Firstlinks

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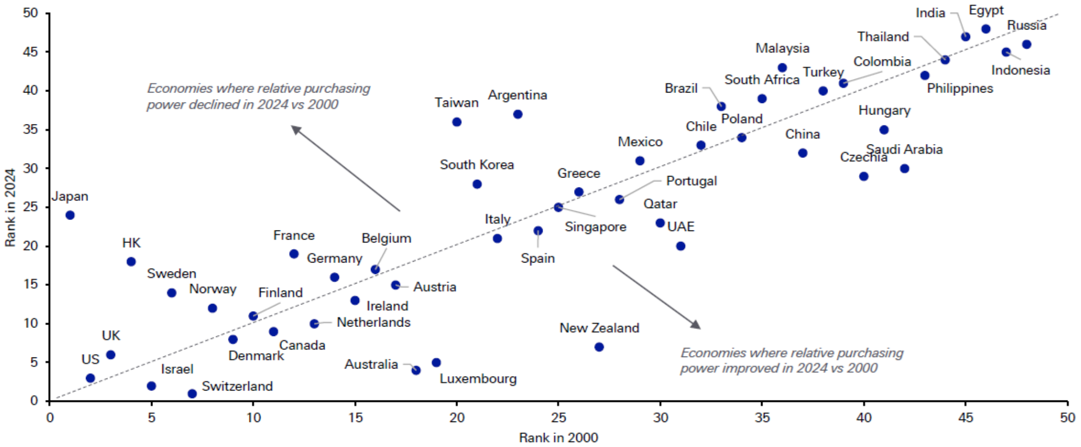
Editorial

We hear a lot about our cost-of-living crisis but how do prices in Australia compare to the rest of the world? Deutsche Bank has released a new report, *Mapping the World's Prices*, that compares the prices of everyday things such as rent, phones, coffee, taxis, and more across 69 of the largest cities. Fair warning that of Australian cities, only Sydney and Melbourne are included.

Purchasing power parity

A common way to compare costs between countries is by measuring purchasing power parity (PPP). This economic concept suggests that in the long run exchange rates should move towards the rate that would equalise the prices of an identical basket of goods and services in any two countries.

Relative Price Levels as Implied by PPP (US = 100), ranked by economy between 2000 and 2024



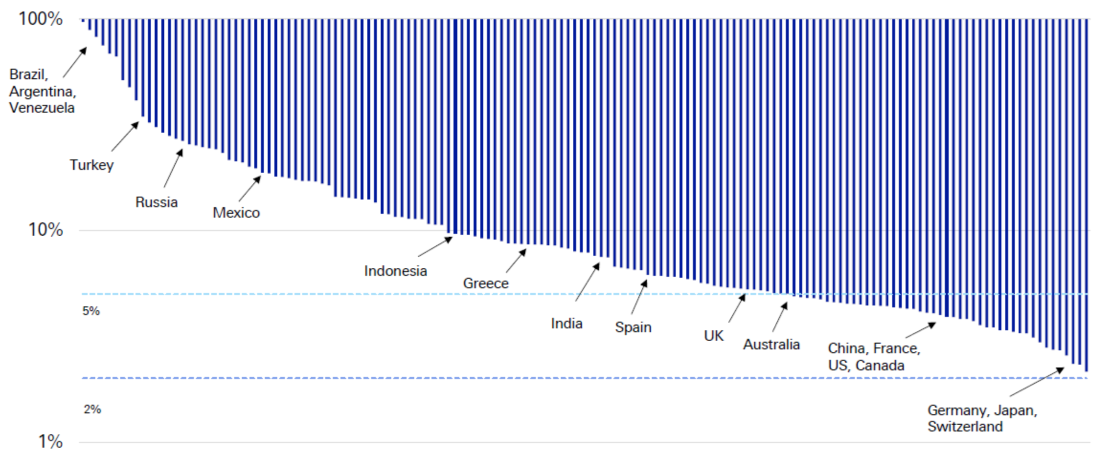
Source : IMF, WEO, Haver Analytics, Bloomberg Finance LP, Deutsche Bank calculations.
Note: The PPP conversion rates as published by the IMF have been adjusted with actual foreign exchange rates (as on 31 December each year) to derive the implied price levels. Also note that some of the above numbers may not match those published last year exactly due to data revisions.

In PPP terms, Australia now ranks fourth in the world, behind Switzerland, Israel, and the US. Australia has become more expensive since the start of the century, when we ranked 18th.

Deutsche asks a pertinent question: why is Switzerland so expensive? The bank believes it's due to an attractive mix of being home to high-paying industries and having a stable currency as well as one of the lowest inflation rates in the world. That's allowed it to retain purchasing power and has helped it to attract capital and people.

The fascinating chart below shows that no country has seen inflation average below 2% since Bretton Woods collapsed in 1971, though Switzerland is closest at 2.2%.

Average annual inflation of 152 countries since 1971 when the Bretton Woods system collapsed. No country has averaged less than 2% inflation but Switzerland at 2.2% comes closest.

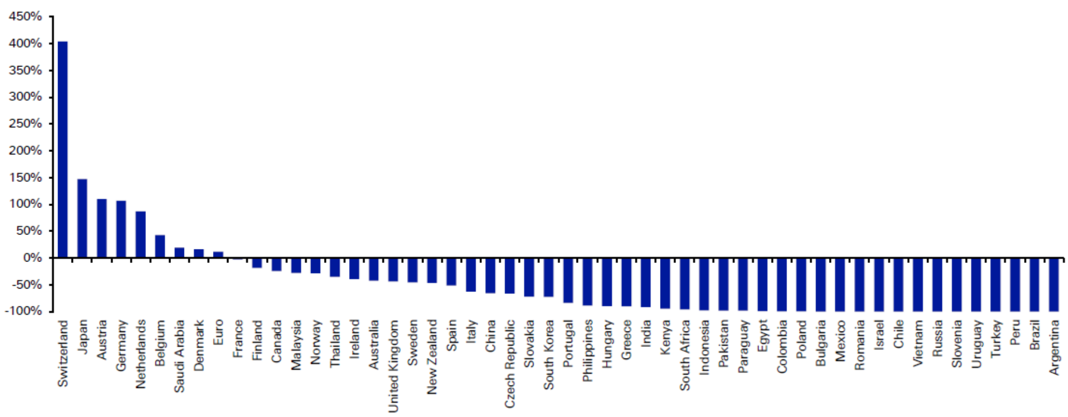


Source : World Bank, Deutsche Bank. Note: log scale.

Interestingly, Australia's inflation has averaged closer to 5% - an inglorious track record.

The track record on inflation for different countries broadly correlates to the performance of currencies. Again, Switzerland stands out here.

Change in value vs US Dollar since June 1971. Switzerland stands out on the positive side but with several EM countries seeing their currency completely debased over the full period….



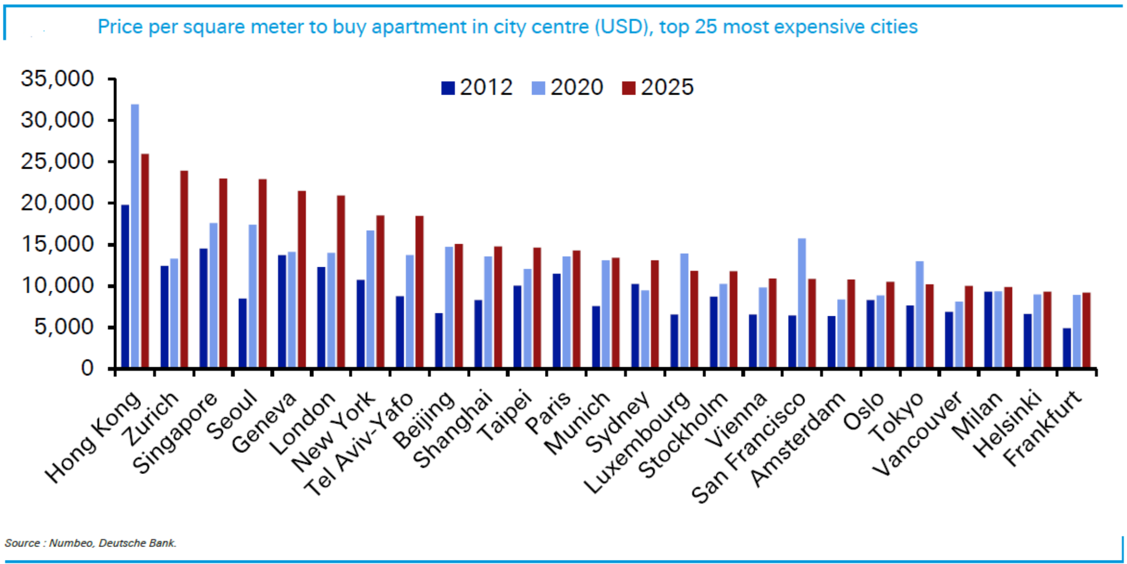
Source : Finaeon, Deutsche Bank.

Prices of everyday items

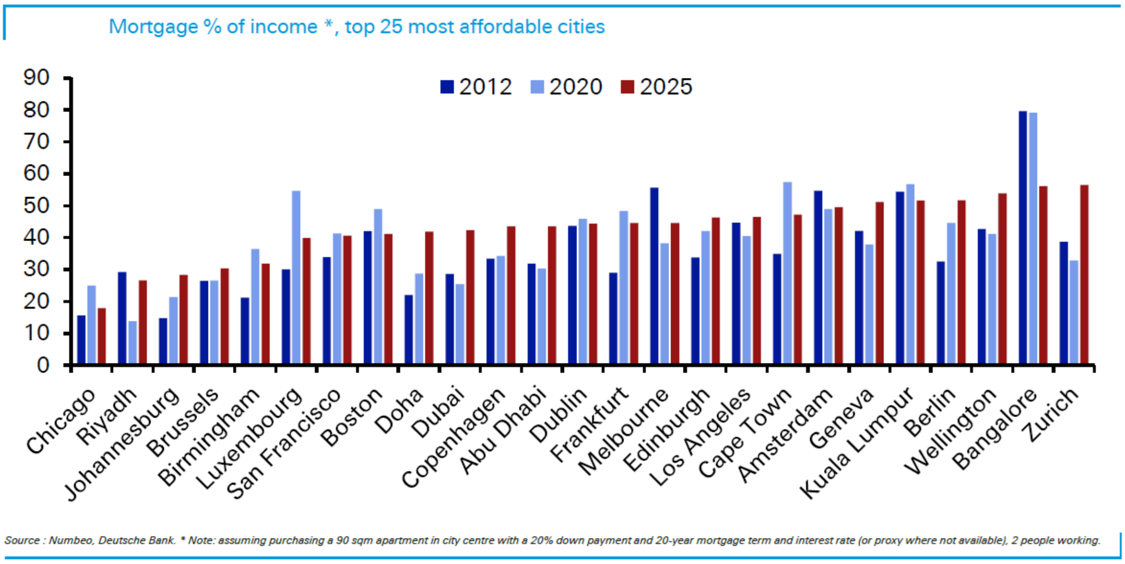
Deutsche goes on to break down the prices of everyday items across the 69 cities.

For apartment prices, it will surprise some that Sydney and Melbourne don't rank in the top 10. The reason is due to the way that Deutsche has measured these prices – it's taken prices *per square metre*. On this basis, Sydney comes in 14th place, while Melbourne is 39th.

Hong Kong has the most expensive apartment prices, followed by Zurich and Singapore.



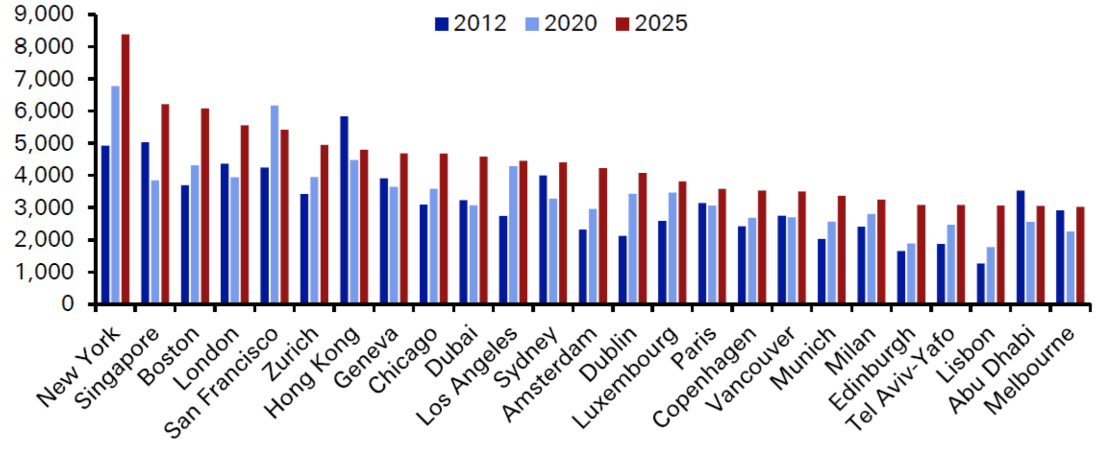
When comparing mortgages to income, we're not badly off either. Sydney is ranked 30th, while Melbourne is now in the top 25 of the most *affordable* cities.



As for rents, Sydney and Melbourne don't feature in the top 10 most expensive cities, coming in 12th and 25th places respectively.

The most expensive rents are found in New York and Singapore.

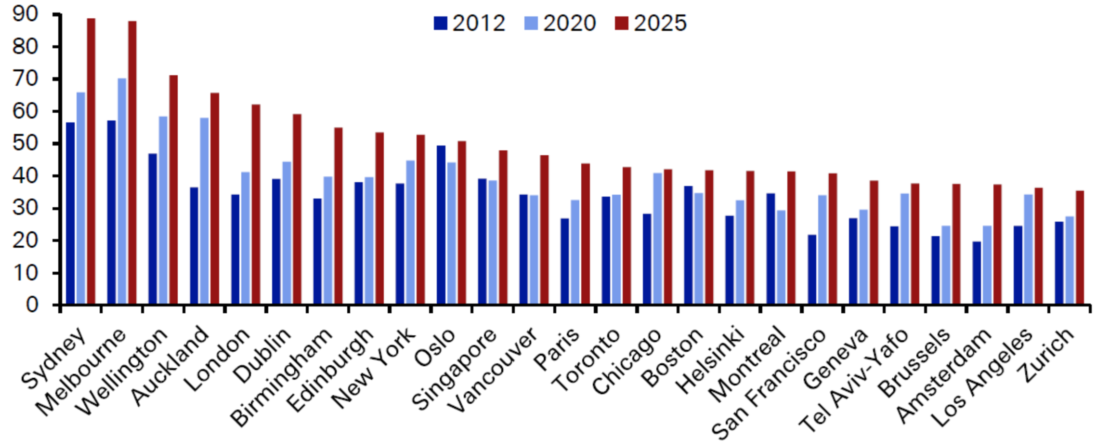
Figure 9: Rent per month for a 3-bedroom apartment in city centre (USD), top 25 most expensive cities



Source : Numbeo, Deutsche Bank.

The one category where Australia is a world leader is in costs for cigarettes and alcohol. Sydney and Melbourne are first and second in this category, cheekily dubbed the 'Oasis index' by Deutsche.

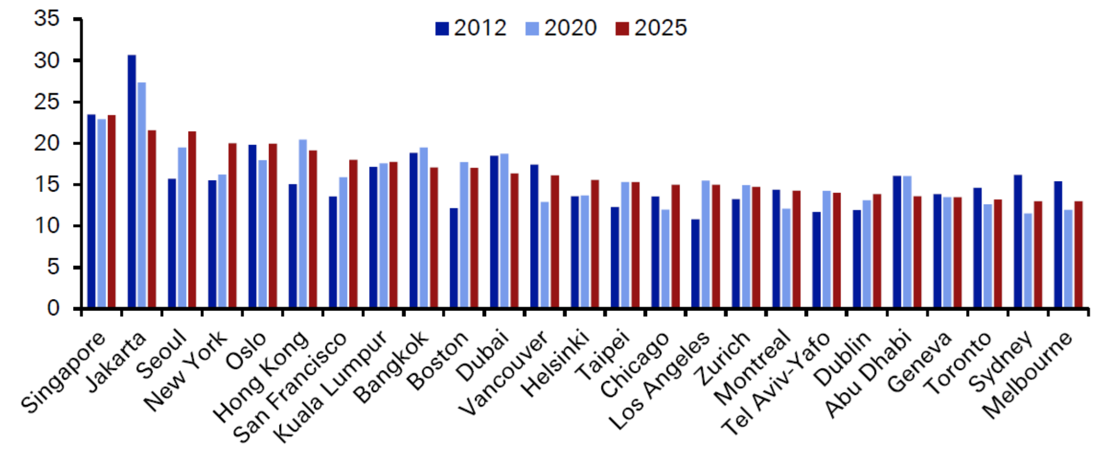
Our "Oasis" index (USD), top 25 most expensive cities for cigarettes and alcohol (beers)



Source : Numbeo, Deutsche Bank calculations. Note: We have defined the "Oasis" index as 5 beers and 2 packs of cigarettes.

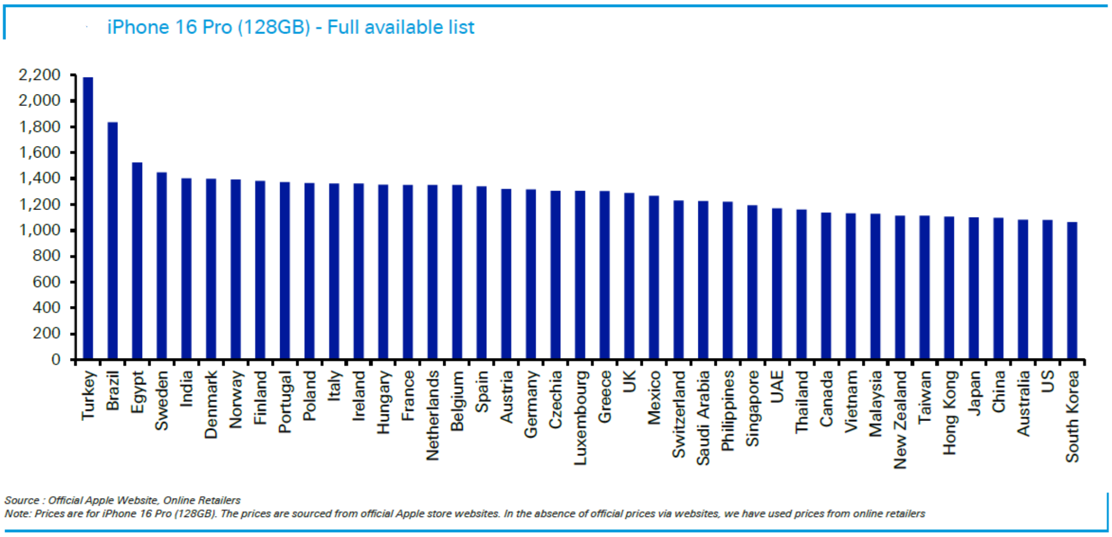
Yet, we're not that expensive when it comes to prices for mid-range bottles of wine.

Prices of mid-range bottle of wine (USD), all cities

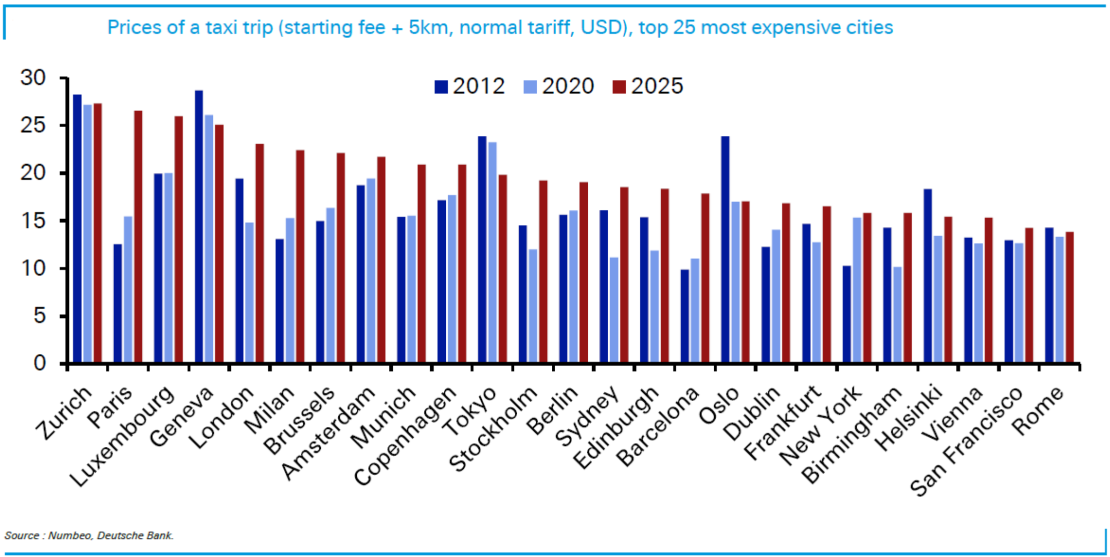


Source : Numbeo, Deutsche Bank.

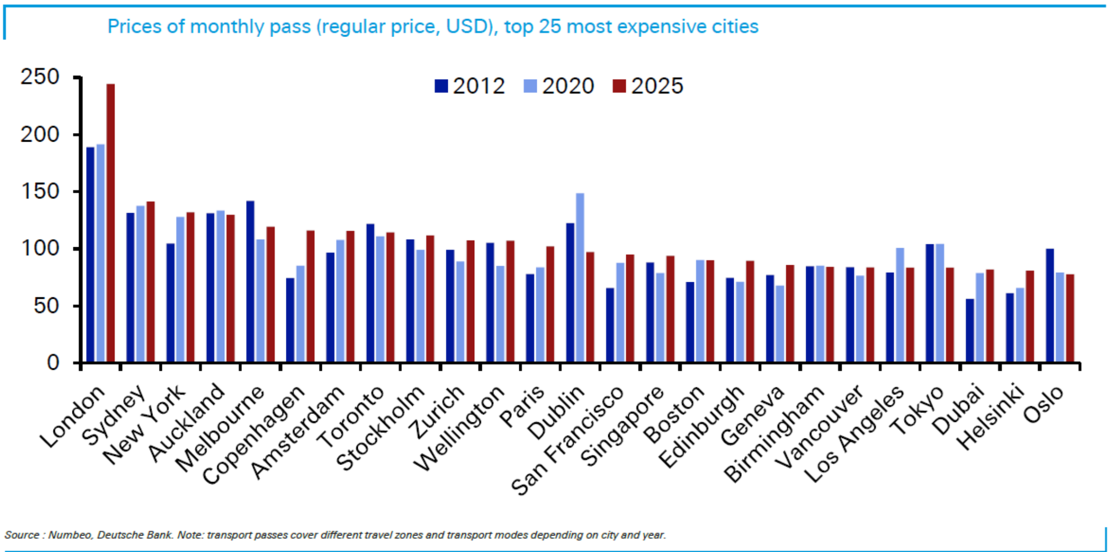
And prices for iPhones here also look reasonable.



However, taxi prices in Australia are relatively high. Sydney is the 14th most expensive place for taxi trips. As a general rule, you want to avoid catching taxis in Zurich, Paris, Geneva, and London.



For public transport though, we are pricey, with Sydney ranking 2nd and Melbourne 5th.



What about food? It seems common grievances about grocery prices are valid. Grocery prices in Sydney and Melbourne rank as the 11th and 15th most expensive. On this measure, Geneva, San Francisco, and Zurich lead the way.

And how do we stack up when it comes to cappuccinos? Pretty well, it turns out. Melbourne ranked 40th and Sydney 47th in terms of cappuccino prices.

Quality of life

Deutsche aggregates a lot of this data into an overall quality of life index. It ranks the cities on eight measures, including PPP, safety, health care, cost of living, property prices to income, traffic commute times, pollution, and climate. The bank admits the quality-of-life index is a “highly subjective measure”.

Nevertheless, on this measure, Melbourne is 9th and Sydney 13th on the list. Melbourne scores strongly on PPP, property prices, pollution and climate, and is let down by traffic commutes and the cost of living. Meanwhile, Sydney scores well on PPP and climate, though poorly on traffic and the cost of living.

According to the report, the top five cities for quality of life are Luxembourg, Copenhagen, Amsterdam, Vienna, and Helsinki.

Intriguing, London and New York are near the bottom, tied in 50th place.

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In my article this week, the Labor government is conducting numerous reviews into productivity and talking up tax reform as a way to boost our stagnant economy. So it's a good time to take a quick stocktake with seven charts on who pays the taxes, who owns the assets and who earns the income. What do an average 100 Aussies look like?

On the topic of Labor's reviews, **Jonathan Rochford** also proposes 10 policies to lift our productivity, including introducing a flat income tax rate, reducing migration, and making childcare tax-deductible.

James Gruber

Also in this week's edition...

Shane Oliver is back with an overview of the state of the residential property market. He has seven key charts on what's really driving prices, supply, affordability, and the outlook.

The proposed $3 million super tax has been criticised for the use of unrealised capital gains and the lack of indexation. In effect, it is a complex measure to introduce improved fairness into the superannuation system. However **Dr David Knox** thinks there's a simple alternative that could fix the issues and achieve the government's goals.

After the meteoric rise in CBA shares, super funds are floating the idea of carving out the weightings of ASX bank securities and indexing them within their portfolios. **Andrew Brown** ventures back through history to show why this might be a bad move.

As money looks for a home outside the US, Asia may soon get more recognition. In an interview, **Fidelity's Anthony Srom** outlines the best places in Asia to invest, including in Chinese consumer names, Indian financials, and Thailand.

One of the most misunderstood concepts in finance is the time value of money. **Tony Dillon** says our overvaluing of the present and underestimating the future costs us dearly when it comes to savings, spending, and loans. He offers some workarounds to avoid common traps.

In this week's whitepaper, the **World Gold Council** has its mid-year outlook for the yellow metal.

Curated by James Gruber and Leisa Bell

100 Aussies: seven charts on who earns, pays, and owns

James Gruber

The Labor government seems intent on introducing its $3 million super tax as well as investigating broader tax reform to boost our flatlining economy. Before pushing through with changes, it's critical to recognize who pays the bills and who owns the assets.

That's where the Australian Taxation Office's annual snapshot of individual tax returns is useful. Because not everyone lodges their returns on time, the latest data are from the 2022-2023 financial year, though they offer fascinating details, nonetheless.

The snapshot reveals around 16.1 million individuals lodged tax returns in 2023.

Breaking it down by generations, for every 100 Australians lodging returns:

- 18 are from Generation Z (born between 1996 and 2009)
- 35 are from Generation Y (born between 1980 and 1995)
- 29 are from Generation X (born between 1963 and 1979)
- 15 are Baby Boomers (born between 1946 and 1962)
- 3 are from the Silent Generation (born in or before 1945)

So, 82% of taxpayers are younger than Baby Boomers.

Of the 100 people, 72 received a tax refund, 21 owed tax and 7 were perfectly balanced. Just 9 declared a capital gain, while 14 earned rental income (7 with losses and 7 with profits). Meantime, the proportion of men and women who lodged returns were split 50:50, and 77 came from states on the east coast.

Let's look further at the key points from the taxpayer snapshot.

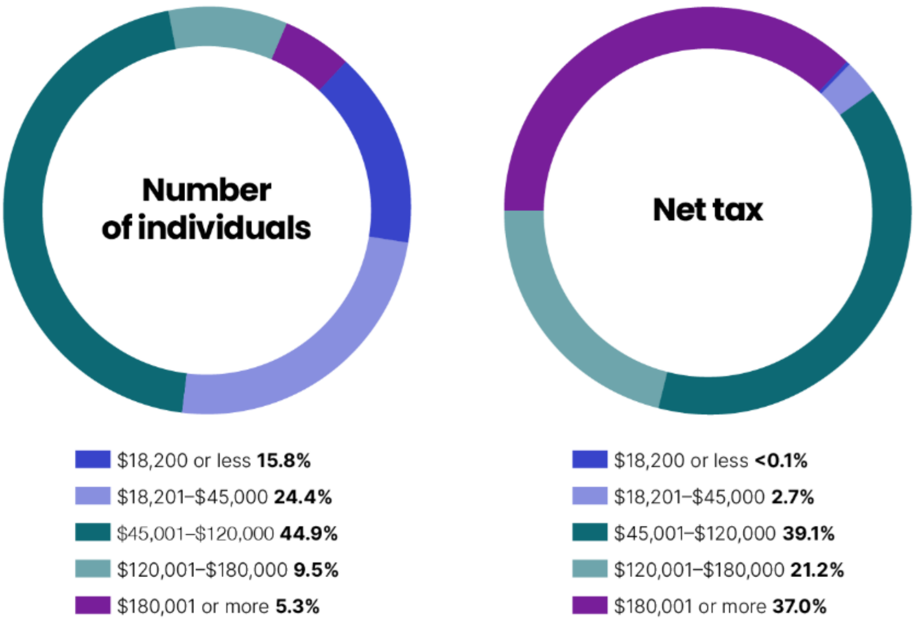
1. Who pays tax?

Australia has a progressive tax system where the more you earn, the more tax you pay. Most consider it a fair and equitable way for those with resources to provide for those without.

Nevertheless, the data on the gap between high- and low-income earners surprised me. Just 15% of Australians have an annual salary of $120,000 or more. And more than 40% earn less than $45,000 a year.

That 40% of taxpayers pay just 3% of the total tax tab. Meanwhile, the 15% earning more than $120,000 accounts for 68% of the net tax collected by the ATO.

Individuals – net tax, by tax bracket, 2022–23 income year



The ATO breaks it down further by ranking the 100 people by taxable income:

- The top 3 paid 29% of all net tax
- The next 6 paid 18% of all net tax
- The next 30 paid 40% of all net tax
- The next 35 paid 13% of all net tax
- The final 21 paid no tax

2. Taxable incomes

For the 2023 financial year, the average taxable income was $74,000. Averages can be deceiving, so it's often better to look at median incomes. And on this front, the median wage was $56,000. Put another way, 50% of Australians earn less than $56,000 a year.

There still seems a large gap between pay for men and women. The median salary for men is around $65,000 while for women, it's less than $49,000. This doesn't consider the proportion of men and women that are working full-time versus part-time or casual.

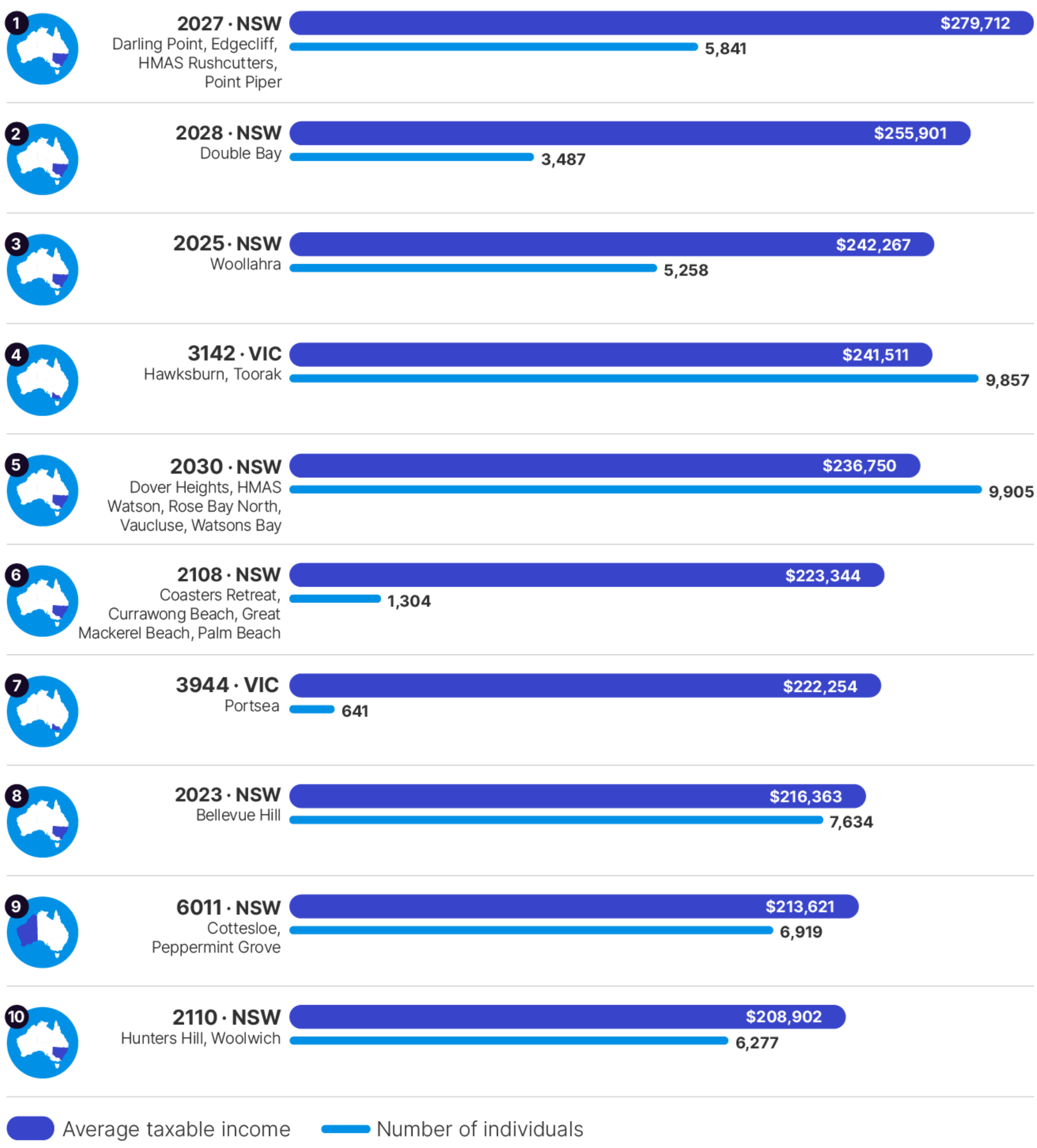
Finally, the average superannuation balance is close to $173,000. However, the median balance is only $60,000.

			2021-22			2022-23
	Male	Female	Total	Male	Female	Total
Average taxable income ($)	84,326	60,054	72,327	86,199	62,046	74,240
Median taxable income ($)	61,988	45,813	53,041	65,051	48,533	55,868
Average net tax ($)	27,206	17,456	22,616	28,206	18,465	23,562
Median net tax ($)	14,905	9,370	12,088	17,118	11,324	14,095
Average super balance ($)	182,667	146,146	164,126	192,119	154,641	172,834
Median super balance ($)	66,159	52,075	57,912	68,568	54,349	60,037

3. Top taxpayers by postcode

Let's turn to the top end of town and the top 10 postcodes by average income. NSW has 7 of the leading postcodes, Victoria 2 and Western Australia 1 (the ATO chart below mistakenly places Cottesloe and Peppermint Grove in NSW instead of WA).

Individuals – top 10 postcodes, by average taxable income, 2022–23 income year



It isn't a surprise to see Sydney's eastern suburbs occupy four of the top five spots. The likes of Darling Point and Point Piper have average wages of $279,000, a reasonable way ahead of Double Bay in second place.

People in Hawksburn and Toorak in Melbourne have average salaries of $242,000.

Meantime, WA's only entrants, Cottesloe and Peppermint Grove, have average wages of $214,000.

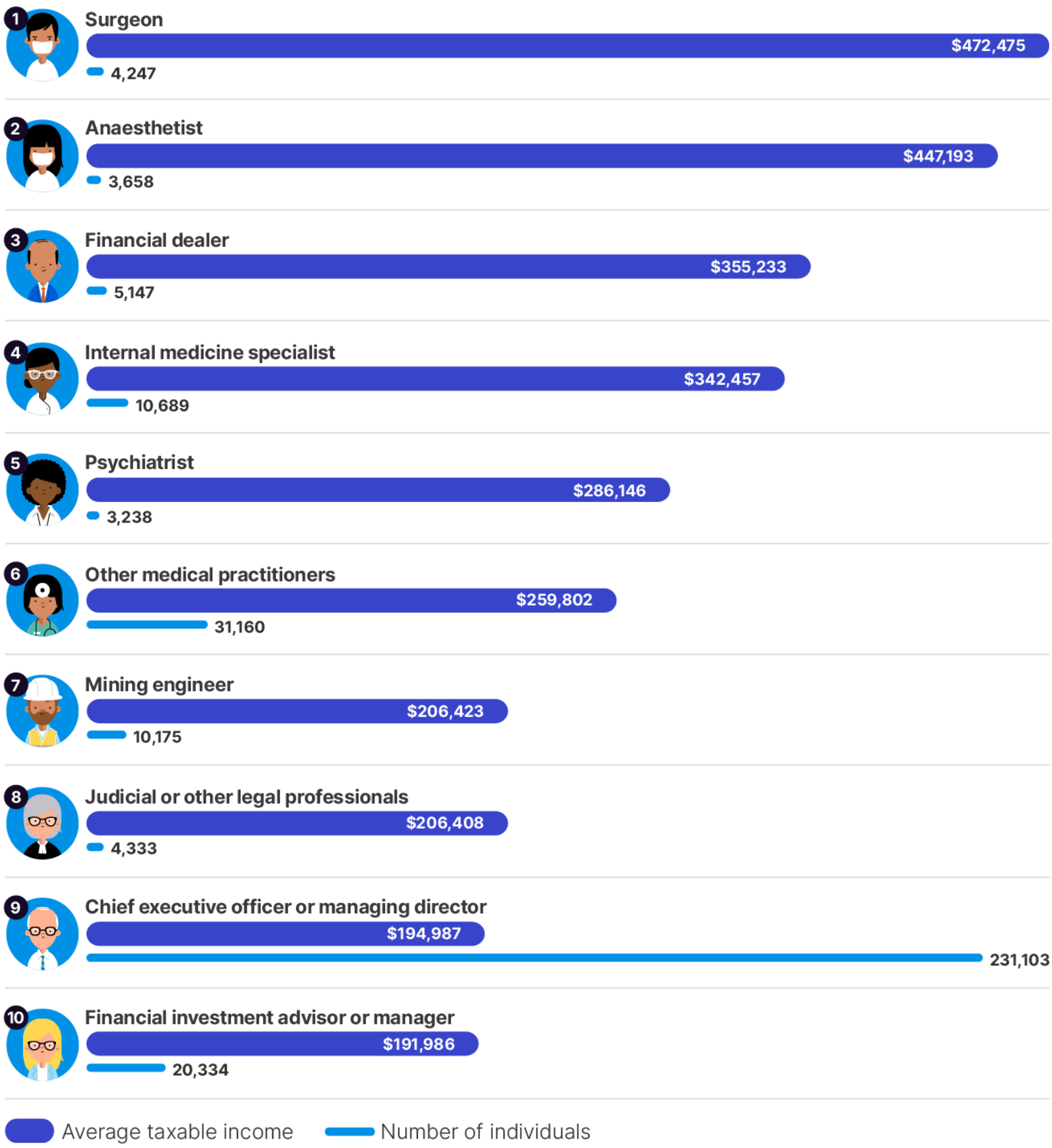
4. Top taxpayers by occupation

Unsurprisingly, the medical field dominates the leading taxpayers by profession. Surgeons top the list for average incomes, followed by anesthetists. Interestingly, anesthetists earn the most on a median basis ($425,000 vs $366,000 for surgeons). This indicates that top surgeons earn a lot more than less experienced surgeons, whereas it's a flatter playing field for anesthetists.

The number of people in leading medical professions is relatively low. Greater numbers of top-earning individuals are found in the occupations of CEO/MD and financial adviser/manager.

Having 231,000 as Chief Executives or Managing Directors seems like a lot, though it's only about 1.4% of total taxpayers.

Individuals – top 10 occupations, by average taxable income, 2022–23 income year

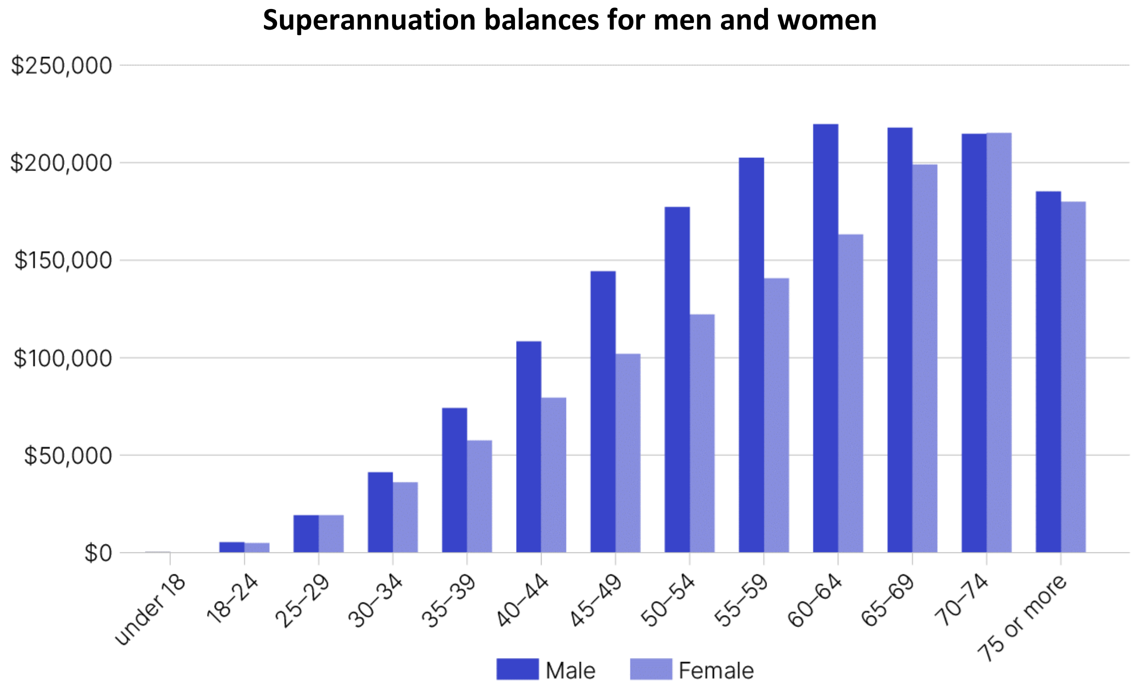


5. Average super balances by age

As mentioned, the median super balance is $60,000. Naturally, older people hold more super.

The largest super balances belong to 60-64-year-old men, at $219,000. Obviously super balances decrease beyond that age as retirees draw down their super.

However, for women, the bigger super balances belong to those aged 70-74. Whether this is due to spouses departing, I am not entirely sure.



6. Who owns investment properties?

Moving onto who owns our assets.

Residential property is the largest asset class by far, valued at around $11 trillion, and most Australians have their wealth tied up in real estate.

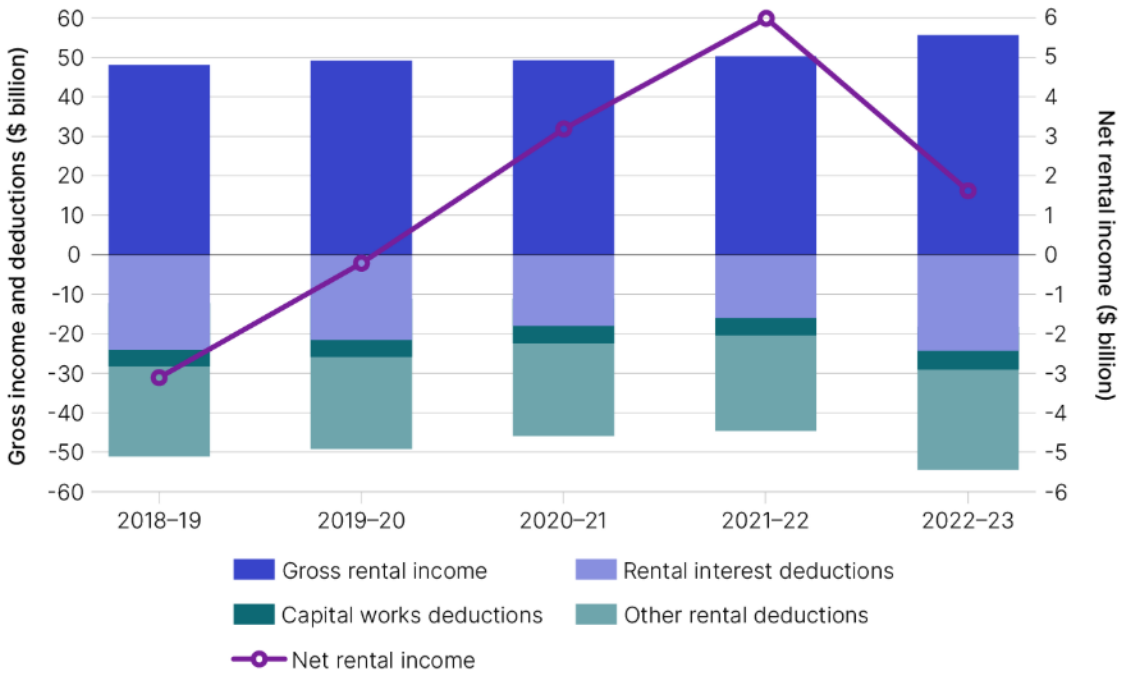
The ATO data shows that 2.26 million Australians own investment property, or 14% of all taxpayers. Of these, more than 1.6 million have just one investment property. And almost 215,000 own three investment properties or more.

			2021-22			2022-23
Property interests (no.)	Net rent loss (no.)	Net rent neutral/profit (no.)	Total individuals (no.)	Net rent loss (no.)	Net rent neutral/profit (no.)	Total individuals (no.)
1	688,312	932,351	1,620,663	810,875	812,125	1,623,000
2	177,357	250,663	428,020	208,978	214,423	423,401
3	52,274	80,064	132,338	60,718	68,977	129,695
4	17,747	29,886	47,633	20,602	26,156	46,758
5	7,024	12,506	19,530	8,163	10,674	18,837
6 or more	6,805	13,172	19,977	7,839	11,550	19,389
Total	**949,519**	**1,318,642**	**2,268,161**	**1,117,175**	**1,143,905**	**2,261,080**

Australia's property landlords get more than $56 billion in gross income from renters. That's significantly more than the $49 billion collected two years prior (thank you, rental inflation post Covid).

However, after mortgage interest and other deductions, investment property owners only earned $1.6 billion in net income. Albeit, that's better than the net losses from 2018 to 2020 when Covid-related rental assistance impacted landlords.

Individuals – rental income and deductions, 2018-19 to 2022-23 income



One takeaway

There are different ways to interpret this ATO data. My takeaway is that there are a relatively small group of people who earn the most, own the most, and pay the bulk of the taxes, and a much greater group that struggles to make ends meet and pays little to no tax.

Our system requires a delicate balance of taxing the well-off in a fair and equitable way to help the less fortunate. The art for policymakers is doing this in a way that doesn't discourage the accumulate of income and wealth, and also encourages mobility up the income ladder.

** Thanks to Firstlinks' subscriber, Bill, who requested an update to Graham Hand's 2021 article, 100 Aussies: five charts on who earns, pays and owns.*

James Gruber is Editor of Firstlinks.

7 key charts on the state of the Australian property market

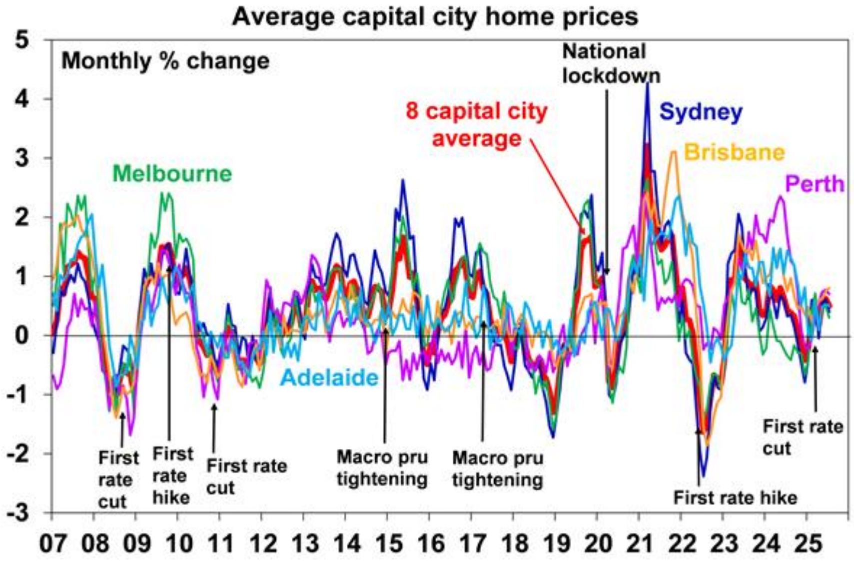
Shane Oliver

The Australian residential property market creates much consternation. On one level there is the debate about the outlook for home prices with some real estate spruikers still wheeling out versions of the old "property will double every seven years" line versus property doomsters at the other extreme saying it's overvalued and overindebted and so a crash is inevitable. The problem with the former is that it implies the already high ratio of home prices to incomes will double again over 12 years! The trouble with the doomsters is that they've been saying that for decades. On another level there is much understandable angst about affordability with some blaming investors and property tax breaks versus others seeing it as largely due to poor housing supply relative to demand. As always with these things there is no black or white answer. To shed some light on this, here are seven key charts on the state of the housing market.

First – the property cycle looks to be turning up again

After a brief dip of just 0.3%, national average property prices have been rising steadily from February (with Cotality data pointing to another 0.5% rise this month) indicating that they have entered a new cyclical upswing.

So far, the gains have been broad based with the soft cities of Melbourne, Hobart, Canberra, Darwin and Sydney now picking up at the same time that the boom time cities of Brisbane, Adelaide & Perth remain strong.



Second – interest rates are a key driver

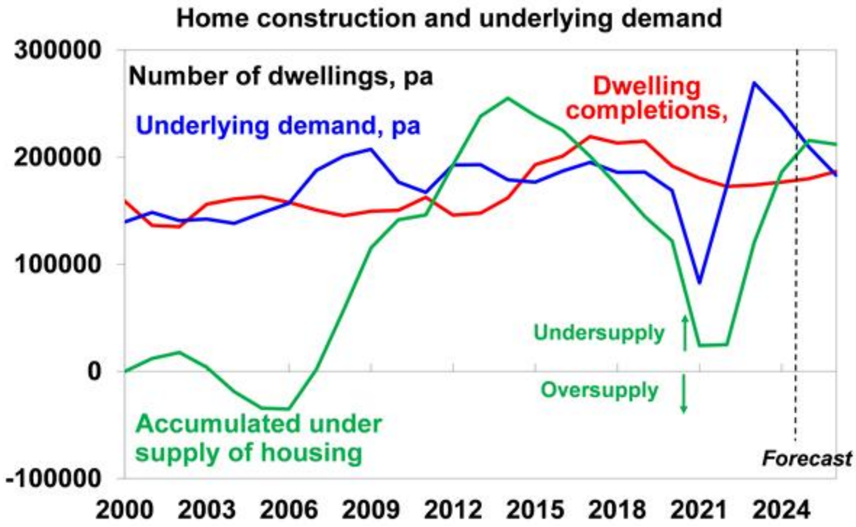
Interest rates matter a lot to the property market because lower rates boost the relative attractiveness of property as an investment and allow home buyers to borrow more. And vice versa for higher rates. Of course, the impact of interest rates can be swamped by other factors at times, as was the case in 2023-24 with the population surge and weak supply. Lower rates are a key driver of the current upswing in prices. As can be seen in the next table, the start of rate cutting cycles since 1982 has been associated with higher home prices over the next 12 and 18 months in five of the last seven rate cutting cycles, providing there is no recession. The average gain over the subsequent 12 and 18 months is 3.9% and 8%. Our base case is for 0.25% RBA rate cuts in August, November, February and May. With increasing signs of labour market weakness, this may occurs faster with back to back cuts in August and September.

Australian average home prices after first RBA rate cut

First RBA rate cut	+3mths	+6mths	+12mths	+18mths
May 1982	-1.4	-2.0	-4.5	-2.6
Jan 1986	-0.6	-0.3	2.6	7.9
Jan 1990	1.7	0.6	-0.1	-2.0
July 1996	1.0	2.5	6.9	10.9
Feb 2001	3.6	8.5	16.2	25.8
Sep 2008	-2.2	-1.3	4.9	11.6
Nov 2011	-0.5	0.5	1.4	4.4
Feb 2025	1.4	NA	NA	NA
Average	**0.2**	**1.2**	**3.9**	**8.0**
Median	**-0.5**	**0.5**	**2.6**	**7.9**

Cotality. Australian recessions are in red. The GFC is in blue.
Source: RBA, Cotality, AMP

Third – Australian housing is chronically undersupplied



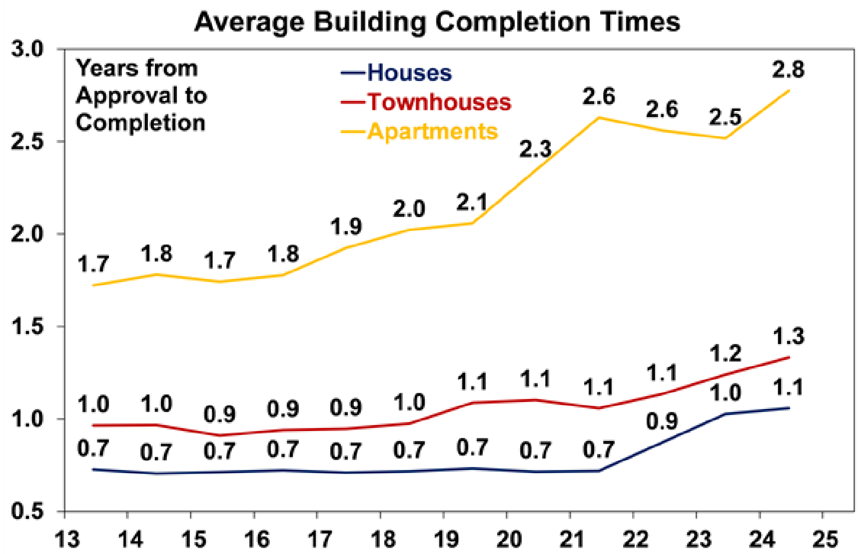
Source: ABS, AMP

This has been the case since the mid-2000s when immigration levels, and hence population growth, surged and the supply of new homes did not keep up. Our assessment is that the accumulated housing shortfall (the green line in the next chart) is around 200,000 dwellings at least and possibly 300,000 depending on what is assumed in terms of the number of people per household.

The economic reality is that when underlying population driven demand for housing exceeds its supply prices rise and that is what we have been seeing for the last twenty years. The capital gains tax discount, negative gearing and foreign demand may have played a role, but they have been a sideshow to this demand/supply imbalance.

Fourth – home building completion times have surged

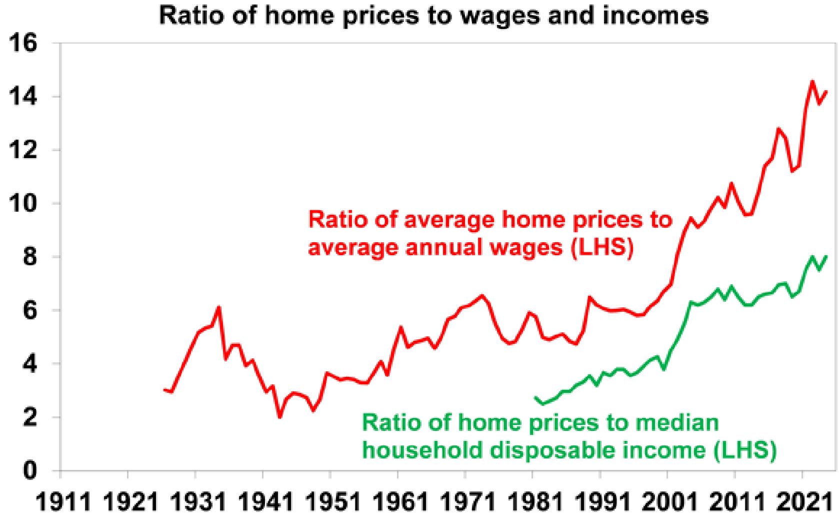
Part of the solution is to slow immigration (and hence population) growth to levels more in line with the ability of the housing industry to supply homes. And immigration has been falling lately. But it's also about boosting supply and if we want to reduce the accumulated undersupply it's critically important that Federal and state governments retain the Housing Accord commitment to build 240,000 dwellings a year (or 1.2 million over five years), compared to around 180,000 over the last year.



Source: ABS, AMP

The next chart shows part of the problem. Over the last decade, the time taken to build a house from approval has risen by 57% and for units it has increased by 65%, reflecting increasing regulations, rising costs, labour shortages, etc. To meet the Housing Accord target we need deregulation, measures to boost the number of homebuilders, a greater focus on units and finding more ways to lower costs (like pattern plans in NSW, smaller houses and greater reliance on wood than bricks and concrete).

Fifth – Australian housing is very expensive



Source: ABS, Cotality, AMP

Chronically deteriorating housing affordability in Australia has been evident since the 1990s. It's clearly evident in rising home price to wage and household income ratios (with the latter adjusting for the increase in two income families), a rise in the years taken for an average earner to save a 20% deposit from around four years 40 years ago to around 10 now and the ratio of home prices to rents (which is a bit like a PE for shares), adjusted for inflation, being around 30% above its long term average level.

The expensive nature of Australian property and the high level of debt that goes with it leaves the economy vulnerable should high interest rates or unemployment make it harder to service loans. In the near term though it may constrain the extent of the upswing in property prices through this cycle.

Sixth – it's also very diverse

Percent overvaluation relative to long term price and rent ratios

City	Houses	Unit
Sydney	41	3
Melbourne	15	-11
Brisbane	38	19
Adelaide	32	20
Perth	10	-10
Hobart	27	27
Canberra	34	8
Capital city average	**30**	**1**

Source: REIA, AMP

While we often refer to 'the Australian property market', in reality there is significant divergence between localities resulting in diverse cycles. The divergence is reflected in measures of valuation. The next table shows the percentage difference between price to annual rent ratios adjusted for inflation relative to their average since 1983. On this basis while houses are 30% overvalued, units are only 1% overvalued. And Perth and interestingly Melbourne stand out as the least overvalued markets in terms of houses and both are actually undervalued in terms of units.

Finally – mortgage arrears are still low

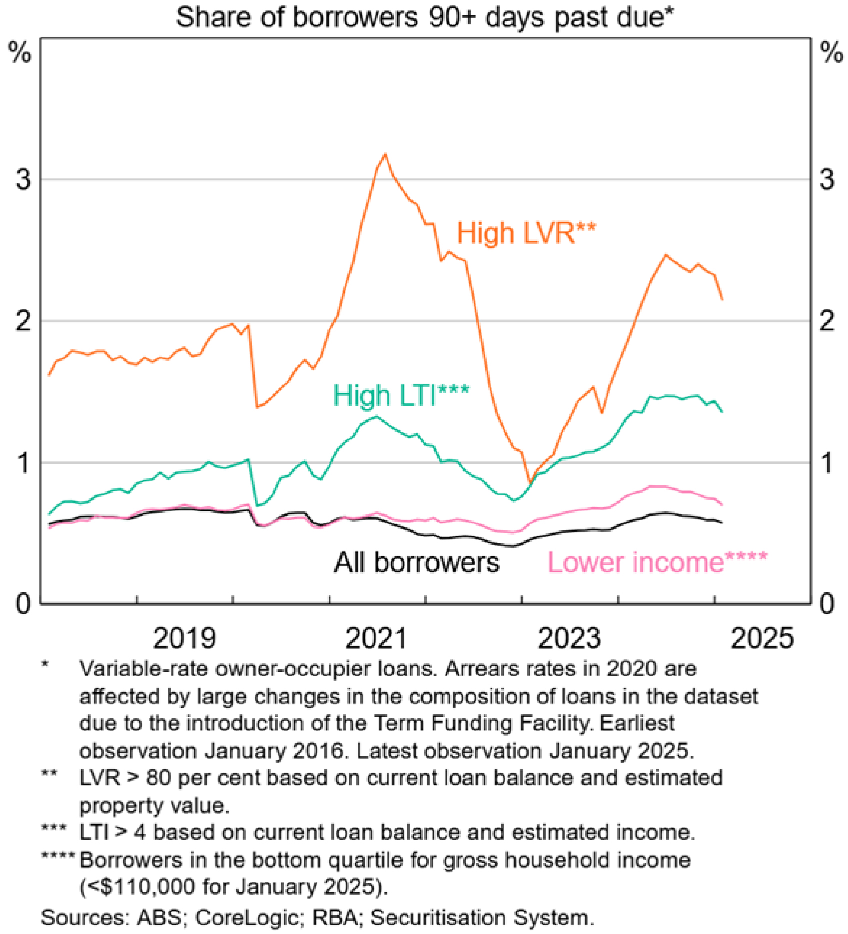
Reports of mortgage stress have been common for the last two decades. There is no denying housing affordability is poor, debt is high, and many households are still suffering significant mortgage stress. But despite this, mortgage arrears rates remain remarkably low at less than 1% on average which leaves them low in international comparisons too. They are higher for those with high loan to valuation (LVR) ratios and high loan to income (LTI) ratios but even here they are still low and have been falling lately.

Mortgage Arrears Rates

The low level of arrears partly reflects strong lending standards in Australia combined with the strong jobs market and a high level of savings buffers coming out of the pandemic. So absent a shock, like much higher unemployment, don't expect an avalanche of distress listings.

Where to now?

Forecasting property prices is fraught. But our base case is for property prices to rise 5 to 6% this year driven by rate cuts and the chronic housing shortage but with poor affordability constraining the upswing. The main downside risk is that rising unemployment and a delay in rate cuts depresses buyer demand, but the main upside risk is that another bout of FOMO takes hold as rates fall. The key for savvy investors is to look for properties offering decent rental yields.



Source: RBA Financial Stability Review, April 2025

Dr Shane Oliver is Head of Investment Strategy and Chief Economist at [AMP](). This article has been prepared for the purpose of providing general information, without taking account of any particular investor's objectives, financial situation or needs.

A simple alternative to the $3 million super tax

David Knox

There is ongoing controversy about the government's proposal to increase the tax on investment earnings for superannuation balances above $3 million. The major sticking points are that the definition of investment income for this tax includes unrealised gains and that the $3 million cap is not indexed.

Before suggesting an alternative approach, let's recognise that on the global scene Australia's taxation of private pensions (or superannuation) is unique. In most of the developed world, contributions to pension funds and the resulting investment income are exempt from tax.

The only taxation paid is on the benefits (lump sums or pensions) paid to retirees. As with our progressive income tax, this approach is normally progressive which means that those who receive larger benefits pay a higher rate of tax on their benefits.

This was the approach in Australia until the Hawke Government introduced a 15% tax on concessional contributions and investment income with a corresponding reduction in the tax on benefits, commencing from 1 July 1988. Subsequently, the Howard Government removed the tax on benefits from 1 July 2007, thereby making most superannuation benefits tax free.

Of course, a flat tax rate of 15% on contributions and investment income is very different from our normal progressive income tax rates. To introduce some progressivity, an additional 15% tax on concessional contributions was introduced for those with incomes above $250,000. In addition, there is a tax offset for low income earners.

However, in respect of investment income, the flat rate of 15% remains except for those in a pension product, where the tax rate is zero.

One purpose of the proposed tax on investment income is to introduce some progressivity into the tax paid on investment income, which would only affect those with higher superannuation balances.

Is there a simpler way to introduce greater fairness?

Australia has developed a very good superannuation system that accumulates funds for retirement. But we do not have a retirement income system as there is no requirement for Australian retirees to withdraw their superannuation during retirement. The money can stay in the system until their death.

This is contrary to most other well-developed pension systems where money must be gradually withdrawn from a certain age. For example, in the USA, there are required minimum distributions from age 73. Such an approach means that the accumulated funds are used to provide retirement income and not for direct intergenerational wealth transfers. This approach also limits the growth of superannuation balances during retirement.

The legislated objective of superannuation in Australia is to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way. Note that the primary purpose is the provision of retirement income, not estate planning.

Currently, there are minimum drawdown rates that apply to pension products which range from 4% of the account balance for those age 60-64 to 14% for those aged 95 or more. But there is no requirement for a retiree to transfer their accumulated superannuation into a pension product. Hence, many older wealthy Australians deliberately leave their superannuation in the accumulation phase and do not receive any retirement income.

Let's consider a high net worth individual aged 75 with $6 million in their superannuation account. As they do not need any income, the funds remain in super with the investment income taxed at the concessional tax rate of 15%.

Under the proposed new tax, this individual would be subject to an additional tax of about $30,000, assuming an after tax return on their super of 7% in the previous 12 months, including income and capital gains (both realised and unrealised).

However, the new tax will not require any drawdowns during retirement. The superannuation balance can continue to grow, even during the retirement years.

However, if we were to apply the minimum drawdown rates that apply to pension products for this 75 year old, the individual would be required to withdraw $360,000 from their super during the next year. In other words, the superannuation balance would gradually reduce during retirement.

Of course, this alternative approach would not generate any additional tax directly from superannuation. However, it is likely that most of the withdrawn amounts for wealthy retirees would be invested elsewhere and therefore the resulting investment income should be subject to other forms of taxation.

As noted earlier, the proposed tax has been criticised for the use of unrealised capital gains and the lack of indexation. In effect, it is a complex measure to introduce improved fairness into the superannuation system.

A more significant reform would be to require all Australians above a certain age (say age 75), to gradually drawdown their superannuation or to invest in an approved pension product. Some individuals who have a significant single asset in their superannuation fund (such as a single property or farm) are unlikely to not support this direction, but this reform would be consistent with the legislated objective of superannuation. It would also be consistent with the policies of the best pension systems in the world which provide regular retirement income and are not primarily used for estate planning.

Dr David Knox is an actuary and has recently retired from being a Senior Partner at Mercer.

CBA and the index conundrum for super funds

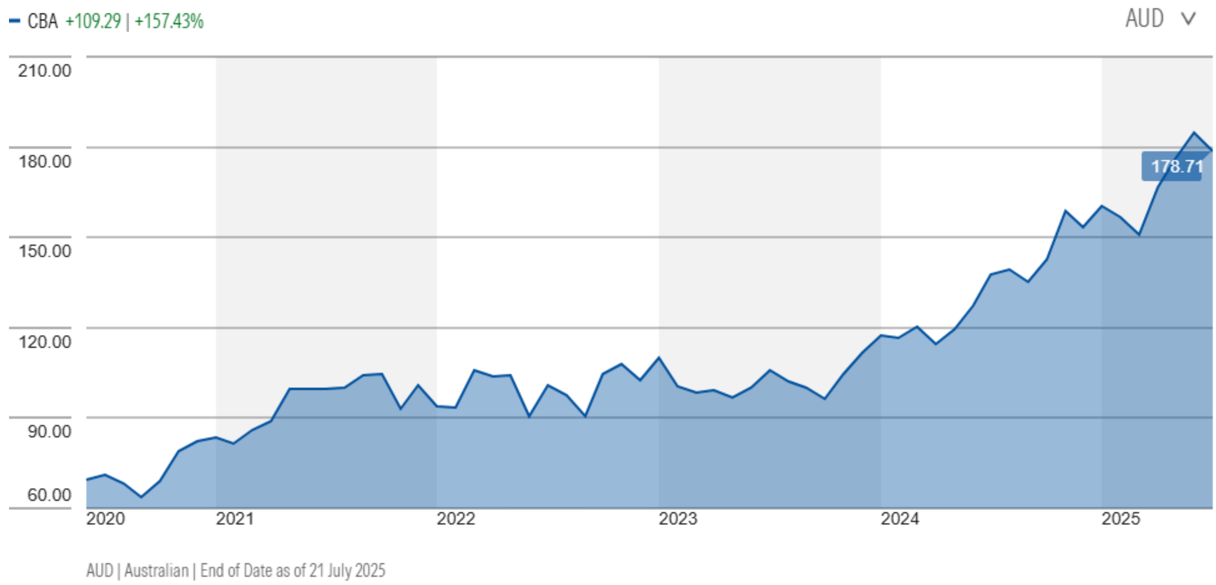
Andrew Brown

"Don't worry, I won't hurt you, I only want you to have some fun"
Prince "1999"

On 9 July this year, an *Australian Financial Review* article[1] suggested that major non-for-profit (NFP) superannuation funds, faced with recent underperformance by domestic equity managers, would move to carve out the weightings of banking securities and index them within their portfolios. And it would allow appointed active managers to manage on an ex-banking sector basis, reducing their fee stream by roughly 25%.

This is in response to most active managers underweighting a single security – Commonwealth Bank – accounting for 12% of the ASX200 index and returning ~20.5% year to date, twice the index measure. On consensus estimates for FY26, CBA shares trade at 29x forecast EPS of $6.32, a meagre 2.74% dividend yield, 4x book value and while earning an ROE of 13.6%. As a crude comparison, the bluest chip US bank, JP Morgan Chase, trades at 14.4x forward earnings generated by a 16.3% ROE and 2.2x forward book value.[2] Notably, the CBA estimates rest upon a pedestal of credit impairment charges equating to 7 basis points of gross loans and advances.

The AFR article contained no names or attribution and may have been an interesting piece of balloon floating by an enterprising allocator. If so, I couldn't disagree more. If not, some highly remunerated allocators have short memories, especially considering a significant anniversary just a few months ago.



Source: Morningstar.com.au

Indexing and its origins

In 1999, aside from panicking about the Year 2000 problem, merging with SFE and moving to T+3, the ASX spent considerable energy working out how to rejig the All Ordinaries index, created from 1 January 1980 to replace the different Melbourne and Sydney Stock Exchange Indices. At that time, just over a year after ASX's demutualisation and public listing, it was starting to get to grips with the various burgeoning income streams that the process of 'commercialisation' had stumbled across.

One of the most lucrative, since it is a natural monopoly, is the ownership of its share price data – live and historic – from which the various indices are derived. If you own shares in one of the few globally listed market makers such as Virtu Financial (NYSE: VIRT) or Flow Traders (Euronext Amsterdam: FLOW) you will know their perennial bugbear is the charges for data and inter-connects with exchanges. The ASX doesn't miss and the revenue from the data component grows steadily at around 8% a year. Nice annuity. The ASX were especially smart by entering an alliance with Standard and Poor's to gain the 'S&P' branding.

Most folks think indices are now just pre-cursors for exchange-traded products and derivatives such as futures. That's hardly surprising given the flows into such investment options and the subsequent benefit to investors in companies such as MSCI (floated in 2007 by Morgan Stanley, and up some 32-fold from the $18 IPO price to $577 in the intervening period). If you are a US-educated investor, by and large indices are created as a proxy to measure performance of markets or stock groups; this reflects the history of the first index – the Dow Jones Railroads in 1884 and two years later, the world's most famous measure the Dow Jones Industrial Average with its price weighted construction. Whilst arithmetically nonsensical, it has worked rather well as a proxy versus its float or market capitalization weighted counterparts.

In the UK, however, index construction originates from a very different and **most relevant place for our argument**: the Institute of Actuaries. Actuaries were responsible for the first UK shares indices in 1929. In 1962, they teamed up with the Financial Times which had been publishing the FT Index since 1935 (originally as the Financial News Index) and the London Stock Exchange to create the FTSE Actuaries All Share Index. Given I started my investment career in the London-based investment department of the UK's then largest life assurance company, Prudential Assurance, asset allocation and performance benchmark measurement were crucial given the life assurance/insurance liabilities to be funded from premiums earned. As the world has increasingly moved away from 'defined benefit/payout' products to a unitised 'accumulation' world, where the consumer accepts investment risk with no liability to the provider, so has advisers and allocators willingness to be more permissive with benchmarks.

However, that doesn't absolve the superannuation fund provider from acknowledgement of the investor's ultimate liability, being their spending power in retirement. In my opinion, this is the obligation about which the anonymous NFP allocator cited in the AFR article has forgotten. Attempts to distort the benchmark and 'lock in' an index position in banking securities is cementing a fixed weighting of banking stocks - one of which is farcically expensive - into the superannuant's future spending capacity. I find that horrifying.

We've been here before

So what of 1999? Any active Australian equity funds manager at the time – including myself – can remember a six-month period from October 1999 to March 2000 (when the index construction changed[3]) where one company dominated your world: News Corporation.

At end October 1999, News Corp's two listed securities (then NCP and NCPDP, the higher dividend preference shares) had a combined market capitalisation of A$45.5billion, being 8.8% of the All Ordinaries capitalisation of $514.2 billion. In the subsequent five months, News Corp was involved in a number of minor deals: sale of 50% of Fox Sports, sale of German assets, divestment of Ansett and AWAS, an investment in OneTel whilst the profitability of its cable programming business was starting to accelerate. In addition, there was strong speculation regarding the ultimate future of its satellite assets. However, with the benefit of hindsight, nothing earth shattering to radically change the ultimate value of the company such as a spin-off, or major divestment or **overall** significant earnings growth.

With the dot-com bubble in full flight, egregious valuations were put forward for anything perceived to be able to utilise the Internet to advantage – ironically except banks where it <u>transformed</u> their business, with a permanent reduction in costs. However, News Corp was at the forefront of every rumour on new business initiatives, being the country's foremost media owner at the time, yet without really executing anything of meaning at that time. In the subsequent four and a half months, News Corp ordinary shares advanced from $11.34[4] at end October 1999 to a peak of $26.20 on 22 March 2000 – a 96% gain. For a brief moment in time, News Corp represented over 17% of the All Ordinaries index, whilst trading on a forward P/E in the 70's, **and with its near $100 billion market capitalisation at the time, was priced at more than the entire listed resources sector**[5].

Imagine you had a zero weighting in the shares on 31 October 1999? You would have lagged the All Ordinaries by <u>over 8.5% in the subsequent 18 weeks</u>. So to 'correct' for this irrationality, what if your allocator decided to index their position in News on 22 March 2000, and just give you 83% of your money? By the end of 2000, some nine months later, News shares were down 47% against an index down a mere 3.7%.

Of course, News Corp in 1999/2000 was a much more volatile conveyance than Commonwealth Bank simply because of the prevailing environment of technological change. News Corp shares have done remarkably well over a 25-year period, but mainly thanks to a company in which they purchased a mere $2 million stake in February 2001 – REA Group (then realestate.com). So does it make any sense to lock in 12% of your Australian equities exposure to a $300 billion bank or 25% of your equity exposure to a sector experiencing virtually no forward profit growth despite minimal current impost from bad debts, and where inflation is one of the sector's worse enemies? I think not. Given funds like Australian Super holding 25% of their balanced option in Australian shares, locking 3% of the **entire** fund into Commonwealth Bank shares seems to me like storing up future difficulty.

Andrew Brown is founder and principal of East 72, and manager of East 72 Dynasty Trust, a wholesale global equity fund, exclusively investing companies with controlling shareholders such as multi-generational families, management or other corporations. This article contains general information only; it does not purport to provide recommendations or advice or opinions in relation to specific investments or securities. It has been prepared without taking account of any person's objectives, financial situation or needs and because of that, any person should take relevant advice before acting on the commentary.

[1] "Fundies could face fee threat if super funds rethink equities mandates" Joyce Moullakis
[2] Data as at 18 July 2025 sourced from tikr.com (CBA A$182.46; JPM US$291.27)
[3] The ASX indices became co-branded with S&P at end March 2000 and had float adjustments applied from that time onwards.
[4] Original data - not adjusted for subsequent splits/spins
[5] "Themes for the market" (Don Stammer) AFR 10 March 2000

10 policies to drive Australian productivity higher

Jonathan Rochford

For the last twenty years, Australian governments have frequently discussed productivity reforms but have taken little action. Australia's GDP per capita recession over eight of the last nine quarters highlights the economic malaise since the Financial Crisis. Government policy over this period has often been characterised by excessive and wasteful government spending, government debt being accumulated with little benefit to the vast majority of citizens and policy decisions made for political purposes rather than the benefit of the country. Government is the cause of much of the productivity problem and the primary barrier to fixing it.

The ten sections that follow focus on policy reforms that the Federal Government can either implement directly, or with assistance from State Governments, which would be incentivised to act by having a much greater share of their funding from their own dedicated revenue sources.

1. Tax reform

A good tax system encourages individuals to work, save and invest. Australia's tax settings, when combined with the RBA Cash Rate and welfare settings, encourage Australians to bludge, borrow and speculate. Numerous tax reviews have called for reform including:

- Shifting the tax base from income to consumption (GST),
- Replacing stamp duty with a broad-based land tax, and
- Strengthening measures against tax evasion, capturing the tens of billions of potential tax revenue lost each year to the black economy.

The recommendations below have had minor updates since first being published in a 2015 paper.

Company, trust and personal income tax: 20-25% flat rate

A flat tax rate supplemented by an earned income tax credit for low income earners is optimal. Earned income tax credits allow only low income earners to have a tax-free threshold, with higher income earners paying the same tax rate on each dollar earned. Closing loopholes, eliminating special interest deductions (e.g. removing lower rates for capital gains) and add-ons (the Medicare levy and surcharge) will greatly eliminate complexity. Closing loopholes is an extremely progressive change as the wealthiest companies and individuals take the most advantage of loopholes and tax structuring techniques. Negative gearing and franking credits will be far less attractive if a low flat tax is implemented. The inclusion of trusts is a simple correction that ensures all structures that receive income are taxed evenly.

Whilst it is often argued that a lower company tax should be prioritised, both companies and highly skilled individuals are easily able to relocate to other countries. Australia should not only encourage the best companies to operate here, but also the most productive and talented individuals to work here as well. A large pool of highly skilled workers is one of the biggest attractions for multinational companies in determining where their offices will be located.

GST: 15-20% with minimal exemptions

The GST needs to be raised and almost all exceptions removed, just like New Zealand. Some additional welfare assistance may be necessary for the poorest 10-20% of the population, but the remainder of the population will benefit from lower rates of income tax and will not need additional assistance.

Land tax: 0.8%-1.25% per annum on all land

Economic research almost always agrees that the most efficient major source of tax revenue is land tax. The property industry and political class in Australia have long forgotten that property is firstly a place for people to live and work, and secondly an investment opportunity. Introducing a land tax will help correct the excessive debt and speculative investment attracted to property and will shift that capital to far more productive sectors of the economy.

In terms of social impacts, lowering the cost of housing (primarily rent but also the cost of purchasing) is the most pressing issue for low-income households. Affordable housing near public transport hubs is rare for most capital cities. Reducing the cost of housing will greatly decrease the welfare expenditure for both State (public housing) and Federal (unemployment benefits and pensions) governments. Vacant properties (occupied less than six months per year) should face triple land tax rates, increasing the rental supply and revitalising local economies.

Small business and personal tax evasion

Three relatively simple measures of mandatory record-keeping and payment methods would significantly reduce tax evasion among small businesses. Every sale should be electronically recorded, with a receipt available. Businesses should also be required to offer a form of electronic payment. The upcoming credit card surcharge reforms will assist this transition. Mandatory electronic payment of wages will increase tax compliance and reduce wage theft.

Once the acceptance of electronic methods of payment is required, the job of monitoring and enforcing tax compliance becomes far easier. ATO employees/contractors and the public could retain receipts, which can then be cross-checked against business records. If a sample of transactions reveals some are undeclared for GST or income purposes, it likely indicates tax evasion, triggering a full audit.

A second, powerful measure is the introduction of a national tax lottery. The ATO should operate a well-advertised online and phone service allowing citizens to report suspicious activity, such as offers of discounts for cash payments or refusal to issue receipts or accept electronic payments. Each report would grant an entry into a nationally broadcast monthly lottery with a substantial prize pool (e.g. $50 million). Prizes could include ten winners of $1 million and 40,000 winners of $1,000.

Large business tax evasion

Large business tax evasion often involves complex, multiple-jurisdiction schemes. Gathering evidence frequently requires whistleblowers with inside information, such as employees, accountants, bankers and lawyers. While well-crafted whistleblower protections sound good in theory, they frequently fail to prevent retaliation, including dismissal, demotion or being sidelined. Employees who report white collar crime often risk their careers and may become unemployable in their industry once exposed.

The solution is a revenue-sharing arrangement. In the US, the tax service (IRS) and the securities regulator (SEC) pay up to 30% of the additional revenue collected to whistleblowers. This substantial incentive encourages the reporting of tax evasion and financial crimes. It creates major headlines when large fines and penalties are imposed and when significant payments are made to whistleblowers. This system deters financial misconduct, increases the likelihood that impacted whistleblowers are compensated and increases government revenue.

2. Decrease government spending

One of the great truisms of modern economies is that economic growth and prosperity increase fastest when government spending is a small share of the economy and economic freedom is maximised. If we want Swiss-level wages and wealth, we should reduce government spending to Swiss proportions. Studies have repeatedly shown that the private sector drives almost all productivity growth, with the government sector typically neutral or negative. It is therefore no surprise that the global productivity slowdown has coincided with increased government spending since the Financial Crisis.

Examples of wasteful government spending include the NDIS, infrastructure blowouts, bailout and subsidy schemes, programs for remote communities and numerous Defence initiatives. They highlight a lack of accountability among politicians and public servants; spending other people's money on other people is a recipe for inefficiency.

Some suggestions to improve the attitude to spending amongst politicians and public servants:

- Requiring government reports to consider both the loud minority asking for increased spending on their areas of interest and the silent majority who would prefer a tax cut,
- Bonuses for politicians who keep government spending growth below inflation, with a double bonus if nominal spending declines,
- Bonuses for public servants who cut spending and sackings for those overseeing wasteful projects, and
- Starting parliamentary and department meetings with an acknowledgement of taxpayers and the historical waste of taxpayers' funds.

3. Reduce and sharpen migration

Australia's migration system shifted from prioritising quality to pursuing quantity around 2006. Since 2022, record-high migration levels have brought in large numbers of low-wage workers and students enrolled in low-cost courses. The obvious impacts include:

- Skilled migrants earning less than the median Australian worker, indicating their purported skills are not translating into workforce participation,
- Capital shallowing, with population growth outpacing investment,
- Sharp rises in housing costs, despite higher interest rates, and
- Reduced savings and increased speculative investments in housing over productive business activities.

A recent paper on this topic highlights these issues and the obvious policy solutions, including:

- Limiting skilled migration predominantly to those with a job offer paying at least $150,000 per year,
- Restricting international students primarily to high-value courses, and
- Requiring international students to depart shortly after completing their courses, unless they have a job paying at least $150,000 per year.

4. Increase the RBA cash rate

Over the last decade, CPI inflation has averaged 2.78%, within the RBA's inflation target range of 2-3%. Despite this, the RBA Cash Rate has averaged 1.84%. After adjusting for the top tax rate of 48.5% (including the Medicare Levy and Medicare Levy Surcharge), a measly 0.95% nominal return is left, which equates to a -1.83% real return. This blatant subsidisation of borrowers, at savers' expense, undermines the RBA's mandate "to promote economic prosperity and welfare of the Australian people, both now and into the future".

The most noticeable outcome is Australia's obsession with residential property fuelling high house prices, excessive debt and distorted capital allocation. The speculative diversion of capital into property reduces business investment, increases financial instability and perpetuates boom-bust cycles.

Two policy changes would help correct this:

- Adjusting the inflation target from 2-3% to a ceiling of 3%, acknowledging that low inflation is a benefit of productivity improvements,
- Requiring the RBA to set the Cash Rate at a level that ensures all Australians can earn a positive after-tax real return over the medium term.

5. Curtail corporate and middle-class welfare

Corporate welfare

There's an old saying in economics that "Governments are bad at picking winners, but losers are good at picking governments." Politicians typically ignore the much larger pool of jobs lost when taxpayer funds are wasted on unprofitable activities and industries, compared to the small number 'saved' by them. Australia's decades-long subsidisation of the car industry and the continued support for aluminium smelters and steelworks are prime examples. Taxpayers have paid billions to delay inevitable closures, preventing workers and capital from moving into more productive sectors.

Australia's high costs for electricity, labour, property and regulation mean it cannot compete in most manufacturing sectors. We need to get past the idea that we should be a manufacturing powerhouse; our decisions in other areas (e.g. renewable power, minimum wages, excessive migration) make manufacturing in Australia uncompetitive.

The default answer to corporate welfare requests should be 'no', except in industries critical to national defence. This includes declining to support farmers and small business owners, especially those operating in disaster-prone areas.

Middle-class welfare

Taxing middle-income Australians, wasting a substantial portion on bureaucracy, then handing it back as welfare is inefficient and discourages families from working. Reducing middle-class welfare alongside substantial income tax cuts would make this reform easier and fairer.

6. Incentivise reliable power generation

Australia has shifted from having some of the most affordable electricity in the developed world to some of the most expensive. Unlike countries with nuclear power, Australia's historical reliance on coal is now a hindrance in a decarbonising world. Current policies have made the system less stable and more costly. Temporary subsidies masking price rises will end, likely triggering consumer backlash and demands to halt the energy transition. System-wide blackouts, as recently seen in Spain and Portugal, are expected to increase, undermining consumer confidence and business profitability. The wave of bailout requests from high-power users this year is a predictable outcome of flawed policies.

The solutions involve three parts:

1. Incentivising reliable, around-the-clock generation through intra-industry payments. Unreliable producers (wind and solar) should compensate those who provide stability (base load, peak producers, hydro and storage),

2. Requiring generators that demand significant grid expansions to share the costs, favouring those who build near retiring coal plants where infrastructure is already in place, and

3. Taxing gas production on both extraction (royalties) and profits, ensuring hydrocarbons are treated like most other commodities. This should be part of a broader federal review aimed at a national royalty framework. Alternatively, governments could trade-off royalties in exchange for a guaranteed affordable supply of gas.

7. Simplify the minimum wage

Australia has two major problems with the minimum wage: it is too complicated for small businesses to easily comply with, and it is too often not being paid in full to workers. Small businesses should be able to access a government-run website offering a simple one or two-page guide explaining the minimum wage and key conditions (leave, casual loadings etc.). They shouldn't have to navigate complex industrial awards. There should be a single national minimum wage, with businesses free to negotiate better terms with workers or unions. Workers would always retain the right to move between employers in search of better conditions.

Once a clear, standard minimum wage is established, excuses for underpayment disappear. Systemic and deliberate wage theft should result in prison terms, just like other forms of fraud or theft. Business owners and managers should face punitive damages payable to affected workers, along with significant government penalties to cover enforcement costs. Wage theft is a widespread scourge, robbing workers, honest competitors (who pay the minimum) and other taxpayers. The brazenness of wage theft in the hospitality industry has been well documented, with universities and supermarkets also recently exposed for widespread underpayment.

8. Get unemployed Australians into work

Australia's unemployment system currently allows recipients considerable freedom to apply for jobs that they want, not necessarily those they are suited for. It also allows for 'cash in hand' work while receiving unemployment benefits.

A better approach for medium and long-term unemployed Australians receiving benefits (e.g. 6+ months) is to require them to select from nearby job openings and start work immediately. In many suburbs, there are likely to be a range of entry-level roles in cafes, restaurants, supermarkets, transport and delivery services or cleaning. The ideal time to implement this is now, when the unemployment rate is low and job vacancies are abundant.

From a productivity perspective, the benefits are clear:

- Lower welfare payments and higher tax collections,
- Increased tax compliance,
- Improved long-term employment prospects for participants, and
- Broader society-wide benefits including reduced crime and better mental health outcomes.

9. Enable school choice

Research from the US consistently shows that non-government schools deliver better student outcomes at a lower cost to taxpayers. While the quality of outcomes remains debated in Australia, it is clear that non-government schools cost taxpayers less. Australia should join the growing group of nations that give poorer families school choice, just as wealthier families already have. Well-run government schools have nothing to fear, they are likely to attract students from underperforming schools.

The structure of voucher payments is simple; state governments calculate the per-student cost in public schools, factoring in teachers, administration, capital/building costs and materials. This amount forms a voucher parents can use towards private schooling. To avoid favouring elite schools, there can be a declining scale to taxpayer contributions as the fees increase. For example, the first $2,000 of fees do not reduce the voucher, but from there on the voucher reduces by 50 cents for each dollar of fees. Schools charging more than a set fee level, say $15,000 per year (primary) or $25,000 per year (secondary) would be ineligible for voucher funds.

10. Make childcare tax-deductible

French economist Frederic Bastiat famously said, “Government is the great fiction through which everybody endeavours to live at the expense of everybody else.” The Federal Government’s ever-increasing subsidisation of childcare is a prime example, aimed at buying votes from young families. These subsidies have pushed up demand, inflated prices and allowed lower-quality operators to gain a foothold. Government-driven wage increases, the growing regulatory burden and Australia’s high property prices further compound the issue.

The Productivity Commission found that recent changes (increasing subsidies and the relaxation of requirements to work) have had little impact on the supply of labour, which is the primary reason for subsidising childcare. Paying people to care for children while the parents do little or no paid work is inherently unproductive.

The solution is simple and effective: remove direct subsidies and allow childcare costs to be tax-deductible when all parents in the family are working. This would target support to higher paid working families, ensuring benefits flow to those expanding the economy and easing the excess demand pressures.

Jonathan Rochford, CFA, is Portfolio Manager for Narrow Road Capital. This article has been prepared for educational purposes and is in no way meant to be a substitute for professional and tailored financial advice. It contains information derived and sourced from a broad list of third parties and has been prepared on the basis that this third party information is accurate. This article expresses the views of the author at a point in time, and such views may change in the future with no obligation on Narrow Road Capital or the author to publicly update these views. Narrow Road Capital advises on and invests in a wide range of securities, including securities linked to the performance of various companies and financial institutions.

Where to find big winners in Asia

James Gruber, Anthony Srom

This is an edited transcript of a recent interview between Firstlinks’ James Gruber and Anthony Srom, Portfolio Manager for Fidelity’s Asia Fund Strategy, on Fidelity’s Sound Bites podcast.

James Gruber (JG): How are you thinking about AI and the impact it could have on Asia and the stocks in your portfolio?

Anthony Srom (AS): From an Asian perspective, negative; from a perspective for the portfolio, a positive.

Let me elaborate. The Fund is very much underweight technology. It's the largest sector underweight, double digits, active position.

If I wind back the clock about 18 months ago, 24 months ago, it was the largest sector overweight. I sense there's a lot of froth, excess positive sentiment still attached to technology, specifically AI. When I talk to analysts in the region, look at research, I think there's a lack of recognition around risks attached to AI and how that could play out for a lot of companies.

There's only one stock left in the portfolio that is technology related, being TSMC, and that's an underweight.

If you think of enablers like SK Hynix, TSMC, Nvidia, the picks and shovels providers, everyone's gone for those. You're seeing a bit of migration of capital into the enablers. But when you look at how these companies could take advantage of it, for example, Tencent - long runway for ad monetization. Not only that: higher monetization of ads. They can apply it to gaming. So, I think if you extrapolate out three to five years, my view would be you're going to get a much better earnings profile to something like Tencent versus Alibaba, who's gone all into cloud, which is quite competitive. I have question marks around something like that, for example. So, I'm quite cautious on AI and tech, but you have some exposure in the portfolio that I think is likely to deliver.

JG: To be clear, the advantages with AI and advertising is that you can get data on individuals and groups and therefore can be more specific with that advertising - is that correct?

AS: Broadly speaking, yes, you can. You've already got a lot of granularity. I think the application for advertising would be to what you mentioned, how to make it more specific, more relevant, and therefore also how you can exhibit to customers a higher return on that advertising roller, which would mean someone like Tencent could charge more, to keep it simple.

JG: Let's talk about some of the other big opportunities that you see in Asia. Your fund has significant positions in Chinese consumer stocks. Does that make you a bull on Chinese consumption going forwards?

AS: No. It basically positively disposes me and the Fund to what I think will be structural winners in a somewhat challenged part of the economy.

When I go through Shanghai, Hong Kong, meet our analysts, besides going through their coverage list, what they like, etc, I always like to ask them: What are you doing? What are your friends doing? What are your relatives doing? How are they feeling? Are they confident? Are they worried?

I think the confidence around the Chinese consumer was shattered during COVID and after COVID - lack of belief in the leadership [and] how they handled the situation. You've seen the economy head south. Since then, people are worried about incomes, job security etc.

That said, I think that has morphed into being resilient. Chinese people have savings. They're willing to spend, but their spending is much more targeted.

Now I'm going to go for an experience, and by the way, I'll spend more on that experience than maybe what I would have done in the past, but I'm going to save for a longer period of time to get there. I will go and buy a pair of trainers, but I'm not going to buy something for 500 renminbi. I might go buy 400 renminbi pair of trainers.

So that's where I'm saying the Chinese consumer is resilient when I look at the companies that are in the portfolio.

The other aspect that I see is a disconnect between the way the markets price those companies and what I believe they can deliver.

Something like the Macau casino operators, for example, have been in the dumps until about two months ago. Has the dynamic changed there? Is this short-term noise? [I'm] still trying to get to the bottom of it, but nonetheless, the market is telling you, I think something has changed in that space.

Another one that the fund owns is Anta sports apparel - Chinese consumption I've just mentioned, let's call it resilient. But is there a thematic there? Yeah. I mean, post COVID, people want a healthier lifestyle. They want more outdoor. This feeds exactly into that part of that sub sector. There are opportunities to be had, is the way I summarise it.

JG: You're also overweight Indian financials - what's the attraction there?

AS: Because no one likes it (laughing). If you look at it, the last 12 months, it's not been a sector that's been liked by the market, and that was the entree for the Fund to increase its exposure.

So, what the market was worried about - consumer stress feeding through to non- performing loan credit cycle coming through, specifically on unsecured consumer lending. You had tightening liquidity in the Indian economy, leading to competition for deposits, which means cost of funding is going to go up, which means net interest margins are likely to be compressed.

The market there hit a brick wall about September. October, some of these dynamics started to play out.

In particular, if you look at Cholamandalam Financial, we believe it's a long-term winner. Went from about 1500 rupees per share down to 1100 rupees in a very short period of time. The fund took advantage to increase exposure to that and it's paid out quite nicely thus far.

Again, Axis Bank came into the portfolio beginning of this calendar year, partly funded through HDFC Bank, which was a big relative outperformer. You're looking for additional exposure to Financials given the thematics that I've just mentioned, negative sentiment, NPL cycle potentially coming through, but not as bad as it could be for certain companies. Axis Bank fits that bill. Where it also ticks the box is relative to its valuation group, you are basically bubbling along rock bottom, 30 to 40% discount to the likes of HDFC Bank, ICIC Bank, which we think is unwarranted. They're not really high conviction positions, but I think an area of the market that looks interesting.

JG: The area that you do seem to have some conviction is in ASEAN. Why is that? And how are you investing there?

AS: The exposures in ASEAN [are] really concentrated in Thailand. I still think it's an underrepresented part of the market because they're [investors are] just still absorbed in geopolitics, the China-US tariffs. They're still absorbed in AI. And where's the catalyst for Asia? It's really hard to see.

So, the exposure that the Fund has got would be Sea in Singapore, where it's headquartered, CP All, which is a 711-franchise operator in Thailand, and Bangkok Dusit Medical, which is a private hospital operator in Thailand.

Just screening through the region before I came down here last week, at the aggregate level the region looks fair value. But I was surprised to see that Malaysia, some of the valuation multiples for the Malaysian market are cheaper than the trough in 2008. Is that an area of potential ideas? I think it is. We'll go do some work there.

Thailand is a similar situation in that it's de rated significantly. I think, year to date, the market's down 30%. It's almost like the whole kitchen sink has been thrown at the Thai market. You've had tourists kidnapped, specifically Chinese tourists. You've had risks around Middle East medical tourism coming to Thailand, you've had political instability, which we'll see how it plays out. You've had an earthquake. So, I just think less bad will be good for something like Thailand. We've just got to wait for sentiment to turn.

JG: Anthony, could you leave us with two thoughts now: one opportunity and one risk?

AS: In terms of opportunity, I would point to China. You've probably all heard the comments around, oh, it's uninvestable. The only problem with that is the market's reacting differently now than what it did say 12-18 months ago. If I go back 12-18 months ago, what was happening was bad news was sold into in China, obviously, good news was aggressively sold into. I sensed a sea change in that back end of last year, and that seems to be the case. If you look at the market this year, it's up double digits year to date. So, when I look at the sentiment, that's changing the market.

Still, I sense a lot of long owned investors are underweight China. The Fund is overweight Greater China, looking at Hong Kong and China put together, about mid-single digits.

In terms of risk, I wouldn't ignore what happened last year in Japan. The question around tightening of monetary policy and the shock wave that sent through global markets. If rates keep trending positively in Japan, does that start sucking liquidity from other markets? US, for example. Do you see a reallocation to Japan? In a relative world, do you see EM and Asia ex Japan start to outperform DM, which hasn't been the case for a number of years? What I'm driving at is monetary policy or financial repression policies, not only in Japan but elsewhere, could have massive implications to where liquidity flows. That's a huge risk. But within risk, there's also opportunity.

You can access the full interview here.

Anthony Srom is a Portfolio Manager for Fidelity Asia Fund strategy at Fidelity International, a sponsor of Firstlinks. This document is intended as general information only. You should consider the relevant Product Disclosure Statement available on the website www.fidelity.com.au.

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We have trouble understanding the time value of money

Tony Dillon

In my recent article on superannuation tax concessions, I focused on discounting for illiquidity. And it got me thinking about a close conceptual cousin, ‘hyperbolic discounting’.

People can make irrational decisions when it comes to money. For example, behavioural experiments that reveal subjects who prefer to have say, $50 today over $100 in six months’ time. Reflecting a huge annual discount rate. This type of behaviour known as ‘hyperbolic discounting’ places a clear preference on immediate consumption over deferred consumption.

Curiously, those same individuals would often prefer $100 in nine months’ time over $50 in three months. A small time shift removes the immediacy bias. These choices are time-inconsistent which if plotted, follow a hyperbolic pattern. Hence the term ‘hyperbolic discounting’.

Financial considerations like investment returns aside, both liquidity and hyperbolic discounting reflect a time preference, placing a higher value on money today than in the future. Both think that future money isn’t worth full-face value today, but for different reasons.

With liquidity discounting, there is a cost recognition of not being able to use tied up funds today, there is an inaccessibility factor. Whereas with hyperbolic discounting, the cost is purely psychological where a person simply prefers current consumption over it being delayed.

Both exhibit steep discounting that flattens over time, whether with respect to access or reward. And hyperbolic discounting can be heavier, earlier, with bigger individual variation driven by personality and context. Liquidity discount rates reflect more objective constraints.

I have already covered liquidity discounting in that previous article, so focusing more on hyperbolic discounting, a classic real-life example exists with so-called ‘payday loans’. This is where borrowers pay exorbitant interest rates on short duration loans that see them through to ‘payday’.

Payday loan lenders exploit hyperbolic discounting by targeting borrowers who have immediate cash needs for things like rent and groceries, and for possibly short-term rewards. People accept irrationally high interest rates to satisfy immediate needs and wants. A small time shift comes at a high cost. This is hyperbolic discounting in action, with people acting against their long-term interest.

And as noted prior, immediacy bias reduces with delayed access, so that placing a small waiting period on access to payday funds, might reduce the number of people willing to take up such loans.

Yet it is not just low-income earners on the edge that can succumb to hyperbolic discounting, as the phenomenon can present under different guises and affect many.

If hyperbolic discounting could be defined as the favouring of short-term benefits at the expense of long-term financial wellbeing, then other examples of it might include:

- Not saving enough for retirement. This might occur if for example, voluntary contributions are not made when there is capacity to do so. While retirement funds could be substantially boosted, the benefits are a long time away, and the cost is immediate with less money to spend now. The long-term payoff is heavily discounted, reflecting in this instance both a hyperbolic immediacy cost and an illiquidity cost for the inaccessible nature of super.

- Early super withdrawals. Like those during the pandemic made by many people even when not necessarily needed. They valued the extra liquidity far more than future income in retirement.
- Not maximising mortgage repayments. Even knowing that total costs will be higher over the term of the loan, it is far more gratifying to have the extra funds available for discretionary spending today.

Though not extreme and irrational examples, compared to the classic '$50 now, $100 later' case, these milder forms of hyperbolic discounting still highlight the immediacy bias that exists in the lives of many of us.

Indeed, hyperbolic discounting might be thought of as 'behavioural discounting'. It's probably a more apt description for discounting future outcomes not just for financial considerations, but also for psychological biases. A process that can place weight on emotion and impatience as much as, or even more than inflation, expected returns, and real constraints like lack of access.

Again, these cognitive biases result in immediate rewards being given disproportionate weight, with preferences being time-inconsistent. Certainty versus uncertainty also comes into it, where the distant future aligns with an uncertain outcome, so we prefer the certainty of immediate reward even if it is less valuable.

And such biases can lead to poor decision making. Which is why it is important to understand that hyperbolic discounting exists so that we can make informed and better decisions in the future.

Tony Dillon is a freelance writer and former actuary.