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Editorial

We live in a time when the 'Magnificent Seven' stocks dominate the direction of markets and are more powerful than most Governments. Investors are rightly fascinated by them and the endless growth they seem to offer.

Yet, pared back to the simplest terms, the main objective of these companies isn't growth. It isn't technology. It isn't having a share price go to the moon, though that doesn't hurt.

Instead, it's survival. The ability to fend off competitors, to endure, and to thrive.

Maybe it's why I've always been intrigued by companies which have managed to last through generations, and what their successes may teach us as investors.

Last year, I wrote of the 'Lindy effect'. It's a theory that suggests how long an idea or technology may last is correlated with how long it has already lasted. In other words, old things have better odds of getting older still than newer things.

Nassim Taleb popularized the Lindy effect is his book, *Antifragile*, describing it thus:

"If a book has been in print for forty years, I can expect it to be in print for another forty years. But, and that is the main difference, if it survives another decade, then it will be expected to be in print another fifty years. This, simply, as a rule, tells you why things that have been around for a long time are not "aging" like persons, but "aging" in reverse. Every year that passes without extinction doubles the additional life expectancy. This is an indicator of some robustness. The robustness of an item is proportional to its life!"

The Lindy effect in action

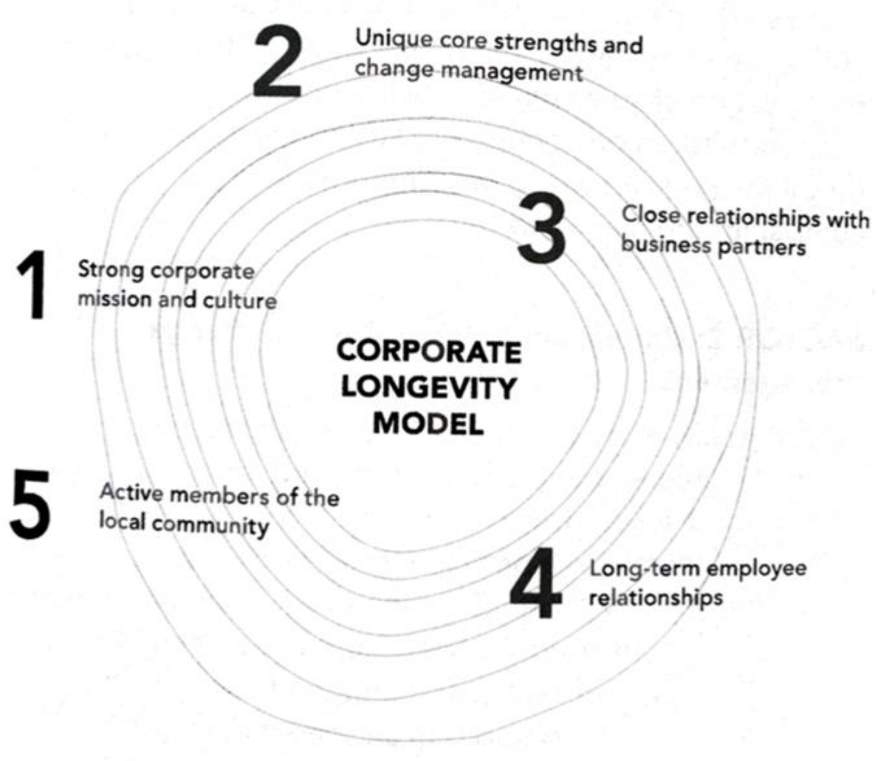
Recently, I came across a book that describes the Lindy effect in action. It's called *Lessons from Century Club Companies* by Vicki TenHaken. The book focuses on companies that have been around for at least 100 years.

TenHaken was drawn to the topic after going to a presentation by an economist who studied long-lived Japanese companies. Japan has some of the oldest continuously run companies in the world, with seven founded more than 1,000 years ago.

TenHaken studied how the US compared to Japan. She found that the average lifespan of a company there is 12-15 years. And that there are more than 1,000 companies in America which have survived over 100 years, yet that represents only 0.5% of all businesses operating today.

Looking elsewhere, the author also discovered an exclusive club of long-run, family-owned businesses, called the Henokiens. It's an association of companies that have been continuously operating, and remain family-owned, for 200 years or more. The association's objective is to promote long-term decision-making (how apt). Starting with four members in France, its numbers have risen to 54.

Through her 10 years of research, TenHaken found five key characteristics of companies that endured through generations:



Strong corporate mission and culture

I've worked at enough firms across my career to know that missions and cultures can be fuzzy concepts. Yet, they often provide the intangibles that ensure success.

So it goes with the oldest companies. They live their mission statements. The statements emphasise the technology or skills that make the company unique and its relationship with business partners.

The companies also tend to have specific values that guide management in their decisions and create a broad culture across the firm. The values are shared with employees, customers and suppliers. They're a way for people to buy in to the company, and to filter out those who don't fit.

That doesn't mean tangibles like finances are forgotten. But the oldest companies often have a different view of them versus newer businesses.

Generally, the older companies take a financially conservative approach. They prefer minimal debt, and profitability over growth.

For them, profits are the fuel that drives long-term survival. The goal is to accomplish the mission, and if that happens, profits will follow.

Max De Pree from US-based furniture company, Herman Miller, is quoted saying, "profit is the *result* of doing well what they do as a company, not their goal."

Nonetheless, TenHaken says older firms are very profitable. In Japan, they are 2x more profitable than peers. In other countries, the gap is less but still significant.

Unique core strengths and change management

"Century Club companies are not dinosaurs. They would not have survived world wars, economic depressions, globalization, changing social and cultural mores, and quantum leaps in technology that created whole new industries (and obsoleted others) without innovation and change."

TenHaken gives many examples of how business survival depends on the ability to innovate and adapt. For instance, the now 126-year-old US-based Jelly Bean Candy Company, founded by the Goelitz family, has a history of making new products. The second generation made candy corn and buttercreams. The third and fourth generation made tangerine slices and spice drops. They experimented by injecting different flavors in mini jellybeans in 1965. And in 1973, they introduced chocolate dutch mints.

Close relationships with business partners

The oldest companies view suppliers as partners and collaborators rather than enemies. That means they often have long-term relationships with suppliers.

TenHaken gives many examples of these relationships. Morse Lumber, established in 1853, has been doing business with Mascot Construction for 60 years. Alden Shoe has been getting its leather from Horween Leather Company since 1930. Flooring products company, Armstrong, has been doing business with Derr Flooring since 1918.

Long-term employee relationships

"Building relationships with employees so they stay with the firm for a long time is consistently described as a key longevity success factor by 100-year-old companies."

TenHaken says century club companies have long-term employees. She cites General Mills, where of about 16,000 employees, more than half has been on the job for more than 10 years. Almost 3,500 for more than 20 years.

Being a good workplace that retains employees isn't just positive for these long-run firms, though. TenHaken cites data showing that the 100 best US companies to work for have outperformed the S&P 500 by 2-to-1 since 1998.

Active members of the local community

The oldest companies tend to have deep roots in their communities. These companies see their community support as being socially responsible. Plus, it's mutually beneficial.

They invest in local projects, step up in times of crisis, and pay employees for local volunteer efforts.

Again, TenHaken provides examples. When an oil spill created a crisis in Michigan, Schuler's Restaurant fed over 2,500 clean-up crew members 24/7 for months on end.

Interestingly, the century club companies were also found to be environmentally conscious. TenHaken says the data backs it up: of the 'Global 100 Most Sustainable Corporations in the World', about half are more than 90 years old.

Lessons for investors

Here are the key takeaways for investors:

1. Companies should focus on processes over results. It's nice to have goals, but they should be loosely held. That's because there are 1,000 things which go into achieving a goal, and it's those things that matter most.
2. Experimentation is critical to success. Companies that aren't trying new things aren't adapting and are likely to fall behind competitors.
3. Supplier relationships are critical and often overlooked by businesses and investors. Of the companies that you invest in, which ones have long-term supplier relationships?
4. Employee turnover provides an important clue to the culture of a firm. Good companies retain good employees and prefer to hire from within than without.
5. Do the businesses you invest in give back to their communities and help out in crises? Or are they constantly fighting to get their way? Successful companies are generally highly community conscious.

Last year, I wrote a piece titled, 'Australian stocks will crush housing over the next decade'. It got a lot of feedback at the time. One year on, my article this week looks at how the forecast is going, and what's changed for both shares and housing since.

James Gruber

Also in this week's edition...

Last week's article on the gender super gap from **Pascale Helyar-Moray** provoked a lot of debate. This week, **Noel Whittaker** pitches in with his own take on the issue. He says the problems have festered for a long time, for many reasons. He proposes some solutions though acknowledges they won't be easy to implement.

Meg Heffron is back. Like many of us, she's been glued to coverage of Cbus' problems, and it got her thinking about the risks in super versus those in SMSFs. She says SMSFs are often portrayed as the riskier option for the community, but that may not tell the full story.

Mercer's **Dr. David Knox** is a world-renowned pension expert, and he's planning his own retirement next year. He's been generous enough to pen a peice looking back at the pension index he helped create in 2009, what's changed since, and the reasons why Australia isn't currently rated an A-grade system.

Magellan's Head of Global Equities, **Arvid Streimann**, sat down with Firstlinks to outline his views on what's ahead for markets. He thinks global markets won't go gangbusters like this year though there should still be positive returns. He favours cyclical stocks in sectors such as resources and financials.

Recently, Australia recorded its seventh consecutive quarter of negative GDP per capita growth. How does this compare to history, and are there clues from the past about what may happen next? **Andrew Wilkinson** investigates.

Markets benefitted from peace for 40 years, but a military resurgence is now underway globally, fuelled by geopolitical tensions and technological advancements. Defence spending is soaring, and **Franklin Templeton's Kim Catechis** says that opens up compelling opportunities for investors.

Lastly in this week's whitepaper, **Pinnacle's** 17 fund manager affiliates offer 17 charts that encaspulate markets in 2024.

Australian stocks will crush housing over the next decade, one year on

James Gruber

This time last year, I wrote an article called, 'Australian stocks will crush housing over the next decade', which got a lot of feedback from subscribers.

I thought it would be a good idea to do something rarely done in the financial media: to hold myself accountable for a forecast. And that doing an annual update and what had changed would be helpful for readers.

Here is that update.

Before I get to it, let's recap the reasons I gave last December for suggesting that the ASX shares would beat housing returns over the next 10 years. The reasons were simple enough. I surmised that housing was hideously overvalued, about 40% overvalued on my estimates. It made housing in Australia one of the most expensive assets in the world. Even more expensive than the 'Magnificent Seven' stocks at the time, which themselves were considered tremendously expensive yet had infinitely better growth prospects than residential property here.

Because of this overvaluation, I suggested that there was a high probability that future returns from housing would be mediocre, in the range of 2-5% over the next decade. That was using relatively optimistic assumptions too.

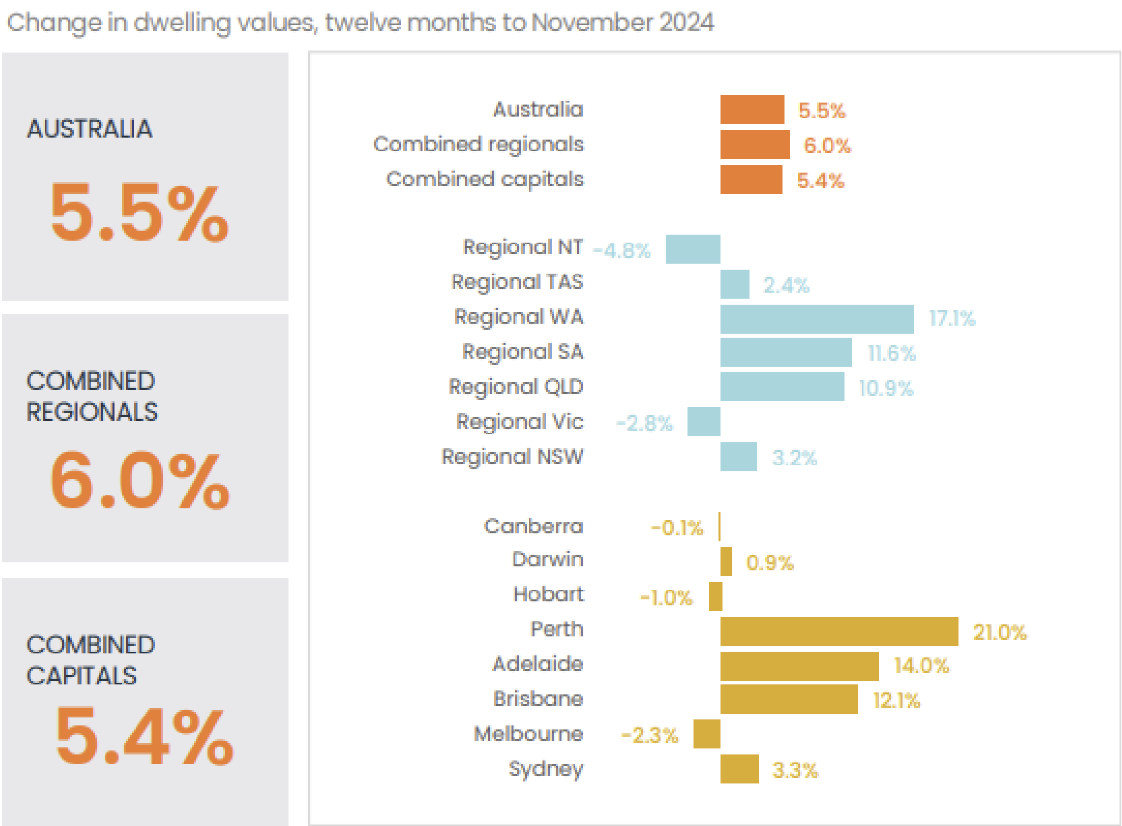
Conversely, Australian shares last December appeared reasonable value. They were trading largely in line with their long-term averages. Assuming average earnings growth with the then dividend yield of 4.4%, returns on shares would be in the range of 6.5-10% over the next 10 years, in my view.

The scorecard one year later

One year into the 10-year forecast, here is the scorecard: from December 1, 2023 to November 30, 2024, the ASX 200 was up 19% in price terms, and 23% including dividends. That compares to a 5.4% gain for Australian housing in the capital cities over the same period.

ASX 200 index

Source: Morningstar



Source: CoreLogic

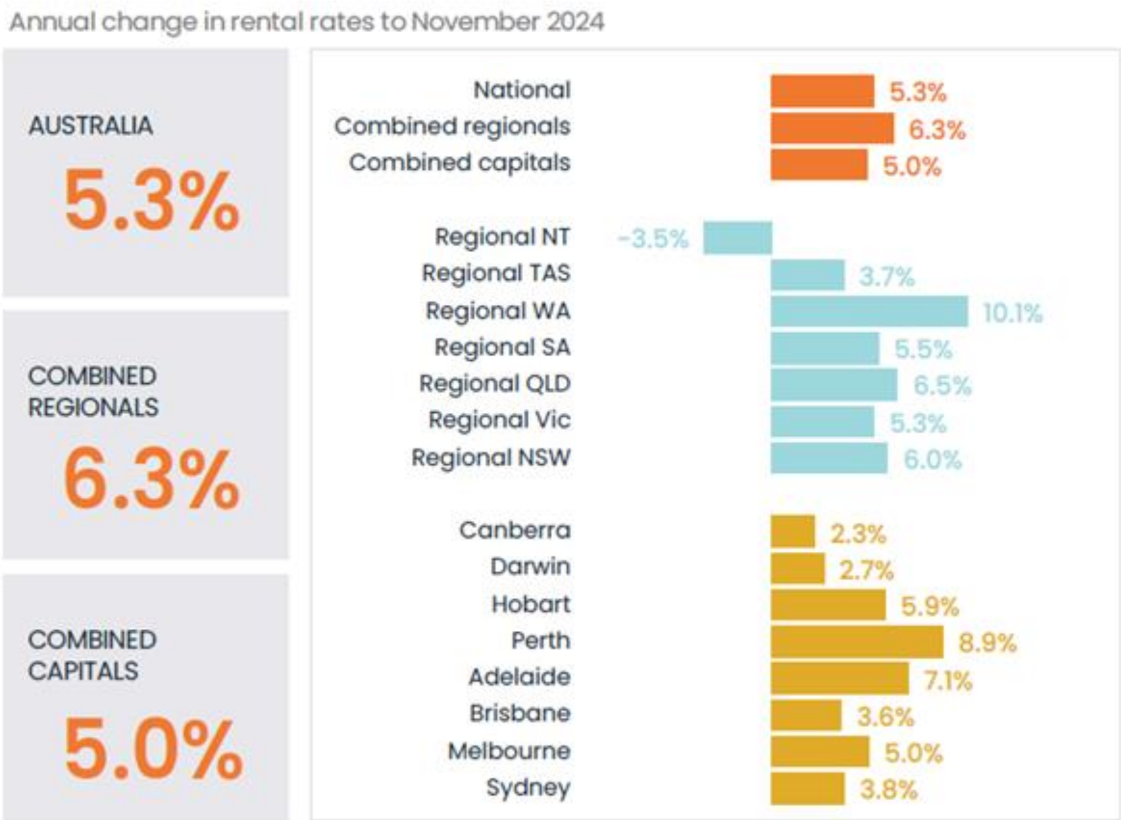
So far, Australian shares *have* crushed housing. Yet, it's early days and there's much to play out.

The fascinating part of the past year was that the gain in shares was driven entirely from an increase in valuation. Earnings for stocks were relatively flat over the period. However, the price attached to those earnings increased, with the price-to-earnings ratio (PER) rising from 17x to 22x.

The extraordinary run of the banks was a big reason behind the jump in the market's PER. For instance, Commonwealth Bank (ASX:CBA) was up 52% over the period, excluding dividends. Amazingly, earnings for CBA went backwards during that time! Trading at 28x PER, CBA is now the most expensive bank in the developed world, and it's daylight behind them.

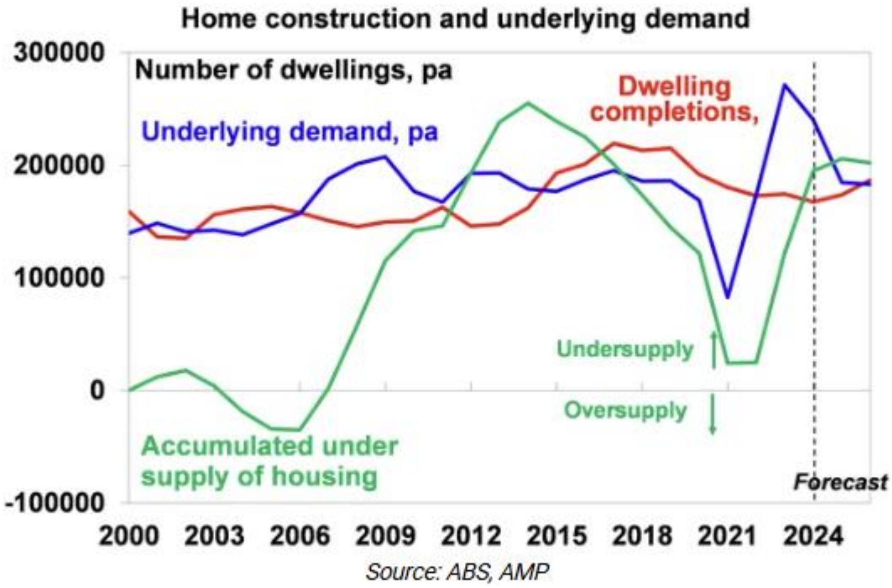
Source: Morningstar

Where the fundamentals for shares were pedestrian, those for housing held up reasonably well. Rents increased 5% across the capital cities. Meanwhile, valuations softened marginally.



Source: CoreLogic

Supply of housing has remained tight. There's an accumulated shortfall of around 200,000 dwellings. The reasons for the supply shortfall are many. From a lack of development approvals combined with the rise of NIMBYs (not in my backyard) to capacity constraints to, construction firms struggling to stay afloat amid cost pressures.



Meantime, demand has held up remarkably well even with higher rates. Surging immigration numbers have helped with this.

Remarkable to me is the continued upswing in investors into housing. Loans to investors were up 30% in the year to September this year. And investors made up 37% of new housing loans. While that type of number is considered normal in Australia, it's anything but that when compared globally.

What do valuations look like now?

Where does that leave valuations now? For housing, not much has changed. It remains extraordinarily overvalued on key valuation metrics. In my previous article, I suggested that one way of looking at housing valuation was to compare it to risk-free bond yields. The risk-free bond yield (the 10-year yield) in December last year was 4.11%. That compared to the rental yield on housing of 3.5% (that's a generous interpretation as this is a gross yield before taxes and expenses).

I proposed back then that all assets are essentially priced off this risk-free rate, and that for taking the risk of owning an asset, an investor would demand a premium to that risk-free rate. The extent of the premium was open to debate, though I put that a reasonable premium for housing should be around 1.5%.

Applying that premium suggested housing's fair value was around a yield of 5.61% compared to the then rental yield of 3.5%. That put housing at close to a 40% overvaluation versus the value ascribed to it back then.

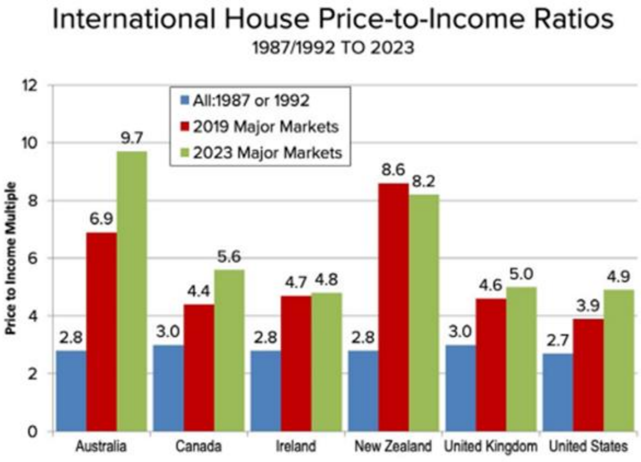
Since last year, not a lot has changed. The 10-year bond yield has increased slightly to 4.25%. Meanwhile, the housing rental yield has remained at 3.5%. Therefore, on this metric, housing remains about 40% overvalued.

Other metrics support the overvaluation thesis. A 3.5% gross rental yield equates to a PER for housing of 29x (100 divided by 3.5). That doesn't tell the full story though because that gross yield neglects taxes and costs. Add in a 30% tax, and that PER rises to 41x. Add in costs, and the PER almost certainly reaches +50x.

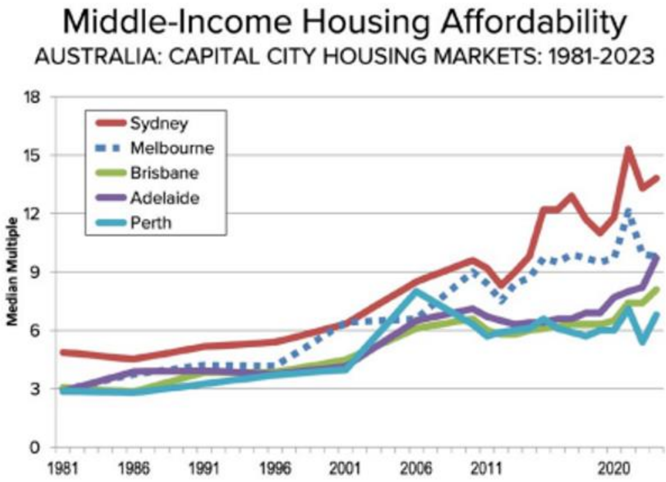
50x PER is almost 2,5x that of the ASX's 22x. It's also well above the 30.2x average forward PER of the Magnificent Six stocks, which are themselves considered expensive (including Amazon, Alphabet, Microsoft, Nvidia, Meta, Apple, but excluding Tesla which trades at 113x PER).

House prices also look stretched according to price-to-income ratios. In June, international consultants, Demographia, released its widely respected annual survey of residential property across eight countries. Its report suggested that Australia's five major capital cities, excluding Canberra, Hobart, and Darwin, were either severely unaffordable, or impossibly unaffordable.

Demographia said that Australia's median price-to-income multiple of 9.7x was more than 2x that of the US, and almost 2x that of the UK.



Derived from Reserve Bank of Australia and *Demographia*



The report found three capital cities in Australia ranked among the top ten least affordable markets in the world. Even little old Adelaide, where I'm from, ranked ninth and was considered less affordable than New York!

Whichever way you cut it, housing in Australia remains expensive.

As for shares, they look less attractive than they did a year ago. At 22x, they're about 30% above the long-term average PER. And earnings growth looks subdued in the near term, with minimal growth out of the banks, and the large miners being hit by lower iron ore prices.

Least affordable markets

Ranking	Nation	Metropolitan market	Median multiple
1	China	Hong Kong	16.7
2	Australia	Sydney	13.8
3	Canada	Vancouver	12.3
4	US	San Jose, CA	11.9
5	US	Los Angeles, CA	10.9
6	US	Honolulu	10.5
7	Australia	Melbourne	9.8
8	US	San Francisco, CA	9.7
9	Australia	Adelaide	9.7
10	US	San Diego, CA	9.5

Source: Firstlinks, Demographia International Housing Affordability report

Future returns

I maintain my forecast of housing returns of 2-5% over the 10 years from December 1, 2023. That forecast was based off a starting net yield of 2.45%, in addition to 2.5% average rental earnings growth (compared to the 2% historical average). Assuming no change in valuations, that would give you an annual nominal return for housing of 4.95% (2.5% plus 2.45%).

Any cut to current steep valuations would result in a reduction to the nominal return.

One criticism I received last year was my assumption for rental growth. 2022-2023 saw extraordinary rises in rents and some expected that to continue. I didn't, and that's played out, with rental growth easing. Growth should slow further in the medium term as supply constraints loosen (they invariably will at some point).

For shares, I had forecast annual returns of 6.5-10%. That remains on track, even after the spectacular gains of the past year. Valuations have pushed the market higher, even though earnings have lagged. The market dividend yield has also come down, from 4.4% last year to 3.4% now. That makes the market less attractively valued and vulnerable to a pullback in the short term.

Long term however, the dividend yield plus conservative earnings growth of +3% should ensure decent returns from here.

Note I've changed the benchmark for share returns to the ASX 200 from the All Ordinaries Index used in the previous article. The former is easier to track over time and the differences between the two indices are minimal given the overlap in heavyweight stocks. Note also that Firstlinks is normally sceptical of forecasts but this seemed a 'no-brainer' at the time even though few agreed.

James Gruber is an Editor at Firstlinks.

Addressing the gender super gap

Noel Whittaker

The subject of women's inadequate superannuation has been in the news for a long time. I remember attending a seminar on this issue eight years ago at Griffith University, run by a group of female economists. Those discussions were insightful, and there have been legislative changes aimed to improve the situation since then, so it's frustrating to see that we're still circling back to the same challenges today.

The realities of the gender gap

The harsh reality is that most women retire with significantly less superannuation than men. This makes it particularly difficult for older single women and widows, exacerbated by the fact that, on average, women live almost five years longer than men.

A key reason for the disparity in super is obvious: there is a 16% pay gap between men and women. Males tend to dominate in higher paid managerial positions; in families with children, it's usually females who take time off from work to raise them. 75% of part-time workers are female: if you look for a GP, a vet or a dentist, it's odds-on the person you deal with will be a woman who works three days a week. To me, that looks like getting the work–life balance right, but it does come at a cost.

Once money is inside superannuation, women still tend to earn less. Why? First, because they often have a number of low-paying jobs in their working life, they accumulate multiple superannuation accounts. Amalgamating them seems just too difficult. I can vouch for that – my daughter has four small superannuation accounts, and I've been trying for three years to get her to consolidate them, but the paperwork always gets in the way.

There is another issue which tends to be swept under the table: different approaches to finances, reflecting the different temperaments of males and females. Norwegian studies have shown that men and women play the financial game with different rulebooks. For men, the focus is on maximising opportunities; for women, the focus is on security — building steady, reliable pathways to financial well-being. The bottom line is that women tend to be more risk-averse than men are.

Possible solutions

So what can be done to change this situation? There's been a lot of talk about increasing financial literacy, but as far as superannuation goes it's as simple as ABC. Three main factors determine how much super you will have when you retire: one, the amount of money contributed; two, the rate of return you achieve; and three, how long a timeframe you have. The employer makes the contributions, leaving the employee responsible for the return and the timeframe.

Young people need to invest in options that give high returns over the long term. The highest returns come from growth assets such as local and international shares, but these are described as 'high risk' assets. Industry professionals understand that in this context risk means volatility, but many investors think it means you might lose all your money. This is primarily a problem of terminology. As a result, people tend to keep their superannuation in overly conservative options from the time they start work, particularly if they are risk averse. The cost of this in later life can be huge.

Case study

Two people start work at age 20 on $35,000 a year. Let's assume their salaries grow at 4% per annum and employer contributions remain at 11.5%. The first person is extremely conservative, so their fund earns only 4% per annum. At age 65 their superannuation balance is $900,000. The second person adopts a more growth-orientated asset allocation and as a result their fund earns 8% per annum. At age 65 their superannuation is worth $2.4 million.

I believe that high growth investments should be the default option for everybody under, say, 50. This would boost their superannuation in the long term and get them used to more growth-orientated assets along the way.

More education is needed to teach people the difference between investing with pre-tax and after-tax dollars. Retiring mortgage-free should be a major goal, and anybody 50 or over with a mortgage should focus on making tax-deductible contributions up to the $30,000 allowed each year. This is much more valuable than increasing mortgage payments. It's a no-brainer: a good superannuation fund should be paying a higher return than the interest on the home loan, and the tax advantages give you much more bang for your back.

We also have to educate people about the importance of time. Think about a person aged 60, who earns $70,000 a year and has $300,000 in super. If they retire now, they have $300,000; if they work for just five more years and retire at 65, they end up with $500,000. That extra $200,000 could make a massive difference to their retirement.

Catch-up superannuation contributions were introduced specifically to help women recover from time spent out of the workforce. If there comes a time when you're back at work and school fees are behind you, this could be a great opportunity. As long as your super balance is under $500,000, you can make substantial tax-deductible contributions to help offset the years when your employer wasn't contributing on your behalf. It's a valuable strategy to get your retirement savings back on track.

Now, laws to pay the superannuation guarantee on parental leave have been introduced to parliament, aiming to reduce the part of the superannuation contribution gap caused by maternity leave. In addition, the COVID-19 early release withdrawals showed that women were more likely to withdraw funds from superannuation in times of difficulty.

Of course there is still much to do, and improving financial literacy for all Australians continues to be one of the greatest challenges facing us. But the better we understand the problem, the better chance we have of solving it.

Noel Whittaker is the author of Making Money Made Simple and numerous other books on personal finance. His advice is general in nature and readers should seek their own professional advice before making any financial decisions. Email: noel@noelwhittaker.com.au.

Meg on SMSFs: Where are the risks in our major super sectors?

Meg Heffron

Given the amount of money in super in Australia ($4 trillion, of which SMSFs represent $1 trillion), it's not surprising that there is a lot of focus on risk.

Interestingly, it's often SMSFs that are portrayed as the riskier option for the community as a whole – as they put members in charge of their own nest eggs. To some, that sounds very risky.

But does that really tell the full story when it comes to the safety of our super savings?

I'd argue that all super sectors bring some level of risk and that risk is, in fact, a part of life. But the risks are very different. And perhaps that's a good thing.

The Cbus affair

ASIC's recent action against Cbus, accompanied by a flurry of press articles and social media criticism, has highlighted a deep-seated problem (and systemic risk) with the APRA sector and industry funds in particular: it is extremely difficult (and requires real people) to support members at scale.

If you've missed it, ASIC has commenced court proceedings against Cbus to have monetary penalties applied for the fund's repeated failure to "act efficiently, honestly and fairly in the handling of claims for death benefits and TPD insurance[1]". The major issue was long delays in getting payments into the hands of beneficiaries at (often) the very worst moment of their lives.

There were thousands of members and their loved ones involved, and even after several years of being put on notice that ASIC was deeply concerned, it's still not fixed. Cbus has chosen to largely blame a third-party provider which does this work for them – Link Group. But in ASIC's own words: "Trustees cannot outsource accountability when it comes to claims handling. It is the trustee's responsibility to ensure there is adequate oversight of their systems and to prioritise the resources necessary to deliver the services they have promised to their members". They're fighting words indeed! From a naturally cautious regulator no less.

These long delays are bad enough in themselves. They potentially lead to acute financial pressure on people who have enough going on already. (And don't get me started about the fact that many industry funds put a deceased member's balance in cash while they think about who should receive the benefit.)

But there's actually another considerable risk not being talked about at all – yet.

When a super member dies, the amount of tax paid depends on who receives it. Generally, if it's received by the spouse, it will be tax free but if it's received by adult financially independent children it will be taxed. If the deceased is over 65, the tax rate is no more than 17% (15% plus the Medicare Levy if applicable) but it's potentially paid on the **full amount** of the death benefit. (So for context – a $500,000 death benefit could mean up to $85,000 in tax.)

So I wonder how many of these death benefits Cbus have failed to pay out *would have* gone to spouses who have died while waiting for their pay out? The long delay now has an added dimension – it has genuinely cost the beneficiaries large amounts of money.

I wonder whether there will be an action against Cbus for that too at some point?

This has to be a major issue just waiting to blow up?

The concentration of super in a small number of large funds, many of whom use the same suppliers (Link Group apparently supports around 80% of industry funds[2]) must present a real challenge for regulators when weighing up the systemic risks in the industry.

For example, the same supplier was blamed for terrible delays in death benefit payments by AustralianSuper – to the point where the fund voluntarily paid out $4.2 million in compensation payments to impacted members and brought claims handling in-house[3]. A nice gesture perhaps but worth remembering that this will ultimately be paid by other members (large super funds maintain reserves to cover this sort of thing and they create them by skimming a little off the top of everyone's super).

Clearly, life is not 'risk free' in the APRA regulated sector of super. And the common themes are:

1. Being big can be great but it brings particular challenges (like finding suppliers and dealing with human beings at scale)
2. Guardrails can be fantastic but they can also create bureaucracy that is difficult to navigate (see point 1)

Risks in SMSFs

It prompted me to think about where the risks lie in the SMSF sector. They definitely exist. But they are quite different and perhaps mean less risk for the community as a whole in some ways.

So where could we see widespread failure that impacts many funds when it comes to SMSFs?

The obvious place to start is where there is concentration. For example, SMSF accounting software is dominated by two major players – Class and BGL. Failure of either of these would present enormous challenges for hundreds of thousands of SMSFs in that their accounting records would potentially be inaccessible - either for a time or forever.

But would it stop pensions being paid? Freeze investments? Prevent contributions? No – in the vast majority of SMSFs, that's handled by the trustees themselves (via banking systems and investment platforms), not their accountants. Regardless of how much hair their accountant is losing over a software glitch, the trustees would continue to operate as usual.

The situation is entirely different for large funds. For a start, all these functions are much more interconnected. If a member asks a large fund for a benefit payment and "the record systems are down", the money genuinely cannot be paid out (the large fund has no way of confirming the member actually has the money available to them).

In fact, this happened for Australian Retirement Trust (Australia's second biggest super fund) as recently as early November 2024[4]. Their outage completely halted pension payments for nearly 100,000 people. Remember, for many people, super pensions are the equivalent of salary for the rest of us – something the recipients depend on for their living costs. And timing is important.

For the same outcome in SMSF-land, automatic payments via thousands of funds' banking apps would need to fail.

According to major software provider Class, over 40% of SMSFs have bank accounts with Macquarie Bank[5]. So what if Macquarie fell over? For a start, a bank comes with some Government protections. But also – remember that only part of an SMSF's assets will generally be in the bank account. Catastrophic failure of the bank doesn't necessarily impact anything else. The trustee could still realise other investments. And of course let's hope that CBA, NAB and Westpac remain fine – since they look after another 40% of SMSFs between them.

By their very nature, SMSFs are looked after by an army of individual members and trustees – the scope for failure across so many individually managed super funds is hard to see.

SMSFs' key service providers (accountants, advisers) tend to be many and varied too. I estimate the largest provider of accounting services has around 5% market share. Within this myriad of accounting firms there are around 19,000 tax agents lodging tax returns for SMSFs. While some do a lot of them, nearly 18,000 (over 93%) do fewer than 100[6].

In contrast, AustralianSuper has around 3.5 million members and the Australian Retirement Trust has over 2 million. Let's hope they don't both depend on the same suppliers because failure there would impact more people than the entire SMSF population. (I have to confess this is said very much tongue in cheek – I don't know but I expect there is a lot of cross over. Our super industry has too few players for there to be much diversification here.)

The Achilles heel of the SMSF sector is not so much the scope for harm to the *community* (via a single failure having a widespread impact on a great many members), it's the risk of harm to *individuals*. By definition, SMSFs are entirely in the control of their trustees / members. This gives the people who have them a unique opportunity to:

- Fall prey to scammers – if an unscrupulous actor can convince an SMSF trustee to follow their plan, all the members' retirement savings are exposed. Even worse, the scammer can be instrumental in extracting the money out of the (more protected) APRA environment in the first place,
- Make poor choices – large funds tend to have guardrails designed to prevent members from over exposure to any one investment, for example. An SMSF trustee can choose not to have these, or
- Just getting it wrong – SMSF trustees are responsible for choosing all their suppliers and using their own knowledge plus support from their suppliers to follow the rules. They'll need to get it right or risk the wrath of the ATO (and consequences).

When it comes to the risk of SMSFs, it's often the 'getting it wrong' risk that bothers people most. That said, my 25+ years' experience would suggest that the ATO rarely seeks to throw the book at people who are genuinely trying to do the right thing but stuff up. They reserve their big guns for people who knowingly (and often repeatedly) do things like: take money out illegally, use super money to prop up ailing businesses or buy things that give the members a current day benefit rather than saving for retirement etc.

To be honest, it is hard to land in hot water by accident. For many less serious breaches, the ATO usually looks to have the trustees fix the problem first and then escalate to penalties if it happens again. Often the worst possible thing that can happen to an SMSF is it's declared 'non complying'. Then, the fund loses all its tax breaks and is hit with a very large tax bill of up to 45% of all its assets. Before issuing a notice of non-compliance, the ATO considers much more than just "did the fund break the law" – things like whether there were multiple breaches of the law, was it an honest mistake or was it intentional, were the trustees reckless and how serious were the breaches are taken into account.

In all three of these scenarios (scams, bad choices or non-compliance), the harm to the community is one step removed. If an SMSF fails and the members end up relying on the age pension in retirement, valuable tax concessions have been squandered. The Government could have used the money for something more useful.

That is – very fairly – where many point the finger at the risks associated with SMSFs. But it's also where the guardrails already in place for SMSFs are critical.

A compliance and financial audit would be unheard of for any other private entity (like a private company or trust). But it's required for every single SMSF every single year. Auditors are effectively the ATO's first line of defence.

This is why a competent and ethical audit population who report the right things back to the ATO is vital. It explains why there has been so much focus on audit independence in recent years. They need to be independent of not just the trustees but also the other service providers involved with the fund.

So is concentration an issue here? The negative press received by Big 4 accounting firms in recent years highlights that bigger doesn't always mean more competent or more ethical. But again – there are some 3,000 individual SMSF auditors. While there are indeed some larger firms auditing (say) more than 50,000 SMSFs, there is also a vibrant community of highly competent and skilled smaller firms.

The major risk when it comes to audit is perhaps the race to the bottom in terms of fees. While it's great for SMSF trustees to get all their services delivered cost effectively, it would be a risk if only the largest firms can remain profitable. If the sector loses its diversity of personnel, thinking and process here, it will be poor outcome for our resilience.

What all this tell me is that there are risks in all our super sectors – including SMSFs. For sure. But this is one area where the SMSF sector's disaggregation is its strength. The risks are generally most likely to be realised and are most acute at an individual level rather than sector wide. In some ways, SMSFs may even provide greater protection for Australia's super nest egg than the APRA sector.

[1] ASIC media release, 12 November 2024 "ASIC sues Cbus alleging systemic claims handling failures"
[2] AFR 29 October 2024 "The next big threat to our $4 trillion super sector might lie within"
[3] AFR 20 November 2024 "AustralianSuper pays members back $4.2m over claims handling delays"
[4] SMH 2 November 2024 "A major super fund had an outage this week. Almost no-one realised"
[5] Class Benchmark Report 2024
[6] ATO Annual statistical report 2021-22, published July 2024

Meg Heffron is the Managing Director of [Heffron SMSF Solutions](), a sponsor of Firstlinks. This is general information only and it does not constitute any recommendation or advice. It does not consider any personal circumstances and is based on an understanding of relevant rules and legislation at the time of writing.

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Global pension reforms and how Australia can improve

David Knox

In 2009, we issued the first Melbourne Mercer Global Pension Index, which compared and ranked 11 pension system around the world. Although it had a modest and uncertain beginning, this benchmarking exercise has continued to grow so that the 2024 Mercer CFA Institute Global Pension Index (MCGPI) considers 48 pension systems covering two-thirds of the world's population.

Its growth and relevance have grown way beyond my initial expectations. Of course, one of the challenges has been to frame questions that are relevant to all pension systems given the huge diversity, and ask questions that will be understood by all, even when English is not the first language. Notwithstanding the differences, the primary purpose of pensions is similar and so we have been able to learn about challenges and solutions from each system.

The changes since inception

As I review our reports over the last 16 years prior to my retirement in 2025, there are several key trends and developments that will continue to influence the ever expanding global pension industry.

One of the key changes has been the global trend away from defined benefit (DB) employer-sponsored schemes to defined contribution (DC) arrangements where individuals bear most of the risks. Although Australia may have been ahead of this development with the introduction of compulsory superannuation in 1992, the world is following. Even the Netherlands, which again topped the MCGPI this year, is reforming its very well regarded pension system from DB to a collective DC arrangement.

In 2023 the OECD reported that

"More than 50% of pension assets were held in (occupational) DC plans or personal plans in 19 out of the 21 reporting OECD economies."

This movement from DB to DC has also influenced some of the questions we have asked in the Index. For example, 16 years ago we were concerned with the separation of pension assets from the employer, the level of in-house assets held by a private sector pension plan and the minimum level of funding required for DB funds.

While these topics remain in the MCGPI, we are now more focused on the requirements relating to disclosure and transparency. That is, if individuals are now bearing the risks and more responsibility, it is critical that they have access to appropriate information. Hence our questions now explore the requirements for the pension plan's annual report, including investment performance, and the contents of the member's annual statement including income projections (not yet required in Australia) and showing the level of fees deducted from the account.

During this 16-year period, we have also strengthened the questions relating to the governance of pension plans as this topic has received increased focus around the world. Since 2009, we have added questions relating to codes of personal conduct, ESG, conflict of interest policies, anti-bribery and corruption policies, cyber security, and the reporting of data breaches. In essence, each of these additions have encouraged governments and policy makers to strengthen the governance of pension plans.

However, it is not just the structure and operations of pension and superannuation plans that have changed during this period. The world's demography has changed significantly.

Fertility rates have fallen considerably, and this trend is likely to continue. The average fertility rate in the 16 nations in the 2011 Index was 1.75, even then below the required fertility rate of 2.1 for a stable population. By 2024, the average fertility rate for these nations was 1.45. Australia's fertility rate in 2023 was 1.50, the lowest ever recorded.

While the world is aging faster than previously expected, there is also clear evidence that more people are working longer. For example, the average labour force participation rate for those aged 55-64 in the original 11 nations in 2009 was 59.6%. By 2024, this average had increased to 70.6%. Interestingly, 5% of the Australian labour force is already over age 65. This has implications for employers as well as the rules relating to the Age Pension.

Notwithstanding the increased participation in the workforce at older ages, the ageing population will place increased pressure on pension systems around the world. Hence, we are likely to see some governments increasing normal retirement ages while others will increase the eligibility age for the state pension. In some cases, future benefits may even be reduced.

Another global development has been the increased focus on the gender pension gap. It is clear that in most pension systems, including Australia, the average retirement benefit for women is much lower than the average male benefit. Hence, in recent years we have added questions relating to the availability of additional retirement benefits for those on paid parental leave or those caring for young children, as well as the requirement to use unisex lifetime annuity rates.

How Australia fares

For most years of the Index, the Australian retirement income system has ranked in the top quartile of pension systems around the world given our relatively high level and affordable Age Pension, good coverage of the superannuation system and strong regulation. However, Australia has never attained the coveted A grade. Without a requirement to take part, but not all, of future retirement benefits as an income stream, Australia is likely to retain its current B+ grade. Such income `products could include longevity products as well as account-based pensions with minimum and maximum drawdown rates. In addition, the introduction of compulsory income projections on annual member statements would highlight the need to focus on income streams.

The government has made an important move to reduce the gender super gap by paying SG on government-funded paid parental leave. But it could go further. For example, by introducing a government superannuation contribution for those caring for young children and requiring unisex lifetime annuities, as occurs in Europe.

In its 16-year history, the Index has benchmarked pension systems around the world with objective data and has recommended improvements for every system. There is no perfect system! Recently the OECD commented that:

"The pension policy debate in OECD countries has switched from pandemic responses back to a focus on more long-term structural issues. The question of how to address the impact of population ageing on pension systems has moved back to centre stage."

By considering the policies, benefit designs and regulations of the better systems in the MCGPI, every system can improve the financial outcomes of future retirees.

Dr. David Knox is a Senior Partner and Senior Actuary at Mercer Australia. This article is general information and not investment advice, and does not consider the circumstances of any person.

Cyclical stocks will drive markets higher in 2025

James Gruber and Arvid Streimann

This is an edited extract of an interview between Firstlinks' James Gruber and Arvid Streimann, Head of Global Equities and Portfolio Manager at Magellan Financial Group.

James Gruber: Stocks have run hard over the past two years now, especially this year. Is there more to come in 2025?

Arvid Streimann: I think that there'll be further gains in equity markets, but not at the same pace as you've seen over the past couple of years, which have been quite extraordinary by historical standards. When I look at what's been driving the market, especially in the past couple of years, over half of the driver of returns has actually been improved sentiment. That's over and above improvements in the fundamentals - those fundamentals being better earnings or movements in interest rates.

It's really that sentiment piece which has driven markets higher to a large extent. It's very difficult to see that sentiment improving further from where we are already.

If I look at the proxies for sentiment and equity risk premiums in the market, they're all at very extreme levels by historical standards. Going forward, it's the fundamental pieces - earnings and interest rates - which are going to drive markets further.

So we'll probably see positive market growth, but not to the extent seen over the past couple of years.

JG: Where do you see earnings growth coming from globally?

AS: Look, I think we're going through a cyclical upswing. I would say the economically cyclical parts of the market will do well. You've got a US administration which is going to be pro-growth. You've got the flow through impact of lower interest rates to spur growth, and that should improve earnings growth in a cyclical sense in North America, that'll trickle through to Europe as well.

We're still quite bearish when it comes to China. They have their own structural problems, and I wouldn't be looking at China as a source of cyclical earnings growth.

'Growers', say your big tech players and companies, should do ok in this environment, but it's the cyclical parts of the market that will probably have their time in the sun in the next year or so.

JG: So we're talking financials, consumer discretionary, those kind of areas?

AS: Yes, that's right. Financials usually do well in this type of environment. I would say that commodities in general should do ok in this type of environment.

JG: Donald Trump is the master of unpredictability. How do you navigate that unpredictability as a portfolio manager?

AS: This is an interesting one. Donald Trump - I think you can look at his first administration for some clues as to how he may act in his second administration. In that first administration, he liked to create a positive legacy. He likes to see the market going up as part of that. And in this administration, I think that he'll also try to get employment back to America. This is part of that decoupling theme, which I think plays against Chinese growth.

I think that what he's going to do is negotiate hard. We know that he's a strong negotiator, and the way that he does that is he tries to coerce people into coming around to his view, either by putting them on the spot publicly or running down the clock. He likes to negotiate hard, and people know that that's what he tries to do.

He's going to do even more of that this time around. And when you look back, he said he's going to raise tariffs on Mexico and Canada, and he's not even in the Oval Office yet! I think that he is undertaking a stronger form of negotiation than what people expected, which is all part of his negotiating tactic. As an investor, this type of negotiating tactic leads to market volatility and opens up opportunities for investors, so long as you know what he's doing and you have confidence in the underlying earning streams of the companies whose share prices have been impacted.

When I think about Donald Trump, his bark is worse than his bite. In his first administration, he did a lot of talking compared to many previous US presidents, but I don't think that he did as much policy change as many US presidents. You'll see a lot of talking, but perhaps not as much action as what that talking suggests.

JG: What are the key risks for markets then over the next year?

AS: There are a couple of risks that investors should be thinking about. The first is Donald Trump himself, and what we would call Trump inflation. He's clearly going to stimulate the US economy, and that is going to be putting upward pressure on inflation. And the one thing that's different in the Fed's latest rate cutting cycle is that it started cutting rates at a historically low unemployment rate. Normally, when the Fed starts cutting rates, there's a lot of spare capacity in the economy, which means that as the economy starts to pick up, a lot of that slack can be used before inflationary pressures start to come out.

Now that's not the case in the labor market, and doubly so when you think about Donald Trump's deportations and the tightening up of the immigrant visas. I'd say that the labor market is going to be a source of inflationary pressures over the next little while, and that will put pressure not only on market interest rates at the short end, but also market interest rates at the long end. When we're thinking about Trump inflation, it's really that bond market impact that we're thinking about, because that can really disrupt investor sentiment, particularly if it happens very fast. If it happens slow, that's less of an issue. But if it's a quick move up over a matter of days or a week or so, then that has a more disruptive impact on markets.

What happens in China is also going to have a major impact on global share markets. It's our view that that stimulus will not be strong enough to trigger an upswing in the Chinese economy. It's more the Chinese authorities trying to manage the downside risk in that economy, because we all know that when housing markets have challenges, it takes a long time for economies to improve again.

JG: With AI, who will be the winners out of that, or is it too early to tell?

AS: I don't think it's too early to tell, but we're not able to have a perfectly clear crystal ball on this.

I would say that there are a couple of factors which the eventual winners will have. Number one is that they will be innovators. And we've seen this already. There have been some companies that have created innovation, and they're winning.

The second piece of that innovation is that there's going to be future innovation. Now, if we cast our minds back to the TMT bubble when the web was first invented, there were many companies that used the web to sell and there were many companies who used the web to innovate further. For instance, social media networks were innovation that was built upon the creation of the web, but when the web was created, no one knew that that was coming. Also put streaming video on demand services like Netflix in that same bucket.

We've been looking for companies that have a track record of innovation, and you can look at a lot of the big tech companies, because not only do they have the track record of innovation, they also have the size and the innovation budgets.

So the first thing is innovation, the second thing is what we would call the implementation of that technology which has been innovated. And there, we always tell people that it's much easier to implement these new technologies if you have one of two things, or maybe both:

1. existing customers, because we all know it's easier to sell to existing customers, as opposed to find some new customers and then sell to them. It's magnitudes harder to do that.

2. if you have a particularly complex company or processes which can be greatly helped by this new technology, we've seen that in the past. Here we think about companies like Microsoft and Intuit - those companies will be well placed to benefit from what's happening in AI right now.

JG: In terms of stocks, you mentioned a couple there, but are there other stocks that you're bullish on that you can talk about?

AS: Amazon (NASDAQ:AMZN) is the largest stock in our portfolio and there are a couple of reasons for that. Firstly, it's got a long track record of innovation, and we're going through a cycle of innovation at the moment. It also has a lot of customers in both its AWS or Cloud Services Division on the corporate side or on the retail side, on amazon.com, the shopping portal, so it's well placed to benefit from innovation that's occurring right now on our numbers. We see low double digit to mid-teens EBIT (Earnings Before Interest and Taxes) growth in the medium term in all of its operating divisions, and that is very attractive to us.

Source: Morningstar

The second company which we think is really interesting is Stryker (NYSE:SYK), which is a leading orthopedics, medical and surgical equipment company. The reason why this is so interesting is not only because it's defensive characteristics. You often see that in the healthcare sector, but there is growth in there as well. We estimate that in the medium term, this company should grow its EBIT in the high single digit to mid-teens range, which is pretty good for a defensive health care company. And the beautiful thing about these types of health care companies, which involve surgeons, is that once you've trained the surgeon to use your equipment, they're very reluctant to move to something else, because quite frankly, instead of training, they'd rather be playing golf!

Source: Morningstar

That interview featured Arvid Streimann, Head of Global Equities and Portfolio Manager at Magellan Financial Group. Magellan Group is a sponsor of Firstlinks. For general information purposes only and must not be construed as investment advice or as an investment recommendation. This material does not take into account your investment objectives, financial situation or particular needs.

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How this GDP per capita recession compares to history

Andrew Wilkinson

GDP was 0.3% for the September quarter and while headlines highlight that this is 0.1% below expectations, the true story is that this was Australia's seventh[1] consecutive quarter of negative GDP per capita growth.

This is the longest period of consecutive negative GDP per capita growth since records started in June 1973. Since that time, Australia has only recorded one other period of more than two consecutive negative quarters, and that was four negative quarters from September 1982 to June 1983.

Immigration: continuing the GDP free kick, but for how long?

A major flaw in the GDP measure that especially affects Australia is the free kick provided by population growth, which, in Australia's case, means immigration.

Looking back 50 years to 1973 (when the per-capita series starts), population growth has provided nearly 50% of the GDP growth, with GDP growing at a 2.9% compound average rate, compared to GDP per capita, which has averaged 1.5%.

GDP per capita has had double the negative quarters

Table 1 shows a similar pattern regarding the number of negative quarters and recessions (defined as two consecutive quarters or negative growth). Since September 1973, GDP per capita has registered 56 negative quarters compared to GDP, which recorded only 26. Similarly, GDP has recorded only eight consecutive negative quarters compared to 19 for GDP per capita.

Table 1: Population growth has delivered almost half the total GDP growth

Since 1973	GDP	GDP per capita
CAGR	2.9%	1.5%
Negative quarters	26	56
Two consecutive negative quarters	8	19

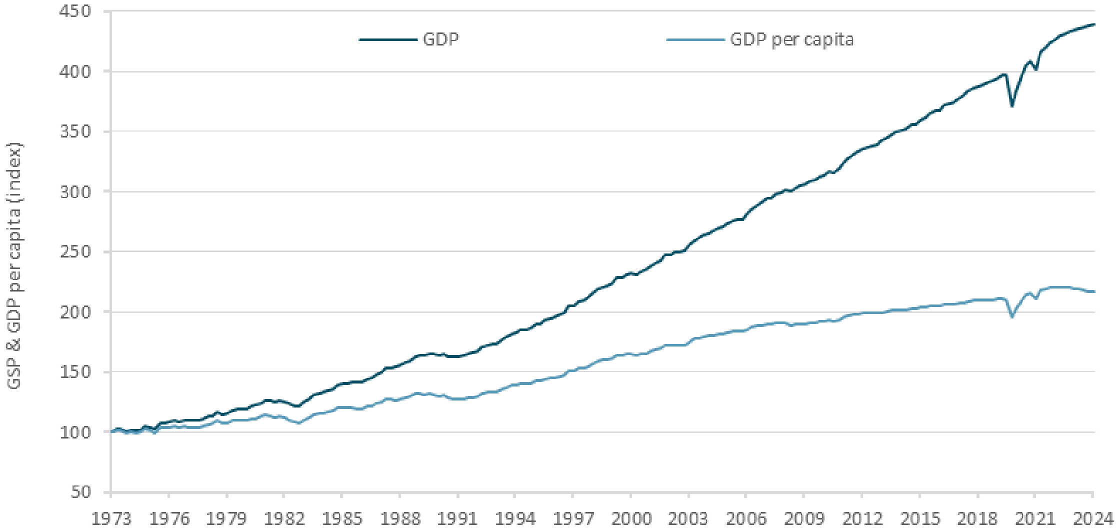
Source: ABS, Venn Brown

Immigration is the magic lever to which governments (of all colours) have become addicted in order to boost GDP (and housing prices). If GDP looks to be slowing, just let a few hundred thousand more people into the country and watch the GDP grow.

There has been some speculation that the growing discontent with the ongoing housing crisis and cost of living pressures might see the end or at least the easing of this policy.

However, no politician wants to be the one that ushers in a GDP-measured recession or, worse still, a meaningful decline in house prices. As such, we don't see a major change in immigration in the near term.

Figure 1: Population growth is responsible for almost half the total GDP growth

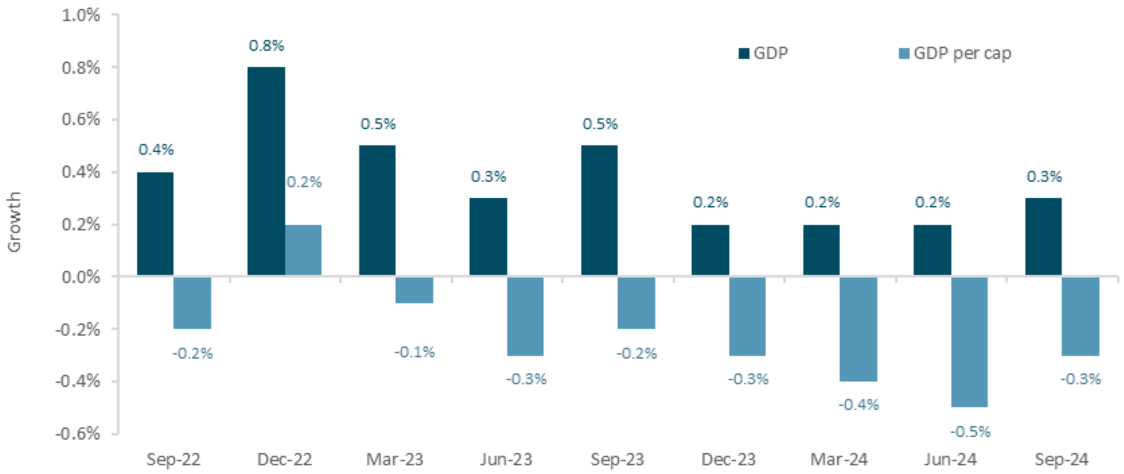


Source: ABS, Venn Brown

While all the talk is on the cost of living and inflationary pressures, it's worth noting that while the government has been proudly reporting unbroken economic growth, GDP has been negative for eight of the last nine quarters on a per capita basis.

As mentioned above, this is only the second time since June 1973 that there have been more than two consecutive quarters of contraction; the other lasted four quarters from September 1982 to June 1983.

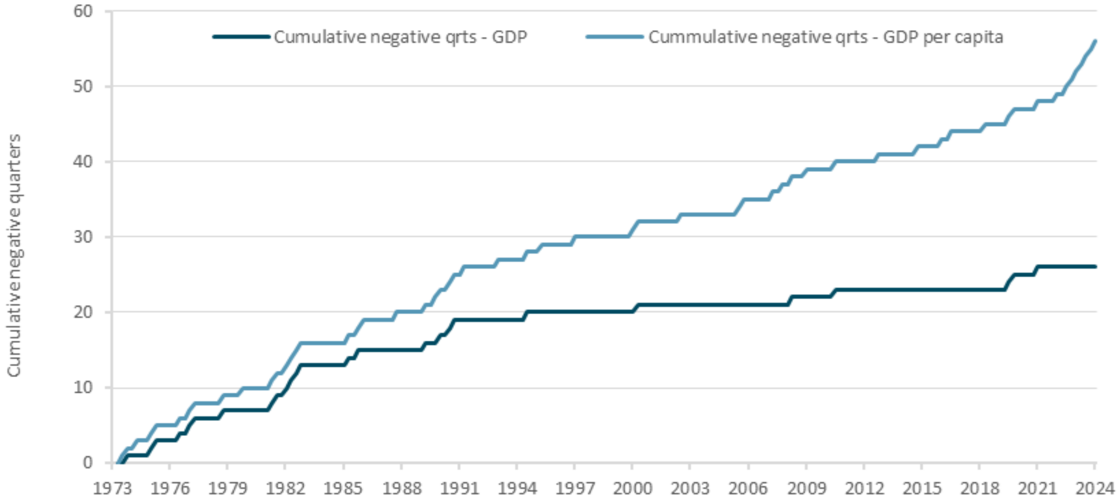
Figure 2: GDP per capita has been negative for just eight of the last nine quarters



Source: ABS, Venn Brown

Figure 3 below shows the cumulative number of negative quarters of GDP and GDP per capita, highlighting the separation of the two measures as immigration increased in the early 90s and gained real speed over the last three years.

Figure 3: GDP per capita has been negative for just eight of the last nine quarters



Source: ABS, Venn Brown

The 1990/91 recession was shorter but far more intense

An interesting reference for the current period is the 1990/91 recession (see Figure 4), during which per capita GDP was negative for six of nine quarters, compared to GDP, which was negative for four of the nine.

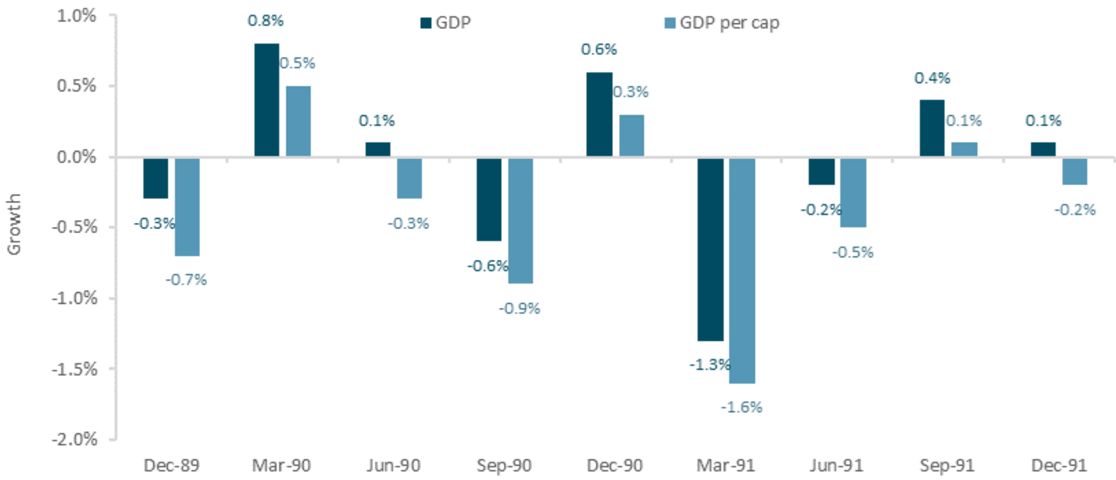
That's not to say we're even close to a similar economic downturn. Back in 1990/91, there were three key differences to our current environment, the most important of which is unemployment:

1. **Unemployment:** Seasonally adjusted unemployment peaked at 11.2% in December 1992, compared to today's persistent, near-record low of 4.1% in October (albeit up from 3.5% in October – December 2022). See Figure 5;

2. **Negative GDP:** Actual GDP was negative for three quarters, bottoming with a -1.3% contraction in March 1991; and

3. **Magnitude:** At the bottom, the magnitude of the negative GDP per capita was double to triple the current levels.

Figure 4: 1990/91 recession had six out of nine negative quarters of per capita GDP



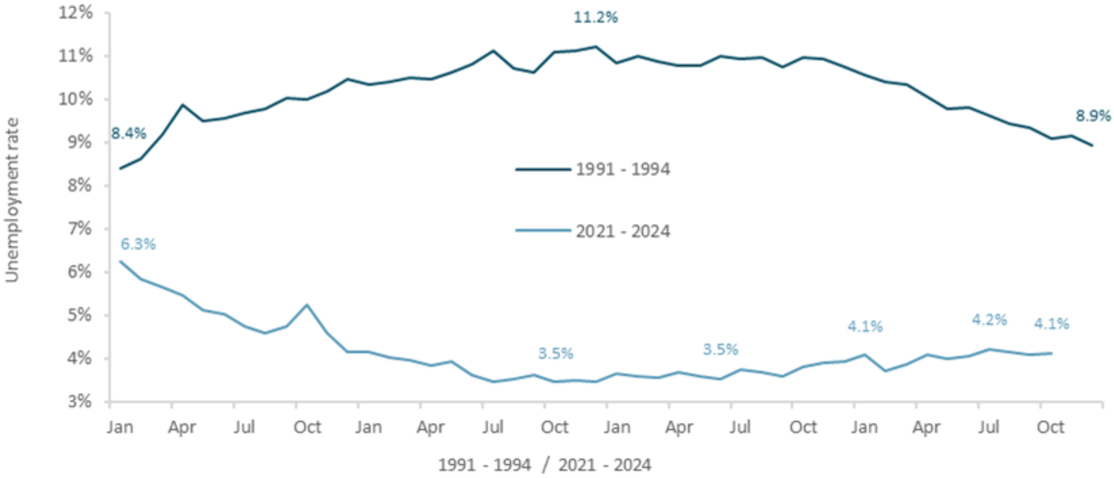
Source: ABS, Venn Brown

Unemployment remains the key factor to watch

While seasonally adjusted unemployment is up 0.7 percentage points from its low of 3.5% in December 2022, it remains near record lows and less than half the rate that resulted from the 1991/1992 recession.

Unemployment and credit defaults remain the key indicators to watch as GDP continues to slow, interest rates remain moderate, and inflation continues to add to cost of living pressures.

Figure 5: Unemployment in 1991 – 1994 was very different to current rates



Source: ABS, Venn Brown

[1] GDP per capita for the March 2023 quarter was revised down from 0% to -0.1% in the September release.

Andrew Wilkinson is the Managing Director of Venn Brown, a special issuer sponsored equity research company.

The mispriced investment opportunity in global defence

Kim Catechis

For most of the last four decades, investors have enjoyed a giant convergence trade.

It was a convergence of economic policy direction, which led to a convergence of generally lower inflation and interest rates—generating higher trend economic growth rates—primarily through increasingly free-wheeling globalisation and free trade.

The trigger for this benign cycle was a generalised geopolitical view that the Cold War was over for good, and most could benefit. We did not question the long-term sustainability of this wonderland, because we believed that economic growth could appease even longstanding ethnic/territorial resentments.

A key driver of the ensuing lack of interest in defence has been the widespread belief that globalisation's benefits, via contributions to prosperity and economic growth, had succeeded in establishing a new paradigm whereby war was unnecessary, and states could simply focus on economic development.

The reversal

The abrupt reversal of the 'peace dividend' – most notably in Europe amid Russia's war on Ukraine – and the deployment of new military technologies like drones and electronic signal jamming has fueled a rapid acceleration of investment in defence.

These investments range from the upgrading of hardware through the modernisation of equipment, the updating of training to absorb the lessons of Ukraine and Gaza, the recalibration of financing and supply chains, and investments to rapidly increase domestic production capacity.

The commitment by European NATO members to invest over US$400 billion annually[1] for at least the next decade is just the start, as the recent growth in the number of private equity and public markets mandates suggests.

Unprecedented spending, again…

Defence spending in 2023 reached its ninth successive annual record, totaling US$2.4 trillion.[2] This amount represents a 36% increase over the last decade.

Over the next six years, NATO spending alone is estimated at US$8.9 trillion, of which US$3.2 trillion is from European NATO members and Canada.[3] It works out to be around US$500 billion a year, rising to US$600 billion a year in 2029.

We believe these developments have reopened an investment opportunity in the defence sector.

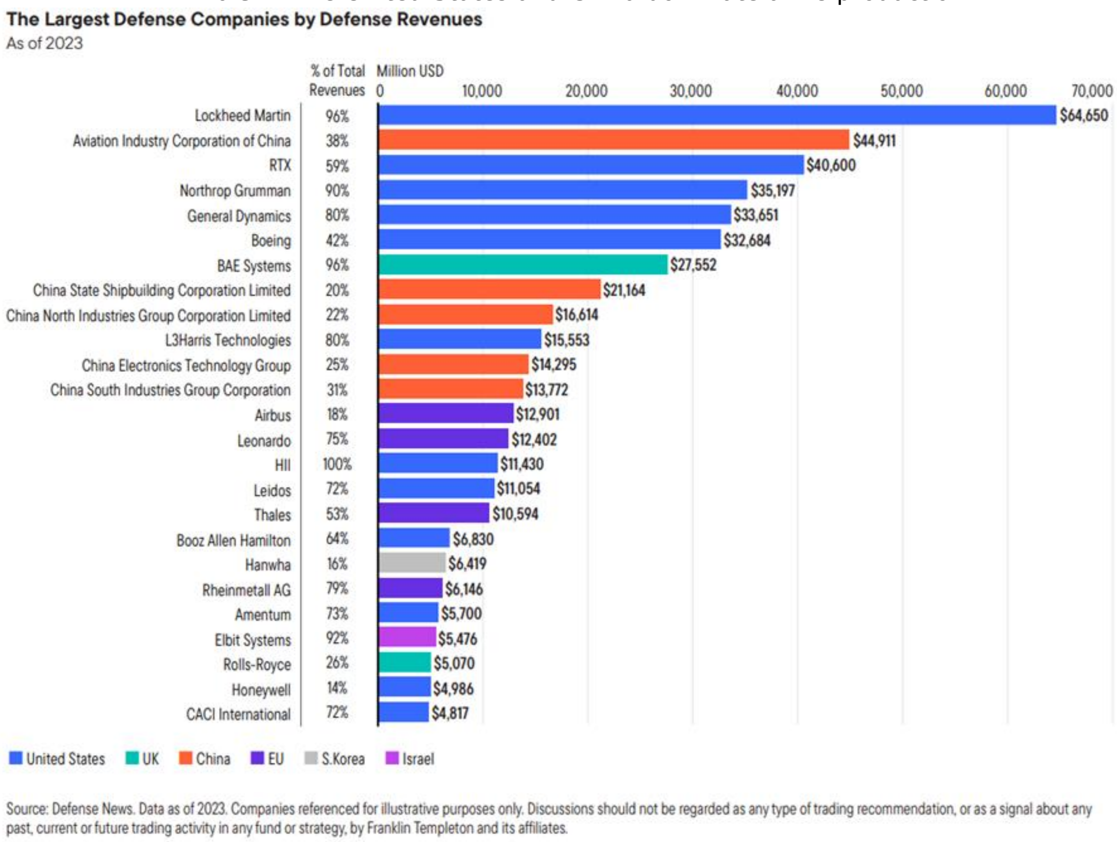
A much-changed industry

The last time a defence stock was among the top 10 performers of the S&P 500 Index was in the 1980s. The global defence industry has changed a lot since then.

In the 1980s, there were estimated to be more than 3,000 companies in what was known as the "military-industrial complex". Tenders often received hundreds of proposals.

Today the sector has consolidated, with contracts tiered by specialisation as well as by geography. There are very few companies that can supply high-ticket, high-specification hardware.

Exhibit 1: The United States and China dominate arms production



Source: Top 100 | Defence News, News about defence programs, business, and technology. Defence News. As of 2023.

Yet there is also a plethora of companies providing newer defence capabilities, and the investment universe provided by the 'new look' defence sector is significant.

This ranges from very large companies like Microsoft, which provides cutting-edge defence capabilities against cyberattacks, to small companies like QinetiQ[4], which provide military robots, risk evaluation across air, land and sea, and cybersecurity solutions.

The obvious and not-so-obvious winners

The obvious winners from this fast-growing spend on defence equipment are the usual suspects—the large, established players with strong balance sheets and stronger relationships with their buyers around the globe.

There is also a less-appreciated universe of French, Italian, German and South Korean producers who are gaining market share, particularly with buyers in Europe and southeast Asia.

European manufacturers, for example, will take market share from Russia over the next decades, as India's gradual modernisation gathers pace and the managed decline in dependence on Russian arms accelerates.

Furthermore, Japanese companies have been banned from exporting weapons since the mid-1960s under the "Three Principles on Arms Exports" policy.[5] This ban is now under revision, with a potential reversal on the cards, which would open up lucrative new markets for Japanese defence companies.

Potential mispricing

The investment case in defence is built on concrete evidence of plans for capital expenditure and research and development programs in a wide variety of subsectors. Three elements of the investment case appear to be mispriced:

1. The magnitude of the public and private sector capital expenditure in defence.

Many countries are still in the process of reviewing their defence architecture in the light of lessons learned in Ukraine and the Middle East.

This process will result in a new set of priorities and requirements to suit modern asymmetric warfare, across multiple domains. It seems prudent to assume that the amount of capital investment will be significantly higher than currently expected.

2. The longevity of this investment theme seems underappreciated.

The combination of changes in capabilities that militaries now require to defend their countries is enormous in scale and in reach, which implies a decades long runway.

3. The wide range of opportunities for investors.

As the template defence structure changes, so does the definition of the defence industry.

The range covers both the traditional (non-proscribed armaments) and the exciting new technologies (LEO Satellite mapping/communications, AI enhanced data management programs, etc.). Much of this will doubtless be transferred to civilian applications.

Finally, there is a group of companies in a variety of geographies (South Korea, India and Japan) that stand to benefit from this investment theme.

[1] Source: "Defense Expenditure of NATO Countries." NATO, 2014-2024. June 17, 2024.
[2] Source: The Stockholm International Peace Research Institute. The SIPRI Yearbook 2024.
[3] Sources: IMF, NATO, Franklin Templeton Institute calculations. (IMF GDP projections and NATO members' statements on future defense spending as % of GDP). There is no assurance that any estimate, forecast or projection will be realised,
[4] QinetiQ evaluates, integrates and secures mission critical platforms, systems, information and assets.
[5] Source: "Japan's Security Policy." Ministry of Foreign Affairs of Japan, Japan's Security Policy. December 5, 2023.

Kim Catechis is an Investment Strategist with the Franklin Templeton Institute. Franklin Templeton is a sponsor of Firstlinks. This material is intended to be of general interest only and should not be construed as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy. It does not constitute legal or tax advice.

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This article is an abridged extract from Franklin Templeton's recent white paper "Deep waves: The paradoxical trinity of defense." Go here to read the full version and important disclaimers.