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Editorial

Imagine a multi-asset fund manager listed on the ASX. It's been successful for decades by mostly investing in Australian equities, bonds and listed property/infrastructure, and that success had resulted in it gathering a large amount of funds under management. They start to gradually diversify into other assets such as overseas and unlisted investments. Then, they announce that they're going to move much more aggressively into these newer areas. They say it will not only help with diversification but also prospective returns.

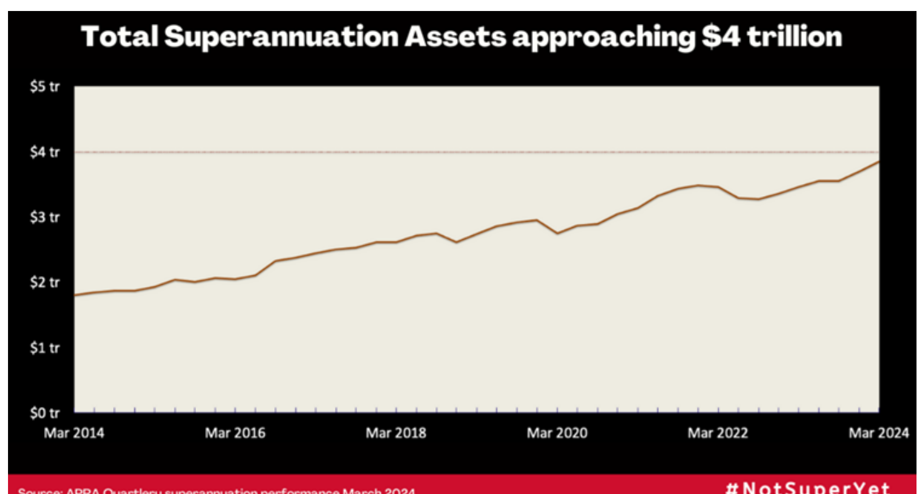
What would happen to the share price of this fund manager? As a best guess, the market would look sceptically at the announcement, and analysts would ask hard questions about the move to diversify beyond the manager's core competencies. There'd also be queries about the risks involved given the poor track record of Australian companies which have ventured overseas.

While the above example is simplistic, the strategy of this fictional multi-asset manager is analogous to that of many of our large super funds. Yet, there's been barely any questions asked about how the size of the super funds is essentially forcing them to diversify further into alternative and international assets, and the risks that this entails.

To infinity, and beyond

First, let's put the size of our super funds into perspective.

New figures from APRA this week show that superannuation assets will soon hit $4 trillion. In the year to March, total super assets increased 11% from $3.46 trillion to $3.85 trillion. Over the past decade, super assets have approximately doubled.



The industry superannuation funds' share of assets continues to grow, reaching 35% at end-March, with corporate funds being the main losers and SMSFs holding steady.

Australia's pension assets are the fourth largest in the world. Super assets are now 145% of total GDP, compared to 108% a decade ago – the fastest growth versus GDP of any country.

Residential property is still the largest asset in Australia by far, at more than $10 trillion, or 2.6x the size of super funds.

However, Deloitte projects that super assets will grow to about $11 trillion by 2043, or close to 200% of Australia's GDP.

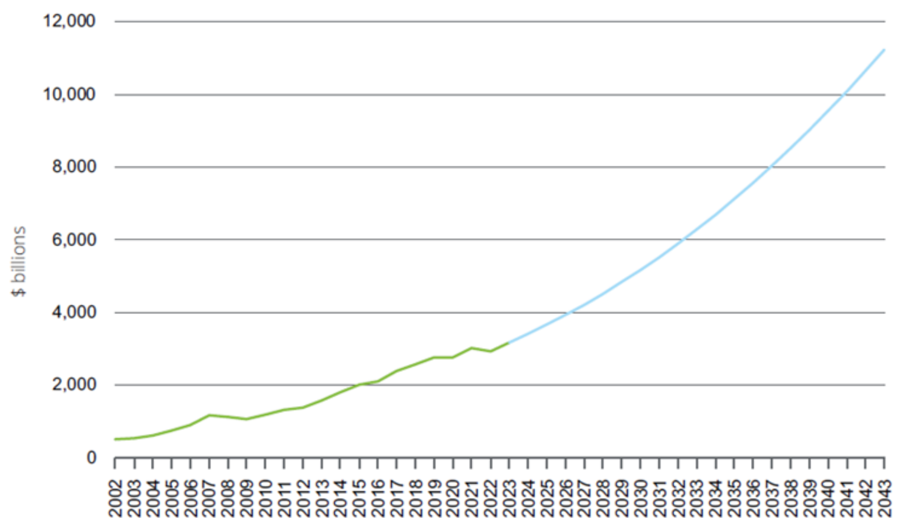
A recent KPMG report suggests that super funds are about to be hit by a wave of Baby Boomer outflows, yet this is likely a significant overreaction. It's true that some of the large retail super funds are experiencing net outflows as their clients withdraw money. However, industry super giants are still growing strong. Net-net, super assets are expected to still increase significantly in coming decades.

Superannuation industry assets as at 31 March 2024

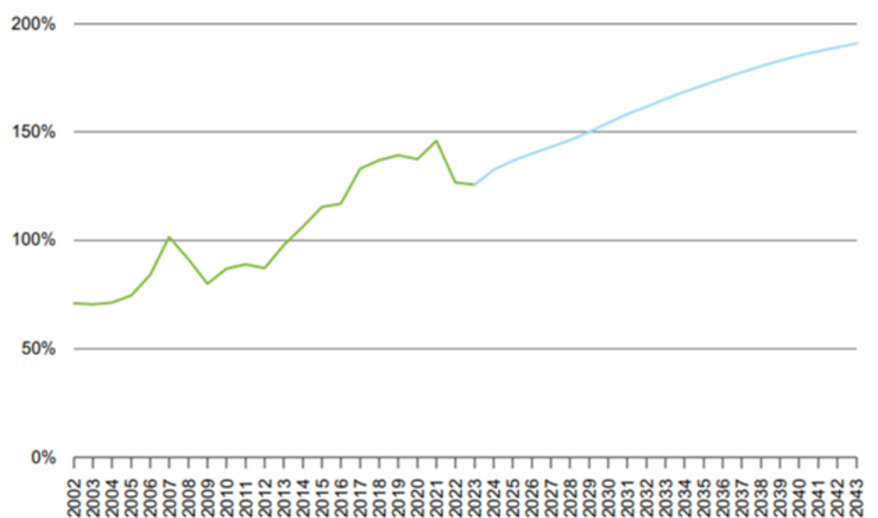
	Dec 2023	Dec 2022	Change	% total
Total Assets	$3,852 bn	$3,461 bn	11%	
Corporate Funds	$47 bn	$57 bn	-18%	1%
Industry Funds	$1,349 bn	$1,157 bn	17%	35%
Public Sector Funds	$712 bn	$658 bn	8%	18%
Retail Funds	$810 bn	$731 bn	11%	21%
SMSF	$935 bn	$859 bn	9%	24%

Source: APRA Quartlery superannuation performance March 2024 #NotSuperYet

Total superannuation assets



Superannuation assets as a proportion of nominal GDP



APRA/ATO market statistics to June 2023

Deloitte projections from July 2023

Source: APRA, ATO and Deloitte Actuaries & Consultants, 2023

Size is already creating challenges for super funds. These funds have always had a lot of equities exposure – initially primarily in Australia, though now more internationally.

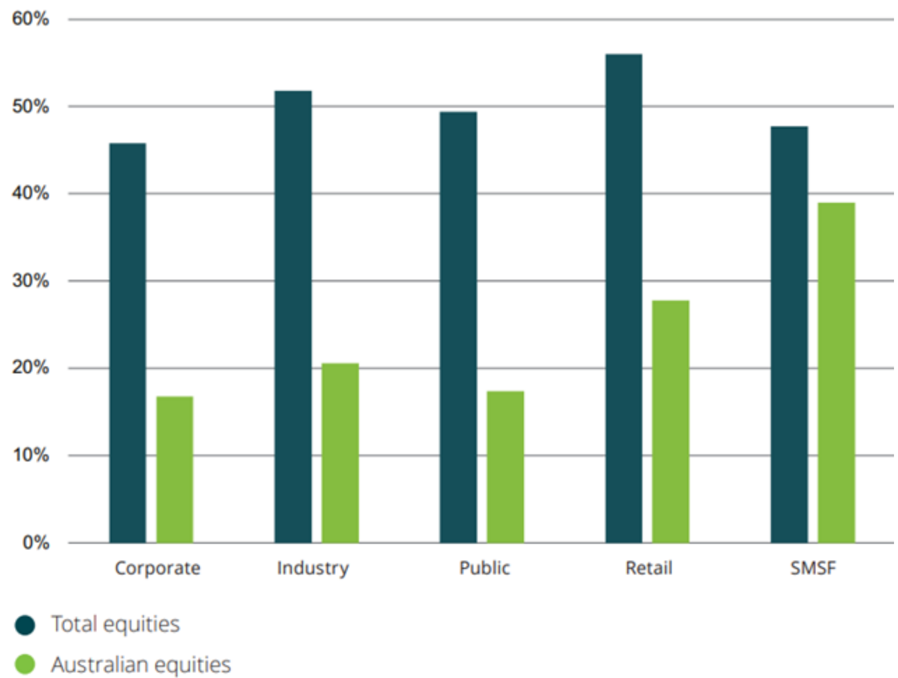
The reason for having greater holdings in international stocks is not only to get exposure to sectors and returns that Australia may not offer, but also because the super funds are simply getting too big for the Australian share market.

Deloitte estimates that investments by super funds were 34% of the total market capitalization of the ASX. And it expects that share will grow to almost 50% by 2043.

Super funds’ diversification beyond Australia has accelerated of late. NAB’s Super Insights Report suggests that allocations to offshore investments by funds rose to 47.8% in 2023, up from 46.8% in 2021, and 41% in 2019.

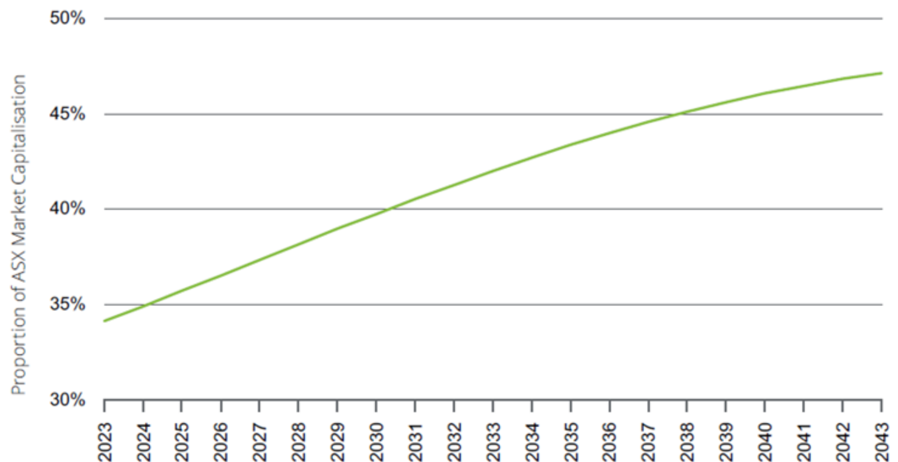
The funds have also been diversifying into unlisted assets, which now account for about 20% of total industry allocations.

Super fund allocation to equities



Source: Deloitte Actuaries & Consultants, 2023

Proportion of ASX market capitalization represented by super funds



ource: Deloitte Actuaries & Consultants, 2023

MySuper funds

Characteristics	Amount ($billion)	%
Cash	31	3
Australian fixed interest	122	12
International fixed interest	64	6
Australian listed shares	190	19
Listed property	15	2
Unlisted property	57	6
International shares	273	27
Infrastructure	103	10
Unlisted equity	58	6
Other	82	8
	995	**100**

Source: APRA September quarter 2023
*Number of MySuper products: 61,25 lifecycle.

Maintaining domestic allocations "not practical"

Australian Retirement Trust's Head of Investment Strategy, Andrew Fisher, had some fascinating things to say about the challenges faced by mega funds at the Morningstar Investor Conference in Sydney last week. He said it's "not going to be practical" for the larger funds to continue to maintain the current level of domestic allocations.

"I'd be lying if I said $280 billion of assets to invest is not a challenging task at times", he said.

"It is a lot of money and we're forecast to go to $500 billion by the end of the decade, those are the internal numbers we're dealing with.

"Realistically, it's not going to be practical for us to continue to maintain the level of domestic allocations, particularly listed market equity allocations that we have."

It's not just an equities issue. With Australia being one of the first countries to privatise infrastructure, locating opportunities in the domestic market has become more challenging, according to Fisher.

"The market is finding new and innovative ways to create infrastructure - digital infrastructure is quite popular now - but realistically, there's some underdeveloped markets offshore where we're likely to see better opportunities," he said.

Fisher suggested that the fund still holds a "strong preference" for domestic investment where possible.

"Our members are Australians, their liabilities are linked to Australian inflation, and the best protection against that is investments in the domestic economy.

"We certainly will be strongly committed to investing domestically, but there is an inevitability with scale that we're going to have to increasingly move offshore, and also an inevitability with being one of the first mover countries in the infrastructure space - there's only so much infrastructure that can be sold," he remarked.

It explains why Australian Retirement Trust opened its first overseas office in London in mid-March.

On the same panel as Fisher at the Morningstar conference, UniSuper's Head of Private Markets, Sandra Lee, said her fund had taken a different tack to investing internationally. Rather than launching an office overseas, UniSuper has chosen to partner with "high quality managers" operating globally.

Lee pointed to the "complexity in going overseas", including currency hedging and finding a common language with a different team of co-investors.

Sizeable issues

There are two key challenges that size brings to Big Super. First, concerns returns. Consider Australian Retirement Trust mentioned above. It manages $280 billion. To get a 7% return, it needs to make $20 billion a year. If its funds increase to $500 billion by 2030 as they project, then they'll need to make $35 billion. Earning that sort of money is far from easy.

Warren Buffett once said that "it's a huge structural advantage not to have a lot of money."

"Anyone who says that size does not hurt investment performance is selling. The highest rates of return I've ever achieved were in the 1950s. I killed the Dow. You ought to see the numbers," he said.

Buffett isn't lying. While he spoke of his hedge fund above, even the numbers from his listed company, Berkshire Hathaway, show that his outperformance has dwindled as Berkshire has become larger.

The other risk that size can bring is if diversification becomes 'diworsification'. The core expertise of super funds has traditionally been in Australian listed stocks, bonds, and real estate. Deeper moves into international equities make sense though require a broader skillset.

Berkshire Hathaway since May 1965

	BRK-A	S&P500 TR	Excess return pa (arith)
1960s	31.2%	4.2%	+27.0%
1970s	22.2%	5.9%	+16.4%
1980s	39.1%	17.6%	+21.5%
1990s	20.5%	18.2%	+2.3%
2000s	5.9%	-0.9%	+6.8%
2010s	13.1%	13.6%	-0.5%
2020s	13.9%	11.3%	+2.6%

(to end Aug 2023) Owen analytics

The funds' increasing exposure to unlisted assets also brings opportunities and risks. Yes, private assets are currently offering higher returns than stocks and bonds. The trade-off is that they're illiquid and offer much less transparency.

You don't have to look far to see the risks with unlisted assets. Whether it be current wrangling over Healthscope's debt, the yo-yo valuations of Australian tech startup Canva as revealed by Franklin Templeton (though not by Australian super fund holders), and redemptions being frozen at several large private equity funds.

There's plenty that the large super funds must deal with, and getting the rewards versus risks right will be a big task in the years ahead.

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In my article this week, housing looks like becoming a key election battleground as the Liberal Party proposes to cut migration numbers to "restore the Australian dream" of home ownership. It got me thinking about this idea of The Australian Dream. Where did it come from? What does represent? Is it still relevant? And, is it the best definition of success and prosperity?

James Gruber

Also in this week's edition...

The introduction of a tax on the unrealised gains accumulated in superannuation funds greater than $3 million in value may also become an election issue. **Clime's John Abernethy** hopes it does, but he also challenges our politicians and bureaucracy to think in different ways to utilise the strategic and unique benefits of our massive superannuation. One idea: infrastructure bonds.

We're often quoted life expectancy at birth but what matters most is how long we should live as we grow older. **Graham Hand** says that it's surprising how short this can be for people born last century, so make the most of it.

What can poker teach investors? **Ophir's Andrew Mitchell** says one key concept is what poker players called 'resulting'. That is, the tendency to judge a decision based on its outcome rather than its quality. It's something that happens a lot in investing, though should be avoided at all costs.

Should you buy and hold an artificial intelligence portfolio? **John Rekenthaler** looks back at the performance of Internet stocks to see if it offer clues about the wisdom of such a strategy.

MFS' Robert Almeida thinks we're entering a new, higher cost environment that will hit the P&Ls of companies in many sectors. He's more bullish on commodities, as there's a supply shortage and increasing demand via mega trends including AI and green energy.

Electric vehicle demand has stalled, surprising many. What's behind the slowdown, and is it a temporary blip or something more long-term? The **Firetrail** team provides some answers.

Lastly in this week's whitepaper, **Payden and Rygel**, an affiliate of **GSFM**, breaks down the opportunities in securitised credit.

Is 'The Great Australian Dream' a sham?

James Gruber

In his Budget reply address, Opposition Leader, Peter Dutton, announced a pledge to "restore the Australian dream" of home ownership.

As Australia deals with a chronic housing shortage, soaring prices and a rental crisis, Dutton unveiled a host of changes to the migration system to help with the problems.

He said that from mid next year, a Coalition government would reduce the permanent migration program to 140,000. The program would then increase to 150,000 in its third year, before climbing to 160,000 in year four.

“We believe that by rebalancing the migration program and taking decisive action on the housing crisis, the Coalition would free up more than 100,000 additional homes over the next five years,” Dutton said.

“The great Australian aspiration of home ownership has become out of reach for so many,” he said.

“But I will never accept a situation where the only people who can afford to buy a home are people with rich parents.”

If you’re cynical about Dutton’s pledge, perhaps you have the right to be. Because in the same speech, he also reiterated a policy to allow Australians access to up to $50,000 of their super to buy their first home.

So, it seems that while he wants to reduce housing demand through migration cuts, he also wants to increase demand by allowing people to use their super to buy a home. Go figure.

The origins of The Great Australian Dream

The speech got me wondering about what this idea of 'The Australian Dream' or 'The Great Australian Dream' is, how it originated, and whether it’s still as relevant today. Peter Dutton clearly thinks it is relevant and he’s betting an election on it.

Firstly, what is the dream? It can simply mean, as Dutton stated: home ownership. In folklore, it’s owning a detached home on a large suburban block, with a backyard, and a barbecue and hills hoist to boot.

Yet, the dream is probably less about the house itself, and more to do with what it represents: success, security, and a better life.

And where did the phrase come? One theory is that it derives from the American Dream. In the US, the dream is associated with upward social mobility. The Great Australian Dream is more specific than that though, as it’s focuses on home ownership as a means to prosperity.

The Australian version is a relatively recent one. It only started to appear in the 1950s as home ownership blossomed following World War Two. Interestingly, the dream was initially ridiculed in the arts, in the paintings of John Brack in the 1950s, the famous novel *My Brother Jack* in 1964, and Robin Boyd’s architectural critique, *The Australian Ugliness*.

The idea gained steam in the 1980s as house prices took off. This was reflected in TV shows depicting The Great Australian Dream like *Neighbours* and *Kingswood Country*. Then, in 1997, came the movie, *The Castle*.

“It’s just the vibe of the thing”

Many consider *The Castle* to be the quintessential Australian movie. It follows Darryl Kerrigan’s fight to save his family home from being compulsorily acquired to make way for an airport expansion. Against the odds, Darryl, driven by his conviction that what he owns is not simply a house but a home, takes his fight all the way to the High Court.

The movie’s popularity, then and now, stems from it being almost a love letter to home ownership and The Great Australian Dream.

Yet, having rewatched the movie recently, I can’t help but wonder if its sentiments remain as powerful now as they did back then. Darryl and his wife, Sal, were able to buy their house in the early 1980s for a “steal” at $70,000. Today, the exact same property in Melbourne’s north is reported to be worth more than $1.4 million. Back then, house prices were 2.8 times average incomes, compared to close to 10 times now. And Darryl was able to buy his home on a single tow truck driver income, which would be a lot harder, if not impossible, to do today.

What the dream means now

Clearly, The Great Australian Dream remains a powerful idea today. Peter Dutton and every other politician knows there’s votes in it and continue to pander to that at every turn.

In a recent *Firstlinks article*, Graham Hand reflected on why houses seem to be changing hands at ever-ridiculous prices. He thinks there may be a few reasons. First, borrowers are willing to increase their loans with the bank, almost to whatever limit is allowed to secure a home. Second, the increase in the role of the Bank of Mum and Dad has changed the market. Third, it is becoming more common for mutigenerational families to buy and live together. Fourth is the other side of the generosity of grandparents. They may delay retirement beyond 60 or 65 by one of them working longer, perhaps while the other looks after the grandchildren.

There's some merit to these thoughts. More broadly, they show the lengths that people are going to in order to buy a home, and the risks they're willing to take – all in the name of achieving The Great Australian Dream.

Does it need tweaking?

The question is whether it's still a dream worth pursuing? If house prices go nowhere for 20 years, would it still be considered The Great Australian Dream? Are there other ways that we should be measuring success and prosperity? Are there better dreams to target? Should we be looking at alternative ways to get wealthy? Should governments be promoting these other methods to get prosperous?

The current debate on housing is dominated by suggestions on making property more affordable for the young. It's an important issue. Yet, just as important may be broadening the debate to include different ways to define success both for ourselves and the country as a whole.

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

Clime time: Taxing unrealised capital gains – is there a better idea?

John Abernethy

A recent Senate Enquiry controlled by Government and Green senators confirmed their support for the introduction of a tax on the unrealised gains accumulated in superannuation funds greater than $3 million in value. The Greens senators upped the ante on the government proposal by suggesting that the tax should apply to funds once they reach a lower threshold of $2 million. The Greens once again showing that they despise self-funded retirees.

The efficacy, logic, and fairness of establishing an unrealised gains tax regime will hopefully be hotly debated at the next election so I don't propose to enter into that debate. However, I will dare to look at superannuation from two different vantage points and challenge our politicians and bureaucracy to think in a completely different way to actually utilise the strategic and unique benefits of Australia's massive superannuation.

My position considers the two basic benefits of Australia's superannuation.

First, the obvious benefit that directly flows to an individual when they accumulate enough wealth or savings to secure themselves a reasonable standard of living in retirement. Even more important to an individual is to maintain superannuation to address their needs as they enter their closing years, where age, failing health or misfortune may need to be urgently funded. A self-funded pensioner takes this burden away from the taxpayer.

The second, less discussed benefit, is the consideration of the proper utilisation of the great national accumulation of savings. Part of these savings (available investment capital) could fund much of Australia's growth without the need for accessing foreign capital. Our massive savings pool can and should be accessed by both private and public investment opportunities. Today, Australia has accumulated near $3.7 trillion in superannuation accounts which is approximately 50% bigger than our GDP. This is a truly incredible amount which will continue to grow for at least the next decade. Given this observation the Government (in particular) should not be timid or scared in accessing some of that capital and more so from those who may be claimed to have too much in superannuation.

In presenting this position I refer readers to this indisputable observation. Today's Australian stock market listings include numerous large companies that were originally government owned and funded by taxpayers. These companies represent large investments of most Australian SMSF and Industry funds. Think Commonwealth Bank, Telstra, CSL, Qantas and the energy companies that originated from State Government enterprises. There is ample evidence that shows that Governments, in the past, appropriately funded and developed businesses. Think about airport assets and parts of toll roads that are now presented on the ASX. A cursory look also shows dozens of successful private companies that have transitioned to listing on the ASX with public funding and which now account for the majority of successful non-financial industrial companies.

This leads to a point that seems lost in the unrealised capital gains debate. Rather than curtailing superannuation investment by creating a tax that will interfere with capital formation and therefore cruel patient investment, why not create a tax regime that actually encourages long-term patient investment? Why not support Government initiatives to create the next generation of successful companies. Why not support initiatives to provide patient public capital or the provision of government debt funding (trade or development finance) to early stage or fast-growing companies? Why not fast track the development of infrastructure assets, housing, health and education assets? Why not build roads which are true toll roads that return income to the taxpayer rather than highly geared public road operators. Why delay a rail connection from Melbourne CBD to the airport?

There is no shortage of capital available inside Australia's superannuation system. Further, there is no shortage of opportunity or ideas flowing from Australia's entrepreneurs. However, there is a growing chasm developing between our massive pool of savings capital and its direction to Australian growth opportunities. The proposed unrealised capital gains tax will widen this chasm and directly inhibit risk capital that flows to start-up ventures outside the development of infrastructure bonds.

So, what can be done as a policy change that would be a superior policy to the proposed unrealised gains tax?

The answer lies in the creation of infrastructure bonds that should be mandated to be only available/accessible to Australian superannuation funds. A directive or requirement to invest in government guaranteed infrastructure bonds aligns this with the maintenance of superannuation tax benefits. Simply stated, Australian super funds would only be able to claim the low taxation benefits embedded in super or pension tax rates if they comply with a mandated investment allocation to Australian infrastructure bonds. Rather than change tax rates that discourage superannuation growth, why not create an environment where more capital is actually directed to the benefit of society and for future generations.

As an example, let's think about an opportunity that sits as a solution to Australia's energy transition needs. Why not create infrastructure (green) bonds that are designed to own solar batteries that are then leased to households to ensure that solar generated energy is appropriately stored and utilized? A lease liability on a 10-year battery to a householder would surely be cheaper than the conventional energy bills. A householder would not be burdened with large upfront battery costs that inhibit battery take up. A 5% (or higher) return to bond holders with some indexing could easily be structured and the government guarantee would probably not even be needed.

Some thoughts on how it could apply in asset allocation

It is not hard to envisage a 'scaled and mandated' asset investment allocation requirement of say 5% into infrastructure bonds for the first $500,000 (or part thereof) of a superannuation account. This could adjust up to a mandated requirement of 30% (say) allocation for funds greater than $3 million. Maybe a 1% yield above a traditional government bond could be a feature of this unique asset noting that foreigners cannot access it? List infrastructure bonds on the ASX so SMSFs can directly access it.

Let's encourage more funding by our super funds towards pure Australian initiatives, opportunities, entrepreneurs, IP, health care, research, education and infrastructure. Scrap the thought bubble of unrealised gains tax that does the opposite.

Let's think about utilizing our abundant capital as much as possible rather than defaulting it to offshore markets. Let's think about superannuation assets from a different perspective that meets the challenge of growing income on pension assets from Australian sources. Let's focus on what is truly important for Australia's long-term needs.

In closing, I observe that many large Industry Funds seem to have outgrown Australia's capital markets, more so because there is no bridge built between their managed capital and Australian infrastructure needs. Recently in mainstream press it is reported that 70% of incremental flows into our largest Industry funds are diverted offshore. These investment flows into foreign investments act to depress the AUD (sell AUD and buy USD) and thereby directly add to imported inflation at a time when we are fighting to bring inflation down.

John Abernethy is Founder and Chairman of Clime Investment Management Limited, a sponsor of Firstlinks. The information contained in this article is of a general nature only. The author has not taken into account the goals, objectives, or personal circumstances of any person (and is current as at the date of publishing). For more articles and papers from Clime, click here.

How long will you live?

Graham Hand

The demographics of how long we will live reveal some surprising statistics, especially in Australia. We frequently hear about people living into their nineties, and even one hundred years or more, but we read less about the other side of the demographics: how short many lives will be.

According to the Australian Bureau of Statistics, the life expectancy median for males born in 2022 was 81 years and for females, 85 years. But what about the expected years of life remaining for a person at a given age? The statistics overlook people who are already living and old. There will be many people alive now who will not reach 81 or 85 years.

If age 81 concerns anyone due to its life brevity, it is worth preparing for a future that makes the most of life's opportunities now. The remaining expectancy might be 20, 30 or 40 years but nobody knows. A person born in 1955 to 1960 may expect to live until they are 70 or so but they may live an extended time. The longer someone lives, the longer they can expect to live.

The main message is that 81 is the expectancy, or median for men, at birth, not for a 81-year-old now. A person born in 1992, about 30 years ago, had a life expectancy of 74 years for males and 80 for females, a gap of almost six years. The Beatles were fresh on the stage and at the start of their lives, but '*When I'm 64*' was considered old.

Maybe dying at the age of 65 to 70, even now, is not so unreasonable based on the original expectations.

Deaths in Australia, 2021

This latest expectancy based on deaths (not expectancy based on birth) in 2020-2022 included the three years of COVID and it is reflected in the death rates. The death rate before 2022 was lower than in previous years due to preventative measures during the pandemic. But in 2022, the number of deaths in Australia rose to almost 200,000 in one year, up from 171,469 the year before. Australia should not expect as many as 200,000 in future years for a while but the number will be up there eventually.

The latest statistics on deaths from the Australian Institute of Health and Welfare (AIHW), 2021, shows death by age with a median of 79 for men and 85 for women. These numbers are based on the 2021 data including the 171,469 in 2021 deaths during the COVID period.

The statistics published by the ABS (due in a few months) for the end of 2024 will cover the 2023 year, and it will be revealing whether Australia holds the 200,000 deaths year level.

Back to the detailed in the 2021 AIHW data, when total deaths were 171,469, with 89,397 men and 82,068 women, drawing out the statistics for men shows:

- 4.4% of men died before the age of 40
- 10.3% of men died between the ages of 40 and 59
- 13.3% of men died between the ages of 60 and 69 (that's 28% by 69)
- 23.8% of men died between the ages of 70 and 79 (that's 52% by 79)
- 31.1% of men died between the ages of 80 and 89 (that's 83% by 89)
- 17.1% of men died over the ages of 90

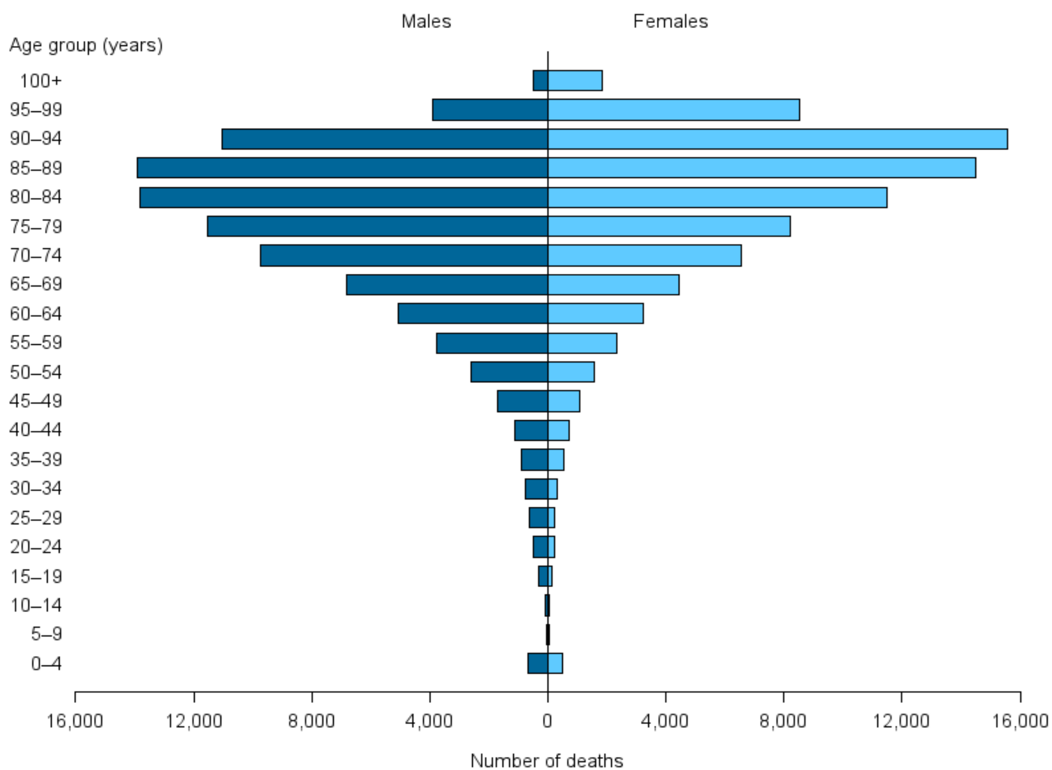
% of males in deaths by age group, 2021.

Age group	Males	% died
0–4	651	0.73%
5–9	66	0.07%
10–14	92	0.10%
15–19	326	0.36%
20–24	498	0.56%
25–29	623	0.70%
30–34	766	0.86%
35–39	894	1.00%
40–44	1,125	1.26%
45–49	1,725	1.93%
50–54	2,595	2.90%
55–59	3,749	4.19%
60–64	5,084	5.69%
65–69	6,811	7.62%
70–74	9,737	10.89%
75–79	11,518	12.88%
80–84	13,797	15.43%
85–89	13,925	15.58%
90–94	11,016	12.32%
95–99	3,885	4.35%
100+	514	0.57%
	89397	**100.00%**

Note: *Year refers to year of registration of death. Deaths registered in 2021 are based on preliminary data and are subject to further revision by the Australian Bureau of Statistics (ABS).*

Source: *AIHW National Mortality Database.*

Deaths in Australia by sex and age group, 2021



Source: AIHW National Mortality Database; Table S2.1.

While plenty of males in particular are living beyond the age of 69 and 79 – that is, people alive now, not their current expectancy – but also a surprising number of 28% are expected to die before they reach the age of 70. While cures for many diseases such as cancer and heart conditions are improving, everyone should consider what life will be like with earlier health problems.

Also consider the 'average' couple. She is typically two years younger than her husband but lives longer, with a period of dependency. On average, he dies several years before she does and she has often been the carer. She becomes dependent after he dies which is one reason why there are many more women in aged care.

Life expectancy and an aging population

In the 1960s, men lived 14 years less and women 11 years less than now (which in my case, was only 67 years at birth). Remarkably, between 1964 and 2021, the median age at death increased from 68 years to 79 years or 11 years longer, but the vast majority of people now expect to live well beyond 68 years.

(And the world was a vastly different place when Australians born at the beginning of the 20th century had a life expectancy of 51 years for males and 55 for females).

Changes in Australia's demographics have other surprises. In 1971, people aged 80 years or more made up only 1.4% of the population, but that is now 4.3%. Instead of 188,819 people over 80 in Australia in 1971, there were 1,115,297 in 2022.

Figure 1 shows the increase since 1971 (and I was born in 1957, so that's 14 years). While the median life expectancy of men is about 80 now, half of them will live beyond 80 and half will die by this age.

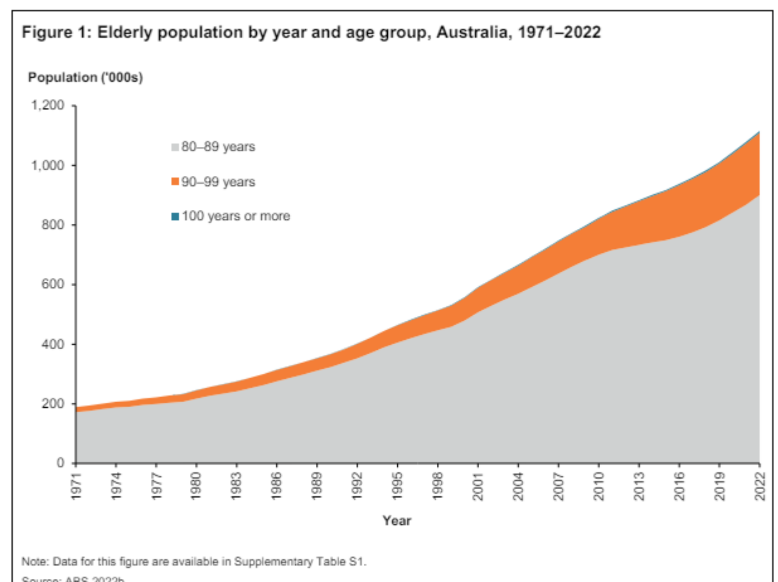


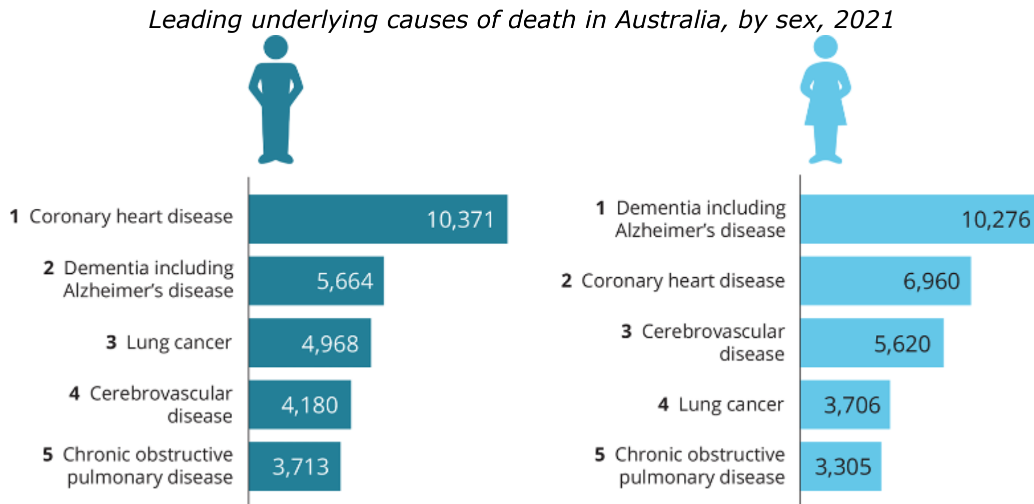
Figure 1: Elderly population by year and age group, Australia, 1971–2022

Note: Data for this figure are available in Supplementary Table S1.
Source: ABS 2022b.

Leading causes of death

There are numerous differences in the reason men and women die, with men of coronary heart disease (10,371 (12%) deaths) and women from dementia including Alzheimer's disease (10,276 (13%) deaths). The chart below shows the five leading categories.

Leading underlying causes of death in Australia, by sex, 2021



Source: AIHW National Mortality Database; Table S3.1.

The leading causes of death also vary by sex and age. For example, chronic diseases feature among people aged 45 and over, while death among younger people up to the age of 44 includes accidents and suicides.

Other implications of ageing and death

Another reason to understand both the ages and causes of deaths is to help to design a better superannuation system. There are an estimated five million Australians in or approaching retirement and drawing down their pensions. Balances and liquidity needs to meet their members' requirements although neither super funds nor SMSFs know when the money will run out.

While many large super funds such as REST and Hostplus can be confident their members will continue as net investors through all their years, other funds will remain in net outflow. Funds need to know the characteristics of their members, especially as many will switch to cheaper ETFs as their balances build.

Despite millions of members, most large super funds do not know their clients. They certainly don't know the needs of their partners and families, and the problem becomes more acute the older the member. These funds need to understand the potential for longevity, plus know the correct legal treatment when their members die at the age of 65 to 75 and beyond. For example, many surviving superannuants think money goes to the spouse on death. In fact, superannuation cannot be held by a surviving spouse and must be cashed in or invested within 6 to 12 months of the death.

Concluding remarks

This article focusses on the ages at which people die rather than longevity expectations when they are born. How to live longer and how to ensure a retiree does not run out of money are subjects for another day.

Life expectancy statistics from the ABS have a reference period of 2020 to 2022 and were released on 8 November 2023. The next release is 8 November 2024 so the numbers in this article are not as out of date as they may appear.

Thanks to demographer David Williams for his comments and explanation of his My Longevity website (www.mylongevity.com.au). And if anyone is offended by the title of the article, it is used by the ABS in its reports.

Graham Hand is Editor-At-Large for Firstlinks.

What poker can teach us about investing

Andrew Mitchell, Steven Ng

It's 2014 at the end of Super Bowl XLIX with 26 seconds left. The Seattle Seahawks were down by four points against the New England Patriots. The Seahawks were on the Patriot's one-yard line just outside the end zone and it was only the second down[1]. It was a golden opportunity for the Seahawks to snatch a victory.

Seahawks coach Pete Carroll called a timeout and told his quarterback to pass the ball instead of making a running play. The quarterback passed. But the Patriots intercepted the ball, and the Seahawks lost a game that they looked like they were about to win.

Coach Carroll was crucified by fans for the passing decision. Many see it as the worst call in Super Bowl history, perhaps all of NFL history!

But was it a bad decision?

Former World Series of Poker Champion and cognitive behaviour expert, Annie Duke, thinks not. In her book 'Thinking in Bets: Making Smarter Decisions When You Don't Have All the Facts', Duke highlights that, based on 15 years of NFL data, the probability of a short pass interception is below 2%.

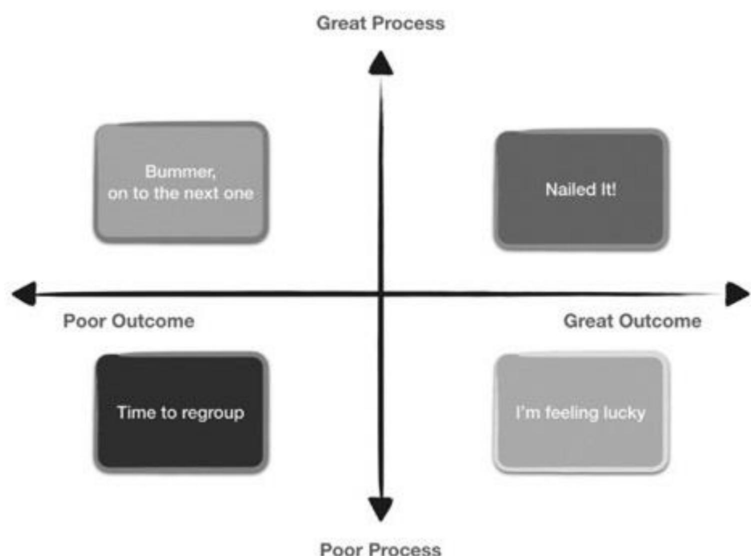
The Seahawks were much more likely to score a touchdown or make an incomplete pass that would have barely used any clock time (and doesn't count as a down).

If a touchdown results, you're a genius who won the game doing what the opposition didn't expect you to do. While an unsuccessful running play loses precious time off the clock and only allows time for one more play.

Just because the low probability event happened (an interception), it doesn't make it a bad decision by the coach. Duke sums it up nicely:

"What makes a decision great is not that it has a great outcome. A great decision is the result of a good process, and that process must include an attempt to accurately represent our own state of knowledge."

The takeaway: in games where there is chance, and the probabilities aren't certain (i.e. 100%), you can't judge a decision by a result.



So-called 'resulting' is what poker players call the tendency to judge a decision based on its outcome rather than its quality. Investors need to avoid 'resulting' at all costs.

Two decades of trusting our process

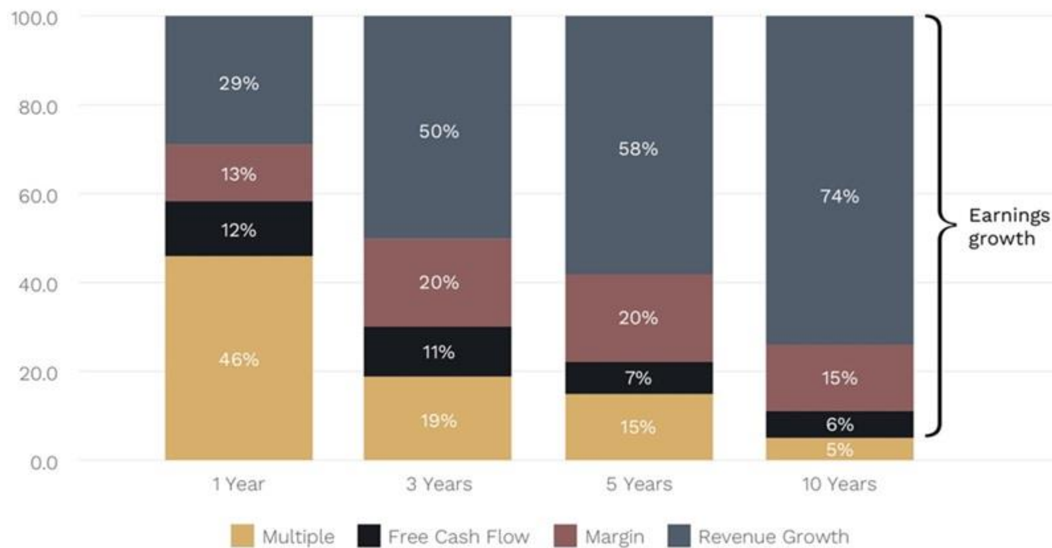
At Ophir, we are highly focused on the 'process' principle at the portfolio level.

As long-time readers will know, we (Andrew Mitchell and Steven Ng) started out as Australian small-cap investors around 15-20 years ago. Then, as our most successful 'Aussie' investments increasingly became global as they expanded overseas, we launched into global small caps some six years ago.

Through that time, the ideal company in which we invest has not changed. It is typically A$500 million to $10 billion in market cap, growing revenue and profits above the market (so generally 10%+ per annum), taking market share, and growing into a big end market wherever that is in the world.

We strongly believe, and the evidence backs it up, that earnings drive company share prices in the long term. You can see this in the chart below where revenue growth, changes in margins and free cash flow all add up to earnings growth, which dominates as the driver of share market returns over time. And providing you don't overpay for that above-average earnings growth, you give yourself a great chance of generating attractive investment returns and beating the market averages.

Key drivers stock performance – S&P 500 (1990-2009)



Source: Morgan Stanley Research

We also believe that one of the best indicators of above-average earnings growth over the longer term is strong earnings growth today that is beating market expectations.

If you were a fly on the wall in our investment team meetings, you would hear us focussed on how confident we are that our portfolio companies are likely to beat the market's expectations for revenue and profit growth at their next result.

This, however, doesn't guarantee you good investment returns in your portfolio in the short term. Changes in valuation multiples (yellow bar above), both at a stock and portfolio level, can swamp the fundamentals of revenue and earnings growth.

This was particularly the case in late 2021 to mid-2022 in our funds, and in particular our Global Funds, where despite still overwhelmingly getting the earnings right, valuation multiples decreased to a degree not seen since the GFC for the entire cohort of small-cap growth-orientated businesses globally, which is of course the pond that we fish in.

Why we're happy with this process … despite

But we are also focussed on the 'process' principle for individual holdings, as the example of Altium shows.

Altium (ASX:ALU) is an Australian stock we held last year in the Ophir High Conviction Fund (ASX:OPH). It makes the most widely used software for the design and manufacturing of printed circuit boards.

But towards the end of 2023, one of our analysts warned us there was going to be an earnings hole at the first half 2024 result due in February 2024.

If we are highly confident an earnings miss is looming at an upcoming result, we will either down-weight the position or sell to zero. In this case the instruction was clear: get out entirely!

Just weeks later, in mid-February, Japanese chipmaker Renesas Electronics lobbed a takeover bid for Altium at $68.50 – a circa 34% premium to the closing price of the company's shares the day before, valuing the business at A$9.1 billion in an all-cash deal.

Our analyst was livid and there was definitely a few swear words in the office! We had lost the chance at significant outperformance by selling the stock early.

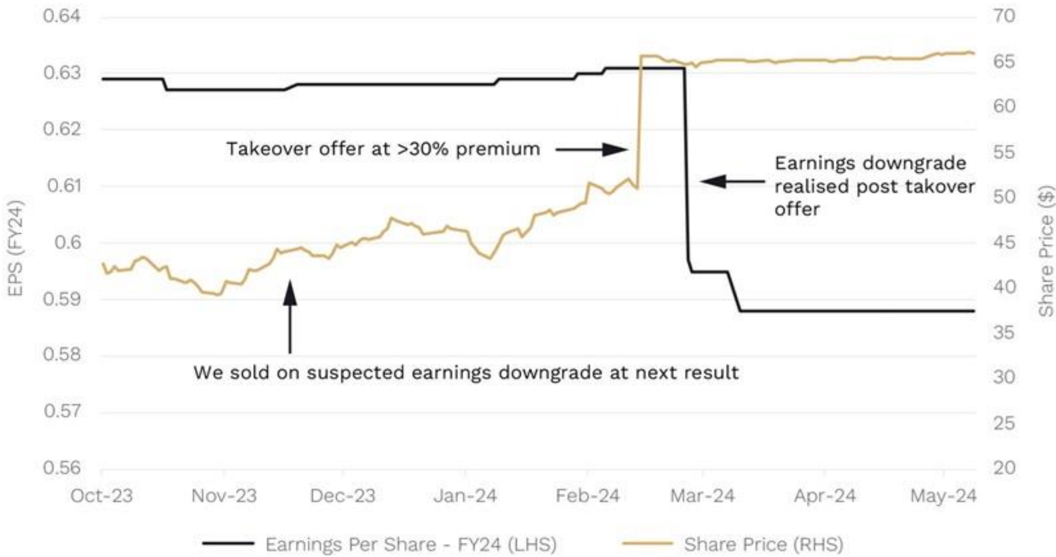
Were we (Andrew and Steven) upset at the lost performance opportunity? No!

The reason is simple: The analyst did all the correct work, as part of our process and made the right call with the information they had at the time.

We will *never* hold onto a company because a takeover offer might be lobbed – the probability is usually just far too small and uncertain.

Low and behold, in late February when Altium came out with its result, it reported a big miss to earnings, that, but for the takeover offer, would normally have seen the stock fall upwards of -30%.

Altium (ALU) share price and earnings



Source: Bloomberg

Our analyst made the right call based on the percentages – a recommendation to sell Altium based on a likely upcoming earnings miss – and this isn't invalidated due to a small-probability left-field takeover offer effectively rendering the earnings miss meaningless.

[1] For non-NFL fans, in American Football you get four attempts to move the ball at least 10 yards up the field. The first of these tries is "first down", the next "second down" and so on. Once they make it 10 yards or further the downs reset and it's back to first down.

Andrew Mitchell and Steven Ng are co-founders and Senior Portfolio Managers at Ophir Asset Management, a sponsor of Firstlinks. This article is general information and does not consider the circumstances of any investor. Read more articles and papers from Ophir here.

Should you buy and hold an Artificial Intelligence portfolio?

John Rekenthaler

Once upon a time, a transformative new technology enthralled the marketplace. Silicon Valley venture capitalists opened their wallets, as did retail shareholders. Veteran portfolio managers were bemused. No doubt the industry would prosper, but given its sky-high valuations, and the fact that many of these first-stage businesses would fall by the wayside, were those stocks worth owning?

The past has returned. As with 1999's internet companies, today's artificial intelligence startups face directly forward. Rarely is upcoming change so apparent. Without question, AI technology will dramatically reshape the economic future.

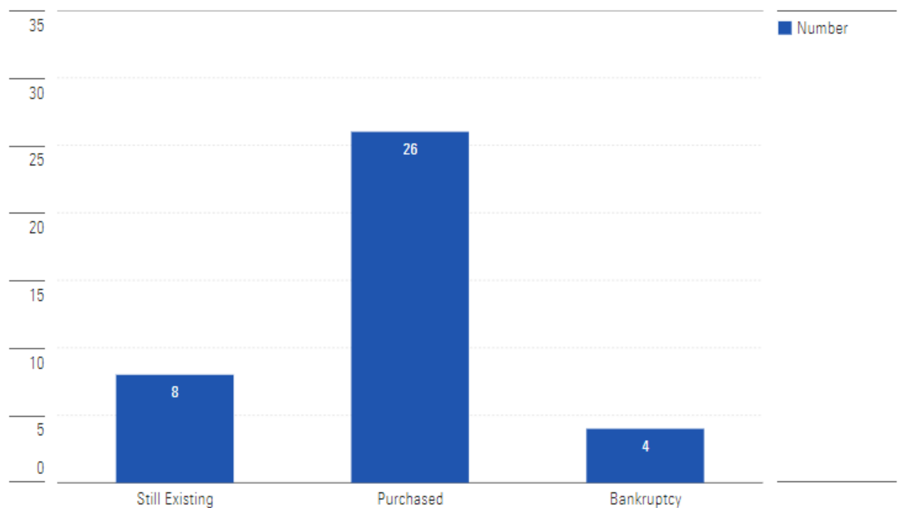
Individual stock returns

This leads to the logical investment question: How would those early internet buyers have fared had they purchased a basket of shares and stashed it away for the next 25 years? Mutual fund history tells us nothing. Of the 12 funds that had the word 'internet' in their names when the millennium began, only one still exists,

and that fund invests more than half its equity assets in energy stocks, including a 17% position in Texas Pacific Land Corporation TPL.

So, fuhgeddaboudit. For the purposes of this article, fund records are useless. So, too, are the track records of internet stock indexes. They show the return for portfolios that are monitored and updated. Of the 10 largest companies in today's Dow Jones Internet Index, only two were publicly traded 25 years ago. Most of the industry's current giants, such as Alphabet GOOGL and Meta Platforms META, were founded during the following decade.

To assess the startups' fates, I found a January 2001 version of the Dow Jones Internet Index. Many of its holdings have long since been forgotten. (If you know what happened to Covad Communications, Excite@Home, or Tibco Software, or indeed that they ever existed, you are ahead of me.) I located the fate of 38 of that index's 40 positions, sorting the outcomes into three groups: 1) Still Existing, 2) Purchased, and 3) Bankruptcy.

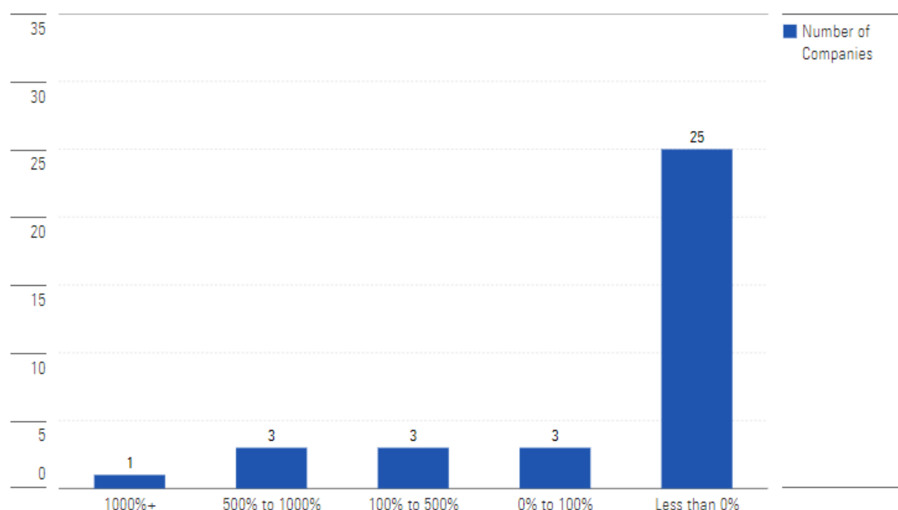


Better than I had expected! Most of the list's businesses had persisted (in some form) rather than liquidating into a puddle. But had they retained significant value? It's one thing for a company to be so coveted that it is purchased before its second birthday—as with YouTube, for which Google paid $1.65 billion. It's quite another to drift for a decade, attempting to right the ship, before selling the business for pennies on the dollar.

The total returns

I could not find the performance records for three of the 38 companies, but I was able to compute returns for the rest. When possible, I began the calculations in March 1999, when the Dow Jones Internet Index went live. However, as my reference article of holdings was published two years later, it included several firms that were not in the index's initial version. In those cases, I used the stock's inception date.

I concluded the study this February, which marked the index's 25-year anniversary. The next chart shows the cumulative total returns for those 35 stocks. This time, I created five groups, ranging from 1,000%-plus grand slams to money-losing strikeouts.



Make that 'grand slam', singular. The only 10-bagger on the list, to use Peter Lynch's term for a spectacularly successful investment, was an online retailer with the peculiar name of Amazon.com AMZN. Three companies gained between 5 and 10 times their original outlay, and three more at least doubled their money. That was it for the triumphs. No other stock kept pace with inflation over the period. Nearly all finished in the red.

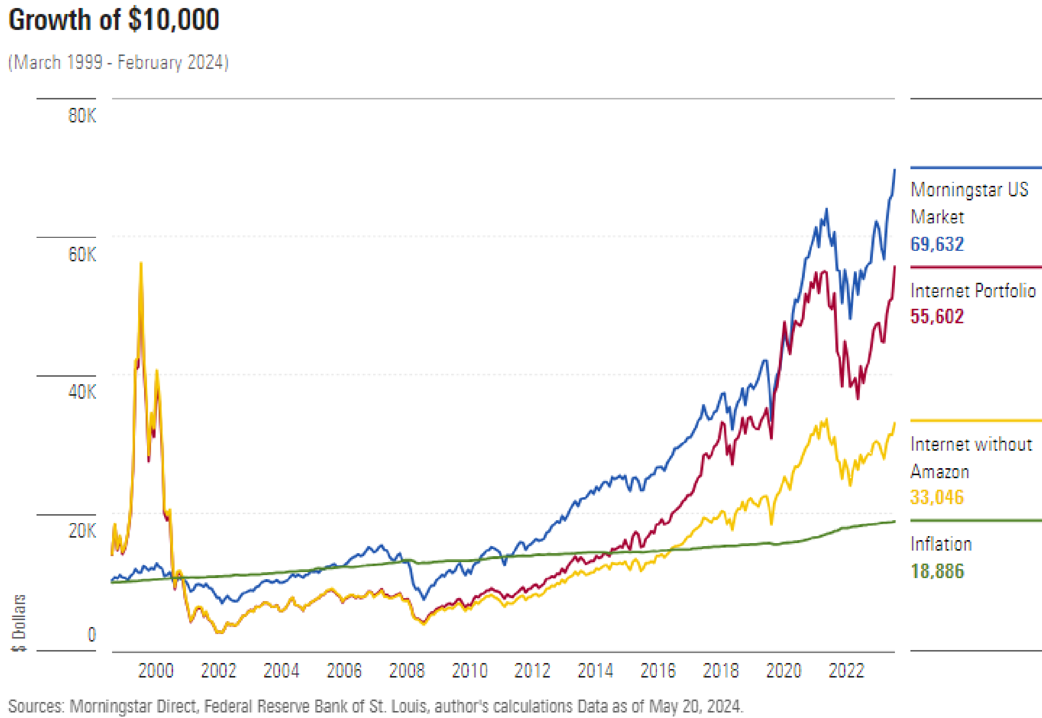
That most stocks stink is no secret. Long-term equity performance is asymmetrical, with a few winners carrying almost all the baggage. But internet startups seem to have carried that principle too far. Over stock market history, found professor Hendrik Bessembinder, 51% of all stocks have suffered negative lifetime total returns. Among the 35 internet stocks, though, the failure rate was 71%, or 25 of the 35 entrants. That is a tough hurdle to clear.

The portfolio

I then measured how the entire portfolio would have performed. For that exercise, I used only the 23 stocks that existed in March 1999, because the proper comparison for AI stocks is when the sector is booming, as with AI today and internet companies in spring 1999, rather than after a downturn has already occurred. I split a $10,000 one-time investment among those 23 companies and let the portfolio ride—no trades, not even rebalancing.

One question remained: How to treat stocks that were acquired? After some deliberation, I decided to invest the proceeds into the Morningstar US Market Index. Ignoring that money would understate the portfolio's return. On the other hand, employing other assumptions—such as dividing the proceeds among the portfolio's remaining companies—would add complexity without meaningfully altering the conclusions. So, the simpler approach it was.

The illustration below contains four comparisons: 1) The entire internet portfolio, 2) the internet portfolio without Amazon, 3) the previously mentioned Morningstar US Market Index, and 4) inflation.



The good news for the internet portfolio was that, albeit with spirit-breaking volatility—the reason the internet funds vanished—it eventually surpassed inflation. What's more, if the portfolio had contained another company that became as successful as Amazon, it would also have outgained the US stock market. The bad news, of course, is that investment 'ifs' don't pay the bills.

Conclusion

This result surprised me. When beginning the project, I already had Amazon in mind and figured that a few champions such as eBay EBAY would have propelled the internet portfolio to relative victory. But the winners were too few and their gains insufficient. Only VeriSign VRSN, eBay, and Priceline (now Booking Holdings BKNG) beat the overall stock market, and not by a very wide margin.

This test is a sample size of one, but it strikes a cautionary note. At least with internet stocks, most of the industry's future leaders arrived not with the first wave of technology, but the second. In effect, the companies

in the first wave threw ideas against the wall hoping to find one that would stick. The firms that succeeded them learned from their predecessors' mistakes. They benefited rather than suffered from arriving later.

For those with the patience to own an investment as volatile as the AI sector, buying and holding a stock basket might make sense. However, based on internet stocks' history, one need not rush to do so.

John Rekenthaler has been researching the fund industry since 1988. He is a columnist for Morningstar.com and a member of Morningstar's Investment Research Department. The views of the Rekenthaler Report are his own. The author does not own shares in any securities mentioned in this article. This article is general information and does not consider the circumstances of any investor. Originally published by Morningstar and edited slightly to suit an Australian audience.

The bull market in commodities may be just starting

James Gruber, Robert M. Almeida

Introduction: Robert M. Almeida is a Global Investment Strategist at MFS Investment Management. James Gruber interviewed Robert after his appearance on a panel at Morningstar's Investor Conference in May.

James Gruber: Robert, you talk about a new paradigm, a higher cost environment that might be with us for a while. Is that structural or cyclical in your view?

Robert Almeida: I think it's structural. So what ended was an era of suppressed costs [and] interest rate suppression, but also globalization. I think what's changed now is while central banks may cut rates because inflation's coming down, what you're going to see is longer rates where companies and households borrow at. I think that's going to be higher than it was last cycle.

And globalization hasn't ended, but it's shifting. So as companies have to shift supply chains, that requires capital, that requires spending, that requires people. We're in a world now where costs, I would argue, are a bit more normal. That's going to have a different effect on P&Ls than what you had in a suppressed cost environment. So I think it's structural.

Gruber: A longer term theme, though, rather than a short term one? Or do you think it's already starting to play out as we speak?

Almeida: It's playing out now, but not in financial markets. I don't think risk assets have discounted that because what risk assets tend to do, as you know, is they focus on what has happened and then look out the next, say, three to six months. But when we think about this being a structural and longer term thing, once financial markets start discounting it, you're going to get a very different behavior pattern. But I don't think it's in asset prices yet.

Gruber: Which sectors do you believe will benefit from this?

Almeida: Capital goods. Throughout the 2010s, the reason it was such a low growth, low inflation environment is people weren't spending, whether that's households or companies. So we didn't build enough infrastructure. If you think about some of these mega trends, the reshoring that we mentioned, but also artificial intelligence, it requires a lot of equipment. So companies tethered to that. Companies that supply parts, goods, equipment to go into an EV factory or gigafactory. Or [companies that] support AI hyperscalers or the building of manufacturing plants outside of China. Capital goods, industrial companies, electric equipment makers, they're in the midst of that.

Gruber: And I imagine also those that have the ability to raise prices in that higher cost environment.

Almeida: Yeah. Every company has fixed costs that they have to absorb. So a dollar in has to go to some level of fixed costs. The last customer is always the most profitable because once fixed costs get absorbed, each new dollar is incremental profitability. But now as we enter into a higher cost world, the differentiator in financial markets will be those companies who have something that people want that's in relatively short supply. They'll be able to raise prices to offset those other higher structural costs. Conversely, those companies that can't, or

don't because their product isn't good enough or there's just too much competition or the business just can't support those higher costs, those companies are going to have a very different financial outcome.

Gruber: Which sectors are the most at risk in this new environment?

Almeida: Coming out of the global financial crisis, obviously banks and households were deleveraging their balance sheets. Then what happened was sectors across technology, staples, industrials, et cetera were using cheap financing and globalisation to drive high profitability. In the 90s we built too much IT hardware and it was the technology sector that was at risk. In the 2000s we built unproductive homes, particularly in the United States. So it was the consumer and financials and banks providing the financing that were at risk. This time it's more ubiquitous. I think businesses that are offering a product or a good that can be commoditised or copied by others [are most at risk] and I think that risk exists across a lot of sectors. It's a lot harder to pinpoint versus prior cycles.

Gruber: How does AI fit in? I imagine that It is sucking in a lot of capital, yet there's a fair bit of growth in the meantime?

Almeida: I think about AI through few different lenses. So if you think about the hyperscalers today, they are spending a tremendous amount of money. If we take them at their word, those capital investments could be US$700 billion, US$800 billion over the next four or five years. How many other technology companies have the financial firepower to be able to keep up with that? Not a lot. So to maybe go back to your earlier question, software companies that sold code, AI will do it for free. Those companies that don't have the firepower to keep up are the assets most at risk. Then on the other side, a lot of investors are making this assumption that all companies are going to be more productive. I think there's something to that. However, the flip side to that coin is companies we've never heard of or maybe don't even exist today. AI allows them to enter the marketplace. That increases competition, increases commoditisation risk. So I think it's a two-edged sword.

Gruber: How does geopolitics fit into all this? What are the risks there? They seem to be increasing.

Almeida: I think about it from wants and ability. What a politician wants to do might be different from what they're able to do. In my country [the US] we have a very important election coming up later this year. It is hard to underwrite both the outcome and what whoever wins will want to do. What will matter is the balance of Congress relative to who wins and what they're able to do. I guess whether it's President Biden or Donald Trump, each of them want to stimulate. A lot of politicians love fiscal stimulus. They saw how much it worked. I'd argue it was more of a short-term thing but they saw how much it worked and they're going to want to stimulate. But what's their ability to stimulate now with yields elevated, deficits elevated? Bond investors need to be compensated for that. So that's a different environment. It's hard to underwrite what those outcomes will be but I think wants and ability are going to be more constrained than they have been.

Gruber: Final question, commodities, where do they fit into the picture of a higher-cost environment?

Almeida: Commodities are beneficiaries and you're seeing that in commodity prices today. As we go from a single polar world where the U.S. was providing safe shipping lanes to a world with more conflict and at the same time increasing protectionism, demand for resources grows. There's ultimately just less sharing and more demand for those goods. Particularly we just have a lot of stuff we need to build to support those mega trends and stuff that we need to build just for a greener world of less pollution. That requires resources and I'm not sure we have enough.

For more articles featuring Robert M. Almeida, please see [MFS Investment Management's sponsor page](#).

The challenges facing electric vehicles

Firetrail Investment Team

Electric vehicles (EVs) are vehicles that are powered by electric motors and batteries instead of traditional internal combustion engines (ICEs). They are seen as a key technology for reducing emissions. Following a period of exponential growth, the outlook for EV manufacturers has recently become more challenging.

Electric vehicle sentiment turns sour

Slowing demand and profit warnings from the EV manufacturers has seen analysts revise down their EV penetration forecasts. EV sentiment has continued to worsen in 2024, with major EV automaker shares down 20-55% year-to-date.

We are big supporters of decarbonisation efforts, but these efforts cannot occur unless businesses are sustainably profitable. Decarbonisation projects must make economic sense.

It looks like EVs may have hit a natural saturation point. EV demand has been regionally concentrated and over-indexed to high income earners where demand might be exhausted for now. Some EVs are too expensive for their segment size (e.g. pickup trucks) and do not have great distribution channels.

There has also been a reality check on the rising cost of capital. Underpinning EV growth is a technology that is more efficient than fossil fuel but every bit as capital intensive. A major repricing of the cost of capital globally has had a clear impact on the payback periods of such projects.

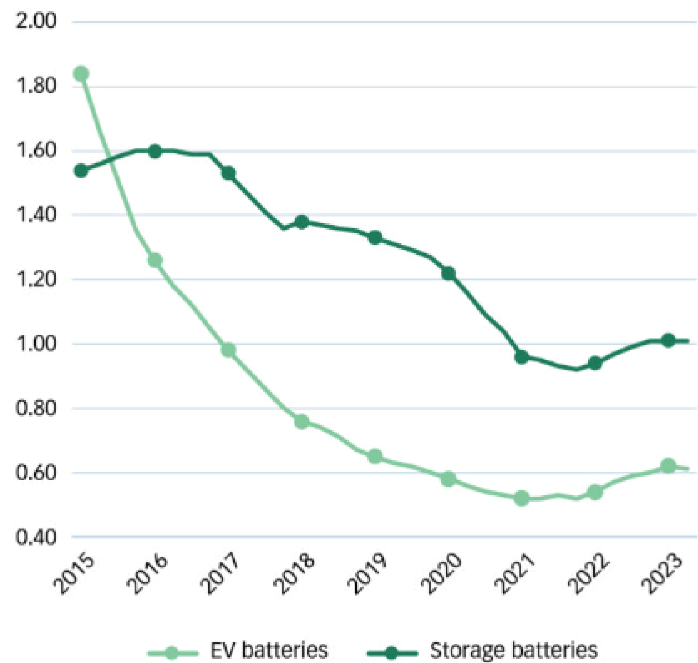
It appears that investors are rewarding certain auto manufacturers for 'dialling back' their EV strategies. The relatively strong total shareholder returns by players like Toyota and Stellantis stand out given these names have spent far more frugally on the EV side.

There are also EV adoption challenges. These include enhancing EV charging infrastructure (both availability and charge time), addressing maintenance issues, and concerns over range. While EVs are the future, it's the traditional internal combustion engine (ICE) product that generates the profits and funds the dividends and buybacks for shareholders. The ICE product has an additional advantage – it is relatively insulated from Tesla and Chinese EV disruption.

Figure 1: Share price performance of EV manufacturers in 2024 YTD

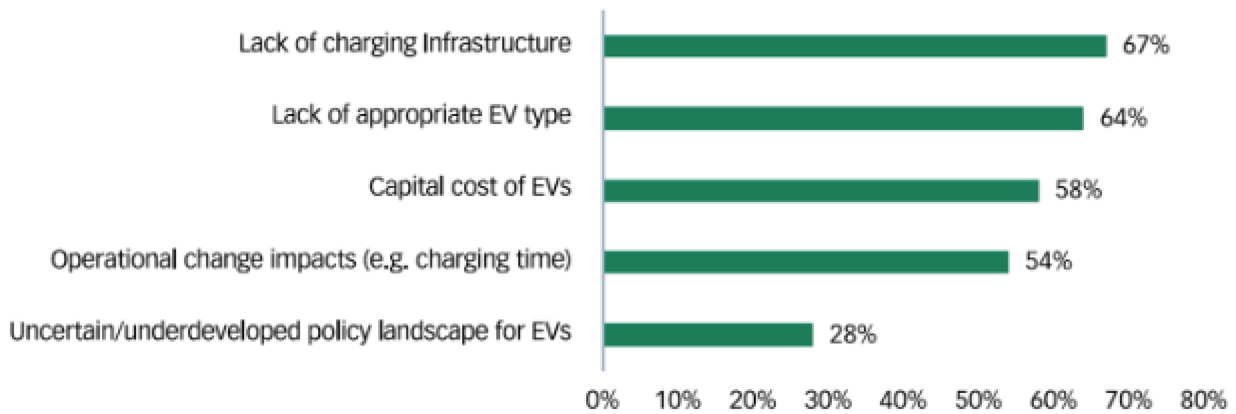
Source: Bloomberg, Firetrail. Rebased to 100 on 29/12/23

Figure 2: Average producer price for EV and storage batteries



Source: IEA, Firetrail

Figure 3: Top 5 barriers to EV adoption reported by EV100[1] companies



Source: IEA, Firetrail

On top of this, the current U.S political environment may discourage new competition or lead to automakers deferring investment decisions.

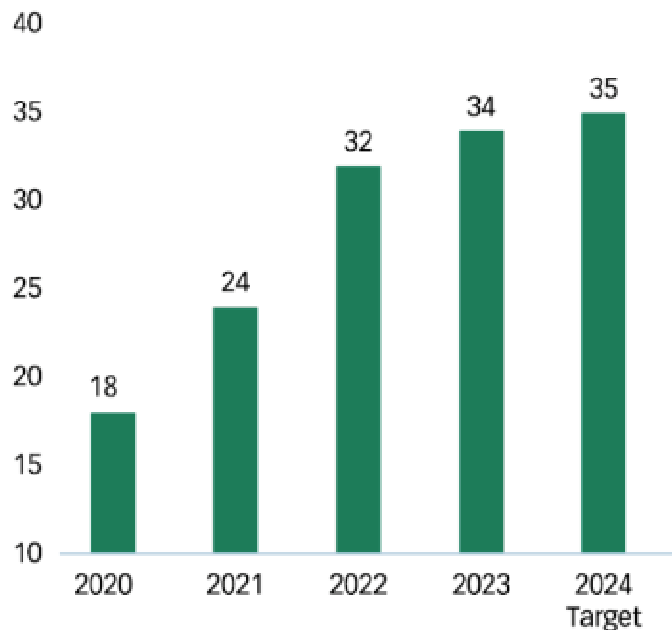
Where are the opportunities?

Cutting through all this noise, and given the de-rating in the EV sector, where do the opportunities lie? We believe that caution is warranted and are taking a prudent approach by maintaining a highly selective approach.

Our preferred exposure today to the EV thematic is Aptiv (NYSE:APTV), a US-listed company that designs, develops, and manufactures software and hardware solutions for both EV and ICE vehicles. To use a human body metaphor, Aptiv supply both the 'brain' (software and computing systems) and the 'nervous system' of vehicles. Aptiv's clients include GM, Stellantis, Ford, Volkswagen, and Tesla. They supply electrical content for 1 out of 3 low voltage vehicles, and 1 out of 2 high voltage vehicles globally. EV bearishness is most focused in the US, whereas Aptiv's high voltage business is around 80% European and Chinese auto manufacturers.

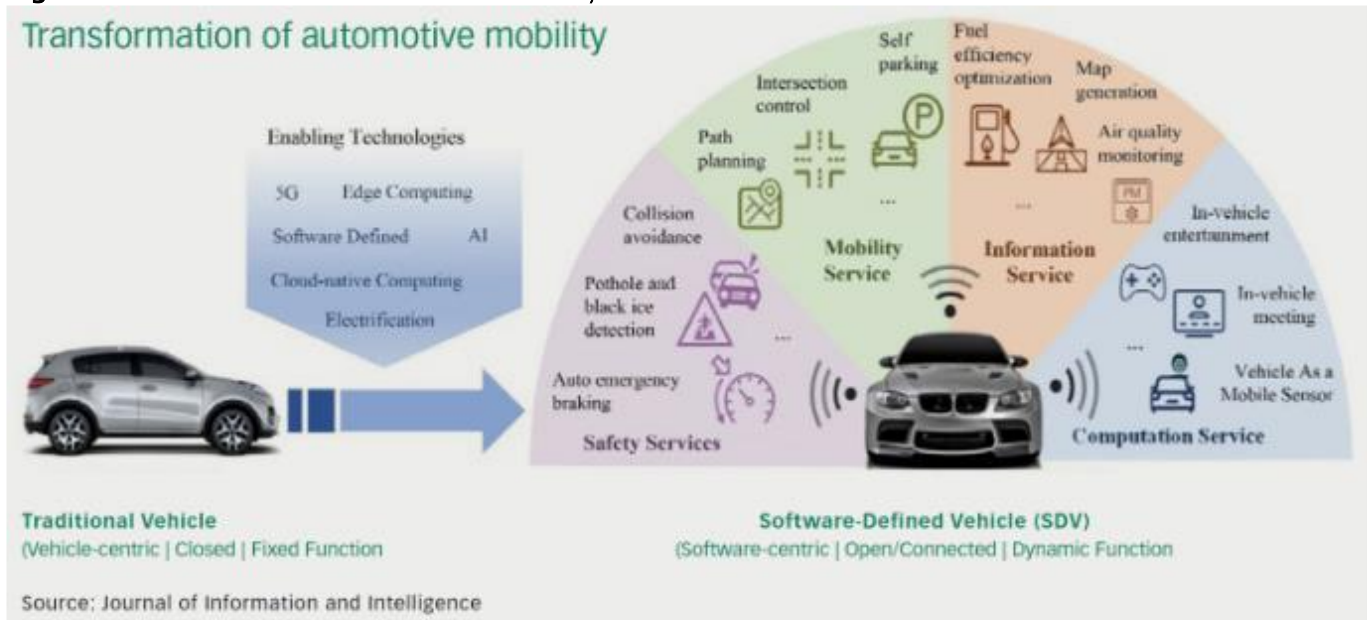
What we really like about Aptiv is that the outlook for the company's earnings isn't solely reliant on successful EV penetration outcomes. However, any upside to EV sentiment from current depressed levels is likely to drive incremental upside to an already compelling fundamental story. New products, an expansion of charging infrastructure, and improvements in affordability would see sentiment shift swiftly around the EV manufacturers.

Figure 4: Aptiv order bookings (USD billions)



Source: Firetrail

Figure 5: Transformation of automotive mobility



Focus on what matters

Aptiv is well placed to capitalise on the secular trends of automation and EV penetration. Investors have been wrong to focus on the near-term headwinds to EV adoption, rather than Aptiv's long-term trajectory. Aptiv have always been more conservative than the market around EV penetration, and we view the company as the best positioned content supplier to benefit from the EV and 'Car of the Future' thematics.

As a business built around these megatrends it has a sustainable business model. As the only full-system provider of smart vehicle architecture and with over 90% sales visibility through to 2025, it has the potential to deliver sustainable earnings, which are supported by the company's strong new business pipeline. The company is a future leader in the EV industry and is placed in two of Firetrail's Sustainable Positive Change themes: Climate Impact, and Innovation & Equality.

We expect significant growth and margin expansion to continue to reinforce the quality of Aptiv to investors. Rather than getting caught up in noise, we are looking beyond the present to uncover and capitalise on opportunities.

[1] The Climate Group's EV100 Initiative brings together over 100 companies in 80 markets committed to making electric transport the new normal by 2030.

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