Edition 406, 7 May 2021

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Editorial

This time last year, we were debating the shape of the recovery in alphabetic terms. Popular choices were the L, where the economy fell and stayed down for a long while, and the U, where the fall was followed by a period on the floor before a decent rise. Others offered the W, a series of rises and falls as pandemic waves took over, and the K, a widespread drop followed by strong rises and falls across sectors and economies. Now it looks like a tick or a swoosh are better analogies.

In Australia, the improvement in the Budget will fully reveal itself on 11 May, when unexpected revenues will allow Treasurer **Josh Frydenberg** to spend as if it's an election Budget ... which it is. For example:

"Deloitte Access Economics estimates that deficits will be almost $100 billion smaller over the four years to 2023-24 compared with the latest official estimates. However, the size of the deficits are substantial – with the underlying cash deficit estimated at $167 billion this financial year and $87 billion next financial year. Government debt has also surged, which is of less concern in a low interest rate environment."

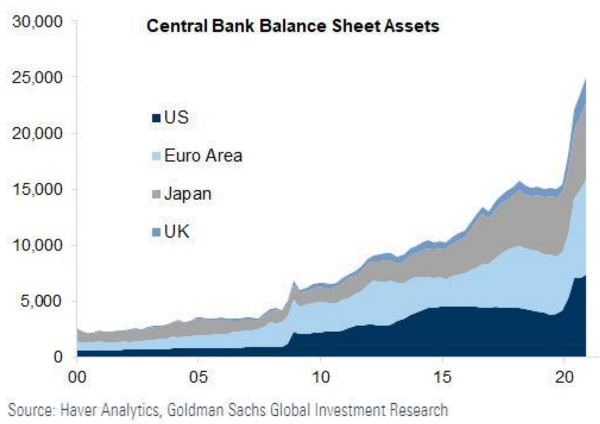
RBA Governor, **Philip Lowe**, said this week that the forecast for Australian GDP growth was revised up to 4.75% this year and 3.5% over 2022, when some were expecting a slowdown. Unemployment is expected to decline to around 4.5% at the end of 2022, raising the possibility of interest rate rises if there are inflationary signs.

In our articles this week, two fund managers believe the stock market still offers great momentum and future gains on the back of this growth.

Tim Toohey describes how consensus growth forecasts have been improving almost every month, but he believes they are still too conservative, as growth will surge over 2021.

Then **Heath Behncke** says any sell off of the big tech companies is a buying opportunity, and calling them 'growth' companies that will be left behind in the 'value' tilt is missing the quality of these great businesses.

What most investors a year ago underestimated was the response to the massive government programmes, the unlimited central bank stimulus, accommodative bank lending and the spending reaction to being locked up.



Source: Haver Analytics, Goldman Sachs Global Investment Research

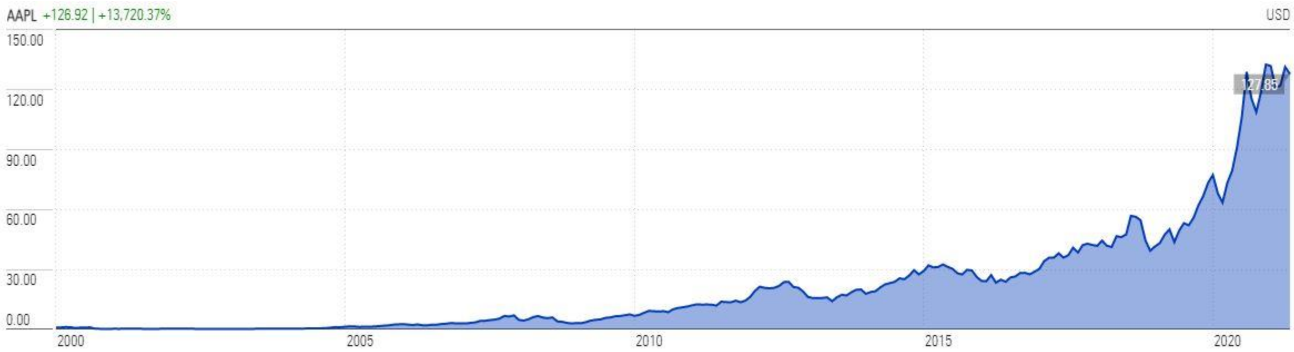
Governments and bankers around the world realised there did not seem to be a limit to the largesse.

Critics were few. While some recognised an eventual day of reckoning, nearly everyone supported the need to spend during a pandemic. Then former US Treasury Secretary under **Bill Clinton, Larry Summers**, finally came out recently as **President Joe Biden** added another couple of trillion to his wish list, taking it over US$6 trillion (or was it US$8 trillion?) over coming years. Summers called it "*the least responsible in 40 years*" on fears of overstimulating and pushing up inflation. Biden responded by calling his programme "*big and bold".*

Yet did we see a chink in the armour of the dovish and current US Treasury Secretary, **Janet Yellen**, which hinted at rising rates? It contributed to a modest sell off in large US tech stocks, although she has since tried to walk away from her comments.

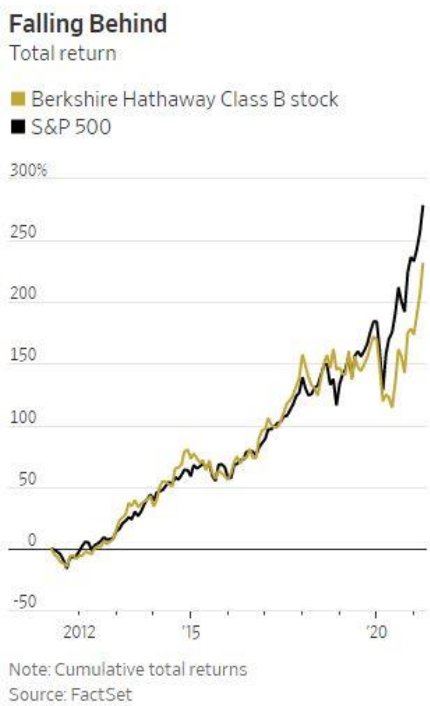
It's far from a set back for FAANG believers. For example, **Apple** shares have risen so much since the 1980 float at US$22 that the company has undergone five stock splits to keep the price manageable for new investors. When we see today's price of about US$130, it's easy to think it has not done much over 40 years. But we need care making comparisons over time, and allowing for the splits puts today's price at about US$22,000. Anyone for a 100,000% return? What, it fell 2%, oh dear!

Adjusting for stock splits in this **Morningstar** chart of the Apple price since 2000, there was no need to get in for the first 20 years to make a killing.



And that's what **Warren Buffett** did. He held off buying Apple shares, and famously eschewed tech stocks, until only five years ago, when he bought 10 million in 2016. He has since made far more investments and is up US$100 billion so far, and Apple has become by far his largest position.

But he warns that this type of individual stock picking is not the best strategy for inexperienced investors, and he and **Charlie Munger** are totally bemused by **Bitcoin** and **Robinhood**. He's been criticised many times in the past and his fund has struggled recently (see chart below), but as **Emma Rapaport** writes, [his advice on how to invest]() is always worth reading. His tables on the difference between the top stocks in 1989 and now are revealing.



Two articles look at a bigger picture and perspective. **Phil Ruthven** provides fascinating charts on the [composition of the Australian economy]() in contrast to the US, and explains why our market is underperforming. We have many great companies but not enough, and in the wrong sectors.

And **Ashok Bhatia** also supports the [case for risk assets]() as economies undergo a transition to sustained and high economic growth but with volatility and changing correlations between asset classes.

And looking further to the future, but firmly in the present in how investors can benefit from a global trend, two articles on climate change. **Richard Montgomery** shows how a major thematic such as this can be backed by investing now, while **Alex Debney** describes how renewables are not only evolving but are already cost competitive, while there are challenges for investing in this opportunity. As Buffett said at his AGM last week, it's a lot more difficult to pick the winning companies than the winning industries.

This week's White Paper from **Vanguard** goes into more depth on 'value versus growth' as it will be a major factor in winning portfolios. Vanguard sees strong reasons for a value tilt. Do you lean towards the tech and disruptive 'growth' stocks or the more traditional 'value'?

Finally, sad to hear about **Melinda and Bill Gates** separating after 27 years of marriage. The increasing longevity we often discuss in a superannuation context is contributing to what are called 'grey divorces'. Most people who reach Bill Gates' age of 65 now realise they will probably live 20 to 30 years longer than their grandparents did, and they think more about how they want to spend those years, as Gates explained on Twitter.

At least we know they are such decent people that we will not have a public spat over the money, and continue their great charitable work.

Buffett says stock picking is too hard for most investors

Emma Rapaport

Co-authored with Susan Dziubinski, Director of Content for Morningstar.com.

An antidote to all the talk about hot stocks and speculative bubbles emerged last weekend at Berkshire Hathaway's Annual General Meeting. Warren Buffett displayed his fundamentals-based approach to investing, touting the virtues of buying the market and holding it, forever.

His ideas may seem out of touch in a market where Tesla trades at a 99% premium to Morningstar's fair value estimate, Elon Musk is sending Dogecoin to the moon and social media is considered a valid source of stock tips. Buffett has also been accused of being out of touch with the modern economy and for 'betting against' America during the pandemic.

The first shareholder question asked at the meeting demonstrated this:

"Mr. Buffett, you're well known for saying to be fearful when others are greedy and be greedy when others are fearful. But by all appearances, Berkshire was fearful when others were most fearful in the early months of COVID, dumping airline stocks at or near the low, not taking advantage of the fear of gripping the market to buy shares of public companies at exceptional discounts and being hesitant to buy back significant amounts of Berkshire stock at very attractive prices. I'd appreciate hearing your thoughts surrounding this time …"

Buffett has been criticised many times in the past in questions posed with the benefit of hindsight. He replied:

"Until both monetary and fiscal policy kicked in, well, we knew we had an incredible problem and I am, just as Charlie is the Chief Culture Officer, I'm the Chief Risk Officer of Berkshire. That's my job. We hope we do well, but we want to be sure we don't do terribly. But we didn't sell a substantial amount."

Here are some lessons the Oracle of Omaha offered to first-time investors. The short of it: the average person can't pick stocks and most investors would benefit from purchasing an S&P 500 index fund over the long term.

Extraordinary things can happen

"I would like particularly new entrants to the stock market to ponder just a bit before they try and do 30 or 40 trades a day in order to profit from what looks like a very easy game."

Buffett took time to remind people, particularly newer investors, of the extraordinary things can happen in stock markets. He included a list of the 20 largest companies in the world by stock market value on 31 March 2021. Apple was number one worth just over US$2 trillion with United Health at number 20, worth around US$330 billion.

Looking back at the top 20 from 1989, Buffett noted that *none* of the top 20 today appeared on the list 30 years ago. He said:

"None. Zero. There were then six US companies on the list and their names are familiar to you. We have General Electric, we have of Exxon, we have IBM Corp. None made it to the list 30 years later, it was zero."

20 Largest Companies by Market Value

March 31, 1989			March 31, 2021		
	Country	Market Cap $		Country	Market Cap $
Industrial Bank of Japan	Japan	104B	Apple Inc	United States	2.05T
Sumitomo Bank	Japan	73B	Saudi Arabian Oil Co	Saudi Arabia	1.92T
Fuji Bank	Japan	69B	Microsoft Corp	United States	1.78T
Dai-ichi Jangyo Bank	Japan	64B	Amazon.com Inc	United States	1.56T
Exxon Mobil Corp	United States	63B	Alphabet Inc A	United States	1.39T
General Electric Co	United States	58B	Facebook Inc A	United States	838B
Tokyo Electric Power	Japan	56B	Tencent Holdings Ltd ADR	China	752B
International Business Machines Corp	United States	55B	Tesla Inc	United States	641B
Toyota Motor Corp ADR	Japan	53B	Alibaba Group Holding Ltd ADR	China	614B
American Tel & Tel	United States	48B	Berkshire Hathaway Inc Class A	United States	587B
Nomura Securities	Japan	46B	Taiwan Semiconductor Manufacturing Co Ltd	Taiwan	534B
Royal Dutch Petroleum	Netherlands	41B	Visa Inc Class A	United States	467B
Philip Morris Cos	United States	38B	JPMorgan Chase & Co	United States	464B
Nippon Steel	Japan	36B	Johnson & Johnson	United States	432B
Tokai Bank	Japan	35B	Samsung Electronics Co Ltd	South Korea	430B
Mitsui Bank	Japan	34B	Kweichow Moutai Co Ltd	China	385B
Matsushita Elect Ind'L	Japan	33B	Walmart Inc	United States	382B
Kansai Electric Power	Japan	33B	Mastercard Inc A	United States	353B
Hitachi Ltd ADR	Japan	32B	LVMH Moet Hennessy Louis Vuitton SE	France	351B
Merck & Co Inc	United States	30B	UnitedHealth Group Inc	United States	336B

Source: Berkshire Hathaway AGM, Bloomberg, EQS Function

Buffett then invited the audience to think about how many of the companies in the 2021 list will still be on the list in 30 years. He said:

"It's not going to be all 20. It may not even be all 20 today or tomorrow. You'd think it could be repeated ... Yeah, it seems impossible and maybe it is impossible, but we were just as sure of ourselves as investors and Wall Street was in 1989 as we are today, but the world can change in very, very dramatic ways."

The lesson for investors is that the world will change in dramatic ways. Don't get too sure of yourself.

Investing themes are attractive but don't fall for them

Buffett said the best thing first-time investors can do is to be in the market.

"The main thing to do is to be aboard the ship. A ship. You couldn't help but do well if you just had a diversified group of equities (US equities would be my preference) but to hold over a 30-year period."

To illustrate this point, Buffett said investors are attracted to popular industries, whether that be railways in the mid-1950s or tech companies today. But picking the winners and losers in an industry is incredibly difficult.

For example, Buffett said in 1903 the place to be was the auto industry. The thesis was that someday 290 million cars would be buzzing around the US. However, there were at least 2,000 companies that entered the auto business. In 2009, there were three left, two of which went bankrupt.

"There's a lot more to picking stocks than figuring out what's going to be a wonderful industry in the future. The Maytag company put out a car. Allstate put out a car. DuPont put out a car. I mean, Nebraska, there was Nebraska Motor Company. Everybody started car companies just like everybody's starting something now where you can get money from people.

But there were very, very, very few people that pick the winner."

The average person can't pick stocks successfully

During the Q&A portion of the meeting, Buffett was asked whether long-term Berkshire shareholders should continue holding their stock or diversify their risk across an index. The question comes after Berkshire Hathaway's stock underperformed the S&P 500 index by -18.5% in calendar year 2020. Buffett expressed a preference for holding the market.

"I recommend the S&P 500 index fund, and have for a long, long time, to people. And I've never recommended Berkshire to anybody, because I don't want people to buy it, because they think I'm tipping them into something no matter what it was selling for. And I've made it public. On my death, there's a fund for my then-widow, and 90% will go into an S&P 500 index fund, and 10% in bonds."

"…I like Berkshire, but I think that a person who doesn't know anything about stocks at all, and doesn't have any special feelings about Berkshire, I think they ought to buy the S&P 500 index."

Buffett's take on hot-button issues

Bitcoin: On Bitcoin, Buffett refused to engage. Vice-Chairman Charlie Munger was more forthcoming, saying that investors should steer clear:

"I hate the Bitcoin success and I don't welcome a currency that's so useful (for) kidnappers and extertionists in our stores and so forth, nor do I like just shuffling out a few extra billions and billions and billions of dollars to somebody who just invented a new financial product out of thin air. I think I should say, modestly, that I think the whole damn development is disgusting and contrary to the interests of civilisation, and I'll leave the criticism to others."

Trading apps: Asked what he thought about Robinhood and other trading apps that allow investors of all ages and experiences to participate in the stock market, Buffett said that they were a driver of the 'casino aspect' of the market dealing in puts and calls. He was also concerned about how they handle their sources of income and communicate with customers about fees.

"They're gambling on the price of Apple over the next seven days or 14 days. There's nothing illegal about it. There's nothing immoral. But I don't think you would build a society around people doing it. If you cater to those gambling chips, when people have money in their pocket for the first time, and you tell them they can make 30 or 40 or 50 trades a day, and you're not charging them any commission, but you're selling their order flow or whatever, I hope we don't have more of it."

Anything else?

Buffett and Munger also discussed key issues facing investors including inflation, bank stocks, Elon Musk's SpaceX, stock buybacks, insurance firms, interest rates, SPACs, selling Apple and airline stock, Berkshire's succession planning, energy companies and ESG risk, ESG reporting and the Fed's 'extraordinary' action amid the COVID-19 crisis.

You can check out the full recording here. Don't be put off by the length. The session starts around 01:10.

Buffett himself admitted to a few mistakes, including selling some of the firm's Apple stock last year, and the healthcare venture he started with JP Morgan and Amazon that folded this year. He praised the swift actions of the Federal Reserve and credited the institution with the US recovery.

Emma Rapaport is Editor Manager at Morningstar, owner of Firstlinks. This article is general information and does not consider the circumstances of any investor.

Are we underestimating the peak of the V-shaped recovery?

Tim Toohey

By now most investors are tiring of their email in boxes filling with economists and strategists talking about reflation (that is, a recovery in spending and economic growth), how much more optimistic they are relative to consensus, and for how much longer the reflation trade will persist.

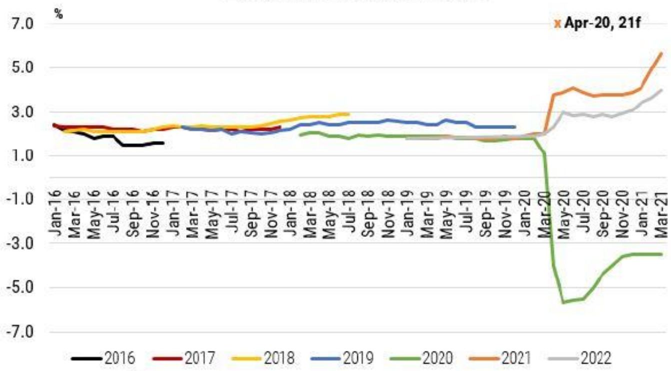
There were very few people talking about a strong V-shaped recovery this time last year. Indeed, a scan of the forecasts of leading sell-side economists in April 2020 shows consensus forecasts of 3% for the CY21 for Australia and 3.8% for the USA.

A switch to stronger growth forecasts

Indeed, peak pessimism was not reached until September 2020, when economic growth downgrades ceased and modest upgrades commenced. Currently, consensus for CY21 has risen to 5.7% in the USA and 4.4% for Australia.

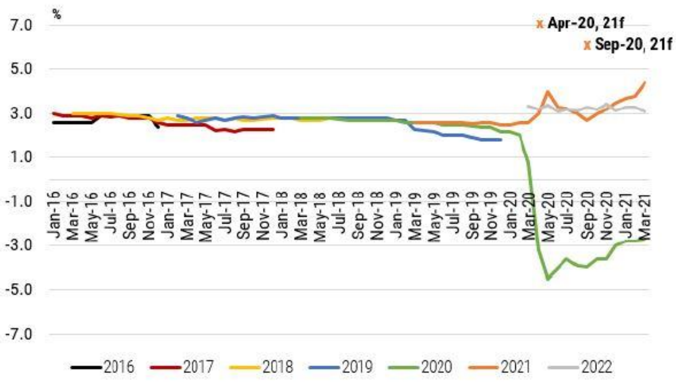
In contrast, our forecasts for the US in 2021 – [which we published in mid-April 2020]() – was 6.5% (represented by the cross in Chart 1). For Australia (Chart 2) we were even more optimistic, forecasting 7.0% economic growth. As we moved through 2020, it was clear the expected contraction in economic growth in 2020 was less than expected and we reduced our forecast rebound in Australia's economic growth in 2021 to a still sizeable 6.0%.

Chart 1: Evolution of Consensus US Economic Growth Forecasts



Source: Yarra Capital Management

Chart 2: Evolution of Consensus Australian Economic Growth Forecasts



Source: Yarra Capital Management

Much of our more upbeat analysis was based on:

1. the nature of the shock being more akin to a natural disaster
2. the quantum of the fiscal packages
3. excess credit growth
4. the outlook for vaccine development
5. the prospect of pent up demand.

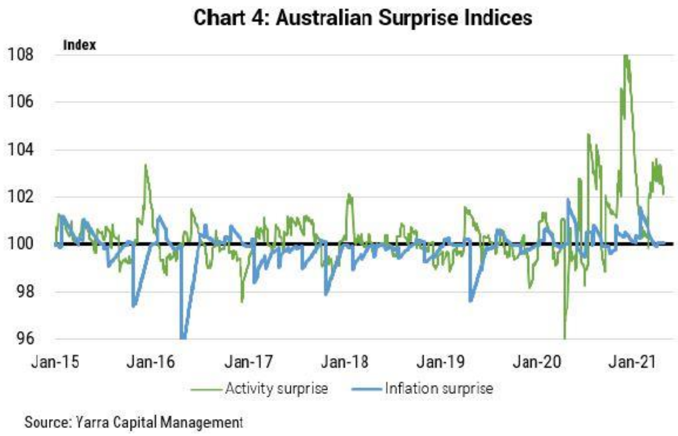
One year on, the clambering to upgrade growth estimates has only intensified. Over the past two months, consensus forecasts for Australian economic growth in 2021 have been upgraded a further 0.7%. In the USA the revision over the past two months is a remarkable 1.6%.

For Australia. we remain 1.5% above the consensus forecast and around 1% above the most optimistic other forecaster. What supports our optimism?

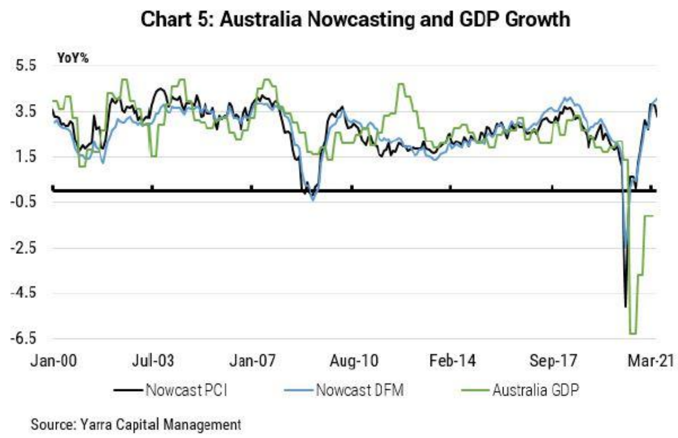
1. Australia's data consistently beats economic forecasters

Charts 3 and 4 show our calculation of economic data surprises for economic activity and inflation relative to consensus forecasts (US vs Australia). A positive reading represents economic data beating consensus expectations weighted by data importance and time decay.

Clearly, Australia's economic activity data is not only continuing to beat increasingly upbeat economic forecasts, the positive data surprises are larger in Australia.



2. Real economic growth is expanding at pace



Our 'nowcasting' techniques (Chart 5) for gauging in real-time how fast the economy is expanding already suggest that real economic growth was expanding at 4% yoy by the end of 1Q2021.

Note: Our nowcasting methodology is to estimate real time economic growth via both dynamic factor models and principal component models for each of the major economies to provide an alternative underlying picture of economic growth to the often noisier official GDP data.

3. Treasury's projections have been comfortably exceeded

Much stronger economic growth, much lower unemployment and much stronger commodity prices have combined to already deliver a $23 billion better fiscal outcome relative to Treasury's December projections and closer to a $50 billion saving over the next four years.

The question for Q2 is how much more of an 'economic surprise' dividend will likely flow through the Budget and what will the Government do with it?

We believe the Treasury's growth figures are 0.5% too low for 2020-21 and 1.25% too low for 2021-22. The unemployment rate is likely too high by as much as 2%. And an iron ore assumption of $55/tonne embedded in the Budget is one-third of the current iron ore price. Clearly there are further major revenue upgrades to come.

Our take is that the May Budget will be used mainly to evidence the vastly better Budget and economic outcomes that have been achieved. We expect the true election Budget will come in late 2021 (i.e. mid-year Budget), with more strategic spending and tax changes announced to setup a May 2022 Election. The combination of the Coalition's political challenges and the Budget's economic windfalls will likely spark additional fiscal spending later in 2021, sufficient to bolster economic growth expectations.

Momentum to continue over 2021

Mid-2021 will likely mark the peak of global economic data surprises and the final phase of economic growth upgrades. Nevertheless, we believe there is more oxygen in Australia's economic recovery and that consensus has long been too slow to recognise the domestic economy's capacity to expand at close to 6% through 2021.

While this will set off expectations of a higher cash rate ahead of the RBA's 2024 guidance, the RBA can be expected to attempt to allay those fears by making the case that inflation expectations and wage growth remains too low to be consistent with their inflation objective. Nevertheless, the likely RBA growth upgrades will almost certainly end the prospect of the RBA rolling the 3-year bond beyond the April 2024 target. Together with the end of the Term Funding Facility in mid-2021 the reality is that a very modest tightening cycle is already commencing.

Tim Toohey is Head of Macro and Strategy at [Yarra Capital Management](). To the extent that this article discusses general market activity, industry or sector trends, or other broad based economic or political conditions, it should be construed as general advice only. References to 'consensus' throughout relate to Bloomberg consensus unless otherwise stated.

Five reasons why growth versus value is the wrong focus

Heath Behncke

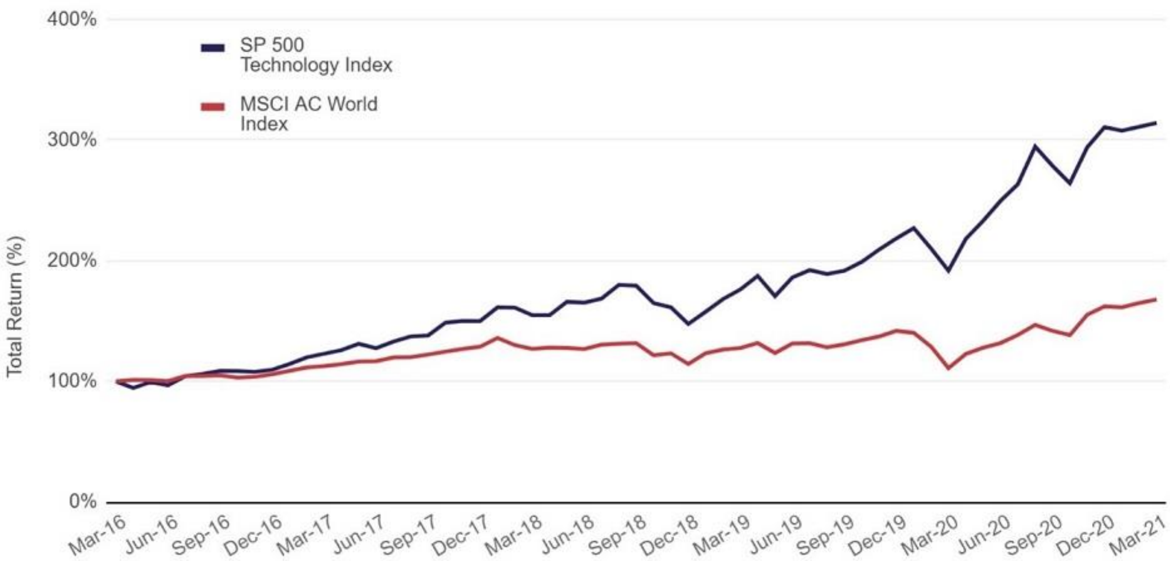
Technology stocks surged at the start of 2020, with the main US technology barometer (US Nasdaq 100 index) rising 97% in the 12 months following Covid-19's original lockdowns in mid-2020. Through late February and March 2021, however, most tech stocks sold off, with a leap in US 10-year bond yields from 1% to 1.75% over the two months. This sparked concerns about the value of the future earnings of leading technology companies.

Investors rotated out of 'growth' stocks like Tesla, Amazon and Google into 'value' sectors like financials, industrials and resources, on expectations of a rapid 2021 global growth recovery as Covid-19 vaccinations rolled out.

Technology's great run

Most investors know technology has been the best-performing sector within global equity markets over the past five years, outperforming the broader MSCI All Country world index by an extraordinary 146% since March 2016.

SP 500 Technology Index v MSCI AC World Index Returns



However, a January 2021 survey of institutional investors undertaken by Deutsche Bank highlighted investor valuation fears, with 89% of investors stating that some financial markets are in bubble territory. Bitcoin was at the top of the list with a 10/10 bubble rating, while investors also felt Tesla would more likely fall 50% than double in 2021.

But rather than marking the end of this bull run for technology, we believe the recent sell-off is just a healthy market correction and is offering investors a great buying opportunity into technology leaders such as Amazon, Microsoft and Tesla that have strong long-term earnings growth.

There are five reasons we believe it would be a mistake for investors to panic and rotate out of technology stocks into traditional value stocks. In fact, the 'growth versus value' debate is the wrong focus as it deflects attention from the best long-term wealth creation opportunities and ultimately reduces the quality of the lifestyle of investors in retirement.

1. The fantastic fundamentals of tech will continue

The strong technology returns over the past few decades have been underpinned by strong fundamental factors. Consumers engage more with technology every day. Ten to 15 years ago, we were performing simple internet searches on Google, but now technology dominates our communication (social media), our consumer purchases, and is about to transform even the actual money we spend (digital currencies).

We believe those fundamentals will continue to accelerate over the long term.

Over the 2020s decade, six amazing technologies will mature and dramatically change our daily lives. These technologies are:

- 5G
- the Internet-of-Things (IoT)
- Autonomous vehicles
- Blockchain
- Biotechnology, and
- Digital Assets.

Each offers massive revenue opportunities over the next few decades.

With outstanding balance sheets and immense operating cash flow, today's leading technology innovators are heavily investing across all of these promising technologies.

Over the next five to 10 years, this should generate strong returns for companies such as Amazon, Tesla, Alibaba, Google, Microsoft and Tencent, driving each of them towards a US$10 trillion market valuation, possibly as early as 2030. Our valuation (using a discounted-cash flow approach) work on these companies supports our view that the innovation remains significantly undervalued for patient investors.

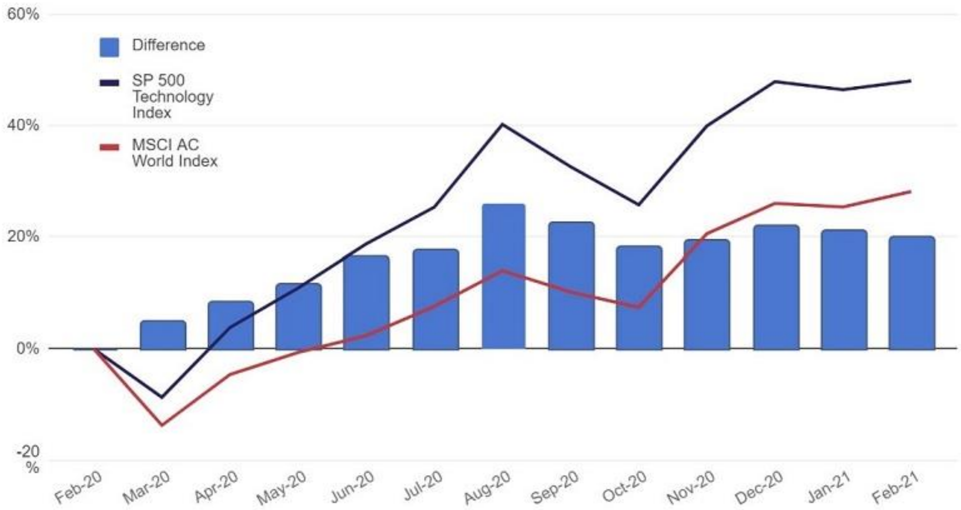
2. Covid-19 will continue to accelerate tech adoption

The aggressive sell-off in financial markets during the first lockdown phase of Covid-19 initially occurred across all asset classes and sectors.

However, as we all turned to digital infrastructure networks to get the economy moving, technology stocks rapidly rebounded on expectations of rapid growth in revenues.

Strong inflows into growth stocks continued over the remainder of 2020, with the technology sector outperforming the broader market by over 20% (as seen in the chart).

Outperformance of SP 500 Technology Index over the MSCI AC World Index over past 12 months



We do not believe that the Covid-19 surge in both technology use and the share price of leading technology providers is over. We believe the six new technologies outlined previously will positively impact the way we travel, communicate, spend and access medical care over the next few decades.

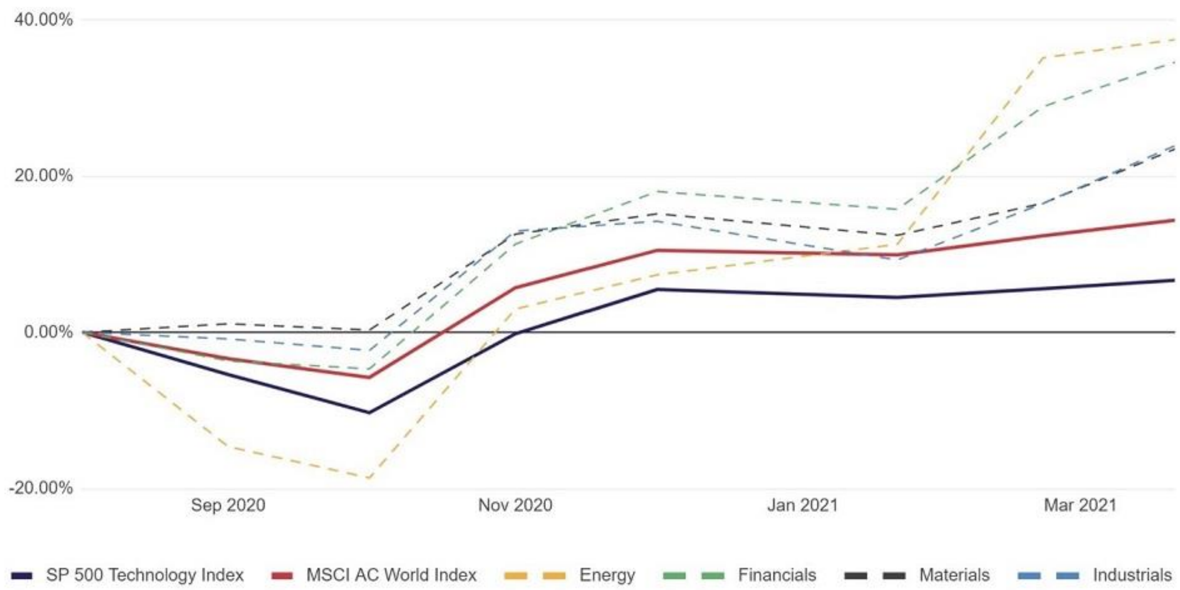
3. The sector rotation to value is temporary

As Covid-19 vaccination programmes roll out across the world, the language from governments and central banks switched in Q4 2020 from individual income support (to cover the wage gap from job losses or reduced working hours) towards fiscal stimulus programmes targeting infrastructure that could generate quick growth and employment.

US President Biden's proposed $2 trillion fiscal stimulus plan is an example. The economic plan is designed to drive higher revenue across the broader economy (commodities, retail, travel, industry).

Starting in Q3 2020, investors began to rotate capital away from last year's winners (growth stocks) into sectors they believed were both undervalued and beneficiaries of the spending plans. As can be seen in the chart below, rotation towards other sectors including energy, financial services, materials (commodities) drove higher performance versus the technology sector since August 2020.

Performance of different SP 500 Index Sectors since August 2020



We believe technology companies' recent share price underperformance is temporary, given our expectations of 25%+ revenue growth over the long-term. Traditional value stocks coming out of Covid-19 shutdowns almost uniformly have poor balance sheets (with high debts) and face rising competition from highly innovative technology innovators across most business sectors. A return of earnings uncertainty, common over most of the past decade, risks a sell-off back to deep-value levels.

4. Traditional asset allocation is challenged

Since the world stepped away from the Gold Standard in 1971, heavy central bank intervention and massive government debt has destroyed the value of fiat currencies. Add in the massive and continuing impact of Covid-19, and we now have to accept the fact that the global financial system is beyond repair.

Once we accept this, we must also accept that traditional asset allocation will almost certainly result in poor returns over the next decade. This is especially true for cash and bonds, both of which offer poor returns and possibly high risks if rising interest rates lead to corporate and possibly even government defaults.

That means growth stocks are even more important to hold across a portfolio. Rising inflationary pressures destroy long-term savings by reducing its purchasing power in the future.

5. Value stocks face structural decline

Traditional value-based investors are also likely to see far greater portions of their portfolios subject to structural decline candidates, especially if companies in their portfolios are going head-to-head with giant innovators like Amazon, Microsoft or Alibaba.

As a result, value stocks will likely remain cheap for a reason. Many must quickly innovate or die. Understanding and investing in accelerating innovation is likely to be the safest and best approach to deliver sufficient investment returns.

The retail sector stands out as a sector in severe structural decline, even before Covid-19 hit. What is most alarming is that online spending as a percentage of total retail sales increased from 12% to 16.3% in Australia over 2020 as a result of forced lockdowns. How many retail brands will be left standing when we hit 20%, 30% or 40%? Retail must urgently reinvent itself by balancing online and offline formats or die. The clock is ticking.

By contrast, technology stocks have immense structural tailwinds that we believe will accelerate as the six convergent technologies become mainstream over the next decade.

Money for traders but buyer beware over time

Bouts of outperformance in value stocks relative to technology may provide additional returns for traders, but low earnings confidence should lead to high volatility as traders lock in their trading profits. Value investing over the next decade will most likely become more difficult.

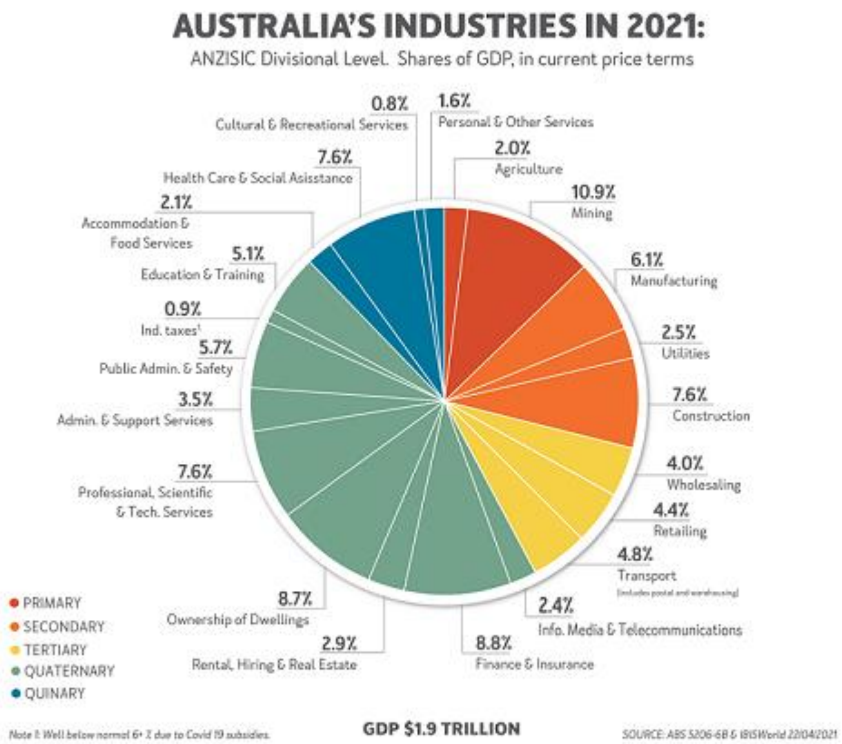
Investors embracing the 'new model' of accelerating change should be rewarded with higher portfolio returns that meet their retirement goals. Those who maintain or return to the old model and way of thinking run the risk of earning suboptimal returns and failing to meet retirement expectations.

Heath Behncke is Managing Director and a Portfolio Manager at [Holon Global Investments](). This article is for informational purposes only and is subject to change without notice. All securities and financial products or instruments transactions involve risks, and this article does not consider the circumstances of any investor.

Why does Australia's skewed stock market underperform?

Phil Ruthven AO

Australia's mix of industries in its economy is broadly similar to all advanced economies. It is dominated by the fast-growing information and financial sectors (quaternary) as well as health, hospitality, culture and other service themes (quinary), as we see below.



Indeed, these two sectors, mainly growing fast in the post-industrial age since the mid-1960s, now account for almost 60% of our GDP.

Agriculture is tiny but mining stands out

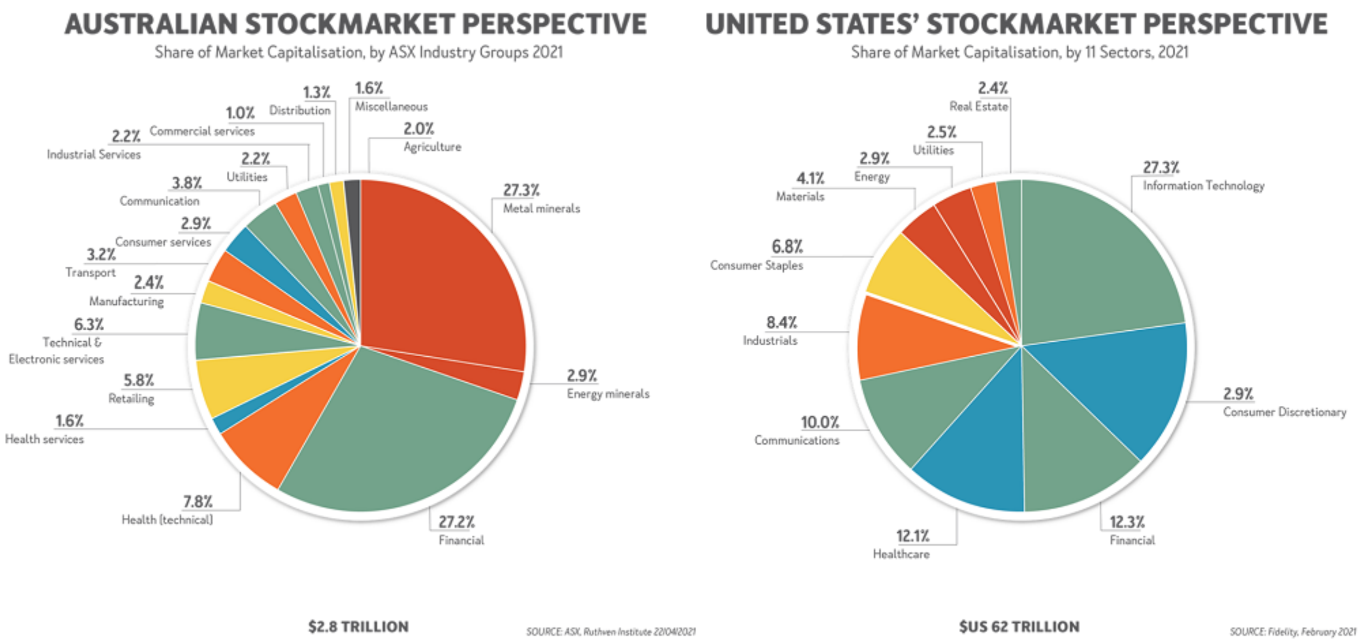
Agriculture is a fraction of the importance it had in the 1960s and is nearly as tiny a share as the USA's 1% of their GDP, such has been the increasing capital-intensity of agriculture that has displaced its millenniums-long labour-intensity.

But our mining industry stands out with over 10% of our GDP compared with other developed economies where this industry is a quarter or less of that importance. And it is reflected in our exports where over half our half our $400+ billion are minerals. More if downstream manufactures are added.

Stock market weightings, Australia v US

Which leads to our industry shares in the stock market, which is skewed both by minerals and financial services. As shown in the exhibit below, these two industry divisions account for a whopping 55% of the ASX's total market capitalisation.

This mix stands in vivid contrast to that of the USA, where these two divisions account for around 17% (a sixth) compared with Australia’s well over a half.



The USA has a stock market much more in tune with the new Infotronics Age of services, information and communication technologies (ICT) that displaced the goods industries and utilities of the Industrial Age up to the mid- 1960s. Their information technology sector (23% of the market capitalisation) rivals our mining industry for relative size. Then add the communications sector (10%) and ICT in total is a third of the market. It is bigger than either our minerals sector or financial services sector.

But does that explain our underperformance?

Does our skew to minerals and financial services explain why our All Ords has underperformed both the Dow Jones and NASDAQ for over 30 years and been left in their wake in the last 10 years?

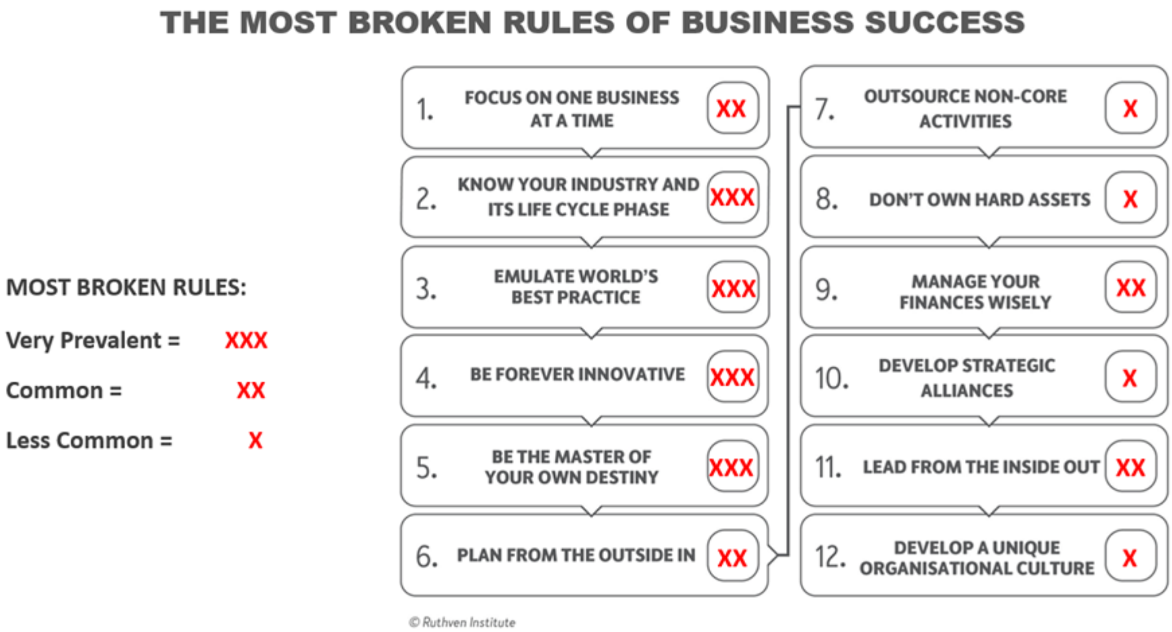
No, that’s not the reason: profitability and wealth creation (dividends and share price growth) are independent of the industry. Any industry can have players with world best practice (WBL) performance. We have WBP performers in all our 19 industry divisions (as described in the first exhibit on our industry mix). As does the USA and most other advanced economies.

Other explanations often used are equally untrue, including: population size, fewer hi-tech companies, distance from markets, corporate tax regime and others.

Why are Australian companies not more profitable?

About one in 10 Australian companies achieve WBP profitability over 5-year periods while four in 10 companies do so in the USA.

The real reasons why we are lagging are more fundamental. We break too many of the keys to success rules and the most frequently breached are shown in the table below. We have to get smarter and understand strategic planning much better than we currently do.



Phil Ruthven AO is Founder of the Ruthven Institute and Founder of IBISWorld. The Ruthven Institute was created to help any business that wants to emulate world best performance and profitability using the Golden Rules of Success, based on over 45 years of corporate and industry analyses and strategy work. The Ruthven Institute is happy to provide a fuller explanation of these 12 Golden Rules.

Three key trends and the power of investing in decarbonisation

Alex Debney

With the upheaval of last year it is easy to overlook huge changes taking place in how the world generates and consumes energy. It has been a long journey to get here.

The concerted push for emissions reduction and a decarbonised global economy has not been easy nor has it been quick. Climate scientists fought for decades simply for acknowledgement of the impending crisis. It took nine years for the UN to ratify the first global agreement combating climate change, the Kyoto Agreement. Another watershed moment was the release of Al Gore's 'An Inconvenient Truth' in 2006, which garnered global mainstream recognition of the climate crisis.

Understandably cleantech investing in the mid-2000s was a 'hot' sector though one that failed to live up to the hype. Climate change pundits are now calling this initial wave of investment Cleantech 1.0. It had mixed success for various reasons, namely the widespread adoption and initial success of oil fracking, the GFC and simply because it was too early from a technological standpoint.

We are now in a different world

Recently we have seen global mobilisation across governments, economies, and communities in the fight to address the climate crisis. The Paris Climate Agreement was signed by nearly 200 countries in 2015 and focused on limiting global temperature increase this century to less than two degrees. And just two years ago, Greta Thunberg inspired six million people worldwide to march in the Climate Strikes.

Yet it is the steady advancement of renewable energy technology that has trumped competing energy generation sources.

Enter Cleantech 2.0. Against a backdrop of volatile and structurally challenged oil and thermal coal markets, iteration of existing technology has driven wind and solar to become the cheapest modes of energy generation, and investment in new renewables technologies is ramping up.

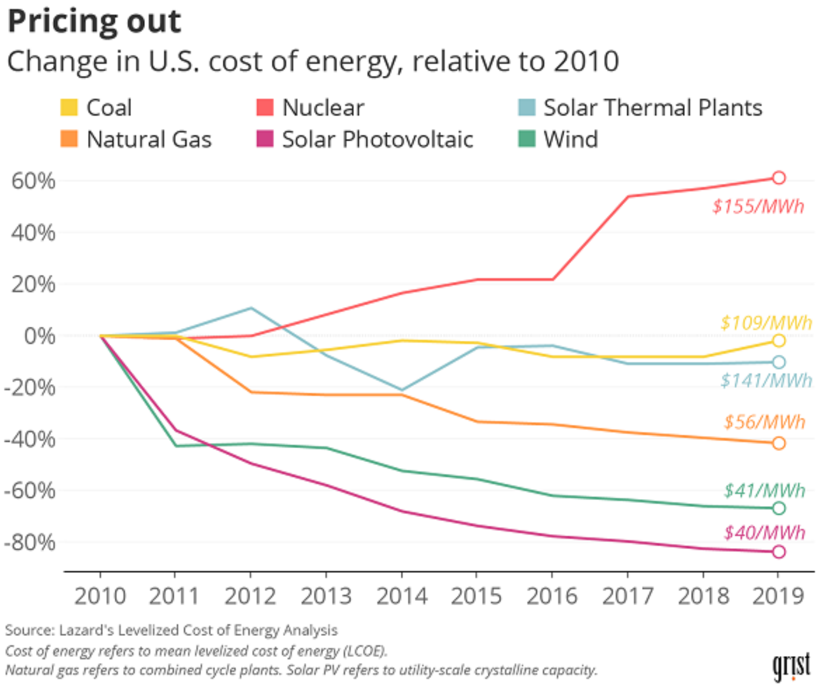
This article explores how renewable energy has evolved, where we see it going, and how we have positioned our strategy in the space.

How has renewable energy changed?

Simply put, incumbent and non-renewable sources of energy generation have been 'priced out' by renewables.

From Figure 1 we can see that the cost of wind and solar energy generation has drastically declined over the past decade. The comparative data provides a complete picture capturing the upfront cost of building energy generation as well as ongoing fuel and operational costs, called 'levelised cost of energy' (LCOE).

Figure 1 – Historical unsubsidised levelized cost of energy comparison (utility-scale; global)

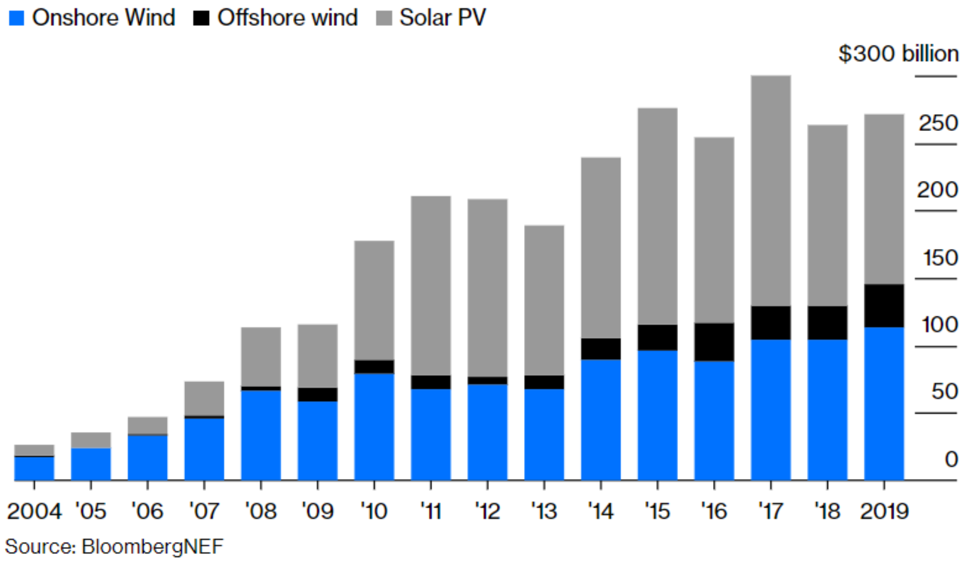


Source: Grist, Lazard

LCOE for renewables has declined as existing solar and wind technologies matured and the ability to access those fuel sources is stable over time. They are endlessly available. Comparatively, non-renewable energy sources are increasingly complex and costly to extract despite spending and innovation in those sectors.

Continual cost reduction in renewable generation has not been a result of major scale 'venture' investment. The boom and bust of Cleantech 1.0 stalled major investment in new cutting-edge renewables technologies by venture and early-stage risk capital. Instead, positive iteration of existing renewables technologies has been driven by major increases in asset financing (Figure 2). Annual global investment in wind and solar generation assets has increased 12-fold in the past 15 years.

Figure 2 – Global asset finance investment in wind and solar generation (nominal US dollars)



A key lesson for those early venture investors was that many cleantech companies developing new technologies were poorly suited for venture capital investment. They required significant upfront and ongoing capital, had long development timelines, and were frequently unable to attract corporate acquirers.

So capital contributions and the types of investors in renewable energy changed following Cleantech 1.0. Venture investors moved away, while asset financiers backed the sector in a big way. As a result, existing and well-known clean technologies related to generation have matured, while spending on delivery of additional new clean technologies has suffered a long hiatus (until now).

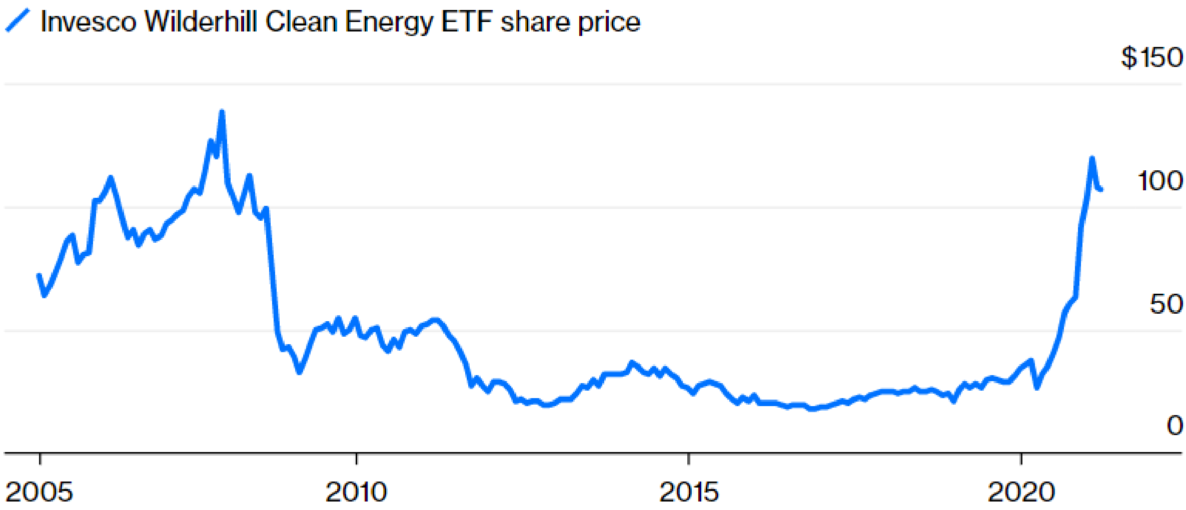
How will renewable energy continue to evolve?

This time, the renewables revolution looks different. Three key trends in today's energy landscape will dictate how the medium term plays out.

1. Clean energy corporate and innovation financing will be more targeted this time round

A clear delineation between asset financiers and corporate backers emerged from the collapse of Cleantech 1.0. Corporate interest in clean technology companies and innovation lapsed for over a decade but has now returned. Figure 3 shows the longest running index that tracks stocks and sectors focused on clean energy and climate-change solutions, and investor interest in corporate climate-change solutions has recently exploded.

Figure 3 – Wilderhill Clean Energy ETF share price



Source: WilderShares. Note past performance is not indicative of future performance.

While investor inflows into clean energy companies have clearly recovered, corporate and venture investors are now largely focused on capital-light sectors in specific niches such as wind and solar services, electric vehicles, and battery technology. Niches that are also adjacent to existing and mature wind and solar technologies.

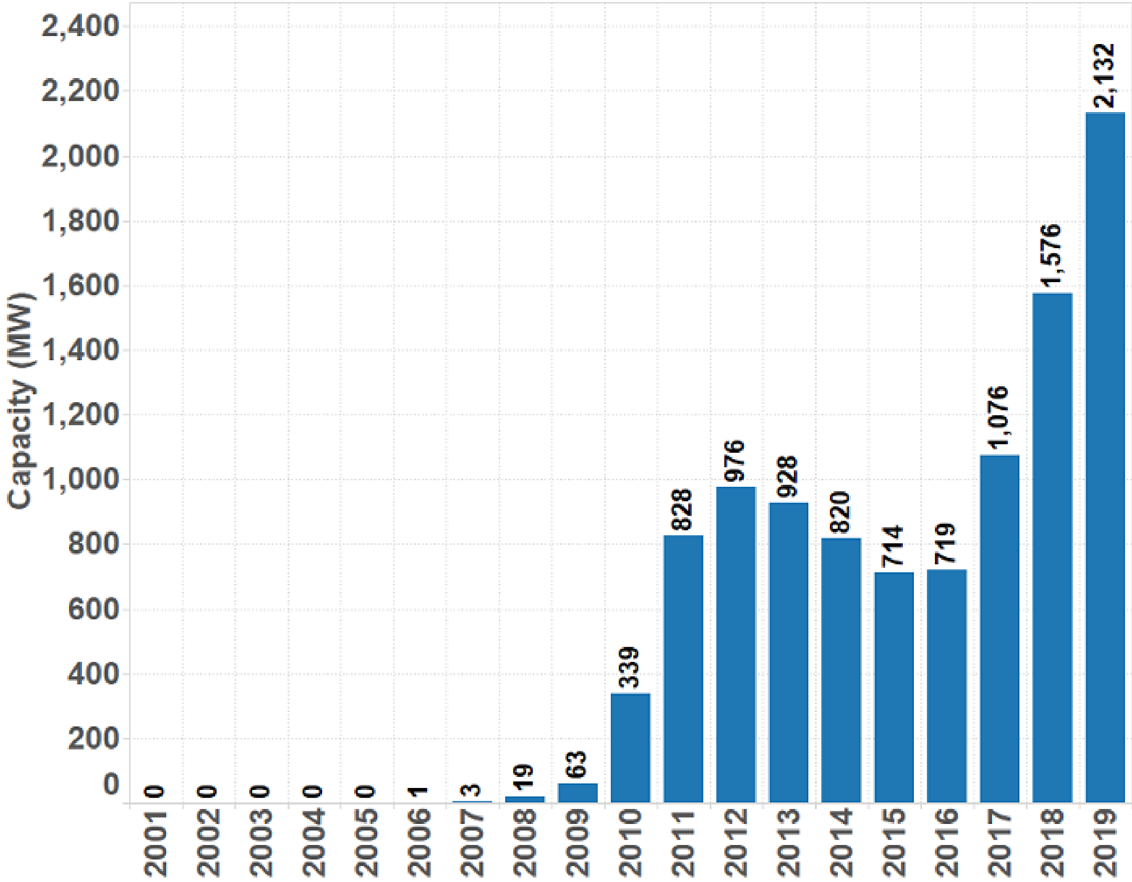
Investment in clean technology innovation will continue its recovery, and we expect adjacent technology niches (such as different battery storage sectors) to attract the most capital and interest.

2. Asset financing is driving increasingly distributed energy markets

Structural inefficiency is embedded in the traditional model of a centralised energy system, where a large power station typically generates electricity far from where it is used. Transmission of energy over distances creates losses and transmission networks require ongoing capital charges to continually refresh the poles and wires infrastructure.

The continual improvement in wind and solar generation technologies discussed earlier in this article have enabled miniaturisation and decentralisation of renewable generation sources. As a result, rooftop solar deployment has rapidly escalated globally, and Australia is no exception (Figure 4).

Figure 4 – Annual installed rooftop solar capacity (Australia)



Source: PV Magazine Australia

Solar panel efficiency will continue to increase as costs continually reduce, and in our view the trend of increasing distribution of energy generation still has a long way to go.

3. Increasing investor focus on ESG and wariness towards greenwashing

A huge driver of capital inflows into climate assets and tech has been the increasing popularity of responsible investments. Last year's pandemic further heightened scrutiny of corporate and individual footprints in carbon and protection of natural capital.

Investor focus on identification and measurement of actual underlying ESG factors and impact is also sharpening. There is a proliferation of new platforms for upfront measurement and ongoing tracking of ESG, and investors are asking more and more social, governance and sustainability questions of businesses. Investors are also much less forgiving of businesses creating adverse social and environmental impacts. Recent community and investor reactions to mining companies prioritising profits over cultural heritage sites and natural capital serve as stark examples.

How do we invest in the changing energy paradigm?

There are many challenges when investing in such a rapidly-evolving space, so there are a few ways we have refined our approach to renewables investment.

1. Focus on a specific and defensible niche that is well understood

Our decarbonisation investments are focused solely on solar assets that are co-located with customers for the provision of renewable power. We enter long-term agreements with those customers to provide contractually locked-in returns and protections. Those returns are also inflation linked to ensure the relative value of those returns for our investors are not decreasing over time.

We have avoided assets that sell renewable energy into the Australian electricity market ('in-front-of-the-meter') because future electricity spot pricing, curtailment and marginal loss factors are just a few areas that are difficult for any investor to accurately price for risk in our national market.

Another important consideration for risk mitigation is diversification. A distributed solar portfolio that is highly concentrated in a single geographic region or with a concentrated group of counterparties has a higher degree of idiosyncratic risk.

2. Continually build domain expertise in a niche, supported by great partners

Our investment strategy is predicated on working with best-in-class operators for our assets within our investment sectors. We build as much domain expertise as possible as active investors. That approach strengthens our partnerships and ensures the best coverage of our portfolios.

In distributed renewables we currently work with two well-known partners in the space – Solar Bay and Green Peak Energy – and have deployed distributed solar across more than 40 assets to date.

3. Understand new technologies, focus on adjacent ones, and avoid the hype until they're 'proven'

We are not venture investors. We create positive social and environmental impact and market rate returns through investment in real assets. Our target returns also include a large component of ongoing cashflow generation for investors. That means we do not invest in new technologies with potentially long development timelines, and uncertain outcomes.

But as with anything in our target impact areas, we spend months and even years understanding the need, and the sector that seeks to address it, to make investments that can combine both impact and financial returns.

Alex Debney is a Partner at [Conscious Investment Management](), a Channel Capital partner. Channel Capital is a sponsor of Firstlinks. This information is not advice or a recommendation in relation to purchasing or selling particular assets. It does not take into account particular investment objectives or needs.

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Making a positive impact with thematic investing

Richard Montgomery

Last week I read an interesting piece by someone who clearly was not a fan of thematic investing.

He demonstrated the dangers of jumping on the 'next big thing', pointing out, for example, the risks early investors in the automobile faced. The Duryea Motor Wagon Company, the first U.S. car maker, was founded in 1895. Over the next 25 years, 436 car manufacturers came into existence, but 30 years later, almost all had fallen by the wayside as the big three of General Motors, Chrysler and Ford emerged.

More recently, those who committed their hard-earned cash to the online shopping phenomenon via Amazon have been rewarded handsomely, but it's easy to forget spectacular failures such as etoys.com, Pets.com, Boo.com, which didn't turn out so happily for investors.

The writer's conclusion? *"Thematic leaps do not axiomatically line the pockets of those willing to finance them."*

Maybe so. But does this mean we should abandon the attempt to profit from trends that have the potential to change the world? Or simply, is it that we need to be smart in how we go about it?

What is thematic investing?

Thematic investors try to identify long-term transformational trends, and the investments that are likely to benefit if those trends play out. Such investments are typically agnostic to industry sectors, or geographical boundaries.

Thematic investing focuses on structural, rather than cyclical trends. These are themes that tend to be one-off shifts that irreversibly change the world, driven by powerful forces such as disruptive technologies or changing demographics and consumer behaviour. By contrast, cyclical themes are typically short- to medium-term, and tend to revert.

An example of structural change is the emergence of e-commerce, which has fundamentally shifted the way goods and services are bought and sold. Another good example is the rise and rise of cybersecurity, which is increasingly becoming a critical threshold component of all technology solutions as more and more of our world goes online.

How can I invest thematically?

Here's where it gets trickier.

The writer I referred to earlier is right - picking winners is notoriously difficult. For every Amazon or Netflix, there are hundreds, even thousands, of companies trying to exploit the same opportunities, but fail.

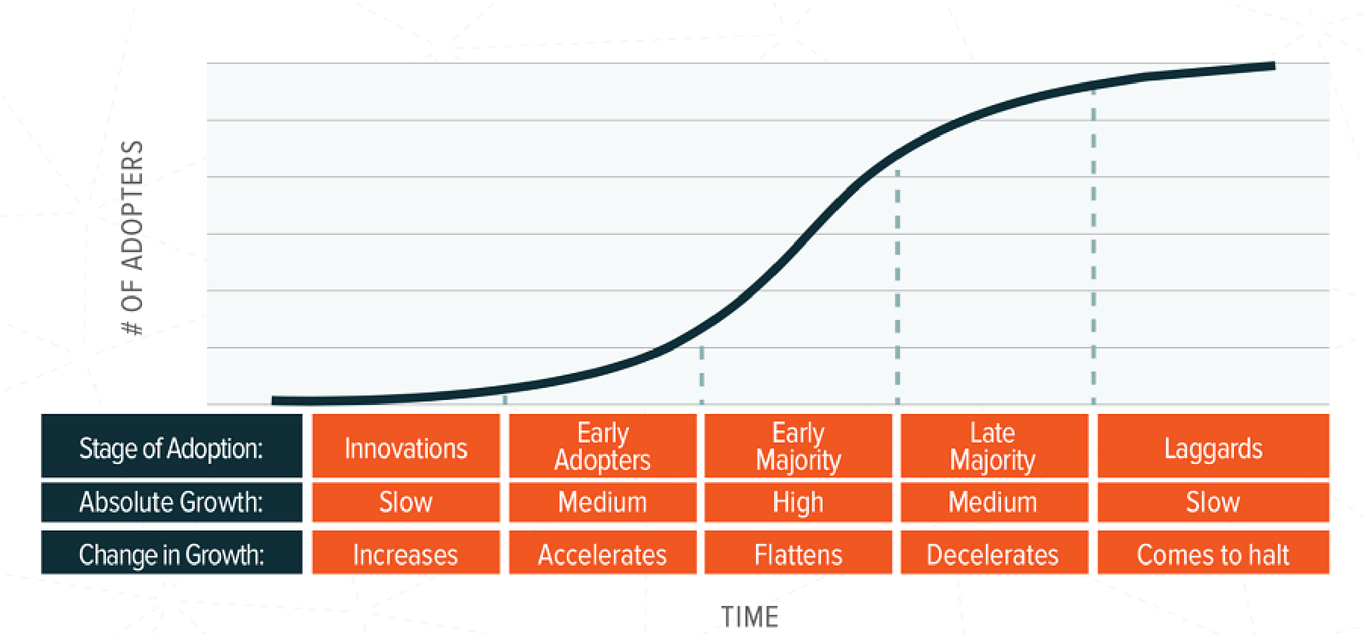
For this reason, there are benefits to gaining exposure to a theme in a different way, one that is not an 'all or nothing' gamble.

Thematic ETFs take this approach. They typically aim to track an index that measures the performance of a range of companies that have the potential to benefit if the theme plays out. And, like thematic investing more generally, they are typically sector and country agnostic. Diversified exposure means that the inevitable failure of some of these companies will have less of an impact. The hope is that some, or many, will succeed, and that overall the portfolio of companies will increase in value.

.... and when?

As important as the *how*, is the *when*.

One model proposes that disruptive technologies, products and ideas typically follow an 'S' shaped adoption curve with five stages. The chart below shows the growth, and rate of growth, at each stage.



Source: Jay Jacobs, 'Investing in Tomorrow – A Whitepaper on Thematic Investing', Global X

The timing of an investment is largely a trade-off between upside potential and risk.

Investing right at the start of adoption has the highest potential reward but also involves the greatest risk, as the trend is far from established, and there is a high possibility of failure.

Waiting until the later stages involves far less risk, as the theme is well-established. However, the potential rewards will also be less, as the successful progression of the theme will already be reflected in the prices of the investments being considered.

What theme might be in the sweet spot right now?

In 2021, what is a theme that fits the criterion of a 'one-off shift that irreversibly changes the world, that is long-term in nature, and driven by powerful forces such as disruptive technologies or human behaviour'? One that is neither at the earliest stages, nor has reached maturity.

While we believe there are a few, the candidate we're focusing on today is climate change.

Global warming is one of the defining challenges of the 21st century. Unaddressed, it will have a catastrophic impact on our planet and the lives of future generations. Many would argue the catastrophe is already unfolding.

Given the dimensions of the challenge, the size of the response and the amount of money needed to be spent on it is correspondingly large.

The United Nations Intergovernmental Panel on Climate Change (IPCC) estimates that to contain the rise in global temperatures to 1.5-2°C above pre-industrial levels by 2100 would require a halving in the level of greenhouse gas emissions (GGE) currently projected by 2050 under the current 2016 Paris Climate Agreement.

Energy currently accounts for around two thirds of global GGE. Global energy producer BP estimates that to achieve the extra GGE cuts suggested by the IPCC would require a 10-fold increase by 2050 in the share of energy derived from renewables - or from around 5% in 2018 to between 40 to 60%.

Meanwhile, the Energy Transitions Committee (ETC), a global organisation of energy producers, financial institutions and environmental groups, believes it is possible to create a prosperous net-zero-emissions economy by mid-century, in which case global warming would be limited to the lower bounds of the Paris Agreement's target range.

The ETC estimates that the additional investment required to achieve a zero carbon-emissions economy by 2050 will be US$1-2 trillion per annum.

The deep cuts to emissions that will be required to limit global warming call for innovation on a range of climate and environmentally friendly activities. Investors wanting comprehensive access to this thematic are likely to want an investment that provides exposure to a broad range of solutions, including clean energy, electric vehicles, energy efficiency technologies, sustainable food, water efficiency and pollution control.

Richard Montgomery is the Marketing Communications Manager at BetaShares, a sponsor of Firstlinks. This article is for general information purposes only and does not address the needs of any individual. Past performance is not indicative of future performance. Investment value can go down as well as up.

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To tap into the long-term growth potential of this theme, BetaShares has launched the Climate Change Innovation ETF (ERTH).

Real yields, inflation and risk assets in a transition

Ashok Bhatia

The fixed income world is beginning to undergo a multiyear transition as monetary accommodation and government spending across key economies drive higher near-term economic growth rates. The result could be a shift to higher real rates as output gaps narrow, as well as moderately higher but stable inflation.

In our opinion, this bodes well for risky assets, but will likely be accompanied by increased volatility and changing correlations.

Investment implications are quickly changing

For the past dozen years since the GFC, the overall environment for fixed income investors has been largely unchanged. Global growth has been sluggish across the developed and emerging markets. Central banks have unleashed a range of programmes aimed at supporting growth and financial assets. And fixed income investors have been persistently rewarded for positioning for low nominal yields, low real yields and a low-inflation (or even disinflationary) environment.

Whether it's government bonds, credit instruments or even trends in the equity markets, these powerful trends in yields and inflation have significantly influenced the return outcomes of a vast swath of financial instruments.

This backdrop, to which investors have grown accustomed, is quickly changing, and we think investors need to position for a different and more complex environment. In our view, this is not a one-quarter or two-quarter shift, but likely the beginning of a multiyear transition to a different fixed income world.

What characterises this new environment?

It's continued aggressive monetary accommodation, coordinated with remarkably high fiscal spending across a range of key economies, that will drive substantially higher growth rates over the near term. For fixed income investors, it means a transition to higher real yields as output gaps narrow globally.

We expect significantly more volatility around real yields in the coming quarters and years than we've experienced in the recent past. Intuitively, that's due to uncertainty about whether this higher fiscal spending will drive quasi-permanent higher growth rates, or whether growth fades as fiscal stimulus eventually fades.

Real yields in perspective

As the chart below highlights, developed market real yields have been in a constant decline over the past 20 years, with acceleration lower after the financial crisis and then again in response to the COVID crisis. Relatively weak growth across the global economy has been the primary driver.

Markets currently appreciate that the growth outlook for 2021 will be strong given the reopening of economies and pent-up demand in many services sectors. However, we think investors under-appreciate how strong the growth trajectory could be after this year. Although declining, fiscal stimulus should support major economies well into 2023. Household savings rates are relatively high and will drive continued consumer spending. And, as consumption patterns change as some forms of work-from-home become permanent, we expect multiyear adjustments toward higher goods spending.

As the chart below highlights, this should all result in significantly above-trend growth in the three major economies not only this year, but over the next three years.

What does a multiyear period of higher growth rates imply for markets?

We are entering a 'period of transition', where strong growth will help close output gaps across the world, and where very accommodative central bank policies will increasingly feel different given these higher growth rates.

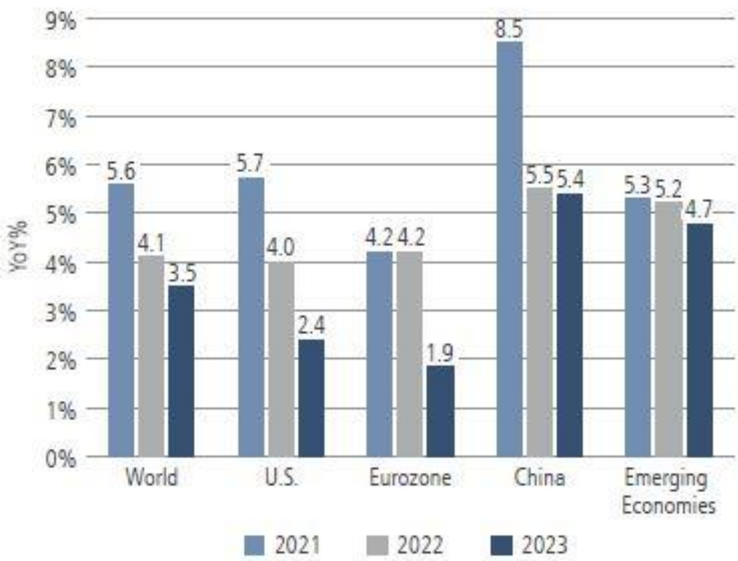
For fixed income investors, this should translate into a period of structurally higher and/or rising real yields, reflecting the more persistent and stronger economic backdrop.

We have three key conclusions about the emerging transition to higher real yields.

U.S. VS. EUROPEAN 10-YEAR REAL YIELDS – LAST 20 YEARS

Source: Bloomberg. Data through February 2021.

BLOOMBERG AGGREGATED REAL GDP GROWTH FORECASTS



Source: Bloomberg. Data as of March 24, 2021.

First, of all the factors that can impact the appropriate level of real rates, we expect that output gaps - or realised growth relative to potential growth - will be the main driver of equilibrium levels. As highlighted in the chart below, this analysis points to continued and sustained upward pressure on real yields in the coming quarters as aggressive policies continue to drive above-trend growth rates.

THE OUTPUT GAP IS SET TO CONTINUE ITS SHARP RECOVERY

Source: CBO, Federal Reserve, ECB, Neuberger Berman calculations. Data as of March 22, 2021.

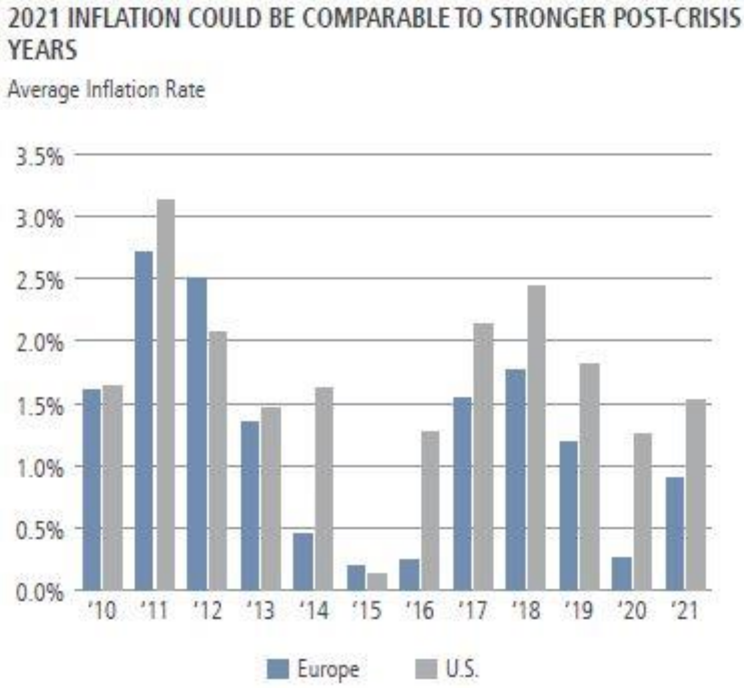
Second, based on our expected evolution of fiscal policy, monetary policy and expected growth, our 'fair value' view for U.S. and German 10-year real yields at the end of 2021 is -0.20% and -1.45%, respectively or approximately 30 basis points higher than current levels (see chart below).

REAL YIELD SHOULD TREND UPWARD BUT REMAIN RANGE-BOUND

Source: Bloomberg, Neuberger Berman calculations. Data as of March 22, 2021.

Third, we expect risk assets to perform well in the intermediate term despite rising real rates. If a rise in real yields is exogenous and driven by a one-off tightening of financial conditions, like the taper tantrum of 2013, risk assets have tended to fare poorly. But if real yields are going up because of stronger growth and closing output gaps, it is generally supportive environment for risk assets.

In addition, just as we are transitioning to a higher real-yield environment, we are also transitioning to a higher realised and expected inflation environment. Perhaps the most significant recent change is credible central bank shifts toward conducting policy explicitly to achieve this outcome. Referencing the chart below, we expect inflation rates to return to levels seen in some of the stronger years since the GFC.



Source: Bloomberg, Neuberger Berman calculations. Data as of March 22, 2021.

This transition to higher real yields and higher inflation rates poses two main risks to markets and economies. We don't think these issues surface in 2021, but believe it's not too early for investor consideration.

- Rising government bond supply versus growth sustainability. Expanded deficit spending in the U.S., Europe and China is driven by the premise that accelerated fiscal stimulus can kickstart economies into higher and more sustainable growth rates. If this spending has low or negative multipliers to growth, the risk is an environment of upward pressure on yields without higher growth.
- Rising term premiums. Central bank purchase programs, primarily in the U.S. and Europe, have helped push government bond term premiums to low or even negative yields. Whenever these programs begin unwinding—we do not expect this in 2021—balancing the positives of a stronger growth environment with rising term premiums will likely introduce a different type of volatility into fixed income markets.

Finally, it's worth highlighting the risk of increasing global divergences. Europe and certain emerging markets may lag in the coming global recovery, particularly versus the U.S. and China. This may result in a more disjointed yield environment globally than has been typical over the past few years, and create opportunities for global investors.

Revisiting our 2021 fixed income themes

Key market themes we identified at the start of 2021 remain intact. With the market movements in the first quarter, we slightly update our views.

- Earn income without duration. This theme was a key driver of relative returns in the first quarter, as short-duration income sectors such as high yield, bank loans and collateralised assets delivered higher returns than other fixed income markets. We expect continued outperformance on both a relative and absolute basis from these areas. However, with the rise in interest rates in the first quarter, tactical opportunities have emerged in intermediate- or longer-duration sectors, such as fallen angels and rising starts in the non-investment grade markets, BBB rated securities in the investment grade market, and emerging market sovereigns.

- Position for rising inflation. We expect continued increases in inflation breakeven rates, driven by the U.S. markets. We continue to believe that emerging market currencies are also attractive expressions of a higher inflation theme, although volatility will remain relatively high as U.S. growth expectations rise.
- Sector and issue selection will drive returns. With relatively tight credit spreads across markets, sector and issue selection will remain key drivers of returns across fixed income. We continue to construct portfolios with an emphasis on secular winners (sectors like telecommunications and media), but are finding attractive opportunities in more cyclical exposures such as commodity-focused companies or countries.

Ashok Bhatia is Deputy Chief Investment Officer for Fixed Income at Neuberger Berman, a sponsor of Firstlinks. This material is general information and does not constitute investment, legal, accounting or tax advice, or a recommendation to buy, sell or hold a security. You should consult your accountant or tax adviser concerning your own circumstances.

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