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Editorial

New data from the Australian Bureau of Statistics (ABS) on deaths in Australia has some good news, of sorts. Total deaths numbered 183,131 in 2023, a 4.1% drop from the previous year. The main reason for the decline was that the number of deaths from COVID-19 fell from 9,862 in 2022 to 5,001 last year. However, all the other leading causes of death decreased too, with the exception of bowel cancer.

These numbers are deceptive though. The ABS thinks that there was about 5% excess mortality in 2023. In plain English, that means there were higher than expected deaths. The ABS says that with an increasing and ageing population, the number of people dying should increase, yet improvements in health care should also mean that mortality rates fall. While the mortality rate for last year was lower than 2022, it was higher than that of 2020 and 2021.

Top 10 leading causes of death in 2023 and 2022

	2023	2022
1	Ischaemic heart disease	Ischaemic heart disease
2	Dementia including Alzheimer's	Dementia including Alzheimer's
3	Stroke	COVID-19
4	Lung cancer	Stroke
5	Chronic lower respiratory diseases	Lung cancer
6	Diabetes	Chronic lower respiratory diseases
7	Bowel cancer	Diabetes
8	Blood and lymph cancers	Bowel cancer
9	COVID-19	Blood and lymph cancers
10	Urinary diseases	Urinary diseases

Source: ABS

Dementia to become our biggest killer

The big news from the data is that dementia is about to overtake heart disease as the leading cause of death.

In 2023, heart disease caused 9.2% of deaths, while dementia, which includes Alzheimer's disease, accounted for 9.1% of deaths. It's expected dementia will become our number one killer either this year or next.

For those unaware, dementia and Alzheimer's can cause death by damaging the brain, eventually affecting areas of the brain that control the body, causing systems to go wrong and shut down.

Dementia is already the leading cause of death for women and has been since 2016. It makes up over 12% of female deaths compared to 6.4% for men. The reason for the disparity is that women have longer life expectancies than men and are more likely to live to an age when they have a heightened risk of developing dementia.

Dementia is already the leading cause of death in South Australia, the ACT, and for the first time in 2023, New South Wales.

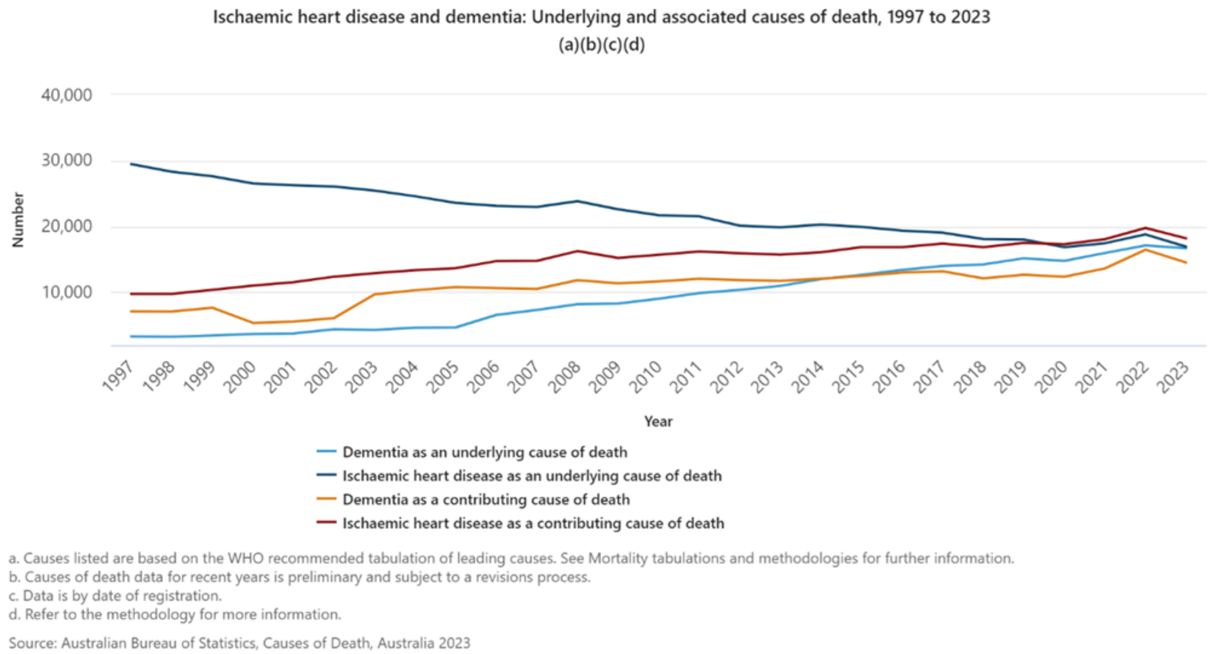
In a separate study last month, the Australian Institute of Health and Welfare found that there were 411,000 Australians living with dementia in 2023. It revealed there were 26,300 hospitalisations due to dementia last year, with an average stay of 16 days, far longer than the average stay.

A historic change

Heart disease has held the unfortunate mantle of being the leading cause of death since 1968, so dementia overtaking it is a big deal.

Between 1968-1978, heart disease accounted for 30% of all deaths in Australia. That's fallen to less than 10% today.

Meantime, dementia contributed to just 0.2% of deaths in 1968, and that's now risen to 9.1%. It wasn't until 2006 that dementia first appeared in the top five leading causes of death.



How it's happened

The big question is why this change has happened. The fall in deaths from heart disease is likely due to several factors. For decades, there have been public health campaigns focused on the prevention of heart disease. I'm sure some of you may remember programs such as 'Jump Rope for Heart' in primary schools.

It's not only preventative programs which have helped. Technological advances such as pacemakers have also allowed people to survive and live with heart failure.

Conversely, public health campaigns for dementia are only starting to be rolled out. A recent Lancet Commission study found that 45% of dementia cases could be prevented or delayed by addressing 14 risk factors starting in childhood.

Programs overseas are beginning to address brain health. In Scotland, the 'My Amazing Brain' program has reached thousands of primary school children, teaching them how to best protect themselves against dementia.

In Australia, Dementia Australia has several useful tools. It has a free Braintrack app as well as the CogDrisk program – a short assessment to help people understand their risk of dementia.

New drugs are also appearing to fight dementia. In July this year, the FDA approved Eli Lilly's Alzheimer's drug Kisunla, also called donanemab, for use in the US. It follows trials that showed the drug can modestly slow a decline in memory and thinking abilities.

An age-old debate

During COVID, there was divisive debate about whether people were dying *from* COVID or *with* COVID. It should be noted that a similar, albeit less public, debate is taking place in the medical community with dementia. Is dementia the real cause of death, or is it organ failure that's secondary to vascular disease impacting the brain, body and so on? I'm sure we'll hear more on this as dementia becomes more prevalent.

Premature causes of death

Talking about death is sad though talking about premature death is sadder still. One of the numbers that still stands out is that of suicides. There were 3,214 people who died by suicide in 2023, about 1.8% of total deaths. Men made up about three quarters of those deaths.

The median age for people who died by suicide was 46, making suicide the leading cause of premature death.

Another 'silent' killer is alcohol. There were almost 1,700 deaths from alcohol last year. Over the past six years, the alcohol death rate has risen from 4.7 per 100,000 people to 5.6.

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My article this week looks into the puzzle of how so many wealth families through history have squandered their fortunes and the lessons that can be learned about the best ways to make and keep money.

James Gruber

Also in this week's edition...

Family trusts are widely used in Australia due to their commercial and tax benefits. **Greg Russo** provides an overview of how these trusts work, their advantages and disadvantages, and whether they may have a place in your individual investment strategy.

The makeup of stock markets changes all the time - companies come and go, through buyouts, mergers, acquisitions, delistings and so on. But how do indexes and the ETFs which track them adjust these changes? **Vanguard's Tony Kaye** has the answers.

Everyone seemingly loves AI and any businesses with exposure to it. Yet, there are other asset classes with significant structural growth opportunities that aren't getting the same attention and are fetching a fraction of the price. **Jan de Vos** of **Resolution Capital** focuses on one of these asset classes and the stocks he likes.

How can we prepare for the next market crash and the inevitable emotions that come with it? **Geoff Saab** thinks there's a lot that we can learn from the ancient Stoics and their idea of "premeditatio malorum"—the premeditation of evils.

Is it too late to buy bonds? **Capital Group's Haran Karunakaran** thinks not, given the impending US rate cutting cycle and that bonds are again proving to be a genuine diversifier with investment portfolios.

It may not be just bonds that benefit from US rate cuts. **Samuel Bentley** and **Yuan Yiu Tsai** believe emerging markets could be the biggest winners from monetary easing. And they address the elephant in the room: whether China's recent uptick is for real or just another head-fake.

Lastly, in this week's whitepaper, and given the recent hurricane in Florida, **Franklin Templeton** offers a timely introduction to catastrophe bonds.

Curated by James Gruber and Leisa Bell

Preserving wealth through generations is hard

James Gruber

In 1877, the US rail and shipping tycoon, Cornelius Vanderbilt, died. He was the wealthiest man in the world with a fortune then worth more than US$100 million. His eldest son, Billy, inherited 95% of Cornelius' assets.

Six years later, Billy had almost doubled his inheritance via several canny business deals. Yet, a quarter of a century after that, there wasn't a single heir or member of the Vanderbilt family who was among America's richest. Vanderbilt had given the original gift to the university that bears his name in Nashville, Tennessee, and when 120 members of the family met at the university in 1973, not one of them was a millionaire.

How such gargantuan wealth evaporated is difficult to fathom. What happened?

In their recently published book, *The Missing Billionaires*, Victor Haghani and James White, suggest that if "the Vanderbilt heirs had invested their wealth in a boring but diversified portfolio of US companies, spent 2 per cent of their wealth each year, and paid their taxes, each one living today would still have a fortune of more than US$5 billion."

The Vanderbilt's case of disappearing wealth isn't unusual, albeit the scale of it is. In 2022, "there were just over 700 billionaires in the United States, and you'll struggle to find a single one who traces his or her wealth back to a millionaire ancestor from 1900." In fact, "fewer than 10% of today's US billionaires are descended from members of the first *Forbes* 400 Rich list published in 1982. Even the least wealthy family of that 1982 list, with 'just' $100 million, should have spawned four billionaire families today."

Why there aren't more billionaires descended from the scions of old-money wealth is the basis for the book.

When genius failed

It's worth mentioning the backdrop to the book. Most of you would have heard of the legendary fall of hedge fund, Long-term Capital Management (LTCM), in the late 1990s. Briefly, LTCM was set up by John Meriweather, a well-known former trader at Salomon Brothers. The board boasted some of the world's finest financial brains, including Nobel Prize winners, Myron Scholes and Robert Merton.

Initially, LTCM achieved impressive results, with net annualized returns of 21%, 43%, and 41% in the first three years, respectively. But in 1998, it made an astonishing loss of US$4.6 billion, due to a combination of extreme leverage and poorly executed options and arbitrage bets. Fearing financial contagion from LTCM's losses, the US Federal Reserve helped organize a US3.6 billion bailout package.

In the aftermath, the LTCM implosion became a tale of how smart people with sophisticated mathematical models could still do very stupid things.

It turns out that one of the book's authors, Victor Haghani, was a bond trader at LTCM who lost a nine-figure amount in the fund's collapse.

In this light, his book on strategies to manage wealth wisely seems appropriate, if not a little ironic.

The disappearance of Australian family wealth

Before I get to the book's answers, it should be noted the story of missing billionaires isn't just an American phenomenon. There are plenty of Australian families that have blown large inheritances too.

Though the history of Australia's wealthiest individuals is patchy at best, I tracked down a list of the richest men (as they were then) from 100 years ago:

- *Macpherson Robertson*
- *E.N. Abrahams*
- *George Juda Cohen*
- *Sir Samuel Hordern*
- *Hugh Victor Mckay*
- *Sir Rupert Clarke*
- *Anthony Hordern*
- *John Wren*
- *Lebbeus Hordern*
- *J.H. Riley*
- *W.G. Angliss*
- *W.L. Baillieu*
- *H.W. Grimwade*
- *Alfred D. Hart*
- *Sir Hugh Denison*
- *F.B.S. Falkiner*
- *John Darling*
- *John Brown*
- *Geoffrey Fairfax*
- *J.O. Fairfax*

As far as I'm aware, no family members from this list are in the top 50 richest Australians in 2024, meaning much of the wealth has been squandered in the years since.

In his 2004 book, *The All-time Australian 200 Rich List*, William Rubenstein tried to calculate the wealthiest-ever Australians. To do this, he took the wealth of individuals at their deaths as a percentage of the GDP at the time.

According to Rubenstein, the richest-ever Aussie was Samuel Terry, the ex-convict known as the 'Botany Bay Rothschild'. Terry died with assets valued at £200,000, equivalent to 3.395% of GDP in 1838, or around $86 billion today. That compares to Australia's richest person now, Gina Rinehart, with wealth worth $41 billion.

Like most wealthy people, Terry did philanthropy, yet there has been no study into what happened to the rest of his enormous fortune. The same goes for most on the list below.

All-time Richest Australians

Name	Yr of Death	Value	Current Value	% of GDP
More than 1.000% of GDP				
1. Samuel Terry	(d. 1838)	£200 000	24.37 billion	3.395
2. Rowland Hassall	(d. 1820)	£15 000	14.35 billion	1.991
3. Robert Jenkins	(d. 1822)	£20 000	13.54 billion	1.886
4. William John Turner Clarke	(d. 1874)	£1 640 931	10.74 billion	1.496
5. James Tyson	(d. 1898)	£2 338 442	9.42 billion	1.313
6. Rupert Murdoch	(b. 1931)		9.12 billion	1.271
7. William Field	(d. 1837)	£69 400	8.86 billion	1.238
8. Matthew Bowden	(d. 1814)	£5000	8.23 billion	1.147
9. Edward Riley	(d. 1825)	£15 000	8.00 billion	1.115
10. Samuel Hordern	(d. 1909)	£3 004 062	7.70 billion	1.073
11. Thomas William Birch	(d. 1821)	£10 000	7.61 billion	1.060
12. John Macarthur	(d. 1834)	£40 000	7.54 billion	1.047
13. John Reddington	(d. 1816)	£5000	7.24 billion	1.009
14. Walter Lang	(d. 1816)	£5000	7.24 billion	1.009
15. William Hobart Mansel	(d. 1816)	£5000	7.24 billion	1.009

Source: William Rubenstein, The All-time Australian 200 Rich List, 2004.

The reasons behind squandered wealth

Getting back to the book and what happened to the missing billionaires, the authors point to obvious mistakes such as overly aggressive risk taking and profligate spending.

Haghani and White believe that bad investments aren't to blame, but the concentration of risk is. Being quantitative finance guys, they call this the sizing decision – the optimal share of wealth to allocate to risk assets, or the equivalent for assessing how much to spend at intervals through time. They suggest that estimating this share is "the most critical part of investing".

The book outlines various quantitative solutions to the investment sizing decision, starting with John von Neumann's game theory research in the 1940s, to John Kelly's in 1956 (the Kelly criterion) and later Robert Merton's in 1969 (the Merton share) – the same Merton who was on LTCM's board.

The book goes into detail on the Merton share, which has since become a cornerstone of modern portfolio design and management.

At its simplest, the Merton share formula is an elegant one:

$$\hat{k} = \frac{\mu}{\gamma\sigma^2}$$

where

$\hat{k}$ = Merton share

μ = expected excess return of the risky investment
γ = personal degree of risk aversion
σ = standard deviation of returns

Source: James Picerno

I won't go into too much detail, but the authors advocate using a dynamic asset allocation to manage the risk and return of portfolios, with the Merton share as a basis.

How to preserve wealth

Unfortunately, the book devotes too much time on formulas and not enough on the practical ways that wealth is often squandered, such as:

- Taking too much risk on too few investments
- Investing in things not properly understood
- Trusting people with money that shouldn't be trusted
- Having unrealistic expectations for returns
- Spending more than what's earned on investments
- Divorce

What's the answer to preserving wealth, then? A dynamic asset allocation, as the book proposes, is too complex for the average investor to implement. Luckier, there are easier, more commonsense methods that are just as useful to maintaining and growing assets. These include two things above all else:

1. Diversify your investments
2. Spend less than you earn on those investments

Do these things, and it's highly unlikely that you'll end up like the Vanderbilts and countless others.

Oh, and one other thing: if you're lucky enough to build a substantial war chest and don't want your children to squirrel it away, be sure to teach them how to handle money and the value of a dollar. They'll thank you later.

James Gruber is editor of Firstlinks and Morningstar.

The nuts and bolts of family trusts

Greg Russo

According to the *Australian Financial Review*:

"…the Australian Taxation Office estimates that there are well over 800,000 Family Trusts in Australia, controlling more than $3 trillion of assets."

The term 'family trust' can be somewhat loosely used at times. Strictly speaking, family trusts are a subset of the wider class of 'discretionary trusts' being trusts in which the trust administrator, the trustee, generally has a wide discretion to distribute trust income and capital amongst a wide class of beneficiaries.

This article explores some aspects of the legal effect, and consequent commercial benefits that family trusts can offer. Given the scope of the subject matter:

- this article is a 'grab bag' of considerations that readers may find useful when considering whether family trusts might have a place in their individual investment strategies; and
- it is recommended that any decision to use family trusts be accompanied with bespoke legal, accounting and financial advice.

Why are family trusts so popular?

John D. Rockefeller, the American businessman and philanthropist is quoted as saying:

"own nothing, but control everything".

That sentiment is at the heart of the structure of most family trusts and one of the reasons that they are so widely used. Trusts create an opportunity to separate legal control and beneficial ownership - so that effectively one entity or person can control an asset for the benefit of another entity, person or class.

Legal framework of trusts

A trust is not a legal person like a company or an incorporated association.[1] Trusts can be understood in terms of the relationships that they create between the legal owner of assets and the beneficial owner of assets:

"…a trust exists when the owner of a legal or equitable interest in property is bound by an obligation recognised by and enforced in equity to hold that interest for the benefit of others. or for some object or purpose permitted by law."[2]

Independent of the legalese, family trusts effectively split ownership and control in property between trustee and beneficiaries.

An interest in property has been described as consisting of a "bundle of rights".[3] Family trusts effectively split that bundle and divide those rights between a trustee on the one hand and beneficiaries on the other. The way that the split occurs in a particular case will depend on the terms of the trust in question.

The nuts and bolts of family trusts

Trustee

The trustee is a person or company who administers the family trust on a day-to-day basis in accordance with the terms of the relevant trust deed. The trustee is responsible for the trust assets, and generally has broad powers to conduct the trust and manage its assets.

Family trusts are also known as 'discretionary' trusts which means that the trustee will be generally given choices about some aspects of the administration of the trust such as:

- who the income is distributed to
- whether any capital distributions are to be made
- how the trust funds are to be invested
- whether the trust should borrow or lend funds and on what terms
- when the trust will end

The Appointor/Principal/Guardian

This person or entity has the ultimate power to control a family trust because they have the power to remove the trustee and appoint a replacement trustee. Sometimes, depending on the terms of the trust, their consent is also required before the trustee may take certain actions in respect to the trust.

Beneficiaries

The beneficiaries of a family trust can be persons, companies, other trusts or charities. They are usually the wider family of the ultimate trust controller. The relevant trust deed will define the class of possible beneficiaries who may benefit from the family trust from time to time.

Trust assets

Family trust assets may include personal property, real property or both.

Advantages of family trusts

Taxation benefits of using trusts

The flexibility of trusts may allow a trustee to allocate future income between a class of beneficiaries in a flexible and tax effective manner.

Trusts are taxed pursuant to Division 6 of Part III of the Income Tax Assessment Act 1936 (Cth) (ITAA 1936).

As a general proposition and ignoring beneficiaries that may be under a legal disability, it is a basic premise of trust taxation that a beneficiary presently entitled to a share of trust income is responsible to pay tax on that income to the extent of that entitlement.

In each financial year tax will be payable by each of the beneficiaries presently entitled to a share of the trust income during that financial year, on those respective shares, at their relevant marginal tax-rates. Any undistributed income will generally be taxed:

- In the hands of a trustee at ordinary progressive marginal tax-rates after the tax-free threshold (for testamentary trusts if the Commissioner's discretion is exercised), or
- At the highest marginal tax rates applicable to trustees generally.

Accordingly, trusts provide an ability to split income between several beneficiaries, and the consequent opportunities for family trust controllers to potentially achieve beneficial tax outcomes depending on the circumstances.

Asset protection benefits of using trusts

Family trusts can offer protection against insolvency of a trustee, beneficiary, or appointor.

- Property held by a bankrupt as trustee of a trust is not property "divisible amongst creditors".
- The power of an Appointor of a trust to appoint or remove trustees has been held to not be property that vests in the trustee in bankruptcy, and it has been held that the power of appointment is not one contemplated under section 116 of the Bankruptcy Act 1966 (Cth).
- The trustee in bankruptcy is in no different position than the bankrupt beneficiary, insofar as trust entitlements are concerned, and would not be able to require the trustee to distribute trust assets unless a beneficiary has a fixed entitlement to trust assets or income. This proposition is confirmed in case law.

Assets held by a family trust may not be susceptible to a claim made against an insolvent family trust controller depending on the circumstances.

Disadvantages of using Family trusts

Some disadvantages of family trusts include:

- ongoing administrative costs, which need to be justified relative to the benefits that are likely to be achieved
- increased complexity in financial structure
- notwithstanding the articulated tax benefits, the taxation of trusts is complicated, and some aspects are, to a degree, uncertain[4]

Family trusts and estate planning

The death or incapacity of family trust controllers changes a family dynamic and may change a family trust power division dynamic but will often not bring a family trust to an end.

The ability of trusts to be able survive the passing of (or loss of capacity of) a trust controller creates both opportunities and complexities when addressing succession of control issues that arise in estate planning.

When estate planning, family trust controllers need, in addition to executing a will to deal with estate assets, to make provision for the succession of family trust control.

Case study

The following case study demonstrates one way in which a family trust can create a bespoke estate planning outcome.

Simone needs to update her Will. She is married to Leonard. It is a second marriage for each of them - Simone has three adult children from an earlier relationship, and Leonard has no children - and whilst Simone and Leonard are close, Leonard and her children don't get on.

Simone has about $1 million in assets in a family trust, a home that she owns jointly with Leonard and various bank accounts of minimal value.

She desires Leonard to inherit the home and bank accounts and her children to inherit the trust assets.

Simone executes documents appointing her children as successor controllers of the Trust and executes a Will appointing Leonard as executor and distributing her bank accounts to him.

On her death, after the funeral, there is no necessity for Leonard and the children to interact.

Conclusion

Family trusts can offer many commercial benefits and are therefore attractive financial entities to many investors. An assessment of those benefits, however, must be tempered with an appreciation of the complexity of family trust administration and the challenges associated with succession of trust control when estate planning.

As with other aspects of commercial life, specific and expert legal, accounting, and financial advice is recommended when considering using family trusts within a financial structure, so that benefits can be maximised and pitfalls avoided.

Greg Russo is a succession law specialist and principal of Greg Russo Law.

Disclaimer

The information given by Greg Russo and Greg Russo Law in this article is given in good faith but is of a general nature only and it is not intended that this article will be acted or relied upon in the absence of individual legal, advice. Each person's requirements and circumstances will be different and accordingly, each person should engage professional assistance according to their own particular needs.

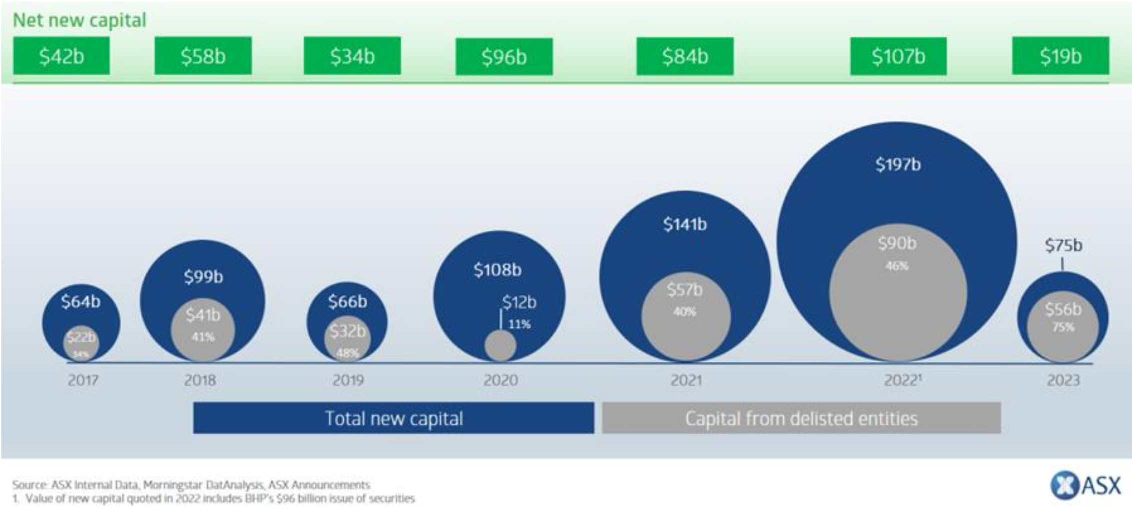
[1] Although for some purposes a trust is "deemed" to be a legal entity – e.g., for taxation purposes in Division 6 of the Income Tax Assessment Act 1936 (Cth).
[2] Jacobs" Law of Trusts in Australia, 8th Edition, LexisNexis, page 1.
[3] See for example Yanner v Eaton (1999) 201 CLR 351, and Brendan Edgeworth, Chris Rossiter, Pamela O'Connor, Andrew Godwin, Leon Terrill, Sackville and Neave Australian Property Law, 11th Edition, LexisNexis.
[4] See for example the ATO's preparedness to address the administration of testamentary trusts in accordance with the practices set out in PSLA 2003/12. Ultimately however that practice statement does not have the force of legislation but is an administrative statement to provide guidance to ATO staff.

How ETFs and indexes cope with company delistings

Tony Kaye

Share markets are ever changing. Companies come, and companies go.

But what happens to share market indexes, and the exchange traded funds (ETFs) that use them as performance benchmarks, when a company is removed because of a merger or acquisition?



Source: [ASX.com.au](ASX.com.au)

One doesn't have to look too hard to find some recent, high-profile examples of company delistings from the Australian Securities Exchange (ASX).

After more than 60 years on the ASX, the building products company CSR that started life in 1855 as the Colonial Sugar Refining Company was delisted in July following a $4.3 billion takeover by French construction group Saint-Gobain.

The construction materials company Boral (which listed in 1946 as Bitumen and Oil Refineries (Australia) Limited) also left the ASX in July after its $1.5 billion acquisition by Seven Group. Likewise, the bauxite mining and aluminium refineries investment group Alumina delisted from the ASX following its $3.4 billion takeover by U.S. giant Alcoa.

All up there have been 67 ASX delistings so far in 2024, including other high-profile removals such as concrete group Adbri (sold for $2.1 billion to Irish group CRH in July), and fruit and vegetables company Costa Group (sold for $1.5 billion to U.S. private equity group Paine Schwartz in February).

Understanding index construction

All of the companies mentioned above had been included in various ASX indexes, such as the All Ordinaries Index and S&P/ASX 300 Index, based on their market capitalisation.

Share market indexes are structured to track the broad performance of markets and specific sectors, typically by tracking the share price returns of the companies that have been included in the index.

For example, the S&P/ASX 300 Index tracks the returns of the top 300 ASX companies based on their market capitalisation. In turn, the Vanguard Australian Shares Index ETF (VAS) uses the S&P/ASX 300 Index as its performance benchmark.

So, what happens to indexes and ETFs when companies effectively vanish from a share market?

Index rebalancing

Indexes are rebalanced on a regular basis as part of scheduled reviews to ensure benchmarks stay up to date and continue to accurately reflect their purpose.

ETFs and unlisted managed funds tracking an index will adjust their own portfolio holdings in tandem with any changes made to the benchmark index.

On the ASX, scheduled rebalancing changes typically take effect after the market close on the third Friday of March, June, September, and December.

The S&P/ASX 300 is rebalanced semi-annually, effective after the market close on the third Friday of March and September.

Eligible stocks are considered for index inclusion based on their rank relative to the stated quota of securities for each index.

But company deletions also can occur between index rebalancing dates due to acquisitions, mergers and spin-offs or due to suspension and bankruptcies. The decision to remove a stock from an index rests with the index provider and will be made once there is sufficient evidence that a transaction will be completed.

Company delistings will typically trigger an intra-rebalancing process if an index level is comprised of a fixed number of companies. But not all indexes are based on a fixed count.

The S&P/ASX 300 and All Ordinaries are not fixed count indices, so intra-rebalancing additions are only made when a replacement added to the S&P/ASX 200 (or a higher index) is not a constituent of the S&P/ASX 300 and All Ordinaries.

Index additions are made according to various criteria as laid out in their respective methodologies. For the S&P/ASX300, market capitalisation, free float and liquidity are some of the criteria considered, whereas for the All Ordinaries Index, there is no liquidity screen or minimum float requirement.

The reference date used to determine an ad-hoc index replacement is determined on a case-by-case basis and taken closer to the time of the event that triggered the vacancy.

More information on how indexes are rebalanced on the ASX can be found in S&P/ASX Australian Indices Methodology.

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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The quiet asset class delivering structural growth

Jan de Vos

Megatrends, super cycles, AI, technological disruption. They're some of the buzz words continuing to drive more investors into the most crowded parts of global equity markets.

Attempting to be on the right side of structural growth is not misguided. But the loudest, most crowded, and generally most expensive parts of equity markets have not always been the right place for the capital growth and capital preservation needs of long-term investors.

Now for some good news. In today's market there is a somewhat underappreciated asset class that provides tangible exposure to the real structural growth themes that are unfolding globally. It also happens to offer very attractive valuations in the current market.

GLI: The enabler

The Global Listed Infrastructure (GLI) market is a liquid US$3 trillion hunting ground for investors, predominately in developed markets. GLI companies are underpinned by real assets delivering hard cashflows. Assets like railroads, toll roads, airports and shipping ports, mobile network towers and fibre, along with energy utility assets.

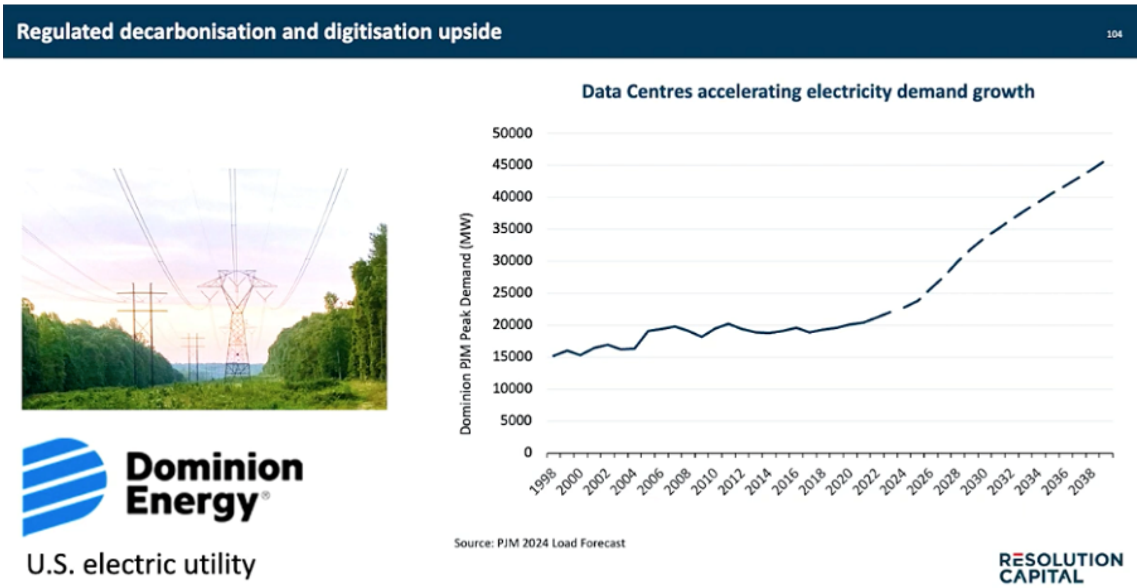
When you think about some of the biggest structural growth drivers in markets and economies today – digitization, decarbonization, and mobility – it's infrastructure that underpins them.

Take energy utilities for example. While some might label these 'old world' investments, right now, they are very much underpinning 'new world' technologies.

The NYSE-listed Dominion Energy is a great example. The company, a holding in the Resolution Capital Global Listed Infrastructure Fund, is a regulated electric utility and the sole distributor of energy in the US state of Virginia. This utility (like many of its peers) is on the frontline of digitisation and the growth of artificial intelligence.

Digitisation is structural shift that requires unprecedented increases in energy supply. Mostly because datacentres that power AI and machine learning are hungry for electricity.

For Dominion, Virginia is the home of what's become known as 'Data Centre Alley'. It has the world's largest concentration of data centres – more than 300, all with high energy demand. The Alley relies on Dominion's output.



But while datacentres and their high-flying tech and software customers attract the headlines and big multiples, Dominion Energy is currently trading at just 16.5x next year's earnings. Those earnings are expected to increase 5-7% p.a. for the next 5 years, and it's providing a 5% yield.

Not the only source of 'quiet' exposure to structural change

Dominion is just one example of how GLI can provide 'quiet' exposure to structural change. Digitisation also benefits communications infrastructure, another large subsector of GLI, and we are finding compelling opportunities in mobile network towers and fibre assets globally.

Beyond digitisation, mobility is another key trend, led by population growth and urbanisation. The likes of Uber and Tesla are some of the big-name stocks that can be linked to structural shifts in mobility. While in Australia, Transurban is another more obvious example. But far less crowded opportunities for exposure can be found in the GLI sector.

The Spanish multi-national infrastructure owner and operator Ferrovial (BME:FER) is a good example.

Among its high-quality global infrastructure portfolio, the company operates the 407 ETR highway in Canada – the world's first all-electronic open-access toll highway. It provides stronger growth characteristics than both Sydney and Melbourne toll road equivalents, and its tolls aren't capped, meaning the company can increase tolls above inflation.

Despite this, Ferrovial remains largely underappreciated by the market and offers an attractive multiple relative to the likes of Uber, Tesla, and Transurban.

Structural shifts within the asset class

There are also structural shifts underway within infrastructure investment that we think can provide a big advantage for the listed infrastructure sector.

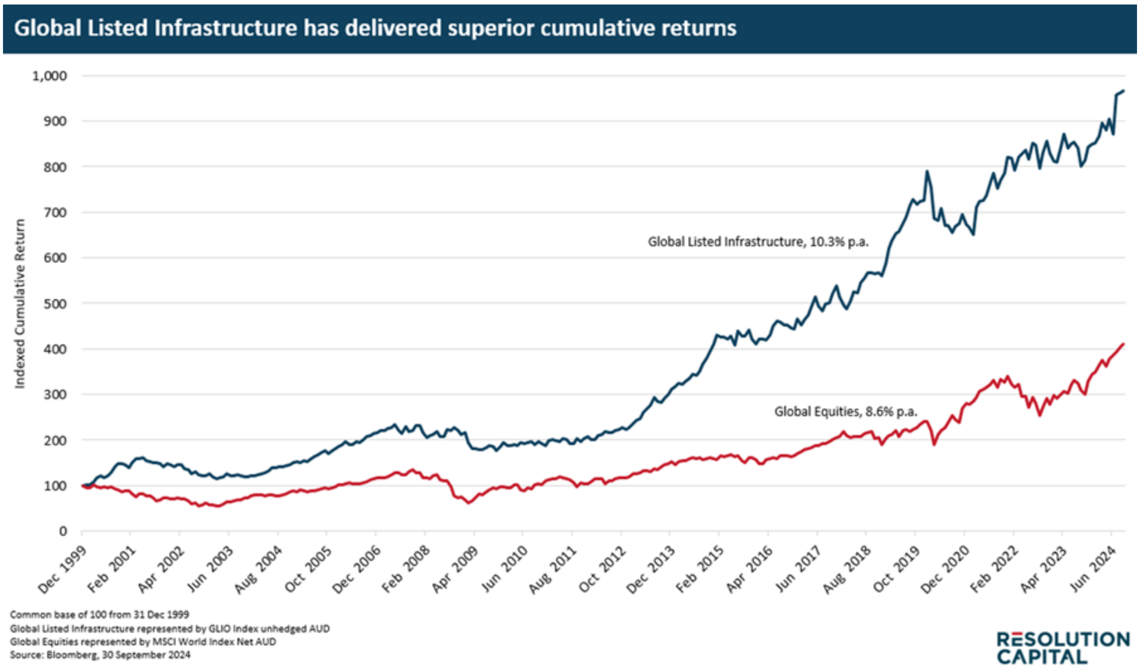
At a time when government debt is at historical highs and the needs of economies are rapidly shifting, a challenging infrastructure investment gap has emerged. It is estimated this global investment gap could grow to almost $15 trillion over the next decade.

Infrastructure investment has traditionally been the domain of Governments, but private investment is rapidly increasing. The listed market provides the most liquid way to access and finance opportunities. It is an asset class key to filling the infrastructure spending deficit expected over the coming years, and investors are likely to benefit.

Structural growth backed by a compelling track record

While this article has covered some of structural growth drivers that support the case for GLI investment in the coming years, it's important to note the asset class has a good historical track record of providing attractive investment returns and risk characteristics.

It might surprise some to learn that since 1999, GLI has delivered stronger total returns than global equities. The chart below illustrates this and shows the power of compounded returns.



This performance has been driven by more consistent and stronger earnings, which result from the attractive investment characteristics of the underlying GLI assets:

- Many are monopolistic.
- They have high barriers to entry.
- They can maintain inflation-protected pricing power (which means over the long term their cash flows are generally not significantly impacted by the economic cycle).
- They generally have resilient demand due to their essential and critical roles in economies and communities.

It may be today's quiet asset class for exposure to structural growth, but it has also been the great quiet achiever over recent decades within investment portfolios.

Jan de Vos is a Portfolio Manager at Resolution Capital, an affiliate manager of Pinnacle Investment Management. Pinnacle is a sponsor of Firstlinks. Resolution provides exposure to GLI through the Resolution Capital Global Listed Infrastructure Fund.

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Survive the next crash by learning from the Stoics

Geoff Saab

The ancient Stoic philosophers introduced me to an idea they called "premeditatio malorum"—the premeditation of evils.

It's a practice that involves considering some of the worst things that can possibly happen to you, as a way of immunising yourself against them. To many, this concept might seem somewhat odd and quite grim, but if the Stoic philosophy appeals as much to you as it does to me, you can see the value in it.

In fact, the idea of premeditatio malorum is rooted in our religious and cultural traditions. From the ancient Bhutanese folk saying "to be a happy person, one must contemplate death five times daily" to the writings of St. John Climacus ("The remembrance of death, like all other blessings, is a gift of God"), spiritual wisdom reminds us to keep in our minds that our time on earth is temporary and fleeting.

Paradoxically, this practice can actually make us happier.

Remembering that you could lose your job makes you appreciate those administrative tasks you can't stand. Being thankful for your health and the use of your limbs makes it hard to complain about all that yard work you need to get done. And recalling the mortality of your loved ones will have you treasuring every routine moment with them, and hugging them a little tighter.

It's a useful practice.

Now we're going to apply it to your investment portfolio.

At the start of almost any financial advisory relationship, you will work through a questionnaire that outlines your attitude towards risk. "How would you react if your portfolio fell 20%?" is a common question, for example. And "I would hold on or buy more" is a common answer.

The thing is, you have no idea how you would react in that scenario, because it's presented in such an abstract and soulless way.

In more vivid and personal terms, one might phrase it as follows:

You have worked your whole life and have finally sold your business for $10 million, after tax. You are ecstatic but also worried about what the future holds. You've never had responsibility for so much wealth, and you're not sure if you're handling it correctly. You hire an advisor recommended by your brother-in-law because he seems knowledgeable. Shortly after he deploys your cash, the market begins to decline. Your $10 million is now $9.5 million. "Don't worry," says your brother-in-law's advisor, "this is a healthy correction." This does not feel healthy at all, but you assume he's an expert and you trust him. After a brief respite, the market suffers another violent selloff. The newspapers begin talking about a big recession… maybe even another Great Depression scenario. The financial news is filled with talking heads in fancy suits telling you to raise cash and head for the hills. Your $10 million is now $8 million, only a few months after investing. At this rate, your life's work will be vaporized in a couple of years. You demand another meeting with your brother-in-law's advisor, who tells you, "This is a healthy correction," and offers to switch you into a lower-risk fund, maybe to rebalance into bonds. What do you do?

If your answer to this scenario is "hold on or buy more," you're a more trusting and patient client than I would ever be.

Premeditatio malorum is about anticipating these events in advance.

That's a nice portfolio you got there… would you still feel as confident in it if it was down 20% tomorrow?

Why conviction is important

Research firm Dalbar conducts a well-known survey that tracks the difference between market returns and those returns actually experienced by investors. The results are often striking. For example, in 2018 they noted that the average balanced fund portfolio returned 6.8% per year over the twenty-year period from 1998 to 2017. During the same period, the average investor in those same funds experienced a return of 2.6%.

How is that possible? Because investors buy when prices are high and the news is positive, and sell when prices are low and the news is negative. In doing so, they ensure they will earn poor returns.

Many advisors use this data to prove to clients that they should stop trying to time the markets and instead stick to their investment plan. This is true.

But what if part of the problem causing this was a mismatch between the investor and their portfolio?

What if part of the reason they were selling is because they never really believed in their investment strategy to begin with?

A well-known example is that of Ken Heebner's CGM Focus Fund, the best-performing mutual fund of the first decade of the 2000s. The ten-year annualized return was an impressive 18.2%. In 2007 alone, the fund was up 80%, attracting $2.6 billion of assets the following year.

And then… the housing crash. The mortgage and banking crisis. The Great Recession. Immediately following a huge inflow of investor dollars, the fund declined 48%.

The money came in when the numbers were hot. But the investors didn't have conviction in Heebner or his strategy. They were just chasing returns. And so despite the fund having the best returns of any fund in the decade, investors performed horribly. According to Morningstar, the average investor in CGM Focus experienced a loss of 11% annually over the same time period that the manager made 18% per year.

A more recent example of this phenomenon are the terrible returns experienced by investors in the famous 'ARK Innovation Fund'. I've talked about that enough and won't revisit it here.

These are great examples of why it's important to avoid chasing returns. Know why you're making an investment. Understand the strategy and have conviction in it. Because if you're just chasing returns, you're going to bail when things get rough.

Premeditatio malorum is important because it's a way to test for conviction. And conviction is the key to investing successfully through downturns.

The long-term trend in the markets, as in the economy, is up. Believing this is a necessary prerequisite to investing in stocks. We all know what we need to do when the market corrects. When we're facing a recession scenario, or a financial crisis. When everyone else is panicking and selling. We need to buy.

But human nature tells us that we'll feel so much more comfortable running with the herd. And if the herd is selling, we also want to sell.

We will sell, even though we know it's the wrong thing to do in the long run, because it will alleviate our pain in the short run.

So what do we need in order to prevent ourselves from selling at the bottom? I'll take it a step further—what do we need in order to buy more at the bottom?

The magic ingredient is conviction. Conviction means that you have a firm belief in what you own or in the strategy being implemented by your money manager. It means that you won't be tempted to sell when the market drops temporarily, no matter how violent the selloff. In fact, it means that when that happens, you'll actually be tempted to buy more.

I'm not talking about blind faith. I'm talking about having a solid understanding of what you own. Confidence backed by objective facts, not predictions of what other investors will do.

Geoff Saab is the author of Low Risk Rules: A Wealth Preservation Manifesto, and writes a free newsletter at lowriskrules.substack.com.

Stars align for fixed income

Haran Karunakaran

It's been a common and persistent claim in global financial markets for the last year or so that "Bonds are back!"

Performance from fixed income markets over this time has indeed been favourable, with global core bonds returning 6% over the last 12 months, and global credit performing even better, with 8% returns for investment grade and 12% for high yield[1] .

Yet some investors may understandably be asking themselves: Have I missed the boat?

I believe that the answer to that question is an emphatic "no" and that the opportunity in fixed income is just getting started. The combination of high starting yields and a supportive macro backdrop means that the stars are finally aligning for investors considering a fixed income allocation.

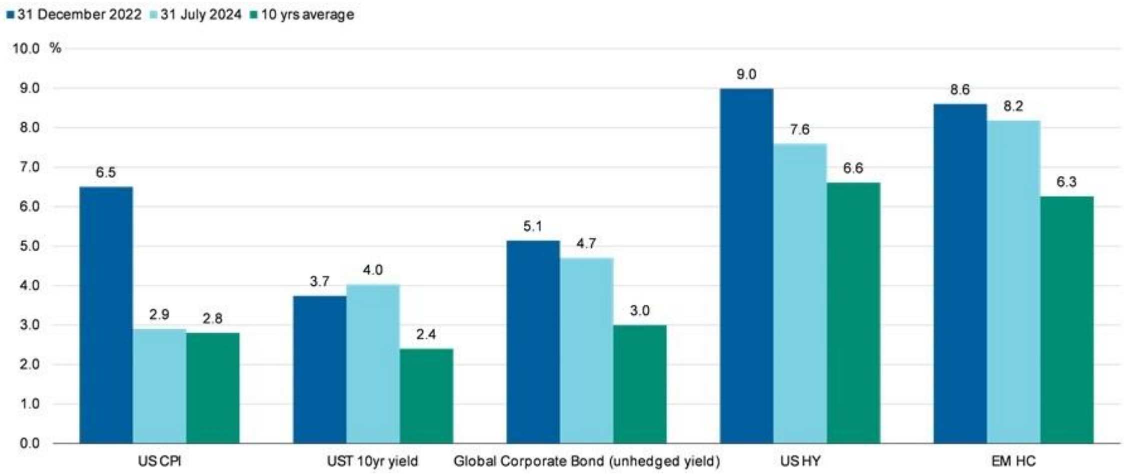
The power of yield

The post-GFC period was one marked by near zero rates, quantitative easing and other forms of liquidity provision by central banks. This was a challenging environment for fixed income, reflected in lower bond returns.

The environment today is very different. The hiking of monetary policy rates by central banks in 2022/3 was painful at the time but had a silver lining – investors in fixed income are now well compensated for holding this defensive ballast, in the form of historically high bond yields.

And even with the strong returns of bond markets over the last 12 months, those yields remain well above historical averages today. In addition, inflation has come down, meaning *real* yields are today well into positive territory.

This is important because the starting yield of a bond is highly correlated to its future total return. For example, high quality global corporate bonds today offer a starting yield of more than 5%; history suggests this correlates to mid-to-high single digit total returns over the coming 5 years.



Potential benefits from rate cuts

In addition to the high starting yield, returns generated by fixed income could see an additional tailwind from the capital gains that typically come with rate cuts.

The macroeconomic backdrop has been marked by a shift in focus from one of inflation to a potential slowdown in growth. This means duration changes, from being a possible drag on portfolio results to a positive contributor.

The disinflation trend that we've seen in the US over the past 18 months has led the Fed to begin cutting rates – a first 50bps rate cut in September is expected to be followed by more cuts over the coming quarters and years. If this does in fact play out, higher quality fixed income markets such as global corporate bonds should benefit from price appreciation as a result of their duration.

Analysing past rate cycles confirms the strong boost to returns that fixed income securities can expect to see in this environment. Looking back at every period of sustained rated cuts of the last 40 years reveals that, on average, investment grade credit returned 10% p.a. in the 3 years after the last hike in a cycle.[2]

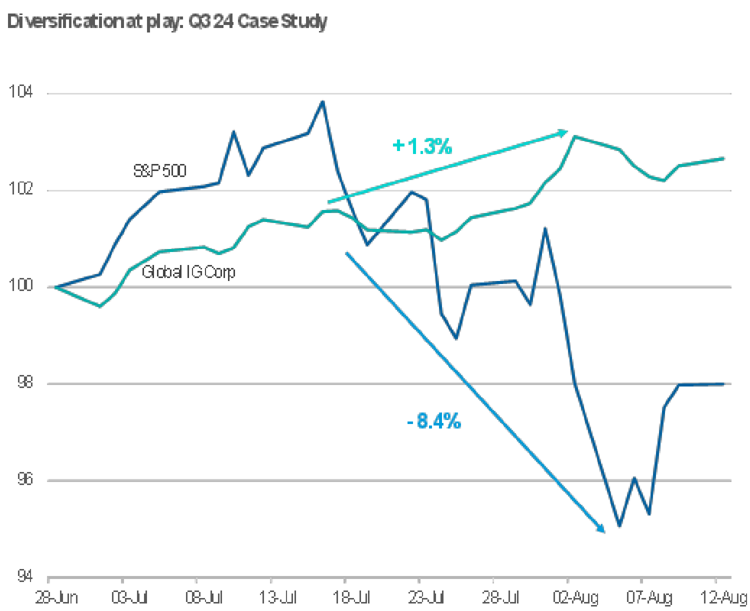
In the current cycle, the last Fed hike was just over a year ago in July 2023. Since then, global corporate bonds have returned 9.5%. If historical patterns hold, history suggests that the next few years should provide similarly strong returns – an opportunity that investors will need to move quickly to take advantage of.

The defensive role of fixed income is more important than ever

A key role of bonds in a broader portfolio is to provide defensive ballast – to protect investors capital and diversify against equity market volatility.

While this diversification role has been less prevalent in recent years, there is reason to believe it is returning. In the recent mini correction in global equity markets, bonds delivered positive returns (see chart below). What we saw was a return of the 'fabled' negative stock-bond correlation.

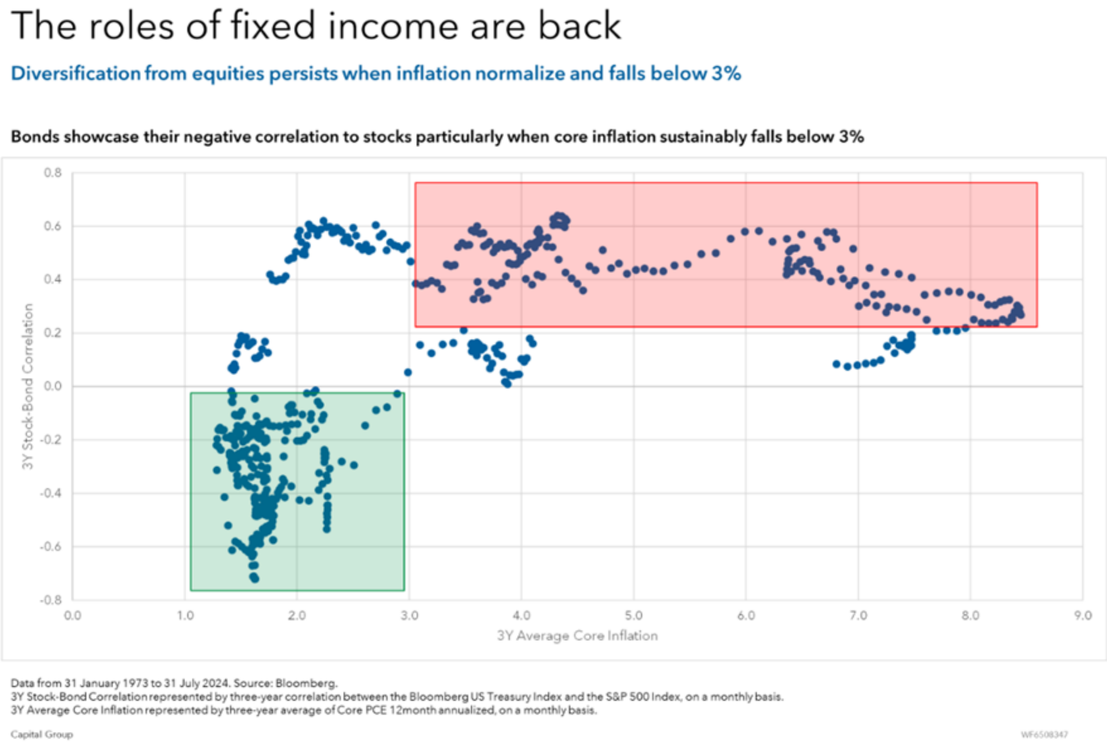
As the market narrative on risks has shifted, from concern about a potential reacceleration of inflation, toward recession concerns, we believe the negative stock-bond correlation could well persist.



Historical analysis shows that the stock-bond correlation varies over time. Typically, in periods of greater inflation uncertainty it turns positive, while in periods of growth uncertainty it is often negative.

Further, as shown in the chart below, historically when inflation falls below 3%, the correlation between bonds and equity normalises and turns negative.

The current environment of moderating inflation, along with a Fed that is primarily concerned about growth risks, suggests a higher likelihood of bonds playing that diversifying role in the future.



So, what does all this mean for investors?

Given the historical relationships between bonds and equities, and the current macro environment, investors might consider deploying cash and investing in fixed income, gradually increasing duration to benefit from the price appreciation coming from lower yields.

Inflationary concerns are today much lower and Fed rate cuts are now more certain; the question is how much rather than if the Fed is going to cut. Investors have the opportunity to take advantage of this early phase of the easing cycle by investing in fixed income securities and particularly high quality corporate bonds, which we expect to deliver high single to low double digit total returns over the next years, driven by a combination of income and price appreciation from yields dropping.

Haran Karunakaran is an Investment Director at [Capital Group (Australia)], a sponsor of Firstlinks. This article contains general information only and does not consider the circumstances of any investor. Please seek financial advice before acting on any investment as market circumstances can change.

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[1] As of 30/8/2004 in AUD hedged terms. Based on Bloomberg Global Aggregate Total Return AUD Hedged, Bloomberg Global Aggregate Corporate Total Return AUD Hedged and Bloomberg Global High Yield Total Return AUD Hedged indices respectively.
[2] Source: Bloomberg. Based on Bloomberg US Corporate Bond Index. Rate cycles captured 1988-89, 1994-95, 1999-2000, 2004-06, 2015-18.

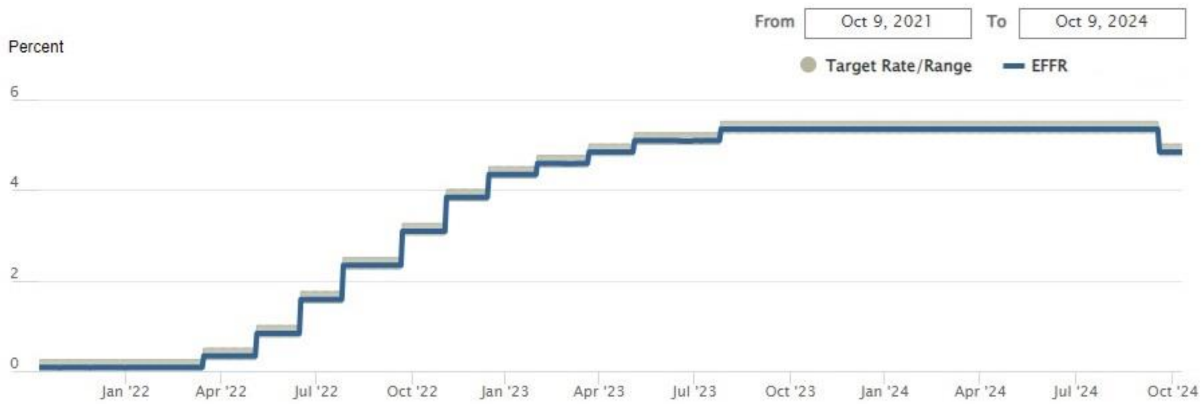
The markets to gain most from US rate cuts

Samuel Bentley, Yuan Yiu

The US Federal Reserve's (Fed) cut in interest rates last month is expected to generate a positive tailwind for emerging market (EM) equities as lower US rates and a potential US dollar weakening have historically created a favourable backdrop for riskier EM assets.

The US Fed has reduced the benchmark federal-funds rate to a range between 4.75% and 5%. While this first move is now done, the scale of more cuts remains open to debate. Still, it signals that the US Fed is winning its fight against inflation.

Effective Federal Funds Rate (EFFR)



Source: Federal Reserve Bank of New York

EM shares have climbed on optimism that their currencies will rise while the US dollar dives as capital flows out of the country. Several other factors are aligning to support EM equities. Notably, a convergence of monetary policy rates between developed and emerging markets could support EM equities as monetary policy is eased in developed nations. Indeed, over the next 12 to 18 months, EM policy rates may sit above those in developed markets, a scenario historically associated with EM equity outperformance.

Reduced uncertainty stemming from the US election cycle passing and a US Fed easing this month, which are likely to lower interest rates and weaken the US dollar. This has also been correlated with stronger performance for emerging market equities in the past, as the purchasing power of domestic currency improves and US dollar debt financing becomes relatively cheaper.

Recession risk may hold developed markets back

While volatility is expected as we head into the final quarter of 2024, EM equities could outperform US equities. We observe widening GDP growth expectations for EMs over developed markets, a trend often correlated with EM equity outperformance. Notably, developed markets (DM) face a risk of recession, especially in the US and Europe because of accumulated rate hikes.

A significant US slowdown would deprive global growth of a key 'engine'. That said, a severe contraction in the US is unlikely, given that the US has no major structural imbalances and better household balance sheets relative to other DM economies. Nevertheless, the US Fed needed to avoid being late in cutting interest rates, so the US Fed's decision this month was widely watched.

Another factor supporting EMs is increasing capital expenditure (capex). The global capex cycle has turned up since 2021 and EMs typically outperforms developed markets in a rising capex cycle due to with EM's higher exposure to commodities and manufacturing.

The strength of the US dollar has hampered this outperformance to date, but it is another supporting factor for EMs moving forward should the US dollar fall. The impact can already be seen as, for the first time in a decade, earnings in emerging markets are growing faster than developed markets – something we think is set to continue.

Historically, low investor positioning in EMs combined with attractive relative valuations has driven stronger EM performance. EM equities are trading at least one standard deviation cheaper than historical averages whereas the US is more than one standard deviation expensive.

All eyes on China and India

Looking at particular markets, idiosyncratic factors helped China and India outperform most Asian markets during the correction in August. We believe that these factors will continue to position these markets favourably during future periods of volatility.

In India, domestic flows have held sway. However, unlike other Asian markets which depend more on foreign inflows, the Indian equity market is more reliant on domestic flows, which tend to be 'stickier'. Although India is often viewed as a popular market among foreign investors, India has outperformed over recent years and now offers very few attractively valued stocks in our view.

Besides the market sell-off in August, the Indian stock market has remained resilient to two unexpected domestic shocks this year - Prime Minister Modi's smaller than expected majority in the June election and the capital gains tax increase in India's July budget.

Given the strength of its domestic inflows, it is unlikely that a US recession would derate the Indian equity market either. In addition, further US Fed cuts could potentially give the Reserve Bank of India room to bring interest rates lower if needed, without stoking volatility in the Indian rupee.

Nonetheless, a value focus should allow investors to participate in the India structural growth story while providing investors with some buffer against potential equity market falls.

Significant improvement in sentiments over China

We believe that the Chinese equity market will also be relatively resilient in the face of global volatility given its trough valuations, low exposures among institutional investors, improving fundamentals in selected key sectors and improved market sentiments triggered by government stimulus.

China still faces challenges and is currently one of the most unloved equity markets amongst investors, with global investor positioning in Chinese equities at its lowest point in 12 years. This suggests that the market has less room to fall if overall investor risk aversion rises, and room to gain in the opposite scenario.

The challenges facing the Chinese economy are well known and well discussed – a weak property market, low consumer confidence and a lack of effective stimulus from the government. We are seeing some signs of change – the Chinese central government has recently responded decisively with a coordinated suite of monetary, fiscal and regulatory measures. Whether the economy is now poised for recovery remains to be seen, but market sentiments have improved significantly.

A convergence of attractive factors

For investors keen to diversify their portfolios, a convergence of factors such as the US Fed's pivot, attractive valuations, and improving fundamentals paint a promising picture for EM equities. Further rate cuts could diminish the US dollar's appeal and drive more capital into higher-yielding emerging stocks, bonds and currencies.

Our approach to EM equities is bottom-up and valuation-driven. While risks remain, the potential for outperformance, especially in select markets like Brazil, Mexico, South Korea, China, and in select stocks in India, makes EM equities an asset class worth considering for investors seeking diversification and growth opportunities that exceed those available in developed markets.

Samuel Bentley is a client portfolio manager and Yuan Yiu Tsai is a portfolio manager at Eastspring Investments. Eastspring is a fund manager partner of GSFM, a sponsor of Firstlinks. This article is solely for information purposes and does not have any regard to the specific investment objective, financial situation and/or particular needs of any specific persons.

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