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## Vanguard's Frank Kolimago on democratising investing

Graham Hand

*Frank Kolimago is Managing Director of Vanguard Australia. Previously, he was Principal at Vanguard's Personal Advisor Services. He has been with Vanguard for 23 years.*

**GH**: Many of our readers would be unsure what Vanguard's 'mutual' structure means, and how it influences your business decisions. Could you explain it, please?

**FK**: Vanguard has a unique ownership model that goes back to our founding in 1975 by Jack Bogle. A typical asset management firm is either owned by public shareholders or privately by a family office or individuals. Vanguard is owned by our mutual funds and ETFs which are in turn owned by the investors in those funds in the US. Jack Bogle believed it was a better way to align the interests of the firm with investors rather than having a tension where business decisions are made on behalf of outside owners versus investors. We have a clearer client alignment.

**GH**: Can you give an example of how it might influence your decision-making compared with say a listed company?

**FK**: The biggest proof point is the fund and ETF expense ratios have declined through history. Our weighted average expense ratio is now about 10 basis points (0.10%) for close to A$7 trillion of investments globally. In Australia, we've had a history of delivering fee cuts. The bigger Vanguard gets, the more we look to pass economies of scale to our investors. At the same time, it's not just about low cost, we want to deliver a world-class service experience.

**GH**: At your recent 10th anniversary of ETFs in Australia, you talked about 'democratising investing'. What does that mean?

**FK**: Democratising is giving investors the best chance of success. ETFs are a good example because they require low minimums to invest and at a low fee. A retail investor can get global diversification in a single trade. A few decades ago, such a solution was only available to an institutional pension fund. Now, mom and pop investors get the same benefits.

**GH**: Given Jack Bogle's pioneering role in index investing, how do you reconcile that with offering active funds?

**FK**: When Vanguard was established in 1975, our initial suite of investments was 11 actively-managed funds. So while the growth of indexing has commanded a lot of attention in recent years, active has always been an important complement. Vanguard manages about US$1.5 trillion in active strategies, or about 25% of our global investment base.

We think of it as a low-cost investing philosophy as opposed to a binary active versus passive choice. Some investors see the benefits of active to seek outperformance, but also an appreciation that active can have periods of underperformance. That's part of that trade off.

We also use 'sub advisory' (*Ed, external fund managers*) relationships when we think they have talent and a track record in their processes and philosophies. We partner with them and they get access to our broad distribution. Vanguard also runs portfolios in-house, for example, on the fixed income side. So it's not a source of any inner turmoil and we've been both active and passive throughout our history.

**GH**: Why hasn't Vanguard joined the move into active ETFs in Australia?

**FK**: Well, a technical point is we do have three active ETFs in Australia, in the form of 'factor-based' ETFs. We have a value-oriented, a minimum volatility and multifactors. It's a more quantitative approach but technically it's active.

In our product development agenda in the 23 years we've been in Australia, our roots were passive and managed funds in the first decade. In the second decade, we've built out the ETFs with newer structures, like ESG, in both ETF and managed funds forms. We don't rule out more active ETFs over time.

**GH**: Can you explain how you manage a global fund during the Australian time zone, where the underlying investments are not traded here but you issue and redeem ETFs during the Australian trading day?

**FK:** We have three trading hubs. One based in Melbourne, one in London and one in our headquarters in suburban Philadelphia, a town called Malvern. They give capabilities in the major regions when markets are open. The trading day begins in Australia, covering Asia Pac, then we hand off to our teams in the UK, and they pass positions to North America. We have the same processes, the same systems, the same structures, in those three markets as we 'follow the sun'.

**GH**: What happens if, say, a global fund owns Apple, Microsoft, Google, etc, which are not trading in this time zone?

**FK**: The pricing intraday on the local exchange is done by market makers who cover our ETF lineup, including global funds. Each day, Vanguard advises the market makers of the basket of securities used to price each ETF. The market makers take the end of day Net Asset Value (NAV) in US dollars after the US market closes. At the start of the day in Australia, the market maker converts that US NAV into Aussie dollars at the current spot prices. From there, they adjust the value the underlying securities using the movement of S&P500 futures which trades 24 hours a day to give the market maker a live value of the ETF. The market maker posts bids and offers throughout the Aussie trading day.

**GH**: So there are traders during the Australian and Asian day who are trading S&P500 futures, and the market makers do not trade in the individual stocks in the ETF?

FK: Yes, S&P500 futures is highly liquid and market makers have all the trading automated, and they make their money on the bid and offer spread. They may use other hedging techniques. We want to see our products at tight spreads with lots of liquidity so we encourage competition. The mom and pop retail investors coming in and out of our ETFs don't need to be concerned about the hedging process.

**GH**: One of your Australian team told me he used to work for an investment bank on Wall Street, and he said it's such a relief to work in the Australian operation of Vanguard. You have worked in many places around the world, do you see cultural differences between these locations?

**FK**: I've worked in four locations with Vanguard, Japan and Australia outside the US plus domestic sites at our headquarters plus our Western Region Service Centre in Phoenix, Arizona. I'm always amazed by the level of consistency in culture across Vanguard. When I started, we had about 2,000 crew members back in 1996. Today, there are over 18,000.

You need to maintain that culture. It's in the way we recruit, the way we onboard, the things we reinforce, client-focused alignment, a strong focus on ethics and values. The strong level of consistency includes things like respect and collaboration. But whether you're in Malvern, Pennsylvania, or Melbourne, Australia, it essentially feels like the same organisation.

**GH**: And what do you think about the differences between investment banking cultures and Vanguard?

**FK**: We sometimes use the phrase in the US, 'Wall Street sophistication with Main Street values' I'm not sure if that resonates with Australians, but we make sure of our ability to handle complexity while old-fashioned ways of doing things shouldn't go out of style.

**GH**: You ran the Vanguard Personal Advisor business in the US. I'm not sure what generic term you call it such as robo-advice or digital investing, but can you explain how that model works.

**FK**: Sure, we're excited about Personal Advisor. Vanguard had a legacy advice business dating back over 20 years. It was a traditional model with a human adviser but essentially telephone-based built in the early days of the internet. It was a bit of a niche offering, but then we saw rising demand from our clients. Many had built their wealth in a do-it-yourself capacity and they were asking for high-quality, affordable advice. The big driver was demographic, an ageing population with lots of wealth. Vanguard was helping with low-fee investing and education and guidance, but clients were facing more complex retirement decisions. Like do I have enough to retire? How do I preserve my assets? Will they last over a long retirement? How do I cover health care costs at the back end?

Based on that need, we researched how could we scale to meet the demand in a way that would be affordable with a high-quality interaction. We settled on a hybrid model that sits in the middle with robo-like technology but a human adviser is a key component. We call it a hybrid, which is not as glamorous as robo, but it now has about US$145 billion under management since May 2015. The interaction is virtual, telephone and video-based with an adviser who participates. We have a couple of interactions upfront to do the consultation, the collecting of the information, then there's a structuring of a plan for the client. If the client accepts that plan, they get enrolled, and then they have an ongoing relationship with the adviser.

A lot of the focus has been on the pre- and in-retirement audience, with 85% of the clients aged 50 and older and half are over 65. It costs 30 basis points (0.3%) for ongoing advisory, and the weighted average investment cost is under 10 basis points (0.1%). So it's advice plus investment with a human adviser and great technology when the traditional price for advisory fees alone in the US was over 1%.

**GH**: Does a client ring up a call centre and talk to whoever answers the phone, or do they receive a more personal relationship that develops over time?

**FK**: The initial engagement would probably start with the website, although they could consult with one of our contact centre reps. They would be directed to licensed advisers who have CFP and specialised skills. We use a team-based model for US$50,000 up to half a million but at US$500,000 and above, clients work continuously with the same dedicated adviser who brought them onboard.

**GH**: US$145 billion in four years is an extraordinary number in an Australian context. Do you know how much is new and how much came from other parts of Vanguard?

**FK**: The majority has come from existing Vanguard clients, but often they consolidate assets from outside of Vanguard, taking more into an advisory capacity. In the US, people have employer-sponsored 401k funds and they often roll them into the relationship. Our mutual model is dedicated to improving our capacity with existing clients and we have built our team to 775 advisers.

**GH**: It sounds like the only business model that will work for mass market in Australia under the new rules. What's the possibility of a rollout here?

**FK**: It's not in our current near-term plans. Our focus is on upgrading and modernising our current retail business and enhancing its digital capabilities. It will create a foundation to extend the business over time. Technology and our learnings mean we can do things in a more cost-effective manner than in the past.

**GH**: Last question, Frank. Can you see any global trends either in investing or advice that will materially impact Vanguard business over, say, the next decade?

**FK**: Sure. Here are a few 'lightning rounds'.

First, the accelerating pace of technology and the future without work or the future of work. Will technology automate work to a degree that will displace workers? And what will happen to portfolio management and financial advice? We think technology will help to automate many routine tasks. We already have portfolio construction and rebalancing and the creation of financial plans that's highly automated. But it gives the adviser more time to be more creative, more empathetic, and to invest more time in the relationship management. We don't think that technology will take humans out of the mix but they will focus more on a higher-order type work. We need to train people to have more of those 'soft' skills.

Second, the continued pressure on fees and the low-cost revolution. We've seen it on the investment product side, and we'll see it in other forms of financial services such as advice. We all need to embrace it, it's not something you can fight against, it's something that is inevitable. And developing business models that are efficient and cost effective where the value flows back to the client.

And the last thing is demographics and longevity. People retire, maybe in their mid-60s, and one member of a traditional couple could be looking at a further lifespan of 30 to 35 years. How do we structure portfolios that recognise such longevity? How do we help people who are doing different things over those decades? In the US, 10,000 Baby Boomers retire every day and we need to see that age wave coming and position ourselves to provide the best services and solutions.

*Graham Hand is Managing Editor of Cuffelinks. This article is general information and does not consider the circumstances of any investor. [Vanguard Australia](#) is a sponsor of Cuffelinks.*

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## Why the Reserve Bank will cut the cash rate twice more

### Bill Evans

This note confirms the forecasts we released on 24 July that the RBA will cut the cash rate by 25 basis points (0.25%) on 1 October and again by 25 basis points on 4 February 2020.

That call updated our previous call on 24 May when we were the only forecaster (Bloomberg Survey on that day) to argue that the cash rate would fall below 1%.

**We were feeling decidedly lonely with our October call**

Over the last few weeks, markets had lost confidence in the October view. On 13 September, markets priced an October move with a probability of only 26%.

Over the course of last week, markets have moved to an 80% probability of this move.

What changed over the week?

The most important development was the release of the September RBA Board minutes. We were encouraged by the sentiments in the minutes.

Following the release of the minutes I wrote:

*"The minutes of the Reserve Bank Board's September meeting contain similar themes to the August minutes but indicate that the Board acknowledges that it is getting closer to its next move on policy.*

*In August the Board minutes concluded that: "Having eased monetary policy at the previous two meetings, the Board judged it appropriate to assess developments in the global and domestic economies before considering further change to the setting of monetary policy. Members would consider a further easing of monetary policy if the accumulation of additional evidence suggested this was needed to support sustainable growth in the economy and the achievement of the inflation target over time".*

In these minutes there is no reference to previous actions. Arguably reference to previous actions is a clear sign that the Board is content to observe developments whereas not referring to previous actions there is less emphasis on the need to wait.

It is also interesting that the theme that drove the June and July decisions to cut rates: "the Australian economy could sustain lower rates of unemployment and underemployment" was repeated in these minutes whereas that particular theme was absent in the August minutes.

**Impacts on the monetary policy decision**

The minutes refer to three "developments that had a bearing on the monetary policy decision".

- The labour market – strong employment growth was recognised but the unemployment rate had remained steady at 5.2% (recall that the Governor has noted on other occasions that he would like to see the unemployment rate at 4.5%) and that wages growth "had remained low". Indeed, the minutes point out that "the upward trend in wages growth appeared to have stalled". We are aware that the Governor sees rising wages growth as the key to a sustained lift in spending growth and higher inflation. In addition, the minutes noted that "forward – looking indicators had continued to suggest that employment growth would moderate over the following six months".
- The housing market – it was noted that there was "a turnaround in established housing markets" but from the perspective of economic activity there was "further weakness in dwelling investment in the near term" and low turnover in the housing market meant that "spending on home furnishings and other housing related items was not expected to contribute to consumption growth in the near term".
- GDP growth – the Board meeting was held the day before the release of the June quarter national accounts. When the RBA released its forecasts on August 9 it was expecting GDP growth in the June quarter to be 0.8%; in the minutes it referred to an expectation of 0.5% due to the weakness of the partials in the lead up to the release. That forecast proved to be correct, but the minutes did note that "private final demand was expected to be weak". (In fact, it was flat in the June quarter and down 0.4% for the year! – "weak" is probably an overstatement of the state of final demand).

With two meetings now having passed since the last move and, from my perspective, most importantly, the key rate cut theme that "the Australian economy could sustain lower rates of unemployment and underemployment" returning to the narrative, our central view that there is no reason to wait until November for the next move still seems reasonable.

Westpac continues to predict cuts in the cash rate of 25 basis points in both October and February next year.

**Influence of the Fed**

The second development in the week was the decision by the Federal Reserve to cut the federal funds rate by 25 basis points.

While this was a widely expected move it would have emphasised to the RBA, that following with the previous week's move from the ECB global rates are falling.

Further, although there were apparent differences amongst Committee members the Chairman appears to be favouring policies that will maintain the expansion.

Chairman Powell saw "high value" in sustaining the expansion and was clear that "history teaches us it is better to be pro–active in adjusting policy".

This approach indicates to us that, given our forecast is that growth will slow below trend through late 2019 and in 2020 the Fed is likely to be decisive in supporting the economy.

**Implications of Australian employment**

Finally, we saw the Employment Report for August last week. Note that the minutes emphasised the labour market as continuing to be central to the policy outlook.

The August Employment Report would have been very disappointing for the RBA although it reported a 37.4k gain in total employment. That is because the unemployment rate rose to 5.3% from 5.2% in July – a disappointing development given the strong increase in jobs (recall the Governor's informal "target" of 4.5%, which he adopted when the unemployment rate was 5%).

It is important to remember how the results of the release are compiled. From the household survey, the ABS derives the various ratios on labour market performance; including the unemployment, underemployment, participation and employment to population ratios. These are which are then applied to an estimate of working age population to generate the level of employment, unemployment, underemployment and labour force.

Consequently, employment is likely to lift as population estimates pick up. This is why the recent softness in the labour market is being highlighted by rising unemployment rather than employment growth since those ratios in the household survey have been deteriorating.

The pace of growth in employment, and the change in participation, are correlated so it is not surprising that participation has lifted as employment remains robust – a strong labour market will bring more workers back into the labour force. But what is surprising this time is that the gains in participation are outpacing those for employment hence the trend rise in unemployment. This suggests that workers are entering the workforce due to a need for more income rather than only because employment conditions are improving.

If we focus on ratios, we can also see that the underemployment rate has lifted from 8.2% in June back to 8.6% in August.

We think the RBA is now firmly on board with this approach to assessing the labour market- strong jobs growth really reflects rising population and higher participation whereas the rising unemployment and underemployment rates are the true measures of the state of the labour market and its spare capacity. And of course, rising spare capacity puts downward pressure on wages growth (note in the minutes that the Board accepted that the upward lift in wages growth had recently flattened out).

**Is the next one in February?**

A realistic question is whether the follow up cut to the October move could come earlier than the February we currently expect.

One of the reasons why we argued consistently for October over the consensus view of November was that if global conditions deteriorated sharply near year’s end the RBA would like the flexibility to move again.

We think that the response of the Westpac Consumer Sentiment Index (down 4% in July as households seemed to be unnerved by consecutive moves) precludes another back to back move so going in October leaves available the flexibility to move in December. Waiting until November loses that flexibility.

We think the RBA would see the move to 0.5% as the low point in the cycle after which unconventional policies might be required. A prudent wait for that last move until early next year seems the most likely option.

Finally, Governor Lowe is scheduled to speak on the evening of September 24. His speech on May 21 effectively signaled the rate cut which was delivered at the June 4 Board meeting.

Markets will be closely watching that speech.

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*The forecasts given above are predictive in character and whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.*

## Business quality matters most

### Vihari Ross

In the future, when you wake up your hot coffee will be ready, the fridge will have reordered your groceries and a drone will already have delivered them that morning. A digital assistant will inform you it’s a little chilly outside and summon your autonomous vehicle to take you to the office. While there, you will collaborate in virtual reality with colleagues around the world, as high-speed internet makes the link-up as clear as real time. Later you will go to your friend’s 150$^{th}$ birthday party.

This might seem like science fiction, but it is a reality well underway to being created by some of the world's highest-quality businesses such as Alphabet, Amazon and Microsoft.

Our focus has always been on quality businesses. For us, this approach makes a lot of sense – by looking only at those companies that we consider have the best economics, we are setting our investors up for better outcomes as well as reducing the risk of material capital losses.

There are thousands of companies listed on world exchanges yet we regard our eligible universe of potential investments to be only about 150 companies. These are the businesses that we have deemed to be of sufficient quality to consider for investment, a hurdle that requires a rigorous dive into the economics of the business and the industry in which it operates.

**But what does quality mean?**

For us, the largest determinant of quality is the presence of an 'economic moat'; that is, a sustainable competitive advantage that protects the economics of the business and enables it to accrete value for its shareholders over time.

However, it's not just about identifying the existence of such an advantage, but also identifying what are the key factors driving that advantage and how dependent the business is on good management for generating these robust outcomes. Sometimes the truly strong businesses are revealed when even poor management teams are unable to undo their favourable economics!

If, however, businesses can be identified that have strong moats, have sensible management as agents of shareholder capital, possess the ability to invest capital at high rates of return and have predictable outcomes or discernible tailwinds that can be used to build conviction, then we are positioning our lens towards those businesses that are most likely to succeed. This is at the core of what our investment committee process seeks to achieve.

Of course, the subsequent step is to determine which of these stocks is then trading at a reasonable price, and then (subject to portfolio construction considerations, including risk controls) which high-conviction investments will be made at a point in time.

**Sustainability in moats**

The factors that drive an economic moat can be varied and evolving. The business might have a structural or size advantage that enables it to be the lowest-cost producer and beat its competitors on price such as Google can via the return on investment achieved by advertisers on its platform and can Lowe's, the US retailer of home-improvement goods. The business might own a unique brand or franchise that resonates with its customers, conferring it with true pricing power as has French luxury-goods conglomerate Louis Vuitton-Moët Hennessy.

A network effect or two-sided market is another source of moat that is incredibly difficult to unwind. This is evident in the platforms operated by payment networks such as Visa. In this case, the two sides – card users and card-accepting merchants – support the utility of the platform. That is, the more Visa card holders there are, the more vendors want to accept them, and the more places that accept cards, the more people want to use them. This network is self-reinforcing over time: since the first cards were issued in 1958 Visa's network has grown into a business that intermediates more than US$11 trillion in global payments spent via 3.3 billion cards issued by 16,000 financial institutions connected to 50 million merchants worldwide.

**Identification of risk**

Equally important to this discussion, however, is the question: Are the advantages we have identified sustainable? This is a critical piece of our analysis as our assessment of quality must be forward-looking. It might be tempting to look at history alone and see which businesses have had the best returns on capital over time, but this might prove to be a poor guide as to the business's future.

Identifying quality goes hand in hand with identifying risk. Disruption, though an emotive word, whether driven by changing technology or changing consumer preferences, in reality simply reflects the way people are now and will in future live their lives.

The earliest two-sided markets were newspapers, where greater readership encouraged greater advertising sales upon the limited real estate of the printed page. Only one side of such a market needs to be disrupted for the network to collapse; in this case, as we all know, it was the movement of readership onto online platforms and away from print.

Advantages related to the low-cost labour in certain countries are being disrupted as the cost of capital goods declines rapidly. A robotic palletiser used to move product from distribution centres through to supermarket shelves now costs only US$25,000 compared to US$1 million five years ago. This means that for many multinationals seeking to cut costs, it now makes sense to replace low-cost labour in emerging economies with low-cost capital – a remarkable shift in relative advantages. Unilever, for example, added 1,000 robots to its cohort in the last year and intends to grow this to a fleet of 10,000 in coming years. Nike is investing in localised manufacturing, intending to autonomously produce customised footwear on demand.

And, of course, Amazon has changed the playing field for retailers and goods producers alike in its ongoing drive to lower prices and usurp commoditised brands with its own.

Further, there is indeed a plethora of other disruptive factors at play, including cloud computing, the dominance of social media, growth in on-demand video content, the trend towards health and wellness, and automated manufacturing and advancement in artificial intelligence technology among many others that require careful analysis of the implications for businesses.

It is important to identify whether or not a company will be a winner from these changes, be immune or be threatened and, if the latter, will it suffer a mere speed hump or face an existential threat to the moat around its business? Some of these identified risks might take 10 or 20 years to play out.

At Magellan, this focus on quality businesses such as Alphabet, Amazon, Microsoft and others represents the core of our investment philosophy and goes directly to achieving our investment objectives of absolute returns coupled with capital protection for investors.

*Vihari Ross is Head of Research at Magellan, a sponsor of Firstlinks. This article is for general information only and is not investment advice. It does not consider the circumstances of any investor.*

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## It's the best time ever to be a giant company

### Ben Inker

The largest companies in the U.S. have seen marked improvement in their profitability on a number of measures over the last 30 or so years, while smaller companies have seen little change. The improvement for the largest companies is probably due to increasing market power and a playing field that has tilted in their favour.

It is my guess that the field may tilt back away from them in a way that will hurt their profitability in the future. But the safer bet is that the process will be slow and uncertain. Given that our valuation models assume margins revert relatively quickly, we may well be a little too tough on these companies, but even giving them the full benefit of the doubt on their future profitability would still leave them looking expensive versus the rest of the world.

**The last decade of global equity performance**

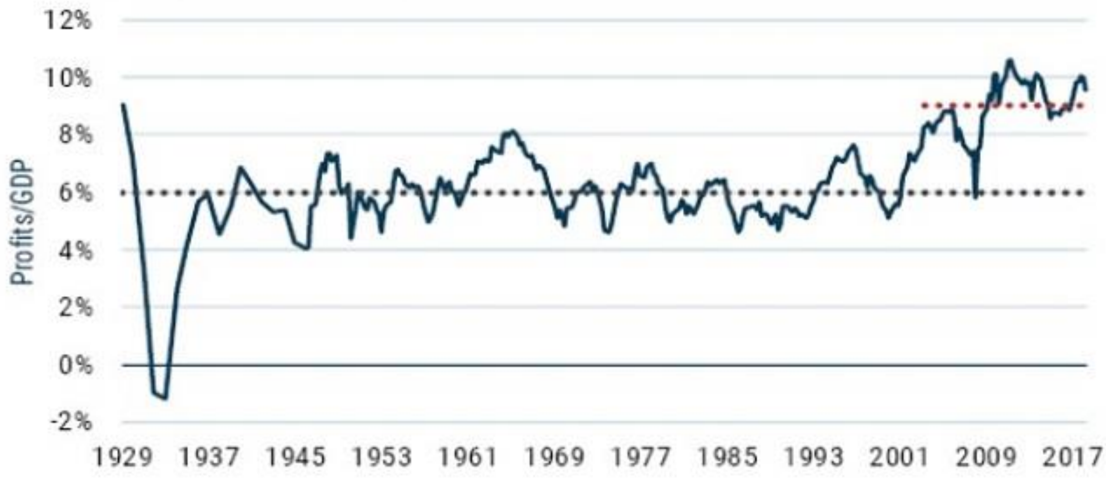
If you will accept a little oversimplification, the last decade or so of global equity market performance can be summarised as follows. U.S. stocks have profoundly outperformed stocks in the rest of the world, whether other developed markets or emerging markets. This outperformance has been partially driven by U.S. P/E ratios expanding more than in other markets. But the largest driver of the outperformance has been the massive superiority of earnings growth in the U.S. relative to anywhere else. This superior earnings growth has been driven not so much by strong top-line growth, but by expanding profitability by U.S. companies relative to sales, gross profits, or other measures that can plausibly be used as proxies for economic capital.

Unlike in past cycles, this rising profitability seems to have been neither a result of, nor a driver of, increased corporate investment. The improvement in profitability has occurred only in the largest companies. These companies have been out-earning their smaller brethren by increasing margins over the past 25 years or so.

The long period of their improvement suggests this effect is not something we should expect to correct over a single business cycle, but my guess is that the world in the future will be less favourable to these large, dominant companies.

For a long time, U.S. corporate profits seemed to be an exceptionally well-behaved. Exhibit 1 shows corporate profits relative to GDP in the U.S. since 1929, with dotted lines marking the average level across the 20th century and the period 2004 to 2019.

**EXHIBIT 1: U.S. CORPORATE PROFITS/GDP**




*As of March 2019 | Source: Federal Reserve*

*Note: U.S. Corporate Profits after tax with IVA and CCadj.*

Up through the 2001 recession, this series was remarkably mean-reverting, with the expected fluctuations across the business cycle and the only outlier occurring in the depths of the Great Depression. Sometime around 2004, however, this series experienced a decided upward shift and since then has averaged 9% of GDP versus the 6% average for the 20th century. Though it has maintained its cyclical variations, the series seems very clearly to have been varying around a different mean.

This shift, as profound as it seems to have been, has not actually been that widespread among companies. Exhibit 2 shows a conceptually similar series, profits as percent of value-added for corporations. It isn't exactly the same as profits/GDP, but it is available on an individual company basis.

**EXHIBIT 2: PROFITS/VALUE ADDED FOR U.S. COMPANIES BY MARKET RANK**


*As of 7/31/19 | Source: GMO, Worldscope*

Exhibit 2 shows that the increase in profitability has not been evenly distributed. With the number of lines on the chart, however, it's probably easier to understand the magnitudes in table form.

TABLE 1: PROFIT/VALUE ADDED AVERAGES ACROSS PERIODS

| | Top 50 | Next 450 | Next 2500 |
|---|---|---|---|
| 1986-1995 | 15% | 13% | 11% |
| 1996-2005 | 20% | 14% | 10% |
| 2006-2019 | 24% | 18% | 11% |
| | | | |
| Improvement since 1986-1995 | 62% | 37% | 5% |

As of 7/31/19 | Source: GMO, Worldscope

The top 50 companies really started to distance themselves from the pack by the late 1990s and today have opened a huge gap on the rest of the listed universe. Smaller companies, by contrast, have seen little or no change over the period, which leaves the large majority of public corporations in the U.S. enjoying no benefit from the greatest advance in overall corporate profitability in U.S. history!

**The impact of business investment on profit**

Until the early 2000s, there used to be a meaningful relationship between profits and investment – high profits were associated with high rates of investment and low profits the opposite. The correlation between them was about 35%. But just at the time that the profit series made its lurch upward, net business investment made a lurch downward, from which it has not recovered.

On the face of it, this is extremely odd. If profitability is high, corporations should naturally respond by increasing investment. While in principle this tendency could be stopped by there being a particularly high cost of capital, it is pretty obvious this has not been the case over this period. You certainly couldn't describe the period since the early 2000s as being a high-cost environment for raising equity.

It has also not been an expensive time to raise capital through borrowing. Exhibit 3 shows the yield of Baa corporate debt, which again has been conspicuously low in this period.

EXHIBIT 3: BAA CORPORATE BOND YIELD


As of June 2019 | Source: Moody's via Federal Reserve Bank of St. Louis

Why would we have a combination of enhanced profitability and decreasing investment? The most plausible answer seems to me to be that increased industry concentration and market power by the largest companies means the bulk of their profits takes the form of economic rents in the businesses in which they are dominant. Because the firms are already dominant in their spaces, there may not be a lot of expanding they can do short of branching out into new business lines, where their position will likely not be as dominant and their profit margins far less enticing.

The investment opportunities of these extraordinary companies do not seem to have grown on pace with the economic rents they are capturing in their current business. And the rest of corporate America is not profitable enough to justify ramping up its investment.

What does that tell us about the future of growth and profits in America? The plus side of low rates of investment is that it means less chance of overcapacity, which pushes down profit margins, being created. The minus side is, of course, slow growth. While it is probably unfair to entirely blame the slowdown in U.S. productivity growth on the fall-off in corporate investment, the period since 2005 has been a uniquely dismal one for productivity growth in the U.S.

**What does this tell us about their future prospects?**

It's hard to look back at history to determine how we expect the future should evolve for them. The trend has certainly been in their favour and absent any change in the environment it is tempting to assume things will continue to get better for them.

There are a couple of potential flaws in that reasoning. No company's competitive position is safe forever. Today's champions have certainly done well historically, but the history of dominant companies shows that their extraordinary profitability tends to decay over time. That decay may be slow or rapid depending on the company.

For the most stable dominant companies, such as the ones favoured by our Focused Equity team in the GMO Quality Strategy, history suggests that their profitability decays to normal over something like a 30-year period. Now, 30 years is a long time to benefit from above-average profitability, justifying a significant valuation premium over average companies. But from the standpoint of forecasting the future profitability for such companies, it argues for a *slow* reversion rate for profitability, not *no* reversion.

The question is really whether the environment that has favoured these dominant firms is likely to remain so biased in their favour. My guess is that it is not. The recent announcement of anti-trust investigations against the largest technology and related communications firms seems unlikely to be a one-off. Apart from the simple issue of their growing dominance and staggering profits, the negative societal and privacy impacts of their basic business models make it harder to paint them as plucky upstarts improving the world and easier for critics to characterise them as disturbing big brother entities feeding off the worst instincts of humanity. Health care companies face a similarly daunting level of unpopularity, driven by their pricing practices combined with the striking disconnect between the amount the U.S. spends on health care versus the rest of the world and the health outcomes that spending seems to deliver. The growing interest in academia and beyond in studying the deleterious effects of large firms beyond looking at the direct impact on consumer prices also suggests a broader push against dominant firms on principle is increasingly likely.

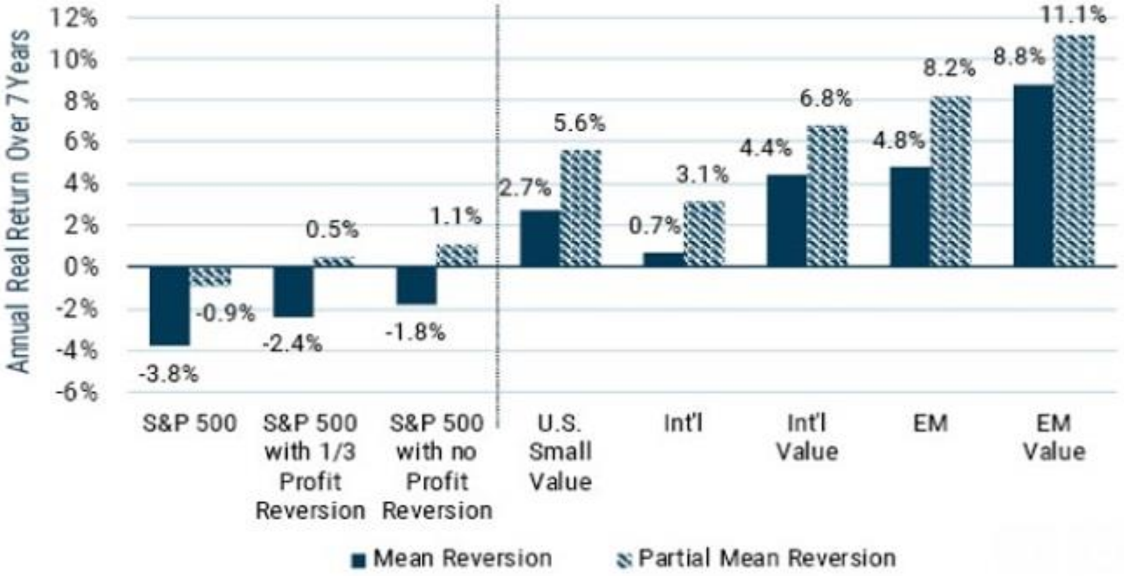
If we took the stance that the next seven years would see a one-third reversion of the trend of large company margins back to their long-term average, our forecast for the S&P 500 would improve by 1.4%. Given that our current forecast for that group is -3.8% and -0.9% on our two base scenarios, that assumption would raise the forecast to -2.4% and +0.5%. That is enough to shrink the U.S. 'margin of inferiority' relative to other equities, but still leaves it at the bottom of the equity barrel.

Exhibit 4 (next page) shows the forecast for the S&P 500 with and without the potential changes relative to some of our favourite equity assets.

The groups we are excited about within global equities – U.S. small value, international developed value, and, above all, emerging markets value – are all at least at a 4.5% higher forecast return in the friendliest version of the forecast for the S&P 500, with EM value a stunning 10% to 10.6% higher.

For the moment, we are not making any changes to our 'official' asset class forecasts despite a guess that we are being a little tough on the U.S. mega caps. Our preference is to not make one-off adjustments to our forecasts but look for the broader principle behind an issue and find a way to systematically build it into our models.

EXHIBIT 4: S&P 500 VS. OTHER EQUITY GROUPS




*As of 6/30/19 | Source: GMO*

*Ben Inker is Head of Asset Allocation at [GMO](). This article is general information and not financial or investment advice, and it does not consider the circumstances of any investor.*

*To read GMO's full 2Q 2019 Quarterly letter, [click here]().*

## Invest more in mining to deal with climate change

### Michael Salvatico

Investors have been the target of political pressure because they acknowledge and intend to manage climate risk. The criticisms are largely unfounded and have been refuted by investment and legal practitioners. Australia's difficulty managing climate risk is the result of vested interests that have led to years of insufficient action and weak policy. Many of the comments regarding investors motives are misleading and not reflective of the principles of responsible investing, especially in relation to mining.

**Australia needs more mining with one exception**

Our large land mass is rich with minerals that make the world turn. Australia benefits from the global demand for our minerals. Responsible investors and advocates of sustainable growth support mining when conducted under global best practice environmental, social and governance (ESG) guidelines, with one standout exception, the extraction of fossil fuels for power generation.

Responsible investors are not anti-mining, but they are most concerned about thermal coal-fired power and the risk of a devaluation of coal assets leaving investors stranded. Ironically, coal itself is not the problem. As Dr Phil McFadden, former Geoscience Australia Chief Scientist declared, the problem is what we do with it. We burn it. Avoiding thermal coal power generation is key to reducing mankind's impact on climate change. Thermal coal is one of the most carbon intensive methods of producing power.

Significant reductions in global carbon emissions are required if we are to keep average global temperatures from rising beyond 2 degrees.

Australia can stop mining thermal coal for power and remain a global mining powerhouse. Australia produces a lot of thermal coal, but the economics demonstrate that Australia can benefit more from mining the minerals required to produce renewable energy materials and infrastructure.

Investors must think carefully about the long-term decisions that are made today as we cannot mine everything all at once. Australia needs to be strategic about where resources are allocated and what is mined as it will determine the quality of our future. Australia approved coal mining in the Galilee basin, which some have declared uneconomic, while other countries such as Germany are kissing the last of their mined coal goodbye.

**Political consensus but disagreement on how to act**

The argument to manage climate risk is pervasive and the message from science is clear. In addition to the consensus amongst scientists, all three Australian financial regulators acknowledge climate change as a material risk. In Australian politics, the Labor Party has been transparent with its views on climate change, and the Liberal Party has acknowledged "the science of climate change" and support "national and global efforts to reduce greenhouse gas emissions" (see Emissions Reduction Fund Green Paper 2013).

Given the political consensus, it is a shame that climate change becomes a divisive federal election issue. The solutions required span many election cycles. Australia needs stable policy that lives beyond the election cycle. Australians should campaign to create an independent body that addresses our country's climate change needs for the long term, rather than leave it to the government. Such independent bodies exist for other critical economic roles, such as the Reserve Bank of Australia.

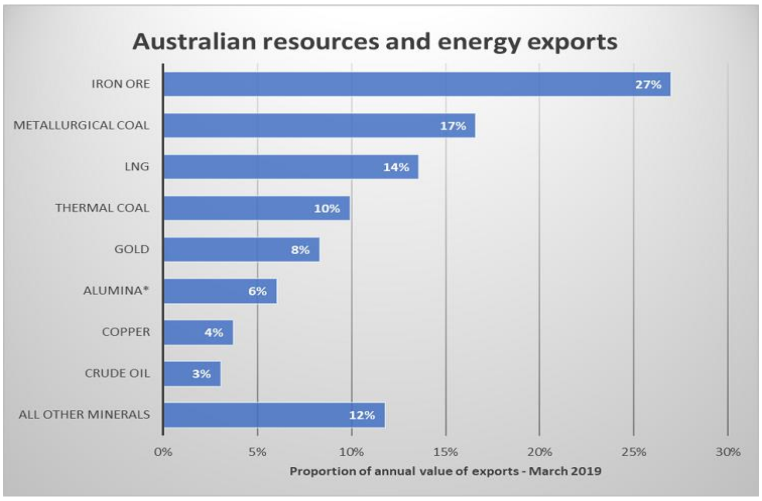
Australians have little time to waste and cannot afford to make poor investment decisions. In June 2019, Australia was heavily criticised by the European Union on its ability to meet the Paris commitment given the reported projections and existing policies. More troubling is that the targets set by Australia are insufficient to contain global temperature rises to 2 degrees. The current Paris commitments would see the world exceed a 3 degree rise in global temperatures by 2100. Five times more effort to reduce emissions is required to limit global temperature rises to 1.5 degrees, says Dr Joëlle Gergis.

**The roles of companies and investors**

Companies have a role to play in reducing emissions and investors are monitoring company progress in managing climate risk. Recent MSCI ESG Research found that approximately 40% of the MSCI AU200 Index companies are not on track to meet Australia's carbon target, published in "Alignment to climate regulatory scenarios: A case study of Australian companies".

Responsible investors analyse more than just the fossil fuel reserves. Assessments of the mining operations include reviews of the impact on the environment and local communities. Some companies are better than others at managing the environmental impact of their operations and ensuring the safety and security of their work force and customers. They have robust strategies in place to manage climate risk. Investors who integrate these impacts into their investment decisions review the strength of management and performance to targets.

So responsible investors are not demanding Australia shut up shop and stop mining. Rather they desire the government provides a strategy and stable policy to rapidly transition from thermal coal mining to mining other minerals.




*Data source: Australian Government – Department of Industry, Innovation and Science | Chart notes * Alumina includes exports of Bauxite and Aluminium Ingots*

Australia's annual resource and energy exports totaled $228 billion as at March 2019. The five largest contributors were iron ore (27% of the total), metallurgical coal (17%), LNG (14%), thermal coal (10%), and gold (8%). Australia is by far the largest seaborne exporter of metallurgical coal globally and the second largest exporter of thermal coal.

The need to transition from thermal coal is supported by declining global demand. World thermal coal consumption peaked in 2013, while Australia has increased thermal coal exports by 76% in the last 10 years. Australia is making progress at a fast pace, but in the wrong direction.

The transition away from thermal coal energy to renewable energy could benefit Australia's mining industry. Professor Martin Green from the University of New South Wales suggests the economic benefit could be five times greater for Australia to replace the thermal coal mining with the equivalent minerals required to produce solar panels for the same quantity of electricity. These minerals include iron, metallurgical coal, alumina, copper and cobalt. The chance is now to reset the compass.

This renewable energy opportunity aligns well with the recently published Australian National Outlook 2019. The report foresees the opportunity for Australia to generate and sell energy generated from solar power to the rest of Asia, becoming the regions renewable energy hub.

**Climate change high on investors' agenda**

Investors globally are solving for climate change risks and opportunities. As an indication of the priority given to climate change, a third of the breakout sessions at the recently held 2019 PRI (Principles of Responsible Investing) conference directly referred to climate change in the title. Investors can engage companies on physical and transition climate risk issues, reduce their investment or divest. They can also identify opportunities to invest in profitable solutions that provide positive outcomes. A focus on renewable energy would meet Goals 7 and 13, affordable clean energy and climate action, of the Sustainable Development Goals, which have been adopted by a growing number of companies and investors.

The Investor Group on Climate Change (IGCC) points to the increased involvement of investors and their desire to manage climate change. The survey indicates a strong increase in the proportion of investors implementing low carbon strategies from 54% in 2017 to 90% in 2018. Some local investors who are broadly managing climate risk with low carbon strategies include New Zealand Super, Vision Super Australian Ethical, and Christian Super, while Local Government Super apply materiality screens to fossil fuels and HESTA restricts investments in new thermal coal.

The investor action on climate change is not just an Australian phenomenon. Investors including Norway's Sovereign Wealth Fund, UK EAPF, AP4 and CalSTRS are implementing low carbon strategies or divesting from coal.

However, more needs to be done to educate investors on the financially material risks of climate change. Slightly more than 40% of superannuation funds believe that climate change was financially material in APRA's survey from 2019. That leaves a large proportion of funds that are not currently concerned.

Climate change transition risk could occur rapidly due to changing policy and technology. Markets could be caught by surprise. The survey found that 'Reputational' topped the list of climate risks, while 'Regulatory and Energy' ranked lower. Arguably the latter two should be of primary concern as they could materially impact company performance. In a scenario were carbon emissions were regulated and priced, thermal coal could be rapidly devalued and investors would be left with a stranded asset.

Australians hold the key to supporting superannuation funds initiatives to protect their assets from climate risk. Contacting superfunds and supporting better climate risk management would help them stand up to the political criticism, putting Australia on the right path to become a renewable energy leader.

*Michael Salvatico is Executive Director at MSCI ESG Research.*

## The how and why of investing in commodities

### David Bassanese

Commodities are one of the building blocks of a balanced portfolio.

In basic terms, commodities are goods that are either grown, or dug out of the ground. They are often used as inputs in the production of other goods.

Commodities are broadly categorised as *hard* or *soft*:

- Hard commodities are natural resources that are mined or extracted, such as gold, copper and oil.
- Soft commodities are things that must be grown and tended to during production. They include agricultural commodities such as wheat, sugar and cotton, and livestock.

**Why invest in commodities?**

The reasons to include commodities in your portfolio include:

**1. Low correlation with other asset classes**

Most investors are familiar with the idea of gold as a 'safe haven' in times of uncertainty or crisis. Commodities more broadly can bring potential diversification benefits to a portfolio, as their performance historically shows a low correlation with other major asset classes such as equities, fixed income and cash.

The table below shows correlations with other assets since 2000, as represented by:

- the S&P GSCI Light Energy Index (commodities)
- the S&P 500 Index (U.S. equities), and
- the Bloomberg Barclays Global Aggregate Unhedged USD (bonds).

The S&P GSCI Light Energy Index includes commodities from all commodity sectors (energy products, industrial metals, agricultural products, livestock products and precious metals).

**Commodities/U.S. equities/global bonds correlations, 2000 - 2019**

| Correlation (Aug 2000 - Jun 2019) | | | |
|---|---|---|---|
| | Commodities | U.S. Equities | Global Bonds |
| Commodities | 1.00 | 0.28 | 0.04 |
| U.S. Equities | 0.28 | 1.00 | -0.02 |
| Global Bonds | 0.04 | -0.02 | 1.00 |

*Source: Bloomberg. Past performance is not an indicator of future performance.*

**2. Benefit from demographic trends**

Ongoing demand for commodities is supported by rising populations and demographic trends.

Infrastructure programmes in emerging economies, for example, support demand for materials such as iron ore, used to make steel, and other materials.

The demand for agricultural products is supported not just by rising populations but also by increasing living standards. The composition of food demand changes, and, increased demand for protein rich diets such as meat and dairy means more grain is required to feed livestock.

With a growing global emphasis on renewable energy, agricultural resources are also in demand for the production of bio-fuels.

**How to gain commodities exposure**

There are essentially four ways to invest in commodities:

**1. Investing directly**

Investing in commodities directly tends to be impractical and costly. Few investors want to take delivery of tonnes of wheat or barrels of oil!

An exception might be precious metals such as gold, which can be held in the form of gold bullion. However, while a few gold bars take up little space, there are insurance and storage costs, and often high minimum investment levels.

**2. Investing in commodities futures**

Traded on exchanges around the world, commodities futures are standardised contracts to buy or sell the underlying commodity at a specified date in the future. They are used by hedgers and speculators.

Investing in commodity futures is not the same as investing in the 'spot' (current market) price of the commodity. While spot and future prices are strongly correlated, factors including expected future supply and demand, interest rates, and storage and insurance costs mean they are unlikely to be exactly the same.

Investing in commodity futures has its drawbacks. A futures trading account is needed, futures typically have large contract sizes, there are administrative demands around margining, and not least, buying and selling futures involves open-ended risk.

**3. Investing in companies that produce commodities**

Another option is to invest in commodity-producing companies.

While such companies may be rewarding investments, this is the least 'pure' commodity exposure on the list. There are many factors that affect the return on an investment in a commodity producer, over and above movements in the price of the commodity itself.

One option for investors who are interested in producers is an Exchange Traded Fund that holds a diversified portfolio of companies involved in the production of commodities. While the exposure is still not a 'pure' commodity exposure, it means that single-stock risk is reduced.

An example of this type of fund is BetaShares' Global Agriculture ETF – Currency Hedged (ASX:FOOD) which provides exposure to the largest global agriculture companies (ex-Australia), hedged into Australian dollars.

**4. Investing in commodity ETFs**

ETFs provide a convenient, cost-effective way of gaining exposure to commodities.

There are several things to consider before investing in a commodity ETF, including:

- Do you want exposure to a single commodity, or to a basket?
- How does the ETF create exposure to the underlying commodity?
- Is the exposure currency-hedged?

Single commodity exposure versus basket

Some ETFs provide exposure to a single commodity, such as gold or oil.

Others provide exposure to a basket focused on a particular type of commodity, such as precious metals or agricultural commodities, or a more broadly diversified basket.

For example, BetaShares' Agriculture ETF – Currency Hedged (synthetic) (ASX:QAG) provides exposure to a basket of the four most significant agricultural commodities (corn, wheat, soybeans and sugar).

How is exposure achieved?

Relatively few ETFs gain their exposure by holding the physical commodity itself. Among the few exceptions to this rule are ETFs that provide exposure to precious metals, such as our Gold Bullion ETF – Currency Hedged (ASX:QAU), which is backed by bars of gold held in a vault in London.

Most commodity ETFs, however, do not directly track the price of the commodity. Instead they aim to track an index based on futures contracts over the commodity.

While commodity spot and futures prices are highly correlated, you should not expect an ETF based on commodity futures to provide an identical return to holding the physical commodity itself.

As futures contracts mature, the futures position must be 'rolled' into a contract with a later maturity. The continual process of rolling means that the return from a synthetic ETF is based not just on movements in the price of the commodity, but also on the 'roll return'.

With an ETF based on commodity futures, BetaShares invests the fund's assets into cash, which is held by a custodian, and enters a swap agreement to receive the performance of the relevant index. ETFs that use this type of structure are labelled 'synthetic'.

We are asked sometimes whether the synthetic structure means increased risk. It is true that a synthetic ETF has a level of 'counterparty risk' to the issuer of the swap but this should be kept in context. BetaShares imposes a 'zero exposure threshold' on counterparty exposure. This means that we revalue the swap agreement on a daily basis, and require that where the counterparty owes funds to the ETF above a certain threshold, payment is made promptly to reduce the exposure to zero. In any event, the ASX's rules require that counterparty exposure be managed so it does not exceed 10% of a synthetic ETF's net asset value.

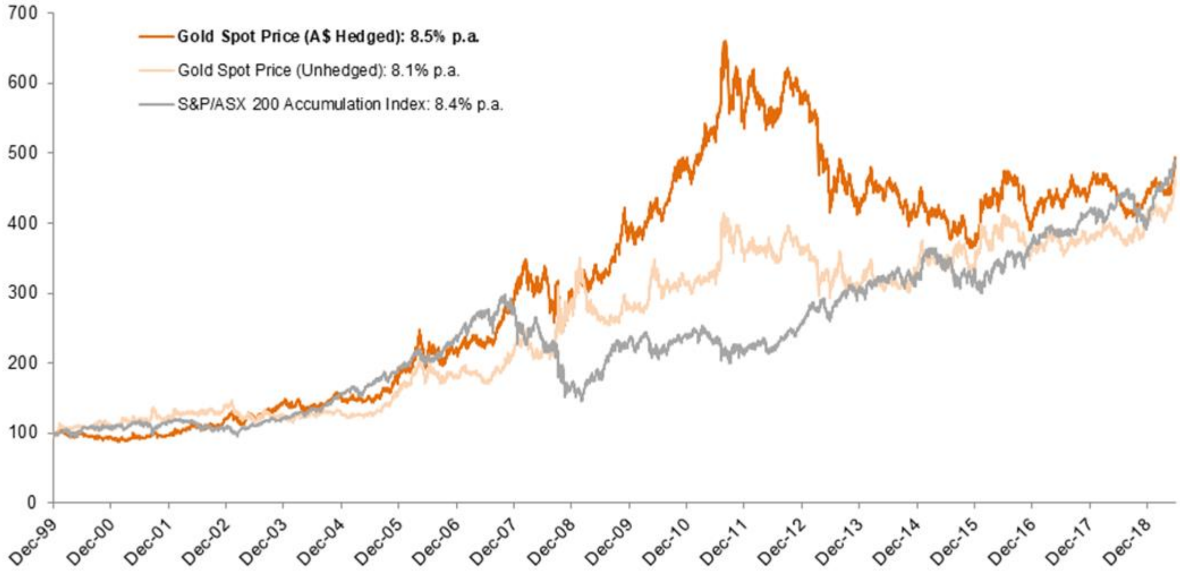
We also apply strict criteria in selecting our counterparty. Our counterparty is Credit Suisse International, part of one of the world's largest financial institutions.

**Check the currency hedging**

Commodities are traded in USD. If your exposure is not currency-hedged, you are exposed to the risk of unfavourable movements in the AUD/USD exchange rate, which can have a significant impact on performance.

The following chart shows the difference in performance between gold in AUD terms and USD terms.

**Gold Bullion spot price performance Hedged vs. Unhedged: December 1999 – June 2019**




*Source: Bloomberg. Past performance is not an indicator of future performance.*

BetaShares currency hedges all its commodity ETFs, meaning that performance is determined by price movements in the commodity (or commodity futures) and not distorted by exchange rate movements.

*David Bassanese is Chief Economist at BetaShares, a sponsor of Cuffelinks. This article is for general information purposes only and does not consider the investment circumstances or needs of any individual.*

*For more articles and papers from BetaShares, please click here.*

## Media worth consuming - September 2019

Jonathan Rochford

**Finance**

FedEx shares slumped after it cut its earnings outlook citing global economic weakness. The global credit impulse points to better growth in the first half of 2020 after a tough second half of 2019. The car industry is dragging global trade and industrial production into a contraction. Global demand for diamonds is collapsing. S&P 500 earnings are well above US corporate profits, just like they were before the Tech Wreck. US small cap earnings per share estimates have gone negative. US IPOs in 2019 are more unprofitable than ever.

Europe's biggest economies voted against further ECB monetary stimulus. Austria is calling for the ECB to lower its inflation target. Denmark is passing on negative interest rates to retail depositors. The ECB is going to pay some banks a higher rate on their deposits than on the loans it gives them. Four reasons for the ECB to raise interest rates. The ECB will soon breach its existing issuer concentration limits under the new QE scheme, but it is telling European nations to start running deficits so it can buy their bonds. As central banks keep cutting rates, macro-prudential tools become ever more important.

Despite Keynesian stimulus being associated with slower long term growth, central banks and governments keep trying it. Larry Summers sees cutting rates as counterproductive in dealing with secular stagnation. The ECB will do more harm than good by taking stimulatory actions with its problem too much stimulus not a lack of it. The ECB is targeting a lower exchange rate and risks America fighting back with trade sanctions.

The US government has $125 trillion in unfunded liabilities. The US budget deficit is even bigger this year, but higher spending not tax cuts are to blame. Illinois recorded a $47 billion deficit after it included an accounting adjustment for healthcare liabilities it had been hiding for years. Cities in Illinois are having their revenues garnished for pension plan payments. Canadian provincial debt has been growing rapidly and is heading for trouble.

Deutsche Bank is being investigated for buying back its own subordinated securities without regulatory approval. JP Morgan's precious metals trading desk is charged with systemically manipulating markets over eight years. American credit card issuers are facing litigation over interest rates higher than allowed in state based usury laws. A former KPMG partner has been sentenced to one year in jail for stealing information from the audit regulator. Amazon's relentless pressure for cheap and quick delivery is killing Americans.

Moviepass is shutting down after subscribers to its all you can watch movie service watched too many movies. The demise of Blue Apron is a lesson for other unicorns without an economic moat. Overstock has crushed short sellers by issuing a dividend in cryptocurrency. Silicon Valley blasted a venture capital investor for daring to call out a failed venture as a bad idea. What happens to the US real estate market if WeWork files for bankruptcy? Banks are getting worried about a $500 million credit line they provided to WeWork's CEO. Softbank's CEO has 38% of his shares used as collateral by 19 different banks.

A lot of things must go right for high yield debt to deliver decent returns from here. Mitsubishi has lost $320 million on oil trades made by a rogue trader. Reliance Capital has been downgraded to default after payments to its debentures were delayed. Moody's has downgraded Ford to Ba1. Santander checks the income of only 3% of its subprime auto loan borrowers. American banks are adjusting their credit criteria as they have run out of creditworthy consumers to lend to.

The small recent outperformance of value stocks might be the start of a turnaround, with value as cheap as it has ever been. The argument that value investing died long ago due to changes in book value accounting. Mining stocks are trading at their cheapest valuation in a century.

Michael Burry sees similarities between today's index funds and 2007's subprime CDOs, but there are reasons not to worry about index funds. The average American IPO slightly outperforms the market but the median IPO substantially underperforms. 11 myths about Australian franking credits.

Memorable quotes from the late T Boone Pickens. How David Swensen made Yale rich. An even-handed review of Jim Grant and his newsletter. Hedge fund Autonomy Capital lost $1 billion in a month on Argentinian investments. The ongoing argument about whether subscription credit lines are excessively inflating IRRs on private equity investments. Hedge fund strategies are more correlated than ever. The basics of the explosive growth in private credit. Even the Federal Reserve is warning about illiquid assets being held in open ended funds.

The blow-up at Japan's Shimane Bank points to the eventual outcome of taking more risk to offset negative interest rates. Even at close to zero interest rates Japan's rural businesses won't borrow because they have little demand for their goods and services. Japan has virtually no high yield bond market as Japanese banks are desperate to lend.

With twin deficits, China now needs international investment and is cracking down on foreign currency transfers. China has eased its bank reserve ratios again. Has China's enormous growth in bank assets been a massive helicopter money experiment? Bank of Jinzhou will stop paying dividends on its preference shares (Coco's/hybrids). For the first time, a Chinese local government finance vehicle has skipped a call date. China's private bonds are defaulting at record pace. A HNA owned airport has defaulted on its bonds.

Argentina's opposition blames the IMF for the financial mess. An Argentinian explains why her country keeps defaulting. Argentina's provinces have $15 billion of debt that might follow the national debt into bankruptcy. The recently imposed currency controls discourage commerce, making a significant downturn likely. The country's bond investors are looking to get around capital controls via the "blue-chip swap". Argentina's default has exposed the gaping logic gap in MMT.

Reckless consumer lending in South Africa has seen 40% of borrowers default. Zimbabwe hiked interest rates to 70% in a failed attempt to stop hyperinflation. Greece is offering its banks $10 billion in guarantees to offload bad debts.

**Politics & Culture**

Trump's IT team trolls "President" Hillary Clinton with webpage error "you are looking for something that doesn't exist". Hillary Clinton's campaign rallies lead to a greater increase in hate crimes than Trump's. A woman has dropped her lawsuit claiming Trump forcibly kissed after video footage of the incident emerged that refuted her allegations. Trump has poor legal prospects if he tries to sack Jerome Powell. The Democrat Presidential debates have been silent on America's inability to afford free stuff. In 1987, Bernie Sanders admitted that Medicare for all "would bankrupt the nation". Democrat socialists love to point to Sweden as an example, but its socialism included eugenics. The forgotten dangers in demanding that politicians "do something".

YouTube has gone on another purge of alternative and right wing publishers. YouTube let Infowars open its channel again, then shut it down 17 hours later. A US Government department has ordered Google to live to up to its claims of having an open and tolerant culture. Twitter has suspended four major Cuban news networks without giving a reason. The New York Times claims it made an "editorial error" in publishing accusations against Brett Kavanaugh that the alleged victim doesn't remember happening.

A boat carrying a team making a documentary about global warming became trapped in artic ice. Yale scientists got upset about a cartoon casting doubt on climate science, so they made a video that accidentally proved the points the carton was making. NBC asked viewers to "confess" their climate change shortcomings and many have taken great pride in doing it. A survey found that Canadians are all for taking action on climate change, unless it costs them and another survey found that the majority of people in the US, Australia, China, France and Germany don't believe that humans are mainly responsible for climate change. An experiment with genetically modified mosquitoes in Brazil failed to reduce their numbers in the long term and may have resulted in mosquitoes becoming resistant to insecticides.

Tony Blair's think tank is more concerned with shutting down criticism of terrorists than stopping terrorists. Britons of all political persuasions are increasingly telling their politicians to respect the Brexit vote and get the Britain out of the EU. Illinois's incoming Supreme Court Justice is married to a man facing 14 counts of corruption. After 20 years in Afghanistan, the US would be better off walking away. Ontario legalised marijuana and lost $42 million selling it.

A Turkish opposition politician is facing almost ten years in prison for insulting the President. China has expelled a Wall Street Journal reporter for writing about President Xi's cousin. The Chinese government has forced churches to replace the Ten Commandments with communist propaganda. China has pledged $500 million to the Solomon Islands to get it to drop diplomatic ties with Taiwan. Israel has denied accusations it has been spying on Whitehouse communications.

California has banned schools from suspending disruptive kids. Female students in the UK were blocked from attending class because they refused to wear pants instead of skirts as part of gender neutral uniform changes. Boston's straight pride parade actually happened, with Milo Yiannopoulos acting as grand marshal. The

University of North Carolina offered a workshop on white privilege to its 30,000 students and only nine showed up, and none were there to genuinely learn. The latest version of monopoly promotes sexism.

**Economics & Work**

Blame governments and bureaucracy for expensive homes, as California seems determined to make more citizens homeless. Government regulations often bring surprising and negative unintended consequences. Kansas and Missouri have agreed to stop competing for business relocations using subsidies and taxpayer funds. Oregon hiked its minimum wages, businesses responded with automation, now Oregon is considering limiting self-service checkouts.

The people that are missed when calculating unemployment figures. How the poorest Americans are better off than the average citizen in the vast majority of countries. Economists need to stop focussing on consumer consumption and start focussing on production and productivity. Zimbabwe is another lesson showing that production comes before consumption.

**Miscellaneous**

Is it really a can of baked beans if it only contains one bean? A brief history of the very tasty fried chicken sandwich. Chess is a surprisingly good way to lose weight. Adults are using Ikea stores for mammoth games of hide and seek. A New Zealand man brought an "emotional support clown" to the meeting where he was made redundant. This year's winners of ignoble prizes are suitably weird.

Very old people are often lying about their age. Two British pensioners financed their cruises by smuggling cocaine. Whilst the Porsche Taycan was setting lap records at the Nurburgring, a broken down Tesla Model S was getting towed off the course. It's not just the kids of today, we are all spoiled. Researchers blame a "lack of economically attractive men" for the declining marriage rate.

Written by Jonathan Rochford for Narrow Road Capital on September 23, 2019. Comments and criticisms are welcomed and can be sent to info@narrowroadcapital.com

**Disclosure**

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