Firstlinks
a Morningstar company

Edition 389, 8 January 2021

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Editorial

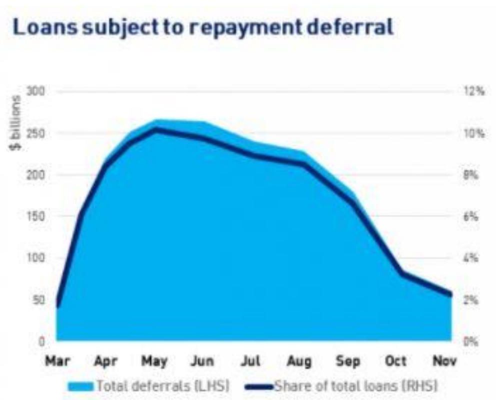
The local All Ords Index started 2020 at 6,943 and, amazingly in such a turbulent year, finished at almost exactly the same level. Therefore, positive Australian equity returns from the broad index depended on dividends, and with the All Ords at 6,850 in November 2007, prices have gone nowhere in 13 years. But that overall index masks many great company successes, and in 2020, tech, resources and retail in particular enjoyed a stellar year. In the US, the S&P500 delivered a price return of 16.3% and a total return of 18.4% in 2020, and NASDAQ was up 44%.

While the All Ords significantly underperformed the US, let's acknowledge that despite the travails and worse experienced by many Australians in 2020, the majority of us would rather be here than anywhere else in the world at the moment.

So we'll start the year with a doff of the cap to **Monty Python** and a general theme for this edition:

"Some things in life are bad
They can really make you mad
Other things just make you swear and curse
When you're chewing on life's gristle
Don't grumble, give a whistle
And this'll help things turn out for the best
And
Always look on the bright side of life
Always look on the bright side of life" etc

The most optimistic chart released in recent days comes from APRA, showing loans subject to repayment deferral by banks have fallen to only 2.3% of all loans or $60 billion, from over $250 billion worth 10% of loans only six months ago. It's not only good for thousands of borrowers no longer facing growing debt, but the improved quality of bank balance sheets.



Australian investors who rallied against Labor's franking credit policy at the last election can also celebrate a long-term victory. Leader **Anthony Albanese** announced this week:

"I can confirm that Labor has heard that message clearly and that we will not be taking any changes to franking credits to the next

election. I want the focus to be on Labor's positive agenda for Australia's future."

And of course, investors in growth stocks and **Bitcoin** are also happy, with the crypto currency rising 300% in 2020. I have no idea whether it's a good investment, with its price now exceeding A$40,000. Whenever I am cold-called about an amazing investment opportunity, as happened with a Bitcoin promoter a couple of weeks ago, I have two instincts: hang up and sell.

The move by investors to 'looking on the bright side of life' was confirmed in a recent **State Street** global study based on actual trades by institutional investors:

"The Global Investor Confidence Index increased to 104.1, up 13.3 points from November's revised reading of 90.8. The North American ICI rose 15.9 points to 103.5, and the Asian ICI increased 17.4 points to 112.6. Meanwhile, the European ICI fell for the fourth straight month, down 4.6 points to 87.2.

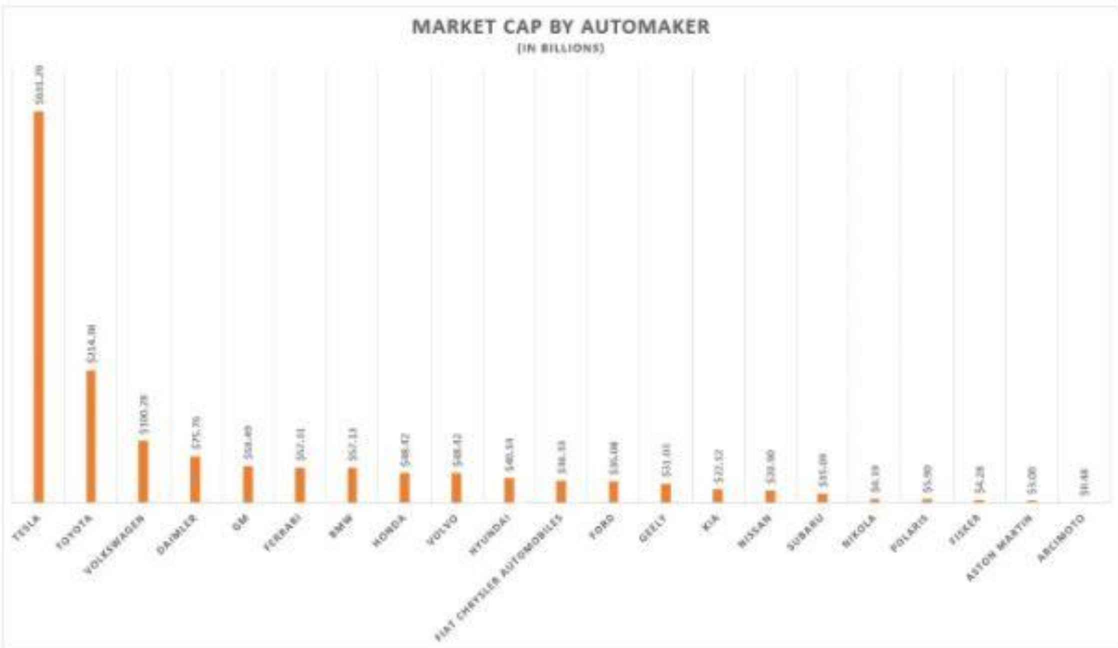
The index assigns a precise meaning to changes in investor risk appetite: the greater the percentage allocation to equities, the higher risk appetite or confidence. A reading of 100 is neutral; it is the level at which investors are neither increasing nor decreasing their long-term allocations to risky assets."

Even when one of the world's most prominent and successful long-term investors issues a warning, he adds that it is "exciting and terrifying at the same time". Legendary **Jeremy Grantham of GMO**, who calls himself a 'bubble historian' having invested through four bubbles in the last 40 years, says he will enjoy the ride:

"But this bubble will burst in due time, no matter how hard the Fed tries to support it, with consequent damaging effects on the economy and on portfolios. Make no mistake – for the majority of investors today, this could very well be the most important event of your investing lives. Speaking as an old student and historian of markets, it is intellectually exciting and terrifying at the same time. It is a privilege to ride through a market like this one more time."

Wow! - "**the most important event of your investing lives**." Be prepared.

The stock most-regularly quoted as a sign of a bubble is **Tesla**. Investors are buoyed by their success and the ready availability of leverage pushes its share price to ever-higher levels on pure speculation. It is estimated that 'shorts' in Tesla, usually professional hedge funds, lost US$40 billion selling Tesla in 2020. At a value of over US$600 billion, it is worth more than the next six automakers in the world combined.



GRAPH VIA THE DRIVE

Warren Buffett's mate, **Charlie Munger**, was also feeling the dizzy heights in an interview last week. Maybe he's never heard of Monty Python:

"We're in very uncharted waters. Nobody has gotten by with the kind of money printing now for a very extended period without some kind of trouble. We're very near the edge of playing with fire."

Closer to home again, the early access to super scheme has now closed with 3.4 million people withdrawing $36 billion. It's not a strain on a $3 trillion system, but it signifies a different approach by this government to allowing access and the eagerness of many to having the money now. The increase in the Superannuation Guarantee will be an major debate leading up to the scheduled rise to 10% on 1 July 2021. In theory, only the unemployed, those eligible for welfare or workers whose hours fell by 20% could access the scheme, but the ATO is relaxed, saying:

"Only in serious cases where an applicant has deliberately applied knowing they were not eligible will the ATO apply penalties."

In this week's edition ...

For those investors who use the new year to review their portfolios, leading fund managers and product providers offer their top stock, fund and sector picks for 2021, collected in a special ebook (which complements our ebook issued before the holidays on the best interviews of 2020). Lots of good ideas to check.

As a final look back at 2020, we highlight the 20 most popular articles, all of which received over 10,000 views on our CMS records. The wide range of subjects show the great diversity of interests of our engaged audience.

Gazing into 2021 (and mainly continuing to 'look on the bright side of life'), three reviews on what the year might bring:

- **Phil Ruthven** gives his provocative views on how we should live and work in future, including reacting to pandemics and the structure of our nation's institutions.
- **Jonathan Bailey** looks at lessons learned from COVID and an unexpected business response to become more aware of ESG responsibilities.
- **Randall Jenneke** finds reasons for optimism about both the Australian economy and company prospects, including identifying some stocks.

Regardless of whether it's a good time for putting more money to work in the market, it's always the right time to consider portfolio construction. **Philip May** provides a post-retirement investing framework which divides your money into different categories to help manage retirement.

Finally, in a variation from tradition in our 'white paper' section and in keeping with our theme, a short video from AMP Capital's Shane Oliver on Five Reasons for Optimism in 2021.

One New Year resolution from all this, despite difficult markets, rioting in the streets in the US Capitol and rising virus cases, is that we can find reasons to 'look on the bright side'.

24 hot stocks and funds for 2021

Firstlinks

There is always doubt about the future, but 2021 will be especially challenging for investing. Equity markets are at stretched valuations as analysts build in optimism about earnings recovery and stimulus in a post-COVID world. The safety of cash and term deposits offers negative real yields, forcing many conservative investors to take on risk they would otherwise avoid. As they seek an elusive combination of defensive market exposure with reasonable yield, they see others enjoying the growth story by buying companies without profits or dividends. Time will tell who wins.

We contacted two dozen fund managers and product providers, and thanks to the following contributors for their views on 2021:

- Shane Miller, Chi-X Australia
- Kris Webster, Magellan
- Sean Fenton, Sage Capital
- Steven Bennett, Charter Hall Group
- Tim Canham and Wik Farwerck, First Sentier Investors
- Aaron Binsted, Lazard Australia

- Franklin Global Growth Fund team, Franklin Templeton
- Gemma Dale, nabtrade
- David Bassanese, BetaShares
- Michael Murray, Australian Ethical
- Nandita D'Souza, Citi
- Perpetual Investments
- Australian Equities Growth Team, First Sentier Investors
- Deana Mitchell, Australian Ethical
- Roger Montgomery, Montgomery Investment Management
- Peter Bell, Bellmont Securities
- Jordan Eliseo, The Perth Mint
- Alex Pollak, Loftus Peak
- Jun Bei Liu, Tribeca Investment Partners
- Marcus Padley, Marcus Today
- Orbis Investments
- Vanguard Investments Australia
- Adrian Martuccio, Bell Asset Management

We allowed nominations for listed companies, funds or sectors to give a broad range of opportunities, and you should read the recommendations in that context as some people mention their own funds.

Please note, responses were received around mid-December 2020 and some prices may have changed.

At the end of the 2021, we will review these selections to check the best and worst results and calculate an overall weighted return.

Download the ebook here

Graham Hand

Disclaimer: Highlighting these stock picks does not constitute any offer or inducement by Firstlinks or the contributing individuals and companies to make any investment. This publication is for general information only and has been prepared without considering any person's objectives, financial situation or needs and you should therefore consider the appropriateness of the information, in light of your own objectives, financial situation or needs, before acting.

Refer to our Financial Services Guide (FSG) for more information at www.morningstar.com.au/s/fsg.pdf.

To obtain advice tailored to your situation, contact a professional financial adviser. Past performance does not necessarily indicate a financial product's future performance.

The 20 most popular articles in 2020

Firstlinks

The most popular articles of 2020 show the wide range of subjects covered by Firstlinks. As we return to work in 2021, although mainly from home, it's useful to reflect on the issues that grabbed our attention. Unlike many other publications, Firstlinks does not simply focus on stock picks or finance industry issues.

These should be read in the context of when they were published, such as a few articles on how we may be affected by COVID. The most-viewed article of the year, my piece on Afterpay, was written when the share price was around $70 and it is now about $120. I'm still not making a recommendation to buy or sell but at this stage, I have held my own shares after participating in the DRP at $66.

Each of these articles has received over 10,000 views as measured by our CMS platform. Each heading includes a link to the relevant article.

11 lessons from my lousy $50K profit on Afterpay
Graham Hand
Afterpay listed at $1 in 2016 and traded recently at $70. How should an investor treat a small holding in a 70-bagger when each new level defies the experts? Should true believers let the profits run?

[10 undervalued stocks if you're worried about volatility]
Emma Rappaport
Amid the coronavirus-induced turmoil, many quality names are trading at a discount to fair value, according to Morningstar analysts. A smaller list of companies also screen for earnings certainty.

[The 20 Commandments of Wealth]
Noel Whittaker
To mark his 80th, we publish a Noel classic plus his timeless commandments for retiree wealth, based on decades of advising clients, writing bestsellers and reaching millions of people every week.

[A hard dose reality check on vaccines]
Rod Skellet
With 160 programmes underway and billions of dollars spent on COVID-19 vaccines, investors are drawn to optimistic news. However, the company that has developed most new vaccines has a sober view.

[Five famous investors with cheap listed funds]
Graham Hand
Why invest in an unlisted fund by a well-known, experienced fund manager when the equivalent listed fund is offered at a substantial discount? Maybe there's a structural problem to fix here.

[20 great ways the government helps retirees]
Brendan Ryan
This list could save a retiree thousands of dollars and provides ideas for a better lifestyle. It's surprising what you might be entitled to, but it's often hard to track down the benefits.

[After 30 years of investing, I prefer to skip this party]
Roger Montgomery
Eventually, prices become so extreme they bear no relationship to reality, and a bubble forms. I believe we are there today, not for all stocks but for many in the technology space.

[Easy money: download Robinhood, buy stonks, bro down]
Graham Hand
Millions of inexperienced traders have entered global equity markets since the end of March, fuelled by hype in a rapidly-rising market. What is happening and how are they having an impact?

[Magic money printing and the reality of inflation]
Tim Congdon
It looks like a magic money tree, where the central bank simply deposits money in the government's bank account. We asked one of the world's leading authorities on monetarism for an explanation.

[What is the likely effect of COVID-19 on the Australian economy?]
Moray Vincent
Our close links to China mean the impact of the virus could tip the local economy into recession and certain sectors such as resources, education and travel will be harder hit than others.

[Howard Marks on 'Which way now?' - UPDATED]
Graham Hand
Howard Marks is the largest investor in the world in distressed securities. What does he think after checking the virus positives and negatives, and how much has he changed his mind in only a few days?

[Australian house prices: Part 2, the bigger picture]
Chris Rands
Three key indicators are useful for predicting the short-term outlook for house prices, although tighter lockdowns make the outlook gloomier. There is enough doubt to create cause for concern.

[Six ratios show the market is off the charts]
Graham Hand
There is an infinite variety of financial charts an investor can watch, with many spurious claims about factors and causality. But here are six common charts that are at historical extremes.

[How $200 billion is magically created]
Shane Oliver

Australia is in a relatively good position to borrow $200 billion, with the RBA using printed money to buy bonds in the market. The long-term consequences are better than the alternative.

COVID-19 and the madness of crowds
Phil Ruthven AO
57 million people die every year, including over 3 million from respiratory diseases. Why is COVID-19 allowed to panic nations around the world and destroy so many businesses and jobs?

Warren Buffett's letter about new investors and speculation
Warren Buffett
A pin lies in wait for every bubble. And when the two eventually meet, a new wave of investors learns some very old lessons: speculation is most dangerous when it looks easiest.

The creator of the 4% rule and his own retirement
Michael Kitces
The 4% withdrawal rate in retirement is an industry standard, a level where a retiree could be confident of not running out of money. Its creator Bill Bengen explains its use in this interview with Michael Kitces.

The three key issues in the COVID-19 outlook
Hamish Douglass
Hamish Douglass outlines the three main issues in the outbreak of coronavirus, with consequences which may change businesses and consumers forever. Will we face V-shape, U-shape or depression?

How do your financial priorities stack up with our pyramid?
Christine Benz
Make sure you're not focussing on minor investment problems while giving short shrift to the game-changers. This pyramid describes the important decisions and it might surprise what comes last.

Who's next? Discounts on LICs force managers to pivot
Graham Hand
The boards and managers of six high-profile LICs, frustrated by their shares trading at large discounts to asset value, have embarked on radical strategies to fix the problems. Will they work?

These articles have previously appeared in Firstlinks but they do not take into account the circumstances of any investor.

Changed visions: 2021 New Year resolutions

Phil Ruthven AO

New Year resolutions have a habit of not surviving the end of the festive season.

However, 2020 was a bizarre and traumatic year for individuals, households, businesses, politicians, religions and, especially, health officials and front-line workers. So, we all need to change our modus operandi to a greater or lesser extent, and this is a good time to take stock of the year we have happily left behind, resolve to adapt our plans and get serious about some new year (and longer term) resolutions.

It is comforting to know we have one of the highest standards of living in the world. We are the 'lucky country' in so many ways and we are geographically in the biggest and fastest growing mega-region of the world, Asia. Most of the other three mega-regions – Europe, the Americas, and Africa and Middle East – while still big, are losing shares of world GDP.

But what sort of changed visions and behaviour do we need to think about?

Health gurus and officials

We need less shock and awe, and wild forecasts from so-called epidemiologist experts and gurus of the sort that terrified us in early 2020 with the COVID-19 virus. It led to political and public panic, saturation media sensationalism and government deficit spending that has set peace-time records.

COVID in the 2020 year gave us less than 2 million deaths of the 57 million total deaths across the world (a miniscule 3.2%), albeit over three times that percentage in the USA. Didn't the other 97% of deaths - over 30 times more than COVID deaths - matter as much?

It suggests our health officials in Australia and more so in many overseas nations need to be on top of the response mechanism for the remaining period of the current pandemic in 2021, and others that are bound to follow through this century. The components of a response mechanism include:

- Border testing/entry clearance procedures (international and domestic)
- Tracing
- Quarantining (the infected and particularly the >70-year-old population wherever they live)
- Masking and distancing
- Hospital and medical treatment adequacy
- Business/economic shutdowns (ever again?)
- Border closures (ever again?)
- Vaccines
- Responsible perspective given to citizens about death, all causes, and cost and benefit issues (as are applied to health expenditure all the time).

Australia, as usual, was only mildly affected by the virus with an almost invisible 0.6% of all deaths in 2020. We have not been nearly as impacted as other nations with pandemics over the past 100+ years for reasons of being in the Southern Hemisphere, being an island continent and having a very high standard-of-living with the wherewithal to action preventative and curative measures.

A world-average 3.2% COVID death rate would have led to 5,000 deaths in Australia, but we had less than 1,000. Saving over 4,000 lives, or 2.5% of all deaths, involved current and future deficit spending of some $90 million per life saved. A very high cost, and we have mortgaged future growth severely with massive and unprecedented peace-time government deficits and debt.

The GFC response in 2008-09 lowered the following 10+ years of GDP growth by 0.5% pa, abetted by a lack of much-needed reforms. And the COVID 19 response looks like reducing that growth by a further 0.5% pa to the end of this decade. So, we need to think hard about future pandemics.

Politicians and emperors-for-life

Politics and government are in bad shape globally, including in Australia. In an age where the capitalism versus socialism ideological battle has long since been replaced by the rational versus emotional/irrational ideological battle, the latter has been winning. None so obvious as in the USA, where a President that can be compared to Rome's Caligula has lost to a more rational new President. Perhaps the tide is turning.

However, emperors-for-life now rule over nearly a third of the population across the world's eight regions and their 7.9 billion people. Of course, not many of us know that a nation needs a standard of living (SOL) averaging A$25,000/capita to afford an effective democracy, the reasons being: the cost of a largely corrupt-free military, police, government and judiciary; and the wherewithal to help the needy and underprivileged with basics.

Australia's SOL is around A$78,000/capita, and the temptation is to say every nation should have democracy, without realising it is a magnanimous and virtuous thought but impractical if not destabilising. At best, we can encourage competent, benevolent dictatorships or plutocracies until a nation can afford democracy.

Sadly, we too often end up with malevolent and incompetent or self-aggrandising autocracies and plutocracies The Russian Federation has an SOL of A$15,000/capita, China around the same, India just over A$3,000, and PNG in the same ball-park - to touch on just some of the not-quite-ready nations of the world's 230 nations, protectorates and principalities, some of whom have a nominal if not actual democracy.

Democracies are under threat across the developed world, even where SOLs are above the A$25,000/capita threshold. The USA is the most obvious. Australia is said to be a democracy, but in effect is compromised by an upper house (Senate) that can and does reject bills from the democratically elected lower house (House of Representatives). It's no longer possible in the UK, but still extant in our country. We urgently need reforms as covered in previous articles, such as here in May 2020 and here in August 2020.

The days when a political party can control both houses are long gone. Apart from a year of the Howard Government's reign, that power went four decades ago. Until we get a democratically elected upper house, or remove its vetoing power - as distinct from a delaying/debating capacity - the ability and courage to reform Australia's structures is stymied.

Individuals and households

We have around 10 million occupied households in Australia with a population of 25.5 million citizens.

While individuality is important, the way we live and work is mostly in family and other types of households, working cohorts, and social and recreational groups. We are, after all, mostly gregarious.

That said, the ageing and empty-nesters, students and other young people, have led to many single-person households. Over one in four households are single-person households, heading for 30% before the middle of this century. Modern telecommunication and videoconferencing technologies are vital anti-hermit, anti-social and loneliness antidotes.

Communication technologies have also led to many workers operating partially or fully on their own across many occupations and industries. Those that work alone from their home are now approaching 30% of the near-13 million employed persons. So, tribalism is taking on a new form as we move through this century, with virtual togetherness usurping a lot of physical tribalism.

Religious tensions are fading in most countries across the world, with some notable exceptions. Some 16% of the world's population claim no religious belief, but in Australia, the no-religion proportion now exceeds 30%. We are, relatively, free of tension in this part of our lives. Long may it continue.

And, fortunately, in a world of polarisation of incomes and wealth this century, Australia has not seen more than a tiny-cum-marginal increase in this socially divisive pattern so far since 2001. A lucky or socially cohesive country indeed, contrary to oft-suggested lack of equanimity.

Australia is often seen as a nation of low crime. This is true when it comes to the murder rate with one of the world's lowest. Robbery, burglary and theft crimes have fallen dramatically since the beginning of this new century. However, we have one of the world's highest drug-related deaths and serious assault crime rates. Sadly, 1 in 10 women over the age of 15 have experienced domestic abuse of a physical, sexual or emotional nature, leading to the most frequent intervention by our police forces.

We need a lot more education, media campaigns, safety and protection measures, and reporting/coping/survival guidelines to reverse the generational abuse practices. Social cohesion needs constant vigilance.

Businesses

It is the business world that creates the majority of the incomes and wealth of a nation's citizens. Indeed, in Australia, it produces around two-thirds of the actual annual goods and services, the balance being the imputed value of household-produced goods and services.

The official total wealth creation (GDP) is traditionally accredited to businesses of which there are around 2.3 million in Australia, and of which only 40% employ persons other than the owner. We lose around 1 in 7 of these businesses each year, replaced by newcomers, much the same as in the USA.

This attrition (and renewal) is generally regarded as healthy and Darwinian in maintaining a vibrant, competitive and productive economy.

But our business world at large is not very efficient in its use of capital. Over the past four decades, the businesses in total have had an average net profit on their equity of less than 4%.

Our 2,000 largest enterprises, now accounting for almost half the nation's $5.7 trillion revenue, have averaged around 8% return on equity. Our 100 largest listed stocks have averaged a better 11% over the past 3 years but compared badly with an average of over 20% - virtually double ours - in the USA's 100 largest.

Some 1 in 4 of the US 100 largest listed stocks achieve 'world best practice' (WBP) returns of 22% or more on equity after tax; but only 1 in 10 for our largest 100. And only 6 of the US 100 stocks had profitability below the bond rate or ran losses; whereas we had 27 of our 100 below the bond rate or in losses.

What are the reasons for such a frightening gap between Australia and the USA?

It isn’t population size or hi-tech or taxation regimes or labour cost advantages, contrary to conventional wisdom. It is due in large part to:

- the American gurus who have written the world’s most and best management success books over the past half-century
- the countless conventions, conferences and seminars featuring these gurus
- the leading US universities, think-tanks and institutes that have embraced and disseminated the New Age (post-mid 1960s) rules of success
- the country-clubs that operate on a more success-sharing basis than our more ‘British’ clubs.

Associations, unions and clubs

Australia has over 18,000 community and business associations, generating revenues of $30 billion in 2021, a third of which comes from social clubs with gambling, dining and drinking services. But growth is expected to be a lowly 1.2% a year to the middle of this decade. Individuals, households, workers and businesses are less interested in them than in the past due to use-of-time issues, relevance, value and datedness.

Union membership has fallen from 50% in the 1970s to less than 15% in 2021. Golf clubs have seen declining numbers due to time-usage factors. Business associations have lost some interest with the fading of protectionism (and the need of lobbying) and in some cases struggle to provide modern and relevant information, education and advanced upskilling. Social clubs have had zero real growth in revenue since the beginning of this century, as society has turned to other forms of entertainment and social togetherness, not the least of which has been digital era-aided entertainment and social media.

So, 2021 and the decade ahead is demanding of serious renewal of associations involving:

- questioning of their raison d’etre and relevance
- reviewing their audience/members (including gender, age and localities)
- reviewing their products
- reviewing their modus operandi (including the digital era options)
- auditing their value-proposition

So?

We began by saying New Year resolutions have short lives. It’s so true.

Societies and businesses have retreated from long-term planning in favour of the here-and-now and have been beguiled by emotive and irrational politics over rational ideologies and politics.

These are insidious trends in a century where Asia is in the ascendancy in population numbers, economic output, innovation and productivity, with long-term thinking (indeed generations long) and ambitious standard-of-living growth objectives.

All Australian businesses should commit to WBP performance in 2021, with appropriate New Year resolutions and good luck.

Phil Ruthven AO is Founder of the Ruthven Institute and Founder of IBISWorld. The Ruthven Institute was created to help any business that wants to emulate world best performance and profitability using the Golden Rules of Success, based on over 45 years of corporate and industry analyses and strategy work.

Retirement changes everything: a post-retirement investing framework

Philip May

The global landscape for retirement investing is changing. Previously the focus was on investing for retirement – accumulating assets for future use – but as Western and Asian populations age, post-retirement investing is becoming more important.

However, the economic backdrop has shifted considerably. The huge economic shock from the COVID-19 outbreak means that interest rates are likely to stay even lower for longer; sources of income previously seen as reliable, such as dividend income from banks and property rentals, have turned out to be vulnerable.

Dividend cuts have impacted income funds, while some property funds have been gated, leaving investors unable to access their money.

These factors could have a significant impact on the willingness of retirees to take on investment risk. Amidst such uncertainties, there has never been a greater need for high quality, affordable investment advice to support investors and guide them to suitable portfolios.

Investor needs differ post-retirement

Investor needs in the post-retirement phase are quite different from the accumulation stage. At Capital Group we have a saying, '**Retirement changes everything**'. Saving for retirement usually means investing regularly, typically monthly through payroll, into a defined contribution plan. For most people it is of little relevance to their day-to-day life, just something out there in the future.

But in retirement an individual's savings and the income that can be generated from them are crucial. Without a salary coming in, your retirement income pot is in many cases the focus of your finances. In the accumulation phase most individuals have the straightforward objective of capital appreciation. But in the decumulation phase, investors will typically look to draw an income from their assets but at the same time preserve capital, and if possible, enjoy some continuing growth in capital.

How they organise their investments after retirement will depend on several factors.

Firstly, what other income and assets they have. Do they have secure income from the state and from defined benefit plans? Do they have non-secure income from any remaining employment earnings? and from non-retirement investments including property rentals, for example? The extent of these additional income flows will vary enormously from individual to individual.

Secondly, what is the pattern of expenditure in retirement? Do they have outstanding mortgages or other debts to pay off? What is their lifestyle expectation for retirement?

Investing in retirement needs to account for more unknowns. Investors will ask themselves questions such as "How long will I live? Is there a risk I will outlive my savings? Do I need to set aside funds for emergency expenditure such as a new roof for the house or even for nursing care in later life?"

Post-retirement, there are three principal risks: sequencing risk, longevity risk and inflation risk. Sequencing risk is a particular problem for retirees. If I make withdrawals from my retirement account in down markets, I run the risk of consuming my capital at an accelerated rate and running out of money sooner than expected. So, volatile assets carry more risk in retirement, yet at the same time I still need real assets, which can protect me against inflation and have the potential for growth in capital and income over maybe 20 years+ in retirement.

A framework to tackle the challenge

Capital Group has developed a framework for thinking about investing in retirement, which utilises a simple 'four-box' approach, shown below.

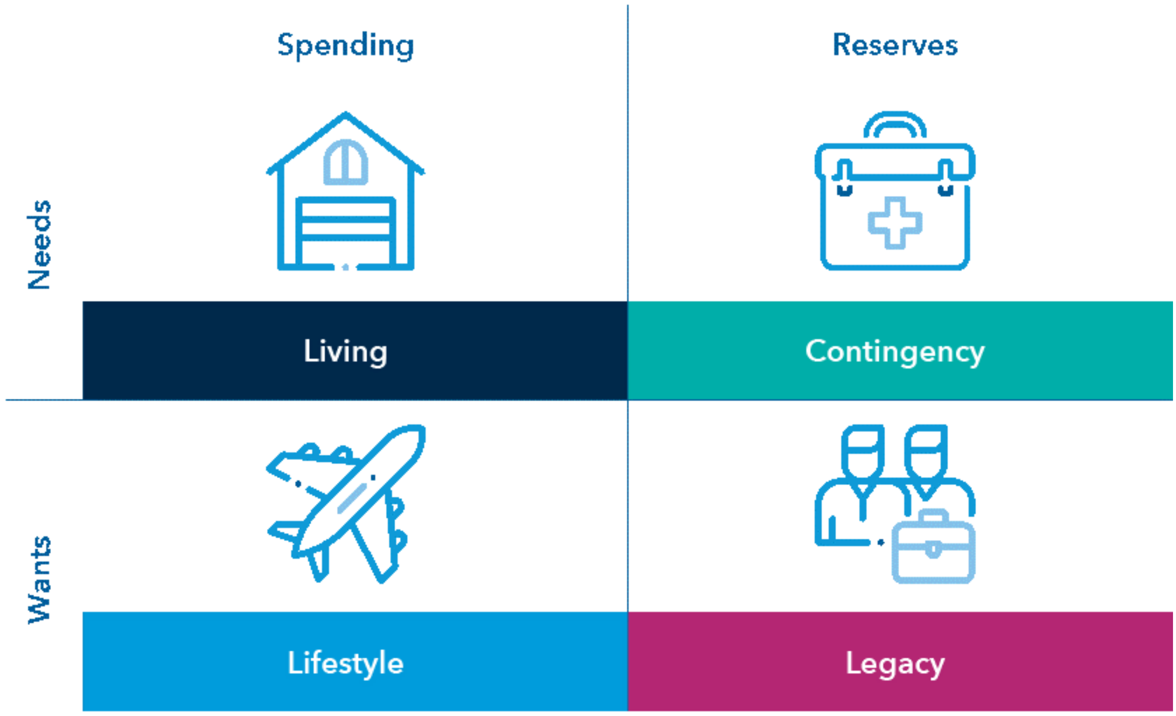
There are two categories of spending, living expenses (the basics) and lifestyle expenses (discretionary spend). And two categories of reserves – a contingency fund (rainy day money) – and a legacy pot for the next generation or charities.

Each of these spending or reserve categories can be matched up with an appropriate portfolio designed with retiree needs in mind. Portfolios designed to fund living expenses will tend to be fairly conservative reflecting the fixed nature of these outgoings, portfolios supporting lifestyle expenditure can be more balanced as expenditure in this category is more discretionary. Contingency reserves will be largely cash or short-term bonds whilst legacy reserves should be primarily assets that can protect against inflation over time.

In retirement, investors tend to have divergent needs and wants. In the table above, these have been simplified into three broad groups of investors.

Future Building – this group of investors will consist of those looking to build a financial legacy for the next generation. Typically, they will have already secured their income streams for everyday expenses and have enough liquid reserves to deal with most emergencies.

Four post-retirement categories



For illustrative purposes only.
Source: Capital Group

How do these categories relate to investment goals?

Category	Living	Contingency	Lifestyle	Legacy
Characteristics	Day-to-day, predictable living expenses	Reserve for living expenses	Discretionary spend e.g. entertainment travel, home improvements	End-of-life bequest to children or charities
Primary goal	Secure income	Accessible capital & capital preservation	Flexible income	Growth of assets
Which categories of spending or reserves should investors in retirement focus on? It all depends on your financial ambitions in retirement				
Future Building	Secondary focus	Secondary focus	Primary focus	Primary focus
Golden Years	Primary focus	Primary focus	Primary focus	Secondary focus
Family & Friends	Primary focus	Primary focus	Secondary focus	Secondary focus

For illustrative purposes only. Source: Capital Group

Golden Years – this group of investors want to spend their retirement getting out and enjoying the world. They need to pay attention to funding their day-to-day expenses as well as lifestyle needs but are less focussed on leaving a legacy other than their main home.

Family and Friends – this group of investors is focused on enjoying retirement with family and friends. They will prioritise spending on everyday needs and putting money aside for a rainy day with less emphasis on lifestyle spending.

So, what steps should investors in each of these groups take, working with their advisers, to construct portfolios that are tailored to their individual needs?

Identify what investment types are appropriate for each category

Defining each category by its ultimate investor goal provides greater clarity in identifying the appropriate asset, whether to provide a secure income stream, capital growth, or capital preservation.

Living

Predictable, day-to-day living expenses need to be supported by a regular flow of secure income. For many investors, this could be covered by the state pension, an employer-sponsored defined benefit income stream or an annuity. These income streams are secure, consistent and are a good match for regular expenses that don't tend to vary from month to month.

For investors looking to supplement these costs from their own pension account, their instinct may be to default to cash. However, returns on cash are unlikely to keep pace with inflation, and drawdowns from an asset class that has neither the potential to grow in value nor provide a significant income stream can deplete capital reserves aggressively.

A more appropriate investment option could be a supplementary allocation that is largely made up of bonds. Fixed income exposure may work best to achieve sustainable withdrawal rates with significant potential for capital preservation.

Living	Characteristics	Investment option
	Day-to-day, predictable living expenses	Secure income + bonds

Contingency

Emergency funds are not intended to provide income flows to cover spending needs, therefore yield isn't necessarily a consideration. However, to rise above today's negligible interest rates, short-term, high-quality bonds, which offer good liquidity, may be a supplement to pure cash holdings.

Contingency funds can also be helpful to mitigate sequencing risk. The benefits of having a liquid source of funds have been made clear in the recent bout of market volatility. Investors with contingency funds could have used those in peak volatility periods to avoid making withdrawals when the market was at its most depressed.

Contingency	Characteristics	Investment option
	Reserve for living expenses	Cash or liquid conservative investment

Lifestyle

The discretionary spending covered in the lifestyle category doesn't have the same need for secure, predictable income as day-to-day living expenses. Therefore, it lends itself to assets whose income flows and capital values are variable. Typically, this could be a mix of equities and bonds.

However, retirees may have different tolerance for volatility and capacity for loss. Generally, investors with greater financial flexibility tend to have greater tolerance for variability in returns and this can be reflected in the underlying asset mix.

Taking our investor groups at the top of this section those in the Future Building and Golden Years groups are more likely to be able to tolerate greater variability in returns, and therefore might prefer a higher proportion of their lifestyle assets in equities, with a smaller amount allocated to fixed income investments. A balanced income portfolio has the potential to provide income from both equity dividends and bonds, coupled with greater potential for capital growth.

For investors in the Family and Friends group, a more moderate allocation to equities might be appropriate as a higher allocation to bonds would help provide a greater level of consistency in returns, albeit this level of return may be lower over time.

Lifestyle	Characteristics	Investment option
	Discretionary spend e.g. entertainment, travel, home improvements	Balanced or moderate income portfolio[3]

Legacy

Investments intended for legacy purposes are mainly the preserve of those with greater wealth, although a broad range of retirees in many countries will seek to treat their homes as legacy assets. For individuals treating their primary residence as a legacy asset, an investment solution may not be necessary. However, for those looking to build a separate legacy investment portfolio, equities and multi-asset funds could be suitable candidates for this category.

Legacy	Characteristics	Investment option
	End-of-life bequest to children or charities	Equities and multi asset funds

Customisation without complexity

Having identified examples of appropriate investments for each of the four categories – living, lifestyle, legacy and contingency – we now have a clear framework to assemble post-retirement investment options.

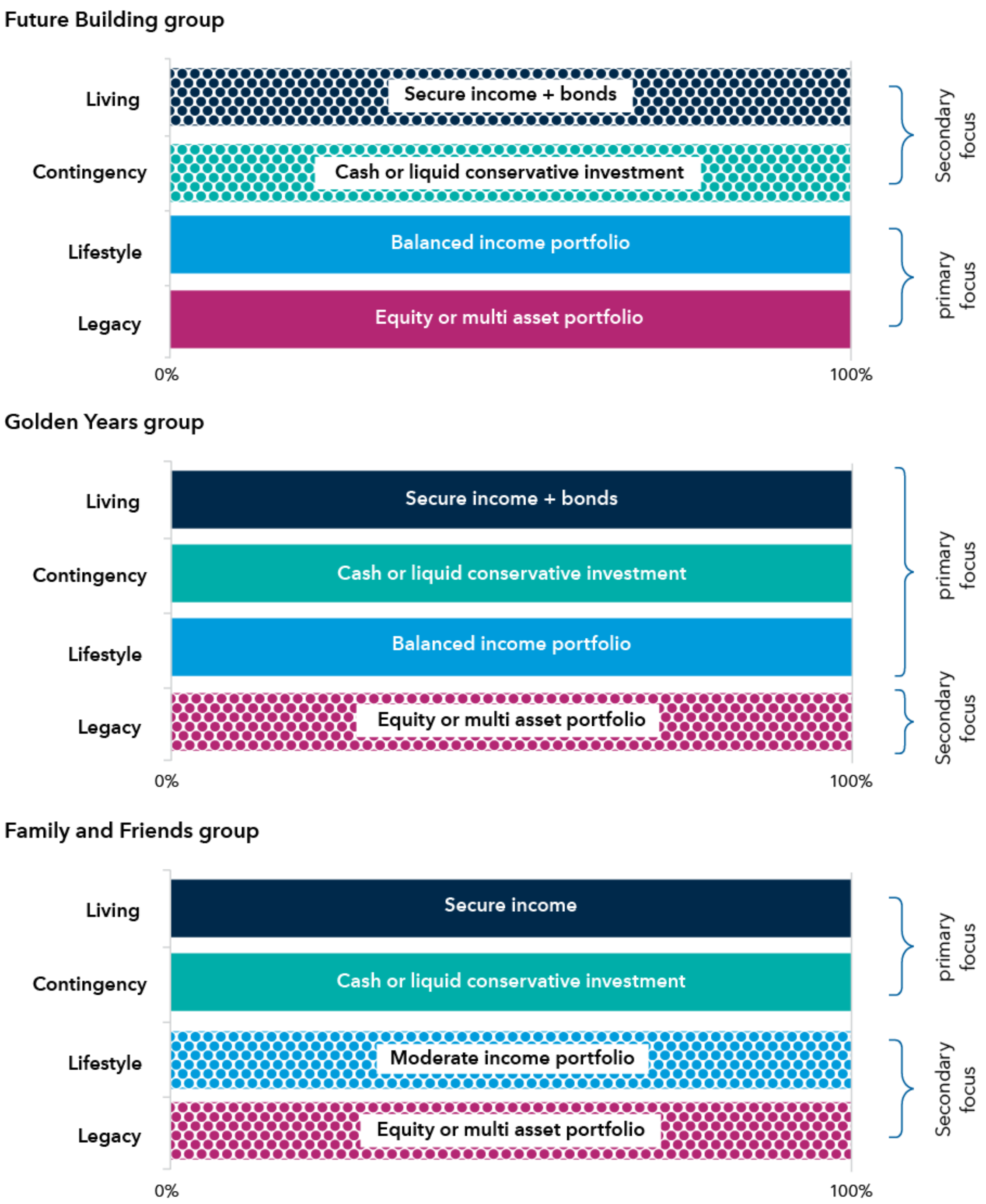
The graphs that follow show what a standard asset framework might look like from the perspective of each of our investor groups. They show the different building blocks available for delivering appropriate solutions.

We believe the benefit of using this retirement investing framework is that:

- it provides a clear link to real-life investor needs and wants
- the suggested portfolios are specifically designed to support retirement investing goals
- the framework can allow for tailoring to specific individual needs by varying the proportions of an individual's portfolio in each category, and
- where an investor uses an adviser the framework is straightforward and can be integrated into overall retirement planning.

The framework is intuitive and flexible enough to create investment options tailored to investor needs. By matching appropriate investments with specific spending categories, it becomes much clearer where investors could focus their attention and, with the help of their adviser, refine their approach to retirement.

Breakdown of retirement categories based on investor priorities



Philip May is Director of Retirement Income Solutions at [Capital Group](), a sponsor of Firstlinks. This article is neither an offer nor a solicitation to buy or sell any securities or to provide any investment service. The information is of a general nature and does not take into account your objectives, financial situation or needs. Before acting on any of the information you should consider its appropriateness, having regard to your own objectives, financial situation and needs.

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Investment learnings from the COVID-19 crisis

Jonathan Bailey

Sustainable investing has gained traction as a way to implement personal values in portfolios and as a means to draw on material environmental, social and governance (ESG) factors in seeking to improve portfolio performance.

However, with the emergence of the COVID-19 pandemic, it was an open question whether sustainability might become an afterthought as companies grappled with a collapse in economic activity and investors sought to insulate themselves from market volatility.

Although this is an ongoing story, the result has thus far been one of surprising resilience. Instead of pulling away from sustainable strategies, investors have increased their exposure, with strong flows into ESG mutual funds and ETFs in 2020. ESG enjoyed a substantial performance advantage, with U.S. equity socially conscious funds gaining 7.1% for the year through August, nearly doubling the 3.7% return for all other U.S. equity funds.[1]

On the corporate front, the pandemic has prompted heightened focus on ESG, and 'doing the right thing' has helped many companies navigate the crisis. It could contribute to reputational and competitive advantages in the years ahead.

ESG lens on the pandemic

At a high level, how has the crisis focused attention on ESG? The impact has been substantial, if somewhat uneven across the three elements of environmental, social and governance factors.

Environmental issues were already central to sustainability, given increased concern about climate change and the carbon impact of companies and portfolios. With the pandemic lockdowns, the world got a brief glimpse at the environment without the smog from carbon-based transportation and industry, and some hope as to what might be achieved through a transition to sustainable energy. Moreover, the disruption to supply chains (already an issue tied to trade conflict) reinforced the importance of reliability and redundancies across operations.

In general, the shift toward digitisation may help businesses build out supply chains. The balance between efficiency and security will likely need to be monitored closely with an eye toward climate effects, potentially providing a leg up to companies with a detailed grasp of their environmental impact.

Social concerns have taken center stage during the crisis, as companies faced enormous pressure to downsize in the face of a drop-off in demand. Even as the economy slowly recovers, limitations to in-person interaction and travel are causing a slow-motion decimation of many once-thriving businesses.

Meanwhile, the disease and its economic fallout have disproportionately affected minority and lower-income communities. For companies, responding with sensitivity could have lasting impact, along with meaningful commitments to help correct societal inequities that have proven so divisive.

Finally, effective **governance** has been highly important, as companies have faced many issues in a compressed timeframe. Having board members with an array of relevant expertise, and who aren’t overcommitted elsewhere, is essential to take appropriate actions with precision and decisiveness. Allocating capital not simply for efficiency but in demonstrating broader commitment may be both the right thing to do and additive when it comes to company reputation.

Assessing the corporate actions that worked

From the early days of the pandemic, many businesses took steps to address issues associated with the health crisis and economic shutdown. Depending on the industry, they announced a wide range of actions related to the crisis, including layoffs, employee furloughing, extended paid sick leave, guaranteed wages and changes to capital allocation plans. Working with Neuberger Berman’s Data Science team, we were able to sift through third-party data to determine what customers and employees have said about these companies, and thereby infer potential performance implications.

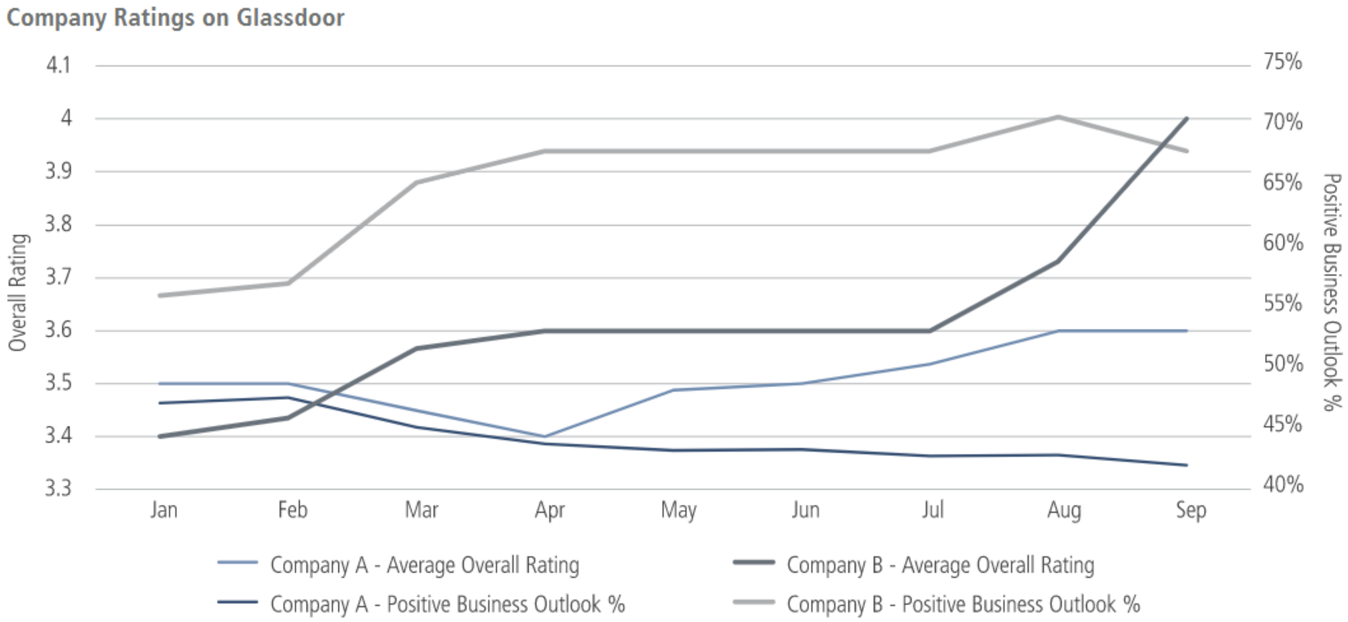
In some highly affected industries like airlines, hotels and gaming, corporate actions widely classified as negative, such as layoffs and furloughs, resulted in varying outcomes on employment review and rating sites.

For instance, some airlines with high employee satisfaction going into the crisis saw a positive trend in their reviews and overall CEO satisfaction, with comments such as, "when COVID-19 hit, they worked hard to protect their employees both physically and financially."

In contrast, those with low satisfaction saw a deterioration despite similar corporate actions. To us, this suggests that treating employees well in normal times can help create a more resilient organisation in times of crisis.

In gaming, the impact was clear-cut, with generous and responsible corporate actions leading to a marked increase in positive employment reviews, and vice versa. To illustrate, early in the crisis one casino operator (Company B in the display) continued to pay employees while its resort properties remained closed; the data showed positive employee reactions and reviews in response. Meanwhile, a competitor (Company A) saw a drop in ratings after announcing furloughs and layoffs, and a more modest subsequent recovery in ratings, as illustrated below.

Maintaining pay supported employee sentiment



Source: Glassdoor. Overall Rating is measured on a scale of zero to five. Positive Business Outlook shows the percentage of employees who believe a company business is getting better. For illustrative purposes only.

Other industries required management teams to quickly adjust policies. In the case of one home improvement retailer, for example, initial criticism from employees on sick leave policy was quickly addressed by specifying that paid leave was for all employees who needed it regardless of whether or not they felt sick. Subsequently, the company temporarily raised hazard pay rates and initiated a second round of bonuses to all hourly associates.

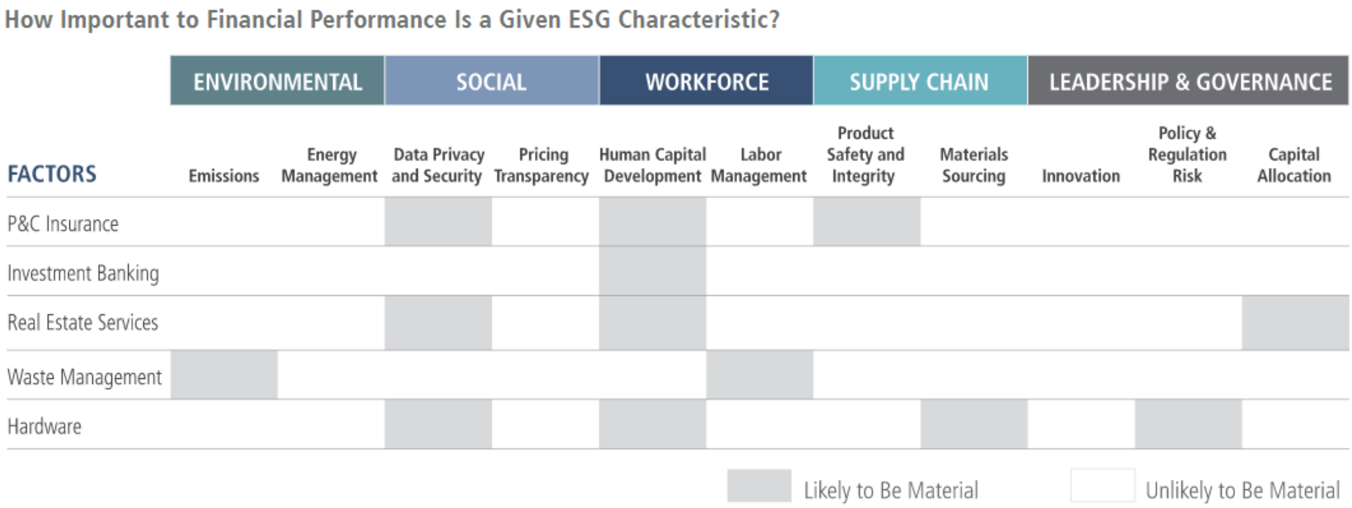
Despite a potential lack of accommodative policies at the early onset of COVID-19 relative to peers, the company made constructive real-time decisions after that point, with a commitment to the support and safety of their employees. We believe a flexible approach that is open to employee feedback is critical in difficult circumstances.

Materiality in action

A key benefit of ESG research is to identify factors that could have a material impact on their operational and financial results. To illustrate, data security can be particularly relevant to technology companies while carbon footprint is a fundamental issue for energy firms.

Some time ago, we created the NB Materiality Matrix (excerpted below) to highlight such linkages, while drawing on our proprietary ESG 'Sustainability Score' rating system to pinpoint likely impacts at the company level. During the crisis, we have found that many of the factors we previously identified as material appear to have become even more important. Some examples follow.

NB Materiality Matrix: Select industries



Source: Neuberger Berman. For illustrative purposes only.

Labor management. Labor relations are a key issue when looking at waste management. Provider W carries an above-average environmental and social score within our proprietary ratings. Given the nature of its core business (solid waste management services), it provides an essential service. The company has worked to meet its customer commitments and minimize trash pickup service disruptions in a responsible manner. It took the initiative to raise pay for frontline employees, provide paid medical leave benefits, and enhance internal safety protocols.

Customer relations. Maintaining strong relationships with customers has always been important to the financial services industry but have now come further into focus. Big banks have largely been viewed as partners and a critical transmission mechanism for government stimulus programs. Many have processed an unprecedented volume of loans very quickly. However, we have seen significant divergence in their performance in scaling up disbursement operations. Some institutions have been criticized for acting too slowly, or favoring particular clients, while others have performed better. These institutions have also supported consumers and businesses in this crucial period through various forbearance programs.

Data security. Challenges around data security have always existed, but are garnering even more attention during the pandemic given that many businesses are being required to operate digitally. As a global technology provider, Company C has understood its responsibility to ensure that its products and services deliver value in a secure manner, such as through its videoconferencing platform. According to our proprietary ratings, Company C scores above the group average on privacy and data security, and has set a standard for creating a trusted partnership with its customers.

Capital allocation. Capital allocation decisions are among the most important factors around which we can engage with companies, especially during a crisis. Company R, a real estate investment trust, set what we consider a strong example for peers through the pause on its share-repurchase program, where all previously generated profits would be allocated to its nonprofit foundation and COVID-19 relief efforts.

Good governance and resilience in crisis

The crisis has shed light on the strength of ESG as an assessment tool, and the role to be played by responsible investors. Stakeholders have long memories and as conditions normalise, employees will likely remember how they were treated, as will customers, suppliers and investors. Relationships built on trust are likely to support nimbleness of operation, and the ability of companies to survive and emerge stronger than ever.

The tools we use to assess corporate actions have not changed. However, the gauges of transparency, responsibility and sound practices that might have drawn more subtle signals in prosperous times often simply flash red in times of crisis. Paying attention to these signals may be more crucial than ever.

As we peer over the horizon, we believe strong governance and sustainability practices will increasingly matter and may influence resiliency in future crises.

Jonathan Bailey is Head of ESG Investing at [Neuberger Berman](), a sponsor of Firstlinks. This material is provided for general informational purposes only and nothing herein constitutes investment, legal, accounting or tax advice, or a recommendation to buy, sell or hold a security. You should consult your accountant, tax adviser and/or attorney for advice concerning your own circumstances.

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[1] Source: Morningstar Direct. Reflects performance of funds' oldest share class. Includes U.S.-domiciled open-end funds, where the Global Broad Category is equal to equity. U.S. equity funds include Large Blend, Large Growth, Large Value, Mid-Cap Blend, Mid-Cap Growth, Mid-Cap Value, Small Blend, Small Growth and Small Value Morningstar universes.

Australia 2021 market outlook: cautiously optimistic

Randal Jenneke

In terms of the global backdrop, the election victory by Joe Biden in the US and news of several potentially highly effective vaccines against COVID-19 have significantly reduced uncertainty over the global outlook for 2021 and beyond, which is positive for all markets, including Australia. Short term, for the next three to six months, some headwinds remain, notably the impact on the US and European economies of second coronavirus waves this winter, plus delayed and possibly smaller fiscal stimulus.

Vaccine progress impressive

With regard to positive news on vaccines, the undertaking of manufacturing and distributing vaccines on a global scale is huge and without precedent. The logistics and financing are not straightforward, and it may well take longer than we currently expect. Nevertheless, a degree of optimism is warranted.

On current production plans, it should be possible to inoculate a significant proportion of the world's population next year. 'Herd immunity' may take a bit longer to achieve, and an early return in 2021 to pre-COVID conditions could yet prove wishful thinking.

Stock markets are forward-looking mechanisms, however, and good news on the vaccination front has given investors hope. Under a best-case scenario, the global economy could embark on a broader, more sustainable recovery from the middle of next year. The Organisation for Economic Co-operation and Development (OECD) believes that early vaccine availability could add as much as 2% to world GDP growth in 2021, raising it to 7%.

Shift to Asia

For now, economic forecasts for 2021 for both the domestic economy and the world remain highly uncertain, with low visibility also for corporate earnings. One thing we can be reasonably sure of, however, is that overall 2021 is likely to be a better year than 2020, with more light at the end of the tunnel as the year progresses. The negative short-term economic costs and disruption from the coronavirus do not detract from the longer-term positive case for Australian equities. The global center of economic activity continues to shift away from the US and Europe toward the Asia Pacific region, the Asian middle classes continue their ascent, and Asia leads in many of the new technologies whose adoption the coronavirus has accelerated.

The Regional Comprehensive Economic Partnership (RCEP) trade agreement, for example, points to increasing regional economic liberalisation and integration. These positive secular trends are not being called into question. The Association of Southeast Asian Nations and five other Asian countries, including Australia, signed a deal that will eventually form a free trade area that includes over 30% of the world's GDP today, rising to around 50% by 2030, even without the participation of India. It brings China, Japan and South Korea - the three largest regional economies - under a regional trade deal for the first time.

It is a development with potentially greater longer-term than immediate significance for a highly competitive market economy like Australia. The RCEP economies already have intra-regional trade shares of 50% or more (based on exports), and increased regional integration should see this rise over time. The agreement eliminates tariffs and quotas for 65% of regional trade in goods, with an ultimate target of 90% in 20 years' time. It can be expanded in the future to include other areas such as services, becoming a driver for closer Asian economic integration.

Economy well placed to rebound

Australia's economic recovery is likely to be uneven, and the country is expected to continue to suffer from the drag of strict international border closure for some time yet. With key state and federal elections due in 2023, fiscal policy is not expected to tighten much as the pandemic programmes start to unwind. Also, with the Scott Morrison Government doing well in the polls, an early federal election in 2021 cannot be ruled out, despite the Prime Minister affirming recently that he is a 'full termer'.

Public construction spending on buildings and works in 2020 has followed a strong countercyclical trend, providing an offset to weak private sector spending. The servicing cost of large fiscal deficits is low, thanks to the aggressive monetary easing by the Reserve Bank of Australia (RBA).

The RBA promised not to lift rates until '*wages growth will have to be materially higher than it is currently. This will require significant gains in employment and a return to a tight labour market'.* RBA easing has provided strong support to the Australian housing market, with little forced selling due to COVID-19 thanks to record-low mortgage rates, loan deferrals, JobSeeker income support payments and stamp duty reform in New South Wales that is encouraging more first-time buyers into the market.

We regard the Australian economy as being in as good shape as any of the developed economies. Most companies are seeing activity and profits rebound and Australians, with few foreign travel options, are spending more at home. Australians typically spend more on tourism and foreign travel than other OECD countries as much greater distances dictate longer holiday trips.

The China factor: plus or minus?

China's economy has also largely returned to normal, the only major economy to have done so, and this is good news for Australia, despite increased trade tensions and the cooling in political relations between the two governments. We expect to see strong demand by China for Australia's commodity exports in 2021. While Beijing has imposed trade restrictions and informal bans on a number of Australian exports, demand for Australian iron ore is significantly higher year on year. With the US expected to adopt more measured policies toward China, there is an opportunity for Australia to recalibrate ties also, avoiding further Chinese tariffs.

We see some scope for China-Australia relations to improve rather than cool further.

Investment opportunities: warming to quality cyclical growth

We favour some of the high-quality growth stocks that can benefit from a low-growth, low-inflation and low interest rate world. Companies like medical device manufacturer Resmed, for example, are showing that their business conditions are starting to improve and normalise. We believe the company is well placed to return to strong growth in its sleep apnea business over the next six to 12 months.

There are a number of other quality growth stocks, which we believe are in a similar favourable position to Resmed, such as James Hardie, Seek Group and Aristocrat. In contrast, after the recent strength we have taken some profits on iron ore producers and the materials sector, as we think the best news on China's economic recovery in momentum terms is behind us.

Given the challenges of rolling out the coronavirus vaccine globally, we are cautious toward the market's rotation into lower-quality cyclicals or heavily impacted sectors like travel and question the sustainability of the recent move. For the market, the real story for earnings is more likely to concern 2022 rather than 2021, when investors will be looking for strong, sustainable earnings per share (EPS) growth.

In view of the ongoing risks, we have maintained exposure to some defensive growth names as well as quality cyclical growth. On the positive side, consensus expectations are not too demanding, with EPS growth of just 6% in FY21 following a 20% decline in FY20 (MSCI Australia in US dollars).

Concluding thoughts

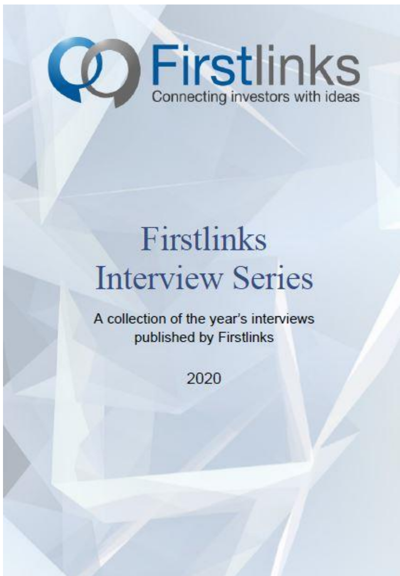
We are cautiously optimistic toward Australian equities in 2021, the only developed equity market that is favoured as an overweight by our global multi-asset colleagues. The Australian share market has supportive valuations (the price to book value ratio is close to its five-year average at 2.0), a decent dividend (trailing dividend yield of 3.2%), while FY20 earnings estimates have bottomed and are being revised higher (three-month change = 2.7%). The market is also less at risk from a small number of highly valued large growth stocks, and returns this year have been more evenly distributed across sectors, including consumer discretionary and communication services.

Randal Jenneke is Head of Australian Equities at T. Rowe Price. This article is general information and does not consider the circumstances of any investor.

Firstlinks 2020 Interview Series eBook

Firstlinks

One of my favourite parts of editing Firstlinks is learning more about products and businesses in our Interview Series.



They are highly popular with our readers as they go beyond the marketing messages to identify investments or styles from leaders in the industry. We often allow the interviewee to mention their own products as readers need to know where to go to find out more. This year's collection of 21 experts covers most asset types and is a window into how portfolios can become more diversified to manage risk.

From the start of Firstlinks (previously Cuffelinks) in 2012, we have focussed on the insights of market experts on investing, superannuation and many social and demographic issues. Our audience now totals about 80,000 Monthly Active Users making over two million pageviews a year. The first year of Morningstar ownership has provided additional resources and distribution reach. Our website includes a searchable archive of over 3,000 articles.

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