Firstlinks
a Morningstar company

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Editorial

'Cakeism' was shortlisted for the **Oxford English Dictionary** word of the year in 2018 and is undergoing a revival. The language is always evolving, with new words entering our lexicon regularly. Cakeism comes from 'having your cake and eating it too', but the word now means variously '*a wish to enjoy two desirable but incompatible alternatives*' or '*proposing a future scenario that sounds better than is actually achieveable*'. Enter the **Reserve Bank** and **Governor Philip Lowe**. They want to simultaneously fight inflation by taking away spending power while not creating a slowdown that pushes into a recession. The massive injection of taxpayer money and stimulus helped cause the inflation which is now hitting the same people the money was supposed to assist.

And here's the dilemma for investors:

> *"Recession talk cannot seriously be applied to Australia. Westpac continues to forecast Australia's economy to grow 4% over 2022, led by consumer spending pent-up from Covid lockdowns into early 2022."* ***Sean Callow*, *Westpac***

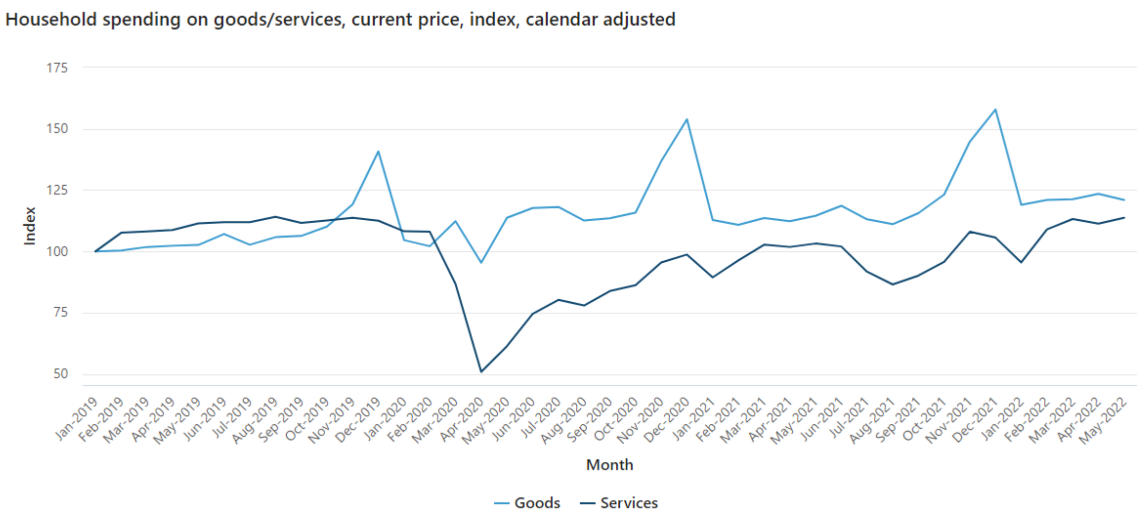
> *"Recession or not, the next 12-18 months is going to feel like one, especially for equity investors."* **Raheel Siddiqui, Neuberger Berman**

One of the reasons the Governor is speaking regularly at public and media events is his desire to talk down consumer optimism. Confidence is usually a good thing, but it is proving a headache for the Reserve Bank, as low unemployment and government assistance have encouraged consumers to spend.

This week, the ABS released the latest household spending for May 2022, showing a rise of 7.9% compared with the same time last year. **Jacqui Vitas, Head of Macroeconomic Statistics**, said household spending increased in all categories:

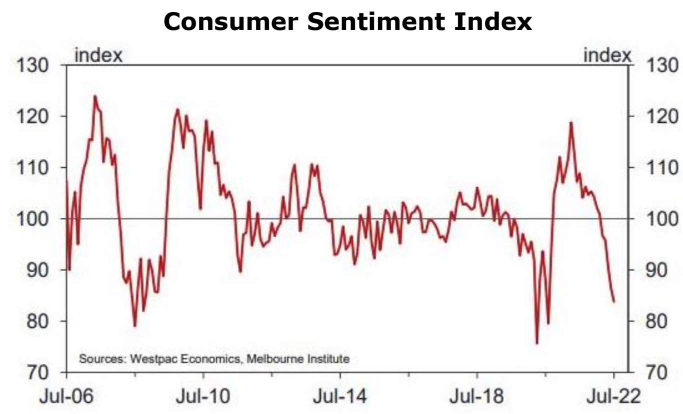
> *"Strength in the services categories was driven by transport (up 14.5%), as air travel continued to recover, and higher petrol prices increased motor vehicle running costs. Strong growth was also seen in spending on miscellaneous goods and services (up 12.6%), hotels cafes and restaurants (up 10.3%), and recreation and culture (up 10.0 per cent)."*

Compared to pre-pandemic January 2020, total household spending is 10% cent higher in current prices. The Reserve Bank started increasing cash rates on 4 May, but only by 0.25%, so perhaps the message had not reached enough people.



While this spending pushes Philip Lowe to raise rates, other indicators of consumer sentiment provide reason for the Reserve Bank to temper its new enthusiasm for rate rises.

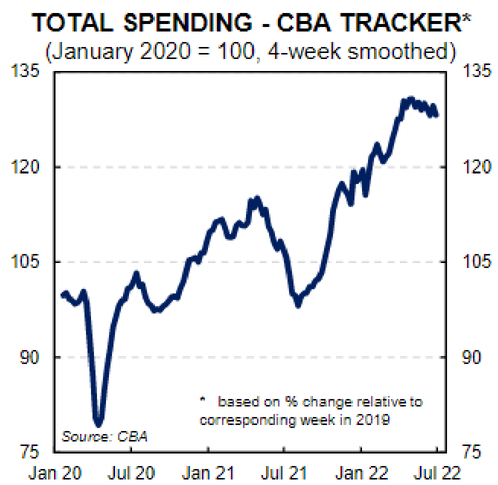
The **Westpac-Melbourne Institute** index of consumer sentiment is falling sharply, and is now at levels only seen during major disruptions. Consumer confidence is hit by economic events, such as the GFC and Federal Budgets, and of course, it took a severe hit in 2020 during the pandemic before recovering on vaccine optimism. It has now fallen for seven months.



What is the relevance of all this for interest rates? As **Westpac** says:

> *"The cash rate has increased at a faster pace than we have seen in any cycle since 1994 and this is clearly unsettling for consumers also facing a sharp rise in the cost of living. A more cautious approach will be appropriate once policy has moved to 'neutral' in August."*

More up-to-date data is provided by the **CBA** Tracker:



> *"Our internal CBA credit and debit card spending data to 8 July has been showing a clear decline in the pace of spending growth. The falls have also been more noticeable in some of the discretionary spending categories that households are likely to pull back on first. With prices continuing to increase, that indicates the volume of consumer spending is likely to be even softer."*

Back to cakeism. Perhaps Philip Lowe will enjoy a rich black forest rather than a simple sponge if consumer sentiment falls enough to stop him increasing rates toward the predicted 3% or even 4%. Thousands of borrowers will celebrate if he has his cake and eats it too. If borrowers want to help, they should stop buying stuff.

Hopes for inflation easing were not helped on Wednesday night when US consumer prices rose 9.1% in June 2022 from a year ago, above expectations. It's a 40-year-high driven by increases in gas, food and rent. The US market is now pricing in another 1% rise from the **Federal Reserve** later this month.

Which is all feeding into the ways Australians are investing, and three recent reports show the latest funds flows locally as well as globally. Compared with 2021, Australians have significantly changed how they are investing in 2022.

Another factor which is suddenly playing into the Reserve Bank thinking is the potential impact of a new Covid wave. I had my fourth jab on Monday, the first day it was available to under 65s, and I'm surprised how many people do not wear masks on public transport. I was in a lift on Monday where people piled in like the old days. We have become too relaxed. The implications stepped up this week when **Federal Health Minister Mark Butler** said Australians should [consider working from home]() to curb rising Covid-19 cases. He said millions of Australians may be infected in the last six weeks of winter.

It's time to pay serious attention to pandemic again. The latest subvariant easily overcomes immunity from prior infections and vaccines and increases the risk of reinfection. The same variant is taking hold in the US and China, and may go some of the way to slowing the economy instead of central bank tightening. **Adrian Esterman** checks the [evidence and numbers]().

Firstlinks has covered the banning of stamping fees paid to brokers and financial advisers in great detail, such as [here]() and [here](). Treasury is undergoing a post-implementation review of this 2020 policy, and we have gained [access to the full submission]() by the **Australian Shareholders' Association's Rachel Waterhouse**. It seems unlikely the policy will change, with **Stephen Jones, Minister for Financial Services** telling *The Australian Financial Review:*

"I will look at the report, but it would be an extremely high bar to get over. I am focused on more Australians getting access to quality advice, not opening up the door to conflicted remuneration again."

I'm with Jones on this one as there was plenty of evidence that brokers and advisers placed clients into funds based on receiving the fee. How else could a relatively unknown fund manager raise a billion dollars in a month?

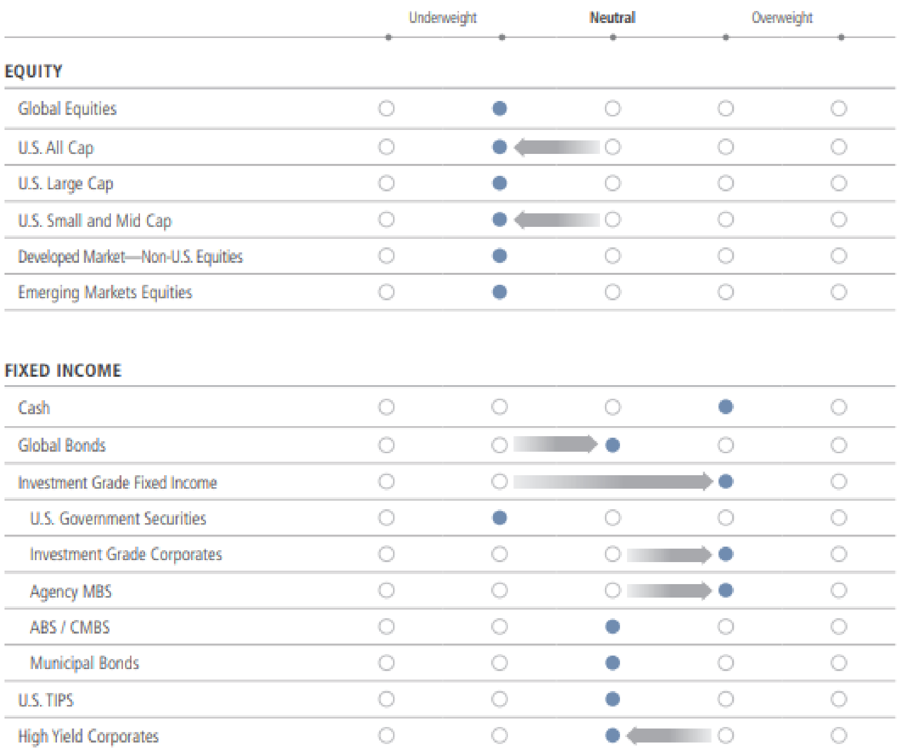
We welcome the return of veteran global pension consultant, **Don Ezra**, who gives an intriguing explanation of how our lives will change when living to 100 is normal. He sees a good life [lived in five acts]().

Ashley Owen shares one of his great slides to show what has happened to Australian [house prices over decades of inflation](), and yes, real price falls are common. The 40% increase in 2020 to 2021 was extraordinary and we are now paying for the stimulus largesse, but buying a home is a long-term decision and favourable fundamentals are still in play.

We tend to focus on averages when describing markets, such as the market went up '*x%*' or recessions usually last '*y days*'. **Robert Almeida** warns that [averages provide no insights]() into variations, and the peaks and troughs that can really damage a portfolio. Every market cycle or recession is different.

Some investors argue firmly for an allocation to gold, but others criticise it for the lack of income and price volatility. **Sawan Tanna** identifies [five major misconceptions]() in making the case for gold in a diversified portfolio.

Even if you don't usually read our White Papers, this week's from **Neuberger Berman** is well worth a look. Reporting on the Q3 meeting of their [Asset Allocation Committee](), they explain the rationale for making multi-sector portfolio adjustments like this:



In brief, more into quality bonds to earn higher yields, less into equities to avoid a possible earnings downgrade.

What are local and global investors doing in 2022?

Graham Hand

Three recent reports on asset allocations reveal plenty of changes in investor activity during 2022. They confirm Exchange Traded Funds (ETFs) are winning market share from unlisted managed funds, but local investors are now favouring Australian exposure over global. While flows into ETFs and managed funds have some similarities, there are some surprising differences.

To recap on stockmarkets in 2022, for example, the largest ETF in Australia, the Vanguard Australian Shares Index ETF (ASX:VAS) with $11 billion in assets, was down 12% in the last three months and 10% calendar year-to-date (as shown below). It was up 17% in calendar 2021. However, the S&P500 was down 20% in the first six months of 2022, its worst first half for 60 years.

Source: Morningstar

Australian managed fund flows

Following good net flows into managed equity funds of about $850 million in April and May 2022, by June, sentiment had turned sharply negative. Net outflows reached $250 million in the month of June 2022, with Australian equities rising marginally but global equities facing heavy withdrawals, according to Calastone's Fund Flow Index. For the June 2022 quarter overall, net flows to managed equity funds fell to $600 million, versus a record $6.3 billion in the third quarter of 2021. As often happens, investors tend to commit money based on prior results, and market rises build confidence and justify optimism. Equity fund inflows then collapse as the market falls.

Figure 1: Calastone net fund flows across selected **equity** categories, all AU domiciled

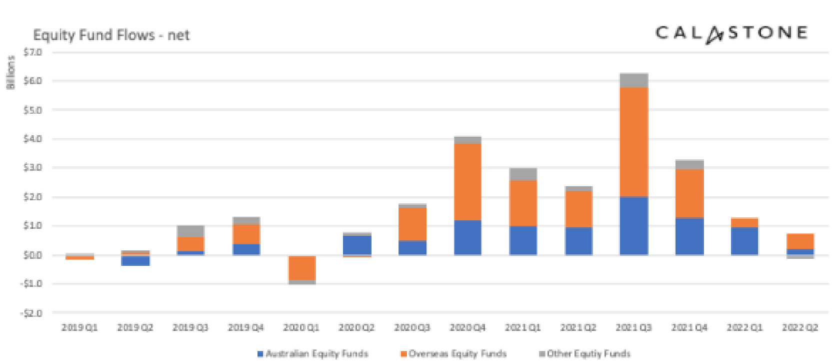
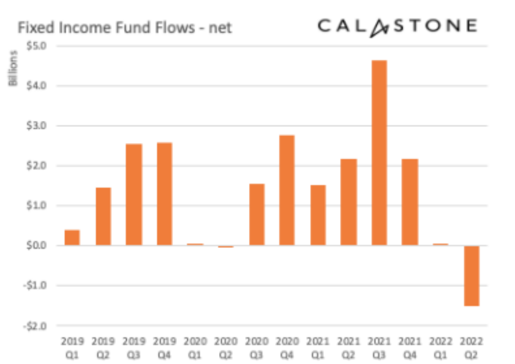


Figure 2: Calastone net **fixed income** fund flows, all AU domiciled



Fixed income funds fared even worse, and by June 2022, investors had withdrawn fixed income funds for four consecutive months. Net outflows were over $1.5 billion in the June quarter, mostly in June alone.

The above numbers are a good sample as more than 95% of Australian managed fund flows pass across the Calastone network.

Australian ETF flows

However, while Australian equity ETFs also did much better than global ETFs in the June 2022 quarter, fixed interest was much stronger, according to new data released this week by Vanguard and the ASX. Australian fixed income ETFs recorded $806 million in inflows, a significant increase over the first quarter. Cash ETFs were well down while global fixed income also saw outflows.

As with managed funds, Australian equity ETFs raised significantly more money than global equity, a reversal of flows in 2021. While investors have missed some of the gains from a declining AUD in unhedged global funds, the Australian market has performed much better than the US, which no doubt discouraged global allocations.

Australian ETF market net cash flow by asset class (Q2 2022 v Q1 2022)

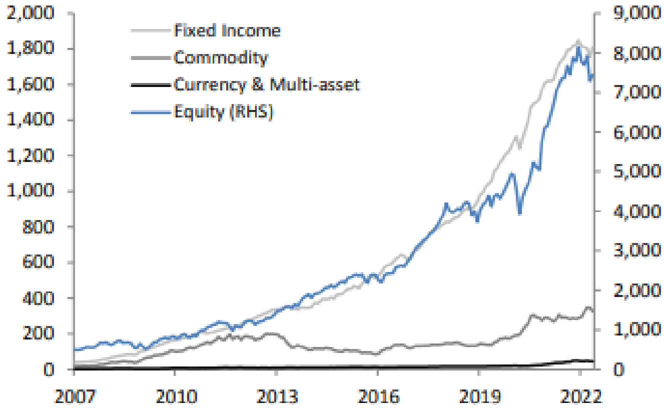
Asset class	Q2 2022 Cash Flow ($m)	Q1 2022 Cash Flow ($m)
Global equity	489.5	1626.4
Australian equity	1700.9	1080.2
Australian fixed income	806.3	325.0
Commodity	107	124.8
Global fixed income	-35.7	277.8
Cash	-313.5	-554.5
Multi asset	196.9	310.2
Infrastructure	35.6	55.2
Australian property	51.2	121.6
Global property	74.6	1315.6
Currency	0.7	-3.6

Global ETF flows

The third new report comes from JP Morgan and addresses funds flows in global ETFs. There are about 10,000 ETFs listed globally, up from 3,700 in a decade, now holding around US$10 trillion.

For many years after the first ETF was launched in 1990, they were based only on broad equity indices, but from about 2005, interest in non-equity ETFs started to grow. But equity ETFs still dominate, comprising 77% of global ETF assets, with fixed income at 19%, commodities at about 3% and others much smaller. Note this first chart (Fig6) give equities a separate axis on the RHS.

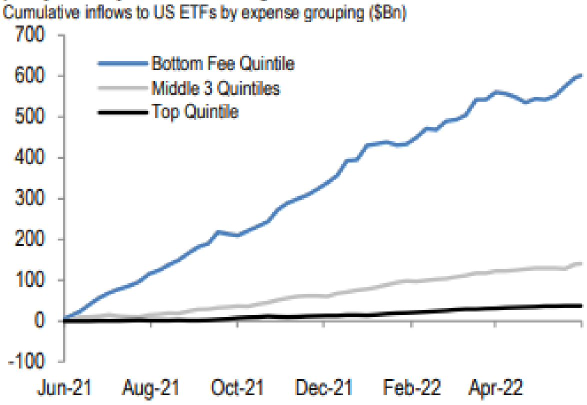
Figure 6: Global AUM historical trends by ETF type ($Bn)



Source: J.P. Morgan Quantitative and Derivatives Strategy, Bloomberg Finance L.P.

Figure 11: The lowest fee funds attracted nearly 80% of total inflows the past year, vs. just 5% for the highest fee funds

Cumulative inflows to US ETFs by expense grouping ($Bn)



Source: J.P. Morgan Quantitative and Derivatives Strategy, Bloomberg Finance L.P.

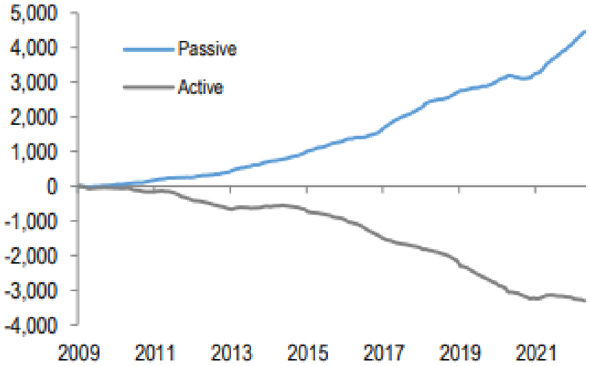
ETF fees are consistently falling, and most money continues to flow to passive investing and lower fee products. Average fees across all ETFs weighted by fund size is 0.18% (18 bps). While a burst of interest in thematic ETFs with higher fees in both 2021 and 2022 led to a brief fall in funds flows to the cheapest ETFs, the recent weaker performance of thematics has resumed the move to cheaper passive. (Fig11, above)

The poor relative performance of thematics in 2022 is dramatic, showing that investors attracted to the next hot sector in 2021 were setting themselves up to fail by overlooking investment fundamentals and traditional valuations (Fig12, below).

Figure 12: Average performance of US Paradigm Shift Thematic ETFs* vs. the S&P 500

Source: J.P. Morgan Quantitative and Derivatives Strategy, Bloomberg Finance L.P. * Excluding levered/inverse products.

Figure 15: Cumulative flows to active and passive US equity funds ($Bn)



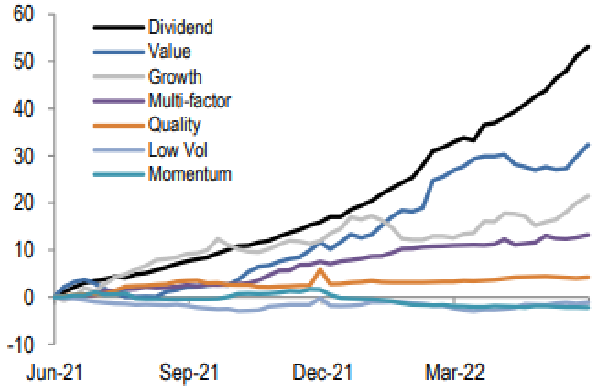
Source: J.P. Morgan Quantitative and Derivatives Strategy, EPFR. Latest data as of Apr 2022.

As the next big thing comes and goes, and active managers have great years and not-so-great years, passive investing continues to win favour (Fig15, above).

Specifically in the US, equity ETFs saw a record year of inflows at US$570 billion, with domestic equities gaining around three-quarters of the total. International was 19% and emerging markets 6%. Half the US flows were into broad large cap ETFs, generally into defensive sectors and out of cyclicals, with inflows to Health Care and bond proxy sectors (Real Estate, Staples, Utilities) and outflows from cyclical sectors (Financials, Industrials and Discretionary).

US 'style' funds were popular, making up 30% of the total. Dividend funds saw the strongest inflows followed by Value funds, while Low Vol and Momentum recorded net outflows. (Fig23)

Figure 23: US Style Equity ETF net flows over the past year ($Bn)



Source: J.P. Morgan Quantitative and Derivatives Strategy, Bloomberg Finance L.P.

Figure 37: US credit ETF market has grown significantly in size over the past few years

US credit ETF AUM

Source: J.P. Morgan, Bloomberg Finance L.P.

Still in the US, credit ETFs gained increasing acceptance as investors look for exposure to diversified bonds offering better returns. US credit ETF assets have increased 17% annually over the past 10 years to $328 billion as of May 2022, although they remain less than 4% of total credit market bonds outstanding. The recent fall in value is driven by rising rates and widening spreads. (Fig37, above)

The big global ETF trends

JP Morgan expects ETFs to take more market share of active management from unlisted managed funds, based on the ETF advantages of typically lower expenses, intraday liquidity and continuous pricing, and the ability to short and trade options. However, the dominance of passive funds is not likely to change, suggesting the growth in active ETFs will come at the expense of active managed funds.

Graham Hand is Editor-At-Large for Firstlinks. This article is general information and does not consider the circumstances of any investor.

How will rising inflation affect house prices?

Ashley Owen

Former Reserve Bank chief, Ian Macfarlane, wisely observed that in the US, easy money ends up inflating bubbles on Wall Street, but in Australia it ends up inflating house prices. This time last year, *The Australian Financial Review* was running stories like the following trumpeting double-digit growth in house prices across the country, driven by ultra-low interest rates and the generous Covid stimulus hand-outs.

Sydney house prices soar 15pc in fiscal 2021

Nila Sweeney

Sydney's home prices surged 15 per cent in financial 2021, defying pandemic warnings of steep falls, as ultra-low interest rates and government stimulus sparked a buying frenzy.

All capitals ended the fiscal year with double-digit price growth except for Melbourne and Perth, which gained 7.7 per cent and 0.8 per cent, respectively. In May, Perth rose by 1.4 per cent and Darwin by 2.1 per cent.

National home values rose 1.9 per cent in June, higher than the decade average of 0.4 per cent, but 3 basis points lower from May and 9 basis points below the recent peak in March.

The quarterly results also showed a noticeable slowdown, ranging from 20

Pumped up

Dwelling values (% change)

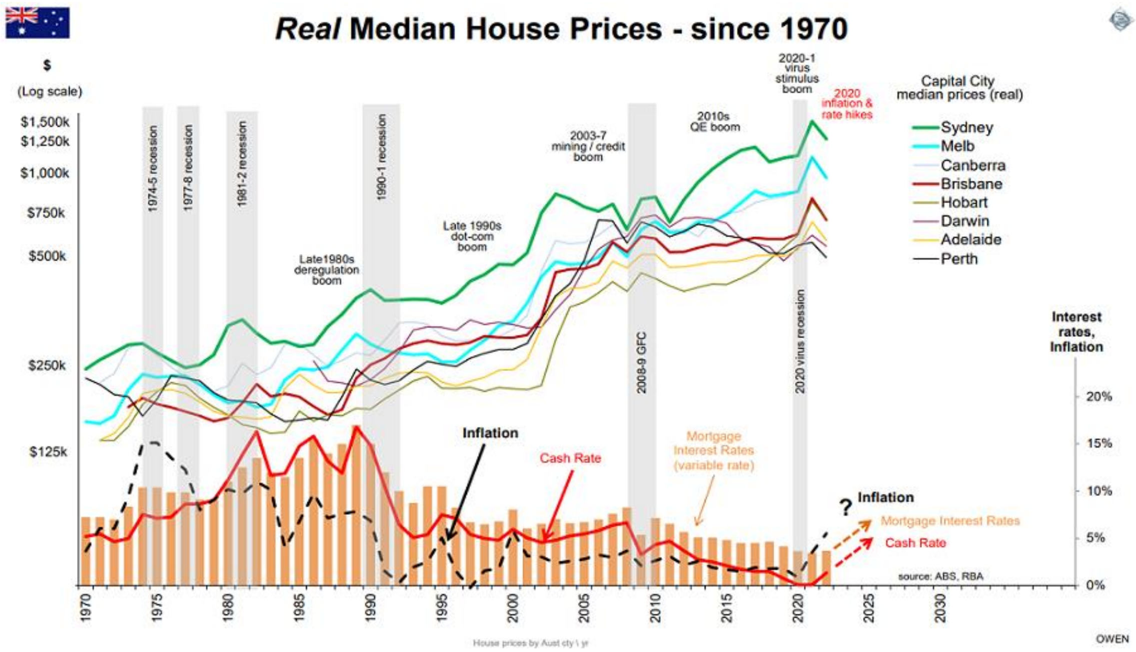
	Past month	Past 3 months	Past 12 months
Darwin	+0.8	+6.3	+21.0
Hobart	+3.0	+7.4	+19.6
Canberra	+2.3	+6.1	+18.1
Sydney	+2.6	+8.2	+15.0
Adelaide	+1.6	+5.6	+13.9
Brisbane	+1.9	+5.7	+13.2
Perth	+0.2	+2.1	+9.8
Melbourne	+4.5	+4.6	+7.7
Australia	+1.9	+6.1	+13.5

SOURCE: CORELOGIC

The party is over

One year later, the stimulus party has finished, interest rates are rising, and house prices have started to give back some of those windfall gains. How far will interest rates rise, and how will they impact house prices?

Here is an update on our regular chart of house prices, cash rates, mortgage rates and inflation over the past few cycles. Here we use *real* house prices (i.e., after CPI inflation), to highlight the inflation protection in housing.



There have been regular price booms once or twice per decade, including during periods of high inflation and interest rates, like the early 1970s, late 1970s and late 1980s. These booms were followed by periods of static or falling prices, usually during economic slowdowns when interest rates were being cut.

Yes, house prices do fall in real terms. Regularly.

We have just enjoyed a tremendous house price boom. In the three years to December 2021, median house prices surged by +43% in Sydney, Brisbane and Canberra, +41% in Melbourne, +62% in Hobart, +35% in Adelaide, but Perth was more subdued with +15% growth. Prices are falling now as there are fewer buyers with less loan money, and more sellers, including recent buyers with big mortgages.

Prices depend on interest rates this time

How far prices fall will depend mainly on how high interest rates rise, and for how long.

A neutral (non-inflationary) cash rate for Australia is around 3-4%, but if inflation does not quickly come back down to target range of 2-3%, then cash rates would probably need to be raised to well above 'neutral' first.

Central banks have a lousy record of controlling inflation without triggering economic slowdowns and recessions. There is no reason to think they will do any better this time.

It is unlikely house prices will give up all their 40% gains from the 2019-2021 boom. However, this might occur if aggressive rate hikes trigger a broad economic slowdown that brings high unemployment and widespread corporate and personal bankruptcies. We have had these before, in the mid-1970s, early 1980s, early 1990s, and the 2008-2009 GFC. The GFC was caused mainly by a global systemic banking crisis, but the Fed hiking rates from 1% to 5.25% was a major contributor to the housing collapse that triggered the banking crisis.

Despite these setbacks, housing is a long-term investment, and housing markets in Australia's large cities have enjoyed a long upward march driven by:

- Population growth, mainly due to immigration
- Favourable demographics, with progressively smaller numbers of people per household
- 'NIMBY' supply constraints, and
- Tax advantages, such as exemptions from capital gains taxes and social security means tests.

These long-term fundamentals are likely to remain strong.

What lies ahead?

Although Russia is still waging war on Ukraine, and the Covid pandemic is still morphing into new strains, the main game affecting all types of investment markets is monetary policy. Can central banks contain inflation by unwinding their ultra-loose and ultra-expansionary monetary policies that created the inflation in the first place?

Political leaders, governments and central bankers have been quick to shift the blame for inflation to Russia, which is a convenient scape-goat. The problem is that, even before Russia's February 2022 invasion of Ukraine, inflation was already running at 7.5% in the US, 5.2% in the UK, 5.1% in the Eurozone (including 5.3% in Germany), and 3.5% in Australia. In 2021, central banks dismissed this inflation as 'transitory', and then in 2022 they jumped on the opportunity to shift the blame to Russia. The Russian invasion certainly added to supply restrictions (severely affecting poorer countries much more than the west), but the main problem was the trillions of dollars of stimulus money from governments and their central banks, sloshing around the market pushing up prices everywhere.

We are not in the blame game here. Inflation was caused by too much money chasing the supply of goods, services, labour, commodities, housing, shares and other assets. This excess money came from governments (loose fiscal policy) and their central banks (loose monetary policy). On the fiscal side, cutting spending and raising taxes to end the deficits, and even run surpluses to pay off debts, is going to be political suicide for elected governments, especially with fractured politics since the GFC in the US, Europe and even in Australia.

This will mean the heavy lifting will have to be done by central banks. Their primary tool is very blunt – increasing interest rates to reduce spending, by reducing peoples' surplus spending money after paying the mortgage, and by taking away their jobs. There are early signs that some of the temporary supply constraints are easing, and that inflation numbers are starting to ease in the US, but is probably still rising in Japan, UK, Canada, most of Europe, and in Australia.

If central banks can manage to pull off a miracle and bring inflation back to target ranges without triggering economic slowdowns and big reductions in jobs, spending, and corporate profits, then the share prices of most companies are probably already over-sold at current levels. On the other hand, if the rate hikes do result in economic slowdowns that materially hurt profits and dividends, then share prices probably have further to fall. And so do residential property prices.

Ashley Owen is Chief Investment Officer at advisory firm [Stanford Brown] and The Lunar Group. He is also a Director of Third Link Investment Managers, a fund that supports Australian charities. This article is for general information purposes only and does not consider the circumstances of any individual.

The five-act future if we knew we'd live to 100

Don Ezra

Recently I attended a conference in Cortona, Italy. It was on aspects of The New Map of Life™. Those two simple sentences conceal a lot!

The conference was put together by Russ Hill, the founder of the International Center for Wealth Advisory Excellence (or ICWAE for short: pronounce it as if it's the start of "I see way into the future"), a learning group affiliated with Stanford University. Russ is also the Chairman of the Advisory Council of the Stanford Center on Longevity. A week before the conference's start date, the facilitator and some presenters got Covid, and so Russ made the difficult decision to cancel the conference. Some of us, however, had already scheduled vacations around the conference, so we showed up anyway. And amazingly Russ promptly reorganised the event, and 10 of us had a day and a half of discussions that were much more intensive and personal than usual because our group was so small – an unexpected benefit.

The theme was The New Map of Life™ (NMOL, from now on) and its potential influence on the future of wealth management. That won't mean anything to you, so let me explain.

Learn to pace life differently

It started with a 2011 book, *A Long Bright Future*, by Dr Laura Carstensen. Laura is the Founding Director of the Stanford Center on Longevity (among many other offices of distinction). Among several ideas she put forward in the book was one about pacing our lives differently.

Our lives seem to divide into learn-work-retire (or learn-earn-burn, as it's sometimes referred to). If we knew we were likely to live to 100 (something today's newborns can anticipate), surely we wouldn't just add the additional years to the retirement stage. It would be far more productive if instead we divide it into many more flexible stages, diffusing work across the lifespan. That would have the additional effect of departing from today's age-segregated society (the young study, the middle-aged work, and the old volunteer or rest), and instead make it easier for generations to interact and for anyone, of any age, to find a better balance between families, work, community and educational opportunities.

Future life as a five-act play

In *Act 1 ('The Show Begins')* – this appealed to me, given my professional background – we start a retirement savings account, at birth. More importantly, we encourage continuing education while the brain and emotional maturity are growing, until roughly age 25. Let the adolescent mind learn and explore, incorporating opportunities for travel, community service and interning.

In *Act 2 ('The Action Builds')* education continues. We work part-time, trying out more than one job before settling on an employer, perhaps around age 40. This gives us the chance to raise a family in a shared, loving experience. Those who choose not to have a family can continue to learn about life, the world, and work.

In *Act 3 ('Taking Center Stage')* our minds are already well shaped by life and work experience, and now we skillfully practice the trade we have chosen. This is where we shift from primarily consuming resources to providing them. Sabbaticals enable us to continue to learn or to do community service.

Act 4 ('The Turning Point') would continue until perhaps age 80 (yes, 80!). Before then, we would wind down our working careers gradually, perhaps with an 'encore career' for a second, deeply personal stage of work life. Perhaps it involves satisfying community needs.

After this 'autumn crescendo' (what a lovely phrase!) we enter *Act 5 ('Resolution').* We have paid our debts to society, raised our family, and are ready to enter a life phase in which we do whatever we want.

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The Stanford Center on Longevity now has research fellows and faculty advisors devoted to Laura's ideas, and prepared an initial report in November 2021 (use the link at the start of this post).

10 principles for a fulfilled life

From it I have extracted the following 10 principles:

1. Make the Most of the 100-Year Opportunity: We are optimists, not dreamers. The NMOL is rigorously grounded in science, driven by pragmatism and seasoned with imagination.
2. Invest in Future Centenarians to Deliver Big Returns: "Aging society" narratives portray the later decades of life as a period marked by vulnerability and dependence.
3. Align Health Spans to Life Spans: While median life spans have increased dramatically over the past century, our health spans – defined as the years in which people are healthy, mobile, mentally sharp, and free of pain – have not kept pace.
4. Prepare to be Amazed by the Future of Aging: Today's 5-year-olds will benefit from an astonishing array of medical advances and emerging technologies that will make their experience of aging far different from that of today's older adults.
5. Life Transitions are a Feature, Not a Bug: While the conventional life course is a one-way road through pre-scripted stages, our new map features roads with forks, which take us in many directions through the roles, opportunities, and obligations that 100-year lives will bring.
6. Learn Throughout Life: Given the strong links among education, health and longevity, the NMOL calls for innovation and more flexible options in our education.
7. Work More Years with More Flexibility: Over the course of 100-year lives, we can expect to work 60 years or more.
8. Build Financial Security from the Start: Financing 100-year lives requires new pathways for working, saving, and retiring.
9. Age Diversity is a Net Positive: Never before in human history have so many generations been alive at the same time, creating opportunities for intergenerational connection that have until now been impossible.
10. Build Longevity-Ready Communities: As a nation, we must start now to design and build neighborhoods that are longevity-ready.

How exactly will these ideas affect our day-to-day lives? We just don't know, today. Chances are that changes will come gradually and in small pieces and in an uncoordinated fashion. Our group tried to anticipate what changes would mean for wealth advisory firms and the industry as a whole. My own focus will be on how individuals can fund actionable ideas that can improve their lives today, regardless of wealth.

This conference was intended as a first exposure to these ideas about the future. That was exciting in itself: conferences typically focus on today's issues and problems, but being there gave the 10 of us a head start. Let's see what we can do with it.

If we knew we'd live to 100, we'd pace life differently, our life's path would have on-ramps and off-ramps and more interaction across the generations.

Don Ezra, now retired, is the former Co-Chairman of global consulting for Russell Investments worldwide, and the author of "Life Two: how to get to and enjoy what used to be called retirement". This article is general information and does not consider the circumstances of any investor.

ASA's view on the banning of LIC commissions

Rachel Waterhouse

This is a copy of the ASA's submission to Treasury's post-implementation review of the banning of stamping fees, in response to this request:

Treasury is seeking feedback from consumers and industry stakeholders on the 2020 change which extended the ban on conflicted remuneration to 'stamping fees' paid by Listed Investment Companies (LICs) and Listed Investment Trusts (LITs).

Treasury is seeking feedback on

- *the policy's regulatory impacts on advisers and stockbrokers*
- *changes to consumers' investment choices*
- *competition settings for managed funds, and*
- *any other unintended consequences in the market.*

Stamping fees are an upfront one-off commission paid to Australian financial services licensees for their role in capital raisings associated with the initial public offerings of shares.

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The Australian Shareholders' Association (ASA) represents its members to promote and safeguard their interests in the Australian equity capital markets. The ASA is an independent not-for-profit organisation funded by and operating in the interests of its members, primarily individual and retail investors, SMSF trustees and investors generally seeking ASA's representation and support. ASA also represents those investors and shareholders who are not members, but follow the ASA through various means, as our relevance extends to the broader investor community.

Consultation process on stamping fees

Thank you for the opportunity to submit comments to the post-implementation review on the removal of the stamping fee exemption.

We will briefly address 4 of the 5 questions posed, grouping 1 and 3:

1.What impact has the policy change had upon retail investors?
3.How have consumers' investment choices been affected?
4.Has the policy beneficially changed competition settings in the managed funds sector? and
5.Have there been unintended consequences resulting from the policy changes?

1 and 3. What impact has the policy change had upon retail investors and how have consumers' investment choices been affected?

We maintain the policy stance enunciated in our submission in 2020 on the merits of the current stamping fee exemption in relation to listed investment entities, that there be no carve out of a subset of listed entities from the overarching exemption. We remain concerned that access to initial public offers (IPOs) is denied to many retail shareholders, denying them the ability to access risk- and price-appropriate assets.

We consider the removal of the stamping fee exemption has reduced the number of listed investment companies (LICs) and listed investment trusts (LITs) coming to market and hampered the creation of new and innovative listed entities designed to meet perceived investor need.

Since the policy change in May 2020, there have been few IPOs of LICs and LITs, with fewer being made available as general offers. The Magellan Global Fund (MGF) listed in November 2020 and was a compliance listing merger of two pre-existing funds; Salter Brothers Emerging Companies Limited (SB2) listed in June 2021; WAM Strategic Value Limited (WAR) listed in June 2021; Touch Ventures Limited (TVL) listed in September 2021 (and had no general offer); and Cadence Opportunity Fund Limited (CDO) listed in November 2021 after commencing as an unlisted fund in January 2019.

The overall statistics in the three tables below, show a reduction of the number of listings of LICs and LITs, and modest growth of $0.08b in the 12-month average transaction value from 2020 to 2022. This compares to an increase in number and lift in the 12-month average transaction value of $7.63b for selected unlisted managed funds available via the ASX (m-Funds) and $2.49b for exchange traded products (ETPs).

LICs & LITs	May-22	May-21	May-20
Market Cap ($bn)	51.61	55.19	45.19
12 months change	-6.5%	22.1%	4.0%
Number listed (actual)	95	101	111
12 months change	-5.9%	-9.0%	-1.8%
12-month avg transactions	123,997	104,997	121,317
12 months change	18.1%	-13.5%	69.2%
12-month avg value ($b)	0.92	0.76	0.84
12 months change	21.1%	-9.5%	50.0%

Source: ASA and ASX Investment Products reports May 2022 and May 2020

4.Has the policy beneficially changed competition settings in the managed funds sector?

There has been an increase in the number and the market capitalisation of m-Funds as shown in the table below and for unlisted funds. ICI Global, in its Worldwide Public Tables for the end of 2021, stated the total assets in Australian unlisted managed funds were valued at about $3.5 trillion, or in US$2.6 trillion and increase from US$2.5 trillion.

m-Funds	May-22	May-21	May-20
Market Cap ($bn)	1707.27	1692.64	1125.04
12 months change	0.9%	50.5%	24.3%
Number listed (actual)	238	239	234
12 months change	-0.4%	2.1%	5.9%
12-month avg transactions	2,814	2,972	2,279
12 months change	-5.3%	30.4%	35.3%
12-month avg value ($b)	70.31	83.91	62.68
12 months change	-16.2%	33.9%	47.5%

Source: ASA and ASX Investment Products reports May 2022 and May 2020

5.Have there been unintended consequences resulting from the policy changes?

It is our understanding from reading the initial consultation paper that the intention of the removal of the stamping fee exemption was intended to relatively advantage managed funds compared to LICs and LITs. It also appears to have advantaged exchange traded products.

ETPs (Exchange Traded Products)	May-22	May-21	May-20
Market Cap ($bn)	128.33	109.49	63.46
12 months change	17.2%	72.5%	31.3%
Number listed (actual)	247	221	195
12 months change	11.8%	13.3%	-5.3%
12-month avg transactions	509,194	370,717	282,884
12 months change	37.4%	31.0%	158.6%
12-month avg value ($b)	9.27	7.15	6.78
12 months change	29.7%	5.5%	111.2%

Source: ASA and ASX Investment Products reports May 2022 and May 2020

In summary, ASA considers the removal of the stamping fee exemption should end, and retail investors be allowed to choose appropriate investments.

We also flag the short eight working day consultation period, with the notification email received at 5pm Tuesday, 28 June and comments required by Sunday, 10 July. We believe short notice periods act to limit the consultation, reducing the number and depth of submissions. We request that longer consultation be considered for future stakeholder engagement on important matters to retail investors.

Rachel Waterhouse is Chief Executive Officer of the Australian Shareholders' Association.

Beware the headlines as averages don't tell the whole story

Robert M. Almeida

Historical patterns can provide a useful roadmap for the future but can sometimes lead to mistaken assumptions. People tend to look to the past to make sense of the present and the future. During bear markets, a wildly overused, and I believe, dangerous, frame of reference is historical drawdowns (losses) and their implied assumptions about future market returns.

For example, a widely-used formula goes like this: Recessions last an average of w number of days, and equities fall an average of x% followed by a recovery of y% in z days. Market commentators use formulas such as these to ease clients' mental anguish and imply that better days are ahead. Better days are ahead. However, they can take longer than experts expect to materialise and may be accompanied by significant financial pain.

The problem with averages

Averages tell us the central or typical value in a data series but provide no window into variation. For example, two cities may share an average annual temperature of 70°F, but if one is in a temperate climate where the temperature is quite steady and the other experiences significant seasonality, the average doesn't tell you much. More data are needed to decide when to visit one city and when to visit the other.

Apart from the problem with simple averages, every market drawdown, financial crisis and recession is different. Even if historical market drawdown averages were accompanied with pages of data, would that help? I don't think so.

Recessions wring out excesses

Economic and market cycles don't die of old age. They end when excesses are corrected due to a financial crisis or a recession. These, often painfully, wring out overinvestment in both the real economy and financial markets. The length of the business cycle is irrelevant. What matters is the level of excess and the magnitude of the needed rebalancing process. That determines how much further we may still have to fall.

To get a sense of where past excesses lay, look no further than to whomever was Wall Street's favourite client at the time. For example, in the 1990s it was the dot-com companies. The Street's favourite (and most profitable) clients were companies with a concept leveraged to the internet, seeking capital. In the 2000s, the preferred clientele was financial institutions looking for enhanced yield without excess risk. The Street sold them mortgage-backed securities consisting of repackaged loans made to American homeowners who were unable (or unwilling) to fulfill their obligations. That led to the GFC.

The time required to heal following the internet bubble and housing crisis is unrelated to the next recession. Different imbalances require different corrective processes. The level of the drawdown in the S&P 500 or MSCI EAFE back then is no longer the issue.

What matters today is whether the real economy and financial markets have cleared the excesses built up since the last recession.

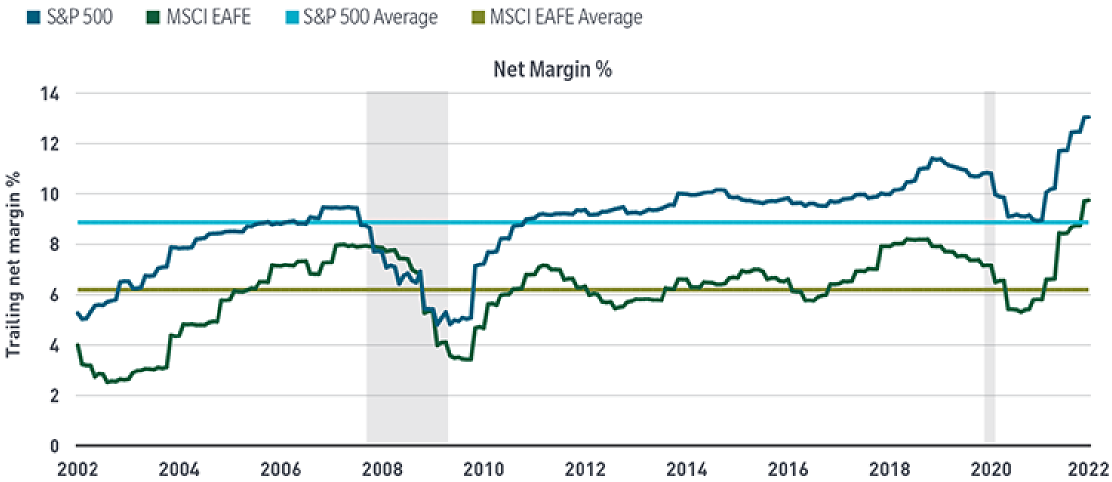
Where are today's excesses?

The policy response to low growth and deflation risks during the 2010s was quantitative easing. Central bankers expected it to lead to capital creation and corporate borrowing to fund productive activities. It didn't, because money-debasing signaled weak growth prospects to producers. Borrowed money instead went to pay dividends and repurchase stock. Quantitative easing turned out to be the problem masquerading as the solution.

Wall Street's favourite clients in the post-GFC era were non-bank companies. Financial leverage among that group reached new heights before the pandemic and exceeded those highs once central banks turned the lending spigot back on in April 2020, unlocking credit markets.

As I wrote back in April, despite the weakest economic cycle in over a century, corporate profit margins reached all-time highs in 2018, only to be surpassed in 2022 due to the lagged effects of an over-stimulated world economy. How? Debt is a pull-forward of future capacity, and companies pulled forward an unsustainable amount of margin and profit.

Exhibit 1: COVID-related stimulus fueled record margins



Source: FactSet. Monthly data from 30 April 2002 to 31 March 2022. Shaded areas = US recessions.

We don't believe corporate margins will be sustained

Margins and profits ultimately drive stock and credit prices. The headline "*S&P 500 on track for the worst start of the year since 1970*," is dramatic but misses the point. What will drive future returns is profits.

Currently, many companies are telling investors they can sustain all-time-high post-stimulus margins despite rising fears of recession and a step-function jump in costs (explaining why earnings expectations remain elevated in the face of obvious revenue and input cost pressures), but we don't believe them.

Risk is usually hidden in plain sight. What do your eyes tell you?

Robert M. Almeida is a Global Investment Strategist and Portfolio Manager at [MFS Investment Management](). This article is for general informational purposes only and should not be considered investment advice or a recommendation to invest in any security or to adopt any investment strategy. Comments, opinions and analysis are rendered as of the date given and may change without notice due to market conditions and other factors. This article is issued in Australia by MFS International Australia Pty Ltd (ABN 68 607 579 537, AFSL 485343), a sponsor of Firstlinks.

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Australia is heading for its third Omicron wave

Adrian Esterman

Australia is heading for its third Omicron wave in the coming weeks, as BA.4 and BA.5 become the dominant COVID strains. BA.4 and BA.5 are more infectious than previous COVID variants and subvariants, and are better able to evade immunity from vaccines and previous infections, so we're likely to see a rise in case numbers.

So what are BA.4 and BA.5? And what can we expect in this next phase of the pandemic?

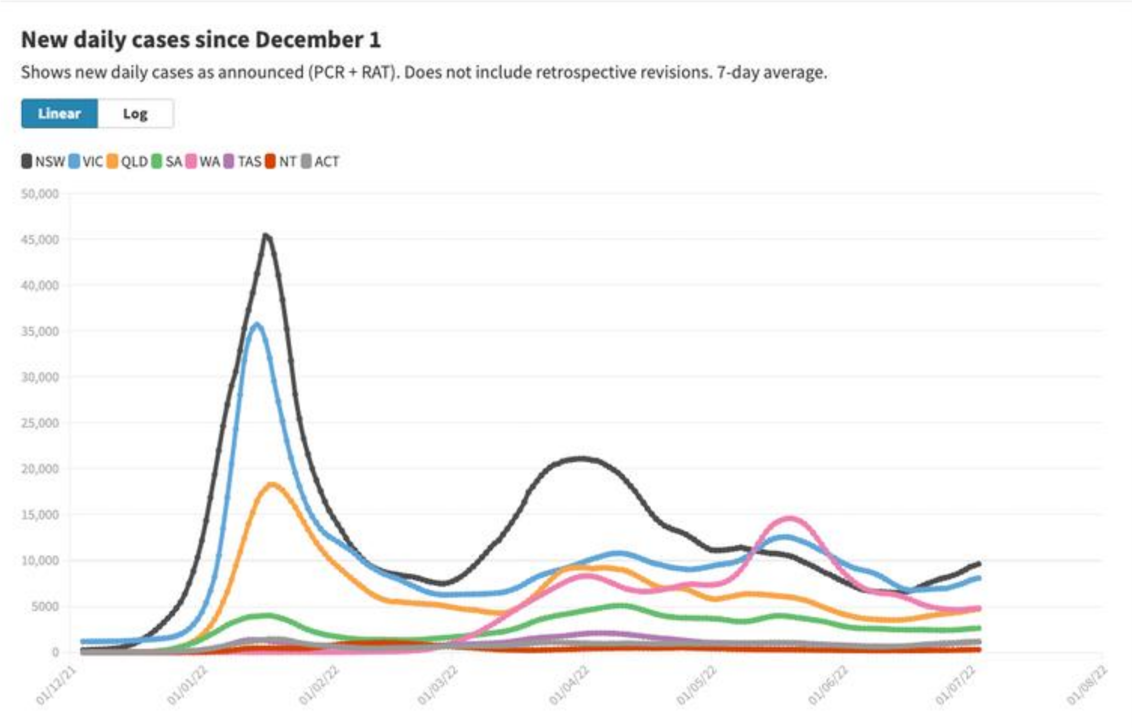
How did it start? BA.1, BA.2 and BA.3

Omicron started off as three subvariants (that is, a group of viruses from the same parent virus), all appearing in late November 2021 in South Africa: BA.1, BA.2, and BA.3.

The three are genetically different enough that they could have had their own Greek names. But for some reason, this did not happen, and the World Health Organization designated them as subvariants of Omicron.

BA.1 rapidly took over from Delta in Australia in early January this year, forming a massive wave of cases, peaking at more than 100,000 a day.

However, BA.2 is even more transmissible than BA.1, and Australia saw a second wave of cases, this time caused by BA.2. This wave peaked in early April at more than 60,000 cases a day.



The first and second Omicron waves peaked in early January and early April. Covid19data.com.au

When were BA.4 and BA.5 detected?

BA.4 was first detected in January 2022 in South Africa. BA.5 was also detected in South Africa, in February 2022. Both appear to be offshoots of BA.2, sharing many identical mutations. They also have many additional mutations likely to impact transmission. They are talked about together because mutations in their spike protein (the bit that latches on to human cells) are identical. (For brevity, I refer to them as BA.4/5.) However, they do differ in some of the mutations on the body of the virus.

How transmissible are BA.4/5?

We measure how contagious a disease is by the basic reproduction number (R0). This is the average number of people an initial case infects in a population with no immunity (from vaccines or previous infection).

New mutations give the virus an advantage if they can increase transmissibility:

- the original Wuhan strain has an R0 of 3.3
- Delta has an R0 of 5.1
- Omicron BA.1 has an R0 of 9.5
- BA.2, which is the dominant subvariant in Australia at the moment, is 1.4 times more transmissible than BA.1, and so has an R0 of about 13.3
- a pre-print publication from South Africa suggests BA.4/5 has a growth advantage over BA.2 similar to the growth advantage of BA.2 over BA.1. That would give it an R0 of 18.6.

This is similar to measles, which was until now was our most infectious viral disease.

How likely is reinfection?

BA.4/BA.5 appear to be masters at evading immunity. This increases the chance of reinfection. Reinfection is defined as a new infection at least 12 weeks after the first. This gap is in place because many infected people still shed virus particles many weeks after recovery. However, some unfortunate people get a new infection within the 12 weeks, and therefore are not counted. Likely, there are now tens of thousands of Australians into their second or third infections, and this number will only get bigger with BA.4/5.

How high are case numbers likely to rise?

Around Australia, we are starting to see a third wave of cases because of BA.4/5.

The effective reproduction number, or Reff tells us, on average, how many people an infected person will pass it on to, given the immunity in the population. All Australian states and territories now have a Reff greater than 1, meaning that even with the current levels of immunity, we are seeing an exponential growth in case numbers. This will inevitably lead to an increase in hospitalisation and deaths.

The second Omicron wave due to BA.2 was not as high as the first one caused by BA.1, probably because there were so many people infected with BA.1, that the ensuing immunity dampened the second wave down.

This third wave may not be as high as the second for the same reason.

How severe is the disease from BA.4/5?

A recent pre-print publication (a publication that has so far not been peer-reviewed) from a Japanese research group found that in lab-based, cell-culture experiments, BA.4/5 was able to replicate more efficiently in the lungs than BA.2. In hamster experiments, it developed into more serious illness.

However, data from South Africa and the United Kingdom found that their BA.4/5 wave didn't see a major increase in severe disease and death.

This is possibly because of the high rates of immunity due to previous infections. Our high rates of vaccine-induced immunity might have a similar protective effect here.

At this stage, we do not know whether any of the Omicron subvariants differ in their ability to cause long COVID.

However, we do know that full vaccination (three doses for most people) does provide some protection against long COVID.

How protective are our vaccines against BA.4/5?

Each new subvariant of Omicron has been better able to evade immunity from vaccination than its predecessor.

Although current vaccines based on the Wuhan strain will still provide some protection against serious illness and death against BA.4/5, they are unlikely to provide much, if any, protection against infection or symptomatic disease.

What about new vaccines?

The good news is second-generation vaccines are in clinical trials. Moderna is trialling a vaccine containing mRNA against the original Wuhan strain and Omicron BA.1. Early results are very promising, and likely to give much better protection against BA.4/5. But this third Omicron wave – along with a very severe flu season – will likely see our hospitals struggling even more over the next few weeks.

If things get bad enough, state and territory governments might be forced to reintroduce face mask mandates in many settings – in my opinion, not such a bad thing.

Adrian Esterman, Professor of Biostatistics and Epidemiology, *University of South Australia. This article is republished from The Conversation under a Creative Commons license.*

Five gold misconceptions that could reduce your returns

Sawan Tanna

It's believed that the first gold coins were minted in the ancient Kingdom of Lydia, located in what is now part of western Turkey, around 550 B.C. These coins were stamped as a guarantee of their purity and weight and since then almost every government has minted gold coins for currency.

Over the past 2,000 years, gold has continued its upward trajectory in terms of value and is still regarded as an item of wonder and beauty, whether that be as jewellery, collector coins or on the stock exchange as an exchange-traded product (ETP).

Investors and advisers struggle to justify buying gold

In 2012, reforms were introduced to the *Corporations Act 2001* which included prospective bans on conflicted remuneration structures. This included commissions and volume-based payments, relating to the sharing of and advice about a range of retail investment products. This was due to the unregulated and somewhat unethical financial guidance given by advisers who only recommended commission-earning products.

The *Financial Planners and Advisers Code of Ethics 2019* (FASEA, 2019a) states the following:

"Collectively, financial planners and advisers are members of Australia's newest profession. As such, while they formerly provided a commercial service, they should be committed to offering a professional service -informed by a code of ethics intended to shape every aspect of their professional conduct."

Prior to 2012, many advisers simply wouldn't recommend gold as there was no incentive for them to offer it. Even after these regulations were introduced, the hangover still exists, especially with the notion that gold pays no dividends.

However, the idea that gold should be disregarded because of lack of return is perhaps an oversight. During uncertain periods like the ongoing Covid-19 pandemic or as the Russian/Ukraine war rumbles on, diversifying portfolios has never been more important. The idea that gold will not help mitigate risk in portfolios is a misconception.

Five common misconceptions about gold

We've pulled together the five most common misconceptions held about investing in gold.

1. Gold is too risky to be included in portfolios

There may be short-term volatility, but long term, it's a different matter. Gold can be used to diversify portfolios to help risk-adjusted returns (risk adjusted returns are a calculation of an investment's return by looking at how much risk is taken to obtain that return).

The table below illustrates that from 1970 to 2020, gold's volatility was in line with equities. If investors had a 50/50 blend of gold and equities, the generally-negative correlation of gold to other traditional asset classes (stocks, bonds, cash and real estate) could significantly reduce portfolio volatilities.

AUSTRALIAN EQUITIES AND GOLD 1970 TO 2020

	Volatility	Best year	Worst year
Gold	20%	**206%**	-36%
Equities	17%	86%	**-42%**
50/50 Blend	14%	135%	-31%

According to the World Gold Council:

"Gold is a clear complement to stocks, bonds and alternative assets for well-balanced … investor portfolios. As a store of wealth and a multi-faceted hedge, gold has outperformed many major asset classes while providing robust performance in both rising and falling markets."

2. Investing in gold is only effective when inflation is high

Often, gold is only seen as beneficial during periods of high inflation. The 1970s oil crisis was one such time that hit the global economy hard, triggering a stock market crash and sending inflation rates climbing. With markets in turmoil, gold rose from a low of USD35 per ounce in 1971 (set during the gold standard) to a peak of USD180 in late 1974. By 1976, however, the gold price fell nearly 40% to USD110 before gaining again in 1978 and then hitting an incredible USD850 in January 1980.

The World Gold Council, covering market data since the 1970s, found that gold has on average delivered gains of 15.1% (in nominal terms) and 8.3% in real terms in the years US CPI has averaged 3% or more.

For local investors, analysis conducted by The Perth Mint suggests the gold price in Australian dollars has on average risen by just over 20% in nominal terms in years when the local CPI was 3% or higher. But even in the years where CPI was below 3%, gold has still returned a nominal average of 3.6%.

Australian inflation and average gold price returns (%) 1971 to 2021

Inflation environment	Number of years inflation in this bracket	Average nominal gold return (%)
Less than 3%	27	3.6%
More than 3%	23	20.4%

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

3. Gold does not provide long-term portfolio returns

Although gold has not outperformed stocks and bonds during various market patterns, it has provided positive returns over a longer term, comparative to many other asset classes. Adding gold to a hypothetical Australian portfolio over the last 15 years would have increased risk-adjusted returns.

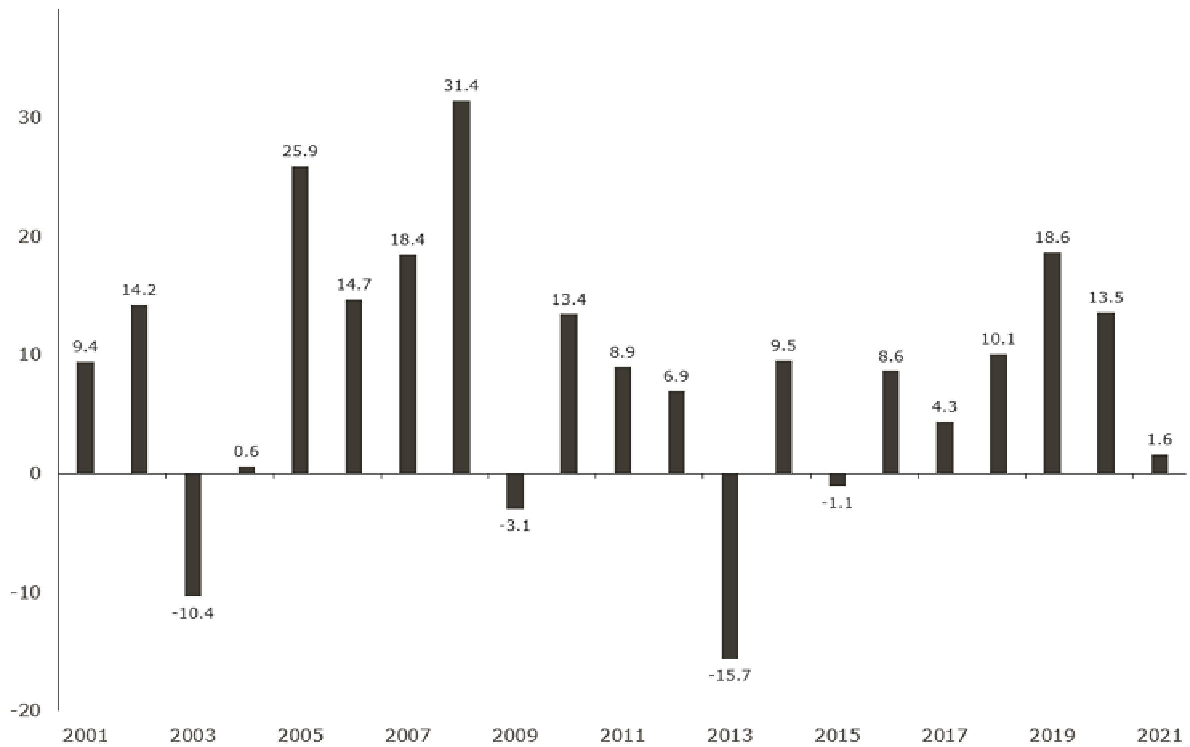
LONG TERM ANNUALISED RETURN UNTIL END OF 2021

Asset Class	1 Year	3 Year	5 Year	10 Year	15 Year
Gold in AUD	1.6%	11.2%	9.5%	5.3%	7.9%
ASX 200	17.2%	13.6%	9.8%	10.6%	6.2%
Cash	0.0%	0.6%	1.1%	1.9%	3.1%
Australian Bond	-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%

4. Without paying interest or dividends, gold has no value

It is indeed true that gold doesn't provide income like some stocks and bonds. Instead, investors in gold are compensated solely by price appreciation, driven by economic and market trends. The chart below shows gold returns in AUD over the last 20 years.

GOLD'S ANNUAL RETURN IN AUD



Source: World Gold Council, The Perth Mint

5. Only when the US dollar declines does gold appreciate

Although the US dollar and gold have had a long economic tie, when the gold standard was abolished by US President Nixon in 1971, central banks were no longer entitled to on-demand conversion of their dollars into gold. Officially delinking gold's price from the US dollar allowed the price of gold to be influenced by open market demand.

Factors such as demand, interest rates, inflation, central bank reserves, production and market volatility can all influence the return on gold, pushing the price of the precious metal up as well as down. In January and February 2020, when the COVID pandemic was taking grip, the US dollar and gold actually rose in price, having a positive correlation.

But it's not all about the US dollar. Gold also offers a de facto foreign currency exposure in an Australian investor's portfolio, with declines in the value of the Australian dollar typically magnifying the gains gold delivers to local investors. In periods of financial market stress, not only does gold tend to go up, but the AUD often falls. GFC is a prime example of this; in 2008, when USD gold price was +4%, AUD gold was +28%.

By complementing investments in bonds, stocks and broad-based portfolios, gold can hedge against currency depreciation and inflation, and has historically provided positive returns as well as offering liquidity in periods of market turbulence.

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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