

This Week's Top Articles

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Your opinions on Labor's franking proposal

Leisa Bell

A large number of readers shared their opinions and future intentions regarding Labor's proposed changes to franking credit refunds – almost 2,000 of you! Thanks for taking the time to participate in last week's survey.

For those who really want to deep dive into the debate, there are 25 pages of comments attached as a document at the end of this article. This subject really fires people up.

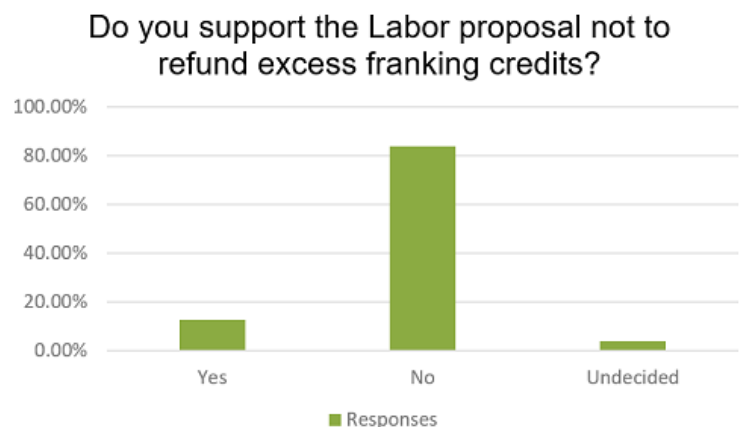
Overall, 12.5% support the proposed changes, 83.7% oppose and 3.8% remain undecided.

Respondents supporting the Labor policy proposal

The majority of people supporting cited paying a fair share of tax as an important factor (more than one choice was permitted).

We all need to pay our fair share of tax	69.42%
SMSFs in pension mode should not be taxed at zero	26.45%
We should tax companies who make a profit	34.71%
I am a Labor supporter and trust the party to do the right thing	2.89%
Other (please specify)	33.88%

Some common reasons for supporting the Labor proposal included:



- Refunding franking credits to retirees (i.e. not paying any tax), especially with large SMSFs, is unsustainable.
- Do not believe in getting a tax refund on income I did not pay tax on.
- Why should someone over 65 (retired) on \$75,000/\$150,000 yearly not pay any tax?
- My assumption is that the zero rate of tax for pension phase superannuants will remain untouched (sacred cow), on which basis I think the priority is to make sure that every single dollar of corporate earnings is taxed.

Respondents opposing the Labor proposal

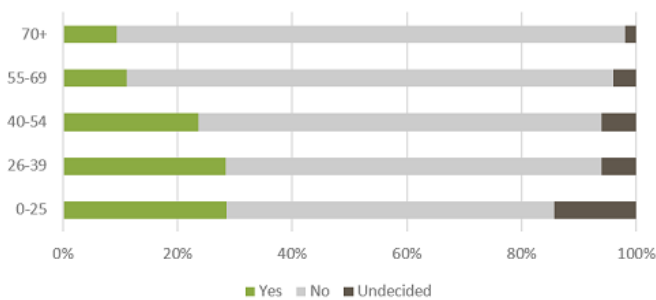
On the other hand, the majority of opposers cited avoiding double taxation as the main factor (multiple responses allowed).

I agree with the principle of not taxing company profits twice	75.76%
The franking credits system is a fair way to collect company tax	33.88%
A better way to raise budget revenue would be a tax on pension super income	16.31%
I don't think the Labor Party fully understands what they are proposing	62.53%
The policy is divisive because it picks winners and losers	69.08%
Other (please specify)	23.49%

Some common reasons for opposing the policy included:

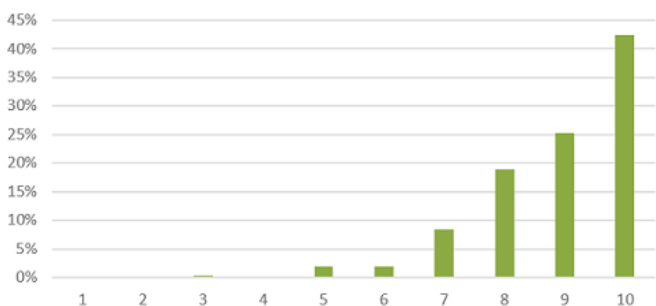
- People have planned their super over a long period of time as this policy has been in place almost 20 years. We stand to lose 30% of our income because of this policy without any way to make it back up. We can't go back to work. It is also very divisive.
- At least needs to be grandfathered or capped. I set us up over 25 years.
- I think the Labor party committed to this policy without having fully understood all the implications.
- The major impact will be with self-funded retirees on lower incomes. They've tried to do the right thing, the goal posts are moving and we'll all pay as some will become eligible for at least part pensions.

Do you support the Labor proposal not to refund excess franking credits?



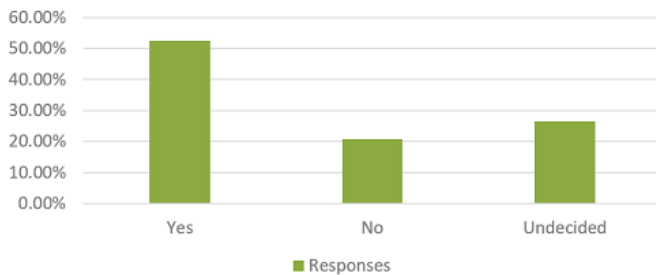
We also found that dissatisfaction rises with age. The under-40 years group were 65% opposed, the 40-54 years group 71% opposed, and 86% of people 55-and-over were opposed.

On a scale of 1 (not at all) to 10 (completely), how well do you understand the franking credits system?



When asked how well the franking system was understood, over 40% gave a score of 10 out of 10, with 95% giving a score of 7 or more. Clearly, a well-informed sample group.

Do you intend to change your investments or super structure if Labor is elected?



Lastly, we asked if there would be changes made to investments and super if the proposed policy were implemented. Over 50% said yes, while 21% said no changes and 27% were undecided.

The most common change will be selling shares that pay franked dividends (74.5%) and buying assets with unfranked income, which augurs well for flows to global equities and property trusts if implemented. The second most popular action was to spend money in order to qualify for the pension (26.6%).

Sell my fully franked shares and buy assets with unfranked income such as global equities or property trusts	74.55%
Switch my super to an industry fund or retail fund	22.32%
Add my children as trustees of my SMSF	16.97%
Spend my money to reduce assets so I qualify as a pensioner	26.57%
Hold on to my house so my main asset remains exempt from assets test	25.86%
Other (please specify)	25.86%

There were many additional comments provided, and an edited compilation of these is included [here](#). Cuffelinks includes this in the spirit of sharing views and an open debate and takes no responsibility for the comments.

How super became a poor deal for SMSF pensioners

Geoff Walker

There's an old saying that two wrongs don't make a right. In the current refundable franking credits brouhaha, it's possible that if Labor is elected, we will have been treated to three wrongs. They still don't make a right because SMSF pensioners will be in a worse position than when pensions were taxed.

We have experienced:

- **Wrong 1** – the introduction in 2007 by the Liberals of tax exemption of superannuation fund benefit payments to individuals aged over 60.
- **Wrong 2** – the introduction in 2017 by the Liberals of the \$1.6 million pension cap which attempted to claw back part of the Wrong 1 tax exemption for wealthier superannuants, but with added complexity.
- **Wrong 3** – the proposed introduction in 2019 by Labor of the removal of franking credit refunds, in particular from superannuation funds.

Why can we say that the three wrongs don't make a right? The answer is that, to the extent that an SMSF pensioner invests in Australian shares, the three steps together will leave that pensioner in a worse financial position than when superannuation pensions were taxable up until 2007.

This is the incredible result nobody talks about, but it isn't the only reason.

For many SMSF pensioners with modest pensions, holding Australian shares for income rather than trading, the changes will even leave them worse off than had they been holding the same shares outside the superannuation system.

Current income outside super versus SMSF after Labor franking

Before turning to the historical superannuation taxation regime, let's compare the after-personal-tax positions for three different SMSF income levels under the Labor 2019 scenario with the current non-super taxation arrangements.

	\$25,000 income = \$17,500 dividend + \$7,500 credits	\$50,000 income = \$35,000 dividend + \$15,000 credits	\$100,000 income = \$70,000 income + \$30,000 credits
2019 Labor	\$17,500	\$35,000	\$70,000
Current non-super	\$25,000 - \$1,292 = \$23,708	\$50,000 - \$7,797 = \$42,203	\$100,000 - \$24,497 = \$75,503

(The tax shown has been calculated at the personal tax rates applicable in the 2018/19 financial year, ignoring Medicare and any other variations that might apply in individual cases. <https://www.ato.gov.au/rates/individual-income-tax-rates/>)

In practice, there is no restriction on the amount of pension income that can be taken in any year beyond an age-related minimum. To compare like with like, I have assumed that net fund income is taken as a pension, although both lower and higher amounts could be taken, subject to the age-related minimum.

The reason that an SMSF pensioner is worse off inside super is because the Labor policy effectively results in a flat tax rate of 30% being applied to share income. In contrast, personal tax is levied at graduated rates with any individual's average rate of tax being less than his or her marginal rate. An individual's average tax rate doesn't reach 30% until taxable income reaches about \$180,000 (or about \$140,000 with the 2% Medicare levy included).

It was better when superannuation pensions were taxed

Now let's turn to a comparison with the historical superannuation taxation regime. In the years until 2007, franking credits were refundable, but superannuation pensions were taxable.

It was a perfectly equitable arrangement and did not draw any criticism back then.

	\$25,000 income = \$17,500 dividend + \$7,500 credits	\$50,000 income = \$35,000 dividend + \$15,000 credits	\$100,000 income = \$70,000 income + \$30,000 credits
2019 Labor	\$17,500	\$35,000	\$70,000
2000 - 2007	\$25,000 - (\$1,292 - \$1,292) = \$25,000	\$50,000 - (\$7,797 - \$7,500) = \$49,703	\$100,000 - (\$24,497 - \$15,000) = \$90,503

(Again, the personal tax rates are those applicable in the 2018/19 financial year, ignoring Medicare and any other variations that might apply in individual cases).

What is different in the personal tax calculations in the second table above is the deduction from personal tax of a 15% rebate (a rebate that still applies today for superannuation pensioners older than their preservation age but under 60).

This table makes clear that SMSF pensioners invested in Australian shares will be much worse off under the Labor policy than in the 'bad old days' when their pensions were taxed.

And further calculations show that the same conclusion applies pro-rata to those with anything above a slowly-increasing income-related allocation to Australian shares, i.e., many if not most SMSF pensioners.

Is the 15% rebate an undeserved concession for superannuation pensioners?

Let's look at how the 15% rebate came about.

Prior to 1983, superannuation pensions were taxed in full as income (apart from any return of undeducted contributions). In contrast, superannuation lump sums largely escaped tax, which was why lump-sum tax was increased to 30% in 1983. Pensions remained fully taxed.

However, because of its gradual phasing-in, the 1983 lump-sum tax (levied at the personal level) would have taken years to raise significant revenue. Thus in 1988, superannuation fund taxation was introduced at the rate of 15%, specifically to bring forward half of the 1983 30% personal lump-sum tax, the rate of which was then reduced to 15%. Both contributions and investment income were legislated as taxable income.

But because the superannuation fund tax applied to all contributions and income, and not just the contributions and income used to ultimately finance lump sums, it was necessary to grant a corresponding reduction in tax to individuals becoming entitled to a superannuation pension. **This was achieved by the granting of a personal 15% rebate**, which recognised the pre-payment of brought-forward tax in respect of taxable superannuation pensions.

For example, if a taxable superannuation pension of \$50,000 generated a personal tax liability of \$10,000, then this was reduced by 15% of \$50,000 = \$7,500 so that the final tax payable was \$2,500.

There are those who like to present any reduction in taxation liability as a concession. But in fact, a so-called concession may in fact be an anti-detriment provision, which is clearly the case for the 15% rebate in respect of taxable superannuation pensions.

In fact, it can be argued that the rebate is insufficient to provide full anti-detriment since:

- it is non-refundable, adversely impacting those on lower incomes; and
- it allows only for the tax on contributions and not that on investment income.

Conclusions on the best and fairest system

I believe the purest and fairest superannuation tax system was that operating between 2000 and 2007, when refunds on franking credits were granted to funds, but they were then taxed as part of the overall pension income when paid to the superannuation pensioner.

This perfectly equitable system was broken by the Liberals in 2007 when they made super payments tax free for the over-60s.

Not surprisingly, in recent times, governments have been looking at ways of reining in the cost of tax freedom of superannuation pensions. The 2017 \$1.6 million cap, with its dauntingly complex administration, would never have been necessary had super pensions remained taxable.

Why are politicians unable to countenance the source of the perceived problem?

The real villain in this long-playing tragedy is not the refunding of franking credits to superannuation funds but the 2007 tax freedom of superannuation benefits to over 60s. Why is hardly anyone, including leading economic commentators, complaining about the cost to revenue of beneficiaries receiving retirement income free of tax?

Geoff Walker is a former Chief Actuary at the State Bank of New South Wales and winner of the 1989 JASSA Prize for published research on the implications of the then relatively-new dividend imputation system.

A response from Chris Bowen on franking

Graham Hand

A reader, Alan, received the following reply from Shadow Treasurer, Chris Bowen, on Labor's franking credits proposal. It adds some balance to the debate in these pages which has been dominated by criticisms.

Also, many of our readers have said they wrote to Chris Bowen and did not receive a reply, so this is a way to reach them.

The original Labor policy on Chris Bowen's website is [here](#). Note it has an implementation date of 1 July 2019, only a few months away.

I sent an email to Chris Bowen and got an answer. I tried to identify reasons why I was not a company, that franking credits were both income and tax, since I paid no tax that Labor could not take my income, etc. I was told by Mr McCrudden in Bowen's office that all my questions were dealt with in the email. I particularly liked the 'nobody will pay more tax' statement – but franking credits are both tax and income, so draw your own conclusions.

Dear Alan

Thank you for your email regarding Labor's plan to reform dividend imputation.

Australia is the only country in the world with a fully refundable imputation system. Under Labor's policy dividend imputation will remain, but cash payments will no longer be made to people who have managed to reduce their tax rate to zero or have paid no income tax. Tax on company profits will continue to be paid only once under Labor's plans. This is in keeping with the intent of the original dividend imputation system and with Labor's principles of fairness and simplicity in tax policy.

Labor's reforms to excess dividend imputation credits will remove a fiscally unsustainable tax arrangement that is seeing billions of dollars in lost revenue, making it harder for the government to fund important services and return to surplus. Dividend imputation worked perfectly well between 1987 and 2000 when cash refunds weren't sent to people who didn't pay income tax. Labor will return to that system. When cash refunds were introduced, it was estimated to cost the budget around \$500 million a year. The annual cost has now blown out to \$6 billion. An ageing population is set to put even further pressure on the budget in the coming years making it harder for future governments to fund important health care services, which is why this is a growing cost the budget can no longer afford.

It is important to remember that our policy means that no one loses a cent of their share dividends, and no one pays more tax. The very generous tax concessions provided to superannuation which allows many retirees to draw an income which is tax-free will continue to apply.

Labor is focused on creating a tax system that works for all Australians and that the burden of budget repair is evenly shared across the community. We also need to ensure that the budget can help support the delivery of world class health and education systems into the future. Whatever your income or wealth in Australia, I want to make sure that if people need to see a doctor or they want to give their children a good quality education, that they can afford it. This is why difficult decisions on the budget are necessary.

Unlike the Abbott-Turnbull Government, Labor is prepared to be honest about its plans well in advance of an election. While I understand not everyone, including yourself, will agree with this policy, it is necessary. If this issue is not addressed it ultimately means that working Australians will have to shoulder a larger burden of budget repair. By being upfront with our plans, people like yourself will have time to seek advice and if desired, restructure their financial affairs to reduce the impact of the policy.

I would also note that a recent Treasury FOI indicated that more than two-thirds of cash refunds to SMSFs are to those whose fund balance per member is greater than \$1 million. I also refer to analysis from the PBO that shows the vast majority of individual taxpayers in Australia – 92 percent in 2014-15 – do not receive cash refunds for excess imputation credits.

Yours sincerely,
Chris Bowen MP

Cuffelinks has contacted Chris Bowen's office to check this is genuine, but at time of publication, had not received a response. We are confident from the content that it is genuine.

Logistics property is a thriving investment

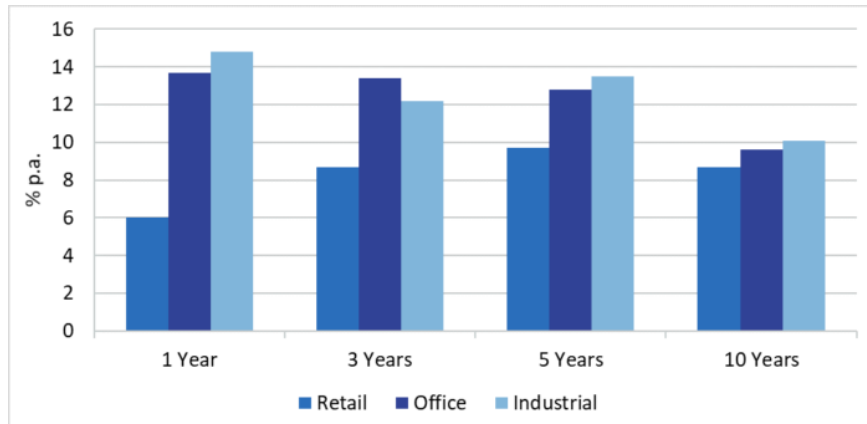
Adrian Harrington

While the rise of online shopping has clearly posed challenges for many retailers and shopping centre owners, it has been a winner for industrial property.

The growth in Australia’s global trade, the boom in e-commerce and businesses wishing to drive efficiencies and lower costs in their supply chain has driven a re-rating of industrial property by investors. As a result, its recent investment performance has been superior to that of retail and office property.

Industrial property generated a total return of 14.8% in 2018, outperforming office (13.7%) and retail (6.0%) as shown below. It’s a similar story over 5 and 10 years as well, although the outperformance is less marked.

Industrial vs retail and office property: to 31 December 2018



Source: MSCI/IPD

The outperformance is even more stark in the listed market. Industrial A-REITs, driven by the Goodman Group, generated a total return of 29.0% in 2018, while office A-REITs returned 15.1% and retail A-REITs returned negative 6.0%.

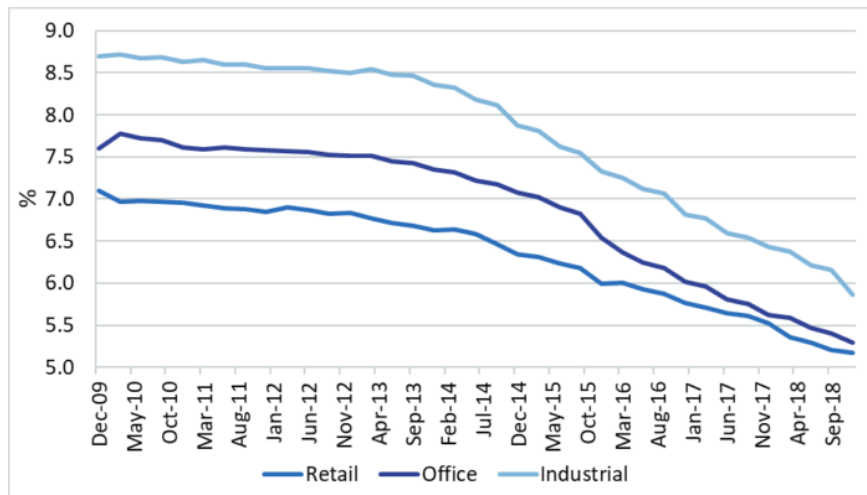
Investors increasing weightings to industrial property

The strong investment performance of industrial has not gone unnoticed by global institutional investors. Many are now re-weighting their portfolios away from retail centres into industrial property.

According to PERE (a global tracker of capital flows into property funds), logistics-focused unlisted property funds raised just over US\$12 billion in 2018, accounting for 43% of the total US\$28.6 billion raised globally for sector-specific funds. Retail-focused funds, by contrast, raised just US\$2 billion in 2018. Wind back to 2014, and the retail and logistics sectors were virtually on par, raising US\$8 billion and US\$8.9 billion respectively.

As a result, there has been a sharp drop in industrial yields, and as yields decline, values increase. Since 2009, industrial yields on average have fallen from 8.7% to 5.9%, a decline of 2.8%, as shown below. Yet for retail, yields on average have declined 1.9% from 7.1% to 5.2%. Back in 2009, the yield gap between industrial and retail property was 1.6%, versus only 0.7% now.

Industrial, retail and office yields: 2009 – 2018



Source: MSCI/IPD

E-commerce benefits industrial at expense of retail

E-commerce is on the rise. Retailing is transforming from buying in store to a delivery service, in effect, moving from mass merchandising to tailored direct selling.

Retailers are running a multi-channel (omni-channel) sales approach that provides the customer with an integrated customer experience across both bricks and mortar and online channels.

Online retail sales in Australia secured record growth in 2018, up 35% on the prior year. Online retail sales now account for around 5.5% (\$17.8 billion) of total sales. Whilst the online growth has been strong, the penetration rate in Australia is still well below the US, where it is now approaching 10% of all sales.

Supply chain management is critical

Logistics and supply chain management is concerned with the transport, storage, handling, order picking, sorting, packaging and distribution of goods. Logistics facilities can serve many functions, such as business to business distribution, retail store distribution, business to consumer and e-commerce fulfillment.

Order immediacy—delivering orders within 24 hours or less—is becoming critical to the customer experience. Yet traditional retail supply chains were built to stock stores, not to achieve order immediacy.

This is changing. Logistics and supply chains are now the backbone of every retailers' omni-channel strategy. From connected warehouses to last-mile delivery services, assisted by the adoption of leading-edge technology such as big data, artificial intelligence, robotics and drones, supply chains are becoming smarter, faster, agile and more sustainable.

Retailers and third-party logistics (3PL) firms, which provide distribution, warehousing, and fulfillment services to third party customers, are revisiting the type of facilities they need, how much space they need and where they need it. Not surprisingly, they are increasingly seeking premises which may include multi-storey racking systems and high-speed conveyor and sorting systems located close to major trade hubs (ports and intermodal rail facilities), freeway interchanges and urban in-fill areas.

Woolworths' new state-of-the-art distribution centre in South Dandenong in Melbourne (developed and owned by Charter Hall) represents a quantum leap in the way distribution facilities are operated. The 69,217 sqm facility comprises:

- 14 kilometres of high-speed conveyors that zig-zag around the building, taking pallets from receiving dock storage racks while eight fully automated palletising stations separating pallets into cartons.
- 50 robotic heads working in pairs packing 650 cartons an hour, almost 4x faster than in a manual distribution centre. These robots not only know how to build the pallets in the safest and most stable way based on carton dimensions, weight and crushability, but also the characteristics of each of Woolworths' 250-odd supermarkets in Victoria.
- A computer system that uses algorithms to work out how to pack more cartons on fewer pallets, reducing space in trucks and therefore cutting down on truck movements.
- Australia's largest industrial solar panel installation with more than 3,827 solar panels installed on the 9,000 square metres roof top that delivers 1400MWh of energy (equivalent to powering 250 homes) delivering 20% of the facility's power from solar.

According to Woolworths, the benefits are not just cost savings and increased productivity, but also an enhanced range of products instore, increased speed of deliveries to stores, better on-shelf availability and improved safety.

Demand for space is strong

According to JLL, take-up of industrial floorspace across Australia in 2018 was just under 2.5 million square metres of space. This was almost 20% above the 10-year annual average of 2.1 million square metres. The transport/logistics and retail sectors combined accounted for 60% of the total take-up of industrial floorspace.

As a result, Melbourne's total vacancy sits at the lowest level in five years, while the amount of vacant space in outer western Sydney is at record lows.

Given the modern logistics facilities require a higher level of user specificity, with the huge investment in design of the internal mechanisms of the facility, space users therefore typically occupy these spaces for longer than for other commercial real estate. It is not uncommon for large distribution users to sign-up for 15- and 20-year leases with fixed annual increases in rent ranging from 2.5 to 4.0%.

Investment into industrial to continue

The continued growth in global trade and e-commerce and on-going supply chain modernisation will drive the demand for logistics space and underpin industrial as a legitimate investment option.

We expect to see investors continuing to increase their allocation to industrial property in the years ahead via both listed and unlisted funds.

However, it is difficult in the listed A-REIT market to get a pure industrial property play as most industrial, with the exception of the Goodman Group, is held by diversified A-REITs such as Charter Hall, Dexus and GPT. For investors wanting a pure exposure to industrial property, unlisted funds offer an attractive opportunity.

Adrian Harrington is Head of Capital & Product Development at [Charter Hall](#), a sponsor of Cuffelinks. This article is for general information purposes only and does not consider the circumstances of any investor.

For more articles and papers from Charter Hall (and previously, Folkestone), please click [here](#).

What do top ESG companies look like?

Leah Willis

ESG integration is a branch of investment analysis that assesses companies on their environmental (E) and social (S) impacts as well as the quality of their governance (G). It is a tool used by investment managers to gauge the long-term financial health of companies. For example, a company that pollutes the environment could face financial penalties as well as damage to its reputation, both of which could affect the company's profitability. In this sense, ESG integration is ethically passive – it is concerned about the financial impact of things like pollution, poor labour practices and a lack of diversity on boards – not whether they are right or wrong.

Ethics is different

An ethical investment manager, on the other hand, will actively screen out companies that engage in poor practices and look to invest in companies that do good for people and the planet. ESG integration is often used by fund managers who want to take a best-in-sector approach. That said, it can still be a useful tool for ethical managers who want to analyse the non-financial practices of companies in more detail. However, basing an investment strategy on ESG alone will never be a replacement for a truly ethical investment approach.

To fully appreciate the difference between ESG and ethical investment, it's worth taking a look at the types of companies that feature on ESG lists or indices. One of the better-known indices is The [Dow Jones Sustainability Australia Index](#), which is reviewed annually by investment manager RobecoSAM using the latter's Corporate Sustainability Assessment.

In its annual update in September 2018, S&P Dow Jones described the index as the "gold standard for corporate sustainability" based on "financially material ESG factors". The Dow Jones Sustainability Australia Index is made up of 43 companies with some surprising inclusions among them. This list is eye-opening because it tends to favour companies with comprehensive sustainability reports rather than the most socially-responsible business practices.

Let's take a look at some of the companies that made the list.

Gambling companies

Two notable inclusions in the index are gambling and entertainment companies Star Entertainment Group and Tabcorp Holdings. Star Entertainment Group is the owner of casinos in Brisbane, the Gold Coast and Sydney, while Tabcorp offers wagering and gaming services and also has a media arm that broadcasts horse racing on Sky. On the face of it, it is hard to understand how companies that earn the majority of their revenue from

gambling could be considered sustainable. On its website Star Entertainment Group touts itself as the “global leader of the casino and gaming industry” as per the Dow Jones Sustainability Index. Star Entertainment Group notes it achieved maximum scores from Dow Jones in the areas of anti-crime policy/measure and promoting responsible gambling.

In its 2018 Sustainability Report, Tabcorp describes itself as a “significant economic contributor to Australia” with a focus on “responsible gambling and advertising practices”. However, despite its impressive ESG credentials Tabcorp was [fined \\$45 million](#) for breaching money laundering and terrorism financing laws in 2017, which at the time was the largest civil penalty in Australian corporate history.

Mining explosives

Also on the Dow Jones Sustainability Australia Index is Melbourne-headquartered multinational Orica, which supplies commercial explosives for the mining, quarrying, and oil and gas sectors. Orica publishes a comprehensive sustainability report each year that covers issues like workplace safety, climate change and good governance. However, in 2014 Orica was forced to pay \$768,250 for releasing pollutants at its Kooragang and Botany plants (the largest penalty ever issued by the Land and Environment Court), and in 2012 the Queensland Court ordered Orica to pay \$432,000 after the company pleaded guilty to releasing cyanide into the environment on 217 occasions. In addition, The Newcastle Herald reported in 2011 that hexavalent chromium had “rained down” on about 25 workers on duty at the Kooragang Island plant in August that year.

Other ESG companies in the Dow Jones Sustainability Australia Index include mining and fossil fuel companies Oil Search, Woodside Petroleum, Wesfarmers and Newcrest Mining. It’s encouraging to see these companies are paying attention to their environmental impact and looking to give back to the communities they impact with their activities. Oil Search, for example, has donated \$5 million to support disaster relief efforts in Papua New Guinea as well as developing roads, hospitals and schools.

However, some mining practices are unsustainable in the long term, contrary to the high ESG rankings of the companies named in this article. That said, some ethical investors may decide to invest in mining companies after intense scrutiny.

Australian Ethical does not invest in any of the companies discussed. However, we acknowledge, for example, that metallurgical coal is necessary in the short term to make steel to build the renewable infrastructure of the future. Higher recycling rates for scrap steel (a process which does not require metallurgical coal) will help reduce the demand for this type of coal.

ESG can be a useful tool but it should never be mistaken for a genuinely ethical approach to investment. Ethical investors are focused on delivering returns without harming (and indeed proactively benefiting) the planet, people and animals. Australian Ethical assesses each company on its merits based on the principles laid out in our Ethical Charter, which has been unchanged since 1986.

Leah Willis is Head of Client Relationships at [Australian Ethical](#), a sponsor of Cuffelinks.

Would a recession in 2019 matter to financial markets?

Robert M. Almeida

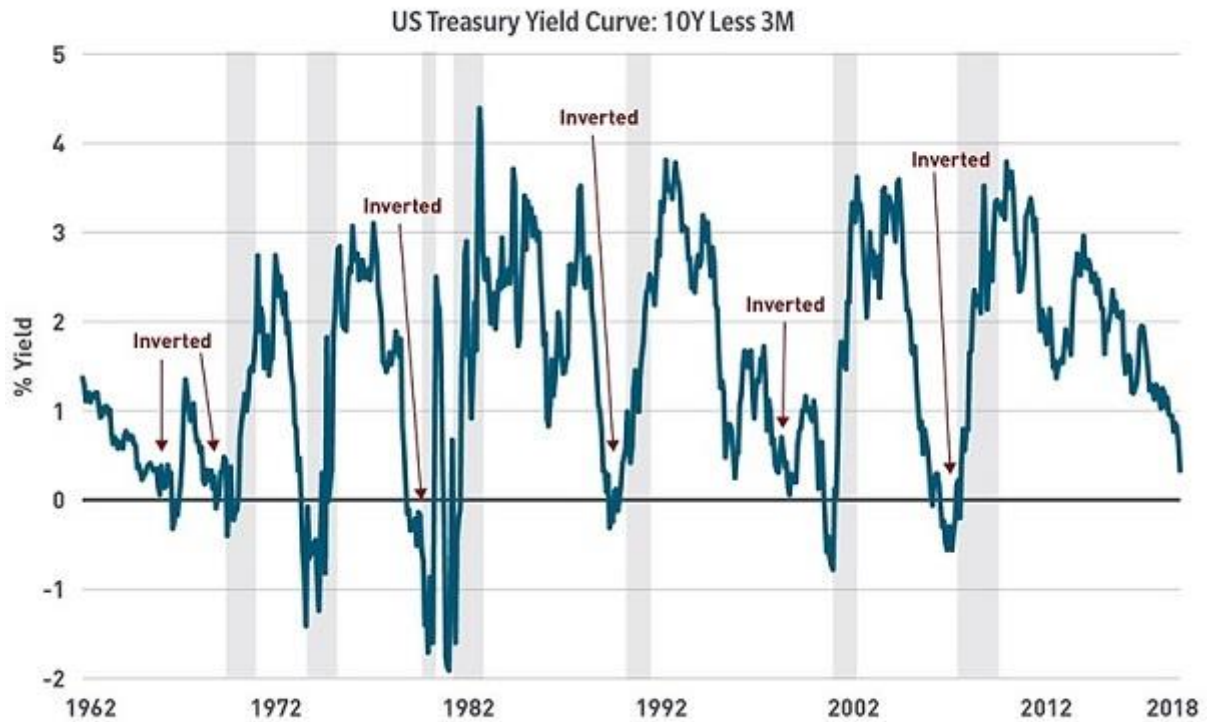
With the S&P 500 Index delivering its worst December performance since 1931 and credit spreads widening back to their long-term averages, fears of a recession in 2019 have increased.

But are those fears justified?

Some market-based metrics have been quietly signaling an increase in the risk of recession, with one of the more popular being the flattening US yield curve. While not perfect — and market watchers need to be cautious about false positive signals, such as in the late 1960s (see illustration below) — the predictive powers of the yield curve historically have been quite high. So how should investors think about this?

I think about it in two ways.

Exhibit 1: How worried should we be about an inverted yield curve?



Source: Bloomberg, as of 12 October 2018. Shaded areas represent US recessions.

1. Would a recession matter to financial markets?

Market falls and recessions have coincided more often than not, as we observed in 1982, 2001 and 2008. So the answer is yes. However, that has not always been the case.

Economic health — or the lack thereof — and investor sentiment are two different things. While the economy is made up of many varying elements, financial markets reflect investors' expectations regarding profits and cash flows. While each can heavily influence or lead the other, we have observed periods in which capital market declines and recessions have been mutually exclusive, like in 1990 (a recessionary non-bear market) or in 1987 (a non-recessionary bear market).

2. This economic cycle has been different from others in many ways.

As MFS chief economist Erik Weisman recently said to me, "In terms of the traditional drivers of recession, most aren't evident today. We haven't just ended a war; there is no negative supply shock (as with oil in 1973 and 1979); and the US Federal Reserve isn't aggressively trying to contain overly high inflation (like the Volker Fed in the early 1980s). Outside of corporate leverage, macro excesses in the US economy are hard to identify."

Something else that makes this cycle different has been the rise of internet platforms. They have provided a new way for enterprise and consumers to optimize business operations and everyday life. They have fostered "de-materialization." In other words, the world is doing more with less capital, and that has been disinflationary.

For example, cloud computing allows enterprises to better engage with customers in a more cost-effective and productive manner. Internet infrastructure technology has allowed enterprises to better manage inventories and deploy capital more efficiently. Similarly, consumers have de-materialized. Internet platforms have allowed people to rent what they once owned, avoiding large, upfront costs in categories such as shelter and transportation.

Not only in the United States, but also in Germany and the United Kingdom, consumers allocate more than half of their discretionary spending to experiences or intangibles rather than physical goods. We are seeing similar trends in emerging markets such as India and Colombia.

The result has been a decline in the volatility of real demand, which partially explains why this business cycle has been low in growth, long in duration and with fewer excesses compared with history.

In conclusion, we are generally not concerned about a recession in 2019. To me, the Treasury market, which has rallied in recent months, is signaling greater concern about a potential Fed policy error than about an overheating economy. However, we have grown concerned about market complacency surrounding margin sustainability and financial leverage. So while we are less concerned with recession risks, we believe investors should be more thoughtful about how portfolio risk is allocated today as compared to how it was in the past decade.

Robert M. Almeida is a Global Investment Strategist at [MFS Investment Management](#). The comments, opinions and analysis are for general information purposes only and are not investment advice or a complete analysis of every material fact regarding any investment. Comments, opinions and analysis are rendered as of the date given and may change without notice due to market conditions and other factors. This article is issued in Australia by MFS International Australia Pty Ltd (ABN 68 607 579 537, AFSL 485343), a sponsor of Cuffelinks.

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More women are investing, but still lagging

Suzie Toohey

International Women's Day represents a moment where, among many other things, it's appropriate to consider the extent to which the historical gaps that women have faced in investing and financial matters are being addressed. Findings from researcher *Investment Trends* shows that females are joining the active online investor population in Australia at increasing rates, but there's a long way to go before we reach parity.

Online brokers improve access

Online brokers have allowed a large number of Australians to take control of their investing by providing easy access to direct equities and ETFs. The good news is that there has been a significant increase in the number of female online investors over recent years, with their numbers doubling from 76,000 to 150,000 between 2013 and 2018. More women are building their wealth and moving towards an independently secure financial future, but even with this strong growth, women still represent only 20% of Australia's online investors.

ETFs are also playing an important role for female investors. Among the Australian online investor population, the proportion of females who invest in ETFs increased more than threefold in the last five years from 7% to 25%. To put the popularity of ETFs into perspective, the proportion of females who invest in managed funds has remained steady at 18% over the same period. Clearly the ability of ETFs to provide convenient, low cost access to a diversified investment portfolio resonates strongly with female investors across Australia.

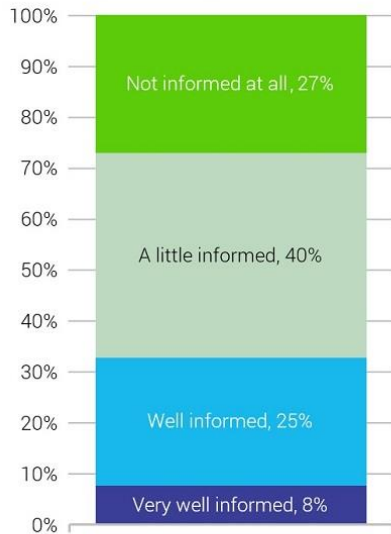
Our latest research also reveals the importance of ESG factors to female investors. When it comes to their investment selection process, 29% of women say it is 'very important' that their portfolio contains companies that have good ethical, social, environmental and governance standards (vs 19% for male investors). This preference increases with age, with 34% of retired women seeking strong ESG performers in their portfolio (vs 19% for retired males). The growing number of ESG investment products in Australia means all investors who want these issues embedded in their portfolios will have more choices that meet their investment philosophy.

Readiness for retirement

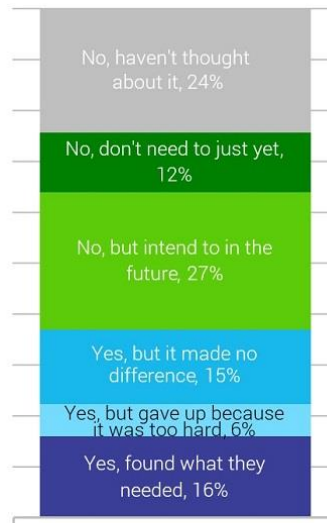
We also have data on retirement on how well-informed women feel, and the proportions of women who say they are well-prepared, as follows.

Australians have access to a vast range of online tools and resources to learn about investing and money matters, but they want more. Given the mounting challenges faced by Australians in building their wealth, planning for their retirement, and affording a reasonable lifestyle throughout their retirement, it is vital we lift financial literacy levels and retirement preparedness across the country.

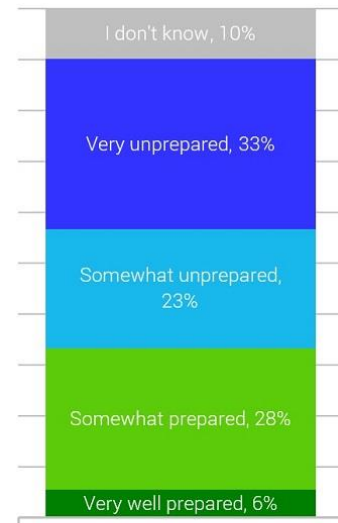
How informed do women feel about what is needed for a comfortable retirement?
Among women aged 40 and above



% of women who tried finding out how things will look for them (financially) at retirement



% of women who say they are well prepared overall for retirement



Source:  Investment Trends

Women live longer, creating financial anxiety

It is also vital that the industry delivers products and services that meet the needs of older Australians, and particularly older Australian women. With only 22% of Australians aged over 40 saying they are confident they can fund the lifestyle they seek in retirement (14% among women), an ever-widening gap in confidence and affordability exists. As Australians live longer than many planned, and as women continue to outlive their partners, this need will continue to intensify, creating enormous financial anxiety at times when stress is already high.

While more women are investing and taking control of their financial future, the gap between the independent financial security of men and women remains too large. The wealth management industry needs to increase its focus on delivering products and services that work for women, and work for them at every stage of their life – young, middle aged or mature; single, partnered or widowed.

Suzie Toohey is Global Head of Client Service and Sales at [Investment Trends](#).

A few big companies drive market results

Ashley Owen

February is half-yearly reporting season in Australia. Overall it was positive, but there are problems lurking behind the headline numbers.

There are more than 2,200 companies listed on the ASX but the vast majority of them have never made a profit nor paid a dividend, and probably never will. Almost half of the total profits and dividends from the market come from just six companies – the four big banks plus miners BHP and RIO. A couple of dozen companies account for around two-thirds of aggregate profits and dividends.

Hot stocks irrelevant for overall market

Although most of the attention in the media is on the 'hot stocks' du jour – like Domino's Pizza, Wisetech, Appin, Afterpay, Lynas – they have virtually no impact on the overall market. Even if they suddenly doubled or trebled their profits, or if they had a miraculous 1,000% increase in profits (most make losses – that's why they are 'hot' stocks). What happens outside the top couple of dozen stocks in Australia has virtually no impact on the market as a whole, but that's where speculators hope to strike it rich.

Here the focus is on the broad market, which has generated handsome returns over the long term for those who study the underlying drivers and get the timing right. The chart shows the broad market index (blue line) since 1960 together with aggregate earnings per share (maroon) and aggregate dividends per share (green). This highlights the significant drops in earnings and dividends in each of the major economic recessions and slowdowns.



The February 2019 reporting season

Aggregate profits and dividends rose in 2018, but most of it was the big miners and their windfall gains from the fortuitous rebound in commodities prices since early 2016, and recoveries from the big losses in the oil and gas, steel and mining sectors from the 2015 commodities collapse.

The big banks – the main engines of profits and dividends – all reported poor full year results (CBA has a June year and the other three have September years). Profits in the big banks were down across the board with weak revenue growth and rising costs of regulatory penalties, customer remediation and compliance. As usual, profits were conjured up by fiddling with their bad debt provisions, which are still at wafer-thin levels and will surely blow out as the residential construction and investment property lending boom deflates.

Dividends were also boosted by two other factors. The first is rising shareholder pressure to return proceeds from sale of mines to shareholders rather than let management waste it on more over-priced acquisitions. The big miners have a long and sorry history of wasting billions of dollars on over-priced acquisitions and projects at boom-time prices, only to write them off when prices inevitably fall when the cycle turns.

The second theme driving dividends this season has been an eagerness to pay out extra dividends to reduce franking balances prior to a possible Labor win at the upcoming Federal election, which would see Labor implement their promised scaling back of franking credit refunds.

Looking ahead to the 2019 profit and dividend picture, the two main sectors look rather weak. Banks will probably suffer lower lending growth and higher costs of remediation and compliance, as well as bad debts from the property slowdown. Miners (including oil and gas) will not repeat their windfall gains as the commodities price rebound of 2016-18 has stalled in the global slowdown. In other sectors, cyclical weakness will probably hit construction, building materials, transport and retailers (including property trusts which are dominated by retail). Telstra is, well, Telstra. Aside from Macquarie, CSL and the big insurers, the other 2,000+ listed companies make little difference to overall market returns.

Miners versus banks: Who wins over the long term?

Australian stock markets have always been dominated by miners and banks, but which sector has been better for shareholder returns?

During February 2019, BHP (including the London end) reclaimed top spot from Commonwealth Bank as Australia's most valuable company. Banks had enjoyed a stellar run since the early 1990s thanks to their

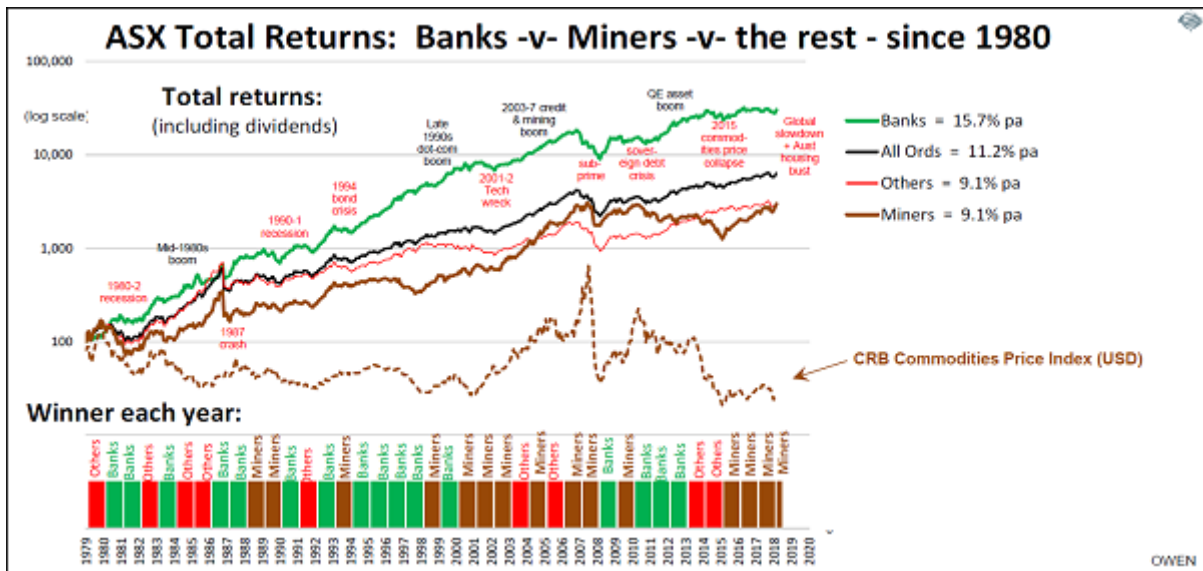
relentless gouging of margins and fees, gobbling up competitors, aggressive cross-selling of internal products, fraudulent selling and a host of other unsavoury practices under their cosy cartel structure and sleepy regulators. But the miners beat the banks in 2016, 2017, 2018, and so far in 2019. Why, and will it last?

Rising commodities prices since early 2016 have driven the recent recovery in mining share prices, while the big banks have been hit by a regulatory backlash and a local housing and construction slowdown. The miners' lead will wane as commodities prices fall in the global slowdown.

Miners have always been speculators' favourites. Probably 90% of all companies that were ever listed on Australia's numerous stock exchanges since the 1850s have been speculative mining ventures. The vast majority disappeared without a trace almost as quickly as they appeared. Shareholders' funds were poked by sharp promoters or disappeared down empty holes in the ground. Despite the woeful history of most mining stocks, many thousands of speculative fortunes have been made by ordinary shareholders who struck it rich in the mining booms that come around about every 30 years.

Banks on the other hand have been relatively stable, high dividend-paying 'safe havens' (apart from the 1890s and 1930s depressions and a close call in the early 1990s). Compared to miners, banks have mostly been relatively boring.

The chart below shows total returns (including dividends) over the past 40 years – from the banks (green line), miners (brown), and the rest of the market (red), compared to the overall market index (black). The banks have won easily with total returns averaging more than 15% per year, compared to just 9% per year from the miners and the rest of the market. The bars in the bottom section show the winner each year.



In the past 40 years, banks won in 16 years, miners won in 15, and the rest of the market won in just 9 years. The brown dotted line in the middle is the broad commodities price index, which is the key to mining cycles. Miners bounced back with commodities prices from early 2016 with the Chinese stimulus, US recovery and signs of life in Europe and Japan. The only other years miners won were 1989 and 1980, but that was because banks were hit by mounting bad debts leading into the early 1990s recession, not by rising commodities prices.

Miners will suffer once again when commodities prices fall in the coming global slowdown. As for the banks, the Hayne Report entrenched their market dominance and they should be free to carry on most of their oligopolistic ways with a few minor tweaks to appease regulators.

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.

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