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Why most LIC performance reporting is inadequate

Chris Cuffe

During my many years in the investment industry, I have watched the 'rivalry' in Australia grow between unlisted managed funds and listed investment companies (LICs). One noticeable aspect is the dramatic increase in the number of LICs. Currently, there are 105 LICs on the ASX with a value of about \$37 billion, a doubling since 2012. New LICs raised \$3.5 billion in 2017 offering investors exposure to a range of asset classes, investment styles and markets.

With this growth, we should expect regular comparisons would be available on the performance of LICs over different time periods, particularly to gauge whether they are giving investors comparable or superior returns to unlisted managed funds. However, from my perspective, few LICs report performance in a manner that is fully transparent and relevant.

In my experience, unlisted managed funds regularly report performance over different time periods – usually for the most recent 1 month, 3 months, 6 months, 1 year, 2 years, 3 years, 5 years and since inception. And they report this performance net of all fees, which is the performance that directly accrues to investors.

By comparison, LICs usually report performance for single periods. In their monthly reports released via the ASX, they usually report their performance for that month. Then in their 6 monthly and yearly reports to investors, they usually report their performance for that half-year or year period, rather than for multiple past periods.

And the performance reported by LICs is usually only the performance of the underlying investment portfolio rather than for the LIC itself. Such results are of limited use as they do not provide the full story from the investor's perspective.

Let's unpack the LIC performance issue

The component parts of the performance of a LIC is best illustrated in the following table¹:

Gross portfolio performance ²	x.xx%
Add back impact of tax paid to ATO on LIC earnings	+x.xx%
Less management fee	-x.xx%
Less performance fee (if applicable)	-x.xx%
Net portfolio performance	x.xx%
Less LIC costs ³	-x.xx%
Add back dividends paid to shareholders ⁴	+x.xx%
Dilutions/accretions from capital raisings ⁵	±x.xx%
Total net performance comparable to unlisted managed funds	x.xx%

¹ The above table assumes the LIC has an external management contract rather than the assets being managed internally with its own staff.

² This is after deducting trading costs such as brokerage (and stock loan fees and interest expense for short portfolios).

³ These include share registry, accounting/secretarial costs, audit, listing fees, directors' fees etc.

⁴ Performance calculations of LICs need to be adjusted for dividends paid, as this is obviously a cash outflow from a LIC. This is no different to unlisted managed funds which adjust performance calculations for distributions paid to unitholders.

⁵ Where a LIC raises capital at a price above NTA it is accretive to existing shareholders. Where a LIC raises capital at a price below NTA it is dilutive to existing shareholders.

LICs and unlisted managed funds should report performance in a like-for-like manner. This means performance for both should be reported after *all* fees (to show the actual investor experience) and *before tax*.

There are two reasons to show performance before tax:

1. Unlisted managed funds are generally not taxed as they are a 'conduit' vehicle, and
2. There are different tax rates applying to different investors (e.g. 0%, 15%, 30%, 45% etc.) regardless of whether they invest via a LIC or unlisted managed fund.

Given LICs are companies, they pay company tax on their earnings. So, any performance calculations of LICs need to exclude the impact of such company tax paid.

How do you calculate LIC performance before tax payments?

Each month, most LICs report their NTA before tax (that is, their NTA excluding any tax liabilities or tax assets). However, whenever company tax is paid to the ATO by LICs this causes their NTA to fall by the amount of the tax. So, it is necessary to add back the impact of such tax payments to the movement in NTA to arrive at performance numbers which exclude tax. While this sounds easy in theory, the reality is that the bulk of LICs do not provide this information to the public.

Some LICs do report actual tax payments as a dollar amount in their monthly NTA releases. The raw data allows the performance calculation to be made, although investors will need a spreadsheet to work out performance after fees and before tax. It would be far easier if all LICs did the performance calculations and reported it as unlisted managed funds do.

Is there another way to measure LIC performance?

There is another way to measure the performance of LICs other than the movement in NTA adjusted for tax payments (as outlined above). It is the movement in the share price after taking into account dividend payments (which, because we want to measure performance on a pre-tax basis, need to be grossed up for franking credits paid).

The problem here is that LIC share prices are influenced by factors other than the NTA, such as demand for the stock, scarcity value, marketing initiatives, LIC size, sizable undistributed profits, franking credits, etc. The share price performance is not totally in the control of the LIC, and there is often a premium or discount to the NTA.

A further problem is this ignores the stored franking credits, being those generated from tax actually paid but which have not yet been paid out, although franking credits are of no use to shareholders unless they are paid out.

If share price and dividend data is all we have to work out LIC performance, then so be it, provided we put appropriate disclaimers around such numbers.

As an aside, I was recently bemused by a major research house that issued a positive report on a particular LIC, citing the manager's strong alpha generation over the past few years. A closer look at the figures showed the research house had used share price performance during a period when the shares went to a considerable premium to their NTA ... methinks they stuffed that one up!

The gold standard for LIC reporting

As stated, LICs usually only report the performance of their underlying investment portfolio rather than for the LIC itself, which can be misleading to investors. Why LICs persist with this reporting weakness is a mystery to me, and they must assess performance over different time periods.

The best of all worlds is for LICs to report performance in three ways, to suits everyone's needs:

- From the perspective of the LIC *company* – the NTA performance, adjusted for dividend and tax payments, as described above
- From the perspective of the LIC *investors* – the performance of the listed securities on the ASX (adjusted for grossed up dividends paid)
- From the perspective of the LIC *investment manager* – the performance of the portfolio (after portfolio management expenses) which may provide a useful insight about the value adding abilities of the investment manager

I have often pondered why most LIC managers only report the portfolio performance rather than the LIC performance. Undoubtedly some would do this for 'marketing' reasons, to give the best spin possible on results announcements and in annual reports. And some would do this because the manager of the portfolio and the promoter of the LIC are often the same, and a manager is always most concerned with their investment performance.

Whatever the reasoning, I contend that an investor in a LIC is most interested (or should be most interested) in the performance of the LIC itself. It ultimately has the most bearing on the share price which in turn affects the investors own financial experience.

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Scott Whiddett, Business Advisory and Assurance Partner at [Pitcher Partners](#), has over 19 years' experience auditing LICs and has provided valuable input and insights into this article.

LICs: Traders versus investors for tax purposes

Chris Stott

The introduction of the Future of Financial Advice (FOFA) reforms and the increase in SMSFs has seen listed investment companies (LICs) surge in popularity over recent years. Investors can gain exposure to a diverse portfolio of assets through around 100 LICs listed on the ASX. These LICs can be categorised in various ways,

including by their asset class, market cap of investee companies, investment style, and whether they are internally or externally managed.

Not commonly discussed is the distinction between LICs that are deemed by the ATO to be 'investors' for tax purposes, versus LICs that are 'traders'. The key differences between these two types of LICs relate to tax, franking, and dividends.

Investors for tax purposes

Many of Australia's older LICs are investors for tax purposes. These include AFIC (ASX: AFI), which was established in 1928, and Argo Investments (ASX: ARG), founded in 1946. Investors for tax purposes tend to *buy* investments and *hold* them for the medium-to-long term. To maintain their status as an investor for tax purposes, these LICs generally turnover 10% or less of their investment portfolios each year. This type of LIC is typically suited to investment managers with a long-term investment horizon and low portfolio turnover.

For accounting purposes, LICs that are investors for tax purposes record movements in the value of their investment portfolios through the balance sheet, rather than the profit and loss statement.

Tax and franked dividends

The franked dividends these LICs pay shareholders are primarily derived from franked dividends received from the companies in the investment portfolio. These dividends are sometimes called 'flow through' dividends. When a LIC which is an investor for tax purposes realises (sells) an investment for a capital profit, the LIC can potentially pay a dividend to shareholders that includes a capital gain component. This is called a LIC capital gain dividend. This allows shareholders to claim the capital gains tax (CGT) discount as though they directly owned and sold the shares in the LIC's underlying investee company. Over and above the benefit of franking flowing through the cash yield paid by the LIC, the capital gain component can be used to further reduce shareholders' tax liability.

Traders for tax purposes

Many of the recently listed LICs are traders for tax purposes. These include the LICs we manage at Wilson Asset Management, such as WAM Capital (ASX: WAM) and WAM Leaders (ASX: WLE). LICs that are traders for tax purposes typically have higher turnover of their portfolios and are often employed by managers with a more active investment style.

LICs that are traders for tax purposes record mark-to-market movements in the value of their investment portfolios through the profit and loss statement, as opposed to the balance sheet.

Tax and franked dividends

Traders for tax purposes can pay dividends out of profits from realised gains, mark-to-market movements in the value of the investment portfolio and dividend income from investee companies. This increases their ability to pay a steadily-increasing stream of fully franked dividends which is particularly appealing to SMSF investors seeking a consistent yield.

Traders for tax purposes rely predominantly on paying corporate tax on realised gains to generate franking credits to attach to dividends paid to shareholders. These LICs derive some additional franking and dividend income from Australian investee companies in their portfolio.

Summary of key differences

	Investors for tax purposes	Traders for tax purposes
Turnover	Typically low turnover of investment portfolio (below 10% p.a.)	Higher turnover of investment portfolio
Portfolio movements	Movements in the value of their investment portfolios through the balance sheet	Mark-to-market movements in the value of their investment portfolios through the profit and loss statement
Franking credits	Franking credits primarily generated from investee companies	Franking credits primarily generated by paying corporate tax on realised gains
Sources of dividend payments	Primarily derived from dividends received from investee companies	Derived from dividends received from investee companies, realised gains, and mark-to-market movements on the investment portfolio
LIC capital gain dividend	Can pay a LIC capital gain dividend	Cannot pay a LIC capital gain dividend

Implications for investors

These different types of LICs for tax purposes each provide different advantages and disadvantages for shareholders and investment managers alike.

Investors should consider their financial objectives and circumstances, including tax implications of owning shares in each type of LIC. While investors for tax purposes and traders for tax purposes are distinct from one another in some regards, both offer the benefits of the LIC investment structure which make them popular with investors. These benefits include the ability to pay a steadily-increasing stream of fully franked dividends, transparency, accountability, and a closed-end pool of capital allowing the investment manager to make rational investment decisions.

Chris Stott is the Chief Investment Officer of [Wilson Asset Management](#). This article is for general information only and does not consider the specific circumstances of any individual.

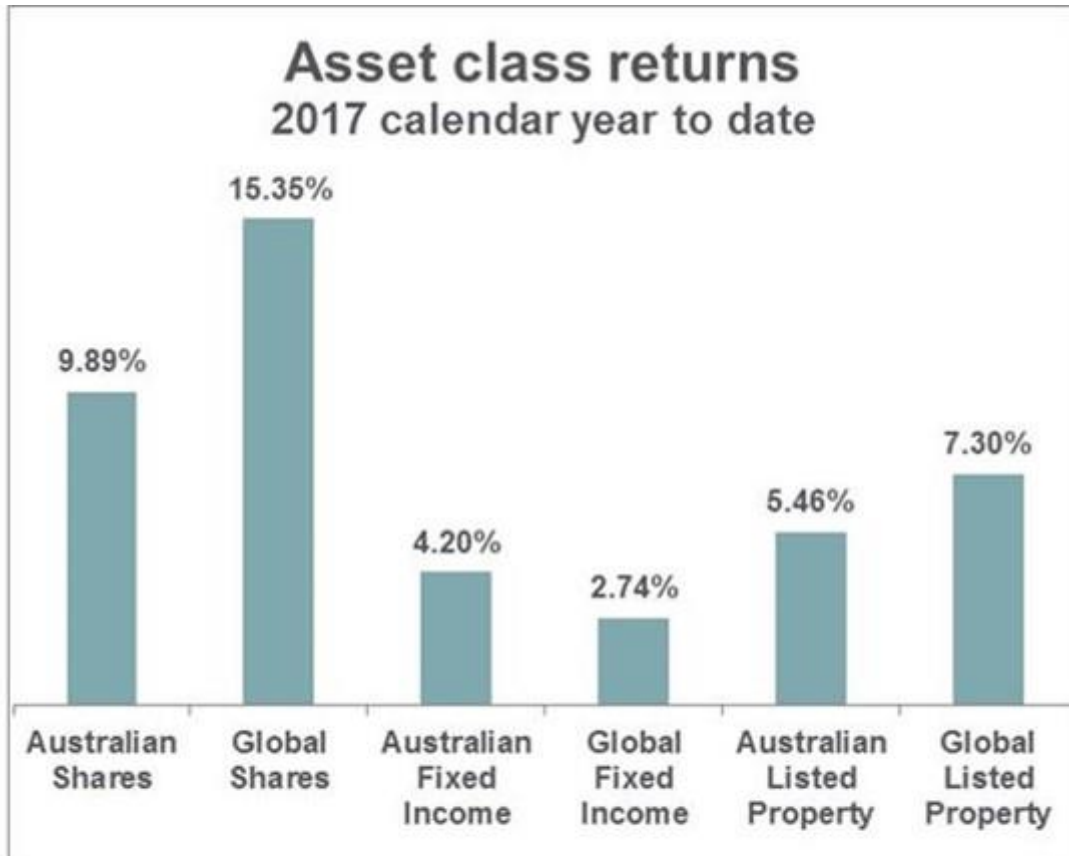
What will investment markets deliver in 2018?

BT Investment Management

BT Investment Management's Crispin Murray, Vimal Gor, Peter Davidson and Ashley Pittard provide a summary of the key drivers of investment markets in 2017 and share their thoughts on the prospects for each asset class in 2018.

Look beyond the headlines

It is customary to sit back and take stock at this time of year to contemplate what has been, could have been and what is likely to be. Participants in investment markets are accustomed to navigating developments on many fronts and 2017 has offered its fair share of these. Fear factors ranged from North Korea's nuclear aspirations, Trump's ambitions to thwart those of Kim Jong Un, Amazon's desire to scare domestic retailers, Holden marking the end of car manufacturing in Australia and Tesla revealing it fell short of its production targets due to a shortage of batteries to power electric cars. Add to these the constant reminders of escalating household debt, housing affordability, persistently low wages growth and pundits even warning of the next global financial crisis, the average investor has had enough reasons to be fearful.



**Asset class returns shown above are based on appropriate index returns for the calendar year to 30 November 2017. Australian Shares: S&P/ASX 300 Accumulation Index; Global Shares: MSCI World Total Return (A\$) Index; Australian Fixed Income: Bloomberg AusBond Composite (0+yr) Index; Global Fixed Income: JP Morgan GBI Global Traded A\$ Hedged Index; Australian Listed Property: S&P/ASX 200 A-REIT Accumulation Index; Global Listed Property: FTSE EPRA/NAREIT Developed ex Australia (A\$ hedged) Total Return Index.*

However, capital markets didn't quite see it that way. Australian and offshore share markets have delivered healthy gains to investors and other asset classes have achieved positive returns. It shows that market noise can be disparate to reality. Investors who looked beyond the headlines with a degree of perspective and remained invested have done well this year.

Australian shares

Investors in Australian shares oscillated between fear and favour for Resources and bond-sensitive stocks, although Resources may have won the battle this year, with a sector return of 17.5%, compared to 8.4% for Industrials. But look a little deeper within the sectors and there are a plethora of winners and strugglers. Consider the retailing segment, Breville Group (+56.9%) has continued to be a solid performer, although sellers of Breville products like Myer Holdings (-40.0%) and Harvey Norman (-16.9%) languished. Within the travel and leisure segment, Qantas (+78.5%) materially outpaced Virgin Australia (+21.7%). In Media, Ten Network (-82.7%) ran into financial trouble while Nine Entertainment (+61.5%) saw a strong recovery in ratings and earnings.

These varied results provide another timely reminder of the importance of deep and rigorous company research to identify risks and opportunities within the market. Most importantly, the quality of a company's management team and its strategy in navigating a challenging environment to ultimately drive stock performance should not be underestimated.

"The uncertainty created by disruption is unlikely to abate. This leads to mispricing and therefore great opportunities for active fund managers like us to add value, which is what we saw this year."

Crispin Murray, Head of Equities

The Australian market does not have the same proportion of high growth stocks as the US so we won't face the same issue with market valuations in that market. At recent levels the market is considered fair value. In the year ahead, valuations will largely be driven by earnings which are expected to be around mid-single digits. Add a sustainable dividend yield of 3-4% and we should see another healthy total return from Australian shares in 2018.

Australian listed property

The listed property sector produced healthy double digit returns over the 12 months to November on the back of solid earnings growth and rising asset values, although some of the gains were surrendered in January. Retail property was an expected focal point for investors, given the economic influences of dwindling retail sales and wages growth together with household indebtedness and the anticipation of Amazon's arrival in Australia. Hence, retail property was not the place to be for investors, with weak returns from Westfield, Scentre Group, Vicinity Centres and Stockland – which together represent over 40% of the A-REIT index. The Office and Diversified REITs sectors delivered double-digit returns, while Industrial REITs – which are limited in offerings – was the best performing sector.

"US bond yields are an unavoidable headwind for the listed property sector, but the market can really be differentiated by qualitative factors"

Peter Davidson, Head of Listed Property

Filtering the sector for quality provides a fundamentally attractive picture. Despite the interest rate headwinds, key support factors such as the net withdrawal of Sydney office supply, low debt profiles, long term leases with inflation provisions and low vacancy rates make listed property an attractive asset class in 2018. The sector offers fair value and is priced at a discount to the direct property market, based on prices paid in major property transactions this year. We are expecting total returns of 6-8% in 2018.

Global shares

Global equities did a reasonably good job of delivering the growth our super funds aspire to achieve, with more than half of the companies within the MSCI World Index rising by at least 10% (in Australian dollar terms). Most regions registered double-digit gains, led by the US (+19.9%) with two thirds of US stocks achieving a positive return. Investing in the mega-techs – Facebook (+46.9%), Netflix (+44.5%) and Alphabet (ie. Google, +24.7%) – delivered exceptional returns. The S&P500 Index closed at record highs 59 times this year. In contrast, the UK (+6.4%) was a distant laggard while the euro zone (+12.0%) was backed for early signs of economic recovery.

We continue to believe that the tailwinds over the last five years which have rewarded indiscriminate broad market exposure are becoming headwinds. This approach is unlikely to yield as market valuations become less compelling and monetary support is ratcheted back. Moving into 2018, the market environment will be best suited to selective ownership of quality companies that are well positioned to withstand a higher interest rate environment and an uncertain geopolitical landscape.

"Share prices are unlikely to continue moving ahead in unison. The changing market environment means investors need to be conscious of valuation, conscious of franchise strength and cautious on cash flow"

Ashley Pittard, Head of Global Equities

Fixed interest

Australian fixed income posted reasonable returns in 2017, with little differentiation between the Government and credit sectors. Markets began pricing in expectations of rate hikes early in the year before pushing out the theoretical tightening timeline. Returns across the major overseas bond markets ranged from -0.9% to +2.0%, with the global fixed income asset class as a whole returning -2.7%. The Australian dollar appreciated 4.8% against the US dollar but weakened against the euro and British pound over the year. Although returns were muted across the government sector, credit investments performed well as they benefitted from strong share market performance. Strong appetite for risk also transferred to the high yield market, where the yield premium over investment grade credit tightened to levels not seen since 2014 when the market began to correct.

"Looking to the year ahead, we are wary that the goldilocks environment that kept yields range-bound and risk assets supported in 2017 will not be sustainable. We believe a defensive fixed interest allocation remains a critical component of an investor's portfolio."

Vimal Gor, Head of Income & Fixed Interest

Factors like an unprecedented unwind of accommodative central bank policy and a leadership-directed shift in the composition of Chinese growth highlight the risks facing credit and government bond markets. This in turn threatens to spark the return of volatility, as well as imbalances like the strong run from high yield credit to correct in 2018.

Investment implications

Investors need to be resilient to market gyrations and ensure risks are appropriate within their overall investment portfolio which is less likely to replicate the path set in 2017. Asset allocations need to be balanced to reflect the inherent shifts in market leadership on many levels. Interest rates are more likely to increase than decrease, albeit in a trajectory that follows evidence of sustainable economy recovery. Investors should also maintain an allocation within a multi-asset portfolio to the Alternatives sector through a selection of strategies that have a low correlation to equity and bond markets and therefore offer additional diversification with the potential for enhancing returns.

This article was prepared by [BT Investment Management](#) for general information and does not consider the circumstances of any individual investor.

The index investing story could be even better

Raewyn Williams

The 2017 financial year was a good one to be a passive (index-tracking) investor in large cap Australian equities. The S&P/ASX200 returned 14.1%. Add to this the other attractions of passive investing – fees are typically lower than active management, taxes and transaction costs are lower, and investors know what they are getting. These attractions no doubt explain why around US\$500 billion globally is leaving active equity strategies each year.

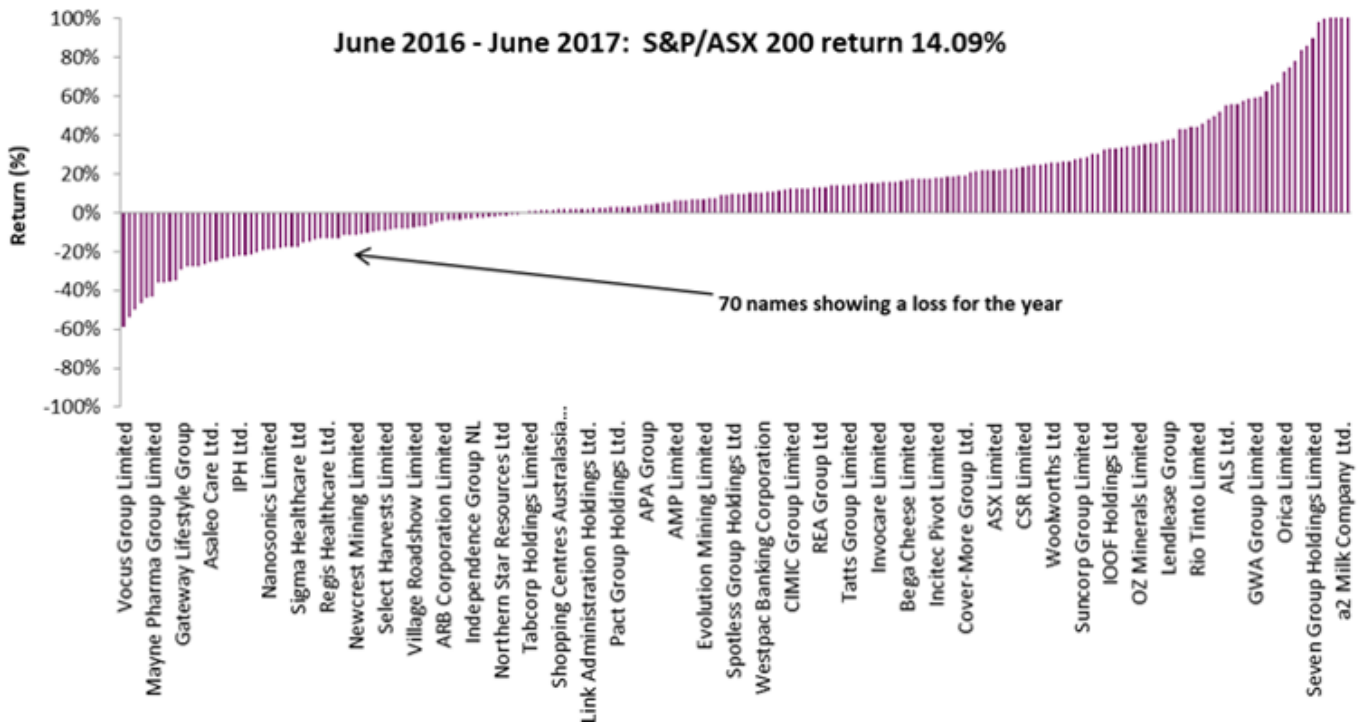
Large superannuation funds in Australia caught up in this global trend have an additional factor to consider. Australia, almost uniquely, taxes the investment returns of super funds. This makes passive investing an *after-tax* optimisation problem for Australian funds. While the headline 14.1% return is eye-catching, there is little insight as to what this looks like after tax or what tax management could have added to this good news story. 'Dumbing down' the after-tax optimisation problem to a simple 'keep turnover low' mantra does a disservice to the smart, sophisticated investment thinking most funds apply to other parts of their investment portfolio.

The forgotten effect of taxes

Most talk is on the extra tax a fund pays when moving from a passive to a factor-based or full active management style. But there are meaningful increases in tax just from moving from a theoretical 'buy and hold' strategy to a real-life index-tracking strategy which typically turns over 5-10% each year due to index reconstitutions, corporate actions and day to day fund cash flows.

It is a step in the right direction for a super fund to ask how much *more* tax could be payable by moving from a passive to factor-based or active investment approach. But given the massive flows in the other direction (towards passive), funds must also explore the whether there are ways to pay *less* tax in the way the passive investment strategy is implemented. Funds and asset consultants seem to stop short of asking this second question. It is not in the interests of the traditional passive managers (the beneficiaries of the flight to passive management) to raise it.

One way to differentiate a genuine tax-managed passive strategy from a simple 'keep turnover low' approach is in how loss stocks are treated in the portfolio. Consider the stock-level returns comprising the S&P/ASX200 over the 2017 financial year, as set out below:



Source: S&P, Parametric. Provided for illustration purposes only. It is not possible to invest directly in an index.

Utilising the losses to offset gains

A portfolio tracking this index could claim to be 'tax efficient' by naturally avoiding the realisation of gains on the 142 stocks which appreciated in value during the year. The accrued gains count for performance measurement purposes, but not for tax purposes – a good combination. But note the 70 loss stocks in the portfolio that depreciated in value over 2017. A traditional passive strategy *has done nothing* with these loss stocks, even though realised losses are valuable as assets which shelter from tax capital gains realised anywhere else in the fund's portfolio (*not just Australian equities*).

In contrast, a genuine tax-managed passive strategy could naturally accelerate the realisation of these losses (within legal limits) to unlock their tax value and improve the after-tax returns of the portfolio further. In fact, the real opportunity set for an after-tax focused passive manager is not the 70 stocks in the S&P/ASX200 that returned a net loss but the 178 stocks that, through natural fluctuations in the market, were showing a loss at some point in time in 2017.

Using super fund capital gains tax rates, our published research indicates that this kind of intelligent after-tax thinking can add (pre-fees) around 25 basis points (0.25%) to an S&P/ASX200 portfolio and 30 basis points (0.30%) to an international equity portfolio each year. Franking credit strategies could add more. These extra returns are relative to traditional passive approaches which claim to be 'tax efficient'.

An interesting sideline is that volatility, the enemy of most investors, actually becomes a useful tool in this exercise. This illustrates how the S&P/ASX200's good news story for 2017 could have been even better if super funds were genuinely approaching passive investing as an after-tax challenge. Of course, if the index's returns move closer to long-term averages (less than half of the 2017 return) in coming years, the extra return increments will be even handier.

Finally, genuine after-tax investing will report portfolio and benchmark performance both pre- and post-tax, which is the only legitimate way to show whether a 'tax efficient' strategy is living up to its claim.

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Manufacturing makes a surprising change

Michael Collins

A defining trait of globalisation is how companies stretch their assembly lines around the world so that goods are made across many countries a long way from where they were sold. Western companies created 'global supply chains' over the past three decades by innovations such as:

- the shipping container that reduced transport costs and times
- the arrival of instant communications that allowed management to coordinate production
- the welcoming of foreign investment in emerging countries and
- the cheap labour that didn't need to be highly educated to operate the machinery in the factories that were moved to China or elsewhere.

The shifting of low-paid factory jobs to the emerging world (where they became sought-after well-paid work) has had vast longer-term political consequences because it boosted inequality within countries while it reduced inequality between countries. The changes wrought by globalisation that have the most political currency are the US trade deficit with China and the widening inequality in the US that helped elect Donald Trump. A rise in protectionism and the rebuilding of immigration barriers that could occur over Trump's time in power are often flagged as the greatest threat to the free flow of goods, people and money around the globe.

Industrial internet is the next big thing

But there is a larger, longer-term development that is likely to lead to a faster unwinding of globalisation. This catalyst is the coming of the industrial internet. Advances driving artificial intelligence and the internet of things (when devices communicate with one another), and their offshoots such as 3D or additive printing, robotics and automation will revitalise manufacturing in the developed world while dimming the appeal of locating factories in the emerging world.

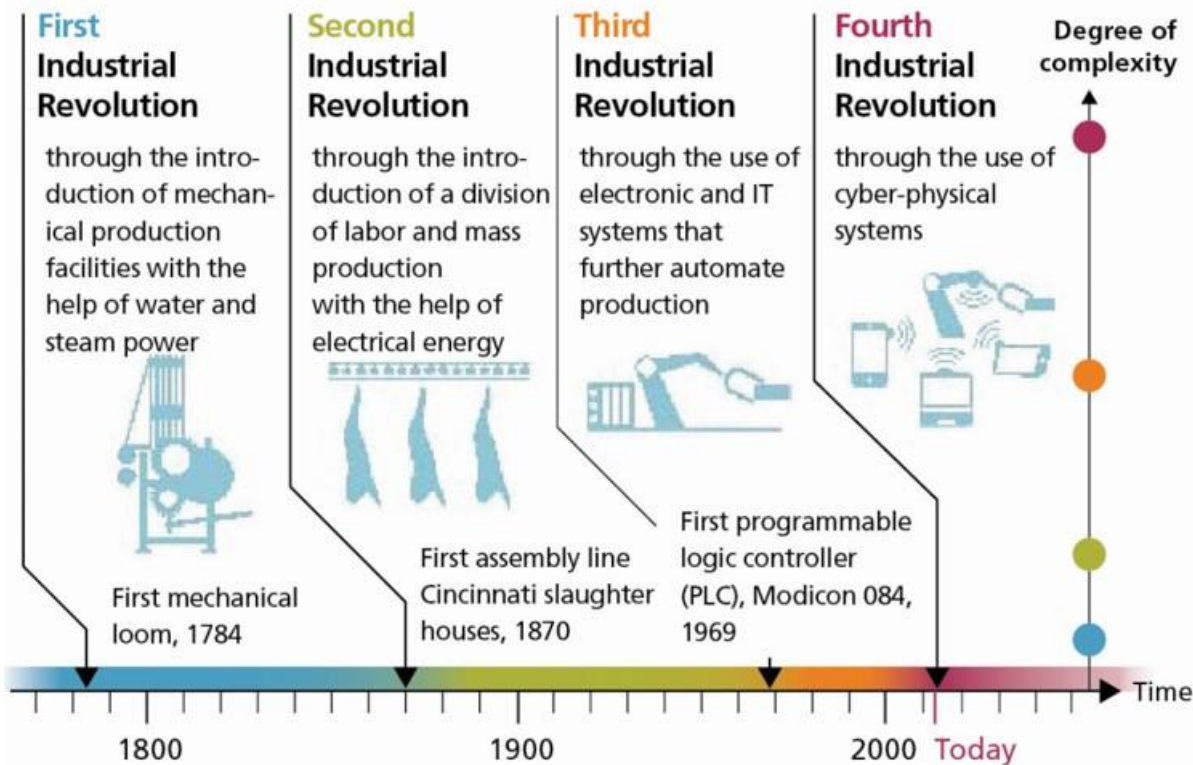
This will occur for two main reasons.

The first is that western industry will rely more on highly-educated workforces to commercialise the latest technology and to build and operate smart factories, and these skilled people can be found at home. The second is the digital world will be a capital-intensive one. Thus, western manufacturers will have less need for the cheap labour found in the emerging world. The economic, investment, social and political consequences that will follow as technological advances unwind globalisation are vast. They will unfold for decades.

To be sure, the economics of making uncomplicated (or low-end) manufactured goods may still justify global production chains sprinkled through the world's poorer countries. Today's robots cannot yet do every intricate task traditionally done by hand. Smart factories still employ lower-skilled staff. The workers supervising robots at Amazon's distribution centres don't have to be highly-educated. Western countries will still encounter much tech-driven disruption, while the coming home of US manufacturing might feel empty when it doesn't create enough jobs to compensate for the five million jobs lost in recent decades. Rather than being spurred by technology, it's higher labour costs in China that is prompting many western companies to relocate factories back home (or to elsewhere in Asia). Other businesses may favour production at home for political reasons.

The fourth industrial revolution

However, partisan deliberations, wage relativities and rising protectionism are shorter-term considerations. The technology advancements associated with what many call the fourth industrial revolution are long term. Today's technological leaps point to western companies locating factories close to their customers. For western companies their most important markets are in the west. The winners when global supply chains crumble will be the developed countries that are home to the most innovative companies, the smartest workforces and the largest consumer markets but also developing countries with big markets and large pools of educated workers at reasonable cost. The losers stand to be the world's poorest countries that will miss out on attracting foreign investment, the world's most basic manufacturing hubs, plus, uncomfortably, advanced countries that fail to take advantage of the shift, a list that could include Australia.



Source: DFKI (German Research Center for Artificial Intelligence).

The 3D difference

Technology has always driven the greatest developments in manufacturing. The world's second great globalisation from 1980, for instance, occurred because technological advances allowed western businesses to exploit the cheap unskilled labour of the emerging world. The world of artificial intelligence and the internet heralds consequences of similar magnitude, but in reverse.

Consider the microeconomic consequences to be provided by 3D printing, which forms part of robotics and rely on the Internet of things. Additive manufacturing (3D printing's other name) was invented in 1983 by Chuck Hall in the US. When using UV light to place plastic veneer on furniture, he thought of a way to create three-dimensional products.

Fine-tuning software is cheaper and quicker than resetting machinery on factory production lines, especially for one-off or low-volume goods. This attribute reduces the need for multiple specialist factories and overturns the theory underpinning economies of scale, which is built on the finding that the average and marginal costs of making items decline with volume. Reduced economies of scale and the need for fewer factory assembly plants undercut the justification for global supply chains.

An acceleration of 3D-printing speeds has allowed its use in mass production, and further dented the economics driving global production lines. Adidas, for example, is setting up 3D-printing factories in Germany and the US that will allow the footwear maker to deliver fashionable trainers to western shopping centres within weeks of design, whereas it takes months to fulfil orders via Asian-based factories using traditional techniques. Another advantage of mass 3D printing is that it reduces the need for warehouses full of spare parts. Thanks to 3D printing, US construction equipment makers Caterpillar and John Deere are moving their warehouse to the cloud. That brings production home to where head office and tech skills are located. Every advance in additive manufacturing gives western companies more incentives to bring home production.

The way 3D printing undermines the *raison d'être* of global supply chains is echoed across other forms and uses of artificial intelligence and the internet of things.

The changes are coming

Twenty-four-hour industrial robots lower marginal production costs while displacing the need for cheap human labour to perform tricky tasks. The digitalised world enables robots and devices to communicate across production chains to maximise efficiency, placing a premium on the skilled labour that can build and oversee

high-tech plants. Sensors compiling 'big data' that is then run through software algorithms boosts efficiency, by forecasting interruptions to production better than factory foremen can. Other sensors will let customers know their items are about to break down, allowing for better client service. The internet of things will propel driverless vehicles, robo-trucks, pilotless planes and automated drones and boost the economics of local, land-based logistics far more than it will smooth international delivery across the seas. Smart grids will lower energy costs in advanced countries, another reason for factories to head homeward and reverse the globalisation of the past three decades.

Michael Collins is an Investment Specialist at [Magellan Asset Management](#). Magellan is a sponsor of Cuffelinks.

No, Gladys, build it and they won't come

Graham Hand

The NSW Government has announced it will knock down and rebuild Allianz Stadium at Moore Park at a cost of \$700 million and the Olympic Stadium at Homebush, only 17 years old, at a cost of \$1.6 billion. However, there is little 'business case' evidence that new stadiums would make a material difference to attendances at football games, although Sports Minister, Stuart Ayres argues, "With better quality facilities, more people will come and attend matches."

The politics are terrible for the NSW Premier, Gladys Berejiklian, and her Government. Over 130,000 people signed an online petition against the proposal in only two weeks. The ABC reported NSW and National MPs were outraged by the weapon handed to the Opposition, quoting one MP as saying, "Labor has a narrative they can use every day until the next election – 'you can't have that money for the school but you can have \$2 billion on stadiums'."

Where is everybody?

On a sunny Sunday, 21 March 2010, a couple of hundred football (aka soccer) fans waited on The Domain for the luxury coach carrying the Sydney FC team to arrive direct from the airport. The previous day in Melbourne, Sydney had won the A-League Grand Final on penalties after extra time when South Korean Byun Sung-hwan scored the winner. A stage had been erected, food trucks arrived and it was a chance to celebrate with the returning heroes. Sydney FC had completed an historic double, delivering the Championship to go with the Premier's Plate for winning the league, but the obvious question was: **where is everybody?**

In the following season, 2010/2011, the average home attendance was a dismal 8,014, half the number in the first season of 2005/2006.

Fast forward seven years and Sydney had not won a trophy in the intervening period. The 2012 excitement of Alessandro Del Piero (record holder for playing the most games for Juventus and 92 caps for Italy) had come and gone. But now something far more special was happening.

Sydney FC was playing the best football in its 13-year history. It was an enthralling season of exciting football built around player of the year, Milos Ninkovic. Sydney went on to hold the treble (including the FFA Cup) for the first time and broke records that may stand forever, including winning the league by an unbelievable 17 points.

Yet in the middle of that winning 2016/2017 season, Round 19, only 8,380 turned up to watch the Wellington game, and the average main season home game attendance was 16,001. In Del Piero's first year, 2012/2013, it reached a record average of 18,737. Sydney's home ground of Allianz Stadium holds 45,500. **Where is everybody?** Here is football at the highest standard Australia is ever likely to muster, and in the country's biggest city, the crowds are disappointingly small.

What's it like to watch games at Allianz Stadium?

In a recent article in *The Sydney Morning Herald*, the Chairman of the Sydney Cricket and Sports Ground Trust, Tony Shepherd, wrote:

"People who claim the stadium is perfectly fine clearly don't go there. The venue is rusted, ageing and doesn't meet modern safety standards."

Well, Mr Shepherd, I go there regularly. Watching Sydney FC at Allianz is one of my favourite activities. I am a Foundation Member and I have held a season ticket since 2005. I rarely miss a home game and sometimes travel to away games. I don't sit in the corporate boxes but prefer the seats with the hoi polloi who sing the songs and love this Sydney team. I want to concentrate on the game, especially when Sydney is so enthrallingly good, rather than entertain guests or sip on champagne while eating canapes.



The irony of Mr Shepherd's claims is that the Trust's website has a [page of endorsements](#) on the wonderful stadium. At the recent FFA Cup Final, I asked a few people near me whether they wanted a new stadium. All said the existing stadium is fine.

Allianz is a rectangular field and fans sit close to the action. My season ticket is in the exact place I want. It's near the halfway line, about 20 rows back under cover, behind where Graham Arnold prowls like an angry leopard. I can see him losing his temper, planning his moves, shouting at players. Heaven.

Last year, the Stadium made a stunning improvement. At each end, massive video screens fill the space behind the goals. The replays are excellent, in crystal clear dimensions on the best screens at any ground I've attended (and I've been to the last three World Cups in Germany, South Africa and Brazil).

The food is a poor effort, but that has little to do with the design of the Stadium. It could be significantly improved by realising not all football fans want weak beer for \$9 to wash down a \$6 meat pie. The toilets are bad and I understand facilities for people with physical disabilities are sub-standard, but they can surely be fixed.

A season ticket for Sydney's 14 homes games for an adult costs as little at \$270. It's far more expensive to watch Paul McCartney for two hours. A modest \$20 a game is an entertainment bargain in this expensive city where it costs \$70 to park in the CBD for a day.

Australians love playing and watching soccer

Soccer is by far the largest participation sport in Australia. Reports Roy Morgan Research:

"Soccer has been the big winner of the new century so far, gaining almost 200,000 regular participants (up 46 percent to 623,000). Now the most-played competitive sport in Australia, in 2001 soccer was fourth on the list."

Soccer fans also love to watch the game live. The Socceroos recently attracted 77,060 to the final World Cup qualifying game against Honduras. An incredible 163,652 attended two friendly Arsenal games (v Sydney FC 80,432 and v Western Sydney Wanderers 83,221) in July 2017. That's more than watch Arsenal at their home ground in London. The Liverpool game against Sydney FC in May 2017 drew 72,892, despite Liverpool including several retired players such as Steven Gerrard and Jamie Carragher. An ageing Steve McManaman was an embarrassment. These games have no competitive meaning and no tension but the public flocks to them.

There is simply no comparison with the excitement of a Sydney FC competition game from the reigning champions. Writing as someone who has followed Manchester United for 55 years, most of the fans at the Arsenal and Liverpool games show Euro snobbery and don't realise how good the local game is.

The first game of the 2016/2017 in the A-League was amazing. Sydney FC played Wanderers at ANZ Stadium and a record club crowd of 61,880 turned up. It was a fantastic atmosphere. A few months later, **where is everybody?**

What's the pool of available fans to attend regularly at Allianz?

Sydney FC has only 13,613 members, and it needs a lot of walkups for a decent attendance. The average crowd in 2017/2018 to date is 15,793 but that includes the Sydney home derby at 36,057. The worry is that Sydney has found a new attendance level of about 15,000 for regular games despite playing such excellent football. Only 10,044 watched Sydney play Brisbane recently. A new stadium of 30,000 or 45,000 will have masses of empty seats except at one or two games a year.

What about the rugby and league crowds?

Allianz is shared with rugby league's Sydney Roosters and rugby's NSW Waratahs.

In 2017, the NSW Waratahs recorded the lowest crowd in its 21-year history, 10,555 on 26 April 2017. The average for the season was 14,500.

In the 11 main season games played by the Sydney Roosters NRL team at Allianz in 2016/2017, the average attendance was 13,971.

Worse, what happens during the rebuilding?

When it was first announced that Allianz Stadium would be knocked down and rebuilt, the three major tenants said in a statement in April 2016:

"When teams are displaced from their established home ground, the impact is negative and of a long-term nature. Some clubs never recover."

Exactly. The Government has indicated it may compensate the clubs while the new stadium is built. Western Sydney Wanderers may continue to suffer from their move away from Parramatta Stadium during its reconstruction. Wanderers now play at Spotless Stadium at Homebush in front of 8,000 people and the fan experience is a shadow of its former glory.

What will Sydney do during the rebuild, perish the thought? Three seasons at either Leichhardt Oval in Sydney inner west, Jubilee Oval down south in Kogarah or maybe the Sydney Cricket Ground. Every choice will alienate a large section of the fan base, and neither of the suburban grounds has much parking. Sydney fans from the north will not want to drive to Kogarah, Leichardt is in the crowded inner city with its traffic problems (and building of WestConnex) and the SCG would be a dust bowl of oval-shaped sadness. Little players kicking a ball in the distance on a field where nobody has played soccer for a good reason for many years.

Where to from here?

Last year, I noticed a small panel of plasterboard near my seat was coming unstuck. I advised Sydney FC and was told that they were only a tenant, and no money is being spent on the stadium because it is likely to be torn down. Little wonder it is 'rusty and ageing'. All buildings, especially a public stadium built from steel, need maintenance. Mr Shepherd's article outlined the safety, dressing room and toilet facilities that need fixing. Okay, fix them, maintain the place and find a better use for most of the \$700 million.

If fans are not turning up to watch the best Sydney FC team in its history, despite the obvious popularity of soccer, a new stadium will do little to improve the numbers.

Graham Hand is Managing Editor of Cuffelinks. A version of this article was first published in johnmenadue.com and their Pearls and Irritations website.

The ethical investing trend and a Kiwi lesson

Simon O'Connor

The expectations that Australians place on the financial services industry are changing fast and traditional ways of managing and advising on investments need to evolve to keep up with these changes. More clients are asking for a responsible and ethical approach to how their money is managed, from retail through to institutional investors.

The industry is responding. Today in Australia, nearly one in every two dollars is being invested with a commitment to responsible investing, taking into account environmental, social, governance (ESG), or ethical considerations into investment decision-making.

The drivers of the ethical investing trend

This proportion reflects a quadrupling over the past three years, largely driven by the growing acknowledgement within the industry that ESG factors contribute to valuations, both positive and negative. For example, earlier this year, Bank of America Merrill Lynch stated that ESG has become the most important signal of future risk and "[a better signal of future earnings volatility than any other measure](#)".

But another driver has emerged which many in financial services have overlooked. Australians expect their investments are managed in a way that is consistent with what's important in their own lives. They hold views on 'what matters' and what is 'right', as demonstrated by the charities they chose to donate to, the businesses they prefer to shop at and the type of world they feel they are contributing to for their children and grandchildren.

The Responsible Investment Association Australasia (RIAA) [recently launched new consumer research](#) underscoring this expectation, with 9 out of 10 Australians stating that they expect their superannuation and other investments to be invested responsibly and ethically.

Lessons from across the Tasman

We witnessed a resoundingly clear example of what this expectation means in practice in the New Zealand market last year when front page reports in the national broadsheet and radio networks exposed that the default pension funds (KiwiSaver funds) across the country were holding investments in tobacco, cluster munitions, land mines, and nuclear weapons. This resulted in a significant outcry by the community and politicians, followed by federal police investigations. The majority of KiwiSaver providers dumped stocks across these most controversial industries within a matter of weeks in order to retain clients and hose down the reputational damage.

While only around 4% of Kiwis had opted in to 'ethical' funds, the vast majority of people expected their retirement savings to be invested, at a bare minimum, in ways that avoided the most harmful of industries. Within a few months, responsible investment assets under management moved from 4% to 60% of the industry with 'ethical' negative screenings in place. This is a cautionary tale for the Australian financial services industry, where portfolio holdings are much less transparent than KiwiSaver funds, but where the stated expectations of Australians are clear.

Notably, our research also showed that this expectation of responsible and ethical investment is supported by a willingness of Australians to switch funds. Four out of five surveyed stated they would consider switching their super or other investments to another provider if their current fund engaged in activities inconsistent with their own values. Some 24% indicated they are likely to consider investing in ethical funds in the next 12 months, and over 50% said they would consider it over the next one to five years.

The money is already moving, with a doubling of funds flowing into traditional ethical investments over the past two years, reaching \$65 billion in AUM at the end of 2016. [Indeed the fastest growing super fund in 2016 according to KPMG was Australian Ethical.](#)

It's no longer just our largest banks and listed companies that face the scrutiny of the public and elevated expectations of transparency. Insurance, banking, superannuation, financial advice and fund managers are being examined much more closely than ever before. It's no longer sufficient to deliver strong returns. An army of small online funds, investing platforms, P2P lenders and boutiques are moving in to capitalise on this shift, and are already nibbling away at market share of the bigger institutions.

The three things to keep in mind

First, our biggest challenge in this industry has been to achieve deeper engagement with our client base. Responsible and ethical investing provides a means to connect more deeply with clients, around issues they care deeply about, and through this, build more loyal clients. If managers want clients to open their emails and letters, connect returns and distributions to a discussion about the issues the clients care about.

Second, our communications need to modernise and move into the digital age. Many of the new cohort are primarily based online, communicating online, signing up new clients online. It is much easier today to move between super funds, managed funds, and banks, and to attract new members through websites and apps.

Third, Millennials count, but data regarding the financial preferences of Australian Millennials has been scant on the ground. RIAA's research dug deeper and confirmed the elevated propensity of Millennials to invest in line with their values: 88% are considering investing in ethical funds in the future or already doing it, compared with 65% of Baby Boomers and 73% of Gen X. Furthermore, 9 in 10 Millennials would change providers if they were engaged in activities that are not consistent with their values (compared with 68% of Baby Boomers and 77% of Gen X).

It's time we reconsidered how we deliver on some of the core principles that underpin the finance industry – notions of best interests, fiduciary duties, and 'know your clients'.

The ability to explore and align people's values with their investments is what will distinguish the leaders in wealth management from their robo-competition over the coming decade.

Simon O'Connor is Chief Executive Officer of the [Responsible Investment Association Australasia](#) (RIAA).

Become an informed user of retirement expertise

Don Ezra

You don't need to become an expert on retirement. You deal with doctors, lawyers, all kinds of experts, and you still cope. What you need is enough information to work with them, to know how to help them to help you. They provide the expertise. All you ought to be is an *informed* consumer of their expertise.

That means two things.

First, you need a framework. When you see pieces of a jigsaw puzzle, you wonder how they fit together? It helps a lot if you have the cover of the box that the puzzle comes in, with a picture to show you what the whole thing looks like when it's complete. If you have that picture, it becomes easier to see where any one piece of the puzzle fits. Here's how I suggest you should feel:

"Now I know how to think about the issues connected with this phase of life. I now have more knowledge and it has helped to shape my opinions and attitudes. I know what questions to ask, and so I'm more likely to get useful answers. It's not really as complicated as it's made out to be. And because of all of that, I'm in control. I'm setting my own path to a happy, comfortable time of life."

Second, what does it mean, exactly, to be an informed consumer of expertise? It means you can do three things, when an expert tells you something, or gives you advice or makes a recommendation.

The three things you can do

1. Assess the expertise. If you don't understand the advice of the expert, say so, and make sure it is explained to you in a way that you understand.
2. Challenge the expert. Get the expert to identify the principles behind the recommendation. Make sure you are told about any research that underlies the recommendations. Where does the research come from? Is the evidence based on what has happened in the past? What assumptions is the expert making about the future? What could go wrong? How would the recommendations work out if the future doesn't evolve in the way the expert has assumed? You need to be able to make that sort of a challenge, and get straightforward answers to assess whether you're comfortable with the risks.
3. See how the advice applies to your own situation. That's the area in which *you* are the expert. You know your own situation better than the expert does. To make the expert's advice as good as it can be, you need to be able to convey the elements that define your situation to the expert. That way, the recommendation can be tailored to fit you, rather than just being off the peg. Not that 'off the peg' is necessarily bad. But the more the expert knows about you, the better the fit is likely to be.

The expert on any other subject is, in fact, an informed consumer of your own expertise about your particulars. So, explain your situation, and the expert can make the advice fit you as well as possible.

Paint a picture of success ... and failure

Let me suggest two things you can do in this regard.

One is to paint a picture of success. Imagine yourself (your partner, your family, whoever) five years down the road. What would make you feel that the outcome has been good? What would make you feel disappointed? Convey to the expert what that picture looks like.

As human beings, we're notorious for hoping for more than is reasonable. Typically, our financial ambitions far exceed our willingness to pay for them, or the amount of risk we're willing to take. That alone is worth discussing with the expert: to see how feasible your definition of success is.

Of course, the second you should do is to paint a picture of failure. What sort of outcome, five years down the road, would make you feel disappointed? If you can let the expert get inside your head, it might be possible to detect early signs, in the future, that events are working out well or not. It might be possible to design a Plan B that isn't too difficult or expensive to move to. The earlier the detection, the more 'Plan B' possibilities.

All of this should make you realise how much better you know yourself than the expert knows you. I hope this realisation will give you the courage to challenge the expert's advice – something you might otherwise be afraid to do, because after all, they're the expert, right, and what do you know? You know yourself, that's the answer. You deserve to fully understand recommendations before they are implemented. And so, raise issues with any expert whose advice doesn't make you comfortable.

Don Ezra has an extensive background in investing and consulting, and is also a widely-published author. His current writing project, blog posts at www.donezra.com, is focused on helping people prepare for a happy, financially secure life after they finish full-time work.

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