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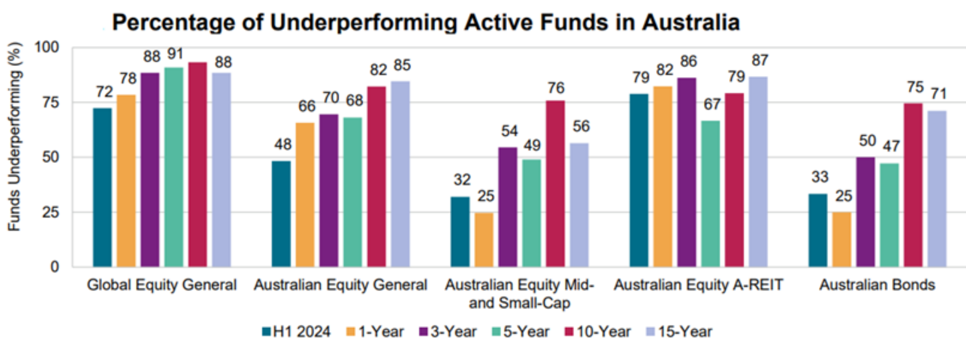
Editorial

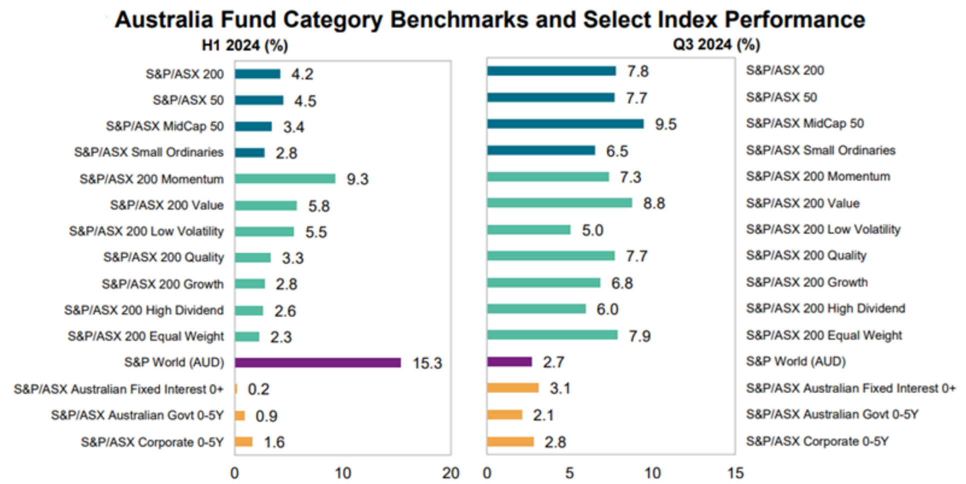
S&P Global's SPIVA Global Scorecard has become the industry standard for assessing active fund managers against their benchmarks.

The scorecard shows that Australian active fund managers performed reasonably well in the first half of 2024. 52% of domestic equity funds outperformed their benchmarks. The number was even greater for small and mid-cap funds, with 68% posting returns better than the indices. Australian bond managers also did admirably, with two-thirds beating their benchmarks.

The news was less positive for Australian equity A-REIT managers, with almost 80% underperforming their benchmarks, and for global equity managers, where 72% trailed the index in the first half.



Source: S&P Dow Jones Indices LLC, Morningstar. Data as of June 30, 2024. The back-tested data reflects hypothetical historical



Source: S&P Dow Jones Indices LLC. Data as of Sept. 30, 2024. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

What accounts for the different results? It's apparent that in local equities, better returns came from the large caps. The S&P/ASX 50 outperformed the S&P/ASX 200 as well as mid and small cap indices. It's also apparent that momentum stocks were the huge winners of the first half of this year, returning 9.3% versus the S&P/ASX 200's 4.2%. Therefore, to outperform, as most Australian fund managers did in local equities, they would have likely been overweight the largest companies and those with the most momentum in terms of price.

In small and mid-cap equities, S&P says that fund managers in this category tend to do well when there's a tight spread between the performance between small and mid-caps. So it proved in the first half of the year, when the spread was minimal, and most of the managers outperformed their indices. S&P notes that the spread blew out to 3% in the third quarter, which may make the second half of the year more challenging for small and mid-cap managers.

Australian bond managers benefited by moving from local government bonds to investment grade corporate bonds. Taking on more credit risk paid off, and with credit spreads tightening further in the third quarter, it potentially augurs well for active bond managers in the second half of 2024.

Turning to Australian-based global fund managers, the six months to June were difficult. With mega-cap American tech companies vastly outperforming versus indices, it meant that managers with below benchmark exposure to these stocks invariably underperformed. Thus, the average weighted average return of Australian-based global funds was 11.8% versus the world index's 14.8% in the first half in AUD terms.

The long-term results of Australian fund managers aren't so good

The long-term track record of local active fund managers is less compelling. For Australian equity managers, two-thirds underperformed their benchmarks in the 2024 financial year. Over 10 and 15-year timeframes, that underperformance number increases to 82% and 85% respectively.

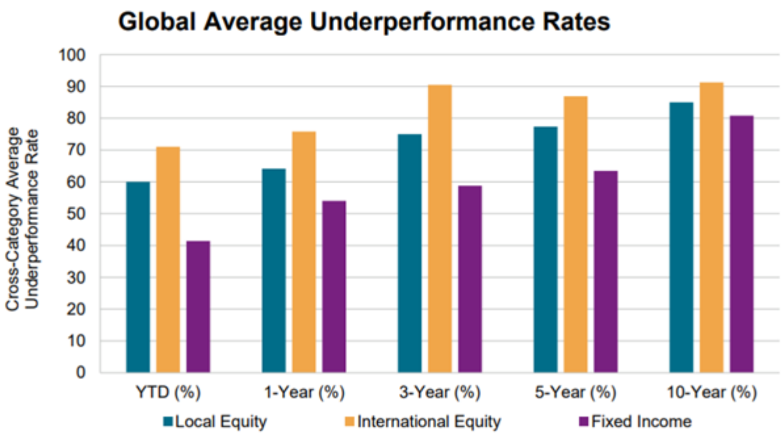
The statistics are similarly poor across all other categories. Some categories are better than others, though. First instance, as bond yields have normalized over the past 2-3 years, Australian fund managers have started to show their chops, with most outperforming during that time.

How did Australian fund managers compare to those overseas?

Australian fund managers performed better than their international counterparts in local equity and fixed income during the six months to June. However, their trailed in international equity.

Globally, 60% of local equity funds and more than 70% of international equity funds underperformed in the first half. Meanwhile, the majority of fixed income funds outperformed.

Again, the long-term results aren't great. Over the past decade, more than 80% of managers in all three major categories have trailed their benchmarks.



Sources: S&P Dow Jones Indices LLC, Morningstar, Fundata, CRSP. Data as of June 30, 2024. Local Equity includes actively managed fund categories focused in geographic segments within their respective SPIVA Scorecard region. Excludes non-USD Global Equity categories for 5- and 10-year periods, and the Japan International Equity category for the 10-year period, because the comparison benchmark performance was not being published in the category currency at the start of the period. Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

Homing in on US fund managers

Broadly, US active fund manager performance has been pathetic over most timeframes.

In local equities, US small cap equity managers outshone the rest in the first half of 2024. 85% of them outperformed their benchmarks.

Large cap equity managers did ok. 43% did better than their index during the first half, as well as over the 12 months to June.

However, the long-term track records of US active equity managers in all categories are miserable.

In fixed income, the results are more positive in the short-term, but less so over five and 10-year periods.

Fund Underperformance Rates – Major U.S. Categories

SPIVA Region	Fund Category	Comparison Index	YTD (%)	1-Year (%)	3-Year (%)	5-Year (%)	10-Year (%)
Global Equities							
U.S.	Global Funds	S&P World Index	70.75	76.61	92.17	86.42	87.80
U.S.	International Funds	S&P World Ex-U.S. Index	56.17	71.25	81.68	79.25	81.48
U.S.	Emerging Markets Funds	S&P/IFCI Composite	46.30	63.47	72.59	72.17	86.21
U.S. Equities							
U.S.	All Domestic Funds	S&P Composite 1500	76.56	76.17	90.09	85.91	90.08
U.S.	All Large-Cap Funds	S&P 500	57.31	57.05	86.08	77.26	84.71
U.S.	All Mid-Cap Funds	S&P MidCap 400	70.76	71.77	72.82	83.17	78.75
U.S.	All Small-Cap Funds	S&P SmallCap 600	15.02	36.50	48.82	62.73	81.31
U.S.	All Multi-Cap Funds	S&P Composite 1500	78.56	74.30	90.79	84.59	89.16
U.S.	Large-Cap Growth Funds	S&P 500 Growth	82.14	50.21	80.80	78.11	82.70
U.S.	Large-Cap Core Funds	S&P 500	58.66	63.67	78.24	78.85	95.95
U.S.	Large-Cap Value Funds	S&P 500 Value	28.09	58.08	88.64	86.31	91.33
U.S. Fixed Income							
U.S.	General Government Funds	iBoxx $ Domestic Sovereign & Sub-Sovereigns	75.00	86.84	88.57	91.43	100.00
U.S.	High Yield Funds	iBoxx $ Liquid High Yield Index	38.95	68.02	64.02	51.81	76.92
U.S.	General Investment-Grade Funds	iBoxx $ Liquid Investment Grade Index	19.51	47.56	36.26	60.67	85.86
U.S.	Investment-Grade Short & Intermediate Funds	iBoxx $ Overall 1-5 Year	12.57	15.95	23.75	31.65	57.24
U.S.	General Municipal Debt Funds	S&P National AMT-Free Municipal Bond	13.33	24.72	90.48	72.29	64.84

Sources: S&P Dow Jones Indices LLC, CRSP. Data as of June 30, 2024. See Appendix for column definitions. Past performance is no guarantee of future results. Table is provided for illustrative purposes.

What it means for the average investor

Undoubtedly, stock market conditions have been challenging for active equity fund managers of late. The outperformance of large caps both in Australia and overseas has meant managers have had a difficult time differentiating themselves and outperforming market cap weighted indices.

Ironically, ETFs have been taking market share from managed funds, yet it’s these same ETFs which may have contributed to the increasing market concentration and subsequent underperformance of fund managers.

For the average investor, the results show that small cap equities funds and fixed income funds may be your best shot for finding managers that can outperform benchmarks. Australia is lucky in having many high quality managers in these areas. However, choosing the right ones is a skill just like stock picking, and that’s a subject ripe for a future article.

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In an article two weeks ago, I wrote of how preserving wealth through generations is hard. This week, I had the pleasure of meeting one family which has managed to endure and succeed over the past 220 years. The family in question, the Schroder family, and specifically meeting with Leonie Schroder, a 5th generation family member and Non-Executive Director of Schroders PLC in London. Ms Schroder was in town to celebrate Schroders Australia's 60th anniversary. As a Firstlinks sponsor, I'd like to congratulate the firm on the fantastic milestone.

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In my article this week, I look into how many of us start to think about our legacies as we get older, but this may not be the best way to get the most out of lives and leave loved ones in good stead.

James Gruber

Also in this week's edition...

We hear a lot about how capitalism is failing and needs reform. That we need to kickstart the manufacturing sector. That more government subsidies are needed in a host of different areas. Stop, says **Peter Swan** and **Dimitri Burshtein**. Government isn't the solution right now; it's the problem, they suggest. They believe the recent cost of living crisis is borne of an inefficient and bloated government sector that continues to expand, hindering economic growth while fostering social and intergenerational tensions.

Does being informed make you more prone to poor investment decisions? Finance Professor **Michael Finke** recently discussed the double-edged sword of taking an interest in your investments, as well as other thought-provoking topics such as three predictors of panic selling and why nurses tend to be better investors than doctors. **Joseph Taylor** reports.

Is near enough good enough when valuing SMSF assets at market value? Not according to superannuation regulations, which require SMSF trustees to value all assets at market value when preparing financial statements. **Shelley Banton** details the challenges of getting it right and the repercussions if you don't.

British colonisation has come under heavy criticism in recent years. In Australia's case, some of that criticism is no doubt justified given what happened to Aboriginal people. However, **Tony Dillon**, says that we should at least be thankful for the Common Law system that we inherited from the British. It's fostered democracy and capitalism, helping to turn our country into a prosperous one. Without this legal foundation, Tony thinks our fate could have been very different.

There's been a big structural shift in Australia's labour market, with the 'care' sector significantly expanding vis-a-vis other areas. **Matt Maltman** analyses how it's happened and the impact that it's having on our economy.

Is there any value left in technology stocks? Platinum's **Jimmy Su** says there is. He believes that the real skill in investing is to be able to know when a stock priced at 30x earnings is cheap and when a stock on 10x is expensive. From this, he explains why the market is mispricing megacaps such as Amazon and Alphabet.

Lastly, in this week's whitepaper, **Fidelity** provides a practitioner's guide to investing in the energy transition.

What will be your legacy?

James Gruber

When we’re young, life seems slow moving – the days are long and the world is rich. As we get older, this starts to change and it feels like we’re running short of time, and consequently we tend to rush to get more things done.

I’m 48 years old now, and it does feel like I’m on the other side of the proverbial mountain. Until my late 30s or early 40s, I was climbing the mountain, like all of us. Trying to find my identity and how I fit into the world.

Then in my early 40s, I had the cliched mid-life crisis. It lasted a long time. For me, it meant questioning much of what I’d learned early in life, and the decisions that I’d made since.

Coming out of that and recognizing that I’m not climbing the mountain of life anymore, and maybe descending it, thoughts invariably turned to my own mortality. Ernst Becker in his famous 1973 book, *The Denial of Death*, suggested that an individual’s character is formed around the process of denying their own mortality, and that this denial is necessary to function in the world.

That seems a stretch to me, though there’s no doubt that many fear death, especially as they age. I sense that fear in my parents, making it difficult to talk about death and the issues surrounding it, including financial affairs.

The issues with legacy

A recognition that we won’t be around forever can lead to thoughts about the purpose of our lives and what we’ll leave behind. Our legacy, so to speak.

When thinking about legacy, the first thought for me is of rich people leaving buildings and monuments in their names. A few years ago, I remember reading of the CEO of a listed company donating money to my university alma mater in Adelaide, and getting a building named after him, and I thought, 'you pompous so and so'.

The problem with legacy is deeper, though. The building with the CEO's name on it won't last forever and there'll probably be wealthier donors at some point whose names will replace his on that building.

The deeper reality is that very few of us will be remembered after our deaths. By family and friends, sure. Outside of that, not so much.

After all, there are 8.2 billion people alive today, and around 117 billion who've lived and died over the past 4.5 billion years of earth's existence. We're but a speck in the scheme of things.

If not legacy, then what?

What should we aim for as we age, then?

New York Times columnist David Brooks in his book, *The Second Mountain*, suggests during the first half of our lives, we pursue largely self-interested goals: career wins, high status, buying nice things. He believes the second half of our lives should be about family, vocation, philosophy, and community. Put simply, it should involve connecting with close ones and helping others.

Connection and relationships are important, yet they may not be all there is to it.

A different framework for finding purpose in life comes from financial coach, George Kinder, in his book, *The Seven Stages of Money Maturity*. Kinder says financial advisers should ask their clients three questions to help them find their life goals, and the questions are paraphrased here:

- If you just won $10 million, how would you change your life?
- If you found out you have just five years to live, but you're in good health, what would you do?
- If you're told today that you have only 24 hours to live, what regrets would you have about your life?

I like the second question most. The problem with it is that the answer likely changes with age. In my 20s and much of my 30s, my answer would have included: travel the world, meet as many people as possible, and go to some of the world's great sporting events. Later, the answer would have been different and including things such as building a business to potentially pass onto my children.

Now, the answer would be far more mundane: to spend as much time with my family, raise my children to be good people, build deeper relationships with friends, pursue work and hobbies that mean something to me, and leave enough assets and income for my family to get by after I pass.

The answer to Kinder's second question will be different for each of us.

There's another way to think about goals for the second half of life. I heard it once, from where I'm unsure, that we leave parts of ourselves with those we're close too. For instance, we teach values to our children, who pass it onto their children, who then pass it onto theirs. Or we influence friends in ways that they pass onto others, who spread it further and onto the next generation, and so forth. In other words, parts of us live on through generations.

The three frameworks for thinking about how to live as we age hint at something else. Most of us spend our lives obsessed with the future: what shape our finances will be in, what assets we'll own, what career and work we'll have, and what our world will be like.

Yet, perhaps we need to obsess less about the future and more about the present. Worrying less about what our legacy will be, and more about connecting better with people in the here and now.

Yes, some planning is warranted and prudent. Wills, estate planning, and the like. And we write a lot about these topics in our newsletter. But they're only a small part of how we'll be remembered once we're gone.

James Gruber is editor of Firstlinks and Morningstar.

It's the cost of government, stupid

Peter Swan, Dimitri Burshtein

Australia is not facing a cost-of-living crisis but rather a 'cost-of-government' crisis. A crisis borne of an inefficient and bloated government sector that continues to expand, hindering economic growth while fostering social and intergenerational tensions.

Contrary to the argle-bargle from some quarters, the basic principles of economics are simple. Economic growth is not a product of government planning or of consumer or government spending. Economic growth stems from the expanded production of goods and services which is driven by savings, investment, entrepreneurship, and innovation. Importantly, growth is determined through how resources are used, principally labour and capital, and most importantly, how productively these inputs are used.

The lifting of hundreds of millions of Chinese people out of abject poverty came not from an expansion of government but from the retreat of government. It came from a massive expansion in production powered through savings, and labour moving from lower productivity subsistence and collective farming to higher productivity manufacturing and services.

Fundamentally, without production, there can be no consumption, and it is an unfortunate distortion of this simple reality by statisticians when they use spending data to measure GDP. This flawed approach also enables peculiar statements like that recently from Treasurer Jim Chalmers, who claimed that 'Without growth in government spending, there'd be no growth in the economy at all.' Chalmers conveniently ignored the fact that without production, there'd be no taxes, and without taxes, there'd be no government spending.

Federal Treasurer Jim Chalmers recently claimed that without growth in government spending, there'd be no economic growth, but UNSW Business School Professor Peter Swan observed that without production, there would be no taxes, and without taxes, there would be no government spending. Photo: supplied

A household does not measure its income by how much it spends but rather by how much it earns. And planning a household budget in the hope of winning the lottery is as irresponsible as the Commonwealth projecting a decade of budget deficits in the hope of perpetually high iron ore prices.

It's very easy to increase the appearance of economic growth by increasing the volume of inputs, such as through immigration. This may increase aggregate output, but it necessarily translates into reduced returns to labour through lower real wages and per capita income. The Black Death decimated the population but dramatically raised per capita income.

By the same token, it may be an insight for members of the big government industrial complex, but real wages do not increase through legislation, regulation, or subsidies. Increasing wages through such means will ultimately need to be paid for via a combination of higher taxes, inflation and unemployment.

The Albanese government's industrial relations alterations will not lead to sustainable increases in real wages.

It is only through productivity growth, by increasing output per worker, that businesses can increase wages without raising prices. And increasing productivity does not necessarily mean working longer or harder, but rather more efficiently.

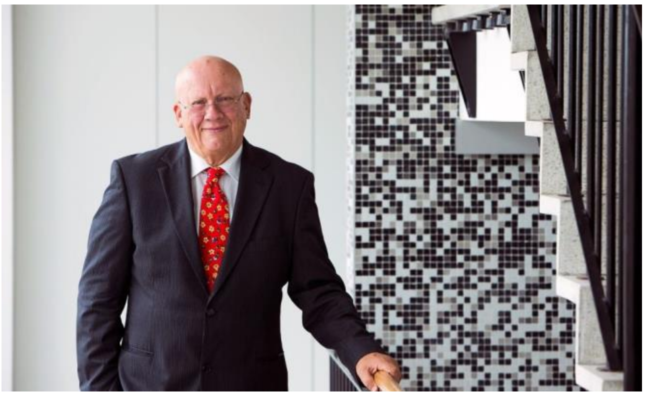
Consider the cost of housing in Australia against the reality that 'since 2014, labour productivity in the Australian construction sector has declined by 18.1 per cent'. Much of this productivity decline can be attributed to regulatory failure.

Addressing Australia's productivity slump is the key to solving many of our economic problems. It cannot be ignored that, at the same time, Australia is experiencing an extended per-capital recession, per-capita government spending is growing at a rapid pace.

When capitalism works, it does so through what the Austrian-born economist Joseph Schumpeter called 'creative destruction'. Competition in markets allows new firms to rise up and replace the complacent ones, making the economy ever more productive over time.

This process generates vast pools of wealth, personal and corporate, but only temporarily, as cut-rate competitors raze monopoly profits and concentrations of power. The downside of this rough cyclical justice is more volatility in the markets. The upside is human progress.

Grand government schemes like the 'Future Made In Australia' policy will only result in diminished economic growth and lower productivity.



UNSW Business School Professor Peter Swan explains that increasing productivity means working more efficiently, and not necessarily longer or harder. Photo: UNSW Business School

Since the turn of the millennium, and particularly after the dot-com crash of 2000, governments and central banks have jointly conspired to stop the creative destruction process working properly through repeated bailouts and stimuluses.

The decision to not bail out Lehman Brothers was a rare exception. What researchers have called 'the cleansing effect' of recessions has disappeared with recoveries lasting longer but at a slower pace of growth.

The rhythm of the financial markets has also changed in response to increasingly large and active government. Investors have come to assume that good economic news was good for financial markets, but so was bad news because it would trigger more government support. With growing government stifling competition and crippling the process of creative destruction, the largest firms will keep getting larger.

It was not government planning, regulation or industry protection that led to the creation of the steam engine, automobile, or smartphone. If these innovations were developed today, governments likely would impose taxes and regulations to protect jobs in the telegraph and horse-and-buggy industries.

The biggest beneficiaries of no market downside have been the wealthiest. Before the year 2000, billionaires numbered barely 470 but have since surged to around 2800.

The general stupefaction of a business culture pickled in debt might be of less social consequence were it not conspiring to slow economic growth. Who, after all, wants harsher or more frequent recessions, more bankruptcies, or a scarier ride in the financial markets?

By smothering capitalism's competitive fire, big government is slowing productivity growth. This is lowering long-run economic growth, thus shrinking the pie and concentrating what's left in fewer hands.

Many Millennials, the next generation of leaders, have been misled into thinking that their distorted version of capitalism is the root of the problem and that a bigger, more interventionist government is the solution. However, the distortions they observe and the inequalities they experience are actually the result of excessive government intervention, not a lack of it.

Australia's only return pathway to prosperity requires a significant reduction in the size and role of government. As Ludwig von Mises observed and history has confirmed: 'The worst evils which mankind has ever had to endure were inflicted by bad governments.'

Peter Swan is a Professor in the School of Banking and Finance at UNSW Business School, and Dimitri Burshtein is Principal at Eminence Advisory and a UNSW Alumnus (Master of Commerce and Bachelor of Economics).
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A guide to valuing SMSF assets correctly

Shelley Banton

Is near enough good enough when valuing SMSF assets at market value? Not according to superannuation regulations, which require SMSF trustees to value all assets at market value when preparing financial statements. The challenge is getting it right because the true impact of incorrect market valuations can have financial and operational repercussions for an SMSF.

What is market value?

The first rule is that the market dictates the value of an asset, not the trustee. Adopting a Goldilocks pricing strategy whereby the trustee has different values depending on their SMSF goals will result in a compliance breach.

The next logical step is to use the market value definition in relevant super rules that refer to the amount that a willing buyer could reasonably be expected to acquire the asset from a willing seller given the following assumptions:

1. Both parties dealt with each other at arm's length in relation to the sale
2. The sale occurred after proper marketing of the asset
3. The buyer and seller acted knowledgeably and prudentially in relation to the sale.

For clarity, the definition covers all types of property, including money. It essentially expects SMSF trustees to make valuation decisions using careful consideration and sound judgment, resulting in a fair and reasonable sale.

ATO general valuation principles

The ATO is aligned with the auditing standards because it also says an annual independent valuation is not required.

A valuation is fair and reasonable if it considers all the relevant factors and considerations that are likely to affect the value of an asset while using a fair and reasoned process.

Trustees, however, must provide objective and supportable data as evidence to support the reasons for their valuations. They must be able to explain the valuation in terms of the methodology and evidence to an independent third party.

It means that trustees are obliged to document what value has been adopted and how that value has been determined.

It is not the SMSF auditor's job to value the asset.

The ATO has said that if trustees follow its guidelines, the valuation will generally be accepted if:

1. It does not conflict with its general valuation guidelines or market valuation for tax purposes guide.
2. There is no evidence that a different value was used for the corresponding capital gains tax event.
3. It is based on objective and supportable data.

Trustee decisions and market values

SMSF trustees must decide whether to pay for an independent qualified market valuation report. If they do, the Fund will be ready for audit.

Alternatively, they must provide objective and supportable data annually for SMSF auditors to confirm compliance.

Trustees (or their SMSF advisers) need to allocate time and effort to obtain sufficient appropriate audit evidence for the audit. Where trustees cannot provide evidence, the SMSF auditor may be unable to confirm compliance, and the Fund may breach regulations.

Most importantly, if the ATO disagrees with a trustee valuation, it will apply an appropriate method to an amended value, which can impact transfer balance caps, non-arm's length income ("NALI"), a member's total superannuation balance and the potential Div 296 tax impost.

It means that the true impact of an incorrect market valuation can make an SMSF worse off where there are potential tax or compliance issues.

Administrative penalties

A breach comes with administrative penalties, attracting 20 penalty units currently worth $6,260 per trustee.

Where a fund has a corporate trustee, the penalty applies once, whereas it applies separately to each individual trustee. Yet another reason to have a corporate trustee.

Acquisition of assets from related party

Some exceptions allowed enable an SMSF to acquire assets from a related party, such as listed shares, business real property, widely held trusts, insurance policies, in-house assets up to 5%, acquiring an asset from another fund as a result of a relationship breakdown or a merger of super funds.

To ensure compliance and avoid the true impact of incorrect market valuations, related party assets must be acquired at market value, with an independent formal valuation undertaken as close to the transaction as possible where relevant.

Acquiring assets not at market value triggers the non-arms length income (NALI) provisions, whereas rectifying a breach of rules requires the trustees to sell the asset.

Case study 1: Scott decides to transfer listed shares to his SMSF as an in-specie contribution. He transfers $100,000 worth of listed shares using the 15 June 2024 share price and fills in the off-market share transfer form.

Life gets in the way, and Scott finally signs the form on 25 August 2024. He sent it to the share registry that day. Does the transaction comply?

Suggested answer: While Scott planned to transfer the shares on 15 June 2024, the form was dated and signed on 25 August 2024. Given that the share price is different on 25 August, the Fund has breached regulations, which are reportable yearly until the shares are disposed of.

The NALI provisions are also triggered because the transfer form specified an incorrect purchase price, and the parties are not dealing with each other at arm's length.

The market value substitution rules apply to modify the cost base but do not affect the application of the NALI provisions. Disposal of the shares will result in a CGT event taxed at the top marginal tax rate and any income incurred before the sale.

NALI

Where an asset is purchased under the terms of a contract in the Fund's name and not through an in-specie contribution, any difference between the amount paid by the Fund and the market value is not an in-specie contribution.

As a result, the Fund will trigger the NALI provisions, and all income from the asset will be NALI and any capital gains on disposal.

Case study 2: Scott decides to purchase business real property from an unrelated party. He personally pays the deposit of $60,000, which is correctly treated as a non-concessional contribution. The Fund paid the remaining $540,000 out of the bank account. Does this comply?

Suggested answer: The purchase contract is in the Fund's name, which paid for part of the asset ($540,000), and the member paid for the other part ($60,000).

Effectively, the Fund has paid for an asset "less than market value" by paying $540,000 for a $600,000 property.

The Fund has triggered the NALI provisions because the asset was acquired under the terms of a contractual agreement and not through an in-specie contribution. All income from the property will be NALI, as well as any capital gain from disposal.

If Scott, as trustee of the Fund, recorded the acceptance of the contribution in writing and reported the market value of the contribution in the SMSF's account and to the ATO, the NALI provisions are not triggered.

Collectable and personal use assets

There is no requirement to have an annual independent valuation undertaken for collectable and personal use assets as long as the trustee provides objective and supportable evidence to show how they value the asset.

However, when an asset is transferred to a related party, the trustee must have the sale price at a market value determined by a qualified, independent valuer.

Each breach, such as the asset being leased to a related party or stored in a related party's private residence, is worth 10 penalty units per instance, or $3,130. In this example, the fine would amount to $6,260 per trustee, providing insight into the true impact of an incorrect market valuation.

Loans

Loans are considered high-risk within an SMSF primarily because of recoverability. The evidence required is the loan agreement and whether it is on commercial terms by reviewing factors such as the interest rate, whether it is secured or unsecured, and whether it is being repaid.

Where the terms of the loan agreement are not met, the question of recoverability and the market value of the loan is raised, which may result in a breach of rules.

Complex assets

Complex assets, such as property and unlisted entities, do not require an annual independent market valuation.

Regarding property, the cost purchased during the audit year at arm's length is acceptable audit evidence. Where the value remains the same in subsequent years, the trustees must be able to provide evidence each year to show how and why they have continued to rely on that valuation.

It dispels the industry myth that a property valuation is required every three years.

Unlisted entities, on the other hand, require the consideration of several factors, such as the most recent sale price between unrelated parties or a property valuation when a property is the only asset of the entity.

Issues arise when a different accountant prepares the financials. The reports are challenging to obtain, and there is no requirement for any other entity apart from an SMSF to value their assets at market value.

Apart from the penalty units that can apply for a breach, all parties waste significant time, never to be recouped, trying to obtain objective and supportable data.

Conclusion

The complexities surrounding market valuations will mean more onerous obligations and responsibilities for all SMSFs and the professionals they rely on.

Shelley Banton is Head of Education at ASF Audits.

Australia is lucky the British were the first 'intruders'

Tony Dillon

The recent article by Nigel Biggar in *The Australian*, providing context around Admiral Arthur Phillip's settlement in Australia in 1788, was enlightening. The thrust of it being that colonisation by Europeans of unexplored lands, was one of global mass migration as opposed to colonialism for colonialism's sake.

Around that time, the British, and others including the French, Spanish, and Portuguese, were active explorers in search of new lands. And Biggar made the argument that "intrusion" into Australia was inevitable, and that it was fortunate that the British arrived here first.

And while Biggar's article covers the direct impact of British settlement on the Indigenous population here, it's worth considering other impacts British colonisation may have had around the world, compared to alternative European explorers of the time.

Comparing the wealth of former European colonies

An area worth exploring is the wealth today of former European colonies, and what effect different colonising countries might have had on that. Consider the Americas.

North, Central, and South America are all former colonies. North American countries, the United States and Canada, were colonised by the British, and to some extent the French (in Canada, Quebec). Whereas Latin America, which is basically Mexico, Central and South America, characterised by Romance-speaking countries, was colonised by the Spanish predominantly, and also the Portuguese.

And there is a stark difference today in per capita wealth of the US and Canada which are wealthy, versus Latin America which by comparison is not.

In fact, the GDP per capita of the former, is approximately eight times that of the latter. According to worldometers.info, the combined US and Canada GDP per capita was $US72,600 in 2022, versus a combined $9,300 for Latin American countries. That difference is staggering. The population of Latin America being around 70% more than total US and Canada, at around 650 million.

The Latin American country with the highest GDP per capita was Uruguay at $21,000, with the biggest contributor being Mexico at about one fifth of the total population and a GDP per capita of just $11,000. Meanwhile, Canada's GDP per capita was $55,000, with the US dominant at $74,500.

And it's not as if North America is an outlier, because if you look at the GDP per capita of other Anglosphere countries, Australia comes in at $64,000, the UK $45,000, and New Zealand $48,000. With Australia the twelfth most prosperous nation worldwide in 2022.

What accounts for the differences?

So why is that measure of wealth so much less in Latin America? Why are former British colonies that much more wealthy? Could it be because of differing legal systems brought to the new founded shores by the Europeans?

In Nigel Biggar's article, he made the point that Arthur Phillip sought to avoid conflict between white convicts, sailors and soldiers, and the Aboriginal people "by declaring the life of a native equal to that of a white man under the law; by punishing white abusers". This is a reference to the rule of law under the Common Law legal system that the British brought to the Australian colony.

British law was rooted in Common Law, a system that is built on precedents, and allows the law to evolve. The Common Law legal system was installed in all British colonies, including those in North America. The main alternative to Common Law is Civil Law, predominant in continental Europe, the system of law that ruled in Spain and Portugal, and taken to Latin American colonies. Unlike Common Law, prior judicial decisions only play a minor role in shaping Civil Law. The primary difference between the two legal systems therefore being the role of past decisions and precedents.

A Common Law legal system is more conducive to a capitalist style economy, as it allows flexibility for economies to adapt and evolve with changing economic developments due to judicial interpretation. Common Law encourages private ownership with strong protection laws engendering confidence in markets. Regulation is market driven, with limited government intervention.

Meanwhile, a Civil Law system may be more attuned to a socialist economy with more rigidity in legal codes, and greater government control over rules and regulations covering resources and economic activities. This system provides more legal certainty which suits socialist structures requiring predictability in long term planning.

In reality, a country's legal system does not strictly determine whether it pursues capitalism or socialism. Rather, it can be more favourable to one economic system over another. And a blend of economic systems is possible, and often implemented.

An economic system, be it capitalist or socialist, links to economic prosperity in complex ways. And even then, the nature of prosperity can differ under different economic systems.

If economic growth is the major focus in an economy, then a capitalist one seeking to maximise profit in a generally market driven private sector, should theoretically produce a better outcome.

If greater equality in the distribution of wealth is desired, then a socialist economy with government control over production and redistribution policies, might be better equipped to achieve that goal.

And both systems may claim to be maximising prosperity, each with a different focus.

The theory therefore dictates that capitalist economies should deliver higher economic growth when influenced by a Common Law legal system that facilitates flexibility in market regulation and corporate law, innovation, and market efficiencies. That is, a system that has delivered high GDP per capita measures in Anglosphere countries.

Meanwhile, socialism has been a dynamic force in Latin America with a complex history taking many forms across most of its countries under a Civil Law legal system, presenting alternatives to capitalist economic systems. And with wealth measured by GDP per capita comparatively low in those countries, the question as to the influence of a legal system on a nation's wealth, at least historically, is a valid one.

Perhaps then it was just plain luck of the draw as to who colonised who around the globe at the time. And while Biggar concluded that it was fortunate for the Aboriginal people that the British got here first, that may be disputed by some.

But when it comes to economic prosperity, it might indeed be fortuitous that we don't today shout "olé" at the footy, or say "bon appétit" over a "plat du jour".

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

A significant shift in the jobs market

Matt Maltman

Job figures for September 2024 reveal that nearly all the additional hours worked over the past year have been in the non-market sector. Much of this has come from the 'care economy' - the fastest growing sector over the past decade, and the most common destination for workers switching industries. This has accelerated a long-standing trend in the Australian economy: its transition from goods production—particularly in agriculture and manufacturing—towards services - such as education, tourism, hospitality, and retail.

An ageing population that demands more healthcare, boosts to wages for aged care and child care workers, potential new investments in cheaper child care, and the continued growth of the National Disability Insurance Scheme (NDIS) underpin projections that this shift will continue.

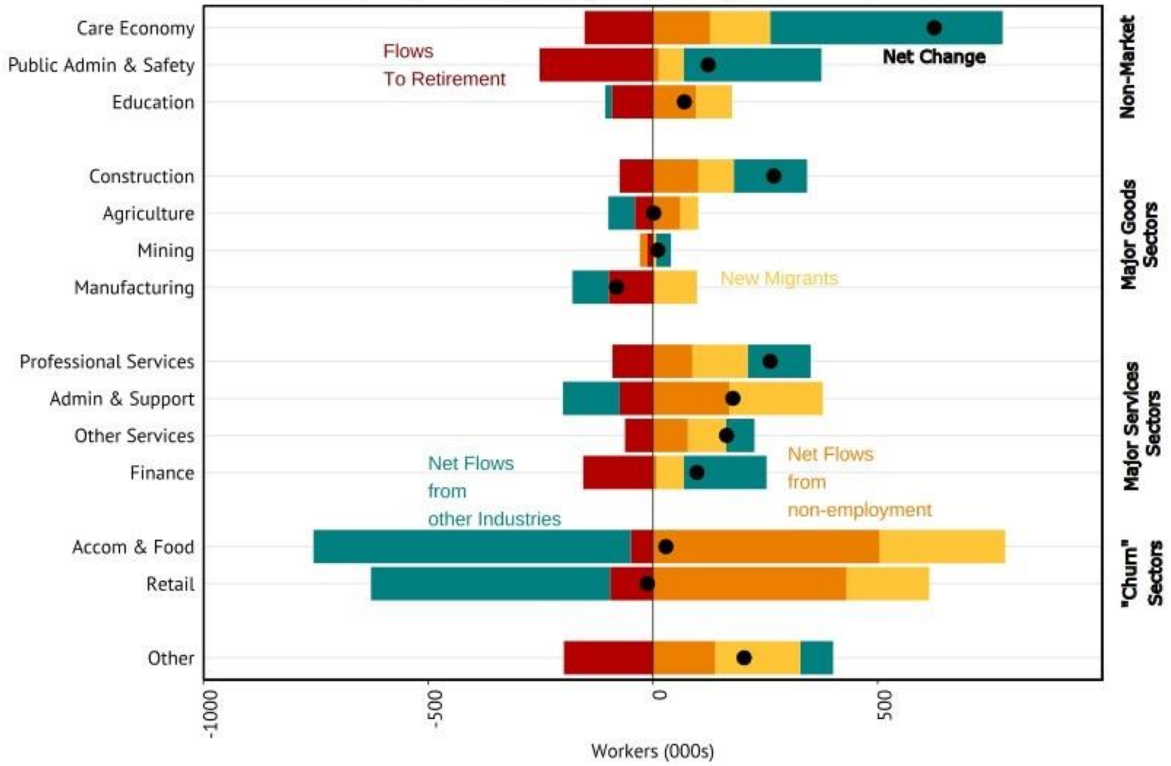
These projections of an ever-growing care economy often do not consider how the economy's supply-side adjusts to accommodate it. Looking at employment shifts between sectors over the decade to 2022 can help unpack this.

The shift towards the care economy is stark in these terms.

You can also see the clear trend away from employment in goods sectors. In fact, employment growth has been negative or small in most major goods industries – meaning they are falling as a share of the workforce. Many workers are leaving these sectors or retiring out of them. The one exception is construction, which has seen robust employment growth and stayed similar as a share of employment. Construction is an anomaly reflecting the high demand for homes and infrastructure running up against declining productivity, possibly in part due to zoning restrictions.

Sources of labour flows into industries

Net change in employment, by channel of entry and exit from 2012 to 2022



* Only the industry of a worker's main job in each year is observed. This means this chart ignores situations where a worker has multiple jobs either within or across industries. See Appendix B for a full overview of how data are constructed.
Sources: ABS; e61

The care economy may look like a participant in the march towards a service-based economy. But the growth of the care economy differs from other service sectors in three key ways, with important economic implications.

First, **while other service sectors have grown largely through new migrants and drawing workers from non-employment, the care economy has grown largely from workers switching in from work in other industries in the year prior**. New research from e61 shows that over half of those switching into the care economy came from two major 'churn industries' – Accommodation & Food and Retail. Australians often use those industries as the first rung on the job ladder and the care economy has been capturing many of the subsequent steps.

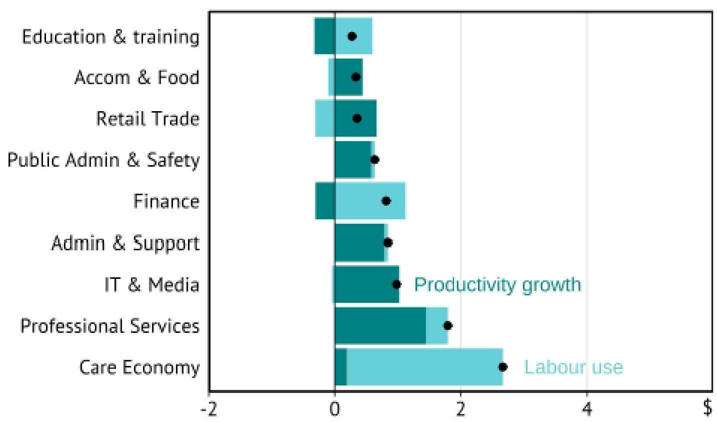
Other significant contributors include Administration & Support, and Public Administration & Safety. This shift has caused market services' share of employment to decline for the first time in decades, dropping from 53% pre-pandemic to below 51% today.

Second, **the care economy has seen almost no measured productivity growth over the past decade**, while most other service industries have shown solid gains. Although productivity growth is difficult to measure in the care economy (and appears to be underestimated in healthcare), a significant expansion in labour—reliably measured—has been essential to drive the growth of the care economy.

By contrast, other service industries have generally grown through productivity growth alone. This is true both in service industries which use technology heavily (such as IT and professional services – with finance being an exception) and those which are more people-driven. Looking at the industries supplying care

Change in output per person ($000s)

Major Services Sectors, 2013-2023



* Per Person is defined as Australians aged 15+. Other Services, Arts and Rec, & Transport ommited due to size. The finance sector's performance appears to be heavily affected by the choice of base year.
Sources: ABS; e61

economy workers: over the past decade, retail labour productivity is up 13%, accommodation & food by 18%, and administrative services by 23%.

However, this trend doesn't hold in the care economy, or for that matter, its companion "non-market" industry, education and training, where output has increased only by adding more workers, given productivity has been stagnant. **The longstanding fear that 'services will slow productivity growth' is not being realised. Service sectors are not a monolith. Some service sectors – particularly in the `non-market' sector - are experiencing weak productivity growth, but not all**.

Third, policymakers may have to **reconceptualise what productivity growth looks like on the ground**. Productivity growth in market services over the past decade can be easy to visualise. Self-checkouts and restaurant QR codes, though sometimes inconvenient, reflect investments in labour-saving technology. Online retail can also improve efficiency in warehousing and inventory management. These changes – potentially also a response to a tight labour market and competition for workers from the care economy, where relative wages have risen materially over the past decade – mean firms can grow output with less labour use.

In contrast, imagining labour-saving productivity improvements in childcare or aged care is more difficult. In these sectors, preserving quality may be more important. It's difficult to imagine a "self-checkout" equivalent for aged care. Instead, productivity growth might come from improving service quality without increasing worker numbers, as the Productivity Commission found in healthcare, rather than cutting labour while maintaining the same quality.

The expansion of the care economy represents the most profound structural change since the mining boom. It also offers the chance to ensure high-quality care for the most vulnerable—something a prosperous country like Australia can and should achieve. However, this brings fresh challenges, particularly in terms of labour demands and the impact on productivity growth both within the sector, and beyond.

Matthew Maltman is a Research Economist at the e61 institute, and previously worked at the Australian Productivity Commission.

Searching for value in tech stocks

Jimmy Su

We are often asked how value investing works in the tech sector. This usually assumes it is near impossible because most attractive technology companies (and a lot of unattractive ones) trade at high-looking multiples.

Yet simply comparing multiples is not an effective valuation framework because it neglects differences in business models, earnings quality, growth prospects and the crucial ability to generate future cash flows. Good businesses making sustainably high returns above the cost of capital can be trading at fair value - or be undervalued - even if their multiples look high.

Figure 1 shows how fair value Price-to-Earnings ratios (PEs) generally increase as earnings growth and the future return on invested capital (ROIC) increase over time. For tech-sector context, a supernormal growth period might be where a company's new technology is rapidly taking market share. ROIC is a key measure of how effectively a business puts its money to work.

Figure 1: Price to earnings assuming 10 years of supernormal growth

		Earnings growth				
		5%	10%	15%	20%	25%
	30%	21x	31x	46x	68x	101x
	25%	21x	30x	44x	64x	95x
	20%	20x	28x	40x	59x	86x
ROIC	15%	18x	25x	34x	49x	70x
	10%	15x	19x	23x	30x	39x
	5%	6x	-1x	-11x	-29x	-54x

Assumes equity only funding, 8% cost of capital, 10-year supernormal growth period

We can simplify this by comparing two hypothetical businesses each with $10 of earnings. CommodityCo sells a commodity widget with many competitors. Over the next 10 years, it could generate a 10% ROIC and grow earnings 10% p.a. before the business matures.

By contrast, MonopolyCo has pricing power, enjoys high barriers to entry and is expected to generate a 25% ROIC and grow earnings ~15% p.a. before maturing.

Figure 1 shows that MonopolyCo should be worth ~$440 (44x PE) vs CommodityCo at ~$190 (19x PE). Given an opportunity to buy MonopolyCo at 30x PE and CommodityCo at 20x PE, the counterintuitive conclusion is that MonopolyCo is undervalued, despite the higher multiple. CommodityCo is overvalued.

A process to find value

Instead of trying to buy companies at low PEs, value investing is about buying stocks at PEs lower than what they are worth. We execute this through a three-step process.

1. We attempt to understand a business' **future free cashflow**[1] generation potential. We ask what value they bring to customers, why they are preferred over competitors, where is their pricing power and whether management is trustworthy and executing the right strategy. Companies that rank favourably on these measures are higher quality and we expect they can sustain a high ROIC over a longer period of time relative to the average company.

We then seek to understand the industry growth rate, where the business is in its lifecycle, their potential to take market share and whether they can expand into adjacent fields. Companies that rank favourably on these measures have higher growth potential.

2. We then classify the business for **quality and growth** and compare its valuations to peers with similar characteristics in our portfolio (see Figures 2 and 3). At this point valuation discrepancies may appear and further investigation will reveal whether we have made a mistake in our assessment or that this discrepancy is due to a (potentially attractive) mispricing.

Figure 2: Quality vs growth – Platinum International Technology Fund (PITF)

Portfolio Holdings

Business quality	Growth potential: Low potential	Avg potential	High potential
Best in class	Visa, Apple, ICE	Google, Meta, Microsoft, Adobe, SAP, ASML, Oracle, Autodesk, Cadence, Synopsys	Intuitive Surgical
Above average	Analog Devices, Qualcomm, Texas Instruments, NXPI, Paychex	Netflix, TSMC, AMAT, Broadcom, Lam Research, Keyence, Constellation, Nice Ltd, Tokyo Electron	Amazon, Veeva, Adyen, AMD
Average	-	Micron	-
Below average	-	-	-

Figure 3: Average FY25 PEs – PITF

Business quality	Growth potential: Low potential	Avg potential	High potential
Best in class	24x	31x	66x
Above average	19x	23x	34x
Average	-	9x	-
Below average	-	-	-

Source: Factset

3. Finally, if a mispricing has occurred, we need to understand why. We believe these mispricings usually result from:

- The company faces a temporary setback and the market loses faith in its long-term earnings power or growth potential.
- The company is undergoing structural change.

Alphabet and Amazon

Alphabet is a good example of mispricing due to a temporary setback. Investors currently price Alphabet as an 'Average' business at ~19x FY25 PE as they are concerned genAI will disintermediate the search business. We believe Alphabet is a 'Best in Class' business and should trade at ~28x in line with peers (see Figure 4).

There is little market share data suggesting monetisable search (e.g. booking a holiday) is impacted by AI and large language models. Over the medium term, it's hard to see how ChatGPT or Bing can attract a larger audience and offer advertisers a better ad product given Alphabet's distribution strengths via Android, Chrome and YouTube and superior targeting based on data from services like Gmail and Google Maps.

Amazon is an example of mispricing due to structural change. Investors currently price Amazon as an 'Average Growth Potential' business and borderline 'Above Average'/'Best in class' on quality at ~30x FY25 PE. We believe Amazon will rank as a 'High Growth Potential' business if it can monetise advertisements in its video streaming business.

We believe Amazon is uniquely positioned to capture a meaningful portion of the $60 billion of linear TV ad spend shifting to digital given the size of its content library, its unique access to user purchasing data and the ability to directly track performance on platform. Doing so will meaningfully change the earnings growth and ROIC trajectory of the retail business.

Figure 4: Alphabet – our expectations vs market expectations

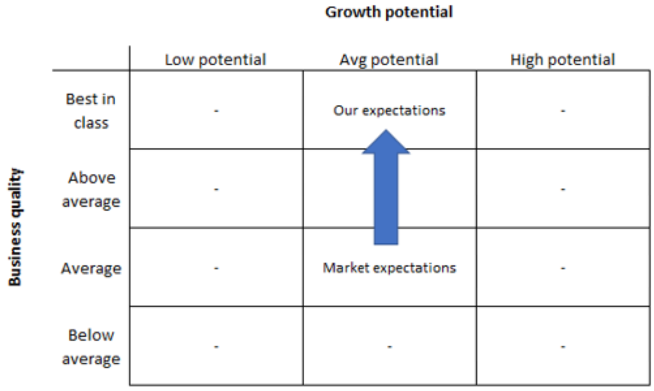


Figure 5: Amazon – our expectations vs market expectations

In conclusion, the real investment skill is to know when a stock on 30x is cheap and when a stock on 10x is expensive.

[1] Free Cash Flow is the money a company has to pay debts and pay dividends. It's calculated after accounting for spending on operations and assets and often seen as a good measure of a company's financial health.

Jimmy Su is Portfolio Manager of Platinum's International Technology Fund. Platinum Asset Management is a sponsor of Firstlinks.

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Are more informed investors prone to making poorer decisions?

Joseph Taylor

An investor's behavior has every bit as much of an effect on their returns as the stock market environment they happen to live through. I know this as well as anybody.

In 2021, I earned a measly 6% in a year where everything - absolutely everything - went up, and putting my money in a global ETF would have scored me 23.5% in sterling. Why did this happen? Because I behaved like an idiot, traded too much, and racked up massive brokerage fees.

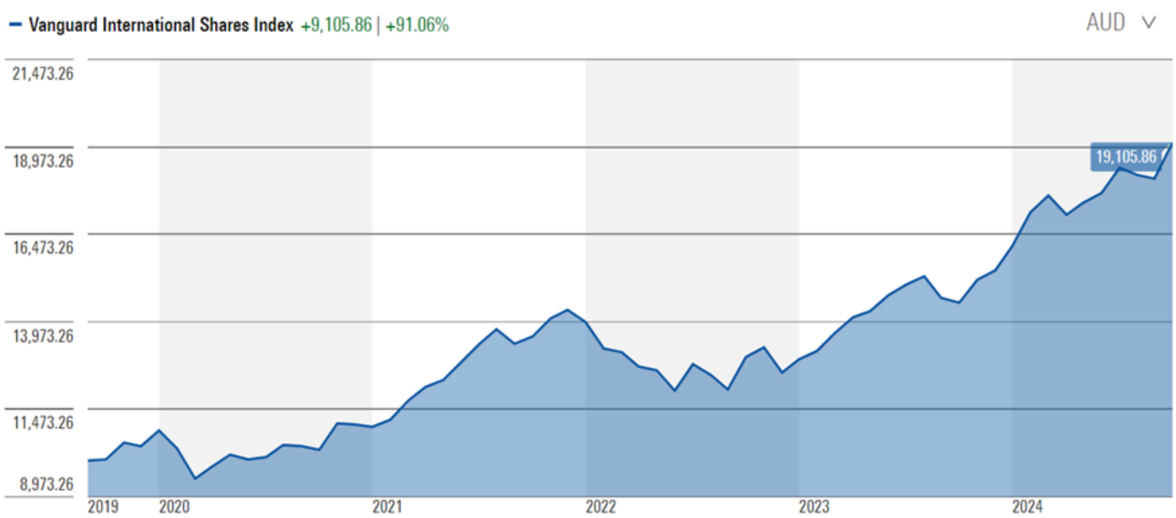
Re-opening this wound to write a recent article reminded me of how important it is to be aware of how we behave as investors and why. In that sense, a podcast appearance by previous Firstlinks contributor Professor Michael Finke popped up at exactly the right time.

Here are four things I learned from his discussion with Standard Deviations podcast host Daniel Crosby about the impact of behavior on investment and retirement outcomes.

The three main sources of panicked trading

Overtrading like I did in 2021 is a classic case of poor behaviour stunting returns. Another classic is our very human tendency to get carried away in the good times (buying high) and overly scared in the not so good times (selling low).

For those investing over the past 25 years or so, perhaps the worst thing you could have done was to panic and sell everything whenever stock markets wobbled. Even in the years since Covid reared its head, this has happened several times. And pretty much every time, markets have tended to bounce back very strongly.



Source: Morningstar

Finke has done a lot of research into how likely different buckets of investors (measured by the type of retirement account they have) are to panic when markets fall. As I understood it, three things seem to have an outsized impact on an investor's likelihood to sell everything and move into cash:

1. The investor's time horizon – how long until the person is due to retire? Investors with less than ten years to go until retirement were far more likely to sell out of equities and go into cash at times of market tumult.

2. The investor's time in the market – has the investor lived through market panics before and realised that it's usually OK on the other side? If they haven't, the investor is probably more likely to sell at the first sign of trouble.

3. How engaged the investor is with their portfolio and markets. The least interested investors (those in a simple lifecycle product) were least likely to panic. The most engaged, self-directed investors were most likely.

The first two make a lot of sense. The third might seem counter-intuitive because it suggests that the more informed you are as an investor, the more prone you are to making poor decisions. But when you think about it, it makes perfect sense.

Ignorance is bliss?

The likelihood of making a poor, emotionally driven decision increases at times of extreme market volatility. This, according to Finke, is where ignorance can be far more of a super power than knowledge or a keen interest in markets.

Why? Because those who take no interest in markets and no role in managing their investments don't care or know enough about what is going on to panic. To illustrate this, Crosby told a story about Betterment, a so-called robo advisor in the US.

Whenever a stock market correction came along, Betterment used to email every single one of their clients with messages telling them not to worry and to focus on the long-term. They did this in the hope that it would encourage better investor behaviour. A noble act.

Instead, Betterman found that their email blasts actually seemed to encourage worse behaviour. Why? Because previously "ignorant" investors became more worried than they would have otherwise. Betterman switched to only emailing investors that logged into their accounts during periods of volatility.

This rings true even outside of market corrections. If I didn't enjoy reading stock pitches and macro articles so much, would I have tinkered with my portfolio so much in 2021? I doubt it. I probably would have been far more focused on the savings part of the equation rather than the investing part.

An active interest in investing might be every bit as dangerous to your returns as it is helpful. Just another reason that I recommend you read my colleague Shani's earlier piece for Firstlinks on her disinterested investing strategy.

The double-edged source of engagement

One measure of engagement is how often somebody tracks their portfolio balance. I've always wanted to reduce the frequency with which I do this, but I find it hard not to check up on the shares that I have selected for myself. As for the index funds I own in my super, I find it far easier to ignore.

According to Finke, being more engaged in this manner isn't *all* bad, but it is a double-edged sword. His research suggests that people who track their investments more tend to save far more than those who don't. This is potentially because during good times, of which the stock market has had many in recent years, a rising balance provides positive feedback and motivation to keep investing.

If the stock market was to reverse course, however, constantly logging in and getting negative feedback could induce feelings of panic and make the attentive investor more prone to making an emotional or rash decision.

Behaviorally optimal versus 'spreadsheet optimal'

Finke and Crosby also discussed the need for a shift in mindset from 'optimal' asset allocations to those that make it easier for investors to avoid poor behaviour.

As an example, stock markets have generally been very strong over the past 25 years. Because of this, most back-tested returns will show that holding excess cash in your portfolio was a grave error. But would it have been an error?

If presence of a 'safe' cash bucket helps the investor think longer-term with the remaining equities allocation, it might help them capture more of the market's strong return than they would have otherwise. I have thought about this a lot in regard to investing in actively managed funds.

It is easy to write off active funds because we all know how hard it is for them to outperform market averages over time. But as Morningstar's Mind The Gap study shows every year, asset class averages do not equal the returns that investors actually achieve.

If you, for example, have deep rooted concerns about the index's concentration – be it in a small group of individual stocks, a certain sector, or a certain country - you might find it harder to simply 'set and forget' that investment. And find yourself more prone to panicked buy and sell decisions.

As a result, I think there is every chance that finding a fund with 1) a manager you trust and 2) a process that fits your own investing philosophy could produce a better overall return for you. Even if that fund does indeed lag the market average.

Joseph Taylor is an Associate Investment Specialist at Morningstar. You can listen to Michael Finke's appearance on the Standard Deviations podcast here.