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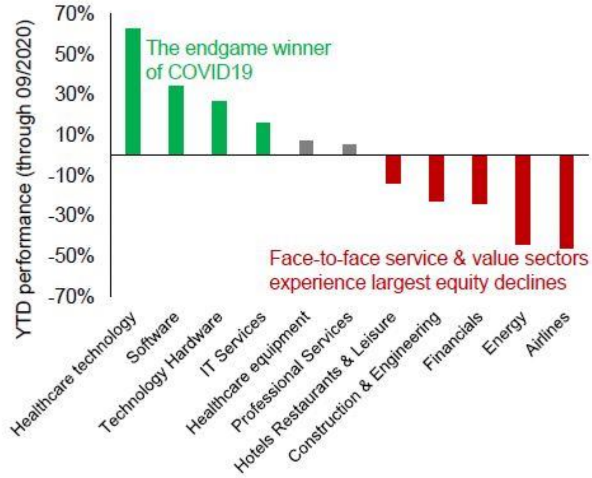
Editorial

There's a favourite phrase that climate change sceptics like to use, that 'the science is not settled'. It's so powerful because it's easy to find a qualified scientist who disagrees with 95% of his or her colleagues. Investing is even worse, because it is more open to personal interpretations and subject to behavioural biases. The science is certainly not settled.

So one minute, a leading investment analyst says we are in a stockmarket bubble and then the next, another reports it's the best conditions for equities ever. Confusing? While there are parts of the market where stocks are priced for perfection, the shares of other companies have struggled. Consider the sectors which have done well during COVID, and those which have lost.

Inter-industry performance has varied significantly

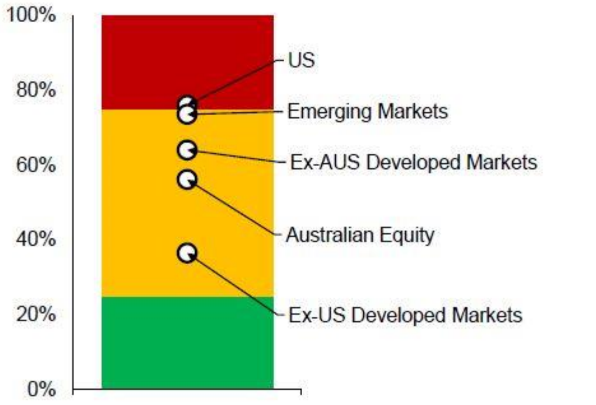


While many US experts such as **Jeremy Grantham** and **Stanley Druckenmiller** are predicting market doom, a leading Australian investor, **Chris Stott of 1851 Capital** told the AFR on 22 February 2021:

"So the data over the next 12 months should look pretty spectacular, some of the best economic prints we've seen for well over a decade if not longer. I think the outlook for the economy today is a lot stronger than what it was pre-COVID. And the sharemarket's still just shy of its pre-COVID peak, so when you marry all that up the outlook for the equity market looks as good as we've ever seen it."

Strong stuff. ***"As good as we've ever seen it"***. Chris invests in Australian stocks, which have not seen as much of the frothy excess of the US. This **Vanguard** chart shows current equity valuations (based on Price/Earnings measures) relative to fair value, and Australia looks reasonable.

International equities valuations are a mixed bag



Notes: Developed market equity valuation measures are the current CAPE percentile relative to the fair-value CAPE for the local MSCI index. The aggregate developed markets valuation measure is the weighted average of each region's (U.S., Australia, U.K., euro area, Japan, and Canada) valuation percentile. The emerging markets and China valuation measures are composite metrics of the relative valuation to the U.S., and current U.S. CAPE percentile relative to its fair value CAPE. Estimated over the period beginning from January 1940 for the U.S., January 1970 for Australia and the U.K., January 1980 for other developed markets, and January 1990 for EM and China, ending December 2020.
Sources: Vanguard calculations, based on Robert Shiller's at aida.wss.yale.edu/~shiller/data.htm., U.S. Bureau of Labor Statistics, Federal Reserve Board, Thomson Reuters Datastream

This week on LinkedIn, **Bridgewater's Ray Dalio** asks the question, 'Are we in a stock market bubble?' and he uses his systemised 'bubble indicator' for a perspective on the US market. He concludes:

"In brief, the aggregate bubble gauge is around the 77th percentile today for the US stock market overall. In the bubble of 2000 and the bubble of 1929 this aggregate gauge had a 100th percentile read ... There is a very big divergence in the readings across stocks. Some stocks are, by these measures, in extreme bubbles (particularly emerging technology companies), while some stocks are not in bubbles ... the share of US companies that these measures indicate being in a bubble is about 5% of the top 1,000 companies in the US, which is about half of what we saw at the peak of the tech bubble."

So when anyone asks if the market is in a bubble, ask which market they are talking about. Take care, for example, with long-term fixed rate bond issues for corporates in the current rising rate environment. Spreads are very tight.

The other complication in assessing value is that many companies are coming out of COVID much better than expected. If anyone should be able to predict the health of corporate Australia, it is the CEO of a major bank, but ANZ's CEO **Shayne Elliott** said this week:

"Look at the results of corporate Australia. It's pretty staggering in terms of profitability. What we didn't count on was the level of government support and the impact of really low interest rates."

As we head into the final days of the February 2021 company reporting season, **Marcus Padley** takes a look inside the frantic world of stockbrokers and their struggle to cope with dozens of companies releasing results each day. He explains why so many broker forecasts tend to a consensus level.

If you think Marcus is exaggerating, consider this chart of broker stock recommendations for the **Dow Jones Global Titans 50 Index** which covers multinational companies in the **Dow Jones Global Indices**. The companies are overwhelmingly listed in the US, and many are the tech companies identified as driving a bubble. Look at the Consensus Summary columns. Of the 50 companies in the so-called bubble market, only 12 have a sell recommendation across the six biggest brokers making 300 recommendations. 'Holds' are more common but both are overwhelmed by 'buys'. What generates such optimism?

ANALYSTS' RECOMMENDATIONS						CONSENSUS SUMMARY		
Goldman Sachs	CITI	UBS	J.P. Morgan	Morgan Stanley	Credit Suisse	BUYS	HOLDS	SELLS
BUY	BUY	BUY	BUY	BUY	BUY	6	0	0
BUY				BUY		2	0	0
BUY	BUY	BUY	BUY	BUY	BUY	6	0	0
BUY	BUY	1 HOLD	HOLD	SELL	BUY	3	2	1
SELL	BUY	HOLD	BUY	BUY	HOLD	3	2	1
HOLD	BUY	BUY	BUY	BUY		4	1	0
SELL	1 BUY	BUY	BUY	BUY	BUY	5	0	1
BUY	BUY	HOLD	BUY	BUY	HOLD	4	2	0
BUY	HOLD	BUY	1 BUY	BUY	BUY	5	1	0
BUY	BUY	HOLD	HOLD	BUY	BUY	4	2	0
BUY	BUY	BUY	BUY	BUY	BUY	6	0	0
BUY	HOLD	BUY	BUY	BUY	HOLD	4	2	0
BUY	HOLD	BUY	BUY	BUY	HOLD	4	2	0
BUY		BUY	HOLD	BUY	BUY	4	1	0
BUY	HOLD	BUY	BUY	HOLD	BUY	4	2	0
HOLD	HOLD	HOLD	HOLD	BUY	HOLD	1	5	0
BUY	HOLD	HOLD	BUY	BUY	BUY	4	2	0
BUY	BUY	BUY	BUY	BUY	BUY	6	0	0
BUY	BUY	BUY	BUY	BUY	BUY	6	0	0
		1 BUY	1 BUY			2	0	0
BUY	BUY	BUY	BUY	BUY	BUY	6	0	0
BUY	HOLD	HOLD	HOLD	HOLD	SELL	1	4	1
	HOLD	HOLD		1 HOLD	BUY	1	3	0
SELL	HOLD	BUY	BUY	BUY	BUY	4	1	1
BUY	BUY	HOLD	HOLD	BUY	BUY	4	2	0
BUY	HOLD	HOLD		SELL	BUY	2	2	1
HOLD	HOLD	BUY	1 HOLD	BUY	BUY	3	3	0
BUY	BUY	BUY	BUY	BUY	BUY	6	0	0
BUY	HOLD	BUY	BUY	BUY	BUY	5	1	0
HOLD	BUY	BUY	BUY	BUY	BUY	5	1	0
BUY	BUY	BUY	BUY	BUY		5	0	0
BUY	BUY	BUY	BUY	BUY	BUY	6	0	0
BUY	BUY	BUY	BUY	BUY	HOLD	5	1	0
BUY	HOLD	BUY	BUY	BUY	HOLD	4	2	0
BUY	BUY	BUY	SELL	1 BUY	HOLD	4	1	1
Restricted	BUY	BUY	BUY	Restricted	BUY	4	0	0
SELL	HOLD	HOLD	1 BUY	HOLD	BUY	2	3	1
BUY	BUY	HOLD	BUY	BUY	BUY	5	1	0
HOLD	HOLD	HOLD	HOLD	1 HOLD		0	5	0
BUY	BUY	HOLD	BUY	BUY	HOLD	4	2	0
1 BUY	BUY	HOLD	HOLD	BUY	HOLD	3	3	0
BUY	BUY	HOLD	BUY	BUY	BUY	5	1	0
	SELL	BUY	BUY	BUY	BUY	4	0	1
BUY	SELL	BUY	BUY	1 BUY		4	0	1
		1 BUY				1	0	0
BUY	BUY	HOLD	HOLD	HOLD	HOLD	2	4	0
					BUY	1	0	0
1 BUY	BUY	BUY	BUY	BUY	BUY	6	0	0
BUY	HOLD	HOLD	HOLD	1 BUY	BUY	3	3	0
BUY	BUY	BUY	BUY	HOLD	BUY	5	1	0
BUY	SELL	HOLD	SELL	BUY	HOLD	2	2	2
BUY	BUY	SELL	HOLD	SELL	BUY	3	1	2
BUY	BUY	HOLD	BUY	BUY	BUY	5	1	0
BUY	BUY	BUY	HOLD	BUY	BUY	5	1	0
1 BUY	HOLD	HOLD	BUY	BUY	HOLD	3	3	0

Drawing out this theme of Australian versus US equity performance, **David Bassanese** explains why the markets differ, the impact of currency and which he expects to perform best in future.

Then **Reece Birtles** pitches in with his take on 'value versus growth'. It's another example of the stocks left behind in the rally, and the cycle is already showing signs of turning. Value's time in the sun will come.

A major change in the investing landscape hit the markets in 2020 with the rapid increase in participation by younger investors. **Gemma Dale** documents the trend including what they are investing in, and it's not what most people assume. The newbies have started well on the investing journey.

Back to the US success stories and the big tech stocks, **Ishan Ghosh** makes a surprising claim that their exceptional performance is not unusual compared with big companies of the past, and in fact, many large US tech companies have done poorly over the last year. So those themes we think are running hot are harder to pick than we might think.

Rachel Lane is a leading policy influencer in aged care, and she explains the changes needed to a poor system. Anyone who has been through the tedious detail will sympathise.

And **Alastair MacLeod** focusses on a problem facing many people, especially retirees, that their 60/40 portfolio is dragged down by low bond rates, and he suggest alternatives in 'defensive equity' strategies.

In this week's White Paper section, something different with a new podcast recording with **Hamish Douglass of Magellan**. He speaks to **Morningstar** in the US on their **The Long View** programme about how Magellan started and how he builds compounding portfolios.

And the **Facebook** thing? I didn't realise so many people receive their news via a social media feed. And don't the news organisations post their content and links onto Facebook so more people will read them? That's what Firstlinks does and we benefit from traffic directed back to our website, so it's not clear to me why Facebook should pay for it.

I'm old school in paying subscriptions for news I want, reading the website, app or newspaper directly. For Firstlinks, only 2% of our users come through social, with 98% of readers directly accessing through our website, the newsletter, search or referrals. We have developed our direct audience for nearly 10 years and do not rely heavily on Facebook. Treasurer **Josh Frydenberg** was speaking as if the only way to view web sites was via Facebook when he said on Channel 7's Sunrise about his call to **Mark Zuckerberg:**

"We spoke yesterday morning and I expressed my deep disappointment as to what Facebook had done ... we view those actions yesterday as unnecessary, as heavy-handed, as wrong and as damaging the reputation of Facebook here in Australia. To restrict access to the New South Wales Fire and Rescue or to restrict access to the Royal Children's Hospital or other important sites, is very problematic and it was a heavy-handed tactic."

Restrict access? Does Facebook control access to web sites? Don't people know how to find web sites on the internet? We welcome any comments on this issue ... what proportion of the news you read or watch do you receive on Facebook?

Dog-eat-dinner: a tough day in the life of a broker analyst

Marcus Padley

As we end the February results season spare a thought for those poor but highly paid broker analysts.

The job of a broker analyst is to scrutinise stocks, and during results season, when a company's announcement drops, the sooner they do it, the better. Here's why February is purgatory for them, and why you should know what they are doing.

First in, best dressed with broker commissions

In order to be competitive, at the very least, on the announcement of an important company result, the big broker analyst must immediately read the announcement and hit the biggest institutional clients straight away. A crisp and accurate analysis is essential, including an action recommendation that hopefully generates an order that makes both the broker and the client look very clever, very quickly.

Analyst bonuses are based on a few KPIs. The first is corporate fees from the companies they cover. The next is market share compared with all the other brokers of trades in the stocks they cover - when a company choses a broker to do a corporate deal, the first thing they check is the market share in their own stock to identify the broker most engaged in their stock. Generating orders is the daily bread and butter but getting a corporate deal is the cherry on top.

A quick update to the dealing desk, then the world

On top of that, the big broker analyst must verbally brief the whole of their dealing desk with a similarly accurate, informed and hero-making opinion. Their dealers can then disperse the view rapidly down the phone lines in the pursuit of even more first-mover inspired salary-justifying orders.

And all before the competition do the same thing.

Next, the analyst tunes into the conference call with the company, furthering their own personal brand and that of the broker through the teleconference protocol which includes stating your name and institution and asking brilliantly insightful questions you already know the answers to. Your future employers, who are almost certainly listening, might also be impressed. Then, in less than half an hour, the analyst issues a written summary of the results that further carries their brand and brilliance to the inboxes of the entire industry.

At the same time, if they want to remain employed, their opinion mustn't jeopardise any relationships their broking house might already have with that company and, if you know which side your bread is buttered, actually furthers the relationship with the company ... just in case they have a corporate deal paying healthy fees sometime in the future.

And finally, amid the constant barrage of client and dealer questions and even a visit or two to the biggest clients' offices, these analysts write a fresh and original 20-page piece of research for the next day's morning note that 'stands out' from the other broker research. It must be proofed and submitted by the research editor's deadline somewhere between closing time on the day of the announcement and 4am the next morning.

Dinner's in the dog

That's if the analyst only has one result a day. Some analysts are responsible for two or three company announcements a day. On the biggest day of the results season, there are 20 Top 200 company results all of which must be digested, analysed and regurgitated before the research is sent out at 6am.

Good luck getting home that day, week, month. "Dinner's in the dog" is a great 'Welcome Home' post-it note when you're busting your arse bringing home the bacon. Tough stuff.

But before you pull out your violins, imagine doing all that and getting it wrong. Imagine what it's like for an analyst running with a buy recommendation when the results are terrible, or a sell recommendation when the results are great. There's standing out and there's standing out for the wrong reasons. Get it wrong and you'll be pushing research out at 4am in a cloud of shame. Your dealer group will abuse you for their lost goodwill, the corporate department will send you to Coventry (or worse) forever. The clients will drop you for your lack of value and your competitors, and potential employers, will rejoice in your misfortune and tear up the CV your headhunter just sent them.

Is it any wonder forecasts hug the consensus? In a broker-eat-broker world just remaining a broker is sometimes reward enough. Survival is a bonus. Success is rare.

So spare a thought for the brokers as you read the research this February. You have the luxury, in the clarity of the morning, on a full stomach, after a good night's rest, with the power of hindsight, in the context of multiple opinions, of casting judgment on a professional, under a lot of pressure, with an empty stomach operating at 4am in the morning whilst their dog sleeps at home, bloated by a well-done rump steak.

They're a tough breed those broker analysts, in a dog-eat-dinner world.

Marcus Padley is the author of the daily stock market newsletter Marcus Today and the Co-Manager of the Marcus Today Separately Managed Accounts. To invest with Marcus or sign up for his newsletter, see marcustoday.com.au.

What drives Australian versus global equity performance?

David Bassanese

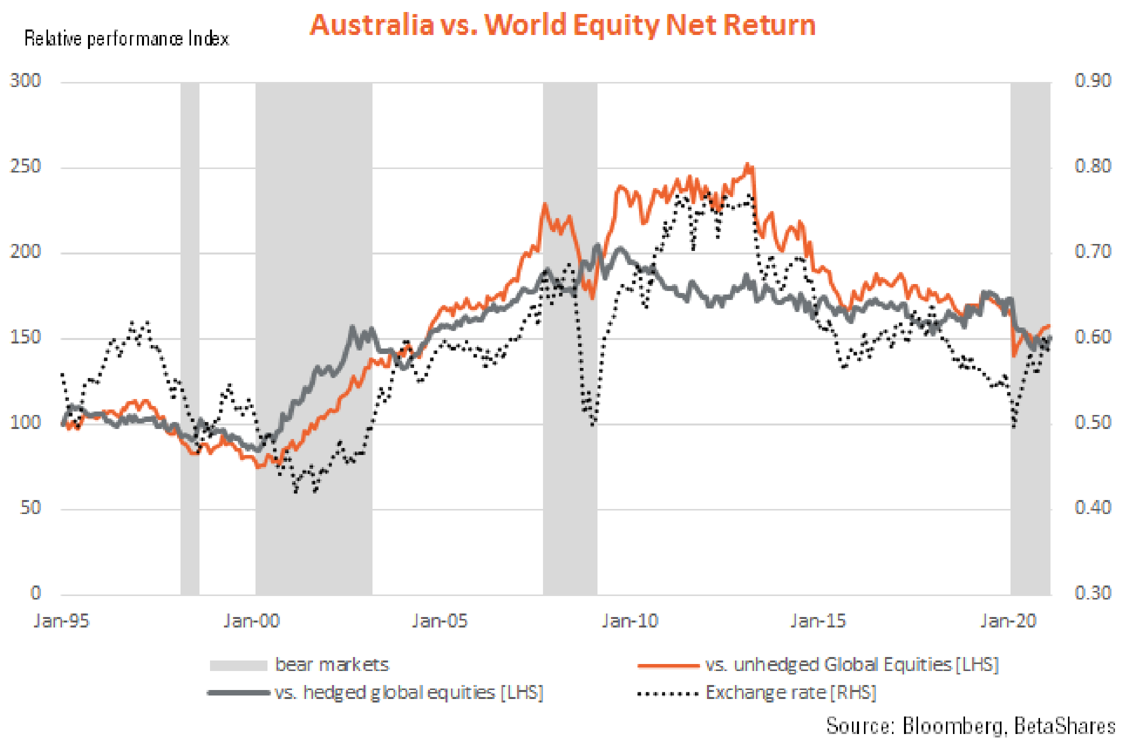
Australia's equity market performance versus global markets has waxed and waned over recent decades. A key driver of relative performance has been global sector performance, in particular, technology versus mining stocks.

Long-run trends in equity market performance

As the chart below shows, Australian relative equity market performance has been through several marked cycles in recent decades. In the late 1990s, the local market tended to underperform. It then enjoyed a sustained period of outperformance from the bursting of the global dotcom bubble in 2000 until the end of the GFC in late 2009. Since the GFC, the local market has once again tended to underperform.

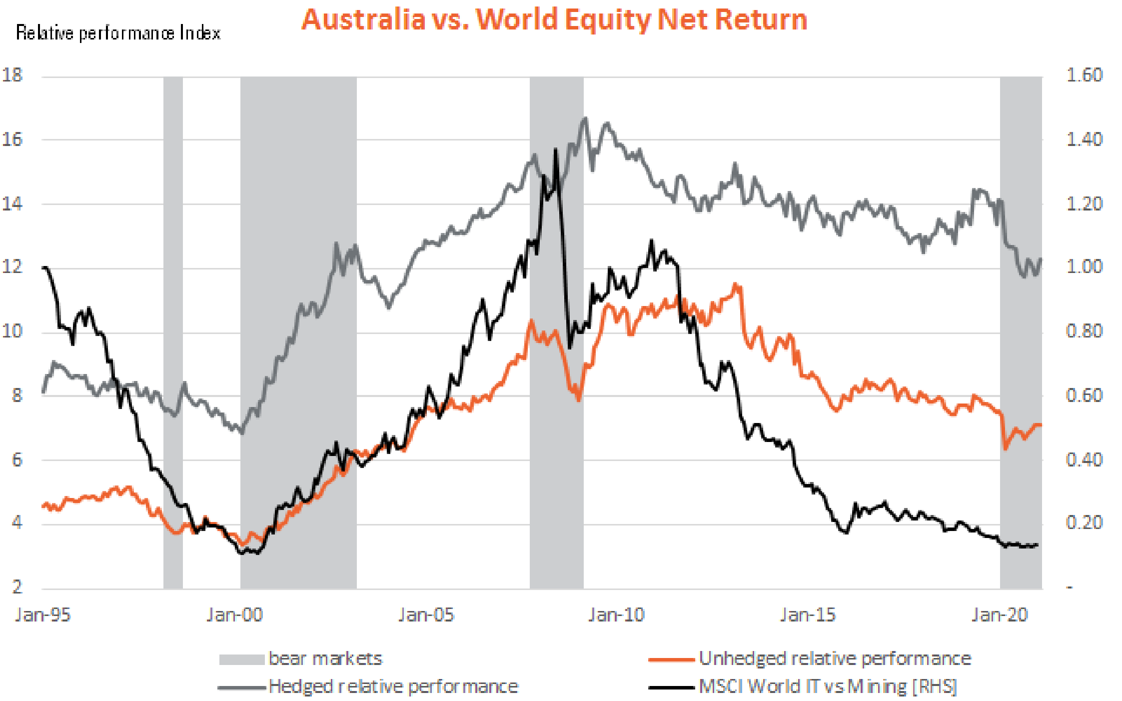
Note, moreover, the swings in relative performance historically have tended to be a bit wider versus *unhedged* global equities than versus *hedged* global equities. That's because when Australian equities have been outperforming, the Australian dollar has also tended to rise. This has detracted from global equity returns in unhedged, $A terms.

By contrast, when Australian equities have been underperforming, the Australian dollar has also tended to fall, which has added to global equity returns in unhedged, $A terms. This is a vital distinction.



Why has Australian relative equity performance shifted over time?

As seen in the chart below, and at the risk of oversimplifying, a major driver appears to be the relative performance of the global technology sector versus the global mining sector. When technology has outperformed (as in the late 1990s and since the GFC), global equities has also tended to outperform. When the mining sector has outperformed (as during the *noughties* China-driven commodity boom between the dotcom bubble and the GFC), Australian equities has also tended to outperform.



Source: Bloomberg, BetaShares

More recent performance: A shift-share analysis

Another more detailed way of understanding relative performance is by undertaking what's known as a 'shift-share' analysis. This deconstructs relative performance into two parts:

1. Industry effect – whereby Australia's performance is based on our relative exposure to global sectors doing either well or poorly.

2. Competitiveness effect – whereby our performance is based on the performance of local sectors compared to their global counterparts.

As seen in the table below, over the past year, Australia's market has been broadly flat whereas global markets (in hedged or local currency terms) have risen a solid 15%.

Australia vs. Global Sectors: Shift-Share Analysis 52-week return performance

	52-week return performance			Sector Weights			Shift-Share Analysis		
	World	Aust.	Diff	World	Aust.	Diff	Comp	Industry	total
Financials	-1.8%	-3.4%	-1.7%	17.4%	27.8%	10.4%	-0.5%	-1.7%	-2.2%
Cons. Discret.	42.3%	15.6%	-26.7%	11.4%	6.8%	-4.6%	-1.8%	-1.3%	-3.1%
Industrials	8.5%	-14.1%	-22.5%	11.0%	8.0%	-3.0%	-1.8%	0.2%	-1.6%
Technology	42.2%	48.8%	6.6%	19.0%	3.0%	-15.9%	0.2%	-4.4%	-4.2%
Materials	20.1%	18.1%	-2.0%	4.8%	17.4%	12.5%	-0.4%	0.7%	0.3%
Energy	-21.2%	-21.5%	-0.3%	5.1%	5.4%	0.2%	0.0%	-0.1%	-0.1%
Cons Staples	1.9%	-0.5%	-2.3%	8.6%	5.5%	-3.2%	-0.1%	0.4%	0.3%
Health Care	12.9%	-8.7%	-21.6%	12.5%	12.0%	-0.5%	-2.6%	0.0%	-2.6%
Utilities	-2.4%	-16.9%	-14.5%	3.7%	1.7%	-2.0%	-0.3%	0.3%	0.1%
Telecom.	-2.1%	3.2%	5.3%	3.0%	4.6%	1.6%	0.2%	-0.3%	0.0%
Property	-6.8%	-12.8%	-6.0%	3.4%	7.9%	4.5%	-0.5%	-1.0%	-1.4%
	14.7%	0.2%	-14.5%				-7.4%	-7.1%	-14.5%

As at 5 February 2021.

Across sectors, the biggest drag has been technology, due to the industry mix rather than competitiveness effect. In particular, although local tech stocks did even better than their global counterparts (48.8% vs. 42.2%), local performance suffered because our listed technology sector is relatively small by global standards (a market share of 3% vs. 19% globally).

The consumer discretionary sector was also a drag, as this strongly-performing global sector has a relatively small weight in the local market and because local consumer stocks underperformed their global peers (though the latter is also partly a tech story as strongly-performing Amazon is treated as a consumer discretionary stock).

Financials were also a drag as Australia has a relatively high weight in this global sector which has performed poorly over the relevant period). Other notable drags were industrials and health care due to competitiveness effects – our local sector underperformed their global peers. The healthcare drag may reflect the relatively good performance of leading global vaccine companies, and recent strength in the $A which has hurt offshore earnings of local companies like CSL.

Where to from here: technology/growth or resources/value?

Of course, all this begs the question: which will be the dominant global thematic over the next few years? Are we about to enter an inflationary commodity 'super-cycle' based on a synchronised rebound in global economic growth, which could expose commodity supply bottlenecks following years of low prices and an under-investment in new capacity? This appears to be the commodity bull case.

Or will the disinflationary global technology boom – largely in place since the GFC – continue to prevail?

My judgement is that the latter, rather than the former, will remain dominant, although commodities/resources could enjoy a short-run post-COVID bounce.

After all, commodity prices have been in a long-term downtrend, which has occasionally been interrupted by the emergence of a new industrial superpower, such as China most recently especially after its entry into the World Trade Organisation (WTO) in 2001. There's no new industrial superpower on the horizon that will have a similar voracious demand for raw materials.

Meanwhile, the technological revolution, encompassing growth in robotics and the shift to cleaner energy, still appears in its early stages, which could see ever greater efficiency in the use of today's popular raw materials.

Innovation will also continue to allow corporations to slash costs, which should keep inflation low, much to the misplaced concern of today's central bankers.

Of course, I'll be watching should trends prove otherwise. If I'm right, I suspect Australia's ability to outperform global peers will remain somewhat challenged given our relatively low exposure to technology stocks and higher exposure to financial and resource-related stocks.

David Bassanese is Chief Economist at BetaShares, a sponsor of Firstlinks. This article is for general information purposes only and does not consider the investment circumstances or needs of any individual.

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Invest in Australian value stocks before it is too late

Reece Birtles

We previously argued the Value style of investing was ripe for a rebound back in September 2019 but COVID-19 put a spanner in the works for the improving outlook for global economic growth and the Value style at the time.

The pandemic downturn exacerbated the market's tendency to overreact and extrapolate, which put Value investing under significant pressure. However, the positive COVID-19 vaccine announcements in November 2020 resulted in green shoots for a potentially enduring Value rally.

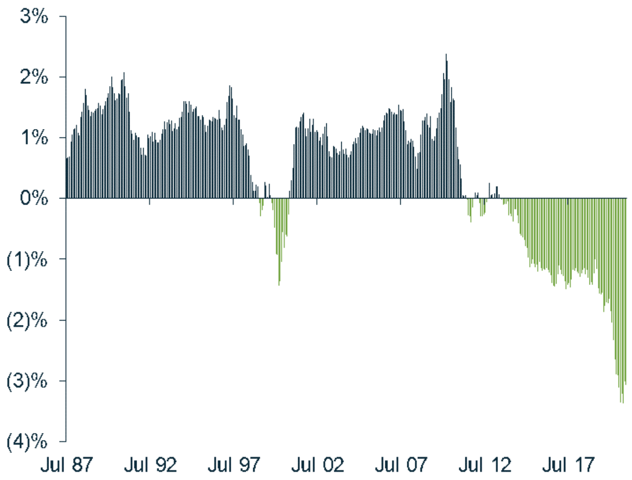
We see that significant opportunities for Value stocks remain from the wide value spreads on offer. Ahead of spreads narrowing as economies rebound, now is the time to position portfolios in Australian Value stocks.

(As a brief reminder, a 'Value' stock is where the share price appears low relative to its intrinsic value based on common market value measurements).

Value performance has been under pressure

Traditionally, history has shown that Value style (based on the MSCI World Value Index) has typically outperformed the broader index (MSCI World Index) over the long term. However, over the last 12 months (through to 20 January 2021), the 10-year rolling return deficit between Value and Growth styles has more than doubled the previous large deficit during the tech bubble, and Value has given up nearly 40 years of cumulative outperformance over Growth.

MSCI World Value – MSCI World: Rolling 10-year annualised relative return differential



MSCI World Value/Growth Cumulative relative return

Source: Martin Currie Australia, FactSet, as at 20 January 2021

But EPS for Value have been consistent with Growth

Despite that, earnings per share (EPS) performance between the styles has been remarkably similar over the last 25 years. This means that the returns differential has been primarily driven by a multiple re-rating for growth stocks. That is, the price people are willing to pay for growth stocks despite similar earnings prospects has been significant.

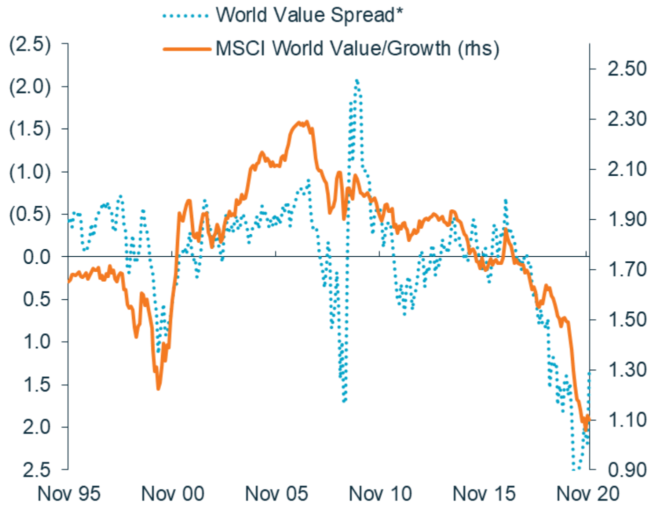
Cyclicality of world and Australian Value spreads

We have in the past created a 'world' Value spread based on an extreme valuation dispersion environment using a composite of typical value metrics including current P/E, next 12-month P/E, dividend yield and Price/Book).

I have now extended the analysis to Australia, using the MSCI Australia Value and Growth indices.

For the Australian indices, the Value vs. Growth performance dynamic has been much more cyclical than it has been for the world indices, with less of a structural decline over the last 10 years given the more consistent quality characteristics of Australian Value and Growth companies.

World Value spreads and MSCI World Value/Growth cumulative relative return



MSCI Australia Value/Growth: Cumulative relative return

Source: Martin Currie Australia, FactSet, as at 20 January 2021
**Composite of current P/E, next twelve-month P/E, dividend Yield and P/B for MSCI World*

Return differential for Australian stocks also driven by Growth re-ratings

EPS growth for Australia Value stocks have been superior to Growth, especially post the GFC. As such, the returns differential has been primarily driven by a multiple re-rating for Growth stocks to an extreme equal to the tech bubble.

MSCI Australia: Next 12-month EPS by Style (log scale)

MSCI Australia: Next 12-month P/E by Style

Source: Martin Currie Australia, FactSet, as at 20 January 2021

2020 created the largest valuation opportunity ever

Calculating the 'Australia' Value spreads based on the same metrics as above, we can see a similar trend to the global Value spreads. Looking at when valuation spreads reach extreme levels (>1) has been a good predictor of stronger future Value returns.

On this basis, the year 2020 witnessed the largest valuation spreads on record for the MSCI Australia indices.

Furthermore, we believe Martin Currie Australia's proprietary discounted cash flow (DCF) based Value spreads are the best measure for the Australian market given they are forecast Growth and quality adjusted.

Comparing the composite MSCI World and Australia Value spreads with our in-house 'return to fair value' based Value spreads (for both the S&P/ASX 200 and our portfolio), the pattern is similar and each show the extreme level of spread in 2020.

Recovery in economic growth and bond yields a leading indicator for Value

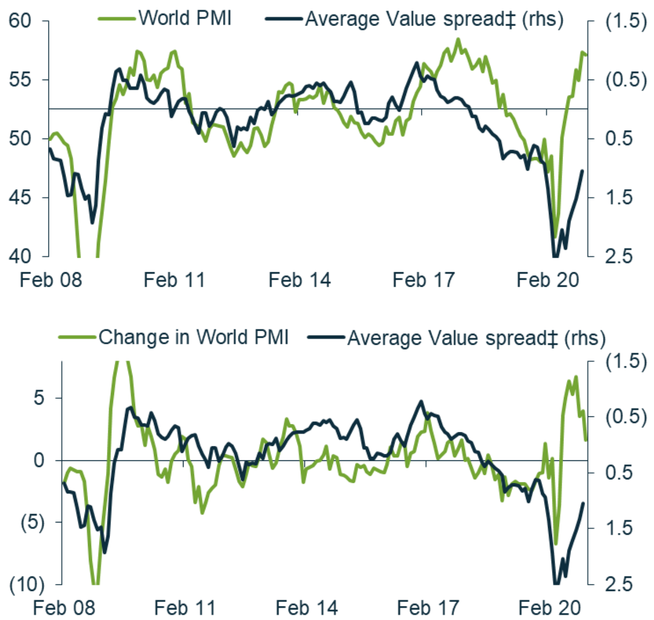
We have previously highlighted the historically tight correlation of Value spreads with economic growth and bond yields, in particular since the GFC. The COVID-19 induced recession in 2020 has resulted in significant declines in both growth and yields, and this is really what has pushed Value spreads to unprecedented levels.

The improvement in World PMI and US 10-year bond yields since mid-2020 has resulted in a bottoming of the Value vs Growth performance deficit in Q3 2020, but Value spreads surprisingly appear to be disconnected from the positive moves.

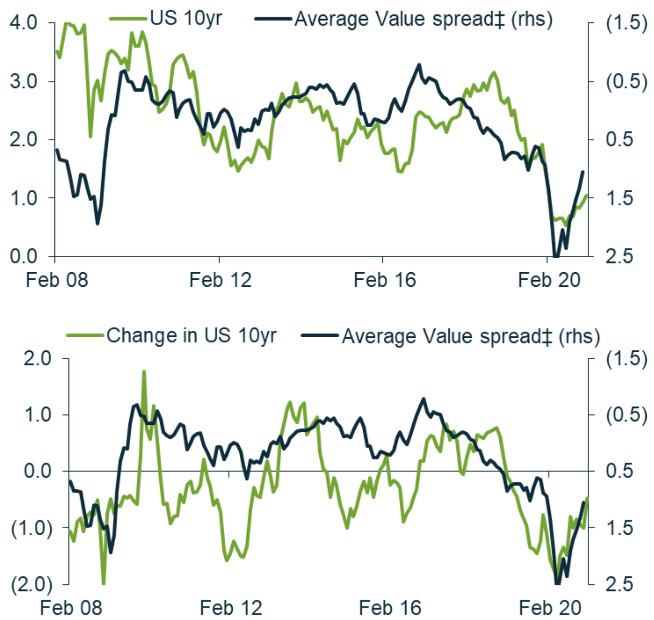
This is possibly because we are at the turning point, the extent of the QE programmes of late, or the market just doesn't believe the data yet.

Given the likely ongoing recovery of economic growth and bond yields as the vaccine is rolled out and the world recovers from COVID-19, we believe that spreads will again tighten, and continued significant Value outperformance is likely.

Economic growth and Value spreads



Bond yields and Value spreads



Source: Martin Currie Australia, FactSet, as at 20 January 2021
‡Average of composite MSCI World & MSCI Australia and MCA Value Equity RTFV – S&P/ASX 200 RTFV spreads

Bigger opportunities in Australian stocks than Global

The Value vs Growth cycle is more cyclical and less structurally challenged for the Australian market than it is for the world, suggesting that it is better to gain Value exposure via Australian equity allocations than the global equity allocation.

Many global Value portfolios are reliant on narrow index relative positions in banks, energy and Europe rather than the dominant technology and healthcare in US stocks. However, Australian Value exposures are not dependent on structural or geographic bets, and offer more diverse sector opportunities. Australian Value stocks are also not up against the high-quality global tech companies.

Supporting this, the Australian MSCI Value index has shown a much more significant upturn in performance since the vaccine, reflecting cyclical forces overcoming structural whereas this is less evident in global indices.

Note that when we talk about opportunities in Value stocks, we don't mean to say that they are poor quality companies versus their Growth counterparts. Maintaining quality in portfolios is integral given the prevailing economic uncertainties.

Many of the key stocks which we believe are undervalued by the broader market have particularly good quality characteristics. For example, these include:

- **Nine Entertainment**, which is benefiting from the shift to video/online, and has cost-out driving its EPS acceleration;
- **Star Entertainment**, which will benefit from the reopening in Australia and is not reliant on international travel;
- **Inghams Group**, who is seeing the end of drought bringing lower feed costs, and experiencing growing demand for cheap chicken protein;
- **Worley**, where renewable projects in solar and wind are driving large revenue growth;
- **the big 4 Australia banks**, which are seeing the post-COVID-19 loan provision unwind increasing both EPS and DPS; and
- **Medibank Private**, who is dominating industry profitability and has the ability to acquire to produce high returns.

Value spreads are lagging the upward trend in PMI and yield, whereas we would expect a much tighter correlation. We believe that as the recovery continues, there is more room to go in the Value rally that started in November 2020. The timings of style cycles are notoriously hard to predict, so investors need to be positioned in quality Australian Value stocks now to capitalise on narrowing spreads.

Reece Birtles is Chief Investment Officer at Martin Currie Australia, a Franklin Templeton affiliate. Franklin Templeton is a sponsor of Firstlinks. This article is general information and does not consider the circumstances of any individual. Past performance is not a guide to future returns.

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Gains of a lifetime reward new retail investors

Gemma Dale

Despite the major players being mostly anonymous Reddit users, the GameStop frenzy in late January 2021 caught the attention of news outlets and commentators. The challenge of a new breed of retail investors has been discussed in broadsheets, online and among regulators not just in the US, but across the globe. Added to the strange Davey Day Trader-Robinhood excitement of 2020, the modern equivalent of column inches given to new investors has been far from glowing.

They may be new but they have done well so far

Despite this, or in concert with it, hundreds of thousands of novice Australian investors chose close to the perfect time to start their portfolios in 2020.

At nabtrade, total accounts increased over 30% following the collapse of the market in March 2020, as new investors flocked to share investing. When the S&P/ASX200 fell 30% in just three weeks, investors rushed to open accounts at five times the usual rate. As the year progressed, new accounts were continuing at two to three times the usual number. Other online brokers had similar experiences.

The big fear of regulators and commentators was that this influx would be mostly driven by newly-minted day traders and novices buying speculative investments.

Instead, the top 10 stocks bought included the big four banks, well known travel companies, an ETF and two high-flyers from the Buy Now Pay Later sector.

nabtrade analysis has revealed that all of the top 10 stocks bought by new investors have generated a positive return since they were purchased. Not surprisingly, Afterpay was the most profitable trade, returning an average of 173% for new investors in 2020[1]. NAB shares generated the next best return, with 38%, and NAB was bought by 25% more accounts than the next most popular, Qantas.

NAB	Qantas	CBA	Westpac	Flight Centre	Zip Co	ANZ	Webjet	Afterpay	VAS
38%	30%	32%	19%	23%	1%	33%	33%	173%	20%

New investors generated returns of over 30% for three of the big four banks, and greater than 20% for the most popular travel stocks. With the exception of Zip Co, the minimum average return was 19%. This analysis does not include any gains since 31 December 2020.

Fortune favours the brave

To be frank, new investors had an astonishing year in 2020. The S&P/ASX200 returned over 50% from its lows, and new investors have captured, on average, more than half of that return, meaning most of them bought in before it started to flatten out in June. Buying in a pandemic shows a great deal of confidence for inexperienced investors.

It's very difficult to pick the bottom of any market, and most investors didn't pick the absolute bottom when they bought. Many have also sold into rallies, which has reduced their return as the market has continued to recover. Over half, however, have not sold any of their investments during the period.

Overall, the average new investor has done far better than the average expected annual return for the S&P/ASX200 of 8-10% (including dividends), and remember that the benchmark was almost flat over the whole of 2020.

This was not simply a punt into tech stocks commonly portrayed in the media. Investors chose to go with well-established companies, such as the banks, and recovery businesses, like the travel sector, believing that they were oversold, and would rally strongly as the world recovered from the pandemic.

Holding onto good buys was key to maximising gains in 2020. Young investors, known as Gen Z, showed the strongest tendency to buy and hold, and have therefore generated a stronger average return than older investors. Ironically, this group, often deemed as takers of the riskiest positions, was the least likely to actively trade their new investments.

Investors who bought outside the most popular stocks were less successful on average. This was particularly true of the Buy Now Pay Later sector. Although Afterpay was one of the best-performing companies of the year, investors were down an average 32% on Openpay, 25% on Laybuy, 19% on SplitIt and 13% on Sezzle. Three times more accounts bought Afterpay than SplitIt and Openpay, and five times more bought Afterpay than Sezzle. Laybuy was bought by just 69 accounts of 10,000 analysed. New investors showed a strong tendency to stick to strong brands, even in hot sectors.

Hoping this is the start of good experiences

The returns most new investors have generated in 2020 are rare for new and even experienced investors and are unlikely to be repeated in a more normal market. Far from punting away their life savings or speculating with stimulus cheques as has been hypothesised in the US, most new investors have bought wisely and held on. May we all have such good fortune in the market in 2021!

[1] Even casual followers would be aware that Afterpay fell to a low of $8, and currently sits at over $150, so 173% probably seems a modest return. It should be noted that the vast majority of investors fail to buy at the absolute lowest point, some have taken profits, while others have added to their holdings at higher prices. The average buy price for Afterpay on nabtrade in 2020 was $40. Most investors are still holding at least some of their APT investment so their overall return would be much higher than when this analysis was produced in late 2020.

Gemma Dale is Director of SMSF and Investor Behaviour at nabtrade, a sponsor of Firstlinks. This material has been prepared as general information only, without reference to your objectives, financial situation or needs.

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FANMAG: Because FAANGs are so yesterday

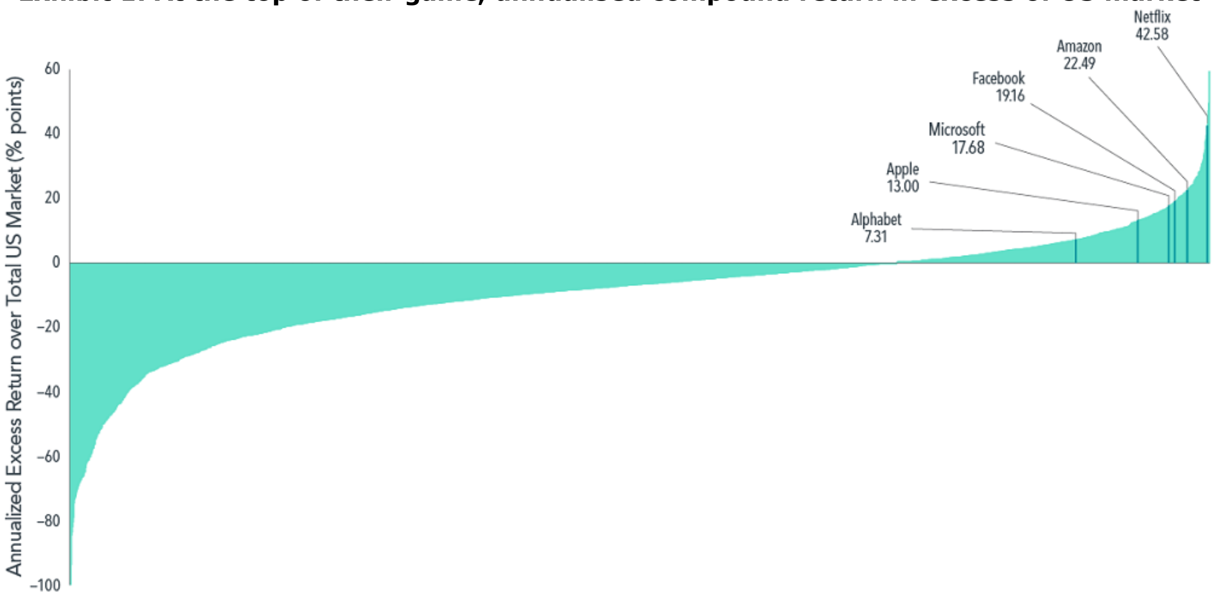
Ishan Ghosh PhD

A handful of large technology stocks have garnered attention for outsize returns in recent years. Collectively referred to by the FANMAG acronym, Facebook, Amazon, Netflix, Microsoft, Apple, and Google (now trading as Alphabet) all substantially outperformed the US market (as defined by the Total Return US Market Research Index*) in the eight calendar years that they have all been public companies (Facebook went public in May 2012).

Emerging as winners from among a large number of companies that fared less well during 2013–2020, these juggernauts bested most of their surviving peers with annualised outperformance versus the US market ranging from 7.3% (Alphabet) to 42.6% (Netflix), as shown in Exhibit 1.

(Note that performance data used in the exhibits is from January 2013 to November 2020).

Exhibit 1: At the top of their game, annualised compound return in excess of US market



But many other tech companies underperformed

While this performance dazzled investors and dominated headlines during 2013–2020, a more complete picture emerges when accounting for the many companies whose investors were less fortunate over the period.

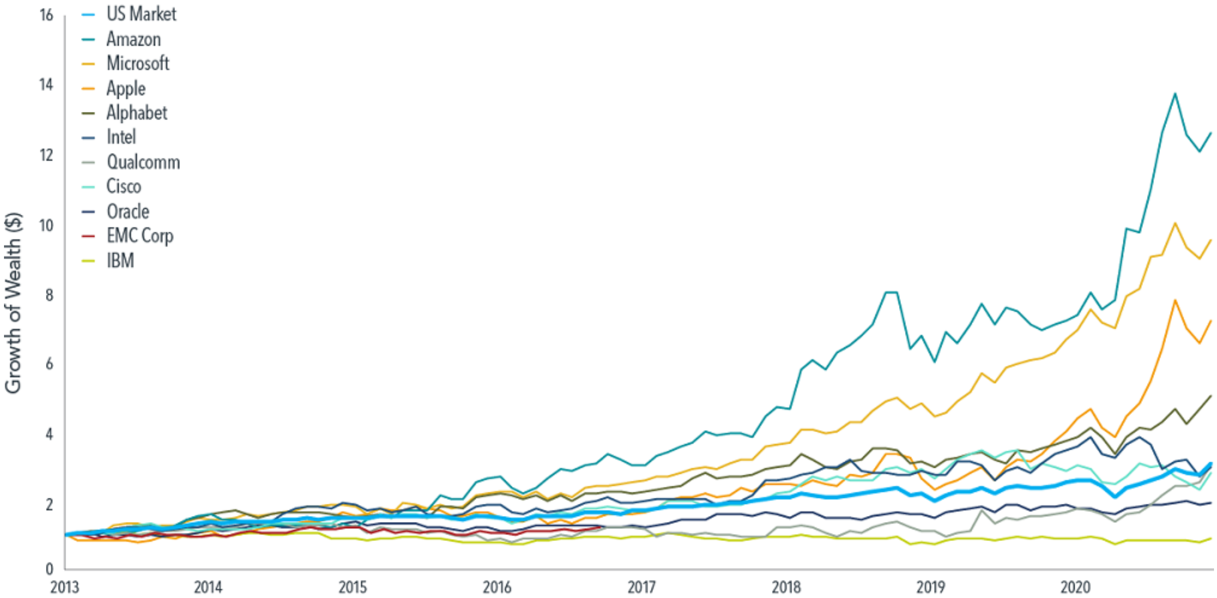
As shown in Exhibit 2, of the 10 largest US technology stocks as of January 2013, all but Apple, Microsoft, Alphabet, and Amazon underperformed the US market over the same period that elevated their tech peers to financial market stardom.

Exhibit 3 shows the hypothetical growth of wealth for an investor who put $1 in each of the 10 largest technology stocks and the US market in January 2013. While the $1 invested in Amazon and Apple, for example, would have grown to $12.63 and $7.18, respectively, by November 2020, the returns of their non-FANMAG tech contemporaries would have failed to even surpass the US market.

Exhibit 2: Same game, different outcome
Performance of the 10 largest US technology stocks.

Name	Annualized Compound Return	Annualized Compound Return Difference to US Market (in percentage points)
Apple	28.27%	13.00
Microsoft	32.95%	17.68
IBM	–1.83%	–17.10
Alphabet	22.58%	7.31
Oracle	8.75%	–6.52
Amazon	37.76%	22.49
Qualcomm	15.01%	–0.26
Cisco Systems	13.83%	–1.44
Intel	14.68%	–0.59
EMC Corp*	5.74%	–8.61

Exhibit 3: Growth of wealth for 10 largest US technology stocks



FANMAG returns certainly stand out among those of their contemporaries, but the range of individual stock outcomes has often been immense. A historical look shows that FANMAG performance has been quite ordinary in the context of past top-of-the-market performers.

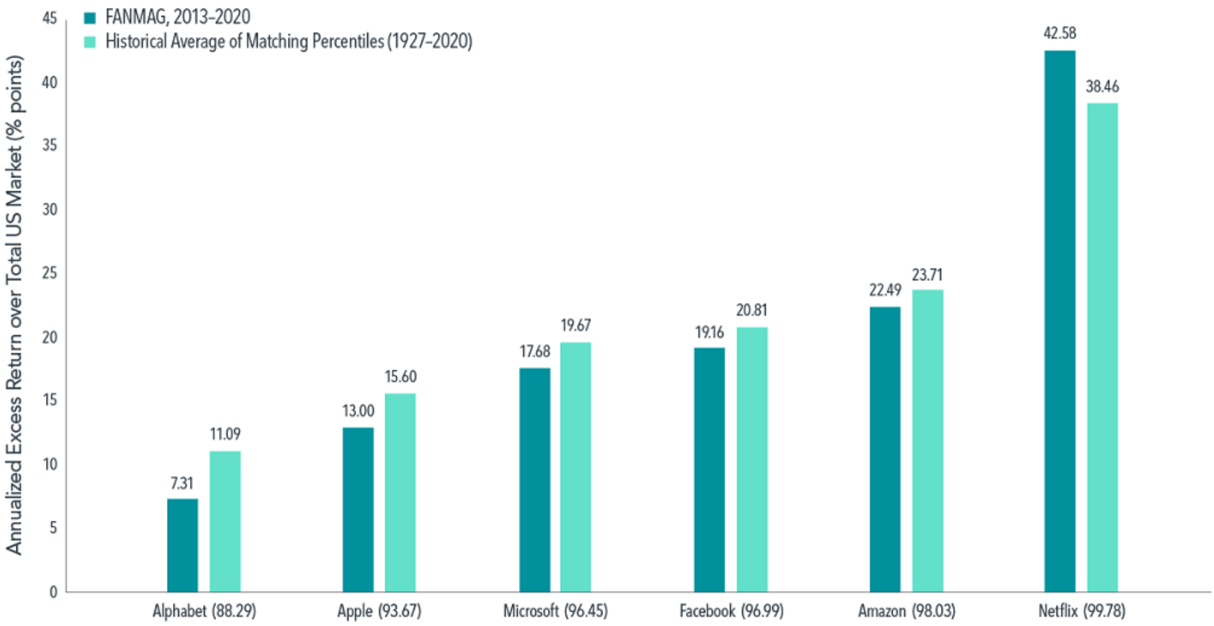
Drawing on stock return data since 1927, Exhibit 4 indicates that historical top performers often experienced larger outperformance relative to the US market than the FANMAG stocks realized during 2013–2020.

For example, Apple's 2013–2020 annualized excess return of 13% places it at the 93rd return percentile among all US stocks that were trading in January 2013 and survived the eight-year period that followed. However, the average outperformance of stocks at the 94th percentile over eight-year rolling periods from 1927 to 2020 was 15.60%, or about 2.60% higher.

With the exception of Netflix, the same holds for the other FANMAG stocks, with historical outperformers at the same return percentile outperforming the market by more than the FANMAG stocks did in 2013–2020.

Exhibit 4: A familiar tale for the right tail

FANMAG outperformance vs. US market, 2013–2020, compared to average historical outperformance of stocks at same return distribution percentile over rolling eight-year periods, 1927–2020



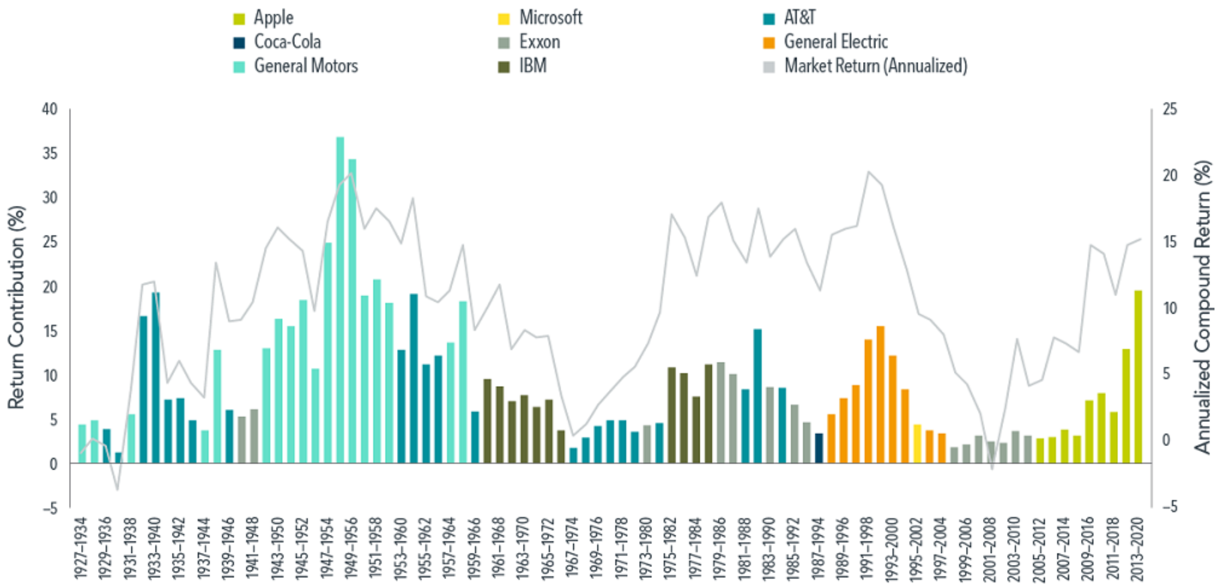
Large US companies have done even better in the past

A defining trait of the FANMAG performance is that these outsize returns have come from among the largest companies in the US, implying they were meaningful contributors to the overall US market's return. However, historical data show that this too is nothing new.

Defining a stock's return contribution as its total return weighted by its beginning-of-period market capitalization weight, we see that Apple's contribution to the US market for the period 2013–2020 was 19.68%.

How does this figure compare to other top return contributors? Exhibit 5 illustrates the top return contribution and the annualized US market return over rolling eight-year periods since 1927, revealing instances of return contributions by the likes of AT&T, General Motors, and General Electric that were comparable to, or even exceeded, that of Apple in 2013–2020.

Exhibit 5: Key contributors



FOTW (Flavor of the Week)

If history is any guide, the FANMAG acronym will eventually be replaced by another trendy name. For example, stock market historians will remember the Nifty Fifty in the 1960s and 70s, a set of 50 blue-chip stocks like Coca-Cola and General Electric. The early 2000s witnessed increasing adoption of the acronym BRIC, representing investment opportunities in the fast-growing emerging economies of Brazil, Russia, India, and China. More recently, the WATCH companies - Walmart, Amazon, Target, Costco, and Home Depot - have also gained traction in the market's lexicon.

While documenting trends in finance is entertaining, there is little evidence that investors can spot these trends in advance in a way that would enable market-beating performance. Moreover, concentrated bets on high-flying stocks can expose investors to idiosyncratic risks and a wider range of possible outcomes.

By contrast, a sound investment approach based on financial science emphasizes the importance of broadly diversified portfolios that provide exposure to a vast array of companies and sectors to help manage risks, increase flexibility in implementation, and increase the reliability of outcomes.

Ishan Ghosh, PhD a Researcher at funds management firm, [Dimensional Fund Advisors](). This article is general information and does not consider the circumstances of any investor. Named securities may be held in accounts managed by Dimensional. This information should not be considered a recommendation to buy or sell a particular security.

Glossary
***Fama/French Total US Market Research Index**: The value-weighed US market index is constructed every month, using all issues listed on the NYSE, AMEX, or Nasdaq with available outstanding shares and valid prices for that month and the month before. Exclusions: American depositary receipts. Sources: CRSP for value-weighted US market return. Rebalancing:

Monthly. Dividends: Reinvested in the paying company until the portfolio is rebalanced. Results shown during periods prior to each index's index inception date do not represent actual returns of the respective index.

Overdue overhaul of Australia's aged care system

Rachel Lane

The current aged care system has failed many senior Australians and providers for years. By participating in the Royal Commission into Aged Care Quality and Safety, we have contributed to the important ongoing process of industry improvement. We were pleased to see our ideas reflected in many of the commission's recommendations.

Principles to underpin the design of a fairer system

To support development of a better aged care system that is appropriate to the needs and wishes of all Australians, it is proposed that the following principles should underpin the design of a new financing approach:

- Quality
- Respect and dignity
- Equity
- Transparency and accountability
- Sustainability
- Responsiveness and innovation
- Streamlined and accessible

Overall, the system that is required is one in which people can access the services they need without delay, with costs and quality standards that are transparent and providers that are accountable and responsive to the needs of people using their services and who will work with them to innovate and drive efficiencies that will enhance sustainability without compromising agreed standards. To achieve these goals fundamentally the system needs to be less complex. The role of the Commonwealth Government is to provide the environment in which that can occur and to ensure the system is fair and equitable.

The principles we proposed can be seen in many of the recommendations, particularly:

- Recommendation #8: A new aged care programme – designed to be more streamlined, accessible and equitable.
- Recommendation #9: Meeting preferences to age in place – clearing the waiting list for home care packages and allocating funding and services in ways that are responsive, sustainable, transparent, accountable, equitable and high quality.
- Recommendation #20: Planning based on need, not rationed – proposes a funding approach that is equitable, respectful, supportive of dignity, sustainable, responsive, streamlined and accessible.
- Recommendation #82: Immediate changes to the Basic Daily Fee – proposes a boost to fees from 1 July 2021, on condition that providers report on, and accept accountability for, high quality services.

Home Care Packages: limitations in the current model

As the Royal Commission has heard, in 12 months more than 16,000 people died waiting for a home care package. For others, a lack of access to supports has resulted in premature entry into residential aged care. Rationing of packages is out of step with community preferences, denying people access to supports that may allow them to stay home. This impacts quality of life, particularly for those without family or friends to help fill the gap.

Transparency

For many the expectation of home care is that you simply "order in" the care you need. In reality accessing a home care package is a test of patience, resourcefulness and forensic accounting. You need patience during the long waits for assessment and for care to start; resourcefulness in finding services, volunteers and family members to fill in the gaps; and forensic accounting to determine whether or not you are getting a good deal.

Administration and case management are services that providers must deliver; without them the package doesn't operate. But they are tasks that are largely invisible, making it difficult to know what is really involved and easy for unscrupulous operators to gouge their customers.

How much care the person can receive with the net funding will depend on where they live, the type of care and services they receive and who provides it.

Care providers who employ care staff have a vested interest in using their own staff to provide care and services which in theory has the potential to offer economies of scale. In practice, consumer choice is often restricted to the services (and rostering availability) of the employed carers with an hourly rate for the services that is far greater than the cost of wages.

Affordability

A significant concern is the home care package fee structure. Older people are expected to contribute towards the cost of their package which includes a basic daily fee based on the level of package and an income-tested care fee which is calculated by Centrelink.

The costs associated with a home care package can result in affordability issues for low income pensioners. The basic daily fee can amount to 15% of annual income, even without considering expenses associated with daily living or any other supports older people might require but cannot access through their home care package. It is possible that older people may not be able to afford the fee contribution which in turn may become a barrier to accepting a package.

Disparity between Home Care and Residential Aged Care Funding

When you crunch the numbers on the funding models it becomes clear that people living in residential aged care receive more funding for care than those receiving home care.

At the ultimate amount the funding for someone receiving a home care package is just over $192/day while the care funding for someone (potentially the very same person) in residential aged care is around $256/day, that's more than 34% additional funding for your care based on where you live.

Similarly the converse can also occur, a person with dementia may receive a higher amount of funding through a level 4 Home Care package (with the dementia supplement) than an aged care facility can receive through the Aged Care Funding Instrument (ACFI).

These disparities in funding raise a number of questions, including why the funding arrangements are different, whether it creates a necessity for some people to enter residential aged care when if the funding was the same they could afford to stay at home and whether the funding, particularly as it relates to dementia behaviours restricts access to residential aged care for some.

Recommendations

Current Home Care Package limitations are tackled head-on by the recommendations:

- Disparity of funding for people receiving care based on whether they remain at home or move to residential aged care service is removed by Recommendation #89: Maximum funding amounts for care at home.
- Transparency and affordability are the focus of both Recommendation #93: Standardised statements on services delivered and costs in home care, and Recommendation #96: Fees for care at home.

The recommendations make a point of separating fees for care at home, including respite care, from fees for domestic assistance, social supports, assistive technology and other costs. This may assist with some of the pricing anomalies that we draw attention to in the issue of disparity and affordability. It will all depend on the details of the implementation.

Our vision is of a system that offers older Australians a true choice between receiving care at home and moving into residential aged care. In the current situation, too many are forced to move into residential care because they cannot access sufficient government funding or cannot afford the user contributions.

Concluding comment

If an expert is required to assist an older person to successfully navigate the aged care system, then it is by definition failing to meet the needs of all. While we believe that there will always be value in seeking expert advice, a simpler, more user-friendly system with a higher standard of accountability and transparency is needed. Whether the proposed recommendations can achieve this remains to be seen in the implementation.

As the Principal of [Aged Care Gurus](), Rachel Lane was invited to contribute to the Commissioner for Senior Victorians' submission to the Royal Commission into Aged Care Quality and Safety. This is a summary of that submission and its recommendations. You can view the [full paper here]().

'Super-defensive equities' may rescue struggling 60/40 portfolios

Alastair MacLeod

Investors concerned about the outlook for their balanced (60% shares/40% bonds) portfolios may need to consider alternate strategies to deliver their future investment objectives.

Specifically, the reasons for including a large allocation to bonds looks particularly challenged. Aside from meagre future return expectations, the ability of bonds to meaningfully appreciate during a crisis appears impaired for the foreseeable future. When preparing for the *next* crisis, investors will likely need to look further than bonds for negatively-correlated exposures.

Two such exposures that should *appreciate* during future crises include:

- Tail hedging – option positions that appreciate in bear markets, and
- Unhedged foreign currency exposures - a more simplistic defensive approach, but one that has delivered a negative correlation during a crisis.

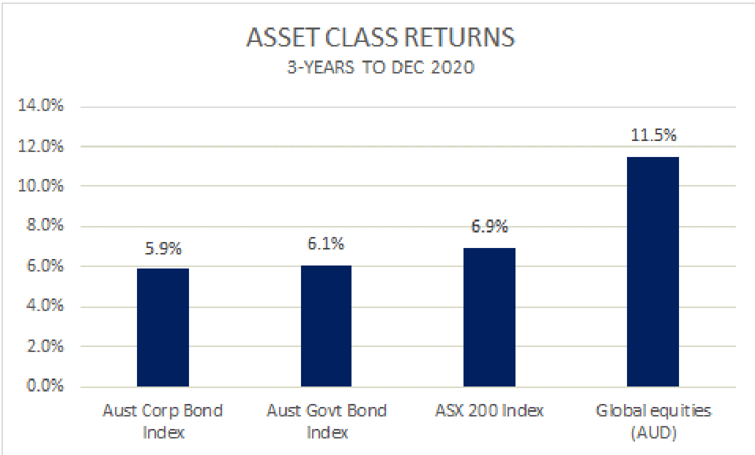
When integrated together within a global equity portfolio, these embedded features have consistently delivered a positive total portfolio return in Australian dollars during periods of peak to trough drawdown. We have coined the phrase 'super-defensive equities' to describe an equity strategy that includes both these negatively-correlated exposures.

Meagre expected returns

Fixed income is coming off the absolute best of times, with the massive decline in interest rates over the past few years helping to generate near equity returns for both government and corporate bonds. Over the past three years, Australian government bonds have returned 6.1% and corporate bonds 5.9%, which compare favourably with Australian equities over the same period despite presenting a dramatically lower risk profile.

As a secondary effect, this secular rally in bonds has caused much of the future expected returns from this asset class to be 'pulled forward', which in turn has left Australian bond indices trading well above par. Future expected returns are likely to suffer accordingly and are represented by meagre yields to maturity.

Figure 1: 3-year asset class returns



Source: Wheelhouse

Figure 2: Australian bond indices

	Price	Coupon	Yield to maturity	Weighted average maturity
S&P/ ASX Corporate Bond Index	107.68	3.32%	1.20%	4.7 years
S&P/ ASX Government Bond Index	110.86	2.65%	0.73%	8.2 years

Source: S&P

It is difficult to envisage returns for balanced portfolios that come close to what was delivered over the past decade. This view is consistent with the current five-year forecasts from BlackRock of negative 0.6% returns for Australian government bonds and positive 0.5% for Australia corporate bonds.

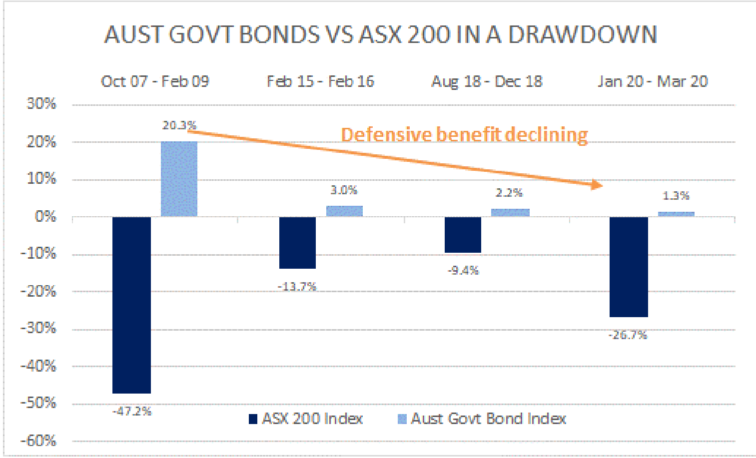
Impaired defensiveness

Alongside the secular decline in interest rates witnessed since the GFC, there has also been a markedly lower positive contribution to returns from bonds during periods of market crisis. There is little room for bonds to appreciate meaningfully during equity market corrections.

The chart below records the movement in Australian government bonds versus equities, from the beginning of a large drawdown to the trough (calendar month basis).

While bonds have remained robustly defensive during these drawdowns and did not decline in value, their recent inability to meaningfully appreciate makes them less attractive to smooth returns within a balanced portfolio. Furthermore, the last 20 years of negative bond/equity correlations is something of an outlier. Over the very long-term, bonds exhibit a more positive relationship, meaning they often fell alongside equities in a crisis. Combined with the poor expected future returns, the current allocation to bonds more closely resembles an allocation to cash.

Figure 3: Returns from Australian bonds vs equities in drawdowns



Source: Wheelhouse

This poses the question of how do balanced portfolios expect to deliver on their investment objectives when they have an effective 40% allocation to cash?

Positive contributions from tail hedging

Properly designed and managed, active tail hedging strategies can provide a positive contribution to portfolio returns during a crisis. The protection is mechanical in nature (markets go down, hedges go up) and not reliant on historic correlations or interest rate cycles.

A basic approach to tail hedging involves the purchase of equity put options, which act as a kind of insurance on the equity portfolio. Similar to insurance, a premium is paid, however when markets decline the put options are designed to increase in value, sometimes exponentially, which serve to offset equity losses. Efficient tail hedging requires specialist skill, including managing the expiry of the contracts and payoff design (at what point they should be bought and start adding value).

Another important point is that the systematic purchase of put options is expected to create some drag on returns. Depending upon the level of protection required, the long-term cost of a tail hedge can vary broadly.

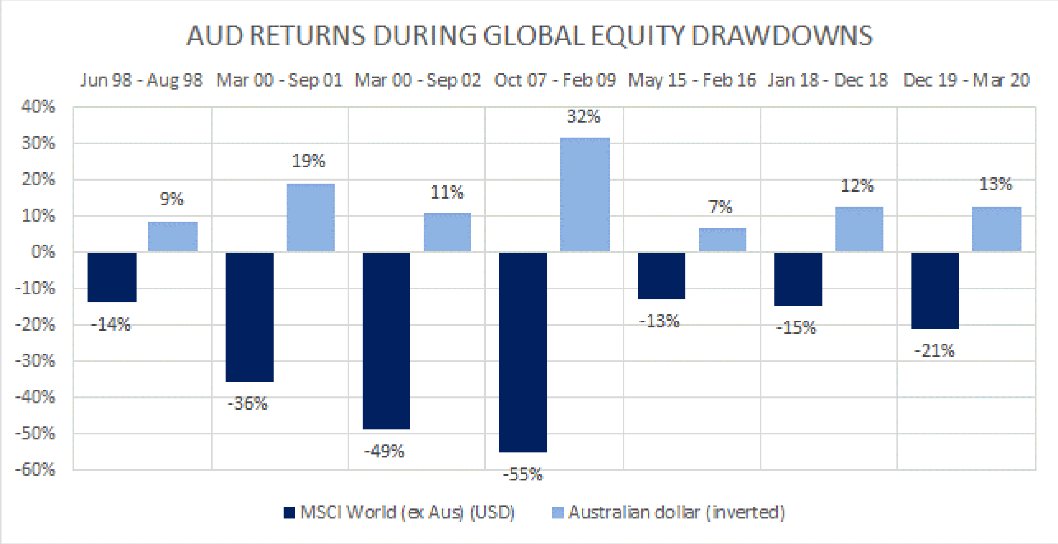
The defensive tail-based strategy used within the Wheelhouse Global Equity Income Fund is expected to have an annualised cost of 1.5%. While this cost is not inconsequential, tail hedging may allow a portfolio to remain fully invested in equities, with the significantly higher expected returns (versus bonds) funding an efficient hedge. Relative to a large fixed income exposure, this may deliver higher returns with a more reliable defensive profile.

Positive contributions from a falling Australian dollar

Historically the Australian dollar has fallen during global market crises, as investors seeking protection buy 'safe-haven' currencies such as the US dollar.

The chart below plots a 20-year history of market corrections (>10% declines) in the global equity benchmark (MSCI World ex Australia) on a US dollar basis, from the onset of the drawdown to trough (monthly basis). Due to the 2.5-year extended drawdown following the tech bubble deflation, we have included a separate point (March 2000 – September 2001) to reflects the initial 18-month phase. Plotted next to these declines is the positive contribution from the decline in the Australian dollar (vs USD) during these periods.

Figure 4: Australian dollar returns during >10% drawdowns in global benchmark (USD)



Source: Wheelhouse

Negative correlation matters most during times of crisis. The Australian dollar has reliably added meaningful positive return to an Australian-based investor in global equities.

While historical correlations do not offer 'mechanical' protections, we see no reason why this relationship should not continue, so long as the US dollar retains its safe-haven status relative to the Australian dollar. Furthermore, with interest rate differentials effectively zero, there is virtually no carry cost at present for having the defensive benefit of an unhedged global equity exposure.

Conclusion

A portfolio with 40% effectively in cash will likely have very different future returns and drawdown than balanced portfolios of the past. This represents the worst of both worlds for a balanced portfolio investor.

We have not considered active management, or other types of fixed income securities in this analysis, which may alter this relationship. However, we expect benchmark returns for all fixed income securities to be far lower in the future.

'Super-defensive equity' strategies as defined here are one solution that may deliver a higher rate of return, alongside a smoother return profile, during the *next* crisis.

Alastair MacLeod is Managing Director of Wheelhouse Partners. This article is for general information only and does not consider the circumstances of any individual.