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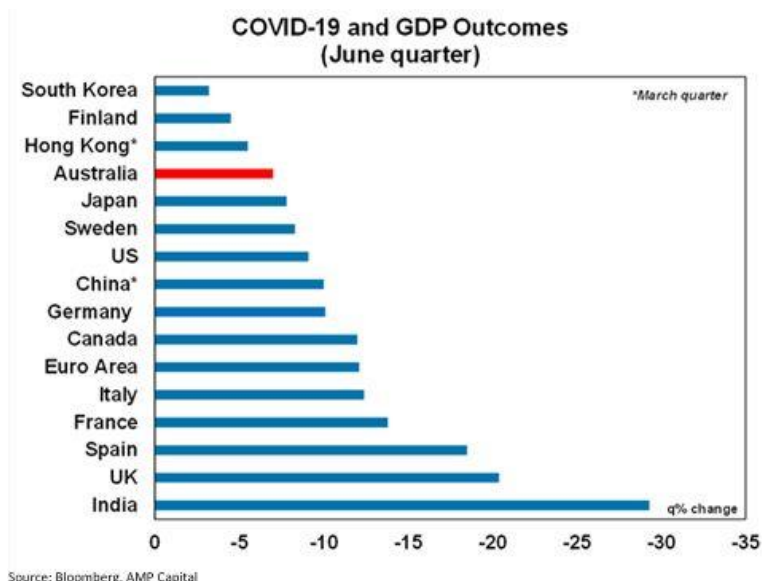
Editorial

Suddenly, it's the middle of September and we don't hear much about 'snap back' anymore. Now we have 'road maps'. Six months ago, I was flying back from Antarctica after two weeks aboard the Greg Mortimer cruise ship. Passengers on a following trip were stranded for a month in Montevideo, Uruguay, and most caught COVID-19. Safe in Australia in March, the Government doubled the 'dole' and introduced JobKeeper on such generous terms that major listed companies drew on it by the million and many people received a large income boost. But it was all supposed to end in September with a 'snap back', yet here we are with stimulus extensions in place.

Notwithstanding our love of travel, most Australians would rather be home than anywhere else at the moment. Just ask the two Australian journalists who escaped from China as our relationship deteriorates.



During the first few months of the pandemic, I wondered why India was not in dire straits. Surely, a billion people living in close proximity with a requirement to go to work each day would be a disaster, but stories ran on why India was coping so well. Now, with 90,000 new cases a day versus Brazil at 30,000, India is second to the US in total cases and has the most deaths per day. We can only imagine the tough conditions faced in many other countries.

Even in wealthy Australia, with unlimited government borrowing capacity and an excellent health system, thousands of businesses have collapsed and a million people have lost their jobs. The first level of the September 'cliff' is fast approaching. From 28 September, JobKeeper falls from $1,500 to $1,200 a fortnight for those actively engaged in the business for 80 hours or more a month and to $750 for all others. Business is given more administrative and compliance complexity. And then from 4 January 2021 to 28 March, the payments fall to $1,000 and $650 respectively.

The stimulus enjoyed by companies such as Harvey Norman, Kogan and JB HiFi from the initial generosity (a part-timer on $100 a fortnight was suddenly eligible for $1,500) is about to hit a wall.

And then there's super access. It was notable that the ATO felt obliged to issue a warning last week on the early access to super. It's not quite a repeat of Senator Jane Hume's "*It's your money*" and "*Australians who have made the decision to access their super early can rest assured that the Morrison Government trusts them*". Said the ATO:

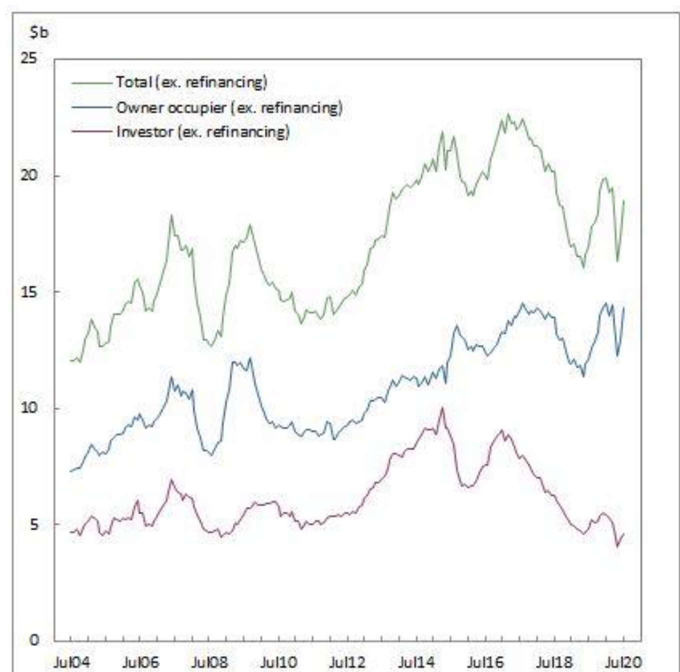
"We're managing the eligibility criteria with strict guidelines and will take action when we identify fraud or people seeking to exploit the program ... If you apply and you're not eligible at the time of submitting your application, we will take action. If you are unable to demonstrate your eligibility when we ask for evidence, we may revoke the determination issued for your application ... If you provide false or misleading information you could face penalties of more than $12,000 for each false and misleading statement."

$12,000 is more than the average super withdrawal of $7,683. With 2.5 million early release applications received, the ATO has indicated it is stepping up checking using Single Touch Payroll (STP) systems, income tax returns, information reported by super funds and third-party data from Services Australia. Compliance is necessary but it doesn't sound much like "*rest assured that the Morrison Government trusts them*".

The residential housing market is surprisingly resilient in the face of the virus, with modest price falls over the last six months after a strong end to 2019. While loan commitments are below pre-COVID levels, new data is robust with the **ABS** reporting this week:

"July owner occupier home loan commitments rebounded with the largest month-on-month rise in the history of the series, as social distancing restrictions eased in most states and territories."

New loan commitments, total housing (seasonally adjusted)



Gareth Aird from **CBA Economics** wrote:

"We expect dwelling prices to continue to decline at a modest pace and to trough in Q1 21. But we expect a solid recovery in prices from H2 21 as the borrowing cost once again becomes the dominant influence on prices."

In this week's edition ...

With so much happening, it's time to update your attitudes. Our survey checks your reaction to recent policies and your COVID-19 responses using similar questions asked in April 2020. Please participate to give the widest sample and we will report the results next week.

Regardless of anyone's personal ethics, there is plenty of evidence that ESG investing adds value. Our Interview Series continues with the CEO and CIO of **Australian Ethical** on how they make ethical investing count in many ways, and what they think of the current market.

The recent reporting season showed a wide variety of results for listed property trusts, and **Jonathan Kriska** explains why this is one sector where strict stock selection is required.

Bill Ackman is a leading investor and hedge fund manager who made millions out of COVID-19. In this extract from his recent Shareholder Letter, he identifies Australia's super system as an example of the way more Americans can reap the benefits of capitalism. Why do we criticise a good system so much?

As in many countries, Australia's family-run companies show consistent outperformance, benefitting from a complete knowledge of the business. **Andrew McAuley** identifies them and trends around the world.

SMSFs are not only tax-efficient vehicles for controlling the cost of investing with more choice, but they facilitate passing of wealth to future generations. **Karen Dezdjek** warns about including an Enduring Power of Attorney.

And **David Bell** is leading a group of industry experts working on a standard definition of growth and defensive assets. Given the widespread use of the distinction and the difficulty comparing 'balanced' funds, it's important work that you can contribute to.

We also received many useful comments on this article on basic investment beliefs. Please add any more and we will compile the good ideas into another article.

And let's look out for each other with a more sympathetic ear. The latest research by **The Medical Journal of Australia** found that significant feelings of depression or anxiety were being experienced by 25% of people after the COVID-19 restrictions. With the Government announcing a deal with **AstraZeneca** this week, it was disappointing to read about a setback in their trials. National Deputy Chief Medical Officer, **Nick Coatsworth**, played down the adverse reaction, saying the deal was not dead but investigations are underway.

This week's White Paper from **BetaShares** is the August 2020 ETF Review, showing Exchange Traded Funds now exceed $70 billion for the first time, a clear lead over LICs and LITs by $25 billion. As recently as January 2019, the LIC/LIT segment was bigger than ETFs.

Survey on COVID-19's impact and management

Leisa Bell

The impact of COVID-19 continues to drag on, especially for Victorians at the moment, and while talk of a vaccine has ramped up in recent weeks, in reality the middle of 2021 would be a good outcome.

Six months ago, when the Australian government introduced its stimulus measures, the confidence in a 'snap back' allowed a September end-date for initiatives such as JobKeeper. Suddenly, the economic cliff is here as the windback begins in two weeks, and initiatives are being extended into 2021.

So how are you coping now versus when we were first affected by lockdowns and restrictions? In this survey, we pose some new questions as well as revisiting some questions from our April 2020 survey to compare changes.

What do you think of the government's policies in relation to JobKeeper and superannuation? How will the US election change things? What will the Australian stock market do? How is your portfolio performing? What are you investing in now? When do you think the crisis will end? How has your own life changed?

We have 12 questions which should take about five minutes to complete, and responses will always remain anonymous. We will publish the full results next week.

Click here for Firstlinks poll on
COVID-19 from snap back to road map

When ethical investing demands more than fluffy answers

Graham Hand

John McMurdo is Chief Executive Officer and Managing Director and David Macri is Chief Investment Officer at Australian Ethical, a listed fund manager currently managing about $4 billion for Australian clients.

GH: A listed fund manager has multiple stakeholders. How do you balance them and what are the major metrics on the way you measure the business and your performance?

JM: Clients come first. Investment performance will always be the key test, we couple that with measuring client overall satisfaction using a Net Promoter Score. That includes both underlying investors and financial advisers. For shareholders, profit and total shareholder returns are key. But like all investment management companies, funds under management is important as it measures not only our growth as a company but also the growing impact our customers are having on the planet and people via how their money is invested. And culture is everything. We run an engagement survey with staff to test all dimensions of our culture. We apply to our own business the various tools we use to assess companies for our portfolios, including a focus on diversity and inclusion.

So balancing all those stakeholders is deliberate and we believe strongly in the interconnectedness of each measure, not just shareholder outcomes. It creates a whole that is better than the sum of the parts.

GH: Do your investors and shareholders invest with you because of your ethical position or for investment performance, or is it not possible to separate the two?

JM: We think people are attracted to us for both in some combination. Some invest for ethical reasons and enjoy the performance, while others want performance and are reassured by the ethics. We are showing you can achieve both.

DM: From an investment perspective, we don't like to separate those two things, it is just one process and one style. It doesn't work if we don't deliver investment performance and alternatively, if we're delivering investment performance without being true to the ethical charter, that's not what our customers want.

GH: But my ethics are not your ethics and your ethics may not be the same as your portfolio managers. How does this play out internally and what if a portfolio manager says, "I liked that company and you forced me to sell it and the price rose?"

DM: Yes, I agree, everyone has different values and it's impossible for us to manage based on individual values. So we have a principles-based Ethical Charter. It states 23 principles that we abide by. So yes, a lot of work goes into interpreting the principles and how we apply them to the investment universe. A portfolio manager would not get penalised for divesting out of a company on ethical grounds and then the share price goes up.

GH: John, I realise you've only been at AE for six months but is there an example of a value or principle that has changed, that was previously acceptable to the community but is no longer?

JM: My overall comment is that the Charter has served us well since inception in 1986. Take gender issues, for example. We are one of the significant minority of ASX300 companies to have 50% gender diversity at both board and executive management level. We have documented frameworks on screening companies for discrimination, lack of inclusion, harassment. So less has changed than more as we stick to our principles.

DM: We've always been true to our values and you can finally see other examples of that as mainstream fund managers and shareholders are holding boards to account on culture and behavior.

GH: We receive articles regularly from dozens of fund managers and it's common to position their businesses around ethics and sustainable investing and ESG. When they start an article with, "Sustainable investing has come of age", it's as if they've just discovered something. Doesn't that make it a crowded space for Australian Ethical to stand above?

JM: There's no doubt the competitive landscape has changed as others replicate what we do. I welcome it. A deeper, stronger ethical investing sector will be good for clients and good for the world. But we have what I call 'ethical authenticity'. Unlike competitors who may offer one or two sustainable options, sustainability and ethics are at the heart of our business and portfolios. It's all we do.

GH: I was chatting with John Pearce, CIO of UniSuper, and he said that if he disagrees with what a company is doing, he needs to decide if it is better to stay as a shareholder and influence them from inside the tent, or go for the big divestment headline and sell the company. What's your view?

DM: The ideal scenario is where you engage, and attempt change in a positive way. But without the threat of divestment, you find yourself in a continuous loop of discussions and there's no real motivation for the company to change. You keep putting in the questions and the fluffy answers come back.

There must be progress and a motivating factor for them to improve something. You need a lot of shares in a company to really influence, so divestment elevates the issue, sometimes in the public domain, and creates some urgency. And we find that you don't necessarily need to own shares to engage with a company, particularly if you're a large institutional investor. Corporates are always eager to speak to large influential investors.

JM: In FY20, we engaged with over 400 companies on environmental and people issues, and we believe at least 70 of those led to a genuine change. We take it seriously.

GH: In your results presentation, the average revenue margin has been falling for many years. Do you have a deliberate policy on reducing fees as you grow?

JM: We do, and we will continue. We're committed to making ethical investing as affordable and accessible as possible. It's an equitable balance between stakeholders so both shareholders and clients share in the success of our growing scale.

GH: And you also called out the 638 investors who closed their superannuation accounts under the pandemic early access rules. Do you have a view on people accessing super early?

JM: Yes, I have a couple of perspectives on it. First, we believe it's the investors' money, and if accessing it early helps their financial security, then we support it in these extraordinary times. But we're anxious to avoid it becoming a common event with super reduced to a glorified bank account. We all know the benefits of long-term compounding and we need to make sure people's futures are protected.

GH: Accepting that in the privileged position we're all in, we can't criticise someone who's struggling to pay off a loan or put food on the table. But a lot of success in the last six months of Harvey Norman and JB HiFi and Kogan is people withdrawing super and not spending it the right way. Do you think that this early access to super has been too easy?

JM: Hindsight would tell us that's likely the case, but I'm sympathetic to the government's need to take drastic and fast measures without the fine detail being perfect. With more time, they may have been more tailored than the policy that was rolled out.

GH: Your flows have been strong in the last six to 12 months, what type of investor is the money coming from?

JM: Yes, we've had 100% growth in net flows. It's a seismic shift in investor sentiment, where people want to see their money do well and do good. The research shows that two in every three Australians want to be certain that their superannuation and investments are not harming the planet. And 62% of Australians accept that ethical investing provides better long-term performance. We're seeing it across the age spectrum from younger millennials to middle age and older. Clients were more the younger demographic three years ago but it's now very broad.

GH: Is it adviser-led or direct?

JM: Both. A lot of clients come direct, but advisers are also saying they want to be on the front foot of the ESG change, investing in both the funds format and managed accounts on platforms. And if we see demand to deliver our funds in a different way, such as listed vehicles, we'll consider it, especially as technology improves.

GH: It's a strange market at the moment. Your own share price has a 12-month high of around $9 and a low of $2 and it's around $5 now. The headline in the *AFR* today says 'ASX rises 1.6%, GDP falls 7%'. What's your take on what's happening?

JM: There's a lot of looking through to the end of the pandemic, which we do too. The world is not going to end even if it will not go exactly back to normal. We'll still have great companies delivering great results, especially post a vaccine, but there'll be plenty of volatility still to come.

DM: Nobody likes seeing these dismal economic numbers, but the market is good at looking well ahead. We already knew we were in a recession, so the GDP fall wasn't news. We will definitely see a rebound although we don't know the duration of the downturn. So we look through it and come to a fundamental intrinsic value of a company that we hold. If they benefit from COVID, that's great. If they don't, is it an opportunity? We stick to our processes and the fundamentals of investing to construct diversified portfolios.

Graham Hand is Managing Editor of Firstlinks. John McMurdo is Chief Executive and David Macri is Chief Investment Officer at Australian Ethical, a sponsor of Firstlinks. David did a recent review of 2019/2020 here. This article is general information and does not consider the circumstances of any investor.

Reporting season winners and losers in listed property trusts

Jonathan Kriska

The August 2020 results were the first real chance investors have had to properly look under the bonnet and dissect the performance of listed A-REITs (property trusts) since the onset of COVID-19. Not surprisingly, there were wide variances reported, given the impact that forced lockdowns have had on the various property sectors. However, the output was better than initially feared back in March 2020 when COVID-19 first hit.

Valuations across the A-REIT sector now look compelling especially relative to bond yields. The A-REIT sector is priced on an FY21 dividend yield of 4.8%, a 390 basis point spread over 10-year bonds, and well above its long-term average of 200 basis points.

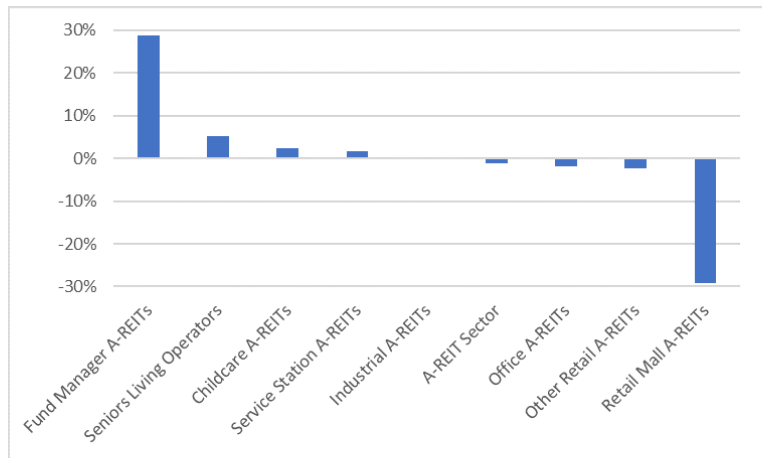
We believe market dislocations create good buying opportunities for active managers. We continue to focus on select A-REITs with high quality portfolios (assets, lease covenants and longer lease tenures) and strong balance sheets (low gearing, diversified funding sources, longer duration debt) which trade on cheap multiples (low P/E and large discount to NTA).

Fund manager A-REITs outperform retail mall A-REITs

On average, A-REITs delivered annual EPS (earnings per share) growth of approximately -1.1% for the year ending June 2020. Yet this headline hides the significant dispersion across the different sectors.

Strong performances were recorded by the fund manager A-REITs (including Goodman Group ASX:GMG and Charter Hall ASX:CHC) and seniors living operators (including Ingenia Communities ASX:INA), which delivered EPS growth of +28.8% and +5.2% respectively, while not surprisingly, retail mall A-REITs (including SCentre ASX:SCG and Vicinity ASX:VCX) were the weakest with average EPS growth of -29.3%.

Figure 1: A-REIT Sector Earnings Growth - FY20



But it’s all about the cashflow

While EPS numbers provide a useful measure of performance the focus this reporting season was on cashflow. Leading into this reporting season, we knew things would be different given the difficult trading operating environment.

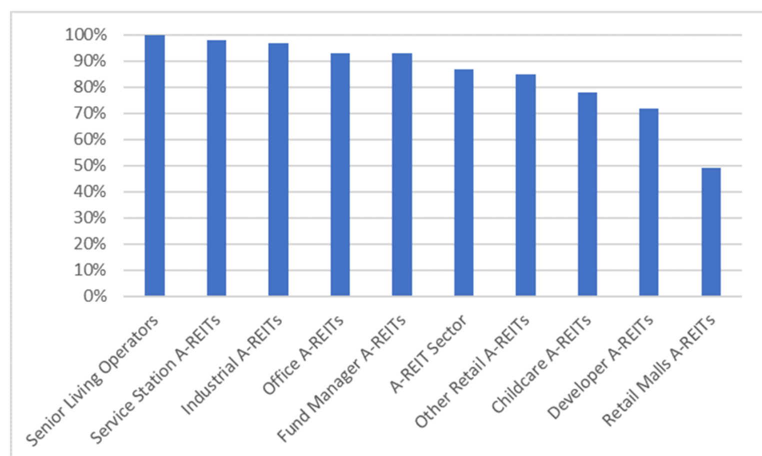
A-REITs have had to contend not only with enforced closures (e.g. pubs) but also the federal government’s Code of Conduct legislation for landlords and tenants which mandated that landlords would be required to waive or defer rent to small and medium enterprises tenants who had annual turnover less than $50 million and had a greater than 30% loss in revenue.

The extent of the impacts on individual A-REITs were influenced by a mixture of sector focus, tenant covenant, and management skills. Clearly those A-REITs whose portfolios were more leveraged to the consumer and small to median enterprises fared worse (Figure 2).

A-REITs took different approaches to account for these shortfalls in rent which made assessing individual earnings performance less reliable than usual. Hence the assessment of cashflow became key.

Given the cash shortfalls across several REITs, dividends were cut by an average of -9.6% for the past financial year, although excluding retail mall A-REITs the result was only -4.8%.

Figure 2: Proportion of Rent Collected – Mar-Jun 2020



A quick take on each sector

Turning to the A-REIT sub-sectors, both industrial and office delivered stable results, and despite all the noise about ‘working from home’, cash collected from rents remained high.

In contrast, the performance of retail A-REITs was weaker, particularly those with larger malls that are more exposed to discretionary focused retail. In particular, Scentre Group (ASX:SCG) and Vicinity Centres (ASX:VCX) reported very weak results with large falls in foot traffic, tenant sales, reported earnings, and asset values. Their performance reflects both the cyclical elements associated with a slowing economy and the acceleration of the structural changes from the growth in online shopping.

The momentum in online shopping was well under way before COVID-19 but as a number of industry players have noted, the COVID-19 lockdowns forced consumers to go online in greater number and frequency, accelerating the shift away from physical stores to digital shopping by at least five years.

Residential developers, Stockland (ASX:SGP) and Mirvac (ASX:MGR), delivered flat growth in settlement volumes on stable margins, but promisingly net deposits were up about 20% which indicates a stronger outlook. Both groups referred to the positive affect on sales activity from recent increases in government stimulus programs for housing.

Property fund managers continued their recent trend of strong growth in FUM and earnings, given the supportive backdrop of low interest rates and demand for yield-orientated investments. Standout performers in this category were Charter Hall (ASX:CHC) and Goodman Group (ASX:GMG).

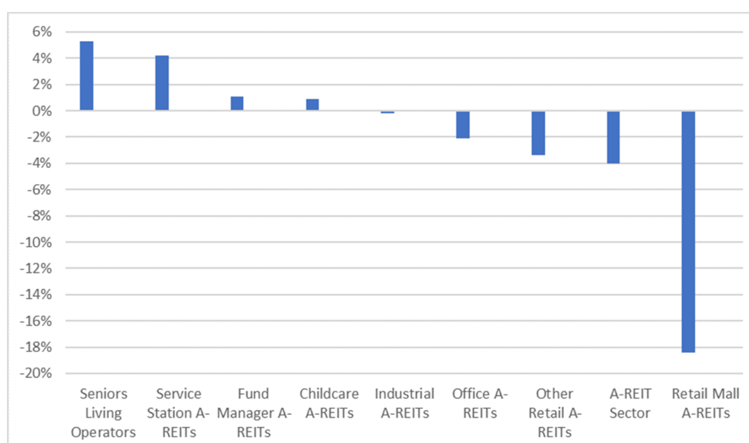
Select alternative sectors, such as rural and service stations, were largely unaffected by the effects of COVID-19 and delivered solid results. In this context we highlight good results from Rural Funds (ASX:RFF), Waypoint REIT (ASX:WPR) and APN Convenience REIT (ASX:AQR).

Seniors living operators such as Ingenia Communities (ASX:INA) continue to benefit from Australia's ageing population and low levels of supply of quality seniors living. These groups were generally able to drive strong EPS growth from their development of new stock and high occupancy from existing villages.

Balance sheets were under the microscope

The emergence of COVID-19 has acted as a trigger for some asset softening across the commercial property sector. But as with EPS results, the damage was largely contained to large retail malls, with mall values falling on average by 11% with some further dilution to net tangible assets (NTA) coming from the cash shortfalls of rent collected.

Figure 3: NTA Growth – 6 Months to June 2020



Balance sheets overall came out in reasonable shape. Some A-REITs went to market and raised capital through April to June to strengthen their balance sheets. The sector appears to have learnt the lessons of the GFC, coming into the COVID-19 crisis with more diversified funding sources, lower gearing – at 30 June the average gearing level was circa 26% - and longer debt tenor (average tenor is circa 5 years).

No guidance but clear upside

Earnings guidance was hard to come by this reporting season, with only a handful of A-REITs willing to stick their neck out given Melbourne is still in lockdown and the timing of a vaccine remains unclear.

However, there are enough signs to be optimistic on the outlook. Operating performance for retail focused A-REITs have started to improve (excluding Melbourne assets), rent collections are up across most sectors in July and August and as noted earlier, most balance sheets are in good shape.

While the potential of further COVID-19 waves cannot be ignored, the most likely outcome is for COVID-19 domestic cases to subside or the emergence of vaccine which would be positive for both the economy and A-REITs. We believe given the significant variance across the underlying A-REIT sub sectors and individual A-REITs that this will continue to be a market for active managers to make selective investments.

Jonathan Kriska is Portfolio Manager, Listed Securities at Charter Hall Maxim Property Securities. Charter Hall is a sponsor of Firstlinks. This article is for general information purposes only and does not consider the circumstances of any person, and investors should take professional investment advice before acting.

Bill Ackman on how super can fix capitalism's inequities

Bill Ackman

Introduction: Bill Ackman is an American investor and Founder of Pershing Square Capital Management, a hedge fund company. He hit the headlines in March 2020 when he created "one of the best trades of all time" turning a US$27 million index and Credit Default Swap (CDS) portfolio protection play into US$2.6 billion as COVID-19 hit the markets. He explains the strong results for 2019/2020 in the following way:

"Our strong absolute and relative performance was driven by our late February and early March hedging program in the index CDS markets, the subsequent unwinding of that hedge beginning on March 12th, and the contemporaneous reinvestment of nearly all of the gains from hedging by March 18th, which allowed us to take advantage of the large decline in the share prices of our portfolio companies, and of certain new investments during that period."

Of more interest for Australian investors are his recent comments on why the stock market is rising when the economy is in trouble, and the need for the US to adopt a superannuation system similar to Australia's.

This text has been extracted from his Letter to Shareholders in the 2020 Pershing Square Holdings Ltd Financial Statement.

The current environment for listed companies

I write this letter at an extraordinary time in the history of the world. Approaching one million people have died from the effects of the virus, the global economy is suffering to a degree that was unheard of since the Great Depression, and we are faced with a greater degree of political uncertainty in the United States and globally as far back as we can remember.

The economic and health effects of the virus have and will continue to have a disproportionately negative effect on the poor and disadvantaged in the U.S. and globally. Yet, we find ourselves optimistic about the companies in our portfolio, which include quick service restaurant and coffee companies, a hotel management company/franchisor, a home improvement retailer, two residential mortgage guarantors, a scientific equipment manufacturer, and a real estate development company.

What explains this dramatic seeming disconnect?

In sum, we are entering an era in which we expect the dominant, well-capitalized, great companies that comprise our portfolio to accelerate their growth in market share and profitability over the long term as they effectively adapt to the changes wrought by the virus. While many have been puzzled by the stock market's resurgence, in our view, it can be best explained by this phenomenon writ large. Said differently, we have a corporate inequality phenomenon in addition to an income inequality problem.

The stock market is comprised of the biggest and strongest companies, and reflects the present value of what is to come for these businesses. It is not representative of the entire economy. If there were a stock market index of private, small businesses, it would likely be down 50% or more. Small business failures will make the income inequality problem even worse.

Need to address social imbalance

If we are to avoid continued political risk and disharmony which create serious risks to the sustainability of the capitalist system, we need to find a way for those left behind to participate to a greater extent in capitalism, broadly defined. This is an important problem that must be addressed, and it is incumbent upon all of us, particularly those of us who are the greatest beneficiaries of the system, to find a potential solution.

Despite its faults, we are strongly of the view that, while far from perfect, capitalism is by far the best system for maximizing the size of the economic pie. One of the principal problems with capitalism, particularly as it has functioned over the last several decades, however, is that wage growth has not kept pace with long-term wealth creation, which has disproportionately favoured the wealthy and the upper middle class. This likely can

be attributed to the higher after-tax returns generated by investment assets compared with wage growth over the same period.

Without funds to invest for retirement – particularly after the housing crash destroyed many Americans' only other source of long-term wealth creation – one has almost no hope to build wealth for retirement, or to give the next generation a head's start.

In sum, the American Dream has become a disappointment or worse for too many.

If capitalism continues to leave behind most Americans as the growth in wages has not come close to the more tax-efficient compound growth that has been achieved by investing in the stock market, more and more Americans will seek changes, potentially radical ones, to the current system, or seek an alternative system. Like those who rent rather than own their homes and thereby have no love lost for their landlords, Americans that have no ownership in the success of capitalism, and who are suffering economically, are more motivated to turn toward Socialism or other alternatives.

Every American child should have an investment account

One potential solution to the wealth inequality problem is to create a way for those with no investment assets to participate in the success of capitalism. We need a program that makes every American an owner of the compounding growth in value of corporate America. Compounded returns over time are indeed one of the great wonders of the world, and every day we wait to address this issue, the problem looms larger.

There are a number of potential solutions to this problem. Among them, the government could establish and fund investment accounts for every child born in America. The funds could be invested in zero-cost equity index funds, be prohibited from withdrawal until retirement, and could compound tax free for 65 years. At historical rates of equity returns of 8% per annum, a $6,750 at birth retirement account - which would cost $26 billion annually based on the average number of children born in the U.S. each year - would provide retirement assets of more than $1 million at age 65.

Praise for the Australian system

Alternatively, or hopefully in addition, corporations could be required to set aside a fixed percent of salary or wages in a tax-free investment account for all workers that would also be restricted from withdrawal until retirement, similar to the approach used by the highly successful and popular Australian superannuation system, which has created savings of scale for growing generations of its citizens. Since the superannuation system's launch in 1991, Australia now has $2.7 trillion of superannuation assets – nearly twice the country's GDP.

Remarkably, Australia has created the fourth largest pension system in the world, in the 53rd most populous nation.

In addition to helping all Americans build wealth for retirement, mandatory equity savings accounts for all would encourage greater financial literacy, and, as importantly, give all Americans the opportunity to participate in the success of capitalism.

We are not going to solve our country's problems in a few short paragraphs, but we highlight the above problems as they are critically important for the country to address, and, like Covid-19, they present black-swan-type risks for investors.

These and other issues of global concern, like climate change, create substantial unresolved risks and uncertainties, and we therefore continue to remain extremely vigilant, cautious, and selective about our approach to investing your capital.

Bill Ackman is Chief Executive Officer of [Pershing Square Capital Management](), a hedge fund with assets under management of $US12 billion. This article is an extract from the 2020 Letter to Shareholders.

Family businesses show resilience through pandemic

Andrew McAuley

Our research highlights that family/founder-owned businesses pursue a longer time horizon in their investment strategy, delivering more stable and superior through-cycle profitability, and ultimately driving significant excess returns for all shareholders.

Using a proprietary 'Family 1000' database of more than 1,000 publicly listed family or founder-owned companies, Credit Suisse has found that since 2006, the overall 'Family 1000' universe has outperformed non-family-owned companies by an annual average of 3.7%. Asia Pacific (APAC) ex-Japan has seen the most pronounced effect, with compound excess returns of more than 5% per annum, followed by Europe, at 4.7% basis points.

Within APAC, Australia has the highest excess return.

APAC family-owned companies continue to dominate the universe

The report covered 12 markets in APAC including Japan that continue to dominate and represent a 51% share of the universe, with a total of 540 companies and a market capitalisation of over USD5.56 trillion.

The universe includes six Australian family-owned companies, with a total market capitalisation of USD63.3 billion.

Within the region, China, India and Hong Kong dominate. These three jurisdictions combined comprise 63% of the APAC universe of the CSRI's database, with a combined market capitalisation of USD3.9 trillion (or 70%) of the market share of the APAC universe.

Figure 1: Family 1000 by region

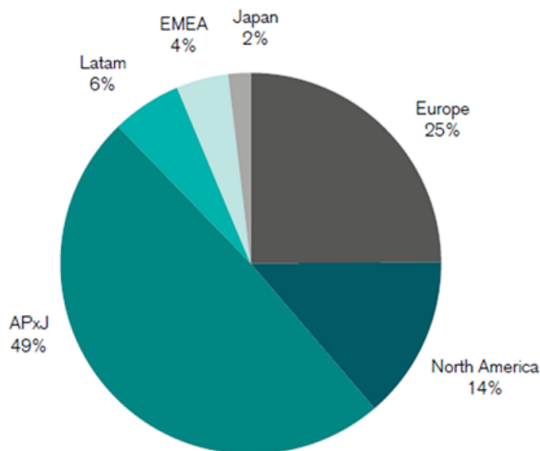
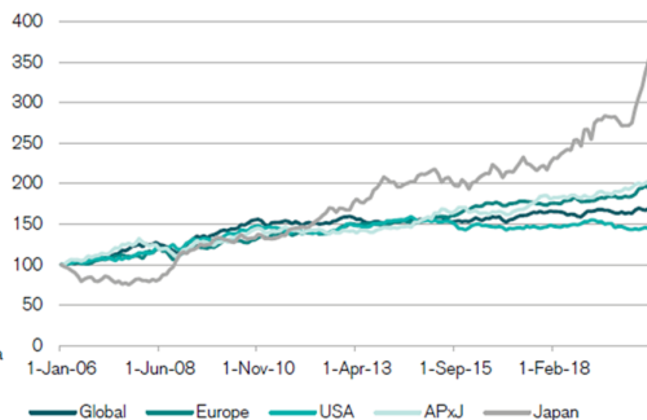


Figure 2: Family alpha by region – relative performance of family-owned versus non-family-owned



Source Figures 1–2: Credit Suisse Research, Thomson Reuters Datastream

The family alpha is strongest in Australia, with an annual average outperformance of 23% since 2006, compared to 12.0% by their Chinese peers and 9% by their Japanese peers.

However, the universe of Australian and Japanese family-owned companies makes up only a small portion of the overall universe.

Family alpha factor during the COVID-19 pandemic

The COVID-19 pandemic has had a significant impact on equity market returns and volatility this year. Family-owned companies tend to have above-average defensive characteristics that allow them to perform well, particularly during periods of market stress.

Return data for the first six months of this year supports that view, given an overall outperformance of around 3% relative to non-family-owned companies. This outperformance was strongest in Europe and APAC ex-Japan, at 6.2% and 5.1% respectively. Family-owned companies in Japan outperformed their non-family-owned peers by 30.1% during this period.

Figure 3: Return statistics – family returns relative to non-family companies

	Annual average since 2006				2020: January to June			
	Overall	Small	Mid	Large	Overall	Small	Mid	Large
Global	3.7%	6.5%	3.9%	3.1%	3.0%	1.6%	3.6%	2.7%
Europe	4.7%	6.2%	3.9%	3.0%	6.2%	6.9%	6.0%	5.2%
North America	2.6%	2.3%	3.0%	1.5%	0.7%	10.1%	5.9%	–1.1%
APxJ	5.0%	4.3%	2.9%	4.5%	5.1%	5.0%	6.2%	5.1%
Japan	9.2%	13.8%	1.6%	11.8%	30.1%	15.7%	5.3%	37.1%
EMEA	3.5%	–0.5%	11.9%	2.5%	0.5%	–41.6%	–1.9%	–2.7%
Latam	3.7%	6.5%	3.9%	3.1%	–5.9%	–11.9%	1.2%	–1.2%

Source: Credit Suisse Research, Thomson Reuters Datastream

Key findings on family-owned companies

Higher growth and profits – The analysis suggests that, since 2006, revenue growth generated by family-owned companies has been more than 2% higher than that of non-family-owned companies for both smaller and larger companies. At the same time, the analysis also suggests that family-owned companies tend to be more profitable. These superior returns are observed across all regions globally.

Perform better on ESG scores – Family-owned companies on average tend to have slightly better environmental, social and governance (ESG) scores than non-family-owned companies. This overall superior performance, which has strengthened over the past four years, is mostly led by higher **environmental** and **social** scores as family-owned companies appear to lag their non-family-owned peers in terms of **governance**. From a regional perspective, European family-owned companies have the highest ESG scores. Family-owned companies in APAC ex-Japan are scoring better than those located in the US and their scores are rapidly converging with those generated by their European counterparts.

Older family-owned companies have better ESG scores than younger firms – This performance is seen across all three ESG areas. Perhaps the fact that older family-owned companies have more established business processes in place allows them to incorporate or focus on areas of their business that are not directly related to their production processes, but that are relevant in terms of maintaining overall business sustainability.

COVID-19 impact – In order to better understand the ESG characteristics of family-owned companies, a survey of more than 200 companies was conducted. The companies were asked how much of a concern COVID-19 is to them going forward. Despite the impact on revenue growth this year, it seems that the family-owned companies surveyed view COVID-19 as slightly less of a concern to their firm's prospects than non-family-owned companies. Family-owned companies have also resorted less to furloughing their staff than non-family-owned companies (46% versus 55%). Among family-owned companies, support programs have been set up most often in APAC Ex-Japan rather than in Europe or the US. This might reflect a greater availability of government-sponsored support programs in these regions.

Social impact – The survey showed that while family-owned companies have focused more on social policies since the outbreak of the COVID-19 pandemic, they seem to lag non-family-owned peers on several ESG-related factors, most noticeably human rights and modern slavery-related policies. Family-owned companies on average have less-diverse management boards, fewer of them have support groups for the lesbian, gay, bisexual and trans (LGBT) and black, Asian and minority ethnic (BAME) communities, or have made public statements concerning respect for human rights or the related United Nation principles.

The largest 25 family companies in the database are:

Table 1: Top 25 companies by market capitalization

Largest 25 companies	Market cap. (USD bn)
Alphabet	988
Facebook Inc.	659
Alibaba Group Holding Limited	588
Walmart Inc.	343
Samsung Electronics	277
Roche	242
LVMH	226
Berkshire	209
Comcast Corp.	197
Ping An	196
Tesla Inc	176
Oracle Corporation	174
L'Oreal	167
Nike Inc.	162
Reliance	138
Anheuser-Busch InBev	115
SoftBank Group	104
TCS	103
Keyence	101
Inditex	93
Hermes International	92
Volkswagen	88
JD.com	87
Christian Dior	82
Chugai Pharmaceutical	78

Source: Credit Suisse Research, Thomson Reuters Datastream

Andrew McAuley is Chief Investment Officer for Credit Suisse Australia Private Banking. This article is general information and does not consider the circumstances of any investor.

A copy of the full report can be found here.

Every SMSF trustee should have an Enduring Power of Attorney

Karen Dezdjek

If you're an SMSF trustee, there are several vital things to consider when it comes to your estate and succession planning.

COVID-19 shows need to prepare

Your will enables assets to be distributed in accordance with your wishes when you die, and a binding death benefit nomination will direct your super and any insurance benefits to your chosen beneficiary.

However, many people are not prepared for what happens if a trustee is incapacitated and not able to act either on a temporary or permanent basis.

COVID-19 and the events of 2020 are an indication of why now, more than ever, SMSF trustees need to be prepared for the 'unexpected' by having an Enduring Power of Attorney (EPOA) in place.

An Enduring Power of Attorney is a legal agreement that enables an individual to appoint another person or people to make financial, personal, medical or property decisions on their behalf in the event that the individual is unable to act. This appointment can be either on a temporary or permanent basis depending on the reason for the appointment.

Importantly, superannuation law allows an EPOA to act in the place of the member without causing the fund to cease to be an SMSF.

Different to a Power of Attorney

Many people believe that if they have a Power of Attorney in place their SMSF is secure. However, what happens if mental capacity is lost? Unfortunately, in this circumstance the Power of Attorney ceases to operate which is why it is important to have an EPOA in place.

All members of an SMSF must be trustees, but to be a trustee of an SMSF an individual cannot be under any legal disability including mental incapacity. If a trustee becomes unable to act or loses capacity, they must be removed, and someone will need to be appointed either temporarily or permanently in the trustee's place until the individual can act again on their own.

A person acting as an Enduring Power of Attorney will take on all responsibilities of being a trustee. They will make financial decisions on the members' behalf. This will include the acquisition and disposal of investments, transacting on the fund's bank account and paying all expenses of the fund including pensions. They will also be responsible for the signing of financial statements, annual returns, and other mandatory compliance minutes required.

In other words, they will oversee the day-to-day running of the SMSF in much the same way the member themselves did.

As blended families are becoming more prevalent, having an EPOA can avoid unnecessary friction or certain unanticipated actions being taken.

Anyone can be appointed as an EPOA and more than one EPOA can be nominated to act jointly in making the decisions. It is also a good idea to appoint a substitute where possible should one of the EPOAs not be able to take on the responsibility of being a trustee.

If something adverse happens without an EPOA in place, there can be dire consequences. For example, if a member resides in NSW an application would need to be made by the next of kin to the NSW Civil and Administrative Tribunal to obtain an order to enable the SMSF assets to be dealt with.

If you have an SMSF, don't leave your assets to chance and arrange not just a Power of Attorney, but an Enduring Power of Attorney sooner rather than later.

Karen Dezdjek is Director, Superannuation and Wealth at Prime Financial Group. This article is general information and does not consider the circumstances of any individual.

Let's clarify growth/defensive and move forward

David Bell

There are many ways to measure exposure and risk. No single metric is perfect which is why professional risk managers use multiple measures of risk.

Many parts of the financial services industry classify portfolios based on a measure known as growth/defensive exposure. Growth/defensive has its fair share of flaws but it appears entrenched as an industry measure. However, there currently exists a one-off opportunity to improve the metric and make it standardised. All members of the investment community are encouraged to participate in the consultation currently open.

How do we use growth/defensive?

Growth/defensive exposure is used in many different ways, including:

1. Research houses create super fund peer groups for performance comparisons, such as grouping together all funds classed as 60% growth/40% defensive.
2. APRA's Heatmap methodology assesses super funds by risk and return.
3. Financial planners define growth/defensive categories to map clients to portfolios based on their risk tolerance.

For all its use in industry, growth/defensive remains undefined. As a result, there is a large degree of subjectivity, whether by industry when they self-assess or by groups such as APRA which has developed its own simple approaches, thereby introducing hard-coded subjectivity. These variations reduce confidence in any analysis produced using growth/defensive.

Industry attempts to standardise

Presently there is an industry-led project to create a standardised approach for assessing growth/defensive exposure to be used by all industry participants including regulators.

A working group (detailed here) was formed by volunteers from research houses and super funds. Following more than a year's work, a proposed solution has been released for consultation.

Already there has been a high level of participation in the consultation process. Industry participants are encouraged to contribute and feedback will inform a better solution.

Consider the following puzzles:

- If we followed traditional thinking that defensive assets are cash and bonds and growth assets are generally equities which participate in economic performance, where does that leave alternative investment products which can exhibit sizable risk, which could be independent of equities?
- If we took a risk-based approach then should there be different scores among the universe of cash and fixed interest products, as they exhibit varying degrees of risk?

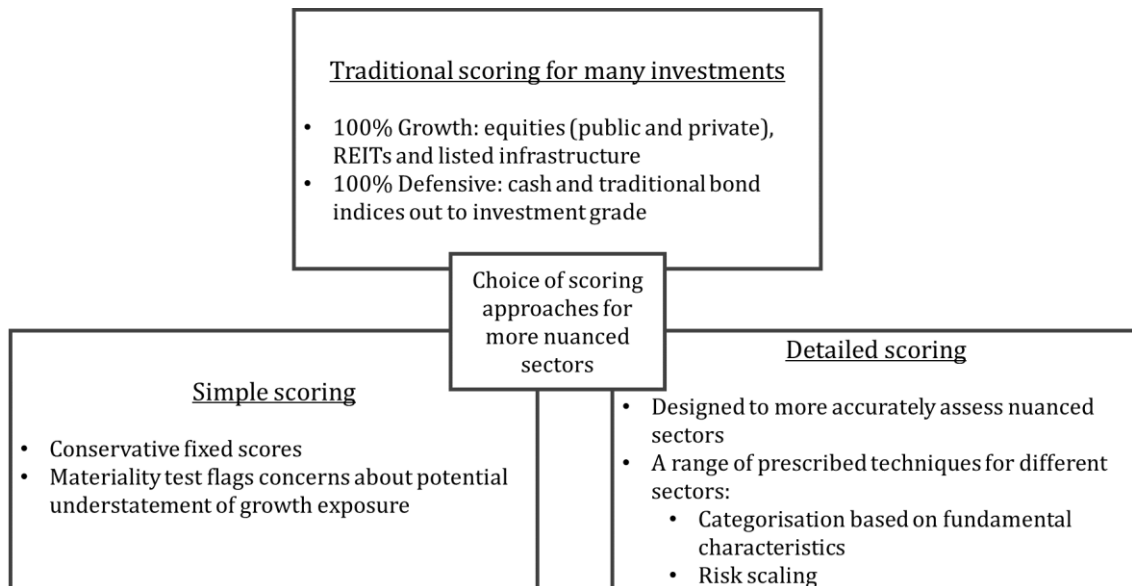
Pragmatism was the key to coming up with a solution. The working group stopped trying to come up with a definition (we accepted it as a hybrid measure of exposure and risk) and focused on the following:

1. A quality measure that broadly reflects the risk/exposure consistently across different multi-asset portfolios
2. A measure that doesn't distort the portfolio decision-making process (compared to a decision made in a traditional risk/return framework)
3. Manageable degree of operational impact.

We often found that these desires pulled against each other. Achieving a balance was the challenge.

Examples of growth/defensive asset scores

The proposed solution is outlined in the diagram below.



A couple of case studies help to illustrate the detailed scoring process:

Property and infrastructure. Fundamental criteria such as leverage levels and asset purpose (lower-risk income or higher-risk development) channel assets into two categories: Tier 1 risk (scored 60% growth/40% defensive) and Tier 2 risk (100% growth).

Hedge funds. The level of risk taken or targeted by the hedge fund is scaled to determine a growth/defensive score. Consider the simplified case of two hedge funds who target 6% and 12% volatility. Under our risk scaling approach, we scale the product volatility by 12% to determine that the two hedge funds would score 50% growth/50% defensive and 100% growth respectively.

Full details of the proposal are here.

It may be a healthy exercise for SMSFs to estimate their own growth/defensive score. The process we have detailed provides a healthy reminder that not all unlisted property has the same characteristics, that there is a huge dispersion among alternative investment products and that higher yielding credit can carry significant risk.

The working group was unable to incorporate portfolio diversification benefits into the solution. A variety of investments with different risk drivers should result in lower portfolio risk compared to the weighted sum of those individual risk exposures. But how do you standardise this calculation when there are so many investments?

Not being able to incorporate diversification benefits should be viewed as a limitation of growth/defensive as a risk measure. It serves as a reminder to those groups that use growth/defensive, including APRA, that the definition should be complemented by other approaches to measuring exposure and risk when undertaking analysis.

Feedback welcome

The aim is for a single industry solution and a standardised approach. At present the industry is under the microscope as never before. All feedback will be shared with the working group. The consultation paper is found here and the consultation closes on Monday 28 September.

Hopefully this will provide clear headspace for industry to move beyond growth/defensive and start using a variety of measurements to assess risk and performance. Thank you to the working group for all their contributions.

David Bell is Executive Director of The Conexus Institute, a not-for-profit research institution focused on improving retirement outcomes for Australians.

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