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Prepare for battle

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The jargon is mind-numbing and the fees will give you a headache but this quick and easy guide to portfolio management will help you take charge of your investments.

The investment landscape is more confusing than ever, with an explosion of products and services. Forget being blinded by science. It doesn't come close to a mind-numbing spiel about platforms, wraps, self-managed accounts (SMAs) and self-managed super delivered by your friendly neighbourhood financial adviser.

The more complex investing becomes, the more intermediaries appear to provide advice and help with its administration, at a cost.

Before you make any decisions it helps to understand how these products work.

In essence, platforms such as master trusts, wrap accounts and SMAs are technology-driven products that let individuals pool resources to save costs and gain access to investments that were once the domain of the super wealthy.

The internet means investors can track and manage all their investments in one spot and receive an individually tailored, consolidated report at the end of the financial year.

But there is a sting in the tail. Too often investors feel they are paying through the nose for expensive products they don't need or understand.

Michael Lannon of 2020 DirectInvest estimates about 80 per cent of all new investments go into some sort of master trust or wrap account.

To get the benefits people need to understand what is being offered, what it costs and whether it suits their needs.

In some cases, investors may be better off throwing away the wrapper and investing directly in shares, property or other assets. Or they may be able to cut out the middle man and invest directly or through a discount broker.

But let's not put the cart before the horse. Cormac Heffernan, head of customised portfolio services at BlackRock (formerly Merrill Lynch) Investment Management says investors first need to think about what investment they want: shares, fixed interest or property. Only then do you decide what vehicle to use.

The easiest way to understand these platforms is to look at their evolution from master trusts in the late 1980s to wraps, which appeared in the early 1990s, and today's self-managed accounts.

Master trusts

Lannon says master trusts were the brainwave of an entrepreneurial group who realised they could aggregate customers and squeeze the big fund managers.

A master trust allows investors, or super funds, to pool their money so they can invest with a wide variety of fund managers at wholesale rates. The investments are consolidated into one fund and held on behalf of the client by the trustee who is the legal owner.

The ASGARD master trust was launched in the '80s to provide financial planners with a one-stop shop for managed funds, effectively moving the large profits from fund managers to financial planners. A decade later the fund managers fought back, buying up financial planning firms to provide a captive sales force. Then the banks twigged and bought the fund managers.

Lannon says the net result is more than 70 per cent of financial planners are owned by large institutions that control the managed funds. The field has been opened up a little by the emergence of boutique fund managers and by the big institutions agreeing to sell each other's products.

Theoretically master trusts save investors money. Anyone with \$25,000 or more to invest will pay annual management fees of 0.9 per cent or less compared with standard retail investment fees of 1.7 to 2.5 per cent. But, unless you have half a million to invest, wholesale funds can only be accessed via a master trust or wrap, which imposes another layer of fees.

So while profits slosh backwards and forwards between fund managers, financial planners and platform administrators, investors get screwed.

Fees aside, master trusts have benefits. As well as giving individuals access to wholesale funds they save time on administration. Your accounting, reporting and tax are taken care of by the trustee and you get a consolidated report at the end of the tax year.

Wrap accounts

Although similar to a master trust, wraps give investors ownership of the investments "wrapped up" in one administrative bundle. All the assets in your wrap are held in your name so you are the legal and beneficial owner.

Lannon says the key difference between master trusts and wraps is the portability and tax treatment of the underlying investments.

A shortcoming of the early wrap accounts and master trusts was their lack of flexibility. If you wanted to switch advisers or wrap providers you had to sell the underlying investments in one master trust or wrap and buy them in the new one, triggering a capital gains tax liability. Newer products allow you to switch without selling your investments or paying capital gains tax.

A wrap can include managed funds, shares and even margin loans that can be viewed online in one account. The wrap provider may have hundreds of products from a variety of fund managers or a more limited choice of mostly their own funds.

As with master trusts, wraps allow investors to hand over the administration to professionals. While this saves time and worry, it comes at a cost.

According to the Australian Securities and Investments Commission, entry fees can be as high as 5 per cent (www.asic.gov.au/fido). Some advisers rebate these but make sure this is not at the cost of higher management fees.

Administration fees of 0.09 to 0.79 per cent are charged by the platform provider. These may be applied on a tiered basis (lower fees for higher balances) or, in Macquarie's case, on a per investment basis. On top of that there is an annual investment management fee of up to 4.1 per cent.

Sometimes the management fee includes a service fee for the adviser but often this is separate and may be as much as 2 per cent of your investment each year. Lannon advocates paying an hourly fee for advice or a flat dollar fee for ongoing advice when it is needed.

"Avoid percentage-based service fees as they effectively reduce the performance of your investments," he says.

"A saving of 1 per cent a year [on adviser fees] over 25 years on \$300,000 could result in savings of over \$470,000."

In response to the growing criticism about fees, many wraps now cap fees on high balances. Some providers offer scaled down "baby wraps" with fewer investment options and lower minimum investment amounts to reduce costs and fees. Even so, most advisers agree investors need to put a minimum of \$50,000 to \$100,000 into a wrap to make it viable.

While wraps are undoubtedly costly, they are often the only way investors can access some of the best fund managers so it is crucial investors weigh up the costs and benefits for their circumstances. For example, if most of your money is in direct shares then a wrap will not offer value for money.

There are five main wrap providers - St George (ASGARD), Westpac (BT Wrap), Macquarie, Navigator and Oasis Asset Management - who each "badge" their wraps for financial planning groups.

While many people are happy to pay for advice and administrative leg work, confident investors with the time and skill to manage their own investments would be better off investing direct. The average annual fee for managed funds is about 2 per cent, half the amount you can expect to pay through a wrap.

Some planners only offer one wrap while others offer a choice. Investors can also buy wraps direct from discounters such as 2020 DirectInvest, bypassing advisers and their fees.

Lannon says investors should be aware not all wrap accounts are created equal. "With nearly 70 per cent of advisers linked to institutions there is a tendency to offer only an employer-owned wrap." He advises comparing fees and charges or executing your own transactions in a wrap you access directly and pay for advice separately.

Wraps are structured according to the investment purpose. Super wraps offer a cheaper and less hands-on alternative to self-managed super funds. But Lannon warns changing from one super wrap to another will result in a change of trustee, necessitating the sale of the underlying assets and payment of the 10 per cent capital gains tax applicable to super funds.

Self-managed accounts

Self-managed accounts are a mass-market form of the individually managed accounts (IMAs) previously available only to the very wealthy. Cormac Heffernan, head of SMAs at BlackRock, says someone with \$50 million can go to a fund manager and get a portfolio designed just for them. SMAs do something similar for the rest of us.

"There is no minimum investment, that is where the revolution is taking place," Heffernan says. To test the theory he put \$20,000 of his own money into a selection of BlackRock's first model portfolios and ended up with 50 stocks for total brokerage fees of \$10.

In practice, the advisers who badge SMA products may impose their own minimum investment. Some are as low as \$5000 and \$20,000 is common but Westpac has a minimum investment of \$100,000 in its BT Elect Portfolio.

Arthur Naoumidis, managing director of platform technology provider Praemium, says for the first time last year flows into SMAs in the US exceeded flows into managed funds. He predicts all wraps will evolve into an SMA platform and says all the major wrap providers are working on this.

"SMAs are a cheaper and more tax efficient way of buying a fund manager's intellectual property," Naoumidis says.

Like managed funds, SMAs provide investors with a professionally managed portfolio but with beneficial ownership of the underlying shares. So if the fund has 5 per cent of its money in BHP and you invest \$100,000 in the fund you end up with \$5000 of BHP shares.

With SMAs, a fund manager builds a model portfolio specialising in some form of securities, such as growth shares or listed property, and buys and sells the underlying shares to produce returns for investors. Unlike a traditional managed fund, the SMA fund manager is buying shares on behalf of individual investors.

At present SMAs offer local shares and listed property but Heffernan says BlackRock will be adding global shares and structured products.

The upshot is investors know what shares they own and receive capital gains or losses, dividends and franking credits. Importantly, investors don't inherit other unitholders capital gains or losses as they do with managed funds. That is, investors have an individual cost base which allows them to better manage their tax.

To illustrate, Heffernan says a financial planner might say you should put 50 per cent of your cash in the BlackRock Australian share portfolio and 50 per cent in the index model. "The client will see just one blended portfolio. If they both have BHP I just see one holding of BHP," he says.

Naoumidis says SMA technology also has the ability to block the purchase of shares you don't like for ethical reasons or because you already have exposure to them. You could put a block on uranium miners or tobacco companies. Or if you already own shares in BHP you could stipulate that every time the fund manager buys BHP you get shares in Rio Tinto instead.

Like other platforms, SMAs have administration and management fees and most have financial advisers acting as gatekeepers. However, costs are reduced by the effects of pooling your funds and netting transactions.

Naoumidis give the example of someone who wants to switch from one income fund to another. In most cases, one income fund will own many of the same shares as its competitors. In a wrap you would have to sell everything and crystallise any capital gains or losses. But in the SMA you would only have to buy or sell the shares not common to both funds.

Naoumidis says it is 0.4 per cent cheaper to buy into a managed fund via a SMA than a wrap. The platform charge plus the fund's management fees average 1.1 per cent with an SMA compared with 1.5 per cent for a wrap.

Costs differ from one provider to another so investors should check the fine print. As well as management fees you need to look for any transaction, switching, performance and adviser fees which will add to the overall cost.

Taking BT Elect as an example, brokerage, management and adviser fees on a \$100,000 investment would amount about \$2250 in the establishment year unless you kept chopping and changing your portfolio. Fees in subsequent years would depend on the level of trading activity.

Investors should expect to hear a lot more about SMAs. BlackRock had 18 investment strategies available on its platform three months ago and has built this up to 39 today.

Heffernan says it will be adding model portfolios as advisers and their clients request them. "I can see it growing quickly. It will get exciting this year when we can offer global shares like Coke and IBM," he says.

Self-managed super funds

Self-managed funds are tax-effective vehicles for retirement savings, not a technology platform like a wrap. However, many investors outsource the administration and reporting requirements of their SMSF to a wrap platform provider.

SMSFs are more flexible than wraps or other platforms because of the range of assets they can hold. You can put cash, shares, property, managed funds, fixed interest, art and other investments into your own fund, provided it is for the sole purpose of providing for retirement. Once you put money or assets into your SMSF you can buy and sell as normal but you can't take the money out until you reach preservation age, currently 55, or retire.

As well as the appeal of paying only 15 per cent tax on income from investments held in super, changes announced in the 2006 budget mean lump sums and pensions will be tax free from July 2007 provided you are over 60 when you withdraw your super benefits. The removal of reasonable benefit limits means you can save as much as you like in super and enjoy concessional tax rates. The old \$5000 limit on fully tax deductible contributions by self-employed people has also been scrapped.

The cost of running a SMSF depends on its size, the type of assets it holds and whether you outsource administration and management to professionals. Mark Johnston of research group Investment Trends says the average annual cost of running your own fund is \$3500. This figure does not include transaction costs for buying and selling investments.

Graeme Colley, super strategy manager at ING, says because of the cost it is recommended people have a minimum of \$200,000 to invest, excluding their home and non-super savings and investments.

SMSFs are especially popular with small business owners and the self-employed who want to roll their business property into the fund, something you can't do with a retail super fund or master trust.