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### Editorial

Budgets are forecasts, and more than most, **Josh Frydenberg** and **Treasury** waved a wet finger in the air in compiling the 2020 version. How many companies will now employ a new apprentice for \$100 a week subsidy? Which back-of-the-envelope showed 3.5 million businesses would use the instant asset write off and the 1 million loss carry-back? At a time when, to use the Treasurer's words, "Our cherished way of life has been put on hold", these estimates are understandable. But the \$17.9 billion for superannuation savings based on the [new YourSuper proposal](#) is wishful thinking.



Exploring YourSuper is our main Budget focus this week. For a broader analysis, see [Shane Oliver's summary](#) in the White Paper section. Given the adverse changes in recent years, we should be grateful there were no meaningful announcements on superannuation and SMSFs, including nothing on the next stage of the Superannuation Guarantee.

We noted last week the strong fund flow into global investments, but the biggest surprise package is the support for fixed interest products with rates at all-time lows. The first two tables below from **BetaShares** show flows in August 2020, and the third table from the **ASX** is total balances as at August 2020. It shows \$12.2 billion invested in fixed interest in Exchange Traded Products, up from \$9.1 billion a year ago, and the trend is the same overseas.

#### Top 5 Category Inflows (by \$) – August 2020

Broad Category	Inflow Value
International Equities	\$722,208,857
Fixed Income	\$367,232,015
Cash	\$208,414,985
Commodities	\$187,614,011
Australian Equities	\$181,104,769

#### Top 5 Sub-Category Inflows by (\$) – August 2020

Sub-Category	Inflow Value
Australian Bonds	\$297,832,585
International Equities - Developed World	\$242,528,414
International Equities - Sector	\$223,785,466
Cash	\$208,414,985
Gold	\$171,774,547

ETPs	Last 12 months (\$bn)			Last month	
	Aug-19	Aug-20	% change	Jul-20	%change
Equity - Australia	16.53	21.04	27.3%	20.29	3.7%
Equity - Global	22.36	28.57	27.8%	26.69	7.1%
Fixed Income	9.15	12.20	33.4%	11.66	4.7%
Property	3.54	3.84	8.3%	3.60	6.5%
Commodities	1.50	3.56	137.6%	3.40	4.7%
Currency	0.34	0.25	-25.0%	0.34	-25.0%
Mixed	0.68	1.21	76.5%	1.14	6.2%

Please don't switch off because we are focussing on fixed income just because bonds may not be as exciting as equities or superannuation or demographics. We have three articles with a fixed income focus which are all worth reading since so many people are now switching into bond funds.

First, **Damien Klassen** examines the cherished 60/40 portfolio, the 60% equities/40% bonds exposure used by millions of Australians. When investing, the past is irrelevant, as all earnings are in the future. [Does 60/40 still work?](#) Second, my interview with **Vivek Bommi** of **Neuberger Bermann** shows how fixed interest and stock markets bailed out companies facing the pandemic, and how high yield bonds are [attracting flows in the current market](#).

Third, **Damon Shinnick** and **Jonathan Baird** explain how an [active bond fund](#) is able to achieve returns not directly available for retail investors. Unlike the stock market where anyone can buy anything, the vast majority of opportunities in fixed interest are not available to the public other than via funds.

On to other markets. There is a crucial problem for active equity managers when they become too big for their market. **Andrew Mitchell** explores why this [temptation to grow causes underperformance](#).

Some industries have benefitted greatly from COVID-19, and **Josh Gilbert** asks whether the boost to food delivery and related services will be sustained in the long run, or [is the happy meal over?](#)

And back to basics on managing an SMSF, **Julie Steed** warns that claiming a tax deduction for contributions needs to follow a process to [ensure a favourable tax treatment](#).

Now, off to check the YourSuper comparison tool and get my share of the \$17.9 billion.

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## YourSuper will save \$17.9 billion! Surely you're joshing

Graham Hand

In the 2020 Federal Budget, Treasurer Josh Frydenberg delivered a surprise for the superannuation industry. He announced the introduction of a 'Your Future, Your Super' package, which included:

*"members will have access to a new interactive online YourSuper comparison tool which will encourage funds to compete harder for members' savings."*

The full [Fact Sheet is here](#), including:

*"By 1 July 2021, MySuper products will be subject to an annual performance test. If a fund is deemed to be underperforming, it will need to inform its members of its underperformance by 1 October 2021. When funds inform their members about their underperformance they will also be required to provide them with information about the YourSuper comparison tool. Underperforming funds will be listed as underperforming on the YourSuper comparison tool until their performance improves. Funds that fail two consecutive annual underperformance tests will not be permitted to accept new members. These funds will not be able to re-open to new members unless their performance improves. By 1 July 2022, annual performance tests will be extended to other superannuation products."*

### How do we measure underperformance?

Objective measurements of super fund performance have practical limitations that make comparisons difficult. Changing funds based on these results will deliver unpredictable and even counterproductive consumer outcomes. As the [MySuper Product Heatmap](#) already produced by the Australian Prudential Regulation Authority (APRA) shows, comparisons and disclosures are difficult to understand. Most people will struggle with the most basic aspects of adjusting performance for risk.

On disclosures, [the Australian Securities & Investment Commission](#) (ASIC) recently stated:

*"Disclosure cannot solve complexity that is inherent in products and processes. Simplifying disclosure, for example, does not reduce the underlying complexity in financial products and services. Nor does it ease the contextual and emotional dimensions of financial decision making, both at the point of purchase and over time."*

Let's take a simple example of two super funds, Fund A and Fund B, which sit in the same risk bucket of 60% to 80% growth. Both are managed by well-qualified, experienced teams offering diversified asset allocations designed to maximise returns over the long run.

Here are the views of both teams in managing their funds.

Investment beliefs and asset allocation	Fund A	Fund B
1. Cash	Only short-term government and bank securities	Allow cash-enhancement by taking credit, duration and derivative risk
2. Defensive assets	Only cash and fixed interest	Allow property, infrastructure and some alternatives
3. Growth assets	Include property and infrastructure	Equities
4. Equity management style	Value	Growth
5. Sustainability and ESG	Major influence	Minor influence
6. Listed versus unlisted	Mainly listed	Mainly unlisted
7. Alternatives/derivatives	Low usage	High usage
8. Allocation in 60/80 category (funds are tiered according to growth/ defensive allocations in tables)	Closer to 60% growth than 80% to reflect desire to protect member capital in expensive markets	Closer to 80% growth to maximise member returns

Each of these choices can influence the outcome depending on market conditions.

### Defensive versus growth assets

There is no industry standard on the definition of growth or defensive assets (although a team is [working on it](#)). Some argue that since infrastructure assets have guaranteed long-term cash flows, often linked to inflation and government contracts, they have strong defensive characteristics like fixed interest. Furthermore, unlisted assets are not subject to the daily vagaries of stock market valuations and therefore have far greater price stability.

For example, [Hostplus states](#):

*"Unlisted assets – including infrastructure, property and private equity – continue to provide important downside protection as they are not directly linked to equity markets."*

APRA's heatmap on Hostplus assessed its MySuper product as having a 93% allocation to growth assets, despite the fact it is usually in the 60% to 80% section in league tables. Hostplus argued 93% was misleading because some of its defensive assets had been placed into growth by APRA.

Clearly, if risk markets are doing well, a fund with higher allocation to 'growth', such as at the 80% end rather than 60% end of the 60/80 spectrum, will do well in a performance comparison. But they are simply taking more risk, they are not managed better.

Then when the market struggles, such as in March 2020, the defensive funds benefit. Some super funds were forced to revalue their unlisted assets to ensure prices more accurately reflected the poorer outlook. Who could claim an unlisted airport had not fallen in value after COVID-19 when listed airports had halved in price?

Contrast Hostplus with the approach taken by UniSuper, which writing to its members in March 2020 advised:

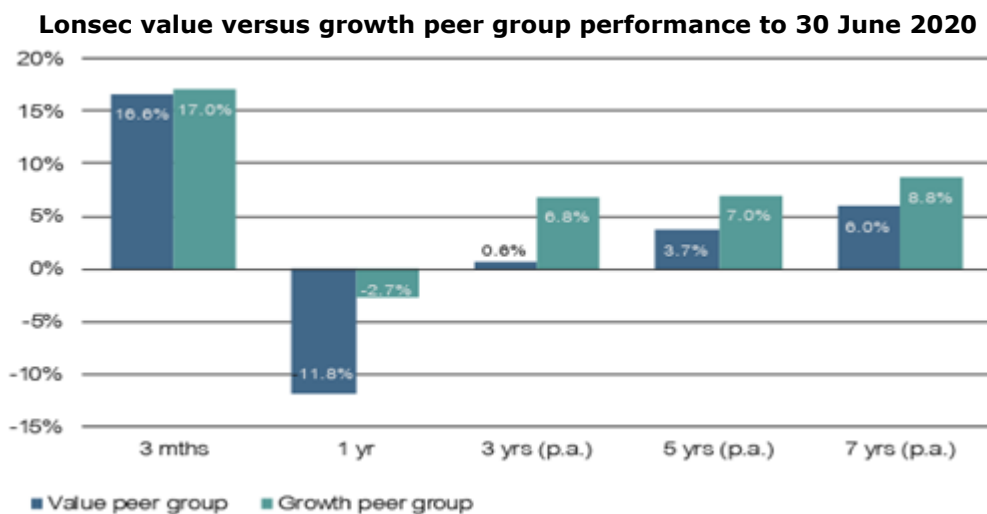
*"We have a relatively low exposure to unlisted assets in our diversified options (about 7% for the Balanced option). We think of property and infrastructure as 'growth' assets so they don't qualify for inclusion in our defensive allocation."*

When superannuation funds take such varying approaches to defensive and growth definitions and allocations, their risks and performance are difficult to compare.

### Growth versus value style

It's the same across a wide range of investment beliefs. In equities, 'value' versus 'growth' investing is a classic example. Historically over long time periods, value had outperformed growth, and many of our leading fund managers have built their businesses arguing that buying value companies below their intrinsic value are better investments than growth companies at high Price to Earnings (P/E) ratios. But as the table below shows for the Australian market, over the three years to 30 June 2020, growth outperformed value by over 6%. Over one year, growth was worse by 9%.

Neither is wrong and both have their day. There are performance differences based on where we are in the market cycle, not 'underperformance'. The Government's proposal could lead to a super fund informing its members of its inferior performance just as the cycle turns in its favour.



Leading research house [Lonsec says](#) about the outperformance by growth over three to seven years:

*"But how long can this run last? Dispersion between these two styles has not been this high since just before the tech wreck at the turn of the millennium, which saw value overtake growth as the predominant style ... This begs the question: Are we due for another correction?"*

When will the market fall out of love with tech stocks and return to more fundamental industrial stocks? Probably after the YourSuper comparison tool gives the wrong signal.

### Many factors influence performance

We could go on. A fund manager may take a strong sustainability position against fossil fuels just as oil prices rise rapidly. Should they be punished for saving the world? Another fund may hold government bonds in its defensive allocation as interest rates rise rapidly, losing their defensive characteristics in the comparison period. Of course, the bond will repay at par on maturity but by that time, the damage is done.

At industry funds, insurance arrangements for members are often unique to the relevant industry, and cheaper than comparable insurance in the public market. For example, many Mine Super (formerly Auscoal) members are miners who need protection in a risky industry, and the fund has negotiated attractive group prices. What happens with insurance when an apprentice coal miner starts work if Mine Super is unable to accept new members?

The fear is that superannuation fund trustees become so worried about the fund closing to new members and the shame of public underperformance that they stop the investment team backing its views. The CIO who decides the market outlook is poor and wants to take a more defensive position to protect member capital may be prevented from doing so or be forced to reverse a position if timing is wrong in the first year. The trustees who cannot tolerate the poor results will push the CIO to return to industry risk-weighting, or switch to passive management to ensure close-to-market performance.

It is common for a fund manager to lead the league tables over one period and be bottom of the pile over another, and few stay on top over all periods. Some hog the index because business survival is often more important than market performance.

### Will this performance tool have an impact?

The Budget announcement says:

*"By 1 July 2021, MySuper products will be subject to an annual performance test. If a fund is deemed to be underperforming, it will need to inform its members of its underperformance by 1 October 2021."*

So the underperformance measurement is operating now, it does not begin on 1 July 2021 as some commentators are saying.

Back to ASIC's comments on disclosure:

*"When disclosure is used to address problems it is ill-suited to solve, it can place an unrealistic and onerous burden on consumers – for example, expecting them to overcome complexity and sophisticated sales strategies."*

*"Like other forms of regulation, mandated disclosure requirements are often 'one size fits all' interventions – yet people and contexts differ and shift. It is hard to predict the individual and context-specific differences in how we will behave, make decisions, and engage with and process information."*

Here are the Government claims for this initiative:

- A typical young Australian entering the workforce in their 20s could be around \$87,000 better off at retirement.
- A typical Australian already in the workforce at age 50 could be around \$60,000 better off at retirement.
- A typical Australian spending their working life in the worst performing MySuper product would be up to \$98,000 worse off at retirement.

The Government's announcement includes:

*"Once implemented, these measures will benefit Australians by \$17.9 billion over the next 10 years. Our \$3 trillion superannuation system is responsible for managing the retirement savings of 16 million Australians. The current system is letting too many Australians down. Australians are paying \$30 billion per year in superannuation fees ..."*

Aspects of the Government package, such as reducing fund duplication and creating efficiency, are laudable, but the performance comparison part of the \$17.9 billion is little more than a political pitch on an unrealistic dream.

*Graham Hand is Managing Editor of Firstlinks.*

## One last hurrah for the 60/40 portfolio?

### Damien Klassen

Markets move in cycles. The last 40 years have seen interest rates down from 20% to less than 1%, quietly fuelling a rise in bond returns over the same time. This has driven the return of the typical 60/40 portfolio (60% stocks and 40% government bonds).

Over the 40 years, the benefit of the 60/40 portfolio has been that when economic growth has slowed:

- stock prices have been weak
- but interest rates have fallen, increasing the return on bonds



And vice versa for when economic growth has improved.

With interest rates at almost zero, there is a reasonable argument that this trade is over for the current cycle. I'm quite partial to that argument for Europe and Japan.

But for Australia, I'm expecting one last hurrah before the end of the cycle.

### **A bond Armageddon?**

Government (as opposed to corporate) bonds are typically a low-risk investment. However, there are plenty of doomsayers for the government bond market calling for a bond Armageddon with 10-year bonds losing 35% with a return to 'normal' interest rates.

And the doomsayers are (technically) correct that if 10-year government bonds rose from the current level of below 1% to a more typical 6% then the ten-year bond price would fall 35%. But this is grossly misleading as to the true risk to investors (rather than traders) for four reasons:

#### **Reason 1: The speed of adjustment is key**

The -35% price movement in 10-year bond prices is only true if it happens overnight.

A bond ladder is a more typical exposure for investors. Those who invest directly or (like our clients) through a separately managed account have far less to fear.

An example bond ladder might have one bond expiring every year for the next 15 years. Each year, your bonds move one year closer to maturing. Each year you take the money from the bond that matures and buy another 15-year bond.

If bond yields move evenly from current levels to 6% over 10 years, then bond investors with this strategy will make a profit. Not a great profit admittedly, only about 0.5% p.a. – but a long way away from a 35% loss.

If the increase in interest rates was faster, say five years, then you would make a loss (if you sold the entire portfolio in five years) of about 2.5% p.a. Not a good outcome. But not a shocking risk.

#### **Reason 2: 10-year bonds are a trading strategy, not an investment**

Ten-year bonds are not really an investment. You can buy a 10-year bond, but in one year you no longer own a 10-year bond: you own a nine-year bond.

To keep a 10-year bond, you need to sell your 9.75-year bond and buy a 10.25-year bond, then wait six months and do the same thing again. And again. And again. 17 more times.

This is the action of a trader, not an investor.

The effect on investors, who tend to have a range of different maturities, especially in a 60/40 portfolio is significantly different from a trader.

#### **Reason 3: Traders take risks on bonds, investors get certainty**

Traders who buy and sell rapidly, or who use leverage, or who take long/short positions have reasons to worry about significant losses on bonds.

Typical investors, though, buy bonds because of the certainty they provide.

When you buy a current Australian 10-year bond, you know exactly the return you will get if you hold it to maturity. You will pay \$115 today for the bond, you will get \$1.25 every six months, and in May 2030 you will get back your \$100. You have locked this return in.

The price of your bond will vary. But for an investor who is holding to maturity, the returns do not change.

#### **Reason 4: Inflation**

Most bond doomsayers that are calling for the Armageddon are doing so because they are forecasting the imminent return of inflation.

One day they will be right. But the developed world has spent the last ten years (20 years in Japan), trying to create inflation. And failed.

Now the world is staring down the largest unemployment shock since the great depression. Household and corporate debt levels are already elevated - it will be difficult and increasingly dangerous to increase them from current levels.

Inflation is the most significant risk facing any bond holding. But it is not a risk right now.

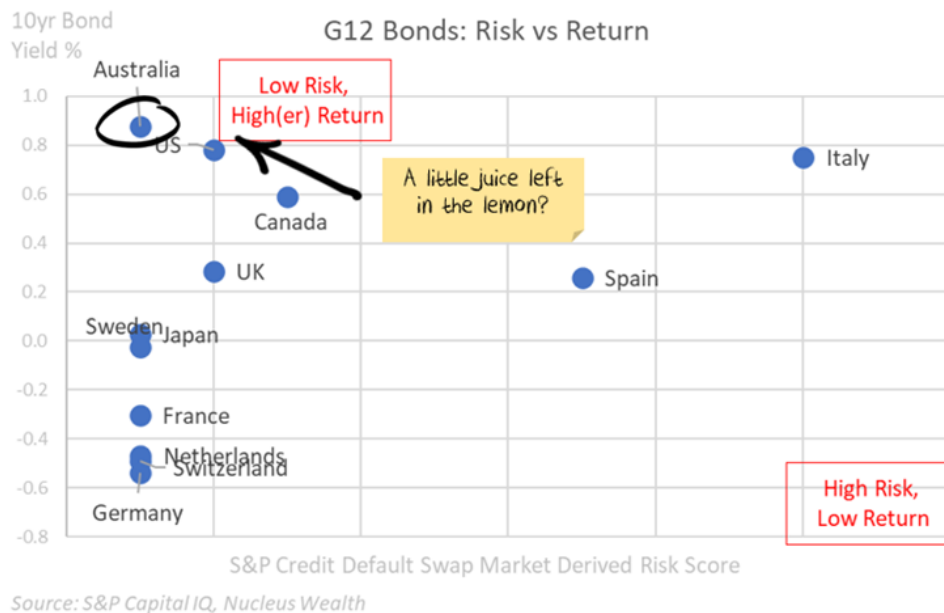
My view is that a mix of increasing inequality and central bank rules make it very difficult for monetary policy to create inflation. Inflation, when it finally comes will be a reversal of inequality and massive stimulatory government spending. The government spending we are seeing at the moment is to reduce the depths of the recession, it is not (yet) the type of spending that increases inflation.

### What is the last hurrah?

The real benefit of bonds is that you know already how much money you are going to lose over 10 years if you hold to maturity. The answer is zero. If you buy a 10-year bond at 0.9% and hold it to maturity, you will get 0.9%.

That is the point. Bonds give you certainty of return. What they also give you is the option to sell the bond part of the way through to take advantage if yields continue to fall.

At the moment, Australian bonds are among the highest in the developed world where credit risks are low:



If Australian bond yields chase the rest of world bond yields lower, and we expect they will, the value of a typical bond ladder will increase 5-10%. As I've noted above, that only matters if you sell the bonds though.

In our portfolios, we do expect to sell these bonds and switch into equities at some stage.

Going forward, the risk-return equation for bonds is broadly:

- 5-10% p.a. upside if we are right and economic conditions worsen.
- 5% p.a. losses if we are dramatically wrong.

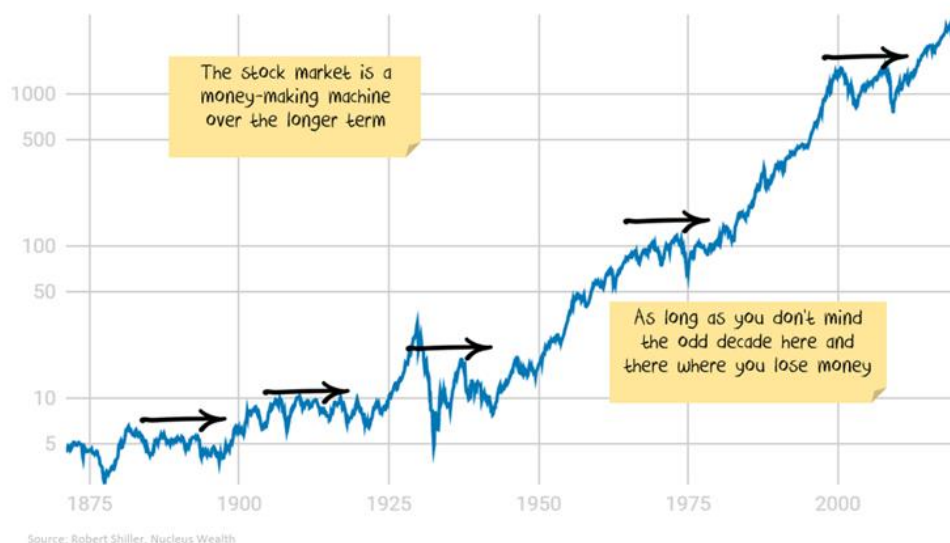
### What about a 'set and forget' 60/40 portfolio?

Here is the difficult part. If you are buying and holding, then your bonds are not going to give you much of a return. Plus, stock markets are trading at valuation levels that are as expensive as they have ever been.

I don't mind the outlook for the world economy once we get deeper into the 2020s - but more on that another day.

It is possible that markets will continue to hope for better profits for several years until the profits finally justify today's prices. Basically, a sideways move for years.

## S&P 500



Based on current valuations, buy and hold is unlikely to be a winning strategy. Within our superannuation and investment funds, we are expecting to need to be considerably more nimble than a set and forget 60/40 portfolio to achieve reasonable returns.

*Damien Klassen is Head of Investments at [Nucleus Wealth](#). This article is general information and does not consider the circumstances of any investor.*

## Interview: How markets saved companies with zero revenues

### Graham Hand

*Vivek Bommi is Senior Portfolio Manager and Managing Director at Neuberger Berman in London. His responsibilities include management of the Listed Investment Trust, NB Global Corporate Income Trust (ASX:NBI).*

**GH:** A lot has happened in the corporate bond market since March. The Bloomberg High Yield Index on 23 March was 11.69% and now it's about 6% which is an extraordinary recovery. How do you summarise the last six months?

**VB:** At the market low, the world was struggling to understand what lockdowns meant, and the virus was looking bad in China with potential to hit the world. Markets were shocked that people were suddenly working from home. People were worried about public health, and investors in risky assets were trying to sell because the unknown is the worst thing for risky assets.

At the same time, in late March in all fixed income markets not just high yield, there was a big liquidity mismatch. Lots of sellers and no real buyers as the natural buyers were either fully invested or assessing what was in their portfolio. We went through each name to see what the effect of a zero-revenue environment would be on each company and whether we needed to take action.

**GH:** What's an example of a bond that was sold off but represented good value?

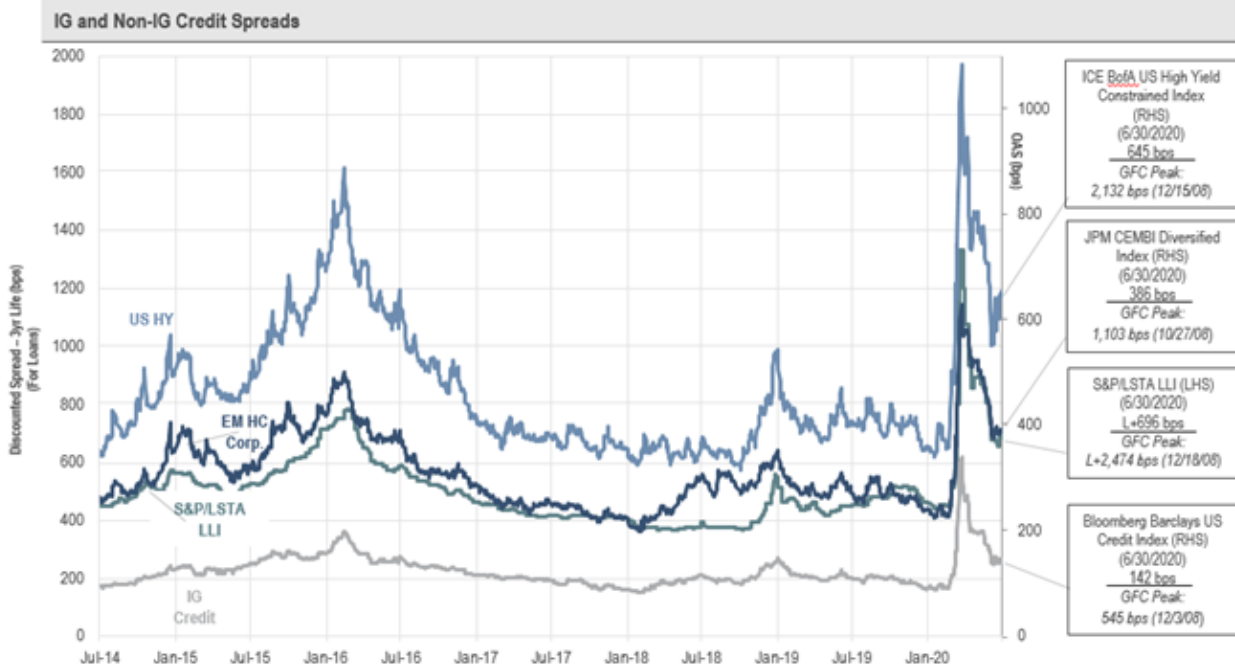
**VB:** Well, there was a one-year bond from Caterpillar, a US-based investment grade company, and because someone was trying to sell it, the bond sold for below 90. That's a 10%-plus yield on an A-rated company. It was not a high yield problem, it was everything, even off-the-run Treasuries.

**GH:** Then what happened?



## Speed of Sell-off

The recent velocity of repricing in credit markets has been unprecedented



Source: Bloomberg Barclays, ICE Index Services, JPMorgan, S&P Capital IQ LCD. As of June 30, 2020. US HY, EM HC Corp., S&P/LSTA LLI, IG Credit represented by the following indices, respectively: ICE BofA US High Yield Constrained Index, S&P LSTA Leveraged Loan Index, JPM CEMBI Diversified Index, and Bloomberg Barclays US Credit Index. "GFC" represents the Global Financial Crisis. Information is as of the date indicated and subject to change without notice. Nothing herein constitutes a prediction or projection of future events or future market behavior. For illustrative and discussion purposes only. Nothing herein constitutes investment, legal, accounting or tax advice, or a recommendation to buy, sell or hold a security. This material is not intended as a formal research report and should not be relied upon as a basis for making an investment decision. Investing entails risks, including possible loss of principal. Past performance is no guarantee of future results. Historical trends do not imply, forecast or guarantee future results. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed.

## Notable Sectors & Themes

	2Q20 Earnings	Forward Outlook
<b>COVID-19 Acute</b> Leisure Lodging Entertainment Gaming Airlines Retail	<ul style="list-style-type: none"> <li>Near zero revenue environment</li> <li>Cost rationalization, minimization of cash burn and ability to raise liquidity better than market expectation</li> </ul>	<ul style="list-style-type: none"> <li>Consumer demand for leisure activities has surprised to the upside following re-opening, sustainability of trends is uncertain</li> <li>Issuers believe some level of cost/margin performance is sustainable</li> <li>Airline ticket demand has flattened</li> </ul>
<b>Cyclicals</b> Autos Chemicals Metals Industrials Homebuilding	<ul style="list-style-type: none"> <li>Wide range of outcomes</li> <li>Ability to match cost structure to revenue key driver of results – in general, issuers have outperformed expectations on cost side</li> <li>Working capital was a material tailwind during the quarter</li> <li>Homebuilding and building products notable relative outperformers</li> </ul>	<ul style="list-style-type: none"> <li>Issuers seeing sequential monthly improvement in demand/revenue through June/July. Rate of improvement has moderated in July</li> <li>Strong homebuilding demand continues</li> <li>Working capital likely a use of cash in 2H20 (assuming trends continue)</li> </ul>
<b>TMT</b> Telecom Cable Broadcast Media Technology	<ul style="list-style-type: none"> <li>Limited impact on telecom/cable earnings</li> <li>Limited impact on software earnings</li> <li>Technology performing relative well (but with mixed end markets)</li> <li>Ad-dependent media revenue down 30 to 50%</li> </ul>	<ul style="list-style-type: none"> <li>Broader TMT outlook generally consistent with 2Q earnings</li> <li>Limited visibility on ad-dependent media revenue</li> </ul>
<b>Healthcare</b>	<ul style="list-style-type: none"> <li>Hospital revenue down 10 to 25%</li> <li>Working capital benefit with federal grants and Medicare advance payments</li> <li>Labor and cost adjustments helped mitigate volume declines</li> <li>CROs, suppliers, managed care have been net beneficiaries</li> </ul>	<ul style="list-style-type: none"> <li>Volumes improved towards QE at ~85-90% of pre-COVID</li> <li>Potential for additional government support for hospitals/providers</li> <li>Lagging ER volumes (impact on physician services names)</li> </ul>
<b>Energy</b> Energy Gas Distribution Utilities	<ul style="list-style-type: none"> <li>Issuers reporting earnings in-line with low expectations driven by significant YoY decline in commodity prices</li> <li>Midstream business model impacted but more resilient than upstream</li> <li>Utilities performing relatively well, particularly retail operations</li> </ul>	<ul style="list-style-type: none"> <li>At current commodity prices issuers are re-starting shut-in production and beginning to complete already drilled wells</li> <li>Near-term drilling activity is expected to remain at depressed levels</li> <li>Issuers focused on managing production declines while minimizing capex</li> </ul>
<b>Financials</b>	<ul style="list-style-type: none"> <li>Loan demand <u>weak</u> in 2Q but improved throughout quarter, stability in June/July</li> <li>Balance sheet metrics stable to improved sequentially and YoY</li> <li>Provision trends mixed but generally better than expected</li> </ul>	<ul style="list-style-type: none"> <li>Deferral requests have declined significantly since March/April</li> <li>Repayment trends have been in-line with expectations</li> <li>Credit losses expected to be ~stable, FY21 still uncertain (stimulus, recovery)</li> </ul>

This material is intended as a broad overview of the Portfolio Manager's views and is subject to change without notice. Portfolio Manager's views may differ from that of other portfolio managers as well as the views of the firm. Nothing herein constitutes a prediction or projection of future events or future market behavior. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed.

**VB:** First, the Fed stepped in and said it would buy investment grade issuers by expanding its balance sheet, and that calmed markets as people stopped worrying about investment grade names rolling over their debt. Second, and more subtly, the Fed backstopped fixed income ETFs. At that stage, fixed income ETFs were trading at a discount and big selling then feeds upon itself. And third, governments around the world stepped in with fiscal policies. Increasingly, markets looked well forward to understand the longer-term consequences.

All these combined to give a better sense of the impact coronavirus would have on various companies and broadly speaking, it was not as bad as first feared. And so capital markets reopened quickly. Companies which needed cash could access equity markets or debt markets. Of course, certain industries were more impacted, such as theme parks and travel for example. But even they were able to raise capital to withstand multiple years instead of multiple months of zero revenue. It changed the dynamics and the picture on the number of defaults.

**GH:** Was the Fed activity in ETFs and direct bonds confined to investment grade?

**VB:** No, they also bought high yield ETFs as well. In bonds, they specifically picked names that were downgraded from investment grade to high yield. But in fact, they did not do that much, but just having that backstop gave people a lot more comfort.

Now, at this point, when you look at fixed income, high yield credit is one of the few games in town. It's a large, diverse market of US\$2.5 trillion, including regular companies everyone knows, which makes them easier to analyse. Not much else offers yield anymore, neither governments nor investment grade unless you're willing to go out very long in the curve. Some money is going into emerging market sovereigns, but many people are less comfortable with that.

In the last few months, there's been US\$30 billion of retail flows into high yield funds and another US\$30 billion of institutional money so the market has a good tailwind.

**GH:** Are you concerned about the 'zombie' companies which could not refinance their debts if not for this injection of liquidity? Is the can kicked down the road?

**VB:** Realistically, few companies pay off all their debt anyway and it's an efficient use of a balance sheet to run with some debt. If a person takes a 30-year mortgage, over what time frame do they expect to pay it off? Almost every company can pay off all their debt in 30 years because corporates are long-term entities. Individuals want to pay off 100% of their debt because they stop working, so it makes sense.

Now, there are certain industries that have increased their debt load and are burning cash, and they probably have more debt sheet than is preferred. They need to pare it down, the obvious examples are hotel companies, leisure cruise lines and the like. Some of these have moved from investment grade companies to high yield. Over time, as their earnings and stock prices improve and they start repaying the debt, they'll probably move back up but it'll take a while.

**GH:** Do some companies borrow even if they don't need the money immediately?

**VB:** Frankly, some take out debt as an insurance policy. Those companies have other debt maturing within 12 to 24 months out and they're sitting on cash and will probably repay their debt. Ford is a perfect example. Pre 2005, it was an investment grade company, it took out a lot of debt for its restructuring and then earnings had a problem. It was downgraded to high yield in 2005 but by 2011 it was back to investment grade. I characterise a zombie as a truly insolvent company, meaning its debt load is in excess of its enterprise value. Those don't last long because markets are pretty efficient. Banks and bond markets won't lend to them.

**GH:** What about governments? Australia now has over a trillion dollars of debt, are we passing problems to future generations or don't we need to worry because the debt doesn't need to be repaid? It can just be rolled over forever when it's a government.

**VB:** Yes, but as you increase your debt, whether a corporate or a government or an individual, you are creating less flexibility in the future. There's a natural limit to how high you can go. At least corporates have levers to pull in cutting costs or raising equity to generate cash flow. Some corporates prefer to raise equity than debt to maintain financial flexibility in the long term.

**GH:** Your highest-profile fund in Australia is the listed trust, NBI, and it's been part of this high yield journey in 2020. What has Neuberger Berman done in the last six months to address the falling share price and the discount to Net Tangible Assets (NTA)? It's seen a strong recovery and now the discount is narrow.

**VB:** The market has obviously improved from the lows, but we have been engaging with our clients as much as possible, explaining the story. The goal is to pay out a Target Distribution on a monthly basis which we have been doing. We have full transparency in the portfolio, which shows large companies rated by the three major rating agencies. Some of our peers say their portfolios are investment grade and in the fine print, the rating is done in-house, not by independent agencies.

**GH:** In Australia, the big flows into ETFs have been in global equities but also very strong into fixed interest in various forms. And yet, investment grade returns are very low in a fragile economy. How are investors justifying such large fixed interest flows with returns that barely cover inflation?

**VB:** First is protecting their portfolios from another equity drop, especially after the market rally. Second, if you take a look at the main corporate bond index (the ICE BofA US Corporate Constrained Index with a market value of US\$8.3 trillion), the year-to-date return is 6.7%, which sounds good, but the current yield is only 2% because it includes US Treasuries. Investors don't look forward, they say, "Wow, investment grade paid nearly 7%, I should put money into that." But US Treasuries returned 11%, meaning the rest lost 4%. With a yield of 2%, if you're just a little wrong on rates, that wipes out your total return.

**GH:** So the gain is all in the duration and not the credit. The last time I saw the duration of the index, it was out to about seven years, so a 1% rise in rates means a 7% loss of capital.

**VB:** It's now out to 8.2 years. It's the largest investment grade index. Yield of 2%, duration over 8 years. If rates go up only 0.25%, you've pretty much zapped all of your yield right there.

In Australia, many retail investors have their money in bank hybrids as their fixed income proxy, which has worked. Yet they have a much higher aversion to non-investment grade debt than almost anywhere else in the world. They think if a company is rated 'junk' it's a terrible company because junk means bad. But the median EBITDA of companies in our portfolio is about US\$1 billion. The median EBITDA of the ASX100 excluding banks is less than A\$200 million. These high yielders are not small companies.

**GH:** What is NB doing in the investment grade space that is available to Australian investors?

**VB:** We offer a flexible multi-sector global bond solution, the Neuberger Berman Strategic Income Fund, which has an investment grade average rating. It's also has a monthly distribution which we think appeals to those looking for a good durable income stream.

**GH:** Let's finish up with your market outlook.

**VB:** If the US election has any impact, it will impact more on broader markets and you may see some of that translate into mark to market within high yield. But we don't see a major impact on the credits in our portfolio. Biden will probably increase scrutiny on big tech but that affects little in the mainstream economy.

There is a possibility that the Democrats may spend more which might put some upward pressure on rates.

On the virus side, I live in London and there is no real lockdown. It's not like March and April where you couldn't go to work and only grocery stores were open and you couldn't travel outside of London in your car. That was a real lockdown. I'm usually asleep by 10 o'clock so the new curfew on bars and restaurants has no impact on me.

The capital markets have been functioning well, supported by the US Fed and central governments, the future volatility in fixed income should be significantly lower even if we go a second lockdown.

Both the virus and the election are highly consequential for the long term. We are keeping risk levels in check given their volatile nature and the range of potential outcomes.

**GH:** The high yield market has improved a lot since March. Is there still value there?

**VB:** I think there's still good value. In today's global index, the yield is about 6% with 3.8 years of duration. So if rates move, say, 1% up, there's enough yield to compensate for that. But rates will only move up if there is growth in the economy, which is good for credit. We now know far more about the likely impacts of the virus on most companies.

*Vivek Bommi is a Senior Portfolio Manager at [Neuberger Berman](#), a sponsor of Firstlinks. This material is provided for information purposes only and nothing herein constitutes investment, legal, accounting or tax advice, or a recommendation to buy, sell or hold a security. It does not consider the circumstances of any investor.*

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## Too big to perform? The importance of limiting capacity

Andrew Mitchell

*"Anyone who says that size does not hurt investment performance is selling. It's a huge structural advantage not to have a lot of money."*

That quote is from legendary investor, Warren Buffett, who highlighted an investment truth: big isn't always best when it comes to investing.

There is a clear inverse relationship between a portfolio's size and its ability to generate alpha. The investment landscape is littered with managers, unable to resist the lure of higher fees from larger pools of money, whose returns slumped when they got too big.

So, while equity portfolio managers track hundreds of companies to find winning companies, they also need to closely monitor the size and liquidity of their portfolios. Indeed, we believe that answering the crucial question of where a fund's capacity level sits, and sticking to it, is a vital source of investment edge.

### Spooked by icebergs

Capacity is an important but often ill-defined concept. It relates to how much money can be invested in an actively-managed strategy without harming that strategy's future returns.

When an investment manager has smaller pools of money, they can rotate between stocks quickly, and with minimal pricing impacts. But once a fund grows its funds under management (FUM) beyond a certain amount — beyond its capacity — it is harder for the manager build meaningful positions in stocks.

Large FUM also makes it harder to exit stocks quickly to avoid 'icebergs'. The manager of big money has to move very early to avoid an iceberg. But that comes at a price, as some of those risks won't play out. By moving early, the manager unnecessarily wastes time and money in transaction and market movement costs to the detriment of investors.

### Multiple channels of constraints

Capacity constraints on a portfolio come through multiple channels:

1. **Constraints on portfolio positions** – These relate to limits on portfolio weights. They might include maximum stock, sector or geographic weights, both in absolute terms or versus their relative weights in the benchmark index for the fund. For example, an investor may not wish to hold more than 10% of the portfolio in one single company, thereby limiting how difficult it is to exit a concentrated position.
2. **Constraints on company holdings** – These relate to how much of the company's shares on issue you wish to own. An investor might have a limit on holding no more than 5% of market capitalisation or value of any company.
3. **Constraints on trading** – These relate to expected limits on the physical ability to trade. Investors may not, for example, wish to participate when their share of the average daily volume traded of the company is above 30%, because being above that threshold is likely to incur material market movement costs. Another trading constraint might be that at that trading level (30% of daily volume), the investor would not own positions in companies they could not exit within some defined period, say a week or a month.

### Establishing capacity

Academic studies have found that increases in FUM for a fund manager are associated with less alpha generation (benchmark outperformance) and reduced absolute levels of investment performance.

But there is no precise way to measure where a fund's capacity sits.

Capacity is fluid and influenced by numerous market dynamics at any given time. Capacity estimates, therefore, are best evaluated using judgement and a range of perspectives, and not fixed forever in dollar terms.

A bottom-up aggregation, from an individual stock to a portfolio level, is one guide to estimate a fund's capacity threshold. For example, assume we have a 30-stock small cap fund where the average company in its investable universe has a market cap of say \$1.0 billion. We can also assume that many funds avoid owning more than 5% of a company because crossing this threshold can lead to a significant increase in regulatory issues. Based on these inputs, we can assign that fund's theoretical capacity at \$1.5 billion (\$1.0 billion x 5% x 30 stocks).

But even outside of these mathematical constraints, we know that being large can hurt returns. You may identify a stock opportunity with 20% upside, but by moving all your money in and establishing that position you raise the price 10%, limiting potential returns.

So, performance-focused managers will put investors first and strictly limit capacity. They will close their fund to new capital or even sometimes return capital to fund holders. They will resist the lure of letting their funds grow too large so they can earn higher base management fees

### **An enduring competitive advantage**

When investing in the smaller and less liquid stocks on the market, capacity considerations are further magnified. For example, we decided in early 2018 to cease taking additional investments into the Ophir High Conviction Fund (ASX:OPH). Similarly, we closed our original fund, the Ophir Opportunities Fund, to additional investments back in 2015.

We had decided that after less than three years of operation these funds had reached their capacity level. We wanted to ensure the underlying investment strategy could continue to take full advantage of attractive investment opportunities.

A consequence of capping the size of an open-ended fund, is that new investors may feel unable to gain exposure to our fund's strategy. Existing investors could be similarly frustrated if they want to increase their exposure. By listing OPH on the ASX as a closed-end vehicle, however, investors are free to buy and sell the fund with the same level of freedom and flexibility as they would with any company listed on the market.

Ultimately, we believe that by keeping the size of our funds well within their capacity limits, our team is best placed to generate strong investment returns for our investors. We see these strict capacity limits for our strategies as an important asset for us and it will remain a competitive advantage against peers that cannot resist the temptation of 'getting big'.

*Andrew Mitchell is Senior Portfolio Manager and Co-Founder at [Ophir Asset Management](#), a sponsor of Firstlinks. This article is general information and does not consider the circumstances of any investor.*

## **How active bond funds hunt for value in fixed income**

Damon Shinnick, Jonathan Baird

Many investors may be wondering whether there is any value left in Australian fixed income markets. From the perspective of a bond fund manager, compelling risk/return opportunities still allow active managers to provide excess returns.

While outright yields look tight on a historical basis, we contend that select sectors provide attractive risk-adjusted returns relative to cash and government bonds.

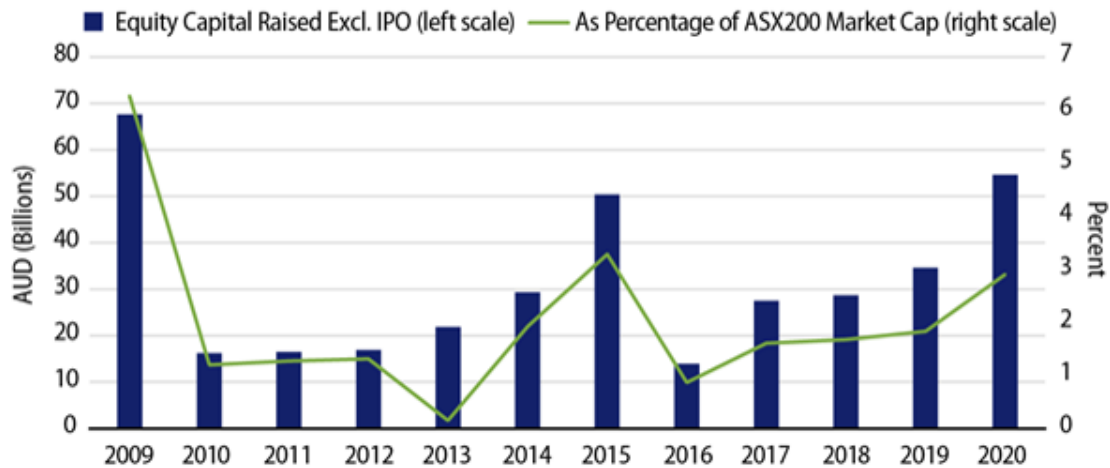
### **Brief Australian debt performance recap**

In April 2020, markets bounced quickly in regions such as the US and Europe, where central banks committed to directly supporting credit markets. However, in Australia [the Reserve Bank of Australia \(RBA\) fell short of this commitment](#) and conditions remained challenged, although they eased somewhat in May following the RBA's easing of collateral lending terms.

Turn the clock forward to September. Yields on senior bank debt for the major banks are now trading at low levels not seen since prior to the GFC. Support for domestic credit markets continues to expand as debt issuance by corporations receives strong demand. A record low cash rate drives investors toward non-government debt in a search for yield, improving liquidity markedly.

Corporate treasurers have also acted decisively to mitigate the impacts of the virus on their balance sheets. Businesses raised liquidity to allow themselves to survive the forced shutdown of the economy. Most companies tapped lines of bank credit, and many listed companies issued equity at levels not seen since the GFC (for example, BEN, NAB, NSR, NXT, QBE, QAN and more), as shown below. Dividends were suspended and costs aggressively cut across the board in order to preserve cash. While slow to start, a growing number of Australian companies are issuing into the debt markets.

**Exhibit 1: Equity raisings by Australian companies**



Source: Capital IQ, Bloomberg. As of 30 June 2020.

**Looking for value across the banking capital structure**

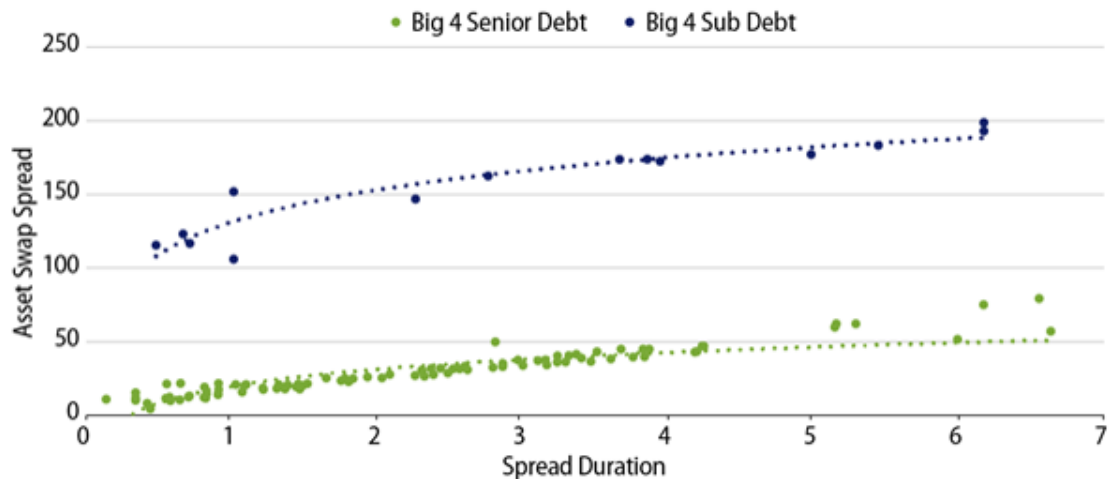
A combination of ongoing access to the term funding facility (TFF) and anaemic loan growth have left the banks with significant liquidity and little need to issue new senior debt to fund loan growth. In fact, banks have not needed to issue senior debt since the onset of the crisis, with maturing bonds not being refinanced. The [RBA has advised](#):

*"The TFF provides a source of low-cost funding for the banking system, with funding available for three year terms at a fixed interest rate of 0.25%. This helps to support the supply of credit and lower interest rates for households and businesses."*

By 1 September 2020, drawing under the TFF reached \$52 billion.

Bank debt issuance usually provides the bulk of investment opportunities in domestic credit markets, and with supply falling, the scarcity value of the outstanding bonds increases. As a result, the low bank yields are not likely to reverse any time soon.

**Exhibit 2: Major bank sub debt offers value**



Source: Bloomberg, Western Asset. As of 2 June 2020.

Banks issue debt across the capital structure, including senior and subordinated debt, alongside hybrid (AT1) capital. While senior debt has repriced to levels not seen since before the GFC, valuations of bank subordinated debt have not retraced to the same extent.

With the capital position of the domestic banks remaining sound, and ongoing support being in place, we feel that subordinated debt has some room to appreciate in value, and remains the more attractive part of the capital structure to invest in.

**Potential opportunities in Residential Mortgage Backed Securities**

Another sector that has benefitted from the current mix of policies is the domestic Residential Mortgage Backed Securities (RMBS) sector. While lockdowns have led to an increase in the number of households unable to meet their monthly payment commitments, the flow-on effects have been mitigated due to significant regulatory intervention.

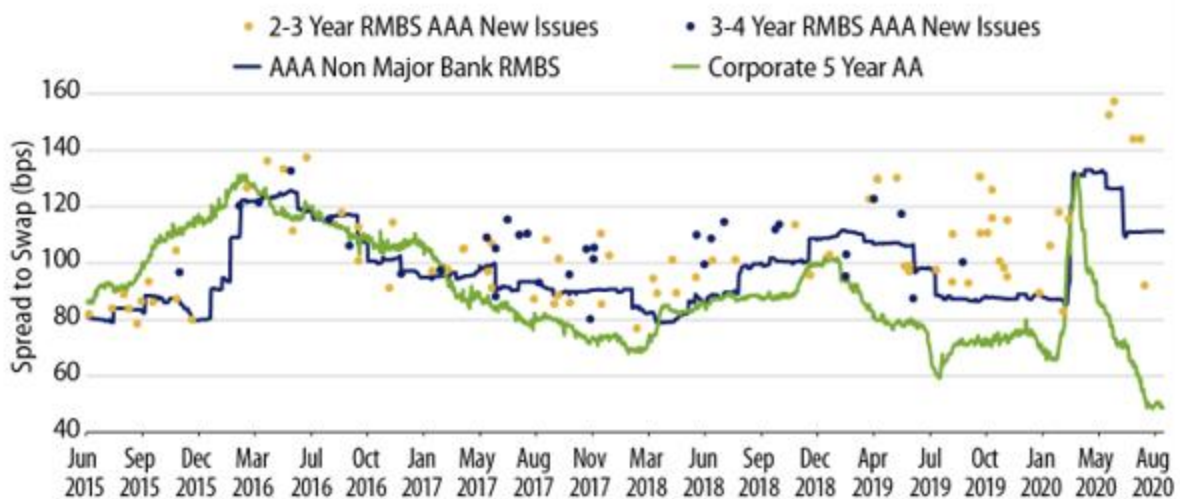
The Government has acted swiftly to limit the impact of COVID-related arrears on the performance of both home loan providers and the RMBS bonds that they issue. The aim is to avoiding the type of dislocation experienced during the GFC, when the valuations on RMBS blew out significantly worse than corporate credit.

Direct purchasing of RMBS by the Structured Finance Support Fund (SFSF) and the establishment of the SFSF Forbearance Fund, which is designed to assist non-bank lenders to cover payment shortfalls on loans affected by COVID-19, have led to the RMBS sector being well supported and have reduced the stresses on RMBS structures. This support has allowed lenders to maintain access to funding and focus on assisting borrowers to manage their way through the crisis, rather than forcing foreclosures on affected borrowers.

In April, we saw the average level of loans in partial or full forbearance rise sharply to around 10% for prime loans and near 20% for non-conforming loans. Encouragingly, we are seeing signs that the sector is repairing as the economy heals, and these forbearance numbers have tracked downward.

Unless the stresses increase significantly from here, we expect the structures to remain robust and therefore expect RMBS to perform well. RMBS yields, like those of bank-subordinated debt, are likely to continue to offer significant value for patient investors.

**Exhibit 3: Australian RMBS vs. major bank senior bonds**



Source: Bloomberg. As of 31 May 2020.

**Foreign issuer AUD debt issuance**

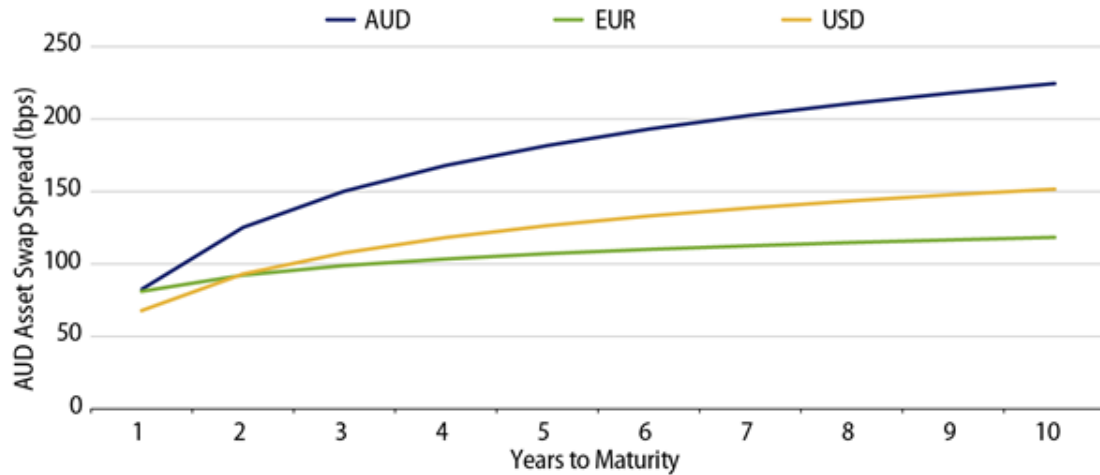
An additional area of opportunity exists in the form of bonds of offshore issuers. These companies primarily issue into the Australian market to diversify their sources of capital, provide a natural hedge for AUD-denominated earnings and for tax efficiency.

Such bonds are commonly referred to as Kangaroo bonds. There are currently many Kangaroo issuers where the AUD-denominated bonds are much cheaper (yields higher) than the issuers' USD- and EUR-denominated bonds. Both the Fed and ECB are explicitly supporting credit markets via their asset purchasing programs. This

has acted to significantly reduce the yields on eligible bonds. No such direct policy exists in Australia, leaving the AUD bonds undervalued in comparison to global peers.

The longer markets remain flush with liquidity in a yield-starved environment, the greater the likelihood that the yields on bonds issued across all currencies will converge. This presents a compelling opportunity for managers with a global research platform to build early conviction in the most robust Kangaroo names.

**Exhibit 4: Foreign Issuer AUD Denominated Bonds Trading Wide of Global Curves\***



Source: Bloomberg. \*A rated issuance from euro bank issuers. As of 30 Jun 2020.

We are not out of the woods yet, in terms of either the health or the economic consequences of COVID-19. However, a combination of aggressive monetary, fiscal and regulatory actions has provided the much-needed support to the economy. This unprecedented level of support does not reduce the need for intensive fundamental analysis. Indeed, it makes such research even more important.

The dislocations caused by selective government support and increased uncertainty within certain sectors does provide what we feel are compelling risk/return opportunities for active bond fund managers across segments of the market.

*Jonathan Baird is a Product Specialist and Damon Shinnick is a Portfolio Manager and Senior Research Analyst for [Western Asset Management](#), a Legg Mason affiliate and subsidiary of Franklin Templeton. This material is issued by Legg Mason Asset Management Australia Limited. This article is for information purposes only and reflects the current opinions of Western Asset Management. It has been prepared without taking into account the objectives, financial situation or needs of any individual.*

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## Claiming a tax deduction for super contributions

Julie Steed

One of the few positive, simplification measures that came with the 2017 major changes to superannuation was the ability for all fund members to claim a tax deduction for contributions made to super. Prior to 1 July 2017, only substantially self-employed individuals were eligible to claim a tax deduction.

Salaried employees may have been (and may still be) eligible to participate in salary-sacrifice arrangements with their employer, which has the same effect as claiming a tax deduction. However, many employers don't offer salary-sacrifice. Also, some employers only contribute deducted amounts quarterly when superannuation guarantee contributions are made, even though deductions from the member's salary occurs weekly or fortnightly.

The change has resulted in hundreds of thousands of additional members being eligible to claim a tax deduction and although the rules for claiming have not changed, there are aspects of the rules that are commonly misunderstood.



## Notice of intent to claim

Claiming a tax deduction for personal contributions requires a member to submit a valid notice of intent to claim a tax deduction to the trustee of the fund. The notice is often known as a section 290-170 notice after the section of the tax law that covers deductible contributions.

Conditions for claiming a tax deduction for personal contributions include:

- the individual is still a member of the super fund at the time of lodging the notice
- the relevant contributions are still retained within the fund (such as before partial/full withdrawal or rollover from the fund)
- the trustee has not begun to pay a pension based in whole or part of these contributions
- the member has not supplied a super splitting notice to the fund in respect of the same financial year
- no part of the contribution/s are covered by an earlier notice
- the member has received a notice of acknowledgement from the trustee of the superannuation fund.

The notice of intent to claim a tax deduction must be submitted on or before the first of the following dates:

- the date the client submitted their tax return
- 30 June of the following financial year after the client made the contributions.

## Impact of partial withdrawals

Where a member makes a partial withdrawal during the year, part of the withdrawal is defined as including contributions made before the withdrawal. This means that unless a notice of intent to claim a tax deduction is received prior to a withdrawal, the member will not be able to claim a tax deduction for the whole personal contributions made that year.

A valid deduction notice will be limited to a proportion of the tax-free component of the superannuation interest that remains after the roll over or withdrawal. The proportion is the value of the relevant contribution divided by the tax-free component of the superannuation interest immediately before the partial withdrawal. The amount that can be claimed is calculated according to the following formula:

**Step 1** – Calculate the tax-free amount of the withdrawal

$$\text{Roll-over amount} \quad \times \quad \frac{\text{Tax-free component of interest before withdrawal}}{\text{Value of super interest before withdrawal}}$$

**Step 2** – Calculate the tax-free component of the remaining interest

$$\text{Tax-free component of interest before withdrawal} \quad - \quad \text{Tax-free component of the withdrawal (worked out in Step 1)}$$

**Step 3** – Calculate the remaining amount of the personal contribution

$$\text{Tax-free component of the remaining interest (worked out in step 2)} \quad \times \quad \frac{\text{Personal contribution}}{\text{Tax-free component of interest before withdrawal}}$$

The law allows members to lodge a notice of intent to claim a tax deduction at any time during the year however some funds have specific product rules that only allow notices to be lodged as an annual process. Accordingly, it is best to check with the fund before rolling over.

Regular rollovers to fund insurance premiums are an example of a situation where members are not fully aware of the impact on their ability to claim a tax deduction.

## Case study

Brian contributes \$2,000 per month to his super fund and intends to claim \$24,000 as a tax deduction. On 31 December he rolled over \$3,000 to pay for his insurance premiums in an insurance-only super fund. Brian does not provide his super fund with a notice of intent to claim a tax deduction before the rollover.

As at 31 December, Brian's super balance is \$50,000 and the tax-free component in his super fund (so far) is \$12,000 (the contributions for which a notice of intent to claim a tax deduction has not been received by the fund). The portion of the \$12,000 that remains in the fund is calculated as follows:

**Step 1** – Calculate the tax-free amount of the withdrawal

Roll-over amount x (Tax-free component of interest before withdrawal / Value of super interest before withdrawal)

$$\$3,000 \times (\$12,000 / \$50,000) = \$720$$

**Step 2** – Calculate the tax-free component of the remaining interest

Tax-free component of interest before withdrawal - Tax-free component of the withdrawal (from Step 1)

$$\$12,000 - \$720 = \$11,280$$

**Step 3** – Calculate the remaining amount of the personal contribution

Tax-free component of the remaining interest (from step 2) x (Personal contribution / Tax-free component of interest before withdrawal)

$$\$11,280 \times (\$12,000 / \$12,000) = \$11,280$$

Brian makes a further \$12,000 of contributions before the next 30 June. Brian then lodges a notice with the intention to claim a deduction for the \$24,000 contribution. The notice is not valid as the super only holds \$11,280 of the first half of the year's personal contribution. Brian can only lodge a valid deduction notice for an amount up to \$23,280.

If Brian made a further rollover on 30 June to fund insurance premiums the process would be repeated and the amount available to claim reduced further.

Brian could claim the whole \$24,000 by lodging a notice of intent to claim a tax deduction before the rollover occurs.

## Conclusion

Understanding the rules in relation to the eligibility requirements for claiming a tax deduction for personal contributions will enable members to maximise their tax deductions.

*Julie Steed is Senior Technical Services Manager a [Australian Executor Trustees](#). This article is in the nature of general information and does not consider the circumstances of any individual.*

## Add extra fries: the growing appetite for food-delivery services

Josh Gilbert

Restaurant and grocery delivery companies are the latest feeding frenzy for investors who are betting that appetites for food brought to homes and workplaces will keep growing beyond the end of the COVID-19 pandemic.

Investors looking to get a slice of the food delivery pie should keep their eyes peeled for trends around popularity and platform use, especially as the world starts to ease lockdown restrictions.

Food delivery giants UberEats, Grubhub, Just Eat Takeaway and Dominos are some of the top names but there is a plethora of platforms underneath fighting for a share of a growing market.

Total worldwide restaurant industry sales are projected to reach US\$2.1 billion this year, with revenue expected to show an annual growth rate of 7.1% and project market volume of US\$2.7 billion by 2024, according to [Statista](#).

Closer to home, market researcher Roy Morgan says the number of Australians over the age of fourteen [who use food delivery services](#) has doubled to nearly 4 million since 2018, driven by the 25% of millennials and Generation Z who regularly order in.

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## Food delivery popularity during COVID-19

COVID-19 has driven the most recent boom in food delivery as restaurants, bars and cafes were shut down by lockdown regulations but remained open for takeaways.

As some people turned to baking their own bread and getting creative in the kitchen, others turned to food delivery services in order to get their 'comfort food' kicks. In fact since the pandemic started, UberEats [reported](#) the term 'comfort food' had broken through the top searches on the platform.

Menulog, Deliveroo and UberEats have all reported rapid growth in new restaurants on their Australian platforms, user numbers and delivery numbers since March.

In August UberEats announced that its delivery revenue grew 103% year on year, as a result of more people ordering from Uber Eats than ever before.

While Menulog [recorded](#) a 54% increase in orders on the platform from Melbourne customers, and Deliveroo chief executive Ed McManus [said](#) 1700 new restaurants joined the platform in the weeks following lockdown closures in Australia.

This includes higher-end restaurants and venues which prior to the pandemic typically had long lines of customers waiting outside their doors, such as Melbourne's Chin Chin.

The buzz around food delivery has spurred acquisitions overseas, with European platform Takeaway.com recently buying JustEat for \$6.2 billion. Shortly afterwards the newly named JustEat Takeaway pounced on GrubHub for \$10.6 billion, after a deal with UberEats fell through. Last year, low-brow delivery service DoorDash also bought high-brow delivery service Caviar.

Since their low in March, Grubhub shares have climbed 142%, which coincides with its revenues in July of \$459 million, a 41% year on year increase from \$325 million in the second quarter of 2019.

### Not all foodies are sold

Despite the growth of the food delivery services industry during the global pandemic, not all Australian consumers and restaurants are sold.

Rather than relying on the food delivery platform giants, which charge high commissions for using their platforms, some restaurants are encouraging customers to pick up orders themselves or offering cook-at-home meals.

In an industry where net profit margins often fall in the low single digits, this commission structure works for highly-profitable restaurants for which delivery represents additional incremental sales and profiles. But for moderately profitable restaurants, low order volumes can be detrimental to the bottom line.

Some industry [experts](#) believe once the pandemic has passed and restaurants are allowed to operate as usual, hype built around food delivery services may die down or return to past performance levels.

### The innovative future of food delivery

It's easy to forget the food delivery sector is relatively young: Deliveroo launched just six years ago, Glovo four years ago, and UberEats entered the market in 2016.

But all are working on new products to further smooth the food ordering process.

Restaurants such as Dominos have already started planning for the future, allowing customers to order pizza through social media platforms such as Twitter by simply tweeting a pizza emoji. The pizza giant has also launched an app which allows customers to order pizza through their smart watches.

Pizza Hut partnered with Accenture and Visa to develop an in-car food ordering system, allowing drivers to buy pizzas while on the road. The secure medium lets customers order food by voice, eliminating the need to check the screen.

Automotive manufacturers Ford, Toyota and GM have successfully trialed autonomous vehicles for food delivery services across the US, in what promises to be a flood of driverless vehicles being employed by online food platforms.

In April 2019, Google's parent company Alphabet was approved to trial drone delivery in Canberra to over 100 eligible homes. UberEats were also given the green light to trial drone delivery in San Diego this year, after a successful pilot at San Diego State University in partnership with McDonalds.

The growth of the online food delivery industry has also given way to a virtual restaurant model known as 'dark kitchens' or 'ghost kitchens' that exist only to deliver food. Some established breakfast or lunchtime venues can rent out their unused kitchen in the evening, and new ventures can trial their wares without major overheads. Deliveroo has launched its own dark kitchen precincts, called 'Deliveroo Editions', which are easily accessible by their delivery riders.

### **Room to grow**

There's still a whole lot of room for growth in the food delivery service industry including plenty of space for new contenders and appetite for fresh offerings, but that will be matched by battles for market share as well as other hurdles along the way.

*Josh Gilbert is an Australian analyst at [eToro](#). This article is general information and does not consider the circumstances of any investor.*

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