Integrated Wealth Solutions

# The Good Life

Ideas, advice, beliefs and perspectives for the enjoyment and education of our clients and friends

April 2014

Period ending March 2014

| Fixed Interest | | | | | |
|---|---|---|---|---|---|
| **Years** | **1** | **2** | **3** | **10** | **YTD** |
| One- year | 2.9 | 3.4 | 4.1 | 5.4 | 0.7 |
| Two-year | 3.2 | 3.9 | 4.5 | 5.4 | 0.8 |
| Five-year | 2.6 | 5.0 | 6.9 | 6.7 | 1.4 |
| Long Term | -1.8 | 3.7 | 8.2 | 6.6 | 2.6 |
| | | | | | |
| **Australian Shares** | | | | | |
| Large | 14.3 | 17.9 | 9.4 | 9.7 | 2.0 |
| Value | 6.7 | 11.2 | 4.5 | 9.2 | 1.5 |
| Small | 1.2 | 1.2 | -1.6 | 8.7 | 1.2 |
| | | | | | |
| **Global Shares** | | | | | |
| Large | 35.4 | 22.6 | 15.0 | 5.0 | -2.5 |
| Value | 39.4 | 25.6 | 14.1 | 5.8 | -1.8 |
| Small | 43.6 | 28.1 | 16.4 | 7.4 | -0.6 |
| Emerging Markets | 10.0 | 6.1 | -1.0 | 8.4 | -4.0 |
| Real Estate | 12.8 | 16.7 | 13.0 | 3.5 | 3.7 |

| Description of Indexes | |
|---|---|
| One-year FI | DFA Short-Term FI |
| Two-year FI | DFA Two Yr Div. FI |
| Five-year FI | DFA Five Yr Div. FI |
| Long-Term FI | UBS Aus Treas. 10+ |
| Australian Large | DFA Aus Large Co |
| Australian Value | DFA Aus Value |
| Australian Small | DFA Aus Small Co |
| Global Large | DFA Global Large Co |
| Global Value | DFA Global Value |
| Global Small | DFA Global Small Co |
| Emerging Markets | DFA Emerging Markets |
| Global Real Estate | DFA Global Real Estate |
| | Data presented may be based on a combination of simulated and actual returns. |
| | **Past performance is not indicative of future performance.** |

## *What We Are Thinking*

Dear Reader,

Welcome to the April edition. This month we look at the secret to higher expected returns, which to long-term readers would not be a secret. We also look at the latest Dalbar analysis of investor behavior and its shocking effect on investor's long-term financial health.

Some people think that their super fund is immune from these problems. Dream on, whether you have a DIY Self Managed Super Fund, or you are in a retail super fund, your portfolio will be diminished by investor poor behaviour.

We continue looking at what is needed for successful long-term investing. Last month we looked at the first and key attitude of **faith in the future**. This month we add two more key attributes of a successful investor.

**Patience and Discipline**

We live in a world of late-breaking news. Sticking to your long-term plan, which you and your financial advisor created, to fund your most important multi-decade goals is difficult. Especially because we are all bombarded with a mountain of financial information from so-called experts pressuring us to do something.

Once the pattern of history reasserts itself, as it always has, we realize the futility and stupidity of the statement "it's different this time". If your goals haven't changed, don't change your plan; if your plan isn't changing, don't change the portfolio.

**Discipline** is more about forbearance, or the capacity not to act – not to do the wrong thing, most notably panicking out of the markets at a moment of maximum pessimism. Especially when all the experts are talking up the latest crisis.

**Federal Budget**

Like most baby boomers we will be watching the Federal Budget this year. If things change dramatically we'll produce a Budget edition in mid-May.

# The Secret To Higher Expected Returns

## Part 1

**By Dan Solin** April 15, 2014

Everyone wants higher returns. To many investors, success in investing means generating "alpha." If you are an investor in mutual funds, that means trying to generate returns in excess of the benchmark index designated by the fund.

There are still many investors who participate in the pursuit of alpha, but the numbers are diminishing. In 1993, approximately 3 percent of investors owned passively managed funds, in which the fund manager simply tracked a benchmark index. That number steadily increased to almost 27 percent at the end of 2013.

Is there something these passive investors know that you don't? Why have they thrown in the towel and abandoned the quest for alpha?

The answer to this question was fully explored in a thoughtful article by Julie Segal, which appeared in *Institutional Investor* on September 18, 2013. According to Ms. Segal, she decided to "research whether alpha -- investment returns above what a plain old index fund would give you -- was just a fairy tale that the investment industry told itself at bedtime."

Here are some of her most salient findings:

1. The alpha of U.S. large-cap mutual funds has been steadily shrinking for 40 years.

2. According to a joint paper from the Center for Applied Research and the Fletcher School of Law and Diplomacy at Tufts University, less than 1 percent of 2,076 mutual funds tracked between 1976 and 2006 achieved alpha after costs.

3. The decline of the ability of fund managers to achieve alpha was reported in a working paper from the University of Maryland. Prior to 1990, 14.4 percent of stock mutual funds delivered alpha. In 2006, the percent of equity mutual fund managers who generated alpha declined to a miniscule 0.6 percent.

4. The shift over time in the market, from one dominated by individual investors to one dominated by institutional investors with access to increased technology, has "reduced the amount of aggregate alpha available in the market." According to Segal, the markets have become "hypercompetitive," reducing or even eliminating the ability to get an "edge."

5. The Internet has made information about stocks and bonds almost instantaneously available to all investors. As a consequence, the markets have become more efficient.

6. You would think endowments, given their extensive resources and access to the best fund managers, would be prime generators of alpha. Yet Segal notes that during the five years since the financial crisis, most endowments have underperformed a basic allocation of 60 percent stocks, 40 percent bonds.

If you look dispassionately at the data, you can't help but be persuaded that investing based on the premise of achieving alpha is unlikely to be successful. In fact, I suspect the search for alpha is the primary reason why so many investors fail to achieve the returns of benchmark indexes.

The secret to higher expected returns may be to accept the reality that trying to obtain alpha is more likely to enrich your broker and active fund managers than you.

# The Secret To Higher Expected Returns

## Part 2 Buy and Hold and Stop Worrying

Boston-based DALBAR Inc. just released its 20th "Quantitative Analysis of Investor Behaviour," a landmark study which has shown since it was first done in 1984 that investors lag the mutual funds they buy, with seemingly every move working against them.

The tale is hardly new. Investors buy a fund after a period of good performance, waiting for the fund to prove something before adding it to their portfolio. But when the market turns and the fund's asset category cools — or when today's hot manager regresses toward the average after a period of oversized results — investors bail out, and look for another fund to buy, typically choosing again something that's been hot lately.

In short, they buy high and sell low, and repeat the process multiple times.

In general, fund investors sacrifice the good — decent funds with reasonable returns — to pursue the great, and wind up with neither.

DALBAR's study quantifies the phenomenon. The Standard & Poor's 500 SPX returned 9.22% over the 20 years ending in 2013, but the average equity fund investor only earned 5.02%.

Now 4.2%pa doesn't seem like much does it? Well, for every $100,000 sitting in a super fund over that period, it would have been the difference between having $583,503 in it compared to $266,342 after 30 years.

Why? DALBAR noted that investors truly are at their worst when the market does poorly, selling once they have a big paper loss and sitting on the sidelines until the markets have recovered their value, thus participating in the market mostly when it is in retreat and sitting out the times when securities are on the rise.

I hope you enjoyed this issue and would like to receive your feedback on articles you would be interested in or ways we can improve our newsletter. We have a lot more information on our website at www.integratedwealthsolutions.com.au where you can register to receive this free monthly newsletter.

**Dr Baden Rumble**
**Editor**

**Disclosure & Disclaimer**

# That Bit Extra…

## Psychology, Philosophy & The30th Birthday of Mobile Phones.

### Curious Investor Behaviours from Platinum Asset Management.

***Confirmation Bias.***

Once we have made a decision or formed a view, we subconsciously emphasise information which reinforces that view. At the same time, we tend to downplay contradictory information.

Confirmation bias is perhaps the most subversive of all behavioural flaws, because it prevents us from arriving at the truth and allows us to wallow in the comfort of our preconceptions and prejudices.

Can we learn without listening to others who have different points of view?

> *Manifest plainness,*
> *Embrace simplicity,*
> *Reduce selfishness,*
> *Have few desires.*
>
> *– Lao Tzu*

Detachment from likes and dislikes, habits and opinions, is not a sign of weakness. It is an enormously strong and positive quality. Nor does freedom from likes and dislikes mean that life is insipid for us, but rather that we are not driven compulsively by rigid ways of thinking. Even if we don't get what we want – or if we do get what we don't want – we can still function cheerfully and efficiently.

Detachment from habits does not mean that we have no habits. Good habits can be very useful to cultivate in life. But we should be able to change our habits gracefully, or drop them altogether when necessary, especially if we learn that they are harmful to us or are not exactly endearing us to those around us. If we are used to a cup of coffee every morning with our breakfast and one morning we discover that we are out of coffee, we don't say, "I can't function without my coffee," and go back to bed. We should be able to say cheerfully, "I'll have tea instead – or soy milk."

## The First Cellphone Went on Sale 30 Years Ago for $4,000

The first handheld cellphone was sold on March 13, 1984 A handheld portable phone was considered a gimmick, a "look what I got!" rich man's toy with dubious utility. Measuring 13 x 1.75 x 3.5 inches and weighing 28 ounces, the 8000X was so big and heavy, even its creators had nicknamed it "The Brick." Plus, you could only use it for a half an hour before the battery gave out. Who would pay a quarter of the average salary in 1984 — more than $9,000 in 2014 dollars —everywhere and only cost a dime to use.

Businessman using a Motorola DynaTAC 8000X portable cellular phone at Meigs Field airport, Chicago, circa 1984.
Image: Motorola, Inc. Legacy Archives Collection