

Investment flows and asset allocation

- Each quarter, at the system level, new capital in the order of \$40 billion (on average) needs to be deployed to new investments.
- For funds, period-to-period investment requirements are volatile. This reflects the net impact of fund inflows and outflows – in particular, realised income from investments.
- In terms of funds’ asset allocation decisions, the over-arching legal requirement on funds is to make investments in the best financial interests of members.
- To this end, super funds set investment objectives for investments options – however, there are numerous, sometimes competing factors that determine ultimate asset allocation at the strategic level, and within asset classes.
- This includes allocation between domestic and offshore assets – which, at the system level, has increased from around 35% to around 50% over the past decade.

For the APRA-regulated superannuation system, the total value of investments currently stands at \$2.6 trillion (end of June 2024). The total value of super investments has more than doubled over the past decade (from \$1.2 trillion in June 2014), with an average annual growth rate over that period of 8%.

Flow of new capital for investment

At the system level, new capital in the order of \$40 billion needs to be deployed to new investments each quarter, on average. Actual quarter-to-quarter investment requirements are volatile, which reflects volatility within the key components of system-wide inflows and outflows.

At the system level, contributions made to super funds currently total around \$45 billion per quarter (net of contribution taxes). Compulsory Superannuation Guarantee (SG) contributions average

just under 60% of total quarterly contributions. Personal contributions – excluding those made via salary sacrifice (SS) – average only around 20% of total quarterly contributions, but drive the seasonality in total contributions (which is related to the timing of tax returns).

System-level investment income can be particularly volatile (Chart 2). In average terms, investment income *excluding* realised and unrealised capital gains is in the order of \$20 billion per quarter. APRA does not publish the disaggregation between realised and unrealised gains on investments. However, a reasonable estimate for realised gains is around \$5 billion per quarter on average.

Outflows of payments of superannuation benefits to beneficiaries (as lump sums or income streams) currently total around \$30 billion per quarter (Chart 2). A very small proportion of these payments return to the system as contributions.

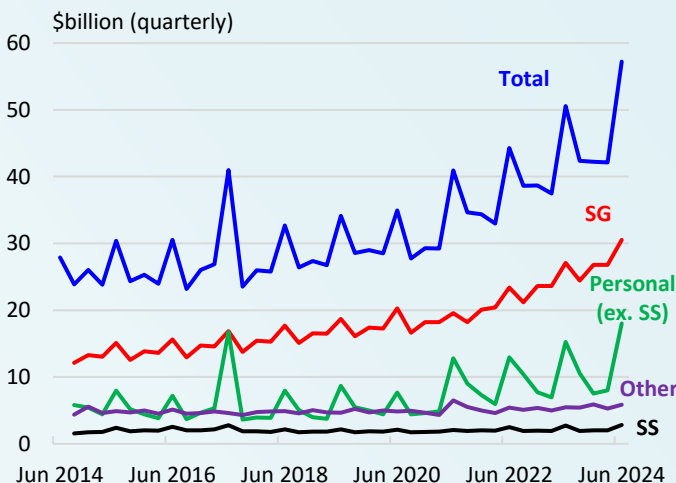
Other system-level flows include transfers to and from self-managed superannuation funds – an average of \$4 billion and \$3 billion per quarter respectively (quarterly flows *between* APRA-regulated super funds are typically around 10 times larger).

Similarly, at the fund level, the net deployment of capital by a fund during any period is a function of its net flows – which reflect numerous factors. These include:

- contributions
- payments to fund beneficiaries
- roll-overs (including between super funds)
- investment income (and allowances for impairment)
- operating expenses
- government taxes and charges.

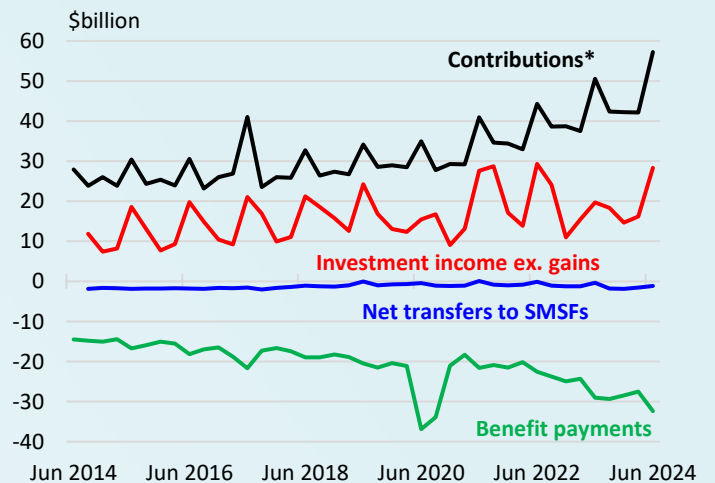
It is important to recognise that net investment flows in any period

Chart 1: System-level contributions, per quarter*



Source: APRA and ASFA derived. *These series include contribution taxes.

Chart 2: Key system-level flows, per quarter



Source: APRA and ASFA derived.

reflect the aggregation of gross investment flows – in other words, total purchases of assets in a period *less* total sales of assets.

Future trajectory of new capital for investment

Looking ahead, the long-term trajectory for the flow of new capital for investment – at the system level – will be driven by two key factors: Australia’s ageing population and the growing size of the superannuation asset base.

As noted above, at the system level, contributions to funds exceed payments to beneficiaries. However, over time, as the proportion of adults in retirement rises, the gap between contributions and payments will diminish. In this regard, Chart 3 shows Australian Government projections for contributions and drawdowns (note, such projections are subject to significant uncertainty).

Chart 3 also shows a projection for super investment earnings – which rises as a share of GDP over the projection period. Towards the latter part of the period, where the quantum of contributions and drawdowns converge, the trajectory for earnings is driven by the compounding impact of investment returns on a rising asset base.

Together, the projections imply a continued net (positive) investment requirement at the system level over the entire projection period.

Determinants of the allocation of capital

In terms of fund investments, the over-arching legal requirement on the trustee of a superannuation fund is to make investments that are in the best financial interests of the beneficiaries (members) of the fund. To this end, super funds are required to set investment objectives in respect of each investment option, and to formulate a corresponding investment strategy to achieve those objectives.

At the asset-class level, the typical approach to investment strategy

involves setting target allocations or ranges across asset classes, and rebalancing portfolios to stay close to the assigned allocations as market conditions change. Fundamental to determining the appropriate allocation is the risk-return trade-off – that is, for a given risk tolerance, the asset-class mix that has the best chance of achieving investment objectives.

There are numerous, sometimes competing factors that determine ultimate asset allocation at the strategic level, and within asset classes. A non-exhaustive list is below.

Diversification: Super funds diversify their investments across and within asset classes to reduce exposure to risks associated with; countries, industries, market segments, technologies, individual entities (and more).

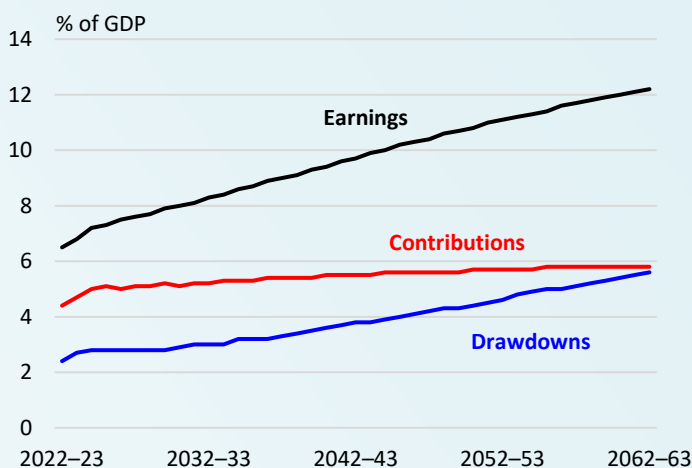
Illiquidity premia: The illiquidity premium is the additional return that compensates investors for holding assets not readily convertible to cash (or equivalent). Super funds, as investors with long time horizons, are well-suited to hold illiquid assets. These include real, unlisted assets such as infrastructure and commercial property.

Liquidity management: A fund’s asset allocation needs to accommodate its liquidity/cash-flow requirements, and ensure that the fund’s liquidity needs can be met at all times. This includes the impact of market downturns on member requests for switching between investment options and for redemptions.

ESG considerations: A fund’s investment objectives can incorporate ESG considerations, where these are consistent with the outcomes the fund seeks to provide members. Related asset allocation strategies – including ESG exclusions, filters and tilts – are guided by these considerations.

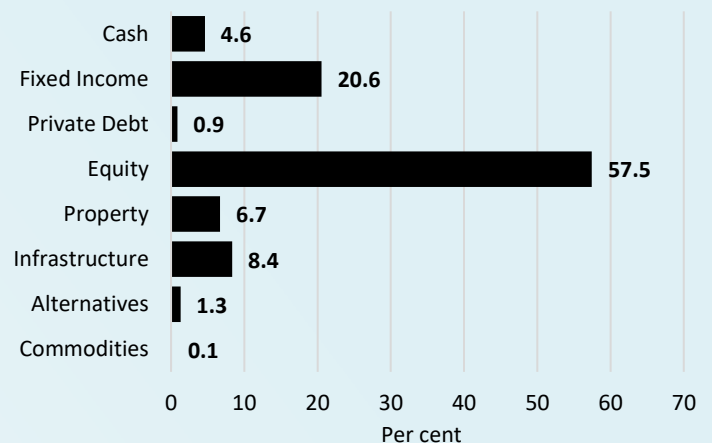
Membership profile: Investment preferences can differ across age cohorts. For example, compared with fund members in the

Chart 3: Government projections for system-level flows



Source: Australian Government, 2023 Intergenerational Report.

Chart 4: System-level asset allocation (June 2024)



Source: APRA and ASFA derived.

accumulation phase, retired members can have a greater preference for ‘defensive’ assets such as fixed-income securities compared with ‘growth’ assets such as equities.

Capital deployment at scale: Fund investment decisions entail utilising limited internal resources for the deployment of large capital flows. While relatively small-scale investment opportunities might stack up on a risk-return basis, they may not be cost-effective.

Regulatory and tax settings: For example, the superannuation performance test may influence investment behaviour such that asset allocation and approaches to risk management can differ from what otherwise might be the case. In particular, funds will invest having regard to their budget for tracking-error vis-à-vis the prescribed asset-class benchmarks in the performance test.

System-level asset allocation

At the system level, the overall impact of the aforementioned factors is reflected in aggregate asset allocation data. Chart 4 shows the high-level asset allocation for the APRA-regulated system.

The dominant asset class is equities (largely listed equities), with an overall allocation of 57%. This share has risen slightly over the past decade – the allocation to equities was 52% in 2014.

Within asset classes, investments are either listed (i.e. readily tradable on established markets) or unlisted. For key asset classes, the allocation to listed and unlisted assets are (respectively):

- Equities: 92% and 8%
- Property: 38% and 62%
- Infrastructure: 16% and 84%

The relatively high unlisted allocations for property and infrastructure reflect the potential benefits to investment portfolios of such assets – such as illiquidity premia and stable long-run cash

flows. Note that in dollar terms, the allocation to unlisted assets for these three asset classes are similar: \$114 billion, \$105 billion and \$179 billion respectively.

With respect to the allocation between Australian and international assets, the system-level allocation to Australian assets is 51%. A decade ago, the allocation to Australian assets was around 65%.

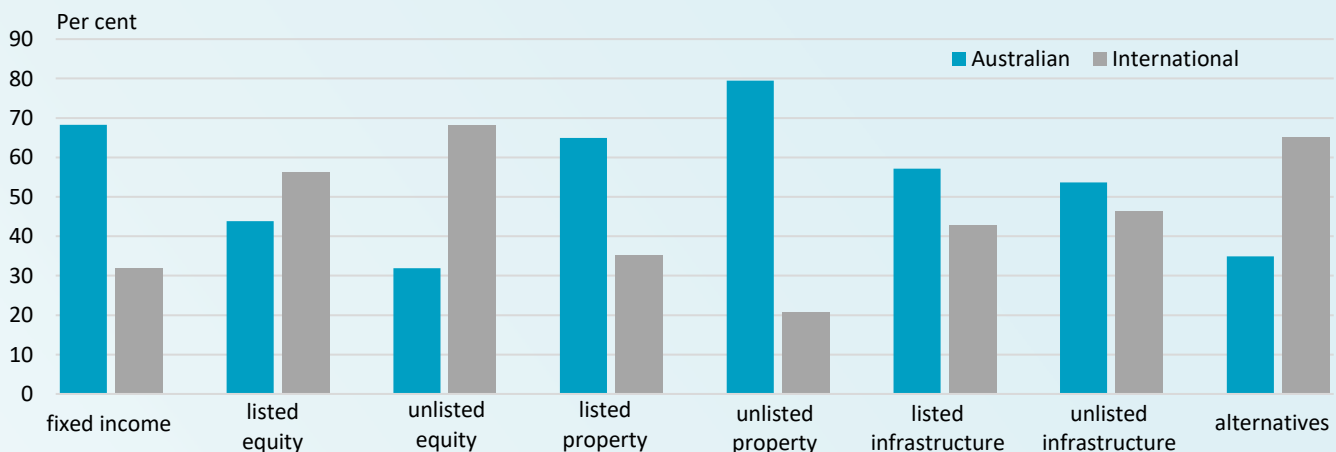
For individual super funds, investment decisions – including the jurisdiction of investments – are made to optimise expected long-run (risk-adjusted) returns for members.

By investing offshore, funds are able to invest in a broader range of assets than is available in Australia. Offshore investments provide members with exposure to other economies, to specific companies and assets, and to industries that are relatively less prevalent in Australia. For example, with respect to the latter, IT companies account for around 20% of global stock market capitalisation but only around 5% of the ASX200. Broad exposure to offshore investments also provides diversification benefits for portfolios.

Looking ahead, the allocation to international investments will likely rise. This reflects both the concentration risk associated with greater exposure to domestic investments and the diminishing costs and knowledge barriers associated with international investments – reflected in the expansion of funds’ offshore investment teams. That said, the optimal proportion of domestic-to-international assets for a super fund is ultimately an empirical question.

For each asset class, Chart 5 shows the percentage allocation to Australian and international assets. There is significant variation across asset classes. This reflects the interaction of; the set of investible assets, varying degrees of knowledge/expertise across the range of asset classes, and the impact of the aforementioned factors that are relevant to asset allocation decisions.

Chart 5: For each asset class, percentage allocation between Australian and international assets (June 2024)



Source: APRA and ASFA derived.