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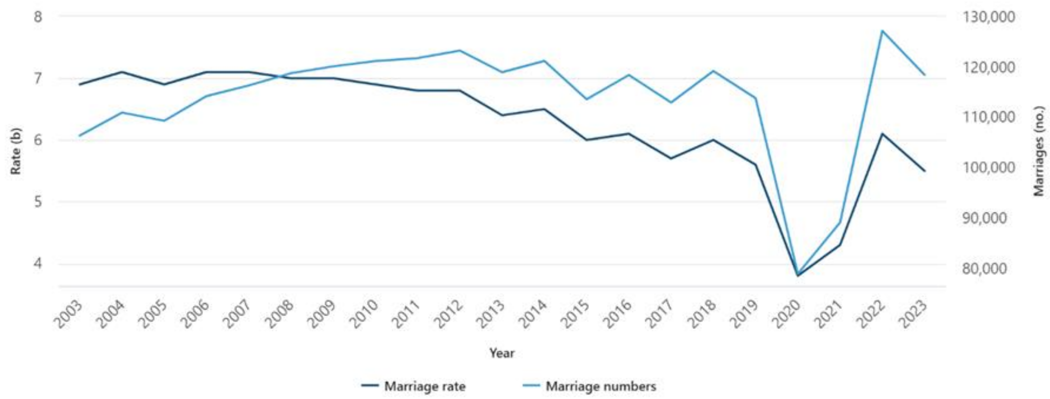
Editorial

New data from the Australian Bureau of Statistics (ABS) shows that there were 118,439 marriages last year, a 6.9% fall from the record high reached in the previous year. The fall was expected given the post-Covid bump in marriages in 2022.

The long-term trends are revealing. While the total number of marriages has increased by around 4,600 since before the pandemic, the marriage rate – the number of marriages divided by the population aged 16 and over – has marginally fallen from 5.6 per 1,000 people in 2019 to 5.5 now.

Zooming out further, and the figures reveal that total marriages across Australia are around the same level as 2008. And the marriage rate has fallen significantly, from 6.9 per 1,000 people in 2003 to 5.5 in 2023.

Number of marriages registered and crude marriage rate, Australia, 2003-2023 (a)(b)(c)



a. Restrictions put in place during the first two years of the COVID-19 pandemic had a direct impact on marriages in 2020 and 2021. Comparisons to other years should be treated with caution.
b. Crude marriage rates reflect the number of marriages registered during the year per 1,000 of estimated resident population aged 16 years and over, as at 30 June for the same year.
c. Refer to the methodology for more information.
Source: Australian Bureau of Statistics, Marriages and Divorces, Australia 2023

The median age that people get married increased last year compared to 2022. For men, it jumped from 32.5 years to 32.9 years, while for women, it lifted from 30.9 years to 31.2 years.

Much of it can be attributed to people postponing marriages during Covid, and them being naturally older when they got married over the past year. However, it does a continue a broader trend. A decade ago, men tied the knot at a median age of 31.5 years and women at 29.5 years.

Breaking down the ages for marriage, 20–30-year-olds are marrying less than before Covid, and 30–40-year-olds are marrying more. What's behind this? Arguably, higher housing prices and the cost of living are playing a part.

Male age-specific marriage rates						
Age group (years)		**2019**	**2020**	**2021**	**2022**	**2023**
16–19	rate	0.4	0.4	0.3	0.3	0.3
20–24	rate	10.0	7.7	7.7	9.3	8.1
25–29	rate	33.1	22.8	27.5	36.9	31.2
30–34	rate	31.6	21.5	26.7	39.0	33.9
35–39	rate	16.7	11.4	12.9	19.0	17.7
40–44	rate	9.9	6.6	6.9	10.4	9.9
45–49	rate	7.4	5.1	5.1	7.5	7.3
50–54	rate	6.2	4.1	4.4	6.3	6.1
55–59	rate	5.1	3.3	3.4	4.8	4.9
60–64	rate	3.5	2.3	2.4	3.6	3.6
65–69	rate	2.3	1.6	1.5	2.3	2.4
70–74	rate	1.5	1.2	1.0	1.5	1.5
75 and over	rate	0.8	0.6	0.5	0.7	0.7
Median age at marriage	years	32.3	32.2	32.1	32.5	32.9

Female age-specific marriage rates						
Age group (years)		**2019**	**2020**	**2021**	**2022**	**2023**
16–19	rate	1.7	1.3	1.1	1.2	1.1
20–24	rate	17.2	12.9	13.4	16.1	13.7
25–29	rate	40.3	27.3	34.1	47.0	39.4
30–34	rate	28.4	19.7	24.1	35.9	32.5
35–39	rate	13.7	9.5	10.1	15.2	14.5
40–44	rate	8.4	5.6	5.7	8.5	8.4
45–49	rate	6.6	4.4	4.5	6.6	6.4
50–54	rate	5.0	3.3	3.6	5.3	5.1
55–59	rate	3.4	2.2	2.3	3.4	3.4
60–64	rate	2.0	1.3	1.4	2.0	2.0
65–69	rate	1.2	0.8	0.8	1.1	1.1
70–74	rate	0.7	0.5	0.5	0.6	0.6
75 and over	rate	0.2	0.2	0.2	0.2	0.2
Median age at marriage	years	30.5	30.6	30.5	30.9	31.2

Source: ABS

Declining divorce rates

Like marriage rates, divorce rates are also falling. Last year, there were 48,700 divorces, down 1.1% from the year prior. The divorce rate also decreased 2.3 per 1,000 people from 2.4 in 2022.

There was a spike in divorces during the pandemic, which has since reverted to trends seen up to 2019.

Marriages are lasting longer. The median age of marriages to divorce was 13 years in 2023, up from 12.8 in 2022, and 12.3 in 2019. The median age of marriages to separation was 9 years last year, up from 8.9 the year prior, and from 8.6 years in 2019.

Over the past 20 years, the number of divorces per year has dropped by about 10%. But the divorce rates paint a truer picture, as they've decline from 3.4 per 1000 people in 2003 to 2.3 now.

What's behind the fall in divorce rates? The figures on marriage breakdowns by age group may provide a clue.

The median age for divorce was higher in 2023 than 2019, up by 1.2 years to 47.1 for men and up by 1 year to 44.1 for women. The numbers show that for both men and women, there have been substantial declines in divorces for those aged less than 44. Conversely, there have been more divorces for aged 50 and above.

According to the Australian Institute of Family Studies, couples who had been married for 20 years or more accounted for more than one quarter of divorces. In the 1980s and 1990s, they made up about one in five divorces.

Male age-specific divorce rates						
Age group (years)		2019	2020	2021	2022	2023
16–24	rate	0.2	0.2	0.2	0.2	0.1
25–29	rate	2.7	2.8	3.1	2.4	2.2
30–34	rate	6.2	6.3	7.0	5.5	5.1
35–39	rate	8.1	8.1	9.1	7.4	7.0
40–44	rate	9.0	9.2	10.3	8.6	8.1
45–49	rate	9.1	9.4	10.3	9.3	8.9
50–54	rate	8.4	8.3	9.7	8.7	8.5
55–59	rate	6.4	6.3	7.4	6.8	6.8
60–64	rate	4.6	4.4	5.0	4.7	4.8
65 and over	rate	1.9	1.8	2.0	1.9	2.0

Female age-specific divorce rates						
Age group (years)		2019	2020	2021	2022	2023
16–24	rate	0.6	0.5	0.6	0.5	0.4
25–29	rate	4.2	4.3	5.0	3.9	3.6
30–34	rate	7.4	7.6	8.5	6.9	6.2
35–39	rate	8.8	8.7	9.9	8.3	7.9
40–44	rate	8.9	9.3	10.4	9.1	8.6
45–49	rate	9.0	8.9	10.1	9.1	8.9
50–54	rate	7.3	7.4	8.5	7.7	7.7
55–59	rate	4.9	4.7	5.6	5.3	5.4
60–64	rate	3.0	3.0	3.4	3.2	3.3
65 and over	rate	0.9	0.9	1.0	0.9	1.0

Source: ABS

Why are the young getting divorced less? There are a few possible explanations:

- People are getting married later, with many couples live together for years before marrying.
- Younger people are more educated than any previous generation, and studies show better education is linked to more successful marriages i.e. if a couple is university educated, the chance of divorce is much less.
- Economic uncertainty may also be keeping people together that would otherwise want to divorce.

Conversely, why are divorce rates up for older people? It’s likely that divorce is more socially acceptable now than it used to be. ‘Empty nest syndrome’ – the unhappiness and upheaval that can happen when children leave home – may also be a factor.

Retirement researcher, Dr. Michael Finke, has another possible explanation. In a Firstlinks article last year, he detailed how the happiest people in retirement were women who get divorced between the ages of 60 and 65:

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

Ramifications of rising 'grey divorce'

Nevertheless, Australian Institute of Family Studies researchers have found divorced people aged between 55 and 74 years have less household disposable income and fewer assets than married couples the same age. And they observed that while household income levels can recover relatively quickly, it takes a longer period for assets such as housing to appreciate.

It may be why a greater number of older people are renting, and several studies show that financial stress and homelessness are increasing among retirees.

One issue that doesn't get enough attention is the ability, or inability, of elderly divorcees to borrow money. I've heard anecdotally that even for retired couples, it's becoming more difficult to borrow from banks. I expect that for those older and divorced, it would be even more so.

Of course, divorce also have implications for super, wills and estates, enduring powers of attorney, and possibly decisions around health care.

For the broader economy, the effects of rising divorce among the old are difficult to forecast. The trend is relatively recent and whether it continues is a matter of debate. Could it lead to more renting? Could it result in greater downsizing? Could it increase the reliance on government assistance in retirement? Time will tell.

It surprises me how often individual investors and even seasoned financial professionals don't know the basics of building an investment portfolio. In my article this week, I run through how to go about constructing a simple portfolio, as well as the challenges involved.

James Gruber

Also in this week's edition...

John Abernethy is back, this time to highlight an issue that's often left unsaid in the debate about Australia's housing crisis - the explosion in mortgage debt. He says that debt and its cost is the sole cause of our great housing price bubble, but there is a lack of acknowledgement of their role. And the lack of regulatory intervention in the mortgage market exposes the failures of the RBA, APRA, and Treasury. He goes on to suggest some solutions to the crisis.

The Transition to Retirement Income Streams strategy has waned in popularity in recent years, but **Lindzi Caputo** says that could change if the proposed extra tax on super balances above $3 million goes ahead. 60-65 year olds who are still working could benefit most.

Separation of assets remains one of the most reported contraventions by SMSF auditors, and it raises the question about whether a declaration of trust can satisfy the requirements of SMSF regulations. **Shelley Banton** says it's a complex matter that demands examination from many different perspectives.

Improving our investment behaviour is difficult. Our choices have a messy confluence of influences. It is impossible to ever understand precisely why we made a particular decision – it is just too complex. This doesn't mean, however, that we are helpless bystanders. In fact, **Joe Wiggins** says there are many seemingly innocuous areas that we can change to improve the chances that we might make sound judgements. Foremost of these is what we pay attention to.

Small caps have significantly lagged their larger counterparts of late, and none more so than those in Europe. Political turmoil and new regulations have left Europe-listed small caps unloved and under-covered. **Alantra's Jacobo Llanza** believes that taking a 'friendly activist' approach to investing in those with global growth opportunities can reap dividends.

The cyclically adjusted P/E ratio, or CAPE, has been a common and widely accepted gauge of market valuation in recent decades. But **Brian Jacobs** thinks it's reached its used-by-date, and explains why.

Lastly, in this week's whitepaper, **VanEck** analyses the current state of play in credit and fixed income in light of expected rate movements in Australia and the US.

The challenges of building a portfolio from scratch

James Gruber

When I talk with acquaintances these days, the topic of investments naturally comes up. At a kids' soccer game recently, a parent told me that he'd earned enough money through his business that he wanted to invest it and asked me how to best do it.

I told him that it depended on his goals, risk appetite, and time horizon, and that he should see a financial adviser for professional advice. I then went on to discuss some of his options, but a short way into the conversation, I realized that a five minute talk wouldn't achieve much. I cut it short and said, "Read *Firstlinks* and I'll do an article up on it over the next few weeks". (no harm in giving the newsletter a plug!)

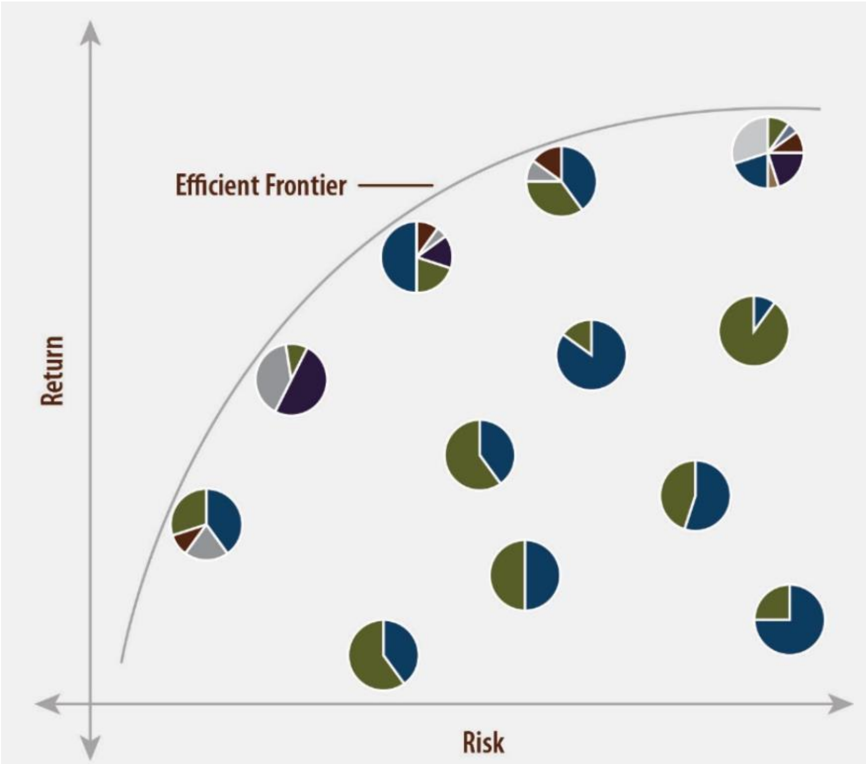
Here, then, are tips on the best ways to build an investment portfolio from scratch, and some of the challenges involved.

Portfolio theory in a nutshell

First, it's necessary to cover off on various theories behind building an investment portfolio. I promise to keep it simple.

A central tenet of finance and asset allocation is that risk and return are related. You can't earn high returns without having large losses along the way. Conversely, you can't achieve complete safety without condemning yourself to low, long-term returns. Anyone promoting high returns with low risk should be treated with scepticism.

Modern Portfolio Theory (MPT) uses concepts such as correlation, risk, and return to find optimal portfolio weightings. MPT states that owning allocations of different asset classes that don't always move up or down together, is the best way of maximizing returns while minimizing risk and achieving the so-called 'efficient frontier'.



Source: MCF Capital

Therefore, the key decision facing an investor is the overall percentages of a portfolio allocated to different assets such as stocks and bonds. That decision will determine the risk-return characteristics of a portfolio.

What is the best allocation? There is no such a thing as a perfect portfolio because we don't know how different assets will perform in future. That's why diversification is important.

It's often said that diversification is the only free lunch in finance. This quote, usually attributed to the founder of MPT, Harry Markowitz, refers to the power of diversification to reduce risk without necessarily hurting returns.

Markowitz won a Nobel Prize for his theories, yet even he admitted that he didn't use fancy maths to determine his own asset allocation. In 1952, he said, "my intention was to minimize my future regret. So I split my contributions 50/50 between bonds and equities."

The three drivers of asset allocation

Markowitz wasn't short of money and minimizing future regret made sense as a goal for him. For others, it may be different.

Markowitz's comments indicate that investors need to develop a coherent and well-defined personal strategy for the allocation of assets. That strategy, as alluded to earlier, will be driven by three key factors:

Your goals. Financial or otherwise.

Your risk appetite. In my experience, what people say about their tolerance to risk and what they do are completely different things. Often the best way to figure out your risk appetite is to look at how you reacted to past bear markets. Did you panic and sell stocks during the sharp pullbacks of 2022 and Covid? How about during the financial crisis of 2008. Did you panic and sell stocks at the wrong time?

As Fred Schweb colourfully put it in his masterpiece, *Where Are The Customers Yachts?*:

"There are certain things that cannot be adequately explained to a virgin either by words or pictures. Nor can any description that I might offer here even approximate what it feels like to lose a real chunk of money that you used to own."

Your time horizon. Conventional wisdom suggests that younger people should invest more aggressively than the old. The guideline is based on the notion that younger individuals can afford to take on more investment risk because of their longer time horizons. As investors get older, their time horizons shorten, making an increasing fixed-income allocation more prudent.

It's the basis of a common rule of thumb used by advisers: that in a stock/bond portfolio, an investor's bond allocation should be equal to their age, with the remainder in stocks. Under this formula, if you're 45 years of age, you should have 45% of your portfolio in bonds, and 55% in stocks.

A mix of these factors will determine the best allocation of assets for you.

A simple investment portfolio

For the novice or lazy investor, a simple portfolio can be best. Say you've worked out that a 60/40 stock/bond split of assets is what you're after. The next question: which stocks to choose? If you want simplicity, then the answer is investing in an ETF which covers the whole market.

The stock allocation is not so simple, though. Should you invest just in Australia? That doesn't make much sense. After all, the Australian share market is only about 2% of the size of global equity markets. The market here is also highly concentrated in banks and miners, and doesn't offer the exposure to technology, healthcare and other sectors, that international markets do.

Does it mean that you should allocate just 2% of the stock portion of the portfolio to Australian equities? Probably not. There is no right answer because no one knows how different stock markets will perform in future. Keeping it simple might mean a 50/50 split of Australian and international stocks. This split can easily be done via popular ETFs such as Vanguard's Australian Shares Index ETF (ASX:VAS) and its MSCI Index International Shares ETF (ASX:VGS).

What about bonds? Bonds are in a portfolio because stocks are volatile. It can be gut-wrenching as stocks move up and down, and sometimes people need some money when stocks are down. Bonds are there to smooth out the journey and act as ballast that balances out the stock holdings.

Given this, it makes sense to stick to local bonds rather than branch out to international bonds. Why? Because with the safer portion of your portfolio, you don't want to be taking the currency risk associated with owning overseas bonds.

As to what type of bonds, government bonds are the least risky and are the most appropriate for a simple portfolio. The most popular Australian government bond ETFs are iShares Core Composite Bond ETF (ASC:IAF), SPDR S&P/ASX Australian Bond Fund ETF (ASX:BOND), and Vanguard Australian Fixed Interest Index ETF (ASX:VAF).

Here is what a basic investment portfolio might look like:

- 30% Australian stocks (ASX:VAS)
- 30% International stocks (ASX:VGS)
- 40% Australian bonds (ASX:IAF)

Getting more fancy

A simple investment portfolio can be made more complex in a variety of ways. Keep in mind that complexity requires more time and effort in both building and maintaining the portfolio.

The stock portion of the portfolio could include small cap companies. US research has shown that small caps have outperformed large caps in America over the long term. Interestingly, the research is less compelling in Australia, as small caps have lagged their larger counterparts. I suspect it's because of the hundreds of small cap miners here which are both scrappy and unprofitable – and that's being generous.

Another thing that can be considered for the stock part of the portfolio is adding value stocks. Numerous studies suggest value stocks outperform growth shares and broader indices in the long term.

REITs can also be considered for a small portion of the portfolio. Historically, REITs have shown a lower correlation to other asset classes and therefore can help to reduce overall risk to a portfolio. Keep in mind though that Goodman Group (ASX:GMG) is now around a 42% weighting in the A-REIT index and is priced more like a tech stock and less like a property play. Goodman drives the A-REIT index nowadays.

What about teasing out the international stocks into those of developed countries and emerging markets? It's certainly an option as different regions tend to offer different returns. Yet, I'm not convinced that it's worth the trouble for individual investors.

Here's what a more complicated portfolio could look like:

- 14% ASX large cap (ASX:VLC)
- 14% ASX small cap (ASX:VSO)
- 2% Australian property (ASX:MVA)
- 14% International large cap (ASX:IOO)
- 7% International small cap (ASX:VISM)
- 7% International value (ASX:VLUE)
- 2% International property (ASX:GLPR)
- 40% Australian bonds (ASX:IAF)

Getting more hands-on

Now, you might be thinking, "Hang on, I'd like to also invest in stocks directly as well as managed funds."

On this point, Vanguard Asia Pacific's Head of Investments, Duncan Burns has an idea, called the core-satellite approach, which may help. This approach is about allocating the core of your portfolio – 80%, for example - to passive investments or ETFs, and the remainder to active funds or an active strategy.

He says that while carving out a small portion of your portfolio for active investing in the satellite portion isn't backed up by academic studies, it may be helpful behaviourally. It could help you to avoid tinkering with the core of the portfolio and free up the satellite portion to pursue other opportunities – whether that's an interest in stock picking or sectors or other elements you feel strongly about.

Rebalancing

Rebalancing a portfolio is generally helpful to enhance returns and to reduce risk. Rebalancing is a quasi-value strategy as it means selling something that has been performing well and switching it into something else that has been underperforming.

How often should you rebalance a portfolio? The research says once every year or two is sufficient. However, selling stock attracts capital gains and losses, therefore it will depend on your tax situation too.

Dollar cost averaging

Building a portfolio from scratch also raises the issue of whether you should put all your money into it straight away or to gradually deploy the cash. Some might be nervous putting a lump sum in.

One way to get around this is to put 50% into the portfolio, and then put the other 50% in via monthly increments over a 12–24-month period.

The latter is known as dollar cost averaging and it can also be used for any subsequent savings that you wish to add to the portfolio after it's up and running. This approach automatically allocates regular fixed amounts and can help you take a disciplined, non-emotional approach to investing that's not affected by what's happening on financial markets at any particular point in time.

Remaining pieces

There is no perfect asset allocation that will allow you to keep up when shares are rising and perfectly hedge your portfolio when shares are falling. The best you can hope for is a portfolio that's durable enough that you can hold onto it, regardless of what happens in the market and economy.

There is a lot I haven't covered in this article that I'll flesh out in future pieces. Next week will explore the pros and cons of 'all weather' portfolios.

James Gruber is the Editor of Firstlinks.

What's left unsaid in Australia's housing bubble

John Abernethy

Basic economics taught at school and revisited in first year economics at university, is overlooked when explaining the failure of Australia's housing market to work effectively for Australians.

The current difficulties confronting both monetary and housing policy partially stem from the explosion of mortgage debt. Therefore, what follows is my view on one of the least discussed but fundamental causes of the housing price bubble in Australia - and it flows from an understanding the basics of market price theory.

Supply and demand obviously dictate the price of housing, but housing policy aimed at addressing affordability, needs to consider the perverse impact of debt. In particular, the availability and the cost of debt (mortgages) has fuelled a house price bubble.

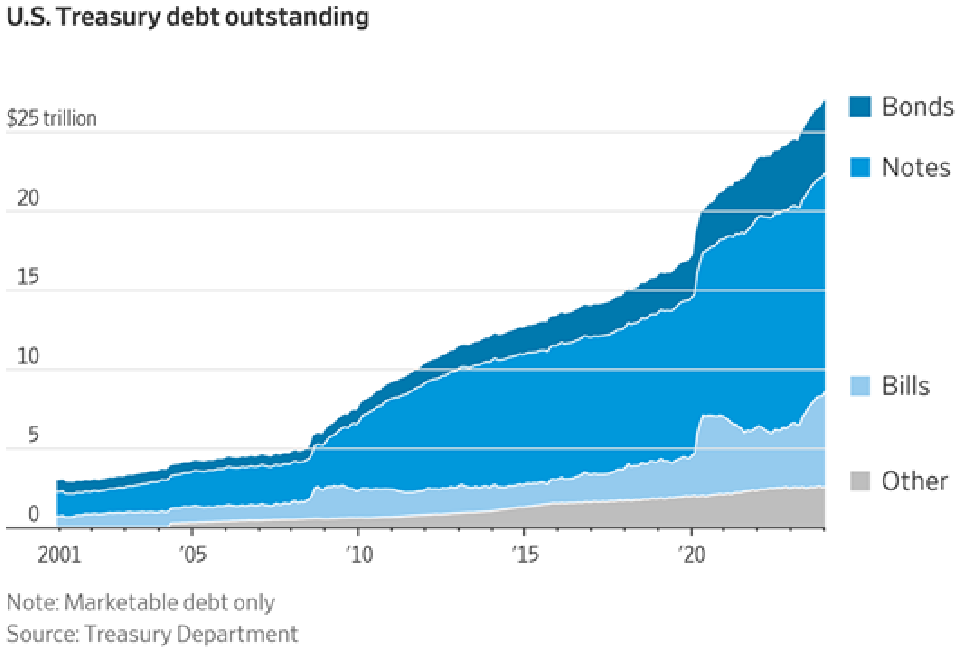
Low interest rates, low deposit requirements and therefore the provision of excessive levels of mortgage debt have, over time, added to driving housing prices higher. Today, Australia has the most expensive houses in the world when measured against income. House prices have become unaffordable for many – particularly young families.

I am not suggesting that debt and its cost is the sole cause of our great housing price bubble, but there is a lack of acknowledgement of their role. The lack of regulatory intervention in the mortgage market exposes the failures of the RBA, APRA, and Treasury. Indeed, have any of these bodies acknowledged that our housing price bubble poses a serious risk to long term financial stability, social cohesion and if unchecked condemns future generations to a declining standard of living?

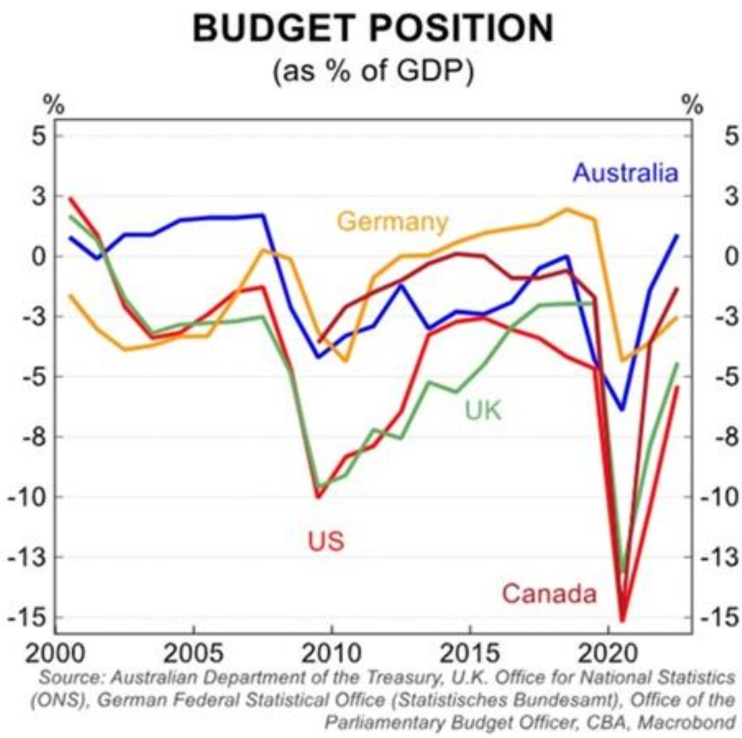
Whilst the liberalisation and deregulation financial markets was a necessary policy initiative 40 years ago, it has surely contributed to Australia's housing price bubble of today.

My view is that deregulation of financial markets has been excessively unconstrained. A thoughtful appraisal, during the last 40 years, of the consequences of financial deregulation has not been undertaken. There has not been a review or analysis to identify the point at which deregulation went from supporting wealth distribution to causing wealth dislocation. At what point did it cause a greater divide in the distribution of wealth by fuelling asset price inflation? Further, has there been adequate analysis of the flow-on effect of quantitative easing (QE), the driving down of interest rates (negative real rates) and the creation of excessive debt in Australia's mortgage market?

An interesting corollary is the analysis of the government debt explosion across the developed world. It is observable that low interest rates and QE, have been used to fund governments that have failed to address the demographic challenge (aging populations) that was well predicted at the turn of the century. This is clearly on display in the United States where a government debt explosion has accelerated since Covid.



Ageing populations with low birth rates have combined to cruel government budgets that have tried to sustain basic social needs but are now confronted by poor wealth distribution. QE has been used as a 'go-to default mechanism' to drive down bond yields so that governments could run deficits and increase debt without suffering higher interest payments. The likelihood is that it will need to be reintroduced because governments cannot balance their budgets.

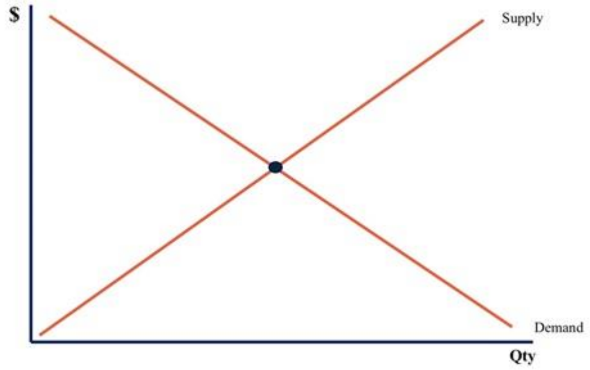


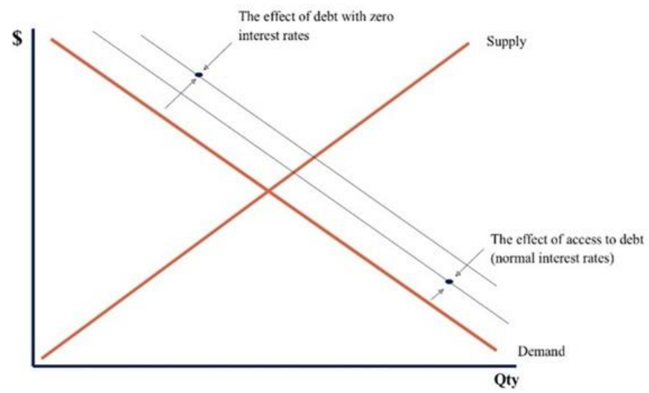
In Australia, we do not have a government debt problem (ex Victoria) and have a strong budget position (as shown above). However, we have a large amount of household debt (100% of GDP) concentrated with just a third of homeowners. Those households that have bought in the last 5 years have large debt balances and they need sustained lower interest rates to service their debt – just like many developed world governments.

Basic market theory explains how debt pushes prices

Below I have produced two simple tables to explain how the creation of debt (leverage) pushes the price higher in clearing the housing market. From that, I will show as to how low interest rates compound the effect of leverage.

The theoretical market clearing price, where purchasers of a house have no access to debt, is shown in the simple graph below (left). The price that buyers are willing or can pay is limited to their savings or capital. A supplier or seller of a house merely decides or agrees to sell at the price bid. The graph logically predicts that a house builder will surely supply more houses if the price rises because their development or profit margin will increase. Market theory at its simplest.





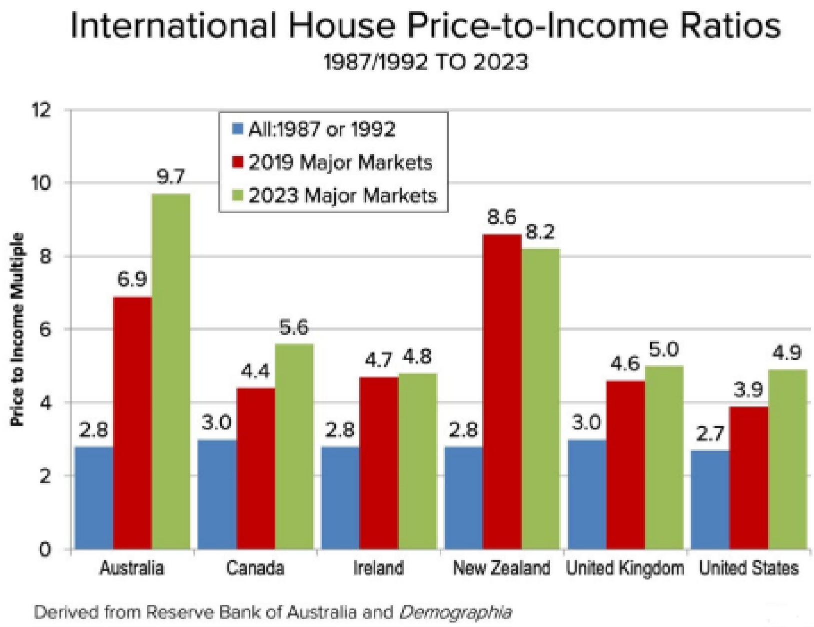
The chart on the right shows the effect on market clearing prices when debt is accessible to the buyer. The first push higher is the effect of normal debt (added to the savings) with normal interest rate settings – i.e. debt set at a margin above inflation. The second push higher may be described as the effect of low-cost debt. More debt can be accessed (borrowed) if the cost of servicing that debt is low. A buyer can afford to pay more for a house. This particularly describes what occurred in Australia at the end of Covid when our cash rates were cut to 0.1% and remember the RBA predicted that they would hold them there till 2024.

Market theory therefore reflects reality by predicting that the market price for housing is set by a willing buyer who can pay more by accessing debt. A willing seller will benefit from a market price inflated by debt.

Theory to observation

The next chart shows the correlation between housing prices and household debt. The more that mortgage debt can be accessed, the higher the ratio of house prices to disposable income.

This leads to the observation (noted earlier) that Australia's housing prices are the highest (and least affordable) amongst our international peers.



The surge in the price to income ratio illustrates the effect of relatively low interest rates. The decline in the ratio seen in New Zealand is explained by the adoption of higher interest rates and the onset of a recession. Elsewhere, there is a broad observation of rising ratios over the last 30 years that suggests that asset inflation has occurred with easy financial conditions and liquidity creation adopted by world central banks.

My conclusion from the above analysis is that both the access to and cost of mortgage debt has been poorly regulated in Australia and therefore contributed to our housing price bubble. The notion that Australian house prices will continue to rise exponentially will be contested by affordability. We have engineered a price for housing (through a debt explosion) that will cause social dislocation and a severe problem for future generations – if it is not addressed.

Whilst banks and other financial intermediaries have facilitated the rise in house prices in the past, there will be a point where they will constrain the availability of debt when they perceive that the ability of borrowers to service that debt has been reached. That point has been manipulated by the low-interest rate settings. However, a reliance on the market to ultimately and independently constrain the rise of house prices has clearly failed as a social policy.

The future may look like this

Australia will at some point undergo a painful reset of housing prices. However, it will be far better to be a managed process through intervention than a reset caused by a sudden unexpected economic event.

What this requires is an initial admission by the regulators and bureaucrats that they have mismanaged mortgage debt creation and the cost of that debt in Australia. The intervention will require the government – in a bi-partisan approach – to absorb the mortgages that are at risk of falling into a negative security position. The funding of these loans may be managed through our superannuation system with government guarantees.

From that point a national housing policy needs to be formed that builds supply, sets the level of immigration, sensibly manages the amount of mortgage creation, specifies minimum deposit requirements, and appropriately resets the excessive taxation benefits provided to leverage in the housing and investment market.

In the meantime, Australia like most of our developed world peers, will need to hold down interest rates. Overseas, it will be necessary to hold down government interest bills. In Australia, it will need to be targeted to keep many housing borrowers from falling behind on repayments.

As I stated above, the policy most likely to be utilised will be QE. However, QE has the insidious effect of supporting asset price inflation when it is utilised without proper debt overlays.

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).

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A $3m super tax could make this strategy attractive again

Lindzi Caputo

Many Australians are concerned about the proposed additional tax on super balances over $3 million and are looking for strategies to keep their balance below this threshold.

For those with high balances, staying below the threshold would require taking money out of super. Typically, this can only be done after meeting a condition of release such as retiring or reaching the age of 65.

What about those who are yet to meet a condition of release? Are their options limited until they retire or attain age 65?

Not necessarily. After reaching preservation age, a Transition to Retirement Income Stream (TRIS), allows people to withdraw an income stream from their superannuation balance **before** they retire. Preservation age is the age at which you can access superannuation and depends on when you were born. It was age 55 for those born before 1 July 1960 and has gradually increased to age 60 for those born after 1 July 1964.

Date of birth	Preservation age (years)
Before 1 July 1960	55
1 July 1960 – 30 June 1961	56
1 July 1961 – 30 June 1962	57
1 July 1962 – 30 June 1963	58
1 July 1963 – 30 June 1964	59
After 30 June 1964	60

How a TRIS works

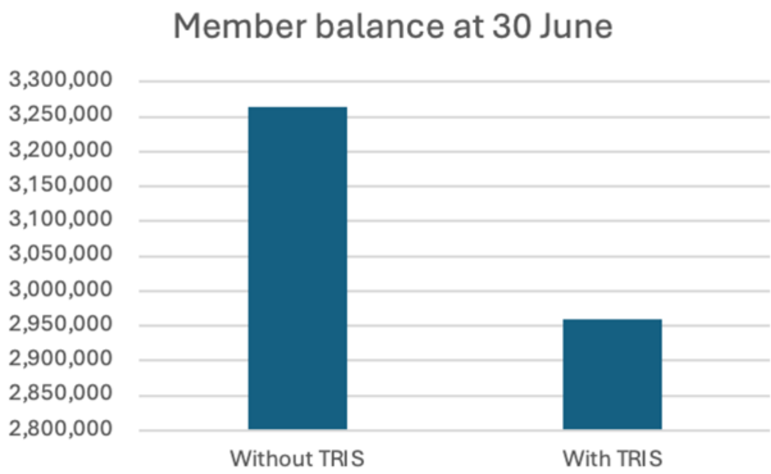
A TRIS allows super fund members to gradually move toward retirement by accessing a limited amount of their super balance before they stop work completely. They must satisfy their minimum annual pension requirement but cannot withdraw more than 10% of their TRIS balance in one financial year.

Drawing a TRIS becomes most tax effective after the age of 60, when the income stream payments become tax free.

There is no upper limit for a TRIS account, unlike the transfer balance cap which limits the amount people can have in a pension account to $1.9 million after meeting a condition of release. The TRIS does not count toward a member's transfer balance cap until they enter retirement or attain age 65, whichever comes first.

Take the example of John who is 62 and has a total super balance of $3.05 million. If John were to commence a TRIS with his full balance, he could withdraw up to $305,000 from his super balance in one financial year tax free.

Assuming his account produces investment returns of 7% for the year, his balance would reduce to $2.96 million after withdrawing the $305,000.



A drawback of the TRIS, and reason why this strategy is not as popular as it once was, is that earnings on the assets supporting the TRIS balance do not receive the same tax-free treatment as earnings on a pension balance. Instead, income is taxed at the standard rate of 15%, with capital gains taxed at 10% as is the case during accumulation phase.

Setting up a TRIS

First a member must decide how much of their total super balance they wish to convert to a TRIS. A TRIS account is distinct from the members accumulation balance and typically requires the establishment of a new account. Those in a retail super fund will need to open a new member account with their super provider. If they are still contributing to superannuation, they may have two member accounts, an accumulation account to contribute to and a TRIS account they are withdrawing from.

Setting up a TRIS within an SMSF may be simpler. Once the fund assets are valued to determine the members benefit a TRIS account can be set-up within the SMSF, alongside the accumulation account if the member is still contributing. Establishment paperwork would need to be completed by the member.

Key points about starting a TRIS:

- A TRIS can be started at any point during the financial year.
- A minimum pension must be withdrawn during the financial year. For those under the age of 65 the minimum percentage is currently 4%.
- The minimum pension may be pro-rated if the TRIS commenced after 1 July during the financial year.
- The member cannot withdraw more than 10 per cent of the TRIS balance in one financial year.

Super rules are complex, so it's important to get advice before implementing any strategy.

Who should consider a TRIS strategy?

Those between the ages of 60 and 65, who are yet to retire and wish to access to their super balance, are most likely to see the benefits of a TRIS strategy.

It could also be a way for people to reduce their total super balance, giving them the opportunity to equalise super amounts between spouses or transition wealth above $3 million into other investment structures.

The proposed legislation to introduce the tax on super balances over $3 million is yet to be passed and there is growing doubt over whether it will pass in its current form due to opposition in the Senate.

If passed, the legislation would come into effect from **1 July 2025**, meaning a member's total super balance would only be assessed at 30 June 2026. So, there is no need to rush to implement any strategies. Members have time to seek advice and consider the available options before making changes to their superannuation strategy.

Lindzi Caputo is a Wealth Management Director at HLB Mann Judd. This article is for general information only. It should not be accepted as authoritative advice and any person wishing to act upon the material should obtain properly considered advice which will take into account their own specific circumstances.

Does a declaration of trust satisfy SMSF separation of asset regulations?

Shelley Banton

While separation of assets remains one of the most reported contraventions by SMSF auditors, the question is: does a declaration of trust satisfy the requirements of SMSF regulations?

It is a complex matter that demands examination from many different perspectives, resulting in the typical "it depends" answer. One might think that a declaration of trust is a get-out-of-jail-free card for making a mistake when registering title to an asset, but it is not that simple. Like anything to do with SMSFs, there are many moving parts to consider, not least of which is understanding how trust law interacts with the Superannuation Industry (Supervision) Regulations (SIS).

The other issue is the many state and territory laws imposing different conditions for stamp duty, registration and document requirements.

SMSF legal requirements

SMSF trustees are obligated to keep money and other assets separate from any held by the trustee personally or from a standard employer-sponsor of the fund. Regardless of whether the fund's trust deed contains this covenant, the regulations determine that the governing rules contain it.

SMSF assets cannot be held in the personal name of the member or trustee, regardless of whether the trustee is an individual or a director of a corporate trustee. Part of the requirement is to protect fund assets by establishing clear ownership in the event of a dispute to avoid costly litigation.

The ATO also clarifies that the principles of SMSF regulations apply to all types of assets, including shares, units in a trust and other property. Without clear title, the audit report may be qualified, and an auditor contravention report (ACR) lodged with the ATO.

Trust law requirements

A trustee must be legally capable of holding SMSF assets in their own right and for the benefit of the beneficiaries.

A duty of care applies to trustees in the management of trustee affairs on behalf of beneficiaries. They have obligations regarding the protection of member benefits and must be able to prove they are the legal owners of the assets.

The trustee's overarching principle is to protect the interests of the beneficiaries, so where an asset is not held in the current name of the trustee, it is a breach of trust.

While this is not a reportable compliance breach in terms of trust law, other repercussions, such as litigation from beneficiaries whose interests were not protected, can arise.

Stamp Duty on Property Transfers

Stamp duty exemptions may apply to property transfers without a change to the beneficial owner. Paying out a limited recourse borrowing arrangement (LBRA) is a typical example where the trustee's name is changed, but the beneficial owner – the SMSF – remains the same.

While there is no requirement to change the bare trustee to the SMSF trustee under these circumstances, a cautionary red flag exists where these transfers occur. The reason is that while a nominal fee may apply in some jurisdictions if the trustee completes the correct paperwork in line with the specific instructions of the Office of State Revenue (OSR), there is no guarantee. Getting it wrong, however, can result in full stamp duty applying.

On the other hand, some states and territories require the title to be held in the name of the SMSF trustee only.

What happens when an SMSF has a multi-purpose corporate trustee and the title is transferred over to the same trustee but with a different beneficial owner? Firstly, the trust deed must allow the trustees to transfer assets through in-specie transfers. It is a dutiable event because the beneficial owner is changing. The trustees must lodge the paperwork with the relevant OSR and pay the correct stamp duty.

Incorrect Legal Title

The ATO gives very little away when it discusses why assets are not in the correct legal title of the SMSF. It provides few exceptions, the most notable due to an unavoidable restriction such as state or territory law. Where this happens, ownership must be established by "executing a caveat, or creating an instrument or declaration of trust to enable the fund to assert its ownership".

In real terms, very few reasons will justify why the title is incorrect. When a trustee makes the mistake of not putting the trustee as the legal owner, trying to fix the issue can trigger bigger problems.

Declaration of Trust

A declaration of trust is a legally binding document made before an asset is purchased, not afterwards. Where it is put in place for property purchases, for example, it must be registered in some states and territories to be effective. It is best to check the rules in each state and territory because it can trigger double stamp duty if drawn up after the property is purchased.

Acknowledgment of Trust

An acknowledgement of trust was previously the preferred document choice to prove ownership after an asset was purchased, but recent changes to NSW and Victorian state laws may now be a barrier. Legislative change in these states shows that making a statement akin to a declaration or acknowledgement of trust where the dutiable property is held (or to be held) on trust for identified beneficiaries may be liable to duty, even if made orally or in writing. As a result, requests for an acknowledgment of trust may result in unintended financial consequences, and trustees should seek legal advice in their respective jurisdictions before putting in place any such documentation.

Related Party Bare Trust

Using a related-party bare trust to address problems with asset ownership can result in further compliance contraventions. An asset held under a bare trust is not an in-house asset if a limited LRBA is in place that meets all the requirements. Unfortunately, where no LRBA has ever existed, it is a breach of the laws and the investment becomes an in-house asset of the fund.

The situation perfectly sums up where trying to resolve a potential compliance breach only creates a worse one.

Conclusion

A declaration of trust, or an acknowledgement of trust, is helpful where the trustee cannot legitimately hold an asset on trust for the fund. Further complications with changing OSR laws in various jurisdictions have effectively made drawing up either of these documents extremely expensive, as potential stamp duty issues arise if done incorrectly.

SMSF practitioners should be extremely cautious about requesting these particular documents from trustees who may require legal help to avoid red tape and unnecessary costs.

Shelley Banton is Head of Education at ASF Audits.

Stop paying attention

Joe Wiggins

Improving our investment behaviour is difficult.

Our choices have a messy confluence of influences ranging from the explicit (financial incentives) to the implicit (our own psychological wiring). It is impossible to ever understand precisely why we made a particular decision – it is just too complex. This doesn't mean, however, that we are helpless bystanders.

In fact, there are many seemingly innocuous areas that we can change to improve the chances that we might make sound judgements. Foremost of these is what we pay attention to – our investment decisions are inextricably linked to what we see and the impact it has on us.

A useful activity for any investor is to note down the major financial market issues that are in focus each week. After a year or so we can review these and realise how unworthy of our attention they were. As an added bonus, we might also want to make a prediction about how these issues will unfold so – on the rare occasion they are meaningful – we can see how lousy we were in forecasting them.

This might seem glib, but it is not. As investors, what we pay attention to dominates our decision making. We are bombarded with information (noise) that encourages costly choices at the expense of our long-term goals.

Our attention is drawn towards things that are available (easily accessible) and salient (provoke some form of emotional response). For investors this means whatever narrative thread is being weaved around random and unpredictable fluctuations in market prices. This is a major problem as the things we are being constantly exposed to are exactly the things that most of us should be ignoring.

For the majority of investors – those who invest over the long-term for profits, dividends and coupons – there is no need to have six screens providing a plethora of real time financial market information. Knowing what equity markets did yesterday is an irrelevance, and it is okay to ignore the latest hot topic.

Even the areas that the industry treats as the most important thing in the world – such as what the Fed will do at its next meeting – just don't matter that much to fundamentally driven investors with long-run horizons. The asset management industry compels us to engage with all of these distractions, when the route to better decision making is finding ways to avoid them.

The problem, of course, is that avoiding them is incredibly difficult. Not only are we designed to care about what is happening right in front of our eyes, but everyone else behaves as if every move in markets is based on a vital new piece of information. Looking one way while the crowd looks in the opposite direction takes incredible resolve.

Is there anything we can do to stop us paying attention to the wrong things?

The first step is to separate the investment industry machine with its '9 seconds until markets open' or 'German equities were down 1.2% over the month after weak industrial production numbers' from actual investing. In most cases, the incessant cacophony of financial market news flow is nothing more than advertising – it is designed to grab our eyeballs, our clicks or our money in one form or another – it is an irrelevance to the real reason most of us are investing. Treat it for what it is – interesting but meaningless at best, a damaging distraction at worst.

Next, we need to clearly and explicitly define what we should be paying attention to. Based on our goals, what are the things that are worthy of our focus and attention? What are the aspects that really matter to meeting our objectives? These will be specific to each individual but will inevitably be stable and boring, and come with no requirement to care that the US ten-year treasury yield fell by 7bps last week.

Asset managers – who are inevitably heavily complicit in this chronic attention challenge faced by investors – will say that financial markets are constantly in motion and that it is not feasible to simply act as if nothing is happening. Clients would be left uncertain, anxious and prone to even worse decisions. Although this sounds credible, it doesn't really hold water. There is not a choice between adding to the gobbledygook or saying nothing at all. How about putting short-term financial market fluctuations in their appropriate context and explaining why it is rarely that worthy of our attention or action?

Talking about topics also bestows credibility to them. If asset managers spend time discussing monthly market fluctuations and performance, they shouldn't be surprised if clients consider it to be important. Professional investors should always be asking themselves – how is what I am saying likely to influence the behaviour of my clients?

What we pay attention to tends to drive the decisions we make, and investors are persistently exposed to meaningless noise masquerading as meaningful information. We tend to perceive investment acumen in those individuals with an intimate knowledge of these daily market gyrations, but we have this entirely backwards – the ones with real skill are those who find ways to ignore it.

Joe Wiggins is Director of Research at UK wealth manager, St James's Place 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.

This article was originally published on Joe's website, Behavioural Investment, and is reproduced with permission.

How to unlock the big opportunity in misunderstood small caps

Jacobo Llanza, Francisco de Juan

The world is in a state of flux. Concerns about the outcome of the US presidential elections are mounting and geopolitical risks escalate elsewhere around the globe.

Against such a backdrop, it is prudent for investors to focus on a value approach to finding stocks and to look for compelling opportunities at a company level. It also can be helpful to consider 'out of the box' investment approaches and a proactive approach to engaging with underlying companies.

This has long been the approach of private equity investors – they find and then invest in promising companies for the long haul.

It's an approach that can also serve investors in listed equities well, particularly with regards to small cap equities. Adopting an approach of 'friendly activism', can reap strong benefits over the long term.

Small cap companies everywhere offer investors the opportunity to get in at ground level and benefit from the growth that happens as companies mature. They are also generally an under-researched sector of the market, with most analysts focussing on larger cap companies. This creates potential for those analysts willing to do the research.

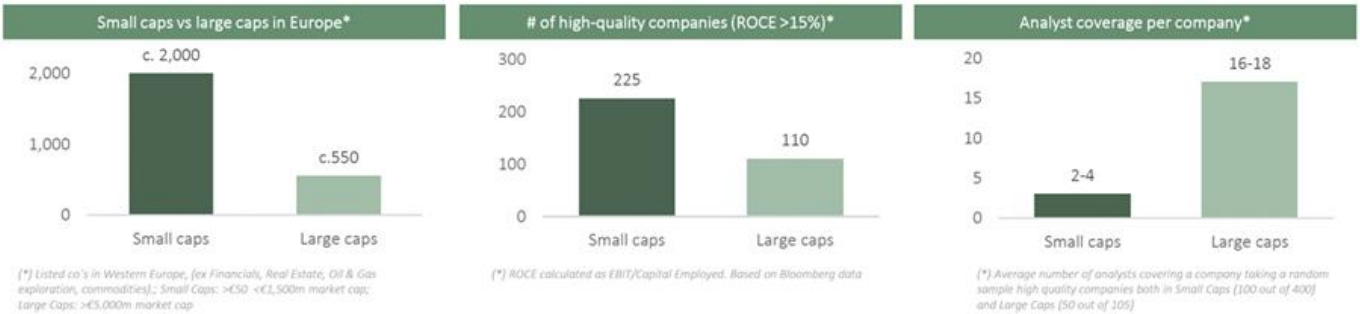
An important consideration, however, is where a potential investment is domiciled. While growth in many regions of the world is desirable, not every jurisdiction offers the regulatory and legislative certainty of Europe. A focus on European listed companies – not as a European play, but rather investing in companies that have exposure to other parts of the world – can be a strategy that adds value.

Finding the dislocations

There are many structural issues at play around the world that can work to the benefit of small cap investors.

If we look to Europe as an example, the introduction of more rules to increase transparency in markets has resulted in lower broker coverage of small caps in Europe. That now presents an opportunity for those still in the space. Those willing to do the research can find European listed companies that are poised to gain from their investments and activities in global markets.

Figure 1: Limited coverage by analysts/investors - leads to opportunities for mispriced assets



Friendly activism

Like a private equity investor buying out a company and transforming it, the small cap space is a good sector to try and encourage change within a company. The relationship where a company board supervises a management team on behalf of the shareholders, is what we call the agency relationship. Ultimately, we believe active ownership can reduce agency costs. By virtue of being a significant relevant owner and having a shareholder oversight, we believe you can help companies to function better.

But it is better for all involved if this kind of engagement is done on a 'friendly' basis. More benefits accrue to the company, and it is always favourable to work alongside management rather than against it.

Often, we find that the small cap companies we are researching and investing in are headed up by first time CEOs. They might be an executive that comes from the first or second level of a large corporation but didn't make it there so wants to start over. They are usually strong at managing people and products but have never been responsible for final capital allocation decisions. Unlike large cap CEOs who constantly have advisers knocking on their door, the small cap CEO is sometimes starved for this type of assistance and advice, and very keen to engage with a 'friendly activist' investor.

We also promote sustainability with a pragmatic and customer centric approach. This is another tool to boost operational performance and terminal value across our companies, typically increasing the total addressable market, margins, or improving capital allocation. Complementing this, our ESG framework helps us to monitor risk.

Example opportunities

CIE automotive

CIE automotive specialises in supplying automative components and subassemblies, and is based in Spain. It represents a global play with 42% of its sales sourced from the Americas, 24% from Asia and 34% from Europe.

It has been in our portfolio for over 10 years and has performed extremely well during that time.

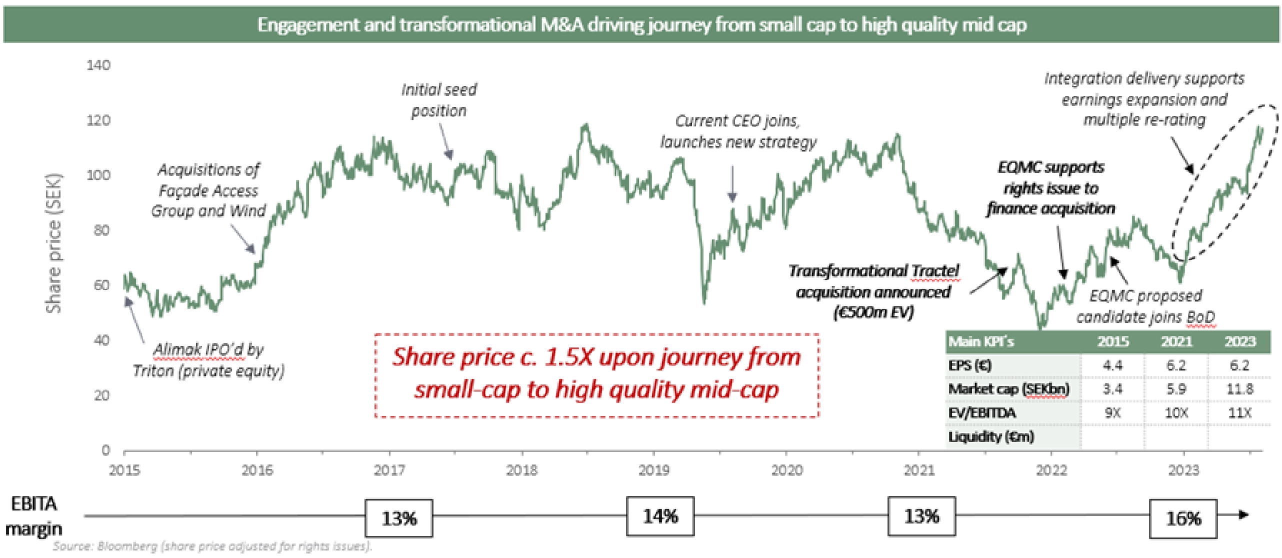
When we made our first investment in CIE Automotive it was primarily servicing just the local market of Spain, but it has since become one of the largest 35 companies listed in that country.

We recognised the potential early on when they were starting to expand internationally. We've worked with them to grow by both acquisition and through organic growth to the point where they are now a $3 billion mid cap company.

We helped them with investor relations, internationalisation, diversifying their business, and shareholder structure. Because of our engagement with their management team, and in turn management's willingness to work with us, we have assisted with activities such as spinning off non-core divisions to focus capital allocation on the core business and introducing new analysts to cover the company by encouraging management to increase investor roadshows.

Alimak

This Swedish company is the global leader and industry standard in vertical access solutions, including lifts, hoists, and related equipment, catering to the industrial, wind, building maintenance, and construction sectors. In total, 34% of its sales are from the Americas, 22% from Asia and 43% from Europe.



Our involvement with Alimak culminated in 2022 when we played an instrumental role, together with top-owner Latour and a few others, in securing additional funding for the transformational acquisition of Tractel, its largest competitor. This acquisition, which we had advocated for over several years, marked a significant turning point for the company.

The strategic merger created a highly profitable and dominant market leader, unlocking substantial cost and revenue synergies. The increased scale of the business is also likely to attract greater investor interest and improved analyst coverage, resulting in enhanced liquidity and higher valuation multiples.

Think outside the box

There is no doubt that there are opportunities to be had in finding market dislocations and taking advantage of cheaper prices to buy outstanding companies.

European small-cap stocks are currently trading at a substantial discount compared to both their historical averages and their large-cap counterparts. Brexit, the war in Ukraine and the general political turmoil in Europe have exacerbated this discount, as investors have broadly devalued European assets without distinguishing between companies focused on domestic markets and those with significant global operations.

Jacobo Llanza is Executive Chairman and Francisco de Juan is a Managing Partner and CIO of the EQMC Fund at [Alantra EQMC Asset Management](), a fund manager partner of GSFM, a Firstlinks sponsor. The information included in this article is provided for informational purposes only.

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This cornerstone of stock market valuation has been left behind

Brian Jacobs

The Cyclically Adjusted Price to Earnings (CAPE) ratio, introduced by Nobel laureate Robert Shiller in 1988, has long been a cornerstone of market valuation metrics.

By smoothing earnings over a decade, it aims to provide a more stable, long-term perspective on market valuations. However, the CAPE ratio's limitations have become increasingly apparent, making it a potentially misleading tool, especially when used in isolation for valuing today's dynamic markets.

Understanding the CAPE Ratio

The CAPE ratio is calculated by dividing the current market price of a stock or index by the average of inflation-adjusted earnings over the past ten years.

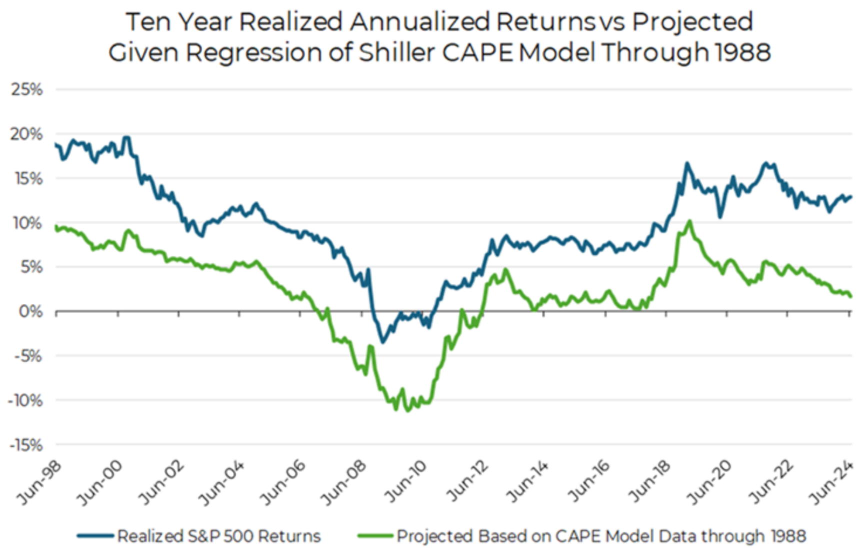
CAPE Ratio = Current Market Price / Average Inflation-adjusted Earnings of the Last 10 Years

This approach aims to normalize earnings over a full business cycle, reducing the impact of temporary factors that can distort traditional P/E ratios.

CAPE's track record: A history of underestimation

Since its introduction in 1988, the CAPE ratio has consistently projected U.S. equity returns 5-10% (or more) below realized returns over various periods. Except for the tumultuous period from the dot-com bubble to the global financial crisis, following CAPE for allocation decisions would likely have led investors into 1) the wrong asset class, 2) the wrong countries, and 3) the wrong sectors.

Below are three critical issues with the CAPE Ratio.

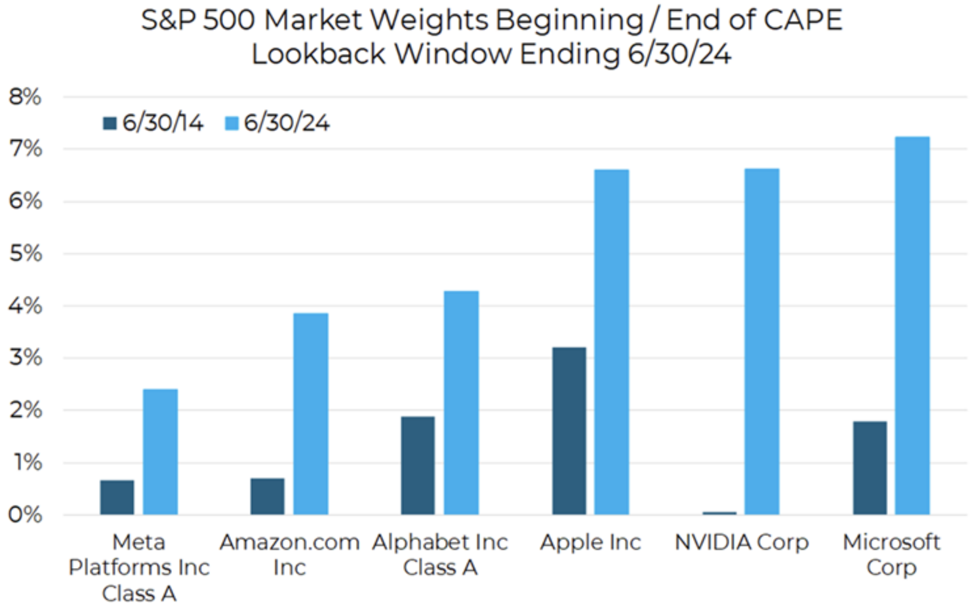


Source: Aptus via Yale.edu

Issue 1: Static stock composition myth

The CAPE ratio assumes a constant mix of stocks over time, which fails spectacularly in today's dynamic U.S. market. High-growth tech companies such as Apple, Microsoft, Nvidia, Google, Meta, and Amazon now dominate the index, with dramatically increased earnings and market weights over the past decade.

For example, the following table shows market weights of a handful of technology companies from ten years ago vs today.



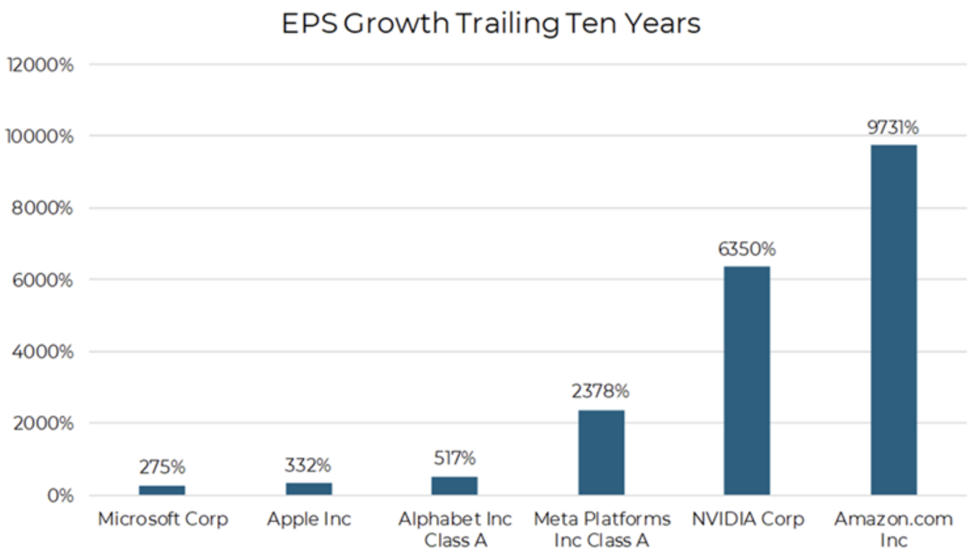
Source: Aptus via Morningstar Data

This leads to a logically inconsistent valuation:

- Price (numerator): Reflects current market cap that reflects their much larger present earnings
- Earnings (denominator): Includes smaller weights and much lower earnings from up to a decade ago

Take NVIDIA as an example: The price component accounts for its current ~7% weight in the index that reflects its 6350% earnings growth that has taken place over the past decade. Yet the earnings component includes its tiny 0.06% weight and much smaller earnings from a decade ago.

This mismatch creates a distorted picture of what an investor is actually buying. It would only be logical if one expected these companies' earnings to plummet by over 90%—an extremely unlikely scenario for established market leaders.



Source: Aptus via Morningstar Data

Issue 2: The buyback blind spot

The CAPE ratio fails to account for share buybacks, a key method companies use to return capital to shareholders. Unlike dividends, buybacks reduce the share count, increasing Earnings Per Share (EPS) even without a change in corporate earnings.

Consider two identical companies, differing only in capital return method:

- Company A: Returns capital via dividends
- Company B: Returns capital via buybacks

Assumptions for both companies are they have the same earnings, initial share prices, P/E ratios, business results, and policies of returning 100% of earnings to investors:

- Constant 10x P/E ratio
- 0% real EPS growth
- 10% return (earnings of $1 per $10 share price)
- 100% of earnings returned to investors

Over time this means:

- Company A: $10 share price, 10% dividend yield
- Company B: 10% annual reduction in shares, 10% increase in EPS and share price

Despite the identical businesses, the CAPE calculation shows company A with a CAPE of 10x and company B with a CAPE of 15.4x. This issue is particularly relevant in today's US market, where buybacks are more prevalent than in the past. As a result, the current market's CAPE ratio may not be directly comparable to its own history or to markets where buybacks are less common.

COMPANY A: CAPE Assuming all Dividends

Constant 10x P/E / 100% of earnings are returned via dividend / 0% real EPS growth / 10% Return

Year	Real Share Price	Share Count	Real Market Cap	Real Earnings	Real Earnings per Share (EPS)
0	10.00	10.00	100	10	1.00
1	10.00	10.00	100	10	1.00
2	10.00	10.00	100	10	1.00
3	10.00	10.00	100	10	1.00
4	10.00	10.00	100	10	1.00
5	10.00	10.00	100	10	1.00
6	10.00	10.00	100	10	1.00
7	10.00	10.00	100	10	1.00
8	10.00	10.00	100	10	1.00
9	10.00	10.00	100	10	1.00
10	10.00	10.00	100	10	1.00
					Average 10 Year Real EPS
Price Year 10 -->	10.00				1.00

Cyclically Adjusted Price to Earnings 10.00 x

*Price Year 10 / 10 Year Average Real Earnings

COMPANY B: CAPE Assuming all Buybacks

Constant 10x P/E / 100% of earnings are returned via buyback / 0% real EPS growth (but 10% real EPS growth from share reduction) / same 10% Return

Year	Real Share Price	Share Count	Real Market Cap	Real Earnings	Real Earnings per Share (EPS)
0	10.00	10.00	100	10	1.00
1	11.00	9.09	100	10	1.10
2	12.10	8.26	100	10	1.21
3	13.31	7.51	100	10	1.33
4	14.64	6.83	100	10	1.46
5	16.11	6.21	100	10	1.61
6	17.72	5.64	100	10	1.77
7	19.49	5.13	100	10	1.95
8	21.44	4.67	100	10	2.14
9	23.58	4.24	100	10	2.36
10	25.94	3.86	100	10	2.59
					Average 10 Year Real EPS
Price Year 10 -->	25.94				1.68

Cyclically Adjusted Price to Earnings 15.40 x

*Price Year 10 / 10 Year Average Real Earnings

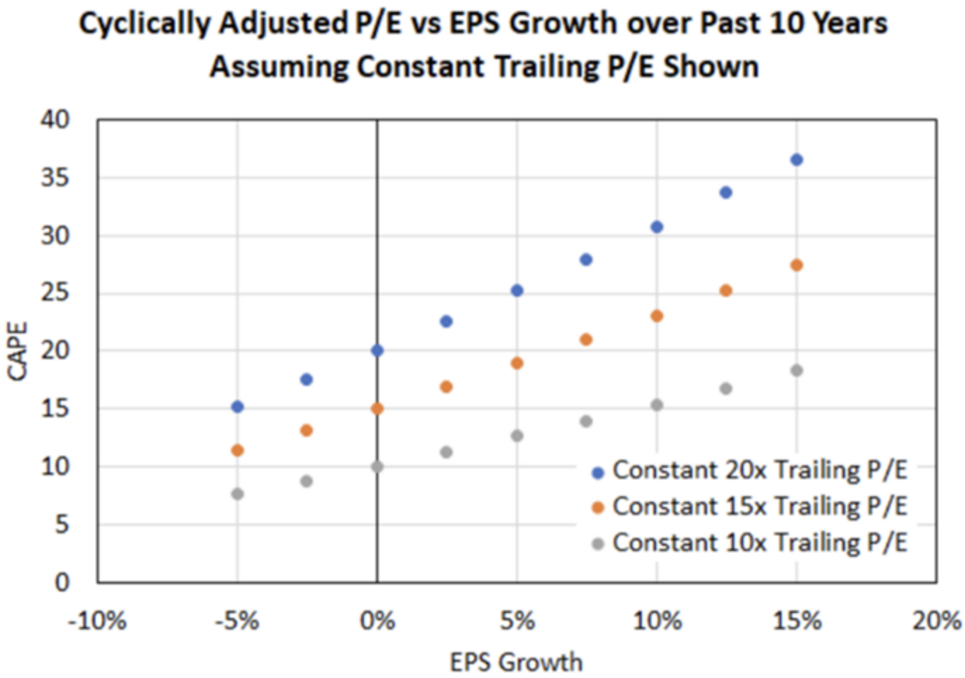
**Conceptual Illustration via Aptus*

Issue 3: CAPE's cross-market incompatibility

CAPE often paints U.S. stocks as more expensive than foreign markets. Direct comparisons between countries using CAPE ignore fundamental differences between markets. US companies are much more likely to buy back their stock than foreign companies and the U.S. market has experienced substantial earnings growth, unlike many foreign markets.

- For a market with 0% EPS growth, the CAPE ratio remains constant.
- For a market with 10% EPS growth, the CAPE ratio increases significantly over time, even if the trailing P/E remains the same.

- Conversely, for a market with -2.5% EPS growth, the CAPE ratio decreases, even if the trailing P/E remains the same.



**Conceptual Illustration via Aptus*

The U.S. market's higher CAPE ratio often reflects higher EPS growth, not necessarily overvaluation.

Moving beyond CAPE

While historically significant, CAPE has become an increasingly flawed standalone valuation tool, particularly for the dynamic U.S. market. Its failure to account for changing stock composition, buybacks' impact on EPS, and varying growth rates across sectors and markets can lead to misleading conclusions.

For modern investors, a more nuanced approach is essential. This should incorporate:

- Multiple valuation metrics beyond CAPE
- Analysis of sector-specific growth trends
- Consideration of capital return strategies (dividends vs. buybacks)
- Recognition of structural changes in market composition

By embracing a more comprehensive valuation framework, investors can navigate the complexities of today's markets with greater accuracy and confidence. As the financial landscape continues to evolve, so too must our tools for understanding and valuing it.

Brian Jacobs, CFA is responsible for Investment Solutions and Strategy at Aptus Capital Advisors. This article is for informational purposes only and should not be considered a recommendation to purchase or sell any particular security. Be sure to consult with an investment and tax professional before implementing any investment strategy.

****Conceptual Illustration:** Information presented in the above charts are for illustrative purposes only and should not be interpreted as actual performance of any investor's account. As these are not actual results and completely assumed, they should not be relied upon for investment decisions. Actual results of individual investors will differ due to many factors, including individual investments and fees, client restrictions, and the timing of investments and cash flows.*