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Editorial

Here's a brief experiment for you. Don't worry, it will only take a minute. Stop reading here (but please come back) and just sit in silence for one minute. Go on, it won't hurt.

Done? If you're like most people, you won't have experienced much silence. Within 10 seconds, you may have noticed thoughts running through your head. And these thoughts may have kept going. Some of them may have been quite random too. You might have thought of one subject, and then it branched off into an unrelated topic.

Don't worry, that's all normal. Nonetheless, it can be disturbing to realise how little control you have over your thoughts and how you react to them.

I've been an on-and-off meditator for a while, and meditation is a great tool for thought awareness and accepting thoughts as they come and go. Oddly enough, I've also found hypnosis is a powerful method for changing thought patterns. It delves into your subconscious, makes some tweaks, and alters thoughts and habits. Though in my experience, habits are hard to change and require ongoing work.

Cognitive biases and investing

While psychological tools for dealing with day-to-day life are advanced, those for becoming a better investor are just in their infancy.

The field of behavioural finance - studying how psychology affects financial decision making - only appeared about 20 years ago. Unsurprisingly, it found the mind impacts investing quite a lot, and that investors often don't think and act rationally. That's because biases and emotions cause errors in judgment.

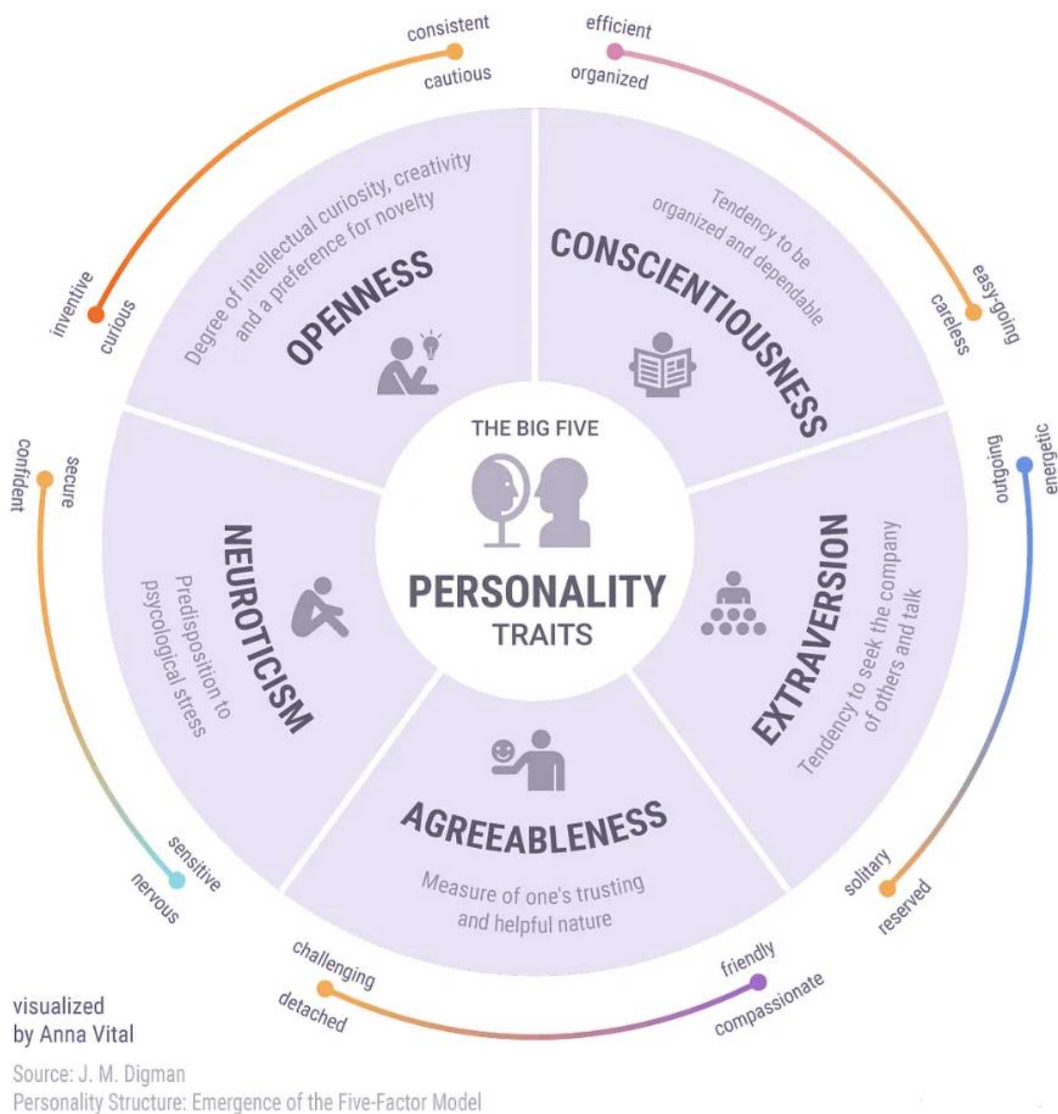
The good thing about behavioural finance is that it's come up with dozens of cognitive biases that investors need to be aware of. The problem is that it's always been generic rather than personal: it's never been able to specify which biases that *you* have, and how *you* can deal with them.

How personality influences outcomes

More recent research has shed further light on the personal. In fact, it's found that your personality has a large influence on life outcomes, including financial success.

To understand why, let's go through what psychologists define as the five broad personality types, known by the acronym, OCEAN:

1. **Openness to experience.** Those open to new experiences are willing to try new things and use their imagination to embrace new ideas. Those at the other end of the spectrum are usually predictable, uncomfortable with change, and not very imaginative.
2. **Conscientiousness.** The conscientious are organized and self-disciplined. Less conscientious people can be careless, impulsive, and procrastinators.
3. **Extraversion.** The extraverted are social, outgoing, and happy to be the centre of attention. The less extraverted are usually reserved, reflective, and happy in solitude.
4. **Agreeableness.** This measures how people tend to treat relationships with others. The highly agreeable are empathetic, trusting, and compliant. Unagreeable people are less caring and can be demanding and even insulting to others.
5. **Neuroticism.** This describes the emotional stability of a person. The highly neurotic are anxious, often hostile, and experience significant shifts in mood. Those less neurotic are calm, resilient, and rarely sad or depressed.



You're not just one personality type; you're a blend of them.

Studies show your personality type can remain relatively stable through your life. And that it's influenced by both genes and the environment. Roughly 50% is thought to be inherited.

There are lots of websites where you can take a relatively quick quiz and get scored on the five personality traits, including OpenPsychometrics, FiveThirtyEight, and Truity.

Personality types and finances

The science suggests that your personality type is a good predictor of important life outcomes, including financial net worth.

Those open to experiences have higher salaries. They're not as organized as the conscientious, but they tackle projects and investing with energy and imagination. However, they're also inclined to spend more and enjoy the finer things in life.

Of all the types, conscientious people are most associated with career and financial success. They plan ahead, have shorter periods of unemployment, and are less indebted. Yet the tradeoff is that the conscientious are not as happy as some other personality types such as extraverts.

Extraverts earn higher salaries and have greater happiness. However, they don't tend to be great with money as they spend too much and save too little. They're also inclined to take greater risks with their cash.

Agreeableness is associated with lower salaries and net worth. Agreeable people might be nice, but that may also be their downfall. And like extraverts, they like to spend a lot, and not save enough.

Lastly, neurotics are also linked to less financial and career success. Unfortunately, they end up less happy due to higher levels of anxiety and stress.

Understanding personality types can help with investing

Unlike many psychologists, I don't see personality types as deterministic. Just because you have 'x' personality doesn't mean that you'll have 'y' outcome. Instead, they indicate tendencies.

I think they're a useful tool for becoming more self-aware. For instance, the personality tests show that I score reasonably high for conscientiousness, and reasonably high for openness. Though I also test moderate for neuroticism and very low for extraversion.

What this tells me is that I need to guard against a number of things. My mild neuroticism means I have some anxiety and don't react calmly in all situations. My introversion suggests that I need push myself to meet more people, be more social, and be bold enough to ask for that pay raise if I deserve it! Also, my risk aversion means that I should try to take on more risk where it's prudent. And I possibly need to seek out fund managers and financial advisers who embrace risk more than I do.

Doing all of the above could improve my chances of being financially successful.

Self-awareness as a superpower

If I've learned anything through the decades, it's this: *know thyself*. Self-awareness is a superpower in life and investing. And tools to increase self-awareness can provide an infinite return on investment.

** Various studies on how personality influences finances can be found here, here, here, and here.*

In my article this week, I look at how the odds favour ASX miners handily beating the Big Four banks over the next decade.

James Gruber

Also in this week's edition...

Jon Kalkman says that while encouraging people to draw down on their accumulated wealth in retirement might be good public policy, several million retirees disagree because they are deliberately and purposefully conserving that capital. Changing that mindset is difficult, so maybe it's time for a different approach.

Chinese AI creator, DeepSeek, has been this week's big story. **Robert Almeida** from **MFS** outlines the implications for the Magnificent Seven tech companies, while **Professor Anton van den Hengel** makes the case for Australian-made AI.

Despite increased competition, Netflix has managed to become the dominant player in TV streaming. **Magellan's Ryan Joyce** reveals the secrets behind its success, and why the good times are expected to continue.

Markets aren't driven by numbers alone, says **Leigh Grant.** Examples from Tesla shares to Sydney houses show that investors must evaluate not just tangible assets or financials, but also the intangible story that magnifies their value.

A big market sell-off can force pensioners to 'sell cheap' in order to meet their minimum withdrawal requirements. **Roger Montgomery** believes that investing in less volatile assets that also deliver regular income could provide an alternative.

Lastly, in this week's whitepaper, **MFS** examines the disappearance of diversification in global markets and what investors should do about it.

Curated by James Gruber and Leisa Bell

Retirement is a risky business for most people

Jon Kalkman

Firstlinks published an article by Bruce Bennett on 8 January 2025 that highlighted some of the problems with the Commonwealth Super Scheme (CSS):

This article drew comparisons between account-based pensions available from industry super funds and SMSFs. I think those comparisons are misplaced. A more interesting exercise would be to compare the CSS with the age pension because both are income streams that are paid for life and indexed to inflation.

In both cases, the provider is the Commonwealth Government and benefits are paid out of general taxation revenue. That means that neither are affected by investment returns or market volatility. Secondly, because the Government has the legislated power to raise taxes or borrow money, there is no risk that the provider’s commitment to the retiree will not be honoured. There is no counter-party risk.

From the retiree’s viewpoint, these income streams are risk-free, allowing the recipient to plan their retirement spending program with absolute confidence and certainty.

On the other hand, retirees whose retirement income depends on the accumulated wealth of invested super contributions and who then depend on an account-based pension in retirement need to manage a range of risks that retired Commonwealth public servants and age pensioners do not. These risks include:

Longevity risk

We are all living longer as life expectancies increase. Longevity risk refers to the risk that we will outlive our retirement savings. Nobody knows how long the money must last. Managing one’s own retirement funds over a lifetime has many pitfalls, even with expert help.

Life expectancy is a median figure, not an average, with half of retirees living longer and a few people living past 100. Planning to live to the life expectancy is risky and will be inadequate for half of retirees. The challenge is to ensure their money will last a retirement of uncertain duration while also dealing with life’s vicissitudes.

Inflation risk

Inflation risk refers to the way the purchasing value of our money declines due to rising prices. Even low rates of inflation can seriously erode the financial well-being of retirees who live many years and is an ongoing concern for anyone living on a fixed income. Increased life expectancy increases inflation risk.

Retirees can manage this risk by investing in more growth assets so that the asset values grow at least as fast as inflation. This, however, exposes retirees to increased volatility of market risk.

Market risk

The price of assets traded on the market often does not just reflect the intrinsic value of the asset, but also market sentiment, which in turn is affected by political and economic events beyond anyone’s control. Retirees who sell assets to generate their income need to manage the volatility of market prices.

Because shares are the easiest to sell, their inherent liquidity makes the stock market the most volatile, and price declines of over 20% are not uncommon. Such losses can seriously erode retirement savings. However, shares have substantially outperformed other investments over time and are often recommended for retirees' long-term investments as part of a balanced investment allocation strategy.

Retirees can manage market risk by holding a diversified portfolio because the prices of different asset classes usually do not move in the same direction at the same time. A diversified portfolio reduces the risk of volatility at the cost of slightly lower returns.

Many retirees manage market risk by reducing or eliminating their exposure to growth assets altogether. Investments in bonds or term deposits certainly have no price volatility, but also provide the lowest return on their savings. Such a conservative portfolio increases both inflation risk and longevity risk.

Sequencing risk

Several consecutive years of falling prices, especially early in retirement, can mean that progressively more assets need to be sold to generate sufficient retirement income. That can have a profound effect on the life of the remaining assets and their capacity to generate income for a long retirement.

Legislative risk

All retirees are exposed to legislative changes which may alter the types and rates of taxes as well as changes to entitlement to benefits such age pension or the health cards. All citizens are exposed to adverse legislative changes, but retirees are generally not in position to return to work to rebuild their savings when unexpected legislative changes seriously disrupt their retirement plans. In recent years, there have been several major proposed and legislated changes to super that dramatically impact the retirement plans of many retirees.

The gold standard of retirement income is the defined benefit pension such as the CSS. It is an indexed pension set at percentage of pre-retirement salary, paid until death, with a lower percentage paid to the surviving spouse until their death. These pensions are paid to retired judges, academics, military personnel and federal politicians who entered parliament prior to 2004. Such a pension may not have any residual capital value, but all the financial risks outlined above are managed by the provider. The beneficiaries of these pensions can plan their retirement with absolute certainty.

The reason these defined benefit pensions are being phased out is precisely to transfer those risks from the provider to the beneficiary.

In most countries, retirees have access to a risk-free pension similar to our CSS that is provided by either their previous employer or the government. Australia is unusual in that retirees enter retirement with a lump sum which is often the largest amount they have ever managed, often with very limited financial literacy, to support themselves for a retirement of uncertain duration and complexity. They also face that challenge largely alone. Financial advice is costly and scarce. The focus of super funds is on accumulating a healthy super balance in preparation for retirement, but there is precious little guidance, from any source, on how to navigate these retirement risks.

The traditional method of managing risk is to pool that risk through insurance. All insurance seems a waste of money until those risks present themselves and we are glad to have access to the pool of money that we contributed to, to help us manage an unfortunate event. But there is no insurance against retirement risk.

For retirees, the rational response to uncertainty is an abundance of caution and to self-insure against possible calamitous events. In practical terms it means hoarding cash for a rainy day. The result is that, whereas retired public servants and age pensioners can spend every last dollar, safe in the knowledge that the next paycheck is just around the corner, retirees who depend on account-based pensions need to hold significant sums in reserve to cover the range of possible unforeseen events.

With this well entrenched behaviour, many retirees typically preserve capital and significantly underspend their super savings thereby leaving large bequests of concessionally taxed savings to their beneficiaries. Policy advisers seem to have a problem with that. Firstly, retirees could have had a higher standard of living if they had saved less while working and spent more in retirement. Secondly, the tax concessions provided to super are designed to support retirees in retirement, not to be bequeathed to beneficiaries. However, these advisers seem to have no problem with the tax-concessional wealth contained in the family home becoming a bequest.

Annuities as an option

The public policy solution to retiree underspending is almost always to encourage/coerce retirees to use a significant portion of their savings to purchase an annuity which has all the certainty of the CSS or the age pension because annuities are seen as the best insurance against retirement risk.

Annuities have the following features:

- The annuity provides indexed income paid for life. There are no worries about longevity or inflation.
- The annuity payment is unaffected by investment returns or market volatility. There are no worries about market crashes.
- Annuities provide certainty and confidence for retirees to spend their hard-earned savings.

For policy makers, annuities offer other advantages. Retirement risks are pooled within a cohort. The capital provided by people who die young generates the income for people who die much later. That means as a cohort it is self-funding and requires no more injection of capital from the government. For the individual, however, this may not be such a good deal. The family of a retiree who dies young not only loses their loved one, but also loses access to the capital that person accumulated over their working life.

Policy makers understand retirees as a cohort. Within a cohort, it is not difficult to determine the median life expectancy, the median super balance or the average annual expenditure on housing and so on. But life expectancy and other cohort averages are of limited usefulness when planning retirement. Indeed, prudent planning suggests that retirees need to plan for the extreme-case scenario. Given that a couple has a 70% chance that one of them will survive until age 90, cautious retirees need to plan for their savings to last for at least 25 years. A lot can go wrong in that time.

For the individual retiree, their experience may be anything but average and individuals will make plans to meet their individual circumstances.

However, the enthusiasm for annuities, coming from people who are not yet retired, overlooks these limitations. As Bruce Bennett points out, annuities offer no access to capital for unexpected expenses such as health crises or age care. They offer no residual value to support a grieving young family, and they are not transferable between spouses. In addition, annuities offer low returns because they are usually backed by bonds to generate guaranteed income for an indefinite period. Because an annuity is a promise to pay a regular income for life, there is also the counter-party risk that the provider may not be able honour that promise over the long term.

The Australian Government provides an incentive so that a retiree buying an annuity will increase their age pension entitlement, but only if the retiree forfeits access to their capital. The government changed the Age Pension means testing rules in 2019 to support the use of certain lifetime income streams which feature payments for life, regardless of how long a person may live, and reducing access to capital over life expectancy. Only 60% of the purchase price of the annuity is counted in the asset test until their 84th birthday and 30% thereafter.

Note that the UK government removed compulsory annuities in 2011 and the demand for annuities in Australia has been weak even with incentives. This evidence has not stopped the latest Grattan proposal which is for retirees to purchase an annuity from the government with 80% of any amount of super above $250,000, because that would boost retiree’s income by a claimed 25%.

It would mean that after a lifetime of work allocating a part of their salary to accumulate a pot of money for retirement, retirees would hand it back to the government to buy the equivalent of an age pension. This removes counterparty risk but the awkward fact is that there are many other retirees who receive the age pension, complete with the valuable pension card, without any effort on their part.

And if the government is the annuity provider, retirees would need to trust that the government will not experience some national emergency during their retirement that required the redirection of their retirement savings to other national priorities. Politicians have form in finding retirement savings an irresistible honeypot for their favourite projects.

An alternative approach

While encouraging people to draw down on their accumulated wealth in retirement might be good public policy, several million retirees completely disagree because they are deliberately and purposefully conserving that capital. Changing that mindset is extremely difficult, so maybe it’s time for a different approach.

A comprehensive retirement income policy would provide more certainty to Australian retirees by mitigating some of the risks listed above.

If the aim is to encourage retirees to spend more, consideration should be given to the idea of a universal health card provided to everyone after a certain age. After all, medical conditions like cancer or heart disease do not discriminate between rich and poor. Without such financial support, the self-funded retiree is compelled to self-insure against life's upheavals.

The retirement risk that is completely within the government's domain is legislative risk. Every time legislation is introduced to make changes to super or tax in retirement, it disrupts careful retirement planning and discourages younger people from making further voluntary contributions because they do not trust the government to honour the promise that super implies. The solution is simple. Any proposed change to super must have a long lead-in time and existing retirees, who made their plans according to existing rules, must be protected from those proposed changes by grandfathering.

Of course, the other suggestion would be to make the age pension universal, but that would require a major restructuring of the taxes and concessions relating to super and is beyond the scope of this article.

Jon Kalkman is a former Director of the Australian Investors Association. This article is for general information purposes only and does not consider the circumstances of any investor. This article is based on an understanding of the rules at the time of writing and anyone considering changing their circumstances should consult a financial adviser.

Why ASX miners will handily beat banks in the long-term

James Gruber

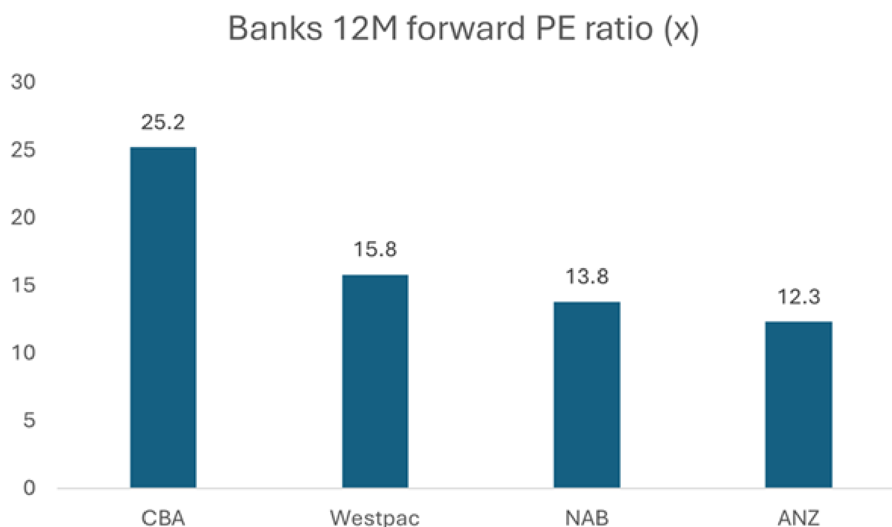
Banks crushed it in 2024. They were up 34%, easily outpacing the ASX 200's 11% return. The stellar performance was led by Westpac (ASX:WBC), up 41% in price terms, closely followed by Commonwealth Bank's rise of 37% (ASX:CBA). NAB (ASX:NAB) and ANZ (ASX:ANZ) lagged the big two banks, climbing 21% and 10% respectively.

Source: Morningstar

The amazing part of the banks' run is that it happened despite earnings going backwards. Normally, share prices follow earnings, yet that didn't occur last year. The stocks rose purely due to an expansion in valuation multiples.

Why did this happen? Many blame passive investing, or a pool of liquidity via super funds that needed to find a home. Though it was more likely a case that miners were unloved, and if investors wanted to put money into the ASX, they didn't have much choice but to invest in the banks.

Valuations for banks now look steep. It's especially so for CBA, which is trading at 27x trailing earnings and 25x forward earnings. Westpac isn't cheap either, trading at 16x forward earnings. Meanwhile, the smaller banks are at much lower multiples.



Source: Morningstar

The Big Four banks' price-to-earnings (PE) ratio is at a slight premium to the ASX 200's forward multiple of 17.6x. That's unusual versus history, and it's difficult to square when the sector has struggled to grow recent earnings.

Is a great sector rotation imminent?

The big question for 2025 is whether bank profits can justify current valuations. And if they disappoint, will there be a great rotation out of the banks into the other ASX 200 heavyweight, resources?

Unlike the banks, miners had a terrible 2024. Their share prices were down 15%, trailing the ASX 200 by 26% and the banks by 47%.

They were pummelled by a stuttering Chinese economy that hit iron ore prices and the bursting of the lithium bubble. Big caps such as BHP (ASX:BHP) and Rio (ASX:RIO) held up better than most miners, ending the year down 22% and 18% respectively.

It's left the resources sector at far cheaper valuation multiples compared to the rest of the ASX. The miners are trading at a 12-month forward PE ratio of 11.2x, a 36% discount to the ASX 200 and a 37% discount to the ASX financials sector.

There might also be a 'double discount' with miners too. Not only are they on inexpensive multiple, but their earnings are also at depressed levels after recent commodity price falls.

The short-term case for a rotation

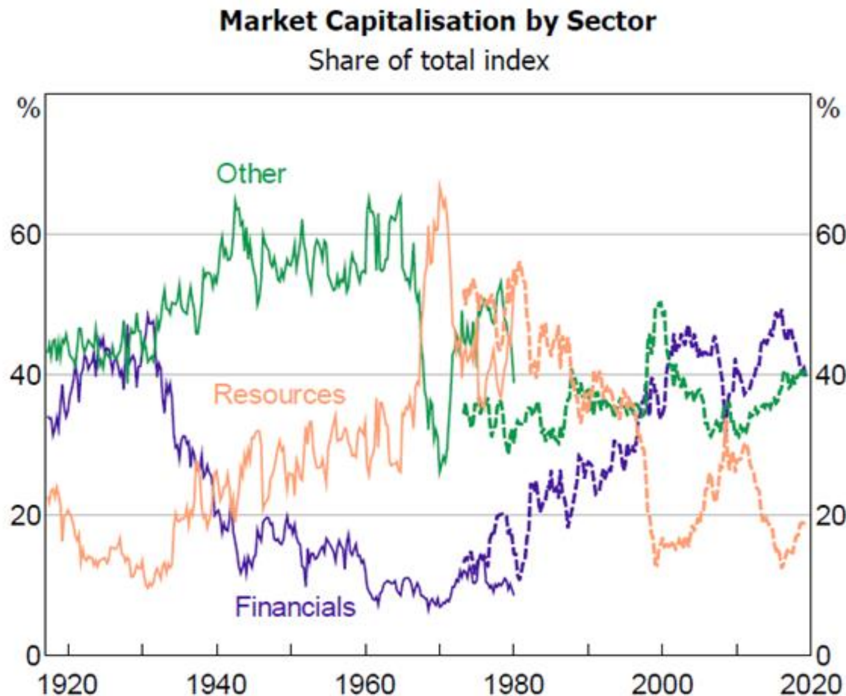
It wouldn't take much for a sharp rotation to happen from the banks into miners. Given the spluttering economy and slowing credit and house price growth, it wouldn't surprise if bank earnings disappointed the already modest projections of analysts.

On the flip side, expectations for the resource companies are the low end. The market will jump on any sign of good news.

The long-term case for a rotation

There's a good case to be made that a rotation out of banks into miners could last a long time, rather than just a few years.

Over the past week, I've spent too much time staring at the following chart:



Source: Thomas Mathews, RBA Discussion Paper: 'A history of Australian Equities'.

The chart tracks the market cap share of different sectors of the ASX 100 from 1917 to mid-2019.

It's a chart that's mesmorised me for a few reasons:

1. Investors nowadays are trained to think short-term, when business, equity, and capital cycles can often last decades, and this chart reflects that.
2. Look at how the financials and resources sectors have mostly moved inversely to each other. When you think about it, this shouldn't surprise because they are the two largest ASX sectors.
3. Notice how the peak share for the financials sector topped out at similar levels in 1930 and then again 78 years later in 2018.
4. Banks performed horribly for 40 years between 1940 and 1980. This was principally due to stricter regulation post the Great Depression and World War Two.
5. Also notable is how the resources sector bottomed in the mid to low teens share in 1930, 1999, and 2017-2018.
6. The 'other' sector – comprising all the remaining sectors in the ASX 100 – was huge between 1940 and 1980, reflecting the rise of Australian manufacturers. However, since the decline of many manufacturers, the market cap share has been relatively steady, hovering mostly between 35% and 45%.

The chart finishes in 2019. Updating it to now, the market share of banks in the ASX 100 has increased over the past five years to 42%, while resources have also risen to 22%.

Zooming in on the banks since 1980, their share of the market has lifted from close to 10% to what it is today. It's been a remarkable rise.

It's partly been a global story of growing financialisation – the increase in the size and influence of financial institutions vis-à-vis the economy and other sectors. Macquarie's Viktor Shvets estimates that the value of financial assets around the globe is at least 5x greater than the real economy, and possibly 10x including gross derivatives and private capital.

Financialisation has been driven by the massive uptick in global debt, aided by lower interest rates, over the past 45 years. Total world debt reached US$322 trillion in the third quarter of last year, around 326% of global GDP. That percentage is up from around 230% of GDP in 2000.

It isn't just an overseas phenomenon. In Australia, housing - valued at $11 trillion – is almost 4x larger than the size of our economy. Superannuation has also grown into a behemoth, with assets above $4 trillion.

The financialisation of our economy has undoubtedly helped the ASX banks. Another beneficial factor has been the deregulation of the economy since the 1980s.

Both these powerful tailwinds appear unsustainable in the short and long terms. A reversal of financialisation would see capital flowing out of the financial sector into tangible assets such as commodities.

And economic deregulation already appears to be on the outer. For the banks, regulation has increased since the Royal Commission into banking, and that's crimped credit growth. It's no accident that the Royal Commission concluded its work in early 2019, and the banks' share of the ASX 100 peaked in 2018.

Going back to the chart on market capitalization by sector, history would suggest that the banks' share is close to topping out, while resources may have a long way to run. In other words, a convergence in the shares of the two sectors would appear more likely than not.

And even a minor reversal in the structural drivers which have helped banks and hindered resources in recent decades could make this happen.

Put simply, I think there are favourable odds that ASX resources will handily beat the banks over the next 10+ years.

James Gruber is Editor of Firstlinks.

After DeepSeek, what's next for the big US tech companies?

Robert M. Almeida

In life, we frequently conflate symptoms with their underlying causes, leading us to sometimes address the effects and not the actual causes of issues. We see this occurring, for example, when a doctor prescribes a topical medicine with negative side effects to treat a skin condition instead of addressing what may be the root issue — an unhealthy lifestyle and a poor diet. The overall effect of practices such as these might be why the length of the average health-span — the period of life spent in good health — has not kept pace with longer lifespans and is actually falling.

A similar pattern can be observed in today's financial markets. With index concentrations at historic highs, I often read and hear from active investors that the growth of passive investing is to blame. However, both index concentration and passive ownership reaching all-time highs are the result of the same underlying cause: investor demand for the stocks of companies with massive profit growth.

The cause

All financial asset prices reflect investors' aggregated expectations of future cash flows. Take equities. While each sector is different, they all generally coalesce around profits, earnings-per-share, net income, free cash flow and what have you. So when a corporation in a large industry manages to capture a disproportionately high share of the profit pool, its stock becomes an outsized proportion of a stock index. We saw this with AT&T, General Motors, IBM and others in the 1950s and 1960s.

Similarly, today we observe this with mega-cap artificial intelligence stocks, the net income growth expectations of which vastly outpace those of other S&P 500 companies (Exhibit 1). In 2023, the growth expectations of AI stocks were 20 times higher than for those of the rest of the S&P. It's these profit expectations and differentials that primarily drive their index weightings.

However, index concentration and the resulting share-taking by passive affects the 495 non-AI5 stocks (The 'Artificial Intelligence 5 or AI5' companies are Meta, Amazon, Microsoft, Nvidia and Alphabet). Liquidity doesn't scale, and every dollar pulled away from discretionary portfolios and allocated to nondiscretionary ones places downward pressure on the cost of equity capital for these companies.

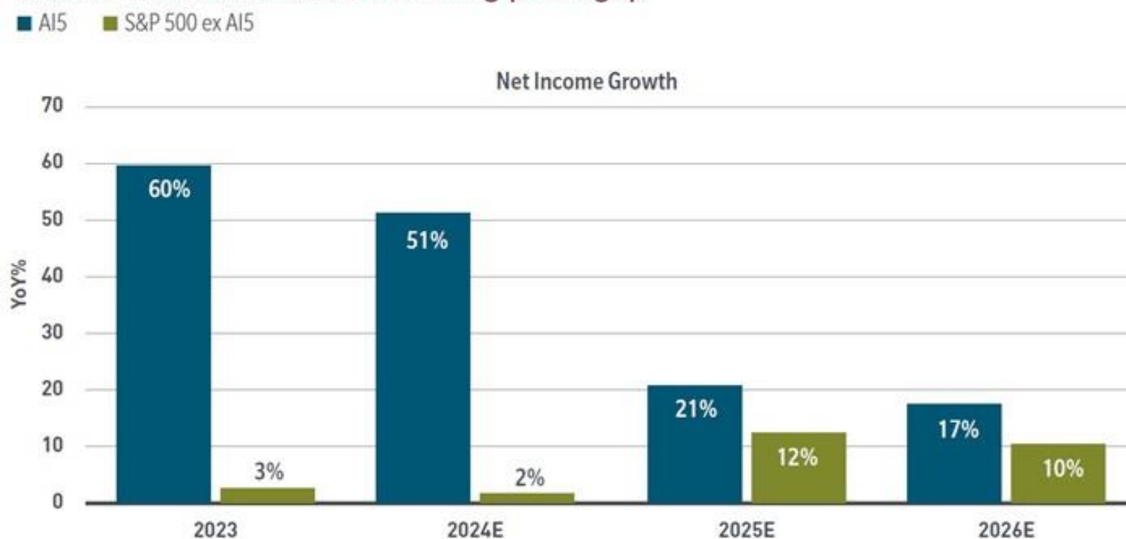
So where's the risk?

Falling net income expectations for the AI companies

Index concentration doesn't end because passive flows reverse. **Any change in stock market concentration, is in fact, a symptom. The cause is a change in profit expectations.**

As shown in Exhibit 1, Wall Street analysts have considerably lowered their 2025 and 2026 net income expectations for the AI5. The delta between the two cohorts went from 20x in 2023 to 6x in 2026. While this is still a sizeable gap — and nominal profits for the AI5 are massive — what will matter to stock prices will be the rate of any changes versus what will have been discounted in stock prices.

Volatility is the market adjusting to new information that corrects erroneous assumptions relating to profits. One of the risks to passive investors, or any investor over-indexed to the AI5, is that prices will adjust in line with the downward estimates in analysts' earnings expectations.



Sources: FactSet, FactSet Portfolio Analysis. Earnings estimates as of 29 November 2024. Annual earnings (net income) data uses the year-over-year change in actual and estimated annual earnings results. The AI5 ("Artificial Intelligence 5") companies are Alphabet, Amazon, Meta, Microsoft and NVIDIA.
The information included above as well as individual companies and/or securities mentioned should not be construed as investment advice, a recommendation to buy or sell or an indication of trading intent on behalf of any MFS® product.

Why the analysts might be right

When a new and broadly applicable technology emerges, supply is low but customer demand is high. The imbalance leads to an outsized return on capital for the first movers. These high returns naturally attract capital, as other entrepreneurs seek a piece of the action. The stock prices of those companies rise too, creating a feedback loop and in effect inviting more entrants into the industry.

Competition rises, bringing supply to the market. But it almost always overshoots and exceeds customer demand. The cycle then begins to reverse: Pricing and returns fall, driving down stock prices.

Overproduction and deflating returns lead to industry consolidation until supply and demand reach equilibrium.

While economics lacks any immutable laws and every cycle is different, the capital cycle has repeated itself throughout history. So while we don't know when the AI capital cycle will turn from growth to consolidation, we believe it will happen, as it has in the past. We can look back to the 1990s internet bubble for a recent example. We can also go back to the railroads in mid- and late-nineteenth-century England and the United States. And it's happened with every other technological advance in the past 100 years, from the automobile to the radio to the telephone to the computer.

Software's evolution

Over the past 30 years, people have bought software to help them complete tasks. Today, AI is changing software from a tool to something that completes tasks on its own. AI agents will combine information retrieval, reasoning capabilities and self-coding to evolve every piece of software and business process.

AI is in the process of redefining SaaS from *software as a service* to *services as a software*. As large language models become a commoditized raw material in the software supply chain, it will be AI-based software products that end up improving the functionality of existing software. Companies' ability to take price will be a function of the customer's return on the investment.

The vectors of competition in software, AI, and the broader technology landscape are just short of incredible. However, the makers of many existing software applications may experience a massive erosion in pricing power. In my view, given how over-indexed benchmarks are to assets with increasing competition due to the capital cycle, there should be much greater dispersion ahead, causing financial markets to rediscover the merits of active investing.

Conclusion

Investment vehicles, whether active or passive, are just collective pools of capital. While they may influence asset prices in the short term, over the long term it's the *return on* capital that drives the terminal value of enterprises, not the *flow of* capital. As bottom-up fundamental investors, we assess where returns on capital are at risk due to rising competition and where they are durable due to the lack of it.

In this environment, stocks, whether public or private, facing rising competition may find it far more difficult to match profit expectations, bringing forward a different paradigm in the value of portfolio construction.

Robert M. Almeida is a Global Investment Strategist and Portfolio Manager at MFS Investment Management. This article is for general informational purposes only and should not be considered investment advice or a recommendation to invest in any security or to adopt any investment strategy. It has been prepared without taking into account any personal objectives, financial situation or needs of any specific person. Comments, opinions and analysis are rendered as of the date given and may change without notice due to market conditions and other factors. This article is issued in Australia by MFS International Australia Pty Ltd (ABN 68 607 579 537, AFSL 485343), a sponsor of Firstlinks.

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The case for Australian AI

Professor Anton van den Hengel

Australia needs a sovereign artificial intelligence (AI) capability. It must be developed in Australia and built on Australian data. It must be AI for Australian questions and Australian problems. It needs to embody Australia's values, geography, and economy. Downloading a foreign model and fine-tuning it undermines our economic future, because it doesn't build Australian capability. If Australia is to control its own destiny in an AI-enabled future, it must build its own infrastructure, not rent it from overseas. Creating an Australian AI capability is the first critical step in the long process of building Australia's AI economy. Having Australian capability will develop exactly the skills, experience, and capability in AI that Australia needs to drive its transition to an AI-enabled economy and set us up to build a better one.

Background

AI is the technology of our time. It has changed the global economy permanently, yet its primary impact is yet to come. Businesses that engage in the transformation will improve their productivity and out-compete those that don't. The larger opportunity that AI offers, however, is to develop entirely new business models.

Various economic reports put the potential value of AI to the Australian economy over the next decade at more than $300 billion. AI is not an emerging technology, or about to descend through the downside of the hype cycle. It is creating far too much economic value right now for that.

Uber, Google, Facebook and TikTok used AI to build global business models that have changed the Australian economy permanently. AI-enabled global businesses will continue to outcompete existing industries over the coming decades. The Australian tax base will shrink, and Australian productivity will continue to decline, unless

we compete. This comes at a time when our economic complexity is shrinking, and our population is ageing. We need Australian businesses that use AI to address new global markets if we are to maintain our GDP per capita, let alone grow it.

Large Language Models (LLMs) like ChatGPT are a critical tool for existing companies and startups that want to develop AI-enabled business models. As a result, they have become critical infrastructure for nations wanting to make the transition to the AI-enabled economy. Australia needs AI that reflects its culture, data, and values if it wants to retain economic and cultural sovereignty. The countries we compare ourselves against have already made this step.

AI and global markets

The five largest companies in the world are AI companies. The revenue of the smallest of the five (Amazon) would see it placed at number 25 in the list of nations ranked by GDP. This puts it above 152 countries including Ireland (population 5 million), Norway (population 5 million) and Austria (population 9 million). Amazon has 1.2 million employees, slightly smaller than the population of Adelaide. AI is driving unprecedented value creation globally and will continue to do so.

The founders of Google didn't inherit a small Internet search engine and make incremental improvements. Larry Page and Sergey Brin were doing PhDs at Stanford and realised that Internet search could be framed as a matrix inversion problem. They started an Internet search engine on this basis, and it was better than its competitors. This meant they attracted more traffic, which gave them more data, which allowed them to improve their algorithm further. Before long they had an insurmountable advantage in search, which they leveraged into online advertising. It is critical to their model that each additional search customer, and each additional advertisement, have almost zero marginal cost to the business. The accuracy and scalability of the model undermined the viability of classified advertising globally, and thus the business model of most newspapers. It had a similar impact on television.

The founders of Uber realised that there was a misalignment of interests between taxi drivers and passengers, and a lot of unused capacity in privately-owned vehicles. They used AI to enable drivers and passengers to connect and undermined the taxi industry's business model as a result. The taxi drivers were protected by legislation, and by the physically and geographically focussed nature of their business. The value of a taxi licence is now less than 10% of what it was pre-Uber. Uber make 30% of every transaction and have almost zero marginal cost.

The challenge for many incumbent businesses is whether they want to be Uber, or Uber drivers.

Value proposition

The value in AI is not chatbots. The value is in the fact that AI enables existing business problems to be solved with far less training data, and far more quickly, than has been possible previously. It has thus removed the moat that many existing businesses depend upon. The truly disruptive value in AI is that it enables solving new problems that would have been considered impossible previously. Some of these new solutions enable global businesses. This is a great opportunity for Australia to transition to a more complex, productive, and modern economy.

Australians need to be able to use AI without sending data to foreign countries or companies, and without leaking IP. More than this, building Australia's sovereign AI capability is the first step towards joining the modern global AI-enabled economy. If Australia does not develop its own capability, it will perpetually need to download this critical infrastructure from overseas. In developing our own infrastructure, we build the skills and experience required to create AI-enabled global businesses in Australia.

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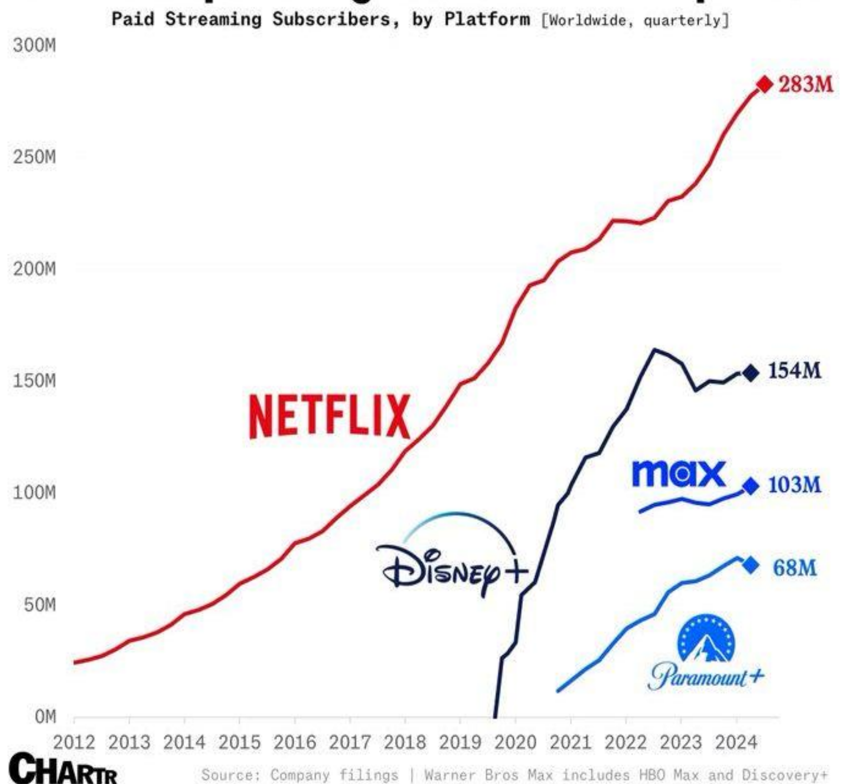
How Nextflix is staying ahead of the competition

Ryan Joyce CFA

Netflix's operating profit increased from US$800 million in 2017 to ~US$10 billion in 2024. We see the potential for this to triple to US$30 billion over the next decade as streaming continues to take share of video viewership and Netflix leverages its leadership position and executes growth strategies to sustain its industry-leading scale.

Scale is critical for video streaming platforms whose largest expense is content, for which the marginal cost of viewership is close to zero. Platforms with greater scale can invest in high-budget, high-profile films and series, offer more diverse content by genre and region, and take more shots on goal in a hit-based industry where *Squid Game* and *The Tiger King* can achieve unexpected success.

Measured across revenue, unique subscribers or engagement, Netflix has 2-4 times the global scale of streaming rivals[1] including Disney and Warner Bros Discovery. Netflix's scale advantage has been expanding as it continues to improve its offering and monetise password sharers while peers have lifted prices and pulled back on content and marketing spend in the pursuit of profitability. In 2024 Netflix added ~30 million subscribers vs ~15 million for each of Disney and Warner Bros Discovery's HBO Max. Looking forward, we expect Netflix to drive further scale through the strategic expansion of its content budget and growth in its ad-supported offering.



Netflix spends ~US$17 billion a year on content, a figure we expect to grow by ~US$1 billion a year. We expect a growing proportion of this budget will be allocated to content franchises, event television and local content.

Being a relative newcomer to the media industry, Netflix owns a limited amount of recognisable IP or content franchises. However, as a small proportion of Netflix's original content breaks through each year, Netflix can increase its annual spend on established IP or returning seasons of popular shows like *Bridgerton*, *Stranger Things*, *Emily in Paris* and *Night Agent* that offer proven engagement, and schedule their release to minimise subscriber churn. Netflix's fostering of IP and content franchises is also a prerequisite should it seek to operate entertainment parks in the future, a large source of profits for Disney and Universal Studios.

While not without its critics, the Tyson vs Paul boxing event garnered over 100 million views globally, demonstrating Netflix's unique ability to aggregate live viewership across a large and diverse subscriber base. This unique ability is attractive to partners like sports leagues and celebrities seeking to grow their own audiences. As a result, partners are open to creating such events by carving out special packages and less focused on extracting the maximum near-term economics. For example, Netflix's NFL Christmas Gameday was a win for the NFL in terms of showcasing it to a younger and more global audience, and a win for Netflix in terms of growing mindshare with older male audiences in the US where it under indexes. We expect Netflix to invest in more win-win event television to deliver targeted subscriber growth and reduce churn.

Local content is another area where we expect to see disproportionate investment by Netflix in the years ahead. Netflix expanded into international markets well ahead of Hollywood peers and has used that head start to understand the taste of local audiences, build local content development capabilities where costs are often much lower, and establish itself as one of a handful of relevant streaming services alongside local competitors

in many markets. This positioning and increasing investment will be critical to sustaining Netflix's subscriber growth and scale advantage vs peers in the years ahead given the relative maturity of English-speaking markets like the US, the UK and Australia.

Another driver of subscriber and revenue scale for Netflix is its ad-supported tier. The introduction of the lower-priced ad tier in 2023 meaningfully expanded Netflix's addressable customer base and has been a key contributor to recent subscriber growth with the ad tier accounting for ~50% of sign-ups in markets where it is available and growing to represent 10% of all subscribers. While having been a drag in 2024, Netflix's ad tier will be an important driver of per-member revenue growth in the coming years through higher engagement, better advertising capabilities and increases in ad load from a very low base.

Source: Morningstar.com

Despite a favourable view of Netflix's long-term earnings potential as it continues to scale, there are risks to this outlook and profits rarely progress in straight lines. Key risks for Netflix include subscriber growth moderating more than expected as the tailwind from the reduction in password sharing fades, a closing of the gap by competitors due to sustained strong execution and the release of highly popular content, and the recent strengthening of the USD that affects revenue and margins.

[1]Excludes YouTube, which has comparable viewership but is predominantly user-generated content and less scalable due to revenue share agreements with creators.

Sources: Company filings

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The million-dollar banana and the power of story

Leigh Grant

Have you ever wondered why a banana that costs 26 cents in a supermarket might sell for an eye-popping 7-figure sum at a high-end auction house like Sotheby's?

Or how a meme coin called "Fartcoin" (something that sounds like it started as a prank) can gain actual buyers in the crypto market? These scenarios might seem bizarre, but they perfectly illustrate the power of narratives in shaping value.

Yuval Noah Harari, in his work *Nexus*, explores how much of human reality relies on shared stories or 'subjective realities'. Although we rely on an objective reality to survive (gravity keeps our feet on the ground, after all), many of our social constructs—money, brands, and status symbols—rest on collective agreement.

In other words, if enough people decide that a banana taped to a wall is 'art', it may indeed be worth a fortune.

Stories as market catalysts

The phenomenon extends far beyond quirky auction sales or peculiar cryptos. Consider the real estate market in Australia, where a modest home in Sydney's Bondi can sell for a price comparable to a palatial residence in the south of France.

If we put these two properties side by side, ignoring location, it seems ludicrous that a Bondi cottage could match the cost of a sprawling estate on French soil. Yet, the Bondi story — "Australian properties always go up" featuring sun, surf, and a globally recognised lifestyle — adds intangible value that's difficult to replicate. Buyers not only purchase a house; they invest in an idea and the bragging rights that come with it.

Liquidity also turbocharges a narrative-driven market. When there's plenty of capital available — fuelled by low interest rates, excess cash in the financial system, or government incentives like tax breaks, lending schemes, and grants — it naturally flows to the hottest stories.

Programs such as first home buyers grants or early access to superannuation for housing further amplify this effect by directing capital into specific sectors. The more compelling the tale, the more investors are willing to plough in money and accept lofty prices. This dynamic often results in breathtaking surges in value, particularly in assets marketed with strong emotional hooks.

Lessons from Damodaran: numbers must underpin the story

In *Narrative and Numbers: The Value of Stories in Business*, Aswath Damodaran (dubbed the 'Dean of Valuation' and professor of finance at NYU Stern Business School) underscores the interplay between a compelling story and the financial data that should ground it.

Businesses often rely on intangible factors like brand perception or visionary leadership to fetch higher valuations than their fundamentals might suggest. However, Damodaran warns that although stories excite investors, there should a marriage of solid financial underpinnings for those valuations to be sustained.

For instance, Damodaran points out how Tesla's ambitious narrative of an electric-car revolution drove its market cap into the stratosphere during its early years, even when it was unprofitable and trading at eye-watering multiples. Was it all hype? Not entirely, because the story was supported by strong product demand, technological innovation, and a charismatic CEO who embodied the brand's mission. The turning point came when Tesla's numbers — revenue, margins, and production capacity — began catching up with the lofty vision, validating the narrative.

Amazon offers a similar example. During the dot-com boom and bust, Amazon was often cited as a poster child for the bubble — an unprofitable company trading at extraordinary valuations. Traditional valuation methods couldn't fully capture the growth potential that some long-term investors could see in its narrative. Those who understood the story, coupled with the direction of its key metrics, had the foresight to invest for the long haul, as Amazon's numbers eventually caught up and surpassed its early promise.

Damodaran's key insight is that, at its best, a business narrative informs specific metrics like growth rates, profit margins, and reinvestment needs. When the stories and numbers diverge (like a company claiming near-infinite growth potential with no proof), it's time to reassess the valuation and possibly the story itself.

The nexus of stories and liquidity

Stories become especially powerful in the presence of abundant liquidity. When interest rates are low and capital is searching for higher returns, investors flock to the next big narrative. Consider the speculative frenzy around certain crypto tokens: 'Fartcoin' or 'Trump coin' can acquire real price momentum if social media communities collectively 'believe'. These tokens might start as jokes, but with enough hype and liquidity, they can temporarily reach surprising valuations.

In the property example, consider the dynamics of Bondi as a magnet for global and local demand. Overseas buyers, immigrants, property investors, and the local populace all compete for an asset that cannot quickly scale its supply. While demand can rise rapidly — with daily immigration or speculative interest — housing

supply is constrained by the time and capital required to build. This mismatch drives prices higher. If the same concentrated demand were to shift to, say, southern France, prices there might soar similarly. The allure of a compelling narrative ("live like royalty in Provence!") combined with strong demand and limited supply creates a powerful cycle. It's not just the story or the liquidity — it's the intersection of the two, amplified by a scarcity dynamic, that drives value into overdrive.

Business applications: selling beyond utility

It's easy to see how these forces shape markets for artwork, real estate, or esoteric cryptos. But the lesson applies just as powerfully to conventional businesses. Two companies might offer nearly identical products — say, two smart phones—but one captures a lion's share of customers and can charge premium prices because it tells a story of innovation, personalisation, and brand excellence.

Damodaran, in *Narrative and Numbers*, describes the building blocks of a strong company story: target market, value proposition, competitive advantages, scalability, and sustainability. When a firm weaves these elements into a coherent narrative and pairs them with credible financials, it can create a moat that's hard for competitors to breach. Meanwhile, a competitor that only highlights its product features without a captivating brand narrative often struggles to differentiate—even if its service is objectively similar.

Grounding your story with numbers

For investors, the key lesson is clear: markets are not purely driven by numbers. Traditional accounting doesn't capture the behaviour of humans or the auction dynamics of markets. Narratives influence decisions, fuel momentum, and shape perceptions—stories create money.

That doesn't mean ignoring the numbers; it means understanding how narratives and numbers interact. As an investor, your job is to evaluate not just the tangible assets or financials but also the intangible story that magnifies their value. A compelling narrative can elevate an asset's worth far beyond its book value, but only if the numbers eventually support the story.

For entrepreneurs, the takeaway is to ground ambitious visions with credible data. Damodaran's advice applies equally to both sides of the equation: balance creativity and discipline. Entrepreneurs must validate their narrative with market size, cost structures, and risk factors, while investors must challenge assumptions and assess whether the story holds up under scrutiny.

Key insights for investors

- **Narrative first, numbers always:** Understand the narrative driving an asset's value. Then evaluate if the numbers support the story or expose its flaws.
- **Market conditions matter:** Liquidity, investor sentiment, and broader economic trends can amplify a narrative's power. Recognising the conditions that enable a story to thrive is critical.
- **Separation of fact and fiction:** Consistency and credibility are the hallmarks of a sustainable story. For instance, a premium brand narrative must align with strong margins and reinvestment rates.
- **Challenge and verify:** A great story can easily turn into hype. As an investor, regularly question assumptions, test financial projections, and seek critical feedback to avoid wishful thinking.

Final word: numbers alone don't move markets — narratives do

The utility of an asset matters, but the narrative is the multiplier. As an investor, the goal isn't just to read financial statements but to decipher the story behind them. Why are people drawn to this company, this asset, or this product? What emotions or beliefs are driving demand?

A banana can be a snack worth cents or a cultural icon worth millions if the world *believes* in the narrative. Similarly, investments can grow exponentially when the right story meets sound fundamentals. By combining the compelling power of story with the discipline of numbers, investors position themselves to identify not just opportunities but sustainable value. As Damodaran reminds us, the real magic lies in the seamless union of narrative and data.

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An alternative asset class for income-seeking retirees

Roger Montgomery

Imagine conducting extensive pre-purchase due diligence on a local business that generated $1,500,000 in net profit last year. Now, imagine you acquire it for $10 million, concluding the purchase price is neither a bargain nor unreasonably high. Finally, you hire managers and staff to oversee its day-to-day operations, allowing you to collect distributions without actively running the enterprise.

Fast-forward one year: the company has delivered an outstanding performance, generating 33% growth in net profit to $2,000,000 – a yield of 20%. You take home the $2,000,000 as a dividend and anticipate further growth, thanks to a nearby competitor's failure. You also test the market for a possible business sale and receive three offers. Despite the business's improving profitability and growth, these are all below your original $10 million purchase price.

Naturally, you decline.

Another year passes, and the growth rate of the company's profits accelerates to 50%, and profits rise to $3,000,000. The yield on your original purchase price is 30%, and a few prospective buyers have knocked on the door, offering to buy your business for less than the $10 million you originally paid.

How do you feel about the business's market value being less than you paid?

I imagine, as you read this, you are thinking the buyers are either idiots or 'bottom feeders' and that their proposed valuations are irrelevant. And you would be right to reach those conclusions. It should be abundantly clear that the external valuations are irrelevant when the business is healthy, growing, and delivering a substantial, increasing cash flow every year.

Why do our conclusions change with listed companies?

So why do our conclusions change when the business in question is listed on the stock market? Why is it that even if the business is growing its profits, we fret over every small daily move in the share price? Why do we fear a crash in the share price of these businesses?

The reason is complex. We might consider the collective wisdom of markets as superior to our own – the market may know something we don't. However, we may also have retirement-related obligations to sell some of the securities each year, and if the share prices collapse, we will be forced to sell more securities than we would otherwise have to in meeting our pension payment obligations.

The aim of investing in equities

In equities, our aim should be to acquire a portfolio of outstanding businesses that continually increase their free cash flow and reliably pay - and grow - their dividends. Alternatively, we will do equally well, and perhaps even better, over the long term, buying businesses that have the capability of increasing their dividend payments, even if they retain their profits to reinvest at very high rates of return.

When you own such enterprises, day-to-day market fluctuations should be far less concerning. And while you can rely on the businesses' dividend streams, rather than fretting over fluctuating share prices, the fluctuations can have adverse impacts.

Mitigating sequencing risk

Sequencing risk - the danger that poor returns early in retirement can rapidly deplete a portfolio when combined with withdrawals - can only partly be mitigated by owning high-quality stocks with predictable, growing dividends.

If the dividend income from a share portfolio is insufficient to meet retirement income stream obligations, you will be forced to sell shares. And if the portfolio has been impacted by a stock market correction caused by geopolitical or macroeconomic shifts (outside of your control) the result is fewer remaining shares to do the heavy lifting of recouping the losses.

From the age of 65 to 74, superannuation income stream beneficiaries must currently withdraw 5% of their retirement account balance (as at the 2023/24 financial year).

Minimum percentage factor for certain pensions and annuities (indicative only) for each age group

Age	Under 65	65-74	75-79	80-84	85-89	90-94	95 or more
2023-24 onwards	4.0%	5.0%	6.0%	7.0%	9.0%	11.0%	14.0%

Note: *These withdrawal factors are indicative only. To determine the precise minimum annual payment (especially for market linked income streams), refer to the pro-rating, rounding and other rules in the Superannuation Industry (Supervision) Regulations 1994.* ***Source:*** *www.ato.gov.au*

If the yield on an equity portfolio is 3%, the difference – 2% – needs to be achieved by selling some of the shares. There is nothing to worry about if the stock market has risen by circa 10% as the S&P/ASX200 has done over the last 12 months. But if the market falls 20%, more shares need to be sold at lower prices to achieve the required payment.

This is why, occasionally, the Government reduces the minimum withdrawal amount required for account-based pensions and annuities to mitigate the adverse impact of lower prices, as it did between 2020 and 2023.

Is there an alternative to equities?

But what if there was an asset class that offered yields of 7-10% each year, paid cash income every month, had a long track record of never posting a negative month and exhibited very low volatility in its unit price?

By way of example, suppose your portfolio was hypothetically invested in a spread of private credit funds that eschewed lending to property developers altogether, yielded 7 or 8%, paid a mix of monthly and quarterly income and has historically offered substantially less volatility than public equity markets.

For retirees aged 65 to 74, they could withdraw their 5% super income stream and reinvest the remaining 2 or 3% into the private credit funds, diversify into equities or pass the funds to kids and grandkids for much needed school fees, for example.

From the age of 75 to 79, retirees are required to withdraw 6%, from 80 to 84, 7%, and from 85 to 89, 9% (refer to table above). Hypothetically, if invested in a diversified portfolio of private credit funds paying 8%, retirees would not need to draw down on their capital until they reached the age of 85 – a full 20 years after retirement.

Of course, there are risks with any asset class, and that's where financial advisers are worth their weight in gold. They can help assess whether private credit aligns with your financial goals, risk tolerance, and income needs. The point, however, is that there are now alternatives to equities that may offer more desirable cash flow characteristics for retirees.

The bigger picture

While 2023 and 2024 provided the backdrop of rising equity markets – something we predicted and wrote about extensively - 2025 and 2026 may offer investors an opportunity to reflect on the virtues of diversifying into private credit. Especially if investing $10 million into an unlisted local business growing its net profit by 50% per year is not an option!

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