

## What exactly is a balanced fund?

Australia's largest super fund, Australian Super, would have us believe a balanced fund has 80% in growth assets, the industry euphemism for risky assets. The Vanguard Balanced Fund has a more cautious 50% in growth assets. At an extreme, the Host Plus Balanced fund has 90% in growth assets but claims 75% by classifying infrastructure as 50% growth and property as 25% growth. Many investment advisory firms have their balanced portfolios at closer to 50% growth assets, while others have it at 70%.

Clearly, we have a problem! How are investors meant to deal with this? They are entitled to think that the industry has some standards so that they may compare like with like, but obviously that's not the case.

Now, the Financial Services Council and the Australian Superannuation Funds Association have had a crack at this with their Standard Risk Measure. For each fund, the manager estimates how often the fund will experience negative returns in any 20-year period, using some reasonably similar assumptions. This should enable investors to compare like with like. Unfortunately, the results produced by the Standard Risk Measure are nonsensical.

Firstly, the results are unstable. In 2010, when the SRM was released, a government bond fund with expected returns of 5% and a volatility of 3.5% would have been deemed to be Low to Medium risk with between one and two negative returns expected every 20 years. Today, with bond rates at 2.7%, the same fund should produce four to five negative returns every 20 years, putting it in the second riskiest category, the High Risk basket.

Secondly, the measure estimates how often a fund may produce negative returns but says nothing about how large that fall might be. Today, a balanced fund may be assumed to produce 7.5% per annum returns with 10% volatility. That implies five negative returns every 20 years - the same as for a government bond fund! The only difference between the two is that, in a bad year, the bond fund might produce a -8% return as opposed to a -30% return from a balanced fund. farrelly's thinks investors would like to know this up front.

farrelly's would like to see a standard risk measure that estimates how a fund may perform in a serious bear market for that fund. We could use 1975, 1987 and 2008 as benchmarks. This would deliver both meaningful and stable outcomes. In this world, the Australian Super Fund would be rated at approximately a -35% risk, and the Vanguard Balanced fund would come in at around a -22% risk. Now we would have a risk measure that provides genuinely valuable information to investors and which would enable sensible comparisons of performance between funds of similar risk levels.

But we shouldn't hold our breath as the industry seems to have little interest in genuinely informing investors about risk. Instead, farrelly's suggests dropping confusing and unhelpful portfolio labels in favour of numbers - as per our portfolios 1 to 5. Using numbers shifts the focus to understanding and communicating the true level of risk in a portfolio rather than trying to match an investor with a nebulous label.

Meaningless fund names? A standard risk measure that tells us very little about risk?

It's nuts and you can clearly see it's nuts.

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