You'd be amazed what some people get up to because most of these are new clients. Most of them are people who've been in the wilderness, for want of a better word, on their own as an SMSF trustee looking after their portfolio. Maybe they were a football coach before and now suddenly they're an investor and you see what they get up to.

Avoid gathering a 'long tail' of small companies

A lot of people are doing that in isolation. So they don't have bouncing boards and they don't know what's normal. They just go with whatever they've experienced. So the mistakes we constantly see are a tail of small companies.

They will make an effort towards balancing a portfolio. There'll be four banks and BHP Rio and Woolworths, Wesfarmers, Telstra, and then there'll be this tail of small companies. It seems everybody wants to find a rocket under a rock and they think that's what the stock market's for.

But when your financial planner's charging a whatever it is, $5000, $10000, clients are burning tens of thousands of dollars, especially the larger they get, the more risk they take. Burning tens of thousands of dollars in mucking about in smaller companies. And the first piece of advice to financial planners is stop them, because they end up with needing far too much vigilance.

Avoid building the unmanageable 'monster portfolio' of 80 stocks

People buy stocks and think they have to hold forever because that's the Warren Buffett way, isn't it? So they end up with small companies that they never sell. Most small companies are volatile, they're trading stocks. So they end up with a lot of stocks. They don't sell either. There are a lot of stocks that will be sitting at a loss. We've had a

portfolio - I name most of the portfolios as I send them back - we had something called the 'Monster Portfolio', which was quite a large portfolio. But out of 75 stocks, 40 of them had been down more than 50% as a number had gone bust. And it was just buy on the latest tip and leave.

Don’t forget to sell when the time is right

So the first thing I'd say to people who are trying to run their own portfolios is small companies is not where it's at. If you notice small company fund managers, some of them add a lot of value because they've got good analysts paid hundreds of thousands of dollars to go and investigate these companies and they watch them and they sell them. They don't necessarily sit with them, but there's a lot of work involved in people trying to do it in an amateur way and most of them are cocking it up.

Diversify by asset class, not just by stocks

The other thing that people do is they don't have any sort of balance. They think it's all about equities. There'll be a 100% equity portfolio and Australian equities as well. And really some of the successful portfolios we see are balanced out. If you're going to take a longer term approach or you are retiring you need to think about risk as well as reward.

So some of the best portfolios we see do have a chunk in exchange traded funds or managed funds or fixed interest ETFs; big stocks and then small stocks. So balancing out would be one thing.

Deploy your cash; it has a negative real return in term deposits

Another thing people do badly and well is some portfolios have masses of cash, 30, 40% of cash. If you are trying to live off your investments isn't the idea that you're invested? You know cash is fine, but in the current environment you're earning less than 1%, inflation is

1.6%. For the first time in 22 years you've got a negative real return by putting your money in term deposits. So cash really is a killer at the moment, especially if someone that's looking for income and for a retiree inflation isn't 1.6%, that's a government fantasy. Inflation is whatever the petrol, food, insurance and car maintenance costs are doing. We've all got our own inflation rates, not 1.6%. So people are going backwards in term deposits. Nothing wrong with that - taking no risk, but you probably could do better. Some portfolios have far too much cash.

Go global. Aussie stocks are just part of the market

You can quite easily get international exposures now through ETFs. We buy individual stocks for clients, but that's where all the growth is because the technology sector has been a huge global growth industry and we're lacking it in Australia. So diversifying internationally would be another thing. Not selling would be an obvious one. People sit on stocks and tinkering, which is trading. Thinking that being in and out and in and out is the way forward. No one ever goes anywhere doing that. But I think the most value I could tell a isolated SMSF trustee is to take a longer term approach. We see some great long term portfolios - people that have held CSL since it listed type of thing. Try and take a longer term, patient approach. Don't think that you have to fiddle all the time. I would say don't diversify your equity portfolio. That might seem stupid thing to say someone's going to take, grab and put it up on social media and say, "Marcus is an idiot." But the diversification comes through asset allocation more than equities.

So some financial advisors, what they do is they take the top 50. They go through, they cross out every stock that they don't understand or can't spell and then they give you that as their portfolio which is why QBEs in everyone's portfolio. But the obvious portfolio isn't

necessarily the best one because we happen to have weightings in banks and financials.

The truth of the matter is some of the best portfolios we see are people who manage the risk through diversification of asset classes. And then when they go to equities they go for growth. And some of them are terribly successful.

Don’t just focus on income

One of the biggest problems in Australia is people are investing for income. The moment you invest for income you're going to end up with banks. We get portfolios with 50% banks in. The banks have underperformed 30, 40 and 50% against the market over the last five years. By looking for income people are making mistakes because they are focused on, they're corralled into mature, low growth companies that are handing money back to shareholders.

Now if you go to America, paying a dividend is seen as failure. This is why Berkshire Hathaway, Microsoft resisted paying dividends for decades because the culture in America is equities are for growth, fixed interest is for income. There's almost no income now from fixed interest, but equities are for growth. And if you have a high return on equity company, say a company that's earning a 20% return on equity - you know some of those WAAAX stocks are running 60% returns on equity - but say you've got 20% return on equity, what do you think is a better investment? Giving it to a low growth, no growth or negative growth bank sector or company that's earning a return on equity of 10% and paying it back to shareholders so they've got no capital to grow. Is that a better investment? Or a company that is earning on every dollar you give them they earn 20 cents every year and they don't give you any of it back. They reinvest it for another 20% growth.

This is one of the most fabulous parts of the Australian market is there are some companies, even larger ones, that will have high return on

equity and have massively outperformed over five years. You will find hundreds of percent from stocks like CSL, Cochlear, Treasury Wine Estates, Aristocrat Leisure. They are not paying yields or they're paying minimal dividends and they're reinvesting at a high return on equity. That is proven over the long term to give you a much better return than investing in a low growth, mature stock that's giving you the money back. What's the point in giving money back to a shareholder who can earn 0.99% in a term deposit when you can reinvest it at 20%? Makes obvious sense.

Focus on growth (missing out on this is 'the biggest mistake in Australia')

So possibly the last thing I would say to Australians running a self managed super fund, especially those that aren't retired, especially those that don't need the income, is focus on growth because that's where the returns are rather than from dividends. And those compound returns will vastly outstrip over the longer term - if you don't need the dividends - high yielding stocks.

How do you find growth stocks?

That is not too hard. The amount of information available on the market, searchable in an Excel spreadsheet is a readily available commodity. We have done a very simple, you could do a very simple search of the All Ordinaries Index. And we can do a very simple search of the All Ordinaries for any company as a simple filter because this might not be the right filter, but it's a pretty good filter. You take all the companies that have got **five years of uninterrupted earnings growth.**

So we colour them blue and red. So you just look at any company with five blue numbers in earnings growth a year ago this year, next year, year after year after on the forecast. So three years' forecast, two years history. And you'll find a list comes up that I believe a lot of

us can reduce. We think we're fund managers who make good decisions, but actually we all have a process and we tend to go through it the whole time exactly the same way.

I believe a lot of fund managers don't have a gut feel. What they have is an algorithm in their head that they could actually probably put on Excel. So this could be your algorithm. You're looking for a company that has got five years uninterrupted earnings growth in the forecast and past.

Another good filter is **five years' dividend growth.** If you're looking for income stocks, that's a good one as well. But when you get this list out, you can then start to filter it a little bit because some of them are very boring companies. You'll get regulated utilities that have got earnings growth every year, but they've got return on equity of eight percent, although five percent is the new sexy. Eight percent could be really sexy in a zero interest rate environment. But they'll have low return on equity.

But if you're looking for growth companies and larger growth companies, you then **search by market cap.** You get that group, you then **search by return on equity** and you will find the list that comes out is remarkable for it's what you intuitively know to be true when you're looking for Australian growth equities. You will find all the names there that you expect to be there. It'll start with CSL and Cochlear and ResMed and realestate.com and Treasury Wine Estates, Aristocrat Leisure. And it makes a fabulous portfolio and it's not hard to find.

Some of the portfolios we've had, one of the best ones had a lot of hybrids. He was more interested in income and where he held equities, he only held growth equities. It's refreshing not to find an equity portfolio with a load of banks and Telstra and Woolies and Wesfarmers, although they'd been doing okay. But this guy just focused on growth. And that is the portfolio that if you look at the

compound growth rates of these companies, most of them have very low yields but their returns, as long as you're prepared to sell shares to buy your groceries and your smashed avocado and your chocolate digestives in your retirement home, you're going to have to sell shares rather than take income into your income account. These companies will produce far superior returns because of their high return on equity and their reliability.

So it's not a hard list to pop out in the market. I suggest everybody does it and you use that list as your base case portfolio especially if you're not retired, especially if you've got a 20, 30 year runway now. Those companies are your go tos. The problem with a lot of them at the moment is the market's already onto growth and CSL is hitting all time highs.

Probably, it won't happen, but goodness, please give us a 20% correction so we can buy them because they're all so expensive and everybody's onto them. But get that list together. When that correction comes, when Trump eventually does stuff it all up for us, please, we'll get all those stocks at the right price rather than the all time highs.

The most successful portfolio I've seen

The most successful portfolio I've seen was a fabulous guy. He sent us a video of him woodworking. Beautiful tools, brass, all arranged neatly. Obviously an ordered mind. And he told the fabulous story of in 2007 he took out a $100,000 margin load to invest in equities and by 2010 it was down to $30,000 and he was divorced and he was living on his mother's sofa. I shouldn't laugh. He was living on his mother's sofa. And he basically had a clean sheet.

The only money he had was $30,000 left in a margin loan. And he had this idea that the Buddhists feel that you will never reach enlightenment unless you have forgiven all your worldly goods. And he'd basically done that as he was looking for enlightenment. And

enlightenment came from him realising he had nothing to lose. And he, with his margin loan, started looking after his own, he was cynical about what the advisors told him, industry had told him, what the normal ways of investing were.

So he decided, "I'm going to do what I think. I'm going to take my path. I'm going to have my process." And off he went. And in 2019 he sent us his portfolio. He has a margin loan of just under a million dollars and the total portfolio's worth $3.47 million. And he's done that on his own with his own techniques. And it was a great lesson.

I asked him to write for our members what he'd done and the messages were that he had to go, he had nothing to lose so he went full throttle, foot pedal to the floor, spinning wheels he described it, the whole time. And he spent $5,000 a year on a newsletter subscriptions. He went to all the fund managers and subscribed to their weekly emails. Most fund managers put out a weekly, if not monthly email telling me, telling you how they've performed and what stocks they've got and any interesting stories they got trying to engage you. Well-worth having a look at. And he played follow the fund manager as well.

The Peter Lynch approach

And if you look at his portfolio and it is just, you couldn't in hindsight have written a better portfolio. He had everything from, started with A2 Milk I think was his first big success. He said he worked in a Chinese area and he could see these A2 cartons everywhere and he feels a Peter Lynch way of doing things which is see what successful around you.

If you read Peter Lynch's book, he has a classroom of kids who do an investment course every year and he brings him in front of the fund managers to tell the fund managers what they're doing because the kids massively always outperform the fund managers. What are the

kids doing? And the kids were buying stocks, hypothetically buying stocks that they knew. McDonald's, Pentel. Their teacher had a two handed pen that had two lids and they thought that was really clever. So they bought Pentel and they picked stocks. So this guy was picking, saying use Peter Lynch, look around you. What's going on?

I've done the same thing as well. I look for companies that have started to advertise on TV. I picked up Webjet like that. You pick one stock that's trending like that. You can actually trade it. You get to know it very well. Another one recently is Hello World, similar to Webjet started advertising on TV. I know some of the boutique fund managers had an interest but that was his approach.

But he'd picked up WiseTech, Altium, Appen, Afterpay, Xero. You really could not have picked better stocks. And he'd got it all from listening to other people, the buzz in the newsletter, the buzz from the fund managers and gone with it, go with the flow is his idea. But these stocks, he hasn't traded and he hasn't fluttered. He's still an investor. He's not short term. He doesn't trade. He says tinkering doesn't work.

"Capital light" businesses

The other thing he doesn't do is he's not interested in a sector weightings. Most of us will hold 25% in banks. No interest in that at all. He was very taken with Hamish Douglass's "capital light' idea. If you take the difference between an IT company in a mining company, a mining company has massive capex to dig stuff out of the ground. An IT company is capital light and has almost no expenditure.

So he was being very focused on IT stocks, the information technology sector, which of course in Australia is quite small, but he didn't have international stocks so he focused on the right stocks in the end and he'd kept investing in the market. The moment he made money he put it back into the market.

Avoid trading. Take a long-term approach

And he said there was a moment where you suddenly realise compounding works. He's accelerating away! You get away from the tens of thousands, suddenly you're dealing in hundreds of thousands and then you're dealing in millions, so compounding works. But you've got to put it back in. And unfortunately for a lot of SMSF retirees, trustees running their own portfolios, they take the money out because they have to because they're living off the income. So he had the luxury of living very modestly and putting the money back into the market because he had a goal.

I don't think he's got there even though a lot of us would stop at $3.5 million. I don't think he's got there yet. He's got a goal. He's now got a 10 month old son and has re-partnered and is looking at buying a house. And when he lifted, he said he lifted his head up from the stock market to look at the property market when he re-partnered thinking "I must get a house". He couldn't believe how much they cost because he'd never really looked at them. He goes "I'm going to stick with the stock market" because I'm got to make more money than sticking it in a savings account or sticking it in a house because I know what I'm doing.

But he understands, ultimately, if you look at his portfolio now, there's a lot of IT there. The average PE was 89 times. The average market PE is 18 times. He understands he's taking a big risk, but he understands that tech stocks, they're reinvesting all their cash flows while the PEs are so high. But he knows there's a risk of an equity market correction, but he's lived through a few.

And a GFC style event aside, which would change a lot of people's standard of living, you've got to accept a 20% correction is quite normal. And we can live with those. He could live with those. A 20% correction from $3.5 million. You can live with that. What you want to do is if you get a GFC style event once in a lifetime, which means

once every 10 years, you want to be able to take advantage of it. It's not about suffering. It is about taking a bunch of it.

So at some point he knows he's hanging out there, wheel spinning, foot to the floor, and he might have to do something about it. But for now, all power to him. I would point out to him that you now have some worldly goods. You don't want to forgive them again. So good luck. But when the market tips over, please do something about it. All power to all of you out there who are trying to do that.