Edition 518, 21 July 2023

Contents

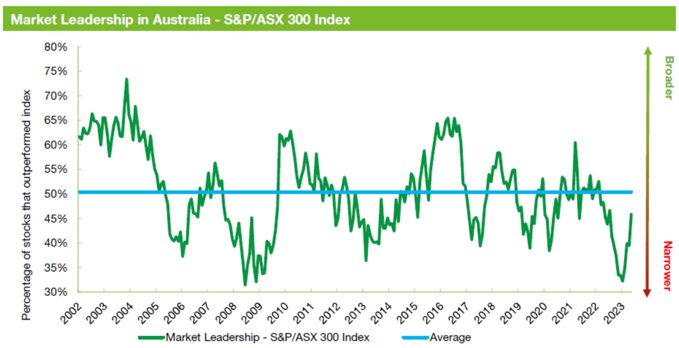
Editorial

There's been a lot of talk about how the 'Magnificent Seven' stocks (Apple, Microsoft, Nvidia, Alphabet, Amazon, Tesla, Meta) in the US have driven most of the market's gains year-to-date. These stocks contributed 73% of the first half rise in the S&P 500.

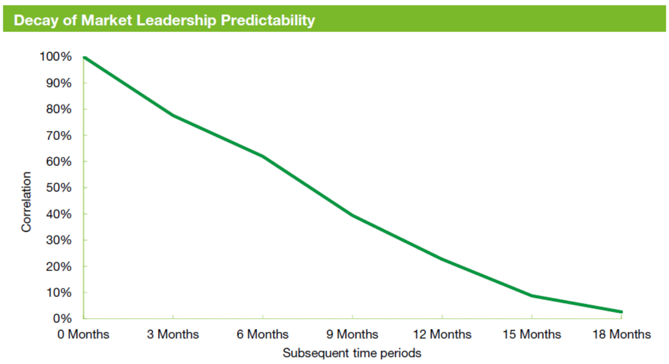
Yet a new report suggests that this phenomenon hasn't just been limited to America. In Australia too, so-called market leadership narrowed over the past 12 months. Despite the S&P/ASX 300's positive return in the year to June, 55% of stocks decreased in value.

As the first chart from Zenith Investment Partners shows, market leadership declined during the year to levels last seen during the GFC. A silver lining is that it's partially recovered from these extreme levels.

The good news for fund managers and individual investors is that market leadership usually mean reverts within 12-18 months (second chart). Put simply, a broader range of stocks is likely to participate in market gains or losses in future.



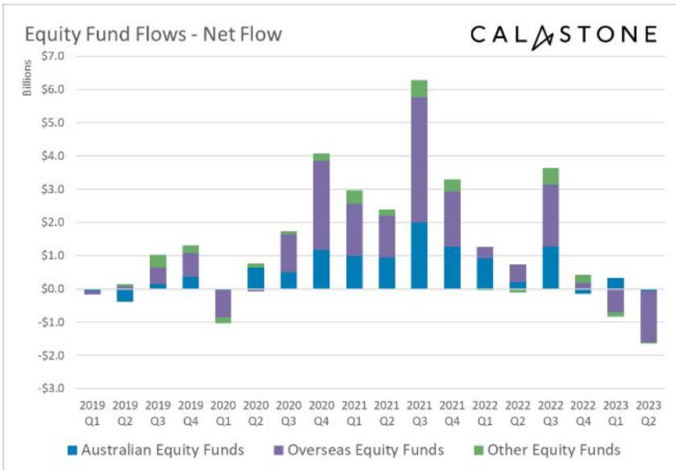
Source: Bloomberg



Source: Bloomberg, Zenith Investment Partners

Many investors aren't waiting to find out though. In the second quarter of this year, they bailed on equities in favour of fixed interest and cash.

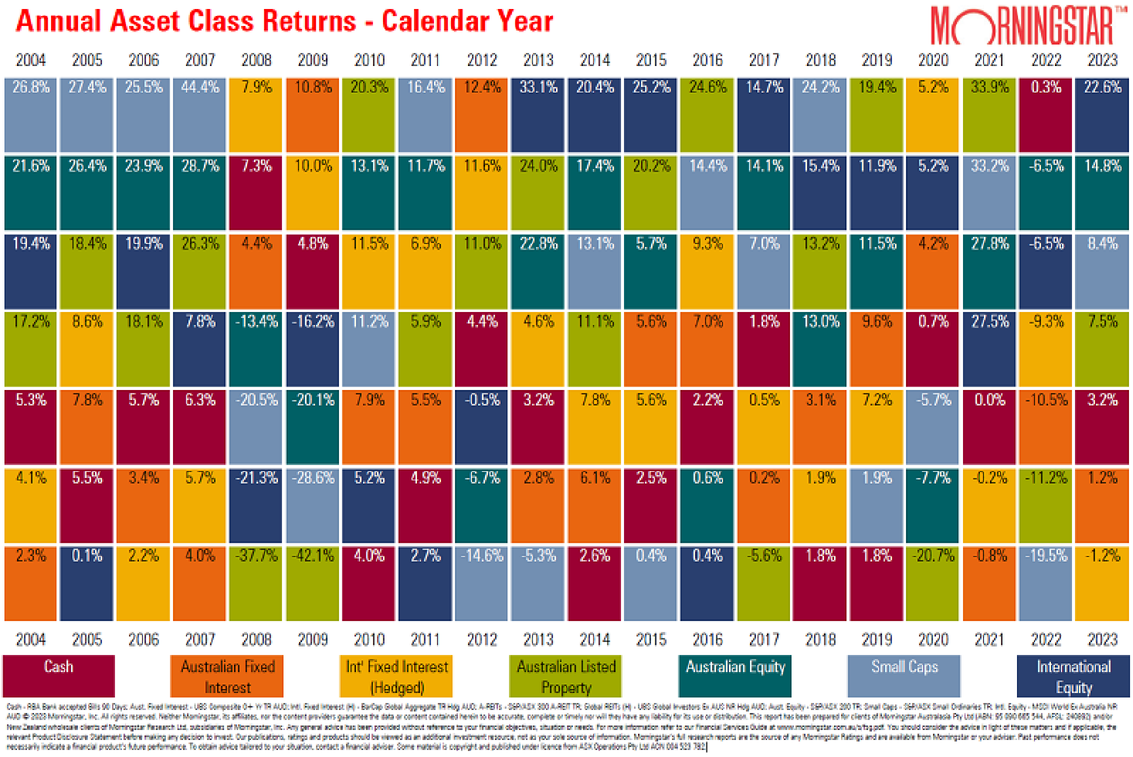
Net outflows from managed equity funds totalled $1.65 billion from April to June, according to figures from Calastone.



As the chart shows though, international equity funds bore the brunt of the outflows. Australian equity funds saw a net outflow of just $59 million.

The big winner was fixed interest which saw net inflows of $582 billion in the second quarter. It seems investors are attracted to the higher yields on offer from both bonds and cash.

The flow data is ironic given that investors normally chase performance. And as Morningstar's new Asset Class Gameboard shows, equities significantly outperformed other asset classes in the first half of 2023.



Note that the figures are to June 30, 2023, and international returns are hedged into Australian dollars.

The gameboard does a good job of highlighting the winners and laggards from seven major asset classes for each year over the past two decades. And it also shows how difficult it is to pick future winners. For instance, who would have thought that equities would come roaring back this year after the hiding they got in 2022?

Gameboard lessons

While the Gameboard won’t help identify future winners, it can provide some useful lessons for investors, including:

- Cash is gradually becoming more useful. Interest rates above zero will do that. Cash was at the top of the class in 2022 and though it slid in the first half of this year, the 3.2% year-to-date return is the highest return on this asset since 2013.
- Fixed interest has had a poor two-and-a-half years. While it’s stopped the hemorrhaging of last year, it hasn’t bounced as much as some would have hoped. Given the steep hike in rates, perhaps the second half of this year may see a change in fortunes. Many of the investors highlighted in Calastone's data will be hoping so.

- International equities have had a stellar decade. It's again the best performing asset class this year. Surprisingly, Europe and Japan have been strong performers, benefiting partly from a declining US dollar.
- Australian small caps have been all over the shop over the past decade. The key trend has been that they've underperformed large caps by a wide margin. In theory, small caps should offer higher long-term returns than large caps to compensate investors for the risks of investing in them. Yet that hasn't proven the case in Australia for a long time. A contrarian bet, perhaps?
- Australian equities have been strong, consistent performers over the past five years. Yes, they significantly lagged international equities in the first half, though given headwinds from China, commodities, and bank margins/costs, the result should be more than satisfactory to investors.
- Australian listed property surprised your author, being the fourth best performing asset class in 2023. The bounce in house prices has obviously helped developers such as Stockland and Mirvac. It's worthwhile noting how volatile this asset class has been since 2015, moving from bottom to top and bottom again on a regular basis. I imagine many investors see listed property as a steady asset, but the Gameboard shows it's anything but.

From 2004, the average annual return of each asset class is tabled below, from best to worst.

Annual asset class returns 2004-2023	**Average**	**Best**	**Worst**
Australian equity	9.00%	28.70%	-20.10%
International equity	8.40%	33.10%	-21.30%
Australian small caps	6.30%	44.40%	-28.60%
Australian listed property	5.30%	33.90%	-42.10%
International fixed interest (hedged)	4.90%	11.60%	-9.30%
Australian fixed interest	4.20%	12.40%	-10.50%
Cash	3.40%	7.30%	0.00%

As you'd expect, equities come out on top over the long-term, albeit with greater volatility. It does make me wonder why so many Australians have their super in a default balanced fund given the underperformance of bonds and cash over long periods. Surely volatility is less of a concern if super is being held for 10, 20 or 40 years?

UniSuper investment boss, **John Pearce**, may disagree with me. His balanced fund delivered a 10.34% return to beat all other mega funds over the year to June. I report on a recent update that Pearce gave to UniSuper members where he said that unlike most other superannuation funds, UniSuper hadn't piled into unlisted assets in recent years. And as a result, it's got extra cash on hand to take advantage of opportunities opening up from current market volatility.

James Gruber

Also in this week's edition ...

Firstlinks welcomes **Clime Investment Management's John Abernethy** to the newsletter. John and his colleagues will contribute a regular column. John has 40+ years experience in markets and brings broad expertise across asset allocation, macroeconomics, financial advice, and equity markets. This week, in his first article, John suggests that the RBA isn't independent of Government and explains why that's actually a good thing.

Meg Heffron is back, this time addressing the thorny issue of whether you should bring your children into your SMSF. Meg conveys her personal story on the subject, and how she weighed the pros and cons of her decision. She hopes her story can help Firstlinks readers make their own call on the issue.

Van Eck's Jamie Hannah thinks the US is in the last stage of the economic cycle with a recession likely by the end of 2023. If right, he names five assets that can potentially shield investors from any downturn that takes place.

Graham Hand returns with part 2 of his report on famed investor **Howard Mark's** recent chat with MBA students. In part 1, Marks expressed scepticism toward macroeconomic forecasts, though this week he qualifies that. He also looks at how he balances aggressive and defensive investing. And Marks reveals how his investment portfolio is positioned now.

Who will emerge as the largest multinationals in the decades to come? **John Stavliotis** from **Antipodes** attempts to answer this fascinating question. Surprisingly, he doesn't think the future global powerhouses will come from the developed world.

Global asset owners have historically allocated capital to two distinct equity asset classes: global large cap and/or global small cap. **Nicholas Paul** from **MFS** believes there's a good argument for a small-mid-cap fund to be part of investor portfolios.

Finally, we normally feature a whitepaper in our newsletter though we've decided to mix things up this week. We've instead included a new 'Demystifying Debt' video series of ten short clips from **Metrics Credit Partners** seeking to debunk common myths about investing in private debt. Enjoy.

Curated by James Gruber and Leisa Bell

UniSuper's CIO on why liquidity is king right now

James Gruber

UniSuper is a $115 billion behemoth so when its Chief Investment Officer John Pearce speaks, people listen. In a recent update to members, Pearce admits high-flying US tech stocks helped him deliver a 10.34% return for UniSuper's balanced fund in the year to June 30. Yet, he's cautious, holding elevated levels of cash to take advantage of opportunities from what's likely to be a volatile period ahead.

From bust to boom

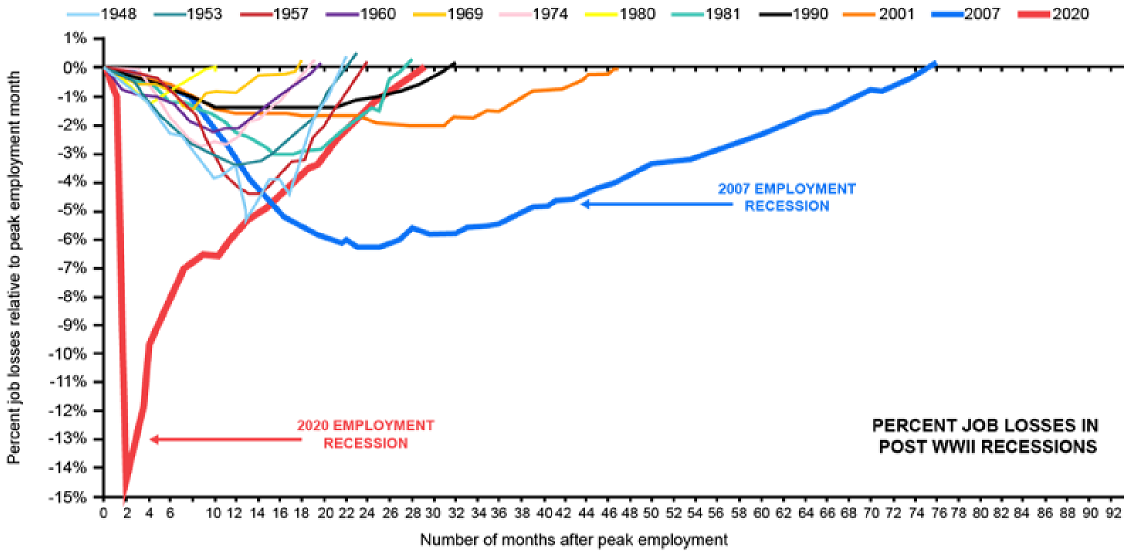
Pearce says what the world has gone through since COVID has been extraordinary:

"That global crisis from a financial markets perspective, it's unleashed an economic and financial cycle the magnitude and speed the likes of which we have never seen before."

He says the Global Financial Crisis (GFC) of 2008 was the largest financial crisis in a century. During the GFC, US unemployment hit close to 6%, and it took 7-8 years for the labor market to recover.

During COVID, US unemployment rose to around 15%. Yet, remarkably, it only took two-and-a-half years for the labor market to fully recover. In absolute numbers, 22 million Americans lost their jobs within a few months of COVID, and all those jobs have since been regained.

US Jobs: V-shaped bust to boom



Source: UniSuper

Pearce says the US job market is extremely tight. There are close to two job vacancies for every job applicant. There are three million excess retirees – that is, the number of retirees above expected trends.

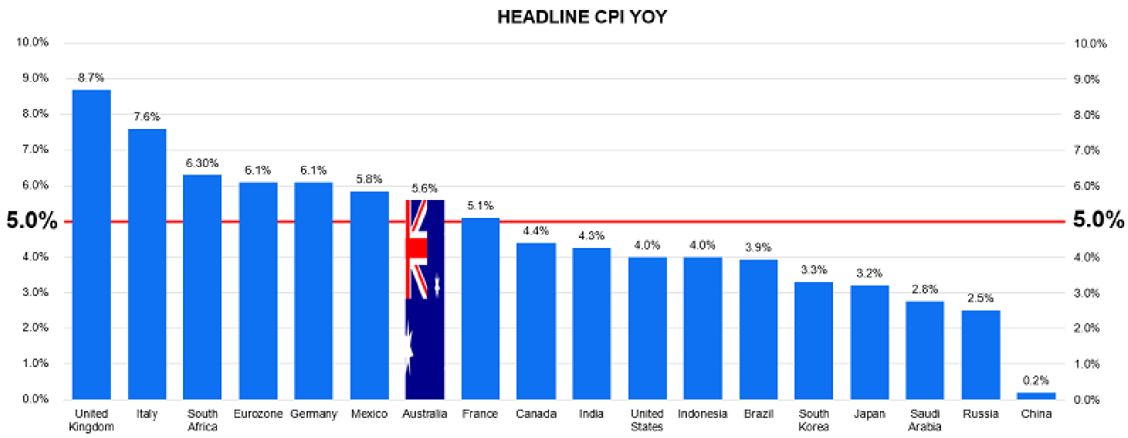
Given this labor market tightness, and the extraordinary levels of government stimulus and cheap money from near zero interest rates during COVID, it’s hardly surprising that inflation has reared its head.

Inflation is nearly everywhere

Pearce says most developed markets target 2-3% inflation, yet inflation remains above 5% in many of these markets. He thinks inflation is almost everywhere and is way too high.

One fascinating thing is that the inflation problem is principally in developed markets, rather than developing markets. Pearce says there’s a simple explanation for that:

“The developing countries did not attack the problem [COVID] the way the developed countries did, they did not stimulate their economies anywhere near as much.”



Source: UniSuper

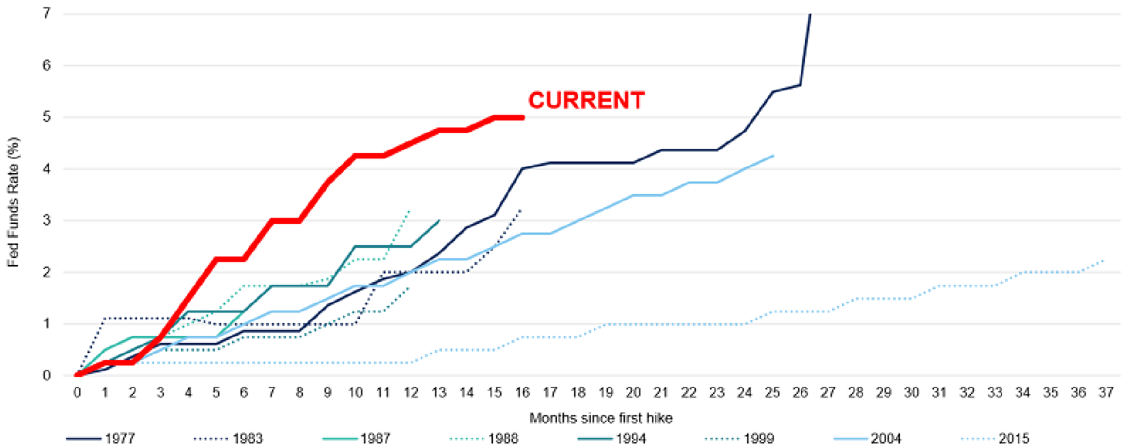
China has the opposite problem to the West: it has an oversupply of labor and housing, among other things. That’s why it’s grappling with a deflation issue.

When the Fed tightens, it can get nasty

There’s the old saying that when the US Federal Reserve tightens monetary policy (hikes interest rates), something always breaks.

Pearce says that this time, we’ve had the fastest Fed tightening cycle to combat inflation in almost five decades.

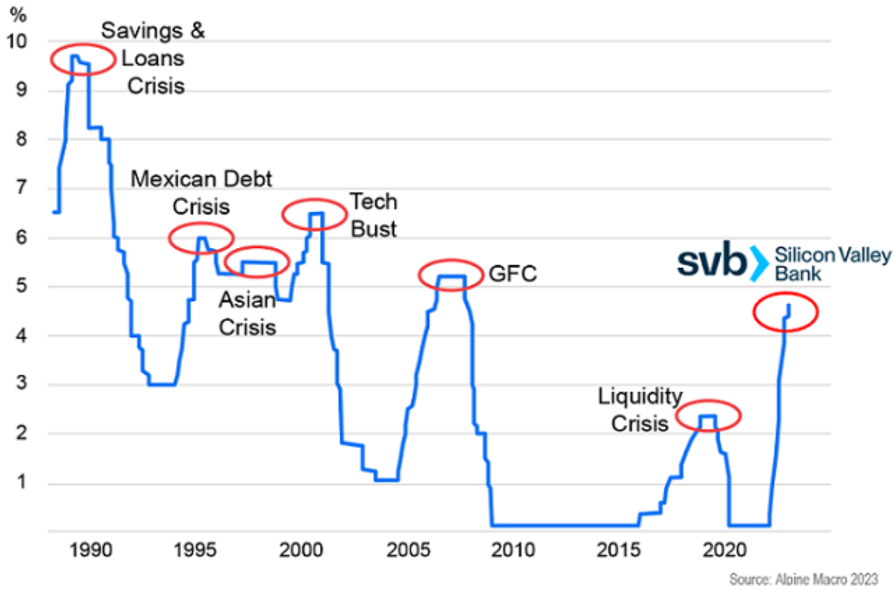
Fastest rate hikes in more than 40 years



Source: UniSuper

Something has broken: regional banks in the US. Pearce says it’s rare that problems like these are solved quickly, though he’s not sure how they may play out.

When the Fed tightens, something breaks



Central bankers channeling Paul Volcker

Pearce says the big question for markets is whether the Fed can engineer a soft or a hard economic landing. A soft landing is bringing down inflation without crashing the economy.

Pearce admits he's turned more cynical these days. And because of this, he thinks central bankers like Fed Chairman Jerome Powell aren't just looking at engineering a soft landing:

"I think they've got one eye on the economy, and I think they've got another eye on their legacy."

Pearce says that if you type into Google search: who is the greatest central banker in US history and who is the worst central banker, the results are definite. The best is Paul Volcker, and the worst is Arthur Burns.

Paul Volcker is a hero to many central bankers. What did he do? He broke inflation in the early 1980s by increasing interest rates to over 20%. The consequences were devastating for Americans in the short-term. The unemployment rate went from 6% to 11%. One in 10 people lost their jobs. Jobs lost, careers ruined, and perhaps many lives destroyed.

Despite this high price, Paul Volcker is known as the greatest banker in US history. That's primarily because he put the US economy back on track after inflation wreaked havoc.

Turning to the worst central banker, Arthur Burns, it was he who failed to stem inflation during the 1970s. Burns is regarded as a Richard Nixon puppet who kept rates too low and let inflation get out of control.

Pearce says it's no wonder that central bankers fear inflation so much. And that they want to emulate Paul Volcker. Because of this, the odds are that central banks are likely to keep rates higher for longer.

Why UniSuper is holding elevated levels of cash

Given this view, Pearce thinks more market volatility is coming:

"I think for the next six months, we could see more volatility. And that is the reason why we are actually holding elevated levels of cash at the moment. And bear in mind, we're getting a pretty good return on cash these days. So the opportunity cost of holding elevated levels of cash is not as high."

Pearce notes that UniSuper holds more cash and less unlisted assets than most other super funds. He says he's lived through many market cycles and each one is different. Yet, if there's one thing that he's learned, it's that liquidity is king:

"If you've got enough liquidity to see you through, right to the other side, not only do you survive for another day; you've got liquidity to take advantage of opportunities."

This is telling given the controversy over super fund holdings of unlisted assets and the valuations of these illiquid assets. It should be noted that at the end of the last year, UniSuper held the lowest level of unlisted assets among the large industry funds (13% of its Balanced option versus 34% for Australian Retirement Trust's Lifecycle Balanced Pool and 31% for AustralianSuper's Balanced Option).

Super fund options by asset class, investment type, and management type

			Fund Name and Option Name									
			Australian Retirement Trust - Lifecycle Balanced Pool		AustralianSuper - Balanced Option		Aware Super Balanced Growth Option		CBUS Growth Accumulation Option		UniSuper Balanced Option	
Asset Class	Investment Type	Management Type	$ (m)	%	$ (m)	%	$ (m)	%	$ (m)	%	$ (m)	%
Cash			3,769	8%	8,718	5%	1,253	5%	4,082	7%	3,488	9%
Fixed Income	All Assets	Externally Managed	5,301	11%	16,138	9%	3,200	13%	7,795	13%	1,592	4%
		Internally Managed	-	0%	11,730	6%	460	2%	976	2%	5,273	14%
Private Debt	*Unlisted*				*5,894*	*3%*	*334*	*1%*				
Equity	Listed		22,542	46%	85,585	47%	12,955	52%	27,934	47%	17,800	48%
Property	Listed		862	2%	2,044	1%	514	2%	1,438	2%	1,582	4%
Infrastructure	Listed		0	0%	1,253	1%	189	1%	132	0%	2,670	7%
Alternatives	Listed		3	0%	5	0%	1	0%	-	0%	0	0%
Alternatives	Unlisted	Externally Managed	2,670	5%	552	0%	269	1%	286	0%	-	0%
Alternatives	Unlisted	Internally Managed	-	0%	243	0%	13	0%	2	0%	-	0%
Equity	Unlisted	Externally Managed	3,789	8%	9,170	5%	1,538	6%	898	2%	448	1%
Equity	Unlisted	Internally Managed	-	0%	855	0%	27	0%	263	0%	476	1%
Infrastructure	Unlisted	Externally Managed	5,635	12%	14,463	8%	1,470	6%	7,491	13%	268	1%
Infrastructure	Unlisted	Internally Managed	243	1%	14,160	8%	1,313	5%	824	1%	2,049	5%
Property	Unlisted	Externally Managed	4,280	9%	5,089	3%	1,152	5%	2,816	5%	979	3%
Property	Unlisted	Internally Managed	-	0%	4,895	3%	334	1%	3,789	6%	739	2%
Total			$ 49,096		$ 180,794		$ 25,023		$ 58,726		$ 37,366	
Total - Unlisted	Unlisted		$ 16,617	34%	$ 55,321	31%	$ 6,452	26%	$ 16,368	28%	$ 4,959	13%

Source: Portfolio holdings data disclosed on fund websites as of Dec. 31, 2022. [Click to enlarge] courtesy of Morningstar's Annika Bradley

Latest opportunities

Pearce says while UniSuper holds more cash than usual, that doesn't mean it's being inactive. Higher interest rates are resulting in less competition for deals and better priced opportunities. Recently, UniSuper has invested in plantation timber and $1 billion in European mobile towers.

UniSuper has also bought subordinated bonds in the major Australian banks. About a month ago, it purchased $500 million of Westpac 10-year subordinated bonds at a 6.95% rate. Pearce reckons a few years ago, the rate for same Westpac bond would have been 1.2-1.3%.

James Gruber is an Assistant Editor for Firstlinks and Morningstar.com.au.

UniSuper's holdings are at 30 June 2023. Holdings are subject to change without notice. Please note that past performance is not a reliable indicator of future performance. The information above is of a general nature and may include general advice. It doesn't take into account your personal financial situation, needs or objectives. Comments on the companies mentioned aren't intended as a recommendation of those companies for inclusion in personal portfolios.

Clime time: the RBA isn't independent nor should it be

John Abernethy

Confronted by news headlines about the inflation challenge and the battle to bring it under control, reasonable Australians may question both the logic of the proposed monetary policy settings of the RBA and the benign response of the Commonwealth Government.

The rhetoric in the RBA policy suggests that it intends to push interest rates higher and move our economy to the brink, but not into a recession. If only we could believe them!

Meanwhile we observe a complete lack of any counter inflation initiative from the Government. They have wasted a budget bounty (significantly higher than $4.3 billion) created from record export trading. This bounty amounted to a $40 billion budget turnaround in just six months, and it should have rightly been shared with low-income earners with the added benefit of being a counter inflationary policy. It now seems that the budget turnaround caught both Treasury and the Government by surprise and resulted in fiscal policy that is completely wrongly positioned to pull down inflation.

Do we need higher rates?

Australians can rightfully ask as to why, under RBA direction, should interest rates be pushed higher. This inflation fighting policy will have no real influence, given electricity prices (a driver of inflation) are set to rise by more than 20% from 1 July before falling in 2024? Further, what will rising interest rates do to lower the price of oil (petrol) when the supply of that essential commodity is manipulated by an international cartel supporting Russia in its war on Ukraine? Then, more crucially, how can higher interest rates lower the cost of rent when higher rates push up the cost of servicing mortgages of geared landlords?

RBA cash rate

Source: RBA

The dogma of "economic group think" are easy to observe by everyone other than economists and bureaucrats. The dogma of economic theory drives thoughtless economic policy settings that belie common sense that suggests that the Government's fight against inflation should have begun by slowing both wage and price rises. For instance, a calibrated tax adjustment for lower wage earners would have slowed wage push inflation and maintained employment. It will have appropriately checked the RBA's policy aimed to create job losses. Wage increases outside productivity improvements, would therefore be directly influenced by Government income taxation adjustments.

A better solution

Given the extraordinary Commonwealth budget surplus to be reported for FY23, it is an absolute travesty that the Government did not move quickly to lower the tax rates for low-income earners. If they had then the Fair Work Commission having reviewed this and on the advocacy of the Commonwealth, could have held wages and throttled the likely broader wages push that will no doubt follow. A focused tax cut could have given more money into the hands of low-income workers than the Fair Work decision.

This observation leads me to observe that politicians, bureaucrats, and the ACTU do not understand that take home pay (after tax cashflow) is more important than pre-tax wage increases to an aged care worker, a healthcare worker, a childcare worker, a cleaner or a low-income service provider? Further, the RBA and Treasury do not understand that a recession will increase a fiscal deficit as payments rise with unemployment and tax collections fall. The movement into a fiscal deficit, in reaction to an economic downturn, is not theory – it is a fact. Therefore, protecting a short-term deficit independent of a strategic economic policy setting is hopeless.

In my view a managed economic downturn by the RBA, in the hope of pushing inflation down, will be much more costly than a thoughtful fiscal policy designed to lower inflation whilst maintaining economic growth. Further, in analysing the components of current inflation it is clear that the proposed rise in electricity prices is based on costs moves of six months ago, that have now reversed. So why support electricity prices higher and add to inflation across the economy when they will be reversed in 2024. That does not make sense!

The outlook for stocks

Self-directed investors are presented with a confusing short term economic outlook that is in contrast to Australia's position in the fastest growing region of the world. To highlight this point, it is noteworthy that Treasury's FY23 budget papers forecast that Australia's major trading partners will grow at over 3 times the projected growth rate of Australia over the next two years.

Adding to the confusion is the observation that long term bond yields in Australia are trading at about 2-3% below reported inflation. Australia's ten-year bond yield of just below 4% suggests that the bond market is less concerned with inflation than the RBA is. Indeed, it is interesting to reflect that when inflation last lurched above 6% in Australia (2021/22) the ten-year bond yielded 7%. Today's long-term bonds have a negative 'real yield' compared to reported inflation and suggests that inflation will fall.

So, what does this 'negative real' ten-year bond yield mean for risk markets and particularly equities? The answer lies in understanding the effect on equity values resulting from the low or negative real returns presented in bond yields.

Normally a recession that flows from higher bond yields (inflation surging) has a significant effect on the value of equities as company earnings fall concurrent with a decline in the price earnings ratio (PER) of the market. However, in this peculiar cycle, with inflation expected to fall no matter what the RBA does, the likely earnings decline of FY24 will not be magnified in the market by a generally lower PER. In other words, any decline in the Australian share market will be moderate. Further, when earnings recover, as they will, given the long-term tailwinds of Australia's trade and population growth, the market will bounce strongly from higher earnings off elevated PERs.

The RBA isn't independent, get over it

Australians in general, especially low-income earners and investors, must wonder how much better Australia would be if there was a constant and sharp focus on sustainable growth. That growth focus requires our bureaucracies to discuss and develop coordinated policies. In particular they should break away from the dogmatic belief that the RBA must be independent of Government. It cannot be independent because the RBA is the largest single creditor of the Government owning about 40% of Commonwealth Government debt.

John Abernethy is Founder and Chairman of [Clime Investment Management Limited](), a sponsor of Firstlinks. The information contained in this article is of a general nature only. The author has not taken into account the goals, objectives, or personal circumstances of any person (and is current as at the date of publishing).

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Meg on SMSFs: why my kids don't belong to my SMSF… yet

Meg Heffron

In a monthly column to assist trustees, specialist Meg Heffron explores major issues on managing your SMSF.

In the last few years, I've found myself pondering whether or not my children should come into my SMSF. They could – both my sons are adults, are engaged with their super and more than capable of learning how to share the management of an SMSF. We're also a small enough family that we can all fit in together under the 'maximum of 6 members' rule.

In some ways it would be nice to bring them in to my existing fund. They've both had that slightly shocking experience that many 20-somethings have where their small contribution amounts are decimated by fees, even though they both belong to well-regarded industry funds.

And when I explained Government Co-contributions and the First Home Super Saver Scheme they actually added some of their own money. (Well, OK, let's be honest, I gave them some money to put in and they did.)

But even a lot of that disappeared in fees. There's no doubt that it would be cheaper for them to belong to my fund than stay where they are.

What I'm not concerned about

I'm not worried about them having too much knowledge of my financial affairs. We're a ridiculously transparent family when it comes to money and always have been (less so about budding romances and speeding tickets as I discovered on a recent holiday but … that's probably not critical in this question of whether or not they join my SMSF).

Initially I wondered if deep down I was put off because they would be able to outvote me even though most of the fund would be my balance. Of course, there are ways to control that if they agree to it.

For example, I could continue to own the shares in the trustee company. That's because there are rules saying that (roughly) "generally speaking, all members have to be directors of the trustee company" but there are no rules at all about who owns the shares in the company itself. Given that most company constitutions give ultimate power to hire and fire directors to the shareholders, hanging on to the shares does mean I keep a lot of control.

In fact, in our case, I could even continue to be the sole director of the trustee company because we all hold enduring powers of attorney for each other. Specifically, the fact that ***I*** have an enduring power of attorney for each of ***them*** means that I could be the sole director even if they were both members.

But to be honest I don't like that approach. There will be some useful learnings for them if they're participants rather than observers. It also feels a bit patronising – they're adults, they should have a direct say in how their SMSF is managed.

So that wasn't it.

A three-person fund would be slightly harder for my financial adviser I imagine as he would need to consider the fund's investments in terms of their appropriateness for people with very different timeframes. As I keep reminding both my adviser and my children, I am **way too young** for retirement but even I would have to admit that I'm closer than my children are.

I don't think my adviser or my Heffron team (who do the accounting work for the fund) would be too concerned about the administrative hassle of having more trustees who don't live together to sign things like investment strategies, annual returns etc. – digital signing makes that incredibly easy these days.

That wasn't it either.

Circumstances can change too

I doubt the arrangement would last forever. I hope my boys are lucky enough to have whatever families they want themselves in the future. That will probably mean they move to their own SMSF one day. But the fact that something won't last forever doesn't mean it won't add value for the next 10-15 years. It's just something we should consider up front. For example, it might not make sense to invest in anything that tied up their balances too much – we'd need to be sure they could get out when they wanted to. (This is the sort of thing ASIC and the ATO mean when they talk about the importance of having an exit strategy. What sorts of things might cause some of the members to leave or even trigger the fund being wound up? Can we plan for them in any meaningful way?)

Often people join forces with their children in an SMSF to genuinely invest together in an asset neither party could afford to buy solo. That's not a consideration in my case – my investments are very boring and even if my sons were to join the fund, I can't see that changing any time soon. Others value the great cash flow management afforded by having multiple generations in the same fund. The cash flow coming in via contributions from the kids' generation funds pension payments to the older generation, leaving the investments to keep growing undisturbed. That's probably a little too far in the future for me to be worrying about yet.

Of course, all of this assumes we continue to be just as aligned as we are right now. I hate to even imagine it but there's always the possibility that we have a major falling out. A new spouse (for any or all of us) could change the dynamics enormously – pretty much everyone who advises clients on their finances has a war story along these lines.

So, I'd need to check my trust deed to make sure it deals with disputes appropriately. And much as I would love to say that we can put watertight provisions in place to solve every problem, the fact is it's never possible. Even the controls I touched on earlier (hanging on to the shares in the corporate trustee or even being the sole director) only go so far. I won't be able to unilaterally expel one or both of them from 'my' SMSF at some point just because they start sizing me up for a nursing home earlier than I want. As members, they would need to initiate any rollover, I can't just choose a new fund for them. So even ending everything will require good faith dealings on all sides.

My decision

As I thought about it more for the purposes of writing this article, I concluded that the main driver for including my children in my SMSF would be to save them fees and give them the kind of freedom and control I enjoy with my SMSF at a bargain price. It would set them up to be confident in having their own one day. And I think the thing that's stopping me is that it would just be less convenient for me. At the moment, decision making is easy – my adviser emails me, I respond, and things happen. I can't be bothered nagging my young adults who are both busy with their own lives to sign things. Perhaps I'm not the wonderful mother I thought I was after all.

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

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5 assets to protect you against a possible recession

Jamie Hannah

As investors continue to grapple with higher rates, sticky inflation and market volatility, a defensively positioned portfolio could help to protect investors from macroeconomic and market risks.

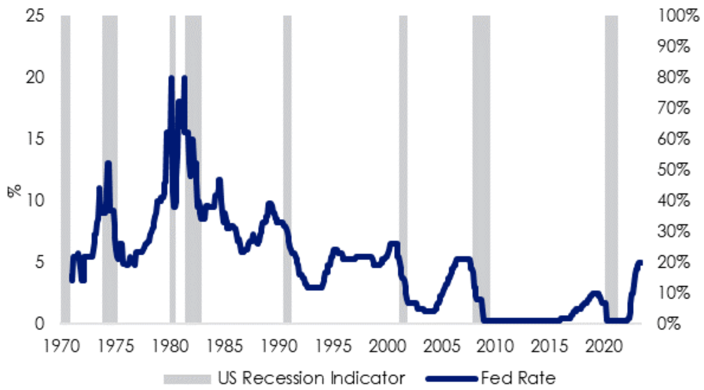
Despite central banks around the world hiking rates at the most aggressive pace in recent times they are not even close to reaching their respective inflation target bands. As rates continue to rise so too does the risk of recession. Europe and New Zealand have already entered recessionary territory, and other countries may soon follow suit.

It's not all doom and gloom, however. At some point during this year, we should see interest rates reaching their peak and inflation begin to subside. It's going to take some time for inflation to fall back to the more stable 2-3% range. This will assist mortgage holders, renters, businesses, and the average Australian consumer with the cost of living.

Yet investors are contending with the unfortunate fact that historically, 75% of rate hike cycles in the US have resulted in a recession in the country since 1955.

Macroeconomic indicators suggest that the US is in the last stage of the economic cycle with a recession likely by the end of 2023. The US government bond yields between the 2 and 10 year are inverted, and manufacturing activity is contracting. Yield inversion has historically been a leading indicator for a recession in the next 6 to 18 months. ISM Manufacturing PMI below 50 highlights that activity is contracting.

US Federal Fund effective rate versus recession periods



Source: Board of Governors of the Federal Reserve System (US)

US ISM Manufacturing Index

Source: ISM

10yr less 2yr US government bond yield

Source: Bloomberg

And while the US has a potentially higher chance of entering a recession this year than Australia, it will be important to watch the key local economic data prints such as CPI, GDP and unemployment numbers as they provide an overall picture of the state of the economy.

As Portfolio Managers we are often asked what type of defensive assets should be held during this period of the economic cycle. While there is no infallible answer, the tried and tested assets listed below should be considered as part of a defensive allocation for an investment portfolio:

1. Gold: is one of the oldest defensive assets and physical gold has a low correlation to other asset classes such as equities, bonds or property. Currently there are several factors converging which could see the gold price reach an all-time high. The gold price is currently testing the base of its recent up trend at around $1,950 USD per ounce, and with the continued recessionary pressures and geopolitical risks there is every chance that gold will push above $2,000 again towards $2,075. We think there is more chance of upside than downside currently and there has also been strong central bank buying of late helping to stabilise the price.

2. Short term US treasuries: are often described as one of the major almost risk-free asset classes, and they are now yielding about 5.2%. We know that the US is still the leading global economy despite the economic headwinds it faces, the US should maintain this commanding position for years to come. Many finance calculations and risk models require a base calculation for the risk and US treasuries are commonly used to represent the low-risk option. As rates continue to rise, a short-term US Treasuries exposure can provide a reasonable hedge to markets.

3. Floating rate bonds: this type of bond adjusts its coupon based on an underlying interest rate, if interest rates go up the coupon on the bond also increases. This minimises the risk of losing capital as interest rates go up. In a fixed rate bond if interest rates go up the value of the bond goes down and hence the investor could lose part of their investment. There are multiple floating rate options in Australia that are yielding 4.5% to 5.5% currently.

4. Global infrastructure: assets like electricity, water or gas companies, rail lines, pipelines, airports, toll roads, telecommunication towers are the backbone of modern society. In the current inflationary environment, many infrastructure companies can adjust their pricing to keep pace with inflation. There is vast spending taking place by governments within infrastructure projects especially with ageing utilities and changing population needs. A recent report by consultancy firm McKinsey estimated that the developed world needs to spend $70 trillion by 2035 to maintain its ageing infrastructure. Infrastructure also has a low correlation to other asset classes so can act as a portfolio diversifier while at the same time paying a reasonable yield.

5. Quality companies: Adjusting investments through a downturn is difficult as picking the top and bottom of the market is nearly impossible. The focus should be on having the right asset mix, and in that respect, a focus on quality companies has proven to be one of the better options. These are companies that have a high return on equity, stable year on year earnings growth and low debt. Companies with these traits tend to fall less in a downturn and bounce back faster in a recovery.

We've obviously focused on defensive assets but there is often a bias to short term investment horizons rather than longer term. The current economic cycle will play out over the next few years, but anyone investing for retirement, or over the longer term needs to be aware that by the time their investments are realised, the cycle will have changed.

At the start of 2023 there was a fair amount of negative talk about the global sharemarket and many investors pulled money out fearing short-term market declines. However, the NASDAQ and S&P500 are up 30% and 15% respectively year to date. Anyone sitting on cash would have missed out on this upswing.

There are many ways to implement the defensive strategies listed above, ETF's however offer an easy way to diversify your investments in a single trade.

Jamie Hannah is Deputy Head of Investments & Capital Markets at VanEck Investments Limited, a sponsor of Firstlinks. This is general information only and does not take into account any person's financial objectives, situation or needs. Any views expressed are opinions of the author at the time of writing and is not a recommendation to act.

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Howards Marks on balancing aggressive and defensive investing – Part 2

Graham Hand

On 24 May 2023, Howard Marks spoke by video to 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. We published Part 1 last week.

In Part 1, Marks said he avoids macro forecasts because they are unknowable and therefore offer no market edge. He concentrates more on the micro risks he can understand if something with a company goes wrong, such as a product going out of favor, too much competition or management mistakes. But he then made an admission that although he believes macro forecasting is "terrible", every micro forecast requires a macro forecast. To predict company earnings, for example, he needs to know GDP in a future year or whether the economy be "booming or cratering".

Making neutral forecasts

How does Marks reconcile this micro/macro view? He relies on what he calls "neutral forecasts", that next year will be like most years or this year, in a neutral extrapolation. He says if everybody thinks GDP will rise by 2%, there is no money to be made by forecasting 2%. Only at 4% or 0% can a forecaster act and make money. But he doesn't know which is correct, so he ignores both.

"Most of the time, forecasts of a deviation from trend, forecasts of the end of extrapolation, are usually wrong. So, in order to make money from a macro forecast, you have to have a forecast which is non-consensus, which is hard because most of the evidence is reflected in the view of the consensus, and you have to be right, which is hard because the future is hard to predict. You put those two conditional things together and you figure out that macro forecasts have no value."

He says the things fund managers do are simple, but it's hard to do them in a superior manner that creates added value.

Taking the temperature of the market

Before Marks engages in a new activity or investment, he takes the temperature of the market to gauge the psychology. It can be pessimistic or optimistic and overdone in one direction or another. Nobody can predict psychology. He cites the market reaction during the pandemic on 23 March 2020, after the S&P500 was down a third in the previous month. When the Fed made some announcements, the market started going up, but most people thought the optimism was wrong. Then it went straight up from there, but it was unpredictable. Investors thought that what the Fed was doing would be insufficient, but the market rose anyway.

Marks believes that even when people say they know what the market is going to do, they never know *when,* because knowing *when* is a matter of knowing when psychology will turn. He says that whenever he hears a statement which starts with the word *when*, he rejects it.

Know your balance between aggressive and defensive

Marks was asked about the ideal investor behavior in an overvalued market, such as when prices are higher than intrinsic values. He says it's about finding the right personal balance:

"Each investor should have a notion for what is the right balance of aggressiveness and defensiveness for them. It's a personal thing, it's subjective, and it varies from one person to another and from one institution to another. So let's say, you have a sense for that. Now the question is, today, should you be at your normal balance, or should you be emphasising offense or defense relative to your norm, whatever your norm is. The S&P was at 4,800 and now it's at 4,200 but last year it was at 3,500. It's kind of in the middle ground. The P/E ratio is a little high, but it's not ridiculously high. The outlook calls for a recession, but nobody says it's going to be a profound recession. We're seeing inflation, super-high deficits and debts of the U.S. and other countries, plus the geopolitical uncertainty in Ukraine and in China and so forth. So, I would be a little balanced toward defensiveness today rather than aggressiveness. And you'd have to be creative to sketch out a very optimistic future for the next year. But don't listen to me because I'm incapable of it."

The future is always unclear

It's welcome to hear Marks say he does not rely on forecasting and his opinion has little merit, despite the fact that he is one of the leading global names in investing. People still want to know about his forecasts even when he tells them they are a waste of time. The investment industry is desperate for sage guesses to remove some future doubt, but the amount of time the financial media, advisers and investors spend on this pontificating does not match its dubious value. Marks expands:

"I don't know what's going to happen. The future is unusually murky, unusually uncertain. Well, I believe that there are two kinds of times. There's the time when the future is clear. And there's the time when the future is murky. The main difference is that when people think the future is clear, they're probably wrong. The future is always uncertain. And the belief that it's not tends to get people into trouble because they become sanguine at a time when they should not be."

The biggest mistakes companies make

Marks is the world's leading investor in distressed debt, and he sees companies at their worst, where they have made mistakes. Oaktree steps in with capital, often to rescue the business when other lenders disappear. But shareholders and the company pay a high price as Oaktree controls a chunk of equity in the form of convertible debt, rather than simply lending money. When the company's fortunes improve, Oaktree becomes a major shareholder and enjoys the upside, not only a fixed income return. He says:

"Companies that get into trouble either can't imagine a negative-enough scenario or overestimate their ability to succeed in a negative scenario. One of my favorite sayings is never forget the person who was six feet tall who drowned crossing the stream that was five feet deep on average. The idea of surviving on average is a ridiculous idea. Like a skydiver, on average, who is successful 98% of the time. It's not a good idea. You have to be successful all the time, which means you have to survive all the time, which means you have to survive in the worst of times. And so, when companies over-lever, it's because they overestimate their ability to persist in a negative environment. And then, the negative environment comes along, and they melt down."

Marks has invested through many different markets, including when Leveraged Buy-Outs (LBOs) were completed with 96% debt and 4% equity. Leverage magnifies successes but it also magnifies failures, and equity carries a company through the tough times. Often, the deals with too-little equity fail. He says management might allow for revenues to fall 10% but not 20%, and then rather than profits falling 60%, they go down 100%.

But he also supports the right level of leverage, not the least. In his student days, 20 American companies were rated AAA, and while it gave them bulletproof balance sheets, their returns on equity were compromised. They realised that a rating of AA or A was high enough and still gave a low cost of capital. But the major mistakes come from too much debt.

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

The emerging multinationals investors can't ignore

John Stavliotis

As geopolitical tensions continue to heat up, incentives seem skewed towards the emergence of a more multipolar world, presenting interesting considerations for investors when it comes to thinking about the world's largest multinationals in the decades to come.

Despite concern about China's rocky post-COVID recovery and longer-term growth, its strategy to align with the developing world (46% of global GDP and 86% of population) provides a significant demand base for emerging multinational champions to thrive and advance the evolution from 'Made in China' by foreign companies to 'Made by China'.

Deglobalisation – just a convenient narrative?

Growing US and China tensions have been likened to a new cold war due to the potential scale of the conflict and economic heft of the players. But in contrast to the US-Soviet era, the global economy is more integrated than ever with China contributing circa 15% of global trade.

Any strategy to cut China out of the developed world would prove costly and difficult, despite the public threats to do so. China's share of global trade has in fact increased by 1.8% since the US began increasing tariffs in late 2017.

The US and broadly the West have rarely allowed ideology to stand in the way of mutual self-interest in external relationships, including its relationship with China. The key difference today is that the West is now threatened by the rise of China's mercantile and political power, and there is evidence of this:

- Prior to distorting effects of COVID lockdowns on consumption, China's consumer goods market neared parity with the US in 2019 (~$6 trillion), having grown at a rate of 15% p.a. over the prior twenty years vs. 3.5% p.a. in the US.
- Western share of global GDP and trade is falling and political influence in a global context will likely be highly correlated to this trend.
- As the developing world share of Chinese exports grows (currently 46%), the West's trade related influence over China will continue to decline.

Whilst the tail-risk of a dislocation is growing, there remains a powerful incentive for the two super-powers (the US and China) to co-exist for the sake of shared economic prosperity.

Just as mutually assured destruction prevented a US-Soviet military conflict, the risk of mutually assured stagflation, as coined by Absolute Strategy Research, is a significant incentive for both sides to pursue a controlled, gradual decoupling ahead of uncontrolled ideological conflict.

Chinese soft power

Since President Xi was awarded a third term and the economy reopened after three years of lockdowns, China has re-engaged with the rest of the world.

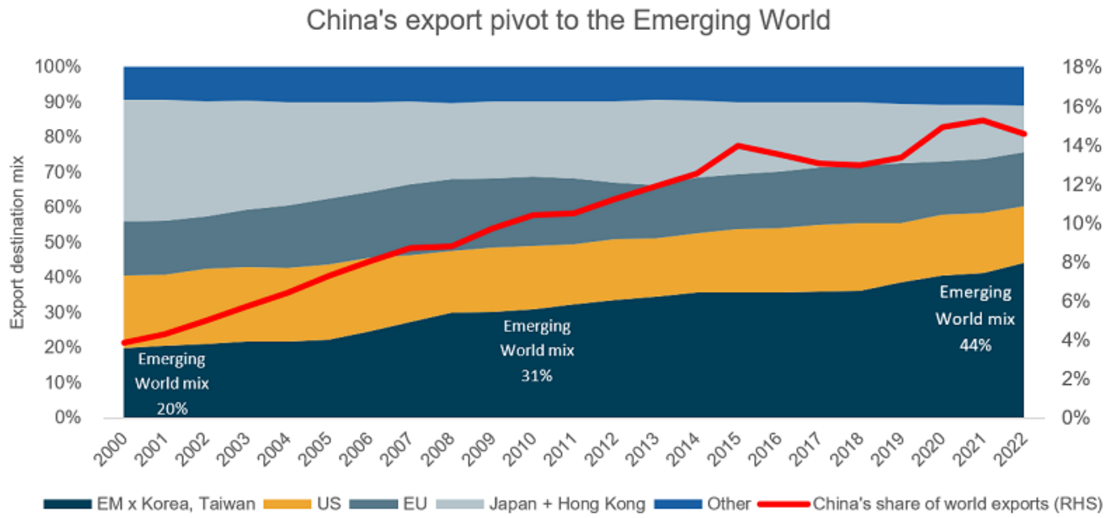
Numerous delegations of business heads and politicians have been hosted, while China's role in brokering an agreement between Saudi Arabi and Iran provides evidence of China's growing influence.

Reinforced by the recent G7 communiques, the US (and the West) is projecting an increasingly hawkish stance towards China and this view has rare bipartisan support at a time when the Republicans and Democrats are more divided than ever.

However, while China and the US may well slowly decouple, they will inevitably remain highly coupled to the rest of the world, with China positioned to take trade market share in an increasingly multipolar world.

China's foreign policy has increasingly looked towards the developing world across Asia, Latam, Africa, Russia and the Middle East for geopolitically aligned partners - historically by offering outward foreign direct investment relating to infrastructure (e.g. Belt and Road initiative) as well as via direct lending. This also represents a material addressable demand opportunity for Chinese companies. This cohort comprises a population of 6.7 billion people, 86% of the world and growing at 1.2 percentage points (ppts) faster than advanced economies, and US$45 trillion of GDP, 43% of total world which has grown at 2ppts faster than advanced economies over the last 40 years.

Exports from China to the developing world have increased in share by 13ppts since 2010, while the share to the US has reduced by 2ppts to 16% over the same period, as you can see in the image below.



Source: General Administration of Customs People's Republic of China and IMF.

Also notable is that as China takes trade market share across the developing world, the prospect of de-dollarisation grows both from a push to pay for imports in Renminbi (RMB), and as these countries' desire to diversify their foreign reserves away from USD.

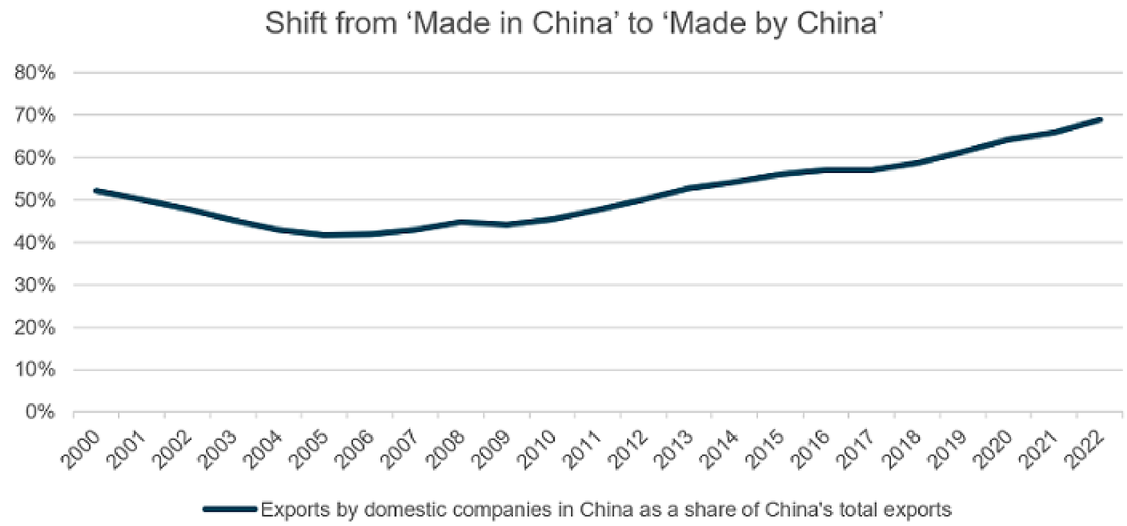
This shift is still in its early stages with the RMB representing less than 2% of global forex reserves - far lower than its 15% share in global GDP. Hence, the USD's reserve currency status remains intact, though the pre-conditions for a slow erosion are in place.

In parallel we have seen the US push toward moving manufacturing locally and to nearby countries such as Mexico, in place of China. We expect however that high costs may limit these actions to leading edge semiconductor and other strategic technology, especially where its availability aids China in its military and security ambitions. Consequently, China will need to put further resources behind the development of advanced computing and global collaboration on the advancement of key technologies will more broadly diminish.

A downstream move for Chinese manufacturing

China is already a global leader in manufacturing and according to Morgan Stanley, leading in 28 out of 47 key security industries (for example, in renewable energy and rare earth metals) and remarkably, in 18 of these technologies, it has over 50% share of the global market. The US is leading in only eight.

As mentioned above, more broadly, there has been a shift from 'Made in China' by foreign companies based in China to 'Made by China' by home grown Chinese companies.



Source: China customs

This is either as the owner of the intellectual property (IP), as in the case of the domestic Electric Vehicle (EV) brands where China has successfully moved downstream to now become the world's largest auto exporter by volume, or by owning the IP along the supply chain.

For example, Chinese homegrown suppliers now develop and manufacture critical components for the iPhone 14 that account for 25% of the bill of materials, compared to just 3%, or $6 of an iPhone 4 in 2010, mostly relating to assembly.

What are the next generation Chinese multinationals?

The domestic scale that will inevitably accrue to Chinese businesses, strategic focus on R&D and expansion into other emerging markets will make it difficult to keep them out of developed markets.

We assess that the significant and durable growth opportunities of many of these emerging multinationals are mispriced as investment opportunities in the market today.

Three of those opportunities that can't be ignored include Midea Group, Sany Heavy Industry, and Contemporary Amperex Technology.

Midea Group Co Ltd

Midea (SHE:000333) made its entry into household appliance manufacturing in the 1980s, initially as the manufacturing partner of the Toshiba brand which it acquired in 1998. It has since developed to be one of the largest air conditioning manufacturers in the world with circa 11% of total industry revenue according to Deallab.

An efficient cost structure and investment in distribution has allowed Midea to price competitively and grow market share both domestically and overseas. Over half of exports are to emerging markets which are suited to its value-oriented products and will exhibit structural growth from higher penetration and upgrades to lower energy intensive units.

This is not to say that the company is ignoring advanced economies where for example it is a sponsor of Manchester City Football club. Building on its success in air conditioning, the acquisition of German robotics business Kuka in 2017 for US$5bn leverages Midea's mega scale manufacturing experience and extends its addressable market opportunity to industrial automation technologies. Midea's PE of 12x and high RoCE compares favourably at almost half the multiple of Japanese competitor Daikin.

Sany Heavy Industry Co Ltd

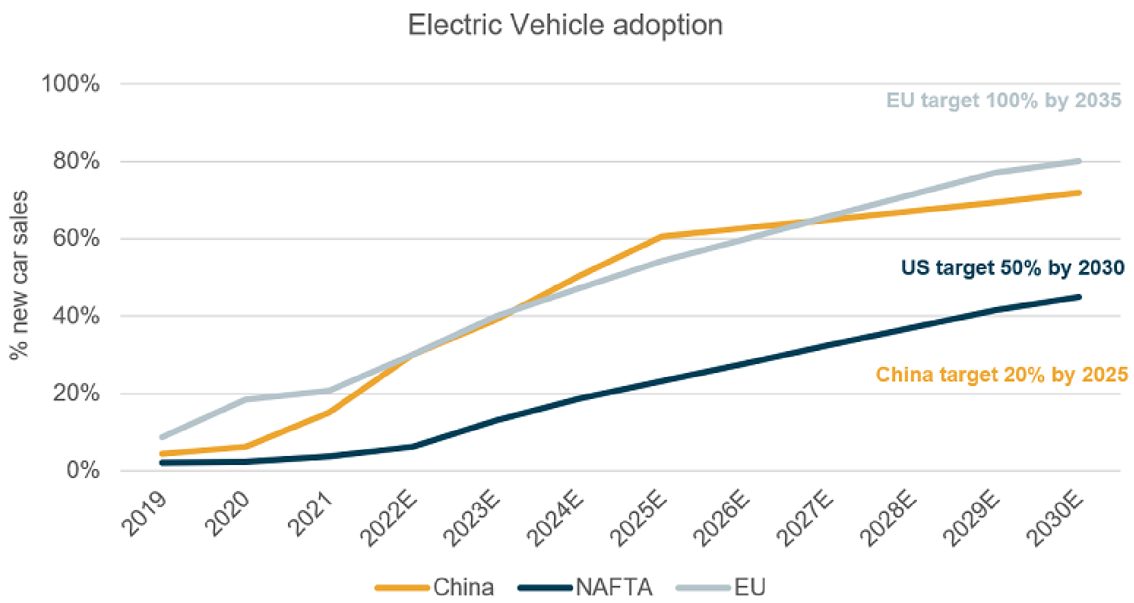
Sany Heavy (SHA:600031) is China's largest construction machinery business and is also a top five global player. Founded in 1995 by Liang Wen Gen who remains Chairman and major shareholder, it began its globalisation effort in 2012 with the acquisition of German concrete machinery company Putzmeister. It now operates production bases in India, Brazil, USA and Germany.

Sany's competitive edge has come from leveraging the established heavy equipment parts supply chain in China and leading with value. Servicing is offered at cost in China and 20-30% cheaper than western peers in export markets which operate servicing and fleet management as a profit centre. This has allowed Sany to gain a leading position in emerging markets which account for over 60% of export sales and is a large potential profit opportunity as these markets mature.

Profitability in their international operations has already improved with scale and the market consolidation potential remains material. For example, Sany is the number one equipment maker in Indonesia but currently has only 20% share despite a narrow focus on the small to mid-sized segment. Domestically the macro slowdown has weighed on margins and the stock is priced at 20x cyclically low 2023 earnings, a likely attractive entry point assuming some recovery in domestic demand.

Contemporary Amperex Technology Co Ltd

Electrification is the largest reset in manufacturing of automobiles since the emergence of mass-production and has offered an opportunity for China to quickly gain a foothold in the US$2.9 trillion per year industry. China's target of EVs accounting for 20% of new vehicle sales was achieved in mid-2022, more than three years ahead of schedule. Chinese auto manufacturer's ability to meet the market, where 58% of total auto sales are for vehicles priced below US$22,000, was key to their success. The recently launched battery electric vehicle from Chinese automaker BYD, priced at US$11,000 with a 405km range, is a good example of mass market capability.



Source: NBS, LMC, Bloomberg, IEA, Antipodes

Contemporary Amperex Technology Co Ltd (CATL, SHE:300750) has grown to be the world's largest EV battery company, with over a third of global market share and over half of the market share in China. It was established in 2011 by founder, Robin Zeng, who built his fortune making low-cost lithium batteries for consumer electronics and identified the early strategic importance of EVs.

Scale, efficient manufacturing techniques and continued heavy investment in R&D results in at least 10% higher energy density from a CATL battery pack versus competitors. This performance gap has widened in each of the last three years despite aggressive competition. CATL boasts more auto OEM customers than any other battery producer and has recently expanded to licensing deals in the USA with Ford and Tesla. These partnerships reflect the company's leadership in LFP (Lithium Iron Phosphate) technology and are coming despite the US' geopolitical preference to partner with South Korean and Japanese battery makers.

As EV penetration increases across the world, the growth in adoption will need to come from the mass segment, for which CATL's batteries are best suited. CATL's ability to maintain a performance gap should see the company able to defend its position in this large and growing industry. At a FY23 PE of 23x, with earnings growth of 30% into 2024, CATL looks attractively priced versus inferior peers on higher multiples.

	Midea	Daikin	Sany Heavy	Caterpillar	CATL	LG Energy
	HVAC		Heavy machinery		EV Batteries	
Global Share	11%	12%	15%	15%	37%	13%
Revenue CAGR 2022-25E	9%	7%	12%	5%	28%	32%
EPS CAGR 2022-25E	8%	7%	37%	13%	34%	88%
ROCE (3 years)	42%	17%	33%	17%	21%	7%*
PE (2023E)	11.9x	25.3x	20.8x	12.9x	22.7x	67.0x

*Source: Factset, Deallab, SNE research, * based on 1 year due to company being listed in Dec 2021*

John Stavliotis is an Emerging Markets Portfolio Manager at Antipodes Partners. Antipodes is affiliated with Pinnacle Investment Management, a sponsor of Firstlinks. This article is general information and does not consider the circumstances of any investor.

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The case for a global small-mid cap portfolio

Nicholas Paul

Global asset owners have historically allocated capital to two distinct equity asset classes: global large cap (as represented by the MSCI All Country World Index or the MSCI All Country World Large Cap Index) and/or global small cap (as represented by the MSCI Global Small Cap Index). As a long-tenured, seasoned active global small/mid- cap managers, we are often asked, “Why the global small/mid-cap asset class instead of the more common small-cap approach?”

Over the past two decades (2003–2022), both global small-cap stocks and global small/mid-caps have outperformed their large-cap counterparts. At the same time, while global small-caps have slightly outperformed the small/mid-cap asset class, we believe that a global small/mid-cap approach may offer a number of potential benefits and features for asset owners not readily apparent when simply looking at historical return metrics.

Exhibit 1: Historical return measures are only part of the global small/mid-cap story

Global Index Returns 2003-2022

Description	Annualized Return Entire Period
MSCI ACWI World Small Mid	9.33%
MSCI ACWI World Small Cap	9.86%
MSCI ACWI World	8.04%
MSCI All Country World Large Cap Index	7.80%

Source: Factset SPAR. This exhibit reflects index performance which does not include any investment-related fees or expenses. It is not possible to invest directly in an index. This exhibit does not reflect performance of any MFS fund, portfolio, or strategy and is intended to highlight select performance and risk characteristics of the global small-mid cap asset class. Index returns are net return in USD for the 20 year period ending 31 December 2022. Past performance is no guarantee of future results.

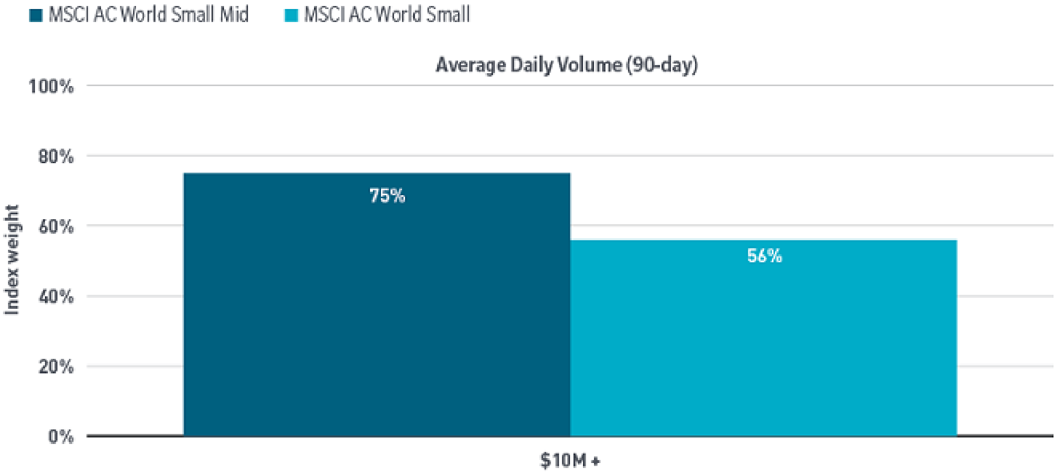
Potential benefits of a small/mid-cap approach

Although past performance is no guarantee of future results, similar historical performance results for time period shown above across asset classes, what might be the potential advantages of utilizing a global small/mid-cap strategy vs. a small-cap only approach? Here are a few.

Improved liquidity

The addition of mid-cap stocks to the investable universe can potentially allow for exposure to more liquid names without paying a 'liquidity premium' for this added benefit[1]. In fact, as of 31 December 2022, the MSCI ACWI Small Mid Cap Index traded at a discount to the MSCI ACWI Small Cap Index while offering a larger percentage of stocks with greater than $10M USD in average daily trading volume, as shown in Exhibit 2.

Exhibit 2: Smid Caps offered greater liquidity exposure



Source: FactSet. Data as of 31 December 2022. MSCI ACWI, MSCI ACWI SMID and MSCI ACWI Small cap. Series shows the weight of each index that trades within a certain 90-day average daily volume bucket.

Date	MSCI AC World Small Mid - P/E - NTM	MSCI AC World Small Cap - P/E - NTM
12/31/22	13.80	14.04

Expanded universe

A global small/mid-cap approach also meaningfully increases the opportunity set for active management. With over 7,500 companies in the MSCI AC World Small Mid Cap Index, making it significantly larger than the global small-cap index that consists of approximately 6,000 names, the associated universe provides abundant opportunity to attempt to uncover unique businesses trading at compelling valuations, as shown in Exhibit 3.

Exhibit 3: Investable universe characteristics over time

Source: FactSet, data as of 31 December 2022.

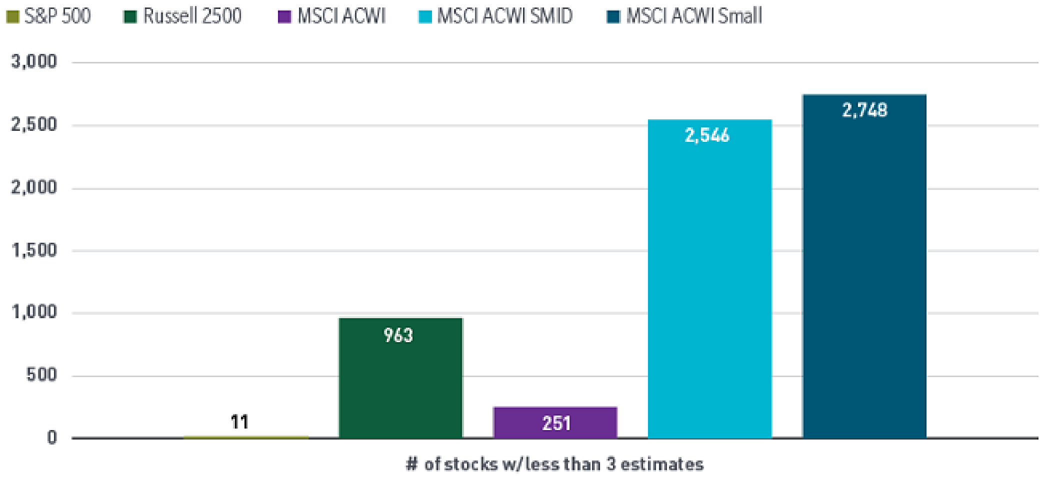
Less risk, greater flexibility

Midsize companies have tended to be early or midway through a growth phase of a new product or market, or dominant players in smaller but very attractive end market. As such, we have tended to find less risk in these often more mature businesses than in new and emerging companies. Plus, midsize companies are still small enough to have years of growth potential ahead of them. Additionally, the ability to hold onto solid companies in the portfolio allows for a longer investment time horizon and the potential for active management to take advantage of short-term market inefficiencies.

Highly inefficient asset class

From a research coverage perspective, the global small/mid-cap universe may offer meaningfully lower sell-side coverage than large-cap stocks (both globally and in the United States) and the US universe of small/mid cap stocks, as well as modestly less coverage relative to global small-caps, as shown in Exhibit 4. This lack of coverage in the small/mid-cap space may allow for increased inefficiencies, which in turn create opportunities for skilled active managers to offer differentiated portfolios, identify new investment ideas and the potential to generate alpha[2].

Exhibit 4: Active management is critical in the small-/Mid-cap equity universe



Source: FactSet, data as of 31 December 2022. Estimate counts and averages are based on the number of I/B/E/S (Institutional Brokers Estimates System) earnings estimates reported for the 3rd fiscal year forward as of 31 December 2022.

Endnotes

[1] 'Liquidity premium', in our view, refers to the fact that stocks that offer more liquidity in the marketplace often trade at a higher multiple than stocks with less liquidity. All else being equal, investors tend to value the ability to trade an asset.

[2] MFS believes that skilled active managers are those who demonstrate conviction through high active share and long-holding periods, manage risk thoughtfully and bring together different perspectives.

Nicholas J. Paul, CFA is an Institutional Portfolio Manager at [MFS Investment Management](). This article is for general informational purposes only and should not be considered investment advice or a recommendation to invest in any security or to adopt any investment strategy. Comments, opinions and analysis are rendered as of the date given and may change without notice due to market conditions and other factors. This article is issued in Australia by MFS International Australia Pty Ltd (ABN 68 607 579 537, AFSL 485343), a sponsor of Firstlinks.

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