Firstlinks
a Morningstar company

Edition 519, 28 July 2023

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Editorial

It's 1979 and Conrad Hilton, found of the Hilton chain of hotels, dies. His will leaves much of his wealth to his foundation. It's contested by family members, as lawsuits fly left and right. And there are plenty of colourful characters duking it out.

There's Francesca Hilton, the daughter to Conrad and his second wife, Hungarian-American actress Zsa Zsa Gabor. She fought her father's will and lost, though received US$100,000. Francesca ended impoverished and living in her car, before dying in 2015.

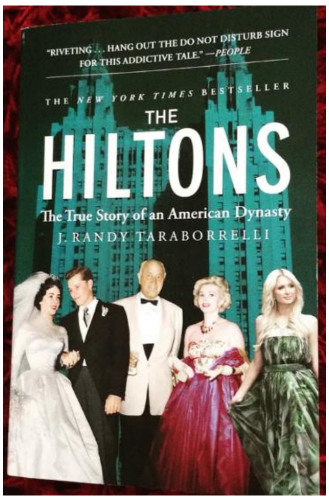
There's Barron Hilton, Conrad's son, who spent much of his career building Hilton Hotels. He reached a settlement where he received a significant number of shares in the hotel company.

There's Zsa Zsa herself, the beautiful socialite, who married Conrad during World War Two and divorced soon after, and who later wrote in 1991 that Francesca was born because Conrad had raped her.

In court in 1979, Zsa Zsa said of Conrad Hilton:

> *"Conrad Hilton was not an easy man to understand. So religious. Always with the nuns, the church. Every day going to the church or praying on his knees in the bedroom to a shrine. In some ways, I think it's the reason why we are here today. He would rather the nuns have his money than his own family. I don't think he would disagree with my saying it, either."*

She was probably right. Conrad Hilton came from humble beginnings to buy his first hotel in Dallas in 1919, before going on to build a worldwide empire. He did it through sheer will and unwavering faith. He tried to raise his children to have his work ethic rather than relying on money, though it was only partially successful.



One of his other sons, Conrad Junior, the first of eight husbands to movie star, Elizabeth Taylor, became an alcoholic and drug addict, and died aged 42. Bizarrely, Gabor alleged Conrad Junior had an affair with her at one time.

Problems have followed the Hilton clan through the generations. So much so that Paris Hilton, famous for an explicit video tape and not much else, is regarded as one of the more 'normal' Hiltons left.

The Hiltons story, well depicted in J. Randy Taraborelli's book, *The Hiltons: The True Story of an American Dynasty*, is akin to that of the Succession television series, albeit a true and arguably better one.

It can be read as an all-American tale of rags to riches or a cautionary one of how that journey may not bring happiness.

More broadly, it has some great lessons about what wealth can give us and what it can't.

What wealth can buy

Let's first look at what money can provide us:

> **It can buy goods.** Money can be used to buy everything from basics such as food and clothing, to houses and cars, and more elaborate purchases such as boats, holiday homes etc. In Conrad Hilton's case, it allowed him to buy a preposterously expensive and elaborate house in Bel Air, Los Angeles. Recently, the house listed with an asking price of US$250 million.
>
> **It can buy better health.** Money provides better access to doctors and healthcare, and leads to increased quality of life and longevity, according to many scientific studies.
>
> **It can buy a social network.** Having money can connect you with other people with money. This can lead to job and other opportunities that you may not have had otherwise.
>
> **It can buy time.** Money can provide for an early retirement and give you the time to do what you like.

What wealth can't buy

Here's what money can't give us:

> **It can't buy social connections.** Recent psychology studies point to three pillars of life satisfaction in retirement: health, money, and relationships. On the last pillar, the single biggest predictor of happiness is your relationship with your spouse or partner. Close behind is having a social network – that is, plenty of friends who you catch up with on a regular basis. Money can't buy these social connections.
>
> **It can't buy wisdom.** Human beings have two types of intelligence. One is called fluid intelligence which is our ability to think abstractly and deal with complex information. It peaks early in life, at around the age of 20. The other is called crystallised intelligence, which is where we age and gain more experience of the world, and that helps us to make better decisions. Money can't buy either of the two intelligences.
>
> **It can't buy happiness.** As the Hiltons demonstrate, wealth has a way of bringing as much misery as it does happiness. Put another way, it can bring out the best and worst in people.
>
> **It can't buy freedom.** A common refrain is that money can give you freedom. It can certainly provide financial freedom. It can alleviate concerns about getting food, shelter, and other things.
>
> As for freedom more broadly, I'm not so sure. In my view, real freedom comes from not being dependent on money or anything else. By this definition, none of the Hiltons were free as all of them were dependent on wealth, as well as the source of that wealth, Conrad Hilton. I'd argue that generations of Hiltons have been trapped rather than freed by wealth.
>
> Buddhists may have it right. They say that attachment (or dependency) is the root of all suffering. That letting go of all attachments is the key to contentment.

As investors, we're in the game of building wealth to secure our financial futures. The tale of the Hilton family is a nice reminder that wealth can serve us, or we can serve it. And that we get to choose.

James Gruber

In this week's edition...

It's been accepted wisdom in markets for decades that investors focus more on limiting losses than making gains - the so-called 'loss aversion' theory. Yet new research outlined by **Don Ezra** shows that as we age, the reverse may be true. If right, it could have broad implications for the investment industry.

We have several articles advocating investors to go where few are willing to tread. First, **Emma Fisher and Matt Williams** at **Airlie** think fears about consumer discretionary spending are putting several quality retailers on sale. They especially like Nick Scali and Premier Investments at current prices.

Next, **James Gruber** looks at how value stocks have again been left for dead in 2023, after a bounce last year. He believes the 16-year bull market in growth stocks is showing many signs of excess that could result in a sharp and enduring bounce in value-based investments.

And, in this week's *Wealth of Experience* podcast, **Andrew Parsons** of **Resolution Capital**, argues the extraordinary negativity around commercial property appears overdone, and that segments such as retail property look like a sound, contrarian bet. The podcast also features **Graham Hand** on home ownership versus super, and **Peter Warnes** on the interest rate outlook.

Tribeca's Jun Bei Liu previews the ASX reporting season. She expects earnings downgrades aplenty, yet the rebasing of company earning forecasts should result in a more realistic outlook and possible buying opportunities.

Chinese demographic problems are far worse than most think, according to geopolitical expert, **Peter Zeihan**. In fact, he says that this is going to be the final decade that China exists as a nation-state.

The **World Gold Council** says SMSF investors continue to face inflationary pressure not seen in decades, and it could influence investment performance if the potential effects are not considered. It provides a guide on how to inflation-proof your portfolio.

This week's whitepaper also comes from the **World Gold Council** and it examines the mid-year outlook for gold after a positive first half of the year.

Curated by James Gruber and Leisa Bell

Our investment thinking changes as we get older

Don Ezra

It's well known that human beings are loss averse. By this is meant that, if (as an example) we're given a 50/50 chance of winning or losing some specific amount (let's say $500) based on a heads-or-tails toss of a coin, we tend not to want to play. Unless, of course, the amount is small (let's say $10), and the sheer thrill of playing is worth it, even if we lose – in other words, we're willing to pay to buy the thrill; but as a serious investment proposition, no.

What we tend to want, in an example such as this, is that the game is biased in our favour: perhaps $500 either way, but with the odds favouring us, say a 70% chance of winning versus only a 30% chance of losing; or, if the odds stay at 50/50, then a win is worth $700 versus a loss costing us only $300.

This attitude of loss aversion has been documented through countless research studies, and it is one of the main conclusions of the brilliant research (now known as 'prospect theory') done by Nobel Prize winner Dr Daniel Kahneman and his research partner Dr Amos Tversky.

When you think about it, this bias, built into our brains, must have been very useful to human beings in our early days, when our survival as a species was in question. Taking chances was clearly something to be avoided, if we wanted to survive, unless the chance of failure was low or carried only a small loss. If we had been a species taking big chances, we probably wouldn't be around today.

And our brains have not changed very much over the millennia: it's just the situations we face today that are very different. But our brains aren't.

I first came across loss aversion when I was studying behavioural finance, as a pension fund investment consultant many decades ago. It was totally consistent with the way in which pension fund fiduciaries behaved. Limit your losses before you go for gains. I tried to express it in a way that was succinct and easy for clients to remember: First survive, then thrive.

It's taken for granted these days. So I was very surprised to find recently that, though the general notion of loss aversion still applies, there are circumstances in which our mental attitudes change. I'll expand on this in a moment.

A second well-known characteristic of human beings, as we make decisions, is that we look at the near future as much more important than the long-term future. This is often called hyperbolic (that is, exaggerated) discounting: a jargon-based way of saying two things.

One is that we discount the future. In other words, the present is far more important to us than the future, and given a choice between having something soon and something in the medium to long term, we place far more value on near-term gratification.

More than that: we discount the future inconsistently. We have, for example, no problem saying that something now is worth much more to us than something in a year's time; but we place virtually no difference between getting something in 25 years and getting that same something in 26 years. That one year of postponement makes little difference to us if it's in the distant future, but a big difference if it's fairly close to us.

All of that too is now accepted wisdom. And again, I was surprised to find recently that, though the general statement still applies, it's not quite as clean as my quick description of our behaviour makes it appear.

That's what this post is about: the fact that that accepted wisdom is more nuanced than is generally known. And it leads me to someone I've admired for a long time: Dr Laura Carstensen, the Fairleigh S. Dickinson Jr Professor in Public Policy and Professor of Psychology at Stanford University and founding director of the Stanford Center on Longevity.

Emotional satisfaction becomes more important when older

Laura has influenced the way I view life, following her book *A Long Bright Future: happiness, health and financial security in an era of increased longevity*. Essentially it says: if we knew we were going to live 100 years, would we still live our lives the same way? Go to school, work, retire, as has become customary – and then keep that retirement stretched out until 100? No, we wouldn't, we'd pace our 100 years differently. In another blog post some time I'll outline her ideas – but for now let's just say that her book has changed my thoughts on life.

So, when I got a chance to chat one-on-one with Laura at a friend's gathering recently, it was like a gift to me. I have recently been contemplating the role of chance in my life, and when I mentioned this to Laura, she promised to send me a paper by Dr Albert Bandura, the most highly cited figure in contemporary psychology, on the role of chance in life, a paper which takes my own ideas much further. But that's incidental to this piece.

As we chatted about the choices we make, Laura mentioned two of her own papers, and sent them to me as well. And, once more, she has had a profound effect on my thinking.

One paper was on age differences in preferences.

It's obvious that the amount of time we have left to live shrinks as we age. What isn't obvious is that we seem implicitly to take our shrinking survival years into account when we make choices, essentially making those choices over a shrinking time horizon. We don't just think: oh well, that's in the future, pretty much an indefinite time away (as we do when we're young). When we're much older, in particular, we're conscious of the fact that our choices will play out over a much shorter time frame. And that shrinking time horizon changes our preferences. What we value much more highly, when the future isn't an indefinite period, is things with emotional meaning in the present. But that makes total sense, as I think about it.

More surprising is that our negativity bias (our loss aversion) in early life changes to a positivity bias in middle life and late adulthood. Not that it needs to make total sense to me, of course – it would be true regardless of my views – but the conclusions resound all the more strongly for that. And remember: these conclusions in the paper are based on rigorous experiments in which large numbers of people of different ages were given choices to make, choices that would be able to have different conclusions drawn from them, and these were the conclusions that came through.

A thought that occurs to me is that perhaps that negativity-to-positivity change as we age is one of the reasons why the U-curve of happiness by age (see Chapter 11 in my *Happiness book*) starts to turn up after bottoming out. I don't know which is cause and which is effect – but the two are consistent.

We focus more on gain than loss as we age

The other paper was much more numerical, and took me longer to process. What fascinated me particularly was that it involved experiments associated with neuroimaging, that is, checking which parts of the brain are activated when choices of various kinds are considered and decisions are made. Again, the conclusion led away from conventional wisdom. It was that, as we age, we tend to consider monetary gain more importantly than monetary loss. In other words, we play down the impact of a loss, and play up the impact of a gain. This seems directly opposite to the loss aversion that we've known as a human characteristic. Apparently, though, it's more a characteristic of younger humans, and not so much with older ones. When we have less time ahead of us, we're thinking of thriving more than of surviving. That makes sense to me: at this age most of my surviving is behind me, and I look forward much more to thriving in the time I have left.

Anyway, put these two of Laura's papers together, and they change what I have learned about human choices. Not only that: they have put me more at ease with myself, as I think about achieving positive outcomes rather than avoiding negative outcomes, and I think about emotional rather than material satisfaction. I feel somehow freer – and I hope this makes you feel that way too.

Don Ezra, now retired, is the former Co-Chairman of global consulting for Russell Investments worldwide, and the author of "Life Two: how to get to and enjoy what used to be called retirement". This article is general information and does not consider the circumstances of any investor.

Quality ASX retailers are on sale

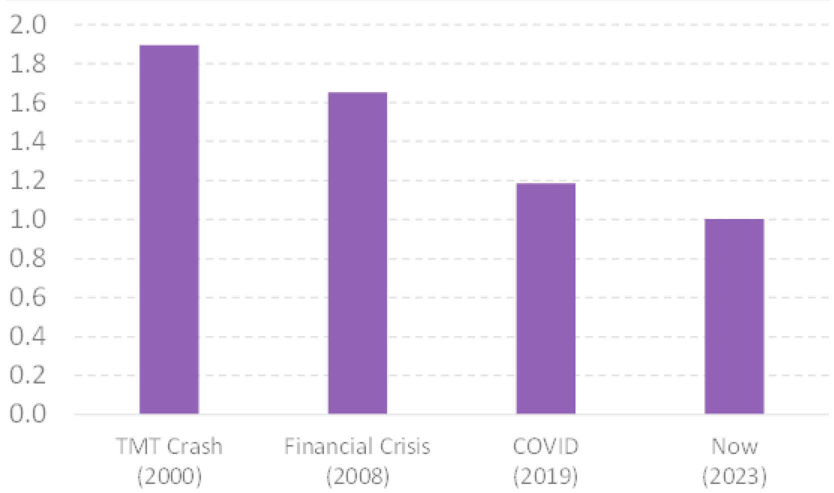
Emma Fisher, Matt Williams

We break down our outlook for the Australian market into these 3 key drivers:

1. Earnings per share: We think it is reasonable to expect earnings could decline over the year as mortgage rates bite and consumers rein in their spending. So much of the Australian share market is a first or second derivative play on consumer spending (e.g. banks, retailers, shopping centres, travel companies), and corporate profit margins look to have peaked. However, we note the earnings downturn has already begun, with EPS expectations falling 1% over FY23. In our view there is a risk of further earnings declines.

2. Dividends: Corporate balance sheets are a bright spot in the gloomy economic outlook. Gearing levels remain low across the board, and if we are heading into an economic downturn, we are heading into one with lower levels of corporate debt than any downturn in recent history. As such, we expect dividend returns to remain in line with their long run average of 4-5%.

Chart: ASX 200 ex financials net debt to EBITDA heading into a downturn



Source: MST Marquee

3. PE multiple: The market PE has re-rated in FY23, following two years of PE declines. This is shown in the chart below – the market went from very expensive in 2020 to very cheap in 2022, and the market multiple has now rebounded to its long-term average. We now see the market as neither particularly cheap nor expensive, although pockets of absolute value have emerged in consumer-facing sectors; most notably, discretionary retail.

We are entering our second year of the economy deteriorating, we have worn 12 interest rate hikes and a de-rating of the market PE. Consumer confidence is at 1991 recession-type levels, and retailers are downgrading each week. The 'vibe check' is bad, people are discussing the cost-of-living crisis everywhere. Even the mortgage-free boomers who should be cheering the return of >5% term deposit rates are grumbling about their super going sideways. Everyone has a job, but no-one is having a good time.

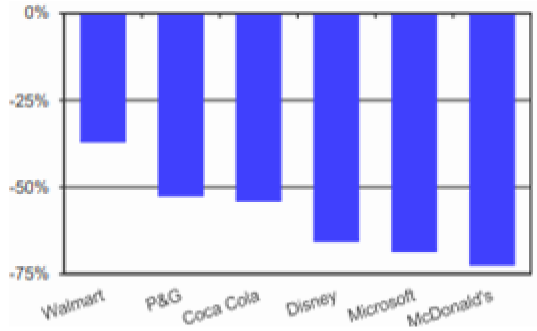
Source: Goldman Sachs

In our view, these are not the conditions in which it is time to get max-bearish. There are pockets of value emerging in the market, for example retailers and some REITs. Strong immigration and resilient commodity prices are helpful counterweights to a sluggish consumer, and our base case is the economy continues to muddle through.

Investing in consumer-facing businesses: lower share price, lower risk

Investing is a complex, interesting, and rewarding job. However, it is certainly not easy. The hardest part of investing is learning to separate the business from the share price. A great business can be a poor investment at the wrong time (if expectations and hence the share price are too high). One example that stands out is the 'tech bubble' of the late '90s – we tend to think the craze swept up only those businesses with 'dot-com' in their name, but it was a very broad-based rally that went beyond tech stocks. The market was actually pretty good at identifying a bunch of companies that would go on to have the best prospects of the next two decades, yet if you'd bought them at their share price peak in the late '90s, you would've experienced 30-75% share price falls from peak to trough. If you'd correctly identified Microsoft as a long-term winner and bought in December 1999, it would've taken you 17 years to get your money back! Never mind the poor Cisco investors who have still never recouped the share price peak. While we are as far from AI experts as could possibly be imagined, it is something to keep in mind when considering the stock market mania for anything AI-related at the moment.

US Stocks - TSR (t=0 at Peak trough Share Price)



Source: Diogenes

US Stocks - Peak Period

	Date at Peak Share Price	Date Share Price Return to Peak	Time (Yrs)
Microsoft	Dec 1999	Oct 2019	17
McDonald's	Nov 1999	Apr 2007	7
Coca-Cola	Jul 1998	Oct 2014	16
Walmart	Dec 1999	Jun 2012	13
Disney	Apr 2000	Feb 2011	11
P&G	Jan 2000	Sep 2005	6

Source: Bloomberg, Diogenes research

Similarly, a poorly performing business can be a great investment at the right time if certain conditions for future improvement are there. We look for a good balance sheet that can buy an underperforming business with time to turn things around, and an agent for change – typically, new management, a new board, and a new operating structure in the case of a demerger. Portfolio holdings QBE and Tabcorp are current examples that we think fit this bill.

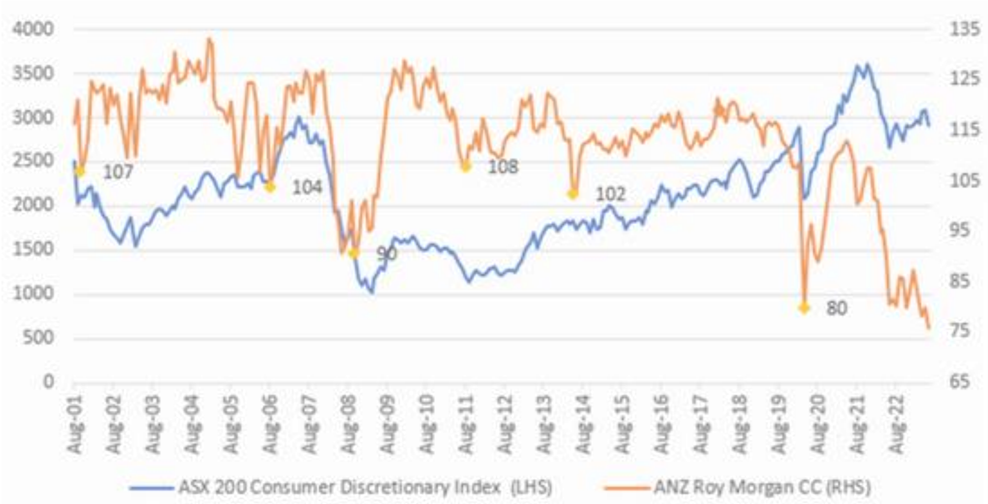
The key lesson to get your head around with investing is that the share price doesn't tell you anything about the company's future prospects. For example, the share price of CBA tells you nothing about the likelihood of it remaining Australia's largest bank or the likelihood of a bad-debt cycle occurring in Australian property. All it tells you is valuable information about expectations. The good news for active investors is that expectations oscillate wildly – share prices imply expectations that swing from "things will be good forever!" to "things will never be good again!" One need look no further than the local 'buy now, pay later' sector to see how quickly expectations (and hence share prices) can change as optimism turns to despair.

We believe opportunities in investing arise when the expectations implied by the prevailing share price are too conservative as compared against what you believe is likely to play out. If a company has a strong balance sheet, then the logical extension of this lesson about expectations is that the lower the share price, the lower the risk. This is because a lower share price implies expectations for future cash flows have fallen. The reason we say the company needs a strong balance sheet for this to be true is because for a company with a weak balance sheet, the opposite holds: a lower share price leads to higher risk of permanent capital destruction. If deteriorating fundamentals cause a company to swing to a loss or breach debt covenants, they may need to raise equity, which can convert a temporary fall in earnings into a permanent value destruction for shareholders.

This was the experience through the GFC, particularly for the local REIT sector. Local REITs were unable to roll their debt obligations as capital markets froze, forcing emergency capital raises at very dilutive prices and, in the case of Centro, the equity was wiped out completely.

So where does all this leave us today? We are starting to see bearish, even very bearish, expectations being priced into consumer-facing parts of the Aussie economy. At the very front line are the discretionary retailers. We're basically seeing a downgrade each week from retailers, with Adairs, Universal Holdings, Best & Less, Dusk, and Baby Bunting all noting a marked deterioration in sales in May/June.

To say that consumer confidence is in the doldrums is an understatement. The Roy Morgan Consumer Confidence survey has now spent 16 straight weeks at a reading below 80; the last time it spent so long below 80 was during the 1990-91 recession.



Source: Roy Morgan, Factset

In the real economy, it's fair to say the outlook for retailers looks extremely tough. However, the stock market is not the real economy, it's the sum of expectations. As the sector is repriced down and expectations are slashed, we think value is emerging.

Historically, buying discretionary retailers when the consumer confidence index hits a low has been a pretty good investing strategy. As per the below table, while the 6-month performance can be mixed (i.e. you can be early), we typically see a rebound on a 12-month view. The subsequent rebound is particularly strong when consumer confidence bottomed at a sub-100 reading, and we note the current index reading of 76 is below all prior low points.

Date	CC Index	6-mth consumer discretionary index	12-mth consumer discretionary index	12-mth change in cash rate (bps)
Oct 2001	107	(6.0%)	(25.7%)	25
Aug 2006	104	25.1%	19.6%	50
Oct 2008	90	(16.0%)	16.2%	-275
Aug 2011	108	3.0%	5.2%	-125
May 2014	102	1.4%	8.4%	-50
Apr 2020	80	35.8%	57.1%	-15

Source: Roy Morgan, Factset

Our consumer discretionary exposures in the fund were among our best-performing names over the second half of 2022, as sales remained more resilient than feared in the face of rising interest rates. In January, we significantly reduced our holding across the fund, exiting ARB and selling 80% of our position in Nick Scali (which had rallied from $7.50 June 2022 lows to over $12 a share). Now we find the sector appealing again – it has been quick to price in expectations of a consumer slowdown. Nick Scali has retraced to c$8.50, and Premier Investments has fallen from $27 to $20. We have been adding to both positions in recent weeks.

Taking Nick Scali as an example, it has traded on a forward PE multiple of 8-18x earnings, reflecting wildly different expectations of future earnings. It is currently on a forward PE of 10x.

Nick Scali NTM PE multiple

Source: Factset, Airlie Data

Buying Nick Scali when the PE has troughed has historically been a good strategy, with subsequent 6- to 12-month performance typically very strong. While we acknowledge the multiple could go lower yet, we believe value is emerging in a retailer with incredible economics and decent store rollout potential, and have been adding to our position again.

NCK-ASX	PE Trough	6-mth Return	1-year Return
2 Jun 2011	9.0x	9.0%	(6.0%)
11 Dec 2012	10.1x	52.5%	107.1%
27 Jun 2013	11.9x	30.5%	45.5%
6 Feb 2015	12.4x	24.4%	54.2%
27 Jun 2017	12.1x	17.5%	25.2%
4 Jan 2019	8.8x	38.6%	47.4%
30 Mar 2020	7.9x	184.0%	245.2%
17 Jun 2022	7.8x	58.0%	31.5%

Source: Factset

Premier Investments is a similar story. The PE multiple has typically ranged from 11-25x, and it is currently trading on 12.9x.

Source: Factset, Airlie Data

Historically, buying Premier as the PE troughs has been a good strategy.

PMV-ASX	PE Trough	6-mth Return	1 year Return
28 Jun 2013	12.7x	24.7%	35.2%
19 Jun 2014	15.0x	12.2%	58.1%
7 Sep 2017	15.4x	5.6%	53.6%
6 Feb 2019	15.7x	7.1%	48.6%
24 Mar 2020	11.5x	105.2%	158.6%
3 Mar 2021	17.1x	32.2%	32.2%
22 Jun 2022	13.0x	29.1%	8.7%

Source: Factset

With Premier's $400 million net cash and >$750 million stake in listed entities (Breville and Myer), we consider Premier's fortress-like balance sheet will allow it to weather the retail storm much better than most. The falling share price reflects a revision in expectations that we believe now appear fair in the short term, and too conservative in the medium term.

Emma Fisher and Matt Williams are Portfolio Managers at Magellan-owned, Airlie Funds Management. Magellan Asset Management is a sponsor of Firstlinks. This article has been prepared for general information purposes only and must not be construed as investment advice or as an investment recommendation. This material does not consider your investment objectives, financial situation or particular needs.

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Is value investing dead?

James Gruber

A useful exercise as an investor is to observe the media and pop culture for trends that are increasingly popular and others which are falling out of fashion. It can help identify sectors which may be overly hot and those that are being ignored, perhaps unjustifiably. For instance, many people like to look at auction listings to gauge the state of the Australian residential property market. Yet, I've found it just as helpful to watch how many pages there are in the Domain property magazine in the Australian Financial Review – more pages equal more listings and popularity. And the state of the property reality shows on TV – more shows and higher ratings normally equates to a hotter property sector.

Recently, I've noticed a trend in the investment world: the supremacy of growth investing and the obliteration of value investing, and investors. Now, you might say: that's not news. We all know about the meme stocks which went to the moon in 2020-2021, and the 'Magnificent Seven' stocks which have driven most of the S&P 500's gains this year.

Yet, the extent of investors' love affair with growth investing has seeped into some intriguing areas. I'm a bookworm and one thing that's struck me is that popular investment books in recent years are all about growth investing. Think of Terry Smith 'Investing for Growth', Christopher Mayer's '100 Baggers', Lawrence Cunningham's 'Quality Investing', and anything about Warren Buffett and Charlie Munger because they've been adopted as growth investors too. On the flip side, how many books on value investing have become bestsellers over the past decade? I can't think of one.

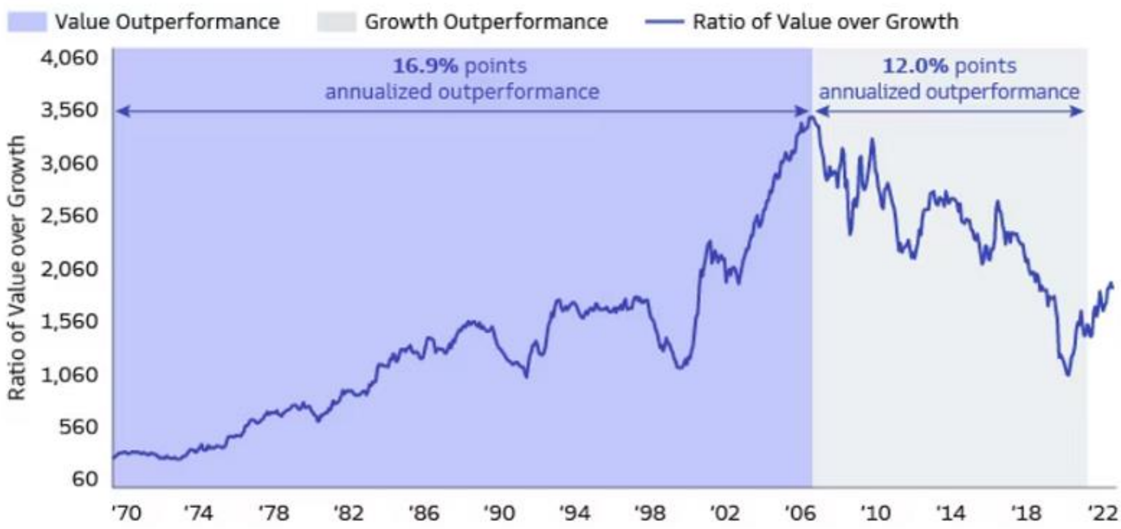
You can look elsewhere to detect this trend too. I've scrolled through podcasts, and my best guess is there's at least 30 podcasts on growth investing versus one on value investing.

It's not just reflected in the media either. The number of investment managers with a value investing style has plummeted over the past 15 years. In Australia, there aren't many left.

I want to explore whether value investing is dead, or if it isn't, whether there may be an opportunity for contrarian investors to exploit.

Value's long period in the shade

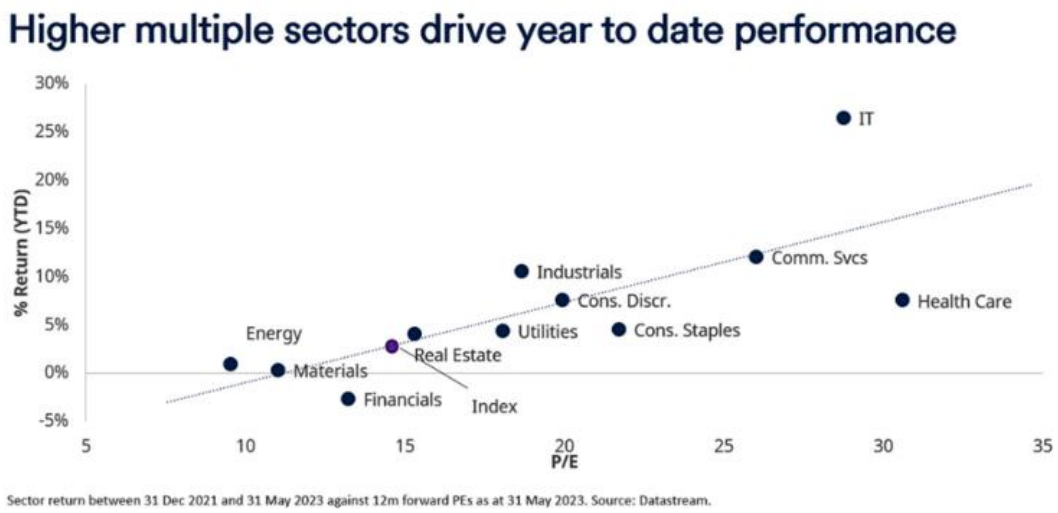
Let's first look at the extent of growth investing's outperformance versus value of late. The chart below of the US market provides some context. Over the past 16 years, growth has outperformed value by 12% per year. That's enormous. The outperformance started in February 2007, it survived the GFC with many value stocks getting hammered, before value picked up in 2011-2012 as the commodities boom peaked, and then growth got rolling especially into 2021.



Source: Kenneth R. French, Bloomberg and Goldman Sachs Asset Management. As of March 9, 2023. Data from January 1970 to January 2023. The ratio of Value over Growth is defined as the ratio of Fama/French H20 portfolio formed on Book-to-Market factor and Fama/French L20 portfolio formed on Book-to-Market factor. Value regime is defined as the period between January 1970 to February 2007. Growth regime is defined as the period between March 2007 and September 2020. **Past performance does not guarantee future results, which may vary.**

The chart tells us a few other things. Over the long term, value has tended to outdo growth. And it's true that value itself got bubbly heading into 2007, and again later in 2012. Since then, though, it's been one-way traffic and value investors have been hammered.

The trend started to reverse last year, although this year, growth investors have regained the ascendancy. For instance, the ASX has seen stocks valued on higher earnings multiples performing markedly better than those with lower valuations in 2023.



Where are all the value managers?

The ascendancy of growth investing was brought home to your author at an investor update from Talaria Capital, a global value firm based in Australia.

Co-CIO Hugh Selby-Smith spoke of how few value investing stablemates are left in Australia. He says most independent investment firms with a value investing bias have either switched to being 'pragmatic' investors or they've gone out of business. Selby-Smith says he has some value investing friends at funds within large institutions, but these funds are often ignored, and are certainly less resourced than their growth counterparts.

The question I put to Selby-Smith is how Talaria has managed to sidestep the carnage of other value investment funds. And he talked extensively about process and discipline. For 17 years, Talaria has largely adopted the same process. For them, it's all about finding stocks that generate substantial free cashflow, have rock-solid balance sheets, and can be purchased at discounts to fair value.

Much of Talaria's investment process is about eliminating behavioural biases in generating stock ideas and even for stocks that are currently in the portfolio. The firm conducts 'anti-mortems' that involve taking the opposite side of a stock idea to make sure the team view it through an objective lens.

Selby-Smith argues this process has helped the firm to largely avoid so-called 'value traps'. These traps are the bane of value investors as they involve stocks that normally have fallen in price and seem cheap though are of questionable quality and, for a variety of reasons, decrease in price further after purchase.

I think there are two other reasons for Talaria's success as a value manager. It's had consistent performance over short-and-long-term periods. It's also had retail investors who've hung around as they've understood the company's investment philosophy and process.

Talaria has been the rare exception where others have fallen on harder times.

Time for a value comeback?

Historically, investment styles run in and out of favour, about every 10 to 15 years. Currently, growth is the top dog. Yet, there may be signs that we might be nearing a top. The decline in numbers of value funds/managers, the rise and rise of books and investment letters on growth investing, the number of 'star' fund managers topping performance rankings who are growth managers (which probably peaked in 2021), and the bifurcation in stock markets where 7 stocks on the S&P 500 dominate returns yet are on forward price-to-earnings ratios of double the rest of the market (30x vs 15x).

A turn in the fortunes of value investing would have significant implications for listed companies and investors. What could be the trigger for a turnaround? One candidate could be inflation. Historically, value stocks have handsomely beaten growth stocks during periods of high inflation.

Macro Drivers of Value and Growth Regimes (%)

Macro	Value Regime	Growth Regime	Unconditional
Inflation (%)	4.7%	2.2%	4.3%
Growth (%)	3.2%	0.7%	3.2%
10-Year Yield (%)	7.6%	3.5%	5.1%
Outperformance (% points)	16.9%	12.0%	–

Source: Kenneth R. French, Bloomberg, Haver Analytics, Macrobond, and Goldman Sachs Asset Management. As of March 9, 2023. Value regime is defined as the period between January 1970 to February 2007. Growth regime is defined as the period between March 2007 and September 2020. Inflation is measured by the YoY change in US CPI. Growth is measured by the QoQ change in US real Gross Domestic Product (GDP) annualized.

It's impossible to accurately forecast the future though if history is any guide, any turnaround in value stocks is likely to prove both sharp and long lasting.

James Gruber is an Assistant Editor for Firstlinks and Morningstar.com.au. This article is general information.

Reporting season – expect early signs of downgrading

Jun Bei Liu

Amid continued economic uncertainty we can expect more companies to downgrade their expectations this reporting season as a result of the slowing growth across many sectors, especially over the past month.

In the first half of 2023, profit margins were still holding up as companies were able to push through their price increases with minimal impact on demand. As the economy softens, and the impact of higher inflation and rising rates takes hold, we expect a softening profile outlook for the second half of 2023.

Retail

The retail sector provides a good barometer to the broader market. We expect many retail companies will provide a trading update within the first six weeks of this financial year. Consumer demand will be the key. If consumers are no longer prepared to pay higher prices for goods and services – which is likely to be the case for many companies in this sector - it will not bode well.

Any insight into foot traffic will also be very important. Despite the prevalence of online shopping options, many retailers still rely on foot traffic. If that is falling, it points to a tough 12 months ahead.

Attention should also be paid to retail inventory levels. Most retailers have managed to lower their inventory significantly over the past six months, but there are a few retailers still holding on to very high inventory. This will negatively impact earnings expectations as we head into an uncertain economic environment because of the possibility of having to write this stock down in six months time.

Another good barometer of the market is the state of consumer staples stocks such as Coles Group (ASX:COL) and Woolworths (ASX:WOW). These companies have performed well to date, but supermarkets need consumer trading to remain strong, which might be a bit of a stretch in the current economic climate. It will also be interesting to see whether they have elevated costs and if so, what they are doing about it.

Resources

Resources companies will report their quarterly results first which means we will hear from them in the next few weeks about their production and capital expenditure. Some will even provide their 2024 outlook.

While commodity prices are holding up, labour shortages and high wages are still a problem. Some resource companies that have had their production impacted by weather events and may be under some pressure. Expected capital expenditure is also likely to be high.

The larger and diversified resource companies will likely remain unscathed but the smaller companies, with just one or two mines or a concentrated geographic area, may be hard hit.

Healthcare

Ordinarily, the healthcare sector provides no surprises – they are a growth leader and run strong business models. But higher labour costs and the lack of labour availability has seen healthcare companies across the board take a hit. A few healthcare companies, including CSL (ASX:CSL), have already downgraded their forecasts. Expect Ramsay Health Care (ASX:RHC) to also be under the spotlight.

Patchy trading conditions means we will see some volatility in healthcare this reporting season. But the impact will likely be short term and investors will be sitting on the sidelines waiting to buy on the dip.

Technology

The tech sector went through its 'near-death' experience last year and six months ago it was largely unloved by investors. But over the past six months most of them have realised they need to focus on profitability, or at least on creating a pathway to profitability. Most tech companies have talked about reducing costs to achieve this and it will be more of the same for most tech companies this reporting season. The narrative will be their businesses are continuing to track well, they are finding more cost efficiencies, and they are working out how they can leverage their pricing power.

M&A activity

There are a lot of buying opportunities for companies in the listed market at the moment, particularly when compared to their unlisted peers. Whether it is in the property sector, or in the consumer retail sector, there are plenty of cheap bargains that present fertile ground for M&A activity, especially if companies report a tough result and the share price tumbles.

Over the next six months M&A activity is expected to be quite strong across the listed market. A few companies in the commercial property sector, such as Dexus Property Group (ASX:DXS), are looking incredibly cheap and under pressure.

There are also the likes of A2 Milk Company (ASX:A2M) and Treasury Wine Estates (ASX:TWE). Both have a very strong balance sheet and continue to be leveraged to what is expected to be a stronger China over the next 12 months. Both companies are also trading at a very cheap multiples and have strong valuation support.

Short-term outlook

The outlook will be soft in the short term and many companies will step away from giving a clear guidance expectation.

This reporting season will see a consensus downgrade for 2024, which is more significant than usual, and is a result of the wide range of potential outcomes for the Australian economy over the next six months.

Long-term outlook

Between six to 18 months, if interest rates stabilise before beginning to head downwards, it will be positive for many of these companies that are about to give downgrades. The challenge is that it is always very hard for the share market to look past a recession, even if it is just a technical one.

What does this mean for investors?

Conditions should improve within 12 months for investors, but earnings forecasts need to be more realistic before the share market can sustainably run higher.

We can expect a rebase of earnings across a lot of sectors. For investors, this presents a buying opportunity to acquire high-quality companies at lower prices.

Jun Bei Liu is Lead Portfolio Manager, Alpha Plus Fund at Tribeca Investment Partners, a specialist investment manager partner of GSFM Funds Management, a sponsor of Firstlinks. The information in this article is provided for informational purposes only. Any opinions expressed in this material reflect, as at the date of publication, the views of Tribeca and should not be relied upon as the basis of your investment decisions.

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Inflation: A rare SMSF consideration

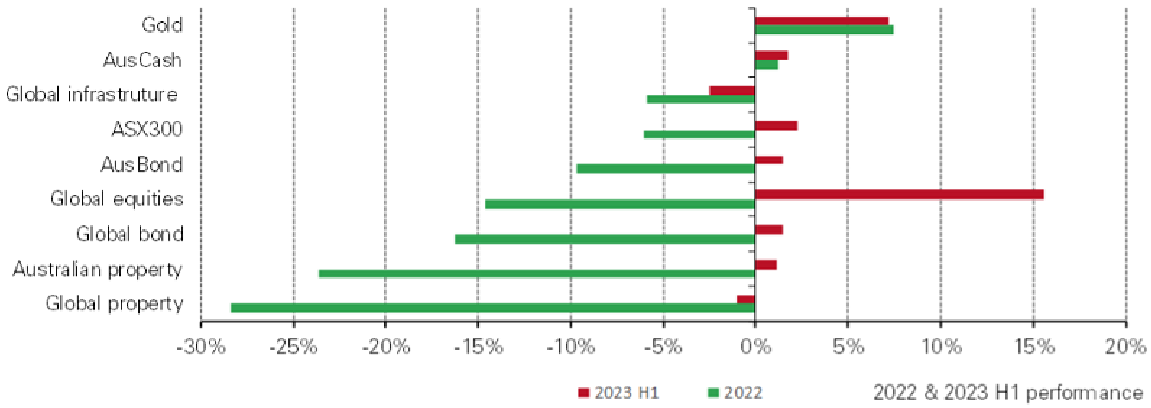
World Gold Council

SMSF investors continue to face inflationary pressure not seen in decades. And it could influence investment performance if the potential effects are not considered.

It has been more than 30 years since the Consumer Price Index (CPI) reached 7%. The effects of rising inflation and subsequent central bank interest rate decision making were plain to see by the end of 2022. Having surprised markets by another 25bp hike in June, the RBA noted in their recent statement, that while inflation in Australia has passed its peak, it is still too high and that it will be some time before it is back within their target range of approximately 2-3%. And the Governor noted upside risks to the inflation outlook has increased and "*the path to achieving a soft landing remains a narrow one*".

Additionally, the vulnerability of global capital markets from negative shocks remains. The most recent example being the collapse Silicon Valley Bank (SVB), coupled with Credit Suisse a few days later. Investors started to call into question the stability of the banking industry which helped move gold over the US$2,000 level, and coupled with a weakening FX rate, gold recorded its highest ever price in Australian dollars on May 4, 2023, at A$3,052/oz.

2022 and H1 2023 returns from major assets in Australian Dollars*



*Source: Bloomberg, World Gold Council. *As of 31 December 2022. 2023 Y-t-d refers to 30 June 2023. Based on LBMA Gold Price PM, AusBond Bank Bill Index, AusBond 0+ Composite Index, Bloomberg Barclay Global Agg, ASX300 Index, MSCI World Index, ASX300 A-REIT Index, FTSE EPRA/NAREIT Developed ex-Australia Index, FTSE Developed Core Infrastructure Index. All calculations are in AUD.*

Where could this lead?

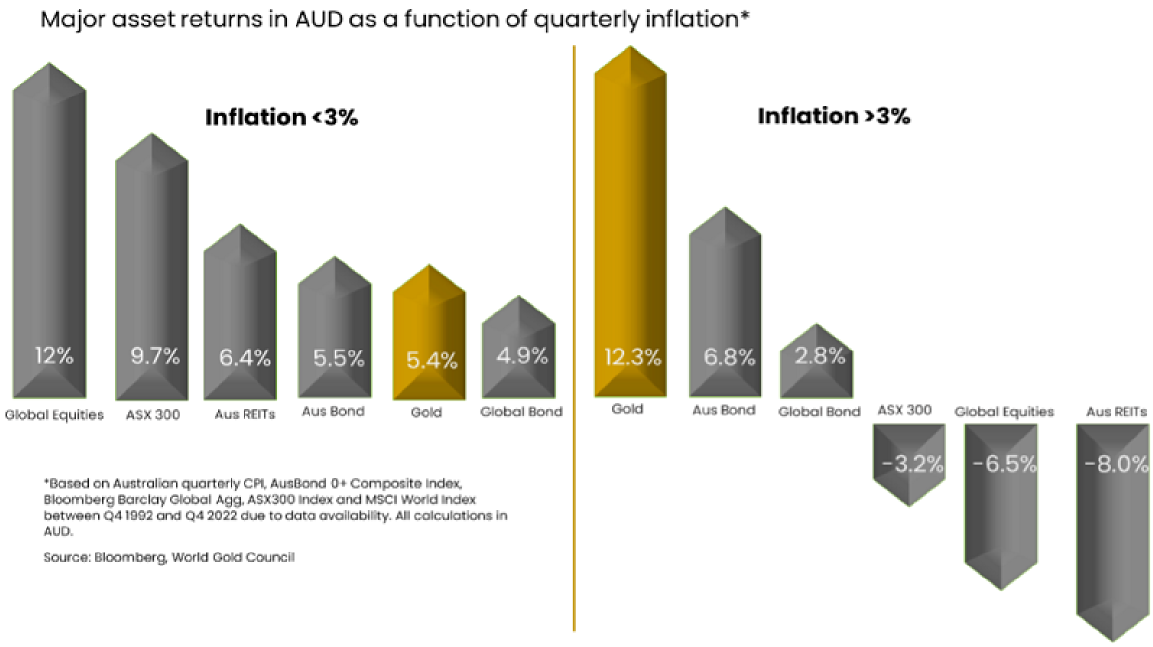
With the upside risk to future inflation rising and local economic outlook dimming, the traditional warning signs of stagflation exist. Stagflation is defined as an economic cycle characterized by slow growth and a high unemployment rate accompanied by high inflation. The most notable period in Australia occurred in 1975 when a recession begun after the price of oil quadrupled.

In addition, the global geopolitical landscape is potentially hindering economic recovery efforts worldwide. The ongoing situation in Ukraine, and tensions between the US and China, might continue to impact financial markets. Over the coming 18 months elections in the US and EU are scheduled. There is additionally the prospect of the UK, Russia and Ukraine going to the polls. All of these events pose risk to the fragility of the economy with some being higher than others.

What should an SMSF investor be considering?

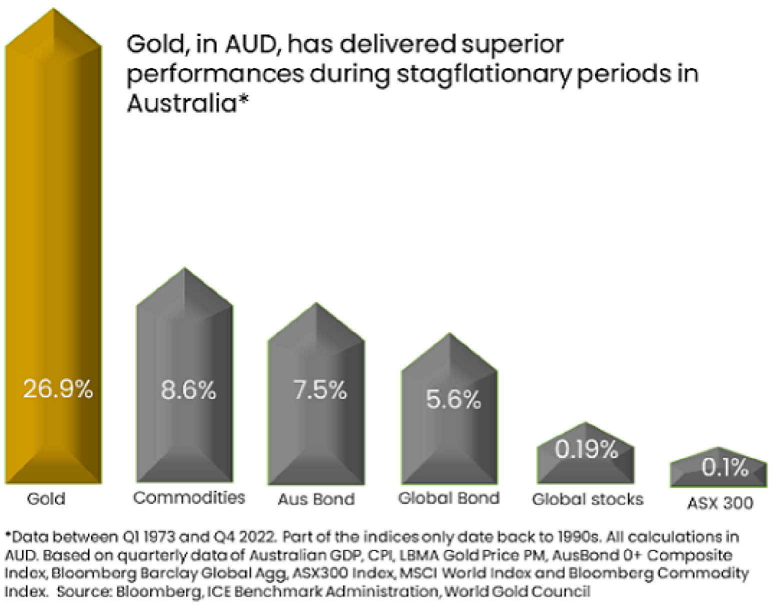
Does your SMSF have enough protection over stubborn high inflation and other possible market events? While property is a stable long term inflationary hedge, it has had considerable setbacks over the past 24 months. Additionally, the sustained interest rises imposed by the RBA to combat inflation, may pose challenges Property is illiquid too meaning that while the long-term return on investment will still remain positive, it cannot help to hedge portfolios in the short and/or medium term.

Another inflationary hedge asset, which is often overlooked by some SMSF investors, is Gold. It has long been considered the hedge against inflation and market events. It can also provide accessible liquidity if and when needed. Historical data confirms its status with an **annualised return of 7.6% in AUD over the past 20 years**, it has outpaced the Australian and world CPIs even in calmer economic times.



And should stagflation arise?

During stagflation periods, financial markets have seen heightened volatility while both commodities and gold fared well. Historical data reveals that investment portfolios have benefited from gold's attractive returns during such periods.



As aforementioned potential risks arise, gold may have a significant role to play over the coming years to help protect and sustain portfolio performance. Our recently published investment update concluded that a portfolio comprising of assets typically held by an SMSF would have achieved higher risk-adjusted returns and lower drawdowns with an allocation to gold over a 3, 5, 10 and 20-year period.

At the very least, SMSF investors should review their existing investment strategy and ensure that it has the right protection over high inflationary pressures, and to gain a greater understanding how it could potentially perform should stagflation hit home.

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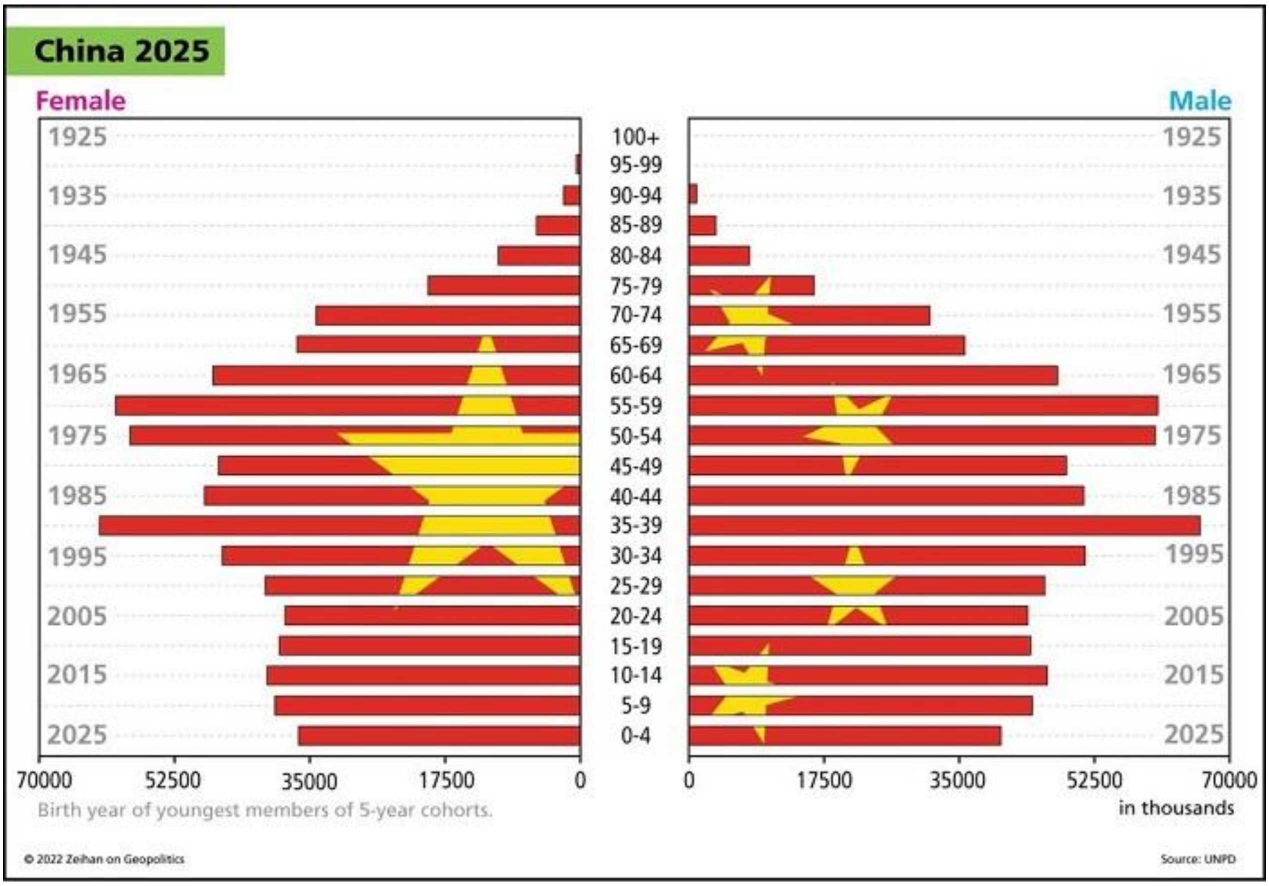
China in advanced stage of demographic collapse

Peter Zeihan

This is an edited transcript of a video talk given by geopolitical strategist, Peter Zeihan, on new Chinese demographic data.

Today we're breaking down the new demographic data from the Chinese space. This will allow us to make some much-needed updates to an already bleak assessment...and spoiler alert, it's going to get a lot worse.

Okay, let's start with this first graphic to show you where the official data had us as of a year and two years ago.

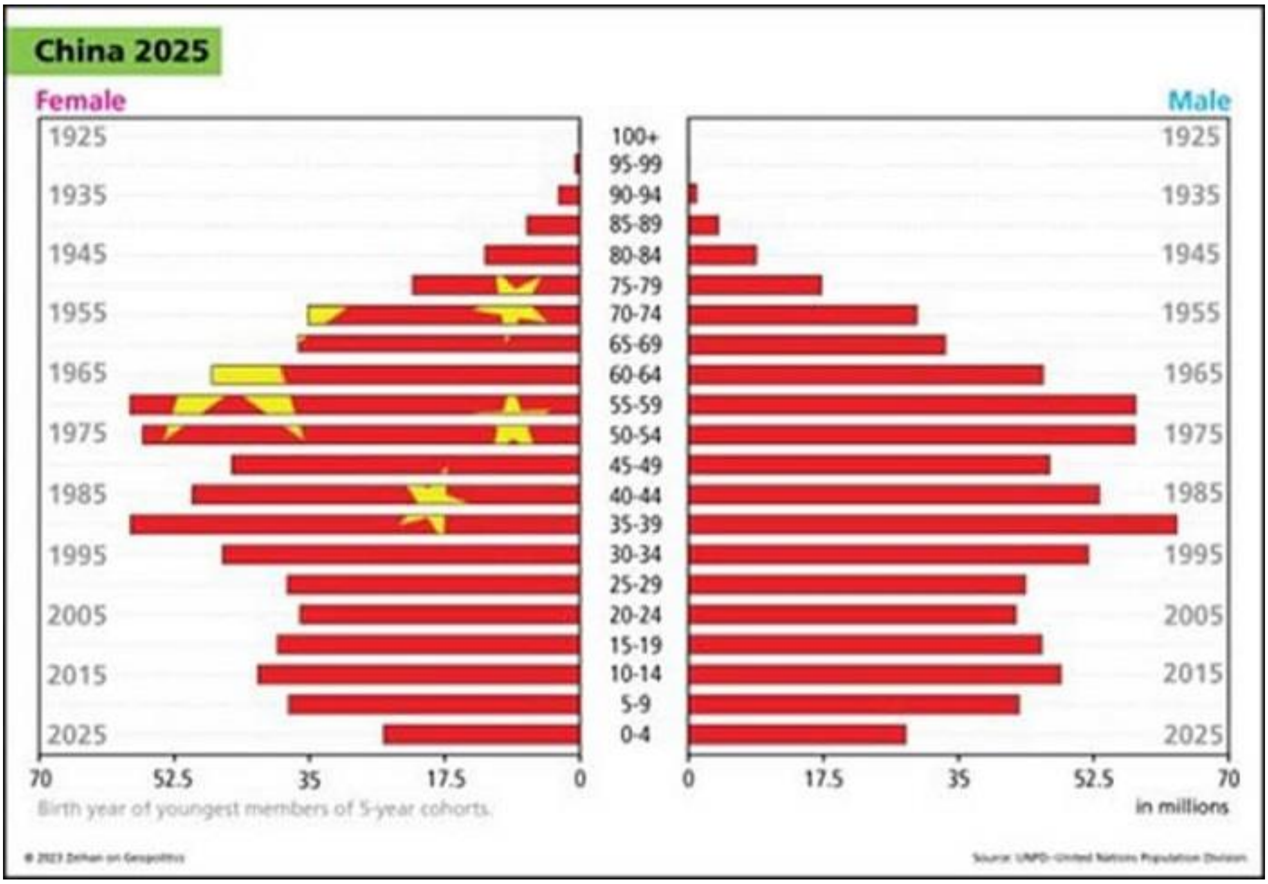


This narrowing for the bottom seven age blocks is the fastest aging workforce in the world and arguably the fastest one in human history. This indicates that the number of new workers coming in is so small compared to the number that are retiring that you're having massive increase in labor costs and from adjacent numbers that we do trust. I mean, Chinese data is always a little touch-and-go. But from the numbers that we do have that we do trust, which is labor costs, Chinese labor is increasing at the fastest pace of any country in any era at any time in history, including during the Black Death itself.

Since 2000 the cost of Chinese labor has gone up by about a factor of 15 while the size of the Chinese economy has only expanded by a factor of roughly 3.5 to 4. The Chinese are only an industrial power today under this data because of the sunk cost of the industrial plant that it took to build everything that's there in the first place.

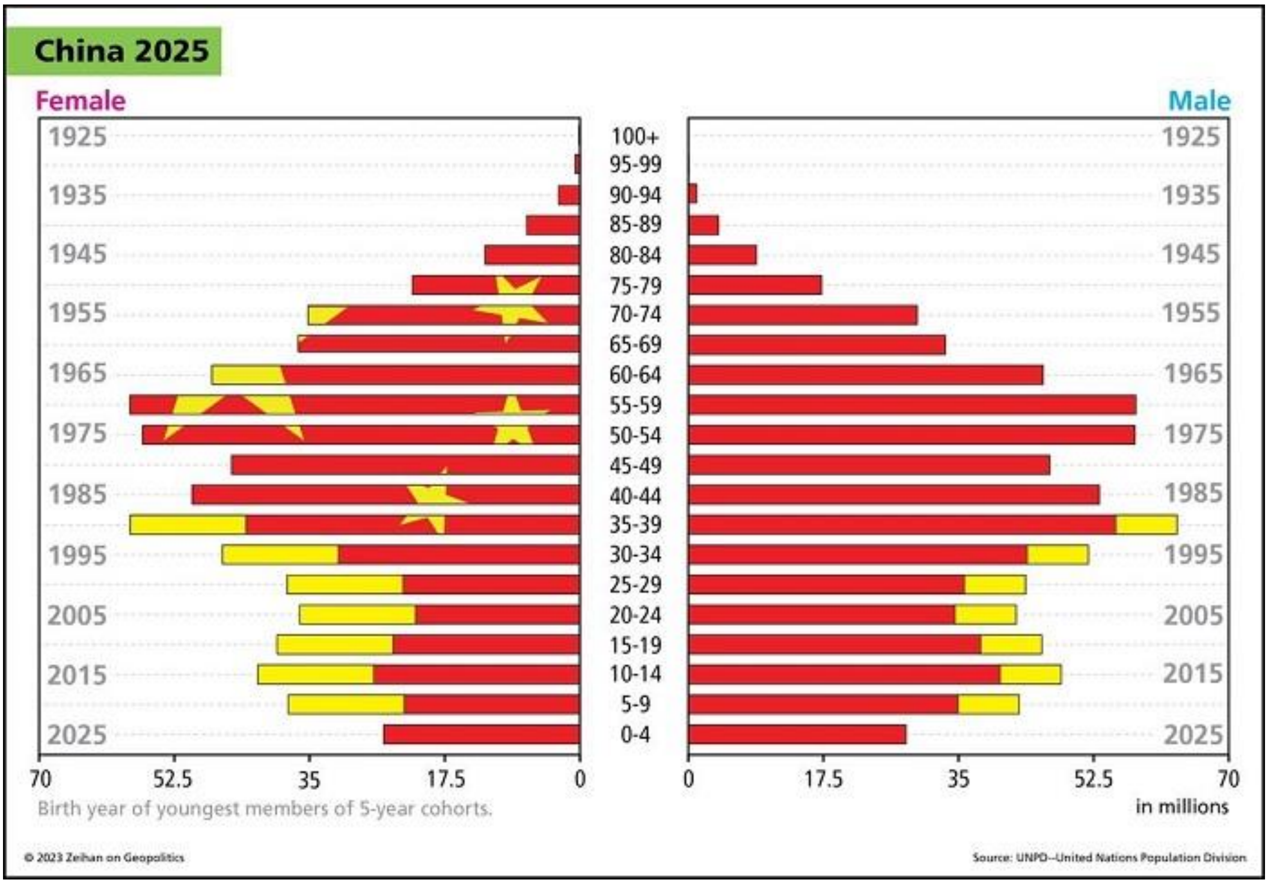
Now, that's not nothing. That is huge. That's trillions of dollars, tens of trillions of dollars. And it's highly relevant. But most industries and most subsectors that have decided to relocate to other countries have discovered that they've got shorter, simpler supply chains, where there's a lot less of a political headache.

Okay, here is the new data. And as you can see that the number of children who are under age 5 has just collapsed and there are now roughly twice as many that are aged 15 as there are aged 5.



What happened back in 2017, well before COVID, is that we had a sudden collapse in the birth rate, roughly 40% over the next five years among the Chinese, the ethnic Han population and more than 50% among a lot of the minorities. And that is before COVID, which saw anecdotally the birth rate drop considerably more and before COVID, which probably raised the death rate considerably. We're now never going to get good data on death rate, or at least not anytime soon, because the Chinese, when they did the reopening, they just stopped collecting the data on deaths and COVID and everything because they didn't want the world to know how many Chinese died, so they don't know.

With this data, the snapshot in time, this is official state data, it's still probably not wildly accurate. We still have the Shanghai Academy of Sciences, which is like the biggest nerd group you've got in the country, saying that the country has overcounted their population under age 45 by over 100 million people in the aftermath of the one child policy. And so, really, what we need to consider is that that official data now at the very bottom, you need to play that up. And this last graphic shows you our internal estimate of where that is. Now, this is not official. Those yellow bars probably don't exist, but that is not what the official data is saying. This is an extrapolation from what the Shanghai Academy of Sciences is saying.



Anyway. Some version of this is probably the truth, which means that China aged past the point of demographic no return over 20 years ago. And it wasn't just this year that India became the world's most populous country. That probably happened roughly a decade ago. And it wasn't in 2018 that the average Chinese aged past the average American. That was probably roughly in 2007 or 2008. So, this is not a country that is in demographic decay. This is a country that is in the advanced stages of demographic collapse, and this is going to be the final decade that China can exist as a modern industrialized nation-state because it simply isn't going to have the people to even try.

For those of you who have business in China, you're becoming more and more aware of the political system, you're becoming aware that it's becoming illegal for foreigners to even access data, data that in most countries is publicly available. You now have on top of that to figure out that not only is the labor force never recovering and the labor costs you're having now are as low as they're ever going to be, consumption is as high as it's ever going to be. Even before you consider the political complications or issues with operating environment or energy access or geopolitical risks or reputational risks, the numbers just aren't there anymore.

You have to ask yourself why you're still there. Some cost of industrial plant? That's a reasonable answer. But it becomes less relevant with every passing year as everything else catches up.

Peter Zeihan, founder of [Zeihan on Geopolitics](), is a geopolitical strategist, speaker and author. This article is general information and does not consider the circumstances of any investor. This article is an edited transcript of Peter's video, [New Chinese Demographic Data = Population Collapse](), posted on 29 June 2023.

Podcast: Contrarian opportunities in property stocks

Firstlinks

Season 2, Episode 4

In this week's episode, we cover the hot topic of real estate. Our special guest is global listed property expert, Andrew Parsons of Resolution Capital, who's turned from sector bear to optimist. As the market marks down the sector, Andrew sees contrarian opportunities opening up, especially in retail property. Meanwhile, Firstlinks' Graham Hand discusses residential property and why he believes owning a home beats super in retirement. Lastly, Peter Warnes looks at why interest rates in Australia won't be cut for some time and what areas that could impact over the next 12 months.

The podcast is also available via our dedicated website page, Google Podcasts, Apple Podcasts, Spotify, and BuzzSprout.

Please share with friends and colleagues, and a favourable rating would help spread the word. We welcome questions and suggestions at firstlinks@morningstar.com.

Grab a cuppa and settle in for our chat.

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