Firstlinks

a Morningstar company

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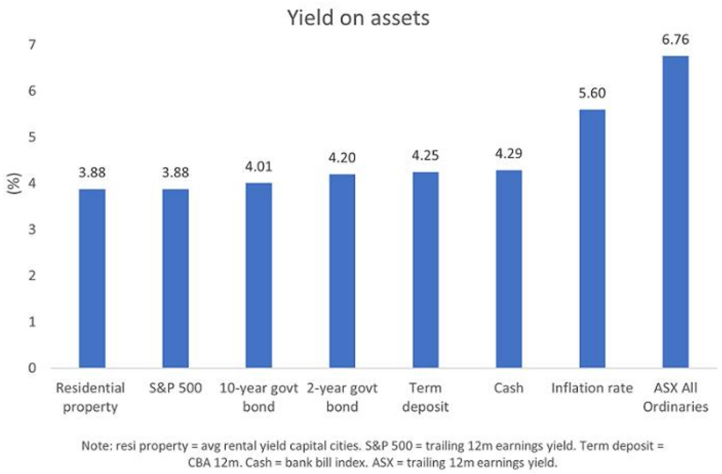
Editorial

I give an update about every six months of the yields offered on key asset classes and how they compare. Here's the latest chart for the four major asset classes: cash, bonds, property, and stocks. And I've included the inflation rate as a point of comparison.

You'll quickly notice that the yields on cash, bonds and property are closely aligned, though they remain well below the inflation rate. In other words, these three asset classes are currently offering negative real yields (inflation rate minus asset class yield).



On the face of it, this doesn't make sense. You'd normally like to invest in an asset class that has positive real yields so you can keep pace with, or exceed, inflation. Yet Australian 10-year bonds for instance, offer a yield of 4.01%, well below the inflation rate of 5.60%. If you buy a 10-year bond at par at that yield and hold onto it for the next decade, and the inflation rate remains at current levels, you'll lose money in real terms. That is, your money will have less purchasing power at the end of that period.

The question is: why are assets such as bonds priced at these levels given where inflation is? Much of the answer lies with expectations that inflation will fall. These expectations were buoyed from recent figures showing the consumer price index (CPI) rose 5.6% year-on-year in May, compared to economist forecasts of 6.1%.

After the CPI rose from close to 0% at the start of 2021 to almost 8.4% in December 2022, it's fallen sharply over the past six months.

Inflation bears will argue that the COVID induced supply chain issues reduced the supply of goods while demand spiked partly from government money printing and handouts, resulting in significant price increases and inflation issues. These factors are receding, and inflation should head back towards the RBA's target range of 2-3%.

Inflation bulls will tell the bears: hang on a moment. While the latest CPI report is welcome, the seasonally adjusted CPI was higher at 5.8% and the trimmed mean CPI was at 6.1%. On the supply side, the fraying of globalization could mean supply chains may not return to what they were pre-COVID. And pricing pressure will remain given significant wage increases being pushed through at the start of July, rental increases, while easing, remaining high, house prices rising off their lows, food inflation increasing at the major supermarkets and energy prices showing no sign of abating as the transition to green energy proves difficult and costly.

The inflation bulls will also point to research from Research Affiliates' Rob Arnott that suggests once US inflation reaches above 8%, as it did last year, history shows that reverting to 3% usually takes 6 to 20 years, with a median of over 10 years. Where the US goes, Australia normally follows.

Most asset classes need inflation to fall towards the RBA's target, otherwise current pricing doesn't make a lot of sense.

Cash is sexy again

Just 18 months ago, cash was trash. Now, it's back in a big way. That's thanks to the RBA lifting interest rates from a low of 0.1% in April last year to 4.1% today. It's been a wild ride over the past 14 months!

You can now get a Commonwealth Bank 12-month term deposit rate of 4.25%. Other banks pushing hard into the deposit space offer better. Macquarie Bank has 12 term deposit rates of up to 5% while Judo Bank has term rates of up to 5.3%. These can come with terms and conditions, so make sure you do your homework.

RBA cash rate

Source: RBA

Are bonds back, or is it just a furphy?

Bonds had a disastrous 2022 and investors ran for the exits. Bonds have steadied so far this year, and many fund managers are proclaiming that bonds offer good value.

I'm not so sure. After all, you can get more yield in cash than in 2- or 10-year government bonds. There's also the problem of high inflation. Sticky inflation is bad for bonds as it erodes the purchasing power of a bond's future cash flows.

Switched-on readers may have noticed earlier that 2-year bonds yield more than 10-year bonds. In economic terms, that's an inverted yield curve as short-term yields are higher than long-term yields, so the yield curve slopes downwards. An inverted yield curve can mean investors believe interest rates in future will be lower than the current rates.

In the US, an inverted yield curve has been a prescient harbinger of a coming economic recession because central banks reduce policy rates in response to lower economic growth and inflation, which investors may correctly forecast will happen.

In Australia, an inverted yield curve has been less reliable as an indicator of a future recession.

Is residential property set for a double dip?

The size of the residential real estate market in Australia boggles the mind. At $9.6 trillion, it dwarfs the likes of superannuation and listed stocks.

The latest figures show that residential property continues to bounce off lows. Nationally, home values increased 1.1% in June, and are up 3.4% from their bottom in February. Sydney has led the way, with property prices 6.7% higher from the trough. The ACT, Tasmania, and the Northern Territory, have lagged, barely rising from their lows.

Where do prices go from here? On the one hand, the extraordinary migrant intake is likely to prop up demand for both home purchases and rentals. Record low unemployment will also help. On the other hand, the bulk of fixed income mortgages are expiring this year, and that will provide a large hit to people's disposable income and ability to buy a home.

What is unarguable is that rental yields on residential property remain terrible. At gross yields of 3.88% nationally, homes are effectively priced at 26x earnings. And that's before costs which can bring those gross yields down 1% or more.

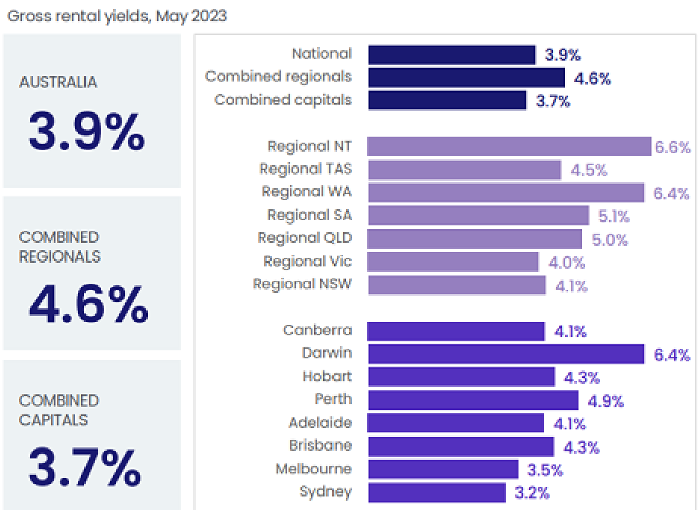
It's not a great deal from an investment viewpoint. For it to work as an investor (as distinct to buying a home to live in), you're banking on strong rent rises continuing well into the future, which could well happen.

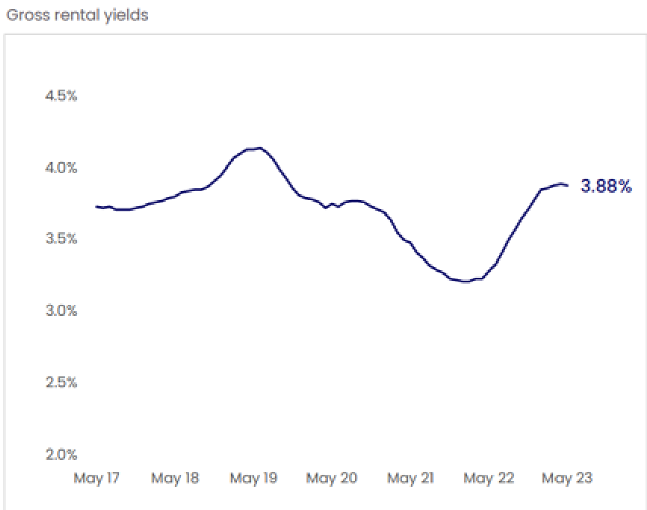
Summary of dwelling values through the pandemic to-date

Geography	Onset of COVID to cyclical peak	Cyclical peak date	Cyclical peak to recent trough	Recent trough date	Recent trough to current
Sydney	24.5%	Jan 22	-13.8%	Jan 23	6.7%
Melbourne	10.7%	Feb 22	-9.6%	Feb 23	2.3%
Brisbane	41.8%	Jun 22	-11.0%	Feb 23	3.1%
Adelaide	44.7%	Jul 22	-2.4%	Mar 23	2.1%
Perth *	24.3%	Jul 22	-0.9%	Feb 23	3.3%
Hobart	37.6%	May 22	-13.0%	Apr 23	0.1%
Darwin	31.1%	Aug 22	-3.3%	Apr 23	0.9%
ACT	38.3%	Jun 22	-9.5%	Apr 23	0.8%
Rest of NSW	47.6%	May 22	-10.3%	Apr 23	0.9%
Rest of Vic.	34.4%	May 22	-8.4%	Jun 23	0.0%
Rest of Qld	42.6%	Jun 22	-7.3%	Feb 23	2.9%
Rest of SA *	53.3%		<at cyclical high>		
Rest of WA	31.2%		<at cyclical high>		
Rest of Tas.	51.0%	Jun 22	-7.7%	Mar 23	0.5%
Combined capitals	22.3%	Apr 22	-9.7%	Feb 23	4.1%
Combined regionals	41.6%	Jun 22	-7.7%	Feb 23	1.2%
Australia	26.2%	Apr 22	-9.1%	Feb 23	3.4%

Onset of pandemic calculated from March 2020
** At record high as at end of June 2023*

Source: Corelogic





Source: Corelogic

What a comeback for US stocks

At the start of this year, many pundits were predicting more doom and gloom for US stocks and, not for the first time, were wrong. Very wrong. After diving 18% and 33%, the S&P 500 and Nasdaq have roared back in the first half of 2023, returning 17% and 39% respectively.

What's driven the turnaround? Declining inflation rates and a potential pause in interest rate increases have certainly played a part. So has the rise of Artificial Intelligence and investor enthusiasm for anything related to this technology.

Eight stocks have driven much of the S&P 500's rise to June 30:

Nvidia +190%	Apple 50%
META + 138%	Netflix +49%
Tesla +113%	Microsoft +43%
Amazon +55%	Alphabet +36%

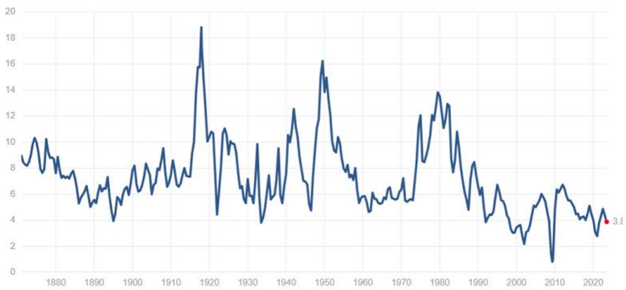
This compares to the S&P 500 equal weight ETF (RSP) rising 7% in the first half of the year.

CREATIVE PLANNING — **Asset Class Total Returns Since 2011** (as of 6/30/23 - Data via YCharts) — @CharlieBilello

ETF	Asset Class	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023 YTD	2011-23 Cumulative	2011-23 Annualized
N/A	Bitcoin	1473%	186%	5507%	-58%	35%	125%	1331%	-73%	95%	301%	66%	-65%	**82.3%**	10044195%	151.3%
QQQ	US Nasdaq 100	3.4%	18.1%	36.6%	19.2%	9.5%	7.1%	32.7%	-0.1%	39.0%	48.6%	27.4%	-32.6%	**39.1%**	662.4%	17.6%
SPY	US Large Caps	1.9%	16.0%	32.2%	13.5%	1.2%	12.0%	21.7%	-4.5%	31.2%	18.4%	28.7%	-18.2%	**16.8%**	346.4%	12.7%
EFA	EAFE Stocks	-12.2%	18.8%	21.4%	-6.2%	-1.0%	1.4%	25.1%	-13.8%	22.0%	7.6%	11.5%	-14.4%	**12.5%**	81.1%	4.9%
CWB	Convertible Bonds	-7.7%	15.9%	20.5%	7.7%	-0.8%	10.6%	15.7%	-2.0%	22.4%	53.4%	2.2%	-19.4%	**9.6%**	192.5%	9.0%
IWM	US Small Caps	-4.4%	16.7%	38.7%	5.0%	-4.5%	21.6%	14.6%	-11.1%	25.4%	20.0%	14.5%	-20.5%	**8.1%**	184.8%	8.7%
EEM	EM Stocks	-18.8%	19.1%	-3.7%	-3.9%	-16.2%	10.9%	37.3%	-15.3%	18.2%	17.0%	-3.6%	-20.6%	**5.2%**	7.8%	0.6%
GLD	Gold	9.6%	6.6%	-28.3%	-2.2%	-10.7%	8.0%	12.8%	-1.9%	17.9%	24.8%	-4.2%	-0.8%	**5.1%**	28.5%	2.0%
TLT	Long Duration Treasuries	34.0%	2.6%	-13.4%	27.3%	-1.8%	1.2%	9.2%	-1.6%	14.1%	18.2%	-4.6%	-31.2%	**4.7%**	49.9%	3.3%
HYG	High Yield Bonds	6.8%	11.7%	5.8%	1.9%	-5.0%	13.4%	6.1%	-2.0%	14.1%	4.5%	3.8%	-11.0%	**4.5%**	65.4%	4.1%
EMB	EM Bonds (USD)	7.7%	16.9%	-7.8%	6.1%	1.0%	9.3%	10.3%	-5.5%	15.5%	5.4%	-2.2%	-18.6%	**4.4%**	43.2%	2.9%
LQD	Investment Grade Bonds	9.7%	10.6%	-2.0%	8.2%	-1.3%	6.2%	7.1%	-3.8%	17.4%	11.0%	-1.8%	-17.9%	**4.3%**	52.0%	3.4%
PFF	Preferred Stocks	-2.0%	17.8%	-1.0%	14.1%	4.3%	1.3%	8.1%	-4.7%	15.9%	7.9%	7.2%	-18.2%	**4.2%**	62.1%	3.9%
VNQ	US REITs	8.6%	17.6%	2.3%	30.4%	2.4%	8.6%	4.9%	-6.0%	28.9%	-4.7%	40.5%	-26.2%	**3.4%**	146.2%	7.5%
BND	US Total Bond Market	7.7%	3.9%	-2.1%	5.8%	0.6%	2.5%	3.6%	-0.1%	8.8%	7.7%	-1.9%	-13.1%	**2.4%**	26.5%	1.9%
BIL	US Cash	0.0%	0.0%	-0.1%	-0.1%	-0.1%	0.1%	0.7%	1.7%	2.2%	0.4%	-0.1%	1.4%	**2.2%**	8.6%	0.7%
TIP	TIPS	13.3%	6.4%	-8.5%	3.6%	-1.8%	4.7%	2.9%	-1.4%	8.3%	10.8%	5.7%	-12.2%	**2.0%**	35.5%	2.5%
DBC	Commodities	-2.6%	3.5%	-7.6%	-28.1%	-27.6%	18.6%	4.9%	-11.6%	11.8%	-7.8%	41.4%	19.3%	**-7.9%**	-14.7%	-1.3%
	Highest Return	BTC	BTC	BTC	VNQ	BTC	BTC	BTC	BIL	BTC	BTC	BTC	DBC	BTC	BTC	BTC
	Lowest Return	EEM	BIL	GLD	BTC	DBC	BIL	BIL	BTC	BIL	DBC	TLT	BTC	DBC	DBC	DBC
	% of Asset Classes Positive	61%	94%	44%	67%	39%	100%	100%	6%	100%	89%	61%	11%	94%	94%	94%

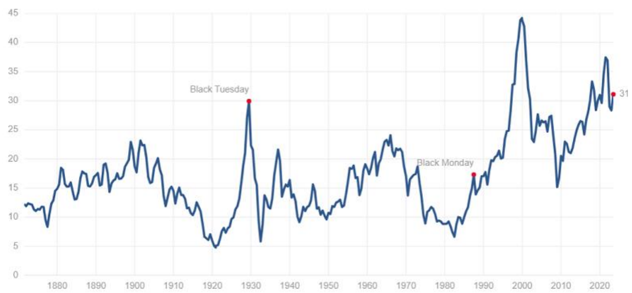
The rally has made US stocks look very expensive, once again. The S&P 500 trades at an earnings yield of 3.88% or a price to earnings ratio (PER) of almost 26x (below, left). And on a cyclically adjusted PER, using average inflation-adjusted earnings from the previous 10 years, things look worse (below, right). At 31x, it's 80% above its long-term average of 17x, and is at levels only seen in 2000 and 1929.

S&P 500 earnings yield based on trailing 12 months earnings



Source: Robert Shiller

Cyclically adjusted PER or CAPE ratio



Source: Robert Shiller

And with the US 10-year bond yielding 3.85%, US stocks offer no premium to the risk-free rate. Note that investors normally demand a premium to the risk-free rate, sometimes a substantial premium, for them taking on the risk of buying stocks. That's not the case now, and it doesn't bode well for future returns for US stocks.

ASX stocks: the value play?

The Australian stock market has had a dull time of it compared to other markets. It's had a small gain this year, trailing most developed markets.

Country ETF returns in 1H23

Country	Ticker	2023 YTD	Country	Ticker	2023 YTD	Country	Ticker	2023 YTD
Nigeria	NGE	50.5%	Vietnam	VNM	12.3%	New Zealand	ENZL	1.9%
Greece	GREK	40.2%	South Korea	EWY	12.2%	Qatar	QAT	1.4%
Argentina	ARGT	35.6%	Denmark	EDEN	12.1%	UAE	UAE	0.8%
Ireland	EIRL	27.0%	Chile	ECH	12.0%	Belgium	EWK	0.7%
Mexico	EWW	26.7%	Saudi Arabia	KSA	10.9%	Philippines	EPHE	0.6%
Poland	EPOL	24.1%	Austria	EWO	10.0%	Kuwait	KWT	-0.6%
Spain	EWP	21.1%	Sweden	EWD	9.6%	Israel	EIS	-3.3%
Italy	EWI	21.1%	Peru	EPU	9.5%	South Africa	EZA	-4.6%
France	EWQ	18.9%	Canada	EWC	8.0%	China	MCHI	-4.9%
Brazil	EWZ	18.8%	Colombia	GXG	7.7%	Hong Kong	EWH	-6.5%
Germany	EWG	18.7%	United Kingdom	EWU	7.6%	Norway	NORW	-6.6%
Netherlands	EWN	17.5%	Portugal	PGAL	5.8%	Egypt	EGPT	-7.0%
Taiwan	EWT	17.1%	Indonesia	EIDO	5.1%	Malaysia	EWM	-10.8%
US	SPY	16.8%	India	INDA	4.9%	Thailand	THD	-10.9%
Japan	EWJ	14.5%	Australia	EWA	3.4%	Pakistan	PAK	-11.1%
Switzerland	EWL	12.7%	Singapore	EWS	2.0%	Turkey	TUR	-20.9%

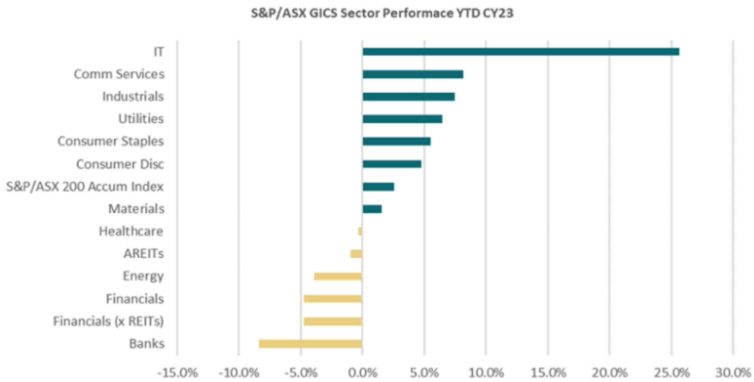
Source: Charlie Bilello

The ASX been held back by the performance of the heavyweight sectors in banks, energy, and materials. Banks have underperformed as profit margins are getting crunched from increasing the interest rates paid on deposits due to political pressure and competition for deposits.

Meanwhile, energy and mining stocks have struggled as the prices of oil, iron ore, gold, copper, and lithium have all retreated from their peaks of last year.

Yet, the ASX stocks are one of the few assets that look reasonably priced. At an earnings yield of 6.76%, the All Ordinaries is priced close to its long-term average. And it offers a nice premium to risk-free bonds.

Of the four major asset classes in Australia, stocks seem to offer the best value at this point.

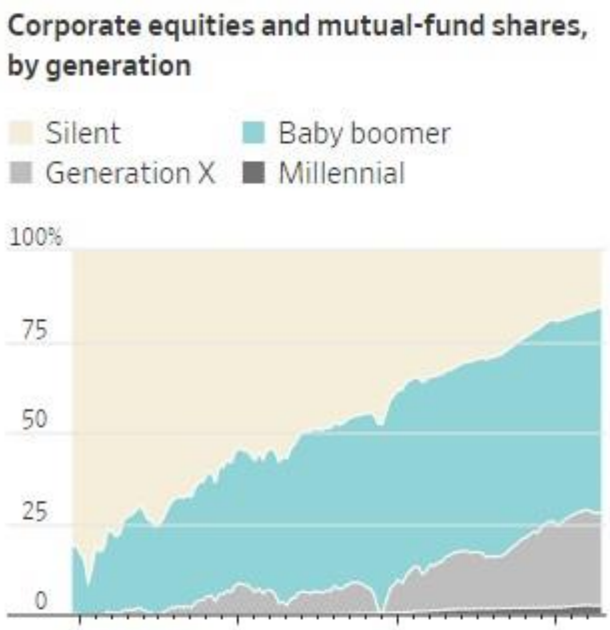


Source: Viridian Financial

James Gruber

Also in this week's edition ...

We examine the many segments of the global and Australian wealth industry to check how they fit together, the enormous sizes of the many parts and who are the major players. **Graham Hand** looks at the trillions and billions and puts [Australia and its fund managers into their place](). Did you know only one Australian fund manager ranks in the top 100, and that global funds under management total over $200 trillion? Yes, $200 thousand billion. We like to think our superannuation indusry at $3.5 trillion is massive but it's a drop in the global ocean. About 55% of funds under management globally are managed by US companies, over $100 trillion. The chart below shows it's currently the Boomers and older who are the owners of all this money, and while much of the wealth will pass to Gen X and Millennials over coming decades, the money is not yet there.



Note: Generations are defined by birth year as follows: silent and earlier (before 1946), baby boomer (1946-1964), generation X (1965-1980) and millennial (1981 or later).
Source: Federal Reserve

We hear a lot of how to retire happy, but what does science have to say on the topic? **Dr Michael Finke** outlines the data behind the financial and non-financial dimensions of retirement satisfaction. And he throws up some fascinating facts including that the happiest retirees are women who divorce between the ages of 60 to 65.

There aren't many optimists left when it comes to the Australian office property market. That's especially after Dexus sold an A-grade office tower at a 17% discount to book value. Yet, **Colin Mackay** from **Cromwell Property Group**, says many concerns about the sector are overblown. One for the contrarians, perhaps?

Janus Henderson Investors' Matt Peron is sticking to his view that a global economic slowdown is coming. He says the concentrated nature of 2023's equities gains, especially in the US, hides increasing vulnerability in equity markets. Peron believes it's time to get defensive and buy quality stocks.

Australia's population rose by 497,000 in 2022, driven by a record net overseas migration of 387,000. It's a mind-blowing number that's captured the media's attention, yet less talked about is the continued decline in our fertility rates. **Emma Davidson** of **Staude Capital** says fertility rates are the real long-term concern.

How should investors go about picking a fund manager? **Morningstar's Michael Malseed** suggest the key attributes to look for include strong stewardship and the ability to deliver long-term returns.

RBA Governor Philip Lowe has been banging on about economic productivity of late, suggesting that slow gains in this area threaten to undermine economic growth and lead to sticky inflation. **Professor Stephen King** of **Monash University** thinks Lowe is correct and wide-ranging reforms are needed.

This week's whitepaper from **Realindex Investments**, of the **First Sentier Investors Group**, investigates the pervasive but misunderstood price effects of stocks in the period surrounding their dividend payments.

Curated by Leisa Bell and James Gruber

Who's who in the zoo of Australian asset management?

Graham Hand

It's not quite Noah's Ark with two of everything, but funds management in Australia is a zoo of different creatures, and who's who is a complicated picture. There are platforms, unlisted managed funds, listed funds, superannuation funds, SMSFs, wholesale, retail, institutional … where do we stop and how are they related?

There will be some big numbers in this article, so let's make it clear:

- A billion is a thousand million
- A trillion is a thousand billion

Focus on the billions and trillions and soon, we're talking serious amounts of money. A note of caution on the numbers, as even the Australian Bureau of Statistics (ABS) says:

> *"The managed funds industry is difficult to measure because of the many inceptions and winding-up of funds each quarter, due to the large amount of financial interactions between managed funds institutions and investment managers, and between investment managers themselves. Consequently,*

double counting of funds which are 'churning' through the system needs to be considered in order to derive a net measure of the managed funds industry."

With such qualifications on data sources, we bring together:

1. Fund managers
2. Total managed funds
3. Superannuation assets
4. Industry and retail super funds
5. Self-Managed Super Funds
6. Wraps and platforms
7. Listed funds (ETFs, LICs, property, infrastructure)

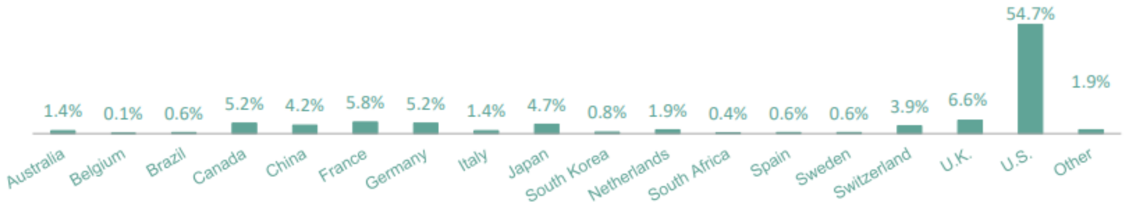
Global context among largest managers

Let's put Australia in a global context.

Australians like to think we punch above our weight in most things, and the compulsory superannuation places our retirement system among the largest in the world. But in asset management generally, the combined funds under management (FUM) of all the asset managers in Australia is less than the biggest individual managers in the US: BlackRock ($14 trillion), Vanguard ($13 trillion) and Fidelity International ($7 trillion). Only one Australian manager, Macquarie, is in the Top 100 in the world, managing less than $1 trillion.

Based on an [October 2022 report by the Thinking Ahead Institute]() (TAI), total discretionary FUM of the 500 largest managers (excluding superannuation funds) in the world totals USD132 trillion, or over AUD200 trillion. That's 200 thousand billion. The Institute reports Australian fund managers hold only 1.4% of the assets of the 500 managers. The US is at 54.7% and rising over time.

Distribution of assets by fund manager country of origin



Source: Thinking Ahead Institute

1. Fund managers

There have been so many changes in Australian funds management in the last year or two that the latest TAI data published in October 2022 but using 2021 data is now out-of-date. IFM Investors is listed as second (but ranked globally 157th) to Macquarie, the three following Australian names – AMP Capital (ranked 159th), MLC Asset Management (ranked 160th) and Pendal (ranked 184th) – have significantly restructured. Further down the TAI list but in the Top 10 in Australia and 232nd in the world is Magellan, but it's probably not in the Top 500 any longer. The other names on the list of the Top 10 Australians are Challenger (211th), Perpetual (234th), Pinnacle (239th) and QIC (242nd).

Another measure of the largest local fund managers in the wholesale/institutional space, from Plan for Life, gives this break up of $1.3 trillion under management. The leading role of SSGA and Vanguard shows their dominance in providing index funds to institutions, although Vanguard has stepped away to focus on retail and adviser distribution.

$millions	Dec-22	
State Street Global Advisors	313,602	24.3%
Vanguard Investments	104,708	8.1%
Challenger Limited	92,789	7.2%
Insignia Financial	75,594	5.8%
Victorian Funds Management	66,226	5.1%
AMP	62,757	4.9%
UBS Asset Management	57,045	4.4%
First Sentier Investors	49,625	3.8%
Pendal Limited	39,066	3.0%
BlackRock	38,364	3.0%
Others	392,500	30.4%
Totals	**1,292,276**	**100.0%**

Source: [Plan for Life]()

2. Total managed funds

The ABS defines managed funds as the assets of financial institutions that pool funds for investment. It covers industry funds, retail funds and other funds managers who provide professional investment services, and despite the definition, it also includes SMSFs.

In March 2023, total managed funds were $4.5 trillion, or $4,544 billion, including $3.4 trillion in superannuation (more on this later).

To give a context to this number:

- the Gross Domestic Product of Australia is about $2.4 trillion.
- the total market capitalisation of the Australian Securities Exchange is also about $2.4 trillion.

With the superannuation industry alone forecast to grow to about $10 trillion by 2040, and many large companies leaving the listed arena, investors will need to look to offshore and private assets increasingly over time. There will be too much money chasing domestic equities.

3. Superannuation funds

The latest Australian Taxation Office data for June 2022 shows industry funds and SMSFs have streaked away from retail funds, which are in decline.

4. Industry and retail super

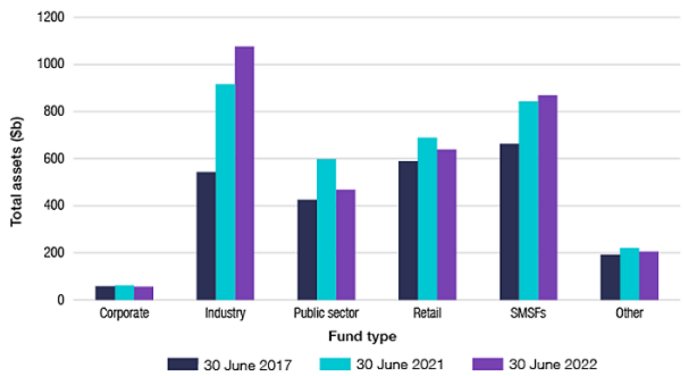
The Australian Prudential Regulation Authority (APRA) produces Annual Fund Level Superannuation Statistics, and The Conexus Institute has cleaned up the data, eliminating duplications and clarifying interpretations where possible. The data refers only to industry and retail funds and not corporate funds and SMSFs.

The first chart shows the 14 super funds in the 'Big Fund Club' each with assets over $50 billion. They hold about 80% of all the assets in the large super funds. Consolidation of funds is now a feature of the industry, with new deals announced every month. The big transactions are in the 'mega fund' category, where AustralianSuper is joined by Australian Retirement Trust (ART) via the merger of Sunsuper and QSuper. Mercer Super has joined the top league after acquiring most of BT's super business.

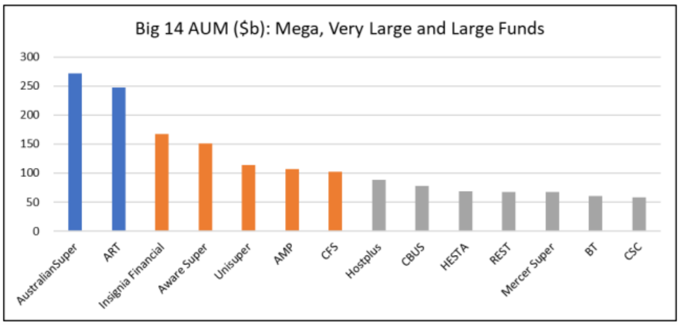
The remaining 20% of assets are held in another 13 funds with assets over $10 billion, and there are many smaller funds not in this table. So that is 27 super funds with assets varying from $10 billion to close to $300 billion.

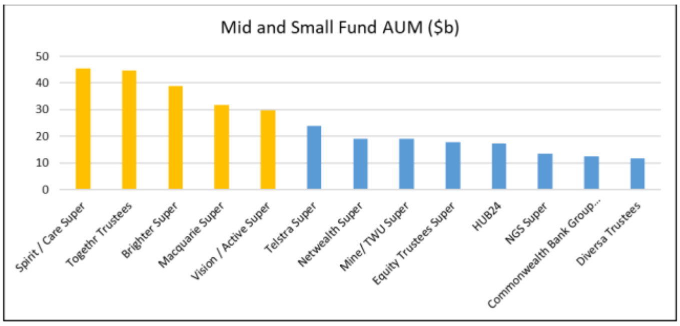
In TAI research on the largest 300 superannuation funds in the world, the data is again dated but useful to see that Australia is better represented in global super and pensions. AustralianSuper was in the Top 20 and 15 Australian super funds made the Top 300. Unlike in Australia where Defined Contributions (DC) dominate, Defined Benefit (DB) funds control 63% of global pension FUM, with DC at 24% and reserve funds at 12% (latest available report). In world rankings in 2021 (before the

Total superannuation assets by type of fund, 2017 to 2022



Source: ATO





Source: APRA and The Conexus Institute merger of QSuper and Sunsuper to form ART), in the Top100 were the Future Fund at 26th, Aware Super 46th, and UniSuper 77th.

5. Self-Managed Super Fund (SMSFs)

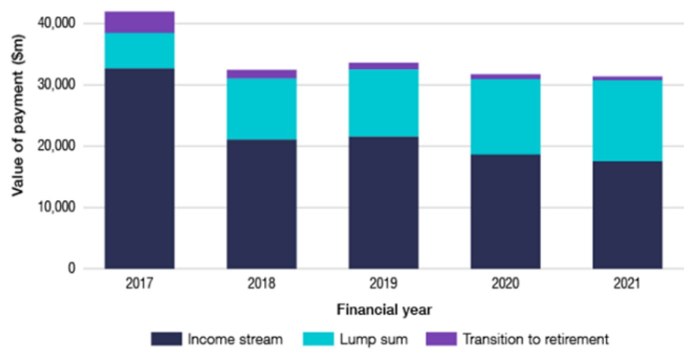
The media often reports the demise of SMSFs due to large funds and platforms improving their offers, while Exchange Traded Funds (ETFs) and Listed Investment Companies (LICs) provide a wide range of funds which do not require the personal investment choice and control of a member-directed fund. But SMSFs remain highly popular, with over 600,000 funds and 1.1 million members holding almost $900 billion, and their numbers continue to increase. The average SMSF holds almost $1.5 billion with the median at $835,000.

A further breakdown on SMSF data includes:

- 66% corporate trustees, 34% individual trustees.
- 55% wholly in accumulation, 36% wholly retirement, 9% mix of both.
- 69% of SMSFs have two members, 24% are single members.

This ATO table shows the majority of payments from SMSFs are income streams, with members relying on their pensions for regular income.

SMSF benefit payments by type



Source: Australian Taxation Office

6. Wraps and platforms

This is where some numbers overlap and should not be added to amounts stated above. For example, platform providers such as Netwealth, HUB24, Macquarie, Fiducian and Colonial First State include super funds and other managed funds in their offers. Platforms benefit from strong engagement with financial advisers who are using the platform structure to manage their businesses and administer their clients. However, most members of the mega industry funds are not introduced via the financial advice process but rather through their occupation.

The [Plan for Life 'Analysis of Wraps, Platforms and Master Trusts'](#) latest report for December 2022 shows around $1 trillion in various types of 'master funds'. The funds fell in 2022 due to market falls, some of which have recovered in a stronger 2023. One ongoing trend is that the big funds from Insignia (the merger of MLC and IOOF), BT Financial, Commonwealth/Colonial and AMP are in outflow, while the disruptors in Netwealth, HUB24, Mercer and Praemium are well and truly part of the main game.

Funds Under Management – Total Masterfunds Administrator View

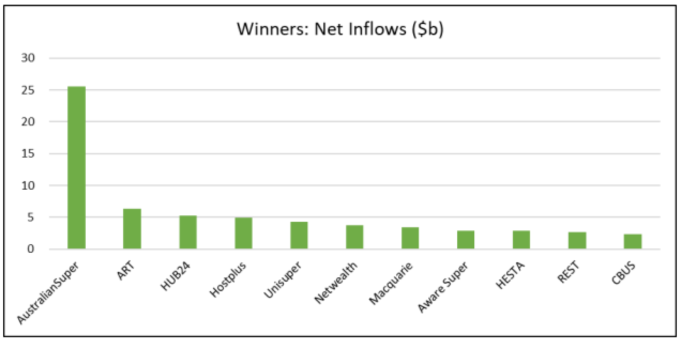
$millions	Dec 22		Dec 21		Dec 20		Annual Growth
Insignia Financial	194,069	20.3%	213,174	20.7%	76,021	8.5%	-9.0%
BT Financial Group	160,918	16.9%	181,495	17.6%	161,274	18.1%	-11.3%
Commonwealth / Colonial Group	134,217	14.1%	149,547	14.5%	133,881	15.1%	-10.3%
AMP Group	132,077	13.8%	149,100	14.5%	138,810	15.6%	-11.4%
Macquarie Group	115,712	12.1%	119,581	11.6%	95,985	10.8%	-3.2%
netwealth	62,414	6.5%	56,654	5.5%	38,799	4.4%	10.2%
HUB24	55,829	5.9%	49,992	4.9%	21,966	2.5%	11.7%
Mercer	29,438	3.1%	29,891	2.9%	25,661	2.9%	-1.5%
Praemium	20,918	2.2%	21,098	2.1%	16,445	1.8%	-0.9%
Others	48,515	5.0%	58,405	5.7%	180,385	20.3%	-16.9%
Totals	**954,108**	**100.0%**	**1,028,936**	**100.0%**	**889,227**	**100.0%**	**-7.3%**

Analysis By Market

Wrap	543,904	57.0%	562,654	54.7%	450,662	50.7%	-3.3%
Platform	333,811	35.0%	380,846	37.0%	349,751	39.3%	-12.4%
Master Trust	76,392	8.0%	85,435	8.3%	88,814	10.0%	-10.6%
Totals	**954,108**	**100.0%**	**1,028,936**	**100.0%**	**889,227**	**100.0%**	**-7.3%**

Source: Plan for Life

Another of the Conexus slides taken from APRA data shows the super fund versions of these newer platforms are also attracting large inflows. While AustralianSuper continues to thrive on the back of good performance and massive member reach, and large funds such as ART, Hostplus and Unisuper are doing well, HUB24 and Netwealth are making inroads.



Source: APRA and The Conexus Institute

7. Listed funds (ETFs, LICs, property, infrastructure)

According to the [latest ASX Report](), there were 437 listed funds comprising Exchange Traded Funds (ETFs), Listed Investment Companies (LICs) and Trusts (LITs), property trusts (A-REITs) and infrastructure funds in April 2023, worth about $400 billion.

Fund Segment	Market Value - $billion	Number Listed
ETFs	143.5	297
LICs and LITs	48.5	91
A-REITs	140.9	45
Infrastructure	67.0	4
TOTAL	**400.0**	**437**

The alternative exchange, Cboe, gives [slightly different numbers](), but it is evident from both that with the much-publicised ETFs at $144 billion and all listed funds at $400 billion, while the growth is impressive, it's a small fraction of the managed fund industry.

Conclusion

The billions and trillions can be confusing, and it's easy to get lost in the numbers of a $200 trillion global industry. Funds management is a massive part of the global economy, influencing governments and companies, and as the world population ages, the numbers are only going one way over time. What comes after trillions?

Graham Hand is Editor-At-Large for Firstlinks. This article is general information and based on an interpretation of latest information.

The three pillars to a happy retirement

James Gruber

This is an edited transcript of an interview between Dr. Daniel Crosby and Dr. Michael Finke, Professor of Wealth Management at The American College of Financial Services, on the [Standard Deviations]() podcast.

Dr. Daniel Crosby: I've read your writing on the three pillars of retirement satisfaction. Can you tell us what they are and spend a little time unpacking what can be done about the nonfinancial ones to help us prepare for the nonfinancial dimensions of retirement that I think are often overlooked?

Dr. Michael Finke: I call them the three pillars because when you run regressions, you know that there's a cluster of three different variables that are going to consistently be the strongest predictor of satisfaction and retirement.

And those are, one, health. Obviously, health is important because if you're in better health, you're going to have a more satisfying retirement because it lets you do so many more things. And I think that all of the three things, the underlying characteristic that ties them together is ... each is an investment. By an investment, that means that you can make a sacrifice earlier on in life in order to enhance that component, that pillar of life satisfaction in retirement. So, one of them is health, that's obvious. There's only so much you can do. Some of it is under your control. Some of it is not.

The second is money. And there has been some really recent – there was this debate about whether money actually made you happy because Danny Kahneman about 20 years ago did a study with an economist where they found that it seemed as you earned more money, you were more happy up to a plateau. And the plateau was maybe US$70,000 or US$80,000.

But other researchers found something completely different, which is that the more money you had, the more income, the happier you were, and it just kept going up. And so, there was a really fascinating article that was done recently by the original authors and the other authors. And what they found was that there was a confound that they hadn't taken into account in the data, and that is that people who are unhappy are made happier by money up to a very low point. And after that point, they continue to remain miserable. But people who are generally happy, the more money they have, the happier they get.

So, one of the questions you have to ask yourself is, are you miserable? In which case, money is not going to have much of an impact on happiness. But if you're generally a happier, more positive, optimistic person, then the money is actually an input into doing stuff that is going to make you more happy.

And remember, money is, it's just grain paper. It has this imaginary value that we place on it. It's numbers on a computer screen. The money itself is not what provides value. It is the access to stuff, to experiences, you can hire other people's time, you can buy physical things with it. But how you use your money is also very important. And there's a lot of great research that shows that people who are smart about how they use money are consistently more happy than people who spend money on the wrong things, the things that ultimately do not lead to greater life satisfaction.

Now, in addition to health and money, of course, relationships consistently show up as the most significant predictor. The strongest single predictor of life satisfaction is the relationship that you have with your spouse or partner. So, the person that you're spending the most time with in retirement is that spouse. And if you have a positive relationship with them, that is the strongest predictor of retirement satisfaction.

So, again, that is an investment just like any other investment, knowing how to have a positive, fulfilling relationship with your spouse. If you have a negative relationship with your spouse, it's also a significant but negative predictor of life satisfaction. So, it's not just being married. It's being married to someone with whom you have a positive relationship with. And in fact, as a side note, when we broke it down by age group and gender, the happiest group of retirees is in fact women who get divorced between the ages of 60 and 65. They are the happiest retirees.

I think that relates to a problem that very often happens in a relationship when people retire. And that is that men tend to have a more limited social network and oftentimes that social network revolves around their work. And women tend to do a better job of investing in relationships that they can then draw from in retirement outside of the workplace. And so, what that means is that women oftentimes want to be able to maintain those relationships in retirement. Men all of a sudden become far more – in an opposite sex couple, they become far more reliant on their relationship with their wife. And the wife is often struggling to be able to manage her existing relationships and this perceived obligation that she has to her husband. And oftentimes they may not have developed the capabilities to spend all day with each other. They get married, and they see each other for breakfast and dinner, but not necessarily for lunch.

Developing those skills oftentimes – and I hate to stereotype, but oftentimes men just have not developed the same social skills that they need to have to be able to flourish in retirement. Women seem to be better at it. And it's one of the reasons why men tend to struggle more when their wives die than wives tend to struggle when their husbands die because the men are so reliant on their wives as an input into social engagement.

The bottom line here is that human beings are programmed. We release endorphins when we interact with other human beings. Oftentimes, we think that we're in control, but basically, we're subservient to the older part of our brains that's squirting out things like dopamine and making us happy. And our brains are programmed to make us happy by having stronger connections with a social group. That is – there's this great book called The Secret of Our Success, which is all about the idea that human beings have evolved. Our strength, the thing that makes us successful as a species is not necessarily that we're stronger or smarter. What we're able to do is, we're able to create these very cohesive social units that we can have – our brains, our prefrontal cortex is big enough to have a social unit of 150 people, in which case we can act collectively in a way that other animals can't. And that really is the secret of our success, which means that we've developed all of these skills to maintain that large social unit. And our bodies actually have responded physiologically to that by rewarding us for maintaining these more close social interactions.

If you recognize that we're basically these big meat sacks that get rewarded with dopamine, then we can be – first of all, we can anticipate ways that the dopamine makes us unhappy. And we can also anticipate ways that dopamine makes us happy, and being more social is a way to make ourselves happy.

Dr. Daniel Crosby: When it comes to relationships, it really is that spousal relationship that reigns supreme. I'm sure there's a halo effect to positive relationships generally, but that marital relationship, that partnership relationship is indeed the most important. Is that right?

Dr. Michael Finke: It is. That's the closest relationship. But let's talk about friends for a moment, because friends are also a significant predictor of life satisfaction. And friendship, just like health, just like money, friendship is an investment.

My wife and I did this research together, and it's something that we have realized that has actually changed our behavior. It is a significant predictor of life satisfaction. But we also realized that as you reach middle age, very often those long-term friendships that you've developed over the years, you start losing them. You lose track of people. You don't interact with them as frequently.

But you can change that. You can actually make an effort to visit your old friends. You can phone them up. You can text them on a regular basis. That's an investment that takes time and effort and energy. But you make that investment so that you can then draw from that friendship later on in life. And in retirement, that becomes particularly important, the ability to draw on those long-term friendships that you've established.

So, that's an investment like anything else. And I think it's one of these aspects of life satisfaction that I was not aware of. I knew it was important to maintain friendships, but I hadn't looked at the data. I hadn't stared it in the face and thought, am I doing as much as I should? We both made an effort at that point to reestablish the friendships that we most valued, to make an investment with them, to buy the airline tickets. That's what it takes to maintain those friendships. And it's an investment like anything else. Why save that extra $1,000 in a 401(k) when instead I could pay the $1,000 for plane tickets to visit a friend and be able to maintain that relationship? Because I'm going to get more happiness out of that than I am from the $1,000 that I invest today.

And that's a really interesting way to look at it is there's these trade-offs. You've got these health relationship and money trade-offs. Now, obviously, more money tends to make people happier. But it is the combination of money and relationships and health. If you don't have your health, what use is the money? If you don't have the relationships, you have a lot of money, it doesn't necessarily make you happy. You have to be able to recognize that all of them are investments and you combine all of them to achieve true satisfaction.

Dr. Daniel Crosby: When you think about smart spending or smart investment, what are some ways that we can spend money that make us happy?

Dr. Michael Finke: When you look at the predictors of life satisfaction in terms of your budget allocation, which is something that we did in that research, the only consistently significant positive predictor was leisure spending. And within the leisure category, it was social spending. Any sort of spending that increases your interaction with other human beings. So going out to dinner with friends, this is one of those things. And it also worries me about how retirees spend, which is they often cut back on the frivolous things when the market does poorly, and they're worried about their money. If you cut back on things like going out to eat with friends because it seems frivolous, you are cutting back on the most important predictor of life satisfaction, the thing that gets you the most happiness per dollar spent. You have to be careful about how you spend the money and things.

Now, I'm going to give you an example of a thing that I think is a good idea for men in particular to spend money on. And I actually found this weird finding, which is spending money on cars that actually had a positive impact on satisfaction, but it wasn't that strong. But I have a hypothesis, which is not necessarily supported by data. And that is that among men, spending money on something like a classic car is entrée into a social group. It's not the car itself that provides that much happiness. They can drive it. They can look at it. That provides a certain amount of happiness, but it's not worth what they're paying for. What is worth it is that it makes them part of a social group. So, they can go to talk with other dudes and they can talk with each other online and they can develop friendships. This is an entrée that was facilitated by buying a classic car, but it wasn't the classic car itself.

This is an edited transcript of an interview between Dr. Daniel Crosby and Dr. Michael Finke, Professor of Wealth Management at The American College of Financial Services, on the [Standard Deviations] podcast.

James Gruber is an Assistant Editor for Firstlinks and Morningstar.com.au. This article is general information.

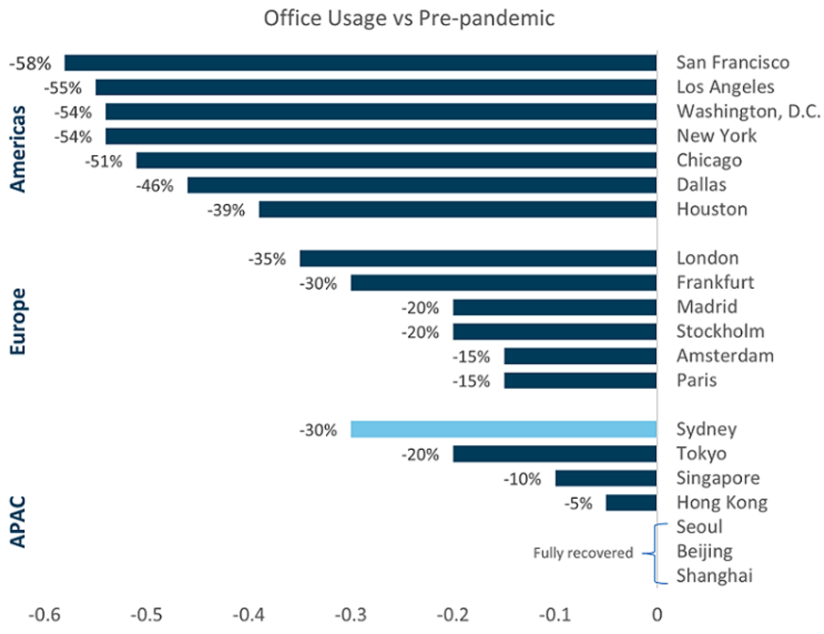
Australian office property isn't dead (or dying)

Colin Mackay

The future of offices in a post-pandemic world continues to be a topic of robust conversation.

Most airtime on the subject has been given to dramatic statements like "expect the death of the office" – perhaps recycling articles from the past decade that incorrectly asserted a retail apocalypse was nigh! The reality is that, as retail has adapted to the internet age – and survived – so too will office spaces adapt to these changing conditions[1].

It can be easy to fear the worst, especially as reports of landlords handing keys to the bank; assets sitting unoccupied; and valuations declining 80% take up the front page of newspapers.



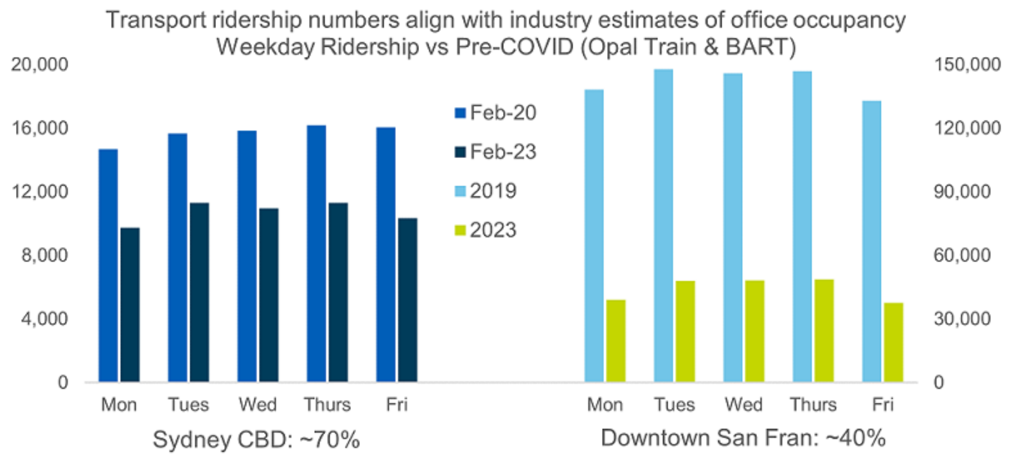
Source: JLL Research (2023); Cromwell

It's important, however, to understand that these events have been limited to the US, a challenged market with different financial, social, and real estate context. The outlook for office in Australia is markedly more positive for several reasons.

Higher office occupancy

Propensity to return to the office appears to be driven by a number of factors, including cultural expectations (e.g., Tokyo/Seoul); industry composition (e.g., finance vs tech); and ease of commute (e.g., rapid transit vs LA traffic). While workers around the globe highlight commute time as the most important driver of returning to the office[2], another critical factor is the micro-location of each office building. In addition to influencing commute time, different locations can vary significantly in terms of crime and safety risks, amenity (e.g., restaurants), and environmental desirability (e.g., proximity to water/green spaces).

Australia measures up attractively on these characteristics, offering reliable rapid transit, exceptional proximity to desirable environmental features, a high density of quality amenity integrated throughout the CBDs, and very low rates of crime. The return to the office should gather more steam in the coming months as large employers mandate a minimum number of days in the office per week, as announced recently by NAB and CommBank. However, over the long-term, locations and assets which can attract employees through choice rather than coercion will outperform.

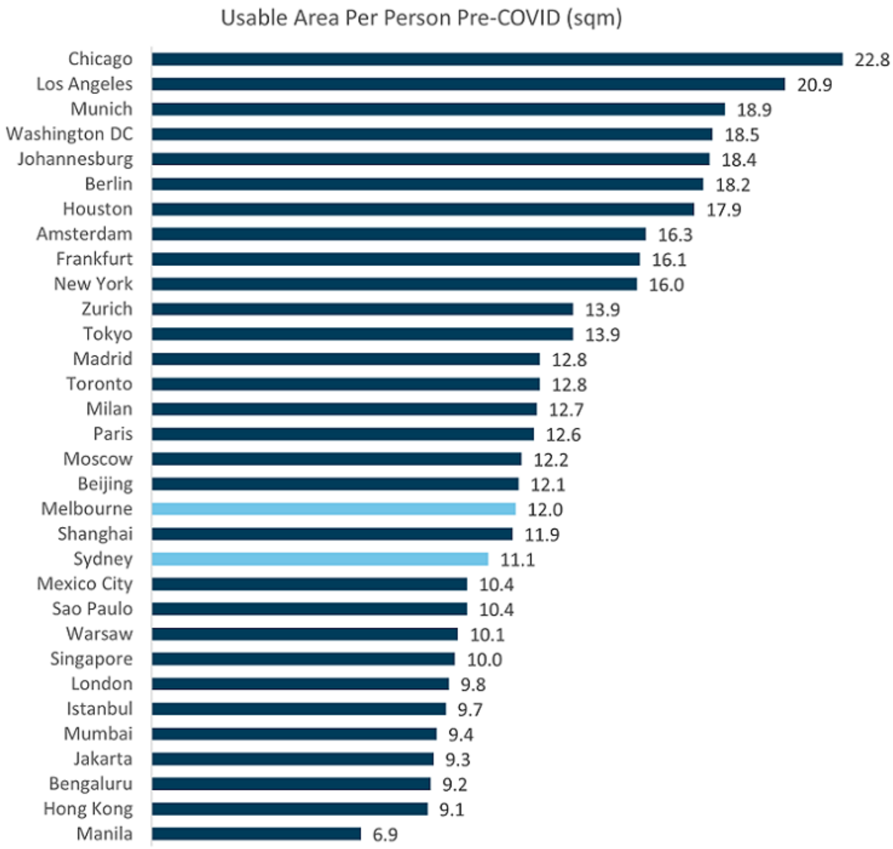


Source: City and County of San Francisco; Transport for NSW; Cromwell

Expanding space requirements

One of the forces expected to offset the impact of remote work is the expansion of workspace ratios – the amount of office space per employee. Forty years ago, in the days of private offices, Australian offices had more than 20 square metres (sqm) of space per employee. Over time, as occupiers sought more 'bang for their buck', desks became more tightly packed together and the corner office was sent to the scrap heap.

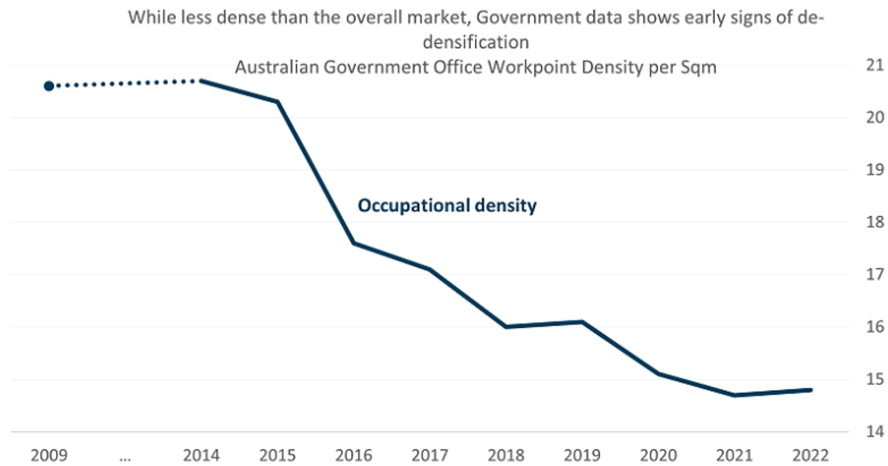
The result has been densification of the workplace, with the pre-COVID workspace ratio sitting at 11.1 sqm per employee for Sydney and 12.0 sqm for Melbourne[3].



Source: JLL Global Benchmarking Services (2021); Cromwell

The experience of the pandemic has initiated a shift in the purpose of the workplace and workstyles. The office is increasingly becoming a place for collaboration and social connection rather than focus work, meaning a greater need for meeting, gathering, and collaboration spaces. There is also a need to lower density and make workplaces more comfortable from an employee wellbeing and retention perspective, as employers fight for top talent. Studies have shown that inadequate privacy and space is the dominant cause of workspace dissatisfaction[4].

In the US, markets such as Chicago and Los Angeles have ratios above 20 sqm per employee, with even New York at 16.0 sqm[3]. The pandemic-initiated evolution of the work environment can be achieved in these markets by simply recalibrating (and even shrinking) existing footprints.



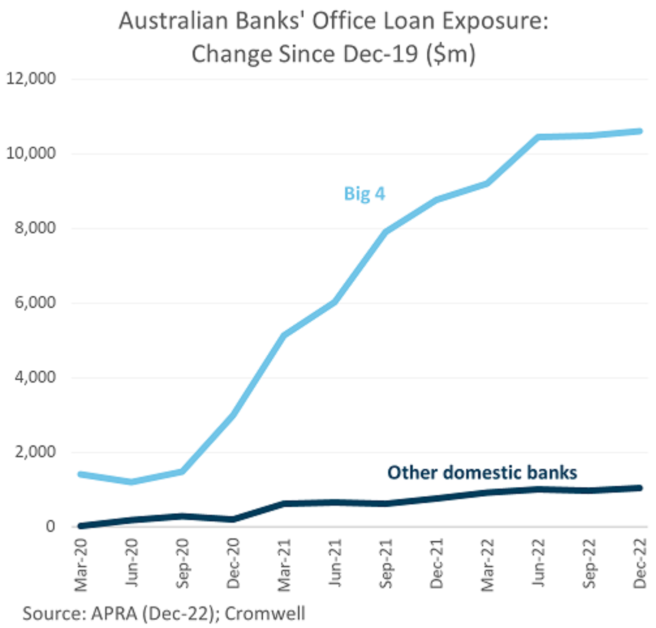
Source: Australian Government Department of Finance; Cromwell

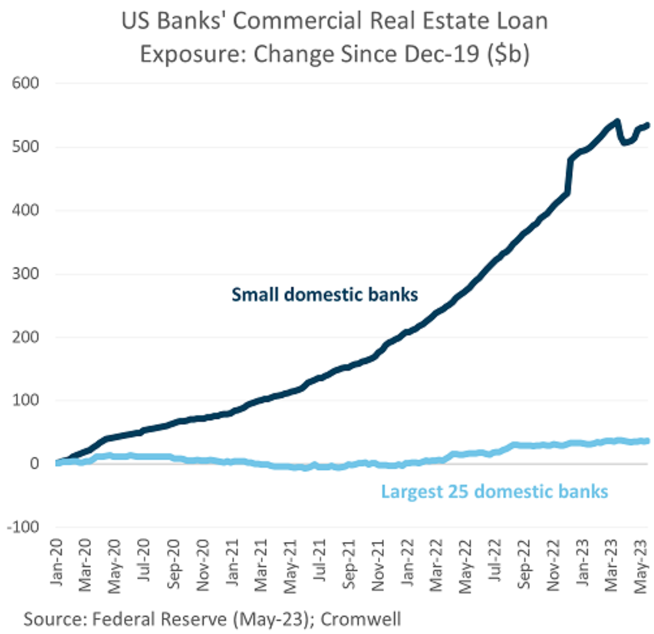
Contrast this environment with Australia, where workspace ratios are below the global average of 13.3 sqm[3] and potential space efficiencies are limited. In this market, the recalibration will likely require additional space, providing a source of demand and limiting the amount of rent-dampening excess stock.

Appropriate financing

Earlier in the year, some high-profile office defaults in the US by Brookfield, and a PIMCO-owned landlord, kicked off concerns about a real estate debt crisis. Risks are certainly elevated in the US, given the aforementioned demand challenges, which will pressure serviceability and put significant downwards pressure on valuations. While pockets of distress may emerge in Australia, the likelihood of a widespread crisis is much lower. Banks remain confident in Australian commercial real estate, increasing their exposure by 5% in December 2022 compared to a year ago[5]. Loan quality has also remained stable, with non-performing commercial property loans as a share of total exposure unchanged at 0.5%.

Most importantly, the office demand outlook in Australia is much more positive. Solid cashflow will support serviceability as debt rolls onto higher interest rates and help prevent valuations from declining to the extent that is expected in the US. Australia's lending market is also well regulated, diversified, and strong, and doesn't face the concentrated exposure or balance sheet issues that smaller regional banks in the US have been contending with throughout 2023.





Additionally, Australian gearing is more conservative with typical loan-to-value (LTV) ratios pre-pandemic of 55%, compared to 72% for the US[6]. While lending conditions have tightened somewhat over the last six months (LTVs now 50%), the US has seen significant tightening (to 57%), contributing to a significant funding gap which will need to be plugged with discount-seeking capital.

The final word

Office is going through a period of change, and assets need to evolve to meet the needs of post-pandemic workstyles. While there will be challenges – and opportunities – as a result, the current narrative erroneously extrapolates issues from offshore to the domestic market.

Australian office is well-placed to contend with increased rates of remote working and tighter capital markets given its resilient demand drivers, quality of stock, and sensible financing arrangements. Skilled managers with the expertise to identify underappreciated assets and adapt them to the future of work will continue to deliver strong investment returns.

[1] The Future of the Central Business District, May 2023 (JLL)
[2] The Global Live-Work-Shop Report, November 2022 (CBRE)
[3] Benchmarking Cities and Real Estate, June 2021 (JLL)
[4] A data-driven analysis of occupant workspace dissatisfaction, August 2021 (Kent, Parkinson & Kim)
[5] Quarterly authorised deposit-taking institution property exposures, December 2022 (APRA)
[6] Analysing the Funding Gap: Asia Pacific, May 2023 (JLL)

Colin Mackay is a Research and Investment Strategy Manager for Cromwell Property Group. [Cromwell Funds Management] is a sponsor of Firstlinks. This article is not intended to provide investment or financial advice or to act as any sort of offer or disclosure document. It has been prepared without taking into account any investor's objectives, financial situation or needs. Any potential investor should make their own independent enquiries, and talk to their professional advisers, before making investment decisions.

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Don't be fooled: a recessionary hit is coming

Matt Peron

Last autumn we suggested that the global economy would likely face a slowdown in 2023 and that equity investors should eventually consider shifting toward a defensive stance. While this year's solid returns may appear to belie our view, we are sticking with our call that a dose of caution is merited. In fact, the concentrated nature of 2023's equities gains – being almost exclusively driven by multiple expansion within a handful of mega-cap technology and internet companies – hides what we consider to be signs of increasing vulnerability within the equities universe.

Exhibit 1: 2023 S&P 500 Index® earnings revisions and price-earnings multiple expansion

This year's equities returns have been driven by expanding valuation multiples of a few mega-cap – mostly tech and Internet – names, and while this category's 2023 earnings expectations have held up better than those of the broader market, its multiple expansion likely masks gathering clouds for equities.

Source: Bloomberg, as of 31 May 2023.

We continue to expect that exceptionally tighter monetary policy will constrict economic activity and, with it, companies' ability to grow earnings. It's irrelevant whether the U.S. or other jurisdictions meet the textbook definition of recession; the trend is for economic growth to slide toward zero and for earnings revisions to continue their downward path. The early-year banking sector tumult only fortifies our view as tighter credit conditions should amplify the impact of restrictive policy. Some have characterized bank failures as idiosyncratic, but we consider them the natural consequence of monetary tightening as higher rates tend to break things – and what typically break first are the most fragile business models.

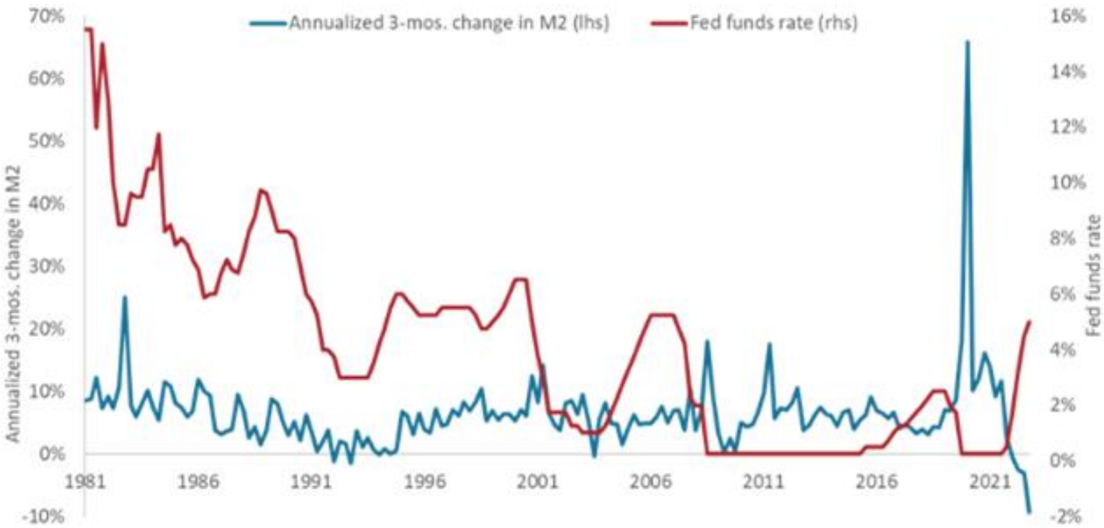
Economic dominoes

Since the Fed's initial interest rate hike in March 2022, the phrase "long and variable lags" has found prominence in the investment vernacular. Typically, one would expect the economy to slow within 12 to 18 months of that first hike. Guess where we are now?

Central banks rely upon the blunt instrument of rate hikes to quell inflation because it works. In a nod to Milton Friedman, who posited that inflation is always a monetary phenomenon, higher interest rates drain liquidity from the economy, starving inflation of its feedstock. The upshot is a higher cost of capital, less economic activity, and ultimately weaker earnings. We are already seeing evidence of this progression. Only a few months after the Fed's first post-pandemic rate hike, annualized quarterly broad money growth in the U.S. had dipped into negative territory. By March 2023, it registered -9.4%.

Exhibit 2: Fed funds rate and change in broad U.S. money supply

The U.S. money supply tends to react fairly quickly to a tightening cycle's initial rate increase, with the current decline being magnified by the Fed's balance sheet reduction program.



Source: Bloomberg, as of 31 May 2023. M2 is a measure of broader money that includes currency held by the public and other categories, such as checking deposits and money market accounts, that can be quickly converted to cash.

Even after 15 months of tightening, the global economy is proving resilient. Our view is that history's most anticipated recession is still on track, albeit slightly delayed. Several factors have contributed to this, including the magnitude of the liquidity created during the pandemic and a puzzlingly tight U.S. labor market.

Not to be overlooked, however, is that the market is out of practice in navigating a garden-variety recession, with the two most recent downturns being sparked by a gargantuan housing bubble and a global pandemic. One must look back to 2001 for the most recent example of an interest-rate, capacity overhang-driven recession. That episode illustrated that – unlike the rapid contraction caused by historic events – monetary tightening takes time. With rate hikes possibly not done in the U.S. and likely to continue in other regions, investors need to recognize that sooner or later the inevitable economic outcomes caused by reduced liquidity cannot be avoided.

Rumbling through markets

Earnings expectations have begun to react to a diminishing money supply but – similar to economic growth – at a pace slower than anticipated. By mid-May, full-year 2023 earnings estimates for the S&P 500 Index and MSCI World Index had fallen 12% and 8%, respectively. Given the expectation of additional rate hikes, along with tightening credit conditions, we expect earnings forecasts to slide further.

Equities' resilience in the face of monetary tightening has the hallmark of a tendency that we often see during this stage of the cycle: complacency. Feeding this behavior is the year-to-date multiple expansion registered by Big Tech and internet stocks. To a degree, this is a reversal of last year's equity losses, which were driven by the multiple compression of secular growth stocks in the wake of a higher discount rate. Economic weakness typically favors growth stocks as investors seek out earnings growth where they can find it, but the current dominance of mega-cap tech in equities indices lends a veneer of stability while hiding festering weakness underneath.

We believe that the disconnect between aggregate multiple expansion and a slowing economy will come to a head once investors stop pricing in the recovery to a recession that has yet to occur. A capitulation in earnings expectations – completing what could be up to a 20% decline, peak to trough – would also likely ignite a wave of multiple compression as investors shed risk. Putting numbers behind these scenarios, another 10% decline in earnings coupled with a 10% compression in price-earnings (P/E) ratios add up to a bear market.

Staying invested, but defensive

A quick succession of trough earnings and trough multiples also represents opportunity for long-term investors. As we stated in December, while we expect an earnings recession, we believe that the U.S. and global economy are on sufficiently solid footing to avoid a deep and prolonged downturn. Rather, we believe the economy is facing a mid- to late-cycle adjustment, characterized by flat to modestly negative growth. Importantly, after 2022's rise in rates, the Fed and other central banks now have room to reverse course and ease monetary policy should a worse-than-expected economic scenario unfold.

Under such circumstances, it is our view that this is a time to stay invested but do so by maintaining a defensive stance until greater clarity emerges on the next stage of the cycle. The preferred destination to ride out this uncertainty is quality stocks, as their sound balance sheets and steady cash flows should insulate them from unforeseen downside risk. Stocks with these characteristics also provide investors the potential to participate in any market gains should economic growth exceed expectations. In keeping with the pandemic-era trend, many of the largest tech and internet stocks also meet these *defensive* criteria. Conversely, exposure to highly cyclical sectors and overleveraged companies should be minimized.

Exhibit 3: Equity factor peak-to-trough returns in recent recessions

Quality tends to outperform in market downturns, and while value lost less than sagging markets in 2022 and growth has led the way in 2023, we believe quality stocks will have the opportunity to prove most resilient as the effects of monetary tightening continue to bite.

Event	Peak	Trough	Value	Growth	Quality	Momentum	Minimum Volatility
Tech Bubble & 9/11	March 2001	November 2001	-7.3%	-2.9%	1.6%	-9.1%	-1.7%
Global Financial Crisis	December 2007	June 2009	-38.3%	-35.8%	-28.2%	-44.0%	-29.2%
COVID-19 Pandemic	February 2020	April 2020	-9.5%	1.5%	1.5%	-1.0%	-3.4%
Recent Peak – Present	January 2022	31 May 2023	-8.3%	-15.2%	-10.7%	-20.6%	-9.2%

Source: Bureau of Economic Analysis, Janus Henderson Investors. Peak to trough returns measured on factor-based components of the MSCI World Index

Given the plodding pace of this stage of the cycle, we are not yet at the point where we would advise investors to look through to the other side and position portfolios for recovery. There will come a time for increasing exposure to small caps and cyclical sectors like energy, but until then, quality and defence remain the most prudent tactics.

When facing a slowdown, it's important to remember that the profit machine of global equities is not broken. Yet, earnings will always remain susceptible to the inevitable economic cycles. Investors need to maintain a long-term view and consult their playbooks on how to navigate economic cycles in a non-zero-percent interest-rate world.

Matt Peron is Director of Research and a Portfolio Manager at [Janus Henderson Investors](#).

Why Australia's roaring population growth won't last

Emma Davidson

The older I get; the more accountability matters to me. Not that it didn't matter before – it did – but perhaps accountability feels rarer in today's fast-paced world?

In this article, I look to hold myself accountable by revisiting some of the topics I've written about over the last few years to see if what I said then still holds true today, or whether new information has come to light that's changed my perspective.

Baby bust: Australia's infertility problem

I first wrote about the worrying trends in global fertility rates in 2021. I'd recently read some of the amazing work that award-winning reproductive epidemiologist Dr Shanna Swan had published in this area, and it was frightening.

Swan's research found that global sperm counts had dropped by approximately 1% per year, every year, for the past four decades. In total, sperm counts had slumped 40% in the 50 years to 2017. We'd also seen a 1% annual fall in testosterone levels and a 1% annual *rise* in miscarriages and testicular cancers.

So, what's the situation today? Well, the total fertility rate in Australia dropped as low as 1.59 births per woman in 2020. It has since recovered to 1.7 births, according to the latest statistics. But this is still far below the 2.1 figure required to sustain the population.

Australia's population rose by 497,000 in calendar 2022, driven by a record net overseas migration of 387,000. As shown below, the Federal Budget forecasts Australia's population will grow by 2.2 million people to 28.2 million by 2026-27, mainly driven by migration. The impact on housing, rents and house prices in the short term could be profound.

Table A.2: Population by state, at 30 June

million	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total(a)	Australia
2021-22	8.156	6.620	5.327	2.788	1.822	0.572	0.457	0.251	25.991	25.996
2022-23	8.300	6.780	5.441	2.847	1.849	0.578	0.466	0.254	26.516	26.520
2023-24	8.423	6.929	5.532	2.896	1.871	0.585	0.476	0.258	26.970	26.975
2024-25	8.528	7.057	5.616	2.941	1.890	0.592	0.485	0.262	27.371	27.376
2025-26	8.631	7.186	5.699	2.985	1.908	0.599	0.495	0.266	27.770	27.775
2026-27	8.734	7.314	5.782	3.030	1.927	0.607	0.505	0.270	28.168	28.172

a) 'Total' is the sum of the states and territories shown, and excludes Jervis Bay Territory, Christmas Island, the Cocos (Keeling) Islands and Norfolk Island.

Source: 2023 Federal Budget

Nevertheless, taking a longer-term perspective, the 2022 Centre for Population Statement predicts the nation's annual population **growth** rate will not have recovered to pre-pandemic numbers within the next decade. Instead, it's predicted to fall gradually until at least 2033, slipping from 1.4% growth per year to 1.2%. This will take the population to 30 million by 2032/33.

In other words, while Australia's total population is predicted to rise over the next 10 years, the rate at which it is **growing** continues to slow down.

Globally, it's a similar story. Since 2020, Dr Swan has been busy keeping her research up to date, and what she's found isn't comforting.

Not only did she discover that sperm counts are falling rapidly in Africa, South America and Asia – regions that weren't well covered in her previous studies – but the pace at which they are declining worldwide is speeding up.

Her analysis shows that between 1972 and 2000, sperm counts were dropping by roughly 1.1% a year. From 2000 onwards, however, that rate has increased to 2.6% every year. Far from plateauing, the problem is getting worse, faster.

As a mother who recently gave birth to another baby boy, the data is upsetting. I would hate for my children to grow up in a world where they may struggle to raise a family. I'm sure every parent feels the same.

In South Korea, women are already having less than one child (0.89) on average during their lifetime. Replicate that on a global scale and the results are potentially devastating.

Many countries are now struggling to solve the problem of ageing populations. With fewer younger people to support older generations, we may see less innovation, poor economic growth, and a stagnation in living standards.

When I first covered fertility rates and ageing nations, I said there were many reasons to remain optimistic. In Australia, we have an excellent pension system, and I was confident that we could continue to drive growth, the economy and innovation.

While I hope that's still true, frankly, I was taken aback at how much worse Dr Swan's new data is. From an accountability perspective, perhaps I was wrong to be so optimistic in 2021, but it has nevertheless reinforced my belief that this remains a key issue that needs more focus.

The good news is that we now know some of the causes of the problem, so I'm still hopeful that solutions can be found.

The generation blame game: then and now

Generational theory was a topic that has fascinated me for a long time. I first learned about it nearly 10 years ago and have written several articles on the subject since.

Most recently, I talked about how the headlines were full of stories of generational conflict. If the media and politicians were to be believed, older and younger generations were constantly at each other's throats.

I admitted I was sceptical of that narrative. Delving a little deeper, contemporary research showed the generations were actually closer than ever before – figuratively and literally. Not only were more Australians living with their parents for longer, but the Bank of Mum and Dad was the country's fifth most popular lender.

Far from being at war, the various generations were offering each other support during difficult times. For example, two-thirds of grandparents were providing childcare to ease the burden on struggling family members.

I welcomed the news that different demographics were working together, especially with a huge generational wealth transfer on the horizon. Over-65s in Australia were predicted to pass down or spend an estimated AU$3 trillion between 2020 and 2040.

That was then, but what about now? Firstly, I think generational 'theory' has become a bit passe. While I was once a big fan, it all feels a bit dated now.

More often than not, it has seemed to drive a wedge between different age groups, rather than offer meaningful, actionable insights into people's lives.

In fact, a year after my article was published, a major survey from the Australian Human Rights Commission (AHRC) found that people are rejecting the concept of 'generations' entirely.

The vast majority of Australians don't identify with labels such as 'boomer', 'millennial' or 'Gen Z'. They view people as individuals with unique experiences and perspectives rather than pigeonholing them based on age.

I checked Google searches for the words 'millennial' and 'boomer' in Australia and found they peaked in November 2019, and have since mostly petered out.

One possibility is that the Covid-19 pandemic helped remind us all how much we appreciate our loved ones, whatever their age? Or perhaps we've grown out of blaming other generations for the problems we collectively face as a society?

Whatever the answer, I believe this is good news for the looming generational wealth transfer. The latest stats from the Productivity Commission echo my previous figures – around $3.5 trillion will change hands between the generations over the next two decades. By 2050, baby boomers will be handing down $224 billion a year in inheritance to millennials and Gen Z.

And parents are already helping their children today by contributing an average of $70,000 to their children's home deposits to help them get on the property ladder, with a third expecting to be never paid back.

Commenting on the AHRC report, Age Discrimination Commissioner Dr Kay Patterson said:

"Although antagonism between the generations is often seen as a given, I was struck by the warmth expressed by focus group participants towards members of age cohorts other than their own."

Final thoughts

Staying accountable is important. I believe there is tremendous value in revisiting our previous positions and examining them through a present-day lens.

Sometimes we're wrong, and it's crucial to own that. In hindsight, I think generational theory has had its day and I need to adjust my thinking there as the world has probably moved on. And the fertility crisis is perhaps even more serious than I originally gave it credit for.

Ultimately, the lessons we learn from being accountable to ourselves arm us with the information we need to better navigate the world. Isn't that worth getting things wrong every now and then?

Emma Davidson is Head of Corporate Affairs at London-based Staude Capital, manager of the Global Value Fund (ASX:GVF). This article is the opinion of the writer and does not consider the circumstances of any individual.

What investors should look for in a fund manager

Michael Malseed

As the Australian funds management industry continues to evolve, it is important to demand the highest standards from the firms that are entrusted with managing other people's savings.

Australia's compulsory superannuation regime has provided a fertile environment for funds management businesses. Barriers to entry are relatively low for what is a capital-light and highly scalable business model.

This backdrop has seen numerous business structures emerge, from more-traditional diversified financial institutions to ultra-focused single-strategy boutiques. The landscape is continuing to change, with mega mergers among both publicly listed firms and industry superannuation funds, and there appears no shortage of boutique startups readily backed by specialist 'incubator' firms.

Faced with such a broad and changing range of options, investors should consider which funds management model is going to provide the best structure for long-term alpha generation.

At Morningstar, we ponder this question in our assessment of the Parent Pillar, which is a key input into our overall ratings framework.

This article outlines the key attributes that we believe investors should look for in a fund manager.

What makes a good fund manager?

The key attributes we look for in a parent is strong stewardship and the ability to deliver positive net alpha to investors over the long term.

There are many factors that drive this, including:

- An enduring business model that will be around for investors over the long term
- A culture of putting investors first
- Well-considered and executed capacity management
- A focus on creating centres of investing excellence
- The ability to attract and retain investment talent

Let's explore each factor in more detail.

1. An enduring business model

To be successful, investors need to take a long-term view. It is therefore critical that any fund manager under consideration will be around for the long term.

With low barriers to entry, many individuals will try their hands at funds management, but to build an enduring and sustainable business, a certain level of scale and profitability must be reached.

Larger and more established firms have an advantage here, but to address the business risk of new ventures, many startups will seek the backing of a well-funded equity partner that can provide a guarantee of working capital over a period of time. Indeed, Australia has seen the rise of the 'boutique incubator' model to solve this problem.

For more-established firms, investors should consider customer concentration risk. Large redemptions (such as from institutional investors) can jeopardize the financial sustainability of the firm.

It is important for investors to examine and understand the financial backing and risks associated with the fund manager itself, to ensure they will be around for the long term, and not close their doors prematurely because of a lack of profitability.

2. A culture of putting investors first

To be a good steward of investor capital, funds management firms must have a strong culture of putting investors first.

Unfortunately, conflicts of interest exist in any business, but investors should have a clear understanding of how these are managed.

One of the biggest conflicts is a firm's desire for profit maximisation, which will come at the expense of investor returns. Fund managers derive their revenue from investment management fees, which are deducted from investment returns.

As mentioned above, firm profitability is important to ensure long-term sustainability, but above a certain level, fund managers should look to share the benefits of scale with investors through lower fees.

Funds management businesses may also seek to maximise profits through asset growth and new product development. This must be managed carefully to not distract or detract from existing offerings (see capacity management below).

While all super fund trustees and responsible entity board members have a fiduciary duty to act in unitholders' best interests, public company boards also have a duty to maximise shareholder returns. This doesn't make them any more conflicted than private companies, which have their own shareholders to consider, but profit drivers for listed companies are more visible because of reporting requirements.

Indeed, this public company transparency can be helpful, allowing investors to assess whether the right balance has been struck.

Industry funds are the best placed to maximise unitholder interests, as profits are reinvested for the benefit of members. Nevertheless, it remains important to ensure that costs are managed appropriately and strong governance practices are in place.

3. Well-considered capacity management

A key component of good stewardship is well considered and executed capacity management.

There is a limit to the level of assets under management a firm can effectively manage before market impact costs have a detrimental impact on investor returns.

If a fund manager is less conservative with regard to capacity, this may be a sign that it is seeking to gather assets to maximise profits, rather than protect the interests of existing investors. Given that successful firms tend to attract the highest levels of flows, it can be a difficult decision to soft-close or hard-close a strategy to new money in order to preserve capacity, but it is an important discipline to maintain.

The other major driver of asset growth in recent years has been consolidation, particularly in the industry superannuation fund segment.

The merger of Sunsuper and QSuper has seen the assets of Australian Retirement Trust exceed AUD 200 billion, joining AustralianSuper in what has been termed the 'mega fund' category. This is a double-edged sword as the potential cost savings from scale are countered by capacity management challenges, particularly when combined with the internalisation of the investment management function.

Unfortunately, there is no standard measure of a firm's capacity, and it is often treated as more of an art than science. The least useful measure that is most often touted by fund managers is looking at strategy size as a percentage of total market capitalisation. This figure has little relevance for active managers that seek to concentrate their investments in specific areas of the market, rather than simply replicate the total market.

Much more useful are the two measures we focus on: days to trade and substantial shareholdings.

Days to trade is an objective measure of the time it would take to liquidate an individual position or total portfolio based on the average trading volume of that security. As a rule of thumb, we believe a fund can trade 25% of average daily volume without having an undue impact on the price. The less time it takes to liquidate a position, the better, as it enables the fund to be nimble in the face of market shifts. Fewer than 10 days to trade represents a highly liquid portfolio, but beyond 30, 60, and 90 days begins to raise questions around capacity management.

For equities, we also monitor the number and weight of substantial shareholdings (greater than 5% of issued capital). A large number of substantial shareholdings or individual holdings in securities that account for greater than 10% of issued capital are signs that capacity management should be closely scrutinised.

4. A focus on centres of investing excellence

When it comes to managing money, it is better to be good at one thing than average at many. This is one of the main benefits of the boutique asset-management model—a singular focus on an area of excellence rather than suffering from the distractions of a diversified product offering.

Larger diversified firms can overcome this issue by developing individual centres of excellence under a single firm umbrella, but it is not easy. The rise of the boutique asset-manager model has seen increased competition for talent. Larger diversified firms must continue to evolve to create an environment that nurtures and retains investing excellence.

Industry funds have increasingly moved toward the internalisation of investment teams. This is a significant shift in approach and brings a substantial challenge of maintaining a strong investment culture across each individual asset class.

5. The ability to attract and retain talent

Funds management is an industry reliant on human capital and individual talent.

The boutique model's emergence was due to star fund managers wanting to own their own businesses and be masters of their own destinies. The list of portfolio managers who have left large, diversified asset managers to start their own shops is a long one.

While boutiques have had an edge, diversified financial-services firms and industry funds are evolving their business models to address the issue of talent retention. Revenue share models and shadow equity arrangements have become more common as large firms seek to replicate the economic benefits of the boutique structure. There are other benefits that a larger diversified firm can bring, such as greater distribution, compliance, and administrative support. But this is where the boutique incubator models have stepped in to simplify the business ownership experience and allow fund managers to focus on alpha generation.

The main drawback of the industry's reliance on individual talent is key-person risk.

Recent history shows that despite all the incentives of equity ownership and profit-sharing, portfolio managers may choose to leave for unexpected and personal reasons.

All fund managers should have a clear succession plan in place. The onus is on the board and management to ensure that contingencies are well-thought-out and implemented.

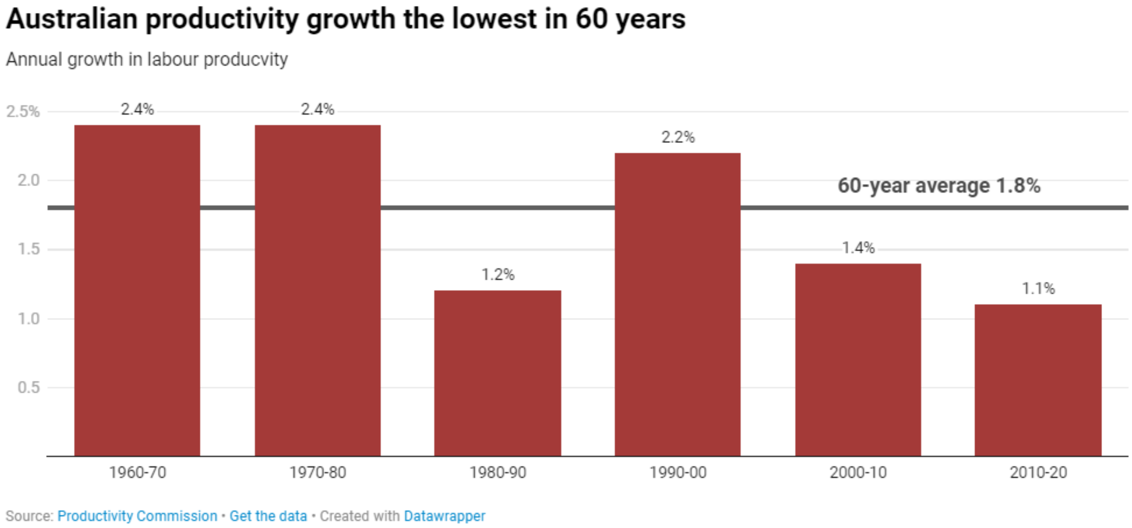
Michael Malseed is a Director of Manager Research at Morningstar, owner of Firstlinks. This article is general information and does not consider the circumstances of any investor.

Why is Philip Lowe worried about productivity?

Prof. Stephen King

Since 2005, annual labour productivity growth (growth in output per hour worked) has been the best part of one percentage point below its long-term average in Australia and other developed countries.

The Productivity Inquiry that I helped conduct for the Productivity Commission found this will lead to much-slower improvements in Australians' living standards than in the past.



In the search for a culprit, economists including Australia's Competition Minister Andrew Leigh have pointed to reduced business competition resulting in decreasing dynamism, by which they mean:

- less entry and exit of firms
- less job-switching
- a significant reduction in business investment
- mergers leading to increased business concentration
- an increase in the markups businesses can sustain
- only few highly-productive firms, with the rest increasingly less so

A study that I have just published in Australian Economic Papers, reviews the evidence and finds that while most of these things have happened (and while many are undesirable) they *aren't sufficient* to explain what's happened to productivity.

The findings suggest that even if we did make our economy more competitive and businesses more dynamic (and we probably should) improving productivity growth depends on a much bigger set of policy reforms.

Here's what we find.

Firm entry and exit have been slowing

In Australia, the rates of firm entry and exit (meaning companies either joining or dropping out of an industry) have declined.

While there's been an increase in firm entry more recently, it's been mainly among non-employing business – sole traders and independent contractors – rather than bigger businesses.

In the US (we don't have an equivalent Australian study) red tape may be strangling dynamism. Investment in new profitable businesses has slowed at the same time as there has been a significant increase in regulation of those businesses.

In Australia, improvements in business survival rates at least partly seem to reflect improved conditions for both survivors and new entrants, rather than barriers that protect unproductive survivors at the expense of more-productive entrants.

Job-switching has slowed

Australian job mobility has declined dramatically over the past 30 years, in part because the population is ageing, and older workers are less likely to switch jobs than younger workers.

Another explanation might be that Australian businesses face a less volatile environment, suggesting job turnover does not have value in its own right.

While job churn tends to fall if barriers to job mobility rise, it also falls when businesses face fewer shocks, making any link between declining job turnover and diminished competition ambiguous.

Business investment has slowed

Non-mining business investment in Australia has stagnated over recent decades, as it has in a number of other advanced economies.

Among the suggested explanations are risk aversion and uncertainty, pessimism about the future and lower productivity growth. The role, played by competition – if any – is far from clear.

Business concentration has climbed

The average concentration of Australian businesses (the extent to which industries are dominated by a few big firms) appears to have been falling until the early 2000s, and climbing since then.

Most of the increased concentration appears to have been in already-concentrated industries, with technological advances and exposure to imports explaining a lot of it.

As an example, concentration has increased in "warehousing and storage", but the industry has taken advantage of technological advances including parcel tracking and smart warehouses, meaning both concentration *and* competition have increased as firms have scaled up to install new technologies.

Businesses profit margins have climbed

Markups (profit margins) appear to have climbed by around 57% in Australia from 1980 , which is less than in the US, Canada and much of the European Union, but greater than in New Zealand and most Asian countries except for South Korea.

But markups at the level of the firm are difficult to measure because they depend on assumptions about the way the firm makes its products. Different assumptions can produce very different estimates.

There are only a few highly-productive firms

Globally and in Australia the most-productive firms seem to be three to four times more productive than the less productive, but, at least in Australia, there is little evidence to suggest the gap is widening.

What evidence there is suggests the gap between the most-productive Australian firms and the most-productive global firms is widening, suggesting *all* Australian firms are slower to adopt leading technologies than they were.

Put bluntly, Australian businesses as a whole appear to have become slow to adopt world best practice; which is a problem, but not necessarily a problem of highly-productive firms versus the rest.

There are a range of policies that can help to reverse the decline, but it is far from clear that competition plays much of a role.

We're at risk of chasing the wrong target

The broader reasons for Australia's declining productivity growth include changing demographics, changing international trade patterns and the changing nature of industries as Australia continues to move towards a more service-based economy.

Fixing our productivity problem requires a suite of changes that address these and other issues. In March, the Productivity Commission laid out a roadmap.

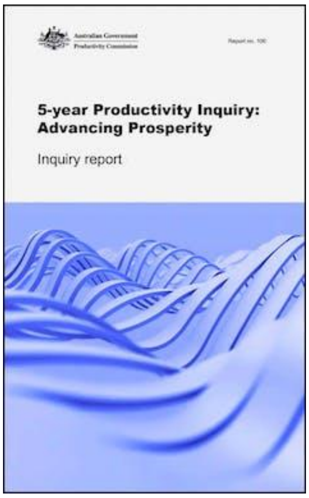
Of course, we shouldn't ignore competition. The government's 2015 Competition Policy Review focused on updating competition and consumer laws.

Many of its recommendations remain on the shelf.

Further, new challenges are emerging. To pick one, Australia currently has three alternative ways to get competition clearances when businesses merge.

Unsurprisingly, they pick the path of least resistance.

The head of the Competition and Consumer Commission Gina Cass-Gottlieb has developed a proposal that would help.



Productivity Commission

Actually boosting productivity will require measures that cover education, technology, business regulation, taxation, carbon emissions, and more.

Blaming declining dynamism and declining competition for declining productivity is not just a diversion, it risks making us do the wrong things.

Stephen King, Professor, *Monash University*