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Super: It’s the returns, stupid

Alan Kohler
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Raise super returns, not rates

THE only reason it might have been a good idea to increase super deductions from 9.5 per cent to 12 per cent is that super funds are doing a lousy job.

The current super guarantee should be more than enough to give everyone a very comfortable retirement indeed, and with no one on the pension — at all.

The problem is not that employees aren’t contributing enough to their funds each month; the problem is that the funds aren’t doing enough with the money.

Super, or saving for retirement, is a game of long-term compound interest, which Albert Einstein is supposed to have called the most powerful force in the universe.

A young worker starting out now at 25 on a salary of $50,000 and having 9.5 per cent per month deducted for super, is saving $336.48 a month after contributions tax of 15 per cent.

The average super fund return over the ten years to 2013 was 6 per cent a year, according to APRA.

If that performance continued for 40 years, until our 25-year-old retired at 65, she or he would end up with $670,000, which by then would probably have to last another 40 years ‘til she or he died at 105.

It’s simply nowhere near enough, either for the retiree or for the government looking to get people off the aged pension.

Raise the contribution rate to 12 per cent of salary, or $425 per month, and the retirement sum from the average super fund becomes $846,000 — still not enough to get off the pension or to live very well.

However, raise the compound annual return by 2.5 per cent, to 8.5 per cent, instead of increasing the contribution by the same percentage, and the retirement sum becomes $1.35 million — double the original number.

The best performing fund over the past ten years, according to APRA, was the Goldman Sachs JB Were employees' fund — 10.5 per cent per annum. If you use that figure over 40 years instead of the average fund return, the retirement sum becomes $2.48 million.

If you use — and here's the rub — the actual 30-year annual compound return of the All Ordinaries Accumulation index, which is 11.34 per cent, you end up with $3.2 million. No pension for you, but lots of cruises.

Such is the power of compound interest. But wait, there's more.

Super funds are basically funds of funds — that is, they place the money with other funds that actually invest the money in assets, and then monitor their performance closely, month by month, quarter by quarter.

Outliers get the sack, which is why contractor funds try not to stray too far from each other or the index against which they're being benchmarked.

The super funds, in turn, use balanced asset allocation strategies, scientifically calculated by expensive consultants, which is why they only averaged 6 per cent over the past ten years when the All Ordinaries Accumulation index over the same period returned 8.9 per cent.

Because of the stupidity known as asset allocation theory, super funds feel obliged to own assets other than shares, even though they know these are the best performing over the long term and would be best for their members.

In a way it's fair enough because too much volatility in their returns would mean that some members might retire in the middle of a big downturn.

Anyway, let's pick a listed investment company at random that only invests in shares and does not "hug" the index — Wilson Asset Management.

Its annual performance since inception 15 years ago has been 18 per cent.

If our $50,000 a year worker saving 9.5 per cent of salary for 40 years were to get 18 per cent per annum return over 40 years, then the retirement lump sum would be $28.46 million.

I'll just repeat that: save $336.48 per month at a compound annual return of 18 per cent and you end up with $28.46 million, which is 42 times what you get at 6 per cent compound.

But can you really expect to get that sort of return over a lifetime? Of course you can.

You just have to be a good investor like Geoff Wilson, or Alex Waislitz of Thorney, or Karl Siegling of Cadence Capital, to name just a few of many. They don't trade stocks, or follow the index, or even try to time the market. They simply buy good companies and stick with them.

In fact for that matter you just had to buy CSL at the float and stick with it to get a 25 per cent compound return over 20 years (and for the record, 25 per cent compound over 40 years, saving $336.48 a month, produces a final sum of $321 million, that's right, $321 million. It's not a misprint).

Of course if every young worker got 25 per cent per annum compound over the next 40 years, Australia would become the richest country on earth. It's not going to happen.

But what definitely should happen is that Australian workers get more than the 6 per cent compound, on average, from their super funds that they're getting at the moment.

Yes, they had an excellent year last year, producing an average (balanced) return of 12.2 per cent, but only because the Australian stockmarket went up 19.4 per cent.

Just getting the long-term return to match the All Ords Accumulation index would mean super deductions would never have to be increased beyond 9.5 per cent and the aged pension would become entirely redundant, saving $39 billion a year.

That, surely, is a powerful enough incentive for the political debate to switch from focusing on the contributions to focusing on the miserable returns that Australia's superannuation industry is producing in return for the its excessive fees.