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Editorial

In 2020, the clichés reigned as we tired of hearing circumstances were 'unprecedented', we lived in 'uncertain times' but not to worry, 'we're all in this together'. Of course, we learned about 'social distancing', 'zoom-bombing' and 'lockdowns'. 'Working from home' was so common it became 'WFH'.

There's a new version in Canberra for 2021. The 'polispeak' has featured in the speeches of Treasurer **Josh Frydenberg** and Superannuation Minister, **Senator Jane Hume**. Listen closely. Two words have become platitudes, that is, words with a moral content that are used so often that they lose their meaning. This week, we explain what '**flexibility'** and **'efficiency**' now mean in superannuation policy. These two innocent-sounding words are softening us up for major changes in the way we think about superannuation.

In fact, if you go to the Treasury website and search for 'flexibility', you'll find the Government is offering flexibility on a wide range of super policies. There's even this little gem dated 3 May 2016 to improve super's flexibility: *"The Government will enshrine in law that the **objective for superannuation** is to provide income in retirement to substitute or supplement the Age Pension."*

We're coming up for its fifth anniversary and nothing has happened. Well, perhaps the Government is not THAT flexible. The Treasurer at the time should have enough clout now to make it happen. It was **Scott Morrison**.

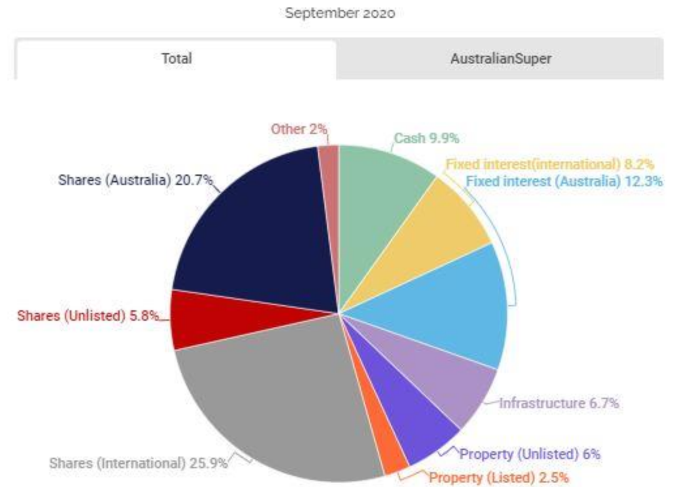
Superannuation, including whether to proceed with the legislated SG increases from 9.5% to 12%, is at an historical milestone as there will soon be more money in the decumulation (or retirement) phase than in the accumulation phase. Spending is a different ball game to saving, coming with a new set of complexities.

But as a sign of growing maturity, APRA announced this week that assets in the system now exceed $3 trillion for the first time. Jane Hume issued an underwhelming media release including:

"*High fees, persistently underperforming funds and too many duplicate accounts are a drag on the system. Australians can be reassured that the Morrison Government is determined to continue our arc of reform ensuring the superannuation system is working harder for all Australians.*"

Total contributions to super were flat year-on-year, as shown in the table, and with personal contributions down 6.4%, the total was held up by employers. This demonstrates the importance of compulsion. Benefits paid grew strongly due to $36 billion under the Early Release Scheme.

	December 2019	December 2020	Change
Total contributions	$118.4 billion	$120.7 billion	+1.9%
Total benefit payments	$81.2 billion	$113.3 billion	+39.4%
Net contribution flows	$40.0 billion	$7.7 billion	-80.9%

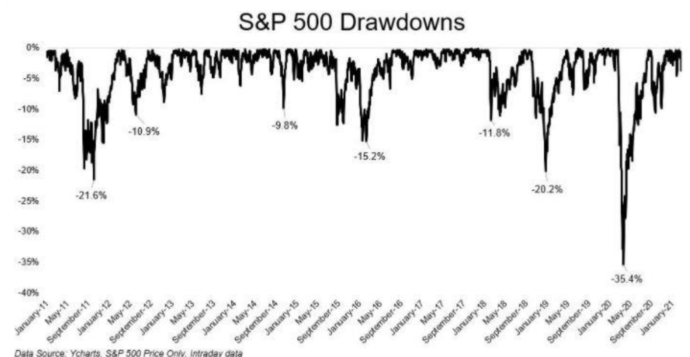


How is Australia's largest super fund allocating its share? This chart from new research by **The Ruthven Institute** reveals the **AustralianSuper** Balanced Fund (the top balanced fund performer over 10 years at 7.6%) adopted the following asset allocation in September 2020. How does this differ from your own allocation?

The next 10 years are unlikely to be as good as 7.6% for a balanced fund. Cash is a 10% allocation earning less than 1%, while bonds at 20% have benefitted from a major rally that is now over. That's 30% probably delivering negative real returns unless the bond investment moves up the risk spectrum.

It's always difficult to pick turning points in bull markets for equities, but we do know that high valuations lead to lower future returns. While the last decade delivered better than the superannuation industry expected back in 2010, don't expect to say the same thing when we look back in 2030. **Roger Montgomery** gives his reading on which parts of the market are overvalued, drawing on the warnings from many of the biggest names in global investing.

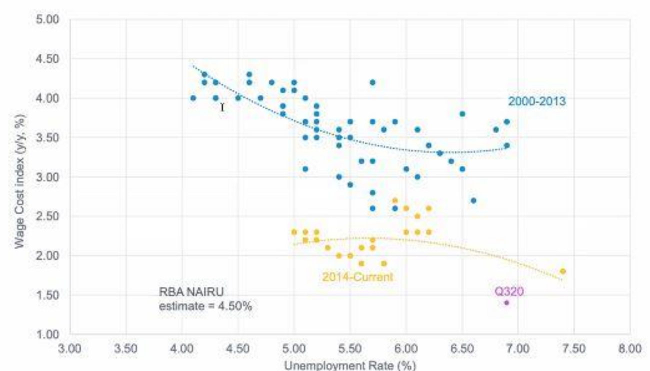
This week's White Paper from **First Sentier** asks important asset allocation questions for 2021, such as whether it is worth owning bonds, can the good times continue for equities and is inflation a worry.



It's useful to remind ourselves that in the last decade, although the US S&P500 Total Return index is up almost 300% since 2011, there were still periods of significant drawdowns (that is, market falls) as shown here. Taking the up days and 10-year price rise chart out of the picture and seeing only the negatives makes it look like a poor decade. Investors need to accept that these drawdowns are an inevitable part of equity investing, and anyone who can't live with it will struggle for returns in the current environment.

It's rare that there is so much focus on bond yields and inflation, and it's mainly due to their potential impact on the sharemarket. The **Reserve Bank of Australia** (RBA) is so aggressive trying to keep the 3-year bond rate at its target 0.1% that it now owns 39% of the $34 billion April 2023 bonds and 60% of the $33 billion April 2024 bonds, according to **Mason Stevens**. It makes genuine price discovery limited as there are far fewer bonds trading in the open market.

The buying should go further along the curve, as it's distorting the yield curve. While 3-year is around 0.1%, it jumps to about 1.7% (and last week 1.96% before a rally) in the 10-year and above 2.5% in the 30-year. But the RBA resolve remains firm, and the market seems to be placing too much emphasis on the near-term threat of a rate increase. The RBA said this week:



"The Board remains committed to maintaining highly supportive monetary conditions until its goals are achieved. The Board will not increase the cash rate until actual inflation is within the 2 to 3% target range. For this to occur, wages growth will have to be materially higher than it is currently. This will require significant gains in employment and a return to a tight labour market. The Board does not expect these conditions to be met until 2024 at the earliest."

As this chart from **Fidelity** shows, wage growth in the blue dots from 2000 to 2013 was far stronger than in the yellow dots from 2014 to now, and in late

2020, wage growth was tiny and unemployment nearly 7%. We are a long way from meeting the RBA employment goals.

Two articles this week explore rates, inflation and economic conditions.

Simson Sanaphay expects a strong Australian recovery and describes five factors which will drive the outcome. Either way, expect bonds and inflation to be a much bigger influence on all assets in 2021 than we have seen for years. The important point for both Australian and US central banks is they are looking for (to quote US Fed boss, **Jerome Powell**) "actual progress rather than forecast progress" on inflation and growth before raising rates.

Then **Miles Staude** describes the market as a 'coiled spring' ready to jump ahead, with strong recovery signs and few clouds on the horizon (Australian GDP rose 3.1% in the December 2020 quarter, beating market expectations of 2.5%). He's one of many fund managers becoming more optimistic about 2021.

Remember also that rising bond rates are a sign of economic recovery, so it's not all bad for portfolios. An upwards move of bond rates is normal after our recent emergency period.

Dr Stephen Nash says the steepening of the yield curve with long bonds around 2% presents an opportunity to repeat the March 2020 trade where bonds provided some protection against the falling equity market. This trade clearly comes with downside price risk should rates rise further.

We haven't given much coverage to **Bitcoin** as its price movement looks like pure speculation not suitable for the portfolios of most of our readers. **Jordan Eliseo** explains why Bitcoin is unlikely to usurp gold as a preferred investment option for risk-conscious investors.

Take a look at the chart of the Japanese stockmarket below and its looks strong. But **Hasan Tevfik** reminds us that this is at the end of a lost generation of investment returns with the market still below its level of 1989. His worry is that some Australian companies might head down the same path, and there are stocks to avoid.

Source: Bloomberg

Hume and Frydenberg reset super with two buzz words

Graham Hand

Adding to the jargon that fills the superannuation industry and confuses most people, two common words have taken on new meanings. They sound innocent, but when a Morrison Government minister uses the words 'efficiency' and 'flexibility' in the super debate, they now have particular definitions. And in neither case is it the way we previously understood superannuation.

Let's find out what these words really mean.

Government draws on Retirement Income Review for changes

It's unlikely to make it on to commercial television or trend on social media, but last week's 2021 Policy Forum hosted by the Council on the Ageing (COTA) was a surprisingly lively affair. While both Treasurer Josh Frydenberg and Minister for Superannuation, Financial Services and the Digital Economy, Senator Jane Hume, have hinted at changes to superannuation before, they stepped up the rhetoric to another level. Some principles that have underpinned superannuation since the introduction of the Superannuation Guarantee in 1992 are under challenge.

The Policy Forum was also the first time that the three members of the Retirement Income Review appeared in public to explain their work. Chair Mike Callaghan did not hold back, saying that the industry trades off the public's fear of running out of money in retirement, and he audaciously cited former Prime Minister Paul Keating as an example of the scare tactics.

Committee members Carolyn Kaye and Deborah Ralston talked about the need for better communication and for retirees to understand a wide range of support measures other than superannuation, such as health, pensions and aged care.

So there was much deflection from the importance of super, and as we have previously written about, the Review encourages retirees to live off their capital and raises the profile of the family home as a retirement asset.

This momentum is reducing the role of income from super investments as the way to fund a retirement, and it's no surprise that Paul Keating comes out regularly to defend the system he feels is under attack. Two weeks before the COTA Forum, he told the ASFA Conference that it is essential to stick to the legislated increases in SG due to the rapid reduction in the number of workers paying taxes to finance welfare dependants such as age pensioners. He said 'self provision' must grow because:

"You are never going to get retirement adequacy off the back of the budget when there are only three taxpayers supporting each retiree."

Back to Frydenberg and Hume, here are some telling extracts from their COTA speeches, and words on the hymn sheet which have new meanings.

All we need are flexibility and efficiency

The Treasurer and Superannuation Minister are reframing the retirement debate in key ways:

- Retirees should not have a better standard of living than they did when they were working.
- Retirees should spend their superannuation savings before they die.
- Workers should not be forced to place excessive amounts into superannuation.

Previously, and especially under Keating, the public was encouraged to save as much as possible for retirement to reduce dependency on the age pension. Now, the Government repeatedly uses the words efficiency (or efficiently) and flexible (or flexibility) to justify a new approach.

Let's check the two speeches for clues. Jane Hume said at the start of her speech (bolding is my emphasis):

*"The Review found that '**more efficient** use of savings in retirement can have a bigger impact on improving retirement income than increasing the SG'."*

For 'more efficient', read not leaving it behind for the kids. There is less need for SG when retirees learn to live off their capital. She said that retirees on average live on the income generated by super assets and die with 90% of their savings still intact. That is not what superannuation is for.

*"Indeed the Review found if people currently in their working lives and currently contributing to super via the SG were able to use their superannuation **more efficiently** when they get to retirement in the future, they would have higher replacement rates and better retirement outcomes than if the SG was lifted to 12%."*

Come on, folks, it's obvious. BE MORE EFFICENT.

And what about the other gem, flexible. Here it comes, complete with another 'efficient':

*"This is why as a government and as an industry more broadly we must turn our minds to **more flexible and more efficient** products that allow retirees to use their super for a higher standard of living in retirement."*

How is it possible to make people feel more secure about spending when they may run out of money and worry about paying for aged care? Greater efficiency of course:

*"But there is also this all-important issue how superannuation is being used. How do we help people have confidence to use their superannuation **more efficiently** to focus their planning on income streams as opposed to balances?"*

So what is this magic pudding of products which funds retirement regardless of how long people live, the so-called CIPRs that are proving elusive for the private sector to develop? All we need is flexibility:

*"We all have roles to play here. The private sector can better innovate and develop **flexible** products."*

There was also much focus on the Retirement Income Covenant:

*"At its core it will require trustees to have a strategy to generate higher retirement incomes for their members. The Covenant allows super funds the **flexibility** to tailor their retirement income strategy to their specific membership base."*

Ah, thank goodness. It will be a flexible product to solve the retirement needs of members, but whether anyone wants it is another matter.

Surely the Treasurer would not be left out of the buzz word talkfest. First, he eases in by quoting the Retirement Income Review:

*"… a key finding of the Review with respect to superannuation, which is that "If people **efficiently** use their assets, then with the SG rate remaining at 9.5%, most could achieve adequate retirement incomes when combined with the Age Pension. They could achieve a better balance between their working life and retirement incomes."*

OK, so we only need 9.5%. But he's the Treasurer, he was never going to allow a humble Super Minister to outdo him on 'flexibility'. Let's sneak in five f-words in consecutive sentences in case anyone misses it:

*"The Review also identified the trade-off between **flexibility** and compulsion. The Review noted that our system has considerable **flexibility** if you want to save more for your retirement. But there is very limited **flexibility** if a person needs to save less to maintain their quality of life today. The COVID-19 early release of superannuation scheme was an example of how greater **flexibility** can benefit those that need it. Recognising the trade-offs, we gave Australians the choice of increased **flexibility**, allowing them to access their savings when they needed them most."*

Josh has not made it to Treasurer by half measures. In fact, far from undermining superannuation by giving people flexibility, the system is improved if personal preferences are met:

*"While compulsion will remain an important part of our system, providing Australians with more **flexibility** should not be seen as an attempt to undermine the system overall. Far from it ... More **flexibility** also means better accommodating the many different circumstances Australians finds themselves (in) over the course of their lives ... we have introduced several changes over recent years to provide greater **flexibility**."*

But let's not be outdone on efficiently either, which by now, we all know what it means – drawing down on capital:

*"Treasury has estimated that at the current superannuation guarantee rate, using superannuation **efficiently** could increase the median person's income in retirement by over $100,000 compared to how people typically draw down on their superannuation now."*

And there are many times when the Treasurer uses the word 'effective' to give the same meaning as 'efficient', so chalk that one up too.

What about the increase in the SG?

Besides influencing behaviour with this 'efficient' and 'flexible' babble, more tangible action by the Government will come soon in the form of a decision on the legislated increase in the SG from 9.5% to 12%, starting 1 July 2021. They they find support in the Review to remain at 9.5%. Said Jane Hume:

"In measuring adequacy, the Review used a benchmark of 65-75% of working life disposable income and found most people who start work today would be at or above the benchmark once they retire – even if the SG rate were to remain at 9.5%."

"Ever increasing amounts of superannuation contributions for your future retirement savings come at the expense of slower wage rises in your working life."

"In the context of the SG … we must consider the implications of compelling people to sacrifice more during their working lives - by forgoing the wages they could be taking home today – that they could spend today – that they could use to pay off a home today – they forgo all that so that their balances are larger at retirement."

There is the home coming into play. Superannuation prevents some people owning a home, a point influential Liberal, Tim Wilson, repeatedly pushes. Let's ignore the possibility that releasing billions into an already overheated property market would push up prices and make home ownership even more elusive for many younger people.

Is Hume supported by Frydenberg on the 9.5% sufficiency? Repeatedly.

"The retirement income system is, by definition, designed to provide retirement incomes. But the system cannot solely be about maximising income in retirement. Were it to seek to do so, it would clearly come at considerable expense to individuals during their working lives."

"For a median earner, increasing the superannuation guarantee could increase their retirement income by $33,000, but lower their working-life income by around $32,000."

"We must rightly carefully consider the implications of the legislated increase to the superannuation guarantee before 1 July this year – even more so at a time when our economy is recovering from the largest economic shock since the Great Depression."

"The Review shows that if nothing changes, by 2060, one in every three dollars paid out of superannuation will be part of a bequest. This raises the question as to whether the answer to lifting the retirement incomes of Australians is more superannuation savings or better guidance about how to maximise their superannuation savings during their retirement."

Let me guess … by using superannuation more efficiently with greater flexibility.

The meaning of efficiency and flexibility

So we now know what efficiency and flexibility mean, and it's simpler than the jargon that makes superannuation such a complex system.

Flexibility is the choice to meet current needs and wants by putting less into superannuation for retirement. There's a hint of not moving to 10% or 12% or alternatively, making it optional.

Efficiency (and its close cousin, effectiveness) is drawing down retirement capital instead of relying on income from super assets.

After all, as Senator Hume likes to remind us, "It's your money." Expect to hear these buzz words a whole lot more as superannuation remains a political battleground.

Graham Hand is Managing Editor of Firstlinks. He was a media guest at the 2021 COTA Policy Forum.

Why it's a frothy market but not a bubble

Roger Montgomery

Sometime in early 2021, a little doubt entered the otherwise optimistic narrative shining on the stock market.

Legendary US fund manager, Jeremy Grantham, started the ball rolling when, in his GMO missive, entitled "Waiting for the Last Dance" he compared current equity market pricing to Japan in 1989, the 2000 technology bubble and the rally up to the Great Depression. He wrote:

"The long, long bull market since 2009 has finally matured into a fully-fledged epic bubble ... 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."

Since the publication of Grantham's memo, he has heaped more burning coals on the heads of bulls and optimists, during interviews in which he pointed out:

"this bubble is more impressive even than 2000, which was the champion. About 80% of the value measures have this one higher. We'll be rather lucky to have this bubble last until May."

A moment of maximum enthusiasm

Grantham has also cited the preponderance of stock market profit stories headlining the press, the frequency of speculative madness in stocks such as GameStop and Tesla, and the plethora of SPAC (Special Purpose Acquisition Companies) IPOs as evidence markets are in the final stages of the bubble, noting:

"The market tops out when the last bull has put his last money in. There is a moment of maximum enthusiasm, and the next day there's plenty of enthusiasm but less than the previous day. So the buying pressure is released a little bit, like the famous water jets under the ping-pong balls. You turn the faucet down a little bit and the ball is still way up in the air, but it's just dropped a couple of inches. It's that process of slowly lowering the pressure, and the overpriced ping-pong ball slowly descends until it hits the proper level."

More recently, Bridgewater weighed into the debate with their analysis of the popularity of growth stocks. Bridgewater identified that many of today's largest companies share characteristics that originally supported a valid and logical investment thesis. That they have all used technology to leverage their margins and scale operations has led to the belief that all technology companies will enjoy the same success.

Consequently, investor capital has surged into any company holding the promise of similar success, irrespective of whether the probability of success is high or low. Of course, the issue with the 'all companies can succeed' mantra is that history doesn't support it. A few will win but most won't. According to Bridgewater:

"Only about 2% of stocks experience real annualised revenue growth of at least 20% for a decade. And, interestingly, that share has actually been on the low side for the last 10 years. And only a small share of about 5% are able to meaningfully expand margins by 15% or more. Doing both, as is currently discounted for around half of the [stocks in question], has historically been rare".

In fact, Bridgewater suggests just 0.5% will make it.

Increasing margins while growing rapidly is rare

As is common in the late stages of a boom, investors succumb to extrapolating the recent past, and in particular the experience of the FAAMGs (Facebook, Apple, Amazon, Microsoft and Google), into the distant future for all stocks.

According to Bridgewater, approximately half of the companies being priced to achieve extraordinary results are yet to even record a dollar of profit. Unlike the FAAMGs and others such as Salesforce, today's tech hopefuls are less mature and generate lower revenues and margins.

An unassailable rule of investing is 'the higher the price you pay, the lower your return". Most tech hopefuls have starting valuations that are extremely high. Bridgewater calculates that in order to generate 8-10% returns, these companies will need to grow over 20% a year for at least a decade. And while they are growing by at least 20% per annum, they will also have to increase their margins.

Of course, some of these companies will achieve greatness. Picking the winner is not so easy and a bet on all of them is bound to destroy wealth. FAAMG stocks are demonstrating business economics the likes of which the world has never seen before. Investors should own businesses with sustainable competitive advantages and ownership of FAAMG stocks is sensible. The most powerful competitive advantage is the ability to charge a higher price without a detrimental impact on unit sales volume and the FAAMGs have this.

Indeed, over the last five years, as these companies have increased in size, they have become even more profitable. As their equity has increased, so has their returns on equity. This is akin to an initial $1 million bank account earning interest of 10% per annum, then growing to $1 billion and earning a 25% interest rate. Clearly this is an extremely rare and attractive asset, and these are now the largest companies in the US with a combined market cap of US$7.7 trillion and strong price rises in the last year, as shown below.

Symbol	Company	Cap Rank 3-1-21	Market Cap 3-1-21	1d Chg 3-1-21	1m Chg 3-1-21	12m Chg 3-1-21
AAPL	Apple	1	2,185.2	5.4%	-4.7%	87.0%
MSFT	Microsoft	2	1,787.1	2.0%	-1.1%	46.3%
AMZN	Amazon	3	1,584.3	1.7%	-5.9%	67.0%
GOOGL	Alphabet	4	1,399.1	2.4%	9.3%	54.5%
FB	Facebook	5	754.4	2.8%	1.1%	37.6%

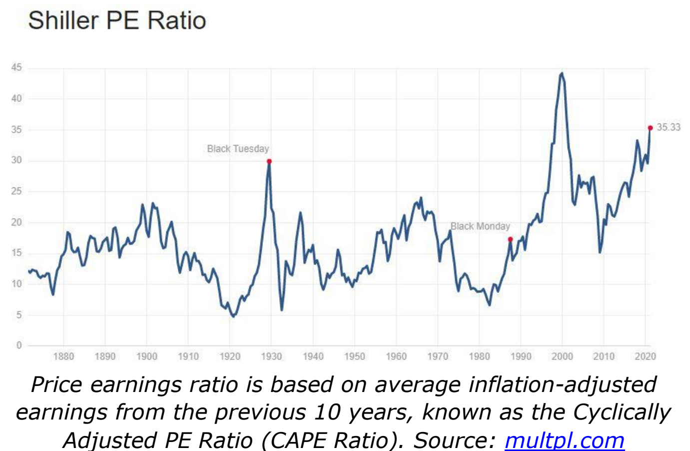
Source: Dogs of the Dow

Additionally, during the first tech boom of 1999, the internet's infrastructure was not capable of fulfilling the then aspirations of the internet hopefuls and their investors. Further, in 1998, there were only 150 million internet users. Today there are 4.7 billion internet users worldwide, yet it has reached only 59% of the world's population implying a very long runway for further growth.

Bubbles in places but not entire market

Bubbles in some segments of the market does not mean the entire market is in a bubble. Nevertheless, paying a higher price - even for those companies that will succeed - will generate a lower return.

Nobel Laureate Robert Shiller channels the 'high price, lower return' aphorism when he points out the current second-to-record-high for his CAPE ratio may not accurately forecast a crash but it has done a good job predicting the annual return for the subsequent decade. At 35 times earnings, the best annual return that can be expected from the S&P500 index for the next 10 years is low single digits.



Price earnings ratio is based on average inflation-adjusted earnings from the previous 10 years, known as the Cyclically Adjusted PE Ratio (CAPE Ratio). Source: multpl.com

Here in Australia, the Future Fund's house view is that most market scenarios are, over the longer term, pretty grim. In order to expect anything more, the Future Fund says an investor must believe:

- monetary policy isn't close to exhausted and could help support the world through a fresh crisis
- the unusual political consensus on massive fiscal stimulus holds
- the COVID-19 vaccine rollout continues apace and is able to deal with mutations
- the economic recovery develops smoothly, and
- that inflation doesn't return for a long time to come.

Back to Grantham, his fears of a crash pivot to some degree on anecdotal observations about the proliferation of unbridled optimism in some segments of the market.

I would counter however that many of these bubbles have already burst without interrupting the market or its advance.

Last year, for example, bubbles formed in the shares of Hertz, Kodak and Nikola. These stocks rallied between 500% and 1500% in just a few months. They crashed by 85% in even less time and yet the market was not interrupted. Similarly, Bitcoin crashed by the same magnitude in 2018 and the stock market went on its merry way.

Are bubble stocks widely held?

My view is that bubbles can form and deflate in blissful isolation provided the assets busting aren't held, in any significant proportion, on the balance sheets of systemically important financial institutions.

Yes, the market is expensive overall. Shiller's CAPE ratio confirms this. But low interest rates justify higher valuations, and a quarter of the market is made up of businesses with economics the likes of which the world has never seen before. That there are pockets of rampant speculation is undeniable, but bubbles have burst recently without disrupting the broader market's advance.

The only valid argument for a major pullback in markets is the steepening of the bond yield curve. Rising bond yields act like gravity on the intrinsic value and prices of all assets including equities. The increase in 10-year bond rates recently has already had a significant impact on the present value of dollars earned in the distant future, especially long duration growth stocks – those currently making no money but expected to in the distant future.

Any further steepening of the bond yield curve - whether because central banks have failed to manage the curve through Quantitative Easing, or because inflation emerges as a genuine concern – will have real world impacts on the market valuations of those growth stocks.

Jeremy Grantham is right to warn investors of the bubbles in these types of stocks, but a broad share market crash would be entirely coincidental. A watchful eye should instead be kept on the yield curve as it has real world consequences and a traceable cause-and-effect.

Roger Montgomery is Chairman and Chief Investment Officer at Montgomery Investment Management. This article is for general information only and does not consider the circumstances of any individual.

Five factors driving the great Australian recovery

Simson Sanaphay

Australia's economic recovery is expected to be driven by a 7.3% boost in household spending in 2021 as an embattled population loosens the purse strings and gets back to business as usual.

While the pandemic is still a persistent threat, it is giving way to a return to more normal living conditions, and both job security and employment are improving with better business conditions.

Underlying the recovery is an improving economy, which is being boosted by strong minerals exports, high commodity demand, and good growing conditions resulting in improved agricultural exports. This is despite ongoing difficulties in Australia's relationship with its biggest trade partner, China.

We expect the trade surpluses Australia has achieved for the past three years to continue in the years ahead.

Those positive conditions have been aided by the extraordinary government and financial institution support through the pandemic, which allowed household finances to remain relatively healthy and stave off more difficult circumstances, like mortgage defaults and financial stress from lost employment.

As we entered 2021, about 90% of the jobs lost to COVID-19 had been recovered, and unemployment is expected to further improve this year from 6.5% currently to about 6% by year end.

COVID-19 risks remain

These positives aside, it is important to remember everything will not snap back to normal:

- Wage growth remains low, and we expect that to continue as businesses seek to recoup losses made during the pandemic and protect balance sheets against any further disruptions.
- Unemployment was about 5% before we went into lockdowns, it is not expected to return to this level in the next few years.
- Inflation to stimulate economic growth remains absent. We are relying on government and Reserve Bank of Australia (RBA) policies to create reflation – which is the measured release of inflation back into the economy through policy.
- Businesses that relied on pandemic-induced support may not survive as conditions normalise and support is withdrawn.

Because of these impacts, we do not expect the RBA to change its loose monetary policy stance. We forecast the RBA to keep the cash rate target unchanged for the next two years, and note the RBA's February guidance that it will not raise the cash rate until inflation is persistently within its target level of between 2-3%. The RBA does not expect this condition to be met until at least 2024.

That said, the impact of the pandemic on Australia was not as great as in most other regions, like Europe and the Americas. It may create an effect where Australia's growth appears to be lagging other parts of the world as they recover from the pandemic, but that is only because we are not starting from such a low base. As a result, growth is not expected to be as strong when vaccines are made available compared to other countries severely impacted by the virus.

Our forecasts can of course require adjusting if new variations of the COVID threat create new emergency conditions, but at this point we expect it would blunt growth forecasts, not derail the recovery. No doubt the inverse is true if COVID is effectively mitigated further, as a result of the imminent rollout of vaccines.

Top five recovery factors to watch

1. Vaccines and the path to immunity

Our economics team anticipates that Australia will achieve herd immunity by the end of this year. By January 2021, Australia had secured 115 million doses of various vaccines, with the Federal Government managing a phased rollout through the general population, starting with priority groups liked aged and disability care and frontline health workers.

We expect the rebound in growth that commenced in the second half of 2020 to continue, but there is a high degree of uncertainty regarding when the Federal Government is willing to reopen international borders. Our best estimates are for the international borders to remain closed in 2021 with a reopening more likely in 2022.

2. Exports and the China factor

If international borders open in 2022, this will coincide with the broader rollout of vaccines in many developed economies. One area of specific concern when it comes to exports is education. Plans to bring back international students in 2021 remain uncertain and our education exports - which totalled $40 billion in 2019 - will continue to negatively impact net export data. However, overall exports are expected to rebound this year, driven by China's strong appetite for iron ore to feed its heightened capital expenditure programs.

We believe that Australia and China trade relations are unlikely to derail growth. More recently, there has been a conciliatory tone between diplomats, which suggests that trade relations are unlikely to deteriorate further and could see some improvements in 2021. Thus, improved relations with China could be a source of upside sentiment.

3. Housing

We refrained from calling a crash in the housing market at the start of the pandemic last year, owing to various demand support measures introduced by the government, along with highly accommodative monetary policy and loan deferrals for stressed mortgages. We had pencilled only a modest decline in prices in 2020, but housing demand trumped our expectations and growth moderated to 2% through the year in December 2020. Since house prices have troughed, further improvements are likely in 2021. We have further upgraded our outlook and now look for house prices to finish +7.2% higher by year-end (upgraded from +2.8% previously).

4. Currency

Currency investors were preparing for the RBA to step back from its commitment to keeping interest rates on hold until 2024, in light of a 90% recovery of the jobs lost in the Australian labour market and quicker return to growth, helped by China's quick path to recovery and higher economic growth. This has resulted in the Australian dollar appreciating by over 25% since the depths of the pandemic.

5. Enter the US

The US is also in position for a strong spring back. Given how hard its economy and population were hit by the pandemic, the progression of a relatively smooth inoculation program could see the US economy perform strongly in the second half of the year. Since it is starting from a lower base, we expect a steeper curve in the US growth path compared to Australia as its government and Federal Reserve continue to ramp up further stimulus measures and inoculation shifts towards herd immunity.

A positive outlook

Citi is positive on the outlook for the S&P/ASX200, based on our top-down earnings per share (EPS) outlook and a market multiple of 19.5x. We expect the index to reach 7,000 by end-2021 (at end of February 2021, it was about 6,700). Australia's healthcare is well under control in comparison to other developed markets. Resource and bank stocks outperformed in the last quarter of 2020, and we think the positive view for these stocks can extend further.

The opportunity is present for investors to diversify into US denominated assets on AUD rallies. We remain neutral on preference for US or Australian equities as both markets are positioned for growth. However, US banks may outperform given the stimulus agenda under discussion in the US and the Biden administration's prioritisation of recovery and growth.

Simson Sanaphay is Chief Investment Strategist for Citi Australia, a sponsor of Firstlinks. This article is general information and does not consider the circumstances of any investor. For more Citi articles, please click here.

How bonds may temper equity market disappointment

Dr. Stephen J. Nash

Paying attention to the current settings of fiscal and monetary policy, as well as the prospects for inflation, gives a reasonable explanation of current market valuations. This allows investors to better understand how bonds, especially long bonds, might strategically act to temper disappointment when stockmarket expectations are elevated.

Context of fiscal and monetary stimulus

At present, global governments and central banks have set a highly stimulatory setting for equity markets, as a way of offsetting the depressing impact of the pandemic, both in terms of fiscal and monetary policy.

Let's check the context for each.

a) Fiscal policy

The Australian Government has increased spending substantially, with Federal net debt expected to grow to around 43% of gross domestic product (GDP), peaking in the period 2023-24. Large stimulus measures, such as JobKeeper, which will stay in place until March 2021, a programme that alone will cost around $90 billion.

In terms of US fiscal policy, there was the initial US$8.3 billion Coronavirus Preparedness and Response Supplemental Appropriation Act, a second US$3.4 billion stimulus package and two other packages of US$2.3 trillion and US$900 million. Currently, President Biden is seeking to provide another US$1.9 trillion of stimulus. Similar fiscal stimulation measures are in place in Europe.

These fiscal stimulus packages are about as large as they possibly could be.

b) Monetary policy

Domestic monetary policy has been eased to completely unprecedented levels, with the RBA expecting to leave rates low for the next three to four years. Bond buying aims to keep the three-year rate at 0.1%. Similar low rate commitments have been made in the US and Europe.

What does this context mean for equity valuations?

Fiscal stimulation is generally aimed at improving the growth at an economy, and the equity markets have come to a consensus view: the vaccine effectively builds a bridge from the current situation of high unemployment and low growth, to a higher level of economic growth and lower unemployment.

As this consensus view has gradually been adopted, a higher level of growth has gradually been built into the pricing of equities, especially the S&P500. One measure of the long-term valuation of the S&P500 is the Schiller PE, where price is divided by the average of 10 years of earnings, adjusted for inflation.

In the past, prior to all the monetary easing of the last decade, a good rule of thumb was to buy the S&P500 around levels of 5 on the Schiller PE and then to sell equities as the level exceeded 25. However, the Schiller PE is so elevated that the old range of 5 to 25 seems to have been skewed upwards to a new range between 15 and 35.

The current Schiller PE is at the top of this adjusted range. In addition, if the current stimulation is withdrawn, and interest rates revert to longer-term averages, then the Schiller PE could then adjust back towards the older range.

Will stretched valuations lead to volatility?

Given this elevation, markets should magnify even trivial issues, and possibly decline more than they would, in the absence of such an elevation. Some issues could inspire this decline by questioning the validity of the 'bridge-building' view of economic growth.

A list of the possible issues is:

Antitrust and technology: Regulation of the large technology companies in the US, especially regarding anti-trust regulation. This debate has been developing for some considerable period of time.

Pandemic variants: The efficacy of certain vaccines may come under increasing scrutiny, as variations of the pandemic become more apparent, and as those variants resist the existing suite of vaccines.

Default acceleration: Business defaults may begin to accelerate, much more than currently expected, once existing relief measures are eventually withdrawn.

Inflation rises: Recent increases in commodity prices are significant, and these have been largely absent over the last decade. The rise of commodity prices might be more about the declining US dollar, but higher commodity prices tend to support higher inflation, all else being equal. If inflation does break out substantially, then rates will rise, meaning current equity valuations will be revised downwards.

Underestimation of virus impact: In general, markets may be underestimating the impact of the virus on the economy, and a recent series of jobless claims releases, where the market has underestimated the size of the jobless claim numbers, is indicative of a complacent attitude.

This is not an exhaustive list and I am not maintaining that any of these triggers will occur in the short term. Rather, the strategic point here is that current valuations should elevate volatility due to stretched valuations.

Role of bonds to cushion equity volatility

The typical institutional portfolio includes a dedicated allocation to long-dated bonds. However, the low level of bond yields has presented the idea that the defensive power of bonds might have collapsed.

To explain, if bonds are already low in yield, then expecting large declines, possibly in reaction to an equity market decline, was seen as not feasible. Even put more simply, if 10-year rates are at 5%, then they can fall a lot, but if they are at 0.5%, then they can still fall, just a lot less.

However, following recent rises, long bond yields are now back to where they were just before the pandemic started. Among other things, this reflects optimism and the deflation of that optimism should enable yields to fall substantially again from current levels in the event of a decline in equity pricing.

For the sceptics out there, I am not saying that bond yields have peaked and that they will not rise for years. Rather, bond yields now reflect the optimism in equity markets, and that optimism is increasingly ephemeral, given the elevation in the Schiller PE.

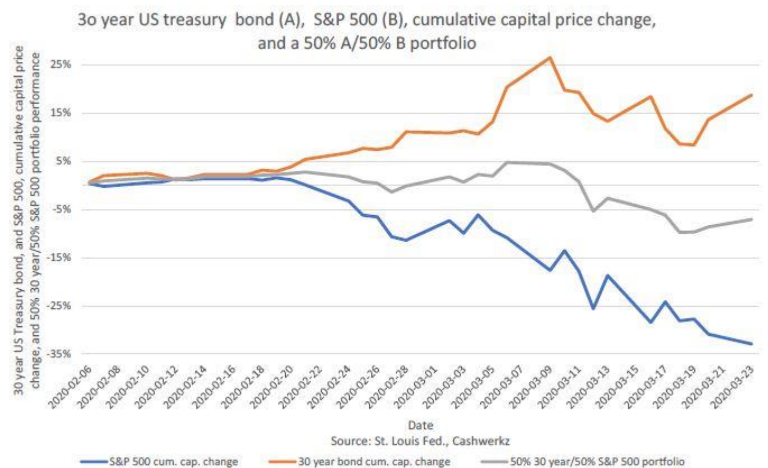
More importantly, and from a strategic perspective, bonds now provide a feasible equity volatility cushion. If equity pricing comes under pressure, a small retail portfolio should benefit from what every institutional portfolio has: a long bond allocation.

If you have a long bond with a 10-year modified duration, then for every 100 basis points that the bond moves in yield, the capital price of bond will vary by roughly 10%. Equally, if the modified duration is 20 years, then the impact on bond prices if yields decline 1%, is roughly 20%.

Of course, the reverse is true as well.

An example of how long bonds helped the portfolio last year

Now, if equity pricing declined by, say 20%, it is likely that long bond yields will decline in yield, which means that capital prices will rise. A decline of 0.5% in the long bond yield might a reasonable estimate of how far a bond yield might decline in a 20% equity decline, although estimates of bond yield declines in situations of economic stress are usually unreliable.



In this situation, where the long bond declines by 0.5%, the capital price on the 10-year modified duration bond would rise 5%. It helps to partly offset, to cushion, the loss from equities to some extent.

The chart indicates in the crisis period of February 2020, 30-year bonds went up strongly in price, as shown by the orange line, and that price increase assisted portfolios which were experiencing losses form equity

positions. A 50/50 portfolio of 30-year US Treasury bonds and S&P500 equities would still experience losses but significantly less as shown by the grey line, relative to a portfolio without long bonds, as shown by the blue line.

Conclusion for your portfolio

Equity valuations are currently lofty, but long bond rates have now returned to where they were before the pandemic crisis of March 2020. Generally, this confluence of events means that while you hold equity in your portfolio, the bond market has recently provided an opportunity to cushion the volatility of equities, by buying longer dated bonds. If equities continue to rise, then you can focus on the overall growth in your portfolio.

Dr. Stephen J. Nash is a member of the FTSE Asia Pacific Fixed Income Index Advisory panel, the author of an extensive list of published journals, and an independent specialist partner of BondIncome, a sponsor of Firstlinks. This article is general information and does not consider the circumstances of any investor. Please consider financial advice for your personal circumstances.

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10 key takeaways on gold, Bitcoin and the Elon effect

Jordan Eliseo

"Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria." - Sir John Templeton

Irrespective of whether you think Bitcoin is a Ponzi scheme, the future of money, or something in between, there is no doubting it is grabbing global attention as front-page financial news.

Prices rose to more than US$50,000 per coin in February 2021, helped by news that Tesla invested US$1.5 billion into the cryptocurrency. From early March 2020, when it was trading below US$5,000, the Bitcoin price rallied more than 1,000%, though it has pulled back in the last two weeks.

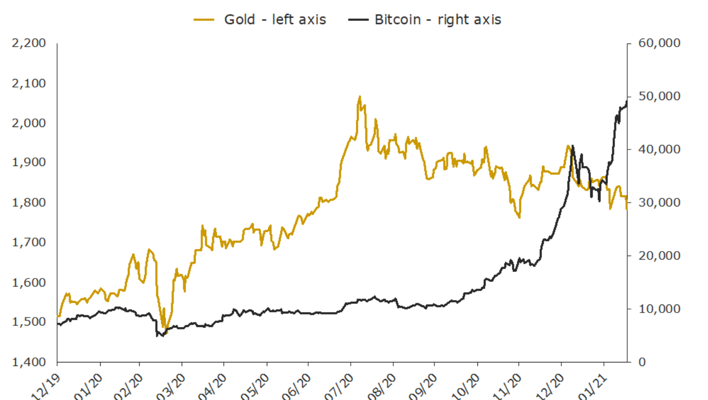
Has Bitcoin taken gold's mantle?

The skyrocketing price of Bitcoin has more or less coincided with a meaningful pullback in gold, as shown below, which had traded at all-time highs above US$2,000 per troy ounce in August 2020.

Given the divergent fortunes of the two assets in the past few months, there is no shortage of commentators stating that the precious metal is being usurped by its purported digital counterpart, with some going so far as to encourage investors to drop gold and reallocate to Bitcoin instead.

Our latest report, *Gold, Bitcoin and the Elon effect* (linked below), questions the wisdom of this narrative, not least because of the multiple bubble warning signs in cryptocurrency markets today.

Gold and Bitcoin prices – December 2019 to February 2021



Source: World Gold Council, LBMA, Coinmetrics, data to morning of 17 February 2021

These include the parabolic price move itself, the launch of Bitcoin ETFs and planned IPOs of cryptocurrency exchanges. It is hard to think of a more euphoric moment for Bitcoin than the world's richest man using company money to invest in this nascent asset class.

Despite those warnings, we have no strongly held view on where the Bitcoin price goes from here, and acknowledged that as a market, it has matured since the last mania seen in 2017. There is now better transparency around liquidity data, enhanced custody solutions and a range of new product offerings, all of

which are helping generate interest. Our report highlights the multiple attributes by which investors can, and indeed should, compare gold and Bitcoin, which remain two vastly different investments.

With one notable exception, gold appears to have advantages over the world's most famous cryptocurrency.

10 key takeaways on gold versus Bitcoin

1. Bitcoin beats gold hands down for generating speculative returns in rapid fashion, and likely always will. There is a price to pay for this, with larger drawdowns (price falls), and volatility that is 12 times higher than gold.
2. The gold market (which includes gold used in jewellery form, industry, ETFs and physical bars and coins) is significantly larger in terms of overall value, with a market capitalisation that is more than 10 times the Bitcoin market. The gold market is substantially more liquid, averaging approximately 90 times the daily turnover of the Bitcoin market in 2020, though liquidity in cryptocurrency markets has risen substantially in the past few months.
3. Free storage options for gold can be much lower risk than free Bitcoin storage options given the counterparty risk inherent in the latter.
4. Gold is a lower cost investment than Bitcoin, with gold ETPs like Perth Mint Gold (ASX:PMGOLD) offering gold exposure for 0.15% p.a. versus 1-2% p.a. for existing Bitcoin products.
5. Gold has a more diverse set of use cases – for investment, as a reserve asset for central banks, as a display (and store) of wealth in jewellery form, and in industry. Bitcoin is almost exclusively used for speculation, with payment volumes across the cryptocurrency network declining in the last three years.
6. Gold has a multi-millennia track record as a store of value and has been the best performing asset in equity market corrections over the past 50 years. In contrast, it is far too early to say that Bitcoin is a store of wealth. This is no fault of Bitcoin per se, rather an acknowledgment that it has only existed in an era of low inflation, economic expansion (up until COVID-19), and a record bull market run in equities.
7. Physical gold can play a beneficial role in a portfolio, given its low overall correlation to financial assets, its traditional outperformance in risk-off environments, its high liquidity and lack of credit risk. By comparison, despite the recent surge in the price, there seems little compelling reason for institutional investors or companies to include Bitcoin in diversified portfolios or on company balance sheets.
8. Gold's network effect is far stronger than Bitcoin's, evidenced by the perpetual marketing of Bitcoin as digital gold. Gold is not marketed as analogue Bitcoin!
9. Bitcoin remains under threat both from hard forks and corruptions of the Bitcoin network itself, as well as thousands of other cryptocurrencies. Gold remains globally recognised as a store of wealth, a status that has been built over thousands of years and remains rock solid (pun intended) today.
10. The gold market is far more decentralised, with the precious metal mined, refined, and owned by central banks, households and investors the world over. Bitcoin is predominately held by a small group of owners, while mining is overwhelmingly concentrated in one country.

Given the above factors, the precious metal will still likely be the preferred investment option for risk-conscious investors looking to protect capital in the years ahead.

The full report can be accessed here.

Jordan Eliseo is Manager of Listed Products and Investment Research at The Perth Mint, a sponsor of Firstlinks. The information in this article is general information only and should not be taken as constituting professional advice from The Perth Mint. You should consider seeking independent financial advice to check how the information in this article relates to your unique circumstances.

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The coiled spring: markets are primed for the year ahead

Miles Staude

A year into a global lockdown, most people are desperate to get their lives back. With vaccine programmes now being rushed out around the world, the good news is that many of us will soon get that wish. In economic terms, what will be unique about this process will be the speed and ferocity of the bounce back that the reopening brings. Financial markets currently expect the effect of this to be akin to a coiled spring: an enormous amount of pent-up financial energy sitting there, waiting to be released.

Ready, steady…

Unlike typical recessions, what differentiates this recent downturn has been its cause - an external shock to the economic system. More normally, recessions are caused by internal shocks. Imbalances build to such a level that the edifice gives way. The resulting fall-out from these events creates significant demand destruction that can take years to fully return.

In contrast, the COVID-19 recession was characterised by deliberate acts of demand suppression. To save millions of lives, governments around the world effectively switched large healthy parts of the economy off.

What's more, governments have responded to this crisis with fiscal packages that dwarf those seen during any past recession. In economic downturns we expect our governments to act counter-cyclically. As demand suddenly disappears from the economy, governments alone have the ability to engage in the large spending programs needed to make up the shortfall.

With this in mind, the lesson most economists took away from the aftermath of the GFC, is that governments were too quick to impose 'austerity' on recovering economies. In contrast, however, history will probably show that governments opened the spigots too wide following COVID-19. Looking at the US as an example, it is estimated that the recession has cost US households around US$400 billion in income. Against this, the government has already doled out US$1 trillion in transfers, with five out of every six unemployed people taking home more from unemployment benefits than they received in their prior job. In addition, and with democrats now (just) controlling all chambers of government, Congress is currently debating a further $1.9 trillion relief spending package.

Have money, will spend

This moves us onto another key argument supporting the coiled spring theory. Due to forced restrictions on individuals' spending and unprecedented government largesse, households have substantially strengthened their finances throughout the lockdown. This is highly unusual behaviour during a recession.

Andy Haldane, the Chief Economist at the Bank of England, recently predicted that UK households could be sitting on £250 billion of excess savings by June 2021, some 20% of annual household spending in the UK. In the US, excess savings are already estimated to have reached US$1.5 trillion. They are forecast to hit US$2 trillion if the latest relief package is passed.

Having been locked away for over a year, it is no stretch to envisage people being eager to get out and spend this money. How much of it they will spend is hard to know. Unlike a typical recession, government actions have spared us the usual trauma that big downturns bring. While COVID has brought immeasurable suffering to society, most households have come through this period well-supported and with increased savings. It is easy to picture consumers coming out of the blocks with a far greater willingness and ability to spend than we normally see during a recovery.

Added to this, government spending is also far from done. In Europe, the new €750 billion EU recovery fund has barely begun disbursing its money. In the US, while the initial headline figure of the US$1.9 trillion in additional relief may be pared back on its passage through congress, expectations are settling on it still ending

as high as US$1.5 trillion. Moreover, parts of this package could boost demand well beyond the headline numbers.

The US proposal also includes legislation that would more than double the US minimum wage from US$7.25 an hour to US$15. What's more, the new Biden administration has its sights on a further US$2 trillion green energy and infrastructure spending bill being its next legislative objective. If passed, these programmes combined will deliver total spending of more than 15% of US GDP.

Great expectations

Financial markets are now anticipating this upswing with a giddy mix of excitement and fear.

The excitement is the easier part to understand. Global GDP growth expectations have steadily been marked higher over the past two months, particularly in the US, which, before the arrival of Covid, had been the key driver of global equity returns. Indeed, in recent weeks, a number of the major investment banks have been pencilling in US growth rates of over 6% for 2021. These sorts of figures would imply that US GDP will be *higher* in 2022 than it would have been absent the pandemic.

If that bears out it will be a remarkable development.

Naturally, expectation of the strong bounce-back has fuelled investors' animal spirits. February 2021 saw the largest weekly inflow into global stock funds on record. Boosting the appeal of equities today is the TINA ('there is no alternative') phenomenon. With investors facing negative real (after inflation) interest rates, there are few viable alternatives to equities.

That brings us onto the fear. With signs of wide-spread investor bullishness everywhere, a debate has opened about whether this good news is already priced into markets, and whether stock markets, particularly the tech sector, are moving towards the later stages of an asset price bubble.

History shows that, once primed, markets tend to follow their own momentum until they hit a clear opposing force. With negative real interest rates, vast amounts of government stimulus coming through and expectations of a strong rebound in growth, there is only one obvious roadblock ahead on the horizon – the return of inflation.

For the last 40 years, every inflation scare the market has faced has proved to be a false dawn. Whether it does now make a return is likely to be the defining issue for markets in 2021. If it does not - and absent some other external shock – there seems little standing in the way of the market bulls as the spring is uncoiled.

Miles Staude of Staude Capital Limited in London is the Portfolio Manager at the Global Value Fund (ASX:GVF). This article is the opinion of the writer and does not consider the circumstances of any individual.

Is Australia turning Japanese? Watch these stocks

Hasan S Tevfik

On 15 February 2021, the Japan Nikkei Index hit 30,000 for the first time since 1990. Media reports celebrated the milestone. However, we think it highlights the misery Japanese equity investors have endured for more than three decades. The Nikkei is still 23% below the all-time-high achieved in December 1989 at the peak of one the greatest equity bull markets in history. Since then the Japanese equity investor has endured an annualised capital *loss* of 0.2% and a paltry total return of 1.1% p.a. with dividends.

How did this happen? Can it happen in Australia?

Why Japan has performed poorly

Our analysis indicates the three main drivers of the dismal equity returns in Japan include:

1. High starting valuations
2. Dilutive equity issuance, and
3. Mediocre profits growth.

First, the Japanese equity market traded on Price/Earnings ratio of 60x in 1989. At the time it was the most expensive market in the world, by far, and it is a valuation level US tech stocks achieved in the late 1990s bull market. Now the Japanese equity market trades on 23x and the derating over the last 31 years has been a 3% per annum drag on equity market returns.

The **second** largest contributor to poor returns has been dilution. While Japanese profits have grown by around 4.6% p.a. since the peak in the bull market, Earnings Per Share (EPS) growth has been a puny 2.8%. Much of this dilution has come from recapitalising the overly-leveraged banks. However, Japan Inc's unwillingness to put equity investors first as stakeholders has led to an erosion of equity returns if it means not sacking employees or restructuring businesses.

Third, mediocre profit growth has contributed to poor returns, but we think this should not be over emphasised. Profit growth of 4.6% p.a. is only 2% lower than what we have enjoyed in Australia over the same period. We think much of the difference has been due to the less forgiving inflationary backdrop in Japan.

So it is de-rating and dilution which have been the biggest culprits of the lost decades for Japanese equity investors. It has been less about deflation and an aging of the population, in our view.

Watch the ridiculous prices and equity diluters

To avoid future lost decades, our work suggests equity investors will need to avoid stocks which are ludicrously priced and are also likely to be big shareholder diluters (that is, issue large amounts of capital when not required) in the years to come.

While we don't see either for the entire Australian equity market (but we are still early into the current bull cycle), we can see parts of the market which could deliver painful shareholder returns over the long-term.

The buy-now, pay-later (BNPL) sector could be one area. The stocks here are exorbitantly priced with Afterpay trading on 250x EV/EBIT. Potentially dragging shareholder returns further could be the capital intensity of these businesses. Credit providers have an insatiable appetite for new equity if they would like to grow. Afterpay, for example, has grown its share count by 20% over the last two years. Shareholders should expect further issuance to come. Afterpay just raised $1.5 billion in a convertible debt issue.

Another potential lost decade sector could be the infrastructure stocks. These companies are highly valued and are benefitting from low bond yields which keeps down their cost of capital. However, shareholders may have to endure dilution *and* de-rating in a world where bond yields push higher on a sustained basis.

While the potential for a lost decade should not weigh on short-term investor willingness to buy into these stocks, longer-term investors should avoid areas of the market that are turning Japanese. This is a sorry chart and set of numbers (ATH=All Time High).

Figure 1: Three decades and still not at ATH

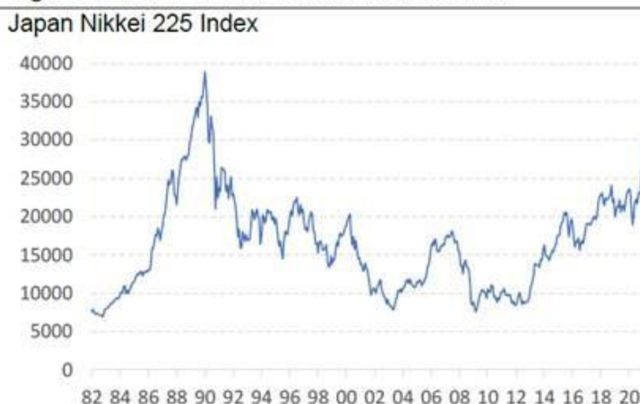


Fig 2: De-rating & dilution weighing down Japan returns

Components of Japan equity returns Dec 1989 to now (p.a.)

Component of Total Return	Contribution p.a. (Dec 1989 to now)	Comment
Valuation	-3.0%	60x PE in 1989 vs 23x now
EPS	2.8%	
Profits	*4.6%*	*Not bad considering lack of inflation*
Dilution	*-1.7%*	*Recapitalisation of banks, shareholder is not the most important stakeholder*
Capital Return	-0.2%	Lost decades!
Dividends	1.3%	Again, shareholders not most important of the stakeholders
Total Return	1.1%	Japanese 10yr bonds delivered 4% p.a. over same period...ouch

Source: Factset, Refinitiv, MST Marquee

Hasan Tevfik is a Senior Research Analyst at MST Marquee. This article is for general informational purposes only and is not a solicitation of any offer to buy or sell any financial instrument or to participate in any trading strategy.

Additional articles, including two marking International Women's Day

How do women really invest? *Christine Benz*

Five lessons from the 'Witch' of Wall Street *Karen Wallace*

Will rising bond rates hit your share portfolio? *Graham Hand*

Editorial

In this Weekend Edition, we include two new articles on women and investing to celebrate **International Women's Day 2021** on 8 March 2021.

Christine Benz checks whether the popular claim is correct that women do not invest as aggressively as men, and we have added Australian data to confirm her findings.

Then **Karen Wallace** examines five lessons from the life of **Hetty Green**, who became a highly successful investor, dubbed the Witch of Wall Street. The title comes mainly from her reputation for extreme frugality, but the lessons are relevant for all investors.

Weekend market update: It shows the perils of short-term predicting when the AFR carried the headline on Friday, 'Bonds blow up equity markets - again' and that night, the S&P500 rallied 2%, NASDAQ recovered 1.6%, and Australia is likely to open strongly on Monday. The US recovery was driven by strong payroll data leaving the market up 0.8% for the week, which hardly looks like a 'blow up'. Australia gained 0.6% last week despite losing 0.7% on Friday.

We have added another article this weekend on what is happening with bonds and how it might affect stockmarkets.

How do women really invest?

Christine Benz

"Women invest less aggressively than men."

How many times have you heard that assertion? And indeed, numerous studies point to women having lower stock weightings than men.

But a closer look at the data suggest that women's lower average incomes - rather than gender-related risk preferences - are the key driver behind their lower average allocations to stocks. Women earn less, on average, than men. And not surprisingly, people with lower incomes contribute less and invest less in stocks than do higher-income people.

That skews the data on women's average savings rates and equity allocations downward. But after controlling for income, it appears that women contribute as much to their retirement accounts and invest just as much in stocks as men at the same income levels.

That suggests that the key area of concern for women's financial health relates to income rather than any sort of risk aversion that's specific to women.

Digging into the data

To be sure, it can be difficult to draw conclusions about how people invest, or how much. There's no central repository of information about investing behaviors for women or men. Any hard data is siloed by investment provider and account type. To the extent that investment firms study and share information about their investors' choices, it's necessarily influenced by the specific composition of their client bases: income levels, what industries their clients work in, and so forth.

The data from individual firms may not be representative of the investing population at large. Extrapolating conclusions from brokerage accounts - rather than retirement accounts where it's at least likely that most contributors are saving toward retirement rather than shorter-term goals - seems especially risky.

Moreover, numerous factors may influence investment decisions: income, education level, marital status, age, and gender, to name some of the key ones. That makes it difficult to untangle what role gender plays in investment decision-making.

(Note that some of the following data relates to the US data, although the conclusions have general applicability. A section at the end is added on Australian data).

To help shed some light on these issues, I delved into available research to look at women's investing behaviors in three key areas: contribution rates, equity weightings, and willingness to use professional advice. I focused on retirement-plan participants in an effort to remove the noise of people saving for goals other than retirement.

The conclusion? Women do indeed appear to exhibit different behaviors than men in each of the three areas. But many of those trends decline or melt away altogether when the data are adjusted for demographics, especially income level.

Participation/savings rates

Women have fewer financial assets and lower company retirement plan balances, on average, than their male counterparts.

In Vanguard's 2020 How America Saves report, a compendium of statistics on more than 5 million participants in Vanguard 401(k) plans (roughly equivalent to Australia's superannuation system), the average deferral rate (that is, the portion of wages automatically deducted for retirement savings) for men was estimated to be 7.1% in 2019, versus 6.7% for women. Interestingly, the gap in deferral rates has widened between genders over the past decade. The average deferral rate for both men and women in Vanguard retirement plans in 2010 was 6.9%.

(Note the article on How Australia Saves here).

David Blanchett, Head of Retirement Research for Morningstar Investment Management, made a similar observation when assessing the behavior of more than 1 million retirement savings participants, using data from another major retirement-plan recordkeeper. The average deferral rate was 9% for male participants in that sample group, versus 8.1% for women.

Yet intuitively, those differences appear to be related to income levels. In the Vanguard research, for example, women with incomes of less than $29,999 had lower deferral rates than males at that same income level. But at every income band over $30,000, women actually invested more than males at that same income threshold. For example, women with incomes between $75,000 and $99,999 deferred 8.3% of their salaries, versus 7.8% for men at that same income level. Blanchett's observation was similar: After controlling for demographics, the differential in contribution rates between men and women was just 0.01%.

Men were more likely to contribute the maximum allowable amount to their company retirement plans, according to Vanguard's report. 11% of male company retirement plan participants did so, as of 2019, versus just 8% for women. But here again, that differential likely owes to income differences: Because of men's higher average salaries, they likely have greater wherewithal to contribute the maximum allowable amount.

Investing choices/asset allocation

What do the data say about investment choices - specifically, the oft-cited assertion that women are more conservative than men? The available research suggests that the answer here, too, is nuanced.

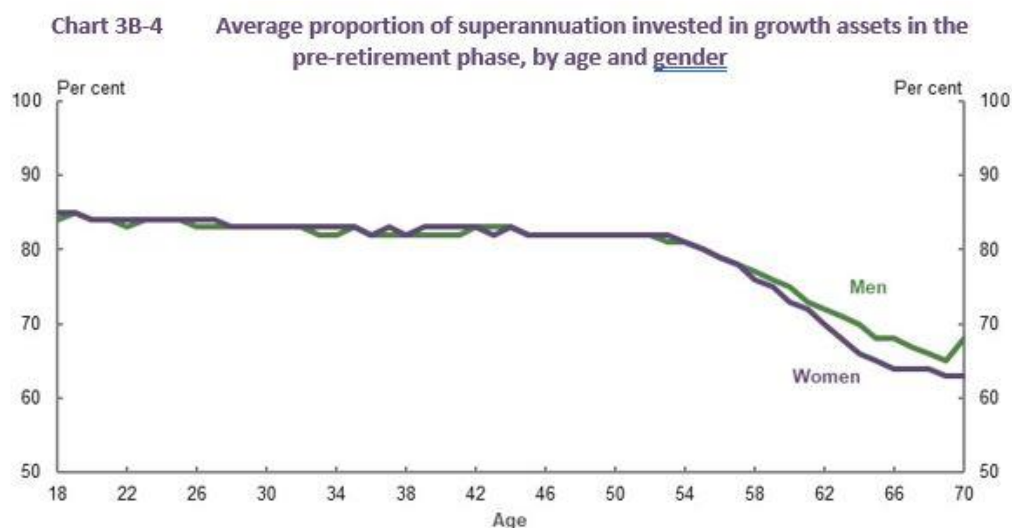
Women allocated their pensions more conservatively than men, according to a 1996 study by Vickie L. Bajtelsmit and Jack L. VanDerHei. After examining investment choices for 20,000 management employees at a large US employer, the researchers found that women were more likely to invest in fixed-income investments than their male counterparts and less likely to invest in employer stock. At the same time, the study's authors pointed out that they were missing information on the household's wealth and marital status, which could be contributing factors to the participant's allocation choices.

A 2008 study by Ann Marie Hibbert, Edward Lawrence, and Arun Prakash found that single men and single women with the same educational attainment (at least a graduate-level degree) tended to invest similarly; single women included in the survey were no more risk-averse than single men.

In the data set he examined, Blanchett looked at company retirement plan participants who were self-directing their own accounts, in an effort to remove the target-date effect and home in specifically on how men and women allocated their assets. Blanchett did observe a differential: The average equity allocation for self-directed female participants was 72%, versus 76% for men. However, after controlling for demographics, including income, the gap shrunk to less than 2 percentage points.

Additional comment based on Australia data

Rice Warner presented the recent Retirement Income Review with a table, shown below, showing men and women have similar proportions of superannuation invested in growth assets during the pre-retirement phase, as expected in a system with strong defaults. However, a gap opens from age 60 onwards. Rice Warner also quoted the US Vanguard numbers.



Source: (Rice Warner, 2019b).

Willingness to ask for advice

What about the likelihood that women will rely on professional investment advice relative to men?

Women were more likely to rely on a professionally managed solution for their investments, according to Vanguard's report. 40% of female-owned accounts in Vanguard's survey included a target-date fund in 2019 versus just 35% for male-owned accounts.

Blanchett found a similar pattern in the data set he examined: 34% of women retirement plan participants went the self-directed route (that is, eschewed target-date and managed account offerings), versus 41% of men. But he notes that higher-income participants are generally more likely to self-direct their allocations. That means that the differential in advice-seeking by gender was minor overall. Adjusted for income and other factors, women were still more likely to rely on professional management then men, but the difference was fewer than 3 percentage points.

Conclusions

Addressing income differences, and in turn savings rates, especially at lower income levels, is key to healing the gender gap with net worth and retirement savings. Of course, that's easier said than done. A complex set of

factors contribute to the lifetime income gap between men and women - notably, the fact that women are much more likely to serve as caregivers for children or elderly parents than are men.

The research suggests that financial advisors shouldn't assume that their female clients are more risk-averse than their male clients. A 2005 study suggested that financial advisors often did just that, even for male and female clients with the same levels of wealth.

Footnote to Australian version

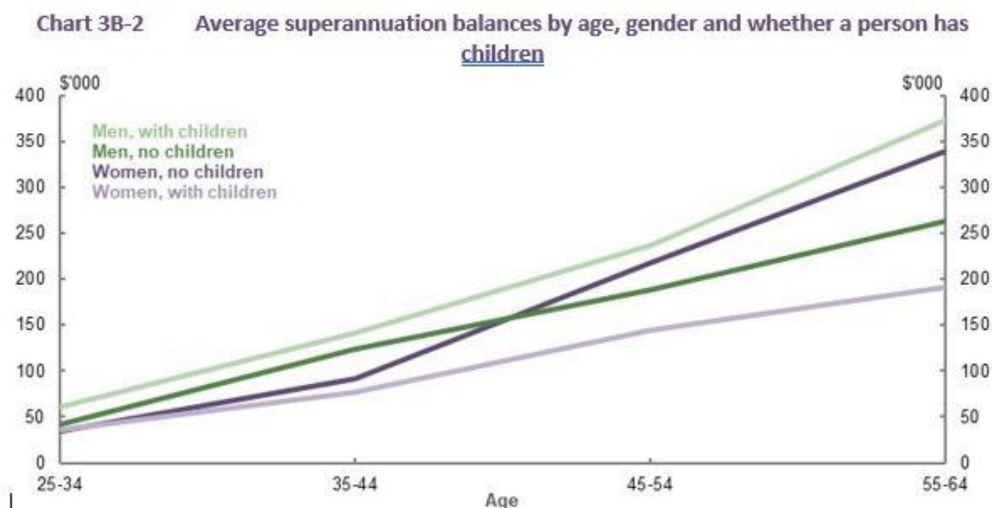
The Retirement Income Review devotes a section on pages 257 to 283 to 'Gender gaps in retirement incomes'. Many of the conclusions are similar to the US experience. Specifically, it identifies that the gender earnings gap during a working life has a significant bearing on the superannuation imbalances at retirement. The earnings gap is caused by:

- Work in lower paid roles
- Work in lower paid industries
- Work part-time or casually
- Take career breaks from paid employment to care for others, including raising children
- Experience discrimination and harassment in the workforce
- Experience family and domestic violence

The Review noted:

"The average superannuation balances of men and women without children are broadly similar until ages 45-54. Lower labour force participation and earnings — taking career breaks and working part-time to care for children — contribute to women with children having lower superannuation balances than women without children."

The following chart from the Review shows significantly higher super balances for women with no children. It also raises a policy issue on the extent to which superannuation should be judged according to the assets of a couple.



Note: 2018 data. Balances are for those not retired. These figures are not controlled for other variables like income or socio-economic status. As such, the results above do not represent the isolated effect of having children on a person's superannuation balance (i.e. it cannot be concluded that the gender gap in superannuation balances is caused by having children). Rather, this shows the distribution of average balances by age, gender and whether a person has children. Source: Analysis of HILDA Survey data (Wave 18).

Christine Benz is Morningstar's Director of Personal Finance. Any Morningstar recommendations contained in this report are based on the full research report available from Morningstar.

This article does not consider the circumstances of any investor, and editing and additions have been made to the original US version for an Australian audience.

Five lessons from the 'Witch' of Wall Street

Karen Wallace

During the Gilded Age of the late 19th century, a woman named Hetty Green was one of the most powerful financiers in the world. She made the vast majority of her $100 million fortune ($2.3 billion in today's dollars) herself, investing in railroad stocks and bonds, government bonds, and mining stocks. She also provided loans to cash-strapped businesses and bailed out the city of New York on several occasions.

But high society didn't quite know what to make of Green. Despite having all the makings of a socialite - a huge fortune and a direct bloodline to the Mayflower settlers - Green preferred to dress plainly and conduct business with men. That Green preferred black, Quaker-style dress to fancy clothes wasn't the only reason she's best remembered by the epithet "The Witch of Wall Street," though.

Green was much maligned in the press and among her contemporaries, who called her stingy and greedy. People couldn't make sense of this wealthy woman who reputedly didn't give to charity and made a habit of suing people - including members of her own family. Her frugality is legendary: She was even listed in the Guinness Book of World Records as the "World's Greatest Miser."

Unfortunately, Green's enduring legacy hinges on the "Witch of Wall Street" dichotomy: Discussions of her enormous self-made fortune are typically offset by tales of how cheap and mean she was. Though it's tempting to dispel a few of these myths and paint a less-wicked picture of Green, doing so ignores the more relevant lessons we can learn from her.

Here are five lessons we can learn from Hetty Green about investing and life.

Bain News Service, Publisher. Mrs. Hetty Green. [undated] Photograph. Library of Congress, Prints and Photographs Division. https://www.loc.gov/item/2014680543/.

1. Teach girls about business

Women would be much happier if they learned the principles of business in girlhood, Green once told the Ladies' Home Companion. Indeed, she credited much of her business acumen to lessons learned watching her grandfather run the family business while she was still a girl.

Green's family made its fortune by owning a successful whaling fleet in Massachusetts. In the first part of the 19th century, whale oil, especially oil from the massive sperm whale, was a hot commodity. It was widely used to fuel lamps and make household items like soap and varnish. It could also be used as a machine lubricant because it maintained its density at high temperatures and resisted freezing.

When his eyesight began failing, Green's grandfather Gideon Howland asked her to read him books and newspaper articles, as well as stock quotes, bond yields, and commodity prices. When young Hetty proved to be a precocious learner who asked insightful questions, he asked her to help him with his business correspondence, which she later said was how she learned her business methods.

After Gideon Howland died in 1847, Green's father Edward Robinson took over the whaling business, and Green became even more involved in day-to-day operations, including bookkeeping, inspecting shipments, and negotiating prices with merchants, clearinghouses, and suppliers. She also learned how to buy stocks and bonds at brokerage houses.

Business boomed in the 1850s, but declined precipitously after 1859, when petroleum was discovered in Pennsylvania. Kerosene, derived from petroleum, was a superior lighting source in nearly every way. It was longer-lasting, did not give off an offensive odor when burned, and was easier to produce and source, which made it cheap.

In 1865, five years before his death, Robinson divested the family's whaling fleet and invested the money in a business that specialized in shipping goods via steamship from New York to San Francisco.

Through close observation Green gained a sophisticated knowledge of shipping routes and logistics, which, along with her keen understanding of balance sheets and financial statements, would give her a huge advantage when she later invested in railroads.

2. Go against the grain

"There is no great secret in fortune making. All you do is buy cheap and sell dear, act with thrift and shrewdness and be persistent," she once reportedly said.

Sound familiar? Green's investing philosophy would be echoed more than a century later by Warren Buffett, everyone's favorite modern-day cheapskate billionaire. (Fun fact: Green even owned stock in Hathaway Mills nearly a century before Buffett would buy his controlling shares of Berkshire Hathaway in 1965.)

One of Green's earliest contrarian investments was buying undervalued currency in the post-Civil War period known as Reconstruction.

The Civil War proved to be longer, bloodier, and costlier than expected, and the government needed to find a way to finance it without taking out loans at exorbitant interest rates. In 1862, Lincoln and Congress authorized the issuance of United States Notes. They were called "greenbacks," and were not backed by gold, but rather by the full faith and credit of the U.S. government.

A total of $450 million of greenbacks were in circulation, but the value of these notes fluctuated depending on investors' confidence in the country's economic future.

When the Civil War ended in 1865, the outlook for the country's future was cloudy. Many people viewed the country's economy as doubtful and, worried about the stability of the government, refused to pay face value for its greenbacks. Instead, they rushed to gold.

As the value of the greenback sank lower and lower (at one point as low as $0.50 on the dollar), Green scooped up more, confident that the greenbacks would recover their value given time, and she was right: The Resumption Act of 1875 effectively put greenbacks on par with gold by allowing greenbacks to be redeemed at face value.

3. Do your homework

Green earned much of her vast fortune by making smart, well-timed railroad investments.

After the Civil War, railroad construction boomed. While the Northern states benefited from a complex railway network that connected major cities, the rail lines in the South were mainly short lines designed for hauling goods to local seaports. (This had proved to be a big disadvantage to the Confederacy during the war.)

Recognizing the important role railroads would play in the nation's future, Green invested heavily in them, putting her knowledge of shipping routes and trade logistics and her sharp analytical ability to work.

On May 10, 1869, a ceremonial golden spike was driven into the ground to mark the completion of 1,776 miles of track that made up the nation's first transcontinental railroad, which united the country and changed it forever.

By 1875, a sophisticated railroad system bridged towns and cities and efficiently moved goods all across the country. By this time Green, along with contemporaries J.P. Morgan, Andrew Carnegie, and Commodore Vanderbilt, had amassed a substantial stake in U.S. railroads.

4. Keep a cool head

Green didn't sweat sell-offs. In fact, she saw them as good opportunities to make more money.

In the first few years of the 20th century, the U.S. experienced an economic boom. Railroads and businesses borrowed money to expand, and investors borrowed money to buy stocks and real estate. The prices of

financial assets kept rising, which induced people to buy even more. As demand for money increased, the cost of borrowing money rose.

At higher interest rates, however, many borrowers couldn't repay their loans, so they were forced to sell off their assets to cover their loan payments. Things got worse when banks and trust companies, already under pressure from their own speculative loans and investments, were faced with bank runs by spooked depositors. Thus ensued the Panic of 1907.

Green was able to act as a major purchaser and lender during this time because she pre-emptively sold assets she believed were overvalued to reduce risk. In her own words, she "saw the handwriting on the wall," and converted every real estate deal she could close into cash. This gave Green what Warren Buffett likes to refer to as 'dry powder': ready cash to scoop up assets at low prices during sell-offs.

But she insisted that she was always fair in her dealings, in sharp contrast to the so-called "robber barons" of the age, who took advantage of the limited regulation at the time to engage in unscrupulous behavior to get rich at others' expense.

5. Stand your ground and be true to yourself (haters gonna hate)

Being a woman put Green at a disadvantage as an investor and financier at a time when few legal protections existed for women's interests or their assets. Women would not even attain the right to vote in the United States until 1920, four years after Green's death. But she was not afraid to defend what she considered rightfully hers - either in court or by telling her side of business disputes to the press. To many this made her an oddity, to say the least.

She would sometimes defend herself to reporters, who were always anxious to listen, knowing Green made good copy.

"I am not a hard woman. But because I do not have a secretary to announce every 'kind act' I perform I am called close and mean and stingy. I am a Quaker, and I am trying to live up to the tenets of that faith. That is why I dress plainly and live quietly. No other kind of life would please me."

Green's father had taught her from a young age that wealth and property were a trust to be taken care of and enlarged for future generations, not squandered. Indeed, when she died in 1916, the New York Times reported that her death would likely have no effect on the stock market or any of the corporations in which she had invested, because she had invested her huge fortune such that "the inheritors, whether individuals or charities, would have no reason to disturb the investments."

The same obituary, which ran on the front page of the Times on July 4, 1916, (sort of) praised Green for her uncompromising determination.

HETTY GREEN DIES, WORTH $100,000,000

Passes Away at Son's Home After Several Paralytic Strokes, Aged 82.

HOPED TO LIVE TO BE 85

Invested Heavily in Bonds and Mortgages in Recent Years—Stock Market Not Affected.

Mrs. Hetty Green, generally believed to be the world's richest woman, died yesterday in her eighty-second year after an illness of several months. The woman whose great business acumen had built up a fortune estimated at $100,000,000 and had made her name known in the market places of the world faced death as she had life, militantly and unafraid.

Source: The New York Times

Karen Wallace, CFP® is Morningstar's Director of Investor Education, based in Chicago. This article does not consider the circumstances of any investor.

Will rising bond rates hit your share portfolio?

Graham Hand

It's rare that there is so much focus on bond yields and inflation, and it's mainly due to their potential impact on the stockmarket. When stock analysts value a company, they estimate the future cash flows from the business and discount the amounts to a present value. This gives an estimate of the intrinsic value of the

shares. The lower the assumed discount interest rate, the higher the value of the company in the modelling. This is one reason why equity markets like lower interest rates, as it tends to push up share prices.

Low rates make growth companies look more attractive because the distant expected profits are worth more in present value terms. Lower rates also mean cheaper funding costs for companies, both in the debt and equity markets.

Of course, the opposite occurs when interest rates rise. It is somewhat paradoxical and another reason why share investing is not easy, because rising rates are often a sign of a stronger economy, which should be good for shares. It's a reason why the market often reacts to economic news counter-intuitively. The economy is strong but stocks are sold. Go figure. If stronger economic growth means higher interest rates, should that be good or bad for share prices?

At the moment, the fear of rising rates is spooking equity markets.

The bond market is reading the signs of vaccine optimism and stronger economic growth (Australian GDP rose 3.1% in the December 2020 quarter, beating market expectations of 2.5%) and pushing up the 10-year bond rate. The chart below shows the 10-year Australian Government bond rate for the last 12 months. For much or 2020, faced with the pandemic and slower economic growth, the bond market was not worried about inflation or rising rates, and the 10-year bond stayed below 1%. Recently, it almost touched 2%, reminding investors that even government bonds can be risky investments.

Remember, prices and yields have an inverse relationship. If yields rise from 1% to 2%, prices must fall. In this case, assuming a duration of 10 years and an immediate rate move, the price of the bond would fall 10%. Or rise 10% if the bond quickly falls from 2% to 1%.

10-year Australian Government bond rate over the 12 months to 4 March 2021

Source: Trading Economics

Reserve Bank wants low rates

What does the Reserve Bank of Australia (RBA) think of all this? Australia's central bank has stated that it does not expect to increase the cash rate above 0.1% until 2024 at the earliest. It is deliberately holding rates down to stimulate the economy in response to the pandemic, and it has extended its interest rate target to 3-year bonds, also keeping it below 0.1%.

In fact, the RBA is so aggressive buying bonds to keep the 3-year rate at 0.1% that it now owns 39% of the $34 billion April 2023 bonds and 60% of the $33 billion April 2024 bonds. The market is happy to sell to the central bank and switch to longer bonds offering some yield gain, with the 10-year bond around 1.8% and 30-year above 2.5%.

Despite longer bond rates rising, the RBA's resolve remains firm. It said in its latest report:

"The Board remains committed to maintaining highly supportive monetary conditions until its goals are achieved. The Board will not increase the cash rate until actual inflation is within the 2 to 3% target range. For this to occur, wages growth will have to be materially higher than it is currently. This will require significant

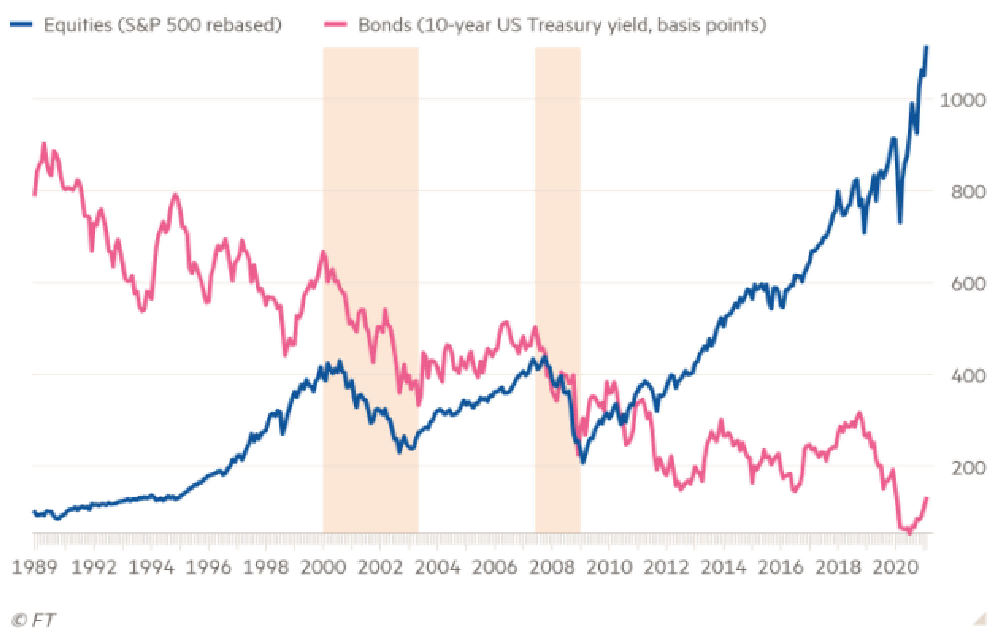
gains in employment and a return to a tight labour market. The Board does not expect these conditions to be met until 2024 at the earliest."

There is little sign of significant wages growth and with unemployment at 6.6%, Australia is a long way from meeting the RBA employment goals. There has also been a major change in their rhetoric, as they now look for actual signs that inflation has risen, rather than anticipating a rise and trying to stop it. It means short-term cash and bond rates should remain low until at least the stated date of 2024.

What is the impact of rates on share markets?

The following chart from The Financial Times shows the complexity of the bond rate/equity market relationship. At first glance, it looks like the blue line, the strongly-rising stockmarket (based on the US S&P500 index) since 1989 is accompanied by falling interest rates, the pink line showing the US 10-year Treasury yield. It is evidence of the valuation tailwind low rates give share prices.

Falling bond yields have often been associated with weaker equities



But look closer at the two shaded areas, the sharemarket declines around the 'tech wreck' of 2000, and the GFC and subprime crisis of 2007 to 2008. Sharemarkets fell and interest rates fell.

Australia tends to follow leads from the US, so it is equally important to know what the US Federal Reserve and its Chairman, Jerome Powell, are thinking. Powell said recently that the Fed will also maintain ultra-low interest rates and massive asset purchase programmes until substantial progress has been made on their US employment and inflation goals.

The central banks are singing from the same hymn sheet. Given current official unemployment in the US is at best 6.3% (and unofficial more like 10%) compared to the 3.5% level prior to the pandemic, there is still a long way to go.

Does it mean as economies recover from the pandemic and rates rise, sharemarkets will fall? Shane Oliver from AMP Capital recently said the key points are:

- Higher bond yields are normal in economic recovery and should not be a major problem for shares if they are matched by rising company earnings.
- But too rapid a rise in bond yields risks driving a deeper correction in shares.
- Central banks want higher inflation but will look through any short-term spikes.
- The 40-year downtrend in inflation and bond yields is likely over.
- But the fundamental backdrop of improving growth, rising profits and still low rates supports the case for solid 6-12 month returns from shares.

To date, the rise in bond rates has been orderly as inflation fears ebb and flow. The higher bond rates are close to pre-COVID levels. There is evidence of inflation creeping into the economic system, especially due to raw

material price rises and some consumer goods shortages. The funding of massive multi-trillion dollars stimulus packages in the US also comes into focus for inflation and rate risks.

It's not that 2% is historically a high rate, but the market is so comforted by artificially low rates held down by central banks that it is difficult to pull away from the feeding trough. Government bond rates also impact company and personal borrowing, and millions of Australians rely on low rates to service their mortgages. Higher rates would therefore feed into consumption and spending patterns.

Where does that leave us?

As ever in economics and stockmarkets, there is no one correct answer. There are many factors at play in the current recovery, especially when a mutant virus could scupper every other scenario.

In any case, investing should be about building a portfolio for the long term based on goals, risk appetite and financial capacity. Worrying about how a market might react to a high inflation number week-to-week is more short-term trading or speculation.

On balance, it is likely that the stockmarket would not react well to further rises in interest rates, especially if central banks seem to be struggling to meet their goals. However, if the rate rise is accompanied by economic growth and strong corporate earnings, then some companies would outperform the overall market and favour stock pickers.

For the moment, central bank resolve is high, they have plenty of firepower and the overall market is optimistic about a rebound from the virus. There is talk of 'revenge spending' as consumers open their wallets after global lockdowns, giving retail stocks a major boost. Service sector, travel and entertainment could recover well as borders open.

The question for central banks and governments is when they should start worrying about repaying the trillions of dollars of debt they have accumulated, when they can raise rates to take the froth out of the economy, and how much inflation to allow into the system. That said, the rise in official rates and short-term bonds seems some years away yet.

Graham Hand is Managing Editor of Firstlinks. This article is general information and does not consider the circumstances of any investor.

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