Edition 505, 21 April 2023

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Editorial

Treasurer **Jim Chalmers** will release the Review into the Reserve Bank today, and even for people wearied by the media's preoccupation with monthly cash announcements and every word uttered by Governor **Philip Lowe**, the changes are profound. In a statement last night, Mr Chalmers said:

"I thank the RBA Review Panel for this significant piece of work and look forward to working across the parliament and with the RBA to implement the recommendations. The review is all about ensuring Australia's central bank and monetary policy arrangements are as strong and effective as they can be into the future."

The Report includes 51 recommendations, and the Treasurer will accept all of them in principle, and is expected to announce:

- the creation of two Boards, one to set monetary policy and another to oversee the operations of the Reserve Bank. Instead of the current dominance of business people on the Board, the interest rate group will include economists and experts in labour and financial markets.
- a confirmation of the Reserve Bank independence from government and the continued use of an inflation-targeting framework to set rates.
- the Governor will appear before a press conference after each rate-setting meeting to explain its decision and comment on economic conditions. There may be other changes in the way decisions are communicated.
- the transformation will require legislation, but bipartisan support is expected.

There may be a change to the monthly meeting schedule for the monetary policy experts, who meet less frequently in countries which use a similar system.

The Review Panel received more than 1,500 contributions and consulted 137 experts and representative groups. The extent of the changes will heighten speculation that the seven-year term of Governor Lowe will not be extended when it ends in September this year.

Chalmers will face little opposition to the recommendations, especially since they come from a respected, independent trio on the Panel. What we can firmly state at this critical moment in the history of financial markets in Australia is that the Reserve Bank has made some poor calls in the last two years. Delaying the first increase in cash rates until May 2022 still beggars belief when inflation signs were clear in late 2021, and maximum pandemic fear was two years earlier. The incredibly loose monetary policy of rates at 0.1% and cheap long-term loans to banks of $188 billion fuelled a housing price boom which severely compromises a generation of buyers ever owning a home. Social consequences rarely come much bigger.

Four leading voices, three from within the Reserve Bank itself, confirm this.

Ian Harper, Dean of the Melbourne Business School and Member of the Reserve Bank Board since 2016, told a panel discussion that during the pandemic, the Bank struggled to balance its dual responsibilities for the stability of the Australian financial system and holding inflation within the 2-3% target range.

"And both of those things led us to be extremely cautious - with hindsight, excessively cautious - in how we set interest rates during that time."

He then made a surprising confession:

"With the benefit of hindsight, obviously, we were well above what we would now accept to be the non-accelerating inflation rate of unemployment, as a result of which it looks like we did a terrible job."

Deputy Governor **Michele Bullock**, although only on the Board since April 2022, said they underestimated the combined impact of generous fiscal and monetary policy, and the Bank's message became "garbled".

Begona Dominguez, Professor of Economics at the University of Queensland, confirmed the poor timing, both down and up:

"It was clear by the middle of 2021 that we were on our way up; measures of inflation - expectations of inflation were rising and becoming more skewed, so I think we should have responded maybe six months earlier or so."

And as far back as November 2022, Philip Lowe himself apologised at a Senate Economics Committee hearing:

"I'm sorry that people listened to what we've said and acted on that, and now find themselves in a position they don't want to be in. People did not hear the caveats in what we said. We didn't get across the caveats clearly enough, and the community heard 2024. They didn't hear the conditionality. That's a failure on our part, we didn't communicate the caveats clearly enough, and we've certainly learned from that."

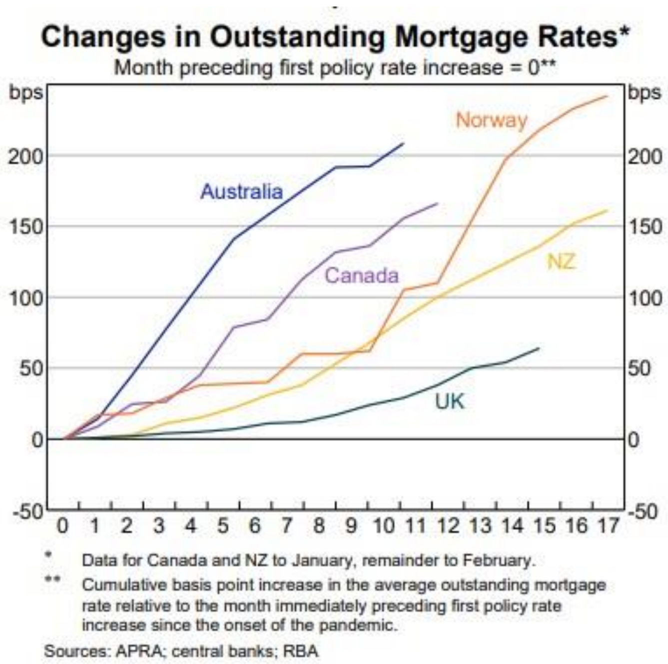
On 5 April, in an address to the National Press Club, he showed one reason why the Reserve Bank is pausing when other countries continue to raise rates.

"And the 35% of households with a mortgage are experiencing, or will experience, a significant increase in their required payments. The predominance of variable-rate mortgages in Australia means that this is a more powerful transmission mechanism of monetary policy than in many other countries."

This chart does not include the US, where borrowers are protected by 30-year fixed rates. There's none of that in Australia. The recent minutes of the Reserve Bank Board show the decision to pause this month was a close call, leading economists to predict that the next rate increase will come next month, but Lowe also said:

"The Board is conscious that monetary policy operates with a lag and that the full effect of the increases to date is yet to be felt. It is also conscious that there are significant economic uncertainties at the moment. Given these lags and uncertainties, the Board judged that, with monetary policy now in restrictive territory, it was time to hold interest rates steady and accumulate more information."

How much more information comes in one month to justify an increase? With such mixed messages, the only reasonable interpretation is that the Reserve



Bank Board itself does not know its next step until it meets again.

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In recent years, investors have gained a better understanding of the impact of their personal behaviour on investment outcomes. The biggest influence on performance is not which fund manager or structure is selected, but the biases and preconceptions we all bring to our investing actions. As **Morgan Housel**, the author of *The Psychology of Money* and one of my favourite writers, puts it:

"The finance industry talks too much about what to do, and not enough about what happens in your head when you try to do it."

We need to learn what goes on in our heads. For non-professionals, investing success is less about the metrics in intrinsic valuations, mean-variance analysis, Sharpe ratios, and - heaven help us - skewness or kurtosis. It's more about the behavioural impacts of loss aversion, confirmation bias, anchoring, overconfidence, reinforcement, incentives and mental accounting.

Each of us has different experiences and interactions which influence how we invest, but we know little about how billion of other people are thinking. When the market seems completely irrational, maybe that's simply our unique perception. Two fund managers with exactly the same training and years in the market may form totally opposite views on the prospects of the same company.

It can be difficult to shake off our preconceptions and our biases, leaving us stuck in an old paradigm. Many of our best fund managers fell in love in 2020 and 2021 with the infinite possibility of low rates forever and skyrocketing valuations of tech stocks which have since fallen by 90% or disappeared. But similarly, some traditional managers have endured a decade of underperformance because they were stuck on valuation techniques that overlook great growth companies.

Warren Buffett's mate, **Charlie Munger**, made one of his typically-pointed analogies in a speech at Harvard University in 1995, which he called The Psychology of Human Misjudgment:

"I am very interested in the subject of human misjudgment, and Lord knows I've created a good bit of it ...

*... the human mind is a lot like the human egg, and the human egg has a shut-off device. When one sperm gets in, it shuts down so the next one can't get in. The human mind has a big tendency of the same sort. And here again, it doesn't just catch ordinary mortals; it catches the deans of physics. According to **Max Planck**, the really innovative, important new physics was never really accepted by the old guard. Instead a new guard came along that was less brain-blocked by its previous conclusions."*

When I listen to fund manager presentations and their stock stories, I try to determine if they have fallen in love with a stock. If they espouse its wonders with little mention of its shortcomings, and then express frustration that the market simply does not understand, it's time to dig a little deeper.

But there's a perverse problem faced by some funds due to the behaviours of their investors, especially selling when the market is low and buying when it is hot. Open-ended funds may be forced to buy or sell by the applications and withdrawals of their clients, even against the preferences of the fund manager. I recently invested in a low-profile fund where I was required to submit my investment beliefs in advance for approval, to convince the manager that I was not flighty and would take a long-term perspective. His fund is now closed to new members and old ones rarely leave.

In **The Wall Street Journal**, **Jason Zweig** writes:

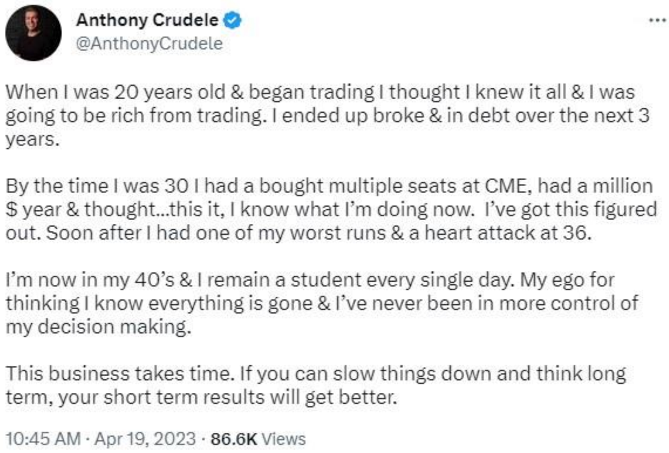
"The typical fund returned an average of 7.7% annually over the three decades, after fees. Fund investors, however, earned only 6.9% annually because of their chronic compulsion to chase hot performance and flee when it goes cold.

Such buy-high-and-sell-low behavior tends to flood fund managers with cash at times when stocks have already risen in price, and to force the funds to sell stocks after a decline. The managers can perform only as well as their worst investors allow them to."

Most fund managers are so desperate to build their funds that they will take money from anyone. I admire the manager who made me qualify to invest as there is some truth to this "*managers can perform only as well as their worst investors allow them to."* To the extent it can be controlled, such as a fund manager accepting a large institutional mandate, it's vital to ensure everyone understands the types of market that suit the manager's style. Nobody should allocate to an active manager with anything short of a five-to-eight-year horizon.

In an article this week, author and portfolio manager **Joe Wiggins** asks why both investors and fund managers [do not focus on skill](#) more often, relying more on easier discussions about performance outcomes and stock stories than a proof of the special abilities of the manager.

Even when results are good, it might be a fortuitous moment in time and circumstances can easily change.



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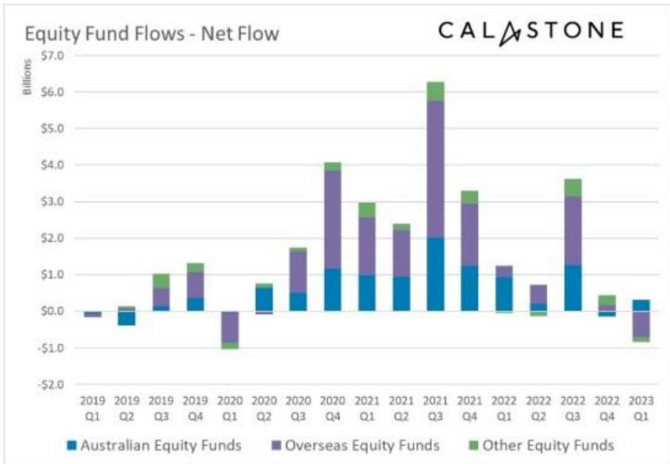
Regardless of the evidence that picking the market is usually a fruitless exercise, investors are reacting to the current global uncertainty, and missing the strength of the stockmarket in 2023. **Calastone** (over 95% of Australian managed fund flows pass across their network each month) reports Australian investors pulled a net $516 million from managed equity funds in Q1 2023, the worst outflows since Q1 2020. However, domestic equities saw inflows while funds investing overseas lost capital, and fixed income funds saw inflows in January and February turn to profit-taking in March.

Figure 1: Calastone **net equity** managed fund flows, all AU domiciled

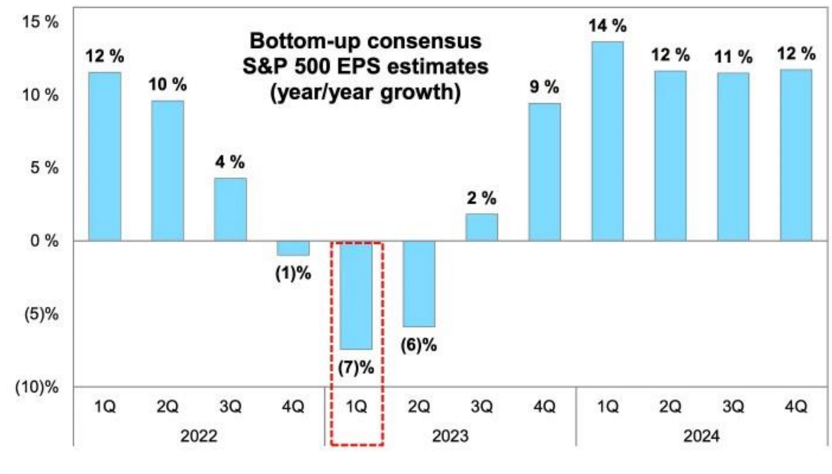


Teresa Walker, Managing Director at Calastone, said:

"Australia's stockmarket is performing in line with its global peers, yet investors drew a marked dividing line in Q1 between home and abroad."

Investor caution is driven by doubts about global corporate earnings and a stubborn US Fed determined to continue raising rates to kill inflation, and likely push the economy into a recession. Rates have increased at the fastest pace since the 1980s and something more than a few small US banks will break before this cycle is over. The **Goldman Sachs** chart shown here of consensus Earnings Per Share (EPS) suggests most of 2023 will not be good but investors need to be ready for a 2024 recovery. Not that investors should be encouraged to time the market, which does have a remarkable capacity to look through near-term problems to the future prospects.

Exhibit 1: Quarterly path of consensus S&P 500 EPS growth
as of April 4, 2023



Source: FactSet, Goldman Sachs Global Investment Research

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My article dives into the rules imposed by **ASIC** on financial product providers under the [Design and Distribution Obligations](#), and why they are denying investors (retail and wholesale) the ability to participate in rollovers of investments they have held for many years. Surely this was not an intended consequence, and changes are suggested.

Graham Hand

Also in this week's edition ...

Meg Heffron's monthly column unpacks the increasingly-important Total Superannuation Balance (TSB). While it's a term that may sound self-explanatory, it's anything but and will become a crucial number for many if the proposed new tax on those with more than $3 million in super is introduced.

It was notable this week that CEO of the SMSF Association, **Peter Burgess**, issued a statement saying:

"The proposed model has been designed for APRA regulated funds, yet three-quarters of the estimated 80,000 members being impacted are SMSF members ... It is unfair that SMSF members with balances above $3 million will be required to pay tax on unrealised gains because some APRA regulated funds may find it difficult to report the taxable earnings attributable to members ... With minor system and reporting changes, the SMSF sector, and we understand some APRA regulated funds, can report a member's actual taxable earnings to the ATO on an annual basis.

So, we are asking the Government to give these funds the opportunity of reporting actual earnings rather than the proposed model which would calculate earnings based on the movement in the member's total super balance and, which by definition, includes unrealised gains."

Jim Chalmers is only a few weeks away from delivering his second Budget, and **Peter Martin** reports on a survey of 59 leading economists on the policy changes he should adopt if efficiency and equity ruled over politics. Of course, most of these changes will not be mentioned on 9 May but it does show where billions in extra revenue are buried in our tax and concessions system.

For many, the active versus passive debate can be divisive - you're either one or the other. But **Shane Woldendorp** from **Orbis** says both approaches have their strengths and weaknesses, which suggests that perhaps the answer is to create a blended approach. Shane provides actionable advice about how to do this.

As more Australians return to international travel and hold their investments in unhedged global funds or stocks, the level of the Australian dollar increasingly affects returns and money in the pocket. The currency has fallen against the US dollar in recent years but **Andrew Canobi** of **Franklin Templeton** sees reason for strength in 2023.

In the face of rising economic risks, switching money into bank deposits may be the first thing that income-oriented investors think of. **Andrew Lockhart** of **Metrics Credit Partners** says there may be better options. He says private debt can provide reduced capital volatility and reliable income, but also attractive risk-adjusted returns that are linked to inflation.

In this week's White Paper, **Neuberger Berman** checks why markets did surprisingly well in Q1 2023 but the investment team considers Fed actions to control inflation will likely push the economy into recession and hit corporate earnings.

Curated by James Gruber and Leisa Bell

Yin and yang design obligations need a rebalance

Graham Hand

There is no doubt the intentions of Australia's financial regulator are honourable in the Design and Distribution Obligations (DDO) imposed on product providers. Putting aside the reality that 99% of investors never read these documents and a further level of red tape has been created, DDO is a good step in protecting unsophisticated investors.

But the balance is wrong. Issuers are wary of the rules and unwilling to offer rollovers to investors who have held assets for many years, and wholesale investors who know the risks are denied access to some issues.

It's a yin and yang of a regulation. In Chinese culture, opposing forces should complement each other, but if yin is too strong, yang is weaker. In cracking down on the yin (still, dark, negative) of financial products sold to the wrong people, the yang (energy, bright, positive) of efficient investing and open distribution is compromised. The balance of yin and yang exists in everything, and it needs fixing in these rules.

Background to ASIC's demands

The Australian Securities and Investments Commission (ASIC) regulates financial services and consumer credit, and is responsible for "*promoting a fair, transparent and efficient financial system for all*." Under Regulatory Guide RG274, the DDO requires issuers and distributors to take 'reasonable steps' to ensure consumers are receiving products that are likely to be consistent with their objectives, financial situations and needs.

Issuers must provide a Target Market Determination (TMD) and ensure products are consistent with the descriptions in the document. A simple example is that an unsophisticated 90-year-old should not be sold a 10-year derivative exposed to leveraged market volatility. DDO generally covers insurance, asset management, superannuation and derivatives but not MySuper.

ASIC requires products identified as 'complex' to carry a higher level of disclosure in offer documents than traditional products which are more readily understood.

How could reducing the yin of inappropriate products not be a good thing? It's an independent regulator protecting investors, and heaven knows, there are plenty of examples of shysters separating unsuspecting people from their hard-earned savings. So what's the imbalance between yin and yang?

The downside example of distributing a convertible bond

The most common example where retail investors have suffered from ASIC's policy is the rollover of bank hybrids, which have been commonly held for years by an army of retail investors. ASIC will argue that hybrid structures are complicated and should only be bought by 'sophisticated' investors or with financial advice. Banks have decided they cannot offer new hybrids to the general public, even when the issuer is rolling over an existing hybrid that may have been held for five years or more. Retail investors are forced to buy on the ASX after the issue is completed.

A specific example of the heavy hand of ASIC has surfaced during the rollover of a CVC bond which demonstrates the wider implications.

a) Brief background on the transaction

CVC Limited (ASX:CVC) is a listed investment company that deploys capital into real estate, listed and unlisted companies and funds. In 2018, CVC issued a five-year listed convertible note (ASX:CVCG) which is maturing soon, on 22 June 2023. The full terms are described in the 2018 Prospectus in detail but major features are:

- Pays a quarterly floating rate margin of 3.75% over 90-day bank bill rate
- Converts at investor option to CVC shares at $3.40, a 30% premium to the CVC share price at the time of issue
- Ranks unsecured but ahead of shareholders
- Protected by a gearing covenant preventing the Gearing Ratio (Liabilities/Liabilities + Equity) exceeding 40%.

I have held this investment in my SMSF for five years. While this is not a recommendation, the two main reasons I was comfortable with it are:

- The gearing covenant, with $2.50 of assets for every $1 of debt (including the convertible note) and rights to the assets for CVCG holders rank above shareholders but behind secured debt.
- The floating rate exposure and decent margin, currently paying around 7.3%.

I did not place any value on the share conversion option, but it was a potential bonus.

While the transaction came with a long offer document, and no doubt the intricacies would be essential in the event of a default, I was satisfied with a modest exposure. I am not attempting to review the full document here, just using this example.

Clearly, the structure is not as simple as, say, a bank term deposit, and investors are paid for the added risk.

On 29 March 2023, CVC announced the successful completion of a bookbuild arranged by E&P Corporate Advisory for a replacement transaction, $31.1 million of CVC Notes 2 (ASX:CVCHA) with a margin set at 4.75% per annum and a new maturity date of 31 March 2026. CVCHA will replace CVCG.

b) ASIC changes the target market appropriately

ASIC issued an interim stop order on 30 March 2023 preventing the distribution of CVC Notes 2. After the target market was significantly narrowed, the order was lifted on 4 April 2023 to allow the transaction to proceed. ASIC felt that the target market in the original TMD was too broad for higher-risk unsecured debt. ASIC said:

"For example, the original TMD indicated that retail investors intending to use CVC Notes 2 as core component (25-75% of investable assets) were potentially in the target market. This has been reduced to 3% in the revised TMD. The original TMD also indicated that retail investors with a 'medium' risk profile were potentially in the target market. These investors are now excluded from the target market.

The original TMD defined the target market based on features that CVC Notes 2 does not provide. For example, the original TMD indicated that retail investors needing to withdraw money frequently were in the target market despite CVC Notes 2 not providing redemption rights for approximately three years. It also indicated that retail investors seeking a capital preservation product were in the target market. CVC has revised the TMD to exclude these investors from the target market."

ASIC has done a good job here, and such directions to issuers are common. ASIC has now issued 28 stop orders due to its perception of deficiencies in TMDs, 23 of which have been lifted after suitable changes.

While many 'retail' investors would not find these notes difficult to understand, they should certainly not represent up to 75% of a 'core component'. Investors should assume there is little or no liquidity and there is no guarantee of capital. CVC and its advisers overstepped the mark with these claims, and ASIC acted appropriately.

c) What are the distribution problems?

Despite the prospectus for the new issue describing at length the reinvestment opportunity, many existing investors were effectively ruled out of the rollover. Here is the chain of events:

1. On 16 March 2023, CVC launched its 'CVC Notes 2 Offer and CVCG Reinvestment Offer' including emailing all existing investors in CVCG. It said:

"The Offer under the Prospectus is comprised of a Reinvestment Offer, under which Eligible CVCG Holders, may elect to exchange their CVCG for CVC Notes 2 and a New Money Offer, which will allow clients of Brokers to apply to make a new investment in CVC Notes 2."

Under 'How to apply', existing holders were informed:

"All Applications must be submitted through a Broker and you should contact your Broker for instructions on how to apply once the Offer opens."

The Reinvestment Offer stated that any existing CVCG Holders were invited to request some or all their CVCG Notes be exchanged for CVC Notes 2.

Under the Replacement Prospectus issued as a result of the ASIC delay, the Opening Date for the Reinvestment Offer was 4 April 2023 and Closing Date 17 April 2023.

Key dates for the Reinvestment Offer for CVCG Holders

Reinvestment Offer Record Date	15 March 2023
Exposure Period	17 March 2023 – 30 March 2023
Opening date for the Reinvestment Offer	4 April 2023
Closing Date for the Reinvestment Offer	17 April 2023

2. On 5 April 2023, I contacted my main broker, CommSec, where I am qualified as a Wholesale Investor and serviced by their CommSec One team for premium clients. Despite the instructions clearly saying to submit applications via a broker, CommSec advised: *"Unfortunately Commsec was not a participant of this deal and as such we are unable to accept your interest in the offer."*

3. I rang the Arranger at E&P immediately and was informed that the transaction had already been completed. I told him that the Reinvestment Offer had only opened the day before and the offer documents said it ran to

17 April, almost two more weeks. He said the opening and closing dates were in the prospectus as a formality and the issue was placed and closed.

Despite the facts that:

- I had held the maturing investment, CVCG, for five years and was offered the opportunity to reinvest in writing.
- I followed the instructions by contacting my broker the day after the offer opened.
- I qualify as a wholesale investor.

… I am not able to participate in this offer and the person at E&P offered no alternative access method.

As notes such as CVCG trade infrequently and liquidity is poor, it's likely that many existing investors are buy-and-hold and simply treating the investment as a long-term bond. The offer structure allowed E&P to restrict distribution to its own clients. Is this what ASIC wants?

Many people have similar experiences with hybrids. For example, in 2022, when ANZ Bank replaced its Series 2 with Series 7, it advised: *"The Offer period is expected to open on 23 February 2022. The Reinvestment Offer closes at 5.00pm AEDT on 15 March 2022 and the New Money Offer closes at 10.00am AEDT on 22 March 2022."*

But then ANZ required every investor to apply through a broker, who advised even before the offer was open: *"Both new money and rollover applications have closed for ANZ Capital Notes 7 (ANZPE)."*

The warning for any investor receiving these documents is that the timetable does not mean what it says.

Freedom to invest via the ASX

Where a note, fund, bond or similar is listed on the ASX, issuers are required to produce a TMD but there is no obligation to check whether anyone has read it or received financial advice. In fact, even if the TMD becomes inappropriate, the issuer does nothing to check if transactions are consistent with the TMD (although in theory, they should monitor the conduct of brokers but that's almost impossible).

So the investors who are effectively barred from participating in a reinvestment can wait until the day of listing or any other trading day, and buy on market with no further checks. It no longer matters how complicated or suitable the note is, all the checks are waived through.

The consequence is no less risk for the investor but higher costs through brokerage and a premium now in the price.

What does this mean for investors?

ASIC has created an imbalance in the yin and yang despite the laudable desire to protect unsophisticated investors.

Whereas the rules were designed so that retail investors without a financial adviser cannot be targeted for new or rollover transactions, the operation of RG274 closes rollovers even for existing wholesale investors without a direct relationship with the sponsoring broker or arranger.

And then as if the protections no long matter, anyone can buy the same investments on market without consulting anyone and without checks.

It's difficult to see what this achieves other than allowing an arranger to control the distribution of a reinvestment. ASIC should consider:

1. An exception from DDO for existing investors to facilitate rollovers. Until DDO was introduced, rolling an existing investment into its replacement was a simple matter of responding to an online offer by the issuer.

2. Where a product is listed that has been subject to an ASIC stop order due to its complexity, brokers should give new investors a warning (online or in person).

Graham Hand is Editor-at-Large for Firstlinks. This article is general information based on an understanding of the regulations and not a recommendation for any product. Investors should take financial advice before considering any investment described in this article.

Meg on SMSFs: Total Super Balance quirks unpacked

Meg Heffron

Total Superannuation Balance (or TSB) is a term many would assume to be fairly self-explanatory. It sounds like 'everything I have in super' and that's more or less an accurate description. For some time now, it has been an important number when it comes to super contributions. For example, anyone whose TSB was more than $1.7 million at 30 June 2022 effectively could not make any personal contributions to super known as 'non-concessional' contributions in 2022/23.

A new meaning for 'earnings'

But if the proposed new tax on those with more than $3 million in super is introduced, it's likely that TSB will become an even more important number to many.

The proposal involves levying the new tax on an individual's 'earnings' in super and these will be measured by the growth in their TSB. The argument is that if a member's TSB has increased from $5 million to $5.5 million in a year when they've taken nothing out of super and haven't added any new contributions, that $500,000 has come from 'earnings'.

The controversial aspect of course is that this particular earnings amount is made up of all sorts of things that wouldn't normally be taxed. For example, it includes growth in the value of the fund's underlying assets even though they haven't been sold (so-called unrealised capital gains).

Many people with large super balances are about to care even more about exactly what goes into a TSB than they used to.

Here are three quirks to understand.

1. Balance in theory versus balance in practice

TSB on a particular day (let's say 30 June) is technically 'what you'd get if you withdrew all your super that day'. In an SMSF, that's often not the same as the amount on your member statement.

The member statement is based on your fund's financial statements which effectively treat the fund like a going concern. In accordance with the accounting rules, they don't allow for absolutely every cost that would be incurred if the fund really did have to pay out all members' benefits that day. For example, they don't allow for the transaction costs of selling a major asset like a property, the costs associated with winding up the fund etc.

While the financial statements **can** take into account the *tax* cost of selling everything at 30 June (ie the capital gains tax that would be paid if all the assets were sold), they often don't. That's simply a practical thing – tax in an SMSF is highly influenced by exactly what's happening with the members at a particular time and that can change quickly and often.

For example, when SMSF members start retirement phase pensions, the fund stops paying tax on some of its investment income. For example, if 40% of the fund is supporting retirement phase pensions, then 40% of the fund's investment income is exempt from tax and 40% of any capital gains would be ignored if all the assets were sold.

So the 'correct' allowance to make for capital gains tax in one year (before the pensions start) and the next (once they're in place) could be wildly different. And it would change again if one of the pension members died and going forward only (say) 20% of the fund was in pension phase. For this reason, SMSF financial statements are often prepared ignoring this potential tax altogether. Instead, it's allowed for when it's actually paid, that is, when the assets are really sold.

In future, will it be desirable to make sure absolutely all these costs are allowed for to make TSB as low as possible? Maybe. But remember that the earnings amount for this tax is really the *change* in TSB from one year to the next. So, it won't always be desirable to make TSB in a particular year as low as possible. What will often be more important is minimising the growth from one 30 June to the next. Paradoxically, that might mean continuing to ignore these extra costs and taxes or it might mean including them. It will be something to work out on a case-by-case basis.

2. Sudden increases in superannuation

TSB is slightly tricky for someone who has inherited a spouse's super.

The most common way for this to happen is via a 'reversionary pension'. This is where a member dies with a pension running and it automatically continues for their spouse. The amount will be included in the spouse's TSB immediately. This often comes as a surprise because for other purposes the treatment of reversionary pensions is different.

For example, let's say Carl has an account-based pension worth $2 million in his SMSF in 2025/26. He dies on 1 May 2026 and the pension continues automatically to his wife Jane (ie, the pension is 'reversionary'). Jane knows about the TSB which limits how much super she can put into a pension, and this will include the pension she's just inherited from Carl. But the law specifically gives her a 12-month window here – she doesn't have to worry about her own TSB until 1 May 2027.

In contrast, Carl's pension will be part of her TSB immediately for the $3 million tax, from 1 May 2026. That means that when the new tax is worked out on 30 June 2026, it will count towards the $3 million limit for her. Jane has always assumed the new tax wouldn't apply to her (she only had $2 million in super herself, comfortably below the $3 million threshold) but now that she's inherited a new pension, she's over the limit and she doesn't have 12 months to think about it.

3. All in the timing

One last quirk of the proposed rules is that it's the TSB at the end of the year that will drive how much of the 'earnings' amount is taxed. That could create strange outcomes.

Let's consider Tim whose TSB was $9 million on 30 June 2025 and it grew to $10 million by 29 June 2026. At this stage Tim hasn't added any contributions or taken any withdrawals from his super so his earnings amount for the new tax is $1 million.

If he does nothing, Tim is facing 15% tax on 70% of this $1 million in earnings. The calculation proposed at this stage is to tax the following proportion of Tim's earnings:

$$\frac{\text{TSB at the end of the year (\$10m) - \$3m}}{\text{TSB at the end of the year (\$10m)}}$$

= 70% (effectively, it's the proportion of Tim's TSB that is over $3m)

That means a tax bill of $105,000.

But what if Tim withdrew $6 million on 30 June 2026, leaving a TSB of only $4 million at 30 June 2026? His earnings amount would still be $1 million because the formula adjusts for withdrawals. It would be calculated as :

($4m + $6m) - $9m = $1m

Tim would have to 'add back' the $6 million withdrawal to his final TSB of $4 million. However, a much smaller proportion of Tim's earnings would be taxed:

$$\frac{\text{TSB at the end of the year (\$4m) - \$3m}}{\text{TSB at the end of the year (\$4m)}}$$

= 25% (effectively, it's the proportion of Tim's TSB that is over $3 million)

Now his tax bill is only $37,500.

Of course, it remains to be seen whether this new tax will be successfully introduced and exactly how it will work. No draft legislation has been released yet.

But certainly, if it does, it looks like there will be some perplexing new issues to think about when it comes to managing TSBs.

Meg Heffron is the Managing Director of [Heffron SMSF Solutions](), a sponsor of Firstlinks. This is general information only and it does not constitute any recommendation or advice. It does not consider any personal circumstances and is based on an understanding of relevant rules and legislation at the time of writing.

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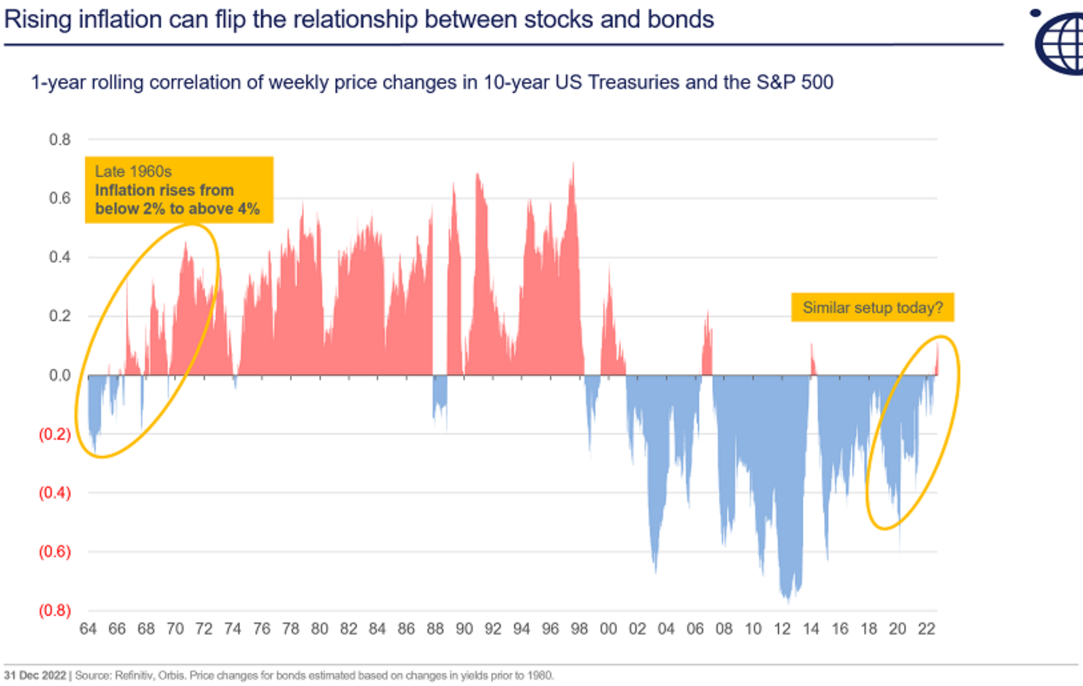
Passive investing has risks too

Shane Woldendorp

In 2022, investors were hit by a double whammy of both equities and bonds suffering similar levels of declines in prices. The perceived wisdom is that this is not supposed to happen. Bonds and equities are meant to be uncorrelated, so that when one struggles the other does well.

The reality is that bonds and equities fall at the same time more often than expected. In fact, a look over history shows the period where equities and bonds were completely uncorrelated is more of an anomaly, particularly in periods of rising inflation.



This means the traditional diversification strategy of 60:40, with 60% in equities and 40% in bonds, is not the silver bullet some may think it is.

Diversification matters in many ways

Now this doesn't mean you should rip up your investment approach and do something completely different. But it would be foolhardy not to try and learn from recent experience and be more open-minded in your view of what diversification means. It's not just about different asset classes, although that obviously helps, it's also about broadening your horizons for different styles, different regions and even combining active and passive strategies.

For many, the active versus passive debate can be divisive: you're either one or the other. But both approaches have their strengths and weaknesses, which suggests that perhaps the answer is to create a blended approach.

For example, 2018-2021 was a tough period for value-oriented managers but 2022 showed the ugly side of a purely passive portfolio. Everyone agrees that timing markets is a fools' errand, but what if you leave a passive 'core' in place and supplement it with a valuation-focused active manager? This can help offset the Achilles heel of a purely passive approach of being fully exposed to the whole market as it becomes over-priced.

Importantly you can add as many managers as you like to your portfolio, active or passive, value or growth or something more contrarian. But it's no use 'diversifying' across 10, 20 or 30 managers if they are all doing the same thing, with the same focus and holding the same stocks in their portfolios.

The key is to choose managers that have a compass that they stick to, staying true to their investment philosophy and process no matter what the market cycle throws at them. It may be painful at times, but you'll know what you're getting over the long-term, and each one can act as a diversifier for your overall portfolio *because* they are each doing something different.

... and valuation matters, too

In the latest 'Everything Bubble', growth stocks were the darlings of the markets, helped along by the money being pumped into the system by central banks in the wake of the GFC and the Covid-19 pandemic.

But now it appears that bubble is bursting, and more people are beginning to recognise that valuations matter.

Focusing on the broad market cycle misses something crucial - the cycle in valuation gaps, which can have just as big an impact on investor returns. Not all assets go up by the same amount during a bubble, and the same is true when that bubble bursts. This can lead to different experiences depending on what type of investment you're in, whether it's the market darlings, or the unloved, boring businesses.

From a diversification point of view, this means it can be beneficial to build a portfolio from the bottom-up, focusing on fundamentals, rather than starting from a high-level top-down macro viewpoint. At Orbis, asset classes such as equities, bonds, commodities, and hedged equity all compete equally for space in our portfolios. We aim to select investments across asset classes to find those that will combine to offer the most attractive balance of risk and reward. By doing this, we end up with a portfolio that can be very different to the benchmark both on the equity and the bond side.

As contrarian investors we recognise that not everyone has the courage to stand above the parapet and potentially look foolish in the short-term, even when they know the long-term thinking is sound. But as a diversification tool, it can be powerful to have alternate viewpoints in a portfolio.

While it is a cliché, the old adage 'don't put all your eggs in one basket' still holds true for investing. When you're constructing a portfolio, the different baskets of risk and return should be truly different and robust enough to deliver a good balance of investment approaches that can weather any environment.

Shane Woldendorp, Investment Specialist, [Orbis Investments](), a sponsor of Firstlinks. This report contains general information only and not personal financial or investment advice. It does not take into account the specific investment objectives, financial situation or individual needs of any particular person. For more articles and papers from Orbis, please [click here]().

Can the battling Aussie dollar find a friend?

Andrew Canobi

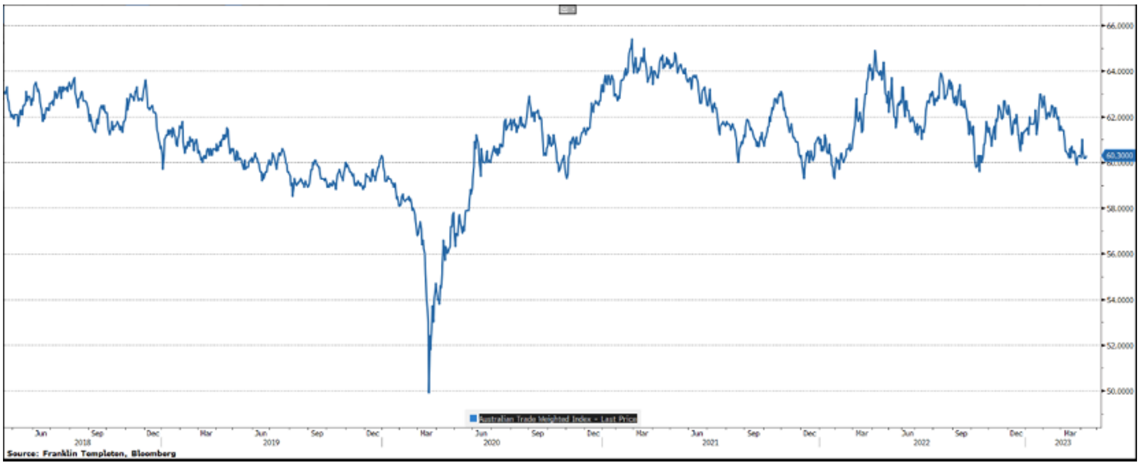
Aside from a brief look above the US 70-cent area in January 2023, the Australian dollar has been generally stuck in a range of 65-70 cents since August last year. What is going on with the little Aussie battler? Are the days of the strong Aussie dollar behind us and are we entering a longer-term structural period of weakness?

There is reason for optimism. In terms of the large factors that tend to be influential on the Australian dollar, pages could be written but we can point to three of the major ones to help explain the recent period of weakness and also why these could recede as headwinds.

It's always the big dollar

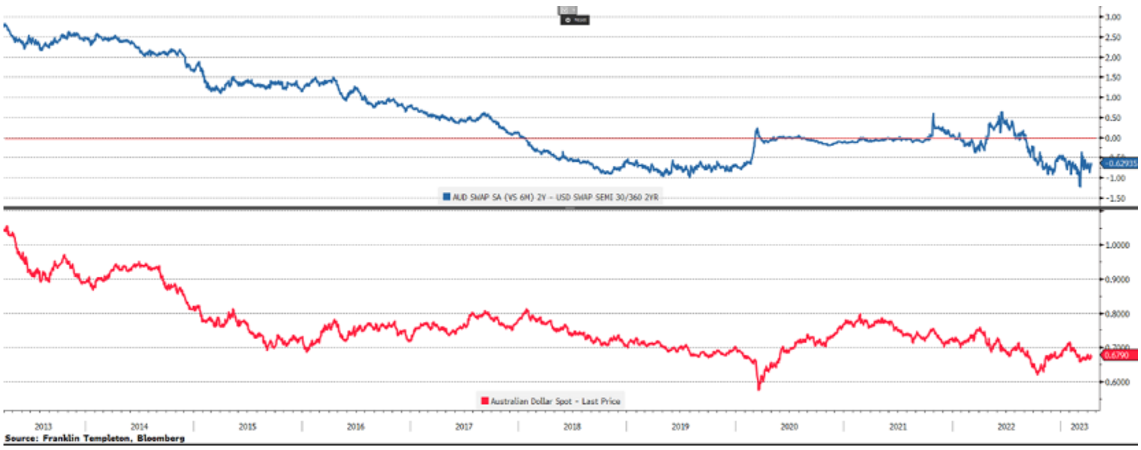
The Aussie dollar has been relatively weak against the US dollar. This is not to be downplayed given that ~70% of global trade is still conducted in US dollar and it matters for an open economy like Australia's. But a quick examination of major currency pairs shows that it's not so much just the Aussie that's been weak, so has the Japanese Yen, Pound Sterling, the Euro etc. The Kiwi has been especially weak. In short, US dollar strength explains a good part of the Aussie's challenges over recent times.

Measured on a trade-weighted basis, the Aussie is hovering around its longer-term average and actually above where it was pre-pandemic, which is why the RBA rarely talks about the currency of late and why, when they do, they usually refer to the trade-weighted index to rebuff any concern over the AUD-USD currency.



The US dollar is the problem

The aggressive Fed and an economy that has held up well have been positive factors for the US dollar. The interest rate differential between Australian and US short end rates is one factor that might explain the outperformance. In fact, over the last 10 years as the Australian dollar has lost its 'high yielding' advantage the currency has generally depreciated against the US dollar. The chart below shows the Aussie dollar versus US 2-year swap yield with the bottom panel the A$/US$ currency. At present, the Aussie has a yield disadvantage relative to the US dollar.

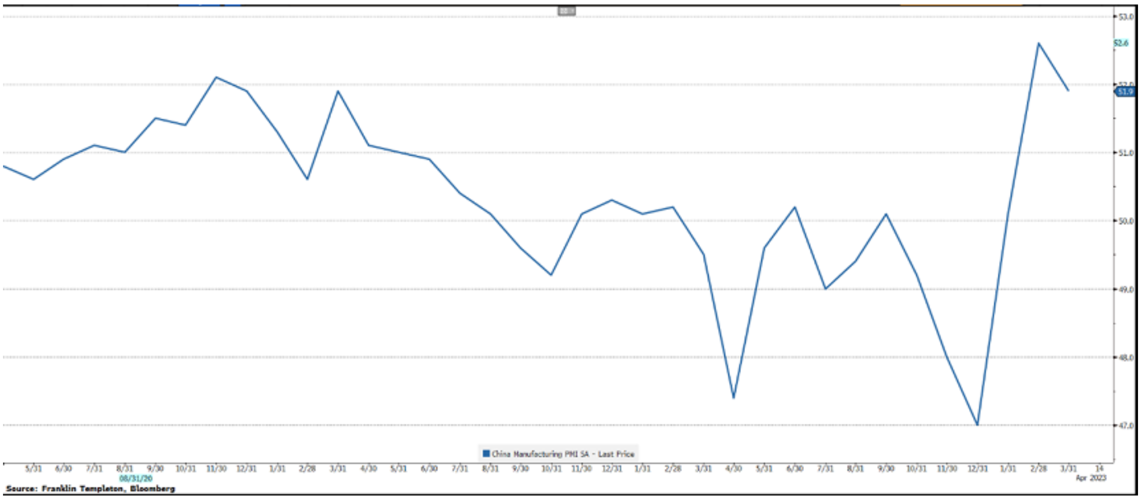


But interest rate differentials don't explain everything. New Zealand is one example where short-end rates are now higher than the US and much more so than Australia but still has a languishing currency. Part of the reason is that the New Zealand economy is headed for a hard recession and markets are looking more toward that. We will come back to this.

China to the rescue?

China's much looked forward to reopening post the COVID lockdown era has been more of a whimper than a bang. There isn't going to be any debt fuelled infrastructure pump priming as in times gone past. The property sector remains a disaster and whilst headlines around major developer defaults have abated, the sector is a shadow of its former self.

But one positive for the Aussie is exports and, perhaps, services in the form of education and tourism where open borders have seen a surge in foreign arrivals. Some ~400,000 net migration last year and an estimated ~350,000 this year are huge numbers. Yes, we closed the borders for two years but we sure are making up for it rapidly. So, we regard China and the export story for Australia as positive but not a return to the boom times of 10 years ago. The China Manufacturing PMI isn't a bad proxy for general growth and it has recently recovered strongly to be back to ~2020 levels. That is probably another positive sign for the battler.

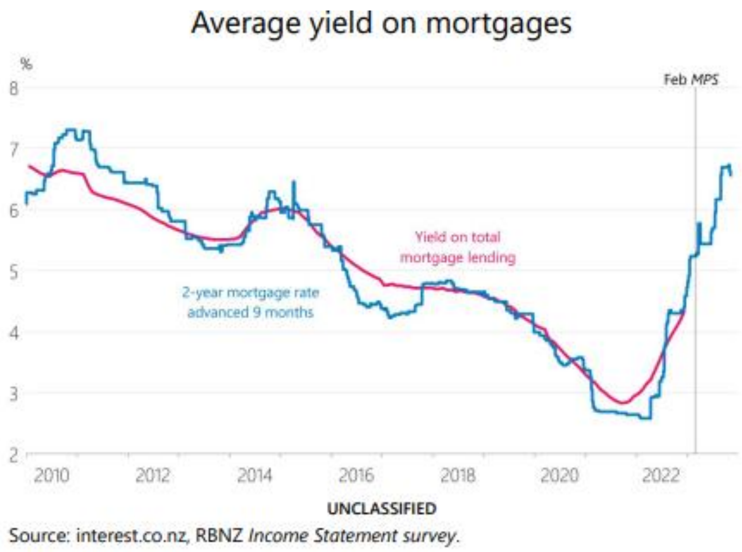


Relative economic strength and outlook

One of the bright lights for the Aussie in the coming quarters is likely to be the relative performance of the domestic economy. The Reserve Bank of Australia has made a strategic decision to seek to curb inflation but not crash the economy. They continue to emphasise the employment gains of the last two years as a trophy to be preserved as inflation is brought back into check. They also have indicated a willingness to tolerate inflation above the target as long as its heading in the right direction in order to avoid a recession. In short, there is a good chance achieve a short landing.

In contrast, the US Fed has probably already overtightened and the number of recession signals continue to grow (deeply inverse yield curve, contractionary readings on the ISM indices, rapidly tightening bank credit conditions, etc, etc). In addition, Australia's economy is likely to materially outperform New Zealand over the next 12 months with the Reserve Bank of New Zealand now openly forecasting a recession.

Part of RBNZ's challenge is the way policy gets clogged in the system. The RBNZ, when it moves interest rates, is essentially targeting the 2-year interest rate swap yield from which the majority of mortgages are priced. Very few (~15%) of Kiwis take out floating rate borrowings with the overwhelming majority holding 2-year fixed loans with the 2-year swap yield acting as the effective base rate. When the RBNZ moves the overnight cash rate the direct impact on households is very limited. By contrast, when the RBA moves the cash rate the benchmark rate from which most mortgages are priced, the 3mth BBSW rate, moves almost basis point for basis point. The transmission is very strong and swift as we are now seeing domestically.



The upshot of this is that New Zealand has one of the longest lags between policy changes and household response in the world whilst also enjoying amongst the most expensive house prices/income and highest levels of household borrowing. The chart below shows the RBNZ's estimate of the current average mortgage rate across the economy versus where it will be once mortgages reset in line with current market pricing. The lag is ~9 months.

To make a long story succinct, the New Zealand economy is heading towards serious indigestion as more than 500bps of rate hikes start to actually show up in household bank statements as we move through 2023. Hence the RBNZ is forecasting a recession to start later in 2023 and last until ~mid 2024 with unemployment forecast to move from 3.4% to 5.5% over this time. That will hurt.

In summary, we don't think the Aussie battler is down and out. There is likely to be some upside versus the US$ as the US economy moves toward recession and the Fed likely is forced to cut. The RBA somewhat ironically could easily go from zero to hero in this story, threading the needle between cooling inflation without crushing the economy in the process. To be sure, downside risks for Australia remain in place but relative to some other economies, the local economy may perform ok. We particularly like the AUD against the NZD, where the macro-economic outlook looks bleak over the next year. Don't count the battler out just yet.

Andrew Canobi is a Director within the Franklin Templeton Fixed Income team and a Portfolio Manager for the Franklin Templeton Australian Absolute Return Bond Fund (ASRN 601 662 631). Franklin Templeton is a sponsor of Firstlinks. This article is for information purposes only and does not constitute investment or financial product advice. It does not consider the individual circumstances, objectives, financial situation, or needs of any individual.

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Private debt returns rise with inflation and less risk than equities

Andrew Lockhart

Rising inflation and official interest rates have helped to bring private debt into the mainstream of investment classes as investors seek to avoid the turbulence of public markets. The risk of a global slowdown is now also testing investment strategies.

Many investors are again looking beyond equities and fixed income to weather the economic uncertainty in a way that reduces capital volatility and maintains a reliable income.

For investors reliant on income from their portfolio, switching into bank deposits may be the first thing they think of. According to the latest SMSF quarterly statistics report (Dec 2022) from the Australian Tax Office, 16% of Australian SMSF capital is invested in cash and term deposits.

While this may be a well-worn path, it isn't necessarily the best strategy for all trustees. Money in the bank does provide security but term deposits deliver lower returns that are locked in at a fixed rate and don't keep pace with inflation.

Reduced capital volatility even during economic downturns

The global economy is in the midst of a broad-based slowdown, as the rise in central bank rates to fight inflation and Russia's war in Ukraine continue to weigh on economic activity.

The International Monetary Fund (IMF) forecasts global economic growth to fall from 3.4% in 2022 to 2.8% in 2023, before settling at 3% in 2024. The slowdown is expected to be especially pronounced in advanced economies, where growth is expected to slip from 2.7% in 2022 to 1.3% this year.

The IMF's latest World Economic Outlook notes the global economy might appear poised for recovery but turbulence is bubbling below the surface. The situation remains fragile, as shown by recent instability in the banking sector, and inflation is stickier than anticipated even a few months ago.

As uncertainty around the economic and policy outlook continues, a key attraction of private debt is that it aims to provide capital stability through the economic cycle.

Australian corporate debt is a lower risk investment than equity because Australian corporate insolvency laws give priority to the interests of creditors in claims over the assets of a business.

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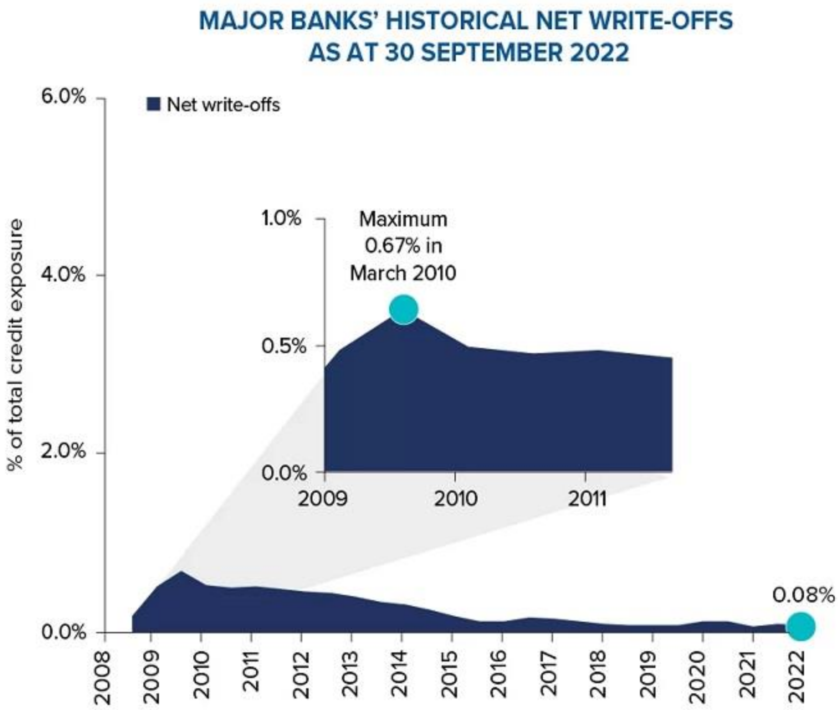
In a private market, lenders negotiate directly with borrowers, enhancing risk management. A skilled lender or private debt manager will negotiate with the borrower appropriate terms and conditions, controls, reporting obligations, covenants, and security to ensure the lender has greater influence on loan terms seeking to mitigate potential risk of loss.

Covenants and ongoing borrower reporting obligations are negotiated and provide protection and early warning of changing risks. Security held over the borrower ensures the rights and protection of capital ranks in priority to shareholder equity and any unsecured creditors.

Most loans in the Australian private debt market are senior secured loans. This means Australian laws protect the lender's capital, giving them the ability to recover interest, principle, and fees from the assets of the borrower.

As a result of the protections in place, the corporate loan loss rates for Australian companies have been very low for many years.



Source: Major Bank APS 330 reporting. Past performance is not a reliable indicator of future performance.

Floating rate structure provides natural inflation hedge

While the economy is slowing, prices have accelerated. Global headline inflation rose to 8.7% in 2022 from 4.7% in 2021.

Central banks in major economies have tightened monetary policy rapidly to tackle this inflation but price pressures are proving quite stubborn. Global inflation is set to fall to 7% in 2023 due to lower commodity prices but is unlikely to return to target before 2025 in most cases, according to the IMF.

Inflation poses a threat to investors because it chips away at the purchasing power of savings and investment returns. It can be particularly damaging to returns on fixed income investments such as bonds.

Private debt offers protection against inflation because corporate loans earn their returns from fees charged to borrowers and interest that is generally charged at a floating rate. The interest on Australian corporate loans is usually structured as an additional margin over the benchmark Bank Bill Swap Rate (BBSW).

The BBSW is essentially the rate at which Australia's major banks are willing to lend short-term money to other banks. It reflects not only the current level of the RBA cash rate but also the expectations the banks have of future cash rate settings.

So, if interest rates rise, income should also rise, which acts to protect capital.

Regular income even in turbulent times

Private debt can provide regular income, even during extraordinary times. Interest and fee payments are received from borrowers at specified intervals under the binding terms of their debt contract. A floating base rate, with additional credit margin, ensures total interest income rises in line with upward movements in market interest rates (which may occur as a means of combating inflationary pressure).

This contrasts with dividends that are paid to equity holders at a company's discretion. Even when equity markets were at their most turbulent in early 2020 during the beginning of the pandemic, and many companies were suspending or reducing dividends, well managed private debt funds continued to deliver consistent monthly income for investors.

Attractive risk-adjusted returns

The private debt asset class can provide attractive risk-adjusted returns throughout the economic cycle. More conservative funds can deliver a return around 6-7%, an attractive alternative to low-yielding corporate bonds, hybrids, government bonds or even cash deposits. A higher yield fund can deliver a cash distribution around 10-12%.

Traditionally the asset class was only available to wholesale investors. However, in recent years, opportunities have become available to SMSFs and other self-directed investors to provide ways to access the opportunity in both listed and unlisted vehicles.

When accessing corporate loan investments through an ASX-listed structure (Listed Investment Trust or LIT), investors benefit from liquidity available via secondary market trading. Investors enjoy the premium income distributions associated with this asset class with the ability to buy or sell units on the ASX daily. When accessing private debt via an unlisted managed fund, investors are not subject to stock market volatility that may impact the LIT pricing and can buy and sell units in some funds monthly (subject to liquidity).

As one of the few asset classes that aims to provide capital stability as well as attractive, reliable returns, private debt can play a key role as investors seek to preserve and grow their portfolio at times of elevated uncertainty.

Andrew Lockhart is Managing Partner and Co-Founder of [Metrics Credit Partners](), an Australian debt-specialist fund manager, and sponsor of Firstlinks. This article is general information and does not consider the circumstances of any investor. Its listed vehicles operate under the tickers MXT and MOT.

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Five reasons fund managers don't talk about skill

Joe Wiggins

In my career, I have spent hundreds of hours with fund managers attempting to assess their investment approach. When I look back at this, aside from questioning my life choices, the one thing that strikes me is how little fund managers discuss skill. Of course, they talk about past performance (if it is good), but the randomness and chance in financial markets render this a terrible proxy. This is a puzzling situation. Investors in active funds are seeking to identify and pay for skill, but the people managing them seem reticent to mention it.

It has always struck me as odd that in active fund selection, the onus falls heavily upon the allocator to strive to prove that the thing they are buying (skill) exists. Surely the seller of the product should be making that case?

Before exploring the reasons why investment skill is such a rarely discussed topic, it is worth defining terms.

Focus on skills rather than outcomes

Skill exists where we can see a repeatable link between process and outcomes (what we intend to do and the result of our action). We are often guilty of focusing on the second part of this equation – if the result is good, then some skill must be involved. This can be an effective shorthand if the activity is simple (shooting free throws in basketball) or heavily structured with limited randomness in the outcomes (playing chess). It is when things get noisy that the trouble starts.

In activities where the results combine luck and skill, focusing on outcomes alone can lead us astray. The greater the involvement of chance, the greater the need to understand the process that led to the outcome.

This is easier said than done. Focusing on process as much, if not more, than outcomes means retaining conviction and confidence even when headline performance is disappointing. Two things are critical here – time and belief. Extending our time horizon should tilt the balance in favour of skill over luck, but to have the required patience we must (continue to) believe that skill exists.

Imagine we have a biased coin that is likely to come up heads on 52% of flips. We should have more confidence in this edge becoming apparent the greater the sample size. To prove this advantage, we would rather see 10,000 flips than 10. We can think of this as akin to lengthening our time horizon.

The problem is that if after 50 flips the coin has landed showing tails more often than heads, we might start to doubt that the coin is weighted at all.

Even if we possess an edge, we must often sit through periods when results make it look like we do not.

In investing, if skill exists, then it is difficult to identify and, if we do discover it, tough to benefit from. That does not mean we should ignore it. Asset managers are not only selling skill, they are paid a great deal of money on the basis that they possess it. They should probably think about it more than they seem to.

Why don't they explain their skill?

Here are five reasons why the subject of skill is usually overlooked.

1. Past performance is everything

The industry is obsessed with past performance, and it is so ingrained in how it functions that trying to have nuanced conversations about skill might seem pointless. Strategies with strong past performance sell; trying to evidence skill does not.

2. Stories sell better

Evidence of skill, which might be about the consistency of decision-making through time, is far less compelling and persuasive than captivating stories about an investment theme or star fund manager.

3. Time horizons are too short

As time horizons in asset management seem to become ever shorter, the relevance of skill diminishes. Nobody operates with a time horizon long enough to even attempt to prove they are skilful.

4. Too much complexity

Looking at past performance is easy, trying to define and evidence skill is complex and messy.

5. Don't want to know

Let's assume some active fund managers – but not many – have skill, 20%, perhaps. If I am one of the 80% majority, it is in my interest to actively avoid the question of skill. My odds of a lucrative career are much better relying on random performance fluctuations and trends.

There are many reasons why the notion of skill is rarely discussed in the asset management industry, and all parties are complicit in its neglect. The existence and persistence of skill, however, is the foundation of active fund management and it needs to be talked about more.

If it is being sold, it helps to know what it is.

Joe Wiggins is Chief Investment Officer at Fundhouse (UK) and publisher of investment insights through a behavioural science lens at www.behaviouralinvestment.com. His book The Intelligent Fund Investor explores the beliefs and behaviours that lead investors astray, and shows how we can make better decisions.

Focus on death taxes, resource taxes and negative gearing

Peter Martin

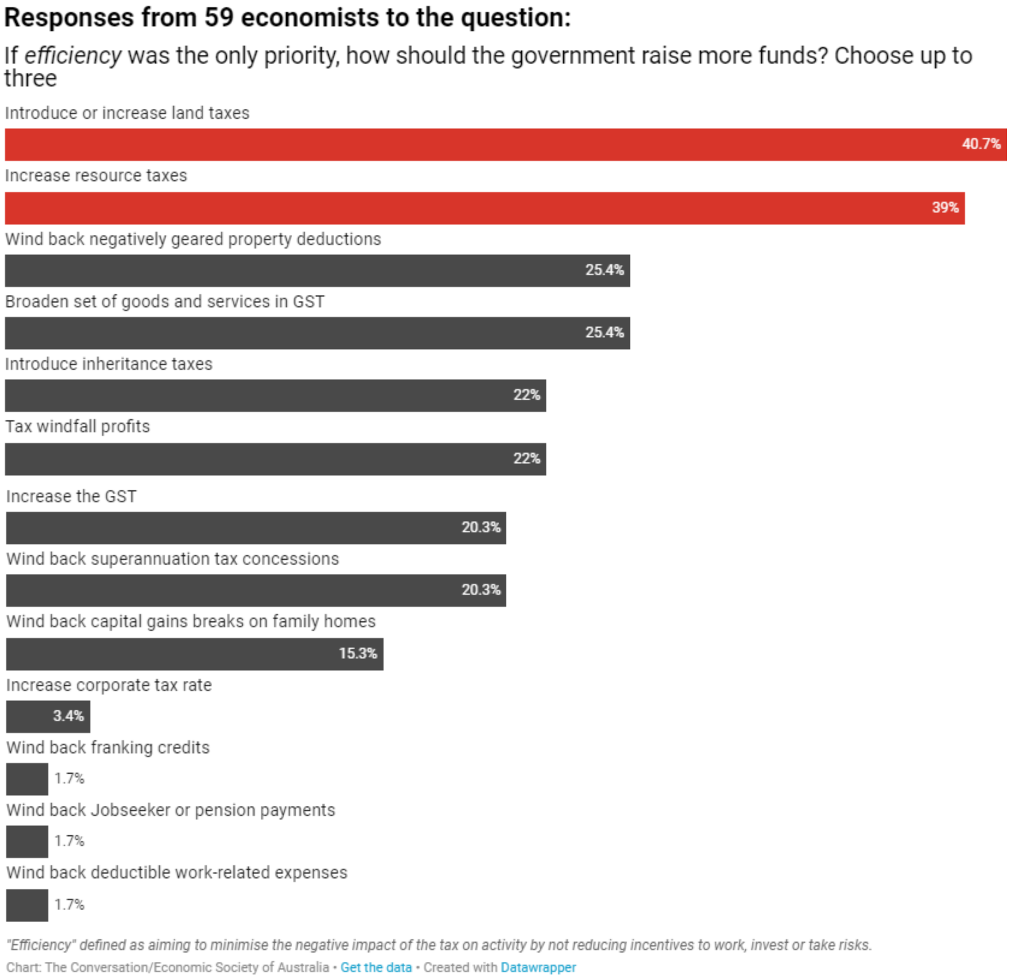
Asked to find an extra $20 billion per year to fund government priorities like building nuclear submarines and responding to climate change, Australia's top economists overwhelmingly back land tax, increased resource taxes, an attack on negative gearing and extending the scope of the goods and services tax.

The 59 leading economists surveyed by The Conversation and the Economic Society of Australia were asked to pick from a list of 13 options (many of them identified in the government's 2022-23 Tax Expenditures and Insights Statement) and reply as if political constraints were not a problem.

The economists chosen are recognised as leaders in their fields, including economic modelling and public policy. Among them are former International Monetary Fund, Treasury and OECD officials, and a former member of the Reserve Bank board.

Policies based on efficiency not politics

Asked to choose tax measures on the basis of efficiency – minimising the economic damage the extra taxes or tightening of tax concessions would do – 40% chose increased or new taxes on land, while 39% choose increased resource taxes.



International consultant Rana Roy said every major economist in every strand of modern economics had found taxes on the use of land and natural resources to be the least damaging way of raising money.

This was confirmed in Hong Kong, which charged for the use of crown land; in Norway, which heavily taxed oil and gas resources; and in countries such as Australia, which charge for the use of broadcast spectrum.

Former OECD official Adrian Blundell-Wignall said Australia's natural resources were the birthright of every Australian. It was time for a resource rent tax along the lines of the one introduced by the Rudd and Gillard governments and abolished by the Abbott government in 2014.

Blundell-Wignall said politicians should ignore the usual hysteria that arose whenever the idea was discussed.

Centre for Independent Studies economist Peter Tulip said he would lump income from inheritances in with income from changes in land value. In both cases the income was unexpected, undeserved, and not compensation for sacrifice. And it disproportionately went to the already fortunate.

A quarter of those surveyed backed winding back the ability to negatively gear (write off against tax) expenses incurred in owning investment properties, a concession costed by Tax Expenditures Statement at [$24.4 billion per year](#).

Blundell-Wignall said negative gearing should have been wound back years ago. Few other countries allowed it, and it contributed to the build up of exposure to property in Australia's banking system and financial risk as interest rates climbed.

University of Sydney economist James Morley described getting rid of negative gearing as an 'easy win'. There were better ways to support home building.

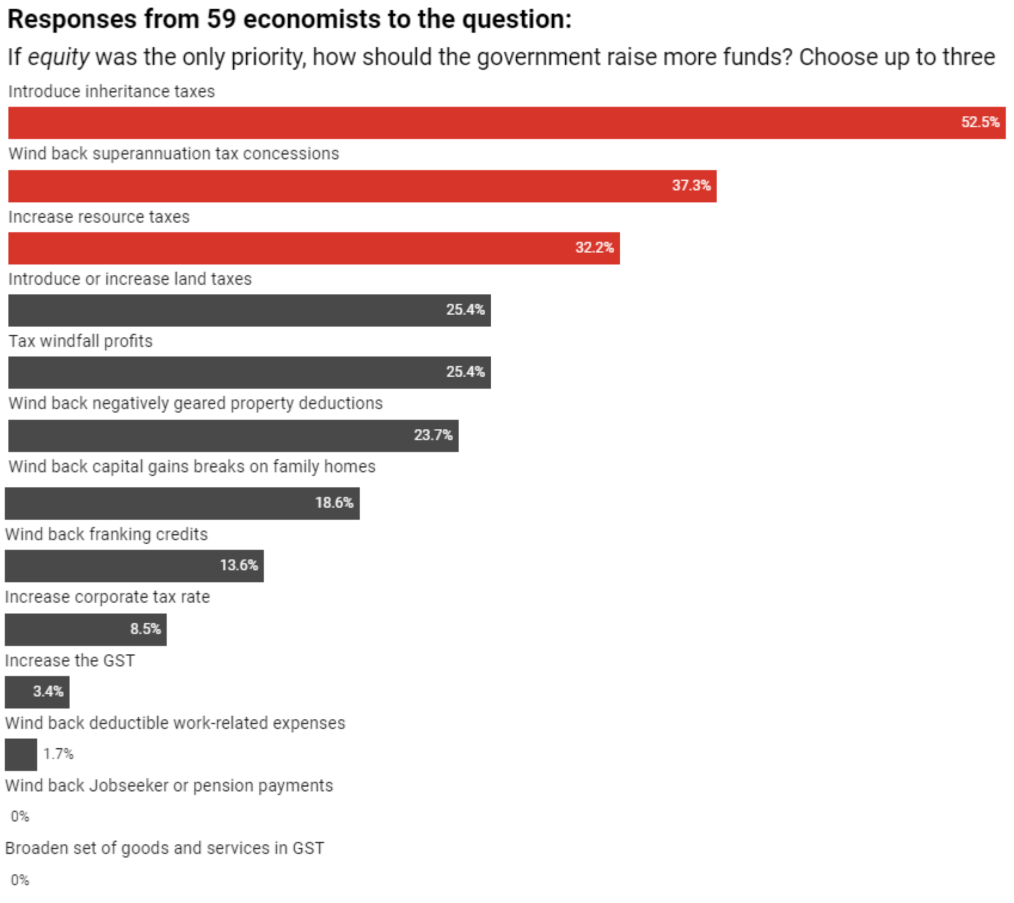
Independent economist Saul Eslake said while he was inclined to extend capital gains tax to the sale of high-end family homes, the problem with the idea was that it might allow owners to write off against tax their mortgage payments (as is the case for investors who negatively gear), encouraging even larger mortgages.

One quarter of those surveyed wanted to broaden the scope of the goods and services tax (at present it excludes spending on education, health, childcare and fresh food) and one fifth wanted to increase the rate, pointing out that a 10%, it was low by international standards.

'Unfair' super concessions and tax-free inheritances

Asked to choose measures on the basis of equity – not treating similar people differently – 52% backed inheritance taxes, 37% backed winding back superannuation tax concessions and 32% backed increased resource taxes.

None would broaden the GST on equity grounds, and only 3.4% would increase its rate on equity grounds.



"Equity" defined as aiming to increase the fairness of the tax system by not treating people with similar characteristics differently; aiming to reduce the burden on less advantaged groups, including low-income people, young people, etc.
Chart: The Conversation/Economic Society of Australia • Get the data • Created with Datawrapper

Grattan Institute chief executive Danielle Wood said two-thirds of the value of super tax breaks went to the top fifth of income earners, who are already saving enough for their retirement and would do so without tax concessions.

Wood said the government should go further than the measures taken against super accounts worth more than $3 million announced in February.

The University of Adelaide's Sue Richardson said super concessions had a negative impact on budget revenue, amounting to tens of billions per year. They were used for tax minimisation by high earners who obtained expensive advice.

Missing fixes: Stage 3 and a carbon tax

Guyonne Kalb of the University of Melbourne said the most important tax measure for fairness was one not listed as an option: scrapping the legislated Stage 3 tax cuts for high earners, due to take effect in 2024.

The tax cuts scheduled for people earning between $120,000 and $200,000 would not have much or any positive impact on Australia's labour supply and would cost the budget more than $100 billion in their first seven years.

Three panellists, Frank Jotzo, Michael Keating and Stefanie Schurer, said they would have selected "carbon pricing to raise revenue" had it been an option.

Jotzo said if Australia fully taxed emissions at $100 per tonne, the revenue would be around $15 billion per year from electricity, $18 billion from industry, and $9 billion from transport – very large sums in relation to other options.

Schurer would also take away all subsidies to fossil fuel industries. In 2021-22 measures that wholly, primarily or partly assisted fossil fuel industries cost federal, state and territory governments $11.6 billion.

If the government needed $20 billion per year, it could raise around half from fossil fuel subsidies alone.

The Conversation

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