Self Managed Super – The SMSF investment strategy

Self-managed superannuation fund (SMSF) trustees are required to prepare and implement an investment strategy. An investment strategy sets out what the fund can invest in. All investment decisions must be made in accordance with the investment strategy.

Some of the key considerations for a fund's investment strategy include:

- The investment objectives for the fund
- Diversification and the benefits of investing across a number of asset classes (such as fixed interest, property and shares)
- The fund's liquidity, including its ability to pay member benefits and other fund expenses
- Whether to hold insurance cover for members
- The circumstances of each member, including their age, income needs and retirement goals.

The investment strategy should be in writing as this provides trustees with clear direction and assists the auditor when preparing the annual report. The investment strategy must be reviewed at least annually and whenever there is a change to the fund, such as if a new member joins or if an existing member commences a pension.

Following is a summary of some of the important features of an investment strategy.

Objective

The investment strategy should set out the fund's investment objectives and the methods that will be used to achieve those objectives. The objective should include a benchmark. For example, to obtain an average yield from all investments of 2% above inflation.

In setting the objective, trustees should consider the needs of each member, such as their time to retirement, risk profile and growth targets. Consideration should also include whether the member is in accumulation or pension phase.

If the risk levels of members are different, trustees can consider segregating member accounts and having different investment strategies for the members.

Risk and return

Risk includes the possibility of loss on an investment. There is a strong correlation between risk and return. Trustees need to determine an acceptable level of risk and volatility of returns according to the fund's circumstances. Risks may include market volatility, liquidity risk, credit risk, operational risk and legislative risk. The investment strategy must include procedures to identify, monitor and manage these risks.

Diversification

A simple risk management strategy is diversification which helps to disperse and manage risk, and helps reduce the volatility of returns on investments. Diversification may be achieved through:

- investing across a range of asset classes
- investing in a number of assets within a single asset class
- investing in Australia and overseas
- investing in several funds with different management styles.

In some situations an SMSF may have very little diversification, for example if the majority of funds were invested in a single property. In this case, the investment strategy should identify the lack of diversification and explain how the trustees will manage this risk.

Liquidity and cash flow

The fund must have sufficient liquidity to ensure that liabilities can be paid as they arise. Liabilities include tax payments, pension payments, administration expenses and any other fund expenses.

One strategy to assist a fund's liquidity is to hold a cash reserve or investments that can be sold quickly.

The investment strategy should specify whether borrowing is allowed and restrictions on any investments that can be held.

Insurance

Trustees should consider the death and disability insurance needs of each member, as well as what level of cover might be appropriate. The types of insurance that should be considered that can be held through a superannuation structure include life, total and permanent disability (TPD) and income protection. The outcomes of any consideration should be documented in minutes as well as the reasons for the decision, even if this decision is to not hold any insurance for members.

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