



WATTLE  
PARTNERS

# *Managing portfolio risks – A fresh look at asset allocation*

Wattle Partners  
Perspectives

Russell Lees/ Partner

## Who we are

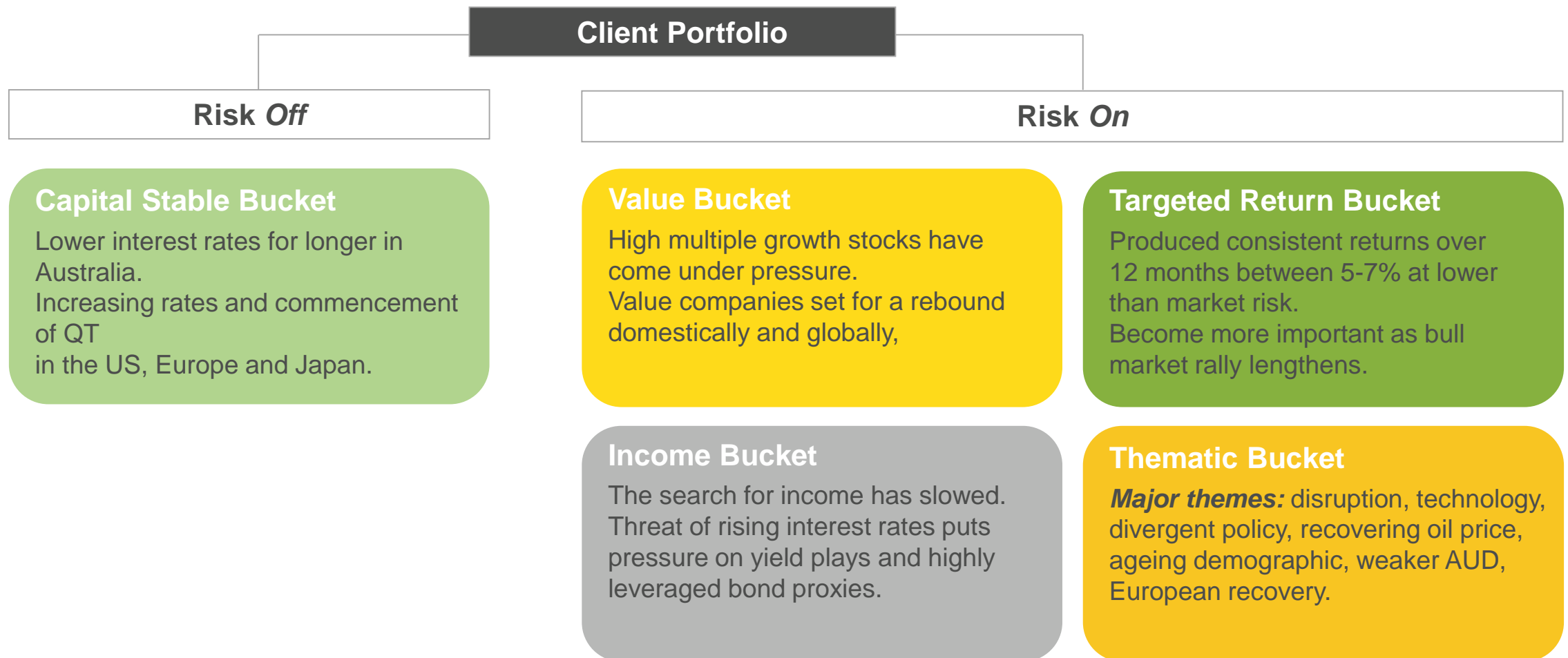


- Wattle Partners is a **family-owned** investment and financial advisory firm.
- Our purpose is to **inform and empower our clients** through independent advice allowing them to concentrate on what they value; families, travelling or careers.
- Whether this is spending time with their families, travelling or progressing in their own careers, **we use our experience to make things easier for you.**
- We **empower people to concentrate on what they value** by ensuring you are at the core of our philosophy.



# *How Wattle Invests – The Bucket Approach*

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# Key Risks when investing for the long-term

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There are two key financial risks Investors who are investing with their retirement in mind are faced with:

***1. Investment Performance***

***2. Insufficient Capital***

# The Traditional Approach to Risk Management

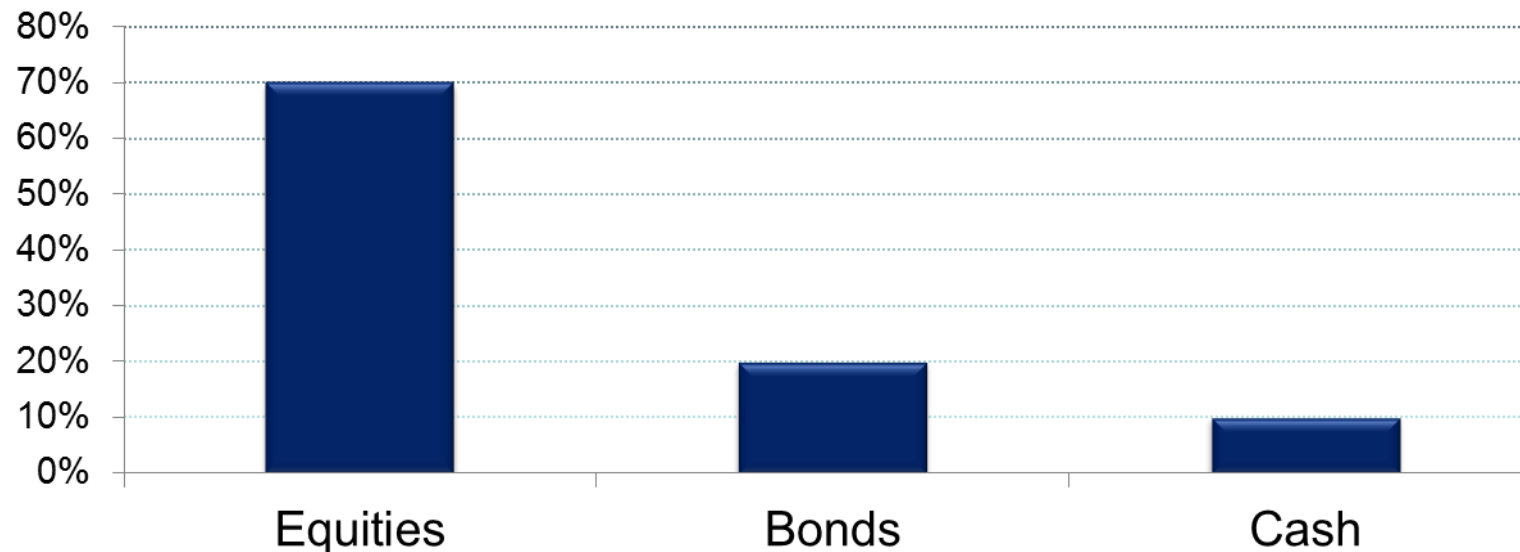


## Balanced Approach 1

Investing all the Investors capital via a “balanced” portfolio (~65-70% equities/30-35% cash and fixed income)

## Balanced Approach 2

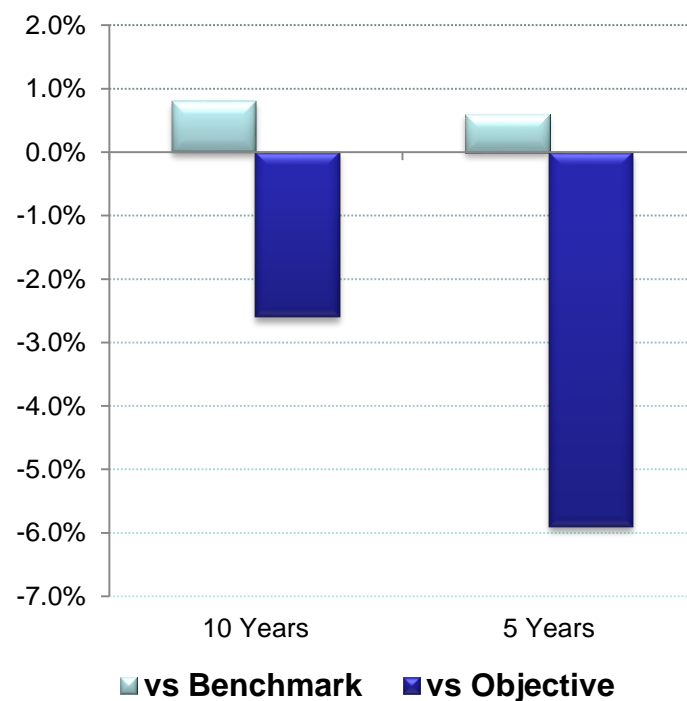
Holding a number of years (typically 2-5) of the Investors expected drawdowns in cash with the rest invested in the “balanced” portfolio



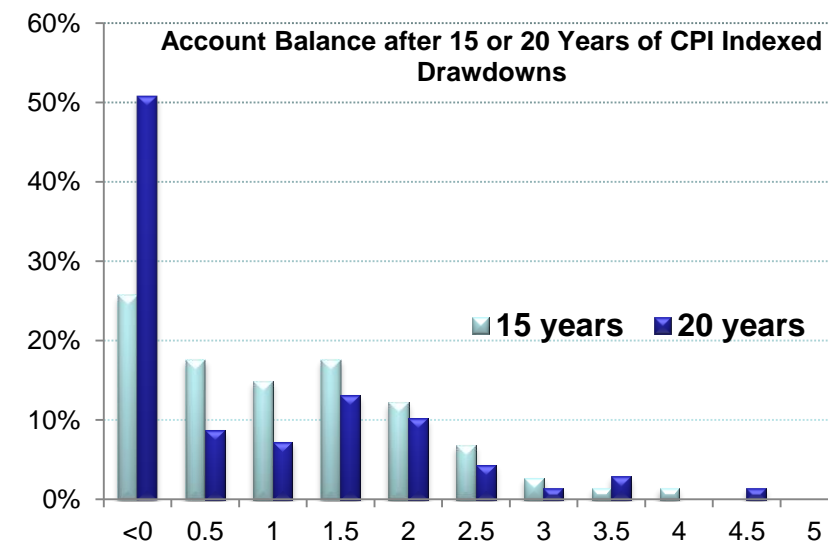
# Risks of the Traditional Approach



Risk #1  
Investment Performance



Risk #2  
Insufficient Capital



# Risk Assessment of the Traditional Approach

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3 key reasons why the Traditional Approach has failed to meet investor requirements and objectives:

***1. Static Asset Allocation***

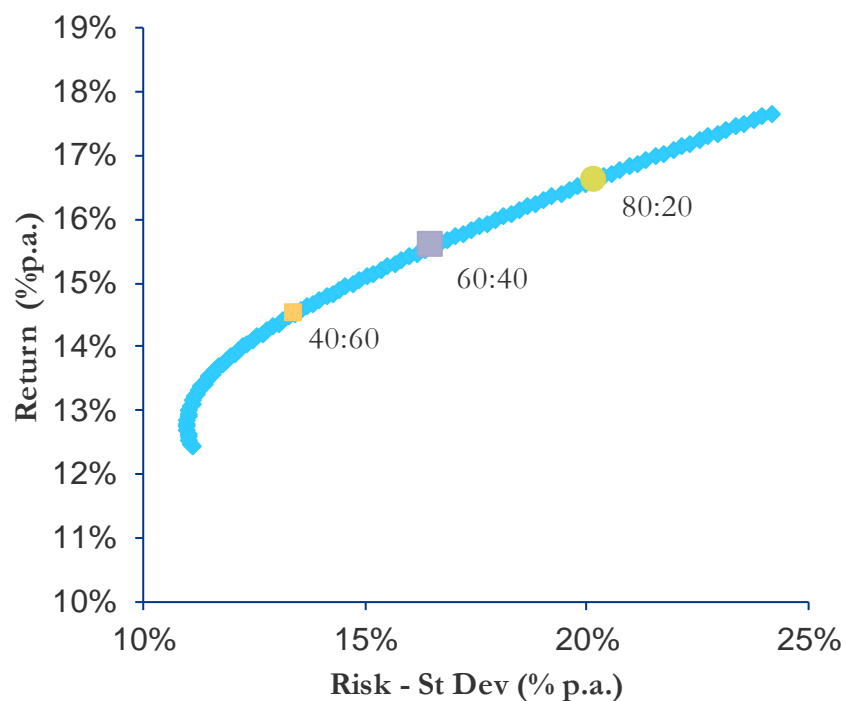
***2. Neglect of Compounding Returns***

***3. Failing to acknowledge Path Dependency***

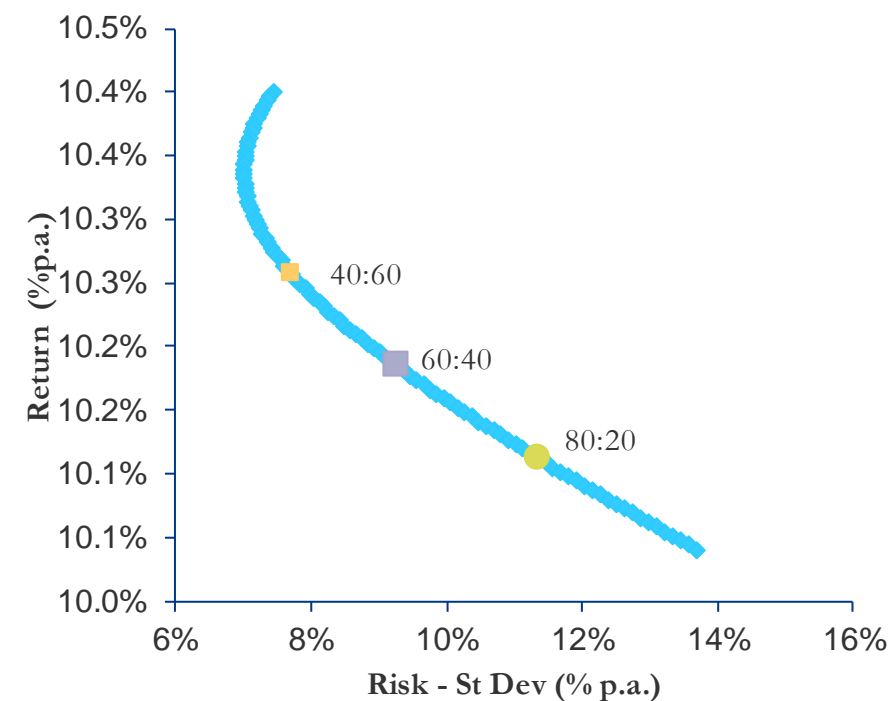
# Risk Assessment #1: Static Asset Allocation



Optimal Portfolio – 1980's =  
Traditional Approach expectations



Optimal Portfolio – 1980's =  
Traditional Approach expectations



## Risk Assessment #2: Neglect of compounding returns



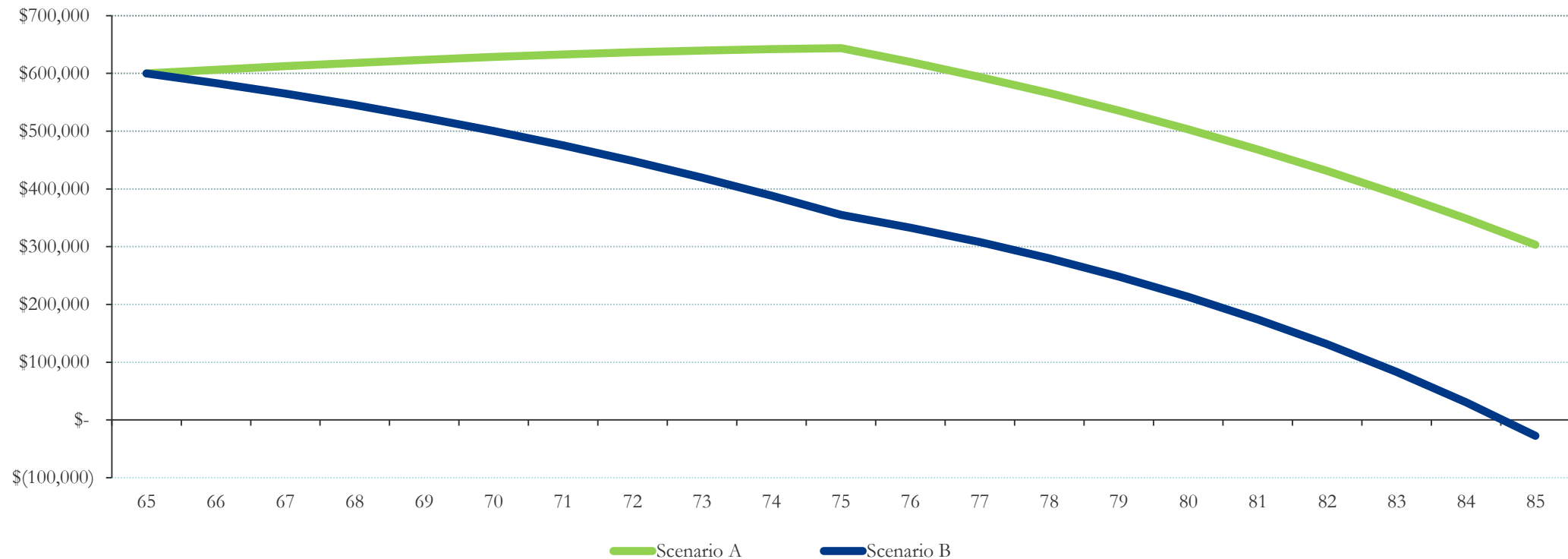
	Earning Rate			% increase in value from change in earning rate	
	6.0%	7.0%	8.0%	6% to 7%	6% to 8 %
Balance after 10 years	358,361	419,159	486,136	17.0%	35.7%
Balance after 15 years	190,573	291,802	410,946	53.1%	115.6%
Years income stream	18.7	21.1	24.5	12.8%	31.0%
Income stream for 20 years*	34,337	37,505	40,816	9.2%	18.9%

\* Represents the initial drawdown that could be withdrawn annually after indexation at 3% p.a. to last 20 years.

Source: Donnelly Wattle Partners.

. \*Represents the initial drawdown that could be withdrawn annually after indexation at 3% p.a. to last 20 years.

## Risk Assessment #3: Failing to acknowledge Path dependency



**Scenario A:** Investor earns 8% p.a. for 10 years, then 4% p.a.

**Scenario B:** Investor earns 4% p.a. for 10 years, then 8% p.a.

Average annualised return of both series is the same at 5.98%

# Why are these risks continually ignored?

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***‘Insanity: doing the same thing over and over again and expecting different results’***

*Albert Einstein*

Insanity: persisting with the Traditional, Static Asset Allocation Approach in the face of evidence that supports adoption of a Dynamic Asset Allocation approach.

## **Why?**

- Cognitive Dissonance
- Representativeness
- Overconfidence
- Herding
- Conservatism Bias

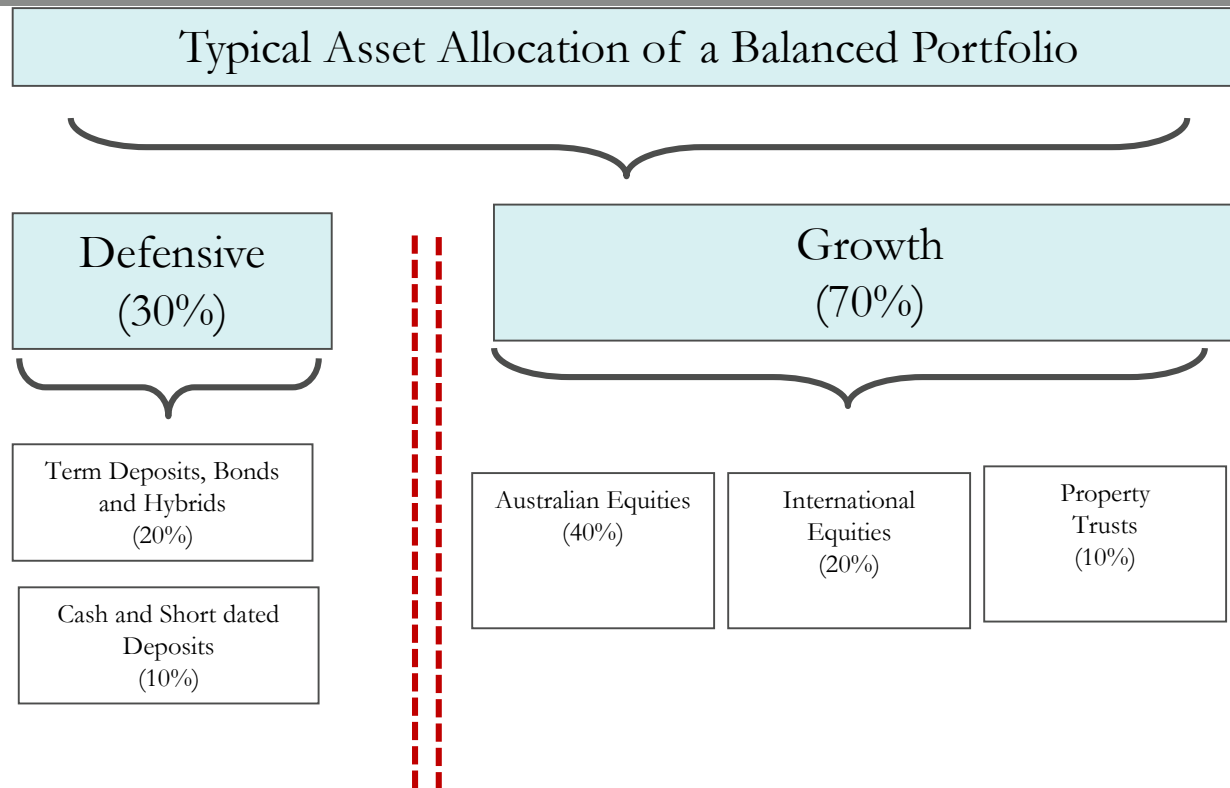
# Conclusions about Risk in the real world

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- Risk is running out of money; real people need to fund real purchases and pay real bills.
- Static strategic asset allocation has been proven inadequate
- Dynamic asset allocation is required to break free of the traditional constraints
- Valuations (timing) matter in determining the level of risk/reward in any given investment

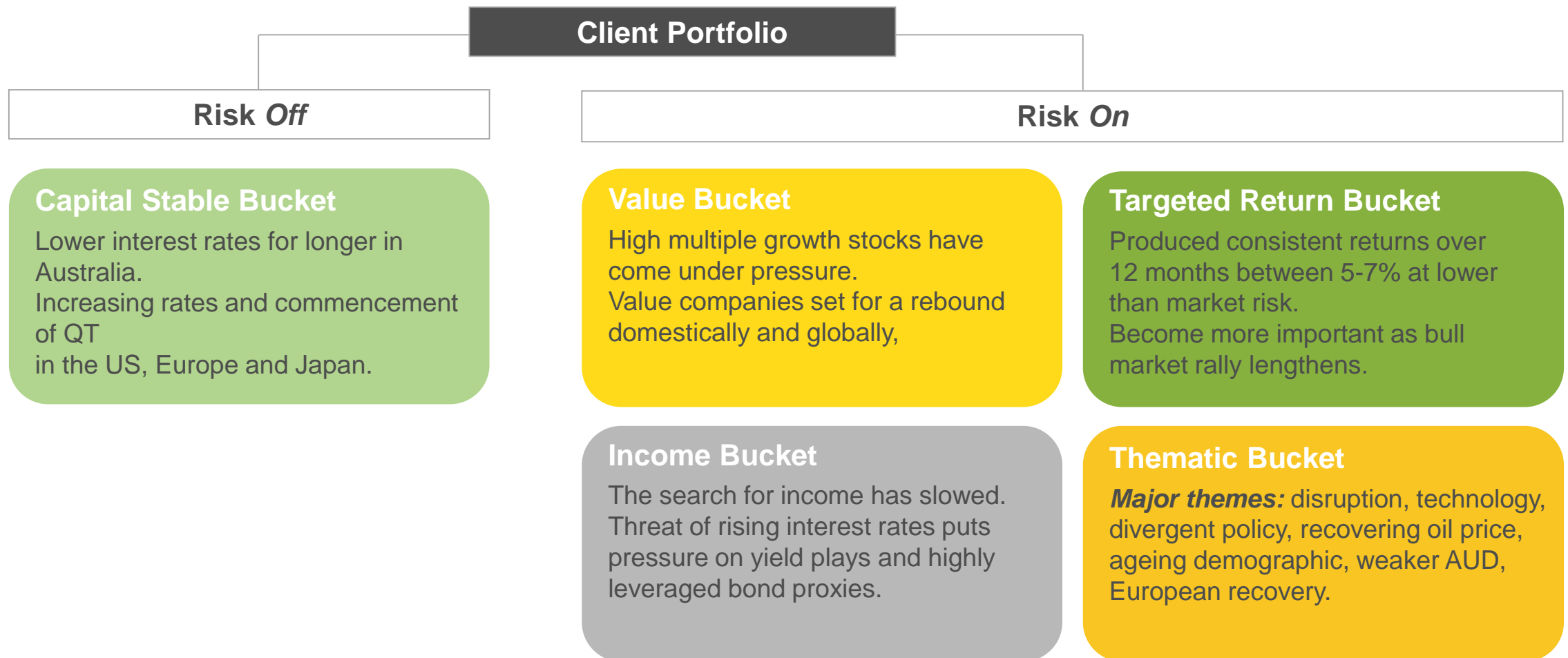
## A typical Strategic Asset Allocation



- Most investors are fitted into traditional portfolios of either Conservative/Balanced or Growth investors.
- Looking at a Balanced portfolio, typically 30% -40% is held in cash/fixed interest with the remaining 60%-70% held in growth type assets.
- The advice industry has operated this way for over 25 years; typically investors would be allocated a risk profile and would hold this asset allocation throughout the investment cycle or their life cycle.

# *How Wattle Invests – The Bucket Approach*

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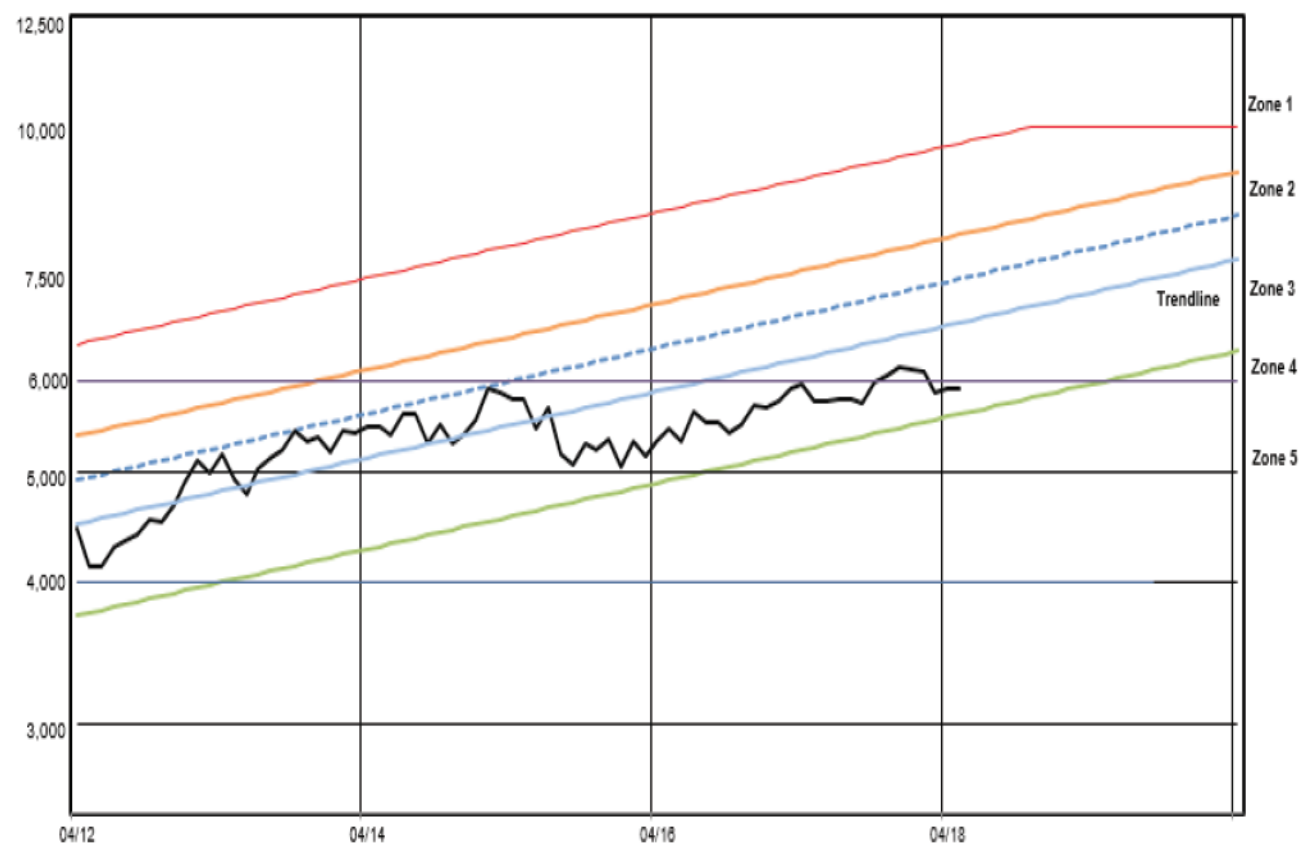
## Building the Asset Allocation

Risk Free Calculation	Portfolio	Yield	Helen & Mike (retired couple)	Robert & Melissa (pre-retirement)
Annual Income Required			\$70,000	\$0
Current Income Produced	\$1,000,000	5.00%	\$50,000	\$50,000
Worst Case Scenario Income (70%)			\$35,000	\$35,000
Annual Funding Requirement			\$35,000	\$0
Years of Funding Requirement			10	0
Required Allocation to Capital Stable Bucket			\$350,000	\$0

## Portfolio Breakdown

Bucket Allocation		Helen & Mike	Robert & Melissa
Capital Stable Bucket		\$350,000	\$0
Risk Bucket		\$650,000	\$1,000,000
Total		\$1,000,000	\$1,000,000
Income Bucket – 30%		\$195,000	\$300,000
Targeted Return Bucket – 20%		\$130,000	\$200,000
Thematic Bucket – 25%		\$162,500	\$250,000
Value Bucket – 25%		\$162,500	\$250,000

# Austin's Zone System



Zone System		
	Defensive	Growth
Zone 1	90%	10%
Zone 2	70%	30%
Zone 3	50%	50%
Zone 4	30%	70%
Zone 5	10%	90%

# Questions

# Two ways to *keep up to date*

## 1) Our Views

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#### Federal Budget Review

May 2018

On Tuesday night the Treasurer Scott Morrison handed down the 2018 Federal Budget. The 2018-19 Australian Commonwealth Budget is a budget focused on small amendments rather than sweeping reforms. It is an election budget designed to win the hearts and minds of middle class Australia through tax reform and aged care spend. There were also a number of measures that will benefit the economy and the country as a whole. This federal budget not only hands out \$140bn in tax income cuts but it locks in a surplus within three years and reduces Government debt. It also looks to spend big on infrastructure and healthcare. Self managed superannuation funds (SMSFs) were largely left out of this year's budget, a relief for SMSF trustees. In this budget you will find measures that may improve your financial position. We have provided a summary of how the main budget changes may impact you, your family and your investments. Here are the main changes:

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Unit 10, 3 Bromham Place,  
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*Thank you*