



Your SMSF Investment Strategy

The majority of people who set up a Self Managed Super Fund ('SMSF') cite 'control' of the investments as their driving factor.

Along with the benefits and flexibility of managing your own superannuation, is the responsibility to ensure your fund is successful in growing your money and providing for your retirement.

As a Trustee of a Self Managed Super Fund ('SMSF'), you are required by law to prepare and implement an investment strategy for your fund and review it on an ongoing basis.

An investment strategy is a detailed financial plan made by the Trustees of a SMSF based on consideration of the Sole Purpose of the fund. It takes into account the current and/or future financial needs of each of the fund members and is framed in the context of their risk preferences.

The Trustee has a duty to make, carry out and document decisions about investing the assets of the fund and to carefully monitor their performance.

The investment strategy is not onerous, and simply requires ongoing review. Examples of times where it is wise to review and if necessary update the investment strategy include:

- Identification and intent to invest in a specific investment opportunity that does not fit with the current strategy;
- Change in risk tolerance or financial needs or expectations of the member(s) over time;
- Adding a new member to the fund;
- Commencement of a pension for a member (likely to require higher cash liquidity);
- Death or change in health of a member;
- Marriage breakdown

Investment Objectives

The Trustees overall objective is to invest the assets of the fund in such a way as to protect and enhance the retirement benefits and (as the case may be) the death benefits of the members of the fund.

Trustees need to consider a benchmark for setting their fund's objectives. An example of an investment objective could be:

'To obtain an average yield from all investments of 6%'.

Tips for setting Investment Objectives

- Consider the profile and needs of each member
- Consider the age to retirement for each member
- Consider whether the assets being contemplated are suitable for a SMSF
- Consider the other assets of members – for example, what exposure do they have to property, Australian or overseas shares
- What is the risk profile of the members?
- Do the members have a similar risk profile, or are they different?
- If the risk levels are different, should the assets in the fund be segregated to member's accounts?
- Are the members looking for growth from their investments, or do they seek a regular income?
- If investing in Australian shares, how can you maximise the franking credits?
- Does the SMSF exist to provide income to the members, or as a vehicle for passing on death benefits?

Must it be unique to our situation?

It is likely every SMSF will be unique. This is because the fund members and their personal financial circumstances will differ between funds.

The risk tolerance, rate of return and asset allocation are likely to vary depending on each and every member's personal circumstances.

Risk and Return

Risk is a possibility of loss on an investment. It is usually measured by reference to the volatility of the returns. When formulating an investment strategy, the Trustee must be able to identify, measure and manage risks associated with particular investments.

Factors such as interest rates, political stability, market changes, risk management techniques and changes of legislation affect risk. This means that the Trustee has to constantly monitor and review the investment strategy, the investment objective and the performance of the fund's investments.

There is a strong correlation between risk and return. This means that the Trustee must determine an acceptable level of risk and volatility of the returns in the light of the SMSF's circumstances.

The risk tolerance indicated will be used to set the diversity and nature of the fund's investments and asset classes.

Diversification vs. Investment in One Class of Assets

Generally, diversification in investments is desirable. It is useful to disperse and manage risk, and reduces the volatility of the returns on the investments. It can be achieved by spreading investments over a number of individual assets, classes of assets, countries or investment managers.

However, it may be difficult to achieve, particularly for a small fund, in the early stages when there is limited amount of money to be invested. Thus, the level of diversification and how it is achieved depends on the size and circumstances of the SMSF.

A small SMSF can invest all its assets in business real property acquired from a related party. However, the investment strategy must reflect this investment decision.

Paying Expenses

The Trustees need to maintain sufficient liquidity to pay taxes of the fund (income, capital gains, GST, PAYG and contributions tax), and must ensure that other expenses such as administration expenses, brokers fees, stamp duty and legal fees are paid on a timely basis to avoid late fees, penalties and interest.

Cost of Investing

The Trustees shall exercise prudence and consider the cost of making investments on behalf of a fund. The Trustees shall allow costs from time to time relating to investment and strategic advice with the intention of maximising investment returns.

Insurance

Trustees should consider the death and disability insurance needs of each member. Insurance can be held within a SMSF and the pros and cons should be discussed with a Financial Adviser.

Prohibited Investments

We recommend Trustees seek advice to ensure the Investment Strategy complies with the law and the trust deed of your SMSF.

For example:

- your fund must not make loans to members or their relatives;
- the investments should be on an arm's length basis;
- the investments do not breach of the in-house asset rules;
- observe the restrictions on acquiring assets from related parties.

The investment rules are one of the most important requirements of the SIS Act and failure to comply with the rules could result in Trustees being imprisoned, removed as Trustees, or fined and/or the fund paying 46.5% of the total value of the assets in the fund as a penalty.

Audits

SMSFs are required to have an annual independent audit. The Auditor will review the investments by the Trustees to ensure they are consistent with the investment strategy.

If a fund does not have an investment strategy on file at the point of audit, Auditors can demand Trustees produce it within 14 days. If it is not produced, they will qualify the audit report to the ATO on the basis that the fund is not meeting the sole purpose test.

A qualified audit report can draw attention to your SMSF with the possibility of a detailed ATO audit being conducted at considerable expense.

Summary

A detailed investment strategy is vital to the success of a SMSF and we recommend Trustees seek professional advice from a qualified Financial Adviser.

For a sample investment strategy template or for more information relating to this edition of Your Guardian, call **Phil Jaquillard** or **Ed Bernard** of our office on 1300 787 576.



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