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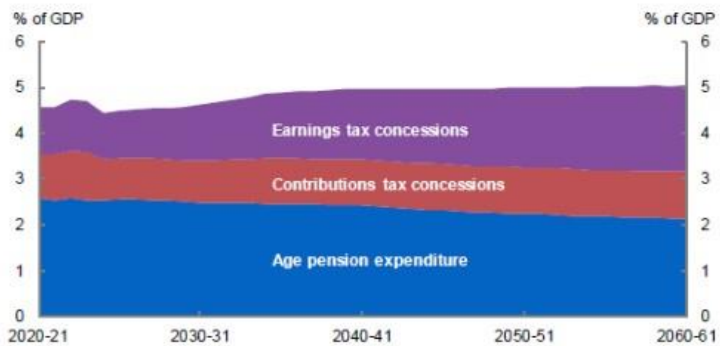
Editorial

The Treasurer, **Jim Chalmers**, will release the sixth Intergenerational Report today. It will give an outlook for the economy, the budget and demographics over the next 40 years until 2062/2063. It is usually released every five years but the most recent was in 2021 (previous reports were in 2010 and 2015). With a few changes in assumptions, we should expect many of the conclusions to be similar to those two years ago.

As politicians do, there have been plenty of leaks to mainstream media, so we already know the big numbers. The headlines will say that health, aged care, the NDIS, defence and interest payments on debt will rise from one-third of Federal spending to a half over the next 40 years, an increase of $140 billion. The predictable commentary will call for curbs on the NDIS, and highlight the intergenerational inequity and funding problems of a growing number of retirees supported by fewer young people. The report will say the number of Australians aged over 65 will double the current proportion, reaching nine million, and those over 85 will triple.

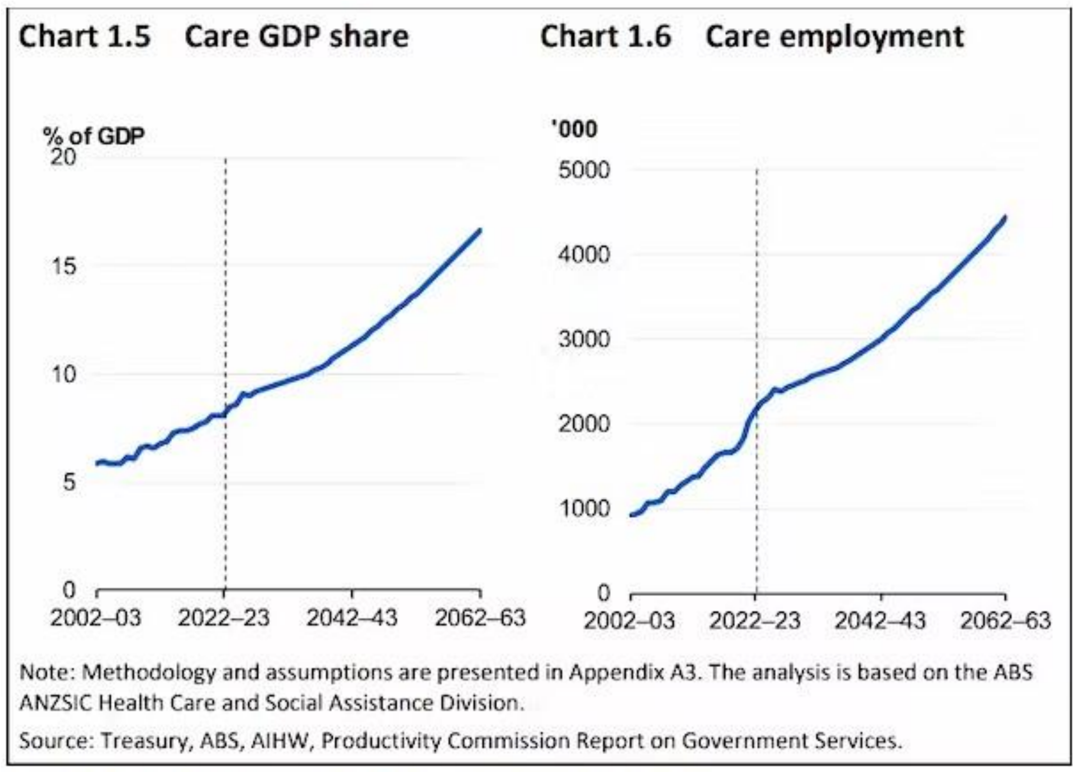
One upside is that the cost of the age pension will fall from 2.3% of GDP to 2% with the rise of superannuation, although this will highlight the cost of super concessions, rising from 1.9% of GDP to 2.4%. We have previously explained why the cost of super is exaggerated but there will be an update of this chart from the 2021 report.



Note: Includes service pensioners. For further information, see the Appendix.
Source: Treasury.

One number with profound implications is Australia's expected population, reaching over 40 million in 2062. As most people gravitate to a few major cities, it will be a challenge to house, care for, educate and transport another 15 million. With so many people living longer, the 'care economy' is forecast to increase from about 8% of GDP to 15%. Employment in 'care' will rise to 4.5 million. Chalmers said:

> *"Whether it's health care, aged care, disabilities or early childhood education – we'll need more well-trained workers to meet the growing demand for quality care over the next 40 years. The care sector is where the lion's share of opportunities in our economy will be created."*



Extract from 2023 Intergenerational Report. Commonwealth Treasury

Where do we find millions of new workers willing to take low-paying jobs caring for others while packing into the most expensive cities in Australia? There's only one place - net inward migration - which is forecast at 235,000 a year for 40 years. Advances in robotics, AI and other technologies will need to fill some of the supply gap. Unlike other countries such as Japan and large parts of Europe, there should be no fear of a declining population and its negative impact on growth in Australia.

While the report will generate worries about whether there will be enough money to sustain aged pensions and health care, there is always money for defence. The Government announced a lazy $1.7 billion for some new high-tech missiles, $800 million for rocket launchers and $430 million for anti-radiation guided missiles. And let's not start on the bottomless pit of submarines, now up to $368 billion, and climate change, costing the economy up to $423 billion.

If all this confirms one thing, it's that we can stop protesting about the new tax on $3 million superannuation balances. Somebody must pay for these expenditures and wealthy superannuants are an easy target.

***

A primary focus of both equity and bond markets at the moment is the equity risk premium, the excess return over the rate on safe government bonds for taking a risk on equities. A 2019 Reserve Bank paper stated that the equity risk premium for Australia was about 4%, based on long-term returns from equities (price and dividends) of 10.2% and government bonds of 6.2%.

Table 1: Total Returns 1917Q1–2019Q1

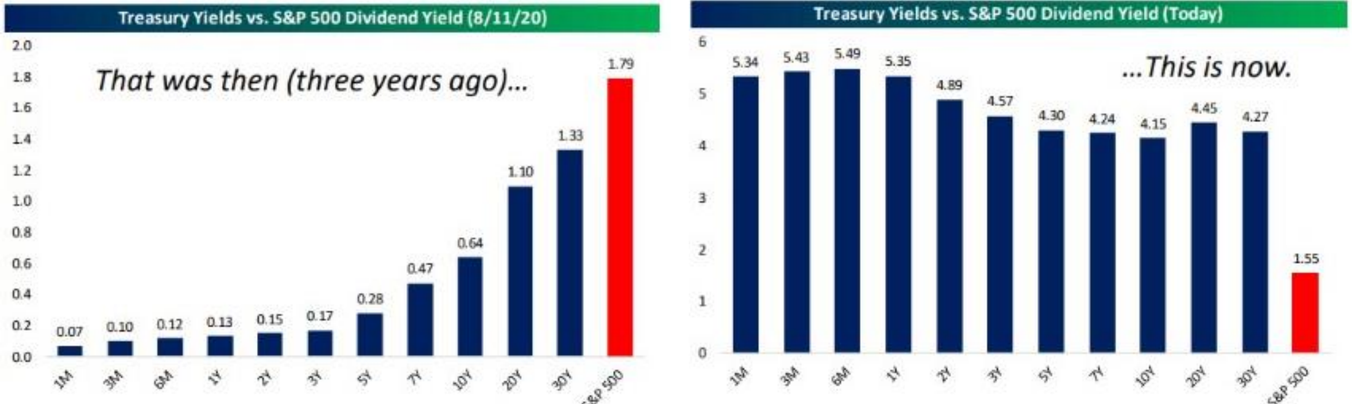
Annualised per cent, geometric average

Total market	10.2
– Resources	10.2
– Financials	10.3
– Other	10.4
10-year government bonds	6.2
Consumer price inflation	3.9

Sources: ABS; ASX; Foster (1996); Hunter (1958); Lamberton (1958a&b); League of Nations Yearbooks; RBA; Refinitiv Datastream

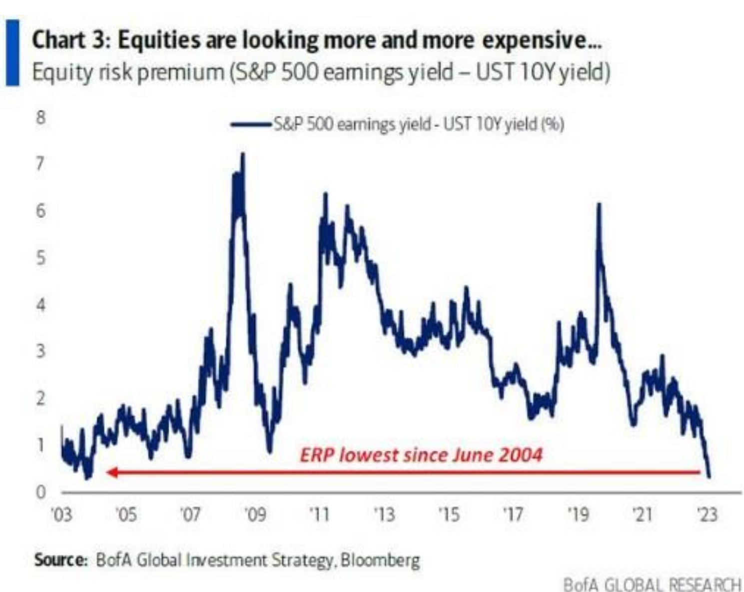
The current 10-year Australian bond rate is 4.25%, and the All Ords dividend yield (excluding franking credits) is 4.45%. While this is not total returns or expected earnings, it shows investors are taking the risk on equities (and other assets such as commercial property) without a dividend premium, in the hope that stock prices will rise.

Looking only at dividend yields versus bond yields in the US, the change in recent years has been dramatic, with S&P500 dividend yields falling despite a rapid increase in Treasury bond rates.

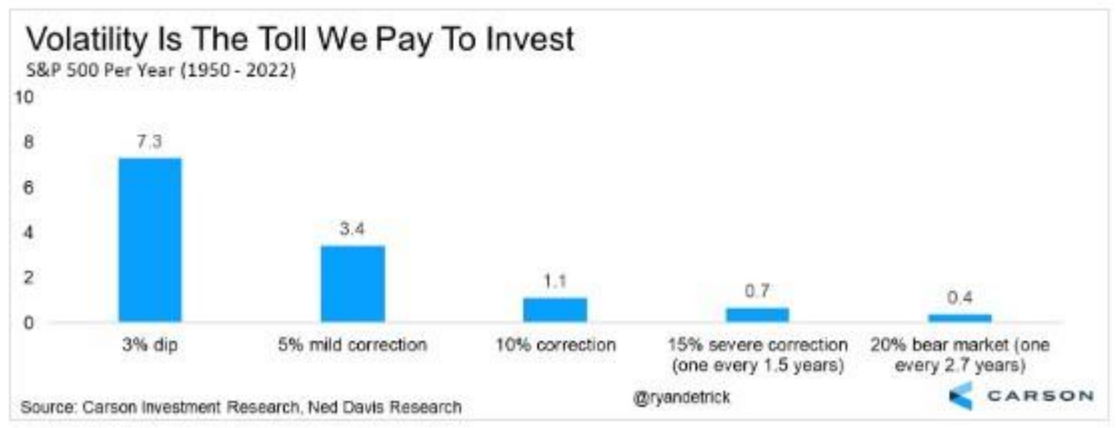


Source: Bespoke Investment Group and Clime

Then based on earnings yield (earnings per share shows how profitable a company is while dividends per share shows how much is paid to shareholders), this chart from **Bank of America** shows the equity risk premium (measured as S&P earnings yield versus US 10-year Treasury yield) is the lowest for 20 years. It has been as high as 7% in this period, and BofA says it shows equities look expensive. Bonds are certainly back in the game for asset allocators.



Still on US data after the recent 5% fall in the S&P500, it's good to remember that such corrections are regular and normal. The chart below shows the average number of 5% selloffs since 1950 is 3.4 a year, while at least one 10% selloff occurs on average each year, with a 20% correction every 2.7 years.



Sell-offs are normal. (Source: @RyanDetrick)

One reason for investor caution buying long-term bonds is the capital loss if rates continue to rise. While there is a growing belief that Australia is at the top of the cash rate tightening cycle, long-term bonds react to many factors other than short-term rates.

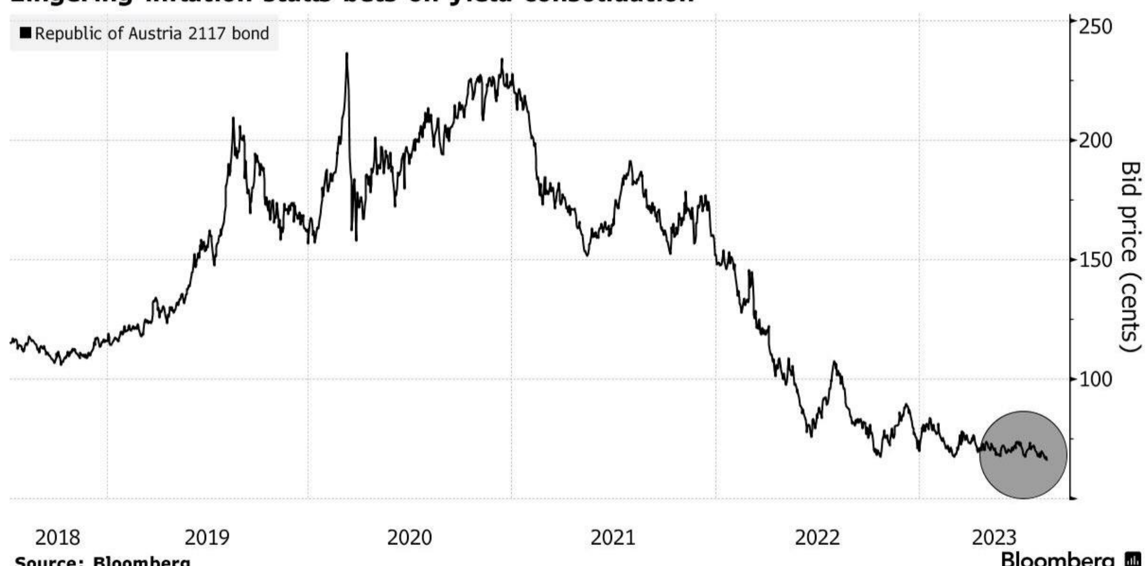
A recent offer of a bond in the market illustrates how a long bond can deliver gains or losses usually expected from equities. A **Treasury Corp of Victoria** (semi-government) bond maturing in November 2042 and paying

a 2.25% coupon is currently offered with a yield to maturity of 5%, at a price of $66.26 (per $100 face value). If yields fall by 1% over a year, the price rises to $77.82 giving a one year capital gain of $10.98/$66.26 or 16.5%, in addition to the coupon. Looks great if rates fall. But if rates rise by 1%, the price will fall by 14%, according to the offer sheet.

In the retail investor space, a common ETF is the **Vanguard Australian Government Bond Index ETF** (ASX:VGB). It offers a current yield to maturity of 4.15% with a weighted average maturity of 6.6 years and a modified duration of 5.6 years. If rates rise by 1%, investors will lose 5.6% on the price. It is important to know the duration of any fixed rate investment and be aware of exposure to rising and falling rates.

Here is the value of $10,000 invested in VGB five years ago with coupons reinvested, and no allowance for inflation. As rates fell during the pandemic, the price rallied, but all has been given back as rates rose. In nominal not real terms, the investment is back to the starting investment. Remember, this is a bond fund, not a bond, so it never matures.

The ultimate bond duration play is the Republic of Austria's Century Bond, due to mature in 2117, but it is more volatile than equity prices and not for the faint-hearted.



In the first of my two articles this week, I give examples of the confusing interpretation of economic and financial data, where it's possible to make bad news out of good news in some perverse ways. Little wonder the direction of markets is difficult to predict when the dismal science of economics does not know its good from its bad.

Then I review the amazing month of the Women's World Cup, a wonderful celebration of sport that brought millions of new faces, female and male, into the game I have played for 60 years. Amid the triumphing of a new era for women's sport and football generally, as the A-League heads into its 19th season, I check whether the Matildas will deliver bigger crowds and viewers for the domestic professional leagues.

Graham Hand

Also in this week's edition ...

Asset allocation doesn't receive enough airtime compared to individual assets such as shares and bonds. **Clime Investment Management's John Abernethy** addresses it, specifically for SMSF allocations. John offers some guidelines for how SMSFs should plan asset allocations and the macroeconomic events that could influence future allocations.

From going it alone with an SMSF to defaulting into a large super fund balanced option, administration time and fees for superannuation vary materially. **Morningstar's Annika Bradley** has an in-depth guide to the costs involved and the potential impact on returns.

There's been the fastest rise in interest rates in 50 years yet consumers and corporates have held up remarkably well. **Munro Partners' Qiao Ma** says we're not out of the woods with inflation proving sticky and further rate rises expected in coming months. But she's positive on the outlook with rates peaking soon and signs of a re-acceleration in corporate earnings.

A new ***Wealth of Experience*** podcast features special guest, **Platinum Asset Management CEO Andrew Clifford**. Andrew explains how investors fleeing China is paving the way for extraordinary opportunities, and why Japan is one of the best world's equity stories over the next five years. **Graham Hand** looks at life expectancy and investment returns, while **Peter Warnes** examines what **CBA**'s result tells us about the outlook for banks and the economy.

Niall O'Sullivan of **Neuberger Berman** says now is not the time to be making major calls on asset allocation. While this 'neutral' view could imply there isn't much to do, Niall disagrees, suggesting there are many ways to generate incremental returns over the next 12 months, highlighting value in US government bonds and commodities.

Lastly, in this week's White Paper, **Franklin Templeton** highlights investment opportunities that it likes, including fixed income, high-yield debt, and emerging markets.

Curated by James Gruber and Leisa Bell

It's dismal: good news is bad news … and vice versa

Graham Hand

There are valid reasons why economics is called the dismal science, and even the origin of the expression is distasteful. The words were first used by historian and philosopher Thomas Carlyle in a piece in 1849 called '*Occasional Discourse on the Negro Question*' when he wrote that economics would justify a return of slavery to improve productivity of plantations. The term was later applied to the theory that population growth would outstrip resources and lead to global misery. An honours degree in economics often does not feel honourable.

In the current day, the dismal label should apply to the ability of economics and finance to draw contradictory conclusions from the same information. Good news is only good news until someone says it is bad.

Weaker economy: good or bad for share prices?

The *good news is bad news* makes it difficult to understand and predict markets. Throw in politics and it's completely confusing, such as:

- If data shows a slowing economy or rising unemployment, the likelihood of interest rate reductions increases, and the stockmarket reacts favourably. So that's weaker economy equals good for equities. Go figure.

- At the same time that the Reserve Bank is increasing rates to slow economic activity and reduce inflation, the Government announces 'cost of living relief' and encourages increasing wages. The economics demands job losses, the politics offers protection. How does that work?

Bad both ways, apparently

There are many other economic perversions. Some of the following examples are drawn from exchanges between Sam Ro and Michael Antonelli, US-based writers and analysts. They have collected examples of what they call *bad both ways* narratives which prove the market can say anything to justify a movement one way or the other, such as:

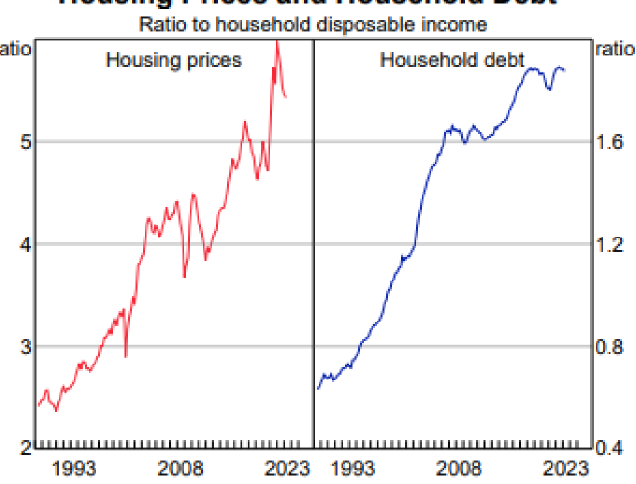
1. Retail sales

Falling consumer spending is bad because it signals a slowing economy and risk of a recession, while rising consumer spending is bad because it places upward momentum on prices and inflation, leading to higher interest rates.

When companies such as Coles and Woolworths report strong sales in private label goods, it's a bad sign for the economy because it shows more people are cutting down on major brands. But when Coles and Woolworths report sales below expectations, it's a bad sign because consumers are cutting back.

2. Lending activity

When individuals and businesses borrow more, especially in Australia with a high household debt to income ratios, it's a bad sign because people are overleveraged and exposed to rising rates and economic downturn. When they borrow less, it's a bad sign because it shows less confidence and a failure to take advantage of investment opportunities.



* Household disposable income is after tax, before the deduction of interest payments, and includes income of unincorporated enterprises.
Sources: ABS; CoreLogic; RBA.

3. Market volatility

Heightened variation in stockmarket prices is bad because it shows uncertainty and a lack of confidence in the future, while low volatility is bad because investors have become complacent and unrealistic and will suffer setbacks when the market falls.

4. Interest rates

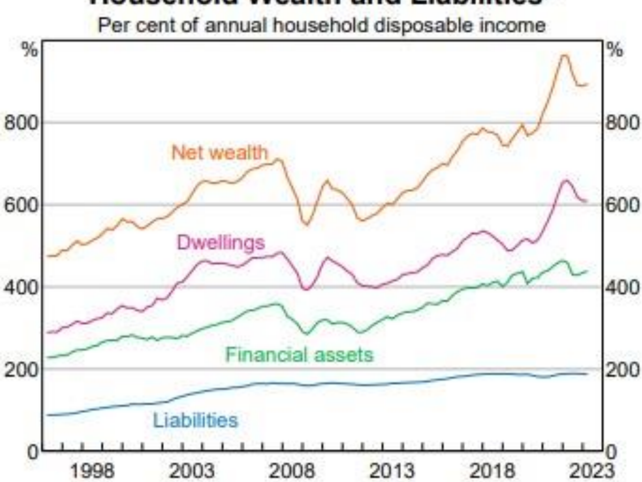
When long-term interest rates rise, it's bad because other assets such as property and shares fall as their future cash flows are discounted at a higher rate. But long-term rates falling is bad, especially when there is an inverse yield curve, as it shows the market is pricing in a slowing economy.

5. Oil prices

Falling oil prices demonstrate weak demand which is bad for economic activity, while rising oil prices are bad because it heightens inflation fears and higher interest rates.

6. Home prices

Rising home prices are a bad sign because aspiring homeowners are priced out of the market, while falling home prices are bad because owners feel a drop in their wealth and become less optimistic. Most of the net wealth of households is tied up in dwellings, far ahead of other financial assets.



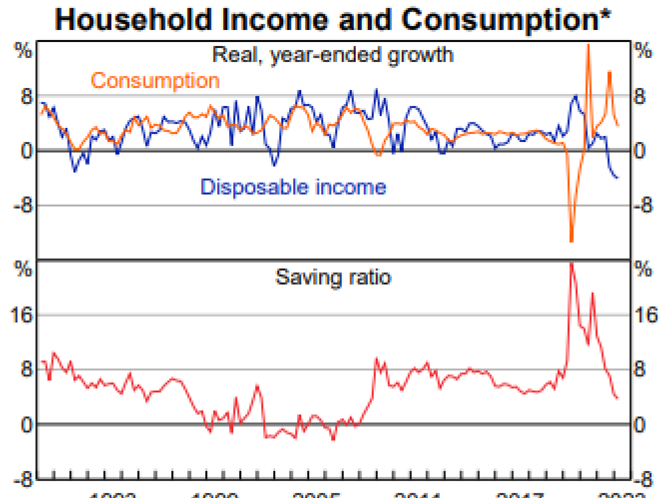
* Household disposable income is after tax, before the deduction of interest payments, and includes income of unincorporated enterprises.
Sources: ABS; RBA.

7. Tech-driven market rally

A rally in the market such as driven by the 'Magnificent Seven' (Apple, Microsoft, Alphabet, Amazon, Nvidia, Tesla and Meta) is bad because traditional industrial companies (in Australia, the likes of Amcor, Orica, Brambles, Aurizon, CSL) who make and do real things cannot attract capital, and the techs mask overall market weakness. But it's bad if these tech companies fall because they are all great companies with the strongest growth outlooks and they dominate the index.

8. Individuals saving

A high savings ratio is bad because consumers are cautious and not spending, and during the pandemic, too much money was handed out leading to future deficits. But a declining savings ratio is bad because households no longer have the buffers to withstand higher interest rates or a slower economy.



The good and the bad of generative AI and indexing

Two more *good is bad* (or this time, is it *bad is good?*) themes in investing currently are the dramatic impact of generative AI (such as ChatGPT) and the rise and rise of index funds at the expense of active management.

Generative AI is more recent while the growth of index has been ongoing for years, but there is a similarity between the two. In both cases, the winners need the losers to continue to function.

Consider how the winners, generative AI and indexing, operate:

1. Generative artificial intelligence (AI) uses algorithms to create new content by searching existing content in its many forms, such text, images, audio and video. AI requires content providers, such as journalists, editors, film makers, sound engineers and photographers to produce work from which AI can 'regenerate' another version.

For example, if ChatGPT is asked 'Write 100 words on active versus index investing', it searches for existing content on the subject and produces an AI version as follows:

> *"Active and index investing represent two distinct approaches in the realm of investment strategies. Active investing involves portfolio managers or individual investors making deliberate decisions to buy and sell securities in an attempt to outperform the market. This method relies on extensive research, market analysis, and timing to achieve higher returns.*
>
> *On the other hand, index investing follows a passive approach, aiming to replicate the performance of a specific market index. This strategy involves investing in a diversified portfolio that mirrors the index's composition. It generally offers lower fees and reduced risk but might not generate the same potential for significant gains as active investing."*

It's a fair summary. The good news for journalists is that AI needs people to write the original content. Without journalists adding continuously to a body of knowledge, AI will itself become out of date. But the bad news is that AI will remove some of the jobs of the people it relies on. Why pay a journalist to write an article on active versus index when ChatGPT will produce it for free in a few seconds?

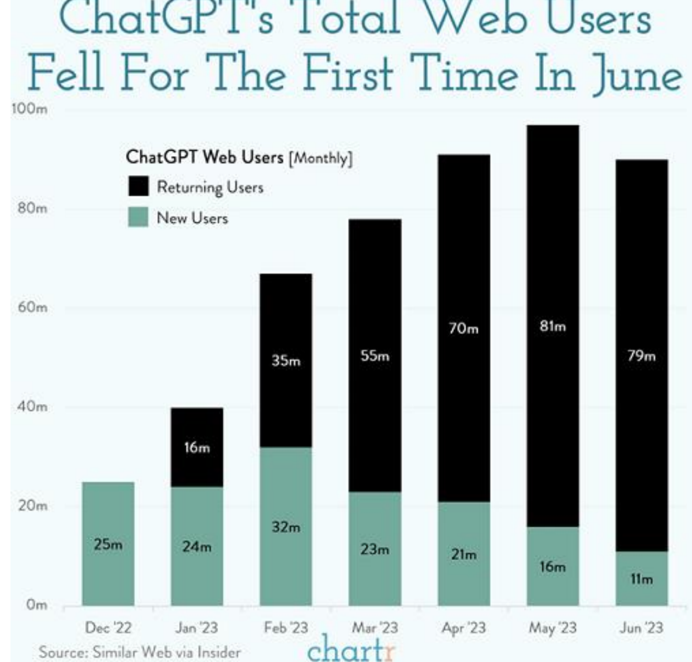
2. Index investing (as AI conveniently explains) holds stocks in the same weighting as the index it seeks to replicate. It does not attempt analysis of a company's prospects. In contrast, active managers undertake fundamental research on the value of a company, and buy when their analysis suggest the market price is below the intrinsic value. Therefore, active managers are allocating capital based on estimated value, they undertake price discovery and therefore set the market price. In *The Index Revolution*, Charles Ellis says indexing relies on:

"*trusting that active professionals have set securities prices as correctly as possible*"

Ellis claims 95% of market trading is done by active investors. The 5% by indexers is more 'set and forget' with scheduled rebalancing around the index weights. There is an alternative view that so much money now flows into index funds that they set the valuations by pumping more money into popular stocks.

The bad news for active managers is that indexing needs fundamental analysis to set prices, but the bad news is that fewer active managers are needed as money flows into index.

Some good news for content creators is that there are early signs that the initial fascination with ChatGPT and similar is waning, as returning and new users numbers have started to fall.



The dismal science explains everything … and nothing

Analysts, journalists and commentators are capable of drawing any conclusion following the release of economic statistics, and generative AI will use the content to produce an '*on the one hand, on the other hand'* explanation. The market may react either way.

Next time a fund manager or analyst presents their earnest and thoroughly-researched conclusions, know there is an equally-qualified person making the totally opposite argument.

Graham Hand is Editor-At-Large for Firstlinks, and this article is general not personal information.

Clime time: Asset allocation decisions for SMSFs

John Abernethy

Asset allocation (AA) is the process of constructing an investment portfolio among different asset classes, such as shares (domestic and international), bonds, property (listed REITs and direct), fixed interest securities, cash etc. The goal is to create a diversified portfolio that matches appropriate risk with appropriate returns for that risk. By investing in a variety of assets that are not closely correlated, investors can potentially earn fairly predictable returns over a period of say 5 years than if they were to invest in just one asset class.

When contemplating an asset allocation review for their SMSF, trustees must understand the level of investment risk that the SMSF beneficiaries should be or are prepared to accept. From this understanding, an assessment of the appropriate target rate of return from the portfolio – noting potential capital gains and income – can be made. The return should consider the benefits of compounding from full reinvestment (during the accumulation stage) or part reinvestment of the income (at pension stage).

Guidelines for asset allocation

Some key guides that I would encourage trustees to follow are:

a. A short-term focus on returns should be avoided unless the beneficiaries are very elderly;

b. The rate of return target (per annum) should focus on at least 5 years duration noting that over the longer term, economic growth is assured;

c. AA should be dynamically reviewed as economic events or observations are noted – in particular bond yields need to be monitored;

d. The AA analysis and assessment is best undertaken with the help and counsel of a qualified financial advisor, who can act as both a sounding board and a guide for an SMSF trustee.

The design of asset allocation for an SMSF starts from an understanding of a ‘balanced’ portfolio. In my view, a balanced asset allocation weighs equally to growth assets and to capital stable income-yielding assets. However, I acknowledge that there is no established or agreed industry position on what constitutes a balanced portfolio.

The proposed or advised AA moves from balanced based on risk adjustments so that a ‘conservative’ AA is created by weighting the portfolio to lower risk, capital stable and/or income assets. Alternatively, AA will move towards ‘growth or aggressive’ by weighting to higher risk, more volatile equity-type assets.

My table below is a ***general advice*** table for an SMSF, and readers should note that it has only one variable input – the age of the beneficiary. The outputs of the table (projected 5-year returns that include franking) simply suggest that a beneficiary will normally seek lower risk and accept lower (but more stable) returns as they grow older.

Representative Age / Risk Grouping	Australian Equities (Growth and income)	Australian Income (Bonds, Corporate Debt, RMBS)	Overseas Equities (Growth)	Direct Property (Growth and income)	Total Return (p.a.)	*Income Objective (p.a)*	*Growth Objective (p.a.)*
50 – 65 (Growth)	40%	10%	20%	30%	**8.0%**	*4.0%*	*4.0%*
65 – 75 (Balanced Growth)	40%	15%	15%	30%	**7.5%**	*4.5%*	*3.0%*
75 – 85 (Conservative)	30%	30%	10%	30%	**7.0%**	*5.0%*	*2.0%*
85+ (Regular Income)	20%	70%	0%	10%	**6.5%**	*5.5%*	*1.0%*

Source: Clime Asset Management

Clearly risk analysis requires more than a reflection of age. A comprehensive analysis considers a range of other issues (personal circumstances) that include health, non-super assets, home ownership and a desired quality of life (running expenses), dependents, and even psychological make-up. If exposure to volatile assets is going to keep someone from sleeping well, perhaps it should be avoided! Nevertheless, the table does provide an insight into how prospective investment returns change with asset allocation.

As noted above, the total targeted returns are expected to be generated from income and capital gains over a five year projection. As noted earlier the allocation to asset classes and the expected returns should be dynamically monitored. Changes to expected returns from the tailwinds or headwinds generally caused by actual or predicted bond yield movements will affect AA. Bond yield analysis sets the basis for determining the desired returns from assets and thereby the entry prices for acquiring assets.

What follows are my current views on the influences to asset prices that SMSF trustees and advisors should note. In particular, I focus on the dilemma of rising long dated bond yields, why they will probably rise further, and the effect this will have on asset prices.

What could affect asset returns

From the table above readers will glean that the main asset classes that I focus on are as follows:

Growth with income
- Australian and international equities plus listed REITs

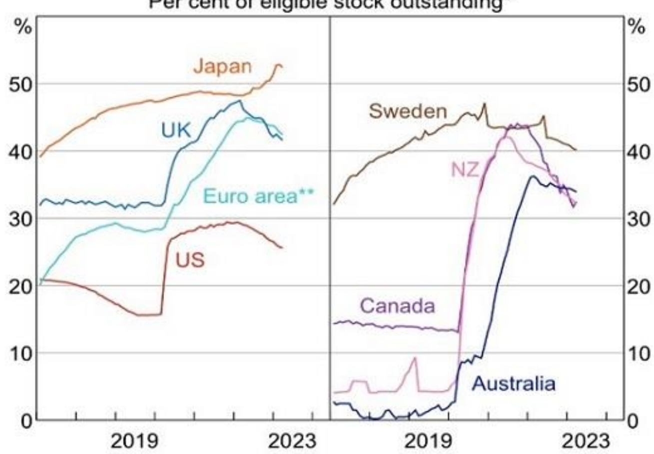
Growth and income
- Direct property

Income
- Bonds
- Corporate debt
- Mortgage-backed securities
- Hybrids

To begin, context is important. Where have we been?

Asset markets are emerging from a decade of rampant bond yield manipulation undertaken by the world’s largest central banks. Quantitative easing (QE) was the tool utilized by central banks.

In the main, central banks effectively printed money, targeted a particular bond yield/s in markets and then intervened by secondary market purchases to attain that yield. Over time, central banks became the largest owners of their government bonds. For instance, in the US, the Federal Reserve owns about US$7 trillion of bonds out of the approximate $30 trillion on issue. In Japan, the BoJ owns around 50% of all Japanese government bonds.



Source: RBA chart pack

The manipulation of bond yields allowed governments to run large fiscal deficits, avoid fiscal discipline and grow government debt with a low cost of servicing the same. Fiscal largesse had become a universal policy setting across the US, Europe and Japan, with its sustainability not questioned. Even now, there is scant regard given to it, but it will in time be reflected by higher bond yields – unless central banks intervene again.

Readers will recall that for sustained periods over the last ten years Japanese, German and Swiss long dated bonds traded with a negative yield. Poorly rated bonds issued by the Italian, Greek or Spanish governments (for instance) often traded at yields below the highly rated Australian bond. During the Covid pandemic, US and Australian long dated bonds traded at yields below 1%.

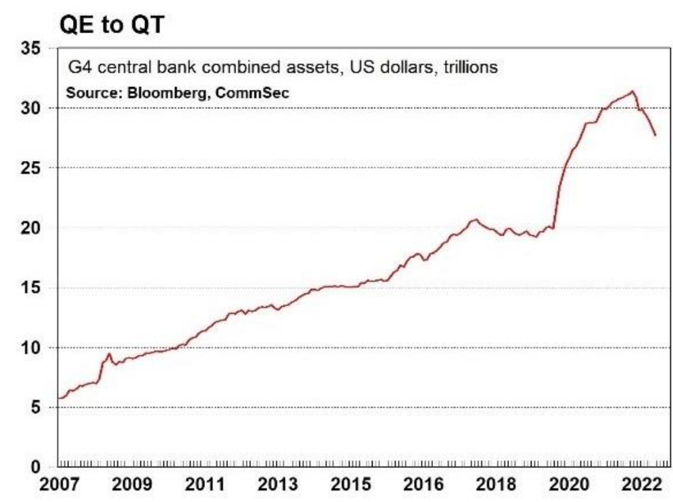
The world bond market passed through a sustained period – after the GFC – where bond yields were not affected by the normal yield determinants that include:

1. observed inflation and the risk of future inflation,
2. currency risk for non-domestic buyers; and
3. default and/or credit rating risk of the issuer.

Effectively, QE blew away all of these market pricing influences which are fundamental to sober valuation metrics. Thus, the so-called but vitally important 'risk free' return was debased and this affected the price of all asset classes.

It is clear that bond yields were not driven by the 'open or free market'. Whilst there were willing buyers and sellers meeting in the bond market to trade their positions, the daily pricing of bonds was dictated by central banks. Today, that is still the case in Japan, but in other major economies central banks are indicating that they intend to reduce their influence over bond yields.

In effect, QE is moving to QT (Quantitative Tightening) whereby central banks reduce their bond holdings by allowing them to mature (redeem) and by not reinvesting the proceeds, or by selling them. The start of QT in the US is illustrated below; readers should note that the same monetary policies are being reflected across Europe. QT in Australia has slowly begun and it will have a significant influence on the bond market from 2024 onwards if the RBA begins to offload the majority of its bond holdings.



QT will add to the supply of bond issuance by governments and more so if governments do not concurrently bring their fiscal deficits back into order. The effect of a seemingly endless supply of bonds means that bond prices will be under pressure and yields will likely rise. This explains why US ten-year bond yields are beginning to rise even whilst measures of US inflation decline. I expect a similar scenario to play out across European and Australian bond markets.

How higher yields may affect asset allocation

Rising bond yields mean that the 'risk free rate of return' or the 'risk free investment hurdle' will lift and be a headwind for the pricing of all assets in the coming few years. This leads me to the following conclusions for both AA and assets prices over the next year:

1. Long dated bond yields (past 5 years) will continue to rise leading to capital losses that offset higher yields.

2. Shorter dated bonds (maturity of less than 2 years) are preferred as they currently match or exceed expected inflation and the risk of capital loss (via market prices) is not high.

3. Rated corporate debt is preferred to bonds as the repricing of long dated bonds flows through. Staying short in maturity is desirable (up to 3 years). Mortgage-backed securities and hybrids are already seeing higher running yields and will be weighted into diversified portfolios as a core income generator.

4. Cash rate settings will remain elevated for longer than generally expected. Whilst cash rates in the US will likely fall during 2024, the same cannot be expected for Europe or Australia.

5. Equity PERs will moderately decline with bond prices, so investors need to focus on companies that will grow earnings greater than and offset PER compression. This will be difficult (short term) as economies slow with tight credit conditions being maintained over the next year.

6. Importantly, the longer-term growth outlook for Australia remains positive and far superior to Europe. The current weak AUD reflects negative "real" cash rates that won't reverse until mid-2024. This suggests that a re-weighting to Australian equities from international equities or a currency hedge should be considered at some point early in 2024.

7. Rising bond yields will lead to a lift in capitalization rates for property with the commercial sector remaining under pressure. Non-discretionary retail (suburban shopping centres), industrial and agriculture will also experience cap-rate compression but offer better growth to offset this and particularly taking a 5 year view.

AA analysis should not be dogmatic, and we must always consider what could go wrong with the forecast of bond yields or the risk free rate of return.

In my view, the key risk to the above view is the potential for the reintroduction of QE, leading to the reinstatement of bond price and yield manipulation that supports the servicing of government debt.

Simply stated, I suspect that there will be a bond yield level set by central banks in each major economy at which they will act to protect the financial viability of their governments. A burgeoning interest bill flowing from a bond market that panics has the potential to destroy a government's fiscal policy and create economic calamity. It will be avoided at all costs and so we must monitor whether QE returns, or QT slows.

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

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Global consumer and corporate resilience surprises everyone

Qiao Ma

Despite months of predictions for a global recession, consumer activity and corporate earnings are holding up surprisingly well. We believe that global long-term interest rates probably peaked in October last year, and we are now observing encouraging signs of the start of corporate earnings re-acceleration.

Clearly, we are not completely out of the woods yet. Inflation is still sticky and further rate hikes are expected over the next few months, but when we look under the hood at the companies we research, resilience stands out.

This global resilience has been surprising to all of us. In Europe, consumers seemed to sail through a severe energy crisis last winter, and in the US, consumer activity in both discretionary and staples has far exceeded most expectations at the beginning of the year.

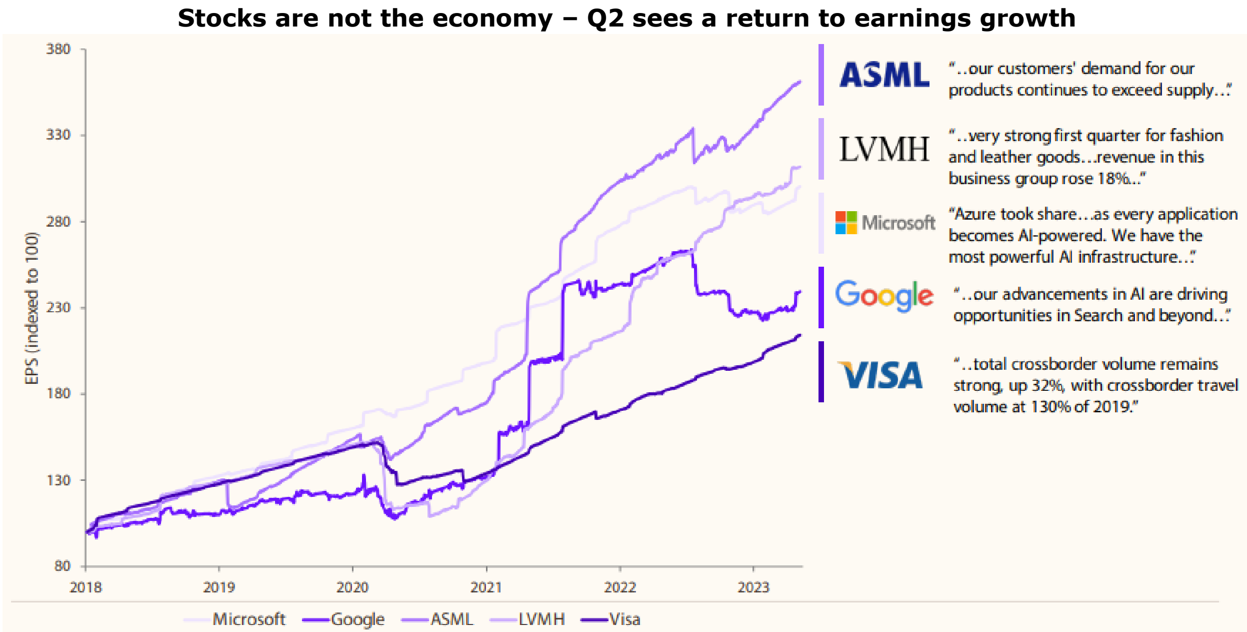
What's going on?

Higher global interest rates and inflation have impacted the consumer, but tight labour markets have tempered any slowdown. With global unemployment projected to be around 5.3% this year (according to the International Labour Organisation), and lower than it was pre-pandemic, anybody who wants to be employed generally is. It also means employers may need to pay employees more to retain them.

Projections for a US recession remain. However, companies that sell to the consumer on a daily basis, and have been watching and waiting for a slowdown, have not seen it materialise over the past 18 months. Clearly, consumption has been more resilient than expected, especially around the trends of health and wellness.

Corporate earnings improving

Stocks are not the economy – Q2 sees a return to earnings growth



Source: Company earnings calls, Bloomberg Finance L.P. 8 May 2023

As a result of this better-than-expected consumption, the market has been returning to a more normalised environment, where share prices follow earnings. This has been particularly the case with the big US tech companies like Microsoft and Google (parent company Alphabet), which reported late July.

Microsoft and Google both reported approximately 8 per cent revenue growth on an organic basis. And despite the dip in Microsoft's share price following its announcement, these companies - arguably two of the best managed businesses in the world - have forecast for potentially higher growth in the second half. Over the past three years, management teams have focussed on two things – de-risking the businesses and improving discipline around expenses.

This combination of corporate resilience and consumer resilience has resulted in earnings resilience which gives us confidence for a strong second half of the year and robust 2024.

AI developments

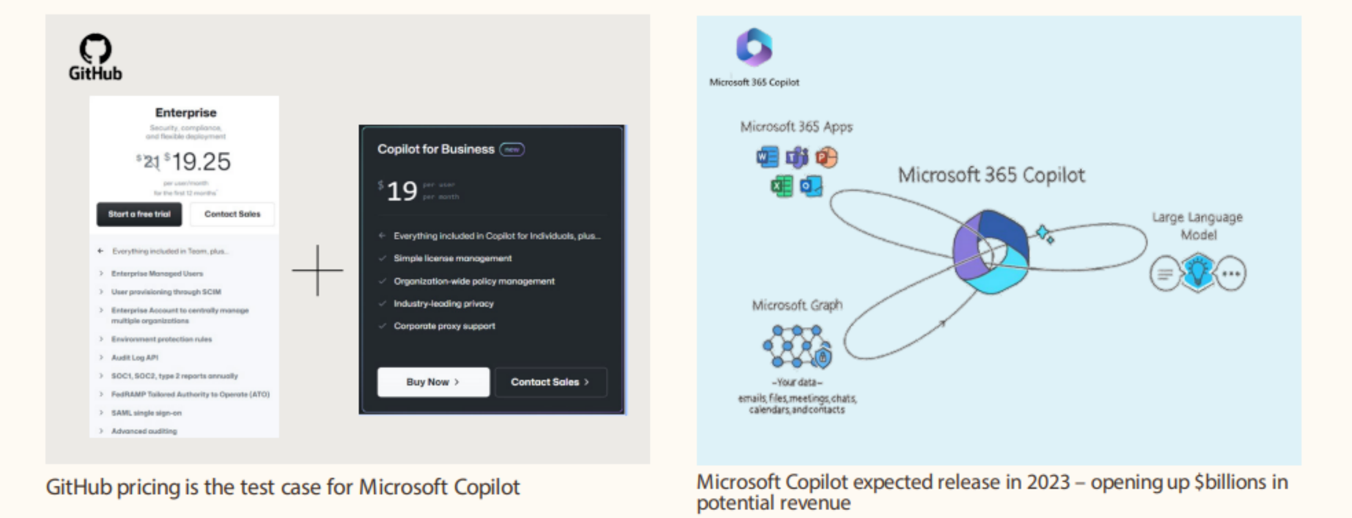
The start of an artificial intelligence (AI) super-cycle will also likely accelerate the rate of innovation across many industries for years to come. This is the other factor that underscores our confidence in the market. The advancements that started with the launch of ChatGPT in November 2022, will radically change a wide range of industries, and speed up the innovation cycle.

When announcing his company's latest results, the chief executive officer of Microsoft, Satya Nadella, said that customers are not just asking how they can use AI but how quickly they adopt AI to tackle the biggest corporate opportunities and risks that they face.

Microsoft case study

Pricing power for AI applications

"RECENT GITHUB DATA SHOWS THAT AMONG DEVELOPERS WHO HAVE USED GITHUB COPILOT, 88% SAY THEY ARE MORE PRODUCTIVE"



GitHub pricing is the test case for Microsoft Copilot

Microsoft Copilot expected release in 2023 – opening up $billions in potential revenue

Source: Microsoft company earnings call, May 2023.

Microsoft is an example of how the value of AI on earnings can be quantified. The company is about to add the AI co-pilot as an add-on to Windows Office 365 suite, at an approximate cost of $30 a month per user. Assuming a small initial discount, that's an annual user cost of approximately $US300. Suppose a quarter of Microsoft's current 400 million users sign up to the co-pilot version of Windows Office. In that case, that translates to roughly $US30 billion increase in revenue. Plugging that into consensus expectations for the company represents about a 10 to 15 per cent lift on the earnings per share for the company in financial year 2026.

While Microsoft's multiple has re-rated in recent months, we believe the consensus earnings are still significantly underestimating the impact that AI will have on the company's earnings. Based on our estimates, the stock is trading below 25 times June 2025 earnings, which we think is cheap for the leading AI cloud infrastructure and software application company on the planet.

Not all companies will be able to leverage AI in the same quantifiable way as Microsoft, but we do think over the next two to three years we are going to see meaningful earnings upgrades coming from AI.

Looking forward

The more normalised market environment we've been observing – of share prices following earnings - bodes well for our investment process of looking for earnings growth opportunities backed by a structural tailwind. Our portfolio is exposed to many different idiosyncratic growth drivers - AI, high performance computing, resilient consumers, as well as industrial companies benefiting from decarbonisation.

AI is the most obvious example of a structural tailwind, and potentially one of the most significant this century, but high-performance computing is another. It is a focus in our portfolio, and we are invested in semiconductor exposed companies, like semiconductor designer Nvidia.

In the accelerated computing market, we believe Nvidia has close to an 80 per cent market share. This places it in a strong position to capture the earnings upside available in the sector, not only from re-tooling data centres to boost the capacity requirements that multiple AI applications necessitate, but also by providing accelerated computing solutions to new data centres being built.

We also anticipate positive performance from the industrial companies driven by spending plans in the US, including the Inflation Reduction Act, which promotes the production of clean energy, and the Creating Helpful Incentives to Produce Semiconductors (CHIPS) Act.

Qiao Ma is a Partner and Portfolio Manager with Munro Partners, a specialist investment manager partner of GSFM Funds Management. GSFM is a sponsor of Firstlinks. Munro Partners may have holdings in the companies

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Admin fees on large super funds vs SMSFs

Annika Bradley

From going it alone with an SMSF to defaulting into the AustralianSuper Balanced Option, administration time and fees vary materially. Price points across Netflix subscriptions vary materially, too, from $6.99/month for standard with ads compared with $22.99/month for premium. Consumers understand that the different price points meet individual viewing preferences. Superannuation admin fees are no different.

The different ways to access super

i) SMSF

The SMSF is a popular, do-it-yourself access point to super, with assets totalling almost $870 billion[1] last year. SMSFs allow investors a vast investment universe and a level of personalisation that is unparalleled, but they are certainly not do-it-yourself-for-free. There are:

- establishment fees
- ongoing regulatory costs such as Australian Taxation Office supervisory fees
- accounting fees
- possibly an online investment platform to help keep track of your investments.
- the personal time expended as a trustee.

For some investors, the flexibility and tailoring are worth it, but for others, SMSFs are a step too far. The time, cost, and complexity are too much for the reward.

ii) MySuper and Choice

At the other end of the spectrum are the 'MySuper' and the current 'Choice' cohorts[2] as defined by the regulator. These groups represent over $1.1 trillion of the approximately $3.5 trillion that Australians have invested in super.

So, what's the difference between MySuper and Choice? The 69 investment options captured in the 'MySuper' heatmap are simply the low-cost, defaults offered to members. Conversely, there are over 1,000 investment options captured in the 2022 'Choice' heatmap. They are typically multisector options commonly offered through a fund's 'generic' investment menu.

The easiest example is to use AustralianSuper. Its default multi-asset 'Balanced option' is captured in the MySuper heatmap; its multi-asset High Growth, Conservative Balanced, Stable, Index Diversified, and Socially Aware options are captured in the 2022 Choice heatmap.

There are a range of services offered across these two cohorts in exchange for the administration fee. Investors can access the tax-effective world of superannuation, a range of investment options that are fully administered, insurances, and investor reporting, support services, and education. While investment fees paid for an investment option and insurance premiums are a different matter, administering an investment option or insurance product in super is not free. Dealing with incoming contributions, members switching between options, and members switching out of the fund incurs costs that need to be covered. Basically, all the non-investment-related costs, including the significant regulatory impost to run a fund, are covered in the admin fee.

iii) Advised or self-directed platforms

In the middle of the spectrum is another cohort of Australians who want more flexibility than a default option but not the responsibility of an SMSF. They could be advised or self-directed and typically opt for more-sophisticated investment platforms. For example, a fully advised offering on an investment platform (HUB24, Netwealth, Macquarie, Colonial First State, and BT, among others) that offers tailored managed accounts and comprehensive investment menus (including shares, ETFs, many funds, and term deposits), complete with sophisticated portals and reporting.

Superannuation access points sit across a spectrum, and what's offered varies greatly. And unlike Netflix's easily comparable options, there are many details to consider.

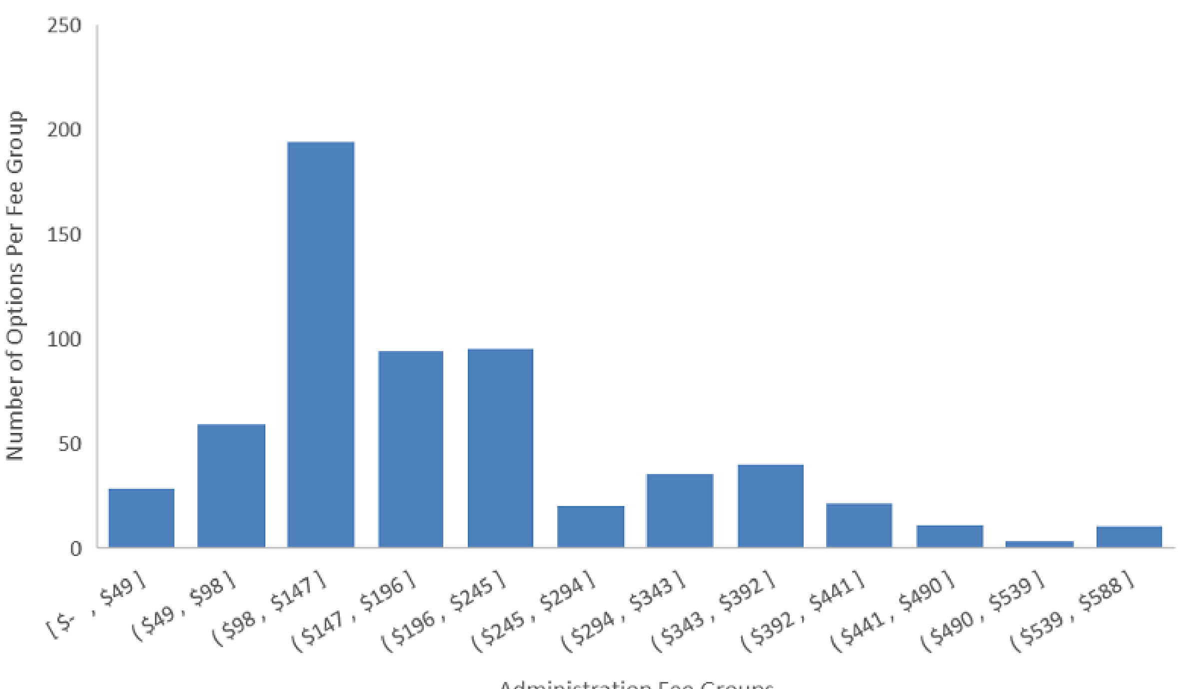
The range of admin fees

What should you expect to pay for these different access points to superannuation?

In the Rice Warner Report: Cost of Operating SMSFs 2020[3], it was estimated that SMSF admin fees range from around $1,200 a year (for compliance admin) to $3,000 a year (for full admin), but this may cover large amounts. This doesn't consider the cost of your time as a trustee, which should not be underestimated. The report also outlines the levels of superannuation assets required to justify the higher levels of admin fees relative to other options.

In the APRA Heatmap Insights Papers, the Choice Dashboard shows that the average annual administration fee for MySuper options is $137 compared with $149 for 'open' Choice options (based on a $50,000 account balance). Averages can hide a lot, though. Exhibit 1 shows that while many Choice options cluster around the price points of $100 - $250 a year, there are plenty that are more expensive.

Exhibit 1 APRA Choice Options – The number of options per administration fee group



Source: Australian Prudential Regulatory Authority's (APRA) 'Choice' Heatmap – 2022.

Finally, the premium platform option. While there are no easily accessible 'average' costs for this cohort and the fee disclosures make comparisons tricky, the Netwealth Super Accelerator Plus Product Disclosure Statement (September 2022) provides a good example. It shows an administrative fee of around $583 a year. For that admin fee, you can access direct international equities, Australian equities, term deposits, and a broad menu of managed funds and managed accounts at additional cost. There is significant scope to tailor an investment portfolio here. It's also worth noting that many advisors negotiate bespoke fee arrangements for premium platforms, and the cost of this access point may be lower through your advisor.

Exhibit 2 displays the spectrum of admin fees across the different access points discussed in this paper. The key takeout is that the range is wide. And that's why it is important to understand what you need and pay an appropriate price for that service.

Exhibit 2 Spectrum of Administration Fees compared

Source: Quoted throughout paper.

Administration fees reduce returns

The more you pay in admin fees, the lower the net return you will receive over time, and less money in retirement. And given the power of compounding, every dollar counts. But administration fees are the price of admission to superannuation. They are an inevitable cost to access a tax-effective environment. Some people need the standard subscription with ads, while others prefer a premium subscription. What's important is that you understand your own needs when it comes to super and pay for what you need. Admin fees matter, and they vary materially, so make sure you understand what you're paying for and why.

[1] Australian Tax Office's SMSF Profile – 30 June 2022
[2] Australian Prudential Regulatory Authority's (APRA) "Choice" and "MySuper" Heatmaps and Insight Papers - 2022
[3] Cost of Operating SMSFs 2020: Rice Warner and SMSF Association

Annika Bradley is Morningstar Australasia's Director of Manager Research ratings. Firstlinks is owned by Morningstar. This article is general information and does not consider the circumstances of any investor. This article was originally published by Morningstar.

Matildas reality check: little impact on the A-League

Graham Hand

On 12 August 2023, the Matildas played France in the Women's World Cup Quarter Final. Australia's victory after a tense and dramatic penalty shootout was the most-viewed television event since Cathy Freeman's gold medal race at the 2000 Olympics. A few days later, a new all-time viewing record of 11 million people tuned in for the England Semi Final.

"I THINK YOU CAN TELL FROM TONIGHT THAT WE ARE A FOOTBALLING NATION"
— CORTEE VINE, AFTER SCORING WINNING PENALTY

The World Cup is widely hailed as a new beginning not only for women's sport and women's football in Australia, but for football generally. By the end of the tournament, total attendances had reached almost two million and global television audiences will surpass two billion.

The morning after the night before

The day after the France game, on 13 August 2023, the reigning champions of the A-League, Central Coast Mariners, played the most successful club in the history of the competition, Sydney FC, in the Australia Cup. The game was held at WIN Stadium, the home ground of Wollongong Wolves FC. The Illawarra club claims a catchment area of 500,000 and has attempted to join the A-League several times, including in 2009 when

Gold Coast United and North Queensland Fury were accepted into the top league. Neither of those clubs still exists.

Wollongong should be a good football territory. When Danny Townsend, CEO of the Australian Professional Leagues (APL) which runs the A-League, was recently asked about the planned expansion of teams in 2024, he said:

"Obviously, Wollongong have been banging on the door for a while now."

WIN Stadium has a capacity of 23,000, but the only green or gold evident the day after the Matildas' record-breaking success was the empty grass on three sides of the stadium. The attendance was 2,540, the lowest number at WIN since 2,502 turned out for an A-League game between Wellington and Western Sydney Wanderers in December 2022. Two weeks before the Australia Cup game, 15,000 people watched an NRL game between the Dragons and the Sea Eagles.

The dawn of a new beginning for Australian professional football leagues? Where were the thousands of kids enthralled by the Matildas, suddenly captured by football and desperate to see more live action? They were at home posting to Instagram and TikTok on how much they love Sam Kerr and Mackenzie Arnold and the other Matildas. They were dreaming of becoming a Matilda but showed no interest in going to the best local football Australia can offer.

Australia is a 'footballing nation' when national pride and a winning team kicks in, or when Barcelona or Manchester United or Liverpool visit these shores, but not in big numbers when it comes to watching the local professional leagues. The media can barely find the space to report the scores.

The bright side and jumping on the bandwagon

Journalists and commentators caught up in the wonderful achievements of the Matildas were desperate for a headline to show their enthusiasm was greater than everyone else. Even *The Australian Financial Review* felt obliged to cover the event, with *"How women saved Australian soccer". The Sydney Morning Herald* headline was "*OMG, what a rush: The Matildas have made even nihilists believe*." Sports editors covered the game for the first time but revealed their true colours when they breathlessly wrote about Australia 'kicking' a goal. In football, goals are 'scored' not kicked.

Let's look at some major positives first:

1. Participation

Football has never had a problem with participation. The Australian Sports Commission's official survey has long confirmed football is the most popular sport to play with 1.2 million participants, followed by golf (740,000), Aussie Rules (700,000) and tennis (650,000). Rugby league and rugby union are far behind.

Junior football clubs report that enquiry levels in the last month are up significantly, from both boys and girls, and the major headache now will not be lack of interest in playing football, but funding and finding the fields, facilities and referees to accommodate the demand. A recent Government promise to inject $200 million into women's sport will help but it is not specifically for football, and will not go far spread across the country and many sports.

2. Matildas brand and support

The value of the Matildas brand has risen multiple times. They showed that women's sport can attract immense crowds that are friendlier, welcoming and inclusive. The biggest problem at Stadium Australia was the long queues at the women's toilets as the designers did not anticipate the rise in female demand.

In analysing the impact on the A-League, this article does not for one moment diminish what a wonderful event Australia staged, proving again that the country does big sport as well as anyone.

3. Attendance at A-League Women

All kids under the age of 16 can attend Liberty A-League (Women) games for free. Any Sydney FC member can attend all the women's games for only $50 for the entire season. Sydney FC women's team is the current Champions and Premiers, and Courtnee Vine, the Matildas' penalty hero, plays on the right wing.

During the World Cup, Sydney FC announced it had broken the club's A-League Women's membership record two months ahead of the new season. While the club did not reveal the number, it is targeting 1,000 members.

So while the women's competition should receive a good boost, it is from a very low base. The average attendance in 2022/2023 was 1,249 and although a healthy 9,519 attended the Grand Final, a month earlier, only 201 turned up to watch Western Sydney Wanderers, a club that should have one of the larger fan bases in the league.

If we can do this and turn up for the Matildas, why can't we do it for the A-Leagues?

MATILDAS AND WESTERN UNITED MIDFIELDER CHLOE LOGARZO

What about the main game in town, A-League Men?

The new A-League season commences on 20 October 2023, two months after the conclusion of the Women's World Cup.

How many new fans among the millions of Australians who watched football for the first time, who claim to finally 'get it', or the avid followers of the global game who have scorned the local version, will attend the opening game due to the Matildas' experience? My guess is not many.

As the chart below shows, the average attendance at the A-League last season was less than 8,000. Sydney FC is far ahead of all others with almost 17,000, boosted by a return to the $1 billion Allianz Stadium but not matching the levels of a decade ago. Previous high-flyers Western Sydney Wanderers, whose success at filling the 20,000-seat Parramatta Stadium in the early days led to the reconstruction of the ground to hold 30,000, now average only 12,000. The move from the old stadium was a disaster for the club compared with the excitement of the first few years. The previous best-attended club, Melbourne Victory, is a shadow of its former self at 10,000 last year and heaven knows why Macarthur and Western United owners campaigned so aggressively for entry to the A-League in 2020/2021. At 3,000 each, they have failed to attract a following, despite Western United being Champions in 2022.

Total and Average Attendances, A-League Men, Season 2022/2023

Club	Games	Total	Average
Sydney FC	14	236,423	16,887
Western Sydney Wanderers	14	167,288	11,949
Adelaide United	15	160,666	10,711
Melbourne Victory	13	131,608	10,124
Melbourne City	15	119,995	8,000
Central Coast Mariners	14	106,452	7,604
Wellington Phoenix	13	82,331	6,333
Newcastle Jets	13	79,982	6,152
Brisbane Roar	13	73,179	5,629
Perth Glory	13	57,868	4,451
Macarthur FC	13	45,684	3,514
Western United	13	41,186	3,168
Total:	163	1,302,662	7,992

Source: Ultimate A-League

The highest-profile Australian coach in the world is Ange Postecoglou, previously in charge of the Socceroos and Celtic and now at Tottenham Hotspur. There are few people more knowledgeable about Australian and global football. When asked whether football will finally "*crack it in Australia*" (SMH 21 August 2023), he replied:

"I battle with that, mate. I really don't know if we will ever crack Australia. I hope so."

Earlier, Postecoglou had reflected on his success with Australia in the Asian Cup in 2015:

"Where it is right now, it's where it's been many times. It's what happens from now on ... we won the Asian Cup and barely a ripple."

Sport in three: participation, commercial and jingoistic

Similarly, Colin Carter was a Commissioner with the AFL and a major factor in its modern success. He gives an informed perspective. He says:

"What the Matildas did was fantastic, but it's unlikely to translate into all the things that people are imagining it will. That idea is grossly exaggerated ... People don't watch second best in anything. On television, you can always see the best in the world."

Carter divides sports into three: participation, commercial and jingoistic. He sees the Matildas and this World Cup in the last category of teams or events that create a short term but intense patriotic pride, without leaving a lasting legacy for their sport. The players will go back to their clubs, nearly all overseas, leaving behind fond memories and struggling A-League competitions, both men and women. As Carter points out, the best football in Europe attracts a big Australian following and that is part of the problem. In football, the best is in Europe and Australian players will always leave, unlike in Aussie Rules or Rugby League.

Unlike other sports, football in Australia is run by multiple bodies, and the fragmentation is part of the problem. There is no unified voice. The governing body for the Matildas and the Socceroos is Football Australia. APL represents the club owners and organises the A-Leagues. State competitions are managed by powerful state bodies.

It's the commercial side of the local professional league based on attendance, broadcast views and overall sponsorship that is the ongoing failing. Media coverage is poor in all major newspapers, and radio and television stations, even after a full weekend of good games. Long-time backers of the A-League, Hyundai, NAB and Caltex, all failed to renew their contracts recently. Foxtel abandoned its coverage, Optus was not interested and a below-standard coverage is available on Paramount Plus.

Tony Sage, long-time owner of Perth Glory, has finally given up after injecting millions into the club over 18 years. He put out this scathing media release when announcing he would no longer finance the club. Newcastle Jets is looking for a new owner as it is currently in the hands of other clubs. Brisbane Roar owners want out. I doubt Tony Sage is looking at the success of the Matildas and regretting his exit.

Others are more optimistic. David Rowe, a Professor at Western Sydney University with special interest in sport and society, says:

"I'm a bit cautious, we've seen a few false dawns in the past. But on reflection, I actually do think this is a watershed moment. I don't think there's any going back from here. Quite how big the leap will be we still don't know, but it's substantial both for football and for women's sport in general."

The Matildas, yes. Women's sport, yes. Participation, yes. Better media coverage and attendance at the A-League, highly unlikely.

There is a lot of enthusiastic talk about how football has united a migrant nation, how it brings in shared cultures from different global backgrounds, and how boys and fathers will now understand that women can play competitive football in a superior spirt to the men. Fair enough, but will they now go to a game?

There have been too many false dawns to list for the local professional league, but let's mention one: the recent men's World Cup. Australia qualified for the knockout stage by defeating Denmark and Tunisia. The Socceroos pushed the eventual winners, Argentina, all the way in a 2-1 loss. Like the Matildas, it was a time of national pride and football authorities hoped it would herald a new era of local interest.

Then came the disaster of the pitch invasion at Melbourne Victory and the assault on a goalkeeper, but even before that, there was little evidence of larger crowds, including when many Socceroos featured in the Sydney FC versus Melbourne City game. In fact, Melbourne City has been the best club in the league over the last three years and averages only 8,000 fans.

The APL and the clubs will work hard to attract more fans on 20 October 2023, although much of the joy of community and winning as one will have evaporated. Courtnee Vine has signed for another domestic season, and will feature as the face of the women's competition this year. But nobody need worry whether they will be able to buy a ticket.

A final word from Tony Gustavsson, the Matilda's Swedish coach:

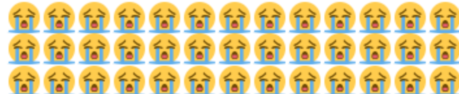
"It's easy now when the spotlight is on all of us, but what about a week or 10 days from now? What are we doing to keep this going? To stay in this. And what are you guys (journalists) doing in a month from now or six months from now or a year from now to keep making sure the spotlight is on women's football and investment keeps happening?"

Exactly. Regardless of how much we loved the World Cup, most people will move on to the next bright thing the media focusses on.

Graham Hand is Editor-at-Large for Firstlinks. He is a Foundation Member of Sydney FC, a season ticket holder for 19 years and rarely misses a home game. He would love to see more people at games, but don't try to sit in the seat he always occupies. Graham plays in an Over-60s football competition and has attended three men's World Cups in Germany (2006), South Africa (2010) and Brazil (2014).

HOW LUCKY ARE WE to have this team 💛💛💛

Watching little boys go insane for this team in the crowd and I'm done



EPIC

They've changed sport here forever

Podcast: Andrew Clifford on finding gems amid China rubble

James Gruber

Season 2, Episode 6

In this week's episode, we welcome special guest, Platinum Asset Management CEO, Andrew Clifford. There are few countries more hated by investors than China and that's piqued Andrew's interest. He sees opportunities in stocks with major tailwinds such as the world's leading EV battery maker and the 'UPS of China', as well as deep value in much maligned Chinese property developers. He also thinks Japan is one of the world's best equity stories over the next five years due to recent improvements in corporate governance. However, Andrew's not so enamoured with the outlook for US stocks.

Regular guest, Graham Hand, explains how a recent report on the performance of assets over a 30-year period is a pointer to retirement outcomes. And our other regular, Peter Warnes, tells us what the recent result of Commonwealth Bank says about the outlook for banks and the Australian economy.

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.

Opportunities but not a time to make major risk decisions

Niall O'Sullivan

We have greeted this year's equity market rally with some trepidation. While strategic asset allocations have done well, we have been cautious as equity markets diverge from economic fundamentals.

Initially, each month of divergence increased our concern about market levels, especially as investors were being 'paid to be patient' by cash and short-term bond yields. Eventually, the balance between tactics and strategy made us recognise that the near-term momentum of equities was too strong to fight, even as we held onto our medium-term outlook. By midyear, we were 'shifting to neutral'.

But a 'neutral' view doesn't mean a portfolio has to be static. We specified that the engines are still running, and maintained the view that we would likely go underweight again at some point.

The message: This is not yet the time to be making major calls on asset or risk allocation. Any signs of a deepening of the economic slowdown "will show up in credit markets before they show up in equities", we wrote in July. So, have we seen catalysts for movement? And if not, what can investors do in the meantime?

Triggers to act?

So far, there has been little to spark concern.

High levels of U.S. credit card and auto loan debt have attracted some attention, but while the dollar amount may be breaking records, the debt as a proportion of wealth does not appear to be at worrying levels.

There has been an uptick in corporate defaults, including the notable bankruptcy of the once-dominant, 100-year-old U.S. freight-trucking company, Yellow. The recent decision by Moody's to downgrade ratings and outlooks on a swath of U.S. regional banks is a reminder that that crisis hasn't entirely gone away. For those of a very gloomy disposition, Fitch's downgrade of the U.S. government could be a 'straw in the wind', we don't see it as a major event.

All that said, index-level high-yield spreads have tightened, and if anything, the most worrying thing in today's credit markets is arguably the recent spread compression in complex and securitised markets, indicating a stretch for yield. These are factors that make us cautious at the margin in high yield, but are not yet enough to trigger wider sell-offs.

In equity markets, we remain concerned about valuations, and our 'prior belief' is that we will move to a short position in the future. The key question is what the market needs to see in the fundamentals to trigger a correction.

In our view, the answer is margins being squeezed by wage and other cost increases that companies can no longer pass on. Second-quarter earnings reports showed a little of that, but this was generally restricted to sectors like communication services, healthcare and utilities, which are known for their high operational leverage.

How to generate returns

With no clear reason to change gears, what can be done to eke out incremental excess return opportunities?

One place to look is within, rather than among, asset classes.

Since April, our Fixed Income team has been saying that it expects core government bond yields to trade in a range this year—between 3.15% and 4.15% for the US 10-year Treasury, for example. With yields currently above this range, the team has identified lengthening duration as a potentially attractive tactical position.

In equities, regional tilts can be explored. Japanese equities still appear attractively valued in a policy environment that remains very accommodative next to other developed markets, even after the Bank of Japan's recent adjustments to yield-curve control.

By contrast, European data, especially in manufacturing, continue to trend weaker, and the recent bank-tax saga in Italy is a reminder of the potential for greater government involvement in markets.

We have also become more cautious on China, in both debt and equity, as it struggles with deflation and the overhang of property debt and falling local government income. A broad, government-led stimulus program could be a positive surprise, but our teams on the ground continue to expect more targeted measures.

In private markets, there are several places where liquidity and capital scarcity make for attractive long-term return potential, whether that be specialized niches like preferred stock or mid-life co-investments or better-known markets such as private equity secondaries. More generally, as Elizabeth Traxler highlighted on our recent Asset Allocation Committee webinar, deal models focused on truly enhancing a business are much more likely to succeed than those predicated on high leverage.

Other possible opportunities

Another place to look is where markets may have taken their eye off the ball and failed to price for potentially disruptive economic events.

As both inflation and commodity prices declined during the first half of this year, we continued to recommend commodities in portfolios, where appropriate. This was because we still considered the supply-and-demand balance to be fragile and at risk from unexpected disruptions, making commodities an underpriced hedge against an unwanted return of rising inflation.

We haven't seen any such disruption feed into inflation data yet, but there *has* been a recent comeback for commodities, accompanied by a steady rise in longer-term US and European inflation expectations.

The fact that European gas prices had fallen almost 90% from their 2022 high is one reason they were able to surge almost 40% in one day on news of a possible workers' strike at liquid natural gas plants in Australia. Oil has rallied hard to a nine-month high through July and August, on the back of supply cuts. Copper has also been edging higher, and could be sensitive to any stimulus measures out of China.

No time for major calls

The most recent comments from the European Central Bank and Bank of England have moved them into the fully 'data-dependent' camp, alongside the Federal Reserve. That stance reflects that the growth-and-inflation cycle appears to be turning and the full effects of their past decisions have yet to be felt. They feel it is not time to be making big policy calls. It's a time for marginal tweaks in response to day-to-day information.

Investors find themselves in the same uncertain environment, at the same apparent turning point, so it's no wonder a similar stance suggests itself. This is no time to be making major calls on asset or risk allocation.

Niall O'Sullivan is Chief Investment Officer, Multi Asset Strategies – EMEA at Neuberger Berman, a sponsor of Firstlinks. This information discusses general market activity, industry, or sector trends, or other broad-based economic, market or political conditions and should not be construed as research or investment advice. It is not intended to be an offer or the solicitation of an offer.

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