

Take a razor to your SMSF



By Tim and Claire Mackay

PORTFOLIO POINT: Getting rid of unnecessary complexities from your SMSF can be very rewarding.

What do a medieval philosopher, a Renaissance man, a 20th century genius and a razor have to do with SMSFs? Read on.

The medieval philosopher William of Occam established the principle that of two equivalent explanations – all other things being equal – the simpler one is preferred. Today we know this as “Occam’s Razor” and we express it as “the simplest approach is usually the best” (unnecessary elements are shaved away).

Those who have taken control of their financial destiny and established an SMSF are seeking to cut through the complexity in order to meet their retirement goals. We believe the most effective approach is to use a razor to cut back the unnecessary complexities of your SMSF.

“Start at the beginning...”

Alcoholics Anonymous urges people to have the courage to change the things they can, and accept the things they cannot. For SMSF investors, that means accepting that the rules governing their fund are complex and ever-changing and that adhering to those rules and bureaucracy is part of the game.

Don’t waste time and energy struggling against the inevitable. Instead, focus on things you can control and wisely invest your time and effort in four key areas where you can make your SMSF simpler and more effective:

- Simplify the rules.
- Simplify your fees.
- Simplify your investments.
- Simplify your service providers.

Simplify the rules

A century and a half after William of Occam, Leonardo da Vinci came up with a variation on the theme, with “Simplicity is the ultimate sophistication”. Da Vinci produced beautifully simple and elegant innovations that revolutionised art and science. You can do it too: by applying Occam’s Razor to the thousands of pages of super and tax law and your SMSF trust deed, you can distil it to six key SMSF principles:

- Your SMSF investments sit in a low-tax environment. For retirees aged over 60 superannuation is your own legal, onshore Australian tax haven. If you have more than \$250,000 in your super and you don’t have an SMSF then you should consider one. If not, stick with an industry fund.
- If you are approaching retirement and have the choice of your investments being in a high-taxed environment or in your SMSF, the answer is obvious.
- There are strict rules limiting how much and when you can put money into your SMSF.
- You cannot withdraw money from your SMSF until you meet strict age

and work restrictions. Once you can withdraw money, you must take out at least the minimum amount each year.

- There are strict rules limiting what your SMSF can and cannot invest in and how to manage those investments.

- In your SMSF you have total control over your retirement assets. You should pay lower fees and you are obliged to meet strict tax office requirements.

Simplify your fees

“Our life is frittered away by detail. Simplify, simplify.” (Henry David Thoreau, American author.)

Ensure you have a thorough understanding of total fees before proceeding with any investment. For listed shares keep track of and manage your brokerage costs. For managed funds, keep track of the fees. For those with large sums to invest, negotiate your fees with the product provider prior to investing – you may be surprised they are willing to lower their stated fees.

There are numerous ways advisers charge for their services: commissions, percentage of assets and hourly fees are typical. Whichever way your adviser charges, be clear about what you’re up for and ensure the fees are less than the value your adviser is adding to your SMSF.

Simplify your investments

Legendary investor Warren Buffett says: “Avoid businesses whose futures you can’t evaluate.” This equally applies SMSF investments: stick to investments you understand that fit into your overall investment strategy and asset allocation.

A famous study undertaken by Brinson, Singer, and Beebower (1991) showed that on average 91.5% of portfolio returns are determined by asset allocation decisions while less than 5% of returns come from individual investment selection. The lesson here is to focus on your SMSF’s asset allocation and ensure that all your investments adhere to your strategy and allocation.

Some new clients come to us with a vast number of SMSF investments – 20, 30, some even approaching 100. We are strong believers in diversity but when you start spending more time buried by the complexity and paperwork of individual investments rather than on your overall strategy, it’s time to wield the razor.

We have seen many SMSF portfolios holding structured or hybrid investments that the trustees don’t understand and even we struggle with, as professional advisers. If you cannot understand and explain the rationale for any individual investment then it should not be in your portfolio.

We regard exchange traded funds (ETF) as a beautifully simple investment tool perfect for SMSFs. Low cost and liquid, they provide instant diversity and simplify your paper work by reducing the number of your investments.

Simplify your service providers

Six hundred years after William of Occam, Albert Einstein argued that we should “make everything as simple as possible, but not simpler”. Similarly, simplify your SMSF by only working with service providers who can truly add value to your SMSF.

The SMSF sector is serviced by 5500 tax agents/accountants, 20% of whom have only one SMSF client (be wary of these!). Of the 11,500 SMSF auditors, 51% perform less than five SMSF audits a year (be wary of these too!).

Ensure your accountant and auditor are SMSF experts. The average



audit fee is \$664 a year, and 50% of SMSFs pay less than \$500 a year. Simplifying your SMSF will simplify the audit and should reduce your SMSF audit fees.

Be wary of advisers who advise your SMSF into a platform. The fees you pay for a platform do absolutely nothing for your overall SMSF investment returns, nor do they simplify your SMSF. Platforms add to the fees and complexity while making your adviser's job easier. Do not pay for this privilege.

Be aware that there is an army of service providers who profit from the appearance of complexity they create around SMSFs. Be cautious of those who promote theirs as the "latest and greatest" trust deed that "must be" updated every year; or the "must have" estate planning for SMSFs; or the "best" ways of getting property into your SMSF.

These bells and whistles come at a significant cost and, rather than simplify your SMSF, simply add to the complexity.

"...and when you come to the end, stop"

"Perfection is achieved, not when there is nothing more to add, but when there is nothing left to take away." (Antoine de Saint Exupéry, French author of *The Little Prince*.)

You should never lose sight of your ultimate goal to support your desired lifestyle in retirement. Ignore the complexity and instead focus your energy on simplifying your SMSF to support this key goal. Continually ask yourself: "What adds complexity in my SMSF and do I really need it?"

A key test to help you determine this is: "If I can't describe it simply, I can't use it simply." If you don't understand it, then just cut it.

So our medieval philosopher, a Renaissance Man, a 20th century genius and a "razor" all encourage simplicity in your SMSF. For good measure we've thrown in the thoughts of a billionaire investor, American and French authors and the AA.

Wielding Occam's Razor and cutting unnecessary complexity from your SMSF can be a highly liberating and rewarding process. Why not sharpen Occam's Razor on your SMSF today? ◆

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