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Editorial

In 1970, one of America's leading scientists Simon Ramo wrote a quirky little book about his favourite pastime – tennis. The book, *Extraordinary Tennis For the Ordinary Player*, didn't sell well initially but has since built a loyal following.

I've been a tennis player and fan all my life, so the book has obvious appeal. Ramo's observations of the game, though, apply well beyond tennis.

Ramo suggests that tennis isn't one game but two. Yes, players have the same equipment, rules and attire and conform to the same etiquette. Yet that's where the similarities end. According to Ramo, there's one game played by professionals and another game played by the rest of us.

Ramo thinks the outcome of an amateur tennis game is determined by the loser. Amateurs watch professionals play tennis and try to hit like them. They don't have the ability to emulate their heroes, though. Their games have few long rallies, and even fewer brilliant strokes. Much more frequent is that balls are hit into the net or well outside the perimeters of the court. Double faults are common. Amateurs seldom beat their opposition; they most often beat themselves via their mistakes.

The game played by professionals is different. There are often long rallies of more than 20 shots with precise, hard hitting. Winners are frequent, whether it be service aces, groundstroke winners, drop shots and by coming into the net to volley the ball away from the opponent. Not only are there winners, but also 'forced errors' – where professionals force their opponent into an error through good shot making of their own. Mistakes are far fewer in the professional game than the amateur game.

Testing the theory

As a good scientist, Ramo didn't just observe; he tested his hypothesis. Instead of counting points in the conventional tennis manner of 15-love, 15-15, etc, he counted points won versus points lost. What he found was that in professional tennis, about 80% of the points are won; in amateur tennis, about 80% of the points are lost.

In Ramo's eyes, this proves that professional tennis is a winner's game – the outcome of a match is primarily determined by the shots played by the winner. Whereas amateur tennis is a loser's game – the outcome is determined by the activities of the loser. Put simply, professionals *win* points, while amateurs *lose* points.

For Ramo, this means amateur players should adopt a game style that's most suited to winning. Forget about trying to hit a spectacular winner like the professionals. Instead, focus on making less mistakes than your opponent. Hit shots well inside the lines, don't do double faults by trying to hit serves too hard, and hit higher over the net to allow more margin for error.

As a tennis nerd, I think Ramo's theory rings true. And I've done some testing of my own.

I searched the match statistics of a recent tennis final between 19-year-old young gun, Holger Rune, and Novak Djokovic. It was a high-level match which Rune won in three, long sets. The stats show Rune hit 42 winners to Djokovic's 36, and 20 unforced errors (easy mistakes) compared to 13. Doing the maths, Rune's winner to mistake ratio was 68% while Djokovic's was 73%.

This doesn't tell the whole story as the statistics don't include forced errors. Include these, and I'm sure that both players' winner-to-mistake ratio would be above 80%.

Applying Ramo's thoughts to markets

Ramo's book has achieved some popularity primarily because of the publication of an article in an investment journal, titled 'The Loser's Game', in 1975. Written by Charles Ellis, the article was subsequently turned into a book, Winning The Loser's Game, which is now into its 8th edition.

In the book, Ellis applies Ramo's theories to the investment world. Ellis suggests the investment game has changed from a winner's game into a loser's game. In the decades before 1975, the stock market was dominated by individual investors. This meant that someone who was willing to put in the work could potentially outsmart these investors and earn market-beating returns.

A big change happened in the 1960s as more professional investors started trading the stock market. By the mid-1970s, professional investors accounted for 90% of stock market activity. These investors worked 70 hours a week at their craft, and with so many of them entering the profession and with leading-edge technology at their fingertips, the stock market became more efficient and chances for outperformance largely vanished.

Winning the loser's game

Echoing Ramo, Ellis suggests that the way you win a winner's game is different to that of winning a loser's game. In the stock market, as it's become a loser's game in Ellis' view, there are two ways to win.

First, you can choose not to play the loser's game. Even in 1975, Ellis had become an advocate of index investing - investing passively in the stock market rather than trying to beat it through active investing. Keep in mind that Vanguard, the behemoth of index investing, was only founded in the same year that Ellis' original article came out.

The second way that you can choose to play the loser's game is by losing less than your opponents via making less mistakes. Ellis advocates four ways to achieve this:

- Be sure you are playing your own game.
- Keep it simple. Make fewer and perhaps better investment decisions. Try to do a few things unusually well.
- Concentrate on your defences. "In a Winner's Game, 90 per cent of all research effort should be spent on making purchase decisions; in a Loser's Game, most researchers should spend most of their time making sell decisions. Almost all of the really big trouble that you're going to experience in the next year is in your portfolio right now; if you could reduce some of these really big problems, you might come out the winner in the Loser's Game."
- Don't take it personally. Most people in the investment world are trained to be 'winners'. A failure to succeed in a loser's game won't be your own fault so you shouldn't take it personally.

What it means for today's investors

What Ellis is really trying to say is that investing nowadays is incredibly hard and you need to have an edge if you want to succeed. I think there are some prospective edges that individual investors can pursue in today's markets:

- Microcap investing or investing in microcap managers. For outperformance, you need to go where there's little competition. For companies worth less than $100 million, you'll be investing alongside other individual investors. These smaller companies are too illiquid for institutional investors, so you'll largely remove them as competition. Do the work on microcaps, and you can have an edge.

  Alternatively, you can invest in a microcaps fund. Recently, the S&P Dow Jones Indices put out figures showing Australian mid and small cap managers are among the best in the world. 40% of these managers

outperform their benchmark over a five-year period, and that increases to 49% over a 15-year period. Compare that to large cap equity managers with figures of 26% and 18% respectively.

- Adopt a long-term time horizon. Individual and institutional investors trade frequently, which increases costs and often reduces performance. Holding stocks for five years or more will give you an automatic edge.
- Buy stocks with moats, as championed by Morningstar. Companies with moats have more durable returns and, if purchased at the right price, can led to market-beating returns.
- Find niches. It could be becoming an activist investor in tiny companies or specializing in a burgeoning sector like community living for retirees or looking outside of stocks to something such as distressed debt, which should have a nice future with interest rates rising off historic lows.

In this week's edition ...

Jon Kalkman examines the distortions appearing in Australia's retirement system. He gives a great overview of the three pillars of the system: the age pension, super and private savings. He goes on to suggest that there are things which need urgent fixing to make the system fair and equitable.

The wealth management industry has been in the doldrums and **Harry Chemay** and **Brett Ebedes** think the key issue is the huge gap between what the customer wants to pay for advice and the cost of supplying that advice. They suggest how the financial advice sector can regain lost ground and create the foundations for future growth.

Don Stammer is back with the 41st edition of the X-factor report. Each year, Don picks the X-factor: a largely unexpected influence that wasn't thought about when the year began but came from left field to have powerful effects on investment returns. What wins in 2022?

Vince Pezzullo from Perpetual Investment Management may have seen a preview of this year's X-factor winner because he's been busy inflation proofing his portfolio. He likes the metals sector, insurers and turnaround stocks such as A2 Milk.

The main risk to an inflationary 2023 is recession and Associate Professor **Konark Saxena** pegs the odds of a US recession at 75%. He thinks it will be a mild recession though, and the prospect of lower rates ahead should give Australia time to fix its main economic weakness: high household debt.

Meanwhile, it's been a year to forget for the US tech sector. **Andrew Macken** of Montaka hasn't lost faith though. Today he focuses on music streaming business Spotify and predicts that it could be making €6 billion pre-tax operating profit by the end of this decade, compared with a market capitaisation of €15.6 billion now. If right, it's a bargain.

And lawyer **Donal Griffin** runs us through a recent case where the NSW Court of Appeal reversed an earlier ruling and declared a live-in carer was in fact a defacto partner. Donal believes significant financial consequences for the family could have been avoided with preventative action.

This week's White Paper is from the **Franklin Templeton Institute** which explores the megatrend 'expanding power of the crowd', Web3 'tokenomic' supply, and a new approach to venture capital.

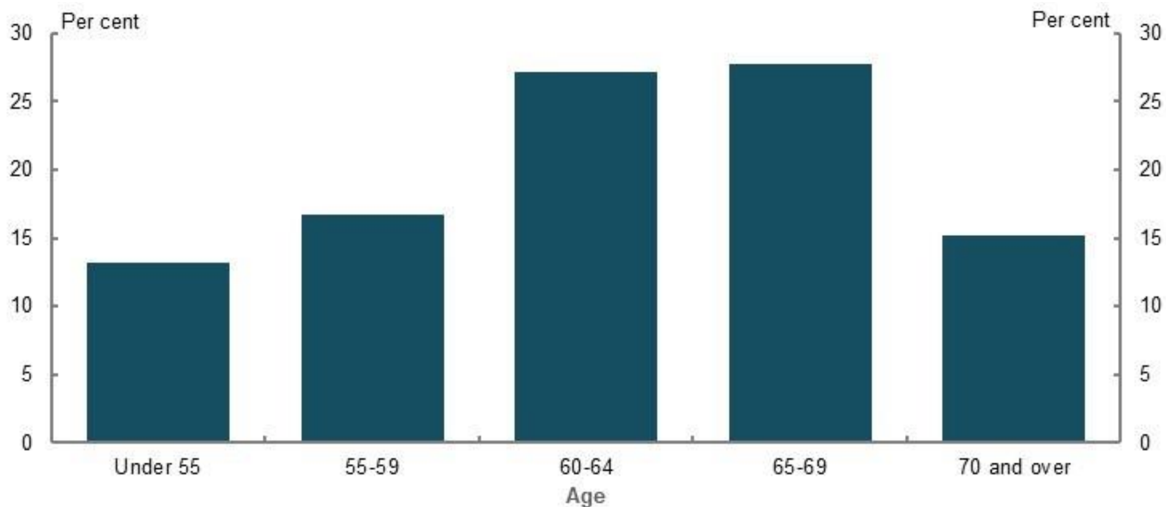
James Gruber

The distortions in our retirement system

Jon Kalkman

Our retirement system has three pillars: the age pension, superannuation (super) and private savings, which include the family home. The age pension has been the backbone of the system for decades, super's contribution to retirement income is increasing and the government is encouraging retirees to use the equity in the family home. In each case the rules are complex, and they interact with each other. At the same time, retirees face a retirement of uncertain length and complexity and tend not to seek financial advice because of the cost.

Proportion of people retiring at particular ages



Source: Retirement Income Review

An overview of the age pension

According to the Retirement Income Review, about 71% of retirees depend on the welfare payment of an age pension for all or some of their income and approximately 60% of that group receive the full pension with the remainder receiving a part pension.

In order to target benefits to the neediest, eligibility for the age pension is determined by both an assets test and an income test. Both tests are applied, and the test that produces the lower pension, is the one adopted. For retirees with substantial savings, the assets test is most relevant. The income test applies mainly to those pensioners who continue to earn an income. For a couple who own their home, the full pension is $1,547.60 per fortnight or $40,237.60 per annum. It is updated each March and September.

Under the assets test, a couple can have $419,000 in assets before their pension is reduced. Assessable assets include superannuation balances but exclude the family home. The pension is reduced by $3 per fortnight ($78 p.a.) for every $1,000 in assets above that threshold and is reduced to zero when their assets reach $935,000. There are different thresholds for singles and for renters, but the rate of pension reduction is the same for each. This is the so-called taper rate and is crucial to these considerations.

The pension is reduced by $7,800 p.a. for every additional $100,000 in assets – a rate of 7.8%. Unless those additional assets can earn at least 7.8%, the pension is reduced by more than the income earned by those additional assets. For example, a 6% return on assets of $900,000 means an annual income of $54,000 plus a part pension of $2,719.60 p.a. By contrast a 6% return on assets of $419,000 means an annual income of $25,140 plus a full pension of $40,237.60 or a total over $65,000. In fact, a couple earning 6% would need to have assets of almost $1.1 million to earn the same income as the couple with $419,000 on the full pension. That differential only widens with lower earning rates.

The reverse process also applies. A reduction in assets will increase pension income unless these pensioners earn at least 7.8%. It creates a perverse incentive to reduce assessable assets. A less punitive taper rate, as was the case prior to 2015, when pensions were reduced by only $1.50 per fortnight for every $1000 over the threshold, created more part-pensioners – some were millionaires in 2015 – but it lacked the powerful incentive for people to impoverish themselves. Treasury only counts dollars, not behavioural incentives, and the taxes any behavioural changes may generate.

How realistic is it for a retired couple to earn these high rates of income on their investments? The age pension is the ultimate annuity. It is government guaranteed, paid for life, and indexed to male wages. With this certainty, pensioners could choose to take on more risk with their own investments to generate a higher income, happy in the knowledge that any lost investment income will be replaced by increased pension. But many are very risk adverse, preferring to stick to term deposits, thereby limiting their possible income and associated lifestyle choices.

Note that under the pension income test, deeming rules are used to calculate assessable income from financial assets for pension purposes. Financial assets are presently deemed to earn no more than 2.25% of the asset's

market value. Because the actual income above the deemed amount is ignored, pensioners are free to maximize their income from those assets without penalty.

Even a part-pension is highly prized, and some go to considerable lengths to secure it. Some see it as an entitlement; a part-return of taxes paid earlier. Others value the pension health card. To remain eligible for a part age pension however, a couple's assessable assets must be less than $935,000. Therefore, their possible income is limited by their investment return.

Family home considerations for retirees

The family home has never been part of the pension assets test and is unlikely to be included because all governments regard the issue as political poison. A higher superannuation balance will decrease the age pension, but the family home of any value will not affect it. This exemption distorts retirement decisions. Hence, a rational response for some pensioners is to reduce their assessable assets by investing heavily in the family home through renovations or upsizing.

According to the Retirement Income Review, 15% of age pensioners live in family homes worth more than $1 million, mainly in Sydney and Melbourne. There is an understandable reluctance to downsize and move to another area for several reasons. Nevertheless, the family home has real value that could be unlocked to improve retirement living standards, but many prefer to remain asset rich and income poor.

When it comes to age care, pensioners pay lower fees, the family home is only partially assessed, and the family home is free of capital gains tax (CGT) after death. Beneficiaries who inherit this asset certainly appreciate its value. Some would say this is a tax-payer unwritten inheritance.

To underline the distortion, a couple that saved $1 million in their super fund instead of the family home would be ineligible for any age pension and thereby save the taxpayer almost $1 million over their lifetimes, and as independent retirees, their age care fees will also be higher and their super death benefits may also be subject to tax.

Firstlinks has run several articles and discussions on accessing home equity and why the family home should be included in the assets test that explore these issues in greater depth.

Despite a clear unwillingness to include the family home in the assets test, successive governments have tried to encourage pensioners to voluntarily access the equity in their home.

The downsizer super contribution allows people to transfer some the proceeds of sale of the family home as an additional contribution into superannuation above the normal contribution caps. In that way they access the accumulated wealth in the family home and turn it into retirement spending. The issue is that downsizing turns part of a non-assessable asset (the family home) into an assessable asset (super) and thereby reduces the age pension.

The Home Equity Access Scheme is a government sponsored reverse mortgage scheme whereby retirees, not just pensioners, can borrow money for retirement spending against the security of their property without the requirement to make any repayments because the interest payments are capitalised. Although it does not affect the age pension, its popularity is uneven because the loan balance continues to grow until the house is sold and it is very interest rate sensitive. The retiree's equity in their property continues to fall until the loan is repaid and that has implications for future bequests.

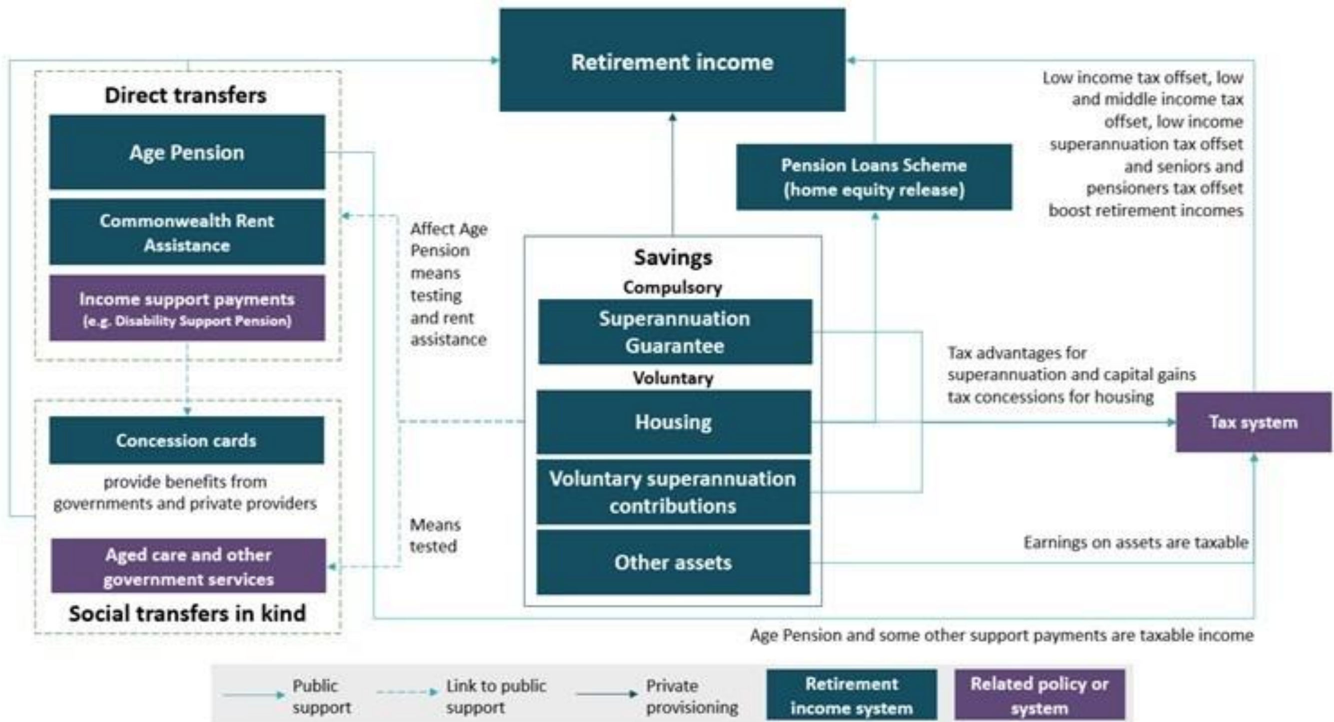
Governments want you to have more super

Super is designed to encourage people to save for their retirement with concessional taxation on contributions and investment returns but limiting access to those savings until retirement. The superannuation system is still maturing. The super guarantee (compulsory super) started at 3% of wages in 1992 and is not expected to reach the full 12% until 2025. Accordingly, Treasury notes that 65% of people retiring in 2020 were expected to have balances below $250,000 at retirement, but that proportion is expected to decrease to 30% by 2060.

The government would prefer retirees to have more super to reduce the cost of the age pension, but not so much that they get an unfair advantage from the tax concessions that it attracts. The debate questioning the cost of super tax concessions compared to the cost savings on the age pension, has already started. This debate often includes the easily measured tax concessions flowing to large super balances, but often ignores the fact that a self-funded retired couple saves the taxpayer over $40,000 per year. It also overlooks the fact that a couple who own their own home can have $419,000 in super and still receive the full age pension.

Compulsory super is clearly intended to reduce the cost of the age pension. From 1 July 2023, retirees will need to be 67 years of age before they can claim the age pension. However, they can access their total super balance, tax-free, from age 60 if they are fully retired. This provides many opportunities to use super savings in ways that do not translate into retirement income. For some, it means they can then afford home renovations or holidays. For others, knowing that this money is available after age 60, may mean they can enter retirement with more debt than they might otherwise.

Key retirement income system interactions



Source: Retirement Income Review

Problems with the system

The age pension clearly favours homeowners over renters. Renters are allowed a higher assets test threshold, but the additional assets and government rent assistance do not cover current commercial rents. A rational response is to take a lump sum withdrawal from super after age 60 to reduce or eliminate the mortgage in retirement and optimize the age pension after age 67.

At the same time there is considerable resistance to the idea of allowing young people early access to their super to reduce or eliminate their mortgage because, with a smaller super balance at retirement, it makes their dependence on the age pension more likely.

The present system has embedded behavioural incentives that neutralize policy objectives:

- The current age pension taper rate creates perverse incentives.
- The family home is a sacred cow that distorts retirement decisions.
- Access to super before it is assessed for the age pension, means that not all super savings are used to fund retirement income.

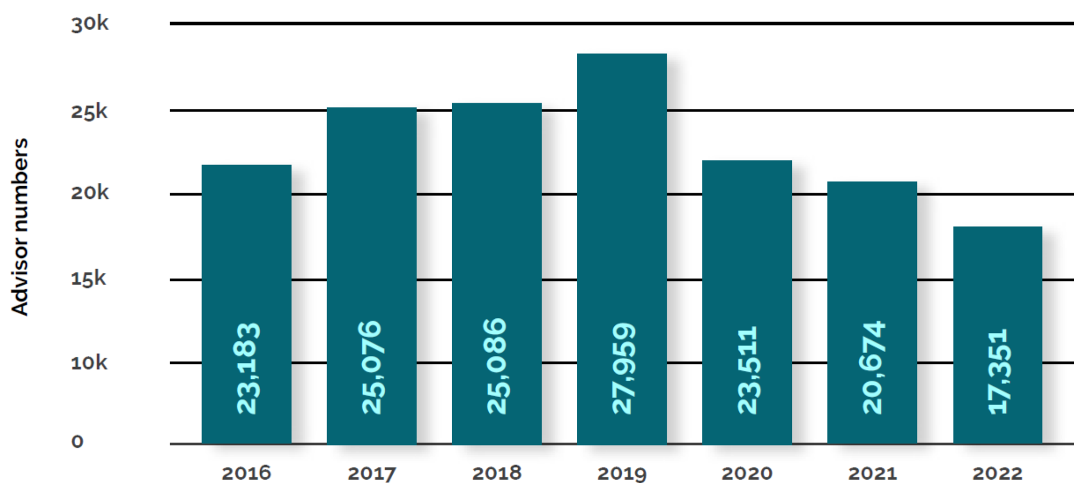
Jon Kalkman is a former director of the Australian Investors Association. This article is for general information purposes only and does not consider the circumstances of any investor. This article is based on an understanding of the rules at the time of writing.

Wealth management reimagined

Brett Ebedes, Harry Chemay

The financial advice sector is experiencing a form of market failure. That is, market demand for the type of advice now favoured by the industry - comprehensive personal retirement planning advice - is severely limited by the cost of supplying it, often exceeding $5,000 for an initial engagement and $3,000 in annual service fees thereafter.

It is only in wealthy pre-retirees with complex retirement planning needs where the service that the financial advice sector offers currently intersects with a willingness and capacity to pay. If one were to assume this cohort represents 20% of those approaching retirement each month, this equates to only 4,000-odd prospective clients for the nation's 16,000-odd advisers to engage with and compete for on a monthly basis.



It should be apparent that the entire financial advice sector chasing this same, small addressable market is not a recipe for organic growth.

What might an alternative future for Australian wealth management look like? And what are the conditions to facilitate it? The following are suggestions that we believe will assist the financial advice sector to regain lost ground and, more importantly, create the foundations for sustained growth into the future.

Applying the Tinbergen Principle to financial advice

The Tinbergen Principle is named after Dutch economist Jan Tinbergen, the first economist to be awarded the Nobel Prize in Economics. In essence the principle states that in addressing complex economic dilemmas, sustainable solutions require as many instruments as there are policy objectives.

Which is a fancy way of saying "one size does not fit all".

For financial advice, there is one dominant 'instrument' being bluntly applied to the varied advice needs of Australians of varying demographics, socioeconomic circumstances, financial literacy, engagement preferences and price point sensitivities.

This instrument is comprehensive pre-retirement personal advice, encapsulated in an unwieldy Statement of Advice (SOA), implemented via an adviser-directed investment/super solution, with ongoing fee arrangements still dominated by the percentage of 'Funds Under Advice' (FUA) model.

The advice sector could continue with this approach, and it would almost certainly perpetuate the issues currently constraining advice accessibility, as well as its own growth prospects. Or it can choose a different path.

Matching advice models to consumer needs

There needs to be a recognition that Australians engage with the financial services sector across multiple decades in ways that shift over that time span. Their needs differ according to their life-stage, and forward-thinking advice models ought to be able to cater for these life-stage cohort preferences.

In addition, research into engagement preferences suggests that consumers have varied preferences for how they choose to engage with their finances, and a 'traditional' financial advice relationship with a financial adviser is only one option.

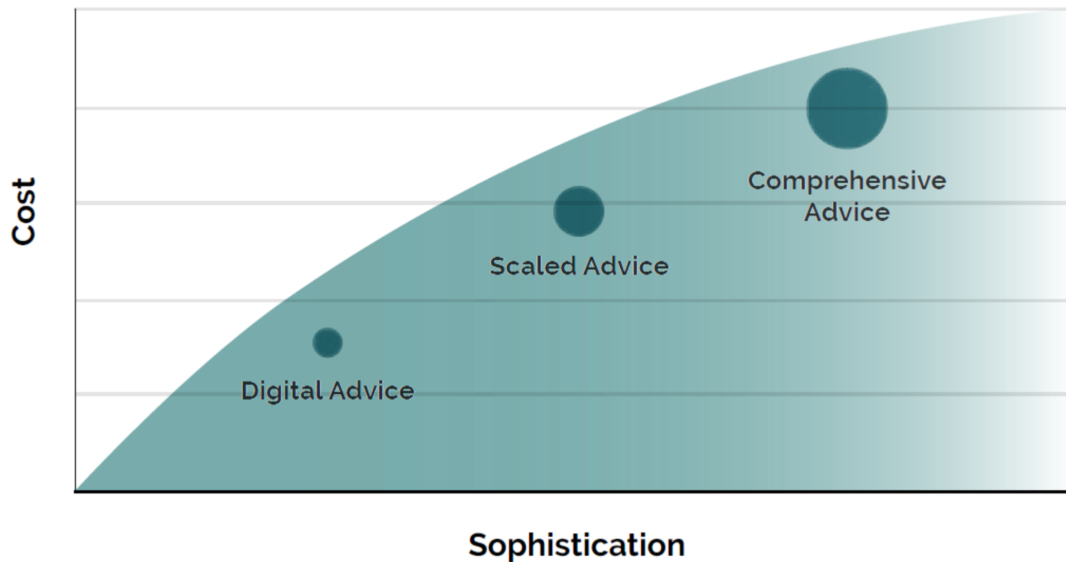
The ASIC Financial Advice Report of 2019 found 31% of those surveyed said that they had received financial advice or guidance from family, friends, or colleagues, while 23% had done so from information found online.

Similarly, even when consumers become engaged with their finances, there are a range of preferences that extend beyond receiving financial advice and/or outsourcing complex financial decisions to an adviser.

At the High Net Worth end of the market, CBA research into SMSFs found that only 22% of survey respondents were 'Coach Seekers' and 13% 'Outsourcers', those more likely to engage with financial advice on an ongoing basis.

Quite remarkably, 30% described themselves as 'Self-Directed Investors' with a preference for a DIY approach toward financial decision making, while 35% were 'Controllers', eager to do things themselves, but open to some advice to support their decision-making. For these individuals, an online SMSF admin solution, coupled with a next-gen investment platform and some episodic advice from a Financial Adviser may be all that is required to meet their needs.

Right across the age and wealth spectrum, from Gen Z commencing their wealth journeys to wealthy Baby Boomers with sizable assets in their SMSF, the notion of 'one-size-fits-all' is no longer appropriate.



Technology to the fore

The rapid adoption of all things digital in daily life since the initial COVID lockdown of March 2020 points to the possibilities for advice productivity that is still untapped in the sector.

Workarounds to lockdown, such as online virtual advisor/client meetings, the rise of electronic signatures over 'wet ink' and the improvement of adviser/client interactivity within leading-edge investment platforms allow advisers to better leverage their time and resources.

These developments will not regress in a post-COVID world.

Rather, forward-thinking licensees and advice practices need to revisit the entirety of the FinTech and AdviceTech landscape to look for ongoing opportunities to increase prospect engagement and reduce the cost of advice provision.

One such example is the CRM, often considered the heart of any financial advice operation. Advice CRMs have been a slow work-in-progress since the 1990s, with the rise of server technology and the ubiquity of the internet leading to advances in CRM capabilities in the years since.

Yet the seamless integration of all the aspects of running an efficient financial advice practice, from prospect engagement to financial modelling to advice provision to the implementation of recommendations (possibly incorporating investment/platform account opening) to ongoing servicing and advice remains elusive.

Part of the reason is that advisers may not be using existing advice CRMs to their full capabilities. Also, the lack of integration between different advice technology systems means that data captured in one system may not flow freely into another to be leveraged for productivity gains.

The advancements in API usage, led by a host of FinTech start-ups over the past several years, represents a large and underappreciated opportunity for advisory groups to drive productivity upward while restraining, and possibly lowering, the cost of advice provision.

A host of novel FinTech applications, from robo-advice to next-gen investment platforms, have conclusively demonstrated that many aspects of traditional advice workflow can be automated to a large degree. AML/CTF client identification and compliance via API calls to relevant databases being only one such example. Automated account opening being another.

Legislative/policy interventions

While technology can help in increasing productivity, the opportunity to improve financial advice affordability and accessibility rests even more so with amendments to the legislative framework surrounding advice provision.

There is a reticence to sail outside the 'safe harbour' enshrined in the definition of best interest duty, with the 'catch-all' provision of Section 961B(2)(g) proving particularly problematic.

While this remains the case for personal financial product advice, risk averse compliance committees will continue to enforce advice workflows that preference costly comprehensive advice over less expensive, lighter touch scaled advice.

It is therefore hoped that the current inquiry by the Australian Law Reform Commission into Australia's financial services legislation, including a review of key definitions such as 'Financial Product Advice' and 'Retail' v 'Wholesale' client definitions will yield recommendations for pragmatic changes to Chapter 7.7 of the Corporations Act 2001

Alternative models – Guidance and assistance

Finally, in respect of the Tinbergen Principle, there must be an acceptance that even with legislative relief, an abundant adaptation of AdviceTech and FinTech and all the goodwill the advice sector can muster, there will be a cohort of Australians who will still face barriers to accessing financial advice.

This may be due to a lack of financial literacy and proficiency in dealing with advisory professionals. It may be due to financial circumstances, with price inevitably being a barrier for some even were advice costs to fall over time. Or price may not be a barrier, it may simply be an individual preference to remain a 'Controller' or to continue with a 'DIY' strategy.

Whatever the reason, a well-rounded financial services sector would have a range of viable alternatives to attaining financial advice from a 'traditional' provider.

Robo-advice, while not anywhere near the penetration of the US or Asia, is one such example. Here consumers with more modest requirements can 'self-serve' within the confines of a regulated environment where choices are deliberately constrained to avoid consumer choice overload.

Next-generation investor-directed portfolio services (IDPS) where consumers can choose either a DIY experience or to have some guidance from a Financial Adviser are another such example.

These solutions point to a hybrid advice future, where the interaction between consumer and adviser might evolve along a spectrum over time, starting with a highly digital, near self-serve model and evolving toward a human-centric relationship as retirement approaches.

Beyond the constraints of the current legislative edifice, the concepts of 'Guidance' and 'Assistance' should be brought in from the cold to sit in between General/Personal Advice on the one hand and Factual Information on the other.

The recent Budget submission by Super Consumers Australia, in calling for a government-funded retirement guidance service in-line with the UK's Money and Pension Service where consumers can gain access to impartial guidance on a range of retirement planning issues, points to a possibility.

The Melbourne University 'FinFuture' white paper of 2019 proceeded in much the same direction, calling for the establishment of a National Financial Wellbeing Agency that would be tasked with improving the financial wellbeing of the nation in aggregate.

These and other ideas need to sit alongside the push toward appropriate legislative relief and amendments spearheaded by the Levy Review and the ACLR Review, and the continued advancement of AdviceTech and FinTech into the fabric of the Australian financial advice sector.

***Harry Chemay** has more than two decades of experience across both wealth management and institutional asset consulting. An active participant within the wealth and superannuation space, Harry is a regular contributor to investment websites in Australia and overseas, writing on investing and financial planning. **Brett Ebedes** is a financial services industry consultant who specialises in working with and solving the business problems of financial services participants.*

The full report "Australian Wealth Management at the Crossroads: Where to from here?", including detailed references and important disclaimer information, can be viewed here.

Time to announce the X-factor for 2022

Don Stammer

Forty-one years ago - coincidentally when I was forty-one years old - I developed an obsession. It's a compulsive need, as each year ends, to list the main X-factors affecting investment returns in the twelve months - and to pick **the** X-factor for that year.

In investment markets, X-factors are the largely unexpected influences that weren't thought about when the year began but came from left field (we used to say came out of the woodwork) to have powerful effects on investment returns over the short, medium or long-terms.

To be a fan of the X-factor, as I am, doesn't preclude one taking a view on where the economy, shares, interest rates, property and exchange rates seem to be headed. Rather, it's a reminder that investors need to allow for uncertainties and surprises – because these are inevitable. That is why diversification and awareness of risk are important to successful investing.

Sometimes, the X-factor was favourable for investors. In chronological order, examples of positive X-factors include: the float of the Australian dollar in 1983; the collapse of inflation here in 1991; our economy being little affected during the global financial crisis of 2008; the surge in share prices that began in March 2009; the boost to most commodity prices in each of 2016, 2018 and 2020 as China avoided the hard landings so often forecast for it; and the sharp recoveries in the global economy and share prices soon after the Covid pandemic had hit hard.

Other times, the X-factor was unfavourable. For example (and again in chronological order), there's been the sharp rise in bond yields in the fake crisis of 1994; the Asian financial crises in 1997 and 1998; the terrorist attacks in the US in 2001; the Enron fraud in US markets in 2002; the near meltdown in the global banking system in 2008; and the disruptions caused by Covid in 2020.

My year-by-year selections of the X-factor have usually been uncontroversial – but last year my phone and email ran hot with people disagreeing with my selection, when I selected the fracturing of the long-dominant view in markets that near-zero inflation would continue for many more years with the result that interest rates, too, would be "lower for longer".

The finalists for the X-factor in 2022

A couple of times in the past 41 years, I included a silly and puerile comment in my report on the X-factor. It was on the lines "if ever a twelve-month period comes along without an X-factor, that would be that year's X-factor".

That flippant remark certainly has no relevance to 2022, which may well have generated a record number of contenders for the X-factor award.

In no particular order, this year's finalists include:

- The sudden return of high rates of inflation.
- Many central banks raised their cash rates, quickly and often in big bites; 'yield curve control' was dropped; and 'quantitative easing' switched to 'quantitative tightening'.
- Some central banks, and notably the Reserve Bank of Australia, gave up offering 'forward advice' on changes in their cash rates - and apologised for being so wrong in the messages they'd put out in the last two years.
- Energy prices, notably for steaming coal and gas, traded at very high levels
- The Russian invasion of Ukraine in February inflicted a big human cost, disrupted the global economy, and underlined the risk of nuclear war.
- Until recent weeks, China kept its hard line on eliminating Covid. It has also maintained a tight clamp-down on dissent in Hong Kong, and its military threat to Taiwan.
- In Australia, employment increased strongly; unemployment rates here (and in the US) fell to their lowest levels in almost fifty years.
- Rates of wage increases have started to accelerate in many countries.
- For a while in September-October markets were in turmoil after the then UK prime minister announced a further, and large, fiscal boost. There were also a few days of unexpected rapture, such as 10 November when bond yields declined on thoughts inflation might have peaked and US share prices jumped 6%.
- In May, Labor won a small but workable majority in the House of Representatives, minor parties and crossbenchers made big gains in both houses, and the Coalition parties polled extremely badly.
- Investors' enthusiasm for ESG guidelines seems have reduced during the year, as fossil fuels rose in price and investors worried renewables might not be able to keep the lights working.
- Gold and particularly cryptocurrencies failed to protect investors after the return of inflation.

And the X-factor for 2022 is …

In my view, the X-factor for 2022 is the surge in inflation experienced early in the year and the sharp increases in interest rates that quickly resulted – and all this at a time when many investors and most central banks had expected inflation and interest rates to be 'lower for longer'.

So, what will be next year's X-factor?

The search for next year's X-factor always makes for a lively debate at the Sunday barbeque. Remember, though, that X-factors must be unexpected; anything that's widely anticipated, doesn't qualify.

The X-factor in 2023 could well be something that happens to inflation or to the resolve of central banks to bring inflation down to their target rates as economic growth slows and unemployment increases.

In my view, inflation should slow a little in coming months, as energy prices come off the boil and as China relaxes its zero-Covid strictures allowing supply disruptions to lessen. Nonetheless, inflation could remain a problem in 2023 (with inflation running at perhaps four to five per cent in the US and Australia). The yield on 10-year government bonds, which in both countries was close to 3.5% at time of writing, may need to rise further. Also, there currently appears to be only limited scope for official cash rates (currently 4% in the US and 3.1% here) to be cut in 2023. But if cash rates are raised, Australia should see smaller moves than the US, because of the predominance here of variable rate debt.

Many investors and commentors had predicted a global recession would start in 2022; it hasn't. Warnings of a severe economic slump in the world economy in 2023 are likely soon to proliferate, with many investors and commentators saying they'll stay away from shares until the next recession stares them in the face.

My prediction for the X-factor next year is that share markets will bottom before the next global recession is underway.

My colleague at Stanford Brown Private Wealth, Ashley Owen, wrote a fascinating and apposite report called "Recessions are usually good for sharemarkets"; and *Firstlinks* published it on 12 October 2022. Ashley looked in detail at the 21 recessions Australia has experienced since the 1860s. He considered the timing of turning points in the economy, average share prices, profits and dividends and concluded: "Nothing scares investors more than talk of a recession. However, history shows that economic contractions have mostly been good for share prices and the Australian share market has actually increased during the majority of economic recessions in Australia. The same is true for the US share market during US recessions."

Dr Don Stammer has been involved in investments for many decades as an academic, a senior official at the Reserve Bank, an investment banker, chairman of eight companies listed on the ASX, and columnist for The Australian and Business Review Weekly. These days, Don is on the investment committee at Stanford Brown Private Wealth, is enjoying his octogenarian years, and is working hard - with reasonable success - to contain his Parkinson's Disease diagnosed seven years ago.

The article is general information only and does not consider the circumstances of any investor.

41 years of the X-factor files

2022 The surge in inflation, tighter monetary policies, and sharp rises in interest rates

2021 The fracturing of the long-dominant view low inflation is here to stay

2020 Covid-19

2019 Strong share markets despite repeated predictions of global recession

2018 The impact from the royal commission on financial services

2017 The positive macro influences that, globally, restrained volatility, boosted shares and kept bond yields low

2016 Election of Donald Trump as US president

2015 Widespread experience of negative nominal interest rates

2014 Collapse in oil price during severe tensions in middle east

2013 Confusion on US central bank's 'taper' of bond purchases

2012 The extent of investors' hunt for yield

2011 The government debt crises in Europe

2010 The government debt crises in Europe

2009 The resilience of our economy despite the GFC

2008 The near meltdown in banking systems

2007 RBA raises interest rates 17 days pre-election

2006 Big changes to superannuation

2005 Modest impact on economies from high oil prices

2004 Sustained hike in oil prices

2003 Marked fall in US dollar

2002 Extent of US corporate fraud in Enron etc

2001 September 11 terrorist attacks

2000 Overshooting of exchange rates

1999 Powerful cyclical recovery across Asia

1998 Resilience of our economy despite Asian crisis

1997 Asian financial crisis

1996 Global liquidity boom created in Japan

1995 Powerful rally in US markets

1994 Sharp rise in bond yields

1993 Big improvement in Australian competitiveness

1992 Souring of the vision of "Europe 1992"

1991 Sustainable collapse of inflation

1990 Iraq invasion of Kuwait

1989 Collapse of communism

1988 Boom in world economy despite Black Monday

1987 Black Monday collapse in shares

1986 "Banana Republic" comment by Paul Keating

1985 Collapse of A$ after MX missile crisis

1984 Measured inflation falls sharply

1983 Free float of Australian dollar

1982 Substantial Japanese buying of Australian bonds

What baked-in inflation means for portfolio construction

Vince Pezzullo

If 2021 was characterised by conditions normalising post COVID-19 and companies benefitting from the economic re-opening, then 2022 has been the year of macroeconomic factors leading to more idiosyncratic trends and rewarding stocks that have levers within their control. The year to date has been characterised by fiscal stimulus waning, geopolitical tensions growing, ongoing (though easing) supply chain constraints globally and central banks walking a tightrope on inflation. The bond market, which has driven so much of the volatility felt in equities over the past year, has continued to shake market sentiment.

This backdrop has reinforced the need to maintain a well-balanced portfolio of quality companies as we continue to navigate one of the most unpredictable markets in history. Broadly, the past 12 months have been about moving away from the COVID winners and positioning for a more inflationary environment. This has meant focusing on companies which have more flexibility at their disposal to manage their own outcomes. In other words, they are less worried about what the market or the economy does and are better able to control their own destiny. Some examples would be Bapcor (ASX:BAP), Healius, (ASX:HLS) and A2 Milk (ASX:A2M).

So, where are we today?

Fiscal stimulus is again a dirty phrase because we've got this issue with inflation. When applied correctly, fiscal stimulus can generate lots of GDP growth but, in a globalised world where we're happy to trade with one another, it needs to happen at the lowest cost. With fiscal stimulus and geopolitics occurring concurrently, you have a deglobalisation occurring and it’s no longer about the lowest cost. It has become about certain assets being more strategic in value than they were before. What COVID did was to bring forward several years of demand into two years, and now we're trying to clear that out. The problem is, we are trying to do this while global systems are a lot less efficient. And when there's less efficiency, there’s greater cost. As a result, inflation is being ‘baked in’.

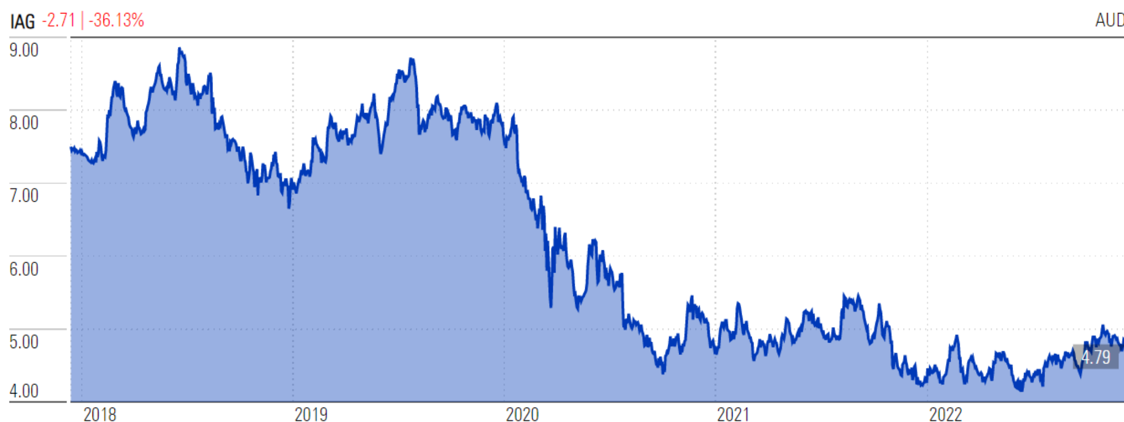
We believe that inflation will normalise at some level, but I think 2% is unrealistic. Already we are seeing parts of the economy starting to normalise. Global supply chains are starting to unclog a bit and materials are starting to move. Global shipping rates are starting to normalise. For example, there were about a hundred ships off the port of Los Angeles in July and that's pretty much cleared. Closer to home, the focus remains on the speed of the rate hike cycle, which may take several months to work its way into the economy, and whether the rate hikes will hit households hard as Christmas approaches.

We are positioned with the expectation of higher rates of inflation and the potential for recession. With low unemployment in Australia and the US, the Fed and the RBA have few levers to pull and all they can do is impact demand by limiting the ability to consume. They are doing this by lifting rates to such a point that people have to cut their discretionary spending down, which we feel will be counterproductive because they’re likely to do far more damage than what they're trying to solve for.

How we're positioning the portfolio

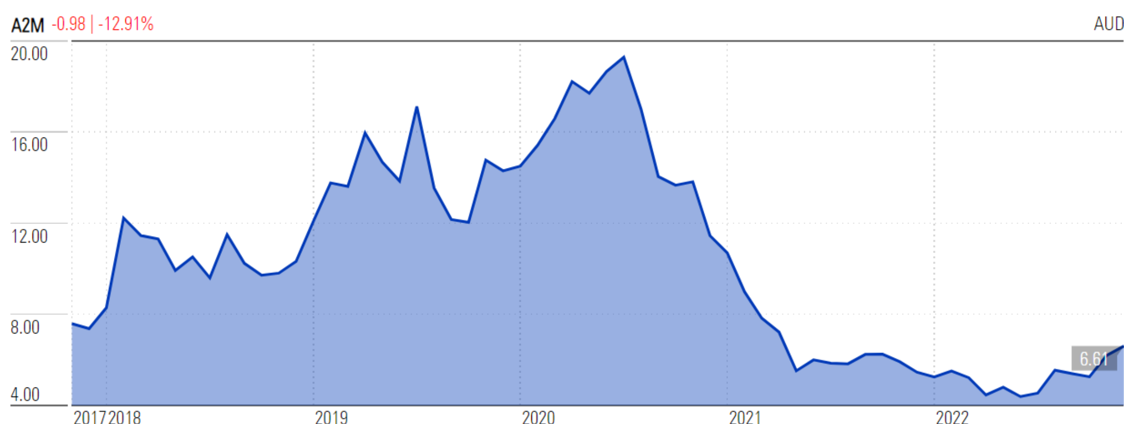
In terms of the portfolio, we are looking at the metals sector, because it has underperformed quite a bit recently. By looking closely at the capital cycle of the commodity sector, you can get a sense of when they are overinvesting and when they are underinvesting. You want to own the commodity sector when they are underinvesting, which they have been over the last 10 years. The copper price has fallen from $4.50 to about $3.30 and most of the copper miners are cutting production. The reason they can do this is that they have very good balance sheets – either net cash or they generate a lot of free cash flow. Commodity stocks do a little bit better in a higher-inflation-through-the-cycle period.

We also like insurance as a defensive play and while the likes of IAG may be a bit boring, the last few years of very low interest rates damaged insurers because they collect premiums every year. The technical reserves, which are held in fixed income, were flat because government bonds were close to zero. But as rates go up, they get a bit of a free kick on top of home and car premiums, which have been raised across the board this year.



Source: Morningstar

I mentioned idiosyncratic stocks, as in more company-specific, and A2 Milk, in which we took a position last year, as an example. There has been a management change there and the new team is doing a great job. The new CEO has centred the infant milk formula business, developed the strategy, and reinvested back into distribution in China.



Source: Morningstar

The results are starting to show and A2 is about 5% of the Perpetual Equity Investment Company (ASX:PIC). Aside from good management, it's got a net cash balance sheet of $900 million. The market cap is $4 billion, so nearly a quarter of the market cap is sitting in cash. They are the sort of business we like, especially when operations are turning around.

Vince Pezzullo is a Portfolio Manager and Head of Equities at Perpetual Investment Management, 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.

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Will investors start tuning in to Spotify again?

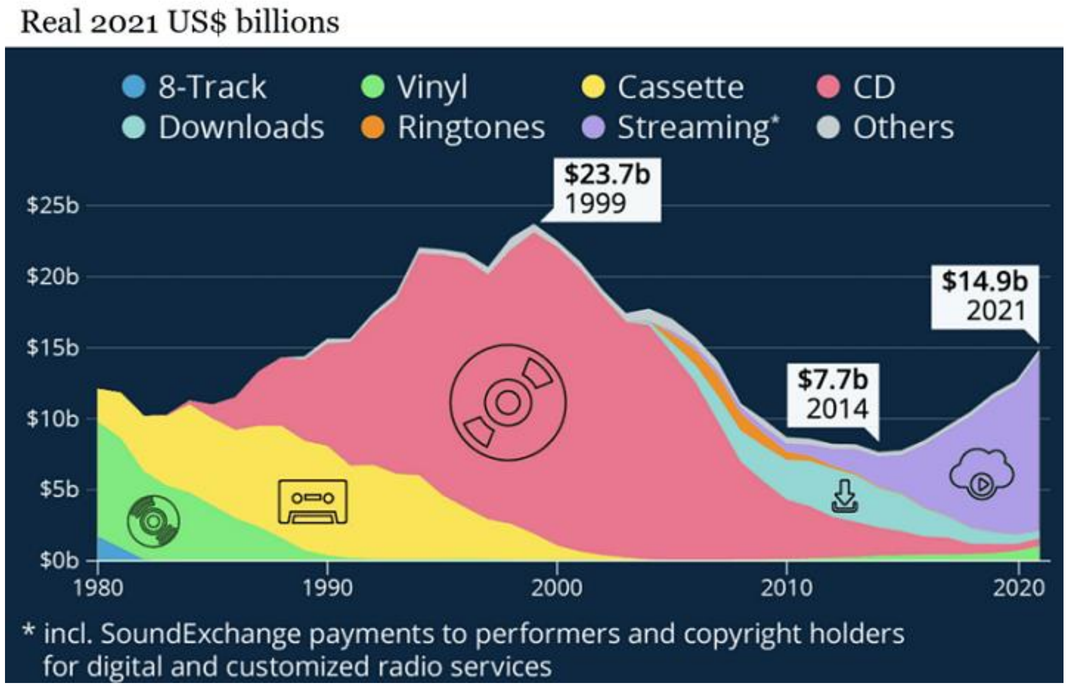
Andrew Macken

Young people probably wouldn't remember when music was bought physically. Listeners would place a vinyl record on a player, slip in a cassette tape, or slide a CD into a machine. It was a lucrative business and US recorded music revenues peaked at US$23.7 billion in 1999, according to RIAA.

While the internet has seen physical music sales in the US crash to just US$1.7 billion, total US recorded music revenues in 2021 were US$14.9 billion, well down from 1999's peak, but still impressive and double the low reached in 2014.

It has been streaming, pioneered by Spotify, that has revived the music industry's fortunes.

US Recorded Music Revenues – By Format



Source: RIAA

But despite Spotify's role in the resurrection of music, which has seen it gain nearly half a billion monthly users, Spotify's business is still only at break-even. Investors have been tuning out of Spotify, with its shares falling around two-thirds from their peak in 2021.

Source: [Morningstar]

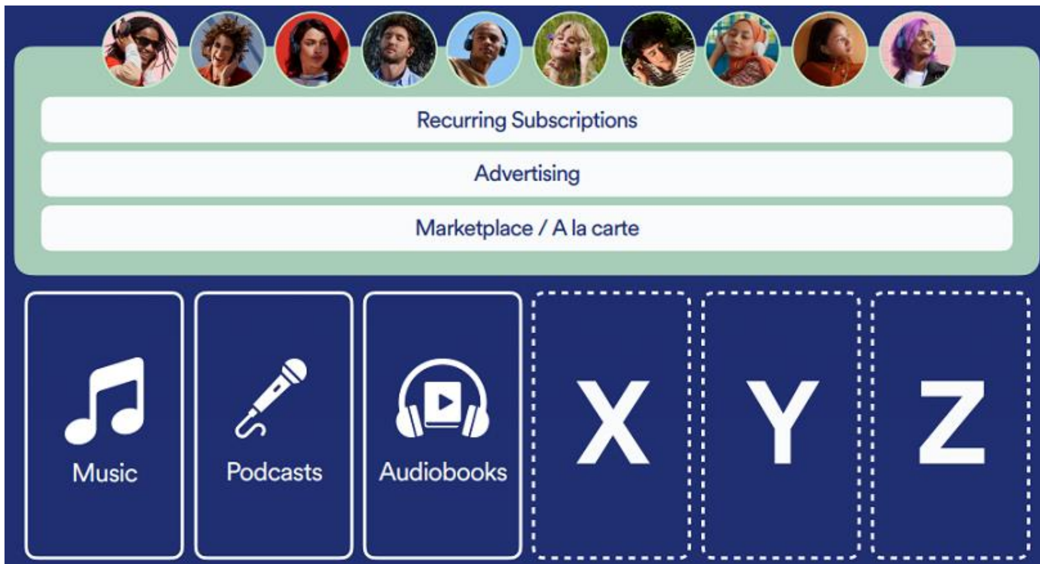
However, investors shouldn't be focused on what a business can earn today. Rather, they should be focused on what it will earn in the future. There are four key reasons why Spotify can materially increase its earnings power in future years, which means the stock is undervalued and a great option for bargain hunters.

1. Spotify's strong platform is now complete

The most important structural aspect of Spotify's business is that it is a single tech platform from which all current and future services can operate. It serves a single user base from a single unified app – but in uniquely personalized ways.

This approach prioritizes the user experience: the software automatically adapts to the user. Whether it be music, a podcast, or an audiobook, the user experiences the same home feed, the same search, in the same app.

Spotify's Unified Audio Platform



Source: Company Presentation (2022)

There are significant network benefits to this consumer-centric approach. Creators in one vertical, such as podcasts for example, can seamlessly access users in different verticals, such as music.

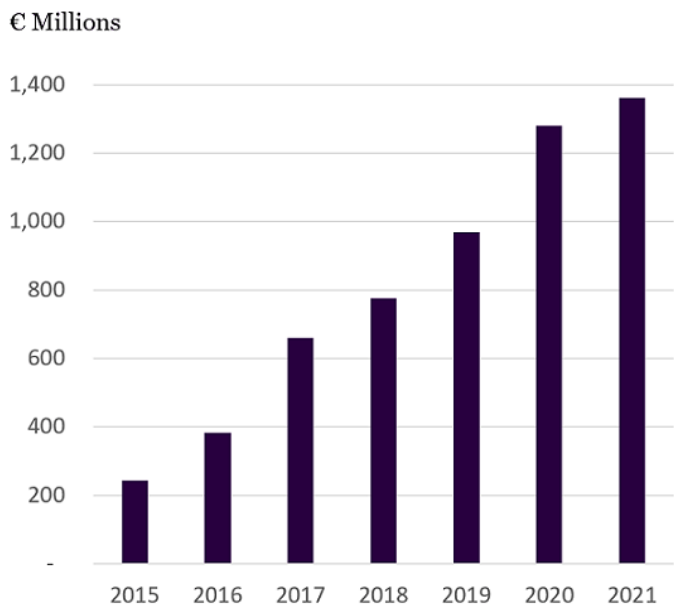
The platform approach also enables Spotify to leverage its scale and distribution to seamlessly launch new verticals to a ready-made, highly engaged user base.

But there are two challenges with this approach. Firstly, it is technically difficult because the software requirements for different verticals, monetization models, and content-types are all unique. Secondly, that means it is more costly to build than an alternative un-unified approach.

This is a prime reason Spotify's development and overhead costs have surged almost six times in just six years.

But Spotify, still led by founder Daniel Ek, is one of the few businesses that has the patience and tolerance to incur several years of short-term profit headwinds to set the business up for superior long-term success and value-creation.

Spotify's annual R&D and administration expenses



Source: Company Presentation (2022)

The great news is that the platform is now largely complete. And in the years that follow, the fruits of these investments will be realised.

2. New verticals with higher margins and cross-selling opportunities

Spotify is years into an investment program to roll out new verticals on its single audio platform. Today, the platform offers music, podcasts and audiobooks. And there are likely more to come in the areas of education, news and others.

If we drill down into the audiobooks category, which Spotify entered after it closed its acquisition of the audiobooks distributor Findaway in June 2022, we find a US$140 billion global book industry, of which audiobooks represent a mid-single-digit percentage and growing at more than 20% per year.

Thanks to its unified consumer experience, Spotify has opportunities to introduce music and podcast listeners to audiobooks and increase the average revenue and gross profit per user.

It's a classic cross-selling opportunity, and it could see a swift ramp up of revenues given Spotify's more than 430 million monthly active users.

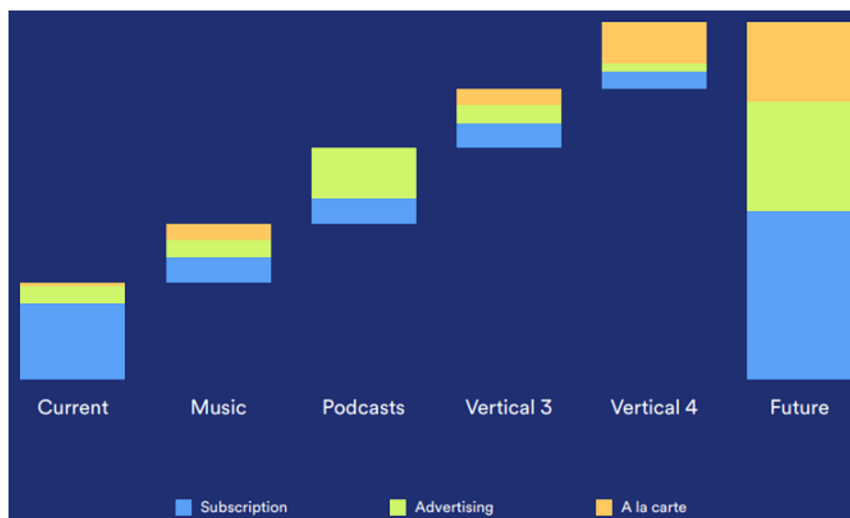
Better still, audiobook revenues are expected to carry gross margins north of 40%, unburdened by the need to pay royalties to music labels, like the company's core business does.

This puts future audiobooks gross margins well above Spotify's 28% music gross margin, which creates a tailwind for Spotify's gross margin rates over time as these ancillary, higher-margin revenue streams are layered on.

And Spotify will enhance the monetisation models of all verticals. The company will add new a la carte pricing (allowing purchase of individual units) for certain services such as audiobooks. But Spotify will also enhance existing monetisation models, particularly in digital advertising.

During Spotify's investor day earlier this year, management was quite explicit about this approach to increase the average revenue per user (or ARPU). They included the chart below which demonstrates the multiple dimensions of ARPU expansion.

Spotify's illustration of average-revenue-per-user build up



Source: Company Presentation (2022)

3. Large advertising opportunity

Ad dollars, over time, follow audiences. While digital audio consumption has been on the rise for years, ad spend is still catching up to this growth. Audio comprises round 23% share of time spent within media but captures just around 5% of total ad spend.

There are reasons for this disparity related to the nature of audio ad formats, yet Spotify has tripled its ad revenue across music and podcasting over the last three years. And there is still a long runway of growth to monetise Spotify users via ads, particularly in podcasting.

Consider that, of the more than 100 billion hours of audio that was consumed on Spotify last year, only 7% related to podcasts. This percentage should grow structurally over time.

And today, Spotify monetises only a minority of users' podcast listening time. Of the total podcast listening hours on Spotify in 2021, approximately 14% were monetised by the company on a global basis.

This highlights a low-hanging fruit opportunity to introduce ads to begin recouping some of the investments Spotify has been making in its podcast ecosystem.

Spotify has been investing in two key products that will boost user monetization via ads:

Streaming Ad Insertion (SAI)

SAI is able to record real-time ad impressions once an ad starts playing, relaying useful insights such as confirmed ad impressions to podcast advertisers. Advertisers previously had to impute the number of ad impressions based on downloads – a crude method to say the least!

Spotify Audience Network (SPAN)

SPAN is Spotify's advertising marketplace that uses first-party data and targeting to connect advertisers to listeners, at scale. Advertisers can reach a target audience across thousands of shows, rather than just targeting a single show.

Spotify's innovations are paving the way for changes in the way podcast ad units are purchased and we believe should translate into higher CPMs, and thus user monetisation, for Spotify over time.

4. Highly margin accretive revenues from Marketplace

Spotify Marketplace is one of the most powerful, but perhaps least appreciated, margin drivers for Spotify over time.

There are tens of thousands of songs uploaded to Spotify each day, with the rate of daily uploads doubling over the last two years. That's a lot of content! If you're a music label, you'd want to do everything in your power to ensure that your songs are getting discovered and listened to. After all, music labels make money when users stream their songs.

Spotify is in a unique position to aid discovery. This is not just theoretical: in 2022, Spotify is averaging 22 billion new artist discoveries per month, more than double the 10 billion new artist discoveries per month just four years prior. In a similar vein to the pay-to-play payments of the linear radio model, artists and music labels can pay Spotify money so that their songs reach fans.

Spotify's Marketplace Gross Profits

Source: Company Presentation (2022)

Spotify, as an aggregator of listener demand, is in a powerful position in the music value chain to extract a greater share of the economics from music labels via their Discovery Mode program.

The program, which has an incredible 98% customer retention rate, is helping drive phenomenal growth in Spotify's high-margin Marketplace business.

Marketplace gross profit grew eight times over just the last four years. It contributed around 6% of Spotify's total gross profit dollars in 2021.

We see Marketplace growing as a share of Spotify's profits. This is a tailwind to margins the market is not properly factoring into their assessment of the business.

Extraordinary value

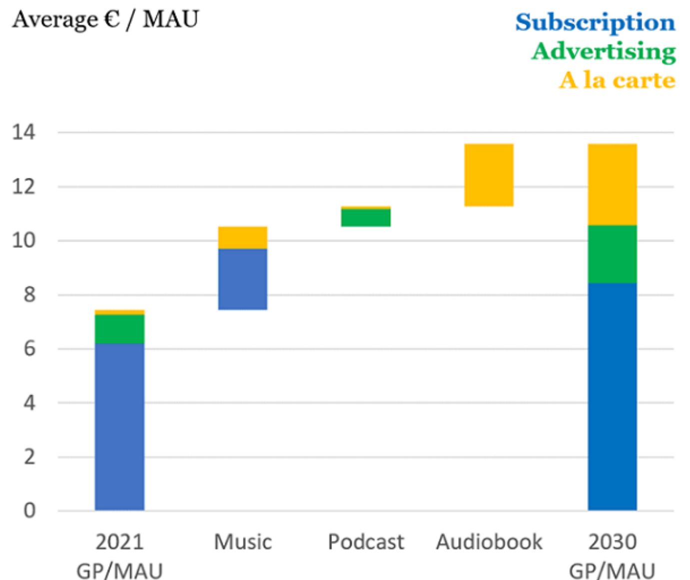
The four factors above will have a profound impact on Spotify's financial performance in coming years.

Over the last year or so, Spotify's 400 million users have generated an average annual gross profit per user (GP/MAU) of around €7.50, or around €3 billion in gross profits. But those gross profits have been offset by the €3 billion in fixed costs of the single tech platform (including annual sales and marketing expenses). So the company is just breaking even today.

But by around 2030, Spotify will likely have around 1 billion users generating GP/MAU of around €14. That is annual gross profits of approximately €14 billion, a nearly five times increase.

Importantly, the fixed cost base of Spotify's single tech platform will not need to increase by nearly as much. We estimate it will increase by less than three times over the period, resulting in annual pre-tax operating income of more than €6 billion.

Spotify's Annual Gross Profit per Monthly Active User



Source: Company Filings; Montaka Estimates

This would equate to cumulative distributable shareholder earnings of more than €26 billion over the next 10 years, and with a business value of more than €100 billion after year 10. Relative to the company's current enterprise value of €15.6 billion, Spotify represents an extraordinary investment opportunity, with the potential for investors to multiply their money by 6.5x over the next decade.

Granted there is a wider range of possible outcomes. But the upside potential of Spotify's shares is very large – and the probabilities of success continue to incrementally increase.

Andrew Macken is the Chief Investment Officer at Montaka Global Investments, a sponsor of Firstlinks. This article is general information and is based on an understanding of current legislation. Note: Montaka is invested in Spotify.

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How likely is a US recession? About 75%

Konark Saxena

The following is an edited transcript of an interview that UNSW did with Konark Saxena, Associate Professor in the School of Banking and Finance at UNSW Business School.

How likely is a recession in the US? Percentage chances?

A/Prof Saxena: The chance of a US recession is about 75%, by my estimates.

Why such high odds? In order to bring down inflation, the US Federal Reserve needs to increase interest rates till either inflation subsides, or economic growth starts flattening. Given the Federal Reserve's mandate and the current momentum of inflation, I feel that economic activity will slow down before the Federal Reserve stops increasing interest rates. Technically, that means that a recession is very likely.

Having said that, I want to point out that there are various types of recessions. My expectation is that the US recession will be a mild one.

In this case, global GDP growth would slow down, but not by as much as the early 1980s, after the Federal Reserve's Volker increased interest rates to combat inflation. And because activity wouldn't slow down by that much, inflation wouldn't slow down by that much either.

This mild recession scenario assumes that the FED would stop tightening before the recession became severe, even if inflation remains persistently high at that time.

What likely impact will this have on Australia, as well as the rest of the world (particularly trading partners)?

A/Prof Saxena: Let's consider the mild recession scenario. In this case, both inflation and interest rates in the US economy are expected to remain high, while growth flattens. I don't expect the US unemployment rate to increase dramatically, which is one of the reasons I'm calling it a mild US recession.

For the rest of the world, this has two main impacts. First, lower US growth is going to slow down the growth in the rest of the world. Especially for countries that export to the US, and those that export to other countries like China, which in turn export to the US. This typically also leads to lower commodity demand and prices.

Second, high US interest rates can create financial distress in countries that are unable to match them. High US interest rates will put pressure on countries to either increase domestic interest rates or accept a substantially devalued currency because capital chases currencies with relatively higher interest rates.

This outflow of capital from lower interest rate countries might push some highly leveraged economies into financial distress, especially those with USD denominated debt.

What factors would likely help protect Australia from a global recession?

A/Prof Saxena: The Australian economy has been resilient in a global decreasing interest rate environment. That spans the last three decades. If the US recession leads us back towards a globally low interest rate environment, then I expect Australia to continue to be resilient – even in times when global growth has slowed down.

While the current low level of wage inflation in a high consumption inflation environment is a significant issue, in the short-run, it is also a strength that will protect the Australian economy and helps keep inflation under control.

Further, this low level of wage inflation means that there is more room for fiscal policy to help wages grow to match rising interest rates. Increasing wages can help offset any required increases in interest rates, so that households with higher nominal wages will find it easier to pay off higher nominal interest rates. For example, if a household needs to pay $100 extra in interest every week, but also earns $100 more in wages, then the effect of nominal interest rate hikes is offset by nominal wage increases.

Another advantage of the current low wage inflation, and a good level of fiscal policy flexibility compared to most other advanced economies, is that it gives the RBA more flexibility to keep rates lower for longer than some international peers. This buys us time to fix some of the issues that risk household financial distress.

Where is the Australian economy more exposed?

A/Prof Saxena: In my view, the main risk to the Australian economy is financial distress. I expect the real economy to be resilient if we are able to avoid financial distress.

There are two types of financial distress risks I am concerned about: household financial distress and currency risk.

Household financial distress increases if households can't pay their mortgages when the RBA increases interest rates too much. Currency crisis risk increases if capital leaves Australia for higher interest rate currencies when the RBA does not increase interest rates enough.

It is a delicate situation and there is a risk that eventually RBA will not have enough flexibility to manage these two conflicting forces.

As mentioned above, I feel one way to avoid these two extreme scenarios, is increasing labour productivity, wage growth, and wage inflation. If households are working and their wages are growing enough, they should be able to handle increases in interest rates thanks to their higher pay cheques. Such wage inflation can help

not only working homeowners pay higher nominal interest rates, but it also benefits renters who can save more.

If we can manage an orderly reduction of (nominal) household debt without incentivising too much risk-taking, then it will give the RBA more flexibility to increase interest rates and bring them in line with US interest rates.

What would the likely impact of a recession be on the average Australian?

A/Prof Saxena: Assuming we are forced to keep interest rates low, I see the impact of the recession on Australian consumers on two main fronts – the first of which is imported US inflation.

High US inflation will also increase the price of US goods and services that we purchase from the US, and thereby increase the general price levels around the world. So, the rest of the world will import US inflation unless they can offer higher real rates and strengthen their USD exchange rates to offset US inflation.

The second front Australians may be impacted with is reduced Australian wealth in US dollars, which would lower the ability to import and consume foreign goods and services. This is likely to hurt Australian consumers as our imports from the US are an important part of our consumption basket.

While the first is largely an external factor that Australian policy cannot influence, the second is not. The reduction in (US dollar-denominated) Australian wealth, can be avoided if we are able to sustain higher interest rates without causing domestic financial distress.

Konark Saxena is an Associate Professor at the School of Banking and Finance at UNSW Business School. This article was originally published in BusinessThink, the digital platform of UNSW Business School, an alliance partner of Firstlinks.

The legal fallout when a carer becomes a partner

Donal Griffin

Carers are wonderful people who do important work, often for little or no reward. Here is another scenario where a carer can be found to be a lover. The case of Sun v Chapman decided whether a de facto partner was a carer or partner at the time of the deceased's passing.

The reversal of an earlier ruling

Recently decided in the NSW Court of Appeal, the case of *Sun v Chapman* [2022] NSWCA 132, follows an earlier judgment (*Sun v Chapman* [2021] NSWSC 955) that found that Ms Sun was the live-in carer of the deceased, Mr Robin Chapman, and not his de facto partner. The recent decision heard that the couple began living together in 1998, and although an earlier decision found that they had ceased a de facto relationship, the Court of Appeal disagreed.

Mr Chapman and Ms Sun lived together from 1998 until Mr Chapman's death on 2 February 2019. Mr Chapman's last will was made in 1996 which pre-dated the relationship and as such made no provision for Ms Sun.

The Court of Appeal reviewed the "evidence of the existence, nature and quality of [the] relationship". Although Ms Sun was caring for the late Mr Chapman and they often fought, this did not negate the fact that they remained in a de facto relationship and there was no evidence brought to the contrary. It is harder to prove something is not the case.

Medical notes and police records demonstrated that the deceased had a dementing condition. These notes also refer to the deceased and Ms Sun in a de facto relationship and not as a carer-patient relationship. Although the Court heard that the adult children of the deceased did not see their father and Ms Sun engage in behaviour that indicated a de facto relationship, the Court decided this was not unsurprising that the deceased did not disclose the relationship to his adult children.

Ms Sun, however, demonstrated in a number of ways that she was in a de facto relationship with the deceased by showing photos of holidays together, as well as corroborative evidence from a friend, a neighbour and her son that was consistent with Ms Sun and the deceased being in a relationship together. In addition, the

deceased made a statutory declaration on 10 June 2003 to support Ms Sun's application for a permanent residency visa and stated they were in an "ongoing de facto relationship."

Relevant to the case, the Court of Appeal makes note of how the legislation defines "de facto relationship," "close personal relationship," and "eligible persons" who can make an application for a family provision order with regards to the estate of a deceased person.

The Court of Appeal stated that Ms Sun and Mr Chapman were in a de facto partnership rather than a carer-patient relationship even though the romance had ended, in much the same way a "wife might continue to look after a demented and grumpy husband."

Get advice in advance

Society expects partners to do some caring. Hopefully they do care! But carers who become romantic partners cross a line.

Advice in advance could have achieved a different result. I have personal experience with this. I prepared an agreement for someone in our family to ensure they received a fair hourly rate for offering care services but no more. They were contractually obliged to advise the family if any offer of a legacy or other support was made by the family member who had dementia. It worked.

Imagine how the family of the deceased feel in this case, having embarrassing evidence revealed so publicly? I comfort myself that, while these articles go viral, our audience are discreet and sensitive people.

Legacy is more than just money; it is how you are remembered. It is worth protecting.

Thank you,Veronica Peters, psychologist for her help with this article.

Donal Griffin is the Principal of Legacy Law, a Sydney-based legal firm specialising in protecting family assets, and author of 'An Irish book of living and dying' (the first book in the 'Be A Better Ancestor' series). Legacy Law is not licensed to give financial advice and this is general information.

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