

Guide to diversification

Disciplined rebalancing to long-term strategic asset allocation

Hopefully this guide has helped to explain the concept of diversification in an investment portfolio. The specific allocation of your investments should be determined according to your long term strategic goals. These allocations may then need to be maintained in a disciplined way to ensure that the portfolio does not become overexposed to any one section of the market. Regularly rebalancing your investment portfolio may help you to achieve your investment objectives over a period of time. Rebalancing simply means selling some investments and buying others to realign the proportion of assets with an investment strategy.

For further information about rebalancing you may like to read through the *Guide to rebalancing*.

Market timing

It is a very difficult task to accurately identify the highs and lows of the market. It can be very easy to be carried away by emotion when markets are running, and making the decision to pull out and possibly miss further increases can be difficult. However, disciplined rebalancing removes the emotion and substitutes a process in its place. Disciplined rebalancing ensures that profits are being realised as markets are rising, and investment is being made into markets which are under performing, where assets are cheap.



Action

Now might be a good time to take a look at your investment strategy. Why not try the online *Asset Allocator* tool which aims to provide you with the ability to 'mix and match' investment options to arrive at a sample asset allocation and investor profile. To take a look at this tool visit the *Member* section of the Plum website – www.plum.com.au

Before you make any decisions about investing your superannuation you should consider whether it is appropriate to your objectives, financial situation and needs. We recommend that you consider the Product Disclosure Statement (*PDS*) for your superannuation fund before making any decision. We also recommend that you speak to a qualified financial planner if you need help in making an investment decision.

The information contained in this guide only provides general information about diversification and does not take into account your personal objectives, financial situation and needs.



Did you know...

As a member of the Plum Superannuation Fund you have access to financial planners on the AdvantEdge ActivePlan panel. AdvantEdge ActivePlan is a service provided by GWM Adviser Services Limited (GWMAS) ABN 96 002 071 749 AFSL 230692 through an agreement with PFS Nominees Pty Ltd as trustee of the Plum Superannuation Fund. GWMAS, the Trustee and Plum Financial Services Limited are part of the National Australia Group of companies.

If you would like more information about AdvantEdge ActivePlan or would like to access this service contact a Plum Member Services Consultant on **1300 55 7586**.

Contact us for more information

If you would like a copy of the *PDS* or want further information, visit the *Member* section of the Plum website:



www.plum.com.au or email us at service@plum.com.au, or



or speak with a Plum Member Services Consultant on **1300 55 7586**.

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The information in this guide is current as at 15 June 2007. Any changes in the law or policy subsequent to this date have not been incorporated.



Guide to diversification

The purpose of this guide is to provide you with general information about diversification. You may wish to consider diversification with your financial planner if you have just begun investing, want to review your current investment portfolio or contemplating the expansion of your portfolio.

Benefits of diversification

One of the most important principles of investing is diversification. Diversification is about spreading investment risk across the different asset classes. The major asset classes – cash, fixed interest, property and shares each have a level of risk and return specific to the type of investments they represent. Investing in a range of options should reduce the risk of an investment portfolio suffering large drops in performance, since one asset class or manager may perform well to counter poor performance in another. The overall effect of diversification is that you may moderate the volatility in your investment portfolio and ‘smooth out’ investment returns over time.

What are the four major asset classes?

An asset class is simply an investment category. Cash, fixed interest, property and shares are the names given to each of the major asset classes. Each asset class differs in the level of risk and return that it can provide. When choosing how to invest your superannuation it is important to take into account the characteristics of each asset class.

Please note that while there are four major asset classes, some of the asset classes also include sub-asset classes. Descriptions of each type of asset class and in some cases sub-asset classes are detailed below.

Cash

Cash is the name given to short-term debt securities (tradeable financial assets). Short-term debt securities (for example, bank bills and Treasury notes) are readily converted into cash. They generally have a short investment term – usually no longer than 180 days. These short-term securities are issued, guaranteed or supported by state or federal governments, banks or large companies. Generally, these assets remain stable in price and return a modest amount of interest.

Fixed interest

Fixed interest investments are mostly longer-term debt securities where the income remains constant and does not fluctuate. This income, for example, is derived from bonds or annuities that have been issued by governments, banks or large companies. The capital value of fixed interest investments is inversely related to changes in interest rates.

Some of the investments available to you through your superannuation arrangement may include inflation-linked securities, a definition of which is outlined below:

Inflation-linked securities

Securities that are issued with an interest rate or maturity value which is indexed to inflation rather than being fixed when the security is issued. This type of investment offers protection against fluctuations in the rate of inflation as measured by the consumer price index (CPI).

Property

Property, in general, may mean direct investment in buildings, shopping centres and industrial sites or indirect investment in listed property trusts. Property trusts are a collective form of property investment providing a wider spread of ownership. Listed property trusts are quoted on the stock exchange and their price fluctuates with supply and demand as with share investments.

Property assets can have moderate to high fluctuations in their value. These fluctuations are usually less than shares over the long term but more than fixed interest and cash investments. Historically, over the long term property assets have provided higher returns than fixed interest.

Shares

Shares are listed on a stock exchange. When you invest in the shares of companies in Australia and overseas you become a part owner of a business. This entitles you to a share in their future performance. If the business makes a profit, it generally pays some of its earnings to shareholders in the form of dividends. Shares also offer the potential for an increasing share price over time if the value of the company in which you are investing increases. Conversely however, share prices can drop in value quite dramatically also. Historically, shares have produced the best returns over time, particularly over the long term. They have also displayed the highest level of volatility of returns in terms of risk. Some of the investments available to you through your superannuation arrangement may include an interest in private markets, a definition of which is outlined below:

Private markets

Investing in Private markets is characterised by an interest in shares in an unlisted company or enterprise, which is made available to investors. The investments may range from small, unlisted companies which have an established track record in their field of business to companies in start-up situations with no track record. The funds raised can be used to develop new products and technologies, to expand working capital, to make acquisitions, or to strengthen a company’s balance sheet.

Diversification of investments

One of the most effective ways of reducing risk in an investment portfolio is to introduce diversification. No one type of security, asset class, investment strategy or investment manager will necessarily provide the best performance over all time periods. Outlined below are some ways that diversification may be used to reduce risk in an investment strategy:

• Diversification across asset classes

Since asset classes react to economic and political influences differently, the returns they generate over any period may also differ. Often a downturn in one asset class may coincide with a rise in another asset class. Should a particular sector perform badly, holding assets in other sectors will reduce the effects on the portfolio of the under-performing sector.

• Diversification within asset classes

It may also be valuable to diversify assets within a broad asset class. For example, within the broad category of ‘debt’ or ‘fixed interest’ investments, a portfolio may invest in government bonds, semi-government bonds, international bonds, and inflation-linked bonds. Many of these assets react differently to economic conditions and may provide a buffer should one category suffer a downturn in investment performance.

• Diversification across investment styles

The performance of various investment managers will differ according to the economic environment. This is due to the fact that their ‘investment styles’ may differ, that is, the way they arrive at their investment decision. For example, some managers may employ a ‘top down’¹ style, others a ‘bottom-up’² approach. Some investment managers will perform best under one set of circumstances, while another manager will outperform under another set of conditions.

It may be worth considering investing with a number of investment managers with *complementary styles* (that is, different styles) within the one asset class. This may provide greater consistency of performance over time, under varying market conditions, than could be expected from a single investment manager.

¹ Top down – a form of stock or security analysis which focuses more on forecasting broad macro economic trends and the effect on the market rather than forecast returns for individual companies (opposite of bottom-up).

² Bottom-up – a form of stock or security analysis which focuses more on forecasting returns for individual companies rather than the economy as a whole (opposite of top-down).