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Editorial

Share investors focus on buying well and selling well, but holding well is at least as important. Next time you attend a fund manager presentation, ask about their longest investment. If they are skilled at identifying great companies, their investments should not be short-term trading decisions. Buy Microsoft or Apple or CBA and stick them in the bottom drawer. But blind devotion to a company whose fortunes are changing is also a failing, so watch where a fund manager falls in love with a stock and overlooks the risks.

Two groups of people who don't worry about buying or selling for themselves are politicians and government officials. We expect them to be passive and yet we want business leaders such as company executives and fund managers to 'drink their own champagne'. Welcome to the issue of who should be 'dogfooding'.

For more active direct investors, two stalwarts of Australians retail portfolios are good examples of the hold or not hold decision. **CBA** floated 30 years at $5.40, and it not only hit $100 this week for the first time, but investors received $4.31 of fully franked dividends in both 2019 and 2018. The dividend fell to $2.48 in 2020 but it will recover in 2021. Those who sold during the GFC or COVID underestimated the power of Australia's banking oligopoly.

Source: Morningstar Direct

But the lesson is not to simply buy and hold, but to hold well the companies that can withstand short-term downturns because they are great businesses. **Telstra**, for example, has disappointed millions with a direct or indirect investment over many years. Faced with heavy competition, poor customer service and large capital expenditures to stay on top of technologies such as 5G, it will never return to its heyday.

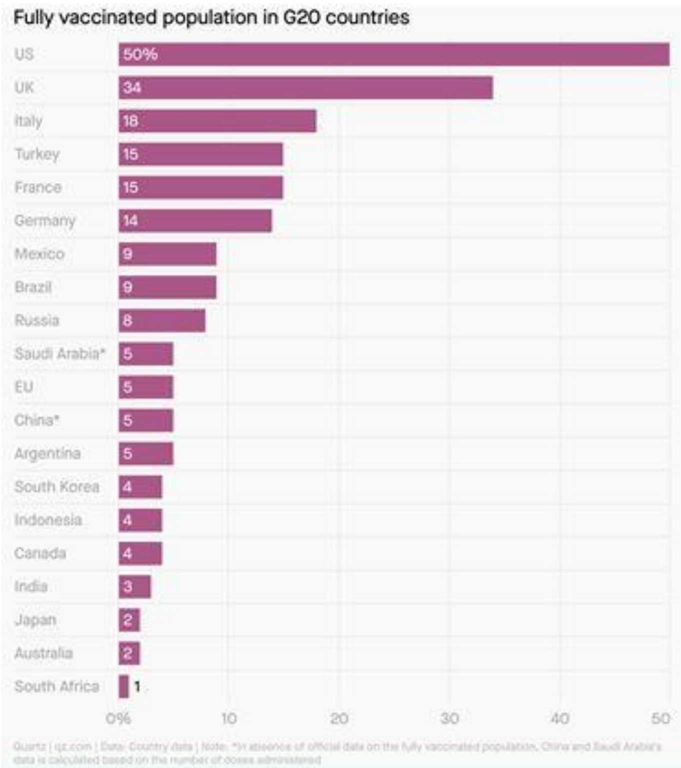
Source: Morningstar Direct

Companies like CBA are part of the 'opening up' story, driven by central bank stimulus and vaccine success. Half of American adults are already fully vaccinated and over 60% have had at least one shot. Plus an estimated 12%-15% have had the virus, taking the US close to herd immunity. As it opens up, economic activity should support the economy, giving more reasons for optimism about US equities.

Unfortunately, other places have not done as well. When the **World Health Organisation** set up Covax in 2020 to send vaccines to developing counties, it expected to deliver two billion doses by the end of 2021. Covax has shipped less than 70 million to date. The **Serum Institute of India** announced this week that it would not provide any vaccines to Covax as India copes with its own disaster.

The table below shows how far Australia is down the vaccine list, second from the bottom. Were we not supposed to be "at the front of the queue"? I had my first jab this week and it was easy and painless. With 30% of Australians refusing to become vaccinated, complacency has set in, although the new Victorian outbreak will change a few minds. The President of the Australian Medical Association, **Dr Omar Khorshid**, said this week that too many people assume there is little risk of a serious outbreak:

"There is no way for Australia to avoid COVID unless we close ourselves off forever. But that's not going to be acceptable. So COVID will come, because there is just no way to eradicate this virus from the entire globe. There's such vaccine inequity that we're going to have virus hotspots, with huge amounts of devastating COVID for a long period of time. And we are going to have to manage that risk with open borders through mechanisms such as vaccination, quarantine and a boosted health system, which is going to have to learn to manage people with COVID."

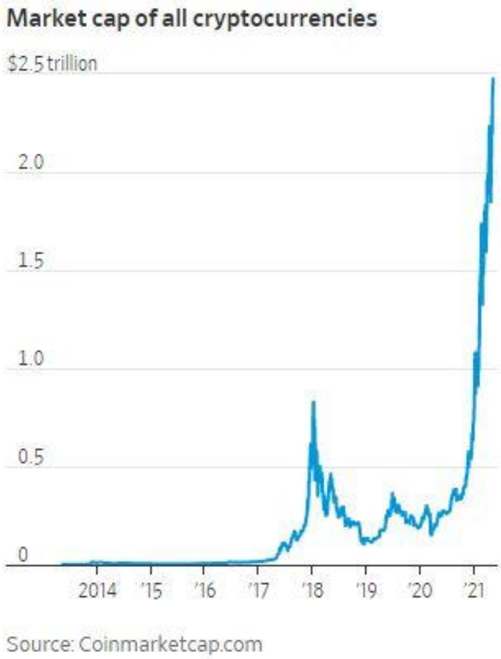


As we open up, the other side of the share price recovery in traditional stocks is the growth companies that boomed in 2020. **Alex Pollak** says valuing great tech companies should not rely on single-point measures, as their revenues will grow rapidly long into the future.

The biggest movers in the last couple of weeks are - surprise, surprise - cryptocurrencies. If you want to see how crazy this market is, check the website CoinMarketCap. It lists thousands of coins, every man and his dog has jumped aboard, not only as a buyer but as issuer. The combined market cap has fallen to US$1.7 trillion from US$2.5 trillion. In case you are losing track of the zeros, that is a loss of US$800 billion or A$1,000,000,000,000 (12 noughts) in a couple of months.

The largest, **Bitcoin**, is down 50% since its mid-April peak but it is still up 300% in a year, as shown below. Where does it go from here? No idea.

Source: Bitstamp



Both the US and Australian regulators are cracking down on the loss of tax revenue from people not declaring their gains. A US Federal judge in Boston has approved IRS summons against crypto payment companies requiring them to provide customer records. The recent Bitcoin fall continues a pattern which shows this is no place to commit retirement savings. Here are other Bitcoin price movements since 2017.

- -35%, January 2017
- -33%, March 2017
- -32%, May 2017
- -40%, July 2017
- -41%, September 2017
- -30%, November 2017
- -21% December 2017
- -23% December 2017
- -84% December 2018
- -31%, January 2021
- -26% February 2021

This week, **Shane Woldenthorp** attempts to make sense of cryptocurrency by estimating its value and considering it as a medium of exchange. It comes in the same week as **Senator Jane Hume** called cryptocurrencies an 'asset class' and not a 'fad', and:

"We have to back Australians to be sensible enough to judge for themselves whether to put their hard-earned money into higher-risk assets. The fact that some people make poor decisions does not justify restricting the ability for ordinary Australians to participate in investment."

We then cover a wide range of interesting issues.

Hazel Bateman and her colleagues explain the changes to the Pension Loans Scheme (PLS) and expect far more people will use it. Remember, it is available to self-funded retirees, not only those on the age pension. The PLS will increase its profile over the coming year as the Government has clearly indicated it wants retirees to access their home equity. The product is likely to change its name as the Minister for Families and Social Security, **Anne Rushton**, told the AFR:

"The name has mistakenly led people to believe that self-funded retirees don't have access to it, which is not the case. I think it could be improved and self-funded retirees haven't picked it up anywhere near the level you think that they might like to."

Then **Lisa Harlow** makes the excellent point that just because an investor uses a passive index fund does not mean they are disinterested in ESG issues. Index fund providers take their stewardship role very seriously.

The concept of a 'Lewis turning point' is used by **Michael Collins** to show how China is at a critical stage in its history, and the implications for a country like Australia which relies on exports to China are profound.

Rachel Lane looks at the $17.7 billion aged care package in the last budget and fears many older Australians will still be left behind.

We reproduce a quick advice from the **Australian Taxation Office** on the Top 5 errors trustees make in their SMSF tax returns, worth checking as the end of the financial year approaches. And remember that the Government temporarily halved pension drawdown amounts during the pandemic but they return to standard levels from 1 July 2021. For example, two members of an SMSF who are 65 to 74 years old each need to draw 5% as a pension. Is your fund liquid enough to finance a 10% withdrawal next year?

And in response to reader demand, we have combined the two articles on risks buying property off-the plan into one document to share with others. For example, **AlanB** commented:

"This is a most informative article that deserves wider publicity and exposure. It should be put into brochure form and compulsorily handed out to all prospective off the plan apartment buyers. But that will be opposed by real estate agents and shonky developers. Parents need exactly this information to pass on to their young adult children."

This week's White Paper from **Vanguard** shows Australian attitudes to investing, including that while half think about their financial future daily, 70% don't have a financial plan. Obviously, not enough read Firstlinks.

Dogfooding and how we expect our leaders to invest

Graham Hand

In the 1970s in the US, a dog food called Alpo was marketed using actor Lorne Greene claiming he personally fed Alpo to his own dogs. Thereafter, the phrase 'eating your own dog food' meant using the product you were promoting or marketing. Later, as software applications became more common, the term 'dogfooding' became popular with developers to mean using their own software to improve the experience and understand problems users might encounter.

It's appropriate to expect that if a product is as good as a company's marketing says, then the people who work there should use it themselves. By having a consumer experience, or by 'eating their own food', they should understand the product and its benefits better.

To what extent do we expect this of company and government executives?

1. Dogfooding in business

There are many versions of dogfooding in business. Or not dogfooding enough. Given the terrible user experience of contacting call centres at banks and communications companies, it's doubtful many CEOs have phoned their own businesses with a user problem. If they had, they would call their senior staff into a room early next morning and tell them to fix the mess immediately. No executive who goes through a couple of hours of agony on the phone with their own staff should accept the experience. Similarly with websites which only the designers can fathom how to navigate.

A good example was the initiative by the President of Apple, Michael Scott, in 1980, when word processing and personal computers were in their

Apple's 1980 internal memo: No more typewriters

Inter Office Memo

YOU ALL BETTER READ THIS

Date: February 1, 1980

To: Purchasing and Everyone

From: Mike Scott MS

Subject: Typewriters

Effective Immediately!! No more typewriters are to be purchased, leased etc., etc.

Apple is an innovative company. We must believe and lead in all areas. If word processing is so neat, then let's all use it!

Goal: By 1-1-81 No typewriters at Apple. (Ken, get rid of the DEC word processor ASAP)

Brownie Points: Typewriter users giving up their machines in favor of Apple II-Apple Writer Systems will get first priorty on new Apple high performance systems. Those who can justify direct typing capabilities and will turn in their typewriter will get first Qume with Keyboard/Apple installations.

We believe the typewriter is obsolete. Let's prove it inside before we try and convince our customers.

cc: Executive Staff
All Typewriter Users

infancy. An internal memo banned typewriters, as he wrote *"We must believe and lead in all areas. If word processing is neat, then let's all use it!"*

That's a great line (was it typed on a WP?): *"Let's prove it inside before we try and convince our customers."*

Another example is the ride-sharing company, Lyft, which requires all corporate employees to know what it is like to drive a car or service passengers. Salaried staff must spend at least four hours every quarter experiencing what their drivers do, which can include staffing the call centre or working as a Lyft driver.

2. Dogfooding in funds management

If there is one common characteristic every investor wants in fund managers, it is evidence of their 'skin in the game'. Perhaps in the lucrative world of investing, a better expression is 'to drink your own champagne'. Fund manager presentations often include a statement about the portfolio managers investing a considerable proportion of their own wealth in their own fund. It shows an alignment of interest, a way to give the investor confidence that the fund manager is working hard for everyone including him or her self.

Morningstar supports this principle as a good signalling factor for investors. For example, Kaustubh Belapurkar, a Director of Fund Research at Morningstar, says:

"We do positively view asset managers encouraging or mandating fund managers to invest in their own funds as a good stewardship practice."

He cites Royce & Associates, a New York-based fund manager with a policy that lead portfolio managers must invest at least $1 million in their own funds, co-portfolio managers $500,000 and assistant managers $250,000. If they do not have enough money, their bonuses are deferred into the fund.

But such an edict, and our preoccupation with fund managers investing in their own fund, must have its limits.

First, every fund manager, whether or not their own wealth is invested there, wants to do the best for the fund. Should we demand they put everything on the line, including their salary, their bonus, their reputation, their status? Unlike other professions, the performance of a fund manager is on public record at least once a month. A fund manager who underperforms must explain the poor results to everyone, including investors, bosses and the public. It's already a massive incentive to do well, yet we demand they lose sleep because their personal investments are on the line.

Second, business leaders advocate for the benefits of a more balanced life and hope our agents look after their personal needs, including their family. Like most people, fund managers at a certain time in life will want to buy a good home (yes, we have a tax system that heavily favours home ownership over renting). They should not forfeit this major life event due to a requirement that the majority of their wealth be exposed to their fund.

Third, the fund might not suit the manager's investment journey. We would not expect a 30-year-old investor to place all their assets in a bond fund, so why expect it from a 30-year-old bond fund manager? It's just not good investing at such a young age, even if they are a talented manager.

Every investor needs diversification, and for example, a manager running a technology fund is already substantially exposed to growth in that sector without committing all their personal wealth.

We accept when senior executives with large shareholdings in their own companies sell some of their exposures for personal reasons. They might wish to buy a house, pay a tax bill or simply bank some reward for their efforts.

So while alignment is good and expecting a fund manager to have 'skin in the game' is desirable, it is given more prominence than is warranted. Every fund manager is desperate for their fund to do well. They don't need to overwhelm themselves with worry in the process.

Another commitment to the cause by a fund manager is demonstrated by Warren Buffett and his daily consumption of Coke. He bought $1 billion of shares in 1988 then worth over 6% of the company, and it remains a top 3 holding today. He promotes the drink at every opportunity, as he does with many products he has invested in. The Berkshire Hathaway Annual Shareholder meeting is dubbed "Woodstock for Capitalists" as it features discounts and displays for products sold by Berkshire subsidiaries.

3. Dogfooding in government and economic policy

So two basic principles of dogfooding are that we expect:

- business executives to know their products by using them and understanding the consequences of their decisions and feeling the pain if something goes wrong, and
- fund managers to align their interest with ours.

How do these principles apply to politicians and government policymakers?

It's the opposite. We encourage them to avoid the consequences of their actions by requiring them to disclose personal interests. Apparently, this makes them more '*open and accountable*' but in practice it encourages them to be passive in their investing. We expect them to feel little or no impact from the decisions they make. In fact, we don't seem to want them to have much experience outside their current roles.

The personal investments of the Governor of the Reserve Bank (RBA), Philip Lowe, and his Deputy, Guy Debelle are on the public record, as advised by the RBA:

"Material personal interests of the Governor and Deputy Governor are published by Reserve Bank. These declarations are made voluntarily to promote openness and accountability."

It's the same with Members of Parliament:

"Under the resolution of the House, within 28 days of making and subscribing an oath or affirmation as a Member, each Member is required to provide to the Registrar of Members' Interests a statement of the Member's registrable interests. The registrable interests of which the Member is aware of the Member's spouse and any children wholly or mainly dependent on the Member for support must also be included in the statement."

We know what Scott Morrison, Josh Frydenberg and all MPs own.

Here are the personal interests of these four men, the leading decision makers in our nation.

Summary of personal interests (including spouses and dependent children where applicable)

	Morrison	Frydenberg	Lowe	Debelle
Shareholdings*	-	-	TLS, CSR	LLC, IAG
Trusts	Family trust (dormant)	-	Estate trust	
Property	Residential home	Residential home	Residential home	Residential home
Directorships	-	-	-	-
Liabilities	Mortgage, redraw facility, credit cards	Mortgage	Credit cards	Mortgage, credit cards
Managed funds			Vanguard, Colonial First State	
ETFs			Index funds (various issuers)	
Superannuation	MLC, Australian Super	PSS†, Mercer, Australian Super, and ANZ	Sunsuper, BT	Macquarie
Savings, investments	Savings accounts	Savings accounts	Savings accounts	Savings accounts
Free memberships^	NPC, QCL, VCL	QCL, VCL	NPC, QCL	QCL

**TLS (Telstra Corporation), CSR (CSR Ltd), LLC (Lendlease Group), IAG (Insurance Australia Group)*
†Public Sector Superannuation Scheme
^NPC (National Press Club), QCL (Qantas Chairman's Lounge), VCL (Virgin Club Lounge)

Source: Australian Parliament website, Reserve Bank of Australia website

The answer to what they invest in is … not much. They seem to have little practical experience in hands-on investing, probably avoiding any perceptions of conflict as we may make them accountable.

The Governor owns his house outright, leaves his superannuation in Sunsuper and BT and outsources some investments to ETFs and managed funds via Vanguard – best known for its index funds - and Colonial First State. His wife owns some Telstra and CSR shares.

It's a passive investment strategy. Perhaps he has no interest in more active management, is too busy or he simply believes in an efficient market and an inability to beat the index after fees. Funds are heavily marketed and he might not buy the story. He does not appear to hold any investments such as bonds, alternatives or investment property directly.

Guy Debelle is similar, although he still has a mortgage. He has no managed funds or ETFs, but his wife has investments in Lend Lease and IAG.

Our Prime Minister and Treasurer are the same, with no investments on their records. Both have a mortgage but their wives own nothing.

All four are members of the prestigious Qantas Chairman's Lounge, and the politicians also enjoy hospitality from Virgin. They even need to declare flight upgrades.

Should they have more investing and business experience?

It's not the typical experience of most people who have reached a position of power and accumulated considerable assets. No SMSFs in here.

Lowe and Debelle guide the RBA in its policy settings. The RBA's duty includes *"the economic prosperity and welfare of the Australian people*". It conducts monetary policy by "*working to maintain a strong financial system."* Both are required to make judgements on the impact of their policies on Australians while maintaining a strong financial system. When they make speeches about market conditions, everyone listens as if the voice of great experience is speaking.

While they are highly regarded in policy formulation and reading conditions in the economy, they have little 'skin in the game' experience. We seem to prefer it that way.

Lowe joined the RBA in 1980, straight from university. That's over 40 years in one place, never in business. Debelle joined the RBA in 1988 from Treasury and his time has included stints at the International Monetary Fund and Bank for International Settlements. Like Lowe, he has no business experience.

Lowe might be accused of self-interest if he owned five investment properties with large mortgages when he lowered interest rates. Yet he seems to have a lot of cash and nobody will accuse him of self-interest when he raises rates.

While Frydenberg spent some time as a lawyer after university, he went into politics without hands-on business experience, and Morrison was in tourism before politics.

Of course, allowing such leaders to invest in major companies introduces potential conflicts. For example, the recent decision to provide taxpayer funding to Ampol to keep its Lytton refinery open led to a 9% rally in Ampol's share price. It would not look good if a political decision-maker on the subsidy were a shareholder.

But plenty of politicians go on to work in the private sector after their parliamentary careers, and we will never know what arrangements were made before they left office. They also become lobbyists for clients in the same industries where they were once ministers. While in office, they do favours for political donors, often for land deals and property developments, or for media supporters. There are major infrastructure projects for dubious benefits and multi-million consulting contracts to provide government services.

Compared with these potential conflicts which never make it onto a personal conflict register, owning a few shares in a company seems a trifle.

Why do we want dogfooding in business and investing but not in government?

There is no doubt Lowe and Debelle make decisions in the genuine best interest of the country, so why don't they own more investments?

We not only allow fund managers to invest in their own funds but we demand it. We expect businesses to use their own products to learn the experience as a customer, and we remunerate executives with company shares.

But for some reason, we do not expect policymakers to know what it's like to run a business, to fire staff when cashflow dries up, to lose a rental tenant, to agonise over a fall of 50% in the sharemarket and to more fully understand the consequences of their decisions. Why do government members have so little experience outside their current roles?

At least it means you can readily invest like the Governor of the RBA or the Prime Minister of the country. Just whack your super in a fund and buy some ETFs.

Graham Hand is Managing Editor of Firstlinks.

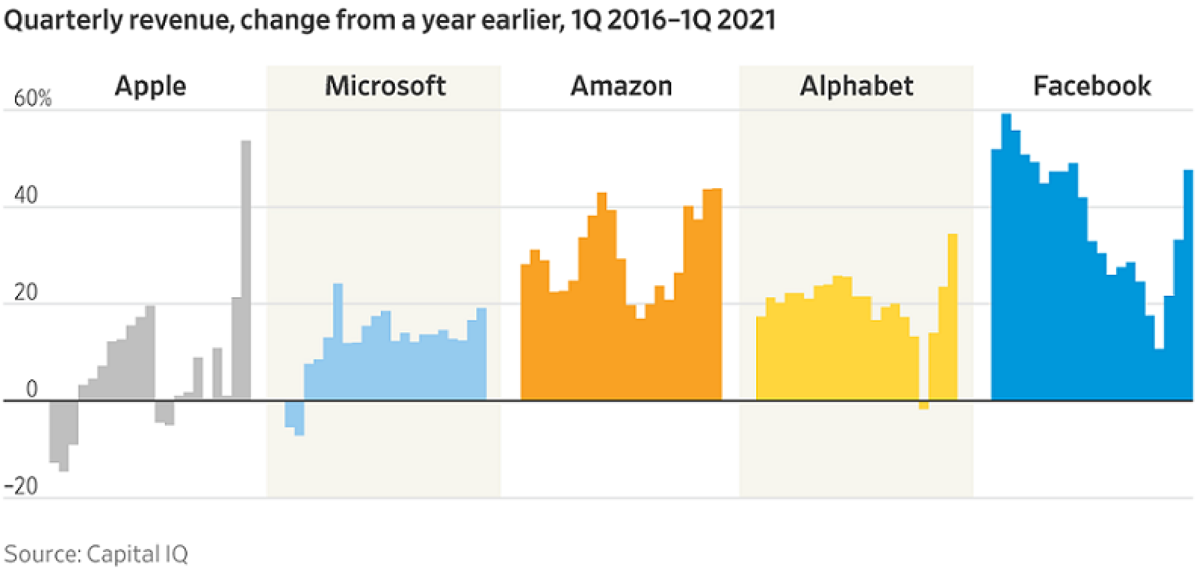
Single-period measures do not work for great growth companies

Alex Pollak

The growth versus value dichotomy lies in plain sight, as broad market indices such as the S&P 500 have outperformed the tech-heavy NASDAQ in recent months. These gains are in contrast to movements in calendar 2020 where tech ran strongly ahead. Investors of both persuasions are wondering whether the price of growth companies has largely been captured with value companies yet to fully reflect the 're-opening trade' as vaccinations increase, borders reopen selectively and airline bookings pick up.

We think not. Earlier this month, the Wall Street Journal published the following chart with accompanying commentary, of the quite mind-bending revenue growth numbers produced by the disruption giants in the March 2021 quarter, relative to the same period last year. These numbers show a pattern of growth accelerating coming out of the COVID year.

Remember, this group picked up steam even as COVID hit. A fall in revenue growth could have been expected as the world began the slow climb to recovery.



Doing well, even in a pandemic

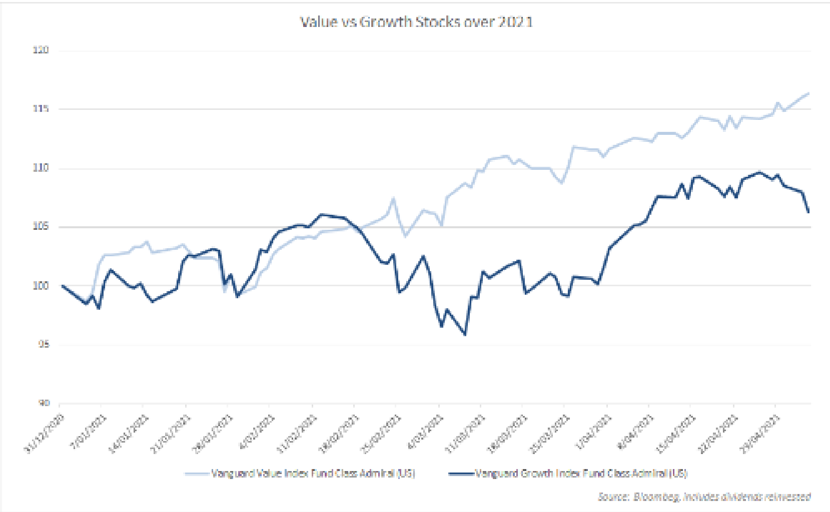
These companies are recording (for the most part) their strongest quarterly revenue growth in five years. Microsoft chief Satya Nadella, on the most recent earnings conference call, said:

"Over a year into the pandemic, digital adoption curves aren't slowing down. ***They're accelerating, and it's just the beginning****. We are building the cloud for the next decade, expanding our addressable market and innovating across every layer of the tech stack to help our customers be resilient and transform."*

But the share prices of these stocks did not rise following these blow-out numbers - indeed a couple fell. In truth, they mostly rose in the weeks leading up to the results, so perhaps no further lift on the result was to be expected.

Meanwhile, there is no doubt that some of the beaten-down value players are enjoying their period in the sun, as the chart below on growth versus value shows.

Our caveat is that this value resurgence should be regarded with some circumspection. Take for instance the European car makers. On the one hand, Volkswagen, the largest car producer in the world with production of over 10 million vehicles annually, has fully embraced the electric vehicle, committing to the virtual phase-out of internal combustion engines entirely within a decade. It has been reported that VW's admittedly smaller rival, BMW, has not committed to the electric switch, with the BMW board against it because the margins are lower than for the ICE cars. Frustrated innovative, creative, and smart engineers left BMW, partly founding their own battery electric vehicle startups in China or the United States, it has been widely reported.



Traditional valuation methods do not apply to strong growth stocks

In our view, there are value (lowly-priced) stocks, and there are value companies which have a plan for the future, and they are different. Disney is in the latter group, moving from a model in which it relies on cable companies to sell its programming in favour of a streaming service like Netflix.

Kodak is an example of a value company which failed to adapt, and so never realised its value promise.

The key is a systematic approach to valuation. We apply a multi-year discounted cashflow valuation process, designed to capture shifts in business strategy (positive or negative). We do not use single period measurement tools such as P/E or EV/EBITDA but consider the likely cashflows looking out over a number of years. This allows us to understand the prospects of the giants mentioned in the Wall Street Journal article as well as many other companies that we expect to be household names in the future.

For example, we have held Xilinx, Nvidia and Qualcomm for over three years as our expectation of the companies' valuation has emerged and the share prices rocketed. The earnings power of these companies cannot be assessed using single period measures.

The process is also useful in assessing the valuation of companies which are moving from loss to profit. We hold a small number of these companies because we consider that their growth potential is significant (meaning global). Netflix was only barely profitable when we initially opened the position yet this quarter announced a US$5 billion buyback of stock.

There are some years to go before Netflix reaches our future valuation of the company. Similarly, with the other FAANG companies (Facebook, Amazon, Apple, Google) we see multi-year growth paths for these companies.

It also helps us to screen out companies which have deep-seated problems which are not being properly addressed by management, notwithstanding how good their earnings may be in any given period.

Alex Pollak is Chief Investment Officer and Co-Founder of Loftus Peak. This article is for general information only and does not consider the circumstances of any individual.

Budget changes make PLS more attractive to senior homeowners

Katja Hanewald, Katie Sun, Hazel Bateman

The Pension Loans Scheme (PLS) allows senior Australians to obtain a loan from the government to supplement their retirement income. It is available to full and part age pensioners and self-funded retirees who own property in Australia. Age pensioners (or their partners) can top up their pension to receive a total amount of fortnightly pension plus loan amount of up to 150% – or 1.5 times – the maximum fortnightly rate of the age pension. Self-funded retirees who do not receive an age pension can receive the entire 150%. The payments are not taxable and not assessable under the age pension means test.

The PLS is effectively a 'reverse mortgage' administered and distributed by Services Australia. The additional payments above any age pension entitlement accrue as a debt secured against real estate the borrower owns, such as the family home or an investment property.

As with a commercial reverse mortgage, participants can stay in their family home and do not have to repay the loan while living there. The government generally recovers the debt when the property securing the loan is sold or from the person's estate after they have passed away.

The interest rate on the debt is currently 4.5% per annum and safeguards limit the maximum loan that can accrue. People can withdraw from the scheme and repay the loan at any time.

Proposed changes to the PLS

The 2021 Federal Budget includes two main measures aimed at increasing the uptake of the PLS.

1) The most notable change is the introduction of lump-sum payments.

From 1 July 2022 participants in the PLS will be able to access up to two lump-sum advances in any 12-month period, up to a total value of 50% of the maximum annual rate of the age pension. Based on current rates, this is around $12,385 per year for singles and $18,670 for retiree couples.

This will allow a full-rate age pensioner to take their entire annual loan amount as a lump sum. A part-rate pensioner may take an annual loan amount of 50% of the age pension topped up with fortnightly payments. A self-funded retiree has the opportunity to bring forward up to one-third of their annual PLS payments.

The introduction of these advance lump-sum payments will increase the attractiveness of the PLS for senior Australians by giving them the flexibility to pay for large one-off expenditures – such as replacing a car, to make home improvements or renovations, or to pay for aged care services.

2) A second change is the introduction of a No Negative Equity Guarantee for PLS loans from 1 July 2022.

The guarantee, which is common for commercial reverse mortgages, ensures that borrowers will not have to repay more than the market value of their property.

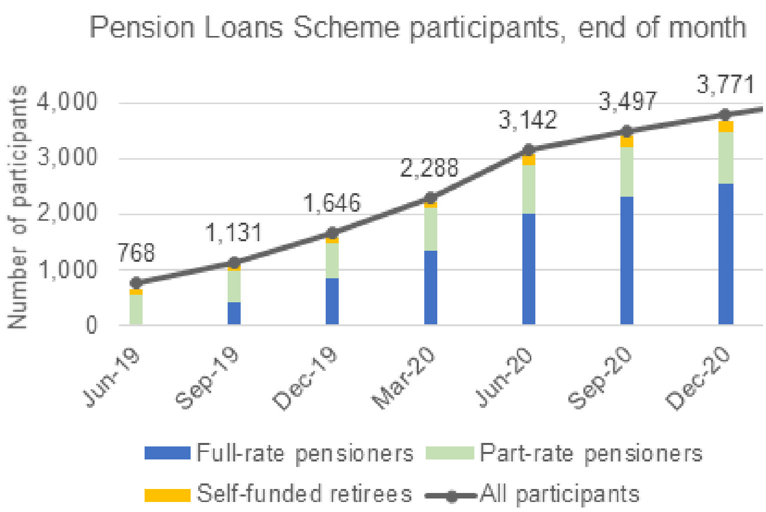
What do these changes mean?

These changes are consistent with the Retirement Income Review which reminded Australians that resources to finance retirement include the age pension, superannuation, their financial assets AND any real estate they own, including their family home. The analysis presented in the final report showed that the PLS is an effective option to substantially improve retirement incomes for both age pensioners and self-funded retirees.

This is the second time recently that the government has expanded the PLS. On 1 July 2019, eligibility was extended to all Australians of age pension age with appropriate real estate. The maximum allowable combined age pension and PLS payment was increased from 100% to 150% of the age pension. From 1 January 2020, the interest rate was reduced from 5.25% per annum to 4.5%, which is up to around 1% lower than for commercial reverse mortgages.

Despite these enhancements, the PLS is not widely used. As of March 2021, there were just over 4,000 participants in the scheme (see Figure 1), which is an extremely low take-up given the 4 million or so Australians of age pension age, including around 2.6 million age pensioners, of which around three quarters are homeowners.

The changes announced in the 2021 Budget to make the scheme more flexible and attractive, if appropriately promoted, have the potential to increase participation.



What more make the PLS more attractive?

Researchers at UNSW have a long-standing interest in exploring how to improve retiree living standards through more effective use of household financial resources, including housing assets. The PLS plays an important role as the family home is typically a retiree's largest financial asset and most people prefer to 'age in place'. Schemes that allow people to unlock their housing assets – such as the PLS - should be far more popular than they are.

Previous research findings highlight how to address barriers to the take-up of home equity release products such as the PLS.

First, there is low awareness and understanding of retirement financial products, which are generally complex and have narrow distribution networks. Commercial reverse mortgages and the PLS fall into this category.

Our research on reverse mortgage products shows that interest can be enhanced where the product is described in an easy-to-understand way with a focus on how it can be used to enhance living standards in retirement, rather than the technical aspects of the product design.

Second, the 'mental account' for retirement financing typically includes superannuation and any age pension but excludes housing assets. Our preliminary research finds that people are more likely to be interested in reverse mortgage-type products, such as the PLS, when they are specifically reminded of the availability of housing assets to fund retirement.

Third, it is often argued that reverse mortgage-type products should be avoided because they 'disinherit' the children. However, our recent research conducted in China, where it could be argued that the generational compact is stronger than in Australia, found that both older homeowners and their adult children supported the take-up of reverse mortgages by the elders but that each group thought the other would disapprove.

Reverse mortgage-type schemes (such as the PLS) should be marketed to both older homeowners and their adult children and families should be encouraged to discuss the opportunity to use housing wealth to fund expenses in retirement.

Finally, interest rate cuts could be considered. The Pension Loans Scheme currently charges an annual interest rate of 4.5% that compounds each fortnight on the outstanding loan balance. This interest rate is lower than that of commercial reverse mortgages available in Australia but is higher than the mortgage rates for owner-occupied mortgages because no repayments are made until the loan is settled, which is typically when the person has passed away.

Katja Hanewald is a Senior Lecturer, Hazel Bateman is a Professor and Katie Sun is an Honours student, all in the School of Risk & Actuarial Studies at UNSW Sydney. All three are also affiliated with THE ARC Centre of Excellence in Population Ageing Research (CEPAR), where Hazel Bateman is a Deputy Director. This article is republished with permission from the UNSW Newsroom.

Is crypto a currency or a collectible?

Shane Woldendorp

It is widely accepted that distributed ledger technology, such as blockchain, has enormous potential. It could be truly transformational for many industries and have a meaningful impact on how business is conducted globally. Bitcoin, the world's largest cryptocurrency, is perhaps the most well-known example of something which makes use of this technology, and whilst there are strong opinions on both sides of the fence with regards to the merits of the technology, that conversation is best left for a different time.

Instead, the focus for investors at this point of the current crypto price cycle should be on how best to *value* cryptocurrencies and what a reasonable expected long-term return should look like.

The price that you pay for any asset is what really matters over the long-term for an investor and has also proven to be a reliable indicator for future returns. But how should you as an investor attempt to estimate what something such as Bitcoin is really worth?

A reasonable starting point would be to treat cryptocurrencies like any other asset and use the common valuation methods available to us. These typically include a discounted cash flow method or a sum-of-the-parts/asset-based approach. Unfortunately, given cryptocurrencies don't pay any cash flows or own any tangible assets, neither approach is very helpful. Historical prices are also not useful, given many cryptocurrencies are new and the first Bitcoin was only traded in 2009. As a result, this makes cryptocurrencies difficult to value and therefore prone to speculation.

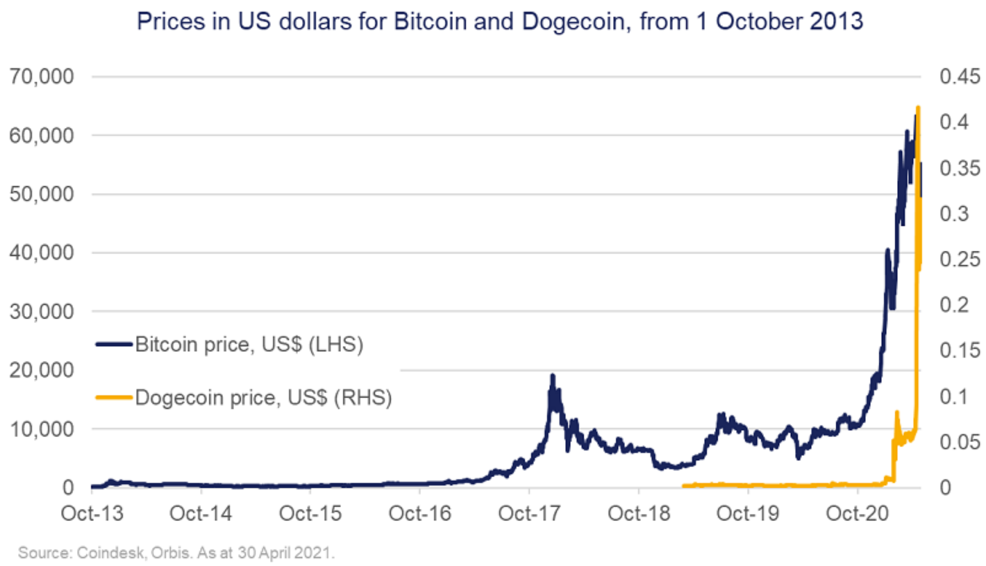
What is a reasonable return for currencies and collectibles over the long-term?

There are perhaps two useful ways to think about the long-term returns that you should expect from cryptocurrencies.

The **first** is to view them as a currency such as the US dollar, British pound or gold. Over the last 120 years (1900-2020), cash in the US and UK have achieved returns of around inflation plus 0.8% and 1% p.a. in US dollars respectively. Similarly, over the same time period, gold has produced a return of inflation plus 0.7% in US dollars.

The **second** argument commonly used is that the supply of something such as Bitcoin is limited and therefore there should be a premium for this scarcity. The same is of course true for your favourite antique watch or real estate in Greenland – just because it's scarce doesn't mean it's valuable. However, let's be charitable and assume that cryptocurrencies fall in the same bucket as rare stamps, coins, art, or diamonds. In other words, let's treat cryptocurrencies as a collectible. Over the period 1900-2017, collectibles delivered a return of inflation plus 2% p.a. in US dollars. Therefore, if you believe that cryptocurrencies are either a currency or a collectible, history suggests that you should expect a return over the long-term of between inflation plus 1 to 2% p.a. in US dollars.

This graph shows the price history in US dollars of both Bitcoin and Dogecoin. As you can see (this article was written before the full extent of the recent fall in Bitcoin and Dogecoin), they have both recently experienced enormous price increases. These returns are much higher than history would suggest is a 'normal' range for both currencies and collectibles, as explained above. This is particularly remarkable for Dogecoin given that it started as a joke on social media. At the time of writing, the market cap of Dogecoin was around US$60 billion, approximately the same size as ASX-listed companies, ANZ and Fortescue Metals, despite Dogecoin not producing any cash flows, products or owning any tangible assets.



What are the key ingredients required to form a speculative bubble?

As a result of these remarkable returns, many inexperienced investors have been attracted to cryptocurrencies, including people who have never invested before. And this creates a virtuous flywheel: new people join the game, prices rise, they talk about it, the fear of missing out or 'FOMO' attracts more investors, and prices rise further.

According to a recent Harris Poll, nearly 1 in 10 Americans used their stimulus cheques to invest in cryptocurrencies. Perhaps the speculative behavior seen in parts of financial markets more recently, such as cryptocurrencies, shouldn't come as any surprise.

You could argue that we have created the perfect recipe to encourage speculation with three key ingredients.

Firstly, there is an abundance of liquidity. Globally, there are many people who are either unemployed or underemployed, but unusually they also have money in their pockets thanks to government and central bank support. Moody's estimates that there is currently around US$5.4 trillion or more than 6% of global gross domestic product (GDP) in excess savings. In other words, savings that people would not have if the COVID-19 pandemic had not occurred.

The **second** feature is lockdowns. As a result of the COVID-19 pandemic, many parts of the world either have had or currently have lockdowns. People therefore haven't been able to spend this excess money in the usual places given that travel is banned, restaurants and bars are shut, cinemas and theme parks have been disrupted, and casinos have also been closed. Live sport (and as a result sports betting) has also been halted in many parts of the world. However, financial markets is one area that people have still been able to participate (and speculate) in.

And **finally**, perhaps the most important recipe for a speculative bubble to form is something new and shiny to attract an investor's attention. If one looks at past speculative periods, one thing you will notice is that many of these periods were associated with things that were brand new. For example, new flowers in the Dutch Tulip Mania in the 1600s, new forms of transport in the Canal and Railway Manias in the 1790s and 1840s, and the creation of the internet in the Dotcom bubble in the late 1990s.

Perhaps we will look back in time and say that in the 2020s, it was digital currencies. But investors should always be wary whenever an asset delivers a return which is well above what history would suggest is 'normal'.

When investors all head in one direction, it can often be safer to go the other way. Of course, this is highly uncomfortable but as contrarians we believe that discomfort is the reason so few do it. Those who go the other way may be highly rewarded, although remaining disciplined in an environment like this of such excess returns isn't easy.

Shane Woldendorp, Investment Specialist, Orbis Investments, a sponsor of Firstlinks. This report contains general information only and not personal financial or investment advice. It does not take into account the specific investment objectives, financial situation or individual needs of any particular person.

Why investment stewardship matters for long-term investors

Lisa Harlow

Each year in the lead-up to company reporting season, individuals who invest directly in publicly listed companies receive notifications informing them of their right to vote at a company's upcoming Annual General Meeting (AGM). The notification also describes the list of resolutions that would be put to a vote as part of the AGM. A person who directly holds shares in a large number of companies can expect a crowded inbox during the peak of proxy voting season, which is during October and November for many Australian companies.

But for the growing number of investors who invest only in managed funds or exchange-traded funds (ETFs), they don't receive these letters even though they own a portion of the companies.

Instead, the fund managers cast votes (known as 'proxy' votes) at company meetings as part of the 'investment stewardship' service - and obligation - that fund managers carry out on behalf of the funds' investors. While each fund manager does this differently, the professionals in a properly-resourced investment stewardship team have broad financial market experience and deep expertise in areas of corporate governance, policy, regulation, and social and environmental risk analysis.

The why and the how

Proxy voting is not the only activity that occurs as part of the investment stewardship process, and for many managers, it may not even be the most important. The role of fund managers as stewards or trustees of the shares is primarily to be a voice for investors acting in their best interests.

This is a fiduciary responsibility that good fund managers take very seriously and includes actively meeting (or 'engaging') with companies on a regular basis, voting on shareholder resolutions (a vote put forward by an owner of the shares rather than by the company's management) and, where appropriate, taking part in public advocacy activities.

The aim is to ultimately hold companies accountable for delivering long-term investment returns to investors. This approach seeks to ensure that companies in a portfolio have robust strategies that not only position them for growth and success, but are actively managing risks that are financially material, or entail risks that may lead to short-term gains but impede the company's long-term performance or value.

For example, investment stewardship teams often place great emphasis on the composition of a company's board, including factors such as whether the board is sufficiently independent from management and suppliers, and whether it has a suitable mix of skills and experience, and whether the board is appropriately diverse.

Investment stewardship teams also analyse and vote on companies' executive remuneration practices. Over the long run, company shareholders stand to benefit when executive remuneration plans incentivise a company's long-term value creation and outperformance versus its industry peers.

Over the past decade, long-term investors have been placing greater focus on the board's oversight of company strategy and risks, including social and environmental risks. This can include workplace culture issues, treatment of community stakeholders, corporate fraud and financial crimes, large-scale industrial incidents that result in reputational damage, or other practices that pose a threat to people's health, safety, or dignity. If such risks are not properly managed and overseen, they can erode shareholder value.

The most widespread example of this today, across virtually all industry sectors, relates to climate change risks and how companies are planning to manage their business in response to the increasingly urgent pressure to transition to a low carbon economy over coming decades.

Passive management does not mean passive ownership

Critics of large index fund managers often believe that a 'passive' approach to fund management equates to a passive approach to investment stewardship. In other words, that these fund managers merely invest as directed by the index and have little concern for material environmental, social and governance (ESG) risk.

For Vanguard, the opposite is true. Index funds are designed to buy and hold the shares of the companies in their appointed benchmark in virtual perpetuity (or as long as the shares are included in the index). The funds can't use discretion to buy more shares of companies deemed to be promising or sell out of companies that may be bad actors.

Issues that are financially material to the long-term investment returns will regularly be on the agenda for index funds and will remain so long after shorter term investors have sold out of their positions. The investment stewardship tools of proxy voting, engagement, and public advocacy are the most important levers that index funds have to ensure that companies are acting in the best interests of their longest-term investors.

Why it matters

People choose to invest through managed funds, index funds, and ETFs for a variety of reasons, including low costs, diversification and ease of implementation. And for those who prefer to keep their investments at arm's length, it is easy to dismiss this process as unimportant or too complicated to bother engaging with or reading up about.

But while investment stewardship outcomes may not be apparent in a daily share price or a quarterly statement, these teams work relentlessly to promote and safeguard shareholder value over the course of years and decades.

If you care about how your investment performs over the long term and whether it will deliver the returns you reasonably expect, it's worth the extra step to ensure that the fund's investment stewardship team is taking a stand on behalf of its investors.

Lisa Harlow is Head of Vanguard Investment Stewardship, Asia Pacific. Vanguard Australia is a sponsor of Firstlinks. This article is for general information and does not consider the circumstances of any individual.

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China's new model is a plan for a hostile world

Michael Collins

Sir Arthur Lewis (1915-1991) was an economist from Saint Lucia in the Caribbean who was awarded the Nobel Prize in Economics in 1979 for his theories on development. His 'dual sector model' suggested that economies can modernise without triggering inflation because the growing industrial sector can rely on a large supply of farm workers to work for low, but not subsistence, wages. This allows industry to earn, then reinvest, excessive profits. But one day the stream of peasants dries up. When a developing economy reaches this 'Lewis turning point', wages growth exceeds productivity, industrial profits decline, investment drops and inflation stirs.

Major changes approaching for China

A big challenge for China is that the country is approaching a Lewis turning point at the same time it faces a 'demographic time bomb', a term that describes the rapid ageing of its 1.4 billion population. Another test is that China is confronting the 'middle-income trap'. This is a term for when a country's initial and successful drive to industrialise becomes bogged at middle-income levels unless the country can develop the skilled workforces, sophisticated manufacturing, financial sectors, institutions, governance standards and rule of law that advanced countries possess.

On top of these challenges, another has emerged for Beijing, along with an opportunity. China's growing political and economic clout has created a hostile global environment but a relatively weaker US.

China's policymakers have long seen the first two challenges coming. Along with some institutional reform, their answer was to make domestic demand a bigger driver of economic growth. But the pivotal market reforms of the past 15 years to rebalance the economy away from exports and investment appears too inadequate a solution for Chinese leaders in a harsher world but one where it senses the US is vulnerable.

Beijing's response to help double the economy's size from 2020 to 2035 and to ensure its global influence? A 'dual circulation' strategy, which marries the 'external circulation' of global demand with the 'internal circulation' of domestic demand.

The split-economy strategy emerged from a Politburo meeting in May 2020 and appears deliberately ambiguous. Official pronouncements since indicate the plan aims to reduce China's reliance on other countries for national-security reasons while boosting the country's 'soft' global power to approach (thus nullify) that of the US. While the previous rebalancing aimed to lessen China's dependence on exports, the dual-circulation strategy seeks to limit China's reliance on imports and the US-dominated global financial and trading system.

The strategy's essence is prioritising domestic production, innovation and self-sufficiency. It is a call to turn China into a sophisticated manufacturing hub, form China-centric global production networks that multinationals come to rely on, develop a yuan-based international financial network, and possibly turn China into a military-technological complex. The means to these goals include subsidies, export controls, data restrictions and dangling China's consumer market as an enticement to attract foreign capital and technology.

Source: World Bank Open Data

A challenge for other countries including Australia

Just as important is what Beijing's dual-circulation strategy does not do. The policy lacks any unleashing of market forces. It is not a retreat into North Korean-style autarky. The strategy heralds no easing of the Communist Party's political control. Nor is it a plan to break the international order.

The dual-circulation strategy, in many ways, might seem a partial shift. But it is poised to drive China's economy, boost its regional hegemony, make China a leader in industrial, technological and financial spheres, and advance China's global influence. The strategy is likely to challenge some of the countries and industries dependent on China as an export destination and offer a fresh competitor to industrial powerhouses such as Germany that export capital goods. It foretells of renewed pushes to internationalise China's financial system and promote the use of the yuan to rival the US-dollar-based global financial network.

The plan signals more significant trade agreements rather than any drive to liberalise world trade. It flags further Chinese efforts to dominate global bodies so it can influence the rules-based global order and set global technology standards. It likely means an intensification of the clash with the US to dominate the technologies of tomorrow. China's dual-circulation strategy signals that an era approaches when international linkages are more an overt means to enhance global power rather than a cooperative way to boost economic efficiency.

Source: *[World Bank Open Data]*

To be sure, China's new strategy might not be that noticeable over time and Beijing's reluctance to provide details means it could morph into anything. It's too early to emphatically rebut those who dismiss it as just the old rebalancing strategy. Same goes for responding to those who say it's just an extension of the *Made in China 2025* drive for technological leadership and the *Belt and Road Initiative*. There are major developments that don't sit easily within the strategy. Beijing's aggression in the South China Sea, crackdown on Hong Kong, intimidation of Taiwan and 'wolf warrior' diplomacy risk a backlash that would nullify any advancements in soft power. The dual-circulation strategy might come with a larger-than-expected cost to efficiency. The strategy relies on a certain level of foreign participation and human-rights abuses might deter some western companies.

The next step in China's global power move

But if developments 'follow the money' as they often do, China's supersized economy will be enough of a magnet to tie much of the world to China. There's every chance Beijing will engineer a partial decoupling from the US-led world on its own terms. Such a separation would form the next phase of China's modernisation, the next leap in its global power, perhaps even the next 'China shock', where China's industrialisation so far formed the first shock.

Michael Collins is an Investment Specialist at Magellan Asset Management, a sponsor of Firstlinks. This article is for general information purposes only, not investment advice. For the full version of this article and to view sources, go to: https://www.magellangroup.com.au/insights/.

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$17.7 billion aged care plan welcome but many will miss out

Rachel Lane

On Tuesday, 11 May while all eyes were on the Federal Budget, the Government released its response to the Final Report of the Royal Commission into Aged Care Quality and Safety. The report details the response to the 148 recommendations of the commissioners in the form of a three-phase, five-year, five-pillar plan. The government has accepted (or accepted in principle) 126 of the recommendations, with the remaining recommendations subject to further consideration and six not accepted at all.

Importantly the plan also details how the investment of the $17.7 billion announced in the budget will be spent.

Among the six recommendations rejected is an aged care levy to fund the system and changes to the means testing arrangements that would have seen pensioners have their accommodation and cost of living met by the government. The recommendation to phase out lump sum Refundable Accommodation Deposits (RADs) is subject to further consideration and will form part of the reformed Residential Aged Care Accommodation framework which will also look at changes to accommodation design standards.

The big tickets in aged care

The big ticket items in the five-year plan include $6.5 billion for an additional 80,000 home care packages over the coming two years, almost $800 million to support 1.6 million informal carers through respite and payments, $3.9 billion to increase the care residents of aged care homes receive to 200 minutes per day including 40 minutes with a registered nurse.

In a move that will likely shake up the industry, $102 million will be spent on placing residential aged care places in the hands of senior Australians instead of residential aged care homes. There is also $200 million for a star rating system to better inform senior Australians and their families.

The need to attract and train aged care workers has seen the Government commit $652 million into the aged care workforce and tougher governance of the industry has seen the government provide $698 million.

Sadly, Recommendation 25 from the Final Report, which was set to revolutionise aged care through a single assessment and funding programme incorporating all home care and residential aged care services, providing funding based on the individual's needs with flexibility and choice across providers was accepted in principle only.

In their response, the Government said that a new home care programme "will be designed to better target services to eligible senior Australians" and that "Senior Australians will also have more control and flexibility to select a residential aged care provider of their choice".

Not available to all

This indicates there will be improvements to how the system operates, the level of choice and transparency and the amount of services that will be available for senior Australians. But unlike Medicare or the NDIS, aged care will still be a rationed system.

It's hard not to be excited about a $17.7 billion plan for aged care but my excitement is tempered by the knowledge that the system that will provide greater choice, transparency and care for many will still see some senior Australians miss out. In his opening remarks Treasurer Josh Frydenberg referred to "Team Australia", it would be great if "Team Australia" adopted the motto to "leave no senior Australian behind".

Rachel Lane is the Principal of Aged Care Gurus where she oversees a national network of adviser dedicated to providing quality advice on retirement living and aged care. She is also the co-author of a number of books with Noel Whittaker including the best-seller "Aged Care, Who Cares?" and their most recent book "Downsizing Made Simple". To find an adviser or buy a book visit www.agedcaregurus.com.au.

Whoyagonnacall? Off-the-plan should not be off-the-cuff

Graham Hand

We published two articles on *Whoyagonnacall:10 unspoken risks buying off-the-plan* which generated not only a lively discussion, but requests to combine into one document to share with family and friends. For example, AlanB wote:

"This is a most informative article that deserves wider publicity and exposure. It should be put into brochure form and compulsorily handed out to all prospective off-the-plan apartment buyers. But that will be opposed by real estate agents and shonky developers. Parents need exactly this information to pass on to their young adult children."

We have combined the articles into one downloadable PDF on the link below:

Document version of
Whoyagonnacall: 10 unspoken risks buying off the plan

The details covered in the 10 points include:

1. Who will identify the defects?
2. Who will fix and pay for the defects?
3. Who will enforce and manage the work?
4. Is your new dream property even what you paid for?
5. Who is on the Strata Committee and what are the strata fees?
6. What internal and external noises will the apartment suffer?
7. What are the views really like, and what's that smell?
8. Why is that community coffee shop still an empty space?
9. Why can't I sell my apartment for more than I paid for it?
10. Is that common property or is it mine?

Avoid these top five errors in your SMSF annual return

Australian Taxation Office

Everyone makes mistakes. When it comes to preparing and lodging your self-managed super fund (SMSF) annual return (SAR), you want to get it right. Below are the top five mistakes we've identified and some tips on how to avoid them.

1. Not including a bank account in your funds name

You need a bank account in your fund's name to manage the SMSF operations and to accept contributions, rollovers of super and income from investments. You need to report this account when lodging your SAR.

The account must be separate from your trustees' individual bank accounts and any related employers' or advisers' bank accounts. This will protect your fund's assets and ensure super payments can be made to your SMSF.

2. Providing an incorrect electronic service address (ESA)

An ESA allows your SMSF to receive electronic remittance advice and contributions if you have members receiving super from non-related employers.

An ESA consists of alphanumeric characters with a combination of upper and lower case characters and is case sensitive. It's not an email address or the contact details of the SMSF messaging provider.

3. Not valuing SMSF assets at market value

SMSF assets need to be reported at market value as at 30 June to prepare your fund's accounts, statements and SAR. If you follow our valuation guidelines, we'll generally accept the valuation you provide.

Accurate asset valuation is important to ensure your SMSF retains its complying fund status. Penalties may apply for inaccurate valuations as these can have an impact on your members' balances.

4. Trying to lodge with zero assets

An SMSF is not legally established until the fund has assets set aside for the benefit of its members. We won't accept a SAR from an SMSF that has no assets unless the fund is being wound up.

If this is your SMSF's first year and you have no assets set aside for the benefit of your members, you can ask us to either cancel your fund's registration or flag the SMSF's record as return not necessary (RNN).

5. Incorrect or no auditor details in SAR

Your SMSF must have its financial statements and records audited each year by an approved SMSF auditor prior to lodging the Annual Return (SAR). The approved SMSF auditor must be appointed no less than 45 days before your SAR is due.

Make sure you:

- receive a copy of the audit report before you lodge your SAR.
- report the correct auditor details on the SAR including the SMSF auditor number, name of auditor and the date the audit was completed.
- If you lodge your SAR without approved SMSF auditor details, it will be suspended and not recognised as a lodgment. This will impact the complying status of the fund until the SAR is lodged with the required information.

If the auditor details are incorrect, you may also be penalised for making a false and misleading statement.

See also: Administering and reporting
Keep up to date: See all recently published SMSF news and alerts
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