Firstlinks
a Morningstar company

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Editorial

Today’s newsletter marks a special occasion for Firstlinks – the publication of the 600th edition. Starting in February 2012, Firstlinks has become one of the must-read publications in the financial industry. We’ve published about 4,000 articles and an estimated six million words from hundreds of different writers.

The occasion is tinged with some sadness as co-founder and driving force, Graham Hand, isn’t here to celebrate it. However, I can hear him in my ear now telling me to get on with the job and ensure that the newsletter is even better over the next 12 years.

Firstlinks will evolve over time though the mission will stay the same: to provide readers with quality, independent writing on key investment strategies and ideas.

To our community of readers, thank you. We appreciate your support and if you haven’t already, please spread the word about Firstlinks.

Finally, a big shout-out to our sponsors and third-party writers – without them, this publication wouldn’t be possible.

Recently, I attended a unique event with a crowded room of mostly financial advisers. Hosted by Pinnacle, the ASX-listed house of boutique fund managers, it featured six of their global fund managers who offered starkly different equities strategies and market insights.

First up was Hyperion’s Jolon Knight. Knight outlined how Hyperion invested in structural growth and innovation leaders. Their companies are disruptive, have strong competitive advantages and are capital light which leads to higher returns on capital. Top holdings in its global fund are Tesla (NASDAQ: TLSA), Amazon (NASDAQ: AMZN), and Microsoft (NASDAQ: MSFT).

Hyperion’s focus on growth stocks has served it well. Last year, the fund returned a stellar 52.5%. Its long-term track record is good too, with annual returns of 20.3% since inception in 2014.

In his presentation, Knight addressed worries about market concentration in US tech stocks. He said they were overplayed and that stock returns have always been concentrated, citing data from Henrick Bessembinder that 2.4% of listed companies account for all net global stock market wealth creation over the past three decades.

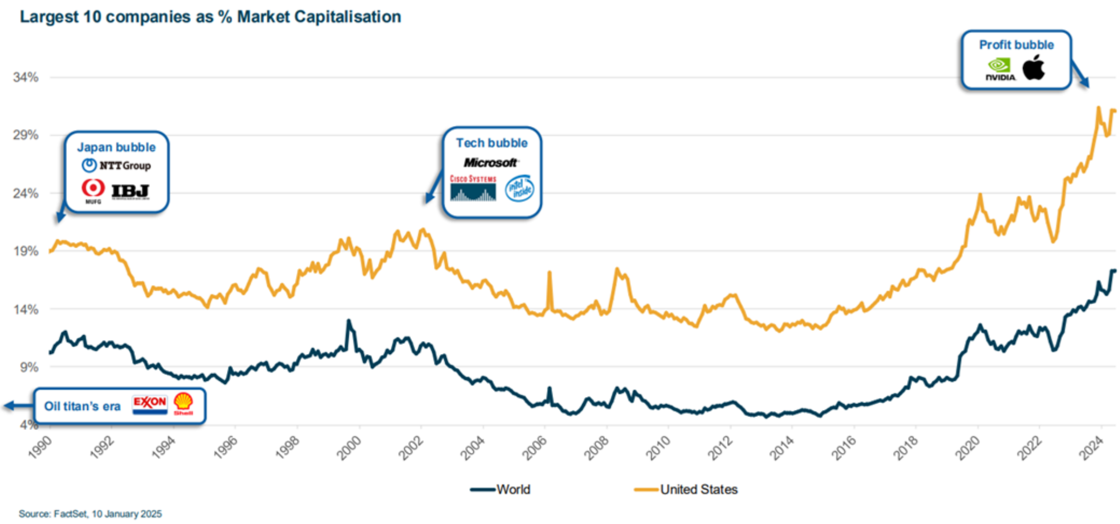
As to the other current concern about valuations of markets, Knight was equally dismissive, suggesting that investors have worried about this every year over the past decade, and yet markets have marched higher.

Next up was Antipodes CIO, Jacob Mitchell, whose take on markets was almost diametrically opposed to Knight's. Antipodes strategy is one of 'pragmatic value' which involves seeking mispriced opportunities relative to the underlying resilience and growth in businesses.

As you can imagine, the global fund has struggled somewhat, thanks to value stocks being in the doghouse.

In his presentation, Mitchell said that, yes, there was a bubble and it's in 'quality' stocks.

Unlike Knight, Mitchell also laid out the case for why US market concentration poses significant risks. He said market concentration wasn't just a US phenomenon but a global one.



Plato's David Allen then offered a different view of things. Allen runs the Global Alpha fund, which is a long/short aiming for consistent outperformance across market cycles. The fund has a shorter track record than Hyperion or Antipodes, though has performed well thus far.

TRADITIONAL APPROACH VS. PLATO GLOBAL ALPHA

	Traditional Concentrated Fundamental	Plato Global Alpha
Active share	High (>70%)	High (98%)
Risk management	Qualitative and ad hoc	Systematic (PRISM)
Thematic risk	High	Low
Sector risk	High	Low
Stock specific risk	High	Low
Style risk	High	Low
Total risk	High (30%)	Benchmark-like
Active risk (tracking error)	High (>10%)	Medium (4-5%)
Drawdown potential	High	Medium
Annualised excess return		11.3% (2nd of 262)
Information ratio		3.37 (1st of 262)
Sharpe ratio		1.63 (2nd of 262)
Sortino ratio		1.60 (2nd of 262)
Batting average		73% (1st of 262)

Source: Morningstar, December 31, 2024, return statistics since inception

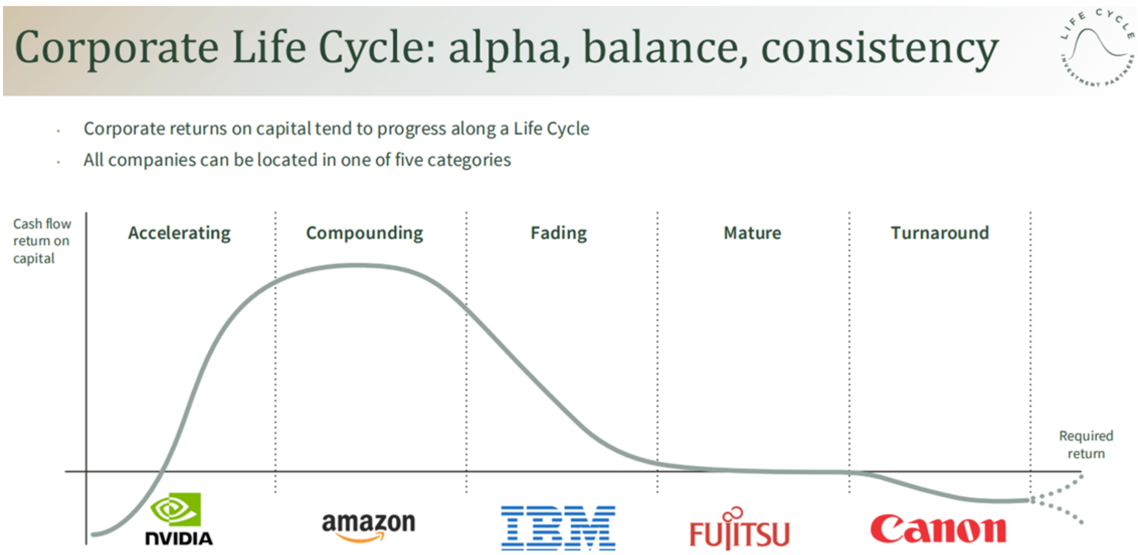
Allen explained how his fund was different to competitors: it relies heavily on quantitative rather than qualitative processes and therefore takes less overall risk.

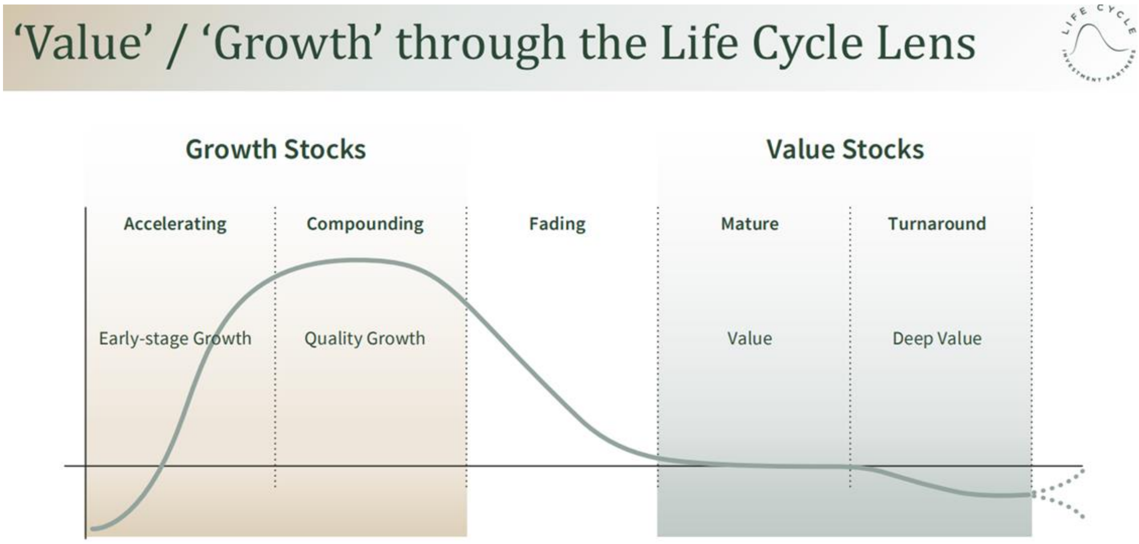
He said his fund takes the best value, growth and other opportunities to create an all-weather portfolio. And on the short side, he leaned on a proprietary +100 red flags system to detect shorting opportunities. The red flags track things such as management stock sales, employee ratings, auditor track records, and accounting manipulation.

A new member of the Pinnacle stable is Life Cycle Investment Partners and its UK-based manager, Peter Rutter, outlined how his fund provided a different type of all-weather portfolio.

He spoke of how businesses have life cycles: they first accelerate, then compound, before fading, and maturing, and then eventually turning around (hopefully). And returns on capital tend to track this life cycle.

Rutter's fund invests across all the different phases of the corporate life cycle. That means it invests in tech and airlines, and everything in between.





Unlike the other funds, Resolution Capital is more niche, and Sarah Lau gave an overview of its Global Listed infrastructure Fund. She detailed how the nuclear power renaissance and the fastest electricity growth since the invention of air conditioning – thanks to AI – is turning previously mundane infrastructure stocks into significant opportunities.

Last on stage was Firetrail's James Miller, who spoke of his company's focus on investing in companies that were adapting to the future, such as agricultural machinery giant, John Deere (NYSE: DE). That said, he was cognizant of current risks, especially of high market valuations.

What to make of the different strategies and views?

At the end of the event, my head was spinning. Six different global equity strategies with six very different market insights.

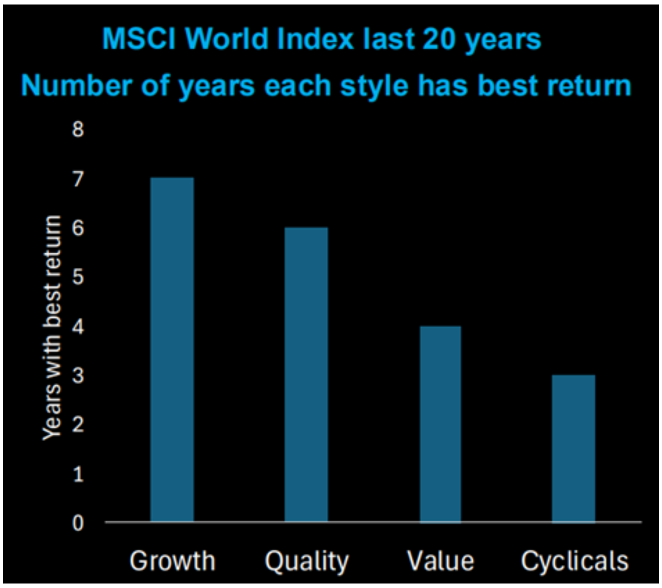
Then I wondered what the room of advisers thought of it. I spoke to one at my table from a family office. He said he owned the Hyperion and Plato funds. When I pressed him on Hyperion, he said that "you own it if you think interest rates are going down". But he noted that you needed to be aware of the "downside capture" – referring to the financial term, downside capture ratio, which measures how well an investment performs relative to a benchmark index during a down market.

Put simply, he was telling me that you want to own growth funds when rates are declining, though look out if they're going the other way.

It gave some useful clues about how he thought about fund managers. Yes, he examined their track records, the managers themselves, the processes, and a myriad of other things. But he also thought of how these funds fit into his overall portfolio.

I imagine that Hyperion would serve a specific purpose in his portfolio, while Plato would serve another. Other funds would have alternative purposes. And I assume that the goal would be to create a portfolio that outperforms across a market cycle.

Why not just go for managers with great long-term track records? Well, the risk is that you might crowd into funds with similar characteristics and risks. For instance, you might be all-in on 'growth' funds which have had fantastic returns in recent decades, though it may not remain that way forever.



- Growth styles have won the last two years
- No single style wins every year

Source: Firetrail

Why not just own the 'all-weather' funds like Plato or Life Cycle? These types of funds are likely to have their own idiosyncratic risks. For instance, one of my questions of Life Cycle would be how their fund managers and analysts can be experts across all five different phases of a business cycle, and the companies in each phase. Having been a fund manager myself, I would suggest that being good at one style of investing, such as value, is hard enough. Being good at five requires a lot of work and even more skill.

A portfolio view

Too often people see stocks and funds in isolation ie. if I own this stock or fund, I'll outperform. But the question you should be asking is what purpose this stock or fund serves in my portfolio. And, how does it complement other stocks or funds in your portfolio.

** Disclosure: Pinnacle affiliates Resolution Capital and Antipodes are Firstlinks sponsors.*

My article this week looks at Warren's Buffett's annual shareholder letter and how what he leaves unsaid speaks volumes...

James Gruber

Also in this week's edition...

With the arrival of the new year, the first members of 'Generation X' turned 60, marking the start of their collective journey towards retirement. **Harry Chemay** asks whether Gen Xers and our retirement system are ready for the transition?

Kaye Fallick is back, this time with an article canvassing four thought leaders in the retirement industry to find out their best ideas on how to fix our broken retirement income system.

Star stock picker, **Jun Bei Liu**, has just formed a new investment firm, Ten Cap, and today she provides her thoughts on an odd and wild reporting season and the outlook for the Australian market.

The 2015 Paris Agreement on climate targets is in jeopardy, thanks to the US withdrawal from the agreement and Trump's vow to "drill, baby drill", according to **Tony Dillon**. He says it has major implications for the push towards net zero emissions, including for Australia.

MFS' Rob Almeida believes the US has started a new capital cycle with funding driving investment in tangible assets instead of dividends and buybacks. That will lead to a regime change in stock markets with a different set of winners and losers.

Commercial property has had a horrid two years and the big question is whether the worst is behind us. **Colin Mackay** of **Charter Hall** says there are signs it might be.

Lastly, in this week's whitepaper, **Kevin Hebner** of **TD Epoch** - a **GSFM** affiliate - investigates a topic that's dominating news headlines: Trump, tariffs, and the new global economic order.

Curated by James Gruber and Leisa Bell

Is Gen X ready for retirement?

Harry Chemay

"Ageing is an extraordinary process where you become the person you always should have been." David Bowie

A curious thing happened at the start of 2025. A social experiment was set in motion with barely a ripple of acknowledgement from the mainstream media.

With the arrival of the new year, the first members of 'Generation X' turned 60, marking the start of the MTV generation's collective journey towards retirement, or their take on it at any rate.

As a member of Gen X, and someone with near-on three decades helping Baby Boomers plan, prepare for and move into retirement, it's quite the mind-shift to realise that friends you grew up with are themselves starting to think about a life beyond work.

Time has a way of sneaking up on you. The years are long, but the decades are short.

The oldest of Gen X is now entering a new phase, one that could reshape Australia's $4 trillion superannuation system as the remaining Xers follow them into the retirement zone over the next 15 years.

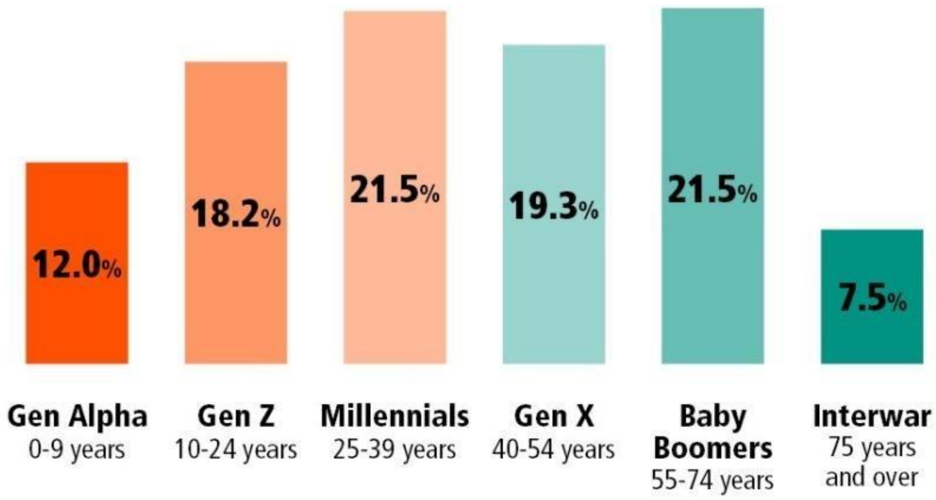
Staring at the prospect of a life beyond full-time work, is Gen X ready for retirement?

Gen X in numbers

While no official delineations exist, Generation X is broadly understood to include anyone born between the start of 1965 and the end of 1980.

According to the Australian Bureau of Statistics (ABS), Gen X comprised just over 19% of the 25.4 million strong Australian population at the last Census, wedged between the numerically larger Baby Boomers (born between 1945 and 1964) who preceded them and the Millennials (born between 1981 and 1996) who followed.

Composition of Australian Population by Generation (Census 2021)



More recent data from the Australian Government's Centre for Population projects the total population at some 27.7 million by mid-2025, of which Gen X will comprise roughly 5.2 million individuals.

What are the societal forces that have shaped their lives, and what are their concerns as they begin to contemplate a life beyond school drop-offs, pick-ups, surly teens morphing into young adults, and frenetic career workloads?

The influence of education

If there are two themes that define Gen X, it's their embrace of higher education and the changing nature of housing they've experienced over the last 25 years.

Census data for those between 25 and 39 shows how critical higher education has been to shaping Gen X (and subsequent Millennial) life experience. At that age, only around 12% of Baby Boomers had a bachelor or higher degree, while 46% of males and 59% of females had no post-secondary qualifications.

By the 2006 Census, 22% of Gen X males had a bachelor or higher degree, as did 28% of females. Only 34% of males and 37% of females had no post-secondary qualifications.

Spin forward to the 2021 Census and 34% of male Millennials had a bachelor or higher degree, as did 47% of female Millennials. Only 23% of males and 18% of females had no post-secondary qualifications at that point.

In Gen X we see the start of a significant uplift in education and skills (what economists call 'human capital') which has had a profound influence on the Australian economy, especially in empowering women to engage more fully in the labour force.

Accelerating house prices and mortgage debt

The other major defining feature of Gen X adulthood has been the astronomical increase in house prices since 2000, when the oldest of this generation would have been breaking into homeownership.

Back then a median house was valued at $191,000 in Melbourne and $287,000 in Sydney.

By 2005 the median house price in Melbourne had risen to $320,000 while in Sydney it had rocketed to $494,000.

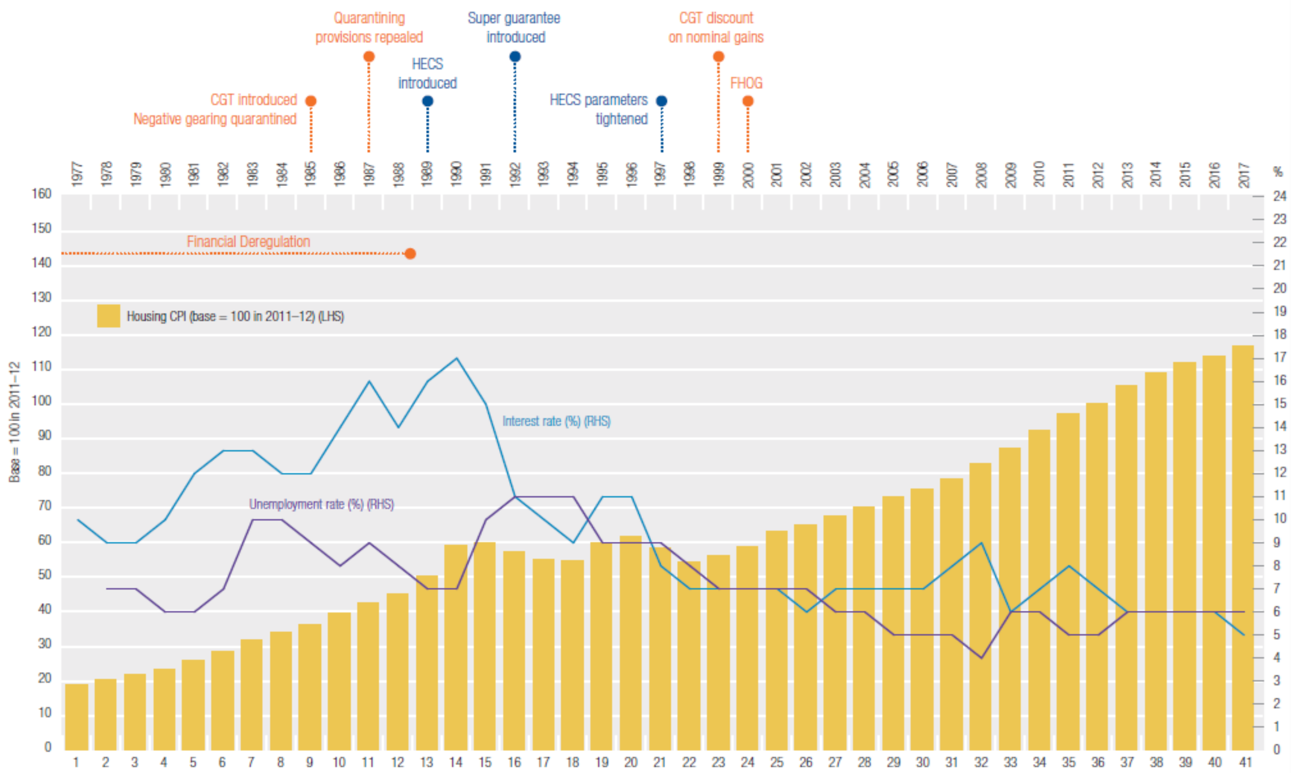
Median full-time earnings stood at around $50,000 per annum then, for a median-house-price-to-median-income ratio of between 6.4 and 9.8 across the two major capitals.

By 2010, when the younger end of Gen X would have been entering the market, median house prices in those two cities were $495,000 and $603,000 respectively. By 2020 they had risen further to $733,750 and $965,000.

Median full-time earnings across both genders now is somewhere around $90,000 per annum. It’s not hard to see why today’s median-house-price-to-median-income ratio sits at between 9 and 13, depending on where you live.

The chart below shows the housing and labour market conditions faced by a Gen X born in 1976 up to their early 40s in 2017. House prices, depicted by the yellow bars, broadly doubled in real (inflation adjusted) terms between 2000 and 2017.

Gen X Housing and Labour Market Conditions (source: CEDA)



In response, Gen X were the first to take on significantly higher levels of mortgage debt relative to their incomes, leaving them (and subsequent Millennials) far more exposed to interest rate rises, of the type that has driven the cost-of-living squeeze since early 2022.

While Baby Boomers might have faced mortgage rates north of 17% in the early 1990s, their debt levels were such that even at those astronomical rates homeowners were spending roughly 20% of their median incomes on mortgage repayments, according to the ABS.

By 2006 the much more indebted Gen X borrowers were spending closer to 30%, even as owner-occupied rates sat in the 7% - 8% range.

Mortgage indebtedness, historically most heavily borne by those between their mid-30s and early 50s, has only grown since 2017.

The average newly written owner-occupier loan then was just over $400,000. It is currently approaching $670,000, according to the latest ABS lending indicators data, with 30-plus year mortgages no longer uncommon.

All this translates into being in more mortgage debt for longer. In 1990, of homeowners aged between 45 and 54, only 36% had outstanding mortgages. By 2014 that had risen to 77%.

For the pre-retiree cohort of 55 to 64, more than one in two currently still have a home loan balance outstanding as retirement approaches.

What might retirement look like for Gen X?

Turning 60, as the oldest of Gen X are now doing, is a key marker in retirement circles, this now being the 'preservation age'. Not that a 60-year-old Gen X might necessarily be looking to pull the plug on the world of work.

While that might have been common in the past when the preservation age was as low as 55, the average age at which people *intend* to retire has been steadily rising over time and is now 65.4 years.

Of the 130,000 people who retired in 2022, the average age of *actual* retirement for men was 66.9 and for women it was 63.2. This is unsurprising, as the age at which males and females can access the Age Pension has steadily risen from 65 for eligible males and 60 for eligible females to now be 67 for both genders.

All going to plan, the oldest of Gen X have somewhere between 5 and 7 years on average before they exit the labour force, at least in terms of full-time employment.

From that point onwards, they will face several risks in retirement, one of them being how long they'll live. At birth, the life expectancy for an Australian male born between 1965 and 1967 was around 68 years. The respective life expectancy for females was then just over 74 years.

According to the recently updated Australian Life Tables, the median 60-year-old male is now expected to live to almost 85, while for 60-year-old females median life expectancy is now 87.

Given that half of all individuals who attain these ages will still be expected to be alive then, it is very possible that many Gen Xers (depending on actual age of final retirement) may experience 25-plus years of life after full-time work.

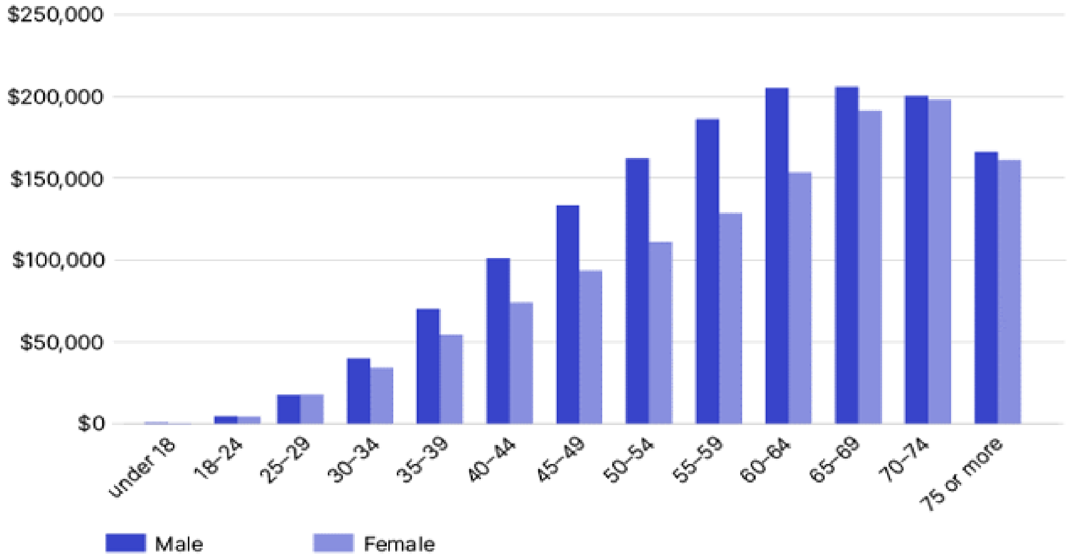
Are Gen X households retirement ready?

Having entered the workforce broadly from the late 1980s onwards, Gen X is the first generation to have had employer super paid on the vast majority, if not totality, of their lifetime earnings. The Super Guarantee, first introduced in 1992 at 3%, will mature to 12% in July this year, where it will remain unless the law changes.

The most recent ATO data on median super balances below indicates that for males aged between 45 and 49, the median male super balance was $133,616, while for females it was $93,471.

For those between 50 and 54, the amounts were $162,146 and $111,063 respectively, while for those between 55 and 59 the amounts were $186,255 for males and $128,675 for females.

Median Super Balance by Age and Sex, 2021-22 (source: ATO)



The Gen X super balance gender disparity remains uncomfortably high at around 31%, and points to more work needing to be done on the long road to gender financial equality, to ensure that all Australians have a fair shot at creating decent retirement outcomes irrespective of their relationship status in their later years; single, heterosexual partnered or female same-sex partnered.

In terms of heterosexual couples however, it appears that the median older Gen X couple might collectively have some $350,000 in superannuation if already aged 60.

What it may end up being at the point of retirement will be dependent on factors such as remaining years of employment, individual incomes, employer super guarantee and other (voluntary) contributions along the way, as well as investment returns achieved.

Whether that final amount will be 'sufficient' will depend on their expectations, preferences and household balance sheet composition at the point of retirement.

Data compiled by the Actuaries Institute shows that for home-owning Gen X, the family home dominates all other assets, and by a long way.

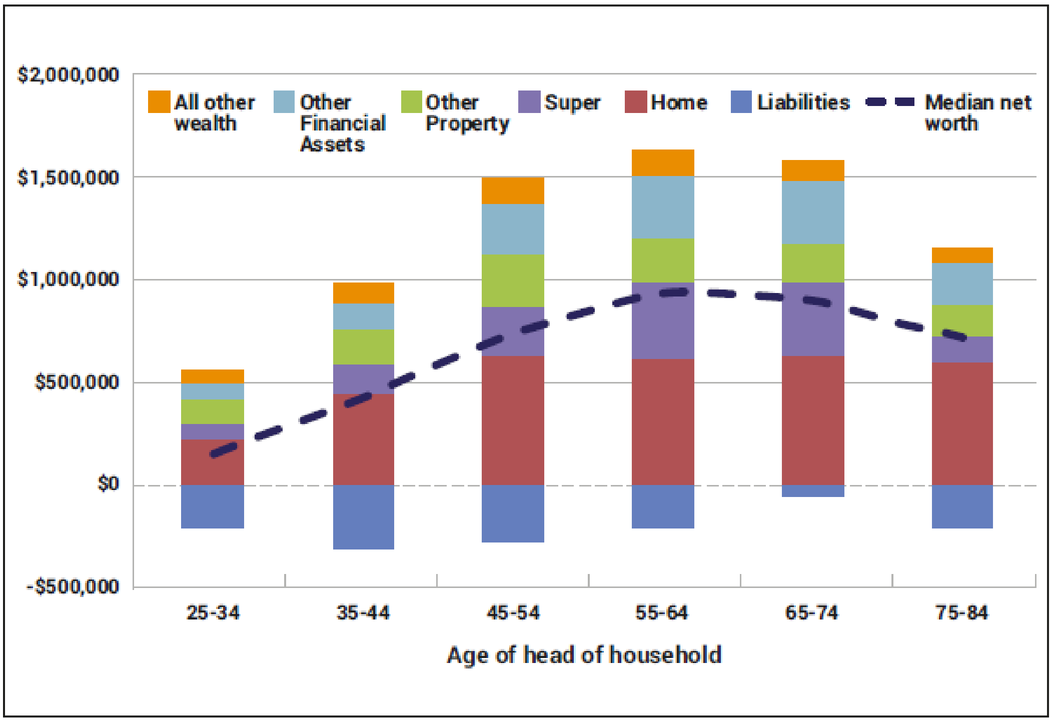
That is wholly consistent with the $11 trillion residential housing market at present, roughly 70% of which is held by owner-occupier households, each owning a dwelling with a current $815,000 median nation-wide valuation.

The remaining 30%, comprising residential investment property, is held by around 15% of the adult population, nearly one in every six taxpayers.

Super is the second largest household financial asset, at around $4 trillion in aggregate.

Other financial assets, including shares, managed funds and interest rate securities, round out proceedings at around $3 trillion, according to the latest ABS Finance and Wealth data.

Composition of Household Balance Sheet by Age Cohort (source: Actuaries Institute)



Against these household assets, mortgage debt is the key liability. The latest ABS data shows combined long-term household debt (mostly mortgage related) sits at some $3 trillion, split roughly 55% to owner-occupied and 45% to investment property. And therein lies the key difference between retirement planning for Gen X and the Baby Boomers who preceded them.

Generation X will be the first generation to approach retirement with sizable mortgage debt outstanding for the median home-owning household, with the effect of periodic property upgrades, renovations, relationship breakdowns and the increasing use of equity withdrawal having all had an impact on Gen X.

With around one in four of those over 65 now renting, it is also likely that more Gen Xers will retire as renters compared to Baby Boomers, either never having attained homeownership or failing to regain it after having ceased being a homeowner through force of circumstance.

Neither state is ideal when approaching retirement.

Hard decisions may have to be made by indebted homeowners; keep servicing a mortgage in retirement or find a source of capital to extinguish it.

For private market renters the options are even more constrained, with a recent Grattan Institute report revealing that housing costs can consume almost 30% of household disposable income for those aged 65 to 74, compared with just 7% for similar-aged homeowners.

This leads to a significant disparity in retirement outcomes for homeowners versus renters, with the analysis revealing that the rate of income poverty for renter retiree couples is around 45%, compared to 11% for mortgage-free homeowning couples.

Among single female retiree renters, the income poverty rate is shockingly high at 78%.

Challenges for the Retirement Income System

Already into their early 60s, it won't be long before the last of the Baby Boomers starts to shift into life after full-time work, aided by our maturing superannuation system.

For the most part superannuation, in conjunction with full or part Age Pension for the majority of the newly retired, has done an admirable job in helping them maintain a dignified existence into their retirement years, with one big proviso: that they enter retirement as homeowners, ideally unencumbered by a mortgage.

So ubiquitous is the narrative of unencumbered homeownership in retirement that much of today's retirement income system is built on the presumption of it. You see it in everything from suggested retirement budgets, to default assumptions in retirement calculators, to the payment rates for the Age Pension.

Applied to Baby Boomers, that was a perfectly sensible rationale under which to operate. Applied to Gen X, not so much, with the Grattan Institute analysis showing that mortgaged retiree households have a rate of income poverty more than double that of mortgage-free retiree households.

Gen X pre-retirees, holding much larger debt levels compared to previous generations, will force a re-think of the assumptions upon which the retirement income system is built.

Changing the retirement narrative

Famed British economist John Maynard Keynes was once reputed to have asked of a colleague: "When the facts change, I change my mind. What do you do, sir?"

The facts of housing security in retirement are changing, and Gen X will ask of the superannuation system Keynes' rhetorical question. Of that I have little doubt.

I am, however, optimistic that the majority of Gen X can attain a dignified retirement of their choosing, even if facing the aforementioned mortgage debt burden and with more retirement stressors than previous generations, including potential health and financial impacts from a changing climate.

Because the 'X' in Gen X stands for eXtraordinary adaptability. For a life lived at the crossroads; at the intersection of the old and the new, between the analogue 20th Century and the digital 21st Century. From the Apple IIe to the latest Apple iPhone 16 Pro, from the Commodore 64 to ChatGPT, and from the Atari ST to Agentic AI, Gen X adapts, incorporates and gets on with it.

We may have morphed from smelling like teen spirit to reading with glasses, but retirement will be just another such crossroad to negotiate.

Gen Xers wouldn't have it any other way.

Now it's up to the superannuation sector to step up to the challenges and opportunities their Gen X members bring to the table.

This is an abridged and lightly edited version of a piece recently published by the author on LinkedIn.

Harry Chemay consults across superannuation and wealth management, having made substantial contributions to the design of retirement income products, the application of digital advice to traditional super/wealth management frameworks, and product enhancements for direct-to-consumer offerings.

10 ways to fix Australia's broken retirement income system

Kaye Fallick

I heard about the concept of VUCA mentioned on radio the other day. It was used in the context of geo-political instability, but as my passion is helping ordinary Australians understand the almost impenetrable rules of retirement income, VUCA struck a chord.

What is it? According to the *Harvard Business Review* it's an acronym which captures the thought, 'Hey it's crazy out there'. More specifically, it refers to:

- Volatility,
- Uncertainty,
- Complexity and
- Ambiguity.

Australia's retirement income system in a nutshell, methinks! Too many changes to the rules, and too many options, poorly explained and then seemingly at odds with each other when decumulation kicks in.

My strong, long-held, belief has been that a lack of financial literacy is the main factor preventing many Australian retirees from overcoming such VUCA and 'living their dream'. Not too few savings, nor using super as an estate-planning vehicle, nor spending too little, nor spending too much. Rather, an inability to grasp the full breadth of their choices across the five funding pillars (Age Pension, super, private savings, work income and home equity) and the sea of complexity in which they exist.

Is it really as straightforward as this?

Having canvassed some thought leaders in the retirement industry, I've now modified my thinking. But more about that later.

I asked two simple questions of four highly respected industry leaders. I chose these commentators because their different areas of activity offer as close to possible a 360-degree view of retirement income needs. Those who responded to these questions are:

- Think tank founder and researcher, David Bell (Conexus Institute)
- Policy expert, now consumer superannuation advocate, Katrina Ellis (Super Consumers Australia)
- Former investment manager now advice solutions founder, Jeremy Duffield (Retirement Essentials)
- Policy expert with specialisation in later life funding needs, Louise Biti (Aged Care Steps)

The questions posed were:

> *If asked about ways to improve Australia's retirement income system, which two things would you change or initiate? What is a quick win and a longer term or structural reform?*

Here's what they had to say about what's needed to improve Australia's' retirement income system.

David Bell, Executive Director, The Conexus Institute

Quick win:

Super funds need to engage with their members more in the lead-up to retirement, introducing them to the decisions they will face and some information materials that they can engage with. Helping future retirees prepare for big, possibly complex, and, in many cases, confronting decisions can only be beneficial. Some funds do this really well as part of what they call their member journey mapping. Funds could establish, say, engagement prompts at ages such as 50, 55, 60, and 65. Best practice at age 50 could include:

- A retirement income projection with links to a more interactive calculator
- A checklist of things to think about around your retirement planning, including:
    - retirement age
    - how retirement is financed (how savings are used, type of products, the role of Age Pension etc.)
    - further information required, including access to interactive tools
    - pathways for further assistance (how the fund can help or access to a financial adviser)

Longer-term or structural reform:

All the data points and anecdotes indicate a large dispersion in progress being made by super funds in developing their retirement capabilities. Some funds have made great progress and others are lagging. Not every super fund should be 'entitled' to transition their members into retirement just because they were members during the accumulation phase. Conexus has proposed a retirement licensing regime as a solution, and we continue to work on this idea. Simply, set high capability-based standards that super funds must reach to be a licensed retirement fund, and only allow licensed retirement funds to service Australian retirees. That would greatly accelerate the super industry and ensure better retirement outcomes for all retirees.

Katrina Ellis, Deputy CEO, Super Consumers Australia

Quick win:

Remove Account-Based Pension (ABP) minimums so anyone who is over 60 can start an ABP if they want. Most large funds are keeping members with low balances from moving into the tax-free phase of super by setting a minimum balance required to open an ABP. This is unfair and means that people are stuck in an accumulation account paying 15% tax on their investment earnings. Everyone should be able to access an ABP and enjoy zero taxes on earnings once they hit age 60, regardless of their account balance.

Longer-term or structural reform:

Establish performance-tested Account-Based Pensions and create a comparison tool so people can find good products.

The performance test has been successful at removing bad MySuper products in the accumulation phase. No such test exists for ABPs. Currently retirees are in the dark about the quality of their fund's ABP options and have no way of comparing returns or fees. The Government needs to do more to protect customers from ending up in a dud retirement option.

Jeremy Duffield, co-founder, Retirement Essentials

Quick win:

Most people apply late for the Age Pension...and the Age Pension is much more important than the industry appreciates, given that over 50% of people in retirement get more than 50% of their retirement income from the Age Pension. Many people also fail to apply for the Commonwealth Seniors Health Card (CSHC). So, I'd say something easy for the government to do is to contact people before they reach 67 to let them know that they may become eligible for government benefits, either the Age Pension or the CSHC.

Another very practical thing the government could do is to make ongoing compliance with the Age Pension less onerous. The requirements for keeping Centrelink up to date are impractical. I'm also in agreement with the Grattan Institute on the need for increased Commonwealth Rental Assistance since it's so apparent that older renters, particularly women, are the worst-off segment of the retirement population, with no relief in sight.

Longer-term or structural reform:

Obviously, implementing the Quality of Advice Reforms (Delivering Better Financial Outcomes). We must make quality affordable advice available to the massive wave of retirees. Beyond that, I think a review of the means testing criteria is needed. Taper rates are too tough.

Louise Biti, Founder Aged Care Steps

Quick win:

Support at home and aged care involve complex and important decisions but emerge at an age when clients are often less capable of making these decisions, and family may have conflicting views and priorities. Objective and qualified financial advice can make a difference. It would be great to see the Government include frailty planning and aged care advice as a service that can be paid for out of the Home Care Package budget.

Longer-term or structural reform:

Frailty risk is the forgotten pillar in retirement planning and needs a greater focus throughout all stages of retirement planning. This extends beyond just how to fund a move into aged care. It also involves planning where a person chooses to live as they age, an understanding of how they will live there, the support needed to remain in that home, and strategies for how to fund these choices. This journey often requires swapping the family home for a more appropriate home in a community setting (e.g. retirement village) or residential care. I would like to see a focus on product development to extract equity from the home that innovates away from the traditional loan product.

True innovation means reimagining the products – possibly through a life insurance option that is used to pay the Refundable Accommodation Deposit (RAD), with the RAD returned to the insurance company to minimise the cost of premiums. I am not sure that I have the solution, but it would be good to see some discussion and innovation. This may require some legislative change to allow RADs to be repaid to the insurance company rather than the person's estate.

My take

And what was *my* change in thinking? At times of peak VUCA, when it really is 'crazy out there', the best way to respond is surely to 'go hard or go home'. So I'm thinking big when it comes to tackling the many problems associated with the Australian retirement income system. It's still way too complex and those with the median super savings (or lower) are not likely to try to access a full comprehensive financial plan, so they are essentially DIY retirees.

Quick win:

My 'quick win' would be to equip pre-retirees (those aged 55-60) with the resources they need to understand how the 'bits' fit together at retirement, through workplace education two years before Preservation Age, and standardised tools (educational slides and calculators) that step them through the basics. These tools would be Government-designed but provided by each and every super fund. I really believe that, after thirty-plus years of mandatory super, it's well past time for the Government to step up and provide some simple, plain English retirement income guidance that must be shared with everyone in the country as they approach Preservation Age.

Longer-term or structural reform:

Initially I thought – in line with suggestions over time from Dr. David Knox (former Mercer partner and actuary) that we need to scrap the means test for the Age Pension. And maybe no longer exempt homes above the value of $3 million from an assets test. But this is still fiddling around the edges given the bloated bureaucracy of Age Pension assessment and delivery. So I now believe that the best long-term solution is to establish a Universal Age Pension. It will be much cheaper and easier to deliver – no rules apart from age and residency will ensure that! We could then encourage retirees to work as much as they like – without penalties to their entitlement – but require them to pay tax on earnings at current rates. There would be no tax favours to older workers as they would already have a guaranteed base income.

Then there's a second, bigger task to tackle in winding back concessions on super, but that's for another article, another day.

It was a fun exercise to ask people with big brains and expertise from decades of experience to redesign the policy settings for the way we fund our later lives. I believe there are some really good ideas in here. But have we missed something? If so, what is it?

Kaye Fallick is Founder of STAYINGconnected website and SuperConnected enews. She has been a commentator on retirement income and ageing demographics since 1999. This article is general information and does not consider the circumstances of any person.

What Warren Buffett isn't saying speaks volumes

James Gruber

Aged 94, Warren Buffett is understandably slowing down. In his 48th letter to Berkshire Hathaway shareholders last weekend, he reveals that he now uses a cane. He jokingly refers to how his regular Sunday phone calls with his sister, Bertie, cover exciting topics such as the relative merits of canes. And in his case, "the utility is limited to the avoidance of falling flat on my face."

The revelations follow a recent interview where he said that he could no longer play his favourite hobby of bridge as he once did.

Buffett's age may be why his annual letters are getting notably shorter. This year's spanned 13 pages. A decade ago, it was more than twice that length. He's also planning to cut down on his speaking time at the upcoming Berkshire annual meeting in his hometown, Omaha.

In this year's letter, he acknowledges that, "it won't be long before Greg Abel replaces me as CEO and will be writing the annual letters."

Buffett's thoughts on his own mortality may explain his reticence on key topics in his latest letter. He seems to go out of his way *not* to court controversy.

But that may be the point: at this stage, he'd rather remain above the fray and be remembered simply as one of the world's greatest-ever investors.

That said, there's still a lot of value in Buffett's letter, if you read between the lines. Because it's as much about what he doesn't say as what he does.

Like a magician who's performing a trick with his right hand, it's meant to be a distraction to what's really going on in his left hand.

The Berkshire result

First, let's run through the Berkshire result. Buffett says that Berkshire's fourth-quarter profit rose 71% to US$14.53 billion, and excluding currency gains totalled US$13.38 billion.

Full-year operating profit increased 27% to US$47.44 billion, a record-high.

That was helped by more income from $334.2 billion of cash and equivalents, invested mostly in U.S. Treasury bills.

Cash doubled in 2024 as Berkshire reduced its stake in Apple (NYSE: AAPL). Net income, including gains and losses from stocks, totalled US$89 billion.

Buffett did find a few things to use the cash from last year by spending US$3.9 billion to buy the rest of its utility business and another US$2.6 billion to purchase the remainder of the Pilot truck stop chain it didn't already own.

Berkshire also increased its investment in five major Japanese conglomerates, and Buffett says he'll likely invest more in them because those companies have agreed to let the company increase its ownership beyond 10%. Berkshire has now spent US$13.8 billion over the past six years on the Japanese investments that are now worth US$23.5 billion.

On *that* cash pile

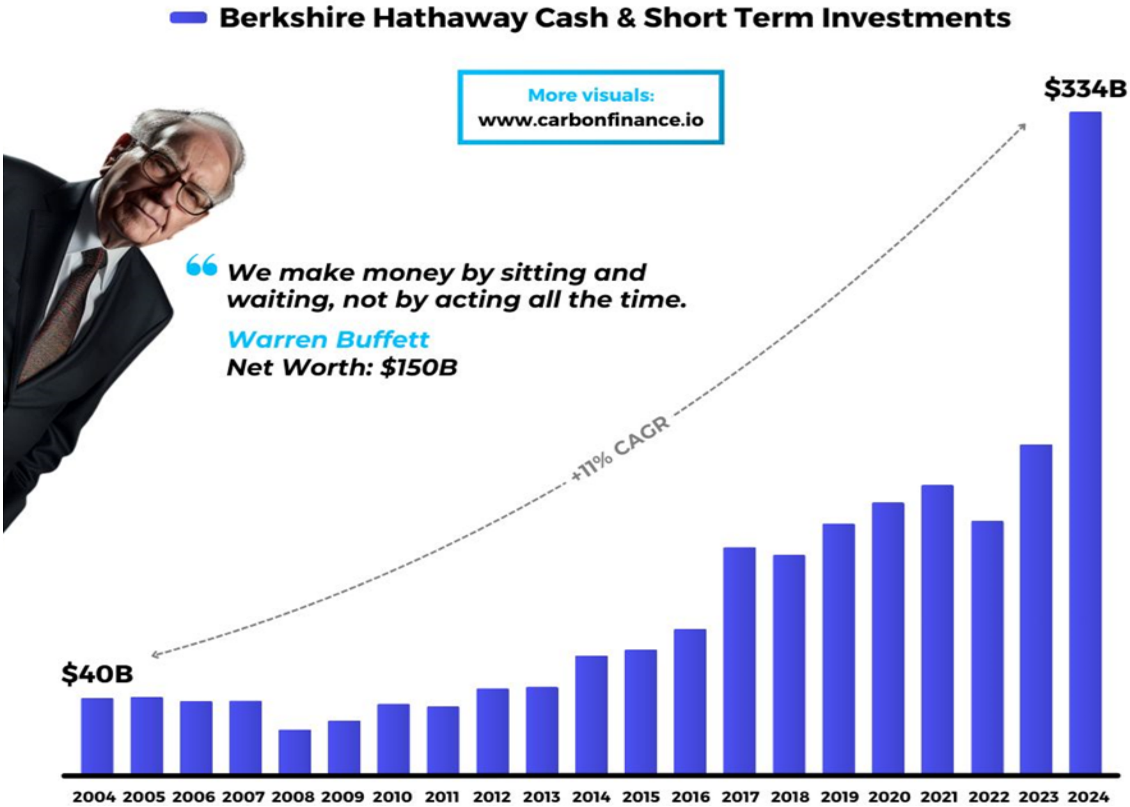
Berkshire has amassed the greatest cash position of any company in history, so it's understandable that it's grabbed media headlines. Of the cash, Buffett is almost defensive in his letter to shareholders:

> *"Despite what some commentators currently view as an extraordinary cash position at Berkshire, the great majority of your money remains in equities. That preference won't change."*

And:

> *"Berkshire shareholders can rest assured that we will forever deploy a substantial majority of their money in equities – mostly American equities although many of these will have international operations of significance. Berkshire will never prefer ownership of cash-equivalent assets over the ownership of good businesses, whether controlled or only partially owned."*

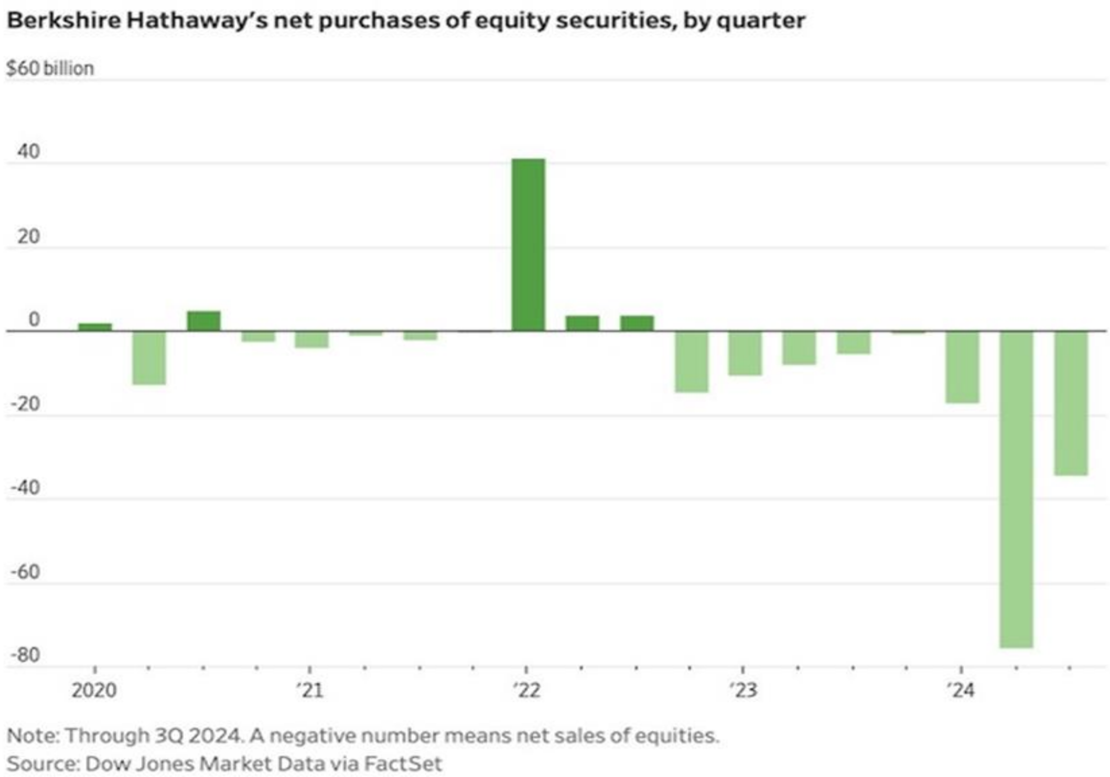
So, Buffett is saying that most of the company's money is in equities and his preference is to own equities rather than cash or bonds.



What doesn't that tell us? A few things.

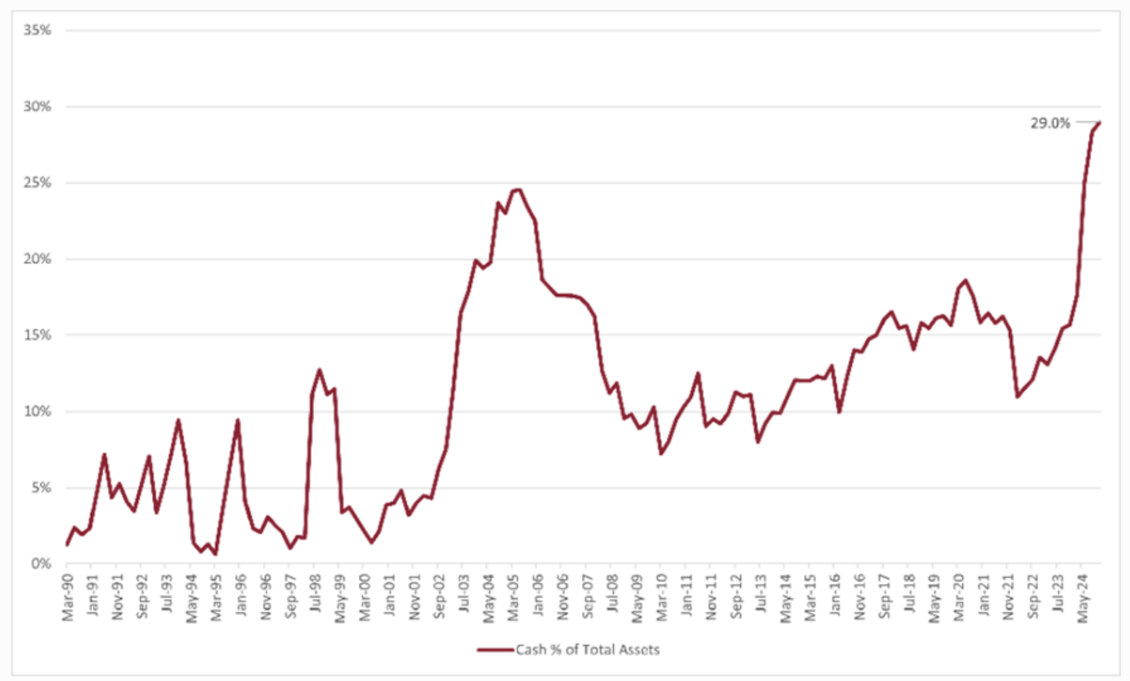
First, why has Buffett been a net seller of stocks? Why did he cut his holding in Apple by 70% in 2024?

To put the stock sales in context, the US$127 billion in net sales last year resulted in a US$97 billion realizable tax gain for Berkshire – that gain is larger than all the cumulative realized net gains over the past three decades (of US$85 billion), according to investor, Christopher Bloomstan.



Also, the cash balance at Berkshire has reached 29% of assets. That compares to the 13% average of the past 25 years.

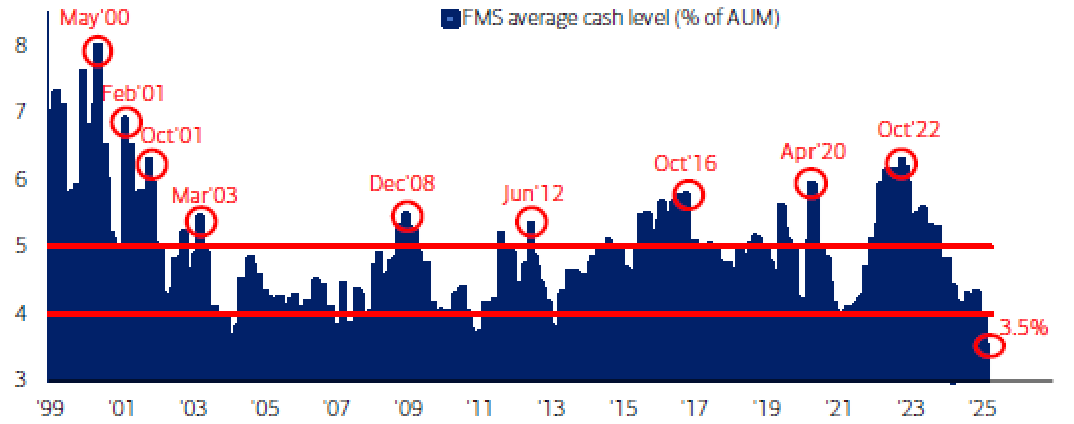
Berkshire Hathaway cash as % of assets



Berkshire Hathaway: Cash As A Percent of Total Assets GLENVIEW TRUST, BLOOMBERG, BERKSHIRE HATHAWAY

Berkshire's record-high cash pile stands in stark contrast to the cash levels of global fund managers, which are at 15-year lows.

Chart 1: FMS cash levels at 15-year lows
BofA Global FMS average cash level (%)

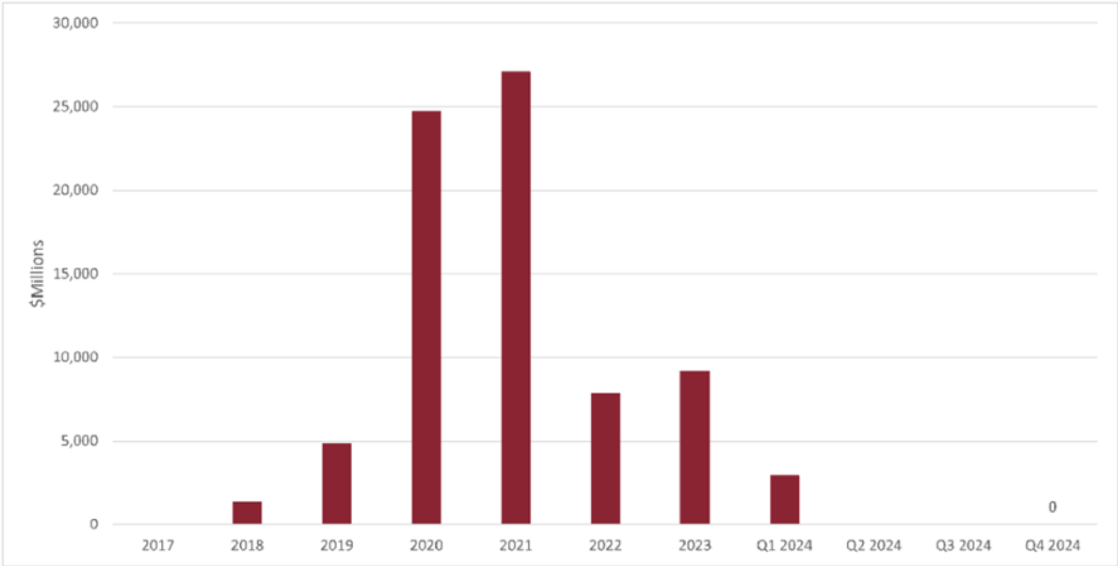


Source: BofA Global Fund Manager Survey

BofA GLOBAL RESEARCH

Berkshire also hasn't been a buyer of its own shares since the first quarter of last year, signalling that Buffett doesn't consider his company shares to be undervalued.

Berkshire share repurchases



Share Repurchases GLENVIEW TRUST, BERKSHIRE HATHAWAY

We have this seeming contradiction: Buffett prefers to own equities over cash, but he's been an aggressive net seller of stocks over the past year.

How to reconcile this? It's likely that Buffett would love to own more stocks, but not at current prices. In plain English, he thinks the current US market is expensive and he's holding dry powder for when stocks get cheaper.

On Apple

Buffett didn't address Apple in his letter, but it really was the big news for Berkshire over the past year. Along with Bank of America, Buffett aggressively cut his stake in Apple. He sold US$100 billion in Apple in the first three quarters of last year, or more than two-thirds of his stake in the company. Interestingly, he didn't sell more in the fourth quarter.

Some commentators suggest that this is Buffett being prudent. That Apple being 50% of his equities portfolio was too much, and his recent cuts get the stake back to a sensible level (it's now 25% of the portfolio and remains the largest stock holding).

I don't buy this because Buffett isn't normally afraid to hold large positions in stocks. He's always preferred concentration over diversification.

Other commentators believe that Buffett is readying the portfolio for his CEO successor, Greg Abel. He doesn't want Abel having such a large Apple position, the theory goes. It may be fine for Buffett, but not for Abel.

This could have some merit. However, I think it's more probable that priced at 39x current earnings and with single digit earnings growth, Buffett sees Apple as very overpriced.

Perhaps, Buffett doesn't want to repeat a previous mistake of his in not selling Coca-Cola when it reached a P/E ratio in the high 40s in 1998 (it took 16 years for Coke to get back to break even).

Also, I'm speculating that Buffett may not appreciate some of Apple CEO, Tim Cook's, recent decision making. Specifically, his preference to buy back Apple shares last year.

On this, I wrote in August:

> *"One reason for Buffett selling that I haven't seen in any commentary is that he may have lost faith in Apple's CEO. Buffett has said that he looks closely at leaders and how they allocate capital. Previously, he's lambasted CEOs who've bought back company stock when the shares were expensive.*
>
> *While Buffett has applauded Apple's large buybacks in the past, he's probably less happy with continued buybacks now. Why? Because buying back shares when the company was cheap made sense. With the company now expensive, it makes much less sense."*

On taxes and currency

Buffett is less subtle when it comes to issues of tax and currency.

In his letter, he notes that Berkshire last year made four tax payments totalling US$26.8 billion. He says this is far more in corporate income tax than the US Government has ever received from any company – even larger than the tech titans with market caps far larger than Berkshire's.

And his message to the Government is clear:

> *"Someday your nieces and nephews at Berkshire hope to send you even larger payments than we did in 2024. Spend it wisely. Take care of the many who, for no fault of their own, get the short straws in life. They deserve better. And never forget that we need you to maintain a stable currency and that result requires wisdom and vigilance on your part."*

Preparing for the next bear market

Over 60 years, Buffett has compounded shareholder returns at almost 20% and turned Berkshire Hathaway into a sprawling conglomerate with a market cap of more than $1 trillion.

Though showing signs of slowing down, Buffett seems to be preparing Berkshire for the next bear market and laying the groundwork for when he's no longer around.

James Gruber is Editor of Firstlinks.

An odd and wild ASX reporting season

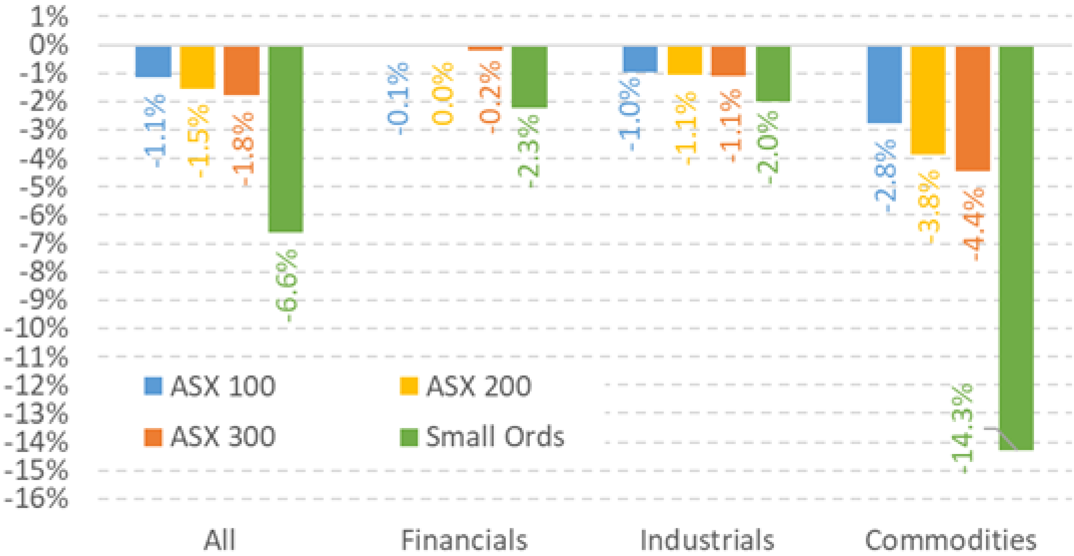
Jun Bei Liu

Reporting season can often be a messy affair. When you overlay an economic turning point that changes the importance of 'what has been' versus 'what is to come' and add a fragile global political backdrop, that by itself is causing significant volatility across financial assets, and it becomes even harder than normal to navigate.

Results were within expectations

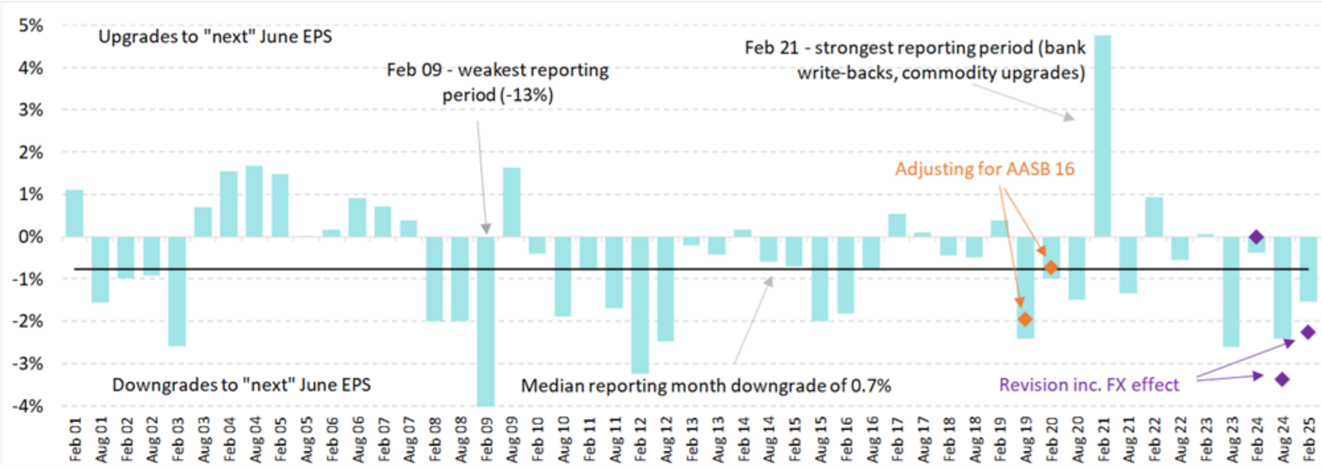
In isolation, the reporting season has been pretty much as expected. Expectations were relatively conservative coming into these results which fit with a patchy economic growth backdrop where there were clear areas of strength (the consumer) offset by areas of weakness (housing, construction, mining). Margins had been under pressure from elevated input costs and wage pressures, but it looked like we had already passed the worse and the market was looking for confirmation of this. The A$ was expected to provide some solid translation gains, but a desynchronised global growth backdrop meant that the tailwind from international earnings was going to be a mixed.

Figure 1: EPS revisions during reporting season



Source: Hasan Tevfik, MST Marquee

Figure 2: Post result revisions gave been more negative than usual



Source: Hasan Tevfik, MST Marquee

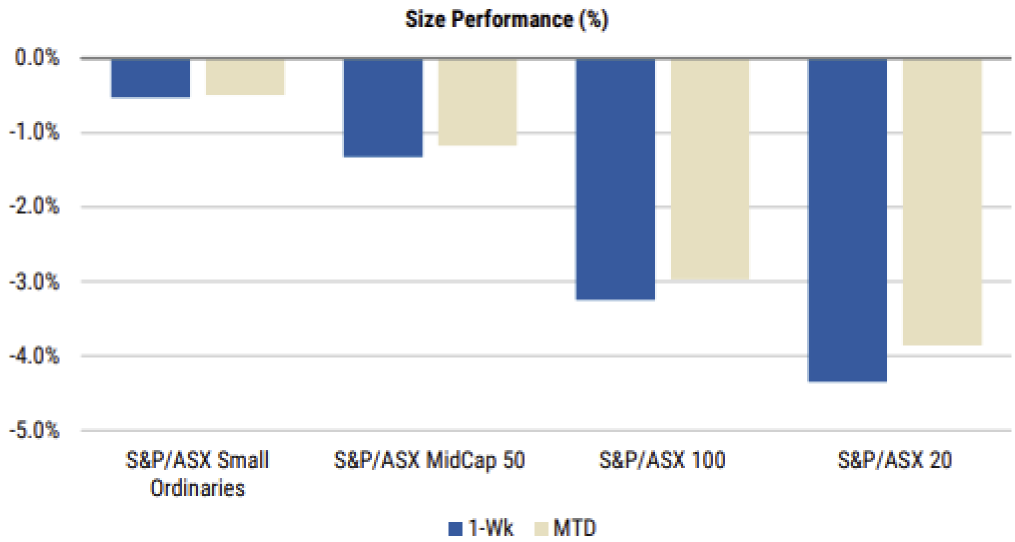
If it is possible to generalise, we would say that revenue lines were slightly better than expected with price over volume the culprit. It was margins that appeared to disappoint with costs coming in higher than anticipated albeit not dramatically so. We did not see much evidence of a broad increase in interest costs, or financial engineering (which tends to happen when the quality of results weakens). Small stocks tended to disappoint a little more than large caps, but post result revisions were slight better. All in all, another messy affair but there was enough positive commentary and post result upgrades to give us comfort that we have past the nadir for corporate earnings.

Share price reactions were all over the place

The real challenge was in adapting to how the market priced companies that reported results. Traditionally a bad result would be treated negatively and a good result positively. What's more, there would usually be legs to these trades – in other words longevity to short term relative price performance. But, when the economic and profit cycle is turning, the willingness to look through a bad result on the basis that the next one will be better came through loud and clear. This meant that for a lot of stocks, not matter how bad the result, if the outlook was better, they were often bid up strongly (particularly for stocks where there was high short interest).

On the other hand, it didn't matter how good the results were for stocks that had performed well in recent times and were trading on elevated multiples versus their peer group because at turning points, there is a rotation out of expensive stocks and into cheap stocks, supported by the notion that the next set of results will be better than the last. This was a sharp case of valuation convergence which is the exact opposite of valuation dispersion that had opened up as the economic cycle weakened and the strong (quality) was a safe haven.

Figure 3: The shares prices of leading stocks have suffered most



Source: Chris Nicol, Morgan Stanley

Let's look at a few examples. Guzman & Gomez (ASX: GYG) reported an incredible strong result with even stronger trading update in its Australia division which bucked the trend of the weaker fast-food category. But, instead of great share price print, the share price was down 14% on the day. Pinnacle (ASX: PNI) is another example of a stronger result with poor share price performance, almost 10% since the result.

On the other hand, poorer results such as Audinate Group (ASX: AD8) has had the opposite effect. The company reported continued weakness with current hardware sales, and probably will continue to be borderline cash flow breakeven, and yet the share price was up more than 38% at one stage. Domino (ASX: DMP) is another interesting example that when the company first updated its earnings ahead of the result, its share price rallied over 20% and caused the short seller community grief, then when the result was finally reported two weeks later, management couldn't even put the whole story together and the share price has subsequently lost most, if not all of its gains.

Banks are an interesting one to touch on. After stellar performance in 2024 exceeding all expectations, we finally saw some weakness during this reporting season except for Commbank (ASX: CBA), as most banks share prices fell closer to double digits, with regional bank Bendigo really surprised on the downside. This weakness did not last very long, and the entire sector rebounded nicely at the expense of the tech and consumer sectors.

The most interesting reporting season in my career

This is probably the most interesting reporting season in my 20 odd years of looking at the market, as share price meaningfully diverged from earnings and prospects. It's reflected all the greed and fear of investor behaviour in short bursts.

Turning points take time to become embedded in economic data and investor expectations. And before they do, sentiment can oscillate wildly. This means a strong stomach is needed until the recovery becomes entrenched and price action less volatile. But the market is not the economy and there are substantial tailwinds that should drive strong equity performance throughout 2025. At Ten Cap, we think bullish signs are there even if they are not yet fully transparent.

Jun Bei Liu is a co-Founder and Lead Portfolio Manager at Ten Cap. Jun Bei is also a popular media personality and a highly sought after public speaker about her investment views. This information is intended for general use only. The information presented does not take into account the investment objectives, financial situation or advisory needs of any particular person.

Is the Paris Agreement on climate change dead?

Tony Dillon

The new United States Energy Secretary, Chris Wright declared at the recent Alliance for Responsible Citizenship (ARC) conference in London, that he "would love to see Australia get in the game of supplying uranium and maybe going down that nuclear road themselves", and that he was "thrilled to see recent efforts in the news recently of the development of shale gas in Australia".

Already a large exporter of uranium, Australia could have an even greater influence in the nuclear energy market, Wright believes.

Wright also said the goal of net zero impoverishes economies. That "the aggressive pursuit of it, and you're sitting in a country that has aggressively pursued this goal, has not delivered any benefits, but it's delivered tremendous costs," he said in an interview with Chris Uhlmann.

His comments at the ARC conference reflect the renewed commitment to fossil fuel driven energy security in the US under Donald Trump, and a message for Western democracies to step up to the plate on energy.

Is that it for the deal?

The Trump administration plans to bolster the production of fossil fuels by removing obstacles installed by the previous administration, according to Wright. That, coupled with the withdrawal of the US from the 2015 Paris

Agreement on 'day one' of the second Trump presidency, prompts the question: is the Paris Agreement now dead?

Maybe not, though it could be on life support, with the departure of the world's second largest emitter of greenhouse gases after China.

While the US Paris withdrawal under Trump in 2017 (re-joined in 2021 under Joe Biden), wasn't terminal for the agreement, this time around it combines with aggressive fossil fuel expansion under the Trump mantra of 'drill baby drill', signalling to the world that fragmentation on climate and energy policy is set to escalate. In turn, this could lead to other countries moderating or even abandoning their net zero commitments.

The Paris Agreement aims to reduce greenhouse gases and limit the global temperature rise from industrial times to well below two degrees Celsius, shifting towards a net zero emissions world.

The impact of recent US moves

With the US withdrawing from Paris, and a renewed energy focus, there will be implications for global energy policy and markets.

In the short-term, the expected boost in fossil fuel production will create conditions for rising US exports which would impact global supply and prices. Short-term instability in implementing and delivering renewables derived energy will see costs remain elevated.

Medium-term implications with the US shifting back to a higher concentration of fossil fuels include that it may deter renewable energy investment, leading to higher capital costs rolling out green energy and higher electricity prices.

Recently, we have seen Andrew Forrest's Fortescue pause green projects, blaming Donald Trump and European policy uncertainty. And in the past year in Australia, Woodside and Origin abandoned green hydrogen projects, with the Queensland Government also scrapping its billion-dollar hydrogen plan. And, the South Australian Government shelved funding for the greening of Whyalla steel.

Higher electricity prices have already been observed, particularly in Australia, to the point where the Government has provided electricity subsidies to consumers, with plans to roll out more subsidies. The intermittent nature of renewable energy, and grid upgrade and storage challenges, have contributed to rising costs.

In the long-term, we could see economies split into pro-fossil fuels and pro-net zero blocs. This could lead to trade disputes, carbon border taxes, and diverging investment focuses, which could make progress uneven and unpredictable.

But a long-term focus on R&D across existing and potential energy sources, with technology improvements for renewables in terms of storage, transmission, and grid upgrades, could eventually see economies less divergent on policy with a more even mix of energy generation. Diversification is likely to be the key to the world's energy needs.

With the re-election of Trump, there will be implications for Australia.

If there is a deterrence effect for investment in the energy transition, costs will rise. In any case, investment hesitancy probably exists already due to a lack of bipartisanship on domestic policy, which swings between Governments of the day. To date, heavy subsidies have been required to underpin consistent private sector investment.

The US endorsement of uranium aligns with the Coalition's plans for nuclear energy in Australia. Though short-term energy relief is unlikely with high capital costs and long lead times, nuclear could eventually stabilise the

Australian energy market. Nuclear energy is being bolstered and fast tracked in other major Western economies.

The resurgence of US energy exports could undercut pricing of Australian liquefied natural gas and coal exports, but it should remain a major exporter to Asia in at least the short-term, if there is a resulting boost in demand.

And increased fossil fuel investment in the US could provide political cover for the extension of coal plant life in Australia, with evidence that aggressive renewables targets may be slipping, and costs blowing out. Already, NSW has underwritten a two-year extension of the life of the Eraring Power Station, recognising the state faced energy reliability risks as it transitions to renewable energy. Certainly, there has been increased recognition that gas will remain a key bridging fuel for possibly decades in Australia.

In the end, we all want cleaner energy, but it must be as cheap, reliable, and as abundant as possible. While the Trump administration may slow down the push to reducing emissions, it may well shake up global thinking to meet those ends.

Tony Dillon is a freelance writer and former actuary. This article is general information and does not consider the circumstances of any investor.

A new capital cycle is driving US exceptionalism

Robert M. Almeida

While equity market forecasters are wrong about half the time, they tend to have a higher success rate than economists, who predicted a US recession in 2024 and inflation falling back to 2%. More recently, the latest US labor report showed that the number of new jobs created in December blew past consensus forecasts by more than 3 standard deviations.

Why is economic modeling so hard?

Economic forecasting warrants a stronger adjective than hard. Its exceptionally challenging and complex. While several factors are at play, at its core, gross domestic product isn't a static measure like wealth, enterprise value or stock market capitalization. Instead, GDP captures the dynamic flow of capital within an economy, meticulously tracking expenditures — their magnitude, location and source — and comprises many variables moving in conflicting directions.

As a result, the aggregated data streams used in economic modeling can sometimes make a change in trend or direction hard to see. Seemingly small or immaterial data points are often underemphasized if not overlooked. Often the most critical datapoints, such those that mark the end or beginning of meaningful directional changes in the flow of capital, reveal themselves years later as important inflection points.

This is where a bottom-up approach may complement a top-down forecast.

Getting at the economic cycle through the capital cycle

The purpose of capital markets is to bring together society's savers, those seeking returns above cash yields and those with ideas but in need of funds. In exchange for capital, entrepreneurs are willing to give up some of the potential spoils. Since capital is allocated in accordance with the potential utility and risk of the project, where capital is being allocated to and from signals where the private market sees growth and contraction.

For example, we can observe this in the very long but weak business cycle following the 2008 financial crisis. Households and banks undertook balance sheet repair that warranted years of austerity and deleveraging that deflated economic growth. With anemic revenue growth, developed market companies only added to the malaise by offshoring, which lowered spending and expenses. With deflation risks mounting, central banks rekindled a capital cycle by artificially suppressing borrowing costs. While a new capital cycle was borne, it wasn't the one many had hoped for, fueled by tangible fixed investment. Instead, newly created capital was cycled to shareholders via dividends and stock buybacks, culminating in one of the longest economic cycles in decades, one that produced immense wealth for many equity owners.

So where is capital flowing today and does the answer to that question explain the current state of US economic exceptionalism? More important, can it give us insight into the future?

The capital cycle now and why it matters

A lot of goods consumed in the US, including many related to national security, are manufactured outside the country. As a result, companies haven't had to create tangible capital because China has done it for them to the benefit of shareholders.

However, in recent years, the combination of COVID, rising geopolitical tensions and prospects for future tariffs has brought about a shift. An efficient, low-cost system is being exchanged for one where products are produced more simply and closer to home. Following many years of US corporate capital expenditures falling relative to sales, today it's reversing. A new capital cycle has emerged, but this is only part of the narrative.

Since the US is the primary home of artificial intelligence, it's sucking up the world's investment capacity. The exhibit below illustrates the net level of US international investment (the difference between US residents' investments abroad and foreign investment in the US). At -$22 trillion, it's more than quadrupled since the runup to the global financial crisis.

Exhibit 1: Foreign investors find the US exceptional

Source: Bloomberg, International Monetary Fund (IMF). Quarterly data from 31 December 2005 to 30 June 2024 (latest available).

The investment needs associated with the AI ecosystem are massive. While there are over 8,000 data centers globally, the bulk are in the US. Think of these as AI factories that turn energy and data into human-like outcomes. The physical and capital needs for data centers alone, never mind that the demand for cooling, power and the like are enormous.

This shifting use of capital helps explain US exceptionalism and perhaps supports the notion that the recent US labor report shouldn't have been as surprising as it was.

The capital cycle of the 2010s deflated cost and produced very little economic growth but fueled huge profits and wealth for stock owners. That capital cycle has ended. Today's cycle is different. It's inflating costs (equipment and labor), driving growth, US exceptionalism and higher interest rates. What remains to be seen is how this will affect profits and thus stock prices.

Future profits and equity returns

US profits are high as companies have been able to maintain the elevated prices from the COVID-stimulus period. Additionally, investors are enthused by the prospect of future corporate tax cuts and continued superior US GDP growth and extrapolate those into continued earnings gains.

While that's a possibility, the changing capital cycle points to a potentially different outcome. Recent investments have already produced new products across varying industries. Increasing supply, particularly that comprising goods better or cheaper than existing ones, challenges the pricing power of incumbents and forces them to invest more. Lower prices and higher costs are a high hurdle for companies to clear, which is what the prices of most stocks imply today.

Take consumer goods. Traditionally, brand power has been a substitute for consumer due diligence, and it has delivered market share and profits. AI has changed that. An online query via a common search engine leads you to products with large advertising budgets, but large language models (LLMs) will go further, cutting through marketing noise and delivering goods tailored to consumers. LLMs will become a workhorse for the consumer by reading what industry experts have to say, checking out every customer review, etc. In other words, AI will give consumers agency, posing immense challenges and bringing changes across multiple industries, potentially disappointing the very high expectations of investors today.

Conclusion

There has been a substantial change in the capital cycle. Instead of funding dividends and buybacks, many companies are funding tangible projects. While that could mean more growth and inflation, it would also mean a whole different set of winners and losers.

Looking ahead, stock market leaders will likely be those companies insulated from competition with the ability to protect profit margins. Laggards will likely be those susceptible to ankle-biters forcing change. Like generals fighting the last war, benchmarks are positioned for a paradigm of the past, not the future. We think that forward-looking active managers who employ a capital cycle lens will outpace the pack.

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

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What does the rest of 2025 hold for commercial property?

Colin Mackay

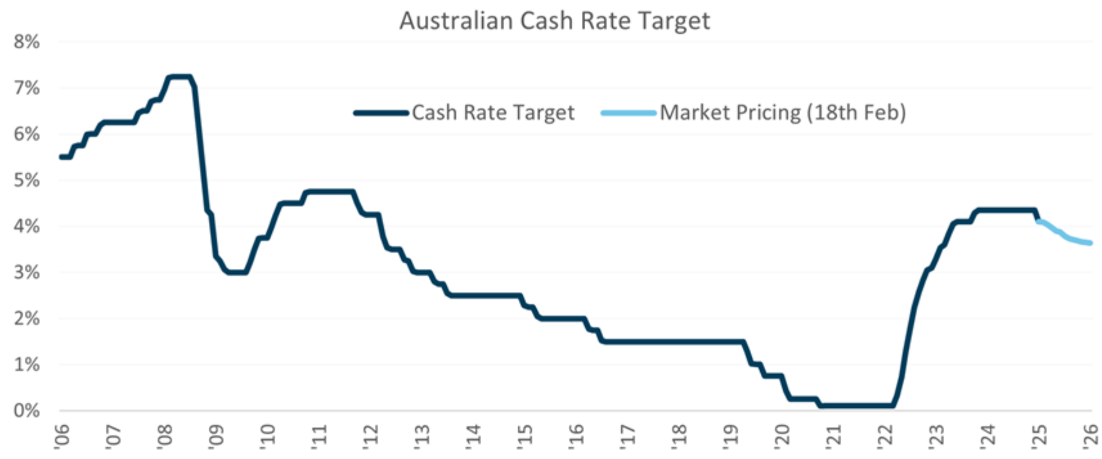
With workplaces and schools finally starting to hum again after the summer break, now seems like a good time to look ahead at what the balance of the year has in store for us. This article touches on five key macro developments expected to influence commercial property performance and investment over the rest of 2025.

1. Rate cuts

After hopes of a late-2024 rate cut were dashed in October by resilient labour data, attention switched to 2025 for the turning of the economic cycle and a return of looser monetary policy supportive of stronger growth. Financial markets were pricing a 90% probability of a rate cut prior to the RBA's decision on 18th February, an expectation shared by most economists. The central bank didn't disappoint, reducing the cash rate for the first time in over four years.

Governor Bullock's post-meeting comments struck a hawkish tone, drawing attention to the upside risk to inflation that a tight labour market still poses and appearing to reflect a preference for a relatively measured and cautious cutting cycle. The market now expects two additional cuts this year, with economists generally forecasting a further 1-3 cuts. Because these cuts are expected by the market, instruments like Australian Government 10-year bonds have likely already 'priced in' most of the change – and so long-term bond yields may not see significant movement from their current level of around 4.5%[1] even as further cuts occur.

Regardless, rate cuts should be a net positive for commercial property by supporting a stabilisation of asset pricing, increasing transaction activity, and easing cost of debt pressures. An 'easier' monetary policy environment should also stimulate the economy, which is a benefit for a growth asset class like commercial property where tenants' demand for space is linked to economic activity such as jobs growth, retail consumption, and trade volumes.



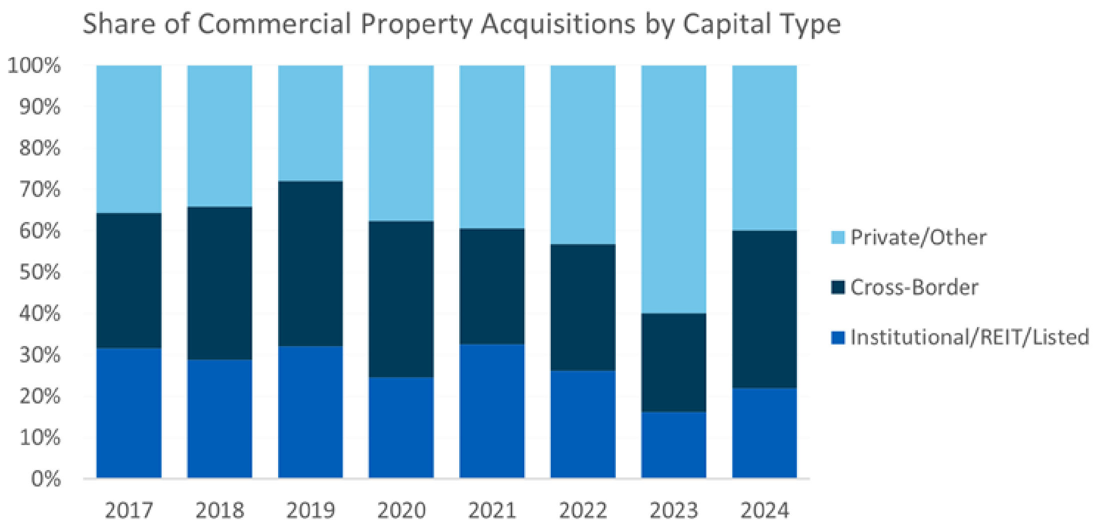
Source: RBA; ASX; Cromwell.

2. Shifting capital composition

In downturns, nimble private investors tend to trade commercial property more actively than institutional holders. This cycle has been no different, with private buyers making up 45% of acquisitions (by dollar volume) from 2022-23, up from 32% in the five years prior. As 2024 progressed, offshore institutional capital thawed and allocated to the Australian market, becoming the dominant buyer type. Such investors have been involved in some of the headline transactions of the year, including Sydney office towers 55 Pitt Street, 255 George Street and 10-20 Bond Street.

Over the course of 2025, we expect domestic institutional capital to join the party and step up acquisition activity. This expectation reflects the turning of the cycle which appears to be occurring, and the stabilisation of prices that should continue as the cycle enters its next phase.

Deepening of the capital pool and increased activity from institutional buyers will be important precursors to price recovery – with more competition comes more aggressive bidding for assets. This competitive shift will likely be felt in specific asset segments (e.g. premium office) before others, and to differing degrees. While markets and segments that follow the cycle (rather than lead it) may face a slower price recovery, acquirers can benefit from a longer 'buying window' where sentiment is yet to align with property fundamentals.



Source: RCA/MSCI; Cromwell. By dollar volume

3. Stronger consumers

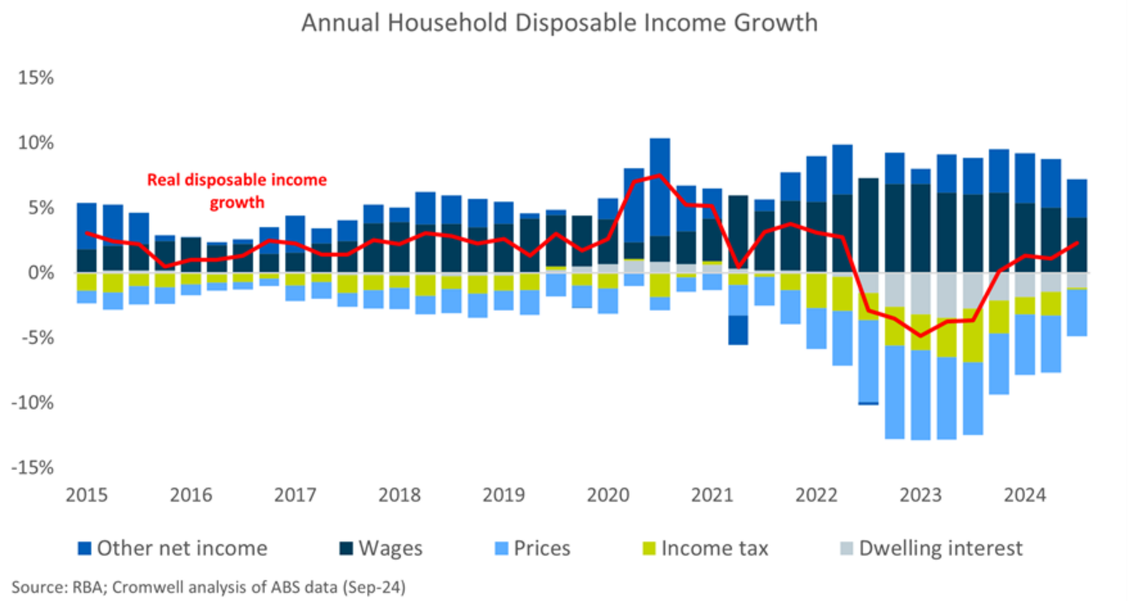
Consumers have been buffeted since 2022 by various cost-of-living pressures, spearheaded by surging inflation, higher interest rates, and bracket creep. These contributed to a stark fall in consumer confidence, subdued retail sales growth, and tough trading conditions for businesses that cater to households more broadly.

In good news for 2025, many of these headwinds are abating.

- Headline inflation has slowed from a peak of 7.8% in December 2022 to 2.4% as at December 2024[2]. Lower inflation is benefitting the real (inflation-adjusted) spending power of households.
- The arrival of rate cuts will lead to a decrease in what is the biggest expense for many Australian households.
- The Stage 3 tax cuts went live from July and are improving households' disposable (post-tax) incomes.

With a federal election approaching, we may also see additional assistance for households announced in the first half of the year as politicians try to shore up support before voters head to the polls.

An improved outlook is starting to become evident in stronger consumer confidence measures, setting the stage for stronger retail sales growth. While rising disposable incomes will be welcomed by retailers across all categories, we believe long-term consumption trends will continue to provide outsized benefits to shopping centre assets which are resilient to e-commerce competition and more heavily weighted towards 'essentials'.

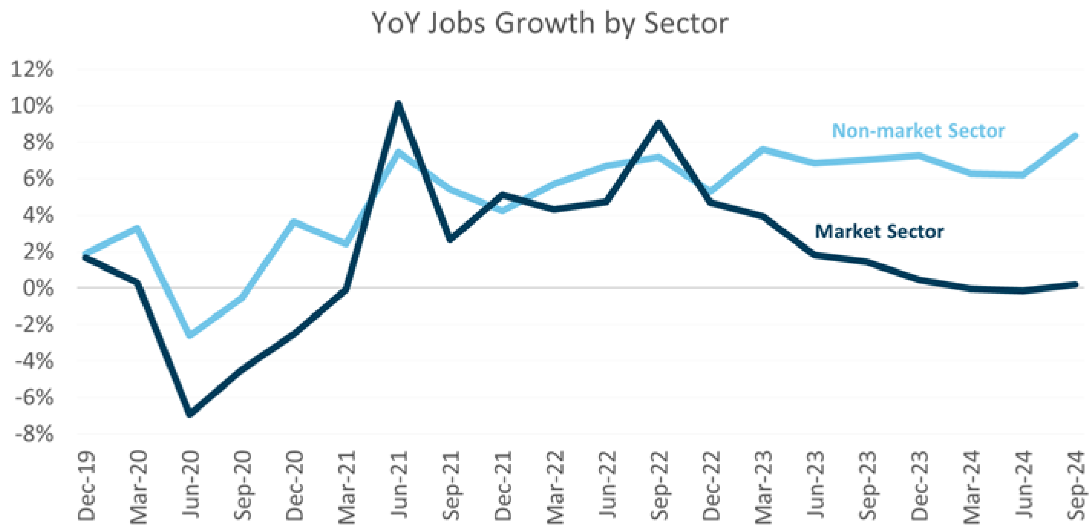


4. Improved market sector job growth

The labour market has been remarkably resilient considering the broader economic slowdown – jobs growth of 2.5% was recorded over the year to September 2024, in stark contrast to GDP growth of only 0.8%[3]. However, the robust outcome was largely driven by the **non-market** sector, comprised of industries such as education, healthcare, and public administration, where demand is not determined by typical market forces or the business cycle. During this period, the non-market sector accounted for 94% of the jobs created and **market sector** jobs growth was a meagre 0.2%.

Demand for office space is correlated with white collar jobs growth, which is largely represented by the market sector. Although headline jobs growth may slow in 2025, **market sector** jobs growth should accelerate from its low base due to the anticipated rate cuts, which benefit industries exposed to the business cycle. This is expected to contribute to stronger jobs growth in the typical 'office-using' industries, positively impacting office space demand, reducing vacancy rates, and enhancing rental growth conditions.

While the outlook for office market conditions appears more favourable over the next twelve months, the risk of asset obsolescence remains elevated due to shifting ways of working and amenity preferences. Property selection will be a key driver of outperformance for investors.



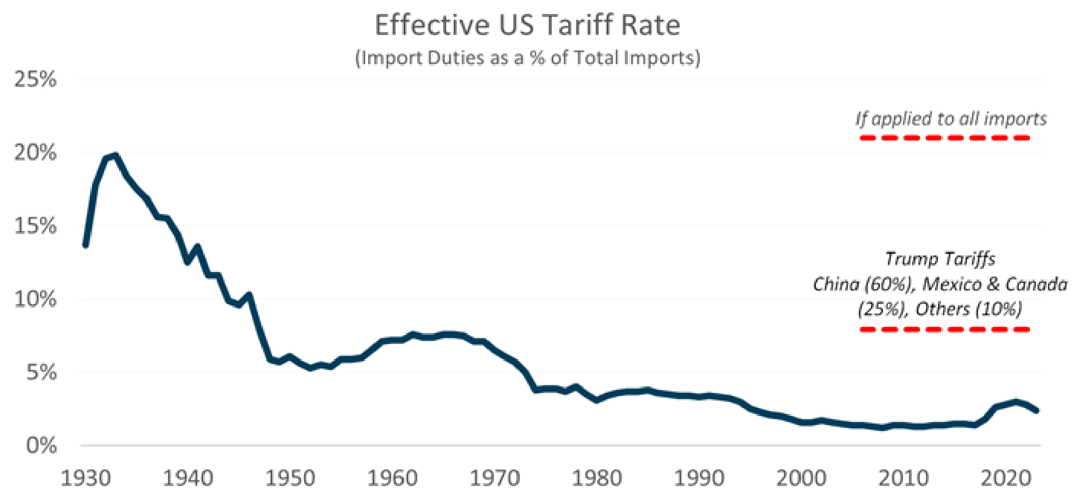
Source: ABS; Cromwell. Data to Sep-24

5. Geopolitical uncertainty

Geopolitical uncertainty was a key feature of 2024. It was the biggest election year in history globally, with 80 countries heading to the polls and incumbents' power diminishing in over 80% of the elections held[4]. At the same time, conflict in the Middle East escalated and the Russia-Ukraine war continued unabated.

It looks set to be much of the same in 2025. While most of the election outcomes are now known, implications for the global and domestic economies are yet to become evident. Trade policy is top of mind following Trump's campaign trail promise of 60% tariffs on Chinese goods, 25% on Mexican and Canadian imports, and 10% on imports from all other countries. While negotiations are underway and such extreme tariffs are unlikely, increased protectionism of some degree is anticipated and could lead to retaliatory measures including counter-tariffs. Similarly, tariffs are typically viewed by economists as inflationary and may stoke cost-of-living pressures once again, particularly if combined with fiscal stimulus. But it's also possible that disrupted global trade has a deflationary effect if confidence and growth take a significant hit. It is a time of known unknowns.

Whatever occurs, times of volatility and uncertainty often reward quality and security. Assets with strong tenant covenants and stable cashflow are well placed, as are those with enduring location advantages. Shifting trade dynamics are of particular relevance to industrial property and assets which can cater to manufacturing occupiers may benefit from an increased focus on domestic industry.



Source: U.S. International Trade Commission (May-24); Fitch Ratings (Jan-25)

5b. A Broncos premiership

The author is unable to provide supporting data for this prediction.

A year with something for everyone

Economic growth should improve in 2025 as the RBA lifts its foot off the interest rate brake pedal, easing pressures on household wallets and business investment. A stronger economy is a positive for commercial property as increased consumption, jobs growth, and trade volumes underpin leasing demand.

Lower interest rates should also support the continued stabilisation of asset pricing, as capital markets normalise after several years of constrained liquidity and elevated debt costs. A stable price environment will be more conducive to improved transaction activity and subsequently valuation recovery.

There are some potential speed bumps which could sap momentum, not least of which is the geopolitical landscape. Given the environment of uncertainty, flight to quality is a theme which will likely continue to play out over 2025, rewarding assets that can provide investors with stable and secure income.

[1] RBA (as at 12th February 2025)
[2] December 2024 Quarterly CPI, ABS (29th January 2025)
[3] ABS September Labour Account and National Accounts (Dec-24)
[4] Market Outlook, Westpac (Dec-24)

Colin Mackay is a Research and Investment Strategy Manager for 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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