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Editorial

In 1920, the world was still recovering from the momentous loss of life and geopolitical turmoil caused by the Great War. To protect domestic industries, especially agriculture, the US decided to increase tariffs on foreign goods by four-fold. Those tariffs stayed in place for nine years.

At the same time, Congress was debating a cut to immigration after a large influx of southern and eastern Europeans following the war. In 1921, it passed the Emergency Quota Act, which ultimately led to an 80% fall in immigrant numbers to the US.

Major tariff hikes and savage immigrant cuts would normally hit economic growth and result in higher inflation. Yet, instead, we got the 'roaring 20s'.

How did this happen? The photo below offers a clue.

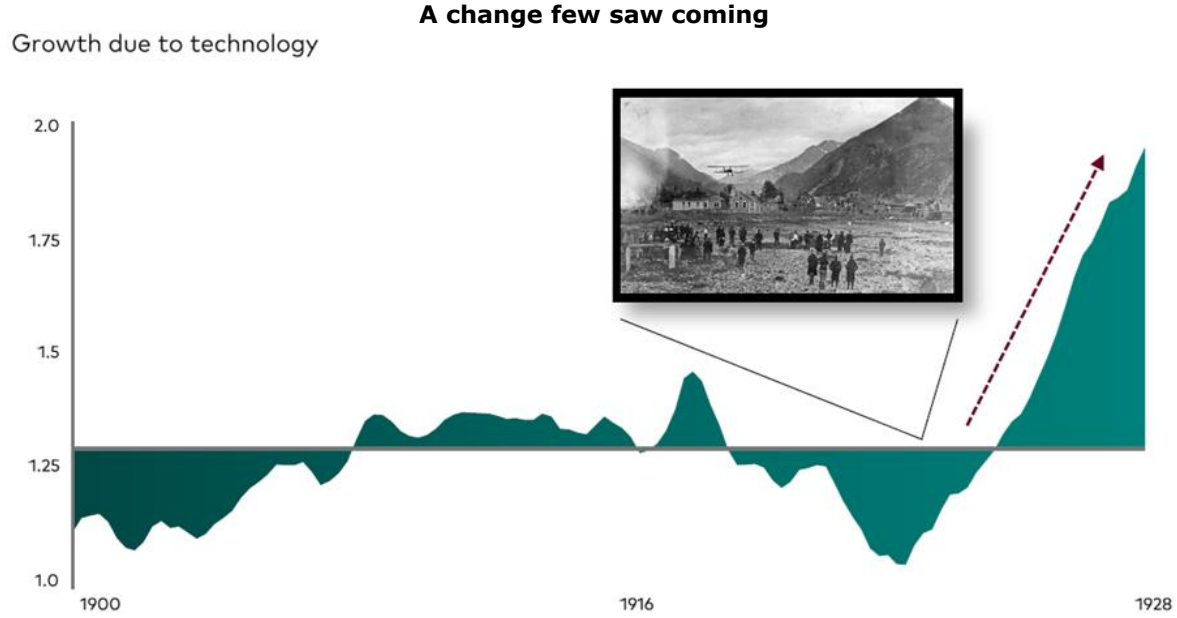
Source: Vanguard

The photo was taken in a small Alaskan mining town in 1920. The plane in the picture was one of four planes making their first long-distance flights from the US to Alaska.

Not only were airplanes changing the world at that time, but the diffusion of electricity was too. Electricity had been around for three decades by then, but it was only in the 1920s that it was used more fully to generate cheap power for the US economy.

These technological trends were enough to overcome the powerful deflationary forces of tariffs and immigration cuts and propel America's economy over that next decade.

A change few saw coming



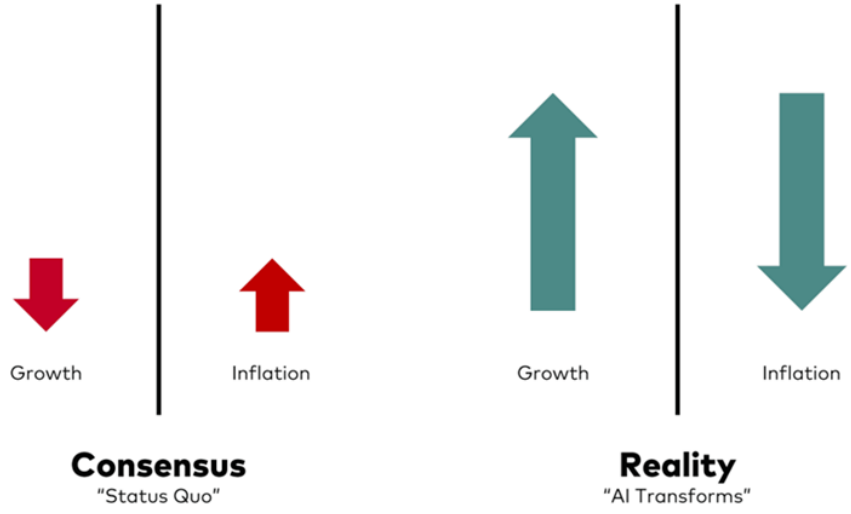
Source: Vanguard

Parallels to today

Vanguard's US-based Global Chief Economist, Joe Davis, told this story to financial advisers in a recent presentation in Australia.

He went on to draw parallels between the 1920s and today. Like then, Trump is now hiking tariffs, though they're nowhere near as harsh as those implemented a century ago. Also, he's looking to slash immigrant numbers, raising concerns about the impact on economic growth.

However, like in the 1920s, Davis thinks that technological change can outweigh these growth dampeners to lift US economic productivity and tame inflation.



Source: Vanguard

Calculating AI's impact

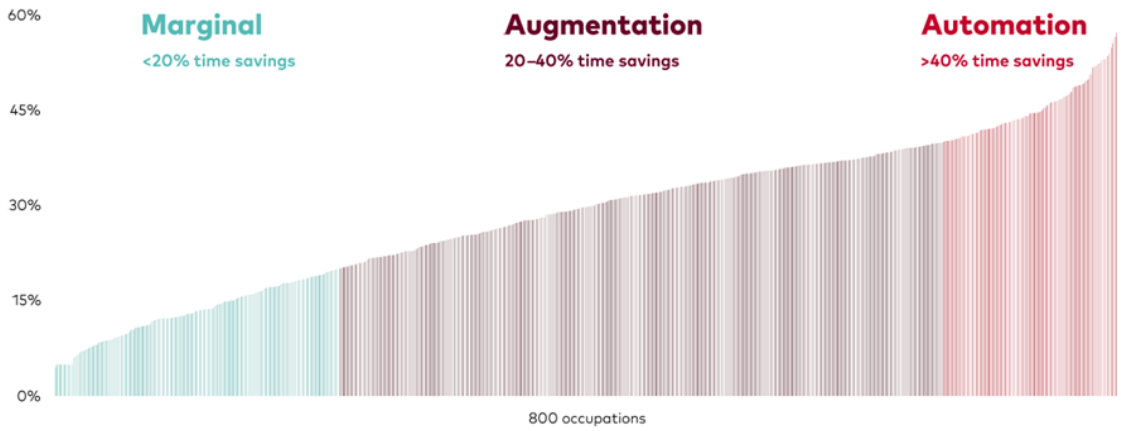
It's all well and good to suggest that AI will transform the economy, but Davis has put numbers on the impact that the technology will have.

He's mapped out 800 different occupations and calculates the effect that AI will have on each of them. He puts the impact into three categories:

Marginal. <20% time savings.
Augmentation. 20-40% time savings (where AI augments a current job).
Automation. >40% time savings.

Here are the results of his research.

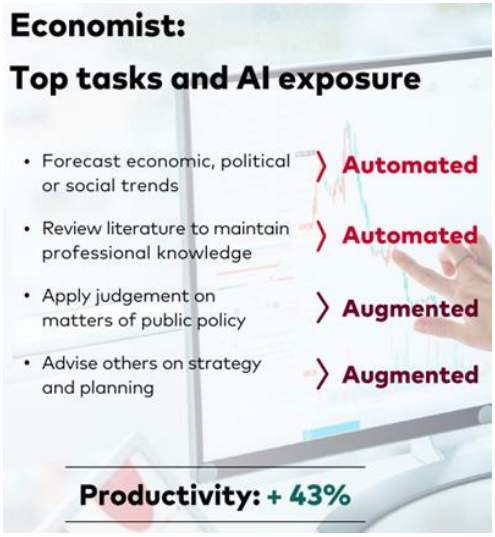
AI's future impact

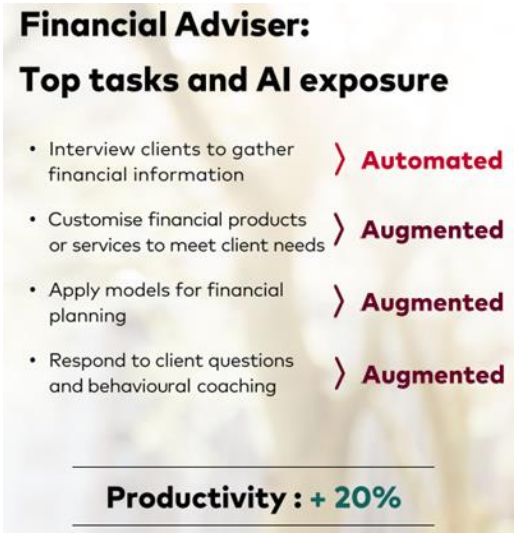


Source: Vanguard

Davis calculates that AI will lead to 20-40% in time savings in more than half of all occupations. Also, the number of occupations that will be augmented or automated by AI outweighs those where it will have a marginal impact by a factor of four to one.

He gave an example from his own profession: an economist. He outlined how he asked ChatGPT to build an inflation prediction model and give a 100-word summary. Davis says AI can do this task in less than a minute compared to the five hours or so that it would take an economist. And he's calculated that AI will lift productivity in the economist profession by 43% over the next decade. Davis gave another example of a financial adviser, and a breakdown of which tasks could be augmented and which could be automated.





Source: Vanguard

He thinks interviews with clients to gather financial information can be automated, though I'm not so sure. As for other tasks, Davis says AI can augment the work of advisers.

At the presentation, I talked to a financial adviser who detailed how he'd automated his administrative tasks as well as client letters and other tasks via AI. He says this led to two of his employees being made redundant. However, AI has allowed him to focus on the most value-added parts of his job – talking with current and prospective clients.

This story amplifies much of what Davis' presentation was addressing.

Investment implications

So, we can look forward to surging US economic growth and muted inflation, according to Davis. What does this mean for markets? It's here that Davis has some surprising conclusions.

He believes that if you believe in the AI transformation, you should own the broader market rather than tech stocks.

Davis thinks overweighting US tech is a mistake for two reasons:

1. Much of the upside potential in US tech stocks is already priced in.
2. The tech sector doesn't usually outperform during periods of technological transformation. He expects some future tech stars to emerge, but there will be a large percentage of those in the sector that flop. For every Amazon that emerged from the Internet bubble, there were dozens of startups that failed. Davis also harkened back to the 1920s, where it wasn't technology companies that ultimately benefited most.

If he's right and AI is a transformative technology with positive economic outcomes, Davis expects AI's influence to emerge most in sectors outside of tech, like healthcare, finance, and manufacturing.

For these reasons, he says investors should own value stocks over growth ones, like tech. And he expects the broader US market to outperform the US tech sector moving forwards.

My take

Davis offers an intriguing and compelling view of the future of AI and its impact on the economy and markets.

Yet, I'm sceptical of his forecasts on productivity growth from the tech transformation. Economists love to use numbers because they can seemingly give certainty to future outcomes. Unfortunately, the future is inherently uncertain.

Even Mike Cannon-Brookes, the boss of Atlassian, recently said in a company conference call that anybody who thinks they know what AI will do in a few years is kidding themselves.

I see three current issues with AI:

1. It regurgitates rather than creates. Ask the AI engines to be creative, and they are found wanting.
2. It sides with consensus over individual thought and truth. AI trawls through public data and often sides with what the majority think of an idea rather than the truth, or original thought.
3. It makes us dumb. AI is providing shortcuts to research and writing, yet it's often in the process of research and writing where hard fought knowledge is won.

That said, Davis may be right about AI being a fillip for economic productivity. And I suspect he will be proven correct about AI being more positive for non-tech companies than the AI providers themselves.

** Disclosure: Vanguard is a sponsor of Firstlinks.*

In my article this week, I cover the latest investment update from one of the most powerful fund managers in the country, **Jon Pearce** of **UniSuper**. Pearce warns that after two years of stellar returns, he expects markets will be flat this year, with the potential for a correction of 10% or more. Though cautious on short term, he's more positive on the long term outlook.

James Gruber

Also in this week's edition...

Clime's John Abernethy says Governments and policymakers have failed us for decades on housing, and it risks creating an underclass in a society that supposedly boasts one of the world's highest standards of living.

He puts forward nine ways to fix the housing mess - some of them controversial and radical - before it's too late.

Meanwhile, **Yunho Cho** and **colleagues** investigate the impact of stamp duty on the housing market, and how reforming the tax could help mobility and improve overall welfare for households.

Australia has one of the world's highest dividend yielding sharemarkets, providing substantial benefits to investors and retirees. Despite this, **Ashley Owen** says that individuals often seek higher yields, to their detriment.

Schroders' Andrew Fleming wants MIGA - to make income great again. By this he means the market has rewarded unprofitable businesses with promises of future riches over the past few years, but that may be about to turn, highlighting recent updates from companies such as Domino's Pizza and Boral.

There are two articles on the US market. The first is from **Eric Marais** of **Orbis** who breaks down the key drivers of recent US market returns, such as revenue, margins, and valuations, and looks at how these drivers will shape future performance. Meanwhile, **Tarek Abou Zeid** and colleagues at **Man AHL** highlight how diversification in portfolios will become important once 'US exceptionalism' fades.

Lastly, in this week's whitepaper, Fidelity shares insights on AI, China, and the new Trump administration, along with compelling investment ideas, from Fidelity International's more than 100 analysts across the world.

Curated by James Gruber and Leisa Bell

UniSuper's boss flags a potential correction ahead

James Gruber

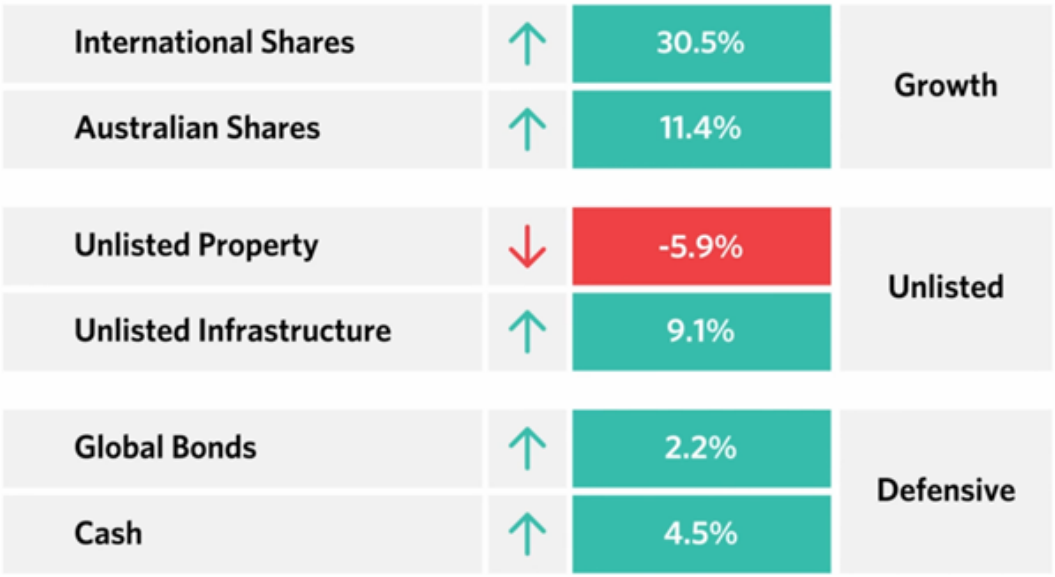
UniSuper's John Pearce is one of the most respected fund managers in the country. When he speaks, people listen.

In a recent update to members, he outlined his thoughts on 2024 and what lies ahead.

Pearce says the optimal strategy for last year would have been threefold:

- Owning growth over defensive assets
- Having international assets, especially US tech
- Favouring listed over unlisted assets.

Figure 1: 2024 market performance



12 months to 31 December 2024. Past performance is not an indicator of future performance. Source: UniSuper.

The thing that strikes your author about this chart is the underperformance of unlisted assets. We've heard a lot of noise about the superior performance of unlisted over listed assets, yet this wasn't the case last year.

To his credit, Pearce had flagged in late 2023 that unlisted assets were looking pricey, and that may be part of the reason for them lagging listed assets last year.

Also to his credit, Pearce was reasonably bullish on markets at the beginning of 2024.

These calls helped UniSuper's funds last year. Its Balanced fund performed better than the peer average, returning 11.72% for the year, while its Sustainable Balanced option was among the best in class, returning 15.25%. The reason for the latter was it overweighting listed assets, and especially US tech.

Pearce notes that index funds outperformed most super funds over the past year. Why? Pearce says that's simple: they didn't own unlisted assets.

He says that while index funds performed well in 2024, it's not always the case. Over a 10-year period, UniSuper's Balanced and Sustainable Balanced options have handily beaten all the index funds, with annual returns of 7.92% and 7.79% respectively.

What's moving markets now?

Pearce gave his take on the two big issues moving markets right now: DeepSeek and Trump. On DeepSeek, he admitted he hadn't heard of it until a few weeks ago.

Put simply, DeepSeek is the Chinese equivalent of ChatGPT. The big news has been that its engineers been able train DeepSeek at a cost of just US$6.5 million. That compares to ChatGPT's US$100 billion and Meta's equivalent, Llama, at US$500 billion.

The market freaked out because it was afraid that the big US tech companies were blowing a lot of money on Nvidia chips and data centres and the like.

Fast forward to today, and the market seems more sanguine about DeepSeek. The US tech companies have reconfirmed that they'll be spending hundreds of billions to continue to develop AI models.

Pearce doesn't say whether this is prudent or not, but is bullish on AI's implications for business, as "cheaper technology is the single best way for businesses to improve their productivity."

He suggests that while AI's benefits are overstated in the short term, they're understated in the long term.

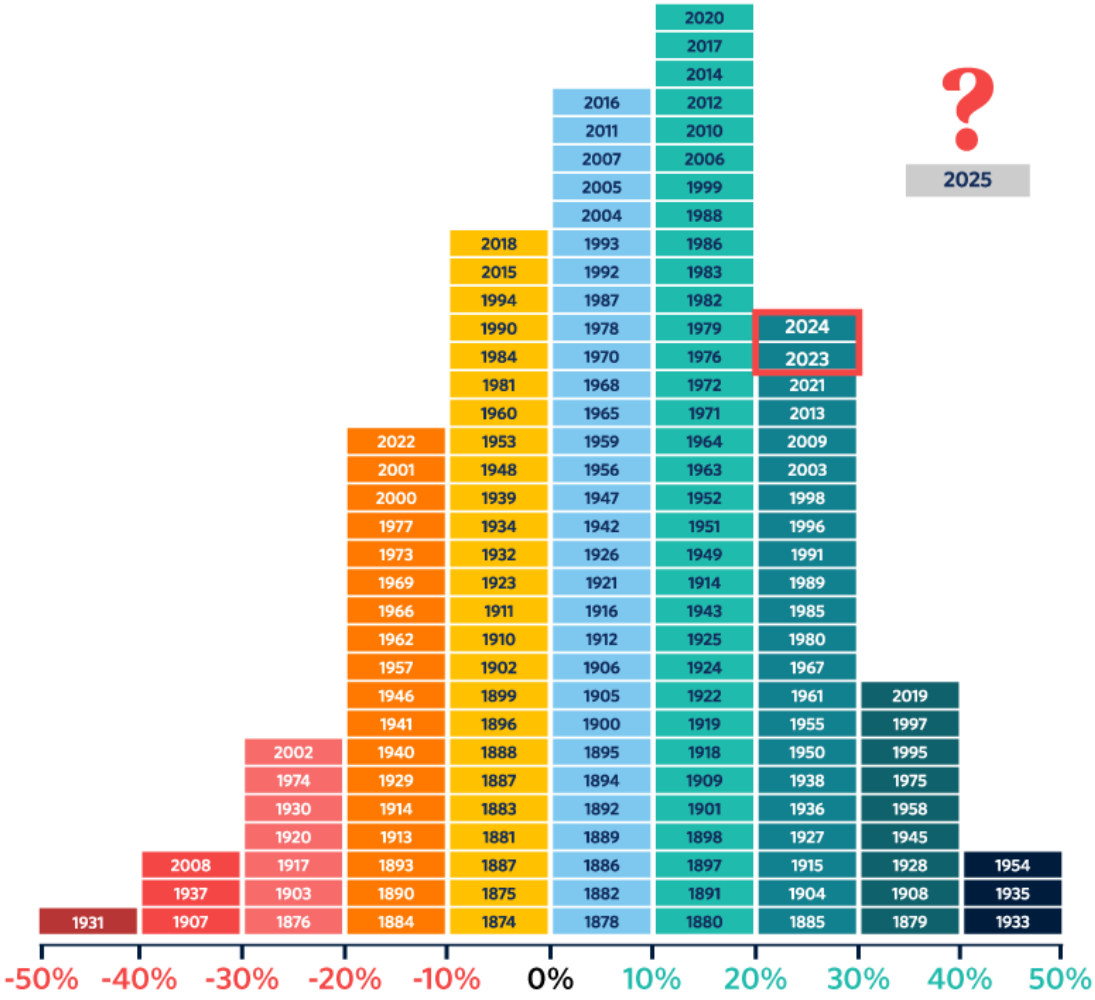
Turning to Trump, Pearce says he was elected to move fast and break things, and that's exactly what he's doing. Despite a flurry of daily announcements, the key one that Pearce is keeping an eye on is tariffs. He says that if it ends in a trade war, "it is going to be bad for the economy, bad for business, and bad for share markets." Pearce hopes that cooler heads prevail on the issue.

The crystal ball for 2025

To this year and Pearce jokingly says that the year of the snake has not been auspicious for markets in the past. On the other hand, the fifth year of each decade has produced the best returns through history.

More seriously, he notes that two years in a row of +20% returns for the S&P 500 is rare, and a third year of such returns is rarer still.

Figure 2: 151 years of S&P500 returns

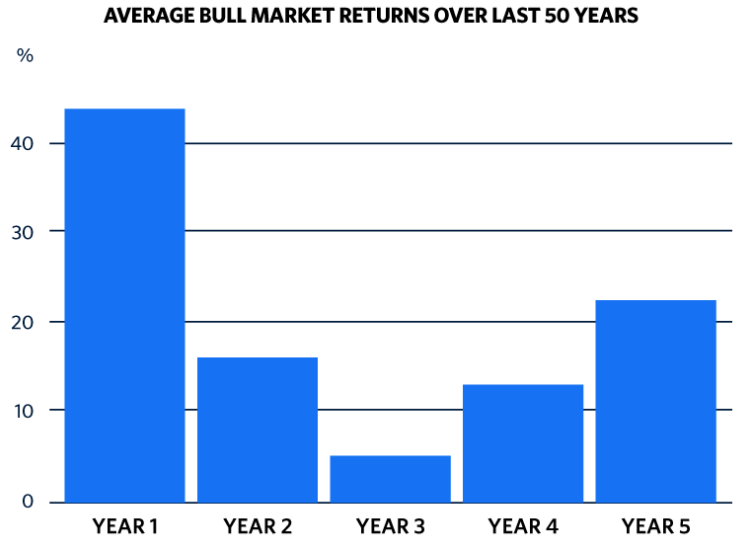


Source: Global Forecast Series, Unisuper

In fact, three consecutive years of +20% returns have happened just once – when the US economy was recovering from a deep recession in the 1990s.

Pearce says that the third year of bull markets have historically delivered subdued returns, and he predicts a flat year for stocks in 2025.

Figure 3: Bull market third-year returns have been the lowest



Source: BMO Capital Markets Investment Strategy Group, Factset, Unisuper

He believes markets are expensive without being in bubble territory. The US market is at about a 20% premium on a price-to-earnings ratio basis. Meanwhile, Australia is at a 10% premium.

Where he does see some irrational exuberance is in cryptocurrency. He points out that Dogecoin, now valued at US$40 billion, was set up as a joke by its founders.

He views the broader crypto market as a joke gone too far, and "our members' life savings will not be going anywhere near cryptocurrency investments."

Figure 4: Cryptocurrencies' irrational exuberance

MEME COIN	TOTAL MARKET VALUE
Dogecoin	$39.07 Billion
Trump	$3.74 Billion
Melania	$731 Million
Pudgy Penguins	$685 Million
Fartcoin	$469 Million

As of 7 February 2025. Source: UniSuper

Pearce says that while he expects a flat year, he won't discount the possibility of a correction in markets of 10% or more. However, he invests for the long term, and on this basis, he remains optimistic given the growth in the global economy, subdued inflation, strong employment, and the tech revolution:

"… if we do get that correction, UniSuper will be using it as a buying opportunity. We've got plenty of cash, and we intend to load up on assets when the price is right."

** You can read John Pearce's full investment update here.*
*** Disclosure: UniSuper is a Firstlinks sponsor.*

James Gruber is Editor of Firstlinks.

9 ways to fix Australia's housing crisis

John Abernethy

It is my view that Australia's rising house prices, which have persistently compounded at a faster rate than either average wages or average household income, are a measure of *'economic excess'* - not *'economic success'.* The unaffordability of housing is the result of decades of appalling failure in public policy.

Governments, Treasury and the Reserve Bank never dare to measure their economic management success on the creation and maintenance of affordable housing for the majority of average income earning households. Today, none of the entities charged with directing our economy have enunciated a strategy to deliver this important public policy goal for Australia.

Rather, all seem focused on strategies designed to drive household wealth higher through the compounding of residential property prices, with little consideration of the burden it creates for either young households or for future generations.

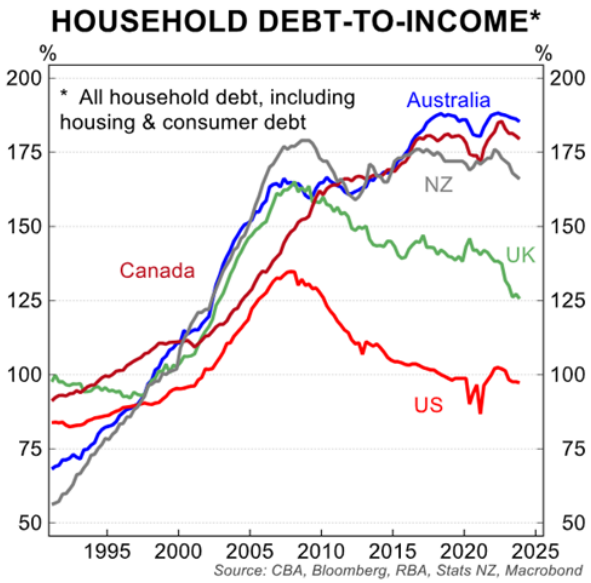
The problem with runaway prices

Unfortunately, as time transpires, and as wage growth consistently trails below house price appreciation, unaffordability will increase and expand across society. This will result in the creation of an underclass, populated by those that will struggle throughout their life to own a home. This will occur in a society that today boasts one of the highest standards of living in the world.

Note: Over the last 27 years, wages have risen by 127.5%, while housing prices have risen by a total of 483%.

The above chart compares the compounded growth in house prices to that of wages. It is a confronting picture that should have concerned successive governments in the periods prior to the GFC, prior to Covid and particularly now in the post Covid period. The 27-year period shows a growing gap between the rise in house prices and wages. It shows why today's Australian house prices have come to trade at historic multiples of household income.

The next chart (right) shows that growth in house prices is substantially correlated to the growth in household debt. Australia now has the world's highest household debt to income amongst our peers and it has amongst the highest residential property prices.



It is a peculiar measure of 'economic success' when the owners of residential property – occupiers and investors – can consistently generate paper wealth through compounding capital gains. The excessiveness of that wealth is measured by the mortgage stress confronting residential property buyers who are driven into debt by their fear of missing out.

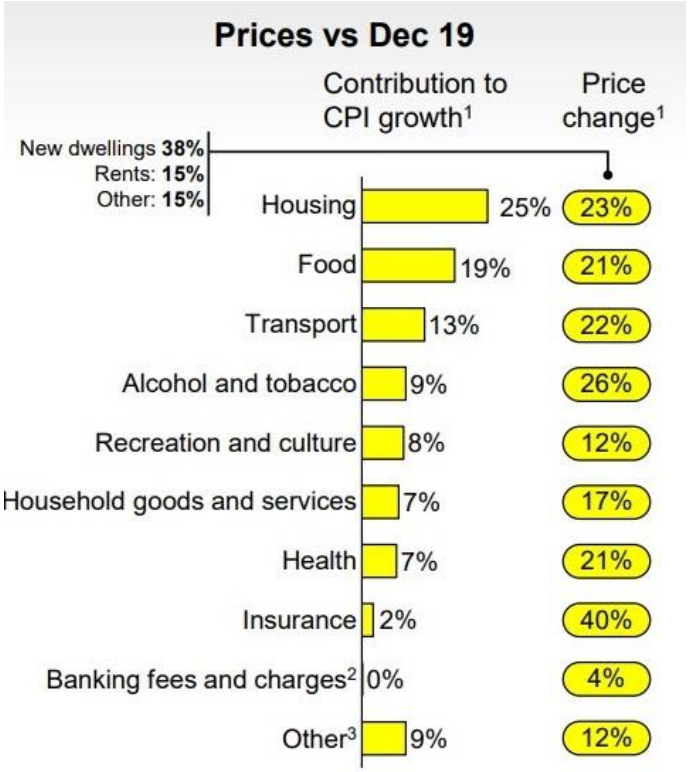
Over the last 27 years, Australian house prices have also compounded at a faster rate than consumer prices. Meanwhile, wages have grown faster than the generally accepted measures of consumer price inflation.

However, the measure of inflation does not truly reflect the surge in the average price of dwellings (the entry price) which is weighted to mortgage servicing costs, rents and maintenance. Inflation measurements, particularly related to housing costs, do not capture the true cost stress confronting families. Clearly, the cost of living for a young family is far different to that of a mature retiree. A bland CPI cannot capture this.

To quote the ABS on its measurement of inflation:

"The CPI is designed as a measure of inflation experienced by households, rather than a measure of the cost of living … Housing is a significant component in the CPI contributing over 22% of the weight of the basket. This includes spending on new dwellings, rents, utilities, maintenance and repair of dwelling and property rates."

With the compounding of housing prices, the cost of housing and therefore living, has and will continue to rise dramatically for each successive new entrant into the housing market. Therefore, as housing becomes increasingly unaffordable, it is near impossible for statisticians to truly measure the cost of housing, either inside an inflation reading or in a cost-of-living index.



Source: CBA FY24 Results Presentation

Young families are increasingly confronted by a rising housing market and there is evidence that they are adjusting their life choices accordingly. The starkest adjustment has been the decline in the birth rate. Offsetting this has been the decisions by Government and bureaucracy to increase immigration. These decisions have ensured that excessive demand is sustained for housing. This is just one example of the growing divide between political necessity and sensible public policy settings. It exemplifies why a national bipartisan housing policy needs to be urgently created to deflate the housing bubble that has been created.

Political incumbents have bathed in the creation, adoption and support of policies that have driven house prices higher. Their focus is towards those that will support them into Government. There are more debt free house owners than mortgaged owners. Rising house prices are positive for owners and will attract their votes. Governments struggle to contemplate or espouse housing policies that may upset this wealth bucket – even if it is for long term benefit and sustainability of society.

The failure to develop policies to address housing affordability and the cost of living, has resulted in a voting shift away from the major governing parties. Minority governments, driven by populism rather than pragmatism, could develop.

There is an overwhelming need to develop a bipartisan national policy for ensuring stable and sustained housing affordability. The following are my thoughts and suggestions to start the process.

How to rebalance our housing market

So, what can be done to stem house price rises and to rebalance the housing to income ratio? How to develop a viable rental market where rents are not driven by excessive leverage?

Australia needs an agreed national housing policy set with a bipartisan approach. A policy that targets agreed outcomes. The affordability of housing, based on sustainable multiples of average income, should be set. The policy needs to address the rental market to make it sustainable for low-income earners over the long term.

Housing policy needs to develop from a proper review and with inputs coming from across society. It cannot be limited or directed by political or bureaucratic thought bubbles.

It first needs an admission that our housing policy has been wrong for many years. It needs an acknowledgement that rectification with be costly and painful.

We need to accept that the housing price bubble needs to be deflated by a managed policy rather than a future market implosion.

My suggestions are broad ranging. Some have already been canvassed in debates, some have already been mildly adopted, whilst some are radical and controversial. All are designed to check housing prices and create a sustainable rental market for low-income earners.

1. Remove lenders mortgage insurance. Banks use this policy to increase the loan-to-value (LVR) for borrowing but insure their risk not the borrowers. Higher LVR's allow higher gearing, which drives further heat into the market. If lenders are willing to take higher LVR risk, then they can put up the capital to do so.
2. Restrict foreign - non-resident – ownership. Now belatedly adopted by the Government from 1 April.
3. Slow immigration consistent with rebalancing housing market demand and drive immigrated skills towards the supply of housing.
4. Agree a national housing building target allocated across the states with penalties (less GST) for non-performance. Local Government and State Governments need to urgently review planning rules. The majority of demand is unmet in areas with appropriate public transport and other infrastructure. Artificially suppressing density drives families into more remote locations which results in higher transport and living costs.
5. Target low income and income support housing developments. Create Public/Private 'build to rent' infrastructure bonds. Government guarantees will be important to create a stable secondary market for these bonds.
6. Support private builders developing mid-range housing. Create a regulated environment for partnerships with superannuation funds incentivised to provide funding (debt/equity) to approved/registered builders. Severely restrict the existence of private builders with thin capital.
7. Consider tax changes inside a proper reset of taxation laws. For instance, should rent (paid) be tax deductible for certain people in certain income bands? Should negative gearing be limited to the income of the underlying asset? Can housing infrastructure bonds be created to channel savings towards appropriate borrowers inside a restructured tax system?
8. Accept that house prices need to decline for a period (painful) with the Government to take over existing loans from banks that do not meet regulated debt ratios, so that the financial system can adjust without depleting bank capital. A once off opportunity setting a point from which banks will be penalized for future excessive lending.
9. Review occupancy laws. One of the contributing factors to housing shortages has been the reduction in people per household, usually divorced families have two houses not one. Planning provisions that prohibit co-living and better use of existing houses constrain supply.

I suspect that there will be many counters and/or responses to the above.

I also expect howls of criticism and that is fine if it is done inside a discussion aimed at achieving an outcome.

Let's get a policy restructuring started with all thoughts heard and considered. Further, let's accept that it is a policy set for an outcome that will be costly, and which may take a decade to bear fruits. Long-term planning is not an obstacle if a bipartisan approach is taken. The AUKUS agreement is a prime example of an agreed long-term policy – and we are risking hundreds of billions of investment capital, with an uncertain timeline and result. Surely a National Housing Policy would be so much easier to develop.

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

Australia: why the chase for even higher dividend yields?

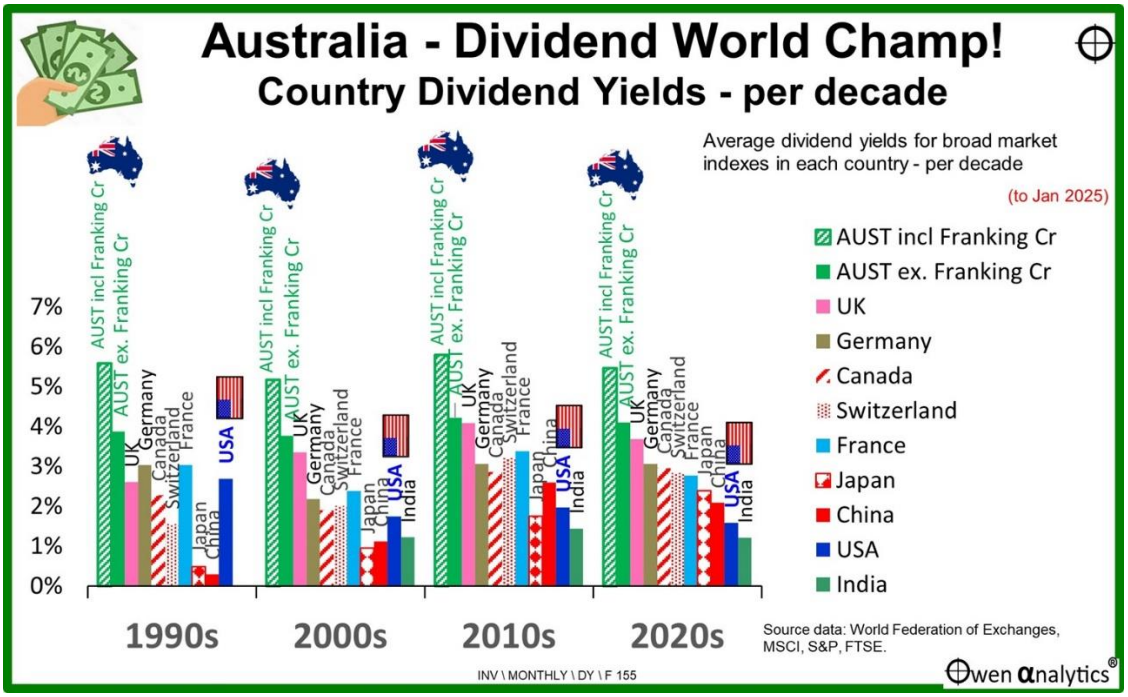
Ashley Owen

For the past 20 years, one of the most common questions I have received from Aussie retirees, their advisers, and 'FIRE' warriors living off their long-term 'passive income' portfolios is: 'How can we get more income from our investments?'

This obsession with boosting portfolio income has always struck me as a little strange because Australia has, for many decades, had the highest dividend paying share market in the world by far. Aussie investors are living in the best country in the world for dividend yields. And that's BEFORE franking credits! When you add franking credits on top of the already very high cash dividend yields, our overall dividend yields (especially for tax-free retirees) are twice what they are in other major markets around the world.

(There are, of course, always some tiny markets that have higher dividend yields from time to time for a variety of reasons – eg Kenya, Nigeria, Jordan, Kazakhstan, Bosnia & Herzegovina, Slovenia, Serbia, Lithuania at the moment.)

Today's chart shows average dividend yields from the Australian share market (ASX200) versus other major global share markets for the past four decades. For Australia we have two types of dividend yields - the cash yield (as in other countries), and also the 'grossed-up' yield including franking credits (this is the yield for tax-free retirees).



For more on franking credits, how they work, and how much value they add, see "'Frankly my dear...we need to include Franking Credits in reporting and portfolio planning'.

Even in the Covid years like 2021 when bank deposits were paying zero interest, and companies were cutting or cancelling dividends, the overall ASX market still paid a cash dividend yield of 3.7%, or 5% including franking credits. Then it jumped back up in 2022 to 4.5% cash yield (6.1% gross yield), then 5.8% gross yield in 2023, and then 5.2% gross yield in 2024.

Who would want more than that?

Envy of the world

American retirees generally use 2% as their mental benchmark for share portfolio yields, because dividend yields on the US share market have averaged around 2% for decades. (see table at the end of this story for all the numbers). 2% yields are 'normal' for Americans, and they are accustomed to thinking about a 2% yield for spending and aiming to leave the portfolio intact to grow. (Actually, US yields are just 1.3% in the current tech bubble.)

When I tell them Aussie investors complain about 4% yields from the Aussie share market, they respond with something like, "Wow, I could live off 2% and re-invest the rest for future growth!", or "What do they do with all that extra cash?"

Portfolio heaven

Long-term retirement portfolios designed to fund inflation-indexed living expenses for decades, need to consist mainly of assets that offer inflation protection plus some real growth ahead of inflation. Typically, they have a total return target of 'CPI+4%', and this generally means mostly shares (plus perhaps some other 'growth' assets like commercial property).

(Why 'CPI+4%' target returns? So you can withdraw 4% of the balance each year, with withdrawals rising with inflation to maintain your living standard, and the balance after withdrawals also at least keeping pace with inflation. Why 4%? Because that has been found to provide a high degree of confidence you will never run out of money, or at least not for a couple of decades or so.)

A typical CPI+4% portfolio translates into a 25-times 'multiple' of your spending budget (1/25 = 4%) and this 25 times multiple is the standard starting point for 'How much do we need?' discussions when planning for retirement (or should be anyway). For example, if your spending budget is $100,000 pa, you would need $2.5 million if you are looking for financial freedom, not welfare dependence. (But that's another story for another day!)

Australia's Superannuation system is conceptually based on this '25-times multiple of spending' idea. The 'minimum withdrawal' rules for Super accounts in 'Pension' phase start with a minimum withdrawal rate of 4% (for retirees below age 65). This 4% withdrawal rate = 25 times multiple of spending budget.

In every other country but Australia, dividend yields are well below 4%, so retirees generally need to sell down some of their shares each year to fund their 4% withdrawals (for a standard 25-times portfolio).

But not here! Australia is the only country in the world where the dividend yield on the broad share market is almost always HIGHER than the 4% withdrawal rate! To quote a raw onion eating former PM – 'How good is that!'

It means a typical retiree portfolio invested mainly in broad ASX funds/ETFs, or in a wide spread of direct shares, can just live off the dividends without even thinking about selling shares.

Avoid the 'big switch' into bonds!

Portfolio management textbooks (all US based) are obsessed with people making the 'big switch' from shares to bonds when they retire in order to increase the portfolio yield to fund retirement living expenses. But in Australia, the share market is already yielding more than necessary to fund the withdrawals, and also usually higher than the running yield on bonds, so there is need for the 'big switch' into bonds!

(Also, bonds have no inflation protection, no growth, and make very poor long-term investments with the return of inflation).

No sequencing risk or volatility worries

Another plus for Aussies is that the dreaded 'Sequencing Risk' also largely disappears! 'Sequencing risk' is the risk of having to sell shares at low prices in a bust, to fund regular withdrawals. Because yields usually exceed withdrawals, there is rarely a need to sell shares just to fund regular living expenses, as the rest of the world has to do.

When you do want to sell some of the portfolio to free up capital for some specific purpose (eg to help the kids buy a house, or go on a big trip, etc), you can usually choose your own timing – not be forced to sell when prices are low in a bust.

High dividend yields deliver all of these benefits to Aussies - it is unique in the world!

Diversified portfolios

Most diversified retiree portfolios have global shares alongside their Aussie share allocation (plus also some bonds – refer above!), and these do reduce the overall portfolio yield. However, I still find a large proportion of Aussie retirees have a (rather unhealthy) fondness for old favourites like the big bank banks, miners, Telstra, Woollies, etc – all of which pay dividends even HIGHER than the overall market average yield.

A typical long term diversified portfolio of say: 40% Aussie shares (5.3% grossed-up yield currently) + 40% global shares (2% yield) + 20% government/corporate bonds (say 4.5% yield) will be paying an overall portfolio yield of just under 4%, which is about double what US retirees get on their US-oriented portfolios.

The underlying problem

So, back to the question of why so many Aussie retirees are always asking how to increase their (already world beating) yields on their share portfolios?

Even with the broad Aussie share market routinely yielding 4%+ (or 5%+ with franking credits), many Aussies still can't resist the temptation to chase even higher yields. Many are lured into all sorts of things like - 'covered-call' option schemes, high-risk mortgage funds, opaque structured 'private credit' funds stacked full of risky property construction loans, black-box trading schemes, and straight-out frauds dressed up as 'safe' high-yield investments.

I put their endless search for higher yields down to poor management of expectations at the outset. It's all about planning, understanding markets, and communication.

Every retirement planning tool and calculator I have seen has fundamental problems. That includes retirement planners and calculators provided by government departments (eg moneysmart), industry groups like the Association of Superannuation Funds of Australia (ASFA), every industry fund (eg. Australian Super, HostPlus, etc), as well as investment platforms, financial planning firms, and a host of online retirement calculators.

From what I have seen (and I have seen hundreds) they all use very simplistic assumptions about critical variables like inflation, financial market returns, life span, etc. They use nice, neat, straight lines and smooth curves, they assume markets are always fairly priced, and they don't allow room for volatility or changes in conditions, or changes in circumstances.

Even the more complex models use fancy terms like 'stochastic distributions' and 'monte-carlo simulations' which are nonsense because they assume returns are random and 'normally distributed'. In the real world, returns are demonstrably not random nor normally distributed! Never have been – never will be. (Why? Because markets are run by human emotions like fear and greed, not calm, considered, logical reason)

These simplistic retirement models are dangerous and create unrealistic expectations. When things don't follow those nice, neat, straight lines and smooth curves, people lose confidence and start to worry. 'Do we have enough?' 'Will we run out of money?', 'I can't go back to work, I'm 86!', and so on.

Better initial planning over the big questions like - 'How much do we need?', 'What if inflation is higher?', 'What if returns are lower?", 'What if I live to 100?', and so on - would set more realistic expectations and engender greater peace of mind for a long and happy retirement.

I will also leave for another day two very important issues related to high dividend yields –

1. **Why** are Australian company dividend yields much higher than the rest of the world? Spoiler alert – it is NOT the Dividend Imputation (franking credit) scheme – our yields were higher than the US and the rest of the world decades before the introduction of franking credits in 1987.

2. The **downsides** of high dividend yields have been low profit growth (because companies retain very little for further growth) and lower returns on equity.

Here is the data for today's chart:

Country Av. Dividend Yields - per decade

	1990s	2000s	2010s	2020s
AUST ex. Franking Cr	3.9%	3.8%	4.2%	4.1%
AUST incl Franking Cr	5.6%	5.2%	5.8%	5.5%
USA	2.7%	1.7%	2.0%	1.6%
UK	2.6%	3.3%	4.1%	3.7%
Germany	3.0%	2.2%	3.1%	3.1%
France	3.0%	2.4%	3.4%	2.8%
Switzerland	1.6%	2.0%	3.2%	2.8%
Canada	2.3%	1.9%	2.9%	3.0%
Japan	0.5%	1.0%	1.8%	2.4%
India		1.2%	1.4%	1.2%
China	0.3%	1.1%	2.6%	2.1%

Owen αnalytics® Source data: World Federation of Exchanges, MSCI, S&P, FTSE. (data to Jan 2025)

Ashley Owen, CFA is Founder and Principal of OwenAnalytics. Ashley is a well-known Australian market commentator with over 40 years' experience. This article is for general information purposes only and does not consider the circumstances of any individual. You can subscribe to OwenAnalytics Newsletter here. Original article is here: Australia: Highest dividend yields in the world, so why the endless chase for even higher yields?.

MIGA – Make Income Great Again

Andrew Fleming

January 2025 heralded a new year with old themes on the ASX. Very strong absolute returns and the stocks which have benefited most from multiple divergence through 2024, won again. Even large ASX listed companies making strong profits are throwing in the towel on multiples ever again converging; although Dominos provided hope by rallying when announcing the closure of loss-making stores whilst embracing the MIGA strategy – make income great again.

Market review

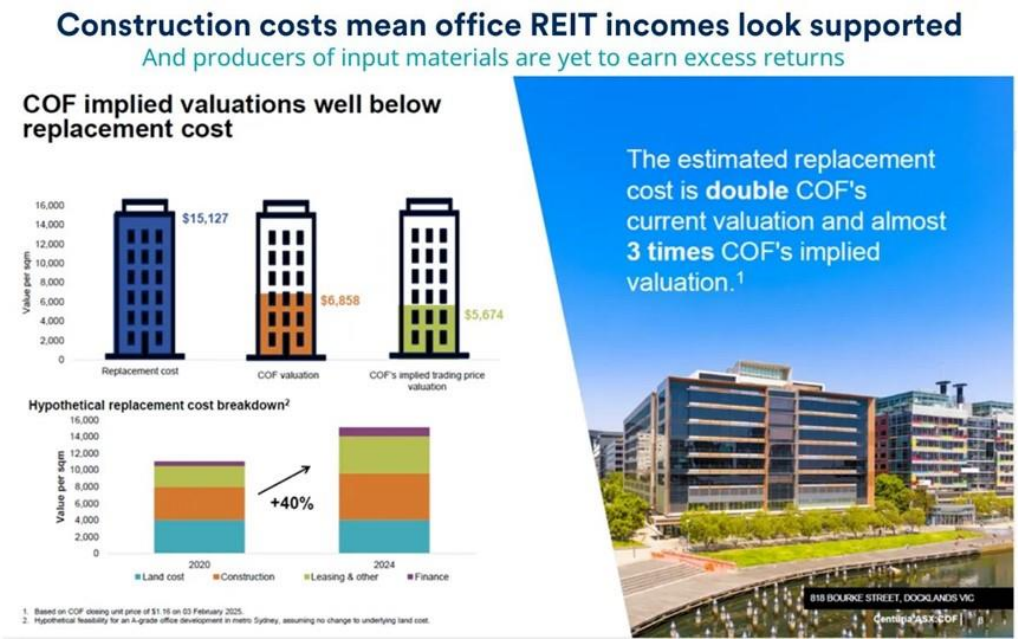
We recently had a visit from a CEO of a major mining company, asking us a range of questions. Much of it was to do with M&A strategy. At one point, he asked to what extent should market prices be relied upon as the 'true' value of the group. The question at one level is easy to answer for an active investor – we have no value proposition if we do not believe that persistent market inefficiencies exist, which are capable of being exploited. In our case, we believe that the basis for that exploitation is that ultimately share prices, whilst in the short term often buoyed or depressed, revert to fair value. At another level, though, the concept of fair value is increasingly being questioned as 'expensive' stocks march ever higher, as again they did in January. Is the whole concept of valuations now redundant in pricing assets?

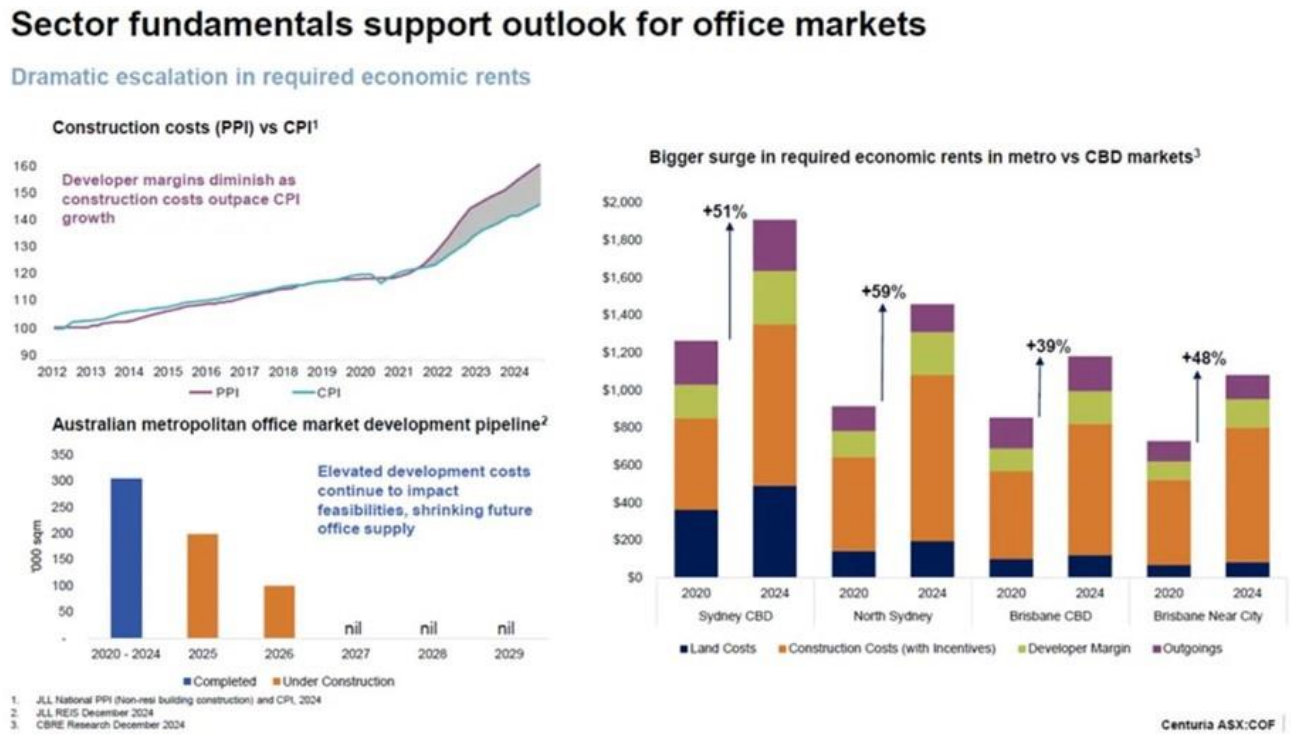
In our view, perhaps unsurprisingly, the answer is no. But, with some important caveats. Generally, management intent is as critical as ever in realising value potential, as highlighted in several examples where that has occurred, is occurring and hopefully will occur. In each case, management intent and action is visible; passively expecting profits to revert to historic norms is clearly unrealistic. Secondly, growth needs to be well defined; ultimately, growth in revenues counts for little if it can't be converted to free cashflow, sustainably. Dominos presents a terrific case study of an ASX listed stock traversing through investor hope and reaching reality, whilst profits remained reasonably stable. The DeepSeek imbroglio also reveals some of the travails often overlooked by the market in assessing the quantum and, more importantly, duration of excess cashflows. Finally, the role of Dirigisme – government interference, sometimes foreseen but often not – in assessing these sustainable free cashflows is as fraught an exercise as it ever has been, with government of all persuasions finding that choices, revealing fiscal winners and losers, need to be made.

A little more than two years ago, Boral recruited Vik Bansal as CEO. Now fully owned by Seven Group, the management intent to decentralise decision making and improve efficiency and effectiveness has seen profits and cashflows improve to the point where Boral is now well on track towards making 15% EBIT margins (and 10%+ returns on assets) after struggling to reach 10% EBIT margins (and 5% RoA) in any year through the prior decade. This followed the precedent in restoring sustained profitability to Australian manufacturing companies set by Paul O'Malley at Bluescope a decade ago, an ethos that has been followed by his successor Mark Vasella. The pain Bluescope went through in restructuring the business to provide it with a base from which to make even better returns than Boral has been well documented, but with recent growth in the domestic cost base the risk is that, to some extent, the lessons are being lost with time. In contrast, Australia's only makers of double-glazed glass, Oceania Glass (formerly Viridian), went into administration several days ago, citing energy and wage inflation, and dumped product from China (and delays in the imposition of tariffs by the Anti-Dumping Commission) as causing its demise.

All three products are essential inputs into 'growth' sectors. There can be no increased uptake of data without data centres, and no new data centres will be built without concrete, steel and glass. It is impossible for the former to have record high (and increasing) margins with long duration, and for the former sectors to have secularly pressured profits, let alone be insolvent. This is especially so, as is the case with concrete, where there are legitimate logistical barriers to imports; cement which is subject to moisture in transit tends to be of little use to any end buyer. Pricing reflecting next best alternative as a substitute material, together with a splash of management intent in looking to differentiate product and service and price for value, has seen shareholders in Boral (and now Seven Group) reap rewards through the past three years, and Bluescope for the past ten. Other concrete producers listed on the ASX haven't yet got the memo.

Apart from being essential inputs into data centres, all three products are also required to construct a new office tower. As Centuria Office REIT highlighted in their results presentation, office assets are now trading at circa half replacement cost given the increase in materials costs in recent years; and yet still trade below book value. Unsurprisingly, no supply is slated in the Australian metropolitan market for the next several years.





Source: COF Results Presentation HY25

The market value in Dominos, having dropped 80% from the heady highs in the middle of lockdowns several years ago, when growth in unprofitable locations was seen as presaging future riches, responded to a strategy pivot; make income great again. The share price rose 20% the day announced a MIGA strategy, i.e. curtail loss making activities. These same loss-making activities were seen as the engine for growth by investors but four years ago, when the Dominos multiple rose to 75 times when EBIT was $270 million. For context, the group is now forecast to make EBIT next year of $250 million; the $12 billion fall in value through recent years was a response to less than a 10% fall in earnings. Several ASX listed stocks which currently make operating losses but enjoy market favour on the promise of future riches from those same activities may do well to examine the Dominos case study. This examination could also be undertaken by the currently brow beaten mining CEO. Perceptions of growth prospects can and do change materially, and quickly; far more quickly than profits themselves can usually change.

The hard and sustainable route to changing perceptions of future profits and cashflows – as reflected in the Bluescope, Boral and Dominos examples – are currently in nascent form in some other companies and industries in our portfolio. Both Orica and Incitec are in a position where the returns on their assets are low, especially on a replacement cost basis for their domestic assets, and yet there is little likelihood of new capacity being added; just as is graphically depicted in the Centuria REIT chart for Office property. Especially in the case of Incitec, new management have expressed a strong intent to improve returns. We expect the same to come from some other holdings across different industries we have, for example Ramsay Health Care, Seek and Woolworths. In each case, returns have suffered after prolonged periods of malinvestment earning poor returns, and in each case management have every incentive to improve that paradigm.

The best thing the Australian banking sector has done for itself in a global era of dirigisme has been to avoid the scourge of dirigisme, or increased government regulation. It was Brad Banducci, not Peter King (or any of Mr King's banking peers), in Canberra arguing whether return on equity or return on funds employed (or even assets for a bank) is the right metric for outsiders to focus upon as a proxy for whether or not the company / sector is making excess profits. In turn, the ever-sensible Matt Comyn, CEO of CBA and hence the bank with the most to lose from any potential emergence of dirigisme in the Australian banking sector, quickly reversed course when CBA flagged the prospect of a $3 fee for a branch withdrawal, for only one account held by only 1m customers, only 10% of whom undertake branch withdrawals. Mr Comyn publicly revealed he was unaware of the proposal until it was revealed in the press the following day. The proposed fee was quashed with three hours and CBA publicly apologised. A fee potentially raising circa $500,000 per annum was not going to be allowed to derail a $270 billion market capitalisation, for a bank trading four standard deviations expensive.

Mistakes will always happen, but this was a great example by a large company in quickly rectifying it in order to avoid any unintended political scrutiny and, potentially, worse. This level of self-help has been absent from some of CBA's competitors in recent years, most notably ANZ, and the sector will be put to the test again this year with the mooted sale of HSBC's Australian banking business, which is only sure to bring with it to the buyer an envelope headed 'Buyers curse'. That envelope will come no matter the price paid for the asset, given the poor history of in market mergers in the Australian banking market. The banking sector remains our biggest underweight. This has been painful as the sector has aggressively outperformed, led by the banks with the highest multiples, and despite pressures in small business solvency there is little yet in the way of credit losses stymying profits.

Execution takes many forms but having a sustained congruence of purpose and an intent in skilling those entrusted in bringing that purpose to a commercial outcome cannot be understated. For example, the establishment of the Denison Miller Academy, named after CBA's first CEO, saw younger CBA executives trained by globally renowned strategy and leadership Professors in Sydney, using CBA case studies. It has spawned much executive talent not just for CBA, but also its competitors. Several years ago, one major competitor recruited a head of Retail banking, head of Institutional banking and a head of IT, all from CBA, within a year of a different person being appointed to those positions within CBA. As is almost always the case with lateral hires, the (corporate) body rejected the transplant; CBA continued to outperform. Cultural change is hard, which is another reason why valuations can only be realised when accompanied by management intent; rarely will mean reversion in itself be enough to change the market performance of a company subject to persistent poor operational and capital allocation decisions.

Equally, on the other side of the equation, and was evinced during the month with the rise and fall of the perception of DeepSeek as a disruptive force in all things AI related, to maintain high returns for long competitive advantage periods is just as hard. Indeed, all of the CEO's of the major US IT companies have reinforced the themes illustrated by the ASX listed old world examples we have touched on in this commentary, when assessing the impact of DeepSeek on their own business through the past several weeks. As Jeff Bezos put it many years ago "Your margin is my opportunity"; in turn, Satya Nadella of Microsoft spoke to the lesson of DeepSeek being that AI is going to be "commoditised" on the back of competition. On the Meta earnings call, Mark Zuckerberg played the Dirigisme card; "there's going to be an open-source standard globally … and I think for kind of own national advantage, it's important that it's an American standard". The Google CEO, Sundar Pichai, spoke to the importance of being the lowest cost producer: "… A lot of it is our strength of full stack development and our obsession with cost per query. I think part of the reason we are so excited about the AI opportunity is because the cost of using it is going to keep coming down, which will make more use cases feasible".

Ultimately, as Bluescope, Boral, and Dominos evince; and Incitec, Ramsay, Seek and Woolworths hopefully will, growth only matters if it is realised in cashflows. The market may frolic with expectations of future growth for some time, but few examples exist where that is sustained, in any industry, over time. Even with AI, taken at

their word through the past several weeks, the CEO's of the major Tech companies in the world agree their industry will likely be subject to the same forces, where capitalism sees excess returns competed for. Markets are always seeking the potential for those excess returns to a greater extent and for a longer period of time than has been experienced before, and the current lust for this paradigm is as great as it has ever been. Which is why multiple divergence is as great as it has ever been. Unlike the Mining company CEO, and the more favoured ASX cousins currently enjoying the favour attached to anything AI related, we suspect the wrong thing to do would be to assume that the equivalent of Dominos at 75 times earnings is a perpetual state.

Market outlook

At a risk-free rate of 4% or more, most assets are currently expensive, unless they can produce sufficient real growth to grow into stretched multiples, which has always proven hard to sustainably achieve and hence is a scarce asset which should be prized. All the more so after an extended period of rerating, the market clearly does this; the question is whether it is being appropriately priced, in the absence of corporate magic. For businesses with large investment requirements and/or labour forces, the emergence of inflation has only made the attainment of real growth even harder, and few have proven up to the challenge. Consequently, our portfolio remains more focused on capital preservation than capital appreciation. The best prospects for capital preservation are unlikely to be the stocks and sectors which have benefited most from aggressive recent reratings, especially if earnings growth continues to be deferred, as in the case of the financials sector. Increasingly, founders/insiders/large shareholders appear to agree with us, as large stakes are sold in some of the best market performers. It would appear they agree with the CEO's of the magnificent 7; to assume excess returns for an extended period, especially in the face of significant capital being applied to the sector, is heroic. Far more likely through the passage of time is that investors' hopes prove to be mostly mislaid, and that ultimately productivity growth needs to be achieved for high ratings to be sustained.

*Andrew Fleming is Deputy Head of Australian Equities at Schroders, a sponsor of Firstlinks. This document is issued by Schroder Investment Management Australia Limited (ABN 22 000 443 274, AFSL 226473) (**Schroders**). This document does not contain and should not be taken as containing any financial product advice or financial product recommendations. It does not take into consideration your objectives, financial situation or needs.*

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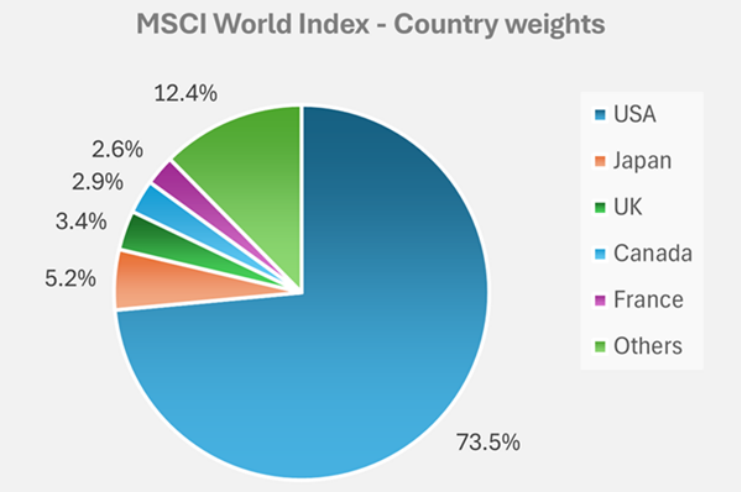
Mapping future US market returns

Eric Marais

Over the last 15 years, the US stockmarket has come to dominate global passive portfolios, with its weight in the MSCI World Index rising from below 50% to nearly 75%. That ascent was driven by exceptional returns. Since 2010, the S&P 500 has returned 13.8% per annum—much higher than markets elsewhere, exceptionally high versus its own history and inflation, and a near-record result against bonds and cash.



Source: MSCI.com, as of 31 December 2024.

Charts showing the S&P's staggering performance are easy to find, often with the implicit message that what goes up must come down. That's both unsatisfying and not how markets work.

The key drivers for US outperformance

It's more useful to understand what drove those returns, and what investors need to believe to expect similar returns again. As we've written before, equity returns come from just three sources: fundamental growth, change in valuation, and dividends. We can get a slightly clearer picture here by splitting fundamental growth into sales growth and change in margins. So where did the S&P's 13.8% p.a. come from?

The first driver was sales growth. American companies grew their sales by 5.2% p.a.—a little low versus history, but then so was inflation. To see what happened to earnings, we need to look at margins. In 2010 net profit margins were 9%. Over the following years, margins expanded dramatically, to about 13%. Margins going up boosted returns to the tune of 2.5% p.a.

Putting sales and margins together gives us earnings. To get price, the next piece is the price-earnings ratio. In 2010 the S&P traded at 15 times trailing earnings. Valuations have since got much more expensive, and the US market now trades at 25 times earnings. Rising valuations kicked in 3.6% p.a. to the S&P's stellar return. The last piece is dividends, which contributed 1.9% p.a.

Scenarios for future returns

Now, let's say we want to re-run history. What do we have to believe to expect 13.8% p.a. again?

Sales growth and dividends are reasonably stable, so let's say they contribute at the same rate as the past cycle. That leaves changes in margins and changes in valuations.

For margin expansion to boost returns by 2.5% p.a. *again*, margins need to go up *again*, from today's much higher starting point. Margins are cyclical, and they are currently near record highs. Doing the numbers, a boost of 2.5% p.a. would require net profit margins at 18% by 2040—higher than the US has ever seen.

Similarly, for rising valuations to boost returns by 3.6% p.a. *again*, valuations need to go up *again*, from today's much more expensive levels. At 25 times trailing earnings, the S&P's current valuation has only been eclipsed at the top of the tech and Covid bubbles. To expect another 3.6% p.a. boost to returns, valuations need to end up at 40 times earnings. Again, this would be a record by some distance.

Putting it together, roughly half of the S&P's tremendous recent returns came from rising margins and valuations. If we want a re-run, we have to expect net margins to reach 18% and valuations to hit 40 times earnings. Crazier things have happened, but it's tough to make the numbers work.

What if margins and valuations don't help, but don't hurt either? If both stay at their current near-record levels, that would leave sales growth and dividends to drive returns. Sales and dividends chugging along would suggest returns of 7.2% p.a. That's normal over the very long term, but it's roughly half what we saw over the latest period. And that's if valuations and margins stay very, very high.

What if they fall to 20-year-average levels? That captures the period since Google's listing where highly profitable, highly valued tech businesses have been ascendant. If margins and valuations fall, the numbers suggest a 3.4% p.a. long-term return for the S&P—less than the yield on US Treasury bonds. Said another way, the broad US stockmarket is dependent on great expectations. Great expectations are already in the price, so to expect a great return, investors need to believe that reality will prove even more amazing than markets already expect.

A few things could help there. Sales growth has often been higher historically. Companies are the ones raising prices, so they can usually more or less capture inflation through sales growth. Higher sales growth from inflation would boost the S&P's absolute return, but not its real return.

Margins could continue to climb. A corporate tax cut helped before and could again. But strategies to reduce corporate taxes also reduce the benefit of any corporate tax cuts. Huge and hugely profitable companies could continue to thrive, pulling up the average margin for the market. But society does not suffer ever-rising profit margins forever. Monopoly-like margins attract competition and regulation, politicians dislike rival power centres, and workers dislike prices and profits growing faster than wages.

Expectations in the US are high, and when expectations are high, so is risk. Fortunately, low expectations are easier to find pretty much everywhere else. Stocks outside the US are cheaper, whether you weight them

equally, by size, or look just at the 'value' or mid-sized companies. The US is not fruitless—some of our highest-conviction holdings are American companies. But generally we've found other markets to be more fruitful hunting grounds for undervalued ideas. We are far happier seeking low expectations.

Eric Marais is an Investment Specialist at Orbis Investments, a sponsor of Firstlinks. This article contains general information at a point in time and not personal financial or investment advice. It should not be used as a guide to invest or trade and does not take into account the specific investment objectives or financial situation of any particular person. The Orbis Funds may take a different view depending on facts and circumstances.

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Read this before you go all in on US equities

Tarek Abou Zeid and others

US equities rule global markets, but history is littered with examples of markets that seemed invincible — until they weren't.

Forecasting market returns is a fool's errand, as history has repeatedly shown. Few predicted the 2023 AI-fuelled US tech rally after a bruising 2022, or the sharp bond selloff caused by stubborn inflation. There's only one certainty: markets remain unpredictable. It's a feature, not a bug.

For the past decade, US equities have been the undisputed stars, delivering an extraordinary run. The S&P 500, powered by the FAANG/Magnificent Seven stocks[1], has vastly outperformed the majority of its global peers, giving rise to the US exceptionalism narrative.

But no market dominates forever. Japan ruled the 1980s, emerging markets were the darlings of the 2000s, and even Europe has had its moments in the sun. The US, while formidable, is not immune to weak performance.

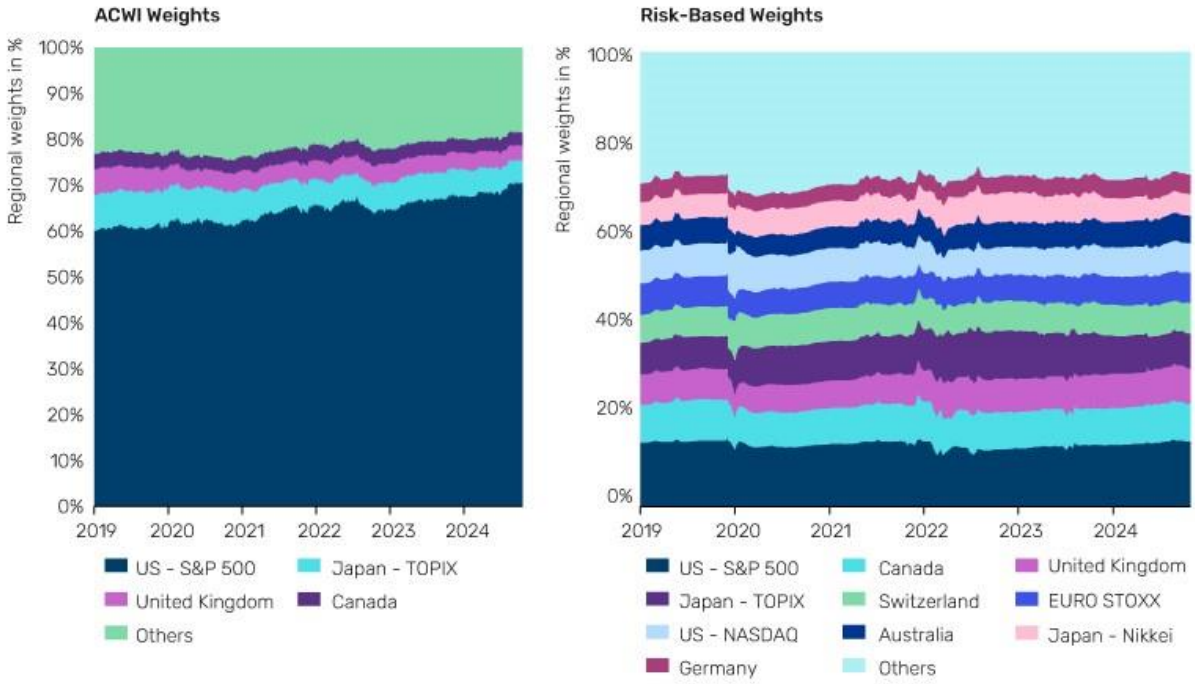
This raises a critical question for investors: should you go 'all in' on US equities, riding the momentum of their recent strength, or should you consider a more diversified approach? After all, the smart money forecasts risks, not returns.

Diversification isn't always as it seems

The conventional response is to allocate to global equities, such as the MSCI All Country World Index (ACWI), which spreads exposure across regions but remains heavily skewed towards US equities. That means a downturn in the US — whether sparked by rising interest rates, US President Donald Trump's policies, Chinese AI developments, or any other unknown — can still leave your portfolio vulnerable.

Shifting the focus from returns to risk and constructing a portfolio that allocates based on diversification and risk balancing can produce a more robust solution. As Figure 1 shows, the ACWI concentrates heavily in US equities, while a risk-based approach allocates more evenly across regions such as Europe, Japan, and emerging markets. This ensures portfolios are better diversified and less tethered to the fortunes of one economy.

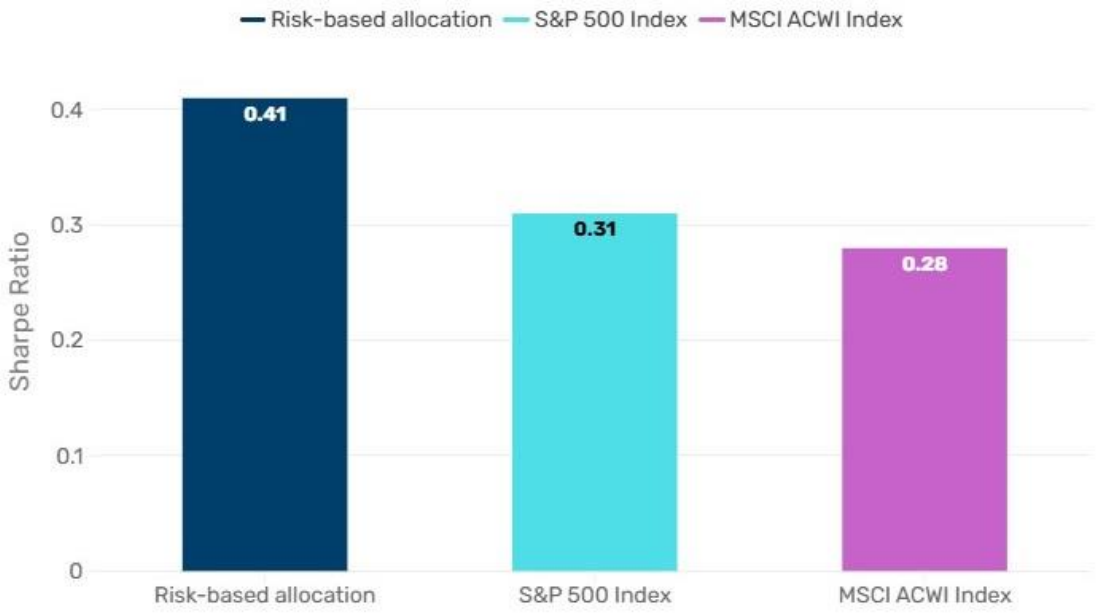
Figure 1. A balanced approach to global diversification



Source: MSCI, Man Group, as at January 2025.

While the S&P 500 has delivered strong returns over the past two decades, a risk-based allocation has delivered better risk-adjusted returns. As Figure 2 shows, a risk-based allocation outperforms both the S&P 500 and the MSCI ACWI Index in terms of Sharpe ratio (i.e., investors are better compensated for every unit of risk they take on). Crucially, this approach doesn't require a crystal ball. It is not about predicting the next big winner but about creating a portfolio that is designed to navigate diverse market conditions without sacrificing upside potential.

Figure 2. Better risk-adjusted returns



Source: Bloomberg, Man Group, as at January 2025.

In equity investing, while risk-adjusted metrics like the Sharpe ratio are valuable, they rarely satisfy investors on their own. In risk-on environments, the focus inevitably shifts to delivering absolute returns — because, as the old adage goes, 'you can't eat Sharpe ratio.'

As Figure 3 highlights, a risk-based allocation strategy not only outpaced the MSCI ACWI but also kept pace with the S&P 500, doing so at a lower volatility — a compelling proposition for investors.

Figure 3. A smoother ride – the returns of a risk-based approach compared with the MSCI ACWI and the S&P 500

Source: Bloomberg, Man Group, as at January 2025.

The allure of US equities is understandable. They have been the stars of the investment world for years, and their track record is hard to ignore. But history is littered with examples of markets that seemed invincible—until they weren't.

So, before you go 'all in' on the US juggernaut, consider whether there's a better way to diversify. Because in investing, as in life, betting everything on one idea is rarely the safest path.

All data Bloomberg unless otherwise stated.
1. FAANG was the original group of tech superstar stocks Facebook (now Meta Platforms, Inc.), Amazon, Apple, Netflix, Google (now Alphabet, Inc.), that morphed into the Magnificent Seven, dropping Netflix, and adding Nvidia, Tesla and Microsoft.

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What impact would scrapping stamp duty have on housing?

Yunho Cho, May Li, Lawrence Uren

Housing affordability is in the spotlight again. This is unsurprising.

Since the beginning of the 21st century, house prices have increased by 165%. Over the same period, the general price level has increased by 71.2% and income per capita has increased by 122%. As a result, housing has become more expensive and purchasing a home has become more difficult for average Australians.

What can improve this situation? In our research, we study the role of stamp duty on housing market outcomes.

The inefficiency of stamp duty

There are two main problems with stamp duty. First, it exacerbates credit constraints by making it more difficult for budget-constrained households to purchase a home.

For these households, who may already struggle to save for the downpayment, the added cost of stamp duty raises the upfront expense of buying property, making homeownership even less attainable. This cost is partly mitigated in some Australian states, with first-time home buyers exempt from stamp duty under some conditions.

Second, stamp duty discourages mobility after a home is purchased. Once households have bought a home, the high cost of stamp duty acts as a disincentive to move, even if their housing needs or preferences change. This creates inefficiencies in the housing market, as people may remain in homes that no longer suit their circumstances to avoid the financial burden of moving.

These problems are becoming more severe over time. To understand why, first, note that stamp duty is a progressive tax; the marginal rate increases with the price of the home.

Furthermore, as house prices have increased, in much of Australia, there has been little change in the stamp duty schedule. The ACT is the only real exception to this rule, where there has been a steady decline in the importance of stamp duty and a shift towards land tax.

Second, there has been a significant increase in house prices in most of Australia. This combination has generated, on average, an increase in the tax burden associated with purchasing a property. This greater tax burden is reflected in a decline in household mobility.

Modelling the welfare cost

We develop an economic model that captures the two primary reasons households may move home. First, they may relocate to a home that offers a different size or quality. This type of move involves a significant shift in price to reflect the change in the home's attributes.

Second, households may move to a home with a similar price but with different characteristics, such as a change in layout, location, or features that better suit their lifestyle or preferences.

These moves often reflect a change in preferences or what we describe as a housing mismatch shock. Over time, a household's needs evolve. Younger, growing families may have the need for more bedrooms. An older household may prefer to downsize and live in a single-storey home. Workers may change jobs, a home closer to their new work location may be preferred.

We use the Household Income and Labour Dynamics in Australia (HILDA) database to study the prevalence of housing mismatch shocks. Using data on the change in the value of homes that a person lives in and their self-professed reasons for moving, we are able to estimate the probability that a housing preference shock occurs. This is a key ingredient that helps our model match the data and turns out to be important for measuring welfare changes.

Using this economic model, we can estimate the effect on key economic variables when stamp duty is removed, Budget balance is maintained by assuming an introduction of either a consumption tax or a recurring property tax.

Overall, we find that removing stamp duty only has a small impact on the homeownership rate. In our different model experiments, we find that removing stamp duty raises the homeownership rate by between 1 – 2 percentage points. The effects on house prices will also be moderate.

This does not mean reforming stamp duty is not worth doing. We find that if stamp duty was to be replaced with either a property tax or a consumption tax, households would be able to move more frequently and this would reduce housing mismatch. As a result, households would be better off in terms of welfare.

For future generations, the preferred policy would be to replace stamp duty with a property tax. The property tax in our model is similar to a land tax and our result aligns with a broad body of literature asserting that land taxes are generally non-distortionary in comparison to other forms of taxation.

Challenges and options

Replacing stamp duty with a property tax may be challenging. Current homeowners who have already paid a large cost upfront in the form of stamp duty would resist the idea of being asked to pay again a recurring property tax.

In our model, the majority of existing homeowners would prefer replacing stamp duty with a consumption tax. Hence, there is an implicit tension between what is good for the economy in the long run versus what is popular in the short run.

With a consumption tax, both homeowners and renters are taxed to recover the lost revenue from eliminating stamp duty. With a property tax, only homeowners bear this burden. Over two-thirds of the population own a home and would prefer the consumption tax.

One option to address homeowners' resistance could be to allow new homebuyers the choice between paying stamp duty or opting for an annual property tax. This approach was implemented briefly by New South Wales (NSW) for first home buyers, but has since closed.

Another approach, as seen in the Australian Capital Territory (ACT), is to gradually phase in a land tax while reducing stamp duty over time. This spreads the impact and allows for a smoother transition to a new tax system.

A final approach would be to provide people who have recently paid stamp duty a tax credit that reduces or eliminates their property tax burden for some time.

Fixing the housing crisis?

Our results confirm some of the previous literature: stamp duty is an inefficient tax. Removing stamp duty and replacing it with an alternative tax system will improve societal welfare.

However, there is a tension. While replacing stamp duty with a property tax provides the best outcome for future generations, replacing stamp duty with a consumption tax will be preferred by current households. It is not a panacea for the housing crisis, as reforming stamp duty will have only a modest effect on house prices and homeownership.

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