

Transcript

The Ideas Exchange

Episode 24: Principles to guide your investment decision making

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Jacinta Schlosser (00:01): Welcome to the Ideas Exchange by ASX, connecting you with investment experts, market updates and ideas. I am Jacinta Schlosser, business development manager, investment products at ASX, and this is our regular podcast covering everything from investment trends through to different ways to invest using a variety of products.

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Jacinta Schlosser (00:48): Hi, everyone. Welcome to the Ideas Exchange. I'm your host, Jacinta Schlosser from the ASX. In the studio, I'm joined by Martin Dinh. He is one of my esteemed colleagues within the listings business at ASX and holds the title manager, investment product specialist. Today, we will discuss investment principles to guide your portfolio construction. Welcome, Martin.

Martin Dinh (01:11): Hi, Jacinta, really great to be here. I actually started the podcast so it's going to be interesting to be on the receiving end.

Jacinta Schlosser (01:18): That's my next question because for those who've been listening to our podcast for some time, you started this about a year ago and ran it for a year. So how does it feel to be on the other side of the microphone today?

Martin Dinh (01:28): It actually feels a lot less nerve-wracking because I have a bit more control.

Jacinta Schlosser (01:32): Oh, don't tell me that. All right, wish me luck, everybody. Let's get started. We want to dive into a presentation that you delivered at the ASX Investor Days during November. How did you enjoy being a presenter at the Investor Days? And can you just tell us a bit about the format of the days?

Martin Dinh (01:49): Yeah, it was exceptional. It is probably the first time I did a presentation in front of that many people, so very nervous. But overall, it was about a topic that I was extremely passionate about, which was developing a number of key principles that investors can use when constructing a portfolio. I think with investing, when I first started in high school, it wasn't really being taught, so I felt like this was the greatest opportunity to teach people who weren't taught this in high school about things that they can apply in real life, in particular, portfolio construction. Format of the day was phenomenal. We had in Sydney, I think it was about 500 people. In Melbourne, it was 350. In Brisbane, it was 250. Spoke to plenty of investors, I think they were extremely enthusiastic and really there wanting to learn more about investing.

Jacinta Schlosser (02:41): Well, I think you hit that well because you looked pretty confident to me and I know that people really enjoyed your presentation and came up to you after. I know you had a lot of questions from the floor and what I particularly loved was the clarity of your presentation, and I'm with you in that being passionate about learning a lot more when you're younger, especially heading out of school. I had a passion for that when I was younger, but not everybody is exposed to it or does have it, so these kind of days are great to give you on demand content, and et cetera. So we're going to delve more into the presentation. So you introduced four principles. You talk about the four principles, and I'll just give those at the top here. So we've got goals, balance, cost, and discipline. So starting with goals, you stated create clear appropriate investment goals. Now I was thinking about that and I thought that sounds simple, right? But I remember at uni, just how hard it can be to write clear succinct statements sometimes when you're encapsulating big ideas. Can you talk us through this?

Martin Dinh (03:37): Yeah, sure. I think when constructing a portfolio, creating investment goals is probably the most important part when constructing a portfolio, the constructing appropriate investment goals provides the right pathway, and you are right. Creating investment goals isn't easy to do, but in general, what I've found based on my research and listening to other podcasts and listening to other presentations is one of the most effective ways to create investment goals is to come up with a plan and write it down and then incorporating those investment goals into the plan. Now when you think about investment goals, you can think about comprising two things, a return and risk objective. A return objective really refers to two things, which is a required and desired return, and really these concepts evolve you assessing how much you need to earn in terms of a return to meet either high priority goals or lower priority goals.

(04:31): And these can include things such as to fund your daily living expenses, to buy a new house or to pay for your child's education, you then need to think about that risk objective, which is assessing how much risk you can take to reach those investment goals. So once you've come up with those investment goals, which take to account both your return and risk objective, you kind of want to figure out do I face any investment constraints as well? Investment constraints are really factors that can determine how much you

can invest in or what you can invest in. Some examples can include your time horizon, your current financial situation, or even your current liquidity requirements. I think that once you come up with your investment plan that incorporates those investment goals that can really put you on the right path. There is no right or wrong, I guess investment goal, it really depends on your individual circumstances as well as your risk tolerance.

Jacinta Schlosser (05:23): I like what you say about writing it down, okay? I had someone say to me years ago, the benefit of that is that it holds your mind subconsciously to it, and you'll be surprised that as you work through the process of anything, in this case investment planning, your brain will just sort of kick that in, and you'll hold you to those goals that you've encapsulated.

Martin Dinh (05:44): Yeah, I think that's absolutely correct because it's really easy when you're investing to lose track because sometimes you can get very enthusiastic or you can get very overwhelmed, and it's in those situations it can be very, very easy to deviate from your investment goals. But by having something that you write down, it gives you the opportunity to regularly review it and then get back on track.

Jacinta Schlosser (06:07): The next principle balance, it starts with consideration the major asset classes over the medium to long-term and about developing a suitable asset allocation. One of my former colleagues, Emma Kirk, she provides a sports analogy when she talks about the major asset classes, which I just love. She likens cash to doing yoga. On the other end of the spectrum, she sort of puts equities with weightlifting, and she goes a step further with crypto and says it's like base jumping. So what are your thoughts here?

Martin Dinh (06:35): Yeah, I mean when you think about asset allocation, it's really that process of figuring out what mix of investments or what mix of asset classes best reflects the investment goals that you've just created, as well as your risk tolerance. I think of asset classes as each having a risk and return profile. So I mean, the foremost broad asset classes, you've mentioned two of them already, which is equities and cash. I won't speak too much about crypto, but two other broad asset classes are property and fixed income securities. With each of these asset classes, they each have a return and risk profile. So equities has the highest return in terms of the long-term horizon in comparison to the other asset classes, but it also comprises the highest level of risk in the short-term as well.

(07:21): And then on the other side of the spectrum, you have cash, where cash is considered the safest investment out of the other asset classes, but it also comprises the lowest level of return over the long-term horizon. What you can see is that each of these asset classes has a different return and risk profile, and generally, the higher the risk of an asset class also comes with the highest return. But also with an asset class with the lowest return, it also comes with the lowest level of risk as well. So really when you're looking at these asset classes, you just need to understand the relationship between

risk and return. So once you understand the risk and return profile and also understand that each of these asset classes also tend to perform quite differently from each other, you can then think about constructing a portfolio that reflects your investment goals and your risk tolerance as well.

Jacinta Schlosser (08:12): So what you're talking about there it sounds like is heading into you, thinking about your asset allocation at that point?

Martin Dinh (08:17): That's correct. Yeah, spot on.

Jacinta Schlosser (08:18): Now, the other point you talked about in your presentation was periodic rebalancing. Do you want to just touch on that for our listeners?

Martin Dinh (08:25): Yeah. So asset allocation isn't a set and forget strategy. It's something that requires you to constantly rebalance your portfolio and I guess to define portfolio rebalancing, it's a process where you bring back an asset allocation that you've designed that's deviated away from that target back into line, and you'll do that by buying and selling assets within the portfolio. Now to understand why that's important, think about a situation. Say for example, for me, I have a target asset allocation that comprises a fairly even split between, say, growth assets and defensive assets or, say, stocks and bonds. And say over a period of time, say, five years, the stock market rises a lot quicker than the bond market. What that means is my current asset allocation is going to contain a significantly higher allocation to stocks than bonds or growth assets than defensive assets.

(09:18): What that actually means is that my current asset allocation doesn't actually reflect my investment goals and risk tolerance. So what I can do is to get it back to the target asset allocation, I can rebalance my portfolio. The process is actually not that complicated. Really, it will involve you selling a proportion of the stocks. So that's the proportion of your portfolio that's risen quite quickly, and then using those proceeds to buy more bonds. You continue that process until you've reached that evenly split between your growth and defensive assets or stocks and bonds. And really, the key takeaway from regularly rebalancing your portfolio is that you're going to ensure that you have that asset allocation that consistently reflects your investment goals as well as your risk tolerance.

Jacinta Schlosser (10:03): The third principle is cost. And this is particularly important consideration over the long-term, isn't it, Martin?

Martin Dinh (10:10): Yeah. Cost is something that I think every investor needs to look at. It isn't the only thing that you should consider. For example, if you're happy to pay an extra fee to a fund manager because they're providing additional services or you think they can provide exceptional returns over the long-term horizon, then go ahead and be happy to take that investment that pays the higher fee. But I think before you even do that, you need to understand the implications of costs on the potential returns. One example that I gave at the Investor Day was to look at a hypothetical example

of two investors that had \$100,000. It was an identical investment. It generates a return of 5% a year with those returns reinvested into the portfolio.

(10:52): The main difference however that I'd used in this presentation was the investor in the first option, they charged a management fee per year of 1% per year, and the investor in the second option charged a management fee of 2% per year. So once I calculated the results over a 30-year period, what I found was that by the investor or a 1% difference in terms of the investment option meant that the investor in option one was over \$80,000 better off than the investor in option two. If you repeat that example over a longer period of time, you can see that the impact of costs actually grows profoundly over time due to the impact of compounding. So I think because the impact of costs on the returns of your portfolio grow over time, I think it's something that you definitely need to consider when you're selecting your investments.

Jacinta Schlosser (11:38): Thank you. Look, one other thing I know you talked about a little bit was the reinvesting distributions or dividends. People might have heard of it as a DRP.

Martin Dinh (11:47): Yeah. I mean, quite simply a DRP refers an investment that pays a dividend. You have two choices with it. So the first choice is you can pocket it as cash or that you can use the dividends to buy additional shares. One of the most powerful things about reinvesting your dividends is that it takes advantage of a powerful investing concept called compounding. So I mentioned it a few times in the ASX Investor Day, but the reason why it takes advantage of the power of compounding is that when you accumulate more shares, those additional shares actually also pay dividends and then you can use those dividends to buy more additional shares at the next dividend payment cycle. When you take that example into account, the returns on your portfolio can be quite profound. Using a really good example that I used at the ASX Investor Day, I compared two investors that had \$10,000 and hypothetically, they invested in the securities that comprised the S&P/ASX 200 index.

(12:45): The investor in option one decided to reinvest their dividends and basically what I did was looked at the returns of the S&P/ASX 200 total return index, which incorporates dividends and then looked at another situation where the investor didn't invest in dividends. Where I looked at the performance of the S&P/ASX 200 price-only index that included dividends. And what I found that over a 20-year period, the investor that decided to regularly reinvest their dividends, they were about, I think, \$8,000 better off than the investor that didn't reinvest their dividends. And what I also found from these results was that the impacts or the portfolio values between the investor that reinvested their dividends and the investor that didn't reinvest their dividends, the gap actually grows profoundly over time, and that's due to the impact of compounding.

(13:34): Should make a couple caveats though, I mean, dividend reinvestments can be a great way to reach your investment goals, but there are some disadvantages as well. So you need to take into account that reinvesting your dividends requires you to sacrifice cash. So if you're someone who needs to use cash on a frequent basis, then it might not be the right thing for you. And also, note that when you're in a dividend reinvestment plan, you don't actually have control any of the purchase price because you're buying it on the dividend payment date. So you could be buying it at a more expensive price, but if you're having a long-term discipline approach, reinvesting your dividends can be a great way to reach your investment goals due to that impact of compounding.

Jacinta Schlosser (14:15): That's a great segue because the final principle is discipline. I don't know about you, but this was something that I didn't have a lot of when I was younger, but it was certainly something my parents drilled into me and which I finally managed as a young adult. Why is discipline so important to investing?

Martin Dinh (14:31): Yeah, this is probably one of my favorite principles and the reason why is I mentioned that when we talked about dividend reinvestment plans is that provides you with the time for your money to grow through a powerful investing concept called compounding. For those who don't know what compounding is, it is quite hard to explain, but the easiest way to explain compounding is to go through a mathematical example. So think about a situation where you have \$10,000 and that investment grows 5% in the first year that means that your investment has grown to \$10,500 at the end of that first period.

(15:05): Now say in the second year, it also grows by 5%. That means that your \$10,500 has grown to \$11,525 in the second year. So what you can see is that your portfolio value hasn't grown by \$500 like it did in the first year. It's grown by \$525, and that's pretty much the power of compounding. If you repeat that example over a prolonged period of time, you can see that the impacts of compounding can be quite profound. So if you use the same example, the \$10,000 example and, say, it grows 5% over year, over 30 years, that portfolio value exponentially will grow to about \$43,000, and that's without making any regular contributions as well.

Jacinta Schlosser (15:45): What I like about that is that that subconscious stuff that we also are facing with managing our finances is that I know myself, I'm guilty of going... Well, it can feel insurmountable to put \$1,000 away a month or 500 or 200, but if that is set up to be automatically reinvesting, or I just put a direct debit for example, that's an example of a discipline where it's done and it's done for me and then I know that I'm contributing for the long term.

Martin Dinh (16:12): Yeah. I mean, so when we talked about creating the investment goals, we talked about the investment plan, and one thing you can actually do is to incorporate how much you regularly want to contribute into that investment plan. And even small contributions can have a profound

impact on the returns of your investment over the long-term horizon. One of the reasons why when you're making small contributions and why it can have a profound impact on the returns of your investment is because the impacts of compounding are actually even more profound. If you think about... I can use the same example as well, luckily, I've done all the math before the podcast so it's all in my head.

Jacinta Schlosser (16:49): Good, thank you.

Martin Dinh (16:50): But if we use the same example, that \$10,000 investment example and it grows 5% per year, but we make once small adjustment in that the investment only makes \$100 contributions a month. And we use that same example over a 30-year period that investor's portfolio value of \$10,000 will actually grow to \$123,000. So that's more than three and a half times higher than the investor's portfolio that didn't make any regular contributions. Now, one of the reasons for why that difference is so wide is that when you are making regular contributions, you are earning an annual compound return on both the original investment as well as all the contributions that you've made over the entire period. Whereas if you don't make any regular contributions, you're only going to earn an annual compound return on just the original investment.

Jacinta Schlosser (17:38): I'm going to throw some questions at you now. In preparation for today, I've been thinking about what sort of things investors have spoken to me about in the past. I'm keen to start with a discussion around active versus passive management. What's the difference, and what are some ways investors should think about the two?

Martin Dinh (17:55): Yeah, quite simply, a passive investment really refers to a fund that looks to track a particular index or a benchmark, and it does this by holding all the securities that comprise the benchmark or a sample of that particular benchmark. It's a rules objective sort of strategy. So it follows a preset of rules, and it doesn't deviate away from those rules. Now an active fund, it looks to not track a benchmark, that's the easiest way to think about it. It can either look to outperform a benchmark or not look at a benchmark at all. The main difference is that the manager will make active decisions in the portfolio. So what you'll see is a portfolio of an active manager quite different. It comprise of securities quite differently than the securities of a fund that tracks a benchmark, in particular, at the asset allocations as well. Now in terms of deciding active versus passive, I think that both can work quite well together. They can complement each other quite well.

(18:57): I think the more pertinent decision when you are selecting whether it's active or passive is to make sure that when you're selecting an active fund or a passive fund, make sure that you understand how it fits in your asset allocation. The idea is you want a combination of either active or passive, or passive or active. You want a composition that reflects your investment goals as well as your risk tolerance. I think what you can do also when you are trying to select a passive or an active fund is to come up with a checklist, know who the fund manager is, know their philosophy, know how much they

charge, know their performance. You can come up with a checklist just to help you to compare different investment options to ensure that you are well-informed. But I think the key takeaway away is that the keys that we think that both passive and active can complement each other. The important thing is to make sure that when you're selecting an active or a passive fund, think about how it fits your investment goals as well as your risk tolerance.

Jacinta Schlosser (19:55): Thank you. I like a good checklist. So I've done that and will continue to do so. I'm heading back to the theme of discipline. What's something you learned in your early days of investing that helped shape your approach to investing? I'm thinking here of pearls of wisdom that you might have learned from some of your reading or study. Maybe there was a peer you worked with or maybe there's someone in your family that you felt was older and wiser, and you wanted to learn from.

Martin Dinh (20:22): Yeah, so I learned a lot of my investing through other people's mistakes. I do feel that you can learn a lot from mistakes. One of the things that happened during COVID was my sister, I don't know if you remember, but the government allowed you to take away some of your superannuation, and she was panicking because she saw her super, the performance wasn't doing very well. She took out the maximum amount, and then what she saw a month later was the market rebounded. It was quite sharply. And what really taught me about that particular situation, it was quite recent as well, was that you really need to remove that emotion from investing. I think that to me that was one of the key takeaways of really the change the way I looked at investing. I think you are making very objective investment decisions. When you're coming up with that investment plan that we spoke about earlier that really helps eliminate that subjectiveness because that investment plan is saying do X, Y, and Z and don't deviate away from it.

(21:22): And I think that that's really the important thing about investing is to remove that emotion and having a long-term discipline approach as well. I think that's another thing that's always stuck in my head. There's been a really cool article about... I think it was Warren Buffett, he did the bet. He basically said, "I'll have a million dollars based on a portfolio of \$100,000 and all I'm going to do is just buy and hold the S&P 500. I'm not going to make any changes." And he put this bet out to 20 other active fund managers, he beat them by a landslide and the way he beat it was because he just buy and held, took advantage of the power of compounding because compounding can have a profound impact on the returns of your investment over the long-term horizon. So I think the two lessons, make sure you don't use emotion when you're investing and have that long-term discipline approach.

Jacinta Schlosser (22:13): See, come back to discipline. I think you and I are aligned on that one. On our way here, we were talking about this as well and a senior PM that I've worked with in the past, he said once in a meeting, "Hold your still, you've got to have your nerve." And he say, "You've made decisions in different climates or market environment and you have to hold your still sometimes."

Martin Dinh (22:34): Yeah, I think it's very easy to get overwhelmed. That's why I think by having a long-term discipline approach and writing out what your investment goals are and what the strategies around those investment goals, it helps you... You stick to it and it helps kind of remove that emotion. So when something, say, the stock market drops 30%, it helps you not be overwhelmed by it and just stick to your investment plan, whether it's to constantly make regular contributions. I think having that investment plan just helps you not get overwhelmed by what's happening in the market because there is a lot of noise out there.

Jacinta Schlosser (23:11): Yep. Yeah, that balancing rational with the emotional that, I mean, if anyone could master that across everything, you'd be a genius I suppose. I've got a few more questions I'm going to throw at you. So reading, what do you like to read to keep across investing in markets when you've got the time because I know you've had a busy end of the year?

Martin Dinh (23:30): Yeah, I think I'd love to read newsletters. So if you go onto fund manager websites or broker websites, they have fantastic newsletters. Also, the ASX website as well. We publish a monthly newsletter. You can learn about a lot of what's going on in the market. You can learn about different investment options and there's also a lot of educational material out there as well. In terms of what I like to read, I think there was a really good book that I read maybe a year ago that a lot of the investment principles have always stuck in my mind is Rich Dad, Poor Dad. It's a book by Robert Kiyosaki, apologies if I pronounced his name wrong, but one of the most fundamental things, key takeaways from this book was that you don't have to be rich to be, I guess, financially well-off. So what I mean is if you earn a lot of money, you don't need to earn a lot of money to be well-off. You can be earning a low amount of money.

(24:23): But if you put the money or you invest the money in the right way, could be the right way to acquire wealth. And basically that whole book focuses on different principles, and we've covered it in some of the presentation, which is having a long-term discipline approach, making sure that you don't leave your money in cash and putting that money to work. One of the morals of that book that I've always really, really liked is that when you're working, you earn money and then that pays for your living expenses. But his philosophy is that when you invest, the money is working for you. And the idea is you want to get to that stage where your investments are generating more money than your actual income. So I think there's been a misconception that the richest people in the world become rich because they are high income earners. It's not always the case. Most of the time, it's because they're putting their money in the right places and investing it in the right places to build their wealth, but I suggest reading those newspapers, newsletters, but also the book that I just recommended as well.

Jacinta Schlosser (25:21): Yeah, I'm going to second that because I read that book. Someone gave it to me at the beginning of COVID and I read it and I particularly enjoyed it, and I also can't remember how to say his surname. One of the things I remembered was his talk about running your own

finances like you would a business. And I have at times said that to friends and family or when they say, "Okay..." I used to be an agent years ago, and I found the clients I worked for who thought of themselves as a business. They made the rational mind would kick in more and they made sound and solid decisions and their earnings would increase or be better.

(25:58): And like you say, not for being wealthy or coming with great financial wins, but because of the commitment, discipline and dedication to making good sound decisions over the long term. So yeah, second that book, Rich Dad, Poor Dad. There's an unplanned plug. Look, last question today is we've seen a huge uptick at the ASX and ETFs coming to market and investors using them in recent years. What do you think some of the drivers to this are?

Martin Dinh (26:26): ETFs, for those who are not familiar with what ETFs, stands for exchange traded funds in... I guess the easiest way to define an ETF is got to go through those each individual letters. "E" stands for exchange. ETFs traded on exchange like the ASX. So the way you buy and sell ETFs is the exact same way you buy and sell shares. T stands for traded, so ETFs trade on exchange. So every time you buy and sell an ETF, you know the exact price that you're getting. And F stands for fund, which means that ETFs are a portfolio of tens, hundreds, or sometimes thousands of stocks or bonds in a portfolio that an investor can buy in a single transaction.

(27:04): Now, four of the main reasons why I think ETFs have been really popular with investors is that they are really, really flexible because the way you buy and sell ETFs is the same way you buy and sell shares. So especially for investors that want to do asset allocation, they want to rebalance their portfolio. Because you're buying and sell ETFs like the way you buy and sell shares, it means you can move money between different asset classes quite easily, which means that portfolio rebalancing can also be quite easy. The second reason is that there's pretty much an ETF that provides exposure to most themed sectors or asset classes. And what that means is that you can express your point of view on a particular area of the market in a single transaction, whether it's hydrogen uranium on the broad Australian stock market, emerging markets, fixed income, and et cetera.

(27:52): Thirdly, I think ETFs in general, in particular the ones that provide exposure to the broad asset classes, they tend to be quite cheap. So an ETF that provide exposure on average to the broad Australian stock market charges a management fee of about 9.7 basis points. So if you have \$100,000 investment, you're only going to be paying \$97 in fees to that fund manager. And I think the fourth and final reason why investors really embrace ETFs is it holds a diversified portfolio investments. And I think by holding a diversified portfolio of investments, it does help reduce risk because you're holding a mix of different investments, meaning that your portfolio isn't totally reliant on one or two investments performing well or poorly.

Jacinta Schlosser (28:37): Thank you so much, Martin. It's been an absolute pleasure to have you as our guest today.

Martin Dinh (28:41): Yeah. Thanks so much, Jacinta.

Jacinta Schlosser (28:43): Look, if anyone would like to hear the full recording of Martin's presentation, please head to the ASX website, so asx.com.au and navigate to the investor's menu. From here, look for investment tools and resources and click on events where you'll find the link to ASX Investor Day. Watch now. Thank you.

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