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Contents

Editorial

The pandemic-induced preoccupation with health problems has eased enough to allow news space for superannuation to regain its place as a political football. **Senator Jane Hume**, the minister responsible for super, told *The Australian Financial Review* that further reform is "in the wings", perhaps at the October Federal Budget, and "a more efficient default system" is under development.

The legislated increases in the Super Guarantee, scheduled to go to 10% on 1 July 2021 on the way to 12% by 2024, are also in doubt. Speaking on the ABC's *Radio National* on 17 August, Ms Hume said she is "ambivalent" about contributions increasing, which is an unexpected fence-sit for a superannuation minister.

"There will be many people, from employees and businesses, that will be concerned that the superannuation guarantee rise comes at a trade-off to their wages and wage increases. It would be irresponsible for a government not to consider that, particularly in light of a pandemic and the economic impact of COVID-19. It is the government's responsibility to make sure that we can persuade the public that the trade-off is the right one to make."

Reserve Bank Governor, **Philip Lowe,** offered his view to the **Standing Committee on Economics** on 14 August 2020:

"I don't know whether it would have a negative effect on employment. It would certainly have a negative effect on wages growth. If this increase goes ahead, I would expect wage growth to be even lower than it otherwise would be. So there will be an offset in terms of current income. Some people say that's perfectly fine because people will have higher future income. There's a trade-off: do we want people to have income now, or do we want them to have it later on?"

In response, Prime Minister **Scott Morrison** said a "rather significant event" had happened since the 2019 election when he promised the increases would proceed.

"They are matters we are aware of and they have to be considered in the balance of all the other things that the government has been doing in this space.”

This week, we take a look at the stoush between Jane Hume and **Paul Keating**, with the Senator saying protecting his superannuation legacy was "obscene" and Keating calling access to super under the early release scheme "willy-nilly".

Meanwhile, back at the coal face of investing, the S&P500 and NASDAQ both hit all-time highs this week. Happy days for investors. **Hamish Douglass** explains why he holds 15% of his portfolio in cash, why he can't call between the boom or bust potential, and why he is optimistic about the future.

A capitulation often occurs at extremes in markets, where the rally becomes so strong that even the doubters cast aside their concerns and dunk into the punch bowl. While Hamish has no FOMO, many other fund managers are late arrivals at the party, with **Bank of America**'s latest survey in the US showing they are now overweight equities again in their Asset Allocation (AA) after exiting during the earlier stages of the pandemic.

Exhibit 33: **Net % AA Say they are overweight Equities**

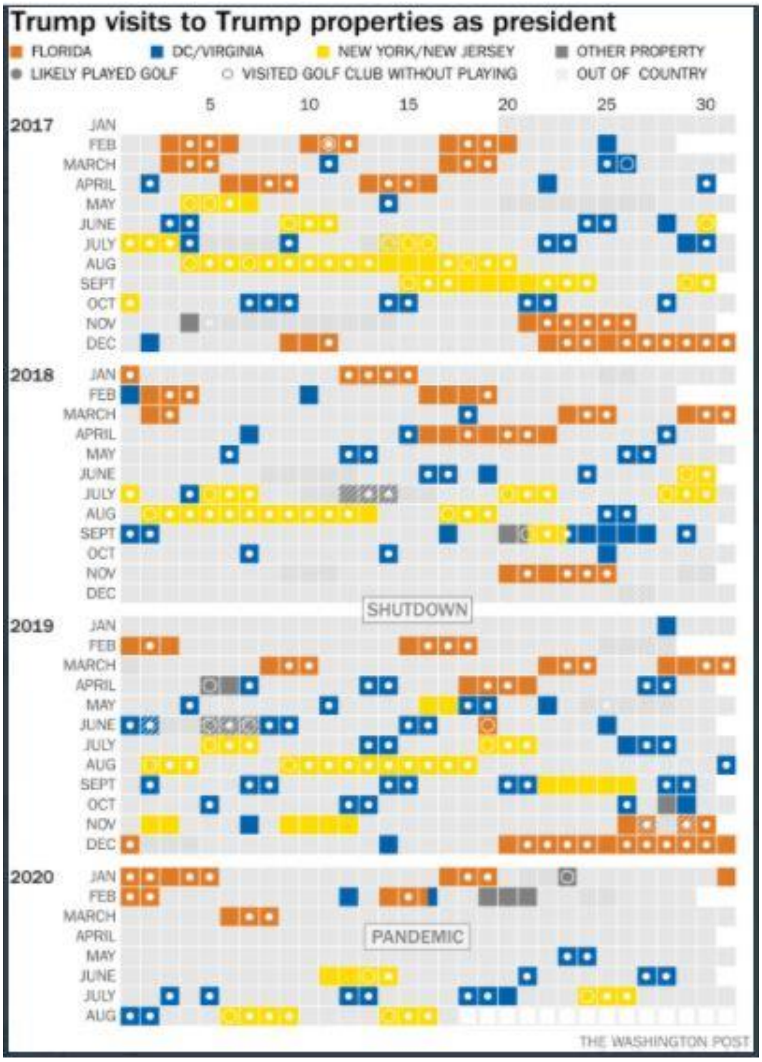
Source: BofA Global Fund Manager Survey

Not only are they now backing a continuing bull market, but the percentage expecting global profits to improve in the next few years rose recently to 57%.

Hamish also writes about the importance of the US elections, especially the fight for the Senate, but nobody should rule out a **Donald Trump** victory. There's little doubt he will better **Joe Biden** in the debates, and **Sportsbet** reported money flowing for Trump last week pushed his odds of victory down from $2.50 to $2.30 with 88% of turnover for him. Biden eased from $1.60 to $1.75. Sportsbet's **Rich Hummerston** said:

"The tide again appears to be turning in the US election race. Lots of larger bets are filtering through for Trump and despite being the outsider the support just keeps rolling in."

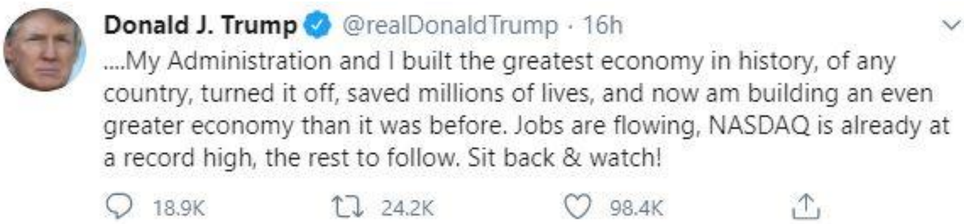
The most remarkable graphic I saw this week was **The Washington Post**'s monitor on the US President's movements. How many company executives spend this much time away from home and playing golf?



Fortunately, there's always time to build the greatest economy in the world and save millions of lives (see @realDonaldTrump below)

Also this week on the optimism theme, **Matt Reynolds** sheds the myopic attention on the next few months and [looks 10 years ahead](#) at exciting developments and big investment ideas.

Then **Jon Guinness** and **Sumant Wahi** write that the [amazing advances in connectivity](#) we are experiencing have only just begun, and it will drive success in many companies outside the mega tech names.



Like many bemused by the market's strength, **Robert Almeida** confesses that unless revenue growth is much better than in 2019, he simply cannot make the earnings maths work to justify the share prices of many companies.

We like to think of Australia as a global trading powerhouse, so the observations by former **Austrade** executive, **Kevin Cryan**, will surprise, as Australia badly lags best practice on trading systems. **Home Affairs** needs to play a better role in pandemic recovery.

And **Jay Kumar** delves into the data to show the commonly-held view that small companies outperfrom large companies over time does not hold up in Australia.

This week's White Paper is the **2020 Vanguard Index Chart**, giving a reminder of how the market changes every day but delivers strong results over the decades. It's always good to step back for this long-term perspective.

Keating versus Hume: where willy-nilly meets obscene

Graham Hand

Senator Jane Hume is treading on ground where many other Liberal warriors were buried at the dispatch box. Whatever you think of Paul Keating, few have matched his devastating one-liners which will live long in the annals of Australian politics. There is even a Paul Keating Insult Appreciation Society on Facebook with 64,000 members. He told John Hewson in 1992: *"I want to do you slowly."* In 1984, he said of Andrew Peacock: *"Put him down like a faithful old dog"* and in 2007, for John Howard, it was: *"The little desiccated coconut's under pressure."*

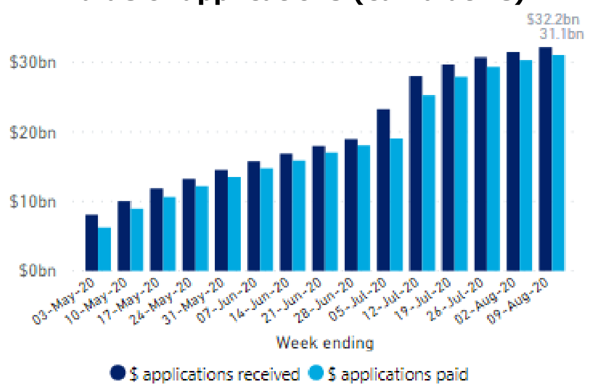
To give Ms Hume her full title, she is Assistant Minister for Superannuation, Financial Services and Financial Technology, and leads the Government's prosecution on super policy. And to also give Ms Hume full credit, she is giving as good as she gets in response to Mr Keating at the moment, although he no longer has the benefit of a parliamentary display platform to fully perform his tricks.

Jane Hume and Paul Keating are kicking around a favourite political football, superannuation, but what's the score at half time?

The scoreboard on early access to super

Treasury initially estimated that $29 billion would be withdrawn from super when the early release was announced in response to COVID-19. With the scheme now extended until the end of 2020, the estimate has been revised to $42 billion. Around 2.6 million people have used the scheme, with 620,000 emptying their super accounts completely. Here is progress to 9 August 2020 according to APRA, reaching $32 billion with the average payment of $7,700 and 97% of applications approved.

Value of applications (cumulative)



What is Hume versus Keating about?

Wherever Paul Keating goes in politics, controversy and sport are sure to follow. He's not a man with uncertain views, but nor is Hume a woman afraid to defend her policies.

Here's the rub. In response to the pandemic, contradicting the previous firm policy to lock up super until retirement, the Government and Hume are prosecuting the view on super that "it's your money". That is, people are entitled to access it early if they need to.

Consider this interview with Laura Jayes on Sky News on 21 April 2020.

Jayes: *Is there a chance here that if we do see a lot of young people take up this offer of essentially $20,000 of early money from their superannuation, does it weaken the system years down the track and is that just putting off a problem for another day?*

Hume: *Well, we think people are best placed to make those decisions themselves and you've got to think about the counterfactual. What would be the effect of leaving that money in superannuation but not being able to pay your mortgage, not being able to pay off a credit card, having to sell something like your car just to get by? So it really is a decision for individuals. We're certainly not encouraging people to take up the offer but we're giving them the option to make an assessment about their own financial situation, their own family budgets.*

So the money belongs to the investor and if they need it for "their own financial situation, their own family budgets", they are entitled to have it.

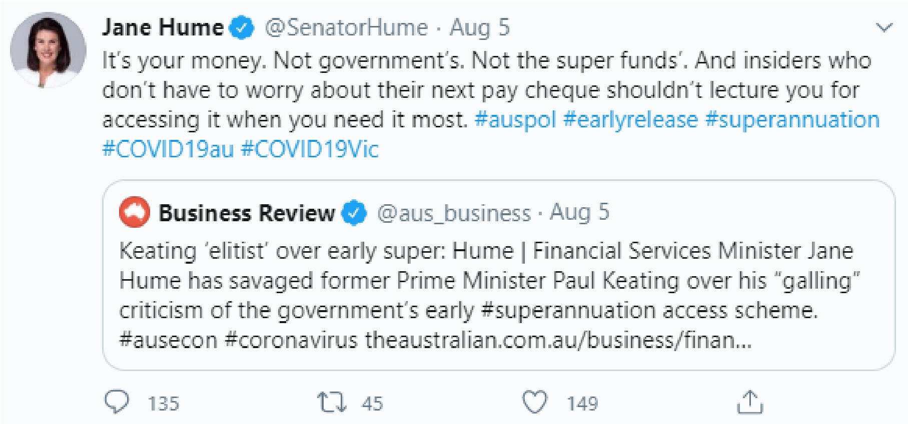
Keating calls this "generational theft". He spoke at a virtual conference run by Industry Super Australia on 4 August 2020:

"It is a breach of the preservation rules to just let anyone take out their money willy-nilly. There has been no scrutiny whatsoever ... The whole point of superannuation was a great public bargain with the community: defer consumption for your working life and you will get a very low rate of tax."

Keating argued that much of the money was probably spent on discretionary items such as cars, boats and motorcycles, and the long-term savings of young Australians are now compromised. As others have argued, the people who needed money could have been protected by the right fiscal policy:

"Every dollar which came out of young peoples' super balances could have been funded by one press of the computer button at the Reserve Bank."

Hume responded in interviews and on Twitter (right), repeating the "it's your money" mantra.



In an interview with *The Australian Financial Review* on 12 August, Ms Hume said:

"The idea that the wagons need to be circled around one sector in order to protect one man's legacy - especially in a time of crisis - is obscene [and] irresponsible. It demonstrates a fundamental misunderstanding of the system he supposedly set up."

She argued that access to super had always been available on compassionate grounds. She also criticised the super system generally with another slight at Keating:

"Fees are too high; there are insurances being applied inappropriately that are eroding peoples balances; there are duplicate accounts out there and a tail of underperforming funds; and many of those problems are directly correlated with the origins of superannuation in the industrial relations system."

So studs up in the tackle, Keating says access is 'willy-nilly' theft and Hume says protecting his legacy is obscene. Who has the scars?

Was access 'willy-nilly'?

One clear point of difference between Hume and Keating is his claim that locking super away until retirement is severely compromised by the ease of access, whereas Hume argues it was more an extension of the existing compassionate grounds.

Qualifying for early release requires a loss of job or reduction in working hours of at least 20% since 1 January 2020. While this sounds like a high bar, the lax part was not so much these tests but the simple online application process with no vetting.

The ATO confirmed the online access was easy. Second Commissioner Jeremy Hirschhorn told a Senate committee that the ATO did not check eligibility due to the dire circumstances around the pandemic:

"This is about getting emergency money to people. We will never have enough information to reject quickly, we will give people their money on the basis of their say so."

So the ATO assumed people were honest. Brave. The government does not trust people for anything relating to social security, where pensioners are subject to close scrutiny and checks. After the initial flurry, the government issued warnings about compliance and penalties, but it did little to halt applications. Hume continued to defend the system and the applicants, saying:

"Australians who have made the decision to access their super early can rest assured that the Morrison government trusts them. They understand that withdrawing some money now comes with a trade-off down the track—but the decision is theirs."

This is a long way from the previous tightly controlled compassionate access, to say it's a matter of trust and "the decision is theirs". Applicants declared their eligibility on an ATO website to receive payment a few days later from their super fund.

Whatever happened to super's objective?

Remember the good old days - if 2015 can be called old - when most people supported the objective of superannuation. David Murray's Financial System Inquiry (FSI) had recommended that:

"the objective of the superannuation system is to provide income in retirement to substitute or supplement the age pension."

In October 2015, the Liberal government announced it would enshrine the objective in legislation, it issued a discussion paper in March 2016 and by November 2016, the *Superannuation (Objective) Bill 2016, was introduced.*

Then it stalled. The years have rolled by, including regular beseeching to put it back on the agenda, to no avail. We are now further away from defining the objective than five years ago.

And let's not forget the sole purpose test

To quote directly from the ATO website's SMSF section on the sole purpose test:

"Your SMSF needs to meet the sole purpose test to be eligible for the tax concessions normally available to super funds. This means your fund needs to be maintained for the sole purpose of providing retirement benefits to your members, or to their dependants if a member dies before retirement.

Contravening the sole purpose test is very serious. In addition to the fund losing its concessional tax treatment, trustees could face civil and criminal penalties."

That's unambiguous. The fund is maintained to provide retirement benefits.

What was the money spent on?

The most frequently quoted data tracking the use of early super withdrawals comes from consulting firm AlphaBeta (part of Accenture) and credit bureau, illion. They claim that 40% of people who accessed super early had experienced no fall in their income during the COVID-19 crisis, and only 22% in Round 1 and 24% in Round 2 of withdrawals were spent on essentials. Discretionary items included gambling (11% of money spent) and clothing (10%), while 12% in Round 2 was for debt repayment, as shown below. Hume has disputed these results.

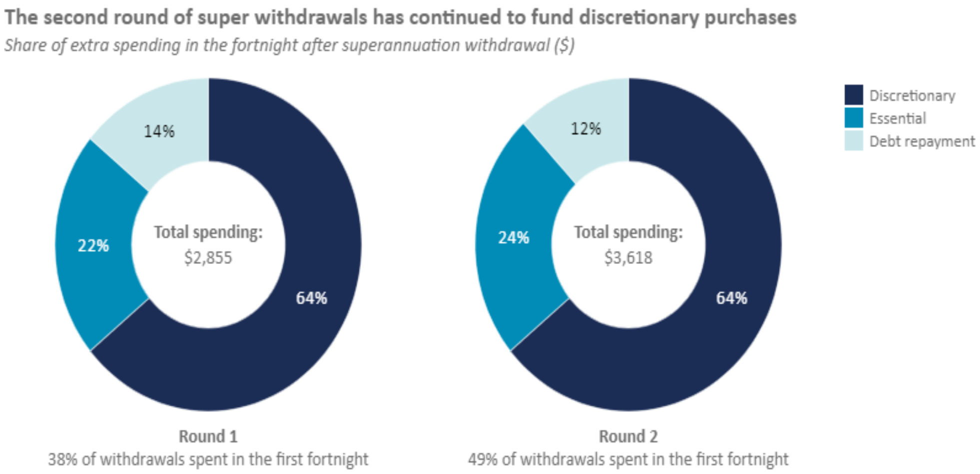
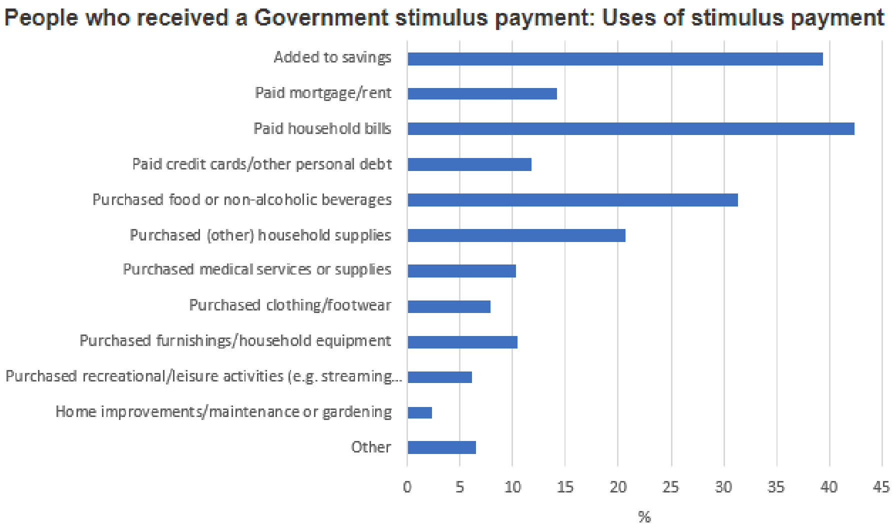


Chart: illion & AlphaBeta Australia (part of Accenture) • Get the data
Note: This chart analyses the spending of people who withdrew funds from their superannuation accounts during the two rounds of the the Government's early release of super scheme. It shows how much spending increased in each category in the fortnight after receiving superannuation withdrawal compared to the average fortnight in the two months before receiving the superannuation withdrawal. Based on a sample of 13,000 people who withdrew superannuation in Round 1 and 10,100 people in Round 2.

The ABS has produced separate data on the way stimulus payments such as JobKeeper have been used.

Notwithstanding the lack of firm evidence, no doubt much of the money directed at retailers such as Kogan and JB Hi Fi, who have experienced rapid increases in sales in recent months, came from both stimulus spending and people accessing their super.



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Three implications of the early withdrawals

What are the consequences of this early access? Here are three:

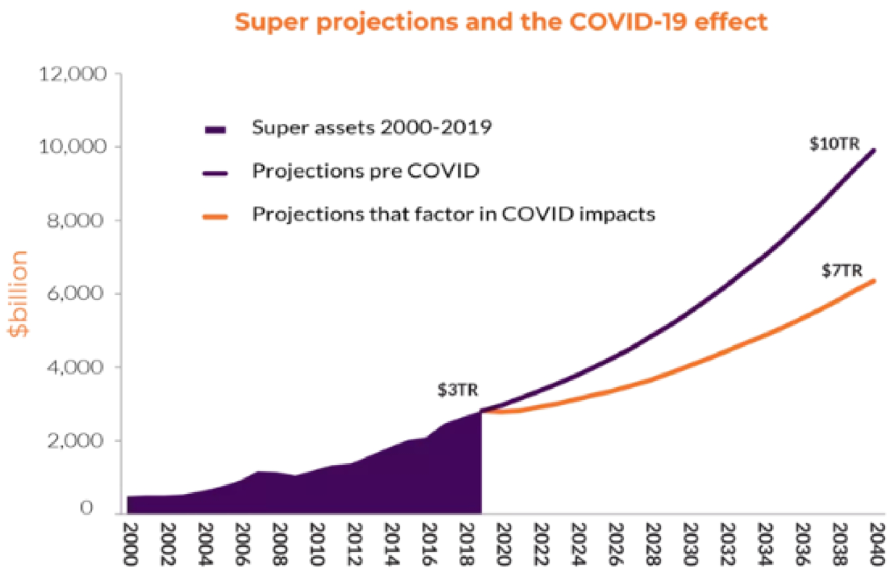
1. Decline in total super in the system in future

Early access to super will compound the adverse impact of COVID-19 on future super balances, with BetaShares estimating the $30 billion withdrawn to date will reduce future balances by over $100 billion:

"An amount between $100 billion and $130 billion represents a very significant future shortfall (which will only increase as further super is released early). It will need to be funded by future Australian governments and therefore the Australian public will ultimately bear the cost, as those who have withdrawn super will be less able to fully fund their own retirement needs."

Other estimates place this in a broader context of future super reductions due to COVID-19. Current superannuation balances are about $3 trillion, and Rainmaker previously projected retirement savings would reach $10 trillion over the next two decades. Their Superannuation Projection Model has now revised the number to $7 trillion due to the virus, including the impacts of rising unemployment, lower super contributions, lower long-run earnings and reduced population growth.

The early release is only one factor but Alex Dunnin, Executive Director of Research and Compliance at Rainmaker, said:



Source: Rainmaker Information

"This lower projected outlook for superannuation savings could have significant economic consequences on Australia if it is not carefully managed."

2. Lower personal superannuation balances

Writing in Firstlinks when the early release policy was announced, and assuming savings grow annually at a rate of 3% above inflation less 0.5% administration fees, David Bell calculated the withdrawal of $20,000 has a different impact depending on age. A younger person at 30 loses $50,000 in their retirement balance.

Current age	30	40	50	60
Reduction in retirement balance	$50,000	$39,000	$30,000	$24,000

The estimates obviously depend on the assumptions and it's easy to derive bigger numbers. For example, BetaShares reports:

"Based on an annual growth rate of 5% plus CPI, $10,000 withdrawn today becomes a $70,400 nest egg over 40 years. When an average annual rate of 7% plus CPI is used, this increases to $149,745."

Either way, the predominantly young people withdrawing their super will miss out on compounding over so many years that their super balances will face a big hit.

3. Changes in the management of large super funds

Large super funds, especially industry funds which rely on large numbers of small investors locking in their super until a gradual drawdown in retirement, must now factor in far greater likelihood of withdrawals. If governments believe "it's their money" then any crisis could lead to further relaxation and access.

As David Elia, Chief Executive of industry super fund, Hostplus, said:

“This has created a form of regulatory risk in the super system that we’ve probably never seen before, and now we’re completely aware of and cognisant of.”

Keating added to his earlier comments that the early access scheme had a "distortionary" effect on investment management by forcing funds to hold more cash.

Industry funds were previously able to hold a higher level of illiquid assets such as unlisted property, infrastructure and private equity than retail funds, and now must be recalibrating their portfolio tolerances for greater liquidity.

'It's your money' versus lockup

Anyone sitting in the ivory tower of a well-paid job and a paid-off mortgage during the pandemic should not judge the struggler who withdraws their super to pay the rent, feed the family or fix the car.

Unfortunately, it is the people with the least in super who are less financially literate who will be left with less in retirement savings. Where the money is used for short-term wants rather than needs, they are doing themselves a disservice. Even if in future they are likely to qualify for the age pension, they should supplement reliance on government support with other assets while drawing a pension. And nobody knows how generous or otherwise the age pension will be 20 or 30 years from now.

Compulsion and tax advantages are usually necessary to make people save for retirement, and Australia has a system recognised as a role model around the world. It included highly-restricted access before retirement, and there will be other crises in coming years where super might be opened again.

Ideally, the Government could have recognised the genuinely needy during the pandemic and set up another scheme to assist them without invading their super. "It's your money" flies in the face of the strict access rules we have accepted since 1992, and many are compromising their future in exchange for current consumption.

Graham Hand is Managing Editor of Firstlinks.

Most Australians live better than the Rockefellers

Hamish Douglass

This article is extracted and edited from a discussion between Hamish Douglass, Chairman and Chief Investment Officer at Magellan Financial Group and Tom Piotrowski of CommSec.

The most important risk at the moment is the pandemic. Usually, you can assess an economic crisis and a policy response and make a decision off the back of that, but this is intersecting with a scientific issue and a medical crisis. The science is very hard to handicap at this stage and the economic crisis will depend upon the depth of the health crisis and we don't know when we'll have a vaccine. The science will guide how long this goes on for and it will guide the economic outcome. That's the number one issue.

Watch the US Senate, not Trump

The second issue is the election in the United States. There is a possibility of fundamental change. Most people assume "Wouldn't it be great for Trump to get voted out" but be careful what you wish for. There's an important element in the Senate that people don't understand. For the United States to get non-budgetary legislation through, they effectively need 60 votes not just 51. There's something called a 'filibuster' where somebody in minority can hold up legislation forever. Obama is advocating that the Democrats change the rules to get rid of that rule and make the Senate a simple majority.

And once they do that, they could change the number of states and include two more states in the Union, being Puerto Rico and DC. Then every state gets two Senate seats and they could change the balance of the power. This may give unlimited ability to implement legislation and that could be radical and progressive on taxation and healthcare and unwinding regulatory reform. Some of it could be very positive such as on climate change but some could have a huge economic impact. So while most people are focused on the White House, we're focused on the Senate race.

The other two major risks are the China-US situation and Australia has its own tensions with China as well, and longer term, the consequences of this world of enormous monetary printing. It looks like everybody's got a free lunch at the moment.

When something is too good to be true ...

It's extraordinary what the central banks have done. The US Federal Reserve is not just buying government bonds and mortgage-backed securities but they're wading into other asset classes here like ETFs. People are starting to believe that there are no consequences—it's Modern Monetary Theory and interest rates can be held at zero forever. They can keep printing money and spending money.

If something is too good to be true, it normally is too good to be true, but it can go on for a long time before the party ends. It isn't today's issue, but some countries will get into the point where these deficits are effectively beyond their savings. It could lead to a runaway inflation and a collapse in their currencies. So they need to be very careful that they've got an unlimited pool of savings. The United States as a reserve currency of the world has an advantage because it has a global pool of buyers. We're not all treated equally here and ultimately this experiment could end very badly with high inflation and collapsing currencies.

But if you're convinced it's going to happen, and therefore you're going to sit out of markets for the next five plus years, that could turn out to be a very expensive decision to make.

Portfolio positioning amid a pandemic

Since the middle of March, we've been cautious, running at around 15% cash. We really do not know what's coming in the next 12 months or so. I'm just being very honest with people. I haven't got a crystal ball that's going to tell me when we get to a vaccine. If it's rolled out through 2021 with all this fiscal support and monetary support, that should support markets grinding higher.

But if we don't get to a vaccine in a reasonable period of time, and we see a spiking in the latter part of this year in the Northern Hemisphere leading into the winter, and emerging markets come under more stress, we could find ourselves really testing the limits of what central banks can do. The economic scenario could get materially worse than it is today.

Between those two market views, either grinding higher or collapsing, I can't tell you which one's more likely. So in a strange way I'm sitting on the fence. I can see both scenarios.

We still own a lot of growth, with technologies in our portfolio that are doing very well like Microsoft, Alibaba, Tencent and SAP. We've got some strong defensive businesses such as Reckitt Benckiser and Nestle and our US utilities have all confirmed the guidance.

This virus is creating winners and losers. It's accelerating trends that were working for or against businesses, such as traditional media losing to streaming services. Microsoft services such as Teams have received far more users and they aren't going to suddenly turn it off when we're through this pandemic. More businesses want their IT infrastructure in the cloud. We're talking a multi-trillion-dollar market opportunity that is probably a few hundred billion into it at the moment.

Last year, I had the privilege of interviewing Howard Marks and Ray Dalio at the Sydney Opera House, and I asked them their views on gold. Howard Marks gave a classic investment view that gold isn't an asset because it doesn't produce an income, it's a speculative investment. Then Ray Dalio said it's not an equity because it's a currency. It's an exchange of value, and gold gives a protection against inflation. With the massive trend to printing money, people are buying gold and gold ETFs. But I'm not saying buying gold is the right thing to do at this price of over US$2,000 an ounce.

Remain optimistic about humanity and future generations

I'm still optimistic on humanity although it sounds a little strange with a pandemic, a cold war developing with China, uncertain political environment in the United States, printing money and running deficits. But remember what's happened in the last 120 years. We had the 1918 Spanish flu, two world wars, cold wars, oil crises, stock market crashes, financial crises. But every decade, the world has become richer. And society has got better with fewer people living in poverty. Our younger generations are benefitting from technology across the world and it will advance artificial intelligence and medical science.

So, I look 30 years or so into the future, it will be more technically advanced, we will probably live longer than we do today. We're in a period where the noise looks overwhelming with a poor political environment and the inequality. But if you look how we live today compared with 100 or so years ago, I would say that most of us live better than the Rockefellers. It's an extraordinary statement but did they have video, iPhones, air conditioners, etc?. We're looking into space travel again. There are so many things such as the standards of education that we now have in the world. So while there are many problems, I have hope in what the human race can do. Let's keep educating our young people. Let's keep investing in venture capital. Let's not destroy the machine that created so much for humanity over time.

There's a risk we will go through a period where we start reversing. I know that capitalism isn't perfect, but you don't want to stop innovation and progressing while we address inequality issues. We should not kill the system that has created so much benefit for the world.

Hamish Douglass is Co-Founder, Chairman and Chief Investment Officer of Magellan Asset Management, a sponsor of Firstlinks. This article is for general information only and does not consider the circumstances of any investor. The full discussion can be viewed here. Extracts taken with permission of CommSec and Magellan.

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The connectivity revolution is only just beginning

Jon Guinness, Sumant Wahi

The scale of connectivity unlocked by the global tech titans has revolutionised the way individuals, groups, businesses and organisations interact. But companies and investors are only just beginning to realise the second-order implications of such global connectivity.

We believe that the speed of revenue growth and the ultimate scale potential of companies leveraging these platforms will surprise investors. As a result, the majority of investment opportunities around connectivity lie in the future.

Zoom is a 10-year overnight success

Six months ago, barely anyone, including most of the investment world, had heard of video-conferencing system Zoom. Today, it's ubiquitous among businesses and the public; and its share price is up 230%. If COVID-19 occurred in 2011, the year when Zoom was founded, or even just a few years ago, it is highly unlikely Zoom would have achieved the level of success as quickly.

One key difference between today and previous years is the digital infrastructures available to businesses. Zoom was able to scale its daily users from 10 million in December 2019 to 300 million in April 2020 by tapping into the cloud network Amazon Web Services (AWS), which seamlessly flexed capacity on its servers and data centres located around the world. These types of platforms are revolutionising the way businesses and their customers are connected and that promises many opportunities in the future.

The connectivity 'Big Bang' and second-tier impact

The connectivity enabled by the top seven 'super platforms' of Facebook, Google, Amazon, Apple, Microsoft, Tencent and Alibaba is unprecedented in human history. Specifically, it's the breadth, depth and ease of use of these networks that has created the paradigm shift.

Breadth is the scale of these platforms. For example, Facebook has three billion users or nearly half the world's population. Depth is the extent to which these platforms are ingrained in our lives. The average American spends three hours per day using their mobile phone, providing masses of rich data on human behaviour for platform providers. Finally, the ease of using them means that whether it's business to business, business to consumer or consumer to consumer, it has never been easier to rapidly reach a global audience.

While many companies and investors are aware of the nature and function of super platforms, there is still a lack of recognition of what the second-order implications are. We think the pace of growth and the potential scale that can be reached by companies effectively leveraging these platforms will surprise most people, and that offers opportunities for investment. We are still in the early days of these opportunities, but the adoption of 5G will accelerate events, especially in emerging markets and rural developed markets, which will see rapid business expansion.

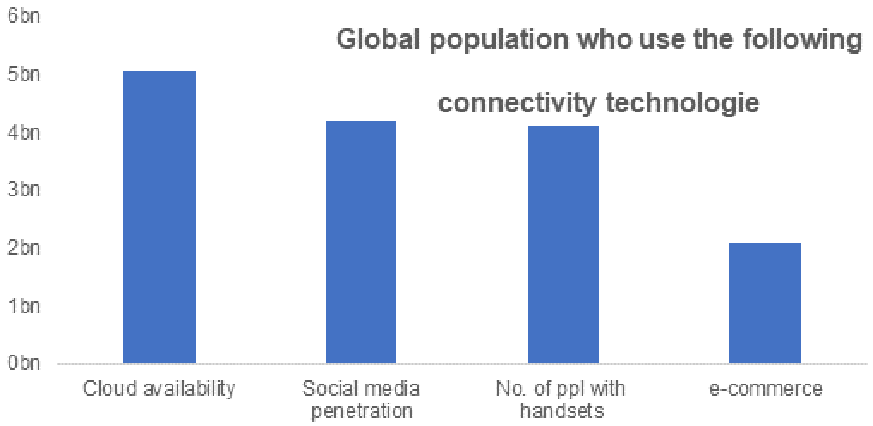
Reaching your audience

Before the internet age, if the Ford Motor Company was launching a new car and wanted to advertise, the biggest audience it could reach would be during the half-time TV slot of the annual Super Bowl, where it could expect 100 million viewers. The next biggest audience would be significantly smaller. If Ford wanted an international launch, it would have to approach each individual national TV station in a cumbersome and expensive process.

Today, companies looking to market products can bid for advertisement spots on Facebook or YouTube and can simultaneously reach every country in the world. If a business has the resources and willingness, it can instantly reach an audience of more than three billion.

It's not only the size of the audience that's important, it's also who the audience is. Using these platforms, companies can target a demographic at a level of granularity that's never been possible before. Collating and analysing the related data can help fine-tune marketing strategies. This makes each advertising dollar far more efficient than ever before. It also means companies with strong products, good management and clever strategies have a chance of quickly becoming successful.

Global scale of connectivity is unparalleled



Source: Fidelity International, Bessemer Venture Partners, 2020.

Reaching scale

Zoom is an example of a company that has scaled rapidly, but there are plenty of others. In 2007, Netflix started to move away from delivering DVDs by mail to streaming content, and now has 180 million subscribers. Dating app Tinder launched in 2012 to reach 60 million users today. Car-riding app Uber was founded in 2011 and estimated that it had 110 million users as of 2019.

In recent years, companies have been able to grow to sizes that would previously have taken decades to do. They have done this by using Apple, Facebook, Amazon and Google to market and sell products, and Amazon and Microsoft for technical infrastructure.

Before cloud computing, companies entering a new country or adding subscribers would have required setting up offices in the country, hiring staff and buying new servers. Today, it's seamless—a business just has to expand its use of platforms. In addition, small businesses can use Amazon's logistics to deliver products. App makers on Apple's ecosystem can sell their products in a new country simply by ticking the correct box on the software.

The start of a second internet wave

Investors are still largely fixated on the platforms that the tech giants provide and their high growth rates. Many investors wonder whether they have missed the tech party or if these companies are overvalued and due a correction.

We think these are not the most pertinent questions. It's not necessarily what the future holds for these companies that's most important, but how the systems and services they provide have unlocked opportunities for a whole set of other businesses and industries—that's where the opportunities lie.

We believe the next phase of tech expansion will be a broadening out of user and revenue growth, from a narrow cast of well-known players such as Netflix and Zoom to a more colourful and varied mix of enterprises. For example, games publishers such as Activision could leverage platforms, social and dating apps could expand their user bases, online grocers could tap into new markets, and newly established streaming players such as Disney+ could quadruple subscribers to 200 million.

We have travelled though the first internet wave marked by the super platforms becoming global phenomena. Today, we are at the start of the second wave where companies that utilise these platforms can use their connectivity to build enormous global businesses. There is more to come from the connectivity revolution.

Jon Guinness and Sumant Wahi are Equity Portfolio Managers at Fidelity International, a sponsor of Firstlinks. The full version of this article is [linked here](#).

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10 investment themes for the next 10 years

Matt Reynolds

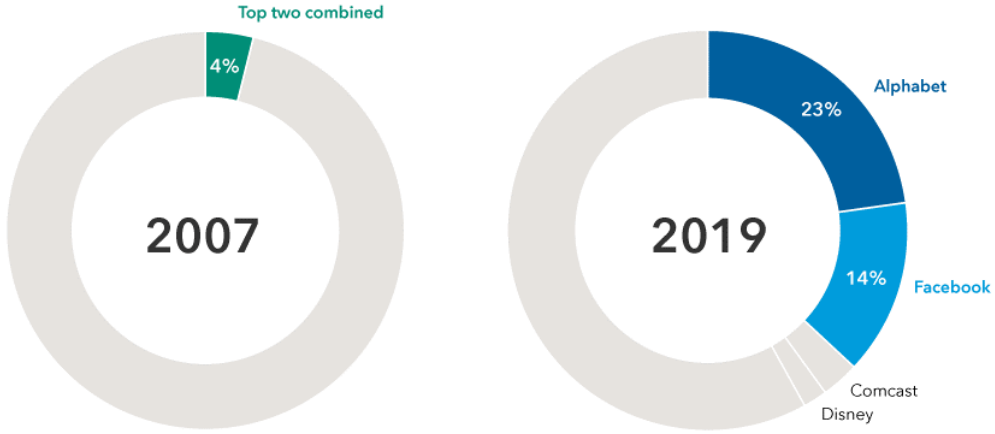
As Microsoft founder Bill Gates has noted, "We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next 10."

Join us on a journey to 2030, as we imagine the change that will take place over the next decade in the investment landscape. To get there, we asked three Capital Group investment professionals to offer their perspectives on the themes shaping the future for investors.

1. The big will keep getting bigger

When it comes to market share in the digital era, size matters. It's a theme affecting many industries but is perhaps most obvious in online advertising where Google (Alphabet) and Facebook control 37% of the market. This is in sharp contrast to the fragmented days of 2007, when the top two competitors combined for just 4%. "Because of their size, they are driving the best returns for advertisers. They are growing by driving more usage and showing more relevant ads, not by raising prices," says equity analyst Brad Barrett, who has been covering media and internet companies for 19 years.

Global advertising share of top two companies



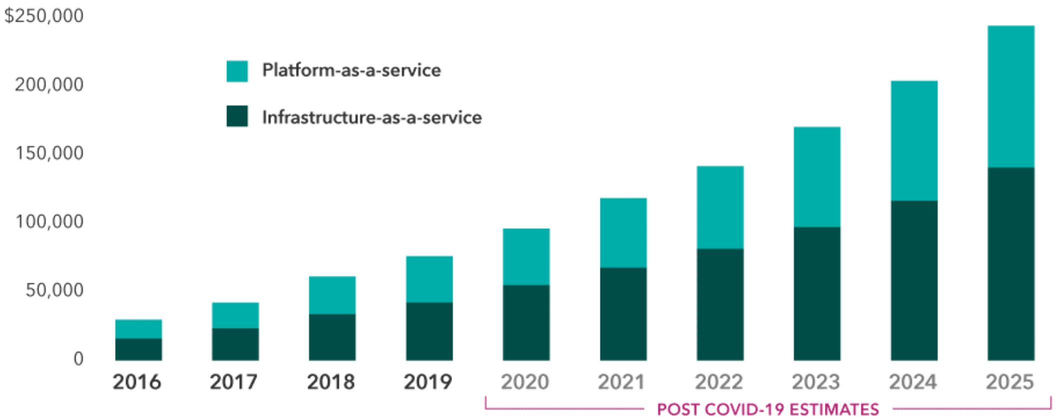
Sources: Capital Group calculations, company financials. As of 31/12/19.

High barriers to entry and scale advantages that favour global instead of regional players are two reasons this trend will likely continue into the next decade. "There is also now a very tight feedback loop related to a company's service quality and the scale of its business," explains Barrett, who believes network effects can be extremely powerful. Consumers tend to prefer social media sites that already have a large and growing user base. Search engines provide better results when more people use them. And the bigger a streaming platform gets, the more it can reinvest in content, helping lower costs and attract even more users.

2. Cloud demand is sky-high

"We've experienced two years of growth in two months," said Satya Nadella, CEO of Microsoft, referring to the great acceleration in demand for cloud services during the pandemic. Capital Group equity manager Cheryl Frank agrees. "I think an ever-larger number of companies will go cloud-first or cloud-only," says Frank, who has spent years covering software companies. She notes that with global information technology spend around US$3.7 trillion, even a moderate increase in companies switching to the cloud could have a massive impact on the bottom line for market leaders.

Revenue in public cloud market (millions USD)



Source: Statista. As of 30/6/20. Forecast adjusted for expected impact of COVID-19.

This is another case where the big get bigger and the well-entrenched—such as Amazon's AWS and Microsoft's Azure—are likely to maintain staying power. The barriers to entry, switching costs and the ecosystem effects are significant, making it tough for new players to reach competitive scale. But service providers won't be the only winners from surging cloud demand. Vendors who supply equipment needed to grow data centers, such as central processing units (CPUs), batteries and cooling equipment, should also flourish.

3. Innovative leaders may emerge in emerging markets

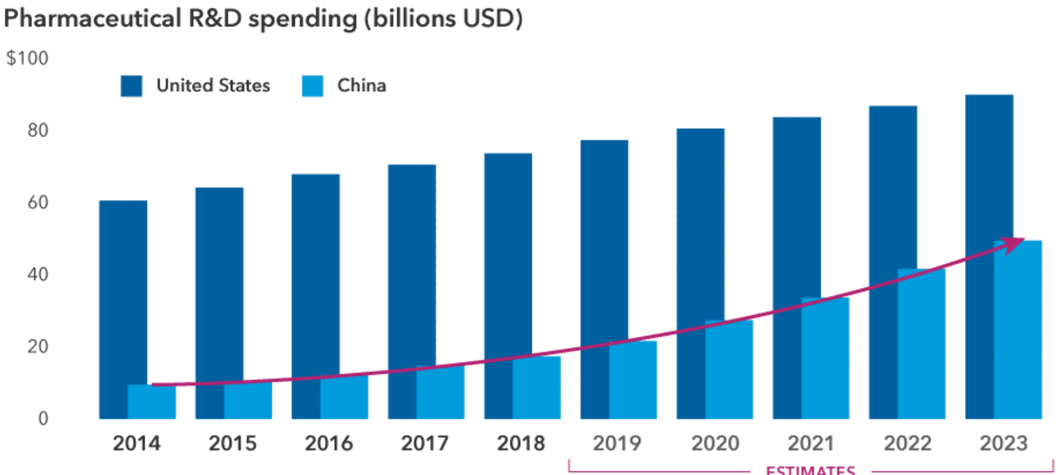
If you think the most innovative companies are in the U.S., think again. When it comes to innovation, large U.S. tech companies seem to get most of the attention. But that conversation may shift toward what's happening in China and other emerging markets, says portfolio manager Chris Thomsen.

"We're going to see emerging markets companies move from copycats to true innovators," says Thomsen. "We used to refer to companies like Alibaba as the 'the Amazon of China' or Baidu as the 'Google of China', but these companies have really developed and localised their technology, while accelerating their growth in ways different from the U.S."

Thomsen also notes that successful new entrants may scale more quickly than older companies, likely long before they become household names outside of local markets. "Consider Pinduoduo, which is an e-commerce company in China that is less than 10 years old but has already surpassed a $100 billion market cap. Likewise, the US$150 billion multi-service platform Meituan has over 450 million active users. There are going to be a lot more of these cropping up across industries."

4. The prognosis looks good for a cancer cure

A cure for cancer may be closer than you think. According to Frank, breakthroughs in gene therapy and new applications of artificial intelligence are accelerating drug development. "I believe some cancers will be functionally cured with cell therapy between now and 2030. New, reliable tests will enable very early detection of cancer formation and location. Beyond 2030, cancer could be largely eradicated as a major cause of death through early diagnosis."

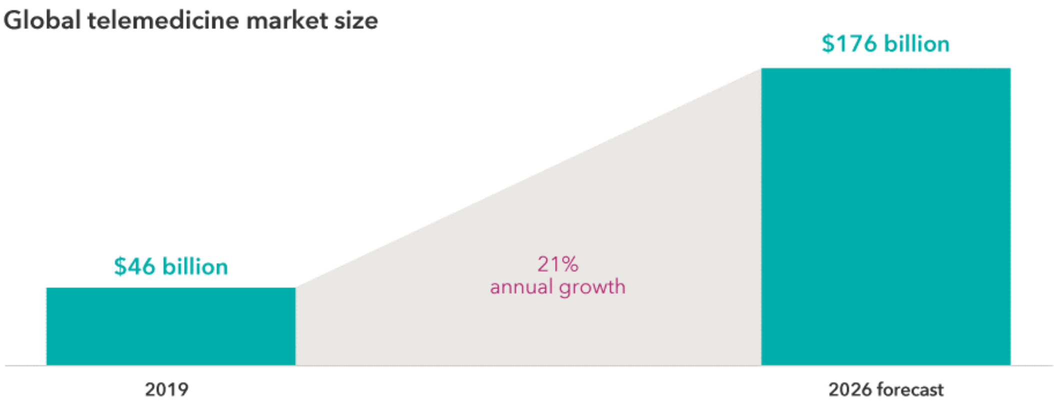


Source: Statista. 2019 through 2023 are estimates.

The next wave of pharmaceutical innovation may come from an unexpected place, suggests Frank. "I expect to see many global blockbuster drugs from China by 2030. The country has the biggest population of cancer patients in the world, and one in two of them enrolls in a clinical trial versus one in 20 in the U.S. I expect they will begin to produce novel drugs within five to 10 years at one-tenth the cost of the U.S."

5. House calls are coming to healthcare

Pharmaceutical companies have been in the spotlight as they race to develop treatments for COVID-19. But one of the biggest shake-ups in the healthcare industry may be happening on a more personal level. Just a few months ago, the idea of meeting with a doctor through a laptop screen may have seemed impractical, impersonal and ineffective. But after months of social distancing, many of us have had our first telehealth experience and realised it works.

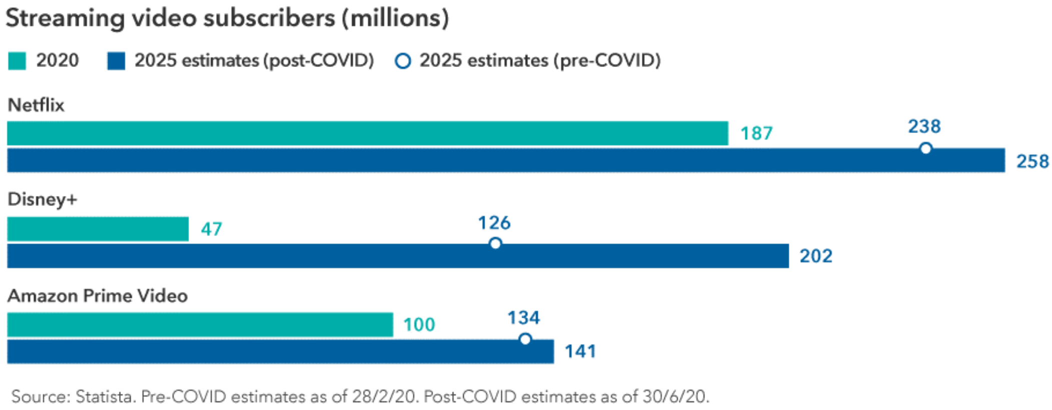


Sources: Capital Group, Statista. As of 30/4/20. Forecast includes impact of COVID-19.

Frank, who has covered the healthcare industry for 21 years, believes this could be a tipping point that leads to a vastly different landscape by 2030. "I believe the combination of telehealth, at-home diagnostics and medicine delivery will enable almost everything to become treatable from home. Personal devices will use this data to help us improve our health, while physical doctor visits may evolve to be only diagnostics and procedures. Wearable and implantable technologies will essentially become an extension of ourselves."

6. Content is king but streaming is the kingdom

The shift to streaming content is another consumer trend that got turbocharged as a result of COVID-19, but Barrett thinks this is just the beginning. "Roughly one-third of all content consumption is currently done over streaming platforms, but by 2030 I think that's going to increase to more than 80%."



Even if consumers moderate their TV bingeing in a post-COVID world, the trend toward streaming will likely remain in place. This is great news for platforms like Netflix, Amazon Prime Video and Disney+ that could continue to see robust subscriber growth. "It's an enormous market. TV continues to dominate people's leisure time. And it's shifting rapidly from linear to streaming. You have this incredible combination of streaming being both better and cheaper than traditional television, and I don't see that changing," adds Barrett.

7. Artificial intelligence could spark the next tech revolution

No need to fear the rise of the machines. Machine learning—which is a form of artificial intelligence in which computer algorithms improve themselves in real time by processing tons of data—is already all around us. "Machine learning is now core to the entire online ecosystem. It drives recommendation engines we see on platforms such as Facebook, Netflix and Amazon, which can influence much of our social and commerce experiences," Barrett notes.

From speech recognition to fraud detection the applications are vast, and computers are getting smarter and more capable every day. "Because they can access enormous amounts of data, the algorithms and computing power are at a place where they can teach themselves in ways that were never possible," Barrett explains. "I think image recognition is one area where computers have already surpassed humans."

8. Self-driving cars may rule the roads

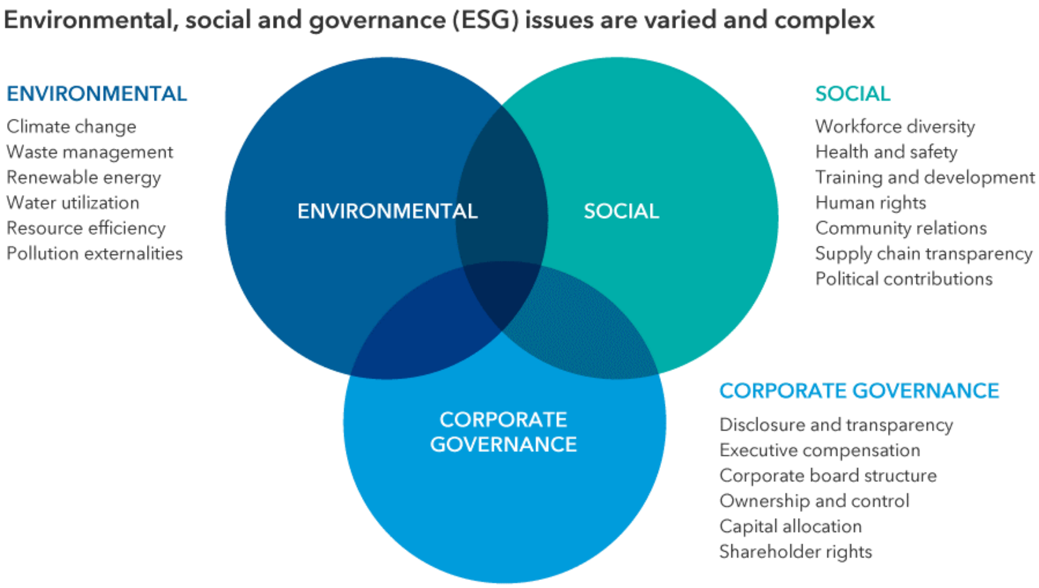
AI is also driving advances in autonomous vehicles. And unlike most of us, Brad Barrett has already ridden in self-driving cars—and lived to tell the tale. "They're incredibly precise. Their lane centering and turning is probably already better than ours," Barrett states, based on his experience riding in autonomous vehicles from Google and Zoox, a start-up that Amazon offered to purchase for US$1.3 billion earlier this year.

The world could look vastly different if autonomous vehicles eat into the 15 trillion miles that are driven annually. "There are big implications for land use, energy consumption, real estate, the ways cities are designed—really for everything."

A world where self-driving cars rule the roads sounds like science fiction today, but Barrett believes we're closer than many may think. "The foundation is already there. There are no new technological breakthroughs that need to happen. Real people are already riding in these vehicles with no safety drivers," Barrett concludes. "Ultimately, I think it's going to be cheaper and safer, and you're not going to have to pay attention to the road. That's a pretty compelling value proposition."

9. ESG could be a pillar of portfolios

Socially responsible investing has been around for years, but a desire for asset managers to screen companies with an ESG lens has risen in 2020. "As we sit in the middle of a pandemic with the renewed rise of calls to eliminate social injustice, there's no question that ESG will be a major investing theme over the next 10 years," says Frank.



Companies that are more environmentally focused and promote diversity may appeal to consumers that increasingly prefer to align with businesses that match their personal values. Strong corporate governance could potentially reduce investment risk due to improved transparency and better capital allocation. Those are but two reasons why businesses with a focus on ESG may appeal to investors like Capital Group.

Screening for ESG factors has long been a part of Capital Group's investment process, which is rooted in deep fundamental research and building relationships with company management. Capital Group president Rob Lovelace explains, "We look for companies with a long-standing focus on corporate governance. We hold them to high standards of governance and goals of operating in the best interests of investors, employees and society."

10. The U.S.-China rivalry may define geopolitics

In what feels like a lifetime ago, trade disputes between the U.S. and China were the biggest economic storylines in the pre-COVID era, but Thomsen cautions that the frosty relationship between the two superpowers should remain one of the top investment themes over the next decade.

"It's not just geopolitics. It will also have a direct impact on businesses as they are forced to take sides and perhaps adjust the way they operate on both sides of the fence," says Thomsen. Earlier this month, the U.S. issued executive orders to ban popular apps TikTok and WeChat if the U.S. segments are not sold by their Chinese-owned parent companies.

While he prefers to avoid those that may get caught in the crossfire, he still believes great investment opportunities abound. "Purely domestic Chinese internet companies, for example Alibaba and Baidu, aren't going to be hurt by a trade war. I also look across industries at innovative start-ups led by amazing entrepreneurs."

It's this long-term perspective that enables us to look past market volatility and maintain conviction in companies that could change the world over the next decade.

Matt Reynolds is an Investment Director for [Capital Group Australia](), a sponsor of Firstlinks. This article contains general information only and does not consider the circumstances of any investor. Please seek financial advice before acting on any investment as market circumstances can change.

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The role of financial markets when earnings are falling

Robert M. Almeida

Over the years, the financial services industry has become needlessly complicated. Ultimately, investing still boils down to an exchange of capital today for cash flows tomorrow. Weaker balance sheets and income statements, dubious earnings assumptions and soaring bankruptcies demonstrate that a challenging investment environment lies ahead, but market pricing doesn't reflect that outlook. Everything is rising in value because there is excess capital chasing too few opportunities.

Is that the role of financial markets?

Capital should be allocated more responsibly than that. The financial services industry of today looks quite different from a century ago, but its role in society has not changed. Back then, investing was the province of wealthy individuals and large institutions until companies such as MFS helped democratise markets and give small investors greater access to investments. At its core, investing is simple. It's an exchange of capital today in return for a cash flow from a company or government in the future.

Against that backdrop, let's take a look at what the price of risk is implying about future cash flows, though at this point it's questionable whether the average investor even cares.

Weaker balance sheets and income statements

Long before the onset of the pandemic, worldwide profit margins had peaked and were contracting. Balance sheet quality was poor and deteriorating before the coronavirus spread around the world. Battling the spread of the COVID-19 forced a sharp curtailment of global economic activity in the first quarter, prompting companies to plug revenue gaps by issuing historic amounts of debt, materially weakening already fragile balance sheets.

At the same time, companies will incur incremental costs to minimise health risks for employees and customers, while many will also have to reorient supply chains to emphasise resiliency after many years of focusing more heavily on wringing out costs. This will weigh on income statements for those unable to offset higher costs with either higher prices or greater volumes. The resulting increased capital investment will lower return on working capital for years to come. In short, future cash flows are likely to underwhelm.

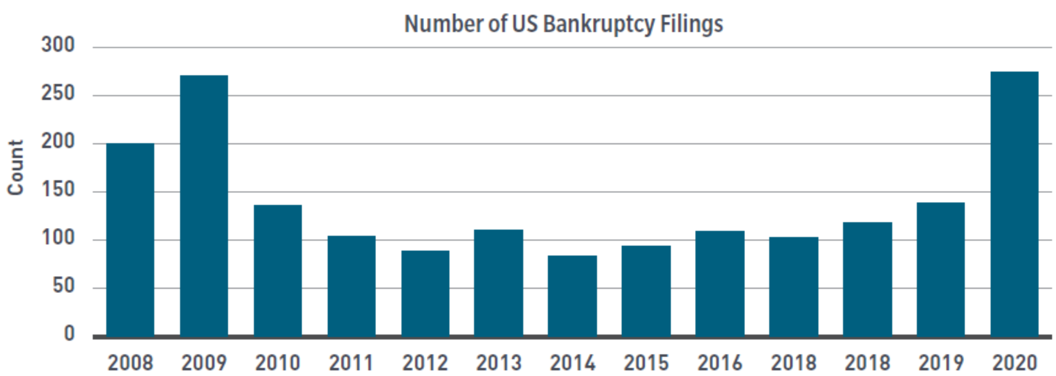
Fuzzy earnings maths

If companies are more indebted, have higher operating costs and greater output yet final demand remains below 2019 levels, how do the market's implied 2021 operating earnings compute? Profits are not linear and the last few customers are always the most profitable. Scale matters immensely.

Absent revenue growth that is materially better than it was 2019, I honestly cannot make the earnings maths work.

Let's look at this through a different lens. On annualised basis, the US economy contracted by a third this past quarter, a level materially worse than any quarter during the GFC.

Exhibit 1: Bankruptcies illustrate an extremely challenging environment



Source: Bloomberg as of 3 August 2020. Number of bankruptcy filings calculated for each calendar year. 2020 bankruptcy filings is from 1 January 2020 through 3 August 2020 and is annualized (unannualized figure = 163 filings). Companies included in the count are those with liabilities greater than $50 million.

The graph above illustrates that the number of sizable bankruptcy filings is on pace to exceed any year since the GFC. This makes sense to me. The imbalance in the real economy leading up to the 2008 recession was over-leveraged financial institutions. The imbalance was largely concentrated in one industry. This allowed the subsequent earnings recovery to be historically fast because most other sector constituents did not require equity recapitalisation.

How is 2020 different?

The weak economic recovery following the GFC and the central bank stimulus undertaken as a result of the weak rebound created more widespread imbalances during the just-ended cycle. The accommodative monetary backdrop afforded companies with weak revenues to substitute borrowed cash flows for operating cash flows. Unlike 2008, the 2020 crisis is one of over-leveraged businesses across many industries and sectors. The pandemic is the excuse often used for weak financial results, while the cause was soft demand heading into 2020, balance sheet fragility and financial engineering. As a result, I expect more bankruptcies during this recession and a weaker-than-normal recovery in overall profitability.

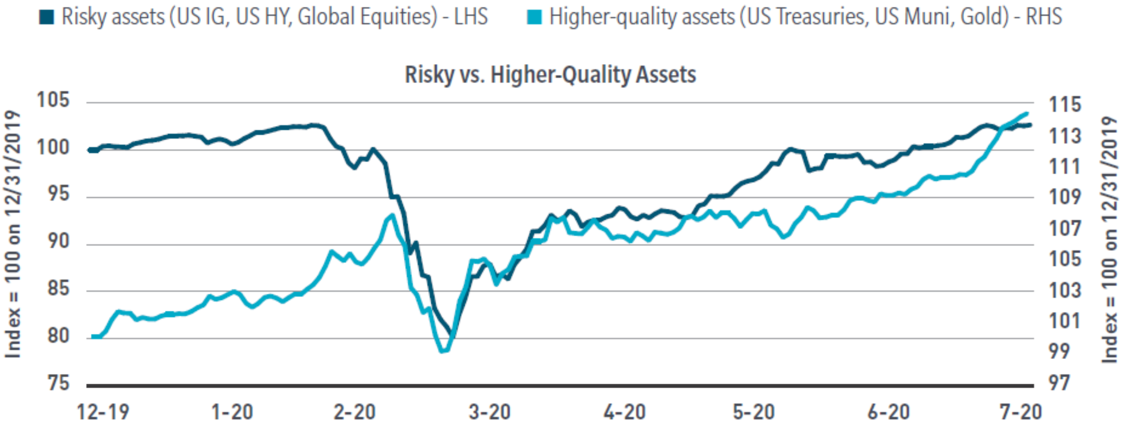
Why are financial markets signalling otherwise?

The honest answer is: who knows? I can offer this perspective.

While there are numerous asset classes for investors to choose from these days: growth or value equities, large versus small capitalisation stocks, developed market corporate bonds or developing, etc., ultimately there is only one asset class: volatility. Most financial assets are effectively short volatility, as they benefit when markets anticipate increasing certainty and stability. Conversely, they suffer when conditions deteriorate.

Assets such as US Treasuries or gold, on the other hand, are effectively long volatility and benefit from greater uncertainty. But lately, as policymakers have injected capital into financial markets to fund operating losses and suppress the cost of risk, the correlation between short and long volatility assets has gone from negative to positive. Today, everything is rising in value because there is excess capital chasing too few opportunities. Is that the role of financial markets? Capital should be allocated more responsibly than that.

Exhibit 2: Risky and higher-quality assets have been moving together



Source: FactSet. Daily data from 31 December 2019 to 31 July 2020. Total return index used for US IG, US HY, global equities, US Treasuries and US muni; gold price is $/oz. Each asset class is rebased to 100 on 12/31/2019. Risky assets is the average of the rebased values for US IG, US HY and global equities. Higher-quality assets is the average of the rebased values for US Treasuries, US munis and gold. US investment-grade (US IG) = Bloomberg Barclays US Aggregate Credit Corporate Index, US high-yield (US HY) = Bloomberg Barclays US Corporate High Yield Index, global equities = MSCI AC World Index, US Treasuries = Bloomberg Barclays US Aggregate Government Treasury Index, US muni = Bloomberg Barclays Municipal Bond Index.

Patience and skilled security selection and a focus on fundamentals are more important now than ever as the outlook for future cash flow deteriorates.

Robert M. Almeida is a Global Investment Strategist and Portfolio Manager at [MFS Investment Management](). This article is for general informational purposes only and should not be considered investment advice or a recommendation to invest in any security or to adopt any investment strategy. Comments, opinions and analysis are rendered as of the date given and may change without notice due to market conditions and other factors. This article is issued in Australia by MFS International Australia Pty Ltd (ABN 68 607 579 537, AFSL 485343), a sponsor of Firstlinks.

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We're number 106, and that's not good

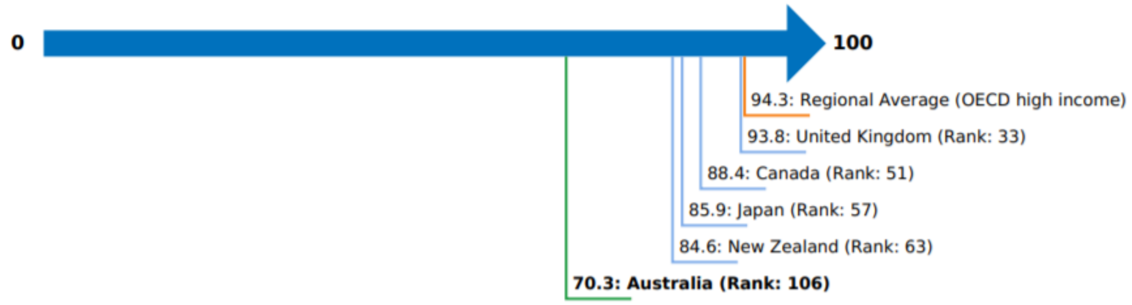
Kevin Cryan

According to the *World Bank's 2020 Trading Across Borders* report, Australia now ranks 106th in trade system productivity, having fallen precipitously from 27th position in 2010. This sounds dramatic, and it is, but why is this global ranking important for Australians?

Falling trade competitiveness

The World Bank has a *Doing Business Score* that, in the case of trade, measures the competitiveness of the regulatory performance of countries based on border compliance, documentary compliance and domestic transport costs. Organisations, such as the Australian Chamber of Commerce and Industry, believe the cause of Australia's decline in competitiveness is quite simply that globally countries have digitalised their trade systems whereas Australia has not, and so our compliance costs are uncompetitive.

Trading across Borders in Australia and comparator economies – Ranking and Score



Source: The World Bank

Some readers may remember Australia's trade battles were traditionally fought on the waterfront, coming to a climax in the 1998 Maritime Union of Australia versus Patrick Corporation stoush. This time the issue isn't waterfront productivity but rather digital productivity.

Best practices in trade productivity today are supported by what is referred to as a Single Window approach, which is a system that allows traders to file standard information and documents through a single-entry point to fulfill all import, export and transit-related regulatory requirements. Importantly, these processes are digital.

Countries have developed web-based systems allowing traders to submit documents and pay duties online. These systems deliver long-term benefits through saving time and money while streamlining procedures. Further benefits from web-based systems are that they can help governments combat fraud and money-laundering, track statistical information on foreign trade transactions, and share information with key support players in trade such as banks, insurers and logistics companies. The benefits of a Single Window system therefore go beyond trade, to national security. The challenge for all countries wishing to secure these Single Window benefits is the ability to migrate their regulatory framework from paper to digital.

Further example of Australian red tape

The ANZ Bank estimates that a company which processes around 1,000 export documents a year would save close to $250,000 by moving to a digital trade solution. And like many government red tape related issues small- to medium-sized businesses are likely to gain the most from the establishment of a successful Australian Single Window trade system.

This is the state of play today, but the goal posts are moving, and quickly. While in Hong Kong in 2018 a large Australian Bank introduced me to the Hong Kong Monetary Authority (HKMA), the equivalent of our Reserve Bank. The HKMA was leading what they called their eTrade Connect initiative, largely funded by local banks, meant to move Hong Kong's trade system from digital to a Blockchain enabled system. Singapore is doing the same, and a few months after returning from Hong Kong I met with a Japanese group with the same mission.

Banks globally are particularly interested in Blockchain-enabled trade finance systems as Blockchain technology provides far more security and transactions occur almost instantly. Trade credit providers are exposed to fraudulent trade transactions, and during the GFC trade finance professionals virtually lived at their offices as companies struggled to understand the financial credibility of the counterparties they were trading with. Blockchain-based trade finance significantly reduces those risks. And importantly the Blockchain technology being deployed is not particularly difficult to incorporate into trading systems, the hard part is getting the participants onside.

The World Bank is supporting Blockchain-enabled trade systems as they believe it will rip out further costs in global trade systems. And the World Bank also believes Blockchain-enabled trade systems will support micro exporters operating in developing countries gain access to inexpensive trade systems, including trade finance, which is often the difference between successful growth and merely surviving.

Left behind on trade competitiveness

Upon my return from Hong Kong (when Australia was ranked 95th) I spoke with government agencies such as Treasury, DFAT and ASIC, as well as private sector organisations with a stake in Australia's trade competitiveness, as to who was responsible for improving our trade regulatory productivity. I was advised that The Department of Home Affairs was charged with delivering Australia's Single Window; however, Home Affairs had no information on their website (and still do not) in respect to the Single Window initiative, and calls I made to Home Affairs on this issue were not returned.

As a country, we have known about our weaknesses in trade processes for many years, as the Australian government has been involved in stop-start initiatives to deliver a digital trade system since at least 2009 without success. Now the leaders of the trade pack are taking the leap to the next technology platform, Blockchain, to enhance their trade competitiveness.

As a trading nation, Australia cannot afford a ranking of 106, and the costs associated with it, in an area so important to our economic well-being. And a government looking for any opportunity to kick start a COVID-weary economy would do well to finally bring our trade systems into the 21st century.

Kevin Cryan is a technology and services investments specialist and Managing Director of Scarborough Partners. He was previously Senior Investment Specialist for Services and Technology at Austrade after spending 16 years at the CSIRO.

Australian large caps outperform small caps over long term

Jay Kumar

An analysis of the performance of factors in the Australian share market reveals some valuable insights for equity investors. Contrary to conventional wisdom, large capitalisation stocks have consistently beaten small-cap companies.

While most investor portfolios have exposure to one or more factors, some factors tend to deliver better risk-adjusted returns than others over the longer term. Traditionally, it is believed that small caps outperform large caps because they are growing faster, a conclusion most famously promoted by academics Eugene Fama and Kenneth French. Their research found investors were rewarded for the greater risk in backing more volatile smaller companies.

A challenge to conventional wisdom

But our factor analysis reveals that over longer-term periods of 10 and 20 years, Australian large cap stocks outperformed small caps convincingly, as shown below to 30 June 2020.

	1 year (%)	3 year (% pa)	5 year (% pa)	10 year (% pa)	20 year (% pa)
Large cap	-5.10	7.89	8.43	8.88	8.74
Small cap	-3.71	5.27	6.55	5.09	6.37
Difference	-1.39	2.62	1.89	3.79	2.37

Source: Foresight Analytics and Refinitiv. Returns are measured by the Foresight Large Cap universe and Foresight Small Cap universe, which are represented by the top 90% market cap of companies in the Australian share market while the small caps are the bottom 10% of market cap.

The main reason is the concentration of the ASX200, where the weight of money, active and passive, has been directed to a few large offshore earners, the big banks, miners and healthcare. Example include miners BHP Billiton, Rio Tinto and Newcrest; financials Commonwealth Bank, Westpac and ANZ; healthcare names CSL, Sonic and Ramsay; IT heavyweights Computershare, REA and Carsales. This has entrenched the gains of large caps over small caps over the longer term.

Top performing sectors within large cap world

Within the large cap world, some sectors stand out in consistently delivering high returns over the past decade, such as healthcare, industrials, technology, consumer cyclicals and financials. The laggards over the past decade include energy, utilities and telecom.

Large Cap	1 year (%)	2 year (% pa)	3 year (% pa)	5 year (% pa)	10 year (% pa)
Healthcare	26.94	19.90	22.13	21.10	22.01
Consumer Non-Cyclicals	9.65	7.09	11.08	8.92	6.36
Technology	5.92	7.51	17.71	16.76	10.40
Consumer Cyclicals	4.87	3.80	10.57	10.79	10.25
Industrials	-0.63	8.98	7.83	12.15	12.50
Basic Materials	-0.96	11.37	17.66	13.72	5.11
Utilities	-6.80	-6.48	-0.66	3.99	5.92
Telecommunication Services	-12.82	15.89	-3.61	-6.85	6.68
Financials	-21.09	-6.68	-3.43	-0.09	7.18
Energy	-30.92	-17.07	-1.21	-2.93	-2.14

Note: Returns are as at 30 June 2020. Thomson Reuters Business Classification (TRBC) is used for industry sectors. Data source: Foresight Analytics Global Investment Database

High-performing stocks from the mining industry have been boosted lately by gold's stellar performance and an uptick in other commodity prices such as iron ore. Large cap consumer non-cyclical stocks are well represented by Domino's Pizza, whose fortunes are continuing to rise with more eating at home due to COVID-19 restrictions.

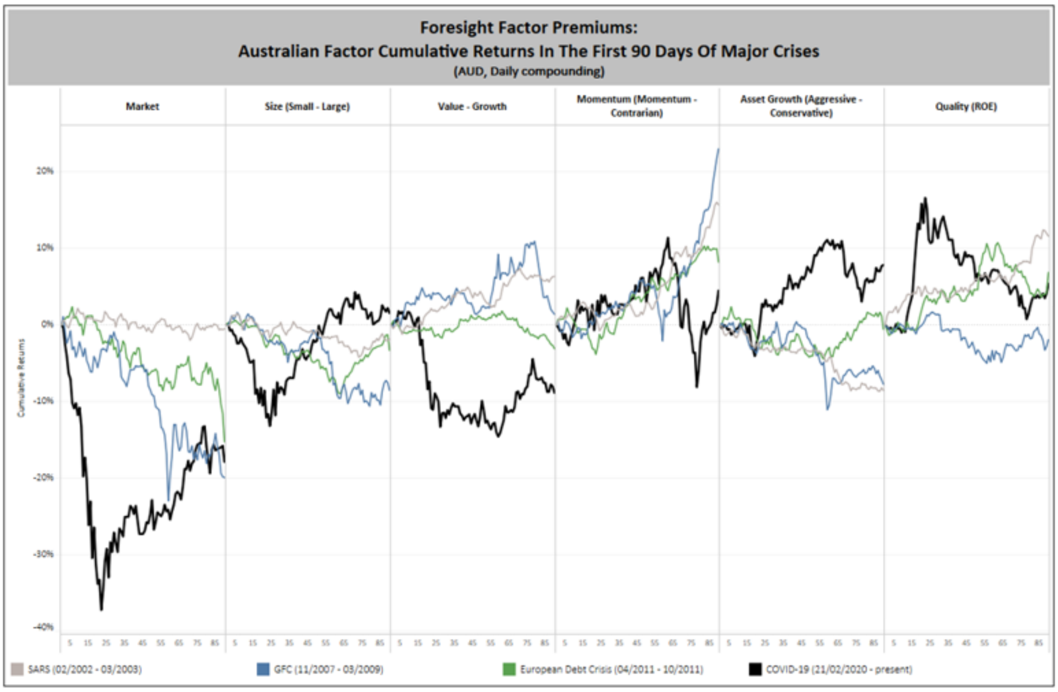
Size performance over the short term

Over the shorter periods, the story is not dissimilar and large caps outperform. Money tends to flow into particular types of assets – most notably quality stocks – during a crisis, but we found that large caps consistently outperformed small caps across all major financial market crises.

This is exactly what happened in the first month of the COVID-19 crisis, though small caps rebounded strongly after the first 30 days of the crisis. The COVID-19 pandemic resulted in large cap, quality and growth factors delivering significant positive premiums. The impact of the pandemic on factor returns has been much more severe (in speed and depth) than the previous major crises, particularly during in the first 30 days. As a result, the coronavirus pandemic provided opportunities for generating alpha from managing factor exposure or pursuing factor rotation strategy.

However, unlike previous crisis, the value factor has underperformed growth while aggressive asset growth beat conservative asset growth. In addition, after a significant underperformance from small caps, we witnessed a strong recovery after the first 30 days. Momentum and quality premiums witnessed significant volatility after first 30 days of the current crisis as well, as the chart below shows.

Initial impact of COVID-19 crisis more severe than previous crises



Source: Foresight Analytics Multi-factor Attribution System (Foresight MFAS) - Datasource: Foresight and Refinitiv

Given the pattern of the large cap performance behaviour during the previous three crises, investors can reasonably expect the large caps to outperform during future stock market crises.

Factor investing is often captured by active fund managers investing in assets with particular attributes such as value stocks or small caps, or 'smart beta' ETFs that track a rules-based index. For investors, it is important to understand how factors work when evaluating your investment's performance and making any decisions to hire or fire a manager or invest in a particular investment product. Some factors give better risk-adjusted returns than others.

Despite the rhetoric from some investors, backing smaller, riskier stocks in the Australian share market will not necessarily give better returns than backing larger, less volatile stocks. Our share market is too concentrated for that.

Additionally, investors can manage the negative drag from size factor by avoiding passive and smart beta strategies that seek to maximise exposure to the size factor without paying any regard to other fundamentals. Investors would be better served by selecting skilled small cap active managers seeking to add value by picking fundamentally strong companies.

Jay Kumar is Founder and Managing Director at [Foresight Analytics](). This article contains general information only and does not consider your personal circumstances.

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