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Editorial

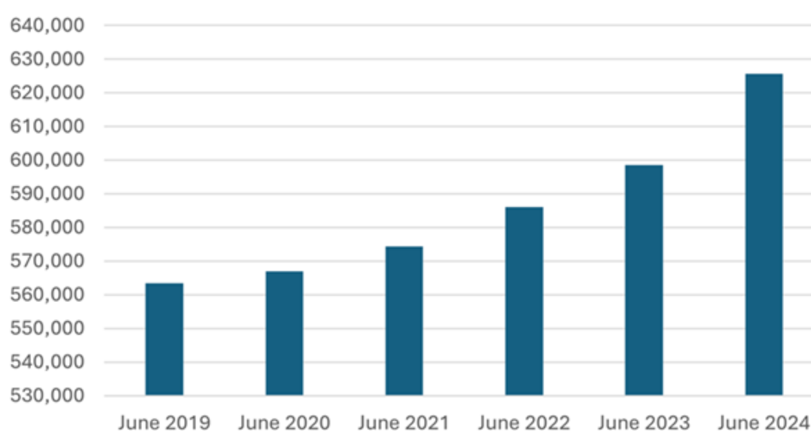
ATO data on SMSFs shows that 8,613 new funds were set up during the June quarter of this year, the highest quarterly growth since 2018. There were also 2,954 closures during the quarter, resulting in 5,659 net new SMSFs being created.

For the 2024 financial year, there were 32,747 new funds established. 5,702 SMSFs were wound up, meaning there were 27,045 net new funds created during the year. That net figure was more than double that of the prior year.

All up, there are now 625,609 SMSFs, with 1.15 million members, a 4.5% rise in both in the year to June.

The young seem to be driving recent growth in SMSFs. In the June quarter, 36% of new members were aged between 35 and 44 – below the average SMSF member age at establishment of 45. Still, 64% of SMSF members remain 55 years and over.

All up, SMSFs now control $990 billion in assets ($957 billion net of liabilities). That figure represents about 26% of the total amount in superannuation in Australia.



Source: ATO

The average assets per SMSF is $1.55 million, while the median assets per fund is $877,498.

Average and median assets					
Asset values	**2022-23 ($)**	**2021-22 ($)**	**2020-21 ($)**	**2019-20 ($)**	**2018-19 ($)**
Average assets per member	835,265	775,831	783,197	676,781	680,619
Median assets per member	497,608	451,638	450,206	393,316	395,836
Average assets per SMSF	1,550,571	1,449,131	1,465,224	1,268,643	1,277,604
Median assets per SMSF	877,498	802,653	799,311	698,340	703,427

Source: ATO

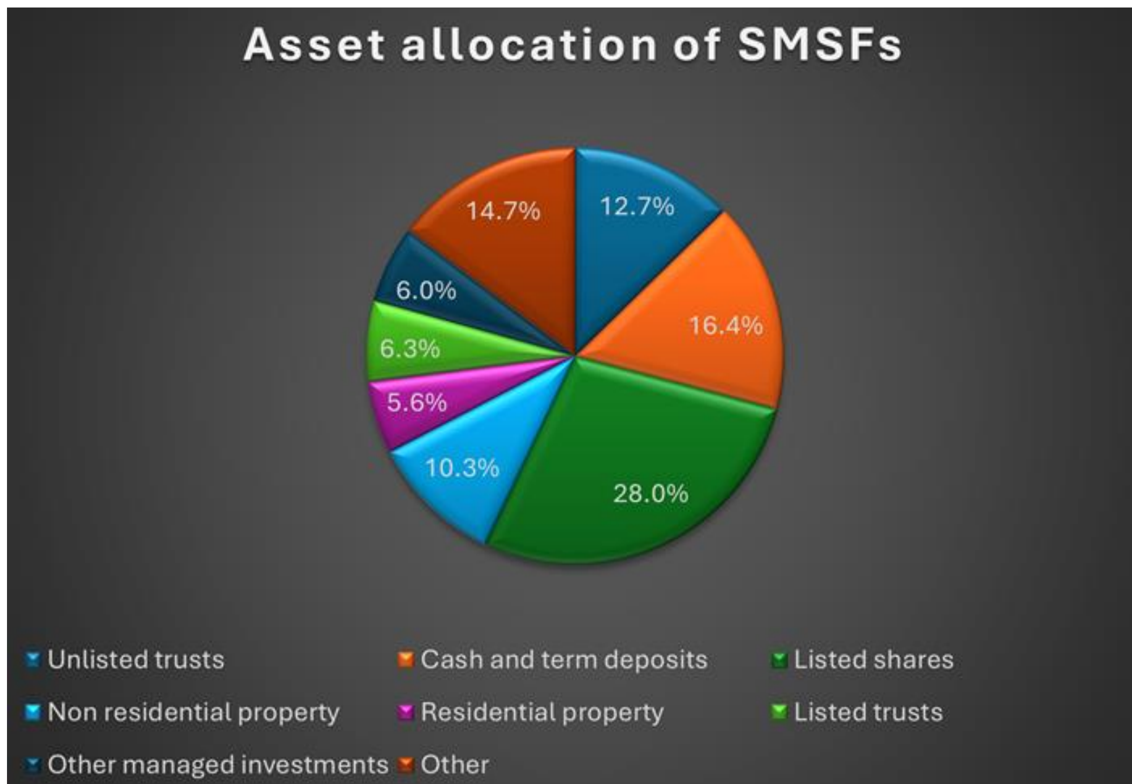
About 24% of SMSFs have assets between $100,000 and $500,000, and almost two-thirds have assets between $500,000 and $5 million. Just 5% are above the $5 million mark.

Proportion of funds, by asset range of fund

Asset Ranges	2022-23	2021-22	2020-21	2019-20	2018-19
$0 to $50,000	5.3%	5.6%	5.5%	6.0%	6.1%
>$50,000 to $100,000	2.4%	2.8%	2.6%	3.1%	3.2%
>$100,000 to $200,000	5.6%	6.3%	6.3%	7.2%	7.3%
>$200,000 to $500,000	17.8%	19.4%	20.0%	22.5%	22.2%
>$500,000 to $1m	25.2%	25.1%	24.8%	25.1%	24.6%
>$1m to $2m	22.6%	21.4%	21.1%	19.7%	19.8%
>$2m to $5m	16.3%	14.9%	15.0%	12.8%	13.0%
>$5m to $10m	3.7%	3.4%	3.5%	2.7%	2.8%
>$10m to $20m	1.0%	0.9%	1.0%	0.7%	0.7%
>$20m to $50m	0.2%	0.2%	0.2%	0.2%	0.1%
>$50m	<0.1%	<0.1%	<0.1%	<0.1%	<0.1%
Total	100%	100%	100%	100%	100%

Source: ATO

As to how SMSFs are allocating their assets, about 28% is in listed shares, 16% in cash and deposits, 13% in unlisted trusts, 10% in non-residential property, and 6% in residential real estate.



Source: ATO

In the 12 months to June, the biggest increases in value were seen in listed and unlisted trusts, as well as listed shares.

Generally, SMSFs with $5 million or more held more in unlisted trusts, listed shares, and less in cash and term deposits, than those with fewer assets.

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Another quarter in markets has ended, and here are the results.

CREATIVE PLANNING		Asset Class Total Returns Since 2011 (Data via YCharts as of 9/30/24)														@CharlieBilello	
ETF	Asset Class	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2011-24 Cumulative	2011-24 Annualized
N/A	Bitcoin ($BTC)	1473%	186%	5507%	-58%	35%	125%	1331%	-73%	95%	301%	66%	-65.5%	155.8%	49.8%	21104466%	143.9%
GLD	Gold	9.6%	6.6%	-28.3%	-2.2%	-10.7%	8.0%	12.8%	-1.9%	17.9%	24.8%	-4.2%	-0.8%	12.7%	27.1%	75.2%	4.2%
IWF	US Growth	2.3%	15.2%	33.1%	12.8%	5.5%	7.0%	30.0%	-1.7%	35.9%	38.3%	27.4%	-29.3%	42.6%	24.3%	665.9%	16.0%
SPY	US Large Caps	1.9%	16.0%	32.2%	13.5%	1.2%	12.0%	21.7%	-4.5%	31.2%	18.4%	28.7%	-18.2%	26.2%	21.9%	487.7%	13.7%
QQQ	US Nasdaq 100	3.4%	18.1%	36.6%	19.2%	9.5%	7.1%	32.7%	-0.1%	39.0%	48.6%	27.4%	-32.6%	54.9%	19.7%	915.6%	18.4%
IWD	US Value	0.1%	17.5%	32.1%	13.2%	-4.0%	17.3%	13.5%	-8.5%	26.1%	2.7%	25.0%	-7.7%	11.4%	16.5%	298.3%	10.6%
EEM	EM Stocks	-18.8%	19.1%	-3.7%	-3.9%	-16.2%	10.9%	37.3%	-15.3%	18.2%	17.0%	-3.6%	-20.6%	9.0%	14.8%	28.2%	1.8%
VNQ	US REITs	8.6%	17.6%	2.3%	30.4%	2.4%	8.6%	4.9%	-6.0%	28.9%	-4.7%	40.5%	-26.2%	11.8%	13.5%	202.1%	8.4%
MDY	US Mid Caps	-2.1%	17.8%	33.1%	9.4%	-2.5%	20.5%	15.9%	-11.3%	25.8%	13.5%	24.5%	-13.3%	16.1%	13.2%	310.9%	10.8%
EFA	EAFE Stocks	-12.2%	18.8%	21.4%	-6.2%	-1.0%	1.4%	25.1%	-13.8%	22.0%	7.6%	11.5%	-14.4%	18.4%	12.9%	115.3%	5.7%
PFF	Preferred Stocks	-2.0%	17.8%	-1.0%	14.1%	4.3%	1.3%	8.1%	-4.7%	15.9%	7.9%	7.2%	-18.2%	9.2%	11.0%	88.6%	4.7%
IWM	US Small Caps	-4.4%	16.7%	38.7%	5.0%	-4.5%	21.6%	14.6%	-11.1%	25.4%	20.0%	14.5%	-20.5%	16.8%	11.0%	241.8%	9.4%
EMB	EM Bonds (USD)	7.7%	16.9%	-7.8%	6.1%	1.0%	9.3%	10.3%	-5.5%	15.5%	5.4%	-2.2%	-18.6%	10.6%	8.7%	64.8%	3.7%
HYG	High Yield Bonds	6.8%	11.7%	5.8%	1.9%	-5.0%	13.4%	6.1%	-2.0%	14.1%	4.5%	3.8%	-11.0%	11.5%	8.1%	90.8%	4.8%
CWB	Convertible Bonds	-7.7%	15.9%	20.5%	7.7%	-0.8%	10.6%	15.7%	-2.0%	22.4%	53.4%	2.2%	-20.8%	14.5%	7.4%	222.7%	8.9%
LQD	Investment Grade Bonds	9.7%	10.6%	-2.0%	8.2%	-1.3%	6.2%	7.1%	-3.8%	17.4%	11.0%	-1.8%	-17.9%	9.4%	5.1%	67.8%	3.8%
TIP	TIPS	13.3%	6.4%	-8.5%	3.6%	-1.8%	4.7%	2.9%	-1.4%	8.3%	10.8%	5.7%	-12.2%	3.8%	4.8%	44.5%	2.7%
BND	US Total Bond Market	7.7%	3.9%	-2.1%	5.8%	0.6%	2.5%	3.6%	-0.1%	8.8%	7.7%	-1.9%	-13.1%	5.7%	4.6%	36.5%	2.3%
BIL	US Cash	0.0%	0.0%	-0.1%	-0.1%	-0.1%	0.1%	0.7%	1.7%	2.2%	0.4%	-0.1%	1.4%	4.9%	4.0%	15.8%	1.1%
TLT	Long Duration Treasuries	34.0%	2.6%	-13.4%	27.3%	-1.8%	1.2%	9.2%	-1.6%	14.1%	18.2%	-4.6%	-31.2%	2.8%	1.8%	49.8%	3.0%
DBC	Commodities	-2.6%	3.5%	-7.6%	-28.1%	-27.6%	18.6%	4.9%	-11.6%	11.8%	-7.8%	41.4%	19.3%	-6.2%	1.0%	-12.2%	-0.9%
Highest Return		BTC	BTC	BTC	VNQ	BTC	BTC	BTC	BIL	BTC	BTC	BTC	DBC	BTC	BTC	BTC	BTC
Lowest Return		EEM	BIL	GLD	BTC	DBC	BIL	BIL	BTC	BIL	DBC	TLT	BTC	DBC	DBC	DBC	DBC
% of Asset Classes Positive		62%	95%	52%	71%	38%	100%	100%	5%	100%	90%	67%	10%	95%	100%	95%	95%

You haven't had to be a genius to make money this year or last, thanks to the 'everything' bull market. Every asset class is up in 2024, and that follows a year when every asset class bar one was ahead too.

It's amusing that many of the world's central bankers and politicians think interest rates are too high and financial conditions too restrictive when most assets are flying.

The S&P 500 is up 22% year-to-date, the best start to a year since 1997 and the best start to a presidential election year in history. Growth stocks have outperformed while mid and small caps have lagged.

Meanwhile, the Nasdaq has risen 20% this year following a barnstorming 2023. Note though that the Nasdaq has lagged the S&P 500 over the past quarter and this year, which suggests that the bull market has broadened out beyond tech stocks.

Emerging markets are playing catchup and have rocketed over the past quarter. That's in no small part due to China recent economic stimulus. The Shanghai Index was up a record 25% in the five days to October 1.

Meanwhile, bonds and cash have been serviceable this year also. Those declaring last year that the 60/40 portfolio was dead have been proven wrong again.

Bitcoin has been 2024's best performing asset. If that trend continues in the final quarter, it will make 11 of the past 14 years that Bitcoin has been the top performing asset. Staggeringly, it's returned 144% per annum (p.a.) since 2011.

Gold has shined this year too, up 27% in US dollar terms, and 40% of the past 12 months. A declining US dollar has helped, as has geopolitical tensions in the Middle East.

If this year holds, it will be the fourth year of the past 14 where 100% of asset classes achieve positive returns.

A big driver has been the 15-year bull market in stocks. The S&P 500 has returned 14% p.a. and the Nasdaq 18% p.a. since 2011. The S&P's return is well above the 10% per annum average returns through history.

With many other assets now joining in the party, could this signal the maturation or near-end to this bull market? Time will tell.

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The Aussie market is also reaching new highs. It was 2% in September and is up 9% in 2024. Though the ASX 200 has performed well, it's badly lagged some other markets such as the US.

A big rotation out of ASX banks into miners seems to be gaining steam, as traders pounce on the potential positives for commodities from China's stimulus package.

The major banks were either flat or down for the month. Though keep in mind that their 2024 performance remains well in the green. Westpac is up 38%, NAB 22%, CBA 21%, and ANZ 18% year-to-date. That performance been a headscratcher given earnings for all the banks have been going backwards.

Though it can be partly explained by depressed commodities for much of the past year and investors have had few other options in Australia but to invest in the banks. Now that's changing, and a big rotation from banks to miners is starting.

The question is whether Chinese stimulus will boost its economy along with inputs such as commodities. Zooming out, it's clear that China had an enormous credit and property bubble which has burst. That cycle will eventually bottom out. However, the boom brought forward the country's consumption of commodities, and it's hard to see how that over-consumption doesn't mean revert going forward.

There's also the larger issue of a government that's proven incompetent in running the economy and has little interest in its entrepreneurs and investors making money.

Stimulus is unlikely to fix these larger issues in China.

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Recently, a friend asked me for advice on where to find writers and websites that could educate him about investing. In my article this week, I seek to answer that question by taking a step back and looking at the qualities of those who provide the best education and guidance on investing, with examples such as Warren Buffett, Charlie Munger and Peter Thornhill. I suggest that if you find these qualities in writers and practitioners, then you'll likely find investment wisdom.

James Gruber

Also in this week's edition...

Are demographics destiny for the stock market? **Nick Maggiulli** looks at fascinating recent research on the topic, and suggests that while demographics influence economies and stock markets, other factors like technology and policy can have a significant impact too. He believes that diversifying across income-producing assets can help mitigate demographic-driven challenges.

Toll road operator, Transurban, has been in the headlines of late as politicians eye re-writing contracts to prevent annual price rises in line with inflation. Has the company's gravy train come to an end? **Ashley Owen** gives his views.

As this bull market matures, it's giving rise to so-called wicked asset classes. According to **Niels Jensen**, these are the untraditional assets like collectables that often rally late in cycles. He says they can be great fun, though people should follow some simple rules to avoid some of the errors he's made in the past.

Capitalisation rates or 'cap rates' are a widely used valuation metric in property. However, they have shortcomings which are becoming more evident as real estate moves beyond the big three subsectors of office, retail, and industrial. **Phoenix Portfolios' Stuart Cartledge** outlines the pros and cons of cap rates.

Research from The Conexus Institute reveals that 50,000 Australians who are retiring over the next year may not be able to access an account-based pension because they don't meet minimum application requirements of their super fund. **David Bell** and **Geoff Warren** believe that needs to change.

Do trade sanctions work? It's a timely issue as the US soon goes to the polls to potentially elect a second-term Donald Trump, who has flagged further sanctions against the likes of China. **Michael McAlary** goes through recent examples of countries which have managed to adapt and thrive despite sanctions. Because of this, Michael thinks sanctions don't have the same impact they used to.

Lastly, in this week's whitepaper, **Charter Hall** provides its outlook for Australian industrial and logistics property.

Where to find good investment writing and advice

James Gruber

Recently, I listened to a podcast featuring Andy Puddicombe, who founded the wildly successful meditation app called *Headspace*. He told his remarkable story of going from a Buddhist monk to circus performer, before founding Headspace and achieving global success.

In his teens, he endured tough times. His parents divorced. Then, he witnessed friends being killed by a drunk driver. And later, his stepsister died.

At university in the UK, it led him to question everything and suddenly quit his course to pursue meditation in Asia. He first went to India, then other countries, practicing the strict discipline of Burmese meditation. It often involved getting up at 2.30am each day, practicing meditation for 18 hours a day, with three hours of sleep. He did that for 10 years and was ordained a Buddhist monk.

Following this, he went back to the UK and pursed a degree in circus studies! After a decade of long bouts of silence and meditation, he needed to express himself physically via the circus. It was the yin to meditation's yang.

While doing this, he gave a lot of thought about how to take all he'd learned about meditation and bring it to a Western audience.

He was teaching meditation to individuals and groups in London, when he met a student, who was a burned out advertising employee. Together, they formed the idea for *Headspace*.

For those who are unfamiliar with meditation, it's akin to sport – there are lots of different ways to do it. Many people have tried to bring the practices of meditation from Asia to the West, with varying degrees of success. Puddicombe's *Headspace* changed all that: it took off like a rocket ship.

The question is: how did he do it? Here's my theory, and it comes from personal experience. I've been an intermittent meditator for several years, struggling to find a style that suits me. Recently, I discovered *Headspace* and it's transformed my practice. The app eased me into so-called mindfulness meditation and made what is often a religious and esoteric experience into a secular, easy-to-understand one.

There's a certain genius to *Headspace* and I think it comes from two things. First, it feels authentic. Puddicombe comes across as a guy who genuinely thinks meditation can benefit everyone and he wants to be an enabler for that to happen. And he does it without bastardising the ancient traditions of meditation. Second, *Headspace* converts complex meditative practices and philosophies into simple, digestible morsels. Puddicombe makes it easy for the average person to understand and practice meditation.

How Headspace relates to investing

It struck me that these qualities of authenticity and simplicity apply not only to building a business app but to many aspects of the investment world.

A few months ago, a friend asked me where he could go to read and learn more about investing. Of course, I pointed first to *Firstlinks*. I then relayed other sources but quickly realized that getting sound investment advice isn't easy.

If I had my time again, I would tell my friend to read broadly, and go with those thinkers and practitioners who are authentic and keep things simple.

Why? Because authenticity means they're being true to themselves, their profession and their audience. Simplicity means that they understand the topics well and can explain it in a way that any layperson can grasp. Simplicity is a skill that only a real expert can obtain.

Think about the greatest investor and thinker of the last century: Warren Buffett. People admire Buffett because he's authentic. He comes from mid-West America and despite his immense wealth, he's never forgotten his roots. Buffett has also been able to communicate complex financial theories with simple, folksy stories that everyone can understand. As Puddicombe has democratised meditation, Buffett has democratised the stock market.

The same qualities were evident in Buffett's offsider, Charlie Munger, who died earlier this year. People liked him because he was authentic. He was blunt and could be offensive at times, but people respected that he was feisty and spoke his mind.

Munger also had the gift of simplifying the complex. Phrases of his such as "invert, always invert' a problem come to mind.

Other writers who I admire display similar attributes. Vitaliy Katsenelson immigrated to the US as a Russian Jew as an 18-year-old. Learning a new language and fitting into a new country can't have been easy. He not only did that but quickly rose to head a small investment firm. Katsenelson has been writing about investing for 20 years, and both his blogs and books have proven popular. The reason? He comes across as a real and humble person. Not only that, he's also able explain investing concepts through beautiful stories and analogies that most people can relate to. There's a certain genius to Katsenelson that reminds me of Andy Puddicombe.

Here in Australia, I admire Peter Thornhill, who's written several articles for Firstlinks. I don't agree with everything he says but most of it makes sense. Thornhill attracts an audience because people can see that he believes what he says, and he has a track record of implementing what he speaks of. That's authentic.

Plus, he explains the share market in understandable terms. And his investment strategy reflects that simple approach.

Detecting bad investment advice

If authenticity and simplicity are features of sound investment writing and advice, then inauthenticity and complexity are the flipside of that.

Being inauthentic broadly means not being yourself. This happens all the time in investing. Being inauthentic can mean making up stories to suit an audience, distorting personal backgrounds to suit a topic, or trying to imitate more famous industry people.

Those who favour complexity over simplicity are doing it for a few reasons. It might be that they don't understand a topic well enough to be able to explain it in a simple way. Or it could be that they use complexity to hide something.

I'll give a specific example of an investment writer who I wouldn't recommend to my friend mentioned above. And he's a famous and wealthy writer too. His name is Morgan Housel and many of you would have read him or heard of him. He's sold millions of books by making investment accessible to the masses. He's done that by making things simple to understand.

A little too simple, in my view. In doing so, he crosses over into being as much a marketer as an investment expert. And it lacks authenticity, in my view.

Housel often offers 'hacks' or 'mindsets' to get wealthy that cater more to those who are already wealthy or others who are 'self-help' junkies. His advice offers less at a practical level to the average investor.

This may be a little harsh on Housel, and there are a lot worse proponents of investment advice out there.

Beyond investment writing and advice

The qualities which made Andy Puddicombe successful not only apply to investment writing but many other things in finance - to seeking formal financial advice, investment funds, and investment products. Look for authenticity and simplicity, and your investment journey is likely to be a more successful one.

James Gruber is editor of Firstlinks and Morningstar.

Are demographics destiny for the stock market?

Nick Maggiulli

A recently released paper called The Wealth of Working Nations found that, after controlling for working-age population (i.e. those age 15-64), historical GDP growth is quite similar across most developed countries. But, this got me thinking, "How much do demographics impact the stock market?"

With the Baby Boomers continuing to retire in the U.S. and population growth slowing throughout most of the developed world, will this spell disaster for future stock returns? This isn't a simple question to answer.

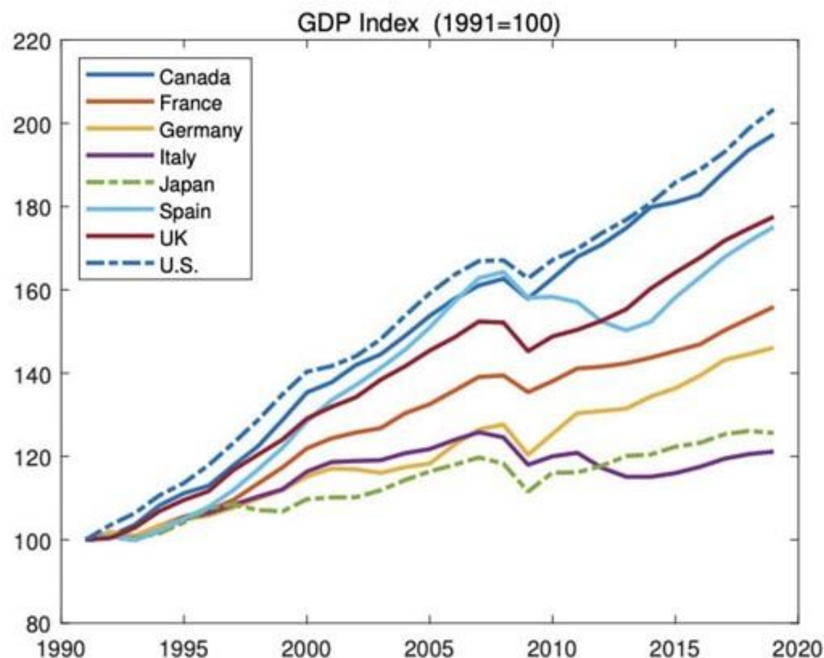
For years, researchers have debated the impact of population trends on economic growth and market performance. Some have argued that demographics are the hidden force behind long-term market trends. However, others believe that other factors such as productivity growth play a far larger role.

In this post, I will explore this relationship in more detail to see whether population really holds the key to economic growth and future stock returns. Let's dig in.

Does population predict GDP growth?

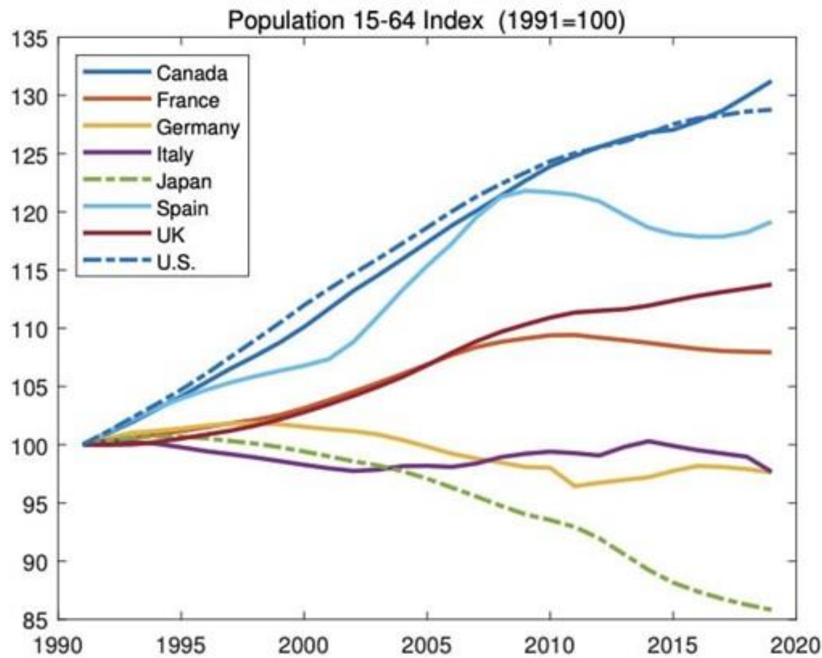
When it comes to population growth and GDP growth, there is some evidence that they are positively correlated, at least within developing countries. The Federal Reserve released a note in September 2016 which concluded that, "demographic changes account for a significant portion of growth slowdown in several of these [OECD] economies in recent years."

Looking at GDP growth and population changes over time makes this more apparent. For example, from The Wealth of Working Nations paper, you can see how GDP has changed in a handful of advanced economies since 1991:



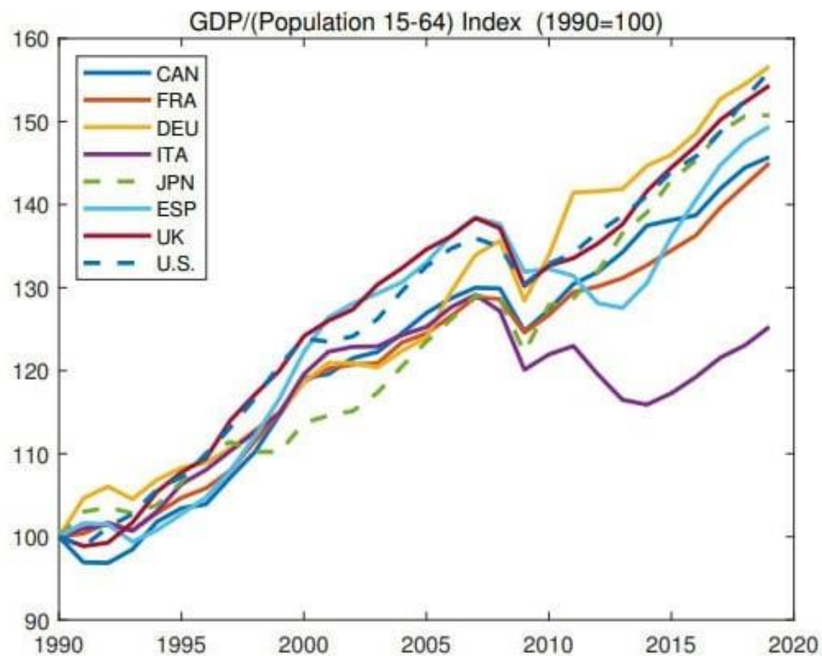
What you may notice is that countries like Italy and Japan have had worse GDP growth than countries like the U.S. and Canada. This has occurred for a multitude of reasons, but one of them is related to changes in working-age population.

When we look at the changes in their working populations, there are many parallels:



As you can see, countries with the largest working-age population declines have also seen some of the worst GDP growth since 1991.

Putting it altogether, the authors divided GDP by the change in working-age population and found some remarkable convergence across countries:



After controlling for working-age population, basically every country besides Italy has had remarkably similar changes in their overall GDP. This isn't GDP per capita because it doesn't use total population, but working-age population. In other words, GDP per worker has grown roughly the same across these developed economies.

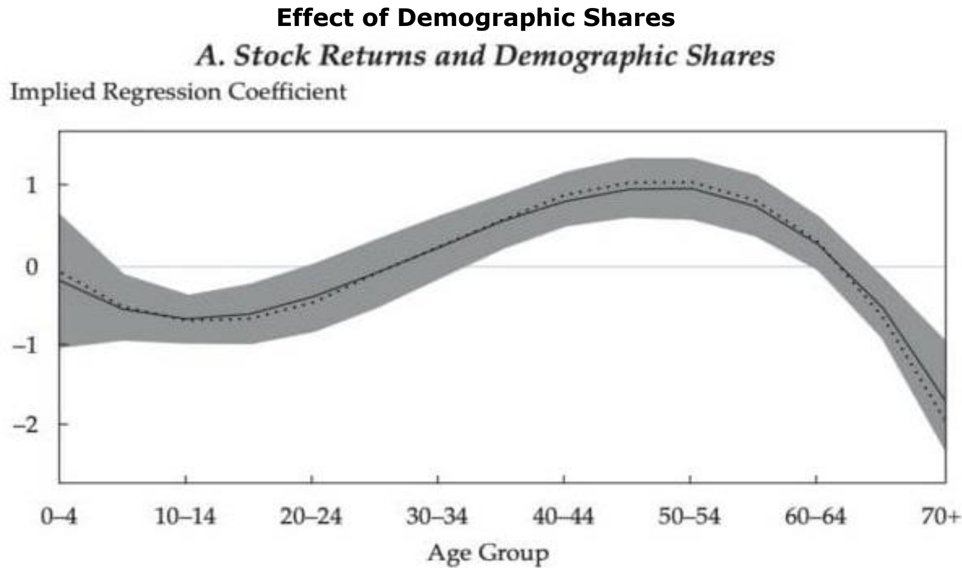
But if this relationship seems to be true for the economy, what about the stock market?

Does population predict stock returns?

When it comes to population changes and the stock market, one of the most comprehensive papers on this topic was released by Rob Arnott and Denis Chaves back in 2012. Their research examined 60 years of data to see how demographic changes impacted stock returns and found a somewhat positive relationship.

For example, after regressing the size of different population cohorts on future stock returns, they found that a roughly 1% increase in those aged 50-54 was associated with a 1% higher annual return for a country's stock market. You can see this in the figure below:

Effect of Demographic Shares

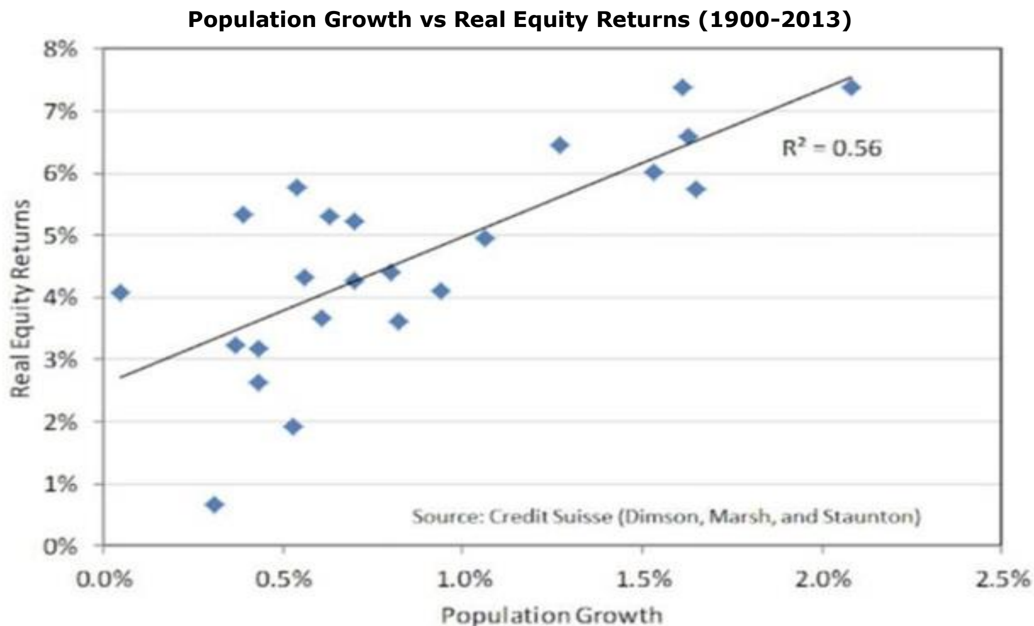


Now compare this with the 70+ age cohort where every 1% increase in their share of population suggests 1.5% annual *decline* in future stock returns. In other words, countries with a higher share of workers have improved stock returns. Arnott and Chaves concluded as much in their paper:

"Large populations of retirees (65+) seem to erode the performance of financial markets as well as economic growth. This finding makes perfect sense; retirees are disinvesting in order to buy goods and services that they no longer produce, and they are no longer contributing goods and services into the macroeconomy."

Arnott and Chaves aren't the only researchers do to an analysis on demographics and stock returns. The blogger EconomPic had a post on the same topic back in 2017. He also found a positive relationship between population growth and real equity returns across countries from 1900-2013:

Population Growth vs Real Equity Returns (1900-2013)



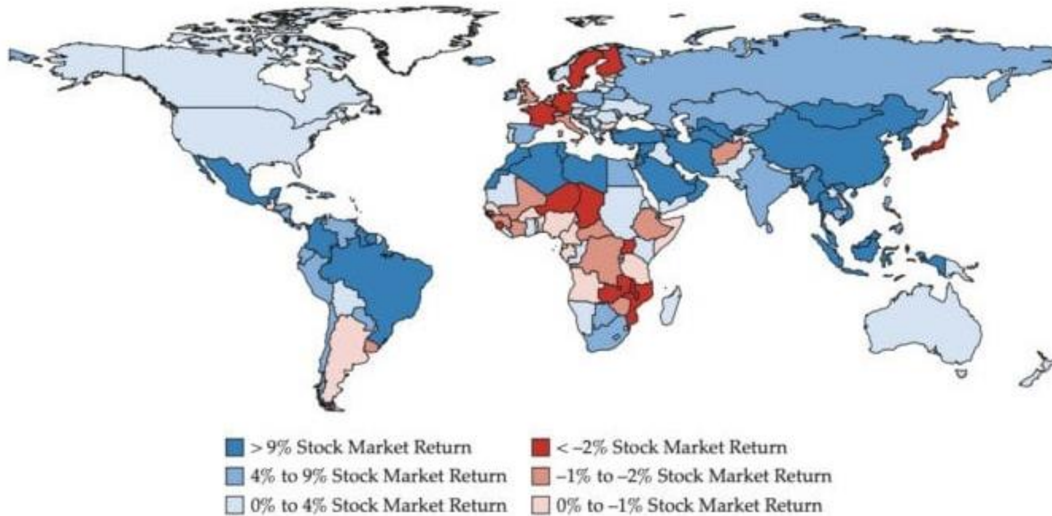
Source: EconomPic Data

So, is this a closed case? If population growth is so important, why do we even bother making predictions about anything else related to stocks?

Because population growth isn't the whole story. If we go back to Arnott and Chaves' paper, they actually made some predictions on future stock returns by country based on their demographics. Here's a map of their annualized stock market forecast by country for 2011-2020:

Annualized Stock Market Forecasts, 2011-2020

A. Forecasts Using Demographic Shares



Source: Financial Analysts Journal

According to this, the U.S. should have had a 0%-4% annualized stock market return, Japan should've had less than a -2% return, and China should have had a greater than 9% return over this period. But what actually happened? None of those things.

From 2011 to the end of 2019 (pre-COVID), the U.S. had the highest return with China and Japan performing roughly similar:

While this is only three countries from the many listed above, it illustrates the difficulty of predicting future stock returns based on demographics alone. Yes, population matters, but other factors such as technological change, productivity growth, and investor preferences can matter even more.

The bottom line

Demographics play a significant role in shaping economies and their underlying stock markets. The research I've highlighted shows a clear relationship between population trends, GDP growth, and stock returns. In general, countries with growing working-age populations tend to experience stronger economic growth, which often translates to better stock market performance.

However, demographics are not always destiny in the stock market. Technological advancements, productivity growth, policy decisions, and shifting investor preferences can all significantly impact stock returns, sometimes overshadowing demographic effects. Additionally, a country's market performance isn't solely determined by its own demographic profile, but can also be influenced by other global trends and capital flows.

While the retirement of Baby Boomers will present future challenges to stock returns, this doesn't necessarily spell doom for your portfolio. A changing demographic profile could spark innovations in productivity or reorient the global economy in a way that mitigates these negative demographic pressures.

Yes, work will need to get done for civilization to keep moving forward. But with the continued development of AI, there's nothing that says that these future workers must all be people.

Either way, what matters for you isn't the demographics of any one country, but owning a diverse set of income-producing assets. That's how you counteract a changing population and build wealth for the long run.

Nick Maggiulli is the creator of personal finance blog Of Dollars And Data and the Chief Operating Officer at Ritholtz Wealth Management. For disclosure information please see here. If you liked this post, consider signing up for Nick's newsletter.

Are we reaching the end of Transurban's gravy train?

Ashley Owen

Transurban (ASX: TCL) was one of Australia's great corporate success stories – until it was hit by a triple-whammy of Covid lockdowns, inflation, and public/political backlashes.

Do the new CEO and chairperson have the political cunning and connections to revive Transurban's once-golden yellow brick road?

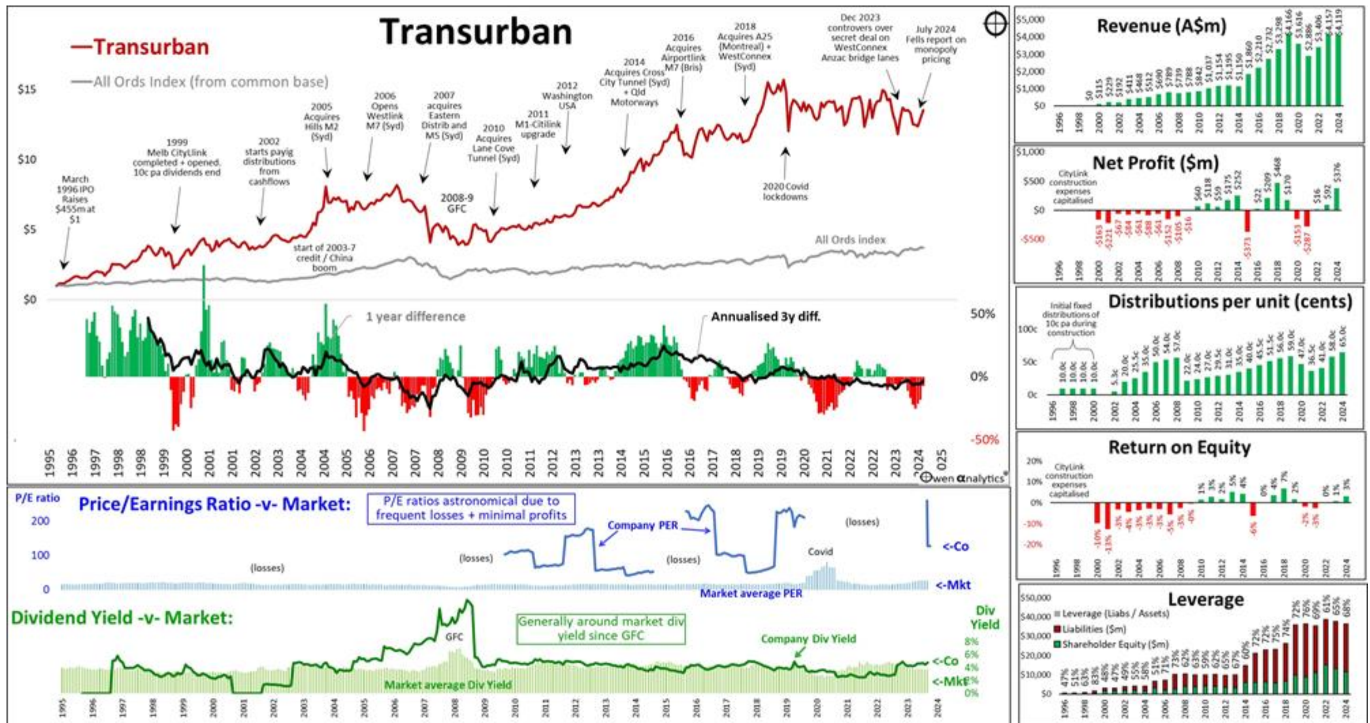
Here's my take on Transurban for long-term investment.

Golden start

From an initial value of $500 million when formed and floated in 1996, TCL's market value grew 100-fold to $50 billion by 2019 (pre-Covid), putting it into the top-10 list of largest ASX stocks, and making it the world's largest 'infrastructure' stock. It was a volatile ride due to high levels of debt but returns beat the overall market handsomely.

But that golden ride ended nearly five years ago. Since its pre-Covid peak, TCL has lagged the market badly. The post-Covid 'work from home' revolution has reduced traffic volumes, inflation has raised the costs of road tolls for drivers, eaten into consumer spending, and increased interest rates on the company's heavy debt load.

In addition, the company now faces a crisis that strikes at the core of its recipe for success – monopoly power and political favours.



Secret sauce

Throughout history, most corporate success stories were the result of the extraordinary drive and ambition of a visionary entrepreneur, but the initial founder-driven momentum rarely continued after the founder's departure.

TCL was different – the 'big idea' was not a new technology or product. The big idea was that cash-strapped governments could outsource the construction and operation of roads and tunnels to commercial companies and allow them to charge tolls, and the governments would support the venture by providing political favours in a variety of forms including deliberately routing traffic to the toll-roads, and promising protection from competition. TCL led this new trend in Australia and has dominated ever since.

Some of these 'Public-Private Partnerships' have been successful, but others have been financial disasters – and TCL has been smart enough to pick up some of the failures at bargain prices.

Monopoly

Every business owner's dream is to have a monopoly in its chosen market. Monopolies can exploit 'pricing power' – the ability to raise prices where customers have little or no alternatives, allowing the business to extract out-sized profits. As road tolls are generally set by governments and restricted by inflation, TCL's growth has come mainly from acquisitions of additional roads, plus extensions and expansions of roads it already owned.

Avoiding the 'four horsemen' of doom

In Australia, corporate success has generally not been about coming up with a brilliant world-beating idea. For Australian companies, survival and success has mostly been about avoiding the 'four horsemen of the apocalypse' – avoiding the four 'dumb things' that blow up most companies: rapid growth, aggressive international expansion, excessive debt, and ego/hubris.

1. Growth – modest and careful

On the growth front, Transurban has stuck to its core business – toll roads, and it has eliminated competition by running an almost complete monopoly on toll roads in the three largest cities in Australia – Melbourne, Sydney, and Brisbane.

Because of this monopoly, it has not had to deal with competition, which is usually the big risk to profitability with rapid expansion. It has even been able to extract extraordinary favourable deals from governments – including the right to tax-payer-funded compensation if new competing roads are built. In what other industry go you get that?!

2. International expansion

The second big risk – international expansion – has been well controlled. TCL has resisted the usual temptation to expand rapidly into foreign markets. It expanded into Washington (USA) in 2007 and into Quebec (Canada) in 2018, but these were relatively small, careful steps. These together make up just 10% of revenues and profits, leaving plenty of room for careful and selective expansion in future.

3. Debt

The third big destroyer of companies is debt – and this is where TCL has been running closest to the edge. Although the tolls are regulated by governments, the volume of road traffic is highly cyclical. High levels of debt dramatically increase the volatility of profitability – rising during economic booms but declining in slow-downs.

The 2020 covid lockdowns virtually emptied roads instantly in Australia and around the world, and TCL was hit hard.

The company has always carried high levels of debt. It was formed initially to build and operate Melbourne's CityLink motorway. The total cost of $1.8 billion was financed by $455 million in capital raised from the public in the 1996 float, plus $1.3 billion in debt. This was a debt/equity ratio of 2.8 (72% leverage ratio), which is very high.

The bottom-right chart shows the level of TCL's equity and debt each year. Around 70% to 80% of the asset values have been financed by debt. The big jumps in asset values from the major acquisitions are accompanied by large jumps in debt levels. The problem is that asset values are reliant on rubbery assumptions like estimates of future revenues and subjective discount rates, but debt is debt, and harder to fudge.

Continually high debt ratios have allowed TCL to grow without overly diluting shareholders, but it has meant frequent accounting losses and a volatile share price.

4. Ego

On the 'fourth horseman'- ego and hubris, TCL has managed the roles of CEOs and Chairperson well - with stability and technical expertise rather than aggressive, ego-driven expansionists. More on this below.

Profitability and pricing

TCL rarely posts accounting profits, and its free cash flows are also mostly negative, thanks to large outgoings for maintenance, capex, expansions, and acquisitions (tip: never accept published 'free cash flows' numbers at face value). Returns on equity have been low single digits, averaging around zero.

Despite big swings in profitability, the company was able to maintain rising distributions in the boom years 2002-8, but distributions were cut savagely in the GFC, rose steadily in from 2009-19, only to be cut savagely again in the 2020-1 Covid lockdown crisis.

Distributions (2024) per share are finally back up to where they were sixteen years ago (2008) – and that's **before inflation**. Between 2008 and 2024, inflation has reduced the real purchasing power of distributions by **one third.**

It's a case of the 'Telstra disease' - shareholders cling on to the illusion of 'stable dividends' but forget that they are losing real purchasing power after inflation, big time.

Price/earnings ratios have been either astronomically high or non-existent, due to frequent losses and minimal profits. Likewise for pricing to free cash flows.

On the other hand, distribution yields for TCL have been more or less similar to broad market dividend yields since around 2010. This is on the rich (expensive) side given TCL's very low profits and returns on equity, high debt load, cyclicality of revenues, regulatory risks, and little/patchy franking.

CEOs competent technocrats

The CEOs have all been career employee professionals, not visionary entrepreneurs. Founding CEO, Kim Edwards (1996-2008), was a Melbourne engineer with deep local and international experience running big construction projects including ports, offices and hotels. He was the driving force behind the company's success in Melbourne, then Sydney, and then in the US.

After developing world-first E-tag technology for the Washington toll roads, he did not fall into the usual trap of aggressively trying to blanket the world in a mad rush. (Are you listening Domino's, Xero, Appen?)

When Edwards retired as CEO, he was followed by Chris Lynch (2008-12) – ex-BHP CFO, and Alcoa. Given the timing of his reign, his top priority was debt management in the GFC. Next came Scott Charlton from 2012, after a long career with construction giants LendLease and Leighton.

In late 2023, Charlton handed over the CEO role to his CFO Michelle Jablko, who was previously ex-ANZ CFO, and originally a lawyer at Allens. Unlike past CEOs, the new CEO has no hands-on experience in construction or engineering, nor in companies involving construction and management of huge engineering projects. One would have thought this would be a mandatory requirement for a CEO. Strange call.

Chair

TCLs' chairpersons have been solid, stable, unexciting, but mostly highly competent and well connected. Political connections and clout are the key. The skill set needed here includes securing political favours and dealing with capital markets on both the debt and equity side, as the acquisitions and road extensions and expansions have been financed by combinations of debt and capital raisings, and negotiating political favours.

First in the chair was Laurie Cox (1996-2007) – former chairman of the ASX, long-time Potter Warburg broker, and supremely connected with governments of all flavours. He was followed by former banker David Ryan (2007-10), and then Lindsay Maxsted (2010 to 2022) – career KPMG partner/CEO (Maxted also chaired Westpac until he was unceremoniously booted out over the disastrous Hayne Royal Commission findings against Westpac).

Maxted was replaced with rookie chairperson Craig Drummond - ex-CEO of Medibank, after a career with NAB, Bank of America, and JB Were. The combination of relatively new, relatively inexperienced CEO and chairperson is a real issue.

Is the game up?

The game (milking monopoly power based on political favours) might be up for Transurban. You can only push monopoly power so far before it triggers a backlash from the public, and therefore populist politicians.

(As an aside - we have a holiday house in the Blue Mountains outside Sydney. A two-way trip up there costs about $30 in petrol and another $30 in TCL road tolls – Ouch! However, I feel for ordinary folk who pay $50-100 or more per week in road tolls just to get to work and back! I have a niece who is an aged/disability care worker who has to travel all over Sydney as part of her job. Road tolls are her second largest expense after rent. Sydney is the most tolled city in the world, and it was only a matter of time before we saw a widespread backlash from hundreds of thousands of ordinary workers who simply cannot afford the cost of the tolls.)

In December 2023, a controversy erupted over secret deals for preferential access to lanes on Sydney's Anzac Bridge favouring Transurban when the NSW government's new WestConnex tunnel system opened, causing traffic chaos and anger across Sydney's inner west. It was just the most recent in a long line of scandals highlighting political favours that included closing and/or redirecting perfectly good lanes on public roads to push traffic into TCL toll roads.

In July 2024, a report by powerful former national competition regulator Allan Fells detailed inequities in Transurban's monopoly pricing, and recommended a raft of radical changes including wholesale renegotiation of tolls, a new regulator, toll caps, and a range of other interventionist measures.

This is probably not something that will disappear quickly, as it is consistent with the new global populist trend toward government intervention, re-regulation, and re-distribution of wealth and power from capital back to labour.

The new CEO and Chair may be very competent and able in their respective fields in their past careers, but neither have experience in building and/or running major engineering projects, nor in political rent-seeking and clandestine deal-making, nor overcoming public / populist backlashes.

Do they have political cunning and connections to revive Transurban's once-golden yellow brick road?

You decide!

NB - I have been a shareholder in TCL over the years, but not at present. Readers should not read anything into my current or past holdings as they may not have the same financial goals, needs, or circumstances as I had or have. As always, my analysis is fact-based and intended to be as dispassionate as possible, regardless of whether or not I am a buyer, a seller, or holder. This quick, initial snapshot is no substitute for more detailed research required before making any investment decisions.

Ashley Owen, CFA is Founder and Principal of OwenAnalytics. Ashley is a well-known Australian market commentator with over 40 years' experience. This article is for general information purposes only and does not consider the circumstances of any individual. You can subscribe to OwenAnalytics Newsletter here. Original article is here: Transurban – end of the gravy train for monopoly toll road powerhouse?.

The dawn of wicked asset classes

Niels C. Jensen

"Stupidity is our destiny." Acadian Asset Management

The painful experience of Greenlandic stamps

In my younger days (much younger), I collected stamps, more specifically stamps from Greenland. A well-meaning uncle had convinced me that there are so few Greenlandic stamps around that, over time, prices can only go up. Little did he realise that the arrival of the iPhone would dramatically reduce the appetite for spending long winter evenings with your stamp collection. Nor did he foresee the arrival of the digital era, where physical mail, thus the need for stamps, would virtually disappear, as it has in the Kingdom of Denmark (which we are supposed to call our country when talking about it in the context of Greenland or the Faroe Islands).

Now, my poor stamps collect dust in a safe. I still try to convince myself that, one day, they will turn into the homerun my uncle 'promised' me, but my conviction has all but gone. The other day, a client of mine asked me about wicked asset classes, which he defined as asset classes that don't fit into one of the mainstream boxes (mostly cash, bonds, equities, property and gold). He asked me why they often perform the best in the latter stages of economic cycles, which is precisely where we are now, and I immediately thought of my stamps again. Maybe they are not wicked enough?

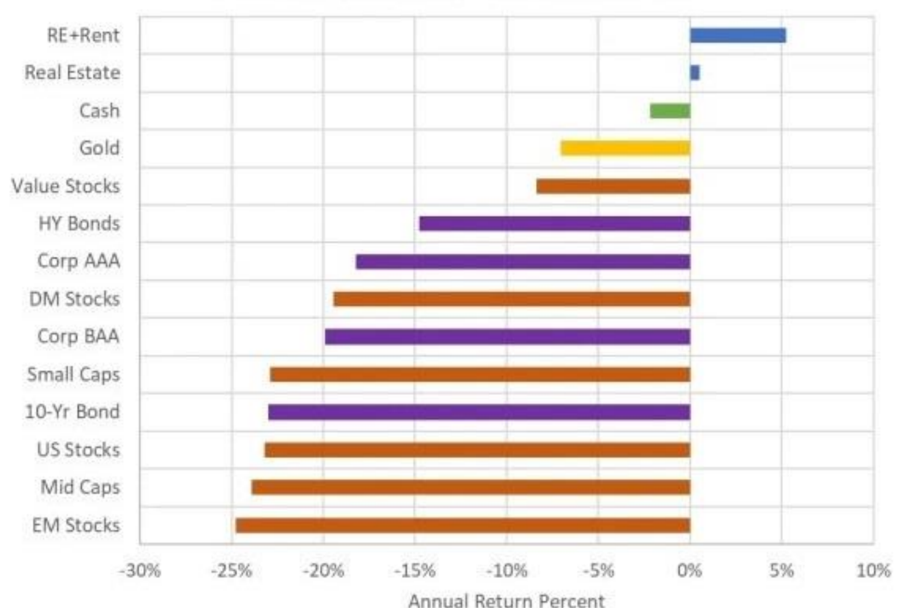
How wicked is wicked?

Now, the list of wicked asset classes is long – very long – but my client is right; the more obscure asset classes often (but not always) perform better after years of outstanding returns in mainstream asset classes, and it doesn't stop there. They also tend to perform (relatively) well in years where mainstream asset classes stink.

Take for example 2022 which was an extraordinarily challenging year. Nearly everything fell out of bed – at least on an inflation-adjusted basis. Returns were already quite poor when measured on an absolute basis; however, when adjusting for inflation, many asset classes delivered outright ugly returns (Exhibit 1). Having said that, the poor environment for mainstream asset classes did not deter investors from throwing plenty of money after fine wine and other not-so-mainstream asset classes.

This brings up the obvious question – where in the sand should you draw the line between mainstream and wicked asset classes? One could argue that everything which is not mainstream is wicked. Following that logic is problematic, though, because it turns many alternative asset classes into wicked asset classes, which they clearly aren't. Is infrastructure wicked? Clearly not. Is corporate private debt? Only my old mum would think so.

Exhibit 1: Inflation-adjusted 2022 asset class returns



Source: mindfullyinvesting.com

In no particular order, I would include more obscure asset classes such as stamps, coins and notes (particularly those that have expired), fine wine, cryptocurrencies, football debt finance, classic cars and potentially also royalty rights although the latter, in recent years, have become more accepted amongst institutional investors; i.e., today, it is probably more alternative than wicked. I should also point out that the list above is far from complete. As long as there is a secondary market (well-functioning or not so well-functioning), in my book, it becomes an asset class in which you can make a profit or, in the case of stamps, a loss.

When do wicked asset classes do best?

As pointed out earlier, effectively, you have two environments where wicked asset classes tend to do particularly well:

i. In late-stage economic cycles where investors are often disincentivised to invest (more) in equities because of the high P/E multiples on offer. NVIDIA trading at 62x LTM earnings doesn't really feel like a dream ticket.

ii. In years like 2022 (see Exhibit 1 again), where many private investors are tempted to invest in asset classes they would otherwise pay little attention to.

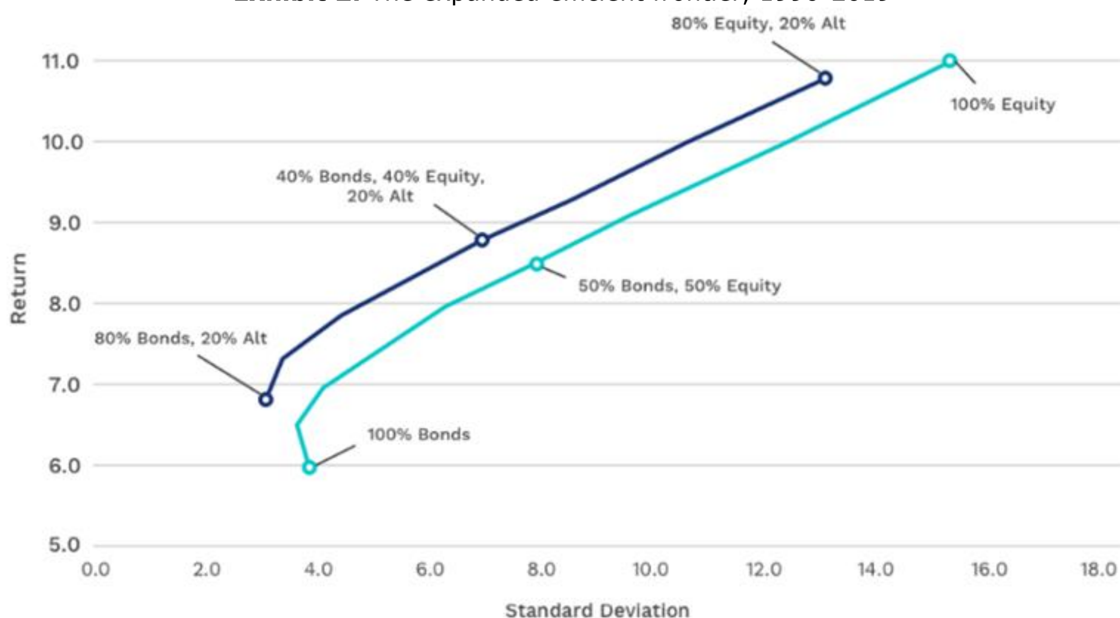
In the first case, after years of solid profits, many investors have plenty of gravy to play around with. In the second case, as the overall environment is pretty hostile, many (mostly private) investors often choose to look into the distant corners of financial markets, where they can find opportunities not on offer elsewhere. The problem is that wicked asset classes are mostly unregulated, i.e. unscrupulous salespeople promise the impossible to get their hands on investors' hard-earned capital without running much risk of ending up behind bars.

The underlying motives in (i) and (ii) above may be different, but the net effect is the same. Having said that, as many investors with experience from dabbling in wicked asset classes will know, it is much easier to get in than it is to get out again. Liquidity is extremely one-sided in most wicked asset classes.

Wicked asset classes in a portfolio context

When establishing a portfolio, the typical starting point, either explicitly or implicitly, is the efficient frontier, and where on the frontier the investor wants to be. In Exhibit 2 below, you can see the returns various financial assets have delivered over the last approx. 30 years. A relatively simple conclusion you can draw from that chart is that it has indeed been possible to move the efficient frontier *up* by including alternatives, i.e. your returns would have improved for the same amount of risk taken (SD of returns), had you included alternative asset classes in your portfolio.

Exhibit 2: The expanded efficient frontier, 1990-2019



Source: CION Investments

Some investors are of the opinion that you can move the efficient frontier up a bit further by including wicked asset classes in your portfolio, i.e. you can improve your risk-adjusted returns by adding for example a classic car to your portfolio.

I have three problems with that line of thinking:

1. Correlations between the returns of the asset classes in question must be relatively stable for the analysis above to make any sense, and correlations between mainstream and wicked asset classes are anything but stable.
2. Facts are often misrepresented when marketing wicked asset classes. If you go back to the early days of bitcoin, it was portrayed as a currency. Guess what – bitcoin trades more or less like the Nasdaq index these days. Such volatility is far too high for bitcoin to be classified as a currency.
3. When wicked asset classes are often portrayed as purveyors of superior returns, the illiquidity premium is usually ignored, but the illiquidity premium is a *major* source of returns in this corner of the market.

Final few words

By writing about this topic, I am not suggesting you should never invest in any wicked asset classes. Not at all, but you need to be very clear in your mind as to what the purpose is, and you should *never* invest any money that you cannot afford to lose. Wicked asset classes are typically *very* illiquid, and they are almost always *very* risky. That said, they can also be great fun. If you follow a few simple rules, which I forgot to do in my younger days, you should do better than me.

PS. If you find this topic fascinating, I suggest you click on this link. Christopher Chappell et.al. have written an insightful, and relatively short, paper on the risks in new asset classes and how to introduce them to your portfolio. The paper is quite mathematical (actuaries like to show off); however, all you need to read is the executive summary and the conclusion, which will take you less than five minutes.

Niels C. Jensen is the Chief Investment Officer of Absolute Return Partners. This material is provided for information purposes, is intended for your use only and does not constitute an invitation or offer to subscribe for or purchase any of the products or services mentioned. The information is not intended to provide a sufficient basis on which to make an investment decision. ARP accepts no liability for any loss arising from the use of this material.

This property valuation metric needs a rethink

Stuart Cartledge

Capitalisation rates, commonly known as 'cap rates', are a fundamental metric in Australian property investing. When a commercial property is sold, two pieces of information will be widely reported. Firstly, the amount the property sold for and secondly, the cap rate. Often properties will be compared by their respective cap rates. Reports will often comment on the 'implied cap rates' of different property securities. However, this seemingly simple and ubiquitous measure can be far more complex to use when comparing different types of properties.

What is and isn't in a cap rate

Whilst different market participants may mean different things when referring to a cap rate, the Property Council of Australia (PCA) defines a cap rate as a property's net operating income (NOI) divided by its property value estimate. For example, if a property generates an annual NOI of $500,000 and is valued at $10 million, the cap rate would be 5%. A purchaser might assume that they would receive a cash flow yield of 5% plus any rental growth that may occur. This isn't necessarily the case and ignores key considerations.

Capital Expenditure (Capex):

Commonly, properties require meaningful ongoing investment, which isn't reflected in the NOI used to calculate cap rates. This investment is known as capex and comes in many different forms. It may be maintenance capex, which refers to significant replacements or additions to maintain the standard of an existing building. For office properties, this may include replacing lifts or air conditioning units, each of which may need a full replacement as often as every 15 years. For shopping centre properties, capex may include items such as

escalators or shared facilities such as bathrooms. Maintenance capex is not directly reflected in increased rent and is commonly used to 'maintain' the relevance of an existing building. This amount is often referred to as a percentage of a building's value. For example, if a building worth $100 million requires maintenance capex of $500,000 per year, it is common to say it requires 0.5% (or 50 basis points) of maintenance capex.

Leasing Incentives:

To attract and retain tenants, commercial property owners often provide 'incentives' to prospective and renewing tenants. These incentives can take many forms, but are commonly provided as rent-free periods, or contributions to a tenant's fit-out. The size and form of incentives varies greatly between different property types. Incentives are commonly quoted as a percentage of the total rent to be paid over the tenant's lease period. For example, if a tenant agrees to a 10-year lease for $100,000 per year, a 20% incentive would mean that $200,000 of benefits are provided to the tenant. Rent, less any incentives, is called 'effective rent' and in the above example effective rent would be $80,000 per year. Rent excluding incentives is called 'face rent'. It is typically face rent that is used to calculate the NOI used in a cap rate.

Whilst not the subject of this article, it is worth noting that lease structures including term and rent reviews, as well as tenant quality are not considered in a cap rate. Buildings with longer leases, higher fixed rent increases and better tenant quality tend to attract lower cap rates than the alternative.

Now and then

In a past generation, institutional grade commercial property primarily consisted of office, retail and industrial property. Approximate leasing incentive and maintenance capex amounts across these subsectors 15 years ago can be seen in the table below:

Property Type	A Grade Melbourne CBD Office Building	A Grade Melbourne Shopping Mall	Modern Melbourne Industrial Facility
Leasing Incentives	20%	0%	5%
Maintenance Capex	0.5%	0.5%	0.3%

Whilst there are some differences between the amount of cash flow leakage, the difference between property types is not enormous. Whilst industrial properties faced limited cash flow leakages, market rental growth had been extremely low for a long period. It may not have been perfect but comparing cap rates across these property types 15 years ago was not a terrible way to assess relative value.

Beyond any changes to leasing incentives and maintenance capex requirements, today's listed property sector is much broader than it used to be. Alternative property types such as healthcare, social infrastructure, petrol stations and long WALE sale-and-leaseback properties are all part of the institutional investment landscape. Many of these property types are commonly leased in an owner favourable "triple-net" manner. A triple-net lease means a tenant is responsible for property taxes, building insurance and maintenance capital expenditure across the life of the lease.

A revised table approximating today's leasing incentives and maintenance capex, including triple-net properties, can be seen below:

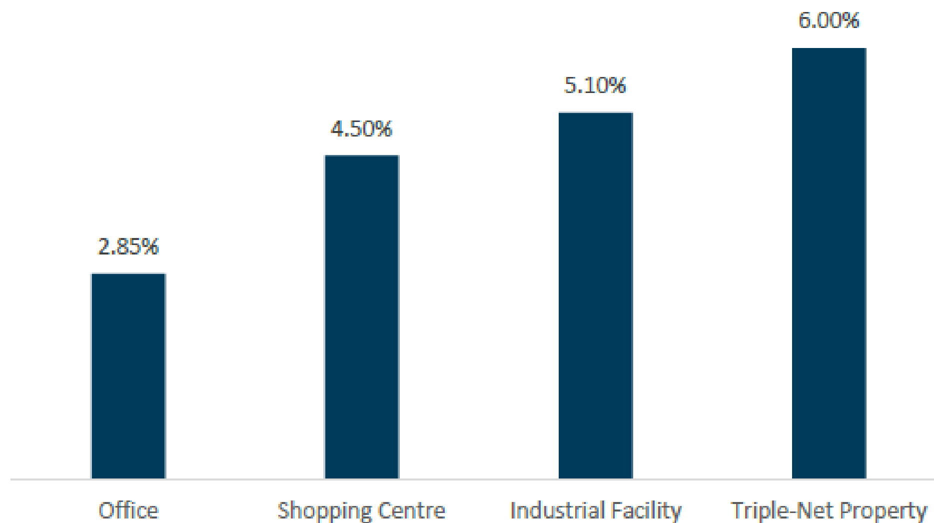
Property Type	A Grade Melbourne CBD Office Building	A Grade Melbourne Shopping Mall	Modern Melbourne Industrial Facility	Triple-net Property
Leasing Incentives	42.5%	15%	10%	0%
Maintenance Capex	0.6%	0.6%	0.3%	0%

Mind the gap

It is clear when comparing the above tables, that the dispersion in incentives and capex has widened materially. In the case of an A grade office building, the gap between the building's cap rate and its true cash flow yield is vast. The chart below demonstrates this visually for an office building with a 6% cap rate:

As can be seen, the cap rate in no way resembles the true cash flow of owning an office building, with more than half of the NOI received (used in calculating the cap rate) lost to capex and incentives.

Consider the four assets in the above table. In this example, each has a cap rate of 6%. The chart below shows the cash flow yield of each:



What to do?

Phoenix actively considers the factors affecting cash flows (among others) and explicitly forecasts longer term capex and incentives that property owners will be required to pay. It is these cashflows that determine value, not next year's dividend or simply observing a cap rate.

A comparison of Dexus (DXS) and Charter Hall Social Infrastructure REIT (CQE) shows the importance of looking beyond headline cap rates and how this affects how Phoenix manages the portfolio.

DXS is predominantly an owner of high quality office properties across Australia. CQE is predominantly an owner of smaller properties leased to childcare providers on triple-net leases. CQE's cash flow is boosted by a lack of incentives and capex. Childcare property rent is also an income stream heavily supported by the government, with support for funding of the sector a politically bipartisan issue. As at period end, DXS' office cap rate implied by its share price was greater than 8.3%. CQE's implied cap rate was more than 6.8%. If one were to merely compare cap rates, DXS would be the more attractive investment opportunity. It, however, faces significant cash outflows (in the form of capex and incentives) beyond what is measured in a cap rate. As such, Phoenix has held no position in DXS for some time and holds an overweight position in CQE.

The detail is important

Cap rates have the benefit of being simple. In the past they were also a reasonable way to compare property.

As incentives and capex levels have diverged between different properties, merely looking at cap rates has become a less appropriate way to consider the relative attractiveness of different properties.

By developing a more nuanced understanding of what's truly "in a cap rate", investors can make more informed decisions. Remember, the devil is always in the details, and in real estate investing, those details often lie beyond the simple cap rate calculation.

Stuart Cartledge is Managing Director of Phoenix Portfolios, a boutique investment manager partly owned by staff and partly owned by ASX-listed Cromwell Property Group. Cromwell Funds Management is a sponsor of Firstlinks. This article is not intended to provide investment or financial advice or to act as any sort of offer or disclosure document. It has been prepared without taking into account any investor's objectives, financial situation or needs. Any potential investor should make their own independent enquiries, and talk to their professional advisers, before making investment decisions.

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Improving access to account-based pensions

David Bell, Geoff Warren

Why an estimated one million Australians aged 65 or above still have an accumulation account is not completely resolved. We noticed while researching this topic that minimum application amounts may be precluding some low-balance retirees from accessing account-based pensions (ABPs). We estimate that 50,000 Australians who are retiring over the next year may not be able to access an ABP because they do not meet minimum application requirements of their superannuation fund. The table below lists funds with the largest minimum ABP application amounts extracted from product disclosure statements (full list in Appendix of original paper). We briefly detail our concerns, acknowledge nuances, and suggest some steps forward for funds and policymakers.

Minimum application values for account-based pensions (largest)

Account-based pension	Minimum application
AustralianSuper Choice Income	$50,000
Fiducian Super	$50,000
HESTA Income Stream	$50,000
Russell Investments iQ Retirement	$50,000
Vanguard Super SpendSmart	$40,000
Australian Retirement Trust Retirement Income	$30,000
Fire & Emergency Services Super	$30,000
IOOF Pension	$30,000
Qantas Super Retirement Income Account	$30,000

Our concerns

We have a range of concerns over limiting ABP access for low balance members:

- **A retirement account provides access to a tax-free environment** – Low balance members may miss out on a tax benefits could easily provide a 0.5% return uplift annually (relative to the comparable investment strategy applied in accumulation). This can have a meaningful impact on income and balance over longer periods. While somewhat coincidental, 0.5% is the threshold level used in the Your Future, Your Super performance test.
- **Exclusion from pension bonus** – Members not meeting the entry requirements for their fund's ABP will also be excluded from participating in any retirement bonus (where offered).
- **Effective member engagement** – It is unclear what options are being presented to members with less than the minimum ABP balance requirements, and whether their super fund is engaging with them in a

proactive manner including suggesting realistic next-steps. A generic message that there is a good retirement product while confronting members with minimum balance requirements that they may not meet seems like a poor communication practice, and may reduce member confidence.

- **System design not being made available to all** – The design features of Australia's retirement income system include an accumulation phase that taxes contributions and income and a retirement phase that is tax-free. Precluding low balance members from the tax benefits during retirement seems inconsistent with a fair and equitable system.

Nuances

We acknowledge that the problem is nuanced:

- **Many low-balance members withdraw their accumulation balances** – Many low-balance members may not make use of an ABP even if available due to an intent to withdraw their balance – although it is challenging to identify the degree to which ABP take-up to date has been inhibited by account access or intentional choice. The extent to which lower ABP take-up is intentional reduces any business case challenges (next dot point), and would reduce the cost of reducing minimum ABP balance requirements.
- **Super funds face a business cost challenge** – Operating a product with operational complexities and small balances is likely to be cost-ineffective, although this challenge is likely to shrink over time as the system matures and balances grow. However, small ABP balances is only one of many areas where super funds face member cross-subsidisation challenges. Other examples include operating and investment fees, insurance design, engagement programs, and retirement income strategy development costs. Whether avoiding cross-subsidisation across ABP members is appropriate is debatable.
- **Consideration of capital reserve or contingency accounts** – The linkage between small ABP balances and the minimum drawdown rules warrants consideration. Many low balance retirees are currently required to draw a very modest income, but may be better off using their modest assets in super as savings they can access as and when required. This leads us to reflect on the merits of what we call a 'contingency account' in this Retirement Explainer, and Treasury called a 'capital reserve' in the appendix of their Superannuation in Retirement consultation paper. Such an account offers scope to allow low balance retirees to access a flexible source of funds while capturing tax benefits.

Our take

Some funds might do more to provide their low balance members with access to an ABP. The benefits would not only be financial, but also include more effective member engagement, and ultimately a fairer system. Given that we estimate 50,000 low-balance members will join the retiree cohort next year, we advocate for steps to be taken as priority. We call on super funds to consider their minimum ABP balances, and Treasury to continue exploring their capital reserve idea as a more appropriate match to the needs of low balance retirees. While the size of the affected cohort will likely shrink as the system continues to mature, this cohort will not entirely disappear, and a sizable number of Australian retirees appear to be impacted now. We think more should be done to assist these members.

David Bell is the Executive Director of The Conexus Institute. Geoff Warren is a Research Fellow with the Conexus Institute, and an Honorary Associate Professor at the Australian National University.

Do sanctions work?

Michael McAlary

According to the US Department of Treasury, there are 38 active sanction programs. Are these programs working? Historically, sanctions have worked because there has been widespread global support in limiting a country's access to foreign investment and products. Support these days is splitting along Global South/North lines with countries in the BRICS (Brazil, Russia, India, China, South Africa) family finding ways to circumvent the sanctions and thus minimising their effects.

Sanctions on China do not appear to be working because of its economic strength and changing relationships with BRICS countries. China's monthly trade surplus continues to increase with July 2024 being around US$100

billion. This surplus is in both US dollars and Renminbi, and as a result, China has become the largest creditor country in the world and is lending the currency (USDs) of the largest debtor country in the world, i.e., the USA which also has the world's reserve currency.

Countries subject to sanctions are circumventing them through a range of actions:

1. Trading in local currencies to avoid the US controlled SWIFT system
2. Pricing discounting on their products
3. Finding new markets
4. Adjusting supply chains
5. Creating new alliances.

For the above reasons and because the US is selectively applying the sanctions and, in many cases, hurting its allies, sanctions are no longer working with the force they used to.

Below are some examples of sanctions and their consequences:

1. Huawei - In 2019, the US government placed sanctions on Huawei, a Chinese technology company over concerns of spying through its technology and specifically the mobile phone. Readers may recall that Huawei's Deputy Chairperson, Meng Wanzhou was arrested at Vancouver International Airport on an arrest warrant from the US who sought her extradition from Canada for fraud and conspiracy to commit fraud by circumventing US sanctions on Iran. A political solution was reached, and she was released.

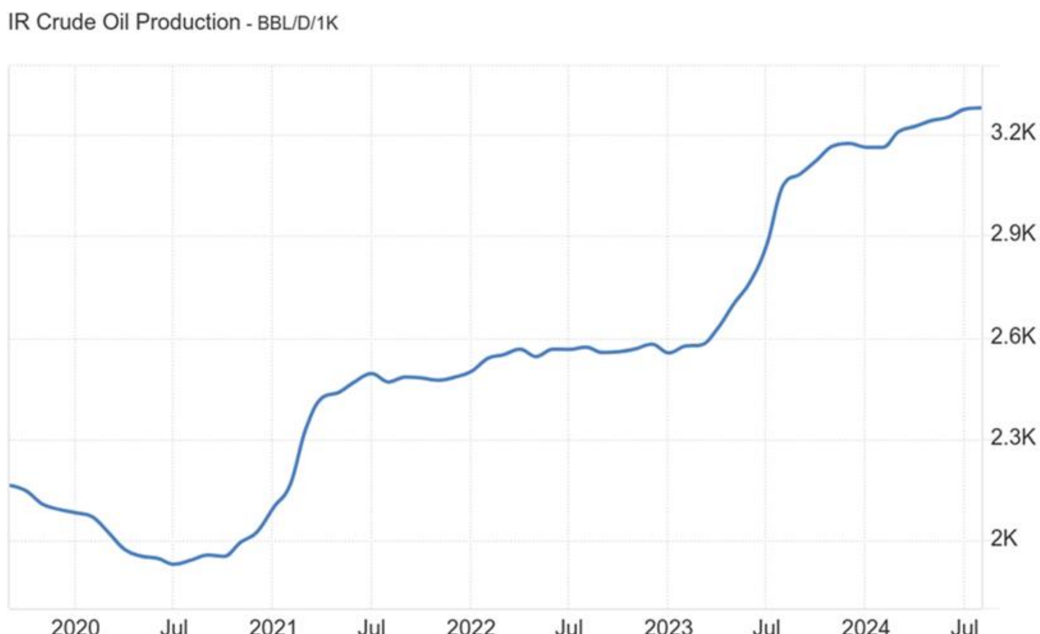
Huawei responded to these sanctions by developing supply chains outside of US control and increased its product range and invested in start-ups further growing its profitability. US corporations have had to find alternative products to Huawei which have turned out to be more expensive or have had to find ways to work around the sanctions.

Interestingly, it has been the Pentagon (US military) that since 2019 each year asks and receive a sanction waiver because of its dependency on Huawei products which the US government will not provide to US corporations.

The US government continues to pressurise non-US companies, e.g., Dutch company ASML that earns half its revenue from China to discontinue trading with Huawei. ASML's share price has collapsed because of the sanctions.

2. Oil - Both Iran and Russia are under US oil sanctions, yet their oil revenues have grown. In July 2024, according to Russian budgetary data, its oil and gas revenues grew by 41%. Since 2020, Iran crude oil production has gone from about 1.75m barrels per day to 3.3m barrels per day as shown in the graph below.

Figure 1: Iran Crude Oil Production



Iran sells its oil in non-USDs and at a discount to China, India and South Korea, a close US ally.

3. Batteries - CATL, a Chinese company, is the world's largest producer of batteries for Electric Vehicles (EVs) producing batteries for Tesla, VW, Toyota, etc., The US Secretary of Defence, wants to ban CATL products. Time will tell as there are enormous implications for the US and world's car industry, if this ban occurs. This will be a 1st import ban of Chinese products, as the US has relied on tariffs for imports and bans for exports.

4. Flight paths - US sanctions require US airlines, e.g. United, Delta to fly around Russia, increasing flight times and fuel costs because of the extra distance. This is forcing prices up for western airlines while Chinese airlines that can fly over Russia are now taking market share because of these sanctions. One of British Airways most profitable and popular routes was London to Beijing. This flight now takes 11.5 hours on British Airways, whereas on Chinese airlines who are flying over Russia, the flight time is 2 hours shorter and their lower cost structure means increased market share and profitability. Passengers may not like the movies and food on Chinese airlines, but they do like the cheaper price and shorter flight time. Consequently, British Airways is giving up this route because it can no longer compete because of the US sanctions. This is another example of US sanctions hurting US allies.

5. Graphite - Batteries need graphite and China has a monopoly on refined graphite. In 2023, China imposed strict export controls on graphite in response to US sanctions. The major expansion plans of US corporations in building new factories to produce batteries are now slowing down because these factories need graphite. China mines 66% of the world's graphite, it controls 60% of the synthetic graphite and it produces 98% of the anodes. More recently, in response to US sanctions, from 15 September 2024, China the world's largest exporter of antimony has set down very strict export controls. Antimony is a critical mineral used in armour-piercing ammunition, infrared sensors and precision optics, as well as solar panels.

Sanctions are no longer as effective as in the past and not likely to be in the future, if the world continues down the multi-polarisation path.

Michael McAlary is CEO of Chairmont Group and Managing Director of WealthMaker Financial Services, a family office that provides investment, financial planning and mortgage broking services. This article is for general information only and has been prepared without taking into account your personal objectives, financial situation or needs.

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