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## Adele Ferguson on 'Banking Bad' and weaving magic

Graham Hand

*Adele Ferguson is one of Australia's most-awarded journalists, receiving eight Walkley awards including a Gold Walkley for her joint Fairfax Media and Four Corners Programme, Banking Bad. She has also won a Logie and was awarded an AM in 2019 for services to journalism. Her reports were influential in the calling of the Royal Commission into Financial Services, and her new book, Banking Bad, tells the story of "power imbalance, toxic culture and cover-ups".*

**GH:** Is investigative journalism almost like a calling that comes with its own sacrifices?

**AF:** I suppose it is in a way although that sounds a bit corny but it's certainly not a nine-to-five job. It's something that is always with you. You're always taking calls, listening to people, looking for things. So yes, it is a bit of a calling.

**GH:** Including circumstances where you've come under some personal attack?

**AF:** Yes, when you're up against big corporations, whether it's banks or franchise organisations or whatever, you are bound to get retaliation. Sometimes it can be a bit dirty with smear campaigns or threats of advertising being pulled. They try to disparage what you've written and undermine the whistleblowers or the victims, all those sorts of things happen.

**GH:** And in the media industry, which has been under a financial strain for a long time, pulling advertising is a big issue, right?

**AF:** Yes, it can really hurt when it's millions of dollars and jobs are on the line, but my organisations have continued to back the stories.

**GH:** Your book is not just about the Royal Commission as it also gives the background on how banking reached the current point. There's the history of FoFA and the impact of various CEOs and executives at CBA and other banks. While the banks have paid heavily through remediation, do you feel there are individuals who've escaped lightly?

**AF:** Yes. Even with the Royal Commission, there were a number of executives who caused a lot of damage but had already left and they were never called by Hayne. It was the same as when I did the first Commonwealth Bank financial planning scandal story which came out in June 2013. Some individuals were culpable but they had moved on. Some were in really good positions in other institutions but they were never called to account by anyone.

**GH:** One of the uncomfortable sides of the Royal Commission was that relatively junior executives, such as Nicole Smith, were beaten up day after day when she clearly felt she was just following instructions and doing her job. Do you think the Royal Commission targeted that sort of person too much?

**AF:** Yes, the Royal Commission allowed the institutions to choose who they wanted to put up as a witness. So the institutions that put up the wrong people. At one stage, Kenneth Hayne or Rowena Orr said something like, "Why are you here? You are so inexperienced, you've only been there a few months." The witness couldn't answer any of the questions. That was a problem. The Commission should have called the people they needed, including some who had already left.

**GH:** You're widely credited for the stories that led to the Royal Commission. Is there one that stands out in your mind that most shocked you?

**AF:** The life insurance scandal at CommInsure. It was about sick and dying people. It really had a much bigger impact. I know many of the stories are terrible, such as the devastating toll of financial planning on a lot of people. But when you're seeing people who are terminally ill being knocked back for payments based on some spurious legal definition, that was really confronting.

**GH:** In your book, you describe how a CBA executive, Peter Beck, said he was shocked that relatively small amounts for medical needs were regularly referred to legal department.

**AF:** Yes, that really shocked me too. I remember a case, Noel Stevens was a scaffolder who had virtually no money to his name, maybe \$10,000. He didn't own a home, he was renting. He got a phone call from a teller at Commonwealth Bank trying to cross sell. They saw he didn't have anything except a Westpac life insurance policy. So the teller referred him to a financial planner and they swapped him out of the Westpac life insurance policy into CommInsure, and said it was better, etc.

A few months later, he was diagnosed with pancreatic cancer and his claim was knocked back. He ended up fighting although he had only six months to live. He won the case and a few days later, he died. And the bank then fought it again and went to appeal. This was over about \$300,000, and they even lost the appeal. It cost them about \$500,000 in legal fees over a \$300,000 claim that they had to pay anyway.

They go after little claims and they go hard because most people just give up.

**GH:** Can I put another side to you. When I was at Colonial First State before I left in 2012, which was relatively early in the remediation process, we felt that among the legitimate claims were people who saw an opportunity for ambit claims. They lost money during the GFC and this was a chance to recover it.

Do you accept that in this entire process, there are investors, the clients, who knew exactly what they were doing and now they're being remediated?

**AF:** No question, of course, there are always chancers who try to exploit something, which is a real shame, because it tends to sully what happened to people who were genuinely ripped off or put into inappropriate products. I get emails every day from people. Some claim forgery or fraud or doctoring of this or that document, but when I look at the claims, they just don't stack up.

Someone sent me an SMS recently saying, "Will you weave your magic?"

**GH:** Okay, they're trying to get you to become part of their lobbying.

**AF:** That's right. Or they'll copy me in emails to a bank CEO thinking that's going to do something. So yes, it certainly happens, I'm very much aware of it.

**GH:** While I was watching the Royal Commission, I felt frustrated that some senior bankers were simply answering yes or no and avoiding any explanations. I've subsequently talked to a witness who was told by his QC to say as little as possible. Do you think bank executives didn't do enough to explain their actions and justify better what the banks had done?

**AF:** It changed during the Royal Commission. The turning point was with AMP when Jack Regan got up. He essentially said AMP had lied 20 times. After that point, the QCs trained executives to be a lot more careful with what they were saying. It became yes or no and it didn't have a good impact.

**GH:** Yes. I felt as someone with a banking background, they should have explained better why they made certain decisions, but they were not prepared to.

**AF:** That's right. They were told to protect the institution and don't give anything away. They'll trick you. They'll do whatever. People were too careful.

**GH:** Most Australians, particularly as they approach retirement, need financial advice. But we now have thousands of advisers leaving the industry and the banks stepping back from advice. And most people are not prepared to pay enough for financial advice. Have you formed a view on how financial advice might be made available to the masses, other than the high net worths who will pay for it?

**AF:** I think financial advice is so important. People need good financial advisers but the industry needs to be professionalised. There were too many people that just did a two-week course. And then their remuneration relied heavily on commissions. Maybe advice should be a tax deduction to make it available to more people.

**GH:** Would you like to see a different business model that allows the banks to stay in financial advice, because that's still the place where people go for financial services?

**AF:** The banks needed to be more transparent. People would go to Financial Wisdom or Meridian Wealth and think they were getting independent advice. But the approved product list was stacked towards the parent institution, so it was deceptive. If you go to Mercedes Benz, you know you're buying a Mercedes Benz. You're not told, "I'm going to give you the best car that is suited to you." If banks were more transparent about the products, it might work better.

**GH:** What were some of the shortcomings of the Royal Commission?

**AF:** One of them is a chapter in the book, about a new whistleblower who has come forward on NAB and its cosy relationship with its auditor. It's a global issue with the role of external auditors and their dual role as consultants and how independent they are. The ex-Chairman of ASIC is talking about the global decline in the quality of auditing. The Big Four auditing firms globally have been loss-leading on audit to get the lucrative consulting. It's causing problems when you look at the so-called independent reports by auditors on some big issues. Over the last decade, we estimate the Big Four audit firms were paid a billion dollars by the major banks.

The other thing I found disappointing with the Commission was that these issues are about the victims. People who've been ripped off, but the remediation schemes have all been different. Some have worked and some haven't. They've lacked transparency on the criteria they're using. The Royal Commission could have delivered a 'gold-plated template', a roadmap to follow.

**GH:** Did the industry funds come off lightly?

**AF:** Yes, they did. While the Commission went for 12 months, they spent only two weeks on the \$2.8 trillion super industry. The Productivity Commission Report showed huge problems with performance figures, multiple accounts and other things. And to spend only two weeks looking at retail funds then spend so much time on NAB was wrong. Day after day with one person. It was just crazy, and industry funds hardly got looked at.

**GH:** Are you aware of anything that the industry funds are vulnerable on?

**AF:** The Commission should have looked at the role of the unions and the issue of slush funds needs to be put to rest.

**GH:** One of the headlines from the Royal Commission was 'charging fees to dead people'. It's become a catchphrase. But if you think about the legal profession, the very people running the Royal Commission, they rely heavily on charging fees to dead people. That's what estates and wills are about. Why did nobody from the banks say a financial adviser has a lot of work to do on an estate of a dead person?

**AF:** Yes, it was a great headline, but far more important was the 'fee for no service' they were charging to the living. The fees to dead people was really a headline that the media got hold of. But behind the fees were some tricks, such as claiming it was administrative errors when in fact it was deliberate.

**GH:** What do you hope is the dominant message that readers will take from your book?

**AF:** To stand up and be heard, not sit in silence as people did for years. Just speak up on wrongdoing, because if you catch it early, it doesn't blow up into something really bad. For customers, speak up because it could be fixed instead of destroying your lives.

One other thing on independent financial advisers. There needs more capital behind them. At the moment, at least if you get ripped off by a bank, they have deep pockets. The small fly-by-nights, they don't have enough capital, and that needs to be fixed by being part of a larger-capitalised group.

**GH:** That's another example of the failure of large institutions to sell their advantages. Let's face it, on the fee for no service issue, it would not have been too difficult to offer services like monthly reporting and a mandated annual meeting with your clients. It would have saved billions in compensation.

**AF:** It seemed so lazy. Even with FoFA, they didn't want to send out a document for a once a year opt in. Was that really too arduous for them? They brought it on themselves and would not take the reforms on board. Even when Matthew Rowe and Mark Rantall of the FPA (Financial Planning Association) said enough is enough, they were badly treated by CBA.

**GH:** There are parts of the book where you don't name an executive. Why was that?

**AF:** I took the names out in places. I didn't think it added to the story, but people know who they are.

*Graham Hand is Managing Editor of Cuffelinks. **Adele Ferguson's book, '[Banking Bad](#)', is available now.***

## 10 ways to make the most of our new website

### Graham Hand

For the first time since we started Cuffelinks in 2012 (318 weekly editions ago with 2,400 articles from 600 market experts), we have launched a new website.

All the content from the old site has migrated across, and we have retained the most popular features while adding some new ones.

We strive to find the best content for our readers and to make our site a resource for your investing needs. We edit all articles and curate them into a readable form to maximise the use of your time, and there is no annoying logins or forgettable passwords to worry about.

Here are 10 ways to make the most of this resource:

#### 1. Enhanced search function

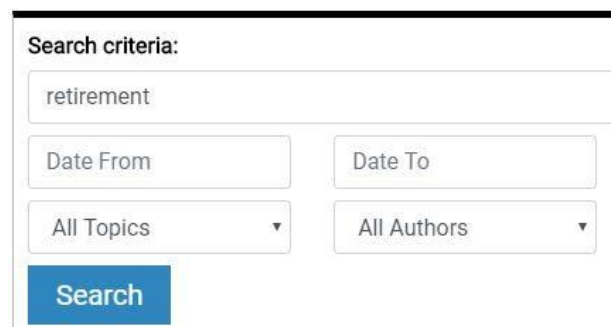
The search box in the top right of the home page is a good way to find articles on almost any financial subject. After you click the magnifying glass, another box will appear so you can refine your search.

#### 2. Education Centre

[This section](#) has become one of the most popular on our website. It holds ETF reports, LIC updates, hybrid pricing and reports on hundreds of listed securities. In recognition of its appeal, we have added a carousel to the home page to show the reports or it can be accessed from the top menu bar.

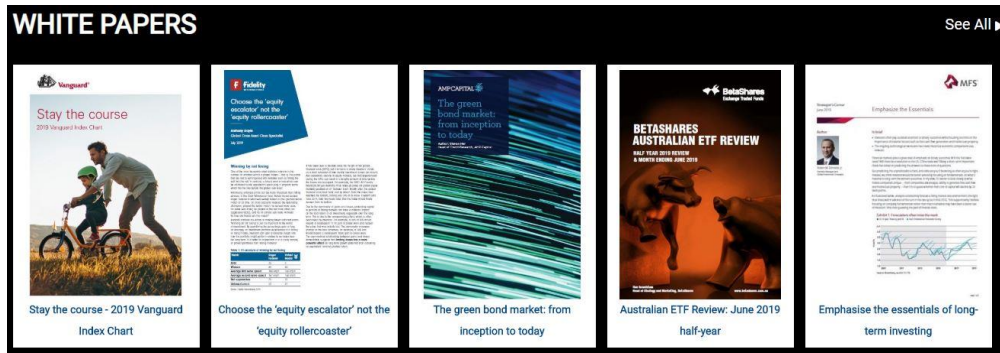
#### 3. White Papers

Our sponsors provide longer research papers which often contain more details than their articles. There is now a White Paper section on the menu bar which shows all the papers since 2015, plus a White Paper carousel with the latest pieces.



The screenshot shows a search criteria form with the following elements:

- Search criteria:** A header label above the search input.
- : The search input field.
- : A date range selection field.
- : A date range selection field.
- : A dropdown menu for topic selection.
- : A dropdown menu for author selection.
- : A blue button to execute the search.



#### 4. Classic Articles

Cuffelinks has published some wonderful articles over the years which may have been missed by newer readers. Who knew, for example, that Paul Keating provided three articles in our first three editions? On the home page, under the new White Papers carousel, is a new section where we will add classic articles from the past, and regularly update them. Always worth another look.

#### 5. Subject articles highlighted

We have grouped articles into major categories and added a new section under the subscription box which shows the latest articles from each of these major subjects. A chance to catch up on recent material.

#### 6. Archive of all previous editions

Seven years of previous editions are stored under the [Archive section](#) on the top menu bar. Select any of the years and previous editions, and there's a wealth of material, most of which has not dated.

#### 7. Trending and 'Most Viewed' articles

Want to know what others have been reading in the last two to three weeks? The 'Trending now' articles will scroll across the top and be included next to any of the articles in the 'Most Viewed' section.

#### 8. Special eBooks

Cuffelinks has compiled six [special eBooks](#), selecting the best content from specific years, or contributions to mark an important anniversary. See them under the top menu tab.

#### 9. List of all authors

Our [list of authors](#) reads like a 'Who's Who' of Australian finance. Under the archive tab on the top menu bar, all authors are listed alphabetically by first name. It's the place to look for insights from Paul Keating, Chris Cuffe, Howard Marks, Hamish Douglass, Roger Montgomery, Phil Ruthven, Monica Rule, Don Stammer, Ashley Owen, David Bell, Noel Whittaker, Pauline Vamos, Jack Gray ... too many to list here.

#### 10. Thumbs up

And finally, a big thumbs up feature on each article. If you like what you read, tell the author with a quick click. It will also help us to know what is working with our readers for future article selection.

After such a big transition, we know some things are not quite right yet. If you find something that should be fixed, please let us know at [mail@cuffelinks.com.au](mailto:mail@cuffelinks.com.au).

Thank you for your continued support.

## **Six warning bells against property spruikers**

### Noel Whittaker

Despite years of bad publicity — and some successful prosecutions — the property spruiking industry is alive and well. This week, I was contacted by a couple in their mid-50s who had completed a survey which asked them to tick the box most relevant to their financial challenges. They chose superannuation.

Within two days they had received a phone call from a person who claimed to know all about superannuation, and who made an appointment to see them at their home. They received the usual spiel: how superannuation is no good because they keep changing the rules, the share market is a mug's game, and the only way to provide for the future is to buy a brand-new property, which of course would be built by the spruiker's company. The sales patter was so good that they signed up on the spot.

### **A better way to buy property**

Luckily, they contacted me within the seven-day cooling off period.

They are an unsophisticated couple who live in a lovely coastal town in northern New South Wales and they still owe \$200,000 on their home. The spruiker's solution to their financial challenges was to borrow another \$500,000 for the entire purchase price of a home near Ipswich.

The man in the couple is a tradesman and the woman works in aged care. I pointed out that the key to making money in real estate is to find an undervalued property with potential and buy it at a good price from a vendor who is keen to sell. Obviously, a brand-new house in a low socioeconomic area sold by a spruiker ticks none of those boxes. I told them if property was their thing, they would be better off buying a rundown house in the area where they live and doing it up. I also strongly agreed with their gut feeling that a debt of \$700,000 was probably not a great thing to have in their situation.

### **Six warning bells**

Fortunately, there were enough warning bells ringing for even these inexperienced investors to hear.

1. The approach came from the spruiker. It always does. It offers a 'free' seminar showing how to become a millionaire, entry in a contest to win something flashy, or an interview to learn how to save tax while paying off your home faster.
2. The spruiker tries to convince you that they are the only people who can find the right property for you. Any seasoned property investor knows the way to wealth is to search out bargains for yourself.
3. A building contract is involved, with the rationale that you will save stamp duty, get a new home, and enjoy bigger tax breaks. The real reason? It gives the spruiker a better chance to load the price.
4. They offer a one-stop shop: the lawyer, mortgage broker, builder and managing agent. This allows them to stay in control throughout the process.
5. The properties are usually in outlying suburbs in lower socioeconomic areas. And it is no accident that properties offered are usually in a different state to where you live.
6. There will invariably be a mortgage required over your own home. The last thing the spruiker wants is for you to order a valuation on the overpriced property they are trying to force on you.

As interest rates continue to fall, and people live longer and longer, more over-50s will be worrying about how to provide for their retirement. It is fertile ground for con men. Keep in mind that once you reach 50 it is hard to recover from any serious financial mistake. The biggest warning sign of all is being contacted by anybody attempting to sell you on any kind of investment. You're welcome to email me if you have concerns.

*Noel Whittaker is the author of Making Money Made Simple and numerous other books on personal finance. Email [noel@noelwhittaker.com.au](mailto:noel@noelwhittaker.com.au) or visit [the website](#).*

## **Retirees facing steep increases for basic items**

Dr. Martin Fahy

The ASFA Retirement Standard benchmarks the annual budget needed by Australians to fund either a 'comfortable' or 'modest' standard of living in the post-work years. It is updated quarterly to reflect inflation and provides detailed budgets of what singles and couples would need to spend to support their chosen lifestyle.

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## What does modest and comfortable mean?

A modest retirement lifestyle is considered better than the age pension but still only able to afford fairly basic activities.

A comfortable retirement lifestyle enables an older, healthy retiree to be involved in a broad range of leisure and recreational activities and to have a good standard of living through the purchase of such things as:

- household goods
- private health insurance
- a reasonable car
- good clothes
- a range of electronic equipment
- domestic and occasionally international holiday travel.

The June quarter 2019 figures indicate that couples aged around 65 living a comfortable retirement need to spend **\$61,522** per year and singles \$43,601, up 0.8% for each on the previous quarter. At the modest level there was an 0.6% increase for singles and a 0.5% increase for couples.

These various changes are more or less in line with the All Groups CPI 0.6% increase between the March and June quarters.

Over the year to the June 2019 quarter, costs were up around 1.5% for couples at both the comfortable and modest levels, compared to the 1.6% increase in the All Groups CPI. This equates to couples needing to spend \$918 more a year, and for singles the amount is \$648.

Budgets for older retirees rose from the previous quarter by around 0.7% at the comfortable level and by 0.5% at the modest level.

Many retirees would have welcomed the recent decision to decrease the deeming rate in the asset test for the age pension but at the same time they have been facing increased costs of living and lower returns from investments, such as term deposits. Having sufficient savings in superannuation to support the lifestyle Australians want and deserve in retirement is an imperative. Moving to 12% for the Superannuation Guarantee is a necessity for those not yet retired.

## Prices that have risen substantially

However, while the increase in the headline rate of the CPI might not look large, retirees have been facing significant increases in the price of many necessities of life. The drought has impacted the prices of a range of foods, the cost of private health insurance continues to grow at around twice the general rate of inflation, and petrol prices are up.

The costs for retirees that increased substantially over the last 12 months are:

- Price of bread up by 4.8%
- Price of beef up by 6.0% and lamb up by 13.5%
- Price of milk up by 2.9%
- Price of fruit up by 4.9%
- Price of vegetables up by 6.2%
- Price of beer up by 2.5%
- Property rates up by 2.3%
- Price of hairdressing up by 2.9%
- Price of private health insurance up by 3.25% on average
- Price of dental services up by 2.3%
- Price of domestic travel up by 3.5% and price of international travel by 4.1%

The most significant price increases in the June quarter were automotive fuel (10.2%), medical and hospital service (2.6%) and international holiday, travel and accommodation (2.7%).

**Table 1: Budgets for various households and living standards for those aged around 65 (June quarter 2019, national)**

Household type	Single Modest	Couple Modest	Single Comfortable	Couple Comfortable
Housing – ongoing only	\$99.58	\$111.92	\$116.66	\$121.94
Energy	\$36.95	\$49.62	\$46.81	\$58.05
Food	\$90.75	\$168.25	\$117.34	\$203.94
Clothing	\$20.40	\$38.78	\$27.25	\$50.75
Household goods and services	\$33.31	\$39.15	\$73.23	\$90.20
Health	\$49.71	\$95.91	\$102.00	\$190.94
Transport	\$90.01	\$96.12	\$146.92	\$159.36
Leisure	\$93.48	\$146.57	\$181.75	\$273.06
Communications	\$18.64	\$21.00	\$23.31	\$30.34
<b>Total per week</b>	<b>\$532.84</b>	<b>\$767.32</b>	<b>\$835.26</b>	<b>\$1,178.59</b>
<b>Total per year</b>	<b>\$27,814</b>	<b>\$40,054</b>	<b>\$43,601</b>	<b>\$61,522</b>

**Table 2: Budgets for various households and living standards for those aged around 85 (June quarter 2019, national)**

Household type	Single Modest	Couple Modest	Single Comfortable	Couple Comfortable
Housing – ongoing only	\$99.58	\$111.92	\$116.66	\$121.94
Energy	\$36.95	\$49.62	\$46.81	\$58.05
Food	\$90.75	\$168.25	\$117.34	\$203.94
Clothing	\$20.40	\$38.78	\$27.25	\$50.75
Household goods and services	\$51.13	\$73.28	\$149.73	\$179.41
Health	\$85.63	\$120.00	\$142.31	\$224.99
Transport	\$40.10	\$50.12	\$45.11	\$55.13
Leisure	\$61.00	\$87.25	\$125.37	\$176.54
Communications	\$18.64	\$21.00	\$23.31	\$30.34
<b>Total per week</b>	<b>\$504.17</b>	<b>\$720.22</b>	<b>\$793.88</b>	<b>\$1,101.09</b>
<b>Total per year</b>	<b>\$26,318</b>	<b>\$37,595</b>	<b>\$41,441</b>	<b>\$57,477</b>

*The figures in each case assume that the retiree/s own their own home and relate to expenditure by the household. This can be greater than household income after income tax where there is a drawdown on capital over the period of retirement. All calculations are weekly, unless otherwise stated. Annual figure is 52.2 times the weekly figure.*

**More information**

Costs and summary figures can be accessed via the [ASFA website](#). ASFA provides individual calculators to help Australians plan for retirement. Australians can find out more about superannuation on the independent [Super Guru](#) website.

*Martin Fahy is Chief Executive Officer of [The Association of Superannuation Funds of Australia](#) (ASFA), the peak policy, research and advocacy body for Australia’s superannuation industry.*

**Helping your children build their super**

Matthew Collins

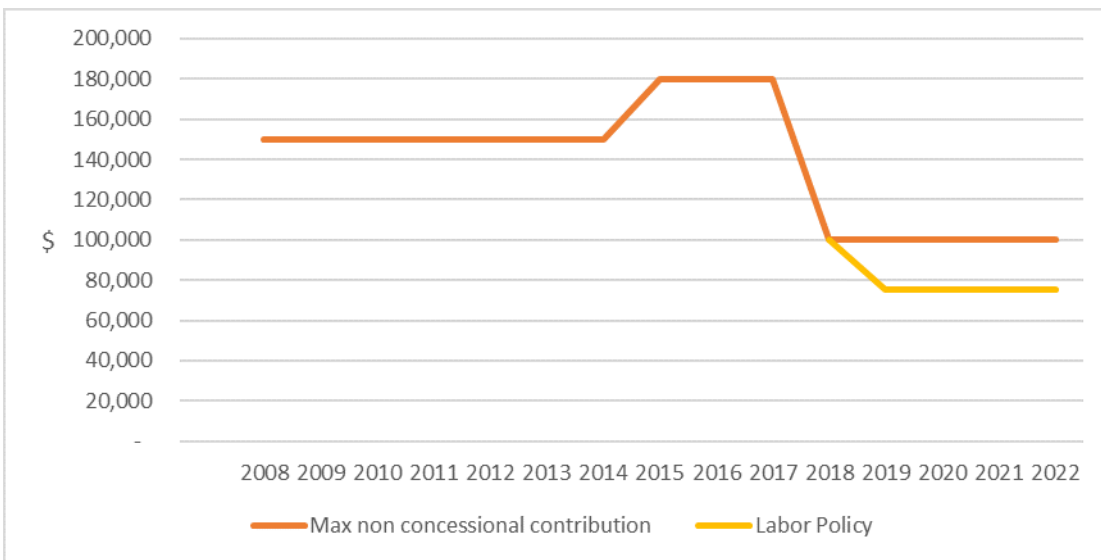
For many years, superannuation has provided significant tax benefits for retirees. However, recent changes in legislation will limit the amount that can be placed into super, and investment returns may not be as good as in the past. As a result, future generations will pay more tax in retirement as they will hold more of their wealth outside super.

This problem can only be minimised with long-term planning.

**What is the problem the next generation is likely to face?**

Many future retirees will not be able to transfer adequate funds into superannuation because:

- On average, mortgages are higher and take longer to pay off. Superannuation is not the main financial priority for many people until well into their 50s.
- There has been a progressive reduction in the amount that an individual can contribute to super. The graph below shows how the maximum annual non-concessional (after-tax) contribution has fallen in recent years (and to zero if the \$1.6 million Total Superannuation Balance (TSB) has been reached).



It is Labor policy to reduce the annual amount to \$75,000. These rules disadvantage individuals who obtain wealth later in life.

- A steady increase in life expectancy means that many children will not receive an inheritance until they are in their 60’s. Given that an individual cannot contribute to super after the age of 64 unless they are working, this will give little time to make more contributions.

So, while the \$1.6 million TSB may be a concern of many retirees of the current generation, it will not be a concern for the next as many will not get even close to this level.

### Helping a child make a concessional (tax-deductible) contribution

There are many different views on whether parents who have money available to help their children should do so. This is a discussion for another time. However, it is my view that the child's tax position should be considered if assistance is provided. Superannuation should be a factor.

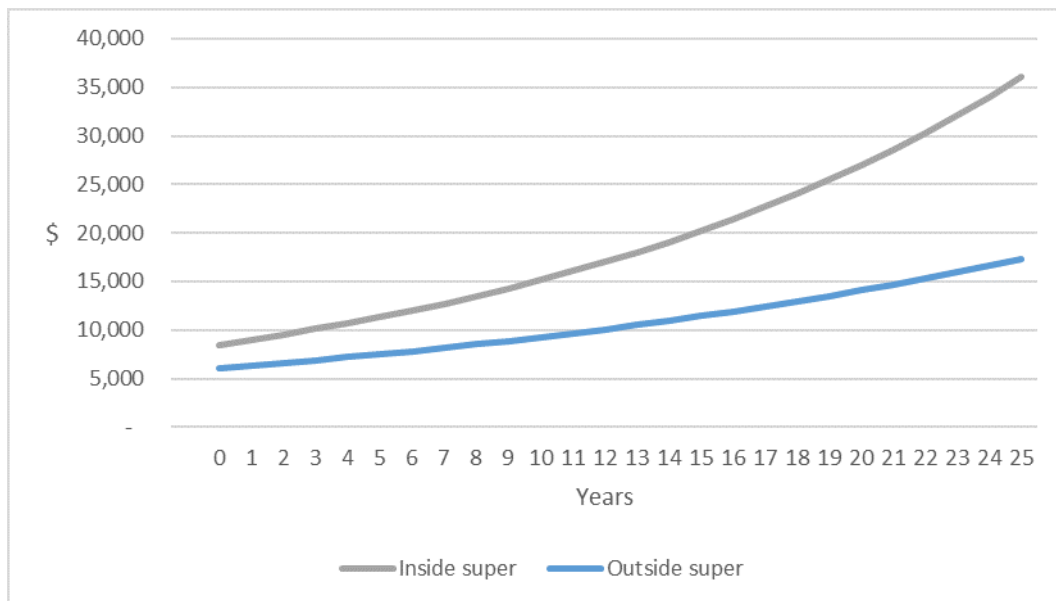
The major benefit received from making tax deductible superannuation contributions is the compounding effect of paying a lower tax rate. This can be shown by a simple example:

Bryce is 40-years-old and earns \$100,000 a year. His employer contributes the minimum required superannuation guarantee of 9.5% or \$9,500. He is entitled to make a deductible contribution of \$25,000 but simply does not have the financial resources to do so.

He expects to retire at age 65. His mother would like to help Bryce build some wealth in a tax-effective way. Note that:

- Bryce's marginal tax rate is 39%
- Contributions to super are taxed at 15%

So there is a 24% tax saving if assistance is added to his super. As shown in the graph below, the long-term effect of this tax saving is substantial. Assuming future earnings are taxed at 15% inside super, compared to 39% outside and the investment return is 7%, the value of this \$10,000 will be worth over double if held inside super compared with outside. Bryce will also have more in super at 65 resulting in a more tax-effective retirement.



### Helping a child to make non-concessional (after-tax) contributions

Given that there is no initial tax deduction, lending money to a child to make a non-concessional contribution is not so beneficial in the short term. However, it still may be considered by high net worth individuals. For example, an individual who is 75 with children who are 50 may take the opportunity to add to their child's super progressively knowing that they may otherwise be left with considerable funds outside superannuation when they receive an inheritance.

Overall it is becoming increasingly difficult to maximise the benefits of superannuation. More thought needs to be put into not only how much wealth is transferred to the next generation but also how it is transferred.

Two final points of caution.

Firstly, the contribution must be made by the child. In other words, the parent would need to deposit the money in the child's bank account and the child will need to make the contribution. It cannot come directly from the parent.

Secondly, a strategy like this may have significant tax, family and estate planning consequences. As a result, it should not be entered into without first receiving both financial and legal advice.

*Matthew Collins is a Director of [Keystone Advice Pty Ltd](#) and specialises in providing superannuation tax, estate tax and structural advice to high net wealth individuals and their families. This article is general information and does not consider the circumstances of any individual investor. It is based on a current understanding of related legislation which may change in future.*

## 50 years ago, Poseidon made today's WAAAX look waned

Keith Ward

Some 50 years ago, Australia was gripped by a remarkable boom in mining stocks, the most famous being the nickel producer Poseidon. Its share price rose from 80 cents in August 1969 to almost \$280 by February 1970. In six months, the price of Poseidon increased by a factor of 350. What triggered a boom of such magnitude? The words of Charles Kindleberger (2000, p16) help set the scene.

*"A larger and larger group of people seeks to become rich without a real understanding of the processes involved. Not surprisingly swindlers and catchpenny schemes flourish."*

### How was the mania created?

The initial movement in the Poseidon share price can be traced to changes in the market. By the late 1960's, the nickel price was rising, driven by the growing demand for stainless steel used in industrial applications such as alloys and nickel plating, as well as from the aerospace and munitions industries. On the supply side, long-running strikes in Canadian nickel mines also exerted upward pressure on the nickel price. At the time Canadian mines accounted for around 60% of the world's production.

Movements in the price of nickel directed attention to nickel miners and nickel explorers. Poseidon attracted the greatest attention. It had claims on a site at Mount Windarra, near Laverton in WA, some 350km north of Kalgoorlie. The stock was tightly held but even with the passage of time, it is difficult to be precise about the initial trigger to the start of Poseidon's remarkable run.

However, a headline in *The Australian Financial Review* on 30 September 1969 (p20) was spot on: "Poseidon Lures the Gamblers"

The article author tried to introduce a cautionary note that the Poseidon price had trebled based on "very little evidence" and "the Board could not explain the sharp increase in the price". This sceptical or cautionary theme continued, with later headlines referring to a "Mining Bubble" (October 1, 1969, p16) and comments that "Poseidon's strike needs considerable proving up ..." (October 2, 1969, p11).

Further price rises in October were attributed to rumours of significant nickel strikes, again not verified by the company. Clearly, formal verification was not required. The price moves reflected optimism that Poseidon had a significant nickel deposit. Meanwhile, nickel prices continued to reflect the supply pressures brought about by strikes at the large Canadian producers, Falconbridge and International Nickel.

The reports of nickel shortages and Poseidon apparently finding high grade nickel deposits in Windarra continued to feed the frenzy in the Poseidon share price, rising from \$6.60 to \$38 over September and October 1969.

### Feeding the frenzy

Such was the mania gripping Australian mining stocks at this time, the AFR (October 10, 1969, p1) reported the Sydney Stock Exchange was trading more shares (by volume not value) than Wall Street. It said that if you rang your broker three times and it was engaged the buyers were in, while if you got straight through, the sellers were in. An interesting heuristic, if not one lifted from a finance textbook. The AFR reported on October 14, 1969 (p14) "The bellhops are in ..."

By February 1970, Poseidon had a market capitalisation of \$700 million, about three times that of Westpac's forefather the Bank of NSW (Sykes, 1995, p279).

When Poseidon released assay results it added to even greater madness. Poseidon reported an assay figure of 9.38% nickel to the London market, later corrected to 0.38%. Not a minor adjustment. Evidently, an experienced mining analyst would have known the initial report was wrong. Meanwhile, continued shortages in world nickel prices contributed to Poseidon share price increasing from \$38 to \$51 in November 1969.

In a report that would be certain to raise eyebrows today, the AFR (November 20, 1969, p15) reported that:

*"Paper profits of more than \$1 million appear to have been made in shares of Poseidon NL by an investment company associated with the consulting geologists who are evaluating Poseidon's Windarra nickel strike."*

Unsurprisingly, Senator Rae, Chairman of the Select Committee on Securities and Exchange, was critical of both geologists and stock exchanges for their lack of attention to insider trading.

There were commentators highlighting the risk involved in Australian mining shares at this time. The geologist and director of the Geological Survey of Western Australia, Mr J H Lord, expressed a word of caution about the size of new nickel finds in WA (AFR November 24, 1969, P1). One British observer went as far to suggest organised rigging of Australian shares (AFR January 16, 1970, p1). Another, Mr Ian Wright a Perth Stockbroker (AFR 10 January p1) suggested that investors should start from the current value and work backwards to gauge what level of reserves are required to justify the current price.

Wise advice largely ignored. Sound familiar?

If such considered comments were not resonating with many investors, what was driving the market? To gain a sense of the times, the AFR (December 2, 1969, p2) comments are worth repeating in full,

*"Although word of Poseidon find at Windarra is generally credited to having been whispered first by drillers and equipment suppliers at the Leonora racetrack, the Palace bars soon got the message. And within minutes it was transferred again to the neighbouring office of Kalgoorlie's only stockbroker, R. Reed, a member of the Stock Exchange of Perth."*

The Palace referred to is a pub in Kalgoorlie, and not surprisingly, the AFR suggests many of the stories were seeded. The article goes on to report,

*"One geologist actually boasted recently that a word in the ears of 10 key drinkers in the Steak Bar could turn the place to a frenzy and cause a run on stock listed in Melbourne, Sydney and particularly Adelaide."*

An AFR editorial (December 10, 1969, p2) said that the Australian stock market was more likely to rely on a call from the Steak Bar than a call to any control centre in Sydney or Melbourne. By the end of December 1969, the share price of Poseidon reached \$200. On the way to this lofty level, the AFR (December 18, 1969 p6) links the increasing price to "rumours" and "unconfirmed reports".

Fingers pointed to the Palace Hotel in Kalgoorlie but it was not the only source of information. Trevor Sykes (1995, p101) reports one strong rumour "was that drillers had been seen in Laverton with sulphides on their boots and things". With such insights, it is easy to picture a market driven by rumour and unverified reports. While the price was rising, it was easy to ignore the naysayers.

Confirmation bias suggests investors will seek out information supporting their position. It may explain why undue emphasis is given to unsubstantiated rumours. Overcoming confirmation bias is not easy. It requires absorbing information counter to a position held. This leads to cognitive dissonance as information at odds with the position held is absorbed.

### **The market finally tops out**

Eventually, the price of nickel fell as world economy slowed. This reduced demand coincided with the end of strikes in Canada and an increase in potential new mines. In fact, as Trevor Sykes mentions, even if the quality of the nickel was of an economic grade, Poseidon could not raise the funds to develop the mine. (Sykes, 1995 p200). So, with the nickel price falling and a more realistic evaluation of the mine's prospects, the Poseidon share price began its decline.

By April 1970, the share price had fallen to \$72. Its fortunes continued to decline and Poseidon was delisted in 1976. The Windarra mine was taken over by Western Mining and closed in 1994. In 2006, Niagara Mining acquired the Windarra mine and in 2007 changed its name to Poseidon Nickel, so the famous name lives on and is currently trading on the ASX at just over 4 cents.

In his report, Senator Rae found “the present regulation of share markets inadequate and ineffective” (SMH, July 19, 1974, p1) and he was critical of the geologists and stock exchanges. He found self-regulation had not worked and there was a lack of investigation into insider trading. He found geologists were sellers of certain mining shares when they had a better understanding of the prospects than the general public. Senator Rae found:

*“reports and statements by the directors and geologists were evasive, distorted, exaggerated and simply untrue in important respects”*

After the report was released, the Sydney Morning Herald (July 19, 1975) reported Senators Rae’s wife had been threatened. The SMH reported a radio interview given by Senator Rae’s wife on ABC radio where she declared “they would have been very comfortably off if they had accepted bribes to provide content of the report before its release.”

It is true the Rae Report was damning, however Trevor Sykes (1995, p322) believes it would be wrong to label the main participants as thieves. He described them as optimists and gamblers as they bought into the story they helped create. Perhaps a quote attributed to Leonardo DaVinci captures it best. “The greatest deception men suffer is from their own opinions.”

### **From 80 cents to \$280 and back**

When we reflect on the movement of Poseidon shares from 80c to \$280 in six months, it is easy to dismiss it as the workings of an immature and unsophisticated market. Yet in recent memory we have had speculation, among others, in dot com companies, Japanese equities and bitcoins. Maybe certain tech stocks currently listed in Australia deserve the same label. The changes introduced following Senator Rae’s inquiry have been important in shaping the regulatory framework of Australian securities markets. However, it is difficult to regulate human nature. When apparent easy gains are there to be made, rational investor behaviour is often jettisoned. Speculative booms can be fun at the time, but like any party, there are no quick and easy hangover cures.

*Keith Ward FFin is a former Head of Retail Banking, St George Bank. This article is general information.*

## **ETFs and the art of portfolio rebalancing**

### **David Bassanese**

Determining how to spread your funds across investment asset classes of varying risk and potential return is one of the most important investment decisions you will make.

Ensuring that this allocation continues to meet your risk-return preferences is another challenge, as investments can produce different returns over time and their significance within your portfolio can change. Your desired blend of risk and return can also change over time, as personal circumstances – like nearing retirement or having a family – evolve.

Having a lot invested in equities will likely mean your long-run returns will be higher, but also that you will have to endure volatility along the way. By contrast, allocating a large proportion of your funds to relatively less volatile cash or bonds may mean you sacrifice returns in exchange for greater capital stability.

Ideally, the aim is to have an asset allocation that gets the balance between high and low-risk assets right *for you* – both now and over time.

### **The need for portfolio rebalancing**

The problem is that asset allocation is not a ‘set and forget’ decision. Your exposure changes as markets move. A strong run in equities will mean the share of your portfolio invested in ‘high-risk’ assets (shares) will increase, making your portfolio more volatile. This may be inconsistent with your desired risk/return profile.

The aim of rebalancing is to adjust your exposure to maintain your target asset allocation.

Another goal of rebalancing may be to preserve diversification within asset classes. For example, if you have significant exposure to bank stocks, and the banking sector has run particularly well, you may end up with an overweight position. You might decide to rebalance to other industry sectors to retain diversification across sectors. The same principle applies to country or regional diversification.

Rebalancing is called for not just when your asset allocation moves out of alignment with your risk profile, but also as your risk profile itself changes over time. For example, it's generally recognised that as an investor ages, capital preservation, income stability and risk management become relatively more important than they were in the investor's youth. As you approach retirement, you might seek to de-risk by decreasing your exposure to equities and increasing exposure to cash or bonds.

### **Portfolio rebalancing can feel counterintuitive**

One challenge in rebalancing is knowing when to do it and what to buy and sell.

Rebalancing often essentially involves 'selling your winners', which seems to go against an investing rule of thumb to 'take your losses and let your profits run'. That rule arguably applies more to individual stocks, which in some cases can show outperformance for long periods of time, than it does to asset classes. In the case of broad asset classes, however, there is typically a 'regression to the mean', in other words, periods of strong returns are often followed by periods of weak returns. For this reason alone, it can be prudent to trim exposure to asset classes that have run strongly for a period of time.

Research suggests that monthly or quarterly rebalancing is probably too frequent and can also involve excessive trading costs. It also is at odds with the fact that momentum within asset classes is often positive over periods up to 12 months.

By contrast, waiting several years is probably too long due to the regression to the mean principle.

A reasonable compromise is to rebalance around every 12 months. This also may offer tax advantages to eligible investors, as assets retained for more than 12 months are eligible for the capital gains discount when sold.

Another challenge is how to fund re-balancing, as selling one asset to buy another may realise capital gains and incur trading costs.

One option is to reserve income earned on existing assets to fund increased exposure to the desired asset. For example, dividends or distributions taken in cash, and income earned from cash and fixed interest investments, can be used to buy more stocks after a sharemarket decline which has reduced your exposure to equities, or conversely to increase your allocation to bonds/cash if equities have had a strong run and you find yourself with too much sharemarket exposure.

### **Individual stocks or bonds versus diversified funds**

When rebalancing, investors must decide between two broad options:

- buying individual stocks, bonds or other fixed interest investments, and
- investing in a fund or managed investment that offers diversified exposure to the desired asset class.

The challenge of buying individual stocks or bonds is that a lot of research may be called for, and to ensure you have sufficient diversification you will need to spread your funds across several products within the asset class, which can increase trading costs. There is also the risk that you may get the asset class 'right' but choose the 'wrong' investments within the asset class, resulting in underperformance.

Managed funds, Listed Investment Companies (LICs) or Exchange Traded Funds (ETFs) can offer broad diversification in one trade. ETFs also offer relatively low costs, for example, the ASX:A200 fund gives you broad exposure to the Australian market for an annual management cost of only 0.07% per annum.

ETFs can also allow you, in one or a few trades, to adjust exposure to international equities, or to sectors of the market, for example the Financials or Resources sector. For example, investors in technology can use ASX:NDQ, our NASDAQ 100 ETF.

The benefit of funds like these is that you don't have to pick which bank/mining/technology stock to buy. You get cost-effective, diversified exposure to the desired sector/region/market in one trade, making portfolio rebalancing simple to achieve.

ETFs also offer attractive options to investors looking to increase their allocation to more defensive assets. It is now straightforward to achieve diversified exposure to corporate or government bonds, assets that previously were hard for individual investors to access, meaning you don't have to restrict yourself to cash or term deposits offered by the banks. Two examples from our range are ASX:CRED which aims to generate income higher than that paid on cash, term deposits or government bonds. Its returns have also tended to be negatively correlated with equities, helping with portfolio diversification. Or the Active ETF ASX:HBRD where investors gain access to a diversified portfolio of hybrid securities.

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