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Investor Insights

The Continuing Search for Growth

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In this edition of Investor Insights, our research, in conjunction with the University of Western Australia (UWA) Business School, continues to show subdued investor confidence with lower preference for equities as a whole group. Market volatility, which persisted into the second half of 2015 and into 2016, continues to lead to cautious investor behaviour. However a clear distinction remains between the investment decisions of younger and older non-advised investors.

In this piece, we revisit the increasing preference for global equities that has occurred since mid-2013, when the Australian dollar fell below parity against the US dollar. Highlighting investors continued desire to search for alternative growth assets that provide diversification to existing portfolios.

We also take a closer look at the baby boomers (those born between 1946 and 1964), how they invest and are impacted by volatility as they move towards retirement. While we will only be able to briefly touch on this topic in this edition of Investor Insights, given its important and topical nature we will likely revisit in future editions and a specific piece later this year.

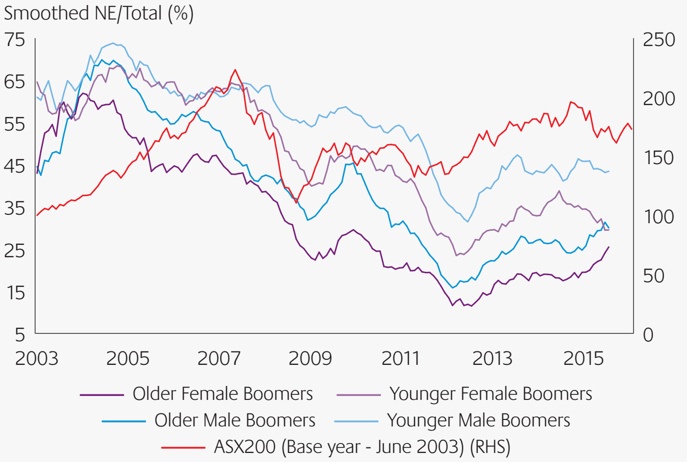
How are younger and older baby boomers investing?

The baby boomers (boomers) are one of the largest (representing 24% of the population according to the Australian Bureau of Statistics (ABS) in 2014) and wealthiest generations in Australia and as the boomers approach retirement it is becoming increasingly important to understand their investment behaviour.

The boomers are a particularly interesting generation as they are the first generation where a significant number will be relying on self-funded defined contribution pensions in retirement, as opposed to defined benefit pensions, and as such their investment decisions will have a greater impact on their retirement savings. To assess the impact of impending retirement, we have separated the group into two cohorts based on birth year, 'younger' (born between 1956 and 1964) and 'older' (born between 1946 and 1955).

The conventional wisdom is that as investors move closer to retirement – or their holding period decreases – their risk appetite declines and they move to more conservative investments. As seen in chart 1, the trend of decreasing equity allocations is generally observed in the latest data, notwithstanding the rising share market through 2004-2006. This trajectory steepens with the onset of the global financial crisis (GFC) in mid-2008, is reversed in mid-2009, and resumes an apparent steeper trajectory again, bottoming in the last quarter of 2012. The last quarter of 2012 highlights not only the gender divide, but also the significant impact of age on allocations. For example, whereas older female boomers were allocating as little as 15% to equity at that time, younger female boomers were allocating closer to 35%. For males the comparison is closer to 25% and 45% respectively. Interestingly, the subsequent 'recovery' in equity allocations commencing in 2013 has been more robust for older boomers. The increasing trend in younger boomers' equity allocations was more short-lived.

Chart 1: Older and younger baby boomers superannuation equity applications



Source: CFSGAM and UWA Business School. Data to 31 December 2015. Bloomberg. Data to 30 June 2016.

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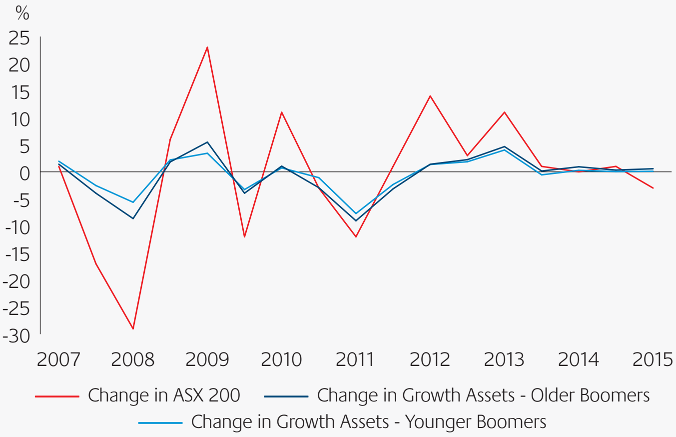
What this may suggest is that older boomers are more sensitive to market volatility and as such, they reduce their holding more in a down-turn but increase them more as markets recover. This behaviour is expected given their vulnerability to capital losses close to retirement, but it also poses a risk. While the older boomers may avoid some of the losses in a sell-off, they may also lock in their losses and are likely to miss some of the gains in the recovery. This heightened reaction to market volatility is something that we have observed in other Colonial First State (CFS) data. Chart 2 below shows the semi-annual change in ASX200 and the allocation to growth assets by older and younger boomers, as can be seen, older boomers generally react more than their younger cohort to market movements.

Chart 2: Older and younger baby boomers semi-annual change in growth asset allocations



Source: CFS. Data to 30 June 2016.

Another potential explanation for the recent pick-up in equity allocations by older boomers relates to adequate superannuation levels. The Association of Superannuation Funds of Australia (ASFA) estimate that for a comfortable retirement, superannuation of $640,000 for a couple or $545,000 for a single is required. Data from ASFA indicates that many of this cohort is at risk of falling short of this level, which is further supported by CFS superannuation data.

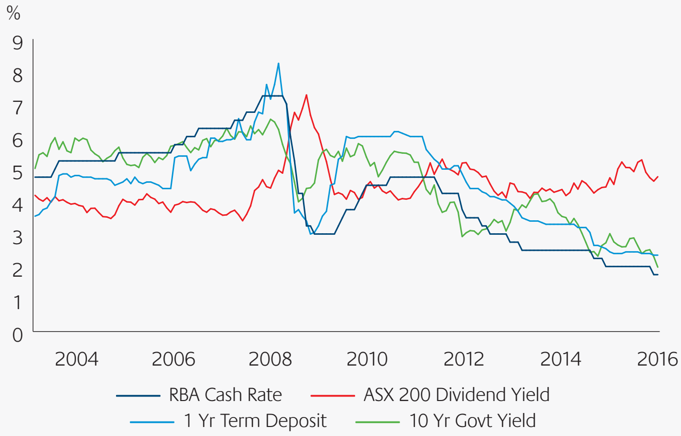
Table 1: Mean superannuation balance

Age	Male	Female	Persons
50 to 54 years	$146,608	$84,228	**$114,895**
55 to 59 years	$227,765	$115,046	**$170,393**
60 to 64 years	$292,510	$138,154	**$214,121**
65 to 69 years	$194,633	$117,144	**$155,474**

Source: ASFA Research and Resource Centre and ABS, data as at 2014.

As this data suggests, many baby boomers probably realise as they approach retirement that they are significantly short of their savings goals and may look to increase their exposure to growth assets as a way of trying to make up this shortfall. This has likely been exacerbated by further declines in the cash rate and bond yields over recent years. This is one potential explanation for the increase in equity exposure observed in 2015, after the RBA cut interest rates twice in February and again in May. Indeed, following the RBA rate cut in May this year, it is likely that we may see further increase in equity allocations as returns on term-deposits and cash fall further. See chart 3.

Chart 3: Fixed income yields vs equity dividend yield



Source: Bloomberg, Data to 30 June 2016.

The market environment

To put the data into further context, market volatility remained high in the second-half of 2015, with the All Ordinaries finishing 0.8% lower. A 4.2% gain in July was offset by consecutive losses in August and September of 8.1% and 3.1% respectively. However the market rallied towards the end of the year with the All Ordinaries Index recording gains of 4.5% in October and 2.4% in December which outweighed a loss of 1.4% in November.

Over the quarter, volatility in China featured heavily in global news. This volatility, which continued into 2016, was due to concerns around a slowdown in Chinese growth and the authorities' ability to respond to this. Since this period of volatility, Chinese authorities have introduced several measures to reduce volatility such as automatic circuit breakers, limits on short selling, tighter margin lending regulations and short term measures such as liquidity injections and bans on sales for significant holders (greater than 5%). Overall these measures, along with an improving growth outlook, appear to have been successful in stabilising markets.

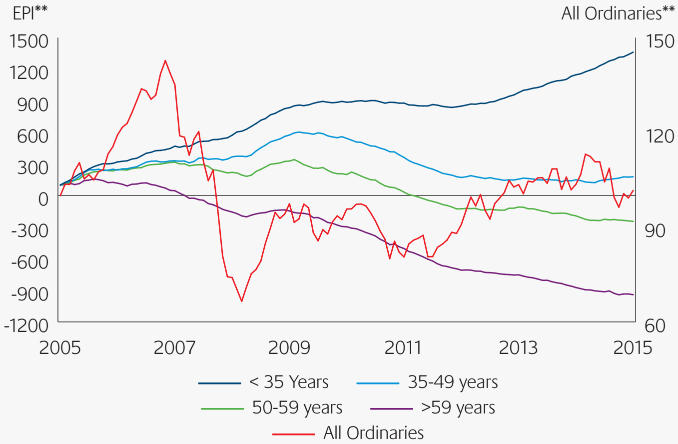
The second half of 2015 also saw another significant event that led to market volatility which was the first increase in interest rates since 2006 by the US Federal Reserve (the Fed). Whilst the rate increase in December was largely expected, substantial volatility resulted from the Fed's decision to remain on hold in September. This, along with the volatility in China, impacted sentiment in Australian markets which have become increasingly driven by global trends.

How did market volatility alter investor sentiment?

Whilst it appears that market volatility dampened investor sentiment in the second half of 2015, the reaction was mild when compared to previous periods. As readers of previous editions of Investor Insights will know, the Equity Preference Index (EPI) measures investor sentiment on the basis of investors' moves in and out of equity-based managed funds. Overall, in the second half of 2015, the EPI declined by 3% compared to 9% and 21% in H1 15 and H2 14, with the majority of the decline occurring in the September quarter. This was likely due to the uncertainty present in Chinese equity markets during this time which drove global sentiment and markets. The December quarter saw a marginal increase in the EPI, as presumably, investors regained some confidence in global equity markets.

As in previous periods, there remains a significant difference in equity preference by age. The two younger age groups, under 35 years and 35-49 years, increased their preference for equities by 9% and 20% respectively. In contrast, equity preferences of older investors declined further into negative territory with the EPI falling by 9% for the 50-59 year old age group and 3% for the above 59 years of age group. See chart 4 for further details.

Chart 4: Equity Preference Index: Aggregate* by Age (Applications, Redemptions and Switches)



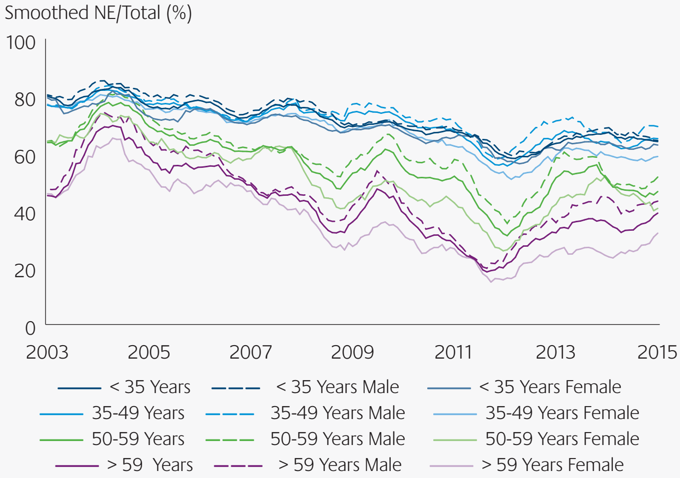
*Includes FirstChoice (Investments, Personal Super both retail and Wholesale) and Managed Investments

**Each series scaled to 100 at 31 December 2005

Source: CFSGAM and UWA Business School. Data to 31 December 2015.

Differing sentiment between age groups was again evident when considering equity allocation in investment portfolios. The second half of 2015 saw equity allocation slightly decline in the under 35 age group but increase in the 35-49 and over 60 age groups. Whilst there was some volatility during the period, the overall equity allocation in the 50-59 year age group ended in a very similar position to where it started. However further analysis of this age group shows a significant divergence in allocation choices between genders, with males increasing and females decreasing their equity allocation significantly over the 2H 15. This age group forms the younger half of the baby boomers and market volatility becomes increasingly important to this generation as they approach retirement.

Chart 5: 12-month rolling average Net Equity/Total Dollar Value: All Products; Applications Only



Source: CFSGAM and UWA Business School. Data to 31 December 2015.

When considering both age and gender, the table below shows that investors' reactions to market volatility were less negative than the previous periods which again could reflect higher investor confidence in the last quarter of the year. It may also be a result of the already relatively low allocations towards equities compared to history (ignoring the extreme GFC period) and that they cannot decline much further without negatively impacting investor's ability to accumulate superannuation and investments.

Are men or women more reactive to market volatility?

As eluded to above and in previous Investor Insights, there is significant variation in equity preferences for males and females in each age group and the movement each period. Apart from in the under 35 year old age group where female preference for equities is higher than males, females consistently have a lower exposure and preference for equities. This continues to place women at a disadvantage when saving for retirement given on average women live longer, retire earlier, earn less and are more likely to take time out of the workforce to raise children or care for relatives and to work part-time than men.

Over the second half of 2015, equity preference for males fell 2%, compared to females where equity preference fell 4%. However this relatively small aggregate difference masks a significant divergence between gender and age groups.

The table below outlines the moves in equity preferences between genders and age groups.

Table 2: % change in EPI by age and gender - 2015

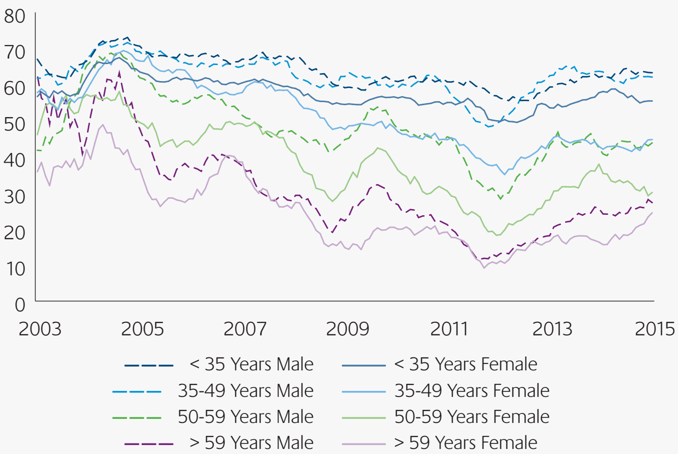
Age			Males			Females
	1H 15	2H 15	Overall EPI	1H 15	2H 15	Overall EPI
Under 35	+10%	+10%	1252	+9%	+7%	1603
35-49	-2%	+18%	255	+27%	+53%	54
50-59	-24%	-15%	-199	-8%	-4%	-359
59 and Over	-5%	-2%	-886	-4%	-4%	-1055

Source: CFSGAM and UWA Business School. Data to 31 December 2015.

As in 1H 15, the age group that has seen the widest divergence between male and female investment choices has been the 35-49 year age group. Whilst the 54% increase in the EPI for females in this group is encouraging, it is important to note that this is from a low base. With the EPI of females in this group at only 54 compared to that of males at 255, almost five times larger. This continues to raise the concern, highlighted in previous reports, that a low risk appetite through a permanently low equity preference may hinder womens' ability to achieve their retirement goals, particularly at such a crucial life stage for accumulating financial resources for retirement.

In this half we also saw a disparity between genders in the over 59 age group when comparing their equity allocation in superannuation accounts. As can be seen in chart 6, women increased their equity allocation in super accounts by 6% from 18% to 24% over the second half of the year whilst males in the same age group increased their allocation by 3% from 24% to 27%. This increase may suggest that women are increasing their equity preference at a faster pace later in life in an attempt to secure their financial wellbeing in retirement as they realise their current allocations and retirement goals do not align.

Chart 6: 12-month rolling average net equity/total dollar value: superannuation - applications only



Source: CFSGAM and UWA Business School. Data to 31 December 2015.

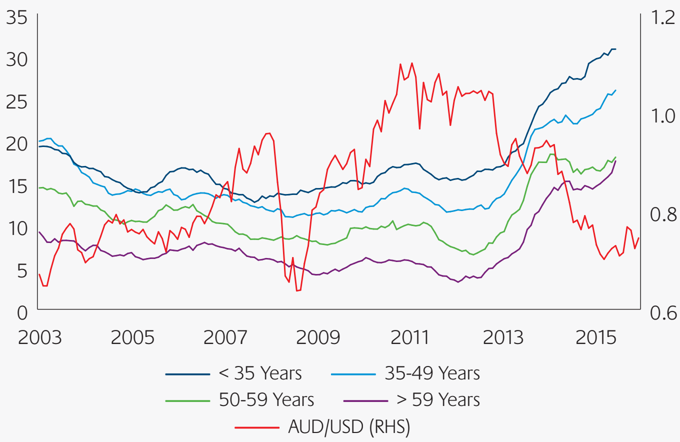
An update on domestic and international equity allocations

We have previously touched on investor's differing preferences between domestic and international equity. In this edition we will revisit this, paying particular attention to the impact of recent volatility and the desire for diversification on this decision.

As stated in the June 2015 edition of Investor Insights, there has been a declining trend in preferences for domestic equity and a significant increase in preferences for international equities since 2012. These trends have continued in 2015, with the exception of the under 35 age group who have increased the allocation to domestic equities in their portfolios.

Allocations to international equities continued to increase over the half as the Australian dollar (AUD) declined further against the US dollar, ending 2015 down 11%. As chart 7 illustrates, allocations towards international equities started increasing after the AUD began its decline from parity with the inverse relationship continuing through 2015. This may be driven by assumptions of continued weakness in the AUD making international investments more attractive to domestic investors.

Chart 7: 12-month rolling average net international equity/total dollar value: all products - applications only

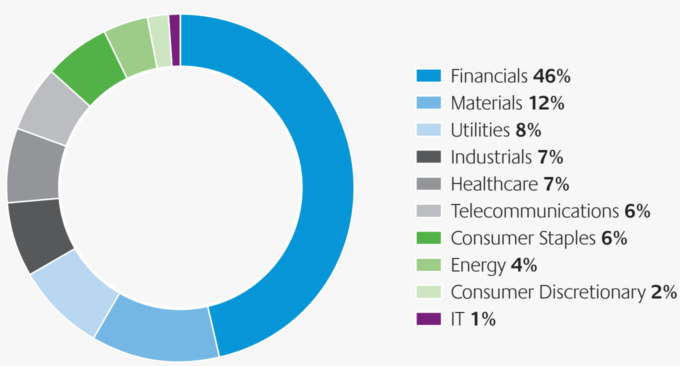


Source: CFSGAM and UWA Business School. Data to 31 December 2015.

There are several factors that may be behind this continued move towards international equities by Australian investors. Volatility in emerging markets, such as China, over the past year has driven investors towards safe haven markets such as Japan and the US. While Australia is not an emerging market, it is often viewed as a proxy for China given strong trade and economic links. This recent volatility in China may have led some domestic investors to look more towards these safe haven international markets.

Furthermore, as the Australian economy continues its transition from the mining sector, investors may be seeking greater diversification within their portfolios. As chart 8 demonstrates, the Australian equity market remains dominated by the financial and material sectors which, together represent almost 60% of market capitalisation (compared to 19% and 25% for the S&P 500 and MSCI World respectively).

Chart 8: ASX200 sectors by market capitalisation

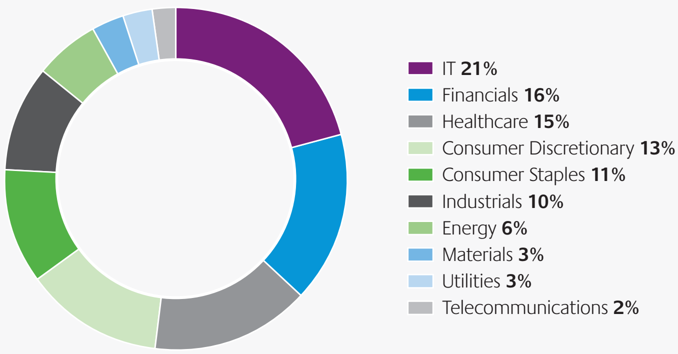


Source: Bloomberg, Data to 31 December 2015.

This means that, short of investing in specific sector funds, investors in the Australian market are over exposed to financial services and mining. This is an even greater concern in the current a falling interest rate and commodity price environment.

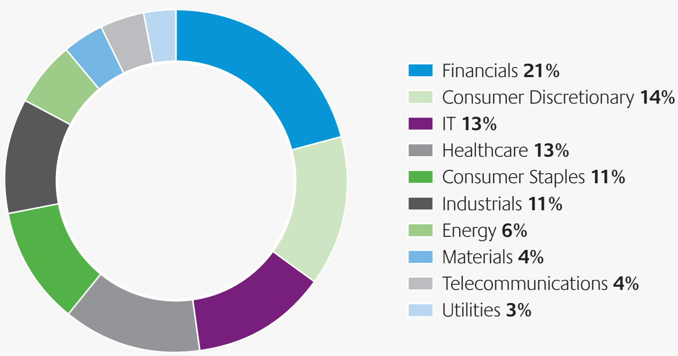
Australian investors are also likely seeking greater diversity and exposure to sectors that are not prominent in Australian equity markets, such as IT, consumer staples and consumer discretionary sectors which are small at only 9% of the Australian market, compared to 45% in the S&P 500 and 38% in the MSCI World Index, as shown in charts 9 and 10.

Chart 9: S&P 500 sectors by market capitalisation



Source: Bloomberg, Data to 31 December 2015.

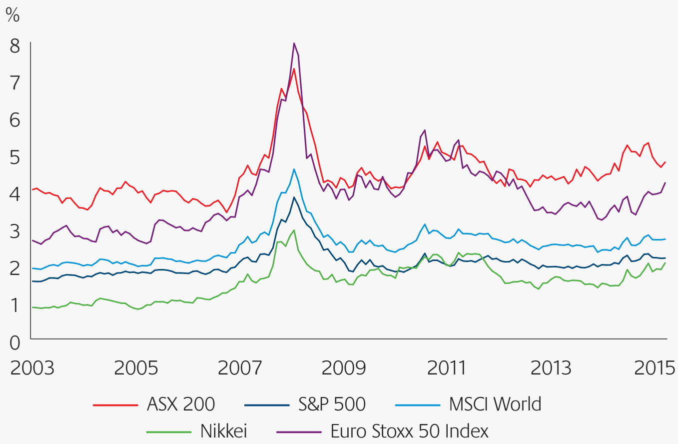
Chart 10: MSCI World sectors by market capitalisation



Source: Bloomberg, Data to 31 December 2015.

Another factor that may be driving this increased preference for international equities is the trade-off between capital accumulation and dividends. The Australian equity market has a high dividend yield when compared to its international counterparts, as shown in chart 11. As dividend yield is inversely related to capital accumulation, Australian investors seeking capital accumulation and wishing to invest in growth stocks (which traditionally have higher retained earnings) are likely increasingly looking internationally for these opportunities.

Chart 11: Global equity market dividend yields



Source: Bloomberg, Data to 30 June 2016.

In summary, investors continued to react to market volatility, albeit in a smaller magnitude than in previous periods. Nevertheless, volatility close to home appears to have encouraged investors to look offshore for returns. The data also suggests that as rates of return for defensive assets continue to decline, older investors in particular are being forced to choose between increasing their equity allocations in an attempt to meet their retirement goals, or maintain low risk defensive portfolios and risk insufficient superannuation at retirement.