

Tim Keegan's Top Articles from the archive

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Summer Series Guest, Tim Keegan

AMP Capital's goal is simple: secure the financial future of as many investors as possible. As part of that I am always looking for new ideas, trends, conversation starters and stories that make me think. Contemplating the future is what Cuffelinks and its array of authors does best. Here are five of my favourites.

1. Let's start at the beginning, with the basics of investing. The holiday season is a time for reflection and a couple of years ago, Cuffelinks put together a comprehensive guide to investing by asking more than 30 investment professionals to provide advice to their 20-year-old selves. From the power of compound interest to the exhortation to 'start now!', from playing to your strengths to learning to manage your emotions, it's full of gems, and is [linked here](#). As this article was also selected by a previous Guest Editor, I have chosen another ebook on the basics of investing, focussed more on lessons from making a mistake.

[What is an enduring investment lesson you learned from making a mistake?](#)

2. Noel Whittaker's 20 Commandments of Wealth is a classic. He tells us to ignore the prophets of doom that fill our media and make sure we take professional advice before investing, not after. The list is full of wisdom.

[The 20 Commandments of Wealth for Retirees](#)

3. Focusing more closely on share market investment, the eloquent Roger Montgomery offered a timeless primer back in 2015 that still holds true. He says first, identify superior businesses, and second, estimate their true value. And then he laments how hard it is for investors to follow these simple rules.

[How to think rationally about shares](#)

4. In a similar vein is David Bell's argument against get rich quick schemes. There's no easy way to make money, he says. And that really is a truism of investing.

[No easy way to make money](#)

5. And finally, this time of the year is a time of thanks – thanks for the life we're living, the society that allows us to live so well and the people with whom we spend our time.

No article contemplates this better than Chris Cuffe's own thoughts on life, family and death – and his frustration at the still true fact that 45% of Australians do not have a valid will. What could be more important

than ensuring your loved ones are safe and cared for after you've gone? Chris contemplates the basics and benefits of leaving an enduring legacy for your children and grandchildren.

But also, perhaps more importantly, he considers how we can also leave an enduring gift for society at large – the very society that has enabled us to live so well in the first place.

[Planning to make your money live forever](#)

Tim Keegan is Global Head of Marketing, Digital, Innovation and Direct at [AMP Capital](#), a sponsor of Cuffelinks.

Special 250th Edition eBook: Mistakes that made us better investors by Cuffelinks on April 24, 2018

*"Regrets, I've had a few, But then again, Too few to mention,
I did what I had to do, And saw it through without exemption,
I planned each charted course, Each careful step along the byway,
And more, much more than this, I did it my way."*

My Way, made famous by Frank Sinatra. © WARNER CHAPPELL MUSIC



Introduction to Special Edition

This Special 250th Edition includes over 30 market experts sharing a mistake that made them better investors.

Since Edition 1, we have focussed on independent financial journalism from finance market professionals to deliver useful insights to our community of readers, now approaching 40,000 strong.

It's an important time to learn these lessons, as the 88-year-old founder of Vanguard, Jack Bogle, recently said in a CNBC interview:

"I have never seen a market this volatile to this extent in my career. Now that's only 66 years, so I shouldn't make too much of it."

We have produced several Special Editions before, but something new happened this time. Disappointingly, some fund managers were prevented from contributing by their legal and compliance team. It's a sad state of affairs when a fund manager is prevented from admitting a mistake, as we're all supposed to learn from them. The question we asked was:

"What is an enduring investment lesson you learned from making a mistake?"

A couple of responses asked what a 'mistake' really is. Markets can hide many sins or punish good decisions, such as in this feedback:

*"What **is** a mistake in investing? Too often managers admit to mistakes (that reveals their deep humility) that weren't mistakes; rather the market went against them. As in bridge, you can make excellent decisions with rotten outcomes and rotten decisions with excellent outcomes."*

One famous local fund manager wrote that **identifying a mistake can relieve stress**:

*"Insights from past failures can help boost performance on a new task – and this study is the first, as far as I know, to explain why. The researchers report that writing critically about past setbacks leads to lower levels of the 'stress' hormone, cortisol, and more careful choices when faced with a new stressful task, resulting in improved performance. The study, published in the journal *Frontiers in Behavioral Neuroscience*, is the first demonstration that writing and thinking deeply about a past failure improves the body's response to stress and enhances performance on a new task."*

Another was more skeptical:

*"The harsh truth is that I don't believe any investor really learns from their mistakes in any meaningful way. By this I mean we can easily avoid investing in the same dud company, but that doesn't stop us investing in other dud companies. We can then develop personal heuristics that steer us away from all companies that have similar traits to the dud one we lost money on, only to find out that some of them turn out to be great investments. **The problem of course is that history never exactly repeats.**"*

The reasons we make mistakes can usually find their roots in the human foibles we learn about in behavioural finance (anchoring, confirmation bias, recency bias, etc), and because we are human we keep making them. And the problem with the behavioural finance work is that its a very good descriptor of why we have stuffed up in the past, but offers little by way of prescription for future success.

Nevertheless I reckon the biggest mistakes we are likely to make comes from over-confidence. As Twain said (words to the effect): "It ain't what you don't know that gets you into trouble, it's what you know for sure that just ain't so."

Investors become better by learning from experiences, whether or not they are considered mistakes, and sharing the lessons of market professionals may help some of our readers avoid the same mistakes.

Click here for the ebook version:

[Special 250th Edition](#)

Thanks to the contributors to this Special Edition:

Anton Tagliaferro; Paul Moore; Justin Wood; Warren Bird; Phil Ruthven; Tony Hansen; Jonathan Rochford; Peter Thornhill; Don Ezra; Daniel Reyes; Shane Oliver; Alex Denham; David Bell; Liz Moran; Hugh Dive; Neil Rogan; Melanie Dunn; Brett Murray; Jonas Palmqvist; Noel Whittaker; Emily Martin; Roger Montgomery; Jordan Eliseo; Greg Cooper; Raewyn Williams; Jack Gray; Chris Neesom; Reece Birtles; David Bassanese; Gemma Dale; Chris Stott; Vinay Kolhatkar; Leisa Bell

The 20 Commandments of Wealth for Retirees

by Noel Whittaker on January 9, 2018

1. Ignore the prophets of doom – they are always with us and usually wrong.
2. Make sure your children have adequate insurance. It's much more affordable than your funding their misfortune.
3. Understand compounding, and appreciate that the rate of return your portfolio can achieve will be a major factor in how long your money will last.
4. Understand the basics that never change, and take advice on the things that do.
5. Take advice before the deed is done – not afterwards. It's hard to rewrite history.
6. Always judge an investment on its merits – any tax benefits should be regarded as the cream on the cake.
7. If a person contacts you by phone with an offer of an investment, or even to help you pay your mortgage back faster, hang up.

8. Don't have all your eggs in the one basket – diversify across the major asset classes and certainly have some international exposure.
9. Involve your partner, if you have one, in all your financial decisions. This will make it easier if one of you passes away or becomes incapacitated.
10. Don't panic when the share market has a bad day – volatility is the price you pay for the unique benefits of shares.
11. Make sure your wills are up-to-date and include a testamentary trust if that is appropriate.
12. Give Enduring Powers of Attorney and an Advance Health Directive to trusted people. And make sure they have copies and can locate the originals when needed.
13. One of the most expensive evenings you can go to is a “free” investment seminar.
14. Be extremely wary of going guarantor for any of your children – especially if they are in business.
15. Don't spend unnecessarily just to maximise your Centrelink benefits. Further cuts to benefits are possible.
16. Investigate if you should have a Binding Death Nomination in your super fund. Keep in mind that what is appropriate in one situation may not be appropriate in another.
17. Each year assess whether it is to your benefit to stay in super. In some cases you may be better off to withdraw the balance and invest outside the superannuation environment.
18. Don't follow the herd and back last year's winner – that's a recipe for disaster.
19. If you decide to take on a reverse mortgage involve family members in the process and have them pay the interest if possible. This will stop the debt increasing.
20. Finally – keep in mind that your potential worst enemies can be the media who focus on the negative, and well-meaning acquaintances who may give you information that may be half right.

Noel Whittaker is one of Australia's foremost authorities on personal finance and a best-selling author of many books including Making Money Made Simple. See www.noelwhittaker.com.au. A colour PDF version of this article is on his website.

How to think rationally about shares

by Roger Montgomery on May 21, 2015

At times of buoyant markets and relatively easy gains, ask yourself whether your approach to investing in shares and building a portfolio condemns you to a lifetime of returns and emotions that rise and fall with the market. If a rising tide lifts all boats and if it's easy to mistake a rising market for genius, then it pays to examine the approach you have adopted to investing and ask whether it is rational, repeatable and replicable.

Shares are pieces of businesses

It is cause for increasing dismay that despite the rise in popularity of shares and dividend yields, there has been no trend towards a rational approach. And perhaps surprisingly, this is true of both seasoned professionals and part time 'investors'. For example in the professional space, fund managers, in an effort to reduce portfolio risk, build portfolios of low covariance stocks – buying even very risky companies simply because their shares move in a different direction to the others. Perhaps even more worryingly, part time investors buy shares in companies without proper due diligence and in the hope they'll simply go up.

Indeed, John Kenneth Galbraith in his book *The Great Crash*, wrote that one of the key ingredients of a bubble was the replacement of considerations of an asset's long run worth, future income and its enjoyment, with base hopes of rising prices next week and next month.

Shares need to be treated as pieces of businesses rather than bits of paper that wiggle up and down on a computer screen. But few investors do this. Witness the professional investor who buys a company loaded with

debt and a manufacturer of some generic junk because its inclusion in the portfolio reduces its overall volatility. Witness the same professional who cannot buy the shares of a great business when they are truly cheap, instead having to wait until the shares have risen sufficiently to cause them to be included in the S&P/ASX200. Buying shares this way or simply buying in the hope they will rise, is not the same as buying a piece of a business.

Over time, the value of a business changes only slowly, and much less than their daily prices on the stock market. The purchase of shares without reference to the quality or value of the business is no different to betting on black or red. Similarly, the focus on daily quoted prices of shares encourages the treatment of the stock market as a casino. Gamblers and those who frequent casinos tend to lose. In contrast, treating shares as pieces of a business helps investors outperform those who don't.

Focus on relatively few excellent businesses

Whether it is because it is seen as too difficult or produces too much volatility, few investors simply purchase at attractive prices, a portfolio of 15 to 20 excellent businesses. This is despite the fact that such an approach can produce substantial outperformance.

There are two steps investors need to adopt: first, identify superior businesses, and second, estimate their true value.

Identifying a superior business is easy. Simply look at its economic performance and earnings power.

In our previous article, [Airlines and indices](#), I described the economics of an airline and explained how the behaviour of equity, debt, profits and return on equity, over years, provides an indisputable picture of the economics of a business as if it were owned in its entirety and how this can be used to select extraordinary businesses.

As Warren Buffett once quipped, "If you aren't prepared to own the whole business for 10 years, don't buy a little piece of it for 10 minutes."

Once you embark on an examination of a business from a business owner's perspective, using equity and return on equity, you not only create a list of candidates worthy of inclusion in a portfolio but you simultaneously simplify your investment process, by creating a benchmark.

A benchmark is a line in the sand or a corral against which you compare outsiders to those things already inside. Your investment process is simplified because nothing needs to be considered unless it is better than the things already on the inside.

Many investment professionals, and the academics who taught them, agree that you reduce your risk by diversifying broadly. I agree that if you buy shares in a lot of different companies whose share prices move in different directions, you will reduce the overall price volatility of your portfolio. But does it make sense to buy shares in an inferior company simply because its share price moves in a different direction to the others that you already have? Why on earth would you buy shares in your twentieth best thing, when you can buy more shares in your best holding? Why cut down your roses to let the weeds through? I believe you reduce real risk – the risk of permanent capital loss – by only owning superior businesses.

Great businesses have high rates of return on equity, little or no debt, bright prospects and sustainable competitive advantages. A sustainable competitive advantage is the intangible thing about a company that the competition cannot replicate or imitate. It's the reason people will cross the street to get the product even if the guy on this side has an alternative with a lower price. It's a barrier to entry or a barrier to imitation. Ultimately, it generates the high rates of return on equity. Over time such business should retain profits at a high rate and increase in intrinsic value at a similar rate to the rate of growth in their equity value. And if I told you that company XYZ's intrinsic value would rise substantially over the next 5 or 10 years, would it matter if the shares fell today?

Choose quality at the right price

Take the case of a company with a low rate of return on equity and little prospect of improving dramatically in the near future. Exclude it. What about a company with bright prospects for its product or service, no debt and 10 years of stable returns on equity of 30%? Include it. Eventually you fill a corral with companies showing a demonstrated track record of superior economic performance. No longer will you be tempted to dabble in the unknown, punting on whether the market or interest rates, employment or inflation will rise or fall in the next

few days. Instead, you will keep a protective eye over a short list of great businesses, any of which are candidates for your portfolio if they become available at a discount to intrinsic value.

In our next column for Cuffelinks, we'll write about that intrinsic value, a DIY on estimating intrinsic value for popular mechanics.

Roger Montgomery is the Chief Investment Officer of The Montgomery Fund. This article is for general education purposes and does not address the specific circumstances of any individual.

No easy way to make money

by David Bell on June 13, 2014

There is no easy way to make money. There are no shortcuts to building your retirement savings. Do not convince yourself otherwise.

This week, the ABC reported on yet another trading programme which appears to have lost lots of money for the people who signed up. The alleged culprit is 21st Century Eminis, which provides financial education and training services on how to become a successful trader. There is little in life that frustrates me more than to see people lose their hard-earned savings on get rich quick schemes.

I have long been outspoken on this topic, including making submissions to ASIC and posting public notices on my advisory business website warning against such schemes. Unfortunately you have to be careful about how you word such public notices for various legal reasons. Simply put, whenever you are introduced to a scheme or an investment opportunity which sounds exciting, please repeat: "*There is no easy way to make money*". If you know a family member or a friend who is considering such an opportunity, say to them with passion: "*There is no easy way to make money*". It may be one of the most valuable things you ever do for them.

Retail investors are sometimes shown four possible shortcuts to financial success, each having a different path to potential failure.

1. Investment products which turn out to be fraudulent

A great (though 'great' is far from an apt description) example is Astarra (Trio was the trustee) which funnelled investors' money offshore never to be seen again. Worse still, Astarra products were recommended by financial planners. Another example is US-based hedge fund Madoff, the largest investment fraud ever seen.

Fraudulent schemes are highly likely to lose you money. They typically have an elaborate design and structure and the payoffs for a successful fraud can be huge. The Madoff hedge fund fraud is estimated to have cost US\$65 billion. If a fraud is cleverly designed it is extremely hard to identify. Before making any investment, you should undertake a thorough due diligence. If you are considering an investment then seek professional advice. Question the skills of your advisor and make sure the advice is truly independent. Astarra, for example, sponsored financial planning conferences and Madoff supposedly provided access to a network of high profile people.

Commonly, frauds promise outsized returns but some of the recent frauds (including Astarra and Madoff) only targeted good solid returns, thereby avoiding people's fraud radars. Finally, diversify – it sounds simple but unless you are so confident you have identified something truly amazing and unique (which is unlikely), then diversification makes sense. Question your own skills. Are you really someone who can identify the needle in the complex investment haystack?

2. Investment products which involve leverage

The underlying assets of these investments vary but the constant theme is leverage. Infamous examples here include Storm Financial (leveraging up equities, and in some cases leveraging up leveraged equity funds), or investors providing leverage to property businesses (Westpoint, MFS Premium Income Fund, City Pacific and EquitiTrust). Once again many of these investments were recommended by financial planners, possibly swayed by large commissions.

Leverage has its place in the hands of professionals. In theory leverage has a proportionate effect on risk (an investment in a risky asset with a volatility of 10% combined with a 200% exposure to this asset becomes a

leveraged investment with 20% volatility). However in practice the risk created by leverage is much more complex because there are many other risks that come with managing a leveraged product such as maintaining the leverage ratio or margin requirement, particularly in periods of market stress when the underlying assets may be volatile and illiquid. For any investment it is important to determine if leverage is used, how much is applied and explore any risks that may result. If this is too complex for you then stay away. Leverage does not always guarantee disaster but it does create greater risk of disaster.

3. Trading programmes and software which fail to deliver

This takes the form of software or training courses that teach you how to become a successful trader, often promising large financial returns and even the potential to give up your day job and become a home-based trader.

With trading programmes (software and education) I maintain a high degree of scepticism. After 17 years in the investment management industry and having visited thousands of investment managers and hedge funds I know it is difficult to develop a set of trading rules guaranteed to perform. If someone did find something special do you really think they are likely to share this with the world? Surely they would either trade their own money or create a hedge fund to earn the associated performance fees. Either of these approaches would also protect their trading secrets.

While there is much debate among academics about whether markets are efficient or not, I work on the basis that markets are broadly efficient. I believe that simple models will fail to generate outsized returns for the risk taken, a point I have proven to myself (and my uni students) many times! Many trading programmes use underlying instruments with embedded leverage such as futures, margin FX and CFD's (contracts-for-difference). These instruments are dangerous in the hands of the uninformed. If you do not understand them then do not touch them.

4. Tax-driven investments

This is where tax benefits are a major driver of the investment outcome. Agriculture schemes, most notably Great Southern and Timbercorp, are the most prominent (read painful) recent experiences.

Tax-driven investing can be complex. The risk is that chasing a tax objective may lead to money being placed with people ill-equipped to handle the day-to-day business of managing the assets and finances of the investment vehicle. If the business activities are mismanaged, then the investment vehicle may not survive to provide any tax benefits at all.

Always be wary of terrible governance practices. Prime Trust is a distressing example where exorbitant payments were made to the founder. While poor governance can exist anywhere there seems to be a greater risk away from mainstream investment opportunities.

I hardly paint a pretty picture for get rich quick schemes. Really, none of this article should be new information. If it is, then you are vulnerable to these risks. If you are presented with an opportunity that looks really exciting, make sure you remind yourself that *"There is no easy way to make money"*.

In July 2014, David will cease his independent consulting and become the Chief Investment Officer at AUSCOAL Super. He teaches the Hedge Funds elective for Macquarie University's Master of Applied Finance.

Planning to make your money live forever

by Chris Cuffe on March 13, 2015

"A man's dying is more the survivors' affair than his own." – Thomas Mann

"The beginnings and endings of all human undertakings are untidy." – John Galsworthy

While these quotations from Mann and Galsworthy are usually correct, it doesn't have to be that way. Surely an important part of anyone's life is deciding what happens to their assets when they die. It never ceases to amaze me how little thought people put into estate planning and creating a lasting legacy. It's bad enough that an estimated 45% of Australians do not have a valid will, and most have not made a binding death nomination for their superannuation. But how many people put even a fraction of the time into deciding what should

happen with their money as they do in accumulating it in the first place? Neat clichés like ‘the dead don’t care’ do not resonate with me – perhaps that is just the forward planner in me and I may be an outlier.

Putting aside your religious beliefs, let’s assume you have departed this world and you are looking down from the heavens on the distribution of your hard-earned money to your loved ones. As Shakespeare wrote in Hamlet, “*What dreams may come, when we have shuffled off this mortal coil, must give us pause.*” The children are squabbling over whether to sell the family home, there’s a stepson you hardly knew claiming his rights, and your spouse has met a new partner with five screaming kids from a previous marriage. Your sister says you told her you would always support your siblings, and there are family members in your old house grabbing your stuff while they can.

You think you’re in heaven and you’ve gone to hell!

Address the basics

In thinking about estate planning, I believe it is essential that the following basics are covered while you are alive and have your marbles intact:

- Make sure your wishes are clear, unambiguous and in writing. Written instructions usually mean a will, but in addition to this I like to have a one to two page ‘plain English’ summary (that your solicitor should tick for consistency with the will) to ensure there is no misunderstanding.
- Ensure you cater for all situations, such as if you die, your partner dies, you both die together, providing for the children’s needs if they are under 18 (such as who will look after them and whether the carer should be paid).
- ‘Complete the package’ and ensure you have an Enduring Power of Attorney (for money/finance decisions) and Enduring Guardian (for health decisions) appointed as well as having a documented Advance Care Plan (dealing with resuscitation, organ donation, and where you wish to be cared for when the time for natural dying comes).
- Ideally, discuss your intentions with your family, so they have a chance to contribute and understand before you are no longer there to influence.
- Develop a strategy that ensures your estate is well-managed by people you trust who know what to do with wealth.

Beyond these basics, I want to focus on the possibility of both creating a multi-generational legacy and enjoying giving while you’re alive.

Create a fund for future generations

It’s natural to care for your own children and grandchildren who you know and cherish while you are alive. But what about their children? What can you do that might also benefit future generations of your descendants?

If your resources are sufficient, one idea is to establish a trust that has the purpose of meeting particular costs of your direct descendants (being your children, your children’s children, their children and so on). The costs that come to mind are what I think of as ‘*must have safety-net costs*’ such as medical insurance, trauma insurance, school education and tertiary education. Plan for only 50% of the tertiary education costs so the recipient has ‘skin in the game’ and an incentive to complete the chosen study.

Imagine the satisfaction of knowing that whatever happens to the family finances, your great grandchild can be confident of a good education and decent health. Who knows what the future brings, as many a family fortune has been destroyed by poor investing or wasteful spending. With Australia facing decades of increasing budget deficits, both health and education expenditure will be targets. We may head more down the US path of user pays and denial of services. While it is hard to estimate what future school, university and hospital costs may be, it’s highly likely to be much higher than today.

The trust should have independent trustees and avail itself of investing expertise, so the money lasts as long as possible into future lifetimes (and who knows, future descendants themselves may end up having the means to contribute to the trust so that it lasts longer). In practical terms, any descendant wishing to have such costs met would apply to the trustees. You could even ‘force’ another gift on them (one that I am passionate about)

and insist that any recipient must first complete a basic course in financial literacy before they are eligible to participate in the trust.

Imagine the day your daughter's grandchild graduates from university to become a doctor and makes a toast to you (long past!) for helping to make the event possible through vision and generosity.

Help your children while you're alive

If you started having children at 30 and you live until you're 90, chances are your children will be retired when they inherit your estate. If they've done well already, they probably don't even need the money, and all you are doing is giving more money to an already financially secure person.

If you live in the crazy property markets of the east coast of Australia, and your children are of a mind that they would like to live in a similar location when they leave home (and perhaps be near you), then it is likely that they will struggle to buy their first home given the prohibitive entry level to now get into the property market. So assuming your own financial needs are met, what better way to help your children than to assist them with their first purchase. Consider gifting the deposit or some type of interest free loan so the capital can one day be recycled again or protected in situations of divorce.

Leave an enduring gift to society

[Buffett once said in his letter to the Gates Foundation](#): 'I want to give my kids just enough so that they would feel that they could do anything, but not so much that they would feel like doing nothing.' I am a big fan of this quote.

Again, if your resources are sufficient, once you have provided for your family, to me there is no better way to leave an enduring gift to society than to set up a Private Ancillary Fund or establish a sub-fund with a Public Ancillary Fund. Any money put into such vehicles is fully tax deductible. The money is invested within the ancillary fund (which is a tax free environment) and from there a minimum of around 5% per annum of your account balance must be donated to charity. Your investment in the fund can last for many years, spinning off a never-ending stream of donations for charity.

[I'll declare an interest here, as I am the founder and Chairman of [Australian Philanthropic Services](#), a not-for-profit organisation that specialises in setting up and administering such vehicles.]

It was not until I reached the age of around 50 that the thought of mortality really entered into my thinking. Perhaps this was from watching my own parents age (and one of them recently passing away). That realisation comes with greater attention to how I can help people while I am alive and after I cross that great try line in the sky!

Chris Cuffe is co-founder of Cuffelinks; Portfolio Manager of the charitable trust Third Link Growth Fund; Chairman of Unisuper and Chairman of Australian Philanthropic Services. The views expressed are his own and they are not personal financial advice.

The end of six wonderful years for investing

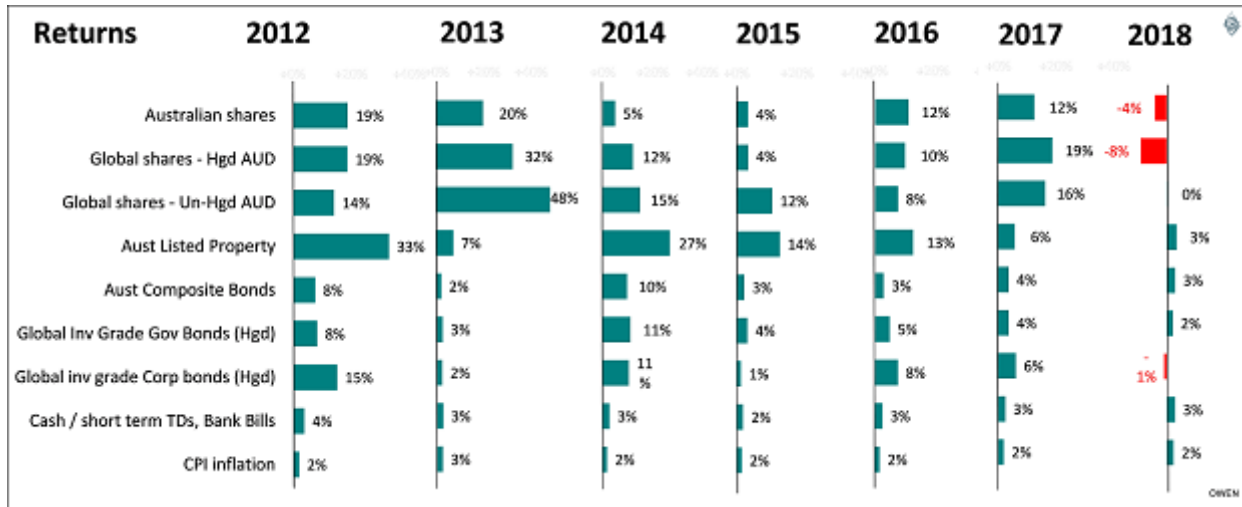
Ashley Owen

A year ago, at the start of 2018, we wrote that 2017 topped off an unprecedented six-year rally in every major investment asset class. Never before in history had each of the main asset classes enjoyed positive 'real' (after inflation) returns for six consecutive years. The previous record was four consecutive years from 1925 to 1928 and that was right before the 1929 crash and 1930s depression.

The end of the illusion

We also noted that the 2012-2017 rally was unlikely to continue into a seventh year because the main drivers of asset returns were fading. Central banks were scaling back and reversing their 'QE' (quantitative easing) asset buying programmes, the US Federal Reserve was raising interest rates and Chinese growth rates were slowing. Asset prices had risen everywhere in the boom but it was an illusion – a house of cards propped up by ever-increasing piles of debt built up by governments, companies and households since the GFC.

As it turned out, 2018 saw negative returns from share markets almost everywhere and lower returns from other types of assets.



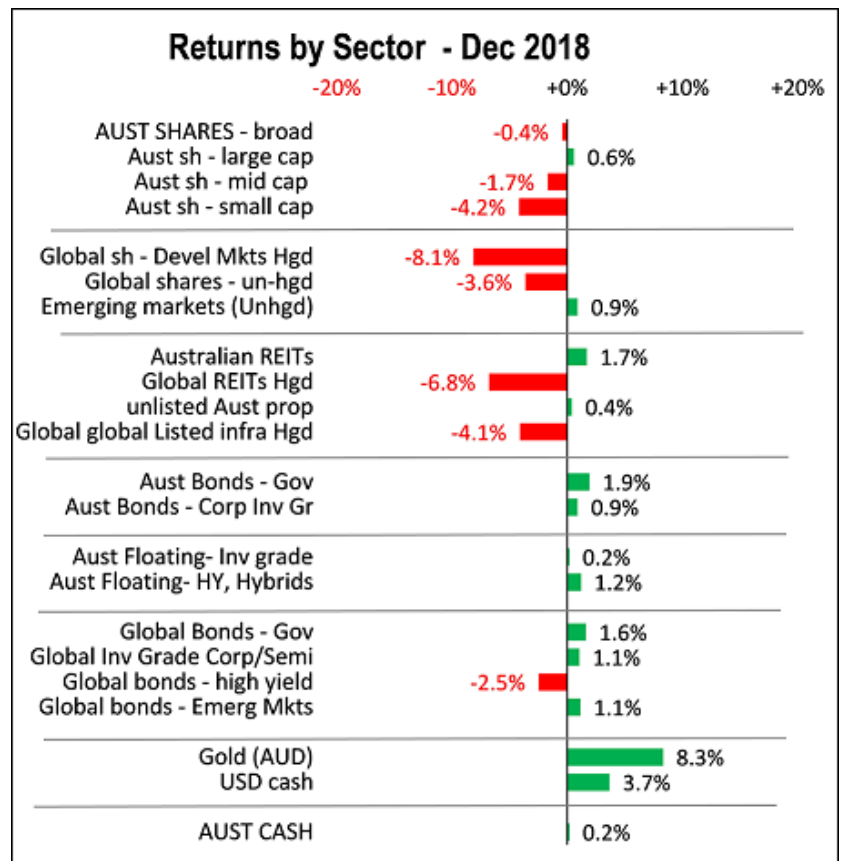
During the six-year boom, many investors became complacent and started to believe that asset prices would keep rising forever – just like the euphoria of previous booms before they burst. People forgot about asset allocation because everything went up. The previous five years from 2007 to 2011 were more like the usual pattern, with a mix of positive and negative returns. The only year when everything went up was 2009 in a rebound from the 2008 crash.

With QE now over in the US and Europe and interest rates rising in the US, 2018 was a return to the more usual pattern of mixed returns. 2019 will probably be another year of mixed positive and negative returns from different types of investments. China is slowing again, Europe has stagnated, the Fed is still raising interest rates, a new 'cold war' between the US and China is brewing, Trump will have to deal with a hostile House, and Australia's housing construction boom is over.

Asset allocation is well and truly back

Even when equity markets fall, portfolios can be protected by good asset allocation and currencies. For example, unhedged global shares usually smooth the pain because the falls in global shares are partially offset by currency gains as the Australian dollar falls, as it almost always does in global sell-offs. Gold (in Australian dollars) and US dollar cash were the best performing assets in December 2018, as shown below, and also for the whole of 2018. The latter two are not traditional long-term holdings in most portfolios but unusual global conditions call for unusual strategies.

In the booms, the most common questions I hear relate to a fear of missing out, such as 'Should I gear up?' or 'Which do I like better: [bubble stock A] or [bubble stock B]?', and the like. A year ago the markets were booming, especially in tech stocks, crypto currencies, 'fintech' and emerging markets. The questions were almost all about how to get in on the action.



However as soon as there is a wrinkle in the markets the questions turn to impending disaster, such as 'Is this another GFC?' or 'Is this the end of the world as we know it?'

Four main factors involved in market crashes

I have studied many different types of market bubbles and busts, and four main elements tend to be present in almost all bubbles that ended in busts. Here is a summary, together with brief comments on the current environment and a current 'risk rating' for each:

1. Over-pricing – Moderate to High risk

Before the late 2018 sell-offs many markets were over-priced, including US and Chinese tech stocks, healthcare and global consumer brands. The price falls in recent months do not reduce the risk of collapse. Over-priced markets never drift back quietly and calmly to fair pricing. They tend to swing wildly from over-shooting savagely on the upside to over-shooting savagely on the downside. Markets are driven by wild emotions, not quiet logic.

2. Speculative fever – Moderate to High risk

US and Chinese tech stocks led the recent boom in share prices. We also saw the recent boom in dozens of new 'crypto-currencies' and 'initial coin offerings' that jumped on the Bitcoin bandwagon, and also the booms in 'fintech' and 'green tech' stocks that are as revenue-free and profit-free as the 1990s dot-com boom. Busts in crypto, fintechs and green techs are unlikely to expand into broad market collapses unless losses start to trigger broad selling and margin selling in the broader market, as they did in the 2001-02 tech wreck, and in 1929.

In Australia the boom in high rise units is on a par with similar speculative property booms in Australia in the 1880s, early 1970s, late 1970s, and late 1980s, all of which ended in banking crises, widespread bankruptcies and corporate losses, deep economic recessions and broad share market collapses. Prior busts were triggered by sudden withdrawal of capital and/or interest rates hikes. This time it is the sudden withdrawal of capital from China and from the local banks.

3. Leverage – High risk

US margin loan volumes are on a par with the peaks prior to the 2008-09 GFC and 2001-02 tech wreck, but not as high as in 1929. This is a clear sign of extreme debt-fuelled speculation.

The extremely low interest rates since the GFC have led to a massive build-up in debts at all levels in almost all countries: government debt, corporate debt, housing debt, personal loans, and margin loans. This makes the entire system highly vulnerable to interest rate rises. The likely impact of rising US interest rates and rising US dollar on emerging market governments and companies was the main reason for removing emerging markets shares from our portfolios before they fell in 2018.

4. New financial instruments and participants – High risk

Not only is this a high risk condition present in the boom, it is also a likely candidate for the trigger for a broad crash. In 2008, it was the sub-prime financial innovations like Option-ARMs, MBSs, CDSs, CDOs and the like that under-pinned the 2000s boom, and triggered the US banking crisis and in turn the sudden collapse in bank finance, the instantaneous global banking contagion and the broad stock market collapse in every country.

The explosive growth of Exchange Traded Funds (ETFs), High Frequency Trading (HFT), and 'algo' (algorithmic trading) now dominate markets. ETFs control nearly half of all investment markets globally, and investors assume they are risk-free in the sense that they can instantly sell all holdings necessary to meet any sell orders. Many rely on derivatives or gearing which are untested in a crisis, relying on thousands of counterparties around the world.

What lies ahead?

Returning to two big questions.

First, 'Are we going to get another GFC-like sell-off?' That's easy. Of course we will! We have had several 40%+ sell-offs in the past, with one every couple of decades, and we are sure to see another in the future.

Second, 'Are we at the start of one now?' That is more difficult.

The conclusions from the above analysis are:

a) Many of the conditions in past cycles are present now: markets are over-priced, including shares, bonds and properties (commercial and housing); speculation is rife in a number of areas; there are high levels of debt at all levels in almost all countries; and there are also a number of financial 'innovations' that could present unknown risks or unforeseen consequences.

b) There are also several potential candidates for triggers for a broad collapse: rising interest rates, government or regulatory attacks on business; a possible collapse in trust in a major element underpinning market confidence; and also the possibility of military strikes or hackers rattling investors and triggering a spiral of sell orders.

What to do with portfolios now

All we can do is assess the conditions as we see them, identify the sources of risk, and steer the ship toward areas where the opportunities are greater than the risks. Usually this means going against the herd.

US and China remain the centre of attention. President Trump will run into more trouble with Congress with the Democrats back in control of the House. There are gathering signs of slowing consumer confidence and spending, and the Fed is likely to raise rates further.

China is entering another cyclical slowdown, and this is dragging down commodities prices. This is bad for commodities exporters like Australia and it could also trigger another bout of global bankruptcies in oil/gas/steel companies like in 2015. Chinese corporate defaults are also rising rapidly. Xi has anointed himself Emperor for life but he is coming under increasing pressure from within the party to play hardball with Trump as he is being blamed for the trade war. Chinese stimulus announcements rebooted global markets in March 2016 but this time Xi appears to be favouring military expansion over internal stimulus.

Locally, the Hayne Royal Commission is due to publish its final report shortly. The recommendations are sure to call for radical and far-reaching changes to the current system of cartel price gouging. Much depends on the outcome of the Federal election which is due by May 2019. This is likely to see major changes to both the government and the make-up of the legislature, in particular the Senate. On current numbers Labor is likely to win but hampered by a fragmented Senate. This will make it difficult to implement many of their policies including scaling back negative gearing, increasing capital gains taxes and removing franking credit refunds.

Prices of Australian houses and especially high rise units will probably keep falling. The main sources of funding are likely to continue to restrict supply with banks restricting lending and the Chinese government limiting capital outflows. Bad debts and bankruptcies will gather pace but it is likely to take some time to build to crisis levels that impact broader spending and demand.

It's a time to remain defensive in portfolios with vigilance to make further adjustments to protect capital and capitalise on opportunities.

Ashley Owen is Chief Investment Officer at [Stanford Brown](#). This article is general information and does not consider the circumstances of any investor, and is based on markets at the time of writing.

Gail Kelly reveals how her family gifts money

Carrie LaFrenz

When Gail Kelly sits down with her family to talk about giving money to charity, it's serious business.

There are no ad hoc conversations about their private ancillary fund (PAF) – a tax-effective structured vehicle that enables the family to set aside a chunk of money in a trust to support charities over time.

They hold scheduled meetings twice a year, often over Christmas or Easter when her four children and husband come together. The family gatherings have involved PowerPoint presentations, business cases about what charities fit the bill for each family member's area of interest and how their giving has made an impact. Each person has an equal pool of funds to give to the charity as they see fit.

Former Westpac boss Gail Kelly says giving away your wealth to charity is not just for the uber wealthy.

The highly regarded former boss of Westpac is adamant that it's not just about giving money. Everyone must be personally involved.

"It's a real time of sharing ideas," Kelly says of her young adult children. "They own it. This is very powerful stuff. This is very rewarding.

"When Alan and I pass away, this is a family asset and they will continue with the giving and frankly they will develop something for their own families because they see the power of it from a family point of view."

Kelly has been a long-time client of Australian Philanthropic Services (APS), where she recently joined the board headed by the founder, stock picker Chris Cuffe.

It took Cuffe three years to convince her to join the high-profile board, which also includes other notable philanthropists David Gonski, Belinda Hutchinson, Tim Fairfax and Michael Traill.

Kelly, who is passionate about supporting the empowerment of women and girls, says she joined the board because of the family involvement, and also due to Cuffe's credentials.

"I think he has really forged a path here that is very impressive with regard to APS and philanthropy more broadly," Kelly tells the AFRWeekend.

"The model is a not-for-profit business – which is awesome. So you know that all the funds are going to charities."

Streamlining a clunky process

Cuffe was instrumental in bringing together the vision that an Australian charity would be dedicated to growing philanthropy.

The Hall of Fame fund manager along with about 30 investors provided around \$2 million to get APS off the ground in 2012. APS is not quite break even today but has enough cash at hand so it does not need to raise more funds.

The services offered were to set up and manage private ancillary funds for individuals and families, and to support wealth advisers to help their clients do the same. It also provided a grant-making service.

Sirtex Medical founder Bruce Gray was one of Cuffe's first clients. APS today services more than 380 clients from just 120 five years ago. It has about \$800 million in assets, and \$52 million was given to charity in the 2018 financial year.

Cuffe spends about 25% of his time on APS, where he manages the day-to-day investment of the near \$70 million public ancillary fund – APS Foundation – on a pro-bono basis.

He is plenty busy with other commitments having just launched the \$500 million LIC Hearts and Minds Investments Limited. He's a founder/PM of Third Link Investment Managers and a member of the UniSuper Investment Committee, among other roles.

But he has a soft spot for APS after his own experience of setting up his family foundation after he finished his executive career as CEO of Challenger Group in 2006.

He ran into difficulties. And it was pricey: it cost him \$30,000 to set up his family's fund.

"It was a clunky experience, and it was not an easy thing to do, dealing with multiple parties," Cuffe says. "I thought it has got a lot of value, so it would be good to streamline this process."

He heard about PAFs from venture capitalist Daniel Petre.

The idea took off, with proven demand for a service that is low cost at \$3000 to set up a PAF at APS.

Lack of incentives

While this is a growing area of structured philanthropy, less than two decades ago Australia didn't have tax-efficient philanthropic structures comparable with those in the US and UK.

There was rising concern there was no incentive for Australians to give away part of their wealth during their lifetime. In 2001 the Howard government introduced the Prescribed Private Fund or PPF (now the private ancillary fund) which allowed for a tax break when giving.

APS has grown to become the largest provider of PAF services in Australia, setting up more than 30% of all such structures each year.

So how does it work? A family donates around \$1 million plus to create a private fund. The funds are put into the trust and the client gets the upfront tax deduction. The family can never get this money back since it's a charitable trust, but they can control how that money is used. Every year a minimum of 5% of the trust must be given away to eligible charities.

APS chief executive Antonia Ruffell says while tax incentives play an important role as to when people choose to set up a structure, it's not usually the underlying reason.

"Some might be driven by religious or personal values. For many people, they are worried about the impact that wealth will have on their kids. They see philanthropy as a way to inspire charitable values, and develop a sense of responsibility around wealth," she says.

Ruffell adds that there will be a big change in the coming years, as the next generation gets more involved in their family's philanthropy.

Aussies could give more

Kelly agrees, saying more young people are getting involved who are interested in fairness in society and climate change.

"There is a new generation of givers," she says. "They bring a focus on innovation. My kids want to know the funds they are giving are having an impact."

APS also offers a public ancillary fund, the APS Foundation, in which people can open a named sub-fund. The APS Foundation has grown from just \$7.2 million in 2014 to nearly \$70 million in 2018.

Graham Hand and his wife, Deborah Solomon, are sub-fund holders in the APS Foundation. Graham, founder and managing editor of investment newsletter Cuffelinks, says he likes the idea of giving an annuity stream, giving \$5,000 to \$10,000 a year.

"I would concede that I wanted to share some money and this was a tax-efficient way of doing it," he says.

Hand says that, while there is giving among Australians, more could be done.

"What you do hear about here in Australia, as opposed to other cultures, we give quietly rather than making a big deal of it," he says.

"We don't need to have the wing of the university named after us.

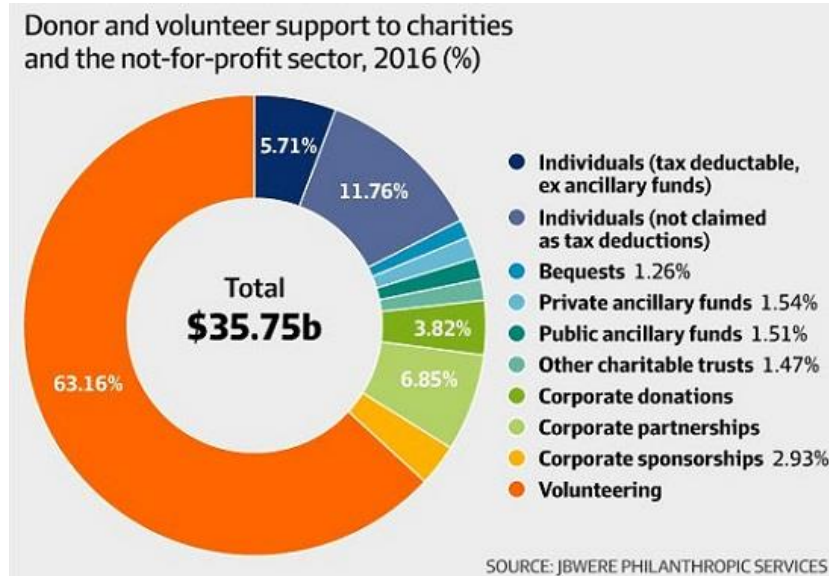
There is lots of giving going on. That said, there are lots of people who are making \$1 million a year that are not giving. It would be good to encourage people who have had good fortune to consider sharing some it."

Cuffe expects the sub fund to double in size every year for several years with the number of sub-fund clients per year far exceeding the private ancillary fund clients. Cuffe adds that some wealthier clients prefer the sub fund: the largest sub-fund account is \$8 million.

He admits that, while APS has had success in a short period, he would like to see "ancillary funds become as popular as the words self-managed super".

The number of private ancillary funds is increasing: there are now about 1600 with a corpus of \$10 billion, distributing \$500 million per annum.

Data from JBWere Philanthropic Services division shows that PAFs are susceptible to financial market performance. When the GFC hit in 2008, the number of new PAFs fell to fewer than 50 in 2009. But the numbers are climbing again.



Not just for the rich

Kelly and Cuffe are both clear that you do not have to be uber-wealthy with a fat balance sheet to donate.

The public fund is a pooled investment vehicle. Families set up a sub fund, with a minimum \$50,000 donation. APS manages all aspects of the foundation, and charges clients 1% of fund balance per annum.

A sub fund must give away a minimum of 4% per annum.

Most the assets of the foundation are managed by external fund managers. Often their investment services are also on a pro bono basis. Cuffe aims for a return target of inflation, plus 4% per annum (after fees) over a rolling seven-year period. Since its inception in 2012 it has posted a 12.5% return.

"A \$50,000 entry point that can be with you for life is quite accessible for many people. In particular as Baby Boomers retire there will be much more transfer of wealth. It's not just for rich people," Cuffe says.

Kelly – who started her career as a school teacher in Rhodesia (Zimbabwe) – has always remained interested in helping others.

Outside of APS, she is an (unpaid) adjunct professor at UNSW, and set up a \$1 million scholarship fund which links UNSW to Cape Town University where students can spend a semester on exchange.

However, she is clear that APS is central to her family. "This is about learning about the impact, and the joy of helping others," she says.

The AFR's, Carrie LaFrenz has more than 10 years' experience as a business journalist having previously covered healthcare, retail/consumer goods, industrials and agribusiness. This article was first published in [The Australian Financial Review](#) and is reproduced with permission.

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