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Editorial

It's tempting to assume our good investments are due to skill and poor investments are due to bad luck. Of course, it's not like that. Every investment decision is made with imperfect knowledge, and it is often luck whether the favourable elements outweigh the problems, known or unknown. As professional poker player, **Annie Duke**, writes in her excellent book, *Thinking in Bets*:

"Why are we so bad at separating luck and skill? Why are we so uncomfortable knowing that results can be beyond our control? Why do we create such a strong connection between results and the quality of the decisions preceding them?"

Nobel Laureate **Daniel Kahneman** goes further in his famous *Thinking, Fast and Slow,* saying we are delusional to think we can forecast accurately:

"It seems fair to blame professionals for believing they can succeed in an impossible task. Claims for correct intuitions in an unpredictable situation are self-delusional at best, sometimes worse. In the absence of valid cues, intuitive 'hits' are due either to luck or to lies ... Remember this rule: intuition cannot be trusted in the absence of stable regularities in the environment."

Hamish Douglass supports this view in the current market. In his article on current market conditions (and why Bitcoin will become worthless), he says:

"A common question from investors is: "What's your outlook for the next 12 months?" My honest answer these days is: "I don't know." That's because the world confronts its most complex set of economic circumstances for at least 30 years. Charlie Munger, Vice Chairman of Berkshire Hathaway, said at the company's recent annual general meeting: "If you are not a little confused by what's going on, you don't understand it."

This week, we focus on luck at a more fundamental level. Charlie's mate, **Warren Buffett,** puts most of his success down to the lucky circumstances of his birth, and he issues a challenge. What type of political and social system would we create if we did not know our privileged place in the world? He pushes the discussion into the types of equitable taxes we should adopt, with relevance this week to the **Labor Party** abandoning a range of policies it clearly believes in. Pragmatic politicians realise the only way to power is to drop your principles if they might be unpopular. No use being right and on the opposition benches.

On luck, see below at how the winners and losers change every year and try predicting it. **Morningstar** has updated its annual gameboard and there's no pattern, but notable that the bottom place from FY20 is the top place for FY21. It shows the risk of selling your losers. It also emphasises the poor returns from cash and bonds and it's no surprise equities continue to see record inflows in the TINA trade.

Annual Asset Class Returns - Financial Year

MORNINGSTAR

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
15.1%	12.5%	26.8%	27.4%	25.5%	44.4%	7.9%	10.8%	20.3%	16.4%
8.7%	12.2%	21.6%	26.4%	23.9%	28.7%	7.3%	10.0%	13.1%	11.7%
6.2%	9.8%	19.4%	18.4%	19.9%	26.3%	4.4%	4.8%	11.5%	6.9%
4.6%	4.8%	17.2%	8.6%	18.1%	7.8%	-13.4%	-16.2%	11.2%	5.9%
-1.7%	3.7%	5.3%	7.8%	5.7%	6.3%	-20.5%	-20.1%	7.9%	5.5%
-4.7%	-1.7%	4.1%	5.5%	3.4%	5.7%	-21.3%	-28.6%	5.2%	4.9%
-23.5%	-18.5%	2.3%	0.1%	2.2%	4.0%	-37.7%	-42.1%	4.0%	2.7%
2002	2003	2004	2005	2006	2007	2008	2009	2010	2011

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
12.4%	33.1%	20.4%	25.2%	24.6%	14.7%	24.2%	19.4%	5.2%	33.9%
11.6%	24.0%	17.4%	20.2%	14.4%	14.1%	15.4%	11.9%	5.2%	33.2%
11.0%	22.8%	13.1%	5.7%	9.3%	7.0%	13.2%	11.5%	4.2%	27.8%
4.4%	4.6%	11.1%	5.6%	7.0%	1.8%	13.0%	9.6%	0.7%	27.5%
-0.5%	3.2%	7.8%	5.6%	2.2%	0.5%	3.1%	7.2%	-5.7%	0.0%
-6.7%	2.8%	6.1%	2.5%	0.6%	0.2%	1.9%	1.9%	-7.7%	-0.2%
-14.6%	-5.3%	2.6%	0.4%	0.4%	-5.6%	1.8%	1.8%	-20.7%	-0.8%
2012	2013	2014	2015	2016	2017	2018	2019	2020	2021

Cash | Australian Fixed Interest | Int' Fixed Interest (Hedged) | Australian Listed Property | Australian Equity | Small Caps | International Equity

A survey on retirement incomes

Our recent focus on retirement incomes has attracted strong readership with some articles receiving over 10,000 views. We add to the background with noted author **Satyajit Das** who looks to a future where many retirees live on tight pensions and drawing on the value of their homes.

So it's time to learn your views. It will take only a couple of minutes to complete our short survey, and we will share the results with policymakers in Treasury as well as reporting back here with the full results. Where are retirement income policies taking us?

Back in November 2020, senior portfolio managers from **Neuberger Berman** looked ahead to 2021 at what might happen (a summary is in the article, the full version is in our White Paper section). Recently, they undertook a mid-year review, again showing how difficult it is to make predictions, but it's good input to see how things have worked out so far.

The impact of COVID on real estate has been fascinating to watch, proving what a heterogeneous sector it is. Of course, residential property around the world has gone crazy on the back of cheap finance. I have been 'on-the-ground' recently on behalf of a family member and it really needs to be seen to be believed, what people are paying in Sydney for dumps. I believe the even real estate agents are shocked as buyers casually add half a million to top guidance. **Steve Bennett** takes a look at business conditions in industrial, retail and office segments of commercial property.

In the latest episode of our podcast '**Wealth of Experience**' with Morningstar's Head of Equities Research, **Peter Warnes**, we discuss which companies have done especially well and badly over recent years with a focus on a favourite stock pick, **Brambles**. We look at the Retirement Income Covenant and I have a rant about how performance fees are measured. We also share some ideas from **Nick Griffin of Munro Partners** as he looks around the world at major growth themes.

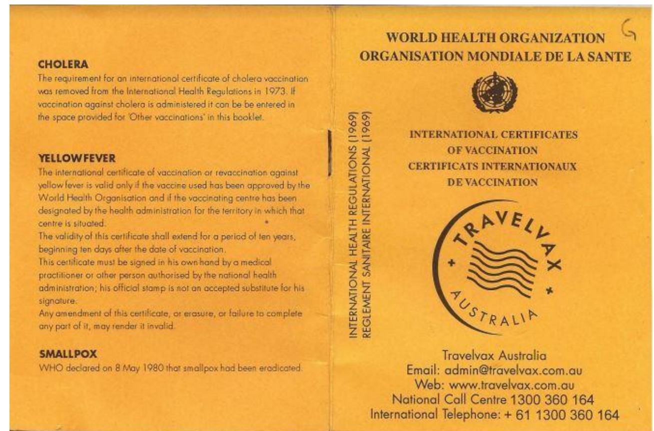
Source: Refintiv, BetaShares. Peformance related to total return net asset value indices

One subject both Hamish and Nick discuss is the crackdown on leading Chinese companies. Many investors may think this has little impact on them, but names like **Tencent** and **Alibaba** are both down 40-50% from their highs. These two companies alone comprise 10% of the MSCI Emerging Market index. Some leading fund managers say China is currently

uninvestible due to the unpredictable actions of Chinese authorities. The Government is reminding outspoken tech billionaires who is in charge. The chart shows how two BetaShares ETFs, NDQ based on the US NASDAQ 100 and ASIA based on Asian tech, have performed in the last year. As NDQ hits new highs, ASIA retreats.

Gold, gold … and last

With the background of Australia's golden success at the Olympics, we have gone from world beaters at managing to spread of the virus to laggards in the vaccination process. There is enough written every day in other places without covering the issues here but a vaccination passport of some type is a no-brainer. Travelling with a vaccination certificate has always been common. Here is mine, updated when I went to Brazil for the 2014 FIFA World Cup, with jabs for polio, cholera, typhoid and yellow fever. We were told we could not come back into the country without it.



CHOLERA
The requirement for an international certificate of cholera vaccination was removed from the International Health Regulations in 1973. If vaccination against cholera is administered it can be be entered in the space provided for 'Other vaccinations' in this booklet.

YELLOWFEVER
The international certificate of vaccination or revaccination against yellow fever is valid only if the vaccine used has been approved by the World Health Organisation and if the vaccinating centre has been designated by the health administration for the territory in which that centre is situated.
The validity of this certificate shall extend for a period of ten years, beginning ten days after the date of vaccination.
This certificate must be signed in his own hand by a medical practitioner or other person authorised by the national health administration; his official stamp is not an accepted substitute for his signature.
Any amendment of this certificate, or erasure, or failure to complete any part of it, may render it invalid.

SMALLPOX
WHO declared on 8 May 1980 that smallpox had been eradicated.

WORLD HEALTH ORGANIZATION
ORGANISATION MONDIALE DE LA SANTE

INTERNATIONAL HEALTH REGULATIONS (1969)
REGLEMENT SANITAIRE INTERNATIONAL (1969)

INTERNATIONAL CERTIFICATES
OF VACCINATION
CERTIFICATS INTERNATIONAUX
DE VACCINATION

TRAVELVAX
AUSTRALIA

Travelvax Australia
Email: admin@travelvax.com.au
Web: www.travelvax.com.au
National Call Centre 1300 360 164
International Telephone: + 61 1300 360 164

OTHER VACCINATIONS - AUTRES VACCINATIONS

Date	Nature of vaccine Genre de vaccin	Dose	Physician's signature Signature du medecin	Year next due
21/11/03	Polio	2 drops	[illegible]	10 years
21/11/03	Boostrix (Diphtheria/Tetanus Pertussis)	0.5Ml	[illegible]	10 years
21/11/03	Typhoid	0.5Ml	[illegible]	3 years
1/12/03	Hep B			
22/4/14	Vivaxim (Hep A + Typhoid)	1 ml	[illegible]	
22/4/14	DTPa Polio	0.5ml	[illegible]	10 yrs
22/4/14	Dukoral (Cholera) # 1		[illegible]	1 wk

So now I can add COVID because I jumped at the chance to take two doses of AZ. Come on folks, get those jabs, get the certificates and get on with it!

Finally, our **Comment of the Week** selected from 42 strong contributions made on ['Retirement income promise relies on spending capital'] comes from David K:

"Graham, I think this topic of the best or right terminology is actually a really important one for the average Aussie. Thanks for raising it. Most people think of income as what is taxed; i.e. they pay income tax on it. In retirement, there is no tax so we need to frame it differently. It's now spending money for them, including the pension, investment earnings and some of their capital. That's a very different perspective."

Who dares loses: Buffett on luck, taxes and a challenge

Graham Hand

"It is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenue, but something more than in that proportion." - Adam Smith, Wealth of Nations, 1776

Flicking through *The Australian Financial Review* last weekend, brief comments by two of our most-respected fund managers caught my eye. They were a pleasing contrast to most market professionals who base their success on skill in picking trends and identifying great companies.

First, Kerr Neilson, Founder of Platinum Asset Management:
"… as a family, we've always understood that good fortune is often just luck. Your origins have a huge impact on how life unfolds, and a single bad turn doesn't deserve a life of purgatory."

Then John Pearce, Chief Investment Officer at Unisuper, explained his good run in the last decade:
"There are always many success factors, including luck."

Some academics spend their lives investigating luck versus skill in investing, and there are shelves of business books on the topic, but this article is about a more fundamental luck at the start of our lives.

Warren Buffett on luck and the 'ovarian lottery'

David Kass is a Professor of Finance at the University of Maryland in the US. According to CNBC, he was the first to publish Warren Buffett's views on luck and the 'ovarian lottery' based on notes Kass took when Buffett was speaking at a 2013 graduate student event. Kass recalls:

"Warren Buffett has stressed the importance of luck in his life, focusing not only on where he was born but also when. His primary skill of allocation of capital has worked well for him in the United States and in his lifetime. Having the good luck to win the 'ovarian lottery' is a major determinant in success in life in general and in business in particular."

Buffett was influenced by John Rawls, a philosopher at Harvard who wrote a book called '*A Theory of Justice*'. He argued that a just society must be based on principles everyone agrees to before knowing where they are placed within society.

Buffett explains it this way:

"Just imagine that it is 24 hours before you are born. A genie comes and says to you in the womb, 'You look like an extraordinarily responsible, intelligent, potential human being. [You're] going to emerge in 24 hours and it is an enormous responsibility I am going to assign to you, the determination of the political, economic and social system into which you are going to emerge.

You set the rules, any political system, democracy, parliamentary, anything you wish. You can set the economic structure, communistic, capitalistic, set anything in motion, and I guarantee you that when you emerge, this world will exist for you, your children and grandchildren. What's the catch? One catch - just before you emerge, you have to go through a huge bucket with 7 billion slips, one for each human. Dip your hand in and that is what you get …"

Buffett has spoken about this many times since so there are variations on what he said but the principles are the same. Other times he has been more explicit about the individual:

"The catch is that you don't know any details about what your place in the world will be. Your gender, race, nationality, health, intelligence level and all other defining characteristics are left up to chance."

What kind of society would you construct?

My guess is that most of us would create a world of opportunity, choice, equality and fairness in case we were about to be born in a refugee camp in Somalia.

And this is where Buffett explains why he and his business partner, Charlie Munger, won the ovarian lottery and after that incredible piece of luck, the rest falls into place. The ovarian lottery is:

"The most important event in which you'll ever participate. It's going to determine way more than what school you go to, how hard you work, all kinds of things."

In another interview, he explained gender and race advantages:

"The womb from which you emerge determines your fate to an enormous degree for most of the seven billion people in the world. Just in my own case: I was born in 1930, I had two sisters that have every bit the intelligence that I had, have every bit the drive, but they didn't have the same opportunities. If I had been a female, my life would have been entirely different."

"You don't know whether you're going to be born black or white. You don't know whether you're going to be born male or female. You don't know whether you're going to be born infirm or able-bodied. You don't know whether you're going to be born in the United States or Afghanistan ... I mean, Charlie - when we were born the odds were over 30-to-1 against being born in the United States, you know? Just winning that portion of the lottery, enormous plus."

Even when he started in investing and found he enjoyed business, the luck did not stop:

"We won it in another way by being wired in a certain way, which we had nothing to do with, that happens to enable us to be good at valuing businesses. And, you know, is that the greatest talent in the world? No. It just happens to be something that pays off like crazy in this system."

What would Buffett like to see?

The world we have created allows people in power, mainly business or politics, to set the rules after they know where they stand in the ovarian lottery. Once we have accumulated our personal wealth, often through diligence, sacrifice and hard work, we feel entitled to keep it.

Warren Buffett is worth over US$100 billion so it's easy to criticise him, but he says:

"The trick, it seems to me, is to have some balance that causes the people who have the talents that can produce goods that people want in a market society, to turn them out in great quantity, and to keep wanting to do it all their lives, and at the same time takes the people that lost the lottery and makes sure that just because they, you know, on that one moment in time they got the wrong ticket, don't live a life that's dramatically worse than the people that were luckier."

And so when asked about US policies that reduce taxes for wealthy people, he said he does not need a tax cut. He said eliminating estate taxes when assets are passed to another person at the time of death would be a "*terrible mistake*" because the US system already vastly favours the rich.

"I sure don't think it's good for a society where there's a ton of inequality to start with. I think that's a terrible mistake."

He has also spoken out about lower taxes on capital gains than wages, where he has said, *"I'll probably be the lowest-paying taxpayer in the office."* He supported a minimum tax on top wage earners like himself which became known as the Buffett rule.

Who dares loses as Labor is wedged on principles

Without taking sides on individual issues, the main reason the Labor Party has abandoned its previous policies on negative gearing, capital gains and franking credits is not because leaders in the party no longer support the ideas. The same people were arguing fiercely for these policies at the last election.

No, Labor has decided there is no point sinking on a principle and nothing can be achieved from opposition. They have removed the policies because they know they cannot win by threatening the plans millions of voters have made for their wealth preservation. Franking credits became the 'retiree tax'. Political opponents falsely dragged out a 'death tax' at the last election, which was not on the policy agenda. So it's better to be a small target.

Peter van Onselen and Wayne Errington have released a new book called '*Who Dares Loses: Pariah Policies'.* It explains why no political party is prepared to threaten the favourable tax and social security treatment of the family home although the greatest benefits go to the wealthiest people. The power of property ownership is so strong that even adjusting policies for investors is difficult. They say:

"One of the problems, however, is that the population bubble of baby boomers has a disproportionate impact on electoral politics. While taxing the family home remains in the broader sense a pariah policy, in post-pandemic Australia, it will at least increasingly be discussed."

That's unlikely for some time. No political party dare threatens that sacred cow.

The policy acceptance which must have caused the most angst in the Labor Party is supporting the legislated stage-three tax cuts to come into force in 2024-25. At a time when budget pressure to reign in massive deficits is likely to be greater than ever before, hopefully coming out of the pandemic, the stage-three tax cuts flatten the marginal income tax rate for anyone earning between $45,000 and $200,000 to 30%. A person on $200,000 will receive a tax cut of about $9,000 a year. Between $180,000 and $200,000, the top marginal rate cuts from 45% to 30%. The cost to the Federal budget will be $19 billion a year.

Shadow Treasurer, Jim Chalmers, who would hold the purse strings as Treasurer if Labor wins the 2022 election, previously described these tax cuts as:

"the least affordable, least fair and least likely to be effective because high income earners aren't as likely to spend in the economy as workers of more modest means."

It is likely that higher income earners have benefitted most from surging house and asset prices in 2020/2021, and now Labor is supporting their tax cuts. That's politics and the price to win office when people vote with one hand on their wallet.

What would you do?

To come back to Buffett's question, it is 24 hours before you are born, and you can set the rules for society. You look into a massive bucket and there are (now) over 9 billion balls in there, and one of them represents your life. (Or you're an Australian politician facing a trillion dollars of debt and at some stage, taxes need to pay for spending).

Start writing the rules.

Graham Hand is Managing Editor of Firstlinks.

Importance of remaining rational and why Bitcoin is worthless

Hamish Douglass

A common question from investors is: "*What's your outlook for the next 12 months?*" My honest answer these days is: *"I don't know."* That's because the world confronts its most complex set of economic circumstances for at least 30 years. Charlie Munger, Vice Chairman of Berkshire Hathaway, said at the company's recent annual general meeting: *"If you are not a little confused by what's going on, you don't understand it."*

It's not a time for overconfidence

I admit it is a little confusing and this may not be helpful if you would like clear advice. But it is not the time to be overconfident. As the great economist John Kenneth Galbraith said: *"One of the greatest pieces of economic wisdom is to know what you don't know."* If you hear other investors expressing strong opinions at the moment, it probably means they are either in 'marketing mode' or they are unaware of today's complexities. Our view is that the coming 12 months could see either further gains on share markets or a major correction. Judging which outcome is more likely is difficult, if not impossible.

The case for continued robust market conditions is convincing. Economies are likely to grow, strongly driven by vaccines allowing economies to reopen, unprecedented fiscal expenditure and aggressive monetary policy (zero interest rates and substantial buying of government and other debt). The scale of government spending and central-bank asset buying is historic and breathtaking.

The problem is that the case for a major correction in stock markets (20% or more) in the next 12 months is also convincing. A slump could be triggered by rising interest rates in response to inflation, a mutation of the covid-19 virus that eludes vaccines, a panic in emerging markets sparked by rising interest rates and a stronger US dollar, a spate of corporate debt downgrades and defaults due to rising interest rates, or the bursting of asset bubbles.

It is foreseeable that any of these risks could trigger a major correction, yet almost zero risk is priced into markets, market risk measures are benign and few people appear concerned. This may be due to the euphoria associated with the reopening of the world's economies. Or it could be the manifestation of our personal experiences as we emerge from covid-19 and maybe a 'fear of missing out' when everyone seems to be making easy money.

We have seen similar situations where markets are priced for perfection and know it often ends abruptly and badly. We are not smart enough to leave a great party at one minute to midnight, just before things turn to

pumpkin and mice. It is even harder to judge when to leave a party where the clocks have no hands. We are custodians of your money and we will never reach for risk due to a fear of missing out. Our job is to remain rational, make fact-based analytical decisions, and not get caught up with what other people are saying or doing.

In 1965, Warren Buffett wrote in his letter to investors in the Buffett Partnership:

"We derive no comfort because important people, vocal people, or a great number of people agree with us. Nor do we derive comfort if they don't. A public opinion poll is no substitute for thought."

We know we will inevitably make investment mistakes and it is important that we objectively recognise mistakes. In the past year, two mistakes stand out.

Our two mistakes

The first was Alibaba Group. After initially outperforming after we invested, Alibaba's share price fell when the Ant initial public offering was pulled in November 2020 after Alibaba founder Jack Ma criticised Chinese regulators. While we never thought Ma would act so counter to his interests, I made a risk-management mistake in allowing our holding in Alibaba to grow via a higher share price to more than 8% of the portfolio.

There are times when we hold such conviction in a position that such an allocation is entirely sensible. The main reason I didn't trim the Alibaba holding prior to the Ant IPO was because reducing our holding might have diminished the chance of securing a decent allocation in the listing. At the same time, Alibaba was performing strongly from an operational perspective and we assessed the stock to be undervalued. The plan at the time was to gain a holding in Ant before trimming the Alibaba holding to a more moderately sized position. In hindsight, this was a mistake and was likely due to overconfidence and confirmation bias.

Since then, we have trimmed our holding in Alibaba, notwithstanding our positive view on the prospects of the business and our assessment still that the company is undervalued. To avoid making the same error again, we have instituted risk controls that set a maximum position size for Chinese companies and certain other technology companies.

The second mistake of the past 12 months was being too cautious prior to the announcements about vaccine trials results that were released in November 2020. Our focus, as always, was on wanting to protect our investors from the risk had the vaccine trials failed. Thus, we did not place enough importance on the opportunity that would arise from successful trial results. Our combined risk ratio cap (which is discussed below) makes it expensive from a risk-budgeting perspective to place a meaningful proportion of the portfolio in cyclical stocks such as banks, industrials and travel-related companies. We knew the trial results were coming and prior to November 2020 we evaluated numerous more pro-cyclical opportunities (that have all done well since). But for various reasons I decided not to invest in these cyclicals and the portfolio entered November last year with limited cyclical exposure. In hindsight, this was a mistake. However, we will not chase the market after that horse has bolted.

We are happy with the underlying operating performance of each company in the portfolio (and, in most cases, their operating performance through the pandemic has been exceptional). We judge that the portfolio is well positioned to prosper over the next three to five years, almost irrespective of how events play out in the short term.

Risks hiding in plain sight

There is considerable debate and uncertainty on whether inflation will re-emerge as a threat and whether central banks will be forced to tighten monetary policy. It is clear that the reopening of economies and pent-up

demand fuelled by expansive fiscal and monetary policies are resulting in constraints along supply chains and in labour markets. This has placed upward pressure on various goods and services such as building materials, certain commodities and transportation costs. It is likely these inflationary pressures will persist for some time.

The big question is whether these pressures will prove to be transitory – that is to say, disappear once supply chains normalise – or lead to more permanent inflationary pressures. Most central bankers say they think inflationary pressures will subside next year and they feel comfortable with their loose monetary policies. While we agree that this is the more likely outcome, we don't think people should be complacent about inflation risks.

There is a meaningful risk that we may enter a period of inflation that troubles markets. Even if you believe that inflationary pressures are more likely to be temporary, the most important question to ask is what happens if inflation pressures are not temporary. If central banks were forced to tighten monetary policy by reducing, or ending, asset purchases and increasing interest rates, we could witness a major correction in equity and other asset markets.

Other risks hiding in plain sight include some worrying asset price bubbles. It would be fair to say that we are witnessing one of the most extreme delusions in modern history, measured by the breadth of participation and size. This delusion has some powerful attributes: cult-like behaviour, rebellion against authorities, gambling, break-out technology, a fear of missing out and the madness of crowds.

You have probably guessed that the prime example of bubbles are cryptocurrencies with Bitcoin being the pin-up. To put Bitcoin into context, if it were a listed company it would be the seventh or eighth most valuable company in the world (depending on the day).

Devoted followers accuse doubters of not understanding blockchain or the role of cryptocurrencies. Calling out a cult is not popular, particularly when people are making 'easy' money. But in times of cult-like behaviour, the most important thing is to stay rational and not be afraid of being unpopular with the crowd.

Let's look at crypto gold

Perhaps the best way to show how weird all this is, is to imagine if someone were to create crypto gold.

Imagine this journey starts via a proposal to launch a gold exchange-traded fund backed by one metric tonne of gold (35,274 ounces). At market prices, the assets of the new gold ETF are worth US$65 million. The gold ETF has one million units on issue so the initial price per unit is US$65, which should move in line with the gold price. The new gold ETF is named GOLDCOIN and listed on a reputable stock exchange. There is nothing revolutionary about GOLDCOIN other than it offers an easy way for investors to trade in gold.

A genius colleague, Hideyoshi Son (excellent, virtuous, good and respectable), proposes some enhancements to GOLDCOIN:

- The total amount of gold in the ETF is fixed at one metric tonne
- The total maximum number of units that can be issued is capped at 20 million units (rising from one million to a maximum of 20 million over time)
- New units are issued to people who solve a complex mathematical riddle.

On review, we run into a problem: that the rules of the reputable stock exchange ban the issuing of units to new investors for no consideration. Not to be deterred, Hideyoshi Son says we need to create a mechanism to trade our product outside the system so we won't be constrained by stock exchange rules or, for that matter, laws or regulations. He suggests that units in GOLDCOIN be recorded on a new fully distributed ledger known as the blockchain.

This form of ledger changes everything, he argues. Most importantly, a blockchain ledger gives reliable proof of ownership but also total privacy – no one can find out who owns units in GOLDCOIN. Our new product is outside the constraints of the current system and doesn't have to comply with any anti-money-laundering laws, exchange rules, consumer-protection laws, etc. This provides GOLDCOIN with an enormous potential market.

We launch GOLDCOIN on the new blockchain but things don't go as planned. Each time we issue a unit to a person who solves the riddle, the value of a unit of GOLDCOIN falls. We are so stupid. Obviously when we

create units for no consideration the value per unit falls. In fact, once the total number of units reaches the maximum 20 million allowed, the value of GOLDCOIN will fall by 95% on a per-unit basis.

Hideyoshi Son sees the flaw in our product. The problem, he says, is that the asset backing of GOLDCOIN is fixed at one metric tonne of gold. The solution, I suggest, is to increase the asset backing up to a maximum 20 metric tonnes of gold, in line with the maximum number of units we can issue. If we do this, each unit will always be backed by 0.035 ounces of gold. We now have the perfect product, a digital form of gold where each unit is always backed by the same quantity of gold, that can be traded anonymously on the blockchain outside of the reach of authorities.

Hideyoshi Son says so far so good but we need to do something more radical. He says the proposal to fully back the product with gold won't work under the magic he is proposing where crypto mining and the solving of a complex riddle lead us to create another unit of GOLDCOIN. He says if additional units are backed by gold, and paid for, then no one will be motivated to solve the riddle.

He says the solving of a complex problem and setting a maximum limit on the total number of units that can be issued is essential to the psychology behind the illusion. He says to solve the problem of dilution resulting from issuing new units we need to remove the physical gold underpinning the value of GOLDCOIN. By removing any tangible asset backing from our product there can be no dilution when issuing new units – you cannot dilute something that has no value. He argues that people can be convinced that GOLDCOIN, with a capped number of units to be issued, is a new form of digital gold.

Sceptical me asked: *"How can something that is imaginary, with no tangible value, be more valuable than our original product backed by one metric tonne of gold?"*

Hideyoshi Son, a master of human psychology, says we have the perfect circumstances to create an illusion, one that defies the laws of economics and logic:

- Post the financial crisis of 2008-09 and the recent pandemic, millions of people are worried that the world's major currencies are being debased by excessive 'money printing' by central banks. He says placing a cap on the maximum number of units of GOLDCOIN that can be issued plays into these fears. He has inverted the law of dilution to a law of scarcity;

- Removing any tangible value from our product removes any anchoring bias around its actual value;

- The fact that ownership is untraceable, and the fact that it can be traded, makes units the ultimate medium of exchange for illicit activity;

- The riddle-solving (or mining as it was to become known) to win a newly created unit and the dazzle of the blockchain give our product mystical properties;

- Social media, with the right clickbait, will fuel unconstrained and widespread promotion of our product – no need to worry about legal constraints such as laws that demand a prospectus. He is most excited by a platform called TikTok due to its ability to attract a generation of first-time speculators. He guesses that as the price is driven up, more and more speculators will get on board. The mainstream media will become infatuated, thus giving GOLDCOIN legitimacy; and

- As momentum grows, more people will be attracted to this unregulated system of easy money. Entrepreneurial people will offer services such as exchanges and crypto wallets.

Hand it to Hideyoshi Son, a true genius. He has created the illusion of scarcity and hence value from something that has no intrinsic worth. Our product, he argues, will become the world's greatest Ponzi scheme. Some call his scheme a new digital currency or even crypto gold – highly amusing given that there is no gold backing.

The above illustration clearly is absurd and defies logic

This imaginary product has attributes that are similar to those of Bitcoin. In our opinion, it is virtually certain that, in time, cryptocurrencies that are not backed by assets or by a central bank will become worthless. It is

concerning, but not surprising, that regulators have not put in place appropriate regulations and consumer protections. They should.

Cryptocurrencies are operating outside the system, which enables their use for money laundering, terrorism, ransom, cybercrime and other illegal activity. It is inevitable that the regulators will catch up, and the day of reckoning may be approaching sooner than people expect. It is likely that this will end in tears for many people.

That said, while we are sceptical about the value of today's cryptocurrencies, we believe in blockchain technology and think it will have profound implications and disrupt many industries. We expect that most central banks in time will issue digital currencies and private asset-backed cryptocurrencies (or stable coins) will enter more common use.

With the explosion of government debt following the pandemic amid the money printing of central banks, the case for a gold-backed cryptocurrency grows by the day. Maybe there is some truth in GOLDCOIN after all.

Hamish Douglass is Co-Founder, Chairman and Chief Investment Officer of Magellan Asset Management, a sponsor of Firstlinks. This article is for general information only and does not consider the circumstances of any investor.

10 big ideas for 2021 - a mid-year update

Neuberger Berman

Editor's Note: The full White Paper (coming soon) 'Ten for 2021' mid year update is available here. In this summary, we have extracted the first paragraph from each section on 'what we've seen'. The full paper contrasts this with what was expected in November 2020.

Last November, the heads of our four investment platforms identified the key themes they anticipated would guide investment decisions in 2021. With the year now half over, we revisited these concepts to see how they've played out thus far and assess our outlook for the second half of 2021.

Macro: The world after the coronavirus

1. A return to early-cycle dynamics - but no substantial reflation
We think inflation is likely to fall back, but we are more sensitive to upside risk than at the start of the year.

What we've seen: The big change since we met in November is the sheer boldness of U.S. President Biden's fiscal plans. The $1.9 trillion American Rescue Plan was arguably baked into market expectations already, but there is a lot more to come. It's unclear how much will survive the legislative process, but it seems likely to be the "significant continuing fiscal stimulus" that we thought necessary to generate structural rather than transient, low base-effect inflationary pressure.

2. Populism is here to stay
If anything, geopolitical tensions are up and economic policy is becoming more explicitly oriented toward social equality-related targets.

What we've seen: Accusations of "vaccine nationalism," the frosty atmosphere at the first talks between China and the new U.S. administration in Alaska in March, and a hawkish NATO communiqué in June leave little doubt of the abiding and growing frictions in geopolitics and global economic relations. The U.S. has rejoined a number of multilateral agreements and institutions, as expected, but diplomatic efforts such as the end of the 17-year Airbus-Boeing trade dispute appear to be just as much about shoring up traditional alliances against China.

3. Accelerated digital transformation puts down roots
Evidence of longer-term investment in more and more sectors continues to build.

What we've seen: Evidence of a desire to continue working from home after the pandemic is mixed. 99% of 227 human resources leaders surveyed by Gartner during its *Workplace Re-Opening Amid Vaccine Rollout* webinar in March 2021 said that at least some of their workforce would be 'hybrid' after the pandemic, with 42% anticipating a majority to adopt hybrid working. Of the 4,264 employees in Gartner's January 2021 *Hybrid Work Employee Survey*, 84% prefer remote or hybrid over onsite working, and more than half said that inflexibility from their employer would make them consider changing jobs. *U.K. workers: a year in the pandemic*, a Deloitte survey published in April, suggested that twice as many workers would like to work from home all or most of the time, compared with pre-pandemic. The same survey indicated that more than a third of under-35s felt 'overwhelmed' by working from home, however, and other studies appear to find a similar desire to get back to the office among younger employees, often for the social and career-advancement benefits. Policy statements from major employers are also mixed, with most appearing to embrace some kind of hybrid arrangement.

4. Supply chains become shorter and more diversified
Business leaders appear to be moving supply-chain resilience and transparency up their agenda, and not just in the semiconductor industry.

What we've seen: While it is too early to say how profound and lasting these forces will be, we are seeing new effects on supply: this year's semiconductor shortage appears at least partly due to U.S. auto manufacturers shifting away from mainland China's suppliers, for example. Rising demand and national security concerns are leading to large commitments to domestic production. U.S. President Biden has pledged $50 billion to the cause as part of his administration's infrastructure spending proposals. Intel has committed $20 billion to build new fabrication facilities in Arizona. TSMC and Samsung have multibillion-dollar plans for new U.S. production capacity in Arizona and Texas, respectively. The European Union will use its pandemic response fund to target a doubling of its semiconductor manufacturing by 2030. South Korea has recently earmarked $450 billion for advanced chip manufacturing, India is offering more than $1 billion to companies that set up chip manufacturing facilities there, and chipmaking is a key element of China's latest Five-Year Plan.

Fixed income: static yields, volatile currencies

5. Low yields and flat curves demand opportunism in credit markets
Flexibility and a tactical approach across the full range of credit markets has been a key source of return opportunities.

What we've seen: The mix of early- and late-cycle characteristics has arguably been clearest in fixed income markets so far this year, where a rapid, 80-basis-point rise in U.S. Treasury yields in the first three months left credit markets virtually unscathed. Spreads in both investment grade and high yield markets actually tightened as investors scrambled to offload interest rate risk. Tighter spreads do increase the need to seek out some extra capital appreciation through tactical allocation, however - and attractive opportunities have arisen.

6. Macroeconomic dynamics will be expressed through currencies
Currency markets have been subdued and Treasury yields have been the big story so far this year.

What we've seen: While central banks do appear to have stabilized real yields during the first few months of the year, they could not prevent a run-up in longer-dated nominal yields and therefore a rapid rise in bond market inflation expectations. That run-up in yields coincided with a New Year rally for the U.S. dollar and a continuation of the secular decline in currency market implied and realized volatility. That said, the decline in credit-spread volatility has been still more pronounced, and alongside the quietness of the majors there have been a number of mini-cycles in emerging markets currencies, as well as some unanticipated strength in the renminbi.

Equities: cyclical opportunities, long-term themes

7. Secular growth stocks ultimately prevail over cyclical rallies
We still expect the shadow of secular stagnation to help growth stocks eventually, but current dynamics could extend beyond this year.

What we've seen: As we expected, given the very strong early-cycle flavor of so much of the economic data, cyclical stocks have pulled ahead of both defensive and growth stocks so far this year. What has surprised us is the sheer strength of the economic data and the speed with which value stocks have re-priced: by mid-June, returns to U.S. large-cap value were more than twice those to U.S. large-cap growth.

8. A thematic approach can help to uncover long-term growth
Long duration and strong performance in 2020 have caused thematic stocks to lag the market.

What we've seen: While we would have acknowledged, at the end of 2020, that base effects would ensure that the world was unlikely to be "low-growth" over the next 12 months, the extent to which it has turned out to be high-growth has surprised us. The corollary to that has been marked outperformance by value and cyclical stocks. Moreover, stocks associated with portfolio strategies focused on secular, technology-related themes such as next generation connectivity and mobility have tended to underperform growth indices as well as value indices, in some cases due to the duration of their earnings expectations and in others due to the strong performance they experienced during the height of the pandemic crisis.

Alternatives: resilience for growth, nimbleness for value

9. Resilient growth will be in favor - but it won't come cheap
Evidence of the quality-growth tilt in private equity portfolios continues to build.

What we've seen: The sector tilt of global private equity deals continues to favor traditionally higher-growth industries: according to Preqin, over the 12 months ending in April 2021, 48% of deal value was in information technology and health care, relative to a weighting of 36% for those sectors in the MSCI World Index. We see this tilt to higher growth in our own co-investment programs. During the first six months of 2021, and including investments still pending, 65% of the companies to which we committed co-investment capital were projecting annual revenue growth of 10% or more; six years ago that proportion was just 26%. When we look at earnings growth projections, which tell us more about opportunities for profit-boosting operational and strategic enhancements, we see even greater ambition: 83% of the companies we have invested in this year project EBITDA growth of 10% or more.

10. A continuing role for opportunistic and idiosyncratic strategies, liquid and illiquid
The year has started well for liquid alternatives strategies, particularly those reflecting themes of inflation, the value equity comeback and the search for yield.

What we've seen: The market dynamics described under theme numbers 6 and 7 - the sell-off in Treasuries, the up-then-down trends in the dollar, the complex push-and-pull between equity styles and sectors - provided a rich opportunity set for trading strategies and other liquid alternatives. Just as important, we believe they are also a reminder of how important it is to seek out new sources of diversification when Treasury yields are so low and inflation expectations are rising, rendering the traditional portfolio hedging asset potentially much less effective.

The full White Paper 'Ten for 2021' mid-year update is available here with more details on each of the above categories. Contributors:

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Four reasons many Australians will work until they're dead

Satyajit Das

The 2008 recession and the 2020 pandemic are hastening the end of retirement as we now understand it. The problems of chronic underfunding, low returns, longer lives and increasing aged care and medical costs are accelerating. The pressure has been exacerbated by individuals forced to draw on funds during the pandemic.

Average balances in super are insufficient

Australia's post-work savings system, a model for the world, illustrates the unsustainability of the arrangements. Despite its small population of about 26 million, Australia has over $3 trillion in private retirement savings. Mandatory contributions (currently 10% of pre-tax income) and generous tax benefits underpin this savings pool, which is one of the largest in the world.

However, the typical accumulated balance at retirement age is about $200,000 for men and about half that for women. The averages are artificially increased by a small pool of people with large balances yet are well below the $600,000 to $700,000 estimated to be necessary for homeowning and debt-free couples to finance their retirements, which may last 20 years or more.

The shortfall forces increased reliance on a government-financed pension, originally intended only as a safety net. About 70% of retirees are reliant in part or full on the state pension, which, at about 40% of average weekly earnings, is substantially lower than the 65-75% thought to be needed in retirement. With public finances stretched, access to the government pension is likely to become more restrictive over time.

Last year's Callaghan Retirement Income Review of the Australian system highlights how retirement arrangements will be forced to evolve.

The centrepiece is the proposition that retirees must live off their savings and the equity in their home, not only the earnings on their investments. Savings should not be seen as building a legacy or nest egg to be bequeathed to the next generation.

All savings must be exhausted and the family home monetised to fund living standards in retirement. In essence, your account balance should be at zero at the time of your and your spouse's death.

Given the need for shelter, this will necessitate taking out reverse mortgages (effectively borrowing against the value of the home with the debt to be liquidated on sale at death).

Policy prescriptions pose difficulties

First, households must borrow when there is no capacity to service debt. The loan and capitalised interest must be recovered from the eventual sale proceeds of the home. This is dependent on asset values. If population cohorts retire and die around the same time, it will place pressure on house prices which secure mortgage loans.

Second, reverse mortgages may not generate sufficient money to finance retirement. It assumes high levels of savings or home equity. This is compounded by the likely low loan-to-value ratio of a reverse mortgage because of the lack of cash interest payments and collateral value uncertainty.

There are difficulties in estimating borrower longevity and partner survival, something which has eluded mankind and actuaries alike. Commercial lenders may be reluctant to participate without government support or guarantees, which would increase the demands on state resources.

Third, the scheme favours existing homeowners. Housing unaffordability means that many in future generations will never own homes. They are simultaneously deprived of bequests from parental estates reducing their seed capital. Given the record numbers of children forced to move back in with parents, the liquidation of the family home may also deprive them of housing.

Fourth, the strategy entails running down the wealth stock of a country as savings are used up and houses sold. In effect, capital is consumed to finance current expenditures. In aggregate, the running down of savings will affect available investment resources across the economy, making the nation more dependent on foreign sources. Uncertainty of drawdowns may affect long-term investment decisions.

The problems highlight failures in economic and social policy. Low wage growth and lack of income security combined with consumerism has meant inadequate savings. Absurd economic policies driving down interest rates over decades have reduced investment income and cash flow. They have exaggerated housing prices, which are now apparently to be used to cover insufficient savings and inadequate investment cash flow earnings.

Paralleling the 2000 *Saturday Night Live* 'More Cowbell' comedy sketch, policymakers now see more debt as a panacea to every problem.

Retirement will revert to a privilege of the wealthy, supported by expensive, regressive tax subsidies which always favoured high-income earners. For the shrinking middle class, savings and state pension, as long as it is around, may prove insufficient. Most will ultimately be unable to retire, having to work, and work, and work till they die.

When the penny drops, this additional inequality will manifest as further resentment against the elites and the swamp with unpredictable political consequences.

Satyajit Das is a former senior executive and banker. His latest book is A Banquet of Consequences – Reloaded (Penguin March 2021) updates the 2015 edition with 150 new pages covering MMT, PPT (plunge protection team otherwise known as central bankers), the Trump/Johnson ascendancy, the climate emergency, accelerating resource scarcity and Covid-19. This article was first published in The Australian Financial Review and is republished with permission of Satyajit Das.

Economic recovery and its impact on commercial real estate

Steve Bennett

The pandemic is far from over, as the current lockdowns across the country attest. However, the recession that it caused, for now, is behind us. When it first unfolded, economists hypothesised how this recession may differ from others. The results are in, and for Australia at least, the pandemic-led recession was characterised by the magnitude of the downturn and the speed of the recovery. The initial downturn was sharp due to the introduction of wide-ranging restrictions (including movement of people) and the recovery was fast because governments moved swiftly to implement record levels of stimulus and the economy was not burdened by the hangover of a financial crisis.

Government stimulus has joined low interest rates and easing restrictions to fuel a rapid recovery in Australia and around the world. The global economy's pace of expansion is accelerating. According to the latest World Bank forecasts (June 2021 Global Economic Prospects), the global economy is set for the fastest recovery from recession in over 80 years. Australia's economic performance has also been impressive. Since mid-2020 the economy has had three of the strongest consecutive quarters of economic growth on record and a sharply falling unemployment rate, which is now at one of its lowest levels since 2008.

What does this mean for real estate?

There are both short and long-term consequences for real estate. However, the themes depend on the individual property sectors.

Industrial and logistics

Globally, capital demand for quality industrial property has driven the strongest period of growth the industrial and logistics sector has experienced in recent years, with leasing and transaction volumes at record levels.

Industrial & logistics sector real estate demand accelerated dramatically during the pandemic. Lockdowns drove Australians online for their daily requirements and substituted consumption which would have been spent on other activities, like travel. As a result, several years of online retailing growth was condensed within one year.

The sector is still adapting to this demand, with both leasing volumes and investment pricing reaching record levels. Additionally, certain businesses and tenants have begun to switch from 'just-in-time' to 'just-in-case' inventory strategies for improved resiliency. Some estimates expect typical inventories will increase 5-10% over the next two to three years. This provides positive flow-on effects to leasing demand as a result of increased space requirements.

Retail

Demand for convenience retail assets with long-Weighted Average Lease Expiries (WALE) has continued to be strong, especially if the asset is underpinned by a blue-chip tenant covenant and the essential nature of the use.

As the growth across the industrial sector has highlighted, this recession did not impact consumer demand for goods. The recent Australian Bureau of Statistics retail trade results remained ahead of expectations and retail sales have remained well above pre-pandemic levels both in aggregate and across nearly all categories. This demand has had varying impacts on retail real estate.

The grocery anchored (i.e. Coles, Woolworths and Aldi) and convenience retail sector has performed well over the year and is expected to continue to do so. However, the larger discretionary retail centres have been challenged by mandated social distancing and travel restrictions for both tourists and international students. While the larger centres will continue to evolve and remain relevant, other centres may not fare so well.

In contrast, household consumption over the past year has surged, particularly benefiting real estate leased to hardware stores and other large format retail tenants.

Office

Investment sentiment is improving and has been evidenced by several office properties trading at firm capitalisation (cap) rates (elevated prices), particularly for long WALE assets with secure income streams.

The movements in office vacancies have broadly reflected the economy's trajectory. The world has watched Australia's office re-entry closely as our comparatively lower COVID-19 numbers enabled the earlier re-opening of cities, although there is a setback in the current lockdowns. Mobility statistics suggest that office occupancies trace the easing of mandated restrictions, and although this may change over time, there is limited immediate evidence of reduced office demand from remote working strategies.

In many ways the past year was a forced experiment which increased the acceptance of remote working flexibility while simultaneously raising awareness around the purpose of an office. It highlighted the contributions an office has on knowledge, information flow, innovation, productivity, risk management and collaboration.

Quality offices provide environments which contribute to lower absenteeism, lower staff turnover, and better organisational performance.

This sentiment has been shared by a growing chorus of business leaders who have emphasised the importance of informal interactions, access to leaders, business hubs and the storage and transmission mechanisms of social capital.

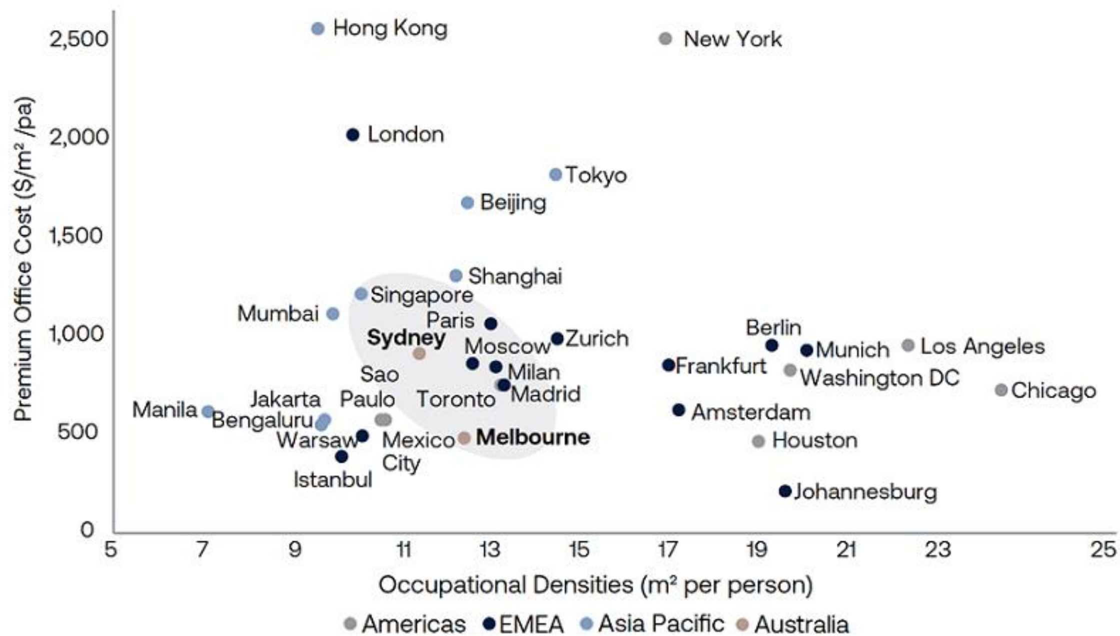
The cost-benefit of offices will continue to be weighed up by corporates: office costs can be approximately 10% of salary costs yet the boost to productivity with the collaboration and culture-building benefit an office brings can be significantly greater. As such, we believe the office market is likely to see more polarised demand between lower and higher quality office properties.

Most businesses and employees believe there will be increased flexibility in the post-pandemic era. However, increased flexibility does not necessarily translate into materially lower office demand. The balance of required

space will ultimately be influenced by the flexibility offered to staff and the de-densification. Over many years, businesses have placed more employees into smaller spaces but the pandemic is expected to halt or even reverse this trend.

According to a recently-released JLL Benchmarking Cities and Real Estate Report, pressures to de-densify will likely occur as office design evolves to support productivity, wellbeing and experience alike, and as organisations allocate more square meterage to collaboration and amenities in order to attract and retain high-quality talent.

Office occupational densities vs. occupational costs



Source: JLL Research, Charter Hall Research

We expect the economic recovery to continue, despite some inevitable short-term volatility as the pandemic recedes. The current lockdowns highlight the difficulty in making short-term economic predictions. However, it is the medium to long-term outlook that Charter Hall focuses on for investors and we continue to hold the view that the outlook for the Australian real estate sectors where we invest remains strong.

Steve Bennett is CEO of Charter Hall's Direct Property business. Charter Hall is a sponsor of Firstlinks. This article is for general information purposes only and does not consider the circumstances of any person, and investors should take professional investment advice before acting.

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'Wealth of Experience' podcast - markets rinse and repeat

Graham Hand, Peter Warnes

Season 1, Episode 4

Peter and I analyse, explain and have some fun talking about financial markets, stocks, products, trends and government policies.

Each fortnightly episode covers highlights in both *Firstlinks* and *Your Money Weekly,* and guests from the market. This week covers Top 20 stocks then and now, Brambles, defining retirement income, performance fees and Nick Griffin's ideas and outlook.

The podcast is also available via our dedicated website page, Google Podcasts, Apple Podcasts, Spotify, and BuzzSprout.

Please share with friends and colleagues, and a favourable rating would help spread the word. We welcome questions and suggestions at firstlinks@morningstar.com.

Here are some comments so far, thanks:

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So good to see a podcast coming from these two stalwarts of the Australian investing community. Frank, insightful and interesting commentary on the current and trending activities of the Australian stock exchange and financial marketplace. A+"

Grab a cuppa and settle in for our chat.

Reader Survey on retirement income

Firstlinks

There has been an excellent response in reader engagement and comments to our recent articles on retirement income.

Tell us what you think of the latest policy development in this short survey and the results will go to Treasury.

A recap on two of our most-viewed articles can be seen here and here.

Please take a few minutes to complete our survey on retirement income on this link.

Disclaimer

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