Firstlinks
a Morningstar company

Edition 521, 11 August 2023

Contents

Selling is the easy part but what about reinvesting? *Graham Hand*

Church of Apple *Blair duQuesnay*

Meg on SMSFs: should I start my pension before selling assets? *Meg Heffron*

Where to from here after this year's big tech rally? *Chris Demasi*

The drawbacks for SMSFs moving funds into cash *Balaji Gopal*

Podcast: Big flows into super funds force unlisted allocations *Firstlinks*

What to consider when paying for a nursing home *Anam Bilgrami*

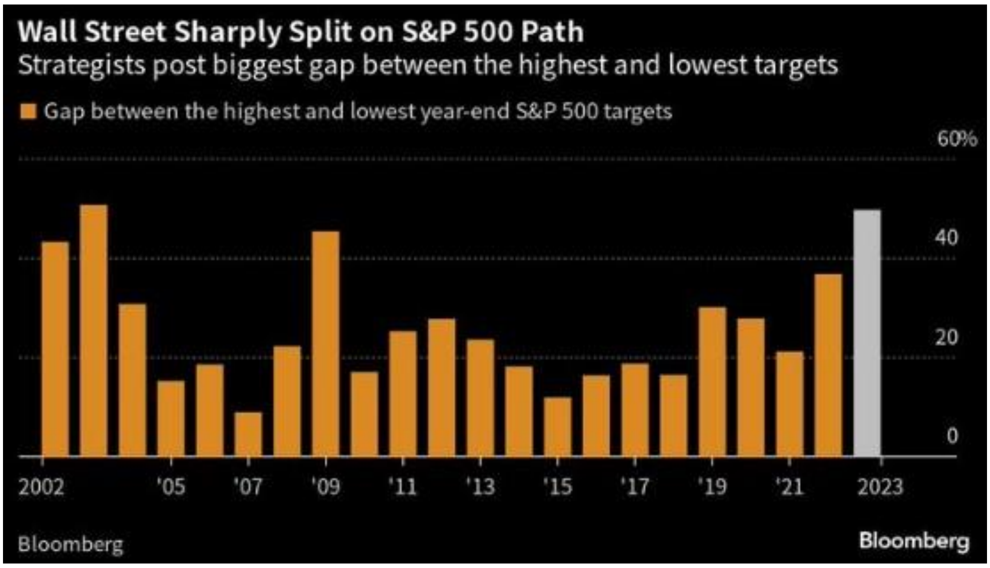
Editorial

I have been overseas for a month, and instead of reading the continuous news stream received sitting at my desk each day, I dipped into my emails less often. And it is striking how much of the hourly and daily milieu is useless noise for most long-term investors. Seen from a distance, the perpetual output from economists and analysts on the Reserve Bank cash rate, the US Fed funds rate, the direction of the stockmarket, the expected company results and consequences for markets and the economy look like contradictory guesses. Forecasts read a couple of days after publication are already wrong.

A recent headline in the leading global investment publication, **Seeking Alpha**, reads:


The S&P 500 May Be Heading Back To 4,100

The S&P500 is currently about 4,500. And guess what. *May be* the S&P500 is heading for 4,700. According to **Bloomberg**, the range of Wall Street analysts' S&P500 targets for the end of 2023 is about 50%.



Where one expert announces "*The Reserve Bank's next move is down*", the next says "*Reserve Bank not finished yet*" while another has two bob each way with "*Next Reserve Bank move uncertain*". It might be relevant for day traders but long-term investors who react to speculation on what might happen tomorrow will condemn themselves to over-trading, exiting the market and struggling to find a reinvestment level. Selling with an intention to re-enter is an attempt to make two correct guesses and is likely to fail. I explain the challenges this week in the context of an investment exit I made on my personal account in early 2022 which for a long time looked inspired. Until it didn't.

The other headline subject that looks useless from a distance is the common claim that these are '*volatile*' or '*difficult*' or '*uncertain*' investment markets. It does nothing but induce caution or worse, exiting the market, when all that is happening is the regular movement of share prices.

Consider this quote on the rapid changes in financial markets:

"In recent years the pace of change and innovation in financial markets and institutions here and around the world has increased enormously as have the speed, volume and value of financial transactions. The period has also seen a greatly heightened degree of aggressive competition in the financial sector. All of this is taking place in the context of a legal and a regulatory framework which is increasingly outdated and ill-equipped to meet the challenges of the day. This has led to … concern that the fragility of the system has increased, in part because the degree of operational, liquidity and credit interdependency has risen sharply."

Was this said last week in these volatile and uncertain times? No, it is **Gerald Corrigan, ex-President of the New York Fed**, speaking in January 1987. Let's not pretend volatility is new just for the sake of a headline. There are always reasons to sell, and what looks like a crisis usually turns out to be little more than ongoing noise. Tune it out.

Let's take one simple example of how wrong forecasts can be, as **Westpac** reported this week.

*"At the time of the May 2023 Budget, the **Federal Government** forecast an underlying cash surplus in 2022/23 of $4.2bn, to be followed by deficits in 2023/24 and 2024/25 of $13.9bn and $35.1bn respectively. These forecasts were based on the government's economic forecasts, which include employment; wages; inflation; output and commodity prices; as well as their forecasts for government expenditure.*

Westpac's forecasts for the budget positions over that period indicate a surplus of $22bn in 2022/23; a surplus of $11bn in 2023/24; and a deficit of $16bn in 2024/25. That would mean a combined improvement in the cumulative Budget positions over the three years of $62bn."

May 2023 was only a few months ago, and the best brains in Treasury missed a cool $62 billion of improvements. $62 billion!

Check this table from *The Australian Financial Review* a little over a year ago showing their Quarterly Economist Survey forecasts for June 2023 and December 2023. Most have a peak cash rate in the 2s and some have an Aussie dollar at 80 cents. The current cash rate is 4.1% and the exchange rate is about 65 cents. As the saying goes, *'If you must forecast, forecast often.'*

Quarterly economist survey

Forecasts for key Australian indicators		Australian dollar ($US) CURRENT 0.69		Cash rate (%) CURRENT 0.85				
Forecaster	Institution	Dec 22	Jun 23	Jul 22	Dec 22	Jun 23	Dec 23	Peak
Shane Oliver	AMP Capital	0.72	0.80	1.35	2.35	2.60	2.10	2.60
David Plank	ANZ	0.76	0.76	1.35	2.25	2.60	2.85	3.10
Tony Morriss	Bank of America	0.78	0.80	1.35	2.85	3.50	3.50	-
Peter Munckton	Bank of Queensland	0.73	0.76	1.35	2.35	2.85	2.85	2.85
Shreya Sodhani	Barclays	0.74	-	1.35	2.25	2.50	2.50	2.50
Jo Masters	Barrenjoey Capital	0.72	0.75	1.35	2.35	2.60	2.35	2.60
David Robertson	Bendigo and Adelaide Bank	0.74	0.79	1.35	2.50	2.75	3.00	3.00
David Bassanese	BetaShares	0.68	0.70	1.35	2.35	2.50	2.25	2.50
Sean Langcake	BIS Oxford Economics	0.73	0.75	1.35	2.10	2.50	2.50	2.50
Ben Udy	Capital Economics	0.74	0.73	1.35	3.10	3.10	2.85	3.10
Gareth Aird	Commonwealth Bank	-	-	1.35	2.10	2.10	1.60	2.10

Saul Eslake	Corinna Economic Advisory	0.69	0.67	1.10	1.85	2.35	2.35	2.35
Phil O'Donaghoe	Deutsche Bank	-	-	1.35	3.10	3.10	2.60	3.10
Craig Emerson	Emerson Economics	0.72	0.72	1.25	1.50	1.75	2.00	2.50
Andrew Boak	Goldman Sachs	0.69	0.72	1.35	3.10	3.10	3.10	3.10
Paul Bloxham	HSBC	0.68	0.67	1.35	2.35	2.60	2.60	-
Alex Joiner	IFM Investors	0.69	0.68	1.35	2.00	2.25	2.25	2.25
Warren Hogan	Judo Bank	0.76	0.74	1.25	2.25	2.50	2.50	3.50
Brendan Rynne	KPMG	0.72	0.72	1.35	2.00	2.50	2.50	2.50
Justin Fabo	Macquarie Bank	0.67	0.64	1.35	2.60	3.10	2.60	3.10
Stephen Anthony	Macroeconomics Advisory	0.67	0.64	1.35	2.60	3.60	4.60	5.00
Bob Cunneen	MLC	0.72	0.73	1.35	3.00	3.75	3.75	3.75
Katrina Ell	Moody's Analytics	0.72	0.73	1.10	1.75	2.25	2.75	3.00
Chris Read	Morgan Stanley	0.68	0.70	1.35	2.60	3.10	3.10	-
Michael Knox	Morgans	0.75	0.80	1.60	3.10	3.80	3.80	3.80
Alan Oster	NAB	0.72	0.74	1.35	2.10	2.35	2.60	2.85
Michael Blythe	PinPoint Macro	0.70	0.75	1.35	2.35	2.35	2.00	2.35
Su-Lin Ong	RBC Capital Markets	0.69	0.70	1.35	2.85	2.85	2.85	2.85
Prashant Newnaha	TD Securities	0.75	0.78	1.50	3.25	3.25	3.25	3.25
George Tharenou	UBS	0.80	0.80	1.35	2.60	2.60	2.10	2.60
Bill Evans	Westpac	0.75	0.78	1.35	2.10	2.35	2.35	2.35
Tim Toohey	Yarra Capital Management	0.76	0.78	1.35	2.35	2.50	2.25	2.50
Mean		**0.72**	**0.74**	**1.34**	**2.44**	**2.74**	**2.70**	**2.89**
Median		**0.72**	**0.74**	**1.35**	**2.35**	**2.60**	**2.60**	**2.85**

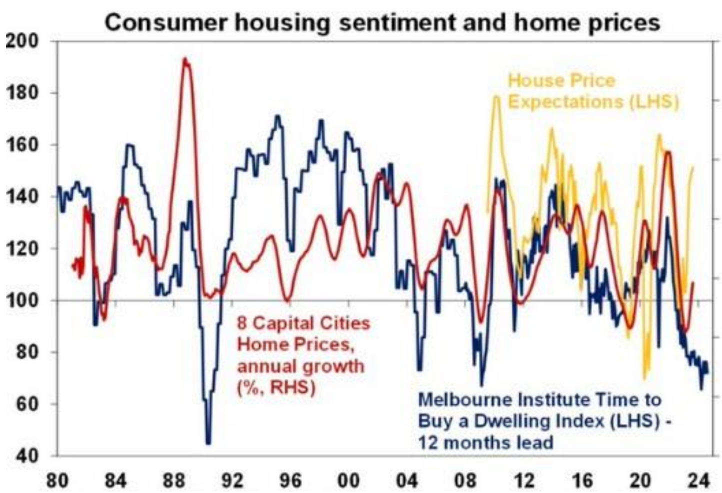
* Year-ended trimmed mean

While we were overseas, we visited the spectacular, **UNESCO**-world heritage listed **Cologne Cathedral**, well worth adding to a European journey. It claims the largest church façade ever built and the heaviest swinging bell in the world, cast in 1448 and weighing 11 tons. And this from the church's brochure:

"On a first visit to Cologne Cathedral (begun in 1248) one is astonished to learn that it took 632 years to complete it. This was made possible only because no generation of builders departed from the original masterplan. Everyone who began and continued this building project over centuries was aware that they would never see completion."

Say what? A consistent plan for **632 years**, in the face of politicians, architects and builders who no doubt came with their own opinions and desires. Most of us can't stick to a long-term investment plan for a few years.

Another high-profile forecast which has defied most analysts is Australia home prices, driven by high immigration and low unemployment. However, as shown below, according to the **Westpac/MI** survey, perceptions of whether now is a good time to buy a dwelling are at their lowest level since the GFC, while prices are rising. As **AMP's Shane Oliver** says, it questions the durability of the property price upswing.

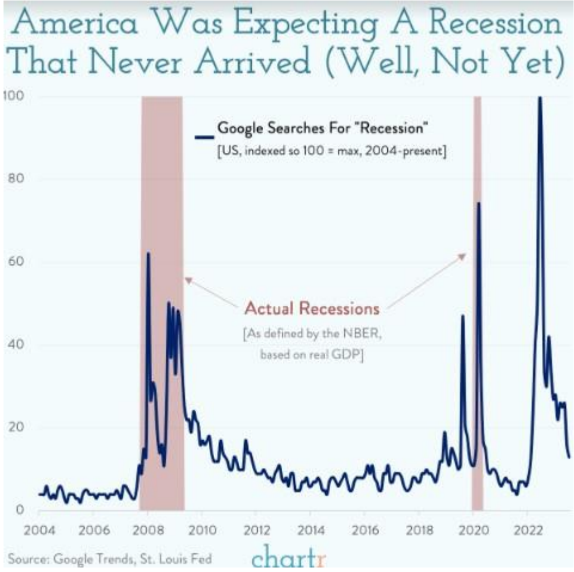


Source: Shane Oliver, AMP

We have all read the articles in the last year on how an inverse yield curve is a strong predictor of a recession. The rationale is that if long-term rates are lower than short term, it means the bond market expects the outlook for the economy to be poor and interest rates will fall. This chart shows the persistence over 2023 of the [2-year US

[Treasury rate above the 10-year](#) (ie a negative or inverse yield curve), yet US equity markets, driven by tech companies, continue to ignore the recession threat. One of the markets is correct, and in my experience, it's usually bonds.

But we can always find other evidence. Another predictor of recessions is how many people search for the word 'recession'. The good news is that while searches were at record highs in 2022, they have significantly fallen in 2023, probably due to lower inflation and robust employment. Hopes for the 'soft landing' yet.



Thanks for the strong engagement in [my article last week](#) on my European travels. For anyone who read the article just after publication, dozens of great comments came in later. And in case anyone doubts that Australia is a great place to live, see the latest global city rankings from **The Economist.** Tiny Australia holds two of the top four places.

Graham Hand

Also in this week's edition ...

Continuing on from Graham's examples of investing in **Microsoft, Apple and Alphabet** comes **Blair duQuesnay**'s thoughts on Apple. It is the [ecosystem of product links](#) that meet basic needs that makes the company so strong.

Further on this theme which is driving US markets, **Chris Demasi from Montaka** argues that while the rapid increases in the share prices of the 'Magnificent Seven' have pushed up valuations, they are [great companies whose rise is not yet finished](#).

Many SMSF members know that their fund stops paying income tax on some or all of its investment earnings when it starts paying 'retirement phase' pensions. This tax break can mean a complete tax exemption on capital gains that have built up over many years, but is it essential to start the pension [before selling assets](#)? **Meg Heffron** has some answers.

Meanwhile, SMSFs have been increasing their allocations to cash and cash-like products. It indicates that capital protection remains a priority for these funds. Yet **Balaji Gopal** from **Vanguard Australia** warns that cash isn't a risk-free asset, especially when its returns still trail inflation. He suggests that SMSFs should instead [look at other defensive assets](#).

This week's [*Wealth of Experience* podcast] features special guest, **John Abernethy**, from **Clime Investment Management**. John has seemingly done it all in his 40-plus years in investing, and in a broad-ranging interview, he questions whether size is becoming a problem for Australia's super funds. **Peter Warnes** offers a different take on super and their unlisted assets, while **Graham Hand** looks at retiree fears of running out of money.

Moving yourself or a loved one to a nursing home can be emotional and difficult. It's an important and complex decision that can affect your income, wealth, means-tested aged care fee, and bequests. **Anam Bilgrami** of **Macquarie University** offers some tips to help you with the decision.

Finally, in this week's White Paper, **First Sentier** has recently met management at North American infrastructure companies, as well as with regulators, and it details key findings.

Curated by James Gruber and Leisa Bell

Selling is the easy part but what about reinvesting?

Graham Hand

One of the bigger challenges facing investors is to hang on to their shares during a market selloff, or when the perception that the future for equities is bleak. Investors often justify the sale by telling themselves they will 'buy back at a lower price', but that will probably become a doomed attempt to make two correct timing decisions. It may mean the investor is out of the market and misses long-term gains.

The sharemarket falls by 10% or more at some stage in most years and suffers negative returns in about three out of every 10 years. Substantial falls of over 30% occur every 20 years or so. There is never a shortage of reasons to sell, as shown below, and always an expert fund manager warning of doom. For retirees in particular, the threat of a significant loss of capital can be too much to bear, leading to selling even when shares are supposed to be part of a long-term portfolio holding.

Double trouble, both the sale and the repurchase decision

The right time to sell is difficult enough to time, and generally done at the wrong moment. Deciding to sell and then buy when the market might be somehow lower is even tougher, doubling the required timing luck. As Howard Marks said:

"In both economic forecasting and investment management, it's worth noting that there's usually someone who gets it exactly right … but it's rarely the same person twice."

Those who are reassured by the intention to buy back in as soon as things have 'settled down' face two major hurdles:

1. If the market falls, the temptation is to wait longer for the bottom, as if someone rings a bell on the critical day. OR
2. If the market rises, there is a psychological hurdle of paying more for the same shares that were recently sold at a lower price.

At least the decision to sell may be justified and driven supposedly by short-term risk mitigation, or a market event or changed outlook which justified caution. But what trigger does the investor look for to buy back in?

The impact of major falls such as in the GFC

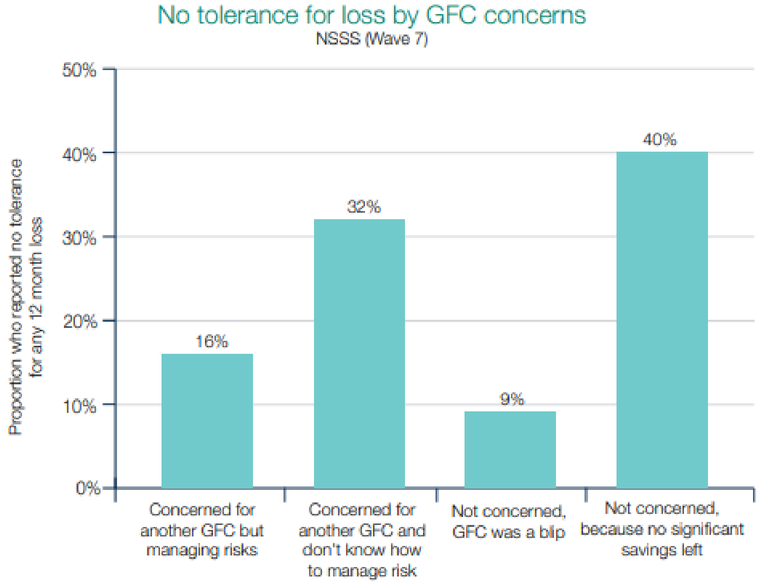
The GFC was about 15 years ago but its impact has remained profound for many investors. Between November 2007 and March 2009, the S&P/ASX200 Accumulation Index fell 51%, and it was a shock for many.

The most unfortunate impact was that retirees experienced such a rapid loss in the value of their retirement savings that it turned them against equity investing. They not only missed the subsequent recovery but the large fall drove a conservatism that misses the long-term benefits of equity market growth.

The most comprehensive survey of the reactions of older Australians to the GFC was conducted by National Seniors. Although *Once Bitten Twice Shy* was published five years ago in 2018, it shows the ongoing impact of a significant market fall. The survey concluded:

"Ten years on from the GFC, its impact lingers for most older Australians, who express a 'once bitten twice shy' sentiment as a result of their experiences. Seven out of 10 are still concerned about another potential market collapse. Older Australians are still wary of market turmoil, with only one in fourteen thought they would be able to tolerate a loss of 20% or higher – about the same as the fall in superannuation returns during the GFC a decade ago. One in four said they could tolerate losses greater than 10%, though the same proportion said they could not tolerate any annual loss on their portfolio."

Relationship between having no tolerance for loss and GFC concerns (%)



Long-term consequences for investment returns

There are many studies which show that investors earn less than the funds they invest in. For example, Morningstar produces an annual Mind the Gap report, which concludes in 2023:

"Our annual study of dollar-weighted returns (also known as investor returns) finds investors earned about 6% per year on the average dollar they invested in mutual funds and exchange-traded funds over the trailing 10 years ended 31 December 2022. This is about 1.7% less than the total returns their fund investments generated over the same period. This shortfall, or gap, stems from poorly timed purchases and sales of fund shares, which cost investors roughly one fifth the return they would have earned if they had simply bought and held."

Morningstar Australia's Mark LaMonica examined the history of the report and the numbers have been similar for many years. He says:

"The larger point is that timing the market is hard. Expectations are baked into prices which means that once there is more clarity on the certainty of an outcome it is often too late. Timing the market means anticipating future events before other investors. It also means getting the call right. That can be a lonely and intellectually

challenging exercise. Because everyone else is doing and saying the opposite. It is hard to go against the crowd."

My missed reinvestment after a 'forced' sale

For many years, when presenting to audiences on investing and superannuation, I focussed my material on portfolio construction, asset allocation and long-term planning. I am not a stock analyst and I argued that returns will be driven more by allocations between various asset classes than particular stocks over the long run. I might discuss managed funds versus ETFs but not Rio versus BHP or Westpac versus CBA.

Despite this background, I am invariably asked for my stock picks. People love stock stories, and to show I am not clueless on particular companies, I explain that I spend most waking hours in some interaction with the products of three great US companies – Microsoft, Apple and Google (Alphabet). I like funds which hold these stocks or I invest directly.

For example, it would be impossible for me not to renew my subscription with Microsoft. I am highly price insensitive, and when this email came in recently, I did not even compare it with the previous year, but I have no doubt it is a higher cost:

"Your subscription is scheduled to be automatically renewed. On Saturday, August 19, 2023, AUD 139.00 including taxes will be charged to XXX."

And of course, Microsoft has other great businesses (cloud and server, LinkedIn, hardware, gaming, etc).

Similarly, I use my mobile phone dozens of times a day. A few years ago, I switched cost from Apple to Samsung because I wanted a phone with a pen to jot down ideas. Apple does not produce such a phone. But for overall functionality, I found Samsung was not as smooth and well sorted, and after a few years, I switched back to Apple, despite the new iPhone costing $1,400. Apple raises its prices every year and still sells hundreds of millions of its phones and a billion people are integrated into its services.

And Google is so much part of our lives that it is a verb, my personal email is Gmail, I watch a lot of YouTube and use maps and Chrome.

So I tell my audiences that I think there is a strong case to include these great companies in most portfolios, perhaps subject to valuation, and I intend to hold them for a long time.

But I didn't.

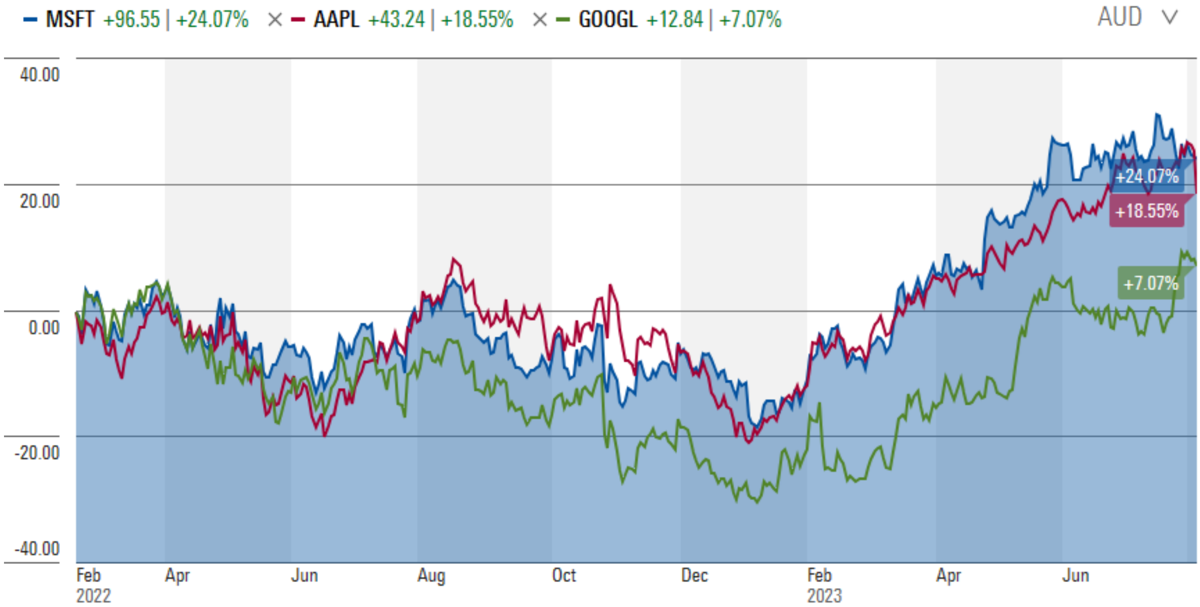
For reasons of administrative simplicity, I invested directly in these US companies using the Deutsche and Chi-X (now Cboe) product called TraCRs, as well as via some growth-oriented funds. It allowed easy investment in many leading US companies on the ASX, handling the FX and any other requirements, as if buying an Australian company. Then in November 2021, Deutsche announced it was terminating the product from 21 February 2022. Investors were given the choice to sell, convert to the underlying US shares by opening a new brokerage account, or do nothing and Deutsche would arrange the sale. I decided to sell the TraCRs on market (completed between 17 and 21 February 2022) but I opened a new international brokerage account with the intention of buying the shares directly.

But I didn't.

For much of 2022, I looked like a timing genius. Although I wanted to hold these great companies, they all fell in price over 2022 as interest rates rose, investors thought they were overvalued, and the recession threat loomed.

Then along came AI and each of them has boomed in 2023. My plan to reinvest was missed. While I can defend myself by claiming I was pushed to sell, I could have bought back immediately, but I took a stab at market timing.

The chart from Morningstar below shows that since I sold my TraCRs in February 2022, in AUD terms, Microsoft is up 24.1%, Apple is up 18.6% and Alphabet is up 7.1%. They fell heavily over 2022 but have come back with a surge, and I don't own any of them, other than through managed funds and ETFs. I did not anticipate the AI boom and I expected interest rate rises to bite harder, in a failed attempt to time the reinvestment price.



What's the main lesson?

Although this example relates to a few specific companies, the main lesson relates to exposure to equity markets overall. Perhaps timing of the exit will look good for a while, but the reinvestment might be missed, and with it the long-term exposure.

If you have identified a great company, let the vicissitudes of the markets and months roll past and the years and decades will look after themselves. Correct execution of two timing decisions will be more a matter of luck than profound foresight.

Graham Hand is Editor-At-Large at Firstlinks. This article is general information and not investment advice.

Church of Apple

Blair duQuesnay

In first grade, my elementary school opened a new campus. It had a computer lab stocked with Apple MacIntosh computers. For one hour each week, we learned coding language on an application called Logo Writer. If we were lucky, the teacher would let us play Oregon Trail when our assignments were complete. I remember the first mouse Apple introduced. We giggled as we adjusted from using the keyboard arrows to the magical handheld device named after a rodent. Actual floppy disks transformed into hard, floppy disks to save our projects and papers. By high school, we were tasked with creating multimedia presentations on our turquoise-colored iMacs. They looked like control boxes on a spaceship. When I went away to college, however, I bought a Dell desktop. MacIntosh was temporarily out of favor.

Then Apple takes over

I moved to New York to work on Wall Street in the early 2000s. The first-generation iPod was all the rage. I felt like the only person in Manhattan riding the subway without earphones and an iPod. The smaller, nano version came out later that year, and I received one as a birthday gift. When the iPhone launched in 2007, it was originally limited to service with AT&T. AT&T service was terrible in Manhattan. We all used Verizon exclusively. Besides, I already had a company-issued Blackberry for emails. When Apple launched new products, people would line up for hours (some overnight) outside the Apple stores on 5th Avenue and in Soho to be among the first purchasers. I didn't go on the first day but waited several hours in line to buy the first iPad at the 5th Avenue store.

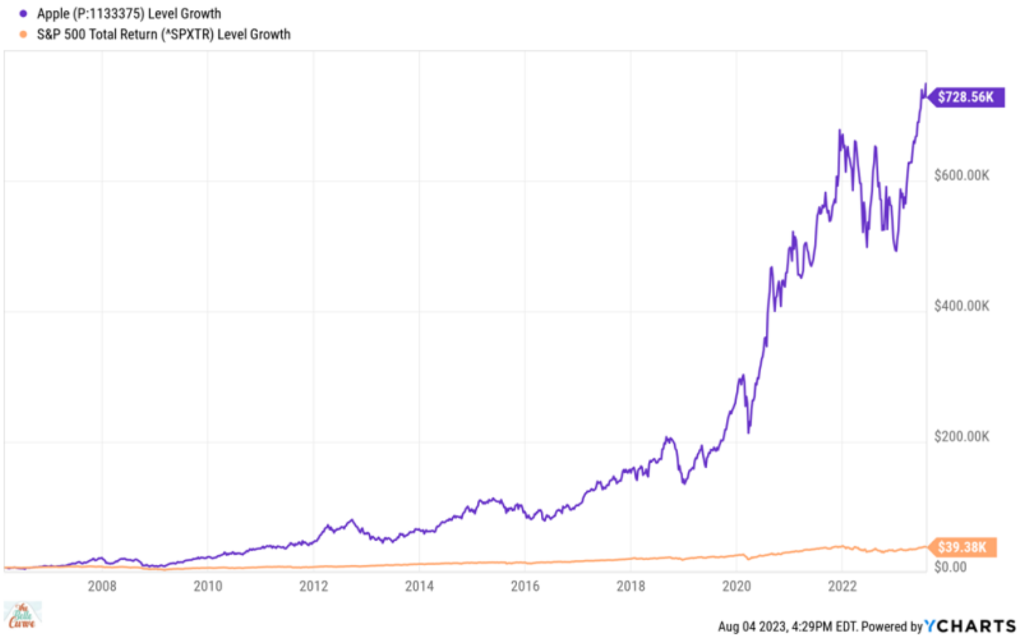
I didn't jump on the iPhone wagon for several years. Fast-forward to today, I have three or more Apple devices that I use daily – iPhone, iMac, and AirPods. I keep a backup pair of AirPods just in case mine die. I cannot imagine life without them. I am fully immersed in the Apple ecosystem, right down to the monthly subscription for storage. My only holdout is the watch. I've never worn a watch, so I find no reason to start. Never say never.

One could argue that Apple, Inc. is history's most influential and powerful company. Apple's products and services permeate every facet of modern Western lives. The iPhone has replaced hundreds of other devices. Devices that, not too long ago, were considered cutting-edge technology in their own right. Now we get all of these devices in one tiny rectangular box that fits in our pocket. iPhone is simultaneously an alarm clock, Walkman, computer, camera, heart rate monitor, map, newspaper, magazine, book, video game console, photo album, weather source, and even television. I could go on. The iWatch is literally monitoring biodata 24/7 - reminding you when to eat, sleep, walk, and stand up. Many well-to-do Americans own not one or two but three or more Apple devices and subscribe to one or more of Apple's monthly services. The Apple savings account, which launched in April, has over US$10 billion in deposits.

I didn't fully comprehend the importance of my iPhone until it was snatched from my pocket by a thief at Mardi Gras. My life runs on that little device. Thank goodness for iCloud backup; my life was up and running on a new device in minutes once I purchased a used iPhone XR. I didn't even miss the last photo I snapped less than 10 minutes before the theft.

The rise and rise of Apple's share price

But the impact of Apple's stock may be even more influential than the company's products and services. I have met countless investors who have life-changing portfolio returns attributable solely to Apple stock. These are everyday people, not uber-wealthy, who invested normal sums of money (think $10,000 – $50,000) into Apple shares and held onto them for 10, 12, 15 years, or more. Their Apple returns have allowed them to retire earlier than planned, to spend more in retirement, and countless other financial dreams. My only challenge is convincing them to dial back their single stock exposure risk and to pay a little capital gains tax to enjoy those earnings.



Just for fun, or maybe to give myself heartburn, I looked at what my first bonus in 2006 (US$8,000) would be worth today had I bought only Apple shares and never sold. Those shares would be worth over US$725,000 today! That's from an investment of US$8,000 in March 2006. I know myself, however, so I know I would have taken gains off the table along the way; either to diversify or put a down payment on a home or something else that reasonably happens in life. But it's still fun to dream or make myself sick with the benefit of perfect hindsight.

How large can it get?

It is no wonder that we all worship at the church of Apple (or Facebook, Microsoft, Google, Netflix, etc). These companies not only permeate our everyday lives – in most cases making them better – but also have contributed significant gains in our portfolios. I recall watching in amazement as Apple became the first stock with a US$1 trillion market cap in 2018. Today Apple's market cap is over US$3 trillion. The GDP of France, the 7th largest economy is the world, is US$3 trillion. The numbers are simply astounding.

I am writing this post as neither a praise nor criticism of Apple as a company or an investment. I am merely in awe of this one institution's sheer size and prevalence in modern life. I am grateful for the ways Apple's products and service make my life easier, and I am equally grateful for the returns the stock has provided not only to those who bought shares individually but also to everyone who invested in the US stock market over the past 20 years. I'm not sure if its dominance is good or bad for society in the long run, but it gives me comfort to know that Tim Cook, a fellow native Alabamian, was hand-picked by Steve Jobs to be his successor.

Blair duQuesnay, CFA®, CFP® is an investment advisor at Ritholtz Wealth Management, LLC. For disclosure information please visit: https://ritholtzwealth.com/blog-disclosures/. Republished, with permission, from The Belle Curve.

Meg on SMSFs: should I start my pension before selling assets?

Meg Heffron

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

These days, many SMSF members know that their fund stops paying income tax on some or all of its investment earnings (rent, interest, dividends, capital gains) when it starts paying 'retirement phase' pensions.

A 'retirement phase' pension is usually a pension that is being paid to someone who is older than 65 or who is slightly younger but is classified as 'retired' for superannuation purposes. This particular tax break is one of the greatest benefits of having long term investments in super because it can mean a complete tax exemption on capital gains that have built up over many years.

But is it essential to start the pension(s) before selling the asset? Maybe, maybe not.

Some examples

It's easiest to explain the rules using examples, and understanding the rules can be incredibly handy.

Let's start with Craig. In 2020, Craig turned 60 and retired. At the time, he started a pension with all his super (in his SMSF) and so today his fund just has pension accounts (he's the only member). His fund has owned an investment property for 15 years which it's about to sell. The property is worth a lot more than his fund paid for it - so will there be a lot of capital gains tax to pay?

In fact, this property can be sold without his fund paying any capital gains tax at all. That's despite the fact that Craig knows most of the growth in value actually happened before he retired and started his pension. All that's important is how the fund looks in the year the property is actually sold.

So a great rule of thumb for anyone approaching retirement is to wait and sell SMSF investments *after* starting pensions if the fund is facing very large capital gains.

But it's slightly more involved than that.

First of all, Craig's situation was really simple. He converted **all** his super into a pension and it happened several years ago. So in his case, all of his fund's investment income (including all capital gains) are exempt from tax this year.

But what about Craig's friend Tony? Tony had a very large super balance and wasn't able to turn all of it into a pension when he retired in 2021. The super tax rules only allow a limited amount – known as the 'transfer balance cap' ($1.7 million at the time) – to be put into a retirement phase pension when it first starts. Tony's super balance was $2 million when he started his pension in July 2021 and so he needed to leave $300,000 out of his pension in an 'accumulation account'. Today, his super is still split between his 'pension account' and his 'accumulation account'.

The tax for Tony's SMSF is worked out slightly differently. A percentage (rather than all) of his fund's investment income is exempt from tax. The percentage is likely to be around 85% for Tony's fund because his pension account represents around 85% of his total fund. So if his SMSF sold an investment property in 2022/23, 85% of the capital gain would be exempt from tax but the remaining 15% would be taxable.

Even that example is still simple-ish because the pension started in a previous financial year.

What if Craig and Tony only started their pensions in (say) January 2023 and their funds sold property in May 2023?

Craig's whole fund was still in retirement phase pensions from January 2023 onwards. That means all of its income after that time will be exempt from tax, including the capital gains from the sale of the investment property in May 2023. (Funnily enough, the position might be different if Craig had other super pensions in another fund – but we'll assume he doesn't for now.)

In Tony's case, remember that only a percentage of the capital gain is exempt from tax. Unfortunately, the percentage has to be worked out over the whole year. In this example, around 85% of the fund was in a retirement phase pension for the second half of the year but it was 0% for the first half of the year. So the percentage for Tony's fund in 2022/23 will only be around 42%. That's potentially a disaster – only 42% of the capital gains will be exempt from tax. It's because the percentage that's being used is very low – dragged down by the fact that Tony only started his pension part way through the year.

In this case, Tony would be better to wait – sell the property early in the **new** financial year. For 2023/24, the percentage will be more like 85% (as long as nothing else changes – like he stops his pension).

A key tip here is that if a pension starts mid-way through a year, the percentage in that first year is often a lot lower than it will be in the future.

What if Craig and Tony's SMSFs had sold the property in August 2022 before they started their pensions? At first glance this sounds like a disaster for both of them. But actually it's not.

In Tony's case, nothing changes. His percentage is still 42% for 2022/23 (exactly the same) and 42% of all the investment income the fund has earned during the whole year is exempt from tax. Even income it earned before his pension started. And even capital gains like this one.

Craig also has a possible solution. Normally Craig's SMSF would work out its tax exemption using the method described earlier – all income (including capital gains) after his pension started is exempt from tax and everything beforehand is taxable. But from 2021/22 onwards, SMSFs like Craig's are allowed to choose to be treated like Tony's – and use the percentage method. In this case, the percentage would be around 50% (ie his fund was 0% in pension accounts for the first half of the year and 100% in the second half). Just like Tony's SMSF, this 50% would apply to all investment income for the whole year – both before and after the pension started.

No easy answers

So believe it or not, it's not always critical to wait until after pensions start to sell assets with large capital gains. But the nuances can be complex – it's definitely a time when good advice can save thousands in tax.

And one final note : just like everything else with super, there are ifs, buts and maybes. In these examples, Craig and Tony had all their super in their SMSF, they were the only members and they'd never had pensions before the dates talked about in this article. Changing any of these circumstances could change the outcome – definitely talk to your adviser or accountant before going ahead. It's also worth understanding when assets like property are 'sold' for this purpose. It's when the contract is exchanged, not when the fund gets the money.

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.

For more articles and papers from Heffron, please click here.

Where to from here after this year's big tech rally?

Chris Demasi

The sharp rise in equity markets this year has been nothing short of astounding. Many investors had written off stocks after last year's heavy falls and amid fears around central bank rate hikes and the threat of a global recession as we entered 2023, but the S&P500 rallied into a bull market.

S&P500 Index from 1 January 2022 to 30 June 2023

Source: Bloomberg

For the first six months of the year, the index was up 16%, its best performance since the first half of 2019. The tech-heavy Nasdaq Composite index surged 32%, its best first half in four decades.

Just a few soaring stocks have driven almost all of the market's rebound. Together Amazon, Microsoft, and Alphabet contributed nearly 30% of the gains made by the S&P500 in the first half of the year.

We previously identified these three owners of the 'hyperscaler' cloud computing platforms as the clearest and most certain winners from the AI revolution.

Adding Nvidia, Meta Platforms, Apple, and Tesla, this exclusive group of just seven AI and technology winners accounted for almost 80% of total index gains, despite representing just a quarter of the value of the index. Such phenomenal performance so quickly from the largest companies has led some investors to wonder if these stocks have run too far and whether they should take profits by selling.

While investors might be tempted to sell these top performers to take quick profits and look for better returns elsewhere, we believe that could be a costly mistake in the long run. In fact, we think the best days for these stocks are still ahead, and holding onto them will be extraordinarily rewarding. There are compelling reasons why several of these big-tech winners have much further to go in the years ahead, and investors who hang onto them will be richly rewarded.

Zooming out puts rallies into perspective

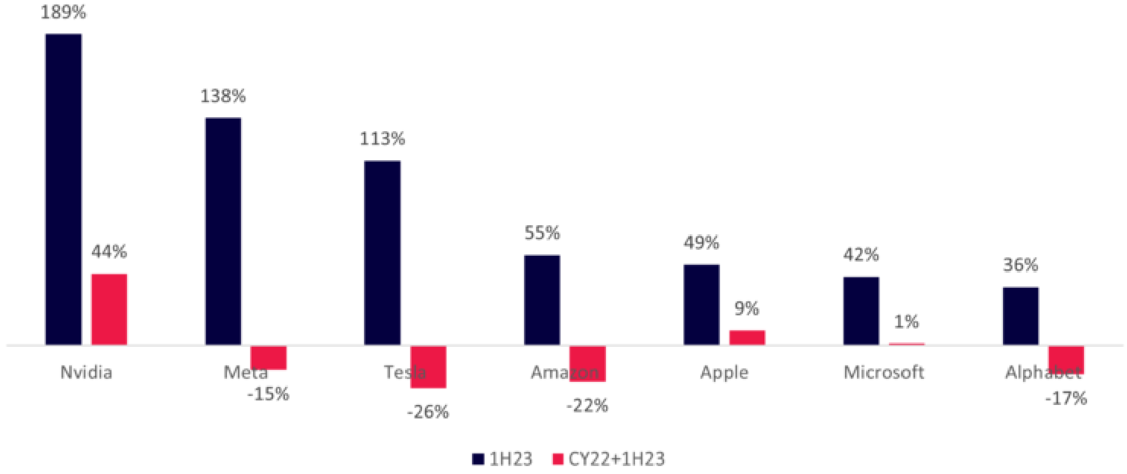
If we look at the recent rallies over a short timeframe, it looks like stocks have run too hard and too far. But if we step back and look at the longer-term picture, it shows that, despite the exceptional run-up in share prices this year, most have not fully recovered from last year's large drawdowns.

The group of seven big-cap technology winners is a case in point. Yes, they rallied hard in the first six months. Yet when we look at the last 18 months – including all of 2022 and the first half of 2023 – their performance is mostly negative.

Over the longer horizon, the weighted average share price performance of the group was negative 3%, compared to positive 63% over the shorter period. Only Nvidia and Apple posted positive results over the last year and a half. Microsoft was flat, and the other four stocks are still down significantly from the start of 2022.

The same can be seen with stocks outside this group, too. Spotify, the world's largest music streaming service, made astronomical leaps, with its stock price more than doubling in the first half. However, that's still almost a third below its price at the beginning of last year.

Share price performance of select stocks across time periods



Source: Bloomberg

Zooming out paints a much more complete picture of stock price performance and helps investors avoid becoming trapped into thinking that share prices have risen much higher than they have.

Improving businesses and AI upside still not factored into share prices

What's more, while the share prices of industry leaders, including big-tech winners, have posted strong gains in the first half of this year, their stock prices still haven't caught up to huge improvements in their businesses, which suggests the rally has further to run.

1. Amazon

Amazon's cloud business, AWS, recently made several new high-powered AI capabilities available to customers, including its own specialized chips for training and inferencing machine learning models, a new managed service to access first and third-party AI models, and an AI-assisted coding program.

Amazon has also been making large strides outside its cloud business. The e-commerce behemoth redesigned its US fulfilment network to operate a regional model with lower costs and faster shipping times for consumers. It also built the third largest digital advertising business in the world by selling ad space on its website and media properties that grab the attention of hundreds of millions of shoppers.

Despite these game-changing improvements, Amazon's stock is down 22% from the start of 2022.

2. Microsoft

Earlier this year, Microsoft's Azure cemented its place as an AI pioneer by deepening its partnership with OpenAI to provide customers access to the machine learning models behind ChatGPT and DALL-E, powered by Azure's cloud platform.

Last quarter, Azure OpenAI customers jumped 10-fold.

Microsoft also announced a new 'Copilot' AI assistant, which combines OpenAI's machine learning models with Microsoft's proprietary data to improve the productivity of Office applications like Word, Excel, and PowerPoint.

Copilot versions of these programs should command a premium price and expand the appeal of Office beyond its current 382 million users.

Yet Microsoft shares trade roughly flat relative to the beginning of 2022.

3. Meta

Meta may be an even more striking case study.

Following the disruption from Apple's app ad tracking changes, and white-hot competition from TikTok's short-form videos over a year ago, Meta has executed a successful business turnaround underpinned by substantial AI investments.

Powerful AI capabilities have allowed Meta to overcome headwinds. It has regained its 'share of engagement' with AI-recommended content in 'Reels' short-form videos, and AI-enabled chatbots promise to expand its $US10 billion message-based ads business.

Yet Meta's share price is down 15% compared to 18 months ago when the company was grappling with a perfect storm – and that's after gaining 138% in the last six months.

4. Blackstone

A similar situation can be seen away from the world of tech companies, in the staider financial services sector.

Blackstone, the world's largest alternative assets manager, has built a team of hundreds of salespeople and partnered with major banks and brokers, establishing itself as a first mover in the $195 trillion private wealth channel.

The money-manager has also made major inroads to service the $45 trillion insurance market while continuing to raise larger funds among its traditional institutional clients that represent a $65 trillion market.

Meanwhile, Blackstone's share price is almost 30% cheaper than it was at the start of 2022, including its 25% rally this year.

Hold on to the winners

The public equity markets can have a way of tricking investors in the short term. It's important to zoom out from recent stock price charts and to look forward at improving business fundamentals and new opportunities.

While stock prices of some of the world's best companies are up a lot this year, they are only just getting back to where they were at the beginning of last year. Meanwhile, their underlying businesses are much better positioned than they have ever been and keep getting better. These are companies that can multiply in value many times over by the end of this decade.

Selling out to bank 'profits' from a 50% or even 100% turnaround following a big drawdown might well look like a big mistake if these stocks increase four or five-fold in the years ahead. Investors have an opportunity to make extraordinary gains if they can stay the course with winning companies as they transform industries and create value over time.

Chris Demasi is a Portfolio Manager at Montaka Global Investments, a sponsor of Firstlinks. This article is general information and is based on an understanding of current legislation.

For more articles and papers from Montaka, click here.

The drawbacks for SMSFs moving funds into cash

Balaji Gopal

Investment trends can sometimes be hard to pick, but the huge and ongoing investor cash inflows into Exchange Traded Funds (ETFs) that invest in fixed income securities such as government and corporate bonds is difficult to miss.

Fixed income inflows are currently running at a record pace, largely thanks to deteriorating economic conditions that have spurred a spike in interest rates. Higher interest rates are translating into higher fixed income returns.

Over the first half of this year, investors in the United States poured US$99.4 billion (A$144.3 billion) into fixed income ETFs, according to Morningstar. Meanwhile, European demand for fixed income ETFs hit record levels as investors added US$36 billion (A$52.2 billion) into listed bond funds.

Australian fixed income inflows also surged over the six months to 30 June 2023, according to data from the Australian Securities Exchange (ASX) and separate data from Vanguard. In Australia, the combined inflows into Australian-listed ETFs that invest in bonds exceeded the inflows into ETFs that invest in domestic and global shares. That's despite the strong first half rally on global equity markets, including on the ASX.

Collectively, investment inflows into Australian and global fixed income ETF products totalled $2.49 billion over the first half, which compared with inflows of $1.56 billion into Australian and global equity ETF products.

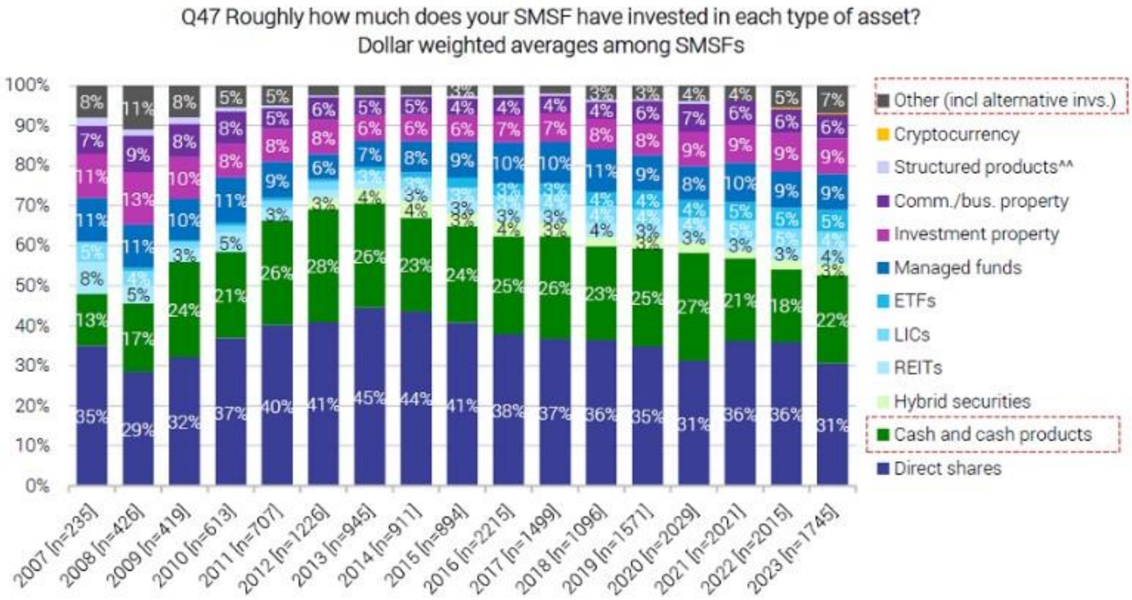
SMSFs become more defensive

This uplift in fixed income inflows is also likely to extend to the investments being made by Australia's self-managed superannuation fund cohort.

The 2023 Vanguard/Investment Trends SMSF Investor Report, released in June, found that many SMSF investors had started to increase their allocation to defensive assets in general. Conducted between February and March 2023, the annual report now in its 18th year represents the largest scale quantitative survey of Australian SMSF investors.

According to the report, one in five SMSFs acknowledge that the prevailing economic conditions have had a significant impact on their approach in selecting investments, with over a third of SMSFs indicating an increased allocation to cash and cash-like products.

Direct shares have seen the largest relative decline in terms of SMSF asset allocation on a dollar-weighted basis. Of the SMSF survey respondents, 36% said they had rebalanced their investment portfolio in the past year by between 10% and 50%. This had resulted in their average asset weighting to direct shares declining from 36% in 2022 to 31%, as shown below.



The primary reasons cited for this were because SMSF trustees had adopted a more defensive stance and had a negative outlook on overseas shares. With the current unsettled economic landscape of high interest rates and inflation, capital protection remains a priority for most SMSFs.

It is typical to see increased allocation to defensive assets such as fixed income or cash products during uncertain times. With interest rates rising, the data suggests SMSFs are favouring assets that they see as low risk.

The bottom line on cash

There is a common misconception that cash is a risk-free asset. While it is not prone to daily market volatility like shares are and is highly liquid, cash does have inherent investment risks.

A decade of record-low interest rates has meant that cash as an asset class has delivered an average annualised income return of just 1.9% since 2012. That's lower than any other major asset class.

Worse still, after taking high inflation levels into account, hovering between 5% and 7% at time of writing, real cash returns have been negative for some time.

Although rising interest rates have created short-term pain for Australian investors, they have helped to improve long-term return expectations for bonds.

While bond prices typically reprice lower when interest rates rise, investors with a sufficient long-term investment horizon will ultimately be better off.

Investors are also flocking to bonds in their search for diversification and income as yields continue to stabilise (a signal that investors are becoming more optimistic), presenting an attractive alternative to holding cash which has generally underperformed bonds post rate hike cycles.

Being slightly higher-risk than cash, bonds are generally expected to outperform cash over the long term. As of June this year, Vanguard's median annualised return expectations for Australian and global bonds ex-U.S (hedged to Australian dollars) over the next decade were 3.4% to 4.4%, and 3.6% to 4.6%, respectively.

Balaji Gopal is Head of Personal Investor and Financial Adviser Services at Vanguard Australia, a sponsor of Firstlinks. This article is for general information purposes only and does not consider the circumstances of any individual.

For more articles and papers from Vanguard Investments Australia, please click here.

Podcast: Big flows into super funds force unlisted allocations

Firstlinks

Season 2, Episode 5

In this week's episode, we welcome special guest, John Abernethy. John is the Founder and Chairman of Clime Investment Management. He's seemingly done it all across 40-plus years in investing, from managing multi-asset portfolios, to venture capital, and now overseeing a sizeable investment portfolio and financial advice business. John tells us that super funds aren't admitting to their biggest problem: having too much money is driving them into alternative assets. In a broad-ranging interview, he also outlines why bonds aren't great value right now and Aussie equities look good in comparison, as well as how the current government isn't doing enough to help reduce inflation.

Regular guest, Peter Warnes, has a different take to John's on super funds and unlisted assets. And he's scratching his head at a recent scathing review into APRA and its supervision of super. Finally, Graham Hand discusses why homeowning retirees should never run out of money, even though many fear they will.

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

What to consider when paying for a nursing home

Anam Bilgrami

Moving yourself or a loved one to a nursing home can be emotional and difficult. While some have their nursing home accommodation costs fully covered by the government (based on a means test), most will have to pay their own way.

The average lump sum room value is A$334,000. Choosing how to pay can make this time even more challenging, particularly for those with low financial literacy.

This is an important and complex decision. It can affect your income, wealth, means-tested aged care fee, and bequests. Here are some things to consider before you decide.

Three ways to pay

You can pay for a nursing home room in three ways.

You can pay the entire room price as a one-off, refundable lump sum (a "refundable accommodation deposit", sometimes shortened to RAD). This lump sum is refunded to the resident or their estate when the person leaves the nursing home (if they move or pass away).

The refund is guaranteed by the government, even if a provider goes bankrupt.

People who don't want to pay a lump sum can instead choose rent-style, "daily accommodation payments" (sometimes shortened to DAP).

These are fixed, daily interest-only payments calculated on the total room price. The rate at which they are calculated is known as the "maximum permissible interest rate" or MPIR.

The maximum permissible interest rate is set by the government and is currently 7.9% per annum. The formula for a daily accommodation payment is (RAD × MPIR) ÷ 365.

Unlike lump sums, daily accommodation payments are not refunded.

The third option is a combination payment. This means paying part of the room price as a lump sum, with daily payments calculated on the remaining room amount. On leaving the home, the part lump sum is refunded to the resident or their estate.

With a combination payment, the consumer can choose to pay whatever amount they like for the lump sum.

The table below shows three different ways someone could pay for a room priced at $400,000.

Three different ways to pay for a nursing home room priced at $400,000

	Option A: Full lump sum payment	Option B: Daily payments	Option C: Combination payment
Lump-sum paid on entry:	$400,000	$0	$100,000 (a)
Daily amount paid over the stay (b):	$0	$86.58 per day	$64.93 per day
Refund received on leaving the home:	$400,000	$0	$100,000

Notes: a). A $100,000 part lump sum payment is only given as an example. Any lump sum amount is possible when choosing a combination payment. b). Daily payments are calculated using the current MPIR (7.9% per annum) applied to the owing lump-sum. For Option B, the daily payment is calculated as ($400,000 x 7.9%) ÷ 365 = $86.58 per day. For Option C, the daily payment is calculated as ($300,000 x 7.9%) ÷ 365 = $64.93 per day.

Table: The Conversation • Created with Datawrapper

So which is best? It's impossible to say. It depends on a person's circumstances, family situation, finances, preferences and expected length of stay.

Why do some people choose a lump sum?

One downside of a lump sum (or part lump sum) is that choosing this option means this money is not invested elsewhere.

By handing over the lump sum, for example, you forgo returns you could have made by investing this same money into property or stocks over the period of your nursing home stay.

On the other hand, paying lump sum means you get to avoid the daily interest payments (the 7.9% in the table above).

So you could potentially be better off paying a lump sum if you think there's no way you could make investment returns on that money that are substantially higher than the interest you'd be charged through daily payments.

One advantage of choosing a lump sum is it's considered an exempt asset for pension purposes; some people may get more pension if they pay the lump sum.

The lump sum, however, does count as an asset in determining the means-tested care fee.

And if you sell your house, remember any money leftover after you pay the lump sum will be counted as assets when you're means-tested for the pension and means-tested care fee.

Why might some people prefer daily payments?

Not everyone can can afford a lump sum. Some may not want to sell their home to pay one. Some may want to hold onto their house if they think property prices may increase in the future.

Daily payments have recently overtaken lump sums as the most popular payment option, with 43% of people paying this way. However, recent interest rate rises may slow or reverse this trend.

And if a spouse or "protected person" – such as a dependant or relative that meets certain criteria – is still living in the house, it's also exempt from assets tests for the pension and other aged care fees.

If the home is vacated by a protected person, its value is still excluded from the pension means test for two years (although rental income is still assessed).

If you do not anticipate a lengthy nursing home stay, daily payments may potentially be the easiest option. But it's best to consult a financial adviser.

What does the research say?

My research with colleagues found many people choose the lump sum option simply because they can afford to.

Those owning residential property are more likely to pay a lump sum, mostly because they can sell a house to get the money.

People who consult financial advisers are also more likely to choose lump sums. This may be due to financial advice suggesting it's tough to earn investment returns higher than what you'd save by avoiding the interest charged in the daily payment option.

Some aged care providers prefer lump sum payment since they use these to renovate or refurbish their facilities. But providers are not allowed to influence or control your decision on how to pay.

The recent Royal Commission into Aged Care recommended phasing out lump sums as a payment option, leaving only daily payments. While that would reduce the complexity of the payment decision and remove the incentive for providers to sway decisions, it would also reduce consumer choice.

Is there anything else I should know?

Some 60% of people we surveyed found the decision complex, while 54% said it was stressful.

It is best to seek professional financial advice before you decide.

Services Australia also runs a free Financial Information Service that can help you better understand your finances and the payment decision. But it does not give financial advice or prepare plans.

You have 28 days to choose a payment method after admission, and six months to pay if you choose a lump-sum payment.

In the interim, you will be charged daily interest payments on the room price.

Anam Bilgrami, Research Fellow, Macquarie University Centre for the Health Economy, *Macquarie University*

This article is republished from The Conversation under a Creative Commons license. Read the original article.

Disclaimer

This message is from Morningstar Australasia Pty Ltd, ABN 95 090 665 544, AFSL 240892, Level 3, International Tower 1, 100 Barangaroo Avenue, Barangaroo NSW 2000, Australia.

Any general advice has been prepared by Morningstar Australasia Pty Ltd (ABN: 95 090 665 544, AFSL: 240892) without reference to your financial objectives, situation or needs. For more information refer to our Financial Services Guide at www.morningstar.com.au/s/fsg.pdf. You should consider the advice in light of these matters and if applicable, the relevant Product Disclosure Statement before making any decision to invest. Past performance does not necessarily indicate a financial product's future performance.

For complete details of this Disclaimer, see www.firstlinks.com.au/terms-and-conditions. All readers of this Newsletter are subject to these Terms and Conditions.