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Editorial

The **Reserve Bank Governor, Philip Lowe**, received his Bachelor of Commerce (Hons) at **UNSW** in 1985. It's the same degree I collected in 1980, in the graduate class with two of Australia's most prominent economists, **Ken Henry** and **Warwick McKibbin**. Lowe had joined the RBA in 1980 in a clerical role after growing up in a large family in Wagga Wagga, and he completed his degree part-time at night with an RBA scholarship. I had a university scholarship with the **Commonwealth Bank** and went straight from university into the investment department.

That's where most of the similarities end. I went off to make money for CBA and myself without a public duty bone in my body, while according to **Ian Saines**, who I worked with at CBA, Lowe was cut from finer cloth (to mix my metaphors):

''He could have pursued job offers in the private sector that would have potentially been much more lucrative but he has a strong, altruistic sense of public duty and a sense that he can make a contribution to the national interest.''

And so fast forward a few decades and Lowe's voice is the most influential on interest rates in Australia. He controls how much it costs to finance a business, borrow to buy a house and earn on deposits. So let's take two quotes from his career, also decades apart, to see what he thinks.

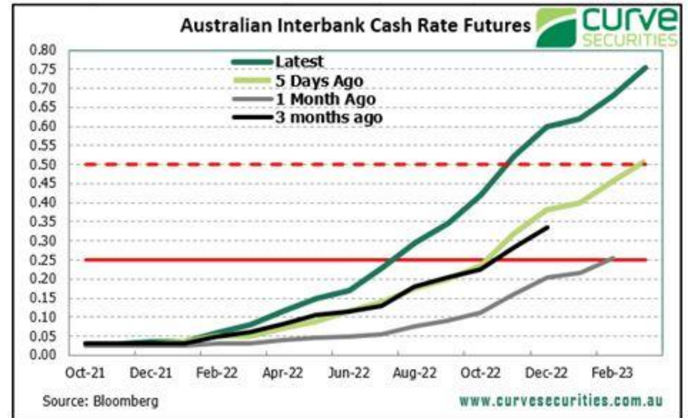
In 2002, he was working for the **Bank for International Settlements** (BIS) in Basel, Switzerland (where I worked with **Swiss Banking Corporation** in 1985), when he wrote a paper on monetary policy and asset prices. A lot has happened in 20 years but it could hardly be more relevant today. Quoting from the paper:

"This paper argues that financial imbalances can build up in a low inflation environment and that in some circumstances it is appropriate for policy to respond to contain these imbalances ... In particular, sustained rapid credit growth combined with large increases in asset prices appears to increase the probability of an episode of financial instability. The paper also argues that while low and stable inflation promotes financial stability, it also increases the likelihood that excess demand pressures show up first in credit aggregates and asset prices, rather than in goods and services prices. Accordingly, in some situations, a monetary response to credit and asset markets may be appropriate to preserve both financial and monetary stability."

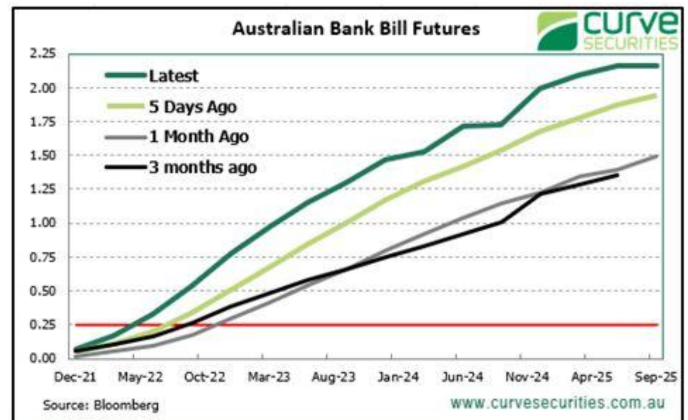
'*A monetary response*' means higher interest rates, but Lowe has changed his targets, as he said on 3 August 2021:

"the Board has said that it will not increase the cash rate until actual inflation is sustainably within the 2-3% target range. It won't be enough for inflation to just sneak across the 2% line for a quarter or two. We want to see inflation around the middle of the target range and have reasonable confidence that inflation will not fall below the 2-3% band again. Our judgement is that this condition for a lift in the cash rate will not be met before 2024."

Lowe and the RBA have set a very high bar. It no longer seems to matter what happens to asset prices, despite his 2002 paper saying: "*Rapid credit growth combined with large increases in asset prices appears to increase the probability of an episode of financial instability*." And "*... a monetary response to credit and asset markets may be appropriate to preserve both financial and monetary stability."*



Financial markets disagree on his 2024 outlook. These two charts from **Curve Securities** show dealers can make a lot of money backing against Lowe's forecast. The cash rate futures curve has pushed out to about 0.75% by early 2023, a big rise in the last month. The current cash rate is 0.1%. Like ... wow, that's a significant difference!



This feeds into the bank bill futures rate against which many business loans and other borrowings are priced, pushing over 2% by late 2024. It's 0.75% before the end of 2022. Only one of Philip Lowe versus the market will be right.

Much of the rate and inflation outlook hangs on whether current trends are indeed 'transitory'. Even the word itself can mean '*lasting only a short time*' or '*not permanent*' which leaves a wide range of outcomes. **Roger Montgomery** is on the side of inflation staying under control, and he identifies two themes and two companies his funds are backing strongly at the moment.

There has been extensive coverage of the $1.2 billion the Federal Government paid to five consulting firms in FY21, especially after cuts to public servant numbers. That's serious coin. We take a look inside the guidelines of a consulting firm to learn how they bill for their assignments. The document might help anyone who deals with a professional who charges by the hour.

We read a lot about life expectancy but do we understand what it really means? In financial planning, it is often used as the time period to cover until your money runs out. **Don Ezra** says this is a fundamental misunderstanding likely to lead to an incorrect outcome.

As threats to supply chains force many companies to reassess how their goods are produced, questions are asked about whether globalisation is dead. **Vanguard** assembled its senior team to respond to investor concerns.

Two articles relating to financial advice. **Rodney Horin** questions the outdated definition of 'sophisticated investor', where rising stockmarkets and house prices have created millions of wealthy people who are far from sophosticated. And **Cecilia Storniolo** looks at ways to lower the high up-front cost of financial advice, because many people who need assistance are missing out while advisers are buried in paperwork.

Finally, **Satyajit Das** examines the favourable conditions that have supported the funds management industry for the last few decades, and asks whether a golden era is coming to an end. When I mentioned some fund manager success stories to him, including highlighting the coming IPO of **GQG partners** which was only established five years ago and will float with a value of about $6 billion, he quoted economist **Rudiger Dornbusch:**

"Things take longer to happen than you think they will, and then they happen faster than you thought they could."

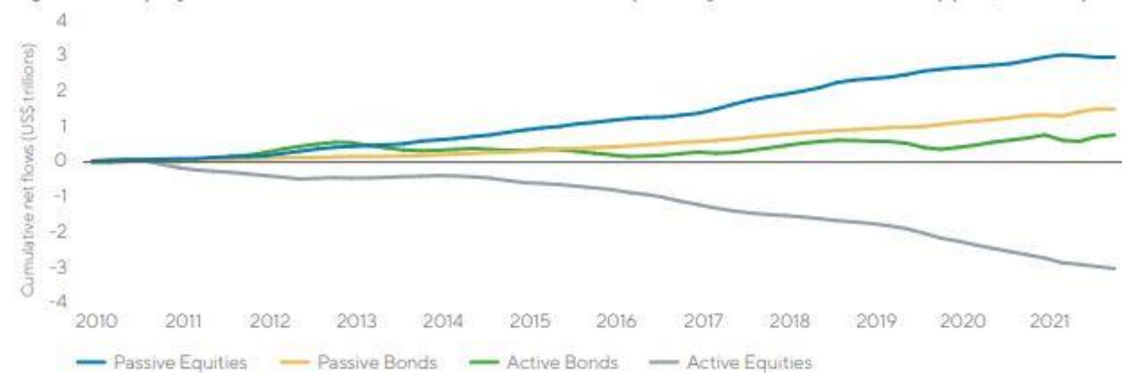
This chart from the GQG prospectus shows estimates by **Boston Consulting** on which asset classes are likely to grow to 2025 and the margins charged (which are gradually reducing). So while this offers support for active management, another chart supports one of Das's arguments about the switch to passive, in the chart following.

Figure 1.3 Funds under management growth by asset class (2020-2025) (%)

Source: The Boston Consulting Group 'Global Asset Management 2021: The $100 Trillion Machine' (July 2021). Notes: 1. Includes foreign, global, emerging-market equities, small and mid caps, and themes. 2. Includes emerging markets, high-yield, flexible, inflation-linked and structured finance – ABS. 3. Includes target date funds, target maturity and OCIO. 4. Includes absolute return, long/short, market neutral, and trading-oriented mutual funds. 5. Includes actively managed domestic large-cap equity. 6. Includes actively managed domestic government and corporate debt. 7. Management fees net of distribution costs.

Amid many success stories, other fund managers are struggling, as described in my article from a couple of years ago.

Figure 1.6 Equity mutual fund and ETF cumulative net flows (January 2010-October 2020) (US$ trillions)



Source: Financial Times 'Active Managers Struggle To Prove Their Worth In A Turbulent Year' (November 2020).

This week's White Paper from **Epoch Investment Partners** (one of the **GSFM** fund managers) looks at the new businesses formed during the pandemic, especially the record number of unicorn births in fintech and biotech.

And the Comment of the Week comes from **Stephen**, who wrote on the house price article:

"I suspect that we might find out in twelve months that the RBA has been fighting the last war in its effort to raise wages and inflation and that its indication/promise that the cash rate will not rise until 2024 was unwise. It has set the scene for it to be boxed in on these issues, which will limit its ability to change policy."

The latest updates below include the September 2021 ETF Review from **BetaShares**, confirming record flows into ETFs and reaching another all-time high of $125 billion.

$1 billion and counting: how consultants maximise fees

Graham Hand

Many years ago, a friend joined a major consulting firm in a senior role. First day on the job, he was given a manual called *'Assessing Opportunities: Do we really want this job?'*. He gave me a copy. Enough time has passed to keep him and the consulting firm anonymous, but the document is no less revealing into how this large consulting firm assessed its clients.

To give the firm its due, the document requires its staff to ask whether any potential assignment will deliver good results and value for the client. The firm must be convinced it can provide a solution to meet the clients needs and (in capital letters) "... FOR A PROFIT!"

This article accepts that most consulting assignments are defined and measured, and the client should understand the costs and other commitments required to complete the assignment.

But in the wake of the recent revelations that the Australian Government is spending over a billion dollars a year on consultants, the emphasis here will be on how the fees are calculated and justified.

Of course, many professional services - legal, architecture, accounting, financial advice, plumber, electrician - are charged on a time basis, so the lessons are universal.

What does the Government pay $1+ billion a year for?

In recent years, despite public service staffing caps and a loss of senior staff in an attempt to control costs, payments to a select group of consulting firms have surged. In March 2020, the Australian Audit Office reported that in the five years after the Coalition came to power in 2013-14, annual fees doubled to $647 million. It has since doubled again.

The Australia Institute recently issued a report questioning the loss of skills in the public sector. Senior Researcher, Bill Browne, said:

"It is worth reflecting on the rise of consultancy spending by the Federal Government, now exceeding $1 billion dollars a year. Compelling the work done by consultancies to be public would be an improvement on the status quo, although there is still the underlying issue that consultancies are doing an unprecedented amount of public work. In fact, the $1.1 billion spent on the largest consultancies last year could have employed an additional 12,346 public servants. It is not just jobs being lost to the public sector; knowledge and experience is being outsourced too."

"Australia's consulting industry (public and private) is the fourth largest in the world. By population, Australia's spending on consulting is greater than that of any other country, and about double that of comparable countries like Canada and Sweden."

The use of consultants is tied to reductions in departmental staff. The current Government has indicated it expects the public service to align its thinking with government policy, which reduces the potential for contradictory opinions. Prime Minister Scott Morrison said public servants are expected to "*get on board and implement the Government's agenda*". The Auditor-General highlighted the loss of public service expertise.

In October 2021, *The Australian Financial Review* reported that Accenture was awarded government contracts worth more than $340 million during the previous financial year, and Deloitte topped the Big Four list at $275 million followed by KPMG, EY and PwC. These five companies earned $1.2 billion in FY21.

Let's explore the consulting manual from one firm on how fees should be charged, so anyone who is a client of a major firm knows what is happening on the other side.

Extracts from how to be a good consultant ... FOR A PROFIT!

Before any assignment is accepted, the firm must be sure "*the client is willing and able to pay for our services".* That's a great start with a government contract as there is no doubt about paying capacity. Then:

"Explore whether the client has reasonable expectations about how much this assignment will cost and enough money available to achieve a satisfactory conclusion."

Here are some questions to ask the client:

1. Have you established a budget for this project?
2. How were you hoping to fund this project?
3. Let's say you really can get the results you want, but not for ($ amount). What would you do?

If the client budget appears insufficient, it could be due to one of three things for 'you', the client:

1. You don't really believe the value we placed on the results.
2. You don't really believe we can deliver the results.
3. You believe someone else can deliver the results for less.

It reads like a confrontational push to make the client willing to spend more. The instructions make it clear that the firm should walk away if there is not enough money to achieve the desired results.

But loss of the assignment is not accepted that easily. Clients should prepare to be hassled. The firm must understand how and by whom each key decision is made:

1. Can you help me understand the steps you will take in order to make the necessary decisions?
2. Who gets involved?
3. What do they have the authority to decide or influence?
4. What criteria will they use?
5. What objections do you expect, if any?

And then this punch line: *"In order for this to be a high-quality decision, who has to be convinced this is a good idea?"*

Then pages on assessing the competition, such as whether the client is talking to other organisations, how comparisons will be made, how do they know who best serves their interests?

And this: *"Forget about us for a minute. Let's assume you hadn't approached us. Based on what you've heard and seen so far, which of the other firms seems to be the most on target in meeting your needs."* Would anyone reveal the answer to this question?

And: *"Nobody is perfect. What seems to be missing from what we've discussed."*

And: *"Given that ABC is offering a good solution, what would we have to do to be clearly superior?"*

And: *"I don't know if we can get you the fee you want, but out of curiosity, let's suppose I could. Then what happens?"*

It's a world where a lot of time and effort is spent on agreeing and collecting fees, which must frustrate those from both sides who just want to get on with the job.

Ensuring services are paid for and value billing

Much of the document is devoted to project scope and ensuring the job and costs are fully understood. Consultants are discouraged from discussing fees early on, and *"seek first to understand, then to be understood."* Fees can later be discussed including scope and timing but:

"Never reduce price/fee without obtaining something in return that can be construed as a value exchange."

Fees are determined according to four main elements:

1. The time we spend on the work
2. The timescale over which the task is expected to be completed
3. The value to the client
4. The amount we are prepared to invest in the relationship

Here is a good part for moving away from depending on hours – **value billing**.

"Fees based on time are traditional in the consulting business and this method is always an appropriate benchmark. However, it has the drawback of focussing not on what we accomplished but on how long it took us. It also draws the client's attention to our hourly rates which may seem very high.

Some clients are willing and perhaps are expecting to pay on the basis of value, rather than strictly on the basis on the time spent. In the past, value billing has been rare, and many consultants are hesitant to do it, at least where the value is higher than the actual time charges. But it is not unethical, and in fact it is expected in many other professional services."

It would be revealing to learn how much of the $1 billion plus paid by the Government is done on time versus value, and how the latter was measured. The millions spent on consulting advice relating to the slow vaccine rollout would make fascinating reading on whether the job was delivered as expected.

Non-traditional pricing must be approved by Head Office, and if fees are discounted for strategic reasons, *"the client should be advised, in writing, why we are making this investment."* In other words, you owe me one and we expect more profitable projects or an expansion of our relationship in future.

The firm's objective is to achieve 100% recovery of time and expenses, but there are exceptions:

New client. "*Bidding low might allow expansion of the business but builds expectations that future services will also be cheap.*"

Sophistication of client. *"Some clients are skilful in using consultants, asking us to do only the tasks where we excel."* Well, you wouldn't want to do a task where you are mediocre, would you? *"Others ask us to do routine work that they are too busy to perform. If we accept those jobs at all, we should make sure the client understands how much it is going to cost."*

Client work style. Consider charging more if the client:

1. loves being involved in the consulting project
2. wants plenty of phone calls, meetings and 'face time'
3. needs a final detailed report or fancy presentation
4. has a complex decision-making process requiring many presentations and revisions
5. has a hard time making decisions
6. always haggles over fees.

This is a great insight. Clients should not look as if they are enjoying the work or if they have a hard time making decisions or they will be charged more. Look out for unnecessary 'fancy presentations'. And: *"If the client seems to be eager for a bidding war, watch out."*

Another aspect to watch is leverage, the number of junior staffers managed by each partner. The senior staff are the business 'finders', but they work on many projects at once, leaving the grunt work to 'grinders'. Many years ago, the bank I worked for assigned a project to an experienced partner and firm, and then a young graduate turned up on the first day. I was supposed to guide him through the assignment. The old saying came to mind: *"A consultant is a person who borrows your watch to tell you what time it is."*

Make sure to issue the full invoice

Then page after page on engagement letters, issuing invoices and collecting fees. *"If you don't write it down, you can't manage it."* So record all time and expenses spent on client work, including:

- Project planning and brainstorming
- Travel
- Time thinking about the project at home, on the road or elsewhere
- Time spend on project and client management activities.

All the record-keeping and planning should be paid for by the client, including sitting on the toilet thinking about the project.

There are strict rules about not entering time and expenses properly, and in bold letters, **there are no exceptions to this policy**. You only get paid if you record it, and if the bill is for less than 100% of time and expenses, a write-off document must be completed and approved. To emphasise the value of the work, consultants must write in the invoice letter how they saved the client time and money and how the assignment benefits the client's business and our continuing relationship.

It's boom time

Consultants are not the only financial professionals enjoying record numbers during the pandemic. IPOs are soaring based on market optimism and a lack of investments, with about $770 million in fees paid to investment banks in FY21. Legal and accounting firms have so much business that they are struggling for staff.

Scott Turow is a best-selling American author and lawyer whose books have sold over 30 million copies in 40 languages. He draws on his professional background in an essay for the American Bar Association called '*The Billable Hour Must Die*'. He says:

"Whoever says to a client that my billing system on its face rewards me at your expense for slow problem-solving, duplication of effort, featherbedding the workforce and compulsiveness - not to mention fuzzy math? ... But recognizing how far behind the eight ball we remain in the eyes of the public, should we really continue to engage in billing practices that even our clients, who know us best, have been telling us inspire distrust?"

And he adds that when someone is billing and working 2,200 hours a year, there's not much chance to pursue the experiences that nourish the soul.

Graham Hand is Managing Editor of Firstlinks. This article is general information. Disclosure: Graham worked as a consultant for many years and assignments were only accepted on the basis of strong personal trust between the parties. It was stated at the outset that if there were any questions about the merit of an invoice, no correspondence would be entered into and the client could ignore the bill or pay whatever they preferred. No invoice was ever disputed.

Two strong themes and companies that will benefit

Roger Montgomery

At the commencement of the year pundits claimed inflation would emerge to slay the high investment returns recently enjoyed. On cue, volatility rose. But danger's partner is opportunity and investors who took advantage of the minor market set back were promptly rewarded.

Our stance on the question of inflation is simple but structural. Money supply has been rising at an exponential rate since the 1960s and yet, since 1980, inflation has been in decline. I was taught at university that the positive correlation between the two was immutable, but the real world has again proven a theory wrong.

Why inflation should stay under control

I believe there are two fundamental and structural reasons for this.

First, unionised labour is a fraction of what it was just three decades ago. Large collectively negotiated annual wage increases are a thing of the past. In the US, a similar lid on wages exists due to the level of unionised labour declining precipitously in recent decades. When wage growth is low, a large component of the pressure on consumer prices is removed.

Second, while we've all been talking about Covid, vaccinations and reopening, the world has been investing a record amount in technology, and in particular, automation. Automation displaces labour, hammering another nail in the coffin of wage growth.

And as we reach 90% vaccination coverage, and international borders reopen, the return of immigration will reduce current competition for skilled workers and the associated pressures on salaries in some industries.

If inflation is structurally lower, investors can be more comfortable with the prospect of lower interest rates and perhaps even negative real rates. Real rates are the difference between nominal interest rates and inflation. They have been negative in the US for some time, rendering equities and other assets particularly attractive. With inflation potentially in check structurally, nominal rates then remain low and real rates potentially remain negative.

It's not great for those relying on income from cash deposits but it's potentially good news for every other investment.

And elsewhere, the economy is cooling. In the US for example, the impulse of economic activity immediately following the Covid-inspired slowdown, is itself starting to ease. US unemployment benefits are now being scaled back and it has been reported some seven million people have had their unemployment benefits cut to zero. Another three million have seen their employment benefits cut by US$300 per week.

While investors may be more excited about the negative influence this potentially has on consumer demand and therefore consumer prices, a less obvious impact will come from these people gaining employment. An increase in labour supply will also place downward pressure on wages.

And while you wouldn't know it right now, looking at price increases in the energy commodity complex, cooler global growth should limit further price gains and ultimately lead to lower inflation, while keeping bond yields capped. Meanwhile, a slowing demand, which is usually associated with declining rates of economic growth, will also provide room for supply chains to catch up and for the concurrent inflationary bottlenecks to ease.

Should the current trends endure, investors can remain reasonably confident that conditions, which have hitherto been supportive for equities, will also continue.

A focus on two strong underlying themes

Of course, that does not mean investors can take a random approach to owning equities. Instead, one appropriate approach should involve acquiring businesses that benefit from supportive underlying themes.

In the Montgomery Small Companies Fund, we have labelled one such theme, *Stable Compounders*. These are businesses offering growth with a defensive element, they tend to be in stable industries, are market leaders and are under appreciated by the market. A Stable Compounder is high quality, commands a superior competitive position and a strong management team capable of delivering a sensible strategy. These companies are also typically at the cashflow-harvesting stage of their lifecycle.

One example of such a business is Waypoint REIT (ASX:WPR), which owns Australian petrol station sites leased to the likes of 7Eleven, Liberty, and the Shell/Coles Express convenience chain. Waypoint properties enjoy 100% occupancy, a 10.5-year weighted average lease expiry (WALE) and 3% weighted average rent reviews. WPR yields slightly more than 5%, which along with an estimated dividend per share growth equivalent to about 3%, offers a potential total shareholder return of 9%.

Management also announced a $150 million capital return buyback on 30 July 2021 which is subject to the settlement from the sale of a portfolio of properties expected to occur this half.

Additionally, the potential for further revaluations exists with WPR’s book of properties appearing to be valued 20% below the prices similar properties are being transacted for in the open market.

Finally, Waypoint’s internally managed structure, along with an open share register, potentially renders it attractive as an acquisition in a sector where mergers appear to be just taking off.

A second theme we believe will assist investors to generate at least relatively better returns is a theme we call *Structural Winners*. This theme also offers investors the ability to be agnostic with respect to the state of the economy.

Structural Winners are businesses benefitting from global megatrends, such as cloud computing or decarbonisation. For the latter we mean the shift from fossil fuels to renewable electricity and hydrogen technology. With Australia blessed with all of the raw materials required for lithium-ion batteries, investors have the opportunity to invest in a once-in-a-generation shift in transportation and energy storage.

Structural Winners are also businesses with long runways for growth, take market share from weaker or legacy incumbents and are therefore in control of their own destiny. A business like Macquarie Telecom (ASX:MAQ) run by David Tudehope is also a company whose shares we own. A data centre operator, it benefits from the trend toward cloud services, which is levelling the playing field for small businesses to compete globally and digitally. As the company expands its footprint, the market is also slowly understanding it can sell its last 10% of capacity for 10 times the price of its first 90%. And whether the economy grows or not probably matters little.

In an environment of slow but steady economic growth and disinflation, the best companies to invest in have historically been innovative companies offering growth. The Structural Winners thematic has rewarded investors over the last 10 years and may continue to do likewise over the next decade. We currently believe, notwithstanding the ever-present risk of a 10-15% set back, financial year 2022 will prove to be as lucrative as FY21.

Roger Montgomery is Chairman and Chief Investment Officer at [Montgomery Investment Management](). This article is for general information only and does not consider the circumstances of any individual.

Reducing the $5,300 upfront cost of financial advice

Cecilia Storniolo

Financial advisors tend to be valued by those who use them, while the financially unadvised don’t see the need to pay.

KPMG research carried out last year at the height of the original COVID-19 pandemic found most people saw financial advice as a discretionary spend, while those who took financial advice saw it as essential and 70% of customers (a higher proportion than for insurers or super funds) were pleased with the service.

Compliance is pushing up costs

With this backdrop, it is important that any unnecessary costs facing financial advisers are reduced as much as possible, to increase the likelihood of more people taking advice. But the cost of complying with rising regulatory and professional requirements has driven the cost of advice production up over the last few years.

The Financial Services Council asked KPMG to assess the impact of proposed FSC reforms on the advice process, including hours, time, and cost per step of the process. These reforms were initially part of an FSC green paper and now a White Paper published ahead of the stated intention of the Federal Government to conduct a review into Financial Advice.

There are seven steps to the advice process:

- Identification of advice needs
- Meeting of advisor and client
- Preparing the financial plan
- Second meeting where the advice is presented
- Client signs the Statement of Advice
- Implementation of recommendations
- Review of the plan

Many advice firms cannot cover their costs

Our research found that it currently costs financial advisers more to produce advice than is charged as an up-front fee to consumers.

The FSC's proposed reforms include abolishing lengthy, complex, *Statements of Advice* for a simpler, consumer-faced '*Letter of Advice*'. They also suggested adopting a new legislated financial advice model, clarifying and removing the currently complex labels for different types of 'advice'. It is recommended advice would be billed as, simple; complex; or specialised. General information would be in a separate category.

It also included removing the best interest duty 'safe harbour' steps from the Corporations Act, while retaining the best interest duty obligations and enhancing the professional code of conduct. We do not believe this will reduce consumer protection but will save costs as the research indicates.

Statement of Advice costs $5,300

Our analysis found that these proposals had the potential to reduce the cost of advice by up to 39% and cut down the time spent on creation of a *Statement of Advice* by up to a third. The average cost of producing a statement of work, we found, could fall from over $5,300 to less than $3,700, a possible saving of 37%.

We also found the proposed reforms could free an adviser's time to enable them to see more clients (up to 44 more a year) or use this time for other business critical activities such as training and business development.

We also looked at how technology could be used better, over time, to reduce costs. While there is no single advice solution which will unilaterally solve the advice challenge, we believe leveraging technology may further aid a provider to reduce the cost of advice, aiding affordability and also facilitate better, more efficient interactions between the client and adviser – aiding accessibility.

We are seeing providers seeking to harness a broad range of technology capabilities to drive enhanced customer experience, back-office efficiencies, and compliance. More could be done.

KPMG welcomes the opportunity to be part of the discussion on reforms which seeks to make advice more affordable and accessible to more Australians.

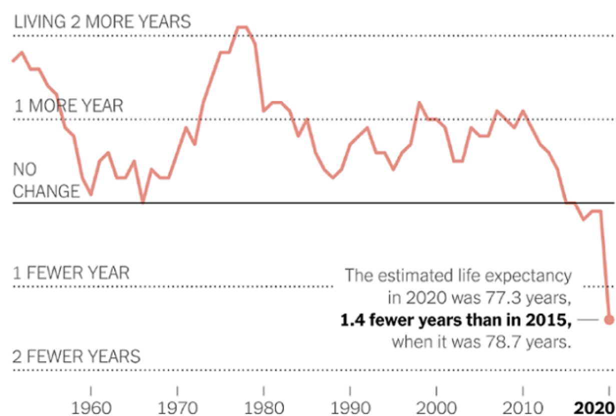
Click here to read the full report.

Cecilia Storniolo is Partner, Superannuation Advisory, Actuarial & Financial Risk at KPMG. This article is general information and does not consider the circumstances of any investor.

Many people misunderstand what life expectancy means

Don Ezra

The New York Times headline screamed '*US Life Expectancy Plunged In 2020*' on 21 July 2021. The sub-headline continued: "*The 18-month drop, the steepest decline since World War II, was fueled by the coronavirus pandemic*." Specifically, life expectancy was reported to have declined from 78.8 years to 77.3 years.



This is such a big deal that The Times (of London) also headlined it: "*Life expectancy gets even shorter for Americans.*" They added that "*Covid-19 was blamed for three quarters of the decline.*"

What does the headline even mean?

Really? So all Americans expect to die a year and a half earlier than before (on average, of course)? That's what the headlines mean, right?

No, not really, but the truth doesn't make for as dramatic a headline. And if you can get an attention-grabbing headline, who cares if it isn't accurate?

The true meaning of the statistics was, actually, reported accurately later in the New York Times article:

"If American children born today spent their entire lives under the conditions of 2020, they would live an average of 77.3 years, down from 78.8 in 2019."

See the difference? If Covid-19 stays around in as virulent a form as in 2020, with no vaccinations or other defences against it, then … yes, future life expectancy will indeed fall.

I went to the actual report from the (US) National Center for Health Statistics (a part of the Centers for Disease Control and Prevention), and it was very clear:

"The period life table does not represent the mortality experience of an actual birth cohort but rather presents what would happen to a hypothetical cohort if it experienced throughout its entire life the mortality conditions of a particular period."

Which is jargon for what I said in the previous paragraph.

A misunderstanding of life expectancy

Why does this bother me? Because people misunderstand what life expectancy means. I'd greatly prefer it if it were instead called 'the average survival age', trying to avoid the macabre feelings that anything involving death can create. And what's a 'cohort' anyway?

Let me explain.

A cohort is a group of people with a specific characteristic in common. When dealing with longevity, cohorts are usually defined by age and gender. For example, 'all female children born in 1970' or 'all males now aged 55' – that sort of thing.

'Life expectancy' means the average expected age to which members of the cohort in question will survive. 'Expected'? There's nothing expected about it. It's a jargon word that means it's the average of a distribution (perhaps even a very wide distribution) of possibilities.

For example … What does it mean if the life expectancy for people of your gender and year of birth is stated to be 80 years? It means that, if you look at all the people in that cohort (your gender, your year of birth), they will have a wide range of ages to which they will survive, and roughly half are expected to survive to some age short of 80 and roughly half to some age beyond 80.

That's interesting, because the number is often (wrongly) interpreted as the expected limit of life, as if (in that example) 80 is the maximum age any of that group can be expected to reach. No, it's not the maximum: it's the average. There's a 50/50 chance of outliving it.

It's higher for older people

Now here's something that is even more often misunderstood. Suppose we subdivide that original group and now include only those who are still alive at age 50. What's their likely average survival age? Is it still 80? No, it's bound to be higher than 80. That's because some of the original group have already passed on, before age 50. They brought the average down. The average for the group of survivors is therefore higher than 80. It might, for example, be 83.

That's right, the definition of the cohort, the group, has changed. It's no longer all of those who were born in your year of birth. It's now limited to those who have survived beyond age 50. That's a different group, even if the members of the (smaller) 'survived to 50' group were also part of the original 'born in the same year as you' group.

It's like starting with 'all people in the world' and then changing to 'all females': the second group is different from the first one, even though all members of the (smaller) second group are also part of the first group. That's a subtle distinction that the vast majority of people are unaware of.

Similarly, those who survive beyond age 60 have an average projected survival age even higher. And so on. The older you are, the higher the average projected survival age.

One final rant on the way this 'life expectancy' was calculated. You'd think, since it deals with future survival, that it would reflect the possibility of improvement in health, the sort of trend that we've been used to for a couple of centuries. Of course you can never get it right, because it would require a crystal ball. And, to put it mildly, that's impossible to find.

But what they've found isn't a crystal ball, it's a rear-view mirror, and indeed it only shows the immediate past.

Which brings us back to the headline.

There are potentially three aspects of it that are capable of misinterpretation.

First, the numbers only apply if Covid-19 (with no vaccination) and all other mortality-related conditions (including, for example, the opioid crisis) prevail forever.

Second, even when adjusted to reflect a probably more-promising future, the numbers don't reflect the maximum age one can reach. Roughly half of us should outlive the stated expectancies.

And **third**, they apply only to newborns. The longer we survive, the higher the average age to which we will eventually survive. It's common sense when it's expressed that way, isn't it?

There! Even with such a morbid subject, I bring you nothing but good news!

Don Ezra, now happily retired, is the former Co-Chairman of global consulting for Russell Investments worldwide, and the author of "Life Two: how to get to and enjoy what used to be called retirement". This article is general information and does not consider the circumstances of any investor.

Slowing global trade not the threat investors fear

Vanguard Investments Australia

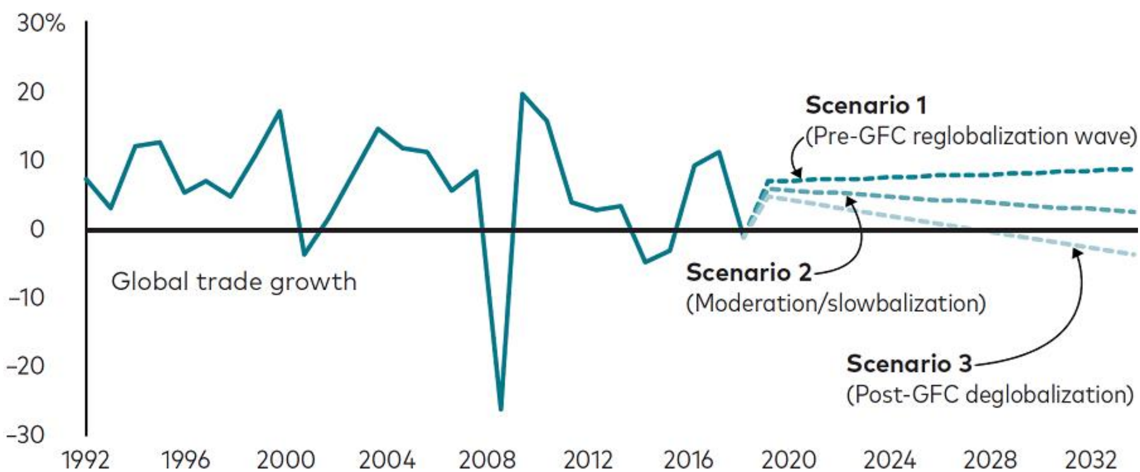
Contributing authors: Jonathan Lemco, Asawari Sathe, Adam J. Schickling, Maximilian Wieland, and Beatrice Yeo, from the Vanguard Investment Strategy Group's Global Economics Team.

The last 12-plus months have emphasised that the COVID-19 pandemic would accelerate trends already in place. One of these trends is the shortening, and in some cases the reshoring, of supply chains, as business leaders question whether their supply chains have been stretched too far and become too complex.

Such a trend raises a natural question: Is globalisation dead?

New Vanguard research, *The deglobalisation myth(s)*, concludes that, no, globalisation isn't dead. Instead, global trade growth is likely to slow, as it's been doing since the GFC. This slowing in global trade growth, what we term 'slowbalisation', is unlikely to turn into a contraction in global trade. What's more, the implications for investors are only modest.

A slowbalization scenario is the most likely outcome



Sources: Vanguard calculations, using data from the World Bank, the Organisation for Economic Co-operation and Development, and the KOF Swiss Economic Institute.

The allure of global trade is understandable

Companies that produce goods or provide services want the largest possible markets for their outputs. But a structural expansion in supply chains, which boosted gross trade in the 1990s and early 2000s, started to slow even before the GFC. A turn toward protectionism - government policies that favour domestic industries - over the last decade in the face of rising inequality in developed economies is likely to similarly tap the brakes on global trade.

We note that other aspects of globalisation, including international capital flows, knowledge sharing, and geopolitics, carry potentially significant economic, societal, and environmental consequences. Our latest research focuses on just one aspect of globalisation that addresses a specific concern of investors: the trade of goods and services.

The concern is that slowing global trade growth may reduce corporate earnings and profit growth and, by extension, weigh on equity prices. After all, a globalisation wave that began in the 1990s coincided with a six-fold increase in S&P500 Index earnings per share and more than a doubling of profit margins, contributing to almost 90% of the index's price return over most of three decades.[1]

Risks to investors may not be as great as they seem

But we contest the view that globalisation has been the central factor in the expansion of these return drivers. Our research demonstrates an inconclusive or weak relationship between earnings growth and changes in trade dependency. And it shows that industries with the greatest increase in profit margins since 1990 - finance and

insurance, and office and computer machinery are examples - have experienced only modest changes in trade dependency.

Trade tensions that precipitated sharp bouts of market volatility just a few years ago underscore the importance that investors ascribe to global commerce with few impediments. No doubt, geopolitical risks are ever present and worthy of attention. But our new research quantifies risks related specifically to a future of slowing global trade growth, and we believe that these risks to investors aren't as large as they're sometimes portrayed.

Rather, we emphasise conclusions shared by our new research and our December 2020 research *A Tale of Two Decades for U.S. and Non-U.S. Equity*: that corporate earnings growth hasn't been a major contributor to U.S. equity outperformance in the past and that we shouldn't expect it to have a meaningful impact on future outperformance or underperformance.

Valuations, or the price investors pay for earnings, represent the most important signal for future asset returns.

[1] The average annual S&P 500 Index price return from 1990 to 2018 was 7.4%. Three factors make up this return: valuation expansion/contraction (dollar paid per dollar of earnings), earnings growth from revenue growth, and earnings growth from ratio of earnings to revenue (profit margins). Contributions from these factors were 0.8%, 3.7%, and 2.9%, respectively.

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Wealth doesn't equal wisdom for 'sophisticated' investors

Rodney Horin

The increase in stock prices and house prices in Australia in recent years has cast the spotlight on the definition of 'sophisticated investors', also known in the investment industry as 'wholesale investors'.

The definition was last reviewed in 2011 in the Corporations Act. Since then, more and more Australians have been able to satisfy the requirements for this definition without lifting a finger. It is estimated that as many as three million Australians now qualify, but they have become wealthier but no more sophisticated while the number is increasing rapidly.

So what's the catch?

Sophisticated investors can be offered securities without the usual product disclosure requirements that apply to everyday mum and dad investors. Stockbrokers and financial advisers are able to offer sophisticated investors access to investments that cannot go to retail clients, such as some unlisted property investments, bonds and other unlisted investments.

Many companies also prefer dealing only with sophisticated investors. It means smaller and tighter share registers, access to bigger amounts of cash and less compliance issues.

In order to be classified as sophisticated investor, an investor needs gross personal income over the last two years of at least $250,000 or to have assets of more than $2.5 million. They also need sign-off from a qualified accountant. Importantly, the stockbroker or financial adviser also needs to be confident that the investor truly is 'sophisticated' – aware of the financial implications of both the advisor's advice and their investment decisions.

The definition makes it easier to do business

Many advisers prefer dealing with sophisticated or wholesale investors, as it shifts much of the burden of risk of investing to the client, who are trusted to make their own decisions. In addition, it reduces compliance obligations for the advisor. Sophisticated investors require no statements of advice or annual reviews and they can be offered products which are more complex to understand.

Crucially, the significant rises in both property and stock prices over the past 10 years suggests the time has come for the qualifying numbers for sophisticated investor status to be dramatically scaled up.

Property prices in many parts of the country have doubled in the past 10 years. The median house price in Sydney is now more than $1.3 million, and the average of all residential dwellings in Australia is $835,000.

During the same period the stock market has had a big run, leading to huge increases in paper wealth. The All Ordinaries Index has risen from around 4,300 on 1 October 2011 to 7,700 now, an increase of almost 80%. During this time investors have been receiving dividends, increasing their wealth still further.

More Australian investors have satisfied the numbers side (assets and/or income) of the sophisticated investor definition, but it is clear that many are not really 'sophisticated' in any sense of the word. They have not accumulated any greater knowledge of investing or capital markets. Inflation and a rising stock market simply does not make an investor 'sophisticated'.

Many others have inherited money or invested in a stock many years ago that has made spectacular gains, such as CSL or the Commonwealth Bank. Some have sold houses that they owned for many years or divested an investment property.

Adviser responsibilities

Importantly, an adviser's duty of care is towards the client. If a savvy daughter brings in her mother who has significant assets, then the mother is the client. It is the mother who must understand the advice that she is given. A simple discussion with the mother will enable an adviser to determine if she is 'sophisticated' far more than a certificate from the family accountant.

We often ask a client to repeat back to us what we have suggested or to explain the significance of certain advice.

But many advisers don't take seriously enough their responsibility to properly assess if an investor truly is 'sophisticated' and the Australian Securities and Investments Commission (ASIC) doesn't have the resources to check. Accountants tend to pass the buck as rarely will an accountant refuse a client a certificate confirming their sophisticated investor status.

It's time to review the area. The criteria is strictly financial and it has not been changed for more than a decade. It has left the system open for abuse and the people who pay the price are everyday investors who may suffer dearly if the classification leaves them with less protection. The government can make a big start by raising the qualifying threshold for sophisticated investors in the Corporations Act and index them for the future.

Rodney Horin is CEO of wealth manager and aged-care advisor Joseph Palmer & Sons. This article is general information and does not consider the circumstances of any investor.

Is the golden era for active fund managers ending?

Satyajit Das

Woody Allen observed that 99% of life is showing up. Despite belief in their unique skill and perspicacity, fund managers have been the fortunate beneficiary of a confluence of events.

The industry has benefitted from the favourable economic and financial environment for the last three decades.

First, rapid growth in wealth and mandatory retirement schemes increased assets under management (AUM).

Second, deregulation and globalisation of financial markets and the economy created attractive investment opportunities. Privatisation of state assets and the opening up of emerging markets, for example, broadened investment choices.

Third, high average returns, in part underpinned by structural asset inflation, reinforced expansion.

Revenues, which rely substantially on fees based on the size of funds, was aided by AUM growth. This was reinforced by strong returns as around 50% of AUM increases is due to rising asset values. Incentive fees from strong market performance boosted earnings.

AUM has tripled globally over the last two decades to over US$100 trillion. Asset management revenues have also grown three-fold to around US$400 billion. Australian superannuation assets now total over $3.1 trillion and generates around $30 billion per annum in fees for the industry.

Are these influences sustainable?

AUM is unlikely to grow at historical rates. Fund outflows will increase as retirees draw down investments to finance post-income lives. Replacement inflows may not compensate for losses. Younger workers have lower savings due to stagnant incomes and discontinuous, precarious employment. Their investment habits and attitudes to money reflect lower trust of financiers and traditional investments.

Sponsored retirement schemes may change. Government tax incentives, seen to be favouring the wealthy, may be withdrawn or reduced in a period of strained public finances. In an environment where fewer people can retire due to insufficiency of savings and income support, formal retirement savings arrangements become redundant. Governments may phase out compulsory schemes to increase disposable incomes and economic activity. Allowing workers to draw on their retirement schemes during the Pandemic provides an interesting precedent. These factors will all reduce inflows.

The range of investments is likely to diminish. Systematic privatisation of markets is under way with smart money moving away from public equity and debt markets. Drivers include the increased availability of funding from high net worth investors and the cost, disclosure and regulatory burdens of public issues. Central bank buying of debt and (in the case of the Swiss and Japanese central banks) equities also reduces available stock.

Controls on free movement of capital and cross-border investments as well as re-regulation are likely to constrain investment choice or increase risk. The Chinese government's ambivalence towards foreign investment or overseas fund raisings by its companies may be copied by others. Sanctions and other protective measures by various countries, as they shift towards autarky, will further limit opportunities. Climate emission tariffs or promotion of 'national champions' may become another impediment to international investment.

These developments are likely to diminish trading depth and liquidity affecting investment opportunities and implementable strategies.

Future returns not as promising

Adequate post-fee returns are needed to attract investors. Future gains are likely to be lower across asset classes affecting both AUM and fees. The higher the price paid for an asset today the greater likelihood of lower future returns and higher the risk of loss. When returns are 10%, a fee of 1% is begrudging acceptable. If returns decline to 2%, an equivalent fee may be problematic.

High current returns, especially from equity and property markets, are misleading. They are driven by low rates, central bank asset purchases and artificial suppression of volatility. This market regime favours short term momentum trading. The dominant investment environment becomes RORO (risk-on/ risk off).

It lends itself to low-cost passive ETFs or specialised quantitative trading techniques. Over time, AI's role may become important. The gamification of markets, exemplified by Robinhood meme investors, supports direct investment bypassing professional fund management. Vicarious pleasure where someone invests your money does not work for YOLO (you only live once) investors.

The consistent failure by many seasoned asset managers to outperform the broad equity market highlights the difficulties. The decision by many storied veterans to close their funds to external investors is testament of the challenge.

These influences collectively place pressure on fund managers' margins, currently 25-40%, and the trickle-up rewards for many investment professionals. The industry's profitability globally has been largely flat or in decline over the last decade.

Some fund managers are responding

Heeding General Norman Schwarzkopf's warning that the unwillingness to change means irrelevance, some fund managers have responded. They have introduced index tracking funds and quantitative strategies, such as

factor investing. Alternatives and new 'virtue signaling' ESG funds are now fashionable. Many have expanded into private equity and debt. Some are rolling out post-retirement income arrangements. The aim is to maintain AUM and also target higher fee products.

But the changes create new issues. Some new markets lack invest-ability for asset managers geared to traded and liquid financial securities. Many necessitate offering greater liquidity to fund investors than that afforded by the underlying investment itself. Others lack scale, being too small and uneconomical for traditional funds. The skill set required for some investments is scarce.

Ultimately, these measures cannot increase returns for all. Financial markets are zero sum games where no value is created with wealth being transferred between participants. Not all fund managers can be above average.

History is replete with industries disrupted or superseded often rapidly. Assuming that asset management can prosper in its current format may not be realistic.

Satyajit Das is a former banker and occasional author. His latest book is A Banquet of Consequences – Reloaded (Penguin March 2021), which 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, of course, Covid19.

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