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Editorial

We're bombarded with news about the 'demographic time bomb' that's coming. Of rising dependency ratios (ie. a fall in total employment rates) and declining economic growth rates. It's not only in Australia but across most developed markets.

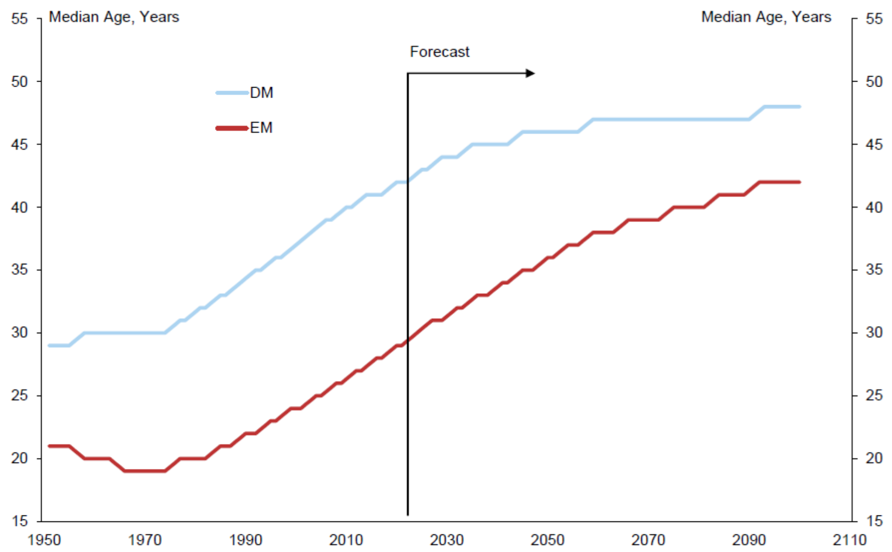
However, new research from Goldman Sachs and IMF suggests that the problems caused by ageing populations may not be intractable. In fact, there are more positives than negatives when it comes to ageing.

Yes, the world's population is ageing

There's no denying that the world is getting older. Over the past 50 years, the median age in developed market economies has increased from 30 to 43 years, while in emerging markets it's risen from 19 to 30.

The United Nations predicts that over the next 50 years the median age will reach 47 years in developed markets and 40 in emerging markets.

There are two key factors behind the world getting older.



Source: United Nations, Goldman Sachs Global Investment Research

First is increased longevity. Since 1975, average global life expectancy has risen from 62 to 75 years. In developed countries, it's increased from 72 to 82 years while in emerging countries it's jumped from 58 to 73 years.

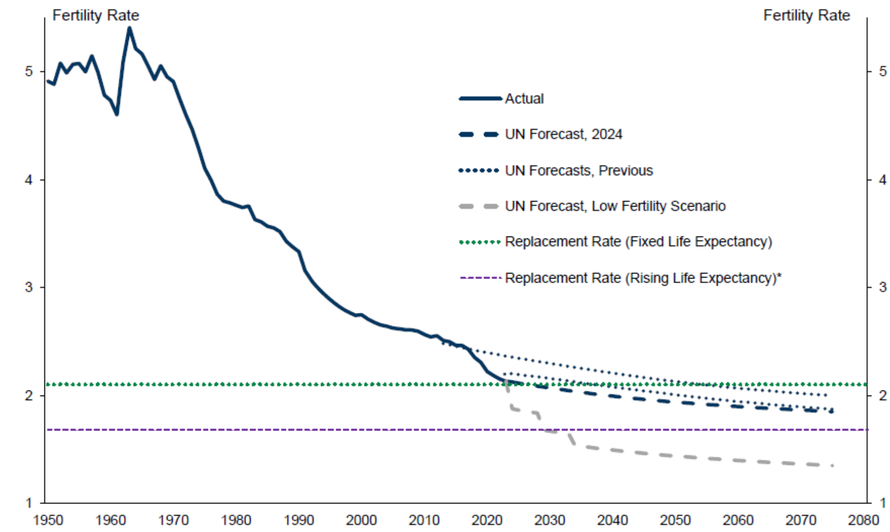
It hasn't all been linear or universal. For instance, you might be surprised to know that US life expectancy has dropped over the past decade.

Yet, generally, longevity has improved. Today, Hong Kong leads the world with a life expectancy of 86 years. Australia isn't far behind, at 83 years.

The second factor behind ageing populations is declining fertility. The global fertility rate – the estimated number of births a woman will have in her lifetime based on current birth rates – peaked at 5.4 in 1963 and stands at 2.1 today. Australia's fertility rate is 1.63, which is better than most of the developed world.

The Global Fertility Rate Has Fallen from a Peak of 5.4 in 1963 to 2.1 in 2024

Fertility rate (estimated lifetime births per woman)



*This assumes that life expectancy rises in line with the 'frontier' trend (0.25 years per year).

Source: United Nations, Goldman Sachs Global Investment Research

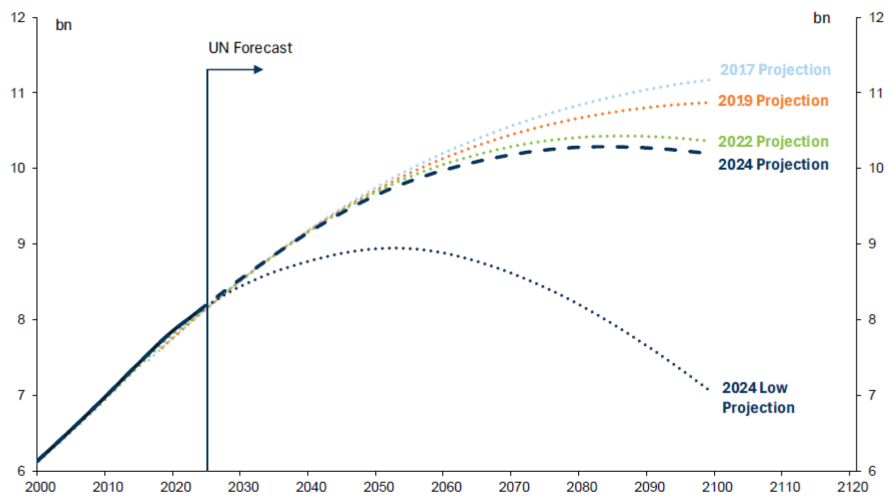
A common perception is that most of the fertility decline has happened in developed markets, but that's not the case. The emerging market fertility rate has plunged from 4.6 to 2.2 since 1975, while the developed market rate has fallen from 1.9 to 1.5.

The global fertility rate is in line with the estimated replacement fertility rate of 2.1. However, most developed countries are trending well below this replacement rate.

Even on pessimistic estimates for global fertility rates, though, the world's population is still expected to grow for another 25 years, peaking at around 9 billion.

The Projected Peak in Global Population Has Declined Due to Lower Fertility But, Even Under a Low Fertility Assumption, the World's Population Will Rise from Around 8bn to 9bn in 2050

UN global population projections, various vintages



Source: United Nations, Goldman Sachs Global Investment Research

A demographic time bomb?

There's little doubt that ageing populations are impacting economic growth and will continue to do so. After all, GDP is a product of the number of employed people and the amount of economic output that each produces. If population growth falls, GDP growth is likely to follow suit.

Global population growth peaked at 2% per year in 1975 and is currently running at 1% per year. That's projected to drop to 0% over the next 50 years.

Yet it should be noted that while this will affect headline GDP growth rates, it won't impact per capita or per person GDP rates.

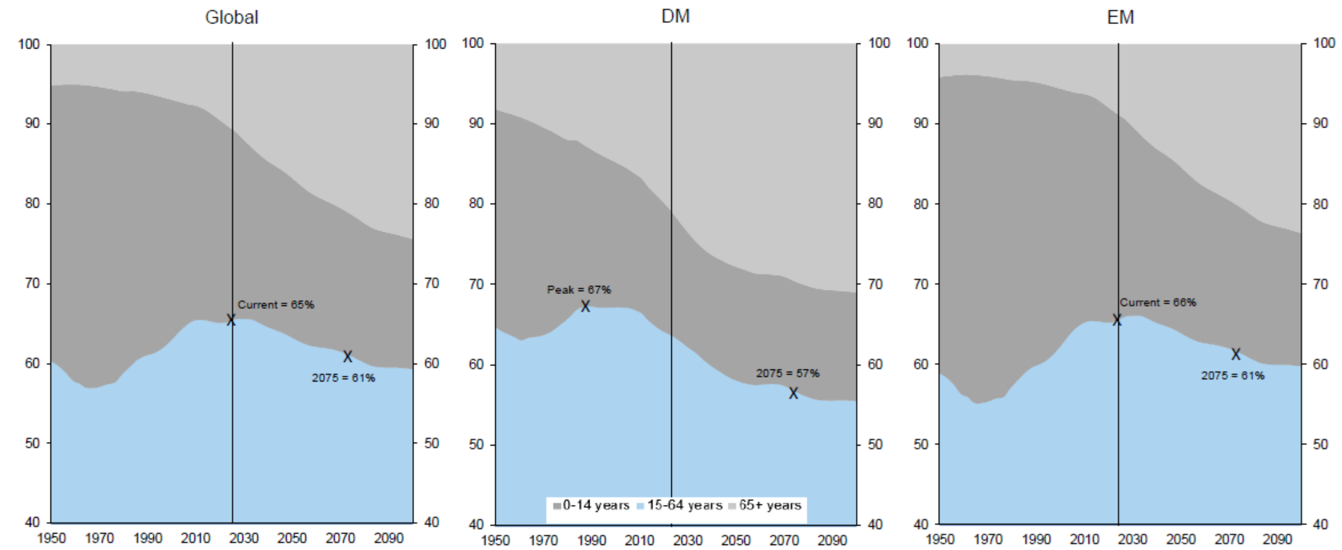
The bigger worry is the ageing population will lead to a decline in the working-age ratio – the proportion of people aged 15 to 64. A fall in that ratio will hit both employment rates and GDP per person.

The working-age ratio has already significantly decreased in developed countries. From 67% in 1985, it's fallen to 63%, and is estimated to decline further to 57% over the next 50 years.

Emerging markets are faring better. Their working-age ratio is close to a projected peak of 66% and is predicted to decrease to 61% by 2075.

The 'Working Age' Ratio (15-64) in Developed Economies is Projected to Fall from 67% in 2000 to 57% in 2075 (-15%)

Share of population (%)



Source: United Nations, Goldman Sachs Global Investment Research

The problems aren't insurmountable

These headwinds from ageing are well documented but are they insurmountable? Goldman Sachs thinks not. It says the challenges can be met by people extending their effective working lives.

I know what you're thinking – great, Goldman wants us to work longer. That's right, but the point is that we're already living longer and that should continue for some time yet, so extending work in line with increased longevity makes some sense.

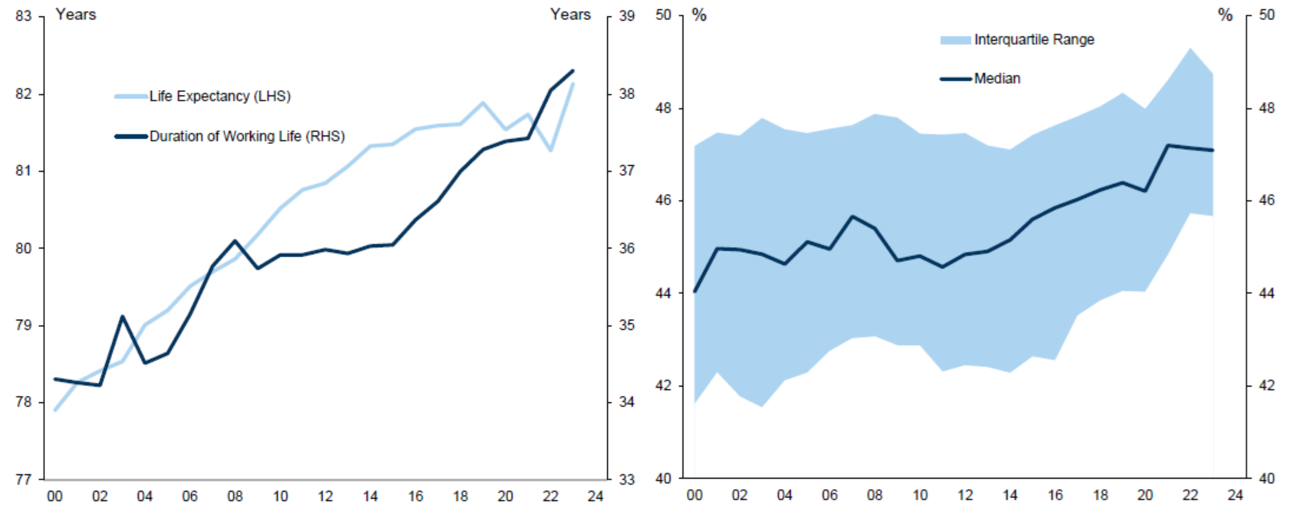
Goldman estimates that to offset the working-age ratio decline in developed markets over the next 50 years, it would require us to extend working lives by 7.5 years.

That's a lot! However, it's a little misleading. Working age ratios are calculated using ages 15-64. The reality is that we enter the workforce later than age 15 on average. Therefore, the 7.5 years' work extension estimated by Goldmans is likely to be less than five years.

That might still sound a lot. Keep in mind though that the trend towards extending working lives is already underway. Since 2000, the average working life in developed markets has increased by four years.

The Increase in Working Lives in DM Economies Has Matched the Increase in Life Expectancy, Resulting in an Increase in the Share of Our Lives in the Labor Market

DM: Life expectancy and Duration of Average Effective Working Lives (LHS); Average Share of Life Participating in Labor Market (RHS)



Source: ILO, WHO, United Nations, Goldman Sachs Global Investment Research

You might think that this trend has happened due to changes to pension age laws. However, there have only been minor changes, which suggests that we're working longer in line with our increased longevity.

70 is the new 53

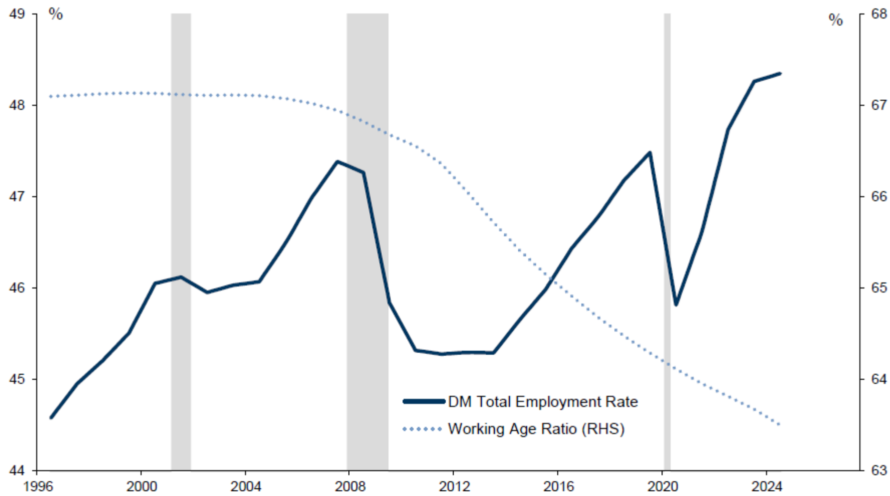
Healthier ageing has helped extend working lives. In a comprehensive study, the IMF has found that "on average, a person who was 70 in 2022 had the same cognitive ability as a 53-year old in 2000, while the physical frailty of a 70-year-old corresponded to that of a 56-year-old in 2000."

The common assumption is that increased life expectancy will extend the amount of our lives that we spend in 'old age'. Yet we're much healthier in older age these days and that's allowing us to work longer.

It's showing up in the labor force data too. Goldman says that the "move towards extending working lives has more than offset the effect of population aging on DM [Developed Market] employment, with the result that employment as a share of total population have also risen materially since 2000, despite the significant decline in the DM working-age ratio over this period."

The DM Total Employment Rate Has Risen (Implying A Lower Dependency Ratio), Despite a Large Decline in the Working Age Ratio

DM Total Employment Rate (Total Employment/Total Population); Shaded areas signify global recessions



Source: Goldman Sachs Global Investment Research, International Labour Organization

All told, we're handling the transition towards ageing populations quite well and that's a good news story.

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In my article this week, I suggest that the $3m super tax represents a broader revolt against the wealth of the Baby Boomer generation. Against the extent of their wealth, how they got it, and how those in power aided and abetted it - seemingly to the detriment of younger generations.

On the super tax, **Professor Kevin Davis** thinks that the proposal to include unrealised capital gains may lead to an effective cap on balances of $3 million. However, he proposes a simpler method to prevent excessive super balances.

James Gruber

Also in this week's edition...

Ashley Owen looks in depth at the US market and with a price-to-earnings ratio of 28x and earnings forecasts of 15% growth over the next two years, he says a lot needs to go right for the market to continue its march higher.

A recent court case involving the Australian Tax Office could have a significant impact on the tax payable by beneficiaries of family trusts. **Peter Bardos** says that if the ATO has previously demanded extra payments on unpaid present entitlements in your family group, you should watch this space closely.

Subdividing can offer a lucrative first step into property development. Yet **Danielle Hart** and **Daniel Walachowski** say it comes with legal, planning and unexpected tax considerations that should be understood to avoid surprises.

This year has had its share of volatility in markets. **Capital Group's Jorden Brown** offers 5 tips to cope with the ups and downs, and ensure you remain on the right track.

There'a a lot of fear about China's rise to power. That it will be aggressive when it comes to Taiwan and projecting its power outwards. But **Michael McAlary** has doubts about that common perception.

Lastly in this week's whitepaper, **First Sentier** explores an approach to integrating ESG considerations that can lead to better financial outcomes.

Curated by James Gruber and Leisa Bell

The revolt against Baby Boomer wealth

James Gruber

The super tax and its intricacies have rightly generated heated debate, though I think it's time to ask some deeper questions:

> *Why did the Government choose to introduce this tax?*
> *Why is the Government refusing to budge on aspects of the tax despite an intense public backlash?*
> *What are the circumstances that allowed them to propose this tax?*
> *Why are many wealthy people ok with the tax, albeit critical of it being applied to unrealised capital gains and there being no indexing?*
> *Why have the merits of Baby Boomer wealth been at the forefront of the tax debate?*

A simple answer to these questions would be that the tax can be put down to the Government needing to raise revenue and a small group of wealthy people being easy targets. I think it's more complicated than that, and this will look at the key factors behind the policy as well as why more taxes on the rich are likely in future.

The young have pitchforks

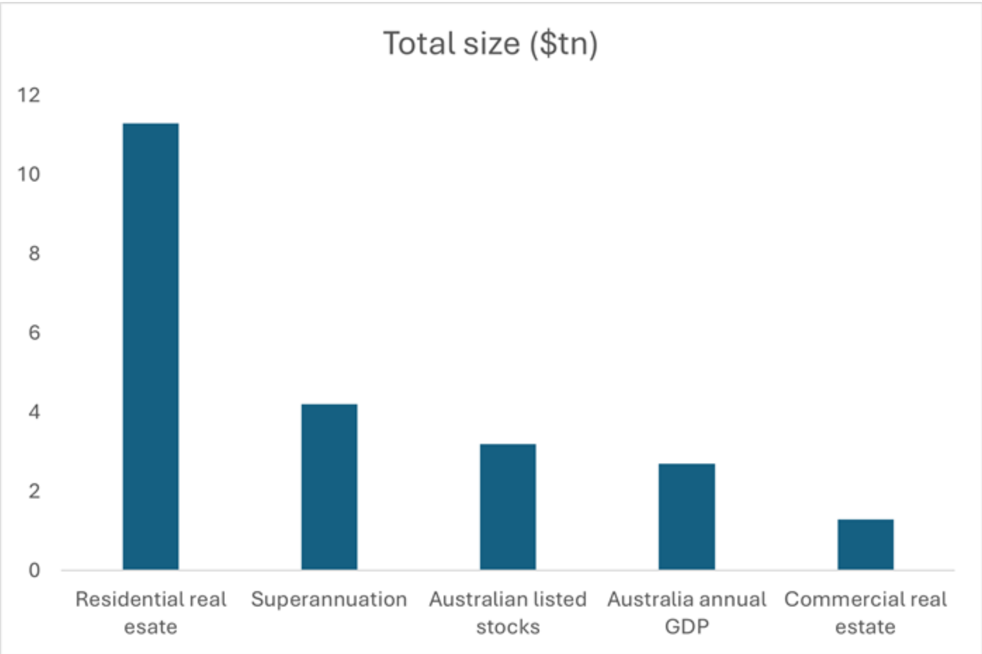
Since the 1980s, Australia has adopted the deregulated, capitalist model of other developed countries such as the US and Britain. It's resulted in us becoming a lot wealthier.

Since the GFC though, that model appears to have run out of steam. Economic growth and wages have stagnated, while asset prices have continued to boom. Those who've owned assets have been beneficiaries and those who haven't have been left behind.

How has this happened? At least some of the blame can be apportioned to successive Governments being unwilling to address the key factors underlying economic weakness. They've been put into the too-hard basket.

Instead, Governments of both sides have been too happy to pump up asset prices to give the *appearance* of increasing wealth and collecting votes from asset owners along the way.

It's led to an increasingly financialized world where Governments pile on more and more debt to keep asset prices inflated. Any economic downturn that threatens ever-rising asset prices is met with more Government stimulus and debt.



Sources: CoreLogic, APRA, RBA

The above chart is the poster child of this increasingly financialized world. Assets dwarf real economic activity. And things like housing, a largely unproductive asset class, crowds out investment in more productive areas.

Who's benefited most from this situation? Undoubtedly, those who are retired or are retiring – largely, the Baby Boomer generation.

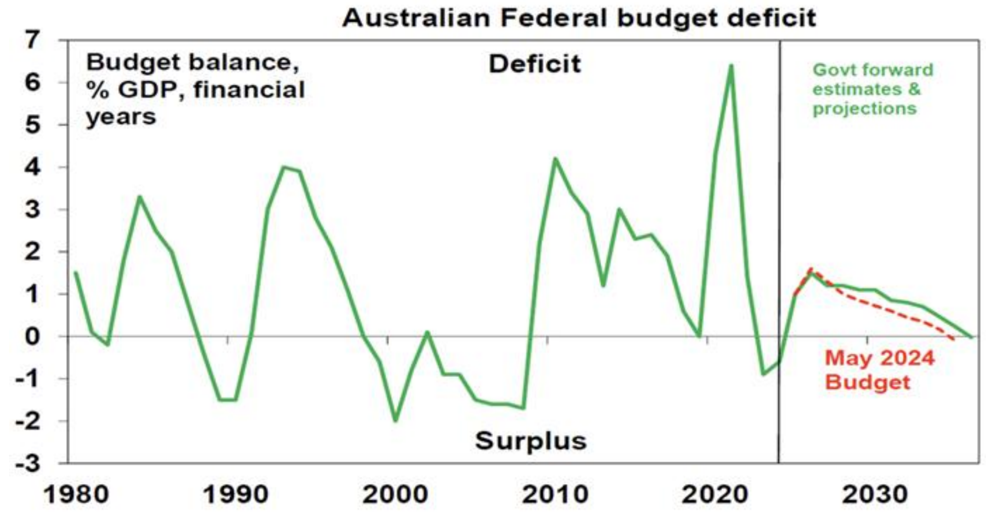
And who have been the biggest losers? The younger generations.

In this context, it's hardly surprising that the young are revolting at the ballot box, turning away from the major political parties who've prioritised asset inflation over real economic growth.

And it's also hardly surprising that the young support increasing taxes on those who've profited most from the asset gains.

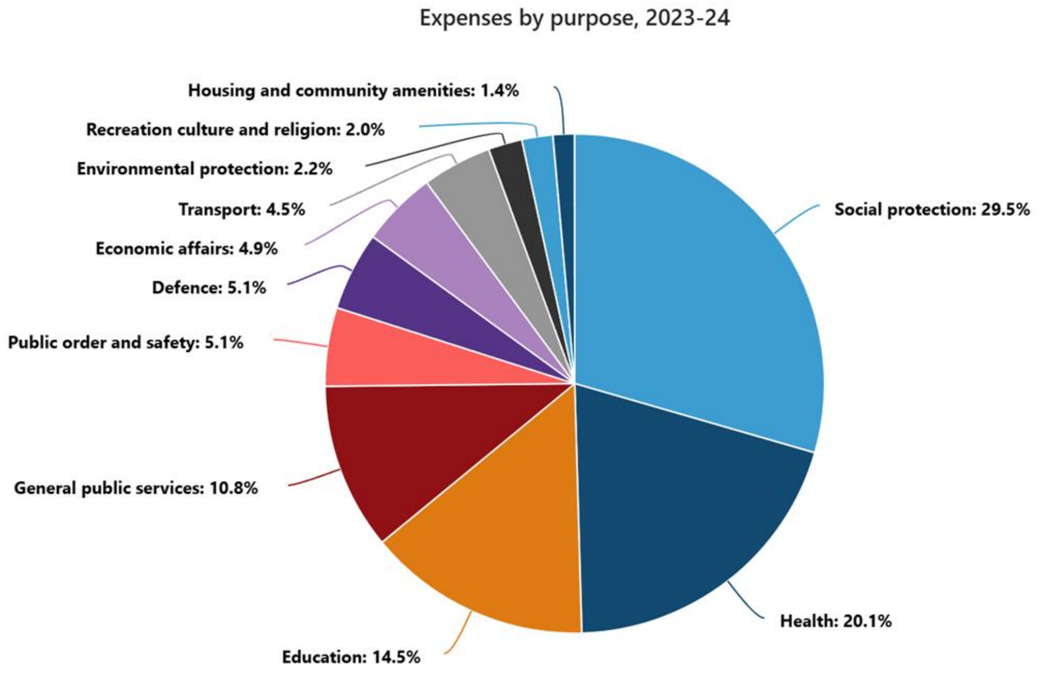
Stretched Government budget

The state of the federal budget has been another factor behind the super tax. The Government is forecasting deficits for much of the next decade, and their predictions are almost certainly underplaying the extent of them.



Source: AMP's Shane Oliver

Total public sector expenses grew by 9% last financial year, and that growth is unlikely to decline much in years to come. Many commentators put the blame on the Labor Government though that oversimplifies it because much of the spending looks structural rather than cyclical.



Source: Australian Bureau of Statistics, Insights into Government Finance Statistics, Annual, 2023-24 22/04/2025

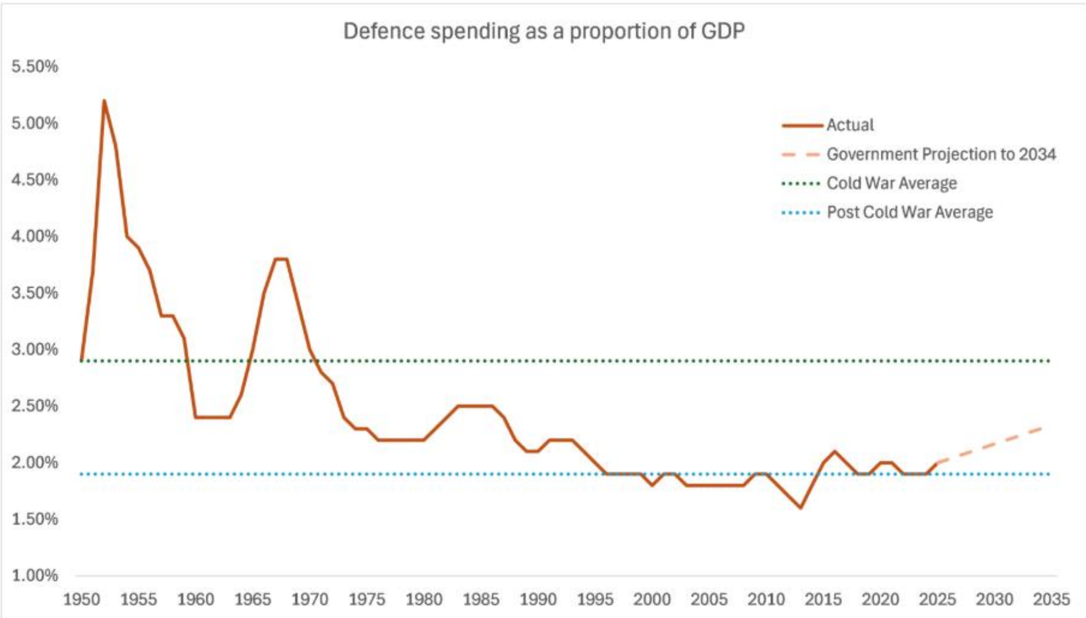
Breaking down the Government expenses, almost a third goes towards 'social protection'. It entails Government payments for old age, disability, and family and children. This category of expenses increased 14% in 2024, thanks to higher Aged Care pensions and subsidies, NDIS costs, and childcare subsidies.

The second-largest expense category is health, which involves hospital services and community health services.

The third-largest expense is education, both school and tertiary. That's followed by 'general public services', encompassing debt transactions and interest costs, and then public safety and defence.

Now, it's hard to see the growth in the four largest expense categories decreasing much. An ageing population means more money going towards Aged Care and hospitals. NDIS seems to have a life of its own and while growth may slow, it's an expense that almost certainly won't go down. Meanwhile, education costs continue to increase well above the inflation rate and there's no sign of that slowing down.

Defence is one to keep an eye on as Australia only spends about 2% of its GDP on defence. This is low compared to most of our history. And keep in mind that Donald Trump is pushing NATO allies to up defence spending from 2% of GDP to 5%.



Sources: SIPRI Military Expenditure Index and Australian government projections

While Government expenses continue to grow, income will be harder to find. Most Government revenue is raised through tax, and most of that comes from personal and corporate tax. Personal tax has been strong of late due to low unemployment and strong migration. These two drivers are expected to fade.

Meantime, corporate taxes are sputtering along as economic growth stagnates. Unless the economy revives, corporate taxes will struggle to grow much.

Whichever way you look at it, the odds are that budget deficits will increase in coming years. Potentially, by a lot.

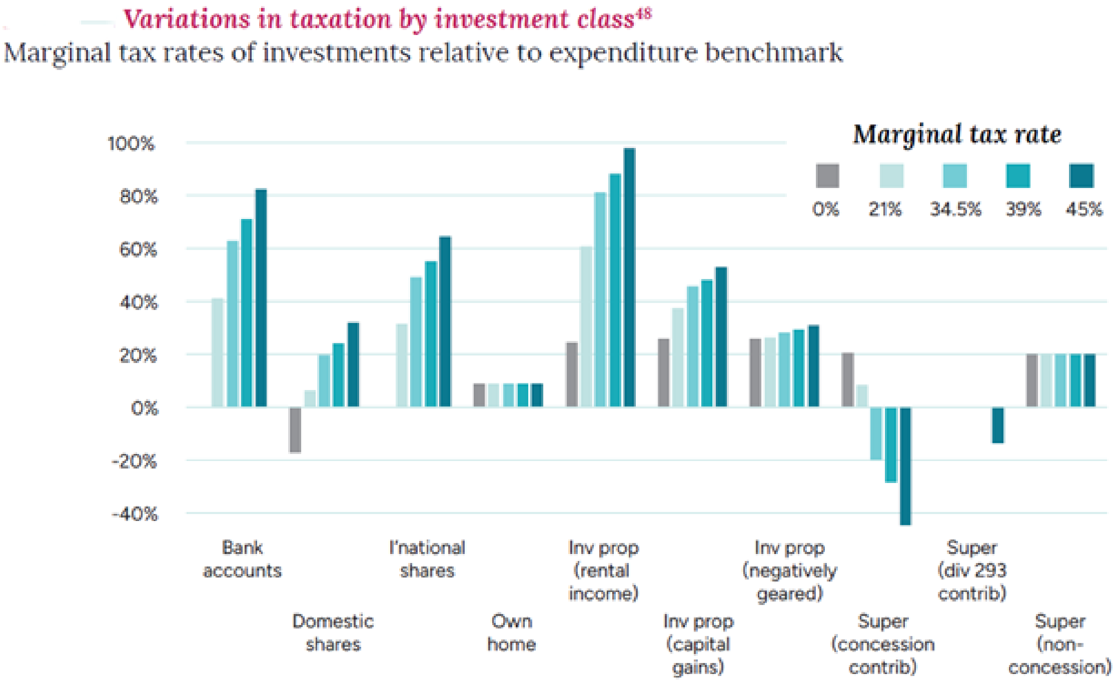
The Government will need to fund these deficits. There are three main ways that it can do this: raise taxes, increase debt, or cut expenses.

As mentioned, cutting expenses will be hard to do. Increasing debt is an option that will almost certainly be taken up given Australia's still relatively low debt to GDP. The other option is taxes, which is another lever that the Government will turn too.

Now, you may think that all of this is blown out of proportion given projected budget deficits are still relatively small and Government debts are low. But unlike periods before where deficits were higher, today we have low economic growth, high Government spending from an ageing population, and greater wealth inequality. Combined they will put further strain on the budget.

Tax concessions are prime targets

Another reason behind the super tax may be that our tax system seems to skew towards asset owners over income earners. Personal income taxes and savings are taxed at high rates, while many investments are not.



Source: Peter Varela et al 2020

Admittedly, this chart is from 2020 and outdated, though I haven't been able to find an updated one. Nonetheless, it gives a flavour of the marginal tax rates of various investment versus expenditure.

What stands out are the relatively low tax rates on super, homes, and negatively geared property.

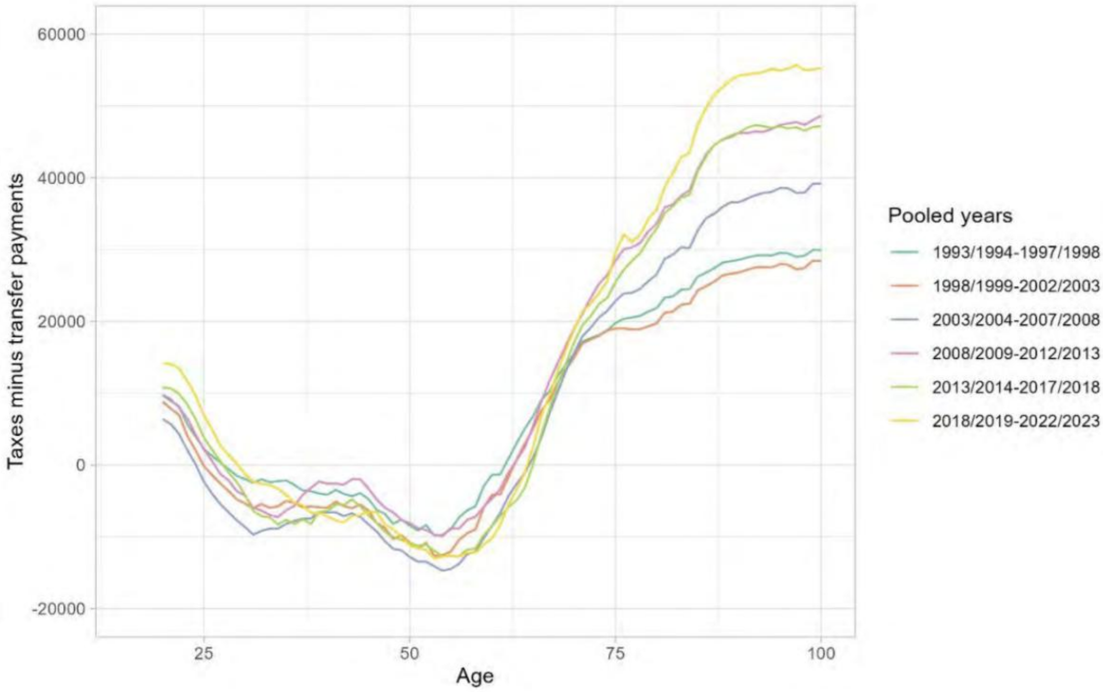
A recent academic paper from the ANU, '*Measuring the changing size of intergenerational transfers in the Australian tax and transfer system*', gives further insights into who benefits most from the current tax system.

It found that the tax and transfer system had been more generous to older Australians than younger ones.

It said government spending on older people, including the age pension, aged care and health care, had increased significantly in real, per-person terms over time. By contrast, net spending on younger households had remained relatively constant.

And the figures weren't distorted by an ageing population as they were measured on a per capita basis.

The intergenerational contract – average transfers net of taxes across the lifecycle



The rich are open (somewhat) to higher taxes

A remarkable aspect of the super tax debate is that there's been less disagreement about the imposition of the super tax than about the lack of indexing and inclusion of unrealized asset gains. From comments in Firstlinks and elsewhere, it seems a reasonable proportion of the wealthy support the new tax.

How did it come to this? After all, these people played by the rules and now those rules are changing and upending their lifelong savings.

Demographer Neil Howe may offer insights into how this happened. Howe is well known for authoring a 1997 book with William Strauss called *The Fourth Turning*. An analysis of generation-driven historical cycles, the book predicted that a period of political, economic, and social upheaval would rattle the US midway through the first decade of the 2000s, culminating in an acute crisis or series of crises in or around the 2020s.

When the financial crisis hit in 2008, the book was hailed for predicting that event, and it's since gone on to achieve cult status and even served as the inspiration for a Pulitzer-nominated 2019 play, *Heroes of the Fourth Turning*.

Howe has written a recent book, *The Fourth Turning is Here*, where he outlines that a crisis period is upon us where the old economic and social order will be ripped up as Millennials rise to power.

I won't go into detail about Howe's generational theory, suffice to say that I think it's a stretch to organize history along generational lines and his forecasts are vague enough to get many people to believe in them.

That said, Howe's views on how Baby Boomers will respond as power shifts to younger generations are intriguing:

> *"With the Crisis itself placing new burdens on the lives of younger generations, Boomers will choose to retain their moral authority by arguing—uncharacteristically—to impose sacrifices on themselves and other older Americans for the sake of their community. This will seem less surprising in the context of their own families; most Boomers today are already providing generously, sometimes more generously than they can afford, for their own children and grandchildren. But it will seem more surprising when they do so in the context of the national community and*

> *support tax and benefit changes that hit their own ranks the hardest. But the logic will be inexorable. The young, acting on behalf of the community at a time of peril, will now have a much better claim on resources than they do. So Boomers will let go.*
>
> *"Everything will be on the table. A persuasive case will be made for taxing consumption and assets along with meaningful inheritance taxes, since these draw the most revenue out of affluent elderly age brackets... Stricter tax compliance measures will flush assets out of the tax havens of Boomer plutocrats. Rationing of high-end luxury services and goods may be instituted to save resources, if such opulence has not already been driven into the shadows by social stigma...*
>
> *... Public benefits will also be overhauled. Entering prior Crisis eras, government spending on benefits to the nonindigent was minimal. This time, it is massive—and it flows mostly to the elderly...*
>
> *Most Boomers won't have their heart in this fight. Here too they will make large concessions and even rationalize them as participation in a larger cause."*

Howe's predictions have eerie echoes to what is happening with the super tax debate.

Future courses of action

Government policies don't just happen in isolation; there are economic, social and cultural circumstances which give rise to them.

My analysis above has tried to give context to why this super tax has come about. However, it also gives potential pointers to the future.

By 2040, I'll surprised if most of the following hasn't happened:

- Further taxes on wealthy super accounts
- Negative gearing removed.
- CGT discount reduced.
- Family homes, perhaps above a certain value, included in Age Pension assets testing.
- A higher and broader GST.

I'm not suggesting these things are right or wrong. It's just that the confluence of factors mentioned - the anger of younger generations, rising budget deficits, the large tax concessions for homes, investment property, and super, as well as the seeming resignation of the wealthy to higher taxes – provide a fertile environment for further taxes, especially on the rich.

James Gruber is Editor of Firstlinks.

How to prevent excessive superannuation balances

Prof. Kevin Davis

The proposal to include unrealised capital gains in calculating income subject to the additional 15% tax rate on super fund balances over $3 million should lead to an effective cap on balances of $3 million. (The additional personal tax involved is referred to in the draft legislation as Division 296 tax liability). If the administrative costs to individuals of complying with this change, and the cash flow problems of making such tax payments, are as large as critics have argued, no one will want to hold assets above $3 million in super.

In that case the deterrent effect of this change will mean that such taxation never needs to be applied. And the mark of a good deterrent is that it is so effective in affecting behaviour that it never needs to be applied. Individuals will transfer assets above $3 million out of super accounts into their personal account.

A better approach

But there is an alternative, simpler, approach which could be used, and which would mitigate some of the difficulties which holders of SMSFs will argue arise from the current proposal. Such difficulties relate to the current holdings of large, indivisible, assets such as properties, businesses and farms in SMSFs.

But, and this is the crucial point, while the assets may be indivisible, there can be multiple claims on the assets. So, for example, an asset worth $5 million could have one claim worth $3 million and another of $2 million on it. The $3 million claim could be held in an SMSF and the $2 million held on the individual's personal account. A notional change of ownership, where the ultimate beneficiary remains the same is all that is needed.

Of course, that leaves unanswered how the income generated by the asset is split between the two claims. And it would raise a massive backlash if the income on personal account for division 296 personal tax were to be measured to include unrealised capital gains. So maintaining the current method for calculating income for tax purposes would seem necessary.

There are many ways in which splitting the income between the two claims could be equitably achieved. But giving the SMSF an equity style claim of a share of income would run the risk of it effectively growing beyond the $3 million cap and getting preferential taxation on that excess.

Using the example from before, suppose the asset generated $0.5 million income in the year. If both claims were equity style, the SMSF would have income of three-fifths of $0.5 million (ie $0.3 million) before tax. This would be taxed (possibly at the usual super tax rate) and the SMSF would need to distribute the after-tax amount to the beneficiary to maintain the SMSF asset value at the $3 million cap.

But suppose the asset also grew in value, so that over several years there were $10 million of unrealised capital gains, not included in the measured income. When the asset is ultimately sold the realised capital gains in that year for the super fund would be three fifths of $10 million ($6 million). Unless some differential higher tax rate were applied to these capital gains, the SMSF beneficiary would have achieved gains from having concessional tax on the undeclared SMSF asset level of over $3 million over the preceding years.

So the alternative would be to make the $3 million in the SMSF a fixed value claim, with all earnings on the asset then accruing to the $2 million claim in the individual's personal account. Of course, unless some adjustment is made the individual would be getting no concessional taxation benefit from the SMSF with all earnings on the asset being taxed at the owner's personal tax rate.

To maintain some super subsidy on the $3 million in the SMSF, one approach would be as follows. Calculate an appropriately weighted average of the 15% super tax rate (or zero if the super fund is in retirement mode) and the individual's relevant personal tax rate to apply to those earnings. (For example, in this case, if the personal tax rate is 40%, the weighted rate if the SMSF is in accumulation mode would be 3/5 x.15 + 2/5x.4 = 0.25. If in retirement mode, the weighted rate would be 3/5 x 0 + 2/5 x 0.4 = 0.16).

Alternatively, to avoid complications from other income sources affecting the individual's personal marginal tax rate, the personal taxable income from the asset could be calculated after deducting some imputed amount for the cost of the non-earning $3 million in super. That could be calculated, for example, by using the average return on super funds in that year applied to the $3 million. If that return were, for example, 10%, then a deduction of $0.3 million would be allowed in calculating personal taxable income.

There are likely to be other approaches for enabling the individual to obtain the concessional tax treatment otherwise available on assets in super.

Downsides to this method

What are the flaws in this alternative approach? The asset(s) involved may not have a readily available, observable, market value. Individuals could rort the system by claiming that the asset in an SMSF is worth less than $3 million, and so not shift part ownership to personal account so as to obtain concessional super tax treatment on eventually realised capital gains. Some special tax rules would be needed to offset this.

Also individuals would need to possibly incur costs of getting a market value for such assets to check it is no higher than $3 million in order to comply with the regulation. But incurring (probably tax-deductible) costs to gain the benefits of a tax concession is not something which is likely to be seen by legislators (or other taxpayers) as a major impediment to such an approach.

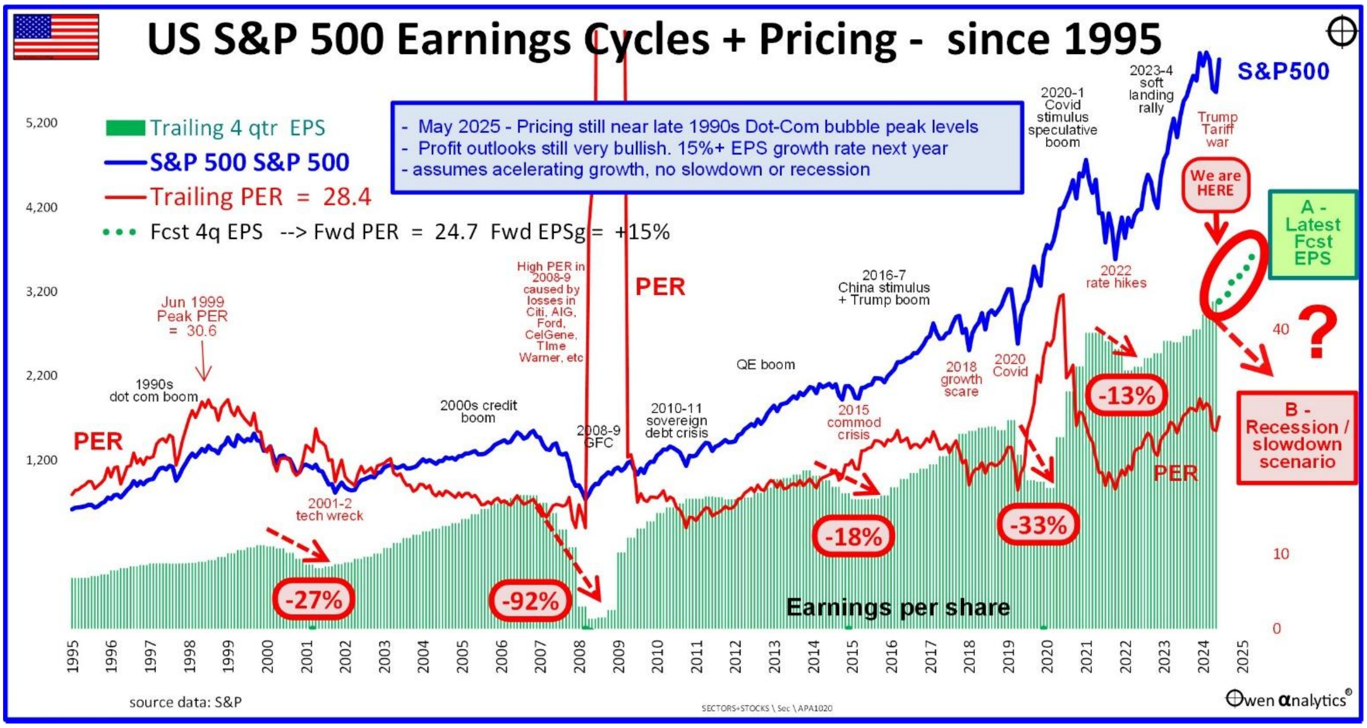
Kevin Davis is Emeritus Professor of Finance at The University of Melbourne.

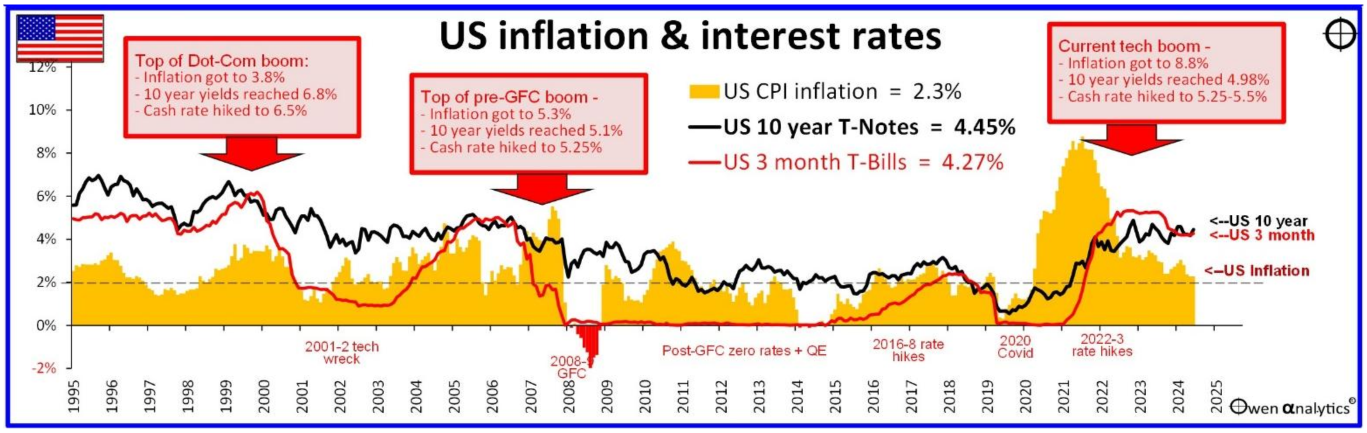
US shares: Ambitious multiples on ambitious EPS forecasts

Ashley Owen

A couple of weeks ago I reported on the current CAPE ratio measure for the US share market. Today's chart drills down into more detail on how the current levels of profits and pricing relate to the recent profit and share prices cycles in the past three decades. Where are we now?

The key challenge is this – can aggregate earnings per share keep accelerating as predicted (green dots highlighted to the right of the upper chart) – or will earnings fall back as they have always done in prior cycles?





Here are the main components of the charts:

1. S&P500 price index

The blue line in the upper section is the S&P500 price index – showing the main boom-bust cycles:

- The 2001-2 'tech-wreck' following the late-1990s 'dot-com' boom,
- the 2008-9 'global financial crisis' following the 2003-8 China/credit boom,
- the mid-2000s commodities collapse following China's GFC stimulus boom. This was not a major share-sell-off or recession, but the commodities collapse did trigger an oil/gas/steel bankruptcy crisis that resulted in a US / global 'earnings recession',
- the recent 2022 rate hike sell-off. This, too, did not result in the much-feared, and much-forecast US/global recession, but it did cause a moderate earnings contraction.

To the far right we can see that the S&P500 index sky-rocketed to new record highs in early 2025. There was a sharp 19% dip after Trump announced his 'reciprocal tariffs on 2 April but quickly rebounded after Trump's backflip a week later. The market is now back to near all-time highs.

2. Aggregate earnings per share (EPS)

The green bars in the upper section show aggregate earnings per share (EPS) for the S&P500 companies. This also rises and falls through the boom-bust cycles, but the **timing** is slightly different. Profits collapsed **after** share prices fell in the busts.

Or, put another way, share prices do NOT fall because, or when, company profits collapse. Share prices fall in **advance** of, and in **anticipation**, of profit declines. (Timing is everything!)

Profit declines

The aspect I would like to focus on here is the **declines** in aggregate earnings in each cycle. There have been five significant declines in market-wide profits in the past three decades – about once every half decade on average. (NB The terms 'earnings' and 'profits' are interchangeable in this context).

- Aggregate earnings per share fell by -27% in the 2001-2 tech-wreck after the 'dot-com' boom,
- fell by -92% in the GFC following the 2003-7 China/credit boom (the main contributors to this collapse are noted on the chart),
- fell by -13% in the mid-2000s commodities collapse following China's GFC stimulus boom,
- fell by -33% in the Covid lockdown recession,
- fell by -13% with the Fed's aggressive rate hikes in 2022.

3. The 'trailing' price/earnings ratio for the S&P500 market (red line)

The price/earnings ratio (p/e ratio or PER) is the index price divided by the 'trailing' (ie backward-looking) aggregate earning per share over the most recent four quarters. How much am I paying per dollar of actual reported profits?

(Contrary to a common market myth, high p/e ratios don't always mean the market is 'expensive'. In fact, most of the high p/e ratios have been when profits collapse, which is usually in the early stages of share price rebounds in the middle of economic recessions or slowdowns. The highest p/er ratio in the past 30 years an extraordinary 148 in 2009 due to the collapse in profits in the GFC.)

The current trailing p/e ratio for the S&P500 market is a rather high 28 times earnings – I am paying $28 for every $1 of reported profits. That is very high, whichever way you look at it.

How high is the current p/e ratio?

For the US market (S&P500) – the median trailing price/earnings ratio since 1950 has been 17.4 times earnings. However, most people use median p/e over a more recent period. For example, since 1980 the median has been 19.8. Rule of thumb: anything over 20 is high.

Using a period like 'since 1980' sounds nice, but the post-1980 period was the wonderful era of disinflation, deregulation, laissez-faire, smaller government, tree trade, and globalisation. That golden era is clearly over, and the median p/e ratio of 20 since 1980 is probably not that relevant anymore.

We are now into a new era re-inflation (or at least no more disinflation), re-regulation, interventionist, big government, protection, and global, de-coupling, so it makes sense to base our median p/e ratio on a longer period which includes more than just the recent post-1980 golden era of disinflation and declining/low interest rates.

Either way, whatever historic period you use, the current price/earnings ratio is still very high. ie the market is very expensive relative to the level of underlying corporate profits.

4. Current broker consensus forecasts for EPS (green dots)

Now we get to the big problem with the current market pricing.

Current consensus EPS forecasts (based on analysts' estimates and company guidance) is indicated by the green dots to the right of the green EPS bars, highlighted in the red oval. This is underpinning the current optimistic sentiment and pricing.

At the start of 2025, the consensus forecast for earnings growth was an astronomical +25% for 2025. That made no sense at all, coming on top of good profit growth of +9% in calendar 2024, and +11% in 2023 (which was a recovery of the profit decline in 2022).

However, over the past month in April/May, broker consensus forecast earnings growth rates have been **cut** by 5-10% because of fears of tariff impacts on company earnings.

The problem is that these reduced outlooks are still forecasting aggregate earnings growth of +13% over the 12 months. This is no 'soft landing' scenario – this is a very bullish forecast for a further **acceleration** of corporate profits?

Likely Fed cut rates?

Much of this bullishness is due to widespread expectations of several more Fed rate cuts this year. Is this reasonable?

The Fed cut rates three times in late 2024 as inflation fell back from 8.8% down to 3%. But in 2025 the Fed has been sitting on its hands waiting to see the impacts of the tariffs. The Fed may well deliver several rate cuts but if it does, it will be because of an economic **slowdown** or **recession**, and that would likely be accompanied by a **decline** in corporate profits, not double-digit growth!

Profit forecasts are still very bullish

The current consensus forecasts of 15% EPS growth in 2025 and another 15% growth in 2026 is extraordinarily bullish, given that nominal GDP growth is likely to be in the order of say 4% to 5% at best (being real GDP growth of say 2.5% to 3% plus inflation of say 2% to 2.5%). US real GDP growth was a fraction **negative** in the March quarter 2025 (caused by a surge in imports before the tariffs), but it was so small we can say it was effectively zero.

Nominal growth in the overall US economy of say 4% to 5% pa limits top-line revenue growth for US companies because the US giants already have dominant market shares globally (and China is increasingly shutting out access to US companies already selling into China).

With wages rising, the forecast big jumps in bottom line profit growth is based on big cuts to interest rates - back down near the wonderful days of ZIRP (zero interest rate policy). The only way we will get big cuts to inflation and interest rates is another deep recession.

US earnings per share growth tracks US nominal economic growth

Here's the problem. Despite US companies growing to dominate the world in a wide range of industries (not just tech), growth in aggregate earnings per share for US companies has more or less tracked the rate of growth in the US economy over time.

Historically, the aggregate earnings per share for S&P500 companies has grown by an average of 6.0% pa since 1980, and 6.1% pa since 1950. These are rather modest growth figures, but that is what the largest 500 US companies have delivered for many decades.

At the same time, growth in the US economy (nominal GDP) has averaged 5.4% pa since 1980, and 6.5% since 1950. This is more or less the same as the growth rate for aggregate US company earnings per share. No big surprise there, so what's the big deal?

The current forecasts are earnings growth of 15% in 2025, and then another 15% growth in 2026. These are at least three times the likely growth rates for the US economy and the overall global economy.

It is not as if company profits are rebounding from a big profit crash like the GFC or the Covid recession, where high post-crash profit growth is really just getting back on to the pre-existing trend. The green dotted forecast line on the current chart is clearly soaring well ahead of recent and long-term trend growth.

'Recession scenario'

Also on the right end of the green EPS bars is my 'recession or slowdown scenario', which would see aggregate profits collapse by say 20-30% or so as in previous recessions. This sounds scary, but it is along the lines of five previous declines in aggregate earnings per share in the past three decades.

5. 'Forward' price/earnings ratio

The forward price/earnings ratio is the current price index level divided by forecast earnings over the **coming (forward)** 12 months. The forward p/e ratio for the S&P500 market is currently 24.7. (anything above 20 is a fed flag).

This is overly bullish for two reasons: First, because the accelerating forecast earnings growth rates appear overly bullish, and second, because the multiple investors are paying for those overly bullish earnings is also too high.

This is a valuation/pricing indicator – NOT a timing tool

The US share market as a whole appears to be in a 'double-whammy' of over pricing – as it is with the **CAPE ratio** and many other valuation measures - but this tells us nothing about **timing**.

An over-priced boom can run on for several years into even more over-priced territory until the final trigger for collapse.

For example - the 1990s was a decade-long boom into vastly over-priced levels until it finally collapsed in the 2000-2 tech-wreck and deep US recession. The 1920s was also a decade-long boom into vastly over-priced levels until it finally collapsed in the 1929-32 crash and Great Depression.

The current boom is just three years old (since the -25% fall in January-October 2022). It could run on for several more years into even more over-priced territory before finally collapsing. It could even break the over-pricing records set in 1999 and 1929. Records are made to be broken!

Although expensive pricing does **not** cause or trigger busts, it does increase the vulnerability and sensitivity to triggers that will one day end the party. The longer and higher the boom, the bigger the eventual bust.

So far, investors have shrugged off China's DeepSeek AI surprise, Trump's reciprocal tariffs, the negative quarter of US real GDP growth, and also Moody's credit downgrade. It is going to take a lot more than these to break US investor confidence!

I did not 'buy the dip', nor did I panic sell, so I am positioned for more upside (and have been over-weight gold) – for the time being anyway.

Ashley Owen, CFA is Founder and Principal of [OwenAnalytics](). Ashley is a well-known Australian market commentator with over 40 years' experience. This article is for general information purposes only and does not consider the circumstances of any individual. You can subscribe to OwenAnalytics Newsletter [here]().

Family trust tax: When is a loan not a loan?

Peter Bardos

A recent court case involving the Australian Tax Office (ATO) could have a significant impact on the tax payable by beneficiaries of family trusts.

Since late 2009, the ATO has held the view that when a trust appoints income to a corporate beneficiary but doesn't actually make the payment (known as an unpaid present entitlement, or UPE), this constitutes a 'loan' for tax purposes. Accordingly, the UPE must be paid or put on complying loan terms according to Division 7A tax rules. Otherwise, it is considered an unfranked dividend and will incur an extra tax burden.

Division 7A is part of the Income Tax Assessment Act 1936 which is intended to prevent profits or assets being provided to shareholders or their associates tax free. Division 7A extends the meaning of 'loan' to include:

- an advance of money
- a provision of credit, or any other form of financial accommodation
- a payment for a shareholder or their associate, if they have an obligation to repay the amount whether it's
    - on their account
    - on their behalf
    - at their request
- a transaction (whatever its terms or form) that is the same as a loan of money.

Within Division 7A is Subdivision EA, which applies where a private company is entitled to a distribution from a trust but the amount remains unpaid and the trust makes a payment or loan a shareholder or associate of the private company. The ATO's view has been that where the UPE remained unpaid Division 7A applied because of their interpretation of 'loan', regardless of Subdivision EA.

The ATO's view on UPEs had not been tested until 2023 when Steven Bendel appealed to the Administrative Appeals Tribunal (AAT) on behalf of his beneficiary company, Gleewin Investments Pty Ltd. The AAT found in favour of Mr Bendel and Gleewin, ruling that UPEs to Gleewin were not loans.

The ATO appealed the AAT's decision to the Full Federal Court which subsequently handed down its judgement earlier this year, on 19 February 2025. In a unanimous decision, the Court ruled that UPEs do not fall within the definition of a 'loan' for Division 7A.

But that's not the end of the story. The ATO has since (on 18 March 2025) applied to the High Court for leave to appeal that decision and has released an Interim Decision Impact Statement.

In this statement the ATO has made it very clear that it still plans to treat UPEs as a loan while it waits to hear from the High Court about its leave to appeal, and that anyone failing to make payments of an entitlement will have those payments viewed as loans.

This has further been confirmed in a recent release on the ATO's website 'Deputy Commissioner Louise Clarke discusses Bendel decision'. In this release the Deputy Commissioner highlights that "where a UPE isn't converted into a complying Division 7A loan, taxpayers face the prospect that other integrity provisions may apply to their arrangement (depending on the particular facts), for example Subdivision EA and section 100A"

What does it mean?

This is not an uncommon issue – we regularly see instances of UPEs, but we are all in limbo regarding how the Bendel case could impact private groups both retrospectively and in the future. There is no indication on how long it will take the High Court to decide whether or not to grant the ATO permission to appeal. It could take months or even years for the process to be completed.

What is of note in the Interim Decision Impact Statement is the ATO's intent to use another part of the law to maintain its position, in this case Section 100A.

Section 100A received some attention a couple of years ago, when the ATO said it knew of people who had been using their trusts to distribute to a range of family members, but the ultimate benefit of that cash was used by someone else. An example of this would be appointing income to adult children but taking the cash personally.

Section 100A refers to appointing income to a beneficiary but another person enjoys the benefit of that distribution. And if section 100A applies, the trustee of the trust is taxed at the top marginal rate, which is potentially an even worse outcome for trusts than Division 7A.

The Interim Decision Impact Statement is implicitly reminding us that in 2022, the ATO released a practical compliance guideline, as well as an updated ruling on section 100A. If it sees a trust appoint income to a corporate beneficiary and that's left unpaid, it might look to apply section 100A. If the unpaid entitlement is put on complying Division 7A loan terms, the chances of that happening are lower.

It seems fairly obvious that the ATO will pursue its position on UPEs and even look to other parts of the law if it is not granted leave to appeal by the High Court. If it is not able to appeal, or the appeal is rejected, the ATO is likely to formalise the interim decision impact statement into a decision impact statement.

This is hardly unsurprising given the potential for millions of dollars in refunds from the ATO if the family trusts that had been caught with UPE not under 7A Division loan requirements, demanded reassessments of excess tax paid.

There are legitimate reasons why UPE might arise in certain situations. Consider a trust that might have taxable income, but it might not get the cash. For example, it might invest in a public trust. And that trust makes income, but it reinvests it and doesn't actually pay the cash to the beneficiaries. It could have investments that require contributions of capital throughout time, and it has a call on that capital. The difficulty arises when the trust doesn't have that money available to distribute to the beneficiary.

What next?

As highlighted above, it looks like the ATO is set on maintaining its position. In its Interim Decision Impact Statement, it outlines that until the appeal process is finalised, where a decision turns on whether or not a UPE is a subsection 109D (3) loan, it does not propose to seek to finalise:

- decisions on issuing amending assessments
- decisions on private ruling applications that go directly to this issue, or
- objection decisions in relation to objections to past-year assessments (for which no settlement was reached).

"However, if a decision is required to be made (for example, because the taxpayer's period of review will elapse or a taxpayer gives notice requiring the Commissioner to make an objection decision), our decisions will be based on the existing ATO view of the law," the statement says.

It is of course possible, and potentially likely, that it is not granted permission to appeal, but there is always Section 100A it could fall back on.

For now, we suggest clients, and anyone in this position with UPEs, wait and see. If you don't have a high-risk appetite, consider putting any UPE on Division 7A complying loan terms in order not to incur unnecessary tax. Note however that once a UPE is converted to a loan within the ordinary definition of 'loan', it will be subject to Division 7A regardless of the Bendel case outcome.

If the ATO has previously imposed additional tax, penalties or interest in relation to UPEs in your family group, we would suggest you watch this space closely or speak to your consulting accountant.

Peter Bardos is a tax partner at HLB Mann Judd, Sydney. This article is for general information only. It should not be accepted as authoritative advice and any person wishing to act upon the material should obtain properly considered advice which will take into account their own specific circumstances.

Things you must consider before subdividing a property

Danielle Hart, Daniel Walachowski

With property prices rising and demand for housing increasing, many homeowners are exploring the idea of property development, often literally in their own backyards.

Subdividing is frequently the first step for those starting out in property development. This may be subdividing your own property or knocking down an old property and subdividing the land.

Subdivision can offer substantial financial rewards but it also comes with legal, planning, and taxation considerations that must not be overlooked. Here, we outline some important considerations:

What does subdividing involve?

Subdividing typically means splitting a single residential block into two or more lots, often to build and sell, or to retain a dwelling. This process requires council approval and adherence to zoning, access rights, and minimum lot size regulations. Property owners planning to subdivide will need to engage a surveyor, town planner, and sometimes a solicitor or conveyancer to guide their projects through planning permits, subdivision plans and titles registration.

[For more information, by state/territory: Australian Capital Territory, New South Wales, Northern Territory, Queensland, South Australia, Tasmania, Victoria, Western Australia]

Tax implications to consider

Before proceeding, it's also crucial that developers understand how the Australian tax system treats subdivisions and property developments. The relevant taxes here include:

1. Goods and Services Tax (GST): When you subdivide with the intent to sell for profit (especially if you have constructed a new dwelling), the ATO may classify your activity as an 'enterprise'. This means you may be required to register for GST, complete Business Activity Statements and remit 1/11th of the sale price to the ATO. Importantly, you will also be able to claim GST on the construction costs while completing the development. GST implications are particularly relevant if you are developing more than one property or operate in a business-like manner. The need to manage GST is a consideration that we frequently see first time developers misunderstand or miss altogether in their planning.

2. Capital Gains Tax (CGT): When you sell a subdivided portion of your land, CGT may apply. While your main residence is generally exempt from CGT, this exemption may not apply to the portion being sold, especially if it's no longer part of your primary residence or, if it's used to generate income. If you have already subdivided your main residence in the past, this will also be considered as an important factor when capital gains are calculated. Depending on your type of subdivision, market value uplifts can apply to the cost base of the property for CGT purposes.

3. Income Tax: The profits you make from your subdivision can be treated as either a capital gain or ordinary income, depending on your intentions. If the ATO determines your actions amount to property development, the profits may be taxed as income, at your marginal tax rate, rather than under the more concessional CGT regime.

4. Stamp Duty: Your subdivision itself doesn't trigger stamp duty – but it may be applied if you transfer newly created titles (for example, to a trust or related entity).

Planning and unexpected costs

In our experience, planning for these unexpected taxes is absolutely critical in your overall property development preparation, and it's a step often overlooked by new developers.

Before undertaking a property development, you must consider what your intentions will be once the development is complete. This may be retaining the property to live in, selling the property at completion, or retaining to earn rental income. Each scenario will have differing CGT, GST and tax outcomes. It's equally important that you also forecast for unexpected costs that can occur during the development, such as the rising construction costs currently being experienced.

Seek professional advice

Given the complexity of taxes involved, we strongly recommend that you speak to a tax advisor or accountant who is experienced in property development before you undertake a subdivision. Proper structuring and planning can help minimise your tax and avoid costly surprises.

While subdividing your property for development can be a lucrative opportunity, it's important to understand the tax consequences and to make informed decisions to help you maximise your return and minimise your exposure to tax obligations and other unforeseen costs.

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5 insights that put market volatility in perspective

Jorden Brown

You wouldn't be human if you didn't fear loss.

Nobel Prize-winning psychologist Daniel Kahneman demonstrated this with his loss-aversion theory, showing that people feel the pain of losing money more than they enjoy gains. As such, investors' natural instinct is to flee the market when it starts to plummet, just as greed prompts us to jump back in when stocks are skyrocketing. Both can have negative impacts.

Given the uncertain environment, investors may have doubts about their investment approach. It is natural to seek calmer shores when markets are choppy. But it is equally important to step back, gain perspective and look towards the horizon.

History shows stock markets have always recovered from previous declines although there is no guarantee downturns will lead to rebounds. Here are five insights that can help investors regain confidence and stay invested for the long haul.

When in doubt, zoom out

If you go back to 2018, the first Trump administration's tariffs on China sparked a trade war that panicked markets and dominated the news. What's more, two US government shutdowns, challenging Brexit negotiations and a contentious mid-term election further stoked market pessimism.

How did stocks react? Fears that a trade war between the two largest economies would lead to a global slowdown sent the S&P 500 Index down 4.4% in 2018, falling as much as 19.4% from 20 September to 24 December that year. But the index recovered sharply in 2019, up 31.1%, as trade deals were announced and consumer spending steadied.

Will market choppiness in 2025 give way to smoother sailing in 2026? There is no way to tell, but next year's mid-term elections could shift the Trump administration's focus to trade deals and more bread-and-butter issues that add economic optimism rather than uncertainty.

Markets typically have recovered quickly

While markets can be treacherous during periods of heightened volatility, they have often bounced back quickly. Indeed, stock market returns have typically been strongest after sharp declines. The average 12-month return from the S&P 500 immediately following a 15% or greater decline is 52%. That is why it is often best to remain calm and stay invested.

How often do market corrections of 10% or more in the S&P turn into entrenched bear markets? Turns out, not often. More common are short periods of pullbacks ranging from 5% to 10%. While these may feel unsettling, a drop of 5% occurred twice per year on average, while corrections of 10% or more happened every 18 months on average, from 1954 to 2024. And while intra-year declines are common, the good news is 37 of the last 49 calendar years have finished with positive returns for the index.

Bear markets have been relatively short-lived

A long-term focus can help investors put bear markets in perspective. From 1 January 1950 to 31 December 2024, there were 11 periods of 20%-or-greater declines in the S&P 500. And while the average bear market decline of 33%

per year might have been painful to endure, missing out on the average bull market's 265% return could have been far worse.

Bear markets are also typically much shorter than bull markets. Bear periods have averaged 12 months, which can feel like an eternity, but pale in comparison with the 67 months of average bull markets — another reason why trying to time investment decisions is ill-advised.

Most bear markets coincide with recessions, which are also relatively infrequent. Without a recession, a growing economy can still spur positive corporate earnings growth, which supports equity prices. Market declines outside of a recession have tended to be shorter than those during a recession, lasting about six months versus 17.

Forecasting recessions is tough. Many investors, for example, were bracing for a recession when the Federal Reserve raised rates in 2022 to combat sky-high inflation. Instead, the US economy grew, and markets posted double-digit gains in 2023 and 2024.

Today, steep tariffs elevate the risk of a recession. Policy uncertainty is causing companies to pause investments and hiring while prompting consumers to reduce spending. But the economy has surprised to the upside before, and it's too early to tell if widespread job losses, the hallmark of a recession, will occur.

Bonds can offer balance when it is needed most

In periods of slowing economic growth, bonds often shine brightest. In fact, it is the reason why high-quality bond funds are often the foundation of a classic 60% equities and 40% bonds portfolio. While the exact allocation may shift, a diversified portfolio is intended to generate attractive returns while minimising risk.

Bonds tend to zig when equity markets zag, and so far this year that pattern is holding. Bonds have returned 1.88% year to date ended 15 April 2025, compared to the 7.89% decline of the S&P 500 Index. An exception was 2022 when stocks and bonds both fell significantly in the face of rising inflation and rapid interest rate hikes by the Fed.

Markets are penciling in rate cuts this year in anticipation of a tariff-induced economic slowdown. Fed officials face a challenging backdrop when it comes to determining an appropriate policy response. They need to balance labour market and growth concerns with potential inflationary pressures.

Still, significant economic downturns have typically been met with rate cuts, which should have helped boost returns for core bond funds during these periods, as represented by the Bloomberg US Aggregate Bond Index. Bonds should offer diversification in equity market downturns as their prices normally rise as yields fall.

Moreover, with bonds offering compelling income potential today, investors may be able to take on less risk with high-quality bonds while still meeting their return expectations.

Staying the course has paid off for long-term investors

When markets are volatile, it is hard to resist the urge to do something. Suggestions to stay the course offer little comfort when markets and emotions are spiraling. But in many cases, the best course of action has been none at all.

The lesson? Market declines can be painful to endure, but rather than trying to time the market, investors would be wise to stay the course. To weather market volatility, they should seek diversification across stocks and bonds, while periodically examining their risk tolerance for elevated volatility. Though it may feel like this time is different, markets have shown resilience throughout history when confronted by wars, pandemics and other crises.

Note: Data as at 31 December 2024. Source: Capital Group.

Jorden Brown is Head of Client Group 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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Concerns about China's rise to power seem overblown

Michael McAlary

Statecraft history may provide some insight into the world where China challenges US hegemony.

Why? Because many folks are concerned about a future with China, a non-democratic country, becoming a global power and possibly a new global hegemony. Western folks have only ever known western imperialism and have generally benefited from it.

In the western world, some view the rise of China with fear and distain, and historically these views are based purely on racist sentiments.

China is considered a threat to the world order and a challenge to US exceptionalism, so many are calling for the preparation for war and American actions including sanctions, tariffs and pulling back from Europe and the Middle East are consistent with moving to a war footing.

The idea that European/American society is an inherently superior civilisation is embedded in a range of ideologies stretching back over centuries. Until recently, these beliefs were embedded in European governments' actions, and in more recent times in American government behaviour and the so called "US exceptionalism".

The key question is whether China will act in the same manner as historical hegemonies. To answer this question, we need to consider both European (which includes the US, as it was a colonial project) and Chinese history.

The European approach to statecraft

European statecraft is based on state dominance, where states are competing with each other, and frequently at war.

State dominance takes three forms - economic, religious and military. All European empires, e.g. the Roman, Spanish, French, Portuguese and British empires have used these elements in their colonial pursuits. Similarly, the American empire has embraced this model, albeit with less focus on religion and more on spreading democracy and control over autocratic regimes, e.g. Saudi Arabia.

This European statecraft approach has meant that war became the normal state of being in Europe from about 500AD to the 1950s, and since WW2 the USA has been involved in the so called "forever wars" and coups.

China's approach to statecraft

China statecraft thinking applies a Confucianism approach which is a system of social and ethical philosophies, rather than religion-based philosophies.

Chinese statecraft is about internal order, and by and large China has had peaceful relations with its neighbours. For nearly 500 years – from 1358 (Ming Dynasty) to 1839 (first Opium war created by the British) – China did not have wars with its neighbours. Instead there were internal wars and power struggles.

The facts support the conclusion that external imperialism and colonialism are not part of the Chinese statecraft. Does that apply today? Some may argue it does, while others say China will act in the same manner as European style statecraft.

Geographically, China is boxed in by the Pacific Ocean to the east, Himalayas to the west, tropics in the south and the dry lands to the north. China has fragmented at times and then reunited. For most of the last 2000 years, China has been a centralised controlled state and isolated from the rest of the world.

Of course we do not know the future. However, we pose some questions below that readers may wish to consider in formulating their views about a future with China being a global power.

1. Will China naturally have a different statecraft because of its lack of democratic history? Or will it simply adopt the approach of the Western countries?
2. Will China's millennia of Confucian-based statecraft – compared with Western statecraft where religion is an important element – lead to a different statecraft? Perhaps it will be a mixture of the two.
3. Will China, having been isolated for hundreds of years until relatively recently, lean towards a different type of statecraft?
4. Are the Confucian values so strong that it will override the natural imperialistic statecraft approach?

Michael McAlary is Founder, CEO and Managing Director of [WealthMaker Financial Services](), a family office that provides investment, financial planning and mortgage broking services. This article is for general information only and has been prepared without taking into account your personal objectives, financial situation or needs.