Firstlinks
a Morningstar company

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Editorial

Warren Buffett and his business partner **Charlie Munger** are by far the most quoted people in investing and finance. They regularly give insightful interviews and Buffett has written a letter to Berkshire Hathaway shareholders every year since 1977. Trawling through his missives are a great way to learn about investing.

It is less well known that Munger often talks about how to enjoy a happy and fulfilling life, despite his many personal setbacks. At the age of 31, Munger was divorced, his young son had died of leukemia and he had no money. He rebuilt his life, and as well as becoming one of the world's most successful investors, he focusses on the essentials of happiness. He will soon turn 100 and seems as enthusiastic as ever. He says:

"Generally speaking, envy, resentment, revenge, and self-pity are disastrous modes of thought. Self-pity gets pretty close to paranoia…Every time you find your drifting into self-pity, I don't care what the cause, your child could be dying from cancer, self-pity is not going to improve the situation. It's a ridiculous way to behave."

There are many articles on Munger's rules for a happy life, but here are a few from various sources, some with relevance for investing:

1. Manage expectations. *"The first rule of a happy life is low expectations. That's one you can easily arrange. And if you have unrealistic expectations, you're going to be miserable all your life."*
2. Avoid envy. Envy not only makes people miserable, but turns them into lousy investors.
3. Eliminate resentment. Wallowing in resentment leads to more misery, and it's better to think of things to be grateful for.
4. Stay cheerful despite adversity. Life does not follow a predetermined path. *"Life will have terrible blows in it, horrible blows, unfair blows. It doesn't matter. And some people recover and others don't."*
5. Be reliable and surround yourself with reliable people. Reliability is about being predictable and reasonable but don't spend too much time worrying about what other people do. *"If you're unreliable, it doesn't matter what your virtues are. Doing what you've faithfully engaged to do should be an automatic part of your conduct. You want to avoid sloth and unreliability."*
6. Follow your natural drift towards something that excites you. *"If you can't somehow find yourself very interested in something, I don't think you'll succeed very much, even if you're fairly smart."*
7. Read and study constantly. Learn from past mistakes and become as educated as possible.

What is the relevance of happiness to investing? It's a stretch to argue happier people make better investors, but if the daily volatility of the market and share prices make you tense and losses create anxiety, then you're not living your best life. It would be better to diversify your investments across a range of funds (active or passive) according to your risk appetite, and leave the asset management to someone else (even if it's an index) while you get on with something that gives you more pleasure, while trying to ignore the market noise.

If a portfolio is constantly adjusted due to the worries of staring at a screen all day, the results are likely to be inferior versus staying invested for the long term. A recent global funds management survey by **EY** concludes:

"Australian clients appear more actively aware of declines in their portfolios than those in other markets, with the vast majority (97%) saying they change investment behaviour due to declines in portfolio value, significantly above the global average of 73%."

But if you enjoy investing for yourself, then go with it, although this quotation from **Thomas Kennedy**, the Chief Investment Officer at **Trafalgar Partners**, a US hedge fund, when asked if he likes his job, shows an extreme:

"Absolutely. Best job ever but you have to love it, otherwise the volatility will kill you. My team and I work 85 hours a week on average. The stress is offset by the money we make and spend when we are not working. My work week runs from 3pm on Sunday until 1pm on Friday here in San Francisco so I get about 50 hours off a week to relax with my wife, kids, and 5 dogs ... there is such a rush standing in the center of the markets as they swirl about, that is the most exciting thing about my life and feeds my passion. If you aren't geared for it though it will kill you."

Take Munger's advice and look for rules that make you happy rather than worrying day and night on your investments. There's no point spending your time trading and investing if it kills you.

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Regardless of the commitment and disposition of a fund manager, nobody is happy losing money for their clients, and investors in many regional US banks have taken a hit. **Morningstar** analysed local portfolios to show Australians are not immune, and with billions of dollars of losses, Sweden's largest pension fund, **Alectra**, has dismissed its CEO and suffered a massive impact on its reputation and performance.

Don't be mistaken in thinking that all investors have been protected by the **Federal Deposit Insurance Corporation**, because shareholders and bondholders have been wiped out by the demise of **First Republic**, whose staff are now employed by **JPMorgan**. First Republic held US$230 billion in assets, making its fall the second-largest in US history and the biggest since 2008. This is serious. US bank regulators do not want the big banks to grow by acquisition, but circumstances are so desperate that there are few other choices. The deal was announced at 4:30am on a Monday morning which shows bankers and regulators had worked all weekend on the terms. Jamie Dimon of JP Morgan held the aces. In this crisis of confidence, many other major U.S. regional banks are losing deposits and their share prices are falling, wiping out hundreds of billions of value.

Australia is often criticised for the dominance of its large banks but the US is heading the same way, with JP Morgan now holding over 10% of all US deposits. Here is a graphic of market concentration in US financial services.

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It's reached the stage where the cash rate leads the news every few weeks. I spoke on **ABC Radio** in Brisbane last week (linked here, start at 1.53.20) about the Reserve Bank Review. After this week's increase in the cash rate to 3.85%, the 11th in a year, it's not difficult to conclude that **Governor Philip Lowe** will use the remaining four months of his term to quash inflation, even if the consequences for some borrowers are dire. Although he is no doubt an honourable person with the best interests to do his job well, criticisms in the Review would have stung him. One reason why his time will not be extended is that while the Government has accepted all 51 recommendations, he disagrees with many claims in the Review. Putting aside that he has been at the RBA for 43 years and 'CEO' since 2016, how can he implement the changes when he does not agree with them, or at least the supporting evidence that led to them?

The most revealing comment in the Review is that he did not advise the Board before he started making his long-term predictions on cash rates staying at 0.1% for many years, and that meant he was setting policy without Board input. In fact, the Board had previously received a paper warning against long-term forward guidance.

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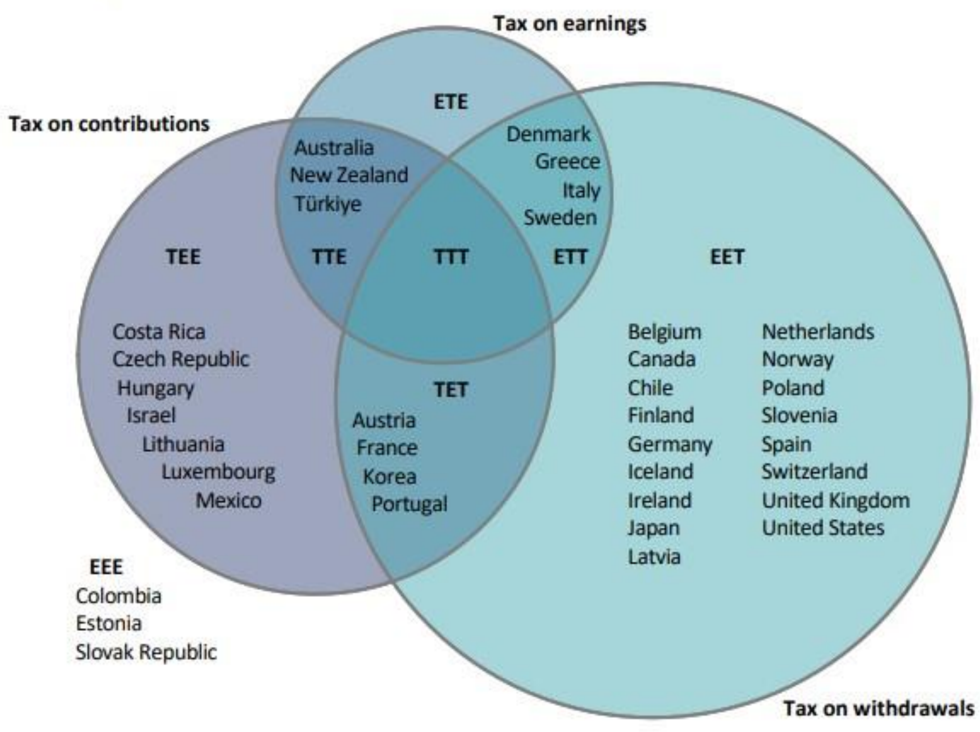
The **Parliamentary Budget Office** (PBO) has taken a close look at how super is taxed, and we summarise the major points. It may give hints to future targets for a government looking to cut concessions. Among many good charts is this one below comparing super taxation in all OECD countries, and Australia's 'TTE' system is unusual.

Superannuation can be taxed at three different points:

1. When contributions are made into a super fund
2. When super fund assets earn investment returns (earnings)
3. When withdrawals are made from a super fund.

If each taxing point is denoted as either 'T' for Taxed or 'E' for Exempt, Australia is said to have a 'TTE' super tax system. No country uses a TTT. Anyone complaining about how lightly our super pensions are taxed should consider how many countries are EET, with no taxing of contributions or earnings.

Figure 14: Tax treatment of retirement-income systems, OECD countries, 2022



Source: PBO presentation of Organisation for Economic Co-operation and Development (OECD) (2022) *Annual survey on financial incentives for retirement savings, OECD country profiles 2022.*

Firstlinks does not normally focus on stock selections but this week's edition has plenty of ideas from leading stock pickers.

We have three fund manager interviews. **Eric Marais** of **Orbis** explains why active managers often need to tolerate underperformance versus an index in the interests of long-term results, while **Simon Mawhinney** of **Allan Gray** describes how he is positioning his portfolio with some examples of stocks he likes, even if it takes the market a while to recognise the value. That's life for a contrarian fund manager.

Then **Emma Fisher** of **Airlie Funds Management** speaks about a recent international research tour which has increased her confidence in three stocks in her portfolio. She is especially keen on companies that can thrive if economic conditions sour.

Graham Hand

Also in this week's edition ...

Brendan Ryan from **Later Life Advice** looks at the recent increase in the aged pension, which he says presents both challenges and opportunities. One issue is a change in aged care costs, and another is that it's not just pensioners impacted by the changes, but non-pensioners too.

Kelli Meagher of **Sage Capital** says that with increasing economic uncertainty and markets near all-time highs, now's the time to focus on quality stocks. Quality being those companies that are insulated from any economic downturn. Kelli thinks **CSL** and **Corporate Travel Management** fit the bill and are poised to outperform.

The telecommunications industry in Australia has seen a seemingly never-ending price war, though **Lucas Goode** of **IML** believes that's now at an end. To play the industry turnaround, Lucas likes dominant market player, **Telstra**. He says improved pricing power for the company combined with continued volume growth, along with aggressive cost cutting targets, should assure several years of strong earnings growth.

Thanks for the hundreds of comments in last week's short survey on why **Australians and French** react differently to pension eligibility ages, as well as your reaction to the level of JobSeeker paid to the unemployed. Leisa has extracted some highlights in her summary article, as well as attaching the majority of the comments.

This week's White Paper from Resolution Capital examines the effect recent bank collapses might have on global commercial real estate markets as, to varying degrees, such financial institutions are an important source of finance.

Curated by James Gruber and Leisa Bell

Six ways the Budget Office is probing super taxes

Graham Hand

Last week, the Parliamentary Budget Office (PBO) released its first Budget Explainer on '*How super is taxed'*. The PBO's role is to improve transparency around fiscal and budget policy issues, and no doubt there are several superannuation specialists among its 44 staff. The Superannuation Guarantee (SG) system is now over 30 years old, super holds $3.4 trillion or 150% of GDP, and it is both a major source of revenue and a major cost due to tax concessions, depending how it's viewed.

Why issue a paper now? Because super is too big to ignore, and the Government is looking for savings, as evidenced by the new $3 million tax. The PBO says:

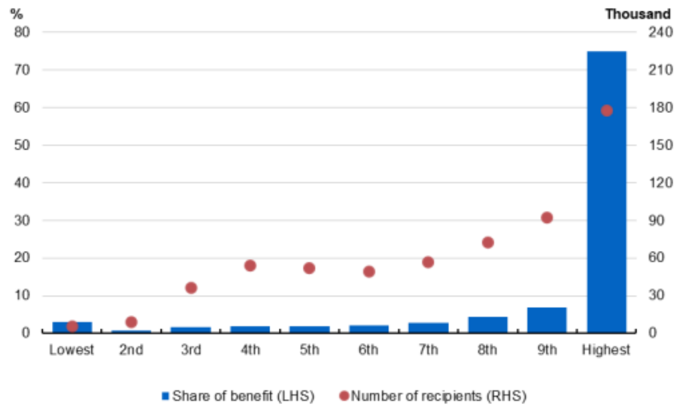
"From a fiscal perspective, super is an important source of Australian Government revenue, accounting for around 5% of total tax revenue in 2021-22. This is the fifth largest source behind personal income tax, company tax, goods and services tax (GST) – which is passed to the states and territories – and customs and excise duties."

In Treasury's Tax Expenditures and Insights Statement (TEIS) 2023, the three top tax expenditures are

- Income tax deductions for personal and business income taxes
- Capital Gains Tax deductions
- Superannuation concessions

Treasury estimates a cost of revenue foregone due to concessional taxing of superannuation at about $25 billion a year, with almost three-quarters of the tax savings going to the top decile of taxable income earners. Of course, this is the case because these are the people who pay the most tax so any concession will be worth more to them, but it is ammunition to cut back on concessions to high income earners.

Chart 2.2 Share of benefit and recipients by taxable income decile, 2019–20



Source: Treasury

Some highlights from '*How super is taxed'*

A check on the wording and emphasis in the PBO Report shows where the Government and its advisers may be looking when considering ways to save on superannuation concessions.

Here are six highlights from the Report.

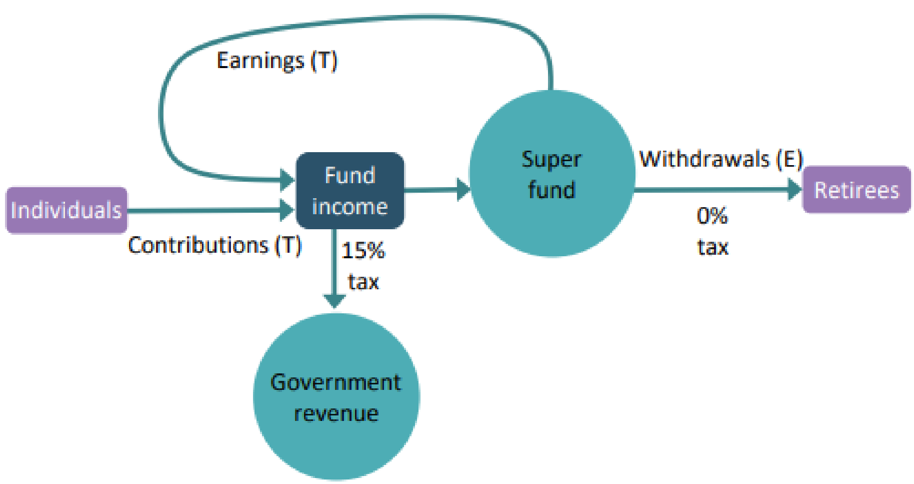
1. Australia's taxing of retirement savings hits earlier

Superannuation can be taxed at three different points:

- When contributions are made into a super fund
- When super fund assets earn investment returns (earnings)
- When withdrawals are made from a super fund.

If each taxing point is denoted as either 'T' for Taxed or 'E' for Exempt, Australia is said to have a 'TTE' super tax system. Contributions and earnings are taxed, while withdrawals are untaxed after a qualifying age. Unlike most OECD countries, Australia taxes earnings on super during working lives rather than when pensions are drawn after retirement.

Figure 3: How super funds are taxed



Note: This is a simplified diagram of how super funds are taxed and excludes more complex elements, for instance that earnings are untaxed for account holders in the retirement phase, and that withdrawals to individuals who are not retired are usually taxed.
Source: PBO.

The crucial point is that contributions made earlier in life are hit by taxes more than those made closer to or after retirement due to the impact of compounding over time. Australia's taxing of contributions and earnings also raises revenue sooner than taxing withdrawals.

2. Some contributions are taxed at marginal personal rates

It is often assumed that all super contributions are taxed at concessional rates, but there are three ways to contribute to super:

- SG contributions, made by employers
- Voluntary concessional contributions, made by employers or individuals
- Non-concessional contributions, made by individuals.

This third method sources super from after-tax income, and tax at full personal rates has already been paid. For many people with large balances, because concessional contributions are capped at $27,500 a year, it is the non-concessionals which create the high balances, and they have already been heavily taxed. This should be recognised more when large balances are targeted and criticised.

And those earning more than $250,000 (inclusive of their contributions) are subject to Division 293 tax, an additional 15% on contributions.

Table 1: Tax treatment of super contributions, 2022-23

Contribution	Who pays	Tax rate	Maximum allowable contribution
Compulsory contributions (super guarantee)	Employers	15%	$27,500[a]
Voluntary concessional contributions	Employers or individuals (before tax)	15%	Same cap as above (both compulsory and voluntary concessional contributions count towards the cap)
Voluntary non-concessional contributions	Individuals (after tax)	Marginal tax rates	$110,000[b]

(a) Eligible account holders can carry forward unused contributions for up to 5 years.
(b) Individuals cannot make non-concessional contributions if their super balance is greater than or equal to the transfer balance cap (the maximum amount an individual can transfer into a retirement-phase account) at the end of the previous financial year. Individuals may bring forward 2 years of contributions.
Source: Australian Taxation Office (ATO) (2022) *Contribution caps*, accessed 21 April 2023; and PBO analysis.

3. Large funds cannot calculate tax for members with over $3 million

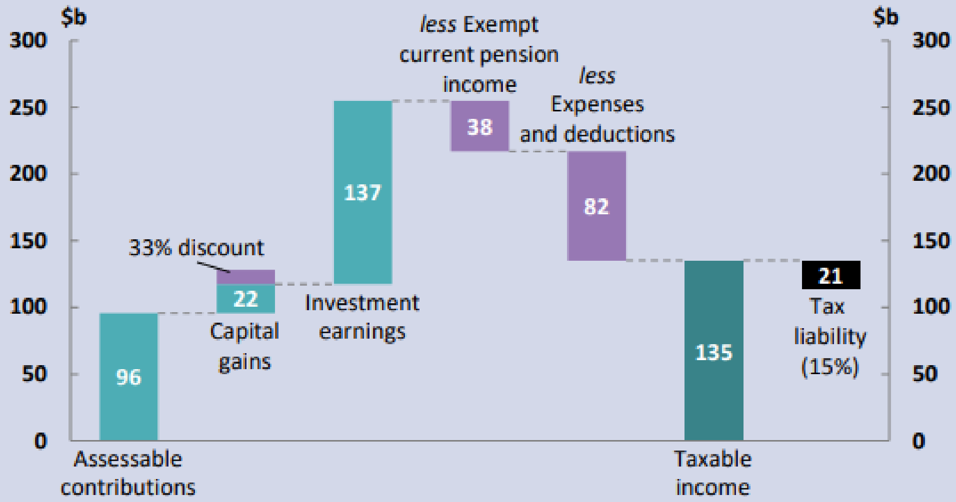
Judging by comments received from many readers, there is little understanding of how a large fund with both pension and accumulation members calculates tax. The PBO explainer demonstrates why the $3 million tax is designed in such an unusual way.

Large super funds know which of their members hold pension funds and which are in accumulation funds, and both are invested in the same pools. But they do not know which members hold more than $3 million in total super balances, and have no way (currently) of imposing the additional 15% on these large balances.

A super fund's tax return includes all fund earnings and then subtracts the earnings applicable to pension accounts, which are tax free. The most volatile earnings sources are generally capital gains and foreign exchange gains and losses, with dividends and franking credits usually less volatile, depending on large share buyback activity. Net capital gains receive a 33% discount for gains on assets held for at least 12 months.

In the example below, the tax liability of super funds was about $21 billion but the super funds themselves paid only around $11 billion as half of the tax liability was paid in advance by companies paying franking credits to the funds. This is a good summary of what is happening with the super in industry and retail funds.

Figure 4: Contributions of key items to the aggregate of all super tax returns, 2019-20



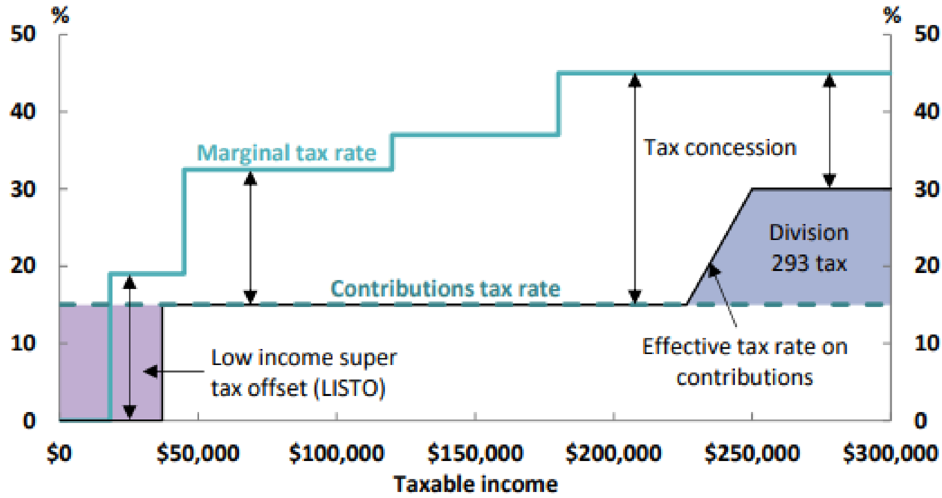
Note: The tax liability is slightly higher than 15% of taxable income. This reflects that aggregate taxable income includes a small amount of funds that made a taxable income loss. Taxable income is around $141 billion when loss-making funds are excluded, and the $21 billion liability is 15% of this.
Source: Australian Taxation Office (ATO) (2022) *Taxation statistics 2019-20*; and PBO analysis.

4. Super tax concessions vary significantly by income

The PBO provides a handy chart to determine which taxable income bracket receives the most concessional treatment versus personal marginal tax rates.

Everyone with taxable income from $37,000 to about $225,000 pays the same tax rate of 15% on concessional contributions, but the sweet spot for most benefits is $180,000 and $225,000, before the Division 293 tax starts kicking in.

Figure 8: Marginal tax rates on personal income and super contributions tax rate, 2022-23



Source: PBO, see page 12 of Report for more details

PBO gives an example of the benefit of super to high income earners:

"For instance, an individual who earns $200,000 in 2022-23 faces a marginal tax rate of 47% (including the Medicare levy). If a dollar is paid to this individual's super fund, the super fund pays 15c of tax on their behalf. If that dollar was instead paid to the individual directly, they would pay 47c of tax. This means that for every dollar contributed to super the individual forgoes 53c in post-tax consumption while their super balance increases by 85c. The ratio of these (85c/53c) shows that, for each dollar of post-tax consumption forgone, this individual's super balance will increase by $1.60."

5. Comparison of super against other investments

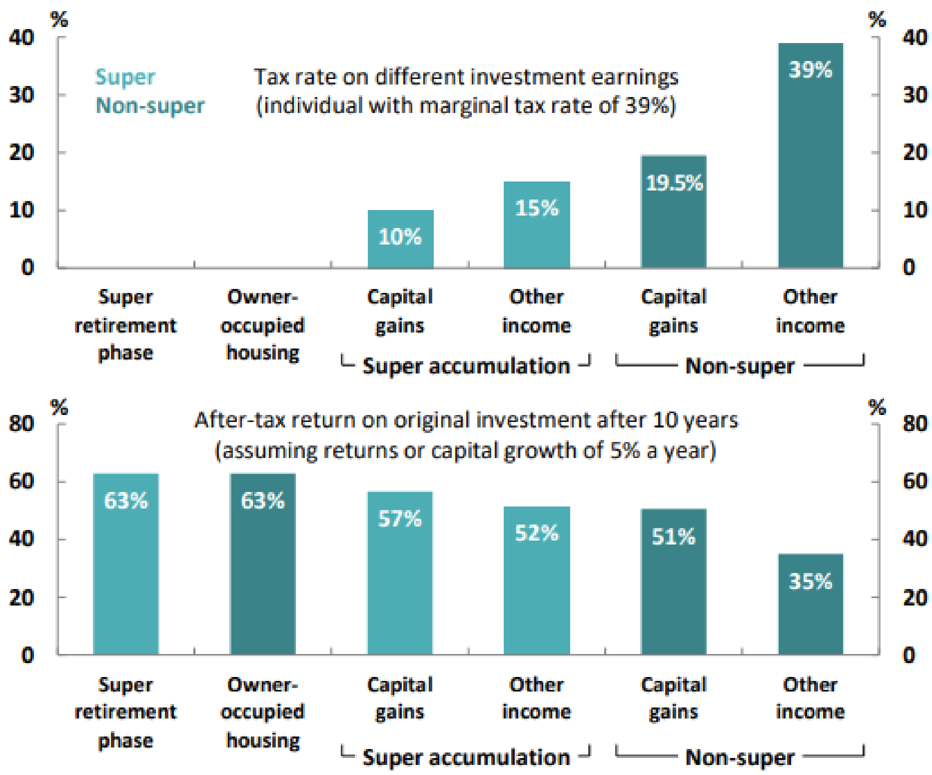
Investors frequently make comparisons between the benefits of using superannuation as a savings vehicle versus other structures, and this will increase with the new tax on balances over $3 million. As the PBO notes, super is not the only place where tax concessions are available.

The table shows how the tax treatment affects returns over 10 years, based on someone in the tax bracket of 39% in 2022-23. It assumes all investments earn either a 5% return or 5% capital growth each year.

The PBO advises that holding money in a super pension versus a family home make the same returns after tax, based on these assumptions:

"Over a 10-year period, super earnings in the accumulation phase make a slightly higher after-tax return than capital

Figure 10: Comparison of super earnings and taxes against other investment options



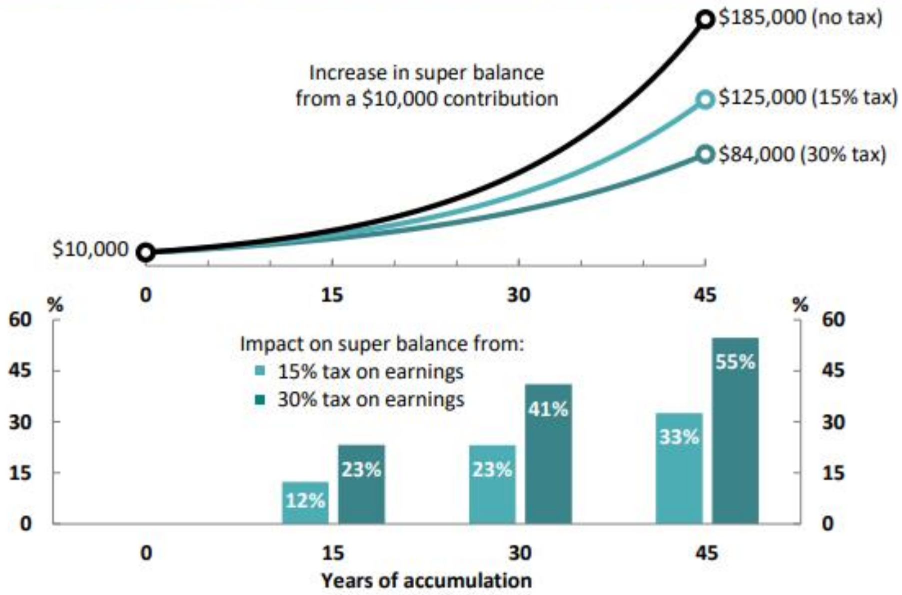
gains outside of super, but a much higher return than investments outside of super that are taxed at a marginal rate of 39%. Owner-occupied housing, for which no tax is payable on the capital gains, makes a higher return, equivalent to the tax-free earnings in the super retirement phase."

6. Dramatic impact of tax rates compounded over 45 years

While compounding earnings creates spectacular results over long periods, it also highlights the profound impact of different tax rates. When investing in super starts, the vast majority of the super balance comes from contributions, but over time, the compounding of earnings dominates. Thus the impact of the T or E taxes changes over time.

The PBO gives an example of an individual who makes a $10,000 post-tax contribution at the age of 22. If this individual retires at age 67 (45 years later), that $10,000 contribution has increased to $125,000 based on an average return of 5.2% plus net capital gains of 1%, taxed at 15%. If earnings were taxed at 30%, the final retirement balance would only be $84,000, or about one-third lower. If earnings were not taxed at all, their $10,000 contribution would increase the final balance by $185,000, nearly 50% higher than with a 15% tax and more than double the balance under a 30% tax.

Figure 11: Comparison of super balances subject to different tax rates on earnings over 45 years



Note: Values are presented in nominal terms only and modelled based on earnings of 5.2% plus net capital gains of 1%. Contribution is assumed to be post tax – no contributions tax is incorporated into the impact.
Source: PBO analysis.

Some final points of PBO emphasis

The PBO recognises that tax concessions are required to encourage people to save for retirement:

"Individuals usually prefer consumption today over consumption in the future. Tax concessions on super contributions provide some compensation to individuals for forgoing today's consumption. But the tax concessions on contributions do not compensate individuals equally."

The PBO also acknowledges significant changes already made to superannuation over the years, and in fact, that prior to 1988, withdrawals were taxed and Australia had an EET super tax system. It then moved to an TTT before today's TTE system came in from 2007-08 when withdrawals became tax free. But the PBO does not favour any one structure, and states:

"In terms of the overall impact of taxes on final retirement balances across a working life, Australia's TTE scheme is broadly equivalent to an EET scheme."

Anyone advocating more taxes on withdrawals should therefore consider whether this means contributions and earnings should be taxed less, as it's the complete picture through a lifetime of super saving that matters.

Graham Hand is Editor-At-Large for Firstlinks. The full paper, [How super is taxed](), is provided by the Parliamentary Budget Office.

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Why an active fund should not perform like its benchmark

Graham Hand with Eric Marais and Simon Mawhinney

Eric Marais, CFA, is an Investment Specialist at Orbis Investments. He joined Orbis in 2013 and is a member of the institutional client servicing team and part of his role includes conducting investment and economic research. He spoke to Firstlinks from his San Francisco office. The Orbis Global Equity Strategy launched in 1990 and has assets of over $28 billion, of which $13 billion is sourced from Australian institutional and retail investors.

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GH: The Orbis Global Equity Fund has experienced a good last 12 months but struggled in the previous few years. What changed?

EM: The biggest thing is that the environment changed. We're not traditional value investors who focus only on low Price to Earnings (P/E) Ratios. We approach valuations by asking what a reasonable businessperson would pay for the entirety of a company if they were buying on the private market. We're very valuation sensitive.

What we saw from say 2006 until 2021 was a once in 50-year cycle where value shares underperformed growth shares by about 50%. We've only seen maybe four or five cycles like this over the last 200 years. It was a tough environment for all value investors but in 2022 it started to change, and we think the current cycle is still at its early stages.

Source: Two Centuries Investments, Value Investing: Even Deeper History.

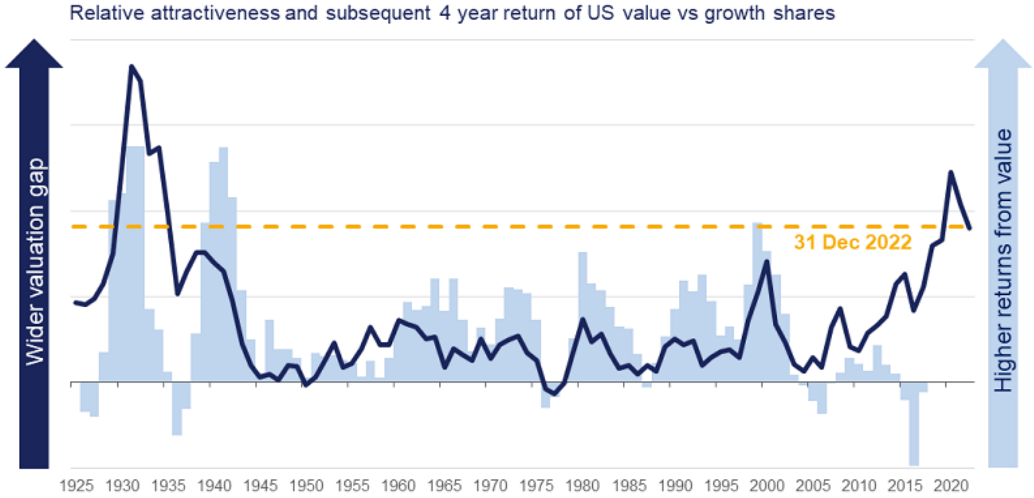
GH: But in 2023, we have seen another surge in NASDAQ, especially the biggest tech stocks, so how has that played out?

EM: Yes, 2023 so far has been the reverse of 2022, but that's only a few months, and we're no less excited about the opportunity set amongst value shares, for three reasons.

First, the long-term trend line would need value shares to almost double relative to growth to return to trend.

Second, the large size of the valuation spreads between low P/E multiple and high P/E multiple stocks. There always is a spread, and usually for good reason, because the better companies tend to grow a little bit faster, so we should pay higher multiples for those businesses. But that gap varies over time and where we today, that gap closed a bit in 2022, now it's opened up a bit, but it's still at an historical extreme.

Valuation spreads are still wider than any time in the last 90 years

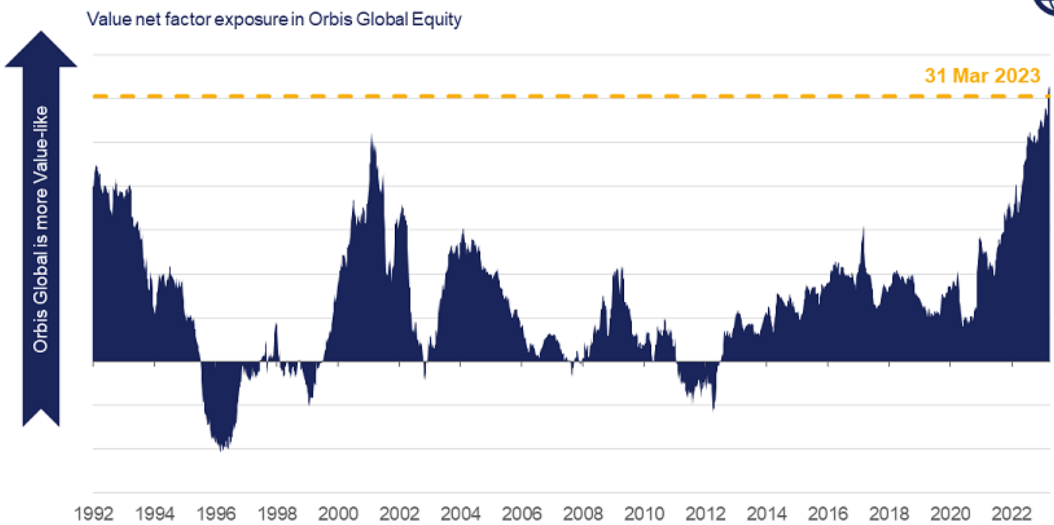


31 Dec 2022 | Source: Kenneth French, Center for Research in Security Prices, Refinitiv, Orbis. Value (growth) shares are those in the cheapest (richest) half of the market on a price-to-book basis. Relative attractiveness is based on the book-to-price ratio of the relevant market segments. 2022 relative attractiveness calculated by Orbis based on NYSE listed stocks in the Russell 3000 Index. Statistics are compiled from an internal research database and are subject to subsequent revision due to changes in methodology or data cleaning. Relative return series calculated from the annual return of US high book-to-price portfolio less the return of US low-book-to-price portfolio, large- and small-cap shares.

And **third** is that investors are worried about recessions, and there is an incorrect perception that value stocks always do poorly in recessions, so investors have flocked to the growth stocks. But a look at the data shows that's actually not true.

So since the inception of the Global Equity strategy, we currently have the highest exposure to the value factor that we've had for the full history of the fund.

Orbis Global Equity's Value factor exposure is near its all-time high



31 Mar 2023 | Source: Worldscope, MSCI, FTSE. Data is for the Orbis Global Equity Fund. Statistics are compiled from an internal research database and are subject to subsequent revision due to changes in methodology or data cleaning. The Orbis Global Equity Fund's inception date is 1 January 1990. Factor style analysis uses statistical regression to forecast the net exposure of the portfolio to movements in the proxy style index. A positive (negative) exposure indicates the portfolio is likely to benefit from a positive (negative) move in the proxy style index.

GH: Delving into the portfolio, are you backing any themes or trends which you think the market has underappreciated?

EM: We are overweight what you would think of as the classic value-oriented sectors, including financials, energy, materials and industrials. It's the other side of being underweight the large technology stocks. Similarly, this puts us underweight the US, with about 40% of the fund in the US versus about 60% for our global benchmark, the MSCI World Index, but that's due to our valuation focus. If there is a better and cheaper equivalent industrial business in Germany versus the US, we will buy the German. On a bottom-up analysis, we're finding more compelling ideas coming from other parts of the world.

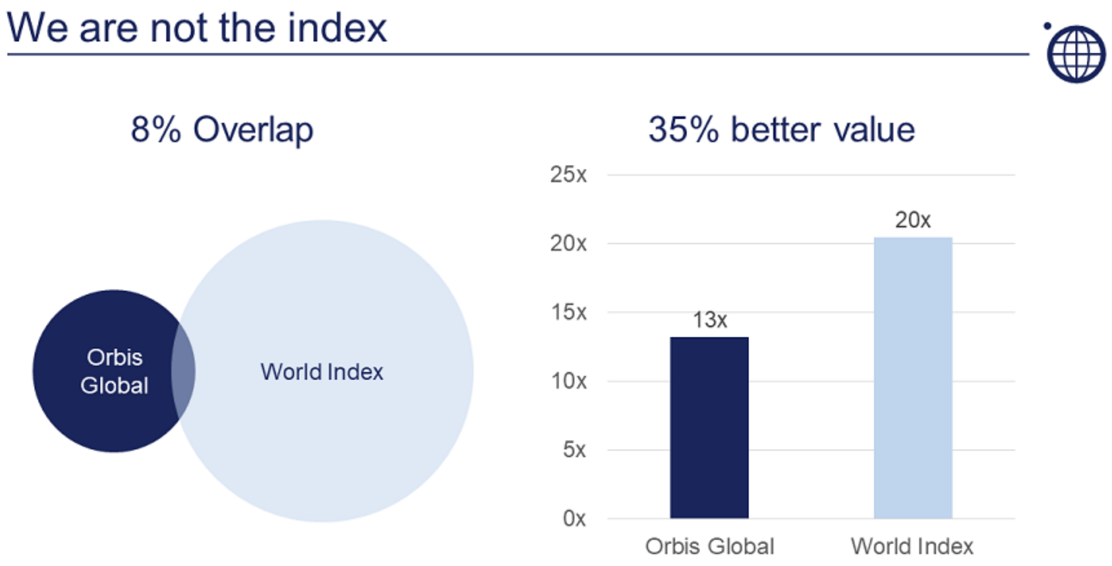
GH: A subject we don’t discuss much is the turnover of stocks in funds, and your fund’s turnover is about 50% per annum. That seems high for a contrarian manager who buys a stock and then waits for the market to catch up.

EM: Yes, the way you describe how we invest is exactly right. I would say it's been a busy year, but it’s more driven by trading around positions due to our valuation sensitivity, rather than major portfolio changes. If we buy a stock that appreciates, we might change the position size actively, and the flip side of that is true as well. Our company name turnover of stocks in and out of the fund completely is lower because we look three to five years ahead.

GH: And another metric, can you explain to our readers what ‘active share’ means, where I saw your last number was 92.

EM: ‘Active share’ compares a fund’s composition versus its benchmark, and it looks at the individual weights of the stocks in the fund compared to the benchmark. For example, if a fund owns every share in its benchmark to the same weight, that is a 0% active share. If the fund owns not a single share in its benchmark, that is called 100% active. Anything above 80% or so would typically be considered highly active. And yes, the fund is currently 92% but that's about normal for us. We build the portfolio based on individual stocks, not looking at a benchmark or an index and then making deviations from there.

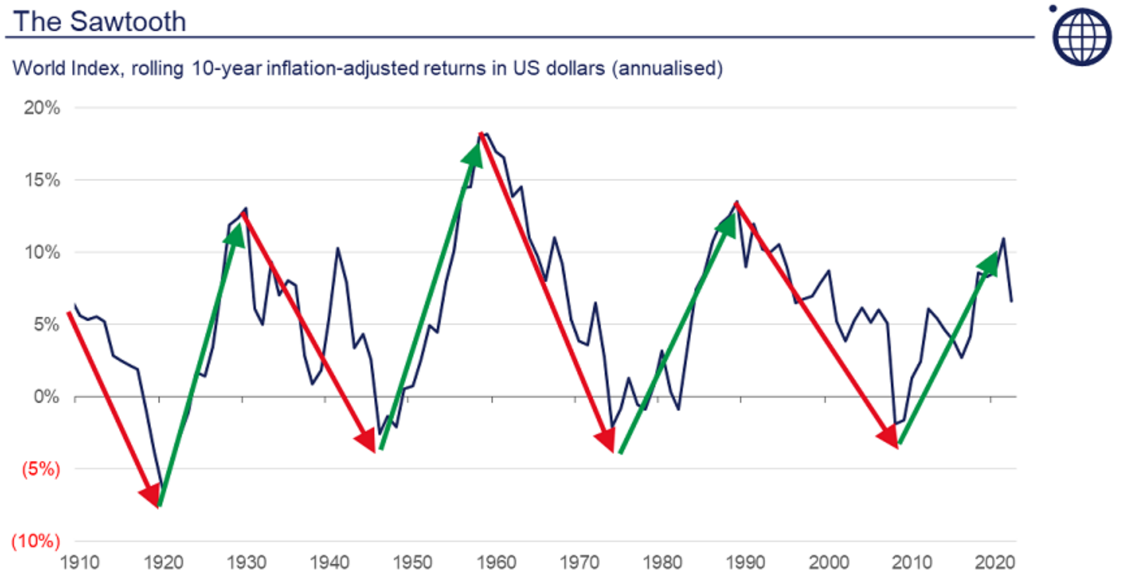
Another difference relative to the benchmark is the valuation spreads, as we are finding some low P/E multiple stocks quite attractive. The overall P/E of our fund is about 13 times earnings compared to about 20 times for the index. That’s striking, and in my decade at Orbis, I don't remember a bigger difference.



31 Mar 2023 | Source: Orbis, MSCI, IBES. World Index is the MSCI All Country World Index. Overlap is based on 92% active share, is a measure of the extent to which the holdings of the Orbis Global Equity Fund differ from the World Index holdings. It is calculated by summing the absolute value of the differences of the weight of each individual security in the Orbis Global Equity Fund, versus the weight of each holding in the World Index and dividing by two. P/E calculated using current fiscal year earnings estimates, calculated first at the stock level and then aggregated using a weighted median for both the Fund and World Index.

GH: How are you feeling about the outlook for equity markets?

EM: By the end of 2021, we came off a strong decade for world markets, returning about 10% a year in real terms. It was an amazing result after the previous 20 years of decline in real (inflation adjusted) terms. If you look at rolling 10-year real returns from the stock market, there’s a saw tooth pattern over decade-long cycles, and we've just seen one of the peaks. So we think it's a good time to look different from the market. In contrast, when the market is strong, you don't need to be different. You're in the market, and you'll have a smile on your face.



31 Dec 2022 | Source: Dimson, Marsh and Staunton, Refinitiv, MSCI, Orbis. Data for the World Index is from the Dimson, Marsh and Staunton (DMS) database prior to 2010, and for the MSCI World Index after that date. Returns prior to 2010 are calculated for 16 size-weighted developed markets. The weights are based on GDP weights prior to 1968, and MSCI country capitalisations after that date. All returns are calculated in US dollars and adjusted for US inflation.

GH: That's what investors in active funds are paying for, not replicating an index and charging higher fees. But it also delivers different outcomes versus the index which a manager like Orbis must explain to its clients.

EM: Yes, and I've personally been a part of many conversations like that over the last three to five years that have been quite difficult. The market for our style looks attractive to us now, but it also did 12 months ago, 24 months ago and 36 months ago. And that's the nature of this approach as sometimes we underperform for an extended period of time. Value versus growth cycles are terrible timing indicators and they don't help in the short run, but they do inform the quality of the opportunity set looking forward.

GH: I notice Alphabet is in your top 10 holdings. How does that fit with your contrarian approach, and why that one and not the other big tech stocks?

EM: It's funny, we have owned each of the FANGS, or whatever they are called these days, at some stage but Alphabet has more recently looked a bit more out of favour than the others, and it looks a little bit better value, except maybe for Facebook/Meta. I think investors are more worried about the impact of the economic cycle on Alphabet due to its advertising exposure, but we like its free cash flow yield and its ability to continue growing. One thing that these big tech companies are proving out now is that they have a lot of room to cut costs.

GH: Your biggest holding is a company called FLEETCOR. Can you give a brief summary of the investment case?

EM: Yes. For a start, the stock is down about 25% from its peak and trades at only 11 or 12 times earnings, and pre COVID, it was double that. Briefly, they operate in a niche of two-sided payment networks. One example is Fuelman. Any business with lots of vehicles on the road, such as plumbers, electricians or landscapers, they issue credit cards to every employee to pay for fuel. And then Fuelman manages all the payments and reimbursements and separates out the personal from business costs which can otherwise become complicated. It keeps track of everything, and they offer discounts on fuel by working with the large groups of petrol stations.

The market is worried about the transition to electric vehicles, but what it misunderstands is that FLEETCOR already offers a sophisticated solution for electric vehicles for when employees charge their vehicles at home, which is very common. So the threat of electric vehicles in the fleet is really an opportunity. And the same guy has run the business for 20 years and still owns about 6% of the shares. He has built the company through a series of acquisitions, and they've grown earnings at 20% a year since going public in 2010.

GH: A typical Orbis stock where the market turns against it for a reason.

EM: Yes, and we think over time, that bear case will become a bull case for the company. We always look for the reason a stock is cheap and whether those concerns are genuine.

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Simon Mawhinney is Managing Director and Chief Investment Officer from Allan Gray Australia, a contrarian fund manager with equity, balanced and stable funds. The Allan Gray Australia Equity Fund held $9.5 billion as at 31 March 2023. This is an edited transcript where Simon responded to viewer questions at a webinar on 6 April 2023, hosted by Julian Morrison, Investment Specialist.

JM: Let's start with a quick market summary. Global equities were up about 4% over the 12 months by end March 2023, but most of that came in Aussie dollar terms from a depreciating Aussie dollar. So overseas shares performed generally worse than most people realise. The Australian share market was down about 0.5% over 12 months. The market remains cautious. There are fears of recession, yet the market is not far from its all-time highs. It's a contradiction.

Our focus always remains on valuation versus price, and we particularly look for asymmetric payoff profiles. Our contrarian approach seeks to take advantage of overreaction, looking at those types of companies where the upside may not be in the price. The Allan Gray Australia Equity Fund is essentially a diversified portfolio of contrarian ideas with about 40 stocks with high conviction in our preferred positions.

Let's start with a question on investing in cyclically-sensitive stocks. If we go into recession, how would you expect these stocks to perform? Is there a margin of safety that you could talk about on those maybe pick one or two? And how do you view Downer in that context?

SM: If we do have a recession, it will be one of the best-telegraphed recessions in history. Everyone is expecting it, so exposure to a cyclical company when stock markets are forward-looking must mean there's some amount priced in already for recessionary conditions. We feel some prices on offer reflect economic conditions which border on woeful.

And that's where the asymmetric profile comes from. Yes, things can always get worse but many companies are already priced for bad. And so I think there's a reasonable amount of upside despite having cyclically-exposed companies in our portfolio. Downer is an example. It has $12 billion of annual revenue and it could either do a really bad job and generate 2% to 3% margins on that $12 billion of revenue and so its earnings of $240 million to $360 million. And that would be awful. But at the good end of the spectrum, it could perform in line with its peers and earn 5% margins and get $600 million earnings. There have been changes at Downer which I think are very positive. I have oversimplified it but I don't think we will lose our shirt if Downer does a poor job but we stand to benefit greatly for our investors if Downer does a good job.

JM: Why have you reduced energy exposure so much? Is it to take profits and reinvest into other ideas representing value, or is it due to stock valuations?

SM: It's a combination of both of those things. The upside to a company that has risen in price is by definition lower than it was when the share price was much lower, and so the discount to our intrinsic value has narrowed. And if we find opportunities to reallocate capital into other areas with at least as much, or better, upside than energy companies, then we introduce portfolio diversity into returns. And so we now have a portfolio which is more spread across a lot of different thematic, although we are not thematic investors. It isn't as heavily exposed to energy as it was, especially after the strong performance in some of energy companies over the last year.

JM: While Allan Gray does not predict macro events or where interest rates are heading, how do you assess value in Real Estate Investment Trusts (REITs)?

SM: The REIT sector uses independent valuations which can be used as a yardstick for value and discounts to intrinsic value. But those valuations have not changed much as cap rates have not gone up in line with interest rates. Cap rates seem low and so valuations seem overstated. We think about more reasonable long-term risk-free interest rates and premium to those risk-free rates to assess whether or not a REIT is worth investing in.

But we are not property specialists, and if we can find a better yield in another sector, that's where we will go. We have not seen capital moving towards the REITs and there are better returns elsewhere.

JM: Yes, and there may be specific examples in property such as Lendlease where a negative sentiment may drive the price low enough to make it worth buying.

SM: Yes. Lendlease is a complicated beast that we've tried to demystify. These property companies have a large element of risk and we aim to buy them at a discount. Many of them have a reasonable amount of debt and higher earnings in the past when operating at full occupancy rents. It's unclear what the future looks like.

JM: There is some corporate activity in companies you hold such as Newcrest and Origin. Would you rather continue to own without a takeover or do you think the offers are compelling enough?

SM: I think Origin's offer is compelling although not certain because it's subject to ACCC approval, for example. But we intend to tender our shares in favour of that takeover offer and would happily redeploy the asset elsewhere. And then in Newcrest's case, there's no firm deal by Newmont and it's a scrip approach. So we wouldn't necessarily need to redeploy the funds. Currently Newcrest is roughly 10% of the portfolio.

JM: Tech and healthcare sectors have moved around a lot over the last year and you haven't owned much of either. Do you find anything interesting in these sectors at the moment? Do you see them as more or less risky than the overall market?

SM: There are some fabulous companies that have done some great things, but the reality is they are just too expensive. We are not about investing in sexy companies that have done good things if they're very expensive, so we still have no money allocated to the tech sector. You know that is probably where most of the entrepreneurial spirit in the world is now, but it's also where the companies are most richly priced. It won't be forever and it would be good to own some of these great companies at a much lower price.

Allan Gray and Orbis Investments will host their 2023 Investment Forum in person in many parts of Australia over late May and into June. More information about the event can be found here.

Graham Hand is Editor-At-Large for Firstlinks. Eric Marais is an Investment Specialist at 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.

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Companies with balance sheet strength and opportunities

Emma Fisher

Emma Fisher is Portfolio Manager on the Airlie Australian Share Fund. She discusses the Airlie portfolio and highlights companies she currently favours with Jennifer Herbert, Head of Listed Funds at Magellan.

JH: CSL is one of the largest positions in the portfolio, and you were recently in Europe at a CSL site visit. What key takeaways from that visit?

EF: Over the last five years, CSL has spent nearly US$6 billion on capital expenditures (capex). It was great to see in person what they've built. CSL has been a phenomenal success story but over the last few years, the share price has been range bound $250 and $300 due to a decline in returns. In 2018, they made a 31% return on invested capital, and last year, it had fallen to about 20%.

Three things have weighed on returns. **First**, plasma collection costs rose in the US where they pay donors donate plasma at their facilities. Pre-pandemic, the cost was US$60 per visit, but the cost went to over $100 during the pandemic as people stayed home. A **second** factor is all the capex, including a massive increase in their fractionation capacity. And **third** was the 2022 acquisition of Swiss pharmaceuticals maker, Vifor.

One of the reasons we've been adding to our position is that these three factors that weighed on returns are now going the other way. Donor fees are falling fast, and the capex has delivered highly automated, state-of-the-art manufacturing capacity. We think the returns will improve as those assets come online. And finally, having visited the Vifor assets in Switzerland as part of this tour, I think got my head around what they see in this business. CSL has been successful in broadening the applications for its products. Vifor's primary product is intravenous iron, which probably should be used a lot more. To give an example, if you need surgery but you're anemic, you should have an iron infusion with a Vifor product. You will typically have better outcomes in the surgery and be much less likely to need a blood transfusion. So, it's a similar CSL DNA of building out indications for the iron products that they've bought. So, you can see long term how that acquisition could be a success.

JH: What other takeaways are there for the portfolio from your European trip?

EF: The vibe in Europe in general, and in particular in London, would be summarised as surprisingly resilient. In Australia, the headlines suggest a dire economic situation over the last 12 months, but I think they took a lot of pain last year and there's almost a sense of relief that they've come through the winter a little bit better. The Government stepped in and capped energy costs for households.

Of the relevant meetings for stocks we own in the portfolio, one of the standouts was QBE. It's been a sort of perennial underperformer but outside of North America, the international business has always been good. The key for that business is the underwriting of risk. It was pleasing to hear in our meetings that QBE has a fantastic reputation in the London community and is able to attract really highly talented underwriters. The insurance cycle has seen significant rate rises for a few years and we expect that to continue. And obviously, insurers also have the kicker of higher interest rates working through their investment book.

The other one in the portfolio is Tabcorp, for us a classic turnaround story. In their wagering business, we met a competitor of Tabcorp that was forthright that they'd seen an improvement in the last 18 months in Tabcorp's competitive offering. That was really pivotal for us as they've also launched a new wagering app.

JH: What's your view on the Australian banks? Do you think there's a risk of contagion from the problems at smaller US banks?

EF: It's never say never with the banks because they are highly geared vehicles, but on the face of it, I don't see much risk of contagion for the Aussie banks. That said, when I look at the cycle, we must be aware that we are late in a tightening cycle globally, and this is the point of the cycle where things start to go bump in the night. Our reading of the SVB and Credit Suisse situations is that they look idiosyncratic. However, the Aussie Banks show the importance of having a low-cost, sticky deposit franchise, and the Australian banks have had access to incredibly cheap funding over the last few years. Now that's come to an end, the banks need to replace those funding sources with more expensive sources, and the recent banking crisis in the US and Europe has increased wholesale funding rates. The real standout performer is the Commonwealth Bank, with far and away the largest deposit franchise in Australia.

With respect to the portfolio, we remain significantly underweight the big four banks and I'm very comfortable with that position. We appear to be staring down at an economic downturn and while a bad debt cycle is not our base case for the banks, they are incredibly levered vehicles. It's not worth being a hero with some of those downside risks.

JH: And commodity prices have been resilient considering the economic doom and gloom, and that's probably partially due to the China reopening. Where do you see the opportunities in this space?

EF: Yes. At Airlie, we are bottom-up stock pickers, so, when we look at commodities, we're focusing on understanding the supply dynamics as well as where these assets sit on the cost curve and the industry structure. Through that lens, a lot of the noise is always generated by demand side factors, and China reopening is an example of that. But over the long term, I think that the returns that a company generates and the returns as an investor in resources companies are much more dictated by the supply side dynamics. So, that's where we spend a lot of our time focusing, especially understanding where an asset sits on the cost curve.

Through that lens, we have owned Mineral Resources for a long time. It's been our best performer. The returns from here will be driven by the lithium price and the penetration story of electric vehicles. The supply-demand perspective is giving conflicting signals. The demand side signals look quite weak. Price are falling, Chinese EV sales are disappointing and the subsidies might be hit by a recession. But the supply side signals look quite positive long-term for pricing as it's costing other producers more to bring their assets online. And Mineral Resources will be a great beneficiary of that. I've got no idea where pricing is going in the short term, but over the long term, I see a positive skew from that supply-demand setup.

JH: In light of everything we've talked about, how is the portfolio positioned for the current market?

EF: There's always doom and gloom and a lot of noise and a lot of headlines. I think if we are going into a recession, it's got to be the most well-heralded, most well-anticipated recession of all time. So, for us, we like this kind of environment because we think in that volatility you can find opportunity. One thing we're always focused on at Airlie, but particularly at the moment, is the strength of balance sheets. The first step in our process is focusing on financial strength. Right now in particular, we want to own businesses that are not only protected from a balance sheet perspective in a downturn, but also have that opportunity on their side, particularly if they're going into a downturn with net cash. So, that's the lens that we're applying.

But we are still finding opportunities out there and businesses like **CSL, Mineral Resources and QBE** show from a bottom-up perspective the potential we are excited about.

Emma Fisher is Portfolio Manager on the Airlie Australian Share Fund. Airlie is part of the Magellan Asset Management Group, a sponsor of Firstlinks. This article is for general information purposes only, not investment advice.

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The companies well placed to weather an economic storm

Kelli Meagher

The Australian equity market was almost at an all-time high when the RBA began lifting interest rates a year ago to rein in inflation. While initially falling over 10%, ten hikes and 3.5% later the equity market is once again back near its highs. Such a steep rise in interest rates drives the cost of capital higher for companies and should result in lower valuations for assets such as equities while earnings should be impacted by the resulting slower growth.

However, the market appears to be shrugging this off, focusing on the continued strength of the economy, data suggesting inflation has peaked and the fact the RBA paused raising rates this month. Inflation may have peaked, but the core is elevated well above the RBA target range, meaning that rates are more likely to go up than down, potentially sending the economy into recession.

Inflation remains a major problem globally and as we know, the policy response of higher interest rates operates with long and variable lags. There is likely more economic pain to come, and data releases will continue to be heavily scrutinised and have a larger than usual impact on market direction.

In this environment of heightened uncertainty combined with the market trading near its highs, we believe it's particularly important to be clear where you can add value when making investment decisions. For stock selection this means focusing on company fundamentals and seeking those that are insulated as much as possible from unpredictable macroeconomic risks and able to weather an economic storm if required.

Companies with the trifecta

Three key factors to focus on in identifying these types of companies are industry structure, competitive advantages, and financial resilience.

Regarding industry structure, it could be a company that operates in an industry with defensive earnings streams such as healthcare, supermarkets or telecommunications. Or it might be in an industry which has cyclical characteristics but is highly fragmented allowing the company to achieve good growth despite a downturn, by taking market share.

The second factor to assess is the company's competitive advantage. Companies with a strong competitive advantage tend to have pricing power, allowing them to pass on cost increases to protect their profit margin in a high inflation environment.

The third characteristic to seek out is financial resilience. This means little or no debt, good cashflow generation and a return on shareholders capital higher than the cost of capital to create value for shareholders longer term.

CSL remains compelling

An example of a company that ticks these boxes would be CSL Limited (ASX:CSL). Its primary business is the production of life saving plasma derived products to treat rare diseases. The industry does not experience reductions in demand linked to the economy and indications for the use of its products are growing.

Key competitive advantages are its scale and production processes which make it the most efficient and lowest cost producer and the capital investment and FDA approvals required to operate in the industry provide high barriers to entry. Given the relatively niche nature of its products and the diseases they treat, CSL benefits from being a price maker rather than price taker.

On the financial front, debt levels are higher than usual due to the recent acquisition of Vifor but are still moderate and can be paid down quickly from free cashflow. In addition, CSL has consistently earned a return on invested capital well above its cost of capital.

Source: Morningstar

Corporate Travel Management ticks box too

Another perhaps less obvious company that fits the resilient category is Corporate Travel Management Ltd (ASX:CTD). It operates in the business travel industry, which is exposed to economic cycles, however given the fragmented nature of the industry, it has the potential to grow through the cycle by taking share from smaller players and winning new clients, including those whose company travel was previously unmanaged.

It also ticks the financial resilience box. It did not need to raise capital for survival during the Covid-19 period, it generates good cashflow, has no debt and outside of the pandemic, earns a healthy return on capital.

Source: Morningstar

These are just two examples of companies that are likely to be resilient in a downturn. Overall, while macroeconomic noise such as changes in interest rates, geopolitical tensions, or economic slowdowns can create short-term market volatility, it can also provide opportunities for patient investors who are willing to do their research and invest for the long term.

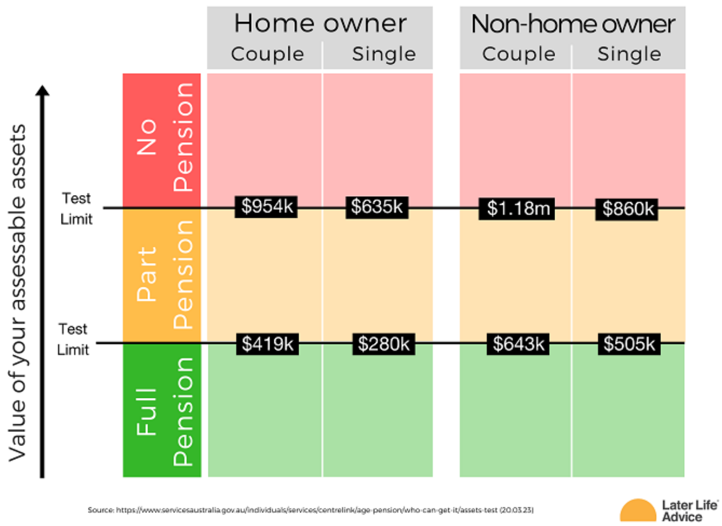
Kelli Meagher, CFA is a Portfolio Manager at Sage Capital. This article contains general information only and does not consider the circumstances of any investor. Sage Capital is an investment manager partner of Channel Capital, a sponsor of Firstlinks. For more articles and papers from Channel Capital and partners, click here.

Recent age pension changes impact non pensioners too

Brendan Ryan

The age pension has recently gone up because of the rising cost of living. It's great to see the increase but along with keeping on top of rising costs, there are now additional challenges and opportunities.

It's also worth thinking about how the pension increase changes how much you could borrow against the equity in your own home via the federal government's reverse mortgage scheme.

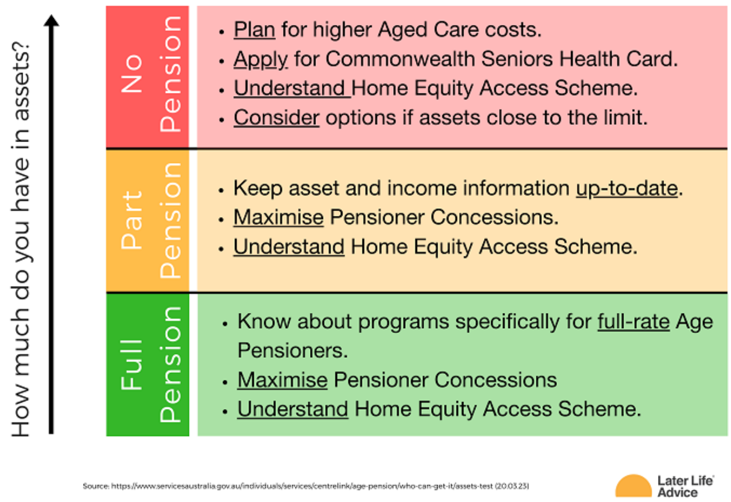


Here's our guide on how the changes could impact you.

Which retiree are you?

All age pension eligible Australians fit into a category based on their assets, their relationship status, and whether they have a home or not. In the first table, a green band means full rate pension, red means no pension at all, and like a traffic light, amber is somewhere in-between.

Recent changes in the age pension mean you may have changed category and if this is the case, you may have work to do. Where do you fit in?



What should you be doing now?

Right, is our action plan. It all depends on what type of pensioner you are, but many people should consider making the best of the changes.

Check if you are a full-rate pensioner

Check your fortnightly pension to make sure you are receiving the maximum. If you think you are a full-rate age pensioner, and you are not getting the full-rate in the table below, you may need to update information held with Services Australia.

Maximum Rate Age Pension (April 2023)	per fortnight	per year
Single	$1,064	$27,600
Couple	$1,604	$41,700

Part-pensioners: make sure your information is up-to-date

If your rate of pension is less than the rates in the table above, you are a 'part-pensioner'. The assessable assets reduce the amount of age pension you get by a formula. For every $10,000 worth of assets over a set limit, pensions are reduced by $780 per year.

It's worth checking that the correct value is on file for your car or caravan (current value not new), and any changes in the value of your savings and investments.

More people can get the age pension and the Pensioner Concession Card

The upper limit for someone to receive a part pension (i.e., to not be assessed to get the full rate, but any amount greater than zero) is now higher.

This is good news for people close to the limits who have been eyeing off the benefits of having a Pensioner Concession Card, as this can be much higher than the actual amount of age pension received.

You can now borrow more with the Home Equity Access Scheme

Homeowners can borrow against their property using a government-run reverse mortgage scheme known as the Home Equity Access Scheme.

The amount you can borrow is linked to the maximum rate of the age pension, so the recent increase means the amount that can be borrowed has also increased.

It is government run, and at 3.95 %, the current interest rate sits well below other reverse mortgage rates in the market. Of course, this could change, but for now the scheme looks attractive.

You can access the loan even if your income and assets mean you are not eligible for an age pension. This can be useful if your assets don't generate enough income.

Aged care costs are increasing

The rules around aged care are complex, and the impacted of the pension changes on you will depend on your financial situation and the aged care decisions you make.

With higher cost of living comes higher interest rates, and these rates are part of the cost of aged care. The cost of paying for residential aged care accommodation by a daily payment instead of a lump sum has become more expensive.

Furthermore, the daily fee all residents pay is based on the rate of age pension. So that has gone up too.

There's no need to worry or panic about these changes. But it is important to understand how they impact on your situation, for better or worse.

Brendan Ryan is a financial adviser and Founder of Later Life Advice. This article is for general information purposes only and does not consider the circumstances of any person. To find out more about your action plan visit our website.

Telstra: the dominant player in an improving industry

Lucas Goode

We have held Telstra shares in our funds for a long time. It's exactly the type of company we like: a market leader, with a strong competitive advantage, recurring earnings, solid dividends, capable management, and resilient in tough economic times.

While we currently look favourably on Telstra, that doesn't mean we always think it's a good buy. Over the years, the size of our investment has gone up and down depending on a number of factors including the industry's competitive dynamics, the regulatory outlook, and value.

Right now, we think Telstra is well positioned for future long-term success.

It's the dominant player in an industry that is improving and becoming more rational. It's also in a strong position to cope with high inflation and rising interest rates and has recently started growing its dividend again.

Are Telstra shares good value?

Telstra shares are reasonable value, and IML's active weight in Telstra (the percentage of Telstra shares we hold compared to the market) has fluctuated over the years.

Source: IML & FactSet, as at 28 February 2023

We built up a significant position in the company between 2009 and 2011 as Telstra's shares wallowed at or below $2.80. The company was embroiled in a dispute with the Federal Government over the NBN rollout at the time and this hurt its earnings and share price.

After the dispute was resolved, Telstra entered a multi-year period where it grew its mobile earnings strongly each year. There were two main reasons for this:

1. The 4G rollout from 2011. The move from 3G to 4G was a massive change for the mobile industry as it allowed high-definition video to be streamed on mobile phones for the first time. Telstra was already well known for having the best network coverage and it rolled out 4G more efficiently than its rivals, leading to it gaining customers from other networks that wanted the best 4G experience on the newly released phones of the time.
2. Vodafone, one of the other two mobile network operators (along with Optus), had significant network issues which led to its customers' often losing signal and dropping out of phone conversations or losing internet connection. This led to it being dubbed 'Vodafail' and losing a lot of customers.

These factors, as well as a generally benign industry environment, allowed Telstra to strongly increase its mobile service revenue over the period through a combination of market share gains and stable average revenue per user (ARPU), leading to a significant increase in both profits and margins. Telstra's share price rallied from 2011-2015 to eventually peak at over $6.

During that period, we reduced our exposure to Telstra significantly because the shares appeared fully valued. We thought that many investors took too optimistic a view of the company's prospects and we also saw that the NBN was likely to impact Telstra's earnings from its fixed-line business.

In the years from 2016 - 2019 Australia's mobile industry was involved in a mutually destructive price war, triggered by new management at Optus. Optus aggressively cut its mobile pricing in an attempt to win market share and Telstra followed Optus down in pricing, to protect its market position.

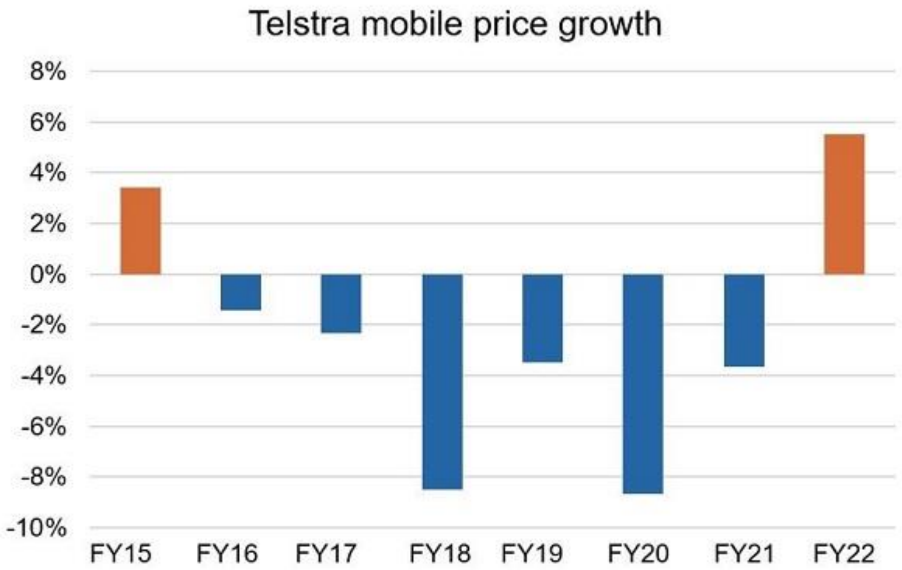
This saw Telstra's earnings and dividends fall, along with its share price. With the share price falling below $4 we saw greater value emerge, despite the negative news, so started to slowly rebuild our holding in Telstra in 2017 and more aggressively in late 2018 after the announcement of the merger between TPG and Vodafone. During this period the dividend declined from 31c to 16c which was below our expectations at the time.

Following the merger between Vodafone and TPG, and a change of management at Optus, Australia's telecommunications industry has become more rational and increasingly attractive to investors like us. We continued to increase our holding in Telstra during the share price weakness through Covid and have benefitted from the appreciation in its share price. Since 2021 the main parties have acted more rationally, increasing their pricing to pursue greater profit and returns for shareholders.

Telstra is the number one player in an attractive industry

Telstra dominates Australia's telecommunications industry and has held this position for many years. It has a strong brand, the best network coverage in Australia, which allows it to charge a premium over its competitors, and therefore has the best margins in the industry.

With the industry more rational today, and the price wars from 2016-2019 over, mobile prices are starting to rise once again.



Source: Telstra presentations, postpaid handheld growth by average revenue per user (ARPU)

As the industry leader in mobile, Telstra will take the lion's share of this increase. Telstra's management also has a good handle on its costs. In its update in February 2023 Telstra showed an impressive ability to keep costs in check, despite high inflation – in our view this increases the likelihood it can grow revenue faster than inflation and so increase profits.

During the Covid years, mobile subscriptions dropped for the first time ever. Now that Covid is (thankfully) mostly in the rear-view mirror, mobile subscriptions are rising again as Australia's immigration, student and tourism numbers are all heading back to pre-Covid (normal) levels. This constant flow of new arrivals should see around 300-400,000 new mobile subscribers added every year, benefitting all players.

In addition to improvements to its operating business, Telstra has begun to successfully monetise its infrastructure assets. It sold 49% of its towers business to a consortium led by the Future Fund in 2021 for $2.8 billion, which valued it at 28x Enterprise Value (EV) to EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization). We think this was a great price which showed how much large, institutional investors will pay for these kind of high-quality assets with recurring, predictable income.

All of Telstra's infrastructure assets are now structurally separated from Telstra into Infraco, including all of its NBN revenue. We think it's likely that Telstra will ultimately sell all, or part, of Infraco at some point in future, noting that the company has already achieved a significant re-rating from the market on the back of this structural separation.

Telstra is well placed to succeed in a high inflation environment

Inflation is high, and while it may have peaked in Australia in late 2022, higher than average inflation is likely to be here for some time. Telstra has many qualities in its favour in this environment.

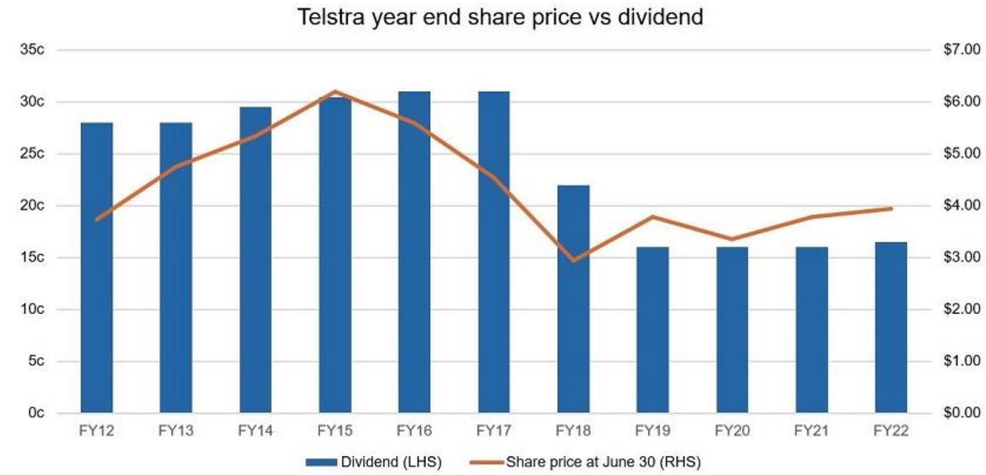
Defensive industry. When times are tight people might eat out less, buy fewer fancy couches and cut back on travel but they're very unlikely to cut their phone or internet.

Pricing power. As mentioned above Telstra has a strong brand and dominant position in an increasingly rational industry, putting it in a strong position to raise prices.

Stable cost base. Telstra is in a relatively fixed-cost industry, so when it increases revenue on that fixed cost base, most of that increase drops through to the bottom line as profit. While Telstra is a large employer, only around 30% of its costs are direct staff costs, limiting exposure to wage inflation relative to more people-heavy businesses. Finally, as part of Telstra's T25 transformation program, it has committed to removing $500m of costs by June 2025 which should more than offset any inflationary increases. Notably, despite the high inflation environment, Telstra reaffirmed its intention to hit its cost reduction targets in its half-year report in February 2023.

Dividends growing again

After several years of declining, Telstra's dividends are back to rising again.



Source: IRESS, Telstra company data

Telstra has now fully absorbed the loss of its fixed-line revenues to the NBN and the 'mobile price wars' of 2016-19 are well and truly over. Telstra's mobile business is now a significant part of its earnings and is growing steadily given the more rational industry. With industry returns still in the low single digits (1-2%), we see further price rises and profit growth in its mobile business in the years ahead. In addition, Telstra owns a number of infrastructure assets whose earnings are growing in line with inflation, supplementing the company's earnings growth.

In February 2023, Telstra increased its interim dividend from 8 cents per share to 8.5 cents.

Get the biggest piece of a growing (and extremely defensive) pie

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Lucas Goode is a Portfolio Manager and Equities Analyst at Australian equities fund manager Investors Mutual Limited. This information is general in nature and has been prepared without taking account of your objectives, financial situation or needs. The fact that shares in a particular company may have been mentioned should not be interpreted as a recommendation to buy, sell, or hold that stock. Past performance is not a reliable indicator of future performance.

Survey responses: French v Aussie reaction to pension age

Leisa Bell

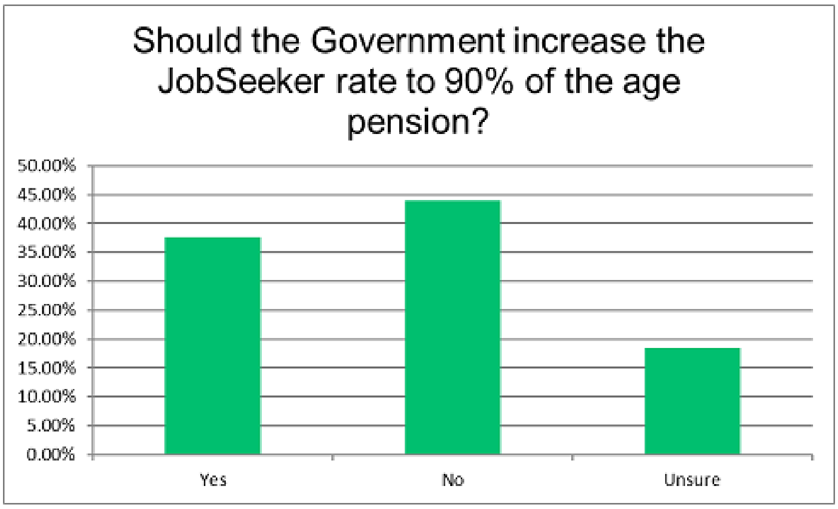
A summary of our survey results and additional comments is provided below, with the full version linked here.

Why have Australians and French people reacted differently to increasing the eligibility age for pensions?

The main themes explaining French and Australian reactions to changes in pension eligibility ages include cultural differences, prior history of fighting for rights and freedoms, each country's existing retirement and taxation systems and the perceived fairness/unfairness of the change.

- It’s more about Macron and the political landscape than about the retirement age.
- French people are used to the age pension starting a lot earlier. No one probably has tried to increase the eligibility age at all and this was a shock. Australians have become conditioned to increases in the eligibility age.
- Ours has been increased gradually over time. France went from 65 to 60 and are now battling to raise it back up.
- Largely national character. Australians are mostly accepting of change and more moderate in response, coupled with often debt being carried into near retirement age, necessitating working longer anyway. The French are more passionate, expressive, and volatile by nature. Not a bad thing, just different, but it's historically how they react.
- The French tend to have a negative view on many issues. Macron is actively disliked by most French people, but the other presidential choices were considered worse. French people have a history of being informed and more active in the expression of views than Australians who use terms like, 'the silent majority'. The French pension reform is more immediate than the Australian introduction to raise the eligibility age. It was not approved by parliament and was enacted using a special presidential power. Most French people will rely almost completely upon their govt. pension that they have financially contributed to unlike Aust. People in France tend to strongly believe that retirement life is very special after a more rigid employment system. Transitioning to retirement is not as common as Aust. I am Australian and have been living mostly in France/Switzerland since retirement over 6 years ago.
- The French have a history of revolution and protest - it's part of their nature; not so for Aussies, or much less so.
- Because the French pension system is "pay-as-you-go" they have paid directly for it so feel more entitled to its timing. Ours comes out of consolidated revenue so there is a lesser sense of entitlement.
- A case was presented to the Australian people outlining the reasons for the increase. One reason being we can't afford to pay the pension to retirees from such a young age. It was a reasonable argument and made sense to most people.

Should the Government increase the JobSeeker rate to 90% of the age pension?

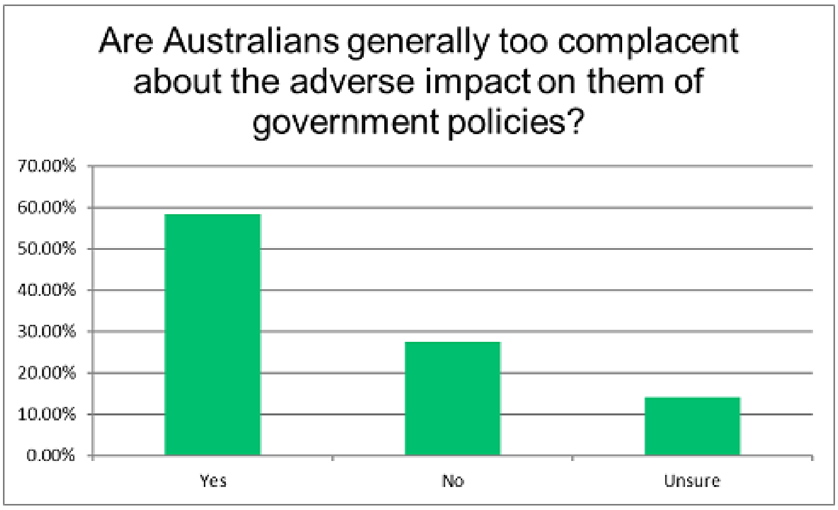


While more people answered ‘no’ to this question than ‘yes’, the comments reveal that many would still prefer to see an increase, but for a lesser amount. Some suggested a tiered approach, where there are larger payments to begin with to assist with job seeking, reducing in time to a more basic level. Another common concern was the need to avoid creating a disincentive to find work, while not leaving people to live in poverty.

- JobSeeker is short-term welfare to bridge involuntary employment while the age pension is a long-term safety net for the aged.

- There are expenses that are unavoidable on JobSeeker, such as a working mobile phone, internet and a computer to apply for jobs and lodge Centrelink forms, transport to interviews and decent interview clothes that those on a pension can avoid.
- If age pensioners find it hard to live on the pension how can younger people get by on less?
- My answer would be yes, provided it did not diminish the desire to look for a job.
- The JobSeeker rate should be set to encourage people to return to the workforce. I would suggest a tiered payment system that reduces the longer you are using the supplement.
- JobSeeker rules, requirements and dollar amount are criminal. More needs to be done about financial education in formative years so that as adults people stand a chance at achieving.
- I really struggle to understand how anyone is on JobSeeker in 2023 when most businesses are crying out for reliable workers? I strongly suspect there is a large group who should be on a disability pension or more appropriate benefit for their circumstances with a very small cohort of diehard slackers who have no genuine intention of contributing to society and they don't deserve rewarding. Thus, has it always been.
- The current level is insufficient for a basic standard of living.

Are Australians generally too complacent about the adverse impact on them of government policies?



Most respondents agreed that Australians are generally too complacent when it comes to government policy changes, but there were also those that were more pragmatic, reflecting on our governments being more ‘centre’ than far left or right, and that Australians pick their battles. Some policy changes are more palatable than others, and the ones that aren’t, are protested against (generally in a non-rioting way) or the party voted out next election.

- Whilst the protest movement that characterised the 1970s has long gone, I wouldn't call us complacent. We simply respect an orderly society, and store up the pluses and minuses until we get to the ballot box.
- Our political system of compulsory voting and proportional representation ensures politicians remain sensitive to the views of the electorate, of voters.
- We understand both sides of the argument we don’t just think how does this affect me we also understand that some policies need to be changed because they are unsustainable in the long run.
- Politics in Australia is very centrist, and policies don't differ too much between the main parties, so the majority of people can accept any initiative, regardless of the government of the day. European politics is far more a question of left or right / socialist or liberal.
- Yes, sometimes. Despite many posthumous bad or average outcomes, the majority aren't prepared to get fully across the issues and determine the likely impact of policy changes. Much of it is maybe because of the type, course and nature of media consumed to stay ‘informed’. Nowadays, perhaps more than before

the media can be extremely biased, often supporting or pushing a government agenda because their politics is aligned. Often all the facts or a balanced presentation are deliberately omitted.

- This is a very broad question, but it is characteristic of Australians to trust authority and be prepared to contribute at some cost to themselves. This has social cohesion benefits by accepting 'the decision' while not really liking it.
- It seems to vary considerably from issue to issue. I would love to understand why some changes in government policy attract aggressive responses while others are more muted. What drives the bandwagon effect?
- We believe in Democracy so unless it's really ridiculous we accept it. Next election sorts them out.

Leisa Bell is Assistant Editor for Firstlinks. The views of our readers do not necessarily reflect those of Firstlinks.