Firstlinks
a Morningstar company

Edition 563, 7 June 2024

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Editorial

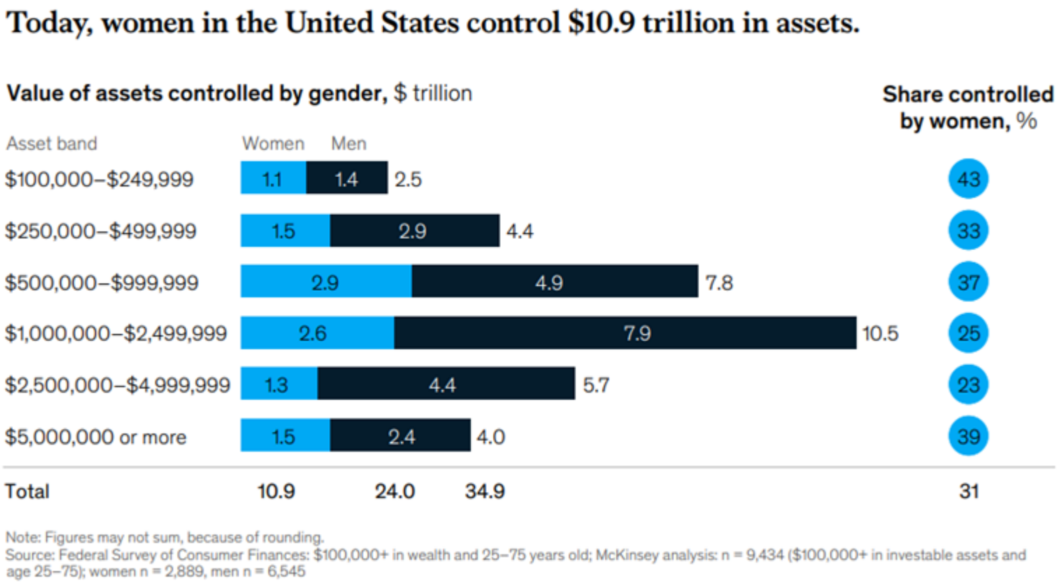
Women will be the largest beneficiaries of Australia's $3.5 trillion intergenerational wealth transfer. The transfer isn't something that's 20 years away either. Much of it will happen this decade.

There hasn't been enough discussion about how this could transform markets as well as the wealth management and financial advice industries. This article is an attempt to right that wrong.

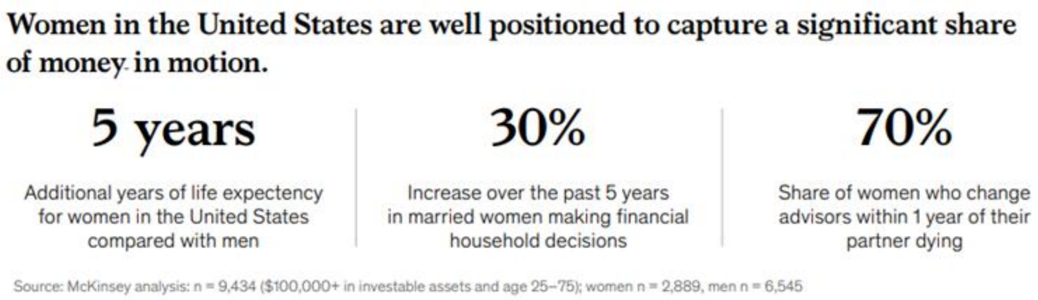
The future is female

There's been a lot of overseas research into the issue of how women will soon inherit much of the largest wealth transfer in history.

Several years ago, McKinsey did a report on how women control about a third of the $35 trillion in US household assets, and that could increase by another third by 2030. It says the biggest driver of the shift is demographics. About 70% of investable assets are controlled by Baby Boomers in the US. And two-thirds of those assets are held by joint households.



Source: McKinsey



Source: McKinsey

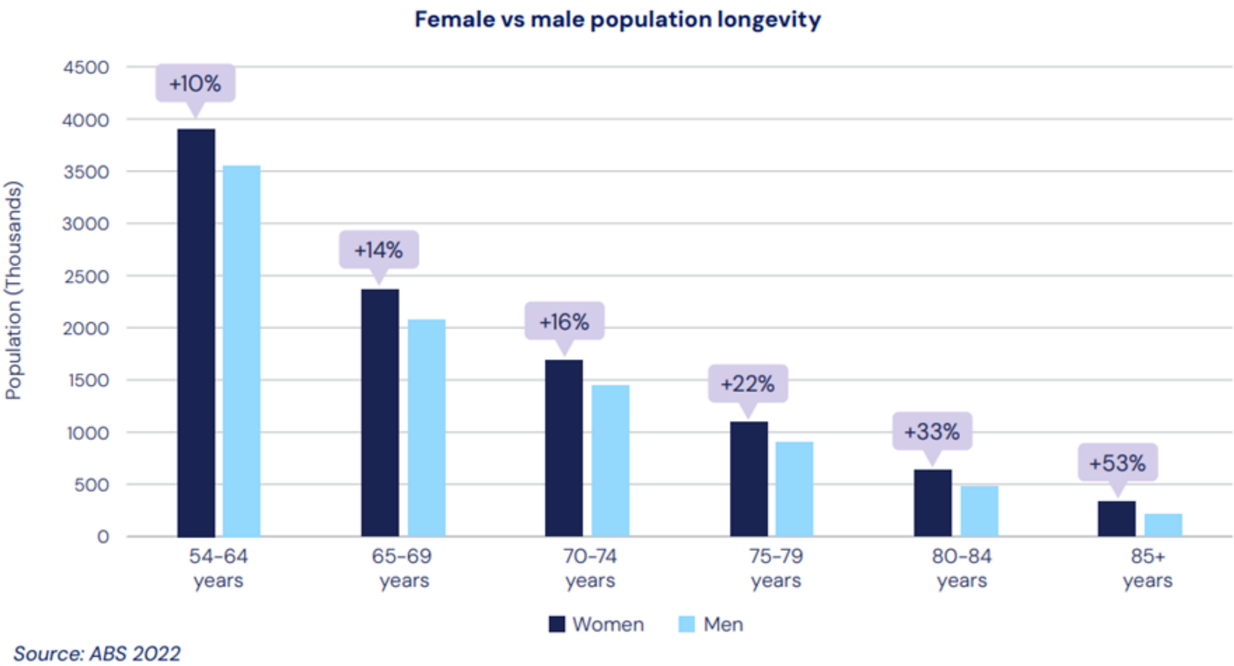
As men pass, many will cede control of these assets to their wives, who tend to be both younger and longer lived. In fact, women outlive men in the US by an average of five years.

McKinsey says that by the end of the decade, women are expected to control the majority of the $35 trillion in household assets, and that it's a potential wealth transfer of such magnitude that it approaches the annual GDP of the US.

Schroders has published similar findings in the UK. However, the wealth transfer would appear to be more imminent there, as it estimates that women will control 60% of Britain's wealth by next year!

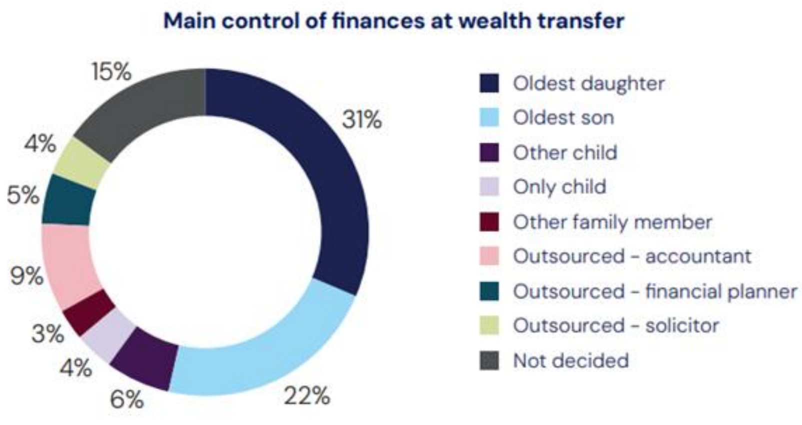
In Australia, the research has been sparser. Recently, JB Were investigated the issue in a report entitled 'The Growth of Women and Wealth'. The report estimates that the potential wealth transfer in Australia isn't $3.5 trillion as suggested by the Productivity Commission, but closer to $5 trillion. And of that money, women are set to inherit 65%, or $3.2 trillion in the next decade.

Like McKinsey, JB Were believes demographics will be the main driver, with women outliving their partners. It cites statistics that in the 70-plus age group, there are 16% more women than men, and this widens to 33% for those aged over 80.

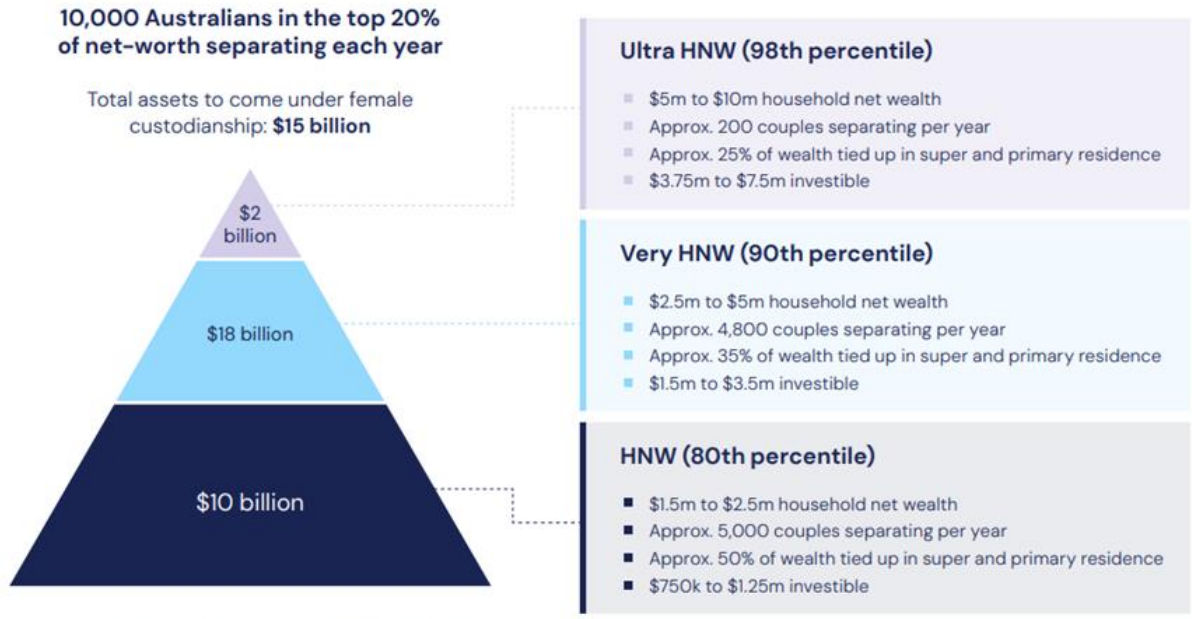


It isn't just demographics, though. The research found that control of the family finances at the point of wealth transfer is most likely to be managed by the oldest daughter in the family.

Women won't just be the beneficiaries of the wealth transfer. They'll also claim billions in existing wealth via divorce and separation. There are more than 50,000 divorces in Australia each year, with couples aged 50 and over being one of the fastest growing cohorts.



Source: ISI 2019



Source: ABS, ATO and Anubis Data Modelling | 2023

**According to research conducted on wealth transfer by CoreData in 2021*

The children may not get as much as they expect

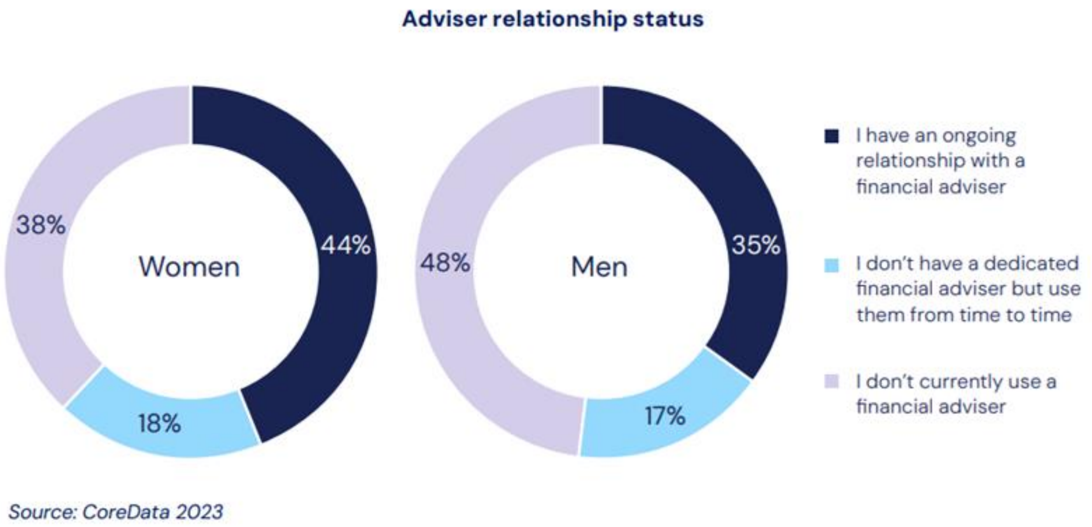
While women may inherit more, children may get less than they expect. A report from AMP this week suggests most retirees believe their children face similar or harder financial challenges than they did growing up, amid rising housing unaffordability and rents. Though they're keen to support their children, 70% of them are reluctant to compromise their lifestyle to provide financial assistance.

Also, four out of five of retirees aren't prepared to downsize to release funds to their children, according to the report. However, about half of them will consider passing home equity value to their children if they can stay in the family home.

Women will manage their money differently to men

How will women manage all their money? The McKinsey US research suggests they'll do it in a very different manner to men, with four key attributes:

1. **Greater demand for advice.** Female financial decision makers are more likely to have an adviser than men. And they'll be more willing to pay a premium for in-person financial advice. These findings are consistent with the JB Were report, which highlights that high-net-worth women already seek more advice than men, as the chart below shows.

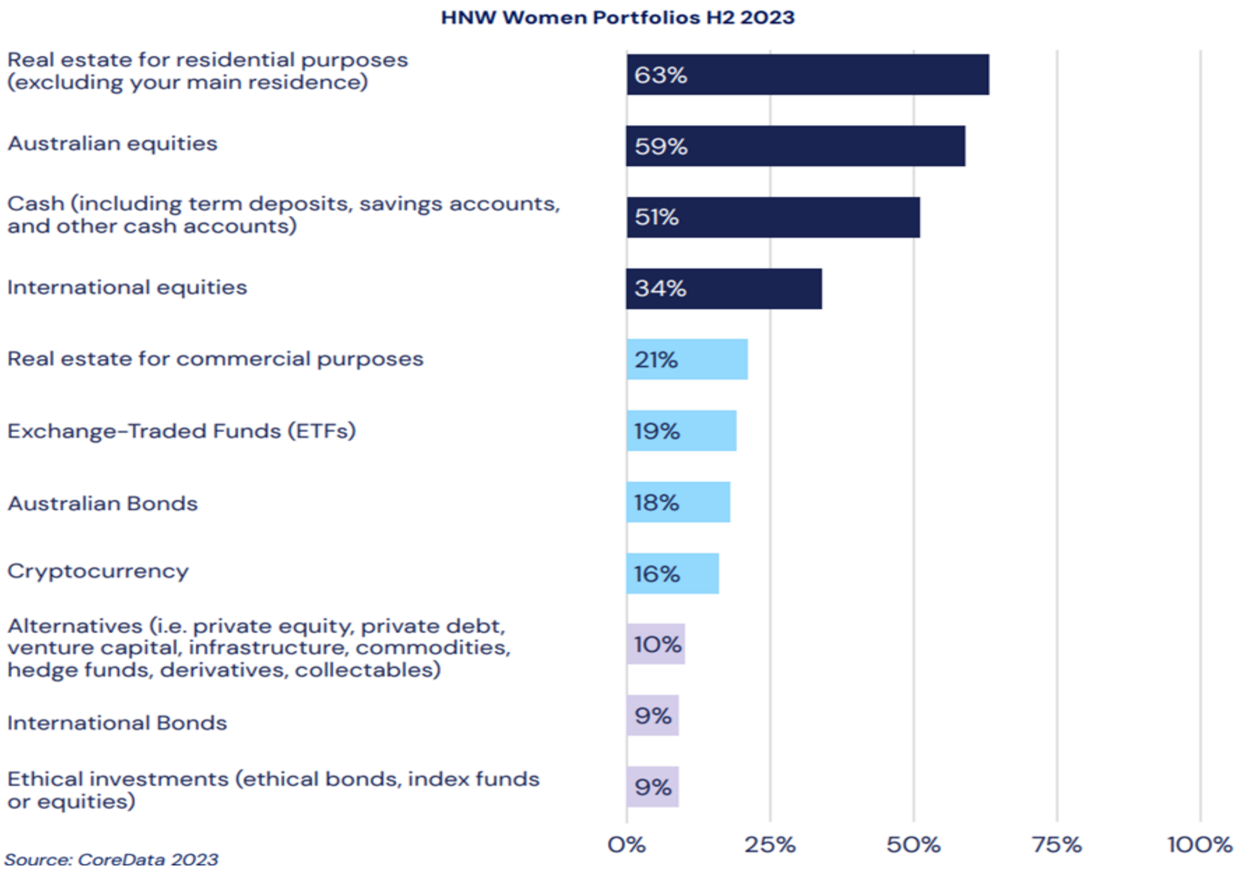


2. **Lower financial self-confidence.** McKinsey's survey found many women report lower confidence in their own financial decision making and investment acumen. Only 25% are comfortable making investment and savings-related decisions on their own – 15% lower than their male counterparts.

3. **Less risk tolerance.** Women are less likely to take big investment risks for the potential of high returns, says McKinsey. And there much more likely to manage their money through passive instead of active management strategies.

4. **Greater focus on real-life goals.** Women are less concerned with outperforming the stock market and more worried about having enough savings for retirement.

The JB Were report in Australia gets more granular on current high-net-worth women's portfolios and what pointers they may have for the future. Most of the women surveyed invest their money in Australian residential property, Australian equities and cash. They're less enamoured with bonds and alternative assets.



From this, it appears that women are investing in mostly what they know well versus what they don't. Whether that changes with inheriting greater sums of money remains to be seen.

Switching financial advisers may be on the cards

While women wanting greater advice would seem positive for the financial advice industry, it doesn't tell the whole story.

The biggest shock comes from Schroders UK research which says that 70% of Baby Boomer widows will leave their partner's adviser within a year of their death. There's been no comparable research on this in Australia, though if it's true here too, then it means that hundreds of billions of dollars might be up for grabs during the remainder of this decade.

What it does highlight is that women often don't have close relationships with their partner's advisers. The overseas research also emphasises that women want a different type of advice to their partners. They prefer hyper-personalised, outcome-based financial advice that meets their real-goals.

Implications

The implications for funds managers, super funds, financial advisers and wealth managers are obvious – they had better get to know their female clients (or partners of their clients as it may be), and quickly. Because the needs of women are likely to soon reshape the entire financial industry.

In my article this week, I look at the secrets behind the extraordinary track record of Australia's equivalent to Berkshire Hathaway - Washington H. Soul Pattinson.

James Gruber

Also in this week's edition...

Aidan Geysen of **Vanguard** says there's an epidemic in Australia that has nothing to do with COVID-19, the flu, or the respiratory syncytial virus. This one is called FORO, or the fear of running out of money. And it mostly afflicts people aged from their mid-50s onwards who are either approaching retirement or are already retired.

Retiring now is more complicated than it was five years ago, as uncertainty around inflation has made the amount retirees need to save less certain. **Investors' Mutual's Michael O'Neill** thinks retirees should focus on income to make future planning easier.

With high inflation and the increased cost of living, most of us are looking at ways to save money. New research from The University of Adelaide's **Lachlan Schomburgk** and colleagues shows that paying by cash rather than card, even if inconvenient, can be a valuable tool in controlling expenses.

Obesity wonder drugs have taken the world by storm, and **Capital Group's Matt Reynolds** believes other health care breakthroughs are coming. He's especially positive on scientific work which manipulates human DNA to find new ways to treat a wide range of diseases. It's an open-eyeing article...

There's been extensive talk about large super funds shifting from public to private assets, though new data suggests that the change hasn't been dramatic. However, **Elstree's Campbell Dawson** says that there are other things that may challenge the long-term performance of Big Super.

Many investors, including Warren Buffett, are believers in concentrated portfolios. After all, if you don't have conviction in positions, what's the point? **Joe Wiggins** has gone from being a fellow believer to a sceptic, and here he details why.

Lastly, in this week's whitepaper, **The World Gold Council** surveys Australian investors and finds that they generally want an allocation to gold, and believe their superannuation fund has exposure to the yellow metal, even though it may not.

The secrets of Australia's Berkshire Hathaway

James Gruber

Last year, I wrote of [ASX stocks that have stood the test of time](). It included some of our oldest businesses and how they've managed to not only endure but thrive.

I followed up with a piece, [16 ASX stocks to buy and hold forever](). Only three stocks featured in both of these articles, and one of them was Washington H. Soul Pattinson (ASX: SOL), or Soul Patts as it's known.

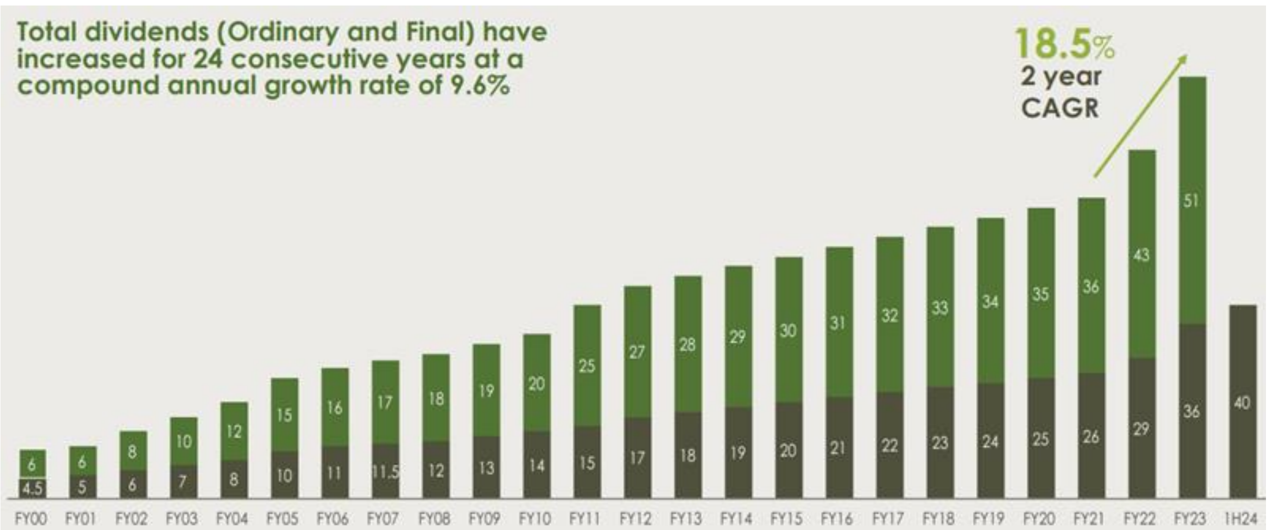
Thinking of Australia's greatest ever investors, names like Greg Perry, Erik Metanomski, David Paradice, and Kerr Neilson naturally spring to mind. Yet, Soul Patts' Robert Millner and his uncle, Jim, should be in the conversation too.

It's true that Soul Patts isn't a pure investor. It's a business operator as well. In that, it's more like an investment conglomerate, not dissimilar from Warren Buffett's Berkshire Hathaway.

Soul Patts' track record is outstanding. Over the past 20 years, it's returned 12% per annum (p.a.), easily beating the All Ordinaries Index. $100,000 invested in the company in 2004 would have turned into $869,000 today, more than double the amount you would have earned from investing in the All Ordinaries over that period.

Source: Soul Patts' investor presentation

Soul Patts has paid a dividend in every year that it's been listed, going back to 1903. It's also increased its dividend for 24 consecutive years. If the company increases its dividend again this year, it will become Australia's first-ever Dividend Aristocrat – a term from the US given to companies that lift their dividends each year for 25 consecutive years or more.



Source: Soul Patts' investor presentation

Exactly, who is Soul Patts?

The company began life as a pharmacy in 1872. It's then that Caleb Soul opened the chemist in Pitt Street, Sydney. In 1886, Lewy Pattinson opened a pharmacy in Balmain. Caleb and Lewy became friends and in 1902, Washington Soul bought out Pattinson and a year later, listed on the Sydney Stock Exchange.

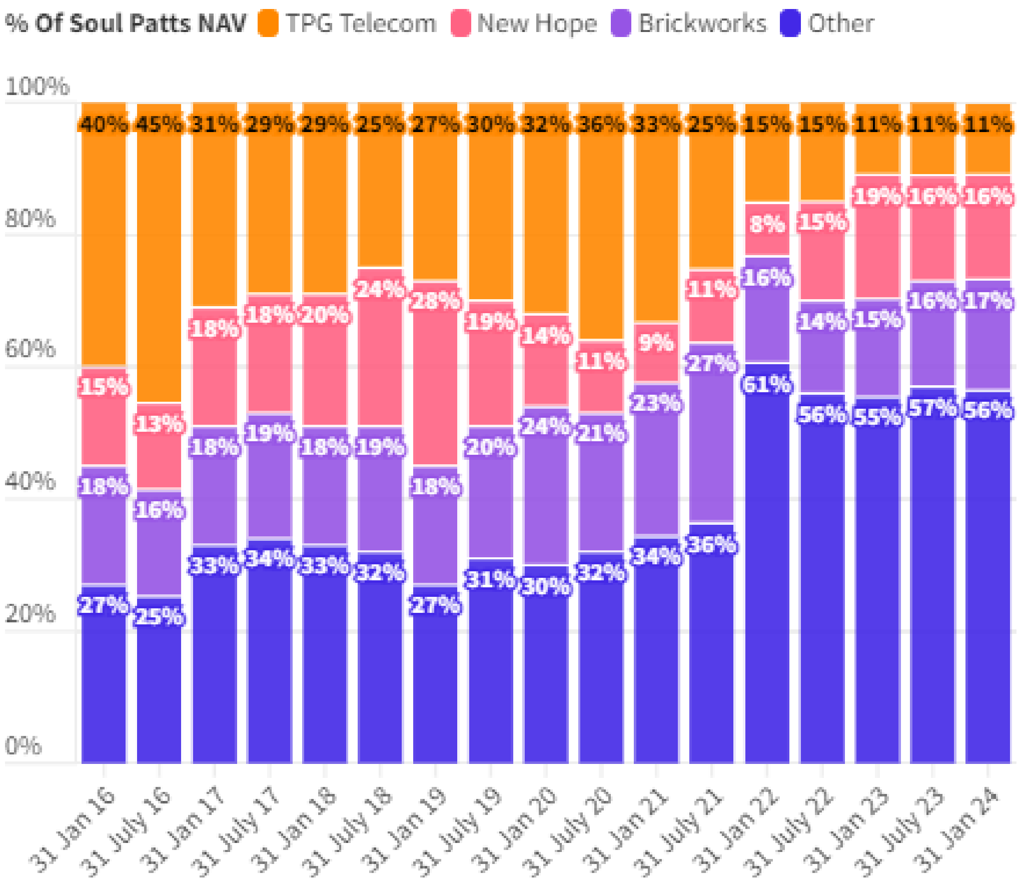
In 1903, Soul Patts had 21 pharmacy stores. By the time of World War Two, it dominated the retail pharmacy market and it also had manufacturing and warehouse facilities.

Jim Millner, who'd been a prisoner of war in Singapore, transformed the business from a pharmacy into an investment powerhouse in the 1960s and 1970s. He made numerous mining investments, which eventually culminated in the purchase of New Hope Collieries, now known as New Hope Corporation (ASX: NHC). He also bought a cross shareholding in building materials company, Brickworks (ASX: BKW). In the 1980s, the company bought NBN Television Station, which eventually turned into TPG Telecom (ASX: TPG).

In 2021, Soul Patts made its biggest play in financial services via a merger with listed investment company, Milton Corporation.

Robert Millner has been Chairman of the company since 1998, and as Lewy Pattinson's great grandson, is the fourth generation of the family to manage Soul Patts.

Today, the company is an $11 billion giant with a diverse portfolio of assets. About 40% of the net asset value is in three listed companies, Brickworks, TPG Telecom, and New Hope. The company has a 43% stake in Brickworks, which in turn owns 26% of Soul Patts. It also has a 13% interest in TPG and 39% interest in New Hope.



Source: Company, Flourish

Besides these long-term strategic holdings, Soul Patts also has close to $3.2 billion in private equity, credit and 'emerging companies'. Among its more interesting private holdings, it continues to build out luxury aged care accommodation, partnering with the Moran family. It's also endeavouring to roll up swimming schools across the country through a business called Aquatic Achievers.

Ingredients to its success

I think there are six secrets to Soul Patts' success since listing 121 years ago:

Be opportunistic. If I had to describe the company and Soul Patts in one word, it would be opportunistic. It invests where it sees opportunity and where the odds are stacked in its favour. And it'll look at any asset, even overseas, if it makes sense.

Always have cash on hand. To be opportunistic, it's important to not take on too much debt and to always have cash on hand, so you can move when the time is right. This is a guiding philosophy of Soul Patts and it's a key reason why it's been able to quickly move on acquisitions.

Partner with great people. Soul Patts seems to choose business partners better than most. It recognizes it's often not an expert in a field, and it's not afraid to partner with someone who is. A classic example of this is the partnership with David Teoh and TPG, which has been immensely profitable for both parties.

Don't be afraid to be unpopular. There have been two major controversies for the company. The first is the cross shareholding with Brickworks. The company has had to fight off the likes of Ron Brierley and Perpetual to retain this arrangement. The second controversy has been with its ownership of New Hope. Anti-coal advocates have targeted Robert Millner, who's held steadfast on the continued need for coal to help meet the world's electricity needs.

An investor and operator. Robert Millner considers himself an investor first, and an operator second. Both have been important to his success. Soul Patts has board positions on most of the companies in which it invests, and provides advice, and capital for acquisitions when needed.

Luck. Yes, everyone needs a slice of luck, and Soul Patts has had its share. The property that it owned via Brickworks has turned into a bonanza. As has the agriculture holdings, the value of which have risen well beyond the company's wildest expectations. To get this kind of luck though, you must be in the game, and Soul Patts has certainly done that.

Opportunities and challenges

Soul Patts has cash, connections, and a good reputation, which means it has the advantage of business deals coming to it, more than it having to go out to hunt for acquisitions. The company is keen to build out its private assets, as well as luxury aged care. Given recent moves with Perpetual, there's also scope for more transactions in financial services.

There are some challenges for the company too. The first is that Robert Millner is 73 and that means someone else may soon take over as Chairman. Who that is will be decided by the Board, but the big question is whether the success of the company can extend to a fifth generation of the family.

The other challenge is one that's less talked about, and that's size. Soul Patts has a relatively small team overseeing $11 billion in assets. If it keeps growing, managing those assets will become more complex, which potentially increases the chance of errors.

Size tends to make it harder to generate returns. It's easier to make $12 from a $100 investment than it is to make $120 million from a $1 billion investment.

James Gruber is Editor at Firstlinks and Morningstar.

Overcoming the fear of running out of money in retirement

Aidan Geysen

There's an epidemic in Australia that has nothing to do with COVID-19, the flu, or the respiratory syncytial virus (RSV).

This one is called FORO. It mostly afflicts people aged from their mid-50s onwards who are either approaching retirement or are already retired.

FORO is the fear of running out of money in retirement, and it's little wonder that many Australians are catching it thanks to the combination of rising living costs, volatile investment returns and, somewhat paradoxically, longer average life expectancies.

FORO, also known as longevity risk, is a growing problem. The most common symptom is loss aversion – a heightened sensitivity to investment risk due to concerns over potential future losses – leading many older Australians to increase their exposure to lower-risk, lower-return assets such as cash. It also tends to lead to underspending in retirement.

Few areas illustrate the concept of loss aversion more clearly than the superannuation industry, where millions of Australians are effectively on a financial treadmill to save as much money as they can before they retire in the hope they don't run out of it when they do.

Life expectancy for retirees is expected to continue to increase over the next 40 years. However, uncertainty over how much it will increase creates risks for the budget and makes it difficult for retirees to plan for retirement, potentially impairing their standard of living.

The *Intergenerational Report 2023* found that outliving one's savings is a key concern for retirees in deciding how to draw down their superannuation, and consequently most retirees draw down at the legislated minimum drawdown rates.

"This results in many retirees leaving a significant proportion of their balance unspent, for example, a single retiree drawing down at the minimum rates would be expected to still have a quarter of their retirement assets at death," the report noted.

The 2020 *Retirement Income Review* included projections from Treasury that outstanding superannuation death benefits could increase from around $17 billion in 2019 to just under $130 billion in 2059, assuming there's no change in how retirees draw down their superannuation balances.

Retiring with greater confidence

How to retire comfortably, with a high degree of confidence of not running out of money, is a topic being increasingly discussed.

There is a plethora of information available, yet for many, how to achieve a confident retirement remains elusive.

Many people expect to rely on the Government for protection against longevity risk through the Age Pension, which provides a safety net for retirees who outlive their savings. The potential role of the family home in providing a cash injection during retirement is also gaining traction.

But a key area that deserves greater airplay is investment portfolio management.

Put simply, retirees should ideally be thinking beyond just income generation by taking into account the 'total return' needed from an investment portfolio to fund living expenses over the longer term.

What is the total return? The total return includes both the growth in an investment's value (its capital return) as well as the income it generates along the way.

A total return strategy therefore involves using both capital and income returns from investments to fund everyday living expenses on a sustainable basis.

Putting such a strategy into practice involves assessing one's broad retirement goals and tolerance for risk. Available savings can then be allocated within an investment portfolio in a way that can support ongoing spending requirements.

Taking a long-term approach

In retirement, taking a long-term approach to one's investment strategy and lifestyle needs, and setting a sustainable spending rate, is just as important as it is before retirement.

Capital growth and income returns are unpredictable over the short term as market returns go up and down.

Using a total return strategy during times when income returns do fall below one's spending needs means some of the capital value of a portfolio can be spent to make up for any shortfall. In a practical sense, this involves selling a portion of 'liquid' assets such as shares, exchange-traded funds (ETFs) or managed funds.

The whole idea is to be able to sustain one's spending needs and having enough liquidity in a portfolio by selling some assets if required.

As long as the total return drawn down doesn't exceed their sustainable spending rate over the long term, this approach can smooth out income gaps during periods when investment returns are more volatile or negative.

Equally, when investment returns are stronger, this strategy also would involve maintaining spending levels (or even reducing them) and reinvesting higher income returns to rebuild the capital value of their portfolio.

The benefits of leveraging total returns

FORO is a treatable condition, especially help from a well-devised, well-managed investment approach that can provide a stable income stream over time.

A total return investment approach is all about establishing realistic spending goals and using capital and income returns to achieve them.

Spending adjustments invariably need to be made along the way, to account for years when the need for money is greater – such as to take a holiday, do house renovations or repairs, or to buy household or personal items.

In other years, it may be possible to reduce spending and use capital and income growth to boost one's portfolio so there is more of a buffer for times when investment returns are poor.

A good approach to building an investment portfolio is to apportion funds across different asset classes, such as shares, bonds, property, and cash. Having a diversified portfolio will offset the risks of being too exposed to one asset class.

Asset classes perform differently from year to year, but historical data going back for decades shows that despite inevitable short-term price dips, different asset classes have tended to deliver long-term growth.

Preparing well ahead for life in retirement is key. A good starting point for many Australians should be to seek out professional financial advice, especially in the context of retirement spending, using a total return strategy, and understanding how the Age Pension and other investment strategies may play an important role.

Aidan Geysen is a Senior Manager, Investment Governance at [Vanguard Australia](), a sponsor of Firstlinks. This article is for general information only. It does not consider your objectives, financial situation or needs so it may not be applicable to the particular situation you are considering. You should seek professional advice from a suitably qualified adviser before making any financial decision.

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Trying to save money? Pay in cash

Lachlan Schomburgk, Alex Belli, and Arvid O.I. Hoffmann

Cash is in crisis. In Australia, it's now only used for 16% of in-person transactions, down from about 70% in 2007.

The situation is so dire that Independent Federal MP Andrew Gee has introduced a private member's bill that would force businesses to accept cash or else face big fines.

The reality is that over the past decade, technological advancements have utterly transformed the way we pay for goods and services. Phones and smartwatches can now easily be used to pay by card, and buy-now-pay-later schemes and cryptocurrency payments offer further alternatives.

The shift away from cash only accelerated throughout the COVID pandemic, as health experts recommended avoiding using it for hygiene reasons.

Despite these big changes in *how* we spend money, Australians have perhaps been more focused on *how much* amid a stubborn cost-of-living crisis.

In light of this, our research team wanted to investigate how our choice of payment method can interact with our actual spending habits. Our latest research offers a simple solution for anyone looking to save money — carry more cash!

We pay less when we pay cash

Drawing on both academic and industry sources, our research team combined the results from more than four decades of prior research on spending behaviour and payment methods into a large dataset.

This data spanned 71 research papers, 17 countries, and more than 11,000 participants. State-of-the-art meta-analysis techniques then allowed us to collectively analyse the results from all these prior studies, and re-examine their insights.

We found that cashless payments were indeed associated with higher levels of consumer spending compared to cash transactions, something that is referred to in the literature as the "cashless effect".

This cashless effect was consistent across all other payment methods in the data set.

Put simply, it doesn't matter whether you use a credit card, debit card or a buy-now-pay-later service – you are likely to spend more money using cashless methods than when you pay with cash.

The pain of paying

Under the traditional economic view that consumers behave rationally, there should be no differences in spending behaviour between different payment methods – money is money after all. But the existence of the cashless effect shows that the payment methods we use do influence our spending behaviour.

The leading theory to explain this effect attributes it to differences in the "pain of paying", a concept first coined in 1996 that describes the emotions we feel when spending money.

Importantly, our choice of payment method can influence the level of pain felt. When paying with cash, we have to physically count out notes and coins and hand them over. Humans seek to avoid losses, and paying by cash sees us physically lose a tangible object.

Conversely, nothing has to be handed over to pay cashlessly. We don't lose anything tangible with a swipe or a tap, so it feels less painful.

Preliminary neurological evidence suggests that the "pain of paying" isn't just an abstract metaphor, and we may feel actual psychological pain with each transaction we make. Research employing functional magnetic resonance imaging (fMRI) scans to observe brain activity in consumers has shown that paying activates brain regions related to experiencing psychological discomfort.

Picture this: You're at a theme park, excited for a fun day. You use your smartwatch to pay for snacks, souvenirs and rides. It's all so convenient that you don't realise how much you're spending until you check your account later and see that you have completely blown your budget!

This is the cashless effect in action - if nothing is physically handed over, it's easy to lose track of how much is spent.

A great tool for budgeting – while it lasts

The cost of living crisis has made spending control front-of-mind for many people. Our meta-analysis suggests that returning to "cold hard cash" whenever possible could be one valuable tool to help.

The increased friction felt when using cash could help people better control their money, even just by providing a moment to pause and consider whether a transaction is necessary.

This could help individuals make more mindful decisions, saving money while they can in an increasingly cashless world.

Lachlan Schomburgk, PhD Researcher in Marketing, University of Adelaide; Alex Belli, Senior Lecturer in Marketing, The University of Melbourne, and Arvid O. I. Hoffmann, Professor of Marketing, University of Adelaide

Inflation uncertainty makes retirement planning harder

Michael O'Neill

When I drive up the coast for a summer holiday, packing is easy. Shorts, t-shirts, thongs – done. It's a bit different if I go snowboarding: my bags are packed full of a wide range of clothing to suit all the possible conditions I might encounter. The more unreliable the weather, and the more severe the consequences of poor packing, then the greater care I take in preparation.

The same is true for investing. When conditions are uncertain, investors should prepare their portfolios for a wider range of possible scenarios. For people about to retire this is critical. The closer you get to retirement the more any investing mis-steps matter. It has always been hard for retirees to work out how much money they need to retire as there are so many variables – investment performance, health, longevity, unexpected expenses – the list goes on. Now, with the cost-of-living increasing more quickly, and high uncertainty when inflation will return to normal levels, the sum of money people need to save to live comfortably for the rest of their life, is even harder to estimate.

Inflation and interest rate predictions keep changing

When inflation re-surfaced in 2021, many economists and central bankers thought it would be transitory. It wasn't. Then they thought inflation had been 'tamed' and would soon head back to the 2-3% target range. Now, that's looking less likely. The latest data shows that inflation has ticked up again recently, and the path back to 2-3% is looking anything but smooth.

Interest rates have followed a parallel path. At the start of this year, US investors were expecting multiple rate cuts in 2024. Then in March, the US Federal Reserve suggested three cuts were likely in 2024. Now, markets are pricing only one cut this year. The same dynamic is playing out in Australia. Six months ago, multiple rate cuts were expected this year, now most economists expect only one cut in Australia in 2024, with some even suggesting a rate rise is possible this year.

Global inflationary forces persist

The ultra-low interest rates of the 2010s were built on a base of deflationary globalisation, combined with a relatively benign geopolitical environment. In the 2020s, this strong foundation has been steadily eroded. Covid forced companies to bring in greater, and more expensive, supply chain flexibility. War in the Ukraine and the Middle East, and increased tension with China, have further increased prices and decreased certainty, leading to more expensive on-shoring. The global push to reduce emissions and fossil fuel usage is expensive and will continue to add to inflation.

While goods inflation (eg buying clothes or household items) seems to have abated in Australia, services inflation (eg renting, taking a holiday) remains sticky and problematic. The Economist says Australia has the developed world's most entrenched inflation. While there is talk about AI being the great hope for increased productivity and deflationary pressure, it hasn't yet had that effect. In fact, it may increase inflation in the short-term as companies invest more in AI and fight for AI chips and data-centre space.

Higher, stickier inflation is retirees' top investment concern

With inflation lingering like the last guest at a party, prospective retirees are understandably concerned. In a Natixis Investment Managers survey last year[i], more than half of Australian investors (54%) said that inflation was their top investment concern, and close to two thirds (63%) said it is significantly impacting their ability to save for retirement. Retiring now is more complicated than it was five years ago, as uncertainty around inflation has made the amount retirees need to save less certain.

Retirees are left with a problem:

- **Take greater risk in their investments**, to improve returns and stay ahead of inflation, but increase the chance of losing money.
- **Invest more conservatively,** but earn lower real returns, and hope that inflation will come down more quickly and so maintain quality of life.

We think there is a third way: ***focus on sustainable income***, rather than returns.

A greater focus on income reduces the likelihood that retirees will need to use their investment capital to fund their lifestyles during times of poor investment performance.

Higher, sustainable income can smooth out investment volatility

There are a number of different ways of generating income from investments including rental properties, coupons from fixed income, interest from term deposits and dividends from equities. All have their advantages and disadvantages but offer important diversification, and greater income for investment portfolios.

While equities, particularly Australian equities, deliver solid income returns (more than half of the returns from the ASX200 over the past 20 years come from dividend income[ii]) equities are more volatile than many other asset classes. Dividends are inherently less volatile than share prices as dividends are paid based on the underlying profitability of the company, whereas share prices fluctuate depending on the whims of the market. Investors can also reduce the volatility of equities by focusing on higher-quality companies, and increase income by investing in companies that pay consistently high levels of dividends. This is what we do in IML's Equity Income Fund. We also further increase the level of income through conservative options trading.

To show the impact higher income can have let's look at a hypothetical scenario where someone retires at the end of 2010 with a lump sum of $430,000 and invests the entire amount in either:

- An income-focused equity fund (IML's Equity Income Fund – EIF)
- Or a generic passive ETF[iii] which replicates the ASX 300, with quarterly distributions

From 1 January 2011 to April 30, 2024 the annualised total return (see footnote under graph) for both funds is very similar (7.9% for EIF and 7.8% for the generic ETF), so if no withdrawals are made then the investment performance is very similar as you can see in the graph below.

Cumulative value of income versus growth investment

Source: IML, Factset. Returns are calculated after fees and assume all dividends and franking[iv] are reinvested in the funds. Past performance is not a reliable indicator of future performance.

However, if you add in monthly withdrawals to pay for a comfortable lifestyle (starting at $3,300 per month and rising with inflation), things change significantly.

Cumulative value of income versus growth investment with monthly withdrawals

Source: IML, Factset. Lump sum and monthly withdrawals based on ASFA's Retirement Standard for a 'comfortable' life for a single person. Returns calculated after fees and including franking[iv]. Past performance is not a reliable indicator of future performance.

On the 1st of May this year the amount invested in the IML Equity Income Fund back would have been worth $396,000, whereas the amount invested in the generic ETF would have fallen to $252,000 – a difference of around $144,000.

The main reason for this stark difference, despite similar investment performance, is the higher income, from the Equity Income Fund, which is distributed regularly. This regular income gives investors money to live on, making it less likely they will be forced to sell shares for living expenses when performance is poor, and so lock in losses and permanently deplete their investment capital. This is called sequencing risk, which is a key risk retirees face, unlike accumulators who typically add to their investments in periods of weak markets rather than withdrawing money and locking in poor returns.

To be clear: we would never recommend someone invests their entire portfolio in one investment option – diversification is a critical component of successful long-term investing. There are also many differences between the products investors should be aware of before considering investing, including the higher fees of EIF compared to the passive ETFs, and the different risk profiles of each fund. This is not meant as a broad comparison between the funds, it is simply intended to show the difference income and capital growth ratios can make for long-term investments.

Focusing on income can make retirement planning less stressful

While financial planning for retirement is complex, there are ways to make things easier – even in a volatile and uncertain investment climate. We believe that if retirees focus on generating enough income from their investments to stay ahead of inflation, then they are more likely to be able to enjoy their retirement and less likely to be worrying about their finances.

Michael O'Neill is a Portfolio Manager at Australian equities fund manager [Investors Mutual Limited](). Michael jointly manages the [IML Equity Income Fund]() with Portfolio Manager, Tuan Luu. This information is general in nature and has been prepared without taking account of your objectives, financial situation or needs. The fact that shares in a particular company may have been mentioned should not be interpreted as a recommendation to buy, sell, or hold that stock. Past performance is not a reliable indicator of future performance.

[i] *Natixis Investment Managers 2023, Global Individual Investor Survey.*
[ii] *Source: Morningstar Direct, as of 30 November 2023*
[iii] *The generic ETF was created by taking the median performance, franking and fees from 4 different passive index funds which track the ASX200 or ASX 300. The index funds used are A200 (betashares), IOZ (ishares), STW (State Street) and VAS (Vanguard).*
[iv] *The fees and franking for EIF are on the EIF Fund page on the IML website, the fees and franking for the generic ETF were calculated using the median of the four funds mentioned above, 5 basis points of fees and 75% franking.*

The health care breakthrough that's not an obesity drug

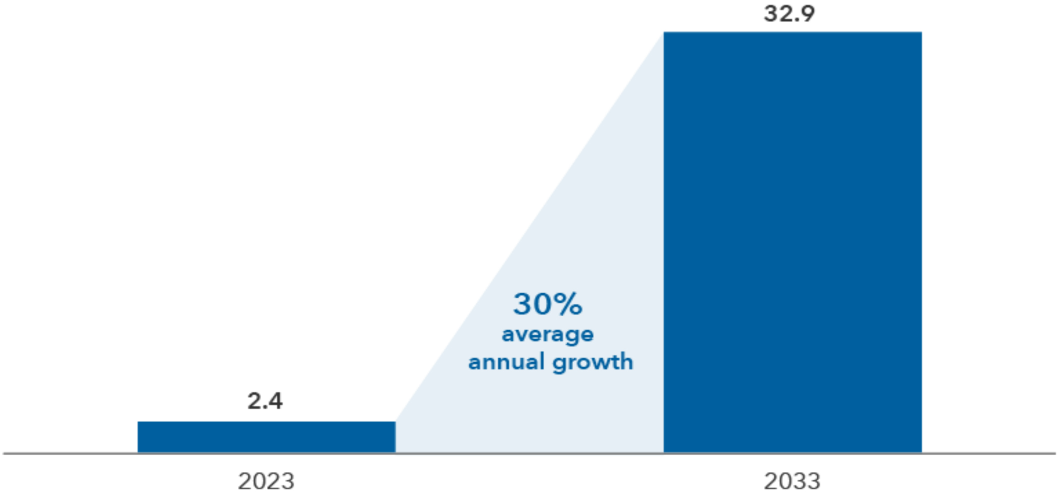
Matt Reynolds

In a period when the case for investing in health care companies is perhaps as strong as it's ever been, it is worth reminding that the advances in the sector are not just confined to the obesity wonder drugs.

In an age of remarkable health care innovation, scientists are manipulating human DNA to find new ways to treat diseases. In this era of "gene hacking", scientists have moved from the laboratory to the real world with a treatment for the life-shortening disease sickle cell — the first approval based on a revolutionary gene-editing technology known as CRISPR (clustered regularly interspaced short palindromic repeats).

It is significant from an investor's perspective. Whether it's biotechnology or medical devices, history has shown that there is always been an important moment that has changed how investors view a new technology or therapy. It could be one major success or a series of successes, and we are seeing pockets of that now across the health care sector.

Gene editing is set to expand over the next decade
Estimated global market size of CRISPR gene editing (USD billions)



Source: Statista. As of January 2023. CRISPR stands for "clustered regularly interspaced short palindromic repeats."

Novo Nordisk's and Eli Lilly's weight loss drugs, originally developed for the treatment of diabetes, are prime examples. The drugs, sold under the brand names Ozempic, Wegovy and Zepbound, could reshape industries beyond healthcare.

Meanwhile, cell and gene therapy companies are forging their own paths. These therapies can modify, replace, activate and disable genes. And rather than outright change human DNA, some companies are working on ways to moderate or fine-tune how they are expressed.

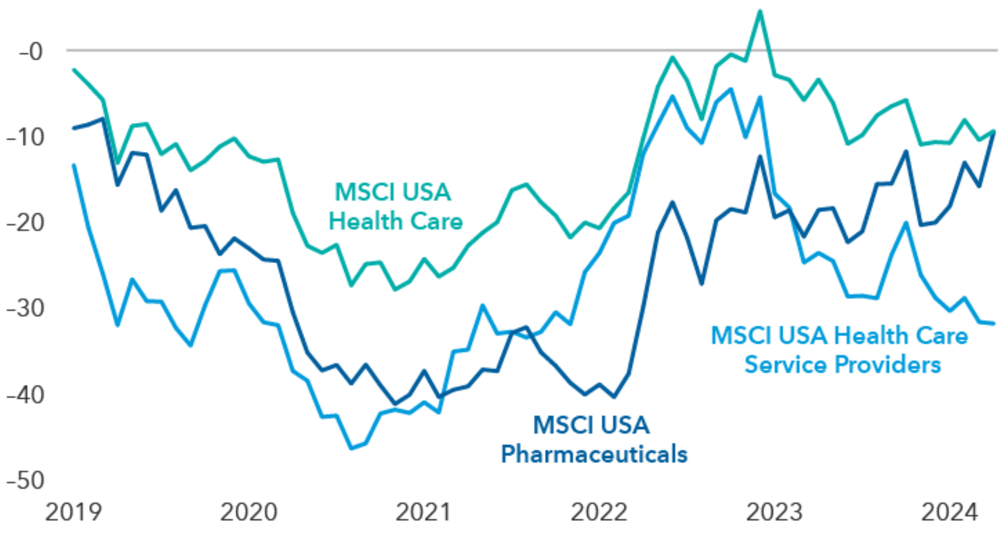
Arguably, approvals for genetic disorders based on a single gene such as sickle cell are just the beginning for gene-editing therapies. There are likely to be more to come, but it's not likely to be a linear progression. Authorities and regulators will need to see these technologies work for diseases that affect a wider patient population before their use becomes widespread.

The science and the share price

Biotech investing is notorious for hype not quite meeting reality. More recently, the US Federal Reserve's monetary tightening policy siphoned capital away from more speculative investments like biotech.

Many companies were also caught flat-footed as demand for pandemic-era innovations such as vaccines, dropped faster than projected. During the Covid-19 period, there was tremendous excitement over anything that was going to treat the pandemic, and valuations spiked in a big way. The bubble has since burst, particularly for companies with their revenue potential tied to the pandemic.

Health care stocks appear undervalued relative to the broad market
Relative P/E valuations – MSCI USA Health Care and sub-sectors vs. MSCI USA



Sources: Capital Group, MSCI. Relative valuation is the ratio between the forward 12-month price-to-earnings (P/E) ratio of health care-related sectors and the MSCI USA Index. P/E for a stock is computed by dividing the price of a stock by the company's annual earnings per share. A value below zero indicates that health care is relatively undervalued. As of 24 April, 2024.

Nevertheless, health care is a global industry, and it is an industry that long-term investors cannot ignore. Health care spending in the United States reached $4.5 trillion in 2022, according to the Centers for Medicare and Medicaid Services, or 17.3% of US GDP. Valuations have improved for industries within health care. Since the start of 2024, investors have returned to health care stocks. And if interest rates decline, that could support continued capital flows into the industry.

As investors, it's important to remember that when an industry is on the cutting edge of science, there will always be failures. Significant hurdles remain for widespread adoption of cell and gene therapies, and health care investing is a decades-long endeavour. The framework that a long-term investor works from is considering the potential future earnings and the probability of success.

Biotech charges forward

Health care companies are racing to define how diseases are treated. Cell and gene therapy companies — including Vertex Pharmaceuticals, Gilead Sciences and Amgen — are going after the same diseases that weight loss drugs are targeting in the kidney, liver and heart, as well as cancers, autoimmune disorders and others.

Companies are developing cell and gene therapies for many diseases

Largest pharma and biotech companies with gene and cell therapies in development

Company	Headquarter and market capitalization	Target diseases
AstraZeneca	United Kingdom **$233B**	Rare diseases, metabolic disorders
Novartis	Switzerland **$224B**	Rare genetic diseases
Roche	Switzerland **$168B**	Hemophilia, Huntington's, spinal muscle atrophy, ophthalmology
Amgen	United States **$144B**	Oncology and rare diseases
Pfizer	United States **$143B**	Single-gene defects, neuromuscular and hematologic diseases
Vertex	United States **$102B**	Cystic fibrosis, sickle cell disease, beta thalassemia

Sources: Capital Group, MSCI, Drug Discovery & Development. Company examples include constituents of the MSCI All Country World Pharmaceuticals, Biotech and Life Sciences Index that fall within the top 15 largest companies by market capitalisation and have gene editing and cell engineering candidates in current development as of March 10, 2023. Market capitalisations as of 25 April, 2024.

In the case of cell therapy, cells are modified outside the body and then infused into patients. One specific type is commonly known as CAR-T, which has gained approval to treat certain blood cancers. CAR-T stands for chimeric antigen receptor, with the T referring to a type of immune cell modified to find and destroy cancer cells.

Current CAR-T treatments use a patient's own cells and are limited by the long, complex journey involved for patients, manufacturing challenges and high costs. However, treatments may eventually become more accessible and safer as scientists develop off-the-shelf techniques derived from unrelated donor cells. Additionally, companies may go beyond using T-cells and incorporate other types of cells over the next decade.

Another area of cell engineering is focused on modifying stem cells to replace missing or defective cells. For example, Vertex aims to cure Type-1 diabetes by transplanting insulin-producing cells into the pancreas, a program currently in human clinical trials.

Yet another promising innovation is RNA-interference (RNAi). This technology allows companies to create highly specific therapies that turn off the production of proteins that cause disease. Biotech company Alnylam is currently developing programs in areas such as heart failure, hypertension and Alzheimer's.

The idea that you're not irreversibly changing the DNA is compelling, but like most health care innovation, safety is paramount. And every patient population has a different risk profile.

Matt Reynolds is an Investment Director for [Capital Group Australia](), a sponsor of Firstlinks. This article contains general information only and does not consider the circumstances of any investor. Please seek financial advice before acting on any investment as market circumstances can change.

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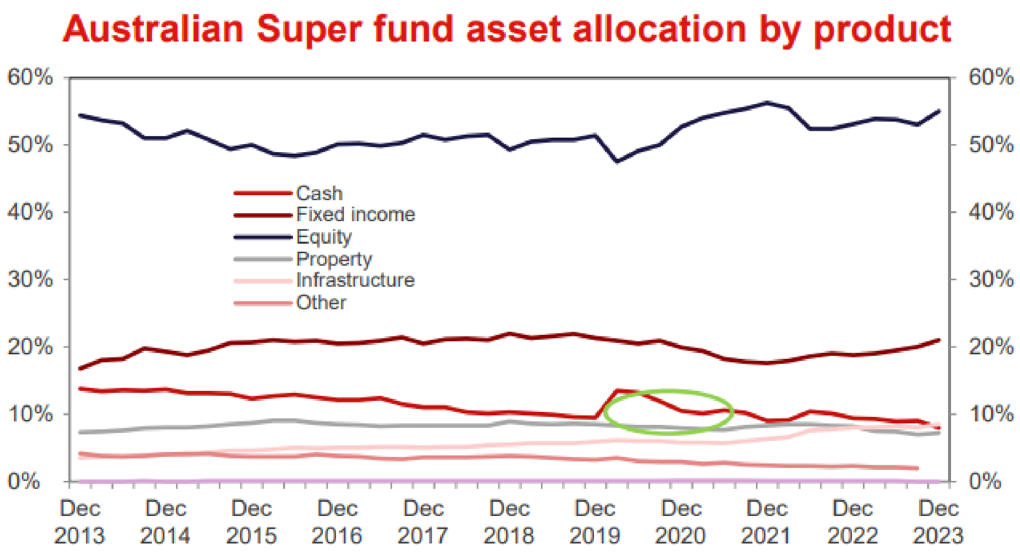
Big Super's asset allocation and future headwinds

Campbell Dawson

There has been a lot of talk about how the asset allocations of large super funds have switched away from public assets to private. The evidence suggests that the change hasn't been dramatic.

We also look at how there are some headwinds that may affect future long-term performance of Big Super, as demonstrated in the charts below.

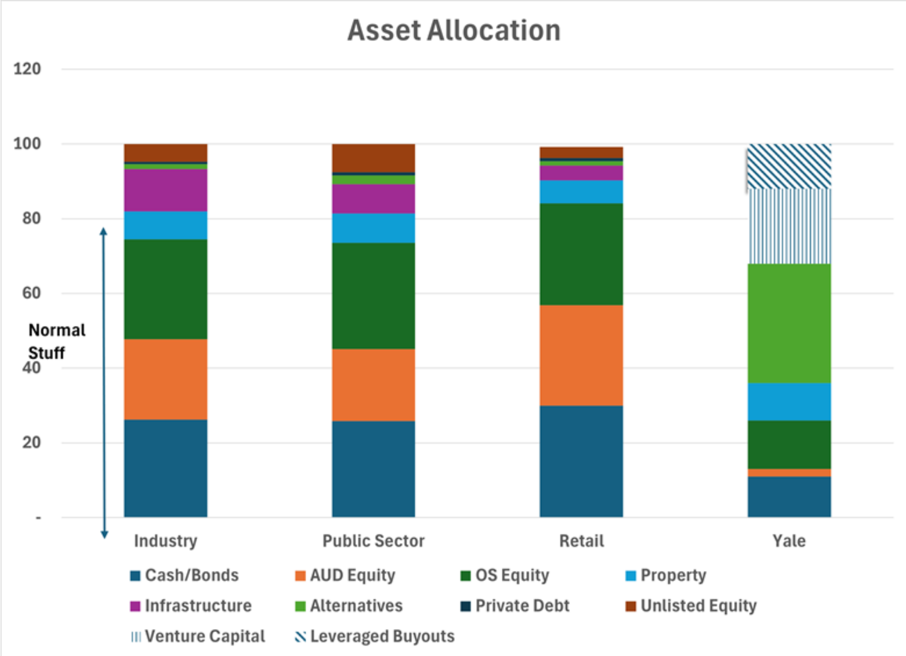
Asset allocation changes overplayed



Source: Westpac

This first chart came from a Westpac report, and it was a surprise to us. There's been endless talk about how big Super is embracing alternative assets. But it's mostly talk. The chart shows aggregated Super Fund asset allocation over the past decade. Everything looks pretty much like it did in 2013. Despite super fund Chief Investment Officers, (who are now the apex predators in the investment industry food chain; $1 million+ salaries and not much accountability), talking a good book, they didn't do much last decade. They sold a few bonds when bond rates were less than 2% and threw a bit more at infrastructure (which kind of resembles bonds plus a bit of inflation), but that was about it.

The second chart (right) shows the asset allocation of the various types of superannuation funds, and they are all a bit same same-ish. Industry funds have a bit more infrastructure than other super funds, but it is largely still the normal assets (the bottom four boxes in the chart) that any investor can easily access. Scared of underperforming peers? Who knows? It's hard to believe this is every CIO's idea of unconstrained asset allocation.



On the far right we have shown the allocation of the Yale University Endowment Fund. That shows what a non-peer aware asset allocation looks like. Big chunks in non-traditional assets and they include a decent slab of commodities and forestry.

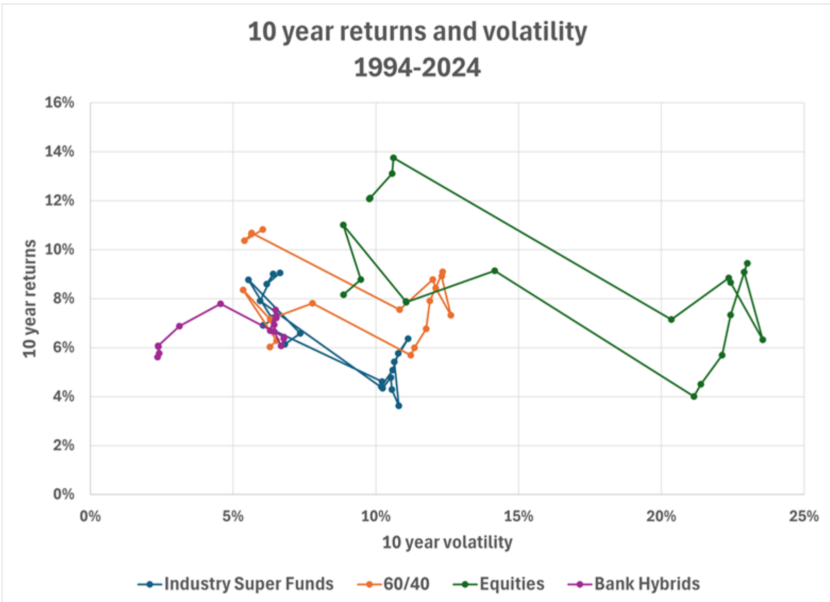
What is the best asset allocation?

It is a genuinely tough question, but what is the right asset allocation for long term super funds?

In the table we have calculated the 10year return/risk/information ratio (a measure of how much bang you get for your risk buck) for each year since 1994 (i.e the 1994 cohort reflected the returns/risk for the next decade. For the 60/40 and Industry super funds we rebalanced at the start of every year. The last cohort is from 2014 to 2024.

	Returns (p.a.)	Volatility (per decade)	Info Ratio
All Ords Acc	8.7%	6.2%	0.28
UBS Composite	5.8%	0.7%	0.07
Industry Super Fund	6.3%	2.2%	0.15
60/40	8.1%	3.0%	0.34
Bank Hybrids	7.1%	1.9%	0.40

The chart shows risk and return for each of the 10-year periods since 1994 (ie decade commencing 1995, 1996 etc).

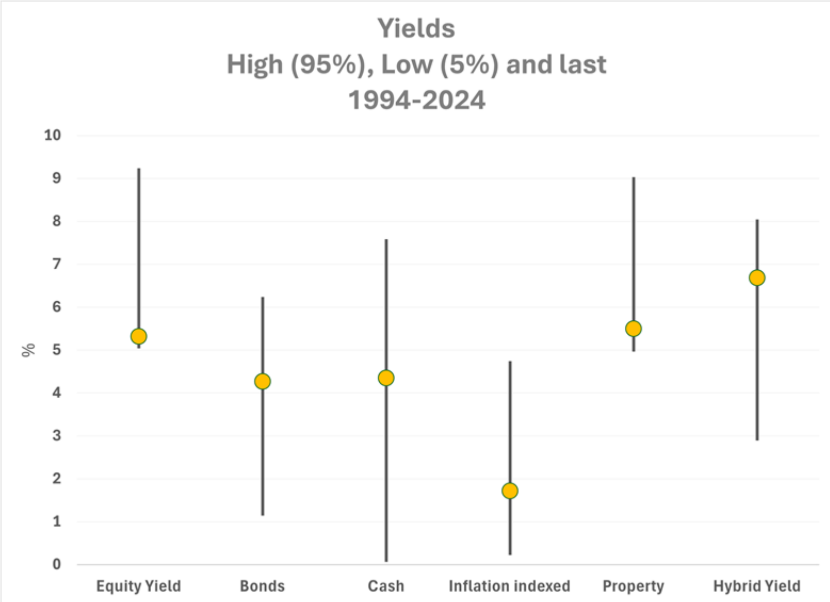


So, what does it tell us?

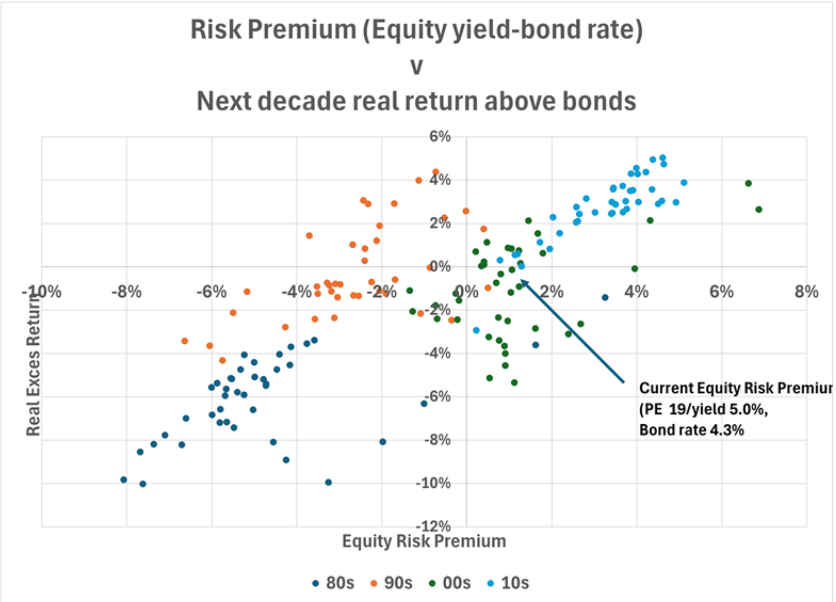
- Equities do best, but there are some messy decades. You probably wouldn't want to have a pure equities portfolio in the 10 years before retirement because there's a reasonable chance you only get 4% and lots of heartburn.
- The 60/40 portfolio outperformed the current Industry Super fund asset allocation. That is at least partly due to the big fall in bond rates (and Industry Funds aren't big on bonds).
- Hybrids are an example of what being a bit more adventurous can do. Returns are decent, not much risk and not much volatility of volatility (i.e) it is always low volatility. The Hybrid information ratio is materially higher too.

What does the future look like?

Super Funds have generated mid to high single digit returns over a decade holding period for the last 30 or so years. That has been comfortably above inflation. Are we going to see this over the next decade?



The top chart shows the current yields of some of the asset classes since 1994. We were surprised that current bond and cash rates are close to three-decade averages (we thought the average would be higher), but even so, it's only around 4%. You need other asset classes to generate more than that to get your 7%. That might be a big ask. Equity yields (based on current PE's) are very low in comparison to the last 30 years. Of course, they can get to 7% returns if there is lots of profit growth or PE expansion, but maybe that doesn't happen. Property is even worse. It is still expensive in historical terms, and we can't see rental growth saving it. And yields are at historically small margins to bond yields, so you need to see bond yields fall to get capital gains.



It's our newsletter so of course we have to give hybrids a plug. Margins might be historically tight but the yields of around 7% are top quartile since 2000. Volatility is muted unless there is material equity weakness.

Buying equities when they are cheap should make any fund manager look like a genius. In the bottom chart we have tried to test that concept. We've taken the Equity Risk Premium (the equity yield less the bond yield - horizontal axis) each quarter since 1980 and calculated the real return of the All Ords (accumulation) less the starting bond rate (vertical axis). We've have shown the results for each of the decades as well. So, the 1980s were painful. High inflation meant relatively low real returns for equity markets and bond yields were high. That's why they are all in the bottom left-hand quadrant.

You would expect when you buy equites cheap (i.e when they show much higher yields than bonds) that you would generate higher return outcomes. That is largely true, and you can draw upward sloping lines for all decades (except the 1990s). It's not infallible though. Most worrying is that compared to recent decades, this is a seriously expensive equity market. It doesn't mean that equities are guaranteed to underperform but they are building in historically high levels of EPS growth to justify the valuation.

Campbell Dawson is Managing Director of [Elstree Investment Management](), a boutique fixed income fund manager. This article is general information and does not consider the circumstances of any individual investor. Elstree's listed hybrid fund trades under ticker EHF1.

The problem with concentrated funds

Joe Wiggins

A topic I have changed my mind on during my career is concentration in funds. I used to be strongly of the view that it was only worth taking active investment positions if they came with high conviction – usually in the form of concentrated positioning – otherwise, what's the point? Although I came to realise I was wrong about this, I am aware that many people far smarter than me remain advocates of this type of approach. Why do I think it is a problem when they don't?

What is concentration in a fund?

Fund concentration is not the easiest concept to define. There are obvious examples such as very focused equity portfolios with large weightings in individual companies, but there is more to it than that. Concentration doesn't have to be about position sizes in stocks, it can come through an extreme sensitivity to a certain theme, concept, or risk factor. It is about our exposure to specific and singular points of failure. Could one thing go wrong and lead to disaster?

The key concept to consider when thinking about the risk of concentrated funds is ergodicity. This is a horribly impenetrable term, but at its core is the idea that there can be a difference between the average result produced by a group of people carrying out an activity, and the average result of an individual doing the same thing through time.

Let's use some simple examples.

Rolling a dice 20 times is an example of an ergodic system. It doesn't matter if 20 people roll the dice once each, or an individual rolls the dice 20 times. The expected average result of both approaches is identical.

Conversely, home insurance is a non-ergodic system. At a group level the expected average value for buyers of home insurance is negative (insurance companies should make money from writing policies). So, why do we bother purchasing it? Because, if we do not, we expose ourselves to the potential for catastrophic losses. The experience of certain individuals through time will be dramatically different to the small loss expected at the average group level.

Investing is non-ergodic. Our focus should therefore be on our individual experience across time (not the average of a group); this means being aware of how wide the potential range of outcomes are and the risk of ruin.

In concentrated funds, the prospect of suffering irrecoverable losses at some point in the future is too often unnecessarily high.

'Risk is not knowing what you are invested in'

One of the most common arguments made by advocates of running very concentrated equity portfolios is that it is an inherently lower risk pursuit because we can know far more about a narrow list of companies than a long list. If we have a 10 stock portfolio, we can grasp the companies in a level of detail that is just not possible if we hold 100 stocks, and this depth of understanding means that our risk is reduced. The first part of this is right, the second part is wrong.

The problem, I think, stems from the fact that there are two types of uncertainty – epistemic and aleatoric. Epistemic uncertainty is the type that can be reduced by the acquisition of more data and knowledge. Here the idea of portfolio concentration lowering risk makes sense. Conversely, aleatoric uncertainty is inherent in the system; it is the randomness and unpredictability that cannot be reduced. It doesn't matter how well we know a company or an investment, we are inescapably exposed to this. The more concentrated we are, the more vulnerable we are to unforeseeable events.

While I think a neglect of aleatoric uncertainty is at the heart of unnecessarily concentrated portfolios, there are other issues at play. Overconfidence is likely to be a key feature. we may be aware that the range of outcomes from a concentrated approach is wide, but that may be desirous to us because we believe that our skill skews the results towards the positive side of the ledger. Given our ability to fool ourselves and the aforementioned chaotic nature of the system, this seems to be a dangerous assumption to make.

Unfortunately, there is also an incentive alignment problem. A wide range of potential outcomes from an investment strategy becomes very appealing if we benefit from the upside but someone else bears the downside. This asymmetry is inevitably one of the reasons why high-profile macro hedge funds so often seem to be swinging for the fence with concentrated views. The often-severe downside of the negative outcomes is borne primarily by the client (a situation no doubt exacerbated when a hedge fund manager is already exceptionally wealthy).

Running a very concentrated investment strategy places an incredibly heavy onus on being right and also leaves us acutely vulnerable to unforeseen events unfolding that can have profoundly negative consequences. Exposing ourselves to such risks willfully seems imprudent and unnecessary.

Investors are likely to overestimate how much they know, and underestimate how much they cannot know.

Being wary of concentration does not mean increasing levels of diversification are always beneficial. There is a balance to strike.

It feels important to note that the risk of concentrated strategies can be diversified by combining them, but we should still consider what the concentration levels say about the investor who is willing to adopt such an approach.

Joe Wiggins is Director of Research at UK wealth manager, SJP and publisher of investment insights through a behavioural science lens at www.behaviouralinvestment.com. His book The Intelligent Fund Investor explores the beliefs and behaviours that lead investors astray, and shows how we can make better decisions.

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