Firstlinks
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Editorial

Headline writers reaching for superlatives to describe the rise in Australian house prices in the last 12 months (up 19.3% on the CoreLogic 5 Capital City Aggregate) make regular references to 'the fastest increase in 33 years'. So what happened in 1988? In only one quarter, June 1988, residential property prices **rose** 9.6%, but that's where the similarities end.

Between September and November 1987, the ASX All Ordinaries price index **fell** 50%, prompting a big asset switch to the security of property, both commercial and residential. Kicking it along, the cash rate fell 1.5% between September 1987 and June 1988.

Cash rates down, money flowing into property ... sounds like 2021, right? Wrong. The cash rate fell from 15% to 13.5%. Such rates would bury current day borrowers financing at 2% with debt to income ratios of 2021. And the current flows to property are not a switch from equities, which are themselves experiencing major inflows. The 2021 property boom is more funded by the ready availability of debt.

According to the Australian Prudential Regulation Authority (APRA), 22% of new mortgages in the June 2021 quarter went to borrowers with debt-to-income (DTI) ratios above six. Some banks allow up to nine times. Since 1988, the ratio of house prices to household debt has risen from 2.5 to over 5.5.

Here's a major difference between 1988 and 2021. Back then, while paying a mortgage at 13.5% was tough, inflation was also high and wages kept pace with rising prices. Over the years, the debt was inflated away, such that most people had paid off their mortgage when they entered retirement.

Now, inflation is low and the debt retains its current value for longer into the future. If someone takes a loan for say nine times their income, while they can service the interest repayments due to low rates, they make little inroads into the principal. Inflation no longer fixes the debt burden, and far more people will enter retirement with large mortgages.

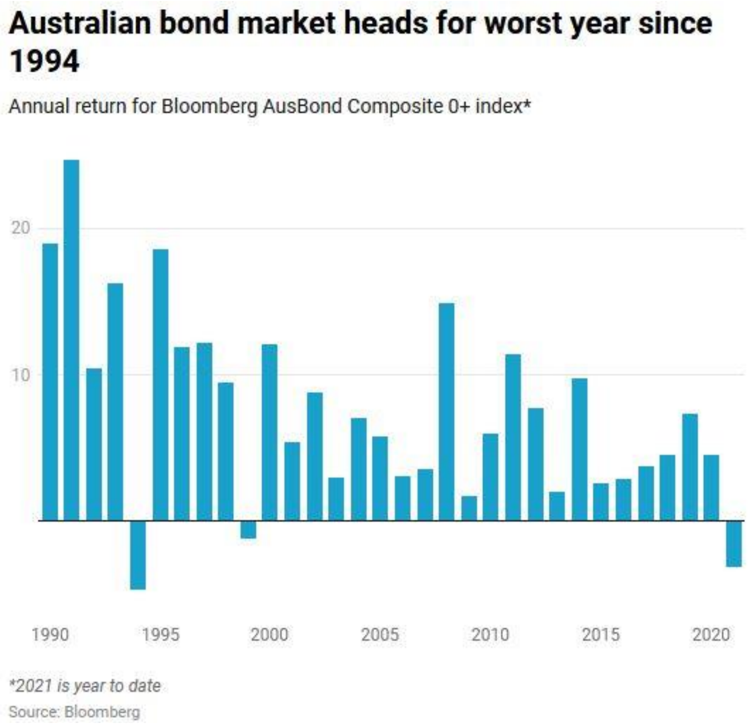
It has long-term consequences, neatly summarised by **MacroBusiness** economist, **Leith van Olselen**. He says it's as if the banks have adopted a subscription model for the clients to buy homes. It's similar to **Microsoft** switching to an annual subscription fee rather than selling their software upfront. The banks now collect annual interest payments but many borrowers never pay off the debt. It works fine as long as interest rates do not rise too much, especially when house prices are rising, except it leaves the owner with a mortgage to service in retirement when work ceases.

Often, the superannuation is used to pay the debt, or Australia will move to intergenerational mortgages, as they have in Japan, where they have 100-year mortgages. A house becomes 'ancestral' and is passed with the loan over multi-generations.

And what happened after the house price boom of 1988? Heavy falls through 1989 to 1991 with many quarters of prices down around 1.5%. In November 1990, **Paul Keating** called out 'the recession we had to have'.

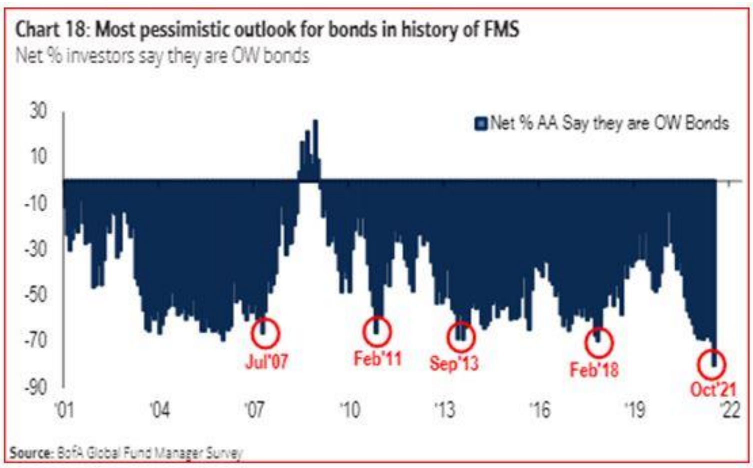
Susan Thorp tackles this issue by looking at the failures of policies to adequately [link home ownership with retirement income](). The family home is the largest asset for most retirees but it's least likely to be used for retirement income. Susan rates the current system a poor 'D'.

Continuing the home focus, we have extracted charts and predictions from the work of **Alan Oster** and his economics team at **NAB** to give a state of play at this critical point. Price rises are slowing and eventually rates will rise, even if only slightly, but there are [reasons for market resilience]().



We have documented previously how **RBA Governor, Philip Lowe**, and the market are differing on rate and inflation expectations, with further evidence in this week's CPI release. It showed a jump in the trimmed mean, RBA's preferred measure of inflation, up 0.7% taking the annual increase to 2.1% which is within the RBA target range and the highest since 2015. The recent rise in bond yields means the Bloomberg AusBond Composite index is likely to produce its first negative return for 20 years in 2021. It presents obvious challenges for defensive portfolio allocations, so watch those 60/40 funds.

Investors in the **Bank of America** Global Fund Manager Survey report their most underweight exposure to bonds since the research began in 2001. Professional investors have voted with their money and this is putting further upward pressure on long-term rates.



The [White Paper]() this week from **Sage Capital** looks at inflationary consequences for portfolios, and how to invest with this threat not seen for many years, transitory or not.

Still on housing, **Michelle Morgan and Norman Derham** take the view that the balance sheets of banks and the vast majority of borrowers are [far more robust]() than those worrying about 'financial instability' claim. It's a challenge to the popular view gaining momentum.

Back on bonds, even if there is a modest rise in rates, the returns will not satisfy investors needing income to live on. With a Government Inquiry reporting this week on how to open the corporate bond market to more investors, beyond the current 'sophisticated' definition, **Matthew Macreadie** checks some unlisted opportunities at different points of the risk spectrum.

Andrew Mitchell then gives some excellent examples of four mental biases that undermine our investment success, and ways to cope with potential mistakes and turn them into opportunities. It's all in the mind.

In the short term, there are many factors which drive stockmarkets, but **Damien McIntyre** looks through the recent expansions in Price/Earnings ratios which have driven popular growth stocks to high prices to show where returns really come from over the long term. Cash flow is king.

Emerging markets are increasingly on investor radars, and **Valeria Vine** reports on 10 trends that will guide the destiny of these newer market opportunities.

This week's Comment of the Week from **Billy** was in response to the article on how financial advice is changing, where many people described that the role of advisers has moved well beyond picking investments.

"I once received a financial plan that (amongst other things) had four pages which showed that in certain times "growth managers" performed better than "value managers" and at other times the opposite was the case. They presented a nice graph to prove their point, and recommended a "blend" of managers, some growth and some value. Dah! I could produce an almost identical graph that showed that at some times a manager who's name commenced with the letters between A and L produced better returns than managers that commenced with the letters M to Z and at other times the opposite. Four pages wasted, which took time to produce and time for me to read, but didn't add value. The average return of the "value" and "growth" managers? Same as the index, but with higher costs. All for "compliance" reasons. Adding cost, but not value."

This week, the Government announced some changes to superannuation rules effective from 1 July 2022.

1. Removal of the $450 per month income threshold under which employees do not have to be paid the superannuation guarantee by their employer.
2. Eligibility age to make downsizer contributions into superannuation will reduce from 65 to 60 years of age.
3. The maximum amount of voluntary contributions that people are able to release under the First Home Super Saver Scheme (FHSSS) will increase from $30,000 to $50,000.

Finally, I will be taking a two-week break and for the first time in nine years, turning on my OOO and trying to switch off completely. **Leisa** will be assisted by Guest Editor, **Harry Chemay**, best known as the co-founder of **Clover** and his years at **Mercer**. Harry recently gave this talk on housing (un)affordability if you want to put a face to the name.

Stop treating the family home as a retirement sacred cow

Susan Thorp

For individual Australians, a reasonable standard of living in retirement can only be achieved with appropriate accumulation and decumulation solutions. As the Baby Boomer generation continues its transition into retirement and life expectancies rise, we must be open-minded to ensure we have the retirement solutions to meet retiree goals right to the end of their days.

Better retirement outcomes are achievable if we stop treating the family home as a sacred cow. One of the big blind spots we have in the retirement income system in Australia is homeownership and the family home in particular.

About 76% of people over the age of 65 at present in Australia are homeowners, but that disguises a large number of renters and an increasingly large number of renters who are moving across from working life to retirement. About 12% of those over 65 currently rent and another 11% live rent-free or in residential care.

One of the features of Australian households when we look at their portfolios is that for the majority, particularly above the first quintile of wealth, the family home is their largest asset, and it's also the least likely to turn into retirement income. It's the aspect of their portfolio that is perhaps the most difficult to deal with when people come to retirement and the least likely to receive attention.

The three 'Ds' of homeownership and retirement incomes

When I think about the way that Australia deals with homeownership in relation to retirement incomes, I would give it a grade of D, and that's not D for a distinction, that's D as in A, B, C, D, next letter E. And my concerns in relation to housing and the way that it's treated in our system can be considered as three 'Ds': **first is distortion, second is difficult decumulation and third is denial**.

1. Distortion

In an efficient economic setting, renting and investing would be equivalent to investing in an owner-occupied house. I would be neutral, setting aside my personal preferences, to whether during my working life, I rented a house and invested elsewhere, or bought in an owner-occupied home. But we know that for many reasons in our system, homeownership is very attractive. I think that there are four things worth highlighting.

First, it's often overlooked that mortgages give households access to leverage that isn't available to them to purchase other types of assets. During our working life, the big loan that most of us attract is to purchase a house, and that's a huge advantage to those who have sufficient income to support mortgage repayments. It's a critical way that young households can leverage that human capital.

Second, homeownership is very attractive and excessively attractive in Australia due to unique tax advantages, obviously around capital gains.

Third, over-investment in housing is supported by the means test exemptions through the social security system partly while people are working and certainly after their retirement. These regulations also discourage downsizing once people have moved into the retirement side.

Fourth, mortgages offer households a special type of savings precommitment device that shares a lot of similarities with the mandatory superannuation. This precommitment device is a way that households get around their own impatience and tendency to spend too quickly and rather, preserve wealth for the future.

The overall goal of the retirement income system is to allow people to reasonably maintain their working life standard of living during retirement. Achieving this goal is much more likely for homeowners than it is for renters.

So one of the areas of obvious attention as our population and asset structures change is that more people are moving into retirement, and homeownership causes a great deal of inequality. Even if homeowners and renters manage to accumulate similar amounts of wealth, they are treated quite differently by the retirement income system.

2. Decumulation difficulties

The second 'D' are the difficulties in decumulation. The intention of the retirement income system is to provide an income in retirement, but our system means that the most valuable asset in household portfolios is inflexible when it comes to supporting consumption. We also have these increasing trends to later entry to the mortgage market which means that people are bringing debt into their retirements. So our other financial assets, which are fungible, are being used to pay off debts associated with a very inflexible asset.

This lack of liquidity encourages households to use houses to save up for major contingencies like costs of aged care or indeed for bequests. Storing up wealth in houses for those major contingencies also highlights further inadequacies in our system. Our insurances around these big risks are not very well developed. We don't have good products to provide for the needs of aged care and other expenses that means houses are used by households to cover them.

3. Denying the role of the home in retirement income policy

And the final 'D' is denial. This is the largest asset in most household portfolios but so far it hasn't attracted much attention, either explicitly in retirement incomes policy or in product design from the industry. We know that the Retirement Income Covenant allows superannuation fund trustees to use homeownership as a characteristic for distinguishing between cohorts of members, but things don't appear to be changing in the product space. Most of the products that are coming to the fore do not directly address or model homeownership as part of the wealth management strategy that they're addressing.

That's three 'Ds': distortion, difficult decumulation and denial. There's an elephant in the room that we really need to address.

Susan Thorp, PhD, is Professor of Finance & Associate Dean (Research) at The University of Sydney Business School (Sydney). This is an edited transcript of a talk as part of a session called 'Better retirement solutions are the means to the end' on 25 August 2021 for the Portfolio Construction Forum.

Hey boomer, first home buyers and all the fuss

Michelle Morgan, Norman Derham

There's been a lot of angst-ing about house prices over the last few months. It's more difficult to start for first home buyers and APRA's announcement that it will tighten lending standards is intended to prevent a 'bubble explosion'.

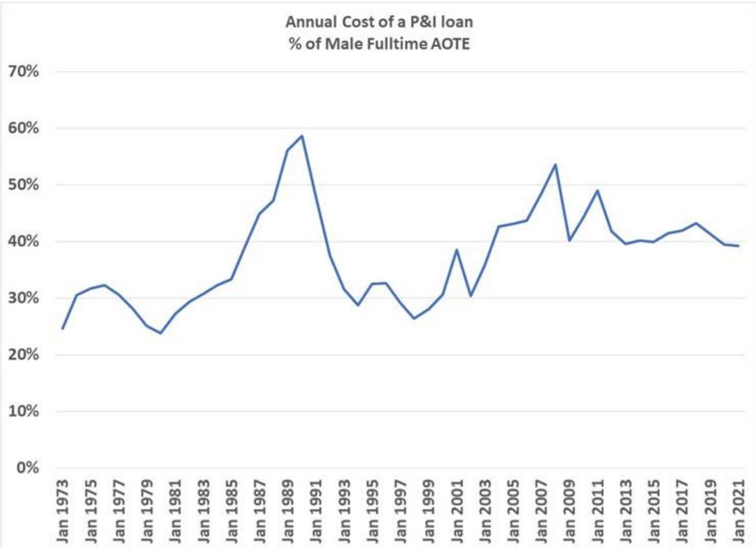
We don't think either of the issues are really supported by evidence.

There's no doubt house prices have had a go-go year. UBS published its annual Real Estate Bubble index last month and Australia has put in a world class performance this year. Sydney's price increase (17% above inflation) is the third highest of the 25 cities it surveys (Moscow was no 1 with 22%). But over a five-year period, Sydney's real price increase of around 3% was well below average, and on other affordability measures, Sydney is more affordable than most of the other 25 cities.

Prices versus servicing

We agree with Saul Eslake (see his Firstlinks article) that first home ownership is an important social construct, and we constantly read headlines about how difficult it is to get into the market (compared to when Boomers were young). The data doesn't support this. Much of the commentary about the lack of affordability looks at the Price to Income ratio but this ignores the effect of lower interest rates on servicing burdens.

We've constructed this chart which shows the cost of an 80% LVR (loan-to-value ratio), 25-year P&I (principal and interest) loan based on home prices and as a percentage of income since the 1970s. We are using 'averages' (full time male Average Ordinary Time Earnings - AOTE - and median Melbourne house prices to 2002 and weighted median house prices since then) and we accept all arguments that it's not a perfect set of assumptions. We suspect the story is much the same if you use your own assumptions.



In a nutshell, we all know that house prices have gone up exponentially since the 1970s, which is the major reason why the house Price to Income ratio has increased. But so have wages (at a rate of inflation+) while interest rates have fallen.

In the simple terms of how much of your income you devote to paying your P&I home loan, it's not a lot different between now and those sunlit uplands we all read about. Plus houses are better now, so maybe it should be more expensive.

The societal group we should feel most sorry for is that cohort who bought in the late-1980s/early-1990s when interest rates were 15% as they spent their 20s living on three-minute noodles and drinking at cheap pubs so they could afford to service their home loan.

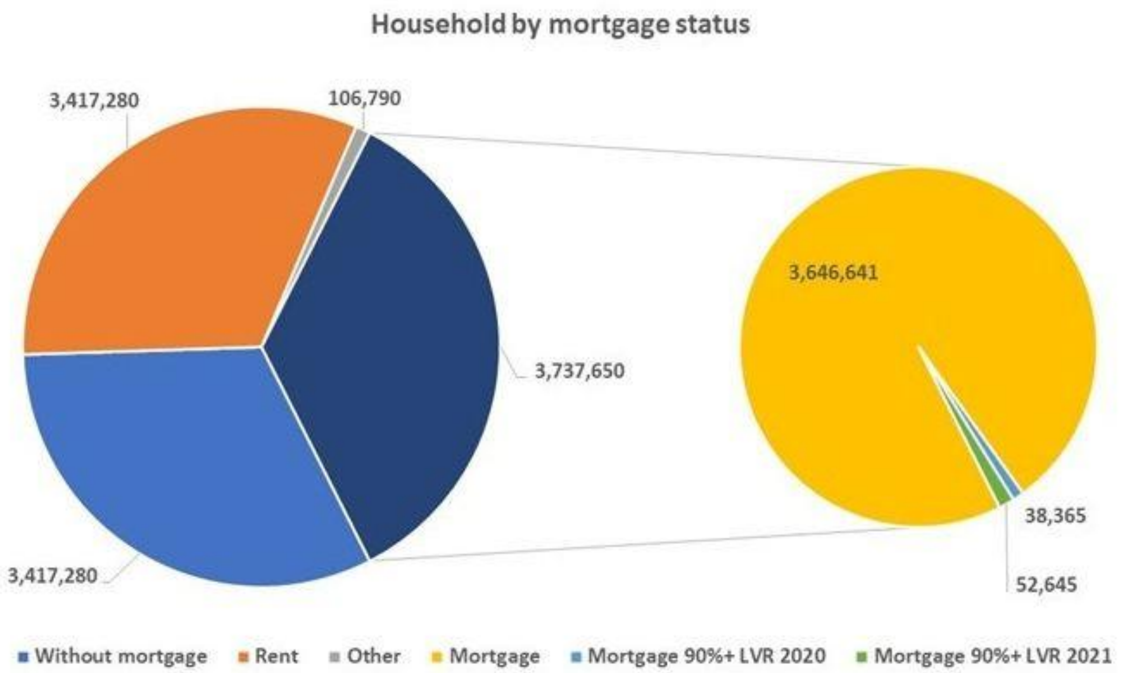
Is APRA really worried?

APRA announced tighter restrictions on lending for new borrowers by requiring higher minimum interest rate buffer on new loans, citing growing increasing financial stability risks and an acceleration in borrowing. This only applies to new loans and the simple chart below demonstrates how incorrect this is.

We've stratified the total number of Australian homes by tenancy types. The number of households **with** mortgages (the dark blue segment on the left side), is around 35% of the total number of households (around 10.7 million) and most of the mortgages are old or low LVR.

In the right side of the pie charts below, we have taken the total number of mortgages and slivered out the loans at risk i.e., the number of new loans in FY20 and FY21 at an LVR of >90%. There are around 90,000 of them.

We can't see existential risk for the Australian financial system arising from less than 1% of the households having marginally increased their risk appetite and maybe borrowed too much. If you look at the number of >80% loans over the past two years, it is 360,000, or just over 3%. Therefore, 97% of Australian mortgage lending is in bulletproof territory.



But what about interest rates going up?

So maybe APRA's concern about a housing market with increasing prices is that it will create problems when rates increase, and rising defaults and low affordability will result in a death spiral for the housing market and Australian economy. We can't see any basis for that either.

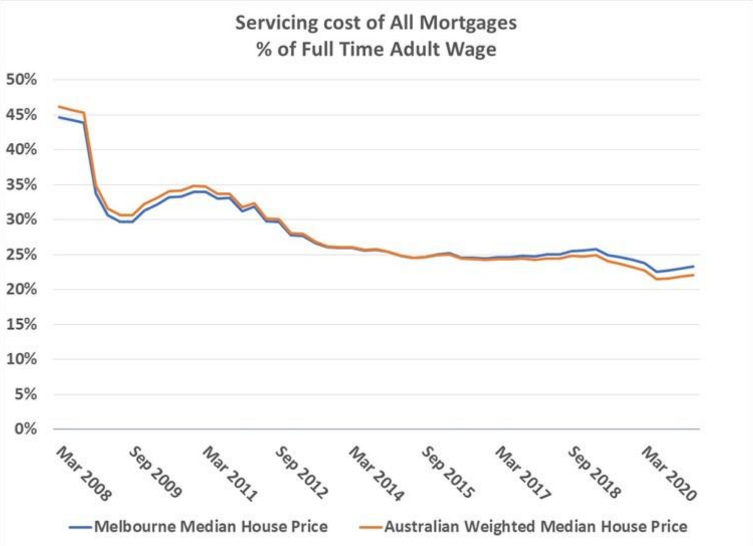
To put our argument in simple terms: except for the group that have bought over the last few years, everyone else has a loan based on the price when they bought it (say, seven years ago) and rates have halved since then, and there has been income growth.

The parameters are this:

- Only 35% of Australian households have mortgages.
- Only 3% of homes trade per year. The average Australian stays in the one home for over 20 years. We've assumed that moving house is the prime driver for increasing or decreasing a mortgage. We also assume that any home equity redraw is offset by others overpaying their mortgage. Clearly younger people move homes and increase mortgages more quickly but you can assume an average seven-year turnover and still come up with unscary numbers.
- Interest rates have fallen materially over the past decade.
- Wages/household income has increased over the past decade.

The result is that the 'average' are not at risk of financial stress if rates increase materially.

We've quantified the numbers in the chart below. The results are the P&I mortgage payments as a percentage of Adult AOTE wages. We've assumed that all mortgagees bought their home in 2008 and every year after that 5% a year sold and reinvested in a new home at the next year's median price. We've used the actual LVRs for the year of the new purchase. So, in 2020, around one-third of the original 2008 owners are still in their houses, paying a mortgage based on 2020 interest rates and 2008 house prices, and earning a 2020 wage.



The analysis shows that the 'average' mortgagee can easily absorb increases in interest rates without posing a systemic threat to the economy or the banking system.

The result is consistent with National Accounts data which shows that households spend around 3% of gross income on household interest, down from 6% in 2008.

Further evidence of the lack of kryptonite in housing lending are the lack of realised losses by lenders. Major bank housing losses over the past three decades are a very small rounding error. Even mortgage insurers, who are the most exposed due to banks requiring borrowers needing an over 80% LVR loan to be mortgage insured, suffer small losses. Average paid losses for Genworth Australia since its IPO are around 30% of the premiums they charge. And they get the worst mortgages as well.

What does it all mean?

We're a long way from housing price movements causing systemic issues.

Maybe APRA has more data that indicates that issues with the 'marginal' homeowner/buyer create outsized problems or maybe APRA thinks that shouting at people creates an effective precautionary firebreak to discourage growth in speculative home borrowing.

In any case, we expect that housing lending will continue to be a profitable and relatively risk-free activity for banks.

On a broader societal issue, APRA should be loosening borrowing standards for some of the population, rather than tightening them. There are still 30% of the population who rent and who would benefit from more certain housing outcomes. Clearly some of them will never be able to own homes, but there are others who just can't quite get into the market and are marginally higher risk. And building new homes is the best solution to too many renters and high prices, so maybe lending for new home building should be incentivised.

Norman Derham is Executive Director of Elstree Investment Management, a boutique fixed income fund manager. Both Norman and Michelle Morgan are Business Development Managers for the Elstree Hybrid Fund (Chi-X:EHF1). This article is general information and does not consider the circumstances of any individual investor.

Residential Property Survey Q3 2021

Alan Oster

Housing market sentiment has eased from record highs and confidence has ticked down further as house price rises start to slow. Construction costs are now seen as the biggest constraint on new housing developments, and there is a lack of stock for buyers of established property. NAB has revised its dwelling price forecast – 23% in calendar 2021 and 5% in calendar 2022 – as the impact of low rates and strong income support begin to fade.

Survey highlights

The NAB Residential Property Index dipped to +60 pts in Q3 from a survey high +71 pts in Q2, as shown in the chart below. With market data showing house price rises slowing, sales easing, and building approvals falling, the survey is also pointing to a market that has passed its peak.

Sentiment softened in most parts of the country (and still lowest in VIC), and confidence fell again (but still above average). With the survey expectation for house prices in the next 12 months to outpace rents, gross yields should fall before leveling out in two years' time as prices and rents rise at a similar pace – though some states (WA, the NT and ACT) may see yields rise.

In established markets, property professionals identified a lack of stock as the biggest constraint facing buyers in all states. The survey also found that though foreign buyers are still bit players in local housing markets, a significant net number of property professionals now expect their market share to rise in the next 12 months, especially in new residential markets.

NAB's view on dwelling prices

The housing market has remained remarkably resilient despite the ongoing lockdowns in the two largest capitals as well as a sharp slowing in population growth over the past year.

The market has been well supported by lower interest rates, the Federal Government's HomeBuilder programme, as well as a range of state government incentives. Contributing to the strength seen in housing has also been the better-than-expected performance of the labour market despite the significant disruptions to the economy.

That said, house price growth has slowed recently (though it remains strong), activity has slowed (with time on market increasing and new listings normalising) and approvals for both construction and lending finance pulling back. Auction clearance rates have seen more mixed results, falling notably in Melbourne on the current lockdown but having since recovered – with all markets now at high levels. Rents have also begun to recover.

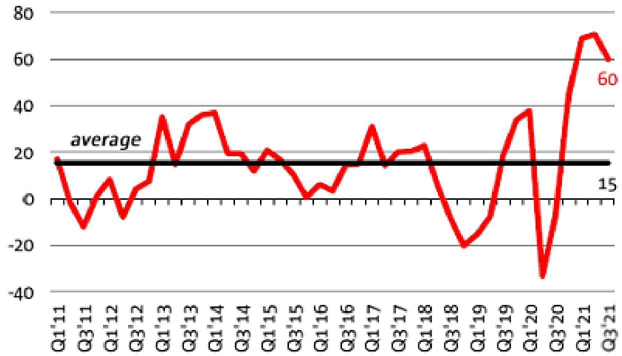
In terms of forecasts, we have revised them up slightly in both 2021 and 2022. We expect a similar pattern of growth across all capitals from here, with the pace of growth slowing in the last quarter of 2021 before slowing further in 2022. Given the outcomes in the year to date, we expect Sydney and Hobart to finish 2021 around 28% higher, Brisbane and Adelaide also in the 20%+ range and Melbourne slightly softer. Perth sees the slowest but still strong growth at almost 15%.

Alongside the rebound in economic activity, we see a solid bounce in the labour market, with hours worked and participation coming back fairly quickly. A near-term read on the unemployment rate remains difficult, with the timing of participation and employment gains likely to skew the headline measure but for now we see unemployment peaking at around 4.9%.

Importantly for the housing sector, policy makers are alert to a build-up of macroprudential risks amidst very low interest rates and the sharp rise in house prices. In

VIEW FROM PROPERTY EXPERTS

NAB RESIDENTIAL PROPERTY INDEX



RESIDENTIAL PROPERTY INDEX BY STATE

	Q2'21	Q3'21	Nxt 1yr	Nxt 2yrs
VIC	58	44	48	50
NSW	69	57	64	64
QLD	80	75	64	57
SA	63	71	76	60
WA	86	72	80	74
ACT	50	88	100	100
NT	100	67	83	83
TAS	75	50	44	39
AUST	71	60	62	59

Date October 2021| Author: NAB Behavioural & Industry Economics

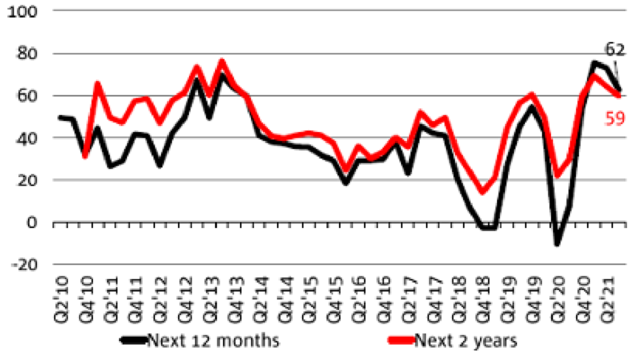
VIEW FROM NAB ECONOMICS

NAB HEDONIC DWELLING PRICE FORECASTS (%)*

	2019	2020	2021f	2022f
Sydney	5.3	2.7	27.5	5.4
Melbourne	5.3	-1.3	18.8	4.9
Brisbane	0.3	3.6	23.2	4.9
Adelaide	-0.2	5.9	20.4	3.9
Perth	-2.8	7.3	14.5	3.9
Hobart	3.9	6.1	28.4	4.3
Cap City Avg	3.0	2.0	22.7	4.9

*% change represent through the year growth to Q4 SOURCE: CoreLogic, NAB Economics

NAB RESIDENTIAL PROPERTY INDEX: NEXT 1-2 YRS

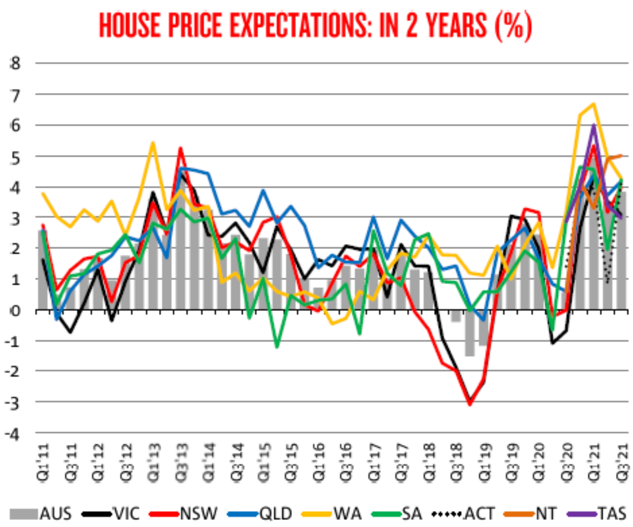


early October the interest rate serviceability buffer was widened by 0.5% to 3.0% above the loan's interest rate. The impact of this will be to reduce the debt capacity of the typical borrower by 5% and the assessment for now is that this will not see a large impact on lending or the property market.

However, macroprudential policies are rarely used in isolation and we remain alert to the possibility of further measures around the turn of the year, likely in the form of high DTI or LVR speed limits.

Get all the insights in the [NAB Residential Property Survey (Q3 2021).]

With the housing market losing steam, market confidence among property professionals also fell further. In Q3, the 12-month confidence measure fell for the second consecutive quarter to +62 pts (+73 pts in Q2) and the 24-month measure to +59 pts (+64 pts in Q2) – though both measures continue to trend well above average.

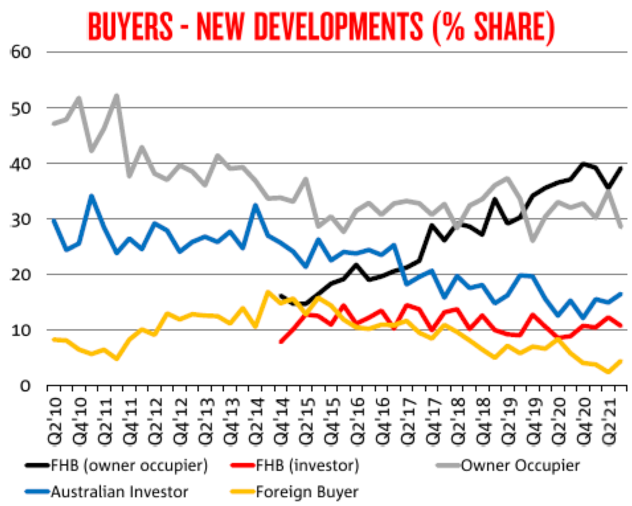


House price expectations

Despite recent data pointing to a continuation of strong (albeit moderating) house price growth across the country in Q3, the average survey expectation for house price growth over the next year is basically unchanged.

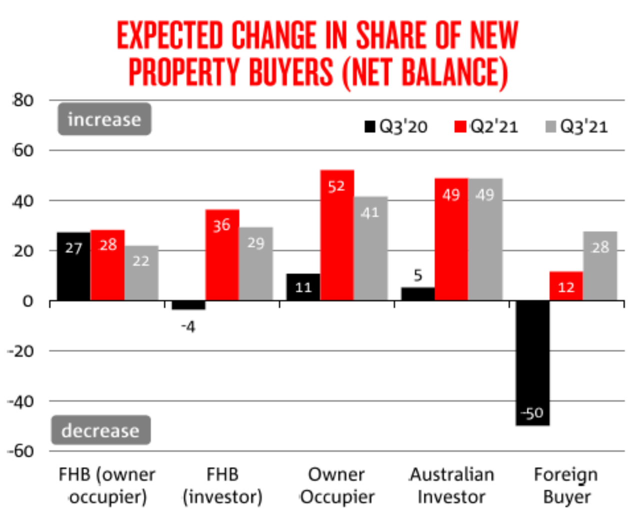
On average, survey respondents expect national house prices to rise by a still solid 4.3% over the next 12 months (previously 4.2%), but at a slightly faster 3.8% in 2 years' time (previously 3.5%).

New developments



First Home Buyers (FHBs) continued to be the most active participants in new housing markets in the September quarter, accounting for 1 in 2 (49.8%) of all sales (47.8% in Q2). FHB owner occupiers accounted for 39.1% of total sales (35.5% in Q2), and FHB investors 10.7% (12.3% in Q2).

Property professionals were asked whether the share of new property buyers in the market would rise or fall in the next 12 months in each buyer segment. In net terms, the number who said it would increase outweighed those who said it would fall in all buyer groups led by resident investors (+49%) and owner occupiers net of FHBs (+41%). Noticeably more property professionals (+28%) also said they expect the share of foreign buyers to increase than decrease in the next 12 months – a big reversal from expectations at the same time last year when significantly more expected their number to decrease then increase (-50%).

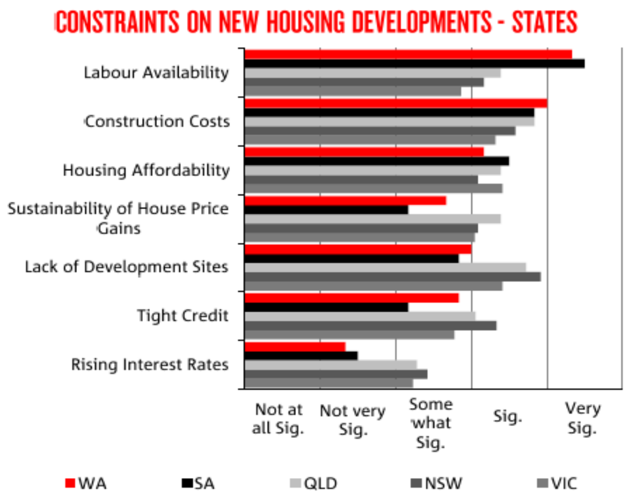


New housing market constraints

With strong building demand and shortages of building materials causing building costs to increase rapidly, construction costs overtook lack of development sites as the biggest impediment for new housing development in the country during Q3. A lack of development sites was the next biggest impediment to new developments nationally.

The negative impact of housing affordability on new housing development climbed for the third straight quarter, with property professionals in SA, VIC and QLD highlighting this issue as a bigger impediment than in other states.

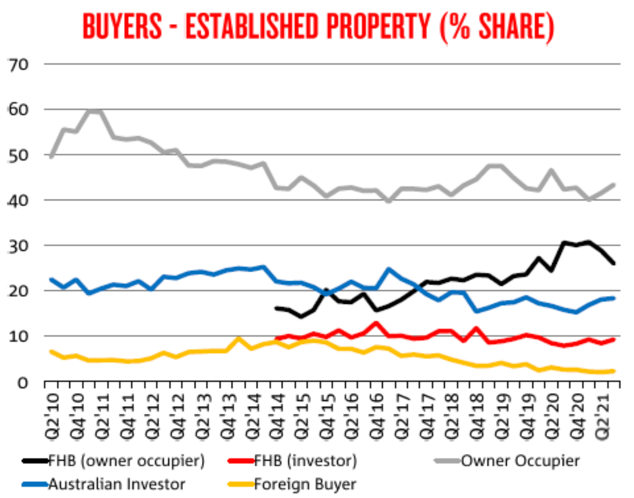
With official cash rates widely tipped to remain on hold for some time, the impact from rising interest rates continued to moderate. The impact on new housing development arising from tight credit also fell to its lowest level since mid-2015, though it was still seen as a 'significant' impediment to new housing development by property professionals in NSW and QLD.



Established property

In established housing markets, buying activity continues to be dominated by resident owner occupiers (net of FHBs), In Q3, the overall market share of these buyers increased for the second straight quarter to 43.3% (from 41.5% in the previous quarter) but remains below the survey average (46.4%).

The overall share of FHBs in established housing markets however dipped for the second straight quarter to 35.2% (37.2% in Q2) but continues to trend above the survey average (31.5%). Overall, FHBs were most active in WA (36.9% and VIC (36.7%, and least active in SA (29.9%).

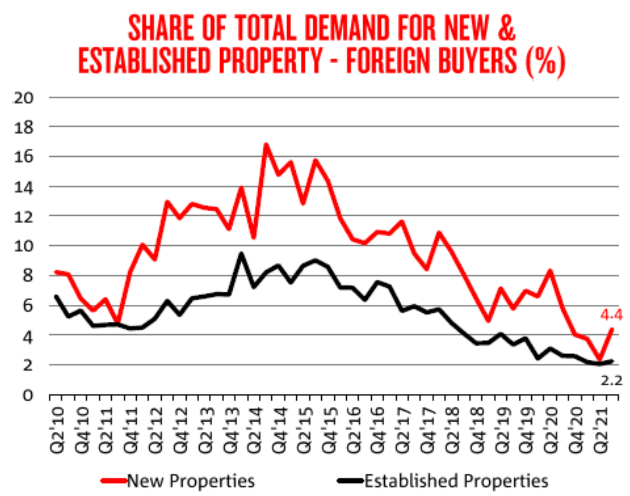


In net terms, more property professionals expect market share among buyer types to increase than decrease in the next 12 months. Expectations were strongest for domestic investors (+55%) and resident owner occupiers (+52%), followed by FHB investors (+33%) and FHB owner occupiers (+25%). Overall, the number of property professionals who expect the proportion of foreign buyers to increase (+5%) was mildly positive, representing a significant turnaround from the same time last year (-38%).

Established housing market constraints

Recent CoreLogic reports indicate that the number of newly advertised properties remains extremely low, with every capital city recording a below average amount of advertised supply, despite a recent ramping up in new listings.

With house price is also still rising solidly, property professionals said the next biggest impact on buyers came from house price levels, with the impact biggest in NSW and smallest in WA. Employment security was also cited as a 'significant' constraint, led by VIC and NSW where hours worked in the September quarter were most impacted by lockdowns and restrictions.



With interest rates widely expected to remain low in the near future, property professionals did not see rising interest rates unduly impacting buyers of established property. They also said that access to credit was impacting buyers less than at any time since mid-2015.

Foreign buyers

Foreign buyers in Australian housing markets where a little more prevalent in Q3 but buying activity from this group is still well down from the peak levels during the middle years of the 2010s. During the September quarter, property professionals estimate the overall share of total sales to foreign buyers lifted to 4.4% in new property markets (their highest share since Q3 2020 and up from a survey low 2.3% in the previous quarter), and to 2.2% in established housing markets (also up from a survey low 2.0% in the previous quarter).

Alan Oster is Group Chief Economist and Head of [NAB Group Economics](). Co-authored by Dean Pearson, Head of Economics; Robert De Iure, Associate Director of Economics; and Brien McDonald, Associate Director of Economics.

About the survey

- *The NAB quarterly Australian residential property survey was first launched in Q1 2011. The survey was expanded from NAB's quarterly Australian commercial property survey which was launched in April 2010.*
- *Given the large number of respondents who are also directly exposed to the residential market NAB expanded the survey questionnaire to focus more extensively on the Australian residential market.*
- *The large external panel of respondents consists of real estate agents/managers, property developers, asset/fund managers and owners/investors.*
- *Around 370 panellists participated in the Q3 2021 survey.*
- *This article is an edited version of the full report.*

Personal finance is 80% personal and 20% finance

Andrew Mitchell

Warren Buffett's teacher at Columbia University, the famed value investor, Ben Graham, is famous for saying:

"The investor's chief problem – and even his worst enemy – is likely to be himself."

From experience, we know this is true. If you cannot control your emotions and face up to your foibles, the sharemarket can be an expensive place to find out.

How you behave when investing often has a bigger influence than your investing knowledge. This is more relevant than ever given the abundance of information prompting investment action, combined with a dramatic increase in the ease at which investors can trade.

If investors can better understand their investing psychology – particularly the four big cognitive biases below – they will be less likely to make mistakes, such as selling too soon and holding onto losing stocks. They will also be better placed to exploit the mistakes of other investors, including picking up undervalued stocks.

Rational or normal?

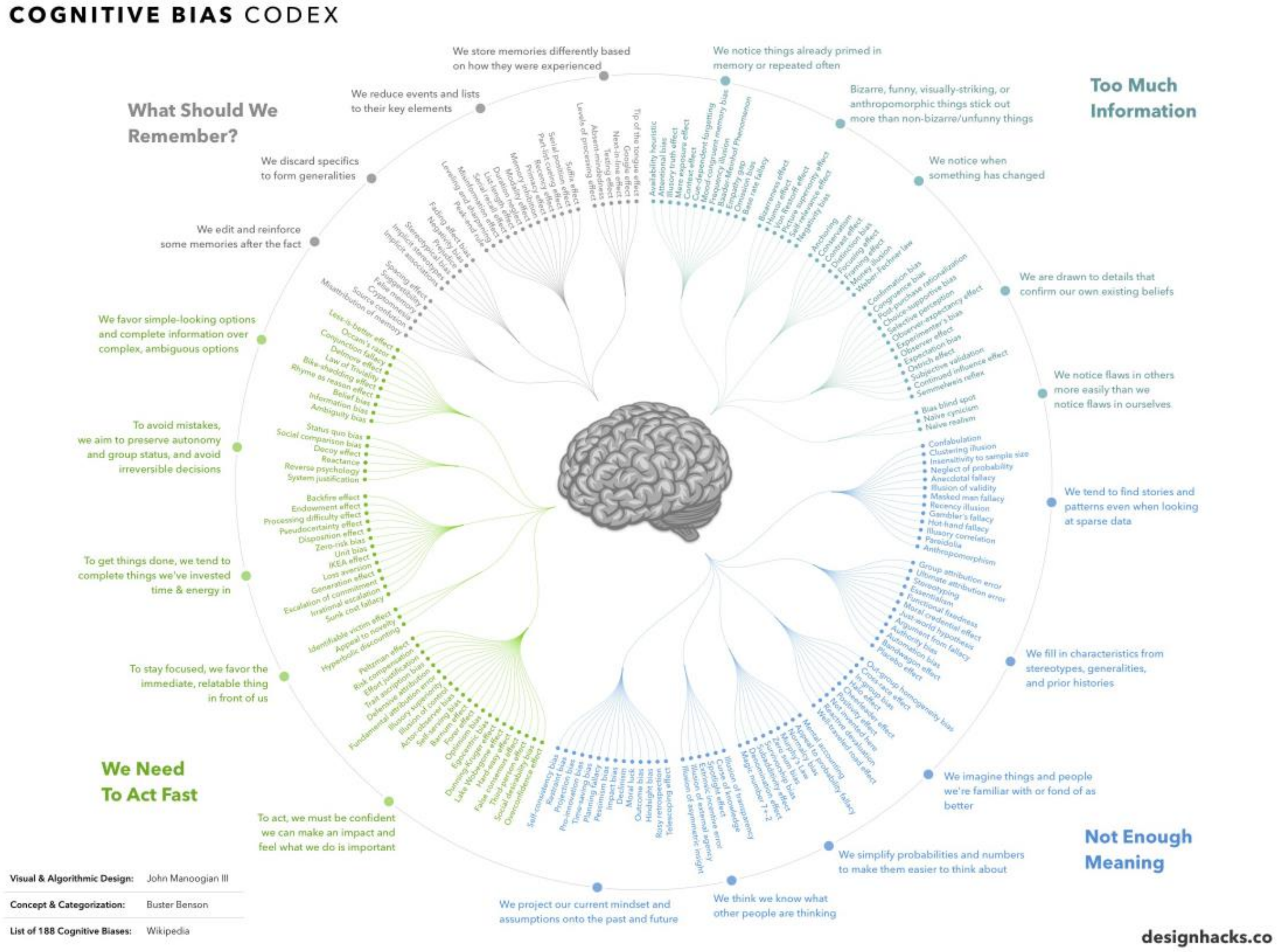
At times, investors lack self-discipline, behave irrationally, and decide what to invest in based more on emotions than facts. The study of these influences on investors and markets is known as behavioural finance.

Traditional theory says markets and investors are rational but behavioural finance believes we act as humans. Or as another giant in the field of finance, Santa Clara University economist, Meir Statman, puts it:

"People in standard finance are rational. People in behavioural finance are normal."

Behavioural finance uses research from psychology that describes how individuals behave and applies those insights to finance. Recognition of the contribution that behavioural finance has on financial economics was reflected in 2002 with the Nobel Prize in Economics being awarded to Professor of Psychology, Daniel Kahneman, now best known for his popular book *Thinking, Fast and Slow*.

The umbrella of knowledge under behavioural finance continues to grow and evolve. As you can see in the chart below, there are over 180 cognitive biases that have been discovered to date.



We believe that portfolio managers, and investors in general, need a firm grasp of four key biases to understand how other investors may respond to particular events or market developments.

1. Overconfidence (buying too high and trading too much)

The overconfidence bias is when we delude ourselves that we are better than we really are.

Surveys routinely show that more than 80% of people think they are better than average for a whole list of things, including driving, intelligence … and even looks. Heck, 84% of the French believe they are above average lovers!

In investing, overconfidence can lead you to believe that you know more about a stock or the market than you do. Various studies have tested the effect of overconfidence bias in financial markets. In one study, Bloomsfield (1999) found that overconfident behaviour unconsciously increases investors' propensity to buy stocks too expensive or sell stocks that are too cheap. Overconfident investors also tend to trade stocks more often than they should and underestimate downside risks. In these instances, when it comes to accumulating wealth overconfidence is detrimental.

Solution: We fight overconfidence by stress testing all our stock ideas in a team environment where everyone else acts as devil's advocate. We also explicitly consider how the stock would perform in a GFC-style scenario.

2. Loss aversion (holding losers too long)

Loss aversion is when the pain of losing is felt much more strongly than the pleasure of winning (profits).

Loss aversion proposes that attitudes towards investment gains and losses are not necessarily symmetrical (i.e., they are uneven). When most investors lose 30%, the pain and frustration is felt more acutely than the excitement and pleasure they feel from making a 30% profit.

The loss aversion bias gives us a rule of thumb: psychologically, the possibility of a loss is on average *twice* as powerful a motivator as the possibility of making a gain of equal magnitude.

But each person's loss aversion can differ. One investor may be willing to suffer a 20% loss for a 30% gain, while another investor may be more sensitive to losses and require the possibility of a 50% gain to compensate for the risk of being hit with a 20% loss.

Loss aversion can mean investors are unwilling to sell unprofitable investments. Even if they do not see any prospect for a turnaround, they wait to 'get even' on the position before selling.

Similarly, loss aversion can mean investors take profits too early. They are too quick to cut and run on investments that have made a profit. This limits the upside for investors, and can lead to too much trading, which has been showing to limit returns for everyday investors.

Solution: Day to day, sharemarkets have only a slightly better than 50% chance of going up and a slightly less than 50% chance of going down. But over longer periods like a month or a year, the odds significantly fall below 50% that your share portfolio will have gone down.

If you're suffering from loss aversion, look at your portfolio of shares less often. The longer you wait to review your portfolio, the less likely you will be to see a loss and be tempted to sell.

3. Mental accounting (not treating all money as equal)

Mental accounting is when we put our money in different buckets which can distort our behaviour.

This bias is a child of Richard Thaler. Thaler also won the Nobel Prize for Economics in 2017. In the 2015 movie The Big Short, Thaler is the character explaining synthetic CDO's at the blackjack table alongside international pop star Selena Gomez. He is also the author of the wonderful book, Nudge.

With mental accounting, instead of viewing your assets as a single portfolio, your divide your investments into different 'mental accounts'.

For example, an investor might have put $20,000 into a fund two years ago that has since generated a $10,000 gain. The theory of mental accounting suggests that many investors may be willing to take greater risk with the $10,000 gain portion than they would with the original $20,000.

But a dollar is a dollar is a dollar. That is to say, money is 'fungible': it is all the same no matter where it came from or how you earned it.

Taking greater risk with the portion gained by treating it as 'house money' violates the fact that all money is interchangeable.

Outside of investing, but within personal finance, mental accounting can lead to simple errors like having $10,000 cash in a savings account for a holiday, but having $10,000 of credit card debt. It obviously makes sense to use the holiday funds to pay off the credit card and stop paying huge interest, but the person views the two as separate buckets.

Another version of this is bucketing money and investments according to whether they generate income or capital returns. Total returns are what investors should be focussed on instead. An obsessive focus on income or capital returns can often mean investors have a suboptimal allocation to investments within their portfolio. Capital returns can be used to fund lifestyle expenses too, providing it is sustainable.

Solution: A simple reminder that a dollar equals a dollar no matter which mental account it is sitting in, can be incredibly valuable.

4. Confirmation bias (only seeing what you want to see)

This bias relates to only seeking out or having selective perception for information that confirms our beliefs or values, whilst devaluing those that don't.

It is easier to digest information that accords with how we already view the world. The cognitive load is much higher when we have to try and integrate new contradictory information into our worldview.

In investing, this often means ignoring any information that goes against a buy or sell decision we have made in the past, rather than objectively analysing it on its merits. At its worst, it means only constructing an 'echo chamber' of information sources so that you never run into a view or data that is going to contradict prior beliefs. The internet has made this echo chamber all the more likely over time as algorithms often selectively find and present you similar content over time, reinforcing previous views.

Solution: At Ophir, we actively ask how we could be wrong in our views and seek out people or broker analysts that hold differing views. Another view does not necessarily mean you are wrong but it can help stress test your position for a more balanced view, lest you only see the world from one narrow perspective.

Slave to vices

There is much further to go before traditional finance can be integrated with the more dynamic findings from behavioural finance.

As psychologists will tell you, the first step in dealing with an issue, such as these biases, is to recognise there is an issue. There are many great books, such as those listed above, as well as Misbehaving (by Richard Thaler) and Irrational Exuberance (by Robert Shiller) on behavioural finance, and investors should understand more about themselves and the investors they are trading with.

At Ophir, we see these biases as an opportunity which leads to investors overreacting and making mistakes that lead to the mispricing of securities.

Andrew Mitchell is Director and Senior Portfolio Manager at Ophir Asset Management, a sponsor of Firstlinks. This article is general information and does not consider the circumstances of any investor.

Read more articles and papers from Ophir here.

Where do stockmarket returns come from over time?

Damien McIntyre

In a world of low-yielding investment returns, finding solid investments by wading through various measures, metrics and methods can seem an onerous task. Free cash flow is one of the more reliable indicators for return on your investment. This is especially true when companies focus on allocating cash efficiently among internal reinvestment opportunities, acquisitions, dividends, share repurchases and debt repayments.

Cash flow basics

First, it is important to define what cash flows actually are. Cash flows, the income statement and the balance sheet are the three financial statements needed to assess a business.

A company's cash flow comes in through sales or cash receipts, for example, and out due to operational expenditures. Cash flows in and out are shown through the quarterly cash flow statements. If the cash outflows are greater than the cash coming in, then it is a cash-losing business.

The cash flow statements also represent how much cash in the bank a business has for that quarter. If the business only has a couple of quarters' worth of cash in the bank, then it may not be a viable business worth investing in.

The income statement, by contrast, represents how much income a business has made through deducting total expenses from total revenues. Meanwhile, the balance sheet represents what assets (land, cash, buildings, machine, equipment, intellectual property, etc.) and liabilities (debt, wages, taxes, etc.) a company might have.

The free cash flow of a business is the cash left over for all financial stakeholders, including investors.

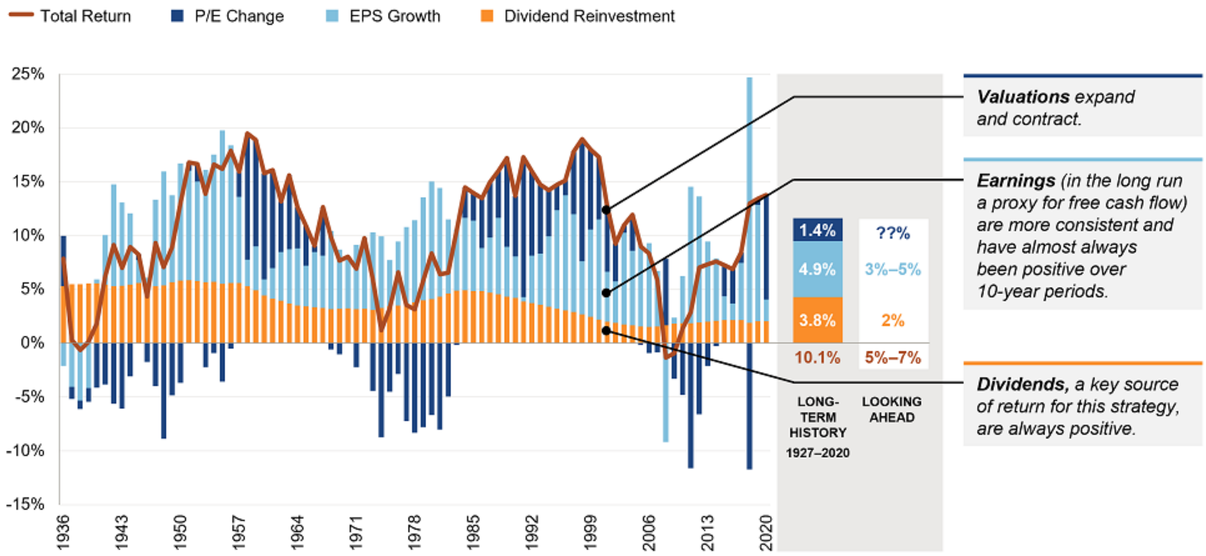
Why is this important?

Take a look at the chart below which is foundational to our investing. It's the guiding philosophy when looking for companies based on cash flow. It shows the S&P500 index since 1936 with total returns broken into three components: earnings growth, Price/Earnings changes (expansion and contraction) and dividends.

In any period of time, P/E multiples can drive total market returns but their impact fades over time. Investors are left with earnings growth and dividends as the fundamental drivers of long-term equity returns.

Check the long-term numbers on the right of the chart below. The total return from the index over this long time period has been around 10% a year (nominal) on average, of which 3.8% is due to dividends and 4.9% is due to earnings, but only 1.4% is due to multiple expansion and contraction. That is why we focus on the cash flow the business is able to generate.

EARNINGS, DIVIDENDS AND VALUATION: RETURN CONTRIBUTIONS FOR ROLLING 10-YEAR PERIODS
(S&P 500 Index 1936–2020)



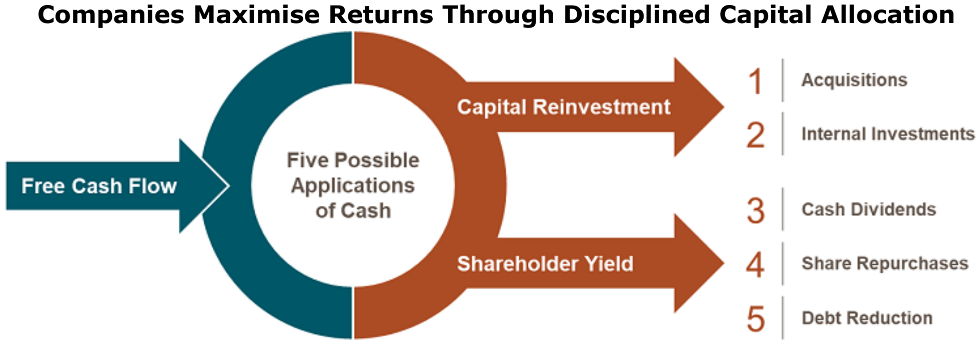
Sources: Epoch Investment Partners, Inc.; Standard & Poor's.
Note: We use U.S. historical data as a proxy for global markets because similarly detailed data is not available for non-U.S. markets.

Free cash flow as an investment value determinant

Investors can use free cash flow to determine the true value of a business for investment and what returns it may generate in the future. The higher the cash flow in any given year, along with the growth rate of further cash flow, usually means a higher value for the company.

Yet, there are trade-offs in this equation as cash must be invested in the business for growth to happen. The management of any business with free cash flow must determine how much it will pay out to investors today and how much it will invest back into the business to create future growth.

Companies Maximise Returns Through Disciplined Capital Allocation



A company should reinvest capital if the expected return on invested capital is greater than the company's cost of capital. Remaining free cash flow should be returned to shareholders via shareholder yield.

Source: Epoch; GSFM.

The free cash flow difference

In many respects, free cash flow investors follow the same process as value investors. They use a valuation metric to narrow the investable universe down to a manageable list of candidates. In essence, free cash flow investors uncover value by determining which companies are efficient allocators of capital.

The focus is on the capital allocation decisions instead of the traditional accounting-based financial metrics such as P/E ratios, earnings before interest, taxes, depreciation, and amortisation (EBITDA), and enterprise value (EV). These traditional financial metrics do not tell the full picture of potential returns due to their myriad accruals and assumptions.

Some investors seek companies that have paid out high dividends recently, but such dividends may not be a consistent feature of the investment. In fact, a high dividend payment can often be a sign of distress within a company and its stock price will fall. It is best to view company dividends in line with the consistency of free cash flow.

Every good company needs a sound capital allocation policy. Reinvestment of cash into the business should only happen when the return on capital is greater than the company's average cost of capital. If not, then the cash should be used to buy back shares, pay dividends and pay down debt.

Company cash flow examples

Most technology companies were able to maintain or increase their dividends and share repurchase programs throughout the pandemic. Microsoft is a good example as the company continues to generate strong levels of free cash flow and increased its dividend in September 2020 and September 2021. The company also maintained its share repurchase programme through the pandemic. Microsoft has been transitioning to an enterprise software-as-a-service company with a strong adoption of its Office 365 platform and it is pushing this model into more of its offerings. The focus on perpetual subscriptions rather than one-time licensing sales will improve the consistency and growth trajectory of cash generation which has been strong in the work-from-home environment.

Another example to highlight is MetLife, a U.S. based global life insurance company. MetLife raised its dividend in April 2020 at the start of the pandemic and again in April of this year. While the company temporarily paused share repurchases during the early part of the pandemic, they did reinstate the buyback programme in Q3 of 2020 which has continued into this year. The company has a strong regulatory capital position, pays an attractive dividend, and has a policy to use excess free cash flow for debt reduction and share repurchases. Growth for the company will reflect the rate of market expansion in the U.S. as well as the more dynamic opportunities to offer insurance and financial products in developing regions outside the U.S.

On the other hand, movie theater operator Cinemark is an example of a company we exited after determining that the business impact from the pandemic was very material which clouded the outlook for dividend sustainability. We sold the position over concerns that the US could experience theatre shutdowns of an indeterminable length which would put pressure on the cash flows of the business.

When assessing any investment, it's important to remember that cash is still king.

Damien McIntyre is CEO of GSFM, a sponsor of Firstlinks and distributor of the Payden Global Income Opportunities Fund in Australia and New Zealand. This article contains general information only. Please consider financial advice for your personal circumstances.

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How to invest in the 'reopening of Australia' in bonds

Matthew Macreadie

Editor's note: the bond investments mentioned in this article are only currently available to wholesale or sophisticated investors, not 'retail'. However, the Government Report, on the 'Development of the Australian Corporate Bond Market: A Way Forward' was released this week with 12 recommendations to enhance the development of the Australian bond market. The Report says:

"We need to do this for two people: working Australians who are approaching retirement and need to regularise their retirement incomes, and growing businesses that want to stay in Australia but have little or no access to venture capital."

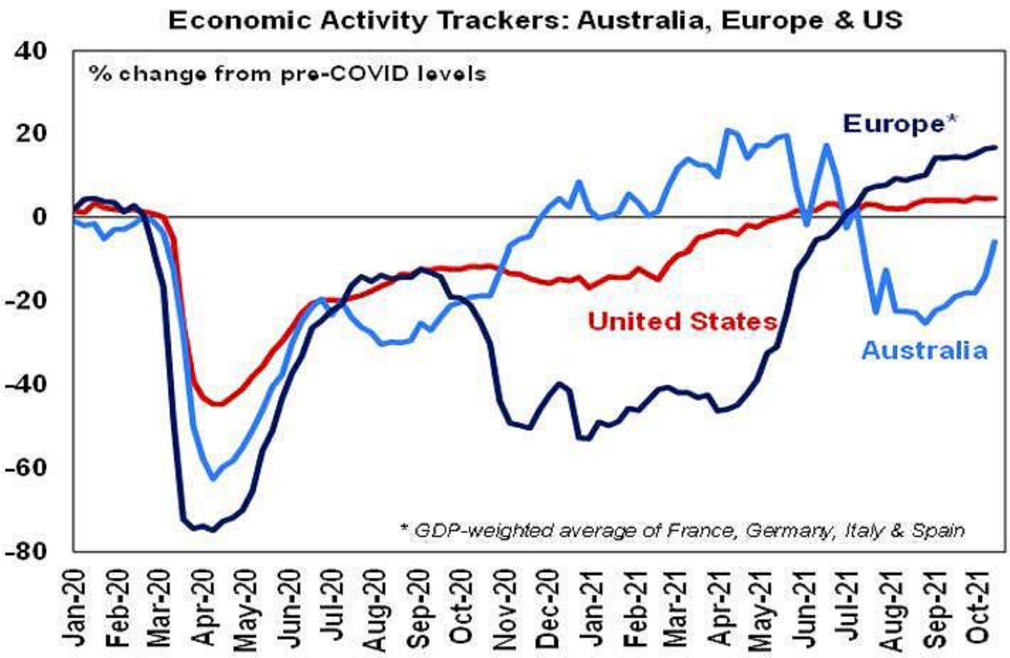
As Sydney and Melbourne emerge from lockdown, there are some reopening trades in the Australian credit market which eligible investors should consider as part of their fixed income portfolios.

The outlook for the Australian economy is looking increasingly optimistic with consumers and businesses starting to see light at the end of the tunnel. Opportunities are coming from bonds in sectors hit hard by lockdowns that are trading relatively cheaply compared with their valuations based on a normalised operating environment. The main sectors include travel, shopping centres, gaming, airports, hotels, and distressed credit players.

Opportunities emerge as business opens

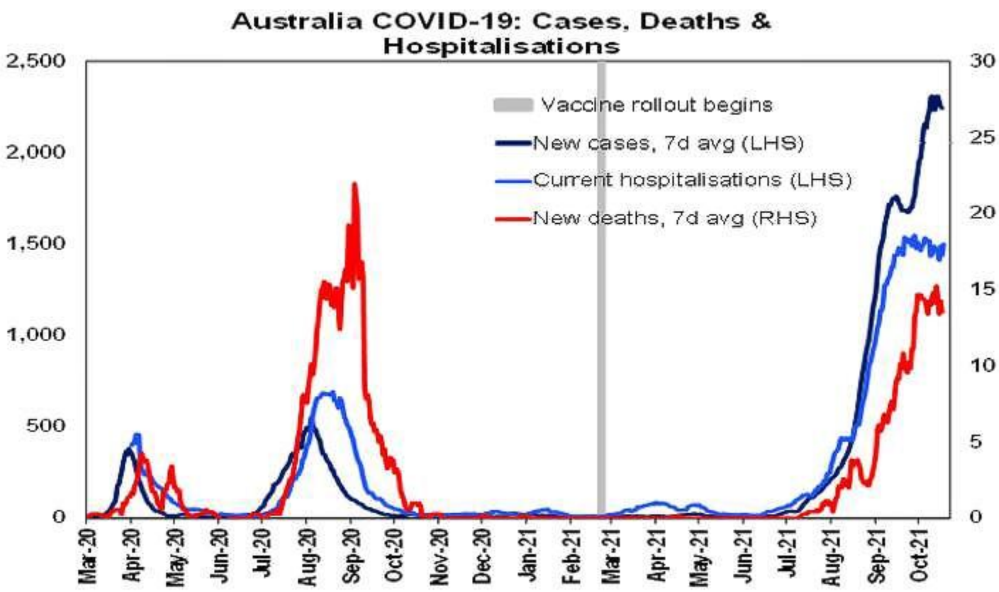
If these bonds are trading relatively cheaply, then there are incremental returns to be made as the bonds migrate towards their fair value. Provided a company's prospects have not been permanently impaired (that is, idiosyncratic risk remains quite low for the credit), then a focus should be on companies which are high-quality, have good balance sheets and are industry leaders. These will benefit the most from the reopening as COVID-19 becomes less of a threat.

Chart 1. Economic Activity During Peak Covid Era



Source: AMP Capital, covid19data.com.au

Chart 2. Covid-related Hospitalisations, Cases, and Deaths in Australia



Source: AMP Capital, covid19data.com.au

The AMP Capital Australian Economic Activity Tracker has risen strongly as the Australian reopening gathered pace. All components within that tracker rose, with the key ones being restaurant bookings, transactions, and mobility. The main risk in Australia remains a resurgence in new cases in NSW, the ACT, and Victoria after reopening, not unlike what has been seen in the UK, Israel, and more recently Singapore.

In the investment-grade space, our top ideas are:

Qantas: *5.25% 09/09/2030 (Yield-to-Maturity YTM of around 4%)*

The outlook for Qantas has improved significantly following recent updates to the long-anticipated travel restart. This has seen the intended take-off date for international travel brought forward from 1 December to 15 November, to (more recently) 1 November 2021.

Overall, increasing vaccination rates across Australia, along with the relaxation of border and quarantine policies, have lessened the risks for the airline, giving us conviction in the company's earnings will rebound with free cash flows (FCF).

Scentre Group: *5.125% 24/09/2080 (callable 24/06/2030, with YTM of around 4%)*

Scentre Group is supported by a portfolio of high-grade retail assets that have traditionally been very high performers. While Australian retail property centres were impacted by COVID-19, rents picked up in H1 2021 and are likely to start ramping up over H2 2021 as restrictions continue lifting — making this a good 'reopening trade'.

Scentre Group is a world-class owner, manager, and developer of retail assets. Asset values have started to stabilise, and the company's net operating income (NOI) appears to be rebasing to a level higher than expected.

Sydney Airport: *3.12% 20/11/2030 (inflation-linked bonds, real yield of around 3-4% depending on inflation assumption)*

With interest rates as they are and the many analysts arguing that the unprecedented COVID-19 economic stimulus will create ongoing inflationary pressures, it is prudent to include some form of inflation-linked bonds in your portfolio.

Supported by increasing vaccination rates across Australia, we're getting closer to a normalised operating environment, and that will be good news for airports, hotels, and tourism/travel in general.

In the high-yield space (where returns come with more risk so extra caution and research is needed), our top ideas are:

Capital Alliance Investment Group (CAIG): *10% 21/10/2025 (YTM of around 10%)*

There are several key credit milestones on the horizon for CAIG, starting with the opening of the Marriott in late October, which should coincide with the 80% vaccination threshold in Melbourne. CAIG also has good cash on hand from the Marriott residence sales and residual stock facilities which will be received by the end of this year. By the start of 2022, there will be three operational hotels that will be ramping up occupancy and cashflows following the completion of AC Hotels (Normanby).

Pioneer Credit: *22/03/23 Note (YTM of around 9%)*

As more purchased debt portfolios (PDPs) are released to the market, Pioneer Credit is positioned to acquire assets at attractive discounts. Concurrently, improving employment conditions for underlying borrowers will improve recovery values. At this time, Pioneer Credit strikes us as a unique proposition, leveraged to a COVID-19 exit that the market has largely overlooked to date.

Crown Resorts: *23/04/2075 (YTM of around 10%)*

With Sydney and Melbourne coming out of lockdown, there's an opportunity to buy into the Crown ASX hybrids at a relatively cheap entry point. Despite the regulatory risk that comes with casinos and negative public sentiment on account of recent problems at both Crown and The Star, casinos should do well once lockdown restrictions are lifted. Crown is well positioned for a rebound, and the recent inquiry into its operations has given its Melbourne casino two years to correct its poor corporate governance.

For now, we maintain a constructive stance on corporate credit due to favourable fundamentals and supply/demand dynamics. We favour certain cyclical sectors, including travel, shopping centres, gaming, airports, hotels, and distressed credit players, complemented by a higher-quality bias in less cyclical sectors that provide defensive characteristics to portfolios.

Should we see a resurgence of market fear that leads to a material widening in credit spreads and yields, then we would be looking to add to these cyclical sectors which offer high income and total return potential.

Matthew Macreadie is a Credit Strategist at [Income Asset Management], a sponsor of Firstlinks. This article is general information and does not consider the circumstances of any investor. Please consider financial advice for your personal circumstances, including eligibility for these investments.

For more articles and papers from Income Asset Management, please click here.

10 trends reshaping the future of emerging markets

Valeria Vine

Not the emerging markets of the past

Emerging markets have always been an exciting place to invest. And while they can be volatile and suffer from liquidity problems, markets are becoming more developed, more mature, more differentiated as well as often more resilient.

From a variety of tech components, to electronics, digital payments, e-commerce, biopharma, gaming, social media and many more areas, emerging markets companies are innovating and becoming increasingly competitive on a global scale.

Here are the 10 themes we believe will drive opportunities in emerging markets in the next 10 years.

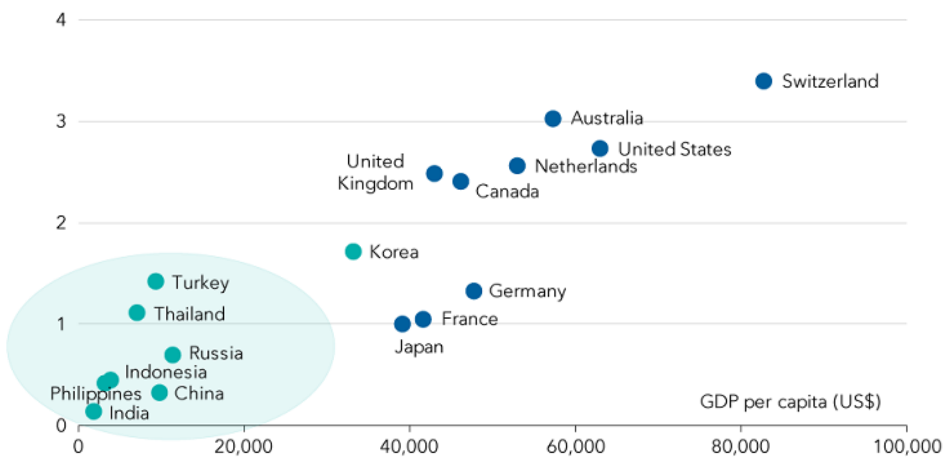
1. Emerging market middle classes are driving growth in air travel

Before the COVID-19 pandemic, around 150 million people in Asia travelled for the first time each year. Over the next 20 years, the region is expected to account for around 50% of incremental air traffic[1], fuelled by the rapidly rising middle-class population.

In China, domestic air travel had almost returned to pre-COVID levels in late 2020 after the coronavirus outbreak in the country was brought largely under control. However, the recent rise in coronavirus cases led to the return of some travel restrictions.

Air travel is a secular growth industry, supported by Asia's emerging middle class

Annual number of flights per capita



Data as at 2018. GDP: gross domestic product
Sources: CIA World Fact Book (Annual number of flights per capita) and World Bank (GDP per capita)

2. Emerging markets underpin long-term growth in luxury goods

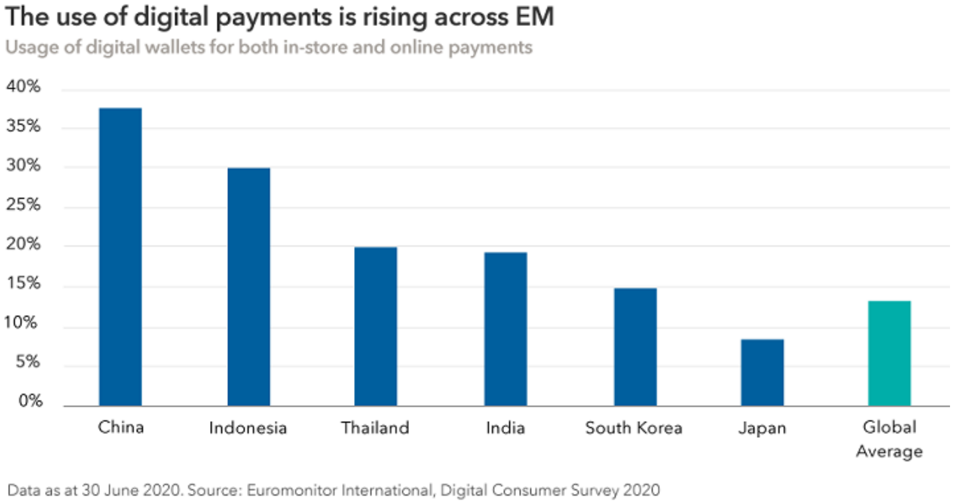
Given the discretionary nature of consumer spending, sales of luxury goods are viewed as cyclical. The evolution of a wealthy class in China and other Asian economies over the past three decades has provided the industry an underpinning of sustained and structural growth.

Capital Group equity analyst Lauren Carter expects demand to escalate in the coming years as the ranks of the consumer class expand and newcomers are attracted by the social cachet and aspirational value of luxury items. She expects China to remain a powerful source of growth in the years ahead. Indeed, Chinese consumers have shown a greater affinity for high-end goods than their counterparts around the world.

3. Emerging markets are driving the transformation to digital payments

The pandemic has expedited the long-term structural trend from cash to electronic payments. In China, electronic payments have been widely adopted due to the proliferation of e-commerce, mostly supportive regulation (until recently) and a large target market.

In Latin America, Brazilian consumers and businesses are benefitting from disruptive ideas and solutions provided by fintech companies. For example, payments provider PagSeguro offers point-of-sale terminals to small merchants, most of whom were previously unable to accept electronic payments. Consumers, on the other hand, benefit from PagSeguro's range of digital banking services, which can be accessed conveniently on their mobile phones.



4. Mobile technology trends are accelerating as internet usage rises

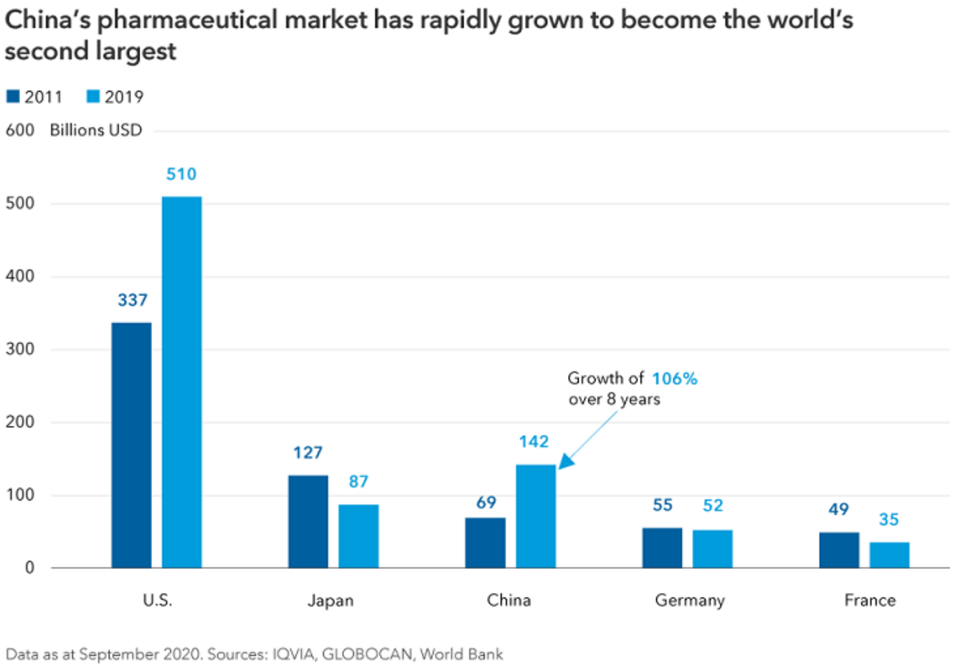
Emerging market companies within e-commerce, gaming and social media have developed and localised their technology, while accelerating their growth in ways that differ from their peers in developed markets.

Gaming is rapidly moving into mainstream entertainment as a wide variety of games become available on mobile devices. China-based Tencent, for example, has grown to become a dominant player in the global gaming market. One of its high-profile investments is US-based Riot Games, the developer of the popular multiplayer game League of Legends. The company acted swiftly in announcing new restrictions limiting game duration and in-game purchases for minors amid expectations of regulatory moves to curb internet addiction among students.

5. Innovation is a dominant force that will transform the health care industry in emerging markets

Over the next decade, China's strategic policy initiatives in biomedicine could have broad ramifications for investments in the global pharmaceutical sector and in China itself. Based on our current growth projections, China is steadily closing the gap between it and the US market. This growth comes as China is already the largest global supplier of active pharmaceutical ingredients, a point that raised concerns during the pandemic given rising geopolitical tensions and policies promoting domestic protectionism.

Elsewhere, telehealth could become a permanent fixture in the way we deliver health care going forward. The idea is that, instead of a visit to see a doctor, the patient's first stop would be an app. Such is the case in Mexico, where doctors can monitor the blood sugar levels of their patients remotely using an app developed by Clinicas del Azucar, a health care provider of low-cost diabetes care.[2] This self-monitoring approach allows patients to remain in the comfort of their home, greatly benefitting those living in remote and rural areas.



6. The US-China rivalry may define geopolitics

Prior to coronavirus, the trade dispute between the US and China was arguably the biggest economic storyline – and the frosty relationship between the two superpowers could remain one of the top investment themes over the next decade.

It's not just geopolitics, it will also have a direct impact on businesses as they are forced to take sides and perhaps adjust the way they operate on both sides of the fence. That said, great investment opportunities abound. For example, purely domestic Chinese internet companies are less likely to be hurt by a trade war.

Indeed, the internet space has been one of the most attractive investment areas. Although companies such as Tencent initially copied their peers, they have since evolved into incredibly sophisticated multifaceted platforms. Today, the company could be viewed as one of the first-generation of Chinese internet companies.

Capturing these opportunities requires in-depth research, which can help us identify companies and industries that are aligned with the Chinese government's policy priorities as well as those that have attractive long-term fundamentals.

7. Indian equities: an expanding opportunity set

India has continued to upgrade its infrastructure following the devastating second wave of coronavirus infections in the country, which now appears to be mostly under control. According to our estimates, by the fourth quarter this year, more than half of the population over 15 years of age would have received at least one dose of COVID-19 vaccine if the current pace of vaccination is maintained.

Pandemic aside, the country's entrepreneurial culture and vast pool of technology talent has given rise to a host of domestic competitors, some with significant private equity funding.

"In our many conversations with companies, we sense a buoyancy in corporate and entrepreneurial sentiment that has been missing for the past few years," says Capital Group portfolio manager Brad Freer. "The central government budget for the 2022 fiscal year, with its focus on infrastructure spending and growth, has further buoyed sentiment."

Now, as companies extend their scale, many are lining up in the initial public offering queue. If successful, these deals could help support the digital ecosystem and diversify India's equity markets. New public companies are part of the further diversification of India's equity market away from state-owned enterprises to private-sector banks, technology companies and consumer stocks.

8. Banks, insurers and financial exchanges: The rising trio of the financial sector sets the stage for long-term economic progression in emerging markets

Financial sector headlines are often dominated by banks and insurers. Insurance companies, for instance, have reported significant growth in business segments serving China's growing middle class and high-net worth individuals. One of the beneficiaries is AIA Group. "To build a sustainable business model, the company (AIA) trains young agents to sell higher quality products. Their focus on rewards and recognition attracts more high-calibre candidates, while improving the brand in the eyes of customers," says investment analyst Patricio Ciarfaglia.

Financial exchanges are another area that have emerged as steady growers and dividend payers. In Asia, exchanges are at the centre of public financial markets that are expanding, providing a tailwind of secular growth. Russia has also experienced similar growth in recent times as retail investors flock to stock trading platforms in search of higher returns.

On the banking front, larger private banks in India have been growing profits and gaining market share. They are well-positioned to scoop up some of the country's weaker lenders. For instance, HDFC Bank and Kotak Mahindra Bank are leveraging technology, amid the digitalisation of India's economy, to make faster lending decisions and reach customers in rural areas through mobile apps.

9. Rapid urbanisation across emerging markets and rising incomes will lead to increasing demands for products and services to support urban lifestyles.

Every year, millions of people across EM move to the cities in search of a better standard of living. While the likes of Jakarta, Delhi and Manila are already among the most densely populated cities in the world, urbanisation is a trend that is expected to continue for years to come. In fact, China alone sees around 14 million people moving to the cities every year,[3] which is roughly equivalent to the population of two Londons. This is an unprecedented rate of urbanisation and it creates immense opportunities for companies looking to tap into the growing city population across EM as well as the higher demand for products and services associated with the change in lifestyles.

10. Frontier markets will continue to be an area of focus given the growth and diversification potential for long-term investors

Frontier markets offer an additional opportunity set for investors, particularly within fixed income, but for many investors, they remain relatively unexplored. Many traditional emerging market countries are now much more developed than they used to be, with more stable institutions and infrastructure. As such, it will be difficult for these countries to grow at the same rate as they did in previous decades.

Within equities, many may consider the frontier markets index[4] to consist of many small countries. In fact, it is very concentrated by country, with the MSCI Kuwait, Vietnam and Morocco comprising approximately half the index[5]. However, frontier markets are generally under-owned and under-researched, which could create opportunities to generate alpha.

An alternative approach to capture opportunities arising from frontier markets is by investing beyond the traditional boundaries of geographical domicile, focusing instead on successful companies that are taking advantage of key secular trends in developing countries.

All in all, multiple secular growth trends underpin the promising outlook for emerging markets. As the focus of growth shifts towards emerging markets, we believe that an on-the-ground presence in these regions and in-depth fundamental research are key to identifying important trends, and finding companies with robust networks and supply chains, while being sensitive to unique intricacies and constraints in these regions. This should ultimately help generate strong long-term investment results.

Valeria Vine is a London-based Investment Specialist at Capital Group. Capital Group Australia is a sponsor of Firstlinks This article contains general information only and does not consider the circumstances of any investor. Please seek financial advice before acting on any investment as market circumstances can change.

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1. Source: Boeing Commercial Market Outlook 2020-2039
2. "After coronavirus, telemedicine is here to stay", an article published by the World Bank on 7 July 2020.
3. As at 30 July 2021. Source: The World Bank
4. MSCI Frontier Markets 100 Index
5. As at 31 April 2021. Source: MSCI