Topic 1: What was my investment return?

Your "return" from an investment is your gain or loss from that investment over a particular period.

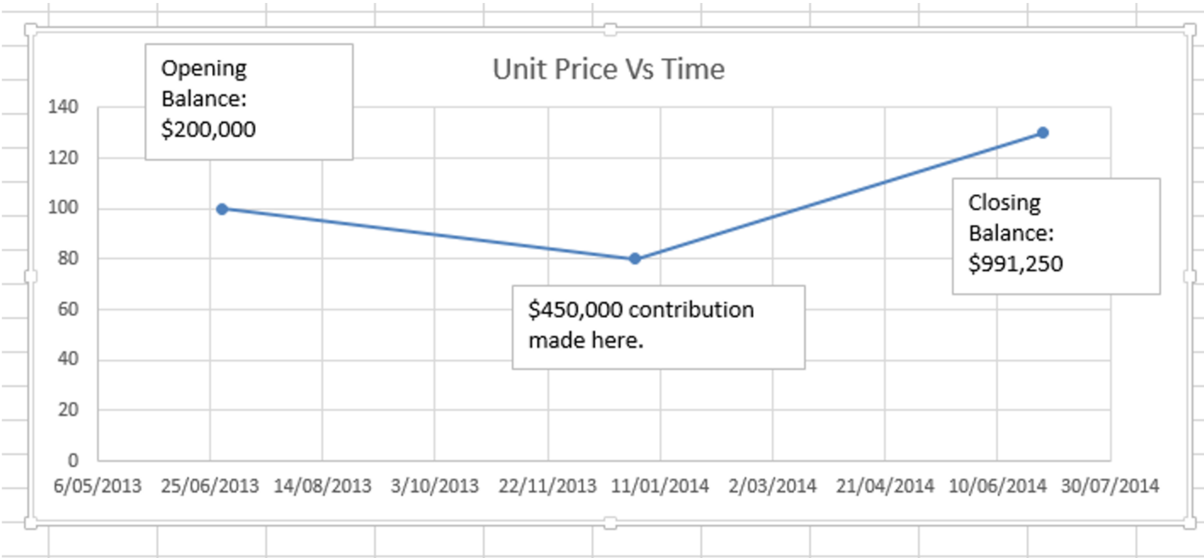
Your return consists of the income and the growth or loss in capital value (capital gain or loss) relative to the cost of the investment. It is usually quoted as a percentage.

Sounds easy, but consider the following example.

"Mary and Jim" started the year with a total SMSF Balance of $200,000. They were selling a property and waiting for settlement, before contributing $450,000 into their SMSF half-way through the year.

As luck would have it, the market fell by 20% before the contribution was made, then increased strongly after the contribution to finish up 30% from where it was at the start of the year.

What was their investment return over the year?



Did you know that there are different methods used to calculate returns, which can give quite different answers, and there is no standard method for reporting SMSF returns?

This makes it very hard to know what your return really was, especially if you made any contributions or pension payments.

This also makes it hard to know how your return compares with other funds or an appropriate benchmark, and without that knowledge you are not coming from a position of power to understand whether your current investment approach is working well or not.

Let's imagine that Jim and Mary are using an administration service which gives them a performance report.

The investment return reported to Mary and Jim depends on which administration service they use. One service may use a Time Weighted Return (TWR) method, another may use an Internal Rate of Return (IRR) method and yet another may use a Return On Asset (ROA) method.

The returns reported to Mary and Jim under each method would have been as follows:

Calculation Method	**Investment Return**
TWR	80.65%
IRR	87.96%
ROA	57.29%

Now this is an exaggerated example, with higher than usual returns, but the point is that there can be very large differences in reported returns depending on which method was used.

Internal Rate of Return (IRR) method[1]

An Internal Rate of Return (IRR) is fine if you are looking at your fund in isolation, but it is not fine if you want to compare your return against other funds or any benchmark.

An IRR method is impacted by the timing and amount of external cashflow items such as contributions and pension payments, and because every fund will have different timing and amounts of these external transactions, it does not allow for fair comparisons.

If you use 'Excel' to calculate your investment return, for example, you will be seeing a return calculated using the IRR method. This is also known as a Money Weighted Return (MWR) method.

Return On Asset (ROA) method

A Return On Asset (ROA) method only gives a rough approximation of returns.

If your accountant does not use an administration service, then when they report your returns they are quite possibly using the ROA method as an estimate.

Time Weighted Return (TWR) method

The Time Weighted Return (TWR) method is the method least impacted by the timing and amount of external cashflows.

There are Global Investment Performance Standards (GIPS) which apply to larger retail and industry funds, but not to SMSFs. GIPS requires the large funds to report their returns using a TWR method, so that investors can make fair comparisons of returns between them all.

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[1] *Please contact us at SMSF Benchmarks for additional information on how the various methods work if you are interested.*

Although GIPS does not apply to SMSFs, the same logic applies, and SMSF trustees should try to find out what their returns were, using a TWR method, in order that they can make fair comparisons of their returns to other funds and an appropriate benchmark.

Measurement Period

It is important to check the measurement period over which a return has been calculated.

For example, as a sub-asset class, Australian Resources had a 1 year return of 19.27% for the 12 month period ending 30 April 2017, yet that sector had a 1 year return of 27.41% for the 12 month period ending 31 May 2017, just one month later.[2]

Total Fund Returns

When reviewing how your current investment strategy is going, it is important to look at your TOTAL FUND performance, and not just the performance of one component within your fund.

For example, you may have had a return of 15% over the past year from the Australian Shares component of your SMSF. But what if you had gone against your intentions, and only had 10% of your SMSF in shares, while the rest was cash? Your decision to take that asset allocation had more impact on your total fund performance than any decision about which shares to invest in.

Or you may have a property worth 60% of your SMSF, which has increased ion value. Great, but how has the other 40% of your fund performed? What was your total fund performance compared to others who also had direct property in their SMSF?

Tax and Fees

When looking at investment returns make sure you understand whether those returns are before or after tax and whether they are before or after fees.

If you are comparing two large managed funds or industry funds, you would probably want to compare returns after tax and after fees, to create a 'level playing field'.

But if you have an SMSF and you want to know how your current investment approach is going compared to other SMSFs investing with a similar asset allocation to you, you should compare returns **before** tax, because some funds are in pension phase paying a lower level of tax to those funds in accumulation phase. You must remove that difference to get fair comparisons.

Around 30% of SMSFs use an adviser, and advice fees are not solely related to investment performance. They cover broader issues such as estate planning and insurance, cash flow modelling and risk management. As advice fees are additional fees for an additional service, if you want to know how your current investment approach is going compared to what others are doing, you would need to compare returns **before** fees.

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2. SMSF Benchmarks publishes the returns of various sub-asset classes each month, using the average return of a 'basket' of Exchange Traded Funds which have a mandate to invest in each asset class.