# Cuffelinks
Connecting investors with ideas

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### This Week's Top Articles



## Australia's government debt position: a 'lazy balance sheet'

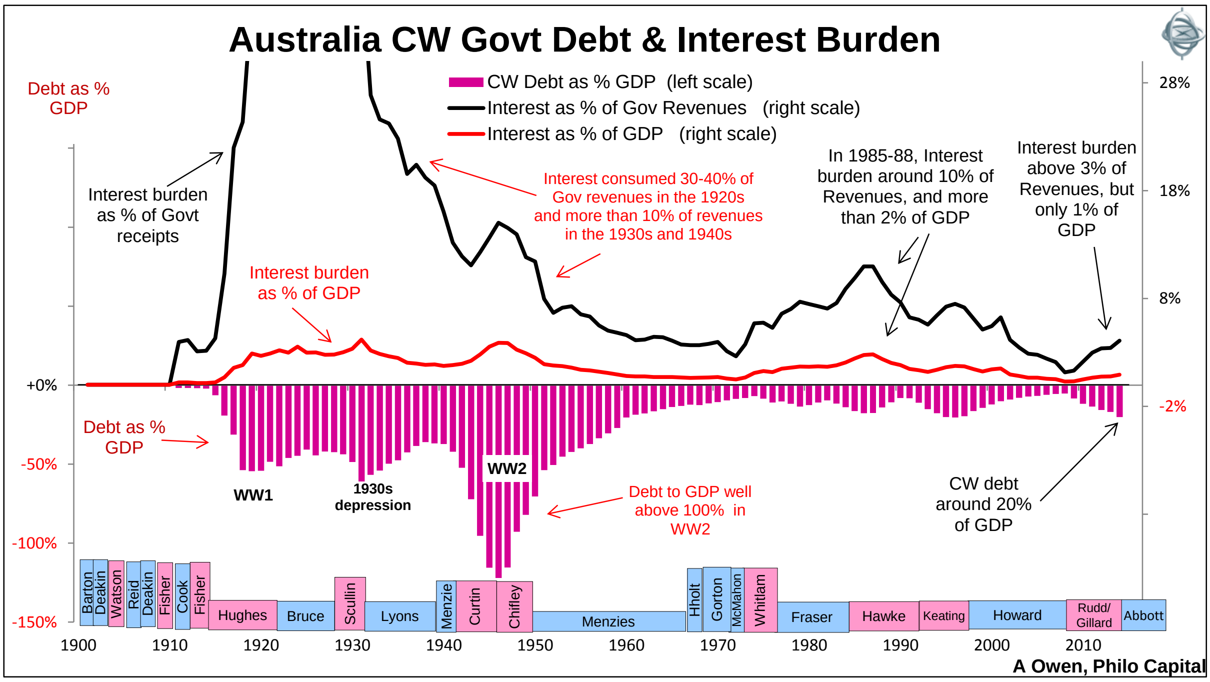
### Ashley Owen

The Federal Budget and the level of government debt are hot topics in the media once again, so an update on the facts will provide some context for the debate.

**Government debt levels and interest burden**

This first chart shows the level of Commonwealth (CW) Government debt measured in three ways:

- debt relative to national income (GDP) - pink bars on the lower section of the chart
- government interest burden relative to national income – black line
- government interest burden relative to government income (mainly tax receipts) – red line



**Where we are now?**

The current position (mid February 2015) is that Commonwealth Government debt securities outstanding total $356 billion, or around 22% of national income (GDP). (Source: Australian Office of Financial Management)

But this excludes many other types of debts, including unfunded 'defined benefit' pension liabilities, other financial liabilities and commitments and derivative exposures. It also excludes assets held to fund those other liabilities, for example, the Future Fund's assets to fund future government pension liabilities.

Interest being paid on debt securities is $16 billion per year or $44 million per day. This equates to 4.5% of Commonwealth Government revenues and about 1.1% of national income.

The above chart shows that on these measures the level of debt and the level of interest paid on that debt are very low, and on a par with the low levels of the 1950s to the 1970s.

Australia's debt-to-GDP ratio first increased dramatically to fund the war-time spending during WW1 and then rose again in the 1930s depression. The main reason for the increase in the ratio in the 1930s was the dramatic collapse in national income, not an increase in debt. In fact between 1929 and 1932 the level of debt actually reduced by 15% but nominal GDP contracted by 31%.

Australia did not go on a Keynesian deficit spending spree in the 1930s depression like the US because we simply were not able to borrow. The Commonwealth and state governments had run out of credit availability in foreign debt markets by 1929, and the Commonwealth's then wholly-owned Commonwealth Bank refused to lend it more money. So the only option was to stick to the savage and deflationary austerity of the 1931 'Premier's Plan' and force all holders of domestic government debt into a haircut restructure deal not unlike the recent Greek debt restructure.

The chart shows that after WW2 the debt to GDP ratio reduced in the 1950s but it was not because the government paid off debt. The level of debt kept growing steadily, but the national income grew even faster, so the debt to GDP ratio declined although the level of debt rose. The rising level of debt was mostly put to good use being invested in productive purposes, mainly infrastructure to support the rapidly growing population, driven by the post-war 'baby boom' and the aggressive 'populate or perish' immigration program.

**Interest burden**

The black line on the above chart shows that interest payments on government debt consumed 30-40% of all government revenues in the 1920s (on a par with the PIIGS and Japan today) and it was still consuming more than 10% of revenues in the 1930s and 1940s (on a par with the US today). The interest burden was then brought down in the post-war boom in the 1950s and 1960s, as national income rose at a much quicker rate than the rise in interest rates.

In recent years the interest burden of government debt was at its lowest level ever in 2007-2008 when the level of debt was also at its lowest level.

However, the current interest burden (at around 1% of GDP and around 4% of tax receipts) is no higher now than it was in the 1950s to the 1970s. This is due to the relatively low level of debt and the relatively low interest rates today.

**'Lazy balance sheet'**

If Australia was a company its national debt would be labelled a very 'lazy balance sheet' and the CEO and Chairman would be thrown out by shareholders for not borrowing enough to invest for future growth!

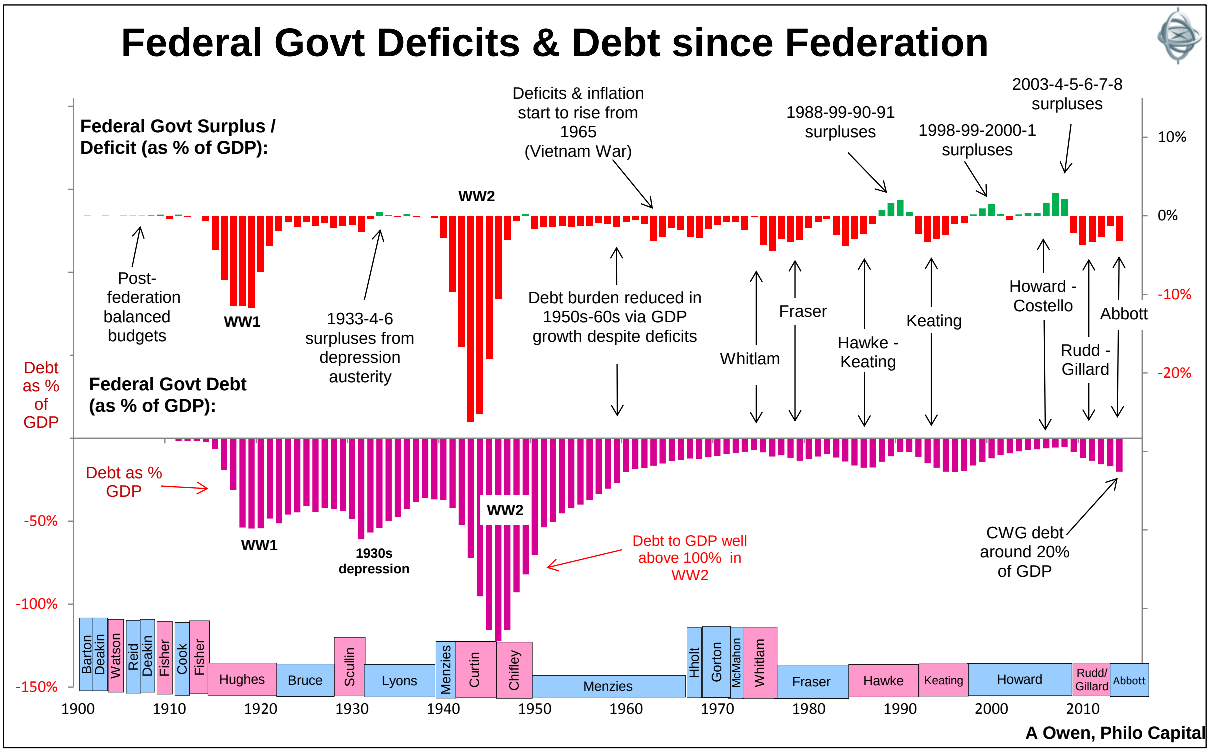
Australia has always been a country in which the opportunities for growth and investment have far exceeded the local savings pool available to fund its development, and so it has always had to import people and capital, in the form of equity and debt.

Many people liken a country to a household, where it is prudent to have no debt, or at least to pay off debts as quickly as possible. However a country is more like a company than a household. In a household, the breadwinner(s) stop generating income and have to draw down their accumulated savings during decades of retirement. Companies and countries can exist forever (in theory anyway) and they can (and probably should) carry debt as long as the cost of debt (interest) is lower than the additional income generated from the investments funded by that debt.

In truth, the reality for most countries is probably somewhere between these two views. Australia has an aging population and rising welfare and health costs, but it is still the best placed among its 'developed' country peers (in the OECD for example) thanks to its relatively favourable demographics. It is far better placed than Japan and northern European countries that have declining populations, declining workforces and declining tax-payer bases. Those countries are indeed more like households, where the breadwinners in aggregate are reducing their income-generating ability and are literally dying off.

**Government deficits**

Governments borrow money when they run a budget deficit – where their outlays exceed their revenues. The second chart shows government surpluses or deficits for Australia (upper section of the chart) together with the Debt to GDP ratio (lower section) for reference.




This chart shows that the Abbott government deficit performance (relative to national income) is similar to those under Rudd/Gillard, Keating, Hawke, Fraser and Menzies, but far lower than the deficits in both World Wars and in the 1930s depression.

**'Good' or 'bad' debt?**

When a household, company or country borrows money, the debt ideally should be used to generate future revenues that will repay the interest on the debt and also repay the principal due at maturity.

In the case of a household there is said to be 'good debt' (debt that is used to buy an asset or activity that generates enough income or capital growth to more than cover the principal and interest on the debt), and 'bad debt' (debt that is used to fund lifestyle expenses). The argument goes that it is the same with a country, and debt used to pay pensions, welfare and healthcare costs fall into the category of 'bad debt' that must be avoided because it doesn't generate revenue to cover the interest on the debt. Whether it is good or bad debt, rising pensions, welfare and healthcare costs in a country with an aging population must either be kept in check or met with rising tax revenues. If not it will require larger deficits and debts in the future.

**Focus on income instead of debt**

This brief story has shown that most of the big changes in Australia's Debt to GDP ratios over time were due to changes in the national income (ie the output from the economy) more than changes in the level of debt. While most of the shrill media debate is focused on the absolute level of debt, what is more important is a debate about what the debt is spent on, and whether it will maximise the productive capacity of the economy in the future.

Australia still has a relatively 'lazy balance sheet' (ie a relatively low level of debt) and is still a country with far more opportunities and development potential than the savings pool available locally to fund it, together with a growing and relatively young population relative to our 'developed' country peers.

With record low interest rates and global investors clamouring to lend us money, this is the time to borrow at ultra-low rates locked in for long periods and use the money wisely to fund long term projects to maximise Australia's long term economic growth. But that requires long term vision and that is sadly lacking in our leaders from all sides of politics in Australia.

*Ashley Owen is Joint CEO of Philo Capital Advisers and a director and adviser to the Third Link Growth Fund.*

## Treasury says don't use the $32 billion number

## Graham Hand

If you enter 'superannuation $32 billion' into Google, you receive about 18,000 responses. The $32 billion number has become the most dangerous weapon used by critics of super tax concessions. For example, in ABC's The Drum, it says:

*"The cost to revenue of the concessional treatment of superannuation reached $32 billion this year. That is almost 50 per cent more than the Defence budget and $2.3 billion above Commonwealth spending on education.*

*Treasury projects that the figure will jump to $45 billion by 2015-16, by which time it will overtake the cost of the age pension. So where is the sense of outrage about this budget-blowing, out-of-control 41 per cent increase in government spending, making it the fastest growing major area of government?"*

It is important to know what this number means, as it is often used as a budget example of how the Government could make savings for other purposes.

At the SMSF Association Conference on 19 February 2015, **Rob Hefernen, Executive Director Revenue Group, The Treasury** spoke at a session with industry regulators called, **'The evolution – Superannuation as the leader in the wealth industry'.** This talk has not been posted on The Treasury website.

"I'm a bit of an imposter as The Treasury is not strictly a regulator, we're a policy adviser to the Treasurer and Assistant Treasurer, and on broader economic policy to the Government as a whole. One thing John Fraser (the new Treasury Secretary) is very keen on is that senior staff should have a much better understanding of how business and private sector make decisions, which is why we welcome these sessions.

The superannuation system is growing at an extraordinarily rapid rate, with SMSF growth outstripping the overall system. In 1996, at the time of the Wallis Inquiry, superannuation assets totalled $245 billion or about 38% of Australia's GDP. Today it is over $1.85 billion, greater than the GDP. SMSFs are now 35% of all super assets, a massive growth. This growth is something that policy advisors and regulators need to understand. We need to understand the drivers, and what it means for the economy. Clearly a vehicle for people who want a direct say in their own retirement savings must be something that people value highly. The idea of people taking responsibility for their own savings and having the highest quality of life in retirement is a good thing and should warrant appropriate government support.

There was a fair amount of comment in the Financial Systems Inquiry about the objectives of superannuation. It's fair to say the objectives are sometimes not fully understood. From the Inquiry's point of view, to provide income in retirement and increase the quality of life is a key objective. Some people might quibble about the effect on the aged pension and we'll see more discussion on that.

I do want to address our Tax Expenditure Statement (TES). It is part of the Charter of Budget Honesty. Let's be clear: there are some things that the TES is, and there are some things the TES is not. **It is not a document with a policy message.** When it is reported in the press - God bless them - there seems to be an inference that simply because there is a large measured tax expenditure, the Government should do something about it. That is not the case. There is no policy message whatsoever in the Tax Expenditure Statement.

What it is meant to be is a benchmark or measure of the amount of money potentially foregone. If I could just bore people for a second, if you think about the aged pension. This costs about $20 billion a year, the measured outlay. No one would say if the aged pension was repealed – not that this would happen – would you get a $20 billion saving. People would go onto NewStart, they might go back into the labour force, they might go onto a Disability Support Pension. All it is, is the amount of the pension multiplied by the number of people who receive it.

Does it take into account behavioural change? No, it doesn't. When people report things that say this is a measure of tax expenditure, and therefore that's the amount the Government could save if they did something about it, **that is untrue**. We do attempt to do a revenue gain estimate and the TES is extremely qualified on revenue gain. It actually says:

*"The revenue gain estimate should be treated with particular caution - (which is code for 'beware') - there is usually little, if any, information on how taxpayers might react to the removal of a tax expenditure. Assumptions about taxpayer behavioural responses therefore need to be made, and these assumptions can be difficult to meaningfully substantiate."*

We really don't know. Going through that, you might ask, 'Why on earth would you do it?' Well, on page 5 of the TES:

*"Consistent with a recommendation of the Australian National Audit Office in its 2007-08 performance audit of the TES, the TES reports revenue gain estimates for 10 large tax expenditures."*

We are asked to do an audit, so we do. **But be wary on the revenue gain estimates. Don't use them, they are too unreliable.** On the revenue foregone, done according to international best practice, that is not a measure of what is saved. Anyone who says this is not reading the fine print – it's not even fine print, it's in bold print. Every year when we put it out, we get criticism, so I wanted to make it clear."

**In response, Andrea Slattery (CEO of the SMSF Association) said:**

"Can I just confirm then that the $32 billion that the Government could save on superannuation and then spend somewhere else if it got rid of tax concessions, they will not get all $32 billion?"

To which Rob replied:

"I don't even think you need a document to confirm that."

*Graham Hand attended the Conference as a guest of the SMSF Association. The bold emphasis in the text is his highlighting, not the speaker's.*

## Is this the end of the traditional term deposit?

## Justin McCarthy

From 1 January 2015 an important change to banking regulation commenced with significant implications for term deposits, with the use of 31+ day break or notice clause becoming more common and a large divergence in deposit rates expected.

In December 2013, the Australian Prudential Regulation Authority (APRA) released a revised liquidity standard (APS 210) for all Australian Authorised Deposit-taking Institutions (ADIs). This standard encapsulated APRA's views of the Basel III regulatory changes for global banks.

A centrepiece of Basel III and APS 210 is the liquidity coverage ratio (LCR). While other countries have transitional arrangements over a number of years for adoption of the LCR, APRA requires the larger Australian ADIs to comply with it from 1 January 2015.

The LCR aims to ensure that an ADI can meet its liquidity requirements in a severe stress or 'bank run' scenario. The regulation requires an ADI to hold sufficient unencumbered high quality liquid assets (HQLA) that can be converted into cash within a day to meet the ADI's liquidity needs for a 30-day stress scenario. The ratio of HQLA to the ADI's expected net cash outflows must exceed 100%.

The three key features (and implications for depositors) of the LCR are as follows:

**1. 30 day horizon**

The LCR looks at a 30-day liquidity period and any product or deposit with a 31+ day break or notice period intact will not be included in the calculation of liquidity required. ADIs must to hold low-yielding HQLA for any deposit (or at-call money) which can be repaid or matures within 30 days. This makes these deposits more 'expensive' for the ADI.

Conversely, a deposit that has a 31+ day break or notice period requires no HQLA backing. As such, ADIs will place a higher value on the latter and will pay higher rates to attract those funds. Traditional at-call and short-dated term deposits, particularly from financial institutions, will receive the opposite treatment with rates expected to be significantly lower come 1 January 2015. Corporates will receive slightly better treatment especially where money on deposit can be proven to be 'operational'.

Since 1 January 2015, the ability to break term deposits has become significantly harder with Product Disclosure Statements and terms and conditions needing to change to prevent the breaking of term deposits, with very few exceptions, the main one being personal hardship.

**2. Depositor classification and 'run off' assumptions**

There are vastly different 'run off' assumptions for various categories of depositors which will have a significant impact on the rates the ADIs will offer. At one extreme are 'sticky' retail deposits that APRA assumes will withdraw just 5% of funds in a crisis scenario. At the other end are 'hot' wholesale deposits from financial institutions that are assumed to see 100% of funds withdrawn at the first sign of a crisis. For the purpose of the LCR calculation, this represents a differential of 20 times between the higher and lower deposit categories.

Again, the implications are clear. Mum and dad 'retail' deposits will continue to be in high demand and hence command higher rates. This typically covers deposits up to the $250,000 government guarantee amount. Self Managed Superannuation Funds up to this limit also attract positive treatment.

However, for wholesale deposits and at-call money from larger institutions, particularly those classified as financial institutions, the traditional deposit looks like a dying breed, to be replaced by 31+ day break or notice period deposit products. Corporations that can demonstrate a long term operational relationship will receive a 40% run-off assumption placing them in the middle of sticky retail and hot wholesale money. The focus here will be for corporate and potentially some financial institutions to prove the operational nature of portions of their funds on deposit and to argue for higher rates.

Another clear implication is that all wholesale depositors will have an incentive to do an accurate assessment of their real requirement for very liquid funds such as at-call or short dated term deposits, given the lower rates expected. This low returning portion of a portfolio should be minimised and as much as possible locked away for a minimum of 31 days.

**3. The LCR does not apply to many other ADIs**

Compliance with the 100% LCR is only required by what APRA terms the 'scenario analysis' ADIs. This essentially refers to the major and regional Australian banks and locally incorporated foreign subsidiary banks (such as HSBC Bank Australia Limited and Rabobank Australia Limited). Branches of foreign banks that operate in Australia (such as Bank of China Limited) are only required to meet 40% of the LCR.

Credit unions, building societies and other mutual banks (technically termed 'minimum liquidity holding' or MLH ADIs) are not required to comply with the specific LCR.

We expect the deposit rates from the branches of foreign banks and the MLH ADIs to be more competitive at certain points in time, especially for corporate and wholesale deposits. However, this will still be a function of demand and supply with many MLH ADIs currently very liquid and not in need of extra funding from the wholesale sector.

**What to watch for when investing in TDs**

The impending changes have already been occurring in the market, with many ADIs releasing 31+ day break or notice period products over recent months. Investors should consider the following when assessing term deposit investments:

- Make an accurate and realistic assessment of absolute liquidity needs and minimise the amount placed at-call or in short dated term deposits if the rates on offer are materially below those available with 31+ day break or notice clauses
- Maximise the amount with 31+ day break or notice clause. Possibly combine this with other sources of liquidity such as an allocation to high quality, liquid bonds that can be sold at short notice if emergency liquidity is required
- Maximise the amount on deposit through personal/retail or SMSF accounts and minimise the amount through deemed corporate or financial institution accounts. Likewise maximise the amount that can be classified as 'operational'
- Watch for special rates in the early stages to attract investors. Typically, the early adopters receive the best rates and this product is here to stay. It is not a fad.
- Don't discount the branches of foreign banks or MLH ADIs who from time to time may offer competitive rates for the traditional deposit products, given the LCR does not fully apply to those ADIs. There are now over 10 credit unions and building societies that are rated investment grade and considered safe places to invest deposit or at-call money.
- The ease and low cost of breaking term deposits that has prevailed for many years has come to an abrupt halt since 1 January 2015, so be sure to have other sources of liquidity if this is a possibility.
- Be aware that ADIs will monitor the behaviour of depositors and over time (later in 2015 and beyond) will reward deposits that remain in place and penalise those that are seen to be 'hot' money. Where the difference in rate is small, it may pay to remain loyal in the long run.

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# Bubbles and the corruption of the sense of risk

## Roger Montgomery

I have previously warned that the combination of the demographic avalanche of the baby boomers retiring, low interest rates and a disproportionately large amount of their wealth in cash would mean that stocks and property could do nothing but go up for a while. I call it 'The Boom We Have to Have.' But like all booms, this one will also bust.

These conditions, especially low rates forcing a big part of the population into riskier products, corrupt investors' sense of risk. Rising prices amid a wave of buying reinforces the behaviour of investors and their brokers who believe their thesis is correct.

**New listings and credit point to problems**

I am not alone in the view that at some point in the next six to eighteen months, there is a real chance baby boomers retirement plans may sink thanks to their inability to avoid repeating the investment mistakes of their past.

Stanley Druckenmiller is an American hedge fund manager, famous for being the lead portfolio manager for George Soros's Quantum Fund. In 2010, Druckenmiller handed back the billions he had been managing for 30 years through his firm Duquesne Capital. He remains a noted philanthropist, keen golfer and speaker on the global investment and macroeconomic circuit.

Druckenmiller should be heeded. He observed that low rates have skewed peoples' sense of risk, particularly in two markets – IPO's and credit. He pointed out that 80% of companies listed in 2014 have "never made a dime". In 1999, just before the tech crash, that number was 83%.

(As an aside, over the Christmas break, I read *You Only Have to Be Right Once: The Unprecedented Rise of the Instant Tech Billionaires.* Twitter, Facebook, Instagram; the book was a who's who of the world's biggest tech companies and the background to their stunning rise. But I couldn't help noticing that all the references to billions had little or nothing to do with profits or in some cases even revenues. Some of the businesses discussed, which were sold for billions, not only had no revenue but no revenue model either).

Druckenmiller had another warning on credit markets. Last year, speaking on CNBC, Druckenmiller said, "When I look at credit … corporate credit is growing at a record rate, far faster than it grew in 2007. And S&P pointed out that 70% of debt issued is a B-rating or worse. To put that in perspective, in the '90s, that number was 31%. Do you remember the hullabaloo in 2007 about covenant-light loans? Companies issued $100 billion of them in 2007, and 38% was B-rated. This year we're going to $300 billion, up from $260 billion last year and $90 billion a year earlier, and 58% of them were B-rated."

At the more recent speech, Druckenmiller also observed, "There are some really weird things going on in the credit market … but there are already early signs starting to emerge. And if I had a message out here, I know you're frustrated about zero rates, I know that it's so tempting to go ahead and make investments and it looks good for today, but when this thing ends … I think it could end very badly."

Why is Druckenmiller so worried? It's simple. If interest rates rise, many investors in corporate debt will want to exit at the wrong time. Australian investors in bank hybrids and corporate bonds (G8 Education is a recent example of a popular corporate bond issuer) should consider the warning too. And if interest rates don't rise, but the economy weakens significantly, then some industries will be unable to cover their debt costs. Either way, investors will face problems at some stage.

**Low rates support asset prices**

Low interest rates are here to stay for a little while and that will support asset prices. Eventually however the price of those assets (stocks and property) will be pushed way too high (we think a strong bull market is likely for some part of this year) as people panic buy amid a fear of missing out when their income is eroded from low rates on cash. After that, a large number of investors will, sadly, suffer financially again – from buying too late and paying too much.

There is a way to avoid it. You must be invested in high quality businesses with bright prospects and buy them when they are cheap. We can think of only a handful of stocks that meet this criteria currently. When we cannot find such opportunities, the only safe alternative is cash (even though rates are low) and we are 20-30% invested in cash at the moment.

If you are invested in a high-performing fund that is fully invested in stocks like REA Group (P/E ratio 44 times), Dominos Pizza (68 times), or many of the expensive stocks below, consider switching at least some of your retirement nest egg to a larger cash weighting. The cash won't make your investment 100% immune to a declining market but it will allow additional purchases at cheaper prices, which offers the opportunity to significantly reduce the time to recovery. In Table 1, PER is Price to Earnings Ratio.

**Table 1. Expensive stocks? You be the judge…**

| Name | PER | Name | PER |
|---|---|---|---|
| Ramsay Health | 42 | 3P Learning | 42 |
| Bursons | 53 | Aristocrat | 46 |
| TPG | 33 | Blackmores | 28 |
| Dominos Pizza | 68 | Invocare | 33 |
| ARB | 20 | Dulux | 21 |
| Cochlear | 44 | Carsales | 26 |
| Corporate Travel | 60 | Boral | 41 |
| REA Group | 44 | Beacon Lighting | 28 |
| Freedom Foods | 39 | Bega Cheese | 38 |

Of course if interest rates stay at zero, the party could last a while yet, but as I have warned previously, be sure to be dancing close to the door in case you need to leave the party. Druckenmiller refers to a "phony asset bubble", with a bunch of investors ploughing money into assets which will "pop". Then we'll see how many people are still enjoying the party.

*Roger Montgomery is the founder and Chief Investment Officer of Montgomery Investment Management.*

## Back to the future with Murray's super objective

## David Brown

In all the fuss over the Financial System Inquiry (FSI) and its 320-page Final Report, one potentially far-reaching theme has attracted relatively little analysis.

Bang, smack in the centre of the first recommendation of Chapter 2 *Superannuation and retirement incomes* is the statement that the heart of the system remains the achievement of a retirement income. Recommendation 9 creates a hierarchy of objectives where all other honourable objectives are merely *subsidiary* to the *primary* objective:

*"The Inquiry's single primary objective prioritises the provision of retirement incomes and precludes the pursuit of other objectives at the expense of retirement incomes." (Recommendation 9 – Option Costs and Benefits)*

**Straying from super's primary objective**

Possibly the reason it attracts little analysis is that it seems so obvious. Yet most of us in the industry were not conscious of having strayed. The pressure to drift away from this singular purpose has led the FSI to ask for statutory protection to ensure the primary objective is achieved.

There is, however, a potential sting in the tail of a law enshrining the *primary* purpose of superannuation. David Murray and his fellow panellists clearly want to guard the system from further political tinkering, but they also appear to have an intention to re-focus trustees back to their task by laying upon them a new *de facto* legal obligation; that is, to deliver income.

What were they doing before that?

The wry answer would be that trustees were busy complying with repeated waves of regulatory change and fending off pressure groups wanting to tap the pot of money for all manner of nation-building projects. While this may be true, the real issue seems to be that the current system treats the accumulation phase as an end in itself. It is this mindset that the FSI seeks to 'reorient'.

*"It will help reorient the community mindset around superannuation, away from account balances and towards the provision of retirement incomes. Nobel Laureate Robert Merton wrote: "Sustainable income flow, not the stock of wealth, is the objective that counts for retirement planning"." (Recommendation 9 – Option Costs and Benefits)*

**Lack of risk pooling**

A key argument of the FSI is that the lack of risk pooling has led to an inefficient provision of retirement incomes (see the *Executive Summary*). Our individual asset accounts are 'pooled' only for the purpose of investment and administrative efficiencies. Our liabilities, on the other hand, are not pooled. They remain inefficiently distributed no matter the size of the super fund to which we belong. This contrasts with the risk pooling inherent in a Defined Benefit (DB) scheme or an insurance fund where the greater the variety of individuals, the cheaper the cost for all.

In this sense, the current system means our risks are borne by each of us individually and, furthermore, these liabilities are really not the responsibility of anyone other than the individual. No official entity, fund, trustee, regulator or agency has responsibility for achieving or monitoring this. The end result is a retirement system that fails to materially alleviate the burden of the age pension on the Federal budget.

It is ironic that the collectivist instincts that brought about our near universal superannuation system should result in such highly individualised outcomes. As the system matures, we are all becoming aware that this policy objective falls between two stools. David Murray, quoted in *Cuffelinks* at the SMSF Association (formerly SPAA) Conference, 18 February 2015, said that the FSI saw three objectives of super, one of which was "*to improve the government budget position by reducing reliance on the age pension, but this has not happened*."

The FSI seeks, within the present construct of our system, to redress this almost complete lack of official accountability for individual outcomes. At the heart of their response seems to be the message that our trustees simply look after assets and have no direct responsibility to look after liabilities. Why else would they be mandating trustees to add a specific new responsibility of nominating post-retirement products?

Investment programmes for DB schemes place much more emphasis on meeting a specified set of long-term liabilities. The risk appetite of pension trustees in predominately DB countries like Canada, US, UK and the Netherlands is therefore shaped by asset-class behaviour relative to liabilities, and is inherently and overtly long-term.

**Australian superannuation has wrong focus**

By contrast, the Australian super industry simplistically defines risk as raw market volatility within reporting periods. Australian trustees are increasingly pre-occupied by competitive product ranking and business considerations such as brand and pricing within the context of peers.

The competitive war between industry funds and retail may be an additional distraction as they reference each other, rather than an overarching immutable single objective. More worrying is that as industry funds shift from the strategies that served them well in the past, increasingly, the investment programmes of the two streams look the same and bragging rights will disappear.

The December 2014 Chant West survey makes the point that retail and industry funds increasingly experience very similar returns and their January 2015 numbers show no evidence of industry funds out-performing in the last five years. That's half a decade since industry funds delivered a convincing win over their retail competition.

When I returned to Australia in 1999 after a decade managing DB assets in the UK, I saw an Australian industry had blossomed in my absence. Pleasingly, I saw earnest and diligent trustees making, perhaps paternalistically but nevertheless, wise, considered, long-term strategy calls.

However, since the introduction of fund choice in 2005, the old world of long-term investment horizons has been replaced by a more peer-competitive, internally self-referencing industry of 'products' designed to do well in their respective Chant West (or other) survey categories.

This shift to a short-term retail-ised industry is possibly the 'account-based' mentality with which the FSI panel takes issue.

Their proposal is subtle but potentially far-reaching if taken to fruition. They propose a system where trustees (and government) are legally bound to accumulate super assets for the purpose of achieving a single result; a post-retirement income. As Dr Samuel Johnson said years before the first fleet set sail; "Nothing so concentrates the mind as the hangman's noose". Will this legal noose cause our DC industry to act more like DB schemes in its investment strategy?

Turning back the clock to a collectivist DB risk-sharing system does not seem possible. However, the FSI has sown the seeds of an elegant compromise that might achieve a similar result.

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