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Contents

Why it's better to be a small investor *Marcus Padley*

Meg on SMSFs: My 30 June 2022 'To Do' list *Meg Heffron*

Steve Bennett on the latest trends driving commercial property *Graham Hand*

Collateral damage follows the end of profitless prosperity *Roger Montgomery*

Is the speculative fever in 'hot stocks' over? *Ashley Owen*

When do demergers work? Backing the ugly duckling *Anthony Aboud, Sean Roger*

Three reasons high inflation may trigger a European crisis *Michael Collins*

Gold remains solid as Bitcoin melts *Sawan Tanna*

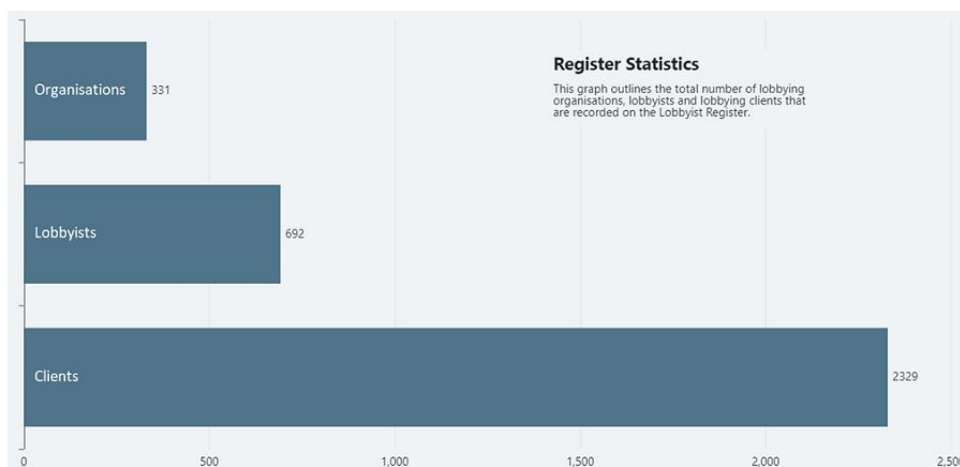
Two of the best-kept secrets for the EOFY *Chris Cuffe*

Editorial

The new **Labor** Cabinet is sworn in and ministers are moving into their offices, meeting their department heads and learning their responsibilities. It's a strange system where the person in charge of a vast portfolio may know relatively little about it but we expect instant expertise on major projects and policies. A company CEO might take 20 years to learn about an industry and move up the corporate ladder, but politics throws someone into the top gig at short notice.

And immediately, the lobbyists come knocking. There are 331 organisations in Australia on the Register of Lobbyists with thousands of clients. About 38% of the 692 registered lobbyists are former government representatives, and all are subject to a Lobbying Code of Conduct.

"The code helps to ensure that contact between lobbyists and Australian Government representatives is in line with public expectations of transparency, integrity and honesty."



Good luck with that. Lobbying is '*pay-to-play*'. Doubts about integrity and honesty were major factors in the recent election.

The Code is intended to:

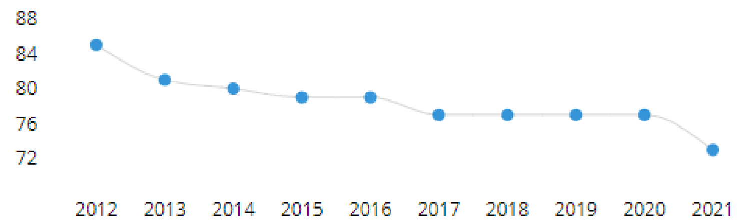
" ... promote public sector integrity and work to strengthen oversight, accountability and transparency measures in Australia's public institutions."

Let's not become too warm and fuzzy about what lobbyists seek to achieve. They are paid advocates who seek to influence political decisions on behalf of their clients. I have previously described how a leading lobbyist gave me a lesson in how politics really works. Following his unseemly exit from politics, **Sam Dastyari** told the ABC TV documentary, Big Deal about lobbying and corporate donations:

"What do you really believe that these companies expect in return for that money? There's no point pussyfooting around on this. You can have as many euphemisms as you want. You can call it donations, you

can call it contributing, you can call it participating in democracy. That's all bullshit. This is one thing and one thing only. It's pay-to-play ... how do I get a seat at this table?"

Australia currently ranks 18th on the Transparencies International Corruption Perception Index, a steady fall over the past decade.



The challenge for the new government is to see this number rise by 2025 but there should be no rose-coloured glasses here. Like any political party, Labor relies on corporate donations, as shown in the data below released recently by the **Australian Electoral Commission** for FY2021. The problems facing the new government on energy and gas policies suggest there is already a well-worn path into the offices of Ministers **Chris Bowen** and **Madeleine King**. The Lobbyist Register allows a search by company name to identify who does the lobbying work.

Fossil Fuel Donations - 2020-21 Financial Year
Source: AEC

Donor	Labor	Liberal	LNP	National	Greens	Grand Total
Ampol Limited	$34,500	$42,850	$0	$0	$0	$77,350
APPEA Limited	$31,650	$49,710	$22,900	$2,750	$0	$107,010
APT Pipelines Limited	$27,500	$27,500	$0	$0	$0	$55,000
Chevron Australia Pty Ltd	$38,750	$28,750	$0	$7,150	$0	$74,650
Empire Energy Group Limited	$25,000	$40,000	$0	$0	$0	$65,000
LET Australia Ltd	$47,000	$40,500	$2,000	$22,000	$0	$111,500
Minerals Council of Australia	$64,660	$87,205	$13,987	$28,091	$0	$193,943
Santos Limited	$44,000	$0	$0	$22,000	$0	$66,000
The Trustee for St Baker Family Trust	$52,444	$42,230	$70,528	$0	$0	$165,202
Woodside Energy Limited	$108,350	$82,000	$0	$42,000	$0	$232,350
Grand Total	**$473,854**	**$440,745**	**$109,415**	**$123,991**	**$0**	**$1,148,005**

The hiring by lobby firm, **PremierNational**, of ex-Labor power broker **Graham Richardson** is prescient given Labor's victory, only it's not lobbying but '*government relations*':

"PremierNational is continuing to strengthen our bipartisan offering to ensure our clients' interests are represented with the best-in-class government relations offering in the nation."

There are not many Labor politicians who would refuse to answer a call from '*Whatever It Takes*' Richo.

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The **Reserve Bank**'s 0.5% cash rate rise was larger than the market expected, and Governor **Philip Lowe**'s hawkish comment also spooked traders:

"The Board expects to take further steps in the process of normalising monetary conditions in Australia over the months ahead."

Even Lowe must admit the central bank has been all over the shop in recent months, and not only the "*no rate rises until 2024*" call. As **CBA's Gareth Aird** says, the Board has fundamentally altered its thinking:

*"The RBA's reaction function has changed. In a 'back to the future' move, the RBA Board will revert to once again being forward-looking. Recall that the Board's reaction function to commence normalising the cash rate was based on **actual** inflation and not **forecast** inflation ..."*

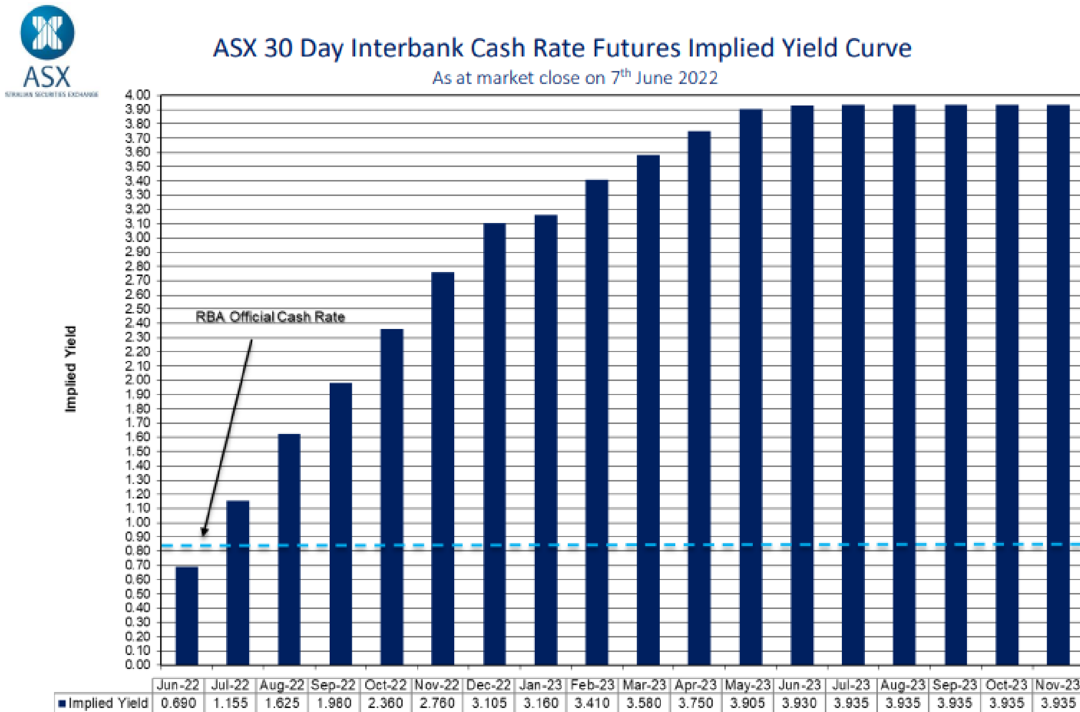
That's not all that has changed, and this is an important point:

"According to the RBA, "inflation is expected to increase further, but then decline back towards the 2-3% range next year." Last month, the RBA did not expect inflation to return to target until mid-2024."

Here is the big twist as the RBA front-loads increases. CBA expects another 0.5% in July, then 0.25% in each of August, September and November, taking cash to 2.1% by the end of 2022. And this forecast:

*"With the RBA now expected to take the cash rate to a contractionary setting, we have pencilled in **rate cuts** for the second half of 2023."*

Big call, as reductions in cash rates in 2023 will require falling inflation and GDP. It's not what the market is expecting with cash at 4% mid-year.



	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23
Implied Yield	0.690	1.155	1.625	1.980	2.360	2.760	3.105	3.160	3.410	3.580	3.750	3.905	3.930	3.935	3.935	3.935	3.935	3.935

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CBA was not alone in predicting rate cuts, with **Bridgewater** Founder **Ray Dalio** telling *The Australian Financial Review* this week:

"We believe that we are in a tightening mode that can cause corrections or downward moves to many financial assets. The pain of that will become great and that will force the central banks to ease again, probably somewhere close to the next presidential elections in 2024."

A packed edition as we head to EOFY ...

Talking of life on the inside, **Marcus Padley** explains how institutional investors have some advantages over smaller players, especially access to favourable placements, but on balance, small is good for nimbleness and execution.

Then SMSF expert **Meg Heffron** identifies her Top Five tips for superannuation for the end-of-financial-year, stressing the importance of completing actions well before 30 June as well as explaining a couple of tricks.

Rising interest rates and inflation have tested property assets in recent months, and the **Reserve Bank** increased rates by a surprisingly large 0.5% this week which did not help. In our interview with **Steve Bennett**, he explains which sectors are most resilient and have the better pricing power.

Then two articles on the fallout in tech and online stocks. **Roger Montgomery** says free money disguised the smoke and mirrors of profitless companies and millions of investors fell for the hype, while **Ashley Owen** shows the price action of dozens of tech companies and compares prices with major indexes to ask if it's safe to jump back in.

Then an insightful piece by **Anthony Aboud** and **Sean Roger** on when mergers might work. A checklist provides hints on what to watch for in future.

Inflation and its consequences dominate investing at the moment and **Michael Collins** fears for the future of European unity with these new threats.

Bitcoin has often been described as 'digital gold', and **Sawan Tanna** tests this theory against some long-term data on gold's performance versus the crypto. New legislative problems are facing cryptocurrency miners due to the massive amounts of power consumed at a time of fossil fuel shortages.

Chris Cuffe is back with a couple of EOFY tips he has shared before, but which tend not to be top-of-mind when people are moving money during June.

And while we're on fixing up your finances in June ...

'Morningstar Investor' deal for EOFY

A special offer for full access to Morningstar Investor with research on thousands of companies and funds. If you derive income from the market, your subscription may be tax deductible. Subscription includes free access to Sharesight software which I have used for many years to maintain my records for monitoring and making tax time easier.

Sign up here for a **free four-week trial*** and checkout with code **DOLLARADAY** before 11:59pm AEST on 30 June 2022. You will be entitled to a special rate of **only $365** for a **12-month subscription** (normally $675).

**This offer is limited to new clients and cannot be used in combination with any other promotional offers and cannot be used to extend an existing Investor Membership. One trial per household.*

Why it's better to be a small investor

Marcus Padley

I have never liked the expression 'smart money'. It is demeaning to individual investors and used by some in the finance industry to imply they are smart and the rest of you are by implication 'dumb'. A lot of supposedly smart professionals do some very dumb things, and a lot of commentators that use the expression (you don't know who you are) I *know* are dumb. And I also know a lot of non-professional investors (you guys) do some very clever things.

Some advantages for the insiders

There are only a few 'smart money' activities, inaccessible to the mortal investor. They include:

Access to IPOs, share issues, and placements. Allocations of larger amounts in of hot new issues is something only the big institutions receive, and they get it because the brokers controlling the issue want to suck up to them to win their secondary market trading business. Those accelerated rights issues are an utter rort. They hand value from existing shareholders to the chosen institutions that may not even hold the stock. So yes, the fund managers are advantaged in this respect over retail money.

Inside information. There is a broker's saying that "*If you are not on the inside, you're on the outside*" and a lot of private investors think that this is how everybody else makes their money. Some private investors (usually after they just made a loss) will also tell you that the stock market is one big Machiavellian plot of big money with inside information exploiting small money investors without.

But it's not. Let me give you a story. I once stood in a lift with a very experienced professional trader who overheard a couple of brokers talking about an inside tip. He piped up in a gravelly voice of experience. "*If I'd never been told any inside information, ever, I would be a million dollars better off.*" I'm sure inside information is around and you may be considered 'smart' if you come across it and use it to make money and not get arrested. But it's not legal and it's not commonplace in or out of the industry. The main misconception of those outside the industry is thinking everybody else has it. Quite simply, they don't. That's not the game.

Writing options. Some wealthy investors do very little other than constantly write out-of-the-money call options against large existing holdings in the big stocks. They do not write naked calls; they own the stocks.

But this will only ever achieve incremental gains, a few percent maybe, over and above the total return of that stock. They see it as a way to achieve a 'higher yield' rather than a way to make capital.

The truth is that what most people call smart money, is not really smart money, it's just 'big money'. Big money is institutional money, fund manager money, money that attracts the attention of brokers that can deliver an advantage by prioritising the big money when it comes to shares issued at a discount, share allocations to IPOs and private placements without using a Product Disclosure Statement.

But before you have a whinge about those privileged institutions getting favours from their broker mates, let me tell you, there are a host of advantages for people like SMSF trustees running 'small money'.

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I have collected some of them. This should make you feel better about the big end of town.

The advantages of being a small investor

- Liquidity doesn't matter. Moving prices when they buy or sell is a big issue for fund managers. When *you* buy and sell you don't affect the share price in a counterproductive way. You get better and quicker execution.
- You don't have a mandate controlling what you do. You can do what you want.
- You can change what you do at any time without reason or explanation.
- You don't have to stick strictly to an investment strategy (the written requirements for SMSFs are notoriously lax).
- You don't have to stay invested when the market falls over, you can sell. Most fund managers can't, their mandates limit the size of their cash holdings.
- You don't have to boringly diversify and include stocks because they are a big part of a benchmark.
- You don't have competitors boasting how well they have done.
- You can walk away without anyone knowing or minding. You can take the day off. You can take a month off. You can take a year off. You can stop managing funds forever without one email asking you why.
- If you buy an ETF or a LIC, it's not seen as a 'failure' (it is for a fund manager who is supposed to select stocks).
- Reputation doesn't matter. You don't lose your job if you underperform.
- You don't get emails from your investors distracting you from the job in hand.
- If you get it wrong, you don't lose investors.
- You don't have compliance issues burning time and money. You don't have to publish, let alone comply with, your FSG. You don't have to pay for a compliance manager. You don't have the threat of ASIC turning up at your door with a 'Please explain'. You don't need an AFSL. You don't have the cost of an AFSL. You don't have the administration of an AFSL.
- You have almost no costs.
- You don't have to justify your decisions to a committee.
- You can react to events almost instantly.
- You can use mechanisms like stop losses if you want.
- No one is comparing you to a compounding benchmark with no costs.
- With today's technology you have almost identical tools available to a fund manager.

On the flip side

- You don't have brokers buying you lunch.
- You aren't given access to IPOs because you're a small client they don't need to suck up to.
- You don't get to read the research before everybody else does.
- You don't have $200,000 analysts finding stocks for you before they tell anyone else.
- If you lose millions in a correction, it's not okay just because everybody else's performance was terrible as well.

The bottom line is that being a 'small money' investor is a big advantage because you have the freedom a professional investor would love.

Marcus Padley is the author of the daily stock market newsletter Marcus Today. For a trial, see marcustoday.com.au. This article is general information and does not consider the circumstances of any investor.

Meg on SMSFs: My 30 June 2022 'To Do' list

Meg Heffron

In a monthly column to assist trustees, specialist Meg Heffron explores major issues relating to managing your SMSF.

There is always a myriad of things to think about before 30 June and this year is no different. But the end of the financial year is still weeks away, it's amazing how quickly the time can disappear when you're not prepared. So this is my 'To Do' list for SMSF members and trustees. In fact, many of the things I discuss could relate to any superannuation vehicle.

1. Make your pension payments

If you have pensions in an SMSF, make sure you have drawn at least the minimum amount required before 30 June. If that doesn't happen, it's as if the pension didn't exist for the whole of 2021/22. For example, the fund won't receive the special tax treatment that normally means it doesn't have to pay tax on some or all of its investment income (rent, dividends, interest, capital gains etc). This tax break is only provided on pensions that actually meet all the rules.

2. Contribution timing

If you want to make contributions in 2021/22, make sure they're paid into your fund in time. There are a few traps for the unwary here.

In an SMSF, if you're making personal contributions via internet banking, make sure the money actually shows up in the fund's bank account before 30 June. And while online transfers often feel immediate (certainly I notice the money disappears from my own bank account immediately!) that doesn't always translate in an immediate addition to the receiving (SMSF's) bank account.

Believe it or not, if you're running very late you're actually better to pay the contribution by cheque. A contribution made by cheque counts as being received as long as it's in the SMSF trustee's hands before midnight on 30 June and there was enough money in your personal account to cover it. It has to be banked promptly but it's virtually the only time a contribution appearing on your fund's July (not June) bank statement will count as a 2021/22 contribution.

You don't have the same flexibility with a personal contribution to a public fund. Many have cut off dates well before 30 June, sometimes a week or more. Make sure you're aware of these dates before assuming a deposit at the last minute will be fine.

It can be even more tricky if your last-minute contribution will come from an employer. These days, it's virtually impossible for an employer to make these by cheque. Many employers also pay their super contributions using what's known as a 'clearing house'. They give all their employees' super to just one company (the clearing house) and it's then the clearing house that splits the money up between the various superannuation funds correctly. That means there's a delay between when the employer makes the payment and when it lands in your super fund's bank account. If that delay takes you into the new financial year then unfortunately the contribution won't be made in time.

Making sure your contributions count in 2021/22 can be important for many reasons. The limits or caps on your contributions operate on a financial year basis. If you have carefully planned your affairs so that you will (say) reach the limit on concessional contributions (contributions made by an employer or ones you make personally but claim a tax deduction) of $27,500 in 2021/22, you need all those contributions to arrive in your fund before 30 June.

Will you (or someone in your family) receive amounts from a family trust (known as distributions) that are counted in your 2021/22 income tax return? If so, are you planning to make a super contribution and claim a tax deduction for it to reduce the tax you pay on these distributions? That contribution needs to be made before 30 June, even if you don't know the exact amount of the distribution yet. The same applies if you're making a contribution you intend to claim as a tax deduction for any other reason.

3. Making co-contributions

Do you have family who might benefit from government co-contributions? This is the scheme where certain people can make personal super contributions and receive another 50% as a top up from the government.

Someone meeting all the eligibility rules can contribute $1,000 of their own money and the government will add another $500. To lock in this benefit for 2021/22, the personal contribution has to be in the super fund before 30 June.

As an aside, this is a conversation all SMSF members (who have already seen the light and value their super) should have with the young adults in their lives. I recently explained the concept to one of my sons. He is in his first job and earning less than the $40,000 threshold so he is eligible for the maximum co-contribution. He couldn't believe that the government would give him 'free money' and that it wouldn't even slow down his saving for his first home as the $1,000 (but not the government's $500) can come back out again when he's ready to buy under the First Home Super Savers Scheme.

4. SMSF costs

Are there costs you've paid for your SMSF personally that should actually have been paid by the SMSF? If you don't get those reimbursed, they get treated as a contribution. For example, Jim has insurance in his SMSF and paid the premium ($3,000) via his personal credit card in June. If he doesn't get his fund to pay him back, the SMSF's income tax return will have to show that this was an expense incurred by the fund but Jim paid it and in doing so effectively made a $3,000 contribution for himself.

If he's already used up his contribution limits this will potentially cause him big problems. Technically there's nothing magic about 30 June here. Jim just has to make sure he's reimbursed 'promptly'. But in practice, it's actually much easier to make sure it's all done in the same financial year.

5. Thinking ahead for contributions in 2022/23

Believe it or not, June is also a time to be thinking ahead for the next financial year. Many super rules depend on how much you already have in super.

For example, most people can make up to $110,000 pa in personal contribution (where no tax deduction has been claimed). Some can make multiple years' contributions at once and contribute up to $330,000. But anyone with $1.7 million or more in super at 30 June 2022 has a cap of $nil for these contributions.

What if you can see that your super balance will be *slightly* above $1.7 million at 30 June 2022 but would still like to add to your super in 2022/23? If you're already eligible to take money out (for example, you're over 65 or meet the definition of 'retirement' in the super rules), it might be worthwhile taking a small withdrawal in the next few weeks to scrape in just under that threshold.

Then, in the new financial year, you can put this and more back into super. Don't forget there are new rules from 1 July 2022 that will make it possible to contribute much later in life. In future, retirees can continue making most super contributions up until they turn 75.

There's never a dull moment when you have an SMSF but June and July are months requiring extra focus.

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 and is based on an understanding of relevant rules and legislation at the time of writing.

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

Steve Bennett on the latest trends driving commercial property

Graham Hand

Steven Bennett is Chief Executive Officer of Charter Hall Direct, part of the Charter Hall Group (ASX:CHC), and is responsible for funds under management of over $10 billion in unlisted property funds.

GH: Which sections of commercial real estate are most resilient to rising inflation and interest rates?

SB: Any asset class that can exhibit strong income growth or pricing power is generally resilient to inflation and interest rates, regardless of whether you're talking equities or commercial property. A key advantage of

Australian commercial real estate is the fixed rent increases. They may be CPI or a fixed percentage but contractually, they're locked in on an annual basis. For example, our $3.2 billion Direct Office Fund has annual average increases of 3.6% which in the context of long-term inflation targeting by the Reserve Bank of 2% to 3% is attractive. Many buildings have 'triple net leases' where the tenant is responsible for building outgoings (see explanation in previous interview).

GH: Do many of the leases build in CPI increases?

SB: Of the $61 billion of real estate that Charter Hall manages, about 25% is CPI-linked, 24% is triple net leases and the balance is a combination of fixed rental increases. It varies by fund. The best protection is to have pricing power in your assets. In an office building, that means prime institutional-grade assets, with good amenity, cafes and restaurants, close to public transport, strong ESG. In the industrial space, proximity to infrastructure, toll roads, motorways, ports. These features give the ability to protect the rental yields, but secondary or lower-quality assets where there's a lot more choice and people don't necessarily need to be in those assets long term are more difficult.

GH: Is there a part of the market which doesn't have this level of pricing power?

SB: In the last few years, although we're not really in this space, the large discretionary malls with discretionary tenants that are competing against online entrants have had a difficult time maintaining headline rents, and some of those asset values have come off 15 to 20%. At the other extreme, the small neighbourhood shopping centres anchored by a Coles, Woolies or Aldi are extremely resilient. They continue to increase their sales turnover and it's been a good story for investors in non-discretionary retail.

GH: Yes, we still need to buy groceries. We all know about the labour and materials shortages in the residential side, but how has it affected your business?

SB: We have a large development pipeline across the Charter Hall Group, roughly $12 billion spread $7 billion in office and $5 billion in industrial logistics. But because we're building to own the assets long term, and not necessarily for speculative development, we approach our developments differently. We've de-risked them wherever possible with pre-committed leases, we use fixed price building contracts and we only employ tier one building firms that are financially strong.

We also benefit from experienced development teams, and they've been on the front foot ordering components and parts. For example, at 60 King William Street, our new Adelaide office development, we ordered the plant and equipment early. At 555 Collins Street in Melbourne, we have 13 levels of glass facade in storage in Australia. It reduces the supply chain issues that are coming out of Asia and China in particular.

GH: Do you have a view on when these global supply issues might return to 'normal'?

SB: Lots of variables there. Shipping costs are still elevated, higher building costs especially in locations outside Sydney and Melbourne. We are expecting pricing to stabilise later this calendar year and through into 2023, but it's dependent on globally moving away from Covid-zero policy settings.

GH: What are some of the global trends in commercial property that we might see more in Australia?

SB: Offshore the build to rent or multifamily sector is continuing to develop. Additionally there is a large and growing focus on allocations into property which are underpinned by data centres, biosciences and a renewed focus on health and education facilities.

GH: Biosciences, that's like the big facilities producing vaccines, that sort of scientific work?

SB: Yes, exactly. We've got an asset that does the Red Cross blood distribution at Alexandria in New South Wales, strategically located near the airport. They can move highly perishable items at short notice and they have 24-hour deliveries coming and going from that centre.

GH: If you think back to pre-pandemic days, say three years ago versus now, what have been the major changes?

SB: There's more focus on tenant quality than ever before, finding tenants that are financially strong, with good balance sheets, ample free cash flow and strong demand for their products. For example, with our own PFA Fund in the office market, 60% of the rent is paid by federal and state government entities. Our two office funds are attracting equity investments because of that.

I do think some people have made strategic mistakes underestimating CBD activity. For example, they moved their small offices to working from home a two-hour commute from the city but they are missing the eye-to-eye personal contact involved in winning business. There are great things about working in the CBD.

On the ESG side, particularly the "E" for environmental, we receive questions from investors on whether our properties or the tenants within them are delivering positive environmental outcomes. In the office markets, there's a major flight to quality with prime space seeing the lion's share of tenant demand, and there's an increased obsolescence risk for inferior offices. In industrial and logistics, there is a turbocharged universe with three trends around onshore versus offshoring, just-in-case inventory versus just-in-time inventory, and the continued growth of ecommerce. In retail, people now have a greater understanding of the difference between discretionary and non-discretionary retail.

GH: So what's happening with B-grade office buildings?

SB: Tenants want space that hits their environmental rating, and it's very difficult to deliver those standards on B- and C-grade assets. The capital cost can be prohibitive and sometimes you functionally just can't do it. And if a company wants its team back in the office, it needs a more flexible workplace, areas that encourage collaboration, where staff want to work in a pleasant space with great natural light. If you're not offering those things, why would staff want to come back into the office? So the pandemic has sped up the risk of obsolescence in the lower quality assets.

GH: Charter Hall offers both unlisted and listed funds. If an investor is looking for exposure to property, does the business make a case one way or the other one?

SB: We don't believe that one form of property investment structure is inherently superior to the other. We do run three large listed property vehicles (retail ASX:CHC, social infrastructure ASX:CQE, long WALE ASX:CLW) and of course, our parent is listed (ASX:CHC). We encourage people to check what structure suits their requirements. Liquidity is a key benefit of the listed market, but if an investor wants less variability in returns and prices linked more to the underlying value of the properties, then unlisted may be the way to go. It depends on the desired investment outcome. I've got both in my own SMSF because I don't want my entire portfolio doing the one thing, they work together.

GH: I'm the same. One aspect I like about the unlisted segment is it's easier to set-and-forget, there's no daily share market asking me every day to assess the price and I expect I'll just leave money there for decades. I want some of that as a core in my portfolio.

SB: Yes, and it does stop people from exiting the market at the worst possible time. For example, we have 10 funds in the direct suite, and the returns over the two-year period from March 2020 to March 2022 - completely pandemic-impacted - show the lowest return was 12.6% per annum and the highest return was 28% per annum. All other funds fell somewhere between. But if there was daily liquidity a lot of investors would have exited at the start of the pandemic and missed those great returns. So there is a lot of value in what you just said, take a long-term approach without assessing your investments each and every day.

GH: While no parent can have a favourite child, do you think there's a specific fund in your suite which is looking the best at the moment?

SB: We don't like to give investment advice, even in interviews like this, so let me describe some trends and allow people to draw their own conclusions. The biggest growth is in the Charter Hall unlisted Long WALE (Weighted Average Lease Expiry) Fund. It's diversified, pays monthly distributions at a rate of 5.4% per annum, and we pick the sectors we think will deliver the best medium- to long-term returns. The biggest flows by quantum are into the Direct Industrial Fund number four (DIF4) with industrial logistics and those three key thematics I mentioned before. And it may surprise people that we've raised over $250 million in our Direct unlisted office funds in this financial year, with many investors looking through the short-term noise around the pandemic.

GH: I know that management team would prefer to focus on the day-to-day business rather than worry about the Charter Hall share price, but it's been amazing to watch it go from $14 in early 2020, down to about $5 in the pandemic, then soar to $22 at the end of 2021, and now back to $13. It's been a rollercoaster, despite the business consistently continuing to grow. What's the feeling in the business? Is it frustrating that the market reacts with such extremes?

SB: We know that listed markets can be volatile and ultimately, we don't price the stock, the market does. The leadership team at Charter Hall focusses on driving the earnings. That's the one thing we can control, and we

believe that over the long term, the share price will follow earnings. Over the last five years, we've delivered EPS growth of 25% per annum and we aren't caught up in the day-to-day share price. Our underlying funds continue to outperform and that's why we've had such strong success in raising capital.

Graham Hand is Editor-At-Large at Firstlinks. Steve Bennett is Chief Executive Officer at Charter Hall Direct and was elected President of the Property Funds Association in April 2019. [Charter Hall](#) is a sponsor of Firstlinks. This article is for general information purposes only and does not consider the circumstances of any person, and investors should take professional investment advice before acting.

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Collateral damage follows the end of profitless prosperity

Roger Montgomery

The end of the free money epoch is now well and truly upon us. Over the last six months, the US Federal Reserve has pivoted from telling markets interest rates would remain at zero during 2022 to warning them it would move 'expeditiously' to a neutral setting. Meanwhile, supply chain disruptions and a lack of labour have contributed to previously unfathomable price increases for finished goods and services. And finally, Covid in China and a war in Ukraine have resulted in rapid increases in raw materials, fuel, and food.

Free money has its consequences

The free money experiment is at an end, absent a desperate act by central banks to kick the can down the road again, ahead of a yet unlikely deep recession.

There will many consequences of the end of free money including the impact of the misallocation of capital by venture capital and private equity during the free money bonanza.

We will eventually look back on this period as one defined by 'profitless prosperity'. This era permitted companies with no profit, and no prospect of making any, to exist. All those start-ups, paying salaries and marketing costs, could do so only because of the generosity of altruistic shareholders and lenders. And their altruism was fuelled by free money.

If interest rates on term deposits were 6-7%, many, if not most, of the start-ups funded by venture capital and private equity since the GFC would never have seen the light of day and therefore would never have signed an employment agreement.

And the longer rates remained at zero and QE provided liquidity, businesses that should not have existed not only survived but thrived and grew.

The growth of these businesses was the unprofitable kind. It did not matter whether a profit was made because money was free. The mantra was simple; grow revenue, take market share, and worry about profits later. Unprofitable businesses however are not self-sustaining. They exist purely because generous investors keep cheering them on with their wallets.

Creative destruction destroyed incumbents

But there's a downside and a terrible social cost. Incumbent businesses – often profitable but old-worldly – went bust as the bright shiny new idea took customers at a zero or negative margin. Nobody made money. The free money-wheeling investors tossed their dollars at shimmering new start-ups to see just how much creative destruction they could muster. And if at the end of the exercise, when all the competition was dead, the business did turn a profit, well that was a bonus.

But it wasn't the plan.

The plan instead was to sell the fast-growing company to unsuspecting mums and dads through an IPO. Let them worry about how to turn a profit. And if the company didn't, it's the mums and dads who bought into the IPO that would lose, along with the employees and the incumbents.

The venture capital investors simply needed the business to grow large enough to reach IPO. Unshackled by the need to make a profit as a going concern, these businesses could adopt stupid and unprofitable pricing models and operate with impunity by blinding regulators and city officials with the promise of making the world a better place.

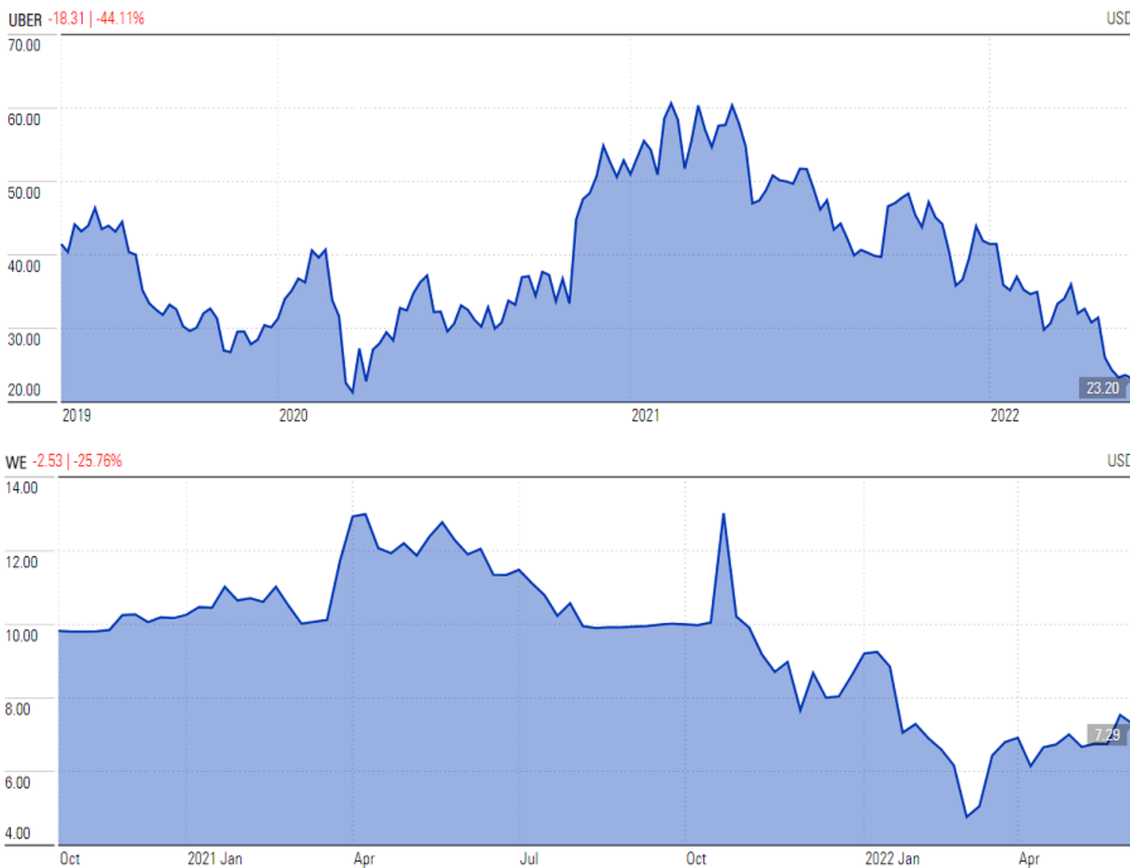
Back in September 2019, in an article entitled How soon until we see the collapse of profitless prosperity?, I asked:

"Is it just me? Or have investors in loss-making US technology companies, like Uber, gone completely insane?"

I then referred to WeWork's 2018 US$1.7 billion loss and Uber's US$3 billion operating loss in the same year:

"In normal circumstances, if a company announced that kind of loss, with no immediate prospect of stemming it, its shares would plummet. But today, the two companies still have an estimated market capitalisation of US$80 billion to US$90 billion. That's roughly the same market capitalisation as the Commonwealth Bank which generated US$6.7 billion in profits in 2018 or Volkswagen (US$14 billion in profits), Morgan Stanley (US$8.5 billion), Christian Dior (US$3 billion), Lockheed Martin ($US5 billion) or Caterpillar (US$6.1 billion)."

Today, Uber's market capitalisation, after a 62% share price fall from its high, sits at US$45 billion. WeWork's market cap is just US$5 billion.



Source: Morningstar.com, as at 2 June 2022.

Multiply WeWork and Uber's travails across the spectrum of profitless, artificially-propped-up hopefuls, and the destruction of wealth, the opportunity cost, and the missed productivity improvements to nations is immense.

Shareholders taken for a ride

In July 2019, I reviewed the 25 US tech companies that had IPO'd that year, raising a collective US$19 billion. The average gain on listing was 34%, although less than half could be classed as major tech companies. They were (percent gain from IPO to 3 July 2019): Beyond Meat, (>500%), Zoom Video (+170%), PagerDuty (+120%), CrowdStrike (+110%), Pinterest (+45%), Chewy (+47%), Fiverr (+30%), Fastly (+10%) and Lyft (negative).

The consequent share price falls from all-time highs of those same tech superstars is blood curdling: Beyond Meat is down 89% from its high, while Zoom Video is 81% lower. PagerDuty is down 57%, CrowdStrike (-44%), Pinterest (-77%), Chewy (+79%), Fiverr (-87%), Fastly (-87%) and Lyft is 77% down from its high. All have cratered.

In the absence of profit, and without continuous funding supplied by generous shareholders or junk bond investors many of the market's former darlings will go broke. Thousands of jobs will be lost and damage to the economy will be significant.

Already the funding of these companies is drying up. In May, junk bond issuance of US$2.2 billion was a fraction of the near US$50 billion in the same month a year ago. May's issuance was the slowest in 20 years. And according to Bloomberg, raising cash in the leveraged loan market has been equally depressed with new loan starts of under US$6 billion in May compare with more than US$80 billion in January.

Initially a round of mergers and takeovers will mask the suffering being felt by many profitless companies and their employees but the more expensive money becomes, the more likely a trickle will become a raging torrent of bankruptcies. And when that happens, a 'soft landing' becomes less likely.

We always knew the era of free money would have bad consequences. They have arrived.

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

Is the speculative fever in 'hot stocks' over?

Ashley Owen

Over two years from the Covid crisis in March and April 2020 to now, the market delivered price jumps in hundreds of tech stocks followed by a harsh reality check. The reasons for the surge in prices were simple: trillions of dollars sprayed around by governments, deficit spending their way to wartime-like debts, to boost incomes, save jobs, and encourage spending.

On top of this, central banks threw away their textbooks and set about to deliberately create inflation, cutting rates to zero (negative in Europe and Japan), and resorting to straight-out money-printing, to entice people to gear up to the hilt and spend. People everywhere threw their free or ultra-cheap money at just about anything, especially online retailing, tech, renewables, 'crypto' currencies, 'NFTs', and even boring old housing.

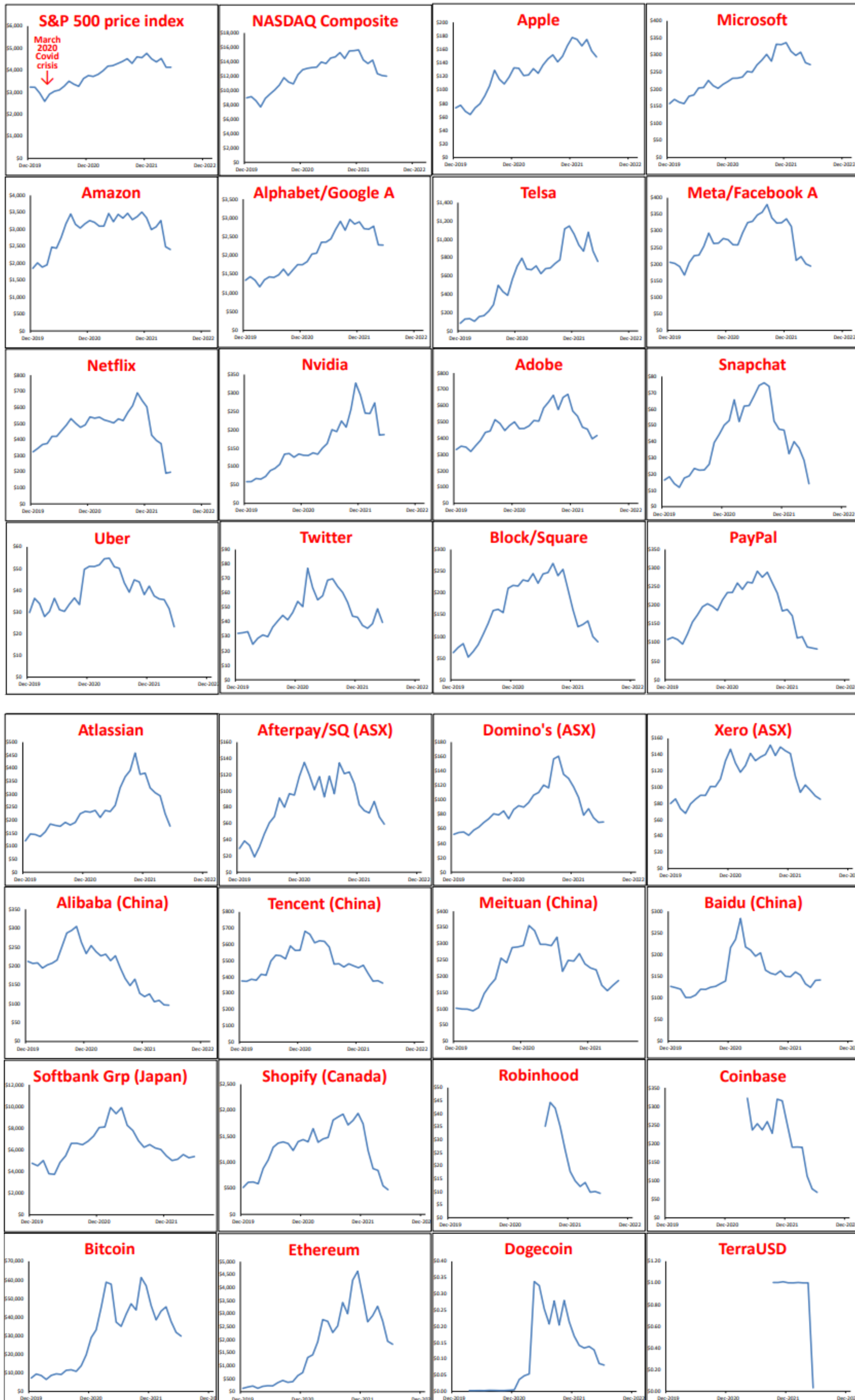
The days of reckoning

Here is a quick snapshot of the rise and fall (thus far) of the post-Covid tech fever. On the following page, are price charts for a couple of dozen stocks since the start of 2020 – ie just prior to the February-March 2020 Covid sell-off. At the top we start with the broad US S&P 500 and NASDAQ indexes, then several US tech/online stocks, and some key stocks in other markets, including Australia. We also include some crypto's, including the terraUSD 'stable coin'.

We have used no charting trickery to make price moves appear greater than they actually are. On each chart, the left scale starts at zero at the bottom, so if a price looks like it has doubled, or trebled or risen ten-fold (like Tesla and Bitcoin), or has fallen by more than half (most of them), then they have.

This is not intended to be exhaustive. It is to illustrate that the patterns are virtually the same in each case, regardless of the circumstances or merits of each individual company (or crypto).

As almost none of them pay dividends, half make losses, and most of the rest make only tiny profits relative to their prices, the charts reflect the rise and fall of mass hysteria – first surging in, and then fleeing.


S&P 500 price index
March 2020 Covid crisis
NASDAQ Composite
Apple
Microsoft
Amazon
Alphabet/Google A
Telsa
Meta/Facebook A
Netflix
Nvidia
Adobe
Snapchat
Uber
Twitter
Block/Square
PayPal
Atlassian
Afterpay/SQ (ASX)
Domino's (ASX)
Xero (ASX)
Alibaba (China)
Tencent (China)
Meituan (China)
Baidu (China)
Softbank Grp (Japan)
Shopify (Canada)
Robinhood
Coinbase
Bitcoin
Ethereum
Dogecoin
TerraUSD

Will the hysteria return to drive prices higher?

Is this just a temporary dip that will recover, or will the mass-selling continue, or pause?

Sentiment changed in early 2022, and the reasons are also clear. It was the sudden realisation that the era of free and ultra-cheap money is over. Inflation surged well before Russia's invasion, and central banks finally started to end QE money printing and raise interest rates back toward more 'normal' levels. There is much debate about exactly where 'normal' is for cash rates in each country, but it is certainly much higher than where they are now.

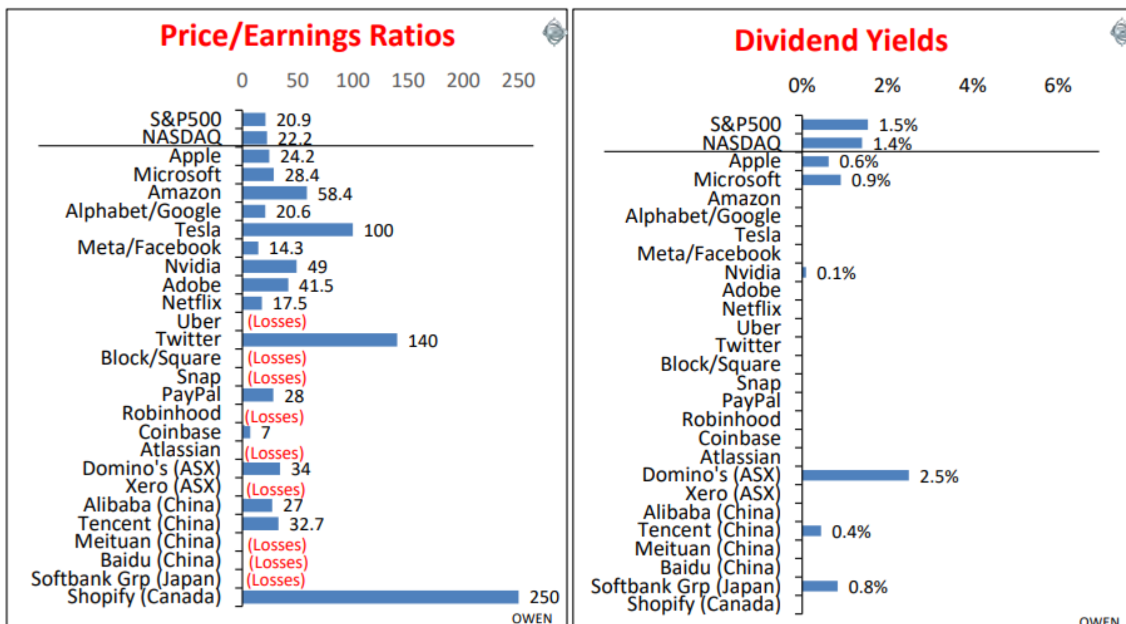
The bell at the top of the market was probably the January 2022 Superbowl, dubbed the 'crypto Superbowl', which featured slick ads showing famous movie stars spruiking cryptos as a sure way to get rich. (This is fitting, as the bell at the top of the late 1990s 'dot com' boom was the January 2000 Superbowl, dubbed the 'dot-com Superbowl'. It featured TV ads for 14 profit-less 'dot-com' start-ups that promptly crashed in the 2001-2002 'tech wreck').

Will central banks suddenly switch back to rate cuts and QE? Not while inflation is running well above target, unless there is another major economic contraction (deep recession with high unemployment, like the in 2020). If that does occur, share markets would have already fallen and started to rebound by then.

On the 'fiscal' (government spending and taxes) front, governments are still deficit spending, but the pace of spending increases has slowed significantly, and many programs have ended. Governments are under pressure to scale back spending and are even talking of raising taxes (e.g., tax hikes in Joe Biden's election policy agenda).

Is pricing now more reasonable?

Has the recent sell-off brought prices back down to levels that are now 'fair' or reasonable (or perhaps even cheap?). Here are the price/earnings ratios and dividend yields for the broad market and for our tech/online stars:



On the left, we can see that price/earnings ratios are a not-too-expensive 21 for the US market as a whole. As a general rule of thumb, a P/E ratio above the high teens is getting expensive and is only justifiable if the company can generate and sustain above-market profit growth well into the future. Here we see that the P/E ratios of the tech and online stars are well above that in almost all cases. Half of them make losses, so they don't even have any 'E' (earnings) for us to calculate the P/E.

The current high pricing relies on assumptions of continued boom-time rates of profit growth, and many of these are going to be a lot more difficult to sustain as monetary and fiscal support is withdrawn, and as higher inflation and interest rates constrain spending, revenues, margins and profits.

The right chart highlights that there is almost a complete absence of cash dividends. This is important for the broader market, as the top half dozen stocks on the list are not just large tech/online stocks. They are the largest companies in the US market, and the largest in the entire world, so they drive global returns. (Australia's Domino's Pizza is seen as a hot tech stock for some bizarre reason, but it is by far the biggest dividend payer).

These numbers suggest profits need to remain strong (with inflation and interest rates not rising too high) or prices have further to fall.

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When do demergers work? Backing the ugly duckling

Anthony Aboud, Sean Roger

As an active value manager, we like investing in companies where we believe there are hidden assets not being properly valued by the market. Sometimes it takes a demerger for parts of a business to really show their worth.

Demergers often work

We have looked at all the significant Australian corporate demergers over the last 20 years to determine whether they added value and if we could glean any insights from the trends this analysis revealed. Intuitively, splitting a company in two shouldn't create any additional value given the cost of the transaction and the ongoing costs associated with duplication of overheads.

However, our research has indicated that some demergers create value. Broadly, we found that the continuing entity – the larger portion of the split up that often retains the CEO and Board of the previous company - narrowly outperformed the S&P/ASX 200 in the following couple of years. However, the demerged entity outperformed this market significantly in the following two years. On our estimates the median outperformance is around 35% over two years, although there is a massive range in outcomes.

Some examples of demerged entities which have performed very well over a longer period were Dulux (spun out of Orica in 2010), Treasury Wine (spun out of Foster's in 2011), Henderson (spun out of AMP in 2003, figure 1) and Orora (spun out of Amcor in 2014, figure 2).

Figure 1: AMP (blue line) and Janus Henderson Group (red line)

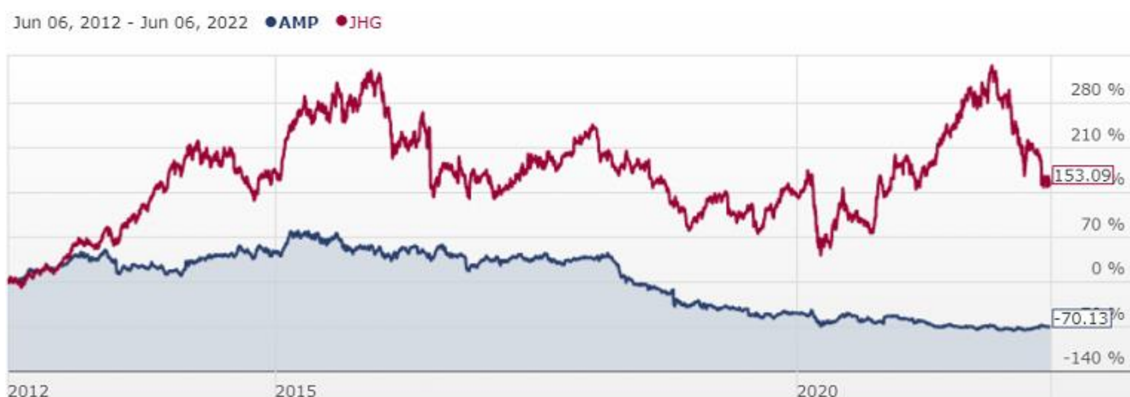
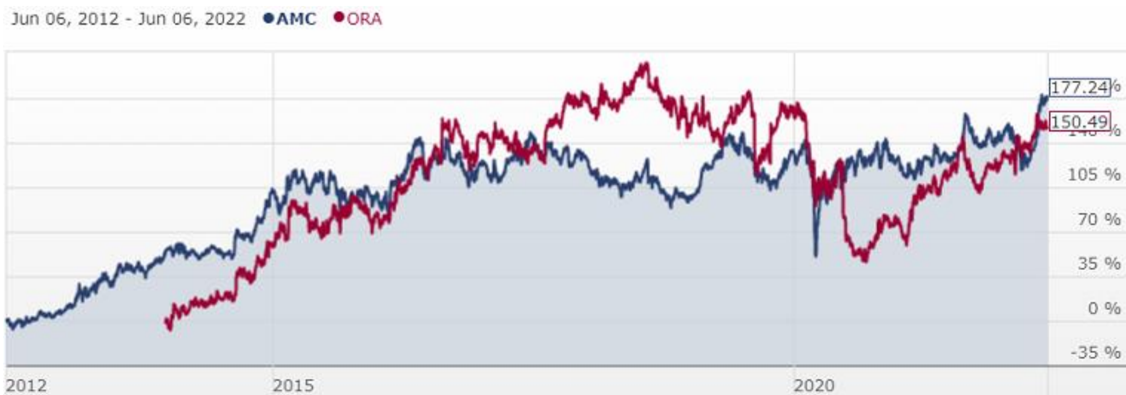


Figure 2: Amcor (blue line) and Orora (red line)



However, demergers don't always go well. Paperlinx (spun out of Amcor in 2000) and Onesteel (spun out of BHP in 2000) did not end well for shareholders. The range of outcomes is significant with Asciano (spun off from Toll in 2007) underperforming by 49% in the following two years while Australian Wealth Management (spun off from Tower in 2005) outperformed the market by almost 200%.

When are demergers successful?

Our analysis of demergers concluded that there are two fundamental reasons behind their success.

1. Splitting the company into two bite-sized pieces increases the chances that one of the two companies will get acquired. Of the 28 demergers we analysed, 18 saw at least one of the two parts taken over, generally within a couple of years.
2. The demerged entity received more attention once it had been demerged. Commenting on Orica's successful demerger from Dulux we noted (Perpetual SHARE-PLUS Long-Short fund update, January 2020):

"Capital allocation, human resources, marketing etc. would be completely different between these two businesses (paint and explosives). Once demerged, attracting and retaining top quality management is made easier as employees of the demerged entity can be incentivised with equity in an entity in which you can make a difference rather than being part of a larger conglomerate."

Senior staff choose where to work

Our view is that while CEOs or chairpersons usually won't reveal which division of the company they are most excited about, they all have their favourites. Capital is a scarce asset and, when push comes to shove, capital will tend to gravitate to the 'favourite child'.

Conversely, when there are extra corporate costs, they will tend to be shoved over to the less-favoured division, which has the impact of understating the earnings of this entity. After a demerger, the CEO and chairperson are eventually forced to make a choice about which division is their favourite as they must make the decision about where they will remain.

In the recent demergers of Woolworths/Endeavour, Graincorp/United Malt and Iluka/Deterra, the CEO and chairperson both decided to go to Woolworths, United Malt and Iluka respectively. What typically then happens is the 'ugly duckling' company will get a new CEO, a new board and generally a new culture. Divisional management is often promoted to the C-suite and there emerges an almost underdog status within the new company.

We think that some of the outperformance that may follow can be explained by this renewed focus a demerged entity gets from its leadership group.

And this runs potentially deeper over time. The new team running the demerged business is unshackled from corporate overheads and other frustrating constraints. This can give way to a new culture which is hungrier, leaner and more agile. The demerged business can make the right investments and seize on market opportunities without having to prepare a pitch book for head office. We have observed from the performance of recent demerged entities like Endeavour, Graincorp and Deterra how a new culture and lease on life can take hold post demerger.

Figure 3: Woolworths (blue line) and Endeavour Group (red line)

Figure 4: Graincorp (blue line) and United Malt Group (red line)

Figure 5: Deterra Royalties (blue line) and Iluka Resources (red line)

Why lifecycle matters in company demergers

It is easy to think that some companies are natural market leaders with a great culture baked into them while other companies are badly run with a poor culture that is likely to be terminal to the business. Most companies are somewhere between these two absolutes. They go through periods of good decision making and periods of poor decision making.

Poor decision making often occurs when things are going well. Either the cycle is in the company's favour, or the management team is basking in the glory of some previously-astute decision making. We believe the contra is also true. When people or companies have their backs against the wall, management teams tend to make their best decisions.

One example is the supermarket sector in Australia. While there are smaller competitors competing for market share, it is essentially an oligopoly with Coles and Woolworths. The last couple of decades has seen the ascendancy in terms of size, profitability and share price swing between the two heavyweights. We have

observed an almost seven-year cycle as each of the major retailers moves from 'outhouse to penthouse' relative to the other and vice versa.

When Woolworths had the ascendency in the mid to late noughties, it focussed on rolling out new stores and maximising short-term profitability through price increases. It thought it was a good idea to start a new hardware business, Masters, from scratch. This ended badly for shareholders as the company stretched its balance sheet and, in our view, got distracted away from their core business of selling groceries.

However, this is when we observed the board and new management start to make smart investment decisions. These included shutting down Masters, taking the short-term profit hit by improving their service and dropping prices. It also invested in the store network and its supply chain, developed a best-of-breed online offering, and demerged their bottle shop and pubs business, Endeavour.

This example illustrates one of the reasons that demergers tend to work. They are executed when a company is going through that part of its lifecycle where it works out that it cannot be all things to all people. Our observation is that this tends to be a decision made by a humble CEO and board who are focussed on shareholder value and understand what that company's core skillset.

Markets prefer pure plays

A final point on successful demergers is that they often work because the market ascribes a higher value to a 'pure play' company than a division within a conglomerate. For us, the fact that market participants are unwilling to assign the same valuation to the same business within a corporate structure as it would if it were to be standalone creates opportunity. When the sum of the parts is worth materially more than the market value, it may make sense for the company to demerge to realise that value.

Further, retail investors often follow a specific investment theme and this may break down when assessing a company which has two divisions with materially different investment traits. Take Graincorp pre-demerger as an example. The malt business (subsequently called United Malt) was perceived to be a 'low growth compounder'. The rest of Graincorp would be put into the 'deep cyclical' camp. The low growth compounder investors didn't like the volatility associated with the cyclical part of the business and the deep cyclical investors didn't like the boring United Malt business as it diluted the cyclical leverage.

By separating these different businesses, completely different shareholders are attracted to the two companies over time. Management can then run capital management and make investments based on its specific earnings stream and shareholders preference rather than a hybrid of the two.

While this is a poor reason to initiate a demerger in isolation, it is an explanation as to why the right demergers tend to work. As value investors, we like finding companies like these hidden gems within larger conglomerate companies where the market has been unwilling to ascribe a proper value.

Anthony Aboud is a Portfolio Manager and Sean Roger is a Deputy Portfolio Manager at Perpetual Investments, a sponsor of Firstlinks. This article contains general information only and is not intended to provide you with financial advice or take into account your objectives, financial situation or needs. Stock charts are provided by Morningstar.

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Three reasons high inflation may trigger a European crisis

Michael Collins

Italy's 66th post-war government collapsed in January 2021 when a coalition led by Prime Minister, Giuseppe Conte, crumbled. President Sergio Mattarella encouraged the parties to revive the alliance so he could avoid calling a snap general election during a pandemic.

But the talks failed. As concerns grew that any election might usher right-wing populists into power, Mattarella pulled off a masterstroke. He unexpectedly contacted Mario Draghi; yes, 'Super Mario' who saved the euro in 2012 with his 'whatever it takes' comment. Mattarella asked the Chief of the European Central Bank to form a 'national unity' government. Within days, Draghi become Italy's 29th prime minister since 1946.

The bellwether of European risks

Investors were pleased. On 13 February, when Draghi became Italy's fourth unelected premier since 1993, the 'lo spread' – the yield at which Italian 10-year government bonds trade over their German equivalents, a number that is judged the bellwether of EU economic and political risks – had narrowed to a five-year low of just under 1% (100 basis points).

Draghi's government retains the confidence of investors yet the lo spread has widened to 200 basis points. What malfunction occurred that widened the gap towards the 300 basis-point level that is seen by many as the tripwire for a crisis?

The culprit, like elsewhere in the world, is inflation. Eurozone consumer prices surged a record 7.4% in the 12 months to April 2022 due to promiscuous monetary and fiscal policies, rising energy prices, pandemic-related supply blockages and Ukraine-war related disruptions.

The ECB has one objective; to maintain price stability, which is interpreted as keeping inflation below 2%. The central bank has little choice but to tighten monetary policy by raising rates and ending its asset buying.

Rising rates bring more worries

Many central banks are doing likewise to tame inflation. For most countries, the main threat is the resultant slowing in economic growth boosts the jobless rate to worrying levels if economies slump into recession.

For the eurozone, the ramifications of tighter monetary policy are more concerning for three reasons.

The **first** is the ECB is poised to stop acting as the buyer of last resort for its almost-bankrupt 'Club Med' members such as Italy, where gross government debt stood at 151% of GDP at the end of 2021. That cessation could trigger a bond sell-off that puts the finances of debt-heavy governments on an unsustainable footing. National government and commercial lenders holding their government's debt might become entwined in a downward spiral. The ECB would be exposed as lacking any credible way to quell such a government-bank suicide bind.

The **second** problem with tighter monetary policy is the resultant downturn will remind indebted euro-users that they have no independent monetary policy to help their economies, nor a bespoke currency they can endlessly print to meet debt repayments or devalue to export their way out of trouble. The only macro tool domestic policymakers possess is fiscal policy but that is maxed out. Populist Italian politicians are bound to talk of readopting the lira.

The **third** means by which higher inflation is poisonous is it creates a fissure between the area's creditor and debtor nations that would make it harder to find durable solutions for the euro. Inflation-phobic but inflation-ridden Germany and other creditor countries will battle with debt-heavy France (government debt at 113% of GDP), Greece (193%), Italy, Portugal (127%) and Spain (118%) over how far the ECB should go to rein in inflation and how it might help the strugglers.

To maintain its inflation-fighting credentials, the ECB must tame inflation even if that stance crushes economic growth. The core concern of such tight monetary policy is that it would expose how the euro's flawed structure – that it is a currency union without the necessary political, fiscal or banking unions – has become explosive due to the large debts of southern eurozone governments.

Whither Europe's fate?

To be sure, policymakers are likely to once again thrash out some last-minute fudge that defers a denouement on the euro's fate. But temporary solutions are only, well, temporary and the euro needs a durable resolution. The indebted south could win the political tussle such that the ECB never makes a serious attempt to tame inflation. But that path might only delay tighter monetary policy and subsequent detonations. The cost of servicing public debt, while rising, is still historically low, which reduces the likelihood of missed debt payments and a crisis.

Eurozone governments are restarting efforts to create a proper banking union but success is not assured. The lo spread is well short of the post-euro record 556 basis points it reached in 2011 during the eurozone crisis that was triggered by the current-account imbalances among members. But Rome's debt was only 120% of GDP then, and that gap narrowed only due to ECB support that is now waning because the problem today is inflation.

Germany's economic slump and dislike of inflation will ensure Berlin pressures the ECB to prioritise inflation. The lo spread could widen enough to threaten a flawed currency union, especially if member countries are squabbling over solutions. While Draghi 'the central banker' could bluff investors, Draghi 'the politician' has no similar obvious masterstroke. To all the world's problems, be prepared to add elevated doubt about the euro's long-term future.

Michael Collins is an Investment Specialist at Magellan Asset Management, a sponsor of Firstlinks. This article is for general information purposes only, not investment advice. For the full version of this article and to view sources, go to: https://www.magellangroup.com.au/insights/.

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Gold remains solid as Bitcoin melts

Sawan Tanna

Among a group lamenting the worrying state of the world – war in Eastern Europe, carnage on stock markets, inflation driving up cost of living pressures – one group of investors is uttering in despair: *"I can't look at my crypto wallet right now. It's losing so much!"*

The price of Bitcoin fell below USD30,000 in May 2022 and has struggled to make headway since. The last time the price fell this low was July 2021. Later that year it surged towards USD69,000. Now the market has been spooked into a radical reversal for those who have bought into the 'digital gold' narrative amid new concerns about the amount of electricity consumed by miners of Bitcoin.

A store of value? A hedge? What is it?

Often used to promote cryptocurrencies, the line argues that Bitcoin can provide a store of value similar to gold. Supposedly negatively correlated to financial markets, Bitcoin and its ilk will help protect the overall value of an investment portfolio in troubled times, or so its backers claim.

And yet, Bitcoin's slump is coinciding with the sell off on Wall Street and other markets worldwide. Stephen Bartholomeusz wrote in the Sydney Morning Herald.

"The selling points for crypto assets used to be that they weren't correlated to other assets classes and therefore would provide diversification from conventional holdings of shares and bonds and also provide a hedge against inflation. It turns out none of those previous investor convictions has proven true."

Others point out that Bitcoin has been behaving more like a speculative tech investment. Research published by The Perth Mint in February 2021 indicated that Bitcoin beat gold for generating speculative returns in a rapid fashion but it was 12 times more volatile than gold.

While Elon Musk, the world's richest man, may be relatively unconcerned by Bitcoin's recent performance, everyday investors, inspired by his enthusiasm for the crypto, are clearly feeling the pinch.

I believe it is still too early to claim Bitcoin can replace gold but understand that the media 'buzz' created by high-profile investors will keep it front of mind for many. Without so many column inches, the benefits of gold are often more opaque, particularly in the minds of new investors. Given the excessive volatility of cryptos like Bitcoin, it's a good time for anyone seeking refuge for their money to familiarise themselves with gold's track record.

Gold is one of the best performing assets this millennium

Gold has been one of the best performing asset classes of the current millennium. The table below highlights end of year gold prices in both US dollars and Australian dollars per troy ounce, and the calendar year returns seen across the last 20 years.

End of year gold prices in US and Australian dollars and % returns since 2001

Year	AUD gold price return %	USD gold price return %	AUD gold price	USD gold price
2001	9.4	0.7	540.1	276.5
2002	14.2	25.6	616.6	347.2
2003	-10.4	19.9	552.5	416.3
2004	0.6	4.6	555.7	435.6
2005	25.9	17.8	699.3	513
2006	14.7	23.2	801.8	632
2007	18.4	31.9	949.6	833.8
2008	31.4	4.3	1247.5	869.8
2009	-3.1	25.0	1209.2	1087.5
2010	13.4	29.2	1371.2	1405.5
2011	8.9	8.9	1493.4	1531
2012	6.9	8.3	1596.5	1657.5
2013	-15.7	-27.3	1346.3	1204.5
2014	9.5	0.1	1473.7	1206
2015	-1.1	-12.1	1456.9	1060
2016	8.6	8.1	1582.5	1145.9
2017	4.3	12.7	1650.6	1291
2018	10.1	-0.9	1816.8	1279
2019	18.6	18.4	2154.9	1514.8
2020	13.9	24.8	2455.3	1891.1
2021	1.2	-4.5	2484.3	1805.8

Source: The Perth Mint, World Gold Council, LBMA, RBA

Despite the occasional negative calendar year return, long-term investors in gold have been well rewarded, with the price of gold rising by 553% in US dollar and 360% in Australian dollar terms over this period.

Gold's performance relative to other asset classes

Not only has gold performed well in absolute terms over the last 20 years, but it's also done so in relative terms, with the precious metal either matching, or in many cases exceeding, the returns generated by other asset classes.

The following table highlights the returns delivered by gold on an annualised rate of return over multiple time periods to the end of 2021, compared to the returns delivered by traditional asset classes, including Australian shares, cash and housing, over the same timeframe.

Asset class returns (%) over multiple time periods to end 2021

Asset class	1 year %	3 years %	5 years %	10 years %	15 years %
Gold in AUD	1.3	11.1	9.4	5.1	7.9
ASX 200	13.0	9.6	5.6	6.3	1.8
Cash	0.03	0.6	1.1	1.9	3.1
Australian bonds	-3.3	3.0	3.5	4.2	5.4
Australian REITS	21.6	8.5	4.7	8.5	-2.2
Balanced pension diversified fund before fees	11.1	9.1	7.5	8.6	6.3

Source: Chant West, The Perth Mint, Australian Bureau of Statistics, World Gold Council

The last 15 years are a testament to the beneficial role that gold could have played in a diversified portfolio.

Gold is an effective hedge against equity market falls

One of the chief arguments for gold is its ability to act as a hedge against volatility in the stock market. A look back at the performance of gold and the local equity market in Q1 2020 demonstrates this point. The

S&P/ASX200 suffered an almost 30% decline in March 2020 as fears over COVID-19 and the measures taken to limit its spread caused a huge decline in economic activity.

Over the same period, the price of gold in Australian dollars rallied more than 20%. The performance of gold during this time was not an anomaly. Instead, it was a continuation of a trend that has been in place for 50 years, with gold typically serving as an excellent hedge against falling equity markets.

Gold is an important diversifier even when equities are rising

Gold's positive role is not limited to time periods where shares fall sharply.

This table, which uses market data from 1971 to 2020 inclusive, reveals the average return for equities and for gold in the months, quarters and years when the equity market has risen, as well as when the equity market has fallen.

Average gold and equity returns when equities fall and when equities rise % – 1971 to 2020

Equity market	Time period	Equities %	Gold %
Equities rising	Monthly	3.9	0.8
	Quarterly	7.9	2.2
	Yearly	22.2	10.5
Equities falling	Monthly	(3.6)	1.0
	Quarterly	(6.7)	3.8
	Yearly	(14.7	16.7

Source: The Perth Mint

Gold is positively correlated to rising equity markets, and negatively correlated to falling equity markets. More precisely, the table tells us that:

- The average gain for equities in the months when equities rose was +3.9%. In the same months, the average return on gold was +0.8%.
- The average loss on equities in the quarters when equities fell was -6.7%. In these same quarters, the average return on gold was +3.8%.

Given all these credentials, investors can secure exposure to the gold price and government-backed physical gold on the listed market, such as Perth Mint's ASX:PMGOLD.

Sawan Tanna is the Treasurer of The Perth Mint, a sponsor of Firstlinks. The information in this article is general information only and should not be taken as constituting professional advice from The Perth Mint. You should consider seeking independent financial advice to check how the information in this article relates to your unique circumstances.

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Among offerings from The Perth Mint, the ASX-listed PMGOLD enables investors to trade in gold via a stock broking account as they would shares on the ASX. Tracking the price of gold in Australian dollars, PMGOLD holds more than 260,000 troy oz of the precious metal on behalf of investors. With a management fee of 0.15%, making it the lowest cost gold ETF on the ASX, it's unique in that client metal is fully underpinned by government-backed physical gold that exists within the Mint.

Two of the best-kept secrets for the EOFY

Chris Cuffe

It's been a while since I last wrote for Firstlinks, although if you check back over the years after Graham Hand and I founded its predecessor, Cuffelinks, you can read many of my articles. I'm still an avid reader each week, and about this time each year, I ask Graham to publish a small piece to make people aware of how they can receive a tax deduction on a donation now but choose charities to support later.

A best-kept secret to an immediate tax deduction

The month of June is often a catalyst for people to establish a structured giving account with the Australian Philanthropic Services Foundation (APS Foundation), which I still regard as one of the best kept secrets around. It's an especially useful structure for people who have done well in FY22 but have not had time to decide which charities to support.

APS Foundation is part of Australian Philanthropic Services (APS), a not-for-profit organisation I founded 10 years ago and for which I have been Chair during that period. I'm honoured to have on the Board other community-minded people such as David Gonski, Gail Kelly, Michael Traill, Jan Swinhoe, Tim Fairfax, David Ward and Dan Phillips.

In essence, APS offers fulfilling ways for people to manage their charitable giving over time using tax-efficient structures called *ancillary funds*. The APS Foundation is a what is known as a 'public ancillary fund'. It enables an individual, family or organisation to put aside money in a trust to support charities over the long term. They are an efficient, satisfying and tax-effective way to put a structure around your philanthropy.

Put another way, the APS Foundation is a communal philanthropic structure in which you can establish an account within 24 hours (known as a 'sub-fund' or 'giving fund'). The minimum is $50,000 to establish an account. While you think about which charities to support from your giving fund, the Foundation's giving funds are pooled and invested by APS. Returns are tax-free and accrue to your fund monthly, offering a style of giving that allows you to both give and grow money for charity as well as gaining a tax deduction.

There are two portfolios you can choose to invest into:

- the **General Portfolio** was established in 2012 and is managed by me. It is well diversified across the full investment spectrum. The performance (after fees) has been 12.0% pa since inception, and
- The **Focused Portfolio** opened this month and is managed by David Wright (co-founder and CEO of Zenith Partners). It will be diversified across investment funds and individually managed accounts with an explicit responsible investing/ESG objective, or in funds that generate a positive, measurable social and environmental impact alongside a financial return.

More information about the APS Foundation can be found here.

The APS Foundation is the fastest growing public ancillary fund in Australia. The Foundation comprises more than 350 giving funds, totalling almost $200 million. Last financial year, APS Foundation supported giving fund holders to make $13.7 million in gifts to charity.

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I'll also take this opportunity to remind people about how some investment structures work and the tax impact of investing in June. It can be a trap for the unwary and cause unexpected leakage in tax.

The timing of tax on distributions from a unit trust

In a unit trust, all income received (including realised capital gains) is divided among unit holders based on how many units they hold at the time of a distribution. Unit holders must then include their share of this income (which may comprise dividends, interest, capital gains and franking (imputation) credits) in their own tax return in the year it was earned.

The same distributions are paid to all unit holders according to their holding on a particular day, whether or not the investor has been in the fund **one day or one year.** Distributions are not pro-rated for investors who were not unitholders for the whole period. An investor may receive some of their investment back immediately as income if they invested just before a distribution.

Immediately after a distribution is declared, the unit price of the fund will usually fall by the amount of the distribution, because the distribution reduces the fund's assets.

Don't convert capital to taxable income

An investment in June that receives a distribution in July may be converting capital to taxable income. For example, if someone invests on 25 June 2022 when the unit price is say $1.00 and then a 10 cent per unit distribution is made on 30 June, the unit price will fall to 90 cents (assuming no market movement) at the

beginning of July. The 10 cents will be taxable income in the hands of the unit holder in their 2021/2022 tax return.

Obviously, the worst consequences are for individuals with high marginal tax rates where the distribution includes no franking credits. This might be the case for a global equity fund which distributes once a year with no franking credits from Australian companies.

Alternatively, an investor such as a tax-free charity or super fund in pension mode in an Australian equity fund might pay no tax and receive a franking credit, so a June investment might actually be favourable for them.

The only way to eliminate these effects would be for the fund trustee to make a daily distribution, but clearly this is not practical. The more often a fund distributes income during the year then the less of an issue this distribution inequity becomes. For example, most Australian equity funds distribute twice per year but most international funds only distribute once per year.

Other funds with particularly punitive outcomes for unit holders who invest close to a distribution date might be actively traded funds in a rising market. They might have large capital gains on shares not held for longer than 12 months (and therefore, not subject to the 50% CGT discount factor). The distribution might contain a large taxable capital gain component.

How do we handle the problem with the Third Link Growth Fund?

Many of you know I manage a unit trust, the Third Link Growth Fund. I consider this issue of such significance that from the start of May each year, I ask our administrator to contact every new applicant and check whether they understand the tax consequences. While this might cost us some application money in the short term, hopefully it builds a better long-term investor experience.

I also provide a health warning in the PDS for Third Link Growth Fund. It says:

"*Distributions are not pro-rated for investors who were not unitholders for the whole period, meaning that you may receive some of your investment back immediately as income if you invest just before a distribution.*"

Anyone who invests in a unit trust in June should at least ask the fund manager for an estimate of the distribution and its tax components, unless they want to share the tax burden for prior investors.

Chris Cuffe is Chairman of Australian Philanthropic Services as well as Portfolio Manager of the APS Foundation. Chris is involved with many other groups as a director, chairman and investment professional. This article is general information and does not consider the circumstances of any investors. The views expressed are his own.

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