Firstlinks
a Morningstar company

Edition 542, 12 January 2024

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Editorial

Writer Morgan Housel likes to tell the story of how Warren Buffett really got to become so wealthy. For the record, Buffett's current net worth is an estimated US$121 billion, making him the world's seventh richest person, according to *Forbes*.

Buffett is one of the greatest investors ever. Yet if you think that's the only reason for his success, you'd be missing the full picture. They key to his wealth is that he's been a phenomenal investor *for more than three quarters of a century*. If he'd started investing in his 30s and retired in his 60s, most people would never have heard of him.

Housel demonstrates this by running a thought experiment where Buffett started investing at age 30 with $25,000. And Buffett goes on to earn the extraordinary investment returns he's been able to generate (22% per annum) but quits investing and retires at age 60.

In this experiment, what would be a rough estimate of his net worth today? The answer: US$11.9 million. An excellent number, though about 99.9% less than his actual net worth.

Instead, what Buffett did is that he started investing at the age of 10, and by the time he was 30, he had a net worth of US$1 million, or more than US$10 million in today's terms, adjusted for inflation. And he didn't retire in his 60s like most people do. He's continued investing into his 90s.

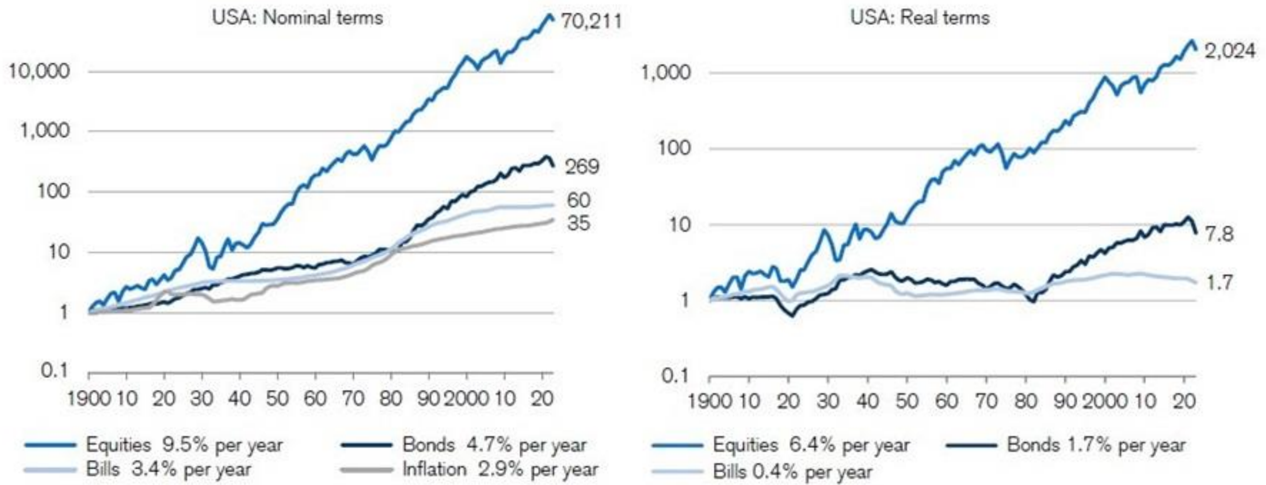
In other words, the real secret to Buffett's wealth hasn't just his investing acumen, but the amount of time that he's been investing.

Source: Finmasters. Note that this chart is about a year old and Buffett's net worth has risen to US$121 billion today.

Becoming a mini-Buffett

That's what most people miss about the concept of compound interest – it isn't just about the rate of return but time in the market. It doesn't just apply to Buffett either.

With enough time, anyone can become wealthy. Don't believe me? Let's look at historical returns from the US stock market. Since 1900, that market has had annual returns of 9.5%. If you'd invested US$1,000 in the market in 1900 (equivalent to more than US$30,000 today) and stayed invested to now, that would have turned into US$88.5 million (note the charts below are to the end of 2022).



Source: Credit Suisse

I can guess that you're thinking: "c'mon, James, this is totally unrealistic. I don't have 123 years to let compound interest work its magic." True enough.

Let's then run the same returns over smaller timeframes. Say, the amount of time that Buffett has been investing – 83 years. The result is that US$1,000 would turn into US$2.57 million. A larger sum invested of US$50,000 would result in US$129 million at the end of 83 years. That's nowhere near Buffett's net worth yet it's a tidy sum.

What about an even shorter time of 60 years? Assuming the same annual return of 9.5%, US$1,000 would turn into about US$292,000, or US$50,000 would become US$14.6 million.

This demonstrates the power of time in compounding money.

Potential objections

There are several possible objections to this analysis:

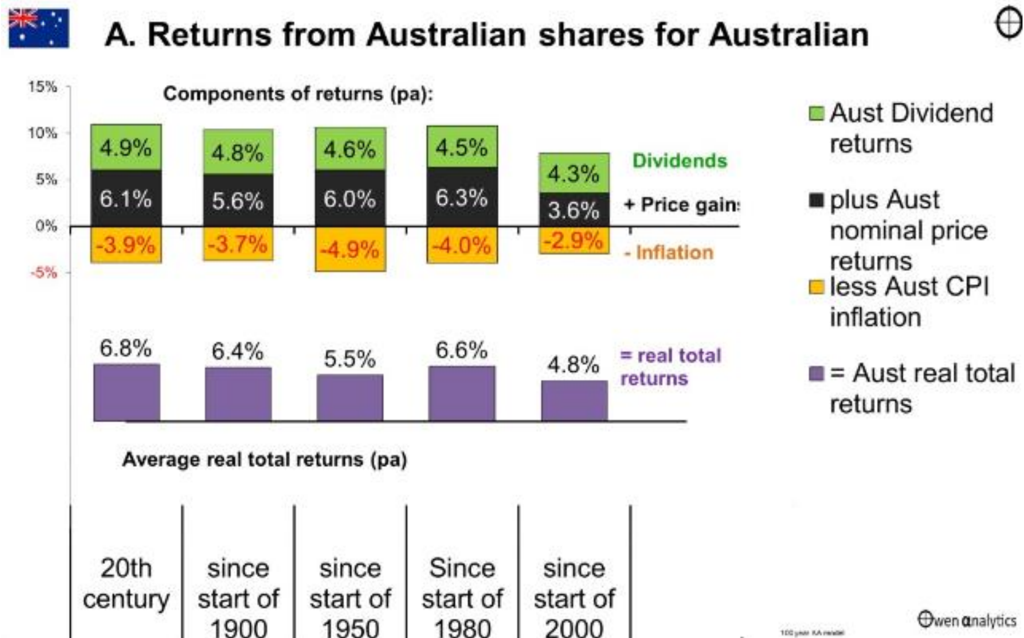
1. 60 years is still a long time to let compounding work.

Yes, that's right. Though I hope the analysis shows the potential to build wealth if not within your lifetime, certainly within those of your children or grandchildren.

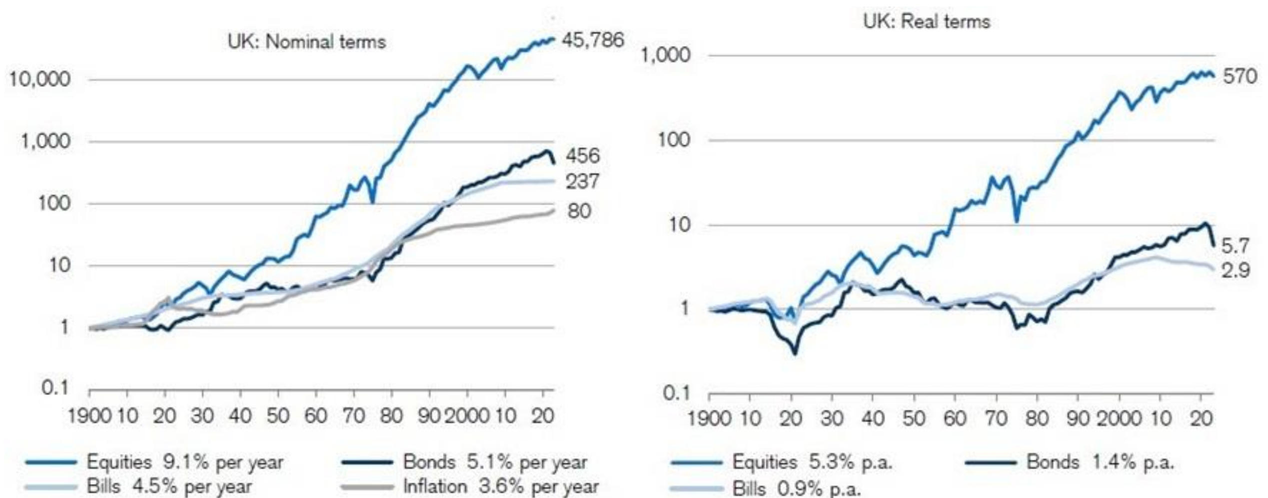
2. Using the US is disingenuous because America has had one of the best-performing markets over the past century.

This is true. Since 1900, the US has gone from being a middling power to becoming the world's only superpower. This rise has been reflected in the performance of its stock market. In 1900, the US made up just 15% of the world equity markets. Now, it's 58%.

Funnily, Australia has performed even better than the US in the long term, at least in nominal terms. Since 1900, the market here has achieved an annual return of more than 10% per annum.



Let’s take a country where recent history hasn’t been as kind to it. Over the past century, the UK has gone from a global superpower to a middling one. Its economic decline accelerated over the past 40 years with sharp falls in oil production in the North Sea, among other factors. Yet, its share market performance, though not as good as the US and Australia, has still been impressive.



Source: Credit Suisse

3. Returns won’t be as high in future.

That’s a guess. While it’s right that past performance isn’t indicative of future performance, long-term equity returns should continue to be favourable, especially in Australia.

4. It doesn’t account for inflation and costs such as brokerage and taxes. It also doesn’t include the benefits of franking credits in Australia.

Yes, these are all things that need to be factored in and applied to potential portfolio returns.

5. It doesn’t include additions or subtractions to the initial amounts invested.

For simplicity’s sake, I've excluded that in this article.

Stop trying to beat time

Building wealth primarily depends on two things: the rate you can earn and the amount of time the money has to grow.

Most investors are obsessed with beating the market when time in the market is just as important, if not more so. In markets as in life, time can be your most valuable asset.

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In my article this week, I look at famed investor, Howard Marks', latest thoughts on what lays ahead for markets. He outlines why rates are unlikely to go down much, that many investors are unprepared for a 'higher for longer' rate environment, and where he sees the best opportunities in 2024 and beyond.

James Gruber

Also in this week's edition...

Retirees have faced a turbulent 12 months, dealing with volatile markets and cost-of-living increases. **Aaron Minney** from **Challenger** says building a retirement plan to withstand these challenges will be important for this year and beyond. And he has some ideas about the best strategies to achieve this.

Professor Lynda Gratton says we should be questioning the whole idea of retirement. She believes increasing life expectancy and technological changes mean the idea of working hard until our 60s and then retiring is outmoded. She puts forward suggestions about how to redesign our lives to better fit our needs.

Every era has its hot sector and/or country, which are bid up by investors into bubble-like territory. Today, US large-cap tech is arguably in vogue. Yet, **Bradley Waddington** from **Longview Economics** believes the parallels between the dotcom boom and bust of 2000 and now are eerie, and a change in market leadership may be near. He thinks the energy sector and Europe could be set for a change in fortunes.

Meg Heffron is back, this time to talk about SMSF trust deeds. Even though these deeds are often generic and almost always easy to change, she says they remain critically important.

While most property segments had a tough 2023, retail was comparatively resilient. **Cromwell's Colin Mackay** thinks the prospects for large retail assets catering to the likes of furniture and appliance stores look especially attractive for this year.

In this week's *Wealth of Experience* podcast, we have **Peter Warnes** on ASX opportunities for 2024, **East 72's Andrew Brown** on why he likes owners with 'skin in the game', including English soccer giant, Manchester United, and **VanEck's Jamie Hannah** explains the increasing popularity of smart beta ETFs and funds.

Lastly, in this week's whitepaper, **Schroders** thinks there's structurally higher inflation ahead, and details what that means for investors.

Curated by James Gruber and Leisa Bell

Howard Marks on the best opportunities in 2024

James Gruber

When Howard Marks speaks, investors listen. Marks is well known to regular Firstlinks readers as the Co-Chairman of Oaktree Capital Management, which he co-founded in 1995 and is the world's largest distressed debt investor. He’s written two books and is best known for his client memos published since 1990.

In his latest memo and interview, Marks outlines how today’s markets are dramatically different from those of the past 40 years, that equity valuations are mildly expensive, and the most compelling opportunities for investors in 2024.

When the good times rolled

Marks says that almost everyone working in finance today had only ever seen interest rates go down ... until 2021:

“You have to be working in this business more than 43 years, before 1980 to have ever seen anything other than declining interest rates and ultra-low interest rates. So it’s only natural to conclude that declining and ultra-low interest rates are normal.”

But he says that period was anything but normal, especially from 2008-2021, when reserve banks dropped interest rates to ultra-low levels. He says that resulted in "easy times, fueled by easy money".

He details the effects of low interest rates, including:

- Stimulating the economy
- Lifting asset prices
- Encouraging risk taking and potentially unwise investments
- Enabling deals to be financed easily and cheaply
- Encouraging greater use of debt
- Fueling expectations of continued low interest rates
- Producing winners and losers by subsidizing borrowers at the expense of savers and lenders

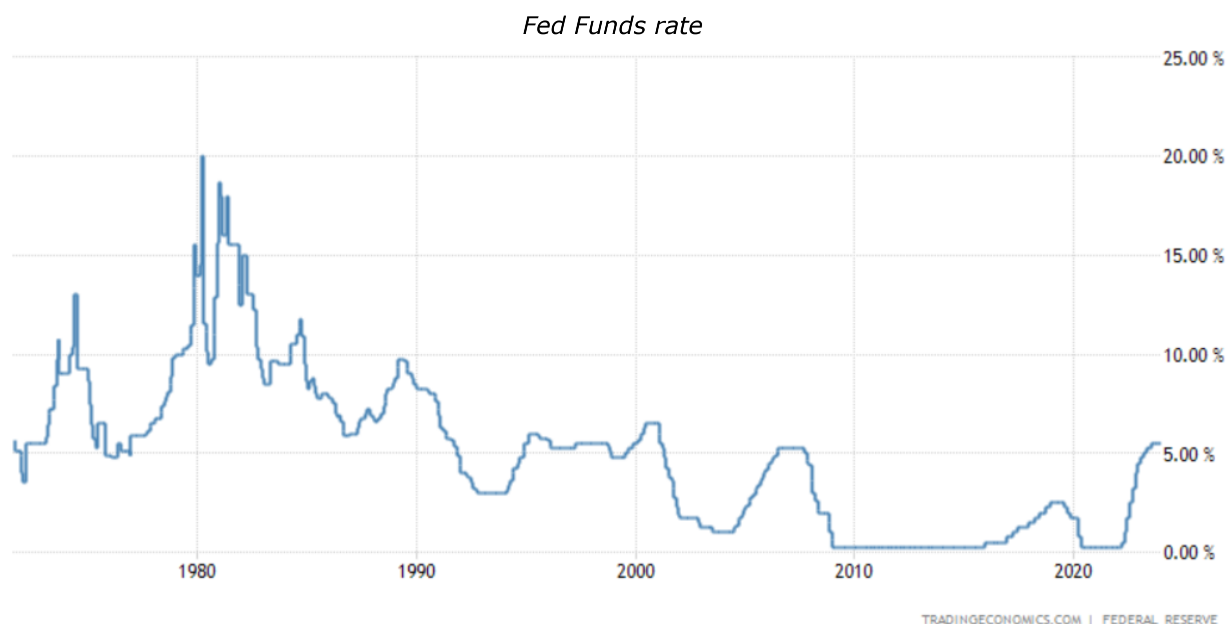
In sum, ultra-low rates made it easy to run a business, easy for investors to enjoy asset appreciation, easy to lever investments, easy for businesses to get loans, and easy to avoid default and bankruptcy.

End of an era

Marks believes that many investors are counting on a return to this period of ultra-low rates. Yet he thinks that era is over.

First, he dismisses concerns that today's rates are high. He says while rates are higher than they've been in 20 years, they aren't high in absolute terms or relative to history. He recounts how when he started work in 1969, the Fed funds rate averaged 8.2%. In the 20 years after that, the rate ranged from 4% to 20%. From 1990-2000, the last period that Marks thinks was 'normal', the rate was between 3% and 8%, suggesting a median equal to today's rate of 5.25-5.5%.

Fed Funds rate



Marks then addresses why we're unlikely to go back to ultra-low rates any time soon. His reasons include de-globalisation, the Fed wanting to prevent another bout of inflation, central bankers wanting enough room to cut rates if there's an economic downturn, as well as avoiding further assets bubbles, malinvestment and creating economic winners and losers.

Future rate predictions

Marks outlines where he believes market consensus sits today:

- Inflation will soon reach the Fed's target of roughly 2%.
- Therefore, additional rate increases won't be necessary.
- Consequently, there'll be a soft landing marked by a minor recession or none at all.
- The Fed will be able to take rates back down.
- This should spur the economy and the stock market.

He doesn't directly disagree with this consensus view, though questions it. Even if the consensus is right, Marks predicts that US rates will be around 2-4% over the next few years. And that if he had to be more specific, that rates will average 3-3.5% over the next 5-10 years.

Investors need to adapt to a new environment

One of Marks' big themes is that investors need to adapt to a new investment environment where rates don't go down to ultra-low levels. Yet changing ingrained habits is difficult:

"Well, if you made money doing one thing over the last 43 years, it's kind of hard to say, "You know what? That's out the window." And that organization that I put together, I got to get rid of those people because I need a new skillset. Everything I ever told you is no longer true to the clients. This is complicated by our human nature, if that's the right term. But I've been making reference to a book Mistakes Were Made, But Not by Me by Carol Tavris. It's about cognitive dissonance and self-delusion. And you have a position, you've had it for a while, you're convinced it's right, it has worked. And now you get some information coming in which says, "No, you have to change your position."

But Marks says only by changing strategies can investors expect to outperform in future. And he says that "if you grant that the environment is and may continue to be very different from what it was over the last 13 years – and most of the last 40 years – it should follow that the investment strategies that worked best over those periods may not be the ones that outperform in the years ahead."

Equity valuations are somewhat expensive

I find one of Marks' best attributes is to take the temperature of markets in an objective and balanced way. While many investors try to grab headlines with black and white, or extreme views, Marks is usually more nuanced.

His latest views on equities reflect this. Marks thinks the US market is neither crazily high nor low, and that it doesn't offer a 'fat pitch', which harks back to a famous Warren Buffet saying:

"I call investing the greatest business in the world because you never have to swing. You stand at the plate, the pitcher throws you General Motors at 47! U.S. Steel at 39! and nobody calls a strike on you. There's no penalty except opportunity lost. All day you wait for the pitch you like; then when the fielders are asleep, you step up and hit it.
… Wait for a fat pitch and then swing for the fences."

Marks thinks the US stock market is about 10% overvalued and at these levels it could go in any direction from here. The "fact that it's 10% overvalued means that there's a slightly greater tendency than usual for it to go down rather than up. But the point is not enough to take action on. I feel the same way about the economy."

Compelling investment opportunities

Marks is more bullish on debt than equity:

"… you can potentially get equity type returns from credit with less risk in better companies than used to be the borrowers with less leveraged companies than used to be the borrowers. And these returns, whether they're approaching 10 for liquid credit or above 10 for private credit, these are fully competitive with equities more than most people need, and they can be earned with greater safety than with equities. So I continue to think that the opportunity is compelling."

Marks' colleague, David Rosenberg, a co-portfolio at several of Oaktree's credit-focused funds, goes further, suggesting debt is one of the best trades that he's seen in his career, as "what we have right now, which is so unique, is the market is handing investors this opportunity to say, "I can sell my equities and go buy debt, which is bringing my risk meaningfully down, but actually preserve the same expected return." … In the investment world, we call this a no-brainer, this trade. The ability to bring your risk down without having to meaningfully impact your expected return is very valuable and something that's really, really exciting."

James Gruber is an assistant editor at Firstlinks and Morningstar.com.au

The big questions facing retirees

Aaron Minney

Australia's highly rated superannuation system finally got a legislated objective in 2023. While most people probably understood the purpose of generating income in retirement, the objective provides a basis for, hopefully, getting the policy settings right for retirement. Last year we had to digest a new controversial tax while making some progress on advice reforms while volatile markets were helped by easing of inflation and a strong run into the end of the year. What will we have to digest in 2024?

The new year brings another consultation from Treasury on the Retirement Phase of Superannuation. This is recognition that Australia's highly regarded accumulation system needs to be better at converting the accumulated savings of Australians into the income they need for retirement. There are different challenges in retirement, and 2024 is likely to showcase some of them.

Issues for retirees this year

Treasury notes that the need to fix the retirement phase is becoming "more urgent". The success in accumulating savings means that there are more retirees who need help with their retirement income. Unfortunately, while the number of retirees has been growing, the number of financial advisers who can help is shrinking. Hopefully the Quality of Advice reforms will address this.

Another challenge lurking in 2024 is the ongoing cost of living. Inflation is down from the peak, but an annual rate of almost 5% (as at October 2023) is still too high to be easily managed. Retirees need help with managing inflation, and funds are required under the retirement income covenant to have a plan to manage inflation risk along with longevity and market risks. While the Australian market is close to highs, volatility in recent years has highlighted a challenge in drawing an income from risky markets. The risk is that the income might not last as long as anticipated. The challenge is to maintain some market exposure while locking in some income that will last for life. If the Age Pension of just over $26,000 for single is enough, you are set. For retirees who want a better lifestyle, they need a retirement income plan that improves their retirement outcome.

An example

A good retirement income plan is one that includes market exposure for long term growth and a secure income stream. Consider the example of Sun and Steve:

Sun and Steve are a recently retired 67-year-old couple. They've worked hard and are now looking forward to having a whole lot more time to do the things they love. They are active, interested and involved. They have a couple life expectancy of age 94 (when one of both is expected to still be alive).

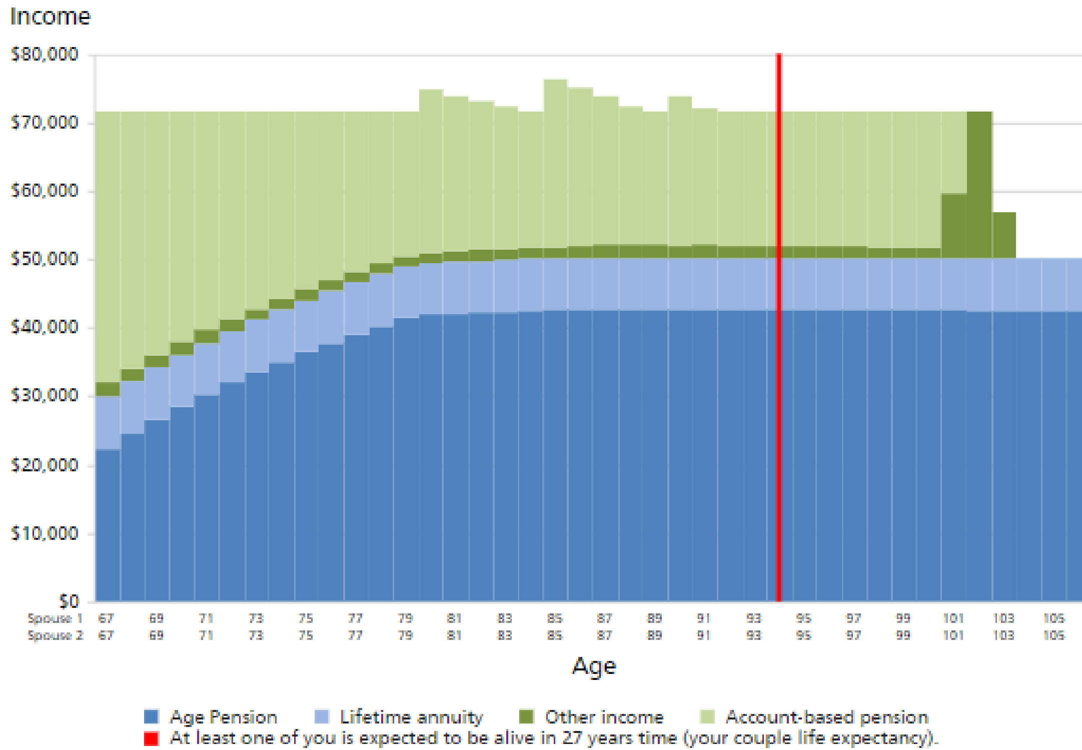
Sun and Steve own their own home and are free of debt. They have $350,000 each in superannuation to start funding their retirement income. Their super (and any future account-based pension) is invested in accordance with their 50/50 growth/ defensive risk profile. They have $50,000 in cash and term deposits and $20,000 worth of personal assets.

Sun and Steve would like to live comfortably for as long as possible and estimate that $71,724p.a. (equal to the ASFA September 2023 'Comfortable' retirement standard[1]), indexed each year with inflation, would be sufficient to meet this goal. As part of their total intended annual spend in retirement Sun and Steve have established that they require at least $46,250 p.a. (equal to the ASFA September 2023 'Modest' retirement standard), indexed each year with inflation, to meet their essential spending requirements in retirement.

Modelling a combination of account-based pensions and a 20% allocation to guaranteed CPI-linked lifetime annuities

The retirement income modelling[2] for Sun and Steve involves a blend of both account-based pensions and a 20% allocation to guaranteed CPI-linked lifetime annuities. This strategy involves a re-balancing of the asset allocation of the account-based pensions to ensure that the allocation to the CPI-linked lifetime annuity does not 'de-risk' Sun and Steve's asset allocation.

This combination of income streams payable to Sun and Steve over their retirement is represented in the graph below.



For Sun and Steve, a 20% partial allocation to a lifetime income stream provides:

- Lifetime income, fully indexed for inflation, for as long as they live. The lifetime income amount in the first year is $7,606;
- An Age Pension increase in year 1 of $4,368 (24% higher than the equivalent non-lifetime portfolio);
- A 100% chance of meeting income 'needs' (an increase of 38% over the non-lifetime portfolio);
- A 74% chance of meeting desired 'needs and wants' (an increase of 17% over the non-lifetime portfolio);
- Total retirement income paid over 27 years increases by $21,101 (in today's dollars); and
- The Estate value at the end of 27 years is $97,836 higher (in today's dollars).

The outcome is that the combined portfolio can deliver the retirement income that Sun and Steve need along with the confidence that the money they need will last. This can provide the confidence to spend so they can live their best retirement.

Predicting the next shock is difficult. Building a portfolio that can adjust to various shocks is a robust way to generate income through retirement. The blended portfolio does just that. It provides an appropriate mix to meet the goals of the retiree.

And it isn't always good to focus on easy digestion. A meal of a steak, veggies and a drink is more enjoyable and probably better than blending them all into a brown-green smoothie that can be drunk on the run.

[1] https://www.superannuation.asn.au/resources/retirement-standard/

[2] All projections sourced from the Challenger Retirement Illustrator (17/12/2023) using Social Security rates and thresholds effective 20 September 2023. 67-year-old female/male homeowner couple. $350,000 each available for investment via account-based pension and partial (20%) allocation to lifetime annuity. Super asset allocation 50% growth/50% defensive. Assumes returns of 4% p.a. for defensive assets and 8% p.a. for growth assets before fees. $50,000 cash/TDs earning 4% p.a. interest. Personal assets of $20,000. $71,724 p.a. desired income including $46,620 p.a. essential income. Amounts shown are in today's dollars. CPI of 2.5% p.a. See Challenger Retirement Illustrator Assumptions for all assumptions. Rates subject to change.

Aaron Minney is Head of Retirement Income Research at Challenger Limited. This article is for general educational purposes and does not consider the specific circumstances of any individual.

The tech sector is in vogue, but look elsewhere for value

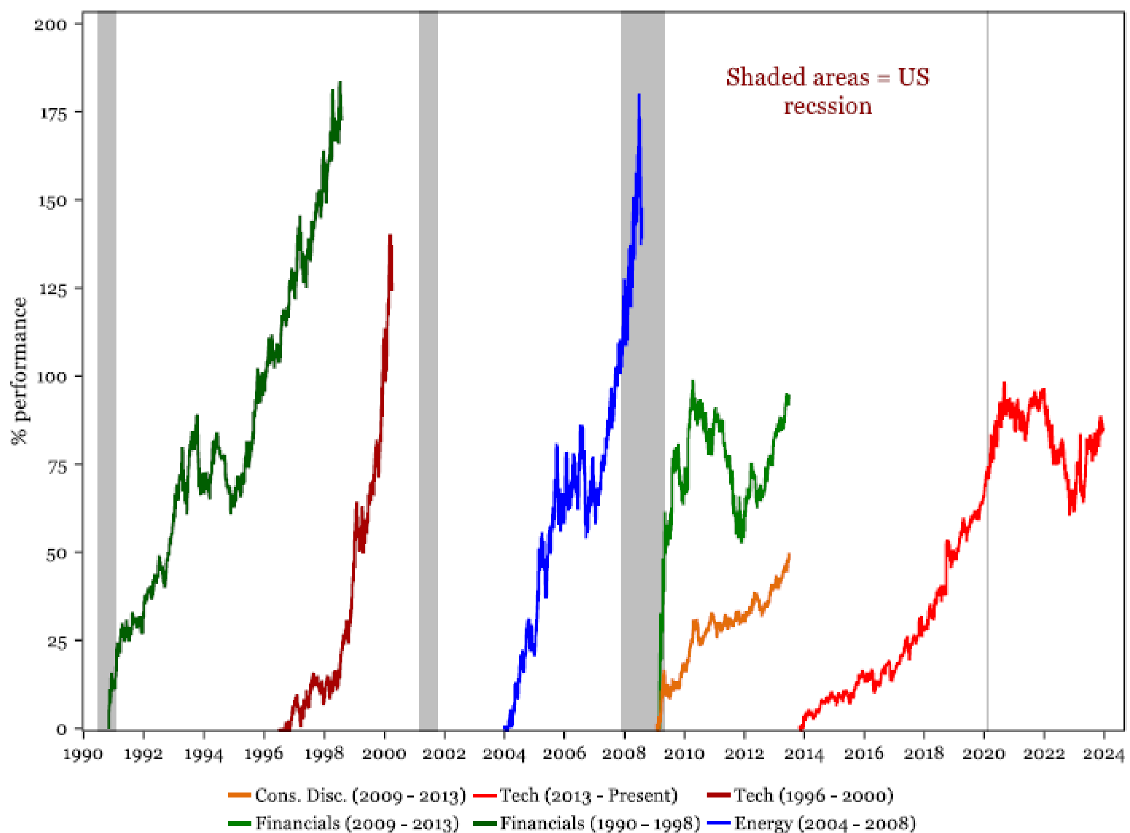
Bradley Waddington

It's clear looking through history that markets have fashions. Every economic cycle has its distinctive characteristics in which different sectors take up leadership

As we've stated previously:

"In the second half of the late 1990s, the market was TMT led; in the noughties (post 2000 – 2002 bear market) the market was led higher by energy, materials and banks; post GFC bust, the defensive sectors initially led the market through to 2015 (healthcare, consumer staples as well as consumer discretionary); while finally in recent years, it's been IT and growth stocks."
Source: 'Markets have Fashions', LV on Friday, 8th Jan 2022

Figure 1: S&P500 sector leadership (% performance of leading sectors)



Tech has led equities higher since 2014, as highlighted in figure 1 above. But, with 'fashions' usually only lasting between 5 – 8 years, the key question is: For how long will the current fashion continue? Are we about to see another major shift in sector leadership?

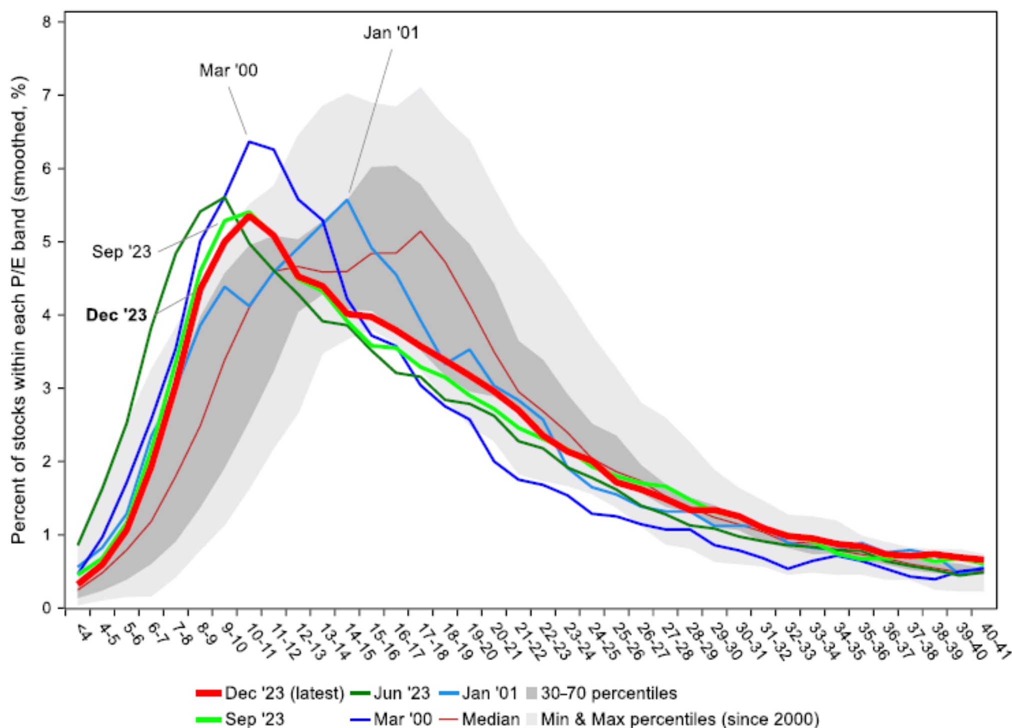
Usually, fashions change when (i) a new macro theme emerges; and (ii) valuation discrepancies become extreme. With respect to (ii), from a valuation perspective, three factors currently point to a forthcoming switch in leadership. All of which draw strong parallels between the current cycle and the 2000s dotcom bubble. In particular:

1. Both periods were dominated by tech sector outperformance, with tech stocks making up a significant share of global market cap (both then and now). **Today's mega cap stocks, though, make up a larger share of the global market share than they did in the dotcom bubble**. In the early 2000s[1], the top 10 stocks made up 9.9% of the global market cap (at their peak). Today, they make up 12.7%[2] (figure 2). In other words, the breadth of market leadership is narrower today than during the dotcom bubble (on that measure). On that basis, therefore, tech sector dominance has become overstretched, which is typical ahead of market leadership switches.

Figure 2: Top 10 stocks (2000 & 2023) as a share of global market cap (%)

2. The distribution of single-stock price-to-earnings (PERs) model remains heavily skewed to the left (figure 3) **as it was in early 2000**. While the distribution has shifted somewhat to the right since our last update in September, it remains skewed to the left compared to the historic median. The distribution remains similar to the 2000s tech bubble. This chart below is therefore another way of showing that America's rich valuation is driven by a small number of mega-cap stocks (while most other stocks within the S&P500 remain cheap relative to history). Indeed, further supporting that, small cap equity indices are at 20-year low valuations relative to the S&P500.

Figure 3: Distribution of individual underlying single stock PERs (US market)



3. Other key models point to a major shift in market leadership in coming months/quarters. The Longview proprietary valuation model, for example, is now generating its first **strong SELL** message since the bursting of the dotcom bubble in early 2000 (figure 4). Historically, this model has generated timely SELL/strong SELL signals ahead of many key market downturns/bear markets, including ahead of the 2000-02 and 2007-09 bear markets, as well as the 1987 crash and the early 1980s recession (i.e. major turning points in sector leadership). That further highlights the expensiveness of the US (which is dominated by tech stocks).

Consistent with that, various US equity risk premium models have fallen sharply and are back at levels of the early 2000s (i.e. signalling that equities are expensive relative to real bond yields/cash rates.

Overall, therefore, a change in market leadership seems likely in coming months and quarters. The question is: Which sectors, and therefore which country indices are likely to take up that leadership?

Figure 4: Longview proprietary valuation model vs. S&P500 (log scale)

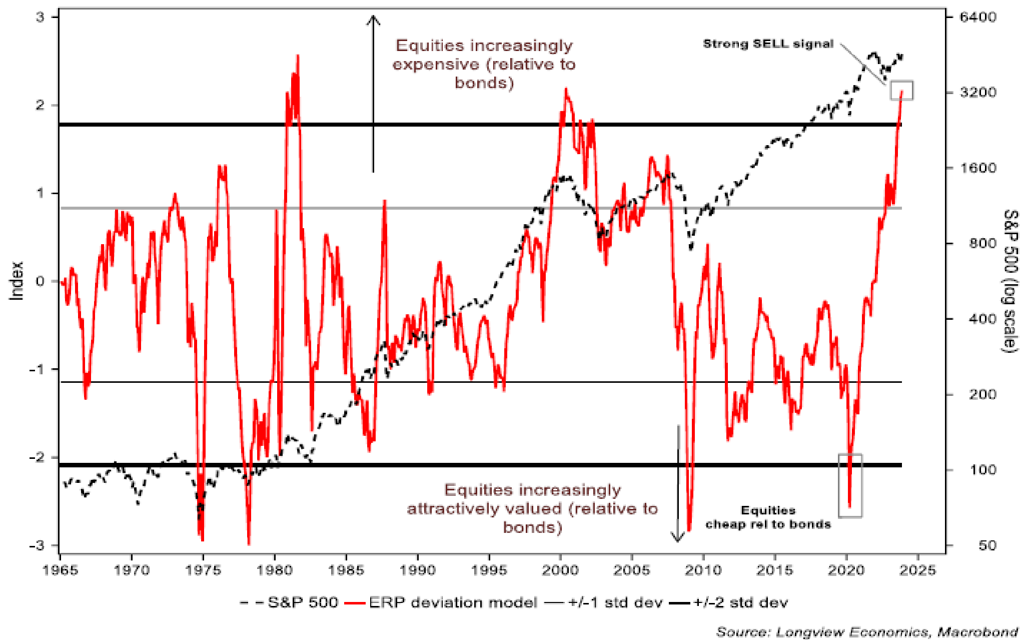
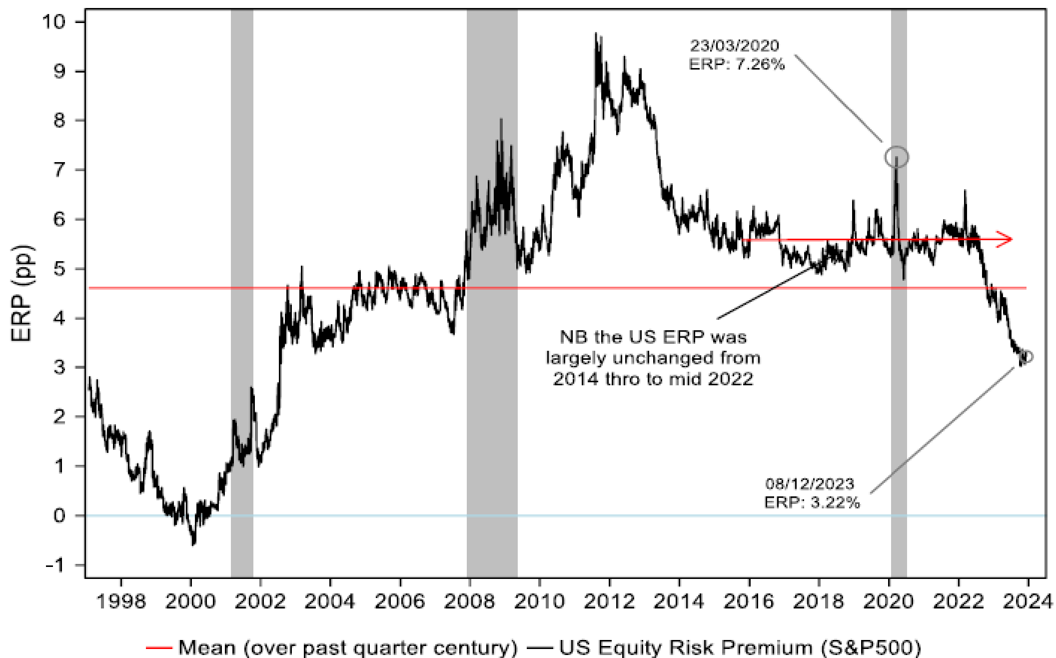


Figure 5: US equity risk premium (earnings yield less real bond rate)



Relative Sector Valuations

As highlighted above, tech valuations are notably high on a standalone basis. Tech/growth stocks are also, though, over-stretched relative to other sectors and equity indices, from a valuation perspective.

In a general sense, for example, the valuation premium of US growth stocks relative to an (equally weighted) basket of (i) defensive; and (ii) cyclical sectors has become extreme (e.g. see figure 6 below). Equally, compared to both US and global equity indices, Tech's valuation premium recently reached a +1 standard deviation.

Figure 6: US tech valuation premium/discount relative to defensives (%)

The key question, therefore, becomes: Which sectors are attractive? Which sectors could become the next 'fashion'?

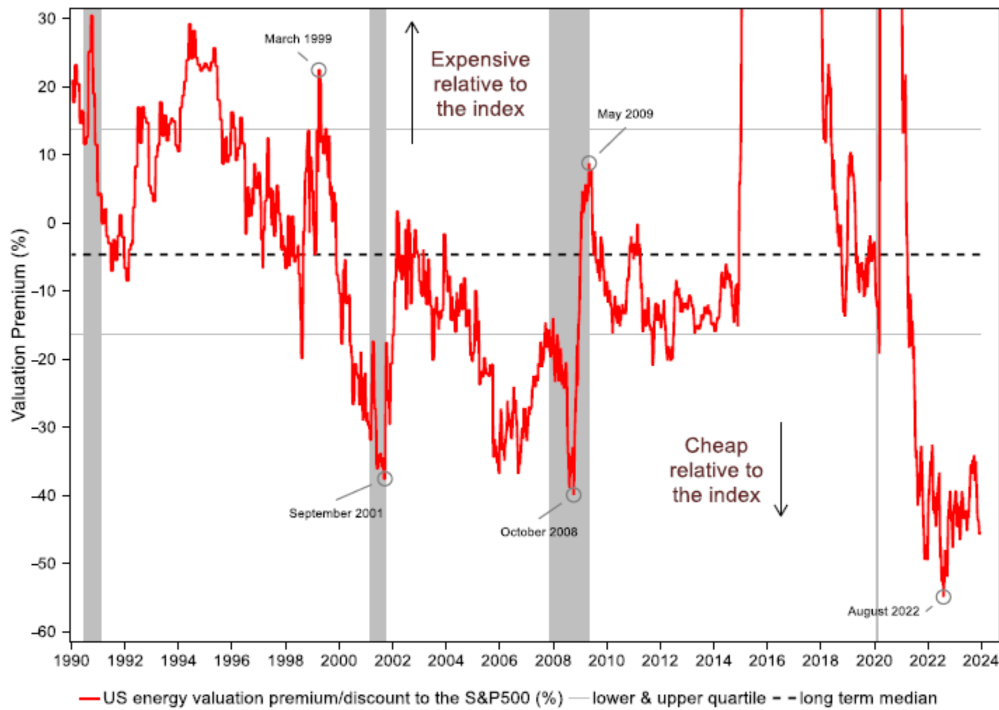
Energy, in particular, is the cheapest relative to other US sectors. As shown in the US sector heatmap below (figure 7), energy PERs are in their second percentile relative to history (vs. the S&P500 index). Indeed, energy is now trading at a deeper valuation discount than at the 2001 or 2008 lows (figure 8 below).

Figure 7: US sector PE heatmap

	Cons disc.	Cons. staples	Energy	Financials	Health care	Industrials	Info tech	Materials	Real Estate	Comms Services	Utilities	Index
Cons disc.		8	2	19	11	21	57	32	13	14	19	14
Cons. staples	93		6	91	64	89	90	91	34	65	58	94
Energy	99	95		98	93	98	98	100	83	95	94	99
Financials	82	10	3		31	67	82	77	5	30	49	68
Health care	90	37	8	70		81	93	81	8	63	54	83
Industrials	80	12	3	34	20		86	63	10	28	38	59
Info tech	44	11	3	19	8	15		27	1	13	21	18
Materials	69	10	1	24	20	38	74		1	29	30	42
Real Estate	88	67	18	96	93	91	100	100		95	28	99
Comms Services	87	36	6	71	38	73	88	72	6		71	79
Utilities	82	43	7	52	47	63	80	71	73	30		67
Index	87	7	2	33	18	42	83	59	2	22	34	

Source: Longview Economics

Fig 8: US energy valuation premium/discount relative to the S&P500 (%)



Source: Longview Economics, Macrobond

When compared to tech, the energy sector is at its lowest relative valuation since the early 2000s. Added to which, from a fundamental perspective, there's a strong case for higher energy prices and, more broadly, a commodity supercycle. Historically, chronic underinvestment in supply results in a prolonged period of high commodity prices. That has been the case this past decade and supports the expectation that energy will become the new 'fashion'. That, if it happened, would draw another parallel with the dotcom bubble (i.e. with energy taking up leadership in the early 2000s, see figure 1).

From a global perspective, energy, consumer staples and financials are the cheapest sectors relative to the others.

Relative Valuations (by Geography)

Consistent with extreme tech valuations (vs. other sectors), US equities are overstretched **relative to other major global equity markets**. The US is now the fourth most expensive market we track (relative to forty-two other major country stock markets). It is the second most expensive on a country-by-country relative PE basis (currently in its 83rd percentile on average, just behind India which is in its 90th percentile).

Consistent with that, **Europe is extremely cheap**. European forward PEs have reached their lowest level since 1992 (relative to the global PER). Within Europe, Spanish equities remain attractive. Italy, similarly, is also cheap on a relative valuation basis (e.g. relative to the US, and other European indices), while the UK is close to record cheap levels versus the rest of the world.

Elsewhere, **emerging markets** broadly remain mid-range on a relative PER basis. Within that, though, several countries/regions are relatively cheap. Most notably, China's PER has sunk to its 16th percentile when compared to the global PER. In contrast, India is now the most expensive market we track (now in its 90th percentile on average relative to other major economies).

[1] In 2000, the top 10 stocks by market cap were: General Electric, Microsoft, Cisco, Texas Instruments, Exxon Mobil, Procter & Gamble, Walmart, Oracle, IBM, Citigroup.
[2] In 2023, the top 10 stocks by market cap were: Apple, Microsoft, Amazon, Google, Nvidia, Tesla, Berkshire Hathaway, Meta, Eli Lilly, Broadcom.

Bradley Waddington is an Economics and Markets Analyst at Longview Economics. This article is an extract from Longview's quarterly global asset allocation report and has been reproduced with permission.

Let's ditch the idea of retirement

Lynda Gratton

This is an edited transcript of a video talk by Professor Lynda Gratton of the London Business School on why we need to change our ideas of retirement.

The economics are clear: we need to be working into our 70s. The idea of retiring earlier is fine if you're going to die at 70. But the truth is most of us aren't.

Every single decade, we live longer. So the thought that you might live to 100 is a possibility. And so the idea of retiring in your 60s I think is entirely outmoded. We need to think about working right the way through our life. But of course, to do that, we have to change the way we think about our whole life.

The pandemic changed everything about work

I've been writing about the future of work for more than 20 years. And frankly, I was beginning to get pretty frustrated. I wrote about how the world was going to change, and I was sort of surprised it didn't change because actually the forces against change are pretty strong. People were saying, "Well, we still need to come into the office. I know there's a long commute, but it's really important. You can retire when you're 60. That's going to be okay." I knew that wasn't going to work, but I really couldn't see the forces that were going to change that.

The pandemic was an astonishing event. Suddenly 50% of workers could work from home. So what that did was to upend many of the traditions we had about work. For example, if you take a look at a typical life that your dad had, or that my dad had in the 40s and 50s, it followed 3 stages, which everybody did, by the way at the same time: full-time education, full-time work, full-time retirement.

You don't really have to have a great deal of self-insight. All you have to do is to look around left and right and ask yourself, "What's everybody else doing at my age?" Because age equals stage. But that's not going to work for me. It's not going to work for you, and it's certainly not going to work for our children.

Think about the way that the world is changing. It's changing in the sense that we're living longer. So that means that simply retiring at 60 or 55 just isn't going to work. It's changing in the sense that there are huge technological changes coming up almost on a daily basis. For example, generative AI is a thing that we're all looking at now. Why are we so excited and frightened of that? Well, it replaces knowledge work.

In fact, there's an argument that it might even replace the creative tasks that we do. Technology requires us to upskill and re-skill every year of our life, and it's changing in the sense that the family structures that we have are also becoming much more individual. If we're going to have different ways of living, different family structures, we need to redesign work.

A multi-stage life

Here's what I think's going to happen. We're going to start doing what I would call a multi-stage life. It's the idea that you can do all sorts of different things at all sorts of stages. For example, education suddenly becomes something you do right the way through your life. It becomes a lifetime of learning.

Work becomes something that you dip in and out of. Rather than starting in a company when you are 20 years old and just going straight through, you could work part-time. You could freelance, you could take time off. And retirement also moves back, and it takes time.

The point that I want to make is it's very hard to work until you're 70 in one, long, never-ending streak. You have to break that up. And you can make a life that works for you. Not the life that worked for your dad or for your mom. The life that works for you.

The challenges of a multi-stage life

Now, what's exciting about a multi-stage life, but also frankly makes it more difficult, is that each of us lives our multi-stage life in the way we want to do it. It could be that the age of 30, you decide to take time off for a year and travel the world. But as you look around, there's not that many other people who are going to be doing the same thing. You have to have more of a sense of yourself.

The truth is, the 3-stage life is relatively easy. You don't need to think very much about it, you can just get on and do it, and do it the same way as all your peers do. Multi-stage life, the ask is that you do something that

perhaps nobody else in your peer group has done. You become, in other words, a social enterprise, you actually do your own thing, and that takes courage.

The sort of questions that you want to ask yourself is, "What's important to me? What is it that I want to get out of my life? How do I want to live my life?" So there's big questions you need to ask yourself now in order to make the most of the trends that shape our work.

Let's ditch the idea of retirement. Let's all work as long as we can and make work fun, exciting, and a learning experience.

Lynda Gratton is CEO & Founder of HSM Advisory and a Professor of Management Practice at London Business School. She's the author of The 100-Year Life. This is an edited transcript of Lynda's video talk on Big Think.

Meg on SMSFs: Why a trust deed is still important

Meg Heffron

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

These days, it is usually easy to change an SMSF trust deed. The trustees agree to make a change, most accounting firms have a regular supplier they use to do it and the work can be done reasonably quickly at fairly modest fees. And most people who use the same supplier will have the same trust deed – it's rare to find them tailored to the individual fund.

So it's tempting to think that the trust deed is not really that important – the logic being that "if we don't like what we have, we can just change it really easily".

While part of that sentence is true – it's generally easy to change – that doesn't mean it's not a critical document. And while SMSF trust deeds might be mostly generic, there are still differences that mean some important questions might be answered quite differently by someone with Deed A vs Deed B.

Take this example

This became clear to me recently when I received a question about a binding death benefit nomination for a member who had recently died – let's call them Xanthe.

In this case, the binding death benefit nomination left Xanthe's super to be divided equally between three different people (Annie, Bertie and Clarice). Let's assume all were valid recipients when the nomination was made – they were "death benefit dependants" for super law purposes. Super death benefits can only be paid to "dependants" (which, for most people, is their spouse and children of any age) or the deceased's estate. The only time the money can be paid to another individual is if there are no dependants and no estate is formed. So in this case, let's assume that the three beneficiaries were Xanthe's children – all dependants for super purposes.

The challenge in this case was that Annie died several years ago – in fact, before Xanthe. What happens? Does it all go to Bertie and Clarice? Or does Annie's share now go to Annie's estate? Or is the whole death benefit nomination invalid? Or… is there another option entirely?

One part of the question is reasonably straight forward. In Xanthe's case, she had some death benefit dependants. So the super can only be paid to Xanthe's remaining dependants or estate. While Annie was a valid recipient of Xanthe's super while she was alive, that doesn't extend to Annie's estate.

So in this case, one thing's for sure: nothing is going to Annie's estate. And it probably won't be able to go to Annie's spouse or children either because in most cases they won't be classified as Xanthe's "dependants" (for example, grandchildren aren't valid recipients unless they were also – say - financially dependent on Xanthe and therefore another of her dependants).

What happens then? The answer really does depend on the trust deed. And in this case, Xanthe has already died – it's probably too late to change the trust deed. That would definitely invite a challenge by anyone disappointed in the result.

Some trust deeds say that whenever **any** part of a binding death benefit nomination can't be fulfilled, the **whole nomination is disregarded**. If that was the case in Xanthe's fund, the rules would essentially revert back to normal super rules when members don't make binding death benefit nominations at all. The trustee decides who gets the money. Of course, they would still be subject to the usual rules about only paying the money to permitted beneficiaries. That would include Xanthe's estate (still not Annie's) and dependants such as Bertie, Clarice and any other children or Xanthe's spouse. This could get particularly tricky if Xanthe's new spouse was the trustee of the SMSF and decided to pay all of the super to themselves!

Other trust deeds take the exact opposite view – they provide specific instructions for what happens when just one part of a nomination is invalid. For example, the deed might provide that the trustee must treat the remainder of the nomination as valid – in this case, paying Bertie and Clarice one third each.

What happens to the final third will also be determined by the trust deed. The deed might hand that decision to the trustee, or it might specify that it is divided proportionally between the "valid" beneficiaries (meaning in this case that Bertie and Clarice would end up with 50% each overall).

Alternatively, some binding death benefit nominations address this directly. Xanthe's nomination might specify that if any of her beneficiaries pre-decease her, their "share" is to be paid to her (Xanthe's) estate. Of course, Xanthe would also have needed to think about this when preparing a Will. For example, if the money was to go to Annie's children, Xanthe would need to ensure that the Will included specific instructions for any super death benefits that were paid to the estate because a beneficiary had pre-deceased her.

Other issues

As you can see, it's complicated.

And even this assumes the trust deed and the binding death benefit nominations make the situation clear. Many older SMSF deeds don't address this at all – meaning it's anyone's guess. Lawyers, courts and all manner of other expensive people may need to get involved.

This is just one example where the trust deed is critical but there are others.

For example, what happens for those who have reversionary pensions (pensions deliberately set up to continue to a spouse) but ***also*** a binding death benefit nomination that leaves everything to their estate? The two sets of instructions contradict each other. Which one "wins"? It will depend on the deed.

And what about those who set up pensions and then want to change something about that income stream (for example, add, change or remove a reversionary beneficiary)? Can they do it without stopping the pension and starting a new one? Again, it depends on the deed.

All up, even though SMSF trust deeds are often generic these days and almost always easy to change, they're still vital. They're definitely not all the same so it's important for SMSF trustees to know what they've got.

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.

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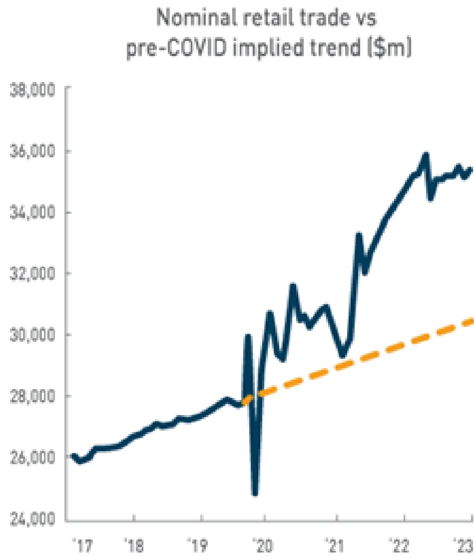
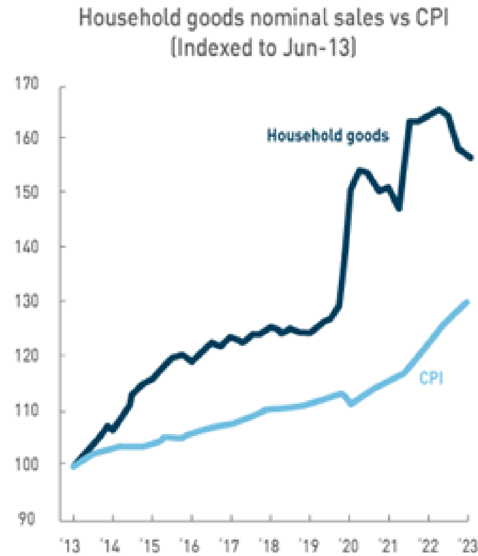
Opportunities in retail property

Colin Mackay

While most property types have experienced a performance slowdown on the back of rising interest rates, retail has been comparatively resilient. The sector was already being viewed with some caution pre-COVID due to the impacts of e-commerce, contributing to less substantial cap rate compression through that phase of the cycle – over the last five years, retail saw a cap rate low of 5.2% compared to 4.8% for office and 4.1% for industrial[1]. This different starting position has meant the negative valuation impact from cap rate expansion has been less pronounced.

The sector has also benefitted from strong fundamentals, namely strong consumption growth and a muted supply pipeline. Incomes have risen, retail spending's share of wallet has increased, and population growth has surged. These drivers have seen Australian retail trade grow by 28% since Feb-20, with spending levels sitting 16% above the pre-COVID growth trend[2].





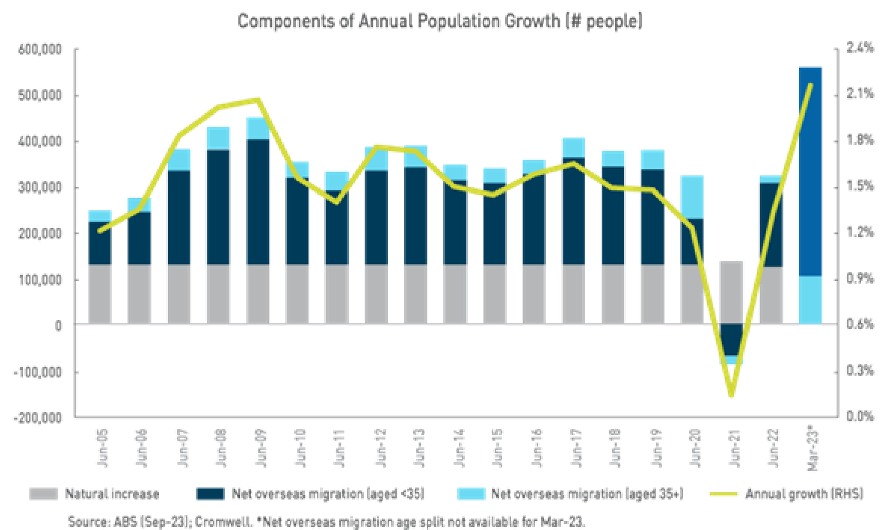
One of our preferred exposures to retail is Large Format, a sub-sector that isn't often in the limelight. These assets don't have the scale or luxury brands of a major shopping centre. It's a no-frills, back to basics retail proposition – but that's not a bad thing. While underwriting assumptions do have to account for a weaker consumer outlook over the next 12 months, Large Format is expected to benefit from resilient fundamentals, offers an attractive yield and 'clean' income, and is better positioned to leverage e-commerce as an opportunity rather than a challenge.

Population growth is a powerful driver of demand

Nominal retail consumption growth can be boiled down to three buckets:

1. People paying more for the stuff they buy (retail price inflation)
2. People buying more stuff (real growth per capita)
3. More people buying stuff (population growth)

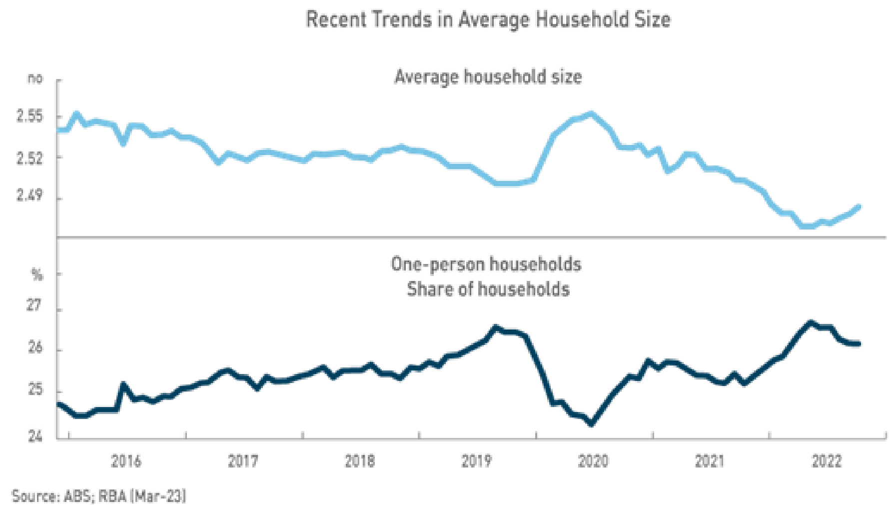
Of the three, population has been the most significant driver of retail growth over the last decade, averaging 1.4% p.a[3]. It has strengthened further post-COVID, with Australia recording population growth of +2.2% in the year to March[3] and preliminary indicators of net overseas migration suggesting the pace hasn't dropped off over the course of the year. The growth tailwind is expected to persist, with population forecast to grow by 1.4% p.a. from 2022-23 to 2032-33[4].



Positively for Large Format and its typical occupiers, Australia's population growth skews to younger families. Around 60% of growth is due to net overseas migration, of which circa 80% comprises those aged under 35. This demographic is central to

household formation and the retail activity that comes along with it, which is more heavily represented in Large Format assets (e.g. furniture/appliances).

Another boost to demand is the changing nature of dwelling composition. Australia is seeing the number of occupied dwellings increase faster than the population, as single person households become more common[5]. This has resulted in a lower average household size, or thought of another way, more dwellings required per person. While people are increasingly living in smaller dwelling types (e.g. apartments versus houses), we expect the net result to be greater demand for household goods and furnishings.



The growth of the under 35 demographic is central to household formation and the retail activity that comes along with it, which is more heavily represented in Large Format assets (e.g. furniture/appliances).

Clean income and an attractive yield

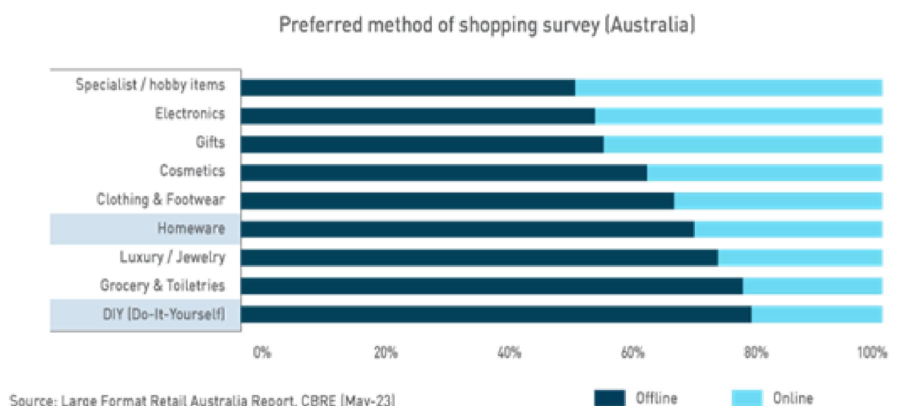
In a time of slowing growth and elevated inflation, the ability to generate stable, growing income is an important driver of investment returns. Large Format's yield nationally is 6.1%[6], higher than many commercial and residential property sectors. We also consider the yield to be "cleaner" – what you see is what you get. Compared to major shopping centres for example, which are complex structures with substantial plant and equipment, often less capital expenditure is required to maintain a Large Format asset. This means the post-capex yield, or the money that actually ends up in your pocket, may be more attractive than a simple comparison of headline yields suggests.

The income underpinning the yield also grows over time, in contrast to the fixed nature of bonds. Like the broader retail sector, Large Format leases typically stipulate rent escalation each year of 3-5% or a CPI-linked amount, usually providing growth in excess of inflation. The income stream is dependable, with the majority of Large Format income derived from 5–10-year leases to ASX-listed or national retailers, such as Bunnings, The Good Guys and Freedom.

We believe the runway for rental growth in Large Format is sustainable, given the lower starting level and attractive economics for retailers. Mosaic Brands recently announced plans to open 40 "mega stores" through to Jun-24, as the larger format is 3x more profitable than their normal store size[7]. For some assets, further growth can be derived from intensification – development of unutilised land, car parks, or air rights into income-generating improvements.

Omnichannel-ready

Online's share of Australian retail trade has increased from 5.1% five years ago to 10.7% today[8]. The rise of e-commerce has dampened demand for physical retail space relative to household consumption, particularly across discretionary shopping centres with large exposures to categories such as clothing and department stores. Cromwell forecasts online's share of spending to increase to 20% by 2030, however there are several reasons why Large Format can view the shift as an opportunity, given its role in omnichannel retailing.



From consumers' perspective, Large Format minimises much of the friction associated with a traditional shopping centre experience – friction which turns shoppers towards e-commerce. Convenience is the number one reason for purchasing online[9,10], as large multi-level shopping centres provide a frustrating car parking[11] and navigation experience. In contrast, Large Format assets are often a simple rectangular layout with large on grade or basement car parks. These assets can provide the benefits of a physical shopping experience, such as better customer service[8] and the ability to touch and trial products[12], while minimising the pain points. In-person shopping is particularly valued across Large Format's typical retail categories such as homewares and home improvement.

For retailers, Large Format facilitates an improved omnichannel proposition in a number of ways. Rents are typically in the range of $300-600 per square metre, much lower than traditional shopping centres and closer to levels being seen across industrial assets today. Sites are generally large, flat, and designed to be accessible to the heavy vehicles delivering bulky goods to occupiers. Assets are also often well-located, with ample arterial and motorway connections servicing significant population catchments. These attributes make Large Format assets well suited to the full suite of omnichannel product 'delivery' options, including buying in store, click and collect, and ship from store, while also offering reasonably cost-effective inventory storage – Nick Scali for example stores 55% of inventory in its showrooms[13]. In this respect, Large Format can offer investors a quasi-industrial exposure spanning warehousing and fulfilment, with the added fillip of revenue generation (making sales).

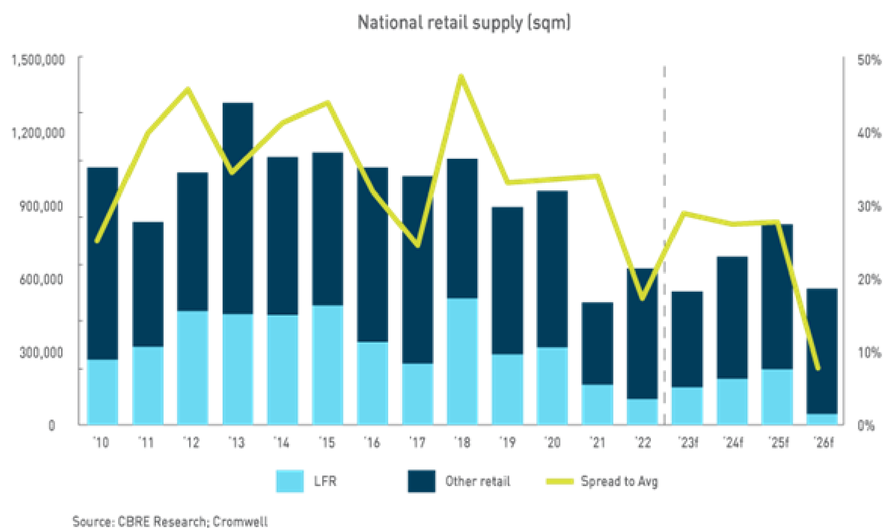
The physical store presence also aids in reducing last mile reverse logistics costs[14] and processing times[15], and provides retailers with an additional opportunity to engage with customers and generate a sale when products are being returned. By offering a seamless omnichannel experience, retailers can drive customer engagement and loyalty.

Customers' preference for omnichannel is evidenced in trading outcomes, with 'Bricks & Clicks' retailers winning online market share at the expense of 'Digital Native' retailers[16], and multichannel customers spending 2-3x more than single channel customers[17]. Omnichannel is important to customers and retailers alike, and Large Format's characteristics can make it a preferred component in that proposition, particularly as e-commerce increases its share of sales and industrial rents reach higher levels.

Large Format is an omnichannel hybrid of retail and industrial, offering consumers a 'touch and trial' shopping experience and retailers a cost-effective shopfront and inventory storage.

Supply is constrained, good news for existing owners

One of the reasons retail in Australia has avoided the "dead mall" phenomenon seen in the US is sensible planning policy and constructive relationships between developers and councils. In the US, developers have taken advantage of lax policy to build more than double the shopping centre floorspace per capita than Australia[18], causing supply to considerably outstrip demand and leading to significant space hand-backs and store closures. Australia, by comparison, has restricted development to more sustainable levels, raising barriers to entry and lowering the likelihood of value-destroying competition impacts for both landlords and retailers. While there are more land zones where Large Format is permissible compared to traditional shopping centres, the lack of excess shopping centre space more broadly means a better supply-demand balance across the whole spectrum of retail typologies.



In addition to the above, Large Format supply has been constrained more than normal by rising construction costs, labour and material shortages, and a lack of suitable sites, exacerbated by competition from industrial uses. The characteristics which make a site compelling for Large Format (size/ configuration/ access/ location) are also desirable to industrial facilities. With industrial vacancy below 1%[19] and yields remaining tighter than other sectors[1], developers are prioritising

industrial over other uses such as Large Format. A recent example is Goodman's 2022 acquisition of Alexandria Homemaker Centre with the intention of future conversion to logistics, which will result in the withdrawal of Large Format space from the market (a positive for existing asset owners). Such transactions also highlight how Large Format centres can be used as a way to land bank large sites in tightly held corridors, with the benefit of income generation over the hold period.

Large Format outlook

The outlook for demand is robust with retailers continuing to look for space – Super Retail Group for example is looking to open an additional 61 stores by Jun-26, while the likes of Baby Bunting, Bedshed, Nick Scali and Plush require a combined 125+ locations to reach their target store networks[20]. The vacancy rate has tightened to 3.2%[21], its lowest level since at least Jun-17, meaning limited space is **currently** available and **future** availability will be constrained by the muted supply pipeline. These dynamics are expected to create conditions conducive to rental growth, which CBRE forecasts will run at +3.0% p.a. nationally from 2023 to 2026[22].

Stock selection is key, with Large Format performance closely linked to location, the strength of the surrounding catchment (i.e. income/population growth), and impacts from competition. Metropolitan sites in land-poor markets are preferred given the protection that scarcity (and lack of competition) provides to valuations over time – acquiring at attractive pricing is a key challenge for these types of assets. Dominant assets in fast-growing non-metropolitan markets can also be attractive if the risk of future competition can be adequately priced.

1. The Property Council of Australia/MSCI Australia Annual Property Index, MSCI (Jun-23)
2. Retail Trade August 2023, ABS (Sep-23)
3. Based on analysis by the Centre for Population, National population projections in the 2023-24 Budget; Cromwell (May-23)
4. National, state and territory population, ABS (Sep-23)
5. ABS 2021 Census; Cromwell
6. Australian Retail Figures Quarterly Market Report, 2Q 2023 (CBRE)
7. FY2023 Market Update, Mosaic Brands (Aug-23)
8. Rolling 12-month basis as at Jul-23. ABS Retail Trade (Aug-23)
9. IAB Australia and Pureprofile Australian Ecommerce Report 2023
10. Shopping Pulse, Klarna (Q2 2023)
11. Bricks & Clicks, UBS (2019)
12. Retail Monitor, Australian Consumer and Retail Studies, Monash Business School (Nov-22)
13. FY23 Results Presentation, Nick Scali (Aug-23)
14. Wallenburg, Einmahl, Lee & Rao (2021)
15. McKinsey (2021)
16. Inside Australian Online Shopping, Australia Post (2023)
17. Myer (Sep-23); Coles (Feb-21); Accent Group (Aug-18); Pallant et al (2020); KPMG (Dec-22)
18. SCCA (Sep-23)
19. Australian Industrial and Logistics Figures Q2 2023, CBRE (Jul-23)
20. Company reports; Cromwell (Sep-23)
21. JLL Research (Jun-23)
22. Large Format Retail Australia, CBRE (May-23); Cromwell. Rental growth refers to Prime net face rents (AUD/sqm).

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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Podcast: ASX value plays and investing alongside wealthy families

James Gruber

Season 2, Episode 15

Peter Warnes from Morningstar's Your Weekly discusses where to find value on the ASX in 2024.

East 72's Andrew Brown on why he likes owners with 'skin in the game', including English soccer giant, Manchester United and ASX-listed Catapult.

Finally, VanEck's Jamie Hannah explains the increasing popularity of smart beta ETFs and funds.

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