returns	It makes more sense to consider investing when mortgage interest rates are lower. Currently owner-occupied mortgage rates are around 3% p.a.	You need to compare the expected return from investments to the mortgage interest rate. Over the long run a diversified Stockspot portfolio has earned 7-10% p.a.
Tax	Is your interest tax deductible? This is based on whether it's your primary residence or an investment property.	The after tax return from investments will vary based on the level of franking credits and concessional capital gains as well as your tax position.
Time horizon	It's a safer option to pay down the mortgage if the period remaining on it is less than 3 years.	The longer you have to pay your mortgage, the more attractive investing becomes. You have a better chance of earning more than the mortgage interest rate from your investments.
Safety buffer	You need to build significant safety buffer and be ahead on mortgage repayments before considering investing.	Make sure investments can be easily sold should your circumstances suddenly require you to pay down more of the mortgage.
Income certainty	If your work income is less certain it makes more sense to pay down your mortgage.	If your work income is stable, investing is more attractive. There's less risk you'll need to sell down your portfolio early to meet mortgage repayments.

Why property investing returns may be lower than you think

What are the real long-term returns from property in Australia? We look at the costs of property ownership.

BY CHRIS BRYCKI, JUNE 3, 2019

The Great Australian Dream isn't fading any time soon. Everyone wants the white picket fence. We get it. There's no denying that home ownership is more than just capital gains, it's about owning the place you call home.

Bricks and mortar are seen as a secure investment yielding good returns over time. In this blog we take a closer look at the long term returns of residential property and weigh up all of the costs.

What are the real long-term returns from property in Australia?

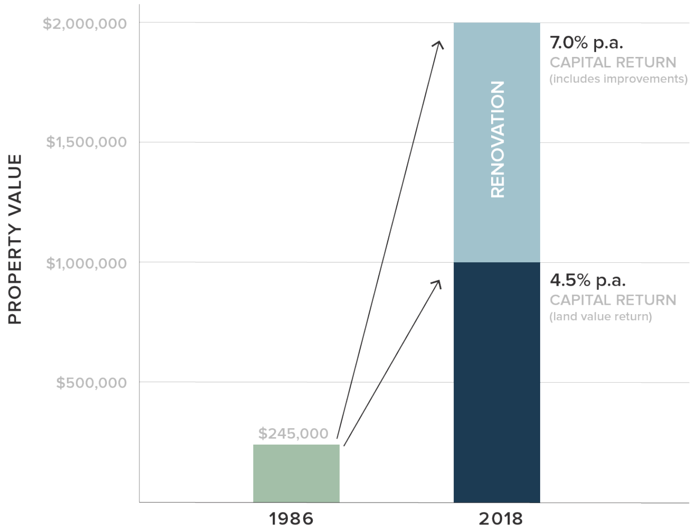
ABS figures from 2019 reveal a price increase of 7% per annum for dwellings in capital cities in Australia over the last 32 years. However, this 7% p.a. fails to account for the cost of renovations, improvements and maintenance over that time. Here's a quick example to show the impact of improvements on your return.

Let's say that a house was purchased for $245,000 in 1986. Nothing has been spent on it in 32 years so the house is quite run down. The property is bought in 2017 for its land value of $1 million. At this point, the ABS would record a price increase of 4.6% p.a. over 31 years.

Since the house is a knock-down, the new owners spend $1 million building a new house on the land. By their calculations, the property is now worth $2 million. If they sell the house at that price, it would be recorded by the ABS as a 100% price increase over 12 months and 7% p.a. over 32 years ($245,000 to $2 million).

However, the actual return – after taking into account the $1m spent on rebuilding the house – would be just 4.5% p.a. This isn't too far off reality, according to the ATO depreciation schedule a house will need to be rebuilt or majorly renovated every 25-40 years.

Impact of renovations on property capital returns



A costly investment to buy, sell and own

The average cost of building a house in Australia is over $1,100 per square metre, so an average size home of 300 square metres will cost around $330,000.

Even if your bank account is healthier than most, it's a big investment. But that's only just the start. By the time you add landscaping, outdoor improvements such as fencing, patios or a deck, you're looking at an investment much closer to $400,000.

Over time, bathrooms and kitchens need updating or replacing, while decks, pools and gardens also need ongoing maintenance. There's also ongoing costs like council rates, body corporate fees (for home units and town houses), water and insurance which the RBA estimates to be at least 2.6% per year.

It's also important to take into consideration the transaction costs of buying and selling a property. The RBA estimates that the costs of buying a house including stamp duty and other costs like conveyancing are around 4% of the value of the property.

The cost of selling a house including real estate agent commissions and advertising add up to about 3%. So the total costs of buying and selling a house are in the vicinity of 7%.

Considering an investment property?

The gross yield (rent) on houses in Australia is 3.2% and 4% for units, according to SQM Research. However there are substantial running costs which need to be taken into account to arrive at net yield.

If you own an investment property, you are liable for council rates, management fees, property maintenance and repairs. And if the property value is above the land tax threshold ($629,000 in 2018), there will also be land tax to pay each year.

Short term rentals can yield more than a long-term tenant due to the higher fees to stay for a night. And it's true – there's been a boom in the short-term rental market thanks to platforms like Airbnb and Stayz – but this has also increased competition among property owners – virtually pitting them against each other in the bid for the next overnight booking.

According to AirDNA market data, there were 1,034 active listings in Melbourne's beachside suburb of St Kilda and 812 active Airbnb listings in Sydney's Bondi Beach alone.

There is also a great deal of additional inconvenience and expense such as managing the property, cleaning and arranging access. And there is the chance that the property is vacant for long periods of time.

Capital gains don't add up

Tax benefits of owning property may be disappearing

Hanging out for capital gains rather than rental yield? Bearing in mind that the property dwelling itself will depreciate over time by around 2.5%-4% per year, the capital gain will be based on the value of the land which historically has increased by between 4%-5% per year.

Once the annual losses are offset against the likely capital gain on sale, the typical long-term return on an investment property in Australia has been marginal.

Tax is a big driver of property investment decisions in Australia. At the highest marginal tax rate of 48 per cent (including Medicare Levy), an annual loss of 4% on a geared property will become 2% after tax.

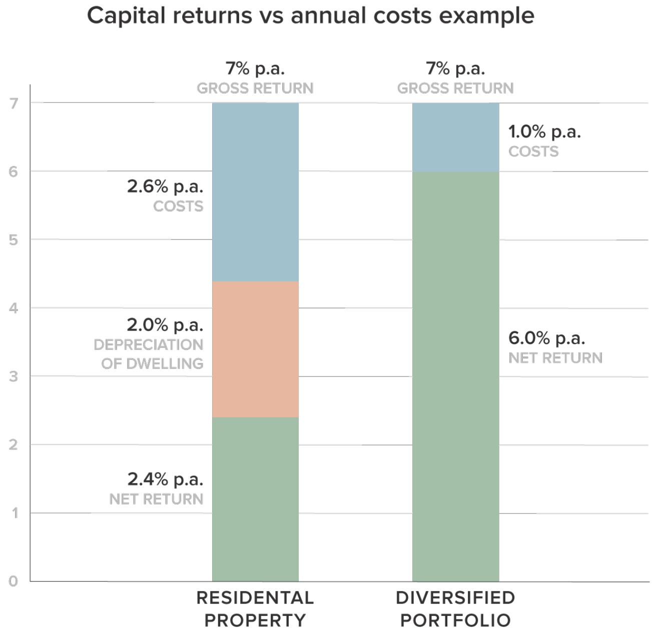
The favourable capital gains tax (CGT) treatment on sale is also a big motivator for purchasing investment properties. Currently there is a 50% discount for individual investors.

If the profit on sale equates to 4.6% p.a. an investor on the top marginal rate will pay the equivalent of 1.1% p.a. CGT on sale of the property.

Weigh up all your options

Once all the annual costs and the long term depreciation of the house have been factored in residential property is a very marginal investment and certainly performs worse than other investment classes.

While the team here at Stockspot fully appreciates the need to have a secure home and the opportunity to make that home more comfortable and enjoyable, there's a good argument for taking into account the long-term costs and considering a future nest egg in other asset classes.



Source: RBA estimates, ATO depreciation schedule, Stockspot

What about investing in other assets?

It's worth considering all options to invest your hard earned money, and whether an alternative to property may be better suited to your goals.

We know people can be turned off from investing in the share market because they perceive it as too risky and difficult. However, holding a diversified portfolio of shares and bonds gives you access to better return opportunities than putting all your eggs into the property basket – as well as much lower annual holding costs and depreciation than owning property.

We believe the best way to start investing is via exchange traded funds (ETFs), which give you the benefit of diversification across many assets. This is why we help clients invest across a range of ETF investments on autopilot.

Our clients get a diversified portfolio of ETFs covering Australian and global share markets, bonds and gold, with typical long term returns ranging from 6%-10% p.a. since we launched in 2014.

Our expert team of investment advisors are available to help when you need it.

Visit our website to schedule a call

www.stockspot.com.au

SARAH KING
Advice and Client Care

CHRIS BRYCKI
Founder and CEO

MATT RUDD
Head of Operations

What our clients say about us

"Great investment option for those who, like me, are time poor and want a simple financial product with decent returns and low fees. These guys are also very professional and have great customer service."

ROBERT T. (JULY 2017)

"I've invested with Stockspot for over 2 years and I am very impressed with both the platform and the level of service I receive. Before investing I looked into several other modes of investing in the market and found Stockspot to be the best in the market for the product they provide."

KEVIN H. (SEPT 2019)

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