Firstlinks
a Morningstar company

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Editorial

Every time I go to Canberra, I marvel at it being clean, green and generally upper-middle class. It's been that way for a long time and it's no accident. Obviously, it houses federal public servants and has benefited from increased government spending, federal and local, since it was created. A bet on most things Canberra has been a one-way bet for 100 years, and I expect that to continue for the next 100 years.

Why? Because increasing government spending is one of the few secular trends that you can bank on. The federal government is running budget deficits and is projected to run those deficits over the next decade.

It's not only here. The US government is spending trillions each year, running deficits that are the largest in a non-recessionary, peace-time world. Europe is similar, and Japan too.

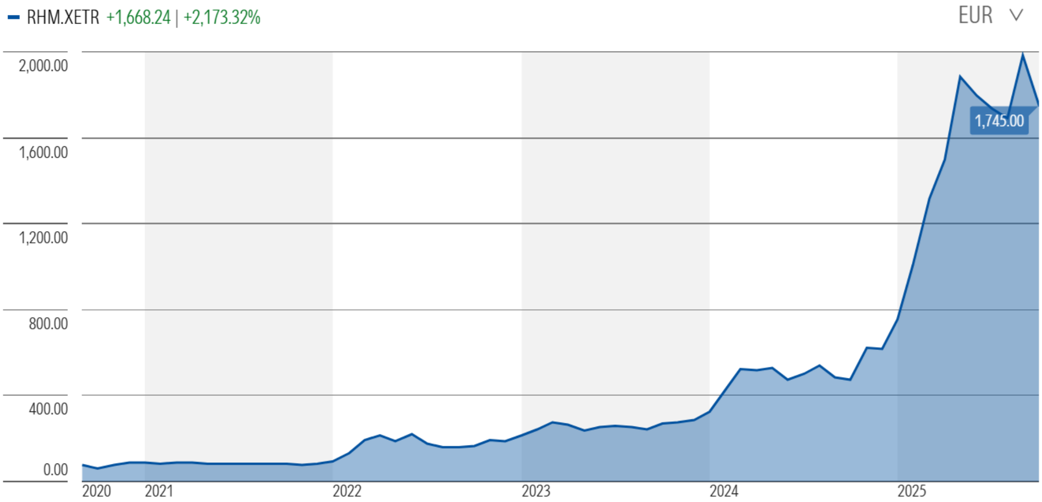
Overall, governments worldwide love to spend more money, and there are no signs that it will change any time soon.

The downsides of this government largesse are widely known. Less discussed are the potential opportunities, so let's do that here.

Defence and policing

Defence is an obvious one. At the start of his second term as US President, Donald Trump made it clear that the US wouldn't continue to be the world's policeman and he pressured other countries, especially Europe, to lift defence spending. The European Union has committed to increasing defence expenditure from under 2% of GDP to 5%. Naturally, European defence stocks have since gone ballistic (have a look at the share price of German arms manufacturer, Rheinmetall AG below).

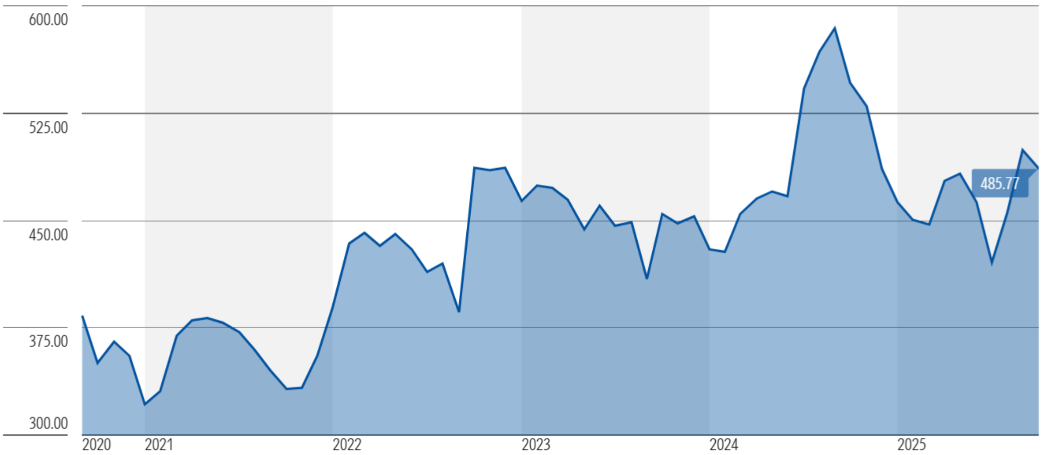
Rheinmetall AG share price



Source: Morningstar

US defence stocks have lagged. If you believe that government spending on defence will continue to rise in the US, and that there's the potential for increased major power conflict in future, ie with China, then stocks like Lockheed Martin, Northrop Grumman, and General Dynamics look reasonable value. The beauty of these stocks is that they're also resilient, generally outperforming during market downturns.

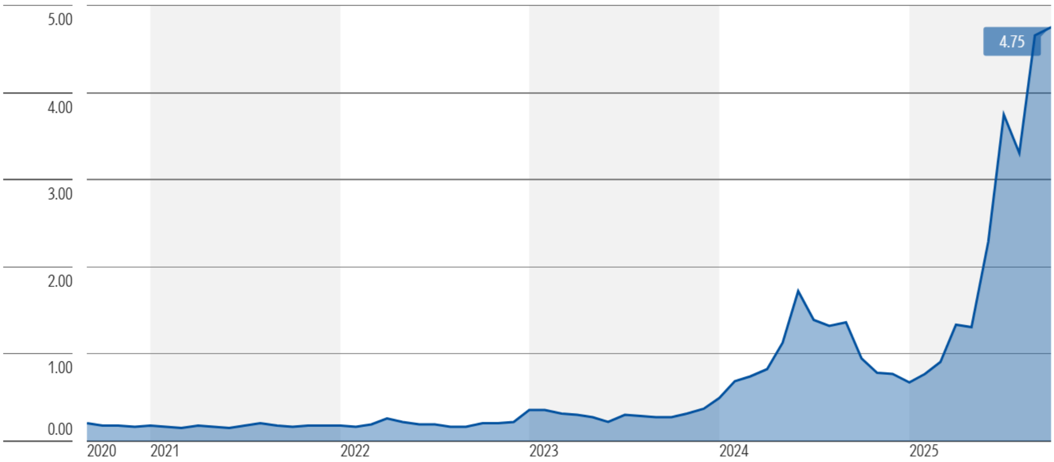
Lockheed Martin share price



Source: Morningstar

Australia has also committed to boost defence spending from around 2% of GDP to 2.4% by 2033-2034. Unfortunately, most of the stocks on the ASX have already factored in this news and positive headlines from overseas. Stocks like DroneShield, Electro Optic Systems, and Austal are worth monitoring, though.

Droneshield share price



Source: Morningstar

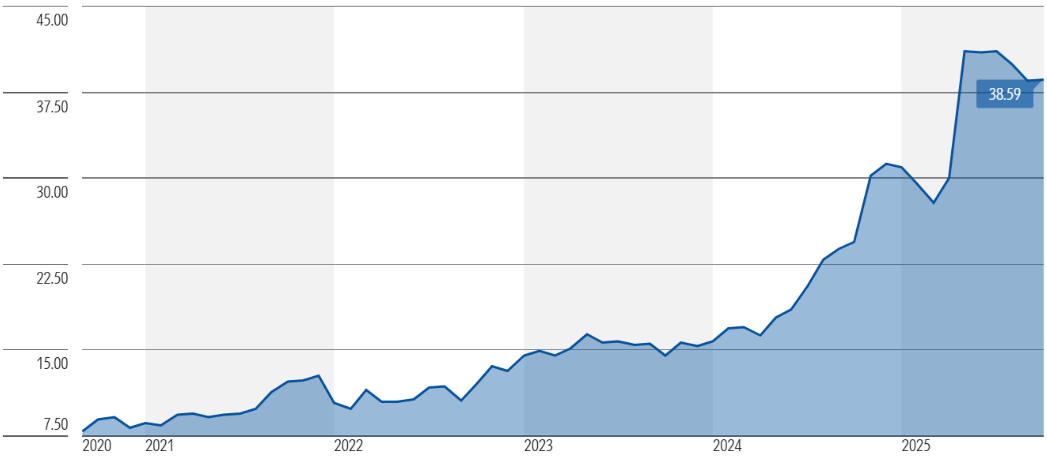
Defence is a trendy theme right now, evidenced by the VanEck Global Defence ETF being up 97% over the past year to September! However, there still seems to be pockets of opportunity.

Policing and public safety also benefit from government spending. In Australia, there aren't any stocks that I know of which are exposed to these areas. In America, AXON Enterprise, which created the taser gun and provides things like body cameras for police, is one company that has successfully ridden this trend.

Software

Software is a beneficiary of increasing government spending on technology. In Australia, Technology One's enterprise software powers many local councils, and state and federal governments. The company has been a stellar performer on the ASX for a long time.

Technology One share price



Source: Morningstar

In the US, Tyler Technologies, a software company with 95% of revenue from governments, has also been an amazing business in recent decades.

The Olympic Games in Brisbane

Thinking laterally, the lead-up to the Olympic Games in Brisbane in 2032 will bring with it plenty of government spending on new stadiums, transport systems etc. Suppliers are one way to play this. Construction materials company Wagners and scaffolding business Acrow have large exposure to south-east Queensland and are likely winners from this.

Wagners share price

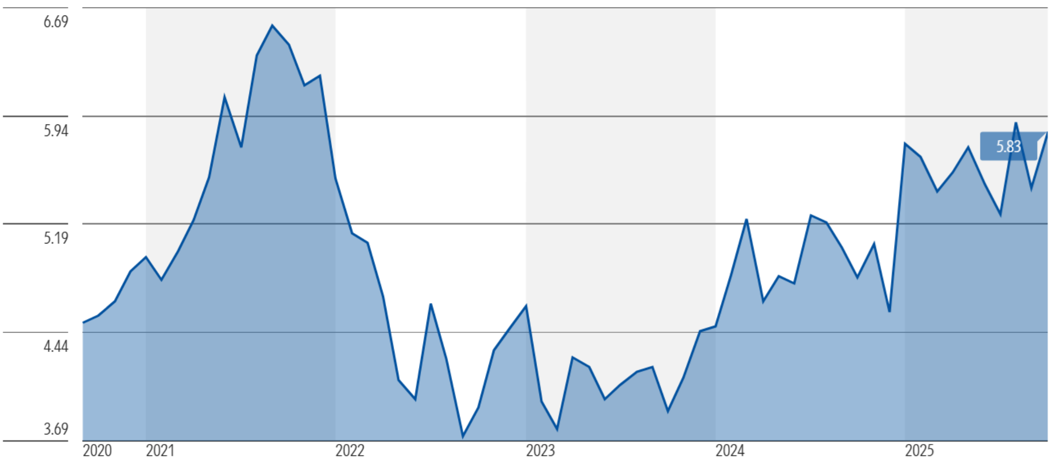
Source: Morningstar

Land lease communities

There are a growing number of retirees and housing is expensive, so more of them are taking up the option of land lease communities. With these communities, they own buy a home without the land attached, making it much cheaper. The businesses own the land, and get rent from the retirees, and the rent increases in line with the pension.

Stocks such as Ingenia, Lifestyle Communities, and Gemlife Communities offer exposure to this theme. Property developer Stockland is also aggressively growing its land lease portfolio.

Ingenia share price



Source: Morningstar

Infrastructure and construction

This is more of a US theme. The Biden Government, and now Trump, have committed to a massive public infrastructure program, via the US Infrastructure Investment and Jobs Act, CHIPS Act, and Inflation Reduction Act. That will drive demand for materials and engineering.

American stocks that should capitalize on this tailwind include Jacob Solutions, Fleur Corp, Vulcan Materials and Martin Marietta.

In Australia, housing is one to watch. We've all heard about how we're not building enough homes. Over time, governments will incentivise more construction and that could benefit the likes of SGH, owner of Boral.

SGH share price

Source: Morningstar

Healthcare?

Australia's population is ageing and that means more government spending on healthcare. However, the structure of many healthcare industries isn't appealing. For instance, private hospitals and aged care suffer from burdensome regulation.

Healthcare insurers are potentially attractive, though the industry runs the risk of being restructured to allow more money to flow to private hospitals at the insurers' expense.

There are lots of indirect beneficiaries from rising healthcare spending, like CSL and ResMed.

Overall, though, most of the healthcare industry gains from government spending though runs the risk of government intervention squashing returns on capital.

Ideally, you want the spending without the intervention.

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I have two articles this week. First, I investigate LICs versus ETFs and which deliver the best returns. The answers are revealing.

Second, I've reprised my most popular-ever article, '18 rules for ageing well', written in November 2023. The rules include, 'the unexamined life lasts longer', 'change no more than one-eighth of your life at a time', 'nobody is thinking about you', and 'pursue virtue but don't sweat it'.

James Gruber

Also in this week's edition...

Harry Chemay is back, this time with a piece on the growing debt burden of retiring Australians and the challenges, solutions and opportunities that presents.

The recent savage share price falls in CSL and WiseTech are a reminder that large cap stocks aren't risk-free. **Yarra's Dion Hershan** suggests these aren't isolated cases and the ASX 20 is full of broken blue chips. He thinks the days of simply holding blue chips forever is gone, and investors increasingly need to look elsewhere to grow their wealth.

My children love eating burritos and nachos from Guzman y Gomez, though that hasn't shown up in the recent share price performance of the company. **Airlie's Will Granger** has taken advantage of the price dip to top up his position in GYG, and here he explains why.

Factor-based investing, long the domain of institutions and active managers, is now accessible to everyday investors through ETFs. **VanEck's Russel Chesler** explains how these smart beta funds use defined rules to target specific drivers of returns, like quality, value, momentum, and low volatility, and offer low-cost and easy-to-trade alternatives to traditional active funds.

John West reviews recent best-selling book, *Breakneck: China's Quest to Engineer the Future*. The book's author, Dan Wang, contrasts China's "engineering state" with America's "lawyerly society," showing how these mindsets drive innovation, dysfunction, and reshape global power amid rising rivalry. John says it's a simplistic view though the book offers many fascinating observations of the two superpowers.

Lastly, in this week's whitepaper, the **World Gold Council** outlines how it's trying to grow the market for digital gold. It's an intriguing guide to the future of the yellow metal.

Curated by James Gruber and Leisa Bell

LICs vs ETFs – which perform best?

James Gruber

Recently, I wrote an article asking whether Listed Investment Companies (LICs) are licked. I concluded that LICs faced a challenging future given waning structural demand. That said, NAV discounts for them could narrow in the short term as interest rates fell.

In response to the article, subscriber Steve made this comment:

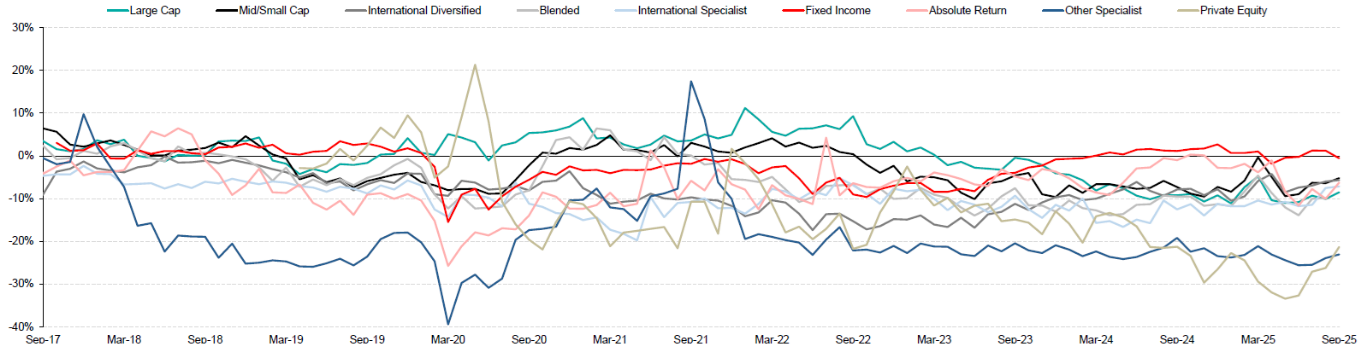
"… it would seem there is a need for a balanced comparison of the two [LICs and ETFs] to try and settle a few arguments that are bubbling along here. Would the author (James) consider a follow up article perhaps simply comparing say the top 5 LIC's (by capitalisation) with the top 5 ETF's (presuming a similar investment universe of ASX200 companies) for (a) total return, including franking credits, (b) total

income, including franking credits and (c) price return over say 5 and 10 years. The only caveat I would throw in is that similar index funds should produce similar returns (by definition) so maybe throw in a couple of smart beta ETF's (eg AQLT, MVW or some of the dividend focused ETF's) to diversify the ETF offerings even if outside the top 5."

This piece takes up Steve's suggestion.

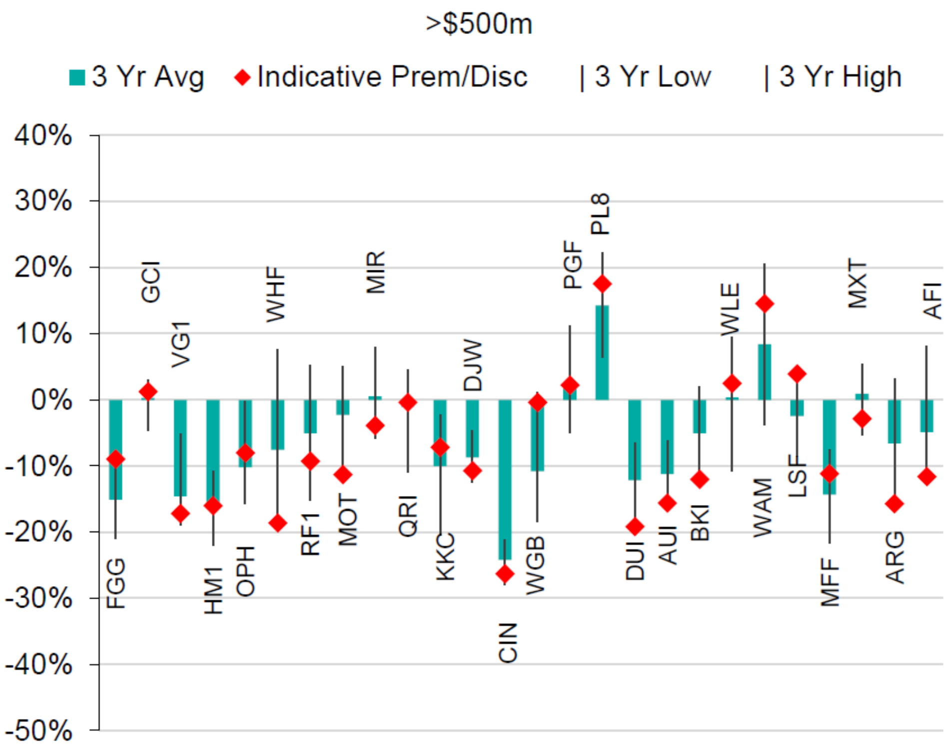
First though, it's worth noting that NAV discounts for LICs continue to narrow.

LIC premium/discount based on investment mandate (market cap weighted)



Source: IRESS, Company Data, Bell Potter Estimates

The next chart shows NAV premiums and discounts for the LICs with a market capitalisation of more than $500 million.



Source: Bell Potter

What this shows is that several LIC large caps are getting more love from investors, including Plato Income Maximiser (PL8), WAM Leaders (WLE), WAM Capital (WAM), MFF (MFF), Future Generation Global (FGG).

Yet, there are some notable laggards, such as Australian Foundation Investment (AFI), Argo (ARG), BKI Investment (BKI), and Australian United Investment (AUI).

Australian equity LIC and ETF performance – comparing the pair

Let's move past NAV premiums and discounts and look at how LIC performance stacks up against comparable ETF products.

The following table takes the pre-tax net tangible asset (NTA) performance of major Australian equity LICs and compares that to various ETFs and indices.

Major Australian LICs vs comparable ETF performance

Company/ETF	Code	1yr	3yr	5yr	10yr
Australian Foundation Investment	AFI	1.5%	12.1%	10.4%	8.5%
Argo Investments	ARG	9.4%	13.4%	12.2%	8.5%
Australian United Investment	AUI	12.4%	16.8%	14.3%	10.2%
BKI Investment	BKI	6.9%	11.2%	11.4%	7.3%
WAM Leaders	WLE	3.3%	6.6%	10.0%	n/a
Plato Income Maximiser	PL8	11.6%	13.4%	11.2%	n/a
Djerriwarrh Investments	DJW	1.3%	11.1%	9.4%	6.4%
Vanguard Australian Shares Index ETF	VAS	10.7%	15.0%	12.9%	10.1%
iShares Core S&P/ASX200 ETF	IOZ	10.5%	15.1%	12.9%	10.0%
Betashares Australia 200 ETF	A200	10.5%	15.1%	13.2%	n/a
Betashares Australian Quality ETF	AQLT	18.2%	22.2%	n/a	n/a
VanEck Australian Equal Weight ETF	MVW	9.7%	14.1%	12.2%	10.6%
ASX 200 Index		10.5%	15.2%	13.3%	10.1%
ASX 300 Index		10.8%	15.0%	12.9%	10.1%

Note: LIC performance is pretax NTA per annum, and assumes reinvestment of net dividends, but does not incorporate franking. ETFs are post fees, pre-tax. The performance figures are through to end Sept. Source: Bell Potter

The table essentially isolates the investment performance of LICs over various timeframes. And the results aren't flattering to LICs.

Only two of the seven major Australian equity LICs beat comparable ETFs and indices over the past 12 months, namely Australian United Investment and Plato Income Maximiser. Over three, five, and seven years, there's just one LIC that has superior performance against those ETFs and indices: Australian United Investment.

The granddaddy of Aussie LICs, AFIC, has badly trailed indices over the past year, and over long time periods. Recently, it's suffered from being underweight CBA and gold stocks. However, it's also held onto some notable 'losers' like James Hardie, Reece, IDP and CSL.

Other heavyweights such as Argo and BKI have also significantly lagged indices and ETFs over all time frames.

Amazingly, the WAM Leaders fund has put up poor performance over one, three, and five years, yet as chart two in this article shows, it still manages to trade at a premium to NAV.

Plato Income Maximiser focuses on dividend stocks, and has been a reasonable performer, albeit it's still trailed comparable indices over all time periods. With investor hunger for income, though, the stock trades at punchy 17% premium to pre-tax NTA.

Australian United Investment has been the best performer of the large cap Australian equity LICs. I don't know a lot about this LIC and the company presentations don't seem to offer detailed information on its largest holdings. However, it's worth noting that AUI uses both options and leverage, which can enhance returns (and potentially detract from them too).

It should be said that the LICs themselves don't all compare themselves to the same benchmark. Six of the seven benchmark themselves against the ASX 200. The only one that doesn't is BKI, which compares itself against the ASX 300.

Also, the largest ETF, the Vanguard Australian Shares Index ETF, tracks the ASX 300, unlike other peers in the table.

The LICs will point to several factors for their recent underperformance. Notably, most have been underweight CBA and the banks, and they've paid a price for that. It's less of an excuse when it comes to long-term performance, and that's where scrutiny should fall on the LICs.

The next table shows the *share price* performance of the Australian equity LICs against the same ETFs and indices.

Obviously, share prices can differ from NTAs, though the overall picture for LICs isn't pretty either.

Major Australian LICs vs comparable ETF performance (share price)

Company/ETF	Code	1yr	3yr	5yr	10yr
Australian Foundation Investment	AFI	0.5%	3.1%	6.2%	6.3%
Argo Investments	ARG	8.2%	5.9%	8.6%	6.0%
Australian United Investment	AUI	7.1%	10.7%	11.6%	8.8%
BKI Investment	BKI	6.4%	7.9%	10.4%	5.9%
WAM Leaders	WLE	6.6%	4.9%	8.9%	n/a
Plato Income Maximiser	PL8	22.9%	13.4%	12.1%	n/a
Djerriwarrh Investments	DJW	2.4%	9.5%	10.1%	2.3%
Vanguard Australian Shares Index ETF	VAS	10.7%	15.0%	12.9%	10.1%
iShares Core S&P/ASX200 ETF	IOZ	10.5%	15.1%	12.9%	10.0%
Betashares Australia 200 ETF	A200	10.5%	15.1%	13.2%	n/a
Betashares Australian Quality ETF	AQLT	18.2%	22.2%	n/a	n/a
VanEck Australian Equal Weight ETF	MVW	9.7%	14.1%	12.2%	10.6%
ASX 200 Index		10.5%	15.2%	13.3%	10.1%
ASX 300 Index		10.8%	15.0%	12.9%	10.1%

Note: The performance figures are through to end Sept. Source: Bell Potter

Only one of the major LICs has outperformed comparable ETFs and indices over the past year – Plato Income Maximiser. Plato has benefited from superior investment performance as well as a widening in the premium of its share price to NTA.

Yet, over three, five, and 10 years, all the LICs have underperformed the ETFs and indices. Australian United Investment did well with its investment returns though suffered from an increased discount of NTA to share price.

International equity LIC and ETF performance – comparing the pair

Here's the same exercise for international stock LICs.

First, let's see the investment performance of these large cap LICs versus comparable ETFs and indices.

Major Australia-based International LICs vs comparable ETF performance

Company/ETF	Code	1yr	3yr	5yr	10yr
MFF Capital Investments	MFF	23.3%	28.1%	16.2%	13.2%
WAM Global	WGB	8.7%	13.2%	5.4%	n/a
PM Capital Global Opportunities	PGF	28.2%	28.5%	24.2%	13.2%
Future Generation Global	FGG	18.8%	16.7%	6.7%	7.7%
Hearts and Minds Investments	HM1	21.8%	17.7%	4.8%	n/a
L1 Long Short Fund	LSF	17.9%	15.6%	18.8%	n/a
Regal Investment Fund	RF1	10.5%	11.6%	14.5%	n/a
Vanguard MSCI Index International Shares ETF	VGS	23.1%	22.7%	16.3%	13.2%
iShares S&P Global 100 ETF	IOO	27.9%	26.5%	19.7%	15.9%
MSCI World Index (AUD)		22.7%	22.5%	16.2%	13.6%

Note: LIC performance is pretax NTA per annum, and assumes reinvestment of net dividends, but does not incorporate franking. ETFs are post fees, pre-tax. The performance figures are through to end Sept. Source: Bell Potter

The hit rate for international LICs is better. PM Capital Global Opportunities and MFF Capital have both outperformed over one and three years. However, both have trailed the index over 10 years.

PM Capital has performed well given it's a value-cased investor in a world where value stocks have been decimated by growth stocks since the GFC. Their bets on European banks have paid off in recent years (yes, European banks – the dogs of yesteryear – have bounced hard).

MFF is a quality/growth investor and principally holds household stocks in the US, such as Visa, Mastercard, American Express, Amazon, and Bank of America. It's run by the highly regarded Chris MacKay.

WAM Global, Future Generations Global, and Hearts and Minds Investments have been poor investments over all time periods.

Of the alternative category of international equity LICs, L1 has underperformed of late, but has a better long-term track record.

Let's turn to how the international LIC share prices have done.

Major Australia-based International LICs vs comparable ETF performance (share price)					
Company/ETF	**Code**	**1yr**	**3yr**	**5yr**	**10yr**
MFF Capital Investments	MFF	30.8%	30.9%	17.1%	13.8%
WAM Global	WGB	17.0%	18.9%	9.4%	n/a
PM Capital Global Opportunities	PGF	25.9%	29.5%	29.5%	15.7%
Future Generation Global	FGG	24.0%	19.6%	9.0%	6.7%
Hearts and Minds Investments	HM1	26.4%	21.4%	4.1%	n/a
L1 Long Short Fund	LSF	12.8%	17.4%	22.8%	n/a
Regal Investment Fund	RF1	2.6%	8.4%	13.7%	n/a
Vanguard MSCI Index International Shares ETF	VGS	23.1%	22.7%	16.3%	13.2%
iShares S&P Global 100 ETF	IOO	27.9%	26.5%	19.7%	15.9%
MSCI World Index (AUD)		22.7%	22.5%	16.2%	13.6%

Note: The performance figures are through to end Sept. Source: Bell Potter

This table tells a different tale. The narrowing of NAV discounts has led to four out of the five LICs outperforming over the past 12 months. That whittles down to two outperforming over five and ten years.

The other striking feature of the above table is how the top 100 global stocks have performed via iShares S&P Global 100 ETF. That's largely been driven by the staggering returns of the 'Magnificent Seven'.

Management fees

No article on LICs and ETFs would be complete without mentioning fees.

Below are the management expense ratios for the major Australian and international equity LICs versus the costs of comparable ETFs.

Major Australian LICs vs comparable ETF ongoing fees/costs		
Company/ETF	**Code**	**Fees/costs**
Australian Foundation Investment	AFI	0.16%
Argo Investments	ARG	0.15%
Australian United Investment	AUI	0.10%
BKI Investment	BKI	0.17%
WAM Leaders	WLE	1.00%
Plato Income Maximiser	PL8	0.80%
Djerriwarrh Investments	DJW	0.42%
Vanguard Asutralian Shares Index ETF	VAS	0.07%
iShares Core S&P/ASX200 ETF	IOZ	0.05%
Betashares Australia 200 ETF	A200	0.04%
Betashares Australian Quality ETF	AQLT	0.35%
VanEck Australian Equal Weight ETF	MVW	0.35%

Source: Independent Investment Research, company websites

Major Australia-based International LICs vs comparable ETF performance fees/costs

Company/ETF	Code	Fees/costs
MFF Capital Investments	MFF	1.33%
WAM Global	WGB	1.25%
PM Capital Global Opportunities	PGF	1.00%
Future Generation Global	FGG	1.00%
Hearts and Minds Investments	HM1	1.50%
L1 Long Short Fund	LSF	1.40%
Regal Investment Fund	RF1	1.50%
Vanguard MSCI Index International Shares ETF	VGS	0.18%
iShares S&P Global 100 ETF	IOO	0.40%

Source: Independent Investment Research, company websites

For LICs, operational expenses like management and performance fees are subtracted from the total assets, reducing the final NTA value per share.

**Full disclosure: Vanguard and VanEck are Firstlinks sponsors.*

James Gruber is Editor of Firstlinks.

The growing debt burden of retiring Australians

Harry Chemay

Australia sits among the world's wealthiest nations on a median# household basis. However, much of that wealth is in residential property, now nearing $12 trillion in aggregate, almost three times the size of current total superannuation system assets.

That concentration of illiquid non-financial wealth is creating its own complications as retirement approaches, particularly for those still indebted.

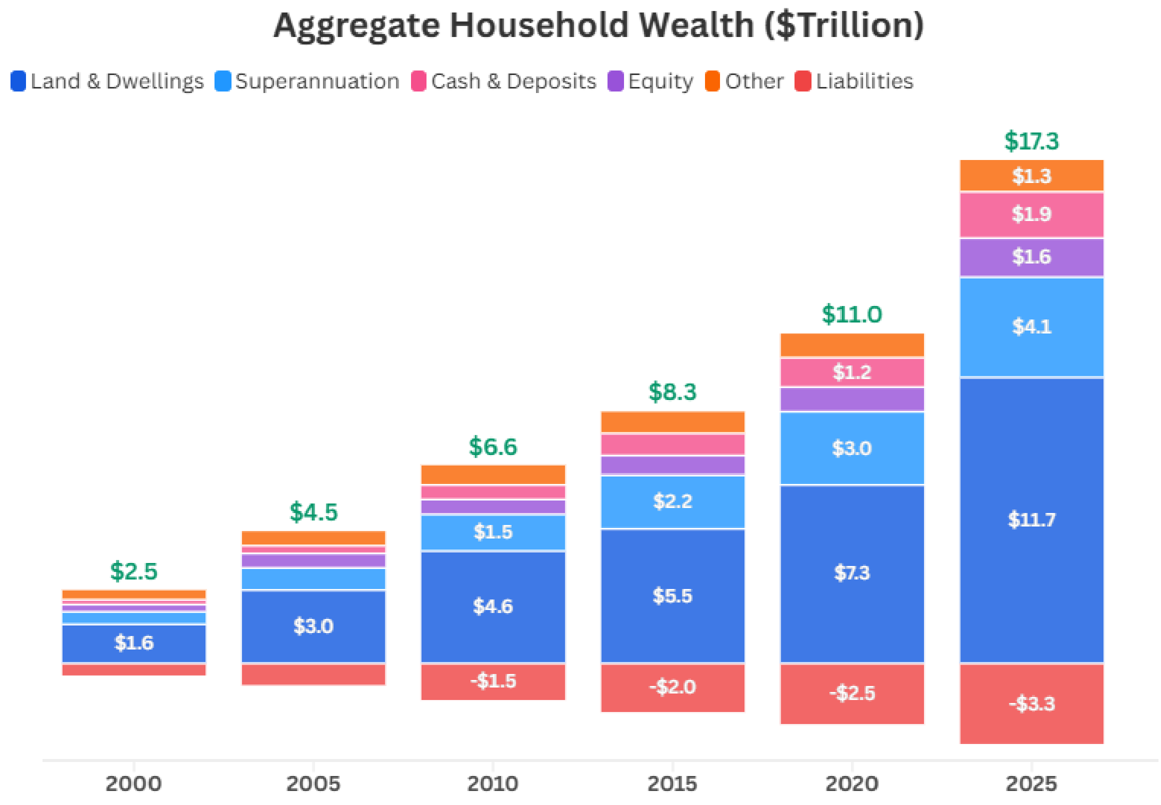
In our new white paper '*The Growing Debt Burden of Retiring Australians: Challenges, Solutions and Opportunities'* we unpack what this growth in housing debt means for retirement. We then suggest some measures to help ameliorate this expanding retirement cashflow imbalance.

Home is where the wealth (and debt) is

ABS data shows total household assets now exceed $20 trillion, dominated by housing (land and dwellings) at almost $12 trillion and superannuation at just over $4 trillion.

Against these stands one key liability: some $2.5 trillion of property debt, comprising some $1.7 trillion in owner-occupier loans outstanding and about $800 billion in investment property debt.

The growth in aggregate household net wealth, from $2.5 trillion in 2000 to today's $17 trillion is shown below. Through every intervening point, residential housing has dominated the household balance sheet.



Source: Authors calculations based on ABS data

Larger housing loans carried later into life

More Australians are approaching retirement with larger mortgages than any previous cohort. Today, effectively one in every two homeowners aged 55 to 64 has outstanding housing debt versus fewer than one in six in 1990.

For those aged 65-plus, 15% of households now still have housing debt, more than double the rate from 1990. For the 55 to 64 pre-retiree cohort, the latest ABS Survey of Income and Housing data suggests the average housing debt balance now exceeds $230,000.

With the 7-capital city average property price (excluding Darwin) around $43,000 in 1980, $120,000 in 1990 and $176,000 in 2000, current debt levels for those who first purchased 20 or 30 years ago are concerning from a retirement security perspective.

What has driven this? Our research points to house prices outpacing real income growth, increased refinancing and use of redraw facilities, and a rise in later-life relationship breakdowns.

The 2020 Retirement Income Review noted that mortgage debt-to-income ratio for borrowers aged 55 to 64 rose from 72% to 138% between 1990 and 2020 and the median age of loan extinguishment drifted from 52 in 1981 to 62 in 2016. These trends have not reversed.

Dealing with housing debt as retirement approaches

Indebted pre-retirees have three broad strategies to dealing with housing debt:

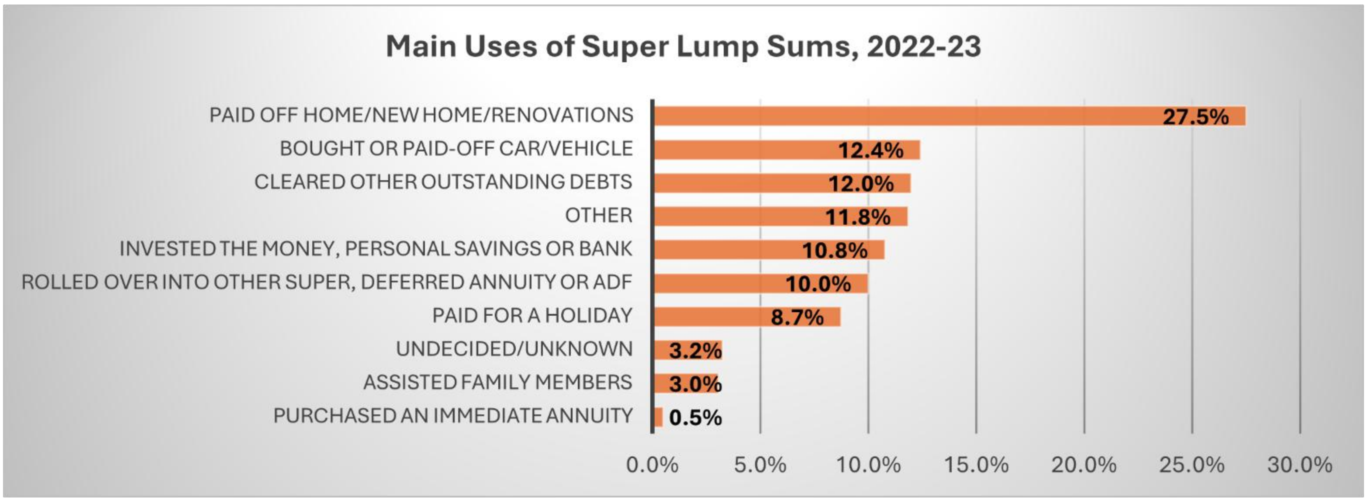
1. delay retirement until the debt is (ideally) extinguished;
2. retire and continue to service the loan; or

3. seek a source of capital to reduce or extinguish it.

The average age of actual retirement has risen from 57.4 years in 2004-05 to 61.4 years in 2022-23, according to the ABS, which also finds the intended age of retirement today to be between 65 and 66. While people may be delaying retirement to match the Age Pension qualifying age of 67, servicing home loan debt may now also be a contributing factor to deferring retirement.

Evidence also suggests many retirees withdraw superannuation lump sums to pay down debt.

The ABS Survey of Retirement and Retirement Intentions below shows property-related expenditure accounting for more than one in every four super dollars withdrawn in 2022-23.



Source: Author's calculations from ABS Cat 6238.0 (Retirement and Retirement Intentions, 2022-23)

This would thereafter clearly reduce the income generating capacity of the remaining superannuation, this residual component we term one's 'Net Pension-Generating Super'.

Reframing housing's role in retirement

The most current data suggests the median Australian home-owning couple today is approaching retirement with a property valued at around $850,000, and with some $400,000 in combined superannuation. Against this may be a home loan balance of some $200,000.

To the extent that some are choosing to partially withdraw their super to extinguish housing debt, the result is that many retirees are entering retirement 'asset rich but cash poor' and heavily reliant on the full Age Pension (now around $46,200 for a homeowning couple).

Given households over 65 are estimated to hold some $3 trillion in housing wealth, our research suggests that accessing some amount of housing equity, instead of using super to extinguish housing debt, could (depending on a couple's circumstances) result in improved retirement outcomes for those prepared to consider a home equity release solution.

The home equity release market has developed significantly in the last decade and is now estimated at more than $4 billion across the Government's *Home Equity Access Scheme (HEAS)* and commercial providers (broadly reverse mortgage and debt-free equity release solutions).

Importantly, commercial providers have made significant strides in improving consumer protection measures in recent years including the No Negative Equity Guarantee (for reverse mortgages), the encouragement for prospective customers to seek legal and/or financial advice prior to contract finalisation, and the possibility of early termination rebates (in the case of debt-free equity release).

Retirement horses for courses

Australia's retirement income system is still a work in progress, some 33 years on from the start of the Superannuation Guarantee.

It must cater for some 18 million individuals of varying incomes, savings capacity, investment risk appetite and retirement income preferences.

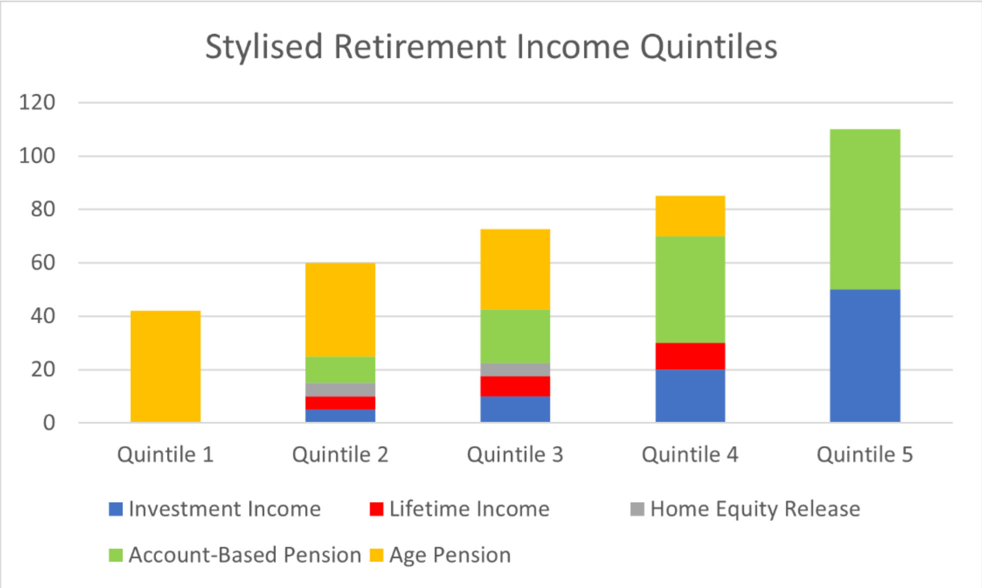
Of those, roughly 1 million are in SMSFs, with a median near-retiree couple balance closer to $2 million than the $400,000 currently for APRA-regulated members.

It is thus less likely that SMSF members will approach retirement with material debt outstanding on their principal residence, and it is more likely that that they will be fully self-funded in retirement (typically until their early eighties).

Australia's retirement income system should therefore cater to this diversity by acknowledging all five (non-employment related) potential sources of retirement cashflow, including:

- The Age Pension;
- Account-based Pensions;
- Home Equity Release;
- Lifetime Income Streams; and
- Non-super Investment Income

Conceptually, these five cashflow sources might be relevant to different cohorts across the wealth spectrum as depicted in the diagram below.



Source: Author's submission to Treasury (Retirement phase of super, 2024)

For a nation where the combined capitals median dwelling value is rapidly approaching $1 million, it is perhaps time that the humble Aussie house helps with smoothing consumption for today's 4 million-odd retirees, and the estimated 2.5 million who'll transition from the accumulation phase into retirement during this decade.

As Treasury's 2020 Retirement Income Review stated:

> *"The existence of many 'asset rich income poor' retirees on the Age Pension suggests home equity release has significant potential to help support retirement incomes."*

Our research concurs with that position.

Harry Chemay is a Principal at Credere Consulting Services and a Co-Founder of [Lumisara](). He has almost three decades of experience across financial advice, wealth management and institutional consulting. Lumisara assists wealth management entities and APRA-regulated super funds to develop retirement solutions through next-generation product, guidance, advice and service delivery models.

[#] The median is that value where half of observations are greater than it and half less than. It thus is considered a better measure of the 'middle ground' compared to the average (mean) which can be disproportionately influenced by a few large observations at either end of the distribution.

The ASX is full of broken blue chips

Dion Hershan

The ASX 20 is intriguing, representing 60%+ of the ASX 200 and making Australia one of the world's most concentrated stock markets. But rather than large blue chip companies compounding earnings and driving up the market (like it is in the US), it comprises mature and cyclical businesses that simply aren't growing and some of which appear to be broken.

As we know, large companies are typically more macro exposed, with domestic facing businesses today either leveraged to a low growth/low confidence/low investment environment (in my opinion Australia is 'going sideways slowly') or China for commodity demand (where growth is slowing and less commodity intensive).

It has been confounding just how well this cohort has performed in recent years, with the ASX 20 up 51% over the last three years (to 30 Sept 2025) despite -19% earnings growth (not a typo!). I suspect the flow of funds (which can be fickle) has overwhelmed the fundamentals (which tend to be more enduring).

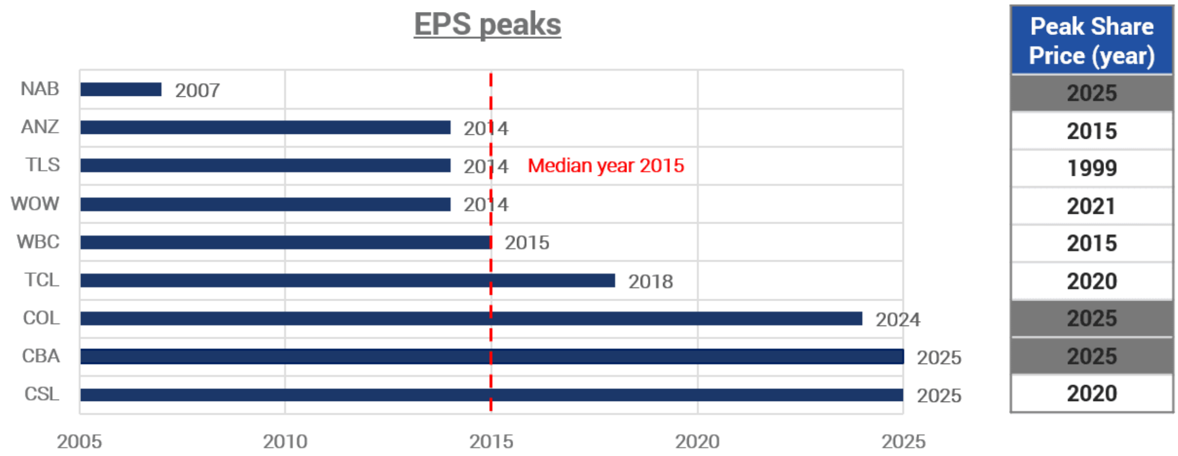
A few relevant/inconvenient facts:

1. Of the ASX 20, 14 companies are expected to earn significantly less this year than they have in the past. In fact, earnings for 8 of the 20 companies are more than 25% below their prior peak.
2. The weakness is broad-based and not confined to cyclical companies (44% of the ASX 20), where the median company's earnings peaked three years ago. For their defensive counterparts (56% of the ASX 20), the median company peaked in 2015 (refer charts).

3. By way of example, there appears to be very little discussion or scrutiny around the fact that Woolworths' earnings today are 25% below 2014 levels, Telstra's are 43% below 2014 and QBE's earnings are 35% below 2007.

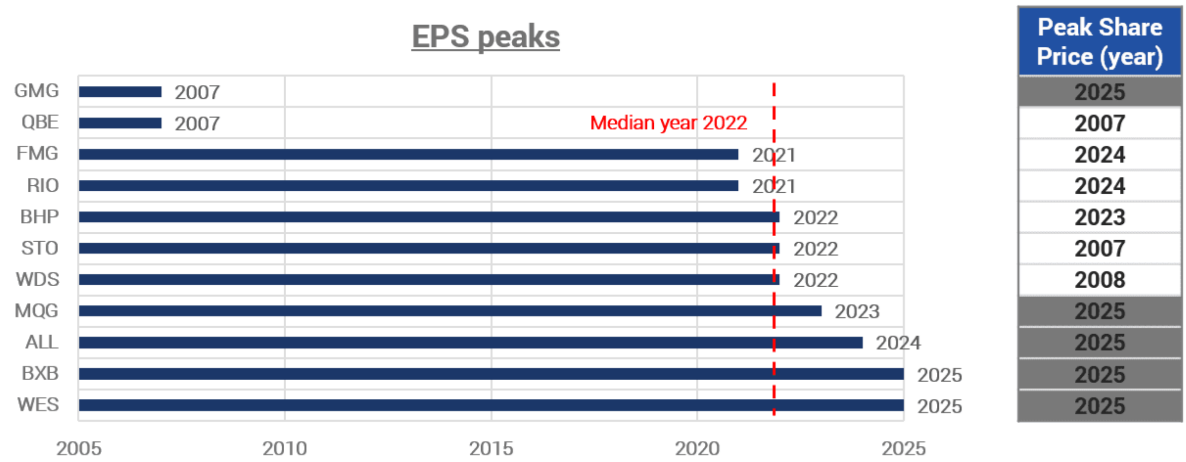
4. The entire banking sector had higher earnings in 2016 than are projected for F26, confirming a lost decade for a sector which represents 25% of the market.

Chart 1 – ASX 20 Defensives & Banks (56% of ASX 20)



Source: Bloomberg, Oct 2025.

Chart 2 – ASX 20 Cyclicals (44% of ASX 20)



Source: Bloomberg, Oct 2025.

The lack of earnings growth can explain why some stocks have been dead money for over a decade, it's hard to believe but you could have sold your WOW holdings for $41 in 2021 (now at $27), Woodside for $66 in 2008 (now $22), or Westpac for $39 in 2015 (now $39)! Back in 1999, when petrol averaged 75-80c/litre and a loaf of bread was under $2, you could have sold Telstra at $8.62 (now $4.90).

The opportunity cost of holding these types of positions is staggering and completely destroys the notion that you can simply hold blue chips forever. It is clear that the ASX 20 today consists of 'blue chips' and 'broken blue chips', I will leave it for readers to decide the appropriate label for each company.

What is clear, however, is that fundamentals can change significantly: many of these incumbents have wilted and been eroded by intense competition, demand peaking, deregulation and acquisitions that have ranged from questionable to outright stupid.

It stands to reason we want to challenge the consensus/complacent view on our largest companies and their respective futures. It's worth contemplating the future of competition in banking, the supply outlook for iron ore (large African deposits being commercialised) and even the displacement/competition risk that ranges on everything from blood plasma to slot machines.

Our view is that if you want to invest in the ASX 20—or the ASX 200, of which 65% is that cohort—you need to be hyper-active, paranoid, disloyal and focus on identifying what might be current or future broken blue chips. Life appears to be easier investing in mid and small cap companies which are less mature, less macro exposed and subject to less regulatory scrutiny.

Dion Hershan is Head of Australian Equities at Yarra Capital Management, a sponsor of Firstlinks. This article contains general financial information only. It has been prepared without taking into account your personal objectives, financial situation or particular needs.

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18 rules for ageing well

James Gruber

We have reprised this classic article from November 2023 due to recent reader interest. Let us know in the comments what your own rules might (or might not) include.

I recently happened upon a practical and often humorous book about how to age successfully. It's called *Rules For Ageing* by Roger Rosenblatt, a literary overachiever who's had success as a Harvard lecturer, newspaper editor and columnist, and is the author of 21 books and six plays. I first came across Rosenblatt on the PBS Newshour show years ago, where he regularly presented essays on an array of topics.

His book has 58 rules for ageing, of which I've picked the best 18. Here they are:

1. It doesn't matter

"Whatever you think matters – doesn't. Follow this rule, and it will add decades to your life. It does not matter if you are late, or early; if you are here, or if you are there; if you said it, or did not say it; if you were clever, or if you were stupid; if you are having a bad hair day, or a no hair day; if your boss looks at you cockeyed; if your girlfriend or boyfriend looks at you cockeyed; if you are cockeyed; if you don't get that promotion, or prize, or house, or if you do. It doesn't matter."

I can relate to a few of these examples. For instance, I've been a stickler for time for most of my life. It probably came from my parents. Over time, I've changed my ways. I'm never deliberately late, it's just that I don't have a panic attack if I am.

Taken to the extreme, Rosenblatt's rule is nihilistic. Though it’s a good reminder to keep things in perspective.

2. Nobody is thinking about you

“Yes, I know, you are certain that your friends are becoming your enemies, that your grocer, garbageman, clergyman, sister-in-law, and your dog are all of the opinion that your have put on weight, that you have lost your touch, that you have lost your mind; furthermore, you are convinced that everyone spends two-thirds of every day commenting on your disintegration, denigrating your work, plotting your assassination. I promise you: Nobody is thinking about you. They are thinking about themselves – just like you.”

It's funny how we’re one of eight billion people in this world, yet in our own minds, we’re at the centre of the universe. And everyone else thinks the same way.

I’ve tried to explain this to one of my children, without success. This rule comes with maturity.

3. Yes you did

“If you have the slightest question as to whether or not you are responsible for a wrongdoing, you are. As soon as you think, “I really didn’t do it” – you did. Come to this conclusion early, act to correct it, and live a lot longer. Don’t come to it at all, never act to correct it, and … how are you feeling?”

Too true. Psychiatrist Scott Peck in his book, *The Road Less Traveled*, suggests the meaning of life comes from solving problems. If you don’t solve them, they can compound and get worse. That speaks to this rule.

4. After the age of 30, it is unseemly to blame one’s parents for one’s life

“Make that 25.”

Guilty as charged. You may have noticed that I blamed my parents in response to rule no. 1 above. As Rosenblatt says: stop.

5. Swine rules

“A swine is not a swan. Over a lifetime, one will encounter several swine – true lowlifes – and one is sometimes tempted to treat them kindly under the theory that, if shown kindness, they will be less swine-like and, perhaps, even reform … this is the sort of optimism that ought to be criminalized. A swine is a swine is a swine.”

I admit to still struggling with this one. I was taught to ‘always see the good in people’, yet life has taught me that this is hard, as Rosenblatt suggests.

6. Pursue virtue but don’t sweat it

“The pursuit alone is sufficient to establish your qualities, and if you fail once in a while, your guilt will remind you of the right path you didn’t take.”

I like this rule. It suggests trying to do the right thing and if you don’t on occasion, then it’s ok because no one is perfect.

7. Do not go to your left

"Going to one's left – or working on going to one's left – is a basketball term for strengthening one's weaknesses. A right-handed player will improve his game considerably if he learns to dribble and shoot with his left hand and to move to his left on the court. What is true of basketball, however, is not true for living. In life, if you attempt to compensate for a weakness, you will usually grow weaker. If, on the other hand, (the right one), you keep playing to your strength, people will not notice that you have weaknesses. Of course, you probably do not believe this. You will want to take singing lessons."

It's probably my favourite rule. Who hasn't wanted to be the well-rounded renaissance person who's good at many things? It usually doesn't end well. Though it may not stop me from taking those singing lessons…

8. Male and female compatibility rules

"a. She's right. b. He's really thinking about nothing. Really."

As Charlie Munger is famous for saying at Berkshire Hathaway's annual shareholder meetings: *"I have nothing to add"*.

9. Do not keep company with people who speak of careers

"Not only are such people uninteresting in themselves; they also have no interest in anything. They often form cliques, putatively for social pleasure, actually for self-advancement and self-protection."

When younger, I remember going to a party with a friend, and it just happened that he was an Oxford University graduate and so were most of the people at this soiree. One came up to me early on and asked the standard: "So what do you do, then?" When I started to talk about my job, he stopped me and said: "No, not boring things like work, I want to know what you do for *fun*".

The lesson - that work should never define you - has stuck with me.

10. Envy no one – ever

As Charlie Munger similarly said: *"Envy is a really stupid sin because it's the only one you could never possibly have any fun at. There's a lot of pain and no fun. Why would you want to get on that trolley?"*

My experience is that this is a hard rule to stick by.

11. Believe everyone – always

"I realise that this rule seems to contradict the spirit of so many others. But when one gets down to it, life's basic choice is either to live cynically or innocently. I would choose innocence."

As would I. A related theme is whether to live life with optimism, pessimism, or realism. Many would choose realism, though that can easily veer into pessimism. I'd rather lean into optimism.

12. The unexamined life lasts longer

"A certain amount of self-examination is useful, but even that should be directed toward what to do in a given situation and not at who you are. However full your nights are with self-recrimination, you are probably all right as person (most people are)."

It was Socrates who once said that the unexamined life isn't worth living. As someone who has made introspection an art form, I tend to side with Rosenblatt over Socrates on this one.

13. No they don't – and so what?

Rosenblatt creates this rule for people who are over 50, now working for younger bosses, and don't feel they are getting the respect that they deserve: "Don't they realize how very special you are, how gifted, how distinguished?" And Rosenblatt's answer is, "No, they don't – and so what?" He says while that may bruise your ego, it could be what you need to produce even better work.

14. Abjure fame but avoid obscurity

"If, instead of seeking fame, you are more interested in simply meriting the approval of peers, the chances are better than you will accomplish this by drawing attention to the things you do rather than to some shimmering persona that you have manufactured for public inspection."

15. Fast and steady wins the race

"Steady excellence is one of the hardest things for Americans [and Australians] to recognize because it is the antithesis of newness, revolution, and excitement. Yet those who achieve steady excellence lead contented lives, which are in fact a lot more appreciated than they may know. Excitement is a reasonable standard only for the young, who know what to do with it."

This rule hit home. I think steadiness with everything in life is a good credo to live by.

16. Change no more than one-eighth of your life at a time

"The trouble with most people is that when they do decide to change their lives, they tend to think of changing everything all at once. Even if this were possible – it isn't – it would lead to disaster. When you are certain that it is time to become the novelist, sculptor, or watercolorist, change your shoes. See how the new pair fits … That's plenty for the moment. In a few years, change your glasses."

I feel seen. Meanwhile, I'm going to change that pair of shoes.

17. Never do it for the money

"I mean it."

18. The game is played away from the ball

"I used to teach this idea to journalism students to make the point that the more interesting things in the news occur without making a big noise."

I remember being taught in journalism such things as "if it bleeds, it leads", and "in news, one Australian dying is equivalent to [insert number] Chinese [or any other people living overseas] lives". Sad, but true.

This rule extends to markets too. High growth companies whose share prices skyrocket and then crash make all the headlines, though often the best stocks are the ones that are slow and steady achievers.

James Gruber is an assistant editor at Firstlinks and Morningstar.com.au. This article is general information.

Buying Guzman y Gomez, and not just for the burritos

Will Granger

We continually seek to enhance the portfolio by selectively adding high-quality compounders at attractive valuations. This is an inherently difficult task – the market is usually very efficient at identifying these types of businesses and pricing them accordingly. However, with the FY25 reporting season being one of the most volatile on record, we found a few opportunities that met our stringent requirements. Most notably, we materially upweighted our position in Mexican fast-food chain Guzman y Gomez, or GYG.

GYG had been on our radar for some time. The company exemplifies many of the attractive traits we look for: market-leading position with a durable consumer brand, capital-light franchise model, long-term store rollout opportunity, predictable long-term economics, and founder-led management. On the back of these enviable qualities, we owned a small position leading into the FY25, with our primary reservation being valuation. While the FY25 result itself was impressive – total network sales in Australia increased 22% to $1.1 billion – the market was disappointed with a soft trading update where like-for-like sales slowed to +3.7%. The market reaction on the day was severe, with the stock trading down 24% at its lows. We viewed this almost one-quarter collapse in valuation as a substantial overreaction to just seven weeks of trading data and took the opportunity to materially upweight our position.

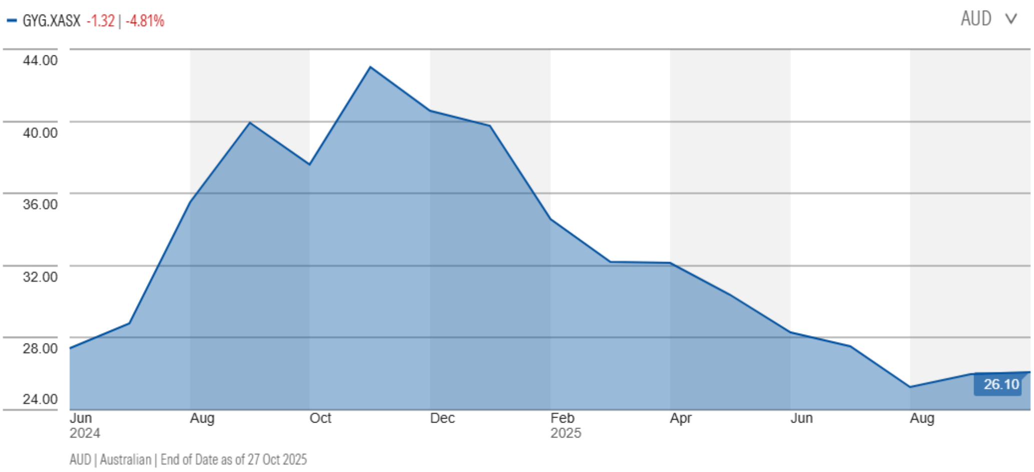
The crux of our thesis for GYG centres on the company's stellar unit economics, in particular its strong sales per restaurant relative to quick service restaurants (QSR) peers. While there are some important nuances regarding margins, it's largely this sales productivity figure that underpins the long-term profitability of the model: the higher the sales throughput in a store, the greater the leverage on fixed costs like rent, labour (partially) and shared corporate costs.

To put some numbers around this, the average GYG restaurant generates around $5.2 million in sales in Australia, well above most scaled QSR peers. For comparison, we estimate the average KFC generates around $4.1 million, Hungry Jack's around $5 million, and McDonald's – the gold standard for QSR in Australia – around $7.5 million in sales per restaurant. While GYG's $5.2 million in sales per restaurant is impressive in absolute terms, what excites us most is the improvement in this sales productivity over time: GYG's average sales per restaurant have grown at a 17% CAGR over the past five years, well outpacing peers despite relying less on pulling the price lever. While the company's restaurant margins are already healthy – the average corporate restaurant margin sits at 17.9%, franchise margin at 20% – if this sales productivity continues to increase it will underwrite some impressive margins in the future.

Importantly, there are a couple of predictable drivers that should increase this sales productivity figure over time. For one, sales per restaurant should increase as the store mix for GYG continues to shift towards higher volume drive-thrus. Drive-thru locations currently account for just 52% of GYG's store mix compared to around 73% for KFC in Australia, 91% for Hungry Jack's, and 85% for McDonald's. Drive-thru restaurants for GYG generate around 50% more in sales per restaurant than non-drive-thrus, so as they continue to roll out more drive-thrus they will benefit from a mix shift that improves both sales productivity and margins. It's also important to contextualise GYG's current sales productivity within this weaker store mix relative to peers. If you were to adjust GYG's store mix to reflect McDonald's 85% drive-thru composition, GYG's average sales per restaurant would theoretically increase to around $6.4 million versus the current figure of $5.2 million. In other words, adjusted for the store mix, GYG's sales productivity is rapidly approaching McDonald's levels in Australia. To be clear, we are not suggesting GYG will reach that level of drive-thru mix any time soon. Rather, this offers a better apple-for-apples comparison of the relative strength of GYG's sales productivity compared to those peers mentioned above.

The other factor driving sales productivity is GYG's strong growth in breakfast and late-night dayparts, bolstered by their rollout of 24/7 restaurants. Breakfast and late-night offerings have averaged like-for-like comp growth of 27% and 26% respectively over the past three years and now account for around 16% of total network sales. At the FY25 result, only 18 restaurants in the network were 24/7 (has now increased to 23 stores), and two-thirds of those restaurants were in the top decile of top-performing restaurants with profit margins well above group average. Initially, any expansion of dayparts is going to be lower margin given the requisite increase in labour costs; however, with enough scale these can be meaningful contributors to profitability. McDonald's generate a material portion of their sales in Australia from their breakfast offering – they sell a reported one in four coffees in Australia – so the opportunity is large if GYG can continue to execute.

These strong unit economics have important implications for GYG's long-term rollout opportunity. Despite its already impressive brand strength, GYG have just 227 restaurants in Australia. For comparison, Hungry Jack's have around 460 restaurants in Australia, KFC around 750, and McDonald's over 1,000 restaurants. The strength of a QSR's unit economics ultimately determines the viability of a long-term roll-out. With GYG's already strong and improving metrics, it's reasonable to think the company could, over time, triple its restaurant footprint in Australia.



Source: Morningstar

In terms of valuation, while the headline multiples today appear eye-watering, on a five-year view we estimate that GYG is trading on just 20x net profit after tax, an attractive multiple for a quality compounder that's only halfway through its Australian store rollout. This multiple excludes the losses related to the US operations, which are currently relatively small at $13 million and are not expected to increase dramatically in FY26. Overall, these losses will only have a small impact on GYG's intrinsic value and while we view the chance of success in the US as slim, the potential upside more than justifies the investment in our view. Importantly, the balance sheet is in terrific shape, with a strong net cash position that could help fund an aggressive US expansion if indeed the unit economics in the US improve to acceptable levels. Accordingly, GYG is now a top ten holding in the Fund, reflecting our conviction in the company's durable brand and long runway for growth.

This excerpt of GYG is part of Airlie's Small Companies Fund September 2025 quarterly commentary.

Will Granger is a Portfolio Manager at Airlie Funds Management, an affiliate of Magellan Group, a sponsor of Firstlinks. This article has been issued by Magellan Asset Management Limited ABN 31 120 593 946 AFS Licence No. 304 301, trading as Airlie Funds Management ('Airlie') and has been prepared for general information purposes only and must not be construed as investment advice or as an investment recommendation. This material does not take into account your investment objectives, financial situation or particular needs.

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Factor investing and how to use ETFs to your advantage

Russel Chesler

It's no surprise then that the ever-innovating ETF industry is now making 'active' outcomes more accessible via the use of factors. This is a subset of smart beta ETFs, and investors are flocking in droves.

Factor-based investing involves identifying the dynamics of an investment that drive its return. It has become more common in recent times, often involving the 'quant' factors that active fund managers have been using for decades to sort the wheat from the chaff.

Factor-based investing has long been a part of institutional investors' portfolios, and academics have backed its investment benefits through numerous studies. These studies have identified certain detectable and constant influences that propel the investment performance of an asset over the long run. They describe these influences as factors, and institutions have long adopted factor-based investing to construct portfolios to achieve targeted outcomes.

Factors defined

Portfolio factors are identifiable, persistent drivers of risk and return. In his 1949 seminal work 'The Intelligent Investor'[i], Benjamin Graham identified that, among other features, return on equity (ROE), low debt and consistent earnings could isolate investments that would outperform over the long run. These identifiable, persistent drivers of risk and return became the precursor for the 'quality' factor.

Many investors rely on active fund managers to achieve their investment objectives. Active fund managers have often utilised 'factors' as a key part of their investment process to identify companies worthy of investment.

More recently, investors have been questioning their reliance on active managers and seeking passive alternatives. Apart from active management being more expensive than passive investing, it also introduces other risks, such as key-man risk and investment process risk.

There is an alternative for investors to achieve targeted outcomes while retaining the low costs of passive investing and avoiding key man and investment process risks. Enter ETFs.

Making it easy for factor-based investing

Factor-based ETFs, a subset of smart beta, combine the best aspects of active and passive management by tracking indices with defined rules that are designed to deliver a targeted investment outcome, while retaining transparency, liquidity and ease of trading for investors.

Most traditional index providers have had the foresight to create factor-based indices in anticipation of increasing demand for low-cost passive investing alternatives. MSCI, for example, has created a range of factor-based indices that aim to isolate factors, including the MSCI Quality Index series, based on Graham's 'quality' factor noted above.

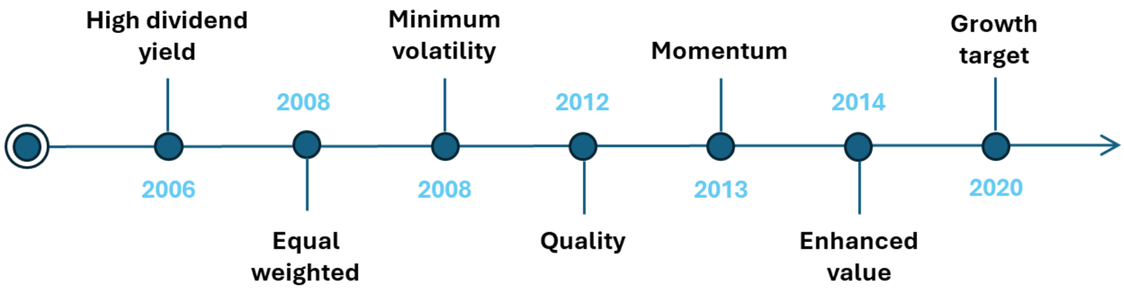
ETFs that track these indices are available for investors on exchanges around the world and are opening up factor investing beyond institutions and active managers to all types of investors.

These low-cost 'beta' strategies are increasingly replacing traditional active allocations - and for good reason.

Seven equity style factors

There are seven main equity style factors that MSCI have created indices for: quality, size (growth), value, momentum, dividend yield, volatility and growth.

Chart 1: Evolution of MSCI single factor indices



Source: MSCI, Factor Indexing Through the Decades, July 2025

Investment strategies may target a particular individual factor or a combination of the factors, outlined below:

1. **Quality** – 'Quality' stocks, with stronger balance sheets, tend to have positive long-term returns and are better placed to withstand economic downturns, according to MSCI. Quality characteristics may include high ROE, stable earnings per share (EPS), growth in profit margins and low debt levels. Research supporting 'quality' includes Benjamin Graham and David Dodd in the 1930s[ii]. Subsequent empirical studies show that quality growth stocks have historically outperformed the market with relatively low volatility over long time periods (Novy-Marx 2014[iii]) and a portfolio of quality stocks produces better Sharp ratios (risk-adjusted returns) than the market (Asness, Frazzini, and Pedersen 2013[iv]).

2. **Size (Equal weighted)** - Smaller companies, which are riskier investments, tend to outperform larger companies over a long-horizon. A company's size, as a proxy for growth, is supported by well documented evidence in equity markets such as Canada (Berges, McConnell and Schlarbaum 1984[v]), Germany (Stehle 1992[vi]) and the United Kingdom (Strong and Xu 1997[vii]).

3. **Value** - As the name suggests, investments in relatively cheaper stocks tend to earn a return above investments in relatively expensive stocks. There are a number of relative 'value' measures, including price to book, forward price to earnings and enterprise value to free cash flow. The 'value' factor is also grounded on the work of Benjamin Graham and David Dodd in the 1930s and academic research by Basu (1977) [viii] and Fama and French (1992) [ix].
4. **Momentum** - Stock prices tend to exhibit certain trends such as upwards movements in price or earnings over certain time horizons. So, winners continue to win, and losers continue to lose. Momentum is identifiable by price changes over three, six or 12 months. Momentum, as a factor, is supported by academic research by Jegadeesh and Titman (1993)[x] which was reinforced by Carhart (1997)[xi] and Rowenhorst (1998)[xii].
5. **Dividend yield** – Many investors have long believed that investment in stocks delivering relatively high dividend yields will return more than those not paying dividends. In particular, high and stable yields are associated with positive long-term performance. Litzenberger and Ramaswamy (1979) [xiii] confirmed this and Blume (1980)[xiv] later reinforced there is a positive relationship between stock returns and expected dividend yields. This was further supported by Fama and Frech (1988)[xv] who found the dividend yield has more explanatory power for longer term returns.
6. **Volatility** - A negative correlation between volatility and returns has historically led to outperformance in weak economic environments. As a result, a defensive strategy focusing on companies that have had low share price volatility has produced a premium over the market and delivered portfolio protection in turbulent environments. Minimum volatility is supported by research by Haugen and Baker's (1991)[xvi] Clarke, Silva and Thorley (2006)[xvii] and Neilson and Subramanian (2008)[xviii] to name a few.
7. **Growth -** Growth investing focuses on identifying companies poised for rapid revenue and earnings expansion, often driven by innovation, market disruption or evolving consumer preferences. According to a recent MSCI paper, "The roots of growth investing can be traced back to early 20th century investors who focused on companies with strong earnings potential and reinvestment prospects."[xix]

Using ETFs for factor investing

Australian investors can now access entire portfolios of Australian and international securities selected on the basis of individual or multiple factors via a range of ETFs on ASX. These factor-based ETFs are attractive compared to active funds due to their:

- lower costs;
- ease of trading;
- explicit rules-based methodology;
- transparency of holdings; and
- reduction of risks, including liquidity, key man risk and investment process risk.

ETFs are ideal building blocks for an investment portfolio because they offer liquid, diversified and cost-effective exposure to many different asset classes and markets via simple trades on ASX.

With the ability to adapt and innovate quickly to meet investor demands for targeted investment solutions, it's no surprise that ETF issuers are now providing investors with opportunities to invest in a range of smart beta ETFs employing different factor-based methodologies, and no surprise that investor uptake is growing rapidly.

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Engineers vs lawyers: the US-China divide that will shape this century

John West

'No two peoples are more alike than Americans and Chinese… masses and elites are united in the faith that theirs is a uniquely powerful nation that ought to throw its weight around if smaller countries don't get in line', according to Dan Wang in his recent book, *Breakneck: China's Quest to Engineer the Future*.

Wang sees these two countries as 'thrilling, maddening, and, most of all, deeply bizarre', but as 'engines for global change'. The two countries are reconfiguring the international order and each other too. In contrast, 'Europeans have a sense of optimism only about the past, stuck in their mausoleum economy'.

Wang was born in China and, at seven years of age, migrated with his parents to Canada, and then moved to the United States. He is currently a research fellow at the Hoover History Lab at Stanford University. He spent six years in China, from 2017 to 2023, as an economic and technology analyst and writer, and his book grew out of this experience.

Despite their commonalities, the US and China have fundamental differences, writes Wang. China would be an 'engineering state' whereas the US is a 'lawyerly society'. Most Chinese Communist Party leaders have been engineers focused on building mega projects such as highways, bridges, fast trains and airports. Such construction has been a source of domestic and international political prestige. It has also been a key foundation for China's rise as the world's manufacturing powerhouse.

While Wang admires China's engineering state, he argues that China's physical engineers are often 'social engineers' who treat society as just another big optimisation problem. As an example, he offers a detailed analysis of China's one-child policy. The policy inflicted much suffering on Chinese women through forced abortions and sterilisation and led to tragic femicide. But it was not effective in addressing China's demographic challenges. Indeed, today the CCP is pushing women to have children!

Another example of wrong-headed social engineering was China's zero-Covid policy which was ultimately ineffectual and abandoned following protests in Shanghai. Wang argues that over the past seven decades China has experienced lengthy periods of stability punctuated by government-triggered chaos. The Chinese state is usually level-headed but every so often succumbs to extreme, ineffective policies. In sum, Wang argues that the engineering state has remarkable strengths and appalling weaknesses—a more lawyerly society can help prevent these weaknesses.

Wang argues that the US used to be an engineering state. It enjoyed a big growth spurt between the 1850s and 1950s. During this period, it built canals, interstate railways and highways, the commercial airline system, and skyscrapers in Manhattan and Chicago. Then there was the Manhattan Project which produced the first nuclear weapons, and the Apollo program which landed the first humans on the Moon in 1969.

But the US engineering state made mistakes, triggering public opposition. Urban planners such as Robert Moses rammed highways through dense urban neighbourhoods; US government agencies sprayed pesticides, especially DDT; and some government regulators were captured by big business.

This provoked a backlash against the US's engineering state, giving rise to the 'lawyerly society' as the country's elite—dominated by lawyers focused on procedure and process rather than getting things done. Indeed, over the past 50 years the US has not been effective at maintaining and building infrastructure.

New York and other big cities have long had housing shortages. New York and California are ineffective at building mass transit compared with such places as Rome, Paris or Barcelona. The military-industrial complex is behind schedule in many projects. Even in the private sector, Detroit automakers and companies such as Intel and Boeing have many tales of woe, sapping the US's dynamism.

Wang is critical of the offshoring of large parts of the US's manufacturing sector to China, motivated by short-term profits. One consequence has been the loss of process knowledge, proficiency gained from practical experience, which is so critical for efficiency and flexibility. By contrast, Chinese workers who assembled the early versions of Apple's iPhone were able to turn their newly acquired skills to making other products, such as drones.

Wang's analysis can seem simplistic as it reduces much of America's and China's challenges and differences to the roles of engineers and lawyers. And it is not clear how their roles could be wound back, as Wang recommends. But Wang's book is of great value as it offers many insights based on firsthand experience in China. While the engineering state has many inefficiencies, notably excess capacity and overproduction, Wang argues it is enabling the top five percent of Chinese companies to be technological leaders and challenge the US in fields including AI, semiconductors, biotechnology and renewable energy.

John West is Executive Director of the Asian Century Institute and author of the book, "Asian Century … on a Knife-edge". He has had a long career in international economics and relations, with major stints at the Australian Treasury, OECD, Asian Development Bank Institute, and Tokyo's Sophia University. This article was originally published on The Australian Strategic Policy Institute Blog The Strategist.