

### This Week's Top Articles

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## Compare the pair: Coalition v Labor super

Mark Ellem

I love an election, particularly a federal one. It's the quintessential characteristic of democracy in action (assuming no undue influence from foreign governments). Any election is about comparing opposing parties' policies. So let's compare Labor's proposals to the current super rules, not only as input to our voting decisions, but as a good reminder on ways to put more into superannuation.

### CONTRIBUTIONS

#### Non-concessional contributions cap

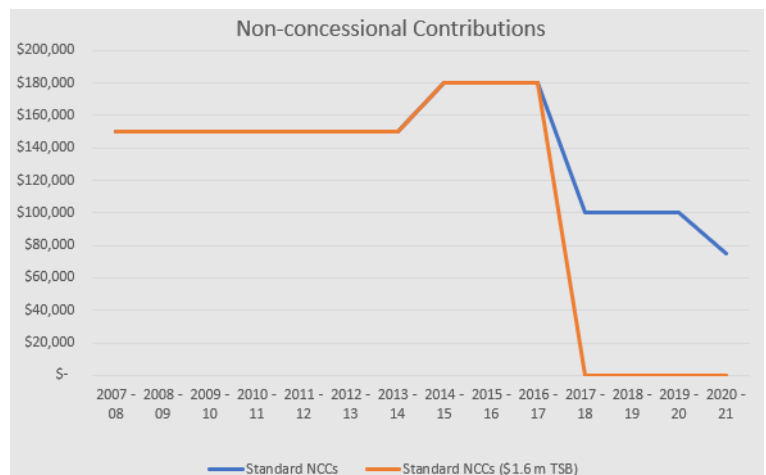
**Current law** - You can make 'after tax' or non-concessional contributions (NCC) of up to \$100,000 if you qualify and have a total superannuation balance (TSB) of less than \$1.6 million at the prior 30 June.

If you are under 65, it is possible to access the 'bring-forward' rule and make NCCs of up to \$300,000 over a fixed three-year period, provided your TSB is no more than \$1.4 million at the prior 30 June. If your TSB is between \$1.4 and \$1.5 million you can make NCCs of up to \$200,000 over a two-year fixed period and if your TSB is between \$1.5 and \$1.6 million, your NCC is limited to the standard annual limit of \$100,000.

**Labor policy** - The standard annual NCC cap of \$100,000 will be reduced to \$75,000. The 'bring-forward' rule will then change to allow a one-off (after-tax) contribution of \$225,000 for an individual, or up to \$450,000 for a couple to a maximum of \$225,000 each.

The cut in the cap reduces the ability to make a 'one-off' contribution to super, which can come from the proceeds of selling investments, an inheritance, a redundancy payment or some other means.

Assuming Labor wins on 18 May, it will be a further step down in the ability to put money into superannuation.



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## Concessional contribution cap

**Current law** - The 'before tax' or concessional cap (CC) for the 2018/19 financial year is \$25,000 for an individual. There is no higher cap for older Australians. The cap is indexed and increased in amounts of \$2,500. The cap will not increase for the 2019/20 financial year.

**Labor policy** - Labor has not announced any changes to the concessional cap, however, it has announced changes to the catch-up concessional cap rules, refer below.

## Tax deductions for personal superannuation contributions

**Current law** - You can claim a tax deduction for personal superannuation contributions providing you have notified the fund of your intention and the fund has acknowledged your notice in writing. The maximum amount for personal superannuation contributions, including any employer or salary sacrifice contributions, is \$25,000 without incurring a tax penalty.

For example, if your salary for the financial year is \$100,000, your employer would be required to make a 9.5% super guarantee contribution of \$9,500, allowing you to make a personal tax-deductible contribution of up to \$15,500 (\$25,000 - \$9,500).

**Labor policy** - Tax deductions for personal superannuation contributions will be more restricted and is likely to revert to the previous rules. However, more detail of the announcement is required to work out who may be affected. The previous rules allowed a deduction for personal contributions if less than 10% of your total adjusted taxable income came from employment sources.

## Catch-up concessional contributions

**Current law** - You may be eligible to claim personal 'catch-up' CCs if you meet certain conditions. Whilst the measure started in the current 2018/19 financial year, the first year that a person can apply any 'catch up' amount is the 2019/20 financial year.

The 'catch up' contribution is the difference between CCs you make plus those that are made for you and your annual CCs cap of \$25,000. You can carry forward the shortfall for up to five years and can claim a personal tax deduction up to the catch-up amount if your TSB as at 30 June in the previous financial year is below \$500,000.

As an example, if you earned \$100,000 for the 2018/19 financial year and your employer contributed the compulsory super guarantee contribution of \$9,500 (9.5% of \$100,000) you would have an unused catch-up CC of \$15,500 (\$25,000 - \$9,500) which you can carry forward for the next five years.

Assuming your TSB at 30 June 2019 was less than \$500,000, your CC cap for 2019/20 would be \$40,500 (i.e. the standard \$25,000 concessional contributions cap for the income year plus the carried forward amount of \$15,500 from the previous income year).

**Labor policy** - Catch up contributions will be abolished as they are considered to provide an unfair advantage to upper income earners.

## Division 293 high-income super contribution threshold

**Current law** - If your adjusted taxable income exceeds \$250,000, you are required to pay an additional 15% tax on CCs up to the standard cap amount of \$25,000, which means a total tax rate of 30% after the 15% contributions tax deducted by your super fund.

As an example, if you had an adjusted taxable income of \$275,000 and your employer contributes \$25,000 to your super fund, you would end up with an additional tax bill of \$3,750 (\$25,000 x 15%). However, if your adjusted taxable income was \$260,000 and CCs of \$25,000 were made to your fund, then only \$10,000 would be taxed at the additional 15% (\$1,500).

**Labor policy** - The high-income superannuation contribution threshold will be reduced to \$200,000.

## SUPERANNUATION GUARANTEE

### \$450 superannuation guarantee threshold to be phased out

**Current law** - Super guarantee is not payable by an employer for employees who earn up to \$450 in a calendar month.

**Labor policy** - The \$450 monthly threshold is to be progressively reduced in increments of up to \$100 each financial year between 2020 and 2024. The intention of this change is to benefit low income earners, casual employees and those in part-time employment.

### **Superannuation guarantee (SG) to be paid on the government's paid parental leave**

**Current law** - Superannuation guarantee contributions are not required to be paid by your employer if you are receiving paid parental leave.

**Labor policy** - Superannuation guarantee contributions will be paid on amounts you receive under the federal government's paid parental leave scheme. At present, \$719.35 is paid weekly for 18 weeks if you are female and meet a work test and earn less than \$150,000 per year. The amount paid for the super guarantee will be 9.5% of \$719.35 (\$68.34 weekly to a maximum of \$1,230.08 over 18 weeks).

### **LIMITED RECOURSE BORROWING**

#### **Direct borrowing by superannuation funds and limited recourse borrowing**

**Current law** - Your SMSF can borrow to invest as long as the loan arrangement and the asset being acquired satisfy strict rules.

**Labor policy** - Limited recourse borrowings will cease, however, those in place prior to the law changes will be grandfathered.

### **FUNDS CLAIMING EXEMPT CURRENT PENSION INCOME**

#### **Restriction on amount of fund income that can be claimed as exempt current pension income (ECPI)**

**Current law** - From 1 July 2017 a transfer balance cap (TBC) of \$1.6 million was introduced on the amount that can be transferred to a 'retirement phase income stream'. This cap effectively restricts the amount of ECPI that a fund can claim.

**Labor policy** - Prior to the introduction of the TBC, Labor announced a policy to limit the amount of ECPI that a fund could claim to \$75,000 per member. It is unclear whether Labor still intends to introduce this policy now that the TBC has been introduced.

### **OTHER DIFFERENCES THAT AFFECT SUPER**

Here is a brief summary of three other differences to complete the picture.

#### **1. Dividend imputation**

**Current law** - Individuals and superannuation funds are entitled to a refund of franking credits, if the franking credits plus any PAYG tax paid by the individual or fund exceeds their tax liability.

**Labor policy** - Refunds of excess franking credits that exceed tax liabilities will cease for some taxpayers. Generally, the policy will apply to most individuals, SMSFs and some larger superannuation funds. As part of Labor's 'pensioner guarantee', SMSFs which had at least one member who was a welfare recipient on 28 March 2018 are exempt from this policy.

#### **2. CGT discount**

**Current law** - A discount of 50% applies to capital gains made on CGT assets held by an individual for at least 12 months. A one-third discount applies to capital gains made on CGT assets held by a superannuation fund for at least 12 months.

**Labor policy** - It is proposed that the 50% discount that applies to capital gains made by individuals on CGT assets held for at least 12 months is halved to 25% for CGT assets acquired from 1 January 2020. There will be no change to the one-third discount that applies to superannuation funds.

#### **3. Taxing discretionary trust income**

**Current law** - Distributions from discretionary (family) trusts are taxed depending on the personal tax rate of the beneficiary.

**Labor policy** - Labor intends to introduce a minimum tax rate of 30% to discretionary trust distributions aimed at reducing tax minimisation and artificial income splitting. This should not affect SMSFs, as trust distributions

received are generally from unit (fixed) trusts, not discretionary trusts. Current law treats distributions from a discretionary trust to an SMSF as non-arm's length income, taxing the distribution at the relevant top marginal tax rate.

We await the outcome of the May 18 federal election to see which party will form government. Regardless of the election outcome, there will still be the issue of the make-up of the senate, which determines, in most cases, the successful or otherwise passage of legislation.

*Mark Ellem is Executive Manager, SMSF Technical Services at [SuperConcepts](#), a sponsor of Cuffelinks and a leading provider of innovative SMSF services, training, and administration. This article is general information only and does not consider the circumstances of any individual.*

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## Five myths of listed infrastructure

Peter Meany

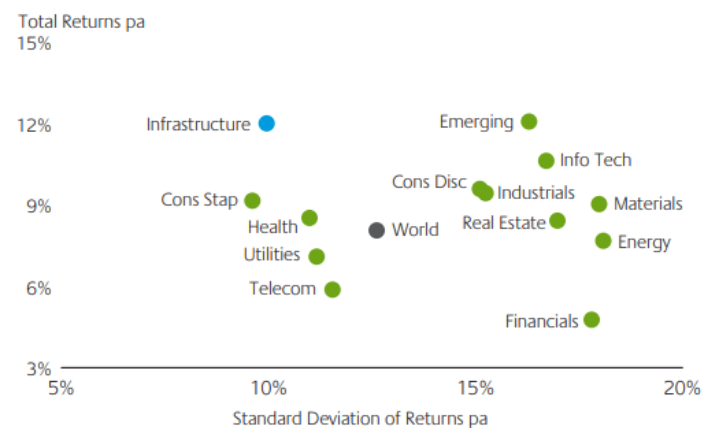
Infrastructure assets exhibit unique characteristics which have become increasingly relevant in the current economic environment. They provide essential goods or services to society that have a low level of sensitivity to the economic cycle, using contracted or regulated price structures which can provide an inflation hedge.

### Myth 1: Listed infrastructure is highly correlated to equities

Global listed infrastructure assets tend to complement other typical constituents of an investment portfolio, meaning that allocating listed infrastructure assets to an investment portfolio can improve its risk/return profile. Global listed infrastructure has delivered higher returns with lower risk than general equities over the past 15 years, as illustrated in the chart below.

The sector has also proven to be defensive during periods of market volatility. In the past 15 years, the sector has provided over 80% of the upside in rising global equity markets but under 60% of the downside in falling markets. It may also suit investors who are concerned about the impact of inflation and aim to ensure that their investments maintain and grow in real terms.

### Global Listed Infrastructure relative risk/return



FTSE Global Core Infrastructure 50/50 Net TR Index AUD Hedged from Dec-05, previously Macquarie. MSCI World Net TR Local. Monthly data for 15 years to May-18.

Source: Bloomberg and CFSGAM.

### Myth 2: Infrastructure assets are low growth and are left behind in rising markets

Infrastructure companies often generate growth from structural rather than cyclical drivers. Long-term trends like urban congestion, globalisation of trade, security of energy supplies, and mobility of communications have placed enormous strain on infrastructure networks and will require investment over many decades. Backed by the right business model, this investment has the potential to deliver strong capital growth for investors.

A number of infrastructure sectors are currently delivering double-digit growth due to structural change. For example, mobile towers have been a beneficiary of the exponential growth in smart phone usage and the resulting pressures on mobile carriers to improve network quality.

American Tower has been increasing rental charges, co-locating new tenants on existing sites and building or acquiring new sites. Strict planning restrictions and community opposition to new tower sites represent effective barriers to entry.

Among listed port and freight rail companies, Union Pacific is the largest North American Class I freight rail company. It owns and operates a 32,000-mile network of railroads covering the western two thirds of the United States. The company has been a beneficiary of volume recovery as the US economy has improved.

**Myth 3: Exposure to listed infrastructure is available through traditional equity managers**

Many global equity managers hold 2% or less of their portfolio in infrastructure assets, and this exposure could be concentrated amongst a small number of large, well-known utility names. However, much of the alpha generated in this sector comes from mid-cap stocks, which are under-researched by global equity managers, such as toll roads, oil storage, mobile towers and water utilities.

It is important to view investments in listed infrastructure from a global perspective. The global listed universe is capitalised at over US\$2 trillion, allowing investors to diversify across various infrastructure sectors and geographies and to actively manage key risks.

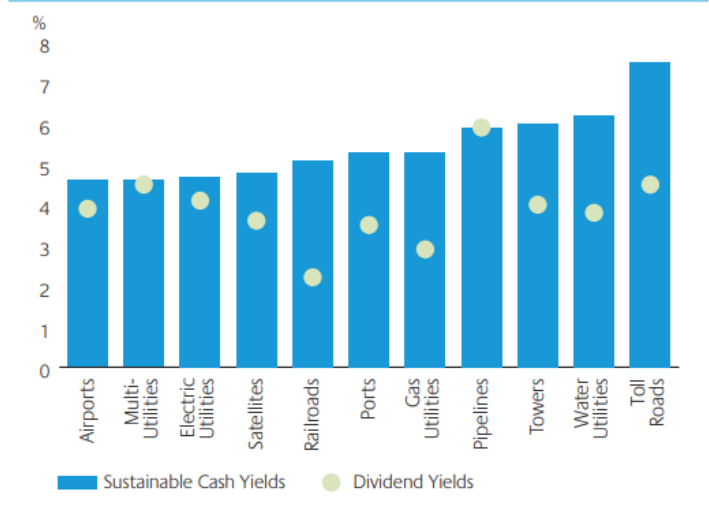
A good example is the airport sector. Sydney Airport is one of the world’s leading airports in terms of profitability by passenger, but this is widely recognised and already fully reflected in the stock price – it trades at a 19x EV/EBITDA multiple. Alternatively, our fund can buy shares in Spanish airport operator AENA, which is currently trading at 11x EV/EBITDA. At these levels we believe that AENA represents a better investment for our clients’ money.

Infrastructure is a separate asset class for many pension funds, endowment funds, sovereign wealth funds, private banks and multi-managers from around the world. Early movers are typically allocating between 5% and 10% to this asset class.

**Myth 4: Infrastructure assets are too highly leveraged and therefore less defensive**

Extreme levels of debt can change the characteristics of equity. A handful of infrastructure stocks, notably in Australia and Spain, created inappropriate capital structures (70-90% leverage) in the mid 2000’s when debt was cheap and plentiful. But these companies represented less than 5% of the global investment universe. The vast majority of infrastructure stocks are traditional companies, sensibly leveraged (30-50%) and run for shareholders. In recent years, they have strengthened balance sheets by reducing costs and repaying debt. We have also seen widespread refinancing of existing debt, to lock in reduced rates and diversify funding sources. The wave of share buybacks and bolt-on acquisitions suggest that many management teams now feel they are under leveraged.

Infrastructure Yields by Sector



Source: CFSGAM as at June 2018, Bloomberg.

Some poorly aligned companies took a back-to-basics approach. Australian toll road operator Transurban is a great example. Following changes in the Board and senior management earlier this decade, the company raised equity to repay debt, cut the dividend to sustainable levels, halved corporate costs and refocused on its core assets. Having undertaken these measures, Transurban became a key portfolio holding and delivered a total return of over 18% pa in the period from September 2011 to May 2018.

The cash yields of infrastructure sectors are higher than dividend yields, implying scope for payout ratios to be raised. This is especially the case for railroads and toll roads.

**Myth 5: Infrastructure is reliant on government funding, which is in short supply**

Following years of underinvestment, a significant amount of infrastructure investment is now needed globally. Rough estimates from the OECD suggest that annual investment requirements for road, rail, electricity (transmission and distribution), telecommunications and water are likely to total around an average of 2.5% of world GDP (roughly US\$53 trillion to 2030) . Economic growth for a number of nations has been hindered in by critical infrastructure bottlenecks, particularly in the transport sector.

However, while scarce government funding is problematic for societies in need of infrastructure upgrades, it is less of an issue for listed infrastructure companies.

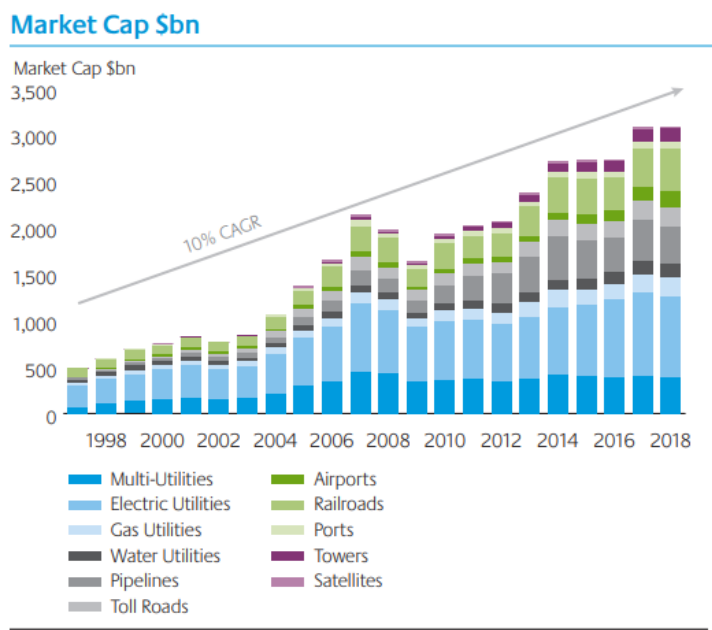
The listed infrastructure investment universe consists of mature, established businesses. These companies provide essential services and generate predictable cash flows underpinned by regulated or contracted business models. Regulatory frameworks often encourage infrastructure companies to invest to maintain or improve their existing assets and allow them to earn a return on money spent in this way. Under this model, infrastructure companies are incentivised to provide better and more efficient services; with no reliance on government help.

Financially-distressed governments have felt the need to divest assets, including valuable infrastructure, to help maintain financial stability. A good example of this theme is AENA, the world’s largest airport operator. The company handles approximately 200 million passengers per year, primarily at 46 Spanish airports including hubs at Madrid and Barcelona. Previously wholly owned by the Spanish government, a 49% stake was IPO’d in early 2015. Since then the stock has risen strongly as robust passenger growth, limited capital expenditure requirements and improving commercial earnings have propelled its share price higher.

Looking ahead, many infrastructure assets remain in state government hands. The partial sale of WestConnex to a consortium led by Transurban offers a roadmap to the recycling of these assets. Brazil is also in the midst of a major privatisation program of toll roads, ports, railroads, airports and utilities.

The listed infrastructure investment universe is benefitting from a wave of corporate restructurings. Many infrastructure assets reside within large, vertically integrated corporations and conglomerates. Companies are increasingly looking to streamline and optimise their capital structures. This has often led to the divestment of infrastructure assets – highly valuable in their own right but deemed peripheral by a larger entity.

Combined, these themes of government privatisation and corporate restructuring have resulted in significant expansion, as well as improvements in quality and diversification, for the listed infrastructure asset class in recent years.



Source: Bloomberg,CFSGAM as at June 2018.

Peter Meany is Head of Global Listed Infrastructure at [Colonial First State Global Asset Management](#), a sponsor of Cuffelinks. This article is general information and does not consider the circumstances of any investor.

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## Two value opportunities in domestic cyclicals

Emma Goodsell

It looks clear that 2019 will be a challenging year for the consumer. The daily headlines on falling house prices, declining car sales, tightening credit, election uncertainty and regulatory changes are having a reinforcing loop. As always, but particularly in such an environment, we’ve looked to tilt the portfolio away from poorly-positioned consumer-exposed stocks. What does poorly positioned mean? Companies that sell goods and services that are easily interchangeable or are in a highly competitive industry.

An example of a company that is not poorly positioned is Bunnings (owned by Wesfarmers) – sure, sales growth is slowing but it dominates the hardware segment in Australia and will be untouched by disruption, either technological or regulatory.

The balance to this view, though, is that a lot of consumer-facing stocks are looking attractively priced – sometimes up to a 50% valuation discount to the broader market averages. So there are opportunities. Analysing industry structure is how we identify those businesses that should be more resilient in a weaker domestic economy.

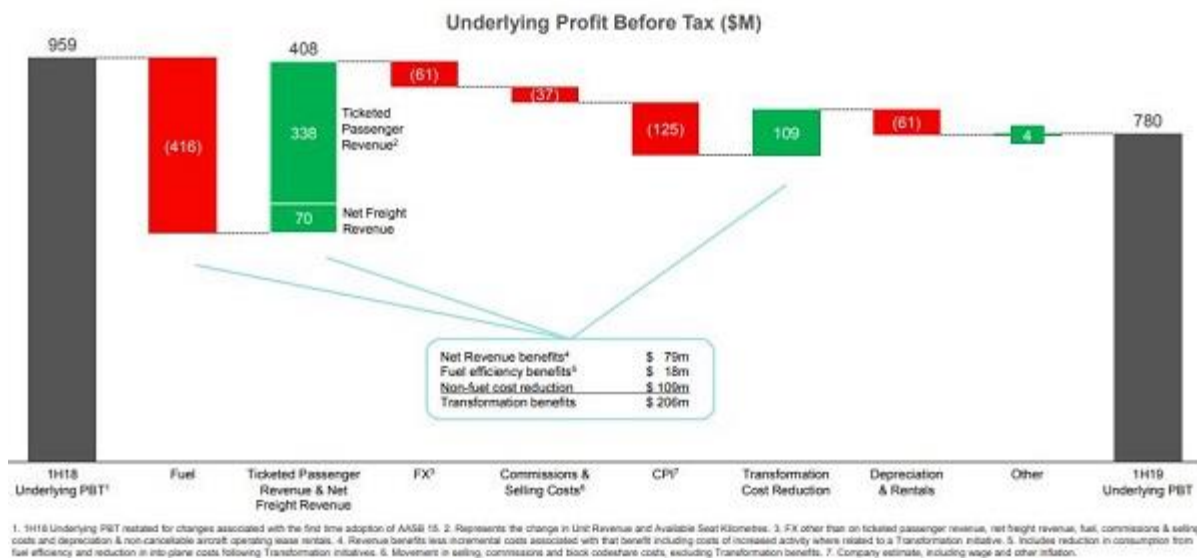
### oOh!Media

One such opportunity is oOh!Media, an outdoor advertising company. The stock has sold off on concerns around advertising spending, which are cyclical and consumer-sentiment driven. However, the outdoor media industry is taking a larger share of the broader advertising market, averaging 9% growth p.a. for the 10 years to June 2018. Outdoor is boosting its reach thanks to digital billboards and because it is an advertising medium that is retaining its audience, allowing it to offer attractive “reach” to advertisers, particularly against free-to-air TV and print that are experiencing audience fragmentation or decline. Generating 47% of outdoor industry revenues, oOh!Media is the market leader and is well placed to capitalise on gains in market share.

Further, we like the market structure, with the market recently consolidating from four main players to two, after oOh!Media acquired Adshel and competitor JC Decaux bought APN Outdoor. As a result, we think the industry is set to become more rational. We’ve yet to see an industry go from four players to two and see pricing get worse. Trading on eight times enterprise value over earnings before interest, taxes, depreciation and amortisation versus transaction comps and international peers on 10 times, the valuation in our view is yet to reflect an improving industry structure and long-term structural tailwinds for outdoor.

### Qantas Airways

Another stock that we expect to perform well in a softer environment is Qantas Airways. The Qantas first half result for fiscal 2018, while at first glance looked ho-hum as profit was down, showed the incredible strength of its franchise. Battling a fuel cost increase that on its own would have led to a halving of profit (see chart below), the company was able to pass all the fuel cost increase through to customers.



Source: Qantas presentation, 2019.

Since the end of the capacity war with competitor Virgin five years ago, Qantas has experienced a golden run. The shares are up from \$1 to \$5.60; the balance sheet is strong; dividends have been re-instated; and more than 25% of the shares on issue have been bought back – a remarkable turnaround. Can it continue? We think it can (subject to the usual caveats re consumer demand, oil prices and competitor behaviour) for the following reasons:

- The pincer movement Qantas has put on Virgin with Qantas mainline and Jetstar encircling the premium and budget market thus allowing Qantas to achieve more than 60% market share but more than 90% profit share.

- The remaking of international routes and alliances, which should make blowout losses a thing of the past.
- The strength of the loyalty program (more than 10 million members) resulting in consistent delivery of about 25% of Qantas's total profit.

Much can go wrong in an airline business but as we study the industry globally we are hard-pressed to find a company that has the unique advantages possessed by Qantas. The share price values Qantas as if it were no better than most global comparables with a price-earnings ratio (PE) of 9 times. If returns can be maintained, we believe Qantas could justify a PE ratio of 12 times, putting it on a similar valuation to premium-rated airlines such as Southwest Airlines (US) and Ryanair (Europe).

While Qantas and oOh!Media have sold off to low PE multiples of 9 times and 13 times respectively versus the broader market average PE of 17 times, we believe their improving industry structures should drive resilient profitability in the face of a weaker domestic consumer.

*Emma Goodsell is Deputy Portfolio manager at Airlie Funds Management. Magellan Asset Management, a sponsor of Cuffelinks, bought Airlie in early 2018. This article is general information and does not consider the circumstances of any investor.*

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## Boring can be beautiful when investing

Richard Ivers

Buying the hottest stock in the hottest industry can be a dangerous game in investing. Valuations and expectations are typically very high, and many an investor has been burnt by purchasing a fashionable stock too late in the cycle. For example, tech darling Tesla is now 30% off its high following a stellar run through to 2017.

Often the best opportunities come from boring industries, which don't generate much 'buzz' but quietly build something special. Sir James Dyson became rich in vacuum cleaners, becoming a household name in a low-growth industry where competition and innovation was previously low.

### Overlooked not overcooked

If you can find the right company in an overlooked industry, returns can be exponential. Earnings exceed expectations and the valuation multiple applied to those earnings increases as investors appreciate the better than expected outlook. It's a double kicker to investment returns.

The table below shows some recent examples of winners operating in boring, low-growth industries that have performed exceptionally well over the last 12 months.

#### Recent winners

Company	Code	12 mth return	Industry
Spicers	SRS	110%	Paper products distribution
Infomedia	IFM	90%	Auto dealership software
Vista Group	VGL	70%	Cinema software
Breville Group	BRG	60%	Kitchen appliances

Spicers distributes paper-based products and has been negatively impacted by the move to paperless communication. Along with capital structure issues the stock did little for seven years. However, the industry has consolidated, Spicers had net tangible assets well above the share price, undertook a successful turnaround and then received a takeover offer.

Infomedia is a global provider of software to the parts and service sector of the automotive industry. The automotive sector is mature, making costs an increasing focus. Yet Infomedia has grown by improving its customer efficiency and adding significant value.

Vista is the leading provider of software to cinema operators globally, which is currently being challenged by streaming providers like Netflix. However, cinema attendances globally are moderately growing, and Vista has delivered five consecutive years of revenue growth above 20%. An exciting new marketing opportunity is also beginning to scale.

Breville has developed an innovative and appealing range of kitchen appliances like toasters and kettles. Hardly exciting. Yet it is expanding globally, broadening the product range and recently reported earnings per share growth of 20%.

**What are some new ideas on this theme?**

What are some other 'boring' industries which offer investment opportunities? The table below shows some new ideas that we like among stocks in industries which may be considered unfashionable.

**New ideas**

Company	Code	Price	Industry
EQT Holdings	EQT	\$26.60	Trustee services
GTN	GTN	\$1.28	Radio advertising
Ive Group	IGL	\$2.22	Printing

EQT provides trustee services for individuals and corporates. It's considered a relatively stable industry. Existing customers are unlikely to leave but it's also hard to win new customers. New management has reinvigorated the business and earnings growth is accelerating. The recent Financial Services Royal Commission is likely to be significantly beneficial as greater importance is placed on external, independent trustees like EQT.

GTN has a near monopoly providing real-time traffic information to radio stations and sells attached advertising. It was sold down heavily after a downgrade in December 2018, but we understand those issues have now been resolved. It is about to benefit from accelerating earnings growth in Canada and Brazil and trades on an FY20 PE of 9x and yields 9%. Only a little needs to go right for investment returns to be large.

Ive Group is a printing and marketing company. The industry is challenged, but recently consolidated, and is increasingly rational. IGL just completed a capex programme and is about to reap the returns. Trading on a free cashflow yield of c. 20%, shareholders should benefit from higher dividends and value-accretive acquisitions.

Sometimes, frogs do turn into princes.

*Richard Ivers is Portfolio Manager of the [Prime Value Emerging Opportunities Fund](#), a concentrated fund which invests in companies outside the S&P/ASX100. This article is general information and does not consider the circumstances of any investor.*

**Where is the super industry heading?**

**Graham Hand**

While the 2019 Federal election may lead to significant superannuation changes, 2018 set the long-term agenda for structural reform. The Financial Services Royal Commission led the way, pushing every major bank to plan an exit from wealth management, once seen as the fast train to growth against the slow train of basic banking services. The Commission's revelations wreaked havoc on financial advice, while recommending the extension of the Banking Executive Accountability Regime (BEAR) to superannuation.

In addition, the Productivity Commission supported the removal of underperforming funds and changes to the default system with a 'best in show' proposal. Regulatory changes included Protecting Your Super to remove small balance funds from the super system, while more power was given to APRA and ASIC.

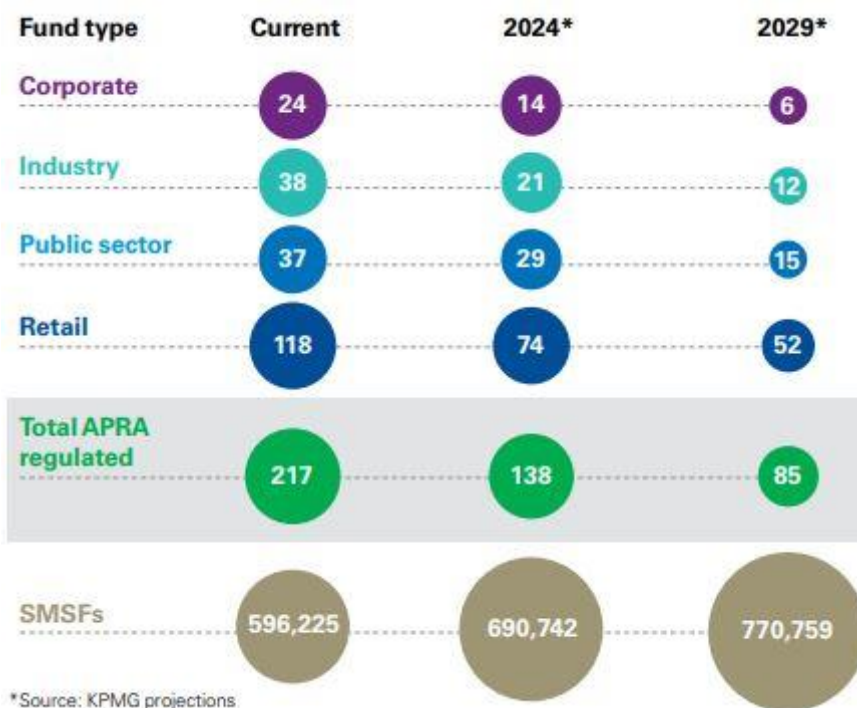
In this context, KPMG’s ‘Super Insights 2019’ is a timely look at the present and future of the superannuation industry. Their work includes a [website report](#) and a fascinating interactive dashboard with great detail on which large APRA funds are growing and which are struggling, and their market shares.

In 2018, despite market volatility especially in the final quarter, the superannuation industry delivered strong outcomes for members overall. The APRA-regulated sector grew by 10.3% over the year, with closing assets nearing \$1.8 trillion. SMSFs experienced slower growth, with assets increasing by 6% in 2018 to close at almost \$750 billion. In total, the assets supporting superannuation closed 2018 at \$2.7 trillion, some 39% higher than the market capitalisation of the Australian share market.

**Number of funds to halve under industry consolidation**

Faced with structural and legislative changes, KPMG expects significant industry consolidation in APRA funds in the short-to-medium term, as shown in Table 1.

**Table 1: Projected number of funds, 2019 to 2029**



**Industry funds to dominate growth, but SMSFs hanging on**

The reduction in large APRA funds from 217 to 85 will create some enormous asset management companies, with considerable clout in all sectors of the Australian economy. In particular, a reduction in industry funds from 38 to 12 will see the power of the big funds taken to another level.

KPMG’s interactive feature shows how fund size has changed between 2004 and 2018. Back in 2004, the retail funds of NAB/MLC, CBA/CFS and Westpac/BT dominated superannuation, and the industry funds looked like minnows. While these three retain high positions, AustralianSuper is now the largest, and QSuper, Unisuper and First State Super will probably overtake the retail funds in the next few years. For the first time in history, the industry funds in total were larger than retail funds in 2018.

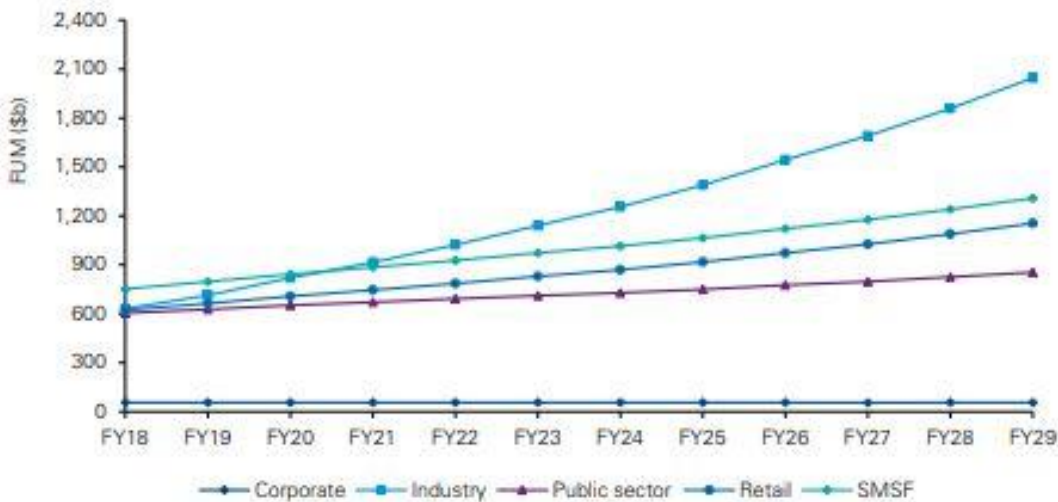
At the end of 2018, as shown in table 2, AMP was second to AustralianSuper by fund size, with substantially more member accounts. AMP’s ranking is unlikely to last, based on latest flow statistics.

**Table 2. Market position, asset and members of retail and public funds**



KPMG expects industry funds to overtake SMSFs in 2020, holding over \$2 trillion in assets by 2029, as shown in Table 3. Retail funds will still grow, but at half the rate, reaching \$1.2 trillion in a decade. The entire superannuation industry at the moment is about \$2.7 trillion. By 2029, total super assets will reach \$5.4 trillion, dwarfing anything the ASX can achieve.

**Table 3. Forecast assets by superannuation sector**



Source: KPMG projections

Despite the optimistic outlook, KPMG’s Paul Howes added:

*“There is no room for complacency, including in the industry sector. During 2019, it is incumbent on all trustees of all funds to review their operations, business models and product portfolios. We believe that in all sectors, significant opportunities exist for funds to develop innovative retirement products to suit the needs of a variety of members.*

*We are concerned that the potential changes to the advice landscape, including the additional educational requirements proposed by FASEA, the removal of commissions and banning of advice fees being charged on MySuper products will potentially impact the number of members that receive advice. This may have the impact of reducing the demand for pension products going forward and may result in more individuals taking lump sums out of the superannuation systems, which may put more pressure on the social security system, which is*

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*unlikely to be a sustainable long-term position for the Federal Government. As such, KPMG believes funds will have to review their advice models to ensure that they can continue to deliver advice to members in an efficient, affordable and compliant manner to facilitate the continued growth of the retirement income product market."*

#### **Footnote, not from the KPMG Report**

If Labor's proposals on the refund of franking credits become legislated, many SMSF assets will switch into industry and retail fund structures, including the wraps and direct investment options. In its costing of Labor's proposal, Treasury wrote that the revenue impact will be reduced by SMSFs retaining franking credits through switching to APRA funds:

*"This behavioural response is assumed to be greater for higher wealth SMSFs ... Assets that shift into APRA funds are assumed to continue to draw the benefit of the franking credit since most APRA funds are in a net taxpaying position. Some other SMSFs will rebalance their portfolios away from franked dividend paying shares towards other forms of income to compensate for the fall in after-tax returns on shares in the absence of refundability. These other forms of income could include fixed income, property trusts, managed funds or offshore equities."*

It will be interesting to see how KPMG amends its 10-year forecast in 2020 if Labor's proposal is implemented.

*Graham Hand is Managing Editor of Cuffelinks. The information in this article is drawn from the [KPMG Super Insights 2019 Report](#). See Report for further disclaimers. This summary is general information and does not consider the circumstances of any investor, and does not seek to cover the detail in the report.*

## **HNWs buying bonds as the yield curve inverts**

Peter Moussa

An inversion of the US yield curve has led to fears of a recession as investors rebalance portfolios and invest in the relative safety of bonds.

The inversion, which refers to US 10-year Treasury yields dropping below US policy rates, indicates markets believe the US Federal Reserve has made the wrong call on interest rates and that the US economy is not as resilient as previously thought. There are similar concerns about the Australian economy.

An inverted yield curve is unusual because it means investors are prepared to take a lower return on a longer-term investment even though it carries more risk than a higher-yielding short-term investment. It is essentially a flight to safety and an indicator that the market is expecting the next US interest rate movement to be downward.

While we understand the market's concern, our base case is for both the Fed and RBA to put interest rates on hold for the rest of the year and for similar reasons. Both economies have strong employment but while the US also has robust wage growth, it is glaringly lacking in Australia. However, both scenarios feed into policy limbo for the central banks until more reliable long-term trends emerge from the data flows.

#### **How is the inverted yield curve impacting investor behavior?**

Markets are moving in anticipation of a rate cut, and in Australia that expectation has pushed both equities and bond demand higher. However, it is not uncommon for bonds and equities to rally when interest rates are expected to move lower. The Australian 10-year bond rate has fallen to a record low of 1.76% with markets pricing in two rate cuts by the end of 2019 in Australia.

The shift into bonds is a trend we observed in our high net worth client base in the last quarter of 2018, and it continued into the first period of this year. The rate of flow is evident when compared to last year, as we've seen a 273% increase in bond volumes.

Since the yield curve inversion, clients have been rebalancing portfolios by taking profits from part of their fixed coupon exposure and shifting into floating rate bonds. We view spreading exposure across different durations a prudent move, because investors are not adequately compensated for taking on additional duration risk when the Australian yield curve is flat, as it is currently.

## Alert but not alarmed

Floating rate bonds allow investors to benefit from a rise in interest rates as the bond is tied to a benchmark rate like the Bank Bill Swap Rate. A shift to floating bonds is based on an expectation the market will lower its rate cut expectations. It also acts to decrease duration in a bond portfolio.

While a yield inversion has often in the past been a pre-cursor to a recession, we hold it as reason to be alert but not alarmed. It is a reminder of the importance of asset allocation across multiple asset classes. The increased demand in bonds from our clients is a strategy to seek higher returns than a term deposit without taking on equity risk.

This is why we have seen a demand for high quality investment grade corporate bonds – in both US and Australian dollars. Some clients are adding bonds as a way to diversify across multiple asset class rather than time markets, given the traditional low correlation between bonds and equities.



The strong flows we witnessed from fixed rate bonds late last year was concentrated in the in the 8-10-year maturity space, which offered yields of about 4.5% in the investment grade space. Clients locked in those yields before markets priced in the rate cut expectations, which pushed bond prices higher.

## Should investors be factoring in a recession?

The last time the yield curve inverted was in 2007 and historically it has been a reliable indicator of an upcoming US recession. However, we feel it may be premature to anticipate a recession on the back of this one and there have been a couple of past instances of inversion without a recession. While we take the recent inversion seriously, we believe a recession can be avoided if policy makers make wise choices. This means equities may both perform better and be more volatile than many expect this year.

Traditionally bond market movements are a precursor of where more broadly markets are heading. So its perhaps not surprising the yield curve began to flatten in 2018 when markets become concerned that the Fed may over tighten and this would slow down economic growth. At the time the Fed indicated it would tighten four times in 2018 and two more times this year.

In January 2019, the Fed indicated it would be more data dependent rather than tightening on autopilot. The markets took that to mean that the economy was not as resilient as anticipated. The view in the market is that the Fed may have over tightened and may now be forced to lower the overnight rate to avoid derailing US economic growth.

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## The business case for diversity and inclusion

### Marisa Hall

In March 2019, the Thinking Ahead Institute conducted its first public seminars in Sydney and Melbourne. We polled the audience of investment professionals on the current pace of action in the industry on inclusion and diversity. Delegates voted on five options and the overwhelming response in both cities shows us there is a lot of scope to improve.

Improved diversity is the new corporate zeitgeist. We need more women, we need more ethnic minorities, we need more, well ... just anyone that doesn't look like 'us'. And sorry, did I forget to mention we need it fast?

The investment industry is struggling to catch up. Why? Because for too long both structural and unconscious bias have limited opportunities for non-white, non-male, non-private school educated individuals. The workforce is so visibly homogenous that it has almost become embarrassing.

Choices	Melbourne results	Sydney results
Far too slow	38%	24%
A little bit slow	45%	49%
About right	17%	22%
A bit fast	0%	5%
Far too fast	0%	0%

There have been signs of progress. The light shone on gender pay gaps, the recently proposed [crackdown in the UK on ethnic pay gaps](#), and the increasing challenge against companies who have exercised discriminatory policies have dragged many companies into the limelight.

Wanted: quick fixes please! But wait ... why exactly are we doing this diversity thing anyway?

As with most things in life, anything worth doing is hard and quick fixes are elusive. While many organisations have accepted the virtue of more diverse teams, it's worth spending a little more time exploring why. Is this about compliance or commercials? Is this about performance or is this about culture? And by the way, will more women help my team make better decisions?

### **Digging deeper: the business case for diversity**

The benefits of diversity have already long been noted. In a speech to Stanford Business School in 1998, Lewis Platt, then-CEO of Hewlett Packard noted:

*"I see three main points to make the business case for diversity:*

1. *A talent shortage that requires us to seek out and use the full capabilities of all our employees*
2. *The need to be like our customers, including the need to understand and communicate with them in terms that reflects their concerns*
3. *Diverse teams produce better results.*

*This last point is not as easy to sell as the first two – especially to engineers who want the data. What I need is the data, evidence that diverse groups do better."*

Therein lies the problem. While it is generally accepted that diversity has many benefits, the arguments quickly meld into answering the question "does having more diverse teams improve business performance?" The often-cited McKinsey publication, [Diversity Matters](#), found that companies in the top quartile of gender and ethnic diversity were 15% and 35% respectively more likely to have experienced financial returns above their national industry median. They found the reverse for companies in the bottom quartile. But, as the study notes, correlation is not causation; greater gender and ethnic diversity in corporate leadership does not automatically translate into more profit.

### **Building collective intelligence: is it diversity or is it cognitive diversity?**

So how do you improve the collective intelligence within teams? Improved cognitive diversity goes a long way. Business school professors, Alison Reynolds and David Lewis, define cognitive diversity as "differences in perspective or information processing styles." In their research published in [Harvard Business Review](#), they noted a "significant correlation between high cognitive diversity and high [team] performance" when executing new, uncertain and complex tasks.

Brilliant. We have a link between cognitive diversity and performance. Unfortunately, the bad news is, unlike demographics, cognitive diversity does not come with a shiny label. It is hard to detect at face value. The worse news, from Reynolds and Lewis, is that:

*"... having run the execution exercise around the world more than 100 times over the last 12 years, we have found no correlation between this type of [surface-level] diversity and performance".*

And to add insult to injury, Wharton management professor, Katherine Klein, [notes](#) that "board gender diversity either has a very weak relationship with board performance or no relationship at all".

Some readers will be torn between wanting to have more diversity in the workplace and some hard-line academics who say that merely putting a bunch of women on your board won't necessarily improve performance (which of course needs to be balanced with the heavily caveated studies which say that they will).

There is, however, some further evidence. Anita Woolley, Associate Professor at Carnegie Mellon University, has devoted much of her research to systematically examining the collective intelligence of teams. In the search for a collective intelligence factor (the c-factor), Woolley and her co-authors [argue](#) that there are three factors which correlate significantly to a team's collective intelligence:

1. the average social sensitivity of group members
2. the equality in distribution of conversational turn-taking, and
3. the proportion of females in the group.

But the latter two factors did not remain statistically significant after controlling for social sensitivity. In Klein's work she postulates that the weak relationship between surface-level diversity and team performance could be due to the fact that the women named to corporate boards may not in fact "differ very much in their values, experiences, and knowledge from men". Even if these women were different from men, "they may not speak up in board conversations and they may lack the influence to change the board's decisions". Her research points to the idea that outliers to a group often self-censor and even when these individuals speak up, majority group members may discount their views, not taking "full advantage of their own cognitive variety".

### **Diversity: the not-so-hard facts**

We need to tread carefully here. This is not a hard science. Greater surface-level diversity is not the magic bullet for solving your team's decision-making issues. But, on the other hand, there are quite a few reasons why greater diversity is of benefit to your organisation.

Improved diversity of people from different socio-economic, educational and cultural backgrounds is a useful path to improved cognitive diversity, especially if all of your team currently comes from a limited range of backgrounds. We also know that good diversity policies (a) ensure that there are clear signals to your employees that there are no glass ceilings and everyone has fair access to opportunities, (b) allow organisations to access the best and widest pool of talent available, (c) ensure that your organisation is reflective of a global client base and a changing global landscape and (d) align with UN's sustainable development goals.

### **So where does this leave us?**

To truly leverage the benefits of diversity requires organisations to put in effort – diversity requires integration for it to work well. James Surowiecki in his 2004 book, *The Wisdom of Crowds*, argues that groups can make better decisions than individuals but only if three conditions apply: diversity, independence and an effective means of aggregating views. His last point on aggregation is critical. There's no point in having a diverse team if nobody listens to what anybody else is saying. And there's no point having a diverse team if people feel excluded and believe they don't have a voice.

Organisations need a sustained, systematic and long-term commitment to diversity and inclusion. While the theory around diversity is important, it's the practice that really matters.

*We explore this point further in our paper, [How to choose? A primer on decision-making in institutional investing](#).*

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