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Editorial

There is a popular belief that retail investors do not even achieve index returns due to poor timing of investing and selling decisions. The theory is that they buy after markets rise as confidence grows, then sell in panic when markets fall, and miss the recovery. This 'buy high sell low' tendency loses the advantages of long-term investing and riding out the selloffs.

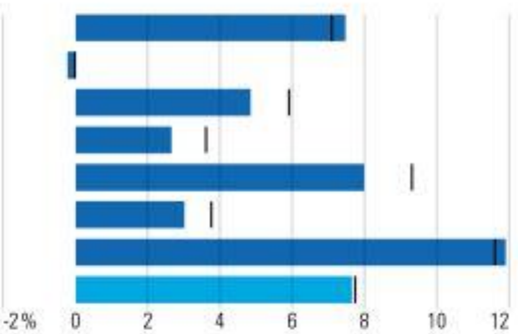
The recent evidence for this is far from convincing. For example, **Morningstar** in the US produces a 'Mind the Gap' report, and the 2020 version concluded:

"Overall, the gap between investor returns and reported total returns has shown notable improvement. As a whole, the returns that investors experienced were only slightly lower (by about 5 basis points per year) than reported total returns over the trailing 10-year period."

As Exhibit 1 shows, average investor returns have varied between 0.4% better to 1.35% worse than the market, depending on the category over 10 years, averaging an immaterial -0.05%.

Exhibit 1 The Gap by U.S. Category Group (10-Year Returns)

U.S. Category Group	Investor Return %	Total Return %	Gap
Allocation	7.47	7.08	0.40
Alternative	-0.22	-0.04	-0.18
International Equity	4.85	5.89	-1.04
Municipal Bond	2.66	3.60	-0.94
Sector Equity	7.99	9.34	-1.35
Taxable Bond	3.02	3.80	-0.78
U.S. Equity	11.91	11.61	0.29
Overall	**7.66**	**7.71**	**-0.05**

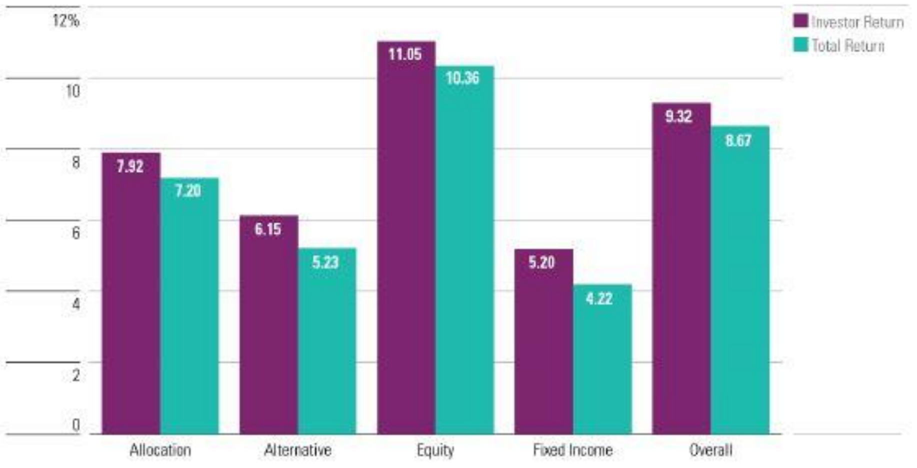


Source: Morningstar. Data as of 12/31/2019. Excludes commodities category group. Gap numbers may not match differences in returns because of rounding.

In a 2019 study of Australian data, the results were even better, with the asset-weighted return for investors delivering 0.65% better than market returns over five years, although this was a period without whipsaw price changes.

However, annual research by **Dalbar** called Quantitative Analysis of Investor Behavior (QAIB) shows much worse investor results, usually underperforming the market by 3% or more over 10 years. For example, Dalbar says:

Exhibit 5 Average of Rolling Five-Year Investor Returns in Australia



Source: Morningstar Inc. Data as of 12/31/18.

*"The comprehensive study highlights the 10 key periods in which investors withdrew their investments during periods of market crises, which represent the 10 most severe cases of underperformance since 1984. Of these 10 cases, the QAIB found 8 cases would have produced better returns for the Average Investor one year later if they had taken **no action** and held on to their investments."*

While the results of such studies are often disputed, stock markets have delivered strong results over the long term, and trying to time the market can indeed lead to poor results, such as missing a recovery. We saw it in the GFC and again in March 2020. It was **Charlie Munger** who said:

"Investing is simple, but not easy."

This week we have two articles on this topic. **Gemma Dale** looks into the trading activity of **nabtrade**'s retail clients during COVID-19 and describes three ways they invested during the pandemic. Not so dumb after all.

Then **Tanya Hoshek** reports on **Russell**'s 'Value of Advice' research which argues that advisers help clients to avoid behavioural mistakes during periods of market disruption. Perhaps the educational messages are working.

Still on risk and investing mistakes, **Josh Charlson** takes a quick tour of 13 risks investors should check in their portfolios, recognising that accepting some of these is inevitable.

Bruce Apted looks at the performance of small cap versus large cap companies in Australia over 20 years and more recently. He gives his views on whether the smaller company price surge in 2020 can be sustained.

Tuesday 3 November in the US is shaping up as a momentous day, either leading down a path of four more erratic and unpredictable years under **Donald Trump**, or a more traditional Presidency but also filled with risks under **Joe Biden**. Analysts from **First Sentier Investors** and **BNP Paribas Asset Management** have short pieces on how the system works and possible consequences. **UBS** has provided this summary of the estimated impacts on S&P500 companies over 2021 and 2022 due to different policies.

Figure 5: Estimated impact of scenarios on S&P 500 earnings

	EPS impact - incremental			Tax
	2021	2022	2021-22	impact
Status quo	0.0%	0.0%	0.0%	0.0%
Biden + Rep Senate	-0.4%	0.0%	-0.3%	0.0%
Biden + Dem Senate	3.2%	-1.1%	2.1%	-3.6%
			Biden Plan	*-7.8%*

	Growth impact (dif)		
	2021	2022	2021-22
Status quo	0.0%	0.0%	0.0%
Biden + Rep Senate	-0.1%	0.0%	-0.1%
Biden + Dem Senate	0.8%	-0.3%	0.5%

Source: UBS estimates

There is a possibility that the result will take weeks to confirm, and the latest betting is Biden a $1.52 favourite and Trump at $2.90.

As more investors turn to ESG investing, Rachel White gives four reasons why this trend will continue, and we can stop thinking of sustainable or ethical investing as anything other than mainstream.

Finally, a question many SMSF trustees must ask themselves as they ponder a sea change or tree change. **Elizabeth Wang** explores whether you can buy a retirement home now in your SMSF.

This week's White Paper from **Western Asset** looks at the problems facing the airline industry and how it may recover from the pandemic. It's relevant not only to **Qantas** and **Virgin** locally but **Flight Centre**, **Webjet** and **Corporate Travel** among many others.

Gemma Dale: three ways 'retail' is not the dumb money

Graham Hand

Gemma Dale is Director of SMSF and Investor Behaviour at nabtrade, NAB's online investing platform.

GH: In this extraordinary year, what have your clients been doing, especially in the hectic days of March and April, and what's happened since?

GD: Yes, it's been a fascinating year. Volumes started low in January and February as the market was quiet. The cash accounts of our clients were at record highs so it wasn't as if people didn't have the money to invest. They were waiting to put money to work but didn't see much to interest them.

GH: Then the reality of COVID hit and everything changed.

GD: Yes, but what was most exciting was that the common view that retail investors panic when markets fall and go to cash at the worst possible time, then miss the first 20% of the upside when the markets bottom out, that wasn't correct. This idea that retail investors are not good at managing their own money because they have too much emotion in investing doesn't play out with our clients. And this is not just during COVID, but over the last four or five years of market pullbacks. Although other falls were not as severe, they start buying on falls. The one that springs to mind was when Domino's was hammered in the press in 2018 and 2019 and fell below $40, and it's now nearly $90.

GH: And this is genuine 'retail', not institutional money?

GD: Yes, nabtrade clients, we don't serve institutions. Obviously, a stock like Domino's was one they wanted to buy. They jump into stocks considered either core of their portfolios like banks or opportunistically exciting.

GH: So what happened in March and April?

GD: Two major things. One, clients started buying like mad. Our buy/sell ratio is usually around 50/50, or slightly more buys than sells because people are building portfolios, although there are pension funds expected to run down their portfolios over time. But we saw the buyers swing up to 70 to 80% of trading activity. So the proportion of both value and number of trades that were sells dropped heavily and people were not selling at the worst time. They were buying and since it was a super-sharp correction, they moved really quickly.

And then the second thing was a huge number of new entrants to market. We saw a five-fold increase in new applications in March and a three-fold increase in April over our average numbers. And then that continued right through, in fact, our biggest trading day was in June.

GH: Was it much busier for all of February to June?

GD: March was the absolute peak of monthly trading value, April was also really strong, then there was some profit-taking in June. Some people had done unbelievably well and were taking some money off the table.

GH: And to finish the year-to-date, has it been more subdued since June?

GD: Much more like normal trading but here's the third thing. Clients weren't just spending the cash on the sidelines from the cash product on our platform, where people keep cash ready to go. Huge amounts of cash came in from other sources and cash is still very high. We have investors not sure that markets will stay at this recovered level and if prices fall again, they have the money ready to go.

GH: That's a strong counter argument to the prevailing view on the way retail reacts.

GD: It's such a good story. I've been saying for five years that retail investors are smarter than the market thinks they are. A lot of the behavioural research on this is historical, some of it goes back 20 years. Investing has changed. The first share I bought when I was 18, I had to find a broker in the Yellow Pages, and look for the share price in the newspaper. I had no idea what I was doing. It was difficult to find information so there was plenty of dumb money. Now, what you find on nabtrade and other platforms and media is real time data and education and quant research from Morningstar like a professional investor has. People are not in the dark and they can respond quickly.

GH: And all this activity includes SMSFs?

GD: Yes, and although SMSFs are only about 7% by number of our clients, they are about 35% by value. We do have a lot of younger investors coming through and there are now more females than in our older clients.

GH: And what have people been buying and selling in recent months?

GD: Let's insert a table of the Top 10 by demographics.

	Baby Boomers and older (born before 1964)		Gen X (1965-1980)		Gen Y (1981-1994)		Gen Z (1995-2004)	
	Stock	**% Buy**	**Stock**	**% Buy**	**Stock**	**% Buy**	**Stock**	**% Buy**
1	NAB.AU	82%	NAB.AU	79%	NAB.AU	83%	NAB.AU	87%
2	WBC.AU	76%	WBC.AU	78%	QAN.AU	79%	QAN.AU	83%
3	ANZ.AU	74%	QAN.AU	81%	FLT.AU	79%	CBA.AU	87%
4	CBA.AU	84%	ANZ.AU	75%	Z1P.AU	73%	FLT.AU	85%
5	QAN.AU	84%	CBA.AU	80%	WEB.AU	77%	Z1P.AU	77%
6	FLT.AU	83%	FLT.AU	80%	WBC.AU	82%	WBC.AU	87%
7	BHP.AU	82%	WEB.AU	76%	APT.AU	62%	VAS.AU	94%
8	WEB.AU	81%	Z1P.AU	72%	CBA.AU	84%	WEB.AU	82%
9	WPL.AU	85%	APT.AU	61%	ANZ.AU	78%	ANZ.AU	84%
10	Z1P.AU	77%	BHP.AU	78%	VAS.AU	92%	APT.AU	65%

(Note that a person must be over 18 to open an account so in theory, 2002 is the latest year in which an investor can be born. It is not known how often parents use a child's account).

It's fascinating that the generations are almost identical, except very young people invest in twice as many ETFs as all other people, at about 12% of trades. And see Flight Centre, Qantas and Webjet. They were popular during the crisis because investors felt they would get rescued and they were great buying opportunities. And Zip and Afterpay of course.

GH: So the educational work on ETFs is reaching younger people?

GD: Young people understand diversification and they see ETFs as an easy solution. They have a strong tendency to buy and hold. This hypothesis that they're just day trading and they're just buying up tech, we just don't see it. Maybe we would not be the broker of choice for a young trader who wants super cheap execution, below the cost of providing the service, where there is a link to chats and rewards and CFDs.

GH: The overall data shows much stronger interest in global ETFs, but are you seeing much in direct equities, into global shares such as Apple, Microsoft and Amazon?

GD: Number one is Tesla in global stocks, but it never cracks the top 10 of total stocks.

GH: nabtrade's site carries a lot of content and educational material. What do people like to read about?

GD: Stocks that are widely held with a high-conviction view on them, either positive or negative. Stories on Telstra, the banks and CSL. Afterpay and Zip. Podcasts have become popular, but a wide variety of media works, including video. People like to consume in different ways.

GH: And the podcast that you host, Your Wealth, how has that been going?

GD: We've had some wonderful guests and the audience has increased tenfold in 12 months, depending on the guest and the topic. We've found people are happy to consume lengthy content so long as they can listen to it and do something else as well.

GH: So you're not seeing much of the 'Robinhood' effect here, where young people are punting the market instead of playing e-sports or because they are bored in lockdowns?

GD: We've had many conversations with the regulator about this. It's not an amusing side story for us as we watch it really closely, make sure that this is not the kind of behavior we're seeing. Neither nabtrade nor ASIC wants to see young people blowing up their money, particularly when you link it to the ability to withdraw superannuation. That would be an absolute heartbreak.

Although we may not be the broker of choice for this day trading anyway, the most telling statistic I can give you is that if anything, new investors are more conservative than existing clients. An older person with $200,000 in shares might put $5,000 into something speculative, but our young clients will not speculate with all their savings.

Anyone who wants to trade options must take an assessment and sign an agreement, but there's little of it with us. It's confined to experienced and wealthier investors for downside protection or income rather than by new investors. At certain times, the 'bear' ETFs have also been popular. And on shares generally, people need to have the cash in their account in order to trade. We're a 'cash up front' business.

GH: Last question. Many of your clients who have done really well in recent months and maybe now feel like they know how the stock market works. Are you worried about them?

GD: Perhaps it was a once-in-a-lifetime buying opportunity where it fell so quickly and then recovered, unlike in the GFC which took 12 years to grind back and picking the right stocks was difficult. So if this was a first experience, some people may think it's normal. My biggest fear is a slow grind of losing money say if we don't get a vaccine for some time. How will people cope with losing money day after day as a new experience? That will be a bigger test than what happened in March when we had an obvious catalyst.

Gemma Dale is Director of SMSF and Investor Behaviour at nabtrade, a sponsor of Firstlinks. Gemma is host of the Your Wealth podcast. Any advice contained in this information does not take account of your objectives, financial situation or needs.

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Unlucky for some: 13 investment risks to check

Josh Charlson

Let's start this article by stating that the 13 ways of looking at risk described are in no way intended to be a comprehensive catalogue. I do hope to convey some of the nuances around risk, as well as to offer a framework for how investors can think about the various forms of risk in light of their own portfolios and plans.

At the same time, I don't mean to overcomplicate your investing life by suggesting that you need to take all of these measures into account. I would suggest instead that it's important to be aware of the range of possible risks and to pick and choose those that are appropriate to the specific goals, personal situation, and investment puzzle that you may be seeking to solve at any given moment in your investing lifetime.

One way to think broadly about this list of risk lenses is to distinguish between those that are backward-looking metrics, those that are forward-looking portfolio-based measures, and those focused on personal risk factors. The list progresses roughly in that direction:

1. Volatility

Volatility is one of the most commonly cited definitions of risk. It has the advantage of being easy to calculate and straightforward to understand and compare, but it also has limitations. One is that it makes no distinction between upside and downside volatility. Perhaps more significant is the question of how relevant volatility truly is to an investor. As Howard Marks of Oaktree Capital has written: "I don't think most investors fear volatility … What they fear is the possibility of permanent loss." But volatility is still useful as an initial measure of a stock or fund's risk, and it can be usefully coordinated with an investor's risk tolerance.

2. Risk-adjusted return

Risk-adjusted return is a step up from simply ranking investments based on their return history. Commonly used measures include Sharpe ratio, information ratio, Jensen's alpha, and the Morningstar Rating for funds (colloquially, the 'star rating'). Investment professionals often prefer risk-adjusted return measures because they show whether returns have been high enough to compensate for the risk. One weakness, however, of all these measures is that they are backward-looking, so you need to be cautious in applying them to future results.

3. Downside risk

Another way to think about risk is an investment's propensity to lose money; investors tend to be less concerned about volatility that works in their favour on the upside, and more about potential losses. Measures that capture this include downside-capture ratio, bear-market performance, and Morningstar Risk (a component of the star rating). A more sophisticated downside metric is value at risk, or VaR, which uses probability methods. It's typically used to estimate maximum potential losses but the model came under heavy criticism for its failures during the 2008 financial crisis.

4. Non-normal risk

One weakness of traditional risk measures is that they assume normal return distributions, which won't account for investments with non-normal return patterns (such as some alternative investments) or outlier events (so-called 'black swans'). Indeed, one criticism of VaR models in 2008 was that they failed to account for the degree of losses in the mortgage market that eventually occurred. Measures such as skew and kurtosis provide an indication of an investment's likelihood of producing results outside the normal distribution of returns, or what is sometimes called 'fat-tail risk'. But forecasting the chance of rare events is a tough enterprise. As Morningstar Director of Research Paul Kaplan has noted, market crashes have occurred more frequently than data would predict.

5. Valuation risk

The aforementioned measures of risk are all derived from investments' past performance. Valuation risk is more of a forward-looking risk. At its root, valuation risk means you may have paid more for an investment than its fundamental worth, and that its price will eventually fall to meet its fundamental value. It can also refer to broad markets inflated by excess exuberance (think the tech bubble in 1999 or real estate in 2006). Commonly cited valuation measures for equities include price/earnings ratio, price/book, or price/sales,.

6. Concentration risk

Concentration risk is an important consideration for both individual funds and your overall portfolio. Diversification is probably the most important tool for reducing risk. A concentrated fund that holds fewer stocks may be prone to greater risk of just a few holdings performing badly. At the same time, more concentrated funds may possess greater potential to outperform. Investors should be aware of allocating outsize amounts of their portfolio to any given manager, investment style, or sector and stay alert for concentrated holdings in individual stocks.

7. Credit risk

This is the first of two specifically fixed income related risks in this list. Credit risk comes into play any time you're investing in a corporate bond or other debt instruments backed by the credit of a company or entity. Credit risk is closely related to default risk, or the risk that a company may not be able to pay back its loans. Defaults can lead to permanent loss of capital, so funds that tend to invest in lower-rated securities require heightened attention and should likely occupy a smaller role in most investors' bond portfolios.

8. Interest-rate risk

Bond prices generally move inversely to the direction of interest rates and will lose value when interest rates rise. That means bonds or funds holding longer-term bonds are exposed to greater interest-rate risk. If you purchase individual bonds that line up with your investment horizon, short-term interest-rate fluctuations don't really matter, but when you invest in funds you will be more exposed. You should be aware of a bond fund's typical duration and how far it may deviate from its benchmark. With interest rates in a long-term downward trend over the past decade, longer duration has generally been a plus, but that won't always be the case.

9. Liquidity risk

Liquidity risk occurs when sellers have difficulty finding buyers in a thinly traded market, leading to unfavourable pricing. Some investment types, such as certain private investments, are inherently less liquid, whereas other investments may be quite liquid under normal circumstances but lose their liquidity in periods of market stress. While funds offer daily liquidity, managers have run into problems when less-liquid portfolio holdings have proved a mismatch for investor outflows, forcing them into a firesale of their assets in order to meet redemptions.

10. Systematic risk

Systematic risk is the risk investors bear simply for being in the market. It's unavoidable, but can be mitigated. Beta describes an investment's sensitivity to the market (a beta of 1.0 suggests that an investment's moves will match those of the market, while a beta of 0.8 would suggest a degree of magnitude 20 per cent lower). Factor exposures are another form of systematic risk, as they identify macroeconomic or fundamental factors that an investment may be exposed to, such as the momentum factor for equities or interest-rate sensitivity for bonds.

11. Risks for retirees

We'll collate three separate types of risk here that are of particular relevance to those in or nearing retirement

a) Inflation risk (sometimes called purchasing power risk) is the risk that the growth of your investments will not keep up with inflation. Although inflation has been suppressed in recent years, that won't be the case forever.

b) Longevity risk is the risk that you may outlive your assets.

c) Sequence-of-return risk is the risk that an untimely drop in the market will have an outsize effect on the future worth of your savings.

12. Correlation risk

Correlation can be thought of as diversification's arch-enemy: the risk that asset classes will act in tandem, particularly during periods of downside volatility. Keep in mind that correlations can change over time, and what was once an effective diversifier may find its correlation to other asset classes increase as investors direct flows toward it.

13. Risk of not meeting goals

This is perhaps the most important and all-encompassing risk that investors should be thinking about. From a goal-based planning perspective, the risk of not meeting a given goal (whether it is a house, college savings or retirement) is the most consequential. All the other risks mentioned previously are, in a sense, supporting players in the bigger production of meeting your goals.

Final thoughts

Let's put this lengthy list into perspective. Risk isn't something to be avoided altogether. A fundamental premise of investment theory is that to get returns beyond the risk-free rate, we must embrace some level of risk. Assessing which risks to take and calibrating them appropriately is the investor's challenge.

Many of the risks listed above overlap, while others may be irrelevant to the investment at hand. Cross-checking several different risk metrics and digging deeper into anything unexpected will get you most of the way to where you need to be.

And, finally, a longer time horizon is the cure for many of the risks listed. Riding out shorter-term volatility will give you a greater chance of succeeding at your biggest risk of not meeting your goals.

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Four reasons ESG investing continues to grow

Rachel White

Interest in ESG (Environmental, Societal, Corporate Governance) investing continues to grow at a rapid pace, and there are no signs to indicate that this investment trend will decelerate. Since 2012, global investment in ESG-centred products has more than doubled to almost $31 trillion, up from $13.3 trillion in a mere eight years.

In Australia, the growth has been even more convincing. According to [2020 research published by the Responsible Investment Association of Australasia], responsible investing currently accounts for 44% of the $2.25 trillion professionally managed investment universe, up from 17% from five years ago.

Further, Australian investors are among the most ESG-aware in the world, with 86% of Australians expecting their super or other investments to be responsibly and ethically invested. An even higher percentage (89%) want their investments to be invested with social and/or environmental factors in mind.

Whether or not this investor sentiment is in response to global events or events here at home – who could forget the fiery images of the 2020 bushfires – the message is clear.

But for anyone holding back from investing in a product with a specific ESG investment tilt because they have heard it may be more expensive, or that it can't achieve diversification, here are four pointers towards why this investment trend continues to grow in popularity.

#1 – Not too niche for a core portfolio

It is still a commonly-held perception that ESG products are too niche and should only be used in the satellite portion of your portfolio. However, the increasing popularity of ESG investing has resulted in new and differentiated products. There is now greater choice and availability of broadly diversified ESG products that could be used as the core of any investment portfolio.

Not all ESG products are created equal. Investors should understand the underlying ESG approach. If a managed fund or ETF utilises exclusions – weapons manufacturers, vice and fossil fuels for instance – investors should look at what portion of the broad market has been excluded, and determine if that is a suitable exposure for the core of their portfolio.

#2 – ESG investing returns are comparable to broad market returns

ESG products do not reflect the entirety of the broad market, which can be a result of the exclusions or screens applied to the investment. Investors should also be aware that returns could vary from the broad market, whether that be underperformance or outperformance. For instance, ESG-screened products typically outperformed the broader market during the first half of 2020, due to the minimal exposure to oil and gas markets which were particularly volatile during the initial stages of the pandemic. However there is no telling if oil and gas markets will bounce back or whether this trend of outperformance will continue for the long run. Based on Vanguard's research, an investor can generally expect similar returns with an ESG product over the long term to that of the broad market.

#3 – ESG can be both active and index

Vanguard is known for its index funds and strategies but we believe that active and index strategies can work hand-in-glove to deliver a broader, well diversified portfolio. ESG investing is not limited to an active investing strategy. You can choose to be an active investor by seeking alpha with an ESG filter applied. Or you could choose to invest in an ESG index fund which provides a broader exposure and diversification, that still reflects your values and beliefs.

Both options should be viewed in the context of ultimately building a broadly diversified, low-cost portfolio, that takes a long-term view.

#4 – Bonds can be sustainable investments too

If ethical considerations are important when building a well-diversified investment portfolio, why would you stop at the equity sleeve of a portfolio?

Companies issue both bonds and equity. It would be inconsistent to exclude an equity based on ethical considerations only then to invest in the same company through their debt or bonds. Investing in a bond fund that reflects an investor's values can be as simple as it is on the equity side, particularly as the number of ESG bond funds continue to grow.

Similar to ESG equity funds, ESG bond funds may screen out companies that engage in activities that are on an exclusion list and investors can achieve an entire portfolio that represents their ethical values.

Of course, whether ESG the core or a part of an overall portfolio, investing should always consider long-term goals, risk appetite and fees. The good news for investors who want their portfolio to reflect their values is, the more popular ESG becomes, the more choice that is available, leading to lower costs, investors feeling good and with the potential for strong performance.

Rachel White is Senior Manager, Product Strategy at [Vanguard Australia](), a sponsor of Firstlinks. This article is for general information and does not consider the circumstances of any individual.

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Why caution is needed in Aussie small companies

Bruce Apted

Small capitalised companies have had a great run since the market bottomed in late March. The S&P/ASX Small Ordinaries Index is up 60% since 24 March 2020, but by contrast, the larger capitalised companies as represented by the S&P/ASX100 index are only up 26.2% (as at 6 October 2020).

The significant outperformance of smaller companies has ignited renewed interest in this sector of the market. Figure 1 shows the two indexes since December 2019.

Figure 1. A wild ride in equities and even wilder ride in smaller companies

Source: Thomson Reuters, State Street Global Advisors as at 6 October 2020. Past performance is not a reliable indicator of past performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income and the reinvestment of dividends (net of withholding tax rates) and other income and are calculated in Australian dollars. It is not possible to invest directly in an index.

Greater returns but with more volatility

Over the last 20 years, smaller companies have outperformed larger companies by almost 0.86% per annum but this outperformance has not been without risk. On average, the volatility associated with small companies is 17% compared to larger companies with 13%.

This is also evident in the beta (a measure of volatility in terms of the overall market, which has a beta of 1 or 100%) of the small company index averaging 114%, as shown below.

Figure 2. Longer term return and risk characteristics from Australian small and large companies

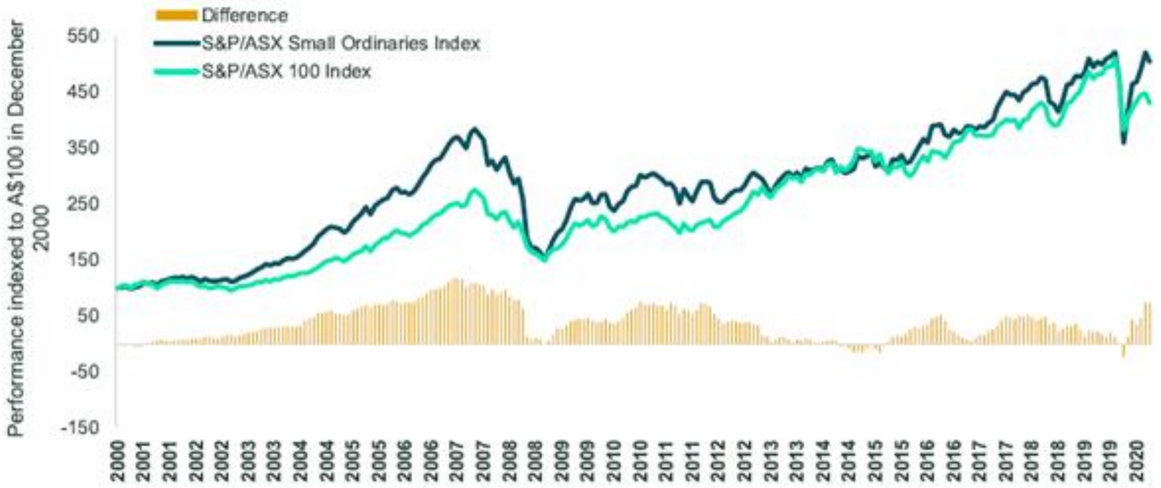
Statistic	Small Companies	Large Companies	Difference
Return p.a.	8.53%	7.67%	0.86%
Volatility (STD pa)	17%	13%	3.65%
Beta vs ASX 300	114%	100%	14%

Source: Thomson Reuters, State Street Global Advisors for the period 30 December 2000 to 30 September 2020. Past performance is not a reliable indicator of future performance.

Smaller companies have had a great run in the last six months but a look at the long term puts that outperformance into some context.

Figure 3 illustrates the journey for the last 20 years. Smaller companies have had periods of significant outperformance, which are historically followed by periods of underperformance. Depending on when you invest, your experience could be quite varied.

Figure 3. Periods of outperformance have historically been followed by periods of underperformance



Source: Thomson Reuters, State Street Global Advisors as at 6 October 2020. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. Index returns reflect all items of income and the reinvestment of dividends (net of withholding tax rates) and other income and are calculated in Australian dollars. It is not possible to invest directly in an index.

Valuations are rich in absolute and relative terms

On average, over a longer period of time, we find the smaller capitalised companies tend to trade at a slightly higher price to earnings (P/E) multiple and generate slightly lower yields. But this tends to be volatile, as during risk-on periods they can trade at much higher multiples, whereas during risk-off periods, they can trade at below average multiples.

It is entirely possible that the economy will recover and many company earnings will return to pre-pandemic levels, but if they don't, then the small company sector of the market is more at risk of disappointment. From a relative yield perspective, the smaller companies are not as expensive as is implied by earnings multiples.

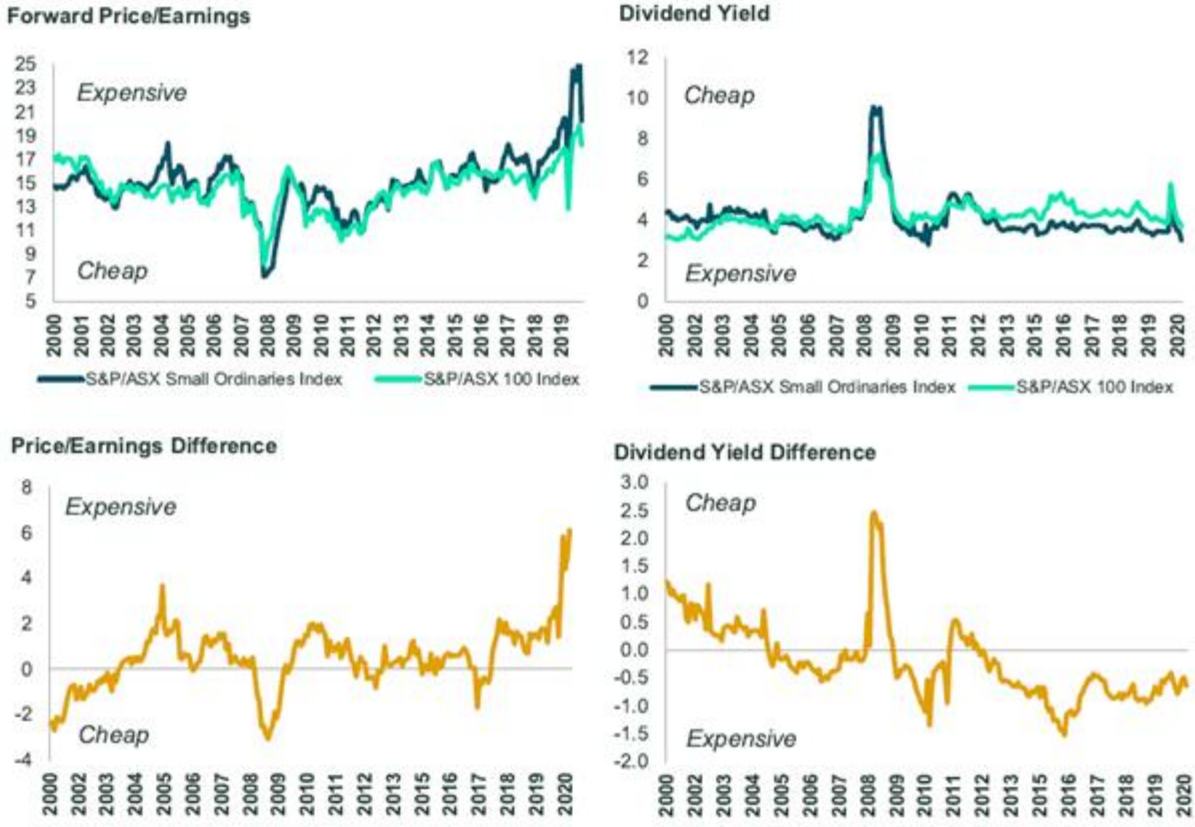
Watch out for overly optimistic earnings

For smaller companies compared with larger companies, the investment community is usually overly optimistic on earnings. In the last 20 years expected growth for the next 12 months has averaged +21.1% and yet on average this group of companies has only delivered +13.2%. By contrast, the expected growth for larger companies is expected to be lower at only +9.4% and has only delivered +6.8%. It's a much smaller earnings disappointment compared to smaller companies. In both cases, analysts' expectations have been overly optimistic but in the case of smaller companies, this optimism is exaggerated.

As investment managers that focus on quality, value, improving outlook and lower volatility, we tend to invest in less volatile companies that have not been priced for excessive growth. That does not mean we will not invest in smaller companies if they are expected to provide the right mix of return for risk.

Indeed, as Figure 5 below highlights, we currently own many companies outside the top 50 but within the top 200, but our active weight in these companies changes.

Figure 4. Smaller company valuations



Source: Thomson Reuters, State Street Global Advisors as at 30 August 2020. Past performance is not a reliable indicator of future performance.

Figure 5. State Street Australian Equity Fund – Active weight to different sized companies since inception^

Source: State Street Global Advisors, Factset As 31 August 2020. ^Inception date of the fund: 30 September 2009. Weights are as at the date indicated, are subject to change, and should not be relied upon as current thereafter.

Currently, valuations are stretched for the market and are especially stretched to the smaller end of the index. Most of this has happened in the last six months as investors have been willing to price a strong recovery in earnings.

Bruce Apted is the Head of Portfolio Management – Australia Active Quantitative Equities, at State Street Global Advisors. This general information has been prepared without taking into account your individual objectives, financial situation or needs and you should consider whether it is appropriate for you.

The value of financial advice amid rise of retail investors

Tanya Hoshek

The third annual *Value of an Adviser* report from Russell Investments outlines five key elements that make up the value of advice, including:

- preventing behavioural mistakes
- advising on appropriate asset allocation
- making investors aware of the cost of holding cash
- providing advice on tax effective strategies, and
- knowledge in additional wealth management services.

The rise of the retail investor

While the financial advice industry has undergone a significant period of disruption and uncertainty in recent years, the profession is now on a more promising trajectory.

New education requirements and regulations are transforming the sector and the exit of the major banks from the wealth management space has left plenty of room for new, innovative players.

But the COVID-19 pandemic and its economic impact have proven to be a critical event that has effectively allowed financial advisers to shine. When markets took a hit and the world went into a panic in the early months of 2020, Australians turned to financial advisers for guidance.

The impact of COVID-19 on the personal finances of Australians and financial markets has created a growing phenomenon: the rise of the retail investor actively participating in the stock market.

During a period of extreme volatility, Australian investors of all ages and levels of experience have jumped into the market, hoping to emulate the wealth they have seen others achieve. It is in this environment where financial advisers have provided value.

According to this year's *Value of an Adviser* report, helping clients avoid common behavioural tendencies such as chasing short-term volatility comprises 2.2% of a total 5.2% in value advisers provide their clients each year.

The report argues that, statistically, the average equity fund investor's inclination to chase past performance cost 2.2% annually in the 34-year period from 1984–2020.

Behaviour coaching is a vital service. While there is strong evidence that portfolio value increases over time, investors can still feel compelled to react to short-term market volatility, which can undermine their long-term objectives.

The report notes that during both COVID-19 and over the longer term without professional advice, investors fall prey to their own behavioural biases, leading to losses in their portfolios that could impact their financial security.

Tax-effective investing

Often considered the realm of the accounting profession, tax is also an important conversation between financial advisers and their clients. Advisers can assist in the management and optimisation of investment tax in a number of ways, including structural tax strategies, managing client-driven trading, and making portfolio recommendations that are tax-efficient for clients.

Taking into account these approaches, Russell Investments estimates the tax-effective investing benefit that advisers can provide is around 1.5% p.a.

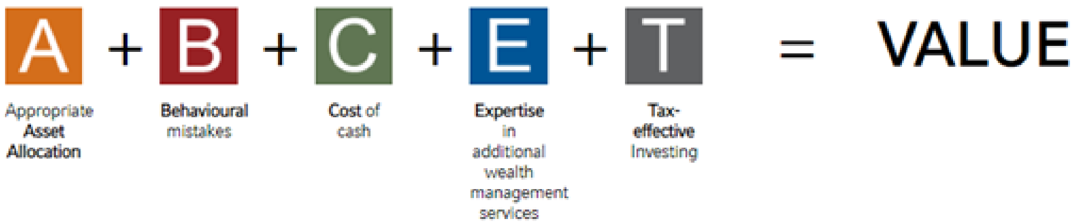
In terms of portfolio advice, advisers are also recommending managed portfolios as they provide opportunities to better manage a client's investment tax implications. Managed portfolios that sit on investment platforms and are professionally managed by an investment manager allow investors to hold the portfolio components directly, providing more transparency and control when optimising tax for individual clients.

When it comes to helping clients with more specific and complex tax needs, many financial advisers work in close partnership with accountants, solicitors, and other professionals. This combined experience provides significant advantages to clients.

Rounding out the numbers

While avoiding behavioural mistakes (2.2% p.a.) and tax-effective investment advice (1.5% p.a.) provide the lion's share of an adviser's total value to clients per year (5.2%), it is important to recognise the other aspects that are included in the report.

Cumulative value of the various services offered by a typical financial adviser



The following formula helps to understand the full value of financial advice services: A+B+C+E+T = value of an adviser.

The formula can be explained as follows:

- **A is Appropriate asset allocation = 0.90% p.a.** Helping clients to work through their values, preferences, and motivations from the outset.
- **B is for Behavioural mistakes = 2.2% p.a.** Helping clients avoid common behavioural tendencies may help achieve better portfolio returns than those investors making decisions without professional guidance.
- **C is for Cost of cash = 0.6% p.a.** Holding too much cash can come at a cost. Advisers can assist clients in investing in a well-diversified portfolio that seeks to balance the needs of liquidity and targeting growth within the risk levels appropriate to the client.
- **E is for Expertise = more added value.** A common misconception is that financial advisers are purely investment managers, whose only job is to select investments and achieve a certain level of return. Quality financial advice goes way beyond this.
- **T is for Tax-effective investing = 1.5% p.a.** Advisers play an important role in a client's tax journey, helping them navigate key components when it comes to tax-efficient strategies.

Expert knowledge is invaluable through periods of change. Whether personal circumstances change, due to redundancy, personal trauma, inheritance or business transactions, advisers will work with clients to identify the best path forward.

If there are external changes, like legislative changes, tax treatment of super or other assets, an adviser will be able to assess the details of the change and evaluate the impacts to the client's individual circumstances.

As the nation navigates its first recession in close to three decades, the value of financial advice has never been more important.

Tanya Hoshek is Head of Distribution, Adviser & Intermediary Solutions at Russell Investments. A full copy of the report can be requested here. This article is for general information only and does not consider the financial circumstances of any individual.

The 2020 US presidential elections

Various

What you need to know about the 2020 US presidential elections

Daniel Morris and Mark Allan

The elections take place on Tuesday, 3 November 2020. Let's first remind ourselves of the US political structure.

US Government 101: Congress

The United States Congress, the legislative arm of the US Government, consists of two bodies: the Senate (upper chamber) and the House of Representatives (lower chamber). Passing legislation requires the consent of both the House and Senate and the agreement of the President.

Today, Congress consists of 100 senators (two from each state) and 435 voting members of the House of Representatives. The number of representatives a state has is determined by its population.

On 3 November 2020, all 435 seats in the House of Representatives, 35 of the 100 seats in the Senate as well as the office of President of the United States will be contested. In addition, elections will be held for 13 state and territorial governorships, as well as a number of other state and local bodies.

The current situation

Democrats have held a majority in the House since the 2018 elections, while Republicans have controlled the Senate since the 2014 elections.

The Democrats enter the 2020 election with 232 of the 435 seats in the House to the Republicans' 196, giving them a sizeable 37-seat advantage. The Republicans hold the Senate by a 53-47 margin.

Control of both the House and the Senate: a Democrat clean sweep?

To enact sweeping change, the next administration would need to have a working majority in both the House and the Senate. This is particularly true given the current divided and very partisan political climate in the US.

At time of writing, Democratic candidate Joe Biden leads President Trump by around 10% in national opinion polls. In addition, the Democrats are clear favourites to retain their majority in the House. It would be a huge surprise if they do not do so.

It is control of the US Senate that is most tightly fought over in this election.

The 2020 contest for the Senate: down to a few states

This year, the Republicans have to defend 23 of the seats up for election, compared to 12 for the Democrats.

Theoretically, to gain control of the Senate, the Democrats need to win a net four seats (or three if Joe Biden wins and Kamala Harris becomes Vice-President and chair of the Senate, with the ability to cast a tie-break vote).

In our view, it is likely that the race for control of the Senate will come down to key, or 'swing', states: Arizona, Colorado, Maine, North Carolina, South Carolina, Iowa, Georgia and Montana.

We agree with the consensus view that the Alabama Senate contest is the only likely opportunity for Republicans to reclaim a seat from a Democrat.

We (and the consensus) anticipate that the Republicans will win Alabama (in a special election contest in 2017, the Democrats won Alabama for the first time since 1992, defeating a scandal-ridden Republican candidate).

Economic policy

Although millions of people have already voted, there is still time for the race to change dramatically. However, absent a meaningful shift in public opinion, a clean sweep for the Democrats with Joe Biden in the White House and Democrats controlling both the House and Senate looks likely.

That outcome would open the way for substantial fiscal stimulus.

In our view, it is quite plausible that a Democratic clean sweep could lead to fiscal stimulus of as much as USD2.5 trillion in the next 12-18 months – that equates to around 10% of US GDP. By way of comparison, the tax cuts President Trump enacted in 2018 represented around USD1 trillion over five years.

Exhibit 1 below summarises what we see as the probable implications of Republican or Democrat control of the White House and Senate for US fiscal policy and the outlook for monetary policy after the elections.

Exhibit 1: America decides - possible implications of Republican or Democrat control of the White House and the Senate for US fiscal policy and for the outlook for monetary policy by US Federal Reserve after the 3 November elections (Republican party symbol: elephant ; Democrat party symbol: donkey)

White House	Senate	Fiscal policy	Monetary policy
Rep	Rep	Tax cuts	Easy
Rep	Dem	Minimal stimulus	Easy
Dem	Rep	No stimulus	Easy
Dem	Dem	Strong stimulus	Easy

Source: Shutterstock, BNP Paribas Asset Management; Oct 2020

In a nutshell, the sort of very significant fiscal stimulus that a Democratic clean sweep could bring may increase growth, and possibly generate a little more inflation in the US.

Daniel Morris is Chief Market Strategist and Mark Allan is a Senior US Economist at [BNP Paribas Asset Management](). The information published does not constitute financial product advice, an offer to issue or recommendation to acquire any financial product. You will need to seek your own advice for any topic covered in the article.

This article was first published on 13 October 2020 on Investors' Corner.

Five ways the US election could impact investments

John Ma and Jason Epstein

The stakes are high for a country that has been grappling with the COVID-19 pandemic, social unrest and an economic crisis.

Before the country heads to the polls, First Sentier Investors invited two of its US-based investment experts to discuss the potential impacts of the election.

John Ma, Head of Investments, North America, Unlisted Infrastructure and Jason Epstein, Senior Portfolio Manager, Co-Head of High Yield, from First Sentier Investments, shared their insights.

1. A 'Blue Wave' win could spark a progressive policy push

As polls are predicting a Democrat win is more likely, this outcome is mostly priced into markets already, Mr Epstein said. What's more difficult to predict is the scale of such a win. If the Democrats gain a majority in the Senate, they will have more scope to make changes.

"A so-called Blue Wave, where Democrats take back the Senate, could lead to a more aggressive push of their policy priorities. Some of the policy areas already flagged in Biden's campaign include tax rates, healthcare, infrastructure spending, climate change policy, education and housing."

2. Stimulus funds will flow freely - regardless of the winner

It's clear that boosting the flagging economy will be a priority for the new President – whoever it is.

Mr Epstein said, "There will be a tremendous level of fiscal and monetary stimulus, combined with the prospect of a new stimulus bill and the idea of a Fed 'put' for the foreseeable future.

"The real question is how sustainable that approach is. Will it continue to underpin markets, or is there a breaking point? There are also questions about if the US Dollar will retain its place as the leading reserve currency."

3. China relations remain under pressure

In a break from past Democrat administrations, Biden has indicated he will maintain Trump's tough stance on China.

"A tense relationship with China is likely to be the new normal, regardless of who's President. Biden is looking to make the US competitive with China and to bring jobs back to US in areas such as automotive manufacturing. The goal is to have strong domestic production capabilities that reduce their reliance on China," Mr Epstein said.

4. Infrastructure will remain a local affair

Mr Ma said it's important to recognise that the infrastructure market is predominantly under state and municipal control, rather than federal.

"The White House has less direct ability to influence outcomes in the infrastructure sector. While funding can be allocated to the states at a national level, it's the states and cities who mostly choose how to deploy the funding. As such, the election is unlikely to have a big impact on specific infrastructure projects."

It is possible, however, that governments prioritise short-term job creation.

"In the wake of the 2008 recession, Federal stimulus funds were focused on 'shovel-ready' projects that would create jobs immediately. It was a missed opportunity for bigger, more ambitious projects. Hopefully we don't see the same phenomenon play out this time," Mr Ma said.

5. Democrats would give renewables a boost

One area of clear differentiation between Biden and Trump is the Democrats' emphasis on renewable energy.

"The more progressive elements of the party put forward concepts like the Green New Deal during the primaries season, and this has informed Biden's policies.

"It's likely Biden would be a net positive for the renewable energy sector, which is already experiencing strong tailwinds. While power generation is controlled locally and regionally, a Democrat administration is likely to put an emphasis on clean energy through levers like tax credits," Mr Ma said.

John Ma is Head of Investments, North America, Unlisted Infrastructure and Jason Epstein, is Senior Portfolio Manager, Co-Head of High Yield at [First Sentier Investors](), a sponsor of Firstlinks.

These views are general information and do not consider the circumstances of any individual.

Can your SMSF buy a retirement home for you now?

Elizabeth Wang

Can you buy your retirement home now in your SMSF and use it when you retire? It may be tempting but is it possible?

Let's look at Garry and Betty who are the directors of the corporate trustee of their SMSF. They are contemplating acquiring a property through their SMSF, which they plan to lease to an unrelated third party at market value until both of them reach their preservation age and retire as a condition of release.

They want to know whether it is possible for them to reside in the property as their principal place of residence once both of them have reached this condition of release.

There are a few things that Garry and Betty will need to consider to ensure that the transaction complies with superannuation laws.

Issue 1: the sole purpose test

Is purchasing the property now with the intent to reside in it in the future once the members of the SMSF have met a condition of release a breach of the sole purpose test?

SMSF Ruling 2008/2 provides that an SMSF may only be maintained for the sole purpose of providing retirement benefits to the members, or to their dependants if a member dies before retirement. It also provides that in determining whether an SMSF has satisfied the 'sole purpose' test, one must consider all the facts and circumstances surrounding the trustee's behaviour in relation to the acquisition of the property.

For example, if the trustee invests in a property where there is a significant likelihood that the investment in the property will not increase any return for the SMSF and the trustee simply purchased the property because the members always dreamed of retiring to a lovely coastal home, then the ATO may take a sceptical view and rule the transaction a breach of the sole purpose test.

If, on the other hand the trustee has supporting documentation such as valuation reports which shows that the investment property is likely to provide an increase in return for the SMSF, then the sole purpose test may be satisfied, notwithstanding the ancillary purpose.

Issue 2: the property remaining in the SMSF

An SMSF will fail to meet the 'sole purpose' test if the SMSF provides a pre-retirement benefit to a member of the SMSF.

If Garry and Betty decide to reside in the property once they have both met a condition of release, they should transfer the property from the SMSF to the members in their personal capacity.

This is to avoid potentially breaching the 'sole purpose' test in the event that Garry and Betty residing in the property is treated as a present-day benefit or personal use of an SMSF asset.

Issue 3: capital gains tax and land tax

As a general principle, there is no capital gains tax on a transfer of property between an SMSF and the members of an SMSF in their personal capacity if the property is solely supporting the payment of one or more pensions for the members (i.e. if the property is a segregated current pension asset under the segregation method or under the proportional method if all members interest are in pensions).

If an SMSF sells a property before the members retire, the SMSF is charged 10% capital gains tax.

If an SMSF property is sold whilst all members of the fund are solely in retirement phases, any capital loss realised would be disregarded for tax purposes and cannot be carried forward to offset future capital gains.

In most states and territories, a principal place of residence will not be subject to land tax. As the property will be Garry and Betty's principal place of residence when acquired, they will not have to pay land tax.

Transfer duty on the transfer from the SMSF to Garry and Betty in their personal capacity will result in transfer duty or nominal duty being paid except in Victoria, the ACT, and Soth Australia where transfer duty on this type of transaction is exempt.

Full ad valorem ('according to value') transfer duty is likely to be charged in NSW, Queensland and the NT. In Western Australia, nominal transfer duty of $20 applies in respect of a transfer of, or an agreement for the transfer of, dutiable property from the trustee of an SMSF to a member of the SMSF.

The trustee must still ensure that the in-specie transfer is permitted under the trust deed. If the trust deed is silent on any in-specie transfer, then the trust deed will need to be updated to allow the in-specie transfer to occur.

In summary, while it may seem advantageous to acquire a retirement property through your SMSF with the hope of residing in the property once you retire, there are issues to consider with this type of transaction, particularly ensuring that the SMSF satisfies the sole purpose test.

Elizabeth Wang is a Solicitor at Townsends Business & Corporate Lawyers. This article is for general information only as it does not consider the individual circumstances of any investor. Consult with a legal or financial adviser before acting on any information in this article.