FRANKLIN TEMPLETON INVESTMENTS

Topic Paper
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Time for Investment 'Wanderlust' - Why Global Equities Make Sense for SMSF Investors

PERSPECTIVE FROM THE TEMPLETON GLOBAL EQUITY GROUP

EXECUTIVE SUMMARY

- As noted in the Productivity Commission's recent report, when it comes to investing, older Australians are far from financial globetrotters and are firmly 'home bodies'.
- SMSFs' current exposure to growth assets is mainly in unlisted property and Australian equities, as highlighted by the Productivity Commission.
- SMSF investors should consider global equities not only to achieve a more diversified portfolio, but to generate growth as well as income, particularly in the retirement phase.

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According to the Australian Bureau of Statistics, the number of Australians aged 65 to 74 holidaying overseas jumped more than 80 per cent in the five years to 2016.

More recently, the 'backpacking senior' has been named one of the emerging travel trends for 2018.

But when it comes to investing, older Australians are far from financial globetrotters and are firmly 'home bodies'.

The Productivity Commission's draft report, "Superannuation: Assessing Efficiency and Competitiveness", publicly released in May, noted: "SMSFs hold, on average, a higher proportion of assets in cash and domestic equities than APRA (Australian Prudential Regulation Authority)-regulated funds, and much less in international equities and fixed income products. It also appears that, on average, SMSFs hold significant assets in unlisted property and in various pooled investment vehicles (such as managed funds and listed and unlisted trusts) … Differences in asset allocation between the APRA-regulated and SMSF sectors will be influenced by the fact that a greater proportion of SMSF assets are in the retirement phase. There is no evidence to suggest that it is not possible for SMSFs to access any particular class of financial asset by way of such vehicles."

Why then do Australian SMSF investors hold low allocations to international equities?

There is a natural tendency for investors to invest in a large number of domestic equities, despite the potential benefits of diversifying into foreign equities. Having a preference for investing in what they are already familiar with rather than moving into the unknown is understandable. As well, investing in foreign companies has been seen to be difficult and costly to access.

In other words, why take a 24-hour flight and suffer jet lag, when you can cruise the Whitsundays?

SMSFs should have a decent allocation to growth assets

Australia has one of the highest life expectancy estimates in the world, with both Australian men and women living into their 80s. This means the average retirement phase is now over 20 years. This is great news for people who want to don the backpack and see the world, but it also means SMSFs should have a decent allocation to growth assets. Given SMSFs' current exposure to growth assets is mainly in unlisted property and Australian equities, as highlighted by the Productivity Commission, this would suggest there is a need for improved awareness and discipline around portfolio diversification. SMSF investors should consider global offerings not only to achieve a more diversified portfolio, but to generate growth as well as income, particularly in the retirement phase.

However, with talk of trade wars, concerns about China's economy, recent issues in Turkey and the direction of central bank policies, many may ask: Is this the right time to leave home?

As value investors, we would argue yes. We are at a unique point in the market cycle where many global equities, particularly outside the United States, look exceedingly attractive relative to domestic stocks.

The improving global economy should help bolster corporate fundamentals outside the US. Tightening US policy conditions may represent a headwind for a maturing US bull market, while helping recovery gain pace in other regions.

In the US, corporate margins and earnings per share are well above the levels reached in the 2007 cyclical peak. Company valuations may inadequately reflect rising political uncertainty, tightening monetary policy and a more mature profit cycle. On the other hand, European equities are experiencing their most extreme and sustained underperformance against the US in at least half a century and the region is trading near its cheapest levels on record relative to the US.

We have been identifying value opportunities in Europe since post the global financial crisis, particularly in financial and energy stocks, and both the equity market rally and the economic recovery in Europe remain less mature than in the US, and we believe they have much more room to run.

Beyond Europe, there is also opportunity. For example, South Korea has been one of the world's cheapest markets for some years and continues to offer compelling investment opportunities, as do other Asian markets such as China and Japan, with telecommunications and utilities two standout sectors.

While there are obviously very different levels of economic development across these markets, they should have a place in a well-diversified portfolio.

When considering their investment universe, SMSFs should inject a spirit of wanderlust into their investment considerations and look beyond Australia. Overseas alternatives are a means of diversification and are also proving to be a strong investment proposition, particularly for value investors. There are currently some good value opportunities to be found in many countries, across many industries and sectors. It's time to dust off the passport.

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal. Value securities may not increase in price as anticipated or may decline further in value. Special risks are associated with foreign investing, including currency fluctuations, economic instability and political developments; investments in emerging markets involve heightened risks related to the same factors.