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Editorial

In Loving Memory of Graham Hand

Graham's wife, Deborah Solomon, and daughters, Jenna and Elana, have established the Graham Hand Gift to honour Graham's remarkable legacy and to support the causes that he cared about.

In addition to Graham's giant legacy in financial journalism and investment thought leadership, Graham was a passionate advocate for giving. His efforts resulted in millions of dollars committed to the community through the Australian Philanthropic Services Foundation.

To honour Graham, the Graham Hand Gift will support projects that mattered to Graham, including social inclusion and empowerment through football (the "real kind", as Graham would say). This giving fund, held within the Australian Philanthropic Services Foundation, ensures that Graham's vision of giving continues to make an impact in his name.

Donors can make a tax-deductible donation to the Graham Hand Gift via EFT or BPAY using the following link: Donate to the Graham Hand Gift (https://apsforms.tfaforms.net/f/donate?accid=001Ob00000MmHWX). For assistance or further information, please contact Rachael Rofe and the APS Foundation team on 02 9779 6312 or email foundation@australianphilanthropicservices.com.au.

Thank you for your support in celebrating Graham's extraordinary legacy.

In this week's edition...

The Big 4 banks have been on a tear of late and it's left income investors in a bind: do they stick with them even though they offer relatively low dividend yields and poor prospects or should they look elsewhere? **James Gruber** gives his take on the issue.

Australian Foundation Investment Company (AFIC) Managing Director, **Mark Freeman**, and his portfolio managers sat down for an interview with *Firstlinks*. **Joseph Taylor** details what they had to say on a range of topics, including the current discount to NTA, AFIC's dividend and buyback plans, and what it's doing with bank holdings after their recent run-up.

Most Australians don't realise they are being charged up to six different types of fees on their superannuation. These fees can be opaque and hard to compare across different funds and investment options, as **Tony Kaye** outlines.

Ausbil Executive Chairman and CIO **Paul Xiradis** was recently inducted into the Funds Management Hall of Fame. This week, he shares his outlook for ASX large caps and why he's optimistic for 2025 and beyond. Paul also shares some of his favoured stocks.

Commercial property has been through a tumultuous two years. The big question is, are we near the bottom? **Cromwell's Colin Mackay** goes through the four phases of a typical property cycle and why we may be through the worst part of it.

The concept of an 'equity risk premium' has driven asset allocation decisions for decades. A revamped study suggests it was a relatively short-lived phenomenon rather than the mainstay many thought. **Phil Graham** has more.

Lastly, in this week's whitepaper, the **World Gold Council** has key gold demand trends from the third quarter of this year.

Curated by James Gruber and Leisa Bell

A full PDF version of this week's newsletter articles will be loaded into this editorial on our website by midday.

Looking beyond banks for dividend income

James Gruber

The Big Four banks have had a stellar run over the past 12 months. For instance, Commonwealth Bank (ASX: CBA) is up 56% during the period, and 43% year-to-date. It's a head spinning move for the ASX's largest stock with a market capitalization of $260 billion.

Source: Morningstar

Is CBA a $115 billion better business (the equivalent of Westpac's current market capitalisation) than a year ago? Not if you go by earnings, which were down 2% in the last financial year. The prospects for future earnings aren't impressive either, with most analysts looking for mid-single digit growth over the next three years. And these analysts assume provisions for bad debts remain near all-time lows – a big assumption.

What explains the rampant run-up in bank share prices? 'Fundamentals' as we like to call them in the finance industry don't explain the moves. More likely, it's liquidity. Mining stocks have been in the doldrums and large fund managers and super funds have essentially been forced to buy the banks to get returns. Passive ETFs have amplified the price rises.

Gone are the good old days

Once upon a time, the banks offered high starting yields (due to lower prices), with steady, growing dividend streams, but that's now a distant memory. For instance, CBA grew dividends by a compound annual growth rate (CAGR) of 9.2% in the decade to 2003, by 8.9% in the decade to 2013, but by just 1.74% in the decade to 2023. Similarly, Westpac increased dividends by 9% CAGR in the ten years to 2003, by 9.5% in the following ten years, yet dividends declined by 3.1% per annum in the decade to 2023.

The slowing dividend growth is the result of slowing earnings growth, due to a host of reasons. Increased competition for deposits and loans, greater capital requirements, slowing credit and economic growth, and other factors have played a part.

Future earnings growth also looks tepid at best, and consequently so does dividend growth. Even with franking credits, the picture doesn't appear anywhere near as positive as it did over much of the past 40 years.

Yet, the current share prices don't reflect this. CBA is sporting a price-to-earnings ratio (PER) of 27.7x, making it the most expensive bank in the developed world, and by a distance. The PERs of the other banks are cheaper, though far from cheap: Westpac (ASX: WBC) at 17.4x, NAB (ASX: NAB) at 17.5x, and ANZ (ASX: ANZ) at 15x.

These high prices have left dividend yields at the lower end of history, with CBA's yield at 3%, Westpac's 4.5% NAB's 4.3%, and ANZ's at 5.1%.

Looking beyond banks

Banks have been the go-to source of dividend income for investors for years, yet they don't offer the same prospects for high, growing income that they once did. What should investors do?

The yields on banks aren't disastrous, so I'm not suggesting that it's time to cut and run from them. However, it does seem an opportune time to look beyond the banks for better dividend prospects.

Here are some ideas:

Steady compounders. These are potential bank alternatives, offering steady, growing income. I like medical insurers such as Medibank Private (ASX: MPL) and NIB (ASX: NHF), with dividend yields of 4.4% and 5% respectively. Yes, there are risks around hospital cost negotiations, yet these seem to be at least partially priced in. While pricing is set by government, growing demand for private healthcare should ensure increasing earnings and dividends for many years.

Origin Energy (ASX: ORG) is another one in this category. It's the country's electricity and gas supplier and its attractive prospects have made it the subject of takeover bids. With a 5.1% yield and reasonable valuations, it deserves a place in income portfolios.

Dividend growers. This group of companies comprises great businesses with relatively low dividend yields but with opportunities to grow those dividends at a brisk clip. Brambles (ASX: BSB) is one, offering a yield of 2.6%, albeit only partly franked. Resmed (ASX: RMD) is another, with a paltry yield of 0.8%, but with a great track record of increasing dividends (more than 7% CAGR over the past ten years). And a personal favourite is Washington H. Soul Pattison (ASX: SOL). It has raised dividends in each of the past 24 years, by 10% per annum. It's a phenomenal track record that's unlikely to be repeated. However, the future still appears bright for the conglomerate. Soul Patts offers a 2.7% current dividend yield.

Comeback stories, returning cash. Here are stocks where there is real value and the potential for business turnarounds and for cash to be returned to shareholders. Ramsay Health Care (ASX: RHC) offers a possible opportunity. Better returns should come from an increased focus on its Australian assets. Also, negotiations with insurance funds over costs could prove a catalyst for the stock.

Perpetual (ASX: PPT) is another one. Everyone hates the company given its history. Yet, it's inexpensive and if a proposed demerger goes ahead, that should result in about a billion dollars finding its way back to shareholders.

What didn't make the list

There are notable absentees from the stock ideas above. First, there are no miners. I just don't think miners deserve a large spot in portfolio given their volatile earnings and dividends. Second, the supermarkets are excluded too. Despite recent issues, the shares still seem on the expensive side and dividends aren't compelling. Government pressure is effectively capping pricing, and they're still dealing with cost issues.

What about dividend ETFs?

Given ETFs are all the rage, the inevitable question is whether there are ETFs that can provide investors with decent dividend income. My issue with a lot of the dividend ETFs is that they're loaded with banks and materials companies. For example, the largest dividend ETF, Vanguard's Australian Shares High Yield ETF (ASX: VHY) has 66% exposure to financials and materials, in line with its benchmark. It's fine if that's what you're looking for.

However, if you want to diversify away from banks and miners for yield, then please carefully read the fine print of dividend ETFs.

Are international shares an option?

International shares are an option for those seeking income. However, these shares don't have the franking credits that are on offer in Australia. For this reason, I've always looking for yield in Australia and growth outside of it. It's a strategy that may not suit everyone and depends on your circumstances.

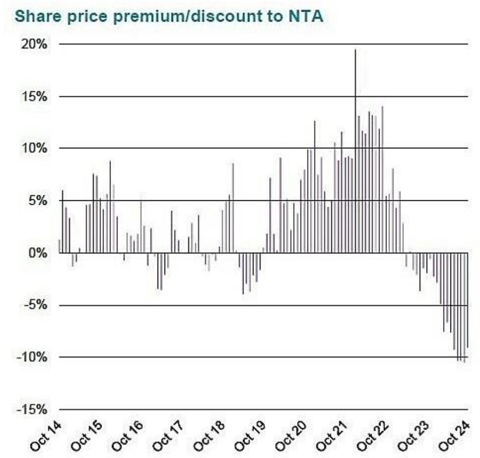
James Gruber is editor of Firstlinks and Morningstar.

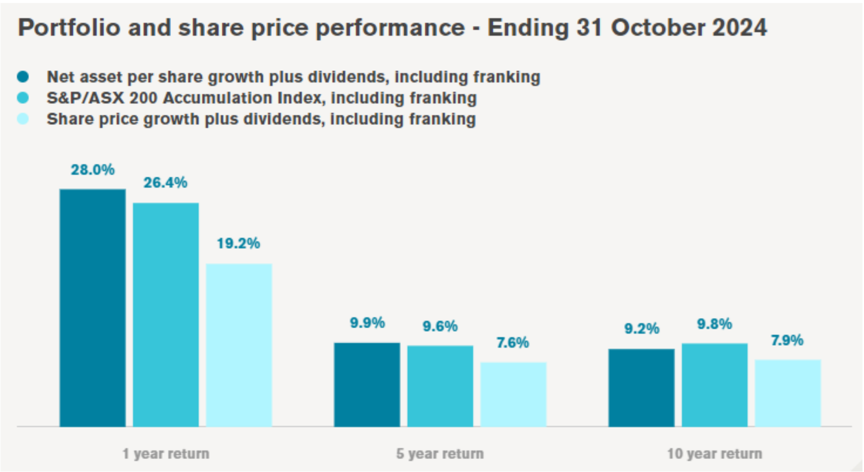
AFIC on its record discount, passive investing and pricey stocks

Joseph Taylor

Imagine overseeing a return of over 28% in a year and beating your benchmark, only to see all of that relative gain (and more) wiped out by something that isn't under your control.

That's exactly what the story has been at AFIC (ASX: AFI) recently, as its investments have outperformed but its discount to NTA surged to 10%.





You could spend all day coming up with reasons why the discount has become so large compared to history. But it's probably just supply and demand – because you could speculate that demand for AFIC shares is probably being hit from three sides.

Number one: there is an alternative again

Those seeking income in retirement have alternatives to equities again. They can get a 4% yield in bonds instead of needing to jack up their risk profile.

AFIC is ***not* your average LIC** when it comes to its historical discount (it has often traded at a premium), but Andrew Mitchell and Steven Ng's article that [featured on Firstlinks in June] showed a convincing connection between higher interest rates and higher LIC discounts on average.

Range for Average of Fed/RBA policy rate	Average Premium/Discount	Median Premium/Discount
0-2%	-4.6	-3.8
2-4%	-6.0	-6.9
4-6%	-8.3	-8.8
6-8%	-12.4	-11.8

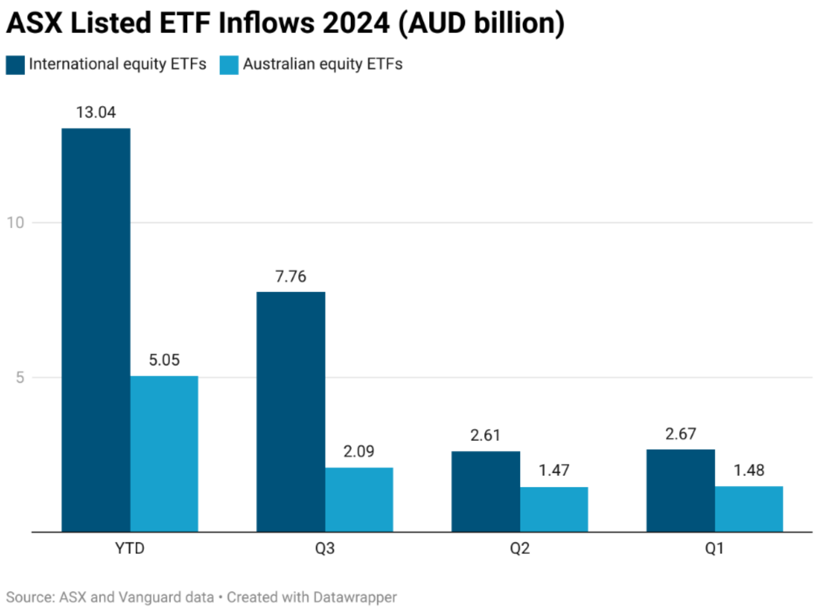
Source: Bloomberg. Data since January 1992 and includes premium/discount history for 38 equity LIC/LITs on the ASX using history back to their inception dates.

Number two: the continued rise of passive

With total costs of just 0.15% last year, AFIC is a remarkably low-cost way to own many of Australia's biggest companies. But, then again, so are index-based ETFs. Given that passive ETFs are very much in vogue and LICs are very much out of vogue, which option has been more likely to woo investors seeking that kind of low-cost exposure?

Number three: attention shifting overseas?

Instead of primarily investing in Aussie shares and considering different options for that, investors are tilting more towards global shares.



The data below from ASX and Vanguard might be skewed a bit by the fact that ETFs are especially attractive for those seeking international equity exposure because they minimise issues like currencies, higher trading commissions that come with owning foreign stocks. But Australia's strong (and growing) appetite for global exposure is clear.

Could this have sucked away some demand for AFIC shares too? Overall, I don't think it's crazy to suggest that AFIC's discount has faced a triple-headwind from three of the biggest investing trends post-2022: higher interest rates, the continued rise of passive investing and ETFs, and increasing demand for international shares.

Passive ETFs versus LICs – an unfair fight, but for how long?

The past few years have been a dream environment for passive ETF adoption. Markets have generally been on the up and up and returns from many markets (especially in the US) have been concentrated in the biggest players.

This is a very tough environment to beat the index and provides a tailwind for those selling investors the lowest cost exposure to it. On the other hand, the potential benefits of a low-cost LIC like AFIC versus a passive ETF – and, yes, there are some – haven't had a chance to shine recently.

Let's start with dividend protection. If you own an ASX200 index fund through an economic slump, the underlying companies are likely to cut their dividends. As a result, you will probably receive less income that quarter or year, income you may have been relying on.

A well-known benefit of LICs is their ability to hold cash and franking credits to support the dividend in weaker years. This allowed AFIC to maintain a flat dividend through the payout cuts of early Covid and during the GFC.

In his interview with me last week, CEO Mark Freeman told me that AFIC regularly assesses its ability to repeat this trick in future crises. With its current franking balance and reserves of retained profits and realised capital gains, he said AFIC could maintain its current fully-franked dividend even if none of its holdings paid a dividend for 18 months.

Is that the kind of benefit that is forgotten in bull markets? When the big four banks have increased dividends handily for several years? And when mining and energy shares delivered a dividend bonanza in 2022/23?

Another obvious difference between AFIC and an ASX200 tracking index is that AFIC can pick and choose what it invests in. As AFIC's portfolio manager David Grace put it, "the index is the last buyer at high prices and the last seller at low prices".

Grace sees the relative valuations of CSL (ASX: CSL) and Commonwealth Bank (ASX: CBA) as a prime example of how an index can keep bidding up one name while shunning another, based on nothing but share price action.

How, given the far superior growth and returns profile of CSL, he says, can these two companies trade at a similar P/E ratio?

5-year average	Commonwealth Bank	CSL
Revenue growth	2.75%	11.54%
Earnings growth	1.85%	6.61%
Return on equity	13.61%	24.2%
Forward P/E 19/11/2024	27.2x	32.7x

Does AFIC suffer from its headline similarity to ASX200?

Apart from a few big-ish overweights like CSL, Macquarie (ASX: MQG) and Transurban (ASX: TCL), AFIC's top 10 holdings did not look vastly different to those of the S&P/ASX 200 index as of October 31.

The ASX holdings below are based on the iShares Core ASX200 ETF. If a holding did not appear in both top tens, I have shown the percentage held in that share by the other product in brackets.

AFIC (AFI)		iShares Core ASX 200 ETF (IOZ)
Commonwealth Bank – 9.7%	1	Commonwealth Bank – 9.8%
BHP – 8.8%	2	BHP – 8.9%
CSL – 7.3%	3	CSL – 5.7%
Macquarie Group – 5.1%	4	National Australia Bank – 4.9%
National Australia Bank – 4.7%	5	Westpac – 4.6%
Wesfarmers – 4.3%	6	ANZ Group – 3.9% (AFI 2.3%)
Westpac – 4.2%	7	Macquarie Group – 3.4%
Goodman Group – 3.7%	8	Wesfarmers – 3.1%
Transurban – 3.4% (IOZ 1.6%)	9	Goodman Group – 2.6%
Telstra – 2.5% (IOZ 1.8%)	10	Woodside – 1.9% (AFI 1.9%)

I am not bashing AFIC's portfolio by pointing this out. Far from it. These companies, by and large, are high quality businesses with strong competitive positions. They align with AFIC's approach.

AFIC has held many of these companies for decades, benefitted from their growth, and has capital gains tax to think about for shareholders. These companies also contribute to an important component of AFIC's dual goal of capital growth and income through the payment of fully franked dividends.

I do wonder, though, if potential investors might be put off by the similarity at first glance. In that case, why not pay even less in fees for an index fund without needing to worry about a discount or premium to asset value?

I put this question to Freeman and co. Their take was that AFIC's portfolio actually *is* rather different to the ASX200. Especially once you look beyond the top 15 holdings or so.

They pointed to the fact that AFIC only held a total of 56 names versus the benchmark's 200 as of the last annual report. And to their far bigger positions in some of their favoured smaller-cap firms like ResMed (ASX: RMD) , REA Group (ASX: REA), Reece (ASX: REH) and Carsales.com (ASX: CAR) than the index holds.

Over the long run, they hope that continuing to hold companies of this ilk – and adding to them in periods of share price weakness – will benefit AFIC shareholders in the same way that holding onto names like CBA has benefitted them in previous decades.

	AFIC	iShares ASX 200 ETF
ResMed	2.1%	0.9%
CAR	2.1%	0.6%
Mainfreight	1.6%	n/a
REA Group	1.3%	0.5%
Reece	1.3%	0.2%

Source: Top 25 positions and NTA sheet October 31, 2024.

For now, though, I see a chance that investors could just glance at AFIC's biggest holdings and not see much scope for performance that is vastly different from the market average.

Will the discount ever close?

The big question for many AFIC shareholders – especially those who bought at a premium – is what might narrow the current discount.

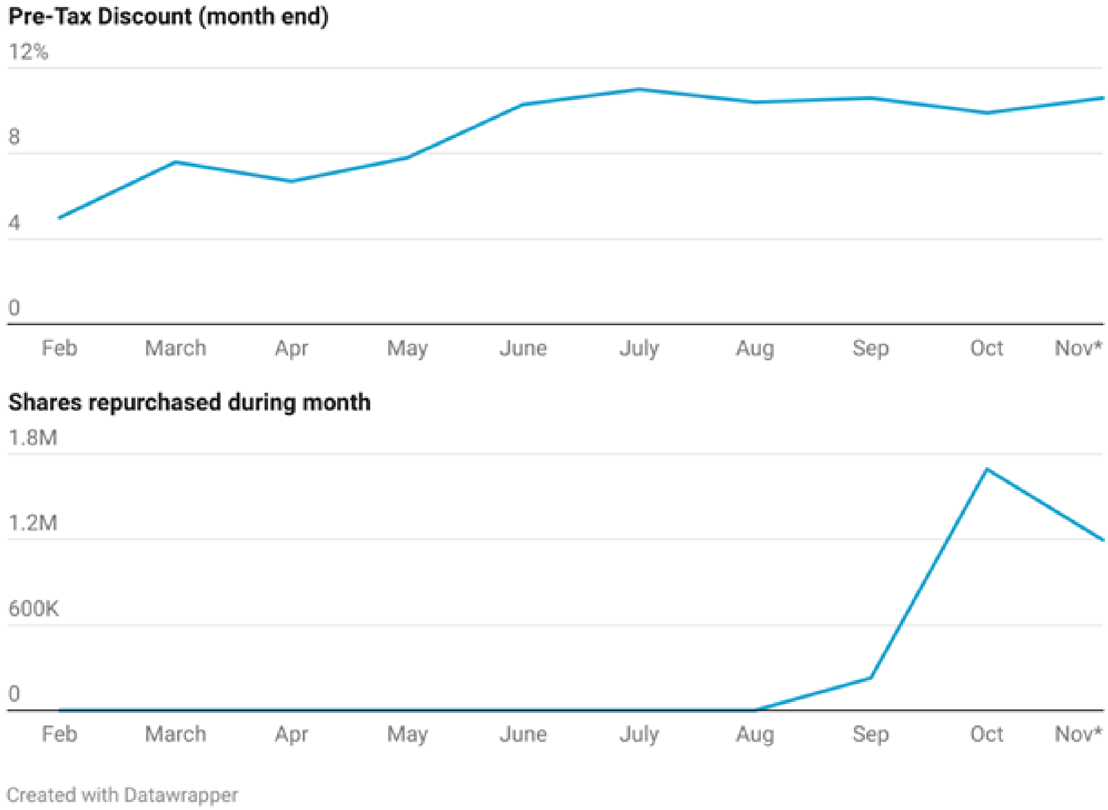
If the interest rate theory holds water, you could argue that elements of the discount are cyclical. But are rates likely to go *that* much lower again? When I look at any kind of historical chart, I constantly have to remind myself that the zero interest rate policy era was anything but normal.

In our conversation, Freeman and co didn't seem to be relying on that. Instead, they feel that marketing and education could bridge some of the gap. They also think that advisors could have an easier time recommending AFIC to clients now that it doesn't trade at a premium.

They are also buying back some shares. As Freeman put it, "we look at opportunities every day and don't see anything cheaper". Looking at AFIC's share repurchases since February, when it announced its latest buyback authorisation, makes two things clear:

1. AFIC has ramped up buybacks since September, from zero shares repurchases to over 3 million shares bought back at the time of publishing.
2. These buybacks still seem like a drop in the ocean. 3 million shares represents less than *a quarter of one percent* of the total shares outstanding!

AFIC discount and buybacks since February 2024



Potentially attractive, but not for the discount alone

I can't stop thinking that AFIC trading at 5 or 10% discount to NTA doesn't make any less sense than it trading at a 5 or 10% premium did. In fact, it probably makes a lot more sense. I have absolutely no idea why anyone would buy a LIC at a 5 or 10% premium.

Given the headwinds AFIC could continue to face on the demand front, I would be more confident in the discount merely *not getting much worse* than it returning to NTA or a premium. And for that reason, I don't think I would buy AFIC purely because of the historically big discount.

I still see plenty to like about AFIC, though.

First of all, it offers incredibly low-cost exposure to Australian companies of an above-average caliber. At 0.15%, its cost is only 8 bps more expensive than the management fee of Vanguard's passive Australian Shares Index ETF. Its costs are lower than the fee on active "factor" ETFs focused on higher quality shares of the kind AFIC focuses on. And, of course, it is streets cheaper than most managed funds.

Investment	Ongoing Fees/Costs
Vanguard Australian Shares ETF	0.07%
AFIC	0.15%
Betashares Australia Quality ETF	0.35%
Average Australia Large Cap Equities Fund	1.03%

AFIC has also proven itself as an excellent long-term steward of capital. Let's not forget, either, that a smoothed dividend could also seem a lot more important in the future than investors seem to think it is now. In an expensive equity market, investors looking for income and a long-term approach to capital growth might find the 10% discount attractive. Just don't bet the house on it closing.

Joseph Taylor is an Associate Investment Specialist at Morningstar.

Hidden fees are a super problem

Tony Kaye

Millions of adult Australians have superannuation that's either held in a managed accumulation account, if they're still working, or a managed account-based pension, if they're retired.

And most of us keep an eagle eye on our account balance, our net investment earnings and, if we're still making contributions, how much we've put in so far this financial year.

But when it comes to knowing how much we've paid in various fees, well, that's generally more challenging to decipher.

In fact, superannuation fees are confusing and most Australians don't realise they are being charged up to six different types of fees.

Super funds will issue an annual statement that aggregates the fees that have been charged to your account during the financial year. Regular fee deductions are also typically listed in your transaction history.

Yet, most super funds typically bundle up the fees that they've charged you as 'administration fees'. These often incorporate a range of different charges.

As well as a general lack of transparency when it comes to fees, it is also very difficult to compare fees across super funds because there is no consistency on how fees are presented on websites, social media and in advertising outside of product disclosure documents (PDS) or a fund's MySuper dashboard.

The three main categories of super fees are administration fees and costs; investment fees and costs; and transaction costs.

Administration fees and costs

Super funds charge administration fees to cover the costs associated with administrating and operating your super account. These fees are often levied at a fixed percentage rate based on your current account balance.

All super fund trustees also have a legislative requirement to fund and maintain an Operational Risk Financial Requirement (ORFR). This fee is normally charged monthly to members and is recorded on annual statements as an ORFR Admin Fee for Vanguard Super.

Investment fees and costs

Investment fees typically relate to the costs involved in managing the investment options you have chosen within your super fund and may vary between different options. These can include investment management costs based on your asset allocations and costs levied by third parties. They are usually deducted from investment returns before they are applied to your account.

Some super funds charge 'performance fees' on their MySuper default options if their investment returns exceed a target level stipulated in their PDS. These typically relate to fees that are charged by third party active investment managers.

Performance fees are normally charged based on a set percentage of an investment return that is above the specified target level and are lumped into the investment fees category. To determine the percentage or costs associated with performance fees super fund members generally need to read the fine print of their fund's relevant PDS.

Vanguard Super is the only fund that does not have a performance fee and has a single yearly 0.56% fee made up of administration, investment, and transaction fees and costs.

Transaction costs

Transaction costs are generally incurred as part of daily investment management activities to buy and sell underlying assets held by the super fund. They will also usually be deducted from investment returns before they are applied to your account and do not appear as specific items in your record of account activity.

Other fees and costs

Super funds also typically charge a **buy/sell spread** to recover the cost whenever you make a contribution, withdrawal, or switch investment options. The buy/sell spread is the difference between the buying and selling of the underlying investments. The buy/sell spread charged depends on your investment option and the number of transactions you make.

Some super funds can also charge **switching fees** if you decide to switch between different investment options, such as from a growth to a balanced asset allocation strategy.

Insurance fees (for default death and total permanent disability (TPD) cover) will also apply unless you decide to opt out of the cover. These fees are generally payable on a monthly basis and deducted from your account balance.

Lastly, where personal financial advice is provided by a licensed financial adviser, **advice fees** can be levied and, with your consent, can be paid via a deduction from your super account.

While this may all seem daunting, and not easily understood, one way you can check on the total fees that you have been charged throughout the course of the year is to review your member statement.

Compare apples with apples

If you compare your super fees with those of other super providers it's important to make sure you are comparing like for like, especially as different super funds tend to have a range of investment options charging different fee levels.

A good starting point is to check investment options that are closest to the allocations you have in your current super fund. You may need to investigate what other super funds are investing in, and their percentage allocations.

Tony Kaye is a Senior Personal Finance writer at Vanguard Australia, a sponsor of Firstlinks. This article is for general information purposes only and does not consider the circumstances of any individual.

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ASX large cap outlook for 2025

Paul Xiradis

Economic growth looks to have bottomed in calendar 2024, and we see it firming into 2025 - which means some return of select cyclical exposures in addition to key thematics like decarbonisation and technological change.

Exposures in this regard focus on profitable models to capture cyclical growth and compound the increased spending that comes with economic growth, and improvement in housing and discretionary spending.

Decarbonisation and the energy transition remain significant themes that are driving value across resources, energy, utilities and the mining services sector with respect to critical commodities. We like copper, uranium and rare earths for the central role these will play in renewable energy, energy storage and upgrading electrical grids worldwide.

We are also seeing structural earnings growth in technological transformation, the rise of artificial intelligence (AI), and the enablers and businesses that increasingly operate in the digital environment, including communications companies. These enablers include data centres, energy and energy storage that backs-up data processing, telecommunications and internet companies that support the web of connectivity and data. We also like beneficiaries of the digital revolution, companies that are able to leverage the networking and processing power offered by enablers to capture more business, more customers and at lower and lower costs.

Asian position

Australia is a young economy that is at the start of a huge story compared to other developed nations. Think America in the nineteenth century. Australia is a key part of the Asian growth engine that includes India, China and other fast-growing regional nations like Taiwan, South Korea, Vietnam, Indonesia, Cambodia and the Philippines. We are also linked closely to the developed markets like Hong Kong, Japan and Singapore. This is a privileged position strategically and financially. Many do not understand how beneficial this is for the growth path of Australia, our economy, and our global companies.

We are of the opinion that there will be a compound growth benefit in the expansion of Australia's export markets in intellectual property, services, technology, commodities, agriculture, tourism and education. Exports and growing immigration will manifest as investment back into local construction, real estate, infrastructure, services and consumer markets.

Australia's population will also grow to become an increasingly profitable internal marketplace, supporting large caps that are heavily exposed to Australia.

Themes position portfolios

These key themes, we believe, position Australia with significant advantages over our peers from an economic growth perspective. In our view, it makes a lot of sense to invest in Australia's future by investing in some of the most successful companies.

Australian large-cap stocks offer an ideal vehicle in which to invest in the compounding benefits generated by key thematics, and by the ongoing compounding growth in Australia's population and economy.

Remember, Australia is one of the safest and most regulated markets in the world from the perspective of continuous disclosure, market regulation and common law, within the context of a functional democracy – all beneficial in reducing large-cap risks so businesses can focus on what they are great

Large caps

Over the years I have observed a number of things about successful large caps.

The first is a strong business model that can generate earnings growth, year-on-year. For us, it all starts with positive earnings growth. Even better, we like finding a company that can invest cashflow from its earnings into capital expansion and business development at returns that are more attractive than the alternative, buybacks and dividend payouts. This sounds simple, but so many businesses just cannot achieve these two things, let alone compete with peers in a global and competitive marketplace.

Beyond the quality of the core business model, in very simple terms, a good large company should have a strong balance sheet, manageable levels of debt, a supportive and stable ownership structure, strong corporate governance, strong and improving ESG credentials, and a strong and experienced management team.

A good large company should have a healthy brand, a strong reputation that is guarded, a unique position or proposition that demarcates it from competitors, and potentially an element of protection or barriers to entry that inhibits competitors and enhances the value of its business.

In most cases, great companies need to be in growing markets or sectors in order to generate growing earnings. This is where our macro-economic outlook helps to determine which sectors are beneficiaries of a given economic view looking forward, and which sectors will be challenged. This allocation is important because it is hard to fight the cycle, even with great companies.

Large caps have always been of interest to me perhaps given the complexity they show, and the potential to find gems in this complexity if you take the time to analyse and know a company. This complexity accords with my naturally curious and forensic approach to finding superior earnings growth opportunities. Owning a share of Australia's largest and most successful companies is an exciting prospect for investors.

Of course, you do not invest in large companies just because they are large, or complex. There can be both good and bad reasons why a company has become a large cap. It is not always apparent, but understanding the reasons can help focus on what matters when finding large- cap stocks.

The relativity between valuation and the earnings growth outlook is what matters for the allocation of risk capital. Investors who are serious about generating compound return on equity look at the interrelationship between earnings and earnings growth, and what assets are acquired for a return on capital that offers the potential for outperformance.

To illustrate this with a contrasting example, in passive market-cap weighted ETFs (exchange- traded funds), the larger the market cap of a company, the more investment capital it attracts, regardless of its earnings profile, growth outlook or whether the business is growing or shrinking. Hence, sentiment-pumped market caps are rewarded for being big, rather than being profitable or having a future earnings growth profile.

By contrast, our active approach allocates capital to companies that we have assessed to offer superior earnings growth and where we believe there are significant potential earnings surprises. We are earnings growth obsessed, simple as that, because in essence, companies are only as good as the earnings they can generate for shareholders.

Risks

There are a number of risks that come with larger companies. Firstly, there is the challenge of complexity that we have already discussed. To mitigate this complexity, we have a team of equity analysts and portfolio managers who study the same companies and are evaluating these companies on an ongoing basis. However, we believe this complexity also offers significant opportunities for outperformance that rewards diligence and a strong investment process.

Who owns the company and how management is incentivised makes a big difference in how they make decisions. How management and staff are aligned not just to the interests of customers but also the interests of equity holders can make a material difference to how a large cap performs. The flipside to this is that poor alignment and bad management can destroy a large cap very quickly.

Other risks which we seek to avoid through our research and knowledge of companies can include transparency problems, specific ESG issues or exposures (including negative momentum in sustainability scores), and any other element of a company or the market in which it operates that is a risk to earnings. We are vigilant on risks to our view on earnings growth, and our process allocates away from anything we think is materially adverse to our view on a company's ability to continue growing its earnings and dividends.

Accordingly, we prefer active investing because we know over time we can improve on the market return. The value of this edge across many years is worth a lot of money to an investor.

With an active approach I don't have to hold companies that I believe are going to be underperformers at best, will fall out of the index, or go bankrupt at worst. I can also focus my capital on companies that demonstrate mastery in their businesses and are far more likely to perform over time than their peers. By perform, I mean that they are more likely to grow quality earnings, and in many cases, generate earnings growth above that of the market.

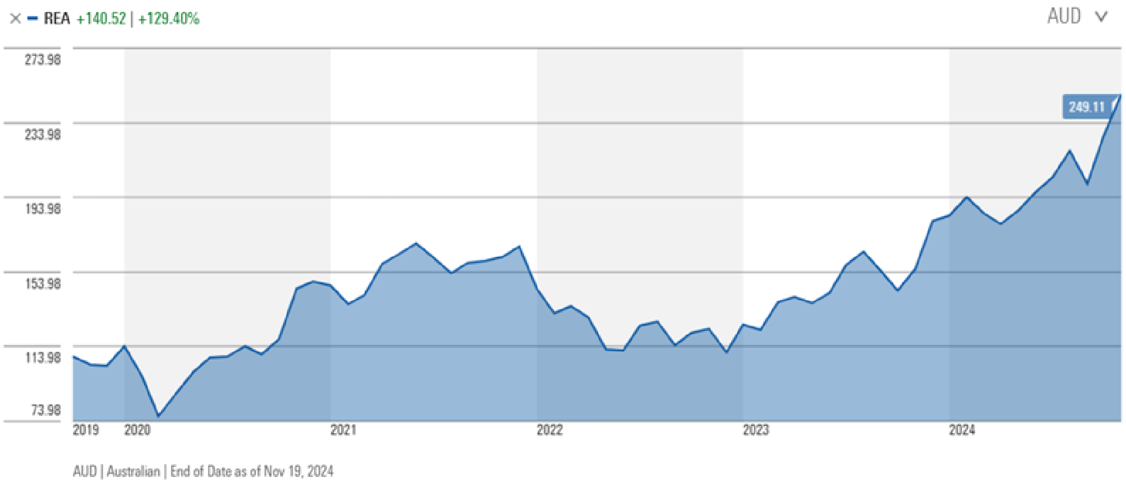
The academic arguments fall either way on active versus passive approaches, but from my decades of actively generating alpha, I believe an active approach works across time.

Stocks

Stocks we like (and reflected in our top 10) include BHP, Commonwealth Bank, National Australia Bank, CSL, Macquarie Group, Goodman Group, ANZ Bank, Xero, Rio Tinto and Aristocrat Leisure.

We are overweight Block, Evolution Mining, NAB, REA Group, Aristocrat Leisure and ResMed. We don't have any positions in Woolworths, Woodside Energy Group, Mineral Resources and Fortescue.

As an example, why we like REA Group (ASX:REA), is that Australia's leading residential and commercial property portal's 'vendor pays' business model enables it to drive strong annual price increases, coupled with product innovation, increasing market share and a forecast lift in listing volumes and top line growth should see it remain strong over the medium term. In addition, we believe REA has other favourable investment attributes including a variable cost base that enables it to manage cost growth below revenue growth, a solid balance sheet and global growth optionality.

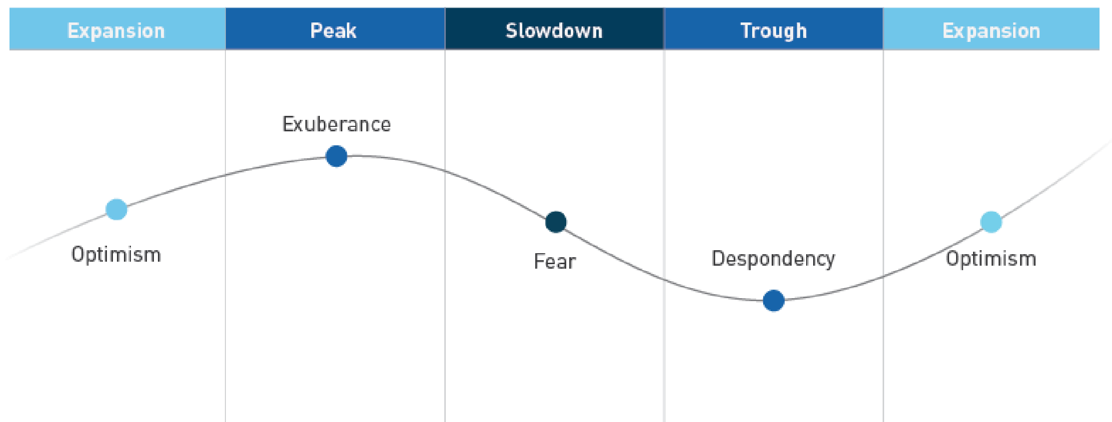


Paul Xiradis is Co-Founder, Executive Chairman, Chief Investment Officer, and Portfolio Manager at [Ausbil Investment Management](). This article contains factual, general information only and does not constitute financial product advice. It does not take account of your individual objectives, financial situation or needs.

Taking advantage of the property cycle

Colin Mackay

In our view, the commercial property market cycle includes four phases:



Peak: This phase features strong economic growth, rising property prices, and high investor confidence. Demand accelerates and vacancy rates drop well below normal levels. However, it can also lead to overvalued assets as sentiment moves ahead of underlying property performance and prices reach their zenith. Interest rates may also start to rise in this phase as the RBA seeks to take some 'heat' out of the economy.

Slowdown: In this phase, market dynamics shift, leading to weaker demand and softening prices. Construction, which typically picks up in the expansion phase, starts to create an oversupply and vacancy rates increase. Interest rates continue to rise, impacting jobs growth and slowing the economy. Sentiment worsens, perpetuating falling prices.

Trough: Characterised by low investor confidence and sometimes widespread despondency, this phase sees prices hitting their lowest point. However, it can also present opportunities for investors to buy undervalued assets at attractive prices. Towards the end of this phase, rate cuts often stimulate activity and lay the foundation for asset appreciation.

Expansion: During this phase, economic and financial conditions improve, boosting investor confidence and supporting asset prices. This is typically the longest phase, underpinned by moderate growth rather than the sentiment-driven extremes of the market peak and trough.

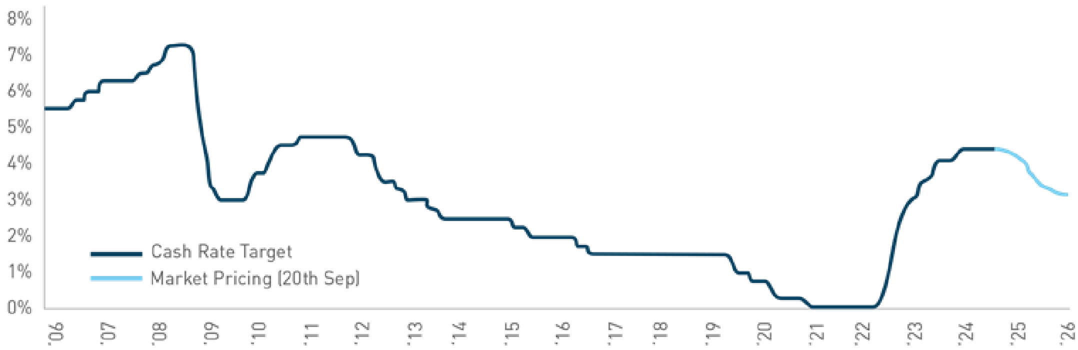
Property market cycles repeat over time, but each one is unique. This is because the intensity and duration of a cycle depends on a multitude of factors such as macroeconomic conditions, geopolitical events, investor sentiment, and unexpected occurrences like natural disasters or global pandemics. Sectors within a market and even different locations can be at different phases of the cycle at the same point in time.

Now that we have the basics covered, let's take a look at the current property market.

The macro landscape

As mentioned above, macroeconomic conditions play a big role in property cycles. Recently, we've seen a significant increase in interest rates – 425 basis points in 18 months, which has significantly impacted commercial property prices. However, many believe that interest rates have peaked for this cycle. Other countries such as the US, Canada, New Zealand, and several across Europe, have already started lowering rates.

Australian Cash Rate Target



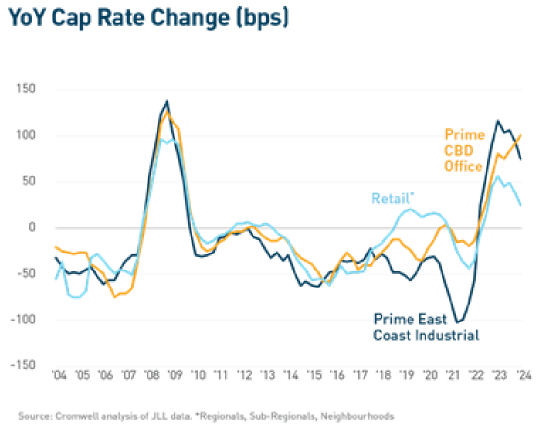
Source: RBA; ASX; Cromwell

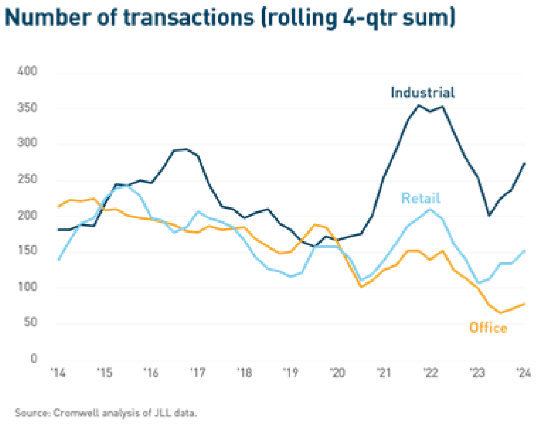
Australia's inflation cycle took hold around six months later than peer markets and rate cuts are also expected to commence a bit later (around early next year). Cromwell expects lower interest rates will boost market confidence, stimulate transaction activity and support property prices.

Property pricing

We're starting to see signs that property prices may be stabilising. The pace of capitalisation (cap) rate expansion (a driver of declining property values) is slowing for retail and industrial properties, an indication that the cycle may be turning for these sectors. It is important to note that because the valuation cycle lags, waiting until market valuation cap rates have started to compress means the best buying (i.e. the bottom of the cycle) has actually already passed you by.

For office properties, cap rate expansion is yet to slow but should follow the example of retail and industrial, in part supported by the emerging cap rate differential to the other sectors, which will boost the relative attractiveness of office investment. Increased transaction activity is another sign that the market cycle might be turning.





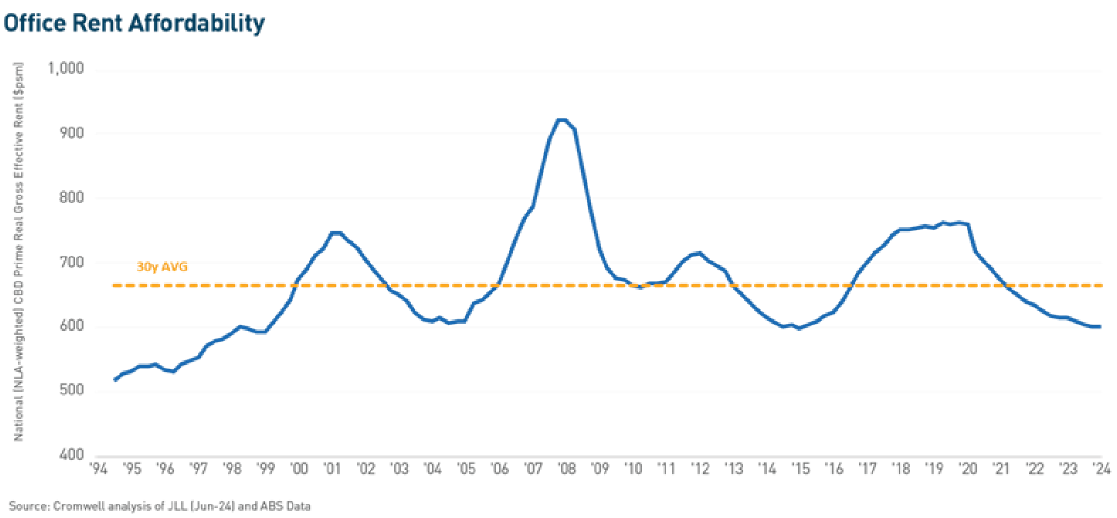
Office fundamentals

While the macroeconomic and capital cycles appear to be becoming more favourable, they would be of little consequence if office market fundamentals were too far out of sync. Despite some challenges, like high vacancy rates in Sydney and Melbourne, there are still reasons for investors to be optimistic about the office market.

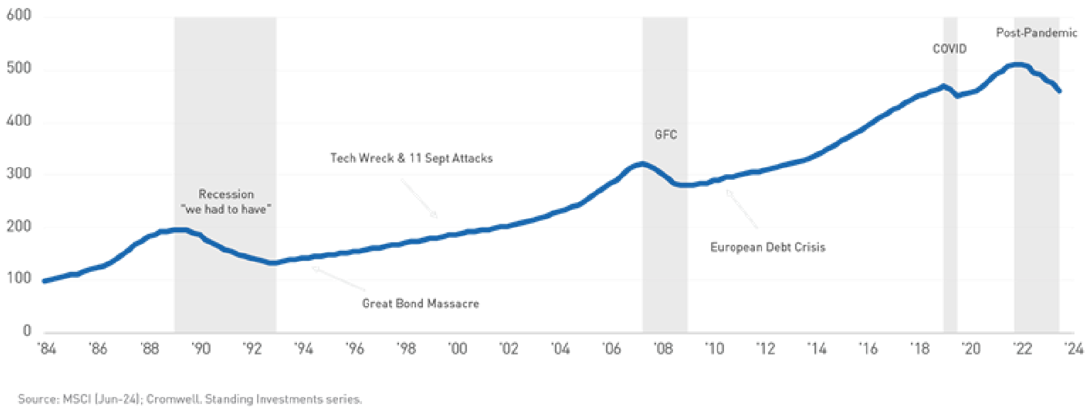
Firstly, rents are at cyclical lows, similar to the levels seen after the early 90s office market blowup. With rents at low levels, occupiers aren't under financial pressure to reduce their space or avoid expanding if they're growing. This also means that cutting office space or rent isn't the first option for saving costs. Companies understand that losing staff or having lower productivity due to a poor work environment is a bigger risk to their profits.

The other cyclical element of office fundamentals is the development pipeline (i.e. supply risk). This is relatively small, with the amount of national CBD stock expected to grow by only 0.9% per year from 2024 to 2028[1], compared to the 20-year average of 1.6% per year[2]. It's not practical to build new offices unless they are already under construction or part of an infrastructure project, due to low rents and high construction costs affecting profitability.

It's unlikely this dynamic will be resolved any time soon, with construction cost inflation expected to remain elevated[3] and state infrastructure pipelines set to continue outcompeting for scarce resources and labour for at least several years. The lack of new development is good for the performance of existing buildings, helping to balance supply and demand and support rental growth.



Commercial property asset value growth index



The long-term trend

Over the past 40 years, investing in Australian office, industrial, and retail properties has generally paid off, with property values growing steadily despite facing a number of downturns and crises. While looking at a shorter timeframe will accentuate cyclical ups and downs, the market has shown a long-term upward trend.

Adopting a long-term approach when investing in property means investors can benefit from this steady growth. This approach helps avoid the stress of predicting market movements. Sticking to a disciplined, long-term strategy based on solid fundamentals can help investors navigate market cycles, reduce risk, and build wealth over time.

Getting in on the ground floor

It's hard to know exactly when any market will peak or bottom out, but there are signs that can give clues about the general position of the commercial property cycle – whether it's falling, stabilising, rising, or peaking.

With rate cuts expected in 2025, financial markets believe the overall economic cycle is close to turning. Similar signs are appearing in commercial property, with slower cap rate expansion in some sectors and increased transaction activity. For office spaces, very low rents and limited supply are reasons for optimism and present a good buying opportunity.

For investors who have the courage and capital to buy now, the benefits can be significant. Attractive prices are available, with buyers able to take advantage of distressed sales and the gap between market fundamentals and sentiment. While choosing the right properties is still crucial for investment returns, getting in early and riding the market upswing can provide a strong advantage for investors. Those who have been patient and held onto their investments through this stage of the cycle are also likely to benefit.

1. Source: Cromwell (Jun-24)
2. Source: Cromwell analysis of JLL data (Jun-24)
3. Source: International construction market survey 2024 (Turner & Townsend)

Colin Mackay is a Research and Investment Strategy Manager for Cromwell Property Group. Cromwell Funds Management is a sponsor of Firstlinks. This article is not intended to provide investment or financial advice or to act as any sort of offer or disclosure document. It has been prepared without taking into account any investor's objectives, financial situation or needs. Any potential investor should make their own independent enquiries, and talk to their professional advisers, before making investment decisions.

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Is this bedrock of financial theory a mirage?

Phil Graham

One of the foundational beliefs that drives strategic asset allocation is the existence of the equity risk premium (ERP) – that is, that by taking on greater risk of owning equity an investor will be rewarded with greater return.

Based on research undertaken by Jeremy Siegel[1] in the early 1990s *"The Equity Premium: Stock and Bond Returns since 1802",* (and expanded by others in following years), very long run data on stock and bond returns was compiled which purported to show that stocks outperform bonds over the long run.

Combined with other research like the annual Credit Suisse Global Investment Returns publication, which many have utilised over the years, the existence of an ERP of 3-4% per annum (an 8% equity return versus a 4% bond return) has become embedded in investment return assumptions.

These assumptions drive the high allocation to equities typically present in diversified investment portfolios. Yet recent updated research suggests that the existence of the equity risk premium may be more episodic than these assumptions imply.

A paper published almost a year ago in the Financial Analysts Journal[2], "*Stocks for the Long Run? Sometimes Yes, Sometimes No*", by Edward F. McQuarrie, questions this fundamental assumption. The paper extended the historical analysis back further to 1792 and, importantly, updated it to:

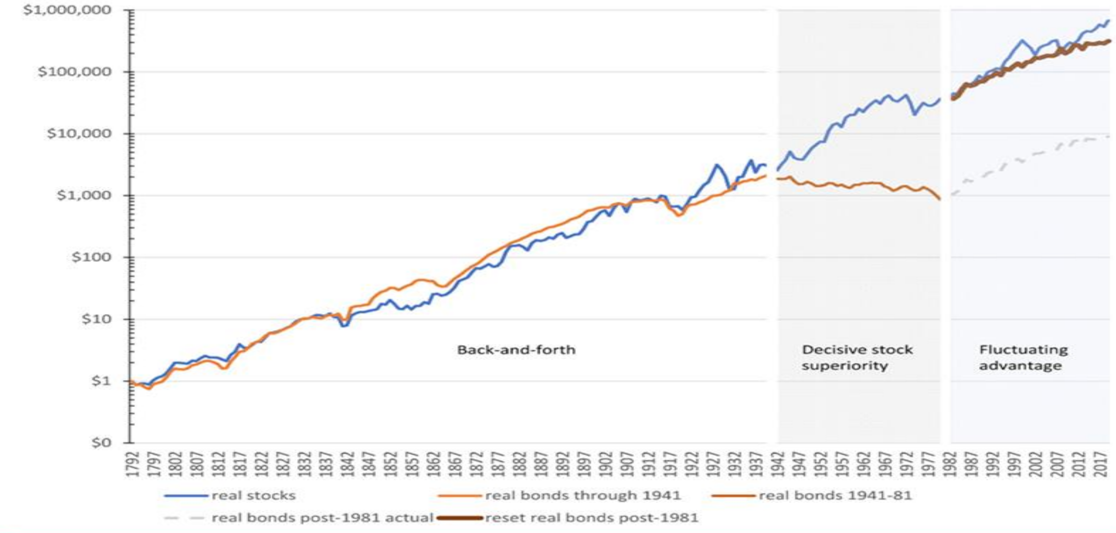
- Include securities trading outside New York (in Boston, Philadelphia, Baltimore and southern and western US cities), increasing the coverage to 3-5 times more stocks and 5-10 times more bonds;
- To capture more failures, reducing survivorship bias;
- Include federal, municipal and corporate bonds; and
- Calculate a cap-weighted total return for stocks.

While historical data must be treated with a significant caution, especially over such long periods, these enhancements appear to be a large improvement on the original data. *For more detail see the paper, which details the methods and contains links to the files containing raw data, for use by future researchers.*

Shortcomings remain, such as annual frequency of data, time-averaged data and exclusion of stocks that traded over the counter. Yet the impact of these enhancements are significant. Stock returns before 1871 are much weaker due to the reduction in survivorship bias, while bond returns look more positive due to the broader collection of securities.

The chart below from the paper shows the new record since 1792, and is quite striking. Two recent periods are highlighted (stock outperformance post World War 2 to 1980, and the period since 1980 to now), with the bond performance line also reset at the beginning of 1980 to facilitate comparison.

Stock and Bond Performance Since 1792 (including bonds rebased to 1981)



Note. Performance through December 2019 (pre-pandemic). The bond performance line (dark brown) is reset equal to stock wealth at the end of 1981 to facilitate comparison in the years that follow.

The revised record suggests that the strong period of equities outperforming bonds was mostly in the post-WW2 period up until 1980. Since 1980, stocks and bonds have performed about the same: while stocks have had periods of outperformance (tech boom up to 2000, pre-GFC, and the current AI rally), they have been followed by reversals. Meanwhile the decline in inflation and bond yields meant that bonds have kept up with equities since 1980.

Over the very long run, the data suggests that the ERP did not exist in the 150 years before World War 2 (WW2) and the 40 years since 1981. It was only the period from post WW2 to 1980 that the ERP was clearly evident. The implication is that rather than being a long-run phenomena, the ERP may have been a 'short-term' event triggered post WW2 until the early 1980s, which has then been baked into historical returns that have been used to 'prove' its existence ever since.

Clearly the existence, or not, of an ERP has significant implications for portfolio construction. To just note two: if the ERP is in fact much lower than normally assumed, there is less need for portfolios to load up on equities to generate returns. It also impacts the total expected return for a portfolio, which has implications for retirement planning.

Unsurprisingly, the paper has generated a lively debate among leading US finance academics. For those interested in further discussion of this topic, the CFA Institute Research Foundation will shortly publish some of this commentary, which will undoubtedly be insightful and interesting!

Phil Graham is an independent director and consultant, and a former Chief Investment Officer. He currently serves as a Trustee on the CFA Institute's Research Foundation.

[1] Siegel, J.J. (1992); "*The Equity Premium: Stock and Bond Returns since 1802*", Financial Analysts Journal, Volume 48, Issue 1, (1).
[2] McQuarrie, Edward F. (2023); "*Stocks for the Long Run? Sometimes Yes, Sometimes No*", Financial Analysts Journal, Volume 80, Issue 1.

Vale Graham Hand

Chris Cuffe, James Gruber, Mark LaMonica CFA

It's with heavy hearts that we announce Firstlinks' co-founder and former Managing Editor, Graham Hand, has died aged 66. Our thoughts and prayers go out to his wife, Deb, and family.

Here are three tributes to Graham:

Chris Cuffe, co-founder of Firstlinks (Cuffelinks)

At 7.33am this morning I heard from Graham Hand's wife, Debbie, that Graham had passed away earlier in the day. Although Graham's illness had been well telegraphed by him, the news has saddened me greatly as it will his many friends and admirers.

Graham and I first met each other around 1990 at the State Bank of NSW where we worked (ultimately acquired by the Colonial Group and then Commonwealth Bank many years later). He was the Deputy Treasurer and I was the CEO of their very fledgling wholly owned funds management subsidiary, First State Fund Managers. First State reported through the Treasury Division at that stage so I had a fair bit of interaction with Graham as time passed.

A friendship grew over time and we stayed in regular contact long after we had both left the Colonial/CBA group. It was in 2012 that Graham approached me with an idea about starting an online newsletter. We were both excited by the concept as we had become increasingly dismayed at the lack of good quality financial journalism in Australia. We decided our point of difference (and strength) would be that we would not have journalists doing the writing, but instead we would have industry experts do the writing. We wanted the authors of articles to be investors and market practitioners. We wanted them to share both their knowledge and their battle scars. And we wanted the publication to bring thoughts/ideas from an informed and impartial point of view, without pushing products or promoting services.

The formula we came up with was a weekly online publication comprising around 5 articles with each article being no more than 1,000 words – we wanted each article to be informative, punchy and to the point.

In early 2013 "Cuffelinks" was born with the tag line…. *a publishing service providing content written by financial market professionals with experience in wealth management, superannuation, banking, academia and financial advice*.

On 6th February 2013 the first article was published by Graham. His opening words…..*"The superannuation, advice and investing landscape is facing more game-changers than at any time since the introduction of compulsory superannuation in 1992. Cuffelinks will be covering these subjects regularly during 2013 and beyond."* How true that statement became and the publication continues to this day.

Graham insisted that the publication used my name in the masthead (and have a catchy logo!) because we needed all the profile help we could get at the beginning and I seemed to have become well known over the years in the investment management industry (not all of my doing!). I was not that keen, but Graham was pretty insistent and he wore me down.

To help gain initial attention and credibility for the new publication, I undertook to contact as many heavyweight people that I knew and get them contributing articles. The big coup, right at the start, was convincing Paul Keating to contribute an article or two… how apt for one of the fathers of superannuation. His first article appeared on 7 February 2013 and can still be accessed on the website.

The years passed and Cuffelinks (subsequently renamed *Firstlinks*) became a great success. Graham was relentless in gaining new readers, selecting/editing the increasing number of articles being submitted for publication, and gaining/keeping sponsors to help defray the costs. He was a machine on a mission. He wanted to create and sustain something special and lasting.

I travelled to Italy on holidays in early 2023 and soon after I arrived the Government announced the proposed additional tax on superannuation balances over $3m. Although we were in opposite time zones, in typical style Graham and I spent hours in the middle of the night in the days following, analysing the proposal… long before others had properly thought about the issues. It was vintage Graham.

A decade after its creation, Firstlinks was ranked the No 1 Investment site in Australia in the Feedspot Report, where they select the top sites from thousands of investment sites using search and social metrics.

The creation and ongoing existence of Firstlinks is one of many legacies left by Graham.

This morning, as the tears welled up in my eyes, I suddenly felt very empty and hollow… like I'd just lost a limb. Graham is a big loss to the world. He was an unusual man of extraordinary integrity and great intellect. He had an enquiring mind. He was a straight shooter (he called a spade a spade and he gave you a view that wasn't sugar-coated) and he didn't suffer fools easily. He strove for perfection in whatever he did. He was articulate. He had an enormous sense of "justice". He was generous and caring. He loved his family dearly.

Graham was not easy to get to know, but once you did he was the type of bloke I could easily hang around and be myself with. Over the years we spent many hours together, sitting by the ocean or in a park or on a veranda pondering the world, swapping ideas, and ruminating on the financial services industry. We talked about "stuff that mattered". We never had enough time to finish our conversations.

Graham was a great human being. So many people will feel the loss with his passing. He will not be forgotten.

Mark LaMonica, Director of Personal Finance, Morningstar

Graham Hand passed away this morning after a yearlong battle with brain cancer. I've been staring at that sentence for a long time trying to think of what to write next. I keep thinking about sitting in my apartment in October of 2023 on a Sunday night and seeing my phone buzz with a call from Graham. This wasn't unusual. Graham would often call me with an idea about how to improve Firstlinks and to hear about what I thought about an article he wrote. This call was different.

The news of his diagnosis was devasting, but Graham - for a lack of a better description - was just himself. He was on to the plan his doctors laid out and was reassuring me that he was going to fight this. Despite the odds he was optimistic.

There are so many stories I want to share about Graham. But there is one that I think perfectly encapsulates who Graham was professionally and what he built with Firstlinks. After Morningstar acquired Firstlinks, Graham was running me through the publishing process. He was describing how he read and approved each comment on a Firstlinks' article.

My suggestion that we find someone else to take over what I ignorantly described as 'an administrative process' was met with disbelief. Graham informed me that he was building a community. And to do that he needed to know what his readers were thinking. Those comments were his way of collecting feedback from the only people that mattered – the members of that community.

The first edition of Firstlinks was published on February 8th 2013. And from that moment on Graham was dedicated to building his community. He would take a paper sign-up sheet when he spoke at conferences and take down email addresses. He would tell everyone and anyone that would listen about how great the content was on Firstlinks. And it was ultimately the content more than anything else that made Firstlinks what it is.

In an age of sensationalism and slick sounding investment pitches that are more about the people writing them than the readers, Graham took a different approach. He genuinely cared about his readers. He cared about keeping them informed so they could create a better future for themselves and their loved ones. And in the end that is all that really matters.

Heartwarmingly, that care for his readers was not a one-way street. When Graham [disclosed his illness to the Firstlinks community] the response was touching. Graham read through each comment and was touched at the outpouring of support. I was reading through the comments again this morning after I learned of his passing. Perhaps that is the best tribute of all to Graham.

James Gruber, Editor at Firstlinks

It's difficult to write this, and doubly so in the past tense. I didn't know Graham for as long as many others in the financial industry, yet it *felt* like I'd known him for longer through reading Firstlinks prior to my working with the newsletter.

Graham hired me in October 2022. He wanted to focus on writing articles and hand over the newsletter's administrative and editorial tasks to me. I remember on the morning of the first day of my employment, he had a twinkle in his eye and told me, "Oh, by the way, I forgot to tell you during the interview process that I'm going away to Europe for six weeks early next week and you'll be in charge of the newsletter!" He had my head spinning from the get-go.

Upon his return from overseas, I worked closely with Graham and quickly gained several impressions of him.

First, I knew of his standing in finance, though had little idea of the extent of it. He seemed to know *everyone* in the industry. Not only that, but CEOs regularly sought him out, rather than the other way around. He was almost like a rockstar with a cavalcade of admirers following him.

Second, he was a prodigious worker. He regularly worked weekends and nights to get the newsletter exactly as he wanted it.

Third, he was endlessly curious about investing and many other topics. His in-depth knowledge of superannuation, SMSFs, demographics, retirement issues, and others was intimidating.

Fourth, Graham was a brilliant writer. He had a smooth, measured, thoughtful, and playful way of communicating often complex subjects. He had a novelist's eye for making finance both readable and entertaining.

Fifth, he loved the Firstlinks community. While many publications don't allow comments on articles, for Graham, they were a sacrosanct part of the newsletter.

Graham and I were of different generations and consequently were different people with varied views of things. Yet there was always a deep respect in our relationship that went both ways.

As Graham fell ill, we became closely personally as our guards lowered. A few months ago, we took a walk together near his home. He was stoic as usual and profoundly grateful to Deb and his family for all the support they'd given him, as well as to friends and acquaintances who'd reached out to him during the year.

Graham will be dearly missed.

In Loving Memory of Graham Hand

Graham's wife, Deborah Solomon, and daughters, Jenna and Elana, have established the Graham Hand Gift to honour Graham's remarkable legacy and to support the causes that he cared about.

In addition to Graham's giant legacy in financial journalism and investment thought leadership, Graham was a passionate advocate for giving. His efforts resulted in millions of dollars committed to the community through the Australian Philanthropic Services Foundation.

To honour Graham, the Graham Hand Gift will support projects that mattered to Graham, including social inclusion and empowerment through football (the "real kind", as Graham would say).

This giving fund, held within the Australian Philanthropic Services Foundation, ensures that Graham's vision of giving continues to make an impact in his name.

Donors can make a tax-deductible donation to the Graham Hand Gift via EFT or BPAY using the following link: Donate to the Graham Hand Gift (https://apsforms.tfaforms.net/f/donate?accid=001Ob00000MmHWX).

For assistance or further information, please contact Rachael Rofe and the APS Foundation team on 02 9779 6312 or email foundation@australianphilanthropicservices.com.au.

Thank you for your support in celebrating Graham's extraordinary legacy.

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