more4life FINANCIAL SERVICES AFSL 316809

The Science of 2%

Normally when we talk about providing a 2% pa better return,

it is usually as you are increasing the risk factor, that is, cash is safe and a low return, whereas shares have greater risk but potentially higher returns. But the 'science of 2%' is not about that.

It is about creating efficiencies as traditional super funds are very expensive products. The greater savings we can provide, coupled with smarter investment strategies regardless of your risk tolerance, provides you with more money in your account and therefore, a better return.

Simplistically, if a super fund return for one year is 9.0% and they charge you 3.0% in administration and management fees, then you have a net 6.0% return on your money for that year. If we can reduce the fees from 3.0% down to 1.0% pa, then we have provided you with a 2.0% saving. Therefore, you have effectively increased your return for the year to net 8.0% pa.

Why is this so important? Well, if you have $500,000 in your super fund at age 45, when you are 65 an average return of 6.0% pa will provide you with $1.8 million, However, if the average return was 8.0%, then that figure goes up to $2.6 million, an increase of around $800,000. So you can see why 2% can make such a difference – but that is just one way.

So how do we obtain 2% greater savings without increasing your risk?

Well it is not just one thing but a combination of factors which we will go through here with you.

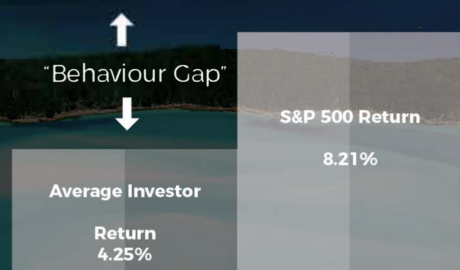
Administration Fees	**0.2%**	Asset Class strategy	**0.2%**	Investment Quality	**0.1%**
Investment Fees	**0.3%**	Rebalancing	**0.5%**	Adviser behaviour	**0.67%**
Appropriate Risk Level	**0.4%**				

Note the percentages above are not a constant and can vary. These have been researched from a number of sources such as Morningstar and Dalbar, and are more to demonstrate the point of efficiencies available rather than exact savings.

"It won't be the economy that will do in investors; it will be investors themselves."
Warren Buffett

The "Behaviour Gap". What causes it? Simple - investors do the wrong things at the wrong time.

Returns Between 1993-2012



Eight Great Mistakes

As human beings, our emotions can often distort or ignore hard facts and rational thinking. We fall prone to making decisions that we might not otherwise make when we have a clear, unemotional mindset. Nick Murray, the author of the book "Simple Wealth Inevitable Wealth", identified Eight Great Mistakes which are commonly made that are detrimental to one's investing health. They are:

1. **Under-Diversification**
2. **Over-Diversification**
3. **Euphoria/Overconfidence**
4. **Panic**
5. **Speculating When You Think You're Investing**
6. **Investing For Yield Instead of For Total Return**
7. **Letting Your Cost Basis Dictate Investment Decisions**
8. **Leverage**

Nick Murray suggests that there are also six variables which he believes dictate 90% of an investor's lifetime investment return. Three of these are attitudinal or behavioural principles and the other three are practices we should employ in the management of our investment portfolios:

Three Behavioural PRINCIPLES

1. **Faith in the Future**
2. **Patience**
3. **Discipline**

Three Portfolio PRACTICES

1. **Asset Allocation**
2. **Diversification**
3. **Re-balancing**

Three Behavioural PRINCIPLES

1. Faith in the Future

Looking back and comparing where we were with where we are now would suggest the future has better things to come. Technology will advance, people will live longer, businesses will expand and the stock market will go higher. It has always been so. Therefore, when dealing with market corrections, we should treat it as just a temporary occurrence, a bump in the road to our long term investment goals because history tells us the market will recover and go even higher as time goes on. This kind of faith is critical for those of us who are planning for retirement and making investment plans that depend on how the market has behaved for the last 120 years. In fact, Nick Murray states that ". . . you will never make a good investor out of someone who is fundamentally afraid of the future."

2. Patience

For many of us, our financial plan and portfolio will be designed to last a few decades. Given this fact, if our life goals haven't changed, then we shouldn't be changing our plans or the portfolio. Too many investors feel compelled to "do something" about their investments when they hear the latest news or investment fad or their neighbour's returns. However, studies have proven that frequent trading is detrimental to your portfolio's performance. Nick Murray advises "Never mind what's working now; try to stay focused on what's always worked in the long run."

3. Discipline

The difference between patience and discipline is that discipline, according to Nick Murray, is the ability to keep doing the right thing even when it feels wrong. Patience has more to do with forbearance, or the capability not to do the wrong thing, like panicking out of the market at times of extreme pessimism. This may be difficult to do when everything you see and hear tells you that the world is coming to an end, but this is precisely when faith in the future comes into play. It reminds us that we have a long-term plan, and that given time, whatever crisis we're experiencing will pass. At times like these, we should also rely on our investment adviser as our Behavioural Coach, to guide us in what we should and shouldn't do.

Summary

Of the six variables identified by Nick Murray, if we embrace these three attitudinal / behavioural principles in our approach to investments, we would then have the proper mindset to employ the three practices that we should use in the management of our investments. Nick Murray states that "the principles dictate the practices, in the sense that beliefs always dictate behaviours."

Three Portfolio PRACTICES

1. Asset Allocation

Investment professionals agree that asset allocation is a critical determinant to portfolio performance. A Vanguard research paper showed that 82% of a portfolio's return can be attributed to asset allocation, while only 18% is attributed to security selection and market timing. How you spread your portfolio amongst the main asset classes of Equities (stocks), Fixed Income (bonds & equivalents), and Cash will largely determine the returns you receive over the long run. However, since returns are directly correlated to volatility, a higher return would mean a higher volatility in your portfolio and vice versa. Having greater portions of your portfolio in Equities may provide a higher return over the long run, but the ups and downs of the portfolio will also be higher. Fixed Income investments have lower ups and downs, but their after tax returns may not keep up with the rate of inflation. So a balance must be made between performance and volatility or risk when asset allocation decisions are made. The "proper" allocation for an individual will depend on a balance between the required return of the portfolio and the risk tolerance of the individual, as well as the time horizon for their financial goals.

2. Diversification

The second practice we need to employ is mixing the investments we hold in our asset classes with various types, industries, sectors, countries, and so on, in order to achieve a diverse holding. Because the prices of various investments do not move in the same way (ie uncorrelated), having a diverse number of holdings will tend to reduce the price volatility of the portfolio. However, we do need to guard against over-diversification, as this would tend to dampen the overall portfolio performance.

3. Re-balancing

If setting proper asset allocation is key to matching our long term financial goals and risk tolerance, then it stands to reason that when the asset allocation is out of alignment, we should adjust it back to the original proportions. This practice is known as "re-balancing" a portfolio. Should an asset class become out of proportion due to gains or losses, we need to bring it back in line by selling or buying this asset class until the portfolio's asset allocation is equal to the prescribed proportions again. Your investment adviser should be monitoring this for you and should advise you when re-balancing ought to occur.

Summary

These three practices, along with the three behavioural prnciples discussed previously, comprise the six variables that Nick Murray states will determine 90% of our investment outcome in the long term. If we can follow these six variables, history tel ls us that we have a very high probability of achieving our long term investment goals. This is exactly what we at More4Life Financial Services are dedicated to doing.