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Editorial

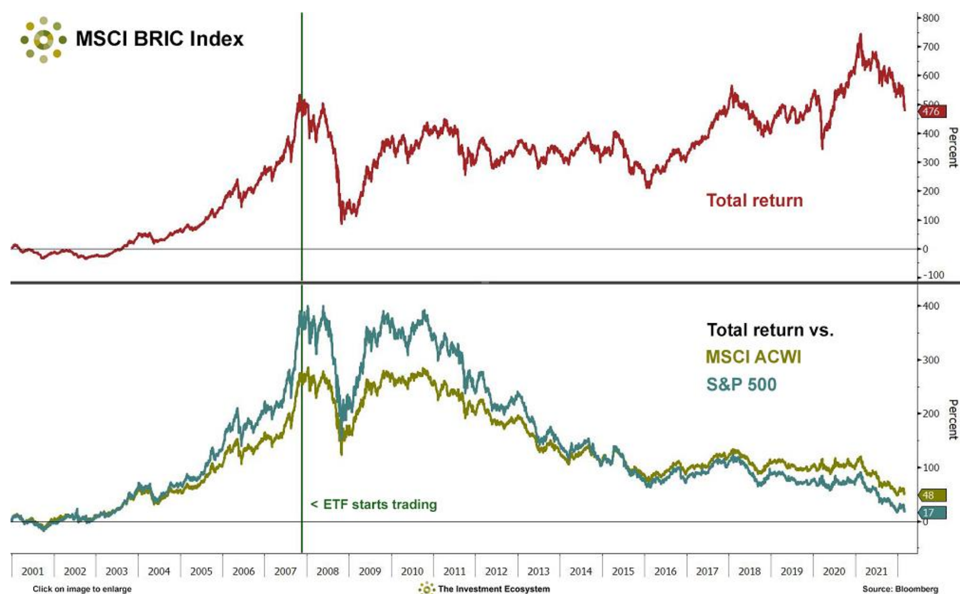
Remember BRIC? Never stand between the funds industry and an exciting new theme. BRIC was one of those acronyms that investment markets suddenly loved after **Jim O'Neill** of **Goldman Sachs** coined it to neatly sum up the emerging economic powers of **Brazil, Russia, India and China**.

The investment case was so obvious that investors lapped it up. Tired of the old stories about Europe and the US, here were four massive growth opportunities driven by a market of 3 billion people. They were supposed to become the dominant suppliers of goods the rest of the world needed. How could the rising wealth of half the world's population not be a long-term investment success?

Fund managers found analysts who knew Rio from Rajasthan and Chongqing from Chelyabinsk, who happily schlepped to meet unknown companies in new frontiers, New Delhi not New York. Funds were launched and presentations polished, and of course, out came the indexes. MSCI created the first BRIC Index, and the iShares MSCI BRIC ETF was launched in 2007.

And yes, the 'R' in this amazing opportunity which comprised about 7% of the Emerging Markets index at the end of 2021 was Russia. Now fund managers are rushing for the Russia exit. BICs anyone?

Not if the past is a guide, as this chart (from *The Investment Ecosystem*) shows, with back-tested data from the beginning of 2001. Since the 2007 ETF launch, or 15 years, the total return has gone nowhere, but relative returns have been an investor nightmare: the total return is 48% of the All Country World Index (ACWI) and a miserable 17% of the US S&P500.



Morningstar analyst, **Ben Johnson**, wrote this week:

"Global index providers MSCI and FTSE Russell announced on

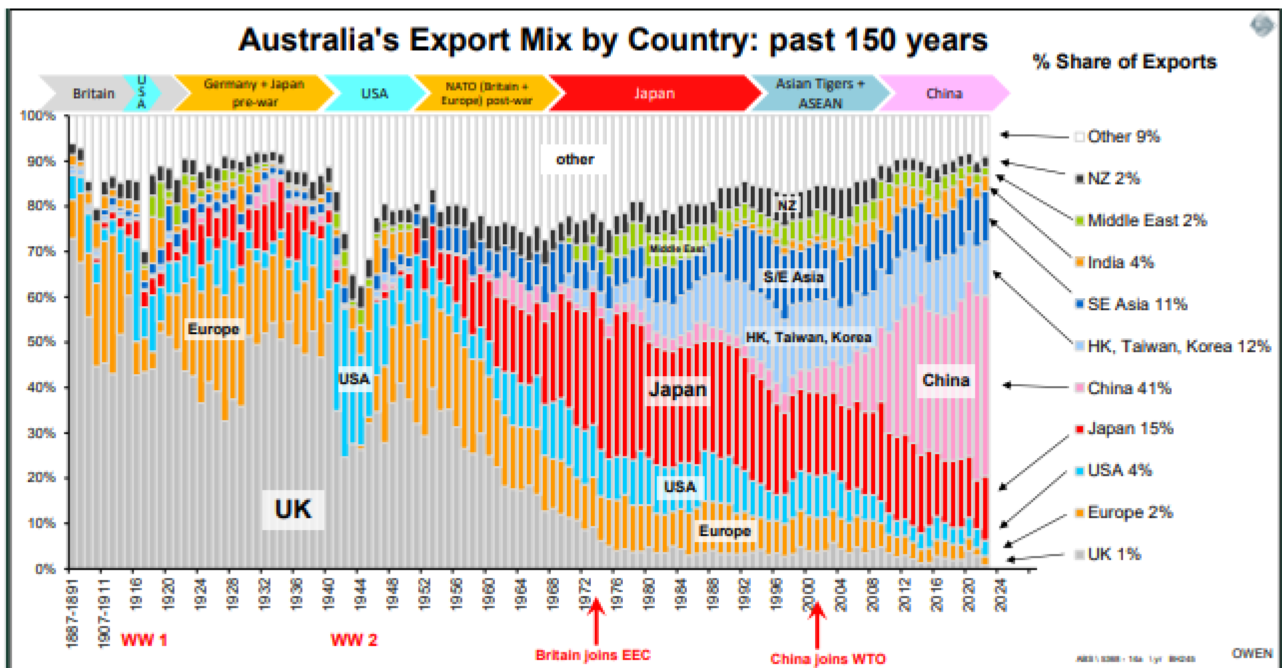
March 2 they would delete Russian stocks from their mainline benchmarks, writing their prices down to zero in the process. They said the country's securities are no longer investable. The Moscow Exchange is closed, and London and New York exchanges have halted trading of listed depositary receipts of Russian firms. If index providers' clients can't trade the stocks, they don't want them in the index.

As I see it, the message is as strong as an index manufacturer can send from its perch, effectively: "You're on your own now, and your stock market is worthless." ... (In the US) Morningstar data shows there were 150 index-tracking ETFs and mutual funds with more than 0.5% of their portfolio invested in Russian equities at the end of last year. The combined value of these funds' Russian stock holdings totalled nearly $17.5 billion, representing 1.9% of their total assets. As of the end of February 2022, the value of these funds' positions in Russian stocks had fallen more than 77%, to just below $4 billion, representing 0.5% of their assets. In the coming days, it is likely that these funds' sponsors will write the value of many of these stocks down to zero."

Australian funds with biggest exposures to Russian assets are listed here.

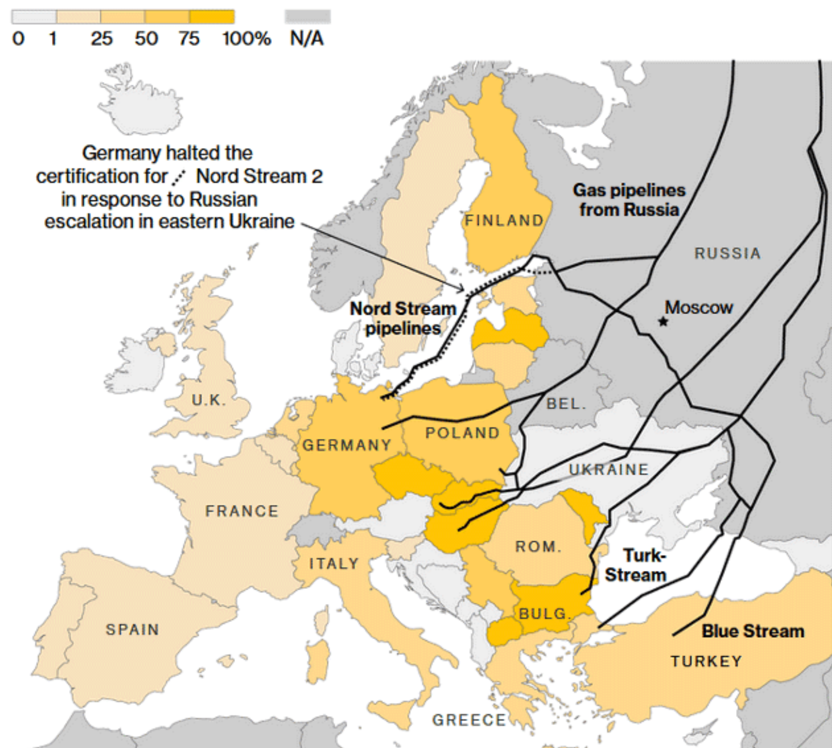
The relative failure of BRICs is a lesson about some investment fads and trends which look good when they are launched. There has never been more initial publicity for an Australian ETF than for **BetaShares Crypto Innovators** ETF (ASX:CRYP). On its first day of listing on 4 November 2021, it smashed previous records with $40 million traded and its price peaked at $12.42 a few days later. At time of writing, CRYP trades a little over $5. Each time Firstlinks criticises cryptocurrencies as an investment, we receive feedback that we don't realise how the world has changed. Maybe that's true.

Meanwhile, on the 'C' in BRIC, Australians will hear daily warnings from our politicians between now and the election about China and the threat to national and Pacific security. Where once the UK, the US and then Japan dominated Australia's export markets, China buys by far the greatest share of exports now, underpinning many corporate profits and the Federal budget, as shown below in Ashley Owen's chart. Russian trade is not significant, while our AUKUS allies the UK is down to 1% and USA is at 4%.



Europe now realises it has made a major strategic mistake with its dependence on Russia for its energy supplies, as this startling map shows the natural gas pipelines and share of supply from Russia and much of it from Ukraine.

One of the lessons they teach in **Business 101** is not to become too dependent on any one customer or supplier. Some day, you might not like their politics, their ethics, their human rights or the people you deal with. Or they may not like you. There are parallels between Europe's dependence on Russia and Australia's on China, and both dependants should have diversified well before reaching this point.



Source: Bloomberg

This week, **Ashley Owen** looks at the history of military conflicts and the impact on stockmarkets, and the likely outcomes of Russia's latest invasion. It's a humanitarian crisis but what are the longer term consequences for markets?

Our interview with **Vic Jokovic** sheds light on the expansion plans of ASX's competitor, Cboe (formerly Chi-X). Investors who think the ASX has a monopoly on share trading, clearing and derivatives should welcome a well-resourced competitor.

In a new monthly column to assist SMSF trustees, specialist **Meg Heffron** will explore techniques for managing your SMSF. She starts with how to prepare an SMSF for a potential incapacity of a trustee.

The recent passing of new superannuation rules will make contributions easier for many, and **Julie Steed** shows the opportunities coming from 1 July 2022.

And completing a trifecta of female authors to celebrate **International Women's Day** (because despite our best efforts, the vast majority of articles sent to us are written by men), **Lisa de Franck** shows that sustainable investing is not a trendy fad driven by fund managers, but due to genuine grass roots demand.

Then **Gino Rossi** shows that the concentration risk in the Australian stock market has some parallels in the US, and investors should not assume the US mega cap stocks are too big to fail. There's a fertile ground in global micro companies that fewer fund managers analyse.

Most investors who buy or sell ETFs assume the price is extremely close to the Net Asset Value, but **Rodney Lay** explains there are times when the spread can be wide and expensive. Watch, for example, trading Australian equity ETFs before all local stocks have opened.

This week's White Paper from **Revolution Asset Management** (an affiliate of **Channel Capital**) looks at rising global inflationary pressures including demand and supply dislocations.

Finally, at this incredibly difficult time for Ukraine, I mention **Sting's** new recording of '**Russians**' which he originally released on his debut solo album in 1985, or 37 years ago. It's as poignant today as when it was written during the Cold War, and he says:

"I've only rarely sung this song in the many years since it was written, because I never thought it would be relevant again. But, in the light of one man's bloody and woefully misguided decision to invade a peaceful, unthreatening neighbour, the song is, once again, a plea for our common humanity. For the brave Ukrainians fighting against this brutal tyranny and also the many Russians who are protesting this outrage despite the threat of arrest and imprisonment. We, all of us, love our children. Stop the war.

What does new global ASX rival mean for your investing?

Graham Hand

Vic Jokovic is Chief Executive of Cboe Australia, which recently acquired the Chi-X Asia Pacific business with plans to fully integrate it into Cboe's global operations and technology platform. This is an edited transcript of a discussion on 2 March 2022. For the full interview, check the podcast link at the end.

GH: Can you explain the significance of Cboe acquiring Chi-X Asia Pacific, especially for the Australian market?

VJ: Cboe coming into Australia is the first time a significant global exchange has operated here. ASX might take exception to not being branded a global exchange, but Cboe has offices in 15 countries and operates in over 25 countries including, obviously, the US. Cboe stands for Chicago Board Options Exchange, but we've got large operations in New York, London, Amsterdam. Tokyo and now Sydney. And so a very large, Australian-centric exchange, the ASX, is competing with a very large global exchange group with products that the ASX doesn't have within its tool chest.

GH: Most of our readers probably assume when they trade online through CommSec or nabtrade or another broker, that the deal goes through the ASX. When does it go through Cboe and when through the ASX?

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VJ: About one-fifth of the Australian market is now traded on Cboe Australia. Let's go a step back and begin with an investor placing an order. There's a broker responsibility to achieve the best price at the time, the best execution. Some follow it to the letter of the law, others don't. It's a little loose in terms of interpretation but it means that the broker uses smart order routers to send that order to the exchange that has the best price at that time. And we set the best price in the market approximately 35% to 40% of the time. Brokers that are not connected to both exchanges - and there are a few that aren't - can't guarantee they're delivering the best price to their clients. But it's seamless, investors don't see the mechanics. It's the broker's responsibility to route to the best price at either ASX or Cboe.

GH: If I'm an issuer or company that wants to come to the market, such as a mining company, industrial company or an ETF, what's your pitch? What's the price competition you bring versus the ASX?

VJ: The pitch prior to the Cboe acquisition was simply price, like any disruptor. Our pricing schedule is significantly lower than the incumbent, which was previously a monopoly provider. We also had the advantage of being nimble and innovative. I know everyone says that but we were focused on what we wanted to be good at, such as ETFs and warrants, trading certain types of market order to make it easier and faster for the brokers. That was our value proposition. Going forward, we have a different set of pluses. We will introduce access to global products and that gives anyone listed on our platform over time the ability to have that product access right across the globe. It's something that the ASX can't offer because it doesn't operate as the largest exchange across 18 markets in Europe, the largest derivatives exchange in the US and the third largest exchange in North America.

GH: Will Cboe have a strength or emphasis on certain types of products?

VJ: Yes. Cboe is the dominant global derivatives exchange but the Australian derivatives market is a monopoly held by the ASX at the moment. The options market has been stagnant in Australia for a long time whereas it's vibrant offshore. The ASX derives about $200 million a year of its revenues from a small number of contracts primarily across the futures side of their business, such as 3- and 10-year bonds, 90-day bank bills and recently, electricity futures. So, we will look at all of those. But for now, our focus will be on business-as-usual in trading shares and warrants - where we have 35 to 40% of the market, sometimes up to 50%. The ETF piece is obviously a key angle for us.

GH: What happened with the TRaCR product which was withdrawn recently? I liked the way investors could access great US companies directly on the local exchange. It seemed like a good idea. What's the potential for investing in global stocks through a normal Australian broker account with the FX handled automatically?

VJ: The advantage of TRaCRs was US mega caps denominated in Australian dollars in the Australian market. The product was going well with about $50 million in assets but it had taken two to three years to get there and it wasn't commercially viable for the issuer (Deutsche Bank) to continue. So, it wasn't a decision made by us and we tried other issuers but for a bunch of reasons, it didn't happen. It's a product that we may resurrect in

future with a different issuer because I think there is a place for an ADR-style (American Deposit Receipt) product around global shares in Australia and the next port of call was going to be Asian and European names.

GH: Chi-X (Cboe) is well known in Australia for its range of Active ETFs. Do you see any new asset classes or developments in that ETF space?

VJ: Yes. We were at the forefront in innovation around the active space, certainly in fixed income funds. We gain the advantage that Cboe itself has about 550 listed ETFs with all the usual issuers, the big fund managers down to some boutiques as well. We're currently talking with a few global managers that are well known plus some lesser-known Australian fund managers, to bring unique product into Australia.

GH: Such as?

VJ: Such as commodities and obviously, crypto. One of the issues is that crypto is not a regulated market, so the concept of a crypto ETF listed on an exchange via ASX or Cboe is the next step, and we are very close. We have ASIC approval to quote a Bitcoin ETF, I think it will be the first crypto ETF offered on this side of the globe.

GH: As an investor, I like the convenience of execution on an exchange and avoiding the 20-page offer document of unlisted funds, the need for a certified copy of an SMSF trust deed and all the other paperwork. I just can't be bothered. Why have more fund managers not gone the listed route yet?

VJ: Good question. It's accelerated in the last 12 months and the pipeline is strong for us and the ASX. I wouldn't be surprised to see 50 to 100 new ETFs in the market over the course of the next 12 to 18 months. Our plans see us moving from our current 20+ funds to close to 100 by the end of 2023. I don't think we're flippant or aggressive in our forecasting, it's just the pipeline.

Why haven't fund managers done it before? I think it needed a few funds to lead the way and the listed space was traditionally the world of the passive index trackers. Magellan, Schroders, Janus Henderson, Perennial … they led the way. They get access to a broker market, the 'Know Your Client' and the other rigmarole is already done for these clients, so the process is easier. It's the last distribution piece that these fund managers hadn't considered, and they have seen the success of others.

GH: Especially when Listed Investment Companies have problems not being able to pay stamping fees, so unless you're someone with a special marketing capability, like Geoff Wilson, a lot of those LICs or LITs done two or three years ago wouldn't be possible now.

VJ: Yes, and we've seen conversations (of LICs to ETFs) and some dual access models.

GH: Does Cboe target a particular part of the market, such as insto, retail or advisers?

VJ: The journey has shifted. When we first started, the most important client base for a new exchange was the brokers as we call them, the large investment banks. We started fishing there 9-10 years ago when Chi-X Australia first kicked off. Then the next step was connectivity to all stockbroking firms, including in some respects global, so we have 50 to 60 trading participants sending us and ASX orders every day. These brokers control 99% of daily volumes. Then as we moved into the ETF and ETP space, we needed strong connectivity into the wealth platforms as well.

We have a higher percentage of our daily volumes and value traded coming from retail brokers than the ASX. There's a misconception that being a newer exchange, we are heavily reliant on high-frequency trading firms. That's not the case at all. The split with the ASX is similar but skewed for us to those big retail brokers.

GH: What's your strategy and communication with the financial advice industry?

VJ: It's a work in progress that's been happening over the course of the last few years. We have two salespeople that look after the retail piece and they're heavily involved with advisers.

GH: Where will the business be in three to five years?

VJ: Where do we want to be? While we compete with the ASX across two or three limbs, we don't compete in clearing and settlement, yet Cboe is a much larger clearing and settlement operator. We don't compete with the ASX in options and futures and Cboe is a much larger futures and options house. And corporate listings is the third key focus for us. They are huge projects.

The government, the RBA and ASIC are pro competition. They're supportive, particularly now that it's not a small exchange looking to compete in these areas. You know, exchanges are typically quite boring. It's hard to make an interesting story out of an exchange business but after 150 years of ASX essentially going on its own, this will mix it up a little bit.

I draw the analogy of an Aldi or whoever else coming in to compete with Coles or Woolworths or Uber shaking up the taxi industry or the telco industry after Telstra had the entire industry to itself. That's the upside. We just can't screw it up.

Graham Hand is Managing Editor of Firstlinks. Viv Jokovic is Chief Executive at Cboe Australia, a sponsor of Firstlinks. This article is general information and does not consider the circumstances of any person.

For more articles and papers from Cboe, click here.

Meg on SMSFs: Future proofing your own fund

Meg Heffron

While reading Firstlinks recently, I was fascinated to see how much just one line of Graham Hand's editorial in Edition 447 (here) resonated with other readers:

"Regardless of personal circumstances – health or financial – we should all take the time to ensure spouses or partners know in advance what steps to take if someone dies or becomes otherwise incapacitated."

Comments sought more information. Digging deeper into exactly what could be done here is worthwhile for a number of reasons. **First**, I'm an actuary and love reading how many comments on Graham's article quoted statistics about life expectancy. **Second**, I've also worked with SMSF advisers, accountants and trustees for over 20 years so have seen the good, bad and ugly of death and incapacity in SMSFs. And **finally**, I've been the widow left behind when the driving force behind our SMSF died suddenly in his 50s.

Make these transitions easier

When it comes to incapacity there are two vital steps to have in place right now for couples who have an SMSF together. In my view, anyone who wants to have an SMSF must have these no matter how young and healthy they feel.

The first is a **corporate trustee** for the SMSF. Both death and incapacity involve changes to the make-up of the SMSF trustee and this is infinitely easier to manage when the trustee is a company.

The second is an **enduring** power of attorney allowing the spouse to keep managing things if one member of the couple is no longer capable of doing so. The enduring power of attorney should be drafted to be effective 'now' rather than only at some point in the future when incapacity strikes.

Consider Chris and Kristy who have an SMSF together and hold enduring powers of attorney for each other. If (say) Chris becomes mentally incapacitated, Kristy is able to continue as the sole director of their corporate trustee even though both of them remain members.

Remember too that incapacity is often a gradual process. There won't necessarily be a clear signal that 'today is the day' Chris can no longer fulfill all the duties required of an SMSF trustee. But the fact that Kristy has an enduring power of attorney means she can become the sole director at any time. It's the existence of the document, not the actual state of Chris's health, that allows their fund to deviate from the usual rule that all members must be directors of the corporate trustee.

What about planning for death

There are the usual important things to do around making sure the death benefit is paid the way the deceased would have liked. This is where devices like **binding death benefit nominations** and **reversionary pensions** become key. They can be the subject of a future article. The issue in Graham's editorial that seemed to resonate was how to ensure 'less involved' partners left behind can continue to run the SMSF.

And let's be honest – running an SMSF is like every other piece of domestic management couples do. There will usually be shared care and interest in the outcome but the work will be split. Inevitably one person does more than the other when it comes to paying the SMSF bills, following investment markets, reading up about new strategies etc. Is there anything that can be done to future proof the SMSF for the death of the 'more involved' party?

Yes.

Perhaps the most obvious point is to ensure the less involved partner is never completely absent. Start with the practical things: both parties should have their own logins to relevant online systems and be signatories on accounts. These days, financial institutions often double check identity using emails and mobile phone numbers so make sure both parties' details are registered, not just one.

Make sure the less involved partner knows where to go to get help if and when they need it.

Some of the best transitions I've witnessed have been where the couple has agreed beforehand what kind of help the survivor would value most and even sought out those professionals while the more active spouse is still alive.

At Heffron, a common role we're asked to fill as the administrator of the SMSF is a 'place to call' when someone dies. We're often relied upon to introduce the survivor to the right financial adviser when the time comes. Or to take on more administrative work (such as dealing with the SMSF's mail) when the partner who enjoyed that type of work dies.

After a death, time is allowed

Another tip for the surviving partner is while there is plenty to do when someone dies, a lot of it doesn't need to happen urgently, particularly if the SMSF has a corporate trustee. Apart from letting ASIC know that one of the directors has died (your SMSF accountant will be able to do this), almost everything else can wait for a bit. For example, the deceased's balance has to be dealt with as soon as practicable (either paid out of the fund or turned into a pension or a combination of the two) but the ATO generally recognises that this can take up to 6 months and sometimes longer.

On this front, life can be much trickier if the trustee is not a company. It's another very good reason to have a corporate trustee well in advance. I once had a client with individual trustees where the financial institution controlling access to the fund's investments wouldn't allow her to sell assets to pay out her husband's super until she changed the trustee to add another person (because SMSFs are not normally allowed to have just one person as the sole individual trustee). At the same time, another party involved in the fund wouldn't let her change the trustee until she'd paid out her husband's death benefit. Both parties were actually wrong but the problem wouldn't have arisen at all if the trustee had been a company.

Don't dive into winding up the SMSF. Even if that's a sensible decision in the longer term, the surviving spouse should take the time to make sure it's what they want and understand the implications of doing so. It may mean giving up some tax benefits or special rules. For example, income from SMSF pensions that pre-date 1 January 2015 isn't counted when testing eligibility for the Commonwealth Seniors Health Card. That special exemption goes if the pension is moved to another fund.

Perhaps most importantly for the surviving spouse is that just because we call SMSFs 'self managed' doesn't mean he or she must take on the same very active 'management' role their partner had. It's common to engage more support (or even just different support) after the death of one member of a couple.

When my husband was alive, management of our SMSF was shared but we had completely different roles. Not surprisingly (given my job) I looked after compliance and strategic issues. I had little interest and no expertise in investing. I'm embarrassed to admit that I didn't even have a login to the relevant accounts and of course his were locked as soon as I notified the institution of his death. Today, I rely heavily on my financial adviser, far more than my husband ever did. But it works.

Meg Heffron is the Managing Director of Heffron SMSF Solutions, a sponsor of Firstlinks. This is general information only and it does not constitute any recommendation or advice. It does not consider any personal circumstances.

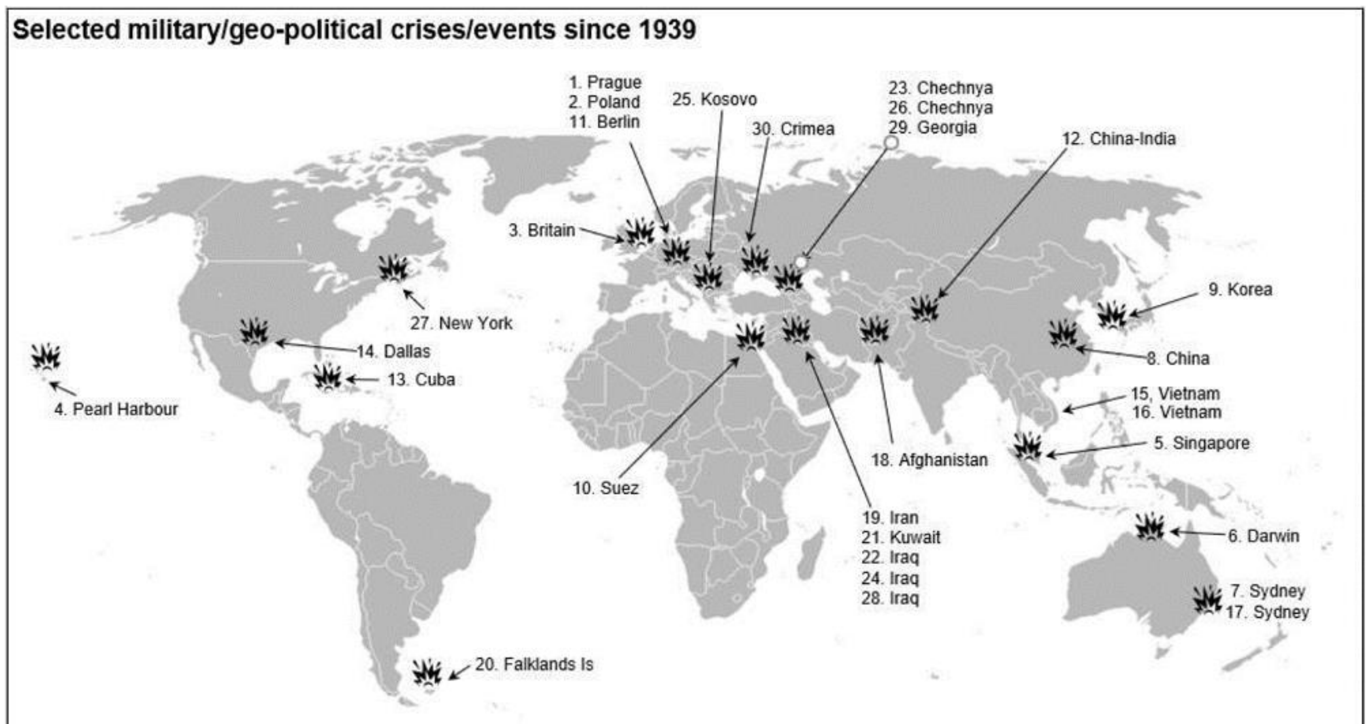
To view Heffron's latest SMSF Trustee webinar, 'Super contributions unpacked', click here (requires name and email address to view).

The impacts of military and geopolitical crises on share markets

Ashley Owen

Most wars and military crises in the past several decades were accompanied by rising share markets, or at worst, had little impact on equity markets at the time. The main reason is that wars generally create sudden increases in demand and spending that flow through to company profits. Besides the humanitarian horrors, the economic downside is that wars are almost always inflationary due to the same sudden increases in demand and prices.

The focus in this article is the short-term impact of crises on share markets, because the sudden escalation of conflict is what captures headlines and triggers investor panic. Here we look at 30 selected military and geopolitical crises since 1939. They include events in the lead up to World War 2 (WW2), then during WW2, and the major conflicts since then, as shown below:



There were hundreds of other incidents and wars during the past century, including dozens of post-WW2 wars for colonial independence across the world, but we have selected the main events affecting the major powers, and affecting Australia (as a UK/US ally).

Quick recovery in Australian and US markets

The tables below summarise the short-term impacts of these events on the US share market (first table) and on the Australian share market (second table). In each table, the four bar charts show:

A) the number of days to the bottom of the share market sell off (if any)

B) the extent of the share market sell off (if any)

C) the share index three months after the start (from the pre-crisis level, not from the bottom) and

D) 12 months after the start.

While share markets reacted negatively in the immediate outbreak in 22 out of the 30 crises (column B), in almost all of these, the sell-offs lasted just a few days (column A). In most cases share markets were back above pre crisis levels within three months (C), and nearly all were ahead after 12 months (D).

In those few instances where share markets were not ahead 12 months later, these were due to other factors at work, like the GFC, the 'tech wreck', or economic recessions unrelated to the wars.

Impacts on US share market

	Start	Event	A: days to bottom	B: US sell-off	C: US 3m after start	D: US 12m after start	comments
1	15 Mar 1939	Germany invades Prague	28	-18.1%	-9.0%	-2.0%	
2	3 Sep 1939	Britain/France declare war on Germany after Poland invasion	0	+9.5%	+8.3%	-4.7%	(shares not affected)
3	10 Jul 1940	Battle of Britain - German air attacks	1	-0.1%	+7.2%	+5.1%	
4	7 Dec 1941	Pearl Harbour bombed by Japan	17	-8.2%	-9.8%	-0.8%	
5	15 Feb 1942	Fall of Singapore - Britain flees	25	-7.0%	-8.9%	+19.1%	
6	19 Feb 1942	Japanese bomb Darwin + North Australia	21	-5.8%	-6.4%	+20.6%	
7	7 Jun 1942	Japanese subs shell Sydney Harbour	0	+1.1%	+1.9%	+36.3%	(shares not affected)
8	1 Oct 1949	Communist revolution proclaims victory in China	0	+0.1%	+9.9%	+24.1%	(shares not affected)
9	25 Jun 1950	Nth Korea invades South - starts Korean War	19	-12.0%	+1.0%	+10.5%	
10	26 Jul 1956	Suez crisis - Egypt nationalises Suez, Britain/France attack	1	-8.8%	-7.4%	+0.5%	
11	13 Aug 1961	East Germany closes broder & builds Berlin Wall	3	-0.9%	+1.4%	-18.0%	
12	20 Oct 1962	Sino-Indian War	4	-2.7%	+17.3%	+30.9%	
13	22 Oct 1962	Cuban missile crisis	2	-2.7%	+17.8%	+30.3%	
14	22 Nov 1963	JFK assassination	1	-2.9%	+8.8%	+21.4%	
15	2 Mar 1965	US starts air + land attacks on Nth Vietnam	28	-1.3%	+1.0%	+4.3%	
16	30 Apr 1975	US flees Vietnam, Nth Vietnam gains control	0	+2.3%	+2.7%	+24.8%	(shares not affected)
17	13 Feb 1978	Sydney Hilton bombing	16	-4.4%	+8.3%	+6.3%	
18	24 Dec 1979	USSR invades Afghanistan start of Soviet-Afghan War	11	-2.2%	-8.8%	+14.8%	
19	22 Sep 1980	Iraq invades Iran - start of Iran-Iraq War	8	-4.3%	-2.8%	-12.2%	US rate hikes, inflation
20	2 Apr 1982	Argentina invades Falklands	0	+0.6%	-3.6%	+35.3%	(shares not affected)
21	2 Aug 1990	Iraq invades Kuwait	22	-14.4%	-14.1%	+4.1%	1990-1 recession sell-off
22	16 Jan 1991	US/UN 'Desert Storm' attack on Iraq	0	+0.7%	+15.0%	+30.8%	(shares not affected)
23	31 Dec 1994	Russia invades Grozny (1st Russia-Chechen War)	0	+0.1%	+8.4%	+33.5%	(shares not affected)
24	16 Dec 1998	US/UK 'Desert Fox' attacks on Iraq	1	-0.4%	+12.9%	+27.2%	
25	24 Mar 1999	US/NATO starts bombing Belgrade (Kosovo War)	1	-0.1%	+8.9%	+14.9%	
26	1 Oct 1999	Russia invasion of Chechnia (2nd Chechen War)	15	-3.1%	+9.8%	-1.1%	tech-wreck sell-off
27	11 Sep 2001	Sep 11 2001 attacks on NY, Washington		-14.3%	+3.3%	-10.4%	tech-wreck sell-off
28	19 Mar 2003	US/UK invade Iraq	13	-2.5%	+13.4%	+25.6%	
29	8 Aug 2008	Russia invades Georgia	12	-0.7%	-21.8%	-18.0%	middle of GFC
30	20 Feb 2014	Russia invades Crimea	0	+0.6%	+2.1%	+13.1%	(shares not affected)

(OWEN analysis)

The next table below shows the impacts of the same crises on the Australian share market. Three of the events selected here occurred on Australian soil:

1. the Japanese bombing of Darwin and northern Australia started on 13 February 1942 (6)
2. Japanese subs shelling ships in Sydney Harbour on 7 June 1942 (7)
3. the bombing of the Sydney Hilton on 13 February 1978 (17).

Impacts on Australian share market

	Start	Event	A: days to bottom	B: Aust sell-off	C: Aust 3m after start	D: Aust 12m after start	comments
1	15 Mar 1939	Germany invades Prague	36	-5.9%	-1.3%	-0.1%	
2	3 Sep 1939	Britain/France declare war on Germany after Poland invasion	1	-4.0%	+3.2%	-3.8%	
3	10 Jul 1940	Battle of Britain - German air attacks	1	-0.1%	+16.5%	+14.1%	
4	7 Dec 1941	Pearl Harbour bombed by Japan		-22.1%	-18.8%	+3.1%	
5	15 Feb 1942	Fall of Singapore - Britain flees	45	-7.3%	-3.5%	+27.9%	
6	19 Feb 1942	Japanese bomb Darwin + North Australia	41	-2.6%	+1.0%	+36.2%	
7	7 Jun 1942	Japanese subs shell Sydney Harbour	0	+0.1%	+14.2%	+32.1%	(shares not affected)
8	1 Oct 1949	Communist revolution proclaims victory in China	0	+0.0%	+6.4%	+14.5%	(shares not affected)
9	25 Jun 1950	Nth Korea invades South - starts Korean War	11	-3.2%	+4.8%	+13.4%	
10	26 Jul 1956	Suez crisis - Egypt nationalises Suez, Britain/France attack	0	+0.0%	+4.6%	+15.2%	(shares not affected)
11	13 Aug 1961	East Germany closes broder & builds Berlin Wall	10	-1.4%	-0.6%	-4.0%	
12	20 Oct 1962	Sino-Indian War	5	-2.5%	+2.5%	+14.9%	
13	22 Oct 1962	Cuban missile crisis	2	-2.8%	+2.1%	+10.5%	
14	22 Nov 1963	JFK assassination	1	-0.4%	+7.6%	+2.5%	
15	2 Mar 1965	US starts air + land attacks on Nth Vietnam	10	-7.3%	-6.1%	-6.2%	
16	30 Apr 1975	US flees Vietnam, Nth Vietnam gains control	0	+0.1%	+3.1%	+30.1%	(shares not affected)
17	13 Feb 1978	Sydney Hilton bombing	23	-5.9%	+2.6%	+23.9%	
18	24 Dec 1979	USSR invades Afghanistan start of Soviet-Afghan War	0	+0.2%	+8.9%	+38.5%	(shares not affected)
19	22 Sep 1980	Iraq invades Iran - start of Iran-Iraq War	17	-4.1%	+0.4%	-10.3%	US rate hikes, inflation
20	2 Apr 1982	Argentina invades Falklands	1	-0.2%	+1.9%	+11.2%	
21	2 Aug 1990	Iraq invades Kuwait	23	-7.4%	-17.9%	-0.6%	1990-1 recession sell-off
22	16 Jan 1991	US/UN 'Desert Storm' attack on Iraq	1	-1.2%	+24.6%	+37.4%	
23	31 Dec 1994	Russia invades Grozny (1st Russia-Chechen War)	40	-4.7%	-0.3%	+15.2%	
24	16 Dec 1998	US/UK 'Desert Fox' attacks on Iraq	0	+0.3%	+11.2%	+16.0%	(shares not affected)
25	24 Mar 1999	US/NATO starts bombing Belgrade (Kosovo War)	1	-0.7%	-0.9%	+8.7%	
26	1 Oct 1999	Russia invasion of Chechnia (2nd Chechen War)	19	-3.5%	+8.9%	+10.6%	
27	11 Sep 2001	Sep 11 2001 attacks on NY, Washington		-9.9%	+3.7%	-2.7%	tech-wreck sell-off
28	19 Mar 2003	US/UK invade Iraq	0	+0.4%	+9.0%	+22.1%	(shares not affected)
29	8 Aug 2008	Russia invades Georgia	12	-2.0%	-20.3%	-14.5%	middle of GFC
30	20 Feb 2014	Russia invades Crimea	29	-1.9%	-0.3%	+7.9%	China slowdown scare

(OWEN analysis)

The first two of these brought WW2 to Australian soil, and the third (Sydney Hilton bombing) is included here because (a) it was the first fatal terrorist attack in Australia and (b) the hotel was hosting the Commonwealth Heads of Government meeting at the time, which included a number of possible international targets.

The impacts of these events on the Australian share market were almost exactly the same as on the US market. Most of the events triggered immediate panic sell-offs for a few days, but recovered over the ensuing months. While past events provide no guarantee of the future, this is a good reminder that military invasions and geopolitical crises (even very major ones) usually cause short, temporary sell-offs that recover quickly.

Russia's aims

Putin appears to have four main motivations for expansion:

a) rebuilding a buffer zone against US/NATO, which it lost when the USSR fell apart at the start of the 1990s
b) restoring dignity to re-capture and re-live Russia's past glory days as a major power after the humiliation of the collapse of the Soviet empire
c) re-uniting ethnic Russians in the former (but now independent) buffer states
d) building pipelines through compliant client states into Europe, making Europe dependent on Russian oil and gas and therefore less likely to oppose Russia's expansion.

There is more to Ukraine and Kyiv than meets the eye. For hundreds of years, Ukraine was the centre of 'Russia' and Kyiv was the seat of 'Russian' power. The idea of Ukraine and Kyiv as a critical part of 'Russia' runs deep, although that does not justify military invasion.

There have been a succession of Russian interventions to achieve these joint aims since the collapse of the Soviet empire, with some by political means and others by military force. These have been included in our list of 30 conflicts analysed above. The first military win was in Chechnya after losing the First Russian-Chechen War (conflict #24 in the above tables) but finally winning the Second Russian-Chechen War (#26) which ended with Russia gaining control and starting to build oil and gas pipelines through to Europe.

Then in the Russia-Georgia War (#29), Russia invaded and took back two more parts of its old Soviet empire, South Ossetia and Abkhazia. In Ukraine, Putin had backed and installed the Russia-friendly Viktor Yanukovych as President, but he was ousted by a popular uprising and revolution in early 2014, and Putin responded immediately by invading and occupying Crimea from Ukraine (#30).

In each case, the US and NATO did not step in with military action although they did impose some sanctions. Russia has been able to build extensive pipelines into Europe via its controlled or friendly buffer states, and Europe has become reliant on Russia for 30-40% of its oil and gas supply, and 30% of Russia's pipelines to Europe run through Ukraine.

Despite Putin's threat of putting Russia's nuclear arsenal on alert, our base case is not for a nuclear or all-out war in Europe yet (or perhaps ever), but for further gradual, opportunistic expansion by Putin to achieve his aims, emboldened by the US and NATO's reluctance to act militarily, and by Putin's support from Xi's China.

Likely outcomes

One possible outcome would be for a long drawn-out guerrilla-style war like Russia fought in Afghanistan during the 1980s (#18 in our tables). In that war, the US and NATO did not take direct action but backed the insurgents for nine years before Russia finally retreated. That type of long drawn-out war would not be good for Putin. If the sanctions incurred serious long term damage to Russian incomes, Putin risks an internal military coup or popular uprising. This is a possible but less likely outcome.

A more likely outcome would be a peace treaty in which Russia takes Donbas (which Russia has partially occupied since 2014), and retains Crimea, in return for withdrawing from the rest of Ukraine and having sanctions lifted. Americans are war-weary after the retreat from Afghanistan in August 2021 and Putin knows it. Putin and Xi Jinping probably have a deal to support each other over their plans for Ukraine and Taiwan but Xi knows that China is not yet ready for a war against the US, although it is catching up rapidly.

Whatever the outcome of this latest invasion, the military build-ups (including in the US, China, Japan, Korea, Taiwan and even Australia) and hostilities are lifting commodities demand and prices, which in turn benefits Australia's commodities exports, but it also adds further to inflationary pressures globally.

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Size doesn't matter when it comes to risk

Gino Rossi

I'd like to suggest to readers that there's more risk in those global large cap allocations in your portfolios than you might think. And yes, I'm the portfolio manager of a global microcap Fund. I have a vested interest, but bear with me.

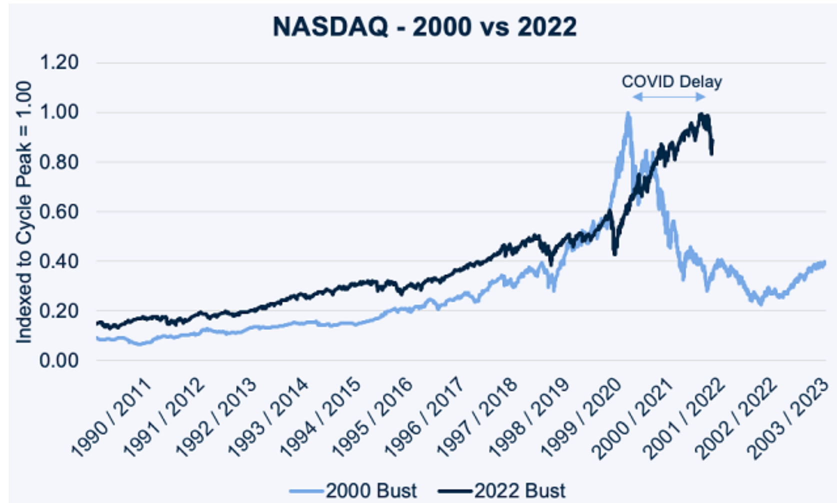
I'm not saying dump your large cap exposure, I'm simply advocating for a little more diversity than most investors currently have. Here's why.

The end of the cycle?

Right now, there are various data points that suggest we are approaching the end of a significant market cycle. One I believe in has been extended by COVID-19. In the chart below, I have taken the decade-long run-up of

the NASDAQ during the dotcom era and compared it to the run-up of the NASDAQ in the current growth cycle (calling a November 2021 cycle peak).

The run-up is almost identical, but for a global pandemic pushing the peak back 12 months.



Source: Bloomberg, Spheria

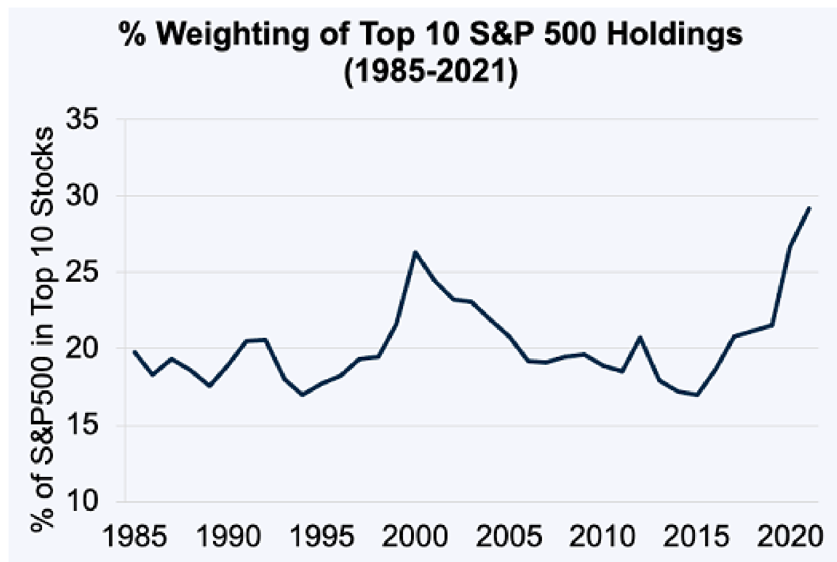
People say dotcom was different. They say it was ridiculous. But there's been many a ridiculous phenomenon during this cycle – profitless tech on nose-bleed multiples, cryptocurrencies, SPACs, war-time-like fiscal stimulus, negative real interest rates.

Now, with many large cap tech names selling off materially in recent months, it appears 'risk off' (that is, reducing risk in portfolios) is back - an awakening perhaps for many investors who've been enthralled by an enduring period of easy money.

Many remain asleep to concentration risk

Concentration risk is often mentioned in Australian equities – "*Too many Australian investors are overweight the big 4 banks, BHP and Telstra"*. But less is spoken about the concentration risk investors are currently taking in global equities.

The impact of the proliferation of passive investing has been immense, with passive now around 55% of US equity funds. Throughout the 90s, it was 5%. In my view, there is no doubt that passive investments are the main conduit in which the tidal wave of Federal Reserve QE has entered the market. The result, as you can see below, is the most concentrated market in US history.



Source: Morningstar Direct, Spheria

Furthermore, in the funds management industry here in Australia, the concentration persists. Here I have compared three popular Australian actively-managed global equities funds. We see many crowded trades and much homogeneity.

Many of these companies are exceptional businesses but the perception that large caps are too large to fail must be challenged. Take a look at the S&P 500s Top 10 over time. It needs little explanation. History shows it's not easy to stay at the top of the pile.

Top 10 Holdings	Fund #1	Fund #2	Fund #3	MSCI World Large Cap Index
1	Amazon	Tesla	Microsoft	Apple
2	Alphabet	Microsoft	Alphabet	Microsoft
3	Rivian Automotive	Amazon	Netflix	Amazon
4	Evotec	Alphabet	Starbucks	Tesla
5	Microsoft	PayPal	Yum! Brands	Alphabet
6	Charles Schwab	Block	Visa Inc	Meta Platforms
7	Meta Platforms	Meta Platforms	Pepsico	Nvidia
8	NextEra Energy	Spotify	Intercontinental Exchange	United Health
9	Roper Technologies	Salesforce	Meta Platforms	JP Morgan
10	Apple	ServiceNow	SAP	J&J

Source: MSCI, Morningstar. As at 31 December 2021

S&P500 Top 10 (1980 – Current)									
1980	1985	1990	1995	2000	2005	2010	2015	2020	Current
IBM	IBM	IBM	GE	GE	GE	Exxon	Apple	Apple	Apple
AT&T	Exxon	Exxon	AT&T	Exxon	Exxon	Apple	Alphabet	Microsoft	Microsoft
Exxon	GE	GE	Exxon	Pfizer	Microsoft	Microsoft	Microsoft	Amazon	Alphabet
Standard Oil, Indiana	AT&T	Philip Morris	Coca-Cola	Citigroup	Citigroup	GE	Exxon	Alphabet	Amazon
Schlumberger	GM	Shell	Merck & Co	Cisco	Procter & Gamble	Chevron	GE	Meta	Tesla
Shell	Shell	Bristol-Myers	Shell	Wal-Mart	Wal-Mart	IBM	J&J	Tesla	Meta
Mobil	DuPont	Merck & Co	Philip Morris	Microsoft	Bank of America	Procter & Gamble	Amazon	Berkshire Hathaway	Nvidia
Standard Oil of Cal	Amoco	Wal-Mart	Procter & Gamble	AIG	J&J	AT&T	Wells Fargo	J&J	Berkshire Hathaway
Atlantic Richfield	Bell South	AT&T	J&J	Merck & Co	AIG	J&J	Berkshire Hathaway	JP Morgan Chase	J&J
GE	Sears	Coca-Cola	Microsoft	Intel	Pfizer	JP Morgan Chase	JP Morgan Chase	Visa	United Health

Source: S&P Dow Jones, Spheria

Where to invest as the cycle turns?

Checking some well-known recent market turning points, the table (right) shows at the dot-com peak, the market was overweight tech. At the GFC, it was financials.

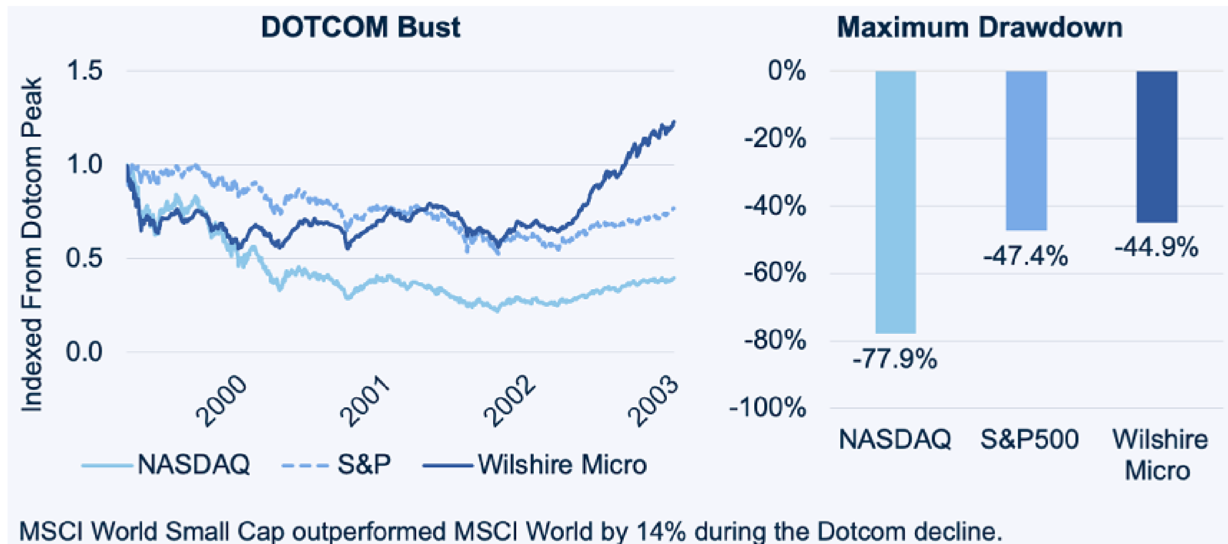
The question is what are investors overweight today as the cycle turns?

There’s strong historical evidence that allocating to stocks outside of the big end of town can strengthen portfolios at this time. The MSCI World Small Cap Index outperformed the larger MSCI World by 14% on the way down during the dot-com bust. While the MSCI World Microcap Index does not extend that far back, if the GFC and COVID are a guide, it would have outperformed by a similar magnitude.

Dotcom		GFC	
1999	2002	2006	2010
Microsoft	Microsoft	Exxon	Exxon
GE	GE	GE	Apple
Cisco	Exxon	Microsoft	Microsoft
Wal-Mart	Wal-Mart	Citigroup	Berkshire Hathaway
Exxon	Pfizer	Bank of America	GE
Intel	Citigroup	Procter & Gamble	Wal-Mart
Lucent Technologies	J&J	Wal-Mart	Google
IBM	AIG	J&J	Chevron
Citigroup	IBM	Pfizer	IBM
AOL	Merck & Co	AIG	Procter & Gamble

Source: S&P Dow Jones

Working with the available microcap data, the dot-com decline (below) shows the Wilshire US Microcap Index (the only microcap index at the time) outperformed both the NASDAQ and the S&P 500.

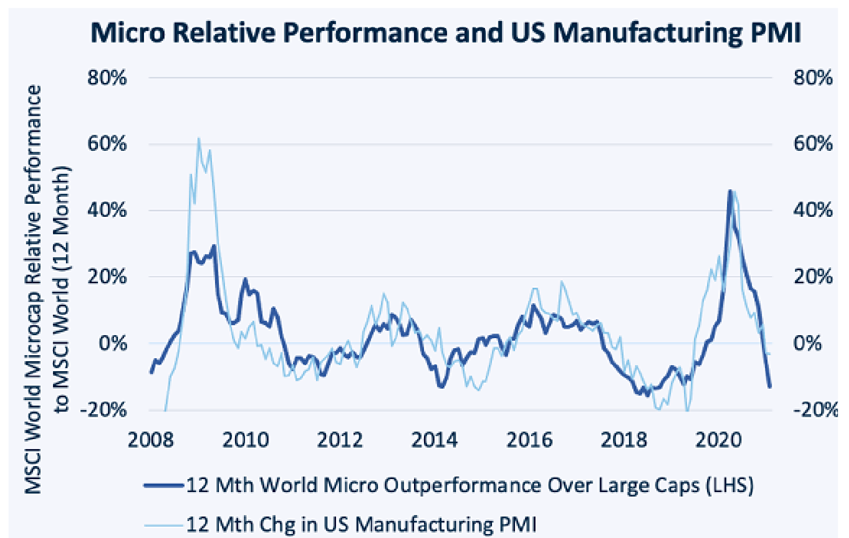


Source: Bloomberg, Spheria. NASDAQ Total Return Index unavailable during period examined. S&P and Wilshire Micro are Total Return Indices.

Microcaps were initially caught up in the risk-off before a plateau then a burst of strong outperformance as the global economy began to recover.

To highlight this further, we have plotted the performance of global microcap relative to global large caps (dark blue line) against the 12-month change in US Purchasing Managers' Index (PMI), a measure of economic activity. In simple terms, as the economy accelerates, microcaps outperform and as the economy decelerates, microcaps underperform. While the asset class led markets out of the dotcom era, the GFC and COVID-19, there was only marginal underperformance on the way down.

This asymmetry during large market events provides investors a powerful asset allocation enhancement.



Source: MSCI, Bloomberg, Spheria

Demystifying global microcaps

Finally, global microcaps are a relatively underexplored and misunderstood asset class, being developed market securities with market caps of under US$1 billion (more akin to what we know as small cap Australian companies).

It's the 'little end of town', you might say. But in this universe, there are over 18,000 securities globally and the US is only 24% of the index. And there are many misconceptions about this asset class, particularly when it comes to risk.

As bottom-up stock pickers, we believe investors are best served favouring growing and innovative businesses with strong cash flow conversion. In global microcaps, it's a philosophy that enables a broad set of opportunity, and we also focus on capital preservation, with valuation discipline being a critical component in protecting capital.

A portfolio of global microcaps constructed against this disciplined framework of active management is why we don't believe size matters, and how we believe investors can better navigate this current turning point in the market cycle.

Gino Rossi is Portfolio Manager at Spheria Asset Management, an affiliate manager of Pinnacle Investment Management. Pinnacle is a sponsor of Firstlinks. This article is for general information purposes only and does not consider any person's objectives, financial situation or needs, and because of that, reliance should not be placed on this information as the basis for making an investment, financial or other decision.

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Elevating responsible investing to solve real world challenges

Lisa de Franck

Investing responsibly became mainstream in 2021. In 2022, we expect the discussion with clients to become more nuanced as understanding deepens and they look more broadly at the bigger picture.

Over recent years, many of our clients have incorporated responsible investing into their standard investment process. They focus not only on investing in companies that engage in environmentally and socially irresponsible practices but also against those which display poor corporate behaviour.

Until recently, this would have been achieved through excluding companies from portfolios altogether on the basis of their involvement in certain industries, such as gambling, alcohol, tobacco, thermal coal and firearms. However, such a simplistic approach to investing does not integrate appropriate financial analysis of future growth prospects and risk into the investment decision.

To overcome these limitations, investment portfolio construction incorporates ESG (environmental, social, and governance) integration.

In its broadest sense, ESG integration is the analysis of all material factors in investment analysis and investment decisions, including ESG factors. We can identify companies that are leading or lagging in their industry or sector to pinpoint significant risks relevant to the company or industry. In this way, we minimise investing in those companies whose ESG policies and practices expose them to unacceptable levels of risk.

Examples of possible ESG issues to consider

Environmental factors

- Positive outcomes might include avoiding or minimising environmental liabilities, lowering costs and increasing profitability through achieving energy and other efficiencies, reducing regulatory, legislation or reputational risk.

- Negative impact would include polluting or degrading the environment, adding to atmospheric carbon levels, threatening a region's biodiversity or cultural heritage or risks associated with climate change, reduced air quality and/or water scarcity.

Social factors

- Social positive outcomes could include increasing employee productivity and morale, reducing staff turnover and absenteeism and improving brand loyalty.

- Negative issues might include sub-standard conditions for production employees in third world countries, aiding human conflict, facilitating crime or corruption, poor product integrity, inadequate health and safety issues for employees' customers or suppliers, harming the local community, or risks associated with large-scale pandemics or shortages of food, water or shelter.

Governance factors

- Positive outcomes would include aligning the mutual interests of shareholders and management, improving timely disclosures, and the avoidance of unpleasant surprises.

- Negative connotations such as the way companies are run, lack of board independence and diversity, weak corporate risk management, poor corporate culture, excessive executive remuneration, inadequate product/market diversification, ineffective community engagement.

Thinking big: aligning investment outcomes to the UN's Sustainable Development Goals

The Sustainable Development Goals (SDG) were set up in 2015 by the United Nations General Assembly and were aimed at creating a better world for all by 2030. We are now six years on, and the SDGs have become the blueprint to achieve a better and more sustainable future for all. They address the global challenges we face, including poverty, inequality, climate change, environmental degradation, peace and justice.

The 17 goals and 169 targets fall into three categories: economic, social and environmental development and provide a good framework to assess an ESG investment portfolio.

Each SDG represents a risk that is presenting challenges to businesses and society and these risks are likely to only continue to grow if not addressed.

Here are two examples of how investors can use SDGs in portfolio construction:

1. Impact of product and services

Mining is without doubt a controversial topic. However, it is important to take a closer look at what is actually being extracted before making a blanket exclusion on all mining companies.

Take coal for example. Access to electricity is important to transform the world, particularly in developing nations, however fossil fuels are responsible for approximately 40% of global carbon emissions, with almost two thirds of these emission from coal. If our view is that the use of coal detracts from SDG 13, climate action, we can exclude companies that have a meaningful exposure to extraction or use of coal from our portfolio.

However, where does that leave you for SDG7, affordable and clean energy? To expand energy access, it is crucial to enhance energy efficiency and invest in renewable energy. Electrification of the grid and transport require materials. Lithium, cobalt and nickel are the most commonly used metals in creating electric batteries. These metals are limited in supply and will be required as the world looks to decarbonize.

The resources and material sector will be essential in delivering the necessary materials to enable the transformation which is critical to reducing carbon emissions. The investment implications of the world's decarbonisation program are enormous. As many countries and corporations committing to net zero carbon emissions targets by 2050, a massive transformation will be required to attain them. These will play out over decades.

2. Companies engaged in controversy

SDGs provide a means for identifying and then mitigating risks through identify issues to address during our corporate due diligence process.

Corporate scandals can have significant financial repercussions ranging from legal penalties to consumer boycotts. These incidents damage the reputation of both the companies themselves and their shareholders.

We have a framework that considers the severity of incidents, the corporation's accountability and whether they form part of a pattern of corporate misconduct. We utilise Controversies Research to support investment decisions, including screening and engagement, and to manage reputational risks.

All of this can be compiled into a forward-looking assessment of how controversies are likely to evolve over the next 12 to 24 months. For example, a company that has demonstrated that it has an increase in adverse employee incidents would be concerning for SDG 8, 'Decent work and economic growth', and could potentially change our long-term outlook on the company.

Returns matter but so do values

Regulators, companies, fund managers and investors are being encouraged to recognise the relevance of incorporating ESG factors to enhance corporate transparency and performance, and the measurement of risk. The availability of increasing amounts of ESG data is allowing investors to incorporate these strategies into portfolio construction.

Effective ESG portfolios will include thematic investments which contribute to social or environmental challenges by investing in companies offering solutions to these issues. For example, a fund manager investing with purpose may include social housing in a property fund.

While we maintain a strong focus on delivering strong financial performance, we are not looking to achieve outperformance relative to our conventional portfolios, more so to provide our clients with an alternate investment solution without comprising on returns.

Lisa de Franck is Investment and Advice Manager at financial services firm Crystal Wealth Partners. This article is for general information purposes only and does not consider any person's objectives, financial situation or needs, and because of that, reliance should not be placed on this information as the basis for making an investment, financial or other decision.

Valuable super contribution changes are now law

Julie Steed

Several valuable superannuation changes that affect an individual's ability to contribute to super, particularly those age 67 to 74, are now law with effect from 1 July 2022.

The Treasury Laws Amendment (Enhancing Superannuation Outcomes for Australians and Helping Australian Businesses Invest) Bill 2021 received Royal Assent on 22 February 2022.

In this article I review the major changes that will assist many individuals grow their super from 1 July 2022.

Remove the Super Guarantee $450 income threshold

Since the introduction of the Super Guarantee (SG) system in 1992, employers have not been required to pay SG contributions for employees who earn less than $450 in a calendar month.

From 1 July 2022, the $450 income threshold will be removed, and employers will be required to pay SG contributions for all employees regardless of income.

However, there are no changes to the SG exemptions for minors. Contributions are not required for employees under age 18 who work less than 30 hours per week, regardless of their monthly income.

This will see an increase in the super savings of many individuals particularly those who have multiple part time jobs.

Employers will need to ensure that their payroll systems are updated to deal with the changes from the first SG payment cycle after 1 July 2022.

Extension of the non-concessional contribution bring forward rule

From 1 July 2022, access to the non-concessional contribution bring forward rule will extend to individuals who are age 74 or less on 1 July of a financial year. Currently the bring forward arrangements are only available to individuals age 67 or less.

All the other eligibility requirements for accessing the bring forward arrangements remain unchanged. Individuals must have a total superannuation balance at the previous 30 June of under $1.48 million to be eligible for a three-year bring forward period and contribute up to $330,000 of non-concessional contributions. Individuals must have a total superannuation balance at the previous 30 June between $1.48 million and $1.59 million to be eligible for a two-year bring forward period and contribute up to $220,000 of non-concessional contributions. They must also not currently be in a bring forward period.

Individuals with a total superannuation balance at the previous 30 June between $1.59 million and $1.7 million cannot use the bring forward rule but can contribute up to $110,000.

Non-concessional contributions cannot be made if the total super balance at the previous 30 June is at least $1.7 million. These thresholds are subject to indexation.

This measure may provide the opportunity for individuals to bolster their superannuation savings from money currently held in less tax effective environments outside of super.

It may also provide individuals with the opportunity to improve their estate plans if they expect their superannuation death benefit will be paid to adult children. By withdrawing monies from super and recontributing non-concessional contributions individuals may increase the tax-free component of their account. This may result in lower tax on death benefits.

Individuals should seek professional advice in implementing these types of strategies.

Changes to work test requirement

As part of the contribution changes, the Government announced that superannuation rules will no longer require an individual age 67 to 74 to meet a work test to be able to contribute to super. There will continue to be no work test requirement to receive SG or Award contributions. These measures require changes to superannuation regulations, which do not require Parliamentary approval and we expect them to be made shortly.

Individuals age 67 to 74 will be able to make non-concessional contributions or salary sacrifice contributions without meeting the work test.

Importantly however, the tax laws have been updated to make meeting the work test a continued condition for eligibility to make a personal deductible contribution. There is no change to the work test definition, individuals must work 40 hours in 30 consecutive days in the financial year in which the contribution is made.

This means that individuals age 67 to 74 who do not meet the work test will not be able to make a personal deductible contribution to offset a realised capital gain.

Increases for release under the First Home Super Saver scheme

The limit on voluntary contributions made over multiple financial years that are eligible to be released under the First Home Super Saver (FHSS) scheme will be increased from $30,000 to $50,000 (plus associated earnings).

For more information on the changes to the FHSS scheme see our recent article at Firstlinks - FHSS scheme.

Reduced minimum age for downsizer contributions

From 1 July 2022, the minimum age at which an individual is eligible to make a downsizer contribution is reduced from 65 to 60.

This will provide additional opportunities to access the downsizer contribution concession for those who sell a home after age 60.

All the other downsizer eligibility criteria remain unchanged including the requirement for the contribution to be made within 90 days of receipt of the sale proceeds. This means that there may be an opportunity for individuals who are between age 60 and 65 who sell their home between mid-April and 30 June 2022 to make a downsizer contribution in 2022-23.

For more information on the eligibility criteria for making a downsizer contribution see our previous article at Firstlinks - downsizer contributions.

Exempt current pension income

In addition to the changes to contribution rules, there is a change in the law for how SMSFs can calculate exempt current pension income (ECPI). From the 2021-22 financial year, SMSF trustees will be able to choose their preferred method of calculating ECPI where not all of the interests in the fund are in retirement pension accounts for part, but not all of the year. This includes funds that have a transition to retirement income stream or an accumulation account.

Trustees will be able to choose to obtain an actuarial certificate to calculate the ECPI for the whole year, which is often a simple solution. Alternatively, they may be able to use the actuarial certificate for only the parts of the year where the fund held both accumulation and retirement pension accounts and use the actual income for the parts of the year that the fund held 100% in retirement pension accounts.

Depending upon the timing of transactions during the year, either methodology may provide a higher ECPI amount.

For more information on the best option for an SMSF, it is recommended that trustees consult the fund's actuary, financial adviser or accountant.

Conclusion

These recently legislated changes provide opportunities for individuals to start planning their eligibility and capacity to increase their superannuation retirement savings from 1 July 2022, until age 75.

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

The five key drivers of buy/sell price spreads on ETFs

Rodney Lay

To state the obvious, ETFs are listed on an exchange in the same way as company shares. However, one key difference is the presence of institutional brokers referred to as either authorised participants (APs) or market makers. Market makers provide price and volume quotes in the ETF and ensure the continuous trading, whereas APs manage the creation and redemption of ETF units in the primary market.

Without wishing to confuse the matter, often APs also act as market makers and hereafter this article refers to both as 'market makers'. There is an important distinction - only APs engage in the creation and redemption process.

Margins between bid and offer pirces

ETF flows are more specifically the increase or decrease in ETF units on issue as determined by investor supply and demand (a key distinction between ETFs and shares). It is a process that is critical to ETF trading at parity to the Net Asset Value (NAV). There is a limited discount to NAV risk in ETFs bar a marginal risk in bond ETFs in extreme market dislocation events.

For market markers, the main role is to provide liquidity to the ETF based on the ability to continuously create and cancel units in response to supply and demand in the market. But of course, this participation is driven by a profit motive. Market makers seek to generate a profit based on a small arbitrage margin between the price at which the ETF is transacted and the underlying value of the securities that represent the ETF portfolio (the NAV of the ETF).

That margin between the buy price and the sell price is the bid/ask spread. For example, if a market maker is in the market as a buyer, it will bid at a price that is marginally below the NAV of the ETF (the bid spread). Assuming the market maker is 'hit' - i.e. there is not a investor offering a slightly higher bid price - the market maker sells the individual shares on market (the redemption process) with the intent of making a marginal arbitrage profit.

To complicate matters further, a market maker may or may not be contracted to maintain a maximum spread, or it may be bound by ASX rules in relation to maximum spreads and minimum bid and ask volume offers. The benefit of a contracted bid/ask spread is it better ensures an ETF remains competitive with other ETFs.

Investors should be aware that it is periods of heightened volatility that spreads are likely to blow out where there is not a contracted bid/ask spread.

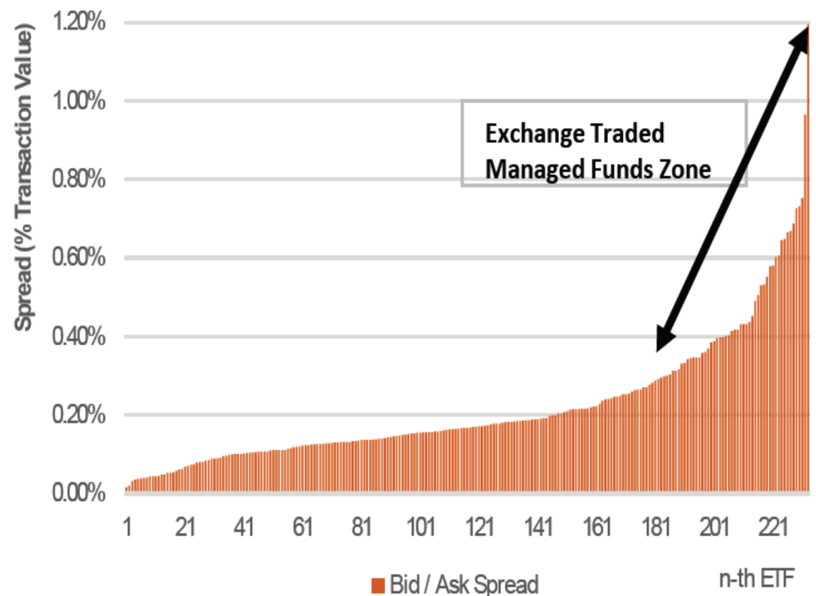
ASX-listed bid/ask spreads

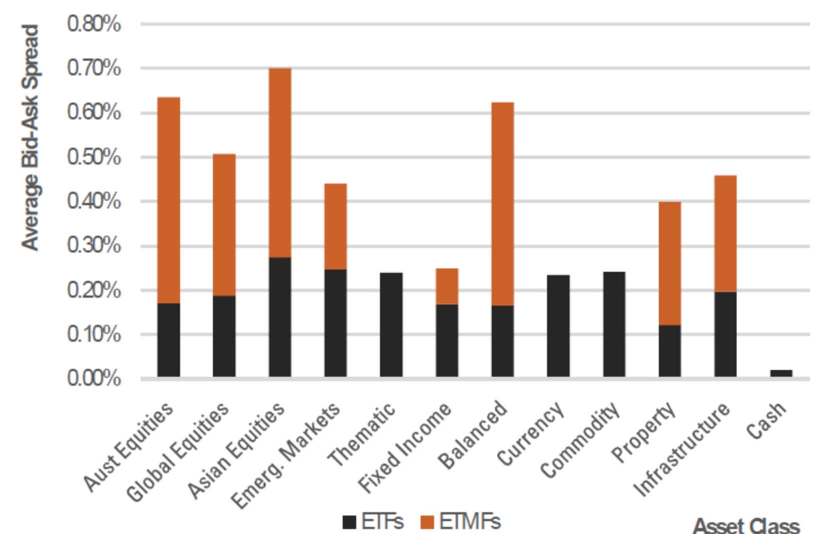
The first chart details the bid/ask spread of all 233 ASX-listed ETFs over the month of January 2022. The amounts are based on the average bid/ask spread over the course of each day of the month divided by two with all daily amounts over the month then averaged to provide the end figure.

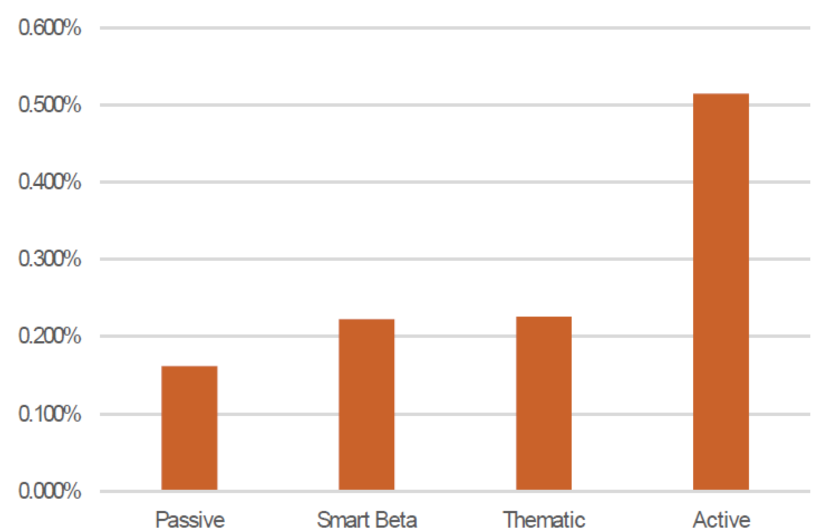
The chart presents these levels sorted from lowest to highest. In this month, there was a material variation between ETFs from a low of 0.015%, or 1.5 basis points (bps) to 1.2%, or 120 bps. Bid/ask spreads for Exchange Traded Managed Funds (ETMFs) or Active ETFs are higher because there is only one market maker (i.e. the responsible entity) and less competition between multiple market makers.

The second chart highlights two key patterns:

1) Australian-based ETFs (i.e., ETFs based on Australian securities) are characterised by the thinnest bid/ask spreads and in equities the spreads are largest for Asian and Emerging Markets mandates (some underlying markets are relatively illiquid), and,







2) ETMFs are characterised by materially higher bid/ask spreads.

What determines a bid/ask spread?

There are a range of drivers that determines bid/ask spreads which investors may wish to consider in the same way they check fees. For example, at 1.2%, the highest bid/ask spread is approaching the management fees that applies to the particular ETF.

The five key drivers are:

1. Timing and liquidity

In the ETF world, average bid/ask spread is a widely-quoted metric for measuring liquidity. Despite its usefulness, the average bid/ask spread cannot entirely capture the complexity of the ETF markets. One of its major downfalls is that it obscures the significant intraday variation that can exist in an ETF's bid/ ask spread. Good or bad timing of trading can lead to a major variation in spreads incurred.

While supply and demand vagaries will impact actual intra-day levels, there is a distinct U-shaped pattern in ETF bid/ask spreads during the trading day for ETFs based on Australian equities. Specifically, there are elevated bid/ask spreads at the opening of the trading day (10:00 to circa 10:09am) and then taper during the trading day and then increase again in the after-market close 'auction' (circa 4:00 to 4:10pm).

For Australian equities-based ETFs, stocks open progressively from 10:00 to 10:09am based on ASX ticker alphabetical order. Until all stocks in a given portfolio are open and have traded, market makers are 'flying blind' to a degree on the NAV of the portfolio. This additional risk is reflected in wider bid/ask prices.

A similar dynamic exists for Asian equities-based ETFs, with spreads typically wider during Australian trading morning hours while Asian markets are pre-open and then typically taper as Asian equities markets open.

For broad global equities mandates or Europe or US-specific equities, the intra-day pattern is less distinct or not materially present at all as these markets are generally closed for the duration of ASX trading hours. ETFs are priced by the market maker by using appropriate futures contracts.

2. Internal market making

Product issuers generally appoint an independent third party that is a market participant to act as lead market maker to fulfil their liquidity obligations. However, in specific circumstances, licensed exchanges may allow the issuer to adopt the role of market maker (i.e. an internal market-making arrangement) on the fund's behalf.

Issuers typically seek internal market making arrangements if there is a concern others will use their portfolio selections (their intellectual property or IP) by replicating the investment strategy to the ETF's detriment. Internal market making arrangements are commonly used for ETMFs (or Active ETFs).

These funds operate under ASIC's INFO 230, designed to manage market integrity risks associated with internal market making. While ETMFs typically have materially higher bid/ask spreads, the profits and losses from such activities are channelled back into the NAV of the ETMF. Nevertheless, it remains a cost to the particular investor that is trading.

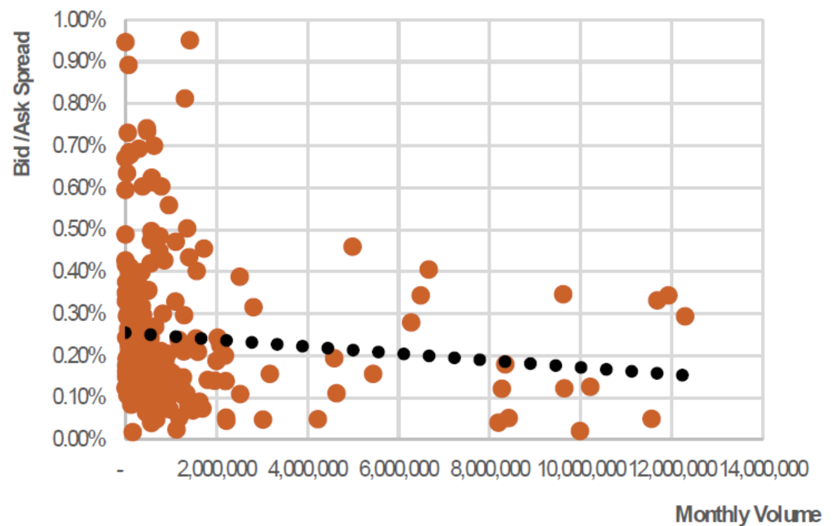
The main reason bid/ask spreads in ETMFs are higher than ETFs is because there is only one market maker (i.e. the responsible entity). On the other hand, an ETF that has an external market making arrangement has a primary market that allows multiple market makers and authorised participants. This promotes competition and tighter spreads.

It should also be noted that the applicable average bid/ask spreads in ETMFs may well be approximately comparable to a fund manager's unlisted unit trust version of the listed strategy.

3. Activity and trading volumes

If the ETF is popular and trades with robust volume, then bid/ask spreads tend to be narrower. ETFs that are thinly traded, or if the underlying securities of the fund are highly illiquid, can lead to wider spreads.

Market makers prefer larger ETFs with larger trading volumes. Ironically however it is in the less traded ETFs that investors are most requiring of a contracted market maker. VanEck, which has a contracted market maker for all its ETFs and ETMFs, suggests for smaller ETFs that financial advisers check whether there is a contracted market maker and whether the ETF issuer monitors the spreads on a intra-day basis (a check done by calling the ETF issuer).



The chart above details bid/ask spreads by monthly trading volumes. The correlation is somewhat thrown askew by the inclusion of ETMFs but there is a positive correlation between higher volumes and lower bid/ask spreads.

4. Risk and information in the underlying portfolio

Risk and information relates to the pricing transparency in the underlying portfolio constituents. If a market is not open during a part or all of Australian trading hours, then there is a lesser degree of pricing transparency on the constituent stocks (notwithstanding the ability of a market maker to partly hedge through the use of futures). This lack of transparency tends to be greatest in more illiquid emerging markets.

Nevertheless, the use of futures is a proxy and implicitly creates an additional level of risk for market makers and which is reflected in broader spreads. Investors should not consider this a weakness of international equities ETFs or more niche based thematic ETFs, rather simply a practical reality relating to the additional risk taken by market makers.

5. Competition

Competition simply relates to the number of contracted market makers present. A contracted market maker (external or internal) must be present 'in the screen' at least 80% of the time between 10:15am and 4pm on a trading day. Contracted market makers (or more accurately, APs) are also bound by a maximum bid/ask spread. The more contracted market makers, the greater the assurance an investor has that spreads will not blow out.

The ASX provides a useful page [here](), which shows the number of market makers present in each particular ETF / ETMF and a schedule that details:

1) the minimum volume they must offer in the screen, and

2) the maximum bid-ask spreads. These maximum spreads relate to all market conditions, capturing differences in volatility (spreads will generally widen in more volatile market environments) and trading volumes. It is generally regarded by product issuers that the maximum levels will rarely, if ever, come to bear in practice.

In summary, don't assume the buy and sell price spreads of all ETMFs and ETFs are the same. Some come with high spreads, which adds to transaction costs which most investors overlook.

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