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Contents

Only 2.4% of companies deliver all net shareholder wealth *Graham Hand*

Meg on SMSFs: Four ways super pensions are better in SMSFs *Meg Heffron*

The growth outperformance myth *Andrew Mitchell*

The mechanics of the $3 million super tax must be fixed *Andrew Gale*

Crisis, contagion or QE? The bigger picture *Roger Montgomery*

Brace, brace, brace: The real issue behind the banking turmoil *Andrew Canobi*

How digital tokens will revolutionise investing *Adam Belding*

Editorial

When interest rates fell close to zero in 2020, including on short-term deposits and investment grade bonds, many investors took on extra risk in a search for yield and income to live on. This included moving along the yield curve (that is, investing in longer-term bonds, and we now know how badly that ended for **Silicon Valley Bank**) or down the credit or capital spectrum. As interest rates rose, 2022 delivered the worst results in bond markets for decades, even without the impact of a recession on credit quality.

For example, a popular Australia ETF such as **Vanguard**'s International Fixed Interest Index (Hedged) ETF (ASX:VIF) holds around 1,500 government bonds from 35 large countries. About 90% of the securities have a credit rating of A- or higher. The credit quality of this bond is impeccable, as Vanguard explains:

> *"Government debt has historically been a stable investment, offering peace of mind during more volatile periods for share markets."*

How has this 'stable investment' performed? Investors only need one statistic to know the picture was not pretty. The duration of the portfolio is 7.4 years, meaning for every 1% rise in rates, the capital value of the portfolio fell by about 7.4%. The price of VIF is down 25% in three years, and none of that is due to poor credit quality. Vanguard was simply replicating a bond index, the results has nothing to do with their asset selection.

Source: Morningstar

Australian retail investors are also major holders of local hybrids, especially issued by banks. With the write-off of AT1 capital securities issued by **Credit Suisse**, the differences between the Swiss and Australian documentation have reassured investors that local hybrids are materially stronger. Not only are Australian banks more profitable and better managed, but these hybrids sit above shareholder capital in the payment waterfall.

Investors looking for yield are attracted to the extra margin on hybrids, despite the higher risk. Wholesale trading platform, **AUSIEX**, reported December 2022 hybrid trading volumes were double the level in December 2021, and:

> *"Trade volume among financial advisers increased 15.7% over the 2022 calendar year, compared with 2021. Across generations, for advised accounts, Gen X showed a significant lift in interest, with the proportion of trades increasing from 31% to 37.7%."*

Something else happened with investor appetite when interest rates headed to zero. Those who qualified as 'wholesale' turned to fixed interest brokers for direct bonds, but in many cases, the clients knew insufficient about credit and duration risk in their quest for yield. Some clients have since learnt the hard way that 'bond' does not necessarily mean 'defensive'.

Retail investors considering direct exposure to unrated bonds must assess their ability to understand company balance sheets, debt structures, loan covenants, payment tiering, and industry and macro conditions. A broker might provide a detailed offer document but inexperienced investors cannot rely on the broker to make the investment decision.

All this reading and assessment is required just to ensure money is returned, as in bonds, there is no upside beyond repayment at par, unlike in equities.

On the other hand, some of the bonds placed with unsophisticated investors were issued by high quality companies, such as **Aurizon** with a coupon of 2.9%, maturing in 2030. While holders of this bond now face a large revaluation 'loss', at least if they hold to maturity, they should receive par. Again, this is due to duration risk, not a credit loss. Similar long bonds were issued by **Lend Lease, Pacific National and Transurban**, which all look good from a credit perspective.

It is in the non-investment grade securities where the credit problems have already occurred, even before any sign of a recession. Examples include:

1. Virgin: The best known of the recent bond failures, and when Virgin entered voluntary administration in April 2020, its new owner, **Bain Capital**, said bondholders would receive less than 10 cents of the par value for their bonds.

2. Privium: On 29 November 2021, The Australian Financial Review reported: *"Privium failure hits more than 2000 home buyers ... The company went under with liabilities of $23 million in secured notes and $17 million in unsecured liabilities equally split between subcontractors and suppliers."*

3. Axsesstoday: Axsesstoday was placed into liquidation in April 2019 and retail investors in its July 2018 bond issue were left with a security which might be worth around 5% of its face value when investors are eventually paid out. These notes were listed on the exchange (ASX:AXLHA) and readily available to anybody.

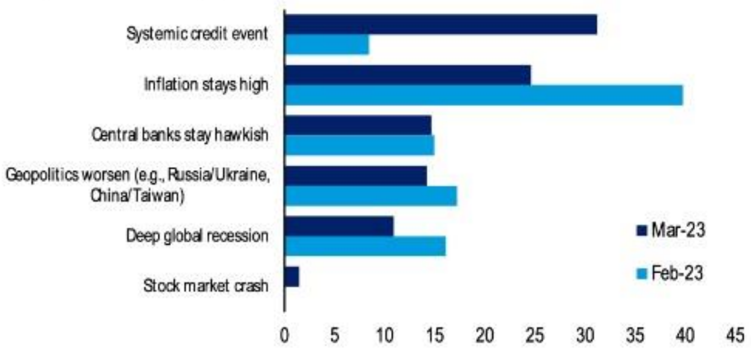
4. Mackay Sugar: Mackay Sugar bonds, issued with a coupon of 7.75% in 2013 as a 'wholesale corporate bond' and expected to mature in 2018, holders were offered half the face value on their notes when the sugar refiner hit financial problems.

5. CF Asia Pacific: Anchorage Capital Partners bought distressed transport company CF Asia Pacific in 2019 with senior lenders taking priority over its subordinated notes.

Many more companies will not survive a climate of high interest rates and recessionary trading conditions. Most 'retail' investors wanting exposure to bonds should stay with investment grade companies or bond funds where fund managers access the issuer risk. And even then, as large European funds holding Credit Suisse AT1s have learned, professionals can miss the detail hidden in plain sight in the offer documents.

And it is credit which is now worrying fund managers most. To show how quickly market sentiment can change, the **Bank of America** Fund Manager Survey for March 2023 shows how 'systemic credit event' has replaced 'inflation stays high' as the major 'tail risk'.

Chart 13: "Systemic credit event" overtakes "inflation stays high" as biggest tail risk
What do you consider the biggest 'tail risk'?



Source: BofA Global Fund Manager Survey

At least hardly anyone believes there will be a stockmarket crash.

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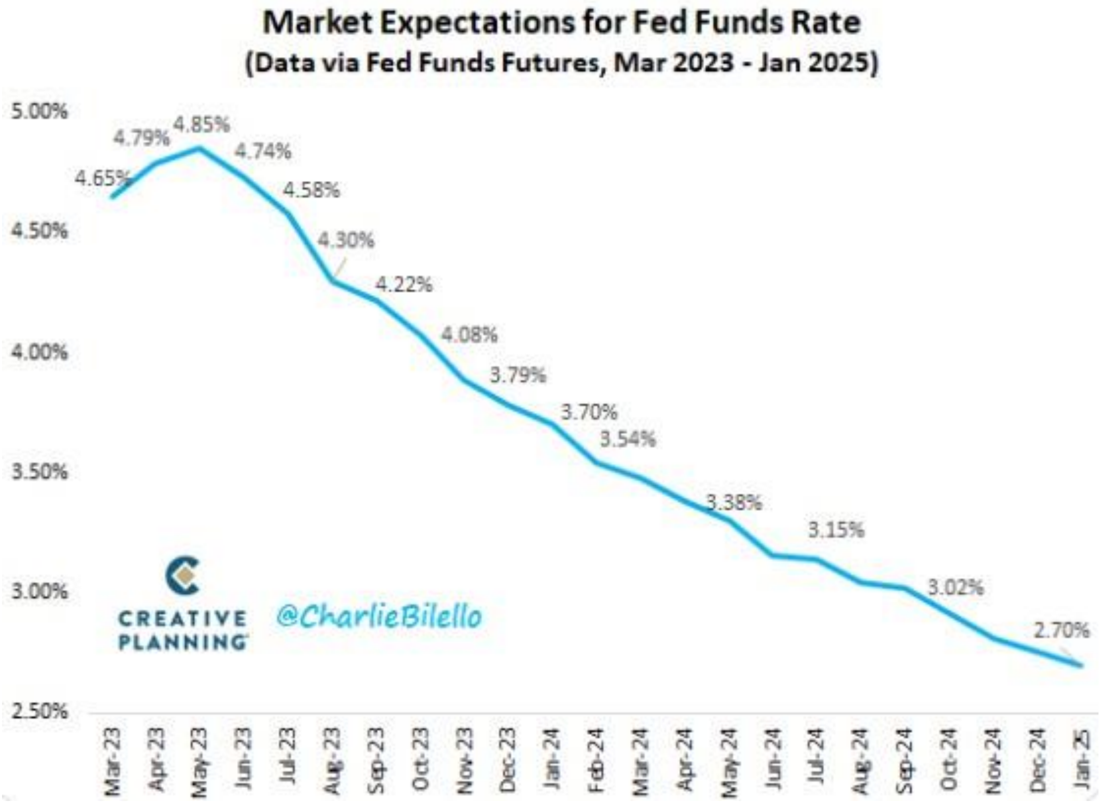
The NSW state election demonstrated a problem facing the **Reserve Bank** in slowing the economy. While **Governor Philip Lowe** tries to reduce consumer spending by increasing cash rates, voters are offered energy subsidies, road toll relief, increased infrastructure spending and business subsidies. It's similar at a Federal level, with the Government struggling to find meaningful spending cuts but plenty of reasons for handouts. Nothing Phil can do about this.

On interest rates, while talk of the US Fed stopping at 5% still has its supporters, it is less often mentioned how much the market expects the Fed to ease over the next couple of years. With **Chairman Powell** vowing to drive inflation back to 2%, the market thinks he will succeed and probably take the economy down in the process.



There was more room for optimism that the Reserve Bank will at least pause at its next meeting, following the release of the CPI yesterday. **Michelle Marquardt**, ABS Head of Prices Statistics, said:

"This month's annual increase of 6.8% is lower than the 7.4% annual rise reported in January 2023. This marks the second consecutive month of lower annual inflation, also known as 'disinflation', from the peak of 8.4% in December 2022."

Of course, economists remain divided, with ANZ still calling for two more rate increases and a top of 4.15%, but they are now in the minority.

Finally, many thanks to the 800 or so people who filled in our **Reader Survey**. It will influence our future content, although without too much change as a common theme was '*keep doing what you are doing*'.

Graham Hand

Also this week ...

The research into the performance of US and global stocks by **Hendrick Bessembinder** surprised many, as it identified that relatively few stocks generate all the stockmarket's outperformance. He visited Australia recently, and read what he says about his research including whether it lends weight to active or passive investing.

Andrew Gale's long career in consulting and investing included time as Chair of the **SMSF Association**. While he has sympathy for a limit on the concessions available on large super balances, he says the Government's proposed mechanism to identify who should pay more tax has serious flaws.

Still on superannuation, we know that industry funds, retail funds and SMSFs are alternative ways to hold retirement savings and they are generally subject to the same rules. But in her continuing monthly series, **Meg Heffron** shows four ways in which SMSFs might be better for paying pensions from super.

There's a common perception that the main reason that growth stocks outperformed value stocks in the decade to 2021 was because of lower interest rates. **Andrew Mitchell** from **Ophir** thinks that's a furphy and provides compelling evidence for his contrarian view.

Roger Montgomery reassures us that this latest banking crisis isn't the GFC 2.0. Yes, there are still risks, but the crisis is also providing opportunities for bargain hunters. According to Roger, price-to-earnings ratios have pulled back, and stocks with solid earnings profiles are looking attractive.

Meanwhile, **Andrew Canobi** of **Franklin Templeton** zeros in on what he sees as the real issue behind the banking turmoil: the constriction of credit supply that central banks are inducing amidst their assault on inflation. He says that in a highly-financialised world fuelled by liquidity and availability of credit, sooner or later things start to break when central banks withdraw that credit and liquidity as rapidly as they have.

Almost all of the large funds management companies are experimenting with blockchains and digital coins. **Adam Belding** of **Calastone** gives an insider's view on the potential of so-called tokenisation to transform the finance industry.

Lastly, this week's white paper from **Martin Currie** summarises the recent reporting season and the key themes to come from it.

Curated by James Gruber and Leisa Bell

Only 2.4% of companies deliver all net shareholder wealth

Graham Hand

"Over the years, I have made many mistakes. Our satisfactory results have been the product of about a dozen truly good decisions - that would be about one every five years."
- Warren Buffett, Annual Letter to Berkshire Hathaway shareholders, 2022

"Focusing on aggregate shareholder outcomes, we find that the top-performing 2.4% of firms account for all of the $US75.7 trillion in net global stock market wealth creation from 1990 to December 2020. Outside the US, 1.41% of firms account for the $US30.7 trillion in net wealth creation."
- Hendrick Bessembinder and colleagues, Financial Analysts Journal, revised March 2023

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When Hendrick Bessembinder published his original study on the stockmarket performance of 26,000 US companies from 1926 to 2016, he expected a few hundred fellow academics to read it. It was somewhat blandly titled "*Do Stocks Outperform Treasury Bills*", and to him, it was about 'skewness' or the asymmetry of returns.

"When I was compiling this, I almost didn't write it up. I thought people must know this. Because it's not exactly rocket science, you know, honestly, to take the same database that other people have been looking at and actually compound the returns. Seems a lot of people were caught by surprise."

But as word leaked out about his results, the world media and financial commentators took notice.

Three New York Times articles.

Four Financial Times articles.

A Wall Street Journal article.

Two Bloomberg articles.

Le Monde, Der Spiegel, etc.

41,000 downloads from SSRN.com

(The original research is available free on SSRN from 2017 here and updated from 2023 here).

The surprising results that caught world attention

There have been a multitude of studies of long-term returns, but it was Bessembinder's results which shocked, and he outlined them in a recent presentation in Sydney. Out of 26,000 US listed companies:

- A few stocks have very large compound long-run returns.
- The large positive 'market risk premium' is attributable to relatively few stocks.
- The top 90 firms (1/3 of 1%) account for half of the shareholder wealth enhancement (relative to US Treasury Bills) since 1926.
- The top 4% of firms account for all of the net shareholder wealth creation since 1926.

Only about 1,000 stocks out of 26,000 accounted for all the US$35 trillion of wealth created (above the Treasury Bill rate). This is far from a coin toss as 96% of companies did not contribute to growing net shareholder wealth. Bessembinder said of his research:

"The basic difference here is that I took those monthly returns and compounded them for a given stock over time. When I compound them out over the full time that they're in the database, most of them deliver negative returns. A few stocks on the other hand give very large compound returns ... The stock market as a whole is doing very well for investors. Most stocks are not doing well for investors. The only way this adds up is that there's a relative few stocks doing very well."

Even more skewed in the global results

In his Sydney presentation, Bessembinder also reported on his updated work, which now covers 64,000 global companies from 43 countries over 30 years. To show the US results were not a fluke, the global stock market returns were even more skewed.

Of the US$76 trillion shareholder wealth created by 63,785 firms from 1990 to 2020:

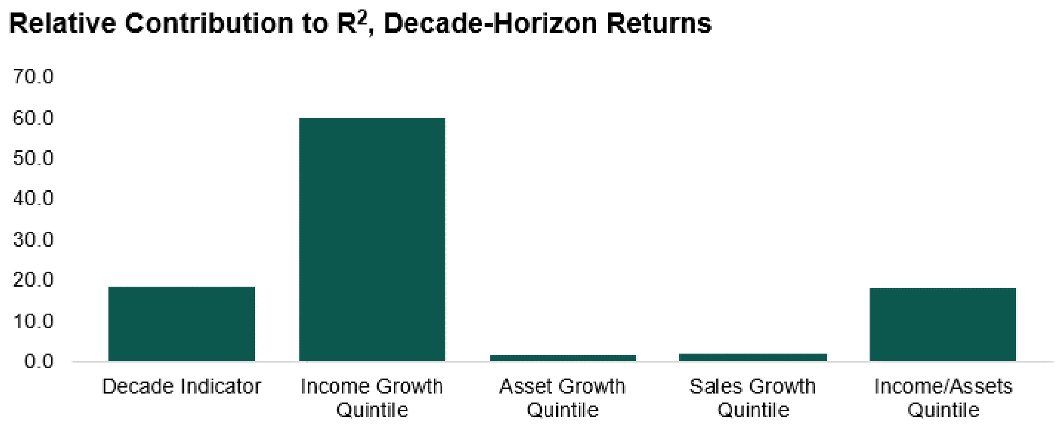
- The top 5 firms (0.008%) accounted for 10.3%
- The top 159 firms (0.25%) accounted for 50%
- The top 1,526 firms (2.39%) accounted for 100%
- The other 62,259 firms collectively matched US Treasury Bills.

In his research, 25,441 (39.9%) companies did generate (modest) positive wealth which just offset the wealth destruction of 36,818 (57.7%) companies.

It's a difficult number to comprehend. Only 2.4% of global listed companies account for all the market performance above a short-term government security.

What factors caused the outperformance?

Bessembinder then started looking for the source of the outperformance, especially the growth in fundamental measures. Based on compound returns in US stocks from 1970 to 2020, he found five fundamental variables which he says explain about 29% of the variation in multi-decade stock returns.



The strongest indicator was income growth, while asset and sales growth were relatively unimportant. He also tested the 'decade indicator' to see if there was something about particular decades which produced strong results, and he compared the income to assets ratio.

What does this mean for investing?

Every company that lists on the stock exchange is sponsored by a broker, who pitches the name to its investors by producing expansive offer documents showing the apparent potential of the company and detailed financial and future plans. While the broker has some duty of care, the main aim is to sell the asset. These companies are bought by market professionals, as well as retail investors. And despite all this professional oversight navigating listing and regulatory rules, the overwhelming majority of companies destroy wealth versus simply investing in a government security. Most companies destroy investor wealth over time.

There are two opposing ways to interpret these results.

The **first** view is that if so few stocks create all the market's gains, it must be extremely difficult to identify them early enough, which speaks to the merit of passive investing and owning everything. At least then, a small slice of the big winners is in play.

The **second** view is that there are extraordinary rewards for the active fund manager who invests in these moonshots, at almost any time in their early development. It does not need to be at pre-IPO, IPO or shortly after. That is only the start of a long and successful run. A big win compensates for losses elsewhere.

The fact that Bessembinder was brought to Australia to speak at a conference called 'Active Advantage' shows his work influences active managers who work to identify rapidly-growing, ground-breaking companies in the list above. In fact, Scottish fund manager Baillie Gifford financed the global study.

What does Bessembinder say?

Knowing his work can support arguments for both active and passive investing, Bessembinder walks the fence. While he says:

> *"I think I have provided some ammunition for the people who say it's their business to chase moonshots. The skewness shows just how big the pay-offs can be if you're good at this."*

… Bessembinder hedged his bets in his own interpretation, making these arguments in Sydney:

- In the long run, stockmarket investing has much in common with venture capital.
While all venture capitalists have a unique approach, in general, they place many bets in startup companies knowing that 80% will fail, 10% will breakeven and 10% will deliver success in a big way. Obviously, they do not deliberately select companies they expect to fail, but picking early-stage winners is difficult. The surprising aspect of Bessembinder's work is that more-established listed companies are the same or worse.

- (Many) Investors should hold on low-cost and broadly-diversified portfolios.
Bessembinder acknowledges that the majority of people do not have special skills to identify a few great companies, and he supports the majority holding cheap index funds. BUT

- (Some) Investors should select focused portfolios.
Some investors have enough of a comparative skill advantage (and this might be individuals or fund managers) to select stocks and build their own portfolios to outperform.

- We should reconsider approaches that implicitly assume that only the mean and variance of returns matter.
Portfolio optimisation theory explains investing as a tradeoff between risk (variance of returns) and mean (average returns) but he argues there are far more factors involved in explaining markets.

> *"I think we've really been missing something by focusing just on meaning variance. If you actually look at how things turn out and longer horizons, mean variance analysis was motivated by stock returns that are normally distributed, more evenly distributed. That's just nowhere close to the truth."*

In the presentation, Bessembinder elaborated on his 'active versus passive' views:

> *"In the long run, stock market investing maybe has more in common with venture capital than we realised. In this asset class, most investments lose money. Most common outcomes, lose all your money. But there's a few really big winners that make the whole asset class worthwhile. Now, the textbooks lay out all the reasons why people should have broadly diversified low-cost portfolios, and my study backs that up. Just picking stocks at random, the odds are worse than 50-50.*
>
> *On the other hand, if you can pick those winners of all the games in the future, some investors should be actively trading. The irony is that when people read my study, it's like a Rorschach test. What do you see here? All I can say is there's actually some ammunition here for both sides. But I do think this a really important idea of comparative advantage comes from economics. What are you good at? I firmly believe some asset managers have the right comparative advantage. And among those who place their funds with asset managers, some have a comparative advantage in identifying the right asset but that doesn't mean everybody should be."*

Are you or a favourite fund manager especially talented?

For most people who are not market professionals, the chance of selecting sustained winners among thousands of listed companies is remote. It's not impossible, and many will argue that picking up the Commonwealth Bank or CSL or Wesfarmers or Macquarie Bank (or going back, the big winner, Westfield) was not that difficult. No amount of evidence will convince them otherwise, so to them ... go for it and have fun.

While index investing in the US now commands the majority of new flows, active funds management dominates in Australia. For investors who have confidence they can identify the fund managers who will outperform over time, then also ... go for it and have fun. Bessembinder does not want to spoil the party.

But for most retail investors, the man who spends his life studying the numbers says buy a low-cost and diversified portfolio. Manage risk tolerance through asset allocation and the mix of defensive and growth assets rather than worrying about individual stocks. Shares will rise over time but with painful periods along the way, and everyone reacts differently to underperformance, either by their own stocks or a selected fund manager.

Just recognise that while you're having fun, the odds of finding the special outperformers are slim, but maybe some people do have a comparative advantage.

Graham Hand is Editor-At-Large at Firstlinks. This article is general information and does not consider the circumstances of any investor. Hendrick Bessembinder was a presenter at the Active Advantage Forum co-hosted by Orbis, MFS International (both sponsors of Firstlinks) and Baillie Gifford, and Graham Hand attended as their guest.

Meg on SMSFs: Four ways super pensions are better in SMSFs

Meg Heffron

In a monthly column to assist trustees, specialist Meg Heffron explores major issues on managing your SMSF.

Superannuation pensions in retirement phase are brilliant for members of any fund, not just SMSFs. They allow super to be converted into an income stream to live on in retirement and the fund itself stops paying income tax on some or all of its investment income (rent, interest, dividends etc).

For some people, the tax break is so large in an SMSF that it pays no tax and in fact receives a full refund of all its franking credits every year.

Same tax rules but not same opportunities

All super funds follow the same tax rules so in many ways, SMSF pensions are just the same as any other superannuation pension. But there are some aspects of running an SMSF that make it the preferred structure from which to pay a superannuation pension.

Here are four ways a pension in an SMSF may work better.

1. Easier to start with no need to move assets

In a public fund, members who start pensions need to set up a new account in that fund and explicitly move some of their existing accumulation super balance into it. That generally means application forms, waiting for requests to be processed, providing information to confirm they are eligible to start and more. Public funds allow members to choose specific investments for their super and the member will also need to choose which ones to move across to the pension account.

In an SMSF there's no need to do any of these things. Because the members and trustees are all the same people, pensions can be started instantly. Of course, there is documentation to prepare and it's every bit as important as in a public fund but the documentation can follow after the pension starts. The critical member request and trustee decision to start can be immediate.

And there is no need to move assets or set up new bank accounts. Everything stays exactly the same but the fund's accountant does some extra work in the background to track the new pension account.

2. Payment timing flexibility

There's no rule that says people with pensions must take their pension payments as regular monthly or fortnightly amounts. But many public funds require it for practical reasons. When there are thousands of people drawing pensions, it makes sense to impose some rules to simplify the administration involved.

SMSF members are free to do whatever they want, subject to the law, and the law is not prescriptive here. The only requirement is that the member takes enough to meet the minimum payment rules each year. Some people do this by arranging regular bank transfers but others might do something completely different.

For example, some people don't take any pension payments during the year but then withdraw the whole minimum amount in one go. Others go to the extreme of having their personal credit card or other bills paid by their SMSF each month (each payment is a pension payment). And some even just take payments when they want them. With online banking, it's as simple as hopping online and transferring money as and when it's needed.

Essentially, it's whatever works for the members concerned.

3. Members of a couple act together

It's common for couples who share an SMSF to think about their pension payments together. For example, they might decide to draw $10,000 per month (combined) and arrange a single monthly direct transfer to their personal bank account. Behind the scenes, their accountant will divide each payment up between them (or between their various accounts if they have multiple pensions) but they don't need to take separate payments.

This is different to pensions in non-SMSFs where each pension account must make its own cash transfer to the relevant member.

In a retail fund where the members choose their own investments, treating each pension account as a self-contained 'pot' may mean a sale of an investment in one account (to pay the pension) even though another account has plenty of cash.

A good example is someone who has both a pension and an accumulation account. The accumulation account might be receiving contributions and investment income and so is building up cash. But that cash can't be used to pay the pension.

An SMSF is quite different. Pensions are paid from the fund's bank account which is generally shared by all members and all accounts. It's common to find that the cash flow for pension payments is coming from contributions (even contributions made by other members) and investment income across the whole super fund investment portfolio, not just part of it.

Again, behind the scenes the fund's accountant makes sure everyone gets their fair share but in a practical sense, it means minimising costs by sharing cash more effectively.

4. Draw additional amounts as needed

The ability to share cash can even have ramifications beyond pension payments. It's common for members of both SMSFs and retail or industry funds to withdraw more than they have to in some years. Those extra payments don't have to be treated as pension payments and there are often good tax reasons to treat them differently.

For example, in some cases, it's better to treat extra amounts as withdrawals from an accumulation account or as different types of payments (called 'partial commutations') from pension accounts.

Once again, this is easy to set up in an SMSF. The member can simply provide standing instructions to the trustee that once they've taken at least their minimum pension out of the fund, subsequent payments should be treated in a particular way. They don't need to keep track of exactly when that happens. And they don't need to take the extra amounts from a separate bank account. In a public fund they would have to do all these things.

First among equals for pensions

In many ways, super in an SMSF and a public fund is the same, but moving into pension phase is one of those times when it's often easier to have an SMSF.

Meg Heffron is the Managing Director of [Heffron SMSF Solutions](), a sponsor of Firstlinks. This is general information only and it does not constitute any recommendation or advice. It does not consider any personal circumstances and is based on an understanding of relevant rules and legislation at the time of writing.

For more articles and papers from Heffron, [please click here]().

The growth outperformance myth

Andrew Mitchell

A recent narrative goes something like:

'Growth investing benefited from around the GFC (in 2007) to 2021 from the tail wind of declining interest rates, and now with rates heading higher, growth investing is dead.'

The inference is that growth managers who outperformed during this period were lucky rather than skilled. And now the circle has turned.

At Ophir, we invest in small caps with higher-than-market levels of earnings and revenue growth, but with a strong focus on not overpaying for that growth. Our style is more commonly termed "growth at a reasonable price" (GARP). Think of it as growth investing but with some value elements.

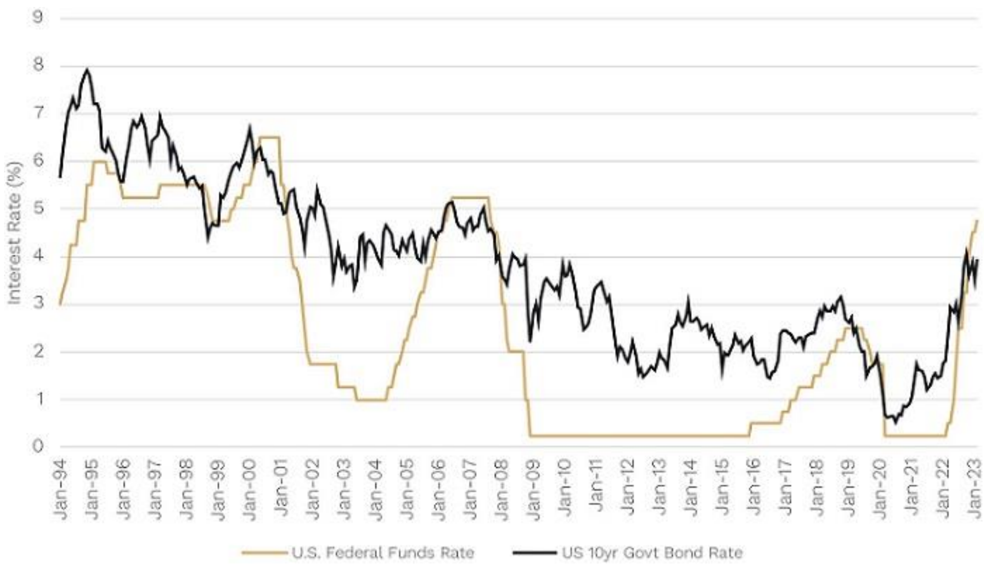
With that background, it's worth checking whether the conventional narrative about growth investing is true.

What are the facts?

Growth investing's outperformance from 2007 to 2021 is usually attributed to the fall in longer-term interest rates, which decreased discount rates used for valuing shares. The theory is this benefited growth-orientated businesses because more of their cash flows are generated further out in the future.

But, as Einstein once said: *"In theory, theory and practice are the same. In practice, they are not."*

Let's see if the theory has borne out in practice.



Source: Factset. S&P500, Russell 2000 and MSCI World data start at January 1994. Data to February 2023

In the chart above, the black line shows longer-term interest rates in the U.S. over the last three decades; the gold line shows shorter-term rates. Through to 2021 interest rates generally fell, particularly longer-term rates that form the discount rates for valuing equities.

In the chart below, we show the relative performance of value investing versus growth investing for U.S. and global shares, including U.S. small caps.

Value v Growth around the World – Total Return Spread (local currency)

Source: Factset. S&P500, Russell 2000 and MSCI World data start at January 1994. Data to February 2023.

A couple of things stand out:

1. The biggest outperformance of growth versus value over the entire 30 years has been in U.S. large caps where value underperformed growth by -1.4% per annum for the S&P500 (with most of the outperformance starting in 2007). Given U.S. large caps' weight in global indices, this contributed to growth's outperformance in global large caps too, with value underperforming growth by -0.7% per annum for the MSCI World.
2. But value has actually **outperformed** in U.S. small caps over the entire circa 30 years by **more** than it underperformed in U.S. large caps. The Russell value outperformed Russell growth by +2.1% per annum compared to -1.4% per annum underperformance of S&P500 value to S&P500 growth.

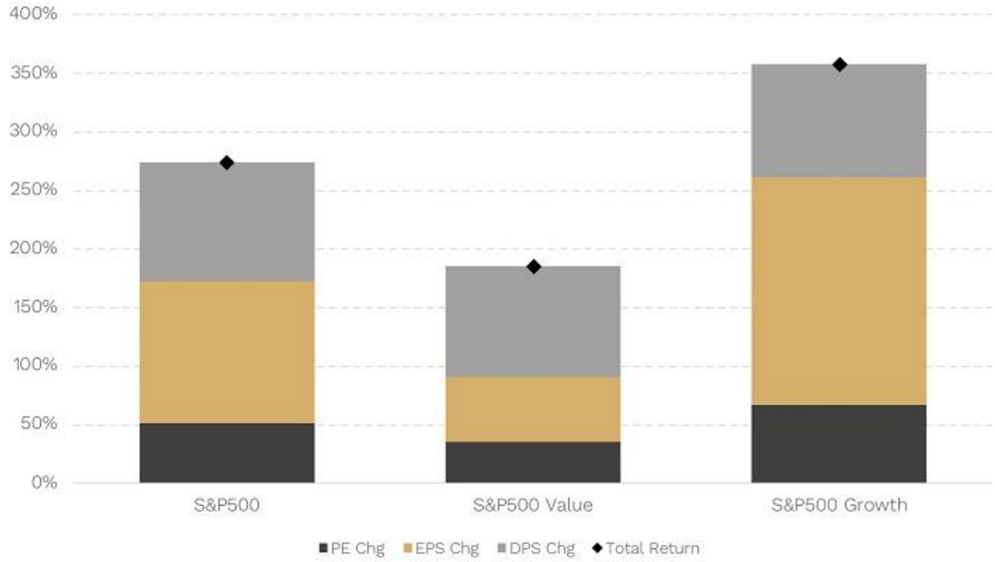
This causes some problems for the simple narrative that falling longer-term interest rates is the primary cause of growth versus value outperformance.

The big growth outperformance of the last 15-odd years seems to be in U.S. large caps. How much of this is justified by fundamentals?

Was U.S. large-cap growth's outperformance of value since the GFC speculatively driven by increases in valuations (P/E ratios), perhaps due to lower interest rates? Or were growth businesses simply better?

As the chart below shows, the outperformance of US large-cap growth stocks – which includes many household names like Apple, Microsoft, Google, Amazon, Tesla, and Visa – has mostly been driven by better earnings (EPS) growth. Yes, they have seen their PEs expand by more than value stocks (and have had them compress significantly recently), but this has been a far less important driver overall.

U.S. Large Caps Return Drivers (July 2007 to Feb 2023)

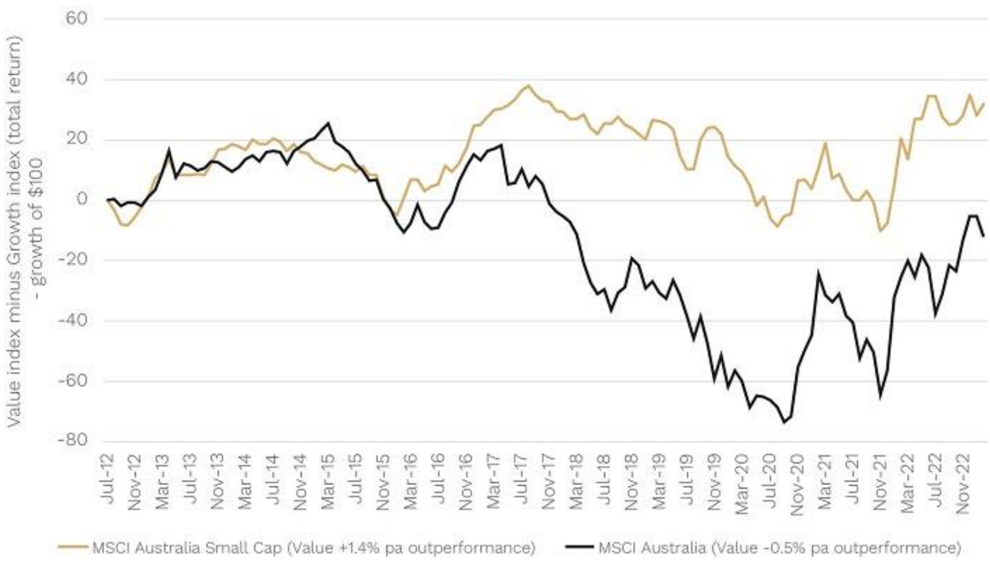


Source: Factset. "PE Chg" = Change in 1 year forward Price/earnings ratio, "EPS Chg" = Change in 1 year forward earnings per share, "DPS Chg" = Change in Dividends per share, "Total return" = price returns plus dividend return.

How big of a tailwind (if any) has growth investing delivered?

We have looked at the very long term above, but what if we look at just the period since we started Ophir in 2012? In this chart, we show the time from July 2012 to today (February 2023) for the Australian share market.

Value v Growth in Australia – Total Return Spread (local currency)



Source: Factset. Data to February 2023.

For Australian large caps (MSCI Australia), value underperformed growth by a relatively modest -0.5% per annum. But value *outperformed* growth by +1.4% in Australian small caps.

(Interestingly, on net, U.S. long-term bond yields have risen over this period. This is also true for Australian long-term bond yields, though to a lesser degree.)

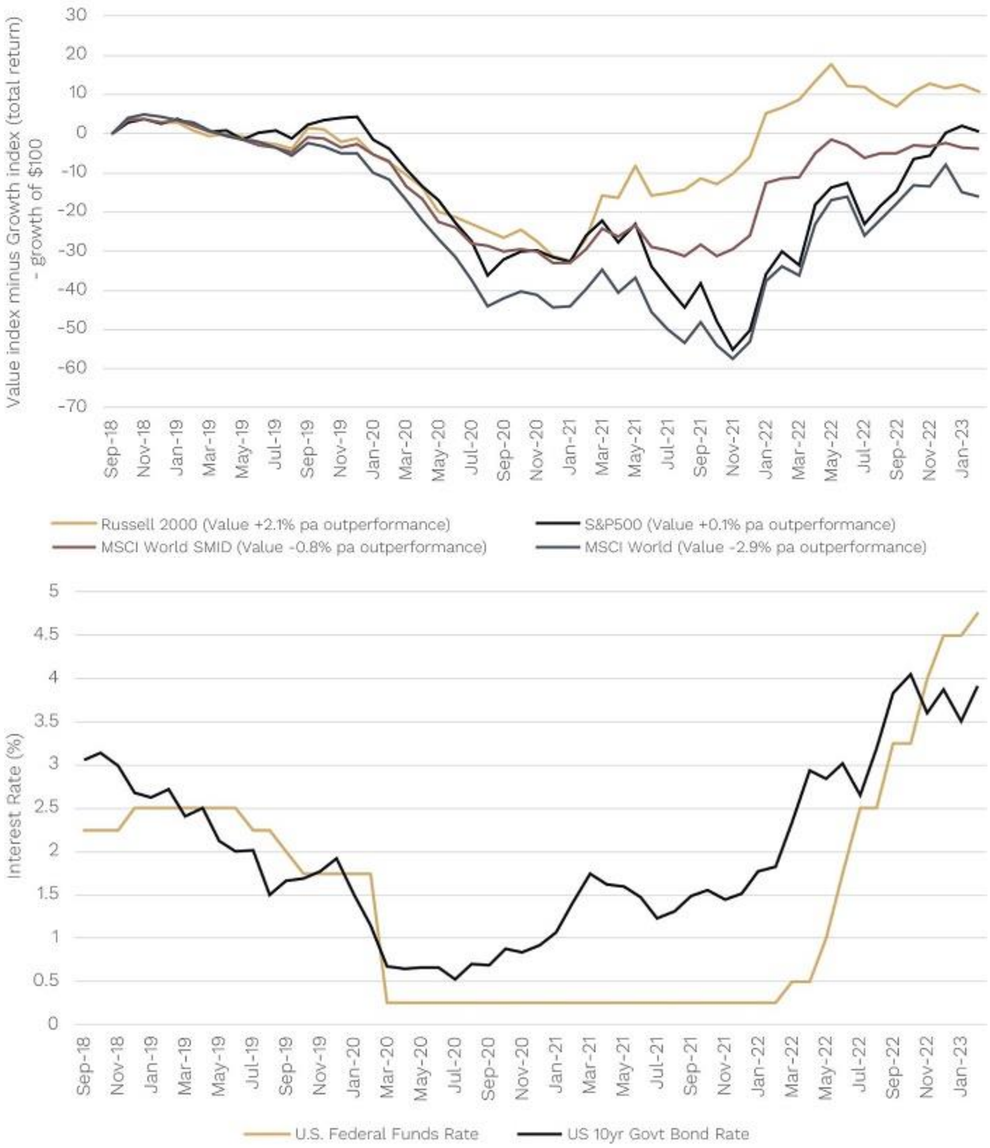
While growth investing in Australia (both the large and small-cap variety) appears to have had a material tailwind for a few years from around 2017 leading in to 2021, this doesn't appear to be the case, especially for small caps, over the last decade or so.

How big of a tailwind (if any) has growth investing had since we started investing in global small caps?

Some of the most violent moves in value-versus-growth performance occurred recently after central banks cut rates aggressively in early 2020 in response to COVID … then raised them even more aggressively in 2022 to fight inflation.

What, on net, has been the response of growth and value to all that cutting and hiking?

Value v Growth Recently – Total Return Spread (local currency)



The top chart above shows the general underperformance of value (outperformance of growth) in the rate-cutting/ultra-low-rates phase.

But that underperformance has been partially, or in some cases fully, reversed in the subsequent phase when rates headed higher.

In small/mid-caps (Russell 2000 and MSCI World SMID), value has outperformed by +2.1% pa and underperformed by -0.8% per annum respectively, highlighting a mixed picture.

There is no doubt late 2021 and 2022 has provided strong headwinds for growth investors after seeing strong tailwinds in late 2019 through early 2021. On net though, at least insofar as the U.S. is concerned, value has outperformed over this most recent period of rate cuts and rate hikes, driving big value and growth performance divergence along the journey.

What does it all mean?

Valuations of many growth companies have been hit hard as central banks have normalised interest rates over the last year or so, leading to a period of sharp growth underperformance in many market segments.

Several growth segments have now fully unwound their COVID valuation excesses while some have further to go.

But providing inflation is ultimately tamed, the race higher in longer-term interest rates is likely nearing the end, or perhaps already over. That means the big valuation headwind for many growth-orientated businesses may also be nearing an end.

Perhaps that means the market will go back to caring more about that boring old concept called company fundamentals. After all, macro forces like inflation and interest rates may play a big role in short term share market winners and losers, but in the long term it's all about the businesses you own. Famed stock picker Peter Lynch said it best:

"Often, there is no correlation between the success of a company's operations and the success of its stock over a few months or a few years. In the long term, there is 100% correlation between the success of the company and the success of its stock."

Andrew Mitchell is Director and Senior Portfolio Manager at Ophir Asset Management, a sponsor of Firstlinks. This article is general information and does not consider the circumstances of any investor.

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The mechanics of the $3 million super tax must be fixed

Andrew Gale

The recently announced additional tax on superannuation account balances above $3 million may be reasonable in intent but the proposed methodology appears rushed and will lead to more complexity and poor outcomes. Even if a reduction in concessions above a certain account balance figure (say $3 million, providing it is indexed) is supported, as I do, both the principles AND the mechanics should be right.

While the proposed high-level principle might be fine, some of the mechanics are definitely not.

Financing an ageing population

First, some context. With all the agitating about the cost of superannuation concessions, it is useful to remind ourselves of the purpose of superannuation. The equity issues are real and should be addressed.

Treasury's Consultation Paper regarding the Objective of Superannuation (20 February 2023) proposes that:

"The objective of superannuation is to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way."

This is a reasonable primary objective. In addition, superannuation has another purpose, which at a national level is to assist Australia in financing its ageing population. Superannuation concessions should be understood in this context.

Key areas in financing an ageing population are Health, Aged Care, and Social Security/Age Pension, and the capacity of the workforce to fund government expenditure.

Based on the 2021 Intergenerational Report (IGR), forecast changes in Government expenditure are as follows:

Government Expenditure	% of GDP – 2021-2	% of GDP – 2060-1
Health	4.6%	6.2%
Aged Care	1.2%	2.1%
Age and Service Pension	2.5%	2.1%

Superannuation, strongly encouraged by appropriate concessional treatment, is playing a valuable macro role, and the *real* aggregate cost of superannuation concessions should be interpreted in this light. As superannuation continues to mature, the reduction in age pension costs (as a % of GDP) is a welcome development.

Notwithstanding this macro view, the need to address equity and fairness issues in super remains.

Ramifications of an additional tax on high-balance earnings

The proposed mechanics include the use of an 'ATO calculation' basis for determining earnings corresponding to account balances in excess of $3 million. Not only is this a purpose for which it was never intended, it is far too simplistic. They appear rushed and not properly thought through, and with unintended consequences.

There has been substantial commentary on many of the key issues in recent weeks, such as:

- the calculation basis for 'earnings' on balances in excess of $3 million
- the lack of indexation
- the tax on unrealised capital gains
- the absence of the usual Capital Gains Tax (CGT) discount mechanism and hence CGT discount inconsistencies depending on asset ownership structure
- cashflow and liquidity issues with illiquid assets
- treatment of Defined Benefit schemes (subject to consultation), etc.

I agree with many of the criticisms and will limit my comments here to minimise duplication.

Indexation of the $3 million amount

The lack of indexing appears to be a conscious decision. It could be argued that this decision constitutes intergenerational inequity (Millennials/Gen X versus Boomers). On the other hand, you can argue that it's a deliberate attempt to reduce concessions progressively over the next 30 years. Ultimately, it will affect the top decile (10%) of account balances by 2050 (based on Financial Services Council forecasts).

What is not clear is how an indexation regime for the Transfer Balance Cap (TBC, currently $1.7 million, and potentially $1.9 million from 1 July 2023) interacts with a non-indexation regime for the additional 15% tax. It is feasible with high inflation indexing of the TBC that it will reach $3 million within, say, seven to 10 years.

Tax on unrealised gains

The tax on unrealised gains (accruals-based taxation) appears to violate generally accepted tax principles that CGT applies on realisation. All OECD countries that tax capital gains do so on realisation (Source: Harding, M. (2013) '*Taxation of dividend interest and capital gain income*') although it is understood that Denmark may be the first to introduce accrual taxation on capital gains later this year.

The tax on unrealised gains (in respect of balances exceeding $3 million) also means unequal treatment in terms of discounting for capital gains (50% personal, and one-third for super). This will add further weight to asset accumulation outside super beyond the $3 million mark, providing a member meets a Condition of Release.

It is not only the unrealised versus realised calculation, but an *additional* 15% tax on gains (super) versus 50% discounted (outside super). This may be what the Government wants, and is preferred compared to a hard cap regime which forces money out of super.

Will 15% CGT accrual payments over the years be applied as offsets to the ultimate amount of capital gains and CGT on realisation? Or will it be simply additional to the CGT payable on ultimate asset realisation? It's shaping up as the latter, but it's not clear from the announcement and the record-keeping is starting to sound daunting.

Large balances in public (non-SMSF) funds are potentially worse off

Large account balances are certainly more prevalent with SMSFs but far from restricted to them. And the issues for members with large account balances in APRA-regulated funds are potentially more significant than for SMSFs, due to their lesser control over the timing of realisation of capital gains.

Reliable and contemporary data on account balance sizes is difficult to access. The Government estimates that the proposed changes will impact about 0.5% or circa 80,000 superannuation fund members. Based on numbers in ASFA's research paper '*Developments in Account Balances – March 2022*', and an earlier ASFA publication '*Superannuation and High Account Balances*' (April 2015), it is reasonable to assume that around a third of those with balances exceeding $2 million to $2.5 million are in funds other than SMSFs and a somewhat lesser portion for balances exceeding $3 million, say 20-25%.

This would translate to about 15,000 - 20,000 members in APRA-regulated funds.

The issue for such members is that included in the calculation of unit prices is a provision for unrealised capital gains (typically 10% for funds in the accumulation phase).

If such a member is in accumulation phase, and the 15% tax on unrealised gains for the amount of the account balance in excess of $3 million is added to the existing provision, then the effective tax on unrealised gains (either provisioned or actual) is 23.5%, calculated as [1-(.85 x .9)]. In this case, and from a tax on capital gains perspective only, it may be preferable to generate capital gains outside super and access the 50% CGT discount.

This is especially the case if allowing for the prospective Stage 3 tax cuts which will mean a 30% tax rate for incomes between $45,000 and $200,000.

Time to consider the implications

Ideally, there will be a lot more consultation in the enabling legislation. There is time with changes not proposed until 2025-6 so no urgent action appears warranted.

Although there are real and worrying issues, the proposed changes are significantly better than the potential 'hard cap' approaches which were contemplated. These would have had major disruptive impacts but perhaps that was just part of the 'softening up' process.

For those who can satisfy a Condition of Release, shifting ownership of assets currently in superannuation in excess of $3 million to some other ownership regime (e.g. personal or Family Trust) is worth considering, at least from a taxation perspective, although that should not be the sole or even primary determinant of investment strategies. This may be even more the case with the proposed Stage III tax cuts.

Perhaps this is exactly what the Government wants to achieve without the political backlash associated with hard caps.

Difficult issues apply for SMSFs with a significant portion of relatively illiquid assets, including property with LRBAs, with the impact of annual assessment of tax on unrealised gains, cashflow issues and avoiding selling real assets into depressed markets over the next few years.

Some members may also contemplate whether to make 'downsizer' contributions into superannuation, or to 'upsize' the family home, with its associated tax advantages, and potentially in conjunction with a home equity release arrangement for generating retirement income.

As always, there are a range of issues to consider including the family home not being income-producing, a concentrated asset and so not great for diversification.

The best solution will always depend on personal circumstances. This all emphasises the need for quality financial advice in coming years.

Given these obvious tax issues and distortions, it is surprising that there hasn't been a greater outcry, with little sympathy for complaints from the 'wealthy'.

The warning sign is that if the Government starts making moves on unrealised gains, and effectively diluting the discounting on capital gains, will there be other areas similarly targeted in the future?

Andrew Gale is an actuary, public policy expert in financial services, a Non-Executive Director and a former Chairman of the [SMSF Association](). The views expressed in this article are focussed on public policy and not financial advice, are personal views, and are not made on behalf of any organisation. This article is not financial or tax advice and it does not consider the individual financial circumstances of any person. No reliance should be placed on this article for personal decisions.

Crisis, contagion or QE? The bigger picture

Roger Montgomery

Investors and markets are preoccupied by the US regional banking industry crisis. It is still highly fluid but if history is a guide, investors would be wise to prepare for more tremors. While the recent decision to backstop US bank deposits, the Fed's newly-announced liquidity facility, as well as UBS's purchase of Credit Suisse - with massive support from the Swiss regulators and government - are helping to calm skittish investors and depositors, these measures may feed further panic. Moreover, the measures may not avoid a credit crunch as banks withdraw liquidity.

Many investors are concerned SVB and Credit Suisse are the 2023 equivalent of Bear Stearns and Lehman Brothers, the 2008 poster children of the GFC.

However, fears of a repeat are misplaced for several reasons.

First, the GFC was defined by lending to borrowers who could not afford repayments.

Second, US consumers are far less leveraged than they were back in 2007.

Third, systemically important banks are far better capitalised and safeguards have been introduced to avoid a repeat performance of 2008/09.

Meanwhile, analysis of many US regional banks, and in particular their available-for-sale, and their held-to-maturity securities, revealed Silicon Valley Bank (SVB) was unique, not only in terms of geographic and industry concentration but also ranking significantly worse than all others in terms of unrealised losses on invested securities. These losses were 100% of equity.

And, as has been widely reported, the unrealised losses it accumulated on its investments represented a disproportionate share of its assets, rendering it particularly vulnerable to a run on its deposits, which occurred amid the drought of private equity and VC funding for its profitless tech company clients.

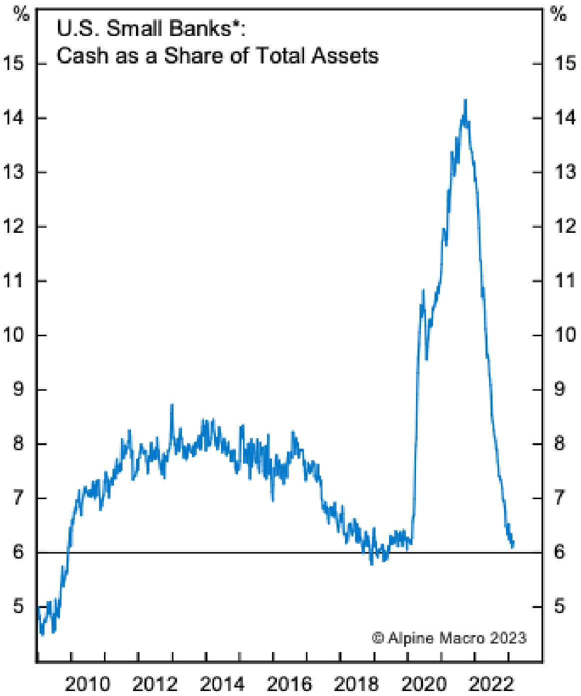
In a fast-moving financial market environment, it may seem risky to rule out another GFC, but the probability, upon an assessment of the odds, appears to be low.

There are still risks, though

But let's not be mistaken. The movements in bond rates in recent weeks have been extraordinary. As recently as 8 March 2023, the US two-year bond was yielding 5.06%. At the time of writing, less than two weeks later, the same security is yielding 3.86%. That's a one-quarter reduction in less than 10 trading days. It is the largest drop in yields since the pandemic first took hold.

That move has been driven by the belief the US Federal Reserve's hawkish stance on the pace of rate rises and

Figure 1. Shrinking Cash at U.S Regional Banks



Source: Alpine Macro, US Fed.

the terminal level of rates, will need to be reined-in amid a tightening of credit conditions by the banks. The risk of tightening credit conditions is real.

Regional banks, defined as US domestic banks outside the top 25 by assets, have relatively little cash on their books, having invested much of it in longer-duration securities to help drive better returns for their shareholders. The risk is that a run on deposits - over 80% of regional banks' total assets are funded by deposits - will force more banks to realise an unknown quantum of losses on those long-duration investments. And keep in mind that banks with less than US$250 billion of assets are not required to mark-to-market their assets, which is why the losses are unknown.

QE may have already started

The last time we went through a scenario reminiscent of the current mire, was the GFC, and the global central bank response was Quantitative Easing (QE). That response ignited asset markets around the globe, so it's worth investigating what central banks are up to now.

UK-based economic research house Crossborder Capital (CC) has conducted some useful research into the global liquidity in the last week and it does look like QE is again underway.

For a picture of US dollar liquidity, CC combine the US Federal Reserve's balance sheet and foreign central banks' dollar holdings. They note that as US policymakers acted with "impressive speed" to address the problems of SVB and other US banks, the Fed balance sheet alone jumped by some US$300 billion.

While it looks eerily like the initial actions taken to stem the GFC fallout in 2007 and 2008, the recent measures taken by central banks and sovereign governments include the special liquidity facilities, advancing international swap lines, and record borrowing by US banks from the Fed's discount window.

The latter resulting BTFP (Bank Term Funding Program) effectively promises US-based banks the ability to borrow for up to 12 months at the one-year bond yield plus 10 basis points. (US primary credit – discount window loans - is limited to just 90 days) against the par value of their eligible US Treasury and Agency securities.

This program is the backstop alluded to earlier that supports the balance sheets of those vulnerable regional banks. It simultaneously ensures these banks will generate operating losses on their security holdings because they'll be borrowing at one-year rates matching or exceeding the yields on their posted collateral.

Some analysts argue the program needs to be made permanent and expanded in terms of its size. As smaller regional banks lose deposits to the major banks, which was anticipated by the regulators and is now occurring, the smaller banks will be forced to borrow from the Bank Term Funding Program. They do this against their eligible security holdings, which currently total US$965 billion.

If the deposit migration from small to large banks accelerates (the regional banks have US$5.5 trillion of deposits), the Fed may have to extend its primary credit/discount window.

If the problem gets worse, more liquidity, an expansion of the US Federal Reserve's Balance sheet, and QE, are likely results.

It seems while we may not enter another GFC, we may soon enter a period where, for equity investors, bad news is good news indeed.

Earnings are what count

As equity markets decline, nothing compromises the immutable arithmetic of PE ratios, earnings growth and investment returns. Even if stocks never become popular again, and their PE ratios, therefore, don't rise, the annual return will equal the earnings per share growth rate of the companies in a portfolio. So I remain wedded to buying shares in companies capable of generating double-digit earnings growth – and there are plenty of those.

However, the current malaise in markets as discussed above makes stocks delightfully unpopular, meaning their PEs have compressed. So, if I buy shares in companies generating double-digit earnings growth at compressed PE ratios, not only do I receive the earnings growth rate as my return, but I may also receive the bonus of an expanding PE ratio and a stock re-rating. It will pay off when the current tumult passes and stocks again become popular. And that's the big picture.

Roger Montgomery is Chairman and Chief Investment Officer at [Montgomery Investment Management](). This article is for general information only and does not consider the circumstances of any individual.

Brace, brace, brace: The real issue behind the banking turmoil

Andrew Canobi

The commentariat until recently had shifted from hard to soft landing to no landing at all. Suddenly, those lags in monetary policy don't look so long and variable after all. But it's highly unlikely that we are about to face another banking crisis, GFC style. The tremors reverberating across the banking world from Silicon Valley to Zurich expose idiosyncratic weaknesses, but the risk is that markets focus on the headlines and miss the bigger issue building beneath the surface. Banks can be rescued in a heartbeat with unlimited liquidity from central banks…

*BANKS BORROW $164.8B FROM FED FACILITIES IN WEEK TO MARCH 15

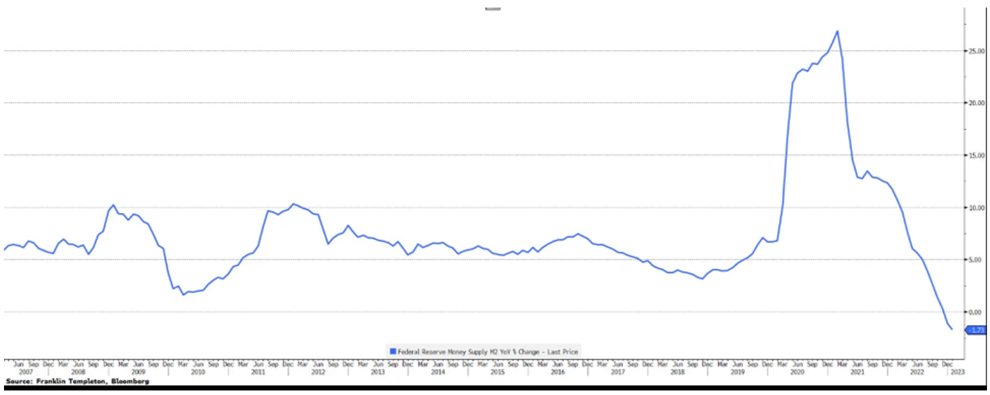
The franchise and confidence in the institution might be irreparably damaged but liquidity crises can be solved with the flick of a switch per the headline above.

Credit constriction is the key issue

The real issue that lies behind the banking turmoil is the constriction of credit supply that central banks are inducing amidst their assault on inflation. The constriction of credit, and withdrawal of liquidity, ultimately finds out the weaknesses in the system. The supply of credit supports growth and drives inflation. Just as the excess creation of money through the pandemic caused inflation to surge, its rapid destruction as central banks shrink the money supply is highly disinflationary.

In a highly financialised world fuelled by liquidity and availability of credit, sooner or later things start to break when central banks withdraw that credit and liquidity as rapidly as they have. The only question has been what and when. The warning signs have been brewing for several months that monetary policy has been choking off the supply of money. This is the pointy end of the hiking process.

Consider the rate of growth of US money as measured by the M2 definition. It boomed in the pandemic of course and started shrinking toward the end of 2022.

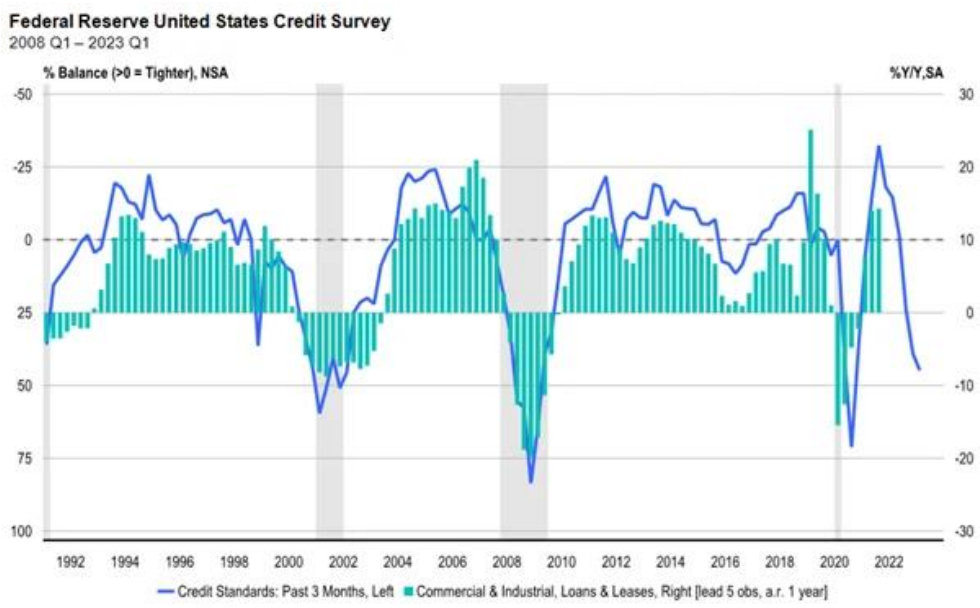


Many may not have realised that the number of banks in the US insured by the Federal Deposit Insurance Corp is nearly 5,000. These figures do not include credit unions which fall under separate regulation. There are around 6,500 of those. In Texas alone there are 375 banks. The rapid demise of smaller banks in the US and at Credit Suisse is a timely reminder that when the liquidity pool gets drained there is always going to be people standing naked.

But the tight credit conditions being inflicted on economies is the ultimate culprit. Arguably, the demise of Silicon Valley Bank owes its genesis to the dramatic shrinkage of capital being made available to the private equity, start-up and tech sectors which made up the bulk of SVB's customer base. As credit has been drained from the system and liquidity become scarce, funding markets for start-up ventures has dried up. What do you do then? You draw on your liquid bank deposits. So, whilst we might finger point at idiosyncratic blow-ups, the fact is central banks have squeezed funding markets like the proverbial lemon making the cost and availability of credit that much more challenging.

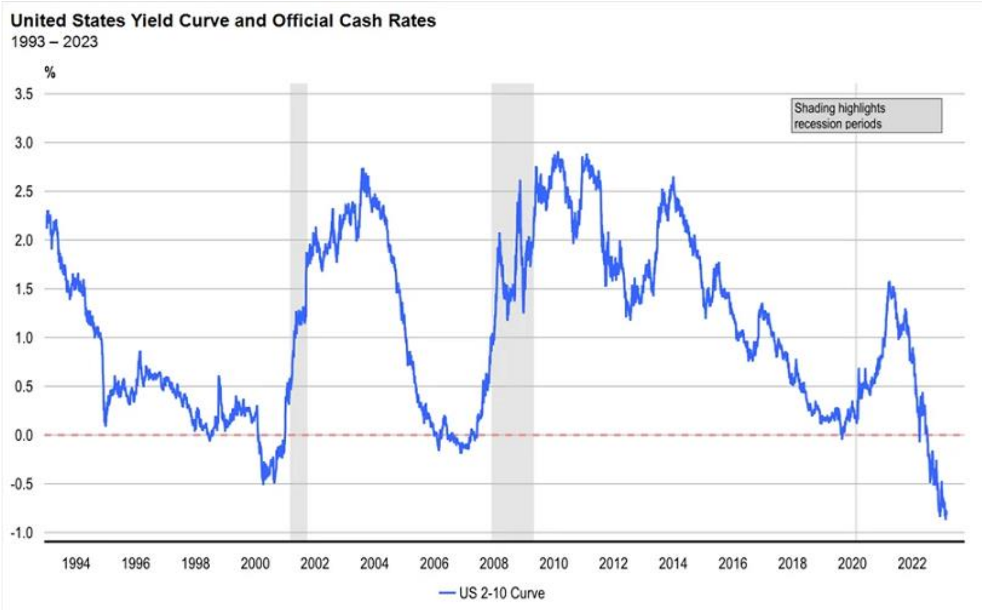
The fallout from credit tightening

Nowhere is the tightness of bank credit more closely scrutinised than in the benchmark New York Fed Senior Loan Officer Survey. Whenever it has signalled conditions as tight as currently indicated the US has been in or soon entered recession. The below chart highlights that commercial loan growth follows the survey with a lag. Note the survey is now a couple of months old and predates the bank mayhem of recent days. If there is one memo that regional bank treasurers are likely sending to their loan officers this week, it's 'don't lend any money unless the credit is pristine and well-priced'. The provision of commercial loans dries up when the survey points to conditions this tight. No doubt the next survey will be a doozy.



Source: Franklin Templeton, Federal Reserve, Macrobond.

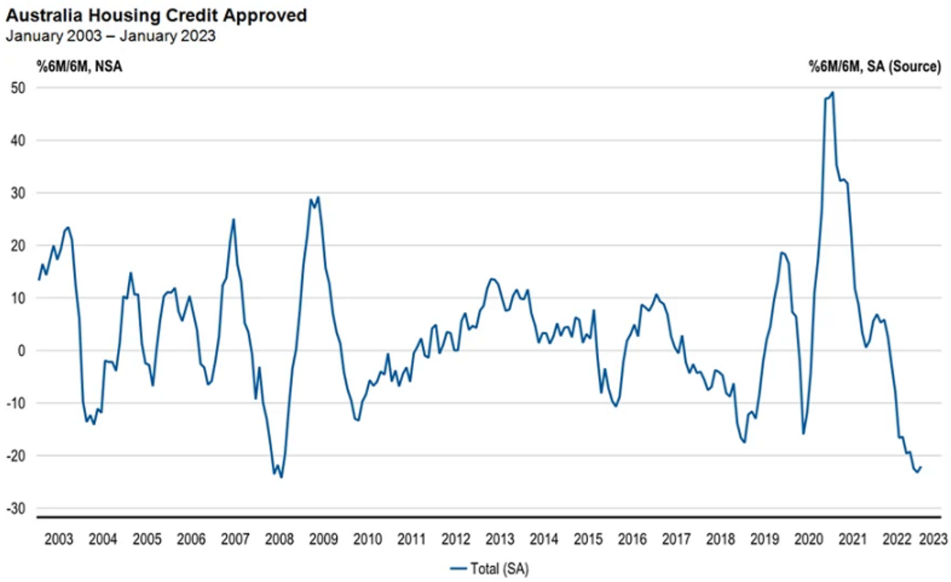
One reason why monetary policy is destroying the flow of credit is the extreme level of inversion of the yield curve in the US. It has until recently been at acute and record levels of inversion. For banks that borrow short and lend long this has been a recipe to stop creating credit or go broke. It's not coincidental that the curve shape maps closely to the loan officers survey above.



Source: Franklin Templeton, <Property Source not found.>, Macrobond.

None of this shows up in official CPI stats for a while, of course, despite this being largely the only thing central banks are focussed on. That's because it leads, and points to a significant contraction in credit creation and GDP and inflation in the coming period, rather than the past.

In Australia, the impact of tighter credit conditions at the hand of the RBA is centred on construction and building. More than 1200 firms in that sector have entered receivership, liquidation or administration this financial year so far. The chart below shows the 6 monthly change in new credit for housing. It's never been weaker outside the GFC. This isn't surprising, as no-one can afford to buy overpriced houses at current interest rates.



Source: Franklin Templeton, Australian Bureau of Statistics, Macrobond. Coverage: Auhorised Deposit-Taking Institutions + Registered Financial Corporations. Note: Excludes Refinancing.

But tremors have been showing up for a while as the credit pool has been drained. The UK Pension system crashing the gilt market, FTX imploding or some banks looking shaky are in some ways distractions that are too easily dismissed as isolated events. Monetary policy is a blunt tool and it's finding out the interest rate and liquidity sensitive areas in the market quickly.

Banking and capital markets run on confidence. If that confidence goes, it's over.

Bond markets are ahead of the game

Central banks are singularly focussed on lagging CPI data whilst largely ignoring the forward-looking data on credit measures. The latter continue to signpost a significant slowdown underway. For the history buffs, it is Interesting that in June 2008 the Fed Meeting notes said:

"The Committee expects inflation to moderate later this year and next year. However, in light of the continued increases in the prices of energy and some other commodities and the elevated state of some indicators of inflation expectations, uncertainty about the inflation outlook remains high." - FOMC June 2008.

Such a statement could easily be included in next weeks scheduled meeting. Of course, Lehman Brothers declared bankruptcy in September 2008, Bear Stearns had already fallen over, and the housing market went up in flames. It's likely that central bankers are a little more attuned to the financial stability risks these days.

This is unlikely another GFC. But it's always something and flow of credit matters in a highly financialised world. In 2018, the Fed broke the High Yield bond market and was forced to back away when not a single company was able to raise money in that market in December of 2018. Many have said central banks can't stop raising rates even amidst these ructions because of inflation. If credit and liquidity tighten as they have, inflation's grave is dug. It may not have been filled in, but it's over and just a matter of time. Central banks will be highly sensitive to signs that the financial system is quaking, and the flow of credit is stalling.

The bond market has decided that hikes are largely over, and cuts are coming. That is consistent with our view, and we have been positioned accordingly but it has been startling how quickly things shift. This isn't a linear path and it's likely we see heightened volatility in coming days and weeks reinforcing the importance of being nimble.

Andrew Canobi is a Director, Fixed Income; Joshua Rout, CFA, is a Portfolio Manager and Research Analyst, Fixed Income; and Chris Siniakov is Managing Director, Fixed Income at Franklin Templeton, a sponsor of Firstlinks. This article is for information purposes only and does not constitute investment or financial product advice. It does not consider the individual circumstances, objectives, financial situation, or needs of any individual.

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How digital tokens will revolutionise investing

Adam Belding

Most fund managers have experienced difficult times recently, with record fund outflows across the globe in 2022. The bear market delivered the biggest fall in assets under management (AUM) since the GFC and the US$14.7 trillion decline was down 21% from 2021's record.

Combined with rising interest rates, inflationary pressures, and a retraction of fiscal stimulus, it makes for a tough macro environment.

In the face of these headwinds, asset managers must look for ways to enhance their proposition for their clients and increase profitability. Mutual funds have been the vehicle of choice for 100 years, and then ETFs arrived, offering investors more choice and accessibility.

What is tokenisation?

Tokenisation represents the ownership of an asset, or pool of assets, as digital tokens. It offers asset managers a new opportunity to benefit their clients and the management of their assets.

For investors, tokenisation can unlock a truly modern user experience: instant purchases, better transparency, and access to a broader range of assets through fractionalisation.

For asset managers, it facilitates new digitally native investment models and helping to defend margins. For instance, tokenisation digitalises the manual processes that exist today, end-to-end, creating a streamlined intermediary chain. This is all the more important in the current environment, where firms are looking for ways to deliver strong returns while removing friction from their operations.

The industry recognises the opportunity. In a recent BNY Mellon survey, every asset manager with more than $1 trillion AUM was interested in investing in tokenised products, and 97% of the 271 institutional investors surveyed agreed that tokenisation will revolutionise asset management and be good for the industry.

Reducing the cost of investing

Tokenisation, and the distributed ledger technology (DLT) that underpins it, helps automate processes like pricing and fund accountancy. It brings greater visibility, instant settlement, as well as improvements in data and analytics, saving many basis points on the management of funds. This increases the potential for alpha generation across both existing and new propositions, handing asset managers the key to reduced costs and increased margins.

At the FT Future of Asset Management conference in September 2022, Jonathan Steinberg, Founder and CEO of fund management company WisdomTree, gave the example of a US Treasury fund from his firm using tokenisation to pass on zero management fees to the investor.

"[It] will not have an expense ratio. It will make its money on transactions, as well as net interest income […] We'll be keeping more of the economics, and net-net for the end customer, they will be paying less."

Business transformation through tokenisation

Tokenisation, however, offers more than simply reduced costs. It has the power to help asset managers achieve a wider transformation mission: creating an efficient, scalable business, with a more flexible and controllable cost base.

First, tokenisation allows asset managers to expand their universe of products, without an increase in cost. With the appetite for fully digital investment products only increasing, and modern investors demanding access to a larger pool of assets, this is key.

While this would usually require a significant overhaul to an investment management system, tokenisation should be geography, distribution channel and product agnostic and handle traditional mutual funds and digital assets within the same infrastructure.

This is important because institutional investors expect to mix both traditional and digital assets in their portfolio, according to BNY Mellon's survey, with nearly three quarters of those surveyed having a strong preference for a fully integrated provider for all their digital asset needs.

Rather than a Big Bang approach to digital transformation, asset managers can set their own pace, bringing their distributors and clients with them without asking them to make major technology investments to access the new tokenised products.

Second, tokenisation, by converting both the asset and the payment associated with the asset into individual digital tokens, streamlines reconciliation and settlement. It optimises core platform operations, reducing friction and increasing liquidity.

Third, a fully digital, tokenised model simplifies and automates many fund administration workflows. This not only boosts asset managers' margins, but also frees up their time, so they can focus on what they do best: research and execution. In addition, the immutability and transparency of data on an open ledger provides regulators and auditors with a single source of information they can request data from on demand, shortening the supervision process.

Tokenisation, then, is a powerful tool that asset managers can leverage in their cost transformation strategy. A typical mid-tier asset manager with AUM in the $500 billion to $1 trillion range, and a total expense base of around $2 billion, stands to achieve cost savings of up to 15% with such a transformation, according to a recent report from EY.

A tokenised tomorrow

Tokenisation should be a core focus for all asset managers trying to build alpha now, and for tomorrow, on behalf of their clients. It ensures they can continue to deliver value for their investors in the face of the current macro headwinds and capitalise on technological advancements and shifting investor demographics, all while streamlining operations and trimming costs.

Adam Belding is Chief Technology Officer at Calastone. This article is for general information only.