ON THE PLATFORM

Top returns not all they appear

Ben Devenish

Feel like you are missing out on the "next big thing"? Currency funds, diversified multi-strategy alternatives, absolute return funds… there are returns being touted from these types of offerings at 15 to 25 per cent.

And that happened in a year where the typical balanced fund delivered 4 to 5 per cent to the end of September.

But how smart have some of those specialist investment managers really been?

Any fund manager who invested in unhedged international markets looks like a genius.

Global sharemarkets achieved 18.3 per cent to September 31, according to Morningstar. An indexed global government and corporate bond exposure delivered 20.5 per cent, says Barclays.

But guess what? The falling Australian dollar contributed most, if not all to those returns.

If we consider that the trade-weighted index (a measure of movement of the Australian dollar against international currencies weighted by our level of trade exchange) delivered gains of 20 per cent due to the Australian dollar depreciating, then that contributed all of those equity and bond fund returns.

If we overlay the alternatives or absolute returns styles (these terms making reference to options, swaps or futures derivatives that are taken to short or leveraged stock or bond positions) then the manager is looking more and more like they have a crystal ball. With these types of fund strategies the managers are shorting their exposure to markets, and potentially leveraging that strategy also.

If the term leverage sends a shiver down your spine then congratulate yourself. You have actually taken some lessons from the global financial crisis. The test now is to not get sucked into the same old tricks.

It is important not to chase those factors that have delivered the high returns over the last year — offshore currency, cash and short equities. These may end up being the strategies that hurt you most when things normalise.

What's more, there are typically higher fees and potentially adverse tax consequences when using these types of alternative strategies in isolation. Smaller investment pools, key person risks, layers of fund administration and high turnover of trading positions add to the potential costs and risks.

Alternative strategies have their place at times but only when you understand the limit of your exposure, how the fund is being managed and what circumstances can affect your ability to access your money.

Ben Devenish is principal at Shadforth Financial Group

ATTHECOALFACE

Raymond Pecotic

The Empire Financial Group boss tells *Ben Harvey* the GFC taught him some important lessons in business

Q. Why did you enter financial services?

A. I think this profession allows for a convergence of two of my strongest traits – I genuinely enjoy meeting and getting to know people and I have a strong acumen for figures and finances. In this line of work both are incredibly important. I used to spend my university holidays in my father's accounting practice coding bank statements and lodging tax returns, all the while watching the financial services person in the practice getting to know and building relationships with clients, and that appealed to my personality.

Q. What is your favourite part of the job?

A. The satisfaction I receive, when after meeting with a client multiple times, we can present our final findings and let them know that they are going to be financially OK. Many people have the right tools, but have extreme anxiety about how to pull it all together to make it work – witnessing the relief they feel when we show them how really makes my day.

Q. What is your investment approach?

A. In our practice we unashamedly put financial strategy first, and focus on the investment selection second. I lived through the global financial crisis relatively early on in my career and that experience taught me that as an adviser putting your entire value proposition on investment performance can be flawed. The right insurance and estate planning is a vital foundation to that financial strategy. Only once that is in order will we work with the client to choose the right mix of investments. We keep it simple and transparent. Managed funds or direct share ownership in easy to understand holding structures. We are also different because we feel really comfortable working with property investors.

Q. Name one regulation you would change?

A. Regulation, particularly when people's money is in question, is necessary and important and no professional practitioner should resist it. However, constant changes don't give clients the certainty they crave, neither in the rules within which they can manage their financial affairs, nor in the delivery of the service that they can expect their professional advisers to provide them.

Raymond Pecotic is managing director of Empire Financial Group

FROMTHEINSIDE

David Huggins

PDS fine print easily ignored

When your financial planner tells you to make an investment you must be given a document called a product disclosure statement which is known as a PDS.

The PDS is produced by the company that wants to sell the investment to you. Its purpose is to give you detailed information about the investment. Having acted for many clients over the years I'm yet to meet a client that has read a PDS. This is a pity because if they had they would not have needed to see me.

I was recently reading a PDS issued by Timbercorp about an almond growing investment that it was promoting. This investment collapsed in 2009 leaving investors with enormous loans that they will be paying back over decades. The PDS is an interesting document because given what is says about the investment it is not apparent to me why any financial planner could have thought that it was an appropriate investment for a client.

Before I get into the features of this investment it is worth looking at the reasons why clients don't read a PDS. My impression is that there are two reasons.

The first is that they are not given an opportunity to do so. In my experience clients are often given a PDS at the same time that they are asked by their financial planner to sign documents to make the investment. This causes the client to make the investment without reading the PDS.

The second is that many clients think that they will not be able to understand what is in the PDS and therefore don't even try to read it. In fact a PDS is usually readily understandable.

The reason for this is that they are carefully written so as to protect the people who are responsible for its contents should the investment perform poorly. The PDS will tell you about everything that could possibly go wrong and will do so in very plain language so the people behind the investment can say that you were made well aware of the risks that applied to the investment. You should be able to understand what is in a PDS. If you can't that alone is a very good reason for not making the investment.

The almond PDS is a very good example of the useful and readily understandable information that can be gained from reading a PDS. The most important thing that the PDS told a potential investor is that Timbercorp's directors were not willing to provide any forecasts about what the returns from the investment might be. The reason for this being that the investment was very long term in nature, involved agricultural production and was subject to various risk factors that the directors could not control. This information was important for three reasons.

The first being that if the people running an investment are not willing to say what the returns might be that is a very strong indication that the investment was highly speculative and was best avoided.

The second is that it is impossible to put a value on the investment because there is no accurate information available about what the returns might be and the factors that might cause the returns to be higher or lower than what was predicted. If you have no idea how much an investment might return how can you decide how much you should pay for it. Again these types of investments are ones that should have been avoided.

The third is that the fact that the PDS did not contain any information about expected returns called into question why this investment was being recommended at all by financial planners.

The promotors of these investments paid commissions to financial planners who provided advice about them that were far higher than applied to other products. This is the real reason why they were being recommended.

If clients had read the PDS and then asked their adviser the very simple question, why am I being told to buy something when the people selling it will not even say what it is worth things would have turned out very differently for many thousands of people who invested in this investment and similar investments.

David Huggins is a lawyer who specialises in resolving disputes about poor financial advice