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Spicing up two main investment principles

Don Stammer

Advice often given to younger or less-experienced investors includes:

- Define investment objectives
- Benefit from the magic of compounding
- Look out for assets that are underpriced
- Maintain a sensible diversification
- Allow for the cycle in investment returns.

Each of those five points is an important principle of investing. Together they provide just about everything an investor needs for success, other than money and experience.

Unfortunately, many introductory lectures on investing are dreadfully boring. (Trust me to know about boring presentations on investments. Over the years, I have delivered about 10,000 offerings in person or in writing. Or was it one presentation given 10,000 times?). They are not tailored to hold the attention of either young investors or of older-but-inexperienced ones.

Make investing more engaging

The solution is to re-express the key principles of investing as parables or fables. To begin this revolution in the teaching of the basics of investing, I offer an investment parable to help the next generation of investors understand the cyclical nature of investment returns (and the case to be counter-cyclical) and an investment fable to exalt the wonder of compounding.

A parable is a short allegorical story designed to illustrate or teach some truth, religious principle or moral lesson and which conveys its meaning indirectly by the use of comparison, analogy, or the like. A fable is a succinct fictional story or verse, often presented at a level that children can understand and illustrates a particular moral lesson.

Parable 1: The cycle in investment returns

The Australian bush ballad, 'Said Hanrahan', is more than a great tale. It should be upgraded to a new status as investment parable.

Written by John O'Brien, who in real life was a Catholic priest named Patrick Joseph Hartigan, and published in 1921, its recurring theme is "we'll all be rooned". ('Rooned' is, of course, Irish-Australian for 'ruined'). The poem is only a page and half long, and was once taught to Australians in primary school (thank you to my teacher, Mr Ashley O'Toole, at Vacy Public School in 1949).

The poem (or should I say 'pome'?) hints at these features of the investment cycle:

- The cycle, which is always with us, is caused or aggravated by swings in public sentiment.
- Cyclical swings often develop a momentum that runs too far. When people sit (or squat) around endlessly predicting gloom or boom, the investment cycle will overshoot both down and up.
- Anyone who can identify turning points in the cycle before others is on the primrose path to riches.

The poem begins with people chatting outside a country church, on a winter's morning, during the worst drought "since the banks went bad" (in the 1890s). In talking together, the parishioners keep raising their assessments of the harm the drought will bring to the once-prosperous farming community. Hanrahan concludes "we'll all be rooned … before the year is out".

Of course, "In God's good time, down came the rain". For a time, the rain was welcomed, as it "drummed a homely tune on iron roof and window pane". But then it "pelted, pelted all day long", and creeks and dams overflowed. Hanrahan opined: "we'd all be rooned if this rain doesn't stop".

And stop it did, "in God's good time". Optimism briefly reigned as "spring came in to fold/A mantle o'er the hill sublime/Of green and pink and gold". However, a new concern soon worried the "men of mark/As each man squatted on his heel/And chewed his piece of bark/There'll be bush-fires for sure, me man/There will without a doubt/We'll all be rooned, said Hanrahan/Before the year is out".

John O'Brien left us an apt reminder of the mistake most investors repeatedly make of extrapolating ahead the current phase of the investment cycle, and to suggest it's the beginning of a long-term trend, though it is just one phase in the investment cycle.

Parable 2: The magic of compounding

A common problem in trying to enthuse young investors about the magic of compounding is their attention can fall away when you introduce them to the daunting formula:

$$FV = PV \times (1+r)^n$$

An alternative approach is to share a viewing of the Mary Poppins movie and to focus on the scene where the directors of the Fidelity Fiduciary Bank entice Michael, with sister Jane watching closely, to invest his tuppence in one of the bank's financial products (Did banks really offer managed products in 1910?).

Their advice, which in my view merits elevation to the status of a fable, is delivered as a verse. Part of it runs like this:

"If you invest your tuppence in the bank, safe and sound
Soon that tuppence, safely invested in the bank, will compound
And you'll achieve that sense of conquest as your affluence expands
In the hands of the directors as propriety demands
You see Michael, you'll be part of:
Railways through Africa! Dams cross the Nile! Fleets of ocean greyhounds! Majestic, self-amortising canals!
Plantations of ripening tea!
All from tuppence, prudently, fruitfully, frugally, invested."

Sure beats a dull formula, and gives you opportunity to explain 'self-amortising'.

As things turn out, Michael pulls out of the deal. He inadvertently starts a run on the bank by demanding his money back and spends the tuppence on buying seed to feed the birds. (Is there the opportunity here for some advice on work-life balance?)

Wrap up the session by pointing out that, had Michael's tuppence been invested in Australian shares in 1910, and allowed to compound, Michael's descendants would today hold an asset worth about $1,200 – and think how much bird seed they could buy.

Don Stammer has been involved with investments since the early 1960s including senior executive positions in Deutsche Bank and ING. These days, in his semi-retirement, he's an adviser to Altius Asset Management, Stanford Brown Financial Advisers and the Third Link Growth Fund. The views expressed in this article are his own.

Retirement planning improved by grey hairs

John Leske

Most planning advice regarding saving for or the enjoyment of retirement is given by people who are not retired. While the advice may be well meaning, it could inadvertently suffer from a lack of empathy with the realities of retirement.

In addition, the experience and expectations of current and previous retirees may differ significantly from that of the vast numbers of baby boomers that will increasingly dominate the ranks of the retirees over the next decade. As a result, retirement advice based on researching earlier generations may not be as relevant as expected.

A recent article in *The New York Times*, titled "Three Things I Should Have Said About Retirement Planning" is a confession. Paul B. Brown co-authored two books on saving for retirement while he was in his 30s and 40s. He is now aged over 60 and his typical advice suffered some inadequacies, now made apparent by his own life experience.

Retirement planning meets reality

He provides three examples where his generic approach to retirement planning failed to accord with the reality he experienced.

1. Working longer

The first example concerns a typical response to inadequate retirement savings. Rather than the suggestion to a client that they need to save more and spend less, the more palatable advice is often to suggest they work longer. Together with the fact that we are usually living longer, working longer doesn't appear an unreasonable proposition.

The obvious argument against this for those in labour-intensive jobs is they may be physically incapable of working longer. But Brown's experience is consistent with that of a number of our clients:

"… I now realize … just how hard it is to keep working as you age. My job doesn't require much more than typing all day long, and I find myself getting fairly tired by day's end. I can't imagine I am going to have more energy a decade from now."

So, unless you remain extremely passionate about your work, working longer to rectify an inadequate savings problem isn't necessarily the easy option it is often held out to be. If our clients are to work beyond a desired retirement age, we prefer it to be by choice, rather than driven by financial necessity.

2. Life is not predictable

Brown's second example concerns an assumption that 'life moves in straight lines', for example, once you begin saving, you keep saving. His earlier advice assumed that when children moved out of home and were financially self-sufficient, the money previously directed to children would then all be available for retirement savings.

His reality was that for some considerable time those 'available' funds went to home repair that had been deferred during the high cost years of raising and educating children. His planning advice had not allowed for the significant and ongoing cost of what we call 'capital maintenance'.

In our view, Brown's previous planning advice failed to sufficiently drill down into the financial expectations of his clients (or book purchasers). We ask our pre-retiree clients, regardless of their current age, to not only tell us how much they are spending now but also what they would like to spend in retirement. We go through a list of likely household expenditures line by line and over time, on the understanding that the pattern of spending may change.

For example, more money may be devoted to travel, sports and entertainment in the early years of retirement. Spending may reduce in later years as mobility and, perhaps, enthusiasm for such activities decreases, but expenditure on medical costs and support for children/grandchildren may rise.

One area of spending that receives special focus is what we call capital maintenance. This usually refers to the cost of updating the family residence and replacing motor vehicles. These generally imply lumpy, irregular outflows that are often overlooked when determining expected ongoing expenditure.

No client has ever told us that they want to run their existing motor vehicles into the ground or let their house fall down around their ears in retirement. The general expectation is that these capital items will be refurbished or replaced so that their pre-retirement standard is at least maintained.

3. Incurrence of large, one-off expenses

This is supported by the third example, where Brown's personal experience included a large one-off expense for a combined major trip and wedding that had not been contemplated and seriously affected the family's financial position. It underlines the need to budget for future desired ongoing holidays and other major, highly likely, expenses (e.g. weddings, support for adult children), so that should a large unplanned once-off expense occur it does not cause an entire financial plan to unravel.

'Rules of thumb' solutions may not be helpful

Brown's solution to the conflict between his earlier advice and actual experience leads him to recommend: *"And no matter how much money you think you are going to need, save another 15%, just in case".*

We believe this advice will fail to handle reality adequately. There is no substitute for:

- A detailed examination of the financial implications of lifestyle expectations, and
- A regular review (at least annually) of the resulting lifelong cash flows, given changes will inevitably occur.

The actual experience of a wealthy accountant, who sought a second opinion from us regarding the veracity of his financial planning, is salutary. He planned to retire within two years and, among other things, estimated a desired retirement lifestyle of $120,000 per annum.

A more thorough analysis of his expected spending and incorporation of overlooked allowances for capital maintenance (of a principal residence, holiday house, investment property and two luxury cars) suggested that $200,000 per annum was more realistic. An additional 67% retirement capital required a dramatic change in lifestyle expectations. In the case of this client, adding another 15% would have been wholly inadequate.

The future is unpredictable and an opinion on a desired future lifestyle many years ahead may change by the time the date arrives. But not making some reasonable guesses makes it almost certain that unplanned adjustments, most likely significant, will be needed at some stage.

John Leske is a Principal of Wealth Foundations. This article is general advice only as it does not take into account the objectives, financial situation or needs of any particular person.

Living the lifestyle you want in retirement

Michael Clancy

Planning for retirement is daunting for many people. The stakes are high, and there is uncertainty around some important issues, like how long will you live? What makes this a particularly vexing issue is that hardly anyone likes talking or thinking about death, especially their own!

So, let's be adults and tackle this 'length of life' issue head on.

How long are you expected to live?

The Australian Federal Government provides updated life expectancy data for the Australian population each time it publishes its Intergenerational Report, which it last did in 2015. It shows that a man born today (that is, in 2015) is expected to live to 80.7 years of age and a woman is expected to live to 84.8 years of age. Whilst interesting, this full life expectancy statistic isn't as helpful as you might think when planning for retirement. That's because, if you are at retirement age now:

- You were born many decades ago and your full life expectancy is different from the numbers being quoted for new births today, and
- You have already outlived some of the people born around the same time as you.

What is a lot more helpful are the next set of numbers in the following table.

If a man is currently 60 years of age, he is expected to live another 23.8 years to **83.8** years of age and a woman is expected to live another 26.8 years to **86.8** years of age.

Similarly, if a man is currently 70 years of age, he is expected to live another 15.7 years to **85.7** years of age and a woman is expected to live another 18.1 years to **88.1** years of age.

Table C.2 Australians' projected life expectancy — period method (years)

	2014-15	2024-25	2034-35	2044-45	2054-55
Life expectancy at birth					
Men	80.7	82.9	84.9	86.6	88.1
Women	84.8	86.4	87.9	89.3	90.5
Life expectancy at age 60					
Men	23.8	25.5	27.0	28.3	29.5
Women	26.8	28.1	29.3	30.4	31.4
Life expectancy at age 70					
Men	15.7	17.0	18.1	19.2	20.2
Women	18.1	19.2	20.2	21.1	22.0

Period life expectancy at a given age is the average number of years a person will live if the age–specific mortality rates at that point in time, given the person's gender, were to apply for the rest of the person's life.
Source: Treasury projections.

Source: "2015 Intergenerational Report – Australia in 2055", Australian Government, The Treasury, March 2015.

Living longer than the average

The Australian Bureau of Statistics ran a survey in 2014/15 about retirement intentions and found that the average intended retirement age was 65 years. Assuming reality matches these intentions, it means if a person retires at age 65 in 2017, a man will be expected to live until age 85 and a woman to age 87 years. That's 20 and 22 years respectively living in retirement, which is a really long time.

And here's the interesting part … that is just the average life expectancy: 50% of people will live beyond these ages, many into their 90s, and some (around 3-4% of the population) will live past 100 years of age.

There are a host of factors that impact how long you are likely to live. Here is a link to an AMP calculator that can give you a better estimate of your own life expectancy.

Preparing for a long retirement

We can't know exactly how long we will live, but there are a few things we can know.

We know that the age pension in 2017 (including supplements) is $23,096 per year for a single person and $34,819 for a couple. This may be enough to survive on if you already own your home, but most people would not consider it enough to thrive on. If you don't own your own home, and don't have much in the way of retirement savings, please, be *really* nice to your family, as you will probably need them later on.

Moreover, eligibility to receive the age pension is already income and assets tested, and given Australia's aging population, the Federal Government is over time more likely to tighten the eligibility criteria and the level of the age pension than it is to be more generous and loosen them.

We also know that based on current life expectancy, you have a 50% chance of living into your mid/late 80s, which is 20-25 years in retirement. And you may well live beyond this average age and therefore will want to stretch your ability to generate additional income in retirement out to 35+ years.

What actions make a difference to your lifestyle in retirement?

There are only so many ways to build up that retirement nest egg to provide a higher and more sustainable income in retirement. Here are a few ideas:

Before you retire

- **Save more:** Spend less and save more. Making voluntary concessional and/or non-concessional superannuation contributions are not the only ways to save, but they are tax-advantaged ways of saving.
- **Work longer:** You will earn more income, make more superannuation contributions and give your retirement savings more time to grow before you start drawing down. This might not mean working full time for longer, but perhaps transitioning from full time work to part time work and then eventually into full retirement.
- **Invest wisely:** Depending on your time horizon or risk appetite, you might choose to invest more conservatively or more aggressively than you do currently. There is an inherent link between risk and return, so investing more aggressively is likely to deliver a more volatile and uncertain ride.
- **Lower your cost of saving:** Lowering your fees without sacrificing the integrity of your investment strategy might eke out a slightly better return. If you have multiple superannuation accounts, consider consolidating them to reduce fees.
- **Get advice:** There are hundreds of pages of government legislation around retiring, and thousands of pages of guidance notes, advice, etc. One of the big value-adds of financial advisers is they can navigate these rules and regulations with you. The decade or two prior to your retirement is an excellent time to engage a qualified financial planner to chart the course of your retirement.

When you retire

- **Modify your lifestyle expectations to match your means:** You might find that when you get to the point of retiring you have more or less assets than you expected. You should consider modifying your lifestyle expectations.
- **Diversify your sources of income:** Diversification still matters in retirement, and maybe it matters even more. But now you should not only think about diversification of investments, but also about a diversity of income sources. For example, you might draw an income partly from the age pension, partly from an Account Based Pension account, and partly from an annuity product.

Step up and plan

While preparing for retirement and discussing your own mortality may not be everyone's idea of fun BBQ conversation, these are important issues to grapple with. And the earlier you do this, the more time and opportunity you will have to develop a plan that makes a difference to the level and sustainability of your lifestyle in retirement.

Michael Clancy is CEO of Qantas Super and the Co-Founder and Director of cloud-based wealth advice service, BigFuture. BigFuture has now made its retirement planning tool free to users, although you will need to register and log in. The tool allows users to see how much they are likely to own in retirement and test how much they can spend.

The indignity of a modest retirement

Martin Fahy

Australians living on modest budgets, that is, those living close to or at pension level, are suffering the greatest additional cost imposts in retirement, according to new figures released by the Association of Superannuation Funds (ASFA). The calculations distinguish between 'modest' and 'comfortable' living, with the comfortable standard budget affording a much more dignified existence for Australian retirees.

ASFA Retirement Standard (RS) June 2017 quarter figures show couples aged around 65 living a comfortable retirement need to spend **$60,063** per year and singles $43,695, up 0.2% on the previous quarter. The modest budget has much to be modest about and is at near pension level subsistence, with singles needing to spend $24,270 and couples **$34,911**.

Modest level suffers higher increase in costs

The **annual** increase in living costs at the modest level was in each case higher than at the comfortable level, reflecting the greater relative importance of electricity, health care and council and water rates in the modest budgets. The annual increase was 1.5% for comfortable and 2.1% for modest. These compare to 1.9% for the general Consumer Price Index (CPI).

The cost of retirement over the most recent quarter only increased by a relatively small amount, but many retirees are still finding it difficult to achieve a comfortable standard of living. Too many people are living without enough super, especially women. Australian retirees living at the basic level are doing it tough meeting costs of living. Financial support and literacy are part of the solution and super funds across the country can help members sort out their retirement living planning.

People need to be retirement-ready by saving for the sort of life they want to live. The magic of compound interest and tax savings in super can help lift living experiences in later life. Retirees now and in the future need super to increase and be safeguarded.

Living costs for retirees by capital city

Cost increases for retirees were highest in Sydney, Adelaide, Hobart and Canberra, while Darwin, Perth and Brisbane had the lowest average overall price increases.

In Sydney, a 3.8% increase in food costs, a 12.5% increase in electricity costs and a 5.1% increase in health costs were higher than average increases in the retirement budgets.

Annual increase in retiree living costs by capital city

	Comfortable	Modest
Sydney	1.8	2.5
Melbourne	1.6	2.2
Brisbane	1.0	1.3
Adelaide	1.9	2.5
Perth	0.9	1.2
Hobart	2.1	2.3
Darwin	0.4	0.8
Canberra	2.1	2.4

Updated retirement standard costs

While seasonal fruit and domestic holidays were more affordable, critical costs of power, health care and rates and water bills continue to be a big cost issue for many retirees.

The most significant price increases in the June 2017 quarter contributing to increases in annual budgets for retirees were for medical and hospital services (4.1%) reflecting the annual increase in private health insurance premiums on 1 April. The most significant offsetting price falls were for domestic holiday travel and accommodation (-3.2%), automotive fuel (-2.5%) and fruit (-4.4%).

Fluctuations in world oil prices continue to influence domestic fuel prices. During the June quarter, automotive fuel prices fell in April (-0.8%), rose in May (+0.2%) and fell in June (-0.6%). Overall, food prices fell 0.2% in the March quarter. Clothing and footwear prices fell 0.3% as a result of sustained periods of specials.

Budgets for various households and living standards for those aged around 65 (June quarter 2017, national)

	Modest lifestyle		Comfortable lifestyle	
	Single	Couple	Single	Couple
Housing – ongoing only	$76.47	$73.41	$88.63	$102.75
Energy	$43.99	$58.43	$44.64	$60.55
Food	$78.54	$162.68	$112.20	$201.95
Clothing	$17.31	$28.10	$37.47	$56.20
Household goods & services	$27.25	$36.95	$76.65	$89.80
Health	$46.05	$88.87	$91.35	$161.23
Transport	$93.18	$95.82	$138.85	$141.49
Leisure	$74.51	$111.00	$225.79	$309.42
Communications	$8.15	$14.27	$22.41	$28.52
Total per week	$465.44	$669.53	$837.99	$1,151.90
Total per year	**$24,270**	**$34,911**	**$43,695**	**$60,063**

The figures in each case assume that the retiree/s own their own home and relate to expenditure by the household. This can be greater than household income after income tax where there is a drawdown on capital over the period of retirement. Single calculations are based on female figures. All calculations are weekly, unless otherwise stated.

The difference in enjoyment of retirement years is stark between modest and comfortable (and both sets of numbers assume the retirees own their own home). The most striking difference is the amount available for leisure activities and health. Superannuation should be taken more seriously by those who seek a comfortable retirement. Inflation may seem to have stabilised, but costs are increasing for retirees on smaller budgets especially as the essentials become more expensive.

Dr Martin Fahy is Chief Executive Officer at the Australian Superannuation Funds Association. Costs and summary figures can be accessed via the ASFA website. The ASFA Retirement Standard Calculator can be used to obtain a breakdown of the Retirement Standard budgets for each state. Australians can find out more about superannuation on the independent Super Guru website.

Big data reveals how retirees really live

Wade Matterson

The superannuation industry isn't quite sure what a comfortable retirement is, even as it desperately works to help members achieve that elusive goal.

It's no surprise given the complexity of the task, which is affected by lifespan, personal expectations, government legislation, savings rates, market performance and more.

Many different opinions

But the problem is that members are likely to become disengaged and lose trust when they read conflicting articles about how much they need to save such as:

- A couple will need about $640,000 in super savings to have a comfortable retirement.
- A couple that saves at least $1 million in super will only generate about two-thirds of their pre-retirement income.
- A couple needs about $1.5 million in super to generate an income equivalent to average weekly earnings.
- A professional couple will need about $2 million in super at retirement.

These numbers stand in stark contrast to the median super balance at retirement (for those aged 60 to 64 years of age) of just $100,000 for men and $28,000 for women. Whatever estimate is chosen for a comfortable retirement, it's out of touch for at least half the population.

The current crop of widely-ranging estimates also leaves much to be desired for wealthier Australians. Super accounts for just a small component of net household wealth according to the Productivity Commission and wealthier people tend to have more assets outside of super. It's just not possible for funds to estimate the level of super their members require when they don't know the level of non-super assets they have and how they're being used.

The amounts many Australians actually spend

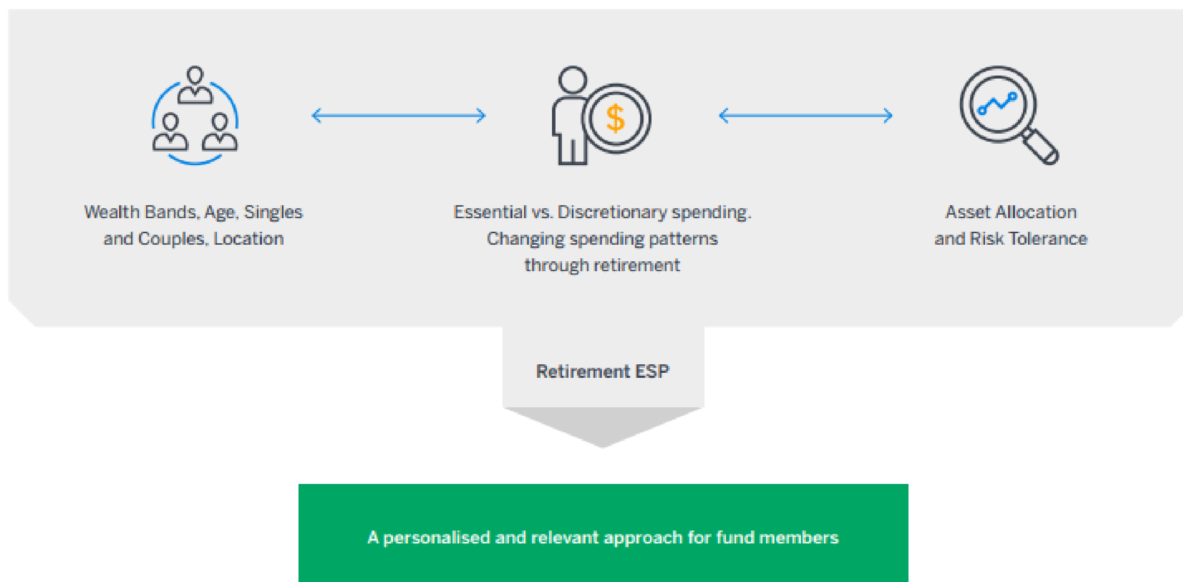
Milliman's quarterly Retirement Expectations and Spending Profiles (ESP) report now allows funds to see that type of information by analysing 300,000-plus retirees' spending data.

The Retirement ESP shows that Australians aged 65 to 69 spend a median of just $31,068 (from all sources including super, non-super savings and government benefits) each year. To fund this expenditure with 75% certainty would require a superannuation balance of approximately $130,000 invested in a balanced fund. This also includes the substantial contribution of the age pension (set at a maximum of $20,745 a year, the maximum basic rate for a single excluding supplements), which funds a major portion of retirement income.

This isn't to say that $130,000 should be a goal. It shows that even small differences in savings can have a hugely positive impact on members' actual retirement lifestyles. This is the basis for true engagement.

More detailed market segmentation also reveals the behaviour of retirees by wealth bands, age, singles versus couples, location, as well as showing their essential versus discretionary spending and how it changes through retirement.

Retirement and Expectations Spending Profiles



This type of quality data is crucial given most members won't seek personal financial advice. However, data is just one component of delivering a personalised retirement experience. A combination of data and analysis can provide a sophisticated profile of members that can ultimately underpin and deliver the right products to the right members at the right time.

Each member must ultimately define their own comfortable retirement but it's only by understanding their reality that funds can help them achieve it.

Wade Matterson is a Principal, Senior Consultant, and leader of Milliman's Australian Financial Risk Management practice and a fellow of the Institute of Actuaries of Australia. Read more about the Milliman Retirement ESP here. This article is general advice only as it does not take into account the objectives, financial situation or needs of any particular person.

Age pension is the world's greatest annuity

Josh Hall

The age pension has been a staple of retirement income for Australians since the early 1900s. Despite much public debate in recent years around reducing its benefits, and the latest changes introduced in early 2017, the age pension remains a relatively attractive, low risk source of cash flow for the majority of Australian retirees. If you consider its true value, you could say it is the world's greatest annuity.

And yet, despite its importance, investors often overlook it when they make asset allocation decisions for their retirement portfolios.

The implied value of Age Pension at 65 yo

Similar to an exceptional insurance company-issued annuity

Thinking of the full age pension as a life insurance company-issued annuity, its product features would look something like this:

- Yearly income of around $34,382 per homeowner couple
- Indexed twice yearly (to at least CPI, if not wages)
- Payments guaranteed for life
- Spouse reversionary
- Issued by an AAA-rated entity
- Government guaranteed.

How much would the average retiree couple be willing to pay upfront at age 65 for an income stream such as this? $200,000? $400,000? $600,000? The answer is, probably more.

Looking at an estimated net present value (NPV) of the yearly payments of $34,382 for an average male and female at age 65 on a full age pension gives a guide. From Aberdeen's estimates (based on constant value of assets during retirement) for a couple, it works out to be around:

- $653,787 for a couple
- $451,375 for a single female
- $398,698 for a single male.

The higher amount for a single female is based on an additional three years' worth of payments due to longer life expectancy.

These figures assume the recipients are on the full age pension. However, even for retirees eligible for a reduced pension, due to their assessable financial assets under the 'assets test', the value of the age pension remains substantial. For an average 65-year-old couple with $400,000 in combined financial assets, the age pension still has an estimated NPV of around $592,687.

This is a large sum, particularly compared to the average superannuation balance of $430,650 for the same couple at or near retirement age (60-64 years old). For a single male of this age, the average superannuation account balance is $292,500 and for a female it is $138,150 (according to ASFA 'Super account balances by age and gender', December 2015).

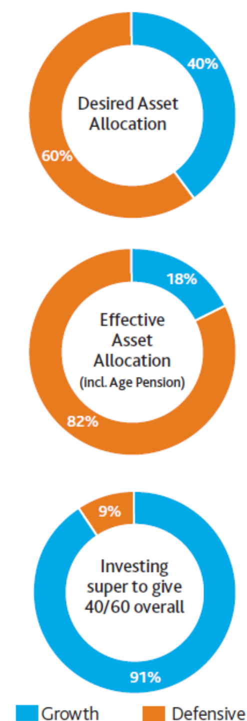
More than 55% of wealth is in the age pension

The average Australian couple at retirement effectively has $430,650 in accumulated super and, based on that super balance, also has $545,398 worth of future age pension payments (in NPV terms). Considered another way, more than 55% of the average retiree couple's financial wealth is in the form of the age pension.

Yet some investors, when determining the most appropriate asset allocation for their retirement portfolios, focus solely on accumulated superannuation balances, without taking into account the inherent value of the age pension. They fail to recognise that the age pension, which accounts for a significant portion of their total financial wealth (55% in the example used here), is a 100% defensive low risk asset. The implication of this is that the average investor can afford to be more growth asset-oriented with the remaining 45% (accumulated super balance) when constructing their investment portfolio.

Let's consider what this means for our couple above who has:

Accumulated super at retirement:	$430,650
Estimated NPV of age pension:	$545,398
Total assets effectively worth:	$976,048



Applying the traditional approach, this couple would invest the $430,650 in super in a 40/60 portfolio. This would include 40% in growth assets like equities and property, and 60% ($258,390) in defensive assets like annuities and term deposits.

Including the age pension as a defensive asset

However, if we were to include the age pension as an asset in this mix (counting it as defensive), their effective asset allocation would be **82% exposure to defensive assets**, and 18% to growth assets. At the overall level, the couple may be $218,000 (or 22%) over-exposed to defensive assets like term deposits and annuities. Such a mismatch between their risk profile and investment portfolio could severely compromise their ability to meet their retirement objectives.

For most retirees receiving a part pension, the inclusion of investments such as term deposits and annuities in their broader portfolio arguably offers similar exposure to the defensiveness offered by their pension, and therefore make less sense from a diversification perspective. Remember that a basic tenet of diversification is that incremental assets included in a portfolio should bring different characteristics and therefore add to the overall diversification benefit of the portfolio.

It can make sense, when considering a retiree's asset allocation, to include the age pension within the asset mix. If we were to do this for the couple in our example, and then invest the accumulated super balance to achieve an overall portfolio mix of 40/60, then 91% of the super portfolio would be invested in growth assets to give an overall 40/60 mix. It may sound extreme but the diversification means such a portfolio is likely to deliver a more optimal outcome over the long term than the portfolio over-exposed to defensive assets.

The age pension provides an important source of income for many Australian retirees. The average retiree who doesn't take into account the inherent value of the age pension is almost certainly over-exposed to similar assets with a defensive set of characteristics, namely term deposits and annuities.

Retirees should take a more holistic approach to their wealth and financial exposures by considering investments that complement the age pension, rather than looking at their superannuation in isolation.

Josh Hall is Investment Specialist at Aberdeen Standard Investments. This article is general information and does not consider the circumstances of any individual.

Facebook: social network or pervasive global media giant?

Tim Samway

Facebook is a fundamentally strong business. It has a sustainable competitive advantage, the ability to grow organically and the capacity to grow earnings over the long term. These are the things we all look for in companies we invest in, but what's interesting and different about Facebook is the business itself. It has morphed from a channel to keep in touch with friends to a sophisticated social media platform. It has disrupted not only the way we communicate and consume media, but it continues to play a more integral role in our lives.

Facebook reports that the average user spends 50 minutes a day on Facebook, Instagram and its Messenger platforms. Considering the average person spends nine hours sleeping, then about an hour out of the remaining 15 is a lot. And that's *the average*. At least 1.3 billion people use Facebook for more than 50 minutes a day and 15% of users look at it more than 50 times a day.

Much of that time may be spent corresponding with friends, but some is also spent consuming media, making Facebook a powerful force to be reckoned with. Facebook is changing and disrupting the way we consume media, and more importantly, what we consume.

Facebook's power lies in the curation of media

Facebook has not replaced traditional forms of communication, but in a way unheard of in the past, it packages other forms of media, TV, print and radio in an accessible and digestible form. But even that isn't where Facebook's real power lies. Far more significant is the fact that Facebook ***curates*** what we consume.

Depending on what we have read, watched or listened to in the past, Facebook can serve up the stories it thinks we are most interested in. Every click and every view is measured and analysed to refine what will be sent next time. As artificial intelligence becomes more sophisticated, Facebook's ability to learn and deliver according to individual tastes will grow exponentially. And all of this content can come from anywhere within its enormous network, not just your friends or even your friends' friends. It's a fundamental shift in the way we receive what we see and hear, and the implications are profound.

Facebook may be more in control of what we see, watch and hear than any single media company or government in history, yet it is largely unregulated. There are no media laws to exert control over what is presented to users, and it's a fine line between being a platform and being a publisher. There's a blurring of lines, and there's no going back.

Does disruption translate into profits?

Just because Facebook has disrupted the way we interact and consume media, does it follow that it is a good investment? Will it continue to increase revenues sustainably and produce returns for investors? As more people and businesses use platforms like Facebook to communicate via messages, photos and videos, the network effect means that the platform's value proposition will increase. Given that engagement, are increased revenues and profits a sure thing?

There's no such thing as a sure thing when it comes to investing, but in our view, Facebook has the strong fundamentals needed to sustainably increase revenues over the long term.

While engagement may not in itself produce revenue, it correlates strongly with advertising effectiveness, which does generate income. That's why 50 minutes a day is significant. When combined with Facebook's ability to reach 26.6% of the global population and target groups of people with certain characteristics, it translates into a strong market position and the ability to charge for advertising.

The more time we spend on Facebook, the larger the number of impressions (items people have looked at) Facebook can sell to advertisers, and the more Facebook knows about you. Which in turn allows advertisers to target you.

At the same time, it's surprising how few companies currently advertise with Facebook, given its wide reach and power. Around 70 million businesses have pages on Facebook yet only five million advertise, and spend a relatively small average of US$7,000.

However, the global advertising market is estimated at US$550 billion and growing at approximately 4% per annum. Of this, US$205 billion is spent on the internet, yet only US$34 billion of that is spent on Facebook. Facebook currently controls only around 7% of the global advertising market.

In our view, Facebook's control of global advertising is set to rise. Even if we don't consume more media in the future, we will certainly consume more of it online. And given that the internet, including Facebook, offers by far the best targeting techniques, the growth in the internet's share of advertising will also accelerate.

The bottom line is that Facebook's advertising revenue is likely to rise, and combined with a small increase in profit margin, it paints a picture of a strong and growing business.

Software developers have worked with Facebook to allow businesses and individuals to manage multiple Facebook pages to stay close to local communities and also promote goods and services consistently across the country. Statistics which Facebook can glean from analysis of users can be crucial for businesses seeking to understand and target their ideal customer.

What does it all mean?

Facebook is the ultimate disruptor. It has changed forever the way we interact with each other and businesses. But more importantly, for long-term, fundamentals-based investors, Facebook's strong business model, competitive advantage and ability to grow revenues organically and sustainably make it an excellent investment.

Tim Samway is Managing Director of Hyperion Asset Management. This article contains general information and does not consider the circumstances of any individual.

Treasurer: super reform was difficult but we had no choice

Graham Hand

Scott Morrison, Australia's Treasurer, was interviewed at a conference on 1 September 2017 hosted by The Economist, called "Innovation as Competition: Australia's Asian Future Summit 2017". As it was not a prepared speech, there is no official record of his comments, although he gave a talk the previous day at Bloomberg, when some of the issues were similar.

After the interview, I asked him a question on superannuation engagement.

GH: Treasurer, one word we have not heard today at this Innovation Forum is a subject where Australia could claim to be a global leader and that is superannuation. Around the world, our superannuation system is the envy of everyone. Yet we still have an expectation that 80% of Australians by 2040 will draw some form of the age pension, and 90% of people don't put extra money into super above the Superannuation Guarantee.

My first question, is the Government concerned by the lack of active engagement with superannuation and that people do not realise what their future outcomes are likely to be?

The second part is, even with those people who are engaged, when you reflect on the changes from 1 July, which you argue were driven by the desire to have a more equitable system, they were widely criticised by large parts of the industry and many people."

Treasurer: "Well, first of all, that 80% figure. That's true at a gross level, but the componentry changes in the Intergenerational Report show it basically inverts. The proportion we expect to be on the full pension and on the part pension after that period of time flips. The degree that people will rely on the age pension dramatically

changes. We will have the same proportion of people on welfare, but the degree of reliance dramatically changes. That is an outcome of the scheme put in place 25 years ago.

There's nothing wrong with making sure this scheme remains on track. The changes that I introduced this year were all about making the system definitely fairer, but sustainable. Australia has an aging population, and those in retirement age will become larger and larger as a proportion. We all know about the tax paid by those who have paid it all their lives, I acknowledge that, but the proportion of tax they pay after age 65 versus the working age population is obviously a lot, lot, lot less. So, if more and more people are going into a lower tax environment, and going into receiving payments on welfare, then the retirement income changes we made over two budgets were about getting that on a more sustainable footing. Whether it's changes to the assets test for the pension or changes to the upper limits of our superannuation. That's why we did it, and I think those changes were sensible.

I realise that for those who were impacted, it wasn't something they liked, but with the fiscal environment we had and the demographic changes we were facing, I'm not sure what other choice we had. So that was a significant and difficult reform.

In terms of engagement with superannuation, I make these comments in terms of people's ability to make additional contributions to super. When we went through the super changes, what was quite clear was that the caps and the potential balances people achieve and the limits we put on those were very high. For most income-earning Australians, those caps are stratospheric for them, they are not going to go close. When people are 50 to 55, they become a bit more focussed, that's why we made some changes post the budget which better reflected giving some flexibility, particularly in those last 10 years before people go into retirement.

It does remain important in our economic system in Australia. I want there to be more choice, more accountability, better governance and my colleague Kelly O'Dwyer has been doing a lot of work in that area as well.

Greater choice. I keep coming back to this point. The strongest markets are those where the customer is the strongest, and that doesn't matter whether it's superannuation, telecommunications, utilities, electricity, gas, banking. All of those markets, we want to see the customer liberated. One of the biggest changes we can make which goes into the broader point about technology in this space is consumer data rights. For the Productivity Commission, that is one of the big blocks in productivity over the coming years. That is, giving customers control of their information. That is the building block every fintech, every technology and every company needs to be able to deliver a better service. That will change our economy, and it's going to change the global economy."

Graham Hand is Managing Editor of Cuffelinks. This article is paraphrased from a recording.

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