

### This Week's Top Articles

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### The sorry tale of our big banks

Ashley Owen

Bank shareholders have benefited tremendously from 25 years of cartel monopoly pricing, gobbling up of small competitors, lax controls, sleepy regulators and the absence of an economic recession.

The Royal Commission has uncovered institutionalised greed, fraud, fee gouging, mis-selling of inappropriate products, predatory lending, document forging, market rigging, lying to regulators and a host of other regular dishonest bank practices. These actions were conscious decisions which lined the pockets of bank staff at every level from the boards of directors down to branch tellers. They have also showered shareholders with windfall profits and dividends.

The current CEOs say they are embarrassed by their banks' failings and while apologising for past mistakes, remediation costs will run into billions.

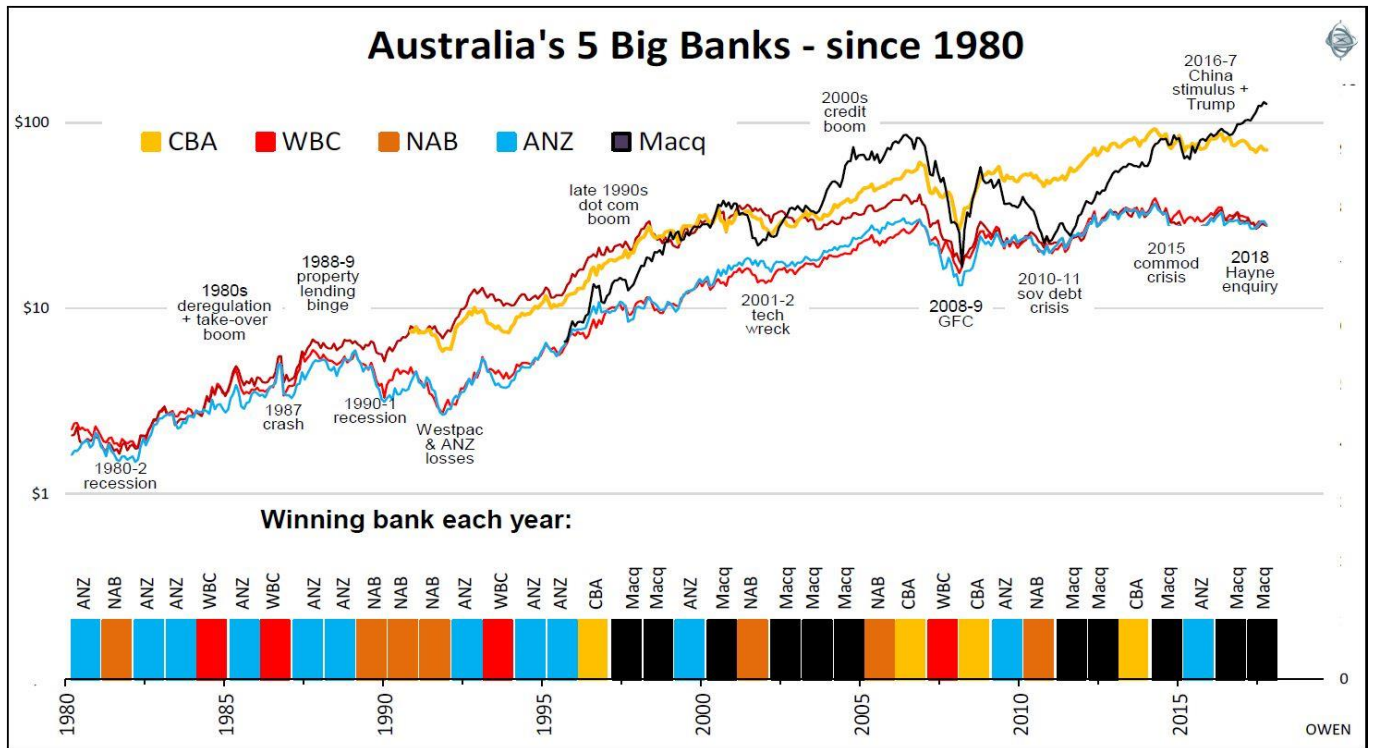
The financial sector is a notoriously high-paying industry relative to its contribution to society. It is not just the sales commissions and bonuses paid to staff, but the base salaries and benefits are much higher than most other industries. Out of the \$20 billion paid to 160,000 bank staff last year, probably 20-30% of it – or around \$4-6 billion each year – was a windfall gain that would not be there if the industry was competitive, efficient and honest. Likewise, probably a similar proportion of the combined \$25 billion in dividends paid to bank shareholders last year was also a windfall gain.

Will the government break up the big banks as Roosevelt did with US banks in the 1930s? Unlikely, but it depends very much who is in power in Canberra. Remind me – who is in government this week?

### Recessionary impacts on banks

The last recession in Australia was in the early 1990s, which ended the bank lending binges of the 1980s. The worst of the major lenders were Westpac and ANZ, but even worse offenders were the state banks of every state government except Queensland (which no longer had a state bank). The property collapse and Paul Keating's 'recession we had to have' exposed enormous piles of bad debts that nearly destroyed Westpac and ANZ. It resulted in the closure and breaking up of every state-owned bank in Australia. The 'good' loans were given mainly to CBA, and the bad debts were borne by taxpayers in each state.

The chart shows share prices of the big five banks since 1980, with the winning bank each year shown at the bottom.



**Recent history and how easily we forget**

Westpac and ANZ are in virtual lockstep during this period although they had different histories. Westpac was formed in 1817 as the Bank of New South Wales, Australia’s first locally-owned bank and the first locally incorporated company. It survived several near-death crises in its first few decades but emerged as Australia’s largest bank for most of the time since.

Melbourne was financed mainly by British investors via British banks. The current ANZ is the result of a merger of three ‘Anglo’ banks in Melbourne. For most of its life, it was the weakest of the big banks, with more aggressive lending and lower capital levels.

After the banking industry was deregulated in the mid-1980s, Westpac and ANZ joined in the mad lending boom being led by the state-owned banks. Prior to the 1987 crash, most of the bad lending was to ‘entrepreneurs’ like Alan Bond, George Herscuc, Chris Skase, Robert Holmes a’Court, Russell Goward, John Spalvins, John Elliott and many others – to finance their crazy take-over deals. The 1987 crash ended the takeover boom (and the ‘entrepreneurs’ were bankrupted, jailed or ran off to hide in Spain), so the banks turned their attention to bad lending on property.

To quell the boom the RBA hiked interest rates to 18% at the end of 1989, sending property prices down and many thousands of borrowers bankrupt. Westpac lost \$2 billion in 1992 and was raided by Kerry Packer then rescued by Lend Lease (which owned MLC), while ANZ lost nearly \$1 billion. These numbers are the equivalent of tens of billions of dollars in today’s terms. In 1992, Westpac had only \$6.7 billion of equity supporting \$110 billion of assets, so the bad debt write-offs of \$5 billion in 1992-1994 almost wiped out its equity. Today’s equivalent would be a \$50 billion loss that would wipe out almost all of Westpac’s \$60 billion in shareholders’ funds. (If that happened today the regulator would probably close the bank, write off all hybrids and subordinated debt to zero and force the bank to raise new capital at a fraction of the prevailing share price.)

From the start of 1990 to November 1992, Westpac and ANZ shares fell 55% but NAB fell only 5%. NAB under Nobby Clark refused to join in the orgy of bad lending. NAB suffered minor bad debt write-offs and it suddenly went from being the smallest of the big banks to the largest. The chart shows how the share prices of NAB and the newly-listed CBA sailed higher for the next 20 years while Westpac and ANZ licked their wounds.

**Overseas adventures and vertical expansions**

Unfortunately, the banks went mad on a string of failed overseas adventures. NAB completely squandered its lead and is now the smallest of the Big Four again. It thought it could teach the British how to do British banking and it thought it could teach the Americans how to do mortgage lending. Westpac also bought banks in

the US. ANZ acquired a network of banks in Asia and Africa in an attempt to 'get big' to compete with Westpac and NAB. It shed them in the 1990s because it didn't know what to do with them. Then it spent the 2000s getting back into Asia under Mike Smith, but is now retreating back to Australia under Shayne Elliott. Oh dear.

These overseas adventures by NAB, Westpac and ANZ wasted billions of dollars of shareholders' money, but they provided bank directors and executives with endless prestige, free travel and entertainment.

After failing dismally overseas, the big banks (including CBA this time) turned their attention to buying up insurance companies, fund managers, financial planning groups and mortgage brokers at home, so they could 'cross-sell' conflicted internal products to their unsuspecting bank customers.

One change that has been significant over the whole period is the type of business done by the banks. Westpac, NAB and ANZ (and their predecessors) all started out as commercial banks, primarily for short-term lending to business. That's what banks do – short-term cash flow loans to business, funded by short-term deposits. Long-term lending to business is done by institutions with long-term liabilities such as life offices. Mortgage and personal lending was done mainly by building societies and credit unions.

The banks have now become primarily home mortgage lenders. Building societies turned themselves into banks and most were bought up by larger banks. Today, the big banks are essentially giant building societies, but with ludicrously overpaid executives.

The 1890s banking crisis was caused by bad lending to residential property developers, the mid-1970s crisis was mainly bad lending to commercial and residential developers, the mid-1980s crisis was bad lending to corporate takeover deals, and the early 1990s crisis was mainly bad lending to commercial property developers. The next banking crisis will be caused by an unwinding of the current boom in housing lending which is financed by the big banks.

Whatever asset is inflated by bank lending deflates when the boom ends.

### **Macquarie – the fifth one**

Macquarie is different. It has a banking licence but it's mainly an asset manager and deal-based investment bank. It has been run by a succession of wily operators. It has always been an innovator that developed new markets for itself rather than competing head-on with the banks. It is one of the few home-grown Australian businesses that have succeeded globally. It nearly blew itself up in the GFC with its fancy structured products and paper-shuffling deals. It narrowly survived and cunningly used the taxpayer-backed government guarantee to buy up cheap operations overseas.

In the chart above, Macquarie won in five out of the past seven years, and 11 out of the past 21. It should remain ahead while the Big Four deal with the Hayne fallout.

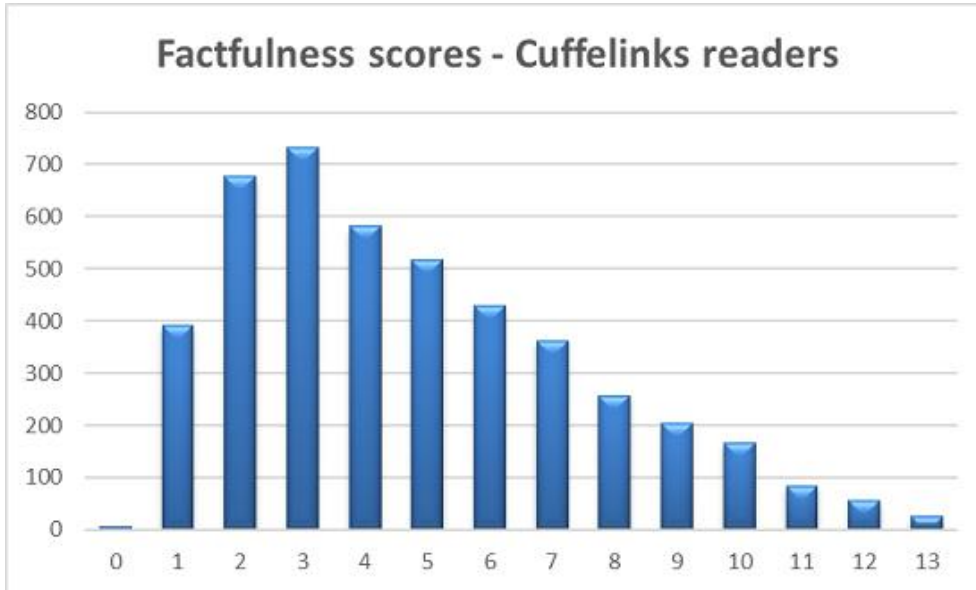
*[Disclosure: I bought shares in ANZ and Westpac in the 1990s crisis and Macquarie in the early 2000s but have not bought bank shares since then (aside from taking up emergency discounted rights issues in the GFC). I still retain the early shares.]*

*Ashley Owen is Chief Investment Officer at advisory firm [Stanford Brown](#) and The Lunar Group. He is also a Director of Third Link Investment Managers, a fund that supports Australian charities. This article is for general information only and does not consider the circumstances of any individual.*

## **Results: Factfulness of Australians and Cuffelinks readers**

Leisa Bell

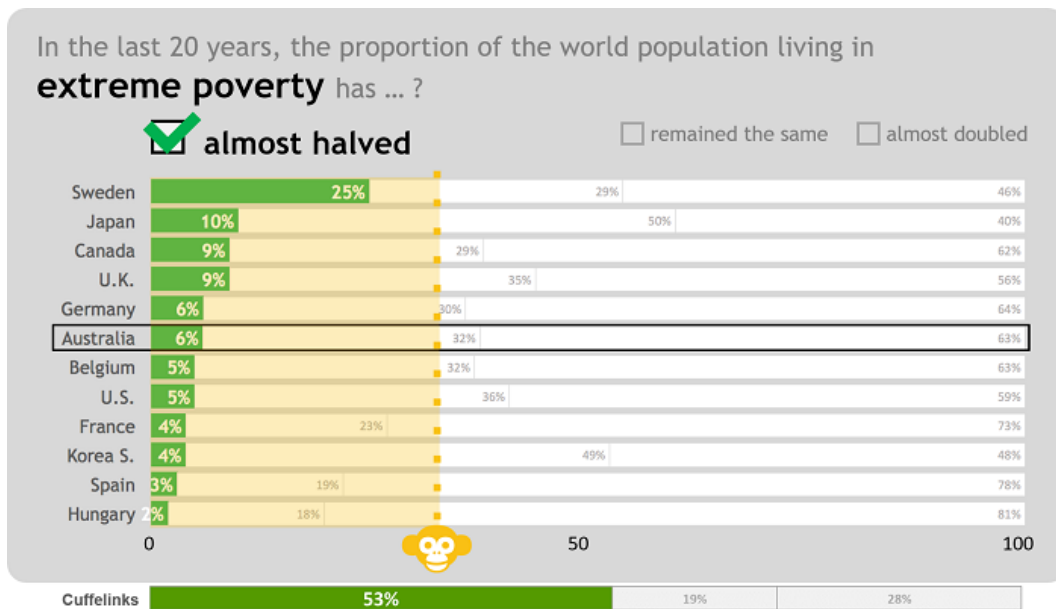
Thanks to almost 5,000 readers who took on the Factfulness quiz. While the majority scored less than 5 out of 13, this was not unexpected and heightens the purpose of the exercise: to give people a more accurate view of global development.



The following charts show how Cuffelinks readers' results compare to the random guesses of a chimpanzee (yellow dotted lines), the Australian average (black outline), and a selection of other countries, question by question.

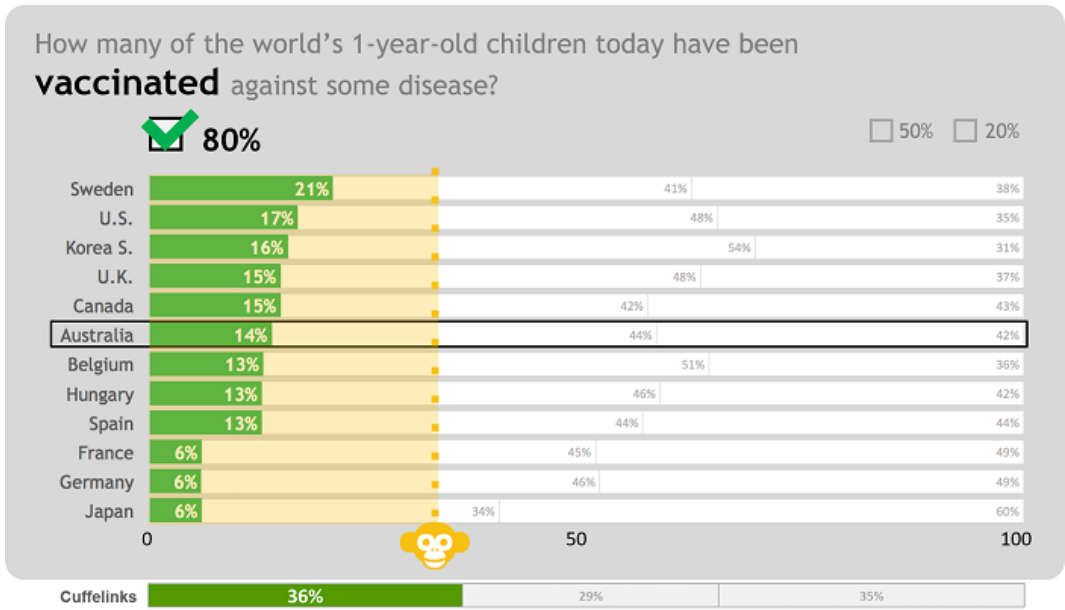
Cuffelinks readers' averaged better than a chimpanzee for 6 of the 13 questions, and better than the Australian average for 10 questions. The question that ranked highest for difficulty was how many girls in low income countries finish primary school (only 16% answered correctly) and the easiest question was on climate change (95% correct). This also corresponds to Gapminder's overall averages. A short explanation, extracted from Gapminder's website, is included for each question.

**Question 1**



The share of people living on less than US\$1.90/day fell from 34% in 1993 to 11% in 2013, according to World Bank. However, extreme poverty is difficult to measure. The poorest people are subsistence farmers with insufficient harvests or destitute slum dwellers, with unpredictable and constantly-changing living conditions and few documented monetary transactions. But even if the exact levels are uncertain, the trend direction is not, because the method for estimating has not changed. We can trust that the level has fallen to at least half, if not one-third.

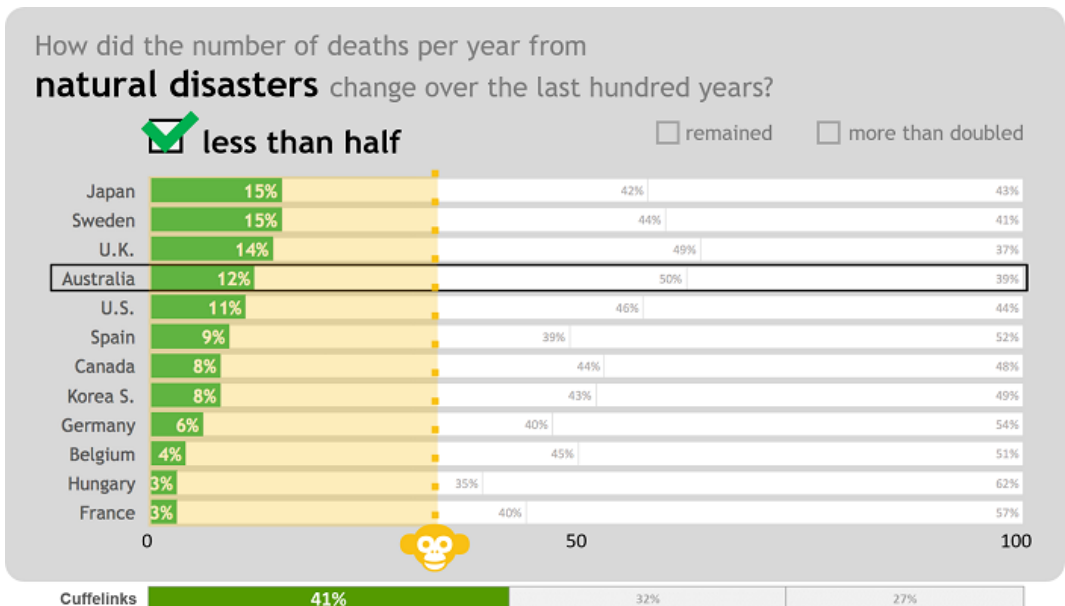
**Question 2**



88% of 1-year-old children in the world today are vaccinated against some disease, according to the World Health Organisation (WHO). Gapminder rounded it down to 80% to avoid overstating progress. The common vaccines are as follows:

- BCG (Tuberculosis): 88%
- DTP3 (Diphtheria tetanus toxoid and pertussis): 86%
- MCV1 (Measles, 1st dose): 85%
- Pol3 (Polio): 85%
- HepB3 (Hepatitis B): 84%
- PAB (Neonatal tetanus): 84%
- Hib3 (Haemophilus influenzae type b): 70%
- MCV2 (Measles, 2nd dose): 64%
- PCV3 (Pneumococcal conjugate): 42%
- RotaC (Rotavirus): 15%

**Question 3**

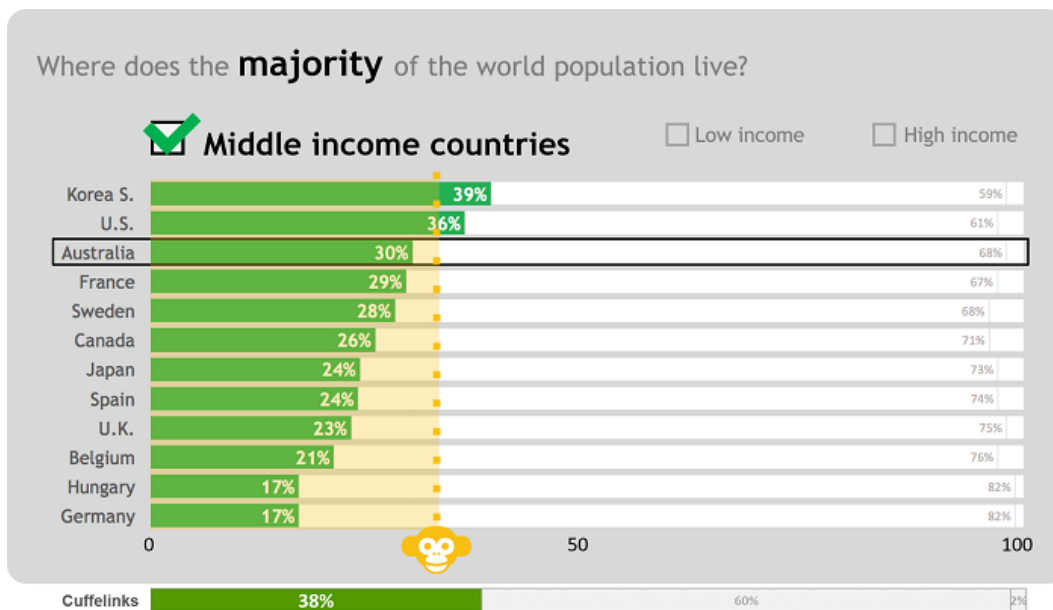


Annual deaths from natural disasters have decreased by 75% over the past 100 years, according to the Emergency Events Database (EM-DAT). Since disasters vary from year to year, 10-year averages are compared. In the 10 years from 2007 to 2016, on average 80,386 people were killed by natural disasters per year. This is 25% of the number 100 years earlier (1907–1916), when it was 325,742 deaths per year.

The huge decline in disaster deaths would be even more striking if two other major global changes were also taken into account. First, the number of people has increased by four, which calls for counting disaster deaths per capita. From 1907–1916, there were 181 disaster deaths per million people, and from 2007–2016, the number was 11. The relative number has dropped to 6% of what it was 100 years ago. Second, 100 years ago the communication technologies for reporting disasters were primitive, compared to the monitoring of today, which means that many catastrophes must have gone unrecorded or been under-reported.

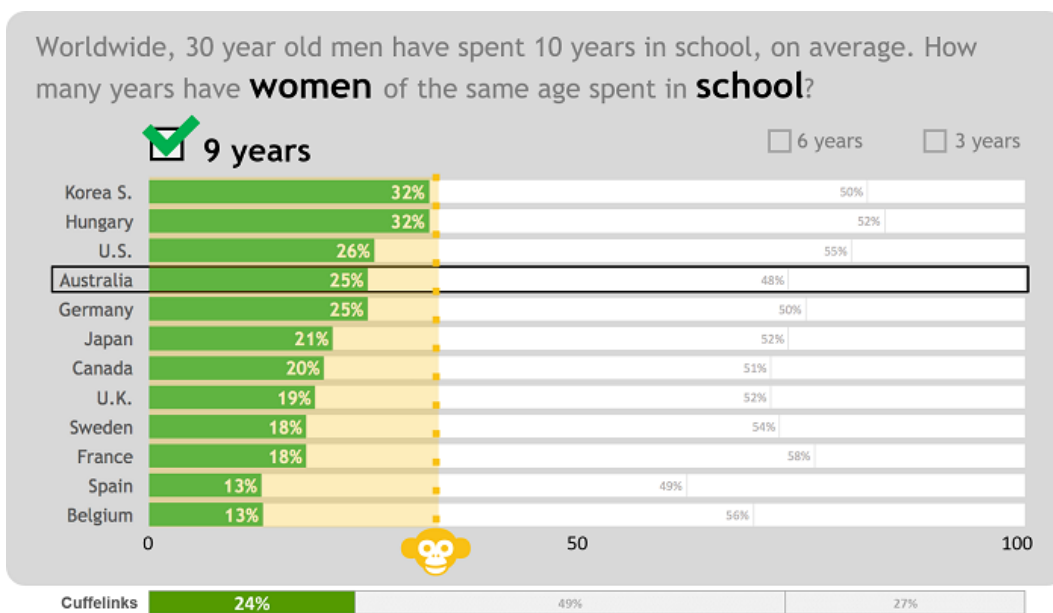
All known emergency events have been categorised as follows: animal accident, complex disasters, drought, earthquake, epidemic, extreme temperature, flood, fog, impact, insect infestation, landslide, mass movement (dry), storm, volcanic activity, and wildfire.

**Question 4**



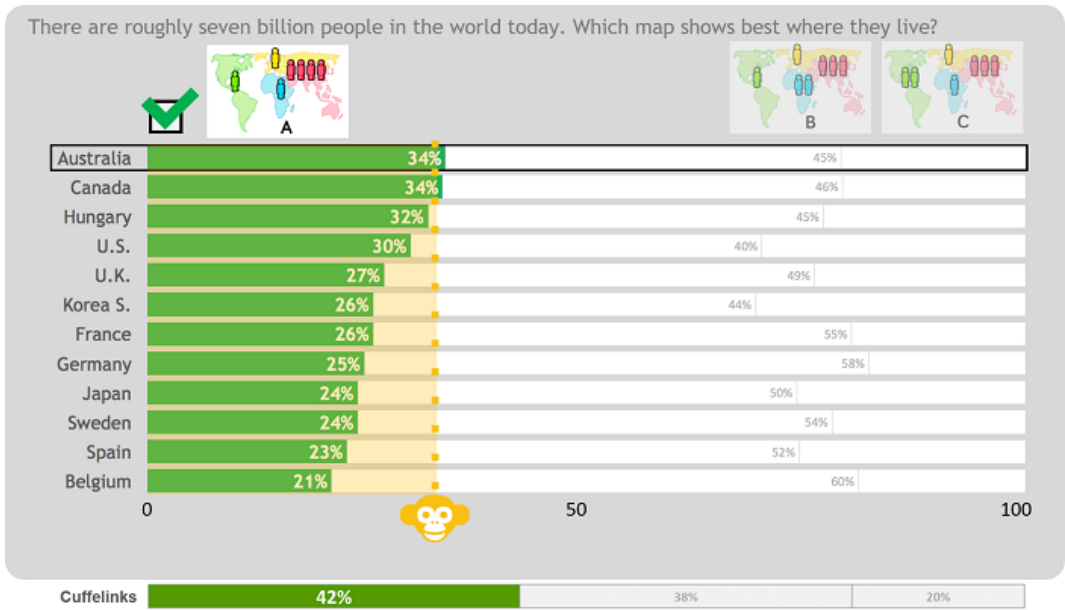
The majority of people live in middle-income countries. The World Bank divides countries into income groups based on gross national income per capita in current US\$. The low-income countries represent 9% of the world population, the middle-income countries 76%, and the high-income countries, 16%.

**Question 5**



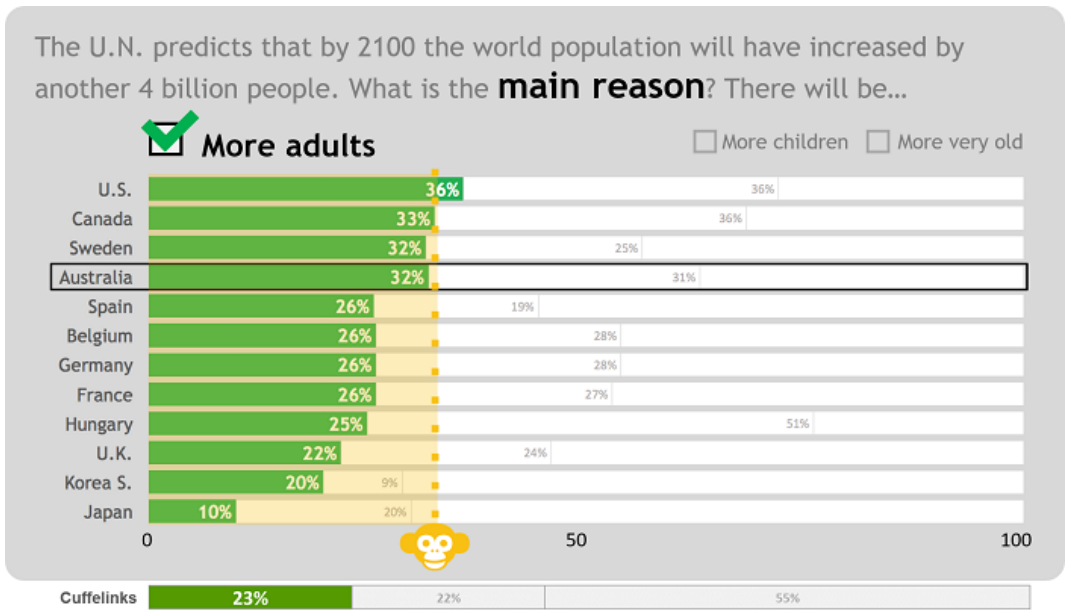
Worldwide, women aged 25 to 34 have an average of 9.1 years of schooling and men have 10.2, according to the Institute for Health Metrics and Evaluation (IHME) estimates from 188 countries.

### Question 6



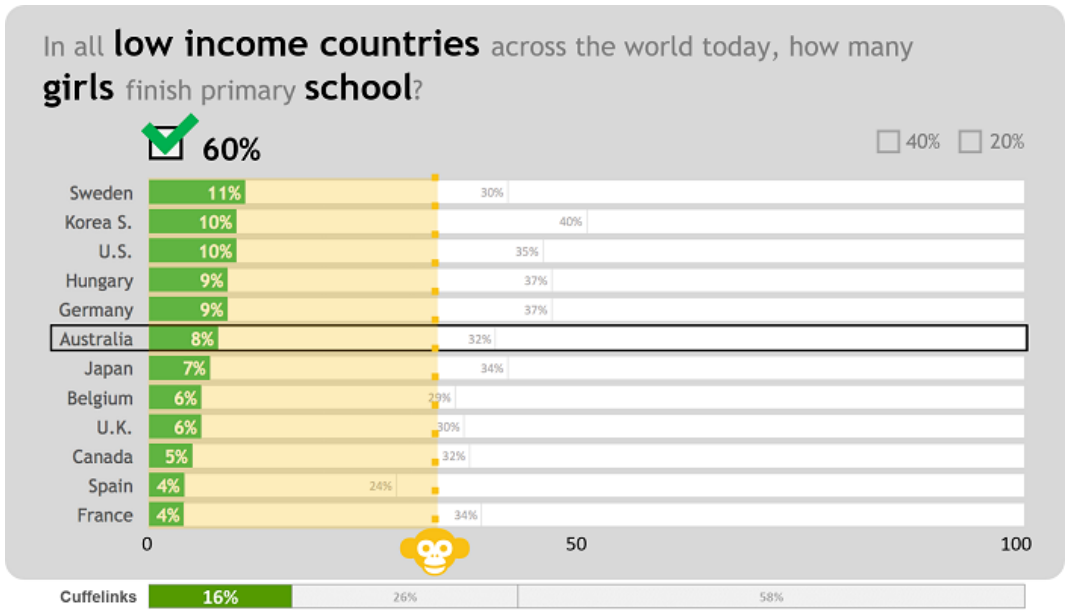
The world population in 2017 was 7.6 billion, according to the United Nations Population Division (UN-Pop). That would usually be rounded to 8 billion, but Gapminder shows 7 billion because they are rounding the population region by region. The populations of the four Gapminder regions were estimated based on national data from UN-Pop: the Americas, 1.0 billion; Europe, 0.84 billion; Africa, 1.3 billion; Asia, 4.4 billion.

### Question 7



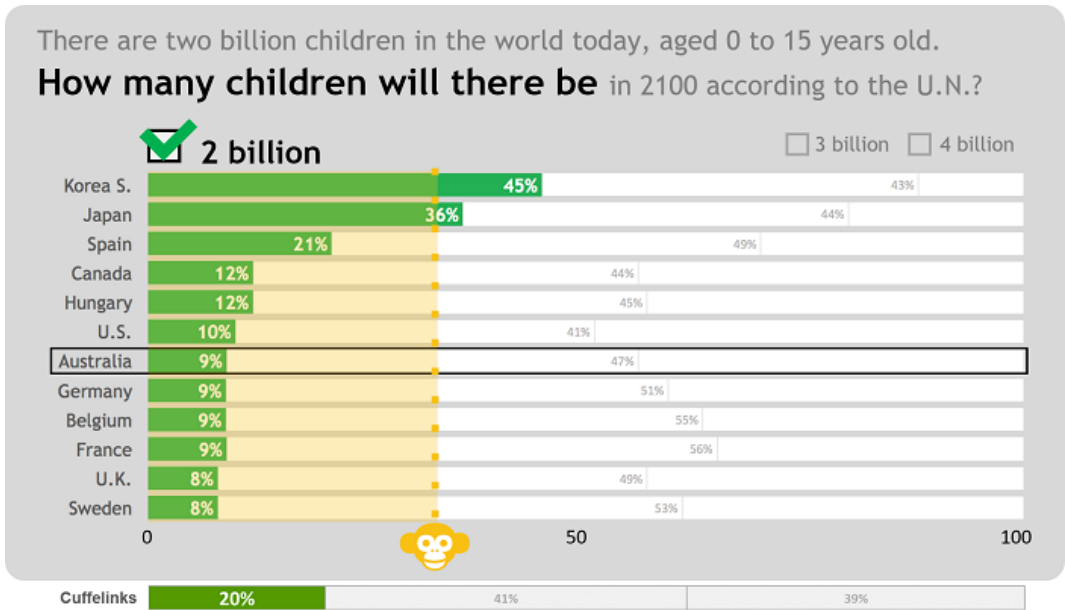
In their forecasts, UN-Pop demographers calculate that 1% of population increase will come from 0.37 billion more children (age 0 to 14), 69% from 2.5 billion more adults (age 15 to 74), and 30% from 1.1 billion more old people (age 75 and older).

**Question 8**



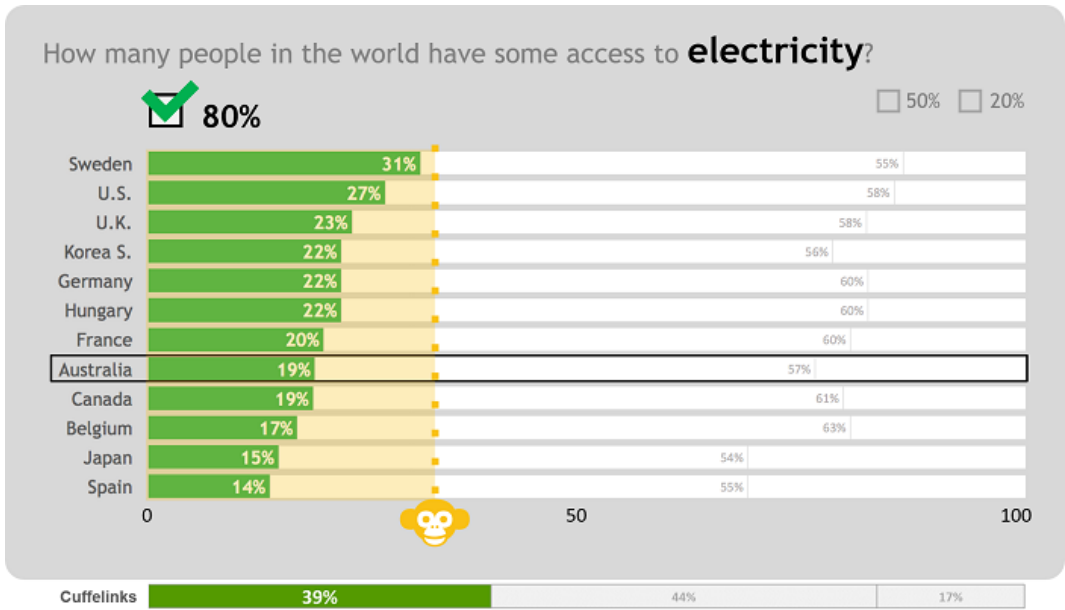
According to World Bank, 63% of the girls in low-income countries finished primary school in 2015. Primary completion rate is the number of new entrants (enrollments minus repeaters) in the last grade of primary education. World Bank defined 31 countries as low-income countries in 2017.

**Question 9**



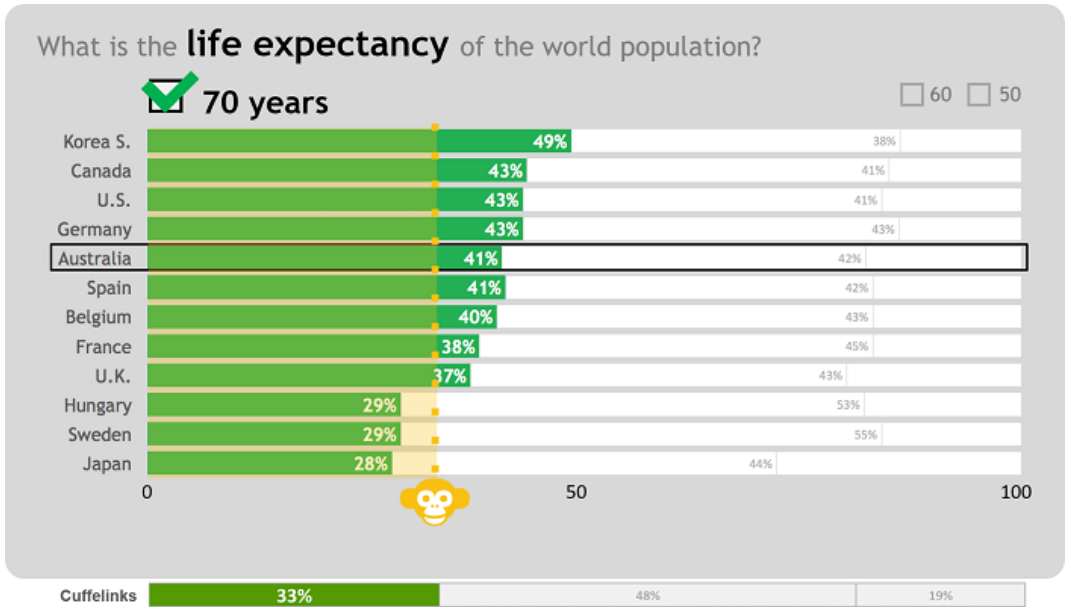
UN-Pop demographers publish a 'medium fertility variant', which falls between the highest and lowest predictions of fertility and mortality decline worldwide. UN-Pop predicts that the number of children in the year 2100 will not be higher than it is today.

**Question 10**



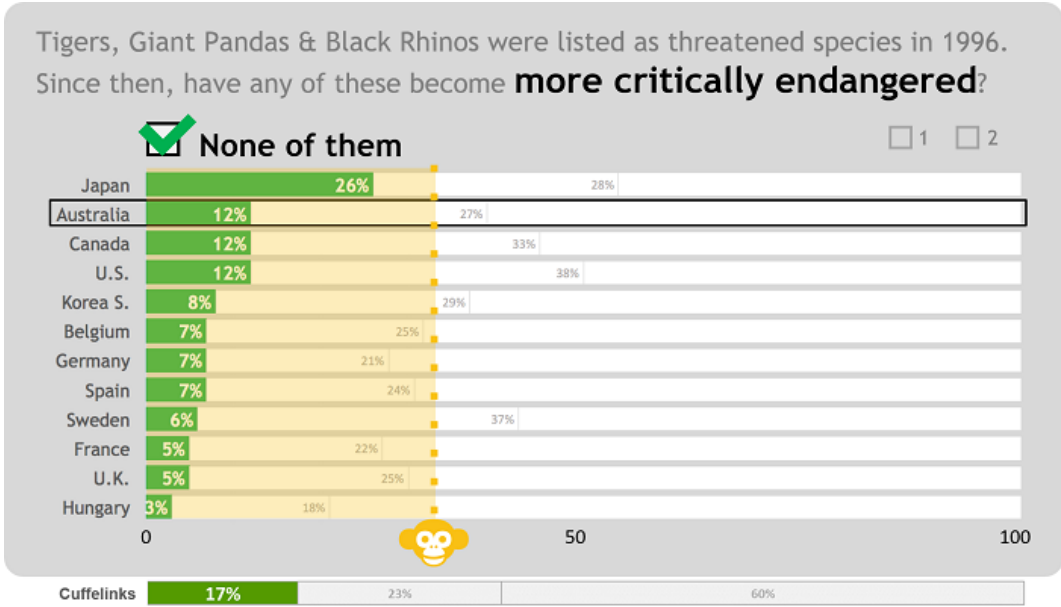
A majority of the world population, 85%, had some access to the electricity grid in their countries, according to Global Tracking Framework (GTF, a collaboration between the World Bank and the International Energy Agency). Gapminder has rounded this down to 80% to avoid overstating progress. The term 'access' is defined differently in all their underlying sources, and households may experience significant power outages and still be listed as 'having access to electricity.'

**Question 11**



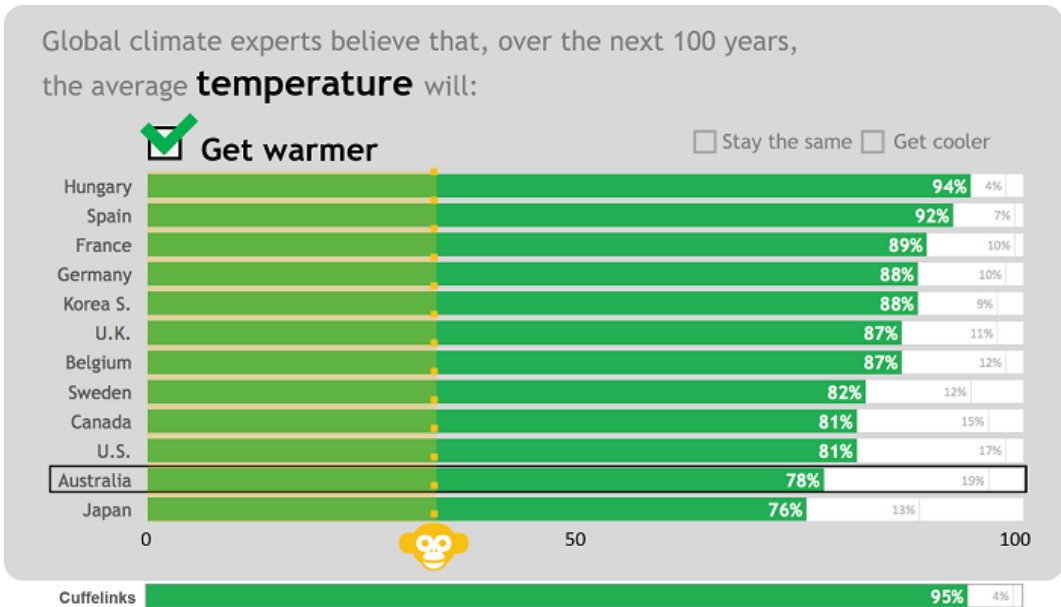
The average global life expectancy for those born in 2016 was 72.5 years, according to IHME. The three answer alternatives were chosen by Gapminder after first having asked the question with an open answer field, letting respondents write any age they wanted. Most people wrote 50 or 60 years.

**Question 12**



None of the three species are classified as more critically endangered today than they were in 1996. The data is based on the [IUCN Red List of Threatened Species](#).

**Question 13**



The term 'climate experts' refers to the 274 authors of the IPCC's Fifth Assessment Report (AR5), published in 2014 by the Intergovernmental Panel on Climate Change. Here is what they predict about the changes in the climate system:

*Surface temperature is projected to rise over the 21st century under all assessed emission scenarios. It is very likely that heat waves will occur more often and last longer, and that extreme precipitation events will become more intense and frequent in many regions. The ocean will continue to warm and acidify, and global mean sea level to rise.*

Leisa Bell is Assistant Editor at Cuffelinks. For a summary of Cuffelinks' Factfulness Quiz results, [click here](#).

Free fact-questions and related information and data from [www.gapminder.org](http://www.gapminder.org).

## Sustainable investing focuses on the future

Stephane Andre and Bruce Smith

In the rapidly-evolving world of socially-conscious investing, sustainability has arrived. The integration of environmental, social and governance (ESG) factors into fund managers' fundamental research processes has become mainstream in recent years. However, sustainable investing takes that approach one step further by also considering the impact a company has on society.

Sustainability is gaining traction with investors, but it is not without challenges. Typically, socially-conscious strategies have focused on negative filters, without taking into consideration the positive contribution a company might have on society. Investment returns can be compromised due to constraining the investment universe and data. Each companies' ESG performance can be of variable quality, resulting in many arguable or 'grey' areas.

### The rise of sustainable investing

[Research](#) conducted by Responsible Investment Association Australasia (RIAA) in 2017 shows that nine-in-10 Australians think that sustainable investing is important. Furthermore, 63% of Australians expect their advisers to incorporate their values and the societal or environmental implications of investments. Millennials are leading the charge. One key attribute of Millennials, now aged in their 20s and 30s, is their stated desire to live lives consistent with the values they espouse. About 84% of them say they want to invest in a socially-responsible way and their influence will grow as they become older and richer.

International organisations such as the United Nations and European Union are encouraging corporates to generate company profits in a positive and sustainable manner. Many of the world's leading companies now consider sustainability in their corporate strategies, including Coca-Cola, Apple, BMW, Adidas, and H&M.

The United Nations has developed its [Sustainable Development Goals Agenda](#) (SDGs), a set of goals which, if achieved, would 'end poverty, protect the planet and ensure prosperity for all' by 2030. Broad and ambitious in scope, the SDG Agenda addresses the three dimensions of sustainable development: social, economic and environmental, as well as important aspects related to peace, justice and effective institutions. These goals are shown below.



Assessing the extent to which a company's operations and products support the SDG agenda is an appealing way to address broader sustainability.

### The investment manager as advocate

The investment industry is also evolving and, in some areas, driving the change. Simply having a 'clean hands' approach is no longer good enough. Many existing socially-conscious funds purely screen and exclude whole industries on the basis that they have a negative impact on society. This approach strictly reinforces a company's adherence to ESG principles but fails to consider whether a company is contributing positively to society.

**We believe investment managers should also be playing an 'advocacy' role, by putting pressure on individual companies to improve their ESG performance.** In turn this operational improvement can lead to improved financial outcomes, along with the broader positive impact to society.

The dilemma for investment managers has been their fiduciary responsibility: their primary goal is generally to maximise returns for a targeted level of risk. In the past it has usually been assumed that pursuing both social good and profits would damage investment outcomes, as screening out potential investments or pursuing goals other than profit maximisation might result in the missing of opportunities. These are legitimate concerns and have often resulted in an unwillingness to commit to socially conscious investing.

However, investing sustainably doesn't necessarily mean sacrificing potential returns.

### **Investing for good and for returns**

The most common objection to investing with a social conscience is that an investor needs to sacrifice returns to invest for the greater good. An increasing body of evidence is beginning to challenge this view, and the outcomes achieved by some such funds suggest it is possible to have both. Industry research summarised by Willis Towers Watson in their paper '[Show me the evidence](#)' confirms better ESG scoring-companies tend to provide moderately better risk-adjusted returns over the long term. From the evidence collected to date, Governance ('G') and company engagement have proven to lead to a positive impact on returns.

A commonality across the research points to a heightened quality factor via a lower cost of capital which in turn leads better stock performance. Published University of Oxford [research by Clark, Feiner and Viehs \(2014\)](#) on over 190 sources showed 90% of the studies on the cost of capital demonstrate that sound sustainability standards lower the cost of capital for companies. 88% of that research showed solid ESG practices result in better operational performance of firms.

Alphinity agrees with Willis Towers Watson's conclusion:

*"Astute long-term investors understand that ESG factors are not necessarily non-financially related factors, as is often perceived, but rather an additional source of insight into the risk and return profile of that investment."*

Selecting better scoring ESG companies is likely to become another pillar of active management, along with conviction, skill and a disciplined consistent approach.

*Stephane Andre and Bruce Smith are Principals and Portfolio Managers at [Alphinity Investment Management](#), a boutique fund manager in alliance with [Fidante Partners](#), a sponsor of Cuffelinks. This article is for general information only and does not consider the circumstances of any individual.*

*For more articles and papers from Fidante, please [click here](#).*

## **Six advantages of an SMSF**

Graeme Colley

Each type of superannuation fund has its own features but setting up an SMSF provides some unique advantages worth considering.

An SMSF gives the trustee options around tax efficiencies, investment flexibility and cost advantages once the fund has grown to a tipping point. Perhaps the biggest advantage of an SMSF is having active control over the investment decisions for your retirement.

Here are six features of SMSFs:

### **1. Business property leasing and deductions**

An SMSF gives the trustee some unique options to make investments that are currently not available to funds of five or more members. For instance, an SMSF can buy business property from members and other related parties, with tax advantages when the property is then leased at market rates to a related party as it continues to build wealth within the fund.

If the related party in the SMSF is also running a business from the property, the rent would usually be tax deductible and help build further wealth for the member above the normal tax-deductible contributions that are being made to the fund.

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## 2. Buying and selling investments

Many SMSF trustees use their fund to make direct investments in unit trusts, term deposits, listed and unlisted shares and property. Having control over your investment decisions means you have the flexibility in an SMSF to buy and sell when you decide.

Market timing is critical for making investment and sale decisions. SMSF trustees are uniquely placed to take advantage of income and taxable capital gains for investments that have moved to a retirement phase and could then provide tax-exempt or partially exempt income to the fund.

This would not be possible in other funds by selling an asset when the member's benefit is in the accumulation phase.

## 3. Control the timing of investments for tax advantages

Control over the timing of buying or selling fund investments is critical in providing tax advantages.

For tax purposes an SMSF is treated in virtually the same way as the larger funds, but with greater flexibility in using the various tax rules for direct efficiencies. For example, the ability to defer the purchase or sale of an investment may provide a reduction in taxable income of the fund.

## 4. Potential cost savings

The cost advantages of an SMSF compared to other superannuation funds will vary according to the circumstances of the fund.

Generally, an SMSF with a low balance may be relatively cost inefficient compared with larger funds. However, there will be a break-even point for a member's balance where the cost of running the SMSF will be relatively cheaper than a larger fund.

If cost is a priority over the flexibility and control, keep a watchful eye over the relative costs in both larger funds and SMSFs and wait until the best moment for your circumstances.

## 5. Estate planning alternatives

An SMSF provides an effective vehicle for estate planning. As many SMSFs have members either retired or nearing retirement, estate planning becomes a priority to ensure that any benefits accumulating for members are paid to the right beneficiaries. This is often done using binding death benefit nominations or reversionary pensions.

Intergenerational transfer of SMSF fund assets can also happen where other members of the family also belong to the fund, which will become increasingly important if the current proposal to increase the maximum number of SMSF members from 4 to 6 becomes law.

## 6. Asset protection from creditors

Creditor protection is an important and little-known benefit of an SMSF. Assets of an SMSF are protected from creditors if a member or their business should run into trouble. It's more of a backstop rather than a primary reason to get into an SMSF, but it's an added assurance that valuable assets designated for retirement are adequately protected when needed.

### The satisfaction of running an SMSF

The main attribute in a word is control. The satisfaction of an SMSF is in your ability to control and direct the fund's investments and fortunes. You are empowered to make decisions which are directed to the benefit of you and your family, which provides the greatest pleasure plus the confidence to own your future. SMSFs are not for everyone, especially those with insufficient time or knowledge to act as a trustee, but worth considering for many.

For more information on the best SMSF strategies, see our [Expert Insights](#) page.

*Graeme Colley is the Executive Manager, SMSF Technical and Private Wealth at [SuperConcepts](#), a sponsor of Cuffelinks. This article is for general information and does not consider any individual's investment objectives.*

*For more articles and papers from SuperConcepts, please [click here](#).*

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## Three key issues with S&P's index v passive scorecard

John Peterson

S&P Dow Jones Indices recently released its updated [Index Versus Active \(SPIVA\) Australian Scorecard](#) covering fund manager versus index performance to June 2018.

The results of the analysis have again found that, with the exception of small-cap equities, the average Australian actively-managed fund underperformed comparable market indexes over the 1-year and longer periods. That is, more than 50% of active funds underperformed the index.

Unfortunately, the S&P SPIVA analysis is not comparable to, and is therefore irrelevant for, institutional superannuation funds, and may be for some individual investors.

### Three key problems with the analysis

If we take Australian equities as an example (general or large-cap style), there are three problems:

#### 1. Managers

The SPIVA analysis is based on over 300 actively-managed funds defined by Morningstar as large-cap. It is not disclosed how many managers actually manage these 300 funds.

From an institutional perspective, there are probably less than one-third that number of large-cap managers and strategies that would even be considered as potential investments, due to the tight compliance and eligibility rules they use.

#### 2. Equal versus asset weightings

S&P Dow Jones Indices does publish some asset-weighted results (that is, weighting the results by funds under management, not giving equal weights to tiny and large fund managers) in the SPIVA. However, the tables of results which are the sources of the outperformance comparisons over 1, 3, 5, 10 and 15 years showing that x% of funds underperform the benchmark are based on equal-weighted returns. A manager with a small portfolio is given the same weight as one with many billions.

Notably, in the tables in the SPIVA Report which give both equal and asset-weighted return levels, the asset-weighted active funds outperform the equal-weighted funds by 30-50 basis points per annum. This suggests that either:

- larger investors are able to select better-performing actively-managed funds, and/or
- larger actively-managed funds have lower fee levels.

In either case, the asset-weighted funds would have had better performance relative to the index over time if these figures had been used for the outperformance comparisons.

#### 3. Retail fees

The SPIVA analysis is based on fund performance provided by Morningstar, which are after-fee returns. Given the large number of funds (over 300), many have 'retail' fee levels. Moreover, even those 'wholesale' funds included would have fee levels significantly greater than those paid by institutional superannuation funds investing through mandates, and some options accessible by retail.

The charts in the SPIVA analysis which show cumulative (growth of a dollar) performance versus the benchmark show clear outperformance by the asset-weighted funds over the equal-weighted across essentially all periods, and for all asset classes (with the notable exception of small-cap funds). This indicates that larger investors select better performing investments.

### Adjusting the results

If the SPIVA analysis was adjusted to reflect an institutional manager selection process and institutional fee levels, it would be likely that the average super fund investor would be found to consistently outperform the benchmark.

Actual results delivered by Australian super funds support this conclusion, with the SuperRatings SR50 Australian Shares Index of after-fee (i.e. actual) returns to super fund members outperforming the S&P/ASX 200 index (before fees) in every period (1, 3, 5, 10 and 15 years).

S&P Dow Jones Indices claim that they are 'the de facto scorekeeper of the ongoing active versus passive debate'. It should be born in mind that the SPIVA Scorecard is only relevant to retail investors, and even there, should be qualified by the above analysis.

*[Editor's note: The SPIVA data is often quoted to demonstrate active manager underperformance, but it is not the only company which monitors managers. The latest Mercer Investment Survey results were recently released for September 2018, as shown below. Perhaps supporting John Peterson's analysis, Mercer shows the median Australian shares manager outperformed the S&P/ASX300 by 1.2% (9.4% versus 8.2%, before fees) over five years. Even after fees, this result is likely to show outperformance].*

The medians (before management fees and taxes) for the Mercer Surveys\* for periods to 30 September 2018 were as follows

	3 Mths (%)	1 Yr (%)	3 Yrs (%pa)	5 Yrs (%pa)
Median of the Mercer Australian Shares Survey	1.4	14.6	12.6	9.4
S&P/ASX 300 Accumulation Index	1.5	14.0	12.2	8.2
Median of the Mercer Overseas Shares Survey	6.3	19.2	12.6	15.3
MSCI World ex-Australia Index	7.4	20.8	12.4	15.3

\* Universe data and rankings as at 9.56am on 17 October 2018. Stock returns are price returns. Index and stock returns are in Australian Dollar terms unless otherwise stated and sourced from Thomson Reuters Datastream.

John Peterson is the Founder of [Peterson Research Institute Pty Ltd](#) and has 40 years of experience in the financial services and investment industry. The views and opinions expressed in this article are those of the author. This article is provided for general information only and does not constitute financial or any other advice.

## When customised solutions ruin a company

Jessica Pallant and Sean Sands

How could you go from winning awards for "Store Design of The Year" and "[Best Shoe Ever](#)" to selling nothing?

In 2009, the Australian startup Shoes of Prey set out to make exactly the shoes its customers wanted. Customers could pick the designs, sizes and exact specifications, and Shoes of Prey would deliver exactly what they ordered.

They wouldn't make shoes no one needed. Traditional retailers use flash sales to move stock that has gone out of fashion. Or they burn or bury it. British fashion label Burberry says it has destroyed more than A\$150 million worth of unsold clothes, accessories and perfume over the past five years.

Last month Shoes of Prey hit pause. Co-founder Jodie Fox went to [social media](#) to say it was considering its future and wouldn't process any further orders. It had been unable to "truly crack mass market adoption". If Shoes of Prey couldn't, maybe no one can.

### The pros and cons of mass customisation

Customisation can increase the perceived value of a product through the 'I designed it myself' effect, giving customers a sense of ownership as 'creators'. It can also improve the customer's perception of the quality of the product. Research shows people are more likely to enjoy the taste of a meal made from a kit they used themselves than the taste of a meal made from the same kit in a store.



*It's tempting to design your own shoes, but it takes time. [Shutterstock](#)*

But there are downsides. Making choices is taxing. And the choices pile up. For shoes, size is probably the easiest, followed by colour, heel size, width, pattern and accessories. There are other judgements to be made. Should there be more than one colour? Will that choice look good? What will others think? And so on.

Having many roughly equal options to choose from is draining. The satisfaction we get from choice [follows an inverted U curve](#). Having more options when there are too few makes us feel good, but having even more when there are already a lot makes us feel worse.

And then there's the cost of time.

When customising, customers have to learn what is possible within the confines of the toolkit, test out different possible solutions, learn from their errors and pick the best solution. All of this takes time.

It's a resource not everyone has. Research shows customers with the most free time are the most likely to appreciate the opportunity to [make choices about what they buy](#).

Shoes of Prey's mistake might have been to increase the range and complexity of its offerings too much. What started as customising high heels in 2009 became selecting styles of heels, flats, sneakers, boots and sandals with a multitude of options within each.

While loyal customers could keep up, for the average customer the choice was overwhelming. For some, it was easier to take the path of least resistance – a pair of off-the-shelf shoes.

### **Mass customisation today**

Some retailers are persisting with mass customisation. More than 60% of online shoppers in the US are believed to have chosen, recommended or bought a brand that provides a customised experience or service. Interestingly though, 42% wanted to customise from a list of options and be 'led by the brands' [rather than start from scratch](#).

So-called 'customisation via starting solution', where customers choose from an initial option closest to their desired outcome and then refine it to their needs, has been found to enhance satisfaction, decrease the perceived complexity of the customisation and result in more feature-rich products being customised.

An example of a brand currently making headway is Choosy, a new, fast-fashion brand that draws its inspiration almost exclusively from the top-trending posts on Instagram. Releasing 10 styles a week, it gives customers just a few days to order before they go into production. By creating only pieces customers have committed to buying, it avoids building up surplus stock and leverages the upside of mass customisation while minimising the downside.

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## Does it have a future?

The waste in mass production of fashion items is unsustainable in the long term, from both an economic and social standpoint.

Shoes of Prey broke ground with its innovative business model of delivering customised shoes through on-demand manufacturing, but faced challenges in convincing customers to make the necessary choices to customise a product.

If brands can tackle the barriers to customisation, reducing the cost to customers in time and choice as Choosy has done, then mass customisation could have a future.

*[Jessica Pallant](#), Lecturer in Marketing, [Swinburne University of Technology](#) and [Sean Sands](#), Associate Professor of Marketing, [Swinburne University of Technology](#). This article is republished from [The Conversation](#) under a Creative Commons license. Read the [original article](#).*

## Super's worsening for self-funded retirees

Carlo Bongarzoni

*[Editor's note: this is a comment received to Cuffelinks' 'Have Your Say' section. It has not been edited. It serves as a reminder on the type of correspondence Chris Bowen's office is receiving.]*

SMSFs in pension mode are required to drawdown from the Fund each year an increasing minimum amount on a percentage basis. I suggest that the original rationale for that imposition is increasingly less relevant or fair in today's world. The drawdown regulation was clearly to avoid members accumulating increasingly large asset bases through a tax-exempt superannuation system and consequently understandable. However in light of developments since, it is surely time to reconsider and adjust the drawdown levels and assessment methods. The relevant factors are detailed below and cumulatively adversely affect the longer-term confidence of many SMSF retirees in their Fund's ability to deliver the sort of security for their older age needs that they had planned for.

1. The numerous Government changes imposed on SMSF superannuation in particular have reduced the levels of attraction for SMSF-type retirement saving – in a stable income accumulation and pension sense. The latest being the relatively recent \$1.6 million total asset cap. In an increasingly less stable world achieving responsible income and asset growth return is a much riskier and uncertain process – especially when the asset total is now capped at a lower level for many whose hard work and saving for retirement had planned on a more liberal asset base regime. Although a one-off government pause was applied belatedly during the GFC, there are no guarantees of similar “legislative pauses” for future significant downturns – even though each such adverse investment period significantly reduces the asset base on which retirees rely for earning their anticipated incomes. Importantly, the older they are the less likelihood they have of ever “repairing” that unplanned asset loss.

2. Retirees' likely life spans are increasingly longer for many. Investment return volatility and downturn risks pose very real concerns for many self-funded retirees about whether they will be able to rely on income levels for which they had planned until death. Actuarial calculations on which SMSF legislation rules are predicated on, use statistics that are some 3 to 5 years in arrears of current experience and in any case questionable when for instance similar UK statistics are compared to Australian. Despite Australia being considered a healthier country than the UK as proved by underlying statistical evidence the UK actuarial tables favour greater longevity and that in turn affects government legislation in respect of superannuation entitlements. That important actuarial discrepancy adversely determines the government's annual compulsory drawdown percentages against Australian retirees.

3. The announced Labor pronouncements relating to franking and related tax effects would further adversely impact SMSF retirees' earning and asset base and consequently add further stress on their ability to earn income sufficient for their living span.

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## Conclusions

Australia's superannuation regime since inception has become increasingly less certain as the medium to save for retirement with confidence. Government has contributed to that uncertainty through rule/tax changes which disadvantage most self-funded retirees. The effect of #1 through #3 above only heighten self-funded retirees' fears that what they had saved for will be inadequate for their lifespan due to increasing longevity, government superannuation changes, less stable investment environments, and outdated annual mandatory drawdown regulations that unfairly disadvantage those who chose to be self-reliant and independent of government benefits through hard work and saving. Much about Australia's superannuation regime remains questionable and in need of drastic review – particularly from a self-funded retiree standpoint. But a critical urgent starting point should be a review of the underlying rules/rationale for the current annually increasing mandatory drawdown levels to reduce the risk to many SMSF retirees of their savings 'bankruptcy' before they die.

Lastly – in the overall Australian superannuation regime context, it is surely reprehensible that politicians and government employees generally continue to enjoy far superior retirement plans and benefits which also often guarantee benefit levels. The historical contexts for such benefits have long since ceased to apply. Most Australians I'm sure would welcome public employee superannuation benefits that more equitably relate to those applying to Australians in general.

*[Carlo Bongarzoni](#) is Principal of management consultancy firm, Carlo Bongarzoni Associates Pty Ltd.*

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