

*Submission to the Productivity Commission regarding the performance of managed share investment funds*

## THE 25-YEAR RISE & DEMISE OF MANAGED SHARE INVESTMENT FUNDS A SUMMARY

The study described herein, records the trends over the 25-years since Sept. 1987, in a monthly unweighted index of the values as measured by published Friday exit prices for each month, of a selection of thirteen retail investment funds, mainly share-based, managed by three leading Australian fund managers. Over the years a few additions were linked in, to make the sample more representative. (It is unfortunate that comparable data for managed "industry" funds is not readily available).

The trends in 'indirect' investments in shares through these managed funds have been compared with an equivalent monthly index of the daily averages of 'direct' investments in shares, as represented by the All Ords index.

The study shows that direct investment in shares has clearly out-performed the indirect share-based managed portfolios as far as their capital values are concerned.

The managed funds, unlike the All Ords-type shares, even failed to arrive in March 2012, to par with their Sept. 1987 values, being only 82% of that level, compared with 172% of par Sept. 1987 for the All Ords.

In this "demise", the Sept. 1987 parity level was achieved by the funds on average in only about 14% of the total months in the period, compared with about 64% for the All Ords.

Despite the disparity in the two series referred to, there is strong correlation between the two series. This correlation is indicated by the fact that for the 300 (approx.) months covered in the study, the "direction" of the monthly movements shown by the All Ords, whether up or down, was accompanied in about 86% of the individual months, by a similar up or down 'direction' for the managed funds (according to the latter's exit prices, as calculated and published by funds after an interval of a day or so).

Whilst the direction is usually fairly consistent for both series, the 'proportionate' fluctuations of the All Ords in both up and down directions tended to be greater.

Over recent years, governments have given a range of major incentives for expanding Superannuation (eg taxation concessions and deductions, higher caps, salary-sacrifice, spousal and co-contributions, the CGS, and so on). Many of the managers who handle 'investment' funds, also offer complying 'superannuation' funds. The option series of both the investment and the super share-based funds are usually constructed and entitled as "balanced", "conservative" or similar. Despite some tax and other differences between investment and super funds, the differences in the published performance rates of the investment and super funds for a given option choice, generally seem rather narrow.

The substantial incentives for and greater growth of managed Superannuation over the past decade or so, are largely responsible I believe, for the relative "demise" of the managed share-based investment funds evident from this study. This warrants strong remedial action because it is precisely government policy which has resulted in these unintended consequences.

Outflows from the investment funds and failure to capture a proportionate share of new money due to the liberal concessions for super, would have had an underlying depressive influence on prices of the investment funds, even when financial markets in general were bullish.

The reason for this "depressive influence" is that whereas super funds can tend to count on a continuing volume of new money being sufficient to cover future redemptions, the same is not true for investment funds; for these, the only means of securing reserves for future redemptions is a more conservative approach in the setting of the entry and exit prices. This reduces the correlation between the two series.

#### OBSERVATIONS AND CONCLUSIONS FROM THIS STUDY

1 It is unwise of the Cwlth. to introduce major tax concessions on super available only for a 'short' period of subscriptions as in the 2006/7 reforms, because a massive inflow of funds into super can be decimated later by depressed financial market conditions emanating from overseas. This did happen when the subsequent GFC-weakened market destroyed the wealth of many super investors, resulting in floods of retirees having to apply for part or full age pensions. In principle, major super changes should be spread over longer time frames.

2 The 12% up-front contribution tax on super needs to be reviewed, possibly scaled down and reduced. Such an up-front tax on investments is unique. I believe it was introduced as such, as a means of avoiding/reducing later tax due. However, these latter taxes have since been completely overhauled. For example, pensions for over 60's from most super funds are now tax-free. In short, since the original rationale for the 15% up-front tax seems to have disappeared or diminished, this tax should now suffer the same fate.

3 The complexity of super has reached tipping point. Few amendments can be made simply and without requiring a range of consequential changes. The typical investor will usually be caused much time and trouble to rely on the ATO and fund managers being the sole arbiters of super law. There deserves to be a new Super Information Agency equipped with the resources needed to provide information on super (but not advice), particularly in view of the increased coverage of super within the population.

4 In view of the evident 'demise' of share-based managed investment funds having been superseded as a reasonable savings facility due to Govt. policies on superannuation, the Cwlth. should now consider extending super status, subject to trustees'/managers' agreement, to those non-super managed funds held for a threshold period by those investors who could be deemed as qualifying for super (this could exclude entities such as companies and some trusts). It is reported (Aust. 11.4.12) that \$12b flows each year into super, solely from awards for 1.7m employees.

5 Statutory authorities such as APRA should consider requesting managers of non-super-funds, to provide a response to the challenge to their funds as a reasonable form of long-term investment for the community.

6 Ordinary managed super funds should have enlarged Withdrawal facilities and so enable Allocated Pension Funds to be superseded as separate pension vehicles. This could limit fees and remove a potential irritant of decision-making for the superannuant. Total fees of share-based managed funds are generally towards 2% pa.

SUMMARY of Index of Values	Mgd Fds	All Ords	% of Mths when Direction was:
Sept 1987	100	100	Similar : 86%
Minimum: Feb '88	53	54	Opposite: 14%
Maximum: Oct '07	117	294	% when Sept 87 parity achieved:
March 2012	82	172	Mgd Fds 14% All Ords 64%

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