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Editorial

My favourite Michael Lewis book is *Moneyball*. The main character is Billy Beane, the General Manager of the Oakland Athletics baseball team from 1997 to 2015. The book first details Beane's life before becoming a GM. Beane was an incredibly gifted young athlete who was drafted out of high school into the baseball major leagues. Then, things went downhill:

"If there was one thing Billy was not equipped for, it was failure … He didn't know how to think of himself if he couldn't think of himself as a success … The moment Billy failed, he went looking for something to break."

Despite his physical gifts, Beane's inability to deal with failure separated him from players who became successful, such as teammate, Lenny Dykstra:

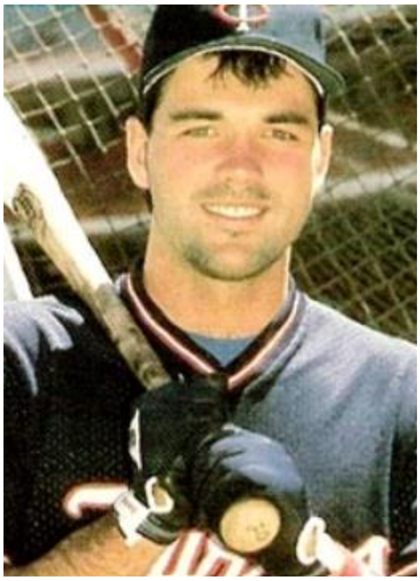
"Physically, Lenny didn't belong in the same league with him. He was half Billy's size and had a fraction of Billy's promise – which is why the Mets hadn't drafted him until the 13th round. Mentally, Lenny was superior, which was odd, considering Lenny wasn't what you'd call a student of the game. Billy remembers sitting with Lenny in a Mets dugout watching the opposing pitcher warm up. 'Lenny says, "So who's that big dumb ass out there on the hill?" And I say, "Lenny, you're kidding me, right? That's Steve Carlton. He's maybe the greatest left-hander in the history of the game." Lenny says, "Oh, yeah! I knew that!" He sits there for a minute and says, "So, what's he got?" And I say, "Lenny, come on. Steve Carlton. He's got heat and also maybe the nastiest slider ever." And Lenny sits there for a while longer as if he's taking that in. Finally he just says, "Shit, I'll stick him." I'm sitting there thinking, that's a magazine cover out there on the hill and all Lenny can think is that he'll stick him.'"

The point about Lenny, at least to Billy, was clear: Lenny didn't let his mind screw him up. The physical gifts required to play pro ball were, in some ways, less extraordinary than the mental ones. Only a psychological freak could approach a 100-mph fastball aimed not all that far from his head with total confidence. "Lenny was so perfectly designed, emotionally, to play the game of baseball," said Billy. "He was able to instantly forget any failure and draw strength from every success. He had no concept of failure. And he had no idea where he was. And I was the opposite."

Beane later went on to become one of the greatest managers in baseball. The irony is his success as a manager was from drafting young players who weren't physically gifted like him, yet they played a team role and were undervalued compared to other players.

The simple takeaway from Billy Beane's story is that people need to overcome failure to mature and become successful. But that's a little too neat. It doesn't address *why* people such as Beane can't handle failure.

Like many mental demons, it's fear that's central to people being unable to deal with failure. It's likely that Beane's fear of disappointing people close to him or disappointing the idealized version of himself led to his hatred of failure.



Billy Beane. Source: Baseball Wiki

Having once been an elite athlete, I can tell you that these fears are commonplace among professional sportspeople. And the ability to tame them often distinguishes those who become great versus merely good.

What's true for sport is also true for investing. Conquering fears, such as failing, are critical to success.

To help with this, we're going to explore what fear is, what types of fear there are, and the best ways to overcome it.

All of us are driven by fear

Dr Pippa Grange is one of the world's most sought-after psychologists, having worked with the Australian Olympic team and several AFL clubs. In her book, *Fear Less*, she outlines what her work has taught her:

"What if I told you that your life is run by fear?

That might chime with you, or it might seem unlikely.

Either way, if you don't feel fulfilled or truly successful, I can promise you that fear is ultimately what's holding you back. If you are quick to judge others or harsh on yourself, fear is speaking. If your life never feels enough, fear is the culprit.

I have spent 20 years working as a performance psychologist, helping people find better, happier ways to work and play. And the conclusion I have reached is that all of us are driven by fear. All of us.

Yet, strangely, that's not a depressing revelation or a permanent life sentence. In fact, once you acknowledge the role of fear, it quickly leads to a truly radical conclusion: if you can shrink the effects of fear, your life will be transformed."

Dr Grange says there are two types of fear. There's in-the-moment fear, which happens in a crisis or high stress situation, and one that you can't help but recognize. Then there's not-good-enough fear. This is the kind of fear that's running your life and making your choices, almost on autopilot. It's the fear about what happened in the past or what might happen in future. It's the fear of disappointing people and failing, like Billy Beane had as a baseball player.

She says these fears can become distorted and lead to behaviour such as jealousy, perfectionism, staying isolated from others, and staying smaller than we really are.

Facing fears

Dr Grange says facing your 'not-good enough' fears is a kind of growing up:

"It's about shedding your parents' fears, your generational and social fears. It will leave you free to explore your true ambitions and rediscover what winning in life means to you."

She suggests several methods to overcome fear, including:

- **Replace fear with a different story.** Think of yourself as a failure? Drop the label and rewrite your story into something else.
- **Replace fear with purpose.** Purpose can direct your attention, influence decisions, and create meaning for you.
- **Replace fear with surrender.** This comes from Eastern philosophy; that the best way to conquer fear is to accept it and let it go. Easier said than done!
- **Replace fear with dreams and desires.** Like purpose, dreams can direct attention, so you don't get flustered by fear.

Applying this to markets

What's this got to do with investing? If you think about the common mistakes that people make with their money, many relate to fear. For example:

Leaving money in a saving account for years instead of investing in markets. This common mistake can come from many different fears: of market dips, uncertain outcomes, lack of market expertise, or repeating past investment failures.

Selling stocks after the market falls. This can be driven of fear of further losses and failure, sometimes being spooked by scary media market stories, or hearing the horror stories of other investors.

Buying a trendy growth stock before it crashes. This happened to many investors in 2020-21 during the meme stock craze: it's the fear of missing out. Greed is a close cousin to fear. It can also relate to wanting to connect with like-minded people.

Listening to a hot tip that goes awry. Again, this is likely the fear of missing out.

Buying complex funds/stocks/products that investors don't fully understand. This can come from ignorance, fear of missing out, or wanting to prove yourself to others.

Giving into fear can mean making irrational decisions that lose money.

How can investors overcome these fears? There are many different methods though the best way may be to take the advice of Dr Grange and have a larger investment goal or purpose. That is, to have a financial plan and the discipline to stick with it. A plan that's suited to you can act like a lighthouse does to a ship, providing a navigational aid even when things can get stormy, or distractions can easily take you off course. It's likely to reduce fear-related unforced errors.

Funnily enough, Billy Beane came up with his own plan later in life as General Manager. It was a radical plan that encountered immense resistance even from those within his baseball club. It didn't work at first as his team hit rock-bottom. Yet, despite the initial failures, Beane stuck with the plan, and eventually found success. In the process, he revolutionized baseball.

James Gruber

Also in this week's edition ...

In a talk with MBA students, famed investor **Howard Marks** doesn't hold back, delivering a scathing assessment of the value of much investment analysis. In particular, Marks is no fan of economic forecasting:

"I've been talking about the uselessness of forecasting for a long time ... And the belief that you know is dangerous if the truth is that you don't know. And that's how you get into big trouble.

Instead, Marks prefers to invest in things that are knowable. He believes investor psychology drives market prices and that it's better to buy underpriced companies than to purchase the best companies ... as **Graham Hand** reports.

The US dollar is diving against many currencies and **Capital Group Australia's Matt Reynolds** thinks that it could spell the end of an 11-year USD bull market. Already markets in Europe and Japan are benefitting from the dollar's decline, and Reynolds thinks it opens up many opportunities in these markets and others outside America.

In less than five years, all Baby Boomers will be eligible for retirement and the Baby Boomer bubble will be all but over. **AUSIEX's Patrick Salis** examines what the generational change will mean for Australia, with an emphasis on the implications for the wealth management industry.

The RBA have been saying for some time that higher interest rates will eventually weigh on consumers and house prices. It hasn't happened yet, so is the RBA early or is it wrong? **Challenger's Pete Robinson** suggests the odds are that it's early and outlines his case for why that is.

The response to inflation in advanced economies has seen rapid interest rate rises, but the money supply has remained elevated, particularly in Australia. **Tony Dillion** says a gradual reduction in the RBA's balance sheet should help with inflation, and if that doesn't work, there are other tools that could be employed.

In the late 1980s, KKR made the largest buyout in history paying the then ungodly sum of US$25 billion ($64 billion in today's money) for RJR Nabisco. Today, the barbarians of buyouts have become the angels of alternatives: KKR is now one of the world's dominant alternate asset managers. And **Montaka's Amit Nath** believes many investors are underestimating the vast opportunities in KKR's addressable markets.

A new ***Wealth of Experience*** podcast is out and our special guest is well-known investor author and speaker, **Peter Thornhill**. He talks about the best way to build an income for life. We also have **Graham Hand** discussing why ETFs grab all of the headlines when they're small fry compared to managed investment funds, and **Peter Warnes** on his outlook for the Australian economy and markets.

Finally, in this week's whitepaper, **Firetrail** thinks investors need to think differently to understand which companies are really helping to decarbonise the world.

Curated by James Gruber and Leisa Bell

Howards Marks rejects forecasts in favour of psychology

Graham Hand

On 24 May 2023, Howard Marks spoke by video to a room of MBA students at INSEAD's Fontainebleau campus outside Paris. Marks is a pioneer of distressed debt investing as an asset class and in 1995, he founded Oaktree Capital Management, where he is now Co-Chairman of a firm with over 1,000 employees globally and more than US$170 billion assets under management. Marks has written two books and is best known for his client memos published since 1990 (free to subscribe). He was interviewed by Roi Lipovetzky and Andras Galambos, students at INSEAD. This is part 1, of a 2-part series.

Marks starts with two lessons from his investing career that started in 1969, over 50 years ago.

"Number one, we pretty much only learn from our failures, we don't learn much from our successes. And number two, it's very desirable to learn the lessons early in your career when you have time to correct your mistakes and when you don't have too much money to lose."

Price is more important than quality

He gives the example from his early days when all the big banks and investment banks believed the so-called Nifty 50 companies in America were the best and the fastest-growing, and so good that nothing could ever go wrong and there was no price for their stocks that was too high. But he saw massive losses by investors after 1969, so what went wrong?

"Well, guess what, the prices were too high, and these stocks sold between 60 and 90 times earnings and five years later they sold between 6 and 9 times earnings, which is an easy way to lose 90% of your money. So, this came as quite a shock to everybody who had thought that these things were bulletproof."

He switched from equities to start a convertible bond fund, also investing in high-yield bonds. And here is the first lesson which challenges some standard investing conventions. He moved away from investing in what were supposed to be the best companies:

"Now, I'm investing in the worst public companies in America, and I'm making money steadily and safely. So, this was really formative for me. What does it teach you? It's not what you buy, it's what you pay, that investing success doesn't consist of buying good things, but buying things well ... But if you buy things for less than their intrinsic value, you're probably on your way to a good outcome."

Investor psychology drives market prices

He then talks about the importance of understanding investor psychology.

"The economy goes along. In a good year, it's up 3%, in a bad year, it's up 1%. Corporate profits increase. Sometimes they're up 10%, sometimes they're up 5%. The stock market fluctuates wildly. The element behind the fluctuations is not changes in the fundamentals, but changes in investor psychology, which are just wild. So, you better understand what psychology is embedded in the price of the asset you're thinking about buying.

If you buy something that's the subject of great optimism, and if that optimism is embedded in the price, which it invariably will be since the optimism is widespread, then it's going to be hard to get a bargain ... the most important stuff is about psychology and understanding where you are in the cycle."

Winning by not losing

Marks describes a surprising discussion with a pension fund client with another important lesson about thriving by surviving, not aiming for the top:

"And in the 14 years, he was never above the 27th percentile or below the 47th percentile. Where do you think you are for the whole period? Well, you might say 37th percentile on average. The answer is, for this particular fund, 4th percentile. How can that be? The answer is that in investing, most people eventually shoot themselves in the foot ... you can succeed by being a little bit above average consistently and by avoiding disasters."

Marks says that anyone who argues you need to take risks to be in the top 5% of fund managers, and that means sometimes being in the bottom 5%, is taking the wrong approach. Clients don't want the bad results and don't demand the top results.

Superior investors need to think differently

Marks does not support contrarian investing for the sake of it, because sometimes, the consensus is right. But at some point over time, to be above average, an investor must think differently. Average active investors can be replaced by an index. Readily-available information about the present cannot hold the secret to superior results because everybody has it. A good investor needs to know something that others don't, or have a variant in perception or interpreting or understanding information.

He gives the example of General Motors bringing out a new Mustang, and investors buying the stock because it will be popular. But everyone knows the car is coming, so what is the superior information? Is there too much optimism in the share price? Thinking must be more nuanced but not simply for the sake of being different.

The incredible 40-year tailwind

Most investors did not realise how wonderful the period of 1980 to 2020 was for investing with decades of falling (and then ultra low) rates boosting asset prices. Marks gives a fascinating example of his own borrowing:

"I had a loan outstanding from the bank in 1980 and they sent me a slip of paper saying the interest rate is 22.25%. 40 years later in 2020, I was able to borrow at 2.25%. This 2,000 basis point (20%) decline of interest rates over those 40 years had a profound effect on investors and investing. When interest rates come down, the discounted present value of future cash flows goes up, that is to say assets become more valuable. Business is strong. Relatively few people default or go bankrupt. Borrowing becomes cheaper so that leverage strategies become more profitable than one expected. All these good things happen in a declining interest rate environment."

He concedes the low rates were bad for savers but the US Federal Reserve had a long history of bailing out the markets when required, and lower rates made it easier for company management and asset holders. It was a wonderful environment for buyouts and private equity because lower borrowing costs would often rescue bad transactions (in otherwise zombie companies). Never confuse brains with a bull market.

Equity returns from fixed interest

Times have changed since 2021. We now know that easy monetary policy from central banks produces inflation and central banks realise they can't be accommodative all the time and they can't engage in continuous stimulus.

Rates are not going back to where they were. Marks believes the Fed Funds rate is more likely to be between 2% and 4% in future, rather than zero and 2%, making it a better time to invest in credit for yield. For example, the S&P return over the last 100 years has averaged a little over 10%, but today, his funds achieve 8.5% from high-yield bonds, 9.5% from levered loans, and 11% to 13% for senior loans to the biggest buyouts. It is equity returns from fixed income, which are much more dependable than equity returns. It is a massive change in two years.

Macro forecasting and economists are a waste of time

Marks says he does not rely on forecasting because it is unknowable.

"In January of 2016, I was having dinner with Warren Buffett. And he says to me, for a piece of information to be desirable, it has to satisfy two criteria. It has to be important. It has to be knowable. The macro is very important. Seems to be the thing that moves the market most, but it's not knowable … You've got Buffett, you have Munger, you have Peter Lynch, you have Bill Miller, and you can go on down the list of successful investors. Now, give me a list of the macro investors who have been successful."

*"Where are the rich macro investors? And there are so few (*under questioning, he conceded on Soros and Druckenmiller*). And if you look at the performance of hedge funds, for example, which has been terrible in the last 20 years, there's a subsector called macro. And their results are even worse. Who knows more than others about the macro future? Virtually nobody."*

Marks calls it the 'Illusion of Knowledge' in one of his memos, placing little value on predictions.

"I've been talking about the uselessness of forecasting for a long time ... And the belief that you know is dangerous if the truth is that you don't know. And that's how you get into big trouble. So, I'm firmly against it. Oaktree, I hope I don't insult anybody in the audience, but Oaktree doesn't have an economist. We don't invite economists in to give their talk. And one of the tenets of our investment philosophy is that our investments are not based on macro forecasts."

He prefers to focus on micro analysis to gain an advantage investing in companies, industries and securities and not trying to guess at what GDP will be next year. He references the US Fed and its hundreds of PhD economists, and the Fed can't even predict what the Fed is going to do.

"Now, if it's your behavior and you publish a prediction, obviously you have it within your power to make it come true. And the Fed's predictions of its own behavior don't come true. So, I would say, if they don't know what they're going to do, how the hell can any of you figure out what they're going to do?"

Which is why Firstlinks infrequently covers macro predictions and market forecasts. Not only do most other financial newsletters cover these macro guesses in detail, regularly correcting themselves with forecast updates, but the predictions are of little merit for long-term investing and portfolio construction. It's good to hear Howard Marks confirm our content preferences.

Graham Hand is Editor-At-Large for Firstlinks. This is Part 1 of a selection of Howard Marks' comments to INSEAD's Fontainebleau students on 24 May 2023. Part 2 will be published next week. The full discussion is here. This article is general information only.

A struggling US dollar bodes well for markets outside America

Matt Reynolds

Even as the global economic outlook weakens, powerful tailwinds are forming behind certain areas of the equity markets that previously spent many years in the wilderness.

Chief among them are stocks in markets such as Europe and Japan, which have surged in recent months amid a pronounced decline in the US dollar. This trend is part of a larger broadening of investment opportunities over the past year — in contrast to the prior decade when large-cap US tech stocks dominated market returns.

Declining dollar could boost non-US stocks

At least part of this dynamic has been driven by a significant reversal in the strength of the US dollar. After an 11-year bull run, dollar dominance appears to be on the ropes as the greenback weakens against the euro, the yen and many other currencies. A continuing downward trend would be welcome news for investors in non-US stocks and bonds, where currency translation effects have eroded returns in recent years.

Non-US stocks have rallied in periods of dollar weakness

Sources: Capital Group, J.P. Morgan, MSCI, Refinitiv Datastream, Standard & Poor's. Relative returns and change in the USD index are measured on a cumulative total return basis in USD. The U.S. dollar index reflects J.P. Morgan's USD Real Broad Effective Exchange Rate Index, which is re-based to 100 as of 2010. As of May 31, 2023. Past results are not predictive of results in future periods.

Markets outside the US are already showing signs of a currency boost. As the dollar slipped, European stocks generated the strongest returns among developed markets during the fourth quarter of 2022 and the first quarter of 2023. Japanese stocks, too, have staged an impressive rally — with the Tokyo Stock Price Index, commonly known as TOPIX, rising to a 33-year high in mid-May.

Since reaching a peak last October, the dollar has declined about 6%, as measured by the J.P. Morgan USD Real Effective Exchange Rate Index. While that may not seem like much, as my colleague Andrew Cormack points out, currency trends often play out over long periods of time. He says, *"The dollar tends to move in big cycles over many years. And I think the strong dollar cycle we saw over the past decade was a bit long in the tooth."*

While the dollar may yet see intermittent periods of strength due to its perceived status as a safe-haven asset, Cormack believes the long-term trajectory is lower. That's due to several factors, including a soft US economy, a weak housing market and indications that the Federal Reserve may be done raising interest rates for the balance of 2023.

US equities also have done well so far this year, largely thanks to a rebound in Big Tech stocks. Technology has been the best performing sector so far this year in the S&P 500 Index, driven in part by investor enthusiasm for the rise of artificial intelligence (AI) systems, such as ChatGPT. Earlier this year, ChatGPT, co-owned by Microsoft and Open AI, became the fastest growing consumer app in history.

The difference now is that tech stocks are no longer the only game in town. Other areas of the market are also enjoying time in the spotlight, suggesting the future of growth investing may be more inclusive.

Dividend stocks rise in importance

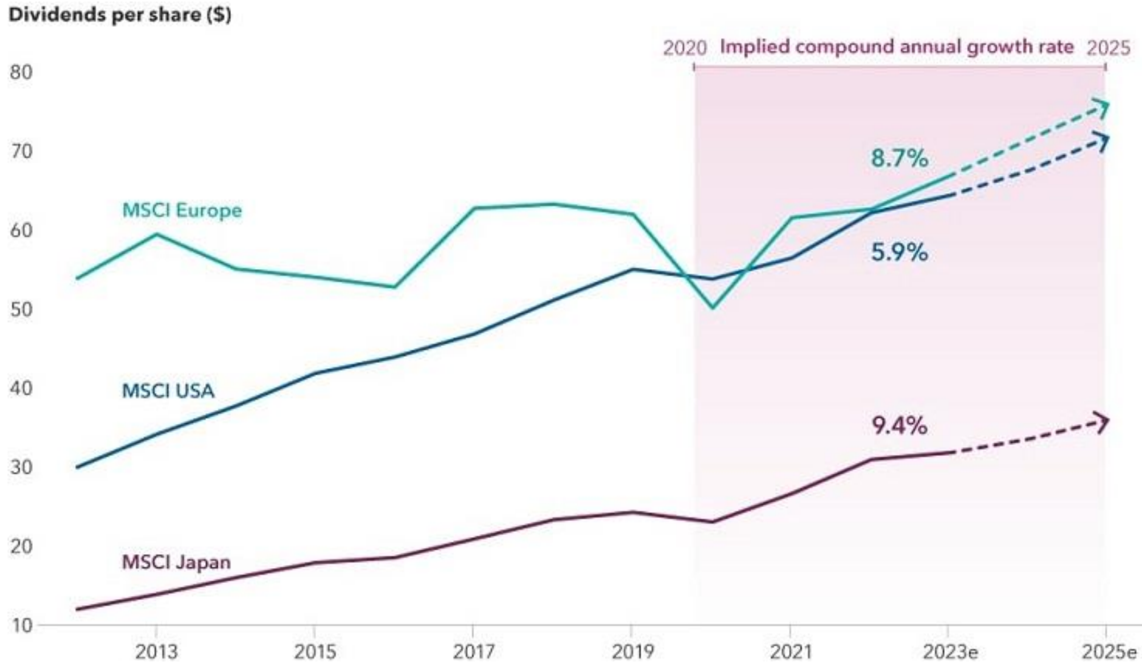
In this environment, dividend-paying stocks may take on greater prominence, especially if global economic growth continues to slow and market volatility returns. This is also an area where international markets have had an advantage given the higher number of dividend-paying companies headquartered outside the United States and the emphasis they place on returning cash to shareholders.

For example, French drug maker Sanofi has increased its dividend payout for 28 consecutive years. UK-based consumer goods giant Unilever has done so for 22 straight years. As of 31 May, 2023, more than 600 companies headquartered outside the US offered hefty dividend yields between 3% and 6%. That compares to 130 in the United States.

Across all markets since the start of 2022, dividend contributions to total returns have increased, as have total payments to investors. Global companies distributed more than $2 trillion in dividend payments for the 12 months ended 30 April, 2023, an 8.9% increase from the previous 12.

Caroline Randall, a portfolio manager at Capital Group comments: *"I expect dividends will be of greater significance to investors this year and beyond. But in a period of relative instability and rising debt costs, it is essential to focus on the quality of dividend payers."*

The dividend decade is here



Source: FactSet. Data for 2023 to 2025 is based on consensus estimates as of May 31, 2023. CAGR = compound annualized growth rate.

For Caroline, finding quality dividend payers means closely scrutinising company balance sheets, credit ratings and interest costs. This has guided her to select companies across the pharmaceutical and medical device industries, utilities, energy producers and some industrials.

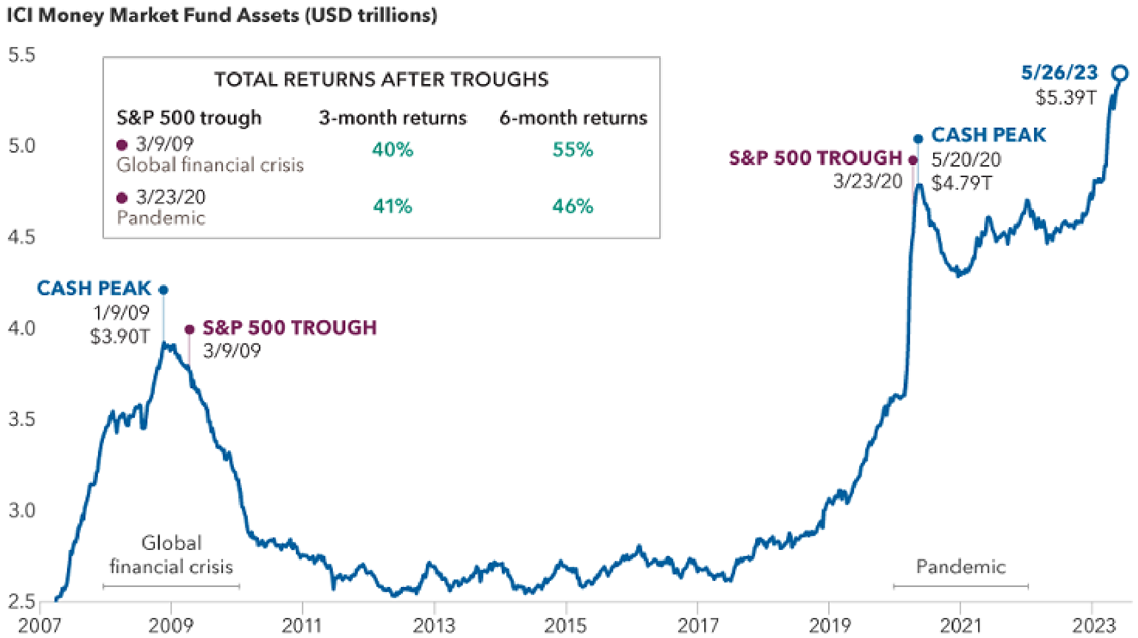
"It is critical to track what management says about dividends and equally critical to follow what they do. If you are going to rely more on dividends, you must be confident the companies will pay them. That's where we can add value as active managers."

Bullish signal: A mountain of cash on the sidelines

Given these and other opportunities, now may be the time for investors to consider moving out of cash. In recent months, investors have shifted assets from stock and bond investments and driven money market totals to a record $5.39 trillion, as of 26 May, 2023.

This flight to cash and cash alternatives such as money market funds and short-term Treasuries is understandable following last year's tandem decline of stocks and bonds in the face of rising interest rates, inflation and slowing economic growth. Many investors moved deposits from banks to money markets amid ongoing volatility and relatively high yields on cash alternatives.

Investors' flight to cash has been followed by strong returns



Sources: Capital Group, Bloomberg Index Services Ltd., Investment Company Institute (ICI), Standard & Poor's. As of May 26, 2023. Past results are not predictive of results in future periods.

But conditions have shifted thus far in 2023, and long-term investors may want to rethink their approach. Levels of cash alternatives peaked near two recent market troughs. During the global financial crisis, for example, money market fund assets peaked two months before the S&P 500 Index reached a bottom on 9 March, 2009. The stock market recorded a 40% return over the subsequent three months and a 55% return over the following six months.

Similarly, during the pandemic, money market fund levels reached a high weeks after the S&P 500 hit its trough in March 2020.

After the painful losses of 2022, more risk averse investors might consider allocating some cash to dividend-paying stocks, which can provide income and capital appreciation potential, as well as select short- and intermediate-term bonds, which have been offering higher yields than in 2022.

Looking out across the investment landscape, short-term bonds, dividend-paying stocks and non-US stocks stand out for their attractive valuations and historically lower volatility, offering potentially attractive alternatives to cash for cautious investors seeking a re-entry point.

Matt Reynolds is an Investment Director for [Capital Group Australia](), a sponsor of Firstlinks. This article contains general information only and does not consider the circumstances of any investor. Please seek financial advice before acting on any investment as market circumstances can change.

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The Baby Boomer bubble is over, what's next?

Patrick Salis

The intergenerational transfer of wealth in this country is picking up pace. COVID has seen many older people reassess what they want going forward, a big part of which is determining how to provide for the next generation.

Put simply, we're at the end of the Boomer phase and the beginning of the Millennial/Gen Z phase. The wealth management industry will deal with the Boomers retiring, the transition of Gen X to being the elders of the workforce, and the rise of the Millennials/Gen Z. The way it will do this is to change its products and services, and in today's digitised world that means primarily through changes in technology.

The generations

While marketers, media and politicians love to talk about 'Baby Boomers' and 'Millennials' using arbitrary windows of time, it is important to remember that lives are bigger than categories and we can be prone to over generalisation.

That said, 'generations' are a useful tool for analysis. This paper uses the definition provided by Australian Bureau of Statistics shown in table 1.

The defining characteristic of the table is the commencement of the reconstruction era that started in 1946 after the end of World War 2. From that point, the Boomer generation is generally accepted to be a 20-year generational period, and then each generation is a subsequent 15-year generational period.

Table 1. Generational Cohorts

	Birth Window		
Cohort	**From**	**To**	**2023 mid point**
Baby Boomers	1946	1964	68
Gen X	1965	1980	51
Millennials (Gen Y)	1981	1996	35
Gen Z	1997	2012	19

Source: ABS

The best way to understand why the Baby Boomer generation has been so consequential is to look at the total fertility rate in Table 1.

The over-representation of one demographic cohort has been characterised as a "bubble" in the population numbers, which is why the "Baby Boomer bubble" has been a constant fixture in discussions about generations and their needs and wants. It's fair to say that the Baby Boomer bubble has been the defining force that has cleared all before it, and its members have also collected resources and wealth as the systems changed to accommodate them and their looming retirement and aged care. And for good reason too, as up until now the Baby Boomers have been the largest and most consequential demographic cohort in Australia since the post war era started.

The boom required more resources such as larger houses, schools, hospitals and cars, the economy expanded rapidly as it consumed to catch up to the needs of the new generation, and the infrastructure of the country grew to support it. Then as the Boomers grew up, they needed education resulting in an expansion of the university system. As they then moved into work, the workplace had to accommodate a workforce that was not just larger from population growth but was also larger because the post war era embraced feminism and women's rights meaning that women were also available for work.

At this point we can also add to this population boom and economic growth the fact that improvements in the areas of general healthcare and medical technology also meant that life expectancy was also increasing, and so governments became aware of the growing need to plan for the fact that pension and aged care systems were going to have to digest age care demands that were simultaneously going to be more expensive and over longer time frames than what the previous pension system was designed to support. This meant saving for retirement needed to be a priority which gave rise to the "Superannuation System" that has become the bedrock of financial services in Australia today.

Table 2. Percent of Cohort of Working Age over 5 Year Strategic Window.

					Strategy Window									
	The Beginning				**% Of Working Age**						**The Beginning of the End**			
Cohort	1946	1964	1981	1997	2023	2024	2025	2026	2027	2028	2029	2045	2061	2077
Boomers					33%	28%	22%	17%	11%	6%				
Millennials					100%	100%	100%	100%	100%	100%				
Gen X					100%	100%	100%	100%	100%	100%				
Gen Z					73%	80%	87%	93%	100%	100%				

Source: ABS

On the cusp of intergenerational change

The Baby Boomer bubble is starting to deflate before our very eyes.

Table 2 shows the percentage of each cohort that will be of working age during our 5 years planning horizon and Figure 2 shows the same data for only the Gen Z and Boomer cohort.

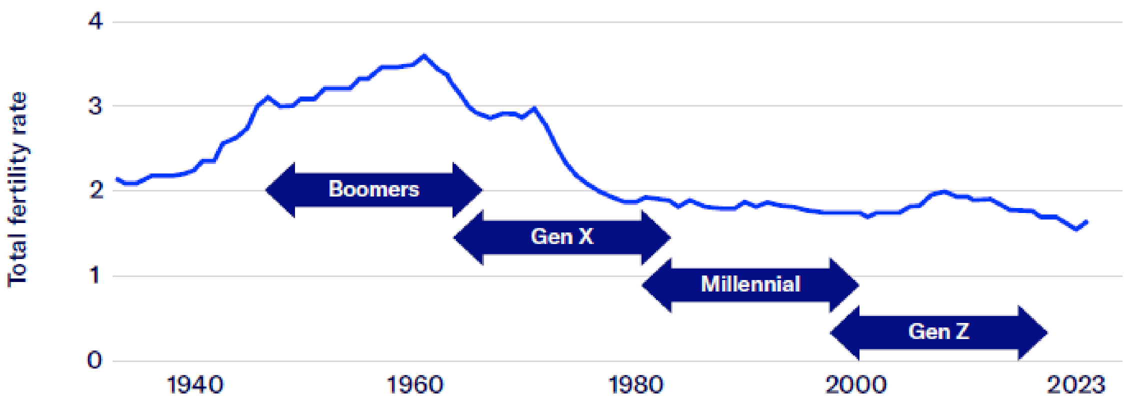
Within 5 years, all Baby Boomers will be eligible for retirement and the Baby Boomer bubble will have all but deflated out of the workforce by 2028. And it doesn't stop there.

In 2029 the first of the Baby Boomers will reach their statistical age of death (Men 81, Women 85) which means that the Baby Boomer bubble will start to deflate completely.

The impact of this on the wealth management industry is three-fold:

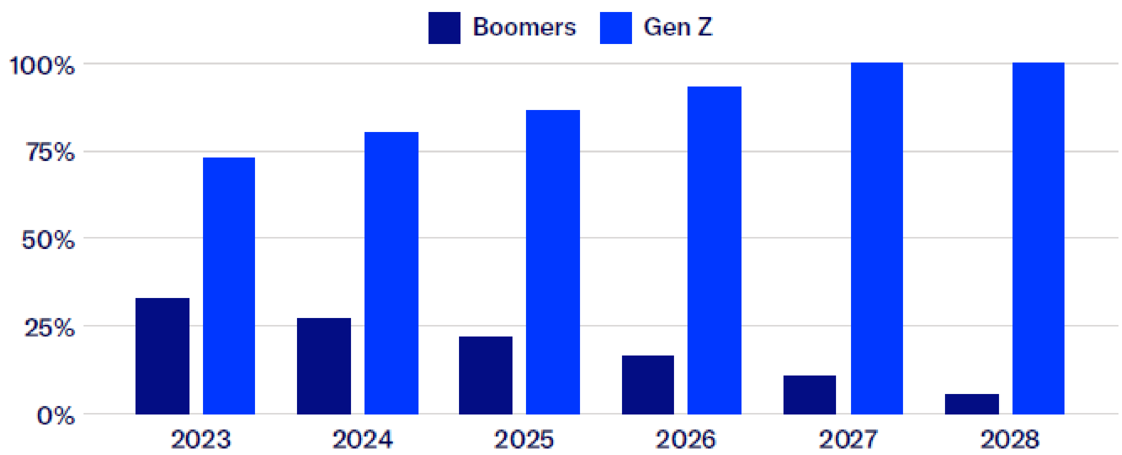
- Baby Boomer superannuation balances will start to deflate out of the superannuation system through retirement consumption, followed by disbursement through the inheritance process.
- Gen X are now the group preparing for retirement and they will become the large balance superannuation account holders.
- With Gen Z fully deployed into the workforce, the predominant demographic groups needing to be serviced by the industry will be Millennials/Gen Z.

Figure 1. The Generations



Source: ABS

Figure 2. Boomer and Gen Z Cohorts of Working Age over 5 Year Strategic Window



Source: AIHW

Financial flow changes

The exit of the Boomers from the workforce means that for the first time in its history, the retirement system is going to see retirement phase withdrawals from its largest accounts, as those in the 60-64 age group have an average balance of $323,000 compared to the younger generations where those in the 30-34 age group have an average balance of $45,000.

While it is difficult to predict the future and how the money will flow from where, to whom, and where it will end up, we can make inferences based on what we see in the superannuation balance and housing data that we know today. If we start with superannuation balances, we find that the facts don't really match the prevailing narrative, that super is an inheritance tax planning device.

Research from The Association of Superannuation Funds in Australian (ASFA) shows that while it is true that there are some large accounts, Australian Tax Office (ATO) data in 2018-19 showed that there were only 322,200 accounts with balances above $1 million. This number will have increased given investment returns since that time, however the system favoured the older participants as they had the benefit of a period when contribution limits were not as restrictive as they are for today's participants, and so the younger generations are less likely to be able to accumulate such large balances, in inflation adjusted terms. Regardless, these accounts are outliers that can be ignored when looking at the mechanics of the system given that the total number of superannuation accounts is 23.3 million.

If we look at the ASFA data on the group that will retire and leave the system over the next 20 years, the average balance across genders for those in the 60-75-year-old group is just under $400,000, however it is highly skewed by the larger balances. If we look at the median, the balance across genders in this group is approximately $180,000, which means that 50% of account holders in this age group have $180,000 or less in their retirement savings accounts. In other words, the larger share of the flow of money will be completely out of the system. This also corresponds with research from ASFA which shows that 80% of those who died over 60, and 90% of those over 80, had no super at death.

The question arises as to where this money will flow? If we look at Australian Bureau of Statistics (ABS) research into home ownership across the generations, we see that only 19.4% of Baby Boomers own their home outright, with 46.4% still having a mortgage, and 30.2% renting. While the value of their properties will have increased in capital value, it is not a stretch to assume that retirement funds will be used to pay down mortgages, especially if a large cash balance reduces access to pension entitlements.

Another tailwind behind the money leaving the system is the increasing cost of living and the impacts of high inflation as the global economy transitions through a regime change, away from cheap money and low inflation to higher interest rates and high inflation. Recent ASFA research shows inflation added 9% for singles and 7.8% for couples to the balance needed to have a comfortable retirement. The balances required to have a comfortable retirement are an estimated $690,000 for couples and $595,000 for singles. These numbers will compound again in 2024 as we already know that inflation is still high. An uncomfortable reminder about the thief that is inflation is that these numbers assume an annual investment return of 6%. This means that in the current environment of high inflation, retirement accounts are going backwards in real terms. At this time, you have to save more to stand still, while you are also living in the present with increasing living expenses.

Finally, let's deal with the assumption that organic growth from future contributions and market returns will replace the older accounts with the younger accounts. The mandated contribution level is 11% and will continue increasing by 0.5% every year until it reaches 12% from 1 July 2025. The net total amount in superannuation has been clouded by recent events with COVID impacting savings rates (they were higher due to less consumption) and early access to super (this reduced some balances), however net contribution flows had been stable at around $10 billion per annum prior to that time and have recovered to slightly above this since the COVID period. Total benefits payments have been increasing and have increased from $20 billion to $25 billion per annum from 2018 to 2022. There was a net -3% decrease in total assets from 2021 to 2022 caused by volatility in financial markets.

So, the system is still in net positive contributions with positive inflows being supported by increases up to 12% in the mandated participation rate, we have seen flat to decreasing returns, benefits payments out of the system are increasing, and inflation is going to put pressure on the cost of living. Among all this volatility all we can say with certainty is that there is change happening, and that more monitoring is required to track how the system and regulators respond to the changes that have been identified in this paper.

With almost universal participation in some form of investment through superannuation and over 35% of Australian adults holding investments on an ASX Chess Account, direct and indirect investment in shares in publicly traded companies was a bedrock of the Baby Boomer retirement preparation phase, and it will continue to be the bedrock of wealth management for all the generations that come after it.

Cultural changes

It is important to note that as the Baby Boomers are leaving the workforce, the values and motivations of their generation are also leaving with them. It also follows then that the values of the new Millennial and Gen Z generations are going to ascend. It's a clear generalisation, but no one would be surprised if I said that Boomers expected work environments and those who worked for them to be rigid and hierarchical and social life to be kept separate from work, while Gen Z expects work environments to be fluid and better accommodate their lifestyles and they will blend social and online lives into their work. This alone is a significant cultural change, yet it is added to an environment where the new generations live in an economic world that is far different and more challenging than what the Boomers experienced. Consider the following issues that we can see already.

Baby Boomers exiting the economy creates significant costs for the remaining generations as they stop providing free services such as family-based childcare, and they also require increased medical care. As an example, while accounting for only 21% of the adult population, half of Baby Boomers have a long-term health condition which accounts for 34% of all adults in the population that have a long-term health condition. These are costs that will need to be paid for by the younger generations.

Add to this that the Millennial/Gen Z generations also have far more grim income and financial prospects than those who came before them. A recent Pew Research study found that when asked how children in their country will fare financially when they grow up, a median of 70% of adults across 19 countries (72% in Australia) say they will be worse off than their parents. The recent burst of inflation, plus the focus on stifling wages growth that reduces their purchasing and savings power, could mean that their prospects are even more difficult. The superannuation industry does not escape this change. A 2017 study by the Financial Services Council also found that even though 70% of Millennials had a superannuation account, they are uninterested and unengaged with it.

We have a new generation entering the system that has low expectations of being able to build wealth, strong indicators that suggest that it is indeed true that they have lower economic prospects, and they are also disengaged. This indicates that there will be a considerable cultural shift in how and why the younger generations engage with the wealth management industry, and how the industry attempts to engage with them.

Patrick Salis is the CEO of AUSIEX.

Trusting the process in a high-rate environment

Pete Robinson

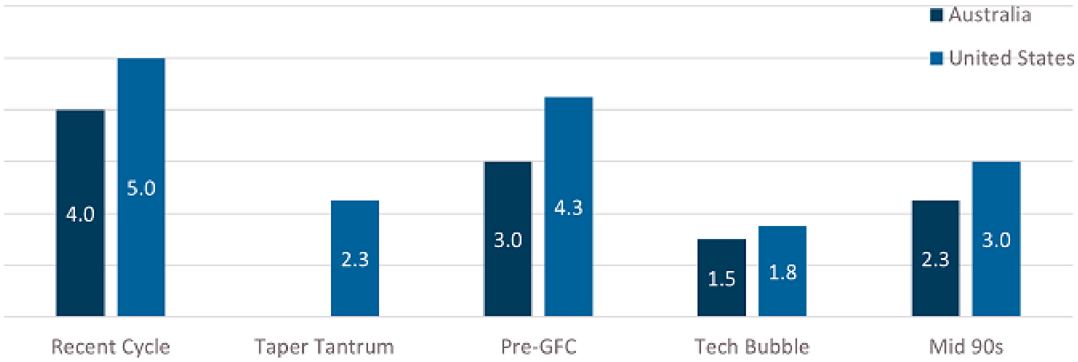
If you follow basketball, as I do, the words "trust the process" have a special meaning. Now a part of the lexicon that has expanded well beyond its origins, it was originally used to describe the approach taken by the Philadelphia 76ers, a basketball team that elected to repeatedly lose to improve their chances to draft the best basketball players coming into the league.

With the RBA's decision to keep interest rates on hold this month, it is "trusting the process" that interest rate increases to date will eventually bring inflation down to the target range of 2-3%.

But its thesis that higher interest rates will eventually weigh on consumers (and house prices) has yet to be borne out. Is the RBA early or is it wrong?

We know the recent increases in interest rates are significant, but the below chart places them in some context. They are the largest in recent history and in the case of Australia, the largest by some margin.

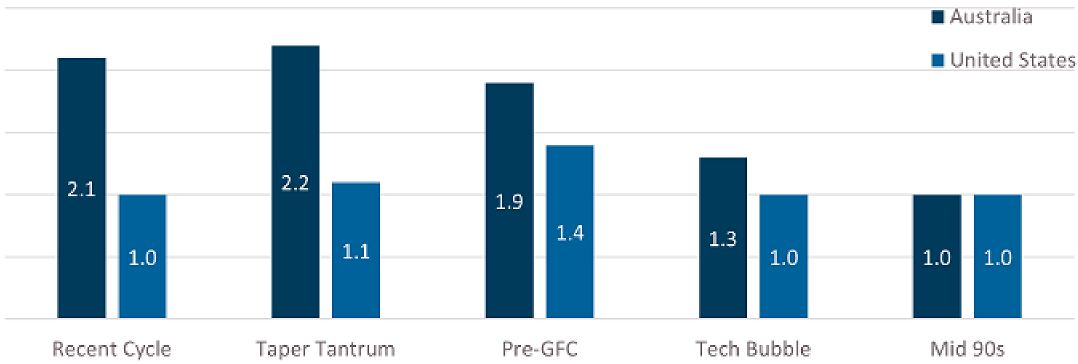
The biggest hiking cycle of the last 30 years – 12-month change in cash rate



Source: Bloomberg

Add to this the overall level of debt. Unlike the US where household debt has declined relative to incomes since the global financial crisis, in Australia household debt is close to the peak (and well above the peak in the US pre-GFC era).

Australia is exposed – household debt to net disposable income



Source: OECD

So, if this is the case, then why are house prices rising and the consumer proving to be so resilient? Is the RBA right to trust the process or is it missing something? Is it early or is it wrong?

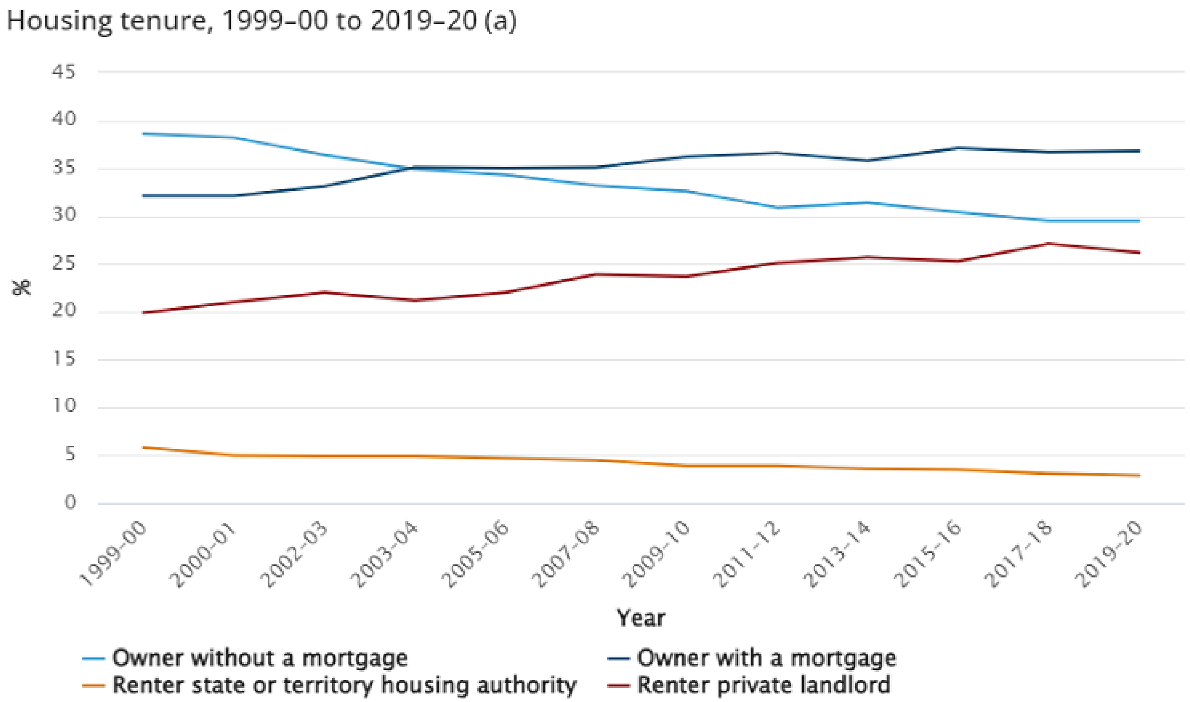
The argument for being early

A possible explanation is there are lags in monetary policy flowing through to the end consumer. This is the case in all scenarios but there are reasons to believe the effect will be more pronounced this time around.

Firstly, the well-documented fixed rate mortgage cliff. According to the RBA, fixed rate mortgages went from around 20% of all mortgages in 2019, to almost 40% at the peak. They are expected to decline to less than 10% over the next 12 months. Fixed rate mortgages delay the transmission of monetary policy.

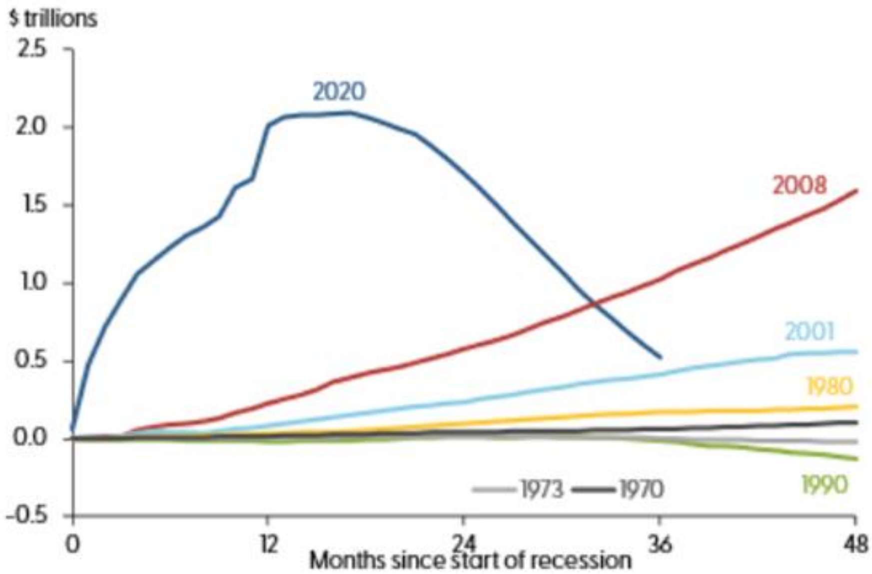
Two, the role of banks. Banks have been aggressively chasing market share and not passing on all of the interest rate increases from the banks. Back in April, the RBA reported that only 250 basis points out of the total of 300 basis points in hikes had been passed on by the banks. It's likely that this 50 basis point differential is not going to increase further from here as banks have indicated that they are pulling back from competition in mortgage markets.

Three, the impact of households who don't have a mortgage and low levels of debt. According to the ABS, around one third of Australian's own their own home without a mortgage. This cohort is faring better under higher interest rates and thus in a position to bid up asset prices. At a point the impact of higher rates on owners with a mortgage (and renters) will offset the impact on those without a mortgage but this inflexion point will be difficult to predict (for us and the RBA).



Lastly, the impact of the excess savings built up during COVID has yet to be drawn down. In May, the Federal Reserve Bank of San Francisco estimated that US$2.1 trillion in excess savings was built up during COVID with US$500 billion in excess savings remaining. As the chart below shows, if the current drawdown of excess savings persists, it will be another 12 months before the excess savings accumulated during 2020 and 2021 are exhausted.

Aggregate excess savings following onset of recessions



Source: Federal Reserve Bank of San Francisco

The argument for being wrong

Despite these arguments for patience, the RBA could be wrong. Here are some reasons why:

Sizeable immigration flows causing scarcity in rental properties and inflation in rents. This has been well publicised and a topic we have explored previously. During COVID vacancy rates declined sharply reaching 1% nationally before climbing slightly to settle at 1.2%. The all-time low was 0.8% in 2006. Pre-COVID vacancy rates were 2-2.5%. To normalise, we would need to see another c. 40,000 properties available immediately plus whatever new stock is required to offset immigration flows.

Despite this figure seeming enormous, 40,000 properties are less than 0.4% of total housing stock. Put another way, an increase of 0.01 people per household would free up an additional 40,000 properties. During COVID average household sizes declined by 0.05 people per home. During recessions average household sizes increase and our view is that cost of living pressures will mean this cycle is no different. Seeing this normalise to pre-COVID levels would be equivalent to an additional 200,000 properties being freed up.

Add to this the 240,000 dwellings still under construction, still close to the all-time high of 243,000. While new housing approvals are falling off a cliff with a bottom yet to be found, there is a significant backlog of yet to be completed projects. An important question for the market is whether these projects will ever be completed and if so, how quickly.

The final point here is immigration flows. Could they overwhelm the trends mentioned above? In 2022 our population grew by close to 500,000 people, the fastest pace since 2008. 75% of the growth came from overseas migration. Most of this appears to be a result of less people departing Australia rather than more people coming. Our interpretation is that this is reflective of temporary visa holders coming back to the country. Even if we assume that this is a "catch up" and not suggestive of permanently higher migration, there are still another 2 years of elevated migration to come, implying that circa 200,000 new households will be created each of the next two years. This exceeds the existing 240,000 dwellings under construction plus c. 120,000 of new dwellings being approved per annum.

In summary, we think the RBA will be watching closely for signs that household sizes will increase as this still seems to be a major swing factor. If they don't increase, it's a sign that households are potentially not feeling enough pressure and interest rates may need to increase further.

What goes up must come down. If interest rate increases are going to put pressure on the consumer, then declines in interest rates should alleviate that pressure. While interest rate futures markets in Australia are pricing another two hikes to a 4.6% cash rate, there are cuts priced immediately thereafter. The front end of the interest rate curve is inverted with the one-year rate 0.35% higher than the three-year rate. The US equivalent is even more pronounced with the one-year rate close to 1% higher than the three-year rate.

Indeed, despite near term expectations of more rate increases to come, longer term interest rates remain below current cash rates suggesting the view that consumers will eventually buckle is consensus. Conversely, the worse things get for the consumer, the more likely that rates will be cut and the pressure valve on consumers released. The key is that expectations that central banks will come to the rescue remains intact. In other words, do we still believe in the central bank put?

Ultimately, it all comes down to the price

Right now, credit spreads are closer to the tights of the trading ranges of the last 12 months. Excluding March of 2020, credit spreads are closer to the tights of the last decade than the wides. This is despite long term risk government bond yields being within 0.50% of the peak level of rates of the last decade, around 3.7% higher than the lows of 2020.

This solidifies our view that there is still a lot more to gain from being patient than we can lose from being wrong.

Like the RBA, we'll continue to trust the process.

Pete Robinson is Head of Investment Strategy – Fixed Income at Challenger Investment Management. This article contains general information only, and does not take into account your investment objectives, financial situation or particular needs.

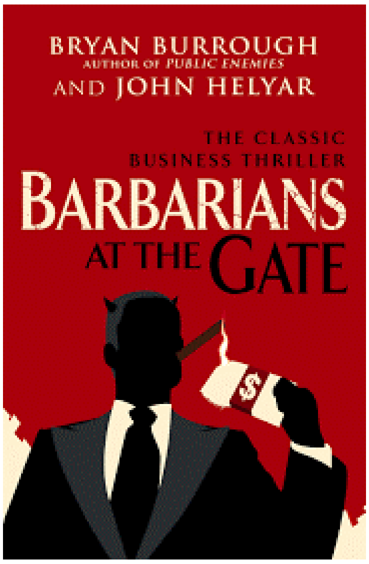
5 reasons to like alternatives giant KKR

Amit Nath

It was a deal that created an industry.

In 1988, KKR launched an audacious takeover of tobacco-and-biscuit maker RJR Nabisco. KKR paid the then ungodly sum of US$25 billion ($64 billion in today's money), making it the largest leveraged buyout in history.

The infamous takeover battle and buyout was the subject of the legendary book, '*Barbarians at the Gate*', which became an HBO movie. KKR went on to become one of the most storied private equity firms in the world.



More than 30 years later, many investors are locked in this narrow, old-world view of KKR as swashbuckling corporate raiders. But KKR's underlying business has significantly changed from those early days of take-private transactions.

The barbarians of buyouts have become the angels of alternatives. KKR is now one of the most dominant alternate asset managers in the world.

The old-world view, however, means many investors are underestimating the vast opportunities in KKR's addressable markets. That addressable market is now measured in the hundreds of *trillions*. Importantly, its shares remain significantly undervalued.

Below, we look at 5 ways KKR is incredibly well positioned for the future and why it represents an incredible investment opportunity for investors seeking superior long-term returns.

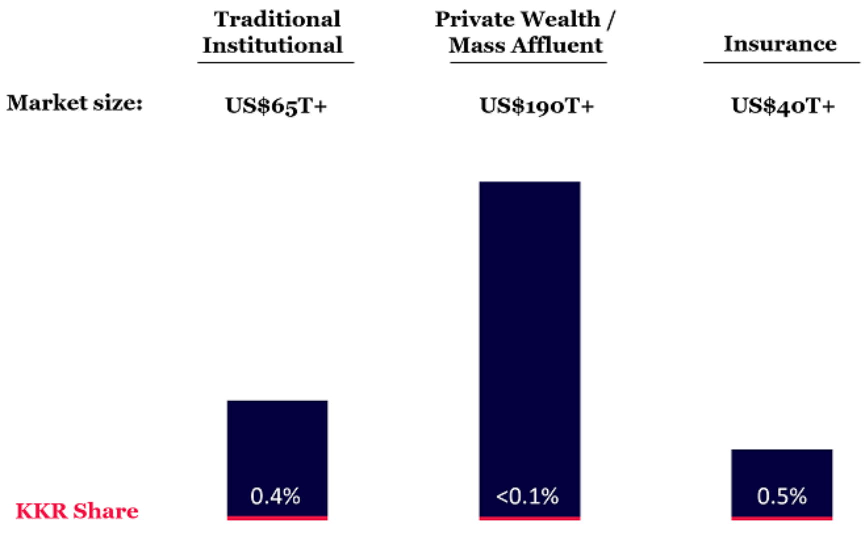
1. KKR is well placed in two enormous, underpenetrated markets

KKR has successfully established itself in an enormous $65 trillion channel that provides private equity investments to big institutional investors, including pensions, endowments, sovereign wealth funds.

But KKR has also been developing reach and product capability that go well beyond institutions.

It can now solve the most complex needs for two huge, emerging capital providers that it has methodically targeted for several years: insurance ($40 trillion) and retail-friendly private wealth ($190 trillion).

Channels have trillions of dollars of addressable opportunity



Source: PwC, Montaka. Note: Chart not drawn to scale.

As you can see in the chart above, despite KKR's seemingly mammoth size (~$500 billion AUM), it has barely scratched the surface of these markets.

And KKR is now equipped better-than-ever to serve them.

In insurance, for example, KKR is delivering fresh investment strategies to solve difficult client needs – leveraging expertise across real estate, infrastructure, credit, public and private equity – to help insurers meet their long-term liabilities.

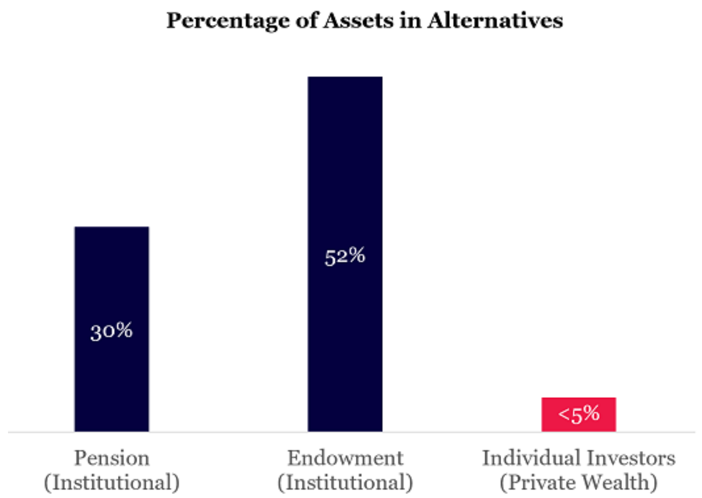
KKR has also created private wealth solutions that have found product-market-fit with nearly $70 billion under management already. The strategy has been centred on creating dedicated sales channels, product platforms and reducing regulatory overheads so its products can be delivered to advisors and their clients in a frictionless manner.

2. KKR's private wealth channel is particularly attractive

In the sophisticated institutional market (pensions/endowments) investors have allocated 30-50% of their portfolios to alternate asset management strategies. Private wealth (individual investors), however, has allocated just 5% to alternatives. There is enormous scope for that to rise.

With lower regulatory hurdles and rapid product development, some $10 trillion of assets are expected to migrate from private wealth into the alternate asset space in the medium term (through 2025). That is a staggering 20x the total assets KKR manages today.

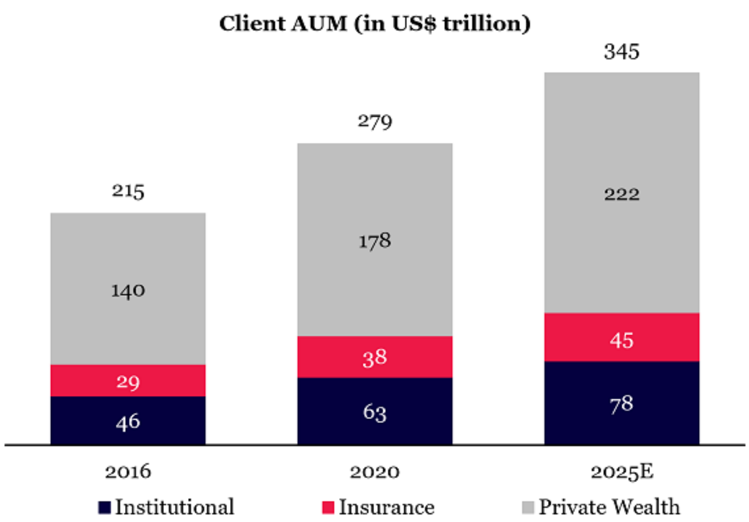
Significant opportunity to expand penetration across major capital pools



Source: KKR, Montaka.

While these numbers are huge, they barely scrape the surface of the ultimate long-term potential in private wealth. The private wealth market is almost three times the size of the institutional market and measured in the hundreds of trillions (with a "T").

Client assets are increasingly expected to flow towards alternate asset managers



Source: PwC, Blue Owl, Montaka.

The tidal wave of growing private wealth allocations to alternatives will be disproportionately captured by a handful of the world's leading 'brands' in the alternate asset space.

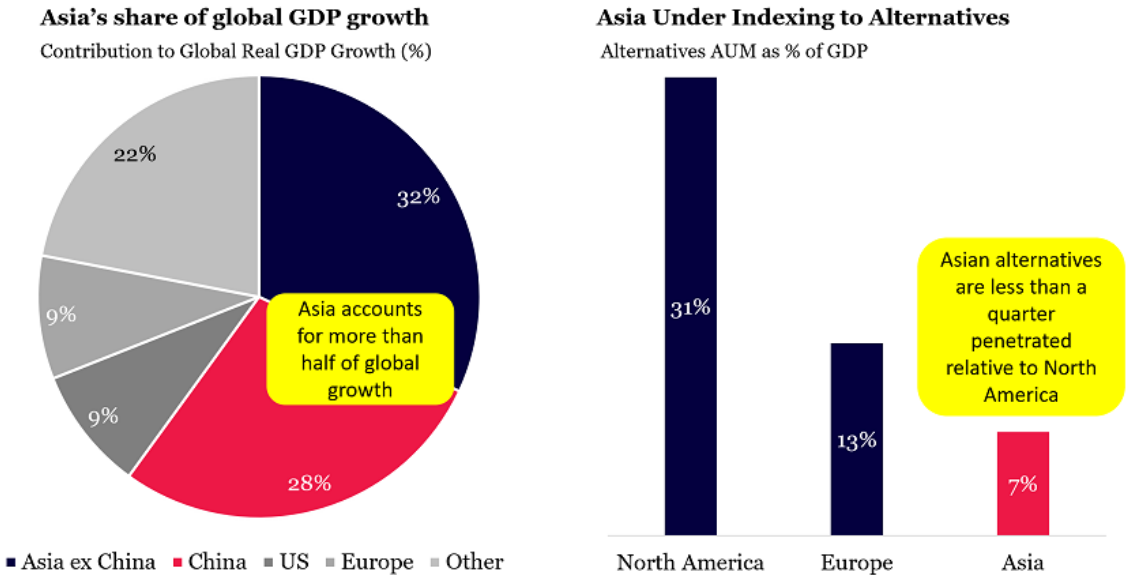
KKR sits at the top of that list (along with Blackstone and a couple of others). Private wealth only accounts for around 15% of KKR's new asset flows. But KKR has indicated that will increase towards 50% over time.

3. Asian business is an underappreciated competitive advantage

KKR is the clear leader in alternatives across Asia, with assets under management tripling in the region since 2019 (well ahead of peers). In fact, KKR believes its Asian business will reach size of its core North American franchise. Given North America represents 60% of AUM today versus APAC at 20%, that means KKR is anticipating another tripling for Asia. This extraordinary growth is not broadly appreciated.

Asia is particularly attractive because it represents an outsized share of global growth and is benefiting from structurally increasing levels of wealth in the region. Asia also has alternate asset penetration of just one-quarter of North America. By leading the market in Asia, KKR has another opportunity to fill a massive market need.

Asia is a major global growth driver with a significant unmet need for alternatives



Source: KKR, Montaka.

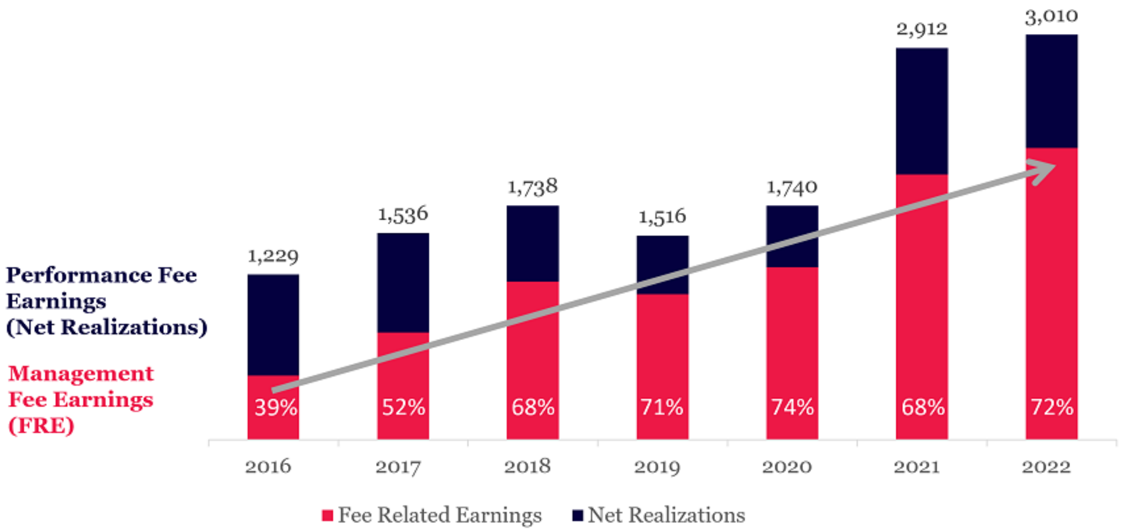
4. KKR has built smoother and more consistent earnings streams

One of KKR's most significant structural shifts has been lessening reliance on episodic 'take-private' transactions – where it buys and delists a public company with the intention of relisting it at a profit in the future and taking a performance fee for the service. KKR's earnings mix and revenue is now much more tilted towards predictable and consistent asset management fee streams, rather than lumpy private equity entry-and-exit fees.

A good example is KKR's 'perpetual' (aka 'permanent') capital vehicles, which deliver customers durable, attractive and consistent yields. KKR builds these strategies on a foundation of long-duration, cash-generative, privileged underlying assets (real estate, infrastructure, credit, etc).

Investors pay KKR management and performance fees on a recurring, contracted schedule. Unlike traditional private equity deals, KKR doesn't have to sell assets with perpetual capital strategies. They high-grade the quality of KKR earnings and smooth them out. Over time, the market will assign a premium valuation to these enduring, subscription-style earnings.

Major shift toward more stable and predictable earnings streams



Source: KKR, Montaka.

As you can see in the chart above, KKR has significantly increased the proportion of fees that do not require the sale of assets … from around two-fifths to nearly three-quarters of the mix.

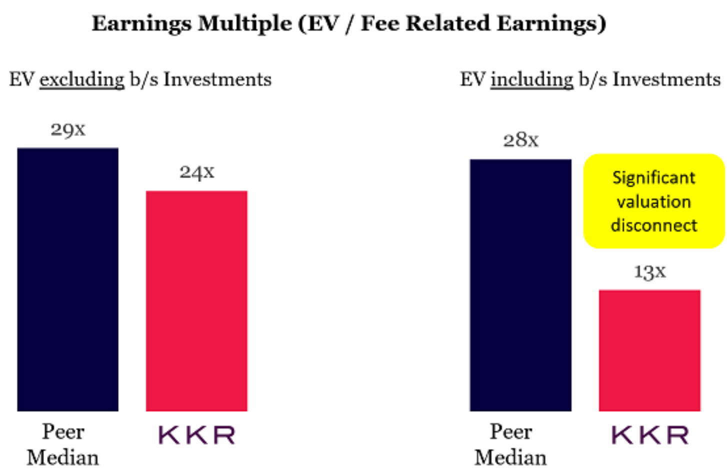
5. Its stock is undervalued

There is a significant disconnect between the market's price and KKR's value. Despite being in the top 5% of alternate asset managers on earth, it trades as though it is well below average (at a discount to its peer group).

Most of KKR's peers do not significantly invest in their own funds alongside their investors. KKR is unique in this regard. It has over $25 billion worth of equity investments on its balance sheet, which is 10-20 times as much as its peers. These balance sheet investments can be thought of as an illiquid form of compounding cash. However, the market prices them at zero.

If KKR's balance sheet investments were valued like cash, its earnings multiple would be less than half that of its peer group. If it were to trade in line with its peers on this basis, the stock would increase by ~50-100% overnight!

KKR is significantly undervalued by the market



Source: KKR, company filings, Montaka. Peers include Blackstone, Brookfield, TPG and Ares. Fee Related Earnings are net of SBC and based on consensus / Montaka estimates.

A window of opportunity

KKR may be thought of as a bullet train that has just begun picking up speed. It started out moving slowly then steadily, but momentum is about to flip and rapidly propel the business forward.

From the enormous opportunity to further penetrate massive new markets like insurance and private wealth, leverage its scale advantage in highly attractive Asia, or the potential for a valuation re-rating with smoother earnings streams or multiple expansion, the future is full of extraordinary opportunities for KKR.

With the stock undervalued, investors have a window of opportunity. They should embrace this multi-decade, secular growth story and get their tickets aboard the train before the market fully grasps – and prices in – what is going on beneath the surface of this incredible business.

Source: Bloomberg, Montaka.

Amit Nath is a Senior Research Analyst at Montaka Global Investments, a sponsor of Firstlinks. This article is general information and is based on an understanding of current legislation. Montaka owns shares in Alibaba and Meta Platforms.

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Podcast: Peter Thornhill on building income for life

Firstlinks

Season 2, Episode 3

In this week's episode, author and speaker, Peter Thornhill, is our special guest, and he'll discuss his secrets to beating the market, including owning high quality industrials and LICs, and holding them forever. Firstlinks' Graham Hand addresses the question of why ETFs receive blanket media coverage when they're small fry compared with managed funds, and Morningstar's Peter Warnes, will give his latest outlook for our economy and market.

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Grab a cuppa and settle in for our chat.

Can quantitative tightening help tame inflation?

Tony Dillon

The parallels between today's inflation and the inflationary period of the 1970s are stark.

Australia's inflation-stricken period of today was largely brought about by a rapid increase in the money-supply, in tandem with significant government spending to combat Covid.

In many respects, it mirrors the massive fiscal spending in the mid-70s which occurred at a time when loose monetary policy was stoking inflation.

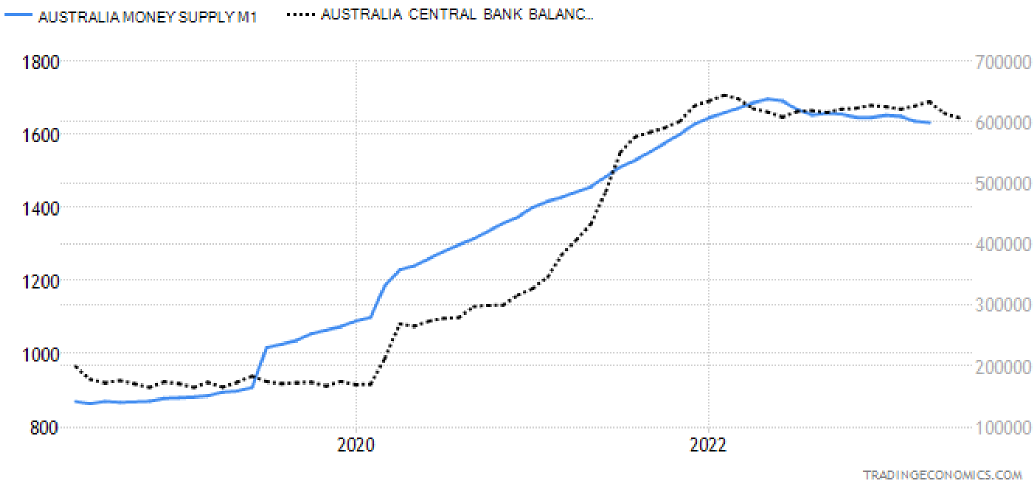
Similarly, the so-called Great Inflation period during the 1970s in the US was spurred by expansionary monetary policies pursuing full employment, at a time of profligate government spending on the Vietnam war and social policies.

The Great Inflation only began to retreat when Paul Volcker became the Fed chief in 1979, and commenced aggressive monetary policy tightening by raising interest rates and curbing the money supply.

Money supply remains elevated

Today the response to inflation in advanced economies has seen rapid interest rate rises, but the money supply thus far has remained elevated by pre-Covid standards, particularly here in Australia, where the M1 money supply measure sat at $1,632 billion at the end of April, up more than 50% on pre-pandemic levels (see chart).

The increased money supply coincided with the RBA's Quantitative Easing (QE) program which saw it accumulate some $330 billion of Australian government and semi-government bonds, expanding its balance sheet in the process (again, see chart). So would not reversing that QE, known as Quantitative Tightening (QT), have the opposite effect in sucking money out of the system and subduing inflationary pressures?



QE recall involves the RBA purchasing longer-term government bonds to increase bank reserves and encourage lending, which in turn increases the money supply. QE therefore aims to lower borrowing costs and stimulate investment, a consequence of which could be higher inflation.

Quantitative tightening

The exact reversal of QE is known as *active* QT. This occurs when the central bank sells its balance sheet assets back into the secondary market before they mature, reducing its balance sheet rapidly, and taking base money out of the system.

Instead the RBA has chosen to implement *passive* QT, whereby it allows its bond holdings to mature over time and to not reinvest the proceeds. In this way, the central bank balance sheet contracts more slowly.

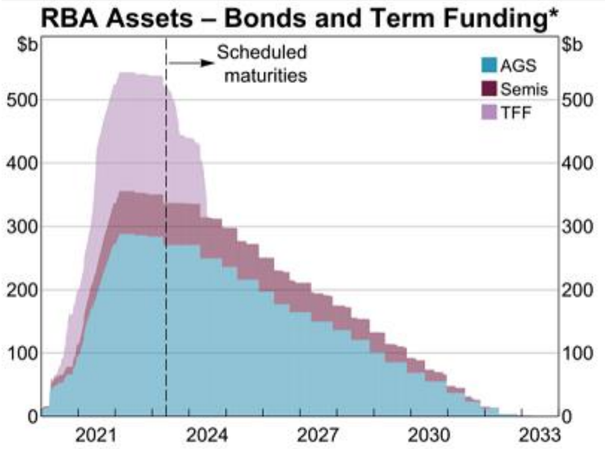
Specifically, when government bonds held by the central bank mature, deposits held at the central bank by Treasury fall by the same amount to *pay* for the maturity. Treasury issues new debt to the market to replace its central bank deposits, and banks buy the securities reducing their reserves held as liabilities by the central bank. The central bank balance sheet therefore contracts by the amount of debt maturing, and the reversal of QE is complete.

The RBA said in its May board minutes that it had reviewed its "approach to reducing its holdings of government bonds". And that "the strategy was to hold these bonds until maturity rather than selling them prior to that". Members agreed that that approach "remained appropriate for the time being".

This passive approach recognised that the RBA balance sheet was "already set to decline rapidly given the maturity of funding under the Term Funding Facility" (TFF). But it did not rule out actively offloading its bond holdings in the future, agreeing that "it was appropriate to review the current approach periodically".

The TFF was basically low-cost funding the RBA offered to banks, fixed for three years, enabling them to on-lend that money at record low interest rates. About $190 billion was drawn down by the time the facility closed in June 2021. It basically complemented the QE program.

Here is a chart showing the projected decline in the RBA balance sheet. Note that it doesn't return to pre-Covid levels until after 2030. Time will tell whether passive QT will draw money out of the economy fast enough to help stifle inflation.



* Face value of outright holdings of AGS and semis.
Source: RBA.

Other RBA tools to fight inflation

While inflation is proving to be stubborn, draining money out of the system with bond holdings maturing and TFF loans being clawed back, along with the rapid interest rate increases to date, should have the desired effect eventually. And if it needs to kick up a gear, the RBA has even more deflationary levers at its disposal.

It could mandate that banks hold increased reserves, thereby reducing lending, which can restrict spending and investment, dampening inflation.

In a similar vein, it could influence stricter lending standards, preventing excessive lending and reducing inflationary pressures.

Forward guidance. In much the same way the RBA influenced aggressive bank lending by verbally communicating that interest rates were likely to stay near zero until at least 2024, it could put that practice in reverse to influence expectations and put downward pressure on inflation.

It could intervene in currency markets. All else being equal, a stronger currency could weaken export competitiveness, lowering export demand and possibly inflation.

The extent to which the RBA employs these tools, if at all, can vary depending on economic conditions, bearing in mind that it must promote overall economic stability. Meanwhile, the interest rate lever will remain the headline act until such time that the inflation beast has been tamed.

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