The Australian Finance Podcast Episode Transcript

Episode: Q&A: Diversified ethical ETFs, portfolio rebalancing & a REIT refresher
Release Date: 15/05/2021
Speakers: Owen Raszkiewicz & Kate Campbell
Duration: 50:23

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Episode transcript:

Owen:
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Owen:
And before you acquire or apply for a financial product, please read the PDS or product disclosure statement, which should be available on the issuer's website. Lastly, please keep in mind that past performance is not indicative of future performance.

Owen:
Kate Campbell, welcome to this episode of The Australian Finance Podcast.

Kate:
It's good to be back, Owen.

Owen:

It is indeed. We are talking Q&A. This month's Q&A, we have lots of questions around investing, some ethical investing stuff, some REIT stuff, REITs if you've heard of them. Lots of interesting questions from the Facebook.

Kate:
Yeah. Some good follow ones as well from our ethical investing episode the other day.

Owen:
This episode, we're going to feature some questions from the community inside Facebook. So if you're not already on that jump in, and it's the easiest way to share questions. We get so many great questions through email at podcast@rask.com.au. So many that we can't keep up. So the easiest thing for you to do is jump in the Facebook group, ask your question, we'll try to pick up on it. And if we don't get to it, others will.

Kate:
Yeah. It's a good way to crowdsource wisdom as well and get tips and suggestions from a whole range of people.

Owen:
Yeah. There's a particular new format to the podcast that I'm hoping to bring in. I don't know if I've won Kate over yet, but I'm hoping to bring it in and the group's going to be play a pivotal role in that, so please jump in there. Okay. Just for disclaimer, we are answering questions, but when we do answer questions, it is strictly and absolutely limited to general financial advice only.

Owen:
We don't have a clue what you ate for breakfast, the name of your dog, your financial situation, or whether you have Vegemite on toast or you put avocado on it as well. But seriously, this is a disclaimer, and if you're confused about any of the answers that we give, you should seek the advice of a licenced and trusted financial professional, who can take into account your needs goals, objectives, because we can't.

Owen:
And as always, if we mentioned ETFs in particular or super or bank accounts, go and read the PDS, it's called a product disclosure statement. It's so much fun. Kate.

Kate:
Lots of pages of legal jargon in there.

Owen:
Yup. However, I reckon you like it?

Kate:
Yeah, I might enjoy it, but I know a lot of people don't like-

Owen:
The mortals amongst us.

Kate:
... reading product disclosure statements and we've also done many episodes on those topics. So if you're brand new to the podcast today, go back and listen to the first 10 episodes of the show and you'll get a good grounding of the basics of personal finance that we'll be talking about.

Owen:
And you did actually do a recent article on how to read a PDS for the Rask Education site, which is good. So you can go check that out if you don't know what you're looking for. Okay. So we did an ethical investing episode recently, we've got the ethical investing course in Rask Education. Not as much uptake as the FIRE course. The FIRE course is super popular, so well done.

Kate:
Who doesn't want to retire early Owen? It's a bit more exciting.

Owen:
Maybe ethical investing has some connotations, I don't know, but it's great to see that quite a few hundred people have already enrolled in the ethical investing course. A lot more have enrolled in the FIRE course, which is fantastic. Just go ahead and enrol in the course, if you want to brush up on any of the basics that we talk about in the first question.

Kate:
Even if you don't want to put yourself into the so-called ethical box, just doing the course is a great prompt to think about the way you invest and the companies you want to invest in and your own values. Because at the end of the day, investing and money is such a personal thing, so it's really good to think more deeply about what you're doing and why you're doing it. It adds to that sleep at night factor that we always talk about.

Kate:
I like being able to go to sleep and not worry about what my investment portfolio is doing in the U.S. or Australia and get up the next morning and live my life without having to check my app every day.

Owen:
Actually, Kate, got to mention this before we get to the first question. Sorry, listeners. I know you want us to get to the questions. But Emma reached out to me on Instagram and said that she loves the devil's advocate episodes. She's in my side of the ring, so we'd love to hear from you if you like a particular format that Kate and I do, the Q&As, just let us know. Send us an email, jump in the Facebook group, send us a message, whatever. Okay. So Kate, first question. Maybe let's do want to read it off?

Kate:
Yeah. Did you want to get stuck into the ethical alternatives to VDHG?

Owen:
Yeah. Sure.

Kate:
Okay. This question's from Angela in our Facebook community and she's keen to do the ethical investing course. She's just applied to a broker and has been considering investing in VDHG, which is Vanguard's High Growth Diversified Fund. I think we mentioned it in our robo-investing the other week, s it's like a one-size-fits-all question. Not question, what am I talking about? One-size-fits-all

Owen:
Investment.

Kate:
... ETF investment that gives you a bit of exposure to Australia and overseas and a bit of everything. But she wanted to know if there is an ethical alternative to that?

Owen:
VDHG is diversified ETF, that means that invest in other ETFs. So you buy one ETF and it gets you exposure to a whole heap. We talked about VDHG quite a bit in the robo advice debate episode. So you can go back and listen to that. Okay. Alternatives to VDHG. VDHG doesn't provide any ethical overlay, it just invests in stocks from Australia and global markets and bonds primarily. Okay. Great work, Angela, on thinking about ethical investing as I guess a way to compliment your investing.

Owen:
One of the questions that we had in the Facebook group was critical/cynical about it costing you money to invest ethically. I think if you do the course, you'll find that it's actually the opposite. Ethical investing, that's just the label that so many people apply to us. That's what we're using for jargon's sake. But ethical investing actually has been proven to make more money for investors.

Owen:
Now that is a critical insight that so many people are missing. It's not about being green, peace, symbols, loving all the hippies, it's actually about just investing better. So if you think about that, why not incorporate it into your process? An alternative to VDHG. I would say an alternative is the DZZF ETF from BetaShares.

Kate:
Yes. That's the BetaShares' Ethical Diversified High Growth ETF, quite a mouthful there.

Owen:
There's the few key phrases in these ETFs, you need to understand. High growth, so that means that it's more in the risky investments like shares versus say bonds, and diversified means that's when you know that they invest in other ETFs. That name, diversified means it doesn't just invest in individual stocks, or individual bonds, or individual like gold. It invests in other things like ETFs. So diversified high growth, you can get diversified, balanced, diversified, conservative, whatever you want.

Owen:
BetaShares are the first one that have come out with a diversified ethical option. There are some limits to these diversified ETFs in the sense that some of them are actually not diversified because they have 100% of the investments in shares. So I can't really just... Personally, I don't think that's diversified. So keep that in mind. So yeah, you can use the DZZF ETF.

Kate:
But I'm Vanguard will launch something like that soon.

Owen:
Oh, they have to.

Kate:
If you just keep your eye out, there'll be other ETF providers are going to jump on this bandwagon as well.

Owen:
To be honest, I'm surprised more ETF providers, haven't done a diversified fund. We know the guys from ETF Securities. I'd love to see if they would do a diversified ETF of their own, Vanguard, maybe incorporate some more ethical stuff. Even BlackRock, SPDR, we need more of these because they're actually such a great product. I just think they're fantastic for beginner investors

Kate:
And it gives consumers more choice, which is great. I know Vanguard have a couple of their own ethically conscious. Are they socially conscious, what they call them.?

Owen:
Yeah. Something like that. Yeah.

Kate:
Like ETFs for Australian shares, international shares and bonds. So you can always build your own portfolio using that kind of thing that Vanguard and other ETF providers have. I guess that's another alternative to VDHG if you want an ethical overlay of sorts.

Owen:
Absolutely, It is, Kate. And so then we have just as an option, we're going to just straight outside of ETFs, Angela. Obviously you've got individual stocks. So we talk about in the ethical course, as you know five different strategies to identify companies that you want to invest in. And I guess, same token, things that you don't want to invest in. But that can come after you build out your core exposure. So we talk about the core being the largest rock in your portfolio, you build that up first and then you can do these satellites that revolve in the side.

Owen:
Another option is obviously there are super funds that do ethical investing, if that's your flavour. Obviously, the differences between super and ETFs in terms of accessing the money. I think Kate, you had a note here about Australian ethical as well.

Kate:
Yeah. I guess another option that I don't think we discussed in the other episode on ethical investing, but there are managed funds that provide ethical investing overlays in their approach. There's a lot of small boutique ones out there that I've come across, but there's also Australian Ethical. So they've got about seven different managed funds that have ethical overlays from international shares to advocacy funds to even, I think, as a bond fixed interest fund.

Kate:
Although some of them quite have quite a small amount of funds under management, which may or may mean they're not as commercially viable that long.

Owen:
But the thing is, as you note in the been a bit of DD that we did here, they do have higher management fees. So I've spoken to the guys at Australian Ethical. One of their funds is quite expensive. I won't name which one of these, but it's actually in my opinion, very expensive, but it's been good enough to justify those fees, but it's very hard to know that in advance. And so my belief is that no one should have to pay extra to have some sort of ethical overlay because it doesn't actually take that much work on the investor's behalf to factor that in.

Owen:
So just be mindful of that. And obviously, Angela, when we're talking about managed funds, those are different to the super funds. Even though they might follow the same strategy from a tax perspective, from an access perspective, those things do influence your decisions. So take all that into account, always read the PDS. And we're just providing some general advice here. So there was actually another question here, Kate that came through and I don't know who asked it.

Owen:
So apologies to whoever did, it's a fantastic question to follow on from that one, "Which is what are the investment risks behind so-called "unethical companies" that are worth considering? The risks associated with unethical companies such as general risk to look out for, regardless of

being anethical investor, et cetera. What if you can't find the right ETF that suits because of the "ethical overlays" don't align with yours?

Kate:
I think they were two different questions, but I've picked up on those lines of questioning from the Facebook group after our episode. But it was more interesting to see. I think ethical investing really makes you think about those long-term risks that can affect a company. And that's what I think when I think about the environmental, social and governance impacts. Is the company doing things that are going to cause damage over the term?

Kate:
Has it got a really undiversified board, so maybe they're not picking up on all the trends and innovation and doing what they can do to stay viable over a long term horizon. That's the things that I would be looking out for just as a normal investor that doesn't know much.

Owen:
That's a really good point. One of the criticisms that I hear of ethical investing, and this comes from people who are supposedly investment experts, they say, "Oh, ethical investing is just high quality investing." Meaning that by investing ethically, you're focusing on sustainable companies, which then means that you're picking higher quality companies to have your portfolio. Yes, that's true, because to your point, you're finding companies that you believe are sustainable. It doesn't necessarily make you an ethical investor, it just means that you're investing in good companies.

Kate:
Yeah. And I guess there's a difference in sustainable there, is like sustainable for the world and the environment, or just sustainable as a company, as in, they're going to be able to sustain operations for a long period of time.

Owen:
Totally. I'd say some of the risks of investing in unethical companies, it's very hard for us to define unethical. That's in the eyes of the beholder, I guess. But I guess some of the things you need to be aware of is that they'll probably face increasing regulation. Alan Kohler, actually... I don't normally mention Alan Kohler. I've got to admit, I'm not the biggest fan of his work. I can say that, it's my opinion, but he actually wrote a really good piece for The New Daily this week.

Owen:
And effectively, one of the things that he said in that, which I'll parrot here is that it's not a debate. This is not political. Climate change is actually a science. People are making it political, it's a real thing. And so if you're investing in companies that are contributing to excess carbon, you've got to ask yourself, when will we make a decision to increase regulation? At the moment, most governments around the world have taken the stance that, let's make it proactive policy to let business decide.

Owen:

Let's create energy, carbon markets, where you can trade credits and whatever to make it, to get them to think in a way that's capitalistic. And yes, that might work, but I think there are no specific risks to all "unethical companies." This is just my view, but you just want to make sure that you're finding sustainable companies and that you factor in the possibility for higher regulation and costs going forward.

Owen:
I try to invest 10 to 20 years out into the future and I find it very hard to believe that we're not going to see increased regulation in regards to like climate change initiatives, carbon emissions or reusability of things. This is a fantastic question you bring up, Kate, but I don't think there's any specific risk. I just think when you go through your business and your investing checklist, just make sure that you've considered it.

Owen:
Considered what could change in the industry, what happens upstream. So when a company creates a widget or product, where do they get their resources from? Who do they need to rely on to get that to then create their own product, to then sell to consumers. If things happen upstream, so if things happen before the company makes those widgets, then the business might fail because of something outside of his control.

Kate:
So looking at the supply chain.

Owen:
Supply chain, exactly. That's the right way to put it. So consider that. In terms of you can't find the right ETF that suits because of the ethical overlay. One of the things that came out of our survey is that you don't have to have everything in your portfolio as ethical or sustainable or whatever. Most people in our survey of investors said that even part of their portfolio is still a great step.

Owen:
So that's the thing, like if you're facing huge tax bills if you sell an ETF, or a stock, or whatever the case might be, it's still good to try and have some of your portfolio invested in a sustainable way.

Kate:
You don't have to do it all at once. It could be you building your portfolio over time to be the representation of what you want the future to be. Like you mentioned that other episode, don't just go cold Turkey and sell everything and just make a complete transformation. That's probably something I'd think about.

Owen:
And one thing I'll just add on here is that, yes, there are very few... We just mentioned, there are very few ethical ETFs you can go to. The best ETS website, we've created a page there of all

the ethical ETFs in Australia. But there are more coming. There will be more coming. Even the ETFs that we have currently, I believe in the next three to five years, will start to put an ethical overlay on those "vanilla ETFs." So you will have more options in time.

Owen:
So you can start with something, and obviously you still have the choice of individual shares. Find companies that you think are doing good or just avoiding doing bad and support them by investing in them, provided they're a good investment. Don't just go and buy something because it's promising, it's greenwashing everything. But those two fantastic questions, there. Go check out the ethical investing course and send us in your questions or ask them in the Facebook group.

Kate:
And I think it's always good to look at the holdings of an ETF because whatever the label says, you might find companies in there that you go, "Hey, this definitely doesn't gel with my view of what things should be, so this is just not the right product for me." And I think they brought up the example of Nestle? Someone in the group.

Owen:
Yeah, that was fantastic.

Kate:
... been in one of the ETFs, and to them that wasn't maybe quite an ethical company. And so that might not have been the right ETF for them. So it's really good to have a look. And even with managed funds and your super fund as well, some of the... I think Future Super definitely gave a list when I had a look of every single individual holding, which is pretty rare for a super fund.

Owen:
Yeah, they did.

Kate:
I think they even listed like the buildings they owned. That was quite transparent disclosure for a super fund.

Owen:
For those of you that are with, say, for example, Australian Super or Hostplus, there are parts of the websites where you can see the underlying holdings. You have to go in... I can't remember the exact user experience, but it's something like investments portfolios, and it's got like daily updates and then you have to dig through to like which strategy you're in. And then you can kind of of see it.

Kate:
Download a holding list of sorts.

Owen:
Yeah.

Kate:
And maybe even ask them-

Kate:
... they might not be something they have on their website, but they might provide it on request.

Owen:
Yeah, that's it. And again, it's probably not going to be perfect because we talked about the differences between ethical and sustainable investing. If ethical investing is more of your personal taste, where sustainable investing is probably like good for the world, and good for the community, and good for the company and stakeholders, et cetera, they're two different things. So you might have to just sacrifice that if you're going into an ETF or you're going into a super fund, that you're trying to invest sustainably and not exactly in line with your ethics.

Owen:
You can do that, you can be direct with your super, but anyway. That's a great question, wonderful. If you want to continue with the conversation, jump into the Facebook group. Next question comes through, and basically it's Joe from Insta?

Kate:
Yes. Instagram DMs. We get a few questions there.

Owen:
It's great. "Hi, Rask team, I have done some of your courses and signed up for the ETF membership. Go, Joe. "The thing I'm not sure about is do we continue to invest in the same ETS for a period of time? Like the five recommended as part of the thematic portfolio for say 12 months? Or is it more about accumulating different shares/ETFs?"

Kate:
I guess it comes back to you getting your portfolio as big as possible, or just keeping it small and concise. I think we've talked about before of how many ETFs is too many ETFs. It can get a bit hard to manage once you've got more than about five or six different ETFs. But I guess with the thematic ETFs coming out, you might have your core portfolio of three or four ETFs, and suddenly you could have a thematic ETF for robotics and a thematic for healthcare, and one for genetics, and all sorts of thematic ETFs. So your portfolio could suddenly start to balloon out quite a lot.

Owen:
Yes. This is a great question, Joe. Joe is obviously a member of our ETF service where we have the different portfolios. We've got four different portfolios, but one of them can kinda be changed

around. And so the way we created the thematic portfolio was... Oh, and by the way, thematic ETF is something that does something not vanilla.

Kate:
You're following a theme, or a trend, or an idea.

Owen:
Yeah, a theme like cloud computing technology, healthcare, whatever.

Kate:
We did an episode on that a while back with Kanish from ETF Securities. That's if you're interested in thematic ETFs, that's a good one.

Owen:
And obviously, these are the ETFs, we believe that they are the highest risk, because they're the ones that even though they might show great chance, they're actually the least proven, and they're probably the ETFs that are most likely to be highly volatile. So lots of ups and downs. Have higher fees. The companies behind them, the ETF providers actually push them really hard because they have more fees to earn if they push them really hard, as opposed to A200 or VAS or insert really boring ETF that really has been around for a while.

Owen:
So yes, you can have as many as you like. Our thematic portfolio was built around trying to capture the best expressions of each of the different themes that we believe were important. So Max, who did the research looked at each of the big things like cloud computing, healthcare, technology, all these different sectors and themes and tried to define what is the best exposure to that theme? We've got a few ETFs in there.

Owen:
I would say that when you're building this portfolio, the thematic portfolio is a higher risk portfolio and it's probably for me like anywhere between a three and seven or three and 10-year view. So be mindful that it is more volatile, slightly high fees, not as long-term as say the core, I'm just going to use an example, VDHG where I would be viewing that as if I'm going to hold that for 20 years. And so keep that in mind when you think about portfolio construction.

Owen:
Okay. I've got some actually interesting things here. This is something that I haven't talked about with our ETF members and I'm actually going to include this in the future is, you could have say five to 10 ETFs. I probably wouldn't want to go too far beyond that just because it gets from the experience, tax-

Kate:
Yeah. You're going to have to find 10 plus different statements and then suddenly they don't all show up on the one page on your CommSec screen. You've got to start scrolling down.

Owen:
Yeah, all of a sudden you have to select more. Okay. I just want to quickly go over this, Kate. I know we're trying to keep one short, but. There are effectively two different types of investments you can make, whether it's a share or whether it's an ETF, or a managed fund or super. You effectively have growth assets, AKA risky assets. And then you have defensive AKA, most should have been income, but in the modern world, they're not income, they're just defensive.

Owen:
So in growth, imagine that bucket with a seedling in it, we've got shares, Australian shares, we've got international shares and we've got most of our thematic ETFs. They would go in that bucket. Now, in the defensive bucket, what I would put in there, every financial planner or whatever is different. In the defensive bucket, I would say we have fixed income, like bond ETFs, gold, that gold ETFs, ETFs that invest in cash, and if you fancy term deposits, property ETFs, REITs, which we're just about to talk about. Those things go in the defensive bucket.

Owen:
So that's like just think of bricks, like really strong foundations of your portfolio, so bricks and seedlings. Now, then we have our long-term strategy. We've got to define what our risk profile is, but I'm just going to say that someone is balanced. Meaning they don't have to retire for at least 10 years, or they're not going to need the money for 10 years. Remember that, 10 years, and they're quite comfortable in their knowledge of investing.

Owen:
So how would that work out? How much would you put in the seedling bucket? How much would you put in the bricks bucket? I would have 60% of my money in the growth seedling buckets. So that's like shares and all that, and I would have 40% in the other bucket. That's what in academic theory, that's what we're taught is a balanced portfolio. Now, in the modern age with lower interest rates, I think it needs to be slightly higher, maybe 70 in growth, 30 in bricks or defensive.

Owen:
And the reason I say that is because most people that listen to this podcast aren't in retirement. If you're in retirement, you'd put more in the defensive bucket. Anyway. Let's say we've got 70/30. Now, what we do with that is we then say, "Okay, how can we build a portfolio out of 70% of this and 30% of that?" ETF is a very easy way to do that. You could do managed funds. I wouldn't include the primary residence or the home in this. That's separate. I would say maybe an investment property would be in maybe in defensive, so keep that in mind, but that's how I'd think about it.

Kate:
As soon as you add your property into these calculations, it'll completely warp it, so it's probably better to do it, excluding that.

Owen:
And I see property as a lifestyle asset if you live in it, whereas if it's an investment, it's an investment. That's what you should be treating it as, after cost, preferably. And I also wouldn't include emergency cash in this. Some people believe that emergency cash is there to invest when the time comes. I don't think it is. I think emergency cash is there literally just for emergencies. So someone like you, Kate or myself, younger people employed, I would say six months of living expenses in cash, and then if you're approaching retirement, two to three years, maybe even more.

Owen:
Two to three years of living expenses in cash. It's shit, I can say that. It is terrible right now because interest rates are really low and it's going to be painful to look at $200,000, if you're a retiree in cash and you think, "Geez, I'm making nothing on that." It could be less soon, so-

Kate:
It's separating that from your investment portfolio. Because if you suddenly add that in, suddenly your portfolio might be swinging a lot more defensive than you're hoping it to be. So taking out all of that.

Owen:
Just keep it simple. Pretty much what's in your stockbroking account and your super fund basically. You might even have a different strategy for your super fund, because that might not be touched for 20 or 30 years. Okay. Now, I just want to go one step deeper and how this all relates to the question. Rebalancing, which is something we don't talk about a lot in the podcast is effectively if you know that your rule is 70% growth and 30% defensive or bricks, there will come times where the growth grows faster than the bricks. And there will come times when the stock market crashes and the growth falls.

Owen:
And what happens at that time is your 70/30 balance or whatever balance you decide is out of whack. By the way, Vanguard in the USA has a free risk profiling tool you can use to determine what might be the right thing for you. You normally have to see a financial planner for that, and that's Vanguards thing, but I'm just letting you know. When it goes out of balance, you have to have a rule set in advance to say, "Okay, my goal is 70/30 for the next 20 years, but it's now at 80/20. I need to fix that up. I need to get that balance right."

Owen:
So then you might consider putting more into a particular bucket, or you might say, "I'm going to sell some of this and put it in there." So how this all ties back to how many ETFs you need? I don't think it's about how many ETFs, how many shares necessarily. As long as you're comfortable in managing that to your point, Kate, that's okay. But the important thing is you know effectively what your risk profile is, which is really, really hard to do in advance, really hard.

Owen:

That's why you need expert advice, unless you are really, really, really confident in what you know, and in your behaviour. The behaviour is the part that people screw up.

Kate:
Most people think they're high risk investors till they're not.

Owen:
That's the famous saying, I'm so glad you said that. We're all high growth investors until the next market crash. Imagine COVID, things were down 30%.

Kate:
Yeah. And a lot of people were freaking out.

Owen:
How many people went to cash?

Kate:
It's quite scary, and how many people are still in cash in their super fund now after changing it last March.

Owen:
Just even the Australian market's up 30%. It's crazy. That's why you need to think about these things now. This is what we call an investment policy statement, IPS. You would set the rules in advance. In the ethical course, we talked about, in a download, we had, "Select the boxes that matter to you like child exploitation, pornography," whatever. I don't want those in my portfolio. You can do the same thing with your investment strategy overall.

Owen:
So you might say, "I want no more than 10 ETFs in my portfolio. I don't want sin stocks in my portfolio. I'm going to keep 6 months worth of living expenses. I'm not going to touch my money for X amount of years. If my balance is out by 10%, I rebalance." So not when, not every six months, but that happens. Does that make sense? You're not timing it, you're just saying, "This is the rule if it goes out of balance, then I rebalance it." Regardless of what the market's doing.

Kate:
But you don't want to do that rebalancing too often or you going to incur tax events and additional fees.

Owen:
That was one of the questions that we had in the Rask invest live stream the other day. The question was, "The VDHG is constantly rebalancing or like regularly rebalancing. Does that create tax events?" And yeah, it probably does, but that's a fair question to ask. So yeah, I would say like, you could reassess it. If you haven't rebalanced, at least reassess your portfolio

every six months. You probably don't want to do it more than that, because then you create a lot of tax and all that sort of stuff.

Kate:
Or you might see there might be a specific market event that makes it more sensible to rebalance say, or your rebalance wasn't for a couple of months, but hey, the market's fallen 20%. Oh, it might be a good time to add additional funds to a certain portion of your portfolio. And I think writing down these rules of what you're going to do with your portfolio makes it a lot easier to stay calm in high stress situations. Having it written down like, "This is my emergency fund, I'm keeping it in this account and I'm not going to touch it."

Kate:
All of the things that Owen mentioned, having that written down is very helpful and sticking to your plan. I have my financial plan and goals for the year even just written down on a piece of paper, pen and paper. I do it in January and I stick it on a pin board, and then I see how I'm tracking each month towards my goals. And that makes it really visible for me. Instead of just having some Google Doc, I've actually got it in front of me so I can review it on a regular basis.

Owen:
That's why it's so fantastic to go see a financial planner. Not only are they experts and can answer your little questions, but they actually write the document out for you. That's their job. So you can either choose to go see a financial planner or you can attempt to do it yourself by educating yourself and doing that. I probably haven't done it enough in terms of my personal portfolio structure.

Owen:
As you know, I'm not the type of person that sits down with my personal net wealth. I think from one day to the next full disclosure, most of my personal wealth is tied to our business, the Rask business.

Kate:
So it's very liquid.

Owen:
It's very liquid. It's going up and down every day, depending on my mood. But I think that this is one of the easiest steps people can do. This is called an IPS, you can Google it, or you could literally just get a piece of paper and write the five rules for your investing overall. You don't have to have goals, they're just rules like, "I'm going to rebalance this. This is how much I'm going to put in ETFs. This is how much I'm going to do that," and just stick to it.

Owen:
Last thing on this before we get to the final question, the single best time to rebalance is around a market crash, which is exactly the time when people don't want to rebalance.

Kate:
Because they might be losing their jobs, they're freaking out.

Owen:
They're scared.

Kate:
In March last year, there was a lot going on apart from the market crashing, so a lot of people, even myself, I just cancelled my trip, I'd been made redundant. It wasn't really the time for me to make big investments. Even though theoretically, it was a great time to invest and buy stocks when now 30% down, it just wasn't the right time in my life. So everything might sort of seem good in theory, but a lot of these times when the market crashes do happen is not the right time.

Owen:
That's why you need these rules, so it tells you, this is what past Kate said to me to do. And if you just think about that, in that COVID crash is what I'm calling it, stocks fell 30%. So your balance from 70/30, I haven't done the math, but it might've become like 50/50 if that was the case because the defensive ones wouldn't have fallen as far. And so it might've gone to 50/50.

Owen:
Then imagine if you took the 20% and you pushed it back in the stocks, and then it went up 30%. All of a sudden that single change, you didn't time the market, you just thought, oh, my portfolio is out of balance, I'll rebalance it. All of a sudden, that is now 30% greater than it would have been if it was stuck in those defensive assets or worse if it was in cash. And that is an example of just setting those rules and events.

Owen:
And so this is the thing, guys, if you actually have the rules, you're more likely to make a good choice. And when you have a plan in a crisis, you're more likely to feel more comfortable. So there's a behaviour

Kate:
You've got to act like your own robo-advisor. They just will rebalance when funds are added, rain, hail or shine. They don't care about what the market's doing, what your emotions are doing. So you've got to become your own robo-advisor for setting your rules out.

Owen:
That's it. So I did a podcast with financial planners Jamie Nemtsas and Drew Meredith, who work in our office. You can check that out on the Australian Investors Podcast. It was published in April, I believe. "What are REITs and how do they work?" Great question from Luke in the Facebook community. Kate, what does REIT stand for?

Kate:

Real Estate Investment Trusts and I don't know if we've talked about them since our beginning 10 episodes of the podcast.

Owen:
The very first 10 or 11 episodes are that first episodes everyone should listen to because they're the foundational episodes.

Kate:
It's been awhile.

Owen:
It's been a long time between REITs.

Kate:
I haven't even thought about them much actually.

Owen:
Yeah. REITs. REITs invest in property-

Kate:
and infrastructure.

Owen:
... and infrastructure, yes. Think about not your house, but think about big buildings in Melbourne, Sydney, Perth, Adelaide, Brisbane, wherever you are. Think about big buildings.

Kate:
Just like walking down Collins Street in Melbourne, looking at -

Owen:
... Sydney, wherever you are.

Kate:
... all of those buildings and going, "Hey, someone actually owns them. It might be a real estate investment trust. It might be a Australian billionaire." It could be your Superfund, Super funds own a lot of these buildings as well. But someone with a lot of money has to own these. And sometimes real estate investment trusts are the way you can get exposure to these massive buildings, to warehouses that are probably not in the city, but a bit further out.

Kate:
You'll see, massive warehouses, maybe student accommodation. They're in a whole heap of different, large property infrastructure.

Owen:

Totally. And so the easiest way to explain what a real estate investment trust is, is to give you an example. So BWP Trust, I believe Barefoot talked about this in his book. BWP Trust is one of the biggest REITs on the ASX the Australian Stock market. By the way, you just buy REITs like you would any other shares in your brokerage go. So BWP Trust owns 75 commercial properties. So commercial properties are many big like warehouses or whatever. They're all around Australia.

Owen:
Most of those, not all of them, but most of those properties have a Bunnings Warehouse on them. You know Bunnings big green shed with some red writing on it.

Kate:
Our favourite store during COVID.

Owen:
Yes, you have to get the card to get in. So BWP Trust was owned by Wesfarmers, which is the same company that owns Bunnings. But in 1998, Wesfarmers said, "We have this beautiful business," which has Bunnings, "but we also own all the land," the property "that we have to put on our balance sheet. And we have debt that's on the balance sheet as well. Why don't we just wrap those things up?

Owen:
So we've got the property and we've got the mortgage, just like your house and your mortgage and we'll just put that in a separate company? And people that want to invest in that company can go and buy that." The other difference is, it's not a company, it's called a trust and which I'll get to in just a minute. So in 1998, and I've got a funky photo of people wearing some weird jeans from 1998. In 1998, the company was separated from the trust, which was BWP.

Owen:
And so in this case, some of the debt was taken over to BWP and what happens is, Bunnings pays rent to BWP who owns the properties. So BWP is like the landlord and Bunnings is like the tenant. But Bunnings is obviously a really good tenant. They're not going to be late on their rent. They're a really good business. So these are long-term leases. And so, that happens. And today, BWP has grown as Bunnings has grown and they've taken over more of the properties.

Owen:
BWP now earns $154 million a year in rent. So these are big businesses, so they're not just like a new investment property you had around the corner. A bigger example of a REIT is a company called Scentre Group. Scentre spelled S-C-E-N-T-R-E.

Kate:
And if you've looked at the holdings of your ASX 200 ETF or your super fund, you've probably seen that name pop up.

Owen:
Yep. Scentre Group is the name for the owner of the Westfield Shopping Centres in Australia. So all of those properties owned by the Scentre Group. So this is far bigger than BWP because these properties are worth a lot. Now, the thing is, when you invest in one of these things, it's not a company, it's a trust. So you're typically getting a unit, that's what you might see on your brokerage account or a stapled security, which is a combination of units, if you like.

Owen:
So you're getting these things called units and they effectively, you get an ownership interest, or a beneficial interest in all the rent that's created inside that as well as the growth of the properties over time. Coming to the end of this, Kate, but the thing that people often know about REITs is there's something called NTA, which is stands for net tangible assets. Or if you just want to think about the value of the properties less the debt.

Owen:
Scentre Group, BWP have billions of dollars of property, So what they do is they break it down. They say, "We have billions of dollars of property, but we also have millions of shares. So what we'll do is we'll divide the value of our properties by how many shares we have and so you can understand what is the property value per share." That's what NTA is. So most people use that, the NTA because it compares the share price that you see on your brokerage account against the value of the properties. So they'd go price to NTA.

Owen:
And investors then just determine, if the properties are worth this much and I'm buying the shares for this much, then that means that under or overvalued. That's pretty much why that happens, but it's not always the case. You don't go up to a property in the street and go, "I can buy that for 700,000, but I think it's worth 600, so it's overvalued. I'm not going to do that." You don't really think that way, but yet we try and make it easy for people in investing. So that's a primer. Any question?

Kate:
I think that confused me a little bit.

Owen:
Okay.

Kate:
Are you saying they're more like exchange traded funds where the unit price is based on the value of the holdings or they're more like listed investment companies where the price you pay is based on what everyone else wants to pay?

Owen:
Okay. I would say they're more like listed investment companies. This is where we're going to be geeky, ladies and gentlemen. When you invest in an ETF, this is the beauty of ETFs. It's almost

always at NTA. What I mean by that is the share price is almost always in line with the value of whatever's inside it. Okay?

Kate:
So you're getting what you pay for.

Owen:
Yeah. But with LICs, L-I-C, which you probably see, it can go all over the place.

Kate:
And they can trade at a premium or a discount to what it's actually worth.

Owen:
To NTA, exactly.

Kate:
And that often depends on how hot that LIC is at the moment, because maybe the fund manager just did a big road show.

Owen:
Yeah. How hot that LIC is. Don't repeat that outside of investing, that phrase. Okay. LICs have a portfolio that's managed by a fund manager and you can buy and sell the shares in that LIC. In the same way with a real estate investment trust, you can do the same. Someone is managing the trust, someone is managing the properties that BWP holds. Someone is managing the Westfield Shopping Centres. But you can get an ownership interest in the properties.

Owen:
So what can happen is typically, I believe a REIT needs to be independently valued by an expert property valuer every year. I think at least every year. Meaning that an expert from some consulting company goes out and says, "Kate, I think your property is worth this much." And then you, because you're the REIT, you then go to your shareholders and you say, "This is how much our property is worth." And then that's the NTA for the year.

Owen:
But then they also do reevaluations, internal reevaluation. So the directors will get an expert inside their business to go and value the properties and they'll say, "This is how much the rent is. These are how long our leases are for. This is our occupancy rate, so this is the valuation." Now, we can get really geeky, but if you want to go further down this rabbit hole, go and Google something called the capitalization REIT, which is effectively just is how they can determine the valuations.

Owen:

So it's more like a LIC, but it's similar to the ETF in terms of when you buy it, you're not just getting a share in a business, you're actually getting properties in this case. So I think the next question should be how to use them?

Kate:
Yeah. Would they be part of your diversified portfolio?

Owen:
I don't own any REITs. I might do through my ETFs. Some of my ETFs, which own-

Kate:
You've probably got exposure to this kind of stuff for your super fund already. Most of the large super funds own plenty of infrastructure around Australia and overseas.

Owen:
Infrastructure is just a fancy word for buildings.

Kate:
Big buildings.

Owen:
Or like roads. That's pretty what it means.

Kate:
I was looking at, I think one of the large super funds, all of their holdings recently and they owned a heap in central London of all sorts of buildings and office blocks. So I was like, "Oh, that's pretty sweet."

Owen:
I could go on for all day about this, but one of the things that really gives me the irrits about that is some of the big super funds own the buildings outright. So they just completely own them, there's no other investors. So then they can just, and I probably can't say this, they pretty much just make up what it's worth. These are called unlisted assets, meaning they're not on the stock exchange, so you can't see the price bouncing up and down because they're not listed and traded every day.

Owen:
Anyway. A whole another thing, what would you use REITs for? Income generation is the number one thing that people use REITs for. They buy REITs because the REITs are required to pay out a certain amount of their earnings every year to maintain their trust status. So to be a trust, you have to pay the income. It's like if you have a family trust, someone has to pay tax, someone has to be responsible for that money.

Kate:

You have to pay the income to the beneficiaries.

Owen:
Yeah, that's it. So it's the same with a REIT, you've got to pay that out. That's why you get the big juicy dividends from REITS.

Kate:
Yeah. And they'll advertise, even just looking at BWP Trust's website, they'll put it right on the front page, what is their dividends and things, their distributions.

Owen:
That's another word that Kate just introduced there, which is important is distributions is basically the same as dividends. It just comes from a different entity. So basically the same thing.

Kate:
They even write dividends/distribution on their websites, so they cover all bases there.

Owen:
So you know. Okay. So income generation is a big reason people buy them. So you can also buy them for long-term growth. When BWP listed, oh God, I had the numbers in front of me. I think I've got the prospectus right here, Kate. Okay. Here we go. When BWP listed, and this is from 1998, it listed at $1 per unit.

Kate:
And now it's $4.10

Owen:
$4.10, and they paid out a truckload of dividends/distributions.

Kate:
Most of it is getting paid out in income.

Owen:
Yep. One of the big reasons that it has is because at the time, I think BWP had less than $200 million of property. There we go, $170 million of the value of its properties. But today, the value of its property is a 2.5 billion.

Kate:
That's quite a few.

Owen:
Well more than 10 times the amount. That's the growth that you get, but

Kate:
241 hectares.

Owen:
There you go. But the thing is, it pays out dividends, so that's money that's coming from rent, so it has to sustain that. And then it also has to keep enough money in the bank or use debt to buy more properties to grow. And it has to rely on the value of the properties going up, which as we all know, since the '90s property in Australia has been a one way ticket. Not saying that that can continue.

Kate:
And that's similar to if you were a landlord, you'd be hoping for capital growth on the property, but you'd also be hoping to get a tenant in and get some rental income. And that's why like retirees love having an investment property in their back pocket because it'll be hopefully paid off by that time and they'll just have a consistent rent check coming in.

Owen:
Yep, totally. The other difference between a REIT and an investment property is there's typically a lot of properties in the REIT. A company manages the REIT and typically earns a fee and-

Kate:
You've got a bit of diversification.

Owen:
Yeah. And that's why the super funds own them, that's why... You know when we talked about the risky buckets before, typically these investments are held in the defensive bucket, but only a small bit, not all of it. And I say typically, it depends. Some experts believe that REITs they're actually riskier than they are. Others believe they actually good. If you were to ask someone in 2007, what the greatest investment on the planet was, it probably was a REIT. But fast forward to now, and people know that the heap of them went broke.

Kate:
And if suddenly a lot of people want out, you can't move these off your books, these massive property-

Owen:
Very hard.

Kate:
... these warehouses. They're hard to move off your books quickly. Especially, if you're in a market where people aren't wanting to buy big buildings, it might be very hard to take them off your books at a fair price, which often means they get left to last.

Owen:

And I imagine that in Melbourne or Sydney in particular right now, I imagine there'll be a fair few REITs that are feeling the pain.

Kate:
Yeah, because there was all these rent pauses and rent reductions last year, companies just-

Owen:
No students.

Kate:
... stopped paying their lease.

Owen:
Okay. So what can you look for in REIT? I just say, I look at the price relative to the NTA, which is the value of the properties, look at the debt levels. So you can look at the debt levels, when I say like, what does that mean? I look at the debt levels? Basically to see how much a debt it has. When I was in a former life, when I was an analyst, we looked at companies and we liked to see rates with less than, I think it was 30% debt against the value of their properties, but some of them were a bit higher than that, some of them were a bit lower.

Owen:
The thing is, if you start pushing the debt levels really high as a REIT really high, it doesn't take long for that to come back and bite you. So ideally, I'd say less than 50% debt levels is what I guess, is a general rule, but the less, the better. The less debt, the better. The next thing I should say before I stuff up my English too much is, the management team. I would say if I'm looking for a REIT, check out who's on the board of directors. I'd want the management team to have a few battle scars to live through 2007, 2008.

Kate:
And would you also be looking for occupancy rate and maybe the tenants?

Owen:
Yes, good point.

Kate:
If they're good quality tenants or they've got a company occuping most of the stores or whatever that you think, "Hey, that company's probably going to go bust in the next year or two. They might be struggling to find a tenant for a while."

Owen:
That's a good point. Kate, really good point. That's why I brought up Bunnings. Bunnings' the best example. If people know what Bunnings is.

Kate:

If Bunnings goes under, they're going to have a lot of empty buildings.

Owen:
Just think of Masters when they went broke. Masters had those giant warehouses and I've seen some Coles, pet stores and plus about 50 other businesses fit into them now. But many of them... not many of them, but some of them would still be there empty.

Kate:
Yeah. It can take years to fill them or repurpose them. If they're very specific store or company in them or a factory, it can take a long time to refurbish and refit it to fit a new company.

Owen:
Yep. So you'd look at occupancy REIT. BWP has an occupancy REIT of 97%, which is really good. Naturally, because a lot of its tenants are Bunnings. I believe it's got some Harvey Normans that rent. The NTA, look at how it's valued, so that will be written in the company's annual report or the REITs annual report. You can find out how often they get it valued and what the value will say. You can even go to the websites just to find out what's actually inside the REIT.

Owen:
You can go to the website like BWP and Scentre Group, both do this. You can use a map, they have a map of where their properties are, so you can see them, go down to visit them, et cetera. Just get a feel for them, get comfortable with it. You can go check them out and obviously read the annual report.

Owen:
REITs for potential diversification, Kate asked me in the show notes. Do whatever you want really, but personally, I'm not in that income generating phase of my investment cycle, my lifecycle, but I know plenty of investors that would include some REITs in their portfolio. And it's okay to have some, but just remember that REITs are linked to property. If your career is linked to property, meaning your job, your income is linked to property, your super's with a property focused super fund, and you have investment properties or your primary residence.

Owen:
That's a lot of exposure to property already, so factor all of that in. And remember, I'd probably put this in a defensive bucket, but if it's a really out there REIT like a small one, maybe it goes into the more, the growth focused side of things because it's a bit more risky. It's really horses for courses, I wouldn't use them for big part of my portfolio, but that's just me.

Kate:
And I believe I've got some property and infrastructure exposure through my robo-advisors, so-

Owen:
There you go.

Kate:
... they've put it as part of that diversified portfolio, a smaller portion, but it's just part of that overall portfolio.

Owen:
Do you know if they have that like the risky side of their bucket? Did they mention... Do you remember why they put that in there? You don't have to know.

Kate:
It's probably more on the growth side because there is some global infrastructure as well.

Owen:
So infrastructure can be a bit of a different one, even though is pretty much the same. Sometimes I can treat that differently as well, so this is one that sits on the fence for some people or some people say it's growth, some people say it's defensive. The reason why I say it's not really a growth asset, but it has the risk of a growth asset is because a lot of the growth that we've seen from properties and infrastructure over the past 20 years has come from falling interest rates. And interest rates are near zero, below zero in some countries.

Owen:
So I don't know how much of that benefit is left. I think Bunnings' still going to pay rent, but I just say, just be mindful with REITs. You can use ETFs to invest in similar type products as well, but REITs, they've been here for a very long time, a very interesting conversation. If you have any comments on REITs, I'm sure there are some property experts and values in our group. Please jump into the Facebook group. We'll put a link in the show notes and you can continue the conversation.

Kate:
If the demand's there, we can get an expert on to talk in more detail.

Owen:
I know a couple of really experienced REIT analysts, so if you want I can get them on the show. But it's an interesting conversation. Obviously, it comes back to the old property versus shares in a way, so it's probably a bit political, a bit hot. Maybe not a hot LIC, Kate, but it's pretty close to it. And in case you're wondering what the coffee was that I was drinking so rudely at the beginning of the show, Dukes, Dukes Coffee Roasters in Melbourne on Flinders Lane, just near Flinders.

Kate:
Soy milk again, Owen.

Owen:
Soy milk. Yeah. I love it. If you've got that yet. Kate went to-

Kate:
It's Vacation. It's on Flinders Street, I believe-

Owen:
Yeah, Flinders Street.

Kate:
... in Melbourne.

Owen:
Yep. Next to the IGA. Both really good Coffees. I was reading, I think it's like an urban list, both of these coffee shops ranked in the top 10 in Melbourne, so check them out.

Kate:
How boujee.

Owen:
Yes.

Kate:
There we go.

Owen:
Yes. We're very fun coffee drinkers.

Owen:
Kate, wonderful to have you on the show. We've got an Australia Investors Podcast episode that could be of interest to you if you're looking at portfolio construction, we'll put a link in the show notes. We've obviously got the courses, the FIRE course, which is Kate's brilliant work. The ethical investing course, which is reasonable work on my end. Not nearly as popular. Damn it.

Kate:
Wow. You'll get there one day Owen.

Owen:
I'll catch up. Wonderful. Kate, as always, thanks for joining me on this episode of The Australian Finance Podcast.

Kate:
Thanks for listening everyone.

Kate:

Thanks for tuning in to this episode of The Australian Finance Podcast, where our mission is to improve the financial futures of all Australians. If you'd like to learn more, create a free account at rask.com.au/account to download free episode workbooks, bonus resources and take our amazing free personal financial courses.

Owen:
You can also join our online community by following the link in the description. If you enjoyed the show, what we'd love is for you to leave us a snap, your review on iTunes. And you can follow us on Twitter and Instagram at @RaskAustralia. Kate and I are also on both of those channels.

Owen:
Finally, if you have any feedback, suggestions for episodes or guests to come on the show, or you just have a question for us, shoot us an email at podcast@rask.com.au