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Editorial

History was made this week. The Reserve Bank of Australia (RBA) held its first extended two-day meeting to set interest rates. Previously, it was just one day. For the first time, the RBA Governor also held a news conference an hour after the rates decision.

The changes are part of a suite of reforms introduced after an independent review of the central bank last year. No doubt, the changes will increase the transparency of rate decisions from the RBA. Whether they influence the substance of the decision making remains to be seen.

The cynic in me thinks the previous RBA Governor Philip Lowe was simply the fall guy for a global inflationary spike that led to rising interest rates, which highly indebted Australians didn't like, and our politicians needed to do something to assuage their concerns. So, there was a review and these changes followed.

While all the focus is on the RBA, the Government is failing to address deeper structural issues holding back our economy. The key problem is what economists' term, productivity. It's a fancy word for doing more with less.

I'm not a trained economist but I have run several businesses, so perhaps I have a different take on the problem. My view is that businesses, not governments, are the primary drivers of economies and economic growth. And businesses here aren't thriving, domestically or on the global stage, because costs are high.

The three largest costs for businesses are wages, rent, and energy. All these costs in Australia are at nose-bleed levels, both in historical terms and compared to other countries.

For example, if you want to start a restaurant business in one of the larger capital city CBDs, my guess is you'd have to be turning over at least $700,000 to cover costs. To do that in year one of a business is very difficult.

High costs ultimately mean fewer businesses are getting off the ground. And that results in less competition and innovation.

The issue not only affects small businesses but larger ones too. Everyone knows that electric vehicles are the future, and Australia has much of the critical minerals to power this revolution. Yet, business bosses in battery metals say that Australia won't be able to compete with other nations in this space until high costs are addressed.

The RBA doesn't have much influence over wages, rent, or energy. The government does, and it's doing little to fix the cost issues.

Until it does, innovation and competition will be stifled, and economic growth subdued. It will prevent Australia moving from being principally a resources producer to one producing more valuable and sophisticated goods and services.

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You may be surprised by one country that is showing signs of moving up the value chain: China. You wouldn't know it by looking at their economy and stock market. The Chinese and Hong Kong stock markets fell through the floor in January. Hong Kong is now below levels reached in 1997.

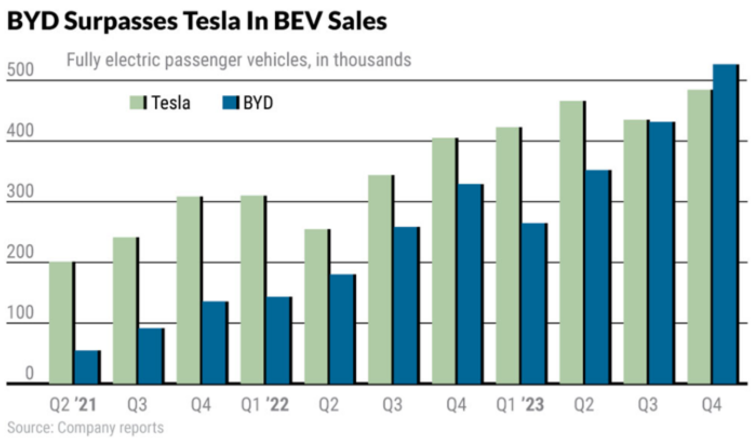
Source: Trading Economics

The Chinese economy is in the middle of a deflationary bust, after an investment-driven, debt-fueled economic bubble. In an article for Firstlinks this week, **Andrew Swan** from **Man GLG**, suggests the [investment-driven model is dead]() and China needs to find a new one. He says China needs to help its exporters and a large one-off devaluation of the currency could do that. And he believes China must drive consumption. The best way would be to provide a better social safety net for people, which would give more certainty around retirement finances and encourage them to consume more before they stop working.

While China has significant problems, it remains a formidable force. Not enough attention is being paid to some of its companies becoming global leaders. And these companies are posing serious threats to the likes of Tesla and Apple.

For instance, BYD Auto recently overtook Tesla to become the number one seller of electric vehicles. The company has grown revenues by 25% per annum over the past decade. For most of that time, it concentrated on selling into the domestic market. But in 2020, it started selling its own cars overseas. First in Norway. Then in 2022, it added France, Germany, and the Netherlands. And it entered the UK market early last year.

Guess where Tesla decided to cut prices last month? In Norway, France, Germany, and the Netherlands.



BYD is posing a global threat to Tesla with the production of lower priced, competitive EVs.

Another Chinese company making serious inroads is Huawei Technologies. In September last year, it introduced its Mate 60 Pro smartphone. The phone has a 5G chip that is competitive with Apple's A17 chip. And customer reviews suggest it has all the functionality of the iPhone 15 Pro.

The US technology community has been taken aback by how advanced the Huawei phone is. After all, the US placed sanctions on China's access to semiconductor manufacturing technology more than four years ago. Historically, China had reverse engineered Western technology and with these sanctions, the US thought China would be less competitive. Yet, here is Huawei developing proprietary technology from its own chip designs and foundries.

iPhone sales in China have struggled of late and Apple reduced their prices on the iPhone 15 Pro and iPhone Pro Max by 16%.

So, it's not all doom and gloom for China. There are companies that are becoming global players and threatening to upend the likes of Tesla and Apple.

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With Tesla and Apple facing stiffer competition, the 'Magnificent Seven' may soon have to be renamed the 'Magnificent Five'. Yet, the remaining five Big Tech companies are doing exceedingly well. Of recent results:

- **Alphabet's** (aka Google's) fourth quarter revenues increased 13.5% over the last year to US$86 billion. Net income increased 52% year-on-year (YoY) to a record US$20.69 billion.
- **Microsoft's** fourth quarter revenues increased 17.6% over the last year to $62 billion. Net income grew 33% YoY to $21.9 billion (2nd highest quarter ever).
- **Meta's** revenues increased 25% YoY to US$40 billion in the fourth quarter. Net income rose 201% YoY to a record US$14 billion.

Meta's results beat expectations and the stock rose 22% on the day. It was the largest one-day gain in history in dollar terms.

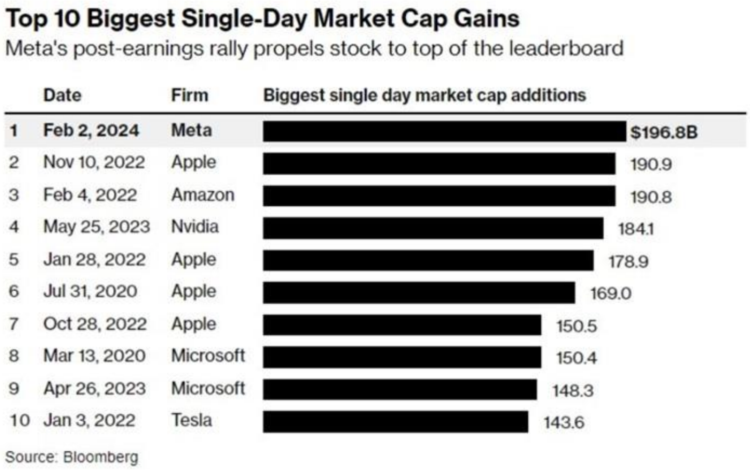
And Meta's stock is up 445% from the lows of October 2022.

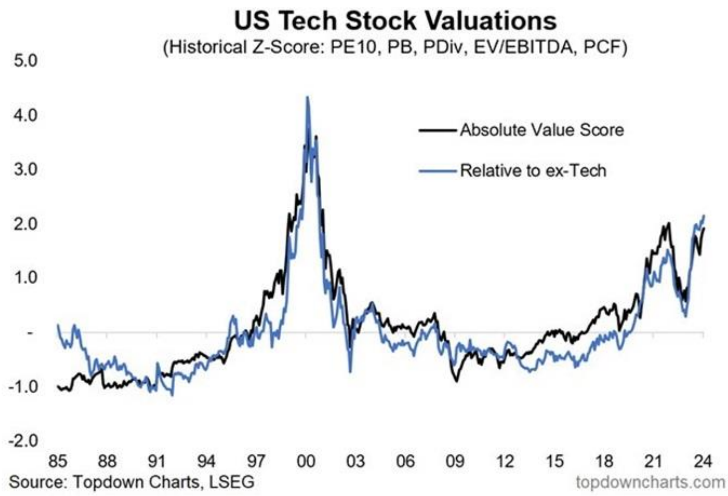
The remaining five of the 'Magnificent Seven' are flying and it may justify the undoubtedly rich valuations that many of the stocks sport.

James Gruber

Also in this week's edition...

Labor's stage 3 tax cuts have provoked plenty of debate and questions are being raised about what other promises the Government may break. Superannuation has been targeted before, and may be targeted again. Though, **Jon Kalkman** says the case for further taxes on super is weak.





Meanwhile, **Rodney Brown**, says Labor didn't really have any choice but to amend the Coalition's tax cuts. He says economic circumstances are different now to what they were when the tax cuts were enacted in 2019. He believes Labor's package is fair, though it could have gone further to simplify the taxation system.

Lawrence Lam has a cracking story on his interview with legendary Flight Centre founder, Graham Turner. Turner details his 50-year entrepreneurial journey and the obstacles he's had to overcome along the way. They include a tour business that Turner owned before Flight Centre that almost went bust, yet gave him valuable lessons which endure to this day.

When is the right time to sell a stock? Of all the questions facing an investor, it's perhaps the hardest. Unlike with the decision to make an investment, selling it requires you to undo something you have invested intellectual, emotional and financial capital in. **Fidelity's Tom Stevenson** offers a guide on good and bad reasons to pull the plug on an investment.

Build to Rent is one of the hottest property segments in Australia. **Stuart Cartledge** went on a tour of some of the newest Build to Rent properties to gauge the prospects for the sector. He thinks there's a lot of room for growth.

US Presidential elections are due in November and it should be both exciting and terrifying to watch Donald Trump run for office for a second time. But when it comes to investing, do elections really matter all that much? **Capital Group** has the answers.

Finally, in this week's whitepaper, **The World Gold Council** gives us the latest trends in demand for the yellow metal.

Are more taxes on super on the cards?

Jon Kalkman

The Prime Minister’s broken promise on tax cuts has prompted speculation about other possible tax promises that the government may be considering breaking. A perennial topic in that space is the belief that super is very lightly taxed and is therefore a prime candidate for special attention. This is because super in the accumulation stage is only taxed at 15% and investment earnings inside super funds in retirement are tax free. Moreover, withdrawals by members from those funds in retirement are also tax free.

How it works elsewhere

In most countries, contributions to a retirement fund are not taxed and the income earned by those invested contributions within the fund are also not taxed, but retirement benefits paid to members are then taxed as normal income at marginal rates in which high income earners pay a higher proportion of that income in taxes. This approach has two advantages:

1. The nest egg can accumulate to a larger amount thanks to the benefits of compounding as there are no withdrawals from the fund over a working lifetime, and larger nest eggs generate more tax.
2. Retirees face the same tax rates as other taxpayers and so there is no intergenerational envy over any special treatment they receive.

It is important to remember that super is a long-term project with contributions over a working life that can extend over 40 years and a retirement that can extend over 30 years. That means we need to take account of the cumulative effects of investment decisions.

Australia is different

In Australia, we do things differently and those cumulative effects make a substantial difference. Firstly, in Australia, all super contributions to super are taxed before being invested.

- Employer contributions (SG and salary sacrifice) are paid into the fund as pre-tax contributions, because neither the employer or employee pays tax on them. These are called concessional contributions because a tax-concession is claimed on them. They are then taxed within the super fund at 15% before they are invested. Therefore, of a pre-tax contribution of $10,000, only $8,500 is invested.
- Personal (after-tax) contributions, such as the sale of an investment or an inheritance are called non-concessional contributions because no tax concession has been claimed on them. They have been taxed at the personal marginal tax rate before they arrive in the super fund. As these are already taxed, no further tax is paid by the fund.

Secondly, all the earnings from the combined invested contributions ***are taxed within the super fund every year at 15%.*** Since no super withdrawals by members are permitted before retirement, these investment earnings are reinvested and subject to compounding.

The effect of this tax on earnings is to reduce the amount reinvested and that effect is also cumulative. Whatever the fund can earn on its investments, only 85% of it can be reinvested after the 15% tax (ignoring fees). If, for example, a super fund can earn 8% on its investments, only 6.8% is reinvested each year.

To illustrate this, imagine a non-concessional super contribution of $10,000. If this was treated the same as a contribution to a retirement fund as in other countries, and we assumed an investment return of 8% for 40 years, this would compound to $201,153. A sizeable nest egg.

Now let's assume that this was a salary sacrifice concessional contribution. It would be taxed as a contribution at 15% in the fund prior to investment so that only $8,500 was invested for 40 years. When this is compounded at 8% over 40 years, the result is lower because it compounds from a smaller amount. It is now $170,980.

If we account for the cumulative effect of the 15% tax on investment earnings, the compound rate over 40 years is only 6.8%, not 8% on an initial investment of only $8,500, not $10,000. The retirement balance is then $110,585. That differential is entirely due to the combined effect of these taxes.

Clearly the result of such a projection is highly sensitive to the compound earning rate selected and the length of time for that compounding to take effect, but the result of these two super taxes (on entry and on earnings) is more substantial than a 'concessional' tax of 15% would suggest.

Instead of claiming that super benefits in retirement are tax-free, it would be more honest to describe these retirement benefits as tax-paid.

It is the fact that super is tax-paid that creates complications. For example, if there is money remaining in a super fund on death, there is an additional tax on the death benefit. That tax amount depends on the beneficiary. A spouse and dependent children can collect it tax free but adult children pay an additional death tax. More importantly the tax payable depends on the proportion, not the amount, of non-concessional contributions within the fund because that part of the death benefit is regarded as a return of the contributor's own money. Because it has already been taxed as a contribution, it is therefore tax free as a death benefit. By contrast, the concessional component has only ever been concessionally taxed and is therefore subject to this death tax.

More tax, please

One might ask why, when designing this super system in 1993, Treasurer Keating adopted this complicated hybrid system compared to other simpler retirement savings systems around the world. The answer is simple. He was not prepared to wait 40 years before the government collected any tax from these retirement savings. The legacy of that decision, however, is that we now have a super system that causes much confusion and intergenerational envy.

Jon Kalkman is a former Director of the Australian Investors Association. This article is for general information purposes only and does not consider the circumstances of any investor. This article is based on an understanding of the rules at the time of writing and anyone considering changing their circumstances should consult a financial adviser.

Labor had no choice on stage 3 tax cuts

Rodney Brown

Despite the impassioned discourse across Australia's major mastheads, realistically Prime Minister Anthony Albanese and Treasurer Jim Chalmers had no choice regarding the stage 3 tax cuts. Clearly, the current state of the economy is far different from that in 2019 when the Coalition tabled the tax cuts, which provided impetus for the modifications to be made. Given where we are at in the political cycle coupled with sustained cost-of-living pressures, Labor would have found it difficult to stick with the legislated stage 3 tax cuts that would have predominantly rewarded high income earners.

The famous quote attributed to both John Maynard Keynes and Winston Churchill comes to mind:

> "*When the facts change, I change my mind. What do you do, sir*?"

Unsurprisingly, at the National Press Club announcement, Albanese was quoted as saying:

> "*We are being very upfront with the Australian people that when economic circumstances have changed, it is a responsible thing to do to change our policy*".

Three main questions

Broadly, three questions remain (brief thoughts are only offered on the first two):

1. Will the decision to rework the legislated tax cuts hurt Labor politically?
2. Will the new tax cuts be inflationary?
3. Are the modified tax cuts a good change of policy?

The answer to the first is uncertain but early evidence is that it won't. While the revamped tax cuts represent a broken promise, they are not removing an established benefit. Rather, all taxpayers receive a tax cut, it's just that some receive less than they were expecting. It is hard to argue it will significantly damage Labor given Treasury analysis shows 84% of taxpayers will be better off in 2024-25 under the changes corroborated by Grattan analysis that shows 83% will be better off during the decade to 2033-34.

In the end, you win elections for getting things done, not by breaking promises. I am surprised people are surprised a politician has broken a promise (anyone remember John Howard's "never ever" promise on the GST…?).

The jury is still out on the second question. The reality is that no-one knows for sure as it depends on several factors including how people will spend their tax cuts. But given the cost-of-living crisis and the fact low- and middle-income earners are struggling with higher interest rates, then it is reasonable to expect the cuts to be largely directed towards mortgage payments which will not impact inflation. Further, given the lack of confidence in the economy, it seems unlikely the post-tax income boost will lead to a huge increase in discretionary spending. Indeed, the Commonwealth Bank's head of Australian economics said that if all the extra tax relief to low- and middle-income earners was spent, it would boost overall consumption by $4 billion which is a rounding error in a $2.6 trillion economy.

An important point: change not reform!

Before answering the third question, an important point needs to be made. Despite the modifications being touted as 'tax reform' by some, they are *not* tax reform but merely another ad hoc change. In contrast, tax reform requires a long-term objective and a series of substantial changes that when implemented, will achieve the long-term objective. Reform is to re-shape in a positive manner (i.e., improvement) and is structural not transitory (tax rates and scales change relatively regularly).

Are the changes good tax policy?

In the lead up to the backflip, the prevailing winds of public opinion were that the legislated cuts were unfair (i.e., they benefit higher income earners), inflationary, and would worsen inequality (especially for women). There is little doubt, as outlined by Treasury, the modifications improve equity (vertical and gender) and efficiency (more people encouraged to work), help reduce the reliance on personal income tax, and give back *some* of the stealth tax called 'bracket creep'. Accordingly, they will help many with the cost of living. However, they could have gone much further to increase the equity, efficiency, and simplicity of the Australian personal tax system.

A politically opportune and socially acceptable alternative

My proposal, based on a unique feature of the UK's tax system coupled with the implementation of one of Ken Henry's recommendations, offers an alternative that not only improves fairness but provides a raft of other benefits.

The UK has a progressive income tax system similar to Australia's with increasing marginal tax rates as taxable incomes climb. But a key difference is taxpayers' 'Personal Allowance' of £12,570 (their equivalent to our tax-free threshold of $18,200) reduces by £1 for every £2 that a taxpayer's income is above £100,000 (roughly $187,000) meaning the allowance is zero once income reaches £125,140 (roughly $234,000).

The thrust of my proposal is to keep the stage 3 tax cuts as originally legislated but reorient them to Australians in more need while simultaneously returning more bracket creep to middle- and high-income earners as intended. The cherry on top is a substantial reduction in tax system complexity.

First, the tax-free threshold should be increased in line with the recommendation of the 2009 Henry Tax Review. The Review's favoured model was a tax-free threshold of $25,000 (this equates to roughly $35,000 in today's dollars).

Second, the tax-free threshold is phased out for higher income earners. For instance, it could reduce by 25 cents for every dollar taxable income exceeds $200,000 (where the top marginal tax rate was to kick in from 1 July this year).

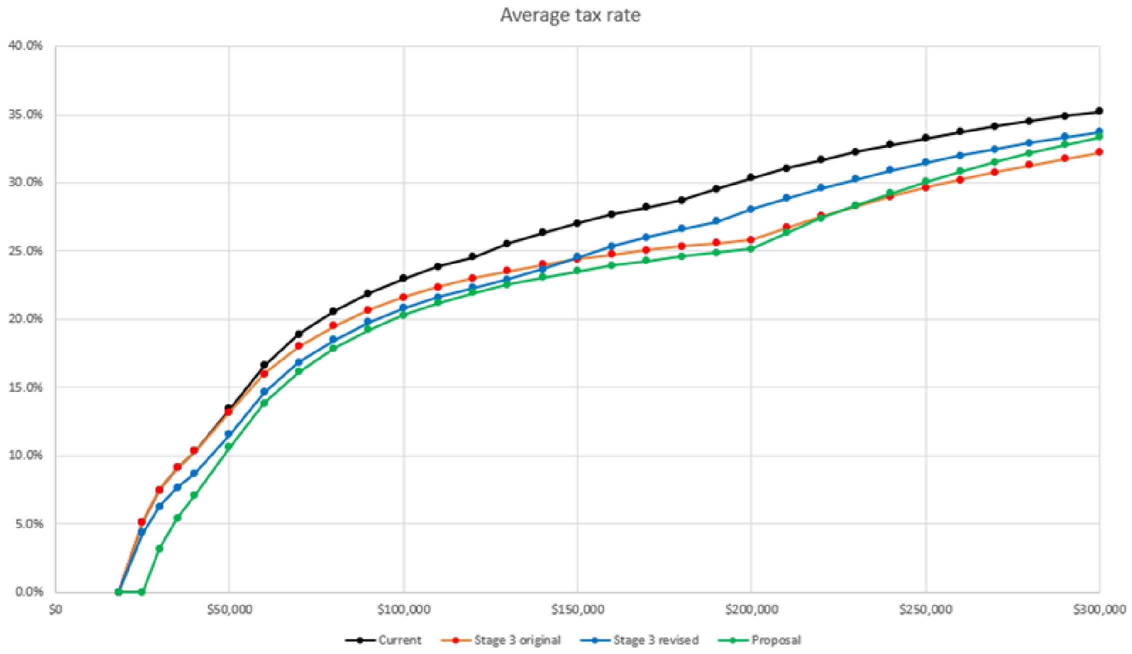
Third, the tax brackets in the original Stage 3 cuts are retained (i.e., a marginal tax rate of 19% on taxable income between $25,000 and $45,000; a marginal tax rate of 30% on taxable income between $45,000 and $200,000; and a tax rate of 45% for taxable income exceeding $200,000).

Everyone's a winner!

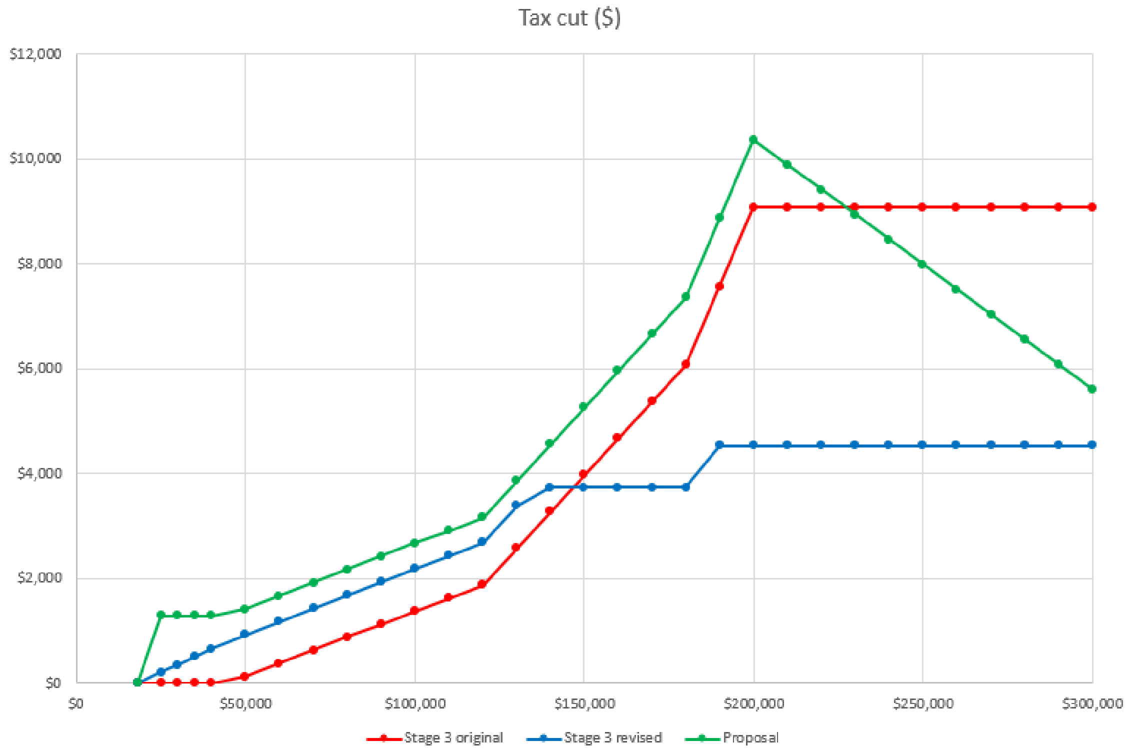
The table below reveals that all taxpayer's gain under the proposed alternative relative to the current system and the revised stage 3 tax cuts. However, those earning above $230,000 in taxable income (around 350,000 people or 3% of all taxpayers) enjoy less tax cuts compared to the original Stage 3 tax cuts but more than the revised version.

TAXABLE INCOME	TAX CUT			TAX CUT AS A % OF INCOME		
	Stage 3 original	Stage 3 revised	Proposal	Stage 3 original	Stage 3 revised	Proposal
$18,200	$0	$0	$0	0.0%	0.0%	0.0%
$25,000	$0	$204	$1,292	0.0%	0.8%	5.2%
$30,000	$0	$354	$1,292	0.0%	1.2%	4.3%
$35,000	$0	$504	$1,292	0.0%	1.4%	3.7%
$40,000	$0	$654	$1,292	0.0%	1.6%	3.2%
$50,000	$125	$929	$1,417	0.2%	1.9%	2.8%
$60,000	$375	$1,179	$1,667	0.6%	2.0%	2.8%
$70,000	$625	$1,429	$1,917	0.9%	2.0%	2.7%
$80,000	$875	$1,679	$2,167	1.1%	2.1%	2.7%
$90,000	$1,125	$1,929	$2,417	1.2%	2.1%	2.7%
$100,000	$1,375	$2,179	$2,667	1.4%	2.2%	2.7%
$110,000	$1,625	$2,429	$2,917	1.5%	2.2%	2.7%
$120,000	$1,875	$2,679	$3,166	1.6%	2.2%	2.6%
$130,000	$2,575	$3,379	$3,866	2.0%	2.6%	3.0%
$140,000	$3,275	$3,729	$4,566	2.3%	2.7%	3.3%
$150,000	$3,975	$3,729	$5,266	2.6%	2.5%	3.5%
$160,000	$4,675	$3,729	$5,966	2.9%	2.3%	3.7%
$170,000	$5,375	$3,729	$6,666	3.2%	2.2%	3.9%
$180,000	$6,075	$3,729	$7,366	3.4%	2.1%	4.1%
$190,000	$7,574	$4,529	$8,866	4.0%	2.4%	4.7%
$200,000	$9,074	$4,529	$10,366	4.5%	2.3%	5.2%
$210,000	$9,074	$4,529	$9,891	4.3%	2.2%	4.7%
$220,000	$9,074	$4,529	$9,416	4.1%	2.1%	4.3%
$230,000	$9,074	$4,529	$8,941	3.9%	2.0%	3.9%
$240,000	$9,074	$4,529	$8,466	3.8%	1.9%	3.5%
$250,000	$9,074	$4,529	$7,991	3.6%	1.8%	3.2%
$260,000	$9,074	$4,529	$7,516	3.5%	1.7%	2.9%
$270,000	$9,074	$4,529	$7,041	3.4%	1.7%	2.6%
$280,000	$9,074	$4,529	$6,566	3.2%	1.6%	2.3%
$290,000	$9,074	$4,529	$6,091	3.1%	1.6%	2.1%
$300,000	$9,074	$4,529	$5,616	3.0%	1.5%	1.9%

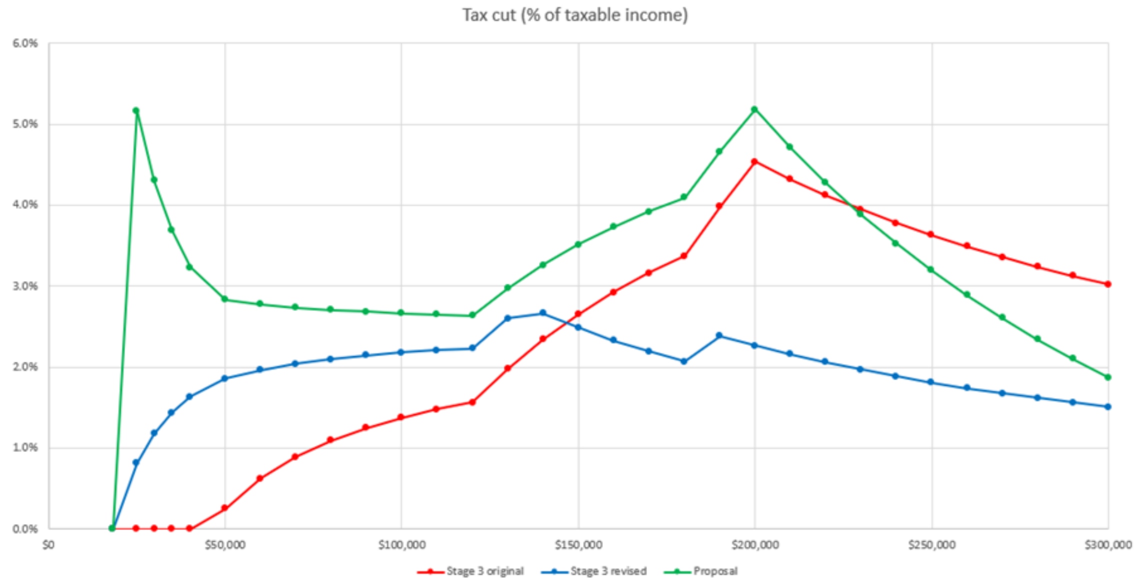
The proposal would lead to a decrease in the average tax rate:



The proposal would put more money into the pockets of all taxpayers relative the revised tax cuts but tapers off at the higher income levels.



Importantly, as a percentage of income, the proposal would see all income earners gain relative to the revised cuts, but higher income earners enjoy less relative to the original cuts.



Benefits of the proposal

The benefits include:

- It heeds the Henry Review's call that "a high tax-free threshold with a constant marginal rate for most people should be introduced to provide greater transparency and simplicity". Streamlined tax brackets are simple and offer incentives to work.
- Removes approximately 350,000 taxpayers from the tax system (based on the latest ATO statistics for the 2020-21 income year). This group represents 3% of all taxpayers and accounts for 0.8% of total taxable income but only 0.1% of total net tax paid. These taxpayers would no longer need to pay any income tax, and many would not have to lodge a tax return greatly simplifying the personal tax system. Interestingly, if the tax-free threshold were increased to $35,000, 1.6-1.7 million taxpayers (14% of all taxpayers) would be removed from the tax system (they account for 4.7% of total taxable income but only 0.9% of total net tax paid).
- Lower tax system costs – lower administration costs for the ATO (resources could be directed elsewhere) and lower compliance costs for taxpayers.
- Reduces Australia's over-reliance on incentive blunting income tax (as advocated by the OECD and IMF).
- Increased after-tax income for low-income earners struggling with cost-of-living pressures. This group is predominantly female, so this also helps restore gender equity (around 55% of the group no longer required to pay tax are female).
- Aligns the marginal tax of most taxpayers (around 69%) to the main corporate tax rate of 30% thereby minimising incentives to incorporate to reduce tax.
- Ensures high income earners still receive some benefit to compensate for bracket creep.
- Provides a greater incentive for people to engage in paid work thereby strengthening the bond between below-average income earners and the labour market. This should encourage more women into the workforce and may help with skill shortages.

Costs of the proposal

Potential drawbacks include the possibility the tax cuts are inflationary and a negative impact to the federal budget. However, the Treasury analysis reveals that while the redesign of stage 3 is broadly revenue neutral in the short term (reduces tax receipts by $1.3 billion over the forward estimates period from 2023–24 to 2027–28), it will increase tax receipts by around $28 billion over the medium term from 2023–24 to 2034–35. This is the 'black hole' Peter Dutton refers to. Why not give more back to taxpayers now?

Of course, additional budget cost may lead to other piecemeal tax 'changes' to raise revenue. Rightly or wrongly, Labor was badly burnt at the 2019 election on the back of a platform that included proposed restrictions on franking credits and negative gearing and halving the capital gains discount from 50% to 25%. Despite the potential revenue on the table (the latest *Tax Expenditures and Insights Statement* released by Treasury last week reveals that for 2023-24, the revenue forgone is $27.1 billion for rental deductions, $56.61 billion for superannuation concessions and $19.05 billion for the CGT discount for individuals and trusts), the 2019 experience will still be fresh in Labor memories meaning Albanese and Chalmers are unlikely to go down this path unless it is part of a comprehensive tax reform package.

Speaking of which, the primary downside of my proposal (or any other offered in isolation) is that it does not form part of a broader reform package with comprehensive changes. It should, and most business leaders and tax experts are now sensibly advocating for such an approach.

So, where to from here?

The proposal outlined here could be tweaked in a myriad of ways, but its essence remains unchanged. That is, *all* taxpayers are more fairly compensated for bracket creep (this is a continual process since tax brackets are not indexed for inflation) and more support is provided to low- and middle-income earners to help with the cost-of-living crisis.

It should be an interesting week or two in Parliament. Nonetheless, it is frustrating that both parties continue to tinker with the tax system in an ad hoc manner and argue over piecemeal changes while trying to score political points. In doing so, they are letting politics trump policy and continuing to delay the comprehensive tax reform Australia so desperately needs.

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Graham Turner on lessons from 40+ years of Flight Centre

Lawrence Lam

Much has been written about Graham Turner's career and how he grew Flight Centre from a single shop in 1982 to a global enterprise generating $3 billion of revenue in over 80 countries. But not many know about the proverbial mountains he's climbed to get to where he is today. From these obstacles, he honed his uncanny business intuition. In my interview with 'Skroo' (as he prefers to be called), we delve into these experiences and the lessons he's learned over decades in business.

Big businesses start small… but always differentiated

Introverted, Intuitive, Thinking and Prospecting. This is the combination of descriptors that make up Skroo's Myer's-Briggs personality type. In their natural state, INTP types are quiet thinkers with vigorous intellects. They enjoy seeking out unlikely paths and taking an unconventional approach.

It becomes abundantly clear these descriptors fit very well with all that Skroo has overcome in his business journey. It explains why he started a business on the other side of the world 'just for fun' with a few mates over 50 years ago.

Just as intriguing as the *why*, is *how* he scaled from one bus in 1973 to over 70 by 1980, running tours all over Europe. Skroo tells me the story of how he purchased the first bus and launched Top Deck Travel.

At the time bus tour companies were in great abundance throughout London. There was no shortage of competition. But when Skroo and his mates fitted out their first bus, he fitted them with a kitchen and bedrooms, capable of taking long-haul trips as far as Afghanistan. It came simply from the fact they wanted to see more countries on a shoestring budget, but in doing so had inadvertently stumbled across his first business lesson: in competitive markets, a subtle differentiation can open up new pockets of demand. Competitors at the time were focused on coach camping tours, not long-haul tours like Skroo's bus. What Top Deck offered was unique and fun. Customers could cook, sleep and visit more countries, which made it an attractive and unique proposition.

A unique value proposition

The ease with which seats were filled gave Skroo and his business partner a taste of early success. Although the business concept of blue oceans would be popularised some decades later, Skroo had already discovered the advantages of creating new markets early on through the differentiation of the tour experience. The unit economics were prime for scaling. At a cost of £12 in weekly marketing costs (Skroo tells me the first ads were placed in a weekly travel newspaper published in London called the Australasian Express), Topdeck could confidently fill a bus which would deliver revenues of £1,650. Even accounting for other expenses, each trip was profoundly profitable.

Scaling became easy with the growing demand and self-generating cashflows. Two years into operations, Topdeck made £15,000 profit and had several buses touring all over Europe. Along the way, he enjoyed many free overland trips, including a 3-month drive from London to Kathmandu. Underneath Skroo's thoughtful and calm demeanour was a strong desire for growth and success. He still enjoys winning in the game of business. As he says, "founders are generally empire builders. One bus was never enough for me. It had to be 2, 3, or 10."

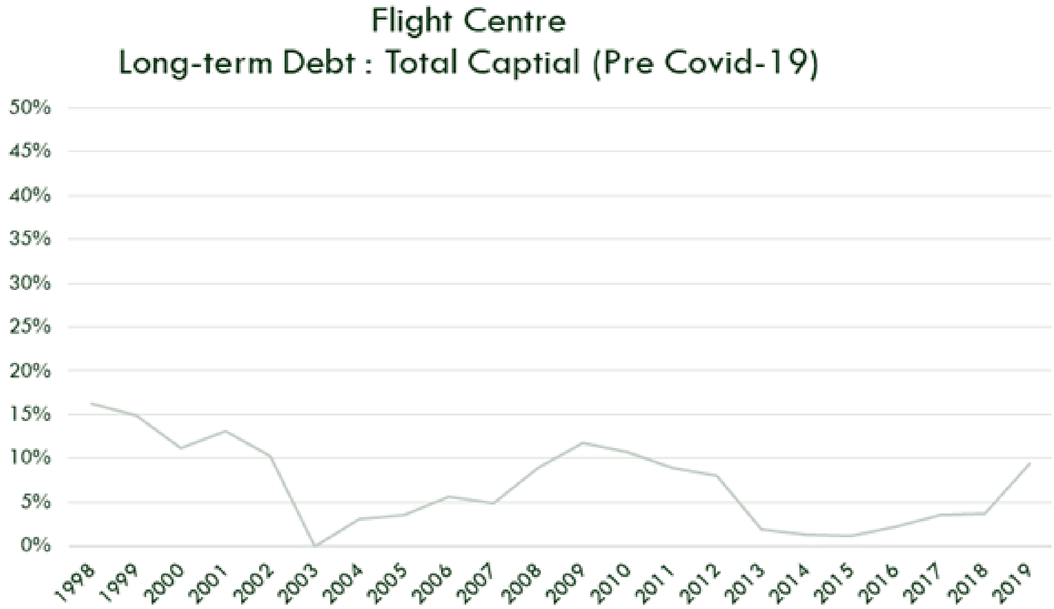
But how does a founder balance the investment required to scale, with the cash needs in the short-term? It was a question of balancing long-term growth and short-term liquidity. Initially, they developed a general rule: every bus purchase should only be made if they were confident it could be paid back in 2-3 trips. The model worked well for the first 10 years as they scaled but by 1980 the market changed. Skroo was about to learn his toughest lesson in business when Topdeck almost filed for bankruptcy.

Balancing liquidity and scalable unit economics

By 1980 Topdeck had 70 buses all over Europe and despite the strong growth trajectory, found itself short of cash when forward bookings in the winter were weaker than expected. And because it had a model that relied on rapid scaling and reinvestment of cash back into more buses, Topdeck became exceptionally reliant on forward bookings. It was the business's first near death experience and taught Skroo a lesson in cash management. Its importance became abundantly clear as Skroo was turned down by banks who had no interest in financing a bus tour business. There would be no white knights. No one was going to save Topdeck in its most crucial time of need. As Skroo aptly puts it: "banks are more likely to loan money to those that don't need it".

They survived only because cash from bookings originating from Australia and New Zealand started flowing through in April of 1980. The southern hemisphere booking season had come through just in time. It was a close call. Survival had come from internal cash, not external. In business there is no such thing as a deus ex machina.

For Skroo, the importance of cash is a recurring lesson he sees over and over again. Forty years on, even after he left the Topdeck business in 1986 and returned to Australia to eventually start Flight Centre, his recollection of that moment is as visceral as ever. That moment shaped how Flight Centre would manage its cash position, and the amount of debt it would hold going forward.



Source: Lumenary Investment Management research; S&P Capital IQ

Finding a niche

Founders like Skroo always find a way to reinvent and adapt. Motivated by a return to Australia with his family, he looked to exit Topdeck but still had one eye on his next move. From his time in London, he noticed the travel market in Australia by comparison was relatively homogenous, controlled predominantly by big institutions who were happy selling exorbitant airfares with little competition. Skroo saw this environment as a ripe opportunity to build a niche - discount travel. He would have an edge sourcing flights from overseas airlines looking to offload tickets at the last minute given his connections in London.

The discount airfare retailers, known as bucket shops in London, was a concept not well known to Australia. At the time, airfare discounting was illegal. It was only a few years later that regulations would change and allow the market to open. As Skroo recalls, there were a few discount retailers who were prosecuted, but he was lucky to avoid this and flourish when the regulations were updated. He fondly remembers the deliberately handwriting messy promotions on shopfront blackboards as a tactic to attract the discount bargain hunters.

“Again we got into a niche that meant we could almost have as many customers as we wanted within reason” - Graham Turner

Taking the cash lessons from Topdeck, market entry was conservatively executed, preserving cash through the use of partnerships in the pursuit of an expansion strategy. When Flight Centre opened its first stores in Brisbane, Sydney and Melbourne, it did so via joint venture arrangements which minimised the amount of cash required. From those three domestic shops, they would eventually spread internationally not long after.

Part 2 of this feature story on Graham Turner will appear in Firstlinks next week.

Lawrence Lam is Managing Director and Founder of [Lumenary Investment Management](), a firm that specialises in investing in founder-led companies globally.

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When is the right time to pull the plug on an investment?

Tom Stevenson

When I said recently that it can be better for an investor to travel than to arrive, I was referring to the Japanese market's surge to within a whisker of the peak level it reached back in 1989. But the Nikkei 225 is not the only investment begging the question of whether or when to sell. Recently both the US and India hit new all-time highs.

Of all the questions facing an investor, when to sell is perhaps the hardest. Not least because, unlike with the decision to make an investment, selling it requires you to undo something in which you have already invested intellectual, emotional and financial capital. That is psychologically hard to do.

There are plenty of reasons to sell an investment. Some of them are good, some bad. It's important to understand why you are deciding to pull the plug.

One of the reasons people struggle to decide whether or not to sell is that they don't know why they bought in the first place. It is impossible to judge whether your investment thesis has changed if you don't know what it was at the outset. So, write it down. Keeping an investment diary can give you something tangible against which to measure your decision. It's good to remind yourself why you got together all those years ago!

Good reasons to sell

Changing circumstances are a good reason to change your mind. The danger here is that you're not the first to notice that things are different. Markets are pretty good at pricing in change. But what they are less good at is assessing the scale or durability of that change. This is why selling after bad news can still make sense. Humankind cannot bear very much reality. It can take quite some time for the penny to drop, and a share that has fallen by 50% can still lose another 100%.

Another good reason to sell is because you made a mistake. We all do it. Indeed, a successful investor can be one who simply makes more good decisions than bad. If you run your profits and cut your losses, a hit rate of only 50% might be good enough.

One underrated reason to sell is to reduce the risk of holding onto a winning trade. I once advised a friend who had made a fantastic investment to sell enough shares to reduce his purchase cost to zero. It's much easier when it's other people's money. At the time he could have done this by selling as little as a third of his holding. Doing so would have ensured that the worst possible outcome would be just getting his money back. He didn't and it wasn't.

Most of the other good reasons for selling are personal. Your risk appetite may have changed, and you can no longer tolerate the potential downside of an investment. You might simply need the cash. That, after all, is the reason we invest in the first place. To be able to spend our money one day in the future. Eventually, that day arrives. Meanwhile, you might be lucky and find that one or two good investments have shifted your portfolio away from your desired weightings. Rebalancing is a good reason to sell.

Bad reasons to sell

What about the bad reasons to sell? Again, there are many. The worst reason to sell is because you have made a profit. Ironically this is also the easiest circumstance in which to bail out. Securing a profit provides temporary validation. And if the investment fails to notice that you have sold it and continues to rise, it's easy to look the other way. Having a target price sounds sensible but it rarely makes sense to exit a winning trade. The trend is usually your friend.

Almost as bad is to sell because you have made a loss. At times, it can make sense to draw a line under a failed trade, but never simply because the price has gone down. This tells you nothing except what other investors are doing and how deeply ingrained is your loss aversion. It says nothing about the investment itself or whether you should stay or go.

The only thing worse than acting on the basis of what other investors are doing is responding to what they are saying. By definition, the commentary and news flow around a share that has fallen will be negative. Being a contrarian is a hard trick to pull off consistently, but it is essential. Going against the herd stimulates the same part of the brain as physical pain. It really hurts to be outside the group. But it is madness to do what everyone else is and to expect a different outcome.

One final, really bad reason to sell is because you are scared. If the news headlines are so grim that you want to hide in a corner until things look better, you can be sure every other investor feels the same way. That can be a recipe for abandoning an oversold investment that's ripe for a rebound. The only worse emotion than fear as a trigger for selling is boredom. Very often we just feel we need to do something. Invariably we shouldn't.

Sticking with it

Given the propensity for markets to go up over time, the safest default is to do nothing. Time is a great healer. But there are times when the odds are stacked against you making an acceptable return in a reasonable timescale. Signs that the risks outweigh the potential rewards include significantly higher valuations than the long-term averages, very narrow market leadership, and a widely shared consensus. Nothing should get your antennae twitching more than everyone agreeing about something.

Tom Stevenson is an Investment Director at [Fidelity International](), a sponsor of Firstlinks. The views are his own. This document is issued by FIL Responsible Entity (Australia) Limited ABN 33 148 059 009, AFSL 409340 ('Fidelity Australia'), a member of the FIL Limited group of companies commonly known as Fidelity International. This document is intended as general information only. You should consider the relevant Product Disclosure Statement available on our website www.fidelity.com.au.

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Is a large Chinese renminbi devaluation coming?

Andrew Swan

This is an edited transcript of comments from Andrew Swan, Man GLG's Head of Asia ex-Japan Equities, at a media briefing hosted by Firstlinks' sponsor GSFM.

What's striking about Asia at the moment is that for most of my career, it has been very synchronous with global growth. And in the last 12 to 24 months, we've seen very asynchronous growth in Asia, to the rest of the world and also within Asia itself. I think a lot of that has to do with the lingering effects of COVID and how that affected the world differently … and the inflation pressure that emerged in the West which didn't emerge in Asia.

Bright outlooks for South and North Asia

[There are] three buckets in Asia at the moment. There are domestic demand economies, which are most of Southeast Asia or South Asia, including India, Indonesia, and the Philippines, and Thailand. The real story here is: growth is good. More domestic demand driven rates are fairly high in these markets because of what the Fed has been up to. And, really looking for a green light from the Fed to cut rates. So, what is already a good environment here can actually get better, and the growth cycle can elongate as rates come down.

The second bucket is more the global demand North Asian economies. And while demand is slowing down, there is this thing called AI that will supercharge the tech cycle, and Asia is a big beneficiary of that, particularly within semiconductors. But even further downstream, that's what's going to be interesting. This year, most of the AI euphoria has been in upstream, in semiconductors and the cloud. And now we're just on the cusp of seeing how that stimulates demand downstream.

So, you're going to see a lot more AI related functions in your phones and your iPads, in your laptops and in your PCs. And when you see this step changing technology, you tend to see a lot of innovation that drives demand after what has been a fairly weak demand environment for consumer electronic products. I think you're on the verge of a new cycle.

The outlook for those economies and companies in the region which are exposed to the tech cycle, I think looks very good.

China's economic model is dead

Then there's the big bogey in the room being China. What has surprised us is how quickly China has moved into a deflationary environment and even idiosyncratic opportunities within the economy have been swamped by this deflationary force that's emerging.

Now, my view on China - it's at the end of the cycle. It's been led by investment and debt, and it has to change. The problem with change and structural changes - normally there's pain involved. And normally, policymakers will do nothing until they have to. I guess we're getting closer to that point where they're going to have to do something because the pressure on the domestic economy and the equity market is going to force their hand at some point.

What has been surprising is the resilience of the currency in the scheme of what's going on in deflationary environment. I do think the China has accumulated a lot of FX (foreign exchange) reserves offshore in the banking sector, not so much with the PBOC (People's Bank of China). But certainly the state-owned banks have held a lot of FX reserves, and if you look at FX reserves in the PBOC, they haven't really changed despite these deflationary forces. I think that's because these hidden reserves are being used to support the economy, but that only lasts so long. China is in this situation where they really need the currency to depreciate to make the economy more competitive.

Source: [Yahoo Finance]

They're running very high real interest rates, which supports the economy the currency in the short term but puts pressure on the economy over the medium term.

China has two main options

There are two options here for China, which are structural in nature:

- a one-off devaluation of the currency; a large devaluation of the currency. Now, certainly the policymakers are not suggesting anything like that. But the reality is, if you're going to devalue your currency, you do it from a position of strength, not weakness. There is very much school of thought that China may do a one-off devaluation to get ahead of these problems.
- the second option for China around structural reform is the savings rate is extremely high and consumption is very low. How do you break that? I think a lot of this has to do with the social safety net, which is broken. The hukou system needs to change. The comments coming out of Xi Jinping in recent weeks and months have started to include social welfare reform, which needs to be watched very closely. Anything that can give people confidence - that there's something there for a rainy day - will lead them to consume more. And that's really what China needs.

Overall, the market is getting a little bit too bearish about China. There are definitely some challenges, but there is still opportunity. When you get these periods of dramatic sell off, that's when policymakers normally are forced to respond. And we haven't seen it yet but we're getting closer.

The final point is the fiscal deficit in China contracted a lot last year because they [policymakers] felt the economy would recover quite strongly. There's definitely scope on the fiscal front for China to do more this year in the face of weakness.

Andrew Swan is Head of Asia ex-Japan Equities at Man GLG, a fund manager partner of GSFM, a Firstlinks sponsor. The information included in this article is provided for informational purposes only.

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Build to Rent is growing fast off a low base

Stuart Cartledge

Late last year, Phoenix participated in an Investor Day, hosted by listed REIT, Mirvac Group, that focused on 'Living Sectors'. Aside from the joy of wearing a high-vis jacket, those with an eye for detail will notice the badge, clearly indicating that the occupant of the jacket is a 'Young Worker'.

In this article we share with you some of the lessons learned by that young worker from the day.

Our housing problem

Australia has a housing crisis. We may have had an inkling of this one before the tour, but with an estimated 1,000,000 new immigrants expected to arrive in Australia over the next three years, requiring approximately 400,000 dwellings, we're going to have to get cracking with the government's new housing targets.

The chart below puts these figures into the context of what has been delivered in the past. The key takeaway for us is that the Australian Government may well be having another Utopia moment.

With demand likely to remain robust, and rental markets as tight as a drum, the opportunity for an entity such as Mirvac Group to deliver product into this environment is compelling.

What is "Build to Rent"?

Build to Rent (BTR) is the creation of residential dwellings, typically apartments, which instead of being strata titled and sold to individuals, remain institutionally owned, professionally managed, and represent high quality rental accommodation, often including a higher level of amenity than competing product. Furthermore, a resident has security of tenure, not just through a lease, but because the entire building forms part of a long-term residential community.

An investor in BTR benefits from typically high occupancy rates, with multiple tenants delivering low volatility of income and stable valuations. Well-designed buildings should certainly benefit from relatively low maintenance capital requirements, at least initially, and certainly do not suffer from the requirement to incentivise tenants with expensive fit outs that plague the office leasing market.

While BTR may be a relatively new concept in Australia, it is a mature property sub-sector in offshore markets, particularly in the US, where it is referred to as 'multi-family'.

Mirvac is pioneering BTR in Australia

The BTR sector is embryonic in Australia, representing less than 0.5% of housing stock across the country. This compares with a ~12% penetration in the US and around 5.4% in the UK. The opportunity set is therefore large.

Mirvac has branded its BTR product with the “LIV” name, and delivered LIV Indigo, its first project in Sydney Olympic Park back in September 2020. That project is now 94% occupied. LIV Munro, opposite Queen Victoria Market in Melbourne’s CBD is the second completed project which opened at the end of last calendar year and is now 70% occupied. LIV Munro is pictured below.

The tour showed investors around LIV Munro enabling us to get a feel for the amenity, including pool, gym, dining areas, podcasting rooms and rooftop BBQ and relaxation facilities and to meet the on-site staff responsible for the community experience. We were impressed.

We also visited LIV Aston, a project under construction on the corner of Spencer Street and Flinders Street West, also in Melbourne’s CBD. Hard hat required! With a total of 474 apartments, the construction project was on time and budget and is expected to compete before the end of the current financial year. This project is almost adjacent to another, yet to be competed, BTR project currently being developed by Lendlease. It will be interesting to see these projects go head-to-head when they are both operational.

Alongside the three projects referred to above, Mirvac has another 2 projects under construction, one in Melbourne and the other in Brisbane, which will bring their collective exposure to BTR to approximately 2,200 apartments across 5 projects.

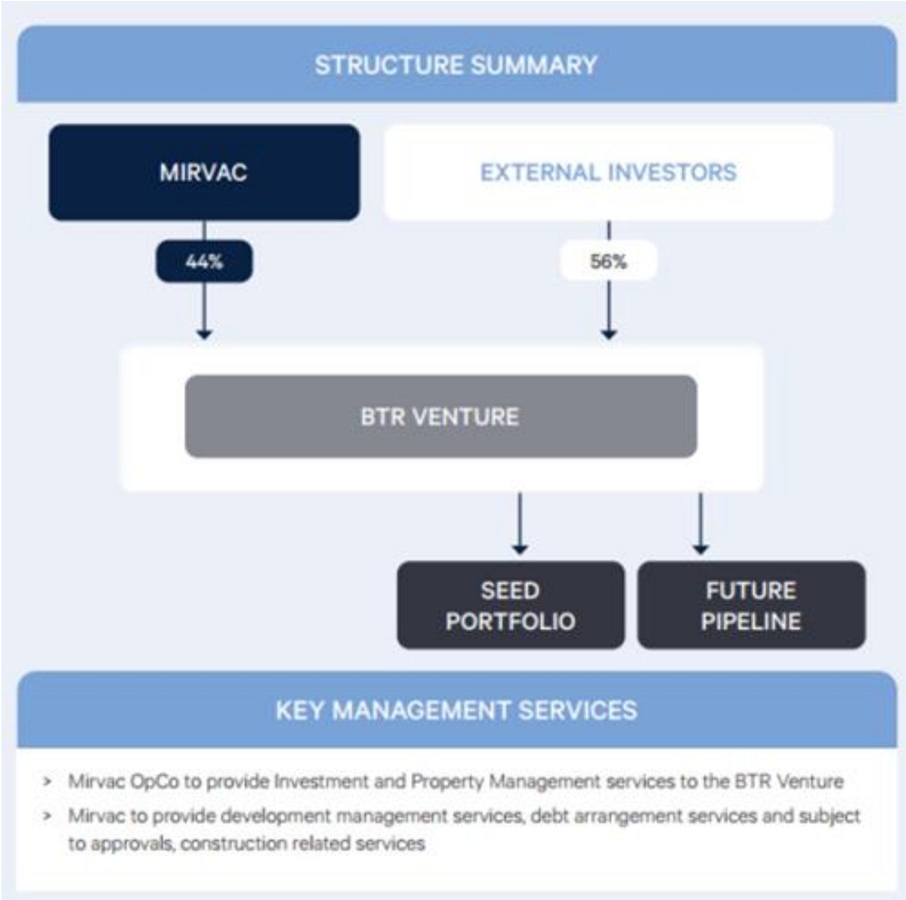
Financial metrics are interesting

Financial modelling for BTR is made a little tricky by some big movements in construction costs over the last few years, which ordinarily would lower returns, combined with some offsetting and also significant market rental increases in the residential sector. For Mirvac, the end result is a stabilised yield on cost of 4.5-5.0%. Along with rental growth, maintenance costs and ancillary income, the investment return (Internal Rate of Return) is estimated to be around 7-7.5%.

Mirvac’s investment in the sector is structured in a joint venture as shown in the diagram below.

External investors sit alongside Mirvac, and enjoy investment returns that benefit from active management of the assets.

In addition to the returns on capital invested in the joint venture, Mirvac also earns funds management, development management and asset management fees across the platform. This fee stream is more volatile but adds to the returns that Mirvac's shareholders enjoy.



Phoenix assumes that Mirvac is able to build out its current pipeline of BTR opportunities and will be able to identify future projects to reach its medium-term target of 5,000 apartments on the platform. Importantly, we also assume that the company will be able to continue to partner with external investors to deliver a solid outcome for all stakeholders.

We expect the BTR market to get more competitive, but with penetration rates so low and the demand for housing so high, we forecast a solid runway for the foreseeable future. The only sad thing about the day was the discovery that BTR is typically targeting the affluent renters, aged between 25 and 39. The "young worker" on this tour is more likely a target for the over 55 land lease portfolio, which we will write about in future.

Stuart Cartledge is Managing Director of Phoenix Portfolios, a boutique investment manager partly owned by staff and partly owned by ASX-listed 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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A guide to investing in a US election year

Capital Group

US Presidential elections can be divisive and unsettling. At times, the fate of the world seems to hang in the balance. But when it comes to investing, do elections really matter that much?

US voters will have their say in November 2024, but by maintaining a long-term focus, investors can position themselves for a brighter future regardless of the outcome at the voting booth. In fact, overreacting to short term volatility during election cycles can be detrimental to investment returns.

In this guide, we address questions about investing in an election year, drawing insights from our analysis of over 90 years of investment data across 23 election cycles.

Which political party has been better for investors?

Investing during an election year can be tough on the nerves, and 2024 promises to be no different. Indeed, politics can elicit strong emotions and biases, but investors would be wise to tune out the noise and focus on the long-term.

That's because elections have, historically speaking, made essentially no difference when it comes to long-term investment returns.

What should matter more to investors is staying invested. A US $1,000 investment in the S&P 500 made when Franklin D. Roosevelt took office would have been worth over US$19 million as at 30 June 2023. During this time there have been eight Democratic and seven Republican presidents.

Current economic and political challenges may seem unprecedented but a look at past election cycles shows that controversy and uncertainty have surrounded every campaign. And in each case the market has continued to be resilient over time. Successful investors stay the course and rely on time in the market rather than timing the market.

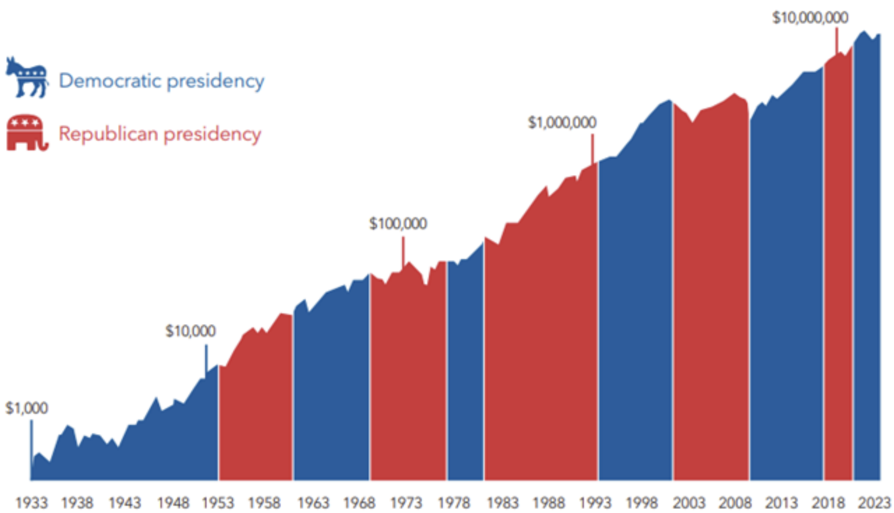
Bottom line: US stocks have trended up regardless of whether a Democrat or Republican won the White House.

What typically happens to the stock market during election years?

Markets hate uncertainty, and what's more uncertain than primary season of an election year? With so many candidates on the campaign trail, the range of outcomes can feel daunting.

But the volatility is often short lived. After the primaries are over and each party has selected its candidate, markets have tended to return to their normal upward trajectory.

Growth of a hypothetical US$1,000 investment in S&P 500 Index



Past results are not a guarantee of future results.
Chart shows the growth of a hypothetical US$1,000 investment made on 4 March 1933 (the date of Franklin D. Roosevelt's first inauguration) through 30 June 2023. Dates of party control are based on inauguration dates. Values are based on total returns in USD. Shown on a logarithmic scale. Sources: Capital Group, RIMES, Standard & Poor's.

Patient investors who stay the course have often been rewarded. Since 1932, stocks have gained an average of 11.3% in the 12 months following the conclusion of the primaries (using 31 May as a proxy) compared to just 5.8% in similar periods of non-election years.

But keep in mind, these are just averages. Investors shouldn't try to time an entry point into the market. Instead, a long-term approach can help investors withstand volatility and feel confident that markets have tended to move higher over time, even in election years.

Bottom line: Primary season tends to be volatile, but markets have bounced back strongly thereafter.

Past results are not a guarantee of future results.
Includes all daily price returns from 1 January 1932 through 31 December 2022. Non election years exclude all years with either a presidential or midterm elections. Sources: Capital Group, RIMES, Standard & Poor's.

Which sectors have done best in election years?

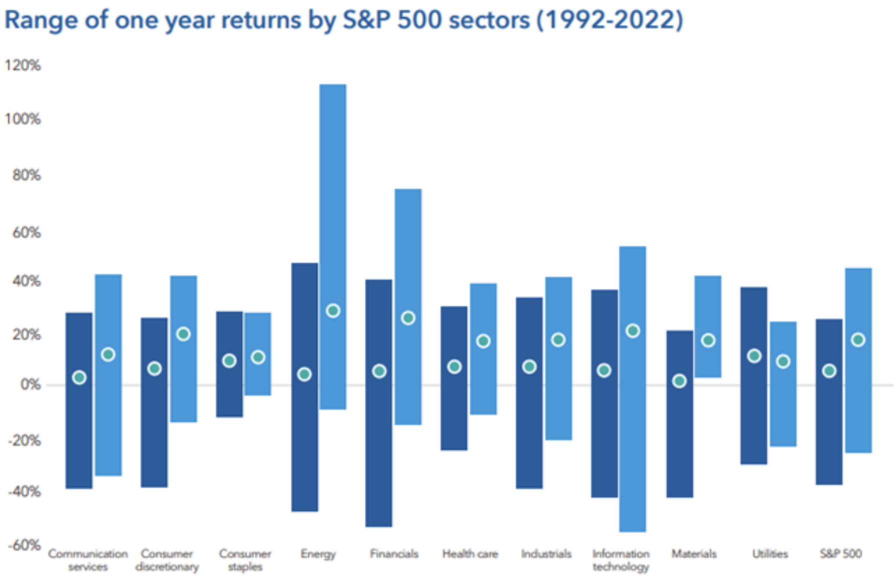
It'd be great if there were go to sectors to invest in every election year, but unfortunately investing isn't that simple. Every election cycle brings its own parade of candidates with their own policy agendas, so market winners and losers are hard to predict.

The health care sector has been in the crosshairs for a number of election cycles. Heated rhetoric over drug pricing put pressure on many stocks in the pharmaceutical and managed care industries. Other sectors have had similar bouts of weakness prior to elections.

Does that mean you should avoid a particular sector altogether? Not according to Rob Lovelace, an equity portfolio manager with 37 years of experience investing through many election cycles. "When everyone is worried that a new government policy is going to come along and destroy a sector, that concern is usually overblown," Lovelace says.

Regardless of who wins, stocks with strong long-term fundamentals will often rally once the campaign spotlight fades. This pre-election market turbulence can create buying opportunities for investors with a contrarian point of view and the strength to tolerate short term volatility.

Bottom line: Election year volatility can create buying opportunities for long-term investors.



Past results are not a guarantee of future results.
31 October used as proxy for each election date. Sources: Capital Group, Refinitiv Datastream, Standard & Poor's.

What have been the best ways to invest in election years?

Spoiler alert: The best way to invest in an election year has rarely been by staying on the sidelines.

To verify this, we looked at three hypothetical investors, each with a different investment approach. We then calculated the ending value of each of their portfolios over the last 22 election cycles, assuming a four-year holding period.

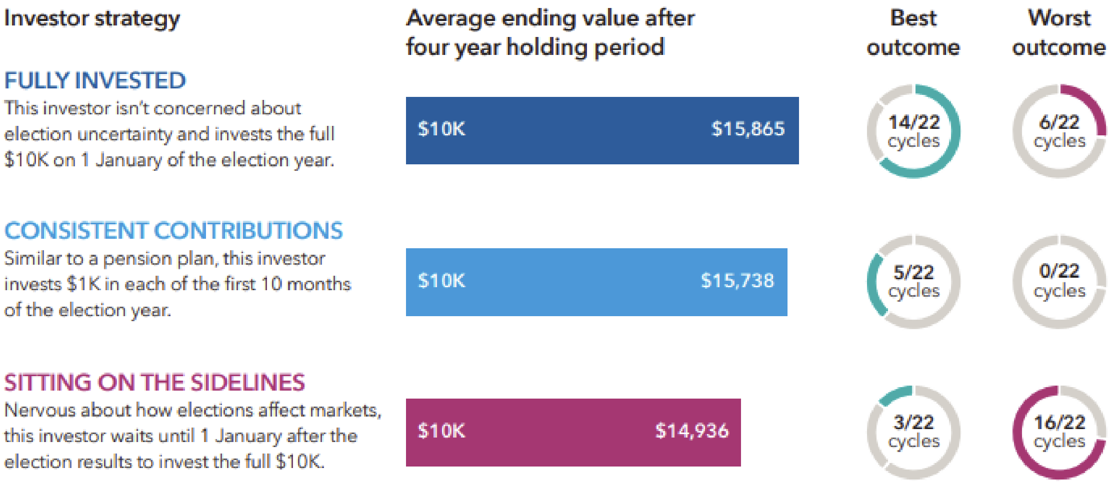
The investor who stayed on the sidelines had the worst outcome 16 times and only had the best outcome three times. Meanwhile, investors that were fully invested or made monthly contributions to a pension plan, for example, during election years came out on top. These investors had higher average portfolio balances over the full period and more frequently outpaced the investor who stayed in cash longer.

Sticking with a sound long-term investment plan based on individual investment objectives is usually the best course of action. Whether that strategy is to be fully invested throughout the year or to invest on a regular basis, the bottom line is that investors should avoid market timing around politics. As is often the case with investing, the key is to put aside short-term noise and focus on long-term goals.

Bottom line: Staying on the sidelines has rarely paid off. It's time, not timing, that matters most.

Three hypothetical US$10K investment strategies during an election cycle

Analysis of 22 election cycles since 1932



Past results are not a guarantee of future results.

As at 30 June 2023, in US dollar terms. The three hypothetical investors each have $10K to invest during an election cycle and are invested in a combination of equities and cash at all times. FULLY INVESTED is always fully invested in equities. CONSISTENT CONTRIBUTIONS starts with $1K in equity and $9K in cash. At t he start of each of the next nine months, this investor reduces cash by $1K and makes a $1K contribution to equities, after which they will have made the full $10K contribution to equities. SITTING ON THE SIDELINES is entirely invested in cash during the first year. At the start of the second year, this investor reduces cash by $10K and makes a $10K contribution to equities. S&P 500 Index used for equity returns, and returns reflect the reinvestment of dividends. 3 month Treasury Bills used as a proxy for cash returns, and returns reflect the reinvestment of interest. Returns and portfolio values are calculated monthly and in USD. Analysis starts on 1 January of each election year and reflects a four year holding period. 2020 election is not include d since there has not been a full four year holding period to analyse. Sources: Capital Group, Board of Governors of the Federal Reserve System (US), RIMES, Standard & Poor's

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