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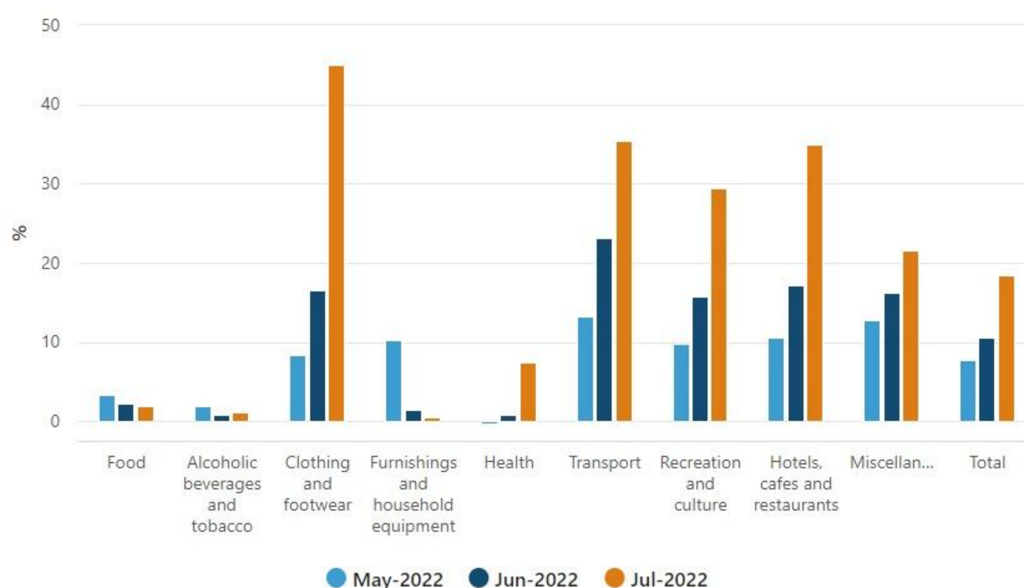
Editorial

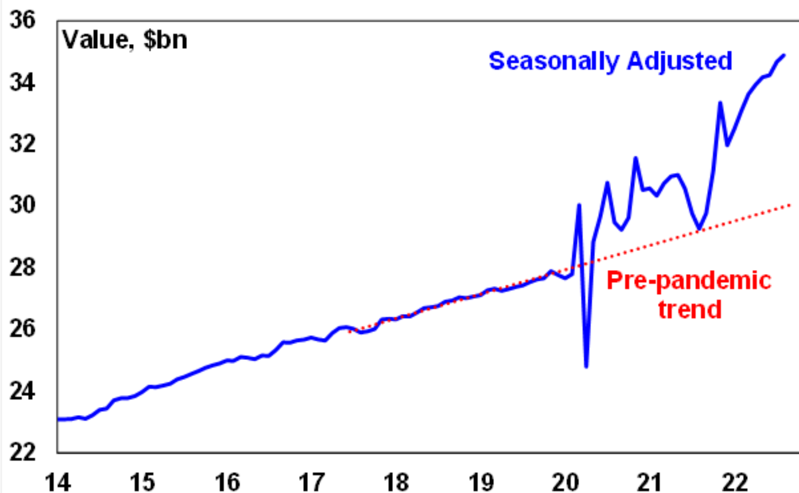
As I stood in the long queue at a NSW South Coast café on the weekend, waiting patiently to buy four bacon and egg rolls at $14 each and four coffees at $4.50 each, I thought back on our recent Reader Survey including whether inflationary expectations are now embedded in prices. I was about to spend $74 (ouch! no tip!) on a simple takeaway breakfast, and so were the dozen people ahead of me. This was not a café in an expensive CBD location, it was in a side street in a country town. I part-own a restaurant at Robina on the Gold Coast and we have reluctantly increased prices three times this year, and turnover is at record levels. Around the corner from where I live, the 'traiteur' and 'boulangerie' (don't call it a bakery and deli) has queues around the corner for its $25 barbeque chickens and $13 miche loaves. After the pandemic, we are out and about and spending.

Reserve Bank Governor Philip Lowe is right to be troubled, as he told a Parliamentary Committee on 16 September 2022:

"But the general inflation psychology appears to be shifting. It is easier for firms to put their prices up and the public is more accepting of this."

We are paying up despite some prices rising 30% or more. While all the inflation talk is about global energy prices, blocked supply chains and labour shortages, it is the public's ready acceptance of higher consumer goods prices that is a major factor. There's far more spending than complaining as the latest **ABS** data shows.





Source: AMP and ABS

In numbers released on Wednesday this week by the ABS, August 2022 retail sales rose another 0.6% month-on-month and 19.2% compared with August 2021.

Acceptance of inflation, what Lowe calls our "*mindset*", is a "*broken spell*" says **Ross Gittins**, writing in *The Sydney Morning Herald*:

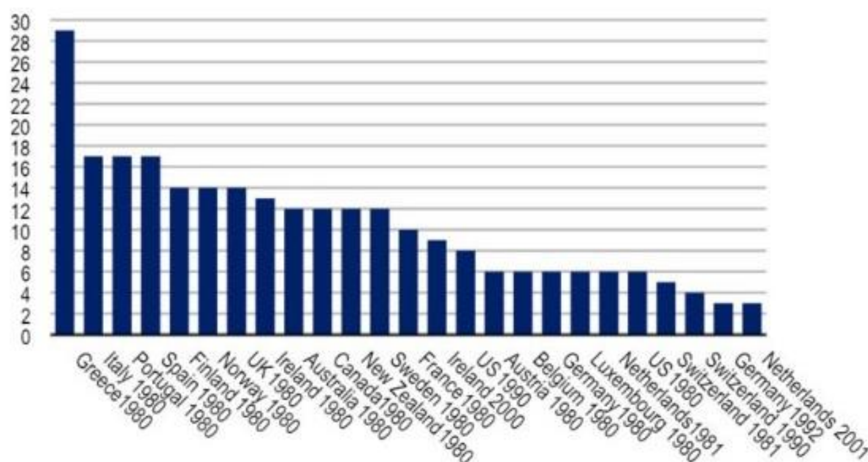
"Suddenly, some big price rises are announced, the dam bursts and everyone - from big business to corner milk bars - starts putting up their prices. The spell has broken, and I doubt we'll go back to the weird world we were in."

The old "*weird world*" was a reluctance of businesses to increase prices, and that's gone. Unfortunately, the consequence is that central banks will probably need to increase rates to shake consumers from their complacency. The cash futures rate in Australia is now about 4.3% for mid-2023 which would take variable rate mortgages to around 7%, an unaffordable level for many borrowers coming off 2% fixed rates.

The dramatic increase in US bond yields as shown here, however, holds an underlying message, with the two-year rate above the 10-year. The market expects short-term rates to rise but long term, the central banks will bring inflation under some level of control.

The US 10-year Treasury yield briefly reached 4% yesterday (Wednesday in New York) but then fell quickly to close at around 3.71% after the **Bank of England** triggered a bond and equity rally when it announced it was purchasing UK bonds. But the 10-year was only 3.2% at the start of September. How long it takes to reduce inflation, nobody knows. Here is a sobering chart [quoted in **Bloomberg**] from **Bank of America**, showing that since 1980, whenever inflation exceeds 5%, it has taken on average 10 years to bring it down to 2%, the bottom of the Reserve Bank desired range.

Cases of inflation above 5% in advanced economies 1980-2020, years to decline to 2%



Source: IMF and BofA Global Research

On a more optimistic note, **Capital Economics** in the US produces an index of product shortages. It suggests a fall in inflation is coming, based on reducing fuel prices, easing global supply constraints, cheaper travel costs and lower food prices.

Which gives an outlook of higher inflation in the short term, lower inflation in the medium term, and plenty of mortgage rate pain in the meantime.

Central banks created too much stimulus in 2021, and the Reserve Bank is rightly taking criticism for its rate predictions, which even the Governor calls "*embarrassing*". I realise it is easy for commentators to take pot shots at central bankers. Conceding I am falling for the same trap, I want to make one point where the Governor is ingenuous. He continues to justify the four-pronged stimulus programme - the bond purchase package (BPP), the Term Funding facility (TFF), forward guidance and low cash rates - as **insurance** against a calamity. He has repeated this point many times, and most recently on 16 September 2022, before the [Standing Committee on Economics]:

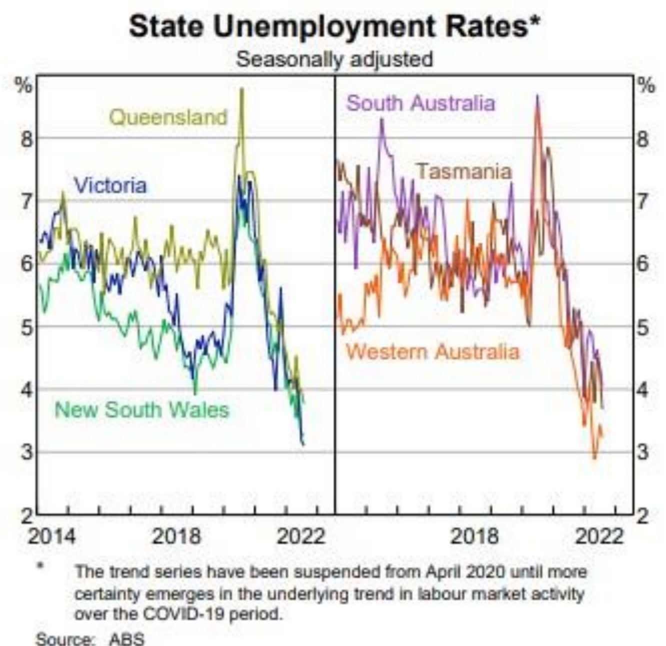
*"At the RBA, we did this to provide a financial bridge to the day when the virus was contained and to provide some **insurance** against the possibility of very bad economic outcomes. As we sit here in Canberra today, it can be easy to forget how dire the outlook was in 2020 ... But in those dark days of the pandemic, the Reserve Bank Board judged that the bigger policy mistake would have been to do too little, rather than too much."*

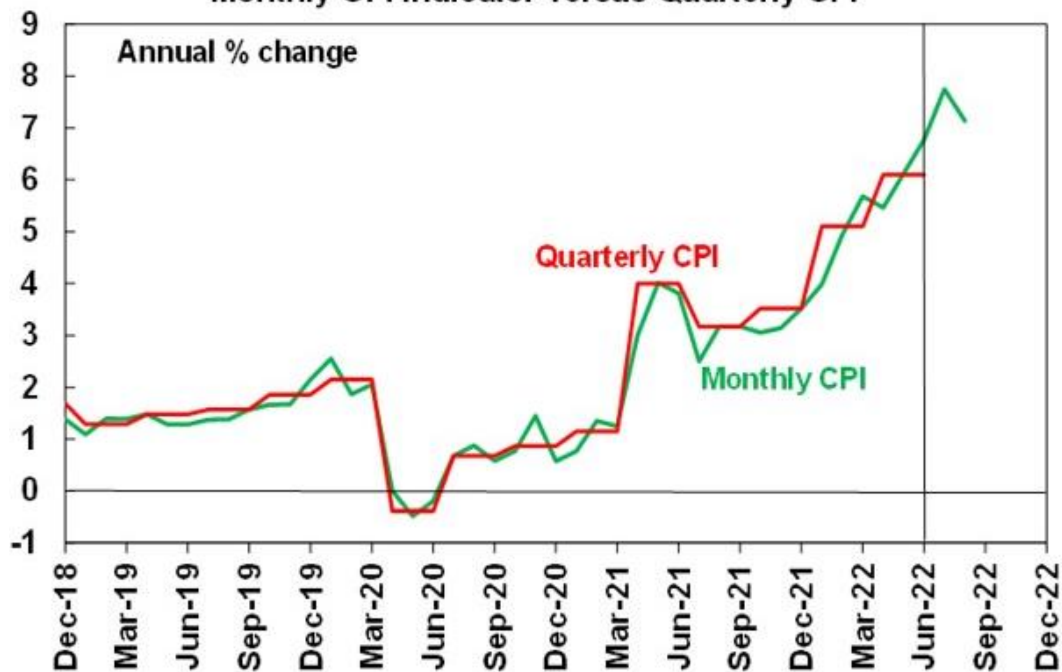
But note the time scale here: "*how dire the outlook was in 2020*" and the "*dark days of the pandemic". No argument about 2020,* but there was little attempt to reign in the stimulus until much later, into 2022.

Recently, another speech by the Deputy Governor, **Michelle Bullock**, on 21 September 2022, on [the operations of the BPP], explained the timing:

"The BPP was introduced in November 2020 ... (it) was extended several times: first, a further $100 billion from April to September 2021 at a rate of $5 billion a week; then, from September to November 2021 at a rate of $4 billion a week; and finally, purchases of $4 billion a week until mid-February 2022, at which point the programme ceased. All up, the BPP resulted in the purchase of $281 billion of Australian, state and territory government bonds."

The Reserve Bank was still buying bonds to inject liquidity into the banking system as recently as February 2022, long after the drop in unemployment and rise in inflation, as shown in the next charts (right and below). The US CPI was up 6.8% in the year to November 2021 but cash rates were not increased in Australia until May 2022.



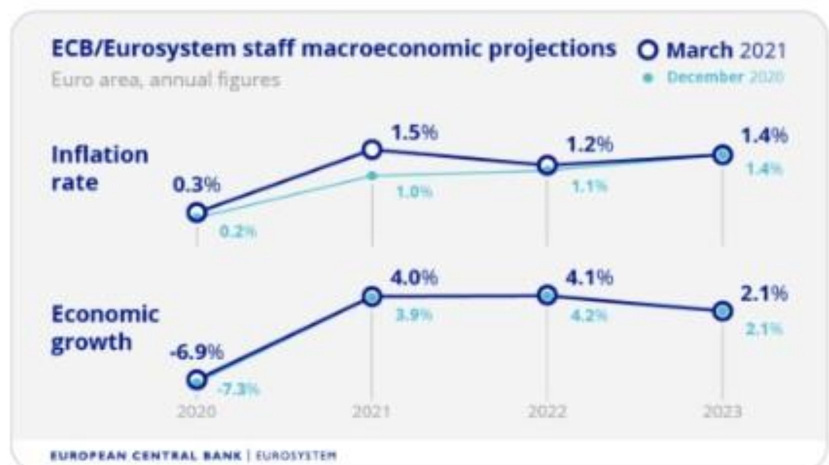


Philip Lowe remained steadfast in his resolve, saying as late as [2 November 2021](#):

"In our central scenario, underlying inflation reaches the midpoint of the 2 to 3% range only in late 2023. Having underlying inflation reach the midpoint of the target range for the first time in seven years does not, by itself, warrant an increase in the cash rate."

The Reserve Bank was part of a cohort, including the **US Federal Reserve** and the **European Central Bank** (ECB), that miscalculated the inflationary consequences of their actions. Here is the March 2021 ECB inflation forecasts out to 2023 issued by their army of analysts and quants. No inflation above 1.5% for four years.

President Christine @Lagarde introduces the baseline GDP and inflation outlook for the euro area.



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In this week's edition ...

We develop some of these themes plus many more useful topics.

At a time when the new Government of UK **Prime Minister Liz Truss** has embarked on a massive experiment in giving A$100 billion of tax cuts to wealthy people, causing the pound to collapse and the **IMF** to question the 'trickle-down economics', the **Bank of England** is raising interest rates to slow the economy. Go figure, but then Australia has its own version with the Stage 3 tax cuts from 2024. Given many readers do not go back to read comments, we have selected 10 highlights from each of the seven questions to show what people are thinking about the challenges facing our Government.

Last week, **Michelle Bullock** gave the fullest explanation yet of the transition from liquidity stimulus to withdrawal, including why the bank bought $280 billion of bonds. It is timely for former actuary, **Tony Dillon,** to explain exactly how this worked and the extent to which it has pushed up inflation.

Robert Dinham of Fidelity reports on a survey of 1,500 people either in or approaching retirement on what makes them happy, and money is not top of the list. There are hints here on planning for retirement but also a few warnings.

Then two investment articles explaining important terms which many people might be unsure about, 'smart beta' and 'index rebalancing'. **Arian Neiron of VanEck** describes how and why smart beta funds are winning market flows, while **Duncan Burns of Vanguard** shows how index rebalancing works and why it's not an easy trade to get ahead of the professional rebalancers forced to buy and sell particular companies.

The current market selloff (although New York rallied last night with the S&P500 up about 2%) is not simply a correction to lower valuations but the market grappling with profound changes in inflation and perhaps stagflation. **Guido Baltussen** and colleagues at **Robeco** say periods of stagflation can be poor for equities but some investment factors may hold up better.

James Gard then reflects on investment lessons following the death of **Queen Elizabeth II**, that despite nobody knowing the total period they are investing for, a multi-decade plan should stand the test of time.

This week's White Paper is from **GSFM** specialist investment manager **Man Group** which presents eight things investors can no longer rely on, starting with the commonly known and ending with the more esoteric.

Graham Hand

7 questions, 70 opinions on major policies facing Australia

Graham Hand, Leisa Bell

As always, Firstlinks readers were eager to share their views on important policy issues facing Australia. We have compiled this document of all comments but to give a quicker look at opinions, a selection of comments is included below.

Thanks to almost 1,000 respondents, the survey is now closed.

1. Should the Stage 3 tax cuts be cancelled?

- The view that the cuts "only benefit the rich" completely ignores that the previous Stage 1 and 2 cuts (part of the overall package) already targeted all the lower tax brackets.
- They are long promised, they are not really tax cuts, but a belated return of tax increases from bracket creep (which will accelerate with higher inflation), and although they favour higher income earners, you can't give cuts to the bottom 40% who pay no tax.
- They were only agreed to avoid a political wedge and are far too costly when so many other top line initiatives need funding.
- People on over $200k do not need more tax cuts, esp since the top 1% will benefit as much as 65% of lower rungs. Outrageous really.
- High taxes rates promote 'clever' tax planning and defeats the purpose favouring those with private companies who can capture the lower rates applicable (25%). I consult through a company for that reason.
- As much as I don't want an increased deficit, people need to have certainty that when the government promises changes to the system, it won't then change it's mind down the track.
- Distribution of wealth in Australia is becoming top heavy.
- They are not needed nor necessary. If the government is determined to give away tax revenue, raising the tax-free threshold would be more equitable.
- Cancelling it may be financially sensible, but we cant deny that we live in a very divisive partisan political environment alongside loud and biased media.
- Tax Reform is needed to broaden the base away from income tax.

2. Are prices increasing due to embedded inflationary expectations?

- Inflation expectations are not yet embedded, but could become embedded if wages chase inflation up.
- With high consumer demands continuing to be impacted by supply chain issues causing material costs to rise unpredictably merchants are probably hedging their bets in including some degree of extra costs in their quotes as a counter balancing to inflation.

- The bulk of cost increases have genuine cause but I think it has been much easier to implement cost increases and also get away with a bit of extra thrown in to take advantage of the situation.
- Restaurants and even some grocers are trying it on and succeeding due to pent up demand from the pandemic. Some higher end restaurants are now charging 25% more for meals to even 50% and more higher for degustation and getting away with it.
- I don't accept the 'expectation'. I'm changing my buying habits.
- The RBA Governor should never make comments reaching into the future. The future is very uncertain and he should keep his cards close to his chest. He didn't listen to a lot of economists, who told him to raise interest rates after the emergency was over. He thought he knew better and kept them ultra low for far too long.
- Like a domino affect, where the prices rise and then wage rises go to off set, adding to inflationary pressures.
- I do believe Australians are less likely to scrutinise the cost of things as much as past generations. So businesses can get away with more.
- I think the missing link is fear of unemployment which was all pervasive in the 70's. This was what slowed people spending even when they had a job.
- Australia manufactures practically nothing now so everything we buy has to be imported with all those associated costs.

3. Should the childcare subsidies be brought forward to 1 January 2023?

- Allow nannies to be tax deductible. Much better for shift workers and multi child families.
- We need to not encourage high fertility rates due to new technologies achieving biological immortality and hence overpopulation risks.
- Allows for a more flexible workforce and more dynamic economy which will assist with economic growth.
- Increased childcare subsidies simply lead to higher fees for parents and tax payer with increased profits going to for-profit providers.
- Give some tax relief to families where mums stay at home (at financial cost) to raise their own kids, in preference to outsourcing the responsibility.
- There are not enough childcare staff. It will take a long time to increase the number of child care workers and it will need a boost in wages for these workers to retain them and be attractive for new entrants.
- I think this sort of subsidy has huge benefits for productivity, closing gender wage gaps, improving childhood education and I think a significant net positive to families and the community.
- It's not about the $, it's about the children - having a parent at home for our children has been amazing and yes, we've sacrificed income and assets, but our children are thriving. You can't outsource it.
- Employers are screaming out for more workers as we have limited workers coming from overseas currently. Tax revenue collected from these workers would offset the Federal Government's investment.
- Blows my mind that we are subsidising people earning $500k per year. There is no-one sitting around at home with their kids thinking "if only the government paid $10k more of my childcare fees I'd get a $500k job".

4. Should a mining super profits tax be introduced?

- Appropriate mechanisms need to accompany the policy to ensure adverse effects on shareholders (which will be most Australians via their super) aren’t too harshly impacted.
- In principle it sounds a good idea, but will it be a disincentive for business to invest?
- Whilst it should produce more revenue, it is "moving the goal posts during the game" and that is not a good practice. The mining companies should be paying a great deal of income tax already. If they are not then that is for the ATO to fix.
- We only get one chance to dig it up. A sovereign fund should be established with the tax.
- It needs to be temporary, as long as there are very high profits.
- Provided the funds generated are invested and used for the greater good of the nation, as per the Norwegian example.
- Introduction of this supertax will lessen exploration for future mines on a risk /benefits ratio assessment for investors.
- Gas, Coal and iron ore exporters are making super profits owing to world issues not as a result of their investment. These resource belong to Australia, it is therefore reasonable that Australia should benefit from this boom.
- Mineral ownership should remain with the Commonwealth with a licence given for extraction and a sliding scale of share in the returns.

- The mining industry is heavily taxed already and additional taxes will discourage research, development, exploration and returns to investors.

5. Should gas supplies be reserved for the East Coast domestic market?

- We own the gas, we should take care of domestic supply; otherwise the benefits to the economy of exporting will be offset by dis benefits.
- To some extent yes but again this is a case of moving the goal pasts after the project has been established. There is a big difference between reserving gas supplies and also expecting a subsidised lower price.
- Biggest policy failing of State and Federal Government in the last 5 years. So called export net back pricing is delivering domestic prices higher than our export customers domestic economy.
- The concept of reserving some local gas for the East Coast Market is attractive, but it should best be out of new fields so that we can honour long term contracts
- It is crazy that we are rich in this resource yet have one of the worlds highest domestic prices.
- Yes but not at an over-the-top cost to gas producers. Should apply Australia wide if introduced.
- This works in WA and was a failure of governments on the East Coast to implement similar measures.
- Outside of the commercial agreements that need to be revisited this is a no brainer. It is just plain stupid to end up in a situation where gas continues to be shipped offshore and Australian's are rationed gas at a higher price.
- For efficiency and equity reasons, as well as social and political reasons.
- Reserving gas supplies will ensure that we will not have energy crisis
- As a prime producer of gas, it is not acceptable to pay such a high price and allow speculators to benefit because of the current state of energy.

6. Should the October 25 Budget include additional cost of living concessions?

- We must learn to live within our means. Having low government debt allowed us to withstand several crashes now, and the more debt the government carries, the less robust we are to shocks.
- Some modest well targeted actions are warranted, but not broad sweeping handouts.
- Any assistance would need to be very carefully chosen so that it does not provide a long term burden on the Government revenues
- Australia needs to make better decisions how it handles its wealth; both in the private personal/corporate sphere and in the public sector. It cannot afford more concessions that defer the reality.
- I thought we had an inflation problem? Only a fool would try to combat inflation by handing out more cash.
- If the world is charging higher prices for stuff we must import, then sooner or later we will have to pay those higher prices. Meaning we will have to learn to live with reduced real wealth. However, social security payments need to keep up with real cost increases. As should minimum wages.
- We need to keep inflation under control, but it’s hard to say that the low paid should be the cannon-fodder in the inflation-controlling exercise when many in our society are much much better than simply ‘well off’ and live with such great excess.
- No good having fiscal and monetary policy pulling in opposite directions. All this stimulus is what got us here in the first place. It was madness cutting the fuel excise. Way more useful to provide cheap, accessible, and plentiful public transport. When is the diesel rebate going to be removed? Sick of subsidising big business.
- Governments need to deal with the cause of the problem, not compensate for the consequences of the problem.
- While politically appropriate, such a measure will place greater responsibility on the RBA to curb inflation (because it is demand side)

7. What other major policy question should we ask?

- When can we have another complete review of the tax system given that the Henry review sadly got lost in the politics of the day? What are the pros and cons of increasing the rate of GST?
- Health spending seen as an investment, not a cost.
- Climate change policies (mitigation, preparedness) should drive all others. This is an existential threat to not only our species but our planet.
- Discontinue property investment concessions including negative gearing and capital gains tax discounts.
- Why are we not investing in more social housing? Residential real estate should not be an investment class but part of a person’s financial wellbeing or base. The percentage of social housing has dramatically decreased over the past 20 years, and we are now suffering from it.

- Improve education learning across primary, secondary, and tertiary. It is not just about more money for teachers, it is about improving the curriculum, especially in primary and secondary. Less lifestyle choice learning early on and back to basic learning in all sectors.
- Increase in immigration of skilled workers in particular in aged care, doctors and nurses.
- What is a sustainable level of national debt and how can we fund good social and medical services and afford the level of defence spending that is clearly required?
- Should there be an upper limit (for example $5m per person) on the amount able to be held in any superannuation account, given the considerable tax concessions on earnings within superannuation?
- Now that we have a legislated emissions reduction target, what is the strategy for achieving this? Vague references to 'renewables' are not good enough.

Leisa Bell is Assistant Editor at Firstlinks. This article and these opinions are general in nature and do not consider the circumstances of any investor.

Retirement planning is not only about the money

Richard Dinham

Retirement is often a massive life change for the majority of people who experience it. Most of us will have mixed emotions around the end of our working life and the beginning of our 'second half'. For some it will be a relief, and something they have long planned for and are looking forward to, but for others it will be a source of anxiety. This anxiety could be due to many factors including, but not limited to, concerns around the potential for running out of money, feelings associated with a lack of confidence or a lack of control and other factors we will discuss here.

While individuals' wealth and health are obviously important for anyone heading into retirement, but we have found there are other factors that are usually more important in determining the life satisfaction for retirees.

Surprising results on retirement happiness

"Retirement: The now and the then" a survey of over 1,500 Australians over the age of 50 by Fidelity International, drilled into the many factors driving happiness for retirees, with some surprising results.

The survey found that the top four drivers of overall life satisfaction for experienced retirees – i.e. those with more than 10 years living in retirement – were:

- purpose
- control
- confidence, and
- emotional experience.

Emotional experience relates to the sense of optimism and contentment that retirees feel. It was the strongest driver of overall life satisfaction and significantly more important that health and wealth.

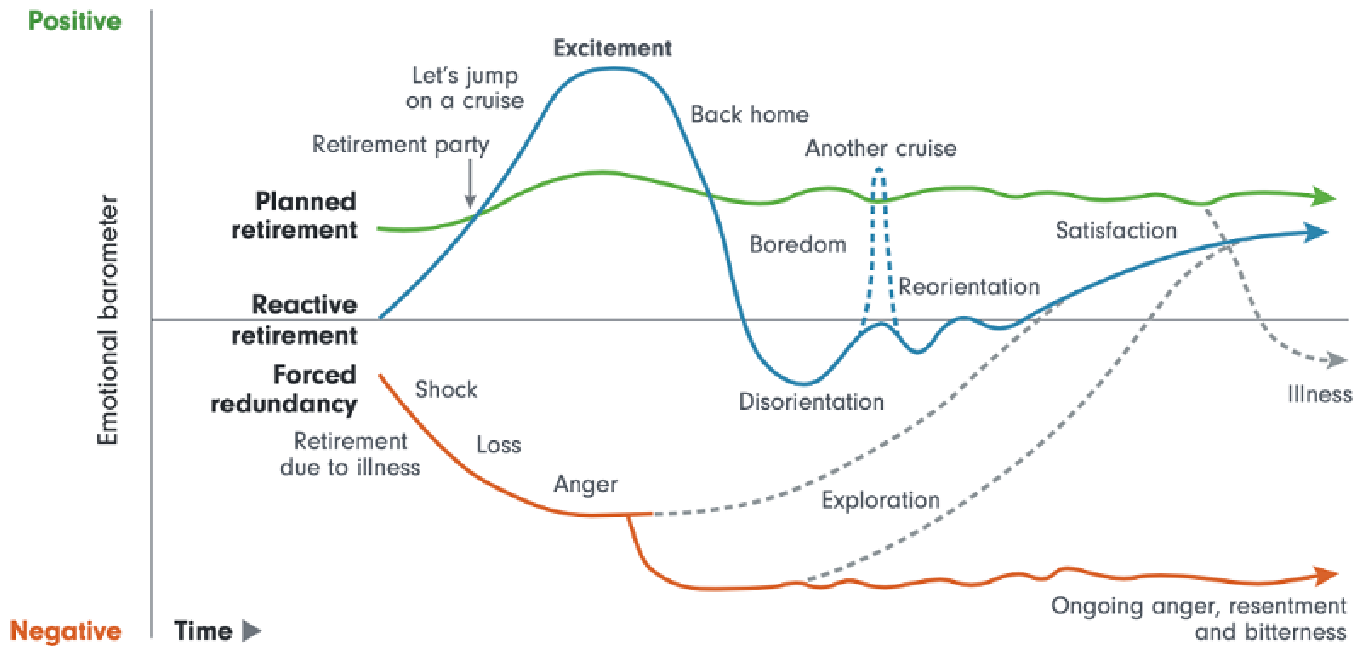
Positive emotional experiences often correlate with retirement journeys that have been well considered and planned, or ones in which despite retirees' plans not having worked out but in which they already had a Plan B or a backup plan. Negative emotional experiences are often felt by those people who may not have planned adequately and may have been forced into retirement through job loss or other factors out of their control.

Emotional roller coaster

This chart (next page) is a useful illustration of what range of emotions are possible during a retirement journey.

The green line shows that the emotional experience of a well-planned and prepared retiree is usually fairly steady with low stress levels and a generally positive emotional experience.

In contrast, the journey of the reactive retirement is much more variable where the lack of planning can lead to significant swings in lived emotional experience.



Adapted from RC Atchley, *The Sociology of Retirement* (1976).

The journey of the person forced into retirement through an unplanned redundancy is much more unpredictable and can be a difficult period from an emotional perspective. However, it can also be turned around with the right mindset and often with the help of a good financial planner, as the alternative paths highlight.

Promoting a good life

In thinking about how best to prepare for a long and fulfilling retirement, we believe that there are six key building blocks that are important elements of any plan.

We call these the six Cs:

Firstly, there is **capability,** which is the agency and ability to act and adapt to optimise a good life trajectory. If a retiree has the capability, they have the potential to turn a negative emotional experience into a more positive one.

Then there is **confidence,** or the peace of mind and optimism to keep looking forward to a good life while still enjoying your existing life. We may all wish we had a bit more confidence sometimes, but this is more about inner confidence and the belief that you have made the right choices and are living, and will continue to live, a good life.

Control is another C. This is about feeling like the master of your destiny while avoiding the pain of uncertainty and failed expectation. Obviously being forced into retirement through a job loss or redundancy is a lack of control but having a plan B already in place can help regain that sense of control.

Circumstance is how we like to bundle health and wealth together. These are critical components for enjoying a good life. A major health problem can derail an otherwise planned retirement but if the other Cs are all there, the overall experience will be better.

Character refers to self-esteem and a person's resilience. These factors can ensure a positive inner narrative which is important for a good life. Again, having the character and discipline to have a plan B already in place, to have a flexible disposition and a positive outlook significantly helps build resilience to life's unexpected turns.

And finally, there is **connection**, which refers to a sense of connection with family and the community. Quality relationships and being able to look beyond, or transcend, a purely inward focus are central pillars of a good life. It turns out thinking of others is also good for us too.

Lessons from the 'elders'

There is a lot to be learned from those that have journeyed before us and retirement is no different. Our survey asked experienced retirees about lessons learnt and challenges did they not anticipate.

Many said they underestimated the emotional impact of retirement, such as their sense of loss of purpose and their personal identity when they retired.

Many also said that due to unexpected life events - such as losing a partner, health and mobility issues or dealing with homecare and aged care needs - they needed to be flexible and had to adapt and change their plans during retirement. Some downsized their homes or returned to work, to do more in retirement.

The two most important pieces of advice that late retirees can give to pre-retirees are not financial but emotional.

First, having a positive and optimistic outlook on life received the joint highest vote in our survey at 64% of respondents.

Second, also from 64% of respondents, investing in your health, and do it early, don't leave it until too late.

Being flexible and adaptable was the next most popular at 61%, followed by finding purpose beyond work at 58% and taking control early with 55% of the vote. Always having a plan B was also important with 52% of the vote.

Plan beyond wealth

We hope that pre-retirees can incorporate some of these insights into their retirement plans. It's not just about wealth, the size of retirement savings and how to build that over time. There are more important factors that can build a satisfying and happy retirement.

The survey showed that having a positive outlook with a sense of confidence, taking control and forming a sense of connection with friends, family and community are significant in building and maintaining a happy retirement.

Richard Dinham is Head of Client Solutions and Retirement at Fidelity International, a sponsor of Firstlinks. This document is issued by FIL Responsible Entity (Australia) Limited ABN 33 148 059 009, AFSL 409340 ('Fidelity Australia'), a member of the FIL Limited group of companies commonly known as Fidelity International. This document is intended as general information only. You should consider the relevant Product Disclosure Statement available on our website www.fidelity.com.au.

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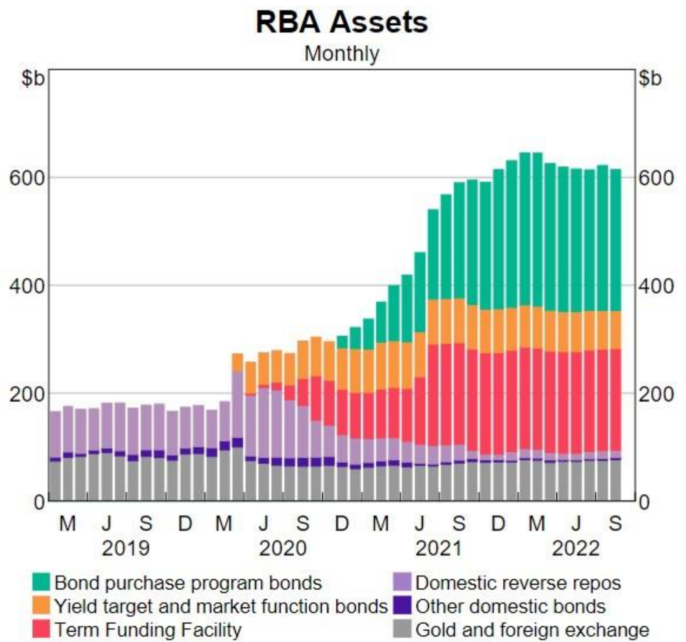
RBA justifies its QE to QT, but did it drive inflation?

Tony Dillon

Last week, the Deputy Governor of the Reserve Bank of Australia (RBA), Michelle Bullock, presented on the central bank's shift from quantitative easing (QE) to quantitative tightening (QT) and its implications. She reported that between November 2020 and February 2022, the RBA purchased $281 billion of federal and state bonds through its QE programme, at a time when the federal government was borrowing hundreds of billions to fund pandemic support measures, including the $90 billion JobKeeper programme. It was the main factor (the green bars) in a massive increase in the RBA's balance sheet.



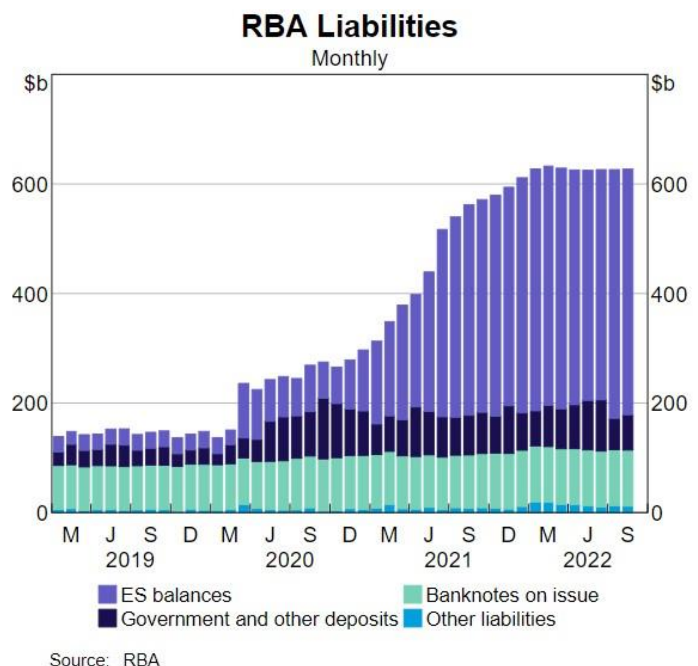
The RBA bond purchasing programme was part of the $US11 trillion injected into the global economy by major central banks in response to COVID-19. And with inflation now entrenched in major economies around the world, central banks are scurrying to reduce their balance sheets. The shift is on to global QT.

Faced with rampant inflation, the US Federal Reserve has indicated it is prepared to bring on a recession to control prices. It's ironic that central banks spent trillions to stimulate activity during the pandemic and now they are withdrawing trillions to reduce spending. Central banks are now paying for their largesse.

The RBA announced in May this year that with the QE phase of expanding its balance sheet ending, the QT phase would begin. It would do this by allowing its holdings to run down as they mature, reducing the balance sheet gradually.

QE and QT and the impact on inflation

QE involves central banks engaging in large-scale asset purchasing programmes. Government bonds are purchased in the secondary market to lower bond yields and longer-term borrowing costs to provide economic stimulus. Debt purchased is recorded as an asset in the central bank balance sheet, offset by the creation of commercial bank (Exchange Settlement, or ES) reserves recorded as a central bank liability, as this RBA chart shows, the other side of the first chart above.



QE adds to base money in the system, and in doing so runs the risk of igniting inflation if the increase in commercial bank reserves spawns an increase in the broad money supply via lending to the private sector. In suppressing interest rates, it can also inflate asset prices.

Essentially, central banks create base money with QE, in the same way commercial banks create private sector deposits (or broad money) when lending money.

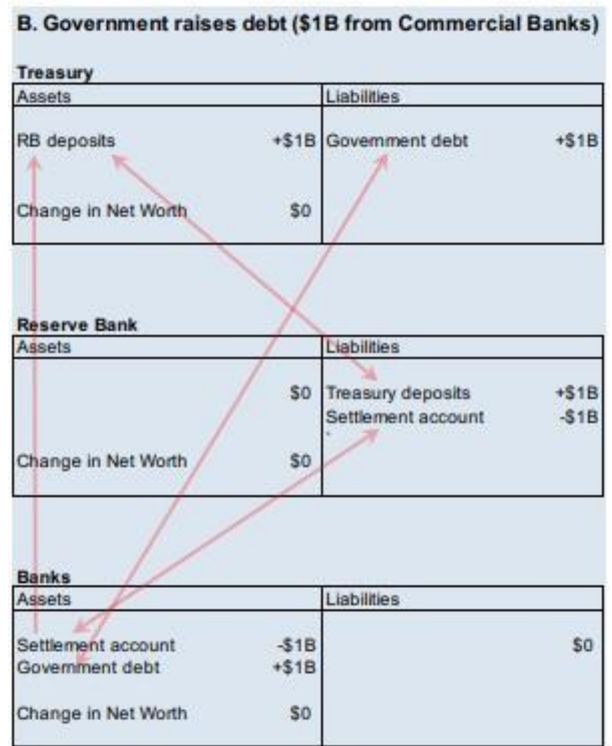
In both instances, entries appear simultaneously on the asset and liability side of their balance sheets, as new money is created.

The RBA's approach to QT of allowing bonds to mature over time and not reinvest the proceeds is a passive approach. The more aggressive scenario is actively selling its assets back into the secondary market before they mature to reduce its balance sheet more rapidly.

The pace at which QE is unwound, if at all, is of importance. To the extent that QE is not reversed, the actions of the central bank could be perceived to be 'indirect' monetary financing. Where monetary financing, as advocated by Modern Monetary Theory (MMT), is the funding of government deficits by money creation, instead of issuing debt or increasing taxes. Because when deficit spending coincides with a QE program, that's what might appear to be occurring.

How Australia financed its spending

Consider, for example, substantial government spending like the JobKeeper programme. That was financed by issuing debt to the market. At the same time, the RBA purchased debt from the market by creating commercial bank reserves, therefore indirectly financing the Government's deficit, at least temporarily.

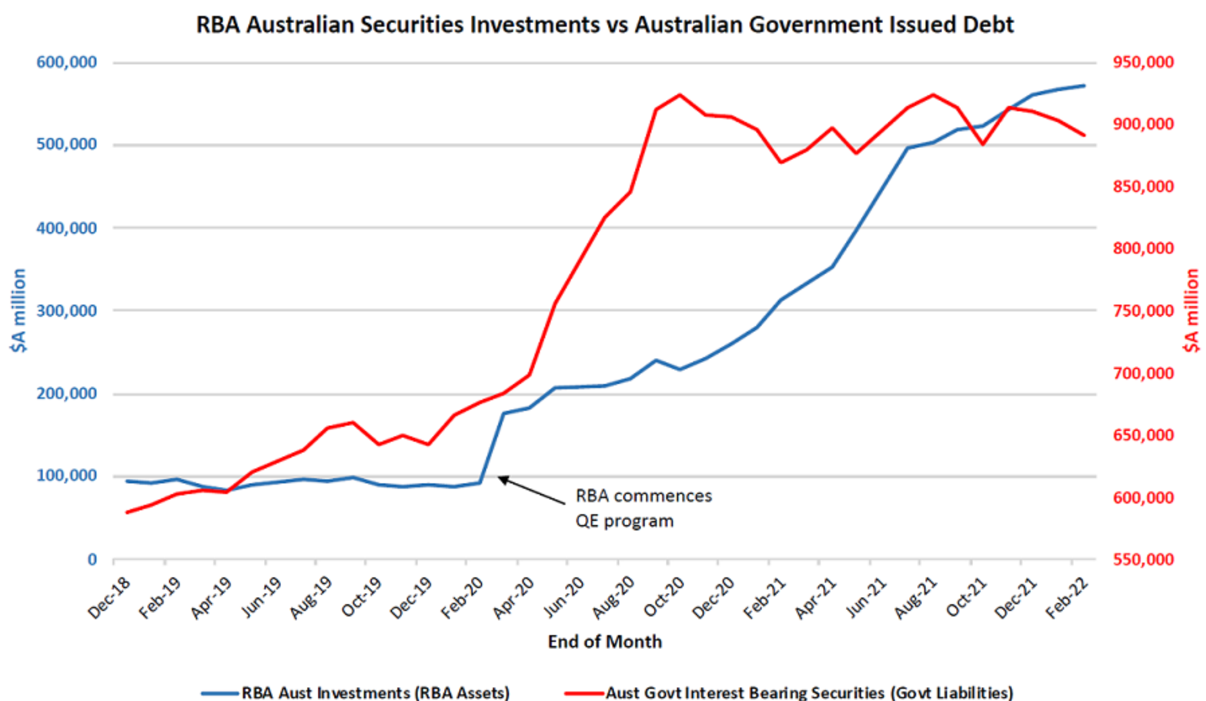


We see here diagrammatically how debt-financed government spending in tandem with a QE program, flows through the relevant balance sheets.

For the purposes of this article, the flow diagram shown is one of six in the diagram which shows the flows between balance sheets.

The move from QE to QT

With the RBA balance sheet and government debt rising steeply since early 2020 (see chart below), if at maturity the RBA rolled over that debt, then financing would remain in place. Only when central banks begin to unwind asset purchases and reduce their balance sheets, will monetary financing prove not to be permanent, and be genuine QE.



Now, full QE unwinding may eventually occur around the world, but it may only be partial. With all that has been spent on COVID-19 globally, it is perhaps inevitable that some of that will end up being monetary finance, but central banks will be careful not to make that explicit.

One way to protect a government's long-term intentions is for the central bank to only trade in the secondary market. That is, with institutions that had already purchased government debt. Indeed, early in its QE programme, the RBA went to great lengths to state that it would not purchase debt directly from the Government (the primary market) to maintain its independence from Treasury.

Minutes of the November 2020 RBA Board Meeting record that:

"the Bank would not purchase bonds directly from the Government, and so the purchase of bonds by the Bank would not constitute government financing."

And in July 2020, RBA Governor Philip Lowe said:

"I want to make it very clear that monetary financing of fiscal policy is not an option under consideration in Australia."

Is this 'money printing'?

In reality, however, regardless of whether a central bank purchases debt in the primary or secondary market, a QE programme running parallel to fiscal spending could be viewed as indirect or at least, temporary monetary financing, with the possibility of it becoming permanent.

Optics are often everything though, and with many commentators suspicious of QE, deeming it to be just money printing, free money, and outright brazen, buying in the primary market would not be a good look.

This is why QE only proceeds in the secondary market, downplaying the perception of money printing.

And with the possibility of QE being long term before being unwound, its distinction from monetary financing is often about policy intentions as opposed to how it is implemented.

Independence of the central bank from the Government is important, because without the separation of monetary and fiscal entities, central bankers could fear uncontrolled monetary financing pushed by government, heightening risks such as Weimar Republic-style hyperinflation, that would have devastating economic effects.

Unconventional, experimental - and now comes inflation

These activities by central banks have rightly carried the label of 'unconventional', and they were always an experiment. Prior to the 2007 GFC and COVID-19, unconventional monetary policies such as QE, QT, MTT, and negative interest rates existed more in the realm of the theoretical than the practical. Yet now we have seen much of it implemented with vigour around the world.

The concern with such potent monetary stimulus was always inflation. And now that it has arrived, the challenge for policymakers is to put the inflation genie back in the bottle and decide how mainstream such policies should become going forward while being mindful of supply-side inflation arising from the likes of a pandemic or a war.

Tony Dillon is a freelance writer and former actuary. This article is general information and does not consider the circumstances of any investor.

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What is smart beta and why is it growing in popularity?

Arian Neiron

It's the investment trend that has quietly been growing as equity markets continue to capitulate, and active managers make missteps. Smart beta is a broad and rapidly-expanding category of exchange traded products (ETP) that seeks to target outcomes beyond market capitalisation passive approaches, similar to active management.

It's been called 'strategic beta', 'alternative beta' and 'quantamental indexing'. Whatever the name, there is no denying smart beta's appeal.

What is smart beta?

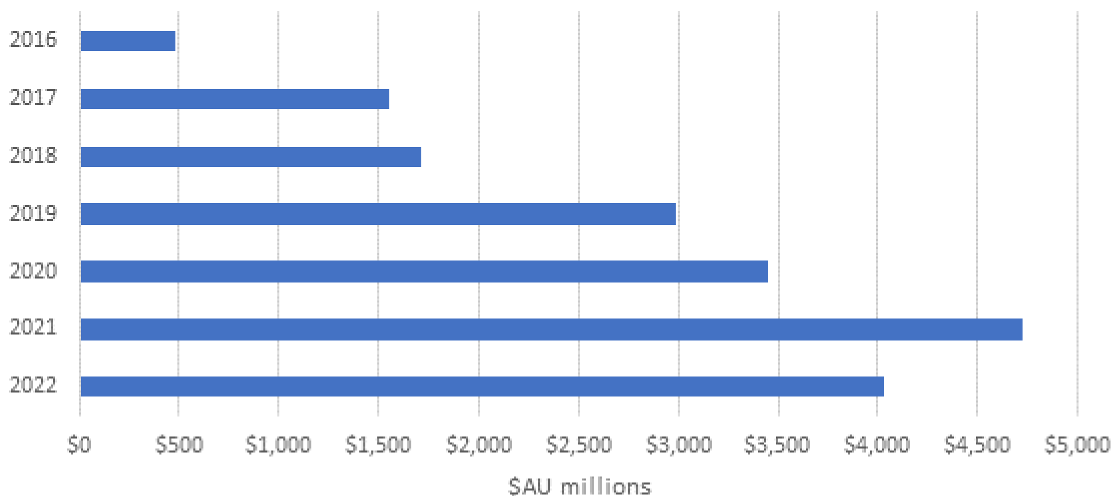
Smart beta ETFs (part of the ETP sector) allow investors the opportunity, with a single trade, to exploit investment objectives which seek to enhance returns, improve diversification, or reduce risk. Whereas most indexes are weighted by the market value of companies, smart beta ETFs are based on one or more predetermined factors or investment methodologies.

It is a type of investment that combines the benefits of passively managed funds, such as lower costs, with the advantage of selecting investments based on certain formula-based rules, adding an active element. Smart beta strategies differ from actively managed funds, where a manager chooses individual stocks or sectors in an effort to target an outcome. Instead, smart beta ETFs track an index with rules but there is little or no human element.

For example, some smart beta strategies include equal-weight (where companies carry the same weight in the portfolio regardless of size), high-dividend, low-volatility, value, or high-quality investment approaches. They are transparent and rules-based, often aiming for increased diversification and lower costs compared with active managers.

In 2018 there were 27 products offered in the smart beta space in Australia. Today, there are 57, an increase of almost 200%. The trend reflects a broader global movement, with over 1,000 smart beta products now offered worldwide.

Chart 1: Australian Smart Beta Net Flows



Source: ASX, VanEck. 2022 is the annualised figure using data as at 31 August 2022.

Survey of Australian demand

The results of VanEck's seventh annual Smart Beta Survey point to the continued growth of the sector. The largest survey of its kind in the world, this year almost 650 financial professionals working in an advisory capacity in Australia took part.

The results show the proportion of net flows going into smart beta strategies rose to 26.6% of total YTD ETP flows in Australia at 31 August 2022, up from an increase of 20.2% a year ago. That gain outpaced both active and market capitalisation index strategies. Smart beta strategies now make up 15.2% of the total ETP industry, up 8% from the prior year.

Many financial professionals (46%) are now using smart beta strategies in client's portfolios according to the survey, compared with only a third (37%) in 2016. Moreover, about 42% of finance professionals are currently using two or three smart beta strategies, with almost 1 in 2 of those currently using smart beta considering an additional allocation to the space.

Most financial professionals surveyed said they use smart beta ETFs for international equities (70%) and Australian equities (69%) exposure.

This is the first time the Survey has been conducted during a sustained bear market. The positive results are indicative of the resilience of smart beta strategies in the face of market volatility.

Two in three financial professionals have increased usage of smart beta ETFs over the last 12 to 18 months, and the main driver for the uptake - reduced total portfolio costs. The Survey also reveals high levels of satisfaction among smart beta users, with almost 99% of advisers using smart beta strategies recorded as very satisfied or extremely satisfied.

Over half of those surveyed, or 56%, said they are using smart beta products as a replacement for active management. Active managers can no longer afford to ignore the popularity of smart beta ETFs. Diversification, performance, reduced volatility and lower costs were also cited as major motivating factors for financial professionals when selecting smart beta strategies.

According to Morningstar, Australian strategic or smart beta ETPs gathered $1.4 billion of net inflows during 2021, a 12.7% jump from 2020. Smart beta investment is continuing to grow this year, notwithstanding the volatility in global markets. According to the ASX in the year to 31 August 2022, $2.7 billion has flowed into Australian smart beta ETFs, surpassing the thematic and ESG categories.

Popularity of 'quality' smart beta factor

The most popular smart beta listed strategy is 'quality', that is, ETFs targeting the quality factor. Quality companies have low leverage on the balance sheet, a high return on equity, and stable earnings. In listed funds, $838 million flowed into this category in Australia by August 2022. While it remains to be seen whether the global economy is headed for a soft or hard landing, investors anticipating a hard landing could consider a quality-focused smart beta ETF.

Companies such as Microsoft and Google which play a key part in many of our day-to-day lives, are by and large considered quality companies. The share prices of such companies have been hit this year, due to a difficult macroeconomic environment rife with geo-political risks, rising inflation, and increasing interest rates. However, it is hard to imagine a world where companies such as Microsoft and Google do not play a fundamental role in the global economy in future. .

While short-term underperformance can be disappointing to investors, no investment portfolio can always deliver positive returns. Legendary investor Benjamin Graham famously said:

"In the short run, the market is a voting machine, but in the long run, it is a weighing machine."

He was explaining that trends and fashions (the *voting*) will drive short-term prices, but eventually a company's share price will come to reflect the quality and substance (the *weight*) of the business. Historically, those companies with quality characteristics have been more profitable, generated higher earnings and tended to outperform their peers over a long period of time.

Smart beta ETFs have grown to encompass a huge array of investment choices, but based on funds under management, the largest smart beta ETF (as opposed to unlisted managed fund) listed in Australia is the VanEck MSCI International Quality ETF (ASX: QUAL). Since inception, QUAL has outperformed the benchmark by 2.27% p.a.*

Arian Neiron is CEO and Managing Director - Asia Pacific at VanEck, a sponsor of Firstlinks. This is general information only and does not take into account any person's financial objectives, situation or needs. Investors should do their research and talk to a financial adviser about which products best suit their individual needs and investment objectives.

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**Source: VanEck, Morningstar. QUAL inception date is 29 October 2014. The table below shows past performance of QUAL and of the MSCI World ex Australia index. Results are calculated to the last business day of the month and assume immediate reinvestment of distributions. QUAL results are net of management costs and expenses, but before brokerage fees or bid/ask spreads incurred when investors buy/sell on the ASX. Returns for periods longer than one year are annualised. Past performance is not a reliable indicator of future performance.*

Performance as at 31 August 2022	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	7 Years (% p.a.)	Since Inception (% p.a.)
QUAL	-15.04	9.67	13.83	11.69	13.77
MSCI World ex Australia Index	-9.62	8.20	11.11	9.38	11.50
DIFFERENCE	**-5.42**	**+1.47**	**+2.72**	**+2.31**	**+2.27**

What happens when an index is rebalanced?

Duncan Burns

When it comes to the topic of rebalancing, most investors tend to think about portfolio rebalancing, that is, the buying and selling of shares in a specific asset class to realign a portfolio's asset allocation back to an investor's risk tolerance and goals. It is largely a risk management exercise that occurs either periodically or when a certain threshold has been met.

But for asset managers that manage index funds, the term 'rebalancing' more specifically as it relates to index rebalances, has a slightly different meaning. How does index rebalancing work?

It all starts with the benchmark index

Market indices are designed to represent and measure the performance of securities in a specific market, asset class, sector or investment strategy. Indices like the S&P/ASX300 are financial calculations, based on a grouping of financial instruments, and therefore are not directly investible. Rather, investors seeking exposure to an index often invest through index-tracking mutual funds and exchange traded funds (ETFs), which are generally designed to track the performance of a specified index as closely as possible.

So what is an index rebalance?

An index rebalance occurs when the composition of an index changes. This process most notably occurs at regular periods throughout the year. Index rebalances are publicised events and the dates are typically known in advance. The S&P/ASX 300 for instance - an index that tracks the performance of the 300 largest ASX shares by market capitalisation - issues notifications for rebalances each March, June, September and December. The notification outlines the new composition of the index and also a specific date when these changes are to occur.

As a result, index fund managers must reconfigure portfolio holdings to match the rebalanced index in order to continue to achieve their index-tracking objective.

Why is an index rebalance necessary?

Index providers, such as S&P Dow Jones/ASX, FTSE Russell, MSCI and Morningstar, are responsible for building and maintaining a wide variety of indexes. These index providers are also responsible for ensuring that the composition of an index adequately reflects its stated methodology or objective.

This is done partially through regular updates, or 'rebalances', which are changes to an index's holdings and holding weights. An index that remains static for a prolonged period of time would likely drift and not accurately reflect the target market that it is attempting to represent. For example, in the ASX 300, a merger or bankruptcy could cause index constituents to temporarily drop below 300 but at rebalance time, additions would top the benchmark back up to 300 names.

What happens during an index rebalance?

Using the S&P/ASX 300 as an example, the March and September rebalances focus on additions and deletions of companies to the index, while the objective of the June and December rebalances is primarily to ensure that the weightings of each company in the index is accurate against the benchmark.

In the S&P/ASX 300 September rebalance announcement, 16 companies were added to the index, while 12 companies were removed. This means asset managers like Vanguard with funds (eg the Vanguard Australian Shares Fund and ETF) that track the ASX 300, had to buy shares of the 16 companies that have made it into the ASX 300 and sell down shares of the 12 companies that have dropped out of the ASX 300.

Keeping cost low

Indexing is a simple concept and easily understood, which is part of its beauty. But like any product or service that is deceptively simple on the surface, delivering what is promised without fanfare, is in reality, a complicated series of steps that must be executed with precision.

Think for a moment how benchmark indices like the ASX 300 are calculated. These calculations are done without taking into account the frictional costs of transacting in the real world, such as commissions, ticket charges, custody fees and market impact cost, just to name a few. It is easy to replicate an index perfectly but that comes with additional frictional costs at the expense of the investor.

Producing a portfolio whose performance replicates the index while minimising the deadweight costs and frictions that could lead to negative tracking error requires a level of heavy investment activity and precision. A good index manager demonstrates their value best during an index rebalance, by deploying sophistication in the complex investment management process and executing for the benefit of investors.

Not easy to speculate ahead of index rebalancing

For some investors, scheduled rebalances could seem like easy opportunities to make a quick profit, by buying or selling securities named in the index rebalance announcement. There might be an expectation that companies added to the index could deliver positive excess returns, and vice versa for those deleted from an index.

However, given the complex and noisy nature of this trading ecosystem, with players on all sides entering and exiting the market at different times and responding to evolving incentives, the profitability of this trade after costs is questionable.

Vanguard would caution everyday investors against engaging in this behaviour without understanding the risks involved, as this is less like investing and more like speculation or market timing.

Rather than chase after that potential lucky needle in a haystack trade, we urge investors to consider buying the whole haystack (ie a broadly diversified index fund) and invest for the long term. Ultimately, buying a broadly-diversified fund can probably help to achieve investment goals with less risk.

Duncan Burns is Head of Investments for Asia-Pacific at Vanguard Australia, a sponsor of Firstlinks. This article is for general information purposes only and does not consider the circumstances of any individual.

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Investing across deflation, inflation and stagflation

Guido Baltussen

with Laurens Swinkels and Pim van Vliet

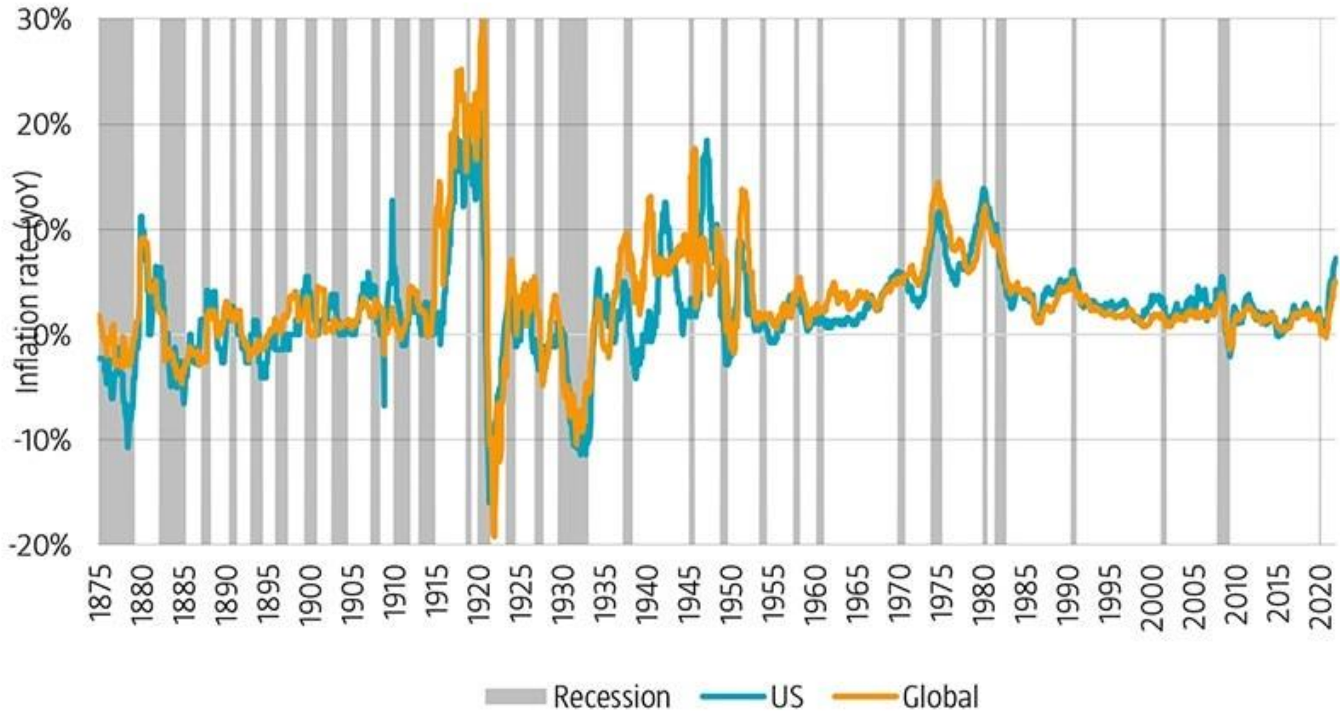
After three decades of muted price increases, inflation has once again become a major talking point for investors. A confluence of factors such as the reopening of economies following protracted Covid-related lockdowns, supply chain bottlenecks, sharply rising commodity prices (particularly gas and oil) and Russia's invasion of Ukraine have driven global inflation well beyond comfortable levels.

Given the environment, it is worth looking into how risk premiums typically behave across different inflation regimes, such as periods of deflation or high inflation. In our study[1], we examined the performance of asset classes and factors using a deep sample stretching back to 1875, thereby accounting for various and numerous inflation regimes.

Behavior of asset classes in different inflation buckets

We observed that inflation varied over time and was punctuated by periods of deflation, moderate inflation and high inflation. Moreover, there were a few periods during which high inflation coincided with a recession, i.e. stagflation. Figure 1 depicts the inflation cycle over our 146-year sample period, with the grey bars indicating recessions.

Figure 1 | Inflation cycles over 146-year period, January 1875 to December 2021



Source: The chart shows the inflation cycles from January 1875 to December 2021. For inflation we used year-on-year CPI data for France, Germany, Japan, UK and US from Datastream and MacroHistory.

To assess the impact of inflation on asset and factor returns, we chose to distinguish four broad types of inflation regimes: deflation (<0%), low inflation (0-2%), mildly overshooting inflation (2-4%) and high inflation (>4%). Table 1 summarizes the average annual returns for traditional asset classes across the different inflation buckets over our sample period.

Tables 1&2 | Asset class returns across different inflation buckets, January 1875 to December 2021

Annualized nominal returns

	Average	Deflation (<0%)	Low inflation (0-2%)	Mildly overshooting inflation (2-4%)	High inflation (>4%)
Equities	8.4%	2.4%	11.1%	11.0%	6.9%
Bonds	4.5%	5.2%	4.7%	4.5%	3.9%
Cash	3.4%	2.8%	2.7%	3.4%	4.2%

Annualized real returns

	Average	Deflation (<0%)	Low inflation (0-2%)	Mildly overshooting inflation (2-4%)	High inflation (>4%)
Equities	5.1%	5.5%	9.8%	8.2%	-1.7%
Bonds	1.2%	8.4%	3.4%	1.6%	-4.6%
Cash	0.1%	5.9%	1.5%	0.5%	-4.3%

Source: The table shows the asset class returns across various inflation buckets from January 1875 to December 2021. For equities, we used return data from the MSCI World Index and before then global value-weighted equity market returns, see Baltussen, Swinkels and Van Vliet (2022). For bonds, we used return data from the Bloomberg Global Treasury Index and before then GDP-weighted bond returns across French, German, Japanese, UK and US bond markets, see Baltussen, Swinkels and Van Vliet (2022). For cash, we used return data based on short-dated US Treasuries from the Kenneth French library and before then data from Jeremy Siegel. For inflation we used year-on-year CPI data for France, Germany, Japan, UK and US from Datastream and MacroHistory. All returns are quoted in USD.

During deflationary periods, equities delivered nominal returns well below their average over the sample period, but above-average real returns due to the negative inflation. The outcome was similar for cash, with above-average real returns. Bonds benefited over this period, generating above-average nominal and real returns, with the latter being particularly strong.

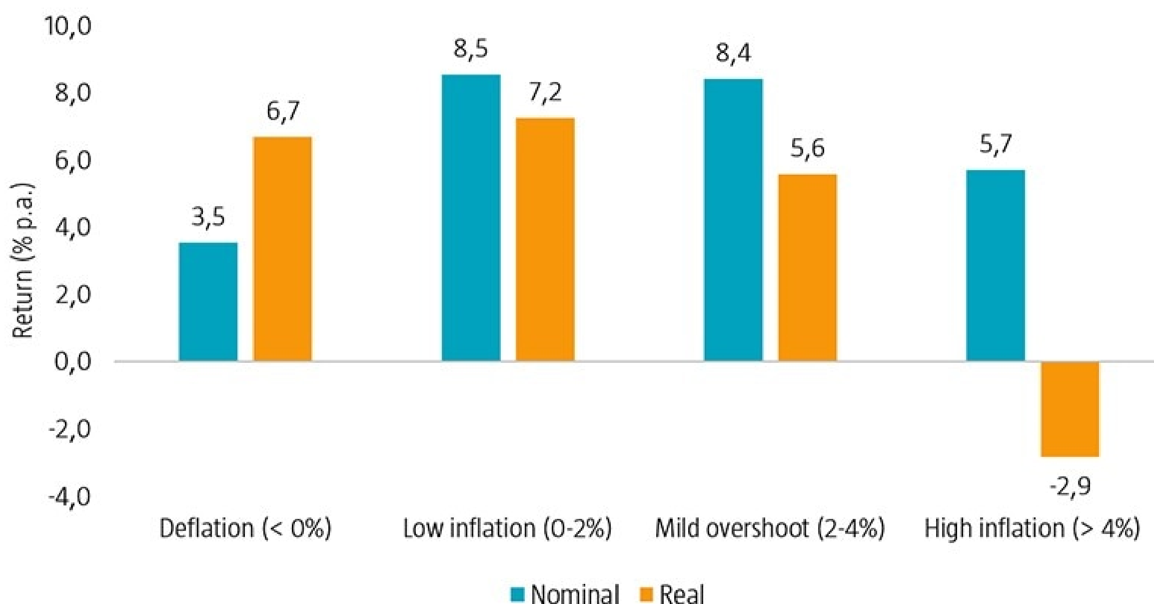
In high inflation intervals, all the asset classes experienced positive returns, but equities and bonds lagged their averages. But more importantly, all asset classes delivered negative real returns as they failed to offset the heightened inflationary pressures.

The low inflation and mildly overshooting inflation scenarios reflect a 'goldilocks' environment, which is typically good for risk assets and was prevalent for more than half of the sample period. In line with expectations, equities displayed their strongest performance in these periods, attaining robust nominal and real returns. Meanwhile, bonds fared reasonably well, delivering nominal returns in line with their average and solid real returns. By contrast, nominal cash returns were below average, but positive in real terms.

Multi-asset impact and the typical 60/40 portfolio

We then assessed the impact of these different inflation regimes on a generic multi-asset portfolio that consists of 60% equities and 40% bonds. As depicted in Figure 2, we observed that the low inflation and mildly overshooting inflation buckets ('goldilocks' environment) were the sweet spot for multi-asset investors both in terms of nominal and real returns.

Figure 2 | Nominal and real returns of generic multi-asset portfolio across different inflation buckets, January 1875 to December 2021



Source: The chart shows the nominal and real returns of a multi-asset portfolio across various inflation buckets from January 1875 to December 2021. For equities, we used return data from the MSCI World Index and before then global value-weighted equity market returns, see Baltussen, Swinkels and Van Vliet (2022). For bonds, we used return data from the Bloomberg Global Treasury Index and before then GDP-weighted bond returns across French, German, Japanese, UK and US bond markets, see Baltussen, Swinkels and Van Vliet (2022). The generic multi-asset portfolio consists of 60% equities and 40% bonds, rebalanced monthly. For inflation we used year-on-year CPI data for France, Germany, Japan, UK and US from Datastream and MacroHistory. All returns are quoted in USD.

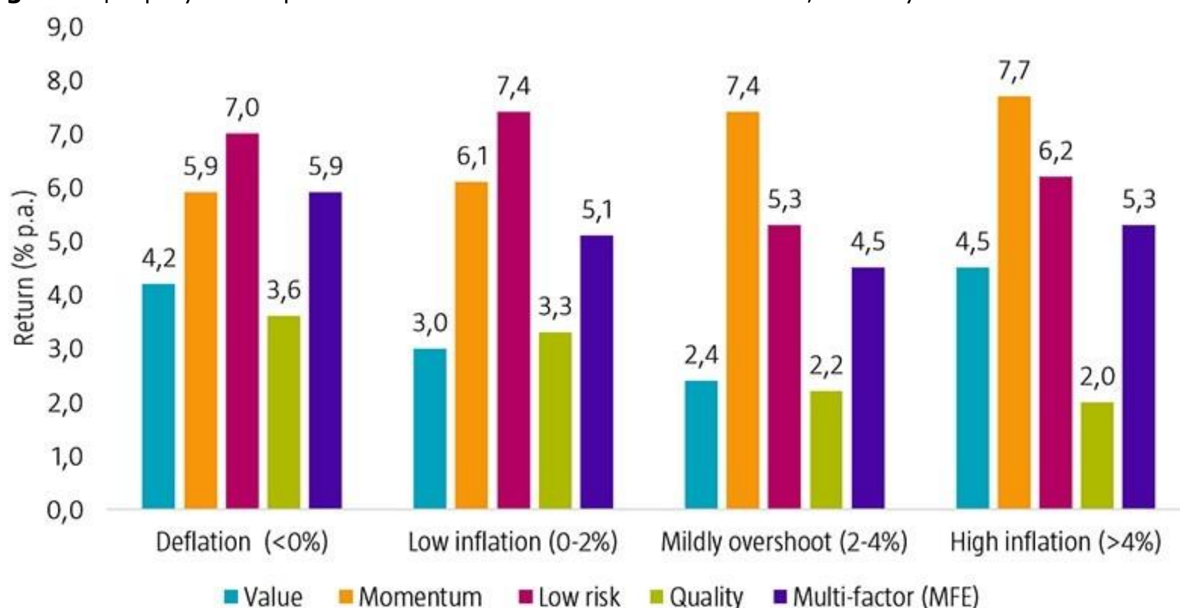
In deflationary times, nominal returns from multi-asset portfolios were subdued, but materially better in real terms. By contrast, nominal multi-asset returns were solid in periods of high inflation, but these were eroded by heightened price pressures leading to negative real returns.

Impact on factor premiums across various inflation regimes

We carried out the same exercise for factor premiums across both equities and government bonds. This is illustrated in Figures 3 and 4, where the factor returns are the differences in performance between a long portfolio with the highest factor exposures and a short portfolio with the lowest factor exposures. Interestingly, we saw that the performance of factors seemingly does not depend much on the level of inflation, in contrast to the asset class returns.

Indeed, Figure 3 shows that the multi-factor equity portfolio produced fairly stable performance across all four regimes. At the individual factor level, the variation in returns across inflation buckets was somewhat higher, but never strayed too far away from long-term averages.

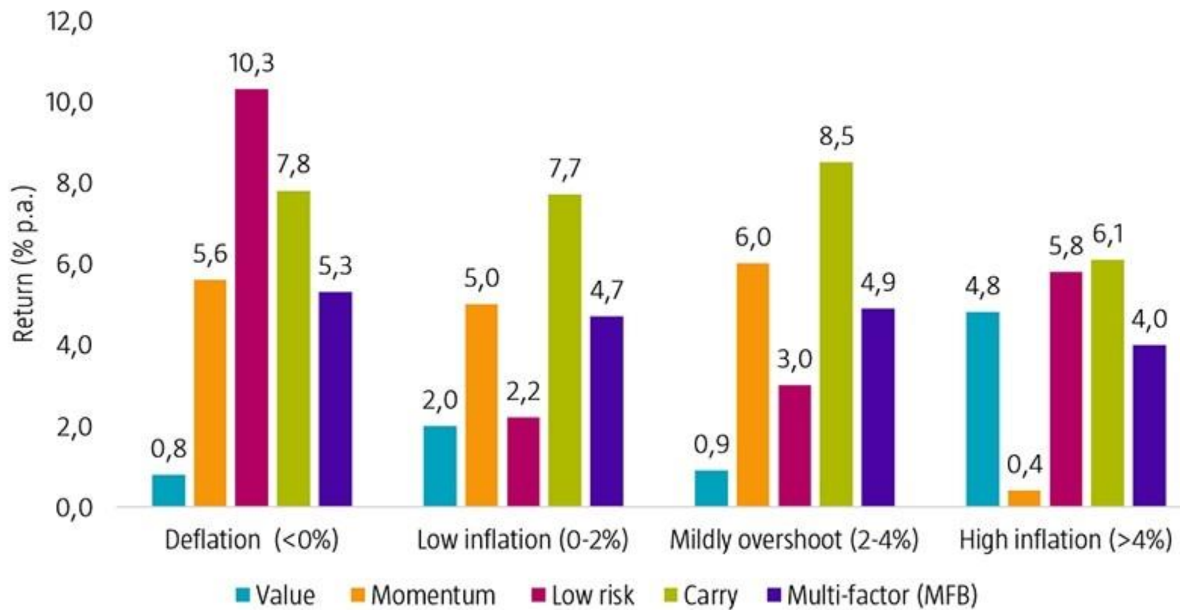
Figure 3 | Equity factor premiums across different inflation buckets, January 1875 to December 2021



Source: The table shows equity factor returns across various inflation buckets from January 1875 to December 2021. For the equity factors, we used data from the Kenneth French library and Baltussen, Van Vliet and Van Vliet (2022) 2 and methodology from the latter. The equity factor returns are based on the return spreads between the top and bottom factor quintile portfolios using US stocks. For inflation we used year-on-year CPI data for France, Germany, Japan, UK and US from Datastream and MacroHistory. All returns are quoted in USD.

The picture for bond factors was similar as they delivered positive returns in all four regimes as depicted in Figure 4, while the multi-factor bond portfolio performed consistently well in all inflation buckets. At the individual factor level, the variation in returns across the different inflation scenarios was higher, leading to a well-diversified multi-factor bond portfolio.

Figure 4 | Bond factor premiums across different inflation buckets, January 1875 to December 2021



Source: The table shows bond factor returns across various inflation buckets from January 1875 to December 2021. For the bond factors, we used data from Baltussen, Martens and Penninga (2022) 3 and methodology from the latter. The bond factor returns are based on the return spreads between the top and bottom factor quintile portfolios. For inflation we used year-on-year CPI data for France, Germany, Japan, UK and US from Datastream and MacroHistory. All returns are quoted in USD.

Asset classes struggle during stagflation but factors provide some reprieve

We acknowledge that not all inflation regimes are alike. Periods of high inflation that coincide with recession particularly stand out. We therefore scrutinized the impact of stagflation on asset class and factor premiums. We found that the nominal (-7.1%) and real (-16.6%) returns for equities were especially weak in these episodes. This suggests that the asset class is a poor hedge during these occasions.

The outcome was somewhat better for bonds as falling interest rates typically present tailwinds for the asset class. During these stagflationary intervals, bonds delivered a nominal return of 5.1%, but a real return of -4.4% due to the high levels of inflation. Overall, a generic multi-asset portfolio tended to struggle in this scenario as it produced nominal and real returns of -2.2% and -11.7%, respectively.

The picture was different when we looked at factor premiums. The multi-factor equity and multi-factor bond portfolios charted in positive territory with gains of 5.4% and 4.7%, respectively. Moreover, all equity and bond factor premiums performed well during stagflation, with the exception of the bond momentum factor which endured losses during these episodes. In other words, equity and bond factors also performed consistently in periods of stagflation, thereby providing some reprieve from poor asset class returns during these periods.

Conclusion

Our findings reveal that asset class premiums vary substantially across inflation regimes. Deflation and moderate inflation scenarios generally result in positive nominal and real equity and bond returns, while real returns suffer in times of high inflation, especially during periods of stagflation.

Meanwhile, equity and bond factor premiums are generally consistent across all inflation regimes, with marginal variations in returns across inflation regimes. Although this may sound unexciting, it does imply that factor investors should, on average, be less affected by inflation. As a result, we conclude that factors can help alleviate the pain during high inflation periods, albeit they are not a perfect hedge against inflation.

Read full research paper

[1] Baltussen, G., Swinkels, L., and Van Vliet, P., June 2022, "Investing in deflation, inflation, and stagflation regimes", SSRN working paper.
[2] Baltussen, G., Van Vliet, B., and Van Vliet, P., March 2022, "The cross-section of stock returns before 1926 (and beyond)", SSRN working paper.,

[3] Baltussen, G., Martens, M., and Penninga, O., January 2022, "Factor investing in sovereign bond markets: deep sample evidence", Journal of Portfolio Management.

Guido Baltussen is Head of Factor Investing, Laurens Swinkels is a Researcher, and Pim van Vliet is Head of Conservative Equities and Head of Quantitative Equities at Robeco Quantitative Investments.

What the Queen taught us about longevity

James Gard

A *reasonable* amount has been written and said about the Queen in recent weeks and that's appropriate given her pivotal position in Britain's sense of identity. I have nothing original or inspiring to add about the former monarch, but I have been thinking about staying power, longevity and the power of time.

One of the biggest issues with saving and investing is knowing how long you're going to live. When you're young you can't conceive of being old or living until you're 100.

Uncertain life expectancy

Retirement planning would be so much easier if you had a fixed date to work with (or even a ballpark figure). Life expectancy figures, genetics, luck (good and bad), illness and wealth are all powerful variables that actuaries blend together.

You could live for the average life expectancy (currently 83.8 years in Australia). In this context, starting investing at say 21 when you leave study – if that's the path you've chosen – you could have 60+ years to build a retirement portfolio and other assets. Living longer is ideal for many reasons, in that your loved ones get to spend more time with you (my grandparents, who were born two years before the Queen, received a message from her on their platinum wedding anniversary and met their great-grandchildren).

Illness and poor health later in life is the obvious drawback to living longer, especially if that carefully accumulated capital has to be plundered to fund health and social care. We had news recently that French film director Jean-Luc Godard, died at the age of 91 through assisted suicide in Switzerland after battling multiple illnesses.

The Queen (and her mother, who made it to 101) were outliers for her generation in terms of age but her father, George VI, died age 56. Death makes fools of statisticians and actuaries: how can you plan for a difference of around 50 years in lifespan? The royals naturally have less to worry about financial planning than most people.

Saving by saving and how it works

Let's look at the maths of saving. Compound interest is powerful, especially over a multi-decade time period of 50 years plus. People tend to underestimate the impact of reinvested interest. Look at how much of an impact the price of a coffee can make, if you invested it instead. If you're spending $3 a day on coffee, that's roughly $90 a month. If invested with an average return of 6% a year for 40 years, that would create $178,252 for your future self.

The below table shows how our savings would accumulate if you started with $100 in your savings account and added an extra $100 at the end of every year.

Interest rate	1 Year	5 Years	10 Years	15 Years	20 Years	30 Years	50 Years	70 Years
3%	203	647	1,281	2,016	2,868	5,000	11,718	23,851
5%	205	680	1,421	2,366	3,572	7,076	22,082	61,895
7%	207	715	1,578	2,789	4,487	10,207	43,599	172,812
10%	210	772	1,853	3,595	6,400	18,194	128,130	867,722
15%	215	875	2,435	5,572	11,881	50,096	830,137	13,596,719
20%	220	993	3,215	8,744	22,503	141,926	5,459,763	209,332,874

Even if your savings only provide a 3% interest on an annualised basis, in 30 years, you'll have $5,000 in your account. Without interest, you'd have $3,100 set aside. Of course, these are future dollars, not adjusted for inflation.

If you did save for the length of the Queen's reign, an astonishing 70 years, that's $23,851 at 3%. If the annualised return is upped to 5%, your account will jump to $61,895. And, if in the probably unlikely scenario that you are Warren Buffett, earning 20% annually but still only investing $100 a year, over 70 years, you will have $209,332,874 in your savings. That's over two hundred million dollars. Even with the impact of inflation, taxes, fees, etc, that will be a lot of money.

Staying power

Apart from high-quality medical supervision, the Queen had relatively little control over her longevity. The nature of her role meant she would be monarch for the duration of her life. Politicians and even fund managers rarely have that much time to make an impact, given the harsh realities of commerce and governance, although asset manager abdrn Plc, Harry Nimmo, manager of a gold-rated UK smaller companies funds, retired from the firm after 38 years. Baillie Gifford's James Anderson, famed for his role as Scottish Mortgage Trust manager (alongside Tom Slater), also spent a similar amount of time at the firm and built a similar legacy and loyal investor fan base.

While there's a correlation between fund manager staying power and performance, the comparison with politicians could be unfair. Cabinet ministers and even the prime minister would no doubt like a 20 or 30 year run, but it's expected that they have shorter shelf lives than money managers. Politicians don't need to be an expert in their subject to become a secretary of state, and rarely do they stay long enough to make a significant impact.

You are not going to be the next monarch (unless Prince William is reading this), but what you may have – but don't realise it yet – is time. The latest generation of investors, born in 2022, could easily make it to the Queen's age and beyond. That means that even without generous parents investing on your behalf from day one, you could have a potential 50+ year run at the investing game.

Spend, spend, spend - or save, save, save

Even if you are financially fortunate enough to set aside funds for long-term investment each year, you will need money for education, property, children, holidays, health care, cars and more. The pandemic may have even engendered a 'what the hell' attitude among some savers – if a virus could take you off unexpectedly, why not spend and enjoy? At the opposite end of the spectrum is the FIRE (Financial Independence, Retire Early) movement, which requires self-sacrifices that most are unwilling or unable to make.

Poet Philip Larkin, who died at the age of 63, was right about our inability to think beyond the everyday and comprehend glacial time:

"We're not suited to the long perspectives / Open at each instant of our lives."

Still, times like these allow people to reflect on longevity and contemplate 'long perspectives'. From the Queen's birth in 1926, the S&P 500 has returned an average of double digits per annum with dividends reinvested, and that stretch has included the Great Depression, World War 2, the oil crisis, the fall of the Soviet empire, 9/11 and GFC and a pandemic.

James Gard is Senior Editor for Morningstar.co.uk. This article is general information and does not consider the circumstances of any investor. Minor modifications have been made for an Australian audience.

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