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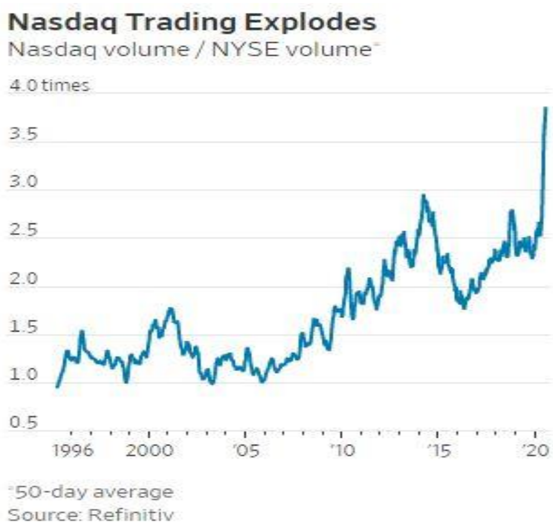
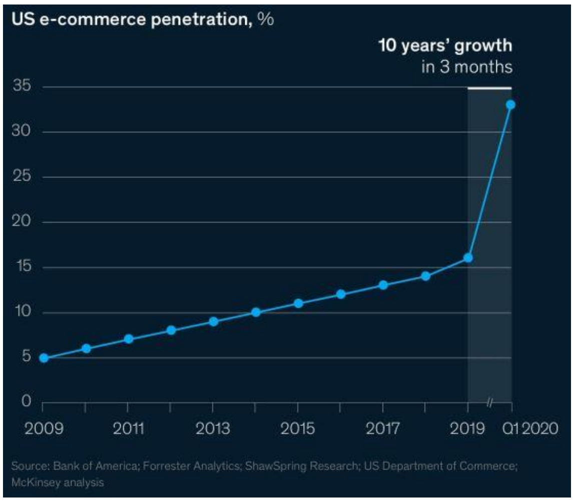
Editorial

Differences of opinion create a market. Technology stock buyers have been the big winners recently but there are plenty of sellers as it's not difficult to make a compelling argument for and against the sector.



The doubters say speculative money flowing into tech has pushed values well beyond fundamentals, with the **NASDAQ** tech index up about 17% this year and 21% per annum over three years. The S&P500 is down 1% this year and up 9% per annum over three years. We have never seen NASDAQ dominate trading volumes versus the **New York Stock Exchange** as much as now.

In many presentations over recent years, I have said that every portfolio can justify an investment in the leading technology stocks. I remember when **BetaShares** launched its NASDAQ100 ETF (ASX:NDQ) in May 2015 at $10, it was an ideal vehicle for Australian investors to gain easy and inexpensive access to the best US companies. It now trades at $24.80. However, just three stocks - **Apple, Amazon and Microsoft** - now comprise over one-third of the NASDAQ index. As they are worth more than the GDP of Germany, the case is not as strong as before with much future success built in. The threat of regulation over their near-monopoly positions is greater than ever.



The main case for tech at these levels is that the future growth which would have taken years without COVID-19 has been compressed. Indeed, as shown below, e-commerce has achieved 10 years of growth in only three months, so future value has been brought forward into the current prices which makes them easier to justify.

As **Arvind Krishna**, CEO of **IBM** said recently:
"The trend we see in the market is clear. Clients want to modernise apps, move more workloads to the cloud and

automate IT tasks. They want to infuse AI into their workflows and secure their IT infrastructure to fend off growing cybersecurity threats. As a result, we are seeing an increased opportunity of large transformational projects."

On the other side, an equally salient argument is made this week by **Roger Montgomery**, who has seen plenty of booms and busts in his three decades of investing. This is one party he doesn't even want to attend, never mind leaving early before the champagne runs out.

Then in an interview with **Gofran Chowdhury**, he describes how his clients have changed their investment patterns in recent months, with caution that the full impact of COVID-19 is yet to hit.

Sean Fenton and **James Delaney** see major company beneficiaries from the pandemic, and their process allows them to go long the expected winners relative to the expected losers. Low interest rates also benefit growth stocks.

There's a popular view that the generations are 'at war', many against the Baby Boomers, with the pandemic creating new tensions. **Emma Davidson** investigates whether we have more to connect us than separate us.

Rarely has gold generated so many headlines as it touches US$2,000 amid rising global geoplitical and economic risks. **Jordan Eliseo** asks whether we should consider gold as a growth or defensive asset in a diverse portfolio.

Large superannuation funds are predominantly active share investors, priding themselves on their investment prowess over passive alternatives. **Donald Hellyer** dives into the numbers to see if the confidence is warranted.

COVID-19 has wreaked havoc on many sectors but greenhouse gas emissions have fallen. **Lise Moret** says society has an opportunity to build on improvements and create a greener future.

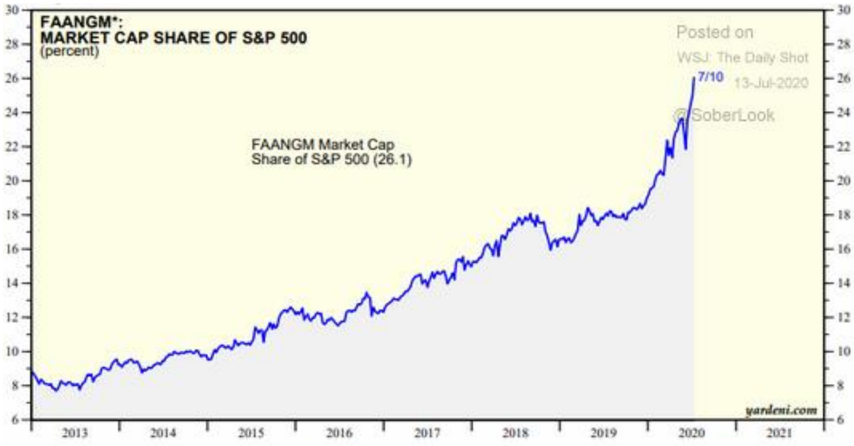
These are difficult times to build the bond part of a portfolio, especially when the **Australian Government** yesterday issued $15 billion (with demand for $37 billion) of 30-year bonds at a yield of only 1.94%. The 10-year rate is about 0.8%. It's all part of funding the large budget deficits, an unavoidable necessity to support the economy, and at least it is being done at low rates. The **Port of Brisbane** recently launched a deal with $2.75 billion of bids for a $500 million issue. There's a lot of cash chasing low rate, high quality bonds, and with headline inflation negative in the June quarter, investors know rates are not rising anytime soon.

To assist in portfolio construction in these tough conditions, this week's White Paper from **Vanguard** is its latest Asset Allocation Report, showing investors are incorporating caution into their outlooks.

After 30 years of investing, I prefer to skip this party

Roger Montgomery

Much of the stock market's buoyancy is attributable to just six tech companies – Facebook, Amazon, Apple, Microsoft, Netflix and Google. They have a market capitalisation of more than US$6.5 trillion or fully one quarter of the entire S&P500 index, as shown below. Their market share was only about 10% five years ago.



* FAANGM stocks include Facebook, Amazon, Apple, Netflix, Google (Alphabet), and Microsoft. Both classes of Alphabet are included.
Source: Standard & Poor's and I/B/E/S data by Refinitiv.

Graham Hand recently mentioned in his article *Six ratios show the market is off the charts* that the Nasdaq (the tech index) is again on a Price/Earnings (P/E) of 30 times. It was last here 16 years ago in 2004. By itself a high P/E ratio means little but it reminds us that P/Es can also decline. In 2002, the Nasdaq's P/E was below 10 and in 2008, 2011 and 2012 the Nasdaq100's P/E touched 13 times.

Even great companies can become too expensive

Over the past five years, Facebook, Amazon, Apple, Microsoft and Google have collectively increased their profits by US$80 billion but their market capitalisation has increased by US$4.4 trillion. That represents an expansion of the P/E multiple of 55 times!

Admittedly these businesses are scarce assets, they have long runways for growth, they are monopolists with pricing power. They are the very businesses long-term value investors like Warren Buffett salivate over. But poor investments can be made in even the highest quality businesses when the price paid is too high. It is a simple reality of investing that the higher the price you pay, the lower your return.

Another reality is that extreme multiples for scarce assets is a common event during periods of low interest rates, and particularly when rates are lower than trend economic growth rates. But extreme multiples are not usually sustained in history.

Low interest rates (whether they are artificial or not) have a disproportional effect on the present values of earnings further out. The present value of $100 earned in a year's time rises by 4.76% when interest rates halve from 10% to 5%. But the present value of $100 earned in 15 years rises by 100% when interest rates halve from 10% to 5%.

Therefore, the biggest jump in intrinsic values occurs for those companies with the bulk of their value in the terminal part of the calculation. Start-ups and emerging companies with little profit today but expected to earn much out over the horizon see their theoretical value rise the most when interest rates are cut.

But again, low interest rates do not immunise a company's shares from shocks and falls. Ultimately the growth in expected earnings must be delivered and for the price to continue rising from already-stretched levels, the P/E must expand. That means the company must exceed the already optimistic expectations. And life simply doesn't work out that way. There are always potholes on the road to success.

Consider that earnings for US technology companies as represented by the Nasdaq have declined 27% since February 2020 and are now back to 2017 levels, but the index is 60% higher than it was in 2017.

The technology theme is a good one, but …

The thesis for buying the technology theme makes sense. Microsoft, for example, will benefit from an increased number of people working from home; Netflix has more subscribers watching from home; Amazon has more online shoppers. The pandemic will be around for much longer than current mainstream commentary seems to suggest.

But of course, all booms start with a legitimate and credible thesis. As that thesis gains acceptance, it also gains momentum, and many less sophisticated investors jump aboard. Eventually investors pile in, not on the basis of the original thesis, but simply because the shares keep going up. Eventually, prices become so extreme they bear no relationship to reality and a bubble forms.

I believe we are there today, not for all stocks but for many in the technology space.

While there is merit in the idea that COVID-19 lockdowns have accelerated the trend to digitisation of work, entertainment and logistics, there is little doubt the rally in technology stocks has also been extended by a veritable tidal wave of debutante investor buying, the poster boy for which is Barstool Sports founder David Portnoy. In June, this self-promoter called Warren Buffett an "idiot" and said day-trading is "literally the easiest game I've ever played" adding "all I do is print money". Frame it!

According to *Gavekal Data,* if one removes the US market from the MSCI World Index, the rest of the world has gone nowhere, in aggregate, for six years. It is a testament to the failed experiment QE has been in attempting to inspire real economic growth.

The strength in US markets is despite S&P500 earnings forecast to fall 20% year-on-year over the next four quarters, according to analysts surveyed by Refinitiv. This represents a significant turnaround from the 10% growth forecast before COVID-19 hit.

My updated opinion on Afterpay

There is no better insight into the real and present madness of crowds than the Buy Now Pay Later (BNPL) leader Afterpay. Its share price is up almost eightfold since March, thanks in part to COVID-19 accelerating online and cashless retail sales. Government employment support programmes both here and in the US ensured millennials were able to meet their repayment obligations to the company. Share price support was also aided by the appearance of the Chinese company Tencent on the register.

Afterpay now has a market capitalisation of $19 billion, although the company generates just $230 million of revenue and a bottom-line loss. At the time of writing, Afterpay is the 18th largest listed company in Australia, bigger than Cochlear, Sydney Airport, Aristocrat, Brambles or shopping centre owner Scentre Group (formerly Westfield). It's bigger than Bluescope, Qantas and Lendlease combined.

Its two founders recently sold $270 million worth of shares in their second sell down in 12 months, which is more than the annual revenue the company generated.

Afterpay is simply a factoring company. It buys a retailer's receivables or debtors for a fee and then collects the amount owing directly from the debtor. Factoring businesses have always made thin margins which partly explains why this company will have to keep raising money and diluting shareholders to fund its expanding book.

In 2021, I will mark my 30th year in financial markets and I have seen many booms and busts in that time, not only in stocks but in currencies and commodities too. Stepping back from all the noise, there are a few occasions in one's life where value simply slaps you in the face.

Oil trading at negative US$37 earlier this year or the US dollar at US$1.08 in 2011 are two relatively recent examples I took advantage of.

There are an equal number of occasions where value is so distant from the minds of the investor that the only safe course of action is to zip up one's wallet. Technology stocks today appear to be one of those occasions.

Trading on revenue multiples, not profit

Putting sentimentality aside, paying 51 times revenue for Shopify, 37 times revenue for Zoom or 20 times revenue for Twilio will produce a low return over the next few years for investors. That low return however is accompanied by the risk of a sharp loss of capital. On a risk-adjusted basis, it makes more sense to secure a low return from cash at present.

Consequently, we are content to hold a higher allocation of cash in our funds. We might miss more of the party but it is a party we'd rather let David Portnoy and his friends enjoy. I wouldn't be seen dead at it.

No fund manager or analyst can see the shape of employment and therefore true consumption because government largesse in the form of wage subsidies has replaced wages of those furloughed. Spending patterns must and will therefore change. Predicting those changes while government handouts remain in place is next to impossible.

Having some cash in this environment makes sense and so does reducing the 'beta' or risk of the portfolio.

Investors would be wise at this juncture to consider whether expectations of an imminent end to the pandemic are premature. If a vaccine is not developed, and first and second COVID-19 waves send cities and countries back into lockdown, keeping borders closed, then the unbridled enthusiasm currently gripping markets is equally misplaced and premature. This may be one time the Fed's liquidity cannot do 'whatever it takes'.

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.

Citi's Gofran Chowdhury: clients don't think the worst is over

Graham Hand

Gofran Chowdhury is Head of Investment Specialists at Citi Australia.

GH: How have your clients changed their investment patterns over the past six months?

GC: Since COVID hit, investors have become a lot more conservative with their portfolios, they are looking for more certainty. Previously, investors were keen on exposure to equities, but now, there is more in fixed income. Our investors benefited from wider credit spreads when interest rates were higher than now. As the market recovered recently, their bond valuations rose, and they have invested more. We saw a 44% increase in fixed income investment in Q1 and Q2 of 2020 versus Q1 and Q2 2019.

People were also worried that interest rates were going to zero, so they locked in an income that pays say 3%. We also saw a big jump in term deposit investments even at low rates, including investors who sold their equity portfolio in February and March and were holding cash on the sidelines waiting for an opportunity.

GH: What's an example of the bonds they have been buying?

GC: The most popular Australian bond during COVID was Coles 2029 paying around 2.8% or 2.9%. At that time, term deposits were paying 1% to 2%. A lot of people realised, especially with the run on toilet paper and pasta, that no matter what happens, shoppers still need to go to the supermarket. We also saw demand for Dell 2026 and Dell 2029 offshore, as part of the technology theme around the fact that people are working remotely, using technology more. So another behaviour change we have seen is investors looking for names that will make money during a pandemic.

GH: And has that continued since the low of March?

GC: There was a change in May and June, when we saw some clients looking for investments that would perform well post the pandemic, the early enablers of the economic recovery, such as resource stocks like BHP and Rio. The thought process was the fact that once we come out of this pandemic, governments will move heavily on infrastructure investments, generating demand for resources.

However, more recently into July, the second virus wave in Victoria and other countries had an immediate impact that surprised us. A lot of investors started to buy US dollars as a safe haven currency and a diversification strategy, although they don't earn a lot of interest. They see the US dollar as a natural hedge to the Australian equity markets, so if there is a correction in equity markets, the US dollar tends to hold its value.

Our investors were also seeking US dollar investments in the fixed income space. It surprised us because traditionally Australians tend to invest in Australian names.

GH: But did your clients see March as an equity buying opportunity and participate in the subsequent rally?

GC: There has been a lot of talk about the rise of retail investors going into the stock market, and we did have some clients looking for growth assets. But more generally, our clients don't think that the worst impact of COVID is over. They certainly don't see a straight-line growth from here, so they were looking to protect the downside as well using tailored investments.

GH: Do your clients believe there is a disconnect between low bond markets and strong equity markets?

GC: Our clients realise the market is flush with cash, driven by liquidity. Central banks are pumping money in, and some clients are worried it will lead to inflation. I like to use the example of a chair with one of its four legs missing. Although you can sit on a chair which has three legs, it might be shaky. The fourth leg needed by the economy is the drugs and vaccines to control COVID-19. Until there is medical success, our investors are cautious of this rally.

GH: Tell us more about these tailored investments you mentioned.

GC: We take the client's view on the market and build something to back that view. Usually, they want certainty but they don't want to time the market. They don't think they are fund managers, but we build a predefined payoff that backs their view. An example last month was clients believing the market will rise over the next five years but they wanted downside protection over the first year. So we tailored a deal which participates in the upside and limits the downside.

Another popular one recently was built around the uncertainty of bank dividends, which are a big part of Citi's client portfolios. Even if the dividends go down, they want a consistent income stream. Sometimes clients ask for Citi's view and we build something around that. For example, Citi is bullish on certain tech sectors, so we have a payoff whereby a client can participate in 125% of the positive performance of tech giants Amazon, Apple and Google. The payoff enables the investor to get more than just the 1:1 return they would receive by buying the equity direct and on the downside have a 40% barrier to protect against volatility.

GH: In your wealth management business, have you faced the same issues as the big Australian banks with conflicts of interest in a vertical integration model?

GC: Our focus is on open architecture, so generally, we are not a business in Australia that manufactures its own funds management products. We've seen our friends in the big four struggle with that business model. We have a global capability to access securities which clients can't get from our competitors. For example, we have one of the largest spectrums of bonds and access to every issue we want. We distribute in all the markets Citi operates.

GH: What's the platform that your clients' investments sit on to make the administration and monitoring and management of those investments easier. Do you offer any of the major Australian platforms or managed accounts?

GC: Again, unlike our competitors, we have our own platform fully integrated with client banking, and we don't charge a platform fee. The reason we are able to do that is that the platform is the same for clients in Singapore or Hong Kong or wherever. Many clients invest and live in multiple geographies so all their wealth can be viewed in one place. Having said that, it does not have all the features and flexibility of some of the local players.

GH: If a wealthy couple comes to see you for the first time, embarking on an investment journey to finance say 30 years of retirement, what's the first question you ask? How does the conversation start?

GC: It's a great question. If someone's looking at a 30-year plan, first we want to understand if they're coming to us for investments or they're coming for advice. We don't provide personal advice, we operate in the wholesale investment space. We are keen to educate and give a good understanding of the markets, but we refer them to a financial planner externally for advice. We want our clients to be comfortable making their own decisions. So the first questions are normally about their knowledge and experience.

GH: Assuming a person understands a reasonable amount about the market and they've had some financial advice, how does the investment conversation start?

GC: We try to understand what problem the client is trying to solve and what is their view. We will provide the options. We operate like a co-pilot and the client is still piloting the plane. We don't make the decisions. Many of our clients are successful in other fields and confident making their own decisions.

GH: Last question. What is Citi's view on recovery from the pandemic and vaccines?

GC: Our base case is a U-shaped recovery. We think we'll be in these difficult conditions longer than many others expect. The adverse long-term impact on many sectors such as airlines and travel will be huge. We thought there would be a second wave and that is now happening. We've been impressed by the collaborative efforts from governments and central banks, both fiscal and monetary policy. There will be a lot of structural changes in future as well.

Graham Hand is Managing Editor of Firstlinks. Gofran Chowdhury is Head of Investment Specialists at Citi Australia, a sponsor of Firstlinks. This article is general information and does consider the circumstances of any investor.

For other papers and articles by Citi, click here.

Two thematics to watch in volatile times

James Delaney, Sean Fenton

We believe a liquid, diverse portfolio focused on a repeatable investment process is the best way to generate consistent returns through time, including in volatile markets. The two thematics that demonstrate how we are applying our thinking at the moment are first, our approach to growth stocks and second, our approach to yield.

1. Growth stocks: lower interest rates magnify growth valuations

Markets have rebounded strongly from a sharp collapse in March 2020, with many stocks now trading at record highs. This has been driven in part by central bank stimulus, but also substantial fiscal support from governments. Much of this liquidity has found its way into growth stocks and the technology sector in particular. Valuation multiples have expanded significantly and while it is tempting to describe this as a bubble in the making, it actually makes sense in an environment where central banks have cut cash rates to zero and driven bond yields down to similar levels.

This drop in discount rates has made growth stocks incrementally more valuable.

This thematic doesn't mean growth and technology stocks are low-risk investments. For instance, good news in markets and stronger growth could cause central banks to pull back on liquidity and taper bond purchases. This could prompt volatility across high growth stocks so it's prudent not to have too much exposure to this dynamic. Our fund structures allow us to take long positions in the most attractive stocks and short positions in the least preferred.

Two stocks we like

Within the Sage growth sector there are two stocks, global artificial intelligence (AI) pioneer Appen (APX) and online recruitment firm Seek (SEK), that demonstrate why it's important to understand the fundamentals that drive earnings and valuations. When we set our long and short positions, we're not necessarily looking for stocks that will fall and rise in absolute terms, we're looking for relative performance.

We believe Appen demonstrates superior relative value compared with Seek. Appen provides human annotated data sets to help companies like Facebook and Google constantly improve their AI algorithms for search optimisation, e-commerce and speech recognition. Appen utilises over one million contractors who annotate data in relevance, language, video and image sets. Some forecasts estimate AI data spending will grow by up to 40% a year to create a US$17 billion market by 2025. Appen, by far the biggest player in this market, is itself growing organically at 30% a year. It has also made some smart acquisitions which have supercharged growth since 2014.

Appen is also building on its competitive strengths. It has access to five times the data of its nearest competitor and it's using this advantage to train its proprietary learning tools. As Appen processes more data, its own algorithms learn and become more efficient, giving the company a pricing advantage over smaller peers. Near term, the US election is an opportunity for the business given social media platforms are an important client for Appen. The Cambridge Analytica scandal marred the outcome of the 2016 US election after Facebook failed to adequately monitor its algorithms, a failure political interest groups then exploited. Going into the US election, we expect strong demand from the major social media platforms for Appen's services as avoiding a similar scenario this time is top priority.

Appen is trading on a price-to-earnings (PE) multiple of 47x. This may seem extreme, but it has re-rated less than many other growth stocks and is relatively cheap compared with Seek. Seek has a one-year forward PE multiple of 64x, but it is not generating the same growth as Appen.

Recruitment firm Seek is a long-term growth stock, which has benefited as job ads have transitioned from newspapers to online. But earnings have not grown since 2015 and the company has been beset by a series of downgrades which the COVID-19 pandemic has accelerated. Seek has also been affected by the maturation of the migration from print to online, as well as increased competition from LinkedIn and aggregator sites like Indeed.com.

Seek does have some potential to generate growth. It is pursuing new, offshore markets and it has had some success in China with Zhaopin, although this business' shift to a freemium model has generated revenue growth that hasn't translated into bottom line or EBITDA growth. It also has the ability to pursue value-added opportunities, such as charging higher prices for high-paying jobs listed on its site, which is a trend among similar domestic portals. In our view, there isn't sufficient visibility around the success of such changes in the business model to justify the valuation multiple in the share price.

When we compare these two stocks, Seek's share price growth has outpaced its earnings-per-share (EPS) downgrades, with the falling cash rate and quantitative easing inflating its valuation. In contrast, Appen's EPS is continually growing, supporting the re-rating of its share price upwards.

The following chart of share prices highlights that Appen (green line) has delivered far greater capital growth despite Seek (white line) enjoying a larger valuation re-rating.

Source: ASX

We believe Appen is becoming a better-quality business with more competitive advantages and more repeatable earnings growth than Seek.

2. Yield: opportunities in the Australian debt collection sector

Credit Corp, a debt collection company with operations in Australia and the US, looks relatively attractive across the Sage yield sector. The experience of the GFC highlights that debt collection companies do well immediately following a recession as banks sell off high volumes of bad debts, creating a buyer's market for companies like Credit Corp. Indeed, Credit Corp's strongest returns on invested capital came in 2009-11.

This opportunity couldn't have come at a better time for Credit Corp. The business has net cash and has plenty of capital to deploy. Its Australian competitors, such as Collection House, Pioneer Credit and Panthera Finance are all in trouble. Even before the crisis hit, they were all over-geared. Indeed, in the last 12 months both Pioneer and Collection House have been in a trading halt pending debt restructuring discussions with creditors. These peers make up more than 50% of the Australian debt collection market. To satisfy their creditors, peers adopted aggressive collection practices, which has led to increased customer complaints and angered major debt sellers. This environment has shifted seller preferences towards Credit Corp. There is a lot to like about this business.

A switch from banks in this sector

Banks are the relative losers in this space, particularly Westpac and Bendigo Bank. One of the core drivers of bank profitability is net interest margins (NIM) which is the spread between what banks lend at and the cost of their sources of funds. NIMs have been trending down for many years as competition has whittled away at them, but the COVID-19 crisis has seen this pressure intensify. Banks traditionally have some very cheap sources of funds from transaction accounts that pay little interest, but lending rates have fallen faster than their cost of funds (because part of that funding source was already near zero). This places pressure on NIMs. Changes in the regulatory approach from APRA also means there is intensifying competition for high-quality low-risk borrowers. This has been a key source of profit for the major banks and is coming under increasing pressure from non-bank lenders.

There are also some tail risks for the banks around bad debts. With 10% of home loans and 30% of small business loans in forbearance due to the COVID-19 disruption, they are all increasing provisions for bad debts, but it's unclear how bad it will be. The banks generally have downside risk to the losers through bankruptcy and credit losses while they gain little from the stronger profits of the winners.

These structural and cyclical pressures make banks a good source of funding for a long position like Credit Corp. Those banks with greater exposure to NIM compression like Bendigo Bank or a higher proportion of investor lending like Westpac are our least preferred among the banks.

Downside risk management is important

We remain intensely interested in the balance between economic growth and central bank and government support that is driving stock performance across the market. We manage this risk by being broadly neutral across our eight Sage Sectors to avoid any style bias and to minimise the impact from economic shocks.

We also maintain a broad range of active stock positions to reduce the reliance on any particular stock idea. We increase or reduce position sizes in line with our conviction, taking into account liquidity and company size. In the current high volatility environment, we can take smaller individual stock positions and still meet our return targets. The sweet spot for the portfolio is in the top and middle part of the S&P/ASX 200 where there is a good blend of liquidity and potential for strong stock performance. This allows us to offer a genuinely style-neutral investment portfolio that we believe is appropriate for current market conditions.

Sean Fenton is Chief Investment Officer and Founder of Sage Capital and James Delaney is Portfolio Manager at Sage Capital. This article contains general information only and does not consider the circumstances of any investor.

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Four ways to reduce the generation blame game

Emma Davidson

"OK Boomer" - you no doubt recognise the phrase. Among some Millennials, Gen Zers and maybe even the newest, Gen Alphas, it's the verbal equivalent of an eye-roll. A way for young people to breezily dismiss the attitudes and opinions of Baby Boomers who they disagree with (or with whom they disagree, depending on the generation reading this article).

'OK Boomer' started as a niche meme in online forums in the mid-2010s, but last year, it went mainstream. Fans of the phrase claim it's a pithy comeback to 'snowflake'; an insult they say is routinely thrown at them by older people who think youngsters are overly entitled, spoiled and sensitive.

Is it really the case that generations are more divided than ever before? If so, what's causing it? Why now? And how can we move forward?

These are crucial questions as the world prepares for one of the biggest wealth transfers in history. American Millennials are expected to inherit more than US$68 trillion from Baby Boomers over the next 10 years. In Australia, the over-60s will pass down (or spend) an estimated AU$3 trillion within the next two decades.

With this in mind, perhaps now would be a prudent time to bury the hatchet between the generations.

Where did generational theory go wrong?

I found generational theory fascinating when I first started learning about it several years ago. It seemed logical and intuitive that people of similar age groups would share common characteristics and values based on the political, economic and social environments that shaped their formative years.

As time goes by, however, the conversation has become more toxic. Instead of focusing on the respective strengths and shared goals of each group, media headlines obsess over generational 'splits', 'gaps' and 'divides'. The worst traits of every demographic are exaggerated and mocked.

The generations are now regularly described as being at war with one another.

That's not to say this is a new phenomenon but resentments have clearly risen over the last few years, and Boomers aren't the only generation under a harsh spotlight now.

So, what changed?

According to Jennie Bristow, author of *Stop Mugging Grandma: The 'Generation Wars' and Why Boomer Blaming Won't Solve Anything,* serious negativity between the generations didn't start simmering until the mid-2000s.

She believes there were two major catalysts: 9/11 and the Global Financial Crisis (GFC). She writes:

"These events had a particular, and profound, impact on the young people coming of age in this fearful new dawn. The 'spirit of the Sixties' - experimental, freedom-loving, boundary-pushing - had never seemed so ethereal.

"And those who embodied that spirit were no longer cast as the bright beacons of the counterculture, but seniors tottering on the brink of retirement, and about to drain what little was left of the national wealth with their greedy houses, rapacious pensions and inflated Social Security entitlements."

Are the generations really at war?

Negative generational narratives have been building since the early 1980s. Back then, people were worried that 'under-achieving' Gen Xers wouldn't be as financially comfortable as their parents.

Unfortunately, policymakers haven't done much to change the mood. Governments have become increasingly worried about ageing populations and the strain that pensions and other state benefits could place on national budgets as the average age of citizens rises.

In the pursuit of austerity measures following the GFC, greater political and media emphasis has been placed on highlighting the have and the have-nots across generations.

But while the generational blame game seems to be a favourite topic among politicians, journalists and other social commentators, research suggests one demographic doesn't buy into it: the general public.

In the UK, for example, a 2017 Intergenerational Commission study found that, yes, young people are very pessimistic about the future, yet very few blame Baby Boomers or government policies that favour older generations.

Survey respondents overwhelmingly criticised house prices (49%), a lack of stable employment opportunities (38%) and the world becoming a more dangerous place (24%). Overly generous state pensions (10%) and older people enjoying a greater share of wealth and income (10%) were considered far less important.

There's even evidence to suggest different generations are closer now than at any other point in recent history, both figuratively and literally. In Australia, more people are living at home with their parents for longer, and the Bank of Mum and Dad is the country's fifth biggest lender.

Two-thirds of grandparents also provide weekly childcare for their grandkids to ease the burden on households where, in many cases, both parents work. And 84% of Australians say they would turn to their family for help in a crisis.

It hardly sounds like generational trench warfare!

Young people today face many problems. Home ownership has plummeted among the under 35s, wage growth has stagnated, and job insecurity is high. But these problems are largely due to structural, economic and socio-political issues, rather than the fault of a particular generation.

So rather than argue over the differences between generations, let's focus on our similarities and strengths.

Passing on the baton

Ultimately, generational theory is just that: a theory. When most people think about their relationships with different generations, it's usually at a much more practical level. We worry about our families - their health, their wealth and their future.

Over the past two decades, I've worked closely with a range of investors from all the generations, and most of them want answers to the same key questions. Will their wealth last? What are the best ways to pass it on? How can they budget for a higher cost of living and medical expenses as they get older?

I've been asking myself similar questions, having had two children of my own in the past few years. If these issues are keeping you awake at night, here are four of my own thoughts on transferring generational wealth.

1. Enjoy your money

First and foremost, the wealth you have built up is yours, so don't be afraid to spend it. As an Xennial with Boomer parents on my side and my husband's, I feel quite strongly about them enjoying their hard-earned cash in retirement and I would hope most children feel the same way.

2. Talk to your family

According to a Perpetual study, 76% of Australians don't have a Will, and 53% have never spoken to their children about their inheritance or legacy. Conversations about money are inevitably awkward, but communication is key to ensuring a smooth transition of wealth.

3. Educate your children on investing

It's commonly said that 90% of generational wealth is lost by the third generation. A great way to safeguard wealth is to teach children (and grandchildren) early about building a portfolio. Let them benefit now from the vast knowledge you've built up over a lifetime of successful (and sometimes unsuccessful) investing.

4. Leave behind an investment how-to guide

If you find it too hard to talk to your family about wealth and legacy (or you think they won't listen to you while you're alive!), write everything down. Whether it's in a will, a letter of wishes or an informal manual, talk about your investment decisions - the good, the bad and the ugly - as a parting gift. And don't be afraid to add personal stories, jokes and anecdotes.

It's not a time to encourage division

Talk of generational divides may be exaggerated, but it's definitely unhelpful. Now certainly isn't the time for division.

Let's instead focus our energy on using the strengths of each generation to our collective advantage.

Emma Davidson of Staude Capital Limited in London is the Head of Corporate Affairs for the Global Value Fund (ASX:GVF). This article is the opinion of the writer and does not consider the circumstances of any individual.

Is gold a growth or defensive asset?

Jordan Eliseo

Gold investors have enjoyed a stellar 2020, with the yellow metal rising by 16% in USD terms and 19% in AUD terms in the first six months of the calendar year. On 27 July, gold reached an all-time high in nominal terms of US$1,944 a troy ounce. Since the cyclical bear market bottom seen in late 2015, the gold price in USD terms has increased by more than 80%.

Investment demand continues to rise, seen most clearly through the more than 700 tonnes of inflows into gold exchange traded products (ETPs) in the first six months of 2020. Whilst the United States and Europe dominate these figures in terms of total tonnage, demand is also strong in Australia. Inflows into Perth Mint Gold (ASX:PMGOLD) have seen total holdings rise by more than 50% in the first half of this year.

The increase in demand locally is driven by self-directed investors like SMSF trustees, as well as financial intermediaries looking to allocate a portion of their client portfolios to gold. Nevertheless, some investors are still grappling with the question of where gold fits within a portfolio. In many cases, investors are assessing whether gold should be seen as a growth asset or a defensive asset.

What kind of asset is gold?

It's easy to understand why some investors see gold as a growth asset. It is a commodity, and commodities are almost universally seen as growth assets. Gold has also historically exhibited price volatility that is similar or even slightly higher than the equity market. Gold also delivers no income stream, with capital growth the only way it can provide a return to investors.

Given defensive assets are expected to generate regular income, and typically display lower volatility than equity markets, some investors struggle to view gold as a defensive asset.

However, gold does have some defensive asset characteristics. Physical gold is a zero credit-risk instrument, meaning there is no default risk. This is one reason why central banks hold almost 35,000 tonnes (worth over US$2 trillion in value) of the metal as part of their reserve assets. These central bank gold holdings have been growing for more than a decade, indicating gold is still seen as an important monetary asset amongst these institutions.

Gold also behaves differently to traditional commodities in terms of its interplay with risk assets. Not only does gold have a low overall correlation to equity markets, but this correlation usually turns sharply negative during the worst equity market sell-offs.

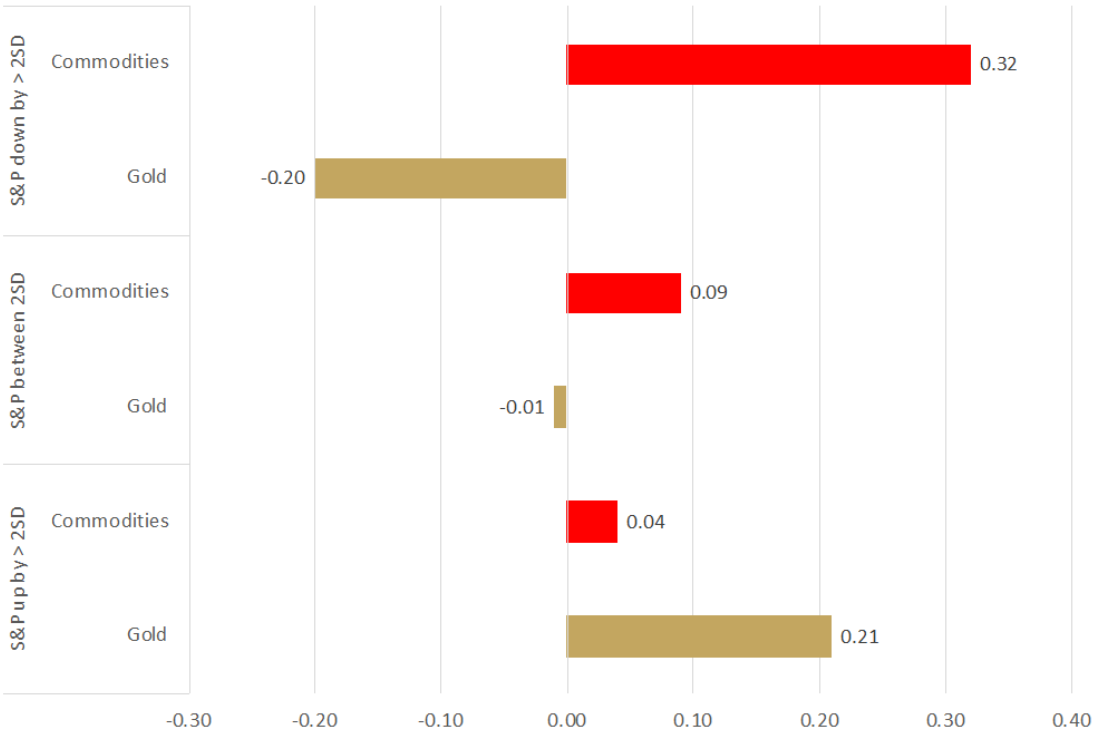
Commodities, on the other hand, are positively correlated to equities, with this correlation rising in the worst equity market sell-offs.

The chart below illustrates these differences, highlighting the correlation of gold (LBMA PM gold price) and commodities (Bloomberg commodity index) to equity markets (S&P 500) based on weekly returns between 1971 and 2019.

The chart shows:

- Correlations when the S&P500 falls by more than two standard deviations (top bars)
- Unconditional correlations over the entire time period (middle bars)
- Correlations when the S&P500 rises by more than two standard deviations (bottom bars)

Gold and commodity correlations to equity markets



Source: World Gold Council

The results show if an investor wishes to reduce overall portfolio drawdowns (losses) during periods of equity market stress, then history suggests gold is an asset to turn to, rather than a commodity basket.

Unlike other commodities, gold has historically delivered positive returns in low inflation environments and during deflationary scares.

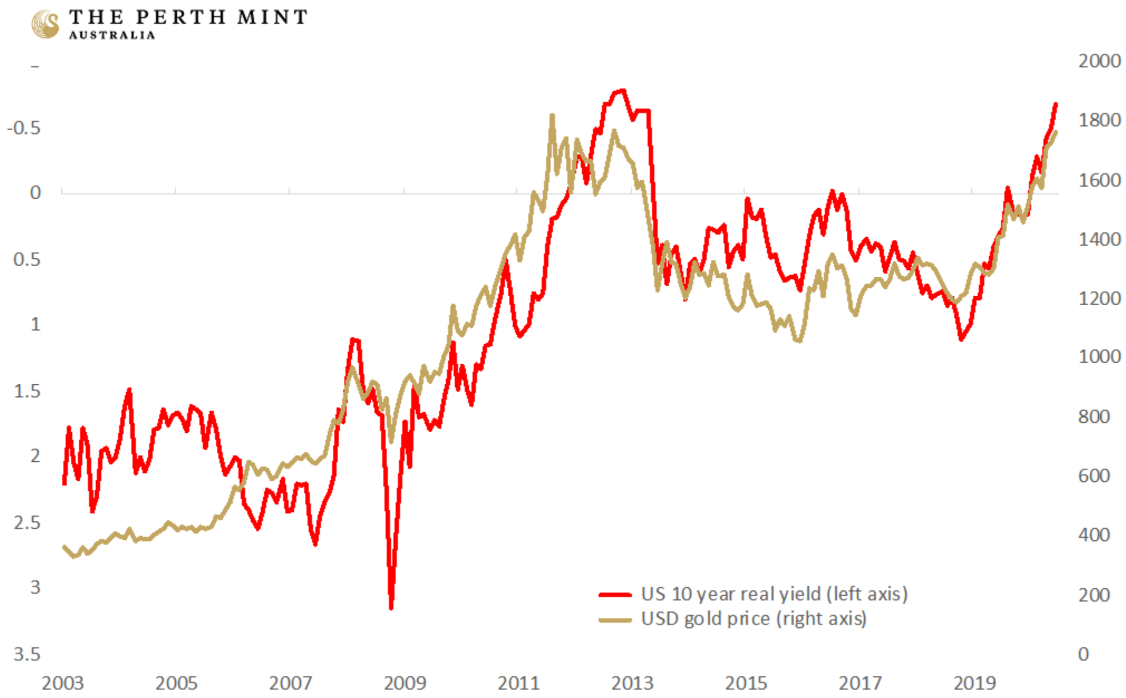
Gold trades more like a bond

Furthering the case that gold can be seen as a defensive asset is the fact that the precious metal tends to trade like a bond and has many attributes similar to types of bonds.

It has no maturity date like a perpetual bond, a credit risk of zero (like most sovereign bonds) and no coupon like a zero-coupon bond. History shows that investors have been willing to pay more for such an asset in environments where the real yield available on zero credit risk (but not zero inflation risk) bonds is declining.

This is demonstrated in the following chart, which plots the correlation between the USD gold price and the real yield (which is inverted on the chart) on United States 10-year Treasury bonds from January 2003 to June 2020.

USD gold price and real yield on US 10-year treasury bonds



Source: The Perth Mint, United States Treasury

While it is not a perfect correlation, the chart is evidence that the lower real yields on Treasury securities fall, the higher the gold price tends to go.

Given the above relationship, it is natural that investors who are worried that real yields may stay below zero or continue to decline for the foreseeable future are turning to gold today.

What do self-directed investors think?

Self-directed investors largely seem to see gold as a defensive asset. In a recent webinar for the Australian Investors Association, we asked attendees whether their motivation to invest in gold was driven primarily by a desire to preserve wealth or to generate a profit.

More than 75% of those who responded stated that wealth preservation would be the primary motivation for making an investment into gold. Indeed, this theme was addressed in a *Firstlinks* article written by Noel Whittaker last week. Titled *Hedging for capital preservation*, the article discussed three options an investor looking to protect a portfolio from equity market drawdowns could consider. Investing in physical gold was one of those options.

Irrespective of whether gold is considered a growth asset, a defensive asset or a hybrid of the two, the precious metal has attributes that can be beneficial to investors managing a balanced portfolio, especially given the challenging economic and monetary environment that investors are expected to face for many years.

Jordan Eliseo is Manager of Listed Products and Investment Research at The Perth Mint, a sponsor of Firstlinks. The information in this article is for general information only and should not be taken as constituting professional advice from The Perth Mint. You should consider seeking independent financial advice to check how the information in this article relates to your unique circumstances.For more articles and papers from The Perth Mint, click here.

Large super funds struggle to match index in Aussie equities

Donald Hellyer

"*Extraordinary claims require extraordinary evidence*," according to the Sagan Standard, the observation made popular by astronomer Carl Sagan. Any large superannuation fund claiming it outperforms the market should provide the proof, but for Australian equities, the public evidence does not support the assertion.

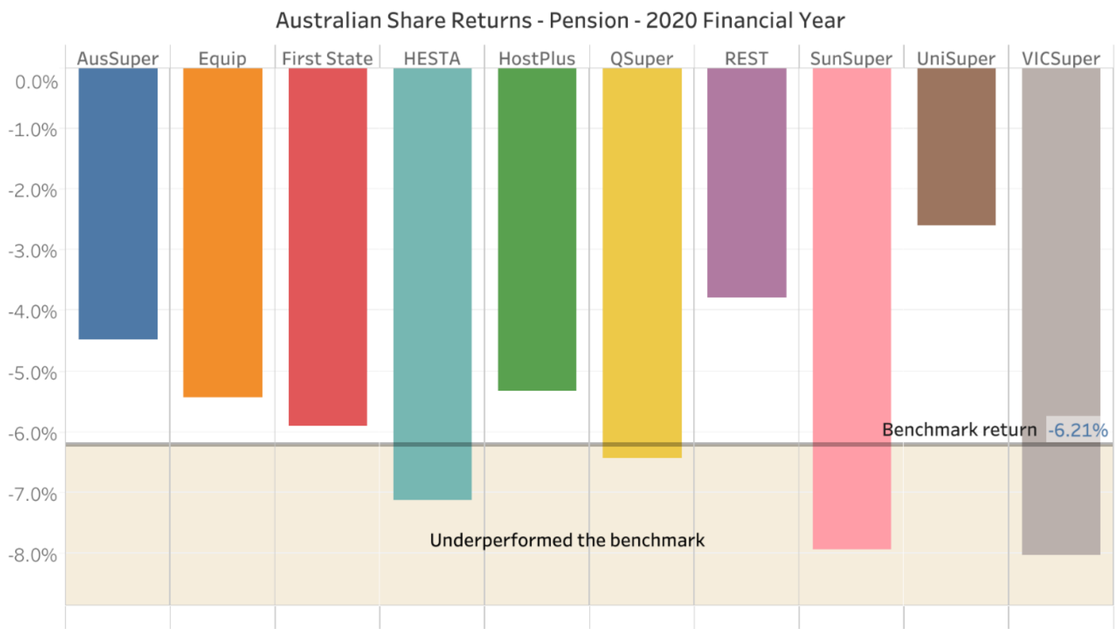
Diving into the data

A sample of Australia's largest superannuation funds shows the average performance for Australian equities over five years after fees for a pension account was 7.29% versus a benchmark return of 7.56%. For 10 years, the average return was 9.11% compared to a benchmark of 9.31%. At best, this result suggests that superannuation funds with their large investment teams performed no better or worse than an individual investing in a passive equity fund.

APRA was not short of critics when it introduced its Heat Map to judge fund performance. Superannuation funds, asset consultants and rating agencies all joined in. Assessing fund performance is indeed tricky, but the mediocre performance by superannuation funds for Australian equities supports APRA taking an analytical view.

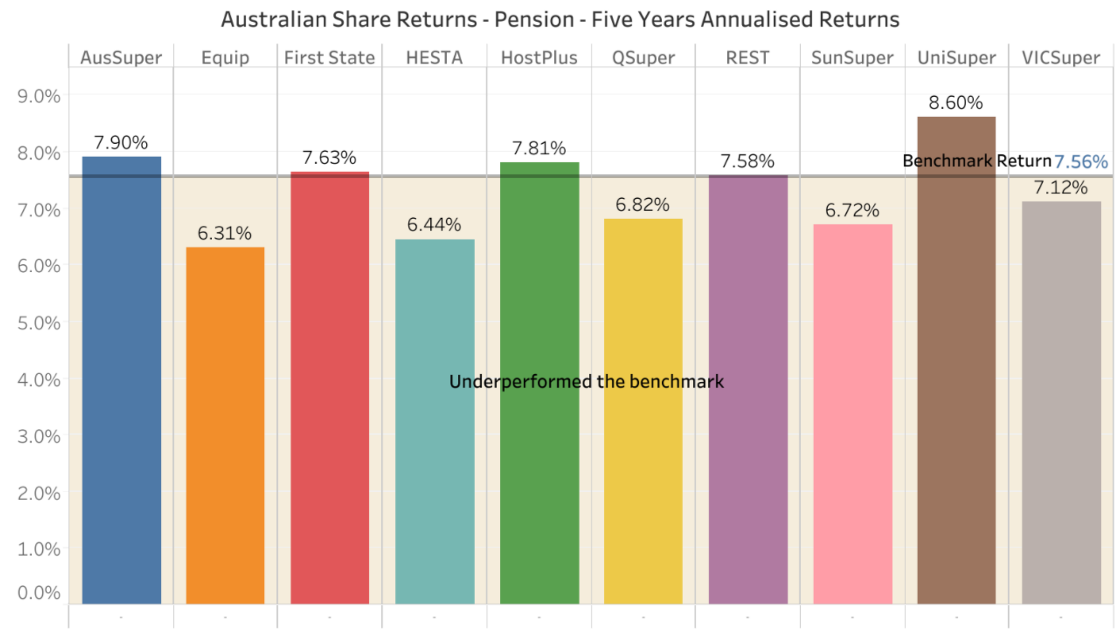
We, at BigFuture, took a straightforward and conventional approach to compare superannuation funds' performance for Australian equities. **First**, we took the returns of a superannuation fund's pension tax-exempt fund. This avoids the debate about a fund's after-tax returns with the split between current versus capital gains. **Second**, we compared these returns to the S&P/ASX300 Total Return Index Adjusted for Franking Credits (SPAX3F0). Some superannuation funds prefer to have the S&P/ASX300 Accumulative Index, but there is a free kick here as those franking credits have value.

First, the good news. Superannuation funds did beat our benchmark for the last financial year to 30 June 2020. The benchmark return was -6.21% compared with the average superannuation return of -5.71%. 50 basis points (bps) or 0.5% outperformance is very useful in a down year.



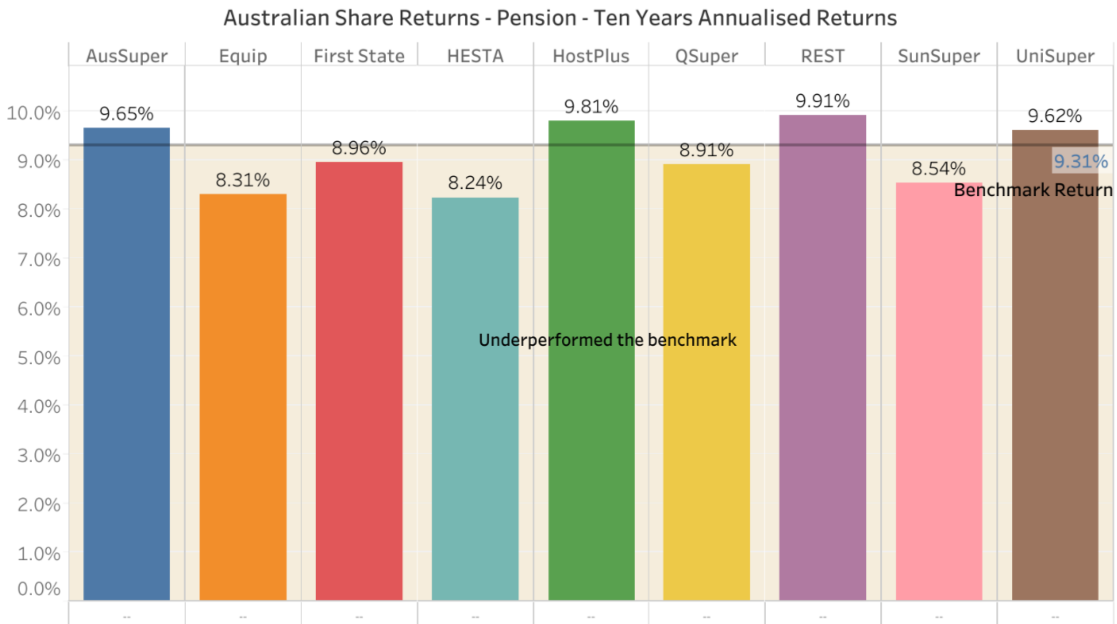
Note: CBUS and CSS do not have Australian Shares investment options.

However, when we look over the longer-term, the picture is less rosy. The returns for five years show an average return of 7.29% against a benchmark return of 7.56%. HostPlus, who *The Australian Financial Review* seems to take pleasure tormenting due to its investments in unlisted assets, performed well beating the benchmark by 25 bps (0.25%). The standout was UniSuper, beating the benchmark by 104 bps or 1.04%. The average return declines from 7.29% to 7.10% if we exclude UniSuper.



Critics of APRA's Heat Map say five years is too short a period to compare funds. Some suggest 30 years but let's get serious. No superannuation fund would keep an Australian equity manager who underperformed for 30 years. Members should not do the same.

Over 10 years, these large superannuation funds are struggling. The average return for superannuation funds is 9.11% after fees compared to our benchmark return of 9.31%.



Is close to the benchmark reasonable?

To be fair, these returns look like noise around the benchmark, but expert investment teams are expensive and their processes are complicated. It would be interesting to know how many superannuation trustees are challenging the assumption of deploying these resources for no additional return. Trustees may be impressed by the economic and political savvy of active managers but where is the extra return beyond good marketing? QSuper Australian equities fund wins our gold star for going passive.

An article like this wins no friends. You don't get employed or become rich by criticising superannuation funds. Investment teams, asset consultants, active managers and even rating agencies all earn good incomes. No doubt, there will be critics who say the logic of this analysis is flawed. But if this is wrong and we tried our best to analyse the data in detail, and if no one else can provide reliable numbers to the contrary, then we will leave it to APRA to sort it out. Members should have easy-to-access, comparable data.

One way to look at it is that superannuation funds perform no better or no worse than the index. Perhaps one reason is superannuation funds now own so much of the Australian share market. It's hard for one professional team to beat another professional team. In 2019, Rainmaker estimated that superannuation funds owned 40% of the total share market and this was expected to grow to over 50% by 2030, a trend supported by Deloitte.

A second reason for seeing an outperformance only last year could have been that institutional investors were favoured over retail investors with new equity raisings during COVID. This is speculative but worth analysis.

Member difficulty understanding the benchmark

Consider the table below to see the challenges for a member to work out if their superannuation fund is competitive and performing well for the most straightforward asset class with the simplest of benchmarks.

Fund	Benchmark for Australian Equities (Pension Account)	Performance vs. Benchmark on Website	Performance vs. Benchmark in Annual Report
Australian Super	To beat the S&P/ASX 200 Accumulation Index (adjusted for franking credits) over the medium to long-term. NOTE: prior to 1 July 2020 the benchmark was S&P/ASX 300 Accumulation Index.	Raw data. No easily seen report for members.	Yes
Equip Super	S&P/ASX Accumulation 300 Index, over a rolling 5-year period	No	No
First State Super	S&P/ASX 300 Accumulation Index before taking into account fees, costs and tax.	No	No
HESTA	95.0% S&P/ASX 300 Accumulation Index (adjusted for tax credits). 5.0% Bloomberg AusBond Bank Bill Index.	No	No
HostPlus	CPI plus 5% per annum on average over 20 years.	No	No
QSuper	S&P/ASX 200 Accumulation Index, after fees and tax.	No	No
REST	Outperform the S&P/ASX 300 Accumulation Index (after fees and including an estimate of imputation credits) over rolling three-year periods.	Yes	No
SunSuper	Beat the S&P/ASX 300 Accumulation Index by 0.25% p.a. before investment tax but after investment fees and costs, over rolling 5-year periods.	No	No
UniSuper	To achieve returns (after Fund taxes and investment expenses, before deducting account-based fees) that are at least 4.5% p.a. more than inflation (CPI) over the suggested time frame.	Yes, for one period, but then they compare themselves with the peer group for all periods.	No

Amid criticism, APRA is pushing ahead with its Heat Map, and it will be notable whether the soon-to-be-released Retirement Income Review 'fact base' reaches a firm conclusion on large fund performance.

Donald Hellyer is CEO of BigFuture. BigFuture is a technology consulting and development company specialising in building applications for fund managers, superannuation funds, brokers and banks. This article is general information based on public data and does not consider the circumstances of any investor.

The green lining of COVID-19: a time for change

Lise Moret

The coronavirus outbreak has been a tragedy for many, a shock for us all and a crisis for economies around the globe. We have embarked on a massive experiment, slashing economic activity to limit the pandemic, sharply reducing carbon emissions and preparing for only a slow resumption of growth.

A 'green lining' of this global crisis has been the significant reduction in carbon emissions. Figures from specialist publisher Carbon Brief estimate that carbon emissions in China fell by 25% in February alone, while the European Union could face a drop of 25% in 2020 compared with 2019 levels. Overall, it is estimated the global emission impact of coronavirus will be -5.5%, the largest annual reduction since records began.

Australian targets at risk

Despite these promising figures, in Australia, the political focus may have shifted from its commitment to climate, and its obligations to the Paris Agreement, to economic recovery, which is currently highly reliant on 'old technology' industries, such as mining.

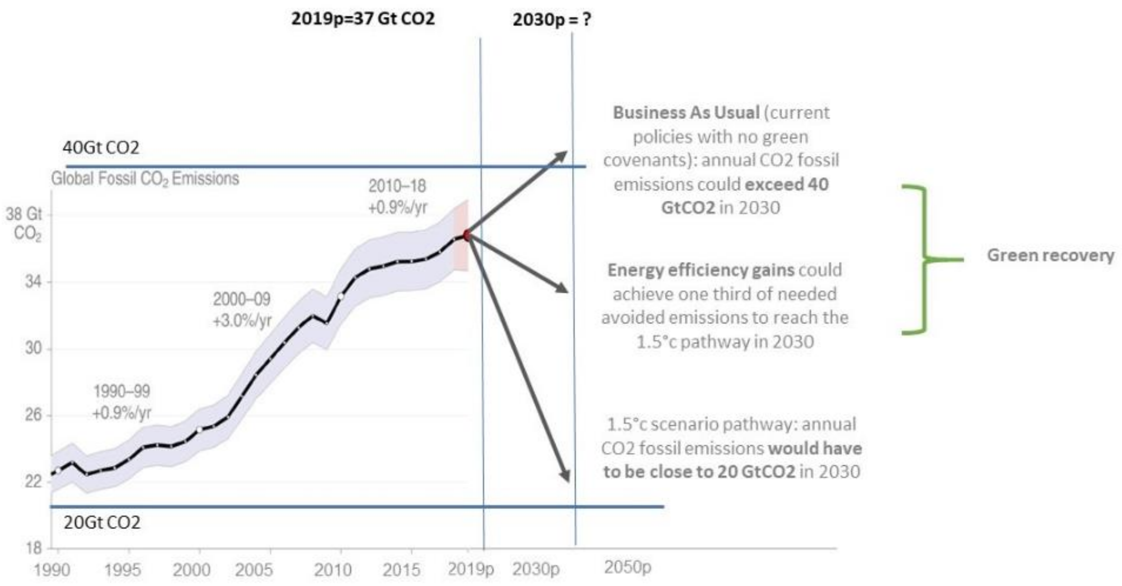
While the Australian Government is currently committed to reducing emissions by 26-30% by 2030, there appears to be reluctance to prioritise green policy and initiatives, putting these ambitious targets at risk. However, following the recent bushfires and social movements, such as Black Lives Matter, Australians are demanding environmental, social, and governance (ESG) initiatives take priority with policy makers, business, and financial institutions.

The question now is whether the world can use this moment to find a 'new normal' and build a less carbon-intensive economic model. It's a model that could put the temperature goals of the Paris Agreement tantalisingly within reach.

Understanding the numbers

To achieve our commitment to a less-than-1.5-degree world, it would take a COVID-19-like event every year until 2050. Starting next year, yearly emissions cuts should be more than 7% and emissions need to peak as soon as possible. If negative emissions technologies are excluded, or fail to become available at scale, then the required emissions reductions for a 1.5-degree world would be an eye-watering 15% every year until 2050, according to the UNEP Gap Report 2019.

Chart: Evolution of CO2 emissions from 1990



Sources: AXA IM estimates, Global Carbon Project, CDIAC, Friedlingstein et al, 2019

It is a sobering thought that over the next couple of decades, we need to replicate and enhance the forced effects of the last few months. This crisis has offered policy makers and investors a rare opportunity to construct a recovery that builds on the progress already made.

The role of policy in economic growth and global warming

One clear point about the hit to global GDP, which is forecast in the IMF World Economic Outlook (April 2020) to contract by -3% this year, is that it is hoped to be temporary. That means the drop in global carbon dioxide emissions will likely be temporary too. Try as we might, to date, we have not yet uncoupled economic growth from global warming.

To create change, an obvious step is to redouble efforts to shift the energy mix. Renewable energy (including wind, solar and bioenergy but not hydro) is growing exponentially (+13.8% per year between 2013 and 2018). However, growth has been too low to offset the increase in fossil energy consumption (+1.5% of oil and +2.6% for gas over the same period) which still dominates. Growth in renewables has outpaced growth in all other forms of energy since 2010 but the share of fossil fuels in global primary energy demand remains above 80%.

Another effective tool for change is through bailouts and stimulus, which governments are offering to support economic activity in the post-crisis environment. Governments can deploy green stimulus to condition business support on a decarbonisation criteria.

Investing for change

Investors can help to build a greener economy through investing in positively evolving businesses and scaling up their company engagement agenda and stewardship commitments.

In 2019, climate change accounted for more than 40% of AXA IM's total engagement with companies. In a 12-month period, we engaged with 217 issuers, voted at 6,016 general meetings, and 64,439 proposed company resolutions were voted on. This was an increase of engagement by 74% from 2018 levels.

Industry bodies and working groups are also an effective tool for driving conversation and change on the climate agenda. An example is the European Alliance for a Green Recovery, which brings together a coalition of policy makers, companies, trade unions and financial institutions to develop a recovery package that accelerates the transition towards climate neutrality and a healthy eco-system. Proposed concrete solutions include the 'European Climate Emergency Fund', which would issue debt instruments whose proceeds would be used to fund green transition projects undertaken by governments or corporations.

The Climate Action 100+ initiative is one of the best-known investor coalitions and engages with the most carbon intensive companies in the world on climate related issues. It has been mostly focused on energy supply sectors, so far, but engagement opportunities still exist in the end-use consumption sectors.

COVID delivers an opportunity for change

It is everyone's responsibility to forge a 'new normal' and capitalise on the significant emissions reductions from COVID-19. To create change, government needs to harden policy thinking and investors need to invest responsibly and proactively engage with companies.

We have been given a glimpse of the kind of adjustments our world needs to make if we are to definitively tackle the looming threat of the climate crisis. Far from distracting us from this, COVID-19 should harden our resolve while teaching us valuable lessons.

Lise Moret is Global Head of Climate Change Strategy at AXA Investment Managers. The full version of this article is linked here.