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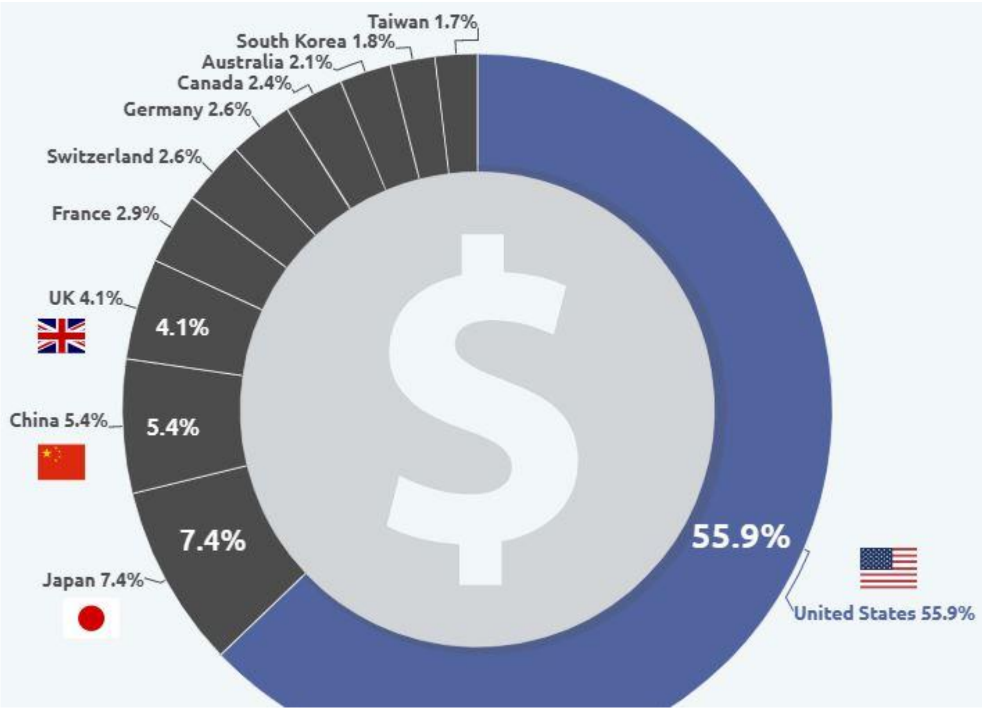
Contents

Editorial

We recently published an article with six stock picks which were all foreign companies, and some people complained that they only wanted to read about Australian companies. Come on, folks. That's like the old days of living in Australia on meat and three veg. The world offers far more variety and opportunity, with a greater range of excellent companies than Australia can ever offer. No investor should ignore the amazing opportunities in the US alone (although it is the home of hot dogs and bad coffee) a country that makes up over half of global stock markets. Australia is a tiny 2.1%.

Sizes of world stock markets by country in 2021



Source: Elroy Dimson, Paul Marsh and Mike Staunton, Global Investment Returns Yearbook, Credit Suisse, 2021, copyrighted. Used with permission.

The move by **BHP** to list all its shares in Australia creates further concentration risk in the local index. **Morgan Stanley** estimates that BHP's index weight in the S&P/ASX200 will rise from 7.2% to 11.7%, becoming

Australia’s largest company. Financials are weighted at about 28% of the index and materials would rise to about 24%.

That's over half the index in two sectors, one heavily leveraged to housing and the other to China. In contrast, US companies such as **Microsoft, Apple, Amazon, Google and Facebook** are among the best businesses the world has ever seen. Global footprints, billions of passionate customers, fantastic technology. Plus leading payment companies such as **Mastercard and Visa**, innovators such as **Tesla and Netflix**, consumer brands such as **Starbucks, Proctor & Gable, McDonalds, Gillette** ... the list goes on, and all well-known to Australian investors.

Check these leading US technology industries with their weighting in the **Morningstar** US Tech Index, and their returns this calendar year. Some Australian techs are impressive but they are relative minnows.

	Weight (%)*	Return (%)
Software - Infrastructure	29.56	16.38
Consumer Electronics	20.26	17.95
Semiconductors	18.08	11.07
Software - Application	12.44	13.20
Information Technology Services	7.30	3.03

Source: Morningstar Direct. Data as of Aug 8, 2021.
*Data is based on the Morningstar U.S. Technology TR USD Index.

In the case of the largest company in the world, Apple, it's fascinating to see what drove recent price gains. As **[Stone Fox Capital]** noted (refer to the chart below to see Apple's P/E expansion versus its share price):

"A lot of the stock price gains in the last few years are attributed to expanding P/E multiples. One only has to go back to 2016 for when Apple only traded at 10x trailing earnings. The stock now trades at nearly 30x trailing earnings, or nearly 3x the multiple from just five years ago. If Apple only traded at 15x trailing earnings, the stock would trade closer to $75, not $150. For this reason, the stock has struggled to break above $150 for a while now ... Investors should easily understand that any growth after reporting a year with 33% growth is impressive, but some post-covid slowdowns shouldn't be surprising."

So Australia has its banks, miners, supermarkets and those franked dividends we all love, but it's long past the time to get over the home country bias. It is now relatively simple to gain exposure to global stocks, such as via managed funds, ETFs, LICs, TraCRs listed by **Chi-X** in dozens of leading names or via foreign trading accounts with brokers. There are no excuses for a lack of diversification into global names.

Australia loves the 'we punch above our weight' image, but we are not even in the Top 10 stock exchanges with our market cap of less than US$2 trillion. The Top 10 are worth a combined US$91 trillion, up from US$78 trillion in only six months. Courtesy of **Finbold**, here are the largest exchanges and recent growth:

Stock exchange	Market capitalization as of January 2021 (in trillion USD)	Market capitalization as of June 2021 (in trillion USD)	Inflows in trillion USD for the period (H1 2021)	% change in H1 2021 (Jan vs Jun)
NYSE	$21.36	$25.30	$3.94	18.45
Nasdaq - US	$19.34	$22.11	$2.77	14.32
Hong Kong Exchanges and Clearing	$6.47	$6.80	$0.33	5.10
Shanghai Stock Exchange	$6.50	$7.61	$1.11	17.08
Japan Exchange Group	$6.35	$6.69	$0.34	5.35
Euronext	$4.88	$6.45	$1.57	32.17
Shenzhen Stock Exchange	$4.90	$5.76	$0.86	17.55
LSE Group	$3.67	$3.71	$0.04	1.09
TMX Group	$2.50	$3.16	$0.66	26.40
National Stock Exchange of India	$2.57	$3.07	$0.50	19.46

While the index has its issues, the local market offers plenty of choice for bottom-up stock pickers, and **Anthony Aboud** describes five stocks which have delivered well for his portfolios in the last year.

And in recognition of the value placed on franking credits by many of our readers and renewed attention as part of the retirement income debate, **Jon Kalkman** gives a clear explanation of why the current franking system is fair. Critics are missing a major point.

Among the increasing number of people trading directly in the market, many are using the new broking platforms which seem to offer cheap fees with decent functionality. However, like **Robinhood** in the US, they may be covering their expenses in different ways, and **Travis Clark** explains what to look for. Maybe saving a few dollars on brokerage comes with other costs.

Emerging markets seem to offer strong growth potential with high commodity prices and cheap exchange rates after more than a decade of relative underperformance versus developed nation stocks. Many leading firms such as **Goldman Sachs, Bank of America** and **Lazard** have issued bullish predictions as vaccine rollouts build. **James Johnstone** explains the opportunities, although stock selection matters as China's regulatory push hangs as a cloud over Asia generally.

One of the great success stories of the last year is thematic ETFs, allowing investors to back a theme, commodity, sector or trend. **Kongkon Gogoi and Zunjar Sanzgiri** take a deep dive into what these ETFs offer and how they sit in most portfolios.

The Sponsor White Paper this week from **BetaShares** takes this a step further by exploring its range of thematic ETFs and how they may meet particular investment needs.

And since we still love our residential properties ...

For all the attention we give to equities and stocks, for most Australians, nothing beats their love of residential property and all the more so as prices go gangbusters. But much like the ACT did a few years ago, NSW is planning a major overhaul of up front stamp duties in favour of an annual property tax. How will it work and why is the **NSW Government** picking favourites?

Then **Julie Steed** explains how some people can access funds under the First Home Super Saver scheme, which is growing in usage since the increased in the maximum to $100,000 a couple. All governments continue to look for ways to help first home buyers into the market.

This week's Comment of the Week comes from **Steve** on our article with three great tables on long-term investing, which has received over 11,000 views and many requests from financial advisers to republish. Steve asks a legitimate question for retirees facing drawdown and not only accumulation:

"How does the argument hold up (re number of years with no capital losses) if we assume dividends are spent to fund retirement and not reinvested? Further, what is the impact on capital if a fixed level of money is taken

each year (say 4% or 5%). This might start to approach a real world post-retirement situation. Anyone can grow assets if they never spend anything, but that only covers the accumulation phase. What about the retirement phase?"

Tax reform favours apartments and owner-occupiers

Graham Hand

The NSW Government is pressing ahead with its proposal for a radical reform of residential property stamp duty, with the recent release of another progress paper. The stakes are high for buyers and sellers in the largest asset class in Australia.

Despite widespread public and media discussion, a major point is overlooked. As proposed, the reform not only treats investors and owner-occupiers differently, but the impact on houses versus apartments is materially distinct. Currently, stamp duty is based on the purchase price and it is the same for a $1 million house as a $1 million apartment, irrespective of who buys it (with some exceptions for first home buyers). The proposal will replace stamp duty with a property tax based on unimproved land value (ULV).

Depending on the location and build quality, the land value of an apartment might be only 5% of the purchase price, whereas the land is often around two-thirds of the value of a house.

For the reform to be revenue neutral, house owners will pay far more and subsidise apartment owners. This must be known to NSW Treasurer, Dominic Perrottet, which means it is a deliberate part of the policy, and begs the question: why is the NSW Government favouring apartments over houses?

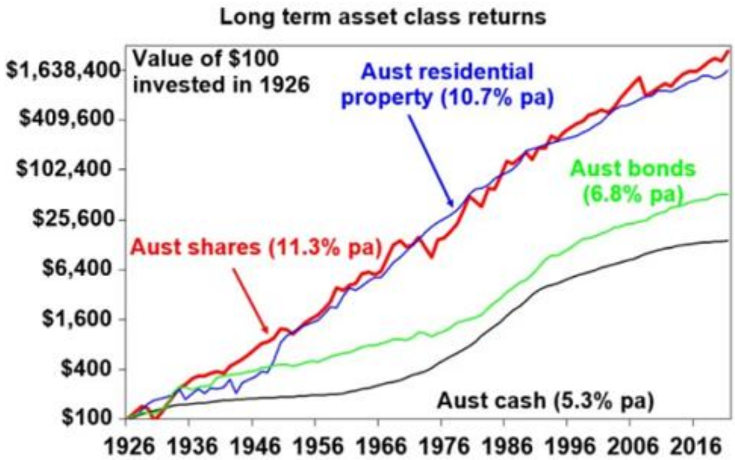
The numbers are big. Stamp duty raised $8.3 billion in NSW last year, of which 75% was residential purchases. Stamp duty is the largest source of state taxation revenue after payroll tax.

Australians hold most of their wealth in residential property:

- Total value of residential real estate: $8.8 trillion (total superannuation assets $3.1 trillion, total value of all listed stocks, $2.8 trillion, total value commercial real estate, $1 trillion)
- Number of dwellings: 6 million
- Total mortgage debt: $1.9 trillion
- Proportion of household wealth held in housing: 54.3%
- Sales in last 12 months: 592,622 dwellings worth $404 billion.

Source: CoreLogic Monthly Chart Pack, August 2021.

Over the long term, with a few blips, Australian residential property has been a wonderful investment, rivalling shares. Even better, it is easy to leverage into property, creating unbeatable returns on own capital invested. Sydney residents who bought modest three-bedroom homes in the inner west 30 years ago are now wealthy beyond their dreams as their houses now fetch $3 to $4 million.



Source: AMP Capital

What is the stamp duty reform?

The main features of the proposal are to replace up-front stamp duty with:

- An annual tax based on ULV.
- At the time of purchase, buyers can choose to pay the annual property tax instead of stamp duty and (where applicable) land tax. From that point onwards, all subsequent owners must pay the property tax and cannot select the up-front option.

- Price thresholds would initially limit the number of eligible properties to reduce the adverse impact on government revenues. With a desire to ensure 80% of residential properties are eligible, the threshold is likely around $2.5 to $3 million (above which current stamp duty rules will continue to apply).

The proposed annual property tax rate is:

- Owner-occupied, fixed fee of $400 plus 0.3% of the ULV
- Investor-owned, fixed fee $1,500 plus 1.1% of the ULV.

In the latest report, Perrottet makes some ambitious claims:

"It would stimulate home ownership, grow the economy and create jobs. It is estimated that, as a result of reform, more than 300,000 NSW residents could achieve their dream of home ownership and Gross State Product could increase by 1.7% ... The proposal, originally outlined in the November 2020 NSW budget, has generated a groundswell of public interest. Over the past six months we have conducted extensive community consultation, hearing from thousands of individuals and hundreds of community and business groups."

Apartments versus houses

Let's consider the example of a house and apartment both with a market value of $2 million, and assume the ULV of the house is 66% or $1.32 million but for the apartment it is only 5% or $100,000 (that is, the total value of the land divided among say 200 apartments).

The current NSW stamp duty is the same for both, at $94,862.40 (stamp duty escalates quickly at a marginal rate of 7% over $3,194,000 but this price is not likely to qualify for the reform).

Under the new rules, here are the annual property taxes for these two properties.

Annual property tax for different owners and types of dwelling

Type of owner	House	Apartment
Owner-Occupier	$ 4,360.00	$ 700.00
Investor	$ 16,020.00	$ 2,600.00

That's a range of over $15,000 EVERY YEAR that does not exist at the moment. It does not sound much in the context of the total up front cost of a house, but an investor planning 20 years of ownership might consider $320,000 too much of a burden and opt for the up-front stamp duty.

Property buying is already an inefficient market. Owner-occupiers borrow at cheaper rates and are exempt from capital gains tax on a principal place of residence. Under current laws, stamp duty is not tax deductible for investors but it is added to the property's cost base for capital gains calculations on sale. Land tax is not deductible for owner-occupiers but it is for investors who earn income from the property. The reform would introduce another set of different annual costs which may distort demand further.

Under the proposal, owner-occupiers and apartments have significant advantages. An annual fee of $16,000 on this house is a hefty 17% of the up-front stamp duty. Hold the property for longer than six years and the stamp duty might be a better option. In this house example, an owner-occupier has an advantage of $11,660 over the investor EVERY YEAR, which is clearly what the policy is aiming to achieve.

And here's a twist. If an owner-occupier buys a house and opts for the property tax, a subsequent investor buyer is stuck with the higher annual tax when they might have preferred a one-off stamp duty. Will investors be discouraged from buying houses where they are forced to pay high property taxes, creating a distorted market?

Many people buying a house to live in need as much money as possible at the start and most are likely to opt for the annual tax. The average holding period of a home in both NSW and Victoria is about 12 years.

The policy intentions and distortions are deliberate

The reform would encourage more people to move homes, such as downsizers who have superannuation incentives (eg, a couple can put $600,000 into super) but are discouraged by up front stamp duty. This might have the attractive social consequence of freeing large homes for the next generation of families, and it is preferable if people occupy homes that suit their needs.

Not surprisingly, the peak body that objected to reforms of negative gearing and capital gains tax is backing this change. The Property Council of Australia said in its submission on the proposal:

"Stamp duty distorts business decisions, locks families out of housing choices, worsens housing affordability, suppresses economic activity and leaves governments with highly volatile revenue streams … It is a tax that is a relic from our colonial past, representing a stamp of the state's authority over property transaction that has absolutely no economic relevance in our modern Australia."

The latest Government report says:

"Some stakeholders were interested in how the shift to ULV could influence property development. Some stakeholders noted the use of ULV could potentially favour apartment development as it is likely apartment owners would pay less property tax than those that own houses due to the amount of land required for each dwelling."

Specifically, The McKell Institute submission noted (15 March 2021):

"The proposed calculation method on 'unimproved land value' would incentivise high-rise development by making low and medium density housing comparatively more expensive. Taxing land rather than capital will encourage substitution of capital for land. In other words, developers will use more capital (building materials, engineering etc.) per unit of land, build up rather than out."

And the Urban Development Institute of Australia noted (15 March 2021):

"Because property tax is on the unimproved land value, low density homes will pay significantly more property tax than higher density homes in similar locations. This will encourage the construction of more medium density properties. This will be important for planning policies to support this shift, to maintain affordability."

Some consequences of adoption

The NSW Government hopes home ownership will increase as a prohibitive up front cost would be removed. This should benefit first-home buyers who have had less time and ability to save a deposit. Owner-occupiers are deliberately favoured, and home turnover should increase.

Or is this like many home buyer schemes where the incentives simply lead to higher prices, and nothing is achieved for the buyer? The Government argues:

"While removing stamp duty alone would cause upward pressure on home prices, that pressure would be counteracted under this proposal by the introduction of the property tax."

I don't believe that's how the property market works, at least for owner-occupiers. The reason why residential properties are surging in price at the moment is the ability of purchasers to borrow at low interest rates. Buyers calculate what they can afford, almost irrespective of how expensive homes have become. By taking stamp duty off the table, owner-occupiers can afford to pay more. It's likely owner-occupiers will see the land tax in the same way they see council rates. It's part of the cost of ownership which has been deeply rewarding for most participants.

And while for social reasons, it's easy to understand why the Government wants more people to own the home they live in, the policy favouring apartments over housing is more of a mystery. Stopping urban expansion? Increasing density to encourage more affordable housing? This part of the policy is going against the momentum of more people wanting to buy houses and move away from high density dwellings in major cities.

The Government should not assume the switch to a property land tax is best for everyone. It is for an owner-occupier buying an apartment but may not be for an investor wanting a house. And since tax rates and ULVs can rise, a retiree who bought a family home 30 years ago may regret not paying stamp duty up front each time the annual land tax bill comes in.

Graham Hand is Managing Editor of Firstlinks. This article is based on a current understanding of the proposal, which may change in final form if adopted.

Let's make this clear again ... franking credits are fair

Jon Kalkman

The recent retirement income reviews have again raised the vexed issue of franking credits and how they are calculated. However, an important bit is missing. Many seem to still believe that franking credits are a tax refund for owning shares and that it only applies to retirees. Not true.

What are some critics missing?

A franking credit is not just a tax refund but **also additional taxable income**. Each shareholder, as part owner of the company, is responsible for including in their personal income tax return, their share of the company's profits, not just the bit they receive as dividend. The taxable income of shareholder/taxpayers **must also include the company tax previously paid to the ATO before the dividend was distributed** as well as the cash dividend they receive in their bank account.

Imagine a company with 1,000 shareholders each with equal shares and assume the company makes $2 million profit. By law the company must pay company tax at 30%, or $600,000, leaving $1.4 million in after-tax profits to be deployed at the discretion of the directors.

Assume the company has a policy of paying 50% of its profits in dividends, that is, a payout ratio of 50%. Dividends are paid out of after-tax profits. With $700,000 to be distributed among 1,000 shareholders, each shareholder receives $700 in dividends.

As part owners of the company, each shareholder receives a dividend of $700 in their bank account, but their taxable income is actually $1,000 because it must include the company tax pre-paid on those dividends. That is why the dividend needs to be 'grossed up' in the tax return to include this company tax component. Each dividend statement clearly identifies this additional taxable amount.

Too many people miss this point.

The money is already paid to the ATO

The bad news is that each shareholder is responsible for tax on income, already held by the ATO, that they never received. The good news is, that because this money is already held by the ATO, it is available as a tax credit to pay some or all of their personal income tax.

It is called a franking credit simply because it is pre-paid.

All Australian taxpayers are subject to the same income tax laws. It makes no difference whether the taxpayer is a salary earner, church, union, retiree, super fund, company, family trust or non-working spouse. In each case, a dividend of $700 from this company translates into additional taxable income of $1,000. The franking credit has the same value to all shareholders regardless of their marginal tax rate, in this case $300.

For Australian shareholders, what happens next depends on the individual shareholder's marginal tax rate. If they are required to pay 49% tax on any additional income, they would expect to pay $490 on a taxable income of $1,000 they receive from this dividend. The money already held by the ATO ($300) now becomes a tax credit. Therefore, the taxpayer only has to find an additional $190 to pay their tax on the $700 dividend that was deposited in their bank account.

If the taxpayer had a 30% marginal tax rate, their tax liability would be $300 and their tax credit would also be $300. In other words, the tax credit has cancelled out their tax liability.

As the new legislated tax cuts come into effect, the 30% tax bracket will extend to $200,000 in income. It means that, assuming all the income is derived from franked dividends, a taxpayer could earn a large income from these dividends and pay no additional tax because the franking credits attached to those dividends cancel out all of the tax payable on that income.

In this way franking credits can be used to pay some or all of a taxpayer's personal tax.

Super funds and zero taxpayers

A super fund in accumulation phase is required to pay 15% tax on its earned income. Its tax liability on $1,000 is $150 but the tax credit is $300. Similar to an employee who finds that, if the tax paid by their employer on their behalf exceeds their tax liability (based on their taxable income, deductions and tax offsets), they are entitled to a tax refund of any excess tax. In this case the super fund is entitled to a refund of $150.

If the taxpayer has a zero marginal tax rate, the tax liability is zero but the tax credit is $300. Since 2001, any franking credits collected on behalf of a taxpayer that exceeds their legal tax liability is refunded as cash. It means that this taxpayer, like the taxpayer above, receives a cash refund of unused franking credits from the ATO. This is because it is additional income on which no tax is payable.

There are several types of taxpayer who have a zero marginal tax rates. They include universities, unions, churches and since 1992, all super funds that pay a pension.

Industry super funds are single taxpayers paying tax on behalf of all their members, some of whom are in accumulation phase and some in pension phase. In most industry super funds, these franking credits will be used to pay the fund's tax liability that stems from income from all sources on behalf of all their members and the pension fund's tax-free status will be reflected in their unit prices.

An SMSF in pension phase has no other tax liability and so the tax on that income is zero regardless of the size of that income. That is why Treasurer Morrison in 2017 introduced the Transfer Balance Cap (now $1.7 million) to limit the size of that tax concession. To the extent that SMSFs in pension phase invest in fully franked Australian shares, the franking credit refund can represent up to 30% of the income earned by the fund. The same is true of all the other taxpayers whose marginal tax rate is zero.

All Australian shareholder/taxpayers benefit from the pre-paid company tax that needs to be accounted for in preparing their own tax return. For some taxpayers it can be used to reduce or eliminate their personal tax liability. For others, if they have unused tax credits because their marginal tax rate is less than 30%, it means a cash refund.

The size of the cash refund has nothing to do with the taxpayer's age or employment status, it is simply a function of their marginal tax rate.

If there was no company tax and profits were simply distributed as dividends, Australian investors would just pay tax on their share of a company's profit at their marginal tax rate (but foreign investors would pay no tax at all in Australia).

It is a fair system

The franking credit system is complex but fair because it ensures that foreign investors always pay Australian tax on their share of a company's profit at the company tax rate.

Because the franking credit system adds the company tax portion back on to personal taxable income, it ensures that Australian investors always pay tax on their share of a company's profit at their personal marginal tax rate.

That is its strength.

Jon Kalkman is a former director of the Australian Investors Association. This article is for general information purposes only and does not consider the circumstances of any investor.

Five stocks that have worked well in our portfolios

Anthony Aboud

In a crazy 12 months for markets, it became clear to us that what was a logical and compelling macro view one moment could fundamentally change a few months later. While we cannot completely divorce our macro view from bottom-up stock picking, we resisted the temptation to make investment decisions based substantially on our macro view.

Picking macro trends is incredibly difficult and if FY21 taught us anything, it is to keep an open mind. We cannot change the past, but we can learn from it. The core of our investment decisions will remain our fundamental bottom-up stock picking.

Here are five stock ideas which have worked well for us.

Eagers Automotive (ASX:APE)

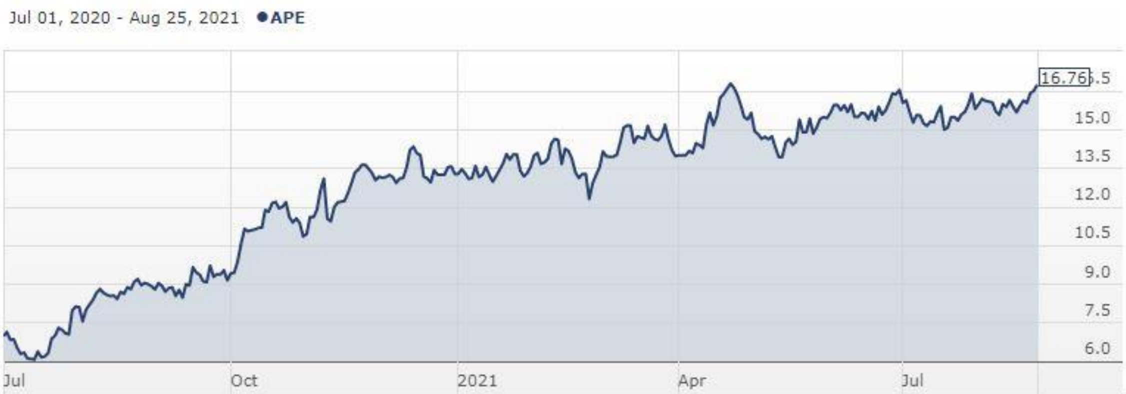
We spend a lot of time looking at cyclical companies. We are not afraid to own companies exposed to a cycle. The opportunity generally arises in the stock market at the low end of a cycle when earnings momentum is negative. This is often met with a weak share price as momentum investors, passive funds and quant funds tend to sell when a company downgrades short-term earnings. The opposite also happens. When there is an up-cycle, earnings momentum is positive and this is usually combined with a strong share price and positive analyst recommendations. This is despite the mid-cycle valuation not really changing.

APE is a good example of this. In February and March 2020 there were on average four buy recommendations despite the share price languishing between $3/share and $4/share. Currently with the share price over $15/share the number of buy recommendations from sell side analysts has doubled to eight.

The important formula is to make sure you own the best managed company in the space, which has a strong balance sheet to take advantage of bargains at the lower end of the cycle - either through mergers and acquisitions or strategic investments. Going into COVID, the auto retailers were already going through recessionary conditions. There had been more than two years of negative industry new car sales and regulatory changes made it more difficult to generate commission from finance products.

In the middle of this, APE took advantage of its strong balance sheet and excellent management team to buy its biggest competitor AHG. We like this sort of move at the low end of a cycle, however, it is easier said than done. During the middle of COVID, APE fell below $3.00/share in March 2020. For our sins, we continued to buy all the way down. We got comfort from the strength in the management team, the strength of the balance sheet and the experience of the board. We felt that mid-cycle earnings for APE would be around $0.60/share conservatively, and hence we thought we were getting a good price at $3-$4/share.

The stock rallied hard over FY21 and finished the year at over $15/share. While we were happy that we kept our nerve when everything was looking bad and everyone was selling the stock, we also got a bit lucky. For a variety of reasons, there is a global shortage of microchips which are essential for new car manufacturing currently. This has stifled supply of new cars. At the same time, change in consumer behaviour has seen a big spike in demand for cars. This has resulted not only in car volumes bouncing back (something we thought would naturally occur as the cycle turned) but margins are at record highs (something we didn't predict).



Iluka Resources (ASX:ILU)

The summary of our investment view was that we liked the supply side set up for both the zircon and high-grade chloride feedstock markets and that if demand were to start to rebound, the market would tighten up and pricing would follow. We also thought that there was optional upside with the company's rare earths opportunity in its tailings deposit in Eneabba.

Since the beginning of November, the Iluka share price has rallied 73% and has been a large contributor to our performance. Already in 2021, contrary to market expectations, we are seeing this tightness lead to price increases. We expect the zircon market to remain in a structural deficit over the next few years and view the price increases as sustainable. The other major part of Iluka's revenue stream is from titanium feedstocks (used to make pigment) and this market has also tightened significantly.

On the project side, we feel the market is only beginning to recognise the potential of Iluka's Rare Earth assets. The major advancement during 1H21 was a letter from the Federal Government for funding support (non-recourse loan) for the construction of a REE refinery in Australia by Iluka as part of the Strategic Mineral Policy. Despite the very strong share price performance over the past ~6 months, we remain positive on the outlook for the business and continue to hold a significant position in the fund.

Boral Ltd (ASX:BLD)

During March 2020, BLD's share price fell from $4.50/share to a low of $1.80/share. The stock had been weak heading into this period due to underwhelming performance in the US business and a slowing cycle being compounded by increasing competition in the core Australian market. As markets fell materially on the initial COVID panic, the market became concerned about BLD's balance sheet and the ability to withstand a long period of subdued operating conditions.

BLD's NTA at the time was $2.10/share and we accumulated a decent position in the fund around this level. Our view was that even considering the COVID related uncertainty, the business was worth materially more than NTA and had significant optionality within its portfolio of assets. Our view was that the Australian business had sustainably delivered returns on funds employed of ~14% over the last decade and thus deserved to trade at a material premium to NTA. We see the Australian construction materials business as high quality with hard to replicate assets including its quarry base.

We also noted the investment the company had made in Australian quarries in recent years ($380m) which had yet to generate full returns. We felt the US business was also worth materially more than its NTA value. In terms of the balance sheet risk, we felt that the market was too focussed on the leverage ratio of the business in an environment where the earnings were depressed and overlooked the optionality the business had on the asset side of the balance sheet. In particular, BLD has a number of surplus property assets in Australia that we felt could have been sold to strengthen the balance sheet without impacting the earnings power of the business. Given this relative comfort and the view that the business was materially undervalued on a mid-cycle view and verse NTA, we continued buying on the weakness.

Over the last financial year, the optionality we saw within the BLD portfolio has played out. BLD sold its 50% share in the plasterboard JV for US$1.015b or 15x FY20 EBITDA. It has also sold its US building products business for US$2.15b and is currently exploring a sale of its North American Fly Ash business which could release another $US1b.

Post this sale, BLD will no longer have any operations in the US and will be left with just its Australian construction materials business which is the #1 in the Australian market. Seven Group (ASX:SVW) launched an off-market takeover for BLD at $7.40/share after initially buying a 10% position at $3.11/share in June last year. In our view, at this price the assets of the business are fairly valued and thus we have sold the position to SVW at $7.40/share.

Woolworths (ASX:WOW)

Woolworths has been a great investment for us over the last five or so years. We started buying it in mid-to-late 2016 and have been holders to varying levels since that time. Our initial interest was aroused as the share price waned in light of the over-earning, complacent core supermarket business making an ill-fated venture into the hardware market through Masters, made possible by a weak management team and Board. The core grocery business still retained much that was good, but its high margins were not only unsustainable, they had also attracted competition from the likes of Aldi and Costco.

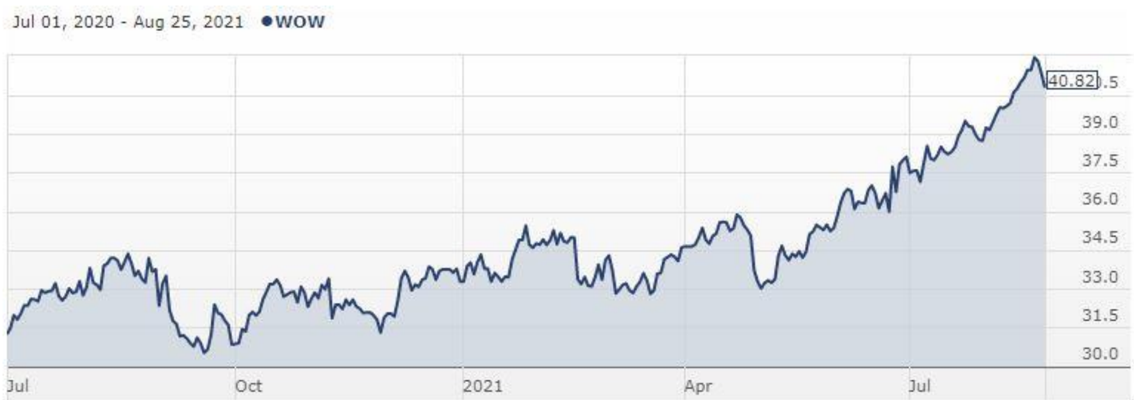
From our perspective, that changed with Board refreshment and appointment of the current management team. We looked favourably on the overall operating assets, balance sheet and turnaround strategy of the company. Initial strategic steps included selling out of Masters, replacing store roll out with upgrades to the existing supermarket store network and sacrificing short term margins for longer term sustainable growth. More generally, Woolworths under this new (current) leadership took short, medium- and long-term strategic decisions centred around resetting itself as a genuine value proposition to customers. This meant becoming increasingly sustainable and defendable over time through sound behavioural practices and solid investment across all aspects of business. Investment has been very substantial over the past five years and while never 100% without hitch, Woolworths is increasingly effective in presenting the most compelling customer offer in the marketplace.

Woolworths is now beginning to grow its overall and already market-leading food market share. Woolworths has a 50%+ market share in the online grocery market in Australia despite having only 37% market share in the traditional land-based grocery market.

We believe that as far as loyalty, digital, data, supply chain and store footprint, Woolworths is materially ahead of any of its national competitors. Just the Australian Woolworths food business has almost 13m active loyalty customers, 12.5m weekly visits to its app or online and almost $4bn annual online sales (growing up 92% in H1 21). The numbers are mindblowing.

The most interesting aspects for me are the customer loyalty and further aligned activities possible for Woolworths within a growing ecosystem of interconnected goods and services. Potentially future developments and innovation will further fortress the Woolworths core food operations with adjacent earnings and unlock the value that is inherent within this enormous customer database. Extensive infrastructure built out over time including important consumer protections, embedded behavioural practices and management accountability added to now incrementally growing scale is expected to offer increased leverage and earnings growth into the future.

While this was the picture over several years, Woolworths was a detractor from relative performance over FY21 generating a return of 18.5%. That is a good annual return, however was a drag on relative performance given the market was up just under 30%.



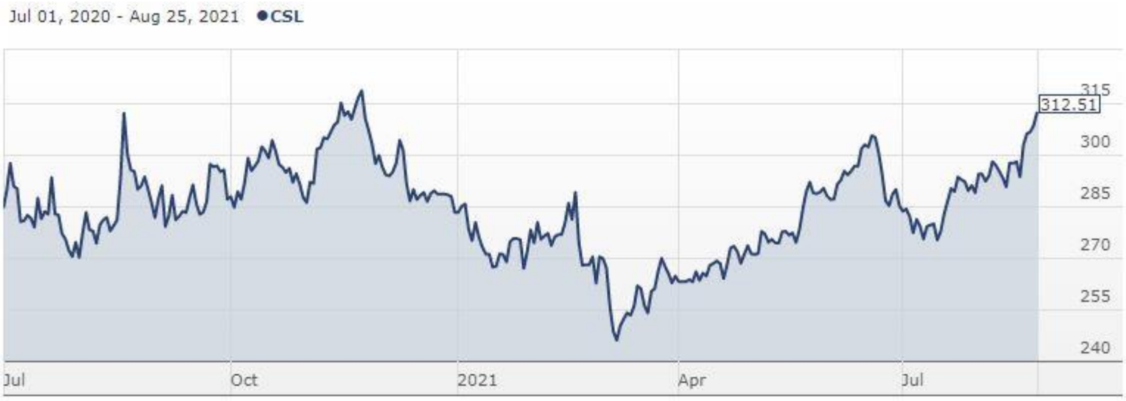
Despite underperforming in FY21, the stock has performed strongly already in FY22 following the spin-off of the Endeavour Drinks division. While the share price may have gotten ahead of itself in the short term, we believe

Woolworths has a good growth outlook which should be able to deliver earnings no matter what the macro environment supported by a stellar balance sheet.

Underweight (avoiding) CSL

As a value manager, generating alpha from being maximum underweight a company like CSL Limited (ASX:CSL) when it underperforms should be a given. No value manager can look at you with a straight face and tell you that buying a specialist pharmaceutical company at 40x+ P/E (double its overseas equivalent companies) is a value investment.

We have been maximum underweight CSL as we are value managers and no matter what way we look at the valuation, we have and continue to believe that CSL is overvalued. Generating alpha from not owning CSL when it underperforms is pleasing given the alpha which it has detracted on the way up, however, this should be a given and hence we don't take credit for that. As a fundamental value manager where we think we can add value is avoiding some stocks which cosmetically look cheap but are in fact value traps.



The fund was short or did not own AGL, AMP, Aurizon, Coles, Lend Lease, Cimic, Amcor, IAG and QBE for most of this year. These are all traditional value-style companies and all underperformed the market materially. We spent a lot of time analysing these companies and, for one reason or another, felt that while cosmetically cheap a lot of them were value traps.

Anthony Aboud is a Portfolio Manager at Perpetual Investments, a sponsor of Firstlinks. This article contains general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. Stock charts are provided by Morningstar.

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Thematic ETFs: is the juice worth the squeeze?

Kongkon Gogoi

With co-author Zunjar Sanzgiri

Thematic funds were long viewed as esoteric, but not anymore. The 'black swan' event of the coronavirus pandemic proved to be a paradigm shift for thematic exchange-traded funds (ETFs). Burgeoning demand for funds focussed on environmental, social, and governance factors is a classic example of this. The outbreak of COVID-19 evoked investors' sentiment toward disruptive trends and sustainable investing across the world, opening a long runway for growth for thematic ETFs.

What is a 'thematic' ETF?

Our definition of thematic ETFs is based on intentionality rather than fund holdings. To identify intentionality, we have relied on a combination of fund names (a strong indicator of intentionality) and information gleaned from prospectuses, marketing materials, index methodologies, and Morningstar's own proprietary data points (such as investment objective) where possible. We have limited our universe to equity ETFs and excluded other asset classes, most notably fixed-income ETFs.

Sustainable funds are included, provided they seek to capture a specific theme. This means that alternative energy funds, which aim to capitalise on the transition to a low-carbon economy, are included, but most broad ESG funds, which select a diverse group of stocks based on ESG scores, fall out of scope. Funds like the **BetaShares Climate Change Innovation ETF** (ERTH), which tracks a climate solutions theme, are included, but broad-based ESG-focussed funds like **VanEck Vectors MSCI Australian Sustainable Equity ETF** (GRNV) are excluded. The thematic funds taxonomy is elaborately noted in our latest Global Thematic Funds Landscape report.

The Australian thematic ETF market composes just over 1.7% ($1.9 billion) of the total ETF funds under management. However, the thematic market has seen a significant uptick over the trailing one year, with six out of a total of 11 Australian thematic ETFs launched during this period. This may reflect investors' increased appetite for thematic investing.

Thematic ETFs, if chosen carefully, have the potential to complement an existing diversified portfolio with added alpha, but the risks are notable.

Setting expectations amid rapid change

Setting specific performance expectations from thematic funds is hard. Many strategies with more-esoteric themes have short track records, and distinguishing whether the underlying theme is really a transformational trend or simply the latest fad takes time. In the interim, factors like regulatory scrutiny, further technical advances, or a shift in investors' collective psyche may result in an abrupt boom or bust of a particular theme. In either scenario, however, forming a forward-looking view on absolute or relative performance can be precarious. As such, thematic funds are not suitable as the main building blocks for a diversified, goal-focussed portfolio.

Is the juice worth the squeeze?

Thematic funds are designed to exploit emerging trends, not to provide diversified, risk-controlled exposure. They are concentrated in their respective sectors of interest and often rely on a relatively fewer number of stocks compared with the typical diversified offerings.

Exhibit 1 highlights these traits for Australian thematic ETFs. The risk of capital loss is high as sector- or industry-specific idiosyncrasies have a huge bearing on the performance of such funds. Adopting a passive approach in such scenarios can add more risk given the little (or lack of any) qualitative oversight. As a result, investors may experience a rougher ride due to higher levels of volatility.

Exhibit 1: Thematic ETFs are generally concentrated in a few sectors

ETFs	Ticker	1 Yr Vol	3 Yr Vol	# of Holdings	Top 10 Assets	Energy	Materials	Industrials	Consumer Discretionary	Consumer Staples	Healthcare	Financials	IT	Comm Services	Utilities	Real Estate
BetaShares Climate Change Innovation ETF*	ERTH			95	40.2%	0.0%	5.8%	36.9%	18.6%	1.2%	0.0%	0.5%	30.2%	0.0%	6.4%	0.4%
BetaShares Cloud Computing ETF*	CLDD			36	42.9%	0.0%	0.0%	0.0%	5.1%	0.0%	0.0%	0.0%	84.5%	5.1%	0.0%	5.3%
BetaShares Glb Rbtc & Artfcl Intlgc ETF	RBTZ	12%		34	73.2%	0.6%	0.0%	45.9%	1.8%	0.0%	13.9%	0.0%	37.5%	0.4%	0.0%	0.0%
BetaShares Global Cybersecurity ETF	HACK	18%	21%	40	47.1%	0.0%	0.0%	12.0%	0.0%	0.0%	0.0%	0.0%	88.0%	0.0%	0.0%	0.0%
ETFS Battery Tech and Lithium ETF	ACDC	21%		34	35.2%	2.7%	21.5%	32.6%	27.5%	0.0%	0.0%	0.0%	12.3%	3.1%	0.0%	0.0%
ETFS ROBO Glbl Robotics and Atmtn ETF	ROBO	12%	20%	85	17.4%	0.0%	0.0%	36.8%	5.6%	0.0%	11.3%	0.0%	46.0%	0.0%	0.0%	0.0%
Loftus Peak Global Disruption Mgd Fd ETF	LPGD	13%	16%	30	66.2%	0.0%	0.0%	2.4%	17.4%	1.0%	0.0%	0.0%	53.3%	22.9%	0.0%	0.0%
VanEck China New Economy ETF	CNEW	16%		123	12.9%	0.0%	0.7%	11.5%	19.1%	22.1%	23.3%	0.0%	20.1%	2.9%	0.0%	0.0%
VanEck Global Clean Energy ETF*	CLNE			34	46.3%	2.7%	0.0%	32.7%	0.0%	0.0%	0.0%	0.0%	24.6%	0.0%	40.0%	0.0%
VanEck Global Hlthcr Ldrs ETF*	HLTH			54	24.4%	0.0%	0.0%	0.0%	0.0%	0.0%	100.0%	0.0%	0.0%	0.0%	0.0%	0.0%
VanEck Video Gaming & eSprts ETF*	ESPO			29	62.5%	0.0%	0.0%	0.0%	4.2%	0.0%	0.0%	0.0%	27.2%	68.6%	0.0%	0.0%
S&P/ASX 200 TR AUD		11%	18%	200	45.2%	3.0%	20.3%	6.6%	8.2%	5.2%	10.1%	30.0%	4.2%	4.2%	1.5%	6.7%
MSCI ACWI Ex Australia NR AUD		8%	12%	2,911	15.4%	3.4%	4.6%	9.9%	12.9%	6.9%	11.6%	13.7%	22.2%	9.5%	2.7%	2.5%

**yet to complete a year of inception* >ASX 200 <ASX 200

Source: Morningstar Direct

The higher risk exhibited by thematic ETFs naturally raises the question as to whether investors are adequately compensated for taking this risk. Our latest *Global Thematic Funds Landscape* report notes that over the trailing 15 years through May 2021, the risk-adjusted performance (Sharpe ratio) of the global thematic funds has been modest compared with pure passive ETFs.

Academic research such as [Competition for Attention in the ETF Space 2021](#) by Itzhak Ben-David, Francesco Franzoni, Byungwook Kim, and Rabih Moussaon, corroborates these results. While the Australian thematic ETF market is at the nascent stage, they also exhibit similar global trends with either middling or, in some cases, worse risk-adjusted performance compared with passive ETFs like **Vanguard Australian Shares** ([VAS](#)) that offer broader market exposure.

Exhibit 2: Australian thematic ETFs have displayed global trend of modest risk-adjusted return compared with broad-based ETFs

				YTD		1 Year	
ETFs	Inception Date	Ticker	Sharpe Ratio 1 Yr	Return	Max Drawdown	Return	Max Drawdown
BetaShares Climate Change Innovation ETF*	11.3.21	ERTH					
BetaShares Cloud Computing ETF*	22.2.21	CLDD					
BetaShares Glb Rbtc & Artfcl Intlgc ETF	12.9.18	RBTZ	2.3%	8.1%	-1.9%	31.2%	-1.9%
BetaShares Global Cybersecurity ETF	30.8.16	HACK	1.7%	16.1%	-5.1%	34.0%	-5.1%
ETFS Battery Tech and Lithium ETF	30.8.18	ACDC	3.0%	20.5%		78.6%	-0.6%
ETFS ROBO Glbl Robotics and Atmtn ETF	13.9.17	ROBO	2.8%	13.6%	-1.9%	40.1%	-1.9%
Loftus Peak Global Disruption Mgd Fd ETF	12.4.02	LPGD	2.3%	14.3%	-3.3%	33.1%	-3.3%
VanEck China New Economy ETF	8.11.18	CNEW	-0.2%	4.9%	-6.0%	-4.6%	-13.8%
VanEck Global Clean Energy ETF*	8.3.21	CLNE					
VanEck Global Hlthcr Ldrs ETF*	8.9.20	HLTH		18.1%	-5.0%		
VanEck Video Gaming & eSprts ETF*	8.9.20	ESPO		1.4%	-5.4%		
Vanguard Australian Shares ETF	4.5.09	VAS	2.4%	14.2%		29.1%	-3.6%
S&P/ASX 200 TR	3.4.00		2.4%	14.1%		28.6%	-3.7%
MSCI ACWI Ex Australia NR AUD	31.12.98		3.4%	18.8%		30.0%	-0.5%

**yet to complete a year of inception*

Source: Morningstar Direct

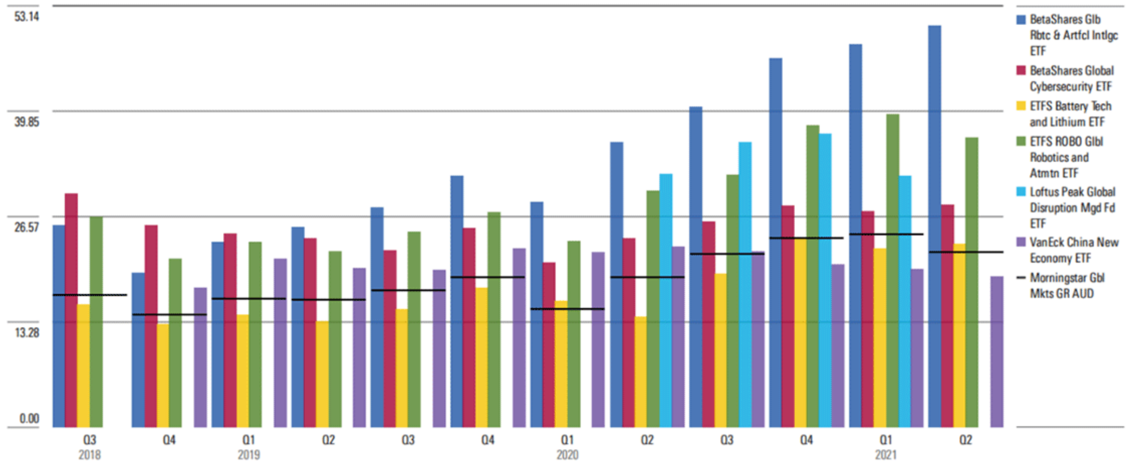
Most thematic funds don't beat global equities over longer periods but since the beginning of the global pandemic, many thematic funds across the globe, including from Australia, have chalked up impressive returns. More than two-thirds of thematic funds globally survived and outperformed global equity markets (as proxied by the Morningstar Global Markets Index) in the year ended March 2021.

However, this success turns pale when longer periods are considered. For example, stretching the observation window to include the trailing five years, success rates drop to 43%. When viewed over the trailing 15 years, more than half of thematic funds globally have shuttered and just 22% have survived and outperformed the global equities benchmark. These figures suggest that the odds of picking a thematic fund that survives and outperforms global equities over longer periods are stacked against investors.

Crowding risk

Thematic strategies can also fall victim to capacity constraints. Theme-based investing frequently targets niche segments of the investment universe, which is often less liquid and less appealing from a valuation perspective. Too much money chasing too few ideas can stretch valuations and is not a recipe for successful long-term investing.

Exhibit 3: Compared with the broad market valuation, thematic ETFs' valuations have been historically stretched on the P/E metrics basis versus the Morningstar Global Markets Index

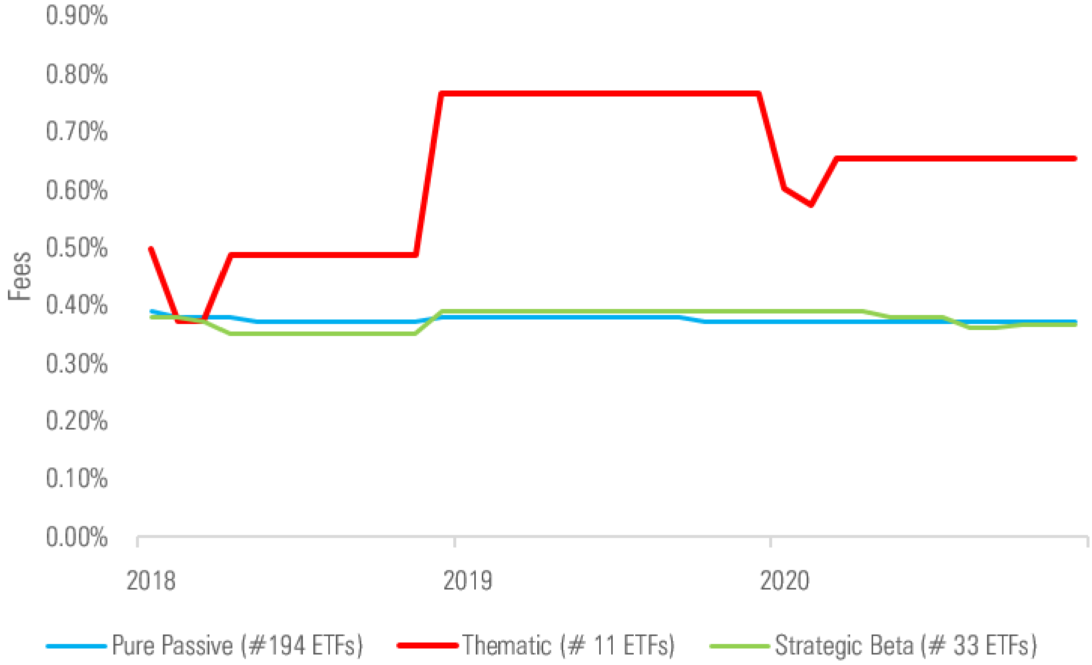


Source: Morningstar Direct. Note: Only ETFs with more than one year of data are considered here

What about the cost?

Thematic ETFs are not cheap relative to passive funds. While Australian thematic ETFs are in their early years, the trailing three-years data reveals that higher fees are being charged by these funds. This is a global phenomenon. The fees across the current cohort of Australian thematic ETF range from 57 basis points to 95 basis points (0.57% to 0.95%), which is substantially higher than their more-diversified peers.

Exhibit 4: Thematic ETFs charge substantially higher premiums for accessing emerging themes

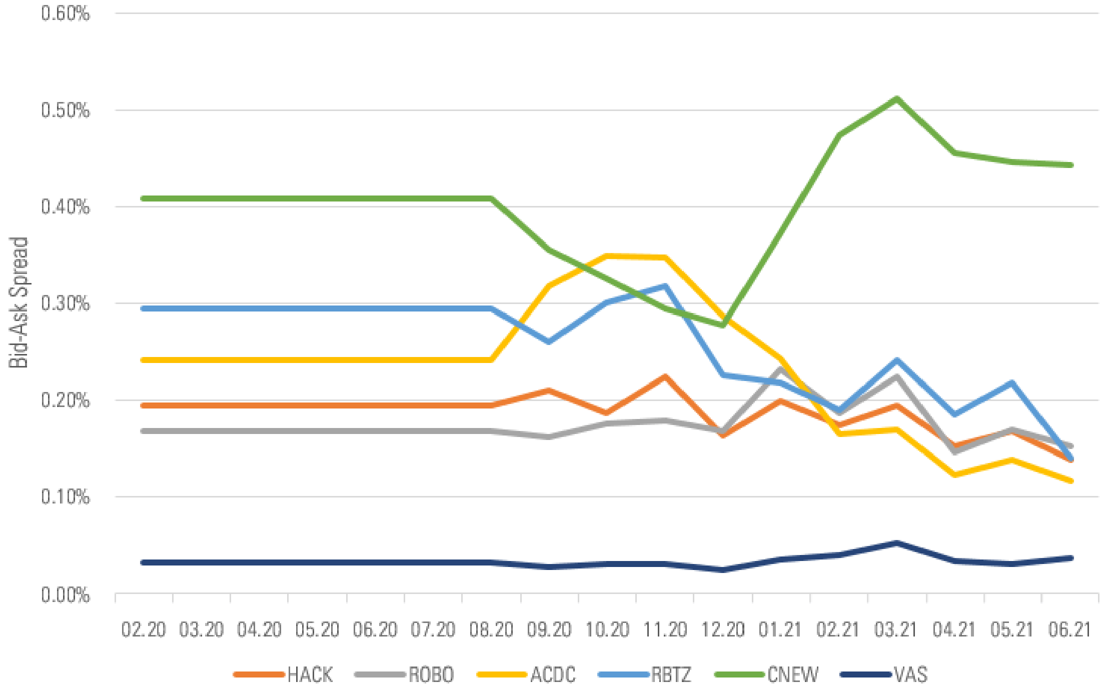


Source: Morningstar Direct

Thematic investors not only pay a higher management fee but trading the thematic ETFs can be a costly affair, too. Exhibit 5 underscores the fact that the higher trading costs (gauged by bid-ask spread) mean a higher total cost of ownership associated with thematic ETFs. These higher spreads also point to the potential liquidity issues, specifically in stressed market environments.

Exhibit 6 shows data from research we published in February 2021 looking at spreads of all ETFs in a normal market environment (from 8 Jan to 20 Feb 2020) and in the stressed market environment during the COVID-19 market volatility (24 Feb to 3 April 2020).

Exhibit 5: Substantially higher bid-ask spreads of thematic ETFs compared with a broad-based ETF



Source: ASX. Investment Products Monthly Update

Exhibit 6: Liquidity during normal and stressed market environments

		Normal		Stressed	
Name	Ticker	Spread	Spread to $100K*	Spread	Spread to $100K*
BetaShares Global Cybersecurity ETF	HACK	0.30%	0.46%	0.71%	1.20%
ETFS ROBO Global Robotics and Automation ETF	ROBO	0.36%	0.44%	0.64%	0.88%
ETFS Battery Tech and Lithium ETF	ACDC	0.36%	0.43%	0.61%	0.70%
BetaShares Global Robotics and Artificial Intelligence ETF	RBTZ	0.34%	0.54%	0.84%	1.49%
VanEck China New Economy ETF	CNEW	0.73%	1.19%	1.07%	1.57%
Vanguard Australian Shares Index ETF	VAS	0.03%	0.04%	0.10%	0.11%

*Source: Morningstar Tick Data. Normal Market: Data is from 8 Jan to 20 Feb 2020. Stressed Market: Data is from 24 Feb to 3 April 2020. Note: Only ETFs with more than one year of data are considered here. *Spread to $100K: Like the spread but calculated with the volume-weighted average prices derived from a notional $100,000 purchase or sale on either side of the order book. This spread is calculated only for periods where there is $100,000 in assets available on both sides of the order book.*

Looking ahead

So how should investors approach thematic ETFs?

For starters, they warrant more in-depth research and due diligence than more-diversified funds. This is especially true because what is considered a theme can evolve through time and can become increasingly complex and nuanced.

In the case of an extremely specific theme, such as global food scarcity, the burnout rate can be high. Information technology is another such sector that is prone to perpetual changes. Once the flag bearer of the 'revolutionary tech' theme, giants like **Facebook** (FB), **Alphabet** (GOOGL), **Netflix** (NFLX), **Alibaba** (BABA), and **Tencent** (00700) (among others) no longer fit that definition following the 2018 MSCI GICS reclassification. As the fortunes of any theme are at the mercy of multiple factors - such as government policy, advances in technology, interest rates, and shifts in investors' own biases - it is incumbent upon an investor to apprise themselves on the fundamental drivers of risk and return of the theme of their interest.

If a theme's longevity is be established, it is critical for investors to identify the ETF which holds the companies that are most likely to benefit from the theme.

Thematic investing is tricky and involves multiple moving parts. It is crucial that investors understand what they own but this is particularly true when picking thematic ETFs, which come in a variety of flavours. Regardless of how certain an investor might be on a theme, we believe a thematic fund is best used as a supporting player to a diversified portfolio, as the performance volatility that may ensue could make it a 'roller coaster' of a ride. Thematic ETFs are best used to complement rather than replace existing core holdings.

Download the PDF version of this report, including Australian market-data snapshot as of 30 June 2021.

Kongkon Gogoi and Zunjar Sanzgiri are Senior Manager Research Analysts for Morningstar. This article is general information and does not consider the circumstances of any investor.

Four reasons emerging markets should outperform post-COVID

James Johnstone

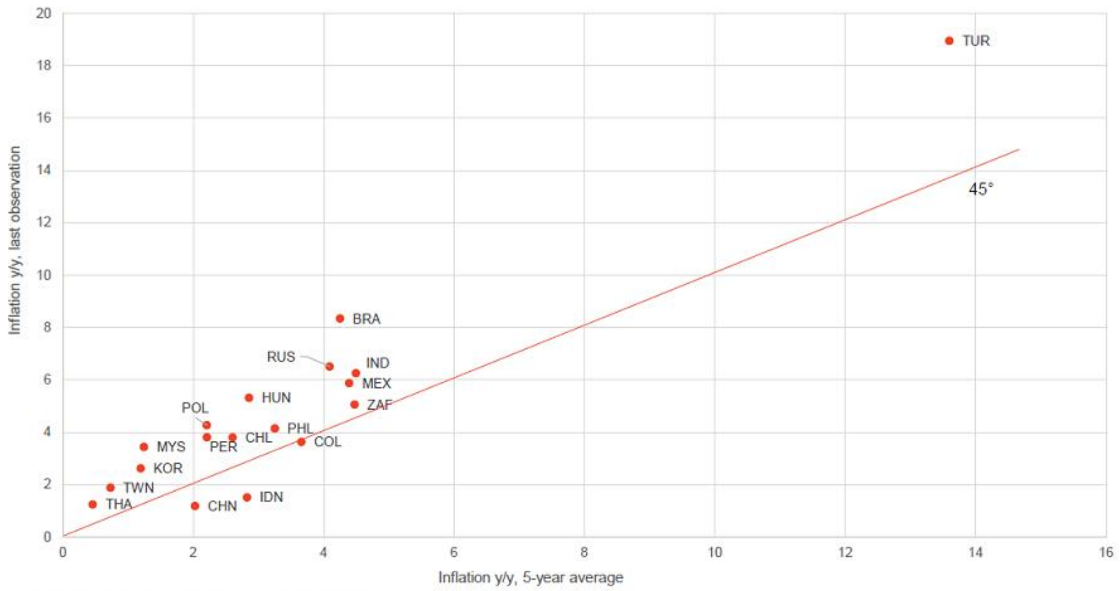
Policymakers in both developed and emerging markets are attempting to reopen their economies as they manage the virus , with varying degrees of success. Despite the short-term uncertainty, there are plenty of attractive opportunities for investors in emerging markets.

1. Inflation is transitory amid central bank discipline

Inflation in emerging markets is often misunderstood. About 85% of the MSCI Emerging Markets Index is made up of six countries: Brazil, Russia, India, China, Korea and Taiwan. Add South Africa and Mexico and almost the entire index is concentrated in a relatively small number of countries.

Supply chain dislocation and numerous bottlenecks due to COVID-19 have caused a big pop in inflation both in emerging and developed markets. We anticipate this will be transitory as disruptions diminish and headline inflation begins to reduce, allowing lower monetary policy rates to be sustained.

Inflation above Long Term average... almost everywhere



Source: Bloomberg, Haver and RWC as at 29 July 2021
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No investment strategy or risk management technique can guarantee returns or eliminate risks in any market environment.

Most importantly, it's been vital for emerging market countries to maintain the hard-fought credibility of their central banks. So far, the signs are good. As an example, at present there's a night-and-day difference in the improved quality of central bank management in Brazil compared with what we saw in 1991.

2. Emerging markets are maturing

The pandemic has shown that the emerging market complex is looking more mature, with Brazil and Russia hiking interest rates to maintain credibility. This is a stark shift from 2020, where central banks across the world were forced to cut rates in order to protect economies following the onset of the virus. While developed markets remain mired in emergency level policy settings, it is pleasing to see the emerging world pivot to a more proactive stance.

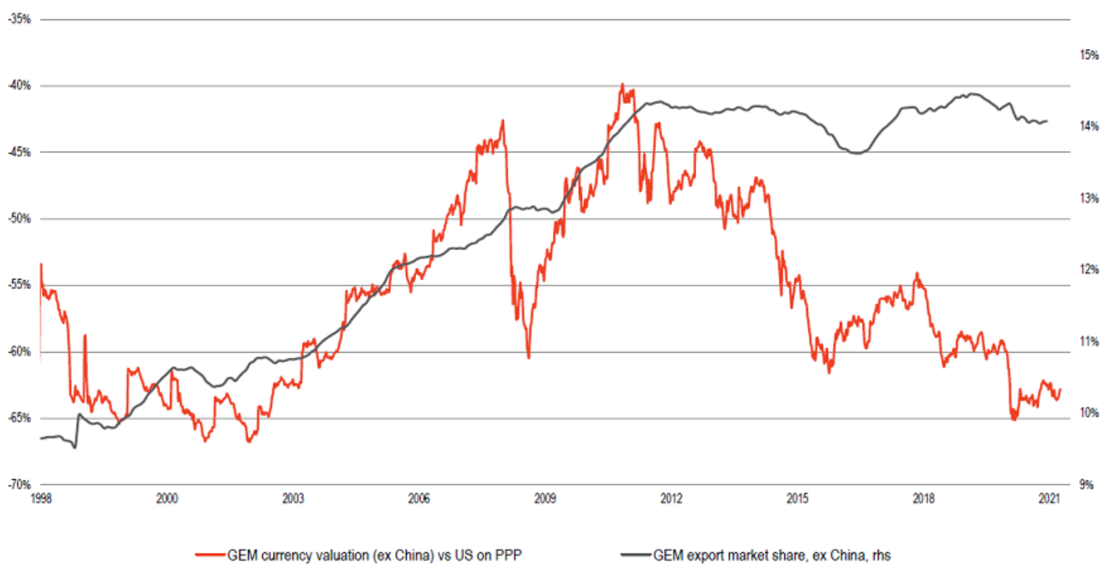
In fiscal stimulus terms, there haven't been substantial moves outside of those countries with large international reserves or the ability to borrow capital on the international market. The emerging markets approach has been cautious and supportive. For example, China has been very restrained relative to what it did in 2008, while still providing ample stimulus to return its economy to a strong growth footing. Ironically, because emerging market countries couldn't borrow as much as the West, there's a lot less pressure placed upon their currencies and debt levels than in developed countries.

Overall, it looks like the emerging market complex will get through this period of unprecedented monetary and fiscal policy response while actually strengthening the credibility that has been built up over the last 20 years.

3. Emerging markets currencies and commodities are attractive

Emerging markets currency (EMFX) is reaching levels we haven't seen since 2002. From 2001 to 2008, there was a very substantial rally in EMFX. One of the great convergence trades was when China, India, Brazil, Korea and Taiwan emerged on the global scene. Their GDP developed well, resulting in a dramatic rerating of emerging markets.

Emerging and Frontier Currencies Are Attractively Valued



Source: Bloomberg, IMF, Credit Suisse as at 14 May 2021
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No investment strategy or risk management technique can guarantee returns or eliminate risks in any market environment.

Since the bounce after the GFC, these countries have performed poorly relative to the S&P500. But that is set to change as emerging market countries benefit from surging demand for commodities on the back of significant global stimulus, infrastructure spending and recovery.

We're more bullish on commodities than most, but the street is catching up with our numbers. The outlook is positive for lithium (due to short-term demand and a lack of supply), copper (it is integral to decarbonisation and electric vehicles) and aluminium (thanks to supply base issues and the need to 'greenify' production).

We're less bullish on steel and we're very bearish on iron ore relative to the consensus due to significant supply capacity in Australia and Brazil.

Commodities remain important for the emerging market complex in supporting economic growth. Therefore, we believe emerging markets countries will provide strong outperformance over the next couple of years, if not the next decade, versus the developed markets. As a result, EMFX now looks very attractively valued.

4. Chinese regulatory risk is manageable

The recent China Securities Regulatory Commission (CSRC) meeting with executives of major investment banks attempted to ease market fears about Beijing's crackdown on the private education industry.

The regulator made clear that China will continue to welcome foreign capital and that there is no intention of any economic decoupling. The authorities will allow time for policy adjustments and public consultation. Unsurprisingly, the CSRC also outlined a positive economic growth outlook for the country.

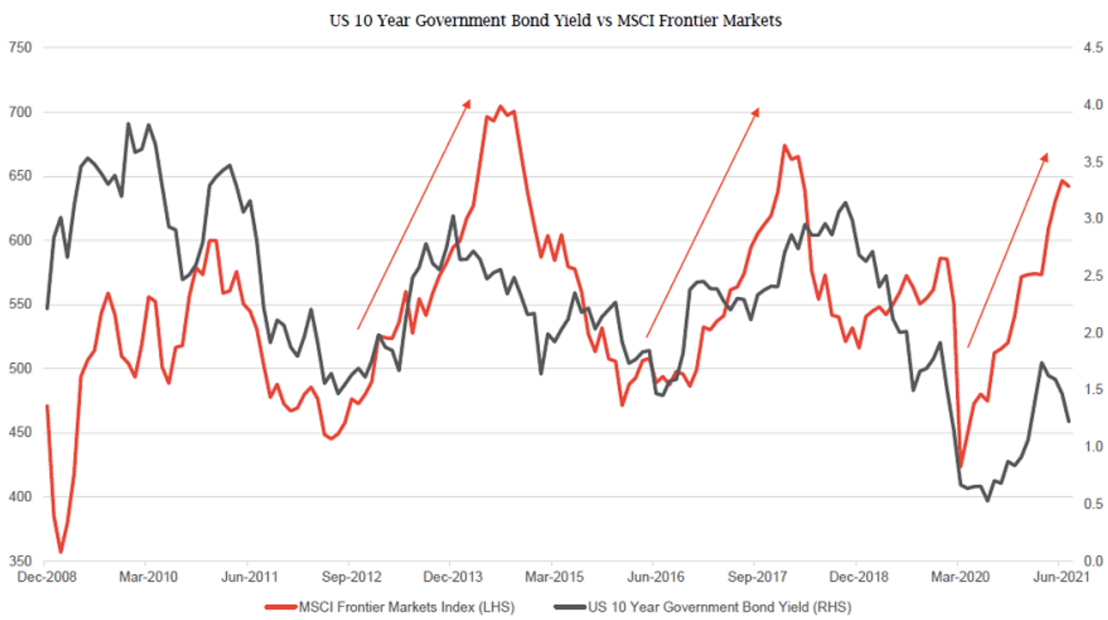
We believe this gives reassurance that the tutoring industry decision was a unique case. If China can convince the market that the regulatory changes are not an attack on profitable companies, confidence should slowly return.

The last 30 years of investing in China has shown that you don't want to be fighting against the authorities. The key point about managing Chinese regulatory risk is that if you align yourself with the authorities, there are very substantial returns to be made.

Which emerging markets sectors could outperform?

The pace of COVID-19 vaccine rollout is accelerating in larger emerging market countries, which is helping their cyclical recoveries. This trend is expected to continue throughout the second half of the year and may allow emerging markets to reopen their economies faster than expected, resulting in significant GDP growth throughout 2021.

Frontier Markets have Performed Strongly in Times of Rising US Bond Yields



Source: Bloomberg, RWC as at 30 July 2021

As an asset class, MSCI emerging and frontier market equities are expected to be up 7-12% in the next 6-9 months (source: RWC Partners and Bloomberg as at 30 July 2021). This will see the so-called 'Fragile Four' – Brazil, India, Turkey, and South Africa – outperform, while long-term upward pressure on the price of oil will also see Russia and Saudi Arabia benefit. China will continue to be weighed down by geopolitical forces and the lack of flows into emerging markets.

Thematically, we expect everything climate change-related to do well, including copper, lithium, solar energy, alternative energy, and electric vehicles. The EMFX carry trade remains intact which should support the financial services and housing sectors, especially in high yielding countries. In emerging markets, the COVID-19 recovery will be fuelled by travel, modern retail, and consumer discretionary spending.

James Johnstone, Co-Head of Emerging & Frontier Markets at RWC Partners, a Channel Capital partner. Access to the RWC Global Emerging Markets Fund is available to Australian investors via Channel Capital, a sponsor of Firstlinks. This article is genral information and does not consider the circumstances of any investor.

For more articles and papers from Channel Capital and partners, click here.

The webinar "RWC Partners: Adapting to the future – long term trends in emerging and frontier markets" can be viewed here.

Why not all share platforms are created equal

Travis Clark

US trading platform Robinhood has received a lot of attention over the past 12 months, attracting first time investors to share in the US by offering zero-dollar trades. The hype grew louder after its IPO earlier this month and its subsequent share price rally.

Robinhood emerged at the right time in the right space, but with a product that added further risk to an already high-risk investment sector. It was also apparent that most users did not know how Robinhood made money.

Many new players in the stockmarket

As we entered into lockdowns around the world, governments handed out cheques to help those who lost income or jobs and people were given the opportunity to remove money from their superannuation. Many people saw the accompanying market downturn as an opportunity to enter the share market and invest in technology companies that were benefiting from more time spent at home and online.

Enter Robinhood … and others, here in Australia. Share trading platforms that pitched themselves as democratising investing. Zero-dollar brokerage meant anyone with a PC (or a mobile) could enter get into the share market for 'free'. We saw an explosion in the number of first-time investors enter the market and the rapid rise in share markets globally that followed made many people see share investing as easy money.

As the amount of people, and money, in the market grew so did the stories of untold riches. 'Reddit' became a popular share tip tool and in Australia we saw the likes of ASX_Bets take off as investors looked for the latest share tips, or more appropriately as the thread is named – bets.

Looking under the covers

In recent months we've seen the downside of Robinhood's 'free' structure come into the spotlight: restricting trading during the meme stock squeeze earlier this year; mis-selling leveraged investments to inexperienced and ill-equipped investors; and issues with the regulator for selling retail order flow to market makers for revenue to the detriment of investors, to name a few.

In Australia, there has been a similar rise of individual investors and an accompanying race to lower, or zero-dollar, brokerage fees. Before the pandemic, there were around 700,000 active online retail (mum and dad) investors in the share market. Many had been introduced to the sharemarket many years ago through demutualistions of blue-chip brands such as CBA, Telstra or NRMA. Today, just 18 months later, the retail market has doubled to around 1.4 million individual active online share investors. The additional 700,000 investors have enjoyed the fastest market bounce ever. They have only seen the good times and many are not prepared for markets that will, inevitably at some point change.

Many of these new investors have been attracted by cheap and cheerful share trading platforms that appeal to the masses on the basis of making investing low cost.

My view is that investors should not be choosing how, or where, to invest based on the lowest cost option. These decisions can ultimately cost significantly more money in the long run. To use Facebook as an analogy, while it costs nothing to use, it has been shown not to be free as they monetise your data. Similarly, most platforms that are low or no cost need to cut corners to make their business model viable. Ask yourself how they make money.

Here's three things investors should consider when selecting a share trading platform:

1. **Who owns the shares? Is it a pooled or individual HIN?** Pooled Holder Identification Numbers (HINs) mean the underlying shares are held in a single trust. You do not have direct ownership and are not covered by the same protections as in individual HIN. Would you prefer to own the underlying shares directly, or just have a 'beneficial' interest? Much can be learnt from the past, with several high-profile pooled trusts exposing their investors to unprotected fraud and mismanagement.
2. **Where is your cash? Pooled or in an individual bank account?** While interest rates are negligible it is easy to think the cost of cash sitting in a bank account waiting to be invested is negligible. But as interest rates rise over coming years, it is much better to have an individual bank account and receive any interest direct rather than it going to your broker. And similar to pooled HIN's, pooled bank accounts have less protections and less flexibility.
3. **Are you seeing live and live-streaming pricing? Are you trading at the right price?** This one is a biggie. Are you happy to trade or follow your investments on prices that are delayed or that have moved since you last refreshed your screen? Real time pricing is critical to ensure you get the best price for your trades. The few dollars you save on a cheaper broking platform can be quickly eaten away if you are trading on delayed prices.

In saying all that, we also do not believe share trading should cost as much as traditional platforms would lead you believe. There is opportunity for disruption in the share trading sector. But with so many platforms emerging, we are advocates for protecting investors and ensuring they are not at a disadvantage through removal of trading features and data, especially given that there are so many new investors who may not know what to look for.

Bull markets don't last forever. There will be down markets at some point and it is important investors are prepared to weather all market environments. Making decisions based on saving a few dollars is not the way to maximise wealth and grow a sustainable, profitable investment portfolio over the long term.

Travis Clark is CEO of share market information platform, Marketech. This article is for general information only. Marketech users pay a monthly subscription fee and a nominal dollar fee per trade with live-streaming pricing, individual HINs and separate individual bank accounts.

How to access money under the First Home Super Saver

Julie Steed

The first home super saver (FHSS) scheme was introduced in July 2017 to assist first home buyers save for a deposit in the tax effective superannuation environment.

Whilst there are no statistics readily available regarding the number of Australians who have made use of the scheme, it seems that the take-up has been relatively low. A possible reason for this may be that the maximum that can be released is $30,000, which with high house prices doesn't always equate to a meaningful deposit.

In the May 2021 Federal Budget, the government announced that they would be increasing the maximum amount that could be withdrawn to $50,000. This provides up to $100,000 between a couple, and financial advisers and superannuation funds have noticed a considerable increase in enquiries about the scheme.

This article provides an overview of how the scheme works.

Eligibility

To be eligible to participate in the FHSS scheme an individual must:

- be 18 or over
- have never owned property in Australia
- not previously requested a release of super money under the FHSS scheme.

The FHSS scheme can only be used to buy a residential home in Australia. It cannot be used to buy a mobile home. If vacant land is purchased, a contract to build a home on it must be signed within 12 months although a 12-month automatic extension will be granted. The individual must also intend to live in the home, the scheme can't be used to buy a residential investment property.

Contributions

Some people have been critical of using super for purposes other than saving for retirement. However, only additional voluntary contributions made from 1 July 2017 can be released under the scheme. This can be personal contributions that the individual has claimed a tax deduction for (concessional contributions) or contributions that have been made after tax (non-concessional contributions). Employer compulsory contributions and government co-contributions cannot be released.

The FHSS scheme can also prove valuable in engaging younger people with their super. When they make voluntary contributions, they also tend to take a greater interest in the fund's features and benefits, including investment options, fees and insurance.

Ordering of contributions

Contributions made since 1 July 2017 are counted towards the release amount in the order in which they were made. This means that if an individual has made more contributions than their maximum release amount, either in a financial year or in total, their later contributions will remain in the fund. If concessional and non-concessional contributions are made at the same time, the non-concessional contributions are deemed to have been made first and will be released.

Withdrawal amount

Eligible contributions that can be released are limited to $15,000 in any financial year up to the current total maximum of $30,000. The Federal Budget announcement will retain the $15,000 per annum maximum cap but provide a total maximum cap of $50,000.

The FHSS scheme maximum release amount includes:

- 100% of eligible non-concessional contributions
- 85% of eligible concessional contributions
- 100% of associated earnings on eligible contributions.

Associated earnings

The associated earnings are an amount calculated by the ATO as a proxy for earnings. This makes it easy for individuals and super funds, they don't need to calculate the actual earnings on the different types of contributions. The rate used is the 90-day Bank Bill rate plus 3% (or currently about 3.04%).

PAYG tax on withdrawal amount

The release amount is paid by the super fund to the ATO. The ATO will withhold PAYG tax on the concessional contribution and the associated earnings component of the release amount. The rate of tax is the individual's marginal tax rate less a 30% tax offset. If the ATO can't determine the individual's marginal tax rate they will deduct tax at 17%.

The non-concessional component is tax free.

The individual includes the taxed component of the FHSS scheme release amount in their tax return, together with the calculated PAYG tax. Any tax adjustment will then be made as part of the return. The amount is included in the financial year that the release was requested, which could be before the amount is received.

Requesting a release amount

When an individual is ready to buy a home, they first need to request a FHSS determination from the ATO. This can be done via an individual's MyGov account and there is no limit to the number of times a determination can be requested.

The ATO will then advise the maximum release amount.

After receiving a determination, the individual then requests a release. This can only be done once and must be done no later than 14 days after a contract to buy or build has been signed but is generally requested before a contract has been signed. The ATO will send the release authority to the super fund and the super fund will make the payment to the ATO. The ATO will deduct any PAYG tax and forward the balance to the individual.

Individuals must enter a contract within 24 months (the standard 12-month requirement plus an automatically applied 12-month extension). They must notify the ATO within 28 days of signing a contract.

What happens if there is no contract within 24 months?

Individuals who do not enter a contract within 24 months have two choices. They can recontribute the assessable component to super as a non-concessional contribution, within the 24 months and advise the ATO. Alternatively, the ATO will issue an assessment for FHSS tax of 20% of the assessable component.

Conclusion

Understanding the workings of the FHSS scheme may provide opportunities for individuals to save effectively for a home deposit. Saving via super has the added advantage for many in that they can't be tempted to withdraw their savings at any time and spend them on something else, like they could in an ordinary savings account.

Julie Steed is Senior Technical Services Manager a Australian Executor Trustees. This article is in the nature of general information and does not consider the circumstances of any individual.