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## Editorial

Howard Marks is well known to most readers of our newsletter but to recap: he is the Co-Chairman of Oaktree Capital, an alternative asset manager with US\$193 billion in assets, and his regular memos are widely read by professional investors and average punters alike.

In his latest memo, Marks discusses his visit with clients in Australia last month and presenting his 'sea change' idea – that interest rates won't go back to the lows seen over the past decade and that portfolios will need to adjust accordingly.

Marks has been pushing this thesis for a while, so there's nothing new there. However, his presentations led to broader discussions about asset allocation, and from that he had two epiphanies on the topic.

### Rethinking the two major asset classes

Marks suggests that 'asset allocation' is a relatively new phenomenon. No-one used the term when he joined the finance industry 55 years ago, and portfolios then generally followed a standard 60% equities, 40% bonds split. For US investors, that meant simply allocating to US stocks and bonds.

Now, investors have far more choices. In the types of assets they can invest in - debt, real assets, venture capital, private assets and so forth. In the countries that they can put money into – developed markets versus emerging, home versus abroad etc. And in the ways that they can try to increase returns - including levered strategies and putting more into 'high beta' assets.

What struck Marks in Australia though was that despite all the choices, there are essentially only two asset classes: ownership and debt. By this he means that if you want to participate financially in a business, the choice is between a) owning part of it, or b) making a loan to it.

You may think that these two choices are just between stocks and bonds. They're more than that. Ownership assets can include common stocks, whole companies, real estate, private equity, and real assets, while debt can include bonds, loans mortgage-backed securities, and other streams of promised payments.

Marks says ownership and lending have fundamentally different characteristics.

Owners put their money at risk with no promise of a return. They buy a piece of a business or asset and are entitled to a proportional share of any profit or cashflow made. Ownership assets typically have a higher expected return, greater upside potential, and greater downside risk.

Lenders, on the other hand, provide funds to help owners purchase or operate businesses or other assets and, in exchange, are promised periodic interest and the repayment of principle at the end. It's a contract between

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borrower and lender, and the resulting return for lenders is known in advance. It's called fixed income because it's a fixed outcome.

All else being equal, the expected returns from debt are lower than from ownership assets but likely fall within a tighter range. There's generally no upside on debt as you buy an 8% bond to make an 8% return. Yet, there's also minimal downside as you'll get the 8% return if the borrower pays, and most do pay.

Marks says that when building portfolios, investors have a choice of ownership assets and debt, and how much to allocate to each:

*"Which of the two is "better", ownership or debt? We can't say. In a market with any degree of efficiency – that is, rationality – it's just a tradeoff. A higher expected return with further upside potential, at the cost of greater uncertainty, volatility, and downside risk? Or a more dependable but lower expected return, entailing less upside and less downside?"*

### **The best framework for asset allocation**

The second epiphany that Marks had in Australia was about the basic characteristics of a portfolio. He says one decision matters above all else in allocating assets: the desired mix between aggression and defence or between preserving capital and growing it. Aggression is usually best played through ownership assets, while defence is better played through debt.

Marks believes that you typically can't play offence and defence at the same time; they're mostly mutually exclusive. "This is the fundamental, inescapable truth in investing", he says. And the choice you make between offence and defence will determine the risk profile of your portfolio.

When thought of this way, the goal of investors shouldn't be achieving the highest return for a portfolio, Marks thinks. Instead, it should be achieving the highest risk-adjusted return, with the right mix between offence and defence to suit your wants and needs:

*"For an investment program to be successful, the level of risk in the portfolio must be well compensated and fall within the desired range ... neither too much nor too little."*

Concluding this second epiphany, Marks says:

*"Ownership assets and debt assets should be combined to get your portfolio to the position on the risk/return continuum that's right for you. This is the most important decision in portfolio management or asset allocation."*

### **Talking his own book**

Marks also uses the opportunity to talk up one of his company's preferred sectors right now: non-investment grade credit. He suggests while the returns on offer were better a year or two ago, you can still get roughly 7% on public credit and 10% on private credit. Marks thinks these returns are competitive with the historical returns of equities, but without the risks associated with owning equities. And because of their contractual nature, the returns on credit should prove more dependable than those of ownership assets.

### **James Gruber**

#### **In this week's edition...**

In recent years, financial scams have been rife. Last year alone, there were more than 600,000 reported scams in Australia, with combined losses of \$2.74 billion. A recent ruling from the *The Australian Financial Complaints Authority* may help to bring these numbers down, **John Abernethy** writes. For the first time, a bank is being forced to [reimburse a customer](#) for the amount that they were scammed.

Most of us don't want to think about death. But there is a compelling reason why we do need to plan ahead, and that's because leaving our loved ones with a mess is not how we want them to remember us. **Kaye Fallick** looks at some of the things you can choose [to do now, financial and otherwise](#), to ensure those you care about will have the easiest possible journey at the time of your passing.

This week, it's a pleasure to welcome eminent financial journalist, **Alan Kohler**. Alan has written a new book on the property market, called *The Great Divide: Australia's housing mess and how to fix it*. In an extract from the book, he tells of how a succession of inquiries and reports haven't fixed housing's problems, and why we [need a national consensus](#) to improve housing affordability to ensure any genuine plan or policy can work.

The 'energy transition' is all the rage in investing circles, with good reason. It's a long-term theme that will impact a swathe of different sectors. **Fidelity's Oliver Hextall** says taking a 'long-term view' on the subject is a bit simplistic though and investors need to keep on top of short-term issues, especially when it comes to the supply of commodities. He looks at [recent trends in graphite and lithium](#) to amplify this point.

The 2024 Nobel Prize in Economics has been awarded to three US-based economists for their work on why nations succeed and fail. The Nobel Prize committee cited the economists' research into the advantages of democracy and the rule of law, and why they're [strong in some countries and not others](#). **John Hawkins** has more.

Over the past year, can you guess which commodity has performed best? I imagine many would suggest gold, and that would be wrong. Here's the scorecard in US dollar terms: cocoa is up 82%, coffee 57%, silver 44%, followed by gold 38%. As a larger asset class, gold rightly gets more attention and today, **Orbis' Eric Marais**, explains why it's prudent for investors to [have some exposure to gold](#).

The US elections are less than two weeks away, and the winner will have a big say on what happens in a host of different sectors. **John DiMarco** and his colleagues at **Igneo Infrastructure Partners**, investigate the possible [implications for the global energy infrastructure industry](#).

Lastly, in this week's whitepaper, **Vanguard** outlines what asset allocators are [currently buying and selling](#).

## A big win for bank customers against scammers

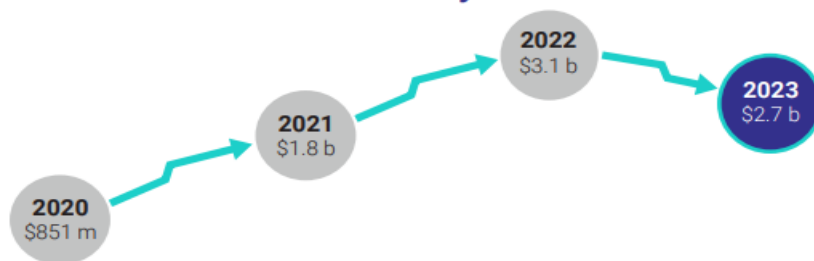
John Abernethy

It is likely that many of us have either encountered or heard of someone who has been scammed. It could be a family member or a friend, and whilst the scams do take a multitude of forms, the highest payouts would seem to occur when a trusted financial institution is impersonated. The trusted relationship – institution to client – gives a scammer an unfair advantage when they infiltrate a banking relationship. The engagement often occurs when a financial institution's phone number is 'spoofed'.

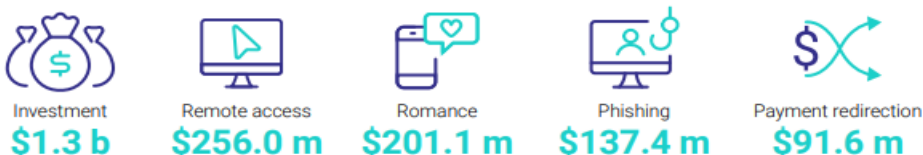
It is known (but not well reported) that organised crime groups are running increasingly sophisticated scams by imitating trusted institutions. Importantly, these scams have been easy to arrange. All Australians should be concerned that there are many loopholes that have been used by criminals to undertake these scams. Importantly, recent revelations concerning [short term visa 'money mules'](#) is disturbing.

Based on data from Scamwatch, ReportCyber, the Australian Financial Crimes Exchange, IDCARE, and the Australian Securities and Investments Commission, the combined losses reported in 2023 were \$2.74 billion (a 13% decrease in losses on 2022). However, in 2023, Australians made over 601,000 scam reports compared to the 507,000 in 2022 (an 18.5% increase in reports).

### Combined losses over last 4 years



### Top 5 scams by loss (combined data)



Source: [Report of the National Anti-Scam Centre on scams activity 2023](#)

From a livelihood and welfare perspective, a scammer can create havoc for an unwitting target. Whether the target loses their life savings, their superannuation, or a deposit for a house, the devastation is the same. Money that is scammed is stolen and lost. It can change lives unless there is recompense.

Whilst my background in investment is extensive, in banking it is both limited and historical. My first job was at the 'new' Westpac Bank in the early 1980s as a graduate trainee working in Kings Cross branch where Abe Saffron and other underworld characters were customers. Back then, the Bank of NSW was merging with the Commercial Bank of Australia to create the Western Pacific Bank (Westpac).

In this bygone era, physical deposits (cheques and cash) limited the ability to directly transfer cleared funds without extensive paperwork and phone calls. Fraud was possible but difficult to achieve. Indeed, it was easier to rob a bank than to defraud a bank customer.

But today, that is not the case. Rather than holding up a bank, the scammers (bank robbers by another name) rob the banks' customers. Further, until a recent judgement by the Australian Financial Complaints Authority (AFCA), the banks claimed that the scammed bank customer should bear the loss.

AFCA's judgement was made in [case 12-00-1016692](#) which was handed down and published on its determination's website on 22 August. There was no press release for this incredibly significant judgement that was made against the HSBC Bank. To quote the basic facts from the case:

*"This complaint is about an unauthorised transaction for \$47,178.54 (disputed transaction) from the account and who should be responsible for it.*

*On 13 June 2023, the complainant received an SMS purporting to be from the bank that:*

- appeared in a thread of legitimate text messages previously sent by the bank*
- referred to a transaction for \$740 that was being attempted by Amazon (Amazon transaction)*
- contained a 1300 phone number for the complainant to contact if he did not recognise the Amazon transaction.*

*The complainant had not made, or attempted to make, the Amazon transaction so he called the 1300 phone number in the SMS. The complainant spoke to a third party, who later was found out to be a scammer. The scammer caused the complainant to disclose two six-digit passcodes, which ultimately enabled the scammer to make the disputed transaction."*

The panel decided that the bank involved should reimburse the customer back for the amount they were scammed. The panel stated:

*"liability must be decided in accordance with the ePayments Code (Code). Under the Code, the complainant will be liable for the disputed transaction if he voluntarily disclosed the passcodes to the scammer."*

The panel made a significant point:

*"The panel is satisfied the scammer's manipulative tactics resulted in a degree of coercion that impacted the complainant's free will and choice, so the complainant felt compelled to disclose the passcodes. In forming its view, the panel has taken matters of fairness and reasonableness into account. The panel is satisfied the scammer created a sense the complainant needed to act urgently to prevent the loss of his funds, and the overall impression he was dealing with the bank, and it would therefore not be fair in all the circumstances to find the disclosure of the passcodes was voluntary."*

This decision, in favour of a customer, appears to be the first made by AFCA and despite years of denial by banks of any liability suffered by scammed customers. One wonders whether historical claims that have been rejected by banks may now be revisited.

Notably, Australia's legal protection for bank customers is a fair way behind a recent law change in the UK. From 7 October, UK banks will have to mandatorily refund bank customers who have been tricked into sending money to scammers up to 85,000 pounds (capped), in just five days. Importantly, after the refund, the paying bank could claim 50% of the payout from the bank the fraudster used to receive the money.

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## Australia's proposed new laws don't follow the UK precedent

Australia's proposed new scamming protection laws are summarised as follows:

- The claimant can seek reimbursement by making one complaint that includes several parties accused of failing to stop the scam.
- The claim could include banks, digital platform providers, direct messaging service providers, search engines and telcos; and
- AFCA (the Ombudsman) will then work out how much (what percentage) each company is responsible for reimbursing.

Notably, but not unexpectantly, Australian banks argued against the adoption of the UK scheme in Australia. Also notable is that UK bank customers are already protected by confirmation of payee technology which Australia will belatedly fully adopt in 2025. With instantaneous cash value transfers between inter bank accounts, this protection is urgently needed.

## "International Students as Money Mules" AUSTRAC and AFP – released June 2024

A [recent report](#) by Austrac also has received little publicity yet it openly outlined as to how simple it was for international crime syndicates to infiltrate the Australian banking system and therefore scam its customers.

It outlined that criminal networks launder illicit funds through the use of 'money mules', which creates distance between the networks and the crime, and helps to avoid detection by law enforcement. They often target international students and non-permanent residents, offering them a way to make money while living in Australia.

At times, mules may voluntarily aid criminal networks. For instance, they may respond to advertisements looking to purchase personal bank account details once they are no longer needed and sell their accounts to criminal groups for mule activity. However, some money mules are unaware that their actions are illegal, often believing their facilitation of funds transfers relates to legitimate employment.

The AFP, AUSTRAC and ABF have identified international students and non-permanent residents in Australia as high-risk groups who are vulnerable to being recruited as money mules.

- International students currently studying in Australia can be recruited as money mules in order to earn money while studying.
- Other money mules are sent to Australia by criminal networks and exploit student visas as a means of entering the country to conduct money mule activity, with no genuine intention of studying.

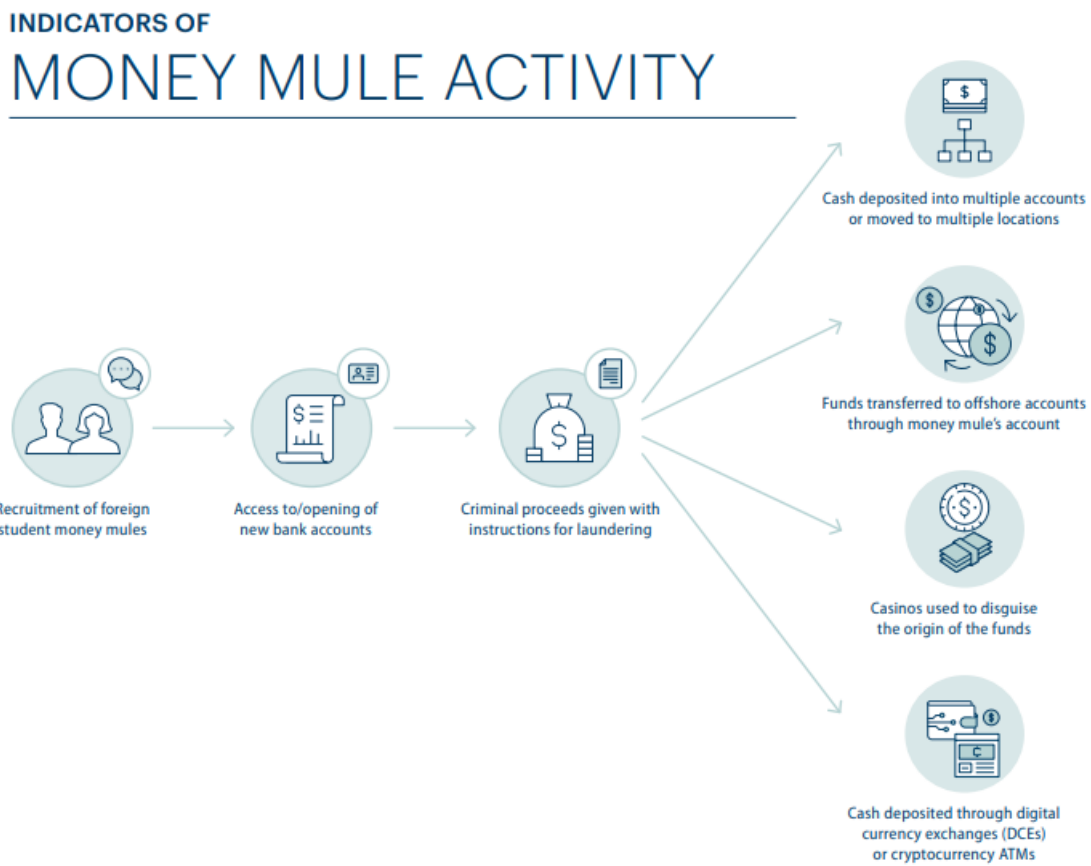
Criminal networks use a variety of means to recruit foreign student money mules through face-to-face contact or online platforms. They target both legitimate and illegitimate student visa holders and can recruit others outside of the student cohort.

Criminal networks are targeting visa holders who may be paid to buy existing account and identification details that are no longer needed by the departing individual. These accounts and identification details are then used to open additional bank accounts. Criminal networks then create new banking customer profiles and accounts across multiple financial institutions to launder illicit funds.

These accounts are critical in the placement and layering stages of the money laundering cycle and enable:

- circumventing daily banking limits of individual accounts
- increased volume of funds to be moved
- increased number of bank accounts controlled by the criminal network
- reduced know your customer (KYC) requirements for profiles that are already established.

The report produced the following chart that covered 'Money Mule' activity:



Source: [Austrac.gov.au](http://austrac.gov.au)

#### Why the secrecy – Austrac/AFP and AFCA?

I question the reasoning behind the apparent suppressing of these significant rulings (by AFCA) and scamming reports (by Austrac)? To whose benefit is it to understate the valuable background information on scamming and the regulatory decisions that may protect bank customers?

Both are significant. Australians should be made aware that international crime networks are accessing bank accounts that have been effectively transferred to their control by short-term visa holders to Australia. The simplicity of the arrangements is staggering and exhibit a lack of diligence by both our banks and regulators. Surely, Australia's banking regulations should critically control the extent to which non-citizens can utilise and access bank accounts.

It is also significant to the thousands who have been scammed and have or are seeking compensation from their bank, that AFCA has ruled and determined in favour of an aggrieved customer and against a licensed bank. The granting of full compensation for loss, when a customer was scammed through intimidation into disclosing sensitive personal banking information, is groundbreaking.

Let's be clear regarding the banking system and the activities of scammers. The ability to circumvent the identity laws for operating a bank account, allows criminals to transfer money from an intimidated customer's bank account to another bank account, and straight out of the country where it can't be retrieved.

#### Why do Privacy laws protect criminal activity?

Claimants when chasing recovery of their money, rightfully seek the help of the banks that were used by criminals to receive their funds as part of the scam. However, Banks have aggressively used privacy laws to push back against investigation by claimants. They have claimed that they cannot release bank account information even if a fraud has clearly taken place.

Think about the scamming transaction - for a customer of Bank 'A' to be swiftly scammed requires an illegal account (a recipient account) to be held at Bank 'B'. Once received, the account at Bank 'B' is immediately accessed to sweep the money out of the country - in a matter of minutes!

Could it be that the whole banking industry uses the claim of client 'privacy' as another way of stalling recompense? Whilst the criminal's name is not on the account, the person (short-term visa holder) who transferred their account is. They should also be held to account.

Is it possible that Bank 'A' does not chase Bank 'B' because invariably the same scam will happen in reverse in due course. A sort of "Gentleman's Agreement"?

Therefore, if it is now the case that Bank 'A' is held to be liable to its aggrieved customer then they will surely claim against Bank 'B'. That is why the recent AFCA ruling is so important and anyone whose claim for compensation was rejected by a bank in the past should be encouraged to revisit their claim.

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

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## The gentle art of death cleaning

Kaye Fallick

Most of us are really squeamish about the word 'death' – we run a mile from it. Similarly with the term 'funeral' – it's difficult to bring ourselves to read articles about planning for our own demise. We're more interested in living, than dying, right?

But there is a compelling reason why we do need to think ahead and plan.

And that's because most of us would walk over burning coals for our loved ones – so leaving them with a mess is not how we want them to remember us.

That may be a reason for the increasing popularity of TV shows such as *The Gentle Art of Swedish Death Cleaning*. While this program concentrates more on the emotional and clutter clearing aspect of leaving things in good order, it does prime your mind about your legacy, be it material, financial or spiritual.

### First things first

The main message is 'Don't leave a mess', whatever shape this might take. There are three main types of mess and they fit into the parameters mentioned above:

- Material – meaning your home, your possessions, your 'stuff'
- Financial – your savings, your super, your property and any other investments, debts or obligations.
- Spiritual – your emotional legacy, the status of your relationships, your family ties and responsibilities, perhaps your faith.

Let's tackle them in order of importance, starting with the spiritual.

### How you will be remembered

Money matters a lot, but how we behave and how we are remembered is the true definition of our time on earth. If we are lucky, we have loving friends and family and good ties to our community, be it local, global or both. But most of us will also have some unresolved matters and some fractured relationships. That's life. But we don't have to think that things can never be fixed, or at least acknowledged. Far too often we attend a funeral and learn things about someone who we thought we knew well. Sometimes we carry regrets about things we didn't say or do. Sometimes families experience deep rifts which cause hurt and sadness for decades. It's a truism, but the only person who can address your issues is you. It's very sad if we miss opportunities to be honest and to set things right.

### There's no need for a legal or financial mess

Apart from creating a future legal or administrative nuisance, leaving unsorted financials is extremely unfair to your nearest and dearest. Many people still do not have a will. There is actually no excuse for this as there are inexpensive options for those with simple affairs and those with more complex situations will need some form of legal input regardless. It all comes back to a clear definition of your assets and your intentions. This applies to:

- your home and any other property
- your superannuation
- your savings and investments
- any business relationships
- your Power of Attorney and
- your advance health directives

There is a lot to understand and to think about here. In Noel Whittaker's excellent book, [Wills, death and taxes made simple](#), he explains all these factors clearly. There are few shortcuts here – you really do need to think about who your beneficiaries will be and how your assets will be divided. In particular, having a Binding Death benefit Nomination for your super means there will be no confusion about how this will be handled by a trustee. And understanding [Centrelink rules when someone dies](#) means that you can ensure you have done all you can to smooth the way for a spouse. For couples, having a separate bank account is a helpful way to ensure you retain access to funds for daily living expenses without interruption.

### **Your home and possessions**

This is the tricky part. One man's (or woman's) treasure is often another's trash. We can become highly emotional when it comes to our possessions. Ask any downsizer. The common experience is that they cannot believe how much unwanted stuff they were able to gift, sell or discard when they had to make hard decisions when moving to a new residence. If you *are* a hoarder, the question to ask yourself is whether you really want your loved ones to reel back in horror when they need to handle the sale of your home or the sorting of possessions in a rental situation. Some people are psychologically unable to throw anything out – true hoarding is a recognised mental illness. Such people may need some medical support. But this is relatively rare – about 2.6% of the population. The rest of us can just be lazy or complacent and simply watch the slow build-up of unneeded possessions for years, as there is no compelling reason to shift this stuff. If you are in this group, then taking action while you are still fit and able makes a lot of sense. How many Tupperware containers without lids can any house need? So why not inspire yourself by watching [The Gentle Art of Swedish Death Cleaning](#) on SBS on Demand, reading the book *The Life-Changing Magic of Tidying Up* by Marie Kondo or by asking a friend to help. Your local op-shop will love you, but your family will love you more. And somewhat perversely, you'll feel kilos lighter even though it's not body weight that you've shed.

### **And one more thing ...**

It's time to talk about your online presence, or 'digital assets' as they are sometimes called. There is nothing worse than having a haunting presence on Facebook or Instagram long after you've gone. It's actually quite stressful for those who love you if you pop up unexpectedly in their socials. You can handle this in a couple of different ways. You can appoint a 'digital executor', entrust them with your login and password details, and ask them to close or delete all relevant accounts. Or you can share a list of all these details with family and friends and again, leave instructions so that someone manages matters according to your wishes. Some families will choose to keep you 'alive' online – it's entirely personal.

There, now, we've done it! We've had a straightforward discussion about your death and some of the things you can choose to do *now* to ensure those you care about will have the easiest possible journey at the time of your passing.

### **Are you actively putting things in place for your nearest and dearest?**

Or is it something you are 'getting around to' at some stage?

### **Helpful resources**

Noel Whittaker has created an [Executor's and Attorney's Cheat Sheet](#) which is a comprehensive downloadable PDF allowing you to share all necessary information with those who matter to you. It's free and a brilliant way of summarising your assets, wishes and other important details.

Centrelink also provides [support and services when someone dies](#).

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## Why has nothing worked to fix Australia's housing mess?

Alan Kohler

[This is an extract from Alan Kohler's new book, [The Great Divide: Australia's housing mess and how to fix it](#)]

Why has a succession of inquiries and reports, along with a museum full of academic papers and journalism on the subject, never led to serious, effective action to improve housing affordability?

In my view it's because all the work has been both aimless and unsupported by a national consensus. Solutions by the dozen have been proposed to increase the supply of dwellings through better zoning and planning and/or to reduce demand, usually by knocking off one or more tax breaks. But what's the aim, exactly? And more importantly, what's the real national mood, and therefore the politics?

The politics of it is both simple and difficult: housing is a cartel of the majority, with banks and developers helping them maintain high house prices with the political class actively supporting them.

Everybody involved in this game – homeowners, banks, property developers and state and federal politicians – wants house prices to rise for their own reasons. Renters don't stand a chance.

Australia's 27 million people live in 10.8 million dwellings, of which 65% are owned and 35% are rented. That is the lowest rate of home ownership in twenty years, but it's still a big majority. Two-thirds of the population is therefore in favour of restricting the supply of houses to maintain the value of their own and they are supported in that by banks and developers.

Banks make more profit as higher house prices increase their assets and interest income, developers make more money if the price of their product is high, state governments make more stamp duty, and greater wealth supports the national economy and keeps federal politicians in power.

It means that any genuine attempt to deal with housing affordability and the shortage of rental accommodation would have to contradict the interests of both the majority of citizens and those with the most power. There is lip service paid to the problem of affordability and 'promises' to build a certain number of houses to ease it, but these are usually not fulfilled, and are never actual promises to build anything, just aspirational forecasts – like the latest one from the Albanese government to 'build' 1.2 million houses over five years.

I'll get to that in a moment, but first, if there is ever going to be a housing policy that means anything, it needs to have an explicit aim. All the work on this subject, including the latest project initiated by Julie Collins and now led by Clare O'Neil, is like a journey with no destination. What are we trying to achieve? And does anyone who matters really want to achieve it?

In my view, the aim should be simple and easily stated and understood and should refer to the problem ... that the price of housing is now twice the multiple of income it used to be. It was three to four times average weekly earnings, now it's seven to eight times. Any serious effort to deal with housing affordability should be explicitly aimed at getting that ratio down and keeping it there.

Expressing that as the aim of policy and then providing leadership towards a national consensus around it must be the start of any genuine plan. Any government policy also needs to acknowledge that the two most important factors in housing affordability have little to do with housing and won't ever be part of any housing policy: interest rates and bank regulation.

Only two things have ever resulted in a (temporary) improvement in housing affordability: higher interest rates and, in 2016–17, a crackdown on bank lending to real estate investors. But neither of those things was aimed at improving the affordability of housing; interest rates rise and fall according to what the Reserve Bank thinks the economy needs, and the Australian Prudential Regulatory Authority is concerned with the stability of the financial system. Neither has a mandate to do anything about the price of houses and their actions won't be influenced by any government policy designed to improve housing affordability.

But perhaps there's an even more fundamental bridge that needs to be crossed before we look at solutions: is the big rise in house prices since 2000 good or bad? Economists refer approvingly to a "wealth effect," and Australia has had that in spades: per capita wealth has increased fivefold in thirty years. Whenever the ABS releases the latest survey of wealth, I get reports from economists writing that it's a very good thing. The economy has got stronger due to the increase in wealth, and the majority of Australians are happier.

The value of other assets – shares, infrastructure and commercial property – has also been increasing more rapidly than incomes, but that is unequivocally a good thing, except when it gets out of control and turns into a bubble that bursts. Superannuation accounts, mostly without residential property, have been increasing at a clip of about 9% per annum, about three times the rate of wage growth, and any fund that only manages to return the rate of wage growth is likely to go out of business.

The difference with housing, of course, is that it's also where you live, and as a result there are losers as well as winners with high and rising prices. And while the winners outnumber the losers two to one, and in a democracy that would normally be the end of the matter, sometimes the right thing for a society isn't necessarily what the majority wants. Many people, myself included, used to enjoy smoking, but governments decided it was bad for society and worked on cutting it back through advertising bans, labelling and taxes.

Half of Australia's homeowners are locked in a wealth-creation partnership with a bank. Real estate is such an effective accumulator of wealth because you can borrow at least 80% of the value, often more, and the leverage means that every dollar you invest is multiplied fivefold when the price increases. That's usually a risky, speculative thing to do in investing, but with real estate it's safe because there aren't 50% crashes in residential property as there are on the share market about every ten years, or not for 130 years anyway, so banks are happy to lend much more than they are with shares. And bank executives build their wealth alongside their customers; they are not only very keen to lend against housing but also keen to make sure that house prices keep rising.

It's not just the house-owning majority who think about housing as wealth-creation as well as, or even instead of, shelter – everybody regards housing as an appreciating asset. Renters talk about getting on the 'property ladder'; they'd prefer it to be easier to get on, but they want it to be a ladder once they're on it. We're all so used to house prices always rising that it's hard to imagine life any other way.

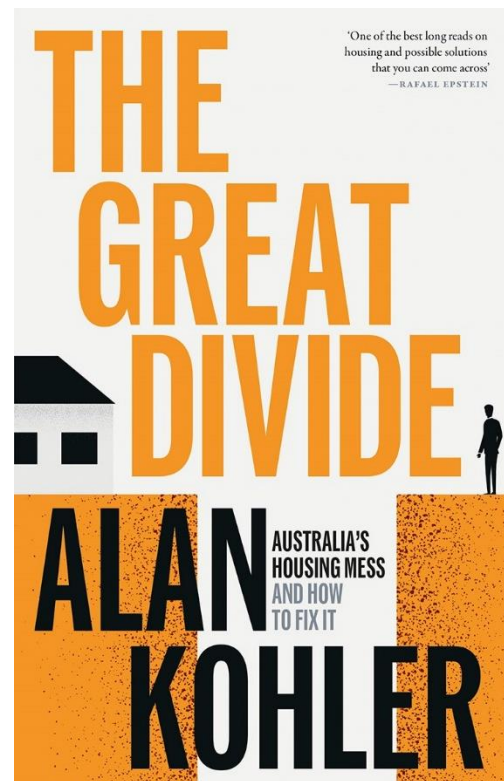
And the biggest tax dodge of all, of course, is that if you live in the house there is no capital gains tax at all. I know families that have grown their wealth by moving every two to five years, buying, renovating and selling for a tax-free capital gain. Tough on the kids and their schooling, but it works a treat!

So the number one blockage to dealing with housing affordability is that there is no consensus that there is a problem at all, let alone how to fix it. Academics, economists and journalists all say it's a crisis, and millennial renters complain bitterly because they cannot buy a house, but the majority of home-owning Australians are happy to shut up and keep growing their wealth – and banks, developers and governments are all happy to make sure it happens.

My view, and the basis of this book, is that there definitely is a problem and that the high price of housing is undermining social cohesion and the proper functioning of the economy and the nation. The doubling of house prices in relation to incomes has distorted Australian society over the past twenty-five years and focused wealth creation on an unproductive asset. Something must be done about it even though most people may not like it.

Moreover, there is no point making a small change, say by trying to keep the housing-to-income ratio where it is, or down from the current seven to eight times average weekly earnings to six to seven times, or even five to six times. To achieve anything in life you have to aim high. If there is to be a genuine effort to improve housing affordability, the aim must be to return the ratio to three to four times average weekly earnings, as it was twenty-five years ago.

The latest national median house price is \$740,668. The current average full-time adult wage is \$1,907.20 per week, or \$99,174.40 a year – call it \$100,000. For the house price-to-income ratio to be what it was twenty-five years ago, the national median price would have to halve, to \$370,000. But that's not going to happen, of course, and it wouldn't be a good idea even if it could. Even if the government could pull that off, which it couldn't, there'd be a riot and, as there was in the United States in 2007/08, an economic collapse.



More realistically, house prices need to stay put for a while and allow incomes to catch up. Average weekly earnings are currently rising at about 4% a year. For the national median house price of \$740,668 to be 3.5 times income, the average wage would have to be \$210,000, more than double what it is now. At 4% growth in incomes per year, that would take about eighteen years.

The only time house prices remained unchanged for that long was from 1930 to 1949 – that is, during the Great Depression and the period of price controls in the war. Even after the recessions of 1982 and 1991, it took less than half that long for prices to start rising again.

So 15-20 years of static house prices would be unprecedented, but that sort of time frame might also get Australians out of the habit of thinking that house prices always rise and that housing is the best way to build wealth. And if housing affordability is to be properly dealt with, we have to change that mindset, because house prices won't stop rising at twice the rate of incomes unless we stop expecting them to.

If the government were serious about housing affordability, it would announce an affordability target like the one that I am suggesting, of something like three to four times average incomes, and would say: "We're going to achieve that target by doing everything we can to ensure that house prices stay where they are for eighteen years, to allow incomes to catch up."

So how would that be done? It's easy: by ensuring that there was enough supply to meet demand, and since it's probably working against two enormously powerful forces that are doing their own thing – monetary policy and bank marketing – that means both sides of the equation, demand and supply, must be pressed into service ... And every tool in the shed must be put to work.

*This is an extract from Alan Kohler's new book, [The Great Divide: Australia's housing mess and how to fix it](#). Alan Kohler AM is the Founder of [Eureka Report](#), finance guy on the [ABC news](#) and columnist for [The New Daily](#).*

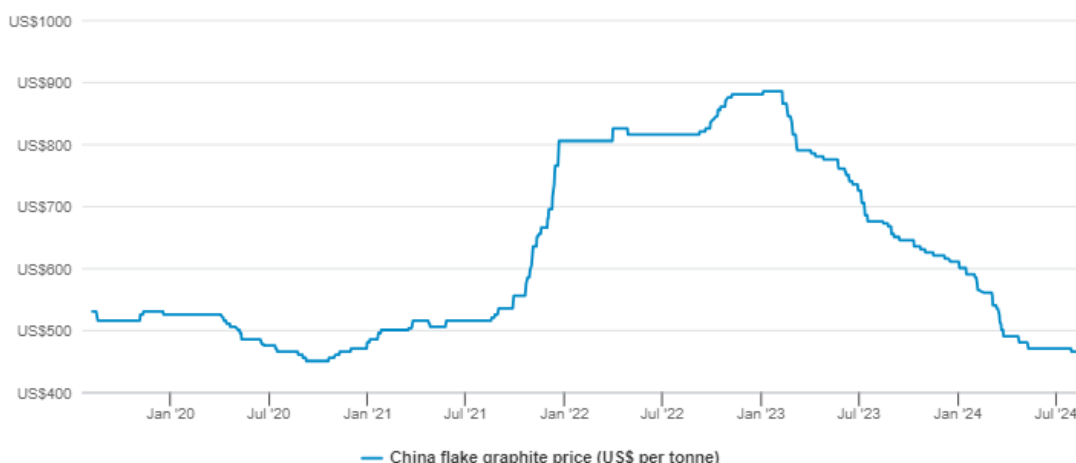
## How to find big winners in the energy transition

Oliver Hextall

The received wisdom that investors should "take a long-term view" is as well-worn as it is simplistic. Because while the long run certainly matters, when it comes to investing in transition materials there's also a strong case to make for a bit of constructive myopia. By that we mean keeping a very close eye on the near term – staying on top of both commodity market fundamentals and those of the producers in each market – and not being so focused on a good growth story that it leads to expensive decisions. Demand is important but the ability of new supply to meet that demand is often neglected and is just as important – if not more so.

Graphite is a good example. The mineral has a tremendous long-term clean energy story thanks to its role in the batteries that power electric vehicles. But if you'd invested in a graphite producer a year ago you would have lost money.

**Chart 1: Graphite: What goes up...**



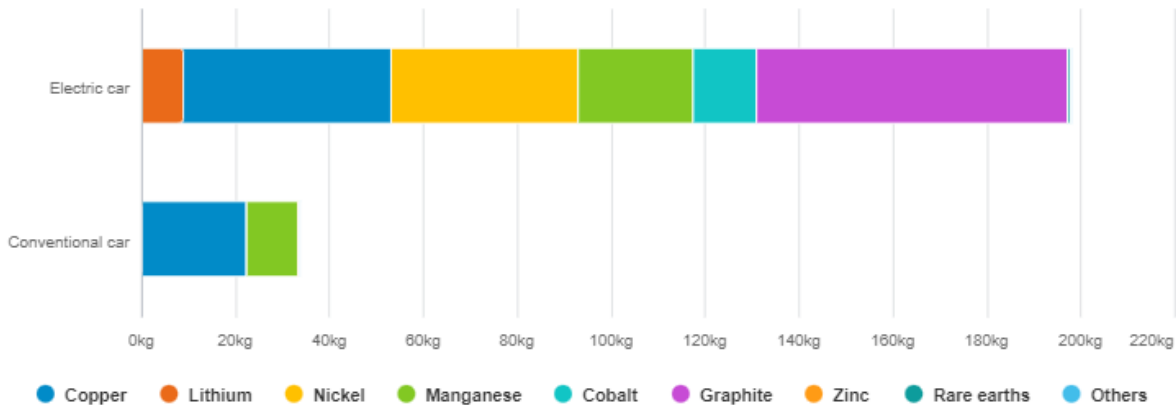
Source: Bloomberg, Fidelity International, August 2024.

Timing clearly matters, and there's a balancing act to perform between short- and long-term dynamics. Commodities are a bottleneck in the clean energy transition. From copper to agriculture, decarbonisation-driven demand is hitting supply networks that aren't always set up to meet it. That triggers a response. As supply of, say, copper struggles to keep up with demand, there's an increased incentive to swap to other materials, to supply more scrap copper, and to use the metal more efficiently.

What incentivises all these behaviours is a higher copper price, and there's an obvious way to profit from that if you can spot the bottlenecks as they emerge.

**Chart 2a: The many ingredients of the energy transition (transport)**

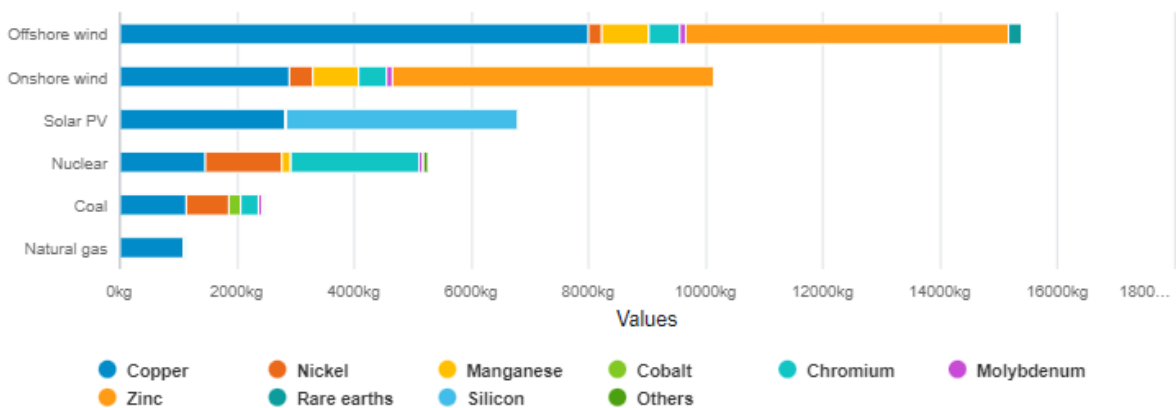
Minerals used in selected clean energy technologies relative to comparable traditional technologies (kg/vehicle)



Source: IEA, 'The Role of Critical Minerals in Clean Energy Transitions', Fidelity International, March 2022. Notes kg = kilogram. Steel and aluminium not included.

**Chart 2b: The many ingredients of the energy transition (energy)**

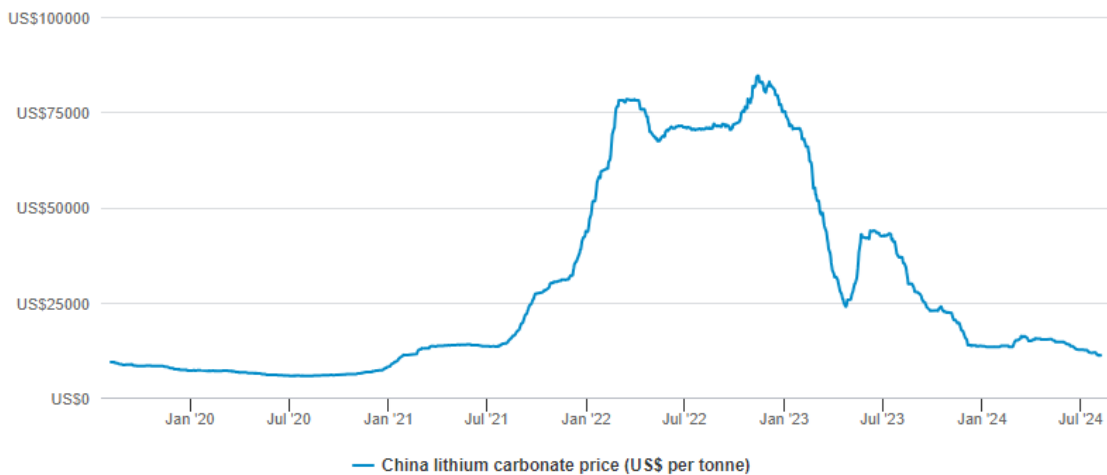
Minerals used in selected clean energy technologies relative to comparable traditional technologies (kg/MW)



Source: IEA, 'The Role of Critical Minerals in Clean Energy Transitions', Fidelity International, March 2022. Notes kg = kilogram, MW = megawatt. Steel and aluminium not included.

But that's only part of the story. The more a commodity's supply is capital constrained – as opposed to resource constrained – the greater the ability to respond quickly to surging demand by boosting supply, and so the less likely those bottlenecks will persist. Take lithium, where a huge shortage in the early part of this decade was followed by a big run-up in price. Lithium, however, is in fact relatively abundant. So, predominantly Chinese producers responded to the higher price and ramped up supply, driving the price back down again, to a level we think is too low to support the investment economics of Western producers – which, in turn, is laying the ground for the next up-cycle.

**Chart 3: lithium pricing has been a rollercoaster**



Source: Bloomberg, Fidelity International, August 2024.

### Take a broad view

Graphite and lithium highlight why commodity choice matters. At least half the work our team does is top-down, identifying which commodity markets look most promising near-term. We try to take a broad view and consider potential ripple effects. Copper, for example, is widely considered a transition material, but fewer investors take the same view of aluminium. Yet the International Energy Agency has reported that a third of projected growth in copper demand arising from expanding electricity grids could be met by aluminium.

The supply chain for renewable diesel and sustainable aviation fuel shows some similar dynamics. Low carbon feedstocks, such as fats and used cooking oil, have a structural advantage under the Inflation Reduction Act in the US and we think these feedstocks will remain scarce. What was once a waste product will, we think, be increasingly valuable over time. The oil used to fry your chips in McDonald's one day will potentially be flying you on your summer holidays.

Ammonia too is a commodity we think has an interesting future. The current ammonia market centres around its use as a fertiliser. But it can also be used as a fuel, including for shipping, a sector that faces almighty challenges in its attempts to reduce emissions. As a compound of nitrogen and hydrogen, ammonia is useful for the transportation of green fuel (cheaper and safer than moving pure hydrogen around) and could be used to reduce emissions in a number of high-carbon industries. These use cases potentially give ammonia a big role in the clean energy transition that could double the commodity's overall market over the next 10 to 15 years.

### Commodity prices: reliably unreliable

Of course, all the analysis in the world won't guarantee getting the commodity story right every time. These are, after all, famously volatile markets and a focus on the top down doesn't mean you can neglect the micro. You need a margin for error.

This is where company analysis comes in, including a consideration of sustainability. A focus on low-cost makes sense because what you want is a stock that can sit tight when its sector is under pressure and still generate cash at the bottom of the cycle. It means you can be confident that its share count is likely to be the same when things pick up because it hasn't needed to issue new shares to raise capital. It's about finding that happy medium between growth and free cash flow producing assets.

### A word on political (and geopolitical) risk

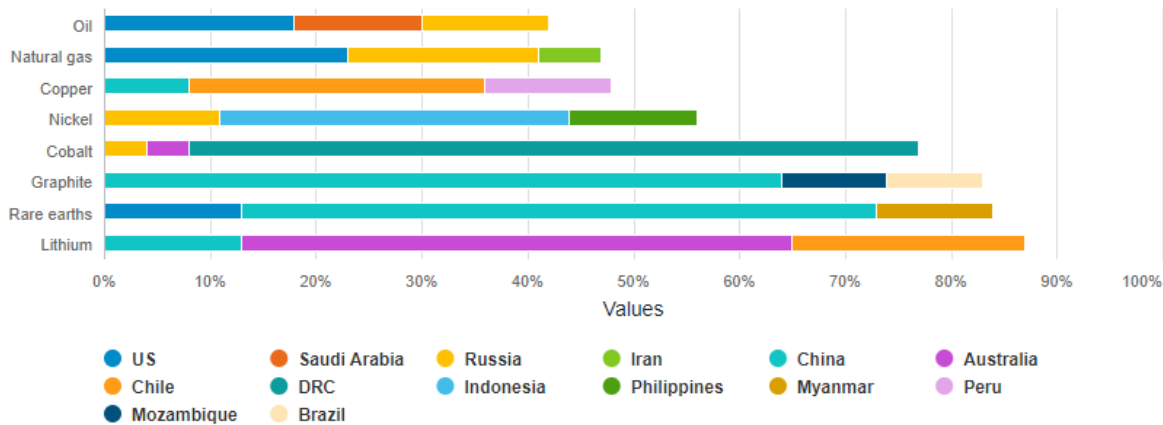
That brings us to a topic that's hard to avoid when investing in producers of transition materials: political risk. Our somewhat idiosyncratic view on the subject is that we would rather make cash flows through the cycle from high-quality assets in more risky spots than guarantee low-risk sub-par returns in so-called 'safer' regions. Because political risk is not static. Chile, for example, has in the last few years gone from being a low-risk jurisdiction to briefly being a high-risk one, and back again. And in 2022, Australian authorities in supposedly safe Queensland saw no issue with imposing a very punitive royalty on mining companies' metallurgical coal revenues.

Political risk is unavoidable and is something we have to manage. It helps to start with solid cash flows from a low-cost asset and then manage that risk, rather than needing the commodity to do you some big favours.

Geopolitical risk, on the other hand, has a direct bearing on commodity cycles and future price formation. While China has a moderate endowment of critical minerals that will play a big role in the energy transition, it dominates processing. Moreover, at a time when Western companies have pulled back from allocating capital, Chinese state-owned enterprises have forged ahead with mining investments all over the world. Nickel, for example, is largely produced in Indonesia but a significant part of that production is Chinese-owned and almost all of the growth projects have Chinese partners.

**Chart 4a: Who controls production – extraction**

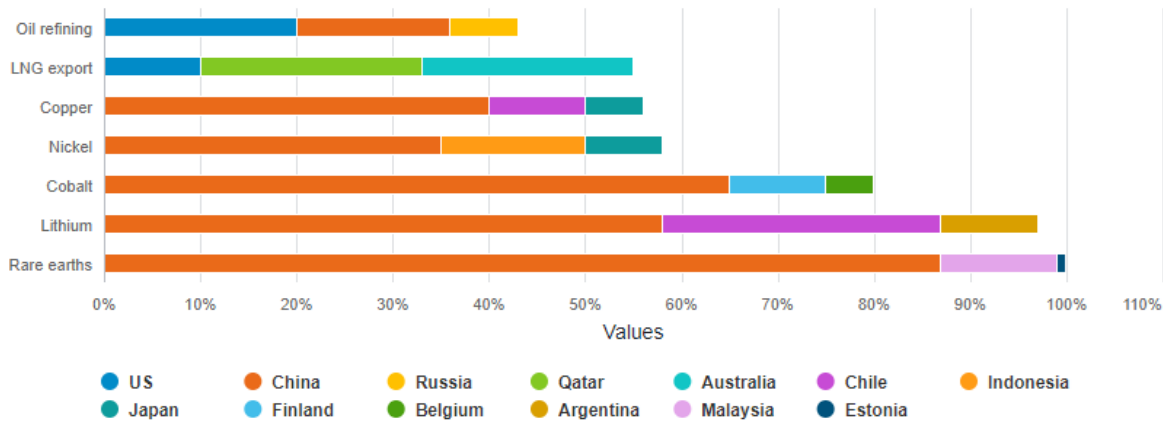
Share of top three producing countries in extraction of selected minerals and fossil fuels, 2019



Source: IEA (2020), USGS (2021), World Bureau of Metal Statistics (2020), Adamas Intelligence (2020), Fidelity International, September 2024.

**Chart 4b: Who controls production (processing)**

Share of top three producing countries in processing of selected minerals and fossil fuels, 2019



Source: IEA (2020), USGS (2021), World Bureau of Metal Statistics (2020), Adamas Intelligence (2020), Fidelity International, September 2024.

The upshot is that Chinese investment in critical mineral production is keeping a lid on prices, which in turn makes it difficult for Western producers to invest at these levels. If certain countries want China-free supply chains of critical minerals, it will require the incentive of higher prices for producers. In practice, this is likely to mean some commodities having an international price that is higher than the Chinese price, as has happened to a degree in polysilicon.

This sort of dual pricing will need to become more widespread if Western producers are to feel confident that they can make profitable investments in growing the supply of transition-critical commodities. There is a clear strategic angle to this, and we’re watching closely how governments might try to incentivise producers.

## Top-down and bottom-up: both matter

Investing in the energy transition is a long-term play, one that requires expertise in commodity markets and the companies that operate in them. In practice, that means not just making bets on which commodities will win big 'eventually'. Because to benefit from the long-term macro trends, it's essential to stay on top of the micro details and understand each producer's business, as it is today.

*Oliver Hextall is a Portfolio Manager of the Fidelity Global Demographics Fund. [Fidelity International](#) is a sponsor of Firstlinks. The views are his own. This document is issued by FIL Responsible Entity (Australia) Limited ABN 33 148 059 009, AFSL 409340 ('Fidelity Australia'), a member of the FIL Limited group of companies commonly known as Fidelity International. This document is intended as general information only. You should consider the relevant Product Disclosure Statement available on our website [www.fidelity.com.au](http://www.fidelity.com.au).*

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## A Nobel Prize for work on why nations succeed and fail

John Hawkins

The 2024 [Nobel Prize in Economics](#) has been awarded to three US-based economists who examined the advantages of democracy and the rule of law, and why they are strong in some countries and not others.

[Daron Acemoglu](#) is a Turkish-American economist at the Massachusetts Institute of Technology, [Simon Johnson](#) is a British economist at the Massachusetts Institute of Technology and [James Robinson](#) is a British-American economist at the University of Chicago.

The citation awards the prize "for studies of how institutions are formed and affect prosperity", making it an award for research into politics and sociology as much as economics.

At a time when democracy appears to be [losing support](#), the Nobel committee has rewarded work that demonstrates that, on average, [democratic countries](#) governed by [the rule of law](#) have wealthier citizens.

The committee says the richest 20% of the world's countries are now around 30 times richer than the poorest 20%. Moreover, the income gap is persistent; although the poorest countries have become richer, they are not catching up with the most prosperous.

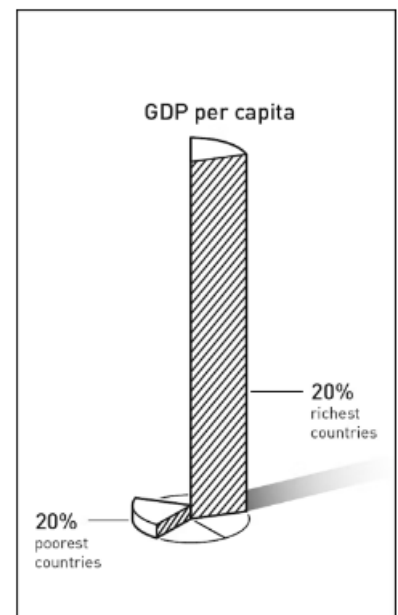
Acemoglu, Johnson and Robinson have connected this difference to differences in institutions, and they find this derives from differences in the behaviour of European colonisers in different parts of the world centuries ago.

The denser the indigenous population, the greater the resistance that could be expected and the fewer European settlers moved there. On the other hand, the large indigenous population – once defeated – offered lucrative opportunities for cheap labour.

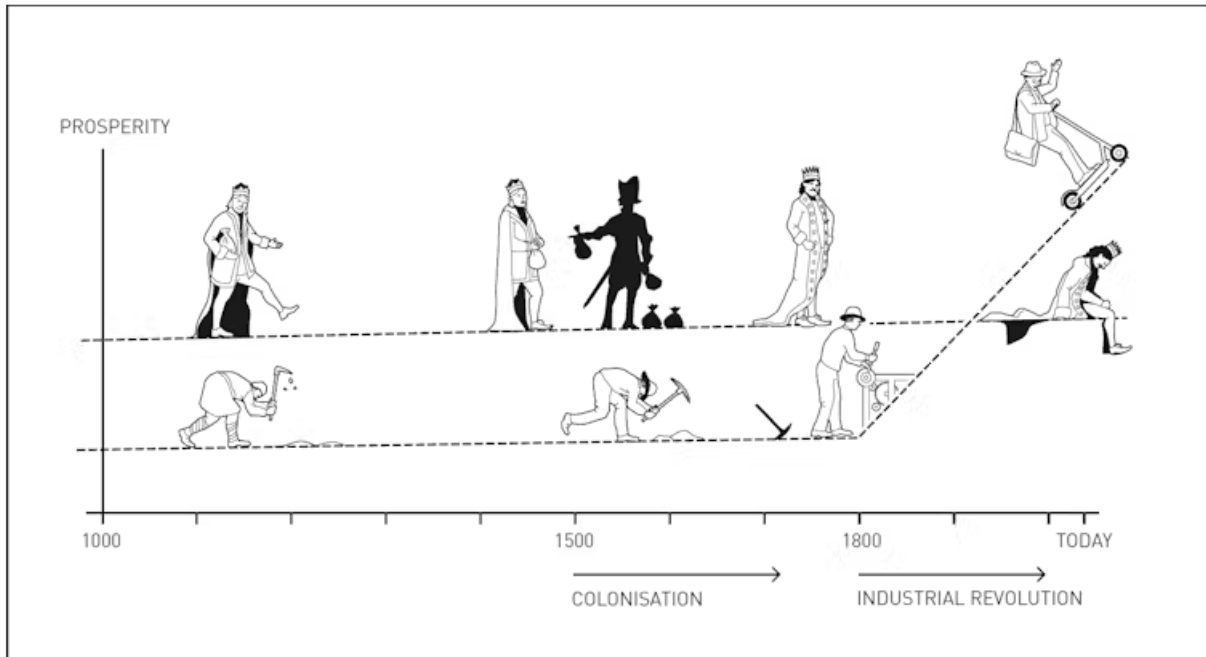
This meant the institutions focused on benefiting a small elite at the expense of the wider population. There were no elections and limited political rights.

In the places that were more sparsely populated and offered less resistance, more colonisers settled and established inclusive institutions that incentivised hard work and led to demands for political rights.

The committee says, paradoxically, this means the parts of the colonised world that were the most prosperous around 500 years ago are now relatively poor. Prosperity was greater in Mexico under the Aztecs than it was at the same time in the part of North America that is now called Canada and the United States.



Johan Jamestad/Nobel Prize Outreach



Johan Jarnestad/Nobel Prize Outreach

More so than in previous years, this year's winners have written for the public as well as the profession. Acemoglu and Robinson are probably best known for their 2013 best-seller [Why Nations Fail: The Origins of Power, Prosperity and Poverty](#). (It has pictures and no equations.)

Last year Acemoglu and Johnson published [Power and Progress: Our Thousand-Year Struggle Over Technology and Prosperity](#).

In May this year Acemoglu wrote about [artificial intelligence](#), putting forward the controversial position that its effects on productivity would be "nontrivial but modest", which is another way of saying "tiny". Its effect on wellbeing might be even smaller and it was unlikely to reduce inequality.

This year's award makes the cohort of Nobel winners a little less US-dominated.

Although all three are currently working at American universities, Acemoglu is from Turkey and the others are British. There is even an Australian link. Robinson [taught economics](#) at The University of Melbourne between 1992 and 1995.

Winning the prize is life-changing for more reasons than the 11 million Swedish kroner (about \$A 1.5 million) the winners share. As Nobel winners, they will have a higher profile. Their opinions will be accorded more respect by most but not all.

Sixteen former winners recently [issued a widely reported statement](#) saying they were "deeply concerned about the risks of a second Trump administration for the US economy". Rather than address their arguments, the Trump campaign called them "[worthless out-of-touch Nobel prize winners](#)".

The new winners might get the same treatment. [Johnson](#) has critiqued Trump's proposal to raise tariffs. Acemoglu has called Trump "[a threat to democracy](#)".

[John Hawkins](#), Senior Lecturer, Canberra School of Politics, Economics and Society, [University of Canberra](#).

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## Gold: trustless, rustless, shiny, and tiny

Eric Marais

As the price of gold continues to reach lofty heights, it might be surprising that it has any kind of place in a contrarian investment portfolio. Yet gold-related securities are among the top holdings in our multi-asset Global Real Return Fund. How do we, as bottom-up investors focused on in-depth company research, think about an asset which produces no cash flows? There are two ways we look at it: from a supply-demand standpoint, and versus currencies. Both are informed by gold's key characteristics: gold is trustless, rustless, shiny, and tiny.

### Supply-demand dynamics

We like to view gold from a supply-demand standpoint, as we do for the price of any asset. Here, gold has two qualities that make it different from copper, iron ore, or lithium. The first is that it's rustless. It doesn't degrade over time, so all of the world's gold is still in existence and theoretically available for sale. This means supply and demand is not purely a matter of mines versus consumers. Second, gold is shiny. Its primary function is not as an input to other products, but as jewellery or a store of value. To those like Warren Buffett who call it a valueless pet rock, you have to ask those folks how much they'd pay for a Rolex watch, a Birkin bag, or for a younger crowd, a rare digital outfit on Fortnite. The value of anything is whatever someone else is willing to pay for it. In this regard, gold has been viewed for millennia as the best store of value available to most people. Being rustless and shiny makes gold a really nice pet rock to have around your finger or hidden away for a rainy day.

On the supply side, gold is tiny—that is, it is rare to find in the ground, and getting rarer. The supply of new gold has been slowly dropping over recent decades. Unlike something like lithium, humans have been scouring for gold for centuries, and the most bountiful deposits have been exhausted. Aggregate mine quality has been dropping for a very long time. This translates into higher and higher mining costs, especially with lower ore grade being met by higher labour and energy costs, plus increasing environmental expenses. Miners require a higher price to justify their higher costs.

On the demand side of the equation, while jewellery demand has been fairly constant, gold has long been the first step in the wealth accumulation process for much of the world. As the emerging world has been growing a middle class, demand for gold has accelerated in recent years. That has been boosted by gold's fourth quality: it is trustless. Gold is not anyone else's liability, and that becomes more valuable as trust becomes more scarce. Coincident with the acceleration of populism and a re-bifurcation of the world into East vs West, both nations and individuals feel less trusting. On top of that, the US has weaponised the dollar system against its adversaries, cutting them off from SWIFT payments and freezing their central bank reserves. Unsurprisingly, central banks for adversaries and non-adversaries alike are buying gold, and we expect that to continue. Gold's trustless quality is becoming more valuable as trust in the US dollar system wanes.

So, from a strictly supply-demand standpoint, the minimum price hurdle has been steadily increasing with lower mine quality and rising costs, and new demand is outstripping new supply and the urge to sell by current holders. So long as mining costs don't fall and the drivers of mass demand remain, the price of gold should remain well underpinned.

### Gold as a currency

The other standpoint is to view gold versus currencies. Many scoff at this perspective, but being trustless, rustless, shiny, and tiny makes gold very currency-like. Its validity as such has been proven over a long time, with its first official use by the Egyptians in 1500 BC. Further, it's the only currency-like asset that has not been devalued through governmental mismanagement.

It is important to remember that the number of dollars, pounds, euros or rands you see in an account is only worth what others are willing to give you in exchange. Unlike gold, where the supply is essentially fixed, all paper currencies suffer the same frailty—politicians or their appointees control the printing press, and their desire is generally to get re-elected and their time horizon only extends through their tenure. This makes them inclined to print, spend and give away as much as they are able to get away with. Recently that has been a lot!

On the US government's own forecasts (using assumptions we consider rosy), Federal debt to gross domestic product is set to rise from today's 100%, to 120% and beyond. Essentially all of the increase is in mandatory programs like pensions and health care. With more debt and ongoing deficits, interest expense creeps up. This year, the US will spend more on interest servicing its debt than it spends on its entire military. Higher interest

expense makes deficits worse, necessitating further debt issuance to plug the hole. With more debt comes higher interest expenses, worse deficits, and yet more debt—it can become a spiral.

While every day, the camel appears to be fine under the weight of the straw on its back, the risk that the camel's back breaks certainly exists, with very significant implications for markets and accumulated wealth. In this light, we currently view holding a decent amount of gold exposure as prudent.

### **Gaining exposure**

The next question is how to get that exposure. We do move the elements that make up the portfolio's gold exposure around over time. The two investable elements are the commodity itself (through exchange-traded vehicles), and gold-related equities.

Recently we've shifted some commodity exposure into the miners after they massively lagged the rising gold price, owing principally to their exposure to labour and fuel costs that inflated faster than the price of gold. This set up the very unusual condition whereby the gold miners' profits dropped despite the price of gold hitting new records. After taking another deep dive into mining economics and interrogating management teams, we've developed increased conviction that the miners now have their costs under control, and should costs merely revert to historic increases, with the price of gold where it is, the likes of Newmont and Barrick Gold stand to potentially produce prodigious amounts of cash flow.

At the time of our big shift into miners in February, this market pessimism translated into double-digit prospective free cash flow yields. Miners have appreciated nicely since, but if gold, copper, and oil prices simply stay where they are, Barrick currently trades at a 7.5% free cash flow yield. That's a better yield than the average global stock, for a stock that is much less correlated with the rest! Those sorts of valuations look compelling to us, and are why we have exposure to the miners as well as the metal.

### **Reasons to sell**

The remaining question is what would make us sellers, and here, gold is not so different from the other holdings in our multi-asset portfolios. Every security is in a continuous competition for capital. In our view, the most likely cause for us to sell gold will be to free up capital for better opportunities—if equities decline and gold holds up better, for instance, fulfilling its traditional diversifying role. A swing in the pendulum towards increased fiscal responsibility or reduced geopolitical conflict would also swing our views, and could make big swathes of the equity and fixed income universe more compelling on a fundamental view. While we hope for that improvement, it looks unlikely to us today. Gold may just prove to shine brightest when the outlook appears to be dimmest elsewhere.

*Eric Marais is an Investment Counsellor at [Orbis Investments](#), a sponsor of Firstlinks. This article contains general information at a point in time and not personal financial or investment advice. It should not be used as a guide to invest or trade and does not take into account the specific investment objectives or financial situation of any particular person. The Orbis Funds may take a different view depending on facts and circumstances.*

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## **How will the US election impact energy infrastructure?**

John DiMarco, Sarah Bibring, Andrew O'Neil

As the world keeps a close eye on the political state of play leading up to the US election on 5 November, infrastructure investors are bracing for the implications of the outcome and what it will mean for the future of the global energy infrastructure industry.

Energy infrastructure in the US is uncertain. Although electricity generation has been deregulated in many areas, federal, state, and local policy and regulatory regimes still play a crucial role in incremental development and investment decisions. Influential policies and regimes include the Inflation Reduction Act of 2022 (IRA); the varying market constructions for the procurement of energy, capacity and ancillary services amongst Independent System Operators (ISOs) and Regional Transmission Organizations (RTOs); and distributed

generation deployment at state level, which is highly dependent on subsidy programs which vary in their incentive structures.

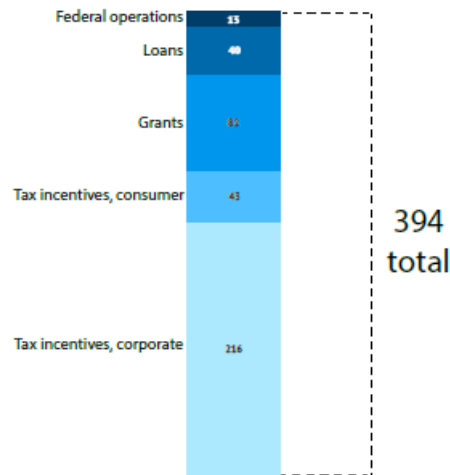
These overlapping systems create a fragmented market which partially mitigates the impact of the US federal elections. However, if a change were to occur in either the Federal Executive Branch and/or Congress, investors can take comfort in Congress typically provisioning for projects that have already qualified for existing incentives, and that legislative changes will only flow through in late 2026.

A change in power may create a state of flux for the industry, bringing a level of uncertainty for the future of infrastructure investment opportunities but what does that mean for key legislation and the energy infrastructure sector, and where will the opportunities be for investors?

**Is the Inflation Reduction Act at risk of a repeal?**

The IRA, aiming to provide federal incentive policy certainty around investing in domestic energy production while promoting clean energy with circa US\$400 billion in federal funding, is a showpiece of the Biden administration. It is expected to deliver on its objective of substantially lowering the US’ carbon emissions by the end of this decade.

**Figure 1:** Energy and climate change funding expected in the IRA (US\$ billion)



Source: McKinsey.

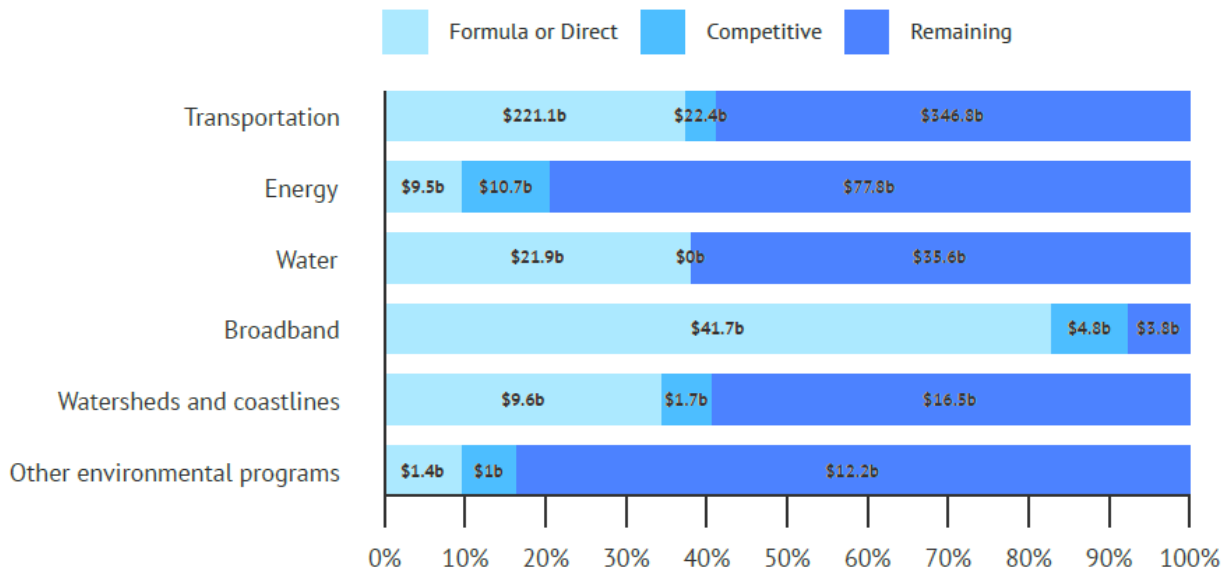
Note: Reflects analysis of the appropriation figures contained in the IRA, as well as those reported by the Congressional Budget Office and Joint Committee on Taxation. This analysis may differ from other analysis due to differences in methodology.

The upcoming US election presents a headline risk for the future of the IRA, with Republican party members calling for a full or partial repeal of the legislation. While any repeal of major policies has historically been difficult, if the Republicans sweep the election and introduce a budget reconciliation to target the IRA, the incentives for nascent strategies such as EV charging, rooftop solar and energy efficiency will be most at risk. This is based upon the number of Republican bills introduced to target these sectors in previous legislative sessions.

Other aspects like production tax credits (PTC) and investment tax credits (ITC) have traditionally received bipartisan support across past administrations and are unlikely to be fully repealed or majorly impacted. Similarly, incentives for nuclear, hydrogen, carbon capture and clean fuels, will likely be safe, given more pronounced Republican support for these technologies.

Additional legislation such as the Infrastructure Investment and Jobs Act (also referred to as the Bipartisan Infrastructure Law or “BIL”) was passed in Congress in November 2021. The aim of the law is to provide US\$1.2 trillion in federal funding to rebuild significant portions of the US’s key infrastructure, including roads, bridges, rail, airports and digital infrastructure. Although approximately half of the direct spending has been allocated to date and most of the competitive grants are yet to be rewarded, generally the content of the BIL is less likely to be targeted for repeal than the IRA, given it was widely supported by the Republicans.

**Figure 2:** Progress of BIL-awarded funding by infrastructure sector and funding type, as of November 2023



Source: Muro, M., Levin, B., & Carlos Martín, A. M. P. (2024, February 29). At its two-year anniversary, the bipartisan infrastructure law continues to rebuild all of America. Brookings Metro. <https://www.brookings.edu/articles/at-its-two-year-anniversary-the-bipartisan-infrastructure-law-continues-to-rebuild-all-of-america/>

### The domino effect of manufacturing and supply chain challenges

Manufacturing and supply chain challenges pose continued risks for US energy developers. At its epicentre is rising political tensions between the US and China, and tariff and regulatory disruptions.

Solar photovoltaics (PV) developers have primarily faced specific supply chain challenges compared to other import-dependent industries. These disruptions include the Section 201 tariffs levied on imported modules from China in 2018, the 2021 Federal Department of Commerce’s investigation into tariff circumvention and the detention of equipment import shipments under the Uyghur Forced Labor Prevention Act in 2021.

Beyond these tariff and regulatory disruptions, the US will likely continue to face additional headwinds from China’s influence and dominance in clean energy, irrespective of the US federal election outcome. It relies on China’s dominance in original equipment manufacturing (OEM), which creates a risk for US energy developers and their import-dependent supply chains. These supply chain issues are a political lever for US policymakers to signal a strong political stance and apply pressure on Beijing.

To neutralise the US’ dependence on China, the IRA created an adder to the base level tax credits that increase credits by 33% to encourage the use of domestic content (i.e. domestically produced steel, iron, and manufactured products) in renewable projects. This has led to energy project developers and OEMs choosing to invest in greenfield US manufacturing facilities to produce compliant products with reduced risk of political or supply chain interference.

While in the long term, the market equilibrium for equipment procurement will feature more domestic production, in the medium- to long-term the industry is likely to face continued volatility, long lead times, and competition for supply capacity. Developers will have to navigate these dynamics and adapt their target project profiles accordingly.

Despite this, OEMs with domestic production facilities such as First Solar, Tesla and Enphase, and the developers that have secured supply agreements with these manufactures, will benefit from these supply chain headwinds.

### The future of offshore wind

While state and local-permitting challenges have impeded offshore wind development, the Biden administration had set targets of 30 gigawatt (GW) of new offshore wind generation by the end of 2030 – creating significant tailwinds for the offshore wind supply chain.

Recently however, the sector has experienced development and construction cost increases, and will experience further construction delays if a change in administration was to occur. These delays are anticipated as the Bureau of Ocean Energy Management (BOEM), the federal agency that is responsible for reviewing the key steps involved in offshore wind development, experienced more restrictive processes during the first Trump

administration. Most states with ambitious offshore wind targets and projects within the US's wind belt, however, have historically held Democratic majorities and are therefore unlikely to change their policy goals.

These headwinds and risks reduce the attractiveness of offshore wind projects to state procurers given they carry a higher levelised cost of electricity (LCOE) production than alternative technologies.

### **Opportunities and risks for investors to consider post-election day**

Investors must keep their exposure to federal policy top of mind when managing their investment in the US's energy transition, as well as evaluate how to manage and mitigate policy risk through political cycles given the illiquid nature of their investments and longer hold periods. It is prudent to consider that Republicans have typically promoted an energy agenda that favours energy independence, security and affordability. While these are not incompatible with advancing climate goals, it has historically translated into greater support for fossil fuels.

Key considerations include:

- Significant change to traditional renewables is unlikely due to the capital already committed to establish economic benefits for transitional Republican states
- carbon capture, and storage has largely avoided political controversy
- Support for nascent strategies such as EV infrastructure, are at risk so investors should ensure they have a thorough understanding of the direction of state policy and incentives in the absence of federal support

As many investors have been steered away from investments with significant scope one emissions, bifurcated capital markets have developed where higher returns are achievable for those willing to bear more transition exposure.

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### **Data citations**

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