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Editorial

Advisers and newsletters like ours inevitably focus on financial strategies that can help people prepare for, and thrive in, retirement. Managing risk is a core part of these strategies.

Recently, John Kalkman penned a fantastic article in *Firstlinks* outlining the long list of financial risks that retirees face, including longevity risk, inflation risk, sequencing risk, and legislative risk. He suggested that for those with account-based pensions, these risks were real, and they were central to why retirees are significantly underspending their super and leaving large bequests of savings.

In this week's edition of *Firstlinks*, **Ron Bird** has a different take on the issue. He says high mandatory super rates are forcing people to give up too much consumption during their working life, resulting in them accumulating more savings than what they require to fund their consumption in retirement. The implication being that mandatory super causes them to enjoy a more modest lifestyle while working and they don't want to drastically change that lifestyle when able to in retirement resulting in them leaving relatively large estates.

Both articles highlight how our retirement system is quite paternal. It nudges us to act and behave in certain ways.

They also highlight how we often focus exclusively on the financial risks of retirement. This neglects the non-financial risks, that are perhaps even more important.

Let's look at some of the key challenges, aside from money, that retirees face:

1. Health. Obviously, if you're in better health, you're going to have a more satisfying retirement because it lets you do so many more things. It also saves money on medical bills. That's why it's important to invest in health early in life, through exercise and diet, to give you better odds of being healthy later in life.

2. Loss of identity. Finding an identity after work can be a real issue. For some, work *is* their identity. Scientific studies show that this can be a big problem, especially for men. I wonder though if the work-from-home trend may loosen the hold that work has on people's identities. That is, the less time spent in workplaces could result in employees feeling less connection to their employer. Let's wait and see…

3. Lack of purpose. This relates to loss of identity. Work gives a sense of purpose and structure. Without work, people can struggle to adapt and find another purpose or purposes.

4. Uncertainty about how to spend time. Without a purpose, there can be uncertainty about how to spend time in retirement. That's why it's important to find a hobby to fill the breach.

Bill Perkins in his book, *Die with Zero*, offers a different perspective. He thinks people should spend more money on 'experiences' and aim to die with nothing in their bank accounts. He says that by aiming to die with zero, you'll forever change your autopilot focus from earning and saving and maximizing your wealth to living the best life you possibly can:

"Why wait until your health and life energy have begun to wane? Rather than just focusing on saving up for a big pot full of money that you will most likely not be able to spend in your lifetime, live your life to the fullest now: Chase memorable life experiences, give money to your kids when they can best use it, donate money to charity while you're still alive. That's the way to live life."

It's a good perspective though misses a key point: it's not so much about the hobby or experience, it's about who you spend it with. Things that deepen your connection to people will help you have a better retirement.

For example, buying a motorbike and becoming part of a motorcycle club isn't about the bike itself or the experience of travelling far and wide, as nice as these things may be. The real satisfaction is going to come from being part of a social group of like-minded people.

5. Relationships. This is the biggest challenge, and research has shown it is the strongest predictor of a happy retirement. First, there's the relationship with your spouse or partner. Retirement researcher, Dr. Michael Finke, offers an intriguing fact on this subject: the happiest group of retirees is women who get divorced between the ages of 60 and 65. He outlines why this is:

"I think that relates to a problem that very often happens in a relationship when people retire. And that is that men tend to have a more limited social network and oftentimes that social network revolves around their work. And women tend to do a better job of investing in relationships that they can then draw from in retirement outside of the workplace. And so, what that means is that women oftentimes want to be able to maintain those relationships in retirement. Men all of a sudden become far more – in an opposite sex couple, they become far more reliant on their relationship with their wife. And the wife is often struggling to be able to manage her existing relationships and this perceived obligation that she has to her husband. And oftentimes they may not have developed the capabilities to spend all day with each other. They get married, and they see each other for breakfast and dinner, but not necessarily for lunch."

Our other crucial relationship is with friends. Robin Dunbar, the world-renowned evolutionary psychologist who famously discovered Dunbar's number, says our capacity for friendship is limited to around 150 people. These are akin to the people who might attend your wedding or funeral.

However, it's the five closest friends – including your spouse or partner - who are most important, according to Dunbar. He terms these as 'cry on your shoulder' friends:

"The best predictor of your mental health and physical health well-being, and even how long you're going to live into the future from today is predicted by the number and quality of friendships you have in that layer. The five is an average. So if you only have three don't panic yet, because introverts tend to prefer to have fewer people but have stronger friendships."

A financial plan and a life plan

Retirees face many challenges, and money is just one of them. That's why it's vital to not only have a financial plan but a life plan. And the financial plan should serve the life plan rather than the other way around.

In my article this week, I explore the two best ways to maximise your dividend income.

James Gruber

Also in this week's edition...

Since the time of Reagan and Thatcher, most business leaders and investors have clung to a dogmatic belief that lower taxes bring higher profits and economic growth. **Joachim Klement** says that the truth is more complicated than that.

Thanks to new rules introduced late last year, many people with old-style super pensions - known as 'legacy pensions' - will look to wind them up this year. **Meg Heffron** offers a guide for how to best proceed.

Cameron Murray has a great piece looking at the Torrens title property system. An Australian invention, the system hasn't been adopted elsewhere despite it being a cheap, low-risk way to handle property dealings. Murray looks at why this is.

DigiCo REIT was the hottest IPO in Australia late last year and **Stuart Cartledge** of **Phoenix Portfolios** assesses the stock and the broader data centre opportunity.

Over the next decade, three million Australians will shift from accumulating wealth to living off it. **Chad Padowitz** says they will need a sound strategy that delivers sustainable income and protection from market bumps.

Finally, in this week's whitepaper, the **World Gold Council** outlines the latest trends in the gold industry.

So, we are not spending our super balances. So what!

Ron Bird

The Callaghan Report prepared for the Treasury on Australian superannuation released four years ago was the first to highlight that people are just not spending their superannuation (super) balances. This finding was confirmed in a recent report released by the Grattan Institute which suggested that guiding people towards purchasing lifetime annuities as the major solution to this perceived problem.

The issue I raise here is to question whether people not spending their super is a problem at all but rather a signal of more fundamental failings in our retirement income system. The purpose of investing is not for people to simply accumulate wealth but rather to assist them to achieve their optimal pattern of consumption over their life. At certain times in their life people will earn more than they want to spend on consumption, and they will build up savings. At other times, they will want to spend more on consumption that their earnings permits and so they have to draw down their savings and/or go into debt. The whole purpose of our mandatory superannuation system is to ensure that people do not consume too much during their working life and so not be able to fund their consumption in retirement. Hence, superannuation has an important role to play in our retirement system to assist people in achieving their optimal pattern of consumption over their life.

In this setting, mandatory super is quite paternal as it is saying to people that without our intervention you will overspend during your working life, and we are going to make it more difficult for you to do this. Now we are being told in the latter years of their lifecycle that they are not spending sufficiently, and we need to take steps to ensure that you will spend more. The Grattan Report suggests that it is concern for longevity and investment risk that is the main inhibitor to people not spending their superannuation balances. Their solution is to guide people to invest the majority of their balances in lifelong annuities. This will certainly solve the perceived problem of getting rid of the super balances as the annuity will be worthless upon the person's death. There are a number of reasons why people need forcing to take on lifetime annuities with a major one being that dying 'early' leaves the issuer of the annuity with so much of a person's hard-earned cash.

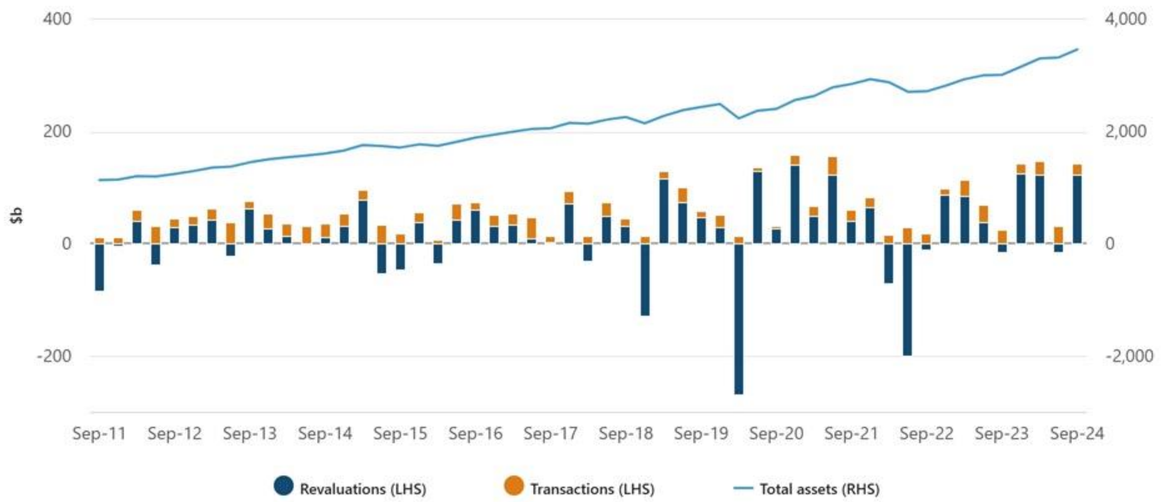
The fact is that we have a system which forces people to save (and so forego consumption) during their working life and now we are proposing a system which encourages them to purchase a lifetime annuity and so fully consume the funds they accumulate over their working life. This is completing the cycle as we are saying that people left to their own devices will make the wrong consumption choices not only while they are working but also during their retirement.

Are mandatory super contribution rates too high?

This is all well and good, but what is disappointing is the Grattan report bases its recommendations on circumstantial evidence without ever addressing the issue as to what are the consumption needs of retirees. This is relatively easily done by modelling the consumption of an individual over their lifecycle incorporating all relevant aspects of the environment (e.g., earnings, investments, super, welfare benefits, longevity and so on). What the report fails to give serious consideration to is that people just do not spend all of their retirement savings because they just do not feel the need to do so. To gain greater insights into this, we need go back several years to when the mandatory contribution rate stalled at 9.5%. At that time there was much discussion of the need to further increase the contribution rate and three independent studies were conducted to throw light on this question. The three studies (one from the *Grattan Institute*, one from ANU and one that I conducted at UTS) all found grounds to suggest that at 9.5%, the contribution rate was already too high for vast sections of the population. By too high, I mean that mandatory super was already forcing people to give up too much consumption during their working life and resulting in them accumulating more savings than what they require to fund their consumption in retirement. The implication being that mandatory super causes them to enjoy a more modest lifestyle while working and they simply do not want to drastically change that lifestyle when able to in retirement resulting in them leaving relatively large estates. If we see people not spending their super balances, the first reaction should not be how can we make them spend it but rather to *examine our retirement income system to determine whether the mandatory contributions rates are being set at too high a level*.

One of the mistakes that we consistently make when talking about super is to assume it is costless and so the more we have the better. This is blatantly wrong as super comes at the cost of consumption foregone during one's working life. Hence it is wrong to segment a person's life and look at optimal behaviour over just one phase of that life. This is just the mistake the Grattan Report makes here by suggesting that we have this pile of money, and we must spend it rather that considering the question as to whether we needed to accumulate this pile in the first place.

Superannuation funds' financial assets



Source: Australian Bureau of Statistics, Australian National Accounts: Finance and Wealth September 2024

Another mistake we make when talking about super is to assume that it impacts on all people equally and so we can set one policy that is optimal for all. For as much as half the population, a 12% contribution rate is clearly causing them to tighten their belts and spend less than they would like over a considerable proportion of their working lives. Further, it is almost certainly preventing them from ever purchasing a property as we see in the diminishing levels of home ownership. In other words, they are conditioned to being used to a lesser lifestyle which they do not want to drastically change when they get the pot of gold at retirement. Indeed, it is not surprising that they choose to devote much of this pot of gold to assisting their children in what are increasingly more difficult times rather than spend it themselves or donate it to the issuer of a lifetime annuity. For the wealthy (say top 25%), we have a completely different situation in that the pile of gold on retirement reflects not only the accumulation of significant mandatory contributions, but also a huge amount of voluntary contributions attracted by the tax incentives provided to invest via super. These people are never going to spend their accumulated balances and quite sensibly leave these funds in tax-shielded super almost up to when they pass them on as part of exceptionally large estates.

Our retirement income system needs revamping

The Grattan Report does have some good recommendations (e.g., the government to offer a lifetime annuity) but to a large extent it is concentrating on an illusory problem. In previous studies, they and others have established that our current retirement income policy is more than adequate to fund the retirement of the vast majority of the population. The real problem is not that we need retirees to spend their pile of gold but rather that we have a retirement income system that we have allowed to grow without any serious attempt to see whether it is working to the lifetime benefit of all constituents of the population. The 'so what' of seeing that people are sitting on their super balances is not to plug another hole in the retirement income system but rather to conduct the long overdue comprehensive analysis of the whole retirement income system to see if we have even the most basic of settings right.

Emeritus Professor Ron Bird (ANU) is a finance and economics academic and former fund manager.

The two best ways to maximise dividend income

James Gruber

In his 2022 Berkshire Hathaway shareholder letter, Warren Buffett discussed the 'secret sauce' to investing, highlighting growing dividends at two of his long-term holdings: Coca-Cola (NYSE:KO) and American Express (NYSE:AXP).

Berkshire bought shares of Coke for a total cost of US$1.3 billion in 1994. The cash dividend that Berkshire received from Coke in that year was $75 million. By 2022, the Coke dividend paid to Berkshire was US$704 million.

Of this, Buffett said: *"Growth occurred every year, just as certain as birthdays. All [business partner Charlie Munger] and I were required to do was cash Coke's quarterly dividend checks. We expect that those checks are highly likely to grow."*

American Express has been a similar story. Berkshire completed the purchase of the company's shares in 1995, also for US$1.3 billion. Annual dividends from Amex grew from US$41 million then to US$302 million in 2022.

The dividend growth from these companies has been incredible for both Berkshire and Buffett. The dividend from Coke grew 9.4x over the 28 years to 2022, at a compound annual growth rate (CAGR) of 8.3% per annum (p.a.).

The 2022 dividend from Coke represented an annual yield of 54% on Buffett's original purchase price (it's now 60%). In other words, for every dollar that Buffett invested in the company, he's now getting 60 cents in annual dividends. In total, he's received US$10.72 billion in dividend income, against a cost of US1.3 billion, and he's used that dividend money to buy stakes in other businesses and shares through the years.

Likewise, American Express grew dividends by 7.4x over 27 years, at a CAGR of 7.7%. Buffett is now getting an annual dividend yield of 23% on his original purchase price.

The wrong conclusion to draw from this is that Buffett bought these companies for their dividends. He didn't. Amazingly, Coke did offer close to a 6% yield in 1994 because Buffett bought it on the cheap. By contrast, his purchase of America Express was when the stock was on a yield of about 3.2%.

But Buffett purchased Coke and American Express because of their ability to grow earnings over the long term. The dividends were merely a by-product of the earnings growth. Without the earnings power of the companies, dividends wouldn't have been able to increase at the clip they did.

Earnings drive dividends

An example can illustrate the point. Let's take a stock called 'Good Dividend Yield Corp'. The business has $100 dollars in equity, and it makes a reasonable return on that equity of 10%, resulting in $10 worth of profit. Of that profit, it pays out 50% as a dividend, equivalent to $5. It retains the remaining $5 in earnings for reinvestment in the business.

I buy this stock for $100. That equates to a price-to-earnings (PE) ratio of 10x and a dividend yield of 5%.

By year 20, the company has increased profits to $26.50 from $10. Dividends are up from $5 to $13.30, at a CAGR of 5%. By year 20, the annual dividend yield at cost for the business is 13.3%.

If the shares trade at a similar PE ratio of 10x, they would be worth $265.50 in year 20. That would equate to a share price return of 5% p.a. ex-dividends. Not too bad.

Year	Equity	Return on equity	Profit	Dividend	Retained
0	100.0	10%	10.0	5.0	5.0
1	105.0	10%	10.5	5.3	5.3
2	110.3	10%	11.0	5.5	5.5
3	115.8	10%	11.6	5.8	5.8
4	121.6	10%	12.2	6.1	6.1
5	127.6	10%	12.8	6.4	6.4
6	134.0	10%	13.4	6.7	6.7
7	140.7	10%	14.1	7.0	7.0
8	147.7	10%	14.8	7.4	7.4
9	155.1	10%	15.5	7.8	7.8
10	162.9	10%	16.3	8.1	8.1
11	171.0	10%	17.1	8.6	8.6
12	179.6	10%	18.0	9.0	9.0
13	188.6	10%	18.9	9.4	9.4
14	198.0	10%	19.8	9.9	9.9
15	207.9	10%	20.8	10.4	10.4
16	218.3	10%	21.8	10.9	10.9
17	229.2	10%	22.9	11.5	11.5
18	240.7	10%	24.1	12.0	12.0
19	252.7	10%	25.3	12.6	12.6
20	265.3	10%	26.5	13.3	13.3

Let's now look at another company called 'Faster Growing Corp'. This business has $100 in shareholders equity but earns a better return on equity of 18%, resulting in net profit of $18. Of that profit, it pays out 50% as dividends, equating to $9. It retains the remaining $9 in earnings for reinvestment in the business.

I buy this stock for $350. That puts it on a PE ratio of 19.4x – not cheap but probably fair given the growth in the company. The dividend yield is 2.6%, lower than I'd like.

By the end of year 20, 'Faster Growing Corp' has increased profits to $101 from $18, up 5.6x, at a CAGR of 9%. Dividends have followed suit, growing from $9 to $50.40 over the same period, also a 9% CAGR.

By year 20, the annual dividend yield at cost for the business is 14.4%. In other words, though 'Faster Growing Corp' had a dividend yield about half that of 'Good Dividend Yield Corp' in year 0, the yield at cost for the former had risen to more than latter by year 20.

Year	Equity	Return on equity	Profit	Dividend	Retained
0	100.0	18%	18.0	9.0	9.0
1	109.0	18%	19.6	9.8	9.8
2	118.8	18%	21.4	10.7	10.7
3	129.5	18%	23.3	11.7	11.7
4	141.2	18%	25.4	12.7	12.7
5	153.9	18%	27.7	13.8	13.8
6	167.7	18%	30.2	15.1	15.1
7	182.8	18%	32.9	16.5	16.5
8	199.3	18%	35.9	17.9	17.9
9	217.2	18%	39.1	19.5	19.5
10	236.7	18%	42.6	21.3	21.3
11	258.0	18%	46.4	23.2	23.2
12	281.3	18%	50.6	25.3	25.3
13	306.6	18%	55.2	27.6	27.6
14	334.2	18%	60.2	30.1	30.1
15	364.2	18%	65.6	32.8	32.8
16	397.0	18%	71.5	35.7	35.7
17	432.8	18%	77.9	38.9	38.9
18	471.7	18%	84.9	42.5	42.5
19	514.2	18%	92.5	46.3	46.3
20	560.4	18%	100.9	50.4	50.4

That's not the full story, though. If we assume the same PE ratio for 'Company B' of 19.4x at year 20, the stock price would be $1,941, up from $350 at initial purchase, equivalent to a return of 9% p.a. ex-dividends.

By the end of year 20, 'Company B' has a higher dividend yield at cost, a faster growing dividend, all the while having achieved a higher total return over the preceding period.

The lesson is that earnings drive dividends. You want to own businesses that can grow earnings over the long term and pay out a portion of those growing earnings as dividends over time. By doing this, you stand a chance of being in the enviable position that Buffett is with Coke and American Express.

Another way to maximise dividend income

The other overlooked aspect of dividend investing is the importance of reinvesting dividends.

Now, the great Warren Buffett doesn't reinvest the dividends from his stock holdings. That's because he takes that money to invest in other businesses which he thinks can offer even better returns.

I'd suggest that you *don't* follow Buffett's example here. Buffett is an exceptional investor and that's why he does what he does.

For mere mortals, if you find a good company that can sustainably grow earnings and dividends over time, it's best to reinvest the dividends. That way, you get to fully enjoy the fruits of compounding returns from the business.

Of course, it's not always possible to reinvest all cash dividends. Some investors are on high tax rates that can cut into dividends. Others must take dividends out for everyday expenses.

Like everything, much depends on your personal circumstances. As a general rule, though, reinvesting dividends in a great business is a sound long-term strategy.

James Gruber is Editor of Firstlinks.

The fetish for lower taxes has gone too far

Joachim Klement

Ok, I am pretty sure today's post will be controversial, so I have already put on my Kevlar suit to protect me against the inevitable comments I will get from readers about this one. Because I am going to talk about taxes.

Look, I work in finance, and you can only get a job in finance if you commit yourself to being a low-tax advocate always and everywhere. And I get it. I don't like to pay taxes and a government that taxes its businesses and citizens too much will inevitably ruin the economy and the country.

But in my view, the fetish of low taxes has gone too far, in particular in the Anglo-Saxon world (he says and immediately ducks behind a wall…).

Ever since the Reagan and Thatcher revolutions in the 1980 the standard answer of business leaders and investors to any problem has been: we need to cut taxes to get people to invest and boost growth.

For 40 years, the beast that is the government has been starved in the name of fighting bureaucracy and regulation and what has been the result: Governments continued to regulate and create more bureaucracy but cut back on investments in infrastructure, healthcare, and education so that today, productivity is declining, and the very foundations of economic activity are cracking. Maybe it is time to admit that cutting taxes is not always the best idea and that sometimes we have to increase taxes to invest in infrastructure or teach workers the necessary skills for today's economy.

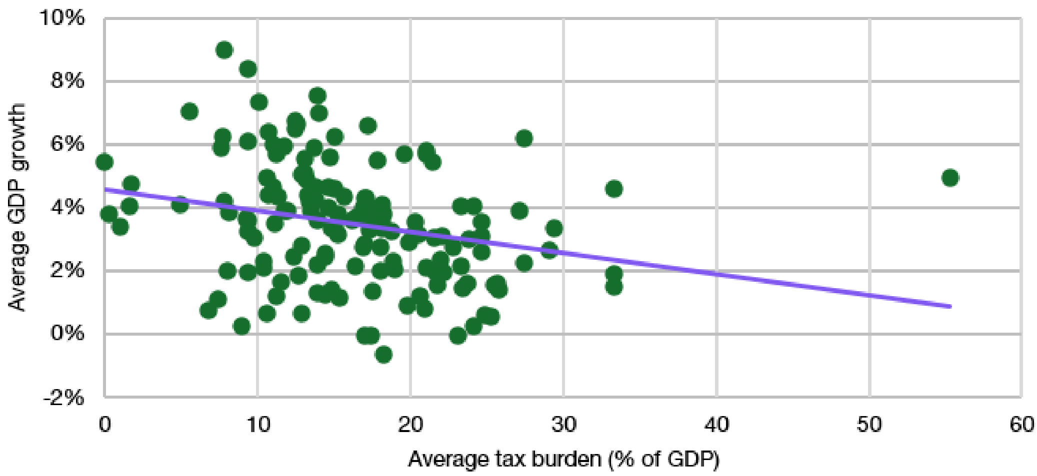
Also, in their dogmatic belief in lower taxes, most business leaders and investors seem to be impervious to the empirical evidence about the link between taxes and profits or economic growth.

Some time ago, I showed why cutting taxes for businesses does not increase corporate profits. Indeed, there is no correlation between changes in corporate tax rates and changes in corporate profits. I encourage all my readers to read [this analysis here](), where I explain why this is the case and why changing corporate tax rates amounts to nothing more than a redistribution of corporate profits from one set of companies to another.

But taxes aren't just applied to corporations. They are everywhere. Advocates for lower taxes tend to show a chart like the one below.

The chart shows the average tax burden (tax/GDP) over the last 20 years vs. the average annual real GDP growth at the same time for 150 countries. As you can see, countries with a lower tax burden on average have a higher GDP growth. A 10-percentage point increase in the tax burden typically reduces annual GDP growth by 0.7% per year.

The correlation between tax burden and GDP growth 2003 to 2022



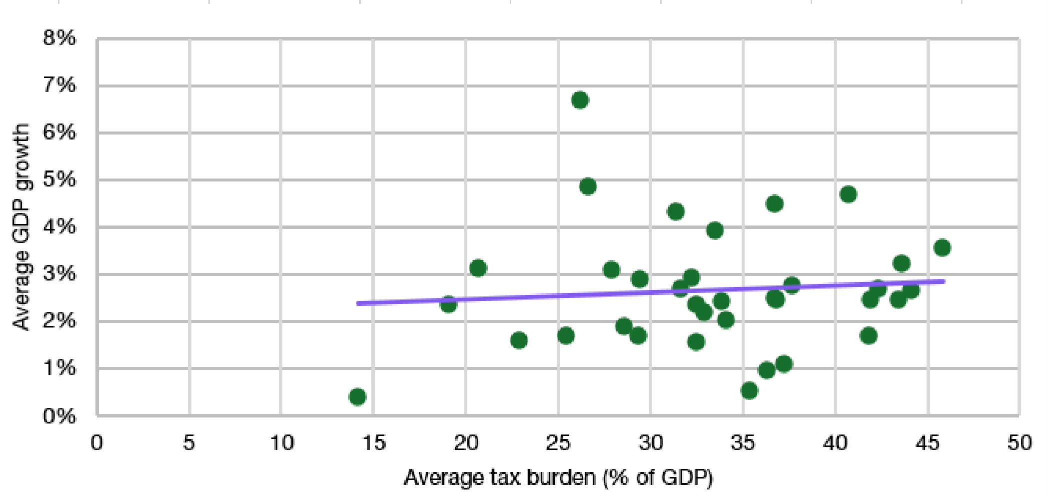
Source: World Bank

Not so fast. The chart above is an exercise in comparing apples with oranges. Because if you create a chart with 150 countries, the sample contains very different countries indeed.

I am concerned with highly developed countries like the US or the UK, not emerging economies that naturally have higher growth rates than more developed ones.

So, let's look at the same chart and restrict our sample to developed countries that are members of the OECD. Here is what the chart looks like when we constrain our sample to a more homogeneous list of countries that are representative of what is going on in the US or the UK.

The correlation between tax burden and GDP growth in OECD countries



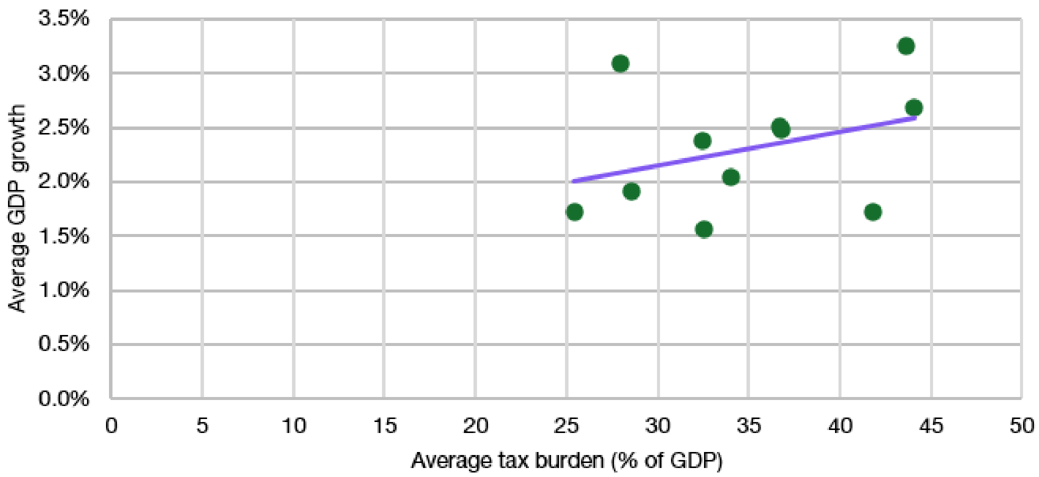
Source: OECD

Oops. All of a sudden there is no correlation between tax burden and GDP growth.

In developed countries in Europe, North America, and the Pacific region, the tax burden does not influence GDP growth. For every country with a low tax burden and high growth like the US or Ireland, we can find another country like Sweden or Austria with a high tax burden and a similar growth rate.

Even better, if I remove small countries like Austria or Ireland and only look at the 10 largest developed economies in the world, I get the following relationship.

The correlation between tax burden and GDP growth in the 10 largest developed countries



Source: OECD

So, in the largest, most developed countries, a 10-percentage point increase in the tax burden on average leads to a boost of annual real GDP growth of 0.3%. Huh?

In short, there is no simple or reliable relationship between the tax burden in a country and its economic growth. As always, it is far more complicated than just lower taxes = higher growth.

It essentially depends on what is taxed and how the money that is raised from taxes is spent. Which brings me to fiscal multipliers.

Fiscal multipliers measure how much output changes for every Dollar/Euro/Sterling of taxes raised. The table below shows the fiscal multipliers the CBO uses in the US to score proposed laws.

Fiscal multipliers for the US

	Low	Mid	High
Tax cuts			
Income tax cuts	0.1x	0.8x	1.5x
Corporate tax cuts	0.0x	0.2x	0.4x
Payroll tax cuts	0.3x	0.8x	1.3x
Government spending			
Unemployment benefits	0.7x	1.3x	1.9x
Infrastructure spending	0.4x	1.3x	2.2x
State aid for infrastructure	0.4x	1.3x	2.2x
State aid other purposes	0.4x	1.1x	1.8x

Source: CBO

For example, if the US government increases personal income tax, then for every Dollar raised in additional taxes the GDP shrinks by 0.1 to 1.5 Dollars with a mid-point estimate of 0.8 Dollars. How much output will suffer from higher taxes depends on the state of the economy. In a recession or a weak growth environment, tax hikes hurt much more than in a strong economy.

So, hiking taxes is bad for growth. But what does the government do with the money? If they just spend it on wasteful activities like increasing the bureaucracy it is unlikely to generate more growth and the net effect of tax hikes is a loss of output.

But if the government invests in infrastructure, it tends to generate 0.7 to 2.2 dollars for every Dollar spent. If the government increases aid for the unemployed, every Dollar spent increases economic output by 0.7 to 1.9 Dollars. If you net it out, an increase in income taxes to spend on infrastructure gives a net boost to GDP of 0.5 Dollars for every Dollar raised in additional taxes.

This is the flaw with the argument that a small government is a better government with less wasteful spending. Every government, no matter how large or small, is subject to lobbying and has certain spending needs it cannot cut. The result is that if a government is starved from its tax revenues it will typically not cut the waste, but the stuff that is easiest to cut. And that often is spending on infrastructure (that road will do another year), or education (what's the difference between the average class size of 20 pupils vs. 25 pupils?), etc.

So, instead of being so incredibly fixated on cutting taxes, business leaders and investors alike should focus more on how tax revenues are used.

PS: One country where this link between taxes revenues and government spending is made very explicit is Switzerland where tax increases tend to end up before the people in a referendum. And Swiss people will vote for higher taxes if you can explain to them what you need the money for. I know, crazy.

Note: This article was part of a series. Please see the explainer to this series at the start of the first instalment.

Joachim Klement is an investment strategist based in London. This article contains the opinion of the author. As such, it should not be construed as investment advice, nor do the opinions expressed necessarily reflect the views of the author's employer. Republished with permission from Klement on Investing.

Meg on SMSFs: Winding up market linked pensions with care

Meg Heffron

Thanks to some new rules introduced late last year, many people with old-style super pensions (known as 'legacy pensions') will look to wind them up this year.

If you have one, you'll know. You'll have seen your accountant grimace slightly when talking about your pension and it will have a name like market-linked (also known as term allocated), complying lifetime or complying life expectancy pension. They're very inflexible, with strict payment rules and can't be switched off (known as being 'commuted') except under very specific circumstances. People who have them often dislike the fact that they can't be turned into a more flexible account-based pension, the money can't be taken out at will and some of them present unique estate planning challenges.

So there were many happy super pensioners when the Government legislated to take the shackles off these pensions from 7 December 2024. From that time, there is a temporary (5-year) amnesty allowing these pensions to be commuted (stopped) at any time, for any reason.

In this article, I've focussed on the most common legacy pension – a market-linked (or term-allocated) pension.

If you're taking advantage of the amnesty, what should you know?

Is it actually law yet?

Laws often have two parts – an Act (resulting from a bill passed by Parliament and setting out the framework for the legislation) and Regulations (which provide more specific rules for some aspects of the law). Changes to acts have to be passed by Parliament but the Government can just make changes to regulations itself. This legacy pension amnesty only needed a change to the super regulations rather than the act. Technically, Parliament has 15 (sitting) days in which any member can put forward a disallowance motion to kill off changes to regulations. We're still in that period because the Regulations came out just before Parliament rose last year and they've only just returned to work. So technically the change could be struck down but that's unlikely – it's a measure that has the support of both major parties. And even if it does get removed, it's law until then.

So anyone who wants to wind up their market linked pension 'right now' can do so and won't be impacted if the change is rolled back later.

What about social security?

Some people with market-linked pensions set them up (or transferred other old-style pensions into them) because they wanted special treatment for the age pension assets test. Specifically, they could ignore 50% of their market-linked pension balance when adding up their assets for this test. If those people take advantage of the amnesty, they will obviously lose their assets test exemption. But there can be even worse consequences (involving retrospective reassessment of pension entitlements for the last few years). We're still waiting on a crucial instrument from the Minister to ensure those don't happen.

That means anyone relying on the partial asset test exemption from their market-linked pension might choose not to wind up yet. So, in this article, I'm focussed on larger market-linked pensions. What should we be careful of there?

***Potentially* less tax-exempt income in the fund**

Funds that pay pensions to people in the retirement phase get a special tax break – they don't pay tax on some of their investment income. If 100% of the fund is in pension accounts, 100% of the fund's taxable investment income is exempt from tax (this includes things like rent, dividends, distributions as well as capital gains). If only 60% of the fund relates to pension accounts, only 60% of this income is exempt. So clearly – the bigger the pension the better.

But winding up a market-linked pension can *potentially* mean ending up with less in pension phase. I say potentially because this won't impact everyone. It happens because of the way in which market-linked pensions work for the transfer balance cap.

To understand why, it's important to remember two important things about this cap.

First, the transfer balance cap is a limit on the amount anyone can put into a retirement pension over their lifetime. It started at $1.6 million back in 2017 and those who didn't use up all their cap have received increases since then. Someone starting their first pension now has a cap of $1.9 million. But someone with a large market-linked pension in 2017 probably used up all their cap at the time (either with their market-linked pension alone or other account-based pensions they had at the time). They don't get any increases.

Second (and this is relevant for particularly large market-linked pensions), people who only had market-linked pensions but they exceeded the $1.6 million cap got special permission to go over the cap back in 2017. They didn't get a higher cap, they were just allowed to exceed their $1.6 million cap.

So why does that mean they'll have trouble winding up and converting their balance to an account-based pension?

Market-linked pensions are unusual in that there are ***formula*** calculations used here for both the amount originally checked against the cap in 2017 and for the commutation value used today.

In many examples we've reviewed already, members commuting (say) a $2 million market-linked pension haven't been able to put the full $2 million back into pension phase. In fact, nowhere near it. It's easy to assume that if this is their only pension (and used up all their cap in 2017) and it is fully commuted, surely they should at least be able to put $1.6 million (their transfer balance cap) back into an account-based pension.

But unfortunately, members with market-linked pensions often can't even put $1.6 million into an account-based pension. That's because every pension payment they've taken since 2017 has used up some of their cap. For example, if they used their cap in full back in 2017 and have taken $600,000 in pension payments over that (nearly 10-year) period, they only have $1 million of their cap left. For those who've had to take large amounts out in pension payments since 2017, sometimes winding up their market-linked pension means no pensions at all in future.

Of course, this doesn't mean the money has to come out of super, it just means it would need to go back to accumulation phase.

And that's where the tax problem comes in. Now, the fund will have less in pension phase, more in accumulation phase. Its tax break on investment income will be reduced accordingly.

That's definitely a downside of winding up a market-linked pension.

But there is often a tax upside to weigh up as well. Larger market-linked pensions (where the pension payments are over $118,750 in 2024/25) are taxed. (Effectively, 50% of the excess over this threshold is added to the recipient's assessable income. No offsets. No reduction for tax-free components. Nothing).

So the recipient of a very large market-linked pension might find themselves balancing a future that is:

- Wind up the market-linked pension and pay more tax in the super fund, or
- Leave the market-linked pension in place and continue paying more tax personally.

It's not too hard to calculate the difference but it's important to do the calculations. Different people will find they have different results.

And it's also important to remember that every year is not the same. Market-linked pensions are specifically designed to run out (they have to end at the end of their term). That means a fund enjoying a high tax break today might not be in the future (as the pension winds down). So calculating the tax break that will be given up 'today' if the pension is wound up is only part of the story – we need to look to the future as well.

In a similar vein, personal income tax on the pension payments might initially be low if the pension payments required each year are only just about $118,750. But one thing that tends to happen with market-linked pensions is that payments balloon towards the end of the term. (Again, this is because they are designed to reach $0 at the end of the term no matter how good the investment returns have been.)

So again, we need to consider the future as well as the here and now.

In cases we've seen so far, sometimes the answer has been to wind up immediately despite a large reduction in the fund's tax exemption. But in others the best outcome has been to wait a few years. Remember – the amnesty lasts for 5 years so not everything has to happen in 2024/25.

Dealing with inherited pensions

Some of our clients have market-linked pensions they've inherited from a spouse. Their issues are slightly different. Remember inherited super can't be rolled back to accumulation phase. That means any part of the market-linked pension balance that can't be turned into a new account-based pension will have to come out of super entirely. This might really impact the decision.

Documentation

Getting the documentation right is going to be critical here. Particularly when you consider a few sneaky traps with the amnesty. For a start, it's only available where the pension is ***fully*** commuted. So in cases where the market-linked pension balance is going to end up split between an account-based pension and an accumulation account, it will be important to make sure the documentation is watertight on exactly how that happens. The last thing anyone wants is for the transaction to look like a partial commutation followed by a full commutation.

And there are the inevitable bits and pieces along the way that are important in getting the wind up right. Things like correctly calculating the minimum pension before the commutation happens, understanding how to do the calculations for transfer balance cap purposes and more.

All in all, winding up a market linked pension is likely to be attractive for many people. But it will need to be done with care.

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

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Why our Torrens title property system hasn't been adopted elsewhere

Cameron Murray

"For a premium, a title may be insured with a title insurance company, the very existence of which is surely no compliment to our present system" - Charles Alfred Patterson, 1938

"Since the distribution and protection of land is generally held to be a natural function of the State, why can not the guarantee of title also be included as a natural function in the protection of land? - Charles Alfred Patterson, 1938

I've recently arrived home from a two-week holiday in Japan. During the flight home I stumbled across Tokyo Swindlers. It's a show about scammers who pose as land sellers and trick buyers into paying large sums of money for land in Tokyo that buyers can never register as their own with official land registers.

I also recently listened to the Planet Money podcast explaining a case of identify fraud and the role of titles insurance in such matters. These events led me to ponder the world outside of Australia's Torrens title property system.

Although we talk a lot about property investment and homeownership, Australians don't think much about the system of property titles itself — how claims of ownership operate, how much the system costs, and how this matters for risks involved in buying and selling property.

That's because Torrens title makes things easy.

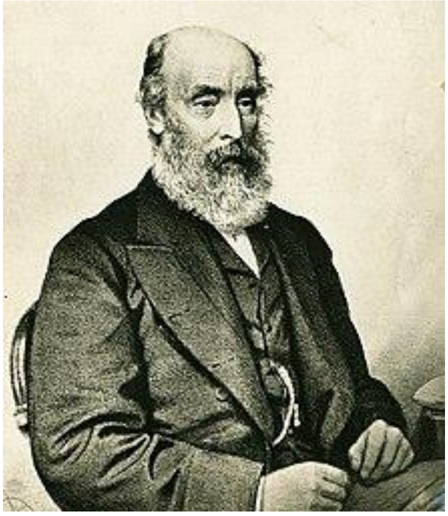
I was initially astonished that such cumbersome property dealings exist in modern economies like Japan and the United States in 2025. Property buyers in Japan can be swindled out of billions of yen, while Americans spend over US$20 billion annually on title insurance. This is unnecessary in Australia because of Torrens title.

In this article, I indulge my curiosity triggered by these events and contemplate some big economic questions around the issue of title security, transaction risk and cost between Australia's system and the alternatives abroad. I then muse about why the revolutionary Torrens title system, an Australian invention from the 1850s, has not caught on more widely.

Before we dig in, here's a quick overview of what I have learnt about property titles in Japan and the United States compared to Australia:

1. In Japan, there isn't a title insurance market, and buyers often risk billions of yen paying a seller BEFORE they are guaranteed ownership. Buyers reduce their risks by doing extensive identity checks, but this still leaves open the gate for identity-thieving swindlers.
2. In the US, the deed system provides no guarantee of ownership after a property purchase. All dealings with a property (inheritance claims, mortgages, etc.) happen independently of any central authority. Risks from previous parties making a claim against a purchased property have fostered a title insurance market that resolves losses for buyers in the case of disputed ownership claims or other errors.

3. In Australia, the Torrens title system keeps an *indefeasible* record of all property and dealings with the property, and the Titles Office is hence a party to all transactions. As the final record keeper, it resolves almost all risks hence there is no need for a title insurance market, nor extensive identity checks by buyers (identity checks happen on the seller side of its relationship with the titles office).



Source: Wikipedia

Torrens titles versus deed-based property

Torrens title is named after South Australian governor Sir Robert Torrens, who first implemented this system of property record keeping and public guarantees in South Australia in 1858.

The basic idea is that since the government is in the business of protecting property rights, it should at least be the final record keeper of who has those property rights.

Under previous deed-based systems, a transfer of property ownership happens independently of any public authority by way of a deed, which is just a type of contract specific to property transfers.

Mortgagees would also make claims over property with another type of contract, a mortgage deed. Historically, there was no requirement to collect and store those deeds anywhere, but generally, there are registrars who collect local deeds and try to build up records of property dealings.

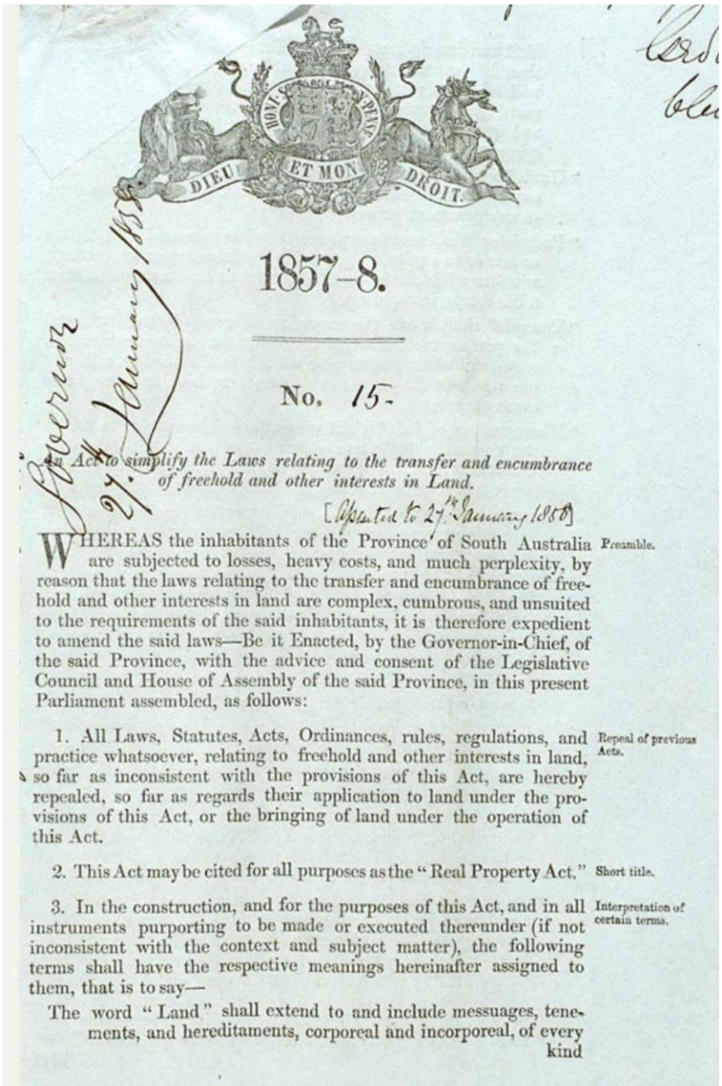
The problem in colonial Australia was this: people could buy property from a seller with no verification that the lot, the street, or anything else was actually real. Many frauds and swindles happened and relatively few risk-takers entered into property trades.

Robert Torrens' experience in trading ships led him to realise there was a better way.

At the time, registration of all ships over 15 tons at their home port was compulsory, and the port/customs authority was required to record all ownership records and transactions of those registered ships. Doing so created a verifiable record of ownership for any parties involved in the trade of merchant vessels.

Torrens campaigned for the South Australian parliament on the idea that States should do the same for land, creating a database to collate all current claims and be the indisputable record of all transactions, encumbrances (mortgages and easements) and dealing. The state should itself guarantee this record, making it [*indefeasible*](#).

Torrens was elected to the South Australian Parliament in 1857 and the Real Property Act 1858 was passed to "simplify the laws relating to the transfer and encumbrance of freehold and other interests in Land". Other states soon adopted Torrens title systems: Queensland in 1861, Victoria in 1862, and New South Wales in 1863.



DIEU ET MON DROIT

1857-8.

No. 15.

An Act to simplify the Laws relating to the transfer and encumbrance of freehold and other interests in Land.

[Assented to 27th January 1858]

WHEREAS the inhabitants of the Province of South Australia are subjected to losses, heavy costs, and much perplexity, by reason that the laws relating to the transfer and encumbrance of freehold and other interests in land are complex, cumbrous, and unsuited to the requirements of the said inhabitants, it is therefore expedient to amend the said laws—Be it Enacted, by the Governor-in-Chief, of the said Province, with the advice and consent of the Legislative Council and House of Assembly of the said Province, in this present Parliament assembled, as follows: — Preamble.

1. All Laws, Statutes, Acts, Ordinances, rules, regulations, and practice whatsoever, relating to freehold and other interests in land, so far as inconsistent with the provisions of this Act, are hereby repealed, so far as regards their application to land under the provisions of this Act, or the bringing of land under the operation of this Act. — Repeal of previous Acts.

2. This Act may be cited for all purposes as the "Real Property Act." — Short title.

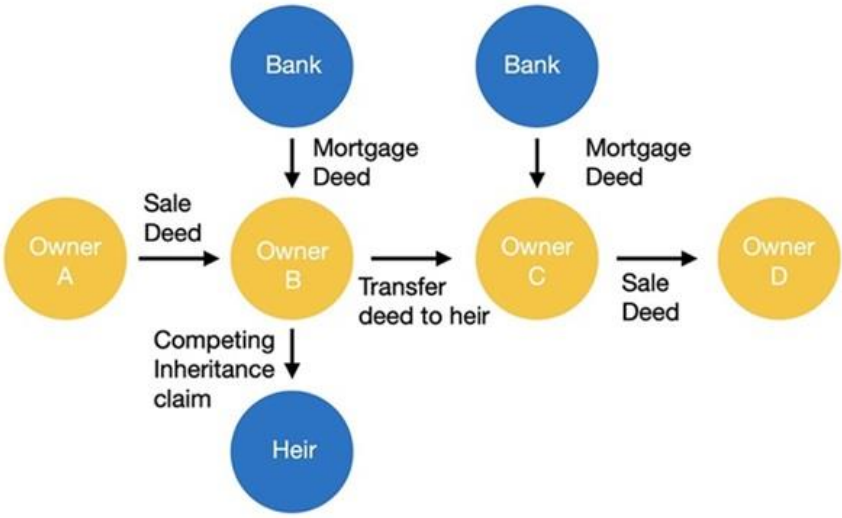
3. In the construction, and for the purposes of this Act, and in all instruments purporting to be made or executed thereunder (if not inconsistent with the context and subject matter), the following terms shall have the respective meanings hereinafter assigned to them, that is to say— — Interpretation of certain terms.

The word "Land" shall extend to and include messuages, tenements, and hereditaments, corporeal and incorporeal, of every kind

The original Real Property Act 1958 that Torrens created for South Australia

Comparison of risks and costs of titles versus deeds

A major risk that a deed-based system could not overcome were claims against a new owner of a property of which they were unaware. For example, consider the diagram below that tracks interests in property over time as a property is transferred from Owner A to B, to C and finally to Owner D.



Owner A sells to Owner B. But Owner B takes a mortgage. When they die, the property is transferred to one of their heirs, Owner C. But there is a competing potential claim on the property from an alternative heir.

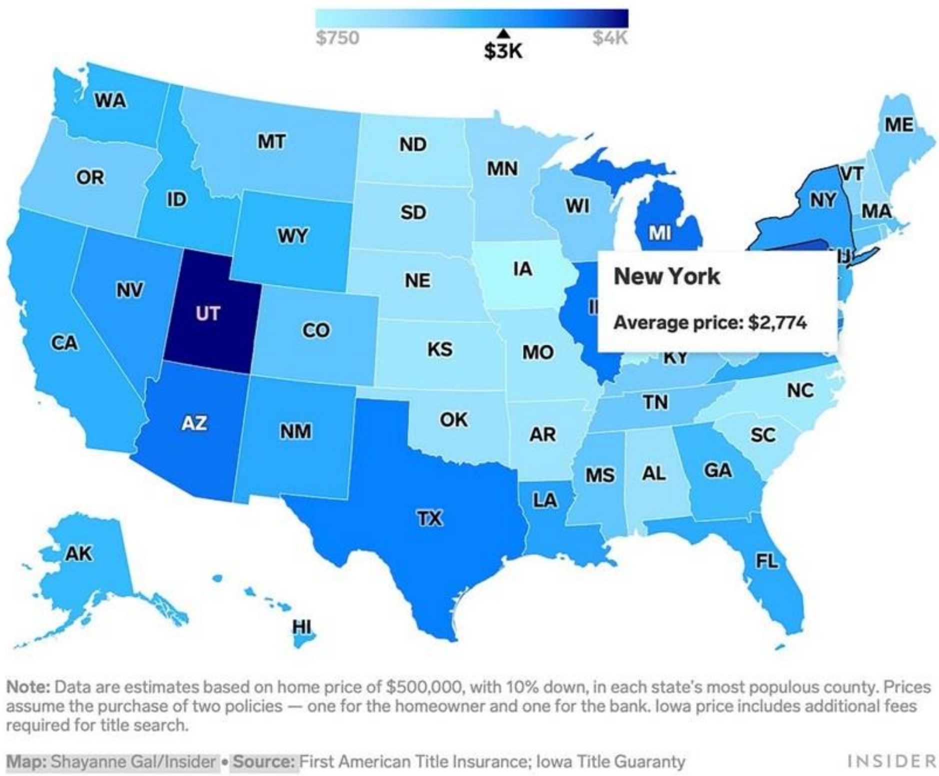
Regardless, the first heir (Owner C) then sells the property to Owner D. The competing heir may go looking for their rightful inheritance, and Owner D will be the one who loses out if that claim is successful.

New property owners take on risks of historical claims to the property, such as unknown mortgages, liens of debt secured against the property, easements, claims by heirs and more. Exactly the problems Torrens was trying to solve.

In the United States, title insurance is bought by the buyer during real estate transactions to cover any loss if they later discover that they haven't bought the *free and clear* property they intended. Title insurance usually costs about 0.5% of the purchase price of a house (see below image), which adds up to over US$20 billion per year.

Money for nothing

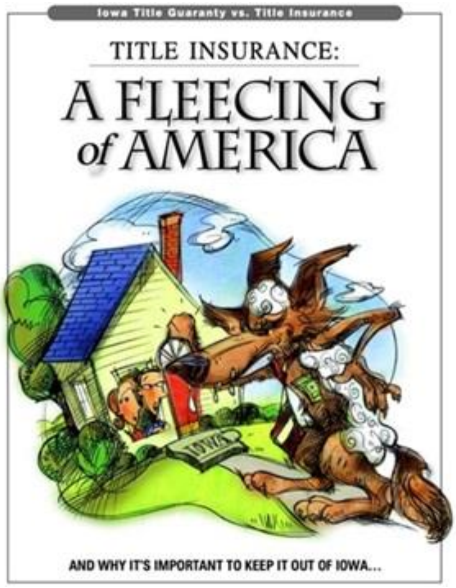
Thanks to weak regulation, prices for title insurance vary wildly from state to state.



The substantial costs of title insurance across the United States

Not only do I think that the whole title insurance industry should not exist at all, it seems that in the United States, it is plagued by undisclosed kickbacks and commissions that end up costing buyers thousands more than is necessary.

You can tell there are some dodgy things happening because these firms work hard to market their credibility and do this by adopting names and logos that just ooze trustworthiness like First American and Old Republic.



I'm not alone in thinking there is something dodgy about this industry.

I find it even more strange that Kurt Pfotenhauer, the vice chairman of First American Title Insurance Company, suggests that the only real benefit of the United States system of deeds that generates the need for title insurance is the speed of transactions.

Yet exactly the opposite was the reason behind the introduction of Torrens title – the indefeasible nature of state title records makes it easy for various parties in each transaction to get the information they need quickly and proceed.

This multi-party settlement process is now done electronically in all states via an app called PEXA, which was created as a public-private company to compensate states for contributing their intellectual property.

Simple property deals in Australia today can settle in as little as two weeks, with the process being so simple that with relatively small fees for property transactions, each state's Titles Office makes a huge profit.

If Australians paid as much title insurance as the United States, we would be forking out about AUD$2 billion per year, while the operation of the Torrens title system costs about 10% of that amount.

With all these clear benefits of derisking and streamlining property transfers, one might ask why, in the 167 years since Torrens, the system is not the global norm.

Why did Torrens title systems fail elsewhere?

There are clear efficiency gains from a Torrens title system when every property in a state uses it. It is therefore puzzling that many states in the United States attempted to adopt a Torrens title system but later repealed it.

Some might have philosophical issues with the fact that the state is directly a party to all property transactions, but this is all semantics. The state is a party indirectly in every situation, so why not make it explicit and derisk the process at the same time?

An interesting 1938 analysis (here) explains some reasons for why Torrens title was not more widely adopted at that time. All objections to Torrens law stem from either: (1) ignorance of its merits, or (2) self-interest (p78).

One influential and self-interested group is the title insurance companies themselves, who could see billions in profits disappear. Hence, they argue that modern title insurance is a more efficient way to deal with the problems of the deeds-based system, even though it costs an order of magnitude more than the alternative.

However, most U.S. states failed in their Torrens title adoption because of a lack of compulsion—an owner could nominate their property into the Torrens title system or choose to stay outside of the system.

Since for any one transaction the costs are higher to get into the Torrens title system than transfer a deed, every party to each transaction has an individual incentive to avoid these initial costs. The only savings are for future parties, not them.

The trouble with weaning property off older deeds-based systems is also why England and Wales took so long to adjust to a Torrens title system. It took until the 1990s to require registration of all lands, completing a 130-year process.

So what?

Far from an outdated relic, Torrens title appears to be the revolutionary, cheap, low-risk way to handle property dealings. Sure, there are still occasional identity fraud cases. But no system is perfect, even if it can save billions per year and reduce risks.

The costs of change, which include creating politically influential losers, suggests that if a place has not yet adopted the Torrens title system, it is unlikely to do so now. Unless, that is, the costs of maintaining the old system become obvious enough to stimulate political pressure.

Dr Cameron K. Murray is Chief Economist at [Fresh Economic Thinking](). The original article can be found [here](). Subscribe to his written work at [Fresheconomicthinking.substack.com](). This article is general information.

DigiCo REIT and the data centre opportunity

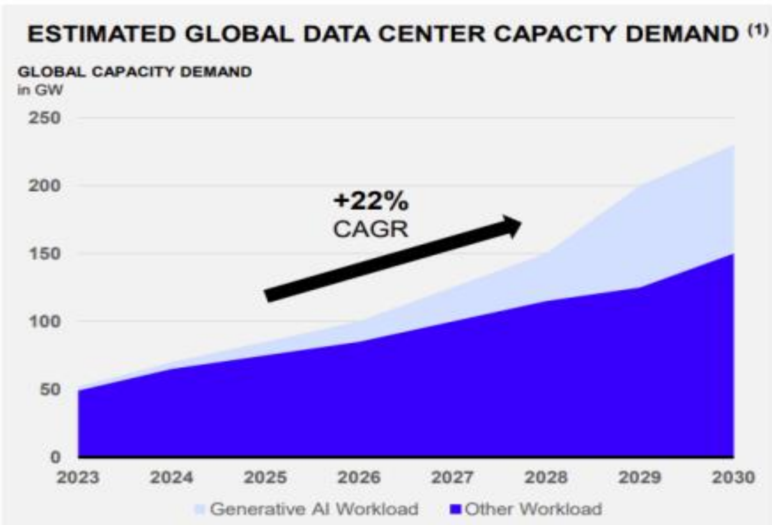
Stuart Cartledge

The data centre industry is a critical backbone of the global digital economy, enabling the storage, processing, and dissemination of data across businesses, governments, and individuals. The sector has experienced rapid growth over the past decade, driven by technological advancements, the proliferation of cloud computing, and the increasing importance of data-driven decision-making across industries.

Key demand drivers include:

- Cloud Computing and SaaS: Cloud computing adoption continues to soar, with enterprises migrating workloads to the cloud for scalability and cost-efficiency. Platforms offering Software-as-a-Service (SaaS), such as Microsoft 365 and Salesforce, rely heavily on data centres.
- 5G and IoT: The rollout of 5G and the growth of Internet of Things (IoT) devices generate unprecedented data volumes, necessitating scalable and reliable data storage solutions.
- Artificial Intelligence (AI) and Machine Learning (ML): AI and ML require significant computational power, leading to increased demand for high-performance data centres equipped with GPUs and specialised hardware.
- Digital Transformation: Businesses across all sectors are investing in digital tools and platforms, further boosting the need for robust data infrastructure. On a conference call in December 2024 with US based Digital Realty, the company described demand growth "greater than anything we've ever seen before" and went on to explain how they've moved from addressing the need for "growth in the cloud" to "enterprise digital transformation" to a current situation where Artificial Intelligence is accounting for approximately 50% of new bookings.

While all forecasts in this space need to be considered carefully, the chart below provides an indication of potential growth.



Source: AI power: Expanding data centre capacity to meet growing demand (McKinsey Company, October 29, 2024)

Supply is being added rapidly, albeit, the physical requirements of land, buildings, IT infrastructure and power can sometimes lag demand. In broad terms, the supply landscape comprises:

- Hyperscalers: Technology giants such as Amazon (AWS), Microsoft (Azure), and Google (GCP) dominate the hyperscale market. These companies continue to invest heavily in expanding their global network of data centres.
- Colocation Services: Colocation providers, such as Equinix and Digital Realty, are also experiencing high demand as enterprises seek hybrid solutions that combine on-premises and cloud storage.
- Enterprise Data Centres: Large organisations such as banks and government, may own and operate their own data centres, specifically tailored to their needs.
  Edge Centres: For certain uses, it is important that data centres are close to end users, helping latency. Edge centres are closely located to end users, but tend to be smaller in scale.

What is DigiCo REIT?

Digico (ASX: DGT) is a newly established, ASX-listed Real Estate Investment Trust that seeks to own, operate and develop data centres. Initially focused on Australia and the USA. The trust has a global mandate and an equally broad strategic focus, looking for exposure across stabilised assets, value-add, and development opportunities.

Unlike traditional real estate metrics, where the focus is on gross or net lettable area, with data centres, it's all about power, so the metrics turn to megawatts (MW) and gigawatts (GW) as the key attribute of a facility. In that context, DGT's initial portfolio has installed capacity of 76MW, with the vehicle looking to materially expand this to 238MW via additions and greenfield opportunities already identified.

Externally managed by HMC Capital Limited, DGT benefits from a recently acquired operating platform of staff that brings the IT capability alongside the funds management, accounting, tax and risk management skills of the HMC Capital platform.

DGT is tapping into one of the mega-trends identified by its external manager.

What's not to like?

Data centre assets are more difficult to value than traditional real estate. Traditionally, as a real estate investor, we have been a provider of land and buildings with the tenants responsible for power, and everything that sits within the buildings. This type of real estate is reasonably easier to value, particularly where long leases provide certainty of income. Once we move further up the risk spectrum, by providing a powered shell, and potentially towards operating the assets ourselves, we benefit from much higher returns but are also more exposed to the operating business, and the risks around obsolescence of equipment. As such, valuation metrics become more challenging, as long-term forecasts for cash generation are subject to large estimation error.

DGT is new to this space, and while we believe they have done a solid job of assembling a diversified initial portfolio and management team, they lack a solid public track record. Over time this will dissipate, but in the short term we require an enhanced return expectation to compensate.

The entire portfolio has been recently acquired and a large portion of it is yet to even settle. Given the strong interest in the sector, it would be hard to argue that it is anything other than a sellers' market which is unlikely to be supportive of cheap acquisitions. Our estimate of the price paid per MW of capacity is around $28m. This includes both the cost and additional capacity of planned projects.

By way of comparison, Goodman Group (GMG), which has been a hugely successful developer, owner and operator of industrial property in Australia and key overseas markets, has also recently pivoted towards the development of data centres. Data Centres are expected to become more than 50% of GMG's total development pipeline. GMG has a data centre pipeline of ~5GW, albeit this will take more than a decade to roll out. GMG is targeting 80MW facilities with an estimated end value of ~$2bn, implying a market value for a brand new facility of ~$25m per MW. Furthermore, this includes a substantial development margin for GMG. These figures are rough and ready, but do not flatter the DGT valuation.

One of the metrics we use to value property stocks is a "Sum of the Parts". For externally managed REITs, this involves estimating a market value for each of the assets held, and then making adjustments for the capital structure (debt) and the management fee structure. For DGT, given all assets have been recently acquired, we have a reasonable starting point for valuation. At IPO DGT was priced at a ~4% premium to book value and a bigger premium to our assessed "Sum of the Parts" once the management fee stream is accounted for.

And finally, a word on externally managed trusts, which we have made many times before, but remains very important. There is an inherent conflict between the manager, who is incentivised to grow assets and fees, versus the unitholders of the trust who may be better served with a more stable portfolio. This misalignment is made worse when there are fees attached to acquisitions and dispositions. Sadly, DGT is encumbered with such fees, albeit the manager does have a substantial co-investment stake offsetting this concern to some extent.

Conclusion

The data centre space is an amazing one. It represents a substantial opportunity, and we expect DGT to grow strongly as it develops out its current pipeline and makes acquisitions. However, each opportunity needs to compete for the same dollar of capital. Right now, we see some compelling opportunities in related areas, such as Centuria Industrial REIT (CIP), which trades at a material discount to its book value and also has some growth options.

Stuart Cartledge is Managing Director of Phoenix Portfolios, a boutique investment manager partly owned by staff and partly owned by ASX-listed Cromwell Property Group. Cromwell Funds Management is a sponsor of Firstlinks. This article is not intended to provide investment or financial advice or to act as any sort of offer or disclosure document. It has been prepared without taking into account any investor's objectives, financial situation or needs. Any potential investor should make their own independent enquiries, and talk to their professional advisers, before making investment decisions.

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The $1.2 trillion sea change facing Australian investors

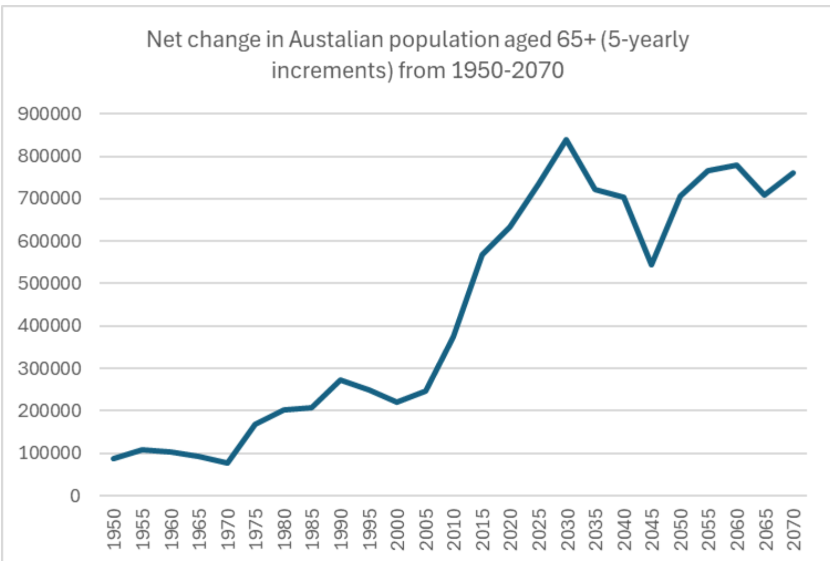
Chad Padowitz

Every year around 60,000 humpback whales leave the frigid, food-rich waters of Antarctica and begin the world's longest mammal migration, a 5,000-kilometre, three-month journey to the warm waters of northern Western Australia and Queensland.

One cohort of Australians who make an effort to witness this event are retirees, blessed with abundant free time and desire to tour our great country. Just like the whales, this group and their collective wealth is about to undertake its own massive migration, one from accumulation to retirement - its early phase forged by the first baby boomers who began hitting retirement age in the early 2010s.

Over the coming decade, around three million Australians will shift from accumulating wealth to drawing down their savings in retirement, migrating ~A$1.2 trillion with them - yes that's trillion with a 't'.

This transfer signifies a substantial amount of capital that could impact investment trends, healthcare and housing markets among others. Migrating from accumulating wealth to living off it also raises the importance of having sustainable withdrawal strategies, to ensure funds can both adequately fund and effectively last throughout the retirement journey.



Source: Australian Bureau of Statistics, historical and projected data.

The role of income

One of the key and often underappreciated strategies is for retirees to have an income stream as part of their savings. The 2024 Mercer CFA Institute Global Pension Index report, which ranks how well countries help their retirees manage their savings and provide a secure income, showed Australia had slipped to sixth position globally and dropped out of the number one spot in the Asia Pacific.

Why the drop? Our system in Australia is great at making people save and invest via compulsory superannuation but when it comes to strategies to help retirees generate a steady income stream that lasts, we're less impressive.

While there are a variety of income strategies available including Bonds, Annuities, REITs and dividend paying stocks, retirees are not required to have any one type of income investment. There is also no real guidance on how investors should balance the 'retirement trilemma' which refers to the challenge of balancing of three interlocking and competing objectives, namely:

- Maximising retirement income
- Managing risks (inflation, interest rate, market volatility, economic cycle)
- Having access to capital when you need it.

In addition, all investments have their challenges when you consider inflation and higher interest rates, the potential for a weakening economy, liquidity, the economic cycle and increasing government debt which places further pressure on the ability of governments to maintain their current level of service (pensions etc).

In the absence of policy that prescribes how retirees invest their superannuation, strategies that can balance the generation of income but also are liquid and less volatile can be crucial.

The volatility factor

Most people understand market prices can go up and down, but it's less apparent that once money is lost, it's much harder to get it back. A loss of 10% requires a subsequent gain of 11% just to break even; likewise, a 20% fall will break even only after a 25% rebound and a 30% fall needs 43% rise and so on.

Withdrawing capital during periods when losses occur involves 'selling low', compounding the effect as the portfolio enters a market upswing with a lower balance, requiring even stronger returns to recover.

For retirees, this makes it critical to effectively reduce the sequence of return risk, by avoiding volatile returns (often hidden by focusing on the 'average' return) so as to help maintain a wider range of financial choices in retirement.

One option is to manage market volatility. While volatility can never be eliminated, it can be mitigated by investing in more defensive assets.

Equities, particularly value stocks, fit these criteria best because they are typically well-established companies with stable earnings. Reliable sources of portfolio income, such as dividends or interest-bearing investments, can also help mitigate market downturns by providing a steady cash flow. However, as we saw during the 2020 COVID downturn, many of the highest paying dividend stocks either cut or significantly reduced their dividends, just when people needed them most.

The option option

For the more financially literate, options can be used to reduce portfolio volatility while generating an additional source of income. The benefit for retirees in particular is that the process is structural, consistent and repeatable.

As the great migration happens over the next 10 years, as more than a trillion dollars are moved into retirement, having a reliable source of income will be increasingly more important for retirees.

Chad Padowitz is Co-Chief Investment Officer of Talaria Capital. Talaria's listed funds are Global Equity (TLRA) and Global Equity Currency Hedged (TLRH). This article is general information and does not consider the circumstances of any investor.

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