# Your future, your super

This year, the Australian Prudential Regulation Authority (APRA) passed new superannuation legislation in Parliament called "Your Future, Your Super (YFYS)." The primary focus of this regulatory framework is fund underperformance, accountability, and reduce 'zombie' accounts (unintended multiple superannuation accounts when employees change jobs). This paper discusses underperformance and presents ideas to mitigate these risks in a global shares portfolio.

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As a part of the new legislation, APRA will conduct an annual performance test each financial year on either a superannuation's MySuper product or a trustee-directed product. If a product doesn't pass the test, the superannuation fund must inform their members about that failure. Because of this, superannuation products that fall short of the annual performance test for two consecutive years are prohibited from accepting new members.

This puts superannuation plans in a precarious position. Superannuation plans that believe in active equity management in their global shares portfolios may be forced to move money into passive funds in order to avoid the risk of failing this new annual performance test. Although passive investing is a possible solution, it's not the only one.

As superannuation plans review their overseas shares portfolios and evaluate the potential risks of underperformance, active currency risk must be considered; there will most likely be active currency positions relative to the underlying benchmark (index)—usually the MSCI World ex Australia—in an actively-managed global shares portfolio. The currency exposure from an active equity manager's portfolio is typically a byproduct of their underlying holdings and not an intended currency bet. As a result, the expected return from the currency exposure in these portfolios is typically zero.

The currency under and overweights, relative to the underlying benchmark, could be immaterial in some cases and material in other cases. These under and overweights must be managed, because they introduce risk with no expected return. One solution is an overlay to neutralise the currency exposures back to benchmark (i.e., benchmark neutralisation).

To demonstrate the impact of unintended currency exposure, Mesirow Currency Management evaluated the currency exposure and risk of two active equity portfolios relative to the MSCI World Ex Australia where the US Dollar weight is approximately 69%.

Due to these significant changes from YFYS, superannuation plans need to carefully assess their investments to ensure their MySuper product doesn't underperform its benchmark.

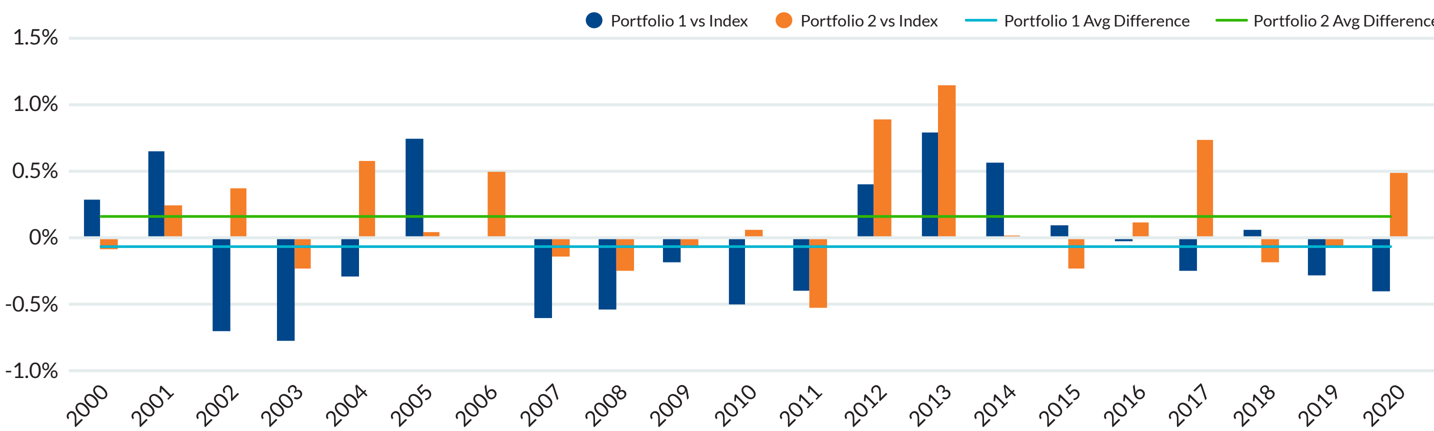
Portfolio 1 had an overweight to the US Dollar at approximately 72% and underweighted in several other currencies. Portfolio 2 had an underweight to the US Dollar at approximately 64% and overweights in many of the remaining currencies.

From January 2000 to July 2021, the annualised standard deviation of the difference between the currency return in portfolio 1 and portfolio 2, relative to the currency return of the benchmark was 43bps and 67bps, respectively. YFYS permits superannuation plans to underperform by at most 50bps; thus, the risk assumed by not hedging the active currency risk to benchmark is significant.

In figure 1, we illustrate the annual differences in the currency returns of portfolio 1 and portfolio 2 relative to the benchmark. The annual differences ranged from approximately zero to over 100bps. The average annual deviation of portfolio 1 and portfolio 2 was -7bps and +16bps, respectively.

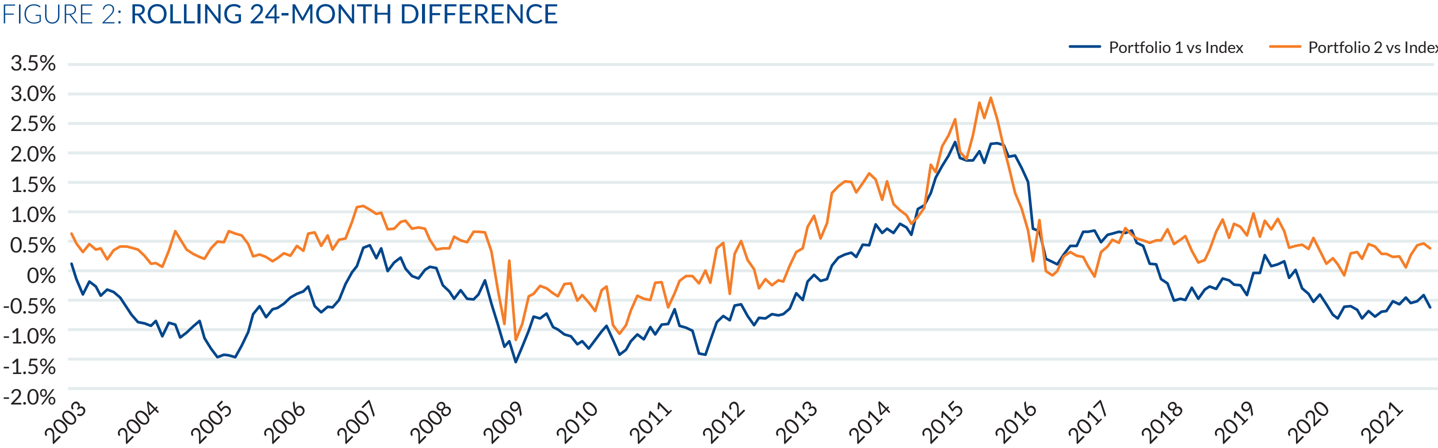
Because a Superannuation MySuper product that is *underachieving* two years in a row will be labeled as underperforming; figure 2 presents the rolling 24-month currency returns of these two portfolios relative to the benchmark. The rolling 24-month differences ranged from -150bps to over +250bps, which illustrates that the currency impact from an active equity portfolio over 24 months can be quite substantial. While there are periods of outperformance, there is also uncertainty and risk introduced from this exposure.

FIGURE 1: **ANNUAL DIFFERENCES IN CURRENCY RETURNS RELATIVE TO THE BENCHMARK**



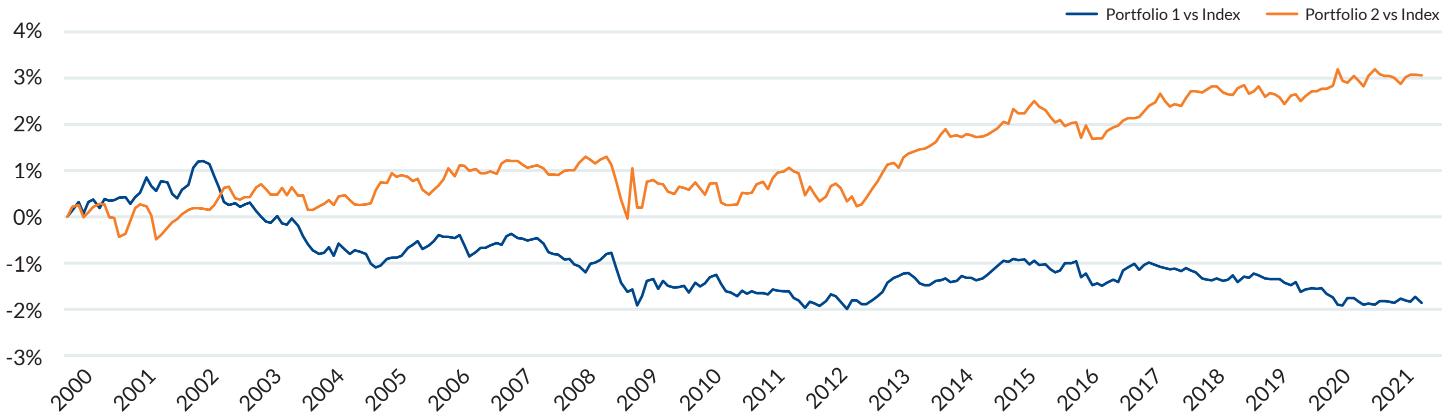

Source: Mesirow & Bloomberg Past performance is not necessarily indicative of future results; actual outcomes may materially differ.

FIGURE 2: **ROLLING 24-MONTH DIFFERENCE**




Source: Mesirow & Bloomberg Past performance is not necessarily indicative of future results; actual outcomes may materially differ.

FIGURE 3: **CUMULATIVE DIFFERENCE**




Source: Mesirow & Bloomberg Past performance is not necessarily indicative of future results; actual outcomes may materially differ.

We've discussed the performance impact that could result over a 12-month period and a rolling 24-month period. In figure 3, we illustrate the cumulative difference in performance of portfolio 1 and portfolio 2 relative to the benchmark currency exposure. The active currency exposure in portfolio 2 contributed to a cumulative outperformance compared to the benchmark of approximately 3%, whereas the cumulative active currency exposure from portfolio 1, underperformed the benchmark by approximately 2%. Over a 20-year period, these values may not appear material, however, the peaks and valleys from active currency risk can be significant over shorter periods. When APRA is assessing annual performance and there is no expected long-term return from the active currency risk, a superannuation fund wouldn't want to be on the wrong side of the benchmark.

## Summary

Due to these significant changes from YSYF, superannuation plans need to carefully assess their investments to ensure their MySuper product doesn't underperform its benchmark. As a result, active risk needs to be managed prudently, especially active currency risk in a global shares portfolio. Given that there is typically no expected return from this exposure, investors should consider hedging this exposure back to the benchmark with a benchmark neutralisation overlay. This type of overlay can be efficiently and cost-effectively implemented as part of a currency risk management program. By removing active currency risk from the portfolio, superannuation plans can focus on other risks within their portfolios that could also require careful management.

## About Mesirow

Mesirow is an independent, employee-owned financial services firm founded in 1937. Headquartered in Chicago, with locations around the world, we serve clients through a personal, custom approach to reaching financial goals and acting as a force for social good. With capabilities spanning Global Investment Management, Capital Markets & Investment Banking, and Advisory Services, we invest in what matters: our clients, our communities and our culture.

To learn more visit mesirow.com.
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## About Warakirri Asset Management

Warakirri is a multi-boutique asset management firm established in 1993 with specialist investment offerings for institutional and retail investors across multiple asset classes, including agriculture, equities, cash and specialised U.S real estate. Warakirri's equities offerings provide access to ethical investing across domestic and global equities, emerging markets and in partnership with Flinders Investment Partners Pty Ltd, to small cap equities. Warakirri also has a distribution partnership with Mesirow Financial Investment Management Inc providing institutional investors access to currency management services and direct U.S. real estate investments. Warakirri is also a leader in Australian agricultural investment management with extensive experience in acquiring, developing and operating agricultural assets on behalf of investors. Warakirri is based in Melbourne and is 100% owned by its directors and employees.

For further information on Mesirow's currency management solutions available in Australia, please contact Conor Hayes, Head of Institutional, Warakirri Asset Management
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