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Editorial

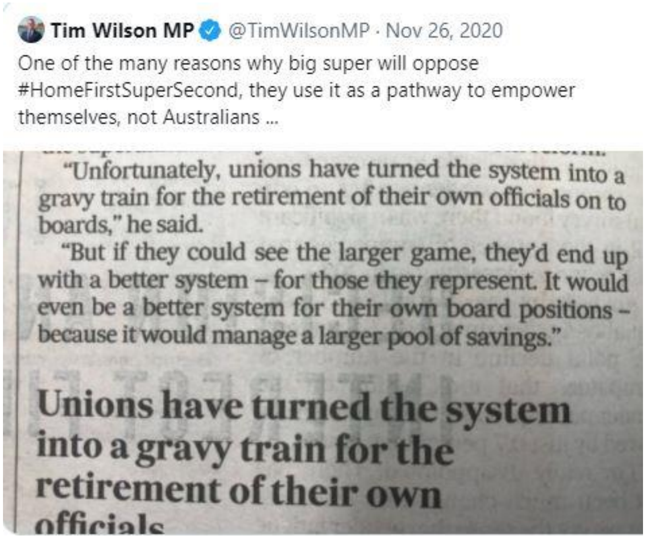
Despite the obvious successes of superannuation, the industry has failed to sell itself adequately to the public. Instead of focussing on the impressive investment returns delivered to millions of Australians, we hear more about the fights between industry funds, retail funds and senior **Liberal Party** officials.

The battles are on many fronts. The industry fund lobby group, **Industry Super**, ran the famous 'fox and henhouse' campaign to undermine retail funds. It depicted foxes surrounding a henhouse with scary music playing late at night, with a frightened child awake in a bed. A deep voice said, "*The big banks want to get their hands on your super.*" Whereupon a man clearly representing the government opened the door of the henhouse to allow the foxes in. The Compare the Pair advertisements continue the attack.

In March this year, Superannuation Minister **Jane Hume** argued Industry Super was acting in its self interest in its push to increase the Superannuation Guarantee to 12% and criticising the Retirement Income Review. The Review had opened the discussion on retirees accessing home equity to fund retirement, and Industry Super ran ads with an older couple saying, *"We've worked all our lives for this place, we'd hate to have to sell it to fund our retirement."*

The Federal Liberal Member for Goldstein, **Tim Wilson**, also holds the lofty title of **Chair of The Standing Committee on Economics**. This gives him incredible power to raise issues, as it is:

"The most senior Committee of the House of Representatives in the Parliament of Australia, and has oversight of the Reserve Bank of Australia, the Australian Securities and Investments Commission, the Australian Competition and Consumer Commission and the Australian Prudential Regulation Authority."



Wow, talk about friends in high places. He can review almost anything financial, so when he pushes a #homefirstsupersecond campaign, it's no surprise that the industry funds object, even writing to Treasurer **Josh Frydenberg** warning Wilson is using his role for personal political campaigning purposes and "*undermining confidence*".

It's part of a larger Coalition v Labor political stoush with members caught in the crossfire.

The retail funds did little to promote their cause at the **Financial Services Royal Commission**, rolling over easily when criticised for charging fees to dead people and fees for no service.

Ian Silk, retiring soon after 15 impressive years running **AustralianSuper** and turning it into the biggest super fund in Australia, conceded on Radio National that funds could have done more to educate members. After host **Geraldine Doogue** had called superannuation a 'gravy train' for collecting over $30 billion in fees every year, she continued:

"I don't know that the industry has accepted the responsibility sufficiently of making people more aware of their super. It's the sort of thing you don't think about until five years before you retire. This is put on the government to do more on communication and education but what responsibility does the industry itself hold?"

Ian Silk replied:

"Yes, you're right, the industry itself does have a responsibility, and we probably have not discharged that responsibility as well as we might have. Most funds, especially the better-performing funds, are promoting their relative performance. Ultimately, it's for every individual to realise that their superannuation savings, next to their house, are probably going to be their second-most valuable asset in their life."

All this infighting in a $3.2 trillion industry disguises the great Australian success story in delivering retirement savings. It's not only that the median growth fund posted 18% returns for FY21, with many funds over 20%. More important, the 10-year annual return from several funds is almost 10%. Compound $100,000 upfront and $1,000 a month for 10 years at 10% gives over $450,000.

These are not personal SMSF returns or the results of a few top-performing fund managers. These funds hold the savings of 'mum and dad' investors who work in nursing, retailing, construction and hospitality who don't know one end of an SMSF from another. I wish my SMSF had done so well last year. So hats off to the best over 12 months - **Qantas Super Growth, BT Panorama Balanced, Hostplus Balanced, CFS FC Multi-Index Balanced and MLC Balanced.** And over 10 years - **AustralianSuper, Hostplus, Cbus, Unisuper and CareSuper.**

This lack of appreciation for superannuation probably contributed to three million people withdrawing $38 billion under the COVID early release scheme, with David Bell estimating that a 30-year-old taking $20,000 will become $50,000 less in retirement. Members have already missed out on the great results in their funds, losing $4,000 in a year at 20% on $20,000.

It would be better for members if superannuation funds concentrated more on selling the benefits of long-term saving without a perpetual slanging match protecting their turf and criticising others.

Still on performance, there was a stark illustration in FY21 of the perils of judging a fund on past performance, as the **Your Future, Your Super** framework does. **Steve Johnson's Forager** had faced a torrid few years as his stock picks failed to deliver, but to his credit, he hung in there with minor changes to his process. This first table shows Forager's results to 30 June 2019, a worrying 10% pa behind the index over three years.

Table 2: Summary of Returns as at 30 June 2019

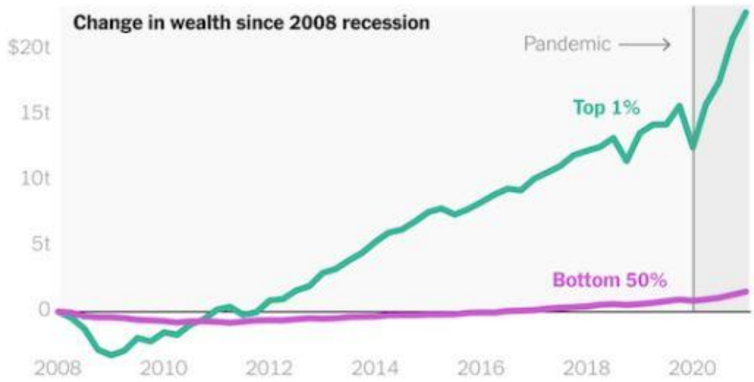
	FASF NAV	S&P All Ords. Accum. Index	Outperformance
1 year	-19.66%	11.04%	-30.70%
2 year (p.a.)	-7.50%	12.38%	-19.88%
3 year (p.a.)	2.31%	12.62%	-10.31%
4 year (p.a.)	6.04%	9.87%	-3.83%
5 year (p.a.)	7.26%	9.02%	-1.75%

Here are the latest results in the **Morningstar database**, with a one-year total return of 91%, or 55% above the index. How many people gave up in 2020 based on past performance?

	1-Month	3-Month	YTD	1-Year	3-Year
Total Return % (Price)	0.02	12.91	19.81	91.42	-3.74
Total Return % (NAV)	1.88	15.22	18.03	87.94	7.20
+/- Category (NAV)	—	—	—	—	—
+/- Index (NAV)	-1.19	6.73	7.27	54.71	-1.40

And don't start me on all the FY21 performance tables showing geared funds at the top, with photographs of fund managers proudly plumping out their feathers. Come on, they are geared at 60% and the Australian index was up 28%. Of course geared funds did well, as explained here.

Ian Silk said another benefit of Australian superannuation is ensuring more people participate in the capitalist system and its ability to generate wealth. In Australia. The table below is from a The New York Times article on how the US central bank is supporting the wealthy. In 2021, the richest 1% of Americans held 32% of US wealth, the highest since 1989, while the bottom 50% held 2% of US wealth. As **Jeff Bezos** said when he returned to earth after his space flight, Amazon's staff and customers paid for that.



Of course, some people would rather use the 10% going into super for another purpose, especially buying a home, and that's legitimate. But the majority will be grateful for the nestegg built for their retirement.

We start this week with **Clay Smolinski**'s explanation of the four guiding principles that have served **Platinum** since the days when **Kerr Neilson** set up the business. Simple guidelines but not easy to adopt.

Reece Birtles continues our series on investing in retirement, this time a more traditional approach of relying more on the long-term income from mainstream assets rather than buying insurance or protection. This approach more closely mirrors an 'allocated pension' strategy that deserves a place at the table.

A major cause of the retirement challenge is generating income without equity risk, and our interview with **Andrew Lockhart** looks under the covers of corporate debt funds to see how they can deliver better cash flows.

Christine Benz is a leading **Morningstar** writer, and as the company has a sabbatical scheme which allows employees a solid break every four years, she reflects on what she learned in a complete change of pace. Fascinating look at how she felt she was trialing her eventual retirement.

Lucy Turnbull AO is well known in business and political circles, and in this interview with **BusinessThink** of the business school at the **University of NSW** (my alma mater), she gives valuable career and leadership tips.

Suddenly, the market has become more relaxed about inflation, with long bond rates falling and concern over the economic recovery despite the latest US inflation levels over 5%. Nevertheless, **Mamdouth Medhet and Wei Dai** check the asset classes which are supposed to protect investors from inflation and they are not overly impressed.

In a new podcast episode, **Peter Warnes** discusses some of his favourite stock picks in long-term assets, how to make your portfolio last the distance, the crazy valuations on some assets and what analysts missed at **Amazon**. I also presented for the **Australian Shareholders' Association** on LIC and ETF opportunities and the full webinar with slides is included.

This week's White Paper from **MFS International** shows how structural changes in credit markets can deliver better returns on fixed interest bonds, which can deliver better result for investors than the low rates suggest.

The **Comment of the Week** goes to **Kevin** commenting on the 'noise' article and 'what the hell is water?':

"I nearly fell off my bike laughing at myself when the obvious suddenly dawned on me. If I'd bought Walmart when old Sam was the richest guy in the world, say 1980. Then he died, Bill Gates became the richest man in the world, what 1992? If I'd bought MSFT then. Jeff Bezos became the richest man in the world 2016? If I'd bought Amazon then, I nearly did. The light came on. All the noise put me off. Then it dawned on me. He is doing the right thing, all profit goes back into the company to build it up. When the next richest man or woman in the world is decided, the shares will be expensive, and probably worth buying."

Platinum's four guiding investment principles

Clay Smolinski

There are four principles that guide our investment approach at Platinum and guide our search for mispriced stocks in the market. These principles have been consistent since the firm's founding in 1994, with past stock picks Facebook and Samsung Electronics used here as cases to illustrate the point.

Principles for finding mispricings

The **first** principle is the price you pay heavily influences the ultimate return you'll make on an investment. And this is especially true when viewed over a portfolio of stocks. Over the long run, price matters.

The **second** principle is the truly great investment opportunities tend to carry a seed of discomfort when you're making them. If everyone thinks that an investment is a sure thing, and they're excited to be making that investment, we need to stand back and ask, why would it then be mispriced in my favour?

The **third** principle is you're more likely to find those mispricings and great opportunities in areas outside of the spotlight, so go and look at the orchard less picked over. So there's always been an impetus to look at industries, and countries that are just getting less attention at the moment.

And the **fourth** principle is the most important, because it really addresses the heart of the question: What type of situations create mispricings in markets? And the observation is the value of business is very subjective, it's in the eye of the beholder. The reality is the stock prices are not purely set by a business's fundamentals. Instead they're heavily influenced by emotion. So it's the state of a narrative around the business, it's the state of investor confidence around that business that is influencing its price.

Two major emotions drive mispricings

So we look for situations around those emotional decision states that are known to repeatedly cause mispricings in stocks. They really boil down to two major buckets.

The **first** is what we would call 'temporary uncertainty'. What we know is when there's a problem, humans can't help but to focus on it. This is called recency bias. And when you focus on a negative, that tends to lead to low expectations, and low expectations tend to lead to mispricings.

The **second** major bucket is what we would call 'long-term change'. This comes down to the fact that investors find it difficult to accurately price in a future that looks very different to what we are used to.

These two situational buckets are common features in many of our investments, and we can bring this to life with two examples.

So a great example of temporary uncertainty that most would remember would be Facebook during the Cambridge analytic data leak. This data leak gained worldwide public and political attention at the time, and the share price fell roughly 40% as people worried about more future regulation or users deleting their Facebook accounts. Viewed with a different lens, this event actually proved the strength of the business to us. Despite very negative sentiment, both user engagement and advertisers' willingness to spend on Facebook, continued to grow the entire time, it really never missed a beat. And this is a great example of a singular focus on a negative, created a large mispricing in the stock.

An example of long-term change is Samsung Electronics, a company we have consistently held since 1998. In the 1980s, Samsung was a humble contract manufacturer of consumer electronics. So they would assemble TVs and stereos for brands like Sanyo, NEC and General Electric. The company had the classic mentality of being happy to start at the low end, learn by doing, then then always wanting to innovate and move up into higher end products. Following this mindset, by the early 1990s Samsung started making low end semiconductors. By the late 1990s, they were been beating the Japanese at the high end. And by the mid-2000s, Samsung had become one of the most dominant semiconductors and consumer electronic companies in the world.

History shows us that markets and businesses are ever changing. But we feel our investment approach and guiding principles are timeless. Here is a video version of the four principles.

Clay Smolinski is Co-Chief Investment Officer and Portfolio Manager at Platinum Asset Management. This information is general commentary only. It is not intended to be, nor should it be construed as, investment advice. Before making any investment decision you need to consider (with your financial adviser) your particular investment needs, objectives and circumstances.

Andrew Lockhart on corporate loans as an income alternative

Graham Hand

Andrew Lockhart is the Managing Partner of Metrics Credit Partners, a non-bank lender to Australian companies managing $9 billion across a range of listed and unlisted funds.

GH: Can you give us a short introduction to Metrics Credit?

AL: We launched our first fund in June 2013, starting with three partners, and the business now runs about $9 billion in assets under management with close to 80 employees. We directly originate loans to companies to support their activities to deliver good returns for our investment clients.

GH: Let's start with the product most of our readers might know, the two listed trusts, MOT and MXT. There's an ongoing debate about the relative merits of LICs, LITs and ETFs. Why do you believe the closed-end structure of a LIT is better for your asset class in the listed space than an open-ended Active ETF?

AL: Both can coexist but we want to create investment products that cater to individual investors' risk, return and liquidity requirements. The attractiveness of the listed closed-end structure is that companies need to know that the lender has committed capital that will not be withdrawn in difficult market conditions.

Consider the context of a large corporate client with a revolving loan facility, which they can draw or repay under a funding facility, or a company that's completing a property development project. They must know that when they submit the funding request, the lender has the capital and can provide the funding. So having that source of funding that is not subject to redemption risk gives our borrower clients confidence when they deal with Metrics. As a result, we gain access to better quality lending opportunities than we might otherwise.

GH: And while LICs and LITs have come in for a lot of criticism, in your asset class, it's not easy to liquidate a corporate loan to fund a redemption in the same way as a fund holding an ASX 200 company.

AL: Exactly right. They are private loans so they can't be bought and sold over an exchange. With an ETF, there is a market maker that has the ability to buy and sell the assets of the fund, creating liquidity for investors. In our asset class, other lenders that are sitting alongside us providing funding to companies are often banks, and there's not a market maker that buys and sells loans to different companies to create liquidity in short periods of time.

The investor is able, hopefully, to achieve a premium return as we are lending for say three or five years. The margin and the fees to the company are higher than a short-term exposure. The investor receives a premium or pick up with the flexibility to buy or sell those units at short notice on the stock exchange on a daily basis if they wish.

GH: The credit you provide is corporate loans or private credit to unrated borrowers. What has been your default and loan loss experience over the years?

AL: Over the eight years since we established Metrics Credit, we've completed lending of close on $15 billion and in excess of 450 individual loan transactions. We have never delivered a loss to our investors. We've had four companies where we've had some form of restructuring or credit management associated with those loans. But in each case, we've been able to manage our investors' exposure and exit from those loans without loss. Two of those four borrowers had a default but we worked through a process to ensure that our investor capital wasn't at risk of loss. The part of the capital structure bearing the most risk of loss is equity, and so shareholders in those companies and those projects suffered a loss but we as a lender did not.

And that's an important feature of where you sit in the capital structure, together with the benefits of corporate insolvency laws that protect the interests of a secured creditor. We're always focused on the ways we can exit our exposure to ensure we can get our investors' money back if we need to.

GH: The test is when you have a severe stress event. How did the portfolio perform in the depths of COVID, say in March 2020?

AL: Credit to the government and the regulators for the support they provided. If you had asked me in March last year, I thought we were facing rising unemployment, declining asset prices and defaults. But the combination of strong management responses, government packages and the Reserve Bank lowering interest rates and supporting liquidity all helped economic activity.

Obviously, for a lender, there's no joy in seeing companies struggling. The government response facilitated the retention of employment and companies weathered the storm, but equally, companies raised equity capital. While that destroys value for existing shareholders, as it dilutes equity, fresh equity capital on the balance sheet reduces risk and gives the company liquidity.

We've seen similar events in other cycles as a lender. If credit quality or market conditions deteriorate, a lender can encourage a company to sell assets to repay debt, or maybe raise equity, while a lender is also conscious of preserving a going-concern value. Over the last year, we've maintained a strong discipline in lending to around 190 individual companies with income and capital stability for our investors.

GH: You regularly report the Net Asset Value (NAV) of your listed funds to the exchange. How do you come up with that number when none of your assets are listed?

AL: Investors need confidence in the NAV of our funds and the governance structure that oversees it. We have an independent RE (Responsible Entity) and a trustee across our funds who are responsible for the oversight of our activities. We also have an independent international accounting firm to test the market value and the portfolio monthly to determine whether there's any risk of credit loss or impairment that would be a reduction to the value of the portfolio.

These are not traded loans so they're generally held to maturity. Based on the credit quality of the borrower and the tenor of the loan, we can derive a market-based price. If there is a situation where a borrower might default or we are unlikely to recover the full value of our loan, then that impairment charge is immediately reflected in the carrying value. We're confident in our processes and we lend to less than 25% of all the transactions that we see.

GH: So I assume the first day or week that you fund a loan, it's in your valuation at say, $1, and if you have a three-year loan to a corporate who continues to service its payments, does that stay in the valuation at $1 or does it change according to the way credit spreads change in the traded market?

AL: It will change. Some of our funds are daily mark-to-market, but one thing to understand about a loan is that you don't get a value greater than 100 cents in the dollar. A loan can be voluntarily repaid by a borrower at any time at par, that's the best you will get. It's not like a bond, you're not going to get $105. We don't hold all of the assets at 100 cents in the dollar as we deduct from that the risk around potential loss. Our reported accounts go through 'expected credit loss testing' on a weekly basis. But if a borrower is performing, and the margin we are receiving is commensurate with the margin and the fees currently charged to similar quality borrowers, then it will be held at $100. In our asset class, the underlying loan assets are all floating rate. If interest rates rise, then it will flow through to a higher total return to an investor.

GH: You also have a suite of unlisted funds and I'm wondering about the relationship between the listed and the unlisted.

AL: One of the things that we don't have in the listed fund is the ability of a market maker to trade an ETF, but our wholesale unlisted funds do have the ability to buy the listed funds if there is a dislocation in the market price. We provide a daily NAV and the listed funds should trade at or around the value of the NAV, but if there's a material discount, it's a signal that investors are looking for liquidity, and our wholesale funds can take advantage of that.

What we're trying to do is create options for investors. Some investors don't value daily liquidity on the stock exchange, they don't want to buy and sell, and they don't want to have the risk of secondary market trading impacting them, so they stay in the unlisted fund where the units revalue at the NAV. Those who want daily liquidity and have the capacity to withstand the volatility of the ups and downs of the secondary market trading might want to go into the ASX listed fund. We're agnostic.

GH: You recently bought about a billion dollars of loans from Investec. Can you tell us more about that transaction, the benefits for investors and how you bedded down the investment?

AL: Late in 2020, Investec was seeking to withdraw from the Australian market. We approached them to acquire that portfolio of assets, initially around $1.3 billion. We spent several months on detailed due diligence to check we were comfortable with the credit risk and that the returns would be good for our investors. There were some assets we were not comfortable with, but we were successful in acquiring around $1.1 billion. They are now in our funds, enhancing the liquidity and returns to investors. As we were not doubling up or increasing exposure to existing borrowers, it also gives greater levels of diversification.

And it also expanded our relationships with some corporate borrowers and gave us access to a part of the market that we were not previously lending to. We raised money from our institutional investors and a capital issue for MXT raised close on $200 million to finance the acquisition.

GH: It seems like a large amount to absorb into your existing portfolios.

AL: It was a combination of raising some new capital and using existing liquidity. While we were negotiating, we started to build up some cash reserves to make sure that we had the capital. We had also received funding proposals from banks that were willing to support the acquisition. So we knew we had funds available.

GH: We hear a lot about ESG (environmental, social and governance issues) in equity markets but how does it play out in private debt markets?

AL: It's a major component of our assessment and risk analysis. For instance, recently we surveyed all companies in our portfolio to understand what they were doing around their environmental and carbon emission reduction strategies. We now have data across our portfolio with detailed insights into how companies are managing, monitoring and seeking to reduce their emissions.

Corporate governance and transparency are also important. There are industries that we don't lend to based on a negative screen for either environmental or other social reasons. In fact, we are becoming more confident in sustainability-linked financing, especially around the capacity of third parties to independently verify and confirm that companies are achieving and delivering on their sustainability KPIs. We're seeing loan agreements with targets over the next three to five years, and if they deliver against those KPIs, then we might lower the interest margin. Some independent third parties have the resources and the capability to monitor and report back to a lender.

Graham Hand is Managing Editor of Firstlinks, Metrics Credit Partners is a sponsor of Firstlinks. This article is general information and does not consider the circumstances of any investor.

Andrew Lockhart features as a guest in this week's 'Wealth of Experience' podcast.

10 things I learned in my faux-retirement

Christine Benz

Christine Fahlund, who retired from her position as T. Rowe Price's retirement-planning guru a few years ago, often liked to say that pre-retirees should 'trial-run' their retirements.

Would traveling around the country in an RV be as fun as they had imagined, for example, or would day after day of close proximity to their spouse start to get old? An extended road trip could yield valuable intelligence. Meanwhile, renting a condo in a warm location for a month could help a pre-retiree determine whether she'd be too lonesome for family and friends if she moved away; such a finding would be valuable before she sold her home up north.

I'm not ready to retire any time soon, but my recent sabbatical from Morningstar--a six-week break totally free from work obligations, available to Morningstar's US employees every four years--gave me a chance to noodle on what retirement would feel like for me. Of course, there were some crucial differences relative to an actual retirement: I continued to get paid (nice work if you can get it!), and I knew I was going back to my job when my six weeks were up. In addition, my husband and I took a trip for a couple of weeks, so my true 'faux-tirement' observation period was really just a month. But after years of researching and writing about the financial side of retirement, my break gave me a sense of the lifestyle aspect of not working.

Here are some of my key takeaways.

1. My powers of concentration improved

Juggling work and family obligations means many of us are multitasking most of the time, me included. But one of the great revelations of my 'faux-tirement' was what a luxury it is to be single-minded about various tasks, even mundane ones. Whether I was organising files in my basement or planting a pot of annuals, I was able to do a better job and enjoy it more than I could under my normal, multitasking conditions. My challenge, now that I'm back at work, is to try to maintain that sort of focus. I realised I'm not really gaining anything, and I'm certainly losing peace of mind, by jumping forward to the next thing before I've finished the job at hand.

2. My to-do list wasn't all that long after all

As sabbatical dawned, I had a long list of projects that I hoped to accomplish--tasks like settling the final details of my mom's estate, organising files on my computer, and figuring out what to do with all of my photos, digital and otherwise. But while my to-do list was daunting, I found that I knocked off most of those tasks in short order. If I were embarking on my actual retirement, I might be asking myself, "Is that all there is?" We're all different, of course, but the experience underscored that I don't want to spend my retirement years attending exclusively to my own to-dos (and there may not be that many, anyway). I suspect I'll need more of a sense of purpose on an ongoing basis, probably community-service work, a part-time job, or both.

3. The balanced days were the best days

In a related vein, I found that I enjoyed my days the most when I combined doing something fun or leisurely with knocking off some bothersome task that had been hanging over my head. Just as we workers enjoy the weekends most when they've been preceded by a particularly tough workweek, my free time was more enjoyable when I had a sense of having accomplished something beforehand. To help keep myself on track and maintain a sense of balance during my time off, I maintained to-do lists for each day, just as I do when I'm working.

4. I missed my work 'family'

This one will be obvious to anyone who has ever worked in an office or in close proximity to others. Bonds form. You know about each other's families, TV viewing habits, and favorite products at Costco. You celebrate each other's birthdays and mourn the loss of loved ones; you know when someone's child is under the weather. You laugh--a lot. Is it any wonder I missed my work family while I was away, given what a big part of my daily life they are? (Missing colleagues was a unifying theme among the various retirees we asked to reflect on their retirement experiences for this video round table, too.) Even if I made a point to schedule regular lunches with my former colleagues in retirement--and I know I would--I would still miss the natural give and take of the workplace.

5. I had to monitor my media consumption

I love news of all kinds, and especially the tragicomedy that is the U.S. political scene. But the opportunity to pop on the TV during the day drove home just how same-y the news flow can be, at least on the major cable networks, with constant rehashing and parsing of the news du jour. It was easy to get sucked into the Twitter vortex.

On the other hand, my consumption of other media types increased during my time away. It was a great luxury to have the time to read about subjects online and in the newspaper that in the past I would have skimmed over--the political and economic scene in a country that I know nothing about, for example, or the history of DDT. I also upped my intake of podcasts; I continue to be amazed at the breadth and quality of podcast series available, and the format lends itself perfectly to car trips and long walks. At the same time, I was mindful of the fact that selecting only those media that jibe with my interests and biases puts me in a bit of an echo chamber; I run the risk of shutting out viewpoints that run contrary to my own. I also had to remind myself that silence--or music--is sometimes more necessary than taking in additional information. After replaying a podcast discussion of the conflict in Syria for the third time, and zoning out each time, I decided it was time to unplug for a while.

6. It was a bit easier to maintain a healthy lifestyle

Many retirees say having time to prepare food at home has prompted healthier eating habits than when they were working, and it also saved them money. I didn't detect big changes in my eating (or spending) patterns. I typically make time to cook while I'm working and did so on sabbatical, too. One difference, however, was that I felt less urgency to plan dinners for a whole week at a time, as I typically do while I'm working. Instead, I could decide that morning what we'd have for dinner that night, then shop for the ingredients in my copious spare time. I'm pretty sure we drank more wine.

On the other hand, being able to allocate an even greater share of my day to exercise, on my own schedule, was one of the great joys of sabbatical. I walked absolutely everywhere--my one-day record was 16,500 steps--thinking things over and listening to podcasts all the while. People who retire in good health and are able to stay active are a lucky lot.

7. My wardrobe changed

In a related vein, my 'faux-tirement' brought a change in my clothing habits, which would likely have implications for my clothes-buying were I actually retired. My workout and yard work clothes were in heavy rotation; I found I needed more such items, especially for warm weather, than I actually had. On the other hand, I found that my supply of dress-up clothes was crazily vast relative to my needs and lifestyle. No surprises there, really, but I expect a similar pattern in retirement would lead to changes in my shopping habits.

8. My spending was a mixed bag

Because I've focused so much on the financial side of retirement in my work, I was keen to see if my spending habits differed significantly during my break from when I'm working. I detected a mixed picture. On the one hand, not working gave me more time to engage in pleasurable activities that don't cost anything--walking, reading, and gardening, for example. And because I was more relaxed overall, I felt less of a need to treat myself for little goodies that might help get me through the working week--an afternoon Starbucks, for example, or little splurges at the Sephora or Zara in my office building. On the other hand, having more time brought more shopping opportunities--I could readily pop by Target after having lunch with a friend, for example. (It could have been a coincidence, but most of my purchases were home-related--perhaps because I was spending more time there?) On the spending front, I'd call it a draw.

9. Home projects were a nuisance

In the category of 'first world problems', I found myself a little annoyed by having workers around the house while I was on my break. As it happened, we were having the exterior of our house painted during my time off, and I felt a little self-conscious about my seemingly aimless schedule--long morning walks and periodic trips out of the house to have lunch with friends. Takeaway: I'd tackle any big, foreseeable home-improvement jobs before my actual retirement starts, because I relish my privacy while I'm at home.

10. I got to take the long view

Finally, having extra time on my hands gave me the opportunity to take the long view on things, to think big thoughts and open my heart a little bit. I thought about growing wealth inequality and the why of opioid addiction and despair. I wondered why so many people drive cars in my neighborhood when they could just as easily walk or ride their bikes instead. I felt - even more intensely than I usually do--about how grateful I am for my departed parents and my whole beautiful extended family. I decided my husband and I should get ourselves to Asia soon, and take some more road trips. I reconsidered a grudge I had been holding against a loved one and decided to let it go. I actually think I might have gotten a little bit wiser. Such moments, I suspect, are among the greatest joys of actually being retired. I'm grateful to have had a few.

Christine Benz is Morningstar's Director of Personal Finance. This article does not consider the circumstances of any investor.

Achieving a sufficient retirement income portfolio

Reece Birtles

We are living through a revolutionary period in investing and portfolio allocation. All time low-to-no yields here in Australia and across global fixed income markets have upended the foundations of retirement portfolio construction. It is not hyperbole to say that investors face a new investment reality to be reckoned with.

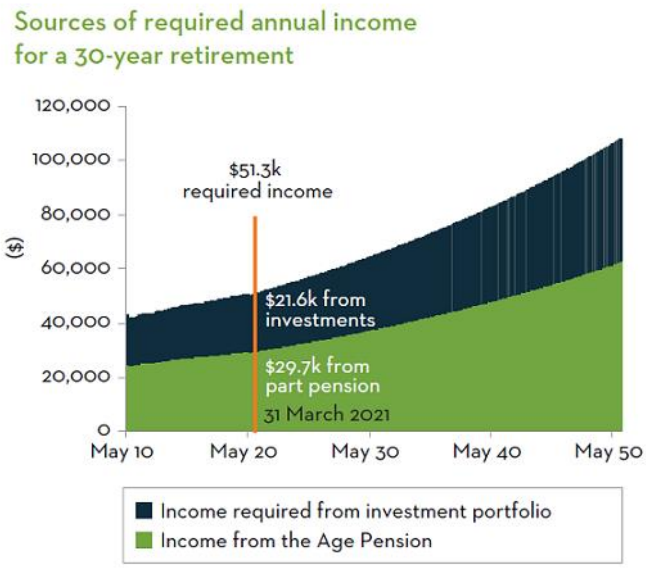
At Martin Currie Australia, we feel it is important that investors and advisers adapt their portfolio construction methodologies to this new reality of financial markets. With this in mind, we have produced a new white paper, *Investing for a Sufficient Retirement Income in a Post COVID-19 World*.

The paper examines why traditional approaches to retirement investing are unlikely to achieve most investors retirement goals and how intelligent approaches to income-oriented investing can help bridge the gap between required and available income.

A sufficient income in figures – the risk of 'defensive' assets

In dollar terms, every retiree's income stream needs will be different, but a good starting point is the ASFA industry standard which suggests a couple aged 65 needs $51,300 in income per annum. [Note that we have used the mid-point between ASFA's modest and comfortable retirement figures to create what we think is a more reasonable estimate of retiree living standards.]

A couple with $500,000 in assets will be eligible for about $30,000 from the part pension based on government income and asset tests. The $21,600 not covered by their part pension needs to be received from their investment portfolio, and a yield of 4.3% is required to generate that today.



Source: Martin Currie, AFSA

To earn that required $51,300 income at a 0.3% term deposit rate, a portfolio of over $17 million is required! Conversely, if a retiree had a $500,000 portfolio in 2008, the ~8% yields available would have met their income needs, but at today's rates the $500,000 portfolio would not even provide for a month's expenses.

It was clear in 2010 that when defensive asset yields fell, the resulting income from a traditional defensive portfolio would not meet these income level and income characteristics and risked sending a retiree's hard-earned capital into a downward spiral without any capital growth to replenish it. We also knew that the age pension would not be a sufficient safety net for a comfortable retirement.

Asset allocation and risk from a sufficient income perspective

Our hypothesis in 2010 was a 'sufficient income for life' retirement solution was more like an asset liability matching problem, and we would need to move away from the Markowitz-based so-called 'low risk' defensive assets which were low growth with high income volatility, and into higher-growth equity allocations.

This is because when retirees are relying on the income generated by investments for their required drawdown, how that income stream behaves and grows over time is important. Thus, the attractiveness of different asset classes is significantly different when viewed through the lens of income volatility and growth.

Source: Martin Currie

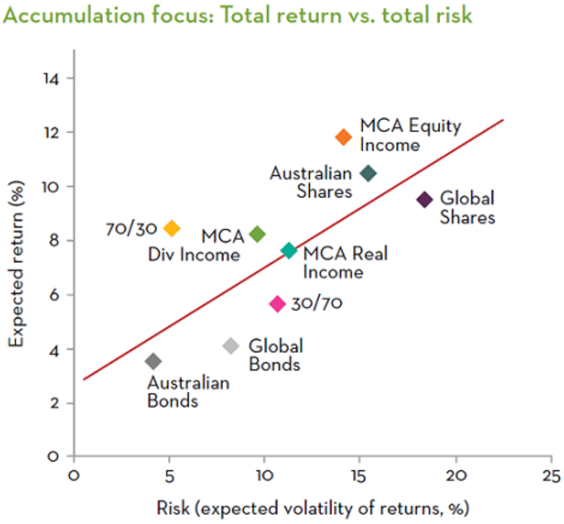
For instance, most multi-asset retirement products assume is that when people reach 65, they automatically become more risk averse and should move away from 'risky', growth-style assets and towards 'defensive' assets.

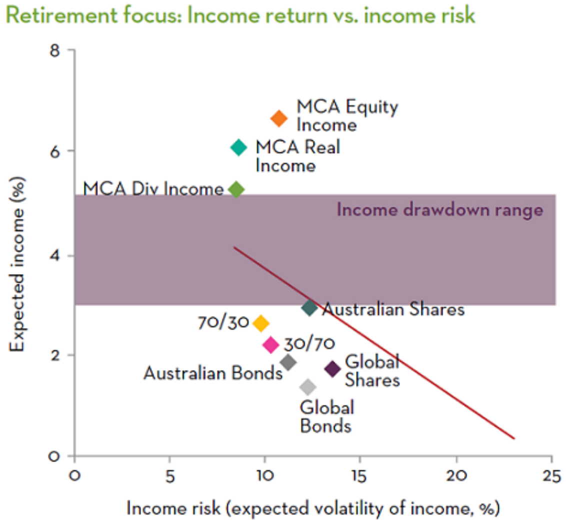
We do not agree. So-called low-risk defensive assets have delivered low-to-no income growth with high income volatility over the past decade.

Instead, our research indicates investors will benefit from approaching retirement portfolio construction through the lens of income volatility. From this perspective, not all growth assets should be considered 'high risk' and all defensive assets 'low risk'.

Instead of total volatility as a standard risk measure, we believed that for retirees, the concept of income stability, or in risk terminology, income volatility is a better proxy for the risk of impaired living standards. Income growth is also important to protect income against rising inflation.

As the chart below shows, the attractiveness of different asset classes is significantly different when looking through a total volatility lens. The more risk that you take in terms of capital volatility, the greater expected return you are likely to achieve out of each asset class along an upward sloping efficient frontier (left), and the retiree income volatility lens (right), where the level of income and income volatility is the critical issue.





Past performance is not a guide to future returns. The investment vehicles shown may have different risk profiles and a direct comparison may not be appropriate. Martin Currie Australia, FactSet, Morningstar Direct; as of 31 March 2021.

Not all equities are created equal - a sufficient income approach

Retirees require a reliable income stream to replace the wages they received when they were working. Thus, when constructing retirement portfolios, it is important to focus on the actual dollar income generated over time, rather than the markets traditional look at headline yield percentage.

This perspective leads to higher equity allocations but critically, not all equities are created equally.

The best equities for the retiree portfolio will be different from those of the accumulation investor. The sustainability of income, future income growth and diversification of income sources must be carefully considered within the choice of growth assets.

With this in mind, we build equity portfolios from the bottom up, and employ unique methodologies designed to secure a sufficient income for clients. Some key characteristics of our approach (more detail is included in the full paper) include:

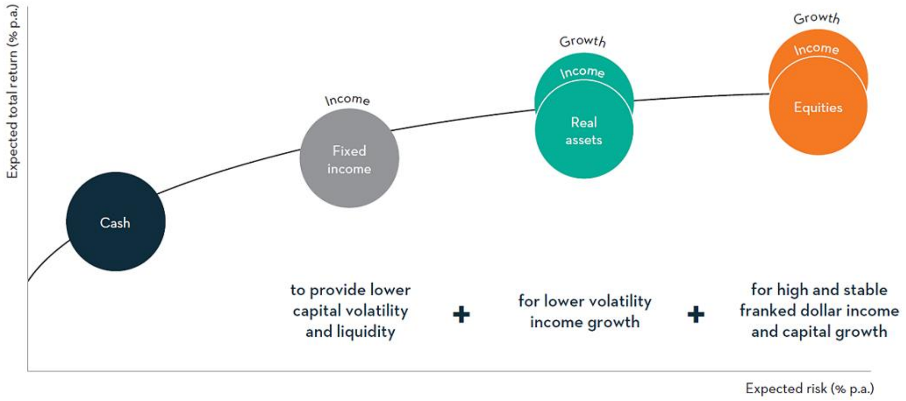
- A truly sustainable dividend
- A focus on quality
- Benchmark unaware construction
- Maximising franking credits
- Australia specific inflation targeting

The result is often a portfolio that looks different from both traditional equities and other income-focused approaches to deliver on key aspects of our 'sufficient income for life' philosophy.

Innovation towards a sufficient income for life

Our Martin Currie Equity Income, Real Income and Diversified Income Funds are aligned towards generating sufficient income for life, and focus on achieving:

- a high and stable franked income stream to support annual expenses
- income growth for inflation protection, and
- capital growth to manage longevity risk.



In our paper, we compare these retirement income strategies across several metrics, versus traditional lower-risk income alternatives such as term deposits, bonds and defensive balanced funds, as well as other categories such as balanced funds, broader equities and a rules-based high-yield index approach.

While the risk profiles vary, our retirement income strategies often deliver the best probability of beating an income return target, compared with the income alternatives.

Towards a sufficient income for life

Despite the short-term impacts of COVID-19 on Australia equities, our retirement income strategies with a focus on a high and stable franked dollar income stream, through diversified sources of income and capital growth, were able to provide income in-line with our objectives during 2020.

Income alternatives for retirees who need a high dollar income stream have continued to be insufficient both pre, during and post-COVID-19, with lower income and capital outcomes. Should income and capital fall into a downward spiral, and retirees be forced on the age pension in the future, the consequences for the whole economy and future generations are concerning.

Read the full white paper here.

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

For more articles and papers from Franklin Templeton and specialist investment managers, please click here.

'Wealth of Experience' podcast and ASA webinar on ETFs v LICs

Graham Hand, Peter Warnes

Season 1, Episode 3

Peter reveals some top stock picks with an emphasis on long-term assets like Sydney Airport, Graham discusses spending in retirement and valuing assets, the key to Amazon, guest Andrew Lockhart.

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Please share with friends and colleagues, and a favourable rating would also help spread the word. Thanks for all your feedback on the first episode. We welcome questions and suggestions at firstlinks@morningstar.com.

Australian Shareholders Association Webinar with Graham Hand

"ETFs are winning the battle against LICs, but is the WAR over?"

Prior to 2017, LICs ruled the listed fund space, but ETFs are now more than double their rivals. Is the first new LIC since 2019, ASX:WAR, a sign of a revival or is the structure doomed? View on Vimeo here.

Lucy Turnbull's three lessons on leadership and successful careers

Lucy Turnbull

Lucy Turnbull AO has always forged her own path. As a prominent Australian business leader, lawyer, philanthropist, company director and the first female Lord Mayor of Sydney, Ms Turnbull has set a high professional bar. She also graduated with an MBA from AGSM @ UNSW Business School in 1985 and was awarded an Honorary Doctorate of Business by UNSW Sydney in 2012.

"When I was doing an MBA in 1983/84, that was the birth of the neoliberal idea in government, in business and in everything, when Microsoft was starting to be a serious company, Excel was slowly taking over Lotus 123, PCs were being born – it was in the early stages of the information technology revolution," said Ms Turnbull.

While the concept of neoliberalism dominated in the 1980s, she said things have since changed and companies cannot focus solely on profits anymore. Markets should not drive a company's decision-making, but companies instead need a clear purpose to survive, and importantly, Ms Turnbull said companies need leaders who live and breathe the company's mission and values.

"Good leaders have an alignment between the purpose of the company and their own values and priorities," she said. So how has Ms Turnbull expressed this in her own professional life and what has influenced her success?

1. A strong executive management team drives organisational culture

Ms Turnbull has always strived to work in businesses, enterprises and public organisations where her expertise could be utilised. "It's important to have a good, strong sense of leadership, and you need to be able to communicate the purpose and the priorities of the organisation very well … clear communication is critical.

"You also have to build and work with a great team. You should never, ever imagine that anything that you achieve is done on your own. It never is; you always have a team with you," she said.

Communication, respect and team development have all played an important part in her leadership style. But one crucial thing she has observed over the years has been the extent to how organisational culture is driven less by senior executives (such as the CEO) and more by people below.

The culture of an organisation is shaped in many ways. While the CEO has an important role to play, culture is communicated at the frontlines – such as the customer service desk where the customer experience is created.

"But often the cultural values and the way the organisation respects its constituents, and its customers and its stakeholders, are actually determined less at the CEO and Director level, and more at the next layer down," such as the executive management team or the team leader in charge of the operational parts of the organisation, she said.

"They're often called different things, but I would call it the executive management team, below Director, Executive Director level ... the culture and the values and the commitment of those people to the organisational goals are really important. If you've got a really strong team at that level, then you're going to have a much better prospect of success – as important as the CEO or the Chief Commissioners or the Lord Mayor," she said.

"You really have to rely on the strengths and capabilities of that executive management team to get you to where you need to go."

2. Follow your interests

Ms Turnbull said another key to success has been pursuing roles she found genuinely exciting and where she felt she could genuinely add wisdom and value.

"Direct yourself to something that you find really interesting and really exciting," she said. "It's clear to me that the people who are best at their jobs and develop their careers the best are actually the ones that are passionate about what they do," she said.

One cause which Ms Turnbull is passionate about is the promotion of women, especially to executive management positions. At the Greater Sydney Commission, for example, she said more than 70% of the leadership team was female at one time. "And I have to say, I've never worked in a more collaborative organisation in my life," she said.

3. Consider non-linear career choices

Making 'non-linear' career choices has also been important for Ms Turnbull, who recommended pursuing "somewhat left-of-field opportunities" that often present themselves, as such roles can help individuals achieve their goals in unique ways.

"My career, I have to say, has not been linear. I didn't lie in bed one day and think 'I'll do this, this and this and this' – far from it," she said. "I love my career, I love what I've done, but I didn't ever think I'd be the Lord Mayor [of Sydney], I didn't think I'd ever be Chief Commissioner of the Greater Sydney Commission."

It is important to be able to respond to and potentially rescind opportunities when they present themselves, she said. "I know some people work in a linear way, and some people don't. But I would encourage you to think a bit of both ways. Have a linear approach, but also a reactive and a responsive approach.

"Be opportunistic when chances arise. Don't let them slip by, too, even if they're... a bit sideways or in a wonky direction, they can actually open the doors to many more interesting things," she said.

In addition, she recommended thinking about how every job, no matter the nature of the role or how clear things are, could inform the next one. "It's good to have a diverse range of experiences," she said.

Lucy Turnbull AO is a businesswoman and philanthropist with a longstanding interest in cities, culture, technological and social innovation and Australian research and commercialisation. She is the Director of Turnbull and Partners Pty Ltd, a family-owned business that invests in earlier stage innovative enterprises. In January 2020, she was appointed by the NSW Government as Chair of the Sydney Opera House Trust. She also holds an MBA from AGSM (1985) and was awarded an Honorary Doctorate (Business) in 2012.

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Are concerns about inflation inflated?

Mamdouh Medhat, Wei Dai

US consumer prices were up by 5.4% for the year ending June 2021, the largest annual increase since August 2008. As US markets feed into all others, inflation is at the centre of attention for many investors.

Our recent research suggests that simply staying invested helps outpace inflation over the long term for a wide range of asset classes. The analysis of data from 1927–2020 covers periods with double-digit US inflation as well as periods with deflation.

Inflation outpaced

Exhibit 1 shows average real returns (that is, returns net of inflation) to different asset classes in years with high (above-median) inflation from 1927 to 2020. We consider a total of 23 US assets that span bonds, stocks, industries, and equity premiums. Over this period, inflation averaged 5.5% per year in high-inflation years. While average real returns were mostly lower in years with high inflation compared to years with low inflation, the exhibit shows that all assets except one-month T-bills had positive average real returns in high-inflation years.

The analysis over 1927–2020 is useful because it covers periods with double-digit US inflation (like the 1940s and 1970s) as well as periods with *deflation* (like the Great Depression, 1929–32). But we find similar results over the most recent 30-year period (1991–2020), when US inflation was relatively mild and stable.

Over this period, we also expand our analysis to non-USD bonds, developed- and emerging-market equities, real estate investment trusts (REITs), and commodities. Overall, outpacing inflation over the long term has been the rule rather than the exception among the assets we study.

Exhibit 1: Keeping It Real

Average annual real returns in years with above-median US inflation, 1927–2020

See Data appendix below for more information

Inflation hedged

Despite the reassuring findings presented above, growth assets that have historically outpaced inflation may not be appropriate for everyone. For investors highly sensitive to inflation and with a low tolerance for market risk, some exposure to inflation-indexed securities might assist. However, in Australia, there is limited supply, mainly from government and infrastructure borrowers such as Sydney Airport.

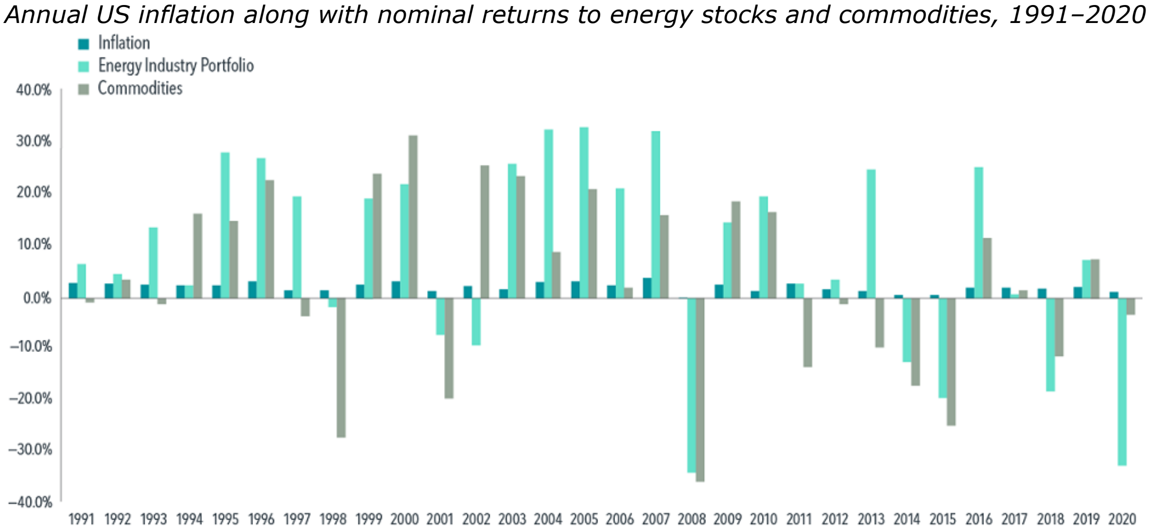
While stocks from certain industries, REITs, commodities, and value stocks are sometimes considered 'inflation-sensitive' assets, the data provide little support that they are good inflation hedges.

Nominal asset prices already embed the market's expectation of inflation. So inflation concerns are really about the negative impact of *unexpected* inflation on the real value of your invested wealth.

An asset is therefore most useful as an inflation hedge when its nominal returns move closely with unexpected inflation. We find mostly weak correlations between nominal returns and unexpected inflation. For the few exceptions where the correlations are reliable, such as for energy stocks and commodities over 1991–2020, the assets' nominal returns have been around 20 times as volatile as inflation, and more than half of their nominal-return variation has been unrelated to inflation.

Exhibit 2: One of these things isn't like the others

Annual US inflation along with nominal returns to energy stocks and commodities, 1991–2020



See Data appendix below for more information

Exhibit 2 illustrates this by showing how the annual nominal returns to energy stocks and commodities differ dramatically from the annual realisations of inflation. If the goal is to reduce the variability of future purchasing power, it is questionable that hedging with something this volatile will effectively achieve that.

Inflation deflated

What is the outlook for inflation? How will it compare to market expectations? Is the rise in inflation temporary or long-lived?

Nobody has a crystal ball. Fortunately, we don't need a crystal ball to address inflation in our portfolios. The data suggest that simply staying invested helps outpace inflation over the long term.

Wei Dai, PhD is Head of Investment Research and Vice President, and Mamdouh Medhat, PhD, is a Researcher at Dimensional Fund Advisors. This material contains general information only. No account has been taken of the objectives, financial situation or needs of any particular person.

Data appendix

US inflation
The annual rate of change in the Consumer Price Index for All Urban Consumers (CPI-U, not seasonally adjusted) from the Bureau of Labor Statistics.

US government securities and long-term corporate bonds
The returns to US government securities (one-month T-bills, five-year notes, and long-term bonds) and long-term corporate bonds are from Morningstar (previously from Ibbotson Associates).

US equity portfolios and factors
The US equity market is proxied by the Fama/French Total US Market Research Index. The US industry portfolios are the 12 Fama/French industry portfolios. The US style portfolios (small cap value and growth and large cap value and growth) are from the Fama/French six portfolios sorted on size (market cap) and book-to-market equity. The US size and value premiums are proxied by the Fama/French size and value factors. The returns to all of the above are from Ken French's data library.

[1] Based on the US Consumer Price Index for All Urban Consumers (CPI-U, not seasonally adjusted) from the Bureau of Labor Statistics.