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Editorial

As we come to the end of another year, predictions for next year will abound, especially when some financial metrics are difficult to reconcile, such as the US 10-year Treasury rate at 1.5% while annual US inflation (CPI) is above 6%. In Australia this week, the **Reserve Bank** seemed to finally step back from its King Canute stance that rates will not rise until 2024, with many economists now calling it in 2022.

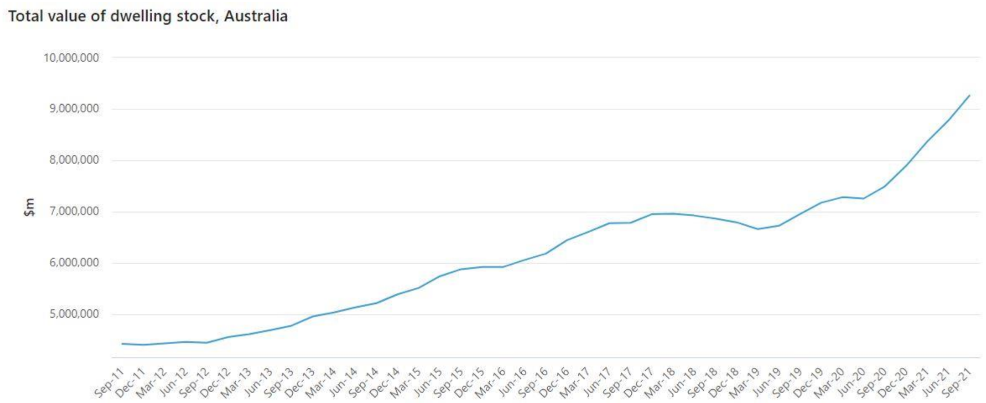
Long-term investing should not depend on short-term predictions, so the challenge for most investors is to look well beyond 2022. As **Nassim Nicholas Taleb** wrote in his book referenced in this quote**:**

"*When an investor focuses on short-term investments, he or she is observing the variability of the portfolio, not the returns – in short, being **fooled by randomness**.*"

In a recent meeting with **Morningstar** colleagues, after I mentioned I had started to reduce my personal equity exposure because I expect a decent market fall in 2022, I was asked to write my reasons. Forecasting is a set up for failure. While I anticipate changes in central bank policies to hit the market, I also reveal my long-term portfolio holds. **Warren Buffett** advises you should invest as if you are allowed only [20 investments in a lifetime](#).

Before the punch bowl is pulled away, let me be the first to note the value of Australian dwellings at over $10 trillion now, before the ABS catches up. Head of Prices Statistics at the ABS, **Michelle Marquardt,** said this week of the September numbers:

"The value of Australia's dwelling stock has risen by nearly $1 trillion in the past six months. By comparison, the previous increase of just over $1 trillion took 15 months, rising from $7.2 trillion in the December quarter 2019 to $8.4 trillion in the March quarter 2021."

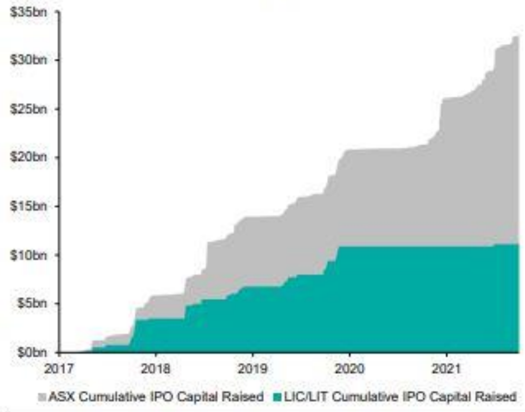


Elsewhere, an opportunity for investors holding USD bonds (or equities) lies in the fall of the AUD, down from close to 80 cents in February to 70-71 cents now. That's a 12% gain in AUD on bonds which shows fixed interest can do well despite low rates.

Figure 1: AUD/USD

Source: Bloomberg, FIS

Figure 10 - Cumulative IPO capital raised since 2017



SOURCE: BLOOMBERG & BELL POTTER. DATA AS AT 30 SEPTEMBER 2021.

It is well documented that Listed Investment Companies (LICs) are now in the shadow of their listed rivals, ETFs. The chart (labelled Figure 10) shows that while ASX IPOs have experienced a spectacular year, LICs and LITs have done little. But under the radar, some managers have quietly gone about the business of adding to their funds in various ways, and the following table shows over half a billion issued in the September quarter. LICs live on!

Figure 11 - 3Q21 Share Purchase Plans, Placements & Entitlements

ASX Code	Company Name	Method	Shares Issued	Issue Price	Amount Raised
CAM	Clime Capital	Convertible Securities	5,641,830	$0.96	$5,416,157
GCI	Gryphon Capital Income Trust	Placement	30,919,014	$2.01	$62,147,218
MOT	Metrics Income Opportunities Trust	Placement	26,043,391	$2.03	$52,868,084
PGF	PM Capital Global Opportunities Fund	Share Purchase Plan	37,303,567	$1.50	$55,955,351
QRI	Qualitas Real Estate Income Fund	Unit Purchase Plan	7,951,219	$1.60	$12,721,950
TEK	Thorney Technologies	Placement	54,268,000	$0.40	$21,707,200
TEK	Thorney Technologies	Placement	8,980,000	$0.40	$3,592,000
WHF	Whitefield	Placement	9,028,216	$5.56	$50,196,881
WHF	Whitefield	Share Purchase Plan	4,714,210	$5.52	$26,022,439
WLE	WAM Leaders	Entitlement Offer	134,483,673	$1.44	$193,656,489
WLE	WAM Leaders	Shortfall Facility and Placement	58,024,970	$1.44	$83,555,957
					$567,839,726

SOURCE: COMPANY DATA, IRESS, BELL POTTER.

Also this week ...

Low rates are forcing retirees to temper how much they can safely withdraw from their retirement savings, but **Christine Benz** offers some good news based on excellent returns of recent years. In fact, specifically in Australia, those who own their own house never totally run out of money. The age pension and benefits for a couple are worth almost $40,000 a year and while nothing to aspire to, many homeowner pensioners cope well. It's a different outcome for renters.

Simon Brown manages a small cap portfolio and sees opportunities in sectors less researched than the big end of town. Here are three companies he likes, especially the quality of management.

Scientists have produced amazing results during COVID, and **Laura Nelson Carney** says it has cleared the way for innovations in biotech to continue as money floods into research. She identified five exciting trends which will create some great companies.

What has gold been doing, and why has it not been stronger with inflation rising, especially given its reputation of preserving purchasing power? **Jordan Eliseo** looks at the links.

Firstlinks has discussed in detail the potential to access home equity in retirement. **Joshua Funder** reports on an expert summit which argued for a united look at the three pillars of retirement - the age pension, compulsory super and voluntary savings (which includes the family home).

After suffering severe reputational damage during **Kenneth Hayne**'s Financial Services Royal Commission, the banks have come through the pandemic relatively well. **Brad Dunn** admires the rebuilding of capital since the GFC, and he is confident that even with investments down the capital structure such as hybrids, banks are well-positioned to meet their obligations.

This week's White Paper from **Vanguard** explores how bonds act as shock absorbers for portfolios when equity markets are under stress, which is fitting given the adjustment described in my article this week.

The Comment of the Week comes from **Jack**, who suggests how the family home may be included in the age pension asset test.

"What is suggested here is not a death duty. A death duty is a tax on all wealth not just housing. What is suggested here is a "claw-back" from the estate of some or all of the age pension paid during a person's lifetime, precisely because the family home is exempt from the pension assets test and therefore recipients get a higher pension than they would otherwise. This payment by the next generation would be easy to avoid. Either downsize and release capital or borrow against the equity in the house. Either way you replace the age pension with your own income stream. If there was no pension received, there would be no "claw-back". But it would mean that if you had the means, you would not rely on the welfare payment of the age pension."

20 punches: my personal investments are not a forecast

Graham Hand

Warren Buffett has described his 'Rule of 20 Punches' when speaking to graduation classes:

"I could improve your ultimate financial welfare by giving you a ticket with only 20 slots in it so that you had 20 punches representing all the investments that you got to make in a lifetime. And once you'd punched through the card, you couldn't make any more investments at all. Under those rules, you'd really think carefully about what you did, and you'd be forced to load up on what you'd really thought about. So you'd do so much better."

Of the hundreds of Buffett investment lessons, this one goes under the radar but is among the most powerful. Many portfolios include a foundation of long-term mainstays but there's a rabble of other acquisitions due to rumours, quick-fire opportunities or hot tips. The tiddlers are often more trouble than they are worth, they need to be watched regularly and then punted when they fall or pay off. Buffett would have no place for them on his punch card.

Trading, investing or something to do?

Some people enjoy the regular activity but it's more akin to trading than long-term investing.

A retired friend told me recently that he spends a couple of hours a day on his SMSF portfolio, worth about $2 million and it includes over 200 holdings, all listed. It's become his hobby. I'm far more of a 'buy and hold', but my own portfolio includes too many small positions which have a negligible impact on the total performance. But there are other investments which I have held for decades which follow the discipline of Buffett's 20 punches in a lifetime.

When I present at conferences or webcasts, I am often asked for a stockmarket forecast. It is a disappointment when I say I have no better insight into what the market might do next month or next year than a taxi driver who has overheard a passenger.

It's always 'time for caution'

I dislike articles which give a list of reasons the market will fall, another list of reasons it will rise, and then conclude with "*It's a time for caution.*" Or how about "*The market will be volatile.*" Really? Well, that covers everything. If the market falls, *I told you to be cautious*. If the market rises, *I told you not to sell*. Let me know when it's a time for all-out aggression.

There are reasons markets are expensive – central bank stimulus, low interest rates, strong earnings – or markets are cheap – low growth, rising rates, slump in earnings. (There, I just gave you two short lists – happy now?). But few people want to sell when markets are expensive in case they miss the next leg up, nor buy when markets are cheap because they are not sure where the bottom is.

But here's the thing. Regardless of whether I think markets will rise or fall in the short to medium term, I have a large SMSF and it must be invested in something other than term deposits at 1%.

Most people are tempted into tactical asset allocation

Chris Cuffe wrote in an article in 2014 called "Why can't we resist tactical asset allocation?":

"*Like many people who manage their own portfolios, I actively engage in tactical asset allocation (TAA), despite evidence that it's a waste of effort."*

I'm the same, and the need to make new investments is constant. Most portfolios throw off cash flow that must be reinvested, unless it is money to live on or left to rollover in term deposits. Even a defensive bond portfolio delivers regular coupons and maturities, and equities pay dividends and sometimes the proceeds of share buybacks. The cash flow requires a conscious decision to buy something, perhaps to reinvest in the same asset class.

Some institutions operate the discipline of a strategic asset allocation but they utilise ranges to make decisions at the margin based on forecasts or expectations.

I have some stocks and funds I never expect to sell. However, while I recommend anyone with a long-term investment horizon should stay substantially invested in equities, I am starting to reduce some equity exposures as I personally believe the market will experience a decent fall sometime in 2022. There, the forecast you make when you're not making a forecast ... and here are my brief explanations:

1. Central banks have delivered too much stimulus

OECD governments have spent about US$20 trillion on COVID support measures. With such massive business and personal stimulus, company earnings have recovered strongly and asset values have surged. In Australia alone, the value of residential property has increased by $2 trillion in a year to almost $10 trillion. The Reserve Bank lent nearly $200 billion fixed for three years at 0.1% for Australian banks to fuel a housing boom.

For many sectors of the economy, the cost of borrowing was close to zero, as central banks bought trillions of dollars of bonds and other securities. Awash with liquidity, markets entered a massive 'risk on' where asset values were pushed up in the buying spree.

Common valuation measures in the US such as the Shiller P/E, the Crestmont P/E and the Buffett Indicator set new records in 2021, and as the chart below shows, flows to equities were unprecedented. In the nine months to September 2021, the value of US stocks rose US$8 trillion from US$41 trillion to US$49 trillion, making a lot of wealthy people even wealthier.

But 2022 will be the year that central banks and government take away the punch bowl.

Chart 6: Inflow to equities exceeds combined inflow of past 19 years
Rolling 12m flows to equities ($bn)

Source: BofA Global Investment Strategy, EPFR

2. Interest rates will start to rise

It's only a few weeks ago when the RBA Governor, Philip Lowe, was still saying:

"Our judgement is that this condition for a lift in the cash rate will not be met before 2024."

But even he changed his tune this week, removing the reference to a date, opening the door to an earlier move. It's a significant development as there has not been a cash rate rise for a decade.

Now that Jerome Powell, the Chairman of the US Federal Reserve, is re-elected for another term, he has already indicated he will spoil the stimulus party. Initially, bond purchases will be tapered, and then the market will experience the first increases in the Fed funds rate to control inflation and take the steam out of asset price inflation.

3. Inflation expectations are rising

Despite US inflation around 6%, the market's main interest rate, the 10-year Treasury, remains about 1.5%-1.7%. Few bond investors have experienced such a large negative real rate, when it had been around plus 2% since the GFC. As inflation takes hold and the economy recovers, the 10-year may rise above 2%, which will fundamentally change the discount rate on earnings of many of the darlings which drove market values in 2020 and 2021.

For example, CBA Economics wrote this week:

"Inflation pressures look to be broad-based. We see inflation in the top half of the RBA's target band around the middle of next year, prompting the RBA to start their hiking cycle in November 2022 ... A key upside risk to inflation in 2022 is that global factors such as supply chain disruptions affect tradable goods prices by more than expected. Another is that the massive pile of excess savings accumulated by households will buoy spending and demand, providing a strong tailwind to prices growth, including for services."

4. New viruses

The scientific community delivered extraordinary protection from COVID in record time, but almost two years later, the world is still experiencing travel restrictions and lockdowns. Professor Dame Sarah Roberts, the co-creator of the AstraZeneca vaccine, warned this week that future pandemics could be more contagious and lethal than COVID:

"We cannot allow a situation where we have gone through all we have gone through, and then find that the enormous economic losses we have sustained mean that there is still no funding for pandemic preparedness. The advances we have made, and the knowledge we have gained, must not be lost."

Forecasts are set up for failure

There are always reasons to sell, and there is plenty of evidence against trying to pick tops and bottoms. Some analysts have predicted six of the last two collapses, and guessing a market change is not much practical use without nominating the timing, the amount and the market's reaction. Much of what is said about rate rises is already built into forward pricing, so even if a forecast is correct, there is no market gain. The more assumptions in a forecast, the more likely it will be wrong.

Look at the litany of recent failures. Nobody expected negative interest rates, we had never heard of Modern Monetary Theory until a few years ago, the experts were seeing a fall in house prices of up to 30% in 2020/21 and governments expected budget surpluses. Contrary to my personal view, Morningstar analysts expect global equities to deliver 9% per annum for the next five years.

So how should I invest? At some point, monetary and fiscal policy must return to a semblance of normal, but regardless of my expectations, I must remain in the market to a reasonable extent.

About 20 punches on my card

Taking a lead from Buffett, here are around 20 investments that I expect to hold for many years. It's not that I will ignore the outlook for these businesses or funds, but I am happy to live with the swings. I also have large, embedded capital gains which I prefer not to realise for tax reasons.

However, I accept that history is full of great companies – Kodak, Blockbuster, Nokia – which looked like long-term holds until bad decisions or better competitors wiped them out. Who would have thought Nokia with its one billion customers could fail so quickly?

I am not a stock analyst, and I am not recommending these investments. I'm showing that regardless of what I think about the equity market, there are some pillars in my portfolio. Some investments are in funds where I accept the superior ability of the manager to access and assess opportunities in particular sectors.

- **CBA** (ASX:CBA) – rock-solid balance sheet of home loans, leading banking platform, strong capital position, big deposit base.
- **Wesfarmers** (ASX:WES) – diverse business operating Bunnings, Officeworks, Kmart, various industrial and resources interests.
- **Transurban** (ASX:TCL) – dominant toll road operator with significant pricing power, I enjoy that 'ding' when I am charged $8.48 to use the Eastern Distributor which once cost only $3.50.
- **Macquarie Group** (ASX:MQG) – global investment bank specialising in infrastructure, now a leading position in mortgage lending, clean energy and funds management.
- **Argo Infrastructure** (ASX:ALI) – one of the few ways to access listed global infrastructure assets at a discount to Net Tangible Asset (current NTA $2.40 versus share price of $2.28).
- **Mineral Resources** (ASX:MIN) – a more recent addition with an entry price enabled by the selloff reaction to the falling iron ore price while overlooking lithium potential.
- **Charter Hall Long WALE** (ASX:CLW) – 468 properties worth $5.6 billion leased to governments and corporates with weighted average lease expiry (WALE) of 13.2 years on 'triple net lease' terms.
- **Djerriwarrh Investments** (ASX:DJW) – old-style LIC offering diverse exposure to Australian equities with low fees and opportunities to pick up at discount to NTA.
- My three A's of **Apple, Amazon and Alphabet** (Google) are some of the greatest companies we have ever seen, and I've made the mistake of not picking up Microsoft along the way (except in funds).
- **Generation Investment Management** – a fund introduced to Australia by me in 2007 while working at Colonial First State, fronted by Al Gore but with a bunch of smart fund managers for global equity exposure.

There are also sector investments in ETFs, LICs or unlisted funds including hybrids, corporate bonds, debt funds and equity specialists such as Loftus Peak, Munro Partners, 1851 Capital, Partners Group, Pengana Private Equity, Magellan Core Series (via Chi-X), Hearts & Minds and Ausbil.

That's about 20 punches in total, give or take. Some of my super is with UniSuper because CIO John Pearce is one of the best. So while I will play with asset allocations and I don't know what the future will bring, I will leave these investments for the long term. As Daniel Kahneman, Nobel Prize Winner, wrote in his excellent book, *Thinking, Fast and Slow:*

"*We cannot suppress the powerful intuition that what makes sense in hindsight today was predictable yesterday. The illusion that we understand the past fosters overconfidence in our ability to predict the future.*"

I will resist the urge to say it's time for caution and next year will be volatile, but rather, think about your portfolio as if you only had 20 punches for the long term.

Graham Hand is Managing Editor of Firstlinks. This article is general information and does not consider the circumstances of any investor.

The good news about retirement income

Christine Benz

When it comes to in-retirement income, and specifically the amount you can safely withdraw from your portfolio without running out, there is good news and bad news.

Chances are you've already heard the bad news, but I'll repeat it just in case. Thanks largely to low bond yields, which in turn depress a portfolio's return potential, new retirees should start with a lower withdrawal percentage than the standard guidance of 4%. Doing so will cut the odds that they'll prematurely deplete their funds over a 25- to 30-year retirement time horizon and help blunt the impact of a bad equity market occurring early in retirement.

That's sobering for people just embarking on retirement but there's a good news story, too. A lower starting withdrawal percentage is advisable largely because core investment assets - stocks and bonds - have performed so well for so long. That means that at the same time that investors are being urged to lower their withdrawal rates, most investors' portfolio balances are enlarged. Because the lower starting withdrawal rate is calculated on a larger amount, the net effect for most retirees' actual spending is apt to be minimal.

The thinking behind a lower percentage

The drumbeat of bad news about withdrawal rates started in earnest in 2013, with a paper called 'Asset Valuations and Safe Portfolio Withdrawal Rates', co-authored by retirement researchers Wade Pfau, Michael Finke and David Blanchett. The paper noted that the combination of elevated equity valuations and low starting bond yields makes the standard 4% guideline dangerous, especially for people whose portfolios were overly reliant on bonds. They wrote:

"We find the probability of success for a 40% equity allocation with a 4% initial withdrawal rate over a 30-year period is approximately 48%."

Most retirees, meanwhile, would prefer that the odds that they'll run out of money during retirement be better than a coin flip.

Of course, equities have performed well since that time, and bond returns have been solid, too. Retirees who reined in spending eight years ago in anticipation of an unforgiving market environment would have done so prematurely. But in a conversation on The Long View podcast in April 2020, Pfau stood firm with the assertion that a 4% starting withdrawal was too rich, particularly given the Fed's ultra-low-interest rate policy. He said:

"Lower interest rates are going to push you toward something like 3% being a lot more realistic than 4% as a sustainable strategy in a low-interest-rate environment."

But that doesn't mean a lower withdrawal amount

On the positive side, we're talking about withdrawal rates, specifically, the percentage you can withdraw from your portfolio in year one of retirement. For many new retirees today, a smaller starting withdrawal percentage comes from a pie that's larger overall.

To use a simple, admittedly arbitrary example, let's say an investor retired in early 2011 with a $1 million 60% equity/40% bond portfolio. If she were using the 4% withdrawal guideline, or $40,000 initially with that amount inflation-adjusted by 3% annually, she would have pulled about $460,000 from her portfolio over the past decade.

Meanwhile, let's say someone who was 55 and had a $500,000 60/40 portfolio back in 2011 is ready to retire today. Thanks to market appreciation and assuming that she hadn't been engaging in regular rebalancing, her portfolio is now worth about $1.4 million.

Even if she takes a lower starting withdrawal of 3%, her larger balance means that her first-year withdrawal is about $41,722. Her first decade of withdrawals, assuming 3% initially with 3% annual inflation adjustments thereafter, would be about $478,000, roughly in line with the 2011 retiree's numbers.

In terms of her take-home payout, her larger starting balance relative to the 2011 retiree helps make up for the fact that the advisable starting withdrawal percentage is lower.

New retirees in 2031 or some other point in the future may get a crack at a higher safe withdrawal percentage. But that would likely be because equity valuations had contracted and/or bond yields had gone up, which would probably have reduced their portfolio values somewhat.

In other words, higher starting sustainable withdrawal rates will tend to occur after poor market returns, when balances are lower. Meanwhile, lower sustainable withdrawal rates will be advisable after periods of good returns and enlarged balances.

Your mileage may vary

It's also worth noting that criticisms that 4% is untenable in a low-yield world relate to starting withdrawal rates. The worry is that if a retiree takes out 4% of her balance in year one of retirement, then subsists on that same amount, with inflation adjustments, in subsequent years, she runs too high a risk of prematurely depleting her money over a 25- to 30-year period.

Such a system doesn't factor in the portfolio's value as the years go by. If she encounters big losses in her portfolio but blithely keeps taking out the same dollar amount, that will lead to too-high withdrawals at an inopportune time. That risk is particularly great in the early years of retirement.

For example, let's say a retiree were taking fixed real dollar withdrawals from a $1 million portfolio, starting with 4% initially. Her year-one withdrawal would be $40,000 and her year-two withdrawal would be right in that same ballpark, perhaps a bit higher if she takes a raise for inflation. Behind the scenes, however, her portfolio could have dropped to $700,000 in year two of retirement, bringing her actual withdrawal percentage to 5.9% that year. She maintained her standard of living but did so at the expense of her portfolio's sustainability.

Adjust withdrawals based on affordability

In practice, retirees may be more flexible in their withdrawals, taking more in strong market environments and less in weak ones. Such strategies, whether the RMD method or Jonathan Guyton's 'guardrails' approach, add more variability to the retiree's spending in exchange for improving the portfolio's sustainability. Much of the latest research around sustainable withdrawal rates points to the benefits of flexibility for retirees who would like to ensure that they don't run out of funds prematurely.

A key challenge for setting your withdrawal rate in retirement involves weighing how much variability in cash flows you're willing to endure in exchange for improving your portfolio's sustainability. Ultimately, it's a highly personal decision and one that can get lost in the discussion of the **right** withdrawal rate.

Christine Benz is Morningstar's Director of Personal Finance. This article does not consider the circumstances of any investor. Minor changes have been made to the original US version for an Australian audience.

Three small companies expected to deliver big returns

Simon Brown

Smaller companies often have great potential and can offer investors bigger opportunities than those found in the broader market. Even over the past 12 months, as share markets have bounced back, small companies have outperformed. The S&P/ASX Small Ordinaries Accumulation Index returned 31% for the 12 months to the end of October 2021, compared with a return of 28% by the S&P/ASX 200 Accumulation Index.

Less-researched opportunities

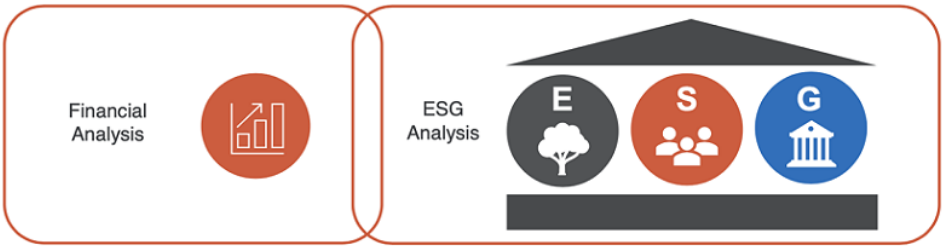
The ability to generate this type of outperformance is driven by the information arbitrage opportunities available to smaller company investors. While large cap stocks are researched intensively, the small companies end is highly differentiated across a broad range of sectors and business models. These can often be unique and generally it is an area that is not particularly well researched across the market. This provides opportunity for the small-cap investor to sift through and find undiscovered gems.

However investing successfully in small companies requires a lot of leg work to understand industries, companies, and their respective management teams. Even in the initial stages of the investment process, an in-person visit is important to get a feel for a company and understand what drives it. There is also a need for rigour and discipline when processing company information.

ESG as a factor

Any factor that may have a material impact on a company's performance and the industry in which it operates should be looked at when considering investing in a company.

ESG involves assessing a company's approach to issues such as climate change, employee development, community impact, supply chain standards, board remuneration and diversity. Ultimately, a company is unlikely to find lasting success unless it has a strong social license and employs sustainable practices.



Environmental Considerations	• Environmental Policy • Environmental Performance • Stranded assets	• Approach to Climate Change • Biodiversity
Social Considerations	• Labor Standards • Human Rights • Health and Safety	• Employee Development • Equality in the workplace • Supply Chain Standards
Governance Considerations	• Corporate Governance • Corporate Ethics • Bribery and Corruption	• Board Composition and Background of Directors • Remuneration and Incentives Structures

Three small companies set for big things

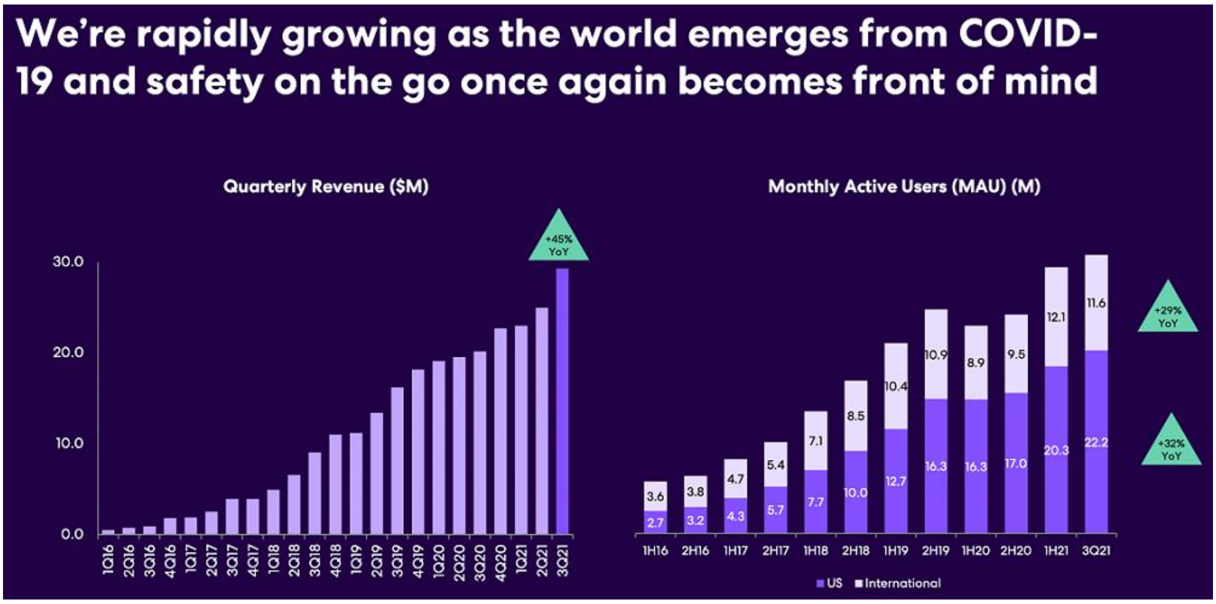
Creative thinking

A great example of the rewards that can accrue from good research is location sharing and driving safety app Life360 Inc. Although based in San Francisco, Life360 founders Chris Hull and Alex Haro decided to look to the ASX to raise 'clean' funds that wouldn't have as many strings attached as in a US listing.

The company listed on the ASX in May 2019 but COVID-19 hit the share price hard. With nobody leaving the home, there was no need for parents to be worried about the safety of their family. The app was never particularly popular amongst the teenage children tracked for their whereabouts, although Life360 did introduce some clever social media marketing campaigns to combat this issue.

But we could see value in the company if they could make the transition to a paid membership strategy. Despite the impact of lockdowns, we could see early signs of success. Management was also looking to make strategic acquisitions to increase market penetration. Earlier this year, the company bought jiobit, a wearable tracker for pets and young children.

With the majority of Life360's users in the US, impressive monthly user and subscriber growth is driving results. Management has capitalised on the economic reopening and the back-to-school period with marketing campaigns that are improving customer conversion rates.



More recently, Life360 announced a binding agreement to acquire Tile Inc and it is conducting an equity raising to raise $280 million. Tile Inc sells hardware devices that can be attached to items, such as wallets, keys etc, to help users find them. With Tile, Life360 can offer the whole suite of location services from 'things' to family and pets. We are heavily overweight Life360 in our portfolio.

Building momentum

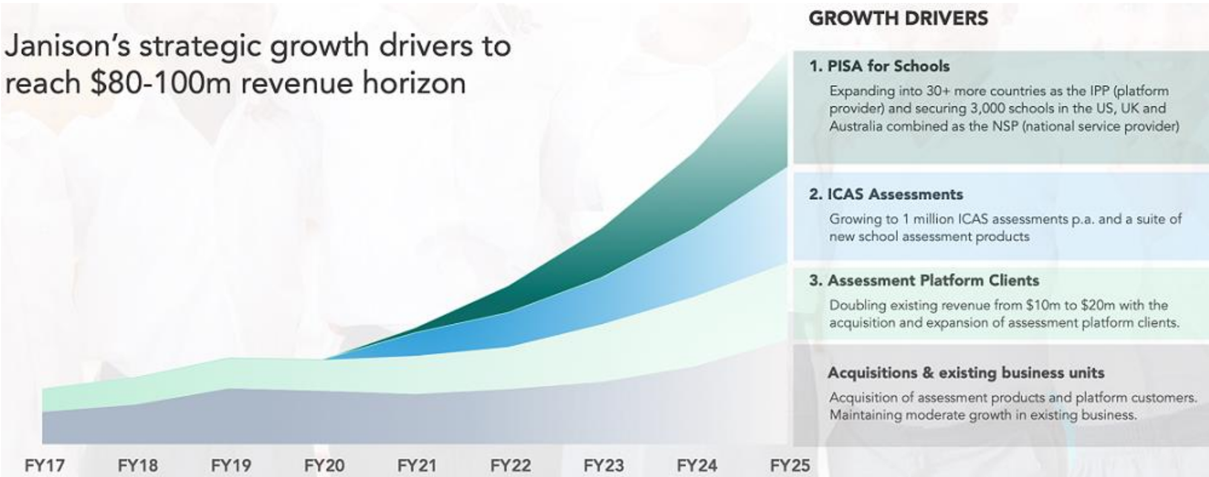
While it has been around for a lot longer than Life360, Australian gas producer Senex Energy has been bucking sector trends in recent months after engaging with Korean steelmaker Posco International regarding a takeover proposal.

Senex management granted due diligence to Posco in an attempt to elicit a higher bid than the initial offer price of $4 per share. They also made public that the initial offer, and subsequent second and third offers, fell short of appropriate valuation levels. Senex holds a unique set of assets that should deliver attractive long-term cashflows and the board was right to wait for a fourth, and potentially final offer, of $4.60 per share.

Factors such as corporate culture and ESG can reveal a lot about how a company's executives and management might act when they receive an approach like that of Posco. Senex's calm but calculated response vindicated our view that Senex would eventually develop utility-like characteristics as energy users embraced gas as a 'transition fuel' in moving to net zero.

Edtech opportunity

We've also recently initiated a position in online assessment and digital learning business Janison Education. COVID-19 provided it with the opportunity to shine. The Edtech business pivoted its model from bespoke online environments to a more standardised platform, better enabling it to scale. The opportunity to digitise and rollout existing programmes while also making targeted acquisitions showed us a business trading at a material discount to emerging SaaS peers.



Small caps might require more work than large cap stocks but they are often worth it. After all, all large companies were small once, and there can be clear benefits of investing early.

Simon Brown is a Portfolio Manager at Tribeca Investment Partners. Tribeca is a specialist investment manager partner of GSFM Funds Management, a sponsor of Firstlinks. Tribeca may have holdings in the companies mentioned in this article. This information is general in nature and has been prepared without taking account of the objectives, financial situation or needs of individuals.

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5 new trends driving the future of biotech companies

Laura Nelson Carney

I am often asked about my outlook for biotechnology in light of how rapidly vaccines were developed for COVID-19. I say this may be a sign of things to come for the industry. I've seen a renaissance that's led to an explosion of novel drug targets in recent years. The industry pipeline is relatively full for both small and large drug companies across the world, and if some of these developments take hold, this could fuel growth over the next decade.

These are some of the trends:

1. Faster drug development

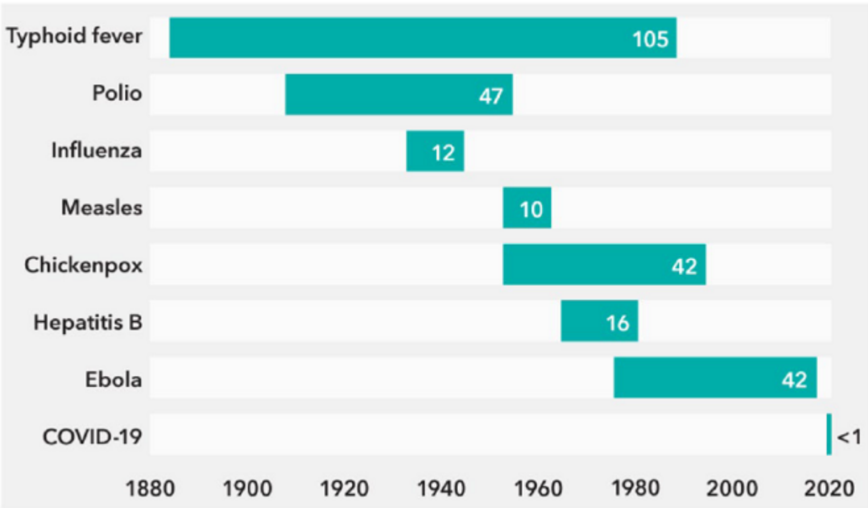
It is possible in certain circumstances to go much faster in developing drugs than people previously thought. The accelerated approval pathway that the U.S. Food and Drug Administration (FDA) used for the coronavirus vaccines has been in place for some time, as well as at other regulatory agencies around the world. Europe, Japan, China and others have similar mechanisms that make it possible to move more quickly, particularly when the unmet need for treatment of a disease is high.

As shown in this chart, the speed of vaccine development has reduced significantly over time. In the case of COVID, we received the virus' genome sequencing in January 2020 and had authorised vaccines by the end of the year, which is just stunning.

It may not be possible to do that again for another vaccine, unless there are billions of dollars of government funding that allow companies to assume all the risks in parallel and move as fast as possible. But since the pandemic, companies are collaborating in ways that we haven't seen before.

Pharmaceutical companies are innovating at a rapid pace

Timeline of previous vaccine development (years)



Sources: Capital Group, NIAID, Our World in Data. Date ranges represent the approximate time between the year the pathogenic agent was first linked to the disease and the year that its vaccine became licensed in the U.S.

2. A focus on infectious diseases

Infectious diseases are among the primary sources of illnesses around the world, yet this was an underfunded corner of drug discovery research. When it came to funding and deals between large and small companies, it used to rank near the bottom of the list.

It's now second only to oncology in terms of the attention and funding it is receiving when it comes to mergers and acquisitions, venture capital and private equity investments. Many of the bigger problems are now being tackled with substantial investments.

3. The next big horizon of innovation of cells and genes as medicines

We've seen three big phases in the history of medicine. For about 200 years, treatment was by chemicals that we could make in a reproducible way. Most of our newest and best medicines came from factories. Then, in the 1970s, we learned how to make proteins in a reliable way in a factory rather than, for example, extracting insulin from cows to use as medicine. That was the era of biologics. It began first with monoclonal antibodies. The next generation of those are more engineering-specialised antibodies.

And the third big horizon is cells and genes being used as medicines, though we are only at the beginning of this. It holds the promise of both (a) functional cures of diseases that we couldn't treat at all (or not very well) with chemicals or proteins and (b) one-time treatment rather than chronic therapy for the rest of a patient's life.

So far, cell or gene therapy products approved by the US FDA are being used to treat cancer, eye diseases and rare hereditary diseases. In the future, the hope is to move into more common diseases too.

The pipeline is growing, with more than 360 such therapies in development in the US, targeting a range of diseases. There's also a large pool of eligible patients who technically could receive these therapies. However, cell and gene manufacturing are both relatively new, much more complex and expensive than protein or chemical manufacturing, so this adds substantial risks.

4. China is rapidly moving up the innovation curve

I would highlight the role of China in the global biopharmaceutical industry in two ways: It is the world's second-largest end market after the U.S. and growing rapidly. It is also a source of globally relevant innovation.

China's version of the FDA has become increasingly more like its U.S. counterpart, in that they have adopted some of the same practices for how they make decisions. Regulatory officials changed some of the technical standards to be more in line with Europe and the U.S. There is a little bit more alignment in the process. They have started to triage applications to deprioritise old undifferentiated types of drugs and focus on newer drugs.

China is a key market for multinational pharmaceutical giants

Multinationals working with local China firms

Company	Market cap (US$)	Revenue from China
AstraZeneca	$187 bn	~20%
Pfizer	$241 bn	~9%
Novartis	$203 bn	~5%
Eli Lilly	$222 bn	~5%

China firms working with multinationals

Company	Market cap (US$)
BeiGene	$33 bn
Innovent Biologics	$14 bn
Zai Lab	$10 bn
HUTCHMED	$6 bn

Sources: RIMES for market cap data as of September 30, 2021. Company filings for most recent fiscal year for revenue from China.

China had a proliferation of undifferentiated old generics, but the government is showing it is willing to pay for innovation, and that is the carrot for companies to keep investing in it. Since 2015, Chinese authorities have pushed policies that encourage and incentivise domestic companies to compete with global companies. In that sense, biopharma is a little different than other industries in China that have been flagged as potentially being the next in line to come under heightened regulatory scrutiny.

5. Harnessing the human immune system to treat diseases

Oncology was the first area to see this concept succeed beyond diseases of the immune system itself, and drugs like Merck's Keytruda and Bristol-Myers' Opdivo have become one of the largest categories in oncology. But we are only just beginning to scratch the surface and figure out how we can harness the human immune system to manage other diseases.

The idea of understanding the immune system better and harnessing that to potentially intervene in other diseases has been gathering a lot of momentum. Immuno-oncology, which is the study and development of treatments for cancer that take advantage of the body's own immune system, is one of those areas.

Drug discovery is more global than ever before

Research is happening at both the bigger and smaller companies. Big companies are very deliberate in how they balance their priorities, where they source innovation, internally and externally. They can source ideas from academic labs and tiny companies, and they buy small and midsize companies all the way up the chain.

The number of small- and midsized companies has grown dramatically. The amount of venture-capital funding for life sciences broadly, and biotech pharma specifically, has also soared. It is the smaller companies that take the biggest risks and work the furthest out on the leading edge and most novel ideas. And then, as they get a little bit of validation, either through animal models or early clinical data, start to partner with big pharma companies as well.

Innovation is happening in all geographies. It's not just Cambridge in the U.K. or the San Francisco Bay area. In China, for instance, there are many small emerging companies working on new areas of biology. It's important to have a global and bottom-up research approach to finding the best value.

Laura Nelson Carney is an equity investment analyst 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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Gold and inflation: what does history tell us?

Jordan Eliseo

Ask most investors about gold and irrespective of whether they have exposure to the precious metal, most will acknowledge that it's a store of value over the long term and that it's a good inflation hedge. Gold has maintained its purchasing power across the centuries.

In more modern times, gold has also served to protect wealth through periods of higher inflation, most notably throughout the 1970s. The following table highlights the average annual returns for gold in high (>3% p.a.) and low (<3% p.a.) inflation environments across the past 50 years.

Average annual US dollar spot price performance of gold (%)

Inflation environment	Nominal return	Real return
High inflation (>3% p.a)	15.1	8.3
Low inflation (<3% p.a)	5.6	3.6

Source: World Gold Council

Despite this track record, some are now questioning whether gold has lost its status as a trusted inflation hedge. Gold has experienced a close to 15% correction since August 2020, despite consumer price inflation (CPI) rates hitting 6.2% p.a. in the United States.

Why hasn't gold moved higher with inflation in 2021?

There are several factors that have held gold back in 2021.

Global economic growth has surprised to the upside, with the OECD September economic outlook suggesting global growth will register 5.7% this year. Going into 2021, they had forecast growth of just 4.2%.

Equities have also enjoyed one of their strongest runs on record, with the S&P 500 essentially doubling since the March 2020 low. Equities have attracted net inflows of almost USD1 trillion in 2021. That's more than the past 19 years in total, highlighting how strong investor risk appetites have been for most of the year, and explaining why portfolio hedges like gold have fallen out of favour, for now at least. The US dollar has been firm, with the dollar index (DXY) up around 7% this year.

Gold made a huge move last year

Perhaps a bigger part of the reason gold has disappointed investors in 2021 is that it made such a big move in the first nine months of last year.

This can be seen in the table below, which shows a handful of key variables at the end of 2019 and each quarter of 2020.

Market indicators during 2020

Date	10 year real yield (%)	CPI - y.o.y change (%)	10 year breakeven inflation rate (%)	Fed balance sheet	Gold price
31/12/19	0.15	2.29	1.72	4,115,957.50	1517.01
31/3/20	-0.17	1.54	0.99	4,618,977.00	1577.68
30/6/20	-0.68	0.65	1.27	7,127,786.25	1768.1
30/9/20	-0.94	1.37	1.66	7,048,374.20	1886.9
31/12/20	-1.06	1.36	1.92	7,319,010.80	1891.1

Source: Federal Reserve, World Gold Council, Cleveland Federal Reserve, US Treasury, St Louis Federal Reserve

The table highlights that:

- The Federal Reserve balance sheet increased by more than USD 3 trillion across the first six months of 2020.
- Real yields on 10-year US treasuries fell by more than 1% in the first three quarters of 2020.
- 10-year breakeven inflation rates bottomed out in Q1 2020, well ahead of short-term CPI numbers.

Given this backdrop, the gold price was up by more than 30% at one point in 2020, even though the official year-on-year change in headline inflation was below 1.5% for most of last year.

So, while it can be argued gold hasn't been a good inflation hedge in 2021, that's coming off the back of a year that the precious metal recorded one of its strongest gains on record.

Ultimately, perhaps the data is telling us is that if you have to wait for the official statistician to tell you inflation has arrived, then you'll pay a much higher price to buy inflation-protecting assets.

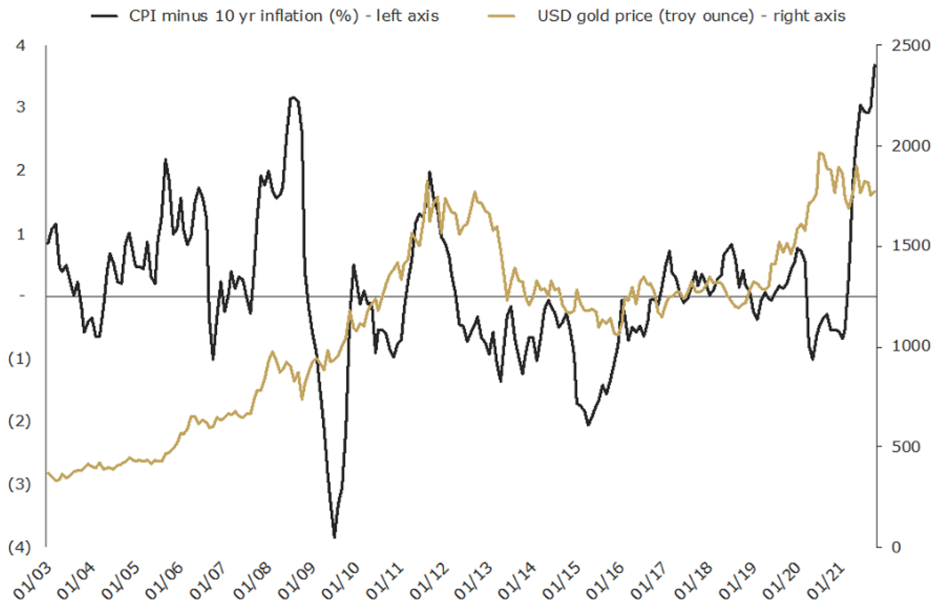
Gold and the inflation backdrop today

An argument can be made that the market's view of inflation today looks somewhat similar to just over 10 years ago, in the period leading into the GFC.

This can be seen in the chart below, which shows the gold price, as well as the percentage gap between annual headline CPI growth and the 10-year breakeven inflation rate expected by the market.

At present, there is a 3.7% gap between current annual CPI (+6.2%) and the 10-year breakeven inflation rate (2.5%). The last time this kind of divergence was seen was back in Q3 2008, though it is wider today than it was 13 years ago.

US inflation and gold prices



Source: Cleveland Federal Reserve, St Louis Federal Reserve, World Gold Council, data as at end October

Gold prices fell by approximately 20% back then, from just below USD1,000 per troy ounce, to about USD750 per troy ounce. The precious metal then went on to rally for the next three years, with the market ultimately topping out more than 150% higher at close to USD1,900 per troy ounce in 2011.

This time around we've seen a similar pullback, with gold dropping by approximately 18% between August 2020 and the low from this cycle seen in April 2021, when gold temporarily traded back below USD1,700 per troy ounce.

And while no one can be certain if history will repeat or even just rhyme, there is a range of factors suggesting gold could be supported going forward, including:

Central bank and fiscal largesse: The post GFC environment was characterised by central banks reluctantly adopting QE, ZIRP and other forms of unconventional monetary policy, and promising to walk it back at the first opportunity. Despite the likelihood of a Fed taper, the post COVID-19 environment sees central banks largely reticent to abandon expanded stimulatory measures.

There is now a much greater focus on full employment, an embrace of average inflation targeting, and the adoption of MMP (modern monetary practice) through the de-facto monetisation of federal deficits.

Trimmed mean inflation rising: While headline inflation rates may ease, there is clearly an increase in underlying pricing pressure building, with the trimmed mean CPI measure now sitting above 4% per annum in the United States.

Supply side shocks: Whether it's a shortage of fuel in the UK and across Europe, industry shutdowns in China, or continued bottlenecks in global supply chains, issues on the supply side may continue to add upward price pressure well into 2022.

For most of 2021, markets expected the current spike in inflation to be transitory, and had priced this in.

Even if headline CPI rates decline in the months ahead, it is unlikely to meaningfully hurt precious metal prices. If, however, this inflation spike proves to be more sustained, as even Fed Chair Jerome Powell and US Treasury Secretary Janet Yellen have recently acknowledged, then there is a good chance the gold price may surprise to the upside.

Jordan Eliseo is Manager of Listed Products and Investment Research at The Perth Mint, a sponsor of Firstlinks. The information in this article is general information only and should not be taken as constituting professional advice from The Perth Mint. You should consider seeking independent financial advice to check how the information in this article relates to your unique circumstances.

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Solutions to unite the three pillars of retirement funding

Joshua Funder

As we take stock of the retirement industry, and where we find ourselves as 2021 comes to a close, it's clear that the long-term outlook for retirees has changed over the past couple of years. Not only has Covid threatened the health of our seniors, but it has also made the value of the family home in providing lifelong housing and a haven more deeply felt.

Combine that with low term deposit incomes, portfolio volatility, and a broad consensus around a lower growth long-term future, and it has made planning for retirement a real challenge. Now, as never before, it is clear that fear undermines retirement outcomes and that confidence is the main ingredient in a good, long life.

Retirees need trustworthy, easy to use, integrated education and solutions that delivers both faith in their savings and safe, easy means to release them.

The Household Capital Your Life Choices survey shows that 85% of retiree respondents are unaware of the three pillars of retirement funding (the age pension, compulsory superannuation and voluntary savings) and only 23% of respondents were aware of the Pension Loan Scheme.

It also showed, even with a relatively digitally-literate respondent group, that 58% of respondents were unsure when asked if they understood the funding options available to them.

Household Capital recently hosted the **2021 Three Pillars Forum**, bringing together industry experts from Australia and around the world. Despite disparate professional backgrounds, the panellists agreed that uniting the three pillars of retirement funding was essential for the consumer, the economy and the retirement industry.

The underspending Australian retiree

CoreLogic figures show the Australian property market smashing new records, with a total residential asset value exceeding $9 trillion. On a conservative estimate, Australian retirees are holding residential property assets of more than $1 trillion dollars.

Senator Anne Ruston, Minister for Families and Social Services, has highlighted the plight of asset rich, cash poor Australian retirees, saying:

"We want our senior Australians to enjoy the best quality of life during their retirement and one of the key factors in achieving this is financial independence. To improve the welfare of our older Australians, these three pillars must work together and be fit for purpose. With housing prices increasing significantly in recent years, we are seeing many of our senior Australians paper millionaires with limited ability to access the benefits of their appreciating assets."

Retirees do not have a full picture of their assets and ability to access their wealth and this is a major contributing factor to their hesitancy to spend. We should celebrate and take confidence in the fact that Australians are the wealthiest median retirees in the world. Instead, the 2020 Retirement Income Review noted widespread underspending and lack of confidence in retirement.

Ben Hillier, General Manager Retirement Solutions at AMP, uses a powerful analogy to describe the information available to retirees:

"[We are] putting someone into a lifeboat, when they're expecting to go on a retirement cruise. They're perhaps thinking that it's going to be the cruise of a lifetime. We whack them in a lifeboat, load them up with lots of provisions and push them off and say, 'There you go, enjoy your retirement.'"

"They say, 'Well, how long do I need to make these provisions last?'. 'Well, you figure it out!'. 'How much do I consume?' Well, it's entirely up to them. We're putting all the risk onto the retirees. Which is just far too much to expect for people who aren't finance professionals."

The Australian economy, a trillion dollars boost

In the UK and Canada, the market for reverse mortgages and home equity release is more advanced than in Australia and gives us a reasonable expectation of how our market may develop.

James Hickey, Partner at Deloitte, said at the Forum:

"*At the moment, the market has really only penetrated around 1-1.5% of the potential addressable market. Even if it went up to the area where the UK and the US are, with around 5% or more of the retirees using the product, then you could see a three to fivefold increase in the current market sizes of $3 billion to $10 billion to $15 billion, if it got to the same level of uptake amongst retirees."*

Putting that money into retirees' wallets has immediate benefits for the local economy. Per Capita CEO Emma Dawson said:

"Housing is a productive asset in that it provides shelter, but it's not moving through the economy. So if that money is released, we know that older people will tend to spend it in their local communities. So particularly in suburban and regional areas, if there's excess disposable income for older people, they'll spend it at a local café, local shops, taking the kids to the cinema, that then creates jobs in the economy, and it does reduce the inequality of labour and of wages as well."

Legal & General CEO Andrew Kail has seen the benefits of releasing home equity in the UK, saying of its Australian potential:

"To the point about the relationship between parents, grandparents, and children, the societal impact and the benefit of sharing this wealth and creating liquidity out of an asset stock could have huge implications for communities, families, and society. It could make a really big difference."

Understanding wealth and how to access it

Australia has a real opportunity to meet the needs of an ageing population because we have good healthcare and longevity, a good pension that's sustainable and means tested, with good housing and a good superannuation system.

This opportunity is not there yet for baby boomers and older generations. First, we have to provide information and advice to create awareness of wealth in the minds of Australians. Then we have to deliver confidence in and access to that wealth in the wallets of our senior citizens.

Superannuation funds have built lifelong relationships with Australians during their accumulation phase and are in prime position to deliver trusted holistic advice covering the full spectrum of the retiree's assets. Current regulations make this much harder than it should be and we see that super funds are nervous to risk regulatory fines or disapproval.

Stephen Reilly, COO of HESTA says:

"Everyone is trying to do the best they can for members who are looking at retirement, and who are scared to death about just how long they're going to live. One of the big challenges for us is that we know a lot, but we don't know everything. It's a bit like that old fable of people feeling different parts of an elephant; you feel the trunk, you feel the tail, you feel those great big legs and you imagine different things. The easy part for us is going to be the tech part, where we start to pull those bits of data together. The hard part is going to be working together so that we can deliver really good advice, good help to members so that people can go into retirement a little more confident and a little less scared."

It's time for the industry to unite, to support new legislation that allows superfunds to become the trusted source of retirement advice for all three pillars of retirement income, and for the industry to deliver the retirement lifestyle our senior Australians deserve.

Josh Funder is CEO and Managing Director of [Household Capital](). Josh is an advocate for positive ageing and co-founder and former chairman of Per Capita.

New capital rules an effective vaccine for thriving banks

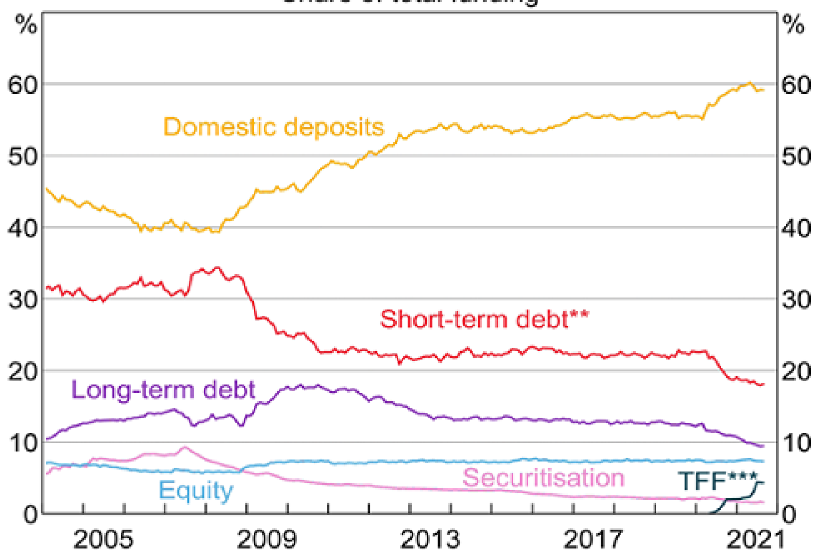
Brad Dunn

Banks played a pivotal role in the early part of the pandemic. They were often the first port of call for customers as the spectre of lockdowns loomed. Governments turned to the banks to help implement support measures and act as a crucial intermediary between themselves and the economy, insofar as an economy is the sum-total of its individual actors.

Having spent the 10 years prior to the pandemic fortifying capital buffers and improving liquidity and solvency measures, banks were well-placed to perform this central role. The Basel capital reforms contributed to a 40% increase in average total capital during the 13 years to 2019, before the start of the pandemic.

Australian bank funding mix

Share of total funding



* Adjusted for movements in foreign exchange rates; tenor of debt is estimated on a residual maturity basis

** Includes deposits and intragroup funding from non-residents

*** Term Funding Facility

Sources: ABS; APRA; Bloomberg; RBA; Refinitiv; Standard & Poor's

Excellent capital strength

Australian banks rank in the top quartile globally when it comes to capital levels, but more recent policies have accelerated improvements in other parts of the balance sheet. For example, Australia is now much less reliant on foreign investors funding loan books, replaced by growing deposits from households, targeted short-term funding known as the Term Funding Facility or TFF, and a quantitative easing programme by the RBA that is purchasing government bonds (of which the banks are some of the largest holders).

Firm footings and calm heads find a pathway forward

Strong foundations and swift action from governments at the outset of the pandemic gave banks much needed time to assess their exposures. They were able to quickly identify those customers that were at most risk of hardship and, most importantly, offer space and time to tailor support packages that eliminated the need for foreclosures or forced asset sales.

These actions were good business practice both financially and reputationally. In Australia, following the confronting Hayne Royal Commission, the events of 2020 and 2021 provided opportunities for the sector to mend and solidify connections to customers and communities. Some examples of this support included:

- Repayment holidays of up to 12 months to provide space to manage cashflows while employees were stood down or while businesses were forcibly closed.
- Structuring advice to ensure that at-risk customers had the right product for their needs.
- Reluctance to enforce foreclosure provisions without considering all other options first.

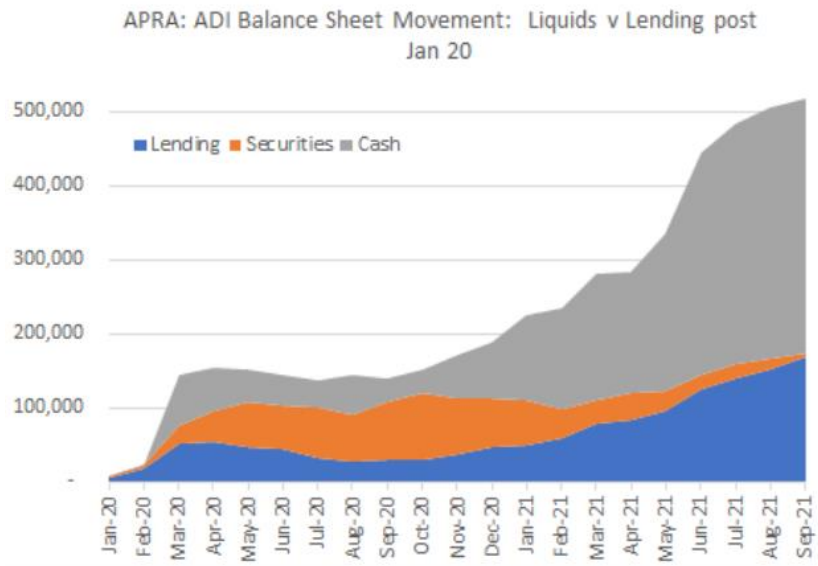
This came with a temporary financial cost to the banks, but one that they were willing to shoulder as part of a wider pandemic response. The banks' actions had positive spill-over effects in terms of confidence across the economy, not to mention in property markets, allowing individual and corporate customers to visualise a path to recovery that was able to be actioned once movement restrictions eased.

Bullish outlooks, just not for lending – yet

There is a strong platform in place for strong economic growth in 2022. Consumption is expected to revert to pre-pandemic patterns and levels over the next two years as international borders reopen, tourism returns and movement restrictions ease.

Households will be comfortable to increase economic activity due to high savings. However, from the banks' perspective, elevated holdings of cash and liquid assets has negative implications for credit demand. Cash held in bank accounts effectively earn zero interest, so as the pandemic recedes the desire to hold excess cash will fade.

Australian bank balance sheet changes



Source: APRA, Westpac

It isn't all bad news for credit demand. Owner-occupied residential borrowing is rising into the end of 2021, exacerbating the challenges for first-home buyers. This does create some hope for lending growth, but competition for high quality borrowers is intensifying. Recent Australian bank results demonstrate how difficult it is to attract the best borrowers, with ANZ admitting that its residential lending had materially lagged system growth despite buoyant market conditions.

Another major headwind for credit demand has been the impact of Buy Now Pay Later (BNPL) offerings, and the emergence of fintech start-ups across the financial ecosystem. Millennials and Gen Z customers are increasingly shying away from traditional bank products, preferring technology-based solutions. This disruption is a common theme globally as large, siloed financial institutions are being outmaneuvered by nimble start-ups that are attracting plentiful capital to support their growth ambitions.

No such hesitancy for credit investors

Fixed income and credit investors know exactly how long-suffering depositors are feeling. Credit spreads for a broad index of global banks have settled at more-than-decade lows around 75 basis points, even tighter than pre-pandemic. Effective yields of a little over 1% seem miserly, especially as price inflation in everything from food to gasoline has jumped quickly in recent months.

ICE/Bank of America Global Large Cap Banking Index

Source: Bank of America, ICE

However, yields and spreads make more sense once you consider that most large banks have reported only a fraction of the losses expected to have occurred because of the pandemic. This has protected capital and allowed profitability to be maintained. Moderate interest rate increases would be a further benefit from a profitability perspective.

At Daintree Capital, we continue to believe that hybrid securities are a smart way to gain exposure to the world's best banks. Offering spreads of between 2.5% and 4.0% above risk-free rates, hybrids provide a compelling alternative to securities rated higher in the bank balance sheet for a modest increase in risk profile but with better spreads. While all assets are currently expensive on an historical valuation basis, we believe that hybrid securities provide an appropriate balance between quality, income, and resilience to cyclical volatility.

GFC lessons helped during COVID

The nature of the two most recent crises are quite different, but the lessons learnt from the GFC and subsequent improvements, particularly in the banking space, have set the stage for a robust recovery.

During 2020 and 2021, we saw the benefits of 10 years of work via the Basel reforms achieve good outcomes for people and business, while simultaneously protecting bank bondholders and shareholders. The financial system, anchored by the banks, has already begun to transition from a defensive posture during the acute phase of the pandemic toward a more constructive footing, asking now "How can we help our customers to thrive?" rather than "How can we help our customers to survive?".

In this respect, they face challenges not just from each other, but from a vibrant fintech sector that is having success attracting younger segments of society. Overall, we see large global banks as viable long-term investment propositions, but the unique features of hybrid securities mean that in the current environment they provide the best risk-adjusted return in the bank capital stack.

Brad Dunn is a Senior Credit Analyst at [Daintree Capital](). This article contains general information only as it does not take into account the objectives, financial situation or needs of any particular person.

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