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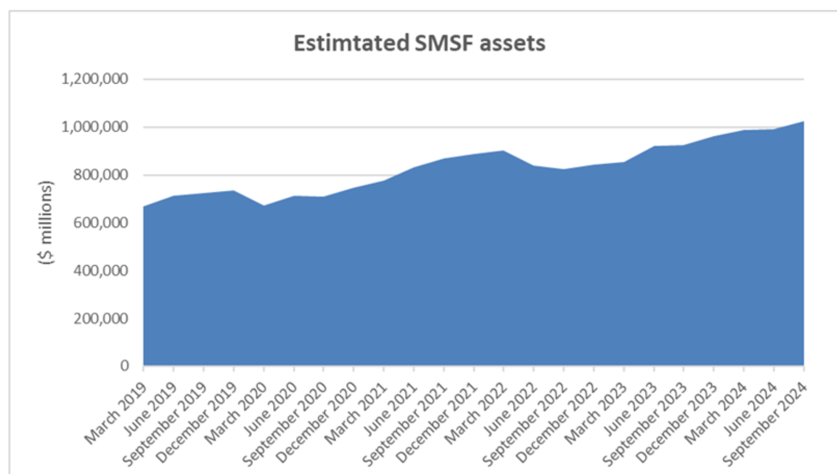
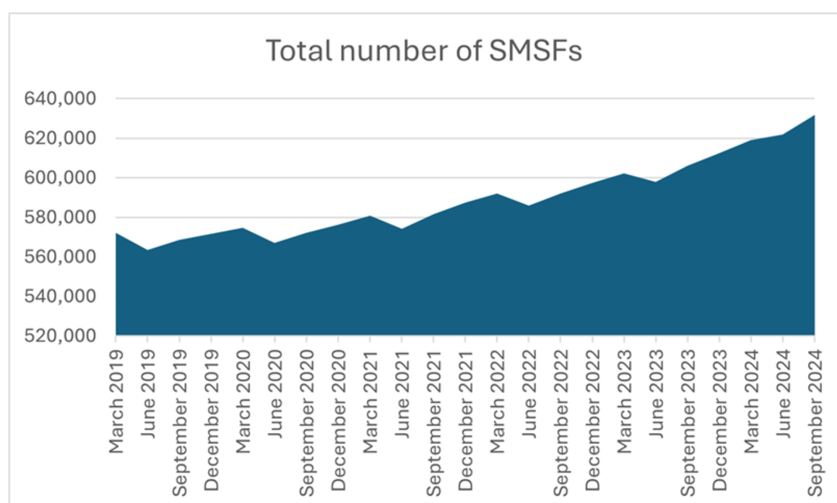
Editorial

New ATO figures show the estimated assets of SMSFs have reached $1 trillion for the first time. The assets were up 3.2% during the September quarter and up 10.9% year-on-year.

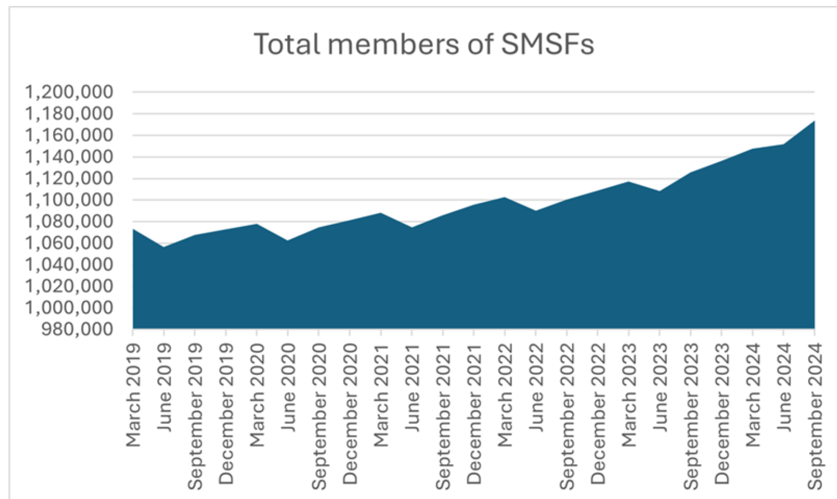


The increase in assets was partly driven by a rise in the number of SMSFs. That number has reached 621,809, up 1.6% on the quarter, and 4.3% for the year to September.



Source: ATO, Firstlinks

There are 1.15 million SMSF members, split 53%/47% between men and women. The average SMSF member continues to be middle aged or older, with 85% being 45 years or more.



Source: ATO, Firstlinks

The data for SMSF asset ranges is somewhat dated, going back to June 2023. It shows two-thirds of SMSFs have assets between $500,000 and $5 million. About 5% are above $5 million.

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

Source: ATO, Firstlinks

Source: ATO, Firstlinks

Figures for how SMSFS are allocating their assets are more up to date. The top asset types held by SMSFs are listed shares (28%) followed by cash and term deposits (16%) and unlisted trusts (13%).

That asset allocation hasn't changed much since the start of the year. Listed shares have declined 1% over the first nine months, while cash has risen 1%, unlisted trusts are unchanged, and non-residential property is marginally down.

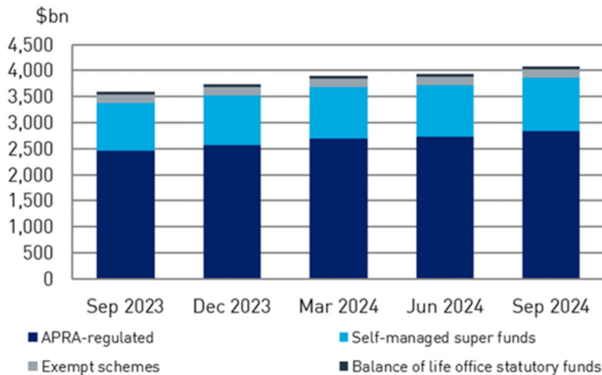
SMSF Asset allocation, Sept 2024	
Listed shares	28%
Other	21%
Cash and term deposits	16%
Unlisted trusts	13%
Non-residential property	11%
Listed trusts	6%
Residential property	6%

Source: ATO, Firstlinks

A separate report from APRA shows total assets in superannuation have topped $4 trillion. These assets increased 3.7% over the quarter to September and 13.4% year-on-year, driven by strong asset returns.

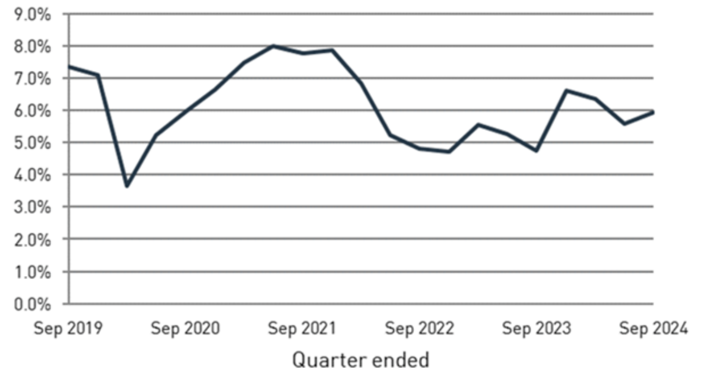
Most super assets are in APRA-regulated funds ($2.8 trillion out of $4.1 trillion), followed by SMSFs. The five-year annualised rate of return for super funds was 5.9% to September this year.

Assets of superannuation entities



Source: APRA

Five-year annualized rate of return



Source: APRA

In my article this week, I look at a new report from ANZ and CoreLogic that reveals some mind-boggling figures on the affordability of housing in Australia. The report shows that only 10% of the housing market is genuinely affordable for the median income family, and that drops to 0% for those on low incomes. Depressing as that is, it may be bullish for the apartments, which are already showing signs of outpacing house price growth.

James Gruber

Also in this week's edition...

The Future Fund has received a lot of press, yet there's been no mention of how much the fund has deviated from its original purpose of meeting the burgeoning unfunded liabilities of Commonwealth defined benefit schemes. That's probably because these liabilities have rocketed to an estimated $290 billion, and the politicians benefiting from the schemes are doing their best to hide the issue, as **John Abernethy** details.

Australians have been moving from regional areas to cities for decades, attracted by the employment prospects, higher wages, and other factors. Now, **Michael Brennan** and the team at consultant e61 say that allure of the cities may be fading due to costs, especially housing, outpacing wages. It's potentially a big opportunity for the regions.

Firstlinks typically steers away from 'stock-picking' articles, which are more than adequately covered elsewhere, yet **Andrew Mitchell** of **Ophir** has written something unique to warrant an exception to the rule. Here, Andrew provides an inside track on how he stared down short sellers and gained conviction in a stock, and why the story may not be finished yet.

Recently, lawyer **Greg Russo** gave us an overview on the nuts and bolts of family trusts. He's back today to do something similar on testamentary trusts. He considers the role that testamentary trusts can play in a well-thought-out estate plan.

Many investors love nothing more than certainty and it's why black-and-white views often get the most publicity. **Neuberger Berman's Joseph Amato** is built different and believes a more nuanced approach is warranted after the election of Donald Trump. He breaks down his views on stocks, bonds and other assets.

On a lighter note, the team at **UniSuper** have come up with a list of book and podcast recommendations for the summer holidays. Uncover the genius behind a secretive hedge fund, debunk healthcare myths, and explore the Cuban Missile Crisis in gripping detail.

Lastly, in this week's whitepaper, **Schroders** explains the role that private assets can play in portfolios.

90% of housing is unaffordable for average Australians

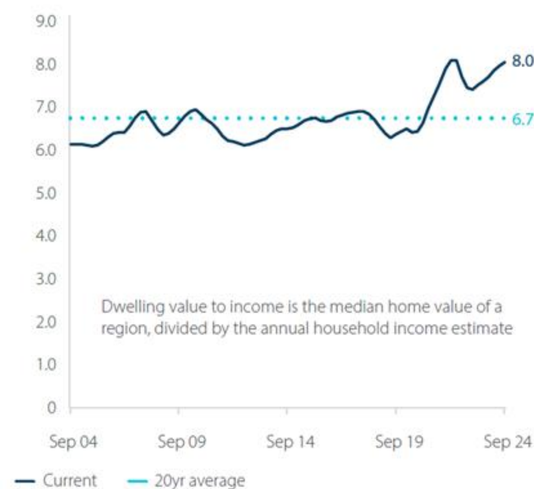
James Gruber

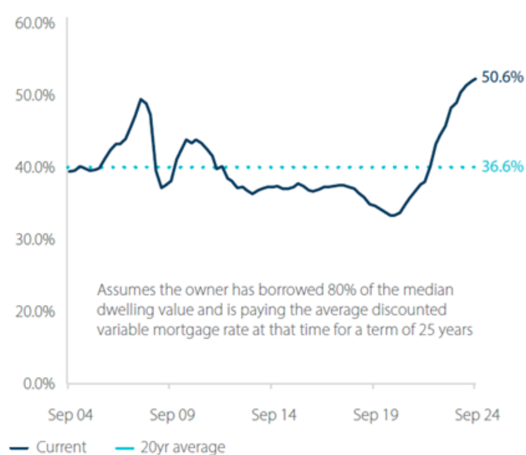
A new report by ANZ and CoreLogic paints a startling and depressing picture of housing affordability in Australia.

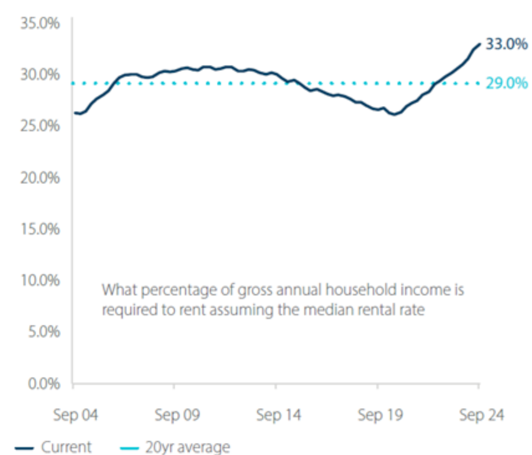
Over the 12 months to September 2024, our income growth has again significantly lagged housing and rental growth. Gross household income increased 2.8% to $101,000, trailing the 8.5% rise in the median dwelling value (houses, flats, and other residences) and the 9.6% lift in rents during the period. At the end of September this year, the median dwelling was worth $807,000 and the median weekly rent value was $642 across Australia.

Consequently, housing has become less affordable. The median dwelling value to income ratio has increased to 8x, almost 20% above the average of the past two decades. It's now caught up to the record highs reached in early 2022.

Assuming an annual savings rate of 15% per annum, it now takes the average household 10.6 years to save a 20% deposit for an average dwelling. And assuming current mortgage rates for owner occupiers, a 20% deposit and a 25-year loan term, more than half of the median household income is needed to service a new home loan.







Source: CoreLogic, ANU

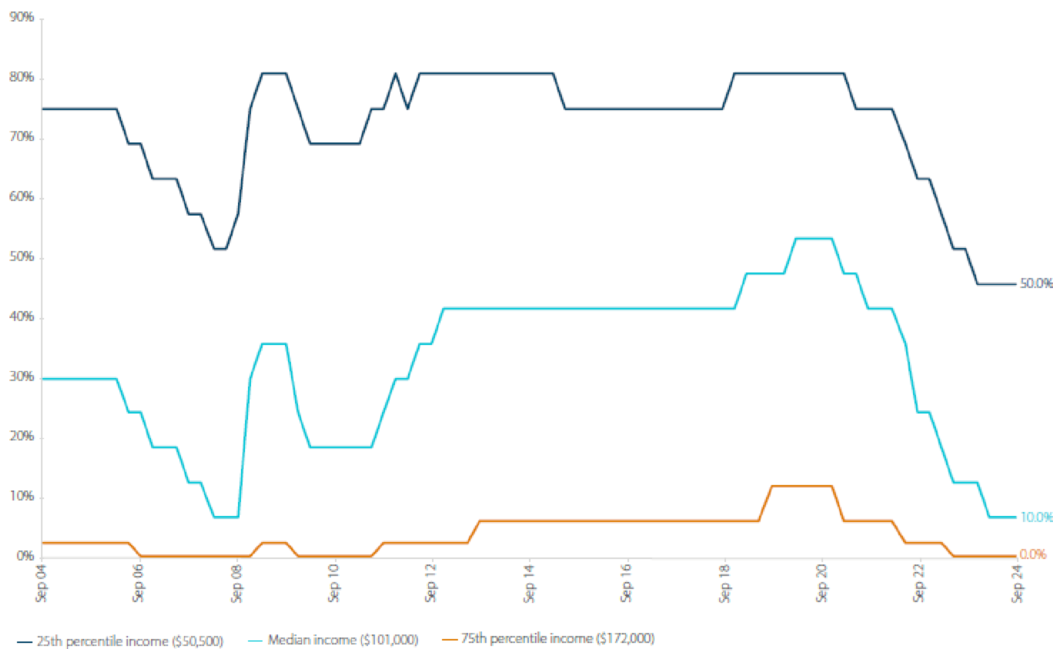
The report acknowledges that its focus on savings and income neglects other means of accessing the housing market such as selling a home already owned, using the Bank of Mum and Dad, access to Government schemes such as the First Home Guarantee, buying a cheaper home than your income would suggest you can, and so on.

However, it says that these alternative measures may be the reality for some, though not all. That's why it's important to assess housing values against incomes to benchmark housing affordability.

An extraordinary picture of housing affordability

The report's breakdown of housing affordability is eye-catching. It reveals only 10% of the housing market is genuinely affordable – require less than 30% of income to service a loan – for the median income household. That's down from the 40% figure recorded just two-and-a-half years ago.

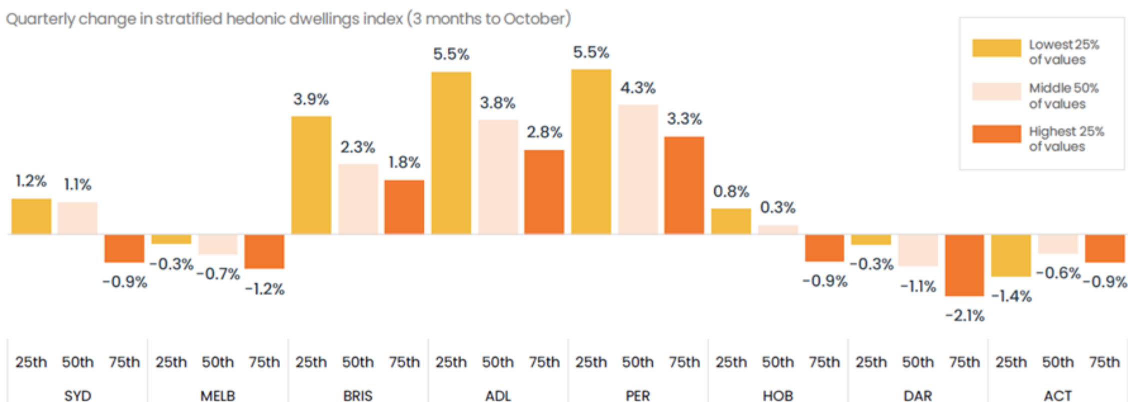
For low-income earners, the affordability figure drops to 0%. And even for the 75th percentile income household, with gross income of $172,00o per annum, only 50% can afford to service a current loan.



Source: CoreLogic, ANU. Based on average owner occupied mortgage rates, gross household income and CoreLogic home valuations. Assumes 30% of income is used to service a home loan with a 20% deposit.

Are apartments set to outpace houses?

The authors note that less affordable housing may be shifting demand towards units over houses. In the three months to October, capital city unit prices rose 0.9% compared to the 0.8% increase in houses. A chart from another CoreLogic paper shows this trend most clearly.

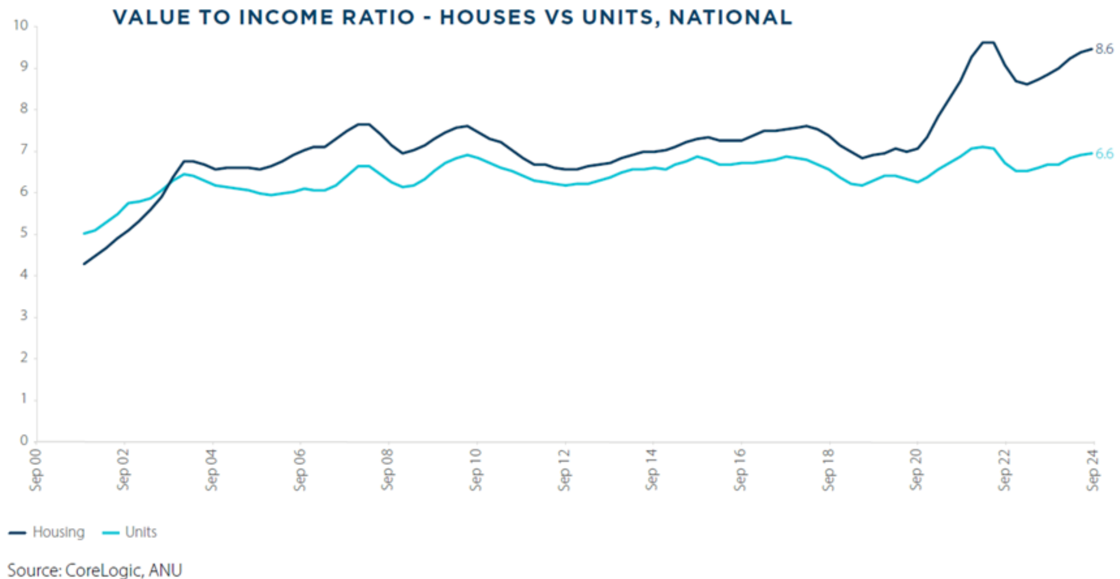


Source: CoreLogic

The growth in unit versus housing values may not seem much yet they're quite a turnaround from recent trends. Between March 2020 and October 2024, national housing values grew 44.5%, more than twice the rate of increase in units, at 20.7%.

Over the same period, the difference between the median house and unit value across Australia increased from $46,000 to $207,000. At September 2024, the portion of income needed to service a mortgage on a median value house was 55% versus the 42% for units.

Moreover, the dwelling value to income ratio for houses has almost doubled to 8.6x over the past 23 years, while the same ratio for units has only increased 32% to 6.6x.

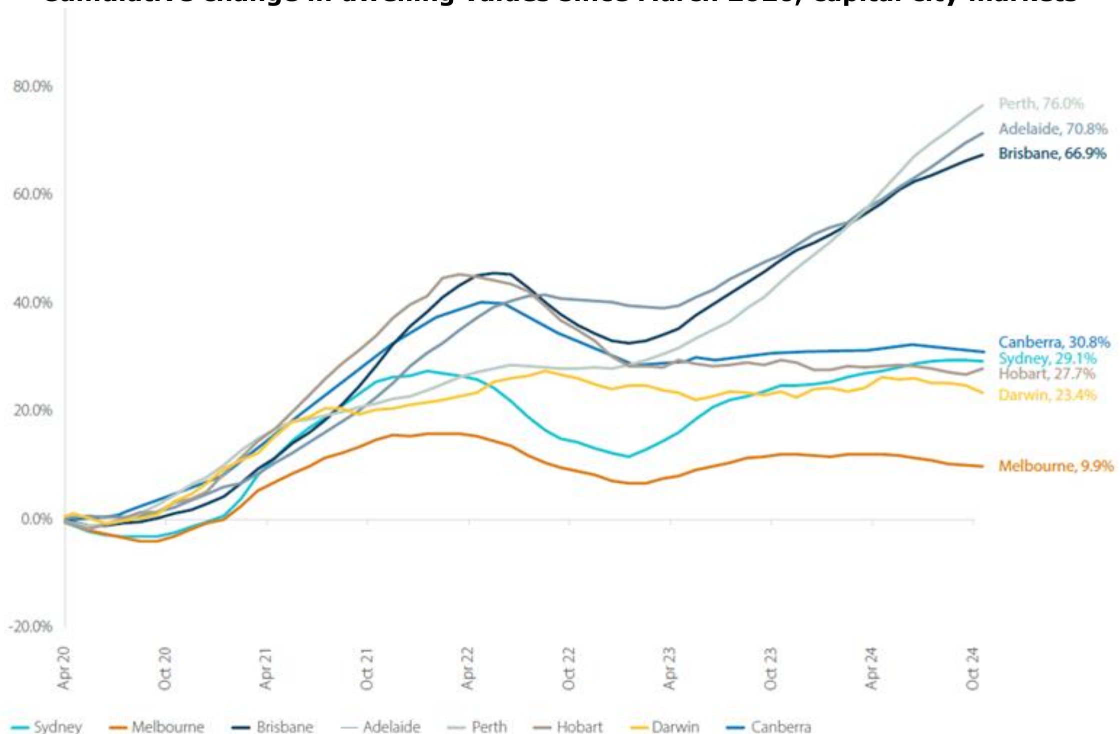


Comparing affordability across cities

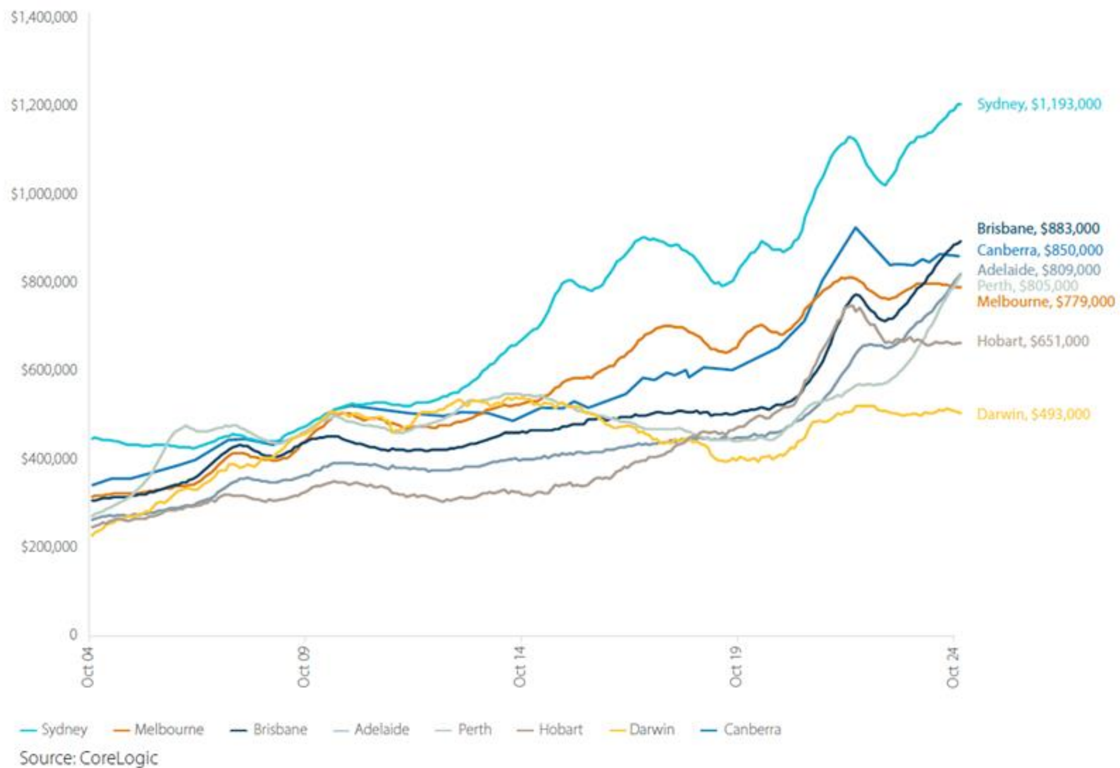
Affordability across the capital cities has changed dramatically since Covid. In the 4.5 years to October this year, the housing prices of three cities have rocketed, leaving the rest far behind. Perth, Adelaide, and Brisbane dwellings rose 76%, 71% and 67% respectively.

Meanwhile, the other cities haven't done much, especially if you take inflation into consideration. Canberra, Sydney, Hobart and Darwin are up 23-31%, while Melbourne is only 10% higher (and down significantly in real terms).

Cumulative change in dwelling values since March 2020, capital city markets



Median dwelling values

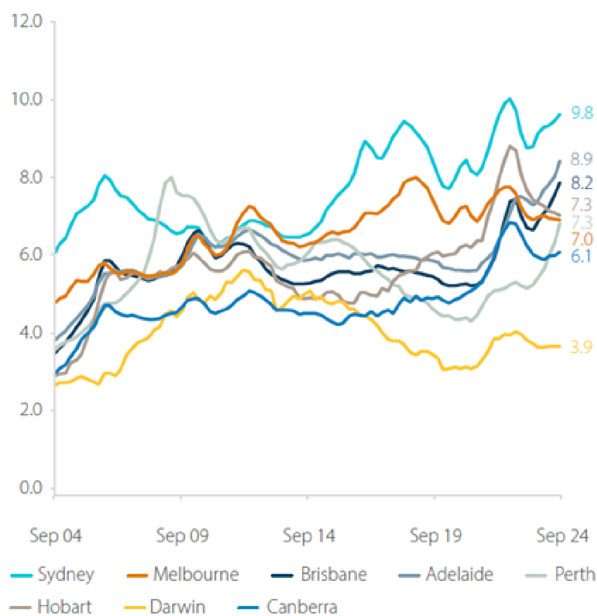


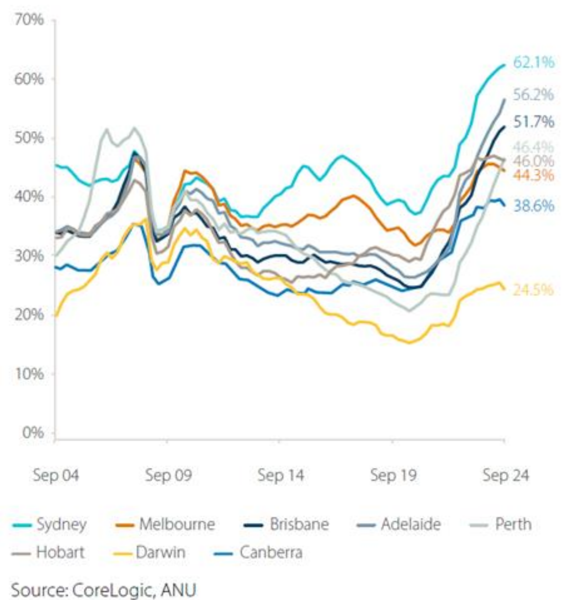
Adelaide has seen the largest deterioration in housing affordability. The median dwelling value to income ratio has risen from 5.9x in April 2020 to 8.9x now. That makes the city the second-least affordable capital city, with 56% of income needed to service a new mortgage and almost 12 years to save a 20% deposit.

It's also harder to afford a home in Brisbane and Perth too. Brisbane is now the third least affordable city, with 52% of household income required to service a new mortgage.

Despite Sydney homes growing less than some of the smaller cities, it remains the least affordable capital city in Australia, with a dwelling value to median income ratio of 9.8x.

Meanwhile, Melbourne has become much more affordable thanks to a gloomy economy and a government mired in debt.





Will housing affordability improve next year?

The report notes that demand for housing has softened in recent months, with higher interest rates, cost of living pressures and elevated home values deterring buyers. And in some cities, such as Sydney and Melbourne, house values have started to fall.

Then it says:

> *"Cyclical downturns often do not lead to long-term improvements in housing affordability, because the declines eventually attract new buyers in the market."*

This seems a little naïve and based on evidence from the extraordinary housing boom over the past 40 years ie. recency bias. A broader sweep of history shows that cyclical downturns can certainly make housing more affordable, and it can take a long time before buyers step in to buy the dips.

The report goes on to suggest that affordability may improve with rate cuts ahead. ANZ forecasts 75bps of easing, starting in February next year. Assuming no change in incomes, and no upward pressure on housing values, that would reduce the national metric of income needed for a new loan from 51% to 47%.

Yet, the data in the report suggests that it's going to need a lot more than lower rates for most Australians to be able to afford a home any time soon.

James Gruber is Editor at Firstlinks.

Taxpayers betrayed by Future Fund debacle

John Abernethy

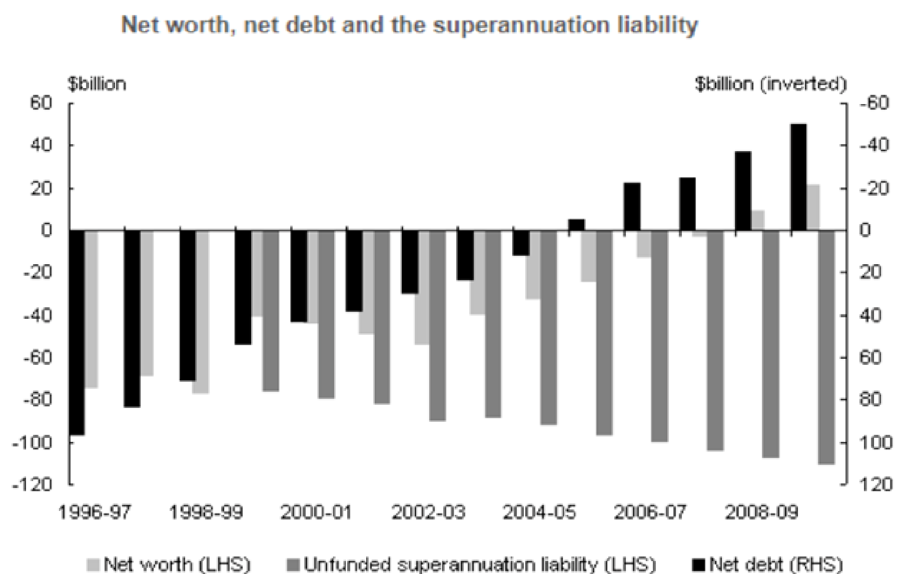
The machinations that have now led to changes to the originally declared purpose of the Future Fund (Fund), treat the Australian taxpayer with utter disdain.

The Government and the Parliament of 2006 entered into a clear 'agreement' with Australian citizens that is not being honoured. The conduct by successive governments in overseeing the Fund exemplifies why there is widespread distrust in politicians.

In 2006 the Fund was created and seeded with approximately $60 billion of Australian citizens capital. It was created with a clear purpose as declared by the public statements of the Howard Government that was notably omitted in the legislation. That declared purpose was to create a financial mechanism to meet the burgeoning unfunded liabilities of the defined benefit schemes of politicians, bureaucrats (including judges), and defence personnel.

The Future Fund was established as part of a broader strategy to improve the long-term financial position of future Australian taxpayers. The Fund aimed to cover the largest liability on the government's balance sheet that existed in 2006.

Readers may recall that in 2006, the Commonwealth had no net debt whilst the Commonwealth Defined Benefit Scheme was an actuarial assessed superannuation liability. The table below — published by the Australian Treasury in 2006 — disclosed the position and the projected outlook at that time.



By 2006, the government had taken a number of decisions to

reduce the burgeoning cost of the unfunded superannuation liability. These included:

- Closing the Parliamentary Contributory Superannuation Scheme to new members of Parliament from 9 October 2004;
- Closing the defined benefit Public Sector Superannuation Scheme to new members from 1 July 2005; and
- Making one-off payments totalling $5 billion to extinguish fully the government's liabilities relating to the Telstra and Australia Post Superannuation Schemes and various state rail employees.

Shifting public service employees from defined benefit to accumulation schemes reduced the fiscal risks to the taxpayer and checked the growth of the superannuation liability arising from civilian public sector employees. The sole remaining defined benefit scheme of any significance still open to new members was (in 2006) the Military Superannuation and Benefits Scheme.

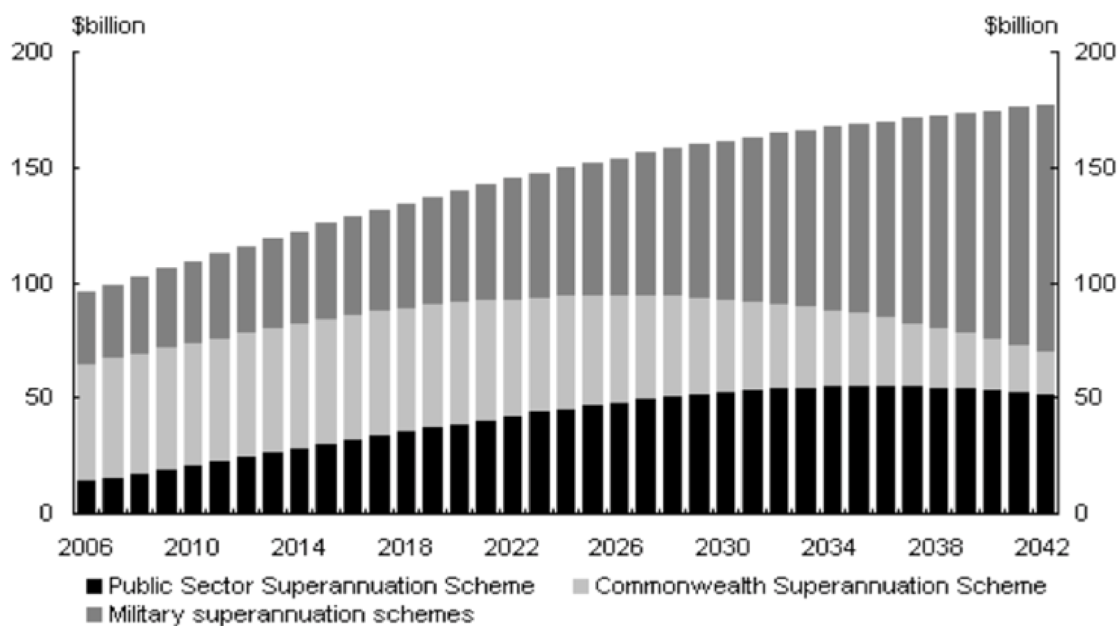
In a report to the Parliament in 2017 the former Fund's chair Peter Costello, noted that the liabilities lay in defined benefit schemes that had been closed, but which continued to accumulate liabilities from public servants still working under the scheme. He noted that paying out those liabilities could run until 2085 — depending on the lifespan of eligible members and (presumably) their surviving partners!

The original actuarial assessment

In 2006, the Commonwealth actuaries estimated (and documented) that the Commonwealth (i.e. taxpayers) liability for unfunded defined benefits was approximately $100 billion, or 10% of Australia's 2006 GDP.

Therefore, a strategy had to be urgently developed to secure the servicing of these liabilities. More so because demographic research indicated that fiscal stress would be created by the ageing Australian population that would progressively retire from the tax paying workforce from 2010.

The next chart shows the 2006 actuarial forecasts of the ballooning liability, as more public servants moved into retirement with defined benefit pensions. Of note is that in 2006, when the Fund was set up, it was forecast that the liability would be about $140 billion (in 2020). The target set by the parliament for the Fund's size was to aim for this amount. To achieve this targeted value, the targeted return (portfolio return target) was set at an average of 5 per cent above inflation. The target was set for 2020, and it was achieved!



However, the bad news, that was kept away from the taxpaying public, was that the Commonwealth actuary had grossly underestimated the liability as at 2020. The mistake has never been fully investigated or publicly scrutinised. What assumptions were made that were hopelessly flawed? The $60 billion actuarial error passed by the financial and political press, with no commentary or assessment. There was no "jumping up and down" by the Labor Opposition - as some were and remain beneficiaries of the Fund.

By 2020 the estimated liability was increased to over $200 billion, and the Morrison government (with Parliamentary approval) had already declared that the Fund would have another six years (till FY27) to accumulate enough capital to meet the new assessed liability.

Thus, in 2020, the budget continued to pay out about $8 billion to beneficiaries of Commonwealth defined benefit pensions – whilst the Fund was left untouched. In the latest budget (FY24) these annual pensions appear to have ballooned to over $15 billion – some 2.5% of total budget outlays - whilst the Fund has grown to $230 billion.

After 18 years of accumulation from that initial ceding of $60 billion of taxpayer funds (some 6% of 2006 GDP), the laudable intention of the Fund — to free budgets from 2020 of the burden of making superannuation related payments — has not yet been activated.

(In passing I note that the $15 billion cash pension payment in FY24 is an estimate because it is hidden in the budget papers. No one in Parliament is concerned to question the actual defined benefit liability or how much pensions are paid each year. Meanwhile the national press seems challenged by the concept of unfunded public liabilities, assets and cashflows.)

Another delay in the payment of pensions by the Future Fund

Last week the Government announced that it will further delay Fund pension payments until 2033 when the fund (it is estimated) will expand to about $380 billion. This is $240 billion above what the actuaries originally forecast as to what was needed in 2006. It will be $180 billion above the forecast of 2020.

It begs the obvious question - what is the real liability for hard working taxpayers?

This week, the current Chairman of the Future Fund, Greg Combet declared that the current value of the Fund ($230 billion) covers 79% of the “estimated” superannuation liabilities. That would suggest the liability has now become $290 billion!

This declaration begs the further questions – Are Australian taxpayers being 'legged over' with the true hidden liability of nondisclosed defined benefits creating a liability that may never be fully met by the Future Fund? Are current and will future taxpayers pay for a superannuation scheme that benefits a few and is simply unaffordable?

Let's be clear - low income but essential workers - like aged care, childcare, cleaners, and nurses etc - pay their tax with little or no understanding that a part of that tax is constantly being allocated to pay the indexed lifetime defined benefit pensions.

Those taxpayers and particularly the latest working generation, can only dream of such a pension benefit. New taxpayers entering the workforce will surely object to their taxes being used to pay these indexed pensions as they struggle with cost-of-living pressures.

Time to come clean and fix this mess

The practical solutions for the Future Fund, that is for the benefit of the majority of Australians, are simple.

The Parliament needs to direct the Future Fund to either immediately begin to pay the pensions that it was set up to do, or to make capital payments to each beneficiary to extinguish the individual liabilities.

By the Fund paying the pensions then the annual cash savings to the budget could be redistributed as tax cuts to low-income earners. Also, for example, an allocation to the building of social housing - build to rent – could be undertaken. In that way the asset base of the Australian public can be replenished.

Through redirected budget outlays, essential assets would be owned by the public and not by a pension fund that is solely for benefit of retired politicians, retired judges and bureaucrats.

The payment of pensions could be made from the cash flows of the Fund as it is redirected to become the pension fund it was originally set up to do.

Alternatively, a mandatory capital payment to beneficiaries, would transfer the liability to their individual superannuation accounts. This is exactly what the overwhelming majority of Australians are required to do for their superannuation.

If the $230 billion sitting in the Fund is not enough to undertake either of the two options outlined above, then the public needs to know why?

The agreement and undertaking of 2006 needs to be honoured.

The public declarations of retired politicians, who continue to passionately argue for the Future Fund to be left alone, need to be factually examined with proper disclosures. What are their defined benefits? What superannuation or salaries do they or can they receive with those defined benefits? What benefits will accrue to their partners?

Also, what is the current highest annual defined benefit pension paid to any beneficiary? That would make an interesting disclosure given the current proposal to tax unrealised gains on $3 million pension funds.

John Abernethy is Founder and Chairman of Clime Investment Management Limited, a sponsor of Firstlinks. The information contained in this article is of a general nature only. The author has not taken into account the goals, objectives, or personal circumstances of any person (and is current as at the date of publishing).

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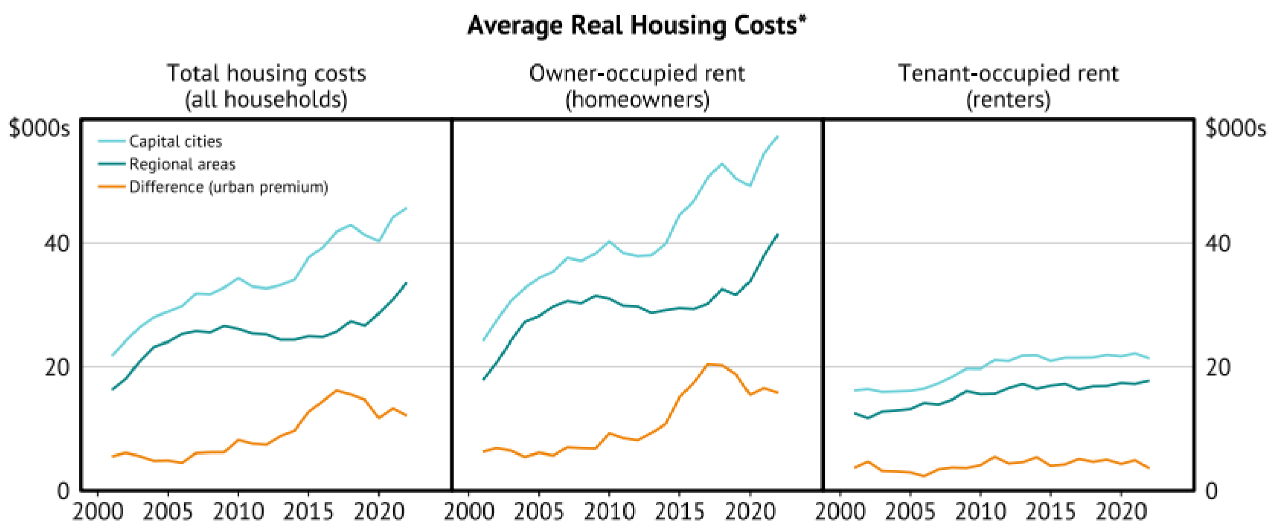
The net benefit of living in Australia's cities has fallen dramatically

Michael Brennan and colleagues

It is well known that there are both benefits and costs to living and working in the city – higher wages on the one hand, and higher housing costs on the other. In this article, we refer to the higher wages in the cities relative to the regions as the urban wage premium and the higher housing costs in the cities relative to the regions as the urban housing cost premium.

Using the Household, Income and Labour Dynamics in Australia (HILDA) Survey, we find that, on average, housing costs – measured as the sum of both tenant-occupied rents and owner-occupied rents – are rising faster in the cities than in the regions.



* Housing costs include both tenant-occupied and owner-occupied rents. All measures are converted to real terms by dividing by the CPI in 2019 dollars.
Sources: e61 Institute; HILDA Survey Release 22.0

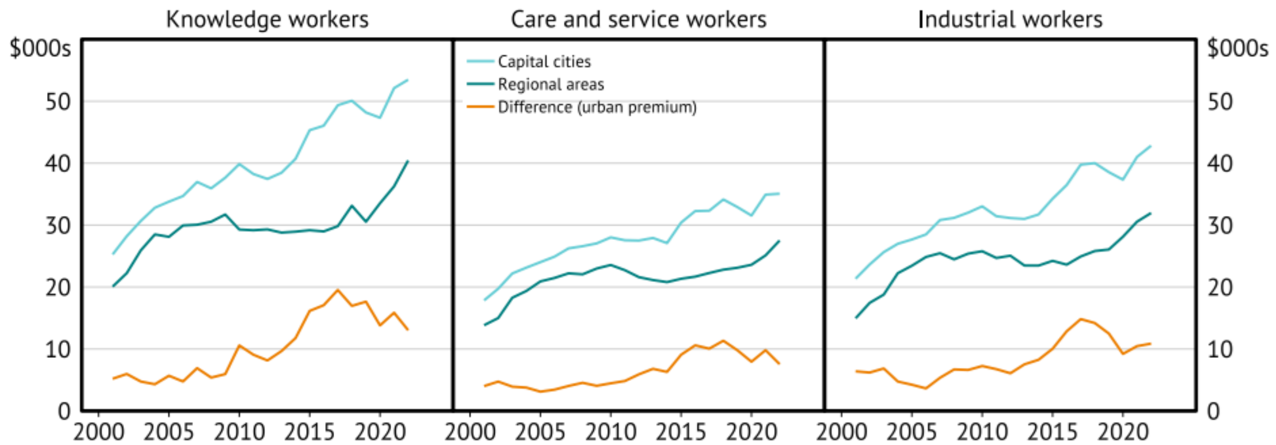
The urban housing cost premium is increasing because of a widening gap in housing prices as measured by owner-occupied rents. Rising housing costs have been a strong feature of the Sydney and Melbourne housing markets.

A novel feature of the housing cost estimates from the HILDA Survey is that we can track how housing costs are changing for workers in different occupations and geographic regions.

The estimates indicate that housing costs have risen by more for city-based workers compared to regional workers across all occupations since the mid-2000s. This increase in housing costs is mostly driven by higher costs of home ownership, as measured by owner-occupier rents.

Average Real Housing Costs*

By type of occupation and geographic area



* All measures are converted to real terms by dividing by the CPI in 2019 dollars.
Sources: e61 Institute; HILDA Survey Release 22.0

Why are housing costs rising more in the city than in the regions?

It is difficult to isolate a specific cause. Housing costs are determined by locational trends in supply and demand – with that demand also determined by relative earnings opportunities in different locations. It is hard to avoid the conclusion that housing supply has not kept up with rising housing demand in these locations.

A further possibility is that, in areas where housing supply is most constrained, immigration has contributed to housing demand, alongside other sources of demand.

Sydney and Melbourne remain the destinations of choice for many immigrants, which has brought many economic and cultural benefits to the cities. Over half of Australia's foreign-born population lives in Sydney and Melbourne.

Regional areas, which typically find it easier to expand housing supply, do not have a high share of immigrants despite in-built incentives in the immigration system.

Without a corresponding increase in housing supply, stronger demand for housing in the cities may be contributing to higher housing prices. And, given the low shares of immigrants moving to the regions, they have not experienced the same housing demand increase. Higher wages and housing costs tend to interact.

Higher wages in a particular location can lead to higher housing costs if supply cannot easily adjust.

Higher housing costs can reinforce higher wages by restricting access to city locations – confining it to those with the highest earnings capacity.

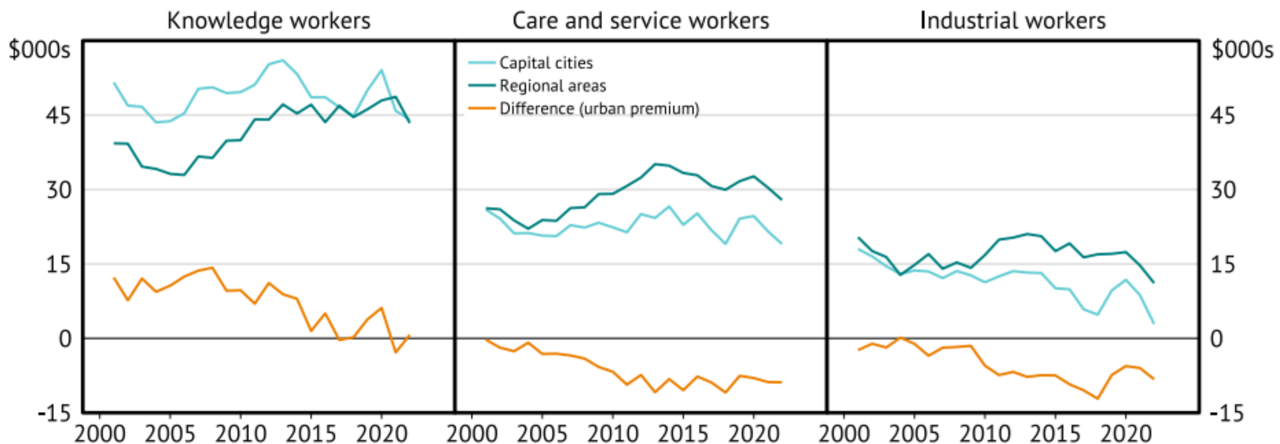
Whatever the underlying causes, a given individual weighs up locational decisions based on relative housing costs and wage prospects between locations. To the extent that housing costs have risen faster than wages for many workers, this is likely to influence their decisions about where to locate.

Broadly speaking, in the early 2000s the benefit of living in capital cities – as measured via wages – outweighed the cost – as measured by housing. But that is no longer the case.

Unsurprisingly, given we have found that industrial workers no longer obtain a wage benefit from being in the city, their urban housing cost premium exceeds their urban wage premium – and that has been the case since the start of this century.

Average Real Wages (Net of Housing Costs)*

By type of occupation and geographic area



* All measures are converted to real terms by dividing by the CPI in 2019 dollars.
Sources: e61 Institute; HILDA Survey Release 22.0

Similarly, for city-based care and service workers, their wage premium has fallen short of their housing premium for some time too. But, most strikingly, this phenomenon is now extending to knowledge workers who earn the highest urban wage premium.

The locational calculus is changing for many workers

For workers, on average, the incentive to stay in, or move to, the city has been weakening. The urban wage premium is no longer sufficient to offset the housing cost premium associated with living in the city.

This average effect does not apply to every individual – many workers have above-average urban wage premiums. Many incumbent city-dwellers have accumulated significant equity in their homes, such that the current urban housing cost premium could be less likely to affect their locational choices.

Hence, a change in the urban wage premium and a rise in the urban housing cost premium may not matter to the same extent for all.

For some, the benefits of city living are more than just wages, including access to a higher share of cafes, bars and restaurants and educational opportunities, as well as proximity to family and established community networks. On the other hand, those seeking to purchase a home for the first time, face a pivotal locational decision. For them, the shift in relative wage and housing cost premiums could prove more decisive.

The combination of rising relative housing costs and flat-to-falling relative wages in the cities may explain why people in their 30s are leaving Sydney and, to a lesser extent, Melbourne. This exodus has been particularly strong for those in industrial, care, and service jobs.

Millennials in Sydney are most impacted

Sydney and Melbourne are experiencing outflows of people to other parts of Australia – with more people leaving than coming, excluding overseas immigrants.

In Melbourne, since 2006, people of all age groups have been leaving the city, with 20-year-olds the exception – they are the only age group entering on net. In Sydney, the outflows are stronger and those in their 30s are leaving at the highest rates.

The fact that those in their 30s are leaving reinforces the idea that rising housing costs are a key factor in their location decision. People in this age bracket will be making life decisions, such as getting married and having children, which are typically associated with demand for larger homes.

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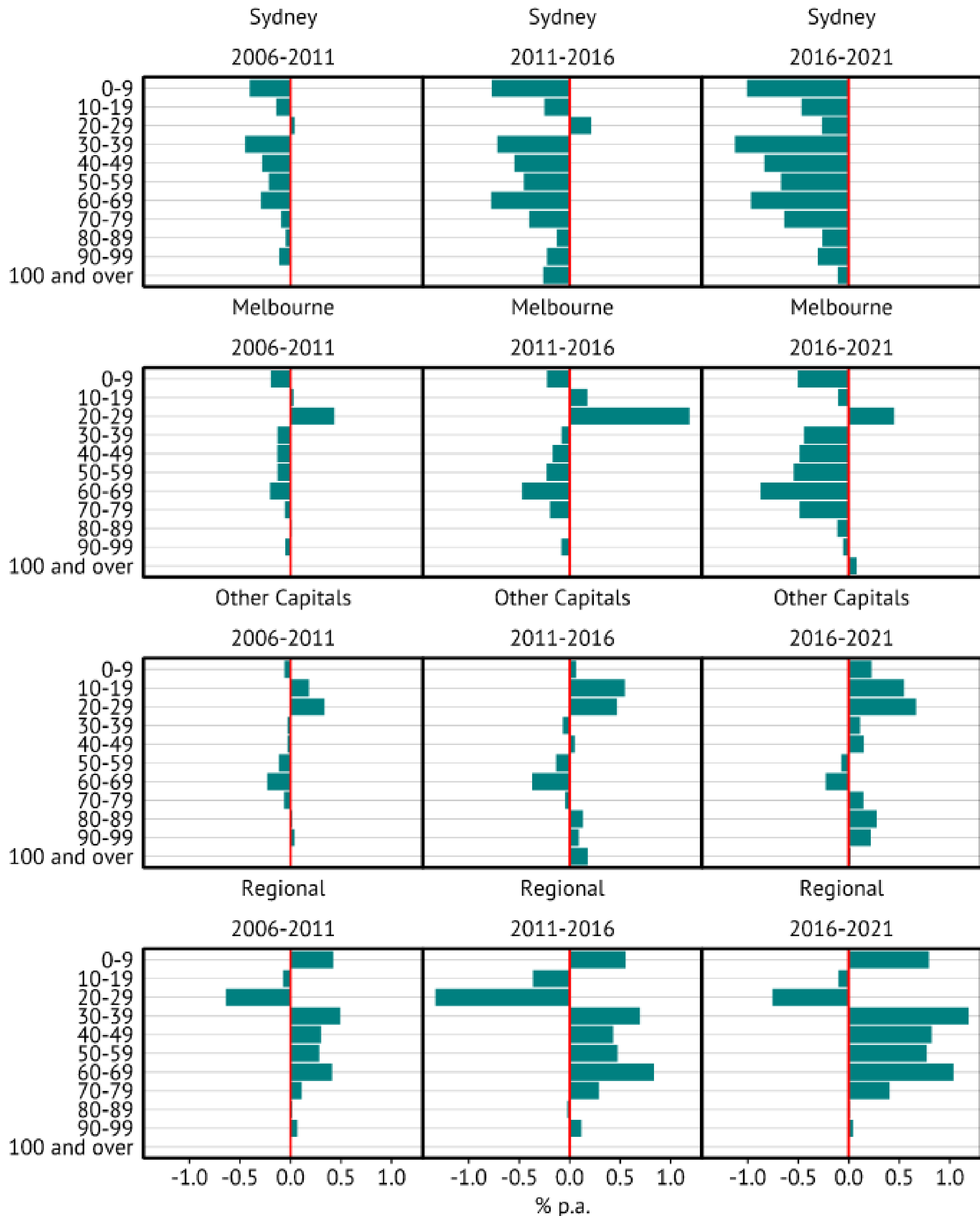


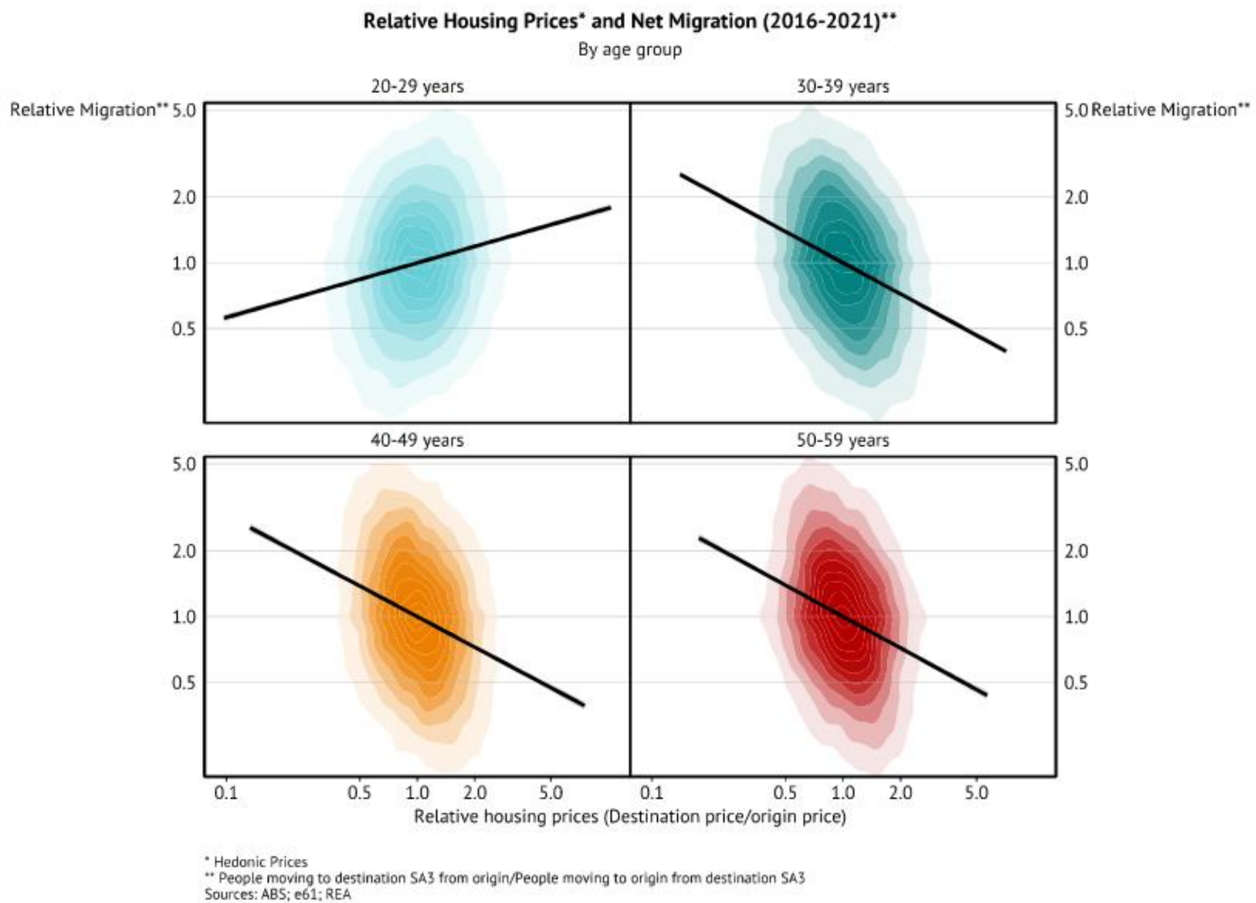
* Lived somehwere else in Australia 5 years ago
** sample excludes people who moved overseas between censuses
Sources: ABS; e61

Where are they going?

For Melbourne, people are more likely to move to the outer suburbs than leave Victoria entirely. For Sydney, some people are moving to coastal regions like the Central Coast and Wollongong, while others are leaving the state altogether.

People who are 30 years and older are moving away from high housing price areas to low housing price areas, suggesting they are seeking home ownership. This is not a new behaviour – but the link has become stronger as housing prices have risen over time.

By contrast, people in their 20s – who are more likely to be renters than buyers – are moving towards areas with more expensive housing. This holds true regardless of labour market status. Those in their 20s may still be choosing to live in the cities to gain better educational opportunities and access amenities.



We note three major economic implications from the above: risk of labour misallocation, cities becoming less occupational diverse, and an opportunity for Australia's regions.

Risk of labour misallocation

Productivity and real income growth have slowed over recent decades. This report raises the possibility that, for some young people, the housing cost premium in cities could be a decisive motivation for moving – causing them to move away from areas of high wages and productivity, and potentially high human capital investment.

To the extent that constraints on the supply of housing in the cities are raising the cost of housing and preventing workers from moving to locations that maximise their productivity, this will lead to a misallocation of Australia's workforce.

Less occupationally diverse cities

The trajectory of wage and housing premia is such that industrial and care workers have faced the strongest incentives to locate away from cities. A key question is whether this could lead, over the long term, to greater

occupational segregation across locations: with highly qualified knowledge workers located in the cities and industrial and care and service workers in regions.

Complete segregation is impractical – there will be demand for the services of industrial and care and service workers in the city. Hence, wages could adjust to attract them.

Opportunity for Australia's regions

The movement of some city-based workers into the regions could also represent an opportunity for the regions. Workers who leave the city tend to earn more than their new neighbours who are in the regions and bring with them city-based skill accumulation.

In addition, the regions have the potential to continue to attract and retain more city-based workers. But it will be important that regional housing supply can adjust, to accommodate the additional demand without upward pressure on housing costs that could create inequality within regions.

This article is an abridged excerpt from the e61 institute's research paper titled "The Lucky Country or the Lucky City?". You can read the full report here. Contributors include Michael Brennan, Elyse Dwyer, Nick Garvin, Theo Gibbons, Rose Khattar, Gianni La Cava, Aaron Wong.

Fending off short sellers and gaining conviction in a stock

Andrew Mitchell, Steven Ng

In January 2021 vaccines were rolling out, people were starting to travel again, and the share market had flipped back from 'stay at home' stocks to the 're-opening trade'. That was when we attended the Needham Growth Conference in New York and found one of our best stocks of the last few years.

The Needham Conference is one of the biggest small-cap investment conferences. Fund managers were lining up to meet the management of companies primed to capitalise on the tidal wave of services spending as consumers emerged from hibernation.

So, what did we do?

We asked the conference organisers: *"What are the companies at the conference with the least requested number of meetings by fundies?"*

The company that no one wanted to see was Stride (NYSE:LRN). Stride provides online education solutions to kindergarten through Year 12 students in the U.S. and their solutions are used in the classroom. But originally and still, they are used by students homeschooled for various reasons including bullying, parental preferences; even for child actors.

When we were all going to 'work from home' during COVID, students were going to 'learn from home'. Stride's share price rocketed from around US$20 to over US$50 between March and August 2020 as demand, and expectations of demand, for their products and services ballooned.

But by January 2021, the time of the Needham Conference, the balloon had popped. As students returned to school, investors thought there'd be no durable increase in demand, so Stride's share price returned to US$20. In any case, fundies had turned their attention elsewhere.

What we found when we decided to dance with the 'wallflower' Stride

Stride was the proverbial 'wallflower' at the prom. But we decided to dance with Stride and we found:

- A company structurally benefitting from increasing adoption of virtual schooling more generally (despite schools having been reopened), which could lead to sustained growth in a market in which Stride was a leader.
- Defensive revenue growth of 8-10%, underpinned by state government budgets that fund the 70 schools across 35 US states in which Stride had solutions.
- High incremental profit margins, driving what we expected would be 20%+ earnings growth.
- A depressed EV/EBITDA (Enterprise Value to Earnings Before Interest Tax Depreciation and Amortisation) valuation multiple of just 5x.

Of course, we never just take what the company says at face value, so we got to work. We checked data around individual schools' login traffic; called enrolment centres for intel, including the number of open enrolment applications; spoke to public and private school peers around market share changes; and spoke with school district budget allocators to ensure the funding was rock solid.

We initially bought Stride in January 2021 between US$22-25. We have held ever since, building our conviction and knowledge around the business. And boy, has it delivered. From financial year 2020 through to 2024 it has:

1. Doubled revenue from US$1.04 billion to US$2.04 billion
2. Improved EBITDA margins from 11% to over 18%
3. 10x'ed profit from US$24.5 million to US$240 million (12 months to Sept 2024)

Fuzzy Panda tests our conviction

But then, last month, our conviction was really tested.

Fuzzy Panda (FP) – no not a Sesame Street character, but a well-known short-selling organisation – released a report on the 16th of October dubbing Stride "the last COVID over earner".

The stock tanked by over 9% on the day but Stride was down -24% if you include the falls leading up to the report, when FP was clearly putting on their short position.

FP was essentially claiming that Stride was a big beneficiary of the US$190 billion in Federal emergency relief funding program for U.S. schools during COVID. The funding was ending in September 2024 and FP warned Stride's profits were about to "fall off a COVID cliff".

Australian investors in ASX-listed companies probably aren't that used to 'short reports' as they're not that prevalent domestically. However, they are big business in the U.S. and par for the course if you've been investing there long enough. The playbook is simple.

Take a short position, put out a scary report questioning the company's profits, and many investors will dump the stock (regardless of the merits of the short report). The shorter then closes the short by buying back the stock at the now lower price, pocketing a tidy profit. Sometimes there is merit to the short report, sometimes it's just hot air.

Over the three years we have owned the stock, we have spoken with Stride's management on multiple occasions each quarter. We have found them diligent, trustworthy and conservative.

But we also did more work.

We already knew from the publicly available individual school budgets that the federal COVID funding was used to offset funding from the states during COVID. But we also went through the corresponding state budgets in detail. These showed that the states were increasing their education spend to offset the federal grant funding that was ceasing.

This gave us comfort there was no big looming funding shortfall from state schools for Stride's offering. And it gave us the conviction to hold through the short report.

When Stride reported its September quarter results aftermarket on the 22nd of October, it blew the market's expectations away. Both at a revenue and profit level. The next trading day the stock popped around +40%!

Source: Ophir & Bloomberg. Data as of 31 October 2024.

The future of Stride

So where to next for Stride?

Even though they are the largest online education provider in the U.S. by enrolment, they are still very underpenetrated across schools. They can also fuel growth by entering or expanding into education verticals including:

1. **Experiential learning:** Through extended, augmented and virtual reality modes; AI voice and chat learning software; and games and simulation teaching solutions.
2. **Learning support:** Building out their tutoring business which we think could add 30-40%+ to today's earnings over the medium to longer term, given their existing relationships with students and teachers.
3. **Workforce and talent development and acquisition:** Providing certifications to the increasing number of U.S. high school leavers who are shunning four-year college degrees and opting instead to directly enter jobs. Stride already owns a business called Tallo, which connects students from Stride-powered schools to opportunities (the Tallo app has 1.7million users already!).

A long career ahead

Today, Stride is still growing earnings at 20%+. That's two to three times the market's growth. Yet it operates in a defensive end market with a large share of its revenues underpinned by state government education budgets. It's a great all-weather stock.

But its valuation is lower than the market. Stride trades on a still cheap 13x price to earnings ratio. Most of the share price move since we have owned it has actually been driven by earnings growth and not valuation expansion. We think it could still be a 20x P/E business.

So while it's been a great performer for our Funds, we still think there is a long 'career' ahead for Stride.

...the hard work pays off

It would have been easy to crack during the Fuzzy Panda shorting drama and sell Stride. The only way to know whether to 'keep the faith' or to 'fold' is to put in the work and back yourself. It won't always work out on your side, but if you go the extra mile, it will more often than not.

We are proud of the team and the work they have done which allowed us to keep our conviction in Stride. We're also glad we took that meeting that no one else wanted back in 2021!

Andrew Mitchell and Steven Ng are co-founders and Senior Portfolio Managers at Ophir Asset Management, a sponsor of Firstlinks. This article is general information and does not consider the circumstances of any investor. Read more articles and papers from Ophir here.

The nuts and bolts of testamentary trusts

Greg Russo

In an earlier article, I briefly analysed family trusts and discussed some of their benefits. This article will consider the role that *testamentary* trusts can play in a well thought-out estate plan.

Because this subject matter is so broad, I have made this article a 'grab bag' of things that readers might think about when considering whether a testamentary trust might have a place in their estate plan. Any decision to use testamentary trusts should be accompanied with bespoke legal, accounting and financial advice.

Family trusts v testamentary trusts?

Like family trusts, testamentary trusts provide an opportunity to separate legal control and beneficial ownership in assets owned within them. Unlike family trusts, which are created during lifetime, testamentary trusts are created by a will and only come into effect upon the death of the will-maker.

That difference aside, testamentary trusts generally operate within the same legal framework as trusts created during lifetime. But as we will see now, they require considerations and create opportunities that are unique and independent of family trusts.

How do testamentary trusts work?

A will incorporating a testamentary trust can be thought of as a simple will *plus a trust.*

Testamentary trusts therefore offer a will-maker an alternative to gifting assets in their wills **directly** to beneficiaries. Instead, they provide a will-maker the option to pass estate assets to a trustee to 'hold upon trust' for an intended beneficiary, pursuant to a trust structure.

The trustee can also be a beneficiary of the trust depending on the will-maker's objectives in creating the trust.

By splitting ownership and control in assets *after a will-maker's death*, testamentary trusts effectively allow a will-maker to exert a degree of control over how their assets are used from beyond the grave – referred to in this article as 'post-death control'.

Controlling from beyond the grave

'Post-death control' can be understood as the ability of a will-maker to impose 'checks and balances':

- at the time that they draft their will;
- on the administration of their wealth after their death;
- to direct how assets are to be distributed to their ultimate beneficiaries.

There are several reasons why a will-maker might want exert control from beyond the grave. An example follows.

Protective testamentary trusts

Testamentary trusts can be designed to provide principally for a specified beneficiary, while also denying that beneficiary control over decisions made in relation to the inherited assets.

Such trusts are often termed 'protective trusts' or 'All needs protective trusts' and usually:

- nominate a beneficiary for whose benefit the trust is to be administered (principal beneficiary);
- include provisions (written into the will) elevating the interests of the principal beneficiary to paramount importance;
- impose an obligation on the trustee to consult with the principal beneficiary from time to time.

Vulnerable beneficiaries can be protected by providing for them as a principal beneficiary through the testamentary trust but vesting control of the trust (and decisions that affect its income and capital distributions) to an independent trustee.

The use of protective testamentary trusts may be an option where a will-maker is concerned that an intended beneficiary is physically or mentally (or for any other reason) unable to take responsibility for the management of their own financial affairs.

A more nuanced approach can be adopted when appropriate. For example, a testamentary trust could provide a Principal Beneficiary with a degree of autonomy but require them to seek third-party approval before inherited assets are sold.

Beneficiary controlled testamentary trusts

Where a will-maker is not concerned about the vulnerability of a future beneficiary, testamentary trusts can also be utilised to promote asset protection and tax planning on the same basis that family trusts do.

In these circumstances, the will-maker may provide effective control of the testamentary trust to an intended beneficiary. This could take the form of appointing them as the initial trustee and appointor (the person who can hire and fire a trustee) of a testamentary trust.

Such a move could allow the person inheriting the assets to split control and ownership in their inherited assets in a manner that they choose. These testamentary trusts can be incorporated into a will on a basis that their use by the intended beneficiary is optional.

Trustee selection

One of the differences between family trusts and testamentary trusts is the person who instigates the creation of a testamentary trust never controls it. This is because it doesn't come into being until after the will-maker's death.

What this means is that will-makers have to decide who will be in control of their testamentary trusts after their death. The choice of a future trustee can be a difficult one to make and is critical to the future administration of the trust:

Independent trustees can be difficult to locate and expensive to engage. And where family members – such as a will-maker's children – might be considered for the role, the family dynamic becomes an important factor.

It may be necessary, for example, to nominate one child over others due to intra-family relationships. The will-maker will also need to assess their children's respective skill sets.

Limitations of testamentary trusts

There are limitations associated with the use of testamentary trusts and with post-death-control.

The life of a trust

In South Australia, trusts can exist in perpetuity. In other states, trusts can exist for the perpetuity period – generally for up to 80 years (and 125 years in Queensland). Therefore in all states other than South Australia, there is a limit on how long post-death control can be exerted.

Trustee succession

With the passage of time, arrangements for ongoing trustee succession will be needed.

The tension between control and flexibility

Depending on a will-maker's motivation for creating a testamentary trust in their future estate, a future trustee's powers and discretions in administering that trust can be drafted to be anything from wide (even absolute) to non-existent.

If discretions remain active after a will-maker's death, the creation of a testamentary trust shifts the focus of control from the will-maker (and the enforceable terms of their will) to the trustee and their successors (and the terms of the trust).

Removing or reducing the scope of discretions, and hardwiring trust distributions, enhances control of inherited assets but at the cost of flexibility, and potentially more advantageous financial outcomes.

Therefore there is always tension between the degree of post-death control that a will-maker is able to achieve and the flexibility of a future testamentary trust.

Reliance on future trustees

Unless trust discretions are completely hardwired, will-makers need to rely on future trustees to act appropriately in administering the testamentary trust.

There are also a couple of potential downsides:

- ongoing administrative costs, which need to be justified relative to the benefits that are likely to be achieved
- the necessity for a more complex (and therefore more expensive) will, and increased complexity in the future estate administration

Also, notwithstanding the potential tax benefits we outline briefly below, the taxation of trusts is complicated and, to a degree, uncertain.[1] In particular, the legislative framework dealing with the taxation of minors on income is complex, lacks clear judicial comment or consideration, and also lacks ATO guidance. A conservative approach accompanied by bespoke advice is warranted.

Advantages of testamentary family trusts

In addition to the advantages that family trusts generally offer, testamentary trusts currently offer a tax benefit that family trusts don't.

The law of trust taxation is extremely complex and cannot be addressed fully here. But here is a glimpse:

- in a family trust, any income distributed to a minor beneficiary in a single financial year in excess of about $500 is taxed at maximum marginal tax rates, and is therefore not commercially viable.
- in a testamentary trust it is possible to distribute income from testamentary trusts to minors taxed at ordinary adult marginal rates[2] that include the tax-free threshold.

Despite some possible downsides, testamentary trusts are therefore a potentially valuable estate tax planning tool.

Case study

Leonard is a single man with two adult children aged 18 and 19. His assets include his business conducted though a corporate entity and substantial assets in his personal name. He wants to provide equally for his two children after his death but does not want them to be in complete control of their inheritance until the youngest is 30 years old.

Leonard has a good relationship with each of the children and they all get on well with each other. He holds a family meeting with the children, his solicitor and accountant to discuss options.

Leonard ultimately decides to make the asset protection and tax planning benefits of testamentary trusts available to his children. As a result, he executes a will that will creates a trust on his death in respect of all of his assets.

- He appoints the two children and his accountant jointly as appointors of the trust.
- He imposes restrictions on the sale of assets while the accountant is acting as appointor, with all trust decisions to be made unanimously between the two children and the accountant.
- The accountant's role will cease when the youngest child reaches the age of 30, at which time the children alone will control the trust and its assets.

Conclusion

Testamentary trusts can, in appropriate circumstances, offer benefits to a will-maker's future estate and the ability to exert control over estate assets from beyond the grave.

An assessment of those benefits must be tempered with an appreciation of the complexity, and limitations associated with future trust administration and the challenges associated with identifying appropriate trustees.

As a result, the use of a testamentary trust should only be considered on a case-by-case basis and on the basis of professional advice.

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[1] See for example the ATO's preparedness to address the administration of testamentary trusts in accordance with the practices set out in PSLA 2003/12. Ultimately however that practice statement does not have the force of legislation but is an administrative statement to provide guidance to ATO staff.
[2] Advice should be sought on a case-by-case basis

Greg Russo is a succession law specialist and principal of [Greg Russo Law](#).

Disclaimer

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The US market outlook is more nuanced than it seems

Joseph V. Amato

After a seemingly endless and exhaustive process to determine the next president of the United States, we can all now get back to business and focus once again on markets and the economy. The substantial retreat in implied market volatility since the U.S. election suggests that investors are, in fact, ready to do just that.

Elections matter, earnings matter more

While we and many others have spent countless hours analysing policy implications that could result from this election, it's important to remember that earnings drive equity markets more than any other factor.

We are nearing the end of third-quarter earnings season, and it has been reasonably upbeat. The other familiar mega-cap names have comfortably beaten analysts' growth expectations. Importantly, we are also seeing broader performance, a theme that we believe will strengthen in 2025.

Third-quarter earnings growth is sustaining the recovery from the rate-hiking cycle that began in March 2022. More industries in the S&P 500 Index grew their earnings over the preceding 12 months than in 3Q 2023. The headline growth number is still being stretched upward by mega-cap tech and dragged down by cyclical companies, especially in the energy sector. However, the growth of the median stock has closed in on the growth of the capitalisation-weighted index over the course of the year. We expect that gap to close further next year, as cyclicals make a comeback and mega-cap tech growth normalises.

Markets like clarity

The nature of some of Donald Trump's policy proposals means that announcements of key appointments could still move markets. Yet the clarity of the result, with confirmation of Republican control of Congress coming in mid-November, has given investors some certainty. Nonetheless, third-quarter earnings are a reminder that the election result is not the only reason the S&P 500 Index crossed the 6,000 threshold last week.

While a lot of attention has focused on the inflationary and deficit-raising potential of Trump's immigration, trade and tax ideas in particular, we tend to think those concerns are overstated. As [Ashok Bhatia](#) has written, we believe disinflation and a path to a 4% policy rate is being baked into investors' expectations, allowing the focus to shift from inflation and central banks to the fiscal and growth backdrop.

For equity investors, this will mean assessing policy implications region by region, sector by sector, stock by stock. We think we will start to see that sometime early in the new year—and our equity research team sees a lot of nuance and complexity to deal with.

Industry sector outlooks in US are mixed

Take energy and power, for example. The headlines might suggest that the election result is good news for fossil fuel companies and bad news for renewables and the Inflation Reduction Act (IRA). But the IRA is creating thousands of jobs, primarily in Republican-controlled states, and renewables remain the quickest and cheapest market solution to the US power scarcity. The liquid natural gas sector looks set to benefit from the removal of the permit pause, and oil field services could benefit from more extraction activity, but oil and gas investors remain focused on capital discipline and wouldn't wish to see rising supply pushing down prices.

Similar nuances can be seen across other sectors.

We see good reason for the general outperformance of industrials, which often greets Republican victories in anticipation of pro-cyclical, pro-infrastructure policies. But, again, that suggests investors see little prospect of a broad repeal of IRA measures.

Adjacent sectors like transport, aerospace and defense, or machinery and autos, face potentially strong crosscurrents. High tariffs could support domestic transport sectors such as railways and trucking while hurting cross-border operators. Tariffs would also raise the cost of inputs for auto and aerospace manufacturers. Whether lower energy prices, looser regulations and other pro-growth measures outweigh these pressures will often depend on company specifics.

Stronger demand for industrial machinery would feed through to the semiconductor sector, but it remains unclear how Trump's "America First" approach might affect existing CHIPS and Science Act funding. A retreat from the previous administration's antitrust regulation is likely to benefit the tech sector in general, but high exposure to China poses a risk for many companies. Tariffs and China exposure are likely to become increasingly important factors in retail and ecommerce, as well.

In health care, we see a potential split between the many health care services businesses that could benefit from a friendlier tax, regulatory and M&A environment, and the large-cap therapeutics companies that face uncertainty on drug-pricing policy.

Financials is perhaps the only sector where this election result seems entirely supportive. A steeper yield curve, lower taxes, a more energized dealmaking environment and looser regulation (including the potential dilution of Basel III measures) would all be positive for the sector.

Zero-sum game?

Overall, we are optimistic on nominal growth as we see inflation and rates trending down against a generally pro-business policy background. However, we think it is important for investors to acknowledge that we have moved from an era of globalization, in which free trade enhances growth worldwide, to a new era of mercantilism and protectionism.

That could mean a zero-sum game with more distinct winners and losers—regionally, sectorally and company by company. We expect to see many of the subsector and bottom-up nuances play out as President-elect Trump assembles his government and settles on policies; and when that happens, we believe an active approach to managing risk and opportunity will be paramount.

Investors are getting back to business after a tumultuous election year. But that business looks to be very different from what we've known for the past four years.

Joseph V. Amato is President and Chief Investment Officer, Equities; at Neuberger Berman, a sponsor of Firstlinks.

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Book and podcast recommendations for the summer

UniSuper

The UniSuper Investment Team are a diverse bunch who read extensively and listen to a range of podcasts. This year, to kick off summer we've compiled a list of our favourites. We hope our recommendations will enlighten and inspire. They cover a broad spectrum from financial markets, history, healthcare and communication to learning from the greats. Happy reading and enjoy listening.

Penny Heard, Head of Australian Equities

Book: The Man Who Solved the Market
Author: Gregory Zuckerman

In *The Man Who Solved the Market*, Gregory Zuckerman explores the life of Jim Simons, the brilliant mind behind hedge fund Renaissance Technologies. What I loved about this book was getting into the head of Simons, a mathematical maverick, who was expelled from the US' Soviet code-cracking team for opposing the Vietnam War but went on to create one of the most relentless moneymaking machines in history.

Simons may not be the household name of Buffett or Soros, but since 1988 Renaissance has generated over US$100 billion in trading profits by uncovering market patterns through mathematical models and algorithms in trading. While systematic strategies may be more commonplace these days, experts were bewildered by his methods, which have remained shrouded in mystery, making Simons and his team some of the richest people in the world. Renaissance also symbolises an era where technology helps money and power concentrate in the hands of a few. What was fascinating for me were the examples of influence by Simons on the Democratic party and his former colleague Robert Mercer, on Trump's (first) election and Brexit. Whether you're a seasoned investor or just starting out, this book will broaden your understanding of the financial world and inspire you to think differently about investing.

David Welsh, Investment Analyst (Global Equities)

Book: Blind Spots
Author: Dr. Marty Makary

Today, more Americans experience peanut allergies than ever in history. The root cause: the American Academy of Paediatrics recommending parents avoid giving peanut products to their children until they turned three. This advice turned out to be fundamentally flawed, inadvertently leading to a huge increase in peanut allergies driven by a lack of early exposure.

A true page turner, *Blind Spots* by Dr. Marty Makary delves into the healthcare system, highlighting how common misconceptions have led to incorrect treatment for peanut allergies, hormone replacement therapy, antibiotics and many more. *Blind Spots* might be the most interesting book you'll read this year.

Tessa Calligeros, Investment Analyst (Fixed Interest and Macro Research)

Podcast: Founders
Host: David Senra

Hosted by David Senra, *Founders Podcast* offers in depth insights into the biographies and autobiographies of notable founders. I find it an easy listen and have gained many valuable lessons. Of the 350+ episodes, one of my standouts is Episode #286 on Warren Buffett and Charlie Munger. Lessons learnt:

- Schedule time to think
- Focus - avoid multitasking
- Learn lessons from others
- Mistakes are a fact of life. Living life totally free of mistakes is a life of inaction
- Preparation is key to make quick decisions
- Study effective individuals (listen to Founders!)

Link to episode: https://open.spotify.com/episode/3j0nU1hztrJ1lQ8pKElGZy

Andrew Ewington, Investment Analyst (Portfolio Analysis and Implementation)

Book: Nuclear Folly: A New History of the Cuban Missile Crisis
Author: Serhii Plokhy

Nuclear Folly: A New History of the Cuban Missile Crisis by Serhii Plokhy offers a deep dive into the flawed decision-making processes that nearly led to nuclear war. Serhii explores critical missteps, misjudgements, and poor communication between Kennedy, Khrushchev, and Castro. The book underscores important lessons in decision analysis, including its cascading effects, the dangers of acting on incomplete intelligence, the risks of assuming the other side's intentions, and the value of back-channel diplomacy. For those interested in how leadership shapes global outcomes, it provides crucial insights into the weight of responsibility leaders bear and the far-reaching consequences of their choices in high-stakes situations.

Rob Stewart, Investment Manager (Global Equities)

Book: Boomerang
Author: Michael Lewis

Michael Lewis is the author behind the books turned movies *The Big Short*, *Moneyball* and *The Blind Side*. These books were all great reads but the one I recommend most is *Boomerang*. It offers a witty and incisive exploration of the 2008 global financial crisis, focusing on its aftermath in various countries. Lewis travels to Iceland, Greece, Ireland, Germany, and California, examining how cultural attitudes towards money and debt contributed to economic instability. He uncovers absurd and often hilarious stories of financial mismanagement, from Icelandic fishermen-turned-bankers to Greek monks engaged in high-stakes real estate deals. Lewis's trademark humour and accessible explanations of complex financial concepts make the book both entertaining and informative. While it may not provide deep economic analysis, *Boomerang* excels at illustrating how national character flaws and delusions can lead to disastrous financial consequences, offering valuable insights into human nature and economic behaviour.

Lou Capparelli, Head of ESG

Podcast: The rest is history
Hosts: Tom Holland and Dominic Sandbrook

The Rest is History podcast is an excellent and entertaining way of finding out more about the most significant events spanning modern and ancient history. History buffs will enjoy the detail but even those with only a casual appreciation of historical events will love the way the podcasters bring those events to life and the comparisons they make to contemporary events. Topics covered span modern history (Kennedy assassination(s), British elections, the origins of World Wars 1 and 2) and ancient history (Roman Empire, the Aztecs, Greek mythology) and much more. The podcasters are renowned English historians who take a lighthearted but still scholarly approach that makes each episode accessible to those with little or no prior knowledge. My personal favourites are the series on the JFK assassination, the causes of World War 1 and the rise of Nazism.

Annika Bradley, Investment Specialist (Portfolio Analysis and Implementation)

*Book: Smart Brevity: The Power of Saying More With Less**
Authors: Jim VandeHei; Mike Allen and Roy Schwartz

Say less to be heard today.

Smart Brevity is the essential communication companion of the future. And I loved it.

Why it matters: The world is awash with content: emails, tweets, messages, audio and video. *Smart Brevity* helps you cut through with crisp communication tips. This (on-brand) brief, yet punchy book provides a practical guide to communicate more effectively.

Go deeper:

- "Roughly one-third of work emails that require attention go unread. Most words of most news stories are not seen" according to the book.
- *Smart Brevity* lays out a simple, yet effective method to structure your content to be heard in today's over-saturated content environment.

Bottom line: commit to a few hours over the summer to learn how to say less and actually be heard.

*The format of this book review has adopted the SmartBrevity style.

We'd love to hear what's on your summer reading and podcast list.

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