Firstlinks
a Morningstar company

Edition 593, 10 January 2025

Contents

Howard Marks warns of market froth *James Gruber*

What to expect from the Australian property market in 2025 *Michael Yardney*

How to fix the Commonwealth Superannuation Scheme *Bruce Bennett*

5 key investment themes for the next decade *Matt Reynolds*

New avenues of growth make 2025 exciting for investors *Brodie-Machura, Dropkin*

The pros and cons of debt recycling strategies *Alex Berlee*

Australia is out of step on nuclear power *Stuart McKibbin*

Editorial

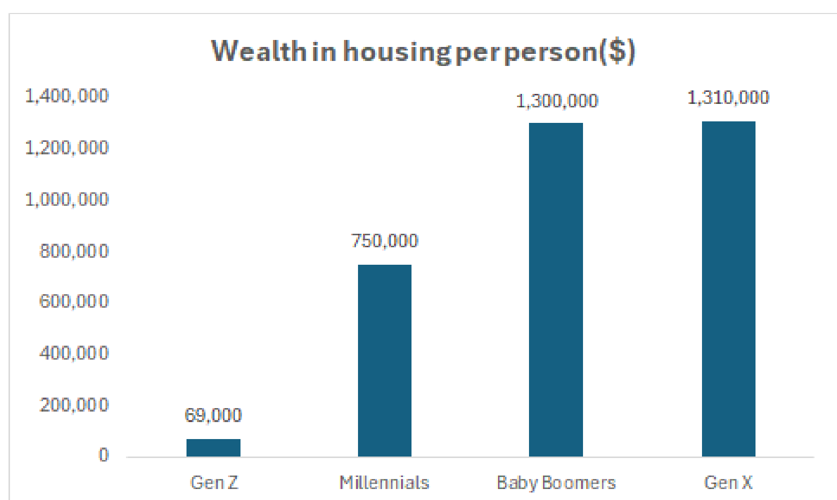
Recently, KPMG Urban Economist, Terry Rawnsley, did some great analysis on generational wealth in Australia, using ABS figures to June last year. His firm put out a media release proclaiming, "The great wealth transfer begins as Gen X overtake Boomers for housing and shares", and the Fairfax press ran with that in their own headline, "From grunge to Grange: How Gen X became wealthier homeowners than Boomers".

A closer analysis at the data, though, suggests these headlines are wrong: while the great wealth transfer may have started, Boomers are still the wealthiest when it comes to housing and total net worth, and younger people are loading themselves with a lot more debt as they seek to get ahead.

To see why, let's look at the numbers.

Wealth in housing

The figures reveal that Generation X has the most significant amount of wealth in housing, with an average value of $1.31 million per person, marginally in front of Baby Boomers at $1.30 million.



Figures as at June 30, 2024. Source: ABS, KPMG

These numbers include any property owned, such as primary residences, investment properties or second homes.

"Baby Boomers have historically been the largest holders of housing assets, but as this cohort ages into retirement they are beginning to sell down their property portfolios," Rawnsley says.

On the other hand, many Gen Xers are upgrading from their first homes to something more.

Meanwhile, Rawnsley highlights the lower wealth in housing of younger cohorts, as Millennials and Gen Z, who face greater challenges to enter the housing market:

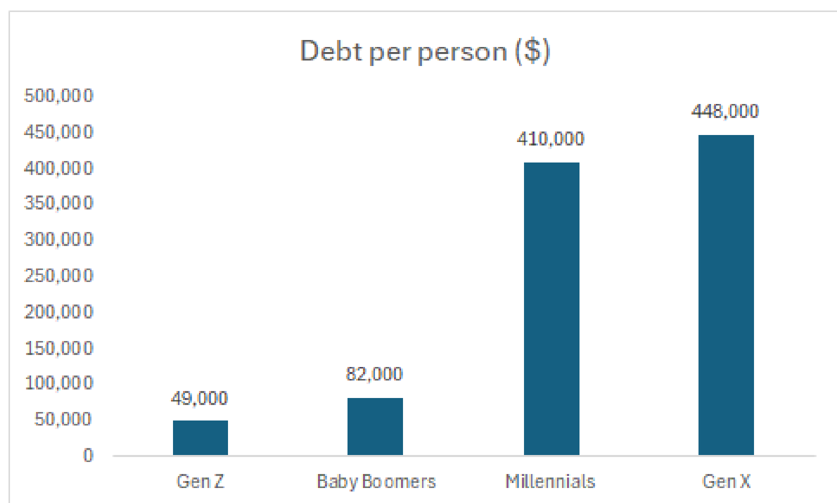
"While the starter's gun has been fired on the great wealth transfer, our findings still demonstrate a clear disparity in housing wealth between older and younger generations."

Rawnsley notes that for younger Millennials and older Gen Zs, the home ownership rate is 10 to 15 percentage points lower than at the same ages for Baby Boomers.

Don't forget about debt

It's settled, then: Generation X has overtaken Baby Boomers for wealth in housing. Well, not quite. Because the above figures only consider the asset side of the equation. They exclude debt.

And when it comes to debt, Baby Boomers are far better off than Gen Xers or Millennials. The latter have gross debt of $448,000 and $410,000 per person respectively. That's 5-6x more than the $82,000 in debt held by the average Baby Boomer.



Figures as at June 30, 2024. Source: ABS, KPMG

It's worth noting that these debts include all loans, not just housing. However, while there isn't a breakdown of housing debt in these numbers, Rawnsley acknowledges that they're likely to account for the vast majority of the gross debt figures. If right, it means that Gen Xers aren't wealthier than Boomers when it comes to housing: their houses may be worth more, but they're holding more debt against those houses.

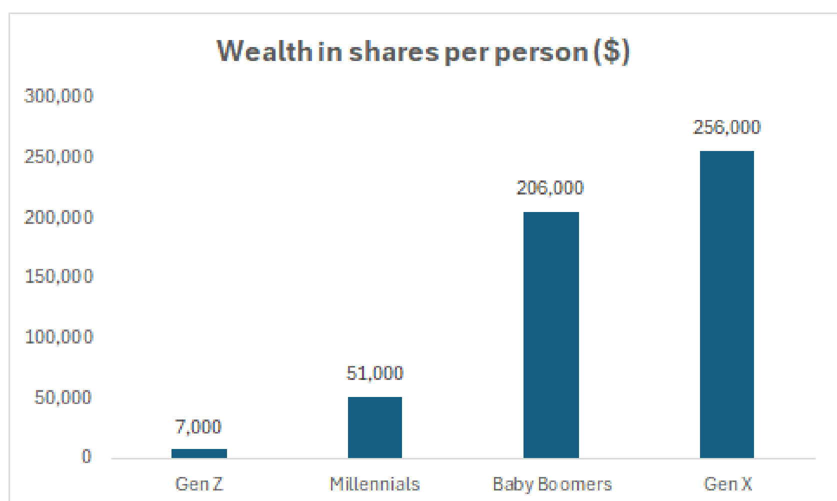
Other assets

This doesn't tell the full story of wealth among different generations. There are other assets to consider.

Of cash and deposits, Baby Boomers lead with $242,000 followed by Gen X with $176,000, while Millennials and Generation Z hold $104,000 and $26,000 respectively.

"Baby Boomers' are gravitating towards liquidity and higher cash holdings which reflect their inclination towards safer investments," Rawnsley says.

When it comes to shares, Gen X has the most, valued at $256,000. Baby Boomers hold $206,000 in shares, highlighting Boomer desire for less risky assets. Meanwhile, Millennials and Gen Z have considerably lower amounts, with $51,000 and $7,000 respectively.



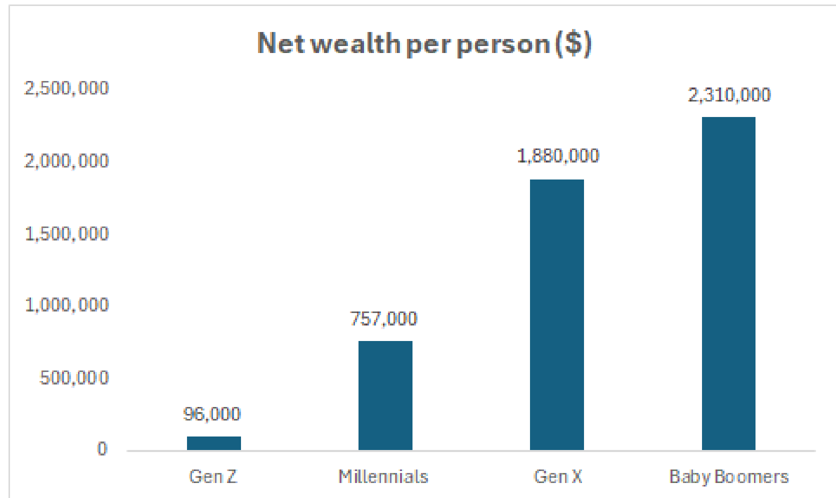
Figures as at June 30, 2024. Source: ABS, KPMG

"These lower levels of share ownership among younger generations indicate a cautious approach towards equity markets, possibly due to financial pressures and less cash to invest," Rawnsley comments.

Other assets, mostly superannuation and business assets, show Baby Boomers and Gen X with comparable

holdings, $641,000 and $586,000 respectively. Millennials and Gen Z hold $260,000 and $43,000 in other assets.

"There is some good news for younger generations in the superannuation asset class as they are coming off a far higher base than their parents. This means the wealth they will eventually accumulate from super will be far higher than older generations," Rawnsley says.

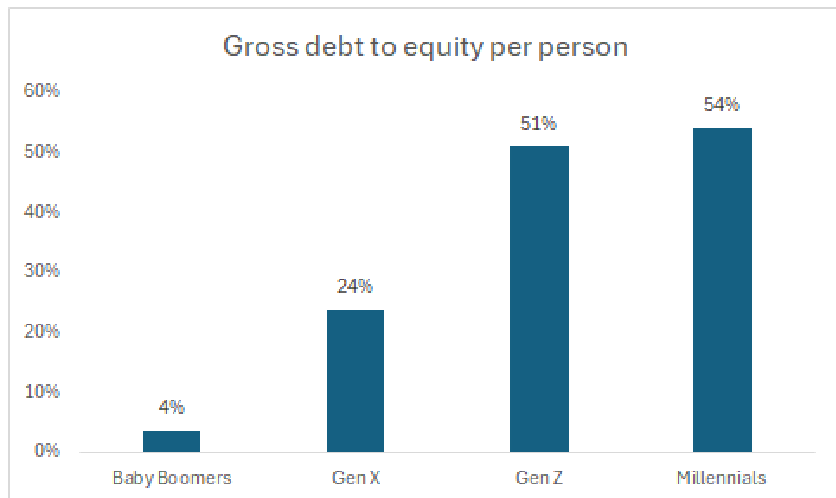


Figures as at June 30, 2024. Source: ABS, KPMG

Net worth

Adding it all up, which of the generations is the wealthiest? It turns out that Baby Boomers remain well out in front, with net wealth per person of $2.31 million, 23% higher than the $1.88 million of Gen X, and about 3x greater than that of Millennials.

"These net worth figures highlight the wealth accumulation lifecycle, where older generations have had more time to build assets and pay down debt," says Rawnsley.



Figures as at June 30, 2024. Source: ABS, Firstlinks calculations

The gross debt held against net worth tells a tale. It's 54% for Millennials, 51% for Generation Z, 24% for Generation X, and just 4% for Baby Boomers.

Summing up, the KPMG analysis shows Baby Boomers are still the wealthiest generation in Australia by far, and younger people are taking on more debt to try to catch up to them. It also underlines the extent that housing has driven the gap between generations.

In my article this week, I outline renowned investor Howard Marks' reservations about the current market and his musings on whether we've entered another investment bubble.

James Gruber, Editor

Also in this week's edition...

Firstlinks has the pleasure of featuring well-known Australian housing expert, **Michael Yardney**, this week. Michael gives us his outlook for 2025 and the key drivers that will shape whether it's a positive one for property owners.

On outlooks, **Fidelity International's Niamh Brodie-Machura** and **Marty Dropkin** consider the opportunities in global equities. They're bullish on the US and Japan, and see the potential for income investing to come back in vogue.

Last year, we had two articles on the issues concerning the unfunded liabilities of Commonwealth defined benefit schemes. Today, we have a follow-up specifically on the Commonwealth Superannuation Scheme (CSS). **Bruce Bennett** highlights how the scheme is no longer fit for purpose as its members now find themselves disadvantaged in several important ways versus those in other super funds.

AI has captured investor imagination, yet **Capital Group's Matt Reynolds** says there are a number of other exciting investment themes for the next decade, including more niche areas like gene editing and RNA interference.

Debt recycling is a potential strategy for those juggling the seemingly competing goals of debt reduction and building an investment portfolio. However, **Alex Berlee** says it's often misunderstood because there's more than one way to do it. He provides an overview of the pros and cons of different debt recycling strategies.

Globally, nuclear power is gathering momentum as a differentiated power source in the energy transition to zero carbon emissions. Yet in Australia, a nuclear ban remains, and **Stuart McKibbin** questions why that is.

Lastly, in this week's whitepaper, **VanEck** says markets are priced for perfection, though there are still opportunities for investors who are willing to dig a little deeper.

Curated by James Gruber and Leisa Bell

Howard Marks warns of market froth

James Gruber

The word 'bubble' is thrown around in investment circles on a regular basis, but billionaire investor Howard Marks can lay some claim to literally writing the memo on bubbles. In January 2000, exactly 25 years, he wrote what he calls a memo (ie. an investor letter) called 'bubble.com' and the subject was the irrational behaviour he thought was happening in tech and e-commerce stocks at that time. The memo garnered much attention because it proved right, and right quickly.

The tech-media-telecom bubble was the first of two spectacular bubbles in the 2000s. The second was the housing bubble and subsequent banking crisis of 2008.

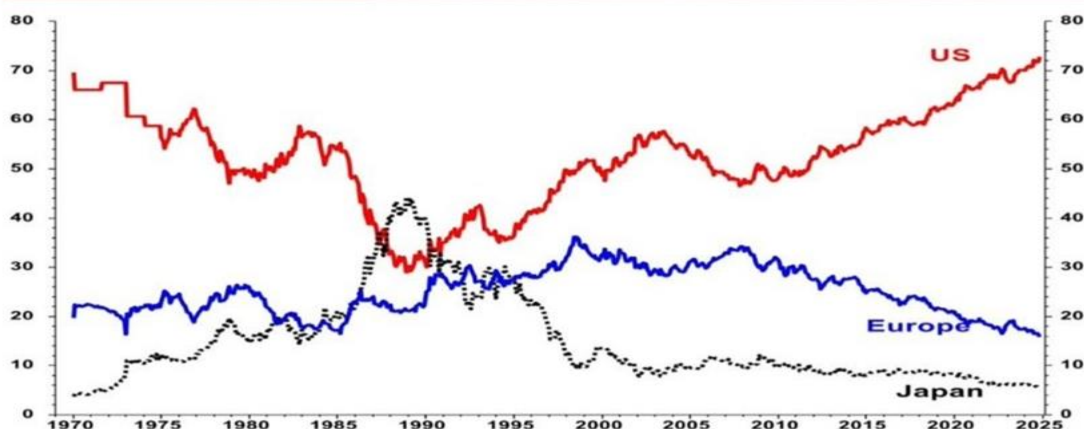
Having been through these periods, many investors are on heightened alert for bubbles, and Marks is often asked about whether today's market represents the third major bubble of this century.

Are we in a bubble now?

First, Marks goes through some familiar facts on the 'Magnificent Seven' stocks (Microsoft, Nvidia, Apple, Amazon, Alphabet, Meta, and Tesla) and their impact on markets, including:

- The stocks represent around 33% of the S&P 500 Index;
- That's roughly double their share of the index five years ago; and
- Prior to the Magnificent Seven, the highest share for the top seven stocks over the past 28 years was 22% in 2000.

The rise of the Magnificent Seven has resulted in US stocks being 75% of the MSCI World Index, the highest percentage since 1970.



The big question is: is this a bubble?

What is a bubble?

Marks initially steps back to ask what a bubble is. For him, it's "more a state of mind than a quantitative calculation". He says a bubble isn't just about rising share prices, but is a temporary mania characterised by:

- Highly irrational exuberance
- Adoration of the subject companies or assets, and a belief that they can't miss
- Massive fear that you'll miss it if you don't invest in the companies ie. FOMO
- Conviction that there's no price too high for said stocks

Mark suggests the final point is critical. Investors can't imagine any flaws in arguments to buy the stocks and are terrified they'll be left behind by those who do purchase the shares.

Therefore, Marks thinks bubbles aren't just about valuations; they have a psychological element. He quotes from Charles Kindleberger's seminal book, 'Manias, Panics and Crashes':

"… As firms or households see others making profits from speculative purchases or resales, they tend to follow. When the number of firms and households indulging in these practices grows larger, bringing in segments of the population that are normally aloof from such ventures, speculation for profit leads away from normal, rational behaviour to what have been described as "manias" or "bubbles." ***The word "mania" emphasizes the irrationality; "bubble" foreshadows the bursting.*** *(Emphasis added)"*

Bubbles can sometimes be recognised through anecdotal evidence, such as when J.P Morgan knew there was a problem when the person shining his shoes started giving him stock tips.

How bubbles form

The question Marks then addresses is what it is that makes investors behave irrationally. The first thing that he identifies is 'newness' or the 'this time is different' phenomenon.

Bubbles are invariably associated with new developments. Historical examples include:

- The 1630s craze in Holland over recently introduced tulips
- The 1720 South Sea Bubble in England over a trading monopoly that the Crown had awarded to the South Sea Company
- The Nifty Fifty stocks in the 1960s
- TMT/internet stocks in the late 1990s
- Subprime mortgage-backed securities in 2004-2006

Marks says that normally if a company or country's shares are at unusually high valuations, people can point to history to act as a tether to temper the enthusiasm.

However, "if something is new, meaning there is no history, then there's nothing to temper enthusiasm" and when "a whole market or group of securities is blasting off and a specious idea is making its adherents rich, few people will risk calling it out."

The second aspect that Marks believes forms a bubble is a belief among investors that things can only get better. The attractions of a new product or way of doing business are obvious, yet the pitfalls are often hidden and are therefore ignored.

He says the trick with bubbles is that there's usually a grain of truth which underlies them; it just gets taken too far.

This can result in investors treating all contenders in a new field as likely to succeed and assigning them valuations assuming success. Though only a few may thrive, or even survive.

It can also lead to investors adopting a 'lottery ticket mentality', thinking a startup in a hot industry could return 200x, then it's worth investing in even if there's a 1% chance of success. Thinking this way, there are few limits to what investors will pay for these stocks.

"Obviously, investors can get caught up in the race to buy the new, new thing. That's where the bubble comes in," Marks says.

Valuation also comes into play

As a value investor, Marks is loath to ignore the role of valuations in a bubble. He makes a great point of a common misunderstanding when it comes to the most used valuation metric, the price to earnings (P/E) ratio. The price of the S&P 500 has averaged around 16x earnings over the past 80 years. Marks says it's typically described as, "you're paying for 16 years of earnings." He says it's more than that, because the process of discounting makes $1 of profit in the future less than $1 today. A 16x P/E ratio is really more than 20x (depending on the discount rate used for future earnings).

Marks says that in bubbles, stocks sell for far more than 16x earnings. For instance, Nifty Fifty companies in 1969 sold for 60 to 90 P/E ratios.

The good news is that Mark believes today's Magnificent Seven are far superior companies to those involved in past bubbles. They have huge scale, dominant market positions, and high margins.

And their valuations aren't as steep as the Nifty Fifty companies. For example, Nvidia's forward P/E ratio is in the low 30s.

The problem of remaining on top

Marks does see an issue with P/E ratios in the low 30s, though. He says it assumes that Nvidia (NYSE:NVDA) will be in business for decades to come, that its profits will grow over decades, and that it won't be overtaken by competitors. He says, "investors are assuming Nvidia will demonstrate persistence." In other words, that Nvidia will remain on top for a long time to come.

History demonstrates that this will be hard to achieve, according to Marks. He points out that that the following companies were in the top 20 in 2000:

Microsoft	Merck
General Electric	Coca-Cola
Cisco Systems	Procter & Gamble
Walmart	AIG
Exxon Mobil	Johnson & Johnson
Intel	Qualcomm
Citigroup	Bristol-Myers Squibb
IBM	Pfizer
Oracle	AT&T
Home Depot	Verizon

Of these, only six remained in the top 20 by the start of 2024:

Microsoft	Johnson & Johnson
Walmart	Procter & Gamble
Exxon Mobil	Home Depot

It's worth noting that this list is now down to five companies with Johnson and Johnson NYSE:JNJ) slipping out, while Walmart (NYSE:WMT), Home Depot (NYSE:HD), and Proctor & Gamble (NYSE:PG) are just hanging on to 18th, 19th, and 20th places in the S&P 500.

It's also worth noting that of the Magnificent Seven, only Microsoft was in the top 20 in 2000.

Marks suggests that in bubbles, "investors treat the leading companies – and pay for their stocks – as though firms are sure to remain leaders for decades. Some do and some don't, but change seems to be more the rule than persistence."

And in bubbles, Marks says that they initially are concentrated in a small group of stocks, though that can extend to whole markets as the fervour spreads.

Where do today's markets stand?

With this background, Marks turns his attention to the current market. He points to the obvious: that the above average returns of the past two years can't last forever. After all, US corporate profits increase by an average

7% per year. For the S&P 500 to rise more than 20% as it's done over the past two years, is unusual and can't go on forever.

He says there are only four times in the history of the S&P 500 when it returned 20% or more, and in three of those four instances, the index declined in the subsequent two-year period. The exception was 1995-1998 when the TMT bubble formed, only to burst in 2000.

So, what about the future?

Marks lays out several cautionary signs including:

- The optimism that has prevailed in markets since late 2022
- The above average valuation of the S&P 500, and that US stocks in most sectors sell at much higher multiples to comparable stocks in the rest of the world
- The enthusiasm for a new thing in AI
- The presumption that the Magnificent Seven will continue to be successful
- The possibility that the rise of the S&P has been aided by ETFs that automatically purchase stocks, without regard to valuation
- The 465% rise in the price of Bitcoin over the past two years "doesn't suggest an overabundance of caution."

He also outlines the counterarguments:

- The P/E ratio of the S&P 500 is high but not insane
- The Magnificent Seven are magnificent companies and their steep valuations may be warranted
- He doesn't hear investors saying "there's no price too high"
- The markets, while high-priced and perhaps frothy, don't seem nutty

(As an aside, I disagree with Marks on point three: I have heard this with the Magnificent Seven, as well as with Australian stocks such as Commonwealth Bank (ASX:CBA), Pro Medicus (ASX:PME), and WiseTech Global (ASX:WTC). In fact, I read a recent stockbroker note which essentially said that Pro Medicus was a buy, no matter what the price.)

What's the final verdict?

Though Marks doesn't say it, I think he believes that though the US market is expensive and exhibits some signs of irrational exuberance, it doesn't constitute a bubble in his eyes. But it's not to say that it won't become a bubble in future.

James Gruber is Editor at Firstlinks.

What to expect from the Australian property market in 2025

Michael Yardney

What's ahead for our housing markets in 2025?

Clearly residential real estate has defied the many doomsday forecasts made over the last few years, having moved through the bottom of its cyclical downturn in early 2023 and experiencing an overall strong recovery since.

However, national home prices fell by 0.17% over the month of December, according to the latest PropTrack Home Price Index, though they remain 4.73% higher than 12 months ago and are up 45.1% since the beginning of COVID-19 in March 2020.

PropTrack Home Price Index December 2024

All dwellings	Monthly growth	Annual growth	Change from peak	Change since March 2020	Median value
Sydney	-0.29%	3.43%	-0.46%	37.5%	$1,106,000
Melbourne	-0.53%	-2.49%	-5.54%	13.9%	$780,000
Brisbane	-0.04%	11.35%	-0.04%	78.0%	$863,000
Adelaide	-0.18%	13.53%	-0.18%	80.3%	$793,000
Perth	0.39%	17.59%	At peak	80.3%	$773,000
Hobart	0.03%	1.59%	-7.18%	37.3%	$671,000
Darwin	-0.25%	-0.20%	-2.07%	26.5%	$503,000
ACT	-0.61%	0.45%	-5.76%	35.4%	$838,000
Capital Cities	**-0.25%**	**4.59%**	**-0.35%**	**40.2%**	**$865,000**
Rest of NSW	-0.02%	3.52%	-0.02%	55.2%	$734,000
Rest of Vic.	0.03%	-2.08%	-5.18%	38.6%	$571,000
Rest of Qld	0.05%	10.52%	At peak	79.1%	$705,000
Rest of SA	0.60%	13.03%	At peak	81.5%	$467,000
Rest of WA	-0.19%	12.97%	-0.44%	75.8%	$555,000
Rest of Tas.	0.10%	3.50%	At peak	57.8%	$515,000
Rest of NT	-0.01%	0.84%	-4.39%	10.9%	$408,000
Regional Areas	**0.03%**	**5.12%**	**At peak**	**59.9%**	**$653,000**
National	**-0.17%**	**4.73%**	**-0.17%**	**45.1%**	**$795,000**

Source: PropTrack

Moving forward, our housing markets will likely experience a year of two halves in 2025, with a slower first half and then a resurgence in both buyer and seller confidence and, therefore, activity when interest rates eventually fall – probably in the second half of this year.

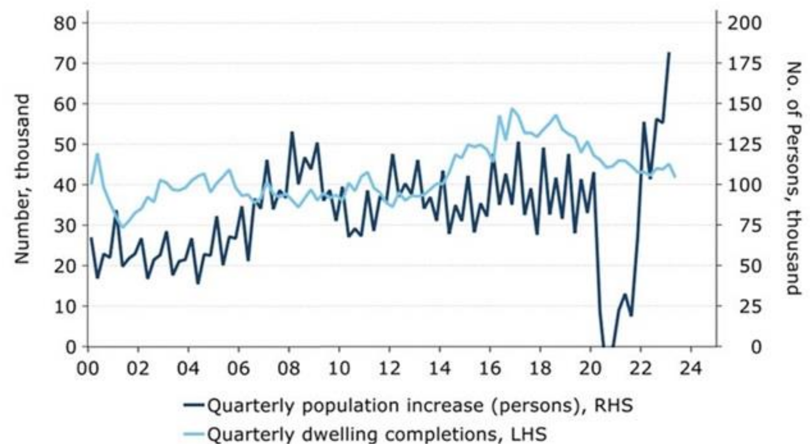
The resilience of the market

Of course, property has always been a cornerstone of Australia's wealth, weathering economic turbulence with remarkable stability.

The total value of Australian residential real estate was estimated by CoreLogic to be $11.1 trillion at the end of November 2024; however, outstanding mortgages against all residential housing are only $2.3 trillion – resulting in a very comfortable 21% overall Loan to Value ratio.

In fact, 56.3% of total Aussie household wealth is held in residential property - one of the many reasons neither the banks, the government nor the RBA wants a property crash.

As we head into 2025, our markets will remain challenged by persistent high interest rates, an affordability crisis, a cost-of-living crisis, a Federal election and ongoing geopolitical problems. But one thing that won't change any time soon is the chronic undersupply of housing, with the supply of new housing unable to keep up with demand from Australia's growing population which will continue to be fuelled by strong immigration.



Source: ANZ Bank

And with the cost of new dwellings rising because of the ongoing challenges in construction, including labour shortages and rising material costs, this supply-demand imbalance is expected to keep upward pressure on property prices and rents in our capital city markets.

Economic and interest rate dynamics

With the Reserve Bank of Australia (RBA) tightening monetary policy since May 2022 in an effort to curb inflation, interest rates were constantly in the news in 2024. While rates have now stabilised, their higher levels compared to recent years will continue to negatively affect borrowing capacity and buyer behaviour in 2025.

However, as inflation eases and the economy adjusts, the RBA is likely to start cutting interest rates in the second half of this year and I can see the market then moving to the next phase of the property cycle.

In general, when interest rates decline, the market tends to experience a surge in activity as borrowers can afford larger loans, buyers who were previously priced out of the market start to re-enter, and those who were sitting on the sidelines rush to buy before prices climb too high. This creates a snowball effect that can rapidly drive up property values.

Other forces that could influence the market include:

1. **Wage growth**: Rising wages will bolster borrowing capacity for many Australians, supporting demand in the property market.
2. **Employment stability**: Even though the unemployment rate may creep up a little, anyone who wants a job can get a job, and this security means it is likely that buyer confidence will stay strong.
3. **Consumer sentiment**: While sentiment remains cautious due to economic uncertainty, when our federal election is over and once interest rates start to fall, confidence will return, and Australians will again feel 'confident' in making big purchases like upgrading their homes.

Clearly, affordability has decreased, and property values have fallen a little in a number of our capital cities, but the housing markets are being underpinned by a number of factors:

- Wealthy buyers entering the market with higher deposits.
- Downsizers who had a lot of equity in their homes are buying debt free - in fact a third of properties last year were transacted with no mortgage at all.
- The bank of mum and dad and inheritances are helping many buyers with a deposit.
- Some buyers are buying in cheaper markets while others are buying units rather than houses.
- The property boom of 2020-21 left many homeowners with significant equity in their homes.

Migration and demographics

In the year ending 30 June 2024, overseas migration contributed a net gain of 446,000 people to Australia's population. While this decreased from the record 536,000 people the previous year, this was a pivotal driver of rental markets as most immigrants rent for the first 3 to 5 years before putting down permanent roots. And while the government keeps talking about decreasing our migration levels, this influx of skilled migrants is not only revitalising our workforce but also fuelling demand for housing, particularly in urban centres like Sydney, Melbourne, and Brisbane, as these three cities are set to absorb the lion's share of population growth, creating opportunities for investors targeting rental properties.

In addition to migration, demographic shifts within our domestic population will play a significant role. Younger generations, Millennials and Gen Z, are increasingly entering the housing market, either as first-home buyers or investors.

While there has been a lot of talk about the plight of first home buyers, there were a total of around 550,000 property transactions in 2024, and according to ABS finance figures, around 110,000 first home buyer transactions. In other words, around 20% of all property sales last year were to first home buyers, and it is likely that a number of investor transactions were also to first time buyers who chose to 'rentvest' – rent where they want to live but can't afford to buy and then use their funds to invest where they can afford to buy.

What's ahead for 2025?

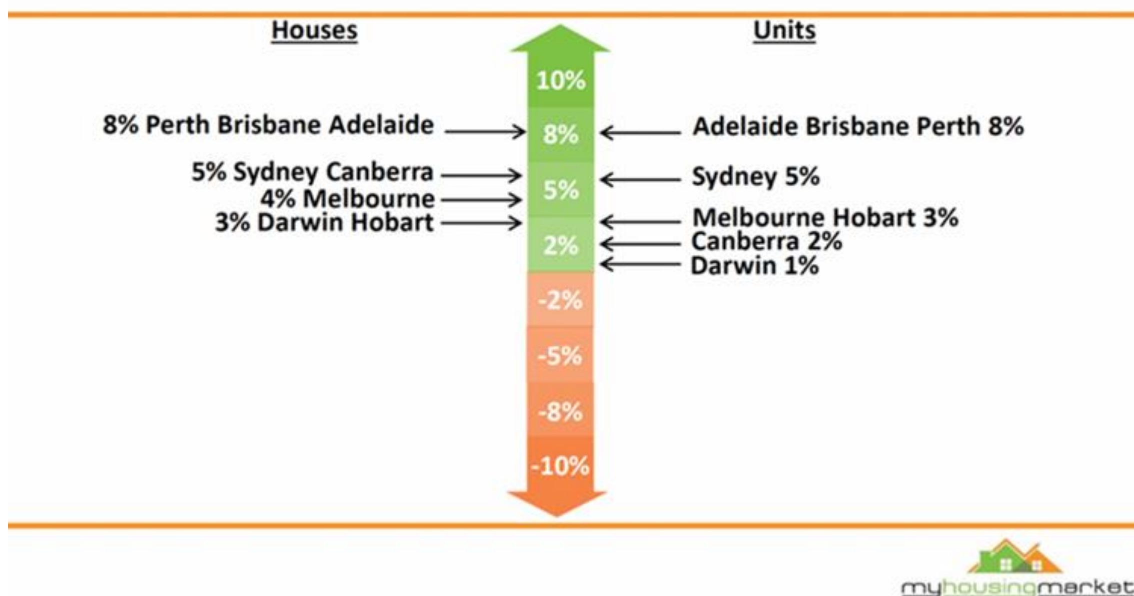
The last few years have shown us how hard it is to forecast property trends, and as always, there will be headwinds and tailwinds buffeting our property markets.

As I said, I see a year of two halves for our housing markets, which will remain fragmented with local economic factors, such as consumer sentiment, employment, and migration, predominantly driving the markets.

While the outlook is largely positive, the market will likely experience a number of hurdles:

1. **Affordability concerns**: Despite softening growth rates, housing affordability will remain a critical issue, not only for home buyers but also for renters, with rents skyrocketing over the last few years as vacancy rates hit historically low levels.
2. **Construction bottlenecks**: While the government is encouraging the construction of 1.2 million new dwellings in the next 5 years, labour shortages and rising costs will continue to delay new housing projects, which will also be more expensive, exacerbating the supply-demand imbalance.
3. **Regulatory changes**: Ongoing debates about taxation policies, such as stamp duty reforms, and potential changes to negative gearing could influence market dynamics. As will any further interference to residential tenancy regulations by state governments, which have already scared off many investors.

Dr Andrew Wilson, chief economist of My Housing Market, has made the following forecasts for 2025.



Conclusion

The Australian property markets are poised for another year of resilience and opportunity in 2025. While challenges persist, and prices may continue to fall a little in the next few months, the market's fundamentals – robust demand from a growing population at a time of limited supply, a strong jobs market and demographic shifts – provide a solid foundation for further price growth, albeit at a slightly slower rate than last year.

While it might feel counterintuitive to buy at a time when there are so many mixed messages in the media, home buyers and investors with a long-term focus will benefit from less competition, minimal downside risk and minimal risk of oversupply.

Michael Yardney is the founder of Metropole Property Strategists who help their clients grow, protect and pass on their wealth through independent, unbiased property advice and advocacy. He's once again been voted Australia's leading property investment adviser and one of Australia's 50 most influential Thought Leaders. Subscribe to The Michael Yardney Podcast.

How to fix the Commonwealth Superannuation Scheme

Bruce Bennett

The Commonwealth Superannuation Scheme, or CSS, was established in 1976 as a Defined Benefit Scheme for retired public servants.

At that time, there was no national superannuation scheme and public service salaries were considerably below those of the private sector. The CSS was important in attracting talent to Canberra.

Since then, there have been numerous Government initiatives to provide superannuation for all Australians. These include:

- The Keating Government introducing the superannuation guarantee for all workers in 1992
- Treasurer Peter Costello introducing Simpler Super and setting up the Future Fund in 2006
- The Government introducing a $1.6 million transfer balance cap in July 2017

By contrast, in the five decades since the CSS was established, there appears to have been no attempt by any Government minister or the CSS board to bring it in line with current practice and ensure a comfortable retirement for its members.

As a result, many former public servants who made significant contributions to Government policy are severely disadvantaged while others, such as former politicians and judges, are on a very good wicket.

This is playing out in several ways, which I will outline below.

CSS pension payments haven't kept up

In the past 10 years, the Age Pension for a single person has increased by 37%, whereas CSS pensions have increased by only 27%. This is at a time when most Industry Super Funds and the Future Fund's earnings are compounding at an average of 8.8% per year.

Age Pensioners are also entitled to a wide range of government assistance including a Pensioner Concession Card and rent assistance that CSS members don't have access to.

One reason for the CSS's lagging pension payouts is the board's failure to adopt the living cost index as its benchmark for inflation instead of the consumer price index (CPI).

More than 25 years ago, CPI actually reflected the cost of living as it included all of the big costs incurred by households. Then in September 1998, in response to representations from the Reserve Bank and the Treasury, the Bureau of Statistics changed the way it calculated CPI and it became a poorer measure of household purchasing power.

For example, while the consumer price index increased 4.1% for the year to December 2023, the latest living cost index issued by the Bureau of Statistics climbed 9%.

Tax and flexibility disadvantages versus regular super

Members of other superannuation funds including industry funds, retail funds and SMSFs pay no income tax in pension mode thanks to the current $1.9 million tax-free cap. Meanwhile, CSS pensions are taxed at marginal rates less 10%.

Furthermore, CSS members cannot transfer their balance to a better performing industry super fund or use a portion of it pay off their mortgage or cover major medical expenses. Even lifetime annuities allow for partial or lump sum withdrawals.

For a person who has $1,000,000 in retirement savings:

- An Australian Super pension account currently earns $80,000/year (8%) tax free (or $112,000 if you include tax at 30%) assuming the person has other income such that their tax threshold is already 30%.
- A Challenger inflation-linked annuity currently pays $62,000/year (partially taxed).
- A CSS member with a notional balance of $1 million receives a taxable pension of $62,500 which comes out as $45,000 after tax.

Obviously, there are differences between the above products and the earnings rate for contributory super funds is not guaranteed.

Furthermore, CSS members cannot withdraw or switch their balance to other funds and there is no residual balance paid to a member's estate.

Members can also only transfer their CSS pension to their spouse if they have an order from the Family Court (due to divorce). As a result, many female spouses are unable to be financially independent and couples pay higher rates of tax than if the pension could be transferred to the low-income partner.

Notional balance pushes many past the assets test

In 2017, 40 years after the CSS was established, the Government Actuary decided that the notional total superannuation balance (TSB) for defined benefit scheme members should equal 16 times the member's annual entitlement.

This figure did not take into account the earnings of the Future Fund, a member's life expectancy, a member's inability to transfer their balance to another fund, to their spouse or to a lifetime annuity; or that there is no residual benefit paid when a member or their spouse dies.

This has affected the ability of some CSS members to claim a part Aged Pension because they exceed the Assets Test. And unlike many non-CSS members, they do not have the option to reduce the balance of their super fund and claim a part pension by buying a bigger house or a lifetime annuity, for example.

Despite the important impact that a member's TSB has on their retirement, there is no reference to it in CSS legislation and members are not provided with an annual statement showing their current balance.

Big potential problems with draft super cap legislation

I believe the Treasury knows that any changes to the CSS Act would incur considerable cost to the Government. This is why they have discouraged Ministers from reviewing the Act. However, now that changes to the Future Fund are being canvassed, the plight of former public servants also gets raised.

If CSS members were able to leave the scheme, some would arrange their finances to receive an Aged Pension by paying off a mortgage, buying a new house, investing in an annuity, et cetera. Others would transfer the notional balance to a retail or industry fund and pay no tax on the income, while others might use it to cover medical expenses, help their kids with a deposit, or pay grandkids' school fees.

When the Government introduced a $1.6 million transfer balance cap in 2017, the notional balance was included in this figure even though pension payments are taxed at marginal rates and there is no residual left when a member (or their spouse) dies.

Most recently, Div 296 proposed including a member's notional TSB figure when calculating the $3 million super cap. Most members' pensions are already taxed at 30% and, for male members with other income, this tax rate is 37% as most female spouses of retired members have little or no income.

The draft super cap legislation would have seen many CSS members' pensions taxed at more than 50% (37% + 15%) while providing no opportunity to have the CSS pay this additional tax.

No alignment between board and members

Finally, like most Superannuation Funds, there is no alignment between the needs of members and representatives of the Board.

The Board of the Commonwealth Superannuation Corporation which oversees the CSS, consists of five Board members and a Chair appointed by the Treasurer and five members by the ACTU. There is also no requirement in the Act that one third and the Chair are independent directors.

Who is going to stand up for the members and risk losing their director's fee?

How to fix the CSS for its members

The legislation establishing the Scheme in 1976 is no longer fit for purpose and has resulted in CSS pensioners being increasingly disadvantaged compared to members of other superannuation funds or annuities.

The Minister for Finance could initiate a review of the CSS Act to:

a. Implement the provision of the Future Fund Act that requires the Commonwealth to discharge unfunded superannuation liabilities once the balance of the Future Fund is greater than, or equal to, the target asset level necessary to fund Commonwealth superannuation liabilities;

b. Wind up the CSS and require all Members to transfer their TSB to a retail or industry super fund. This one-off payment could be funded from the balance in the Future Fund;

c. Allow all members the right to transfer their pension to their spouse without the need for an order from the family court;

d. Exclude from any revised version of Div 296 the notional value of defined benefit funds, such as the CSS, where: members have no control over investments by the Fund; pensions are taxed at marginal rates; balances (actual or notional) cannot be transferred or withdrawn; there is no residual balance when the member (or spouse) dies. The CSS should also pay any additional tax incurred by a member if the cap is exceeded.

e. Enhance APRA's regulation of the CSS to include pensions paid to members in its product performance test. In particular, if the CSS Board fails to maintain pension payment increases equal to or greater than those applying to the Aged Pension, the CSS should be wound up and members notional balances transferred to better performing funds.

f. Ensure that future CSS pension increases are indexed to, or greater than, the Aged Pension.

Bruce Bennett is a former Commonwealth public servant and businessman.

5 key investment themes for the next decade

Matt Reynolds

Investors in global markets had a lot to absorb in 2024. Elections around the world dominated much of the public discourse during the year, coupled with ongoing geopolitical tension, set against a backdrop of frequently disappointing economic news. As a consequence, volatility flourished.

But taking a longer lens to the view we are afforded as the new year starts is perhaps much more revealing, especially to those wanting to build long term wealth. The picture that history reveals when it comes to equities is that markets have tended to move in decadal mega cycles, where one major 'theme' has dominated.

From an investment return perspective, being on the right side of these trends has been very rewarding. So, investors are understandably asking now: what themes can we expect to dominate over the next ten years and beyond?

A unique point in history?

A large proportion of equity returns over the last decade-plus have been generated by companies that have benefited from lower interest rates. This has led to very narrow market leadership from a band of asset-light, predominantly US-domiciled, mega-cap technology platforms.

Arguably, however, the past few years have witnessed the beginnings of a prolonged secular change, the scale of which we typically only see every ten to 15 years – a new era of higher inflation, higher rates and heightened geopolitical tension.

But what is particularly unique – and exciting for us as investors – about this current point in time is that there appears to be a confluence of several transformational and multi-generational shifts occurring simultaneously.

Disruptive force of Artificial Intelligence (AI)

From an investor's perspective, one of the most attractive features of AI is that its ultimate addressable market is potentially limitless, given its pervasiveness across so many parts of the economy.

However, there is much analysis still to do. Determining the potential implications of AI, understanding what factors may accelerate or decelerate pace of adoption, and crafting a potential investment approach will be vital for investment success.

Our AI investment framework focuses on the following areas: **compute** (semiconductors, or the 'brains' of AI), **infrastructure** (cloud hyperscalers, data centres and networks, which provide the 'plumbing'), **AI model developers and software applications** (embedding valued-added AI into software and charging a recurring premium), and finally the **real-life and end-industry beneficiaries**.

Most of the current hype is around two of these areas: real-life and end-industry beneficiaries, and AI model developers. And although beneficiaries in these areas are potentially enormous in scope, it is still too early to have definitive views given the high degree of speculation and wide range of possible outcomes.

As for AI model developers, the risk of potential commodisation is high, given a large and growing open-source AI community advocating the 'AI for Humanity' concept. This community has been highly collaborative in sharing research, ideas, coding and best practices. There will likely be a small number of winners in this space. Determining who they will be will come down to those owning the large data sets required to train AI models.

In contrast, there are significant potential long-term opportunities in companies providing the computational processing power and the infrastructure on which most AI workloads will run, and, very selectively, in software businesses that can successfully embed a value-added AI application into their systems and charge a recurring premium.

A significant difference to previous technology cycles is that the incumbents possess many first-mover advantages to deploy AI at massive scale. Large tech companies already have proprietary data, huge amounts of capital to spend and some of the brightest engineering talent. Some of them also own the cloud computing infrastructure necessary for training AI models. In addition, they already have massive user bases into which they can sell AI products and services. While there may be some AI startups that find success over time, the starting point for incumbents is strong, in contrast to previous cycles.

The genetic era of health care innovation

There is a strong argument that the world is entering a golden era of medical innovation, which will likely enjoy multi-decade tailwinds. Behind this is a substantial increase in the number of novel drug platforms, which is expected to accelerate the pace of drug innovation and discovery.

In particular, breakthroughs in genomic sequencing and data processing are allowing drug companies to research, develop, and apply specific and precise interventions for illnesses.

The confluence of these technologies and pace of innovation is paving the way to address large but, as yet, mostly untreated illnesses worldwide, including obesity, cancer, cognitive impairment and pain.

As this wave of healthcare innovation accelerates - the genetic era – it may well be transformative. Breakthroughs are enabling a deeper understanding of genetics and leading to the creation of highly targeted, interventions to tackle a wide range of genetic disorders. Examples of these treatments include RNA interference (RNAi), gene therapy and gene editing.

And what is very exciting as an investor is that this genetic era in health care innovation coincides with another transformational shift - AI.

Industrial renaissance

For much of the 15 years post-the GFC, which were characterised by ultra-low interest rates and bond yields, investors have focused on 'growth' companies - especially those long-duration, asset-light digital innovators and disruptors - and largely ignored more cyclical old-economy industrial businesses that make physical things.

Signs are emerging that the more cyclical, old-economy industrial businesses that make physical things may return to favour, driven by several multi-year trends. This sets the stage for the kind of capex supercycle not seen in decades. This could potentially drive earning of various well-placed industrial companies for years to come.

These may include companies at the forefront of the energy transition, energy security, the buildout of data centres, rising defence spending amid a heightened geopolitical risk environment, and the desire to reconfigure global supply chains.

Old-economy cyclical manufacturers could become critical enablers of the future economy and, in doing so, transform themselves into secular growth companies.

Enabling the energy transition

Growth in renewable energy has been a major investment theme for at least a decade thanks to declining costs and government commitments in the trillions towards infrastructure buildout.

While the initial energy transition focus has been on areas like electric vehicles, less visible but equally critical changes include better air-conditioning hardware, as well as more efficient methods of heating buildings.

Elsewhere, alternative fuels such as hydrogen will play an important role where electrification could be challenging, such as long-haul trucking or steel making.

What remains underappreciated in the ongoing transition to renewables is how transformative this trend could ultimately be for manufacturing and the broader economy. Unlike coal or natural gas, renewables have essentially zero variable costs and once infrastructure is built, there are only small maintenance expenses. This could collapse power costs and provide major competitive advantages to a range of manufacturers, from steel to textiles, to consumer goods to chemicals.

A further factor to consider is energy security, which has come into sharper focus in recent years.

Reconfiguration of global supply chains

Just as countries are seeking greater security around energy supply, many companies are improving the resilience of their supply chains by rebuilding them closer to home and end markets.

Recent geopolitical tensions and supply disruptions have caused many countries to reconsider the balance between efficiency and resiliency of supply chains, and the merits of cross-border complexity. Manufacturers have realised they need greater resilience, namely visibility into their supply chain, flexibility to change types of production, and remote monitoring. This has sparked a wave of reshoring or friend-shoring.

A subset of companies could be better placed to navigate these changes

A cohort of companies that has proved particularly effective in responding to the types of changes discussed here are multinationals.

Global multinational businesses typically are well equipped to deal with uncertainty and disruption. For the most part, they have strong and experienced management teams, capable of navigating different - even hostile - environments. They are also used to conducting business across the world, finding ways to succeed by responding effectively to local competition.

An unpredictable environment can often play to the strengths of multinationals, which have the expertise and resources to adapt quickly.

As we head into the new year, it is clear, then, that the next decade and beyond could present a rich and diverse set of investment opportunities for global equity investors.

But that also means it is important to find investment strategies that can navigate significant market shifts, while keeping true to their objectives and philosophy.

Matt Reynolds is an Equity Investment Director for [Capital Group (Australia)](), a sponsor of Firstlinks. This article contains general information only and does not consider the circumstances of any investor. Please seek financial advice before acting on any investment as market circumstances can change.

For more articles and papers from Capital Group, [click here]().

New avenues of growth make 2025 exciting for investors

Niamh Brodie-Machura, Marty Dropkin

Top convictions for 2025

- US stocks are expected to outperform rest of the developed world on earnings
- Japanese shares still a strong bet as reforms improve returns
- Nerves over valuations make the case for income

Pound for pound, macro and monetary policy should deliver a positive environment for stock markets going into 2025. The business cycle will enter a new stage - but the year will also see geopolitics resound ever more loudly.

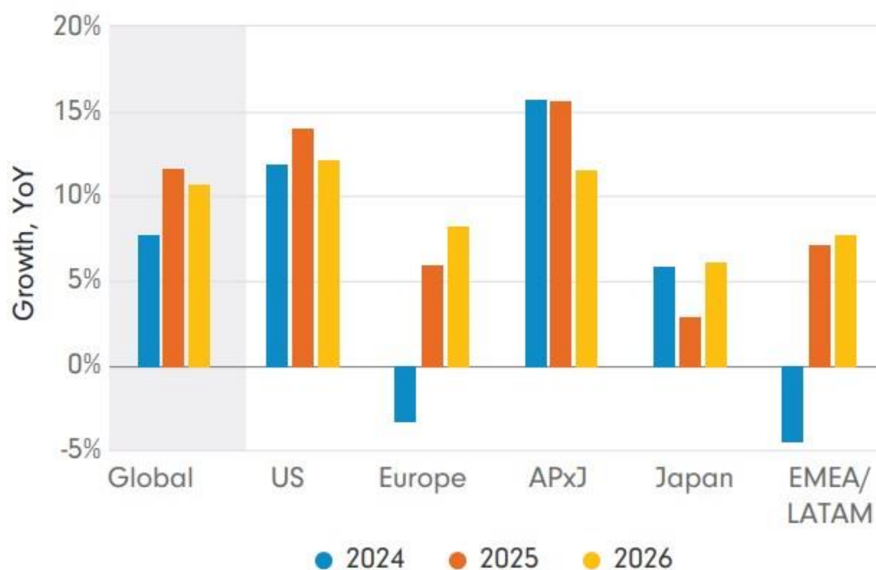
The trends we have seen dictate recent price moves may have further to run. But we can expect new directions and a broadening of areas of growth in markets. These are exciting times for equity investors.

Global trends

For good or bad, a landmark Republican election victory is likely to reinforce American exceptionalism. Even before November's poll, we expected US corporate earnings to increase by more than 13 per cent in 2025, beating most other regions and the global average in terms of growth, return-on-equity, and the level of net debt.

The election has fanned optimism in the market that the coming year will prove pro-business, pro-growth, and pro-innovation. There are risks to some sectors from potential tariffs and further trade frictions between the US and China, but at least some of any resulting reflation will be helpful for earnings and ease fears over higher corporate valuations.

Figure 1: Regional views – Aggregate earnings growth estimates through 2026



Source: Fidelity International, October 15, 2024.

Nevertheless, investors will have to be more discerning in where they look this year. The artificial intelligence (AI) trend is a case in point. On the one hand there is a debate about valuations of the big tech companies; Nvidia and others are still hitting record highs and there may be further to run, but our attention is also turning to which companies are next in line to benefit.

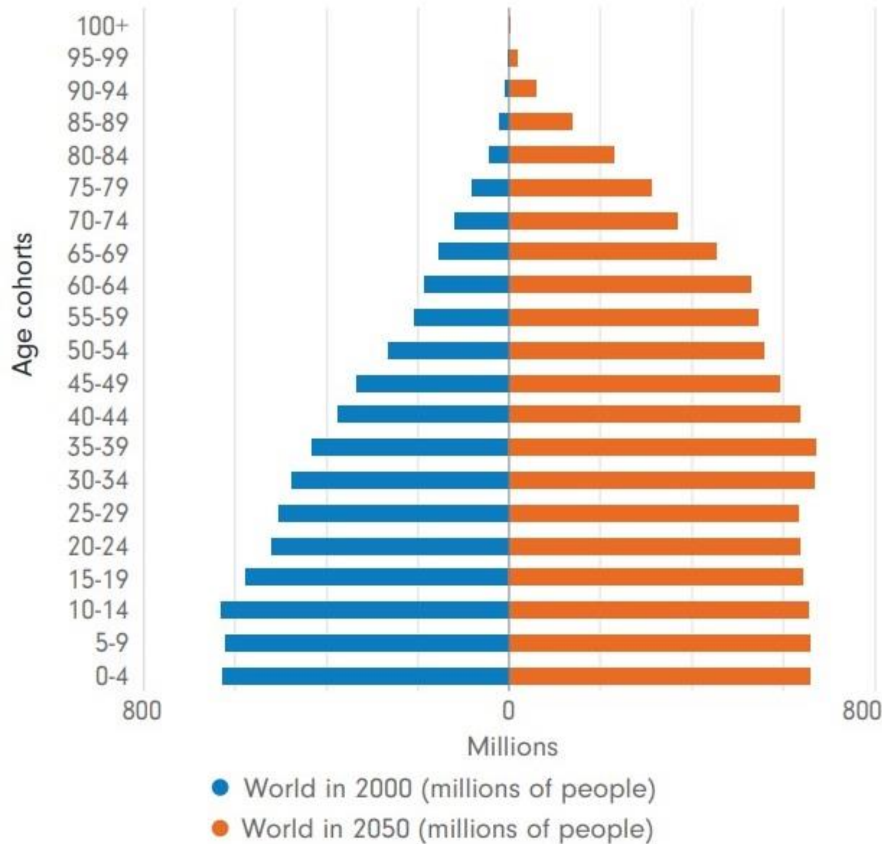
Those who facilitate the use of AI are one obvious group but ultimately many less directly related industries and consumers will also be beneficiaries. Apple made a fortune from smartphones, but their arrival fuelled growth across a wide range of existing and new businesses.

Less than a third of companies have so far embedded AI and machine learning in their operations, but more than 70% plan to: its impact on the economy will broaden. It is an area where American leadership is unquestionable.

The other big structural trends of this decade will continue to play out in 2025 and will be worth watching. The breakthrough in anti-obesity drugs is significant but, like AI, Ozempic and others have the potential to change the game in areas well beyond the small list of healthcare index constituents currently profiting. There are already hints of knock-on effects in how people use hospitals and gyms, and other use cases are developing.

Healthcare has another notable structural driver: the global population aged over 65 will double by 2050 and the proportion of incomes we spend on keeping ourselves healthy will continue to grow.

Figure 2: An ageing world – Demand for healthcare will grow strongly in the decades to come



Source: Fidelity International, HSBC, UN Population Database, February 2021.

Homeshoring

While it's widely expected that the Republicans may repeal some areas of President Biden's Inflation Reduction Act including electric vehicle credits, manufacturing incentives should be more protected given a large proportion of investments are located in Republican-held districts.

The onshoring trend has gathered momentum and has bi-partisan support. We are seeing manufacturing activity driving growth and investment in middle-America and our research shows it will add 2-3 percentage points to the base growth rate of fixed investment in coming years.

The picture for small-and-mid-cap segments may prove more complex. An ongoing rally has put straight much of the discrepancy in valuations with the top end of the market, but the coming year will provide different impulses. Tax cuts are likely to benefit small businesses, as would lower financing costs. But the latter will evaporate if price rises force the US Federal Reserve to change tack and immigration and tariffs bring potential threats to growth and spending on the ground.

In general, both the soft landing or reflationary scenarios outlined by our macro team for the months ahead bode well for earnings of early cyclical stocks. And if the new administration reflates the economy and reduces regulation it should bode well for US financials and value sectors.

Trade risks

Going into 2025, we see sentiment and fundamentals metrics as supportive of Japan. It remains on track for reflation with strong wage growth, and capital expenditure and shareholder returns will increase steadily over

time. The percentage of TOPIX companies outperforming the index has also been on the rise, as investors scout for beneficiaries of the country's corporate governance reforms.

One caveat is that a strong yen combined with higher interest rates could hurt earnings later in the year, especially in the consumer discretionary sector, where overseas sales outweigh domestic demand for carmakers and durable goods exporters

On the other side of the developed world, there are significant challenges. Recent profit warnings by European industrial and automobile companies, as well as lacklustre sales by consumer discretionary names, signal that doubts over Chinese demand could weigh heavy on these shares. Our macro team's modelling also suggests a partial implementation of the tariffs floated by Republicans would knock as much as half a percentage point off German and Eurozone GDP.

On the flip side, the arrival of a concerted campaign of monetary loosening should in theory be helpful for European cyclicals, but the cheaper and more defensive bet currently is income: returns from dividends and share buybacks combined in some areas of the market are running at as much as 8% and are better priced.

Asian potential

In China itself, we prefer sectors that are already high on the government's policy agenda: technology, high-end manufacturing, consumer, and healthcare. We're conscious that Chinese equities can be volatile, and that many companies have rebounded from depressed to fair valuations on the policy pivot. The good news is that there's no shortage of stocks with clear paths to earnings growth in this massive market.

China is positioning to preserve, but not reignite, economic growth. Policymakers recognise the need to stabilise home prices; they are not about to jeopardise the hard-won progress they've made in reducing debt by reflating the housing market. An incremental recovery in Chinese equities is the most likely outcome.

Elsewhere in emerging markets, Indonesia has good growth and earnings momentum, but banks' dominance makes the market vulnerable to interest rate cuts. While liquidity is much thinner for global investors, the Asean region widely stands to benefit from the secular trend of supply chain diversification and an increasing share of foreign direct investment from across the world.

India will again be a bright spot for long-term investors. Although some foreign flows are taking profit after the recent rally, and extreme weather is disrupting agriculture, the country's prospects remain solid, underscored by advantageous demographics and investments in infrastructure and manufacturing. And that's why domestic investors are still buying.

Earnings are everything

No one can know with certainty the future of US-China relations, or predict commodities' trajectory precisely, should conflicts in the Middle East escalate further. But with volatility comes both risk and returns.

The outlook for earnings growth globally remains robust and our view on equities going into 2025 is generally positive. However, with valuations high, smart money will be looking for the right homes as the economic cycle turns. Our approach is to stick to the fundamentals, while staying vigilant and disciplined on valuations. This will guide our thinking through 2025 and beyond.

Niamh Brodie-Machura is Co-Chief Investment Officer, Equities, and Marty Dropkin is Head of Equities, Asia Pacific at Fidelity International, a sponsor of Firstlinks. This document is issued by FIL Responsible Entity (Australia) Limited ABN 33 148 059 009, AFSL 409340 ('Fidelity Australia'), a member of the FIL Limited group of companies commonly known as Fidelity International. This document is intended as general information only. You should consider the relevant Product Disclosure Statement available on our website www.fidelity.com.au.

Read the full report and relevant disclaimers here.

For more articles and papers from Fidelity, please click here.

© 2025 FIL Responsible Entity (Australia) Limited. Fidelity, Fidelity International and the Fidelity International logo and F symbol are trademarks of FIL Limited.

The pros and cons of debt recycling strategies

Alex Berlee

Debt recycling is a powerful strategy for those juggling the seemingly competing goals of debt reduction and building an investment portfolio. Many people have a natural instinct to pay off the home first, then consider investing later. However, waiting to invest can be a wasted opportunity. Through debt recycling, you can tackle both financial goals in a smart way, with significant benefits.

Online searches and forum posts reveal huge misunderstandings about debt recycling, in many cases because it's not just one single strategy – there are several twists or varieties to the central theme. Here's an outline of the basics of debt recycling and how it can be used.

What is debt recycling?

At its core, debt recycling is a financial strategy that allows you to replace non-deductible home loan debt with deductible investment debt. It's a powerful strategy for paying off your home sooner AND building an investment portfolio at the same time.

Typically, the debt recycling process involves using home equity borrowings to invest in income-generating assets, such as shares or managed funds. Income from these investments is used to pay down your mortgage, while the capital value of your investments typically grows, accelerating your wealth-building efforts.

Plain vanilla debt recycling

In its most basic form, debt recycling starts with paying down debt with surplus cashflow and borrowing back equivalent amounts to invest. Imagine a couple who have an existing $300,000 mortgage, and $1,000 per month surplus cashflow, which they direct towards additional mortgage repayments. After 12 months, that $12,000* is available for redraw. In conjunction with their lender and/or an experience mortgage broker, that available amount is split off into a separate loan account, then borrowed back for investment purposes (say some ETFs or managed funds). Their total debt is still $300,000, but it's a combination of $288,000 non-deductible debt, and $12,000 of tax-deductible investment debt. Income from the investments can be used to pay their home loan down further, and each year they repeat and compound the strategy. Eventually, the non-deductible debt will be down to zero, and the investment debt up to $300,000, meaning their debt is fully recycled. Over this time the shares, ETFs or managed funds ought to have increased in capital value.

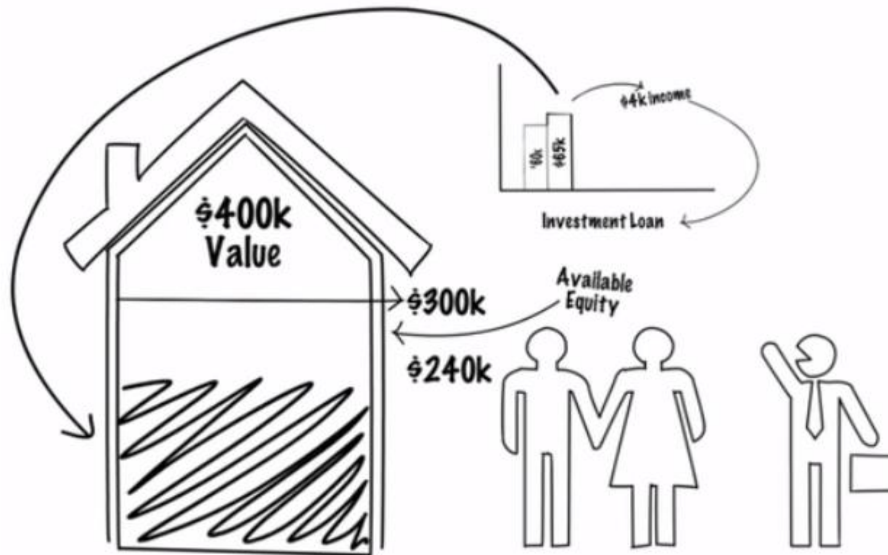
This 'plain vanilla' strategy is fairly non-threatening – there's no actual increase in debt levels relative to the starting position. The benefits of tax and market exposure are slow to begin with, but it's the routine and compounding nature of the process that makes this quite a powerful strategy over time, especially compared to a 'pay off the home first and invest later' approach.

Care should be taken to ensure the loan structure keeps personal and investment debt separate at all times.

**In practice, interest savings on their loan will give them slightly more than $12,000 available.*

Vanilla with a dash of spice

To kick off a debt recycling strategy with a bit more gusto, it's quite common to apply for an increased loan facility and invest an initial amount on day one. I always suggest "a big enough amount to be meaningful, but not so much that it's scary." We're essentially introducing some extra leverage at the start, so compared to the vanilla debt recycle, there's the potential for increased investment returns over time, assuming the investment portfolio outperforms the net cost of borrowing. This is only possible if the client has enough equity and loan servicing capacity to borrow the additional amount – otherwise they need to create the borrowing capacity via extra repayments in the vanilla scenario. The amount chosen for an initial investment can be placed in a single transaction or fed in gradually to reduce timing risk.



A modest vanilla Debt Recycle with an initial $60,000 extra gearing

The one-off debt recycle with existing assets

Existing assets, such as employee share parcels, and ETFs and managed funds acquired either before the mortgage, from an inheritance, or from spare cashflow (not borrowings) represent an additional opportunity for debt recycling. Remember we're aiming to reduce non-deductible debt and replace it with tax-deductible debt. So, imagining we have $100,000 of available existing assets that did not involve borrowings, that's $100,000 of debt we could recycle (less potential Capital Gains Tax). After calculating the CGT (let's imagine it's $10,000) the benefit from this one-off debt recycle would be $90,000 x loan interest rate (say 6%) x Marginal Tax Rate (say 47% including Medicare) = $2,539 of tax saved per annum, or approximately a four-year break even. Lower CGT (eg employee shares immediately sold on vesting, investments with low gains etc) present an easy decision, as do assets that you want to dispose of anyway. Replacement assets, acquired with borrowed funds, might be the same, similar, or completely different investments according to preference - just be careful with the ATO's wash-sale provisions.

Debt recycling property

The previous concept can also apply in some cases to property assets – for instance, former principal places of residence or investment properties with significant equity.

These cases really do require detailed analysis, as there can be significant transaction costs to sell and buy, and investment properties would likely incur significant CGT.

However, knocking $1 million off your home loan through sale of another property and buying a replacement investment property, thereby recycling $1 million of debt, can bring a $28,200 per annum (p.a.) tax saving – so it's worth a thought. Even more so if you want to exit that particular property or location for whatever reason.

Properties that are most likely to be suitable for a debt recycle include former principal residences (due to no CGT) that were largely paid off, inherited properties that pre-date CGT or were themselves a principal place of residence, as well as properties owned as a principal place of residence before commencing a new relationship.

Property recycle with a trust

One last variation that also involves property comes in where a former principal place of residence is intended to be retained as an investment property, but where there is a desire to maximise tax deductible debt. With this strategy, the property is sold to a trust structure, with full borrowings, releasing maximum equity for non-deductible debt reduction. Costs to be considered include stamp duty on the transfer, annual accounting costs for the trust structure and usually land tax, but the savings include sale costs on the property and stamp duty on a replacement property (assuming the alternative was to follow the previous property Debt Recycle strategy). As per the previous example where the fully paid off property is worth $1 million, when sold to a unit trust under this strategy, the $1 million of debt that is made tax deductible generates tax savings of up to $28,200 p.a. (less the costs of running the trust and land tax).

Conclusion

Many people have financial goals that include a debt-free home as well as a decent nest-egg and tackling them both via a debt recycling strategy can make those goals happen faster. It's important to think outside the box and realise that there are several different types of debt recycling, which have a common theme of applying any available cash (from surplus cashflow, investment income, or disposal of existing assets) against non-deductible debt, and then borrowing funds back to invest (resulting in tax-deductible debt).

We highly recommend working with financial planners, accountants and mortgage brokers who are experienced with all forms of these strategies to ensure the right outcomes.

Alex Berlee is a financial adviser with AGS Financial Group Pty Ltd.

Australia is out of step on nuclear power

Stuart McKibbin

Nuclear power would provide optionality across the energy spectrum in Australia. There is no valid argument for Australia to continue to ban the use of nuclear power. The removal of this ban would allow both the public and private sectors the ability to implement nuclear power generation if indeed, the investment decision, had validity. It would leave the Final Investment Decisions (FID) for nuclear power infrastructure to those financing and investment professional groups that have the necessary expertise to make that decision.

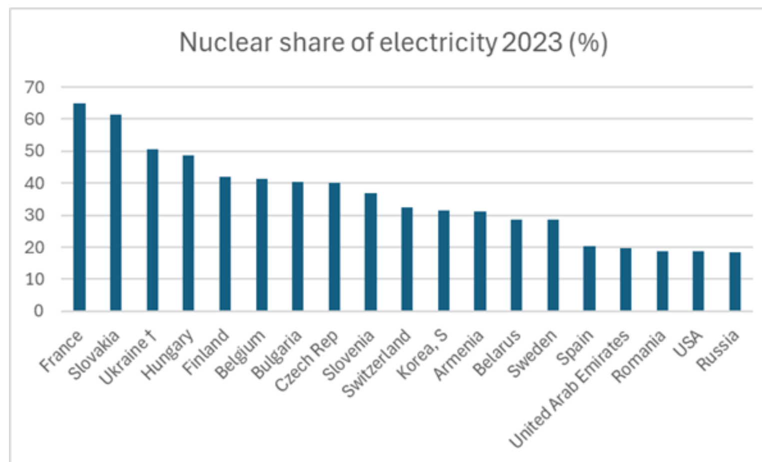
Safety concerns overblown

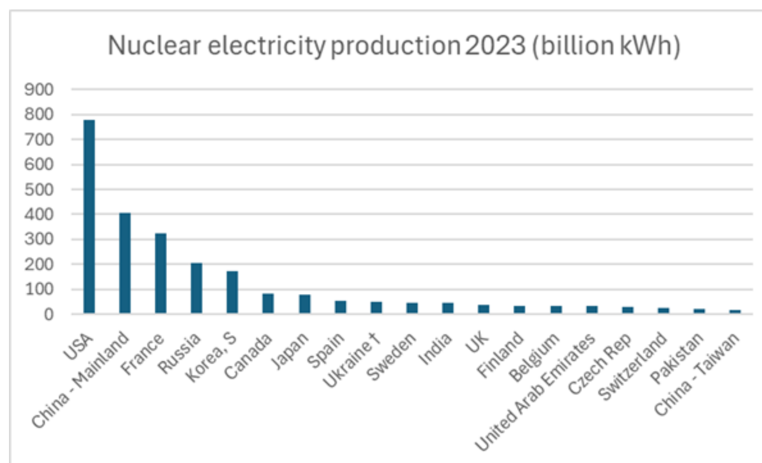
The overwhelming issue over the decades has been safety concerns regarding nuclear power. But when compared to other energy sources, nuclear safety is one of the least risky, according to the US Department of Energy. Over those decades, nuclear power has been utilised for power generation, in defence equipment such as nuclear submarines, and in nuclear medical infrastructure such as Lucas Heights in Sydney. There has been less than a handful of headline nuclear disaster. However, even these events have not resulted in fatalities as significant as compared to fossil fuel energy sources. And nuclear safety compares well to those of renewable energy sources.

Nuclear power is key for many countries

Nuclear power is an important low-emission source of electricity, providing about 10% of global electricity generation. In advanced countries, nuclear power generation rises to 20% of total energy source, per the International Energy Agency. Many countries rely on nuclear energy. Look no further than at the nuclear power plants that dot the France countryside, clearly observed during the television coverage of the Tour de France cycle race.

According to the International Atomic Energy Agency and the US Energy Information Agency, the countries with the largest total percentage of electrical generation being sourced from nuclear in 2023 were France (64.8%), Slovakia (61.3%), Hungary (48.8%), Finland (42%) and Belgium (41.2%). The US, China and France are the largest users of nuclear power generation in absolute terms. Approximately 20% of US and 5% of China electricity generation is from nuclear in 2023. There were approximately 440 power reactors and **over 50 countries utilize nuclear energy in about 220 research reactors** in 2023.





Source: [World Nuclear Association](). † Ukraine 2023 electricity generation estimated.

European nuclear power plants have been and are being revamped to meet the current power requirements. US tech companies are realising the ongoing and future demand of three large energy requirements – electrification, artificial intelligence and crypto mining – and entering long term power contracts with nuclear power utility companies for sustainable, reliable and continuous data centre power generation.

Partly due to this, the US Electric Power Research Institute estimates that by 2030, data centres will account for approximately 9% of overall US electricity consumption.

Additionally, US utilities are now increasingly including nuclear power sources in their future investment planning. Most of this investment planning is in nuclear energy through Small Modular Reactors (SMR). At the White House Summit on Domestic Nuclear Deployment In May 2024, Duke Energy, a US energy company, announced agreements with Amazon, Google, Microsoft and Nucor to explore new and innovative approaches to support carbon-free energy generation and help utilities serve the future energy needs of large businesses in North Carolina and South Carolina. Duke Energy is executing an ambitious clean energy transition, keeping reliability, affordability and accessibility at the forefront as the company works toward net-zero methane emissions from its natural gas business by 2030 and net-zero carbon emissions from electricity generation by 2050. The company is investing in major electric grid upgrades and cleaner generation, including expanded energy storage, renewables, natural gas and nuclear.

More are signing up to nuclear power

At COP28, the World Climate Action Summit of the 28th Conference of the Parties to the U.N, more than 20 countries from four continents launched the Declaration to Triple Nuclear Energy by 2050. The Declaration recognized the key role of nuclear energy in keeping within reach the goal of limiting temperature rise to 1.5 degrees Celsius. These countries included the US, France, Japan, UK, Sweden and Canada.

Importantly, at Climate Week events in New York in September 2024, and aligning with the commitment of these countries at COP28 to triple nuclear energy by 2050, a group of 14 major global financial institutions expressed support for expanding nuclear energy capacity. This is a commitment by the largest financial

institutions that nuclear energy is fundamental to the energy decarbonisation transition requirement to zero carbon emissions by 2050. These financial institutions included Bank of America, Barclays, Citigroup, Goldman Sachs, Morgan Stanley and BNP Paribas.

The US Government has announced long term funding commitments to nuclear power facilities. The Inflation Reduction Act (IRA) provided substantial tax credits and increased the authorities of the Loan Programs Office (LPO) for the deployment of commercial technologies, while demonstration and research programs are funded and underway within the Office of Clean Energy Demonstrations (OCED) and the Office of Nuclear Energy (NE) to de-risk more innovative technologies.

Nuclear offers a differentiated power source in the energy transition to zero carbon emission. It will contribute to reducing the cost of decarbonisation by providing both necessary base load power and optionality, to overcome the disadvantages of renewable energy- namely, variable generation capacity, energy storage and transmission.

According to a recent US Government Department of Energy report, 'Pathways to Commercial Liftoff: Advanced Nuclear', the existing fleet of 94 nuclear reactors at 54 sites provide approximately 20% of US electricity generation and almost half of domestic carbon-free electricity. This report noted that 'US nuclear capacity has the potential to triple from ~100 GW in 2024 to ~300 GW by 2050.' Importantly this report identified that when total generation and transmission system costs are included, the overall energy power framework is estimated at 37% lower with nuclear as part of the energy mix compared to without nuclear.

At COP29 in November 2024, another six countries were added to the declaration to triple nuclear capacity by 2050. There are now 31 countries that have signed up to the declaration. Nuclear was discussed as a 24/7 energy solution including both electricity and heat and providing optionality and flexibility in decarbonizing global economies.

Australia is being left behind

In April 2024, the World Nuclear Association noted Australia has the largest known uranium resources representing almost one third of the global total uranium resources. It is the fourth largest uranium producer globally. This represents around 8% of global uranium. All Australian uranium is exported.

The overwhelming outcome from reviewing the current use of nuclear power globally is that Australia is an outlier amongst its Western allies when it comes to its energy policy. It's an outlier to the country's largest consumer of commodities – China. Is the Australian public going to rely on ideologically and politically based decision making to determine our energy future?

Stuart McKibbin is a consultant and independent contractor specialising in portfolio management, investment research, and industry and company thematic strategies. His five-decade long career includes oil and gas experience as a petroleum geologist, investment research and corporate finance. He has written and presented on macro investment themes, company analysis, managed accounts and ETFs.

Disclaimer

This message is from Morningstar Australasia Pty Ltd, ABN 95 090 665 544, AFSL 240892, Level 3, International Tower 1, 100 Barangaroo Avenue, Barangaroo NSW 2000, Australia.

Any general advice has been prepared by Morningstar Australasia Pty Ltd (ABN: 95 090 665 544, AFSL: 240892) without reference to your financial objectives, situation or needs. For more information refer to our Financial Services Guide at www.morningstar.com.au/s/fsg.pdf. You should consider the advice in light of these matters and if applicable, the relevant Product Disclosure Statement before making any decision to invest. Past performance does not necessarily indicate a financial product's future performance.

For complete details of this Disclaimer, see www.firstlinks.com.au/terms-and-conditions. All readers of this Newsletter are subject to these Terms and Conditions.