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"For informed and knowledgeable investors, 'choice of fund' will be a good thing, allowing them to change their superannuation arrangements if and when change provides a real benefit. For the uninformed or those susceptible to believing the myths, it could lead to poor financial outcomes."

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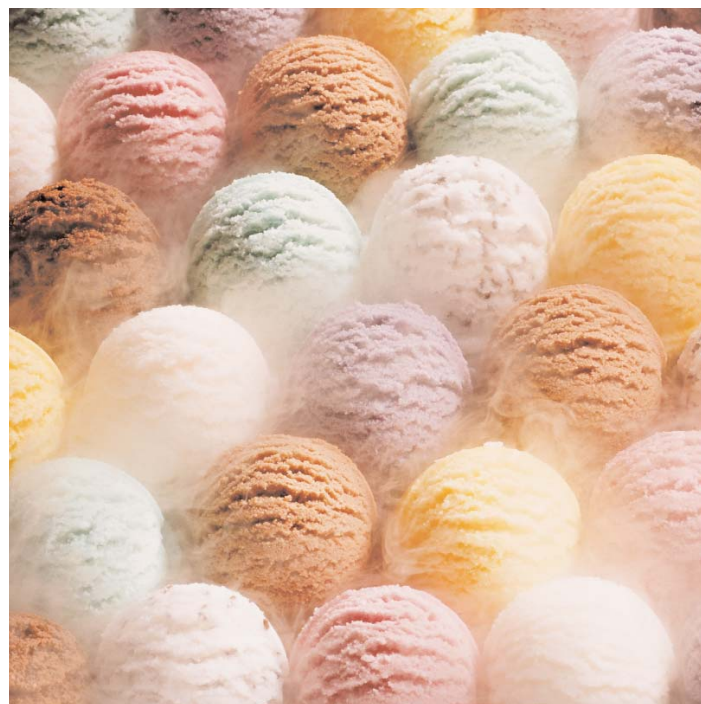
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DEBUNKING THE MYTHS OF CHOICE

And strategies for super investing in a 'choice of fund' environment



The Government estimates that around 5 million Australians will be able to choose where their employer super will be invested from 1 July 2005. That's over a million Australians who could fall for each of the four myths, which Russell believe will be prevalent in a choice of fund environment. In this edition of Insights, **Heather Dawson** highlights and debunks the myths and calls for more education to ensure that investors make informed choices based on reality.

A QUICK OVERVIEW

Myth #1: The Bigger the Brand, the Better the Product

- ❑ **Fact:** There is no correlation between brand and investment performance.
- ❑ **Russell Approach:** Our analysts ignore brand in the manager research process, and focus on in-depth research of people and process to identify tomorrow's winners today.

Myth #2: Past Performance will be Repeated

- ❑ **Fact:** Research has proven that past performance is a poor guide to future performance
- ❑ **Russell Approach:** We recognise that certain market conditions suit certain managers. So we evaluate managers on their area of expertise, and aim to select a mix of managers that when combined, can offer above average returns in all market conditions.

Myth #3: Returns are all that matters when it comes to Super

- ❑ **Fact:** Super funds offer a number of important benefits - returns are just part of the bigger picture.
- ❑ **Russell Approach:** Under the new 'choice' system, the onus is on the investor to consider all aspects of a super fund in light of their own needs and circumstances (see enclosed 'choice' checklist)

Myth #4: You can pick the next winning asset class

- ❑ **Fact:** Research has shown that investors cannot pick which asset class will provide the best returns
- ❑ **Russell Approach:** Diversifying your super across a range of asset classes is a safer strategy - providing you with more consistent returns to help your super grow.

For informed and knowledgeable investors, 'choice of fund' will be a good thing, allowing them to change their superannuation arrangements if and when change provides a real benefit. For the uninformed or those susceptible to believing the myths, it could lead to poor financial outcomes.

“For uninformed investors, choice of fund could lead to poor outcomes”

Here we identify four of the more common myths that affect investors in the lead up to and following the introduction of 'choice of fund' on 1 July:

- ❑ **MYTH 1:** *“The bigger the brand, the better the product”*
- ❑ **MYTH 2:** *“Past performance will be repeated”*
- ❑ **MYTH 3:** *“Investment returns are all that matters when it comes to super”*
- ❑ **MYTH 4:** *“You can pick the next winning asset class”*

MYTH
1

The bigger the brand, the better the product

FACT: *There is no correlation between brand and investment performance.*

Some of the big corporate scandals of recent years provide testament to the fact that investing in a big, well-known brand is not necessarily safer or more profitable. Yet, it is no surprise that most consumers follow brand names. Even those not necessarily convinced by the brand advertising often take comfort in knowing that many other investors have chosen the brand. This can create a herd mentality that can blinker investors to the underlying realities of their choice.

Another fact is that big brands often have big advertising budgets - costs that might ultimately be passed on to investors by way of lower net investment returns and/or higher fees and charges. Investors should keep this in mind when they are exposed to the barrage of advertising they are likely to be confronted with in the lead up to 'choice of fund' over the coming months.

THE RUSSELL APPROACH:

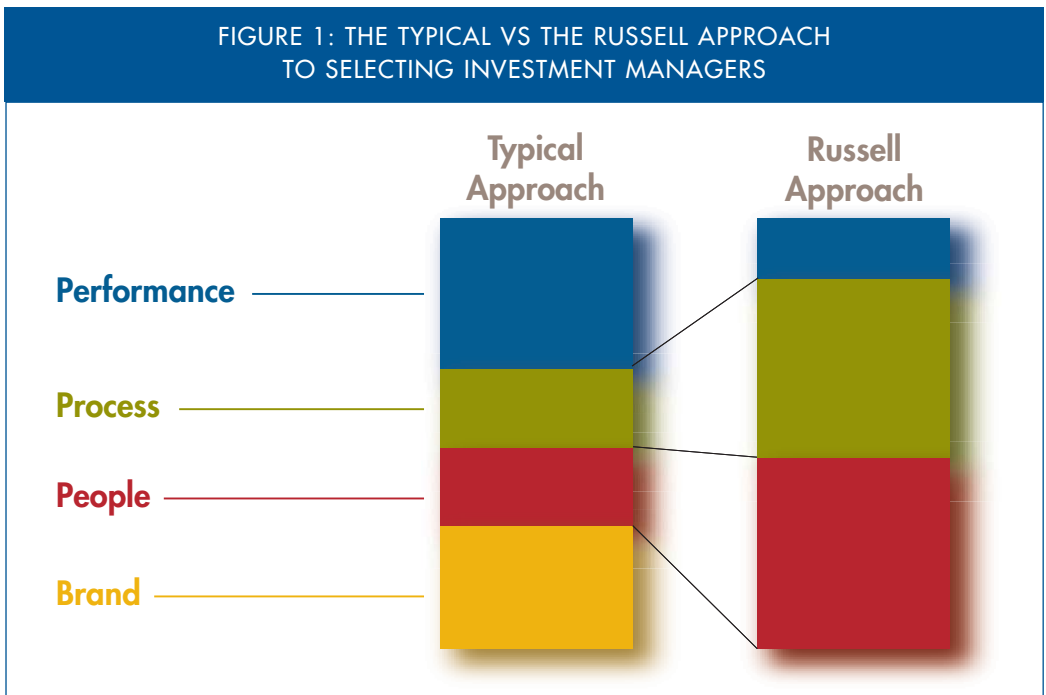
Russell is in the business of researching and selecting, then combining and monitoring the world's best investment managers. In this endeavour, Russell is not swayed by brand. In fact, our approach is to completely ignore the brand and focus on extensive, in-depth research of the investment managers to whom we entrust our investors' savings.

“Russell’s approach is to ignore brand and focus on extensive, in-depth research of investment managers’ people and processes”

We have formidable resources and the global reach to do this properly. We conduct extensive face-to-face interviews with investment managers, both locally and internationally. Evaluating an investment manager is not a clear-cut exercise. It involves getting to know the strengths and weaknesses of the people running the show as well the broader organisation, processes and their investment philosophies. Figure 1



FIGURE 1: THE TYPICAL VS THE RUSSELL APPROACH TO SELECTING INVESTMENT MANAGERS



2000. Of those 19 managers, only 8 finished in the top quartile in the year 2001. Of those original 19 top quartile managers, only 5 finished in the top quartile in 2002. And only one of those managed to finish in the top quartile in 2003 and 2004 as well. Imagine an investor had reviewed the results of these investment managers in 2000, and had invested money

(above) shows the factors that are typically considered when researching investment managers, compared with the Russell approach - which is mainly focused on people and process.

Our manager research is a massive undertaking - in fact to our knowledge no other firm commits more people and resources to researching managers across the globe. We actively monitor about 9,000 manager products, of which less than 7% ever earn our 'buy' ranking, and fewer than 2% receive an assignment in a Russell

“Of the 9000 manager products that we monitor, fewer than 2% receive an assignment in a Russell portfolio”

portfolio. We don't research investment managers so much as we research their people, because at the end of the day, the quality of the people drives the investment returns.

MYTH
2 *Past performance will be repeated*

FACT: *Research has proven that past performance is a poor guide to future performance.*

Investors often assume that if an investment manager has performed well, they must be doing something right or will continue to do well in the future. But this is often not the case.

Figure 2 (on the next page) shows the number of Australian shares investment managers that finished in the top 25% (top quartile) in

with one of these top quartile performers at the start of 2001. By the end of 2004, only one of the original 19 was still a top quartile performer!

“Certain market conditions favour certain investment managers and when these conditions change, manager performance changes with it”

This demonstrates that most investment managers do not consistently remain as top performers for long. Generally certain market conditions favour certain investment managers and when these conditions change, as they inevitably do, manager performance changes with it.

FIGURE 2: MANAGERS SHOULD NOT BE SELECTED ON THE BASIS OF PAST PERFORMANCE



THE RUSSELL APPROACH:

Just like brand, Russell does not assess investment managers based on past performance. Russell utilises a manager’s performance record only to verify that their investment process has achieved what it should have. Russell’s approach of selecting managers through extensive research is forward looking, whereas picking tomorrow’s top-performers based on past performance is backward looking and unreliable at best.

“Picking managers based on their past performance record is unreliable at best”

In every type of market environment there are investment managers who should outperform

and there are investment managers who should under-perform. Russell recognises this fact and evaluates managers on their likelihood of outperforming in their particular area of expertise - also known as their investment style. We aim to select a mix of style specialist investment managers that when carefully combined, can offer above average returns throughout the full range of possible market conditions.

MYTH 3 Returns are all that matters when it comes to super

FACT: Superannuation funds offer investors a number of important benefits (eg insurance) - investment returns are simply one part of the bigger picture.

The bigger picture involves benefits that include, but are not limited to, the following:

- The range and level of insurance cover provided
- The range and quality of investment choice available
- Specialist, qualified, customer service personnel
- Reasonable fees and charges
- Access to a range of retirement products
- Access to current benefit information online through websites or call centre facilities
- Communications, including regular newsletters and member presentations
- Access to individualised financial assistance
- Other member services such as discounted home loans, etc.

“Under the new ‘choice of fund’ system, the onus is on the investor to consider all aspects of a superannuation fund in light of his/her personal circumstances and investment needs.”

Let’s look at insurance for instance. Insurance cover provides financial support in the event that a person is permanently disabled or dies leaving dependants behind - a critical benefit. Part of the Government’s choice

legislation stipulates a basic level of insurance coverage that should be offered for a fund to qualify as a 'default fund'. In any case, investors need to assess:

- whether the insurance cover offered by the fund is sufficient for their circumstances, and if not, what type of additional cover is available and at what cost?
- do they require medical examinations to qualify for the basic and/or additional insurance cover?
- the issue of insurance fees and determining what these fees cover, and don't cover

Also keep in mind that your employer considered a wide range of superannuation providers and went through a long process to select the one that best fit the needs of its employees. Alternative funds that may seem to offer better performance and features at first glance probably don't stack up when you dig a little deeper.

THE RUSSELL APPROACH:

The range and level of benefits offered by funds in the market differ widely. If an investor is thinking to move to another fund he/she needs to carefully consider all features, not just investment returns, when comparing the alternatives. Under the new 'choice' system, *the onus is on the investor* to consider all aspects of a superannuation fund in light of his/her personal circumstances and investment needs.

Be certain to ensure that your choice of super fund offers a comprehensive array of important features to help meet your financial needs. The checklist (figure 3) to the right highlights the range of important features to consider when comparing alternative funds.

FIGURE 3: 'CHOICE OF FUND' FEATURES CHECKLIST

A CLEAR AND EASY TO UNDERSTAND FEE STRUCTURE?	
No entry or contribution fees?	<input type="checkbox"/>
No commissions?	<input type="checkbox"/>
No investment switching fees?	<input type="checkbox"/>
THE ABILITY TO CREATE WEALTH FOR YOUR RETIREMENT?	
Investment returns that provide consistent, long term performance?	<input type="checkbox"/>
A range of diversified investment options?	<input type="checkbox"/>
The ability to maintain your current level of insurance without medical evidence?	<input type="checkbox"/>
A superannuation fund for your spouse by opening a spouse account?	<input type="checkbox"/>
Income in retirement using an allocated or growth pension?	<input type="checkbox"/>
ACCESS TO A FREE RANGE OF SERVICES?	
Self-service 24 hour helpline?	<input type="checkbox"/>
Dedicated superannuation specialists to answer your super questions?	<input type="checkbox"/>
Secure website to access your personal details?	<input type="checkbox"/>
Website with real-time information about your super?	<input type="checkbox"/>
Access to a wide range of superannuation modelling tools?	<input type="checkbox"/>
SUPERANNUATION AND INVESTMENT EDUCATION?	
Access to on-line seminars and booklets?	<input type="checkbox"/>
Option to attend free face-to-face seminars?	<input type="checkbox"/>
Education via regular newsletters?	<input type="checkbox"/>
SOME EXTRA BENEFITS?	
Discounts on financial planning advice?	<input type="checkbox"/>
Discounted bank services including mortgage lending, car insurance and health insurance?	<input type="checkbox"/>

MYTH 4

You can pick the next winning asset class

FACT: *Research has shown that not even professional investors, never mind individuals, can pick which asset class will provide the best returns in the coming month, quarter or year.*

Most funds in the market offer investment choice and allow investors to change between investment options and asset classes. In a 'choice of fund' environment this can prove to be detrimental to investors who try to predict the performance and then direct their superannuation contributions to what they will believe will be the next 'hot' asset class or fund. There are also other issues to consider like switching costs, entry and exit fees and other administrative costs related to switching that can cut into an investor's account balance.

"Choice could be detrimental to investors who try to predict the performance of asset classes"

THE RUSSELL APPROACH:

Russell's research shows that trying to predict where each asset class is heading can be a very dangerous game that can lead to

missed opportunities. Let's take a look at one asset class to illustrate - but remember the same concept is applicable for all asset classes. Over the 301 months to January 2005, the Australian sharemarket achieved almost half of its growth during the best 12 months of market performance.

"Spreading your super across a range of asset classes ensures that you are always partly invested in the best performing"

Put differently, the Australian sharemarket returned 13.4% pa during this period. If an investor were invested in shares for all but the 12 best months, the return would only have been 7.4% pa. Certainly dangerous, and certainly not a risk worth taking!

Spreading your super across a range of asset classes is a safer strategy than trying to predict the next hot asset class in the short term, as it ensures that you will always be at least partly invested in the best performing - and in turn will provide you with more consistent investment returns to help your super grow. A well diversified super strategy can still be aggressive (weighted toward growth investments such as shares and property) or conservative (weighted more toward income

investments such as bonds and cash) or somewhere in between.

This decision of where to be positioned on the conservative - aggressive spectrum and what percentage of your super should be allocated to each asset class should be made on the basis of an your own personal circumstances, including your time until retirement, target super balance upon retirement and tolerance for risk. Once set, this should be held for the longer term or until a change in your personal circumstances or risk profile may alter this decision.

Russell makes allocating super easy by offering complete portfolio solutions via a range of pre-mixed diversified choices or the option to mix your own portfolio by assigning weightings to a range of asset classes.

A final warning ... don't feel pressured to exercise choice

The Government, employers, and Russell will be providing choice education programs over the coming months in the lead up to choice. The general industry consensus however, is that many investors are not prepared enough to make an informed choice. With that in mind, investors should not feel pressured into making an immediate decision come July 1.

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