Edition 540, 22 December 2023

Contents

Editorial

New forecasts from the Australian Bureau of Statistics (ABS) highlight how quickly our population will age, and investors need to prepare now for the enormous changes that it will bring.

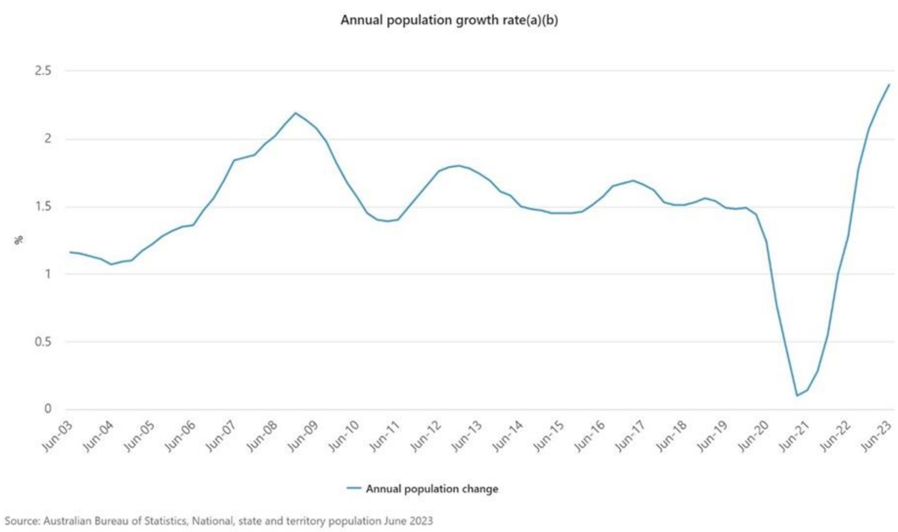
For a start, it will put huge pressure on Government budgets as spending on healthcare and welfare skyrockets. To pay for this, Governments will need to increase taxes, borrow and print more money, or cut spending on other things. A combination of all three options is possible. Further changes to superannuation and the Age Pension seems inevitable in this context.

The ageing population will lead to slowing growth in our working age population, or even an eventual decline. Fewer workers may mean a tighter labor market. Could that result in structurally higher inflation?

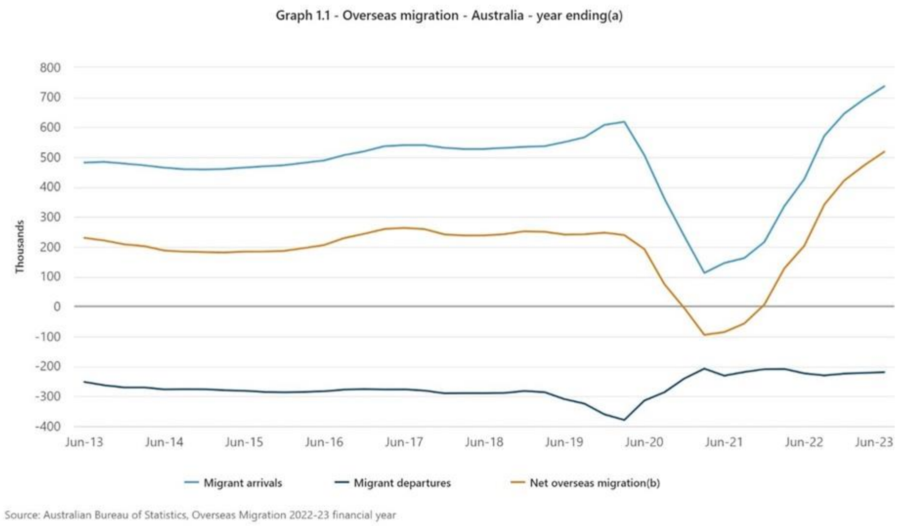
It will also affect valuations of stocks and sectors on the ASX. There should be long-term tailwinds for companies catering for our ageing population including private health insurance, retirement villages, hearing aids, annuities, and pharmaceuticals/biotechnology. Conversely, there will be headwinds for companies exposed to the young, including childcare, toys, and teenage fashion.

New life expectancy estimates

Recent population statistics from the ABS made front-page news. The data showed that Australia's population had increased to 26.6 million, rising 2.4% over the past year.

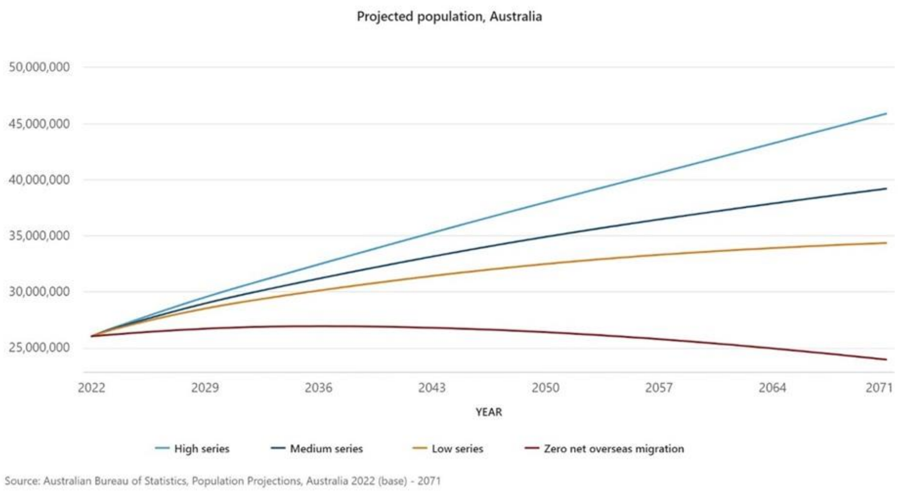


The headlines focused on the key driver for the increase in population: record high migration. In the year to June 2023, there were 737,200 migration arrivals and 219,100 departures, resulting in net overseas migration of 518,100. That figure was dramatically up from pre-Covid levels though it's at least partially a catchup from Covid when numbers dipped sharply.

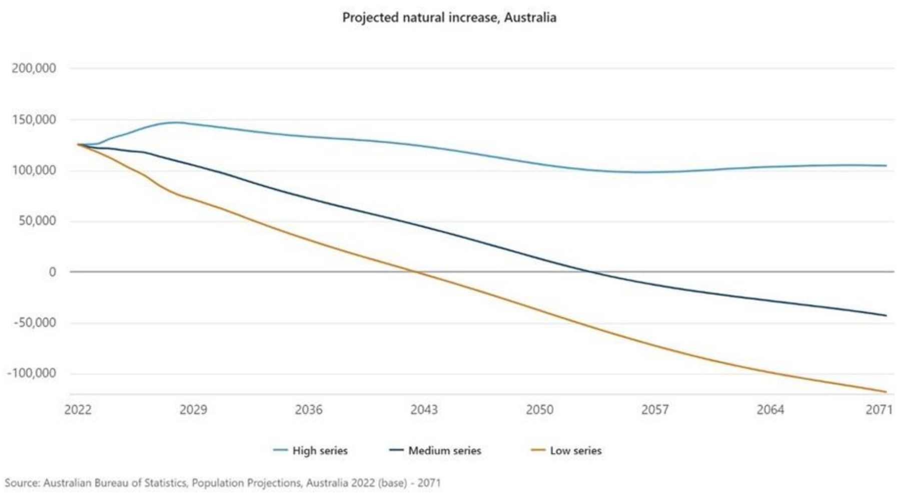


What didn't grab headlines was data from the ABS on population projections and life expectancy. The ABS now forecasts that Australia's population will rise from the current 26.6 million to between 34.3 and 45.9 million by 2071. That's a large range and is based on the current 10-year average annual population growth rate of 1.4% falling to 0.2-0.9%.

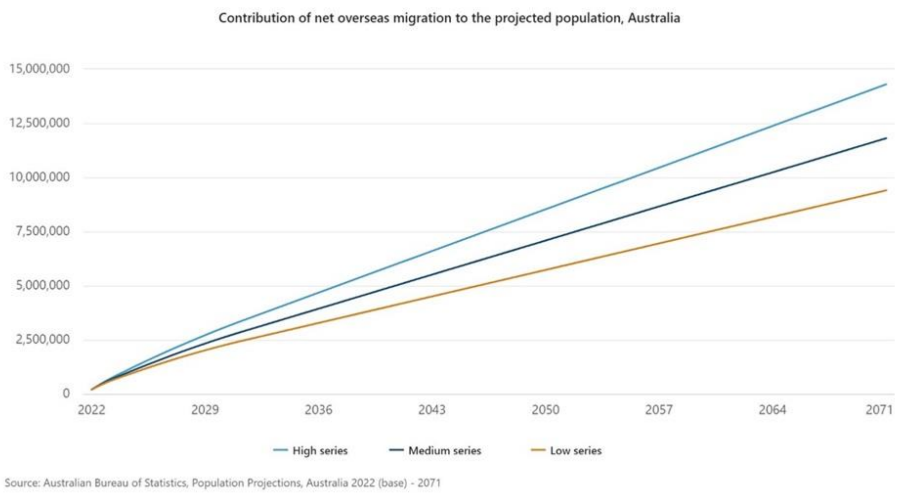
The ABS forecasts the median age of 38.5 years will increase to 43.8-47.6 years. Taking the mid-range of that projection of 45.7 years means that the ABS is expecting a 20% increase in median age by 2071.



The ABS predicts that the natural increase in population could turn negative by as early as 2043. That means more Australians will be dying versus being born by then. That's in the ABS' so-called 'low series' scenario. Under its 'medium series' scenario, it'll be 2054 when that happens, and under the high series, it won't happen at all over the next 47 years.



A big variable in the forecast is migration. The ABS forecasts that net overseas migration will contribute 9.2-15.3 million people between now and 2071. The 'medium series' forecast of 11.8 million averages an annual intake of 246,000 overseas migrants.



In other data, the ABS revealed that life expectancy at birth was 81.2 for men and 85.3 for women from 2020-2022. 30 years ago, those figures were 74.5 for men and 80.4 for women. In other words, men are living 6.7 years longer and women are living 4.9 years longer than they were in 1992.

Australia's life expectancy now ranks third in the world behind Monaco and Japan.

Top 20 countries for life expectancy in the world(a), United Nations, 2021

Country	Persons		Males		Females	
	years	rank	years	rank	years	rank
Monaco	85.95	1	84.34	1	87.68	2
Japan	84.78	2	81.8	4	87.73	1
Australia	84.53	3	83.17	2	85.84	6
Switzerland	83.99	4	82	3	85.9	5
Malta	83.78	5	81.44	6	86.11	4
Republic of Korea	83.7	6	80.39	15	86.76	3
Liechtenstein	83.26	7	81.1	8	85.35	9
Norway	83.23	8	81.56	5	84.88	13
Spain	83.01	9	80.21	17	85.77	7
Sweden	82.98	10	81.08	9	84.91	12
Italy	82.85	11	80.52	13	85.1	10
Singapore	82.75	12	80.64	10	84.93	11
Iceland	82.68	13	81.21	7	84.18	22
Canada	82.66	14	80.62	11	84.67	16
Luxembourg	82.63	15	80.45	14	84.81	14
France	82.5	16	79.43	22	85.49	8
New Zealand	82.45	17	80.58	12	84.32	19
Israel	82.26	18	80.15	18	84.3	21
Finland	82.04	19	79.35	23	84.72	15
Ireland	82	20	80.25	16	83.77	26

a. Based on life expectancy for persons.

Source: For all countries, see United Nations, Department of Economic and Social Affairs, Population Division (2022), World Population Prospects 2022, Online Edition

The predictions for our ageing population aren't new as the ABS, along with the various Intergenerational Reports, have continually updated their forecasts. As a rule, they've consistently underestimated life expectancy increases. This is understandable given that medical advances that extend life are impossible to predict. Yet it is also a fair bet that current estimates will prove too low as well.

A faster-than expected ageing of Australia's population may mean we're dealing with its effects far sooner than most think.

The great demographic reversal

A fascinating book called *The Great Demographic Reversal* outlines the potential impact from a rapidly ageing population on our economy. Written by Charles Goodhart, a Professor at the London Stock Exchange and former Chief Advisor to the Bank of England, and Manoj Pradhan, a macroeconomics consultant, in 2020, the book became well-known in economic circles for suggesting that higher global inflation was imminent. Back then, no one was suggesting that. The prediction turned out to be correct, albeit perhaps not entirely for the reasons that they put forward.

In the book, Goodhart and Pradhan argue that economic growth in the developed world is bound to fall because the tailwinds of the past three decades are now reversing.

Economic growth is a function of growth in working age population plus productivity growth. Goodhart and Pradhan suggest the days of a growing working age population are behind us and productivity improvements won't be enough to offset this.

They say the rise of China as an economic superpower has been the dominant story of the past 30 years. It led to a global influx of hundreds of millions of workers. These cheap workers help fuel the rise in supply of goods for companies around the world. Along with favourable demographics, it resulted in increased economic output and lower inflation growth across developed market economies.

The authors think China's largest contribution to global growth is now past as its working age population is shrinking, as its people grow old. And the West is witnessing sharp declines in fertility rates, continued increases in life expectancy, and falls in growth rates of working age populations. This means the ageing of populations everywhere, barring Africa.

Also, the dependency ratio – the ratio of those who need support because they do not earn income relative to workers – is worsening. The populations of most countries will go on rising for the next 25 years because the number of old will offset the number of young. But between 2045 and 2050, the global population will begin to decline.

The authors say this decline will lead to labor shortages and upwards pressure on wage rates, which will be reinforced if taxes on workers increase to pay for welfare for the ageing. That will fuel structurally higher inflation and higher nominal interest rates (but not necessarily real rates).

It will lead to employers increasing investment because labor will become more expensive. That will improve worker productivity, but it won't be enough to counter the declines in the working age population.

The book doesn't consider technology as a major factor in declining inflation rates in previous decades and they play down its potential role in future. To critics that mention Japan as an example for ageing populations not leading to inflation, Goodhart and Pradhan argue that Japan' situation happened against the backdrop of China's rise and that rise explains much of the low inflation that Japan has experienced since.

They also mention that immigration can help offset ageing populations in some countries. They say the issue of immigration is partly to blame for the rise of populist parties in recent years. The authors believe it's also divisive because it pits mainstream economists, who largely welcome immigration, against the public, which wants it restricted.

Impact on super and the Age Pension

As Australians live longer, it will also put enormous pressure on welfare budgets. Governments will need to raise money to pay the bills. And they'll pick politically easy targets to achieve this.

For example, negative gearing is political dynamite, and the Federal Government will avoid tinkering with it unless forced too.

On the other hand, super and the pension are easier targets. This year, we saw the introduction of a new tax on super balances over $3 million. Given future pressure on budgets, further changes to super seem inevitable.

That isn't to say that super isn't a good vehicle to build wealth. It currently is. Though whether it remains the case is an open question. Making sure that you have diverse investments outside of super to fund your retirement would seem prudent.

As for the pension, it used to be seen as a 'right' but is now perceived as welfare. In recent years, the Government has tightened criteria for the pension. More tightening seems a given. In future, a generous pension is far from guaranteed.

All of this suggests that people need to think carefully about how they best accumulate wealth to fund their retirements.

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In my article this week, I look at why Australian stock returns are likely to crush those from housing over the next decade. In my estimate, housing is up to 40% overvalued and is far more expensive than the 'Magnificent Seven' US tech stocks, which themselves are richly valued yet have infinitely better growth prospects. That doesn't bode well for future returns from property.

James Gruber

Also in this week's edition...

It's the time of year for reflecting on the rollercoaster of 2023 and what may lay ahead for next year.

VanEck's Russel Chesler thinks interest rates will stay higher for longer due to sticky inflation, and based on that, he makes five big market calls for 2024.

Martin Conlon from **Schroders** believes decarbonisation is the big theme for next year and the decades ahead. However, he estimates the costs of the energy transition are being vastly underestimated. Because of that, he thinks commodity prices will stay elevated for a long time to come, and thus favours ASX mining companies.

Munro's Qiao Ma surveys global markets and observes the striking outperformance of large caps versus small caps. She thinks that's set to reverse, and quality small and mid caps are set to shine.

Morningstar's Martha Norton looks back on the lessons from 2023. Her key takeaways include that economic outlooks have limited usefulness in positioning portfolios, and there's a difference between falling prices and cheap assets, and that difference matters a great deal.

Meanwhile, **Meg Heffron** has just the thing to be fully prepared for the new year. She gives us a quick reference guide to popular facts & figures for super caps, rates and thresholds. It's a great guide.

Tony Kaye from **Vanguard** makes his Firstlinks debut with a piece on picking your retirement point. He says one of the hardest decisions for many people – excluding those who want to keep on working – is choosing when to stop. Moving into pension mode is a big decision, and Tony provides some options and considerations.

In this week's whitepaper, **Franklin Templeton** gives an overview on the state of investment and wealth management in 2023-24.

This is the last edition of Firstlinks for 2023. We'll be back on January 4. Thank you for your support this year. The strength of Firstlinks comes from the engagement of its readership and on that score, we're both privileged and lucky. We wish you and your families a safe and happy festive season.

And a special thank you to our sponsors, without whom this publication wouldn't be possible.

See you next year.

Curated by James Gruber and Leisa Bell

Australian stocks will crush housing over the next decade

James Gruber

I am a reluctant writer on Australian real estate because the sector doesn't need more promotion. It gets enough of that from quacks and lobbyists that fill the daily newspaper columns and broadcast airwaves.

Yet I can't help but notice a large gap in the coverage. There's lots of news about housing prices, clearance rates, 'hot' suburbs, interest rates, and where to get the best loan. There's much less about property values, or valuation. It's a curious omission.

After all, there's constant talk of valuations when it comes to stocks, bonds, and other assets. The price-to-earnings ratios for stocks are regularly spoken of, as are the yields on bonds.

For residential property, not so much. Why is that? Perhaps, valuations on housing don't matter. Or maybe they don't fit the uniformly bullish commentary on the sector.

I'm going to suggest that valuations do matter and they're little mentioned because housing remains ludicrously priced. Up to 40% overpriced in my estimate. And that housing here is far more expensive than the 'Magnificent Seven' US tech stocks, which are richly valued yet have infinitely better growth prospects.

I'll also argue there are very high odds that returns from the ASX will handily beat those from residential property over the next 10 and 20 years.

The maths on property valuation

How do you value a property? Commercial property valuers will tell you that valuations are based on the discounted cashflows generated from an asset. The reality is a lot of valuations are based on capitalization rates – net operating income divided by market value – or price-to-book values from recent transactions.

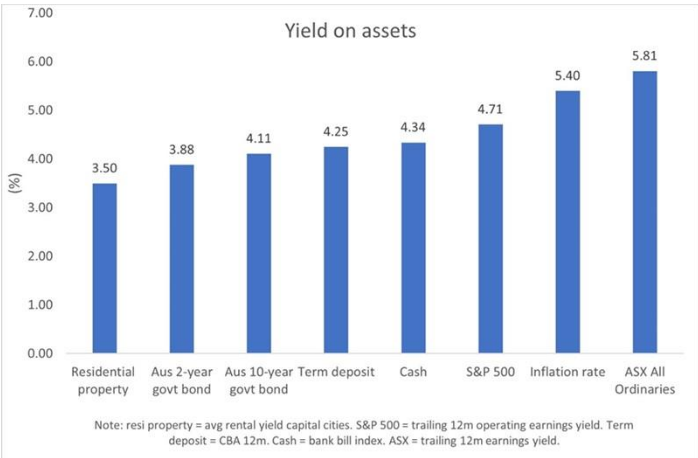
In residential property, it gets murkier. Valuations aren't based on land value. They're not based on cashflows. They're not based on book values. In my experience, they're largely based on recent transactions in the neighbourhood.

The problem with this is that current prices or recent transactions tell you nothing about the value of a property. It' like saying that the current price for the stock market equates to fair value of the market – because prices equal fair value. It's a circular argument that doesn't make sense.

How do we value the Australian residential market, then? One possible method is to take the so-called risk-free rate of return and apply a premium to reach a fair value estimate. The 10-year Australian Treasury yield is generally regarded as the risk-free. It's regarded as risk-free because you loan the Government money and are guaranteed (in theory) to get your money back in full. As I write, the 10-year yield stands at 4.11%.

All other assets are priced off this risk-free rate. For taking the risk of owning an asset, an investor will demand a premium to that risk-free rate. The extent of the premium is open to debate.

The advantage of this method is that we can compare yields and risk premiums across different assets. Below is an updated chart from a recent article in Firstlinks.



Form the chart, you'll see that the yield on residential property is well below the 10-year Government bond. It's also below what you can get from cash and a term deposit. And it's way lower than the current inflation rate.

It doesn't tell the full story though. The yield on residential property is based on a gross yield. It's before taxes and costs. That's not the case for the ASX and S&P 500, for instance. So, the chart isn't a like-for-like comparison.

What premium to the risk-free rate should housing command? There's no hard and fast rule. Stocks generally trade at 1.5-3% above the risk-free rate. Commercial property can be +3%.

Given housing is less risky than stocks or commercial property, a risk premium of close to 1.5% seems appropriate. That would put residential property on a gross yield of 5.61% (risk-free rate of 4.11% plus the risk premium of 1.5%). And it would fair value for housing at 40% lower than current prices.

Does this fair value make sense? Let's cross-check it against other valuation tools.

Valuation sanity checks

Perhaps an easier way is to look at it from a price-to-earnings ratio (PER) basis. At a 3.5% gross yield, property is currently on a PER of 29x. Though that's not quite accurate as the earnings are gross earnings not net earnings. Applying a 30% tax rate (which is the tax rate on an average salary) to those earnings would increase housing's PER to 40.8x. That's more than double the valuation of the ASX All Ordinaries 17x PER and almost 2x the S&P 500's 21x PER.

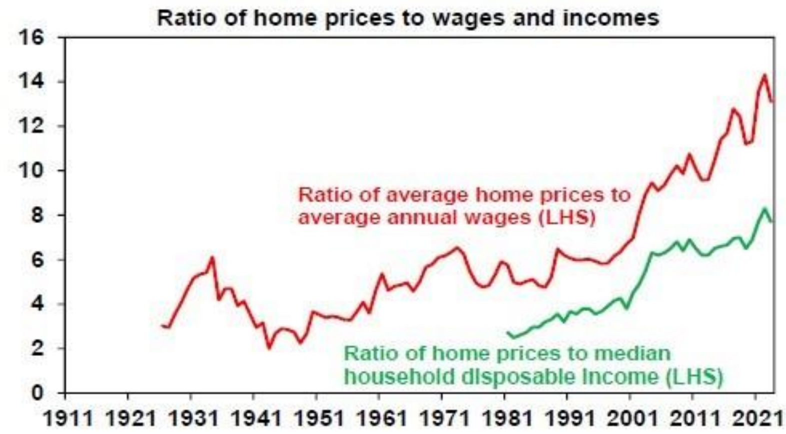
That doesn't paint the full picture, either. That's because that PER is before costs, and maintenance costs for property can quickly add up. In put those costs and the PER for property is easily north of 50x.

The 'Magnificent Seven' technology stocks in the US are priced at 33x forward earnings. Therefore, it can be argued that Australian property is priced at a far higher multiple than these stocks, which themselves are regarded as richly valued albeit with vastly superior growth prospects.

At our fair value estimate, housing would be valued at a PER of 17.8x (the inverse of a 5.61% yield). Again, though, that's based off a gross yield. Applying a 30% tax rate to housing earnings would lift the PER to 25.5x. That would equate to a 50% premium to the ASX's PER. That's a sizeable premium though not unreasonable.

Why Australian housing is so richly valued?

Housing is incredibly expensive even compared to other countries. The 2023 Demographia Affordability Survey says the median multiple of house prices to income for major cities is 8.2x in Australia versus 5x for the US and UK. In Sydney, it's more than 13x. And the time it takes for someone on a full-time wage to save for a 20% housing deposit has doubled from 5 to 10 years since the 1990s.

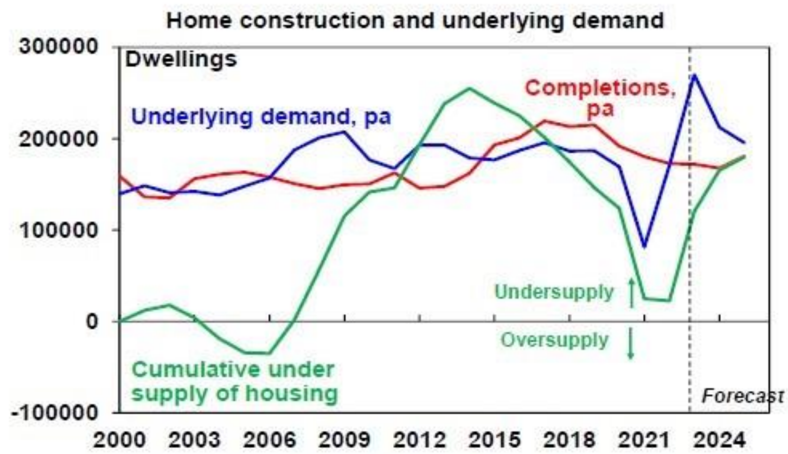


Source: ABS, CoreLogic, AMP

The question is why have prices become this expensive? Looking at the chart above, it's really since the 1980s that prices have taken off.

What changed then, and since? One obvious answer is that from 1980 to 2022 we had falling interest rates. I'd argue it was more than that though. Especially over the past 15 years, the RBA and central banks around the world kept interest rates below the rate of inflation, otherwise known as financial repression. This stoked speculation across most assets and resulted in an enormous increase in global debt. It also led to the 'financialization' of economies, where capital flowed into financial assets at the expense of real assets (think of the lack of infrastructure spend in Australia, for example).

Interest rates can't be the sole reason for expensive housing here because it doesn't explain why Australian property has steamed ahead of most other countries.



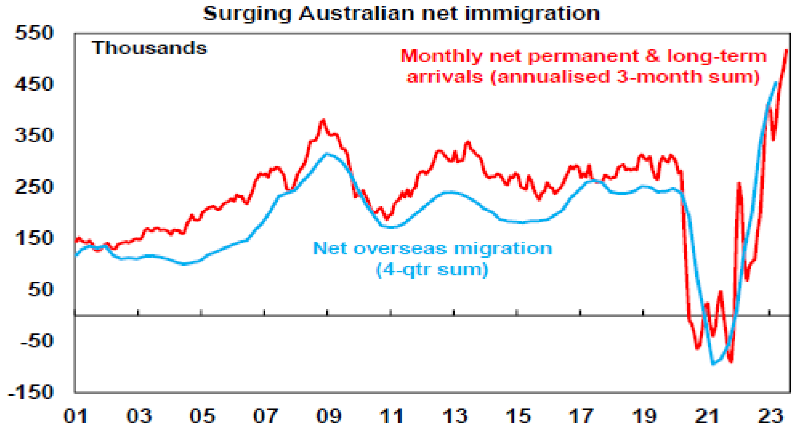
Source; ABS, AMP

Supply issues have undoubtedly played a role. Up until around 2006, the market was roughly in balance, where there was enough supply to meet demand. Since then, there's been a persistent shortfall. Currently, the shortfall is around 120,000 dwellings, and that's expected to increase over the next few years.

The reasons for the supply shortfall are many. From a lack of development approvals combined with the rise of NIMBYs (not in my backyard) to capacity constraints to, lately, construction firms struggling to stay afloat amid cost pressures.

The Federal Government has heard the message and is targeting to build 1.2 million new homes over five years from 2024. Over the past five years, we've built around 1 million new homes, so this isn't a significant step up, and is unlikely to be enough to stem the supply shortfall.

On the demand side, surging immigration has played a part. In the early 2000s, net migration averaged 100,000-150,000. That surged to 518,000 in the year to June 2023. Part of that was a catchup from the pandemic, but net overseas migration has been at high levels since 2006.



Source: ABS, AMP

Demand has also been fuelled by massive government subsidies. Whether it's first homeowners' grants, negative gearing, or capital gains tax concessions, all have helped to propel demand and prices.

What's little talked about is the staggering number of individual investors in the housing market. It's somehow considered normal here that 36% of new housing loans go to investors. In the US, that share of loans to individual investors is about half of Australia's.

Portion of new lending for investment housing (excluding refinance)

Source: CoreLogic

I have friends and acquaintances who've purchased investment properties well before they bought their own homes, some that own two investment properties and don't own their own home (and have recently moved back into their parent's place), and several others with average paying jobs who own multiple investment homes. And all of them are loaded to the gills with debt.

The fact that investors are willing to buy houses that are almost guaranteed to lose them money on a cash basis (for instance, the average CBA variable loan at 6.5% exceeds the average capital city rental yield of 3.5%) shows you the power of government subsidies and the optimism about future returns.

Future returns

How about the future returns of property versus shares? It's difficult to estimate short-term returns though much easier to predict long-term ones.

To calculate the potential returns over a 10-year timeframe, we can use the following formula:

Starting net yield + earnings growth rate + % change in earnings multiple

For property, the starting net yield is 2.45% (this is before costs, which are difficult to calculate and are therefore subjective). What would we assume for rental earnings growth? Though rent has ballooned over the past two years, during the 2010s, average rent growth was 2%. In the long-term, we'd assume that it heads back towards that rate. Let's assume 2.5% annual rental growth.

If there was no change to the earnings multiple, that would give you an annual nominal return for housing of 4.95%.

Predicting no multiple change is a big assumption. Remember, housing is currently priced at a PER of 40x before costs. If we assumed a 25% haircut to the multiple, that would reduce annual returns to 3.71%.

We can assume different rent growth rates and multiples to come up with different estimates. I would suggest a range of 2-5% in annual returns over the next 10 years is reasonable.

Let's apply the same formula to estimate stock returns over the next decade. The current dividend yield on the ASX is 4.44%. A conservative earnings growth estimate is 3% per annum. Given the current PER is almost bang in line with the long-term average, let's assume no change in the multiple. That gives you an annual return of 7.44%. I consider this conservative.

Again, we can play around with earnings growth estimates and dividend yields (possible cuts?) and the earnings multiple. I would put the range of future annual returns is 6.5-10% for the ASX All Ordinaries. For reference, ASX stocks have returned 7.3% per annum over the past 10 years.

Putting this together, I think the odds are very high that ASX stock returns will handily beat those from residential property over the next decade.

What are the chances of a meaningful housing correction?

Given the high prices for property, can we expect a larger correction at some point? I doubt it. In the near term, supply shortfalls are severe and that will keep prices up. Long term, it's up to the Government to bring meaningful reforms to the sector to bring prices down.

But that isn't going to happen. The Government has no desire for house prices to go down. It may talk about bringing on extra supply, and doing other things around the fringes, but it has no intention for property prices to fall.

To understand why isn't hard. The average parliamentarian owns multiple investment properties. Also, 67% of the population are homeowners.

As Charlie Munger once said, "Show me the incentive, and I'll show you the outcome".

The Government could remove all subsidies for housing and prices would quickly drop. But major changes won't come until they're incentivized to do it. And that won't happen until the majority of voters aren't homeowners. When that occurs, the political calculus will change.

James Gruber is an assistant editor at Firstlinks and Morningstar.com.au

5 big calls for 2024

Russel Chesler

Equity market performance from the beginning of the year has been a roller coaster.

Year-to-date, we have seen the strongest performance coming from US equities, mainly driven by the seven large tech stocks. Australian equities have been slightly positive for the year, and we are seeing bonds barely positive after negative returns in 2022.

From an investment perspective, it has felt like an episode of The Twilight Zone. What was happening did not reflect reality with the equity market being cheerily optimistic that the Federal Reserve (Fed) would come to its rescue by cutting rates before any real economic slowdown. This was despite all signs pointing to a Fed remaining firm in its fight against inflation.

What is clear is that we are going to see higher rates for longer – in the US, in Australia and most other developed markets.

We're still seeing inflationary pressures in both countries and these pressures are likely to continue to impact markets throughout next year.

The US may be able to avoid a recession next year although a recession has followed the last five times when inflation peaked above 5%. US inflation hit 9.1% in June last year and has fallen to 3.1% at the end of November.

At least so far, a recession doesn't look like a necessity in Australia, though that doesn't rule out accidents, especially with the tightening cycle starting so late and so far from neutral, too. The reason a recession may be avoided, for now, is that neither inflation nor wages growth look completely out of control. Also, although resource prices have come off, they remain elevated and will continue to have a positive effect on GDP. That said, with current inflationary pressures, we believe there will be another rate rise in Q1 2024, likely in February.

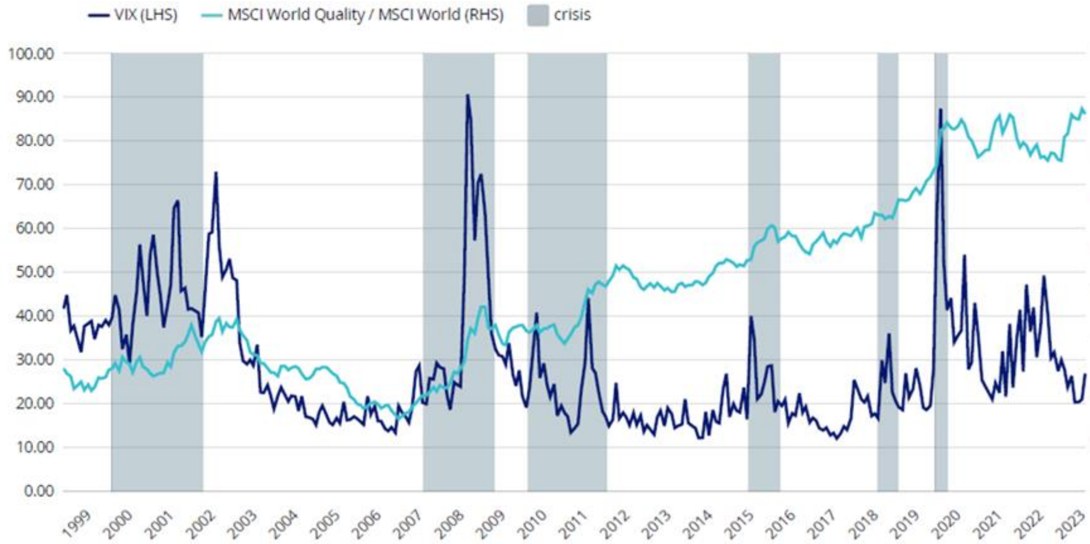
Now more than ever, being selective is key for investors. My top picks for 2024 centre around being defensive and looking for pockets of opportunity.

1. Seek out financially strong companies with solid balance sheets

Companies with these characteristics, known as 'quality' companies, have historically shown resilience in the market environment we're currently in. Quality stocks tend to be defensive and tend to outperform in times of volatility.

This is illustrated in the chart below. The VIX Index, shown in dark blue, is a measure of market volatility related to the S&P 500. The teal-coloured line is the ratio of global quality companies (represented by the MSCI World ex Australia Quality Index, known as the 'Quality Index') relative to the benchmark of the world's largest companies (represented by the MSCI World ex Australia Index). When teal line is upward sloping, quality is outperforming. You can see quality companies outperformed during key crises, including the US banking crisis earlier this year.

Chart 1: Relative performance of Quality vs VIX



Source: MSCI Data/Calculations, Bloomberg. Chart shows performance of MSCI World ex Australia Quality relative to MSCI World ex Australia compared to VIX Index. Results include the reinvestment of all dividends. You cannot invest in an index. Past performance is not a reliable indicator of future performance of the index.

Further, if we look at the performance of the Quality Index compared to its benchmark going back over the last 25 years, quality companies have shown significant outperformance in periods of contraction and recovery.

This is why taking a quality investing approach to global equities is often referred to as a "strategy for investing throughout the seasons".

Table 1: Quality through the cycle

Performance p.a

Period	Quality	Benchmark	Difference
Recovery	2.78%	-3.38%	6.16%
Expansion	14.75%	15.84%	-1.10%
Slowdown	1.65%	-0.55%	2.20%
Contraction	12.03%	4.16%	7.87%
Since Inception	8.61%	6.32%	2.29%

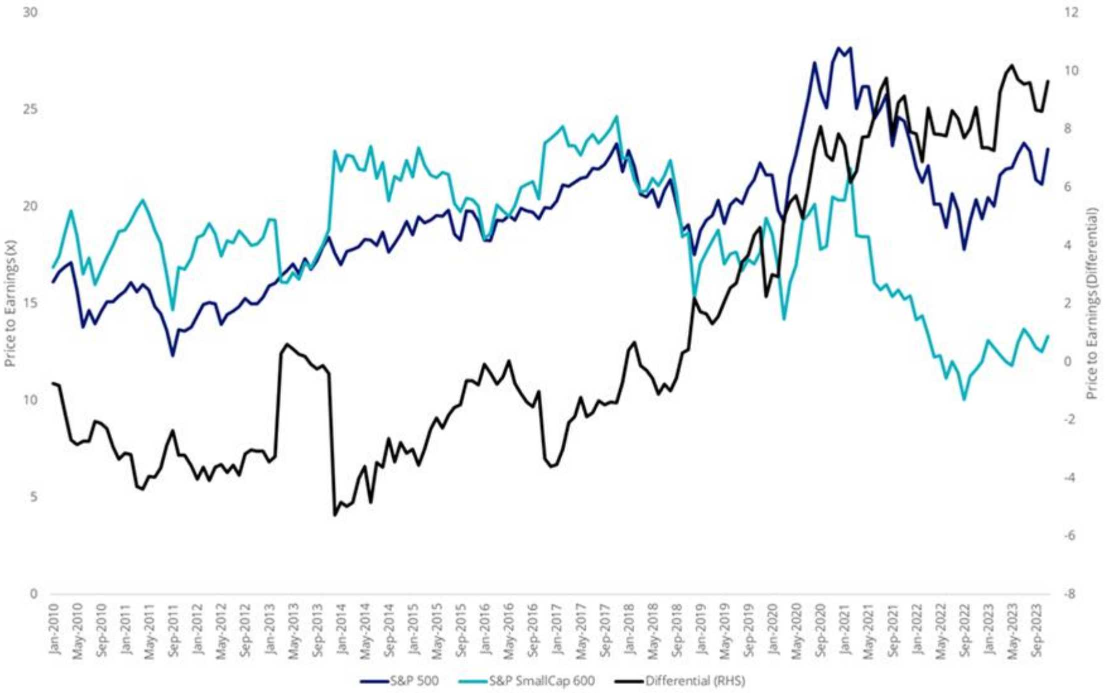
Source: ISM, MSCI, Bloomberg, since November 1997 to November 2023. Quality is MSCI World Ex Australia Quality Index. Benchmark is MSCI World Ex Australia Index. You cannot invest in an index.

2. Harness the growth potential of (the right) small caps

The next idea is an extension of the quality theme into global small caps. Global small caps in the past have performed better than large caps during periods of recovery. Right now, global small caps are looking relatively cheap compared to large caps and presenting a buying opportunity. If we then apply a quality screen to select only quality global small companies, performance looks even more promising.

Chart 2: Price to equity (P/E) of S&P 500 and S&P SmallCap 600

Global small caps, relative to large caps, remain as cheap as they have been in the past decade



Source: FactSet, 30 November 2023

3. Be mindful of the Australian equities trap

Australians continue to favour Australian companies, with Australian equities typically still dominating the majority of investment portfolios. The challenge is the Australian equities market is one of the most concentrated in the world. This is an important fact to consider, particularly those investors who use an ETF that tracks the S&P/ ASX 200. The top ten securities make up 47% of the S&P/ASX 200, with resources and finance sectors dominating. We have one company (BHP) making up around 11% of the S&P/ASX 200, and an additional 20% comprise of banks. This creates concentration risk.

Investors can build a more defensive Australian equities portfolio that is less concentrated, by reducing their allocation to the mega caps and having a greater allocation to large and mid-caps. An equal weighting approach is one way to achieve this goal. Equally weighting delivers more diversification and is therefore less risky as you are less reliant on a couple of sectors and a limited number of securities; while it also gives you the added bonus of a portfolio better positioned to take advantage of the grow prospects of large and mid-caps.

Our house view on Australian sectors:

Sector	Status
Banks	Neutral
REITs	Neutral to overweight
Resources	Neutral to overweight
Consumer Staples	Overweight
Consumer Discretionary	Underweight

4. The safe haven of gold

While the barbarous relic (gold) hit a new, all-time high recently, we see a number of drivers that point to continued gold price strength in 2024, including the shift in consensus beliefs on short-term interest rate expectations and a correction in the US dollar.

Gold has historically offered resilience during times of volatility as well as during inflationary periods. An environment where rates remain high due to inflation also bodes well for gold.

Our view is the drivers that have pushed up the price of the shiny metal are still firmly in place and do not look to be receding any time soon. For this reason, it is entirely plausible that the rush on gold will continue.

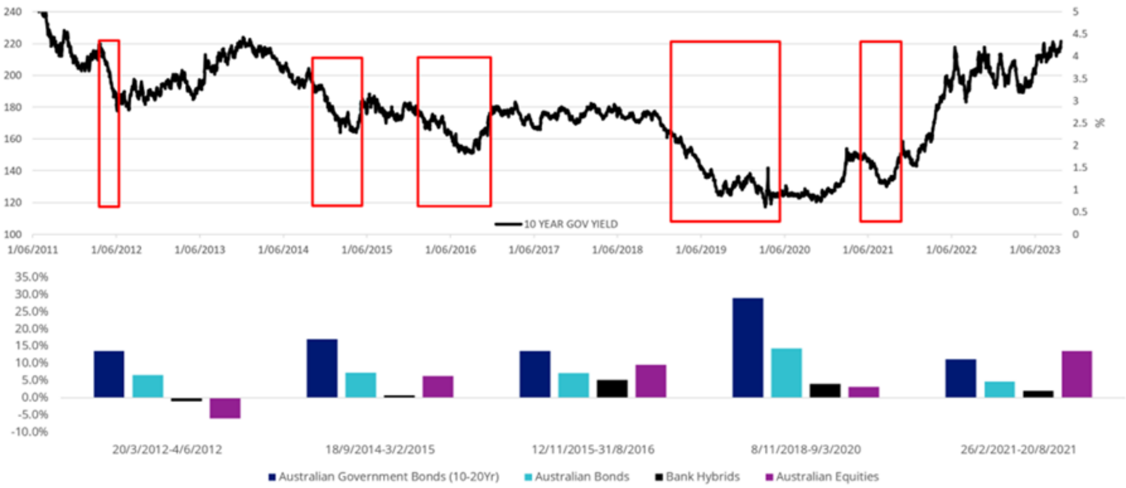
Broad economic weakness is generally supportive of gold prices. To this point, it has been said that gold is a 'hedge' against the US Government. This is a government that has in excess US$33 trillion of debt (over 120% of GDP). Meanwhile real GDP in the US for 2024 is forecast to be just 1.2%, a weak result which could drive investors away from other asset classes toward the safe haven of gold.

5. Bonds outlook

In fixed income it may very well be time to add duration to your portfolio. Although the 10-year Australian government bond yield has pulled back from the 5% level it is till yielding around 4.3% in mid-December, which in our view still offers good value.

When yields fall, the value of a bond increases with the effect being greater the longer the term of the bond. Looking at historical asset class returns during periods of economic downturn, longer term government bonds outperformed. While we've had almost three years of poor returns, 2024 could be the year for fixed income to perform again.

Chart 3: Longer term government bonds outperformed during periods of economic downturn



Source: VanEck, Bloomberg, as at 31 August 2023. Australian Government Bonds (10-20Yr) as S&P/ASX Government Bond 10-20Yr Index, Australian Bonds as Ausbond composite index, Bank Hybrids as Solactive Australian Hybrid Securities Index, Australian Equities as S&P/ASX 200 Index. Results are calculated to the last business day of the month and assume immediate reinvestment of all distributions. You cannot invest directly in an Index. Past performance is not a reliable indicator of future performance of the index. Australian equities, S&P/ASX 200 Index shown for general stock market comparison purposes only.

Russel Chesler is Head of Investments and Capital Markets at [VanEck](), a sponsor of Firstlinks. Russel is responsible for managing VanEck's Australian ETFs. This is general information only and does not take into account any person's financial objectives, situation or needs. Any views expressed are opinions of the author at the time of writing and is not a recommendation to act.

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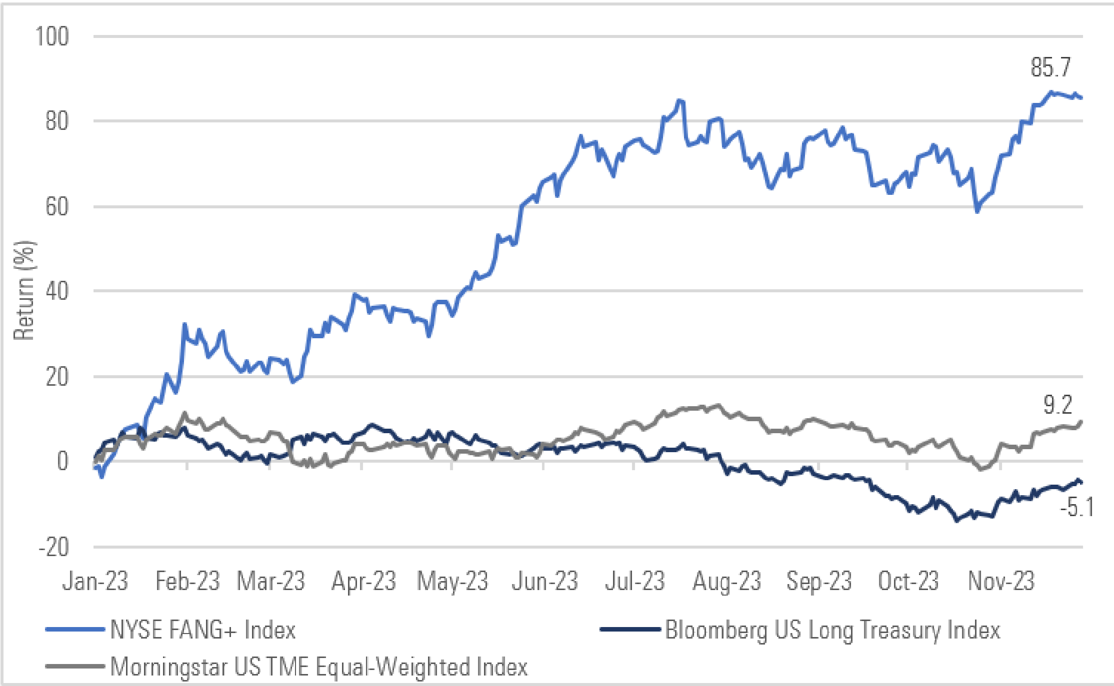
Lessons from 2023

Marta Norton

A look at 2023 in one chart.

Exhibit 1: YTD Returns for the Long Treasury Index, Big Tech, and the Equal-Weighted U.S. Stock Market



Source: Morningstar Direct, January – November 2023

No one expected 2023 to play out quite like this. Most economists were forecasting a recession, quicky falling inflation, and a Fed pivot, while investors were bracing for equity losses and leaning toward fixed income, expecting higher yields to bolster bond returns after 2022's historic losses.

Instead, we've seen a US economy that has continued to keep the start of a recession at arms' length, a higher-for-longer rate policy, and stickier inflation than experts predicted. Meanwhile, fixed income has continued its losses and equities have outperformed expectations. In the case of AI-related stocks, returns have been stratospheric.

In a year of surprises like 2023, there are plenty of lessons for those willing to learn them. And the end of the year is the perfect time for reflection, just in time for New Year's resolutions.

So, what are the top three lessons that spring to my mind as I reflect on the year? The folly of basing portfolio decisions solely on economic projections; the value of valuation at market extremes; and the easy confusion between valuation and falling prices. More on each one below.

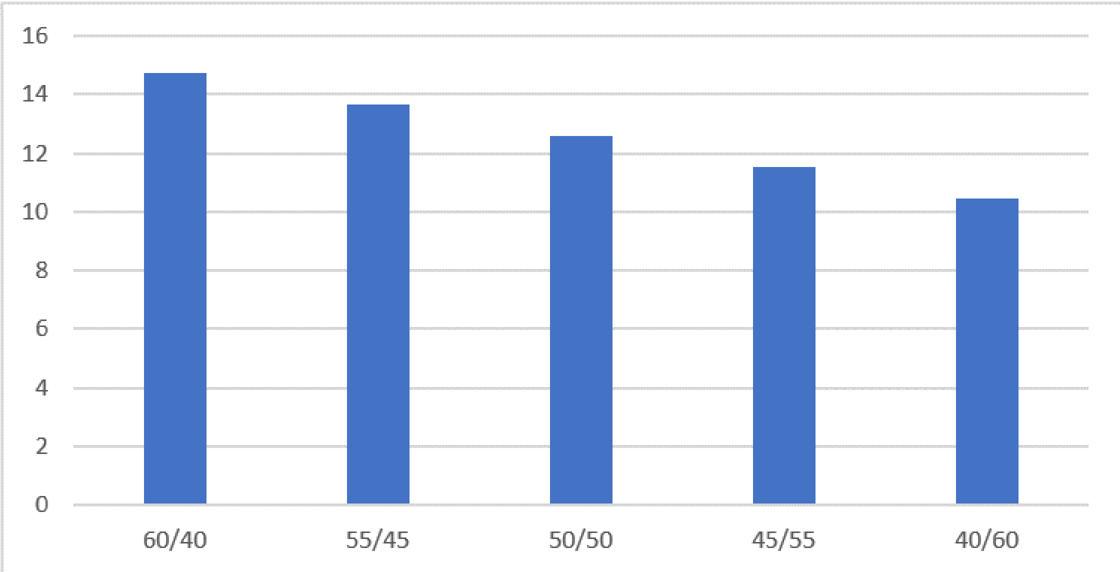
The Head Fake of Economic Projections

I started my career as an economist at the U.S. Bureau of Labor Statistics, so I'm the last one to cast stones at economists. Predictions are often wrong, but a solid understanding of the prevailing economic conditions can be incredibly useful, allowing for investors to consider what potential economic outcomes are *not* fully appreciated by the market, thereby building more robust strategies. Today, for example, some of our portfolios are overweight U.S. regional banks, since the economic outcomes implied by bank stock prices are far more severe than the prevailing consensus for a soft landing.

The temptation, however, is to do more than compare consensus expectations to market prices. The temptation is to use economic projections as market-timing signals, swinging broad exposure according to the economic consensus.

Of course, some years, there's no cost to doing this, particularly if the economic conditions follow historic precedent. In surprise years like 2023, however, outcomes are less benign. Investors who piled into bonds for fear of an economic crash gave up return. Consider below: A 10% shift from U.S. large-cap stocks to the core U.S. bond market for a moderate $100,000 portfolio cost more than $2,000 in total return over the course of the first seven months of the year. (I assume the investor pivoted again at the end of July, when the soft-landing view began to dominate the economic consensus.) As you'd expect, more meaningful shifts into bonds proved more costly.

Exhibit 2: January through July 2023 Percentage Returns for Varying Stock/Bond Splits



Source: Morningstar Direct. Portfolios are comprised of varying splits of the Morningstar U.S. Large Index and the Morningstar U.S. Core Bond Index. We assume a buy-and-hold methodology from January through June 2023. For educational purposes only. Data as of November 21, 2023.

I'll say it again: We don't ignore economic projections. However, we think the key is to use economic projections in conjunction with valuation. This is particularly critical at market extremes. Read on!

At market extremes, become a value investor

By the end of 2021, value investing felt like a relic of a bygone era. Growth stocks—particularly mega-cap growth stocks—had trounced the rest of the global equity market for so long that the soundest investment approach appeared to be not just a market-cap weighted passive index, but direct ownership of the largest five to seven stocks in the U.S. equity market, dropping the index structure altogether.

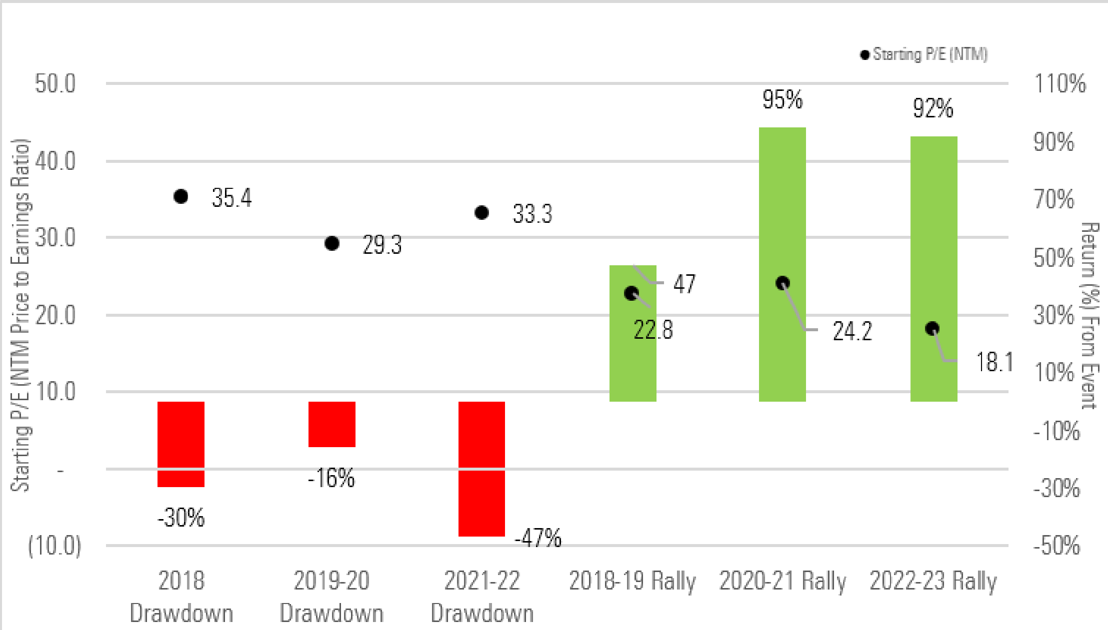
However, the late 2021 market reversal that continued long into 2022 rattled more than a few market participants. With Big Tech suddenly on the losing end of U.S. equity performance, investors began to look for fundamental explanations for the performance. Narratives abounded: Meta had lost its way, spending too much on the metaverse, while Alphabet was on the verge of becoming a has-been, laboring under a bloated employee base, facing increasing search competition from AI, and likely to suffer from waning dominance in global ads. Meanwhile, Amazon's e-commerce business was showing signs of plateauing.

We didn't share these views. We just thought the lot was way too expensive. And then, in our view, 2022's losses made them far more attractive. So much so that despite market consensus around a recession, we started buying communication services—home to Meta, Alphabet, Disney, Netflix, and a host of cable companies—in the second half of 2022.

The rest is history. Communication services—along with information technology and consumer discretionary—have rallied hard from October 2022 through today. And not surprisingly, the fundamental explanations for performance have shifted again. Big Tech—now called the Magnificent Seven—is once again unassailable, this time because of the companies' AI exposure.

Here's the larger point: valuation isn't a perfect market timing indicator—as value-oriented investors ourselves, we've had to learn this the hard way—but at market extremes, we find more often than not valuation rules the day. See below for more evidence of the relationship between extreme valuation and subsequent performance for Big Tech.

Exhibit 3: NYSE FANG+ Index: Analysis of Peak/Trough Valuations and Subsequent Return



The index returns measure periodic total returns of the NYSE FANG+ Index. An equal-weighted index re-balanced quarterly, the NYSE FANG+® Index "provides exposure to 10 of today's highly traded tech giants", according to NYSE. These include Meta, Inc. (META), Alphabet (GOOGL), Amazon (AMZN), Microsoft (MSFT), Apple (AAPL), Nvidia (NVDA), Tesla (TSLA), Netflix (NFLX), Snowflake (SNOW) and Broadcom (AVGO). "NTM P/E" measures the index-level price-to-earnings based on next twelve months' consensus earnings estimates. Index returns for periods greater than one year are annualized. Source: NYSE, Bloomberg, Morningstar Investment Management LLC analysis. For illustrative purposes only.

But how do you know a market extreme is actually a market extreme? You don't. That is why dollar cost averaging is so important. The downside of edging in is that you aren't always able to build a full position size before the market turns. But I've found moderately less exposure than I'd like is far better than piling in and owning too much as something continues to nosedive.

There's another risk to manage, too: the past isn't prologue. This means that, at times, a market is collapsing because the market is *changing*—for good. With that in mind, let's take a look at the final lesson that was reinforced for me in 2023.

The past isn't prologue: Falling prices doesn't always translate to greater value

Many of us have heard that, "This time is different" are the four most dangerous words in the investing dictionary. And that's because they usually are. Until they aren't.

While asset prices bounce around daily, the underlying drivers of returns—the actual cash flows that drive bond and stock prices—aren't meaningfully changing. Thus, when a big disconnect arises between prices and fundamental value, investors usually consider it a buying opportunity.

Every now and again, though, that's not the case. I learned this the hard way. In the wake of the Global Financial Crisis, as fracking emerged in the U.S. and natural gas prices plummeted, I assumed that investors were selling the asset too hard, too fast. I took a small position in a natural gas ETF and waited.

Seven years later, I sold my position at about an 85% loss. Harvesting the loss for the sake of my broader portfolio was nice but hardly the goal I had in mind years earlier.

The loss taught me two things: First, investing for the long term—in my case seven years—doesn't ensure a good return if you are massively wrong on price. And second, using price movement as a shorthand or substitute for assessing underlying value can lead to costly mistakes.

Investors who piled into intermediate- and long-term bonds at the end of 2022 learned a mild version of the same lesson in 2023. Sure, prices had sold off significantly in 2022, making bonds at the longer end of the curve a far better buy than the year prior. However, the conditions that led to quick snapbacks in bond prices over the past decade weren't in place in 2023. The Fed was still geared toward tightening, and inflation, while rising at a slower pace than earlier in the year, was still a headwind. Finally, higher rates dragged fiscal deficits into the picture, muddying the fixed-income outlook even further.

Exhibit 4: 10- and 20-Year Treasury Yields, 2021 – November 2023

Source: U.S. Department of the Treasury

I'm not calling for a continued bond meltdown. In fact, the U.S. 10-Year Treasury is now—for the first time since we began running our fixed-income model in 2016—above fair value. As a result, our portfolio managers have been edging out the curve, taking advantage of the improved yields.

Still, the bond market duress of the past few years reminds me the importance of conducting actual fundamental analysis rather than using price movement alone to guide decision-making.

This fundamental rather technical (price following) orientation will minimize errors like my misguided foray into natural gas or an overzealous reaction to an overpriced asset class that has only just begun its journey back to fair value.

Marta Norton, CFA, is a chief investment manager with Morningstar Investment Management, a wholly owned subsidiary of Morningstar, Inc. This article is general information and does not consider the circumstances of any investor. It has been edited somewhat from the [original US version](#) for an Australian audience.

Picking your retirement point

Tony Kaye

One of the hardest decisions for many people – excluding those who want to keep on working – is choosing when to stop.

There's no mandated retirement age as such, although there are prescribed preservation ages when people can legally access all or some of their superannuation funds.

Anyone turning 59 on or before 30 June next year, for example, if they choose to fully retire, can legally access their super after their birthday. They can do this by moving their accumulated savings to an account-based pension income stream, making a lump sum withdrawal, or doing a combination of both. Those born after 30 June 1964 will need to wait until they turn 60.

The Federal Government determines the minimum amount that retirees must withdraw from their account-based pension each year, starting at 4% of the balance for those aged up to 64. The minimum amount then rises progressively over 10-year age bands to a maximum of 14% for those aged 95 and over.

These withdrawal amounts are mandatory, regardless of whether a retiree eventually receives full or part Age Pension payments.

But the super access door is also open to people who have reached their preservation age starting at 55 and over for those born before 1 July 1960 and who want to keep on working.

They can start what's known as a transition to retirement (TTR) strategy, which enables them to transfer some of their super to an account-based pension account and draw down an income stream. Those 60 and over pay no tax on their TTR pension payments, while those aged 55 to 59 are taxed at their marginal tax rate but receive a 15% tax offset on the taxable portion of their income stream. No tax is payable on the tax-free portion.

At the same time, as they're still working, those using a TTR will continue to receive compulsory super guarantee payments from their employer (which are taxed at the normal rate of 15%) into their super accumulation account.

There are a range of options and considerations, so it may be highly worthwhile consulting a licensed financial planner to go through your personal circumstances.

Weighing things up

One of the key findings from Vanguard's 2023 *How Australia Retires* study is that Australians who have low confidence about their retirement generally have low expectations about the amount of income they'll likely receive during retirement.

The *Intergenerational Report 2023* projects that average life expectancies will continue to rise over time, reaching 87.0 years for men and 89.5 years for women by 2062-63.

Meanwhile, it projects that the proportion of people with accounts in the retirement phase, from which they are drawing a superannuation pension, will increase from 8% currently to 19% over the next 40 years.

"Longevity risk – the risk of outliving savings – is a key concern for retirees in deciding how to draw down their superannuation, consequently, most retirees draw down at the legislated minimum drawdown rates," the report notes.

"This results in many retirees leaving a significant proportion of their balance unspent, for example, a single retiree drawing down at the minimum rates would be expected to still have a quarter of their retirement assets at death."

How much is enough?

Retirees continue to face significant cost pressures on their household budgets due to historically high consumer price inflation.

Every quarter the Association of Superannuation Funds Australia (ASFA) publishes its estimate of how much retired couples and singles need to spend each year based on them living either a 'comfortable' or a 'modest' lifestyle.

For the September 2023 quarter ASFA estimated couples wanting a comfortable lifestyle would need to spend $71,723.56 per year, and singles $50,981.27. The expenditure needed to reach ASFA's modest retirement standard was $46,620.05 for couples and $32,417.48 for singles.

The figures in each case assume that the retiree(s) own their own home and relate to expenditure by the household. This can be greater than household income after income tax where there is a drawdown on capital over the period of retirement.

Planning and retirement confidence

Vanguard's *How Australia Retires* research has found that having high retirement confidence is not dependent on age or income, but rather on having a plan.

More than half (52%) of the people we surveyed who presented themselves as being highly confident about their retirement readiness feel that they know what they need to do to achieve the retirement outcome they desire and are optimistic about this phase of their life.

They are relatively likely to use budgets and prioritise their savings. Of the people participants who received professional financial advice, 44% indicated they were extremely or very confident in funding their retirement.

And, of the Australians who have never sought any professional advice, only 25% indicated they were extremely or very confident in being able to fund their retirement.

Furthermore, those who had not sought professional advice or sought only the assistance of family and friends tended to have less comprehensive retirement plans.

Tony Kaye is a Senior Personal Finance Writer at [Vanguard Australia](), a sponsor of Firstlinks. This article is for general information purposes only and does not consider the circumstances of any individual.

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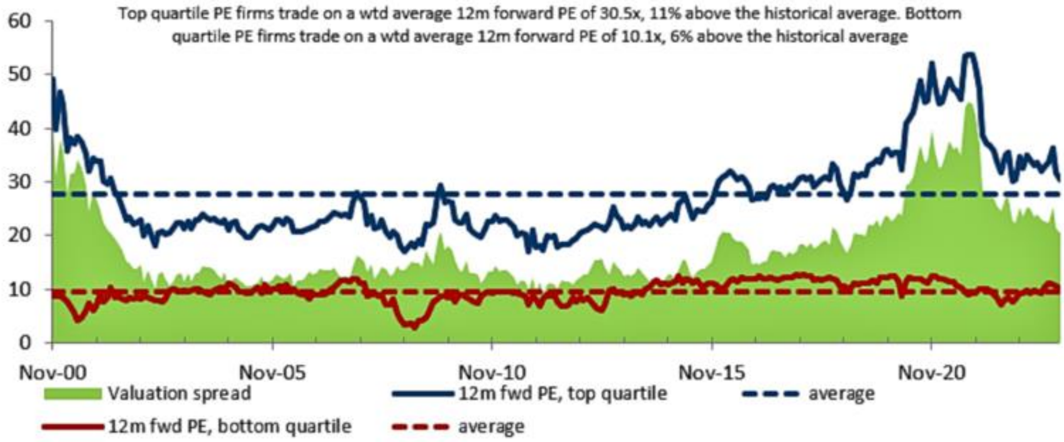
Buying miners for a new regime

Martin Conlon

Everyone loves winners. Popularity and perceptions of skill in investment normally correlate closely with recent investment experience. What the wise do in the beginning the fool does in the end. We know cycles and bubbles are driven by human behaviour, yet no-one is ever keen to believe they might be the fool.

The past decade or so has been extremely abnormal. Efforts to avert financial crisis morphed into an era of crazily low interest rates and unprecedented monetary intervention. The price corrections and wealth redistribution (away from the wealthy) which financial crises normally accomplish were averted. Unsurprisingly, when taught that speculation and aggressive financial leverage have no cost and potentially large gains, they are embraced. These behaviours impacted the equity market unevenly. Growth, quality, technology, cloud, green energy – an endless stream of thematics and characteristics were fuelled by money growing at a rate faster than the real economy could productively use it.

In a valuation context, this saw the valuations of the popular grow at a rate far beyond the more pedestrian. To the surprise of many, including us, the savaging of the real economy induced by COVID-19 at the end of this extended period saw this heighten further, highlighting the often disconnected real and financial economies.



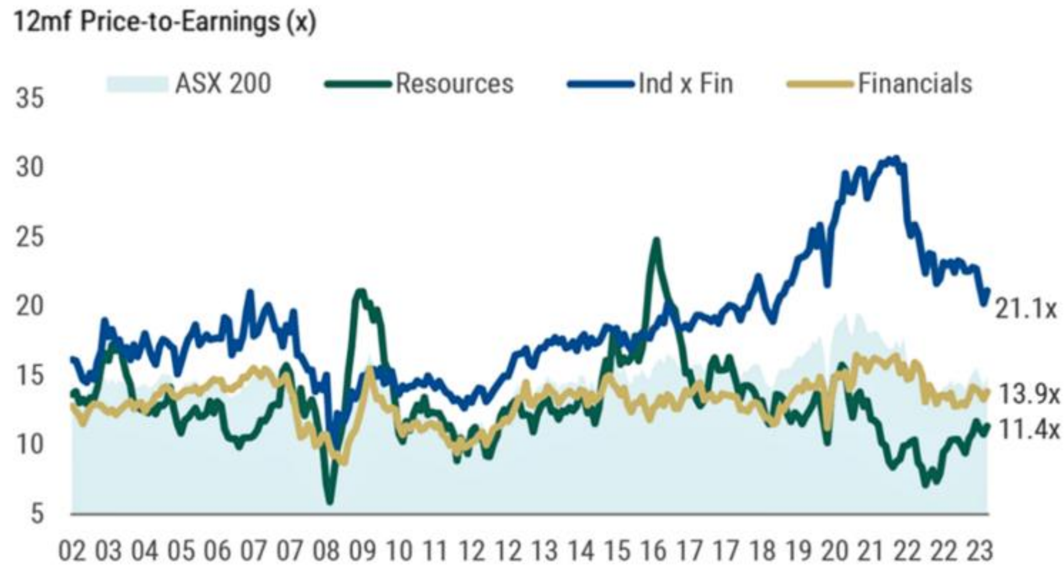
Source: Factset, Schroders

While the return of inflation and the necessity of higher rates has dented this enthusiasm, the valuations of the popular remain sharply above long-term averages, while the pedestrian have retained their reputation. High growth, high levels of profitability and low capital intensity remains the potent cocktail for high valuations.

Like Australian housing, long track records of exceptional returns are seen to reinforce the likelihood of continuation rather than depressing the likelihood of future returns due to highly unattractive entry prices. As staunch believers in the importance of valuation and entry price as important drivers of future investment returns, it is these businesses in the extremely popular category which we believe will be crucial to future returns. Just not in the way most people think.

Returning to more normal levels of interest rates, acknowledging a world which is highly indebted and therefore low growth means accepting more pedestrian returns than have been earned through the 'free money' era. It is highly unlikely this path will be smooth, as learned behaviours will not be discarded easily.

Recent market performance in both Australia and the US has again seen performance concentrate around market darlings and technology thematics. Valuations suggest future returns should be far better in embracing the pedestrian and sensible. As history has shown in episodes such as the TMT bubble in 1999-2000, the payback period for being late to the party can be long.



Source: Morgan Stanley

A transition to higher energy prices

At a thematic level, the pervasive impact of demographics and decarbonisation is indisputable. We expect decarbonisation, in particular, will be a vital driver of future investment returns, though not perhaps in the ways many expect. The appetite for investing heavily in the costly infrastructure on which we all rely is always high until it comes to paying for it. Having become accustomed to egregious road tolls, airport taxes and ever escalating fees for education and healthcare it should be evident that falling prices are not the norm, particularly where construction or services requires high-cost domestic labour. In this light, we find the extent to which the population has come to expect the energy transition can be achieved without sharp changes in energy pricing startling. A couple of basic issues should be obvious:

1. We are early in the decarbonisation process and the future path will require accelerating spend
2. Fully costed (including the required backup of intermittent power) renewable energy is not cheaper and countries with more renewable energy do not have cheaper prices

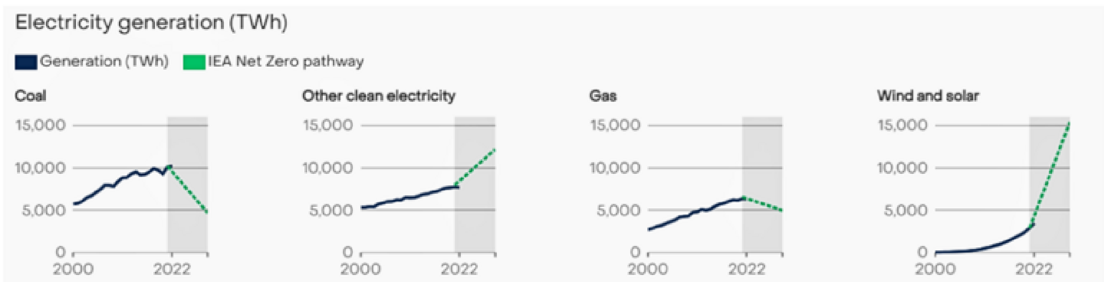
Numbers in the vicinity of $300 billion have been put forward as rough estimates of the cost of decarbonising electricity generation and the grid. Assuming we need a long-term return between 5% and 10% to justify this investment, we need to find operating earnings of $15-$30 billion.

The debate on the future of Origin Energy, together with the promised investment by former takeover suitor Brookfield in renewable energy, highlights these issues. Ignoring for a minute the value of APLNG (one of a number of large and perhaps ill-considered LNG investments to export Australia's East Coast gas resources) and its investment in the low cost and highly successful technology deployed by Octopus Energy, the remainder of the value of Origin lies in its customer base and existing power generation fleet.

The retail and power generation operations of Origin and AGL provide the majority of energy consumed in Australia. The operating profit pool attached to these operations has generally been well under $2 billion. Valuing a retail customer at around $1000 requires a profit per customer of perhaps $75, a skinny and volatile margin on household energy spend. Removing this value for the systems, workforce and complexity in ensuring power is delivered to households leaves the value for power generation. The residual profit pool barely provides a return on written down investments in gas peaking plants and the still necessary but unpopular investments in fossil fuel generation let alone incentivising more investment.

Wind and solar investments are financially and operationally struggling globally and require higher prices. If the government chooses to pretend the investment can be achieved without raising energy prices and tries to extinguish the profit of current operators, private investment should disappear. Socialising costs under the guise of government spending merely sees the costs appear as higher taxes rather than higher energy prices. Decarbonisation is costly and requires profits to incentivise it. The investment, engineering and construction capability will eventually appear if there is money to be made. Workers will follow the money. The profits which will necessarily be sacrificed to fund decarbonisation will need to be found elsewhere in the economy. They are more likely to be found where they are currently fat rather than where they're lean.

What needs to happen for 1.5 degrees?



Source: Annual electricity data, Ember, IEA (WEO 2022)

Bullish for mining

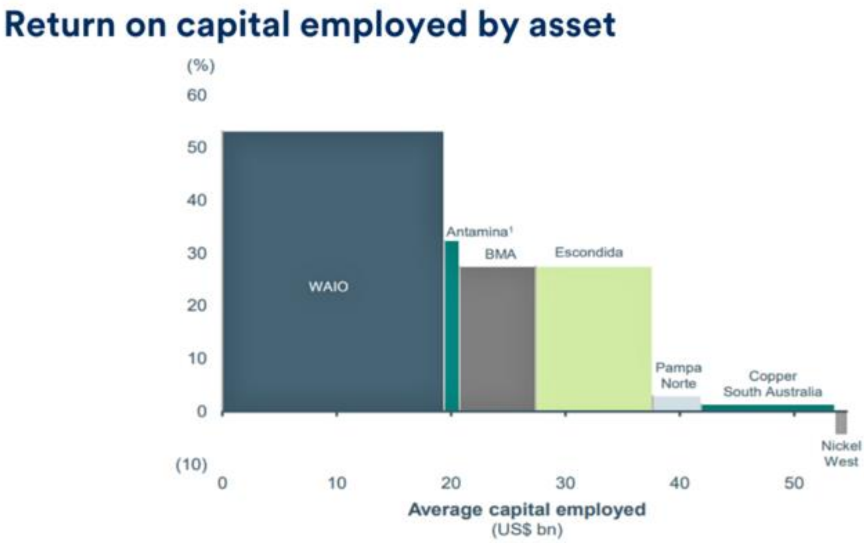
The global perspective on the energy transition is inextricably linked to mining, a sector on which the equity market outlook significantly rests, and one on which we remain positive.

The deglobalisation theme has emerged as Western economies react to the realisation of their dependence on Chinese and Asian manufacturing capability. Globalisation flourished courtesy of the cheap labour and lower environmental and safety standards in China and other parts of Asia. Any reversal will require higher prices. Whether subsidies are in the guise of an 'Inflation Reduction Act', regulation or tariffs, the outcome should be the same.

As the building blocks of all economies are greatly amplified by the challenge of substituting vast quantities of hard metals for the prodigious (and not yet falling) quantities of fossil fuel consumption in the energy production process, metals demand should be strong unless appetite for decarbonisation spend collapses. Even then, spend which should arguably be diverted to adaptation and resilience spend should still be positive for commodities. The pattern of selling commodities aggressively on the expectation of declining demand in the face of higher interest rates and economic slowdown is one of copying historic patterns. Even if history repeats in the short-term, we believe the reasons for greater optimism in the medium term are strong.

Inventory levels and supply are not indicative of impending price collapse. Most commodity prices, with the probable exception of iron ore, do not appear elevated versus cost curves and the likely costs of new supply. Longer term commodity and goods prices have bifurcated depending on whether China is a producer or a consumer. The iron ore which China has ravenously consumed and had to import has been pushed higher for longer. The rare earths for which China is the major producer or the aluminium which they use cheap and subsidised power to produce, have been depressed.

The sharply divergent experience is evident in results. Returns are low outside iron ore, while iron ore returns, though high, reflect the fact BHP Billiton and Rio Tinto are the lowest cost suppliers in the industry. Western economies claim to be keen to address globalisation, however, when it comes to permitting new mines and coping with environmental impact of chemical and processing plants, the NIMBY effect will be tough to overcome. This should remain very supportive for assets already in place.



Source: BHP Billiton and Rio Tinto result presentations

Real assets for a new regime

Apparently smooth seas disguising far more turbulence underwater, characterise both economies and equity markets - underlying our cautious outlook. Whilst there is every possibility inflation abates and interest rates stabilise and potentially retrace to some degree over the coming year or two, our expectation is for a return to more 'normal' historical interest rate levels rather than the extremes seen since the Global Financial Crisis of 2007-08.

The side effects of 'free money' are becoming painfully obvious. This 'adjustment' back to a level at which debt holders expect at least some compensation for lending money to consumers, businesses or government seems unlikely to occur quickly and painlessly.

Starting valuations, or the price paid for an investment, remain vital to future investment returns, and that starting point remains above historic averages for most listed equities. There are exceptions of course, and valuations are further complicated by often cyclical underlying earnings streams, particularly in resources. Nevertheless, when taken as a whole, earnings forecasts for coming years are neither anticipating unusual headwinds nor expecting much change in the pool of corporate profits and how it is currently split. With government and consumer debt, house prices and inequality closer to extremes than averages, an oasis of calm in the future is not our base case scenario.

Martin Conlon is Head of Australian Equities at [Schroders](), a sponsor of Firstlinks. This article does not contain and should not be taken as containing any financial product advice or financial product recommendations. It does not take into consideration your personal objectives, financial situation or needs.

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Meg on SMSFs: Facts and figures 2023/24

Meg Heffron

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

Download Meg's Facts and Figures 2023/24 for your records or print it out so you have all the latest information at your fingertips.

Personal tax rates & offsets

RESIDENT MARGINAL TAX RATES	
Taxable Income	Tax Payable[1]
0 – $18,200	Nil
$18,201 – $45,000	0 + 19% of excess over $18,200
$45,001 – $120,000	$5,092 + 32.5% of excess over $45,000
$120,001 – $180,000	$29,467 + 37% of excess over $120,000
$180,001 and over	$51,667 + 45% of excess over $180,000

1 Plus Medicare Levy of 2%.

LOW INCOME TAX OFFSET (LITO)	
Taxable Income	Offset
0 – $37,500	$700
$37,501 – $45,000	$700 – (5% x [Taxable income – $37,500])
$45,001 – $66,666	$325 – (1.5% x [Taxable income – $45,000])
$66,667 and over	Nil

SENIORS & PENSIONERS TAX OFFSET (SAPTO)[1]		
Thresholds[2]	Singles	Couple (each)
Maximum offset	$2,230	$1,602
Shade-out threshold	$32,279	$28,974
Cut-out threshold[3]	$50,119	$41,790

1 Eligible if have met qualifications for age pension or received some age pension in income year, reached pension age & eligible for Veteran's Affairs (VA) benefit or included social security pension payments or certain VA payments in assessable income and not in jail at least one day during FY.
2 Thresholds based on taxable income – assessable FHSS released amount + adjusted fringe benefits + net investment losses + reportable employer super contributions + deductible personal super contributions.
3 Phase-out rate is 12.5¢ for each dollar of income above shade-out threshold.

SPOUSE CONTRIBUTION TAX OFFSET	
Spouse's Total Income[2,3,4]	Maximum Tax Offset[1,5]
Up to $37,000	$540
$37,001 to $39,999	Reduced by 18¢ for each dollar of income above $37,000
$40,000 and over	Nil

1 Member must make a contribution for spouse & spouse must not have excess NCC for year.
2 Spouse's total super balance must be < $1.9m at 30 June 2023.
3 Total income = spouse's assessable income + reportable fringe benefits + reportable employer super contributions – assessable FHSS released amount.
4 Total income & total super balance are not the only eligibility tests to be satisfied.
5 Spouse contribution tax offset equals 18% of all contributions for spouse up to a maximum of $540.

COMMONWEALTH SENIORS HEALTH CARD (CSHC)		
Thresholds	Singles	Couple (combined)
Cut-out threshold[1]	$90,000[2]	$144,000[2]

1 Thresholds based on taxable income – assessable FHSS released amount + fringe benefits value + net investment losses + target foreign income + reportable super contributions + deemed income on ABP started on/after 1 January 2015.
2 Add $639.60 to these amounts for each child in your care (amount next indexed 20 September 2023).

Superannuation contributions

CONTRIBUTION ELIGIBILITY

Age of Member	Tests for acceptance of contributions by a complying fund[1]
< 75[2]	No tests apply to contributions other than downsizer contributions. If a downsizer contribution, member needs to be at least age 55.
Over 75	Contributions must be mandated contributions (eg award or SG) or a downsizer contribution.

1 Work test requirements for members aged 67 to 74 were removed effective 1 July 2022. Other tests may apply to claim a tax deduction for a contribution. For example, effective 1 July 2022, to claim a tax deduction for a personal super contribution made on or after a member's 67th birthday and up to and including 28 days after the end of the month in which a member turns 75, a member needs to be gainfully employed for 40 hours in 30 days at any time in the income year in which contribution is made or they need to meet the "work test exemption". A member will qualify for the work test exemption if the member is not gainfully employed in 2023/24 but was gainfully employed in 2022/23, their total super balance was < $300,000 (not indexed) at 30 June 2023 and the member has not previously used the one off "work test exempt" contribution rules.

2 Contributions (other than award, SG or downsizer contributions) must be made within 28 days after the end of the month in which the member turns 75.

TAX RATES ON CONTRIBUTIONS

Type of Contribution	Tax Rate[1]
Non-concessional (NCC)	Nil[2,3]
Concessional (CC)	15%[4,5]

1 Paid by the fund which received the contribution.

2 Excess NCC released from super not subject to tax but associated earnings amount taxed at marginal rate plus Medicare Levy less 15% tax offset, levied to member (strict process to be followed).

3 Excess NCC not released from super subject to tax of 47%, levied to member but must be paid from super fund.

4 Excess CC subject to additional tax at marginal rate plus Medicare Levy less 15% tax offset, levied to member.

5 Where member's "income" exceeds $250,000, additional 15% tax is charged on contributions within CC cap. "Income" = taxable income + certain family trust distributions + reportable fringe benefits + net investment losses + concessional contributions within cap – assessable FHSS released amount – taxable component of super LS within low rate cap. Called Div 293 tax & levied to member.

SUPERANNUATION GUARANTEE (SG)

SG System	
SG rate	11%
Basis	Ordinary time earnings
Contribution cut-off dates	28 Oct, 28 Jan, 28 April, 28 July
Maximum salary base	$62,270 per quarter
Maximum cut off age	None
Minimum salary[1]	None

1 Employees <18 must be employed to work ≥30 hrs/week.

SPOUSE CONTRIBUTION SPLITTING

Eligibility Test[1,2]	Conditions
Eligible contributions	Concessional contributions (CC)[3]
Maximum splittable amount	Lesser of: 85% of CC for financial year, or CC cap for financial year
Receiving spouse must be	Under preservation age or between preservation age & age 65 & not retired[4]

1 These are not the only eligibility tests to be satisfied.

2 Application to split must be lodged in the financial year after the CC were made, or in financial year the CC made if splitting spouse's entire benefit is rolled out, transferred or cashed in that year.

3 Only CC made in financial year before application to split is made are eligible. Current year CC can only be split in current year if splitting spouse's entire benefit is to be rolled out, transferred or cashed in that year.

4 At the time the application to split is made.

GOVERNMENT CO-CONTRIBUTIONS	
Member's Total Income[2,3,4]	Maximum Government Co-contribution[1,5]
Up to $43,445	$500
$43,446 to $58,445	Reduced by 3.333¢ for each dollar of income over $43,445
$58,446 and over	Nil

1 Member must make a personal contribution and not claim a tax deduction, and must not have excess NCC.
2 Member's total super balance must be < $1.9m at 30 June 2023.
3 Total Income = Assessable income + reportable fringe benefits + reportable employer super contributions (but excluding any excess CC included in assessable income) – business related tax deductions – assessable FHSS released amount.
4 Total income & total super balance are not the only eligibility tests to be satisfied.
5 Co-contribution will equal 50% of personal contribution to a max of $500.

LOW INCOME SUPER TAX OFFSET	
Member's Total Income[2,3]	Maximum Tax Offset[1,4]
Up to $37,000	$500
$37,001 and over	Nil

1 Member must make personal deductible contribution or have employer contribution made on their behalf.
2 Total income = taxable income + reportable employer super contributions + deductible personal super contributions + adjusted fringe benefits + target foreign income + net investments losses + certain tax free Government pensions – child support payments – assessable FHSS released amount.
3 Total income is not the only eligibility test to be satisfied.
4 Low income tax offset is paid to fund and will equal 15% of all concessional contributions to a max of $500 (up to $3,333 in CC).

Superannuation contribution caps

CONCESSIONAL CONTRIBUTIONS (CC) CAP[1]		
Type	Member's TSB[3]	Amount of Cap[2]
Standard	$500,000 or over	$27,500
Using "catch-up" rules	< $500,000	$27,500 + "unused CC amount"[4]

1 CC generally includes employer contributions (including SG & salary sacrifice), personal contributions claimed as a tax deduction & reserve allocations (unless exemption applies). Can also include contributions made on behalf of member by anyone other than member's spouse or the Government.
2 Excess amounts may be subject to additional tax (refer "Tax Rates on Contributions").
3 Total super balance (TSB) determined at 30 June 2023.
4 Member's CC cap is increased in 2023/24 by the "unused CC amount", being the cumulative CC cap in the preceding 5 financial years less amount of CC assessed against CC cap in those years, starting with earliest year to most recent year (with 2018/19 being first eligible financial year).

NON-CONCESSIONAL CONTRIBUTIONS (NCC) CAP[1]		
Type	Member's Total Super Balance[2]	Amount of Cap[5]
Standard	< $1.9m	$110,000
	$1.9m or over	Nil
Bring-forward mode[3]	< $1.68m	$330,000 over 3 years[4]
	$1.68m to < $1.79m	$220,000 over 2 years[4]
	$1.79m to < $1.9m	$110,000
	$1.9m and over	Nil

1 NCC generally includes personal contributions not allowed as a tax deduction, spouse contributions and excess concessional contributions not released from super. Do not include Govt contributions, downsizer contributions, eligible COVID-19 re-contributions, eligible small business CGT contributions within CGT cap or eligible personal injury contributions.
2 Total super balance (TSB) determined at 30 June 2023.
3 Available to members under age 75 at any time in the financial year in which "bring-forward mode" is triggered, subject to TSB.
4 If bring-forward mode was triggered in 2021/22 or 2022/23 and some "bring forward period" remains in 2023/24, the member will be able to make contributions within their NCC cap of any unused "bring forward amount" in 2023/24 if their TSB at 30 June 2023 was <$1.9m. If TSB is $1.9m or more at 30 June 2023, the member's NCC cap in 2023/24 will be Nil, despite being mid-way through a "bring forward period".
5 Excess amounts may be subject to additional tax (refer "Tax Rates on Contributions").

OTHER CAPS[1]	
Type of Cap	Amount of Cap[2]
CGT Cap	$1,705,000[3]
Downsizer Cap	$300,000[4]

1 Eligibility tests to be satisfied.
2 Excess generally counts towards NCC cap.
3 Lifetime limit, for contributions made in respect of both small business retirement exemption and small business 15 year exemption. At most $500,000 (not indexed) of this limit can be utilised by small business retirement exemption.
4 Lifetime limit (not indexed).

Superannuation benefits paid to members

ACCESS TO SUPERANNUATION[1,2]			
Age of Member	Retired[3]	Lump Sum	Pension
< Preservation age	n/a	No	No
Preservation age – 64	Yes	Yes	Yes
Preservation age – 64	No	No	Yes, but TRIS only
65+	n/a	Yes	Yes

1 Preserved or restricted non-preserved benefits only. Unrestricted non-preserved benefits may be accessed at any time.
2 There are other conditions of release including permanent incapacity, terminal illness or injury & death.
3 Retired means reached preservation age and ceased a form of gainful employment with no intention of ever again working for 10+ hours/week OR if age 60+, ceased one gainful employment position after age 60.

TAX TREATMENT OF SUPERANNUATION LUMP SUMS (LS)[1]		
Age of Member	Tax Free Component	Taxable Component
< Preservation age	Tax Free	Up to 20%[2]
Preservation age – 59	Tax Free	Up to $235,000[3] = nil
		Over $235,000[3] = up to 15%[2]
60+	Tax Free	Tax Free

1 Applies to lump sums paid to members (ie not death benefits) from taxed funds only, which are drawn from unrestricted non-preserved money. Note, different rules apply to terminal illness or injury benefits, and lump sums drawn from any money that is not unrestricted non-preserved.
2 Plus Medicare Levy.
3 Lifetime limit.

TAX TREATMENT OF SUPERANNUATION INCOME STREAM PAYMENTS[1]		
Age of Member	Tax Free Component	Taxable Component
< Preservation age[2]	Tax Free	Taxable at MTR[3,4]
Preservation age – 59	Tax Free	Taxable at MTR[3,4] less 15% tax offset
60+[5]	Tax Free	Tax Free

1 Applies to benefits paid to members (ie not death benefits) from taxed funds only, where income stream met requirements of SIS Regulations.
2 Monies would need to be unrestricted non-preserved.
3 MTR = Marginal Tax Rate.
4 Plus Medicare levy.
5 Where income stream is a capped defined benefit income stream, 50% of any payments drawn in excess of $118,750 pa "Defined Benefit Income Cap" is included in assessable income & taxed at MTR. Note, the amount of excess is not adjusted to reflect any tax free component of excess payments drawn, nor is any of the excess "tax free" because the pensioner is age 60 or over.

ACCOUNT BASED PENSION DRAWDOWN %	
Age of Member[1]	Minimum Pension %[2, 3]
< 65	4
65 – 74	5
75 – 79	6
80 – 84	7
85 – 89	9
90 – 94	11
95+	14

PRESERVATION AGE		
Date of Birth From	Date of Birth To	Preservation Age
Born on or before 30 June 1960		55 (met)
1 July 1960	30 June 1961	56 (met)
1 July 1961	30 June 1962	57 (met)
1 July 1962	30 June 1963	58 (met)
1 July 1963	30 June 1964	59 (met)
Born on or after 1 July 1964		60

1 Based on member's age last birthday at calculation date.
2 Min pension was halved due to COVID-19 impact for period 1 July 2019 until 30 June 2023.
3 If pension is a TRIS, a 10% pa maximum pension limit (excluding lump sum commutations from unrestricted non-preserved money) also applies until member reaches age 65 or retires or satisfies another condition of release with nil cashing restrictions.

Superannuation benefits paid on death

TAX TREATMENT OF SUPERANNUATION LUMP SUMS[1]			
Beneficiary[2]	Tax Free Component	Taxable Component	
		Taxed Element	Untaxed Element
Dependant[3]	Tax Free	Tax Free	Tax Free
Non-dependant	Tax Free	Lesser of MTR or 15%[5,6]	Lesser of MTR or 30%[4,5,6]
Estate for benefit of Dependants[3]	Tax Free	Tax Free	Tax Free
Estate for benefit of Non-dependants	Tax Free	Lesser of MTR or 15%[6]	Lesser of MTR or 30%[4,6]

1 Applies to death benefits paid from taxed funds only, made in accordance with SIS Regulations.
2 As per tax definition.
3 Generally includes legal or de facto current or former spouse, children if <18, persons in interdependency relationship with deceased & dependants per the "ordinary meaning".
4 If deceased age <65, trustee has claimed tax deduction for cost of life cover for deceased & life policy is still in effect, portion of death benefit will consist of untaxed element.
5 Plus Medicare Levy.
6 MTR = Marginal Tax Rate.

TAX TREATMENT OF SUPERANNUATION INCOME STREAM PAYMENTS[1,2]			
Age of Member on Death	Age of Pensioner	Tax Treatment of Income Stream Payments	
		Tax Free Component	Taxable Component
60+[3]	n/a	Tax Free	Tax Free
< 60	60+[3]	Tax Free	Tax Free
< 60	< 60	Tax Free	MTR – 15% tax offset[4,5]

1 Applies to death benefits paid from taxed funds only, made in accordance with SIS Regulations.
2 Death benefits can only be paid in pension form to certain beneficiaries ie at time of deceased's death, their spouse, child (but only if <18, 18-24 & financially dependent on deceased or disabled) or person in interdependency relationship (excluding child of deceased), or dependant per "ordinary meaning" (excluding child of deceased).
3 Where income stream is a capped defined benefit income stream, 50% of any payments drawn in excess of $118,750 pa "Defined Benefit Income Cap" is included in assessable income & taxed at MTR. Note, the amount of excess not adjusted to reflect any tax free component of excess payments drawn, nor is any of the excess "tax free" because deceased was/recipient is age 60 or over.
4 MTR = Marginal Tax Rate.
5 Plus Medicare Levy.

Total super balance

TOTAL SUPER BALANCE[1,2,3]	
Inclusions	**Amount Included**
Accumulation phase	Amount payable as a lump sum if account voluntarily closed
ABP, MLP, TRIS	Amount payable as a lump sum if account voluntarily closed
Lifetime/life expectancy pension (capped defined benefit pension) or flexi pension	Amount credited to Transfer Balance Account
Defined benefit interest not in pension phase	Amount payable as a lump sum if account voluntarily closed
Excess transfer balance earnings	Amount credited to Transfer Balance Account
Rollovers in transit	Amount in transit
Certain LRBAs commenced on/after 1 July 2018[3]	Individual's proportionate share of outstanding loan balance
Exclusions	**Amount Excluded**
Personal injury contribution	Amount of any contributions received

1 Individual's total super balance at a particular time is the sum of each of the "inclusions" above less any "exclusions" above.
2 Other amounts may also be included in certain circumstances.
3 Applicable where lender is an associate of fund (relevant amount is included for all members) or the member has met a full condition of release eg retirement (relevant amount is included for that member only).

Total balance cap and transfer balance account

TRANSFER BALANCE CAP[1,2]	
General Cap	\$1.9m[3]
Personal Cap	From \$1.6m to \$1.9m[4]
TRANSFER BALANCE ACCOUNT – AMOUNT CREDITED[5,6]	
ABP	Total of all lump sums that could be paid from ABP
MLP/TAP or life expectancy pension commenced pre 1 July 2017	Annualised equivalent of first pension payment after calculation date x remaining term (rounded up to next whole number)
MLP/TAP commenced on/after 1 July 2017	Total of all lump sums that could be paid from MLP/TAP
Lifetime pension	Annualised equivalent of first pension payment after calculation date x 16
Flexi pension	Annual pension payment payable at calculation date x relevant valuation factor in Sch 1B of ITAR
Excess transfer balance earnings	Amount of excess transfer balance account earnings

1 Cap on total amount of superannuation which can be transferred into "retirement phase" pensions.
2 If balance of transfer balance account (TBA) exceeds personal cap at the end of a day, excess plus excess transfer balance earnings amount must be moved back to accumulation phase or withdrawn as lump sum commutation. Excess transfer balance earnings taxed at 15% (or 30% if subsequent breach), levied to member.
3 Lifetime limit.
4 If started TBA on/after 1 July 2023, personal cap will be \$1.9m. If started TBA prior to 1 July 2023, personal cap will be between \$1.6m & \$1.9m, subject to indexation.
5 Other amounts may also be credited in certain circumstances.
6 Amounts may also be debited in certain circumstances (eg commutations).

Superannuation funds

TAX RATES ON EARNINGS

Type of Fund		Tax Treatment
Complying	Accumulation phase	15%
	Pension – retirement phase[1]	0%
	Pension – not retirement phase[1]	15%
	Non-arm's length income	45%
Non-complying		45%

1 Pension is in "retirement phase" if ABP, MLP or TAP, lifetime/life expectancy/flexi defined benefit pension. TRIS also included if recipient aged 65 or over or a reversionary beneficiary, or trustee has received notification that recipient is retired, permanently incapacitated, or terminally injured or ill.

INSURANCE PREMIUMS[1,2]

Type of Cover	Deductible?	%
Term life	Yes	100%
Terminal illness	Yes	100%
TPD – any occupation	Yes	100%
TPD – own occupation	Yes	67%
TPD – own occupation bundled with life	Yes	80%
Trauma[3]	No	0%
Income protection	Yes	100%

1 Insurance policy must be owned by a complying SF for the purpose of providing benefits for insured member.
2 Policies entered into on or after 1 July 2014 only permitted where policy definition of death, terminal illness or injury, permanent incapacity & temporary incapacity consistent with SIS definition.
3 Trauma insurance not permitted on or after 1 July 2014 unless policy entered into prior to that date.

LRBA WITH RELATED PARTY LOAN[1,2]

Loan Feature	Real Property	Listed Securities
Interest rate (fixed or variable)	8.85%	10.85%
Interest rate type[3]	Fixed (max 5 years) or variable	Fixed (max 3 years) or variable
Maximum loan term[4]	15 years	7 years
Maximum LVR	70%	50%

1 To satisfy "safe harbour" rules, principal & interest payments must be made monthly. Loan agreement must be in writing & executed. Must have registered mortgage over property or registered charge/mortgage or similar over listed securities.
2 If trustees do not comply with "safe harbour" rules, must be able to otherwise demonstrate LRBA is on commercial terms.
3 Trustee can choose to fix rate at start of new loan or refinance.
4 Maximum loan term starts from date of original loan used to acquire asset under the LRBA, and includes any refinancing.

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

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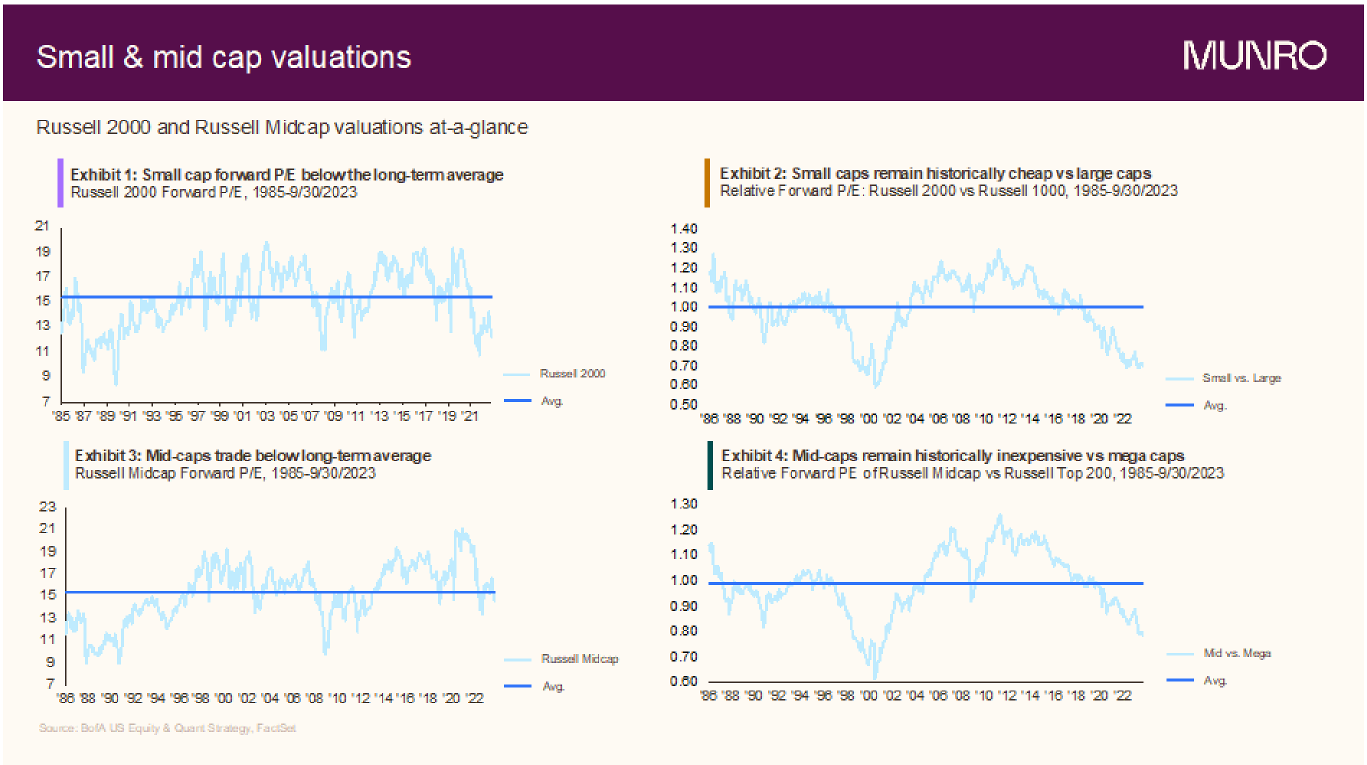
It's time small and mid-caps play catchup

Qiao Ma

2023 had been a strong year for the share performances of large technology companies. The Magnificent Seven tech stocks - Apple (AAPL), Microsoft (MSFT), Alphabet (GOOGL), Amazon (AMZN), Nvidia (NVDA), Meta Platforms (META) and Tesla (TSLA) drove the bulk of market returns for the S&P 500.

Looking forward to 2024, we see many opportunities for smaller, less discovered companies. At Munro, we believe that stock returns follow a company's earnings trajectory over a long time horizon, and we search all over the world for sustainable earnings growth. We are now observing earnings growth re-acceleration in many high-quality small companies.

Fortuitously, these companies are also 'on sale' – in our opinion these companies are cheap both relative to their own historical average valuation and their larger peers.



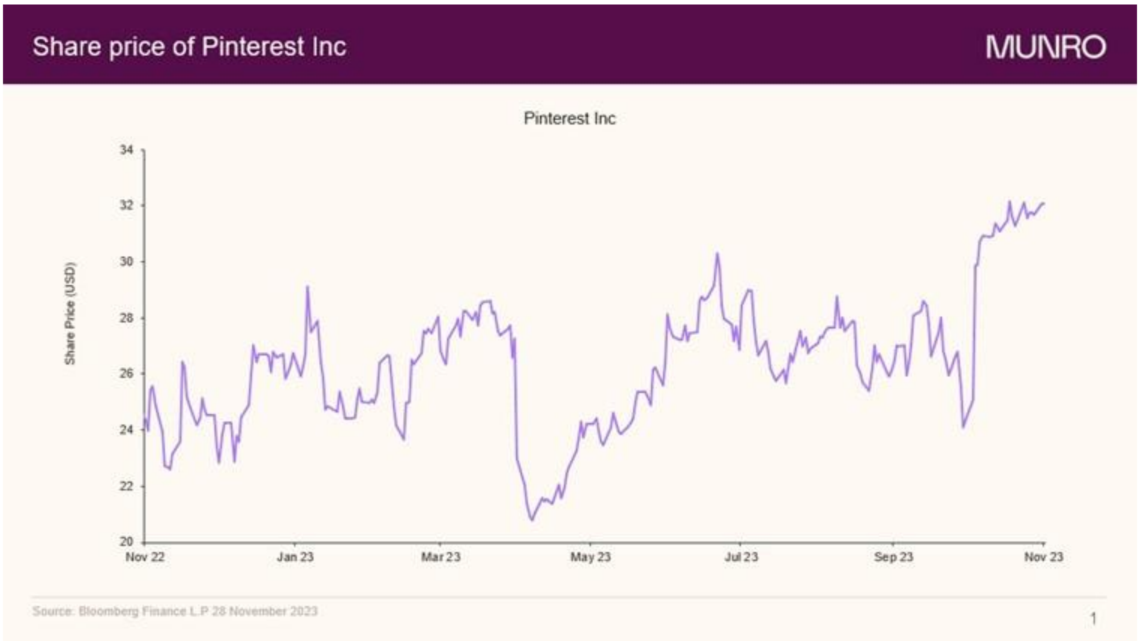
Why Generative Artificial Intelligence will start to benefit smaller companies too

Generative AI is a revolutionary tool, and so far, it mostly benefits the largest companies. The simple reason is cost – it takes over US$1 billion to train a large language model, so very few companies can afford it. However, 2024 is when these models are finishing the initial 'training' phase and entering the 'inferencing' realm, which is another way of saying now the world will try to generate real use cases from these staggeringly intelligent models.

Few companies outside of the Magnificent Seven can enjoy their fruits during the model training phase. During inferencing, however, anyone can benefit from them. This is an Appstore moment for Gen AI, and we expect to see a sharp increase in the number of smart, entrepreneurial companies racing to incorporate AI more deeply into their products and services.

Pinterest

An example of the kind of company we like is 'visual discovery engine' Pinterest (PINS). It had been labelled as a 'boring' legacy company, but we have observed how they have reinvented themselves into something much more exciting.



They brought in a stellar management team from Google and transformed Pinterest from a website for browsing pretty pictures to an incredibly shoppable interface on both the mobile app and their webpage. We are seeing many positive early results – user growth has re-accelerated, revenues are growing strongly again, and margins have expanded substantially. The stock jumped 20% on the recent positive earnings announcement, and we think this is just the start.

Area of Interest - Consumer

Activewear and outdoor living sportswear brands are a subsector of broader consumption which is becoming more of a focus for us. In our all-cap funds, we like companies like Lululemon, and in the small and mid-cap funds, we currently own On Running (ONON).

On Running

On Running started up 13 years ago in the Swiss Alps by a retired athlete who wanted to create a running shoe with a new feel. It is a small, specialised brand pulling ahead of the pack. It is also not as impacted by the range of macro factors hitting the market as it has a very specific set of devoted target customers to which it can sell a differentiated product.

We were able to add the company to our portfolio at, what we consider to be, a very attractive entry point, potentially its lowest valuation since the initial public offering (IPO), because at the time, the share price was being impacted by overall market macro concerns around consumer stocks.

It was encouraging to see that reported earnings for the financial year far exceeded expectations. The outlook for On Running is also looking very positive with a slew of innovative products in the pipeline.

Qiao Ma is a Partner and Small-Mid-Cap Lead Portfolio Manager for [Munro Partners](), a specialist investment manager partner of GSFM Funds Management. GSFM is a sponsor of Firstlinks. The information contained herein reflects the views of Munro Partners as at the date of publishing and is provided for informational purposes only. It should not be considered investment advice or a recommendation of any particular security.

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