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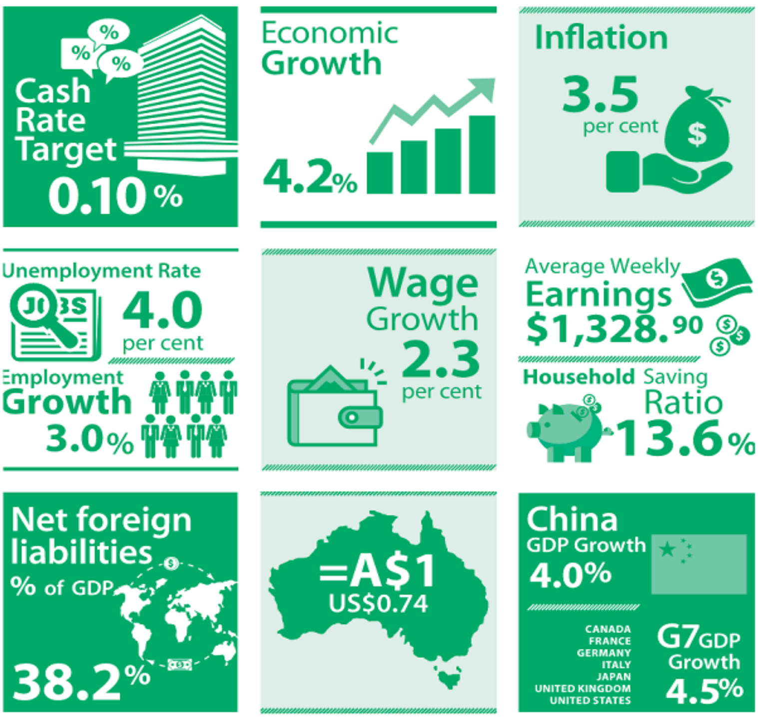
Editorial

Before the last Federal election, the Firstlinks pages were filled with policy discussions and articles generating hundreds of comments. Labor ran a large target agenda including negative gearing, capital gains tax, family trusts and franking credits. The Labor Shadow Treasurer, **Chris Bowen**, was so confident of election success that he responded to a question on ABC Radio on franking credits in a way he would live to regret:

"*I say to your listeners, if they feel very strongly about this, if they feel that this is something which should impact on their vote, they are of course perfectly entitled to vote against us.*"

Any new policy has its losers who are easy to whip up into a frantic opposition. Labor policies were badged as 'retiree taxes' and 'death taxes' with fears they would destroy property values. Elections are more marketing that substance and messages on repeat, repeat, repeat. The days when governments worried about raising revenues to meet spending objectives are gone with structural deficits now stretching on forever.

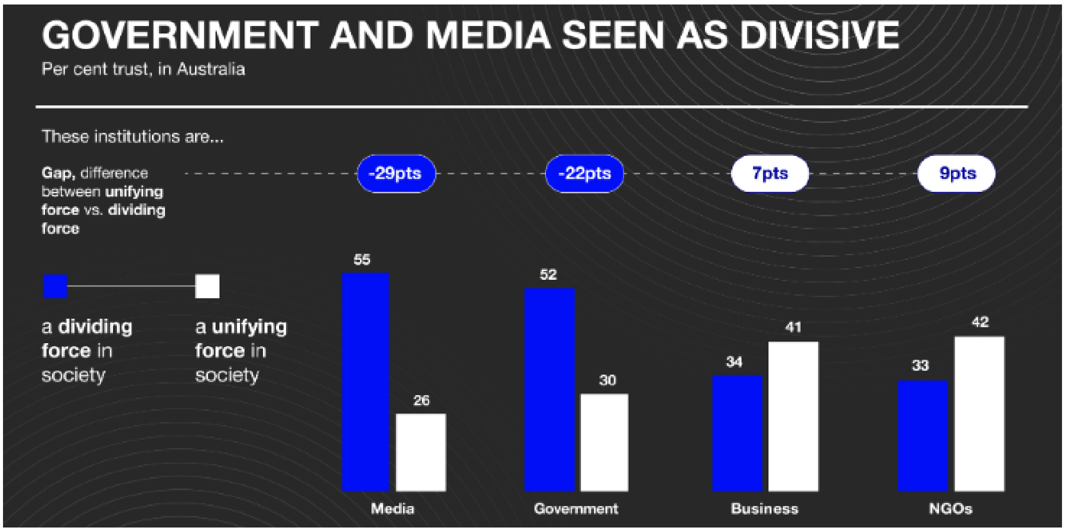
Anthony Albanese would be in a lot better position today if one of his advisers had tucked this **Reserve Bank** graphic into his shirt pocket on Day One of the campaign.



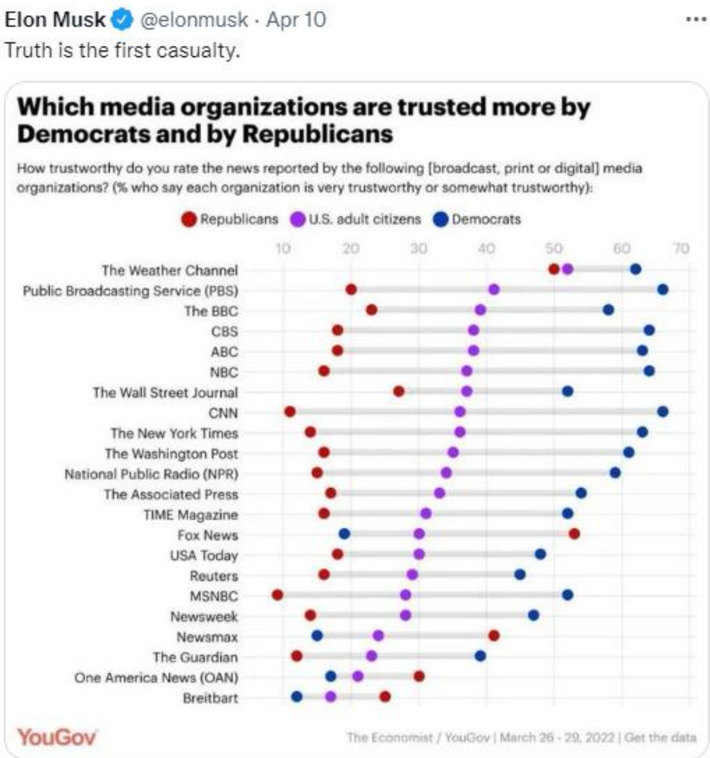
Who can blame Labor for now avoiding controversy, supporting the handout Budget and keeping their heads down after nine years in opposition? We get what we deserve and voters don't reward policy bravery. This painful campaigning period until 21 May will be dominated by character assassinations and more handouts rather than meaningful policies, and it's hard to see how such politicking does not lead to more division.

With unlimited sources of news, we all choose our favourites, and with that comes confirmation bias. We filter out information inconsistent with our beliefs. If you watch ABC current affairs, read The Guardian and Sydney Morning Herald/The Age, subscribe to Crikey or Michael West Media, then you may think Labor is certain to win the election (at least before Albo forgot a couple of key statistics). But spend a day listening Ray Hadley on Radio 2GB, watching Sky News at night or reading The Daily Telegraph and you'll see how the other half thinks. Our carefully-chosen social media feeds and friends make it worse.

Each year for Australia, Edelman publishes a Trust Index, which this year shows most Australians see media (55%) and government (52%) as divisive rather than a unifying force. It's wishful thinking to believe there is momentum in the other direction.



In the US, the divide between **Democrats** and **Republicans** in trust of media organisations is staggering. It's reached the point where people need to know the politics of their countrymen and what they watch before they can have a decent conversation. Is Australia heading this way, or are we already there?

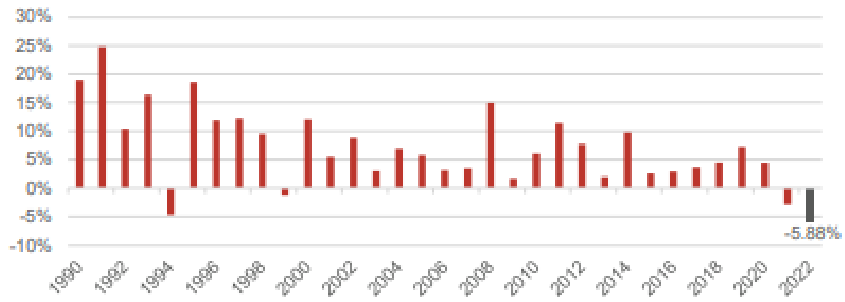


Back to investing, the impending rise in cash rates has already fed into longer-term rates, challenging portfolio construction techniques in a way we have not seen for a decade or more. The traditional 60% growth / 40% defensive portfolio has become a standard asset allocation and has paid off well since the GFC. However, as **Goldman Sachs** research below shows using US data, there are periods since 1900 when 60/40 in real terms delivered poor returns, shown in orange shading. The good times usually end after a strong run for equities and high valuations relative to history.

Real total returns of 60% equities/40% growth portfolio in the US 1900

In recent years, investors who rely on the cash flow from their investments for income to live on were forced to take on more risk in equities or be satisfied with 1% on term deposits and draw down their capital. Now that's changing, and a quality bond portfolio can deliver around 5% with careful credit selection or via a bond fund. But rising rates hit fixed income portfolios that are revalued, such as bond funds, with the AusBond Composite Bond Index returning its worse loss for at least 30 years in the first quarter of 2022, and the first loss of any amount since the turn of the century.

Figure 3. AusBond Composite Annual Returns (2022 QTD)



Source: BondAdviser, Bloomberg. As at 31 March 2022.

The **Roy Keenan** article makes a case for floating rate exposure during rising rates, while the White Paper from **IAM** explains more about the 5% opportunity and shows how to judge the price risk due to a 1% rise in rates on a range of fixed rate investments.

Graham Hand

Also in this week's edition ...

Arian Neiron founded **VanEck** in Australia nearly 10 years ago, and has since introduced 30 ETFs to their suite, ranging from broad market indexes to themes and sectors. What makes the range different is a background forged in active management, but how does he select funds, which are his favourites and which does he expect to do well in 2022?

An investor named **Wesley Gray** created what he called 'God's portfolio' which invested exclusively in the top decile of stocks based on their performance over five years. Over the 90-year investment horizon, God's portfolio compounded at more than 29% per year yet endured the pain of drawdowns that exceeded 20% on ten different occasions. **Chris Demasi** writes that this is a reminder while sell-offs and drawdowns are difficult experiences, a long-term view is a critical component of being a successful investor.

Andrew Mitchell also explores market volatility by looking back at history and highlighting the journey investors should expect when investing in the share market through the seven laws of volatility.

Against a backdrop of economic and geopolitical uncertainty, rising inflation and expectations of a rate hike, Australian investors are searching for investments that can benefit from these evolving market conditions. **Roy Keenan** makes the case for floating rates and that hybrids are just such an investment.

There were many questions and comments on **Meg Heffron**'s last article on future-proofing your SMSF, so this week she covers how to manage some trickier situations.

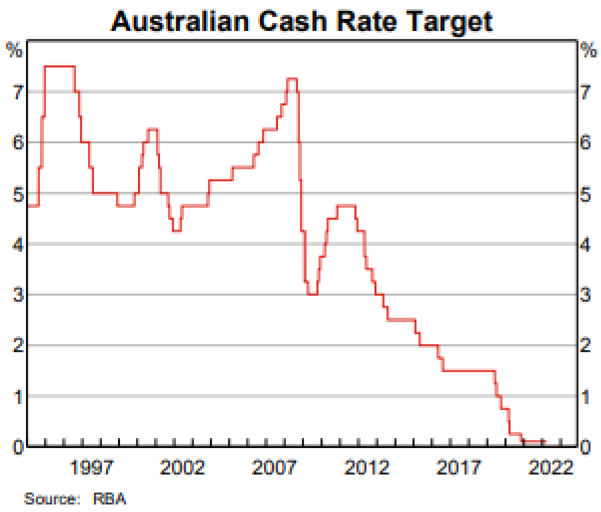
David Williams has been developing the concept of a National Longevity Strategy, and he shares his thoughts here.

We will be taking a break next week for Easter and the next edition will be published on 28 April. Hope everyone has a great Easter break!

Now you can earn 5% on bonds but stay with quality

Graham Hand

The recent increase in longer-term interest rates and widening spreads between government and corporate bonds has opened opportunities that investors have not seen since 2014. It's a chance to earn better returns without taking equity risk but is this simply exchanging one market risk for another?

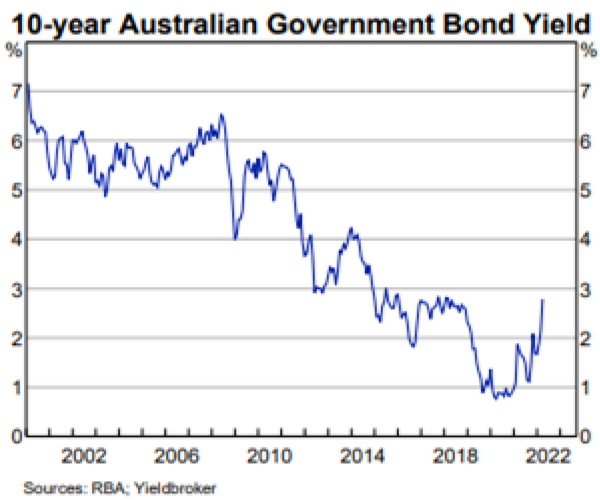


For more years than they care to remember, conservative retirees have faced a difficult choice to generate income to live on. To meet a 5% drawdown on their pension, they could either take more risk and invest in dividend-paying shares or keep capital safe in term deposits and draw on the principal. Many retirees with little tolerance for capital losses on shares have tightened the purse strings as their income dropped. It is 10 years since the cash rate was above 3%, and the last increase was on 3 November 2010.

The reach for yield

There are many ways to achieve 5% or more depending on risk appetite. Analysts forecast the dividend yield on the S&P/ASX200 for FY22 at a healthy 5.2% plus franking (some are even higher) due to increased payments from large dividend payers such as banks and miners. Investors have received $36 billion in dividends in the past month. Elsewhere, Australian property trusts offer decent yields such as Scentre (ASX:SCG) 4.9% and Charter Hall Long WALE (ASX:CLW) 5.7%. Hybrids are at 3% or more to first call depending on the issuer (see table in our Education Centre) which will increase over the next year. In the unlisted space, there are thousands of funds offering income across a vast choice of asset classes.

For the first time in eight years, the 10-year government bond rate is above 3%, rising further since the Reserve Bank produced its latest update below. When the spreads between government and corporate bonds are factored in, the 5% investment world suddenly has some new inhabitants.



Corporate bonds are back in the 5% game

Anyone who is a client of a fixed interest broker has received offer levels with decent credits and names they know showing a 5% yield.

Here is a selection of Bloomberg screenshots for examples. Without judging the merit of the credit quality of each company, these familiar names are now available in retail sizes, usually around $100,000 but often as low as $10,000.

As these are 'wholesale' bonds broken down into smaller parcels, each fixed interest broker has its favourite names and sources of supply. The screenshots show (prices as at 11 April 2022):

- Aurizon (ASX:AZJ, bond AZJAU) issued with a coupon of 2.9%, maturing in 2030, yielding almost 5.5%, up from around 2.5% in 2021. The price has fallen to below 83 delivering a heavy capital loss to existing holders in less than a year.
- Lend Lease (ASX:LLC, bond LLCAU) issued with a 3.7% coupon maturing in 2031, yield 5.3%.
- Pacific National (Australia's largest private rail freight company, bond PNHAU) issued with a 3.8% coupon to 2013 yielding 5.5%.
- Transurban (ASX:TCL, bond TQLAU) with 3.25% coupon priced at about 85.5 yielding 5.25%.

There are many more examples for investors to consider, although these are fixed rate issues and if longer-term interest rates rise further, prices will drop even more. That's the challenge of investing at fixed rates in an inflationary environment, but any retiree happy with locking away 5%+ for up to a decade now has many choices.

Further down the capital structure but issued by an undoubted name, brokers are currently offering a Commonwealth Bank subordinated issue maturing in 2027 and yielding 4.65%.

Lessons from Privium and others

What can go wrong on the credit side, besides the risk of further rises in rates? These are bonds, and all the investor needs is for the company to be solvent and liquid on maturity.

Not so easy. Unlike equities, where risk may be rewarded with unlimited upside, the most an investor in bonds can achieve is a return of 100 on maturity and the regular coupons. If a bond is offering 5% at purchase, that's as good as it gets. If rates rise 1%, for example on the Transurban bond above with a modified duration of 7.75 years, the price will fall 7.75%. Nobody offers the extra 1% to an existing holder.

It is in the unrated or sub-investment grade bond market where retail or so-called wholesale investors can come unstuck. These bonds are marketed by fixed income brokers (some, not all) to investors who are not sophisticated enough to assess the credit quality. In fact, some of these issuers would be forced to pay more in the genuine wholesale professional market but they go to the retail market to save costs.

The small extra margin is not sufficient reward for a credit the investor cannot assess.

Let's look at a case study of Privium, a Queensland building company with a $45 million face value issue paying 6.5% which was due to mature 12 August 2022. On 14 October 2021, it was offered for sale in the secondary market to 'wholesale' retail clients at a 'discounted price' of $95.25. It was called a senior secured credit with residential property security, amortised (repaid) to 49% to date. It was marked 'green' (for go) on the broker's credit tracker, plus:

"A small allocation to this sub investment grade bond issued by a QLD based home builder may be warranted for those looking for high returns, and who understand the risks involved in this investment. To reiterate, at a yield offering over 15%, this is certainly a higher risk credit and I encourage you to please review the attached documents for full credit strength and risks.

This bond has a benefit that most other corporate bonds do not have, which is a guaranteed from a group of companies with significant residential property holdings (Property Alt Group Pty Ltd, Alternative Aus Pty Ltd, Property Alternative Developments Pty Ltd, and Property Alternative Aus Pty Ltd), and a personal guarantee from the person who is CEO and major shareholder of Privium."

The accompanying material talked of 1H21 results "*well ahead of expectations*" as "*evidence of the strong housing market in Australia, with a commitment for new loans at historical highs*" and "*we believe the operating environment will remain positive for Privium over the near-to-medium term*".

Six weeks later, on 29 November 2021, [The Australia Financial Review reported]:

Privium failure hits more than 2000 home buyers

"More than 2000 individual home-buying customers across Queensland, Victoria and NSW have been hit by the collapse of builder Privium, which went into administration last week owing secured and unsecured creditors close to $43 million.

The company went under with liabilities of $23 million in secured notes and $17 million in unsecured liabilities – equally split between subcontractors and suppliers – with close to $3 million owed to other creditors across the nine entities in the group, creditors heard.

But while the company with a $200 million annual turnover was badly affected by delays in supplies of building materials that showed production even as overheads remained, there were still outflows of money – such as to the evangelical church Hillsong, of which chief executive Rob Harder was a senior member – that administrators were trying to track, Mr Park said."

And what is the outcome for bond investors, those who somehow were able to gain comfort from "*review the attached documents for full credit strength and risks.*"?

Privium is in liquidation and holders are advised there is only one likely buyer, who recently reduced the offer price, and "*any attempt to enforce the original transaction would likely cost in excess of the difference (and no certainty of a positive outcome in any event)".* The note trustee advises that the recovery estimate is 23% to 43% (36% mid-point) after fees are taken out and the process could take two years to finalise.

That is, only six weeks after the broker offer, rising costs sent this company into liquidation and the other claimed protections are not worth enforcing on a $45 million transaction. It's not only equity IPOs which can quickly.

But not to worry, it was only marketed to qualifying 'sophisticated investors'.

This is not an isolated example. When Axsesstoday, a provider of equipment finance to SMEs, was placed into liquidation in April 2019, retail investors in its July 2018 bond issue paying BBSW+4.9% were left with a security which might be worth around 5% of its face value when investors are eventually paid out. The company faced higher loan arrears and inadequate capital. Perhaps even worse than Privium, these notes were listed on the exchange (ASX:AXLHA) and Axsesstoday itself was a listed company (ASX:AXL) but was delisted in October 2019. For a short time in its listed life, as part of the boom in up-and-coming financial companies, Axsesstoday was a market darling with a rapidly-rising share price, but in the end, even the bond investors were buried.

And investors in Mackay Sugar bonds, issued with a coupon of 7.75% in 2013 as a 'wholesale corporate bond' and expected to mature in 2018, were offered half the face value on their notes when the sugar refiner hit financial problems. Again, the flattering description of the issuer did little to protect 'retail' investors.

Buyer beware. Each of Privium, Axsesstoday and Mackay Sugar came to market with an investment rationale sufficient to convince retail investors to pile in with millions of their retirement savings.

Easy qualification as wholesale

We have covered the problem of retail investors qualifying as wholesale previously, including the relatively easy criteria which were designed 20 years ago. The test allows millions of Australians to qualify as if they have a special ability to value securities. We noted:

"Modelling by Australian National University Associate Professor Ben Phillips, commissioned by Coolabah Investments, and reported by The Australian Financial Review, suggests the wholesale investor test is met by 16% of Australians, or over one million households and 3.25 million consumers. It was only 100,000 in 2002."

In addition, research company Investment Trends defines the category of High Net Worths as those with investible assets over $1 million outside the family home. At the end of 2021, they reported an annual rise of 31% to 635,000 in the number of millionaires, with investible assets up 37%.

Bonds listed on the ASX

It is not only investors who have access to fixed income brokers who can lock in better returns in the listed arena. Government bonds are listed but their rates are below the corporate deals. We have also written about fixed rate convertible notes which are backed by portfolios of equities.

In addition, XTBs are traded on the exchange in the same way as any share and offer a range of fixed and floating bonds. The fee on XTBs is 0.4% of the face value multiplied by the number of years to the maturity date. The yield in the table below is before the 0.4% fee, and only one of these issues achieves the 5% threshold.

Fixed Coupon XTBs

ASX Code of XTB	Underlying Bond	Underlying Bond Issuer	Closing Price of Under-lying Bond	Closing Yield of Under-lying Bond
YTMALD	ALD 4% Apr-25	Ampol Ltd	100.585	3.774
YTMAP1	APT 3.75% Oct-23	APA Pipelines	103.170	2.819
YTMAST	AST 5.75% Jun-22	AusNet	102.689	0.858
YTMAS2	AST 4.4% Aug-27	AusNet	100.954	4.339
YTMDO2	DOW 3.7% Apr-26	Downer	100.356	4.057
YTMDX1	DXS 4.75% Nov-25	Dexus	105.621	3.678
YTMDX2	DXS 4.25% May-27	Dexus	102.953	3.993
YTMDX3	DXS 2.5% Oct-29	Dexus	87.493	4.473
YTMGP1	GPT 3.657% Aug-26	GPT	99.707	3.849
YTMIP1	IPL 4.3% Mar-26	Incitec	99.968	4.390
YTMMG2	MGR 3.5% Sep-23	Mirvac	101.662	2.481
YTMMQ1	MQG 4.15% Dec-27	Macquarie	98.906	4.643
YTMORG	ORG 2.65% Nov-27	Origin	91.649	4.591
YTMQF3	QAN 7.75% May-22	Qantas	103.765	1.051
YTMQF4	QAN 2.95% Nov-29	Qantas	83.825	5.785
YTMSCP	SCP 3.9% Jun-24	Shopping Ctr	102.887	3.155
YTMSG2	SGP 4.5% Nov-22	Stockland	102.963	2.476
YTMSG3	SGP 3.3% Mar-24	Stockland	100.569	3.096
YTMTL1	TLS 4% Sep-22	Telstra	101.482	1.186
YTMTL2	TLS 4% Apr-27	Telstra	100.602	3.850
YTMVCX	VCX 3.5% Apr-24	Vicinity	102.431	3.084
YTMVC1	VCX 4% Apr-27	Vicinity	101.192	4.145

Floating rate investments will protect investors from duration risk. The most liquid listed examples are hybrids, which will yield over 5% if current market expectations of increases in rates are realised.

100% downside, 5% upside

The higher yields available on corporate bonds open the opportunity for investors to construct portfolios of bonds capable of delivering 5% or more for many years.

Of course, building diversified portfolios under strict credit quality rules is what expert bond managers do every day, including long experience assessing credit, terms and conditions and thousands of alternatives. For most investors, it is better to leave it to the experts rather than hope to avoid a Privium.

The most important point if you must do it yourself is to stick to investment-grade quality and do not go into unrated names where the broker requires you to do your own credit assessment. When there is 100% downside for a 5% return, there's little to be gained by reading a broker note and hoping you find some magically-reassuring insight.

Graham Hand is Editor-at-Large for Firstlinks. This article is general information and does not consider the circumstances of any investor. Prices are correct at the time of writing. There is no attempt to analyse the credit quality of any companies mentioned in this article and credit assessment is probably beyond the competence of most financial advisers.

Disclosure: Graham invested $50,000 in Privium at issue which has since amortised to about $24,000 with regular capital repayments. About $8,000 is now expected after the liquidation process. That was an expensive lesson in credit analysis and the meaningless value of some credit enhancements.

Meg on SMSFs – More on future-proofing your fund

Meg Heffron

Last month I shared some ideas for getting a self-managed super fund prepared for the eventual incapacity or even death of a member.

Several comments flagged the challenges for single-member funds where the eventual beneficiaries (or support team in the event of mental decline) will be the member's adult children. Even worse, what happens if one or more of the children live overseas?

It does get trickier but there is still plenty to do.

An enduring power of attorney is still very useful

It's not common for adult children to have an 'active' enduring power of attorney for their parent until the parent gets quite old. But it's something worth considering early for people who have SMSFs.

Don't forget the attorney's powers can be constrained. For example, I could have an enduring power of attorney that lets my children be trustees of my SMSF in my place *now* (regardless of my capacity) but doesn't let them sell my house. I might reserve the "selling all my belongings and putting me in a nursing home" kind of muscle for an enduring power of attorney that's only activated when I'm unable to make my own decisions.

The SMSF rules accommodate a number of different member/trustee configurations – some that rely on having this document in place and some that don't. Consider all these examples for a single parent (Tim) with two adult children:

- Tim and his children could be both members and directors of the trustee company (remember SMSFs can now have up to six members). The fact that both of Tim's children belong to his SMSF doesn't mean they have to put all their super in it – they could just have a nominal balance, or
- One or both children (holding an enduring power of attorney for Tim) could be directors of the trustee *in place of Tim* without being members, or even
- One of the children could be a director *with Tim* without being a member – in fact, the enduring power of attorney wouldn't be necessary for this option.

What about overseas residents?

Children living overseas can complicate things, but they don't necessarily make life impossible (except when it comes to planning Christmas during a global pandemic). For example, an overseas resident can be a trustee of an SMSF. In this modern era of digital communication and even digital signing of many documents, it's not that impractical.

The thing to watch is that the "central management and control" of the fund is ordinarily in Australia. That means the important decisions are made by people who are normally physically here. But in Tim's case, if **one** of his children lives in Australia, it would be fine to have both (under an enduring power of attorney) as directors in place of Tim. For this rule, 50/50 control in Australia is enough.

Alternatively, just the Australian-based child could be a director in place of Tim. Even if the enduring power of attorney normally requires the two children to act together when they are doing things as their father's attorney, they don't have to both be directors of the SMSF trustee. It's the existence of the document that makes it OK for one or both children to be SMSF trustees for Tim - the document itself doesn't determine how they do it or impose any restrictions on the way in which they make decisions. Once they become the trustee of their father's SMSF, they are just like any other trustee – they are not "acting for" Tim.

The big issue to think about very carefully is the amount of control that gives just one of Tim's children. They will hold the keys to the SMSF. Does Tim want that? And will the 'right' balance of power change over time? For example, the family might feel it's fine to have a lot of control resting with the child who lives in Australia while Tim is still alive. After all, Tim still has all the same rights and powers as a member (as opposed to a trustee). If those powers are exercised under the enduring power of attorney, the children ***will*** have to act together if the document requires that. But what about after Tim dies and the trustee is making very big decisions like who gets his super balance? At that point, it might be more appropriate to have both the children involved.

One other point I usually suggest to SMSF members with family overseas is that even if the children become members, they get more specific advice before having any contributions or rollovers directed to the fund. That's because doing either of these things makes them an "active member" and having too much of the fund owned by an active member who lives overseas is a problem.

Getting it wrong on either the "central management and control" or "active member" rules can mean the fund loses its status as an Australian superannuation fund. That is an unmitigated (very expensive) disaster and the ATO has no flexibility to forgive mistakes.

Get the money out

Several readers of my previous article commented that they would want to get the money out of the SMSF if they were in Tim's position. There are good reasons for that. The tax on superannuation death benefits to financially independent adult children can be very high. (In contrast, the treatment of beneficiaries such as spouses or dependent children is much more generous.)

When it comes to tax, the death benefit is divided into two parts. One part (called the tax-free component) is the bit that can be traced back to amounts like personal contributions from the member for which they haven't claimed a tax deduction. This part can come out to the children tax-free. But the rest of the death benefit (the taxable component) is generally taxed at 15%. An even higher rate (30%) can apply to some of it if the member died before they turned 65 and had insurance.

If the benefit goes directly to the children (rather than via the estate), the Medicare Levy is also added.

While a tax rate of 15% doesn't immediately sound like a lot, remember we're talking about a tax on *capital* rather than *income* here. A $1 million death benefit could cost more than $150,000 in tax. Even the Medicare Levy would be $20,000! (One pro-tip for death benefits is to pass benefits to adult children via the estate where possible.)

It gets more complicated if the child is an overseas tax resident – then things like tax treaties become relevant. The benefit might be assessable in the foreign country rather than Australia and taxed entirely differently.

Unsurprisingly, no one likes to die with lots of money in super when the beneficiaries aren't classified as 'dependents' under the tax laws.

But that doesn't make it obvious to me that Tim should close his SMSF and get out of super entirely. I think it really depends on factors like Tim's age and the make-up of his super.

For example, if Tim is a healthy 60-year-old, he's likely to have many years of fantastic superannuation tax concessions ahead of him. Does he really want to take all his money out of super now just on the off chance that he might die prematurely and that would cost his children money? But if he is in his late 80s with declining health, the answer to that question might be entirely different.

And what if Tim's super was mostly a 'tax-free' component? In that case, he might decide to leave it in super if possible – there's no real downside to his children.

Like so many things with superannuation, it's a classic case of picking the right strategy at the right time.

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. For more articles and paper from Heffron, [please click here]().

30 ETFs in one ecosystem but is there a favourite?

Graham Hand

Arian Neiron is the Chief Executive and Managing Director for VanEck Australia and Head of Asia Pacific. VanEck is an Exchange Traded Fund (ETF) issuer with 30 trusts worth over $10 billion listed on the ASX covering broad markets, sectors and thematics.

GH: In nine years since starting VanEck in Australia in 2013, you've launched 30 ETFs. How do you decide what's next?

AN: In the ETF industry, it seems like there's a new idea every second Monday. Some funds are common sense and some are a bit spicier or esoteric. We want to create an ecosystem, or a range of strategies within a portfolio. We always go back to our guiding principle, our *raison d'etre.*

It's about democratising investing and ETFs are a fantastic platform. It's about accessing the opportunities and we think about how the world is changing, such as geopolitical, structural or societal. And that presents a range of different opportunities reflected in asset prices.

We also leverage off the capabilities of the Australian team. We all come from active management backgrounds, plus the global firm was set up in 1955, so we also leverage off the franchise globally. If there's a new idea, we stress test it, we look at modern finance theory, we speak to academics, we look at any empirical research, and we do our own research. We might speak to different index providers, or we partner with active managers. We think about what will withstand the test of time and it might take three to five years to process all these inputs.

GH: You've avoided the traditional cap-weighted indexes in favour of other types of indexes. For example, your Australian broad market index is based on an equal-weighted index. Why have you gone down that path?

AN: Two things. Number one, it's beyond the usual approach of the standard ASX200, we have the Australian Equal Weight ETF (MVW) that equally weights the most liquid securities on the ASX. We're not trying to be simple market beta, and this is really the genesis of the firm. The second part is a by-product of the Australian leadership team and the firm's history with John van Eck. Active management is infused in the DNA of the business and that intellectual capital has been transposed into the ETF side. We are more of a smart beta pioneer.

We think if there's a genuine investing edge in active management then we look for a systematic, rules-based way. We look for identifiable alpha or persistent drivers of return, ensuring funds in our entire ecosystem are complementing each other. So, in international equities, we launched international quality (QUAL). In the small cap space, we went for international small and mid-caps (QSML) with a far bigger opportunity than Australian small caps. These are all different approaches to align with how we think about managing money for the long term.

GH: After launching 30 funds, have any of them done much better than you expected?

AN: It's always a pleasant surprise when a fund does well. One that's done better than expected is our bank ETF. My parents and in-laws have owned banks since the 1990s and they have done well with dividends and franking credits, but our Australian bank ETF (MVB) has been a pleasant surprise. People were saying the banks are all correlated but one is more into residential mortgages, another in SME lending, so is it 'much of a muchness'? The bank product has helped people to top up and the fund now has over $200 million doing exactly what it should do. Dividends and franking credits seem kind of vanilla boring, but boring can be really good.

GH: And what has done worse than you expected.

AN: The word 'worse' is harsh but what hasn't met expectations on gathering assets is in emerging markets, our broad-based fund (EMKT). It's a multi-factor approach and it looks at four persistent drivers of return (small companies, momentum, quality and value) and it combines them all. It holds about $50 million but why I'm disappointed is it is the number one by percentile across all periods against active managers in its sector with about 9% alpha for the year. We're charging only 69 basis points (0.69%) when the market beta is 0.65%p.a. I think in Australia, there's no active manager incumbency but emerging markets is not an arena where people are strategically allocating, it's more of a 5% at best.

GH: I think that's a widespread emerging markets experience, it's a sector not in most portfolios. You have a range of thematic and sector ETS. Do you find that inflows and outflows go hot and cold depending on the news or the macro events of the day?

AN: I like to split thematics and sectors, they are quite different. On the sector side, infrastructure, property, even global health care, they have defensive earnings. Thematics is covering a large universe with a lot of market participants.

Australian ETFs are still in an embryonic stage at around $130 billion and it's really been a one-way street and flows have been more in than they have been out. But has the money really followed the momentum or the hot money for these thematic ideas? Some thematics in the market are flavour-of -the-month and returns look phenomenal for a year but it's often profitless technology and then gravity hits as we have a reversion to the mean. We've not really experienced this because we don't proliferate a lot of thematics going from hot to cold.

In our space, we've got clean energy (CLNE) and video gaming and esports (ESPO) but we look at it more as structural trends. We do tend to see flows when there's momentum and strategies are performing well as investors chase historical returns as opposed to assessing fundamentals. When prices come off, it definitely puts the brakes on money coming in.

GH: We recently finished the first quarter of 2022, where did you have the biggest inflows and outflows?

AN: Investors are contending with a lot of geopolitical hurdles. Our best flows are in international quality, QUAL, the flight to quality is very strong. Also, our A-REITS (MVA) and global infrastructure (IFRA) have done well. A-REITS was a surprise and I think investors are still looking for income perhaps with a view that the 10-year bond has peaked and property responded favourably to that.

GH: And the other side of the ledger.

AN: A real surprise to me since VanEck is the biggest gold equity ETF issuer in the world and gold has risen strongly this year, we've had a bit of money come off the table in our gold miner EFT (GDX), especially since gold is seen as a hedge for inflation.

GH: With the majority of 2022 still to go, if you picked two of your funds that will do best over this calendar year, what would you forecast?

AN: I'm a big believer in diversification and people only talk about their good investments and not the ones that failed. But if I had to pick two from our suite, I would say gold equities (GDX) is well positioned given concerns in capital markets around valuations in a stagflation period, especially in a new inflation regime. Investors get operational leverage with gold companies, sustainable costs are low relative to the gold bullion price and balance sheets are clean. And if you look at simple ratios such as the price of gold companies relative to bullion, they are at record lows.

The second one is global infrastructure (IFRA). With aging utilities around the world and an estimated $60 trillion needed to spend by 2035, particularly in the US. Investors receive good, stable income streams, often regulated and CPI-linked with more compelling valuations than other securities. The more defensive nature over the long term with diversification should bode well for investors.

GH: And with 30 babies that you've given birth to, do you have a personal favourite, perhaps one that you're confident if you invested today, you'd probably still hold it 10 years from now?

AN: That's like asking about your favourite child and you can't choose. One that's really my baby as it extends on my career is our equal weighting, MVW. A lot of my training was at Perpetual which is a strong fiduciary and fund manager. If you look at the ASX200, BHP is 11% to 12% concentration now, compounded by the cyclicality of the market. The Australian market is too concentrated across stocks and sectors, so we targeted liquidity and in large caps, there's better price discovery than in small caps. I'm quite optimistic about Australian equities and I don't think we have the inflation conundrum that the US has. MVW also has good exposure to some great companies in the mid-cap space without moving too far away from the large caps.

GH: Can you give us some hints about what funds are in the pipeline?

AN: We're always working on a few ideas but I'll give you a bit of a teaser, it's around the climate change megatrend and how to access that. And we're looking at Bitcoin and Ether and cryptocurrency which creates a quite vicious debate, even internally, because we come from a more traditional asset management background. But we do think digital assets and decentralised finance done in a more regulated structure such as an ETF with market makers supporting it is a more appropriate way to do it.

Also, a lot of active managers have come to us to partner and we're looking at some long-standing and sustainable investment strategies, but nothing yet where I can really get down into the detail.

For me, the key question or consideration for investors with ETFs is while it's very exciting, always look under the bonnet and ask advice like test driving a car and know what you're getting into.

Graham Hand is Editor-at-Large at Firstlinks. Arian Neiron is CEO and Managing Director - Asia Pacific at VanEck, a sponsor of Firstlinks. This is general information only and does not take into account any person's financial objectives, situation or needs.

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Drawdowns: Even God's portfolio can't avoid them

Chris Demasi

To reap big rewards in stocks, history shows you must accept the drawdowns.

Investors have been promised an elixir of big returns and low volatility. But the truth is that to achieve outstanding long-term returns, investors must be prepared to endure large drawdowns along the way – even for the best-performing stocks and portfolios.

While the selloff in global equity markets early this year was unpleasant, it was not unusual. Instead of raising alarm, it has been a great reminder that investors need to stay the course with winning businesses – the likes of Apple and Amazon - if they want to reap great rewards in the future.

Even the best stocks have big falls

In July 2020, Hendrick Bessembinder, a finance professor at Arizona State University, published a series of papers with an important and surprising conclusion: that even the stocks of companies that had created the most wealth for shareholders over a decade experienced deep and protracted share price reversals along the way – often several times.

Bessembinder had become well-known after he demonstrated that all the stock market's value creation over the long run was concentrated in just a few stocks with extreme outperformance.

His more recent research focussed on the characteristics of those 'outlier' stocks, including their interim share price movements.

Bessembinder studied the wealth creation of all publicly listed US stocks across each of the seven decades from 1950 to 2019. He then concentrated on the top 100 performing stocks, measuring their maximum peak-to-trough share price drawdowns.

He found that, on average, the most successful 100 stocks created US$219 billion of wealth over a decade-long horizon. However, shareholders had to endure a maximum drawdown in the same decade of 33% that lasted for 10 months.

Those shareholders that invested earlier in these top stocks, in the decade preceding their decade of greatest performance, would have suffered a maximum 52% drawdown lasting 22 months, on average, on their way to extreme wealth creation.

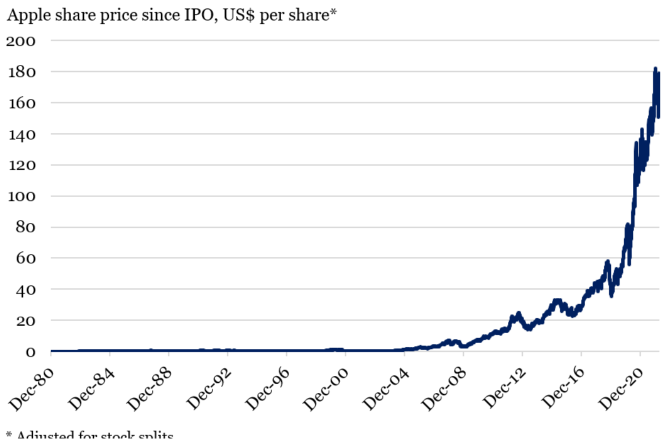
Apple and Amazon the rule not the exception

Apple and Amazon are two striking examples of remarkable companies with exceptional long-term stock performance that have been accompanied by staggering drawdowns.

Apple created the most wealth in a decade of all the companies in the study, adding US$1.5 trillion of shareholder value from 2010 to 2019. But this hasn't stopped the stock from making substantial retracements. For example, in this decade Apple's share price fell by 40% over 9 months in 2012.

Looking back further, shareholders since Apple's IPO in 1980 have earned a compound annual average return of 22% but have experienced drawdowns of more than 70% on three separate occasions.

Apple has created the most wealth



Apple has drawn down over 70% three times

Amazon is another of the most successful investments in history and the fourth-highest performer in the Bessembinder study, with shareholder wealth growing by more than US$600 billion between 2010 and 2019.

Still, Amazon stock has not been impervious to very large drawdowns. Although shareholders from the 1997 IPO have made compound annual average gains of 36%, they also suffered through the dot-com crash of the early 2000s when Amazon's share price fell by a gut-wrenching 91%.

A perfect portfolio isn't pain-free either

Some investors would be quick to point out that while these companies may be the best of the best, they are still just individual stocks, and a portfolio approach should limit the drawdown risk. Unfortunately, the research shows otherwise.

Wesley Gray, PhD, an asset manager and former US Marine, published a paper in 2016 concluding that a hypothetical stock portfolio constructed with perfect foresight would deliver stratospheric long-term returns … but still could not avoid agonizing drawdowns.

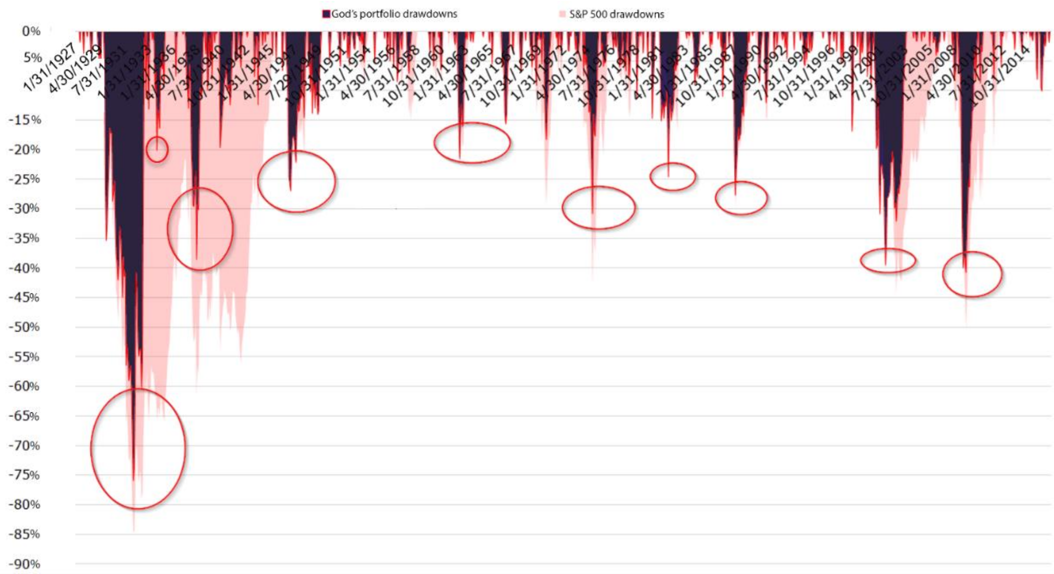
Gray created what he called 'God's portfolio' which invested exclusively in the top decile of stocks based on their performance over the next five years. After five years he rebalanced the portfolio to invest only in the top performers for the next five years, and so on. He ran this exercise from 1927 to 2016 covering the 500 largest publicly listed stocks in the US.

Over the 90-year investment horizon, God's portfolio compounded at more than 29% per year which would have turned an initial investment of just $1 into almost $12 billion! (The S&P500 index of the top 500 US listed stocks returned on average just under 10% per year in this time and a $1 investment would have grown to about $5,000.)

While the theoretical value created by God's portfolio is no doubt staggering, the drawdown profile is more astonishing. Instead of protecting against large reversals in fortune, God's portfolio endured the pain of drawdowns that exceeded 20% on ten different occasions. The worst of these was a 76% decline over almost three years in the Great Depression – not dissimilar to the stock market's 85% drawdown around the same time.

'God's portfolio' still has large drawdowns

Drawdowns since 1/1/1927, per cent



Clearly it is impossible to create Gray's divine portfolio in the real world but that's the point. Knowing which stocks to select in a portfolio based on the returns they *will* achieve with *certainty* would deliver exceptional long-term gains. But only if investors could stay invested through the short-term pain.

The Oracle has drawdowns too

Back in reality, Warren Buffett is often seen as the closest to perfection in the investing world. The Oracle of Omaha's performance as the Chairman of Berkshire Hathaway has been phenomenal over a long time. Yet Buffet has also been unable to escape gruelling drawdowns.

From 1980 to 2016 Berkshire's stock price appreciated at an average annual rate of 20%, far outpacing the 10% achieved by the S&P500 index. The difference in total return is starker. This means that Buffett presided over a 700-fold increase in shareholder value while the broader index increased 31 times.

Extraordinary returns were not, however, associated with restrained drawdowns. Over the course of 36 years Berkshire stock pulled back by at least 30% on four occasions. Relative to the market these losses were sometimes shocking. For example, in the dot-com boom Berkshire fell by 44% at the same time as the stock market advanced by 23%, representing 67% underperformance.

What to do?

So, when Apple, Warren Buffett and God can't eliminate drawdowns, what are investors to do?

The most important lesson is that investors should identify long-term winning businesses that are undervalued _and_ own them for the long term too. Staying the course has been critical to realising the powerful compound returns of the best companies even, or especially, as they experience large drawdowns from time to time.

In fact, AQR, one of the world's largest hedge funds concluded the same following a study of Buffett's performance over decades. Cliff Asness, CEO of AQR, said:

"What was beyond human was him [Buffett] sticking with it for 35 years and rarely, if ever, really retracting from it. That was a nice little lesson that you have to be good, even very good, but sticking with it and not getting distracted is much more the job"

Sell-offs and drawdowns are difficult. But if investors take a long-term view, as we do at Montaka, they are the price you pay to benefit from the powerful, wealth-building compounded returns from equities and the stocks of remarkable companies.

Chris Demasi is a Portfolio Manager at [Montaka Global Investments](), a sponsor of Firstlinks. This article is general information and is based on an understanding of current legislation.

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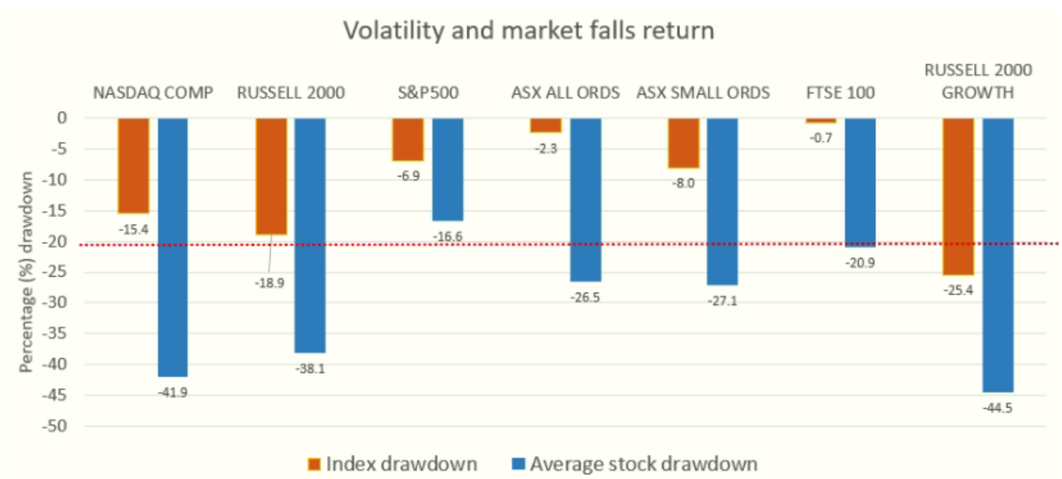
7 truths of volatility, but are they friends or foes?

Andrew Mitchell

Volatility is back

After a good 18 months or so of share market gains, 2022 has been characterised by higher-than-usual volatility and market pull backs. Interest rates are heading higher in key economies, a war in Eastern Europe is creating fear and uncertainty, and there are louder and louder calls that the United States is moving towards recession.

The volatility and sell offs, though, have been unevenly spread across indices. The S&P500 in the US, the ASX All Ords in Australia and the UK's FTSE100 are only showing modest falls But the NASDAQ (US tech), Russell 2000 (US small caps) and Russell 2000 Growth (US small cap growth companies) indices are all in or near bear market territory (>20%+ falls, see orange bars below).



Source: Factset. Data to 10 April 2022. Drawdown equals % off 52-week high.

That, however, understates the full extent of share price action. The average index/market stock on many exchanges is down much more than the headline indices suggest (see blue bars above). How can this be?

The headline indices are market-cap weighted, so the largest companies have an outsized impact on the index return. But smaller companies in each index are generally falling much more than the larger caps.

Virtually every share market investor knows that markets are risky. But how risky are they, and what exactly is 'risk' in share markets?

Reasonable people disagree and have differing opinions on what risk is. (We prefer Elroy Dimon's, a Professor of Finance at London Business School, definition: "Risk means more things can happen than will happen".)

We are all unique individuals with our own risk preferences. Sadly, we are not going to be able to tease out all of your risk preferences here. But we can show you a little about what you should expect on the journey so you can know if the risk is worth the return.

Below are seven truths of the volatility of shares that we have discovered from history.

1. Even Buffett can't avoid volatility

Many of us would love to achieve 20% per annum returns in perpetuity with no downside or falls in investment value. The only people that can do that are the Bernie Madoff's of the world and they at some point get exposed for the frauds they are and hopefully end up in jail.

Even the inimitable Warren Buffett – whose Berkshire Hathaway has provided an incredible 20.1% per annum return versus the S&P500 at 10.5% per annum from 1965 to 2021 – has had 10 negative return years (the S&P500 logged 12 over the same period).

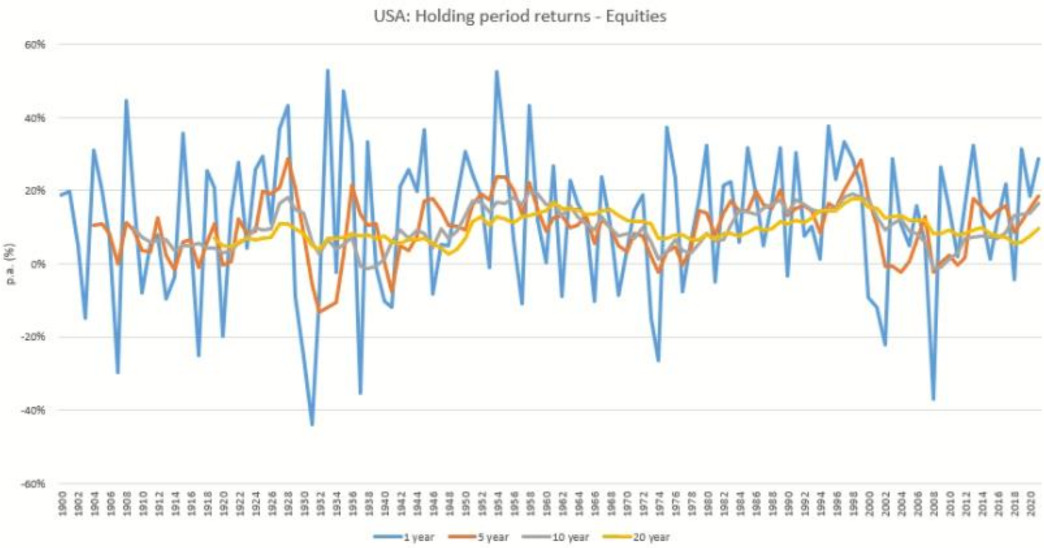
Berkshire has also seen four years where it returned -20% and six years where it underperformed the S&P500 by more than -20% (this included years of -40.9%, -34.7%, -23.8%, -22.3%, -20.5% and -20.0% underperformance of the S&P500).

The lesson for investors here is nobody is immune from market falls. Even the best in the biz!

2. Big losses are a given (but not over the long-term)

We love going back in time to form our views of the future. In the charts below, we show the rolling one, five, 10 and 20 year returns for the US equity market from 1900 onwards.

What you can immediately see is that one-year returns for equity markets (blue line, top chart) can be incredibly volatile. Regular calendar year falls of -10% to -30% are relatively frequent.



Source: Factset, Cambridge Associates

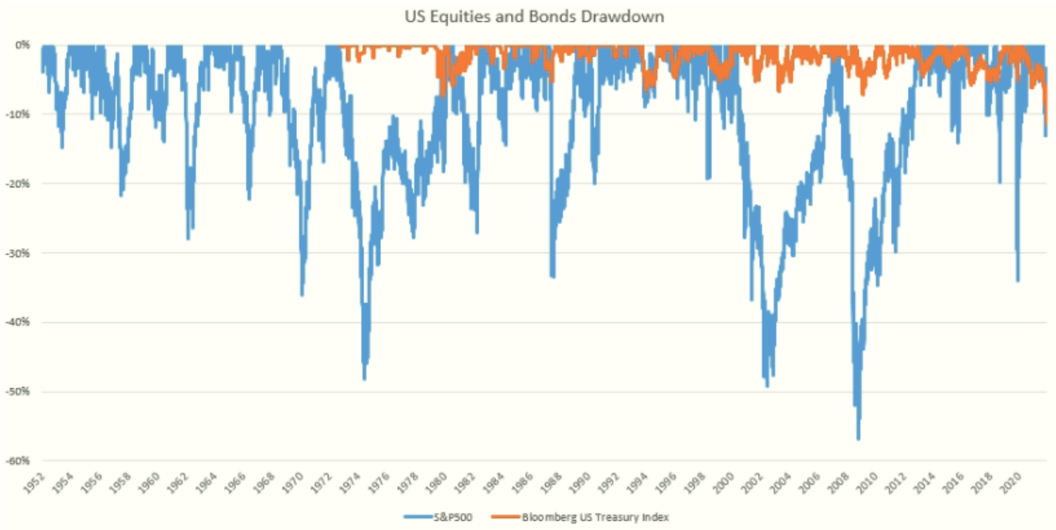
However, as we go out to holdings periods of 5 years (orange lines), falls become MUCH less frequent. At 10-year periods (grey lines) they have become practically non-existent, and there are no periods of negative 20-year returns (yellow lines). This is a trend that has held fairly consistently across other developed economy share markets over time – albeit the US and Australian stock markets have been two of the better very long-term performers.

The takeaway here for investors is that the longer your holding period for shares the more likely you are to see a positive return on your investment.

3. You are likely to see shares cut in half during your life

One of our favourite Charlie Munger quotes is: "if you can't stomach 50% declines in your investment you will get the mediocre returns you deserve". Charlie never was one to mince words.

Now 50% falls sound a lot. No one likes losing half of their investment, at least on paper. What Charlie was referring to here was the fact that share markets have historically gone through periods of circa -50% falls more than you may think. Below we show the drawdown (top to bottom fall) of the US share market for the last 70 years.



Source: Factset

There has been three approximately -50% falls:

1. The 1974 market crash
2. The 2000s tech wreck
3. The 2008-2009 global financial crisis

History suggests there is a very good chance you may encounter at least one or two of these, if not more, in your investing lifetime.

And of course, there has been a myriad of bear markets or falls greater than -20%.

4. Dodging big falls (timing) is impossible

We'd all love to be able to time markets and miss these falls, but history, and the data, suggest this is likely to be nigh on impossible. Just think about it for a minute. If it was possible to miss these falls, the math can very quickly show that you would become other-worldly rich over time by just being exposed to the upside of share markets. Your name would be up in lights, and you would become one of the richest people in the world.

As we will see shortly, it is BECAUSE investors have to go through the painstaking drawdowns of the share market that they tend to be handsomely rewarded over the long term. If it was possible to miss the falls, this timing wonder drug would become incredibly valuable and would likely not stay secret for long with other investors incorporating it into their investment approach. If, en masse, investors could miss all of the market falls, then the share market would cease to be as risky, it would trade on higher valuation multiples and we all would receive the commensurately lower returns we deserve from this now safer investment.

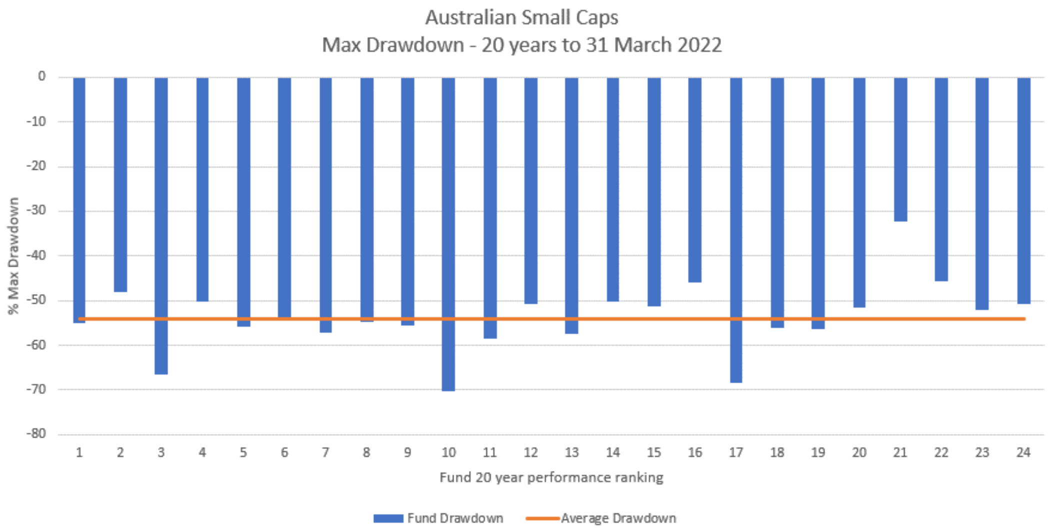
Or if you don't believe us on it, perhaps Ben Graham, one of the legends of investing can convince you: "In financial markets, hindsight is forever 20/20, but foresight is legally blind, and thus, for most investors, market timing is a practical and emotional impossibility."

5. The pros can't avoid drawdown risk

In case you thought mum and dad investors were the only investors who can't time share markets and largely avoid drawdown risk, think again.

Below we show a case study using Australian small cap fund managers, though the conclusion holds in general across all equity managers.

The chart below shows all the Australian small cap managers that have had a fund running for at least 20 years to 31 March 2022 (from the FE fund info database). There are 24 of them. We have ranked them from best performing to worst (left to right) over the two decades. We also show the maximum drawdown or fall in performance each has experienced over that time.



Four things stand out:

1. Even the best performing managers over the long term have big drawdowns.
2. There's no relationship between the long-term performance of the manager and the size of their biggest falls in performance.
3. No manager has been spared from material falls.
4. The size of the biggest falls are all fairly consistent – with most between -45% and -60%.

This 20-year period includes the GFC in 2008-2009 which is when all the managers saw their biggest maximum drawdowns. This is not to say that the better performers 'only' falling -45% isn't adding significant value for equity investors when the market was down more.

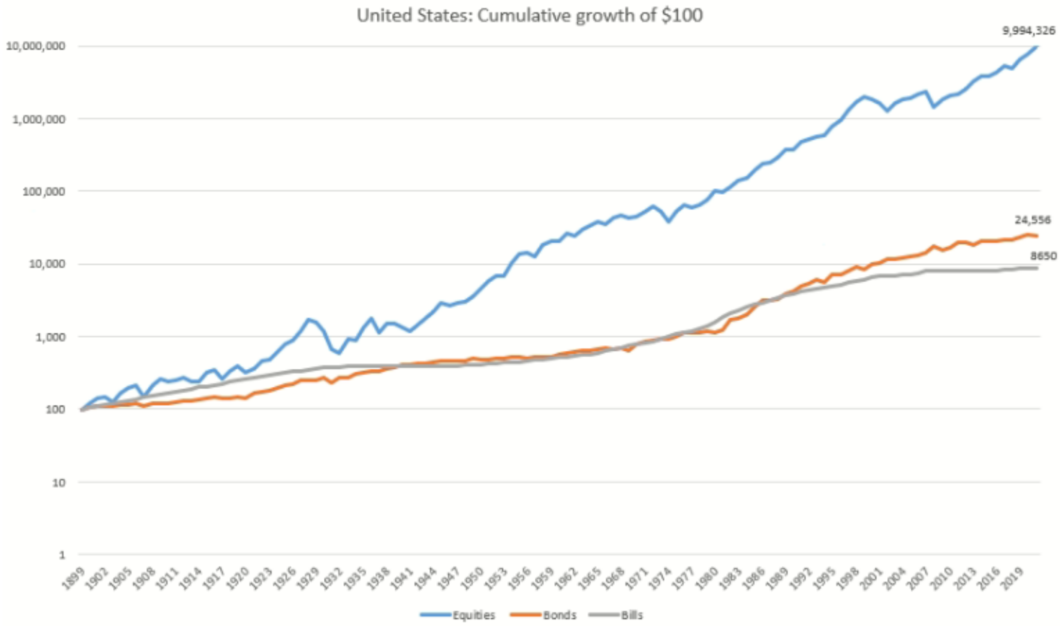
But rather the evidence is clear that investors should not expect the pros to be able to time the markets either and avoid the periodic -50% falls that Munger says you must stomach to avoid the mediocre returns you may otherwise deserve.

6. Shares reward you handsomely over the long term

So, what has been the reward for bearing these occasional -50% share market falls and more frequent -20% bear markets?

Below we show the growth of $100 invested in US shares, bonds and bills (a cash equivalent).

We had to put this chart in 'logarithmic' mode on the vertical axis (it jumps by multiples of 10) so that you could even see the returns of bonds and bills next to equities such is the Grand Canyon-sized chasm between them. If the chart was plotted on a standard vertical scale, it would be almost impossible to even see the growth of the investment in bonds and bills they are so comparatively miniscule.



Source: Factset, Cambridge Associates

A $100 investment in bills would have grown to $8,650 by the end of 2021, while you would have made almost three times this ($24,556) if you had placed it in bonds. However, in another galaxy is equities at $9,994,326! Hard to believe but true, at more than 400x the dollar return of bonds over the last 122 years. The shorter-term risk of shares has been handsomely rewarded over the long term.

It's hard not to think of the wealth that could be accumulated in equities over generations if only most people didn't spend most of it during their lifetimes!

Now one word of warning with the above. The United States has been one of the best-performing share markets over the last 100+ years. Not every country has seen results as good. But of all the 23 countries that we have good data going back to 1900, all have share markets that have very handsomely outperformed bonds, bills and inflation (Credit Suisse Global Investment Returns Yearbook 2022).

7. Shares may actually become safer than bonds … over the very long term

As mentioned, shares can be very volatile in the short term, but because of that volatility and risk of significant drawdowns, they tend to provide significantly higher long term returns than 'safer' bonds and bills.

But as shares get safer over the long term, through a reduced probability of providing negative returns, do they always remain riskier than bonds? Not necessarily.

Source: Factset, Cambridge Associates

Above is close to our favourite investment chart of all time. A big call I know. But understanding the chart will be worth the effort.

It shows the average real (after inflation) returns for portfolio mixes of US shares and US bonds on the vertical axis over different holding periods since 1900. What you can see is that portfolios made up of 100% stocks have average annual real returns well above those comprised of 100% bonds over all holding periods.

This first part shouldn't be a surprise. Stocks tend to do better than bonds on average, no matter what period you hold them for. It also shows that as you add more bonds to the mix, going from a 100% stock portfolio closer to a 100% bond portfolio by moving down each line, your returns tend to get lower. Again, this should make sense.

What we have shown on the horizontal axis is the range of outcomes historically around the average real return of each portfolio, as measured by that great stat we all learned about in year 10 at school: standard deviation. It shows that for holding periods of just one year, a 100% stock portfolio is very risky with a large standard deviation and therefore a wide range of outcomes around its average. Over a one-year holding period, though, as you add bonds to the portfolio, the return tends to go down on average but so does the range of outcomes around that average.

As your holding period increases to five years and eventually to 30 years, the range of outcomes (standard deviation) decrease dramatically, particularly for the 100% stock portfolios. And when you get to a 30-year holding periods (a common investment horizon for most over their lifetime), nirvana happens. Historically at least, US shares have provided higher returns AND lower risk than US bonds! Incredible.

Before you dismiss this as a US share market anomaly, this outcome also holds for the Australian share market.

As investors raise their investment horizon to the longer term, risk to real stock returns dramatically decreases and approximates or may even become less than bonds. This suggests that investors over long horizons may be able to be more confident of the purchasing power of a diversified stock portfolio than they are of a diversified government bond portfolio.

To the victor goes the spoils if only investors can resist getting worried about the short-term volatility of shares. As Buffett once wisely said: "The share market is a device for transferring money from the impatient to the patient".

No risk, no reward

In sum, volatility and drawdowns are the price you pay for higher returns from shares over the long term. You genuinely can't have the sweet without the sour. That is not to say risk management to minimise drawdowns and permanent loss of capital are not worthy or valuable endeavours – they are highly valuable. But expectations must be realistic about what these practices can achieve – they are not a cure all for avoiding declines in value when markets fall.

At Ophir, we see volatility and market falls as the friend of the long-term high-quality active manager. It is always painful whilst you are going through it, but ultimately it is a necessary ingredient for shares to outperform over the long term and for active managers, such as ourselves, to be able to stand the chance of beating the markets over time.

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

Read more articles and papers from Ophir here.

The forgotten asset class set to outperform in 2022

Roy Keenan

Against a backdrop of economic and geopolitical uncertainty, rising inflation and expectations of a rate hike, Australian investors are searching for investments that can benefit from these evolving market conditions.

With credit spreads at attractive levels, now might be the opportune time to have exposure to hybrids and credit. With minimal returns on cash continuing to underpin strong demand for hybrid securities, we anticipate demand for yield to remain robust throughout 2022, resulting in strong returns over the year for this asset class.

The upside of rising interest rates

Rising inflation, above average GDP growth and the unwinding of quantitative easing (QE) in 2022 has seen financial markets reprice interest rate expectations.

The rising rate environment will push the outright return on hybrid securities higher, without having a material impact on spreads given the strong economic backdrop. Given most hybrids are floating rate, investors will benefit via higher income from these rising short-term rates.

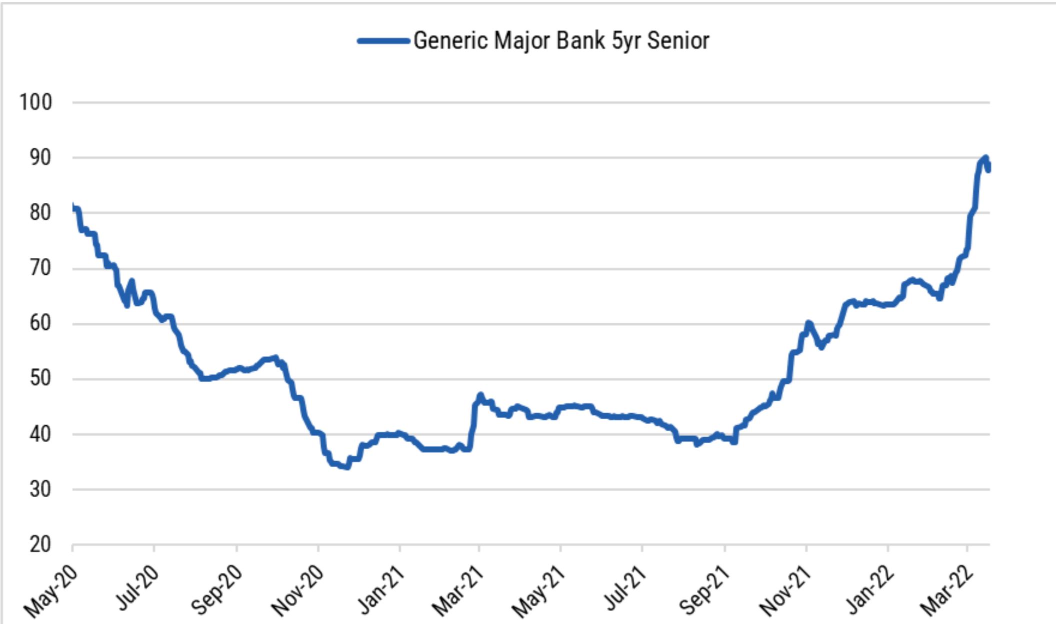
Strong balance sheets you can bank on

Australian banks are the largest issuers of hybrids domestically and their balance sheets are in fantastic shape, with capital ratios at historical high levels. COVID-19 provided Australian banks with access to cheap funding via the Term Funding Facility (TFF), which provided them with a degree of funding certainty and lower funding costs.

Following the withdrawal of the TFF in 2021, new bank issuance is coming to market at attractive credit margins, providing the ideal environment for active credit managers to identify the most positive risk adjusted opportunities.

For instance, bank senior credit margins are significantly off their TFF lows, which is leading to an attractive re-pricing across all bank capital issuance (refer to Chart 1). Overvalued growth sectors are likely to lead an equity market sell off similar to 2000 – 02, but are unlikely to impact credit market returns.

Chart 1: Bank senior credit margins – Well-Off Their TFF 2021 lows



Source: YCM/NAB/BBG –March 18, 2022

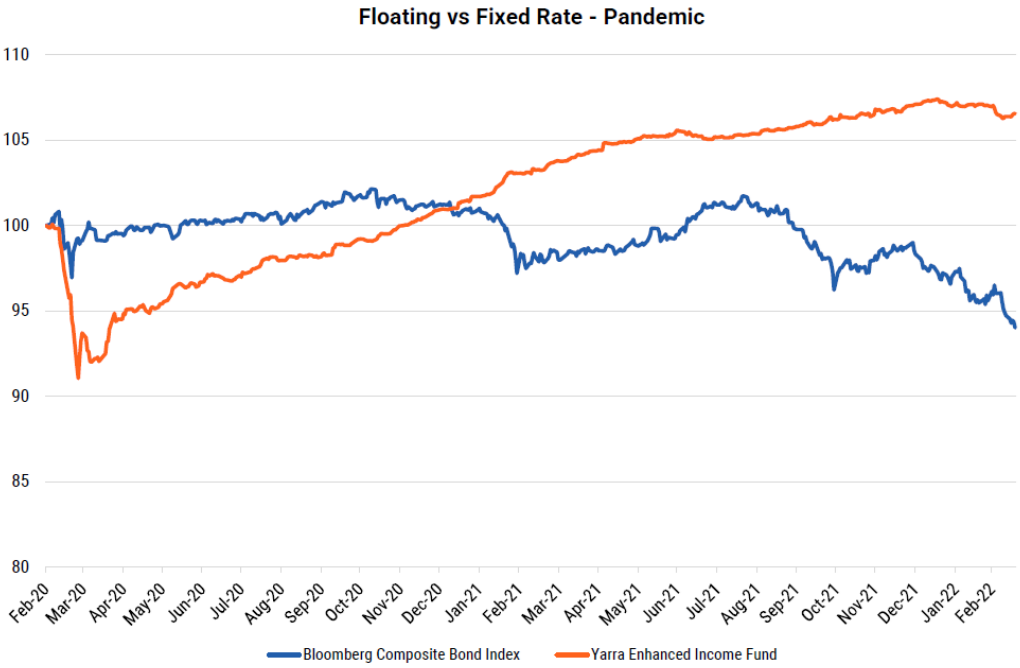
Fully protected from higher interest rates with high carry protecting returns

The higher the carry (running yield of an investment), the greater the protection it offers investors from adverse movements in credit margins. The carry for the Yarra Enhanced Income Fund ("EIF") is currently sitting at ~3.0% above cash.

Based on an average portfolio maturity of ~3 years, we'd need to see an extreme 1.0% move wider in credit margins to wipe-out the carry. However, given the robust economic backdrop in 2022, we expect credit margins to remain relatively stable throughout, adding to floating rate credit's income generating credentials.

This benign outlook is in contrast to the capital losses currently being observed in traditional fixed income due to the reset in interest rates and real yields. Usually, a rise in real yields will impact the value of everything long interest rate duration, from traditional fixed income to most equities. That's not the case with floating rate credit, since its short duration offers protection to portfolio valuations from rising interest rates. This is observable in EIF's outperformance compared to traditional fixed income (Bloomberg Composite Index) since February 2020 (see Chart 2).

Chart 2: Floating rate credit with carry continues to outperform fixed rate with little carry



Source: Yarra Capital Management, Bloomberg. As of March 18, 2022

Making the grade

In a world that seems to be getting riskier by the minute, investment grade hybrids look to be a safe haven for investors. Here's why:

- Investment grade hybrids appear to be fairly priced in an environment appearing increasingly more expensive, especially if real yields rise or normalise in a post QE world.
- Investment grade issuers remain well capitalised, making them more likely to be able to service their interest payments and repay debt.
- Most Australian investment grade hybrids are floating rate securities, which tend to pay higher yields if prevailing rates go up because they are based on a variable interest rate, rather than fixed. Not only does this mean more income when rates rise, but there is also no loss of capital.

Roy Keenan is Co-Head of Australian Fixed Income at Yarra Capital Management.

Why Australia is crying out for a National Longevity Strategy

David Williams

***Definition**: A person's longevity is 'the rest of their life'.*

Why 'longevity'

Longevity is a holistic term covering the 'time base for everything' in a person's life.

Most of the terms we associate with increasing lifespans have negative connotations. Consider ageing, retirement, age pension, aged care, age discrimination, home care, seniors, frailty, superannuation and end of life. While each has a specific relevance, a term to cover all of them frees us to envisage the whole framework – the good and the challenges - before focusing on the parts.

The definition starts with the person. We become more different from each other over time. Our own remaining time frame is unique. By just focusing on 'community' longevity, we lose sight of how different we are and how differently we respond.

A National Longevity Strategy will focus on maximising the social and financial benefits from:

- understanding and supporting individuals from midlife in making the best of the rest of their own life through raising their personal longevity awareness
- development of a longevity aware and proactive community
- harmonising the activities of government entities involved in longevity support

Where we are

At the end of 2021, there were 4.3 million Australians over the age of 65, about 16% of the population. The five-year cohorts over 65 are the fastest growing across the whole population, averaging 3.5% last year. No other cohort grew faster than 2.5%.

A huge longevity bonus accompanies this growth. Average life expectancies continue to increase. Half the oldest baby boomers alive today (75) are likely to live at least 30% beyond their life expectancy at birth and beyond 90.

However, the longevity bonus is petering out beyond 90, where successive cohorts are living less long than their predecessors. We face an increasing logjam of older Australians – most of whom will still live much longer than was expected when they were born but with more requiring support.

The crisis in aged care remains unresolved, creating major uncertainties in the older community about their future. The pension system encourages people to 'retire' at age 67 when at least half achieving this age will live close to their 90s, most independently. While community unemployment is reaching historically low levels, seniors' employment is not increasing with the demographics.

Large sums are spent on research into better medical treatments for older Australians, yet very little on prevention. Health professionals struggle to reach beyond immediate patient issues to achieve effective preventive health and wellbeing support. The hospital system is fully stretched with little prospect of relief, even after the pandemic, as the ageing demographic grows.

Investment products and services are increasingly complex. Advisers are required to provide expensive and detailed assessments which are becoming even less accessible to many consumers. The Australian Law Reform Commission recently strongly criticised this trend.

Gender imbalance is a distinctive feature of increasing longevity. Women live longer and typically with longer dependency in later life. Women are usually the caregivers and outlive their partners, with less likelihood of personal care themselves. Women are less likely to accumulate superannuation, constrained by rearing children and fewer employment opportunities.

Ethnic inequalities are typified by the shorter total and healthy lifespans of these minorities. A National Longevity Strategy would clarify and provide consistent solutions to many of the challenges.

Consumer groups like COTA and National Seniors make a major contribution but need more support.

Where we could be

We face an increasing challenge of dealing with larger and less healthy numbers of people in their late 80s and early 90s. However, social and medical research is revealing how existing services, products and facilities could be much better harmonised to improve their delivery to the older demographic and reduce the cost.

Longevity research is moving very quickly to understand much more about ageing. It's increasingly likely we will see real solutions to considerably extend lifespans and quality of life at greater ages. If this happens, it will change the paradigm of ageing on which current responses are based.

Both these opportunities require better oversight and major improvements in how well and how quickly we address increasing longevity in the community, and personally.

National Longevity Strategy

A National Longevity Strategy is urgently needed to effectively deal with the growing challenges and opportunities of increasing personal and community longevity, with bipartisan support.

Separate silos of interest (both in government and in the private sector) have grown strongly to deal with this phenomenon but can work together much more effectively. A National Longevity Strategy will harness all available capabilities and financial resources to make the most of the remarkable community and personal longevity bonus. It will underpin major savings.

To achieve this, the Strategy will draw on and provide oversight and guidance for the activities of:

- Treasury (demographics, superannuation, tax, financial advice)
- Social services (age pension, home equity release, disability)
- Employment (age discrimination, retraining)
- Health (including doctors, other health providers, health funds and researchers)
- Aged care
- The financial planning and legal professions
- Federal and State governments
- Superannuation funds and other financial product providers

A primary focus will be on improving longevity awareness of individuals from 60 years of age, along with improving the understanding and support of their health and financial advisers.

As a society, we are responsible for the remarkable longevity phenomenon. A National Longevity Strategy will focus Australians on making the best of it in every way.

David Williams is Founder and CEO of My Longevity. Try the SHAPE Analyser to focus on your own longevity.