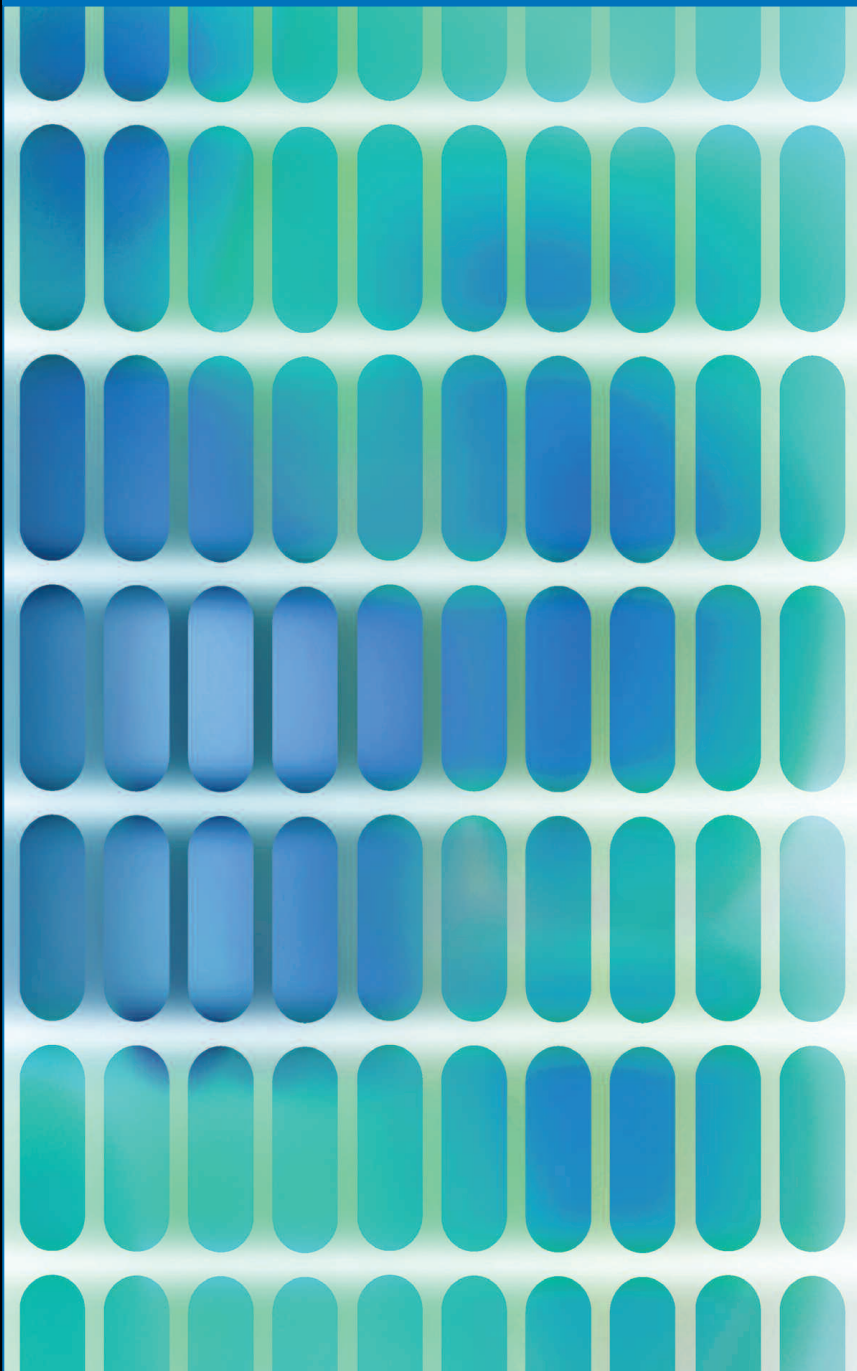


# SMA's – professional share portfolios for every investor

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Having a professionally managed portfolio of direct shares has traditionally been viewed as the domain of high net worth investors. However, the advent of Separately Managed Accounts (SMAs) is leveling the playing field for investors with smaller amounts to invest.

One of the most effective strategies for long-term investing is dollar cost averaging – the concept of investing consistent amounts into the market on a regular basis. However, dollar cost averaging into a portfolio of shares can be difficult due to the costs and administration involved for the adviser and their client each time they invest.

This article looks at the benefits of dollar cost averaging into a portfolio of shares. It examines the difficulties and costs associated with executing this strategy from an adviser’s point of view. The article then looks at the evolution of SMAs and how they can be an ideal vehicle for implementing a regular investment strategy – even for clients who have small amounts of money to invest.

## **The benefits of direct share ownership**

The proposition of investing directly in a share portfolio is attractive for many Australians, and for good reason. Recent returns have been particularly strong and direct share ownership has its privileges. Investors know exactly what they own and the cost of transactions. Thanks to the internet and mobile phones, they can also check the performance of their shares as often as they like.

Owning shares directly enables investors to retain control over their tax position. For example, there are no embedded capital gains hidden within the investment. They also have the ability to tailor their portfolio to suit their individual circumstances.

## **Direct shares and the rise of the SMA**

Professionally managed direct share portfolios were once the domain of high net worth investors. These investors traditionally needed to invest large sums and paid sizeable fees to have their portfolios professionally managed for them. However, with the arrival of SMAs in Australia, all investors now have the ability to access a professionally managed share portfolio.

An investment in an SMA gives investors access to a portfolio of shares that are professionally managed and reported on. The securities in the account are visible and portable just as they would be if the investor had purchased the shares themselves. However, with SMAs the investment is allocated across one or more existing model portfolios, and the end result for users of SMAs is a professionally managed, blended portfolio of shares.

Developments in technology mean that SMAs can now be offered with low minimum investment amounts and at reasonable ongoing costs. This offers all investors a cost effective means of building a share portfolio.



## Direct shares and wealth creation strategies

With the volatility the sharemarket has experienced in 2007, investors may be understandably nervous about the prospect of putting their money into shares. However, studies by global investment research group, Russell, show that long-term investors should ignore isolated incidents of market volatility, stay invested in the markets over the long-term and refrain from trying to time investments. The research shows that the most significant risk for long-term investors is actually being out of the market when it has bottomed out because this is when potential future returns are at their greatest.

This is where an investment strategy such as dollar cost averaging – investing consistent amounts into the market on a regular basis – can eliminate the temptation to try and time the market. The approach is similar to that of superannuation contributions in that investors will add a predetermined amount at regular intervals resulting in the accumulation of assets over time.

The table below shows an example of an investor investing \$10,000 into Tabcorp shares over a one year period, with the investment made in four equal quarterly investments of \$2,500.

Instead of investing one lump sum, the investor used a dollar cost averaging strategy to average out the cost of their investments and provide some insulation against market fluctuations:

An example of using a dollar cost averaging strategy				
Date invested	Amount Invested	Share Price	Shares Purchased	Average Share Cost
31/12/06	\$2,500	\$16.85	148	\$16.85
31/03/07	\$2,500	\$16.49	152	\$16.67
30/06/07	\$2,500	\$17.15	146	\$16.82
30/09/07	\$2,500	\$15.15	165	\$16.37
<b>Total</b>	<b>\$10,000</b>		<b>611</b>	<b>\$16.37</b>

The example shows that the average cost of Tabcorp shares during the year was \$16.37 per share which – in three out of the four quarters – was less than the actual share price at the time of investment.

The best time to invest of the four dates was on 30 September 2007, given the share price was at its lowest. However, the problem is that it is incredibly difficult to predict low or high points for individual share prices or the market. Dollar cost averaging avoids this issue altogether by making investments at regular intervals – giving the investor a potentially better outcome than attempting to time the market.

Dollar cost averaging can be an effective strategy that instills investment discipline and avoids the emotional aspects of investing. Combining this strategy with the benefits of owning stock directly can be a powerful investment solution for clients.

While dollar cost averaging is generally acknowledged as an effective investment strategy, it can be costly and difficult to implement when investing into a portfolio of direct shares.

Some of the key issues that may discourage advisers from implementing regular contribution strategies for their clients into direct shares include:

### Brokerage

The effect of minimum brokerage on small regular investment amounts can make dollar cost averaging into direct shares costly. For example, even \$20 minimum brokerage on a regular investment amount of \$1,000 a month equates to a brokerage cost of 2% and can add up over the course of year.

### Diversification

For those with regular investment amounts of \$1,000 or less to invest, it may not be practical to purchase more than one or two companies' shares each time, as minimum brokerage is applicable each time a stock is purchased. Therefore maintaining a truly diversified portfolio can be difficult and costly to achieve.

### Administration

Investing regularly into a portfolio of shares can result in significant amounts of paperwork. For example, keeping all relevant documentation in order and dealing with corporate actions. In addition, for the majority of advisers, providing advice on direct shares requires them to obtain their client's approval for each trade and provide confirmation to them of any advice provided.

### Tax reporting

There can be quite a bit of work involved at tax-time for the adviser and the client's accountant, particularly where there is a trail of regular purchases as part of a dollar cost averaging, or regular contribution, strategy.

## SMA, dollar cost averaging and direct share ownership

As we have seen, despite being acknowledged as an effective investment strategy, dollar cost averaging into a portfolio of direct shares can prove costly and difficult – particularly for investors who do not have large sums to invest.

SMA offer a practical solution for dollar cost averaging into direct shares. With low minimum investment requirements, SMA can provide a cost effective way for long term investors to build their portfolio and capture the benefits of dollar cost averaging – regardless of their current levels of wealth.

### Brokerage

With SMA there is no minimum brokerage per share and even small trades benefit from wholesale execution and brokerage rates – with some services offering brokerage from as low as 0.05% per transaction. This is particularly powerful when considering the low investment amounts that may be associated with a dollar cost averaging strategy, which ordinarily would attract minimum brokerage (eg. \$20) for each trade.

### Diversification

SMA offer clients an investment in one or more model portfolios. The model portfolios are created by investment professionals and each portfolio offers different levels of risk and return with a particular emphasis (eg. income, growth, small companies, index, ethical etc).

Investors, with advice from their financial adviser, can then choose one or more models that suit their investment objectives, leaving them with a blended and diversified portfolio of shares.

### Administration

Within an SMA, all administration and paperwork normally associated with a direct share portfolio is taken care of by the SMA provider, helping to reduce the administration burden on advisers. In addition, it is easy for advisers to move existing shareholdings into an SMA via an 'in specie transfer', and for the investor to add to their investment via direct debit or BPAY. Using the internet investors and their advisers can monitor the performance of an SMA and, at the click of a button, get an up-to-date report on their account.

### Tax reporting

As the SMA transacts on the client's behalf, the tax base of the shares held for the client automatically adjusts with each trade and all dividend payments are recorded and paid to the client's account. Complete and concise records, available via the internet at any time, simplify the preparation of tax returns for the client and their accountant.

### Compliance

Some SMA operate as managed investment schemes (ie they have the same legal structure as a managed fund) and, as such, can be offered by financial advisers who aren't licensed to offer direct share investment advice. A managed investment scheme classification also means that it is not necessary for advisers to notify a client when shares are bought and sold within a model portfolio.

## Taking advantage of leveraged investing

Another element that can be simply added to a dollar cost averaging strategy under an SMA is margin lending. For example, investing \$500 of a client's own money per month and adding \$500 of borrowed funds.

In this way, leveraged investing provides additional funds in the market, potentially improving long-term investment outcomes. In addition, interest costs of the borrowing may be tax deductible.

## Summary

One of the most effective strategies for long-term investing is dollar cost averaging. However, dollar cost averaging into a portfolio of shares can be difficult due to the costs and administration involved for the adviser and their client each time they invest.

SMA offer a practical solution for dollar cost averaging into direct shares – even for clients who have small amounts of money to invest. SMA offer direct ownership of a portfolio of shares that are professionally managed and reported on. In addition, the minimum investment amounts for some SMA services are now quite low and ongoing administration costs are also attractive for all investors.

Importantly for advisers, some SMA operate under the same legal structure as a managed fund – reducing the cost and administration involved in offering share portfolios to their clients – while still offering their clients the key benefits of investing directly in the sharemarket.

The advantages of SMA as an investment tool, used in conjunction with proven wealth creation strategies, make them an extremely attractive investment option for Australian investors.



## BlackRock Customised Portfolio Service

The BlackRock Customised Portfolio Service (“the Service”) is our Separately Managed Accounts solution. The Service enables financial advisers and their clients to tap into the advantages of professionally managed investment models, while still retaining beneficial ownership of the assets held in their account.

### How does the Service work?

Each client has a separate account into which their investments are allocated. This personal portfolio is constructed using one – or a number of – investment models managed by a range of leading Fund Managers, as selected by the adviser to meet their clients’ individual needs and objectives. BlackRock then purchases the securities so that they reflect the model or combination of models chosen.

On an ongoing basis, the Fund Managers manage the models and BlackRock executes any trades required to reflect changes made by the Fund Managers.

### Why use the Service?

#### Spend less time managing your clients’ direct equity portfolios

Once your clients are signed-up to the Service and you have allocated them into one or a number of investment models, the Service is completely automated. Unless the clients’ portfolios are re-weighted, they can be left to be managed by a professional fund manager.

#### Reporting at the click of a button

The automated reporting feature offers 15 basic reports. This means you can produce a range of reports (such as reports showing the underlying securities, model or portfolio performance or a clients’ tax situation), at the click of a button. All the reports use data from the close of business the day before – or for any time period selected.

#### Tax consequences easily managed

Capital Gains Tax (CGT) consequences are easily managed. This includes distributions of realised CGT, tax free and tax deferred when calculating CGT positions. As data is available from the close of business the day before, with the exception of LPTs, you can see your clients’ tax positions instantly.

#### Easy to move clients into the Service and add to their current holding

Setting up a client in the Service is as easy as completing forms and having the client transfer the money into a holding account. Should clients already hold existing stocks, these stocks can be “in specie transferred” into the Service and filtered into the chosen investment models. Clients can add to their investment via a direct debit to the Service.

#### A flexible fee structure

If you have clients on different types of fee structures and on different rates, the Service is flexible and enables you to have each of your clients on a different pricing structure if you choose.

#### No additional licensing required

The BlackRock Customised Portfolio Service is a registered managed investment scheme. If you are licensed to advise on managed funds no additional certification is required.

**For further information on the BlackRock Customised Portfolio Service please visit:**  
[www.blackrockadviser.com.au/cps](http://www.blackrockadviser.com.au/cps)

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## CONTACTS

### Melbourne

Level 18,  
120 Collins Street,  
Melbourne Vic 3000

### Brisbane

Level 2, Waterfront Place,  
1 Eagle Street,  
Brisbane QLD 4000

Adviser Services Centre: 1300 366 101

Email: [cps@blackrock.com](mailto:cps@blackrock.com)

Website: [www.blackrockinvestments.com.au/cps](http://www.blackrockinvestments.com.au/cps)

### Sydney

Level 41, Governor Phillip Tower,  
1 Farrer Place,  
Sydney NSW 2000

### Perth

Level 3, Suite 4,  
1292 Hay Street,  
West Perth WA 6005