Lumo

FINANCIAL PLANNING

LUMO FINANCIAL PLANNING

Investment philosophy

How we help you invest your money with confidence — written down, so clients, advisers, staff and partners can all read the same thing.

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Most financial advice is sold. Ours is written down, in your own language — so a plan you understand becomes a life you actually live.

CONTENTS

What is inside

WHERE WE START

Our promise to you

Like any advice practice worth its licence, we hold a core set of investment beliefs. They shape every decision we make on your behalf, and they keep the oversight of your goals focused and disciplined.

Nobody can control short-term market movements, so we spend our attention on the things that are genuinely in your control:

- Understanding how you feel about risk and return, and writing down a detailed risk profile.
- Spreading your investments across a wide range of assets: shares, bonds, property and cash.
- Reducing the cost of investing wherever we can, including through tax-effective strategies.
- Rebalancing back to your target asset allocation, so you stay on track.

We do not follow the markets, the economy, manager ratings or the performance of individual securities. We follow four principles instead, and here is what each one commits us to:

- We will help you set specific, measurable investment goals.
- We will help you build a suitable asset allocation using broadly diversified funds.
- We will help you keep costs down.
- We will help you hold your perspective, and your discipline, over the long term.

These principles sit inside our culture. They guide every investment decision we help you make.

THE FOUR PRINCIPLES

Principles for investment success

Focusing on the things within your control gives clarity to every investment choice. It lets you look past the markets, the manager ratings and the performance of individual securities, and put your attention on the four principles that we believe give you the best chance of success.

01

Goals: create clear, appropriate investment goals

A good goal is measurable and attainable. It should not depend on outsized returns, or on saving and spending you could never keep up. Without a goal, you end up building a portfolio from the bottom up, holding by holding, rather than asking what the portfolio as a whole is for.

02

Balance: build a suitable asset allocation using broadly diversified funds

Diversification is the most powerful tool there is for managing risk. Spreading your money across a range of asset classes protects you from a large loss in any one part of the portfolio.

03

Cost: keep what you pay as low as it can go

Markets are unpredictable. Costs are forever. The lower your costs, the greater your share of an investment's return — and the research suggests lower-cost investments have tended to outperform higher-cost ones.

04

Discipline: hold your perspective for the long term

Investing provokes strong feelings. The temptation to time the market, or to shift your allocation because of something that happened this month, is real. A long-term perspective and a disciplined approach are the defence.

PRINCIPLE ONE

Goals

We believe you should set measurable, attainable investment goals — and then build the plan that reaches them.

Without a plan, most people build a portfolio from the bottom up, paying far more attention to choosing and buying products than to the business of reaching a goal. Each investment gets judged on its own merits. If it looks good, in it goes, often without anyone asking whether it fits.

That is how a portfolio ends up mismatched to its purpose, and how avoidable mistakes creep in: performance chasing, market timing, a holding nobody can quite explain.

So before asset allocation, before investment styles, before fund managers, securities or strategies, we sit down with you and ask one simple question.

What sort of investor are you?

Are you prepared to ride out the ups and downs in search of higher returns? Or would you rather sleep well and give up some return for safer ground? Or, like most of us, are you somewhere in between?

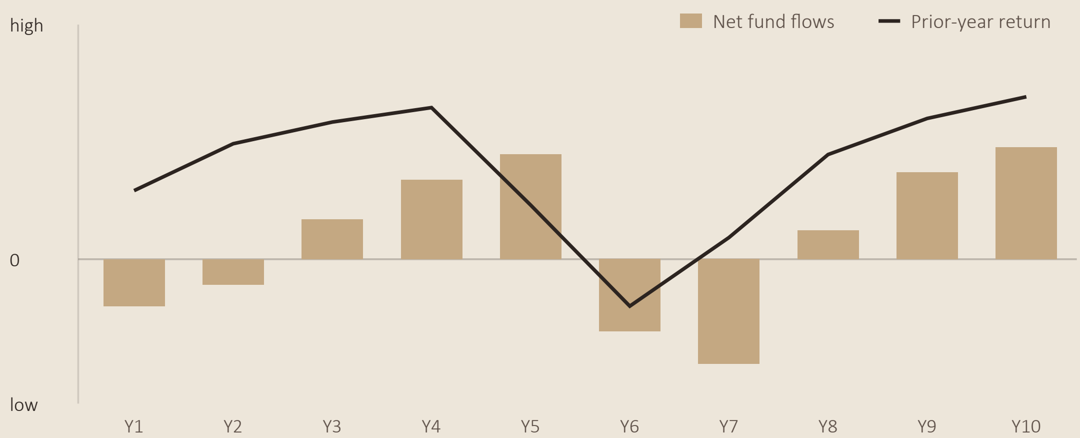
Things change, too. Earlier in life, with more time ahead of you, you may be willing to take on more risk. Closer to retirement, with less time to recover from a setback, safer investments may start to look better. Although it is worth remembering that every investment carries risk — even cash, where the risk is that your money does not keep pace with inflation and cannot deliver the standard of living you want.

Working out your risk profile — how much risk you are prepared to carry for the return you want — is a foundation stone of your strategy. We then use it to spread your investments across asset types, from defensive assets like cash and fixed interest to growth assets like shares and property.

> *If one does not know to which port one is sailing, no wind is favourable.*
>
> Seneca

THE DANGER OF LACKING A PLAN

Money flows into managed funds after the good years, not before them



Illustrative only. The shape of the relationship, not measured data: investors tend to buy in after strong returns and sell out after weak ones, which is the opposite of what a plan would tell them to do.

PRINCIPLE TWO

Balance

How you spread your money across shares, bonds, property and cash is one of the most important decisions you will make as an investor.

Studies have shown that asset allocation drives most long-term investment outcomes. So we believe every successful strategy starts with an allocation suited to what it is for.

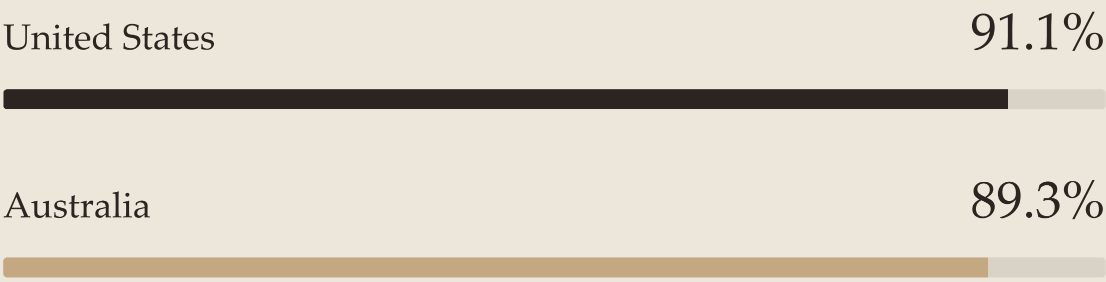
Every investor is different, with their own circumstances and their own goals.

We start by finding out what you are trying to achieve, how long you have to invest, and how much risk you are prepared to carry. Then we allocate your money across the broad asset classes — shares, bonds, property and cash — before going inside each one to choose specific investments.

> *You should have a strategic asset allocation mix that assumes you don't know what the future will hold.*
>
> Ray Dalio

Asset allocation defines your return, and your risk

Research shows that about 90 per cent of the variation in returns is explained by asset allocation. The figure moves a little from country to country: 91.1 per cent in the United States, 89.3 per cent in Australia.



Share of return variation explained by asset allocation. Figures as cited in the source research; chart drawn for illustration.

When it comes to investing, it is hard to make out a pattern. In any given year, any asset class can finish on top, and last year's star can be this year's also-ran. Building a diversified portfolio pays you to take the broader view. Whatever your risk profile — conservative through to high growth — it is worth managing and reducing risk wherever you can.

BALANCE

Diversification: it is hard to pick a winner

Which asset class leads and which lags in any given year follows a pattern close to random. Each column below is one year, ranked best to worst.

Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8
Int. shares	Property	Aus. shares	Bonds	Int. shares	Aus. shares	Cash	Property
Aus. shares	Int. shares	Property	Cash	Aus. shares	Int. shares	Bonds	Aus. shares
Property	Aus. shares	Diversified	Diversified	Diversified	Property	Diversified	Int. shares
Diversified	Diversified	Int. shares	Property	Bonds	Diversified	Aus. shares	Diversified
Bonds	Cash	Bonds	Int. shares	Property	Bonds	Property	Bonds
Cash	Bonds	Cash	Aus. shares	Cash	Cash	Int. shares	Cash

Illustrative only, not measured returns. Note where the diversified portfolio sits: rarely first, never last.

PRINCIPLE THREE

Cost

In most of life, when you are making a big decision about how to spend your money, past performance is a fair guide. Investing is the exception.

Upgrading the family car, choosing a restaurant, picking a suburb: the top-rated ones tend to stay at the top, year in, year out. They also tend to be the most expensive. You pay for what you get. Price equals quality.

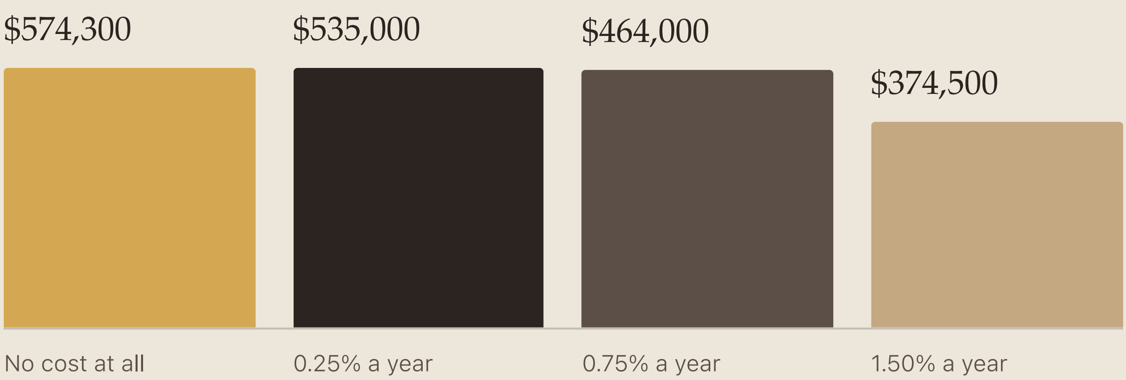
Investing does not work that way. The fund that underperformed last year may top the table next year. In fact the better approach is often the reverse of your well-trained instincts as a consumer.

Far from marking quality, cost is often a barrier to performance. You cannot control the markets, but you can control what you are willing to pay. Every dollar you pay to invest is a dollar less of potential return.

Our experience matches the research: lower-cost investments have historically tended to outperform higher-cost ones over the long term. Low-cost funds take a smaller bite out of your returns, and over time that adds up.

The long-term impact of investment costs on your balance

Starting balance of $100,000, a 6% yearly return, reinvested, over 30 years.



Why buying the market tends to work so well

Index funds charge you less to track the market. Many active funds charge more as they try to pick the best stocks and bonds, and they usually trade more often, which means you pay more tax as well.

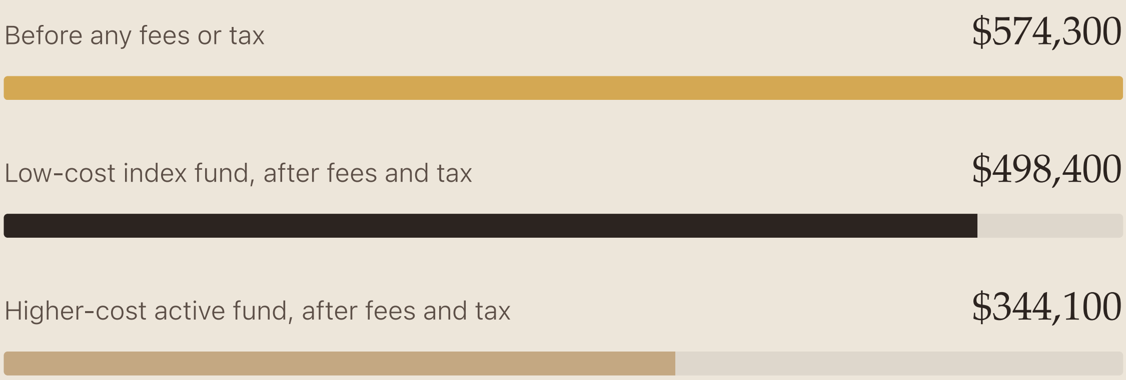
Costs and taxes together mean you end up with a lower net return.

We help you find the best low-cost index and active funds across a wide range of diversified assets.

> *In investing, you get what you don't pay for.*
>
> John C. Bogle

The impact of taxes and fees on your balance

Starting balance of $100,000, a 6% yearly return, reinvested, over 30 years.



Illustrative only. Fee and tax drag assumed at 0.5% a year for the index fund and 1.8% for the active fund; actual costs vary.

PRINCIPLE FOUR

Discipline

Setting your target asset allocation is not enough on its own.

As different asset classes deliver different returns, your portfolio drifts away from its target. We believe in rebalancing back to that target regularly, so the plan we put in place has a chance to work over the long term.

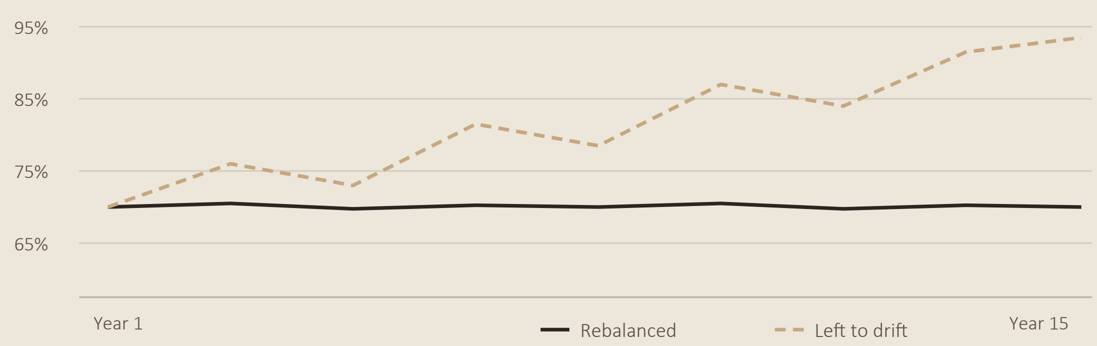
Say Australian shares have a great year. Set and forget, and you will find your portfolio has quietly moved away from its target: more of your money in shares and less in everything else than you intended.

Fast forward a few years, and as markets keep moving, an unattended portfolio ends up overweight in some places and underweight in others, bearing little resemblance to the target you set against your risk profile.

That is why rebalancing matters. It means you are never exposed to risks you did not agree to when you first invested.

Rebalancing controls your exposure to risk

Share of the portfolio held in equities: a rebalanced portfolio against one left to drift. Target 70%.



Illustrative only. The drifting portfolio ends up carrying materially more equity risk than the investor ever agreed to.

> *The stock market serves as the relocation centre at which money is moved from the active to the patient.*
>
> Warren Buffett

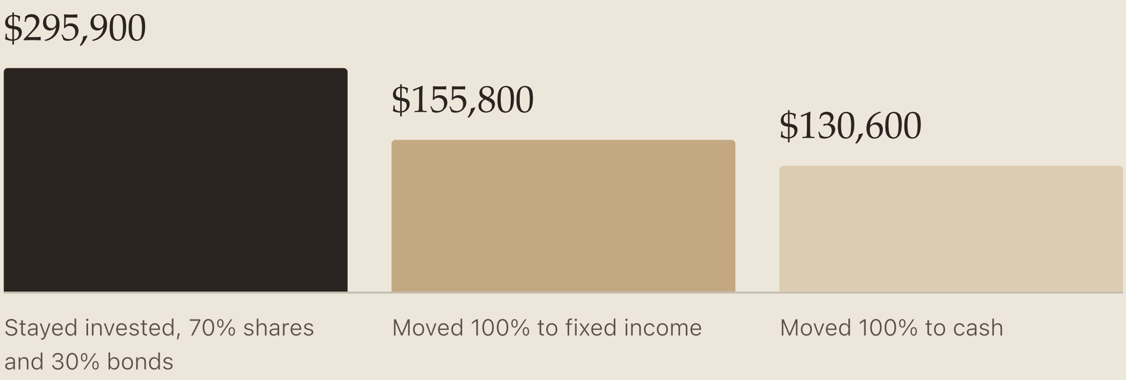
And when you are tempted to change your strategy

Rebalancing also helps you stick to the plan through a severe downturn.

Look at what happened after the global financial crisis. Investors who abandoned their asset allocation for the perceived safety of lower-risk investments missed the recovery that followed.

The importance of maintaining discipline

Growth of $100,000 from 2009, if the drifting investor had fled equities after the 2008 plunge.



Illustrative only, over 15 years. Past performance is not a reliable indicator of future performance.

DISCIPLINE

The worst declines make the best buying opportunities

Investors who stayed in their diversified portfolio got the benefit of the recovery. A portfolio held at 70 per cent shares and 30 per cent bonds delivered a far better outcome than one moved entirely into cash or bonds.

When shares are doing badly, it feels wrong to sell the bonds that are doing well in order to buy more shares. But the worst market declines have led to the best buying opportunities. Not rebalancing through those stretches can put your long-term goals at risk.

Investing stirs up emotions that derail even sophisticated investors. It is easy to make a rash decision when markets are moving. We can help you meet that with discipline and a long view: a systematic approach built on asset allocation and diversification, and then the patience to stay with it.

We also suggest reviewing your portfolio whenever something big happens in your life.

And when your life changes

Just as markets change over time, so does your life. A new job, a new home, a new family — each of them can change how your money should be spread across different types of investment. When your life changes, your asset allocation may need reviewing, and not necessarily rebalancing back to where it started.

Plan for what is difficult while it is easy, do what is great while it is small.

Sun Tzu

DISCLOSURE

Important information

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Charts in this document are illustrative. They are drawn to show the shape of a relationship or the scale of an effect, and are not a record of measured returns.

The Australian Transaction Reports and Analysis Centre (AUSTRAC)

AUSTRAC is an Australian government agency which plays an important role in protecting the reputation of Australia's financial system. The agency is Australia's anti-money laundering and counter-terrorism financing regulator and a specialist financial intelligence unit.

AUSTRAC's purpose is to detect and counter money laundering and the financing of terrorism. It is our obligation to identify our clients, conduct risk assessments, and make reports to AUSTRAC.

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