LICs fall out of favour with SMSFs

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Self-managed superannuation funds are taking a step back from listed investment companies, instead allocating more money towards shares and cash in pursuit of greater transparency in uncertain investment markets.

Between May 2007 and April 2010, the average SMSF allocated as much as 5 per cent of their portfolio to listed investment companies (LICs), research by Investment Trends shows. But in the year to May 2011 the allocation fell to 2 per cent.

The research also found that as LICs fell out of favour, investment rose in shares, exchange traded funds (ETFs), cash and term deposits during the 2011 period.

Drew Corbett, head of investment strategy at ETF provider Betashares, said a greater desire for transparency in the wake of the global financial crisis was one reason why SMSFs were turning to other investments.

“The key difference is that, with an ETF, you have the certainty that it will trade around its current market value. With shares, they will also trade at what the public deems the value of a company to be worth,” Mr Corbett said.

In the wake of the crisis, SMSFs have also increased their holdings of cash because of the stable and consistent returns that are offered relative to other investments such as shares – traditionally more volatile.

Mr Corbett said the chief problem with LICs is investors have little certainty that the shares they hold will trade at their true value.

“There is no daily open mechanism to ensure that market makers can buy or sell them at their net tangible asset (NTA) value. There is also no certainty that the LIC will either outperform or deliver the benchmark return,” he said.

Bell Potter investment specialist William Spraggett said that concerns about liquidity could also be contributing to the decline in LICs within SMSFs.

“Liquidity can be an issue depending on the type of LIC, but if you look at some of the bigger ones with a market capitalisation in excess of a billion, they tend to be more liquid,” he said.

Unlike exchange traded funds, LICs are closed-ended vehicles and are not subject to external capital flows. This means that they do not regularly issue new shares or cancel shares in response to changes in investor demand.

Instead, investors have to buy and sell to each other through a broker on the Australian Securities Exchange. The share price is negotiated based on the dynamics of supply and demand, which means that sometimes a LIC can trade at a premium and at other times it may be discounted to its underlying NTA value.

Diversification, fully franked dividends, low management fees and good long-term performance are sighted as some of the main reasons to invest in LICs (which operate in a similar way to managed funds only, instead of buying units, shares are traded on the Australian Securities Exchange).

LICs allow investors to gain exposure to actively managed and diversified assets such as local and international shares, private equity, and specialist sectors such as wine and resources.

Contrary to the drop-off in LIC investments in SMSFs, Mr Spraggett believes LICs are underrated and perfect for SMSFs because of their low fee structure and diversification benefits.

”From my perspective, the closed-end structure means that they can also be invested for the long term,” he said.

Since the end of the financial crisis, no new LICs have been issued in the Australian market.

Some of the companies that specialise in LICs include Argo Investments, Australian United Investments, Djerriwarrh Investments and Australian Foundation Investment Co (AFIC).

The Australian Financial Review

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