Successful investing a matter of approach

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Portfolios

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Rich people have a very different approach to handing their money compared with the average investor. Obviously, the wealthy have more money at their disposal, but experts say it's the attitude affluent people have to their money that sets them apart from people of more modest means.

For instance, Yak Yong Quek, director and co-founder of boutique Australian equities manager Prime Value Asset Management, says wealthy investors tend to employ more concentrated investment strategies.

"By concentrated, I mean they will stick with certain asset classes. HNW [high net worth] investors may like equities, yet only be comfortable with the local market. They may avoid international equities altogether, which differs from the classic approach to diversification, which suggests [your investments] must be spread across all asset classes," he says.

Quek says wealthy people will still have a diversified portfolio, but not in the classic sense. So they won't have 20 per cent of their assets in cash, 30 per cent in equities, 30 per cent in property and 20 per cent in - international investments.

"HNW people tend to reject this kind of diversification by numbers approach. They see it as a distraction. Their strategy is about sticking with what they understand, which makes it easier to measure the performance of their investments and to choose investment managers," he adds.

Quek says the wealthy will place their money with a select group of asset managers, rather than spread their wealth among dozens of managers.

Managers with specialist expertise

"They look for managers with specialist expertise in an asset class. If HNW investors have an interest in small caps, they will allocate heavily to one small cap manager. If they understand private equity they will invest substantially in a private equity manager. Many HNW investors have grown their wealth from one or two businesses, so they are used to putting a high stake in a single venture."

But he says wealthy people don't invest all their capital. "They are not afraid to take a more defensive position, even if it's contrary to the market.

For example, when the market is hot they often do the opposite of many investors and carry more cash. They're not concerned with missing the market top if they think the risks have increased or the valuations are stretched.

Another difference between wealthy and average investors, says Alex McNab, investment director with Blue Sky Alternative Investments, is the rich take a portfolio approach, rather than focusing on individual holdings.

'They tend to look at how an investment will contribute to the portfolio's total return, volatility and liquidity, and what it means for overall correlation within the portfolio and its cash flow profile," McNab says.

Correlation is a concept whereby investors look for investments whose returns are unrelated. For instance, when the sharemarket is performing well, generally returns from cash and fixed interest investments will be lower. This diversification helps spread risk across the portfolio.

McNab says affluent investors also take a different approach to liquidity compared to other investors. An investment with high liquidity means that it can more easily be sold, whereas an investment with lower liquidity will be more difficult to exit.

Not a question of liquidity

"Retail investors think liquidity is good and illiquidity is bad. High-net-worth investors have a greater appreciation of liquidity and are more comfortable investing in illiquid assets.They understand they don't need liquidity across the entire portfolio and that the price paid for higher liquidity is lower returns."

Of course, thanks to the volume of money at their disposal, wealthy people have access to investment opportunities that are out of reach of mum and dad investors. For example, theyThe wealthy may take an interest in wholesale investment opportunities usually only open to professional investors such as investment

banks.

Nathan Lear is a director and private client adviser at Hewison Private Wealth, an independent private wealth firm. He says wholesale investments often have lower management fees than retail investments, as there's no requirement to issue a product disclosure statement .

"Wholesale managed funds are designed to cater for HNW investors with significantly higher minimum investment amounts, typically in excess of $50,000 per investment.

In contrast, the minimum investment amount on retail investments can be as low as $1000," he says.

Lear says the wealthy are more inclined to invest in commercial property where rental agreements are generally for five years or more, compared with 12 months for residential leases. Average yields for commercial property are higher than those for residential properties, Lear says. An office property might generate yields of between 6.5 per cent and 8 per cent, whereas industrial properties can produce yields of between 8 per cent and 10 per cent, compared with 3 per cent to 4 per cent a residential property might yield.

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