Firstlinks
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## Editorial

*our usual editor James Gruber is taking a well-earned break, so I've been tasked with bringing you the 581st Firstlinks. Thanks for having me back.*

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Among other things, finding stories for Firstlinks each week involves attending industry events and discussions.

Quite often the conversation at these events revolves around macro topics that, while interesting, are more pertinent to investment managers (and their short-term performance) than the long-term goals of our audience.

Here is a sampler of what you can expect people to talk about:

- What the economy at home or in the US will do in the next six months
- What the next interest rate decision might be
- What positioning *might* help an investor outperform with all of those things in mind.

As a result, it can be quite hard to glean insights that are truly valuable to the individual investors, who are generally more focused on achieving their financial goals rather than having a good quarter or year.

For that reason, I have got into a habit of asking speakers to share an investment or theme they are enthusiastic about regardless of what happens at the macro level. The most interesting answer I've had yet came from Janus Henderson's Josh Cummings, who gladly offered up two themes.

The first theme was companies that deliver the "impossible to replicate" product that are elite live sport events. The fund he co-manages has had exposure to this through several shares including Formula 1, Manchester United, and the Atlanta Braves baseball team.

The rest of this note relates to the second theme he mentioned. Mostly because I thought this theme would be more "played out" by now than it seems to be. And also because it could have some interesting effects in Australia.

**Still early days for e-commerce?**

If I were to ask you what percentage of retail revenue in Australia was generated online, what would your guess be?  If you guessed somewhere around 50%, you'd be way off. Even if you said 20%, you'd be miles away.

According to NAB's study of retail data for the year to July 30th, the answer is something closer to 13.5%.

That was a smaller number than I expected, and it is mostly due to how people buy their groceries. Grocery shopping makes up 40% of Australia's retail spend, and over 93% of these purchases are still made in store.

Reasons for groceries being e-commerce's Achilles heal for so long aren't hard to grasp. For one, selling groceries online is a harder and more costly business to run than selling groceries in a store. The seller has to pack and sometimes deliver each customer's shopping rather than the customer taking it home themselves.

Selling and shipping food is also harder than selling other goods online - food deliveries are a lot bulkier than your average Amazon package, and they are more likely to decompose in storage or be damaged in transit. As Cummings put it, there's a reason Amazon started with books and not eggs.

**Figure 1:** Online share of Australian food sales


*Source: ABS [Retail Trade Data]()*

Yet the tide continues to grind slowly in favour of eGroceries - even in Australia, which has always been a long way behind countries like the UK when it came to ditching the shopping trolly for the digital cart. The 6.4% of Aussie food sales made online in August 2024 compares to 6% a year earlier and is easily more than double the 2.7% from 2019.

Covid pulled a lot of growth forward, with online sales peaking at 7.4% of total food sales in October 2021. But the long-term direction of travel is clear.

**How far could this go?**

Finding reliable and easily comparable data from other countries is hard. And it's not like you can just copy and paste the adoption rate of one country across to another – especially when you are talking about a country like Australia.

But just for some context:

- Data from the UK's national statistics office suggests that 9% of sales from 'predominantly food' stores were made online in August 2024.
- A report by Agriculture and Agri-Food Canada estimated that e-commerce's share of US grocery sales in 2023 was 11.8%, up almost 2x from 2019.

**Figure 2:** Growing well before COVID: Online share of food store sales in UK


*Source: [UK ONS]()*

Both countries obviously saw big bumps from Covid. But it's not as if eGroceries weren't taking share from in-store sales before the pandemic.

Whatever way you cut it, Australia still potentially has a long way to go when it comes to online grocery sales.

**Who stands to benefit?**

As investors, we aren't just interested in the trends themselves but in which companies might stand to benefit from them.

On headline numbers from August's reporting season alone, you might think that the most obvious beneficiaries from the shift will be Woolies and Coles. Woolies championed a more than 20% uptick in e-commerce sales in Australian food business and Coles bettered it with a 30% lift.

I'm not so sure and see three potential issues here.

1. Our retail analyst at Morningstar, Johannes Faul, sees a potential problem if (as is most likely the case) these are not incremental sales. If revenue simply shuffles from a more profitable channel (in-store) to a less profitable one, this trend could actually hurt supermarket earnings – unless scale and investments in technology improve the economics of online.
2. Could online customers be less loyal? My choice of supermarket is usually dictated by two things: 1) the store's proximity to where I live and 2) to what extent I can be bothered driving. This means a lot less if I shop online and get it delivered. I'm sure supermarkets will invest heavily in loyalty programs to combat this. But that's even more cash out of the door.
3. Longer term, what if Amazon really manages to crack groceries in the US and brings a "your profit margin is my opportunity" approach to Australia? Coles and Woolies would then be competing with a low price juggernaut and one of the world's best loyalty programs in Amazon Prime.

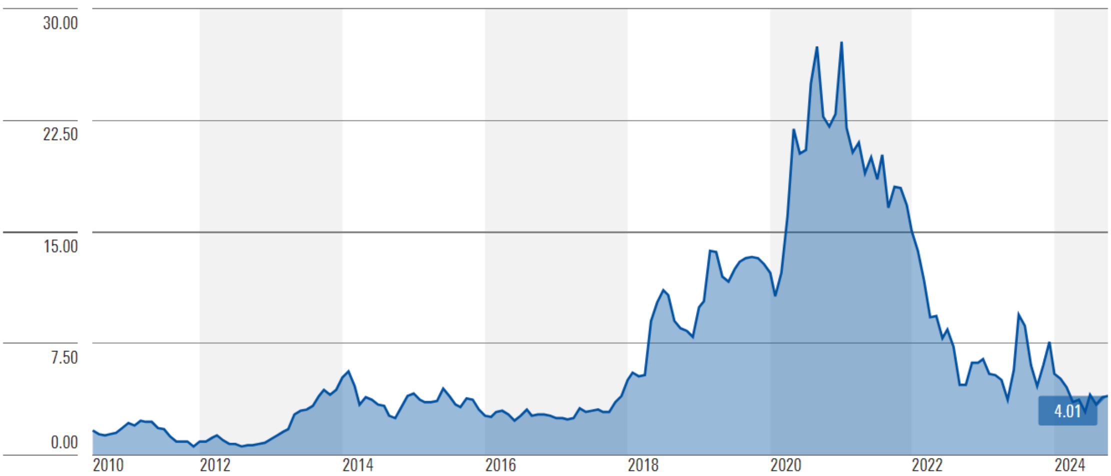
**A better way to play it?**

When you consider that Australia spends $170 billion every year on food, every 0.5% of share taken by online represents $850 million more in spending. Do those sums for bigger markets like the US and you get even sillier numbers.

My thinking? Platform businesses able to skim a few basis points in commission from those amounts could do quite well. Amazon's marketplace obviously counts here. As do other platforms that lend their logistics networks and customers to retailers. Whenever I've ordered a Coles delivery, for example, I have used Uber to order it. Uber own the customer relationship with me and presumably charge Coles to generate sales on their platform.

Another interesting one could be the UK-listed Ocado. Ocado found a way to make online food retailing work and now sells its logistics and warehousing expertise to supermarkets worldwide (it is Coles' major partner in their online push).

**Figure 3:** Ocado share price chart




*Source: Morningstar*

As you can see from the chart above, Ocado has ridden this wave before only to be dumped hard. I have also found the way Ocado describes its business and cash flow potential rather confusing in the past. But if the eGroceries trend is bigger and earlier than many people realise, maybe I should try again.

**Joseph Taylor**

***In this week's Firstlinks...***

Couples with a big age gap face unique challenges when it comes to retirement planning. **Glen James** fleshes out some of the big financial and non-financial things to consider, and explains why having a frank conversation – and having it as early as possible – is essential. Read more here.

Many market participants today have been swept away by the need for quick returns and validation of their opinion. **Chris Mackay** from MFF makes a case for ignoring the noise and instead practicing old-fashioned patience and focused analysis of companies and industries. Investors who can do this while making the most of the unprecedented technology at our fingertips can add plenty of value.

Building your own home usually sees your dream outcome collide with reality at some point. And in many ways, building an investment portfolio ready for the ups and downs of financial markets isn't too different. **Jamie Wickham** provides a framework for real world portfolio construction.

Rob Arnott once said that "in investing, what is comfortable is rarely profitable". Yet buying assets at or near the 'point of maximum pessimism' can be extremely hard. In an extract from his new book, **John Addis** reveals how to fight your evolutionary instincts, feel the fear and buy anyway.

Investors today are faced with highly concentrated markets and a lot of noise about elections, AI, interest rates and other factors with the potential to affect markets. **Ted Maloney**, Chief Investment Officer and CEO-elect of MFS sat down with me to discuss what really matters for investors seeking long-term success.

Prolonged periods of geopolitical tension don't usually set the scene for stellar equity market returns. With this in mind, investors may benefit from considering assets that have fared better in such environments in the past. **Ray Jia** makes the case for gold's role in a portfolio at times of high geopolitical tension.

Sydney Swans flunked the AFL grand final again and **Tony Dillon** thinks a well-meaning rule change in 2016 might have played a small part. In this article, he uses data to show the changing face of AFL finals and explains why AFL bosses are unlikely to be sad about the outcome.

Lastly, in this week's whitepaper, **Neuberger Berman** compare returns from Evergreen and Traditional funds.

**Curated by James Gruber, Leisa Bell and Joseph Taylor**

## The quirks of retirement planning with an age gap

### Glen James

Planning for retirement can be a complex process, even for people with relatively simple circumstances. And let's be honest—most people don't have uncomplicated situations. Having a long-term partner, for example, adds complexity. If you've experienced a breakup and found a new partner, that brings even more layers. Add children into the mix, and things become even more intricate!

While those scenarios are challenging but common, it becomes even trickier when there's a significant age gap between partners. These situations are less frequent, and often overlooked in retirement planning discussions.

I've worked with many couples where the age difference led to friction. In most of those cases, the trouble stemmed from a lack of early discussions about their personal and financial goals. It's not just the financial aspect—both partners need to be clear about what they want out of life. One partner may be winding down their career and looking forward to the freedom that retirement brings, while the other is still deep in the throes of their career. This can lead to feelings of impatience, loneliness, or even a sense of lost opportunity if one partner feels they are sacrificing their dreams for the other. Acknowledging these emotions can make a significant difference and make figuring out the practicalities of your age difference much easier to navigate.

**Key considerations for retirement planning when partners are of different ages**

For couples early in a relationship who hope for long-term success, there are three key factors to consider: lifestyle, financial plans, and estate planning.

**1. Lifestyle**

When couples from different generations come together, they typically have shared interests that bring them closer. But are those enough to maintain a relationship over time? Do their different life stages mean their goals might eventually clash?

Having an age difference means that you might not always be on the same page, but you should at least understand the other person's perspective. For instance, a 60-year-old might be eager to explore the country on a long caravan trip, while their 45-year-old partner is still busy with their career. These aren't financial issues—they're more about how each partner views life and what they want, which is equally important to address.

It's also worth considering the impact of health and energy levels. As people age, their physical capabilities naturally change. Will both partners be in a similar place physically when it comes to activities like travel, hobbies, and social engagement? What happens if one partner experiences health challenges earlier than expected? These are difficult, but necessary, conversations to have.

**2. Financial planning for couples with age differences**

When discussing finances, the focus doesn't have to be on the age gap itself—it's about how each person sees and handles money. What's your attitude toward money? Is it simply a tool, or does it carry deeper meaning? Are you a spender while your partner prefers saving? Will you combine your finances or keep them separate?

There aren't necessarily right or wrong answers to these questions, but they do need to be discussed. Once you've both clarified your views, you can develop financial strategies that work for your future together. For example, when one partner reaches the Centrelink age pension eligibility age (67), both of their income and assets are assessed for eligibility. If the younger partner is under 67, any money in their superannuation isn't counted in that assessment. These are the kinds of nuances that make retirement planning more complicated for couples with a significant age difference. There may be some opportunities in this scenario to maximise the age pension entitlements.

It's a smart move to consult a financial adviser early in the relationship to ensure you've considered all potential scenarios. In addition, it's wise to regularly update your financial plans as circumstances change—whether that's a shift in income, health status, or unexpected life events.

**3. Estate planning**

Estate planning is a critical aspect of preparing for retirement, particularly for couples with an age difference. As one partner may pass away earlier, it's essential to have a clear plan for how assets will be distributed. This is especially important if there are children from previous relationships, as it can prevent disputes and ensure that all parties are provided for. Having legal and valid will for each offers certainly for both partners, safeguarding the financial well-being of the surviving partner. Without these safeguards, the younger partner may face financial insecurity or legal challenges. Further to this, it's important to ensure there are Power of Attorney documents set up for each. Estate planning brings peace of mind, knowing that both partners and their loved ones are protected as they approach and live in retirement. Part of your estate planning will be ensuring superannuation beneficiaries are set up, housing arrangements if there is a blended family and the home is to eventually form part of one spouse children's inheritance but not the other spouse children.

**So what do you do?**

Both partners in a relationship, especially with an age gap, come into it as established individuals—no one is starting with a blank slate. Having open, early discussions to identify any major points of conflict can be incredibly helpful. And frankly, this is great advice for all couples, regardless of any age difference. I believe it all comes down to expectation alignment, from both people. Have the conversation and have it now.

*Glen James is a former financial adviser and the creator and host of the Retire Right and money money money podcasts.*

## The everything rally brings danger and opportunity

Chris Mackay

*The following is an edited extract of a presentation from MFF Capital Investments' Managing Director and Portfolio Manager Chris Mackay at the company's recent annual general meeting.*

Risk and Opportunity are never far apart. It would be more comfortable but imprudent to talk only of the Federal Reserve cutting interest rates, of China's belated stimulus multiplying around the globe, of Goldilocks, of the owners of capital riding sustained increases in record market prices for most asset classes plus better interest rates on their bonds than they have had for decades.

Most importantly – and before we get distracted by risks or anything else – now is the time of greatest opportunity for many. Including calm, rational knowledge seeking investors. A few decades ago, it was impossible to access knowledge easily. Now, in an instant, we can go back centuries to first principles.

Steve Jobs famously studied Aristotle and wished to know what Aristotle might have thought about digital technologies' ability to deliver the knowledge and learnings of modern geniuses as well as centuries of cumulative knowledge. In business, we have at our fingertips the combined experience of thousands of failures and successes, the track records of the greatest entrepreneurs, capitalists and investors.

**A desire for quick validation and few questions**

Concurrently, in markets, opportunity has the huge advantage that the Index has conquered the world and has been perverted even beyond what Jack Bogle feared. Market players today require immediacy of reward and validation of opinion.

Many trillions of dollars are misapplied on the basis of 140 "characters" of false opinion. On predictions of short-term unknowables. Trumped up cats and dogs of narrow ETFs. Record single day option and meme trading. Agency fallacy idiocy that higher prices for illiquidity or opaque black box lock-ups better protect capital. Active decisions that are handed to index providers, provided that they are labelled passive and fee-takers take but don't think to question.

Beliefs are embedded into marketing, and huge incentives and institutional imperatives retard prospects of change. They reinforce the narratives and nothing exceeds like success. Bertrand Russell decided that most people fear thought as they fear nothing else on earth. This applies to 2024 markets despite the massive advantages of technology, which should unlock curiosity.

MFF's opportunities are better and our risks of permanent capital loss smaller when most do not seek to question and understand the WHY of principles and processes, the how of business operations and valuations and refuse to accept ambiguity, to challenge shortcuts, the beliefs and truisms of appearance.

Contrary to today's noise, and despite the Intelligent Investor being first published 75 years ago, successes in markets continue to include sensible rationalists, to outsiders willing to use old-fashioned patience and focused analysis, now aided by vast tools of new technology.


**History rhymes**

Why the Giraffe? Why the advertisements from Australia's leading mortgage trust from before Australia's last real recession, before many were born, before Victoria almost was bankrupted and Royal Commissions were held into economic collapse and mismanagement?

In Australia in the early 1990s, it was not about equity speculation as euphoria had not returned after the heavily borrowed paper entrepreneurs evaporated with the 1987 market crash aftermath. Early 1990s risks were disguised by the success of yield chasers which encouraged greed and envy and of course fraud and total devastation.

In the 2020s, the 'everything' rally amazes, with direct and second order risk effects building over time. Yield chasing has become rampant with myriad promotions providing everyone with extra percentages and basis points, except in Omaha where US treasuries are rolled over month after month.

As many companies report reduced revenues, profits and forecasts, their share prices gloriously uncouple from the drudgery, whilst cost of living pressures bite hardest on non-asset owners. Anti-business, anti-growth regulations, decisions, commissions and enquiries, fines, taxes and tariffs are becoming more popular as many voters favour populists and socialists, rejecting responsible, prudent societal growth policies.

However, unlike the early 1990s there are massive booms going on in all things digital and in financialisation. Massive efficiency benefits of the internet, mobile data and communication and digitization is followed by general artificial intelligence. The profits of digital businesses and networks have exploded, and equities have followed - as have alternative investments. Real technology benefits accrue to some businesses on revenue and to more on costs. Alphabet technologists already use AI with leading health insurance companies to cut half hour human tasks to mere seconds for each of many thousands of claims.

Of course, euphoria loves technological success and breakthroughs to amplify rather than replace market economic cycles. Alphabet's Google easily finds credible research that a small minority of equities represent total sustained above inflation returns over decades and very few animals sustain the heights of giraffes.

**Benefitting from irrational markets**

We sometimes benefit when markets are irrational. In early August, the Japanese equity markets fell more in a short period than they had in over 30 years: 20% in less than 2 days. Other markets collapsed in sympathy. We dropped everything, assessed causes and anticipated effects, and swapped our steady selling for some buying. The rebound happened within days, which was not to our favour as we are investors who can hold high quality businesses for decades.

Despite equity markets generally being high by historical standards and volatility modest over recent years, we have found a few opportunities where high-quality companies within our focus areas have been underpriced. Even very large companies have periodically been materially underpriced, sometimes because of disillusioned, panicked forced sellers.

Although these recent opportunities have been okay, low risk and high probability opportunities with massive margins of safety are rare and we have not seen them recently. Our process is to be prepared but, in the meantime, to earn from more moderate mismatches and from compounding gains in the high quality businesses we hold.

Currently it is fashionable to rebalance towards lesser quality businesses and demonstrably less attractive market jurisdictions as most market participants chase short term rewards and overweight lower probabilities with perceived higher potential payoffs. But history indicates lower aggregate results. Better to instead read Benjamin Graham's warnings about lower quality and late cycles.

**Keep the focus on individual companies and industries**

In assessing risks, the primary focus is upon individual companies and industries within the context of the portfolio. If we were required to invest directly in so-called emerging markets, so-called macro considerations would loom larger than simply saying "no thank you".

Many will have seen the charts for share price returns for the greatest emerging market which net out to about zero over 20 years. Specificity also applies to opportunities; for example, markets underestimating the potential for profitable growth for a small number of extraordinary companies which can comprise significant holdings in the portfolio.

Broader risk assessments currently include high levels of government and consumer debts (with unconstrained, unfunded election promises currently not dissuaded by the recent UK Truss crisis), geopolitical issues, ageing demographics, immigration, competing deflationary and inflationary pressures, which mean that margins of safety (or margins of error) should be wider than in recent decades of digitization and globalization benefits plus low inflation and interest rates.

For those interested in the very short term and overall markets, our views are of limited value. It is best to ignore much of the Noise that derogates from core fundamental processes and risk controls must consider alternatives. Less time is wasted if we do not predict but focus upon understanding businesses, their cycles and current details in comparison with market prices. The best bargains are when outlooks are bleakest.

*Chris Mackay is Managing Director and Portfolio Manager [MFF Capital Investments](#).*

## Portfolio construction in the real world

### Jamie Wickham

Building an investment portfolio is akin to building or renovating a house. You have a dream home in mind, but there are practical issues to consider - budget, compliance, design and construction challenges. You may love the dream, but those are real-world parameters you can't ignore.

Similarly, if you want your investment portfolio to help you achieve your goals in life, you need to keep a whole range of variables and often opposing practicalities in mind.

This article presents a framework for thinking about these challenges, using the interplay between risk, return, time horizon and the likelihood of negative returns for different asset allocation profiles.

The analysis is based on 30 years of rolling monthly returns to 30 June 2024, and incorporates the most common asset allocation profiles we use among our clients. These various growth/defensive portfolio splits are 60/40, 75/25 and 85/15.

This is important because your decision on asset allocation, specifically the mix of growth and defensive assets, is pivotal. In fact, it can drive 94% of your return - according to the often-cited 1986 study "Determinants of Portfolio Performance" by Brinson, Hood and Beebower.

So let's get into the detail and look at how these different allocations work.

**Asset allocation profiles**

| Asset Class | Balanced – 60/40 | Growth – 75/25 | High Growth- 85/15 |
|---|---|---|---|
| Australian shares | 30 | 35 | 35 |
| International shares | 15 | 25 | 35 |
| Property and infrastructure | 15 | 15 | 15 |
| Growth | 60 | 75 | 85 |
| Credit | 14 | 0 | 0 |
| Bonds | 20 | 21 | 13 |
| Cash | 6 | 4 | 2 |
| Defensive | 40 | 25 | 15 |

*Source: Minchin Moore*

Each asset class here has a specific role to play relative to the portfolio objective. For example, the Balanced portfolio is typically more appropriate for those in need of cashflow – hence the greater allocation to shorter duration, floating rate credit and cash.

Conversely, the High Growth portfolio is built to deliver capital growth, and therefore its defensive portion is designed to protect against equity market volatility.

**Controlling the controllable**

Markets are inherently uncertain and none of us has a crystal ball. For all the pundits forecasting the trajectory for interest rates or the impact of the US election on markets, there are others who admit they know what they don't know, accept the uncertainty and focus on the controllables.

One thing you *can* control is building an efficient and durable portfolio – one that is based on sound investment principles; one that is aligned to your objectives, horizon and risk appetite; and one designed to give you the best chance of meeting your goals while controlling for risk along the way.

Diversification across asset classes is foundational to this approach. It will not only determine your return but will allow you to minimise volatility.

The table below shows the returns and risk of key asset classes over the same 30-year period (included as a reference point relative to risk/return for the asset class profiles).

| | Australian Shares | International Shares (unhedged) | Property & Infrastructure | Credit | Bonds | Cash | CPI Inflation |
|---|---|---|---|---|---|---|---|
| Average Return | 10.1% | 9.3% | 9.1% | 5.6% | 6.5% | 4.2% | 3.2% |
| Highest Return | 47.0% | 56.6% | 45.2% | 20.1% | 20.6% | 8.0% | 9.4% |
| Lowest Return | -41.7% | -33.4% | -31.8% | -6.2% | -12.9% | 0.0% | -0.4% |
| Standard Deviation (Volatility) | 14.0% | 16.6% | 15.2% | 3.8% | 5.1% | 2.1% | 2.2% |

*Source: Minchin Moore, ABS, Dimensional*

**The risk-return relationship**

The relationship between return and risk should be your starting point. To achieve higher returns, you need to take on greater risk. To take on more risk, you need more time.

To demonstrate this, look at the table below, which references rolling monthly annual returns. As expected, the returns increase incrementally from left to right. So far, so good. But note:

Relative to the volatility shown in the table above, the asset class *profiles* have meaningfully *less* volatility than the growth asset *classes* (shares, property and infrastructure). For example, High Growth returns slightly lag Australian shares (9.1% v 10.1%), but it delivers a material reduction in volatility (10.9% v 14%). That is the power of diversification.

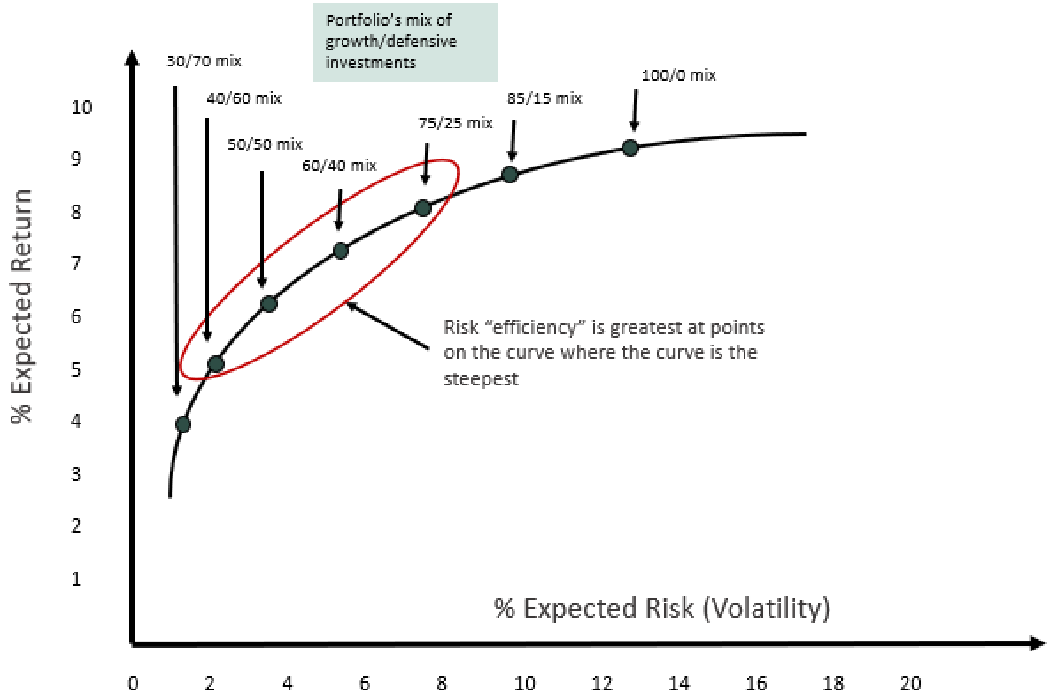
Note also that the increase in standard deviation (the volatility of returns) is relatively more than the increase in return as you move from Balanced to Growth to High Growth. In other words, the relationship between return and risk is non-linear.

| | Balanced | Growth | High Growth |
|---|---|---|---|
| Average Return | 8.1% | 8.7% | 9.1% |
| Highest Return | 25.5% | 28.8% | 31.6% |
| Lowest Return | -19.2% | -24.2% | -27.1% |
| Standard Deviation (Volatility of Returns) | 7.9% | 9.6% | 10.9% |

*Source: Minchin Moore*

To show this another way, let's look at the "efficient frontier".

The chart below plots a series of portfolios from those with less expected risk/volatility (and therefore lower expected returns) to those with a greater allocation to growth assets such as the 85/15 portfolio, which exhibit higher returns and greater risk. Optimal portfolios sit on the curve (the frontier) and are optimised to maximise expected return for a given level of risk or conversely, minimise risk for a given level of expected return.




*Note: Not to scale, for illustrative purposes only*

You can see that risk "efficiency" is greatest where the curve is the steepest. Here, you expect relatively higher return for taking on incremental risk. But as the curve flattens out at a greater allocation to growth assets, the opposite occurs – you need to take on relatively more risk for incremental return.

This means finding that optimal mix is an important consideration. It influences not only headline returns, but the amount of risk required to achieve those returns. Yes, taking on additional risk beyond the 75/25 portfolio brings additional return, but it comes at a price.

**Time is of the essence**

Your time horizon and allocation to growth assets are directly correlated. For a growth objective, you need more time for the portfolio to withstand inevitable volatility. The higher the allocation to growth assets, the more probable there will be extended periods of negative returns.

The table below shows the maximum, minimum and average return for the rolling monthly data series – across different periods and asset allocation profiles. It also shows the likelihood of a negative return over those periods.

Note there are zero instances of negative returns over a 10-year time period for all asset allocation profiles. Over a shorter period, there is a marked difference between the profiles – the likelihood of a negative return for High Growth over three years (14%) is double the Balanced profile (7%).

Two key lessons here: First, your time horizon matters. Time allows portfolios

| | | Balanced | Growth | High Growth |
|---|---|---|---|---|
| Rolling 1 yr Returns | Max | 26% | 29% | 32% |
| | Min | -19% | -24% | -27% |
| | Average | 8% | 9% | 9% |
| | % positive | 83% | 81% | 80% |
| | % negative | 17% | 19% | 20% |
| Rolling 3 yr Returns | Max | 17% | 19% | 21% |
| | Min | -4% | -6% | -8% |
| | Average | 8% | 8% | 9% |
| | % positive | 93% | 91% | 86% |
| | % negative | 7% | 9% | 14% |
| Rolling 5 yr Returns | Max | 14% | 15% | 17% |
| | Min | 0% | -1% | -3% |
| | Average | 8% | 8% | 8% |
| | % positive | 100% | 95% | 94% |
| | % negative | 0% | 5% | 6% |
| Rolling 10 yr Returns | Max | 11% | 11% | 12% |
| | Min | 5% | 4% | 3% |
| | Average | 7% | 8% | 8% |
| | % positive | 100% | 100% | 100% |
| | % negative | 0% | 0% | 0% |

*Source: Minchin Moore, ABS, Dimensional* to grow and compound. During drawdowns, time allows portfolios to recover. The deeper the drawdown, which is directly correlated to the allocation to growth assets, the more time it needs to recover.

Second, discipline matters. Our experience is the trauma of sustained negative periods can encourage emotional and counter-productive decisions among some investors. But those armed with discipline and a well-constructed investment framework are better equipped to weather the storm.

**Conclusion**

Building a portfolio is like building a house. You need a framework that starts with clarity on your goals, time horizon and risk tolerance.

- Construct a portfolio with the right growth/defensive mix relative to that plan. Don't ignore risk – you can give up some return and dampen volatility meaningfully by diversifying across asset classes.
- Focus on the controllables – the plan itself, diversification, and keeping your costs down. Focus more on what you know (as opposed to what you think might happen) and what this historical data tells you.
- Discipline matters. The investing concepts here are straightforward. Keeping your nerve is the hard part - don't be distracted and let your emotions overrule the plan.

*Jamie Wickham, CFA is a Partner at Minchin Moore Private Wealth and former managing director, Morningstar Australia.*

## Feel the fear and buy anyway

### John Addis

*This is an extract from John Addis' new book How Not to Lose $1 million. The extract itself was first written in August 2011.*

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*'One broker (The Clown of Collins St) came in yesterday saying "Capitulation over … now's the time to buy ... expect a short-term rally of 3–4%". D***head. Typical of the "guess, guess and guess again" value add of some financial professionals.'* **Marcus Padley, Crikey, 9 August 2011**

As things transpired, the d***head was right. A few hours after those words were published, the ASX All Ordinaries index had risen not 3 or 4 percent but 5. Whether stocks are rising rapidly or crashing, the market makes fools of us all.

Value investors implicitly understand that cheap stocks are a product of pervasive fear just as expensive stocks are an expression of greed. But in both cases, when the time comes to act, many of us stumble.

Often, it's not our value investing skills that fail us but our psychology. What follows is a dose of psychological fortitude to help you avoid critical mistakes and profit from the opportunities in collapsing share prices.

**1. Hold cash and ensure it is quickly accessible**

Affording you the ability to act quickly, cash is not a dead asset. When prices are cheap and opportunities plentiful, cash is the source of future returns. If you haven't accumulated much of it during the good times, take some tough decisions. Don't hold stocks in your portfolio just because they've been there for years when better opportunities exist outside it.

Ensure that cash is not stuck in a three-month term deposit or requires an overnight bank transfer before you can use it. It should be available through your broking account at a moment's notice.

**2. Have a watch list with buy prices**

A watch list is a great technique to sideline emotions that can prevent you from acting. If you know what you want to buy and at what price, you'll be more likely to act when the time comes.

Developing a watch list gets the commitment principle working in your favour, especially if you show the list to friends or display it in a prominent place so you get social proof working for you as well.

**3. Prepare an action plan; buy gradually**

Now you've got the cash and an idea of what you want to buy at a particular price and yield, you need an action plan. This technique relies on you committing to a course of action before gut-wrenching emotion takes over.

Do not pile in all at once. Buy gradually, acquiring more shares as prices fall. Buying at the point of maximum pessimism is a great ideal but impossible to confidently execute without the benefit of hindsight. Buying gradually in fearful times and sticking to high-quality companies at prices cheap enough to offer a good margin of safety is a more realistic aim.

**4. Stick to portfolio limits**

There's every chance that a few of the stocks in your portfolio won't work out as you expect. That is the nature of investing. These failures might do to a highly concentrated portfolio won't be fatal to a more diversified, well-structured one.

As in many areas of life, we need to stay alive long enough to get lucky. Don't kill your portfolio by loading it up with a few highly speculative stocks. Concentrate on the high-quality businesses and diversify, paying close attention to portfolio limits.

**5. Challenge your evolutionary impulses and buy anyway**

We're programmed to respond to fear because in the past it was a successful way of not being eaten. In the sharemarket, fear inhibits rational, profitable action.

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Whilst these practical steps help you to act when the time comes, we also need to reassert a few fundamental investing truths that conflict with our typical reactions to uncertainty and rapid share price falls:

- If you want certainty, you're going to have to pay for it. When everything's going well, you won't get anything cheap. Bargains are a product of a climate of fear. If you want to buy cheap stocks, you must feel the fear and buy anyway.
- Accept that prices may fall after you've bought. You can't pick market bottoms or tops, but if you're buying high-quality businesses cheaply, that shouldn't stop you from buying more when prices fall further.
- Separate price falls from underlying business performance. The market can be irrational. To avoid getting caught by the herd, focus on business performance, not macro issues (important as they may be) or media headlines. This is the major, long-term determinant of share price direction.


*John Addis is the co-founder of [Intelligent Investor], a value-oriented investment research house and funds management firm. John's new book [How Not to Lose $1 million], published by Major Street, is out now. Firstlinks readers can use the promo code MORNINGSTAR25 at checkout for a 25% discount.*

## The risks of market concentration and not staying invested

Joseph Taylor, Ted Maloney

*The following article is a transcript of a conversation between Joseph Taylor and MFS's CIO and CEO-elect Ted Maloney, who recently visited Australia on a tour of MFS offices in the Asia-Pacific region.*

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**Joseph Taylor:** Hi, Ted. Great to have you here with us today.

**Ted Maloney:** Great to be here. Thank you.

**Taylor:** You're visiting us here from the US and obviously, even here in Australia, we see a lot of headlines about the US economy and the Fed. What's your view on that at the moment?

**Maloney:** We don't have a very differentiated view actually. We think the most likely outcome is the soft landing. Inflation is back in the box. Central banks have managed inflation down to a level that's manageable for the economy and we probably muddle through. But we'll be watching for risks to both sides of that equation, whether we see some weakening on the labor side or some stresses on the inflation side.

We can see scenarios where both of those could happen. We think what's most important is to manage those risks for our clients through a cycle and try to help our clients stay fully invested so they can compound returns through the cycle.

**Taylor:** Most asset classes have performed really well recently and some of them even look quite pricey at this stage. What's the best way for investors to generate returns in that kind of environment?

**Maloney:** Again, I think the most important thing you can do is to stay invested through the cycle for the long term. But as you say, there are some pockets of really high valuations in the market across asset classes.

We think the concentration in a number of indices, including US tech, is concerning. We think those are great companies that obviously have great prospects for the long term. But whenever you've seen markets get as concentrated as some U.S. and global benchmarks are today, it poses real risk for clients. So being thoughtful about real risk versus risk just versus a benchmark is one of the most important things we think clients can focus on today.

**Taylor:** You touched on concentration there, and it's true that quite a small number of names have really driven the broader market's returns. How do you see this playing out in terms of its implications for active managers?

**Maloney:** The exact details of how it plays out are uncertain, but we're reasonably confident that over time, the next five to ten years, markets will become less concentrated and exposure to that concentration will pose real risks.

If you take two periods that we think are analogous to today, the NIFTY 50 and the dotcom bubble, those were the only times that markets got as concentrated as they are today. And if you take any period of time around that level of concentration and look forward five to ten years, the overall benchmarks meaningfully underperformed equal-weighted versions of those benchmarks.

They became less concentrated because the areas of concentration underperformed, and we think that's the most likely outcome over the next five to ten years. Although when that happens, how it happens, what causes it, there's a lot of different scenarios there.

**Taylor:** Perhaps turning to nearer-term drivers, obviously you've got an election going on back home. How does a Trump or Harris victory affect markets from here?

**Maloney:** Politics are very fraught in the U.S. and around the world, and there are lots of important issues on the table. In terms of the ones that most directly affect markets, the policies both candidates are proposing might have some similar impacts. Both of them have different versions of policies that are directionally inflationary. So we think that if they're able to enact those policies, there might be more of an increased risk of inflation. Both are also more protectionist than the U.S. has been over the last number of decades.

In both of those cases, we think they're directionally similar impact and their ability to actually get them through both the legislature and the overall bureaucracy probably puts a damper on both of them. But in terms of market impacts, other than the volatility that could happen around protests and otherwise, we actually don't think it's as big a driver as maybe the amount of attention that it gets.

**Taylor:** Another investment theme that has had a lot of attention is AI. How do you see that having an impact on markets and also on your industry?

**Maloney:** We think that AI is both the most important technological change that the world has ever seen and, simply, the most recent technological change that the world has ever seen. So, it'll have meaningful impact but it'll be a step function and evolutionary.

We think that companies and economic actors that fail to embrace AI will be left behind. We think it'll have dislocating effects in terms of what it means for various parts of the labor market and various consumer drivers. But company by company, market by market, actors in the markets will implement it or not. It'll come back to stock picking, bond picking, understanding the details underneath the macro picture.

**Taylor:** You'll soon move from CIO to CEO of MFS. Congratulations. What kind of opportunities and challenges do you see going forward for the business?

**Maloney:** I think our biggest opportunity is to do what we've done well for 100 years, which is serve clients by prudently allocating their capital through cycles, being stewards of their capital in addition to managers of it, offering them solutions across the full spectrum of public equity and fixed income, and waking up every day with a focus on delivering value for our clients.

Our key lever to that is our global platform of MFS employees working together across the globe. We think that does differentiate us and it takes a lot of work. It takes a lot of investment. As CEO, my primary job is to make sure that we've got the right teams, the right people in the right seats, and importantly, bringing the culture forward to deliver results for our clients.

**Taylor:** Maybe if we could look beyond some of the macro themes, what one thing would you like individual investors to take home from this?

**Maloney:** It may sound boring and simple, but it's actually pretty difficult and extremely important: just stay invested through the cycle. We're here to add value within asset classes, as well as to advise clients on which asset classes to be in. But if you stay fully invested in a diversified portfolio across equity and fixed income for the long term, you're going to do better than just about any attempt to be tactical within that. Clients that sell low and buy high are going to destroy all the value that we and others can add along the way. So, stay invested for the long term. It sounds boring but trust me. It's going to work out.

*Joseph Taylor is an Associate Investment Specialist, Morningstar Australia and Firstlinks.*

*Ted Maloney is chief investment officer at MFS Investment Management, a sponsor of Firstlinks. This article is for general informational purposes only and should not be considered investment advice or a recommendation to invest in any security or to adopt any investment strategy.*

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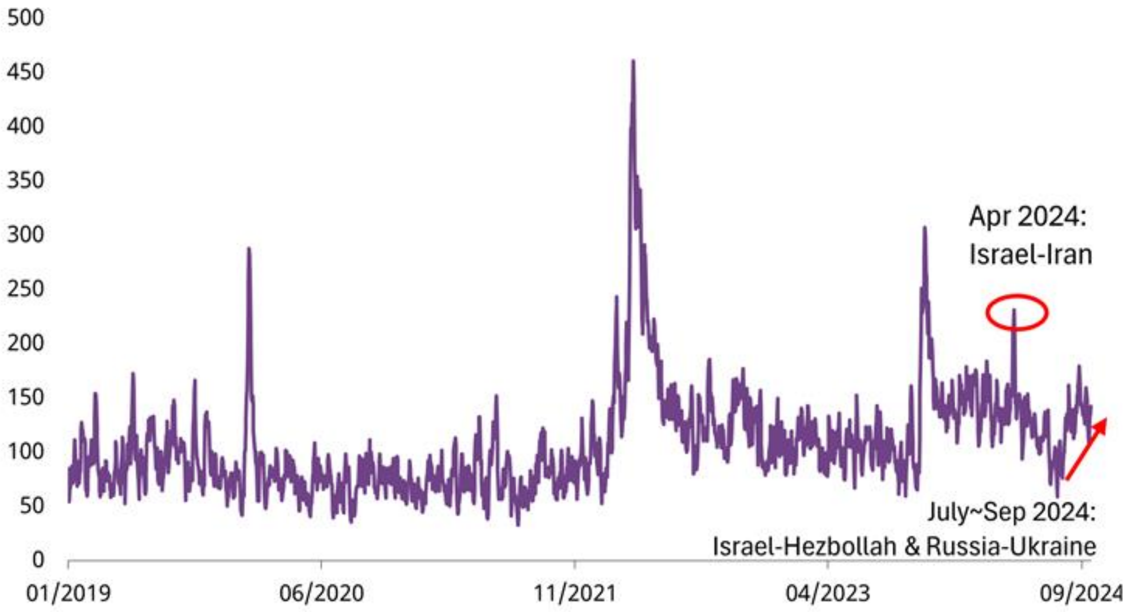
## Gold's important role as geopolitical tensions rise

### Ray Jia

Geopolitical risks have spiked again.

Ukraine's cross-border attack in early August followed by Russia's largest air assault escalated the conflict. Meanwhile, the assassination of Hamas and Hezbollah's political leaders and subsequent retaliatory actions have sharply increased geopolitical tensions in the Middle East. Waves of explosions in Lebanon and Israel's declaration of "a new phase of war" have also raised fresh geopolitical concerns in the region.

**Chart 1:** A period of heightened risks
Five-day moving averages of the Geopolitical Risk Index (GPR), as of 20 September 2024.

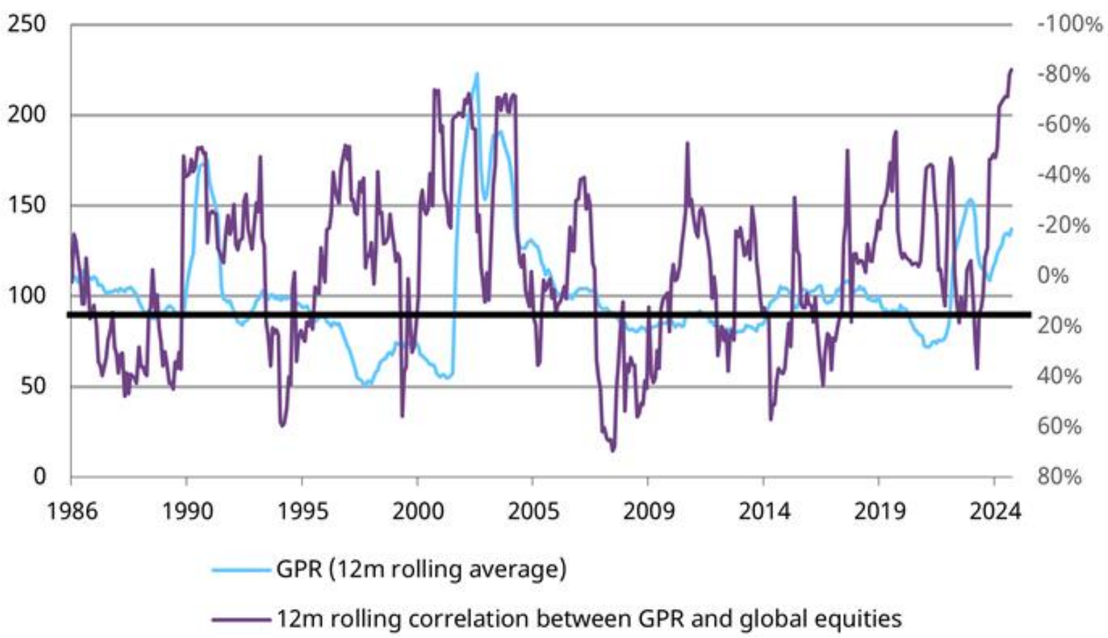



*Source: [matteoiacoviello.com,](matteoiacoviello.com) Bloomberg, World Gold Council*

The Geopolitical Risk Index (GPR) indicates increasingly frequent periods when geopolitical risk is elevated – periods that have been particularly challenging for investors over the past three years. So far in 2024 the GPR Index has recorded 15 spikes – days when the Index surged by more than 100% – on the back of tensions in the Russia-Ukraine war and developments in the Middle East. This follows 31 spikes in 2023, 20 spikes in 2022 and 41 spikes in 2021.

Historical data tells us that when geopolitical risks stay elevated (typically above 100), global equities suffer – evidenced by the negative correlation between the GPR Index and global equity returns (chart 2). Currently, the correlation between GPR and VIX is marching towards a record high.

**Chart 2:** Rising geopolitical risk leads to equity market selloffs
Rolling average GPR index and correlation with the VIX*, as of August 2024.

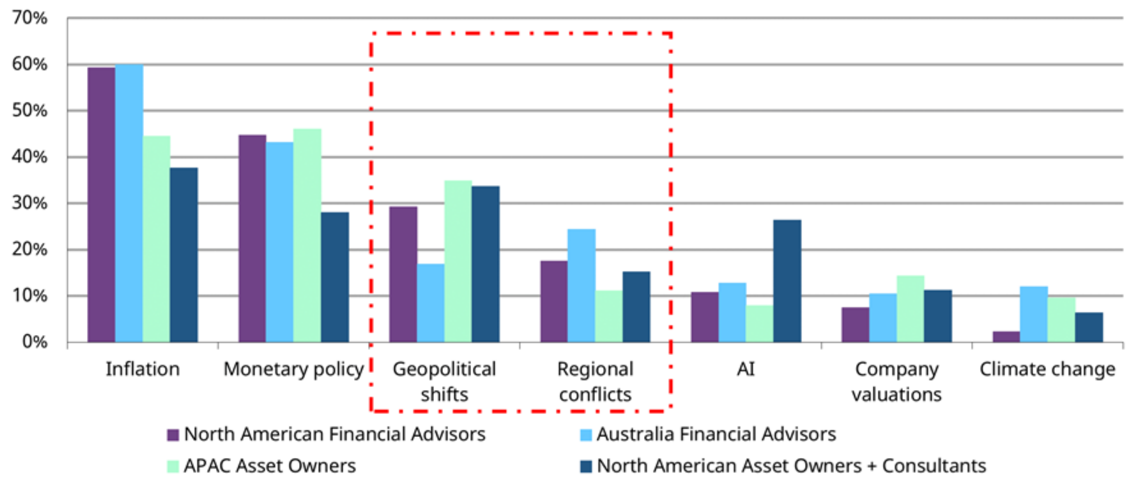



**Based on 12m rolling average of the GPR index and correlation between average monthly changes in the GPR Index and the MSCI World Index. Source: [matteoiacoviello.com,](matteoiacoviello.com) Bloomberg, World Gold Council*

In fact, geopolitical risks have been front of mind for institutional investors for some time.

Based on results from a survey we commissioned last year, geopolitical shifts and regional conflicts are identified by global investors – including Australian financial advisors – as the third and fourth biggest trends affecting their investment decisions (chart 3).[1] Geopolitical instability is also one of the top concerns of [global central banks](#) when it comes to reserve management.

**Chart 3:** Geopolitical risks: one of the top concerns for global investors*
Q: Which of the following are the top two global trends affecting investments right now?

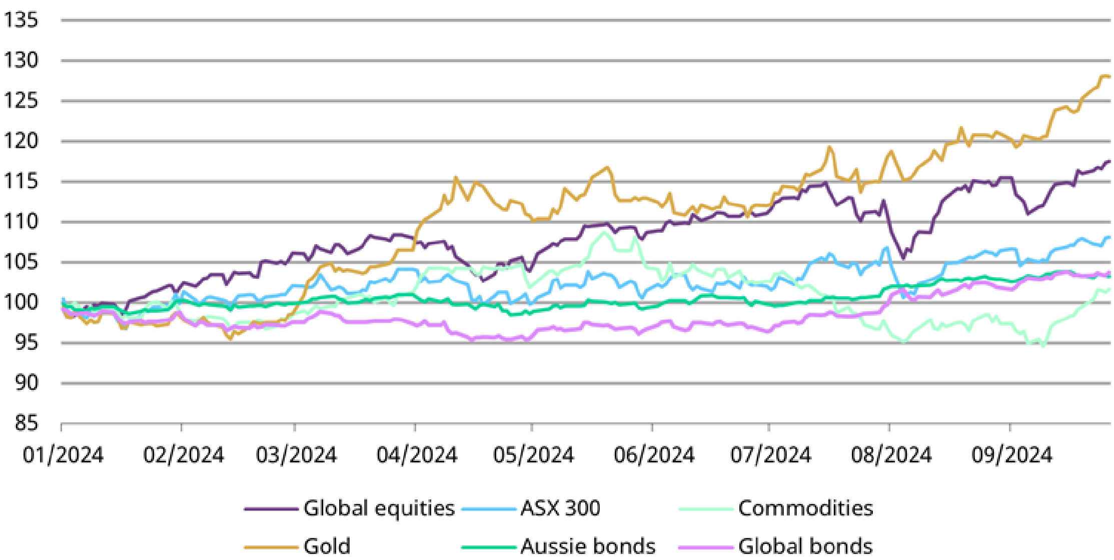



**Base: 75 North American Asset owners, 50 North American consultants, 400 North American Financial Advisors, 250 Australian Financial Advisors and 75 Asia Pacific Asset Owners.*
*Source: ZoomRX, World Gold Council*

**Asset allocation implications**

How have major assets fared so far this year? Gold has outperformed to date, surging by 28% (chart 4). Global equities have delivered robust results too. While US stocks rocketed by 20%, the ASX 300 witnessed an 8% increase, mainly driven by factors such as the prospect of lower global interest rates ahead. But taking a closer look, when geopolitical risks spiked during April and August, equities fell back – impacted by multiple factors including surging geopolitical tensions – and gold rose higher.

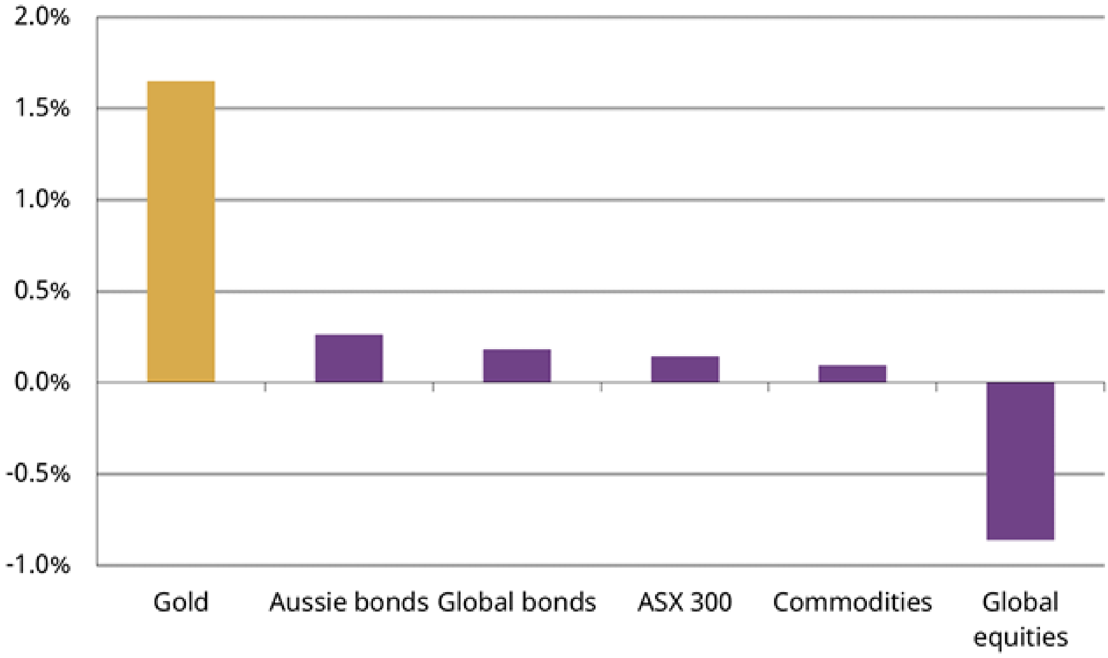
**Chart 4:** Gold has held up during geopolitical risk spikes so far this year
Performance of indexed assets to date in 2024* as of 27 September 2024.




**Based on MSCI World Index, ASX 300 Index, Bloomberg Commodity Index, LBMA Gold Price PM, Bloomberg AusBond 0+ yrs Index and Bloomberg Barclay Global Agg Index. 1 January 2024 value = 100.*
*Source: Bloomberg, World Gold Council*

In almost every week during which the GPR index soared by over 100%, gold saw positive returns. Gold averaged a weekly return of 1.6% during these spikes while global equities declined, on average, by 0.8% (chart 5).

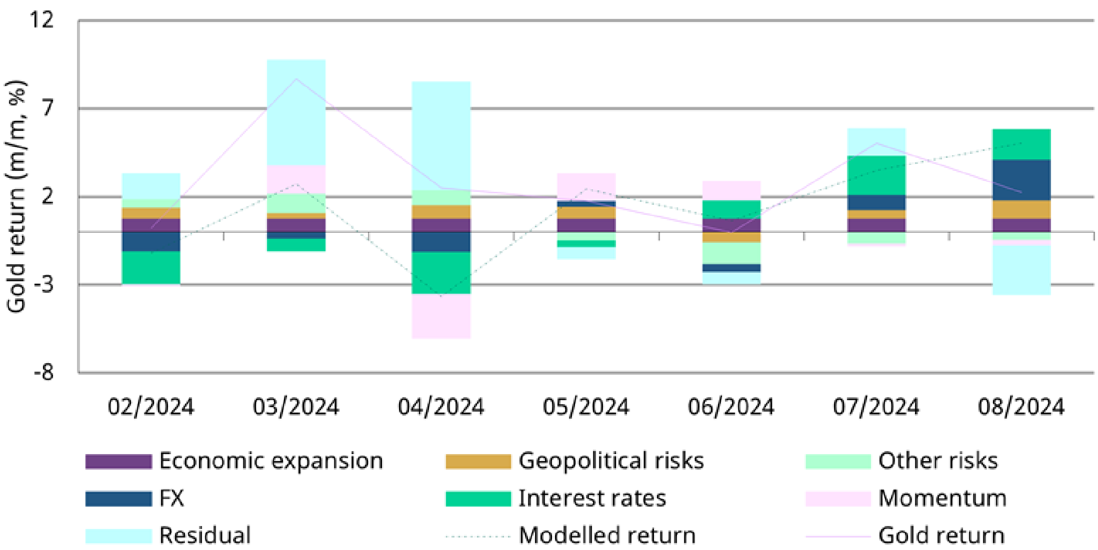
**Chart 5:** Gold, a consistent outperformer during geopolitical crises
Performance of various assets during geopolitical risk spikes*




**Based on average weekly performances between January 1999 and September 2024 due to limitation of certain indices. Figures show when the GPR index during the week soared by 100% or more.*
*Source: Bloomberg, World Gold Council*

As our previous analysis demonstrates, geopolitical risks are a statistically significant variable that drives gold's performance (chart 6). Our monthly Gold Return Attribution Model (GRAM) shows that geopolitical risks have contributed 4.3% of gold's return to date this year. Furthermore, our research shows that every 100-unit increase in the GPR Index corresponds to a 2.5% rise in the gold price.

**Chart 6:** Geopolitical risks have been a consistent contributor to gold's return in 2024
Monthly GRAM results* to 31 August 2024.



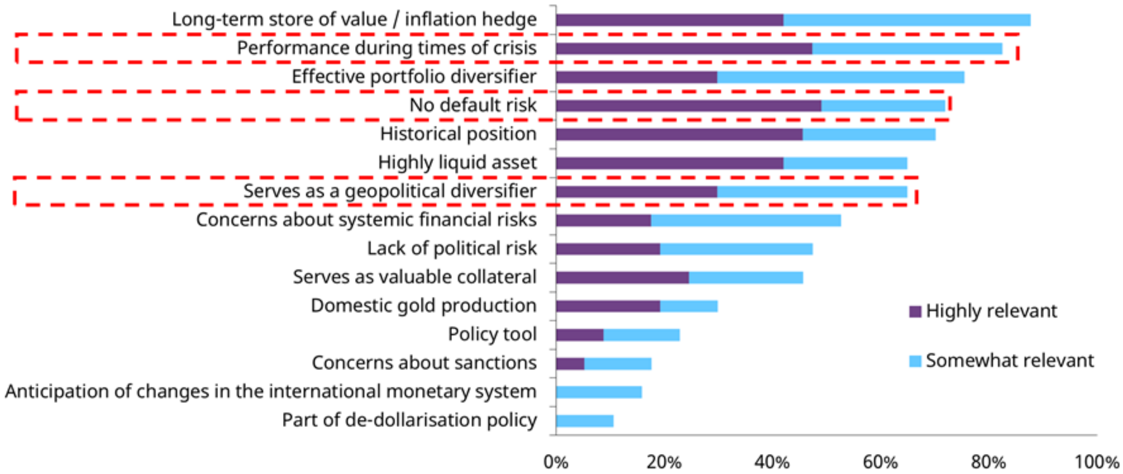

**For more information, see: Gold Return Attribution Model | World Gold Council. Results shown here are based on analysis covering an estimation period from June 2019 to August 2024. We have reduced the estimated window to five years to better reflect current conditions. Sources: Bloomberg, World Gold Council*

**Gold as an effective geopolitical risk hedge**

Creating a resilient portfolio is a topic constantly explored by investors. We believe one of the keys to building this resilience is to prepare for "unknown unknowns". While scenarios such as global economic growth can be deduced from economic data clues, geopolitical risks tend to be sudden and unpredictable. And these geopolitical tensions often lead to financial market turmoil, damaging investor portfolios.

When we examine how various assets respond to sudden geopolitical risk spikes, gold's robust performance during such events becomes clear. We conclude that gold is an ideal hedge against unpredictable geopolitical shocks. This is further evidenced in our 2024 Central Bank Gold Survey, which revealed that geopolitical risk was a key driver that spurred on central banks in their recent record-breaking gold purchases (chart 7).

**Chart 7:** Geopolitical risk-related concerns are driving the gold purchase decisions of global central banks*




**Base: All central banks that hold gold (57); Advanced economy (18); EMDE (39). Ranked by "highly relevant" plus "somewhat relevant". Source: World Gold Council*

We believe that gold's key attributes – its safe-haven nature, its ability to generate long-term returns (especially now that a global easing cycle has begun), and its low correlation with risk assets – will continue to represent immense value to investors who seek to build a resilient portfolio in today's world.

*Ray Jia is a Senior Research Analyst at World Gold Council, a sponsor of Firstlinks. This article is for general informational and educational purposes only and does not amount to direct or indirect investment advice or assistance. You should consult with your professional advisers regarding any such product or service, take into account your individual financial needs and circumstances and carefully consider the risks associated with any investment decision.*

*For more articles and papers from World Gold Council, please click here.*

[1] The World Gold Council and State Street Global Advisors commissioned ZoomRX (formerly Vivisum) to survey 75 North American Asset owners, 50 North American consultants, 400 North American Financial Advisors, 250 Australian Financial Advisors and 75 Asia Pacific Asset Owners. Fieldwork was conducted between 20 October and 18 December 2023.

## The changing face of finals footy and the numbers behind it

### Tony Dillon

Competition in our footy codes drew to a close over the weekend, with Penrith claiming a historic fourth premiership in a row in the NRL grand final. It followed the conclusion of the AFL the week prior, when Brisbane had an emphatic grand final win over Sydney.

Brisbane came from the clouds to win from fifth position on the AFL ladder over the minor premiers. Since the inception of the current AFL final eight system in 2000, this was only the second time that a team has won from outside the top four. The Western Bulldogs won it from seventh in 2016 (with again, the hapless Sydney minor premiers and runners-up).

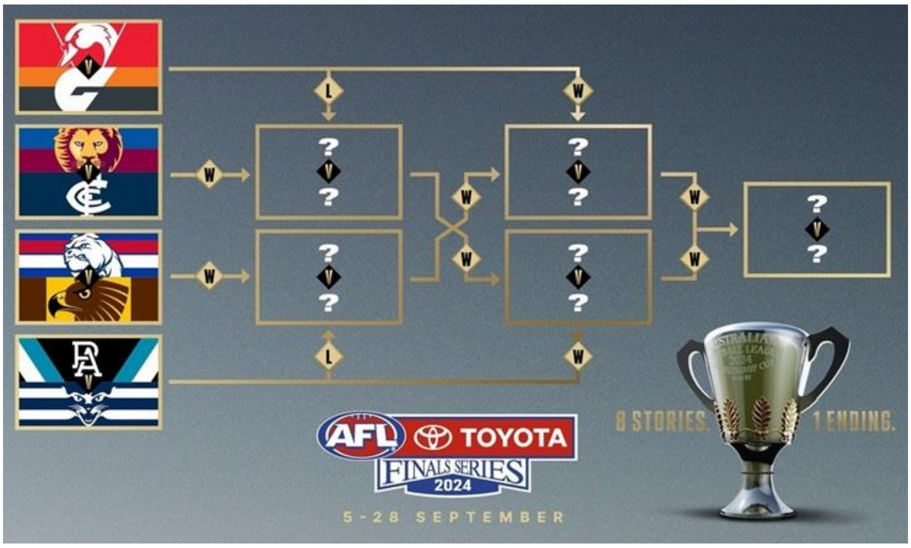
This got me thinking about the overall performance of top four sides in recent times, where inglorious finals exits seem more prevalent. In particular, I wondered what effect the controversial pre-finals bye introduced in 2016 has had on top four sides' chances. I had a feeling that teams 1 to 4 were losing continuity in playing, particularly for those teams that won in the first week of the finals, advancing straight through to the third week. Meanwhile, the bye would perhaps favour teams with final ladder positions 5 to 8, enabling them to freshen up before week one of the finals, reset, and build momentum with every final sudden death for them.

First, a quick look at how the AFL final eight system works:

**Week 1**
Qualifying Final 1: 1st final ladder position vs 4th final ladder position
Qualifying Final 2: 2nd vs 3rd
Elimination Final 1: 5th vs 8th
Elimination Final 2: 6th vs 7th
**Week 2**
Semi-final 1: loser QF1 vs winner EF1
Semi-final 2: loser QF2 vs winner EF2

**Week 3**
Preliminary-final 1: winner QF1 vs winner SF2
Preliminary-final 2: winner QF2 vs winner SF1

**Week 4**
Grand-final: winner PF1 vs winner PF2




*Source: AFL.com.au*

I looked at two measures to probe my intuition, over the periods 2000 to 2015 when there was no pre-finals bye, and post 2015 when it was introduced:

1. The frequency with which top four teams won their first final, then exited in their subsequent week 3 preliminary final. So those teams bypass week 2 finals, and in the pre-finals bye period, may have only played one match in nearly four weeks up until preliminary final day.

2. The frequency with which top four teams exited the finals in so-called 'straight sets'. That is, a loss in weeks one and two of the finals series.

The results were compelling.

From 2000 to 2015, only four times did top four teams lose the preliminary final having won their week 1 final and bypassing week 2. That is, just 12.50% of the time (4 out of 32 losing preliminary finalists). From 2016 to 2024, seven top four preliminary finalists failed to advance to the grand final after a first week win. That is, a strike rate of 43.75% (7 out of 16 losing preliminary finalists). Note, 2021 has been excluded from the analysis, when there was no pre-finals bye due to a Covid restructured season.

That's a significant increase in rate of failure to advance, which supports the theory that top four sides were losing continuity in game time, while the lower ranked teams had momentum on their side.

**Straight set exits have also spiked**

For the period 2000 to 2015, there were five straight set exits out of a total of 64 top four finals participants, a rate of just 7.81%. For 2016 to 2024, that rate jumped to 21.88%, as seven out of 32 teams lost in rounds one and two of finals.

Again, this backs the assertion that teams ranked 5th to 8th have closed the gap on the top four. Perhaps because the week off has provided a circuit breaker between a long season and an arduous finals series, where the teams need a win every week to progress. Without the bye, there would be no respite for those teams.

The pre-finals bye was introduced by the AFL in 2016. By that point, there had been several cases of teams that had already locked in a certain finals position resting a number of players to keep them fresh for the upcoming finals. The AFL thought this compromised the integrity of the competition as clubs were not fielding their strongest available teams. In theory, a pre-finals bye meant that teams would not need to sideline players in the last round.

But did the ruling have unintended consequences? The analysis here suggests that it did. The AFL may be comfortable with that as it seems to have brought about a less predictable finals series. Others would argue that it unfairly disadvantages higher ranked teams, who have worked hard over a long season to achieve top four status and the week one double chance.

Note that this year, minor premiers Sydney did not fall into the two categories analysed here, instead winning in weeks 1 and 3 before losing the grand final. However, by the day of the preliminary final, Swans had played only one game in 27 days. Meanwhile, all-conquering Brisbane had played four hard-fought finals in as many weeks, building up significant momentum in the process. Did a lack of match practice - aided by the pre-finals bye - bring about Sydney's demise?

**Footnote**

For those interested, assuming each team has a 50% chance of winning (or losing) per final, the probabilities of teams ranked 1 to 4, and 5 to 8 winning the premiership, can be calculated at the outset of the AFL final eight series.

Teams 1 to 4 can become premiers via one of two paths:

1. Win weeks 1, 3, and 4 (the path most frequent, with 17 premierships since 2000).
2. Lose week 1, win weeks 2, 3, and 4 (6 premierships).

Therefore, the probability teams 1 to 4 win the premiership = (0.5 x 0.5 x 0.5) + (0.5 x 0.5 x 0.5 x 0.5) = 18.75% each.

Teams 5 to 8 can only become premiers via one path: win weeks 1, 2, 3, and 4 (happened only twice). Therefore, the probability teams 5 to 8 win the premiership = (0.5 x 0.5 x 0.5 x 0.5) = 6.25% each.

Note that these numbers are more about relativities than absolute probabilities because in reality, a probability other than 50% of winning per final would be arrived at by factoring in characteristics like recent form, home ground advantage, injuries, and so on.

The numbers show that teams 1 to 4's chances of winning the grand final, are possibly several multiples of that of 5 to 8's chances. Which emphasises the difficulty of winning from outside the top four, and puts Brisbane's effort into perspective.

*Tony Dillon is a freelance writer and former actuary. This article is general information and does not consider the circumstances of any investor.*