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Contents

Editorial

There is another side to the surge in inflation that deserves far more attention. When inflation was close to zero, and the central bank fear was deflation, it was not so important to think about markets and returns in real terms, that is, nominal returns less inflation. If inflation is zero and stock prices rise 5%, that's a 5% real return. But with Australian inflation now at 6.1% and perhaps heading to 7% according to the **Reserve Bank**, US inflation already at 9% and the UK above 10%, investors need to think in real terms. A total nominal return of say 6% including dividends may represent a real return of zero.

There are many consequences for investing. At zero inflation, it did not matter as much if money was left in a bank account earning little or no income. But if inflation is 6% to 7%, significant purchasing power and living standards are being eroded. The table below shows the interest rates currently paid on my SMSF's main transaction account where I leave a decent amount of cash. My bank has passed on a fraction of the cash rate rises.

Balance	
Up to $9,999.99	N/A
$10,000 to $19,999.99	0.15% p.a.
$20,000 to $49,999.99	0.25% p.a.
$50,000 to $99,999.99	0.35% p.a.
$100,000 to $249,999.99	0.45% p.a.
$250,000 to $499,999.99	0.55% p.a.
$500,000 and over	0.65% p.a.

The yield curve is now steep so the opportunity cost of leaving money in the cash account versus term deposits, notes or bonds is far higher than for many years, depending on the alternative. This week, for example, I deployed some cash into a new **NAB** subordinated issue paying around 6.3% with an issuer call in 2027. Yes, I am accepting fixed rate risk and credit risk on NAB but I'm also 6% ahead of current cash rates. Although cash will continue to rise, my bank will not pass on the full increase.

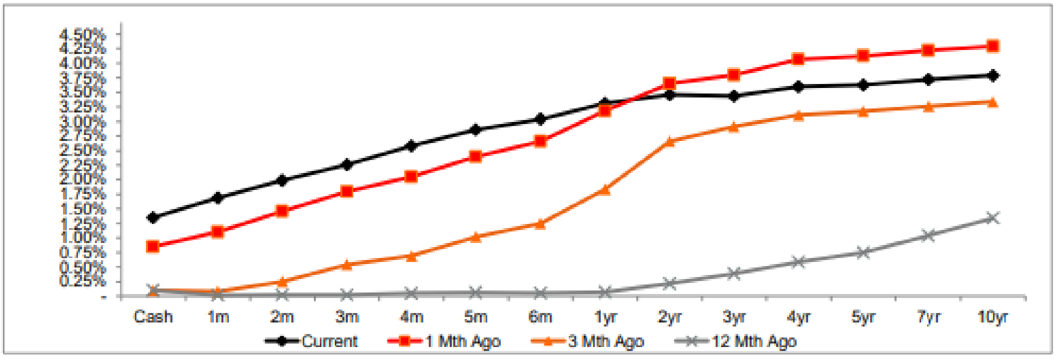
Source : BofA Global Quantitative Strategy, MSCI, FTSE, Factset, Bloomberg, 13F Filings, Benchmark Indices, Country Stock Exchanges

Retail investors holding cash are not alone. According to the latest survey from **Bank of America**, cash holdings in fund managers portfolios in major global centres have risen over 2022 and although not historically high (holdings in equities still dominate), they are the highest level for over two years.

Another side of inflation rising above 6% is that many social security payments or regulatory limits linked to CPI which moved slowly in the past will now rise rapidly (in nominal terms). Examples are pensions, usually linked to six-monthly changes in CPI, and superannuation limits. The Transfer Balance Cap (TBC) increased for the first time to $1.7 million on 1 July 2021, but an additional 6% is $102,000, which might mean the next increase up to $1.8 million comes a lot quicker. Is this enough for someone to delay opening their first retirement income stream until after 1 July 2023 to obtain a personal TBC at the higher level?

With rising rates in our minds, many people do not realise that longer-term fixed rates have already fallen in the last month. The bank swap yield curve chart below, sourced from NAB, shows the current (as at 26 July 2022) 10 year (the black line) at 3.8% but it was 4.3% a month ago (the red line) and 3.3% three months ago (the orange line). Maybe investors have missed the rate top a few weeks ago (when we published this article on the choices) but it's volatile and rates may yet go higher.

At some point, like on the NAB issue, investors have to accept the deal on the day it is available. My opinion is that 6.3% fixed on NAB for five years has a place in my diversified portfolio but NAB also offered a floater at 3 month BBSW+2.8%. As a sign of demand, NAB received bids for $2.4 billion in a couple of days and printed $250 million of the floaters and $1 billion of the fixed. NAB is indifferent but investors voted with their wallets.



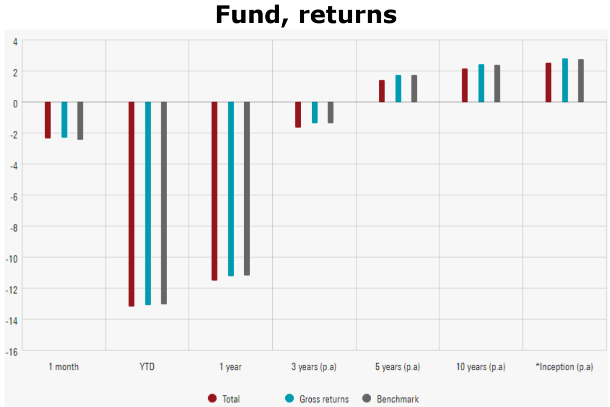
The chart also shows how much the yield curve has flattened and this is significant. Someone tried to convince me during the week that if the cash rate continues to rise, so will the long bond rate. Maybe, but it doesn't usually work like that. Rising cash signals Reserve Bank determination to bring inflation under control, and that is why the long-end rates have fallen. The market is saying central banks around the world will tame inflation relatively soon.

Here is the view of **Russel Chesler of VanEck** after the ABS released the latest quarterly CPI data on Wednesday:

"The CPI rose 1.8% in the June 2022 quarter, to be 6.1% higher from a year ago. The stock market rose on the news, as inflation in the second quarter dipped from the first quarter and was slightly lower than expected. Inflation in Australia may have already peaked with the fall in quarterly inflation from 2.1% to 1.8%. Recent falls in the prices of wheat and corn are likely to slow food inflation, which accelerated over the last quarter ... VanEck expects further increases bringing official rates to 2.75% by the year's end, which will place significant upward pressure on mortgage lending rates."

Meanwhile, last night the US Fed raised its rate by 0.75% to 2.25%-2.50% but suggested the next increase could be smaller. The Fed said that although *"inflation remains elevated"*, *"recent indicators of spending and production have softened"* but *"anticipates that ongoing increases in the target range will be appropriate."* The stockmarket liked it and the S&P500 rose 2.6% with the rate-sensitive NASDAQ up 4%. Although bond rates were little changed, there is more hope that inflation will be managed without significant economic impact.

Vanguard Australian Inflation-Linked Index Fund, returns



In fact, the US market is now pricing in a switch from rising to easing rates from mid 2023. A good example in Australia of inflation expectations is shown in the prices of inflation-linked bonds. Intuitively, an investor might expect high demand for these bonds as the yield rises with inflation. Yet, as shown here, the Australian index of such bonds has lost 13% YTD. Investors see the inflation spike as temporary, and as the Vanguard fund has a weighted average maturity of nearly 10 years, the market focus is on the long term.

Back to adjusting our thinking for inflation, this tweet from **Michael Burry** (the guy featured in ***The Big Short*** who made millions buying credit default swaps before the GFC) reminds us that share prices should also be adjusted for inflation. If your portfolio is down 20% in nominal terms and inflation is 5%, your money has lost 25% of its purchasing power. And by the way, Burry believes the market has much further to fall because all we have seen so far is a shrinking (compression) in Price to Earnings ratios, not the consequences of a fall (compression) in earnings.

Finally, some thoughts on the strength of the Australian consumer and recent company results from **Johannes Faul, Director of Equity Research at Morningstar.**

"So, we've been very surprised on how strong the consumer is in Australia in terms of their spending. So, JB Hi-Fi surprised us significantly on the upside on their sales in the fourth quarter, in the June quarter. And then, today, Myer announced very strong sales results on top of already strong sales in the previous corresponding period. So, everything is pointing towards the Australian consumer has been still buying TVs and apparel in the June quarter and into July. But we see that shifting. We see the warning signs that we're seeing in the US, just like everyone else, and we think the writing is on the wall. And what's really happening is, if you think about the momentum where that's going to head is, we have record low unemployment. We've got very low interest rates that are now sharply going up. We have a lot of savings that are on the sidelines. So, we are almost in the perfect position, but the momentum we see is going backwards and that spells trouble for earnings in the consumer discretionary market, so thinking JB Hi-Fi, Harvey Norman, Myer, those stocks will see earnings weaken going into fiscal 2023 on our numbers."

In this week's edition ...

The most-used standard for deciding how much money and income is needed in retirement has been the **ASFA** Standards for many years, but there is now a rival from **Super Consumers Australia** (SCA). Claiming ASFA numbers are too high due to a bias towards superannuation, SCA estimates the amount required is significantly lower. Do you agree?

As investors look for better signs to commit more to equities, we have two articles reminding us that the sharemarket is not the economy. Our interview with **Anthony Aboud** of **Perpetual** includes his thoughts on the leading indicators he looks for and stocks he likes at the moment, while **Andrew Mitchell** says investors should not equate bear markets with recessions as he describes a range of historical patterns.

Hugh Selby-Smith argues that price is not a scientific measure but is better described as a liar, and he offers three steps for those who want to invest in the current tough markets.

When people think about EVs, attention turns to cars or commodities, the **Teslas** and the lithiums. But **Kate Turner and Peter Meany** check a sector which has done relatively well this year, infrastructure. There should be more focus on the 'E', as all these 'Vs' will need charging.

A recent High Court decision has ruled on lapsing binding death benefit nominations for SMSFs, and **Julie Steed** looks at the implications. Part of the responsibility of being an SMSF trustee is staying aware of the rules.

Given the importance of bank lending and interest rates for our economy, **Stephen Wu** gives a quick take in six charts summarising the dramatic changes in lending in only six months. Hard to believe it was as recently as the start of 2022 when central banks believed inflation was not a threat.

This week's White Paper from **Vanguard** highlights the major economic and market developments expected for the rest of calendar 2022.

Rival standard for savings and incomes in retirement

Graham Hand

There's a new contender defining how much savings and income are needed in retirement. For many years, the 'standards' for both has come from the Association of Superannuation Funds of Australia (ASFA), and they are regularly used by policymakers and financial planners in setting goals. The new standard from Super Consumers Australia (SCA), now in partnership with CHOICE, aims "*to counter the established industry lobby groups*". They claim that ASFA numbers are too high as part of a vested interest campaign for more super so it is no surprise the SCA numbers are smaller.

We'd better not let them know what Firstlinks readers expect because it's a heck of a lot more than either of them.

The ASFA and Firstlinks results

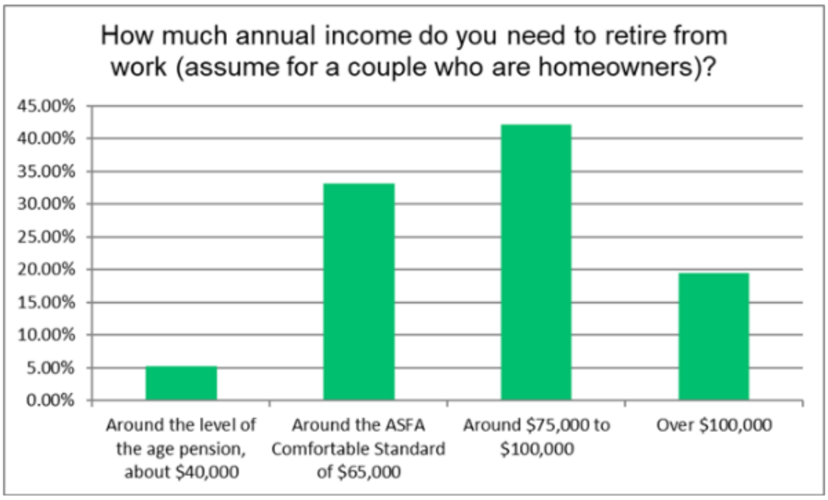
ASFA's latest lifestyle standards required for retirees aged 65 to 84 are shown in the first table and defined in more detail on its website.

Comfortable lifestyle (p. a.)		Modest lifestyle (p. a.)	
Couple	Single	Couple	Single
$65,445	$46,494	$42,621	$29,632

The corresponding amount of assets required for the above 'comfortable' lifestyle is in the second table, allowing for qualification for some age pension.

Savings required for retirement at age 67	
Couple	Single
$640,000	$545,000

In our recent retirement survey of Firstlinks readers, the income required showed 62% need around $75,000 or more.



Firstlinks readers are way above average, which I guess is why they are reading this publication.

The SCA results

SCA defines savings targets to sustain a desired standard of living for people without a mortgage. SCA consulted widely among consumers, academics, regulators, industry experts and superannuation funds, and recognises that most Australians will access at least a part age pension. SCA said:

Savings targets for current retirees (aged 65-69)

If you will own your own home when you retire and you live*	And you'd like to spend about this much in retirement‡ Per fortnight	Per year	Then you need to have saved this much by the time you are 65, on top of your income from the Age Pension
By yourself	$1,115 (Low)	$29,000	$73,000
	$1,462 (Medium)	$38,000	$258,000
	$1,962 (High)	$51,000	$743,000
In a couple†	$1,615 (Low)	$42,000	$95,000
	$2,154 (Medium)	$56,000	$352,000
	$2,885 (High)	$75,000	$1,021,000

*These targets assume you will own your own home outright (or otherwise won't pay rent or a mortgage) when you retire.
†Figures for couples represent the combined spending of two people living together.
‡Spending levels are in today's dollars and have been adjusted for inflation. These levels are based on ABS data about retirees' spending.

Super Consumers Australia

"These savings targets are based on what people spend in retirement with a buffer built in to provide confidence that people's savings can weather the type of market volatility we're currently

experiencing. Having credible targets, based on actual spending, means people can confidently spend and get on with enjoying their retirement."

SCA has ambitious goals for its research, expecting the targets to be used by the superannuation industry as part of the Retirement Income Covenant obligations *"to help members make sense of their retirement income needs".*

Whereas ASFA sets a 'comfortable' level of assets required for a couple at $640,000 to give an annual income of $65,000, SCA says only $352,000 is required for its medium spenders requiring $56,000 a year.

SCA taking on ASFA

SCA directly criticises ASFA for "*representing the superannuation industry*", quoting the Productivity Commission which said the retirement income standard is "*more than many people spend before retirement*" and "*no more than an arbitrary benchmark that should be ignored in policymaking".*

The result is that middle-income earners need to compromise their living standards before retirement to achieve the ASFA levels. SCA also quotes from the Household, Income and Labour Dynamics in Australia (HILDA) surveys that 88% of recent retirees are financially satisfied or neutral about their retirement spending. Hence SCA looks more at actual spending rather than something higher and aspirational.

SCA argues ASFA 'comfortable' levels were designed for the top 20% of retirees, and create unrealistic expectations for most people. Based on the table above, SCA says a single person retiring between age 65 to 69 today would need to have saved $258,000 in super to draw a 'medium' level of income in retirement of $38,000 a year, including income drawn from super and the age pension.

Reaction from other media

The well-known 'Barefoot Investor', Scott Pape, quoted the SCA numbers in a recent newsletter, and then reports this response:

Wow-wee! Last week's column – on how much you need to retire – triggered an avalanche of reader responses.

"That's WAY TOO LOW!" "Are they eating baked beans in retirement?" "You need AT LEAST $1 million to do anything half decent in retirement!"

My view? The million dollar retirement number is a myth ... As long as you own your own home, you can live a meaningful, purposeful, retirement with much less money. After all, we have the amazingly good fortune to be living in the greatest country on earth, with a strong social safety net based on the aged pension plus subsidised medical and aged care."

Then Jessica Irvine, writing in *The Sydney Morning Herald*, said:

"If I were to cut out overseas holidays, eating out, gym fees and stop driving to work, I'm fairly confident I could get myself somewhere closer to the industry's 'modest' standard. And that's comforting, indeed. Learning how to live on less is definitely the most empowering thing you can do when it comes to setting yourself up for retirement. Don't forget that once you're retired, you'll have more time to cook meals at home and less need to spend money to offset the stresses of work."

So how much do you need?

... is a different question to how much do you want? Our opinions must be influenced by our environment. Yes, a couple that own their home could live on the SCA 'low' spending level of $42,000 (which is remarkably close to ASFA's 'modest' of $43,000 despite the criticism), requiring only $95,000 of assets because the overwhelming majority comes from the age pension.

But when a 50-year-old sees a financial adviser, few plan to live on less than $1,000 a week. They outline a strategy to reach goals that finance a rewarding retirement with annual holidays, a new car every five years, eating out regularly, helping the grandchildren, drinking good wine and private health insurance to stay well enough to enjoy it.

Following the release of the SCA numbers, many in the media are accusing the superannuation industry of "fearmongering tactics" making Australians believe their retirement savings will be inadequate and they need to save more. Sure, in retirement, time with friends and family, walking on the beach and smelling the trees in the forests, are the greatest rewards, but it helps if you've got the money to do it in some style. Plan for it - it's amazing how much savings compound given enough time.

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

The sharemarket is not the same as the economy

Graham Hand with Anthony Aboud

Anthony Aboud is a Portfolio Manager for the Perpetual Industrial Share Fund, the SHARE-PLUS Long-Short Fund and the Perpetual Pure Equity Alpha Fund and has been at Perpetual for 10 years and an analyst for 22 years.

GH: You're a portfolio manager for the Industrial Share Fund. Do you sometimes feel there are sectors on the ASX, perhaps energy and resources, where you would like to invest as well?

AA: Resources can be feast or famine types of businesses and there may be times in the cycle when you want to be invested there and other times not. One of the rules of the Industrial Share Fund is that it is not allowed to invest in resources companies so yes, there are times when you would want to own certain stocks. This constraint has not really hurt the performance of the Fund over many decades as it has avoided some speculative booms. Industrials is the nature of the Fund and it has a good investment universe.

GH: You have a large exposure to banks which have done well over time but sold off recently. Do you think that the market is overreacting to some negative factors for banks such as the potential for rising defaults?

AA: There is talk of a recession on the back of higher energy prices, higher interest rates and potentially overstretched consumers. Australian banks were more expensive than their international peers and it has driven some underperformance in the short term, but over the last two years, banks have done well in absolute and relative terms. If we head to a recession and house prices fall materially, our banks will struggle to perform. However, they are extremely well provisioned, well capitalised and are yielding between 5-6% fully franked yields. Our big positions in the space are Suncorp and NAB.

GH: In your day-to-day thinking about risk in the portfolio, do you watch any leading indicators to guide how the mood of the market might change?

AA: There's the market and there's the economy. Two things I watch for the strength of the economy are inventory levels and mortgage applications. They are different but give good, leading information. For example, if there are a lot of inventories in the system, it suggests some weakness is coming as stock cannot be sold. Inventory needs to clear before new orders are made. In the US, big retailers such as Target and Walmart have experienced downgrades due to overstocking. Mortgage applications show if people plan to bid for a house, influencing clearance rates and house prices and ultimately construction. They turned negative in May in Australia so that's a cautionary sign.

Generally on other indicators, I am a contrarian and I feel when everyone is negative about the economy, that may be a positive sign for the stockmarket. Which is why I say the market and the economy are different, as we need increasingly negative shocks for the market to continue to fall.

GH: You wrote a note in January 2021 when the market was going crazy for hot growth and tech companies, often without profits, saying, *"When the market environment changes, the focus will swing back to companies with sustainable cash flow. When that happens, we will see a lot of these hyped-up tech names fall 90%."* Are you feeling vindicated?

AA: Absolutely. What we saw with zero interest rates for a long period of time was bubbles all over the place. With no cost of capital and people chasing long duration companies, all it took was a good narrative, a big-talking CEO and suddenly we had the next Amazon. I never believed it. I understand some businesses need to invest capital and be loss-leading for a while, but it's a lot more difficult than many people think to go from a loss-making concept to becoming a sustainable cash-generating business. The market underestimated that.

GH: On your long/short fund, how do you go about stock selection and risk management with a short book in contrast with a long book?

AA: The main issue with a short book is that you can lose more than 100% of your position. If a short goes against you when prices rise, it becomes a bigger position in your portfolio. If a long position goes against you due to price falls, it becomes smaller. With a long, you might think you got the timing wrong, and you can leave it there for a while. You can't do that with a short book. You really need good risk management, especially getting the size of the position correct. And you want to be clear at what price you stop out your position.

On identifying shorts, I think the company knows about its problems before the rest of the world does. So look for flags and analyse the behaviour of management and boards, such as accounting tricks or mistiming of acquisitions. The other reason for shorts is where we have a materially different view from the market on the downside potential. Some stocks just appear ridiculously expensive.

GH: So when you look at the ASX now, what sectors or companies look cheap or expensive?

AA: I think there's some crowding into defensive stocks as investors are nervous about the market and the economy, and money has gone into defensive sectors such as supermarkets, consumer staples, even health care. I understand the reasons but all of a sudden, you're paying too much for something where margins could be squeezed. I also think sectors such as long duration infrastructure will face pressure from rising rates for some years.

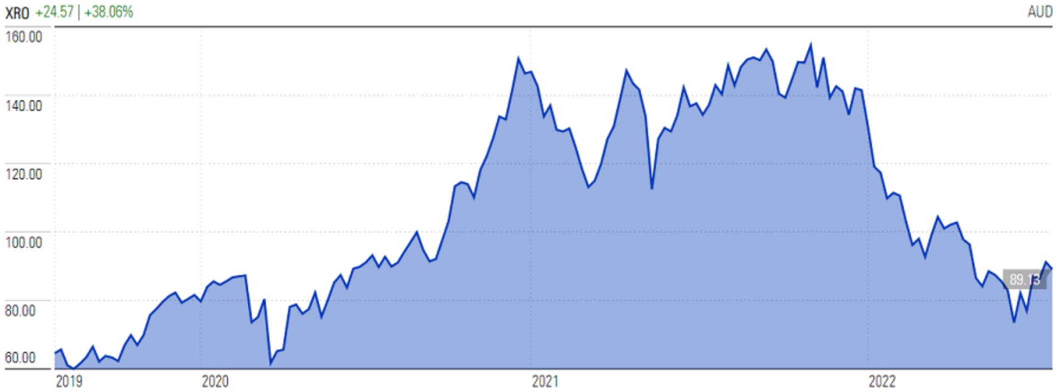
On the long side, first, some of the fallen angels are babies thrown out with the bathwater. They have been de-rated but are starting to look good. Carsales (ASX:CAR), for example, is off around 30% with a P/E in the low 20s for a very high quality business. Second, in energy, we've had 10 years of underinvestment, often due to decarbonisation, which is a good thing but we have this tricky period right now for the next five to 10 years where economies need new supplies to meet the demand for energy, such as from a company like Santos. And third, again being a bit contrarian, I like discretionary retail where the balance sheet and management team are strong. Premier Investments is the best in the retail space, and Harvey Norman is unique in the way it owns many of its properties. Harvey Norman is not trading much over its book value which is rare for a retailer.

Carsales.com Ltd, three-year price chart, source Morningstar

GH: Is there a particular stock on the ASX that you like if it can reach your price target?

AA: Xero (ASX:XRO) is a very good business. It has great stickiness of customers, who are so positive about the product, especially relative to its competitors. It has upside in adding more features and there's nothing more certain than the need for companies to maintain accounts and pay taxes. The complexity of taxes is not going away, and they have dominant market share in Australia and the UK with growing earnings. For me, it's always been a matter of getting the valuation to stack up but it's a company I constantly watch.

Xero, three-year price chart, source Morningstar



GH: Yes, once they set up their financial accounts, most can't be bothered moving even if the company puts up its subscription fees. Do you have a stock you've sold out of where the thesis didn't work out as you hoped, and it's made you think about your investment process and something you missed?

AA: An international example is Foxtons, a real estate agency in the UK. I liked it because it was generating a lot of cash, it paid a high dividend yield, and I felt I was getting exposure to London property when it was a bit on the nose, a few years ago. But I didn't heed enough that it was an IPO out of private equity and some industries probably shouldn't be listed. It can be better to be small and nimble and on the ground than become a big company with all the corporate costs. But also it's more about the people and the individuals in specific markets than the corporate name.

GH: We all love a Warren Buffett quote and he says his favorite holding period is forever. Do you think of a particular stock when you hear that?

AA: This might surprise people but for me, it's Event Hospitality (ASX:EVT). It's like a founder-run business, it's got a strong balance sheet, they have continued to invest in technology and new revenue drivers putting them in a stronger position coming out of the pandemic. Event Hospitalities is one of the largest cinema operators in Australia, owns and operates hotel chains with Rydges and QT Hotels and they also own Thredbo Alpine Village. When the company and the board are making investment decisions with shareholder capital, I feel confident that they are allocating capital to generate long-term returns rather than trying to please the market in the short term.

Event Hospitality, three-year price chart, source Morningstar

GH: Is there a stock in your short book that you continually run over time that has done well for your fund?

AA: I don't like talking about current shorts but I'm happy to talk about a past one. One that was fantastic for us that went bankrupt was the vocational training company, Vocation (listed under ASX:VET in 2013, delisted in 2015). This was a merger of three business from three founders. There was large insider selling at IPO which is always a red flag, and we questioned the sustainability of the business. The company generated 90% of its revenue from subsidies from the Victorian government and these were subsequently cut. That was one of our best shorts.

GH: There's an ongoing active versus passive debate and passive has attracted more flows recently. With such a spread of stock winners and losers in the last six months, is it a market for active managers?

AA: It should be a good time for active managers. Passive works best in a momentum market that goes up and up when interest rates were low. More money piles into the stocks that are rising in the index, but passive funds don't work as well in choppier markets. Active managers also engage with companies more. It should be a stockpicker's market and a chance for active managers to shine. But when fund managers appear in the media and say how good they are, that's usually a time to sell them so I'm not going to criticise any other funds.

Graham Hand is Editor-At-Large for Firstlinks. Anthony Aboud is a Portfolio Manager at [Perpetual Asset Management Australia](), 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.

For more articles and papers from Perpetual, please click here.

Price is a liar: take three steps before you dive in

Hugh Selby-Smith

'*Price is a liar*' is a bold proposition. Many might argue that it is also absurd. And I recognise that it needs careful consideration. But understanding price is vital to understanding financial markets. Let me explain.

Price pretends to be an objective measure, a metric as reliable as a centimetre, a kilogram and a second. But price is a liar because it has no link to the material world, the world of hard facts. It is no more accurate than a handshake. It is less a measure than an event.

Scientists define the kilogram based on physical constants. Its characteristics are precise regardless of time or place. A kilogram in Melbourne is no different to a kilogram in London or New York. A 2019 kilogram was not heavier than a kilogram today nor will it be heavier than a kilogram in 2025.

Price, on the other hand, has no scientific or mathematical definition. It is no more than when buyer meets seller, demand meets supply, and opinion meets money. People drive prices, and people, as behavioural economists like Tversky, Kahneman and Thaler have shown, are not rational.

Investors must guard against behavioural biases such as anchoring, confirmation and loss aversion. They should watch out for the Dunning Kruger effect, which refers to a cognitive bias whereby people with low ability or expertise in a particular topic tend to overestimate their ability or knowledge.

Bubble trouble

Historic examples of prices lying are infamous bubbles: Tulip Mania, the Mississippi Bubble, the South Sea Bubble, the bubble preceding the Wall Street Crash, Japan's Financial Market Bubble, the Dotcom Bubble and the US Housing Bubble.

More recently there have been bubbles in tech, particularly profitless tech (ARKK), SPACS (special purpose acquisition companies), meme stocks (GameStop) and cryptocurrency.

All of these have been accompanied by acronyms like FOMO (fear of missing out) and YOLO (you only live once), and by ideas like greater fool theory (there's always someone stupid enough to buy at a higher price). These are more lifestyle choices than investment processes.

Technicalities and patterns

There is a discipline that not only recognises price as behavioural but aims to profit solely from that knowledge.

Technical analysis, the study of historical patterns to generate targets, is hundreds of years old. Its idea that investors are buyers or sellers of an asset at predictable levels has fierce fans and caustic critics.

The old joke in financial markets that '*charts are for sailors*' is at the expense of an approach that leans heavily on graphs of past prices and volumes for its predictions. Yet for it to be joked about means someone is taking it seriously.

For those not in the technical analysis club, price alone gives little information. There are stocks this year in the tech heavy US Nasdaq Composite index that are down 90% from their highs, but that gives no clue about their attractions as an investment. One definition of such stocks is a good reminder of the dangers of being enticed by shares that have collapsed:

"A stock down 90% is one that went down 80% and then halved."

Lie detector

Valuation may be art not science, but it approximates the truth. More than this, it helps an investor understand how much a price is lying, both for good as well as ill. After all, prices can be too low as well as too high.

Valuation's premise that an asset is worth the sum of its future cash flows still leaves plenty of room for blow-ups, after all that word 'future' is a minefield. But it also allows for a structured, repeatable process based on something resembling objectivity.

Valuation is a defence against behavioural biases. Terms that appear often in the stories of people trying to sell you something mean no more to valuation than the cash flows the words represent. Wonderful companies, beautiful cashflows, disruption, growth, moats, and the rest only matter to valuation as numbers.

Eyes wide open

Investing with reference to valuation is not the same as value investing. Value investing aims to work out an asset's worth and then buy it at a discount. A value investor might only transact if they can buy a dollar for 80 cents, expecting that the price will move up to what is known as intrinsic value over time.

Another sort of investor might buy something at fair value or a premium because, having identified where they stand in relation to an asset's value, they have reasons other than money to motivate them.

We have all bought or sold something at what is known in markets as the 'wrong price' out of clear-eyed choice, "*I really wanted that house, car, ring etc even if I am over-paying*". This is a different sort of falling for it.

Investing while knowing when price is a liar

With many stock prices sinking, the temptation may be to dive in. If that is what you want to do, I would suggest bearing in mind three things.

Firstly, try to identify opportunities that do not rely on, let alone magnify, the market's direction. Look for what are called low beta equities.

Secondly, favour shares with shorter rather than longer payback periods. This may be no more than saying favour good value.

Thirdly, hunt down income, especially in conjunction with my first and second suggestions. Income has been the poor relation over the last decade or more but anyone with an eye to history understands its integral role as a component of total return.

Hugh Selby-Smith is Co-Chief Investment Officer of Talaria Capital. Talaria's listed funds are Global Equity (TLRA) and Global Equity Currency Hedged (TLRH). This article is general information and does not consider the circumstances of any investor.

Bear markets don't go paw-in-paw with recessions

Andrew Mitchell

After a savage sell off over 2022, the S&P 500, along with other major indices, officially entered bear territory in June, or a fall of 20% or more from recent highs. Investors are now worried that the sell-off could be worse if the US and major economies tip into recession.

Yet while bear markets and recessions are often linked, from an investment perspective, they are distinct. Why?

Bears and recessions don't always hunt together

Firstly, bear markets and recessions do not always coincide.

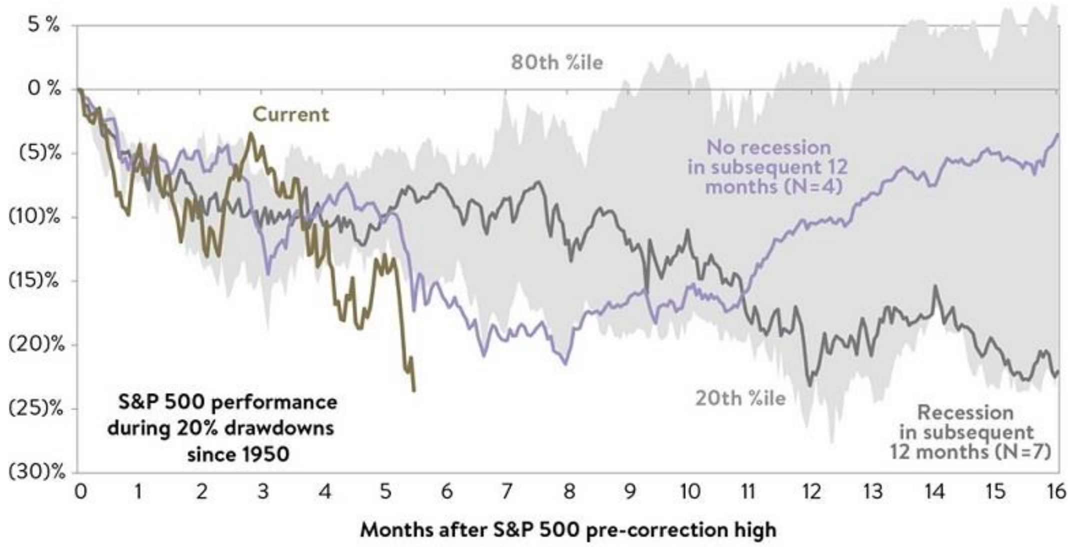
Worsening economic conditions do have an impact on the psychology of the markets, which are inevitably driven by sentiment as well as fundamentals. Investors often respond to fears of recession, or growing pessimism about the overall economy, by becoming more risk averse and reducing their exposure to equities.

Yet four of the bear markets after World War II did *not* lead to a recession. For instance, the two bear markets in the 1960s that did not prefigure a recession were driven by interventions by the Federal Reserve to tame inflation, which allowed the authorities to orchestrate a 'soft landing'.

Gummy or Grizzly?

The recent fall in the market has been more severe than the average bear market and is close to a level that has, in the past, preceded a recession. It remains to be seen if this bear market will be a 'Gummy Bear': a shallow fall, or a 'Grizzly Bear': a deep fall.

Bear markets that come before recessions tend to bottom out and begin to recover before the recession is over. Quick recoveries also tend to happen if no recession ensues (dark grey line):



Taking a historical perspective, in the 12 U.S. recessions since World War II, the S&P 500 index has contracted from peak to trough by a median of 24%. If this were to be replicated, the S&P500 would fall to approximately 3,650. An average decline of 30% would reduce the S&P 500 to 3,360. (At time of publishing, the S&P500 closed on 27 July 2022 at about 4,000).

Falling valuations drive this bear market

So far, the US equity markets fall has mostly been about de-rating valuations (Price to Earnings ratios, or P/E) so they are appropriate for a more normalised 3-4% long-term interest rate environment.

Over the last 15 months, the historical earnings multiple of the S&P 500 has fallen from 32 times to 19 times, one of the swiftest and largest falls in valuation in history. The forward earnings multiple, which is based on expectations of future profitability, has fallen to around 16 times.

The current earnings multiples are still above the level hit by previous recession-linked bear markets, however. In the recession of 2020, the forward P/E ratio fell to 13 times and in the recession of 2008, it dropped to nine times.

The question now is, where to for earnings?

The market seems to be guessing whether harsher economic conditions will hit global corporate earnings, and, if so, how large the drop will be.

The picture will to some extent become clearer in the June quarter US reporting (during July/August) but will probably not be fully evident until after the September quarter reporting in October and November 2022.

Recession warning signs

The market is, however, flashing some warning lights about a recession.

One feature of this bear market, when compared with previous selloffs, is an unusually high level of volatility. About 20% of the trading days this year have seen the S&P 500 experience a price move greater than 2%. In the past 20 years, only 8% of annual trading days exhibited such volatility. It points to a high degree of uncertainty, although it should also be noted that about half of the turnover on the New York Stock Exchange is automated high-frequency trading, which could be contributing to the higher levels of activity.

Another indicator that may be of significance is that the dividend futures market is expecting that S&P 500 dividends will decline by nearly 5% in 2023. This points to a greater likelihood of a recession. For 60 years, S&P 500 dividends have not declined except during a recession.

Monetary policy will cause demand destruction and more rate rises are likely. The Federal Reserve is tightening monetary policy to rein in inflation, with 2022 seeing its most aggressive hikes since 1994 (another 0.75% increase in the Fed benchmark rate to 2.25%-2.50% was added on Wednesday 27 July).

But the rate is still low by historical standards and well below the June US annual inflation level of 9.1%. There are likely to be more rate rises given that real interest rates are in such strongly negative territory.

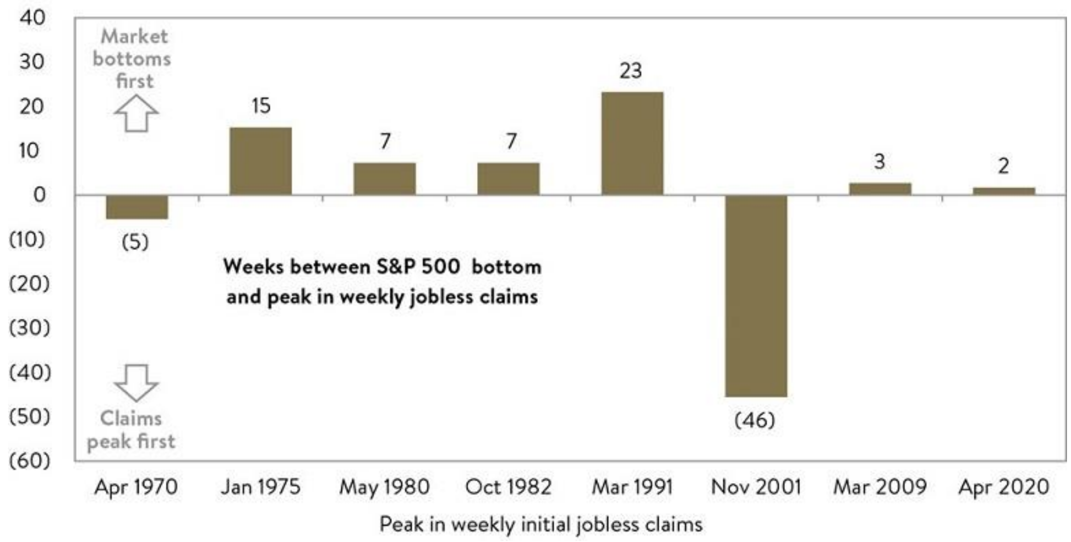
The era of cheap money, which has had a strongly positive effect on equity prices, seems to be over, at least while inflation is causing concerns.

Watching for the bottom

Past patterns are not always a guide and should be approached with caution. But they suggest that, although there is a risk that the market may have a way to go before reaching bottom, the severity and speed of the downturn suggest a substantial amount of the repricing has already occurred.

Historically, equities tend to stop declining when the market becomes confident that financial tightening has been sufficient, and the Fed has started easing rates. If a recession does occur, the case for increasing rates will become weaker, which may trigger such an easing.

Changes in the direction of inflation are another pointer to when the market has hit bottom. Equities on average decline when inflation is rising and approaching its peak, but they typically rebound quickly past that peak if a recession is avoided. If a recession materialises, history suggests that equities are likely to remain under pressure for six months after the inflation peak.



Using economy-wide data to identify when the market will hit its lowest point is especially flawed because of the difference between lagging indicators and future expectations.

One of the better indicators, though, may be high frequency employment data, which are a more specific economic measure. The bottom of the equity market has generally exhibited a relationship with the peak in weekly jobless claims. Since 1970, the S&P 500 has reached its local trough within weeks of the peak in weekly jobless claims.

The problem still though is a lack of consistency between jobless claim tops and equity market bottoms, and that often months can still separate them.

Markets tend to bounce strongly after bear markets

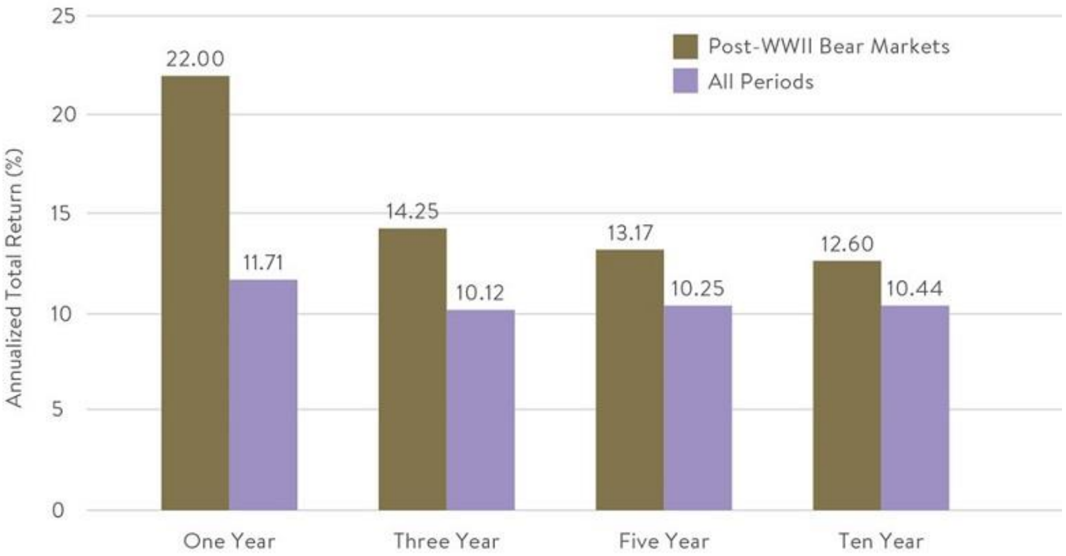
The good news is that this environment is throwing up opportunities and setting up stronger returns for investors.

It is an investment truism that generally the best time to buy, and the worst time to sell, is when the market has entered bear territory.

Looking at the S&P 500 bear markets that have occurred after World War II, the average one-year return after the bear market was 22%, which is almost double the average return over all periods.

The best short-term returns usually occur when the market bounces back.

The three-year return after a bear market was 14.25%; the five-year return was 13.17% and the 10-year return was 12.60%. In all these time periods the post-bear market returns were substantially above the average return for all periods:



Opportunities in small caps

The most common strategic response to tightening financial conditions, slowing economic growth, and elevated market volatility is to shift to big cap, stable companies with robust and predictable earnings streams.

But the flip side of this is that at the smaller end of the market this often creates greater mispricings that provide significant buying opportunities.

This time there has been some overly aggressive price falls of small caps. The selloff in the small and medium-cap sector has been greater than usual and they are, in relative terms, unusually cheap, trading at a historically big discount to large-cap companies.

We are now finding some wonderful businesses that were too expensive for us to own in the past but are now close to levels that we think provide great investment opportunities. We have seen these times before when indiscriminate and liquidity driven sell offs push down the valuations of some businesses to unsustainable levels given the strength of their underlying operations. We think this bodes well for investment returns for those that fit this mould during the inevitable market recovery.

But attempting to pick the bottom of a bear market can be counterproductive. Being a few days or weeks too late or too early can mean failing to outperform a buy and hold strategy.

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

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Different investments to catch the Electric Vehicle charge

Kate Turner, Peter Meany

Given that Elon Musk, the founder of Tesla, is now the richest man in the world (Forbes, 18 July 2022), it's fair to say that Electric Vehicles (EVs) appear to be a compelling sector for wealth creation. But scratch below the surface, and it's clear that not all EV investment opportunities are created equal.

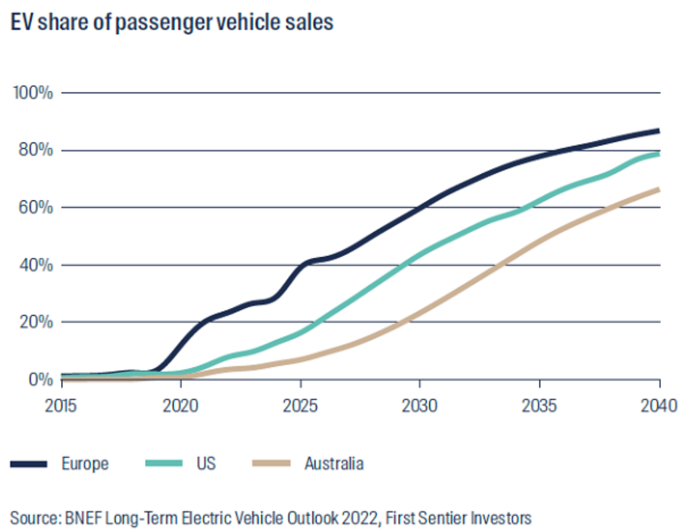
There are many ways to gain exposure to the EV thematic, from investing in lithium producers who help to power EV batteries, through to the manufacturers of the vehicles themselves. However, we see the 'E' in EV as a significant opportunity. This article explains how investors can support the EV revolution by investing in the charging infrastructure that underpins the whole sector.

The opportunity

As the world moves to lower greenhouse gas emissions, transport is key to decarbonisation – road transport in particular, which accounts for around 75% of emissions in the transport sector.

EVs are set to be an important part of the solution. Already accounting for around 9% of vehicle sales globally, they are even more popular in countries like Germany, where 1 in every 4 vehicles sold is electric. In fact, global sales doubled between 2020 (3.2 million sold) and 2021 (6.6 million) according to BloombergNEF (BNEF).

Most governments around the world recognise the need to accelerate uptake of EVs to address the climate impacts of transport. European policies have been particularly supportive with the region's largest car manufacturer Volkswagen Group expecting electric vehicles to represent 70% of sales by 2030 and to stop selling internal combustion engines by 2035.



Data as at 31 March 2022

The infrastructure gap

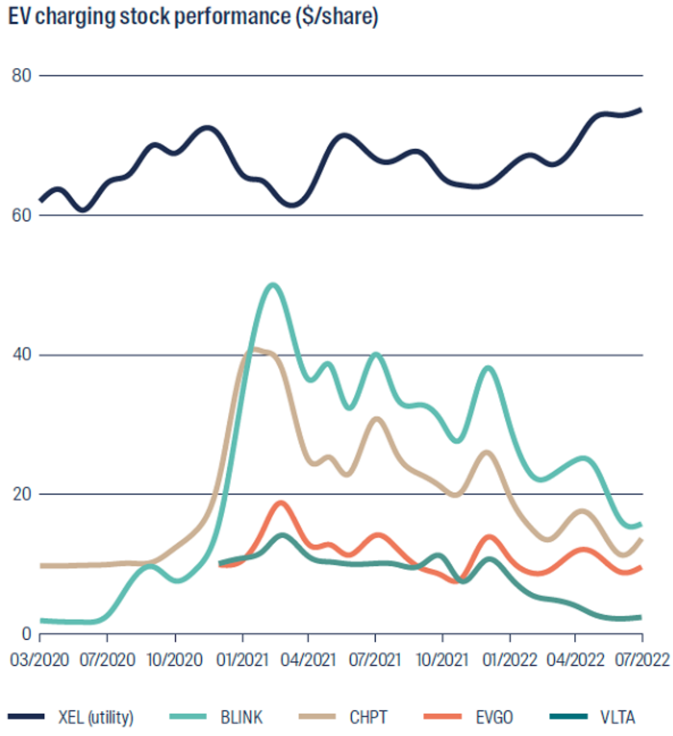
As the new range of EVs hit the showroom floor, the real challenge begins. A Deloitte survey found that the number one barrier to EV adoption was a lack of charging infrastructure (33% of participants). If we add driving range (22%) and charging time (16%), then it could be argued more than 70% of the problem is about charging infrastructure.

As the fleet of passenger EVs expands, so too will the need for charging. BNEF estimates this investment opportunity could represent $US1.0–1.4 trillion over the next 20 years, roughly split evenly between private, public and commercial uses.

There are a number of ways to invest in this theme, including EV vehicle and battery manufacturers like TSLA, BYD or CATL, or gaining exposure to key minerals like lithium, cobalt or nickel. However, manufacturers are likely to face significant competition over time, while commodities could be a wild ride.

A number of EV charging infrastructure companies listed in recent years – ChargePoint, EVgo, Allego, Wallbox, Blink Charging and Volta. The business models vary, but may include the manufacture and sale of charging hardware, installation and maintenance of the hardware, a margin on electricity sales, and software for subscription-based access to charging networks.

Initial excitement in this growth opportunity has been overwhelmed by the reality of heavy losses. Our analysis indicates that these business models deliver low gross margins, there are few barriers to entry, supply chain issues have delayed rollouts, and the "land-grab" for charging sites is expensive. As a result, stock price performance has been disappointing.



Source: Bloomberg, First Sentier Investors as at 31 May 2022

Utilities as an EV play

In our view, regulated utilities with electricity distribution networks represent a more compelling exposure to EV charging infrastructure. With the right policy and regulatory settings in place, utilities are well placed to deliver a coordinated rollout of a consistent product at a reasonable cost.

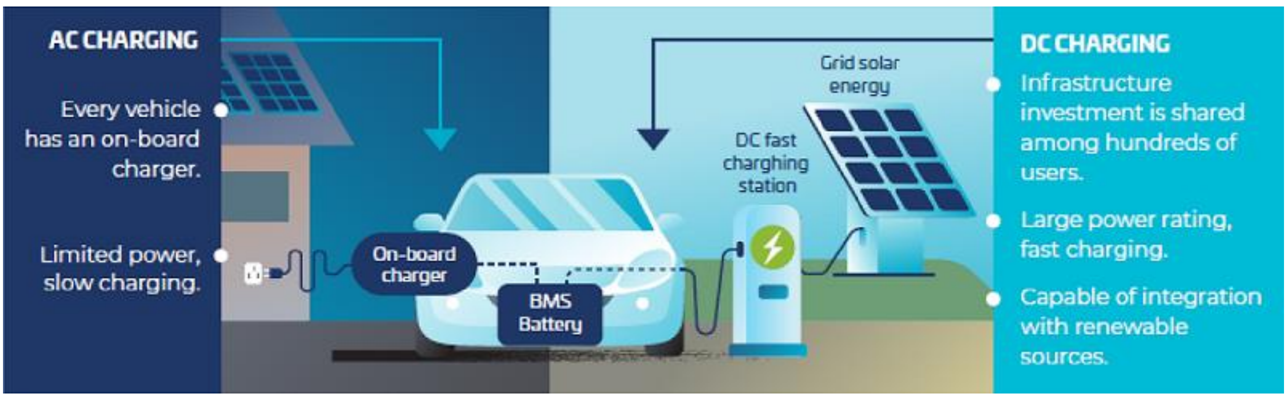
By including the EV charging infrastructure rollout costs in the regulated rate base, along with the required distribution and transmission network upgrades, costs can be shared across the customer base.

Xcel Energy provides a useful case study. Xcel owns electricity distribution networks in Minnesota, Colorado, Wisconsin and New Mexico with approved EV programs. The utilities intend to invest over $US2 billion over the next 10 years to enable 1.5 million EVs in their service territories. In current dollars that equates to around $US700 for charger equipment plus $US700 for installation for each customer.

Xcel is not alone. Across the US there are now 60 electric companies in 35 states or territories with regulatory approvals for EV programs, including: PG&E, Edison, Sempra in the west; ConEd, PSEG, Avangrid, Eversource in the north-east; and Duke, NextEra in the south-east.

The investment opportunity could be materially higher if customers demand faster charging. While a home AC installation for overnight charging should price below $2,000, a fast DC charger that gets you back on the road in 20 minutes could cost more than $US100,000 (see table).

Types and cost of EV charging



Hardware and installation cost assumptions in 2020 (US $)

Hardware type	Hardware cost	Install cost	Total cost	50 kWh charge
11kW private/home	855	950	1,805	–
11kW public/work	1,080	3,040	4,120	4h 30min
50kW	20,421	16,646	37,067	60min
150kW	54,720	51,243	105,963	20min
350kW	96,390	61,161	157,551	9min

Source: Electric Vehicle Council, BNEF, First Sentier Investors

Data as at July 2022

Investor-led solutions

We believe EV charging is an enormous investment opportunity, despite the challenges. So, how can responsible investors contribute to accelerating the uptake of EVs? Below are a few ideas worth considering:

1. Allocate investor capital towards electric utilities which have regulatory approval to rollout EV charging infrastructure
2. Lobby energy regulators to include EV charging infrastructure plus associated electricity distribution and transmission network upgrades in the rate base to encourage investment. Multi stakeholder engagement with utilities, regulators and industry bodies could be a useful tool
3. Real estate investors require minimum 1-in-5 vehicle parking spaces to be EV-ready for new or re-developed office, commercial, housing projects
4. Explore opportunities for toll road companies to develop EV fast charging and recreation areas on vacant land along suburban or intercity roads
5. Challenge integrated oil companies to transform retail fuel sites into EV fast charging centres
6. Allocate higher risk capital to supply chain solutions including rare metals mining, semi-conductors and battery manufacturing. Allocate capital to the manufacture of component parts such as semiconductors
7. Allocate your personal capital to an EV

Peter Meany is Head of Global Listed Infrastructure and Kate Turner is Deputy Head of Responsible Investment at First Sentier Investors, a sponsor of Firstlinks. This material contains general information only. It is not intended to provide you with financial product advice and does not take into account your objectives, financial situation or needs.

For a more detailed look at the EV industry, read the full report here.

For more articles and papers from First Sentier Investors, please click here.

Making death benefit nominations work for you

Julie Steed

A recent High Court decision has confirmed that traditional binding death benefit nominations do not need to apply for SMSFs. In this article we will review the rules and practical application of death benefit nominations in both SMSFs and retail and industry funds.

Nomination types

Superannuation funds offer a range of death benefit nominations including:

- Binding death benefit nominations
- Non-lapsing binding death benefit nominations
- Non-binding death benefit nominations
- Member directed nominations in small funds

Binding nominations

A binding nomination can provide certainty as to who will receive the member's death benefit. Under this type of nomination, members can nominate the person(s) to whom their death benefit will be paid. Superannuation law requires that the following conditions must be met:

- The trustee must give the member sufficient information to understand the nature of a binding nomination
- The nomination must nominate a superannuation law dependant
- The nomination must be in writing
- The nomination must be signed and dated in the presence of two witnesses
- The witnesses must be over 18 and not a nominated dependant or legal personal representative
- The nomination must be clear and unambiguous
- If the nomination is not clear, the trustee must seek clarification as soon as practicable
- The nomination expires after three years
- The nomination may be amended or revoked

Non-lapsing binding nominations

Non-lapsing binding nominations have increased in use in retail funds in recent years. The nomination must be in writing but does not have to be witnessed and does not expire after three years.

These nominations require the trustee to actively consider and consent to the nomination. The trustee will generally consider whether the nomination is intended to be enduring and that the member does not intend for the nomination to ever expire. For example, if a spouse or the member's estate is nominated, the trustee could reasonably conclude that the member intended for the nomination to never expire.

Non-binding nominations

A non-binding nomination is an expression of wishes which is not binding on trustees. The trustee will exercise discretion to determine the recipient of the death benefit but will take the nomination into account when exercising this discretion.

Where the death benefit is to be determined by trustee discretion, the trustee is required to undertake a claim staking process to identify potential beneficiaries and inform them of the trustee's intentions as to how the death benefit will be distributed.

Potential beneficiaries include anyone who meets the superannuation law definition of dependant. The potential beneficiaries have 28 days to object to the trustee's intention. If a potential beneficiary objects to the intended distribution, the trustee must obtain further information about the potential beneficiaries' level of dependency, reassess their decision and recommence the claim staking process.

Except for SMSFs, if potential beneficiaries are dissatisfied with the trustee's decision, they may lodge a formal complaint through the fund's internal complaints process. They can also make a complaint to the Australian Financial Complaints Authority (AFCA).

SMSF member-directed nominations

SMSFs and small APRA funds (SAFs) are exempt from the provisions of superannuation law which prohibit a person who is not a trustee from exercising discretion as to who will receive the death benefit.

Members of SMSFs and SAFs can incorporate certainty in the nomination of beneficiaries using a clause in the fund's trust deed. Such a clause would typically state that if a member nominates a valid dependant, the benefit shall be paid to them.

The High Court of Australia recently ruled in the case of Hill v Zuda Pty Ltd [2022] that the traditional three-year lapsing binding death benefit nominations do not need to apply to SMSFs. Whilst this view has been widely held, this is the first time that the courts have definitively clarified the matter, which has been welcomed.

SMSF trust deeds

In an SMSF, it is essential to review the fund's trust deed to determine the rules regarding death benefit nominations. Although the High Court has ruled that traditional death benefit nominations do not apply to SMSFs, many trust deeds expressly include the traditional requirements. If this is the case, they must be complied with, and the nomination will lapse.

It is also important to review other SMSF trust deed requirements. It is common for trust deeds to provide an appendix or schedule that sets out the death benefit requirements, often in the form of a template. Any nomination that doesn't meet the requirements would not be valid.

Many SMSF trust deeds also contain specific provisions regarding how the nomination must be given to the trustee and/or whether the trustee must accept a nomination prior to a member's death.

No nomination

Where a member of any super fund has not made a nomination, the fund must have rules for determining the death benefit recipient(s).

Some funds will exercise discretion and follow the same process as if a member had a non-binding nomination.

However, many funds have automatic provisions that require the benefit to be paid to the legal personal representative. If a member does not have a will, their benefit would be distributed under the relevant state laws for dealing with intestacy. This is also particularly important for members who don't have legal capacity to make a will but for whom the distribution of a death benefit under the laws of intestacy would result in unjust outcomes.

Case study – Pia

Pia was involved in an accident and no longer has mental capacity. He has not made an enduring power of attorney or a Will, nor has he completed a superannuation death benefit nomination.

He received a $1 million compensation payment that was paid to his super.

Following his injury, he lived with his father who is his full-time carer. His mother abandoned them both. Pia has never married and has no children. If Pia were to die and his superannuation benefit was paid to his estate, in most states, each of his parents would receive half of his super. If Pia was a member of a fund where the trustee was able to exercise discretion, it is likely that his father would qualify to receive all the benefit.

Invalid or partially invalid nomination

A death benefit nomination can never bind a trustee to make a payment to a person who does not meet the definition of a superannuation law dependant. In many instances, a person may have been an eligible dependant at the date of nomination but is not at the date of death.

In this respect it is important to understand what the fund rules are in respect of invalid nominations. Common options are for the benefit to be required to be paid to the legal personal representative or alternatively for the trustee to have discretion. Where multiple beneficiaries have been nominated but only one is invalid some fund rules state that the whole nomination is invalid whereas other fund rules will determine that only the portion of the non-dependant's nomination is invalid.

Conclusion

Understanding the types of nominations offered by different funds can help members to ensure they are in a fund that offers death benefit nominations that suit their personal circumstances.

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

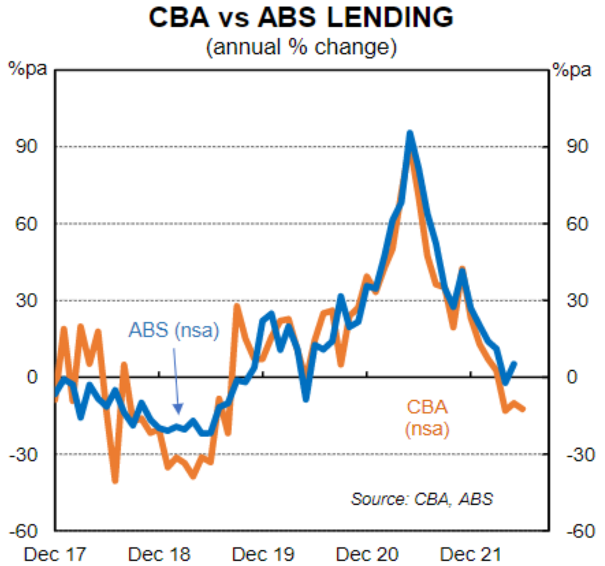
A six-chart snapshot of June 2022 lending data

Stephen Wu

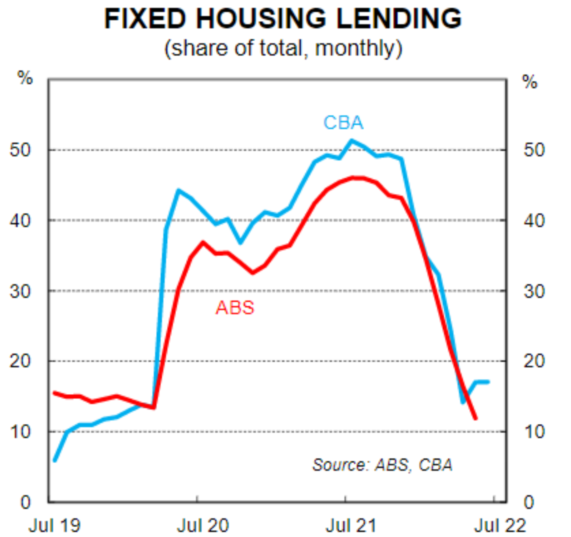
Lending data for June 2022 show that annual growth in new housing lending remained negative, approaching levels not seen since the restricted lending period around 2019. Reflecting the recent rise in interest rates, both fixed and variable lending rates are well above their pre pandemic levels. However, consumer lending for holiday finance and car finance increased.

Housing lending and rates

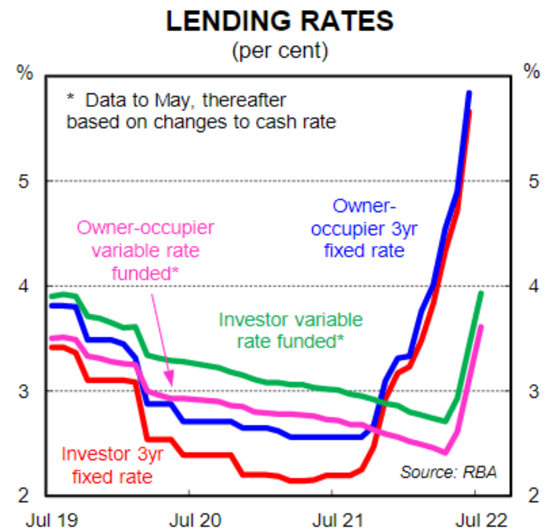
Annual growth in new housing lending remained negative with the weakness led by lending to owner-occupiers and also lending for the purchase of existing dwellings.



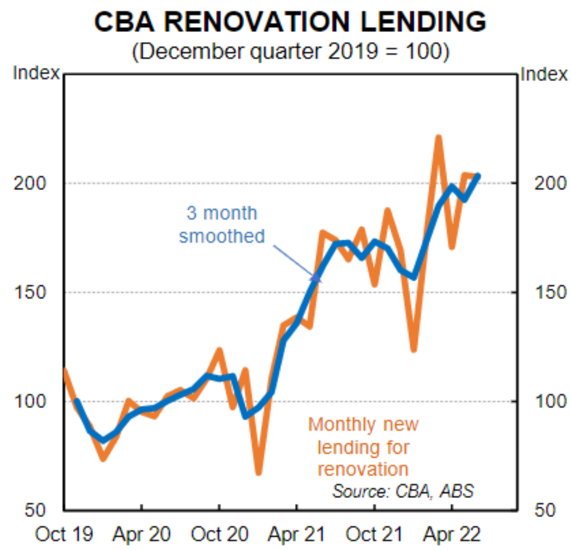
The fixed share of new lending was little changed in June. It remains around its pre-pandemic levels, having fallen sharply as fixed lending rates have risen rapidly.



Borrowing costs for both owner-occupiers and investors have risen sharply in recent months. Both fixed and variable rates are now well above their pre-pandemic levels.



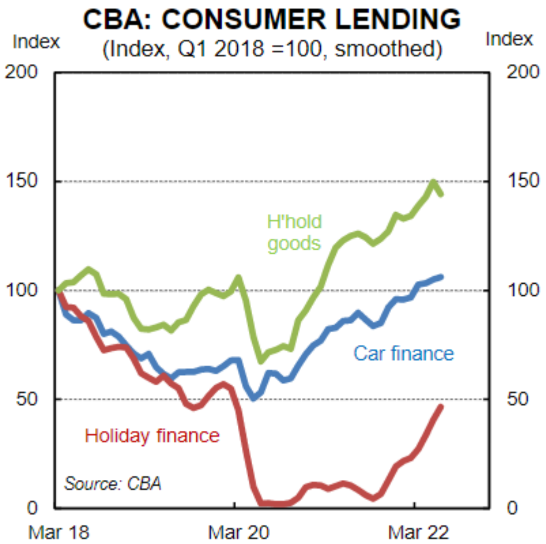
New lending for alterations and additions was unchanged in the month at a high level. On a smoothed basis, renovation lending appears to be at or close to a peak.

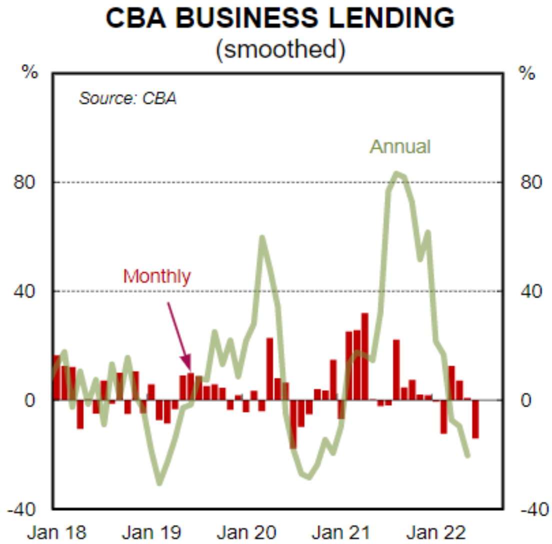


Consumer and business lending

On a smoothed basis, consumer lending for both holiday finance and car finance increased but there was a tick down in household goods finance.

Business lending tends to be quite volatile, but on a smoothed basis, there are signs of a softening in new business lending.





Stephen Wu is an Economist for Global Economic & Markets Research at [Commonwealth Bank of Australia](). This report is for informational purposes only and is not to be relied upon for any investment purposes, as it has been prepared without taking into account your objectives, financial situation (including your capacity to bear loss), knowledge, experience or needs.