Firstlinks
Connecting investors with ideas

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Coronavirus and a roadmap for infected investing

Roger Montgomery

With the data changing daily, the only things moving faster than the spread of coronavirus are the financial markets. In this exclusive note for Firstlinks, we explore the possible paths the stock market might take in the next few weeks and months, noting short-term predictions are a very high-risk venture.

This too shall pass

Indeed, on the subject of short-term predictions, it’s worth sharing the 19th-century retelling of a Persian fable by both the English poet Edward FitzGerald and US President Abraham Lincoln.

When an Eastern sage was desired by his sultan to inscribe on a ring the sentiment which, amidst the perpetual change of human affairs, was most descriptive of their real tendency, he engraved on it the words: "And this, too, shall pass away."

FitzGerald retold it thus:

“It is said an Eastern monarch once charged his wise men to invent him a sentence, to be ever in view, and which should be true and appropriate in all times and situations. They presented him the words: "And this, too, shall pass away." How much it expresses! How chastening in the hour of pride! How consoling in the depths of affliction!”

When considering how deeply the world might be afflicted by Covid-19 it is worth remembering that we will not even be talking about it in five years’ time. Acknowledging the tragedy that the outbreak has already wrought on families all over the world is important. Notwithstanding, humans are resilient and adaptable and a solution will be found. When we look back, the virus will have been contained, a vaccine developed, and the world will move forward.

The viral and financial market contagions that could occur in the interim, and which have been demonstrated already, are worth considering, if only to try and anticipate when it might be best to venture a purchase of shares at prices that may not be revisited for a decade.

We care about the answers to this question deeply if only because, like Berkshire Hathaway, we also approach the crisis with about 30% of our portfolios in cash.

The success story in South Korea

We have been tracking the data daily, including the number of tests being conducted. This is important because you only find something when you are looking for it.

South Korea has published 183 updates since the start of the outbreak. This may be a function of their level of concern, which itself is a function of the country's proximity to China. Regardless, at some point they realised they had a problem and began testing in earnest. As at the time of writing, South Korea has conducted 4,000 tests per one million head of population, or 210,000 tests in 10 days.

As a result of the tests, South Korea has produced a detection rate of 3.58% (obviously the infection rate is higher because not everyone is being tested and many are quarantining themselves at home).

Table 1. South Korea

		Confirmed Cases				Suspected Cases		
Date	Total	Total	Discharged	Isolated	Dead	Total	In Process	Negative
7/3/20	196,618	7,382	166	7,165	51	189,236	17,458	171,778
8/3/20	210,144	7,513	247	7,212	54	202,631	18,452	184,179

Source: Montgomery Small Companies Fund

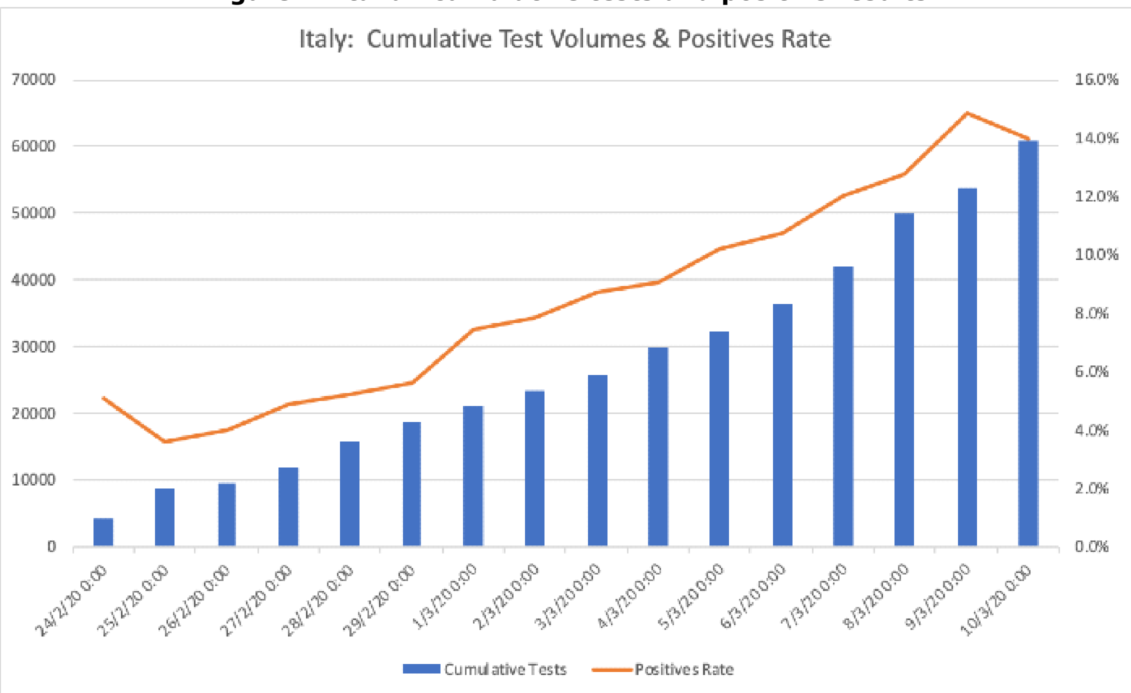
As the data in Table 1 reveals, of the 210,000 tests, 7,513 have been confirmed with Covid-19 (3.58%). Of the 7,513 confirmed cases, 54 people (0.7%) have died, 96% have been quarantined and 3.3% have been discharged. Given that testing is continuing and that there is a large cohort who have been quarantined and are therefore unresolved the fatality rate of 0.7% is likely to go up.

But South Korea's story is one of relative success, being able to isolate the outbreak to a death cult, and thye rapidly ramped up their testing.

The challenge in Italy

Italy, by contrast, is a basket case and the poster child of the consequences of a poor response.

Figure 1. Italian cumulative tests and positive results



Source: Montgomery Small Companies Fund

As we write this note, Italy is experiencing the first economically and socially significant outbreak outside of China and South Korea. Italy is also the first liberal democracy to enforce a country-wide lockdown. Until today, the country had implemented a haphazard approach to lockdowns, confined to the Lombardy region. I say 'haphazard' because eyewitnesses at the sieve-like boarder control roadblocks reported cyclists and vehicles moving through the checkpoints unimpeded.

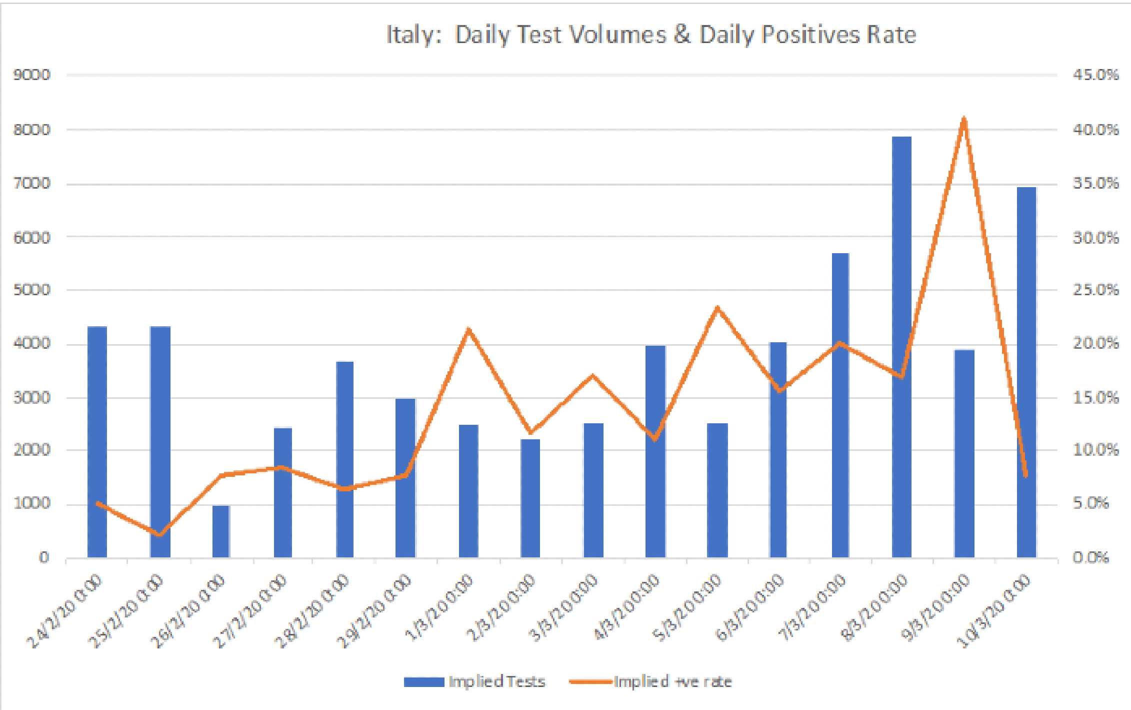
Italians turned up late to admitting there was a problem and consequently we have seen their numbers explode.

Italy today has only conducted a quarter of the number of tests per million (1000 tests/million population) that South Korea has conducted. And because those tests commenced late, they have been shocked to discover a detection rate of 16.7%. Italy only really started testing on 24 February with 4324 tests, but the number then fell away and it was not until 7 March that testing numbers again exceeded those earlier numbers.

As at today (10 March), the Italians have only tested 0.1% of their population and already they have experienced almost 12 times the number of deaths (631) as South Korea. As Figure 1 illustrates, this is the result of commencing and then scaling testing late.

Figure 2 makes an observation that should be troubling for the US and therefore for the markets. As the rate of testing goes up in a country that is late to commence, the number of confirmed cases understandably surprises.

Figure 2. Italian daily tests and confirmations



US is slow to move

To show how late the United States is to respond to the outbreak, the CDC (Centers for Disease Control and Prevention) has thus far reported only 26 tests have been conducted per million population. The US CDC spotted coronavirus in January but left it to public sector laboratories to develop a test. It has obviously taken some time because by the end of February, the US had averaged 92 tests per day in a country of 340 million people! Today, the testing is beginning to scale and 810 tests were conducted on 6 March 2020.

If they scale effectively, what will the US find? They will report a high detection rate, much higher than the 7.5% detection rate as of 10 March 2020. Of the 647 confirmed cases, 4.3% have died. This number will rise too. Italy appears to be offering a road map.

A limiting factor is that Amercians do not kiss each other as a greeting, the US population is younger and the frequency of smokers is lower. However, a large number of people could die.

Short-term implications for equity markets

So, is it time to start buying the dips in shares again? The answer is probably not. Of course, there will be companies that are affected by the virus directly and if their share prices overreact negatively at any time, investors should ask whether the company's ills are being treated as permanent. If the market is treating the issue as permanent, but it proves to be temporary, an opportunity could be presented. Keep that in mind.

The US could soon experience a parabolic jump in the number of confirmed cases as they scale up their testing. This means broad-based value may yet be just around the corner.

Roger Montgomery is Chairman and Chief Investment Officer at [Montgomery Investment Management](). This article is for general information only and does not consider the circumstances of any individual.

Douglass on coronavirus: 'Expect volatility but don't panic'

Emma Rapaport

"Expect volatility but don't panic, would be my view, because before 12 months, I think we'll be looking back, and this event will have passed."

This is the view Magellan's Hamish Douglass delivered to the thousands of investors who packed Sydney's International Convention Centre on Friday night to hear his latest update.

With fears about the coronavirus pushing stocks closer to a bear market, Douglass adopted a relaxed tone, telling investors to sit tight and take a long-term view. He told the crowd of advisers, industry professionals, retail investors and students.

"Our best view is that this may be six times as serious as the seasonal flu.

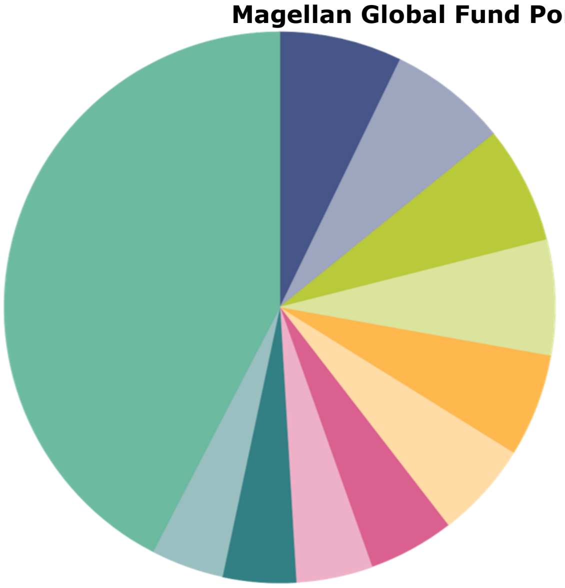
"While [the virus] is going to affect a lot more people, I think the spread may well be less because of the extreme containment measures. But with the extreme containment measures is going to come a pretty sharp economic impact around the world, which will realistically be three to six months.

"During that period, I would expect a lot of share price volatility as people react to the headlines. I think if we look a little bit longer out, this flu or pandemic or whatever you want to describe it will have its consequences. But the economic effect is likely to pass very quickly."

Douglass avoided discussing the virus for much of the presentation, devoting his time on stage to how interest rates will affect equity valuations and the rise of the Chinese consumer.

But talk of the virus, which dominated headlines for the days leading up to the event, infected audience question time.

Magellan Global Fund Portfolio Holdings, 31/12/2019



	%
Microsoft Corp	7.2
Facebook Inc A	7.0
Alibaba Group Holding Ltd ADR	6.9
Alphabet Inc Class C	6.8
Starbucks Corp	6.0
Visa Inc Class A	5.7
LVMH Moet Hennessy Louis Vuitton SE	5.0
Novartis AG	4.5
Mastercard Inc A	4.3
Yum Brands Inc	4.3
Other	42.4
Total	**100.0**

Source: Morningstar Direct

'Buy the dips'

Douglass was more eager to share his view on opportunities in the market as global banks rush to slash interest rates to fight coronavirus.

"While people are panicking and very concerned about the short-term economic impact, what the central banks are doing, and I think they're going to go further here, is they're further reducing interest rates.

"So, when we come out of this, we're going to be even in a lower interest rate world, which is supportive of higher valuations. Once you've lowered, the cost of lifting interest rates is very high. This has a very interesting dynamic for valuations when people's panic stops.

"If there are any severe dips here, my advice to people would be buy, and just expect more volatility. You're very unlikely to pick the bottom of any of the sort of ups and downs. But I expect when we get some calm water, some of the businesses will be reflecting the low interest right, which is kind of a benefit to all this uncertainty."

Magellan sees opportunity in China

Investing in China is clearly on Douglass's mind following the Magellan Financial Group's first direct investment into the rising global power, with a 6.5% holding in Chinese online platform Alibaba. It also invests in other Chinese-market linked companies such as coffee giant Starbucks and luxury French brand LVMH Moët Hennessy – Louis Vuitton.

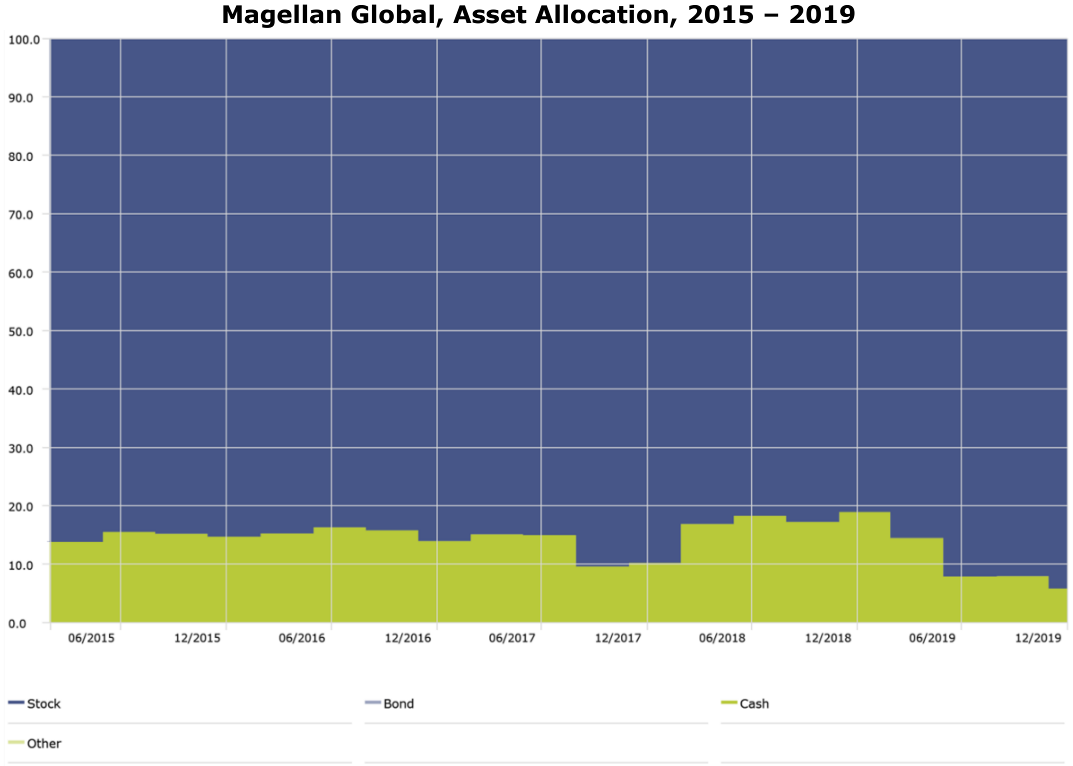
On stocks within his own portfolio, Douglass acknowledged that things could get ugly in the short term, but insists he is doing nothing to fundamentally change the portfolio.

"Starbucks closed half their stores in China. It's just said it's going to have a severe impact on the China business in the next three months. We know that. Its share price has been affected somewhat. But in 12 months' time, it won't have any real impact on the long-term value of a Starbucks or a Louis Vuitton."

Within the Magellan Global Fund, Douglass has taken major bets on several US tech names including Microsoft, Facebook and Alphabet, and payments giants Mastercard and Visa.

Starbucks and Alibaba both provided personalised video presentations for the roadshow. Starbucks plans to open a new store every 15 hours in China between now and 2022, Starbucks Chief Executive Kevin Johnson told the audience.

Magellan Global, Asset Allocation, 2015 – 2019



Source: Morningstar Direct

None of the Magellan Global Fund's top 10 holdings (at 31 December 2019), excluding cash, has been spared from the virus. The worst hit is Facebook, down 16% over the last month. NASDAQ is down 16.5% for the month, and the SPDR S&P 500 ETF, a proxy for the S&P 500 Index, is down 13.8%.

Magellan Global has slowly reduced its cash position over the last two years, from highs of 18.35% in mid-2018 to just under 6% at the end of 2019.

Emma Rapaport is Editor of Morningstar.com.au. The author attended 'The Great Repression: Magellan Investor Evening Series' on 6 March 2020 as a guest of Magellan.

Hamish Douglass is Co-Founder, Chairman and Chief Investment Officer of Magellan Asset Management, a sponsor of Firstlinks.

Virus creates liquidity threat for lower quality bonds

Charlie Jamieson

Markets are dominated by coronavirus fears, triggering significant positive performance in high quality fixed income assets. As the threat of a global pandemic increases, economies are likely to collectively suffer with both lower demand and significant supply disruptions.

There isn't a magical human policy which can easily make this go away. Interest rate cuts and liquidity will help, but they cannot solve the clear and present dangers we are currently facing. That's worth thinking about as we look forward over the coming months, because we don't think liquidity helps with supply issues this time.

Jamieson Coote Bonds (JCB) believes that the global environment was already slowing into the onset of this outbreak, but it is almost certain that economies will suffer intense slowdowns as a result. Virus-effected economic data for February is only now coming through.

Looking at China data to date, as the earliest country to experience COVID-19, it has been far worse than expected. This could trigger a cashflow crisis in corporates, and we hold grave fears for markets' and central bankers' ability to help in a 'supply' side shock.

Weak manufacturing data from China

The depth of the shock is sobering indeed. The official Chinese Government manufacturing data and the private sector manufacturing series for February posted outcomes far worse than the depths of the GFC. This type of economic outcome is likely in all virus-affected geographies over rolling time frames as the virus spreads.

The outlook for bonds in the short term

For bonds there are two clear pathways forward as we see it.

1. **The virus has already created significant supply and demand destruction, putting large pressure on corporate cashflows, killing incoming economic data.** Hoping for the best, if the virus can be contained in the days and weeks ahead, markets will still require huge policy accommodation to deal with this shock. We are seeing the start now as the RBA cut rates 0.25%, the US Federal Reserve (the Fed) cut rates by a 0.50% emergency, the first since GFC, the Bank of Canada cut by 0.50%, and Hong Kong also followed suit. Rate cuts and liquidity programs will see bonds, as well as some other assets, continue to perform well.
2. **Our worst fears are realised, the virus drags on for a prolonged period and triggers a global credit event.** In this instance return 'of' capital will be paramount, rather than return 'on' capital and government bonds would be one of the few standalone asset classes to provide that certainty plus providing significant liquidity. In this instance we would expect strong returns both on an outright and relative basis versus other asset classes.

Liquidity is the key in this uncertain terrain

We cannot stress enough the possibility that markets may totally seize. The speed and velocity of the current moves in an algorithmic dominated world are quite astounding versus what we previously experienced in the

GFC. A total panic moment could potentially be ahead if the plumbing of the financial system cannot be lubricated – the credit markets must find a way to re-open and provide corporates the ability to roll existing debt obligations forward.

There is a very serious liquidity crunch unravelling, as parts of the funding markets and most of the corporate credit market are frozen. To date, central bank rate cuts have clearly not resolved these issues. It is highly likely the Fed and other central banks will need to inject an avalanche of additional stimulus and liquidity. In other words, more rate cuts, liquidity provision, extended swap lines, uncapped repurchase agreements and further quantitative easing.

Charlie Jamieson is Executive Director and CIO of Jamieson Coote Bonds (JCB). This article contains general information only and does not consider the circumstances of any investor.

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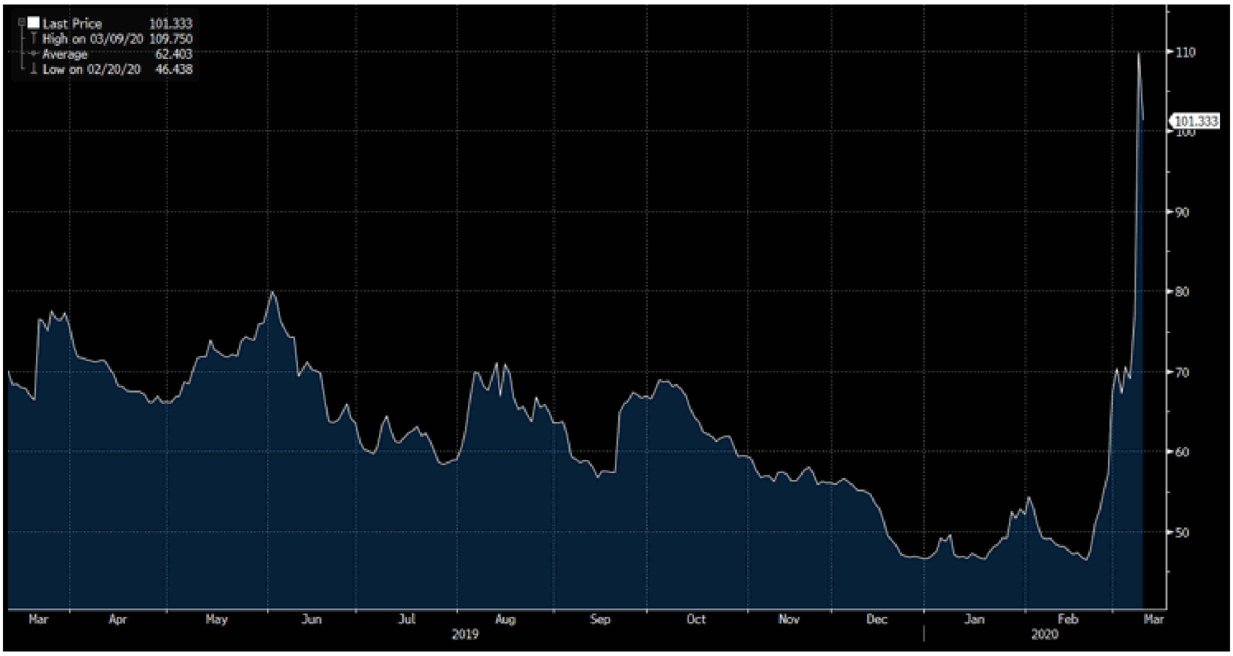
5 lessons from the GFC as panic whips hybrids

Brad Newcombe and Justin McCarthy

The last fortnight has caused carnage on global markets. The S&P/ASX 200 dropped close to 20% in less than 10 days and the benchmark Australian iTraxx index (a proxy for Australian investment grade credit spreads) blew out from just 46 points on 20 February 2020 to 110 points on 9 March 2020, as shown below:



Source: Bloomberg

The circumstances evoke memories of the GFC. There were some important lessons that can be learnt from that experience for fixed income investors.

Unlike equities, the terminal value of a bond is largely a known quantity. The vast majority of bonds are issued at $100 (or par value) and they mature at $100. The value fluctuates between issue date and maturity date but the key point is that unless the company fails, bond holders will get $100 on maturity.

Five rules of thumb for assessing bonds

Failure or default is the key risk that investors need to assess but even in the most difficult economic times, the default rate of high quality, investment grade bonds is rare. However, the default risk increases significantly for sub-investment grade or high yield bonds. This makes assessing bond value far easier than valuing equities in times of severe market dislocation such as the past week.

Following the blueprint from past crises and in particular the GFC, there are a number of simple 'rules of thumb':

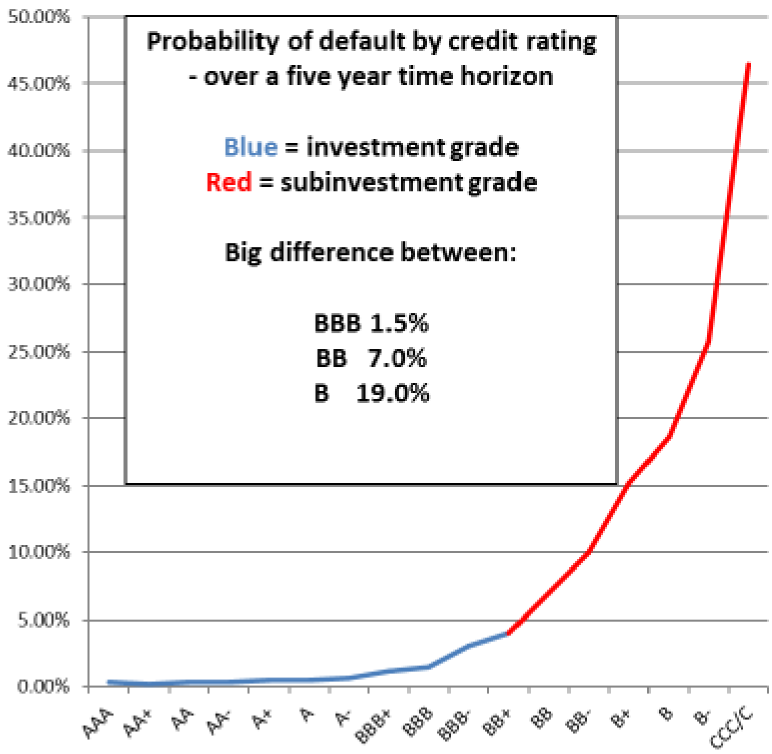
- **Assess the probability of the company or issuer defaulting.** If you think default is highly unlikely then all you need to assess value is the yield to expected maturity. In other words, if the company survives, you will be able to determine the expected yield to maturity, as the 'terminal' or maturity value will be $100 or par.

- **Be patient but also be ready to act at very short notice.** Short notice means as little as a few hours. Many of the best opportunities in the GFC came with very little notice and investors were rewarded handsomely for simply providing liquidity.

  Single-A rated Tier 1 Hybrids from the likes of Rabobank, CBA, SwissRe, NAB and AXA all traded at less than 50c/$ in 2009 when large funds had to liquidate holdings at short notice or overnight. These highly-rated securities provided returns of circa 20-25% p.a. for a number of years for those who invested at prices below 50c/$.

  Even in today's market panic, ASX listed hybrids ANZPE, NABPD and WBCPF traded at margins over +850bps for those ready to act quickly but closed closer to +500bps. The best time to buy is when there is a forced seller (typically a fund or institution) in the market who just needs to find a buyer. If you are comfortable that the company will survive to maturity date, it is a question of what price to pay because it could go lower.

- **Stick to large, high quality issues.** Focus on investment grade companies that are large and have good access to equity and debt funding. We call these companies 'best of breed'. The probability of investment grade bonds defaulting is significantly less than high yield bonds. As the chart below of historical probability of default by credit rating demonstrates, credit risk past BBB- (i.e. sub-investment grade) is exponential. The price volatility of investment grade bonds versus high yield is also significantly lower. A number of oil and gas sub-investment grade bonds in the USA are down 20-30% this week alone, whereas names like BP and ExxonMobile have only fallen 2-3%.



Source: Standard and Poor's Historical Default Rates

- **Be prepared to move down the capital structure or take call risk** on subordinated bonds and Tier 1/Additional Tier 1 hybrids from best of breed companies. As detailed above, many of the best returns after the GFC were Tier 1 hybrids from SwissRe, AXA, RaboBank and NAB. But also consider re-set margins. The higher the re-set margin, the higher the probability of call at first opportunity.

- **Watch out for companies that have a large refinance due.** In a crisis it can be very difficult and often impossible for companies to raise new debt (typically required to refinance debt coming due). Companies that have spread their debt maturity profile and even companies that are just unlucky enough to have a large refinance right in the middle of a crisis can quickly become stressed or even default. This risk is magnified as you move down the credit or rating spectrum and is typically the cause of high yield bond defaults. Companies that run a high level of cash on balance sheet are highly sought after. In a crisis, cash is king.

Opportunities in bank hybrids

The bank hybrid market is worth keeping a close eye on. Given the inefficiencies and relatively illiquidity in this market this is presenting some outstanding opportunities. Today, we have seen our favourite security in the hybrid market – the National Income Securities (NABHA) – trade as low as $85 providing a yield to expected call in excess of 10.0%. However, it recovered and closed unchanged at $92. NABPD had a range of almost $10 over the day.

We are not sure how long these opportunities will last and acknowledge that investors essentially need to be 'watching the screens' to take advantage. We prefer those with initial credit margins over 450bp (4.5%).

We have often written our simple rule of thumb for ASX listed hybrids are they are expensive at credit spreads under 300bps but attractive when approaching 500bps. Earlier today, the average major bank 5-year credit spread was well over 500bps and possibly 600bps. Just a month ago, that measure was just under 300bps, demonstrating how quickly the market can change.

A comment on the mining and energy sector

A number of debt securities in the mining and energy space have been caught up in the market sell-off, especially those that are non-investment grade. We remain wary of many of the companies in this sector particularly those with high debt loads given the potential for a phase of significantly lower commodity prices in the event that the world slips into a global recession which is becoming an increasingly likely proposition.

Justin McCarthy is Head of Research, and Brad Newcombe is a fixed income analyst at [BGC Fixed Income Solutions](), a division of BGC Brokers, and a sponsor of Firslinks. The views expressed herein are the personal views of the authors and not the views of the BGC Group. This article does not consider the circumstances of any individual investor.

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What night moves on the US market mean for Aussie stocks

Bruce Gregor

You wake up in the morning, turn on the radio and the announcer says:

"…and now to the markets overnight, where the US share index fell 100 points - looks like being a black day for the Australian market today".

If you're lucky you might hear the actual index value that the US drop relates to. If it's the Dow, it's currently around 24,000, so 100 points is only 0.4%. Occasionally the voice might compute the percentage for you as your early morning brain clicks into gear.

How Australia reacts in the day ahead

I studied daily one-day closing price moves on the US S&P500 index and the Australian All Ordinaries index the next day. (At this time of year, the New York market closes 8am Sydney time. The ASX closes at 4pm). This gave 6,882 days of data in the 35-year period from January 1985 to February 2020.

I excluded Monday trading in Australia because of the longer time lag from US Friday close to when Australian trading closes on the Monday. Of course, on all Australian trading days there could well be Asian market events breaking which were not reflected in US markets overnight, but the time gap is much shorter.

My analysis of the results is set out in the table below.

Table 1: Total period – 3 January 1985 to 28 February 2020
Tuesdays to Fridays of All Ords trading

S&P500 move +/- % bigger than this	% of overnights S&P500 does this	% of next days that All Ords ends in same direction
0.0%	100%	65%
0.2%	76%	69%
0.5%	50%	75%
1.0%	24%	82%
1.5%	12%	86%
2.0%	6%	88%
2.5%	4%	90%
5.0%	0.5%	91%

For moves of plus or minus 0.5% or less in the S&P500, there is no reliable pattern on which to base a strong expectation for direction of the next Australian All Ords move – i.e. the Australian market is just as likely to go in the opposite direction to the US about one day in four.

But I found a neat **rule of thumb** we could pass on to the finance journalists to encourage them to talk percentages while we are pouring milk on the muesli.

When the S&P500 overnight moves more than 2.5% up or down, there is a 90% likelihood the Australian market will move in the same direction. Moves above 2.5% have occurred in 4% of days over the long-term period studied – that is an average of about one trading day a month.

Variations by trading day

It is also interesting to explore variation in these results by trading day and whether there was any change over time in this 35-year period.

Firstly, let us look at trading days – and remember as explained earlier, "I don't like Mondays". The following table splits the results for Australian trading days for Tuesdays to Fridays.

Table 2: Days of the week variation (Australian days)
Percentage of days that the All Ords move on close is in the same direction as S&P500 close overnight

S&P 500 move +/- % bigger than this	Tuesday	Wednesday	Thursday	Friday
0.0%	64%	66%	64%	67%
0.2%	68%	70%	67%	71%
0.5%	74%	74%	74%	78%
1.0%	82%	80%	82%	84%
1.5%	86%	85%	84%	88%
2.0%	84%	86%	92%	92%
2.5%	86%	88%	94%	94%
5.0%	91%	89%	100%	75%

There is not much of a trend to observe here. The bigger than 2.5% results are slightly lower on Tuesdays and higher Thursdays and Fridays. Perhaps there is a volatility momentum effect through the week when big moves are occurring.

To look at the variation effect over time, I split the analysis into last century and this century, see table 3.

Table 3: 20th Century vs 21st Century
% of next days that the All Ords ends in same direction as S&P500 overnight

S&P 500 move +/- % bigger than this	20th Century 3 Jan 1985 to 29 Dec 2000	21st Century 3 Jan 2001 to 29 Feb 2020	21st Century excess over 20th Century
0.0%	62%	68%	6%
0.2%	65%	72%	7%
0.5%	71%	78%	7%
1.0%	79%	84%	5%
1.5%	81%	89%	8%
2.0%	86%	89%	3%
2.5%	90%	90%	-
5.0%	88%	92%	4%

There is a stronger trend here for following the S&P500 but mainly where there are more data points. Perhaps we could conclude that globalisation and the internet bring a stronger influence in the 21st Century.

Now before you all go off and start day trading with these results, I should add my disclaimer – **don't try this at home!** The rule of thumb presented here is for general education purposes so that market commentary is encouraged to talk and think percentages and to give big market moves rational historical context.

Postscript

This article was finalised after 4pm Tuesday 10th March 2020, a time when we saw a classic exception reflected in the 'rule of thumb'! The S&P500 was down 7.6% the night before, and the All Ords was up 3% at close the next day due to various stimulus packages announced around the world. Events can overtake overnight movements. This opposite direction has happened 10% of the time when the S&P500 moves more than 2.5%.

Bruce Gregor is a Demographer and Actuary, and Founder of Financial Demographics. This article is general information only and does not consider the circumstances of any investor.

Worried about low rates, SMSFs drop banks and diversify

Gemma Dale

SMSFs are well-known for holding substantially greater allocations to cash and Australian shares than professional investors, while being underweight fixed income and international shares. They're also known for heavy allocations to high-yielding Australian shares, particularly financials.

But new nabtrade analysis suggests some of these allocations may be changing as ultra-low interest rates start to bite, and global and domestic markets reward risk-taking behaviour.

How allocations are changing

nabtrade SMSF trustees have reduced their allocation to **banks** by nearly 25% over the last four years, while increasing their allocations to diversified instruments such as **ETFs** and **international share funds.**

In 2019, SMSFs were net sellers of Australian equities in the first six months, taking profits as the S&P/ASX200 rallied, then they resumed buying as prices fell in July and August. Selling into rallies and buying on price weakness reflects the contrarian behaviour we typically see from our SMSF investors.

In addition to diversifying their portfolios to reduce exposure to banks and other overweight sectors, it's likely some investors were seeking to prevent a fall in their income should a future government ban the rebate of franking credits in a no or low tax environment.

Despite the reduction in financials, which fell 5% in 2019 alone, bank shares remain the most-held stocks by SMSFs, taking the four top holdings.

SMSFs also hold larger amounts of Woodside Petroleum, Transurban and Macquarie than non-SMSF investors.

Given the preference for high-yielding bank shares, many SMSFs have missed out on one of the biggest success stories on the ASX, with only 11% of nabtrade SMSFs holding global biotechnology company CSL. CSL is now the second largest stock on the ASX (and has been the first, dependng on when the market cap is measured), up over 50% in 2019 and 250% over five years.

Those SMSFs who do hold CSL are high conviction, with an average holding of over $150,000 versus $40,000 for Telstra. SMSF holdings of healthcare stocks has increased from 6% to 9% over four years.

Telstra was sold down throughout 2019 as its price strengthened, with 38% of SMSFs holding it at the beginning of the year, and only 34% holding it in December.

SMSFs also loosened their grip on BHP, ending the year with holdings down from 5% to 4.3% despite an increase of 18% in the price.

SMSF adoption of ETFs

SMSF trustees were early adopters of Exchange-Traded Funds (ETFs) with growth continuing in 2019. At the beginning of 2020, SMSFs held $20,000 more in diversified products (including ETFs, listed investment trusts and companies and mFunds) than at the beginning of 2019, of which 58% came from net buying (42% from market growth).

SMSFs took up increasing parcels of the large fixed interest Listed Investment Trusts (LITs) brought to market in 2019. Popular ETFs and mFunds also included those with exposure to international shares and fixed income. ETFs accounted for 8% of net buys in 2019.

The start of 2020 has been marked by a return to volatility, with coronavirus fears hanging over a market that had only recently reached record highs. nabtrade SMSF investors tend to respond less to volatility than other investors, and may see price falls as an opportunity to top up on favoured stocks. Interestingly, the cash position of nabtrade's SMSFs was largely unchanged throughout 2019, leaving plenty of trustees with dry powder should further declines in domestic and international shares present good value.

Gemma Dale is Director of SMSF and Investor Behaviour at nabtrade, a sponsor of Firstlinks. This material has been prepared as general information only, without reference to your objectives, financial situation or needs.

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Retirement: you can have your kayak and heat it too

Graham Hand

How to turn a 10-day expedition to Antarctica with 120 other passenger into an investing and superannuation story? Simple. Look around the dining room on the first night and chat to a few people, and you soon realise how many retirees are ticking off their bucket list. And it's quite a list, with the next trip and the one after that already planned.

For those who can afford it, this is what saving, investing and superannuation are intended for. It's not simply being 'comfortable'. ASFA's Comfortable Retirement Standard for a couple is $61,500 a year, and Antarctica is an expensive trip. Many passengers have worked hard all their lives, and they are enjoying their freedom while they are healthy enough.

The warm kayak, or making the most of a life of work

Let's start in South America, at the bottom of Argentina in Tierra del Fuego province, which translates to 'Land of Fires'. The major city is Ushuaia (see map at end), and it's close to the Southern Ocean and the departure point for many boats heading for Antarctica. The name derives from a time when natives lined their canoes with clay and lit fires to warm themselves on fishing trips. While this immediately prompted the 'you can have your kayak and heat it too' thought, it's also a good summary of the aim of 'retirement'.

During the 10 days, it was apparent how much money and willingness to spend it was in that room. Lots of affectionate chat about grandchildren (try to look interested) but handing them back to their parents and going away is as good.

Businesses and marketers, including in wealth management, who focus on younger generations are missing an opportunity. Generally, these people were not born into money and would not consider themselves 'wealthy' but have accumulated assets over 40 years of work. They now carry expensive cameras with zoom lenses, dress in the latest outdoor gear, wear cool sunglasses and carry the latest mobile tech. They may be into their seventh or eighth decade, but there's no asking the kids how the internet works or how to copy photographs to a USB. Other equipment such as walking sticks and hearing aids are common, but there's surprisingly little complaining about aches and pains and health.

We previously published this article on marketing:

"Australians over the age of 50 have the highest levels of wealth and disposable income of any age segment, they outspend millennials in entertainment, auto, health, travel and almost every other category, but are largely ignored by brands."

The Bank of Mum and Dad

Another popular topic was how difficult it has become for their children (now adults aged in their 30s and 40s) to buy their first home. Even when the Bank of Mum and Dad comes to the rescue, there are at least three models on the best way to do it for those who have sufficient resources.

(Most older people do not have the luxury of helping their children in these ways, but it's a goal to aspire to when planning for retirement a few decades in advance).

1. Give a gift as a contribution to a better property

   Residential real estate in most Australian capital cities (what's wrong with Darwin?) has become so expensive that gifting half a million to help buy a $1.5 million property still leaves the child to find a significant $1 million. For those who think it is 'spoiling them' and 'they should make their own way in life', consider if it is better to wait until they are 60 when they will inherit the estate anyway. Why not give some of the money early and make a better life for both children and grandchildren when they need it most?

2. Provide a loan backed by an unregistered mortgage

   A couple who had worked hard in a successful business wanted to help each of their three children equally but were worried that their marriages may not last and any gift would then be shared with the son- or daughter-in-law in a settlement. So they lent the money with a unregistered mortgage, which would give them a claim on the debt in a change in circumstance. They had no intention of invoking the mortgage terms, but it was a safety net. Consult with a financial adviser for this strategy.

3. Become joint owners of the property

   Another person had gone 50/50 with his son as joint owners. This enabled the child to make a start in a better quality of house, without the feeling of a handout, which the son strongly resisted. Instead of paying rent to his parents, they agreed he would be responsible for all outgoings including council and water rates and renovation costs. The parents have an investment with capital gain potential (which in reality is only about 2% after expenses on a normal residential investment property).

For anyone who can afford it, these methods allow the Bank of Mum and Dad to function while addressing some of the emotional, financial and future risk problems that might arise. Seek financial advice before taking any of these big steps.

Some ways to have your cake and eat it too

Let's acknowledge not everyone can plan to spend far more in retirement than in their younger years. The 2015 Intergenerational Report says most people will continue to rely to some extent on a part age pension in retirement.

The starting point to affording trips like Antarctica is setting a goal early in life, often with the aid of an adviser who will have the tools available to show how much needs to be saved, in which investment vehicles over what period.

Assuming some level of spare spending capacity, how can a retiree travel the world when they have spent most of their lives paying off the mortgage? They may have accumulated a decent superannuation balance and a house but little extra spare cash.

Far be it for me to encourage profligate spending when running out of money is a major worry for many retirees. However, anyone who lives a parsimonious retirement, denying themselves a few luxuries and then leaving millions of dollars to their kids seems to have the wrong priorities. Yes, the house might be needed to fund the nursing home, but the deposit usually goes back to the children on death. Do your numbers and live a little, such as:

1. The Pension Loan Scheme (PLS) can be accessed by eligible people over the age of 65 who own their own home. The PLS ensures some restraint by not allowing lump sum borrowing but gives a cash flow equal to 150% of the age pension, creating a debt against the future value of the home after death. See previous articles here and here for more details.

2. The age pension 'retirement gap' attracts a lot of attention, such as in this article which describes how much pension is lost due to holding assets above a set level:

   "On the assets side, for individual homeowners whose assessable assets are above $263,250, the pension is reduced by three dollars a fortnight (or $78 per year) for every additional $1,000 in assets. To offset this reduction, each $1,000, if invested, must generate an annual return above 7.8%."

   There are obvious risks in spending money (on non-assessible assets such as the family home or expenses such as travel) to qualify for a larger pension. I don't like this strategy for the reasons outlined here but some financial advisers encourage their clients to spend money on themselves for this reason. There's also a possibility that the rules might change.

3. Downsizing a property can release capital and allow up to $300,000 per person to be added to superannuation for people aged over 65.

Back to the trip itself

We heard that the tempestuous Drake Passage crossing between South America and Antarctica could literally be hell at the bottom of the earth, and three days there and three back in violent seas was a major barrier.

But with our fly/fly trip, we flew to and from Punta Arenas in Chile into a military airfield on King George Island in the South Shetlands near the Antarctic Peninsula, where zodiacs whisked us onto the waiting ship and the warmth of hot chocolates and spacious cabins. No Drake Passage ship crossing in our case.

This is the type of trip that many of the passengers had worked and saved for, and SKI holidays which 'spend the kids' inheritance' are real.

The size of the ship is a vital part of the enjoyment. There are dozens of interesting places to visit in Antarctica, from isolated scientific research bases to penguin colonies, to close-up whale and seal watching and stepping onto ice floes. However, the maximum number allowed at any landing site is 100, and some sites permit only 35 people at historic locations.

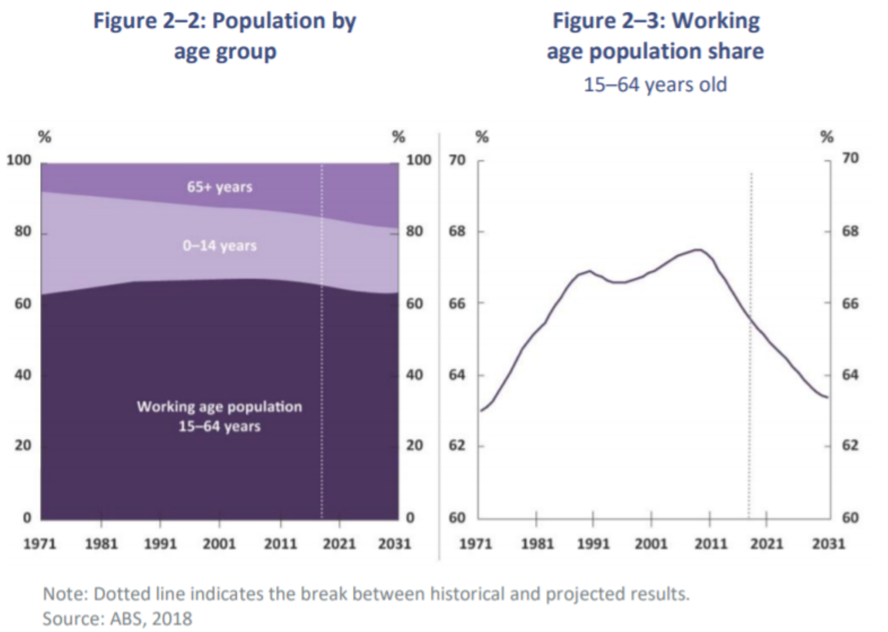
A ship with 120 passengers, with a couple of dozen who take off elsewhere on kayaks and snorkelling trips, is ideal because everyone can go ashore at the same time. It allows two activities a day, and these visits are the highlights. It's extraordinary to run around while floating on sea ice on the Weddle Sea, with massive icebergs drifting past. Not as amusing is a penguin pecking at your legs when you're not supposed to move.

A ship with 500 passengers, and certainly one with thousands, would require passengers to remain onboard and this would compromise the experience. It must be an expedition, not a cruise. A ship with large numbers of passengers might mean they rarely disembark, with glaciers and wildlife spotted in the distance.

Source: Aurora Expeditions

Having your cake

The chart below, provided by the Parliamentary Budget Office in February 2019, from a report called 'Australia's Ageing Population', shows the proportion of the Australian population aged over 65 is set to double between 1971 and 2031.



In 2020, these people are not like their parents at the same age. It's a growing, multi-billion dollar market of retirees living the good life, for travel, outdoor gear, cameras, hearing aids, expeditions, retirement savings, mobile tech, health services, airlines, real estate … the list is endless, long before nursing homes kick in.

What are you waiting for? Start your plans now, if not for Antarctica, then for something you have always wanted to do. Tell your adviser about your goals.

Graham Hand is Managing Editor of Firstlinks.

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