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Editorial

Unless you're under a rock, you'll know that the RBA delivered an expected 25 basis point cut to cash rates to 3.6%. A typical headline read: "A belated boost for homeowners". It certainly was a boost for those with plenty of debt, and the media was at pains to highlight the plight of homeowners (property gets clicks and are big advertisers, after all), while focusing less on the 'losers', such as savers, both young and retirees.

And the rate cut came with a sting in the tail: the RBA downgraded its expectations for medium-term productivity growth from 1% to 0.7%. That's a big cut, though the trend had been down for some time – the government's 2023 Intergenerational Report pegged productivity growth at 1.2% over the next 40 years, down from its previous estimate of 1.5%.

So, the RBA is cutting because our economy remains in the doldrums. The problem is that it knows interest rates aren't likely to revive our economic fortunes.

Instead, the heavy lifting will have to come from government policy and the private sector. On that front, the government is ruling out every potential economic reform, and none in, at present.

If Mr. Chalmers is looking for fresh ideas, he should read a new paper from the Australian National University, 'How ready is Australia to improve productivity'.

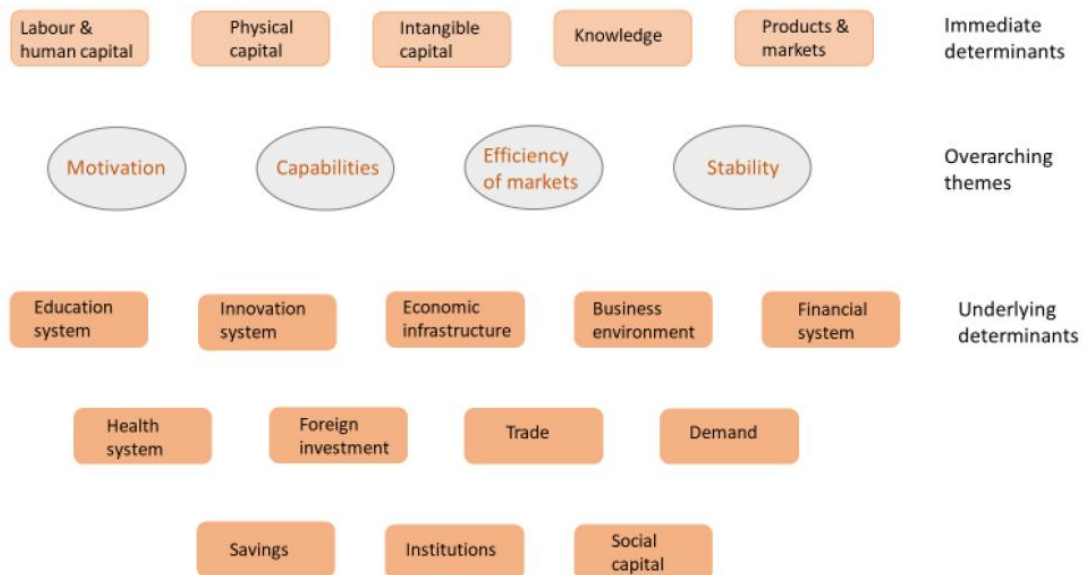
Unlike so much of the economic claptrap that's been written about turning around our economy, this paper provides an easy-to-understand framework of the key drivers of productivity and where Australia is doing well and where it can improve.

The authors, Robert Breunig and Dean Parham, first define what productivity is and why it's important:

“Productivity is a measure of the rate at which inputs are transformed into outputs. More national productivity means a country is leveraging more and higher-value goods and services from its inputs and endeavours. National productivity growth reflects the ability of a nation to generate additional income from the same inputs. That is why productivity growth is central to lifting living standards.”

The authors then outline the key drivers for the economy:

Key determinants of national productivity performance



Source: ‘How ready is Australia to improve productivity’, Robert Breunig and Dean Parham.

The four over-arching themes are:

Motivation: people must be motivated to improve productivity. Competition motivates individuals and businesses to do more. On the other hand, burdensome regulations can sap the incentive to be more productive.

Capabilities: Individuals and businesses must have access to the resources they need to improve productivity. Skills, technology, and infrastructure are critical here.

Efficiency of markets: Markets need to operate in a way that encourages investment in skills, capital and knowledge, and the productive allocation of resources.

Stability: Investments that lead to strong and sustained productivity growth are underpinned by economic, social, and political stability.

The paper makes that great point that governments can’t directly affect national productivity – except for improving their own productivity. However, what they can do is to influence the key drivers to improve living standards.

The authors have measured ‘productivity readiness’, via various quantitative metrics, across 118 countries, including Australia. So, where does Australia rank?

Well, it comes in at 11th for productivity readiness, with Singapore, Luxembourg, and Switzerland topping the table. The US lags, ranking 19th.

Values of productivity indices

	Motivation	Capabilities	Efficiency of markets	Stability	PRI	Ranking
Singapore	98	98	88	94	98	1
Luxembourg	91	95	95	92	97	2
Switzerland	92	98	80	94	95	3
Denmark	93	91	78	97	93	4
Finland	91	87	77	95	91	5
Netherlands	89	90	79	89	90	6
Sweden	89	91	76	90	90	7
Hong Kong	86	90	81	80	88	8
Norway	88	83	74	93	88	9
Canada	86	89	75	87	88	10
Australia	87	87	74	87	87	11
Ireland	84	85	77	87	87	12
UK	84	89	74	83	86	13
New Zealand	84	77	70	91	84	18
USA	82	87	70	79	82	19

Source: 'How ready is Australia to improve productivity', Robert Breunig and Dean Parham.

Australia does well on scores for motivation, capabilities, and stability, though not as well for efficiency of markets. The latter reflects "relatively stringent labour regulation environment and increasing government involvement in the economy."

I'm surprised by Australia's high score for motivation given the large number of industries operating as duopolies and oligopolies, especially versus the likes of the US.

Nonetheless, Australia's scores well overall, though the authors suggest the following to boost our economy:

- Our biggest weakness is efficiency of markets, which means improving the regulatory environment and labor market flexibility stand out as areas ripe for reform.
- Improving competition, investment freedom and government effectiveness could lift the motivation score.
- Reducing barriers to trade and foreign investment could boost the motivation and efficiency of market scores.
- The capabilities score has fallen over time, suggesting opportunities for improvement in education and R&D spending.
- The stability score has declined in Australia and globally, indicating more can be done to bolster the rule of law and government effectiveness.

Bank of America's latest survey of institutional fund managers has let slip what has been obvious for months: fundies have been front running Trump and the new Fed Chairman, sending markets roaring higher.

The Trump playbook is clear: he wants a new Fed Chairman who will slash rates. Why does he want this? Because he wants to spur economic growth and lower the hefty interest rate bill for his heavily indebted government. And he is prepared to overheat the US economy and inflation if necessary.

Fund managers have taken Trump at his word. 68% of those surveyed expect a soft economic landing in the US.

Most see higher inflation, yet lower short-term rates. While seemingly contradictory, it makes sense given Trump's pronouncements.

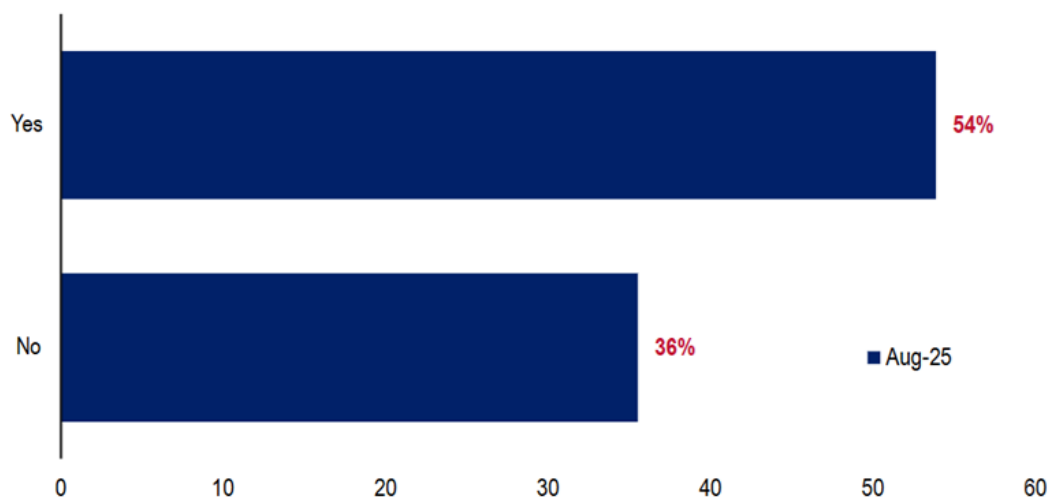
August FMS sees rising expectations for higher inflation, lower short-term rates
Net % expecting higher inflation and Net % expecting higher short-term rates



Source: BofA Global Fund Manager Survey.

And an amazing 54% of fund managers survey think quantitative easing or yield curve control is coming to the US.

54% of FMS expect next Fed chair to resort to QE or YCC
Do you expect the next Fed chair to resort to QE or Yield Curve Control to help alleviate the US debt burden?



Source: BofA Global Fund Manager Survey. QE = Quantitative Easing

So the fund managers are indicating that the US debt situation is out of control and Trump running the economy hot is likely to increase inflation and long-term rates. While the Fed influences short-term

rates, they don't control long-term rates, and to keep a lid on the latter, QE or yield curve control will be necessary.

This type of scenario would be bullish for equities and risk assets and explains why these assets have already run hard.

Whether it's positive for the long-term is the big question.

Either way, it appears we're headed for a new regime of 'national capitalism' that investment strategist Russell Napier alluded to in a [Firstlinks article](#) early this year.

In my article this week, I look at a new book by Bill Bengen - the creator of the 4% rule for retirement withdrawals - which offers [fresh strategies to outlive your money](#), including holding fewer stocks in early retirement before increasing allocations.

On the topic of retirement, the association representing super funds, ASFA, has released research that a home owning couple needs just \$690,000 in super, as a minimum, to have a 'comfortable' retirement. **Clime's John Abernethy** explains why that number looks light and how it highlights [broader problems with our superannuation system](#).

James Gruber

Also in this week's edition...

Are franking credits factored into share prices? **Geoff Warren** says the data suggests they're probably not, and there are certain types of stocks that [offer higher franking credits](#) as well as the prospect for higher returns.

18th century Scottish economist Adam Smith is best known as an advocate for free markets and the 'invisible hand'. Less known is that he also wrote extensively on morals and moral conduct. In a new book, Judo Bank co-founder **Joseph Healy** says that Smith would despair at many [aspects of modern Australia](#), which has let materialism override basic human values such as kindness, compassion, and having a fair go.

Despite the perception that successful investors nimbly navigate each zig and zag in the market, the evidence suggests otherwise, says **Duncan Burns** of **Vanguard**. He believes a long-term approach can help an investor [avoid self-harming their returns](#).

As the world's largest ETF manager, Blackrock has a treasure trove of data on where people are investing and how. The firm's **Tamara Haban-Beer Stats** outlines the four ways that global investors are [currently reshaping their US exposure](#).

As the hybrid market starts to wind down, high yield bonds are becoming more popular. **Macquarie Asset Management's Blair Hannon** has a useful primer on these [bonds and the opportunities available](#).

In this week's whitepaper, **Heffron**, provides an [SMSF facts and figures guide for 2025/2026](#).

Curated by James Gruber and Leisa Bell

Supercharging the '4% rule' to ensure a richer retirement

James Gruber

Despite being a giant in retirement planning, Bill Bengen is a humble chap.

He was a financial advisor in the US in the early 1990s trying to figure out how his clients, mostly Baby Boomers like him, needed to save for retirement to ensure they wouldn't run out of money.

It was becoming a pressing question at that time because his generation was the first to have a long life expectancy in retirement.

Bengen sifted through the academic literature for answers on the topic but couldn't find anything of use.

So, he investigated the data himself. He wanted to find how much retirees could safely spend each year without the well running dry.

He looked at what would happen if someone retired every year since 1926, and what the outcome would be based on different withdrawal rates - the percentage of your retirement savings that you can safely withdraw each year to ensure your money lasts throughout your retirement.

Bengen was aware that the US had seen some torrid stock market downturns, such as the 89% peak to trough fall during the Great Depression, and the 34% decline in 1973-1974. And he knew that these kinds of bear markets could be harmful to retirees, especially if they happened early in retirement (so-called sequence of returns risk).

Bengen wanted a fixed withdrawal rate that could outlast any 30 year period, even the worst ones.

Using a portfolio of 50% US stocks, 50% US bonds, he found that a starting withdrawal rate of 4.15%, with the initial dollar amount adjusted thereafter for inflation, would ensure a retiree wouldn't run out of money over a 30-year period.

That 4.15% became the '4% rule', and it ended up revolutionizing retirement planning. It became a simple rule that advisors and their clients could use.

It meant retirees could easily calculate how much they needed to save for retirement - by simply dividing the amount of money they would like to spend each year by the withdrawal rate. So if they wanted \$50k each year from their portfolio at a 4% withdrawal rate, they could divide \$50k by 4%, equalling \$1.25 million.

How 4.15% became 4.7%

Critics of Bengen thought his 4% withdrawal rate was too low. But Bengen himself admitted it was very conservative, based on surviving worst-case scenarios.

Like other advisers, Bengen subsequently found that many retirees didn't spend enough. They'd take their dividends and interest and try not to tap their principal. That ran counter to the 4% rule though Bengen copped some of the heat anyhow.

In his new book, *A Richer Retirement: Supercharging the 4% Rule to Spend More and Enjoy More*, Bengen, now retired, has refined his research and come up with fresh strategies to ensure people get the most out of their retirement.

He's tinkered with the data, and instead of using a 50% equities/50% bonds portfolio as he initially did, he increased the number of assets and created a more diversified portfolio – adding micro, small and midcap stocks in the US as well as international stocks.

Each one of the additions increases the withdrawal rate that retirees can use. Consequently, Bengen has changed his estimate of a safe withdrawal rate from 4.15% to 4.7%.

Again, that's a conservative number, and Bengen suggests that he'd probably recommend 5.25-5.5% for today's retirees.

The biggest enemies for retirees

Bengen says inflation is the biggest enemy for retirees. In the 1970s, US inflation averaged 8-9% per annum. It destroyed many retiree portfolios. That period had significant input into his 4% rule.

The other enemy is a bear market, especially a prolonged one. In America, there were two severe bear markets in the first half of the 1970s. Combined with high inflation, retirees were impacted not only by nominal portfolio declines, but it was worse when adjusted for inflation.

Bengen says if you can avoid periods of high inflation or a bear market at the start of retirement, then things should turn out fine (much easier said than done).

The 'free lunches' for retirees

Bengen says there are four 'free lunches' that can add to your withdrawal rate without adding additional risk:

1. Diversifying your portfolio
2. Rebalancing once a year
3. Slightly tilting your equity allocations to microcap and small cap stocks
4. A rising equity glide path

The last point needs elaboration. Bengen suggests starting with a lower stock allocation of 30-40%, before increasing it each year.

Bengen says the data indicates that this results in a higher withdrawal rate.

He admits he was surprised by the results, though they make some sense. If you encounter a bear market early in retirement, having low stock exposure will protect you, and when markets rebound, you'll be buying into that through your rising equity glide strategy.

His other piece of advice is that everyone is different and your retirement portfolio and spending should be customised to suit you.

James Gruber is Editor of Firstlinks.

Are franking credits worth pursuing?

Geoff Warren

Access to franking credits is generally thought to make investing in Australian stocks more attractive. Does it follow that that Australian companies paying franked dividends offer higher after-tax returns as a consequence? I explain why this is probably, but not necessarily, the case. The nub of the issue is whether franking credits are associated with an offset in terms of lower pre-tax expected returns.

Nature of franking credits

Franking credits might be conceptualised as a prepayment of income tax made by the company on behalf of the investor. This prepayment occurs only with respect to fully-taxed Australian company profits out of which a dividend is paid, which the investor then includes in their tax return as a franking credit. The investor effectively either tops up the tax or receives a credit that adjusts the tax paid on the underlying company profits from an assumed 30% to their personal marginal tax rate.

This means that an investor on a marginal tax rate of (say) 45% pays an additional income tax of 15%. Superannuation funds pay a 15% tax on income and hence get a tax credit of 15%. And those on a tax rate of 0% – such as retirees or charities – can claim the franking credit back from the ATO in cash.

First up ... don't forget about the alternatives

Franking credits effectively put a stop on double taxation of Australian corporate profits, under which company profits are first taxed at the company level and again when distributed as dividends. The dividend imputation system thus places investing in companies that pay Australian corporate taxes on the same footing as other investments where the income is distributed to investors and taxed in their hands, such as fixed income and REITs (as well as managed funds). From this perspective, the imputation system addresses a potential distortion rather than necessarily creating an advantage.

However, franking may create an advantage over investing in companies where double taxation can still apply, including international stocks and Australian companies that pay unfranked dividends say due to overseas earnings. In some cases, such companies pay lower dividends and deliver more in capital gains, where the investor is taxed at half their marginal tax rate and may defer the payment of the tax and possibly avoid it by waiting until retirement to sell. This complicates the comparison.

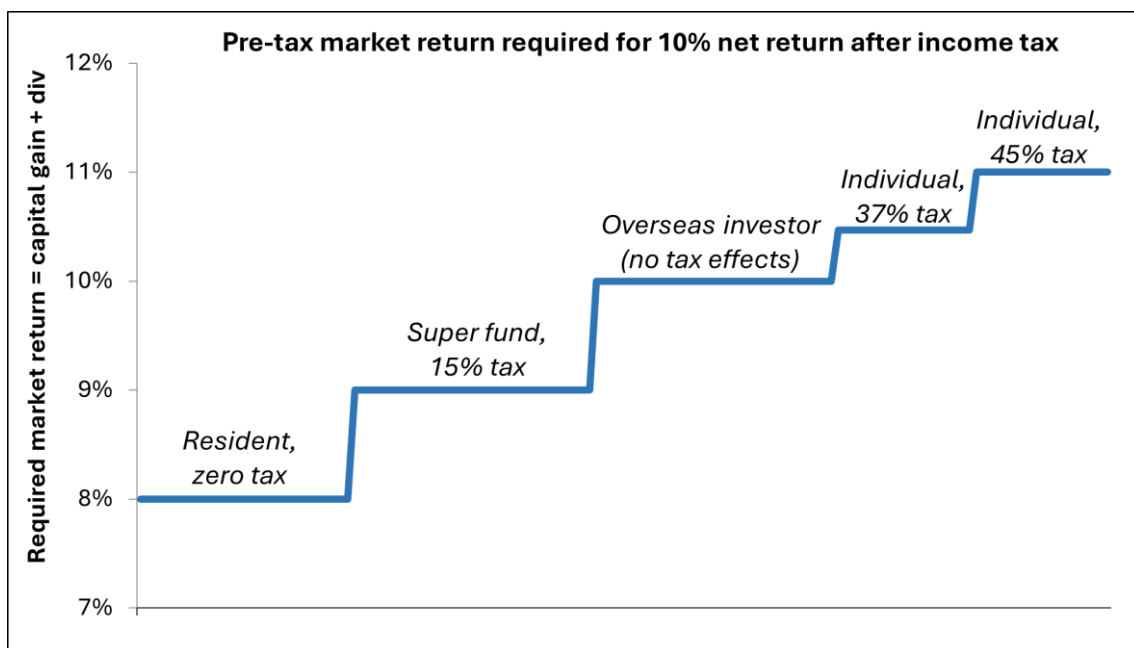
The key message is that, if you have money to invest, the existence of franking credits does not automatically make Australian stocks paying fully franked dividends more attractive. Expected return and risk on all available investments still needs to be weighed up. No point in holding Australian companies purely because they pay franking credits if other investments are more attractive after any tax effects are considered.

Where franking credits are available, do investors necessarily benefit?

Franking credits appear to offer an additional source of value to Australian investors. Does this mean that Australian stocks paying franked dividends offer higher expected returns? Not necessarily. It depends on the extent to which franking credits are priced. Which leads to the question of how share prices are determined.

Here is a simple thought experiment to set the context. Consider a stock that offers franking credits equal to 2% of the price. (I shall call this a 'franking credit yield' or FCY, which is the difference between the gross and net dividend yield.) And say that all investors agree that the 'fair' return for the stock is 10% after tax. One extreme is where prices are set by an Australian investor who places full value on the franking credits. The stock would then be priced to deliver an 8% expected market return (comprising capital gains plus net dividends), with that investor getting their 10% required return by including the 2% franking credit. Investors who cannot utilise the franking credits only get 8%. The other extreme is where franking credits are unpriced, so that the stock is priced to deliver a 10% expected market return. The Australian investor gets 12% including the 2% franking credit. In the former situation, franking offers no return benefit to the Australian investor. In the latter, franking provides a return bonus.

The question then is how market prices are determined when investors differ in the benefit they receive from any franking credits. While some researchers approach this issue by applying a weighted average, I suggest that identifying the marginal investor is more in accordance with economic theory. This perspective suggests a 'demand curve' that looks something like the ladder plotted in the chart below of the market return required by different investors to deliver them a 10% return after applying income tax on the dividends allowing for franking credits.



So, who sets the price? It might be any of these investors, depending on the time and situation. In any event, two things are required for franking credits to offer an additional return bonus. First is that they are NOT fully priced, i.e. not set by a low tax paying resident. Second, you are an investor that sits lower on the ladder than whoever happens to be setting the price. For instance, if overseas investors are the price setters, both super funds and zero-tax residents should benefit from franking credits.

Evidence around the pricing of franking credits

Numerous researchers have tried to tease out the extent to which franking credits are priced. Four methods have been used:

1. *Dividend drop-off studies* that estimate the value of franking by observing the price drop-off that occurs when a stock goes ex-dividend to establish if the presence of franking credits have an effect.

2. *Comparative pricing studies* infer the value of franking credits by comparing differences in the pricing of comparable securities that vary in their entitlement to franking credits, e.g. certain derivatives, stocks with overseas and Australian listings.
3. *Studies examining returns* that aim to establish if stocks paying franked dividends generate lower realised returns than otherwise expected.
4. *Studies focusing on share price levels* that focus on whether stocks paying franked dividends are more highly priced using valuation models.

While the findings are mixed, they generally come down on the side that franking credits are somewhere between unpriced and partially priced. This is hopeful for investors on lower tax rates, in particular zero-tax payers and probably super funds.

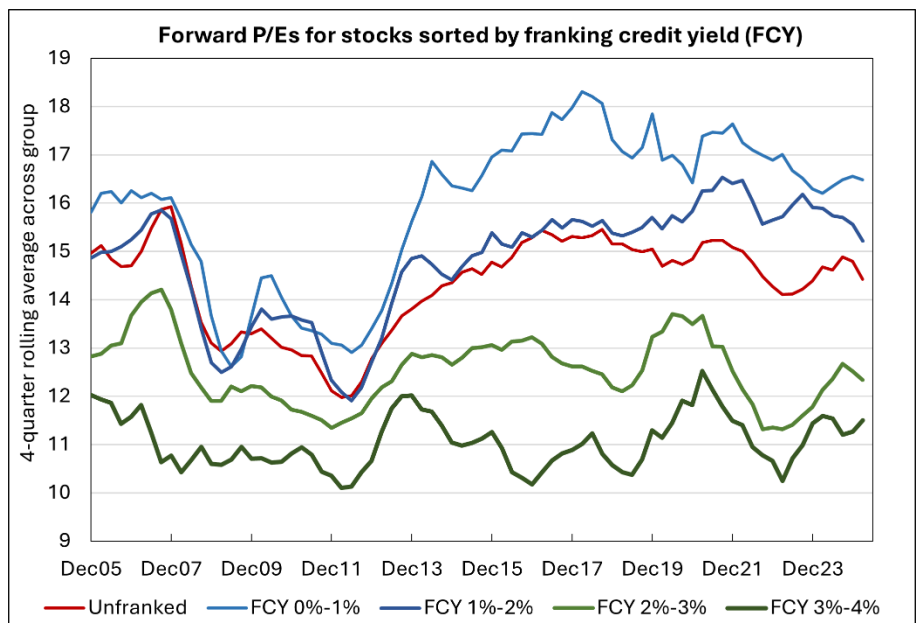
Could the pricing of franking credits have changed?

One question is whether the extent to which franking credits are priced may have changed over time, perhaps due to the rising influence of superannuation funds in Australian markets. For instance, one wonders whether super funds and other investors seeking franking credits may have contributed to a shift in how Australian banks are being priced.

I investigated by examining how consensus forward P/E ratios (or earnings yields, i.e. E/P) vary with FCY (franking credits / price) over time. The intuition is that, if franking credits are priced by the market, then stocks offering higher FCY should trade on higher PEs (lower E/P) all else held constant. Further, if the value placed on franking credits has increased over time, the relationship should have shifted.

I examined the data from a variety of perspectives, including analysing P/Es for stocks sorted by FCY and FCY for stocks sorted by P/E, double-sorting on both variables, running models (regressions) that control for other determinants of P/Es, and cutting the data along industry sector lines. The consistent result was that a higher FCY tends to be associated with lower (not higher) P/Es, and that this relationship has not changed meaningfully over time.

This chart illustrates this^[1]. The P/Es for stocks offering higher FCYs of 2-3% and 3-4% as appearing in green are lower than the PEs for stocks on lower FCYs 0-1% and 1-2% appearing in blue. Stocks with zero franking sit in the middle. And there are no obvious trends over time. Although this is simplistic analysis, one might expect to see some clear trends if the pricing of franking credit had changed.



The relationship between FCY and P/Es is in a sense unsurprising. It simply means that stocks on lower P/Es and thus higher E/Ps not only deliver more earnings per \$ of share price but are also likely to distribute more franking credits per

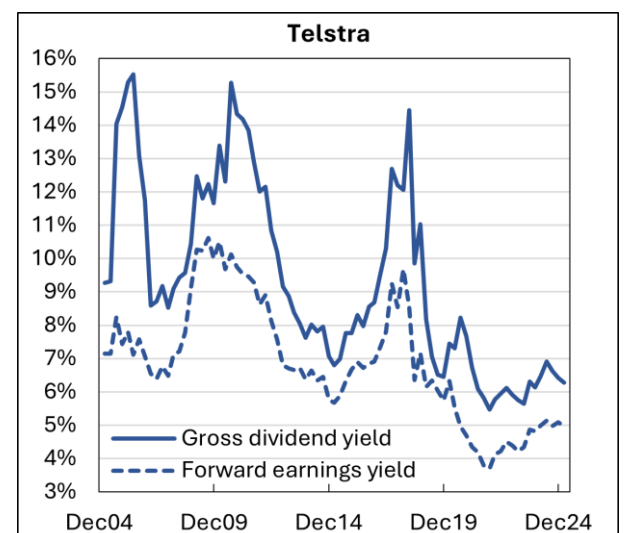
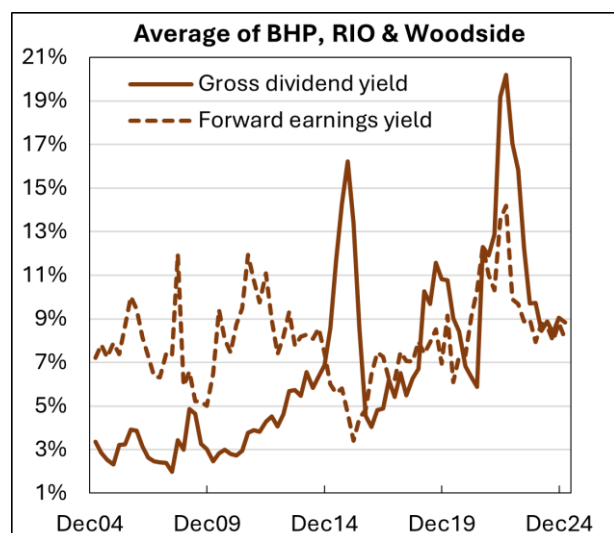
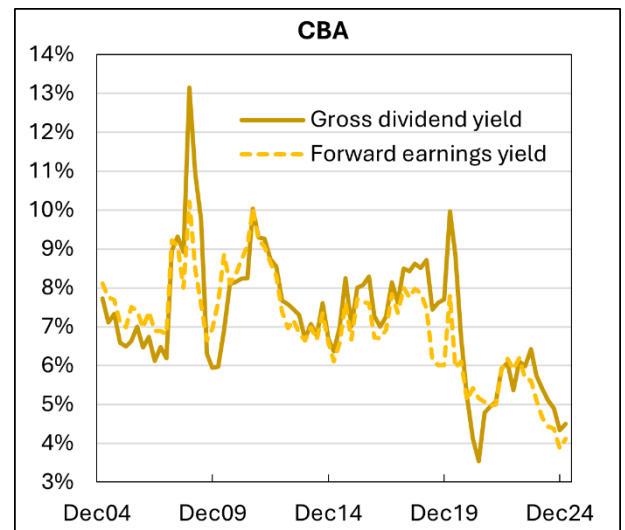
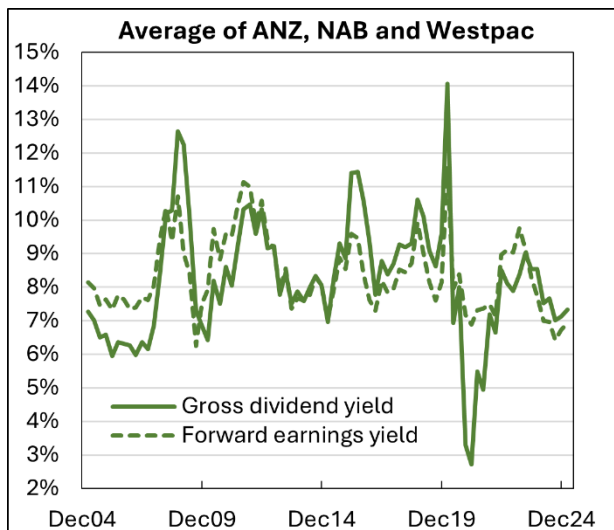
\$ of share price. Greater earnings mean greater dividends and greater franking, at least for companies that pay Australian corporate tax.

Applying an investor lens

The implication is that stocks that are 'cheap' on a P/E basis are prone to pay more franking credits. This opens up the prospect for investors to buy stocks that could be 'cheap' *AND* receive an additional return kicker from franking credits. Good news for value-based investors, especially those who prefer income. (See [Does dividend investing make sense?](#) for my discussion of the merits of income investing.)

It also means that the benefit from franking credits might fluctuate over time as stocks are repriced by the market. The panel of charts below plots gross dividend yield versus E/P for some traditional sources of fully-franked dividends in the Australian market, namely the big banks, the large resource stocks and Telstra. It is clear that E/P and gross dividend yield (and hence FCY) are closely related. And that these traditional sources of franking credits are not what they used to be, most notably in the case of CBA^[2].

Forward earnings yield vs. gross dividend yield



I am not suggesting that low P/Es coupled with a generous FCY suffices as investment criteria. Far from it. It is still important to invest in good companies at reasonable prices. Low P/Es stocks are not necessarily good investments. Nor are high P/E stocks necessarily bad investments. I am merely pointing

out that lower P/E stocks can often be associated with higher franking credits, and this component may act as a type of bonus return over that delivered by the market.

Where this all leaves us

The message is that franking credits deserve consideration and are probably worth pursuing. The evidence suggests that franking is at worst partly priced and possibly unpriced, and that some stocks paying franked dividends might also be relatively cheap. Nevertheless, franking credits are not enough in themselves. Pursuit of franking credits should be secondary to investing in good companies ideally at reasonable prices. Similarly, generous weightings to Australian equities purely to capture franking credits becomes questionable if other assets offer more attractive returns. As usual, there are rarely hard and fast rules when it comes to investing.

[1] We filtered the data to include companies trading on an E/P of between 3% (P/E of 33.3) and 13% (P/E of 7.6), to capture a sample where the P/E ratio is likely to be meaningful.

[2] Some investors might take the view that they purchased CBA at much lower prices and are receiving a good fully-franked yield on their initial investment. Sure. Nevertheless, I suggest there is a better way to look at the issue than anchoring on the initial entry price. This is to consider whether one might be better off selling and reinvesting in another stock on a lower P/E that offers much higher gross dividends. While an investor might not be better off after paying capital gains tax, at least it seems the right question to ask.

** A special thanks to RQI's David Walsh and Ned Guan for providing the data that forms the basis for this article.*

Geoff Warren is a Research Fellow with [The Connexus Institute](#), and an Honorary Associate Professor at the Australian National University.

Inflation cruels a comfortable retirement

John Abernethy

The association representing super funds, ASFA, has released research that a *home owning couple* needs just \$690,000 in super, as a minimum, to have a 'comfortable' retirement.

A *single* retiring homeowner needs \$595,000.

Also, ASFA suggests that annual retirement income, to be deemed comfortable, needs to be just \$74,000 per annum (p.a.) for a couple and \$52,000 p.a. for a single - both representing between 50% to 70% of average wages (tax affected).

By drawing the mandatory 4% p.a. from their super (as a pension), the difference is made up from the full entitlement (or drawing) of the 'means tested' Commonwealth pension. Commonwealth Health card benefits would be essential for these low-income retirees.

Clearly a couple or an individual with less in super than ASFA's minimum at retirement will have an extremely uncomfortable retirement. People who also rent and have less in super are also destined for a

difficult and problematic retirement. The extent of the discomfort will be determined by access to non-super assets. There are still over 20% of Australians who retire without a super account.

ASFA provides information on what expenditure that is covered by this income, but it's arguably flawed as it quotes averages and doesn't differentiate by age or health. AFSA makes no mention of retirees who rent.

In any case, it should not be a surprise, though it should be disturbing, that a majority of today's retirees, men or women, enter retirement with less than what is required to meet ASFA's comfortable level. After 33 years of compulsory super, this is a sobering observation.

But there is good news, according to ASFA, who suggest that the average 30-year-old who today has \$30,000 in super, and will earn the average wage, will reach the equivalent of today's \$595,000 by age 67. I will consider what this means later, but I do acknowledge that the compulsory 12% p.a. contribution rate helps the future look better than both the past and the present.

Today's average super balances

The ABS has produced the following table, as of 2024, detailing the average super balances for each age cohort. It suggests that the average 'single' retiree (65 to 69) will retire with less than enough to achieve a comfortable retirement. Average married couples (male and female) in general will have enough.

However, retiring low-income earners need to navigate the 'assets test' for the full entitlement to a Commonwealth pension. Having just enough may be better than having slightly too much as the Commonwealth pension is adjusted downward accordingly. This is where the much-maligned financial advisor comes into their element in strategic advice.

Superannuation in future

ASFA references how the 30-year-old of today will retire at 67 in 2062, and that opens up some questions:

- How will today's \$595,000 - the minimum needed by a single, retiring homeowner, according to ASFA - be measured in 2062 dollars?
- What will an annual pension payment require to equal today's \$52,000 for a single?
- What affect does inflation and the compounding of the cost of living and average wages mean for a future comfortable retirement?

Assuming a moderate 4% growth in annual 'average wages' (pretax to match inflation plus 1%), and the same ratio of drawings from super and the Commonwealth pension, the requirements in 2062 dollars for an individual retiree are:

Average super balances (\$)

	Males	Females
Under 18	7,687	4,699
18-24	9,062	8,163
25-29	27,021	24,821
30-34	55,690	46,586
35-39	96,122	76,020
40-44	140,680	109,209
45-49	193,501	147,146
50-54	254,071	190,175
55-59	319,743	242,945
60-64	395,852	313,360
65-69	448,518	392,274
70-74	501,785	449,540
75+	525,627	454,333

- \$2.5 million in the individual's retirement fund; and
- An income of \$220,000 p.a. of which \$100,000 is drawn pension, with about \$120,000 p.a. coming from the Commonwealth pension.

Quite simply stated, even multimillion-dollar retirement accounts will not be enough to enter a 'comfortable retirement' in 2062. Compounding inflation fairly covered by average wage rises create this consequence.

Clearly the proposed non indexed unrealised capital gains tax targeting \$3 million super accounts will hit millions of retirees over time - and many of these retirees will be average workers on average retirement benefits.

Even in 2062, some 70 years after the introduction of mandatory super, it is likely that more than 50% of retirees will still need to draw a full or part Commonwealth pension even if they retire with over \$2 million in their super account.

Concluding thoughts

My points are simple:

1. Australia's account-based superannuation system is flawed - it is well past time to acknowledge this.
2. It would have been much better, and there still may be time, for the creation of a national mandatory contributory pension scheme that targets a 60% of average wage pension to all retirees. A 'reasonable asset tested' savings pension account (with a reduced earnings tax) could be an adjunct to the national pension scheme and thus most current super accounts would already comply.
3. The government should junk the unrealised capital gains tax proposal as it is an intellectually limited tax policy inside a flawed super system.
4. Indexing of taxation bands, both inside and outside super (i.e. wages), should be mandatory for both tax regulation and fiscal integrity.
5. The defined benefit pensions inside Commonwealth and State schemes need to be much more transparent. They need to be both funded and taxed, consistent with a sustainable and fair national retirement scheme developed for all Australians; and
6. The persistent adding to inflation, through the indexing of government charges, needs curtailing. Government indexed charges make the ambition of a 'comfortable retirement' simply unattainable for many.

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

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Australia's sleepwalk into a damaged society

Joseph Healy

The following excerpt is taken from Joseph Healy's new book 'What would Adam Smith make of modern Australia?'.

Adam Smith reminded us of the importance of moral conduct – the standards of good or bad behaviour, fairness, honesty, prudence, and so on – when he concluded that without reverence for the rules of moral conduct, 'society would crumble into nothing'.

He also helped us understand that happiness and fulfilment in life were not a product of financial riches when he wrote, 'What can be added to the happiness of the man who is in health, who is out of debt and has a clear conscience?'

In *The Theory of Moral Sentiments*, Smith writes about a world defined by the people closest to us that define our community – family, friends and neighbours. The reality of the world we live in is that family and community have been allowed to weaken as essential foundations of a healthy society.

Today, too many people we interact with are remote and impersonal, a situation made worse by the inflexible working-from-home (WFH) movement – WFH quickly moved from a commitment to flexible working arrangements, which is a good thing, to an inflexible cultural movement that insists on always WFH on certain days of the week.

We live in a world defined mainly by impersonal exchange, yet we crave human connections as individuals. Many would quickly agree that the lack of interpersonal interaction is a significant loss. Yet, so many business models are defining what we do and need to drive us towards digital, remote, impersonal interactions.

It is rare to find a parent who is not concerned about how much time their children spend on digital devices at the expense of human interaction, sport, cultural activities and community.

Australia's spiritual decline

Many people see the demise of faith in Western culture as a form of nihilism, which has seen traditional religions replaced with a new 'religion' of consumerism and wokeism, which is equally intolerant of alternative views.

There is little argument with the view that we have seen a diminishment in spirituality in our communities. Spirituality is more than being religious; it can mean finding a sense of meaning and purpose in our lives. This reality of shallowness and spiritual void was captured by the then CEO of the AFL, Andrew Demetriou, when he said to a group of Melbourne businesspeople that because of the demise of the Catholic Church, 'Australians are now looking up to the AFL for guidance'.

Adam Smith would agree with his fellow Kirkcaldy native, former British PM Gordon Brown, who observed, 'I don't think we should underestimate the motivational power that religion and ethics provided to people.' This sentiment was echoed by former UK Chief Rabbi Jonathan Sacks, who

complained that without God, we have increasingly adopted a utilitarian and economic definition of human worth, and questions of meaning and value have been relegated to the private sphere.

Dopamine nation

Smith, reflecting in his 'be lovely and be loved' philosophy, would be concerned about the way Australia has become a 'dopamine nation' and how a culture of individualism has dominated the community. Consequently, sympathy and care are weakened in the pursuit of self-interest.

The practice of putting ourselves in the shoes of others and imagining how they might feel because of our actions is not, unfortunately, a feature associated with modern society. Our ability to see ourselves as others might see us is not what it once was and not as Adam Smith saw how people should view their actions.

It is not the love of humankind that makes the 'man of humanity' willing to make sacrifice, but because he sees himself through the eyes of the impartial spectator. In an individualistic society – the one that defines Australia and much of the West – this is sadly less of a consideration.

Smith also highlights the dangers of allowing the quest for material wealth to dominate and corrode our moral values. The search for more dopamine and the risk of anhedonia is evident in Australia's alarmingly high levels of household debt, which only adds to the stress on household budgets, particularly in times of rising living costs more generally.

In the 20 years to 2023, household debt increased from half to twice the average disposable income, and from 40% of GDP to 120%. The average house price in Australia in 2023 was 7.5 times the average income, up from 3.5 times 20 years earlier, the space of one generation.

A twisted national obsession

Alan Kohler, in his essay on housing, observed that the houses we live in have become speculative financial assets rather than simply family homes.

The amount of wealth Australians have concentrated in their homes has created a national psyche obsessed by property prices – and for many, with excessive levels of debt used to buy their home, a terrible burden which views the likely next interest rate move by the Reserve Bank of Australia (RBA) as national news of the highest importance.

The incentives caused by negative gearing are one cause of this high-risk profile, and so is the banking system's insatiable appetite for lending on housing – in my view, a huge misallocation of capital because of the low-risk profits it generates.

These factors should not negate the accountability of poor government policy and individual responsibility. If people choose to take on high levels of debt, and banks, lending prudently, think that is a sensible thing to do, then people must accept the consequences of their decisions in the very same way that a driver of a car under the influence of alcohol must accept responsibility for his or her decision.

Yet today, nearly one in four households faces mortgage stress or the so-called mortgage cliff, and the likely date of the next move in interest rates has become a national obsession.

The dangers of speculative lending

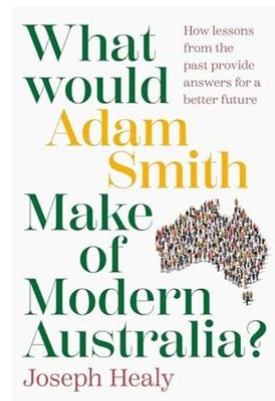
Through APRA and the RBA, the government must be mindful of the risk to the economy of the build-up of speculative lending in the housing market and remember the wisdom of Smith on the risk to the economy of excessive bank lending.

This is a risk that builds slowly and hits suddenly. As John Maynard Keynes observed in 1931, the banks can be prone to 'herding' behaviour. They can fall into the trap that then Citibank CEO Chuck Prince did in 2007 when he said, 'As long as the music is playing, you've got to dance. We are still dancing.'

This unfortunate quote is reflective of how banks think. Citibank was close to becoming insolvent during the GFC, absent government support (which was true also of some other banks in both the US and Britain). Smith understood this risk, as did Keynes, who famously said in 1931, 'A sound banker, alas, is not one who foresees danger and avoids it, but one who, when he is ruined, is ruined in a conventional way along with his fellows so that no one can really blame him'.

High debt levels and a crisis in housing supply are just two of the stressful challenges facing many households. Dr Anna Lembke asks a pertinent question relevant to Australia: 'Why, in a time of unprecedented wealth, freedom, technological progress, and medical advancement, do we appear to be unhappier and in more pain than ever?'

Joseph Healy's book ['What would Adam Smith make of modern day Australia?'](#) is out now. Joseph Healy is an international banker and mental health entrepreneur. He held senior positions at two of Australia's major banks and was a co-founder of Judo Bank.



The simplicity of this investing method hides its power

Duncan Burns

Investing is simple. But keeping it simple, that's the hard part. Especially when markets get choppy, the temptation to 'do something' creeps in. Tweak your portfolio. Time the market. Chase performance. Sound familiar?

But here's the truth: great investors don't get clever – they get consistent. Sounds easy. But in reality, doing nothing is one of the hardest parts of investing – especially when your portfolio dips and headlines scream panic.

That's where single fund solutions, such as one-click multi-asset ETFs and target date funds, are coming to the fore as an antidote to complexity. These are ready-made, globally diversified total market portfolios of stocks and bonds designed to ride through multiple market cycles.

Minding the gap

Morningstar's annual [*Mind the Gap*](#) report is a great tool to help figure out what's at stake. Its research is a sobering reminder of how costly it can be to tinker with a portfolio by estimating the gap between reported returns on managed funds and ETFs and the actual returns harvested by investors.

There is a startling difference between the two, which is directly attributable to the poor timing of investor purchases and sales.

Over the 10 years to December 2023 fund returns outperformed the average investor actual returns by 1.1% annually, largely due to investors' performance chasing tendencies. A 1.1% reduction in returns is a sizable sum over one year and a crushing blow to a long-term retirement portfolio over 30 years of compounding returns.

Morningstar also looked at the prevalence of performance chasing drag across different fund type categories. Interestingly, multi-asset funds stand out from the pack as products where investors came closest to earning their full return and self-harmed the least (only 0.4% behind).

Turns out there are some good reasons why these one-click solutions come out ahead.

Superannuation clues

Everyone is happy to stay invested when markets are rising, but how can investors avoid the cost of panicking when things turn south?

The superannuation system gives us some clues. With its compulsory contributions and the prevalence of single fund investment management frameworks, super funds have delivered some world-leading pension results.

Super may have cracked the difficult problem of how to get people who say they are long-term investors to actually be long-term investors. And many Aussies are starting to adopt a similar mindset and investing approach for their non-super nest eggs.

The first Australian 'one-click ETFs' debuted in 2017. The category hit \$1 billion in 2020 and has been growing at roughly 40% annually for the last five years. Which brings us to \$6 billion today, after raking in \$1 billion in new cash flow across the past 12 months alone.

One of the biggest benefits of a one-click portfolio is you cannot measure individual investments inside your portfolio. There is a big behavioural advantage in this, because when you can there is a tendency to look at the performance of each investment individually.

In a well-constructed balanced portfolio, some assets will always outperform and some will always underperform. And to assume that the under performers are bad because of a recent drop is an easy trap, because the whole is greater than the sum of its parts.

As the *Mind the Gap* report shows, there is a strong desire to get rid of underperformers at just the wrong time. This leads to the dreaded buy high and sell low pitfall. So in that sense, one-click solutions don't give investors that opportunity to self-harm.

One-click funds also auto-rebalance, which ensures the desired asset allocation and risk level is maintained. With the added benefit of systematically selling high and buying low, rebalancing can actually add to expected returns when volatility hits.

These behavioural and automation benefits, paired with a dollar cost averaging contribution strategy, can put a portfolio on autopilot. Recurring contributions over a period average out the buying price and can further reduce the impact of market volatility.

There's a common perception that successful investors are the ones that nimbly navigate each zig and zag in the market. But the evidence suggests otherwise, and Warren Buffett, arguably the greatest stock picker of all time, sums it up nicely: *"Wall Street makes money off your activity. You make money off inactivity."*

One-click funds aren't flashy, but don't overlook the sophistication hiding behind their simplicity. Investing should be like planting a tree and watching it grow—not digging it up every time the weather changes.

Duncan Burns is Chief Investment Officer for Asia-Pacific at [Vanguard Australia](#), a sponsor of Firstlinks. This article is for general information purposes only and does not consider the circumstances of any individual.

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Four ways that global investors are reshaping their US exposure

Tamara Haban-Beer Stats

Since 'Liberation Day' on 2 April 2025, markets have experienced heightened volatility. Shifts in US trade policy and growing fiscal concerns are prompting some investors to reassess their broad exposure to US assets within multi-asset portfolios.

Recent global client surveys show that over 20% of investors based in Asia Pacific and Europe are considering trimming their benchmark allocations to US or US-dollar denominated assets^[1]. With US equities making up more than 70% of the MSCI World and over 60% of the MSCI All Country World Index, investors are increasingly looking further afield for diversification.

Despite these shifts, the US dollar remains the dominant global currency, and US assets continue to serve as core components in a global portfolio. For Australian investors, European and Emerging Markets ex China equities, along with local fixed income strategies and currency hedges, are gaining traction. Additionally, some are recutting their US equity allocations to include active US equity strategies that aim to outperform the broad US equity market.

1. Diversify internationally

While we continue to see value in US equities, their benchmark dominance and high foreign ownership are prompting investors to look elsewhere. Europe is leading the shift: iShares European equity ETPs have attracted more global flows year-to-date than their US counterparts^[2]. In Australia, over \$52 million flowed into our European equity ETF in the first half of the 2025.^[3]

Similarly, global investors have also flocked into Emerging Markets ex China equities, which has seen US\$9 billion in global net inflows so far this year^[4]. This trend is mirrored in Australia, where more than A\$238 million has flowed into the locally-listed ETF, placing it among the top 10 iShares Australian ETFs by inflows in 2025.^[5]

Europe's resurgence is being driven by bold fiscal initiatives and improving economic fundamentals. The European Commission's €800 billion ReArm Europe plan aims to boost defence capabilities^[6] and reduce reliance on US imports. Germany alone is increasing defence spending to 3–3.5% of GDP. Meanwhile consumer confidence is rebounding, bank profitability is rising, and manufacturing output is steadily climbing across the Eurozone.^[7]

European equities also offer a value tilt and exposure to long-term, structural 'mega forces' such as AI transformation and geopolitical fragmentation.

A similar story is unfolding in select emerging markets. Taiwan, for example, is a global leader in AI-related industries, with nearly 15% of its GDP tied to technology^[8]. Brazil, rich in commodities and with a diversified exposure base spanning Asia, Europe, and the Americas, stands to benefit from the global realignment of supply chains. India, with a growing working-age population and supportive monetary policy, is also poised for long-term growth.

2. Lower beta to the US(D)

US fixed income assets remain a cornerstone of global portfolios but rising term premiums and fiscal concerns are creating vulnerabilities. Across Asia Pacific, investors are rotating into shorter/intermediate US Treasuries and diversifying into global government bonds.^[9]

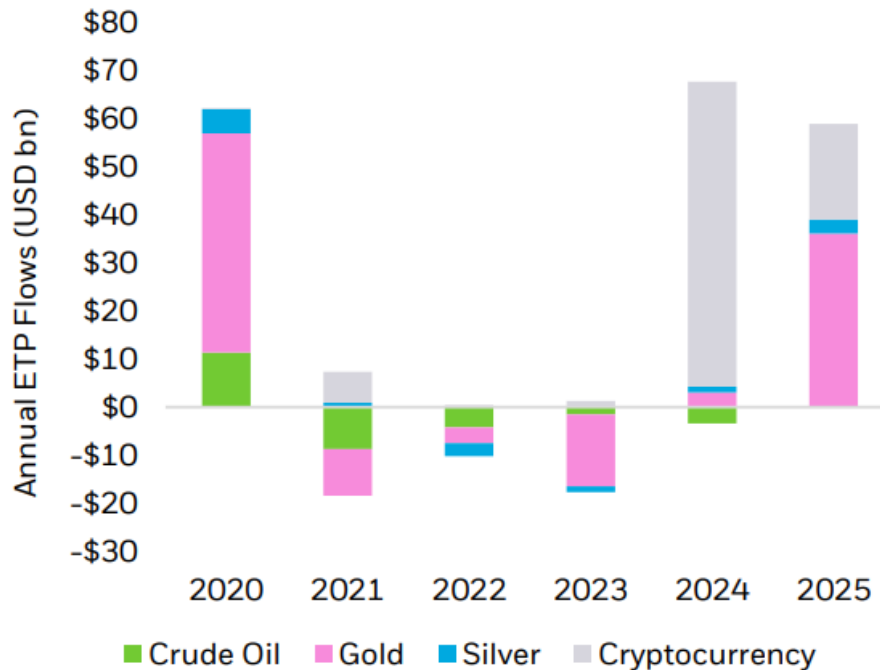
In Australia, we've also seen a marked preference for Australian government bonds and domestic investment grade credit, as investors shy away from US-dollar denominated assets.^[10] Our broad Australian bond and more granular Australian corporate bond exposures were the top asset gatherers across the iShares fixed income ETF range over Q2, receiving \$76 million and \$124 million in flows respectively.^[11] With further RBA rate cuts anticipated, Australian bonds are well-positioned for consistent performance.

3. Hedge against USD debasement

While the US dollar remains dominant, signs of a cyclical downturn are emerging – driven by slowing growth, fiscal deterioration, and rising hedging activity. Currency overlays and partial hedges are gaining popularity, and gold is back in favour. Global gold ETPs have seen the strongest inflows since 2020, with nearly US\$40 billion of net flows so far this year.^[12]

Global gold ETP flows have grown 10x versus 2024

Commodities ETP flows by exposure, 2020 onwards



Source: BlackRock and Markit data as of 30 June 2025

Australian investors are also embracing currency hedging. Hedged U.S. and global ex Australia equity exposures were among the top five iShares products by inflows in Q2.^[13] BlackRock Australia's model portfolios have also increased their hedge ratios to mitigate currency moves in the months ahead.^[14]

4. Going active on US equities

For investors recutting their US allocations, we recommend being deliberate with exposure across style factors and sectors and keeping an eye on diversification. The US equity market has become extremely concentrated following the outsized growth of the 'Megacap 7' stocks^[15]— Apple, Alphabet, Tesla, NVIDIA, Meta, Microsoft and Amazon – with tech and communications now making up almost half the S&P 500 Index.^[16] For example, Apple, with its strong free cash flow and low debt levels, typically aligns with the 'quality' factor.

In US equities, blending an index exposure with an active exposure using a factor rotation strategy may help investors offset this concentration risk and potentially enhance long-term returns across their US holdings. BlackRock's factor rotation strategy uses a combination of fundamentals, sentiment, and macro signals to dynamically tilt towards favoured factors - having recently increased its overweights to value and momentum - and has consistently outperformed the S&P 500 over 1-, 3-, and 5-year timelines.^[17]

Ultimately, US assets remain central to long-term portfolio construction given the depth and liquidity of US capital markets. However, in the world of shifting policy dynamics and market uncertainty, global investors are rebalancing, diversifying across geographies, asset classes, and currencies in order to weather the short-term storm.

- [1] Source: BlackRock, based on a survey of 2,557 clients globally in the week of 2 June 2025
- [2] Source: BlackRock data as of 20 June 2025
- [3] Source: BlackRock data as of 30 June 2025
- [4] Source: BlackRock data as of 30 June 2025
- [5] Source: BlackRock data as of 18 July 2025
- [6] Source: BlackRock data as of 16 April 2025
- [7] Source: Trading Economics, as of 22 May 2025
- [8] Source: US International Trade Administration, September 2024
- [9] Source: BlackRock and EPFR data as of 30 June 2025
- [10] Source: BlackRock data as of 16 June 2025
- [11] Source: BlackRock data as of 30 June 2025
- [12] Source: BlackRock and Markit data as at 30 June 2025, refers to global ETF industry flows
- [13] Source: BlackRock data as of 30 June 2025
- [14] Source: BlackRock data as of 16 June 2025
- [15] This is not a recommendation to invest in any particular financial product.
- [16] Source: Past performance is not a reliable indicator of future performance.
- [17] Source: BlackRock data as of 31 March 2025. Past performance is no indication of future performance

Tamara Haban-Beer Stats is [BlackRock Australasia's iShares ETF & Index Investments Specialist](#).

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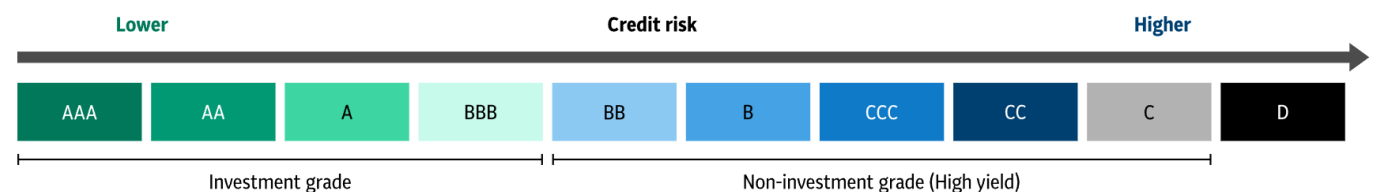
The case for high yield bonds

Blair Hannon

High yield bonds are fixed income securities that credit ratings agencies rate between BB and C grade and are also known as 'non-investment grade', indicating they are below an investment grade credit rating. High yield bonds are typically fixed rate securities issued by corporations, and they generally pay higher rates of return than investment grade securities to compensate for their higher credit risk.

Credit ratings are determined by one or more independent rating agencies, who assess the credit worthiness of an issuer or security, and the probability of default. Credit ratings provide investors with an independent and transparent way to measure the credit risk of fixed income assets;

- A higher credit rating indicates a greater ability of the issuer to meet its financial obligations i.e. pay back their debt. Investment grade securities have a credit rating between AAA and BBB.
- As credit risk increases, these securities are classified as non-investment grade – or a high yield security. To compensate for higher credit risk, high yield securities offer the potential for higher yielding returns.
- A credit rating of D would indicate the security is in default.



Source: References Standard & Poor's rating methodology.

High yield vs investment grade bonds

The global high yield market is highly diversified, covering a broad range of sectors and security types. Ford, United Airlines, Tesla and Netflix are just a few examples of major corporations that have depended on tapping the high yield credit market to fund their growth phase at some point. High yield securities range from corporate bonds, bank loans and emerging market debt to hybrid or subordinated debt securities, as well as structured securities.

High yield bonds generally have higher credit risk than investment grade bonds, because high yield bonds are typically issued by companies with lower credit worthiness. Securities with lower credit ratings are more sensitive to a downturn in economic cycles as this can increase the potential for corporate defaults.

High yield bonds generally have lower interest rate risk compared to investment grade bonds. This is because high yield bonds offer higher coupon payments to compensate for their higher credit risk and a larger portion of the bond's return is received earlier, which reduces the bond's duration and, consequently, its sensitivity to interest rate changes. High yield bonds also often have shorter maturities than investment grade bonds, meaning that the bond's price is less sensitive to interest rate changes, as the bond will be repaid sooner. Lastly, the prices of high yield bonds are more influenced by changes in credit spreads, while investment grade bonds are more sensitive to interest rate movements because their credit spreads are narrower and more stable.

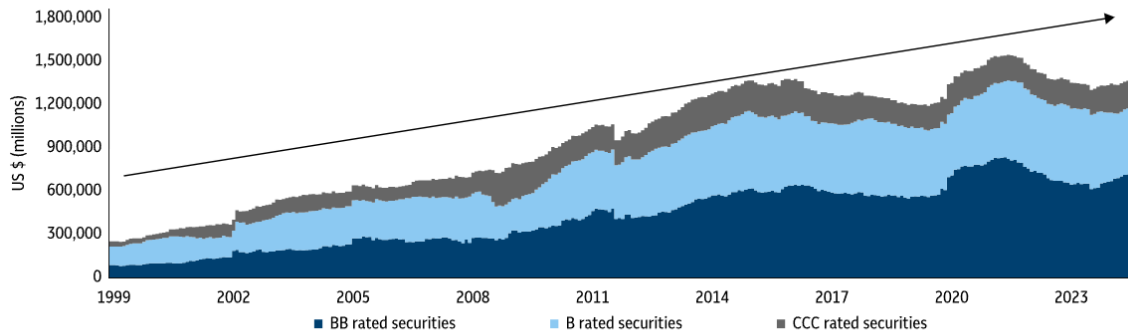
Here's how investment grade and high yield securities compare.

Feature	Investment grade bond	High yield bond
Yield/Income potential	Lower	Higher
Interest rate risk	Higher	Lower
Credit risk	Lower	Higher
Sensitivity to economic cycle	Lower	Higher

Why invest in high yield?

The global high yield market is well-established, having first originated over 40 years ago. At US\$2.7 trillion (including bank loans), it's larger than the ASX300 and is continuing to grow in size and improve in credit quality. In particular, the issuance of BB rated securities – the highest credit quality in the high yield market – have experienced a steady increase over the past 20 years, becoming the largest component of the market.

Size and credit quality of the high yield credit market

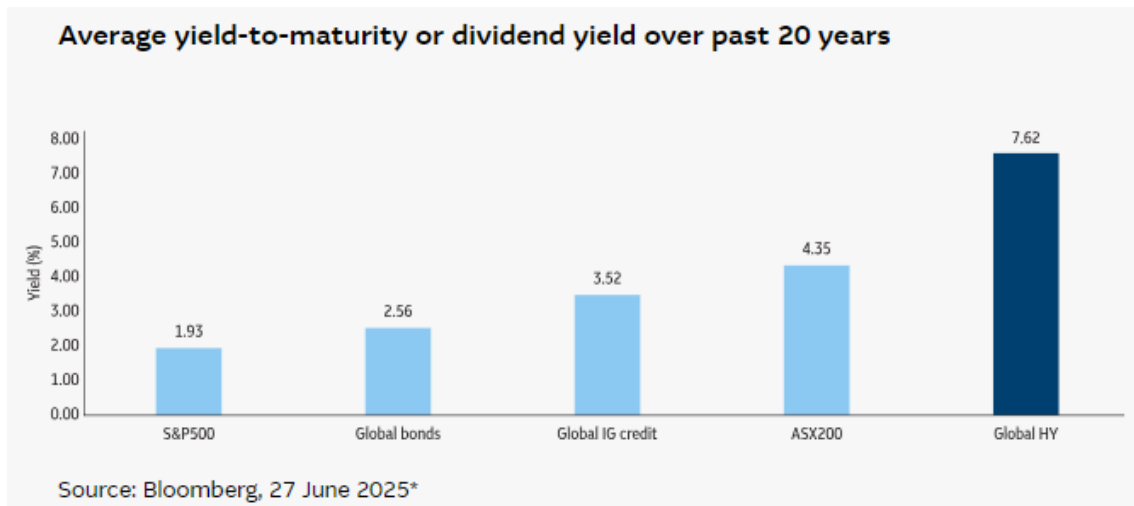


Source: Bloomberg, December 2024

The global high yield market is also highly diversified when compared with investment grade credit, which is typically dominated by financial corporations. Global high yield opportunities exist across a broad range of industries including technology, industrials, communication, energy providers, and consumer goods.

As shown in the graph below, the average yield generated by the global high yield market has been notably higher over the past 20 years than other traditional asset classes, including both traditional fixed income and equities.

An allocation to high yield can provide an opportunity to enhance the level of yield in a traditional equity-bond portfolio, as this chart indicates.



** Past performance is not a reliable indicator of future performance. The following indices have been used to represent the different parts of the fixed income investment universe above: Global bonds – Bloomberg Global Aggregate Index; Global investment grade corporate – Bloomberg Global Aggregate Credit Total Return Index; Global high yield – Bloomberg Global High Yield Index. Yield-to-maturity is the return that would be earned over the next year if there were no changes to interest rates and assuming there are no changes to the underlying investments. The number which is quoted is before fees. Yield-to-maturity is not the actual return that an investor can expect to receive by investing in these indices. Average yield-to-maturity has been calculated as the average of the daily yield-to-maturity over the last 20 years or since inception of the relevant index. Dividend yield is the annual dividend income on an equity position divided by the current market price of that equity position and has been calculated as the average of the daily dividend yield over the last 20 years.*

How to invest in high yield

Many alternative high yield credit assets – such as private debt – tend to lock capital up for an extended period and offer limited liquidity windows. However, high yield securities are now easily accessible as exchange traded funds (ETFs), listed on a stock exchange.

Blair Hannon is Head of ETFs, ANZ at [Macquarie Asset Management](#). This is general information only and does not take account of investment objectives, financial situation or needs of any person and before acting on this information, you should consider whether this information is appropriate for you.

The Macquarie Global Yield Maximiser Active ETF (ASX: MQYM) offers an actively-managed strategy focused on high yielding credit opportunities in global markets. You can learn more about it [here](#). It is also available as an [unlisted managed fund](#).

All investments carry risk. Different investments carry different levels of risk, depending on the investment strategy and the underlying investments. Generally, the higher the potential return of an investment, the greater the risk (including the potential for loss and unit price variability over the short term). The risks of investing in this Fund include:

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- **Manager risk:** There is no guarantee that the Fund will achieve its performance objectives, produce returns that are positive, or compare favourably against its peers, or that the strategies or models used by the Investment Manager will produce favourable outcomes.
- **Income securities risk:** The Fund may have exposure to a range of income securities. The value of these securities may fall, for example due to market volatility, interest rate movements, perceptions of credit quality, supply and demand pressures, a change to the reference rate used to set the value of interest payments, market sentiment, or issuer default.

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