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Editorial

Recently, I appeared on Morningstar's [Investing Compass](#) podcast and I was asked by host, Mark Lamonica, about how I invest now compared to when I was a fund manager. I was on the podcast to talk about ASX stocks to buy and hold forever, so this question towards the end of the interview threw me somewhat, and I'm not sure I answered it well. Here's my attempt to rectify that and give more detail on the topic.

The key differences

The key differences between how I invest today versus when I was a fund manager include:

- 1. I invest with a longer-term horizon than I did as a fund manager.** As an individual investor, I feel like I can afford to take a long-term perspective on investments, and my time horizon these days is 10+ years. As a fund manager, I never had the same luxury. I had clients who often demanded short or medium-term results, and that created pressure to find investments that would pay off over that time horizon.
- 2. Because I think longer term as an individual investor, I focus more on the quality and moats of businesses.** The longer the time horizon, the greater the need to concentrate on business quality. That a company has an edge to keep competitors at bay. That it has a long runway to grow their businesses. That it has a management capable of executing. And that it has a track record of delivering on promises.
- 3. Being long term oriented, I focus more on companies I own than those that I don't own.** I was once a Portfolio Manager for an Asia-ex Japan fund, and autos were one of the sectors that I covered. I didn't invest in Hyundai Motors at the time, which had the largest weighting of any company in the auto sector. It outperformed the autos part of the index for 18 months and I remember having to justify why my fund should stay underweight Hyundai. As an individual investor, I don't need to concern myself with things like this so much.
- 4. As an individual investor, I am not as spreadsheet focused as I was as a fund manager.** Fund managers and analysts are obsessed with spreadsheets and models. As an individual investor, I rarely use a spreadsheet. It's important to know the key earnings drivers for a company and what assumptions will drive earnings going forward. Though I prefer simplicity to complexity when it comes to earnings forecasts nowadays.
- 5. As an individual investor, I don't have access to the same information as I did as a fund manager, and therefore rely more on primary sources.** As a fund manager, I was bombarded with information from brokers, consultants, internal research, government research, and a million other sources. As an individual investor, I don't get access to that same information. I rely much more on primary sources for information on companies, such as earnings releases, management presentations, and annual reports. This can be good as it

filters out a lot of noise. The bad is that I don't get to same opportunity to test my views against those of others.

6. As an individual investor, I don't get access to company management like I did as a fund manager and therefore use other avenues to assess senior executives. As a fund manager, I often had access to senior executives at companies. As an individual investor, I barely get access to the receptionists! That can be good and bad. Meetings with management can be a mixed bag – sometimes there's useful information but there can also be a whole lot of smoke. As an individual investor, I rely more on primary sources to assess management. What their track record is like. What they were like at previous companies. Whether they delivered on previous promises. Their vision and whether it's achievable. Evidence of whether they have created a good culture ie. employee feedback.

7. As an individual investor, I embrace simplicity over complexity. Fund managers and analysts love complexity, and I was no different. As an individual investor, I prefer simplicity. For instance, I now prefer investing in a good business with decent prospects than a potential turnaround story. It's simpler, consumes less time, and is usually more profitable over the long term.

A different example: China is dirt cheap at the moment, has just announced much-needed economic stimulus, and its market could bounce hard off depressed levels. But I also know that the government controls the country, that it isn't interested in investors making money, and that China has a track record of poor shareholder returns despite spectacular economic growth. For me, China is in the too-hard basket and there are other, easier ways to make money.

The differences above point to some of the pros and cons of being an individual investor.

The pros include:

- **Freedom to invest how you want.** Obviously, being an individual investor is solo sport. Being a fund manager isn't, and that has limitations.
- **No teams/bosses to worry about.** A corollary of the first point.
- **No clients to worry about.**
- **Fewer short-term performance pressures.**

The cons include:

- **Reliance on yourself rather than a team.** The good and bad is on you, not a team.
- **Don't inherit processes to guide investment decisions.** Most investment teams have detailed processes to guide decisions. The mantra is, 'good processes lead to good outcomes.' Individual investors don't inherit these processes and need to create their own process to help them achieve their goals.
- **Don't get the same access to information.**
- **Don't get access to company management.**
- **Don't get to influence company decision making.**
- **Don't get the same access to company competitors, suppliers, and customers.**

In sum, I love having fewer constraints as an individual investor. Yet, I also miss bouncing investment ideas off fund manager/analyst colleagues.

Investing, like life, always involves trade-offs...

In my article this week, I compare the valuations of the four major asset classes - cash, bonds, stocks, and property - and point to what seems overvalued as well as where [investors may be able to find a bargain](#).

James Gruber

Also in this week's edition...

Mark Lamonica looks at why [dividend ETFs may disappoint](#) income investors. He suggests the structure of many dividend ETFs leads to lacklustre or non-existent dividend growth. He runs through the different options for investors.

Martin Currie's Reece Birtles is downbeat on the outlook for the ASX. He says the recent reporting season delivered disappointing earnings guidance from companies, and that this may be a sign of a slowing economic

environment. He also notes a concerning trend of companies hoarding retaining earnings and reducing their dividend payout ratios. He says this [doesn't augur well for dividends](#) in FY25.

The Coalition's persistent calls for first home buyers to be able to tap superannuation for housing purchases continues to get widespread publicity. **Saul Eslake** explains the reasons why it's a bad idea, including that it'll [likely result in more expensive house prices](#).

Immigration remains a hot button issue in Australia given the skyrocketing house prices and cost of living. **Peter Zeihan** looks at how overseas countries such as Canada and Germany have handled the problem. He says while there are undoubted economic benefits to immigration, they need to be [balanced against the social costs](#).

Mining companies are famous for destructive mergers and acquisitions and **Schroders' Justin Halliwell** says that BHP was lucky that its bid for Anglo American fell over. He runs through the numbers on why [BHP's proposed deal would have been a bad one](#). He also goes through his latest views on lithium after the commodity's unprecedented recent collapse.

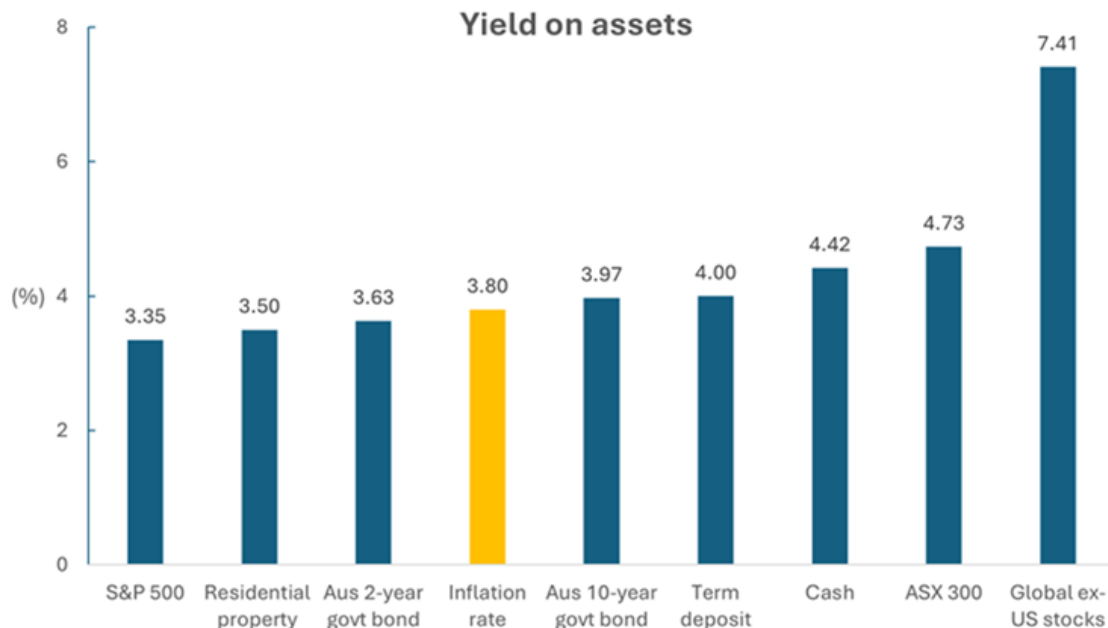
Kion Sapountzis has an intriguing theory on why the discounts on some listed investment companies (LICs) and listed investment trusts (LITs) are deepening and persistent. His data reveals LICs and LITs that exhibit lower volatility tend to trade [closer to their net asset values](#). Conversely, those with more concentrated portfolios and higher volatility generally trade at steeper discounts.

Lastly, in this week's whitepaper, **Man GLG**, an affiliate of **GSFM**, outlines three reasons to be [optimistic on Asian stocks](#).

Which asset classes are a bargain now?

James Gruber

Periodically, I give an update on the valuations of key asset classes and how they compare. Here's the latest chart on yields for the four major asset classes: cash, bonds, property, and stocks. I've included the inflation rate as a point of comparison.



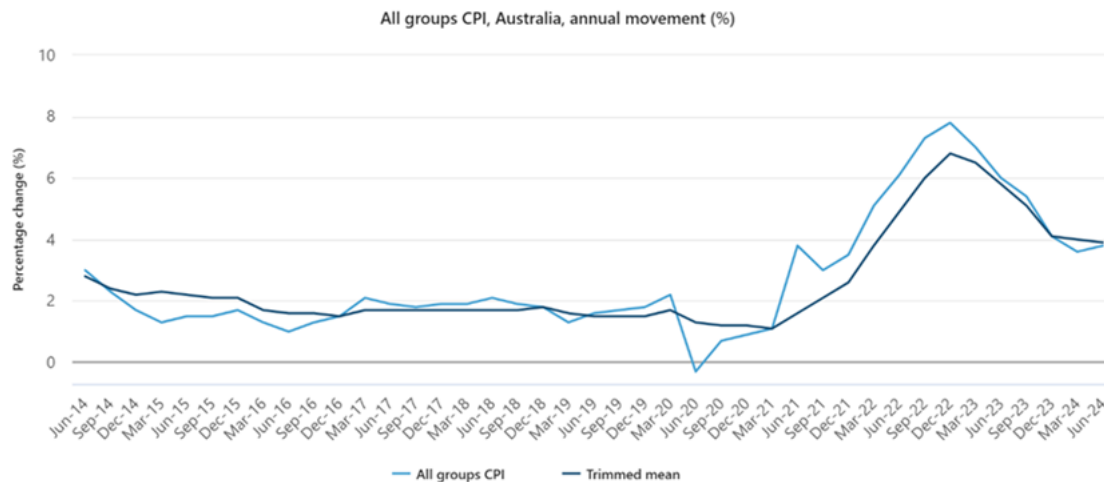
Note: resi property = avg rental yield capital cities. S&P 500 = trailing 12m operating earnings yield. Term deposit = CBA 12m. Cash = bank bill index. ASX = trailing 12m earnings yield.

Sources: Firstlinks, CoreLogic, Robert Shiller, CBA, ASX, Morningstar

What stands out is that the yields on many asset classes are quite condensed. When I'd compiled this chart 10 months ago, inflation was much higher and there was a greater dispersion in yields. Most assets have performed well of late and that's lowered the yields for them.

It seems to me that most of the assets are pricing in inflation coming down further. The reason is that when you buy an asset, you're hoping to earn a yield above the inflation rate ie. a positive real return. Yet some asset classes are currently yielding below the inflation rate, and others are only marginally above. Note that in the above chart, I've used the quarterly inflation figure, which is widely considered more reliable than the monthly number.

The odds favour inflation declining further, though whether it goes lower and stays lower is the question. Australia has stickier inflation than many other developed countries after not raising rates as aggressively.



Source: Australian Bureau of Statistics, CPI rose 1.0% in the June 2024 quarter 31/07/2024

The overvalued: US stocks

Let's first run through what I consider the overvalued asset classes. The S&P 500 looks expensive, and parts of it appear very expensive. On most valuation metrics, it's 1-2 standard deviations overvalued compared to history.

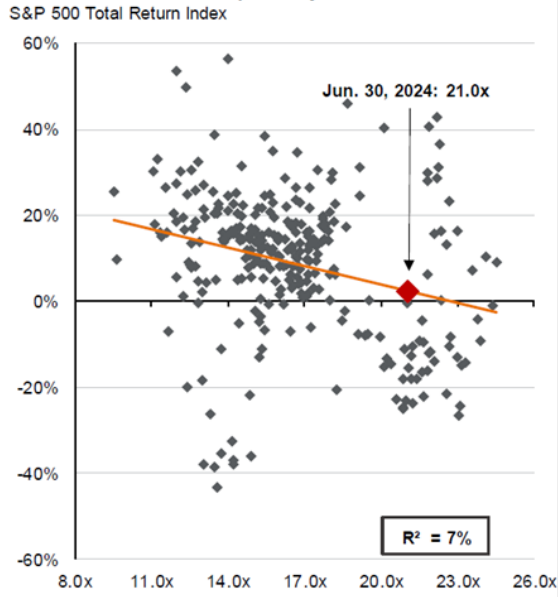
S&P 500 Index: Forward P/E ratio



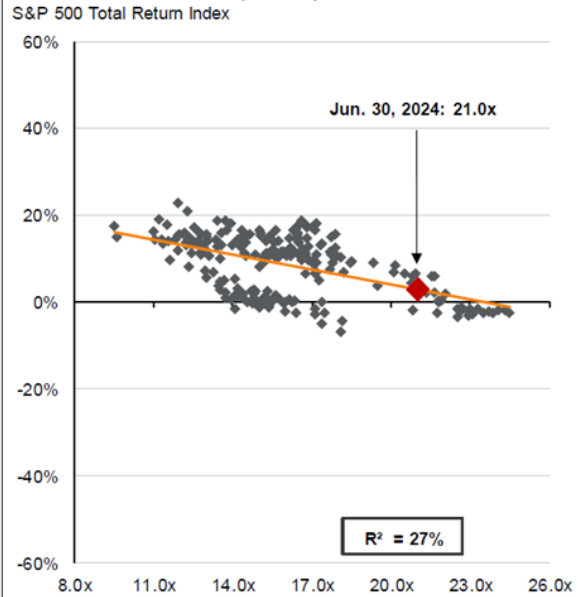
Source: FactSet, FRB, Refinitiv Datastream, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management. Price-to-earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since March 1994 and by FactSet since January 2022. Average P/E and standard deviations are calculated using 30 years of history. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies. Dividend yield is calculated as the next 12-months consensus dividend divided by most recent price. Price-to-book ratio is the price divided by book value per share. Price-to-cash flow is price divided by NTM cash flow. EY minus Baa yield is the forward earnings yield (consensus analyst estimates of EPS over the next 12 months divided by price) minus the Moody's Baa seasoned corporate bond yield. Std. dev. over-/under-valued is calculated using the average and standard deviation over 30 years for each measure. *Averages and standard deviations for dividend yield and P/CF are since November 1995 due to data availability. Guide to the Markets - U.S. Data as of June 30, 2024.

At a 21x forward price-to-earnings ratio (PER), the S&P 500 is well above its average PER of 16.7x. Through history, the higher the PER, the lower future returns have been.

Forward P/E and subsequent 1-yr. returns



Forward P/E and subsequent 5-yr. annualized returns



Source: FactSet, Refinitiv Datastream, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management. Returns are 12-month and 60-month annualized total returns, measured monthly, beginning 6/30/1999. R² represents the percent of total variation in total returns that can be explained by forward price-to-earnings ratios. Price-to-earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since May 1999 and by FactSet since January 2022. Guide to the Markets - U.S. Data are as of June 30, 2024.

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The technology, consumer discretionary, and healthcare sectors in the US look most overvalued. For instance, US tech is trading at 30x forward P/E versus its 18x average of the past 20 years.

	Energy	Materials	Financials	Industrials	Cons. Disc.	Tech	Comm. Services*	Real Estate	Health Care	Cons. Staples	Utilities	S&P 500 Index	
S&P weight	3.6%	2.2%	12.4%	8.1%	10.0%	32.4%	9.3%	2.2%	11.7%	5.8%	2.3%	100.0%	Weight
Russell Growth weight	0.5%	0.6%	5.7%	5.1%	14.1%	46.8%	12.7%	0.7%	10.1%	3.8%	0.1%	100.0%	
Russell Value weight	8.0%	4.7%	22.9%	14.3%	4.7%	9.5%	4.5%	4.6%	13.9%	7.9%	5.0%	100.0%	
Russell 2000 weight	7.5%	4.5%	16.0%	17.2%	10.4%	15.3%	2.2%	5.6%	15.2%	3.5%	2.6%	100.0%	
QTD	-2.4	-4.5	-2.0	-2.9	0.6	13.8	9.4	-0.8	-1.0	1.4	4.7	4.3	Return (%)
YTD	10.9	4.0	10.2	7.8	5.7	28.2	26.7	-1.9	7.8	9.0	9.4	15.3	
Since market peak (February 2020)	104.3	60.3	45.1	56.8	47.7	151.0	67.4	9.1	51.2	39.4	12.5	72.9	
Since market low (March 2020)	363.4	150.8	154.2	168.8	116.3	264.6	134.4	75.2	109.7	83.6	74.7	161.2	
Beta to S&P 500	1.2	1.1	1.1	1.1	1.2	1.2	1.0*	0.9	0.7	0.6	0.5	1.0	β
Correl. to Treas. yields	-0.1	-0.6	-0.5	-0.5	-0.6	-0.7	-0.8	-0.8	-0.6	-0.6	-0.6	-0.7	ρ
Foreign % of sales	39.0	51.9	28.1	33.2	33.2	57.4	48.1	16.9	34.4	39.8	1.3	41.4	%
NTM earnings growth	2.5%	7.0%	11.4%	10.9%	14.1%	19.4%	17.8%	2.8%	13.5%	6.4%	9.5%	12.8%	%
20-yr avg.	100.2%	13.2%	20.6%	13.8%	16.8%	12.1%	11.3%*	6.9%	7.9%	7.5%	4.7%	10.9%	EPS
Forward P/E ratio	12.0x	19.5x	15.1x	20.5x	24.5x	30.4x	19.4x	16.5x	19.0x	20.0x	16.4x	21.0x	P/E
20-yr avg.	13.5x	15.0x	12.5x	16.3x	19.7x	18.0x	18.7x*	17.1x	15.0x	17.5x	15.7x	15.7x	P/E
Buyback yield	3.8%	1.1%	2.0%	1.8%	1.5%	1.4%	3.2%	-1.7%	1.0%	0.8%	-0.2%	1.7%	Bbk
20-yr avg.	1.8%	1.0%	0.5%	2.3%	2.5%	3.0%	1.8%	-1.4%	1.9%	1.8%	-0.7%	1.8%	Bbk
Dividend yield	3.3%	1.9%	1.8%	1.6%	0.8%	0.7%	0.9%	3.9%	1.7%	2.8%	3.4%	1.4%	Div
20-yr avg.	2.8%	2.4%	2.3%	2.2%	1.4%	1.2%	1.1%*	3.8%	1.9%	2.9%	3.8%	2.1%	Div

Source: FactSet, Refinitiv Datastream, Russell Investment Group, Standard & Poor's, J.P. Morgan Asset Management. All calculations are cumulative total return, not annualized, including dividends for the stated period. Since market peak represents period from 2/19/2020 to 6/30/2024. Since market low represents period from 3/23/2020 to 6/30/2024. Correlation to Treasury yields are trailing 2-year monthly correlations between S&P 500 sector price returns and 10-year Treasury yield movements. Next 12 months (NTM) earnings growth is the percent change in next 12-months earnings estimates compared to last 12-months earnings provided by brokers. Forward P/E ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates and J.P. Morgan Asset Management. Buyback yield is net of share issuance and is calculated as last 12-months net buybacks divided by market cap. Dividend yield is calculated as the next 12-months consensus dividend divided by most recent price. Beta calculations are based on 10-years of monthly price returns for the S&P 500 and its sub-indices. *Communication Services (formerly Telecom) averages and beta are based on 5-years of backtested data by JPMAM. Past performance is not indicative of future returns. Guide to the Markets - U.S. Data are as of June 30, 2024.

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Much of the overvaluation resides among the largest companies in the US. Many are pricing in gains from AI and the consensus outlook for an economic soft landing in America. If either of these falters, earnings may disappoint, and valuations will come under pressure.

The overvalued: Australian housing

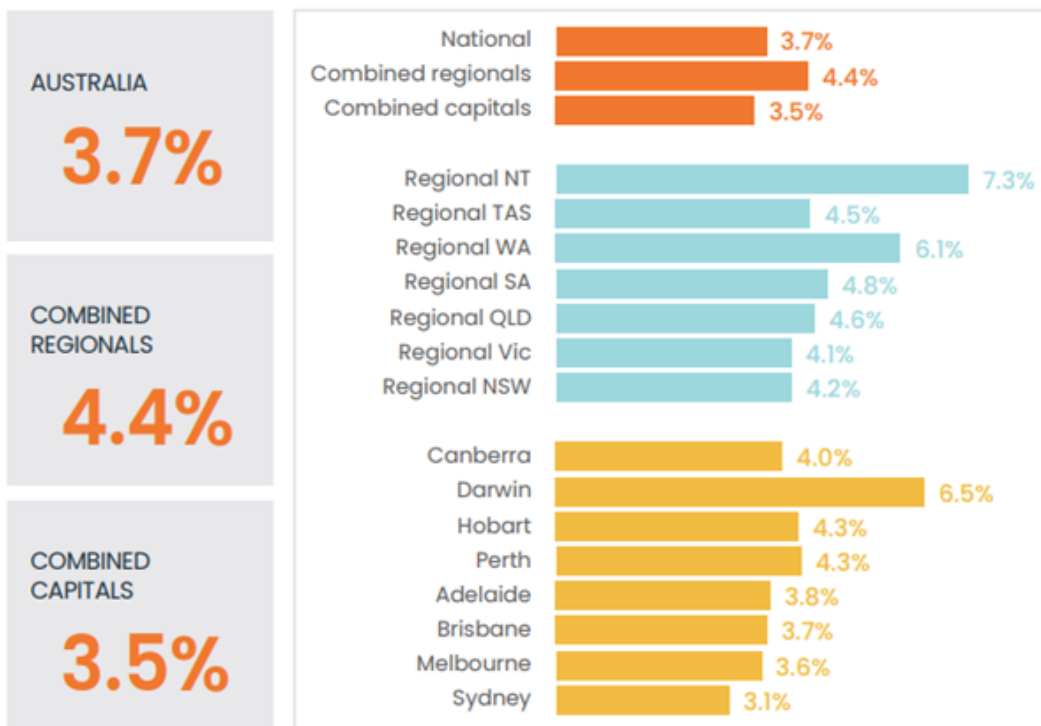
Residential real estate dwarfs every other asset in size in Australia. At almost \$11 trillion dollars, it's 3.5x larger than the market for publicly listed stocks, 2.8x bigger than the superannuation sector, and 2.5x total GDP.

I've stated [previously](#) that residential property in Australia is possibly the most expensive asset anywhere in the world. And that it's at least 40% overvalued, in my view. I stand by that view, and here's why.

The gross rental yield on property is 3.5% in capital cities. That gross yield is essentially revenue for a landlord. Therefore, the yield essentially equates to a price to sales (P/S) ratio of 29x (ie. 100 divided by the gross yield).



Gross rental yields, July 2024



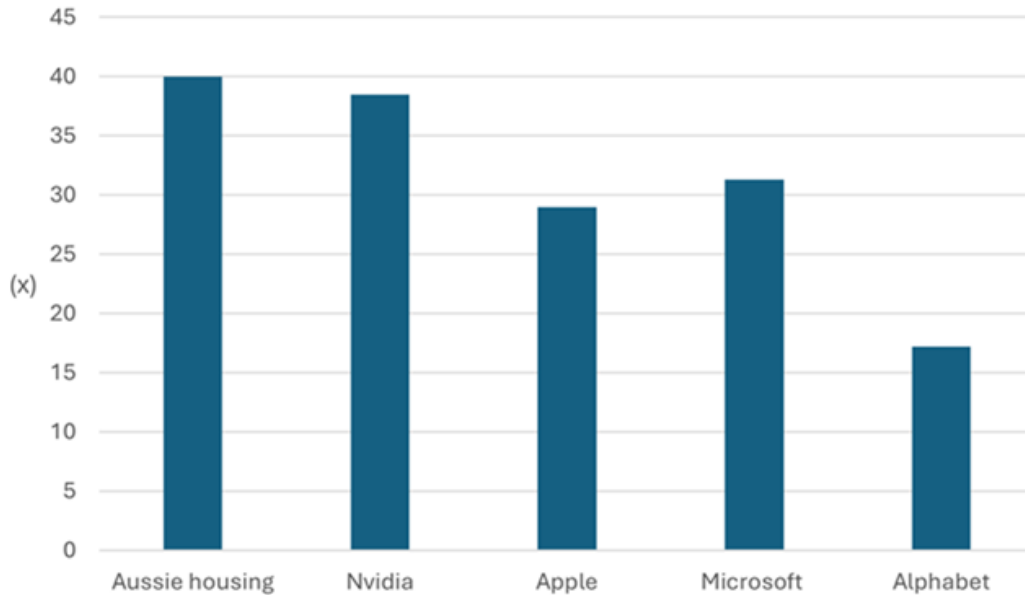
Source: CoreLogic

That P/S ratio is extraordinarily expensive. For instance, Nvidia – the world's third largest company by market capitalization and regarded by most observers as expensive if not bubble-like – currently trades at a P/S ratio of 28x.

That's not the fully story though. The gross yield on property comes before costs, including maintenance, interest, and taxes. Property experts I speak to suggest maintenance and other operating expenses would reduce that yield by at least 1%. In other words, the yield would be sub-2.5%, and that's before taxes.

Let's be generous and call it a 2.5% net yield for residential property. That equates to a price-to-earnings ratio of 40x. Again, compared to the pricey US tech sector, that P/E ratio also looks high. And remember, US tech company earnings are growing exponentially, while those of property aren't.

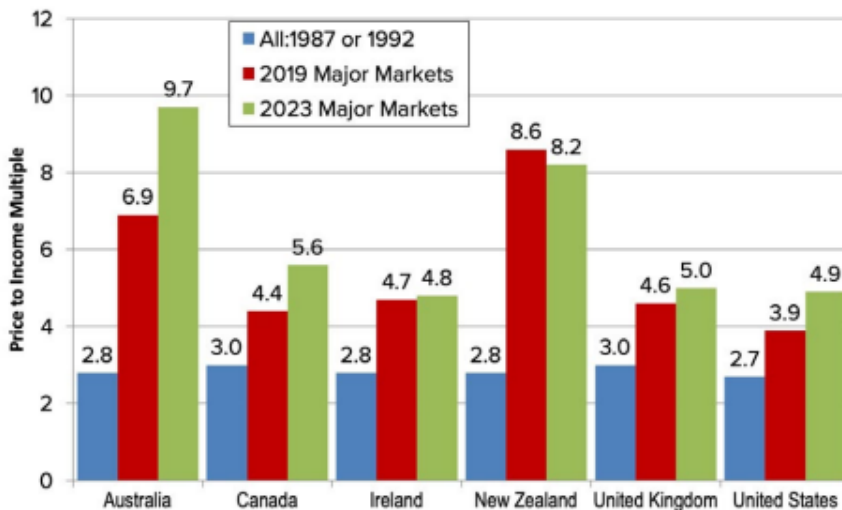
Australian housing P/E vs US mega tech stocks



Note: tech stocks = forward P/E. Source: CoreLogic, Morningstar

Compared to other housing markets around the world, Australia also stands out. The price to income ratio is 9.7x, about double that of the US. The ratio has more than trebled over the past 40 years.

International House Price-to-Income Ratios 1987/1992 TO 2023



Derived from Reserve Bank of Australia and Demographia

Figure 1

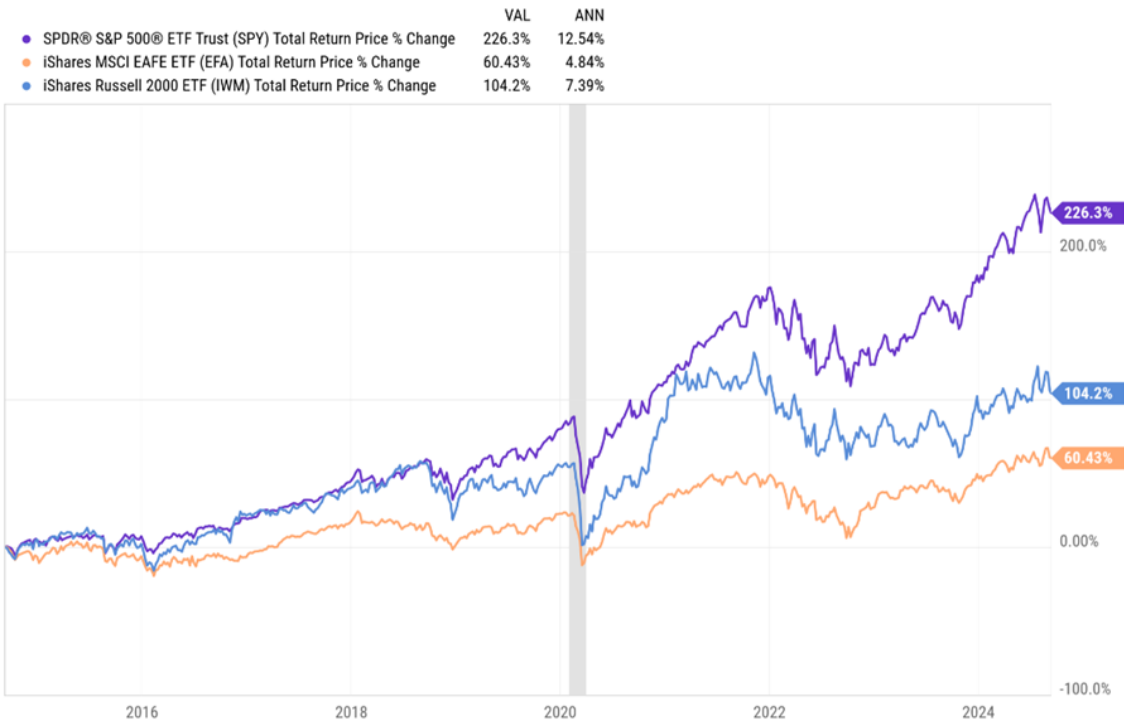
Australia has three cities in the top 10 least affordable metropolitan markets in the world, according to consultants, Demographia. Incredibly, the likes of Adelaide rank as less affordable than global destinations such as New York.

For price to income ratios to decline, either prices must drop or incomes need to rise. The outlook for incomes looks relatively muted. Meanwhile, supply constraints mean prices are unlikely to come down in the near term, though growth from here may prove more challenging.

In other words, Australian residential real estate may be one of the globe’s most expensive assets, but it’s likely to remain that way, at least in the short term.

The undervalued: international stocks

Outside of the US, stocks look reasonable value. International stocks have had mediocre returns over the past decade, badly lagging America’s.



Source: A Wealth of Commonsense

That’s led to favourable valuations for global stocks, especially compared to the US. The dividend yield on international shares of 3.2% is also much higher than the 1.4% of the US.



Source: FactSet, MSCI, Standard & Poor’s, J.P. Morgan Asset Management. Guide to the Markets – U.S. Data are as of June 30, 2024.



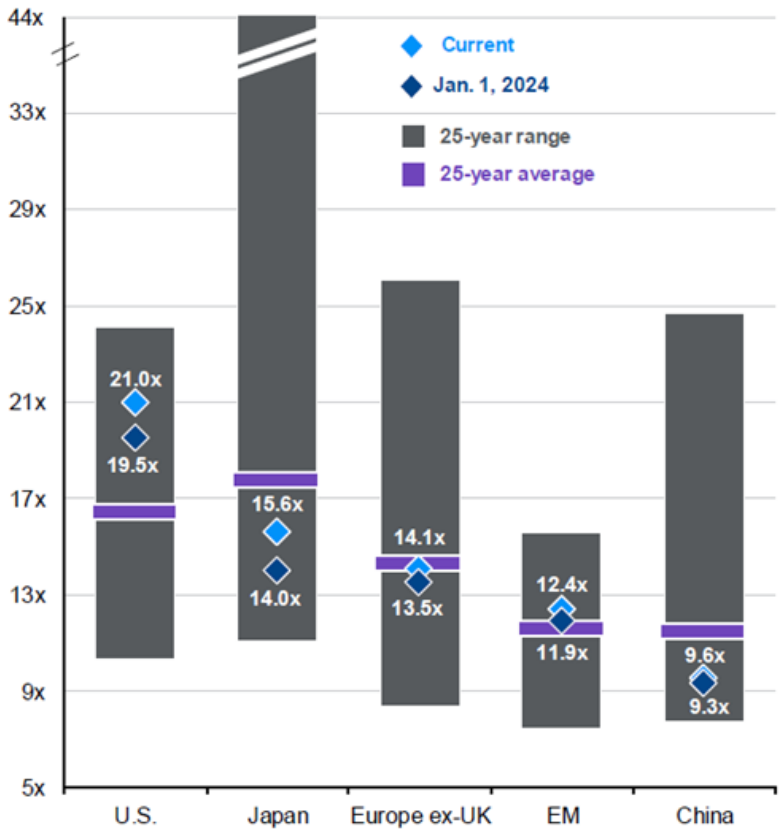
Of the different markets, Japan and Emerging Markets offer good value. China is cheap and due for a bounce back, though whether that proves sustainable will depend on fixing a broken political and economic model.

The undervalued: value stocks

Value stocks may also be an opportunity. Over the past 15 years, growth stocks have left value stocks for dead. Because of this, there are few true value-oriented fund managers left. It's resulted in value being inexpensive.

Global valuations

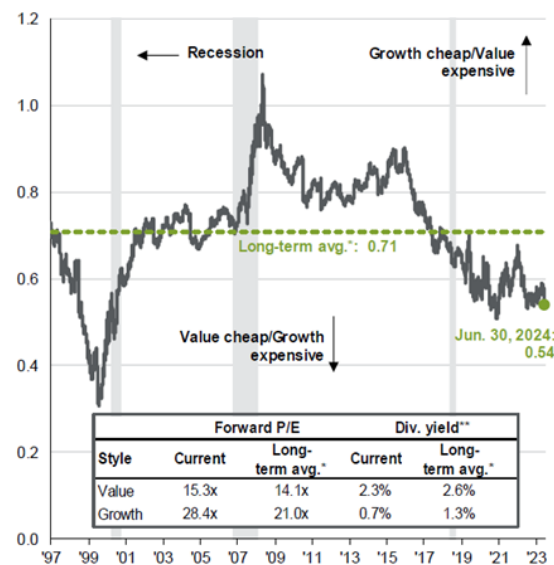
Current and 25-year next 12 months price-to-earnings ratio



Source: JP Morgan

Value vs. Growth relative valuations

Rel. fwd. P/E ratio of Value vs. Growth, 1997 - present

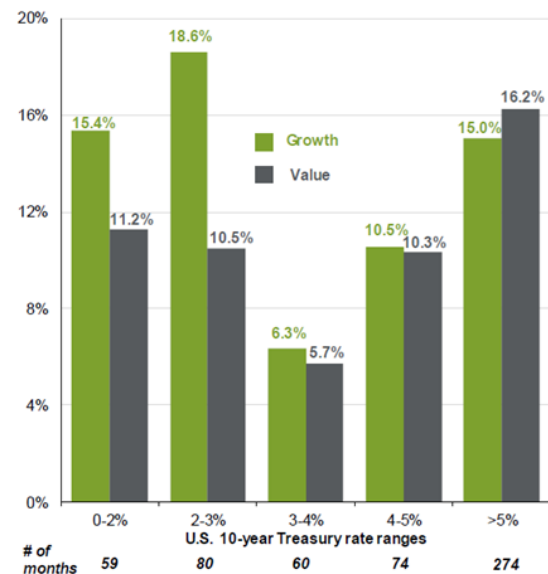


Source: FactSet, FTSE Russell, NBER, J.P. Morgan Asset Management.

Growth is represented by the Russell 1000 Growth Index and Value is represented by the Russell 1000 Value Index. (Left) *Long-term averages are calculated monthly since December 1997. **Dividend yield is calculated as the next 12-month consensus dividend divided by most recent price. (Right) Returns are calculated by annualizing the average monthly performance during each interest rate range. Guide to the Markets - U.S. Data are as of June 30, 2024.

Value vs. Growth in different interest rate environments

Annualized total return by 10-year Treasury rate ranges, 1979 - present



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Interestingly, the chart on the right shows that value stocks perform especially well in higher interest rate environments. So, if you're worried about high inflation and rates, owning value stocks makes sense.

The undervalued: small caps

Small caps may also be a contrarian play. They've significantly underperformed large caps in Australia and globally over the past decade, leaving them on undemanding valuations. Smaller companies are generally carrying larger debt loads, which means that they're more sensitive to changes in interest rates. If rates are heading down, small caps may be a primary beneficiary.

The undervalued: cash

It seems odd to say that cash is undervalued, though I'd suggest it might be.

Investors poured money into term deposits last year, after stocks and bonds endured a poor 2022. That defensive stance has slowly switched. This year, the cash in term deposits has eked out into risk assets as investors get more comfortable with the outlook for the likes of equities.

The question is whether term deposits are still attractive in the current environment. With 12 month term deposits of up to 4.9% available at reputable banks, there still appears to be value here, especially with inflation at 3.8% and many risk assets offering inferior yields.

The fairly valued: Australian bonds

Bonds have performed reasonably well over the past 12 months, though most retail investors still seem to be gun shy given the poor performance of this asset class over the prior three years.



Source: Trading Economics

At this time last year, many investors were declaring that the 60/40 portfolio (60% equities, 40% bonds) was dead. That's proven overblown.

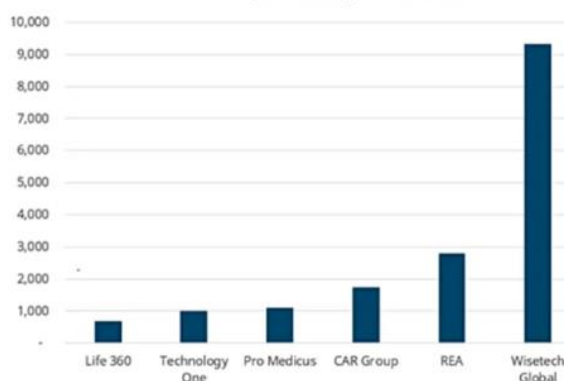
However, given the recent pickup in bond prices, the yields on bonds are less attractive now. With 2-year Australian bond yields at 3.63% and 10-year yields at 3.97%, they don't offer the same value as they did 12-18 months ago. And the key risk for bonds is that inflation stays sticky in Australia.

How do bonds compare to cash? The two assets serve different purposes in a portfolio. Cash is more of a placeholder, until there's a better place to allocate money. Bonds serve as a ballast in a portfolio, buffering it against the potential for sharp drawdowns in riskier assets. Bonds also gives investors protection against economic downturns, which is something that cash doesn't do.

The fair valued: Australian stocks

The other asset that seems fair valued is Australian stocks. It's deceptive, however, as the market is split between the haves and have nots. On the one hand, the prices for tech companies are extraordinary.

	2024 Revenue (\$m)	EBIT (\$m)	Market Capitalisation (\$bn)	Current PE
Life 360	564	25	4.4	98
Technology One	498	148	7.7	65
Pro Medicus	162	108	16.0	200
CAR Group	1,101	488	14.8	45
REA	1,445	692	29.5	65
Wisetech Global	1,065	382	40.8	151

Market Cap in August (\$m)


Source: Datastream, Schroders.

Banks have also been bid up. Possible reasons for this include ever-increasing superannuation and ETF flows into the sector and cash exiting the depressed mining sector and into banks.

It's left financials sector valuations on par with the ASX 200. That's unusual as banks traditionally trade at a discount to the index due to them being cyclical and selling highly commoditized products.

Note that the bank's steep valuations can be primarily attributed to the otherworldly pricing attached to Commonwealth Bank (ASX: CBA). CBA is the most expensive retail bank in the developed world, and it's not even close.

CBA versus global retail banking peers

Company	Code	Market cap (USD billions)	PER (x)	PB (x)	ROA (%)	ROE (%)
Bank of America	NYSE: BAC	305	13.80	1.14	0.72	8.74
Wells Fargo	NYSE: WFC	184	11.06	1.15	0.92	10.96
HSBC	LON: HSBA	239	6.98	0.93	0.73	12
Royal Bank of Canada	TSE: RY	174	14.8	2.05	0.79	14.47
Mitsubishi UFJ	8306: TYO	126	9.56	1.03	0.53	11.65
Citi	NYSE: C	111	16.23	0.58	0.29	3.67
Toronto-Dominion Bank	TSE: TD	107	19.55	1.44	0.40	7.61
Sumitomo Mitsui	8316: TYO	82	11.00	0.79	0.37	7.69
Santander	BME: SAN	73	10.55	1.75	1.78	15.98
U.S. Bancorp	NYSE: USB	70	14.34	1.42	0.72	10.24
Bank of Montreal	TSE: BMO	60	13.02	1.13	0.48	8.33
<i>Average</i>			<i>12.81</i>	<i>1.22</i>	<i>0.70</i>	<i>10.12</i>
Commonwealth Bank	ASX: CBA	157	25.55	3.29	0.75	12.95
CBA premium/discount (%)			99.48%	169.87%	6.73%	27.94%

Note: PER = price to earnings ratio, trailing 12m. PB = price to book ratio, trailing 12m, ROA & ROE trailing 12m

Source: Morningstar

Meantime, the mining and energy sectors have been left behind. Yes, China is depressing demand in many commodities, with iron ore at the top of the list. However, supply remains constrained in several commodities, including copper, oil, and coal, and that augurs well for prices going forward.

While of these sectors, there are pockets of opportunity. Earlier this year, I wrote an article on [16 ASX stocks to buy and hold forever](#). It was a wish list – stocks to buy in future at the right price.

Of the stocks, there are four that currently offer value, albeit for different reasons:

- ASX Ltd (ASX: ASX) – problems now with replacing Chess but still a superb business with multiple ways to win.
- SkyCity (ASX: SKC) – casinos are hated, but therein lays the opportunity with this sound operator.
- The Lottery Corporation (ASX: TLC) – brilliant business, and valuations are starting to look ok.
- Washington H Soul Pattinson (ASX: SOL) – Its main businesses in New Hope, Brickworks and TPG should bounce back from cyclical issues.

James Gruber is editor of Firstlinks and Morningstar

Dividend ETFs may disappoint income investors

Mark LaMonica CFA

Investors love income. Investors also love ETFs. An income ETF seems like a match made in heaven. Income ETFs can play a role in a portfolio but like any investment it is important to understand what they can and can't do to help you achieve your goals.

A good place to start is understanding how the typical income ETF works. Most income ETFs will take a group of shares represented by an index like the ASX 200 and will select shares that meet income related criteria.

Some ETFs use backwards looking criteria like the dividend yield. Some look at forward projections of dividends to weed out dividend traps. All things being equal we believe that investors are better served by the latter. Periodically these same criteria are re-applied and shares that no longer meet the criteria are exchanged for new shares that do.

An example of an ASX listed income ETF

An example is illustrative. Vanguard Australian Shares High Yield ETF [[ASX:VHY](#)] is an ETF that receives a Bronze Medallist rating from Morningstar analysts. I also happen to own this ETF and went through the process of comparing it to other income [ETFs in this article](#).

The ETF tracks the FTSE Australia High Dividend Index. The index is constructed by ranking each share by their forward estimated dividends based on consensus analyst opinions. There is also a mechanism to lower portfolio turnover and avoiding too much concentration. There are currently 66 holdings in the dividend index out of 200 in the overall universe of shares that may be selected.

I am going to use the approach that VHY takes to a hypothetical example of a dividend ETF. In my simplified approach I will use an overall universe of 10 shares with the top 6 selected by the ETF which rank highest based on forward estimated dividends. The ETF goes through the ranking exercise twice annual at the end of the financial year and the end of the calendar year and the holdings are adjusted.

Many dividend ETFs weight holdings by dividend yield or forward projected dividend yield. This is used to keep the yield high. Not only will the highest yielding shares be in the ETF but more of the ETF will be allocated to the shares in the highest yield.

These are estimates for the future and anything can happen but if the projections come to fruition this gives investors a high yield. And many income ETFs do provide investors with high yields.

This checks one box for income investors by providing high levels of income. However, I've long argued that income investors are best served long-term by both higher levels of current income and income growth. As an income investor the goal is to grow an income stream in real or inflation adjusted terms. Whether income is currently being spent or not this increases the purchasing power of the cash flows from a portfolio. And to do this growth is key and an income portfolio should balance both higher yields and growth potential.

For many income ETFs the track record for growth is less appealing. Below is an example using two popular dividend ETFs in Australia.

ETF	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Vanguard Australian Shares High Yield (VHY)	\$4.71	\$3.15	\$4.65	\$4.81	\$3.23	\$2.09	\$3.17	\$3.84	\$3.43	\$4.24
Russell Inv High Dividend Aus Shrs ETF (RDV)	\$1.59	\$1.47	\$1.58	\$1.91	\$2.09	\$1.31	\$0.87	\$1.79	\$1.52	\$1.43

Why is income not growing from income ETFs?

The structure of many dividend ETFs makes growth challenging. We need to start with some generalisations about share investing. This isn't a universal rule, but investors tend to pay higher valuations for shares with higher expected growth. Companies with higher expected growth often invest more resources in the business to take advantage of those growth opportunities. They dedicate less of their earnings to dividends which results in a lower dividend payout ratio.

In general, this means that companies that are expected to grow earnings quickly will have lower yields – both forward-looking yields and backward-looking yields – than companies where growth is expected to be slower.

Since earnings growth is often a pre-requisite for higher dividend growth it means dividend growth will be lower. Many of these lower yielding shares with higher expected growth will be excluded from dividend ETFs that use yield as a selection criterion.

There is an example from the US that is illustrative of this fact. We can compare the Dow Jones US Select Dividend Index and the S&P 500 Dividend Aristocrats Index.

The Dow Jones Select Dividend Index contains the 100 highest yielding US dividend shares and weights them by dividend yield – meaning the higher yielding shares get a larger weight in the index. On August 30th the index yielded 4%. This yield may seem low in Australia but given the overall yield of the S&P 500 is 1.3% it is high in comparison to the US market.

The S&P 500 Dividend Aristocrats Index contains US companies that have raised their dividend for 25 consecutive years. This index is equal weighted. On August 30th the index yielded 2.33%. This alone illustrates that shares with consistent dividend growth – driven by consistent earnings growth – trade at higher valuations and have lower yields.

Since 2006 the S&P 500 Dividend Aristocrats Index which focuses on companies that have long track records of growth has had annualised dividend growth of 7.72%. The Dow Jones Select Dividend Index which focuses on high yields has had growth of 4.86%.

This is a real-life example of the generalisation about higher yielding shares growing dividends at a lower level. But it is a US example. And the Australian market is different. Unfortunately, the differences in the markets make dividend growth harder to come by in the Australian dividend ETFs.

In the US there is more of a stigma around dividend cuts. And companies respond to this stigma by doing everything possible to not cut their dividends. The dividend payout ratios are lower, and the yields are lower but most companies won't cut a dividend unless absolutely necessary.

In Australia companies tend to set dividend payout ratios as a range of earnings. Payout ratios are higher, and yields are higher but as earnings fluctuate dividends will fluctuate. And due to the cyclical nature of many companies that dominate the ASX in the mining and financial services sector those earnings and dividends tend to fluctuate a lot on an aggregate basis. This explains why the examples of the local dividend ETFs bounce around so much.

Why this matters for most dividend ETFs that rely on yield to select shares

Given this relationship between yield and dividend growth it becomes obvious what the issues are with many dividend ETFs that are constantly adjusting into the highest yielding shares. That adjustment is also constantly rotating into shares with lower dividend growth prospects.

These dividend ETFs are not completely turned over every year. There are some shares that are held in the portfolio over the long-term. These shares constantly have high yields which is likely an indication that investors have low expectations for future earnings growth that is needed to fuel dividend increases.

The yield of the ETF will often mirror the directional changes in yield of the overall market – just at a higher level. In a rising market when yields drop as prices increase the yield will likely go down. In falling markets when yields rise the yield of the ETF will likely rise. Relative performance between higher yielding shares and lower yielding shares will impact this dynamic.

For the issuer of the ETF, they can continue to market a higher yield than the overall index. But the impact on investors over the long-term is a little less clear. If an ETF uses a backwards looking yield, there is a risk that the ETF can hold dividend traps that cut dividends.

If the ETF uses a forward-looking yield dividend growth will be constrained by holding the highest yielding shares and will be directionally impacted by the overall trends of dividend growth or cuts in the market. After all a higher forward yield is not an indication that a dividend will be higher on an annual basis. A forecasted dividend reduction may still result in a higher yield than other shares. Especially in a market like Australia where dividends fluctuate.

The impact on dividend investors

A higher yield has an advantage for investors who want current income even if the level fluctuates on an annual basis. For long-term investors I would argue that dividend growth leads to better outcomes. Consistent and

growing levels of dividend income matter if an investor is living off of income and wants to at least maintain a consistent standard of living given inflation.

This doesn't mean avoiding dividend ETFs or high yielding shares. They have a role to play in an income portfolio. Reinvesting the higher dividends provides an investor with growth. But balance is important to ensure growth. And that means having ETFs and shares that will grow their dividends over the long-term. These are often shares and ETFs with lower yields.

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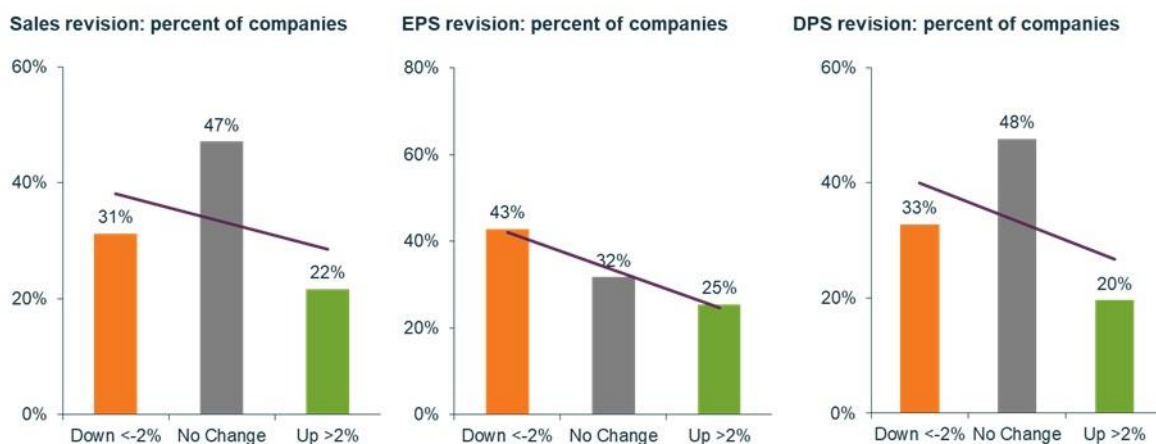
Rosy markets ignore darker dividend outlook for ASX

Reece Birtles

The market's stock price reactions appear to be disregarding any evidence that contradicts the 'Goldilocks' narrative for the economy. Many corporate results and company communications from August 2024 reporting season, however, seem to echo the poor conditions that we experienced back in 2019, a period overshadowed by the subsequent Covid years.

Weaker than expected guidance abounds

After assessing the tone of management guidance for sales, earnings and dividends, we see a two-to-one negative skew of guidance below what brokers were expecting before the results.



Brokers unsurprisingly adjusted their next 12 months forecasts closely in line with the negative guidance, leading to more than 40% of companies receiving downgrades to their EPS forecasts versus only a quarter receiving upgrades.

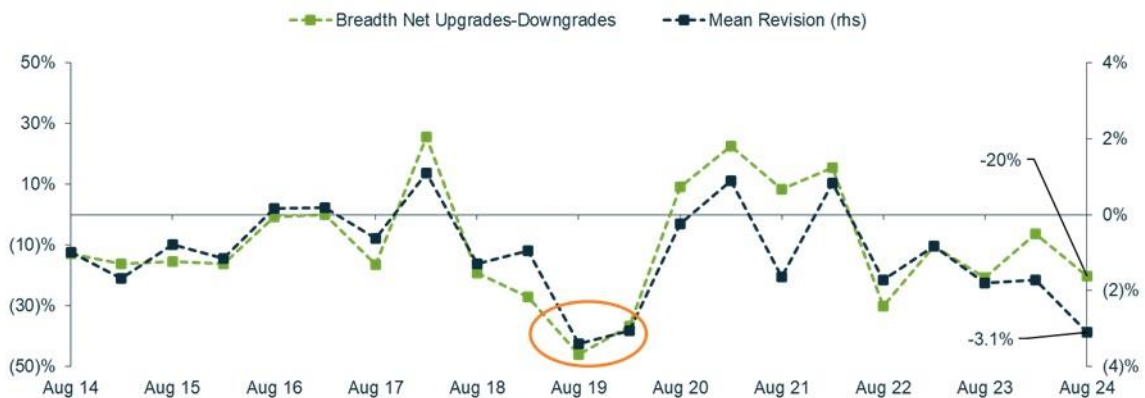
The biggest driver of the weak guidance from management was the slowing inflation environment that everyone seems to be wishing for. The result of this is a less desirable, slowing sales environment.

For the first time since August 2020, we saw a downgrade skew to the sales per share (SPS) line, which had been much more resilient until now due to inflation. This slowing sales environment, sitting at around 2% p.a. growth, is making it a lot harder for companies to maintain or grow EPS.

The environment is looking like 2019

Putting those revision downgrades into context, the net breadth of the number of companies receiving upgrades versus downgrades was somewhat negative, but we note that it was not terrible versus recent history. However, the size of the mean EPS revision (-3%) was the worst since 2019 and the second worst for the decade.

EPS revisions over time



While this poor revision statistic is in part driven by the concentration of the S&P/ASX 200 in the large cap miners who experienced commodity price downgrades, and weakness in demand from China’s excess capacity, it is truly a signal of where we are in the economic cycle.

The low point in 2019 was when economic conditions were slowing, earnings and profit expectations were being cut, and rates were getting cut. Covid seems to have distorted the market’s collective memory of how bad these conditions were, and we are seeing similar conditions now.

Income scorecard reflects slowing environment

We have also updated our Income Scorecard to capture any changes post reporting season in earnings and dividend expectations.

The scorecard allows us to track how sectors and individual companies have delivered on the market’s forecast dividend expectations over the last 12 months, and if their dividend expectations are providing any inflation protection or growth expectations. Our scorecard allows us to look more closely at the potential income outcomes for the type of higher quality income opportunities within the S&P/ASX 200 that we consider for inclusion in our retirement income-focused portfolios.

In our analysis we limit the universe to focus on results of true income opportunities only, those that meet a minimum franked yield threshold, and our proprietary assessment of sufficient quality and liquidity for an income investor. This leaves us with around 100 stocks out of the S&P/ASX 200.

We also strip out the impact of stock price movement when looking at the growth in forecast yield over the last 12 months by assuming a static stock price based on the start of the period. This allows us to see if the changes in yield are due to true earnings expansion or just share price changes.

In keeping with the slowing sales and earnings environment, we are also seeing poor DPS outcomes over the last 12 months, and ongoing subdued growth expectations across the sectors:

Scorecard for MCA’s income universe: by economic sector



A key highlight over the past 12 months is that the resource stocks have continued to deliver good dividends versus expectations 12 months ago. However, the outlook is a lot tougher now, and most of the downgrades in future dividends can be found in this sector.

A particular stock of concern is **Woodside Energy Group**, where their M&A decision to invest in two new projects in the US have put a lot more stress on their ability to have enough free cash flow to fund strong dividends going forward.

The other standout concern was with the banks, which did deliver good earnings results, and reasonable or flat dividends over the last 12 months. However, there has been no growth to their forecast DPS because the underlying fundamentals haven't improved. The only thing that has changed is share prices.

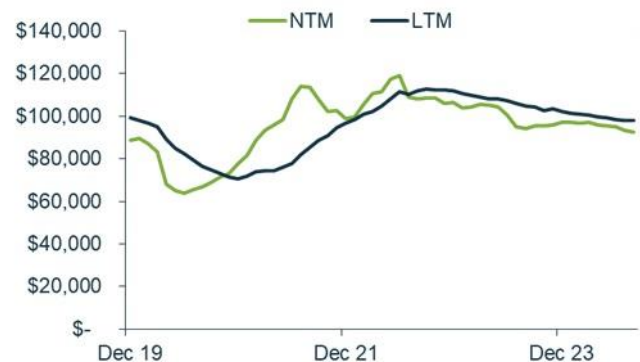
Commonwealth Bank of Australia is a prime example of this. The bank is now at a level that is hard to call a strong dividend paying stock. The price being paid for the Bank at this point is unprecedented, and as a result the yield has dropped to below even the bond yield. To us, there is no fundamental basis for its P/E ratio, apart from the weight of passive investors creating a supply / demand issue. This has resulted in everyone analysing the price rather than the fundamentals. We warn people to remember that bubbles never last.

Concerns flowing into further dividend conservatism

A concerning trend overall for dividends is that companies are becoming even more conservative, in both their payout ratios, and also the level of debt ratios that they are willing to run. The average payout ratio across the market has dropped from 62% pre-Covid to 53% now, and companies have similarly dropped their amount of debt/revenue from 33% to 22%.

This hoarding of retained earnings, which is also not being reinvested into growth areas or areas with the highest return, is a worry for us. The lack of pressure being put on boards and management around payout ratios in recent times is a byproduct of the momentum driven market and the lack of scrutiny on fundamentals. Once the momentum bubble bursts, we do expect to see a return to dividends, and more focus on improving shareholder value.

S&P/ASX 200: Aggregate Dividends (A\$ millions)



Muted profit growth expectations amid extreme valuation spreads

Combining the results, guidance, revisions and fundamental insight gained from engagement and the macroeconomic reality, we are left with a less-than-ideal outlook for company profits. The forecast for next 12-month profit growth for the S&P/ASX 200 is down to just 2%, with the most negative expectations in the resources space, and most positive in industrials. However, given the slowing sales growth environment, we do question how much more of that growth can be wrung from gross margin expansion.

Despite the poor profit outlook, the market remains disconnected from this impending reality. We are witnessing a situation where Valuation spreads between the cheap and expensive stocks in the market, either by simple P/E measures or our proprietary Valuation research, are back at near extreme levels. There have been only three points in recent market history when the valuation spread has been this wide: pre-dotcom bubble, GFC and Covid.

This dispersion has hurt active manager performance over the past 12 months, and particularly managers exposed to Value factors. However, this is where we see the opportunity is going forward. In today's environment of wide Valuation spreads and potential rate cuts, it is likely today's cheap stocks will prove more defensive than the expensive Growth stocks.

Next twelve-month P/E ratio



While it is difficult to pick an exact turning point in market sentiment, we believe that now is the time for investors to evaluate the balance in their portfolios. This environment can be navigated, but it is as important as ever for investors to be discerning in their stock picking.

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Why tapping super for housing is a bad idea

Saul Eslake

Before the 2022 Federal election, the Coalition proposed a 'Super Home Buyer Scheme' under which people would be allowed to withdraw up to 40% of their superannuation savings, up to a maximum of \$50,000, to be devoted towards the purchase of their first home.

Since the 2022 election, the Coalition in Opposition has re-iterated its on-going support for this scheme, with shadow ministers variously suggesting that the \$50,000 limit could be increased (Sukkar 2024), or that existing homeowners be allowed to transfer superannuation savings into mortgage offset accounts (Kehoe 2023).

An alternative suggestion, recommended by a Coalition-dominated Parliamentary Committee on Tax and Revenue in 2022, is that first home buyers be allowed to use their superannuation savings as collateral for a housing loan. Although it added that this should be conditional on "implementing policies to increase the supply of housing".

Proponents of the use of superannuation in any of these ways argue that home ownership status has a bigger impact on a person's security in retirement than his or her superannuation balance. That is, a person or couple who have attained home ownership and paid off their mortgage before reaching retirement will be in a better financial position than if they hadn't (Bragg 2024).

Some proponents also argue that housing represents a better investment than superannuation because:

- Returns from residential property have historically been almost the same as those from shares (and higher than those from bonds) with less volatility
- Investment in housing can be more highly geared than investment in other assets
- Owner-occupied housing enjoys more favourable taxation treatment than superannuation
- Owner-occupied housing is exempt from the pension assets test, unlike superannuation savings or other assets

There are, however, four significant problems with policy suggestions of this nature.

1. Inevitably higher house prices

The widespread use of such a scheme in a supply-constrained market like Australia's would inevitably result in higher housing prices rather than in higher rates of home ownership.

Evidence from past attempts to put additional purchasing power in the hands of would-be home buyers - be they through cash grants, stamp duty concessions, deposit or mortgage guarantees, lower interest rates or easier lending criteria - have all resulted in higher residential property prices without reversing the decline in home ownership rates. This is especially true among people in the age cohorts at which these measures have ostensibly been targeted.

This was the conclusion of the Australian Treasury when it considered a similar proposal in the context of the 1998-99 Budget. It noted that "a superannuation for housing scheme could not be targeted efficiently to those individuals who would not otherwise achieve home ownership before retirement" and that "it would also reduce retirement incomes and national savings" (Australian Government 1998: 2-15).

Even the House of Representatives Standing Committee on Tax and Revenue in 2022, which recommended that people be allowed to access superannuation savings to enhance their capacity to purchase housing, acknowledged that “allowing first home buyers to access or borrow against part of their super to purchase a home would, in the absence of increased housing supply, likely increase demand and lead to higher property prices”.

2. Little value to younger aspiring homebuyers

The median superannuation balances of singles and couples aged between 25 and 34 – the archetypal first home buyer cohort – are only \$20,300 and \$45,200 respectively. This means that the median amounts which they could divert to the purchase of a home would be just over \$8,100 and \$18,000 respectively.

Again, depending on their incomes – which are highly likely to be lower than those of people in older age groups – this would increase their purchasing capacity by up to \$40,500 and \$90,000, respectively.

The table below shows that fewer than 3% of single non-homeowners aged between 25 and 34 have superannuation balances large enough to withdraw the maximum amount of \$100,000 (combined) allowable under the ‘Super for Housing’ proposal; while more than 78% of single people in this age range would be unable to withdraw more than \$20,000.

Similarly, only 5.25% of single non-homeowners aged between 35 and 44 would have superannuation balances large enough to withdraw the maximum amount of \$100,000 (combined); while more than 50% of single people in this age range would be unable to withdraw more than \$20,000.

Number of single people eligible to withdraw sums within specified ranges under the Coalition’s ‘Super for Housing’ proposal

Age range	Maximum superannuation release (\$)					
	\$1 - <\$10,000	\$10,000 - <\$20,000	\$20,000 - <\$30,000	\$30,000 - <\$40,000	\$40,000 - <\$50,000	\$50,000
	<i>Number of single income units</i>					
25-34	624,651	230,641	106,679	41,102	22,241	28,328
35-44	144,815	78,775	87,955	40,721	39,952	80,430
45-54	81,815	41,682	37,855	24,278	28,680	126,839
55-64	42,349	26,670	16,010	15,295	26,068	74,952
65-74	23,123	6,082	3,511	5,677	5,035	27,796
	<i>Percentage of single income units in each age group</i>					
25-34	59.3	21.9	10.1	3.9	2.1	2.7
35-44	30.6	16.7	18.6	8.6	8.5	17.0
45-54	24.0	12.2	11.1	7.1	8.4	37.2
55-64	21.0	13.2	8.0	7.6	12.9	37.2
65-74	32.5	8.5	4.9	8.0	7.1	39.0

Note: Data on superannuation balances is sourced from the ABS Survey of Income and Housing for 2019-20 and updated to 2023-24 values using growth in Average Weekly Earnings. ‘Non-home-owner’ households includes both renters and adults living with their parent or parents. Source: Super Members’ Council analysis.

The table below shows the number and percentage of couple non-homeowner households who would be able to withdraw amounts within \$20,000 ranges up to the maximum of \$100,000 (\$50,000 for each member of a couple) under the proposed ‘Super for Housing’ Scheme.

Number of couples eligible to withdraw sums within specified ranges under the Coalition's 'Super for Housing' proposal

Age range	Maximum superannuation release (\$)					
	\$1 - <\$20,000	\$20,000 - <\$40,000	\$40,000 - <\$60,000	\$60,000 - <\$80,000	\$80,000 - <\$100,000	\$100,000
	<i>Number of couple income units</i>					
25-34	343,805	143,948	81,960	45,349	6,522	2,077
35-44	164,938	92,304	116,530	71,736	34,266	26,690
45-54	41,426	28,338	56,427	25,551	30,869	22,215
55-64	23,481	15,161	39,571	17,598	12,499	13,014
65-74	17,501	14,903	12,465	7,854	2,027	7,208
	<i>Percentage of couple income units in each age group</i>					
25-34	55.1	23.1	13.1	7.3	1.0	0.3
35-44	32.6	18.2	23.0	14.2	6.8	5.3
45-54	20.2	13.8	27.5	12.5	15.1	10.8
55-64	19.4	12.5	32.6	14.5	10.3	10.7
65-74	28.2	24.1	20.1	12.7	3.3	11.6

Note: Data on superannuation balances is sourced from the ABS Survey of Income and Housing for 2019-20 and updated to 2023-24 values using growth in Average Weekly Earnings. 'Non-home-owner' households includes both renters and adults living with their parent or parents. Source: Super Members' Council analysis.

In simple terms, 'Super for Housing' would do little for the people who need most assistance to become homeowners, and it would do most for those who need it least (over 45s).

3. Loss of retirement income more than offsets savings

Allowing people to draw from their superannuation accounts to purchase housing would inevitably leave them with smaller superannuation balances upon reaching retirement. In most circumstances, under plausible assumptions, the loss of income in retirement would more than offset housing cost savings from earlier entry into home ownership.

Super Members Council (2024c) modelled the impact of the scheme on the lifetime disposable income after housing costs of a hypothetical couple from age 22 until assumed death at age 93 (Super Members Council 2024).

Each member of the couple was assumed to earn their respective median wage for their age and gender whilst working, with the female partner assumed to work part-time between the ages of 29 and 43 in order to care for children, while the male partner is assumed to earn some business income between the ages of 45 and 66. The male partner is assumed to have a starting superannuation balance of \$4,000 and the female partner \$2,500.

The couple are assumed to rent from age 22 until age 30, when they purchase a median-priced house, two years earlier than they would have done otherwise, assisted by withdrawing a combined \$55,000 from their superannuation accounts. Both partners are assumed to retire at age 67, at which point their superannuation assets, having earned an assumed 7.5% pa (after tax but before fees of 58 basis points) during the accumulation phase, are converted to an account-based pension earning 6.5% per annum (before fees) and, together with non-superannuation assets held in the form of term deposits, drawn down at a rate of 10% pa until death at age 93.

The SMC modelling finds that this couple's disposable income after housing costs over the course of their lifetime is over \$165,000 lower (in today's dollars) than it would have been otherwise – despite attaining home ownership two years sooner than they would otherwise have done.

The couple's housing equity is \$161,900 higher than it would have been otherwise, but this additional wealth is untapped unless they sell their home. Their superannuation assets are \$149,000 lower (in today's dollars) than

they would otherwise have been, which under the assumptions above results in their disposable income after housing costs being \$107,600 lower during retirement.

Additionally, their lifetime housing costs are \$142,200 higher than they would have been otherwise, because of the higher rents paid during the eight years prior to attaining home ownership, and higher stamp duty, mortgage interest and council rates during the period of home ownership (flowing from the scheme's estimated impact on the general level of residential property prices).

Even if the impact of the proposed scheme on the general level of residential property prices were half what SMC has estimated – i.e. 4.5% rather than 9% - so that the impact on lifetime housing costs is \$29,300 (in today's dollars) rather than \$142,200, the hypothetical couple's lifetime disposable income after housing costs would still be \$52,600 less than otherwise.

Alternatively, if it were to be assumed that the hypothetical couple were able to bring forward their entry into home ownership by four years (rather than two), lifetime disposable income would be \$87,600 lower than otherwise assuming a 9% increase in the general level of property prices.

4. A significant hole for the Federal Budget

Finally, the proposal to allow people to withdraw accumulated savings from their superannuation accounts in order to finance the purchase of housing is likely to entail a significant cost to the Federal Budget.

That's because contributions to superannuation funds, and earnings generated by superannuation funds (including capital gains) are subject to income taxation (albeit at lower rates than income in the form of wages and salaries), whereas capital gains on owner-occupied housing are completely exempt from any form of taxation; and because of greater demands on the age pension due to more people reaching retirement age with smaller superannuation savings.

Modelling undertaken by Deloitte for Super Members Council (2024a) suggests that the annual cost to the Federal Budget arising from the scheme proposed by the Coalition would escalate from around \$300 million in 2029-30 to \$1.3-1.4 billion in the 2040s and 2050s, to almost \$8 billion per annum by the 2090s. These shortfalls would need to be made up by tax increases elsewhere, spending cuts or additional borrowings.

Saul Eslake is an economist, consultant, speaker, and the principal of [Corinna Economic Advisory](#). This article is an extract from a research paper commissioned by the Super Members Council.

Immigration: Social costs vs. economic benefits

Peter Zeihan

This is an edited transcript of a video talk given by geopolitical strategist, Peter Zeihan, on the social and economic effects of immigration.

People always talk about the economic upside and the tax upside, but they rarely talk about the downside, things like crime and social identity. It's a reasonable question. And as we have more and more countries that are ageing, immigration is often brought up as one of the few if only possible patches or even solutions.

The economic case for immigration

Let's start by saying that Canada is a very special case. Canada knew that they were on a German style demographic implosion 30 years ago, and then under the Harper government and later into the Trudeau government, the decision was made to open the floodgates and become an immigrant country. And so, you've probably had – they don't count the statistics the same way as in the United States – you probably had three to four million immigrants coming and become Canadians in that time period, and most of them in their 20s and their 30s. They specifically were going after people who were younger as opposed to most of the migrants that they got before. And that's managed to stabilize the number, but only so long as they keep those inflows coming because native Canadians, to use a charged term, still have a very, very low birth rate. So, there's no replacement coming on and you have a very different social fabric developing.

The new migrants especially for under age 40 generate far more in tax in payments than they do in tax take over their lifetime. And it's definitely a net fiscal benefit. In terms of the jobs as a rule, the people who are

doing the migration tend to be the more aggressive and the more skilled and the more educated of the countrymen from where they came from. And so, you tend to get a kick up in terms of labor productivity. Not everybody is an Elon Musk, but you get the idea.

The third is crime. Unequivocal data on this. In every country that collects this sort of data, crime committed by immigrants is significantly lower, typically at least a third lower than it is by the native-born population.

Fourth – there's something that people usually don't think about, and that's education. In the United States, it costs over US\$150,000 to graduate a kid from high school. That's just the government cost for education. That doesn't take into account the societal cost of actually raising the kid from zero to 18 when healthcare can be an issue as well in terms of cost. One of the benefits of migrants is that they've already paid that in another country and you're just benefiting from their labour. So economically by the statistics it's a very, very, easy case to make.

Two things to keep in mind. Number one – not all migrants are the same. For example, if you think of the United Kingdom and Indian migrants and family reunification, basically the U.K. would bring in one person from India who might meet all of these numerical criteria that I just talked about. But then they bring in their extended family and all of a sudden, you've got 60 Indian Brits, half of whom are over 60. Different sort of math there. If you're bringing in near retirees, the cost of the society can be high. Also, for example in the German case, the migrants that came in from Syria, there were about a million of them and they were about 80% to 90% male. So, you're not getting too much of a demographic boost there because there weren't women to then have more children.

The social complexities from immigration

And that brings us to the second complicating factor that's social cohesion. If you have included immigration as part of your social fabric going back decades and preferably even centuries, then the difficulty of society absorbing a number of people from different places is relatively low. When you look at the seller states such as the United States, Australia and New Zealand and Canada, this is something that we have done in phases – we run hot and cold – for a long time. And, if you tell somebody that your parents are from a different country, most Americans aren't even going to blink because people in the United States assimilate quickly. But if you don't have that culture – like Germany does not have that culture – and you suddenly open the floodgates, then all of a sudden, you look very different.

The first real wave of migration into Germany happened with the Bosnian Wars in the 1990s. The Germans did the right thing for the right reason, took in a lot of refugees from that conflict, but it changed their social character. They now have done it again in the 2000s with Syrians, changing the social character. They're in the process of doing it again with Ukrainians, changing the social character. And if you wait too long, if you wait till you have more people in their 40s than their 30s than their 20s than their 10s than their 0s, then you will be a different place.

And this is the situation that the Canadians are facing not right now, but will in 20 or 30 years. They waited until it was very late in the day, and then they started bringing in millions of people. If this happens over a long enough period, society, the new society and the old society, can adapt. But in the German situation, it's happened so recently. And to keep it up, the Germans are going to have to bring in 2 million to 2.5 million people under age 30 every year for the next 20 years just to hold where they are demographically. Well, those people will be the majority of the country by then. That's a very different place. So, if you look at immigration as purely a math issue, a fiscal issue, an economic growth issue, it's a slam dunk case. But we don't live in that world. And you know what we call the gap between the ideal and reality? Politics.

Peter Zeihan, founder of [Zeihan on Geopolitics](#), is a geopolitical strategist, speaker and author. This article is general information and does not consider the circumstances of any investor. This article is an edited transcript of Peter's video, [Immigration: Social Costs vs. Economic Benefits](#), posted on 29 June 2023.

Avoiding destructive M&A and hype cycles in mining

Justin Halliwell

This article is an edited transcript of Justin Halliwell's segment in Schroders' recent broadcast "What happens when concentration cracks?"

We talk a lot about the asymmetric risk associated with M&A [mergers and acquisitions] with all companies. We have seen a lot of value destruction from M&A over time and miners have been very much at the forefront of that issue. BHP's failed bid for Anglo American feels like they escaped, like they were saved from themselves.

The miners have extremely privileged assets. They generate amazing cash flow and really their key job is to allocate that efficiently. We really felt with the Anglo bid that was not the case, and I can put a few numbers around that.

It was a complicated transaction with Anglo owning a lot of assets which everyone will have slightly differing views on regarding value, but really all BHP wanted was the copper. And our numbers showed they were paying about \$30 billion for the copper assets, which is about \$50,000 a ton of copper production.

That's around triple the typical greenfield cost of late. And in fact, one of Anglo's copper assets they would have been acquiring was a greenfield just completed. So for a brand-new asset, they were going to pay triple what was paid for the building of that asset.

The important part there is that, I mean, that's probably a good asset. It's probably going to generate 15%, 20% returns on that recent capital investment. For BHP to make that kind of return, which is what they're looking for on the acquisition, we're looking for implicit returns north of 50% on that asset. That's just not feasible.

Even if the asset is good enough and copper prices are high enough, we'd expect governments to want to take more and more of that profitability. So, we just think it's a one-way risk in terms of that transaction. Now, like I said, they were saved from themselves. They've gone into a smaller asset in copper with less scope to destroy value.

On the flip side, they're also selling assets. So, they've been getting rid of what they consider poorer-quality assets, such as in the coal space where there are less buyers. And you can see the Whitehaven transaction, you kind of feel like Whitehaven has done well out of that one. So, BHP should just stick to their knitting, generate cashflow and allocate it more efficiently.

Future facing metals still small fry in Australia

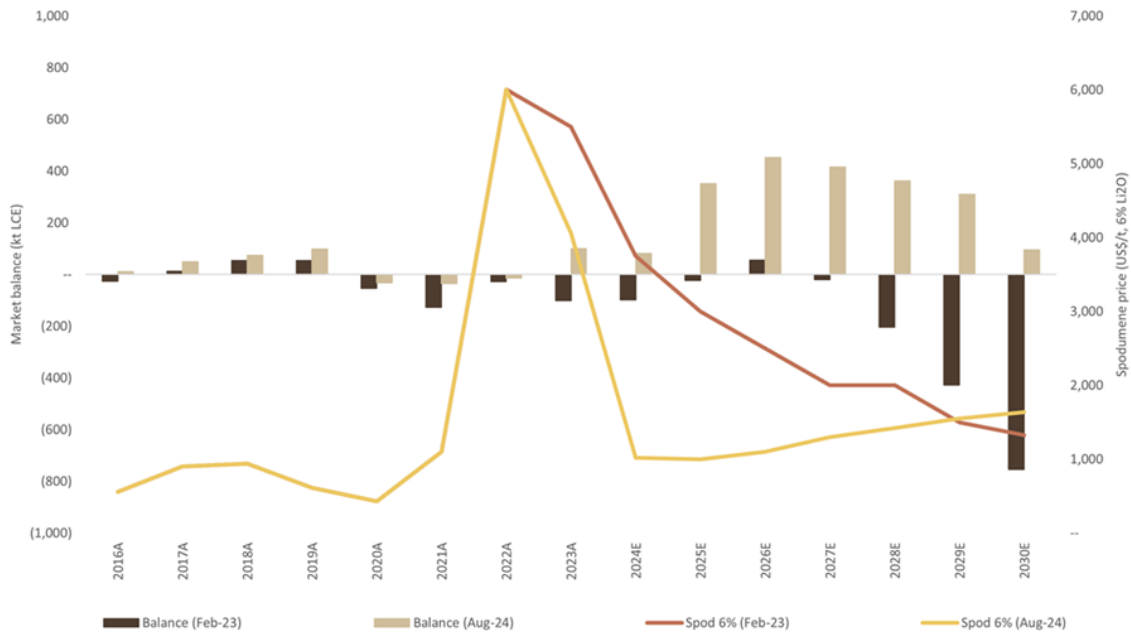
Copper is important for electrification and decarbonisation, and lithium obviously gets a big play in that as well. BHP are very bullish on copper, there's no question, and that was a big driver behind the Anglo transaction. But the numbers are small still - even within copper, which is obviously a far more developed commodity than something like lithium.

If you look at Australia specifically, the numbers in 2023 in terms of export value were something like \$90 billion of iron ore, \$60 billion of coal and \$5 billion of copper. And lithium, with an incredibly strong price, was about \$10 billion.

So \$15 billion for the future facing materials, which is what the companies like to call them, versus \$150 billion for the dull and boring iron ore and coal. So, we're a long way from those green and future facing commodities, certainly in Australia, from overtaking the more mature commodities.

Now it's probably worth reflecting on something like lithium, and it really comes to how we look at commodities and how volatile commodities have become. There's a lot of money washing around the system, trying to find a home in commodities. What we're trying to do, like with lithium, is avoid the storytelling that comes with some of these commodities.

So, this is a chart from UBS. It's not to pick on them. But what we can see here is the bars on the chart are the forecast of the market surplus or deficit.



Editor's note: the forecast from 18 months previous is shown in the dark bars and predicts a significant deficit. The lighter bars show the surplus that is now being forecast by the same broker for the same periods in the future.

It's been a huge turnaround. The lithium price has gone from a peak of \$8,000 a ton 18 months ago to now sitting at \$700 a ton. I mean it's a huge, huge fall. Like nothing that we've ever seen in commodity land. And as that's happened, the market and the consultants have started to change their forecast dramatically.

It's also a commodity acting like all commodities do when there's high prices. Guess what? Supply comes in that no one dreamt of. 18 months ago, it was a race for forecasting electric vehicle penetrations. As the prices of those vehicles have risen, in part due to the commodity inflation, consumers have become more focused on the price of those cars, demand started to fall a bit and at the same time, supplies come in.

What we're trying to do is we're trying to look through those cycles. We try not to get caught up in the hubris when things are very bullish, but also, we're not trying to get too bearish at the bottom. The flip of that would be something like alumina, where 12 or 18 months ago, everyone was super bearish and the price was maybe \$300 a ton. Few people were making money and guess what? Supply starts to get shut down, demand stays robust and the price flips around.

So, that's what we're trying to do. We're trying to look through cycles, trying to not get too caught up in the ups and downs and try and keep a steadier view.

Justin Halliwell is Head of Research for Australian Equities at [Schroders](#), a sponsor of Firstlinks. This extract was taken from a recent Schroders webinar titled "What Happens When Concentration Cracks?". You can view the full webinar and selected highlights from it [here](#).

For more articles and papers from Schroders, [click here](#).

An intriguing theory explaining persistent LIC discounts

Kion Sapountzis

[Editor: the following is an extract from Bell Potter's latest quarterly report on the latest trends in LICs and LITs.]

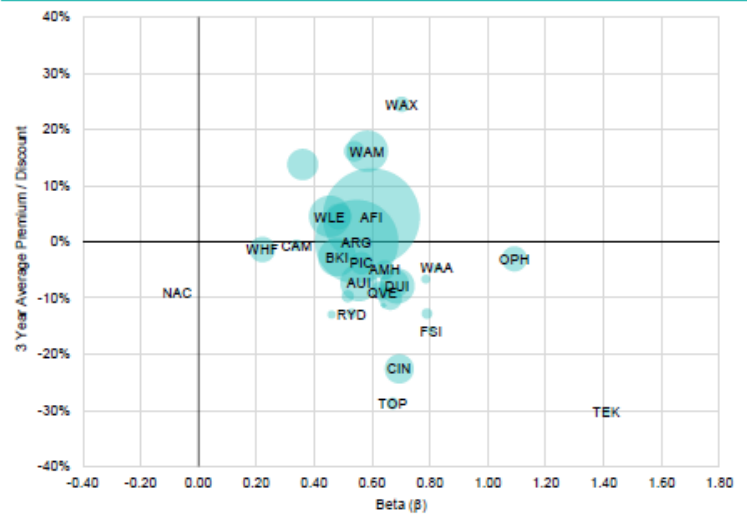
Paying for the beta

The emergence of trading discounts amongst closed-ended funds has become a challenge for investors and managers alike, with the combination of market rallies and interest rate volatility fueling the growth of trading

discounts to historic wide levels for many Listed Investment Companies (LICs). Whilst trading activity for LICs have been volatile, investors look to the relationship between returns from the LIC and the benchmark in determining the dislocation from NTA.

The relationship between LIC and Listed Investment Trust (LIT) returns and the market can be captured through 'beta', being a useful measure in understanding the riskiness of an investment. A beta of 1 reflects returns which are just as volatile as the market, with a value greater than 1 indicating greater volatility relative to the market portfolio. The relationship between LIC/LIT beta and its corresponding trading premium or discount over the last three years, is depicted in Figure 1, noting many domestic listed strategies exhibit risk-return characteristics close to their respective benchmarks.

Figure 1 - Australian Mandate LIC/LITs and Market Beta

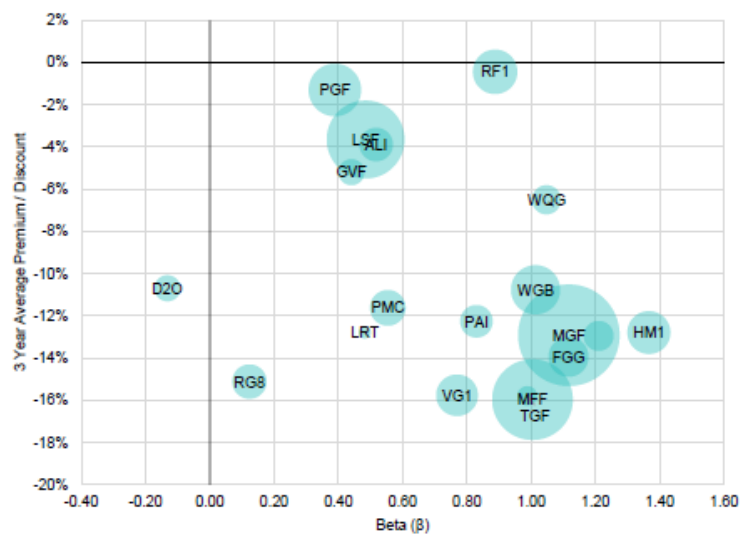


SOURCE: COMPANY DATA, IRESS, BELL POTTER.

Amongst LICs with a domestic equity mandate, investors continue to preference funds with a benchmark like risk return relationship, highlighted by the majority of LICs capturing a market beta of between 0.5 to 0.8, with larger market capitalisation listed products trading near NTA. Smaller and more concentrated portfolios demonstrate dislocations from the market beta and NTA. This is headlined by the **Australian Foundation Investment Company (AFI)** and **Argo Investments (ARG)** which report a 3-year average beta of ~0.6, signifying a reduction in market risk compared to their respective benchmarks.

A similar relationship can be inferred amongst international and alternative mandated listed closed ended funds, with the average trading discount for LIC/ LITs closing as beta rises towards 1. Most listed products with this mandate trade on a beta of less than 1, reflecting a return profile which is less volatile than the underlying index. Divergence from NTA is more prevalent in listed products with international and alternative mandates, with markets unable to close trading discounts irrespective of historical return performance. The **Regal Investment Fund (RF1)** best captures market volatility whilst trading near NTA, reflected by an average beta of 0.89 and underpinned by strong performance in the LITs small company and global alpha strategies over the last 12 months.

Figure 2 - International and Alternative LIC/LITs and Market Beta



SOURCE: COMPANY DATA, IRESS, BELL POTTER.

The relationship between historical market discounts and beta indicates markets are better able to price index replicating strategies, with trading discounts becoming the result of divergence from the market portfolio. This relationship is best demonstrated with Australian equity mandated LIC/LITs, whilst International and Alternative mandates have less of a defined relationship. Outside of this the flow of additional capital towards exchange traded funds (or 'ETFs') has coincided with the recent emergence of trading discounts, with the sector reporting a FUM CAGR of circa 35%. Whilst ETFs remain a popular alternative in capturing market returns, similar exposure exists in the LIC/LIT sector given multiple products hold broad market mandates, whilst exhibiting risk-return characteristics similar to the market portfolio, notwithstanding the impact of trading discounts, dividends and manager risk in overall returns.

It's all the same to me

Diversification is key in looking at LICs as investors want to minimize the degree of correlation in returns between assets in order to reduce overall portfolio volatility. Correlation is the degree in which two assets move together, captured by a value between -1 and 1. The higher the correlation between two assets, the closer they move in line with each other, with a value of 1 capturing perfect positive correlation, and a value of -1 capturing perfect negative correlation. In assessing the LIC/LIT market, assets which report a high correlation offer lower diversification benefits when held together in a portfolio, compared to assets which exhibit lower correlation.

Figure 3 - Three Year Correlation of Australian Mandate LIC/LITs

	AFI	ARG	AUI	BKI	DUI	CIN	WLE	WHF	PIC	AMH	CAM	FSI
AFI	1.00											
ARG	0.63	1.00										
AUI	0.62	0.59	1.00									
BKI	0.63	0.62	0.66	1.00								
DUI	0.60	0.63	0.79	0.72	1.00							
CIN	0.60	0.54	0.59	0.57	0.62	1.00						
WLE	0.25	0.38	0.44	0.42	0.36	0.38	1.00					
WHF	-0.02	0.22	0.25	0.12	0.21	0.24	0.45	1.00				
PIC	0.38	0.53	0.53	0.41	0.56	0.65	0.48	0.34	1.00			
AMH	0.62	0.62	0.55	0.52	0.73	0.64	0.20	0.15	0.47	1.00		
CAM	0.56	0.30	0.41	0.52	0.52	0.42	0.10	0.13	0.36	0.45	1.00	
FSI	0.35	0.31	0.23	0.32	0.55	0.52	0.08	0.24	0.46	0.38	0.52	1.00

SOURCE: COMPANY DATA, BELL POTTER.

Amongst LIC/LITs with Australian equity mandates, Whitefield Industrials (WHF), Clime Capital (CAM) and Flagship Investments (FSI) exhibit a weak positive correlation against other listed products. The strongest positive correlation is held between Australian United Investment (AUI) and Diversified United Investment (DUI) given both companies share similar investment philosophies. Furthermore, LICs which hold a large cap only mandate report a strong positive correlation given there is often high overlap between underlying portfolio investments.

Figure 4 - Three Year Correlation of International Mandate LIC/LITs

	MFF	WGB	PMC	PGF	PIA	WQG	ALI	LRT	GVF	FGG	HM1	PAI
MFF	1.00											
WGB	0.78	1.00										
PMC	0.42	0.54	1.00									
PGF	0.36	0.51	0.48	1.00								
PIA	0.72	0.66	0.30	0.25	1.00							
WQG	0.58	0.57	0.28	0.39	0.52	1.00						
ALI	0.16	0.26	0.10	0.34	0.41	0.19	1.00					
LRT	0.04	0.27	0.32	0.40	0.16	0.03	0.11	1.00				
GVF	0.07	0.16	-0.07	-0.04	0.18	0.06	0.29	0.09	1.00			
FGG	0.67	0.80	0.53	0.48	0.70	0.53	0.37	0.29	0.38	1.00		
HM1	0.70	0.71	0.36	0.36	0.70	0.66	0.20	0.14	0.36	0.78	1.00	
PAI	0.30	0.34	0.65	0.23	0.10	0.12	-0.03	0.21	0.21	0.30	0.20	1.00

SOURCE: COMPANY DATA, IBELL POTTER.

Looking at LIC/LITs with International equity mandates, the Global Value Fund (GVF) exhibits low historical correlation, given returns are driven by the managers discount capture strategy. Together with GVF, both Argo Infrastructure Limited (ALI) and Lowell Resources Trust (LRT) report a low correlation with their peers given their sector specific exposures. Contrastingly, both MFF Capital (MFF) and WAM Global (WGB) demonstrate a return high correlation given both LICs hold similar thematic and geographic allocations in their respective portfolios.

Capital raisings

Strong market conditions provided a backdrop for LICs and LITs to raise incremental capital. A total of \$398.87m was raised via the secondary market through Dividend Reinvestment Plans (DRPs), Stock Options and Placements.

The majority of additional capital stemmed from fixed income LIT managers on the back of stronger demand from the market, given LITs under this mandate trade at a weighted average premium of 1.48% versus the sector at a 7.33% discount. Managers have taken the opportunity to offer the ability to subscribe to additional units in the trust at NTA, allowing investors to capture value during a period of trading at a premium to NAV. The increased appetite for alternative income strategies comes during an elevated interest rate environment, coupled with shifting appetite from traditional lenders in participating in commercial lending.

Figure 5 - 2Q24 Successful Share Purchase Plans, Placements & Entitlements

ASX Code	Company Name	Method	Shares Issued	Issue Price	Amount Raised
GCI	Gryphon Capital	Placement	24,900,000	\$2.00	\$49,800,000
MOT	Metrics Income	Placement & Unit Purchase Plan	64,090,707	\$2.14	\$136,945,006
MXT	Metrics Master	Placement	23,750,000	\$2.00	\$47,500,000
QRI	Qualitas Re Income	Unit Purchase Plan	11,558,124	\$1.60	\$18,492,998
WMI	WAM Microcap Limited	Placement & Share Purchase Plan	63,526,075	\$1.42	\$90,079,974
					\$342,817,979

SOURCE: COMPANY DATA, IRESS, BELL POTTER.

Figure 6 - 2Q24 Dividend Reinvestment Plans

ASX Code	Company Name	Shares Issued	DRP Price	Amount Raised
AOQ	Acorn Cap Inv Fund	763,439	\$0.79	\$605,560
CAM	Clime Capital	279,062	\$0.85	\$237,286
CDM	Cadence Capital	2,250,519	\$0.75	\$1,678,009
D2O	Duxton Water Ltd	3,731,340	\$1.43	\$5,320,891
FGG	Future Generation	883,760	\$1.26	\$1,116,675
FGX	Future Gen Aust	1,042,199	\$1.15	\$1,202,937
HMI	Hearts and Minds	179,747	\$2.59	\$465,144
LSF	L1 Long Short Fund	2,954,911	\$2.88	\$8,510,144
MFF	MFF Capital Inv Ltd	2,725,793	\$3.51	\$9,557,721
MOT	Metrics Income	337,728	\$2.14	\$722,770
MXT	Metrics Master	771,508	\$2.00	\$1,543,016
NOC	Naos Emerg Opp	489,193	\$0.65	\$317,193
PCI	Perpetual Cred Trust	146,278	\$1.11	\$161,786
PGF	Pm Capital Fund	545,483	\$1.99	\$1,088,075
PIA	Pengana Int Equ Ltd	251,262	\$1.13	\$283,725
PIC	Perpetual Equity Ltd	1,167,913	\$1.18	\$1,378,137
QRI	Qualitas Re Income	265,883	\$1.60	\$425,413
SNC	Sandon Capital Ltd	1,656,308	\$0.72	\$1,200,326
WAA	WAM Active Limited	410,375	\$0.81	\$333,766
WAM	WAM Capital Limited	6,323,489	\$1.49	\$9,446,471
WAX	WAM Research Ltd	1,536,989	\$1.06	\$1,628,763
WGB	WAM Global Limited	922,627	\$2.23	\$2,053,408
WHF	Whitefield Ind Ltd	392,017	\$5.11	\$2,003,207
WLE	WAM Leaders Limited	2,893,534	\$1.35	\$3,893,597
WMA	WAM Alternative	327,628	\$0.97	\$318,405
WQG	Wcm Global Grow th	367,363	\$1.53	\$562,065
				\$56,054,491

Option exercises were a negligible source of additional capital with most trading deeply out of the money at circa 20-50%.

Figure 7 -- 2Q24 Options Exercised

ASX Option Code	ASX Code	Company Name	Exercised	Exercise Price	Amount Raised	Expiry Date
NCCO	NCC	Naos Emerg Opp	488	\$0.67	\$314	31/12/2026
NSCOA	NSC	Naos Smicap Com Ltd	189	\$1.02	\$172	28/06/2024
					\$486	

SOURCE: COMPANY DATA, IRESS, BELL POTTER.

Figure 8 -- 2Q24 Options Outstanding

ASX Option Code	ASX Code	Company Name	Share Price	Exercise Price	Outstanding Options	Potential Raise	Expiry Date
NACD	NAC	Naos Ex-50 Opportunities	\$0.50	\$0.90	50,874,164	\$45,786,748	31/12/2026
NSCOA	NSC	Naos Small Cap Opportunities	\$0.44	\$1.02	50,874,164	\$51,891,647	28/06/2024
NCCO	NCC	Naos Emerging Opportunities	\$0.42	\$0.67	14,234,845	\$9,537,346	31/12/2026
D2OOA	D2O	Duxton Water Ltd	\$1.53	\$1.92	38,165,906	\$73,278,540	31/12/2026
						\$180,494,281	

SOURCE: COMPANY DATA, IRESS, BELL POTTER.

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