ALMAN Financial Planning
AFSL 222107

Your Money
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MANY HAPPY RETURNS

In the words of one of my old school teachers "It's pencils down, hands away" for the financial year 06/07. The end of June sees a line drawn in the financial sand which provides a start and end date to measure a plethora of financial data. At this time investors both professional and DIY analyse how one portfolio has fared against another. Often, the only number many investors consider is the performance number, for example Fred's fund has returned 10% while Barney's has returned 15%. Intuitively it may sound as though Barney's has performed better, and this is where many DIY investors strike trouble.

To accurately analyse the portfolio performance we firstly need to consider what percentage of the portfolio was invested in what asset classes (cash, fixed interest, property, Australian & International shares). It's this asset allocation decision which will have the biggest effect on returns and there is no point comparing apples with oranges.

Secondly, how much diversification within the asset classes was there? For example – Barney's return of 15% may have been achieved by a single speculative investment which next year goes broke! Last financial year many DIY investors suffered this fate when attracted to slick marketing by property syndicates like Fincorp and Australian Capital Reserve.

Thirdly, what are the after tax returns of the portfolios? Fred may have achieved his 10% with a buy and hold approach while Barney traded madly throughout the year and incurred a large amount of capital gains within his 15%. If Barney's in a high marginal tax rate, his after tax return may be less than Fred's 10%.

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Academic research has shown time and time again that asset allocation, diversification and tax are the biggest determinants of investment returns and to accurately compare investments of a portfolio of investments it is sensible to consider all of these factors.

Remember, if you primarily want safety from an investment, expect lower returns and invest in quality defensive assets (not the type promoted by a certain ex-Queensland Premier in the Sunday Papers). On the other hand, if you primarily want a high return (better than bank interest) without speculating - diversify and invest in growth assets like shares and property and ride out the volatility over time.

Over the last five years those investors who have been broadly diversified through shares and property and gained at least average market returns have done exceedingly well – in most cases, doubling their money.

So congratulations and many happy returns to all the 2006/2007 investors who allocated their capital wisely and prospered accordingly.

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