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Editorial

Two major decisions by the **Morrison Government** confirm that anyone saving for retirement or a home must make plans in the face of great regulatory uncertainty. One change is already announced, the other is pending.

Almost everyone was taken by surprise in September 2020 when Treasurer **Josh Frydenberg** said the Government would abandon the responsible lending laws. They were a high profile issue in the **Hayne Royal Commission** (remember that?) recommendations, released in February 2019, following evidence that the banks had been lax in their lending practices. Insisting that banks conform with the law led to credit restrictions and a fall in property prices over 2019, but Kenneth Hayne had said in his Final Report:

"If this results in a 'tightening' of credit, it is the consequence of complying with the law ..."

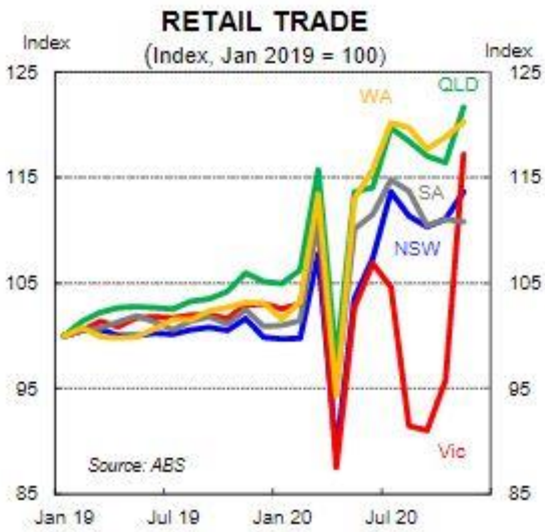
In response, Josh Frydenberg proudly proclaimed that the Government would adopt all Hayne's recommendations. Bank behaviour in not conforming with the law was unacceptable and "*From today, the sector must change, and change forever.*" Now, apparently, those laws are no longer required, which is little comfort to those who missed out on a home in early 2019.

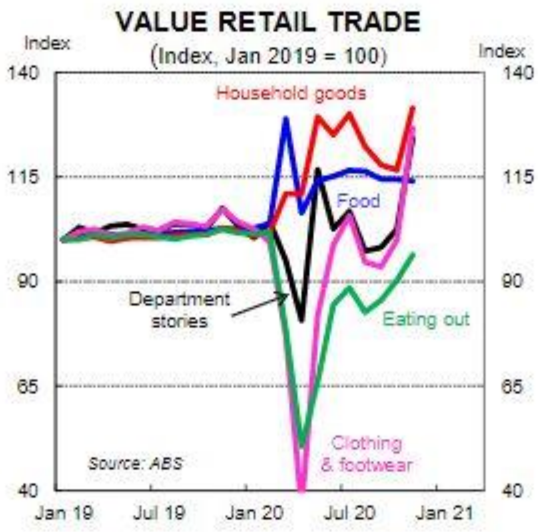
Second, it is doubtful that the compulsory increases in superannuation to 12% (and perhaps even 10% on 1 July 2021) will go ahead. The debate about the trade-off between super and wages has powerful forces on both sides, but the added dimension is a possible 'homes first, super second' policy. It has such broad political appeal beyond first-time buyers. Older people want their children to own a home. So now we hear the Government is considering a choice between pay and super, which sounds like a change in the phrase 'compulsory superannuation'. Minister **Jane Hume** (now in Cabinet) is firmly in the camp arguing super costs workers in their present-day wages.

This new slogan has the same potential impact as the Coalition's 'retiree tax' campaign against Labor's franking credit policy. If it's true that **Scott Morrison** plans to call an election in 2021, expect this super trade-off to feature heavily.

Either way, the rules around saving for a house or retirement change regularly, requiring plans to remain flexible and not build in regulatory assumptions.

Making wealth accumulation even harder is the market uncertainty. On the one hand, retail sales are booming and people are clearly in the mood to spend, even in lockdown. As shown below in charts from CBA, the recovery from the pandemic has been extraordinary.



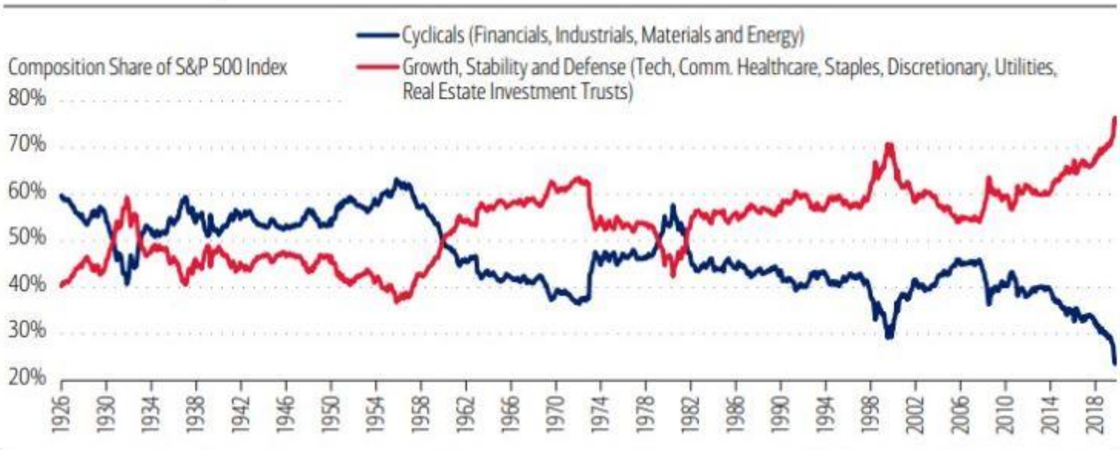


On the other hand, the number of leading global investors issuing dire warnings grows by the day, with Carl Icahn and Jeremy Grantham adding their most severe 'bubble' statements. This week, we reproduce Grantham's paper in full, including:

"The one reality that you can never change is that a higher-priced asset will produce a lower return than a lower-priced asset. You can't have your cake and eat it. You can enjoy it now, or you can enjoy it steadily in the distant future, but not both – and the price we pay for having this market go higher and higher is a lower 10-year return from the peak."

The complication is that today's market has the massive benefit of low interest rates, little inflation and a Fed injecting unlimited liquidity. Even the Biden Presidency now pleases the market, which is ignoring the prospect of higher taxes because they pay for greater stimulus. The reason some fund managers are producing great results and others are terrible is apparent in this chart of the S&P500 since 1929. The market share of cyclicals (financials, industrials, materials and energy) has never been smaller, and index funds buying according to price exacerbate these trends without analysing the investment merit.

Exhibit 3: The Premium On Quality, Yield and Growth Has the Potential To Drive the Market Composition.



Source: Cornerstone Macro. Data of June 18, 2020. **Past performance is no guarantee of future results.**

Ashley Owen charts the sharemarket results for Australian and global companies over the last 12 months, and it's a great pointer to why your portfolio might not have done so well when there is so much talk of a bubble.

As these stock performances feed into managed fund results, some fundies delivered a wonderful 2020 while others suffered. It's a tough gig when you stick to your principles but they don't work. **Emma Rapaport** looks at the **Morningstar** database of 480 flagship Australia funds, and finds the top fund delivered +33% in 12 months while another struggled at -11%. Ouch! 44% is a lot in a retirement savings plan. The trick now is deciding whether to hang on or switch as the results could be the oppositive next year. There's a lot of luck involved.

Speaking of luck, do you own any collectibles? Who hasn't squirreled away a first-day cover, a mint coin, an Olympic pin or a 'collector's edition' of something in a bottom drawer? In a vague hope they will rise in value, they gather dust for decades. What do you do when it's time to clear up and nobody wants them?

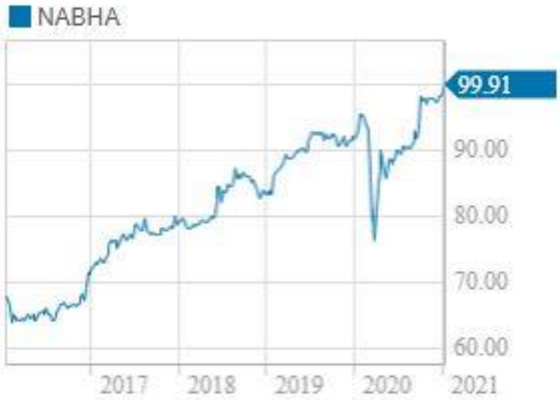
Noel Whittaker has delivered financial advice to millions over his long career. He describes some advice given to a client 30 years ago, and how patience and compound interest has improved her retirement. Just invest and wait.

Leading universities in the US are known for their 'endowment' investing, finding assets which throw off regular income to meet the needs of running their activities. **Rob Holder** explains this style of investing and who it is suitable for.

Those of us for whom rising wealth and income inequality causes disquiet know there is little we can do about it. If the market delivers vast wealth to a few billionaires, if the Fed ramps up asset prices, if a bubble rewards risk, there is not much an individual can do but call out the injustice. However, **Andrew Macken** shows there are ways these movements affect all portfolios and investors can manage the implications of rising inequality.

And repeating, **Jeremy Grantham**'s piece is reproduced in full. It's a long and sober read which one day will prove correct. Grantham has been a bear for many years, and there is always a timing problem for these predictions which ultimately look prescient.

Finally, **NAB**'s decision to redeem its hybrid, NABHA, first issued in 1999, shows how these securities can deliver much higher returns than their margins suggest. Those in the know realised NAB would one day repay $100 for a hybrid which no longer qualified as Tier 1 regulatory capital (from 1 January 2022), and there have been plenty of chances to buy this at a big discount over the last five years, as we wrote in February 2020.



This week's White Paper from the **Capital Group** called 'The long view: investing through adversity' explains how staying invested through periods of volatility has rewarded long-term investors.

What to do when your collectibles become collapsibles

Graham Hand

The media loves the little-guy-made-good stories, where the comic book bought by a kid for a few cents is now worth thousands of dollars. If you had the foresight to buy and hold a 1950 VW Kombi with the prized 23 windows, you have not only enjoyed 70 years of driving (and repairing) but it may now fetch half a million dollars. A pair of Michael Jordan game-worn Nike sneakers recently sold for a sneaker record of US$615,000, while Star Wars action figures produced before 1985 can fetch up to $10,000.

These examples of how a few made a lot create an impression that almost anything old and ‘collectible’ will be bought by someone if the holder waits long enough.

But for every sought-after basketball card, there is a ‘collector’ Olympic pin nobody wants. For every vintage Super Mario video game, there is a ‘collectible’ photo of Shane Warne taking his 300th test wicket sitting idly on eBay. And don’t think your collection of old first-day covers in a stamp album in the attic is a part of your retirement income strategy. With a few exceptions, there is little demand for most ordinary stamp collections as a check on eBay or Gumtree will confirm.

And then there is my once-valuable and loved mint collection of phonecards which only one person in Australia really wants, and that’s not me. More on that later.

Yes, there are many success stories

In all bubbles and manias, popularity initially creates its own momentum. Buyers beget buyers, especially in an age of social media where minor celebrities can have a million followers. But they quickly move on, and so do their fans.

The reason stamp collecting has lost its lustre is that few people send stamped letters. Where once a letter covered in exotic stamps from an uncle or auntie living overseas drove enthusiasm for the hobby, now an email or text is received to celebrate a birthday. Most schools had stamp-collecting clubs which created a buzz, but it's now more likely to be a video game.

Collecting items goes in and out of fashion, and the secret to making money is to stay ahead of the wide adoption and not get caught when the excitement dies down. Two examples of products that have experienced a renaissance are Pokémon cards and Lego.

Pokémon cards from the late 1990s and early 2000s were originally exchanged in schools based on the successful Nintendo video game. It then died, but interest has been revived by leading YouTube influencers taking part in 'unboxings' of sealed cards. During COVID, people have more time to follow these celebrities and jump on the bandwagon. There is also a rumour that Pikachu, a Pokémon character, will be a mascot at the 2021 Tokyo Olympics.

In 2003, the Danish company, Lego, was struggling with massive debts and declining markets when it made a strategic change away from simple bricks for buildings into 'toys-to-life', where action figures relating to movies or games were issued in Lego sets. The most collectible sets are the early Star Wars editions, and an unopened Millennium Falcon from 2007, part of the Ultimate Collector's Series, can now fetch thousands of dollars. Many other Lego classics have also appreciated as part of the overall Lego revival, helped by the television programme, Lego Masters, which is a global hit and a big success in Australia.

Perhaps the most famous of all collectibles, at the point where significance and scarcity meet, is the 1938 Action Comic No. 1, featuring Superman's debut. There are only about 100 surviving copies, and in mint condition, it can fetch over US$3 million. As a sign of its appreciation, sales have been recorded for $US82,000 in 1992, $US150,000 in 1997 and US$2.2 million in 2011.

The rise and fall of the phonecard frenzy

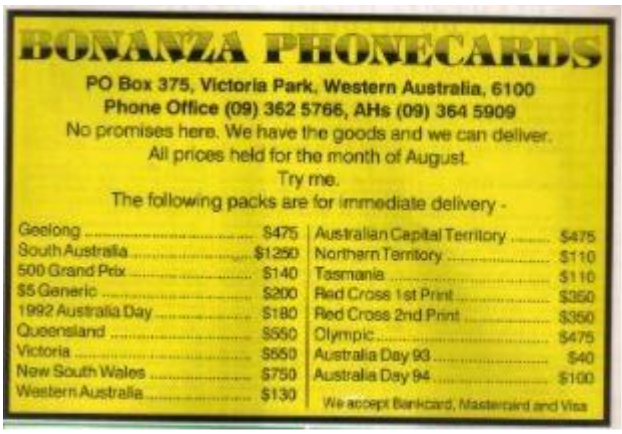
Not all these stories end well financially, but most can end happily.

Telecom (now Telstra) began issuing phonecards to operate their public pay phones in 1989. This was pre mobile phones and while most people with homes had a landline, pay phones on the street were still popular. Some people could not afford their own phone, while renters did not bother with a connection, and it was common to see queues at pay phones as people waited impatiently for others to finish.

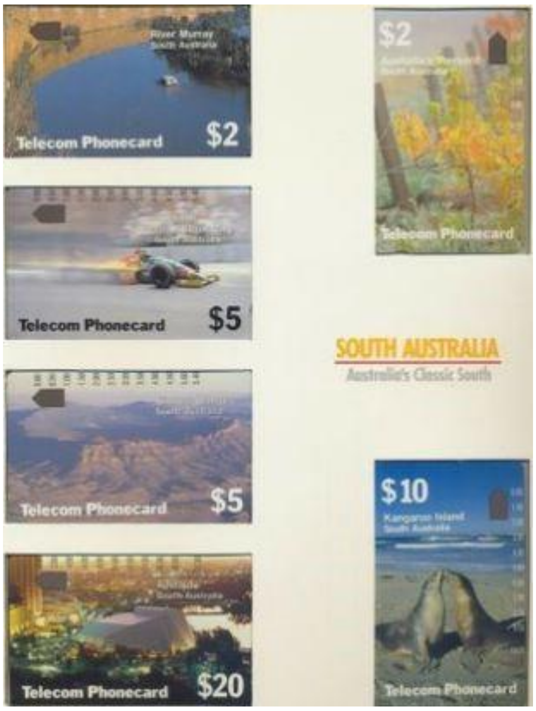
Telecom issued standard, plain phonecards with their simple logo and prepaid values up to $50, but soon realised collectors would be far more interested in editions and series with different themes. Thousands of people started collecting phonecards, used or mint, and it became a lucrative service offered by stamp and coin dealers.

Cards issued in mint packs included sporting heroes, events such as Australia Day and the Grand Prix, state series, and cards issued by companies and organisations – the list was endless. Serious amateur collectors and professional dealers published catalogues of cards and prices, and for a few years, it developed into a serious hobby to rival stamps and coins.

The most prized card of all, as shown below in a price list from 1992, was the South Australia mint pack in the state series. I remember buying it for $90 after walking from dealer to dealer looking for a pack. Most had sold out, and the market went crazy, peaking at over $1,250.



Serious money was being made. Here are the cards in the South Australia pack, with a face value of $44.



I rarely bought in the secondary market, preferring to acquire almost everything that Telecom issued, sometimes in multiple packs, convinced their value would rise as scarce editions sold out quickly. I did not go into the international phonecard game where the range, demand and supply were infinite. Japan in particular had a massive phonecard bubble.

I arranged my cards into neat folders and categories. Now when I think back, I realise I was in my mid-thirties and it's embarrassing to consider how much time the hobby consumed. I was hooked on the thrill of collecting, of obtaining everything, and the future investment potential. My recollection is that I spent about $3,000 on cards (don't tell my wife) which at one stage had at least doubled in value.

I had a lot of fun and I became an expert in Australian phonecards for a few years. A serious collector issued a monthly newsletter which became compulsory reading.

The technology changed by 1998 and pay phones no longer accepted phonecards. The first 1G mobile phone was introduced by Telecom in 1987 (and retailed for $4,250) although the iPhone was not released until 2007. During the 1990s, mobile phones gradually made their way into more hands, reducing demand for pay phones.

The serious collector market for phonecards collapsed from about 1994, and it never came back. Long before then, I had lost interest, and my collection went into the attic. I'd like to say it was a strategic decision to park them until they increased in value, but with my children showing no interest, the cards went the same way as old mobile phones, dated pairs of glasses or souvenirs from an overseas trip. They sit in a bottom drawer, and for some reason, we cannot bring ourselves to throw them out, and they gather dust as the years roll by.

Discovering my phonecard collection again

In my case, for at least 25 years until a few months ago, and I was not even sure where I had stored them. Then we sold our home of 30 years and started clearing out all the storage spaces. And there was my prized collection, neatly wrapped in plastic bags, as good as the day they were minted.

There was no point moving them to our new place, so what was the best way to deal with them? Sell them, of course.

Telstra (ex Telecom) had stopped buying them back 10 years ago. As I looked through them again, I was reminded how much I had spent. Noting that 1993 dollars were worth twice what they are now, many pristine cards held $50 of stored value. I found some of my favourite cards, once treasured with their beautiful presentation boxes and packages. And there was South Australia, itself once worth $3,000 in today's money.

So I hopped onto eBay and Gumtree to check my riches. I knew they had fallen in value, but I did not realise most were almost worthless. South Australia pack for sale at $20, no bids. Mint cards for $2 and $5. Bags of used cards, the lot for $20. No buyers.

And I had hundreds of cards. There was no way I could be bothered listing them and waiting for a bid, or responding to questions, and then posting them to a buyer (if one existed).

I rang a few stamp dealers who once dealt in phonecards. Each said the same. With few exceptions, there was little demand, they were not worth bothering with, the market has collapsed. So much for my precious.

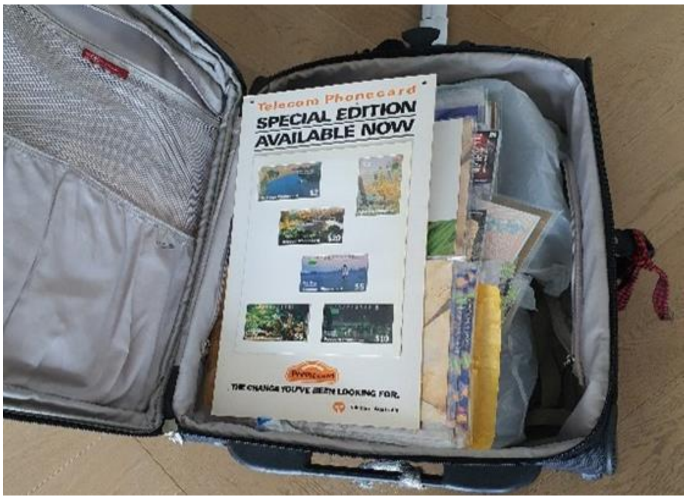
And then along came John Quick, and the solution was right before my eyes.

Forget the money, make someone happy

I could not simply throw them out, and I did not want to take them to our new place and store them for another 30 years.

I Googled 'Phonecard collecting' and the name of the President of the Australian Phonecard Collectors Club (APCC) came up. I emailed John, and he promptly replied, saying that while there are still a few motivated people adding to their collections, prices are very low. He already had an extensive collection but would be willing to pay for cards he was missing. He did not know anybody in Sydney or NSW who was looking for the more common mint packs, and he lived in Adelaide. It would hardly be worth mailing my cards to him in the hope he would buy a few.

Then an idea came to me. Later in the year, I would be attending a wedding in Adelaide. How about I take all my phonecards with me and just give them to him. Gratis. John was happy to meet, indeed, pick me up at the airport, and I would show him my cards over dinner at his place.



Come the appointed day, I packed all my cards into the biggest suitcase I could find. I was amazed at the quantity and weight. It came in at 22kg, a smidgen under the weight allowance for the flight.

At Adelaide Airport, John arrived in his little blue Suzuki to pick me up. He saw my suitcase and carry-on baggage, and pointing to the case, he said:

“Is that what I think it is?”

“Yes,” I replied. “Full of phonecards.”

“Oh dear. My wife will kill me.”

The case filled his car boot and we drove to his house while we had my first chat about phonecards for a quarter of a century. At his home, his wife greeted me at the door with a friendly smile, until she saw the suitcase.

“Is that what I think it is?” she asked.

I soon learned she had tolerated her husband’s collecting for decades while taking little interest in it herself. But they were both mad Port Adelaide AFL supporters, so I pretended I knew what that meant and the ice thawed.

Still, taking out all the phonecards was a shock. I had forgotten how much I had accumulated. We spread them over the dining table, and John was thrilled to see them, as shown below. Like a kid in a lolly shop, I had found the most passionate collector of Australian phonecards in the world.

But then a worrying pattern unfolded. He already owned nearly everything I had brought, and in some cases, I had multiple copies of the same item. He started to pick out a few cards, the ones he wanted, such as hard-to-find cards from a Bowral Tulip Festival. Those he absolutely loved, but had he misunderstood the reason for my trip?

“John, you do realise that I’m giving you all this, don’t you? I didn’t lug 22kg of phonecards from Sydney to Adelaide just so you could pick out a couple.”

His wife looked skeptical. Was she wondering if this was a setup of some type? Did he even want them? I reassured them there was no catch, they could keep the cards with a face value of thousands of dollars for free, to give me the satisfaction of knowing they had gone to a good home.

And so we enjoyed dinner, talked cards and football and he explained how once the APCC served over 300 members doing a thriving trade and holding regular meetings and auctions. Now there were maybe a dozen people seriously involved, including a few with massive collections. Websites are maintained with extensive historical records but it's not enough to generate new interest.

Satisfaction all round, I left everything behind and headed for my hotel.

Over the next few days, John emailed me each day on how much he was enjoying going through my cards. He wrote:

"Sorted through your cards and have put them into order of issue. Am still wrapped to have filled the gap with the Bowral Tulip Festival cards. Have sold a few of your cards to a collector friend of mine. Am sussing out some of the APCC members to see if anybody might be interested in me auctioning off some of your packs early next year. Could you please send me your banking details and any monies I am able to raise. I will happily send you the funds. I'm just so happy that you were prepared to go to so much trouble for me to be given first look at what you had available. As I have said previously, it was a real pleasure meeting you."

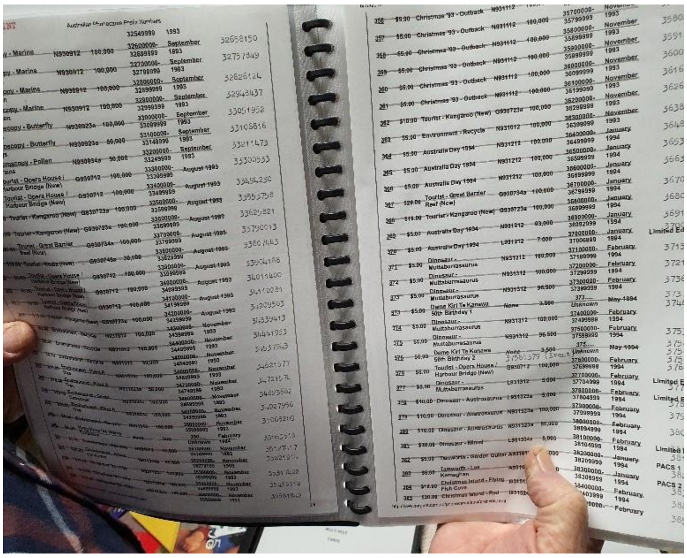
I don't want the money, it was a great result as is.

Are there any lessons about collecting?

Financially, I lost a few thousand dollars, but I enjoyed the thrill of the chase in keeping my collection complete and studying the market. So the first lesson must be that you need to enjoy the actual collecting and not consider it solely as an investment.

Second, however, if it is an investment, watch for signs of interest waning and be prepared to sell, even if you miss the peak. There's a good chance that collectors will move on to another exciting trend, especially when there is little rationale for follow-up demand. Phonecards died because the technology was replaced and people stopped using them. The ability to generate new demand comes with the ongoing Star Wars franchise, the nostalgia for old cars like the Kombi, or the legendary status of Michael Jordan. Stamps are facing the same ignominy as phonecards, although they have 200 years of history to support the hobby.

I ask myself if I collected simply for the pleasure itself or if there was always a money incentive. If I'm honest, there was a financial motivation, and part of my enjoyment was the rapidly-rising value. I made the mistake of assuming the hobby would continue to grow. John is different. He loves the cards and collecting for what they are, and his forensic attention to cataloguing his cards has become a major part of his retirement. He showed me his database and spreadsheets, part of which is shown here, and he clearly lives by a higher calling than my motivations.



And the final lesson is that there is always someone out there who will love your collection more than you do, even if they do not need to pay for it. Find them and make them happy, before Pokémon Go becomes Pokémon Gone.

Compound interest rewards patience in an impatient world

Noel Whittaker

Compound interest - its impact is truly miraculous. For more than 30 years I have been writing and speaking about its power, but do you understand it?

It is slow to start: nothing much happens in the early years. But that's life – anything worthwhile takes time. This applies to getting fit, losing weight, becoming good at your sport, or building a business.

Accept that success takes time

In his book *Atomic Habits*, James Clear talks about "the plateau of latent potential". He likens the plateau to a species of bamboo, which spends its first five years building extensive root systems underground, before shooting 90 feet into the air over six weeks. Just because it sometimes takes longer than we'd like to see the results of our efforts, doesn't mean that our efforts are going to waste.

In fact, most of the important work — the build-up — won't seem like it's amounting to anything, but of course it is.

Any goal we have will take time and effort to accomplish and beginning it will most likely be harder than finishing. But we have to keep going, because habits and hard work compound.

Epictetus tells the story of Lampis the ship owner, who, on being asked how he acquired his great wealth, replied, "My great wealth was acquired with no difficulty, but my small wealth, my first gains, with much labour". Yet the average human being is wired for fast results. This is why many of those who start an investment programme (or fitness programme, dietary change, sport, or business) give up in the early stages. They are discouraged by what they see as lack of progress.

Just be patient and consistent

So, in compounding, you have to wait to see results. Your small, consistent efforts will, if you are patient and consistent, reap great rewards. But the other most important factor that determines how fast your money will grow is the rate of return you achieve. The combination of time and a good rate of return turns small sums into a small fortune.

Over Christmas I was thrilled to receive an email from a woman I first met as a client in 1991 — 30 years ago. Beryl is now 88, and the $20,000 I invested for her in January 1991 into the Advance Imputation Fund is now worth just over $700,000. The fund was run by legendary investor Robert Maple-Brown until his death in 2012.

The numbers are fascinating. If we go to the Stock Exchange Calculator on my website, we find that $20,000 invested in the Ordinaries Accumulation Index in January 1991 would now be worth $337,000. That's a return of 10.23% per annum, which is great by anybody's standard. However, Beryl's fund clearly beat the index. If we run the numbers using my Compound Interest Calculator, we discover that a return of 12.6% per annum would grow $20,000 into $700,000 in 30 years. That 2.37% difference in rate of return almost doubled Beryl's money over the 30 years.

Why have I compared her returns to the All Ordinaries Index? Because the index is available to every investor, irrespective of their financial knowledge, and there is no requirement to pick winners. Some 20% of actively-managed funds do outperform the index long-term. The Catch-22 is that 80% do not beat the index after fees have been taken into account.

So, the problem for investors is finding the outperforming funds. The obvious solution is to consult a good adviser to get advice on funds which suit both your goals and your risk profile. Good advice costs up front, but in the long run it doesn't cost – it pays.

But there is more to financial success than just picking a good selection of managed funds. Beryl's husband is now 94, and they have a large amount of money coming out of a maturing interest-bearing account in a month or so. She was also seeking input from me about to what to do with the maturing money.

Financial planning options

After a long discussion, I pointed out that out that at their stage of life, ease of management is critical. Given their investments are already well diversified for their ages, and they have no chance of getting the age pension, they could simply leave the share trust to keep compounding and draw down on the money in the bank. Hopefully, the share trust will grow faster than their money in the bank would reduce. They could also consider whether to give funds to family members sooner rather than later, updating their wills, and/or increase donations to charity.

Beryl then disclosed that they have eight grandchildren at different stages in their lives. Some are good money managers, and some are at the other end of the spectrum. This was causing them grave concern.

This is where further advice is critical. There will be a large unrealised capital gain on the shares, which could be mitigated if their wills are drafted in such a way that the managed funds go to those grandchildren who intend to keep the funds intact. Testamentary trusts are also an option.

I recommended that Beryl and her husband talk to a solicitor who specialises in estate planning, and involve both their accountant and a financial adviser, to draw up their wills in both a tax effective and a fair manner.

Thanks to compound interest, this couple are facing one of the best problems for any investor to encounter: how best to use and bestow plenty of money. I concluded our phone conversation by reminding her of the Chinese proverb: "Best cashews come when teeth are too old to chew."

Noel Whittaker is the author of Making Money Made Simple and numerous other books on personal finance. noel@noelwhittaker.com.au. This article is genral information and does not consider the circumstances of any investor.

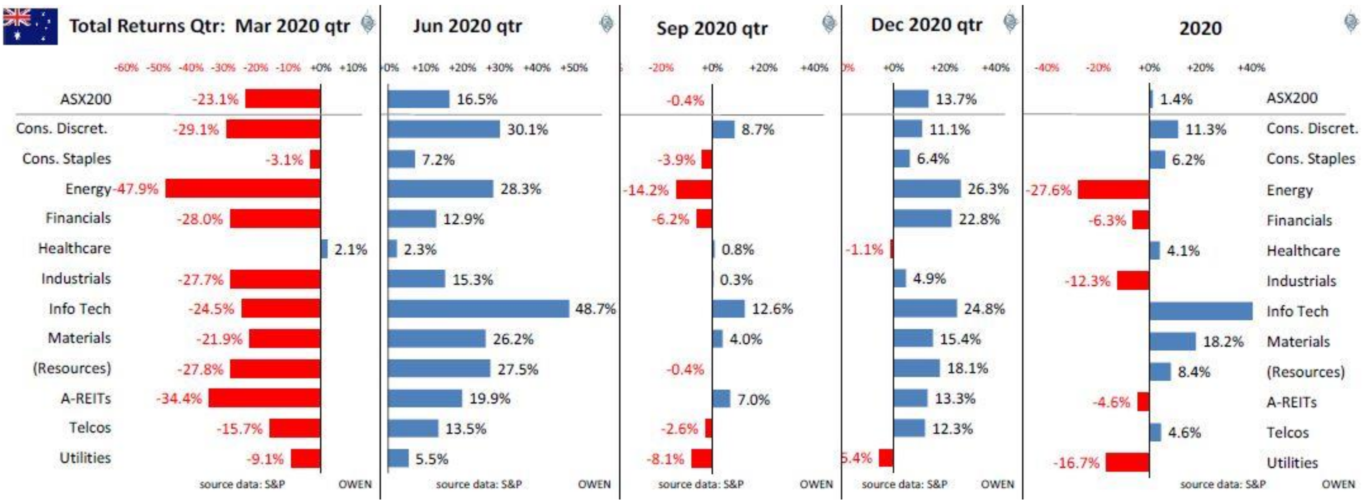
How did you go? Australian and global stockmarket winners and losers

Ashley Owen

Calendar 2020 ended well for shares. Although the coronavirus crisis entered second and third waves in Australia and around the world, there was optimism from:

- the development of vaccines by three different companies
- the US elections that resulted in a Democrat clean sweep, and
- a belief that the worst of the economic contractions are behind us, thanks to huge deficit spending programmes by governments everywhere.

Following are the total returns for the ASX200 index by sector for each of the four quarters, and the full year:



The overall market was back to square in 2020. The best returns for the December quarter were from 'cyclicals' in anticipation of easing of restrictions and economic recoveries:

- the big bank (also boosted by the ending of the dividend cap)
- oil/gas stocks (with oil prices recovering 20% on improved global demand outlooks)
- iron ore miners (on a 25% jump in iron ore prices with strong China demand and more export problems in Brazil)
- other cyclicals including gambling dens (Tabcorp, Star Casino), travel stocks (Flight Centre, Qantas), share registries (Computershare, Link), retail property trusts (Scentre, Mirvac), builders (LendLease, Cimic/Leighton), building materials (Boral, James Hardie, Bluescope), and other cyclicals like Seek (employment), REA (housing)
- tech stocks also continued their boom run (mainly Afterpay, Xero, Wisetech).

The main winners for the year included:

- Businesses that benefited from the lockdowns and welfare handouts, including Wesfarmers (Bunnings, Officeworks) and JB Hi-Fi (benefiting from the home office boom), Domino's Pizza (home delivery), supermarkets (Coles and Woolworths), Carsales.com (people buying cars instead of travel), Goodman (warehouses for the online retailing boom in lockdowns), and healthcare stocks (ResMed, Sonic, Ansell, Fisher & Paykel Healthcare).
- Businesses largely unaffected by the lockdowns, mainly in the tech sector: Afterpay (buy-now-pay-later lender), NextDC (data centers), Xero (accounting software), WiseTech (software).
- Iron ore miners Fortescue, RIO, BHP, benefiting from China's stimulus boom and Brazil mine closures and lock downs.

Worst for the year included:

- Oil/gas stocks – Oil Search, Origin Energy, AGL, Woodside, Santos, Worley (oil/gas engineering) – all of the global oil/gas majors around the world posting big losses after the collapse in oil prices in 2020.
- Insurers such as IAG, QBE, Suncorp – hit by a variety of disasters and crises – including some of their own making.
- Banks – hit by bad debt provisions, margin squeeze from rate cuts, lending demand, and regulatory penalties.
- Retail property trusts – most except Goodman (which owns distribution centers for Amazon and other online retailers) and Charter Hall.
- Construction – LendLease, Cimic (Leighton)
- Miners other than iron ore – most were lower due to the collapse in global demand, production, trade, prices.
- Transport stocks hit directly by the lockdowns – Qantas, Sydney Airport, Transurban, Atlas Arteria Brambles, Aurizon
- Some hit by retaliatory China trade actions – Treasury Wines. A2 Milk, Blackmores.

Global share markets

The leading sharemarkets in 2020 were those that had large weightings of companies in sectors that did well in the lockdowns and welfare hand-outs – mainly online retailing, streaming, gaming, social media, hardware, and essential household supplies.

Conversely, countries with weaker share market outcomes (including Australia) had larger weightings of companies in sectors worst affected by the lockdowns – banks, oil/gas, and retail/commercial property.

This can be illustrated by showing 100 of the largest global listed companies (next page), organised into industry sector groups. Most of these are household names, and most are US companies, as the US makes up more than half of the global share market value.

The US tech giants led the world in 2020, but this is obscured by the fact that they are categorised into three difference industry sectors – 'consumer discretionary', 'technology' and 'communications'.

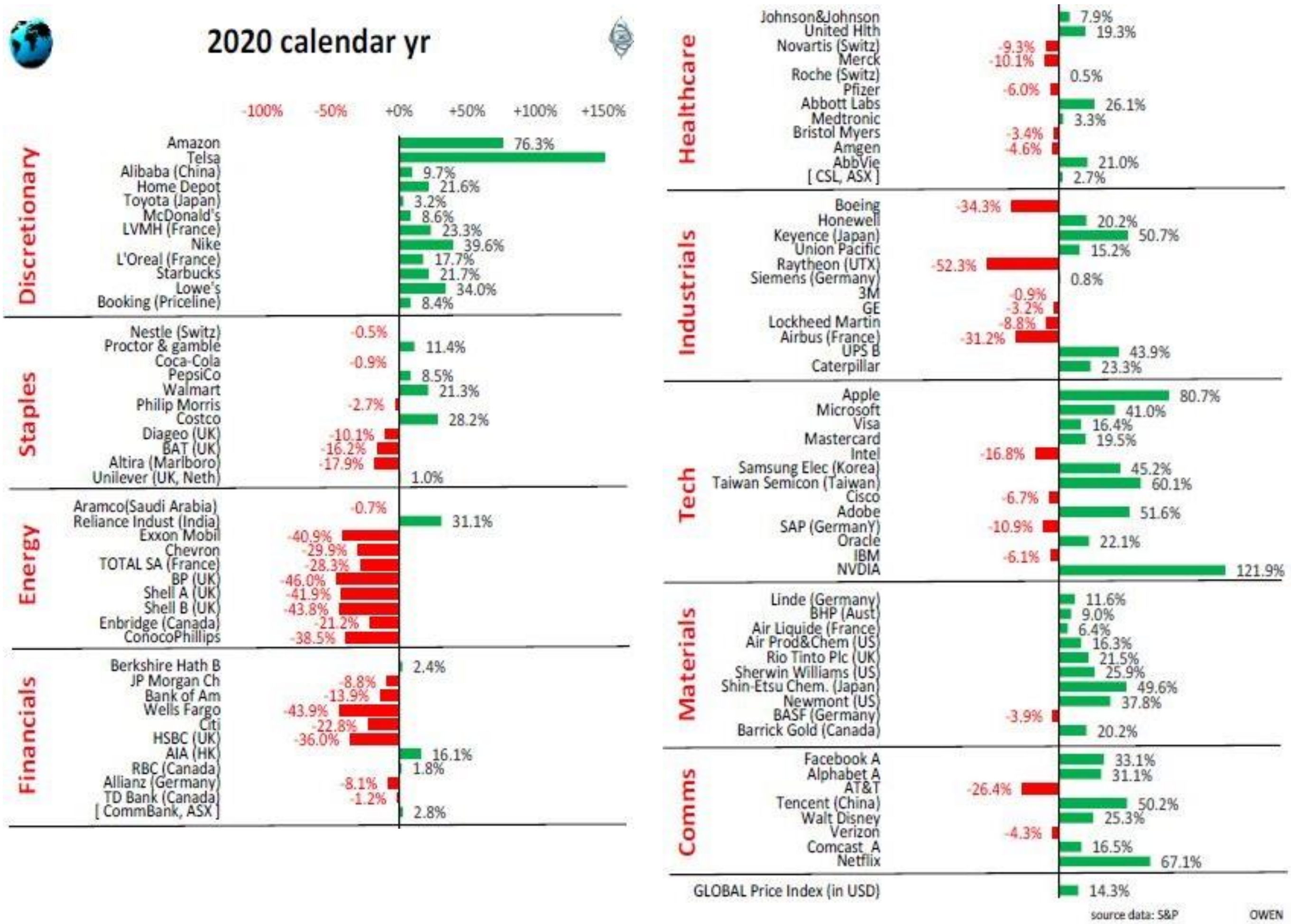
The 'consumer discretionary' sector was led by Amazon +76% for the year. We now also have Tesla +743% for the year (Tesla was added to global indexes only in December, so its impact on indexes in 2020 was limited) US hardware chains Home Depot (the model for Bunnings) and Lowe's also benefited from the home office/renovation boom in the lockdowns.

The 'tech' sector also did well in the lockdowns and welfare sprees, led by Apple, Microsoft, Adobe, Oracle, Nvidia for the US. Visa and MasterCard (classified as 'tech' stocks for some reason) also did well in the online sales boom. Samsung lifted South Korea, and Taiwan Semiconductor lifted Taiwan.

The 'communications' sector has the social media giants Facebook, Alphabet/Google, plus streamers Netflix and Disney for the US, and Tencent for China. However, this sector also contains the old style telcos that dragged the sector down (AT&T, Verizon in the US, as did Telstra in Australia).

The healthcare sector had another good year with most shares up, although the coronavirus crisis partially deprived many firms of their normal revenues. (Australia's CSL doesn't make the global list but is included in the table for reference).

The other winning market was 'Materials'. In most countries, this refers to industrial materials like chemicals and gases, but also miners like BHP and RIO, which were lifted by the windfall spike in iron ore prices and volumes.



'Consumer staples' were mixed – but the winners were Walmart and Costco for the US (likewise, Coles and Woolworths did well in Australia).

'Industrials' were also mixed – airplane makers Boeing (US), and Airbus (France) were down heavily, but UPS (parcel delivery) soared in the online retail boom.

Weighing down the market were 'energy' (oil/gas and coal) –this is where the US market was less affected by the negative oil price shock; and 'financials' (mainly banks) – hit by bad debt provisions, margin squeeze from the rate cuts, and regulatory fines and penalties. (Australia's CBA doesn't make the global list but is included for reference).

The remaining sectors (real estate and utilities) are smaller, with negligible impact on global markets. Australia has the largest real estate sector, and this was also a factor in Australia's below-average outcome in 2020.

Ashley Owen is Chief Investment Officer at advisory firm [Stanford Brown] and The Lunar Group. He is also a Director of Third Link Investment Managers, a fund that supports Australian charities. This article is for general information purposes only and does not consider the circumstances of any individual.

What is endowment-style investing and who should use it?

Rob Holder

In theory, the goals of all investors are founded on the same underlying principle: to maximise returns for the risk that they are willing to bear, or to maximise risk-adjusted returns. In recent years, there have been considerable changes in how professionally managed portfolios are constructed, with many investors implementing larger allocations to alternative assets, a strategy that was pioneered by endowment-type investors.

The best-known example of such an investor is David Swensen, the Chief Investment Officer for Yale University's endowment assets. An endowment portfolio is usually invested to generate continuous income, such as to fund Yale's services, using large allocations to alternative asset classes.

Moving beyond typical stock and bond portfolios

Over time, we have seen considerable changes in the make-up of portfolios as investors have moved beyond typical stock and bond portfolios and introduced alternative assets, such as hedge funds, private markets, direct property and infrastructure. It is this allocation to alternatives, however, that still differs materially between investor types, with the allocation typically increasing as the investment pool increases.

This is true as we move from retail to high-net-worth (HNW) investors and then to UHNW and large endowment pools of capital. The driving force behind the often-low allocation towards alternatives appears to be a lack of familiarity, particularly among retail investors, and liquidity constraints. There are also questions of scale and access to investment opportunities.

Endowment funds, however, now have a long track record of investing with high allocations to alternative assets. We have also identified a reduced home country bias within the equity allocation of endowment-type asset allocations, as investors are able to focus on maximising returns, rather than matching liabilities in their domestic currency.

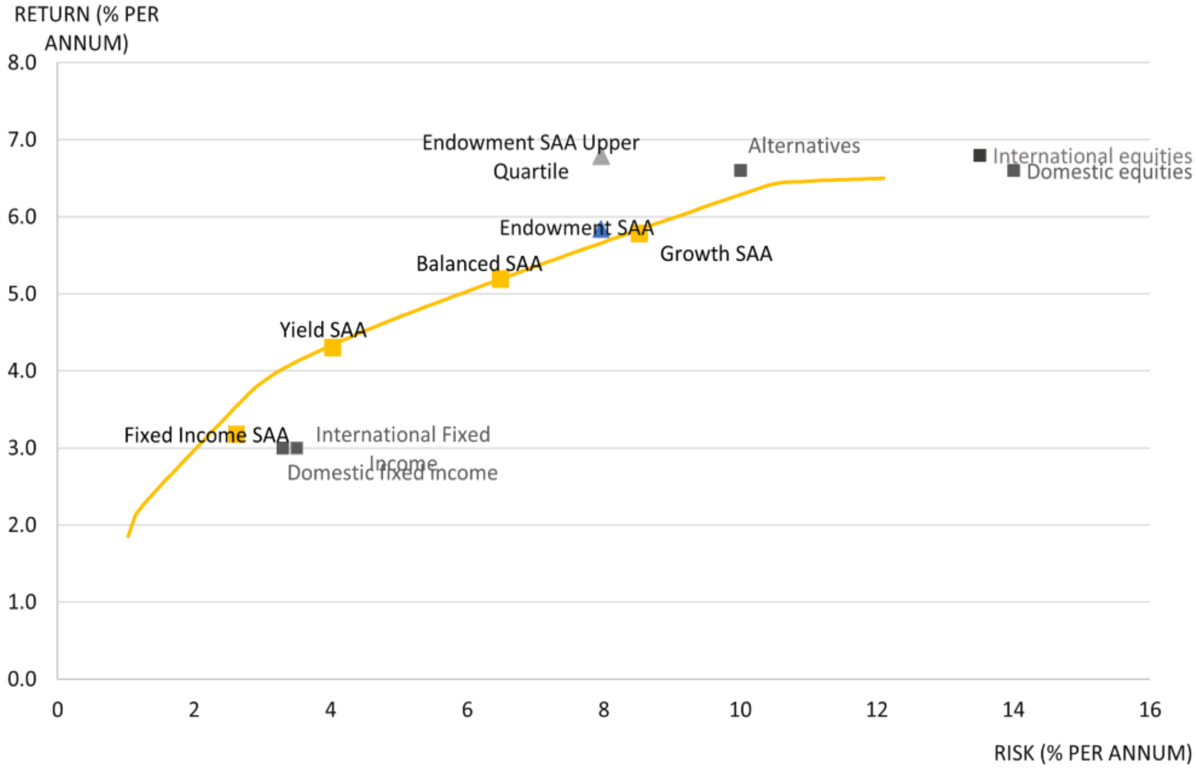
Maximising return for a given level of risk

Crestone's asset allocation process begins with the formulation of five-year forward-looking expectations of return and risk for each asset class, as well as the expected correlations between those asset classes. Quantitative analysis then helps drive the efficient frontier, which is the subset of all possible portfolios, which maximise return for a given level of risk. It is at this stage that we traditionally impose constraints on the types of portfolios that we want to look at. For example, we impose:

- a minimum cash holding to provide some operational liquidity
- a minimum domestic equity holding since most investors have liabilities denominated in Australian dollars, and
- a maximum weight to alternatives to avoid building overly illiquid portfolios.

Asset allocations can then be developed according to the investor's risk tolerance.

The efficient frontier maximises return for a given level of risk



Source: Crestone Wealth Management. Data as at October 2020. SAA is Strategic Asset Allocation.

What happens as we ease constraints?

As we ease those constraints, the model pushes for an increased weight in alternative assets at the expense of other asset classes, and a reduced weight in domestic equities via an increased weight in international markets.

In the case of a growth investor, where the typical cap on alternatives is 20%, the portfolio's allocation to alternatives might move towards 40-50%. This is an uncomfortable level for most investors in what is a comparatively illiquid asset class.

However, some investors, typically those who are unconstrained and have a large pool of capital to deploy, are both willing and able to bear that additional illiquidity and are, therefore, able to construct more efficient portfolios. An increased allocation to alternative assets has a number of advantages at the portfolio level. The imperfect correlation with traditional assets helps to reduce portfolio volatility and the higher expected return helps increase overall portfolio return, thereby improving the expected risk-adjusted returns of the portfolio.

For Australian investors, the second major shift we see as we move towards an unconstrained allocation is a greater holding in international equity markets relative to the domestic market. This is a function of a reduced need for liability matching within the portfolio, facilitating a larger weight to a greater variety of exposures (and therefore return drivers) that are available offshore but not in Australia.

It also allows for a greater allocation to emerging markets, which are expected to be a key return driver in today's low growth environment. However, the correlation of domestic equities with international equities, particularly on an unhedged basis, means that domestic equities will generally hold a greater weight in a portfolio than a simple market cap weight would suggest.

The case for alternatives

Various studies have found that increased allocations to alternatives, as pioneered by some of the large US endowment funds such as Yale, have delivered superior risk-adjusted returns. Our research finds the typical alternatives allocation ranges from 44%-72%, while Frontier research shows that US endowment funds greater than USD1 billion in size have outperformed traditional portfolios by 1-2% per annum on average across various time periods.

The reason behind this outperformance is multi-faceted.

The most obvious improvement in the risk-return outcome stems from the low correlation between alternatives and other assets in the portfolio, which reduces overall portfolio volatility (traditionally used as a measure of risk). There is also a return benefit to be gained from holding less liquid investments, the so called illiquidity premium, which is essentially the return amount in addition to that provided by a liquid equivalent.

For example, part of the outperformance of private over listed equities would be attributed to the fact that private equity is less liquid than the listed equivalent. From a practical standpoint it is also true that alternative markets tend to be less efficient than traditional markets, meaning that there are more opportunities, and greater reward, available to savvy investors.

The potential for outperformance in alternatives is far greater than in traditional asset classes, making it much more important (and rewarding) to be able to identify and access the best managers. BlackRock research shows that manager return dispersion within alternative asset classes is three to five times higher than for traditional asset classes, making the rewards for being able to identify (and access) the top-performing alternatives managers much greater than for traditional asset classes.

There is a higher manager return dispersion within alternative asset classes

Source: BlackRock. Data as at April 2017.

Is an endowment style right for you?

For investors who have the scale, long-term investment horizon and lack of liquidity requirements, it makes sense to implement an asset allocation that can take advantage of a lack of constraints.

However, the ability to identify high quality managers and strategies within the alternatives space is of key importance. Therefore, while adjusting public equity exposures may be relatively straightforward, when implementing an increased weight to alternatives, a more patient approach is required. This experience mirrors that of some of the largest investors, with the Future Fund a good local example. Here, the alternatives allocation currently sits at around 45% but this has progressively been built out over the last 12 years, with just a 10% allocation back in 2008.

Although asset allocation methodologies are generally consistent across investor types, as investors seek to maximise risk-adjusted returns, the optimum asset allocation will vary according to the investor's specific requirements.

By observing how some of the largest investors in the world build their portfolios and by studying the performance outcomes, we find both evidence of these asset allocation skews and that the resulting portfolios have delivered superior performance outcomes when compared to more traditional asset allocations. This suggests that those investors who are able to adopt an endowment-style of investing would benefit from doing so.

Rob Holder is Asset Allocation Specialist at Crestone Wealth Management. This article is general information and does not consider the circumstances of any investor.

The hazards of asset allocation in a late-stage major bubble

Jeremy Grantham

Waiting for the Last Dance

Executive Summary

The long, long bull market since 2009 has finally matured into a fully-fledged epic bubble. Featuring extreme overvaluation, explosive price increases, frenzied issuance, and hysterically speculative investor behavior, I believe this event will be recorded as one of the great bubbles of financial history, right along with the South Sea bubble, 1929, and 2000.

These great bubbles are where fortunes are made and lost – and where investors truly prove their mettle. For positioning a portfolio to avoid the worst pain of a major bubble breaking is likely the most difficult part. Every career incentive in the industry and every fault of individual human psychology will work toward sucking investors in.

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.

Most of the time, perhaps three-quarters of the time, major asset classes are reasonably priced relative to one another. The correct response is to make modest bets on those assets that measure as being cheaper and hope that the measurements are correct. With reasonable skill at evaluating assets the valuation-based allocator can expect to survive these phases intact with some small outperformance. "Small" because the opportunities themselves are small. If you wanted to be unfriendly you could say that asset allocation in this phase is unlikely to be very important. It would certainly help in these periods if the manager could also add value in the implementation, from the effective selection of countries, sectors, industries, and individual securities as well as major asset classes.

The real trouble with asset allocation, though, is in the remaining times when asset prices move far away from fair value. This is not so bad in bear markets because important bear markets tend to be short and brutal. The initial response of clients is usually to be shocked into inaction during which phase the manager has time to reposition both portfolio and arguments to retain the business. The real problem is in major bull markets that last for years. Long, slow-burning bull markets can spend many years above fair value and even two, three, or four years far above. These events can easily outlast the patience of most clients. And when price rises are very rapid, typically toward the end of a bull market, impatience is followed by anxiety and envy. As I like to say, there is nothing more supremely irritating than watching your neighbors get rich.

How are clients to tell the difference between extreme market behavior and a manager who has lost his way? The usual evidence of talent is past success, but the long cycles of the market are few and far between. Winning two out of two events or three out of three is not as convincing as a larger sample size would be. Even worse the earlier major market breaks are already long gone: 2008, 2000, or 1989 in Japan are practically in the history books. Most of the players will have changed. Certainly, the satisfaction felt by others who eventually won long ago is no solace for current pain experienced by you personally. A simpler way of saying this may be that if Keynes really had said, "The market can stay irrational longer than the investor can stay solvent," he would have been right.

I am long retired from the job of portfolio management but I am happy to give my opinion here: it is highly probable that we are in a major bubble event in the U.S. market, of the type we typically have every several decades and last had in the late 1990s. It will very probably end badly, although nothing is certain. I will also tell you my definition of success for a bear market call. It is simply that sooner or later there will come a time when an investor is pleased to have been out of the market. That is to say, he will have saved money by being out, and also have reduced risk or volatility on the round trip. This definition of success absolutely does not include precise timing. (Predicting when a bubble breaks is not about valuation. All prior bubble markets have been extremely overvalued, as is this one. Overvaluation is a necessary but not sufficient condition for their bursting.) Calling the week, month, or quarter of the top is all but impossible.

I came fairly close to calling one bull market peak in 2008 and nailed a bear market low in early 2009 when I wrote "Reinvesting When Terrified." That's far more luck than I could hope for even over a 50-year career. Far more typically, I was three years too early in the Japan bubble. We at GMO got entirely out of Japan in 1987, when it was over 40% of the EAFE benchmark and selling at over 40x earnings, against a previous all-time high of 25x. It seemed prudent to exit at the time, but for three years we underperformed painfully as the Japanese market went to 65x earnings on its way to becoming over 60% of the benchmark! But we also stayed completely out for three years after the top and ultimately made good money on the round trip.

Similarly, in late 1997, as the S&P 500 passed its previous 1929 peak of 21x earnings, we rapidly sold down our discretionary U.S. equity positions then watched in horror as the market went to 35x on rising earnings. We lost half our Asset Allocation book of business but in the ensuing decline we much more than made up our losses.

Believe me, I know these are old stories. But they are directly relevant. For this current market event is indeed the same old story. This summer, I said it was likely that we were in the later stages of a bubble, with some doubt created by the unique features of the COVID crash. The single most dependable feature of the late stages of the great bubbles of history has been really crazy investor behavior, especially on the part of individuals. For the first 10 years of this bull market, which is the longest in history, we lacked such wild speculation. But now we have it. In record amounts. My colleagues Ben Inker and John Pease have written about some of these examples of mania in the most recent GMO Quarterly Letter, including Hertz, Kodak, Nikola, and, especially, Tesla. As a Model 3 owner, my personal favorite Tesla tidbit is that its market cap, now over $600 billion, amounts to over $1.25 million per car sold each year versus $9,000 per car for GM. What has 1929 got to equal that? Any of these tidbits could perhaps be dismissed as isolated cases (trust me: they are not), but big-picture metrics look even worse.

The "Buffett indicator," total stock market capitalization to GDP, broke through its all-time-high 2000 record. In 2020, there were 480 IPOs (including an incredible 248 SPACs) – more new listings than the 406 IPOs in 2000. There are 150 non-micro-cap companies (that is, with market capitalization of over $250 million) that have more than tripled in the year, which is over 3 times as many as any year in the previous decade. The volume of small retail purchases, of less than 10 contracts, of call options on U.S. equities has increased 8-fold compared to 2019, and 2019 was already well above long-run average. Perhaps most troubling of all: Nobel laureate and long-time bear Robert Shiller – who correctly and bravely called the 2000 and 2007 bubbles and who is one of the very few economists I respect – is hedging his bets this time, recently making the point that his legendary CAPE asset-pricing indicator (which suggests stocks are nearly as overpriced as at the 2000 bubble peak) shows less impressive overvaluation when compared to bonds. Bonds, however, are even more spectacularly expensive by historical comparison than stocks. Oh my!

So, I am not at all surprised that since the summer the market has advanced at an accelerating rate and with increasing speculative excesses. It is precisely what you should expect from a late-stage bubble: an accelerating, nearly vertical stage of unknowable length – but typically short. Even if it is short, this stage at the end of a bubble is shockingly painful and full of career risk for bears.

I am doubling down, because as prices move further away from trend, at accelerating speed and with growing speculative fervor, of course my confidence as a market historian increases that this is indeed the late stage of a bubble. A bubble that is beginning to look like a real humdinger.

The strangest feature of this bull market is how unlike every previous great bubble it is in one respect. Previous bubbles have combined accommodative monetary conditions with economic conditions that are perceived at the time, rightly or wrongly, as near perfect, which perfection is extrapolated into the indefinite future. The state of economic excellence of any previous bubble of course did not last long, but if it could have lasted, then the market would justifiably have sold at a huge multiple of book. But today's wounded economy is totally different: only partly recovered, possibly facing a double-dip, probably facing a slowdown, and certainly facing a very high degree of uncertainty. Yet the market is much higher today than it was last fall when the economy looked fine and unemployment was at a historic low. Today the P/E ratio of the market is in the top few percent of the historical range and the economy is in the worst few percent. This is completely without precedent and may even be a better measure of speculative intensity than any SPAC.

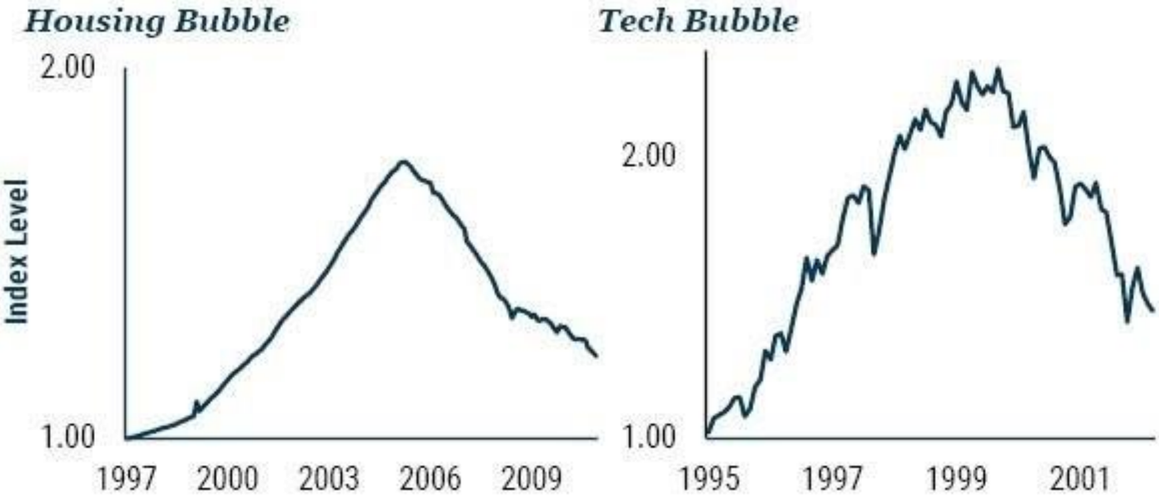
This time, more than in any previous bubble, investors are relying on accommodative monetary conditions and zero real rates extrapolated indefinitely. This has in theory a similar effect to assuming peak economic performance forever: it can be used to justify much lower yields on all assets and therefore correspondingly higher asset prices. But neither perfect economic conditions nor perfect financial conditions can last forever, and there's the rub.

All bubbles end with near universal acceptance that the current one will not end yet…because. Because in 1929 the economy had clicked into "a permanently high plateau"; because Greenspan's Fed in 2000 was predicting an enduring improvement in productivity and was pledging its loyalty (or moral hazard) to the stock market; because Bernanke believed in 2006 that "U.S. house prices merely reflect a strong U.S. economy" as he perpetuated the moral hazard: if you win you're on your own, but if you lose you can count on our support. Yellen, and now Powell, maintained this approach. All three of Powell's predecessors claimed that the asset prices they helped inflate in turn aided the economy through the wealth effect. Which effect we all admit is real. But all three avoided claiming credit for the ensuing market breaks that inevitably followed: the equity bust of 2000 and the housing bust of 2008, each replete with the accompanying anti-wealth effect that came when we least needed it, exaggerating the already guaranteed weakness in the economy. This game surely is the ultimate deal with the devil.

Now once again the high prices this time will hold because…interest rates will be kept around nil forever, in the ultimate statement of moral hazard – the asymmetrical market risk we have come to know and depend on. The mantra of late 2020 was that engineered low rates can prevent a decline in asset prices. Forever! But of course, it was a fallacy in 2000 and it is a fallacy now. In the end, moral hazard did not stop the Tech bubble decline, with the NASDAQ falling 82%. Yes, 82%! Nor, in 2008, did it stop U.S. housing prices declining all the way back to trend and below – which in turn guaranteed first, a shocking loss of over eight trillion dollars of perceived value in housing; second, an ensuing weakness in the economy; and third, a broad rise in risk premia and a broad decline in global asset prices (see Exhibit 1). All the promises were in the end worth nothing, except for one; the Fed did what it could to pick up the pieces and help the markets get into stride for the next round of enhanced prices and ensuing decline. And here we are again, waiting for the last dance and, eventually, for the music to stop.

Nothing in investing perfectly repeats. Certainly not investment bubbles. Each form of irrational exuberance is different; we are just looking for what you might call spiritual similarities. Even now, I know that this market can soar upwards for a few more weeks or even months – it feels like we could be anywhere between July 1999 and February 2000. Which is to say it is entitled to break any day, having checked all the boxes, but could keep roaring upwards for a few months longer. My best guess as to the longest this bubble might survive is the late spring or early summer, coinciding with the broad rollout of the COVID vaccine. At that moment, the most pressing issue facing the world economy will have been solved. Market participants will breathe a sigh of relief, look around, and immediately realize that the economy is still in poor shape, stimulus will shortly be cut back with the end of the COVID crisis, and valuations are absurd. "Buy the rumor, sell the news." But remember that timing the bursting of bubbles has a long history of disappointment.

Exhibit 1: Bubbles – Great while they last



Housing bubble as of 11/30/2011, Tech bubble as of 2/28/2003. Source: S&P 500 (Tech bubble); National Association of Realtors, U.S. Census Bureau (Housing bubble)

Even with hindsight, it is seldom easy to point to the pin that burst the bubble. The main reason for this lack of clarity is that the great bull markets did not break when they were presented with a major unexpected negative. Those events, like the portfolio insurance fiasco of 1987, tend to give sharp down legs and quick recoveries. They are in the larger scheme of things unique and technical and are not part of the ebb and flow of the great bubbles. The great bull markets typically turn down when the market conditions are very favorable, just subtly less favorable than they were yesterday. And that is why they are always missed.

Either way, the market is now checking off all the touchy-feely characteristics of a major bubble. The most impressive features are the intensity and enthusiasm of bulls, the breadth of coverage of stocks and the market, and, above all, the rising hostility toward bears. In 1929, to be a bear was to risk physical attack and guarantee character assassination. For us, 1999 was the only experience we have had of clients reacting as if we were deliberately and maliciously depriving them of gains. In comparison, 2008 was nothing. But in the last few months the hostile tone has been rapidly ratcheting up. The irony for bears though is that it's exactly what we want to hear. It's a classic precursor of the ultimate break; together with stocks rising, not for their fundamentals, but simply because they are rising.

Another more measurable feature of a late-stage bull, from the South Sea bubble to the Tech bubble of 1999, has been an acceleration of the final leg, which in recent cases has been over 60% in the last 21 months to the peak, a rate well over twice the normal rate of bull market ascents. This time, the U.S. indices have advanced from +69% for the S&P 500 to +100% for the Russell 2000 in just 9 months. Not bad! And there may still be more climbing to come. But it has already met this necessary test of a late-stage bubble.

It is a privilege as a market historian to experience a major stock bubble once again. Japan in 1989, the 2000 Tech bubble, the 2008 housing and mortgage crisis, and now the current bubble – these are the four most significant and gripping investment events of my life. Most of the time in more normal markets you show up for work and do your job. Ho hum. And then, once in a long while, the market spirals away from fair value and reality. Fortunes are made and lost in a hurry and investment advisors have a rare chance to really justify their existence. But, as usual, there is no free lunch. These opportunities to be useful come loaded with career risk.

So, here we are again. I expect once again for my bubble call to meet my modest definition of success: at some future date, whenever that may be, it will have paid for you to have ducked from midsummer of 2020. But few professional or individual investors will have been able to have ducked. The combination of timing uncertainty and rapidly accelerating regret on the part of clients means that the career and business risk of fighting the bubble is too great for large commercial enterprises. They can never put their full weight behind bearish advice even if the P/E goes to 65x as it did in Japan. The nearest any of these giant institutions have ever come to offering fully bearish advice in a bubble was UBS in 1999, whose position was nearly identical to ours at GMO. That is to say, somewhere between brave and foolhardy. Luckily for us though, they changed their tack and converted to a fully invested growth stock recommendation at UBS Brinson and its subsidiary, Phillips & Drew, in February 2000, just before the market peak. This took out the 800-pound gorilla that would otherwise have taken most of the rewards for stubborn contrariness. So, don't wait for the Goldmans and Morgan Stanleys to become bearish: it can never happen. For them it is a horribly non-commercial bet. Perhaps it is for anyone. Profitable and risk-reducing for the clients, yes, but commercially impractical for advisors. Their best policy is clear and simple: always be extremely bullish. It is good for business and intellectually undemanding. It is appealing to most investors who much prefer optimism to realistic appraisal, as witnessed so vividly with COVID. And when it all ends, you will as a persistent bull have overwhelming company. This is why you have always had bullish advice in a bubble and always will.

However, for any manager willing to take on that career risk – or more likely for the individual investor – requiring that you get the timing right is overreach. If the hurdle for calling a bubble is set too high, so that you must call the top precisely, you will never try. And that condemns you to ride over the cliff every cycle, along with the great majority of investors and managers.

What to do?

As often happens at bubbly peaks like 1929, 2000, and the Nifty Fifty of 1972 (a second-tier bubble in the company of champions), today's market features extreme disparities in value by asset class, sector, and company. Those at the very cheap end include traditional value stocks all over the world, relative to growth stocks. Value stocks have had their worst-ever relative decade ending December 2019, followed by the worst-ever year in 2020, with spreads between Growth and Value performance averaging between 20 and 30 percentage points for the single year! Similarly, Emerging Market equities are at 1 of their 3, more or less co-equal, relative lows against the U.S. of the last 50 years. Not surprisingly, we believe it is in the overlap of these two ideas, Value and Emerging, that your relative bets should go, along with the greatest avoidance of U.S. Growth stocks that your career and business risk will allow. Good luck!

Jeremy Grantham is a Co-founder, Director and Chief Investment Strategist of [GMO](). The views expressed are those of the author through the period ending January 5, 2021 and are subject to change at any time based on market and other conditions. This is not an offer or solicitation for the purchase or sale of any security and should not be construed as such. References to specific securities and issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations to purchase or sell such securities.

Best and worst performing equity funds of 2020

Emma Rapaport

This is a round-up of the best and worst performing equity funds under Morningstar coverage for 2020. Morningstar fund analysts conduct reviews of over 480 flagship Australian funds, exchange-traded funds and listed investment companies. Data is not available for LICs. Performance of all funds over the calendar year is available via the Morningstar Fund Screener.

Brisbane-based growth manager Hyperion Asset Management has swept several categories after taking strong bets on highly quality tech firms which benefited from the pandemic.

The boutique manager topped three Morningstar categories – Australian Equity Large Cap, Australian Equity Small/Mid cap and Global Equity Large Cap – delivering returns well above the index.

Morningstar senior fund analyst Christopher Franz said Hyperion portfolio managers Mark Arnold and Jason Orthman had a spectacular year, taking positions in companies that thrived from people staying indoors. The managers' global fund features several US megacaps like Amazon, PayPal Holdings, Facebook Inc and Salesforce, while locally it holds sizeable positions in CSL Ltd, Xero Ltd, HUB24 and Domino's Pizza.

"Hyperion's highly concentrated growth portfolios delivered yet again in 2020 across domestic and global markets," Franz says.

"The manager's preference for disruptive structural growth names have long pointed them towards technology, healthcare, and discretionary names, which were either unfazed or quick to recover from the early year selloff and pushed the portfolios to top-decile performance across the board."

Growth managers dominated overall thanks in part to the low interest rate environment and global lockdowns, which fuelled the strength of remote working stocks such as Zoom and Slack, stay-at-home winner Amazon and music streaming service Spotify. The top-5 mega US tech companies – Microsoft, Apple, Amazon, Alphabet and Facebook – now make up over 20% of the S&P 500 Index, with their market share increasing 25% in the first six months of this year. Australian investors were drawn to a local version of growth darlings as names such as Afterpay, Xero and Kogan continued their growth streak.

Style wars

Value managers continued to test the faith of their investors, extending their underperformance. Growth-at-any-price became the mantra for 2020, while traditional value areas of the market such as energy and financials languished. Managers who didn't participate in the strong tech run struggled to outperform even the index.

"Value is a word on many people's lips at the moment, and it's for some been quite a dirty word in investment terms over the last couple of years because so-called value managers have performed pretty poorly," says Morningstar Investment Dan Kamp.

"That's because people have become very enthusiastic about growth stocks, technology stocks, so-called working-from-home stocks that are expected to benefit from the current environment. These were already expensive coming into the pandemic and really the pandemic has just heightened the price of some of these growth, technology, working-from-home stocks."

However, the tide could be turning. If 2016 was a value year, then November 2020 was a value month. While global equities as a whole rose 8.8% over the month, there was a wide disparity between styles: the value index soared 11.1% while the global growth index climbed 6.8%.

Kemp believes that growth is poised to underperform value over the next year as "valuations reassert themselves back to something approaching normality."

Australia Equity Large Cap

Silver-rated Hyperion Australian Growth Companies led the Australian equity large cap category for a second year in a row, delivering a return of 31.90% above the S&P/ASX 200 Index. 2020 has been a banner year for the fund, outperforming the benchmark in both the coronavirus-driven sell-off and subsequent rebound.

Morningstar director, manager research, Michael Malseed says the portfolio managers are willing to look past expensive near-term earnings multiples, as well as any short-term trading weakness, as long as the long-term thesis remains intact. The portfolio is highly concentrated (15-30 holdings) and skews heavily to certain sectors such as technology and healthcare. Major wins for the fund in 2020 include an overweight position in information technology, healthcare and consumer discretionary sectors. Leading contributors to performance included tech firms Afterpay and Xero, fast-food chain Domino's Pizza and global building materials company James Hardie Industries.

Hyperion typically holds no materials and energy stocks, reflecting managers' lack of confidence in the sectors' earnings predictability and pricing power. Hyperion also prefers nonbank financials, with strong organic growth prospects such as Netwealth and Hub24, and since late 2018 has held none of the big four banks.

Hyperion's punchy approach delivers periods of feast and famine however, says Malseed.

"The strategy fell 38.92% in 2008 - worse than the market. It had a peer-beating resurgence of 59.25% in 2009 thanks to sold-down mid-cap names recovering.

"In 2010 and 2011, it was again lacklustre, before stellar returns in each of the following

Sector exposure
Hyperion v Lazard v S&P/ASX 200 (current portfolio)

	Hyperion Australian Growth Companies %	Lazard Select Australian Equity W Cl %	Index %
Basic Materials	6.91	13.25	19.44
Consumer Cyclical	7.27	6.88	7.00
Financial Services	9.62	24.71	27.76
Real Estate	0.00	0.00	6.99
Communication Services	6.61	2.95	4.58
Energy	0.00	19.67	3.75
Industrials	6.25	9.94	7.84
Technology	34.03	6.77	4.40
Consumer Defensive	0.00	9.50	6.17
Healthcare	29.30	1.10	10.67
Utilities	0.00	5.24	1.40

Source: Morningstar Direct

three calendar years, in both absolute and relative terms.

"Though the performance history is undoubtedly top-draw, Hyperion is not immune to mistakes."

Morningstar senior fund analyst Ross Macmillan says [Lazard Select Australian Equity's]underperformance in 2020 can be summed up in two words: concentrated and value.

"It's not a place you wanted to be last year," he says.

"The fund was exposed to coal and energy with investments in Whitehaven Coal and Woodside Petroleum and to AMP. These three were in top ten holdings for most of year."

The Bronze-rated manager returned -10.89% in 2020, underperforming the S&P/ASX 200 index by -12.29%. The portfolio managers run a high-conviction value strategy with a portfolio of just 12-30 stocks, adopting a long-term approach will inherently incur volatile annual returns through the cycle.

"The fund is placed in the first quartile among category peers, over 10 years to 31 Aug 2020, though this disguises an occasionally rocky ride," Macmillan says.

Stock style | Hyperion v Lazard (current portfolio)

Source: Morningstar Direct

"The strategy's value skew saw it struggle in the global financial crisis, falling 35% in 2008, and even though it recovered strongly in 2009, it still landed in the fourth quartile that year. However, the team had a great run from 2011 to 2014 when it outperformed the index and the category average in each calendar year."

Nine of the ten worst performing funds are value-orientated funds.

	Morningstar Category Style	Morningstar Analyst Rating	Total Return 1-Yr ↓	Total Return 2019	Total Return 5-Yr Ann	Total Return 10-Yr Ann
Hyperion Australian Growth Companies	Growth	Silver	33.30	30.61	14.00	13.31
Bennelong Australian Equities	Growth	Silver	23.17	27.34	14.13	12.45
FSI Wholesale Australian Share	Growth	Bronze	22.61	25.99	12.16	10.44
Ausbil Active Sustainable Equity	Blend	Bronze	16.23	27.72		
Platypus Australian Equities - Wholesale	Growth	Bronze	15.77	27.42	12.59	11.22
S&P/ASX 200 TR AUD			*1.40*	*23.40*	*8.73*	*7.84*
Nikko AM Australian Share Concntr	Value	Bronze	-8.59	21.88	3.59	7.03
Investors Mutual All Industrials Share	Value	Bronze	-8.90	14.12	3.11	8.32
Nikko AM Australian Share W	Value	Silver	-8.96	23.63	5.06	6.40
Solaris Australian Equity Long Short Fd	Blend	Bronze	-9.52	21.60		
Lazard Select Australian Equity W Cl	Value	Bronze	-10.89	12.27	5.75	8.30

Source: Morningstar Direct

Australia Equity Small/Mid Cap

Hyperion similarly outperformed its peers and the index in the small/mid cap category. The gold-rated [Hyperion Small Growth Companies] fund returned 33.71%, helped by holdings in Hub24, Pushpay Holdings and Xero.

"The investment process is differentiated by its genuine long-term approach, seeking to identify high-quality companies with enduring competitive advantages that can grow into large total addressable markets over time," Malseed says.

"This approach is well-suited to the Australian small-cap segment and tends to skew towards technology and healthcare names, as well as consumer discretionary stocks."

Portfolio managers have delivered strong long-term performance, achieving top-quartile results over the trailing one-, three-, five-, and 10-year periods.

Investors Mutual WS Future Leaders underperformed the index in 2020 due to its value-style. The strategy was also hampered by stocks calls in sectors particularly impacted from persistent coronavirus restrictions, most notably, prominent holdings in Crown Resorts, Event Hospitality and Entertainment, and Skycity Entertainment.

Morningstar fund analyst Chris Tate, however, notes that Investors Mutual Australia Smaller Companies has delivered exceptional long-term returns, beating the benchmark and peers over a variety of market cycles.

"[The fund] has historically delivered particularly strong performance in down markets, achieving an outstanding downside-capture ratio of around 48% for the 18 years to May 2020," he says.

"However, this downside protection was not evident in the first half of 2020 as it was in past sell-offs."

2020 proved a difficult year for active managers to outperform with an index-tracking ETF featuring in the top 10. Over the 10 years to May 2020, most active managers have handily beaten small-cap indexes.

	Morningstar Category Style	Morningstar Analyst Rating	Total Return 1-Yr ↓	Total Return 2019	Total Return 5-Yr Ann	Total Return 10-Yr Ann
Hyperion Small Growth Companies	Growth	Gold	33.71	30.69	13.41	16.25
FSI Wholesale Australian Small Co	Blend	Silver	24.68	26.38	15.02	11.74
Bennelong ex-20 Australian Equities	Growth	Silver	24.14	25.06	12.45	12.87
Australian Ethical Australian Shr	Blend	Neutral	19.94	27.02	11.36	11.58
Perpetual Wholesale Smaller Companies	Blend	Neutral	17.38	17.52	10.13	9.20
S&P/ASX Small Ordinaries TR AUD			*9.21*	*21.36*	*10.46*	*3.77*
Realindex Aus Small Co-Class A	Value	Neutral	5.05	20.71	11.34	8.78
Investors Mutual Small Cap	Value	Bronze	2.98	11.20	7.37	10.17
NovaPort Smaller Companies	Blend	Neutral	2.07	27.03	7.29	9.89
Investors Mutual WS Aus Smaller Co	Value	Silver	1.71	12.12	6.93	9.42
Investors Mutual WS Future Leaders	Value	Silver	-3.73	9.98	4.95	8.53

Source: Morningstar Direct

Global Equity Large Cap

Hyperion's outperformance extended to overseas markets, topping the global equity large cap category. Managers of the Hyperion Global Growth Companies fund seek high-quality, global businesses with long-term structural growth and have a clear focus on capital preservation and quality of management. A healthy cash stake helped, as did strong absolute performance from top holdings like Amazon.com, PayPal, Alphabet, and Microsoft. Still, the concentrated, 20-stock portfolio isn't for the faint of heart, says Franz.

"The fund maintains significant biases towards technology, discretionary, and non-bank financial names, which push the portfolio to extreme growth multiples relative to the MSCI World Index and world large growth Morningstar Category peers," he says.

"Nearly all the portfolio's holdings carry Morningstar Economic Moat ratings, and its aggregate portfolio profitability metrics (profit margins and return on capital) are far above the benchmark and peer group."

BetaShares Global Sustainability Leaders ETF also featured in the top 10 with a return of 24.92% for the year thanks to large exposures to healthcare and tech stocks and evasion of energy and mining. With oil prices collapsing in the early part of 2020 and climate change concerns accelerating, energy stocks have been among the worst performers – and many of these oil giants have compounded investor pain by announcing dividend cuts.

	Morningstar Category Style	Morningstar Analyst Rating	Total Return 1-Yr ↓	Total Return 2019	Total Return 5-Yr Ann	Total Return 10-Yr Ann
Hyperion Global Growth Companies B	Growth	Bronze	46.05	28.44	22.83	
T. Rowe Price Global Equity (Hedged)	Growth	Silver	34.60	26.75		
Franklin Global Growth W	Growth	Silver	30.60	35.76	17.08	16.45
T. Rowe Price Global Equity I	Growth	Gold	30.51	29.85	17.57	15.65
Capital Group New Perspective Hdg	Blend	Silver	28.11	29.16	15.26	
MSCI World Ex Australia NR AUD			*5.73*	*27.97*	*10.94*	*13.20*
Acadian Global Equity Long Short-Class A	Value	Neutral	-8.40	18.21		
Epoch Gbl Eq Shldr Yld Fd Uhgd	Value	Bronze	-10.75	20.12	4.31	9.63
Robeco Global DM Conservative Eqs	Value	Bronze	-10.87	23.77		
Dimensional Global Value Trust	Value	Silver	-12.38	22.07	5.79	9.32
SPDR® S&P Global Dividend ETF	Value	Neutral	-19.33	20.28	3.92	

Source: Morningstar Direct

Emerging Market Equity Large Cap

GQG Partners Emerging Markets Equity had a spectacular year thanks largely to its stock-picking prowess. The portfolio featured large holdings in some of the year's best performing stocks, including online gaming, e-commerce, and digital payments platform Sea Limited, Latin American e-commerce company MercadoLibre and Chinese alcoholic beverage company Wuliangye Yibin Co.

The gold-rated fund, which is new to the Australian market, looks for companies with a manageable (if any) amount of debt; proven leadership with a record of prudent capital allocation; and a history of weathering tough economic conditions.

"Portfolio manager Rajiv Jain is more interested in steady growth than the firms with the highest growth rates," says Morningstar senior fund analyst Matthew Wilkinson.

"He is willing to pay relatively high prices for top notch opportunities, but if valuations seem excessive for low- or moderate-growth stocks, he turns away."

	Morningstar Category Style	Morningstar Analyst Rating	Total Return 1-Yr ↓	Total Return 2019	Total Return 5-Yr Ann	Total Return 10-Yr Ann
GQG Partners Emerging Markets Equity	Growth	Gold	22.19	22.53		
Capital Group New World Hedged	Growth	Gold	21.04	25.83		
Aberdeen Std Emerging Opports Fd	Growth	Bronze	15.89	18.05	11.17	7.70
Fidelity Global Emerging Markets	Growth	Bronze	14.75	32.02	15.60	
Capital Group New World	Growth	Gold	13.25	27.74		
MSCI EM NR AUD			*7.77*	*18.61*	*11.49*	*6.61*
Realindex W Emerging Markets	Value	Neutral	-2.48	12.82	10.30	
Stewart Investors Glb Emerg Mkts Leaders	Blend	Silver	-3.52	5.55	5.56	6.73
Dimensional Emerging Markets Trust	Value	Bronze	-6.70	10.94	7.86	3.41
Lazard Emerging Markets Equity I	Value	Bronze	-9.25	18.59	7.32	4.22
Robeco Emerging Conservative Equity	Value	Gold	-12.33	15.75	5.91	

Source: Morningstar Direct

Morningstar analysts say Robeco Emerging Conservative Equity's underweight position in tech and China, and overweight position in sectors and stocks that became the losers of the global lockdown, explain the strategy's underperformance.

"While the strategy was expected to deliver downside protection during the corona-driven sell-off in 2020, it failed dramatically and also didn't recover much during the subsequent recovery rally," analyst Jeffrey Schumacher says.

"The fund suffered from negative effects from lower exposure to Tencent, Alibaba and TSMC and from underweight technology, owning Chinese banks and Thai financials and being overweight to lockdown-sensitive, but normally low-beta Brazilian utilities which also suffered from a weak currency.

"Higher allocation to small- and mid-caps versus peers/index hurt performance too."

Emma Rapaport is an Editor at [Morningstar](), owner of Firstlinks. This article is general information and does not consider the circumstances of any investor.

Five ways investment portfolios can prepare for growing inequality

Andrew Macken

Most investors are aware that COVID-19 is accelerating economic forces such as indebtedness, low interest rates and asset price inflation. But there is perhaps less awareness of another powerful trend that COVID is also accelerating: the 'Gilded Age'-style economic inequality that has been emerging in recent decades.

Inequality is an important consequence of our economic system, and we see it becoming more extreme in a post-COVID world.

Growing inequality will lead to slower economic growth, even more indebtedness, increased financial risk, and greater political instability. These are all factors that will have a significant impact on investors' portfolios.

Inequality creates winners and losers. And there are key steps that investors can take to be on the right side of these changes – to not only protect their portfolios from accelerating inequality, but also generate strong investment returns into the future.

The return of the Gilded Age

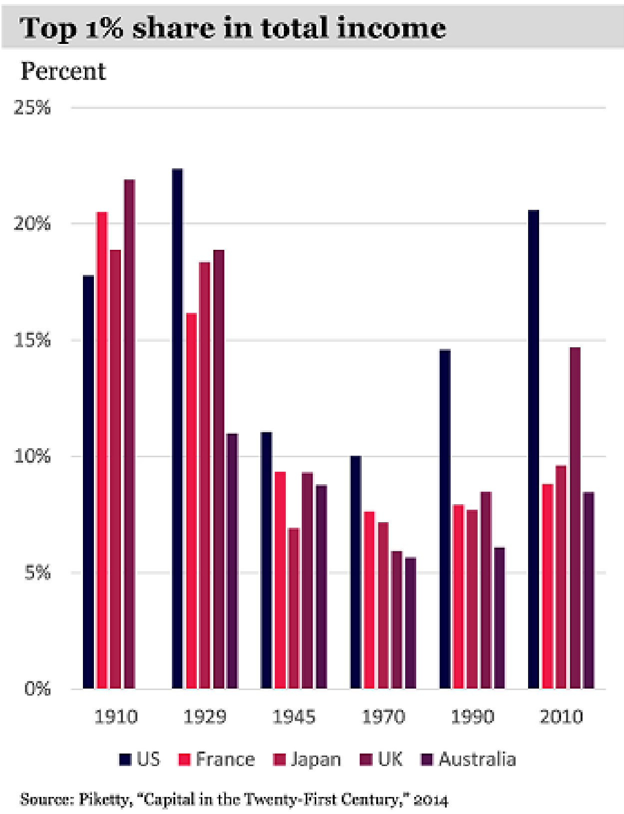
At the start of the 20th Century, the world was in the grip of the 'Gilded Age' as described by Mark Twain. Plutocrats accumulated vast fortunes and economic inequality surged as the top 1% captured a disproportionate share of income from wages and capital.

Following two world wars, this inequality reduced dramatically with higher taxes, weak asset prices, and financial repression by governments. That continued for three generations.

But inequality began to return in the 1980s and 1990s, driven by 'super managers' – corporate executives earning huge wages and bonuses. And we now have a new era of billionaire plutocrats such as Gates, Bezos and Musk. Indeed, some historians are calling our current economic situation the 'New Gilded Age'.

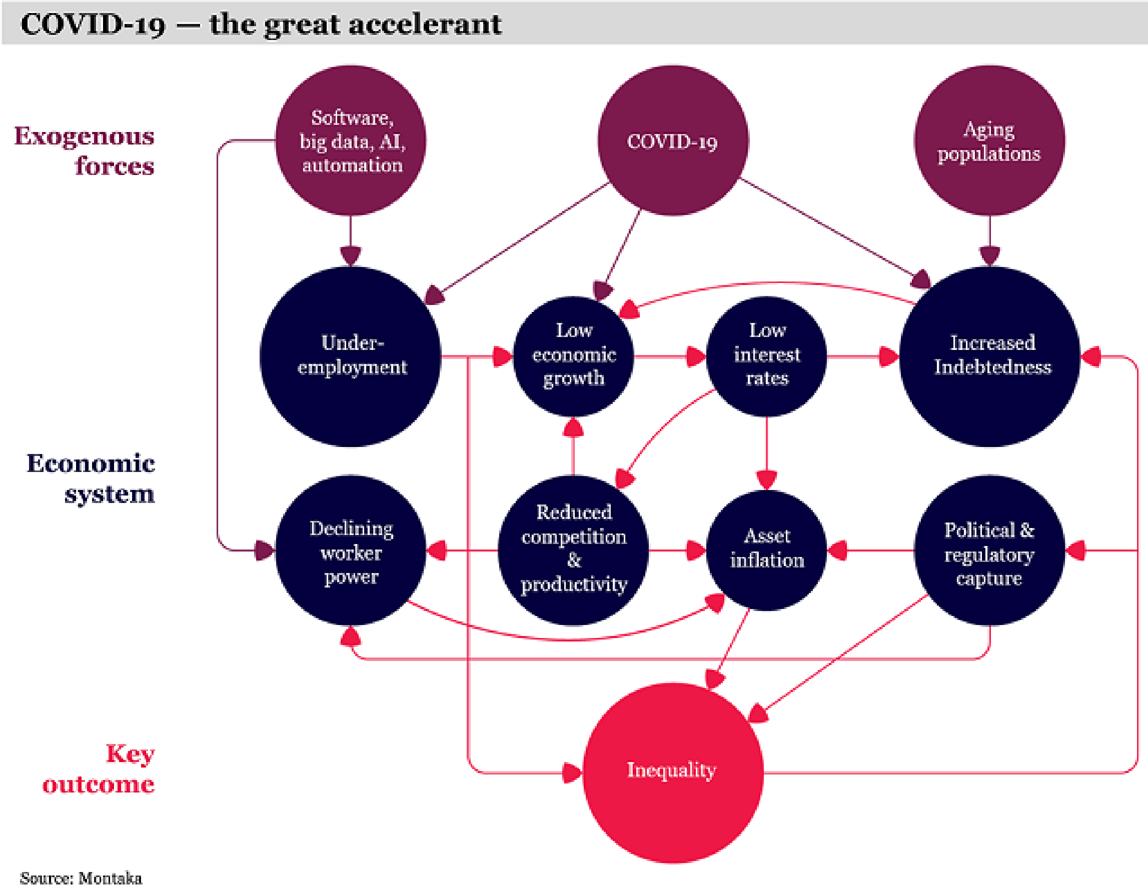
The US has found itself back to pre-WWII levels of inequality. The top 1 per cent capture more than 20 per cent of total income, up from 10 per cent just 40 years ago. What's more, that doubling of income flowing to the top 1 per cent came from the bottom 50 per cent. More recent data from the US Federal Reserve suggests that over 30 per cent of total wealth is attributable to the top 1 per cent in the US.

There is no doubt that inequality is being driven by an economic system in which structural forces such as technology, indebtedness, globalisation and demographics deliver low interest rates, low growth, and asset price inflation.



Other drivers – falling competition and productivity, political and regulatory capture, and declining worker power – are also creating 'feedback loops' that compound the dynamics above.

A natural result of this system is higher inequality, as wealth gains importance and power, while the middle and lower classes struggle to raise their incomes and maintain living standards.



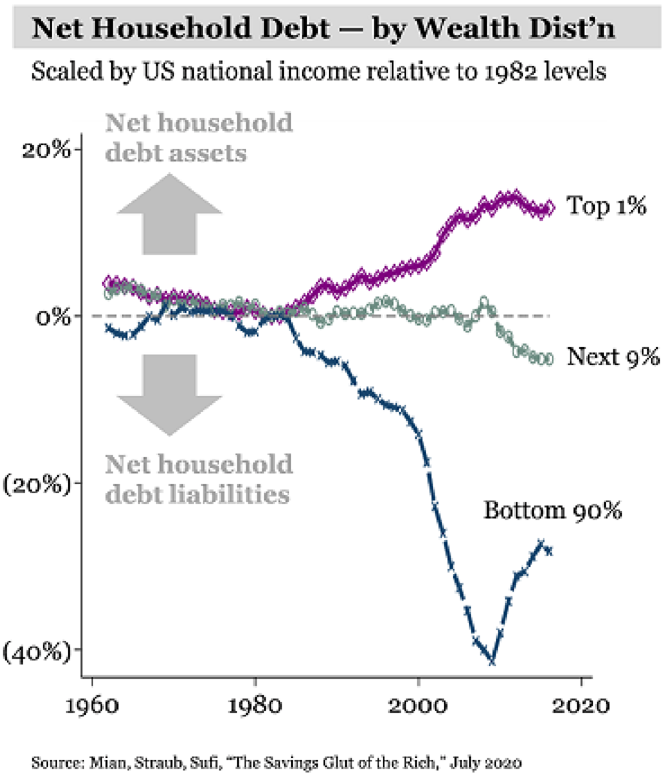
Unpleasant side-effects

Growing inequality is leading to a number of adverse economic and political side effects.

The first is rising indebtedness. The wealthy can't spend all their income, so instead use it to accumulate more assets. The value of these assets, however, is underpinned by the continued consumption of lower income earners – which can only be effected with additional borrowings, given their income stagnation. But should borrowers reduce spending to make payments on their debt, then aggregate economic growth deteriorates.

Inequality heightens financial risk. With lower income earners heavily indebted, this higher leverage exposes the economy to a greater risk of financial crises.

Inequality also increases political instability. The wealthy can use their growing power to influence Government and politicians. It can also cause political parties to ramp up rhetoric that leads to social division.

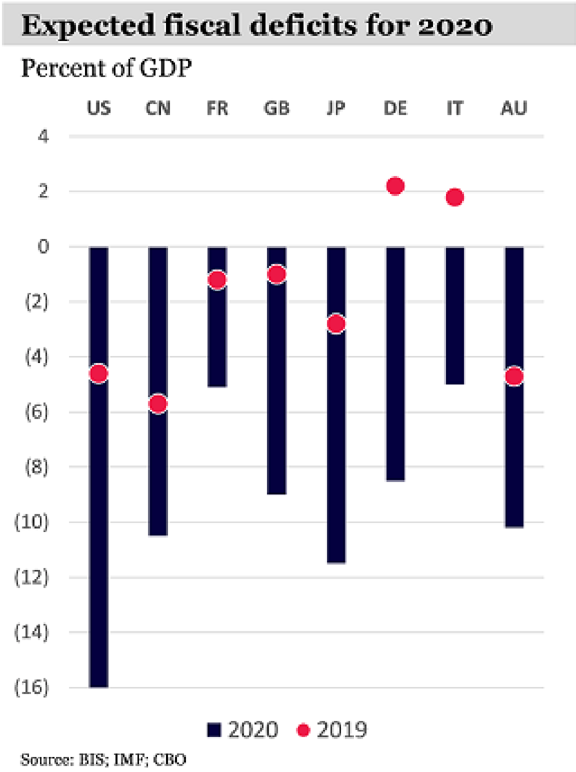


COVID-19 accelerant

Over the long run, we expect COVID-19 to act as an accelerant to an economic system that was already driving inequality higher.

For a start, COVID is disproportionately hurting low-income earners. Between March and July, 2020, 28 per cent of workers in families making less than US$40,0000 a year were laid off, considerably higher than the 13 per cent of workers from families with incomes over $100,000 a year.

COVID is also leading to increased indebtedness – particularly at the government level. Across the board, fiscal deficits for 2020 are blowing out. In the US, for example, the level of deficit spending (as a proportion of GDP) has not been experienced since 1945.



This debt will likely exacerbate the low-growth, low-interest rate environment that elevates the relative importance of wealth accumulated in the past and that exacerbates the political side-effects of inequality.

Five investment implications

So how do investors prepare for a world of growing inequality?

We believe there are five things investors should do to navigate this landscape.

1. Favour equities over fixed income assets

The economic environment described above is perversely favourable for equities (and highly unfavourable for fixed income assets). The most plausible long-term path out of our global mountain of indebtedness is via financial repression.

Financial repression will see real interest rates remain depressed (and likely negative) for an extended period. This is a painful environment for fixed income assets and a wonderful environment for equities.

2. Focus on businesses generating high-quality growth

It is logical to own businesses which can deliver high-quality growth. In the low growth world that naturally results from the current economic system, the most resilient and sustainable growth stories are those which relate to ‘penetration’ or ‘disruption’ of existing large addressable markets, rather than those which derive their growth from the broader economy. The biggest sustainable growth story taking place right now is the digital transformation of the enterprise, in our view.

3. Seek a sustainable data advantage

Investors should own those businesses that have sustainable and growing data advantages and are winning from the new technology this data unlocks. Similarly, those businesses being disrupted by these new forms of technology should be avoided.

Obvious examples of businesses with growing data advantages include Amazon, Facebook and Alphabet. Less obvious examples include Spotify, Blackstone and UnitedHealth.

4. Invest in businesses with wealthy customers

In a time of accelerating inequality, companies with wealthier customers are preferable and more likely to deliver the high-quality growth we seek.

On the consumer side, Apple has demonstrated the enormous value of a relatively wealthier customer base (versus, say, the Android customer base); as has Salesforce and ServiceNow on the corporate/enterprise side.

5. Buy businesses contained in borders

And finally, investors should prefer businesses which are contained within borders, or stable economic blocs.

Higher inequality increases cross-border trade imbalances, and we see a high probability of ongoing economic nationalism, trade disputes, as well as a likely decoupling with China – at least along the dimensions of critical technology and data.

Microsoft dominates the world outside of China in cloud-based platforms and productivity applications, for example. While Alibaba and Tencent dominate the Chinese mainland in cloud, e-commerce, digital advertising and gaming, for example. The cross-border overlap here is favourably minimal.

Prepare your portfolio

There is no doubt that growing inequality is one of the major trends of our era. And it is accelerating post-COVID-19. Inequality doesn't just have social implications, it has economic and investment implications as well.

The Gilded Age eventually ended and after World War II as we entered a new period of equality. We don't know how long this new 'Gilded Age' of growing inequality will continue, nor how it will end.

But investors need to prepare their portfolios to navigate a landscape of low-growth, low interest rates, and rising inequality.

Andrew Macken is Chief Investment Officer at [Montaka Global Investments](). This article is based on a new in-depth Montaka research paper titled [Covid-19: accelerating our journey to inequality]() which can be found at [montaka.com/blogs]()