Firstlinks
a Morningstar company

Edition 640, 5 December 2025

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Editorial

"There are many things money can buy, but the most valuable of all is freedom.
Freedom to do what you want and to work for whom you respect."
- J. L. Collins, The Simple Path to Wealth

Many of us dream of having enough money to do whatever we want. If we want to lie on a beach for months on end, we can do that. If we want to travel the world, we can do that. If we want to keep working part-time, and pursue more leisure activities, we can do that.

In many eyes, this is what wealth can bring: freedom.

Is it true, though? It certainly has a ring of truth. If you only just get by on a meagre income, it will feel like you don't have much freedom. You must have a job, even if you hate it. You must take orders from the boss. You may have to take two jobs and limit free time, just to make ends meet.

More wealth can give you greater options and freedom. The freedom to pick better jobs and bosses. The freedom to possibly not work at all. And more broadly, the freedom to deal with who you want and when you want to.

But is it freedom that we're really after? I'm not so sure. Often when we talk about freedom, we really mean time. We want more money to free up our time. We've all heard the saying that "time equals money;" perhaps it should be "money equals time."

Is time what we're really after? I'm not so sure about this either. If you look carefully at what drives our desire for more time, underlying it is the quest for greater happiness. Often, we assume more time will lead to more happiness. If we have the money, we can have the time to pursue what we desire most and that will make us happy.

That may be right, though I know plenty of retirees who have all the time in the world, and aren't happy. Time doesn't automatically lead to greater happiness.

Numerous academic studies bear this out. The consensus of these studies is that money increases happiness to a point, and then it plateaus. And that point isn't that high, at around US$75,000 (A$114,000) in income a year.

This makes some sense. Once we have our basic needs covered – the bottom of Abraham Maslow's famous hierarchy of needs – then we're generally pretty satisfied.

And academics have found that the characteristics we possess when having less money persist with greater wealth. In other words, if you're a twat when poor, you'll still be a twat when rich. If you're a friendly person when less well off, you'll remain that way with more money.

So, underlying the concepts of freedom and time is happiness. That leads to the obvious question: if money can't make us happy, what can?

Through the centuries, a lot of people have searched for an answer to this.

These days, 'self-improvement' is all the rage. If we have a slim body, we'll be happy. If we have a great job, that will make us happy. Or, if we get in touch with our inner feelings, that will lead us to everlasting happiness. You'll see these things lining the shelves at your local bookstore under the heading of 'self-improvement.'

Despite all this 'self-improvement,' though, it doesn't seem like happiness is on the rise, and that's shown in many surveys both here and overseas.

It's easy to see why self-improvement may not be the way to go. After all, self-improvement is focused on your own needs – on the self. And typically focusing on your own needs doesn't increase satisfaction in life.

In my experience, it's the opposite. The happiest and wisest people that I know are more often focused on the needs of others. Helping and caring for others, with no expectations of anything in return.

That reminds me of a happiness equation I once read:

Happiness = expectations – reality.

People who help others and expect little in return can't help but have reality exceeding their expectations.

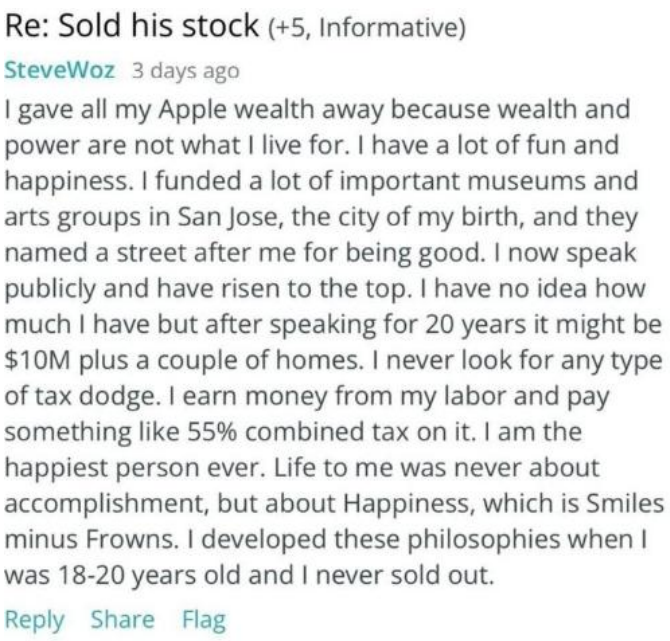
I'll end with an anecdote I came across a few months ago.

Steve Wozniak was one of the founders of Apple, alongside Steve Jobs. He left Apple in 1985 to pursue other things and sold all his stock around then too.

On the Reddit website in August, one commenter ridiculed Wozniak for selling the stake in Apple, which would be worth US$300 billion now, give or take: "Smart man. Great engineer. Bad decision."

Then, Wozniak popped up to reply to the thread:

Smiles minus frowns…


Re: Sold his stock (+5, Informative)

SteveWoz 3 days ago

I gave all my Apple wealth away because wealth and power are not what I live for. I have a lot of fun and happiness. I funded a lot of important museums and arts groups in San Jose, the city of my birth, and they named a street after me for being good. I now speak publicly and have risen to the top. I have no idea how much I have but after speaking for 20 years it might be $10M plus a couple of homes. I never look for any type of tax dodge. I earn money from my labor and pay something like 55% combined tax on it. I am the happiest person ever. Life to me was never about accomplishment, but about Happiness, which is Smiles minus Frowns. I developed these philosophies when I was 18-20 years old and I never sold out.

Reply Share Flag

Wealth bought Wozniak freedom and time, though happiness came from giving to others, and ultimately creating more smiles over frowns.

A fine motto to live by.

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In my article this week, I interview Mark Freeman, CEO at Australian Foundation Investment Company, the largest listed investment company in Australia. Mark discusses how speculative ASX stocks have crushed blue chips this year, companies he likes now, and why he's confident AFIC's NTA discount will reverse.

James Gruber

Also in this week's edition...

Jamie Wickham is back with an article on solving the great Australian stock market conundrum - how to invest in an index over-reliant on old-world banks and miners. He has some ideas on building durable Australian equities portfolios that can outperform going forward.

Schroder's Martin Conlon has a different take on the issue. He says the ASX is divided between the haves and have-nots, or growth and momentum stocks versus the rest. He thinks the best future returns will come to those willing to veer away from the crowd to find opportunity.

Harry Chemay updates us on warnings from APRA and ASIC to super funds about lifting their retirement focus. It's becoming an urgent need with a forecast 2.5 million Australians commencing their journeys toward retirement in the coming decade, joining over 4 million retirees already there.

Global fund manager, **GQG**, caused quite a stir when it came out with its original "Dotcom on Steroids" report in September, positing that today's AI bubble has all the hallmarks of the 90s tech bubble. Today, it's back with part 2, focusing on OpenAI, the maker of ChatGPT, whose business model GQG says isn't sustainable. If that's right, it could have major implications for the Magnificent Seven stocks, as well as broader markets and economies.

Yarra's Phil Strano offers an alternative view on the parallels between today's AI bubble and that of tech in the 90s. He explores how 'hyperscalers' including Google, Meta and Microsoft are fuelling an unprecedented surge in equity and debt issuance to bankroll massive AI-driven capital expenditure. It's similar to what European telcos did during the tech bubble, and the outcome then wasn't pretty.

Leveraged ETFs seek to deliver some multiple of an underlying index or reference asset's return over a day. Yet, **Jeffery Ptak** finds that they aren't even delivering the target return on an average day as they're meant to do. It's a revelatory piece on the potential pitfalls of buying leveraged stock ETFs.

Lastly, in this week's whitepaper, **Fidelity** looks at the longevity revolution and how investors can prepare for that new reality.

Curated by James Gruber and Leisa Bell

AFIC on the speculative ASX boom, opportunities, and LIC discounts

James Gruber

It's been widely noted how profitless companies in the US have trounced the S&P 500 this year. Less spoken of is that a similar thing has happened here, according to Mark Freeman, CEO of Australian Foundation Investment Company (AFIC).

Gold and smaller miners have soared while many blue-chip stocks have been left behind. For fund managers like AFIC which favour quality companies, it's been a tough ride.

Freeman cites Goodman Group (ASX: GMG), REA (ASX: REA), and Car Group (ASX: CAR) as examples - all fantastic businesses, though their share prices are down 17%, 15%, and 4% respectively in 2025, compared to the 5% gain in the ASX 200 index.

Even after more than 30 years working in markets, Freeman has been taken aback by some of the volatility in share prices. The market has walloped any company with even a hint of disappointing news.

Source: Morningstar

Source: Morningstar

Source: Morningstar

A cynic might suggest that his remarks are cover for AFIC's underperformance versus the index this year. Freeman acknowledges that recent performance has been "confronting" for shareholders.

However, he is very comfortable – "relaxed", in his words – about where the current AFIC portfolio is positioned.

Your author checked AFIC's portfolio before the interview and had a similar reaction to Freeman's. It's a portfolio I'd be comfortable holding - full of quality, growing companies with generally sound balance sheets and management teams.

Top 25 investments valued at closing prices at 31 October 2025

		Total Value $ Million	% of Portfolio
1	BHP *	901.1	8.9%
2	Commonwealth Bank of Australia	880.2	8.7%
3	National Australia Bank *	535.8	5.3%
4	Westpac Banking Corporation	514.6	5.1%
5	CSL	485.2	4.8%
6	Macquarie Group *	469.1	4.6%
7	Wesfarmers	405.2	4.0%
8	Transurban Group *	382.1	3.8%
9	Goodman Group *	380.6	3.8%
10	Telstra Group *	318.3	3.1%
11	ANZ Group Holdings	271.8	2.7%
12	ResMed *	254.1	2.5%
13	Rio Tinto	247.4	2.4%
14	Woolworths Group	235.7	2.3%
15	Coles Group	203.6	2.0%
16	CAR Group	203.1	2.0%
17	Woodside Energy Group	202.5	2.0%
18	ALS *	164.5	1.6%
19	ARB Corporation	152.6	1.5%
20	Brambles	145.2	1.4%
21	James Hardie Industries	141.7	1.4%
22	Computershare	132.7	1.3%
23	Cochlear	127.3	1.3%
24	Mainfreight	126.8	1.3%
25	REA Group	123.0	1.2%
Total		**8,004.0**	
As percentage of total portfolio value (excludes cash)			79.0%

* Indicates that options were outstanding against part of the holding

Investment by sector at 31 October 2025

- Banks 21.4%
- Materials 14.0%
- Industrials 11.8%
- Healthcare 10.9%
- Other Financials 9.1%
- Communication Services 7.5%
- Consumer Discretionary 7.1%
- Real Estate 5.2%
- Consumer Staples 4.3%
- Energy 3.4%
- Information Technology 3.3%
- Cash 2.0%

Source: AFIC

There are a few things that stand out with the portfolio. First, AFIC remains significantly underweight the Big 4 banks versus the index. It's overweight NAB (ASX: NAB), but substantially underweight CBA (ASX: CBA) and ANZ (ASX: ANZ).

Second, it's also underweight materials. The main holdings in resources are BHP (ASX: BHP) and RIO (ASX: RIO).

Third, there are major overweights in industrials, consumer discretionary, and healthcare. These are the main areas where AFIC is plying its trade.

Portfolio problem children

A few AFIC stocks have been in the news for the wrong reasons. CSL (ASX: CSL) is a big one given it's AFIC's fifth largest holding.

Freeman says the brutal plunge in the share price is partly down to a downgrade in earnings expectations. CSL had been guiding double-digit earnings growth but the latest profit growth has come in at 5-6%. The other factor behind the decline in the share price is valuation multiple compression. Previously, the market had been exuberant and priced CSL at close to 40x earnings. That's dipped to 16x – a massive derating.

Freeman thinks the market reaction looks overdone if the company can deliver on guidance of high single-digit EPS growth. Conversely, if profit growth remains at current levels of 5-6%, then today's share price may be close to fair value.

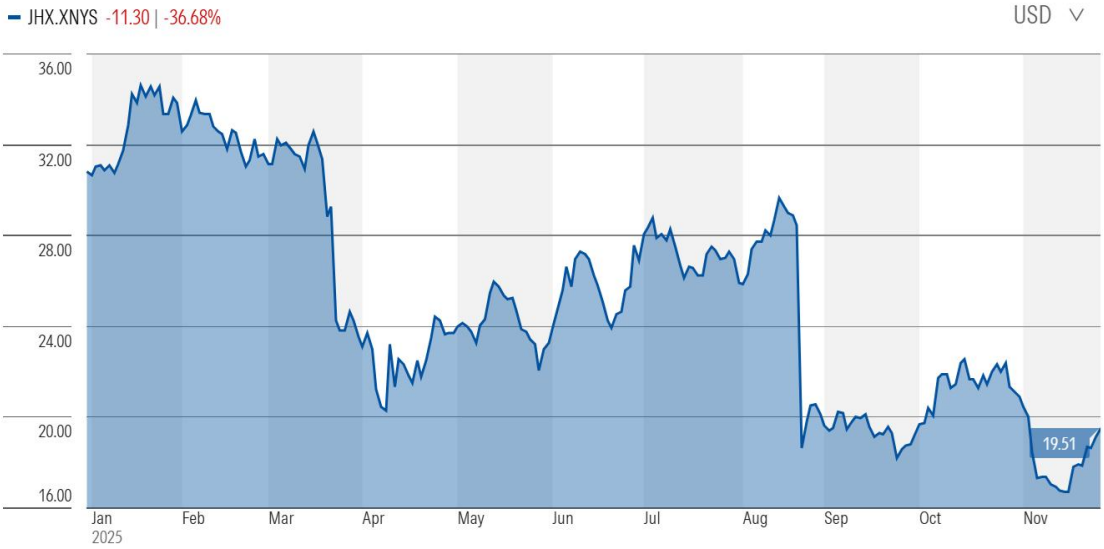
While the company has had its issues, Freeman believes if it can execute well and deliver high-single-digit earnings growth, then combined with a potential valuation rerating, it can reward shareholders going forward.

Source: Morningstar

James Hardie (ASX: JHX) has been the other problem child. The company was 2.3% of AFIC's portfolio at the start of the year, and it's now down to 1.2%. Much of the reduced holding can be explained by the sharp drop in the share price, though some of it is likely AFIC trimming its exposure too.

Freeman says the company's acquisition of US-based outdoor living building products maker, AZEK, made some sense. However, James Hardie made two mistakes. First, it overpaid. Second, it used debt instead of shares to finance the purchase.

He thinks James Hardie is still a quality business, but it's down to how you assess management and whether the current price factors in all the bad news. And on these things, Freeman was coyer.



Source: Morningstar

Major bank outlook

On the Big Four banks, Freeman likes the businesses, though he's not enamoured with their growth prospects. He doesn't see much earnings growth moving forward. And that means that if you get a 6% grossed-up dividend yield in a bank, that will be your annual return if earnings don't move and P/Es don't decline. If the bank with that 6% grossed-up yield has no profit growth and a 10% derating in its P/E ratio, then your return will be -4% over the next 12 months. Freeman sees P/E deratings as a big risk, especially in the likes of CBA.

AFIC has been underweight the banks over the past few years, and though that proved painful initially, it's looking better now.

If money continues to move out of banks into other sectors, where will it go? Freeman isn't sure that it will automatically rotate into the other large ASX sector, resources. He's hoping it will also find its way into quality industrials, where AFIC has many of its holdings.

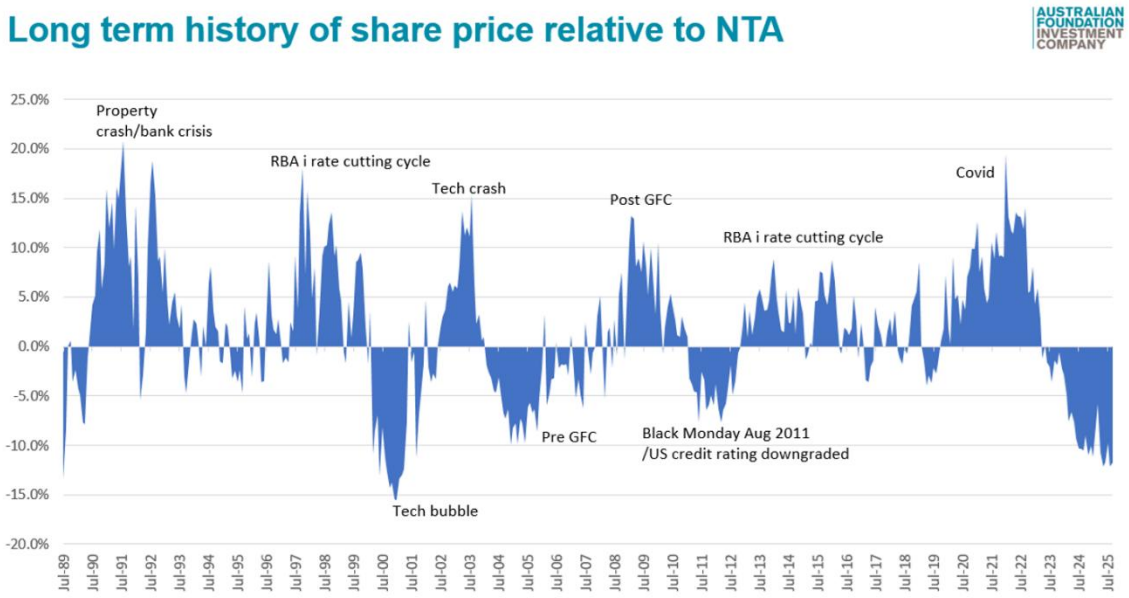
ASX 200 prospects

On the outlook for the Australian market in 2026, it was refreshing to hear Freeman's reply: "I've got 100% confidence that I've got no idea." He says the market is expensive and at current multiples, future returns are likely to be lower. It could go sideways or return 4% per annum over the next 3-4 years, compared to its historical long-term return of 9% a year.

AFIC's NTA discount

The large net tangible asset (NTA) discounts with many listed investment companies (LICs) has been a big investor discussion point over the past year. AFIC's NTA discount remains at 9.3%, down from double digits for much of 2025.

While the discount isn't ideal, Freeman isn't too concerned. While many point to the rise of ETFs as a driver for the discount, he's not buying that. He forwarded me this chart, which shows that previous market peaks have coincided with large NTA discounts for AFIC.



In 1999-2000, AFIC traded at an NTA discount of more than 15%. Then, after the tech crash, it traded at an NTA premium of up to 15%. The same sort of thing happened pre-and-post GFC.

Fast forward to Covid, and investors rushed into AFIC for its income during a turbulent period. That's since reversed as markets have rebounded and soared to new highs.

Freeman's point is that what's happening now with NTA discounts isn't new and it should turn at some point.

Meantime, his company is continuing to buy back AFIC shares. The buyback program is primarily to stabilise company share issuance – its dividend reinvestment program increases the number of shares, which is then decreased through buybacks.

Freeman says buybacks will also be used opportunistically when the stock is cheap.

AFIC's prospects

Freeman pointed out that AFIC has built up a substantial pool of franking credits in recent years. Consequently, they paid a 5 cent special dividend this year, and they've just announced that there'll pay another 5 cent special dividend in FY26, split 50:50 between interim results in January and full year results in July.

In sum, Freeman says he's comfortable with prospects for AFIC's portfolio, investors will get special dividends on top of the normal dividends over the next seven months, and the NTA discount may shrink if history is any guide.

Personally, I think Freeman makes a compelling argument and a turnaround in AFIC's fortunes may not be far away.

James Gruber is Editor of Firstlinks. Mark Freeman is Chief Executive Officer and Managing Director at Australian Foundation Investment Company (AFIC). He is also Managing Director of Djerriwarrh Investments Limited, AMCIL Limited and Mirrabooka Investments Limited.

Solving the Australian equities conundrum

Jamie Wickham

The performance of the Australian equities market this year has highlighted, once again, a persistent conundrum facing investors – how to approach a heavily concentrated index reliant on two sectors and a handful of stocks.

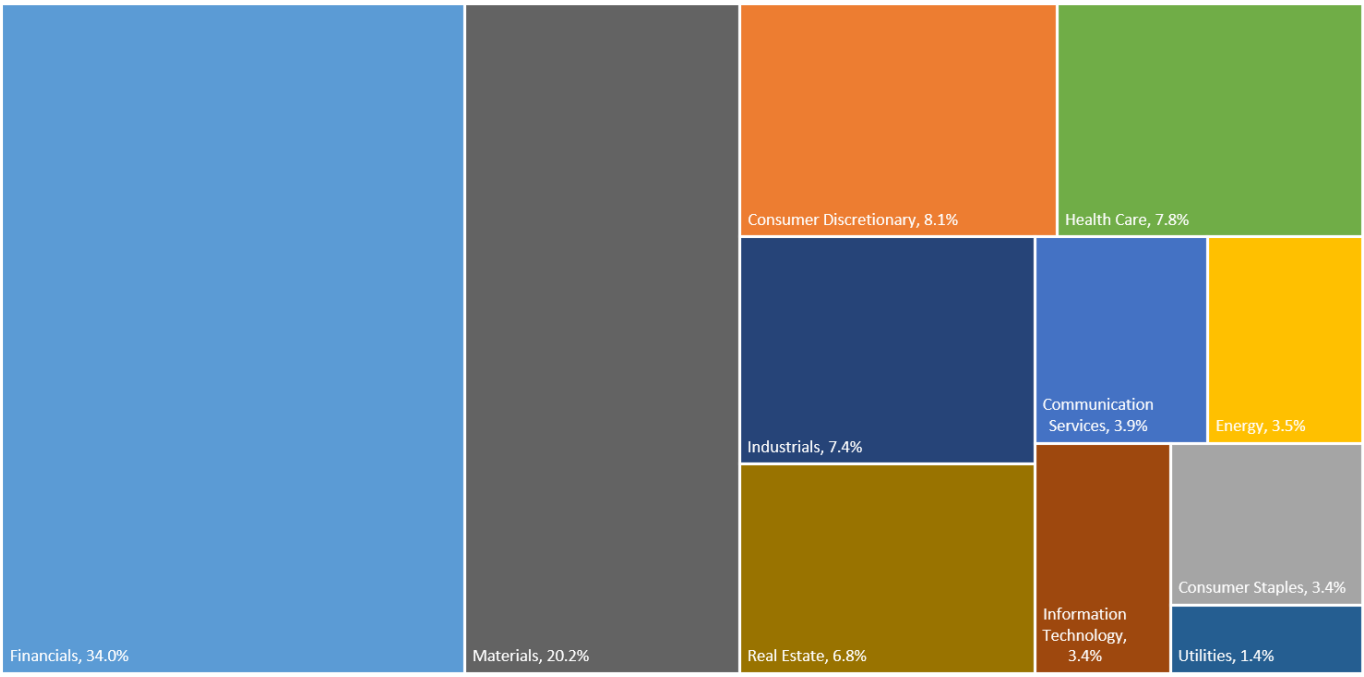
The biggest driver of the S&P/ASX 200 on the way up to the record high on October 21, and the retracement since, has been the performance of some of the biggest companies in the index. These are the cornerstones of many portfolios – the likes of CBA, Westpac, ANZ, NAB, CSL, Telstra and Wesfarmers.

As these household names are all terrific businesses admired for delivering for investors over a long period, many people are content to leave them in the bottom drawer – particularly the banks, as a source of much-loved fully-franked dividends.

In the meantime, however, share prices for these mature businesses can run well beyond their fundamental values (see my previous article on the importance of systematic rebalancing). CBA is one of the most expensive banks in the world. It doesn't take much bad news for performance to turn around and for the portfolio to go with it. Those with overweight positions in CBA and CSL can attest to this phenomenon in the last few months.

Equally, those taking a passive, market index approach are experiencing a similar conundrum. Of the S&P/ASX 200 index, 54% is made up of banks and miners. The recent strong performance of the banks has lifted the financials weighting to more than a third. Just 10 companies account for almost half of the index value. And CBA alone accounts for almost 10% of the index.

Composition of the S&P/ASX 200 by industry sector weight as at 30 September 2025

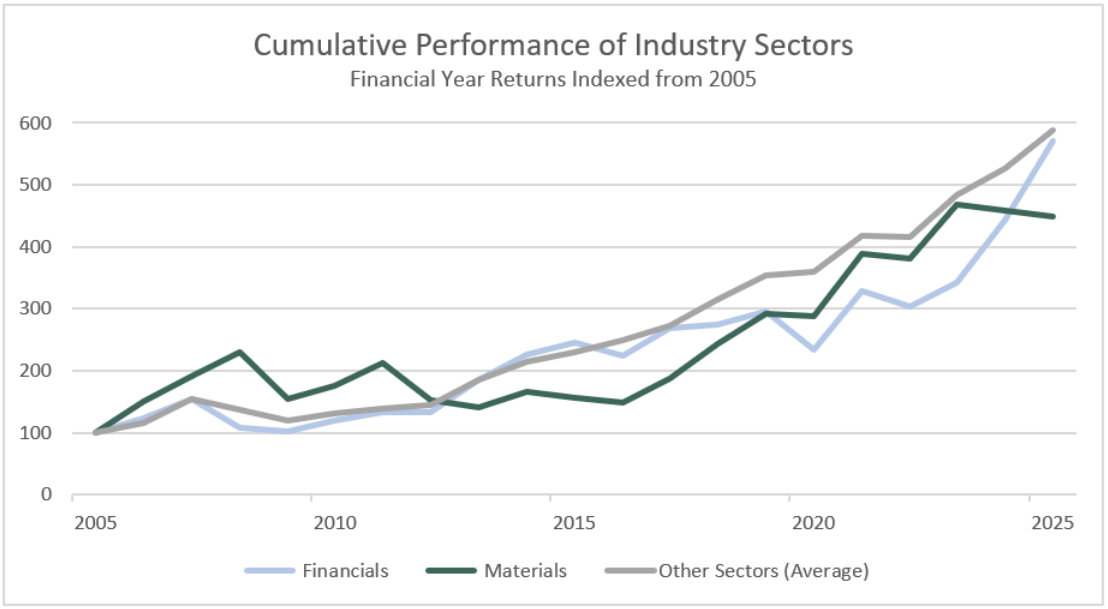


Source: Minchin Moore Private Wealth.

Looking to the future

Saying these household name companies have delivered up till now is all very well, but investing is about the future. And in a market so top-heavy, it is worth asking whether such mature businesses - with potential headwinds in excessive valuations, cyclicality and slowing relative growth in earnings - will continue to do so.

Indeed, the chart below shows that both Materials and Financials over the last 20 years have underperformed relative to other sectors in the Australian market. Furthermore, those two sectors have been more volatile, and each have had long periods of underperformance.



Source: Minchin Moore Private Wealth.

What's more, we know that the make-up of the local market is as challenging for professional investors as it is for the self-directed investor.

For instance, evidence shows most actively managed 'stock picking' managers in Australian large caps underperform the benchmark after costs over the medium to longer term.

So the question becomes if the index is too reliant on two sectors and active stock-picking has proven to be so difficult, how do we address these challenges?

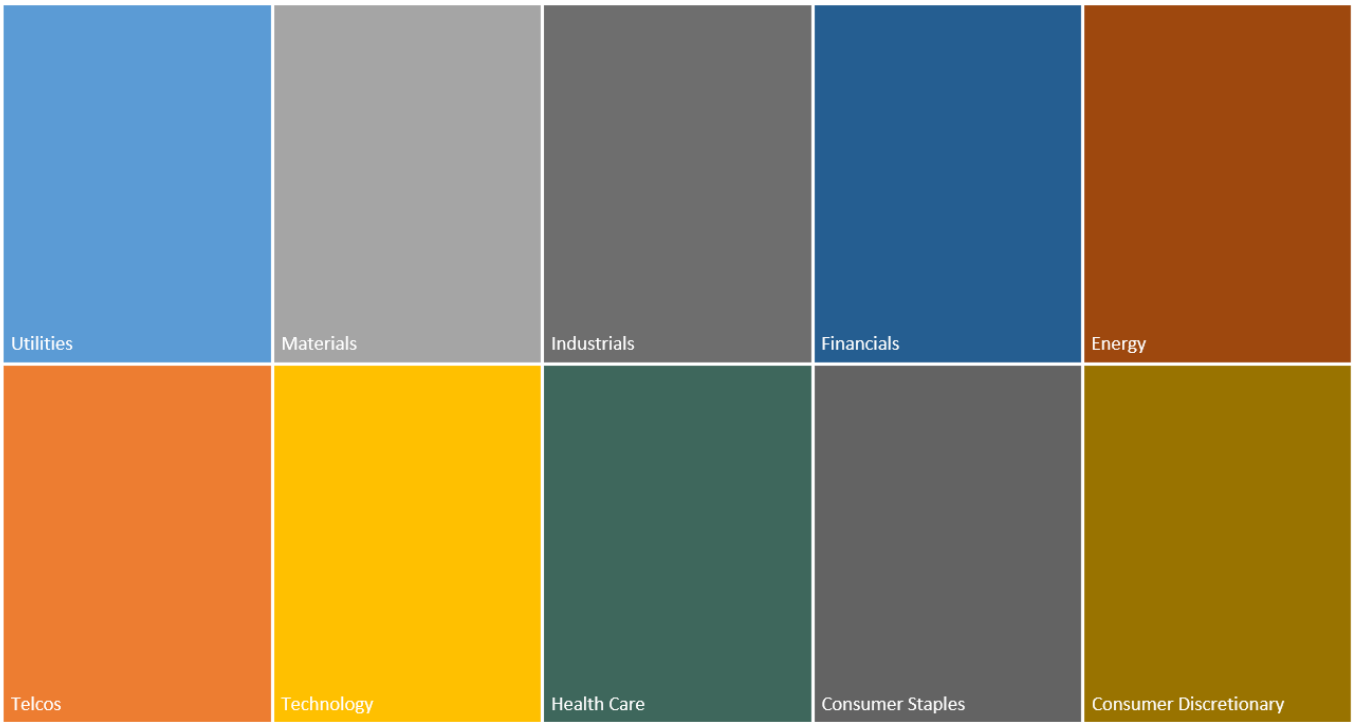
Rethinking the core portfolio

One idea is to take a more diversified approach to large cap equities by equally weighting exposure to industry sectors – 10% in each of the 10 industry sectors (excluding property given it is treated as a discrete asset class).

This can be implemented in a systematic, rules-based approach coupled with periodic rebalancing. Not required here is active stock picking, forecasting, valuation models, or second-guessing constituents. Instead, we can stick to an index-style mandate and a set of rules regardless of market sentiment.

Equal-weight investing has consistently shown evidence of enhanced long-term returns and diversification benefits compared with traditional cap-weighted approaches. Academic and practitioner

studies have found that equal-weight portfolios tend to outperform over time due to a systematic "rebalancing premium". This contrarian effect captures mean reversion and maintains balanced exposure across all constituents rather than concentrating exposures in the largest companies and sectors. Evidence suggests equal weighting reduces concentration risk, improving portfolio resilience when dominant mega-cap stocks and sectors underperform.



Source: Minchin Moore Private Wealth.

There are not only substantial diversification benefits from holding a higher exposure to the often-neglected smaller industry sectors, but also return opportunities across the cycle.

On the diversification front, the matrix below highlights the low correlation between sectors, which can optimise the risk/return characteristics of the portfolio.

Correlation Matrix - Australian Shares Industry Sectors (1/1/2005 to 31/12/2024)

	Communication Services	Consumer Discretionary	Consumer Staples	Energy	Financials	Health Care	Industrials	Information Technology	Materials	Utilities
Communication Services										
Consumer Discretionary										
Consumer Staples										
Energy										
Financials										
Health Care										
Industrials										
Information Technology										
Materials										
Utilities										

Low: 0 to 0.4
Medium: 0.4 to 0.7
High: 0.7 to 1.0

Source: Minchin Moore Private Wealth.

From the performance perspective, sector leaders and laggards often rotate from year to year as market and economic conditions support or detract from the performance.

A good example is 2022. The Ukraine war had broken out, oil prices spiked and energy stocks outperformed. At the same time, the surge in inflation and subsequent increase in interest rates after COVID impacted adversely on long-duration, technology stocks. In the subsequent years, however, the relative performance of these two sectors reversed.

This is the benefit of a systematic approach of rebalancing back to sector and stock weights. Positions in outperformers are trimmed to reinvest in the laggards. But this is done in a disciplined way that effectively means selling high and buying low, thus enhancing portfolio returns.

Industry Sector	2022	2023	2024	2025 YTD
Communication Services	-10%	17%	6%	14%
Consumer Discretionary	-20%	22%	24%	7%
Consumer Staples	-5%	1%	-1%	5%
Energy	49%	4%	-14%	5%
Financials	2%	11%	34%	8%
Health Care	-7%	4%	8%	-18%
Industrials	-3%	14%	15%	16%
Info Technology	-34%	31%	50%	-13%
Materials	13%	16%	-14%	28%
Utilities	30%	3%	17%	14%
S&P/ASX 200 Accumulation Index	**-1%**	**12%**	**11%**	**9%**
Note: Real Estate Excluded				

Source: Minchin Moore Private Wealth. Calendar year returns and 2025 year to date to 30 November

The outcome of this approach is a core Australian equity portfolio which over the long-term has:

- Lower volatility than the market index
- A higher Sharpe ratio than the index
- Significant active sector positioning
- Higher exposure to smaller companies than the market-weighted portfolio
- And an increased “growth” bias than the index.

Adding another layer

In addition to rethinking the construction of the core, large cap portfolio, the Australian equity sleeve can be optimised further by introducing value and size “factors”, for which there is strong academic evidence of a long-term premium.

Value captures the positive link between stocks that have low prices relative to fundamental values. Size captures the excess returns of smaller firms (by market capitalisation) relative to their larger counterparts, even after adjusting for betas and other factors like value, momentum, and liquidity.

Combining these factor exposures with the core large companies holding leads to a well-diversified aggregate Australian equity exposure consisting of:

- Large Companies (for broad market exposure),
- Value Companies (those with cheaper relative valuations), and
- Mid/Small Companies (expected to deliver higher returns over time).

Each of these constituents behave differently across time, and each plays a role in contributing to performance and risk management.

Through the investment cycle we expect each to experience different sequencing of return, leading to opportunities to top up the underperforming components and take profits from the components that are performing well.

Solving the conundrum

The Australian market, as we have seen, is concentrated in a couple of sectors and a handful of names, posting thorny challenges for both self-directed and professional investors.

One answer, as we have shown here, is to set up a durable portfolio and process that is not overly reliant on one or two sectors or a bunch of household names.

Over time, structure and discipline will prove to be more reliable features of your investing toolkit than research-based forecasts or poring over the daily financial news.

By attending to diversification, disciplined rebalancing and long-term value and size factors, we can build a sustainable and methodical portfolio that focuses on variables within our control and gives us the best chance of meeting our objectives.

Jamie Wickham, CFA is a Partner at Minchin Moore Private Wealth and former managing director, Morningstar Australia.

Regulators warn super funds to lift retirement focus

Harry Chemay

97% of super fund trustees say that they've improved their understanding of member retirement needs in the last three years, yet only 15% rate that understanding as being better than "good". Only around 1 in 6 trustees can robustly track how members are faring toward (or in) retirement.

Incomplete member insights and patchy outcomes measurement are just some of the findings of the recent third annual review into the implementation of the retirement income covenant (RIC), released jointly by the Australian Prudential Regulation Authority (APRA) and the Australian Securities & Investments Commission (ASIC).

As the ASIC media release to this 2025 RIC 'Pulse Check' bluntly stated:

"The report highlights that despite RIC obligations being introduced over three years ago on 1 July 2022, the gap is widening between trustees actively promoting better retirement outcomes for their members and those that are not."

Concerning words, given the forecast 2.5 million Australians who will commence their journeys toward retirement in the coming decade, joining over 4 million retirees already there.

Retirement income covenant – a refresher

The retirement income covenant joins a host of other legislative 'promises' that super funds must uphold to members (whether explicitly written into their governing rules or not), with effect from 1 July 2022. It does not apply to SMSFs.

In essence, the RIC requires APRA-regulated funds to formulate, regularly review and give effect to a ***retirement income strategy*** to help members achieve and balance three retirement objectives:

- maximising their expected retirement income;
- managing expected risks to the sustainability and stability of this retirement income;
- having flexible access to expected funds during retirement.

Strategies may differ for different types (cohorts) of members (e.g. by age, balance, income needs or other factors).

Every super fund must make a summary of its retirement income strategy publicly available on its website to help individuals decide if the suite of retirement measures on offer is suitable/sufficient for their needs.

As to why the RIC was introduced, population dynamics are forcing the hand of governments and regulators, as I recently wrote about in 'Super crosses the retirement Rubicon'.

The 2025 Pulse Check findings

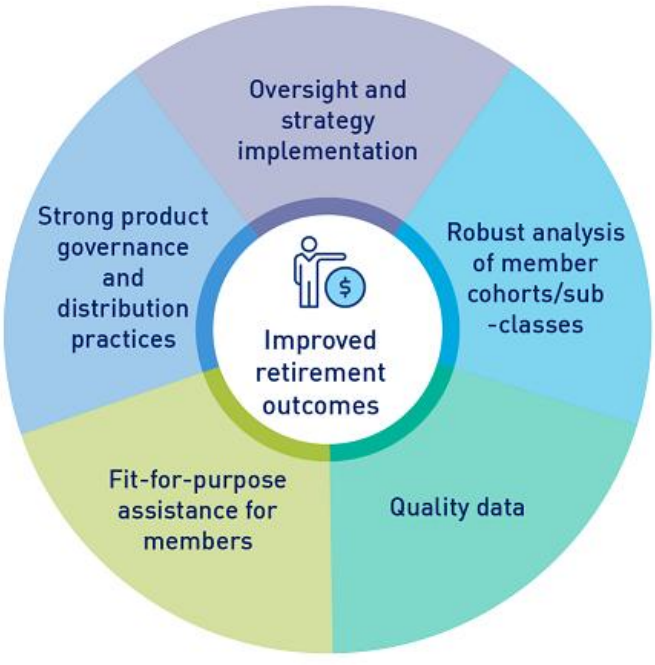
This newest review follows similar reviews at the first and second anniversary marks of the RIC commencement.

The July 2023 'thematic review' expressed concerns with trustees properly understanding member needs, designing fit-for-purpose assistance and overseeing retirement income strategy implementation.

This was despite clear written expectations by APRA prior to July 2022 on the key areas that trustees should consider in formulating and executing their RIC programmes.

The July 2024 RIC 'Pulse Check' noted that while trustees with larger memberships and more members approaching retirement had made better progress, it still found *"considerable variability in the implementation approach taken by RSE [registrable superannuation entities] licensees, and a lack of urgency in embracing the intent of the covenant."*

As for this latest, more detailed, RIC 'Pulse Check', it involved responses from 39 RSE licensees, representing some 95% of the ~$550 billion in retirement phase assets under APRA regulation.



Source: APRA, 'Implementation of the retirement income covenant,' letter to RSEs, published 7 March 2022

The high-level findings are best captured in the following passage:

> *"Some RSE licensees have shown leadership by investing significant effort into meeting the needs of members transitioning to and in retirement, with a smaller number innovating and pushing forward best practice.*
>
> *Still, far too many have been content with making incremental improvements. In many cases, we have not observed the level of investment in robust governance, innovative retirement income solutions and tailored support for members that regulators and, more importantly, members should expect."*

This is broadly consistent with recent regulatory commentary that RIC implementation is bifurcating into a market environment of 'leaders and laggards'.

As to why so many trustees are still struggling three years into the RIC becoming law, the below table outlines the challenges some are finding difficult to overcome.

Key challenges RSEs cite in implementing the RIC (adapted from Table 3 – 2025 Pulse Check)

Challenge area	What fund trustees (RSEs) report
Member Data	Inadequate data (partner status, home ownership, external assets/income), making it hard to segment, form a holistic view or personalise income solutions.
Advice & Engagement	Uncertainty around advice-related regulatory reforms, combined with low member engagement and financial literacy make communicating with and educating relevant members difficult.
Cohort & Product	Difficulty in defining/segmenting cohorts for tailored drawdown strategies. Market immaturity for longevity products.
Privacy & Regulation	Privacy concerns around member data use and uncertainty related to regulator expectations.
Metrics	Difficulty agreeing on, and tracking, meaningful success metrics for retirement outcomes.

Source: 'Industry update: 2025 Pulse Check on retirement income covenant implementation', APRA/ASIC, 26 November 2025

In terms of member data, that this most recent review finds trustees still struggling with developing a holistic representation of member circumstances is highly concerning, as the 2023 review had suggested better practice as:

> *"… seeking to better understand the financial profile of their membership in different sub-classes beyond superannuation balance, including key information such as home ownership, partner/marriage status, and material assets and income outside of the RSE or the superannuation system."*

Having outlined why understanding the member's household balance sheet (in particular home ownership and any related debt) is so important to formulating a view of retirement readiness, including here, here and most recently, here, the lack of progress since 2023 is unfortunate indeed.

Tension between the 'cohort of one' and 'just one cohort'

Another area of concern is the lack of progress on *cohorts*; segmenting members such that there can be differentiated member experiences for information, communications, behavioural nudges, education, guidance, retirement income product solutions and suggested drawdown strategies.

Over half of the trustees surveyed (54%) have reviewed and updated their cohort approach since the 2024 Pulse Check. Around 75% of respondents who used cohorts self-assess their approach as 'good' or 'very good'.

However, on closer inspection the report found that only 28% of trustee respondents currently measure the success of their retirement initiatives against specific cohorts.

And therein lies the tension, with fund trustees caught in a bind between knowing and not knowing their members, due to the legislative complexities of their operating environment.

The regulatory expectations of the retirement income covenant plus improved member outcomes (SPS 515) pulling in one direction, versus the sole purpose test plus best financial interests duty often pulling in the opposite direction, are by no means trivial to navigate.

That said, three years on from becoming law, super fund trustees should now be on notice that the RIC is no longer negotiable, especially when some 20,000 members will start their homeward run to retirement each month on average for the next decade.

Regulatory patience wearing thin

The regulatory tone of this triennial Pulse Check has become noticeably more strident compared to the previous two years, with the media release stating that:

"APRA Deputy Chair Margaret Cole noted 'ASIC and APRA are committed to holding superannuation trustees to account for improving the experience of members approaching and in retirement, in line with the objective of the RIC."

Fund trustees would do well to consider the 2021 introduction of the Design and Distribution Obligations regime (DDO), which saw a similar period of implementation reviews and industry engagement, before engagement turned to enforcement for the laggards.

Trustees who move early can treat the retirement income covenant not as a compliance hurdle, but as a design aid - to build richer member insights, interactive tools and journeys that help members make better decisions, before and throughout retirement.

The opportunity is to act now while the regulators are in 'engage and support' mode, rather than waiting for the enforcement phase to define the agenda. The future belongs to funds willing to embrace the RIC's intent, and which design end-to-end solutions driven by quality insights into member retirement needs, circumstances and preferences.

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Australian equities: a tale of two markets

Martin Conlon

One only needs to glance at a map of the US equity market to determine ‘we’re not in Kansas anymore’. The era of network economics and ever greater financialisation has wrought massive change on equity markets and increasingly on the real economy.

Source: Finviz. S&P500 as of 18/11/2025

Ever-growing government deficits and strong ongoing growth in household borrowing are funding a relatively buoyant profit environment, albeit one that is distributed increasingly unevenly. Disequilibrium is becoming the norm and the economic forces which tended to work against this are proving ineffective. While the reasons for this ongoing disequilibrium are debatable, a few seem important.

Network economics

While the line between network economics and monopolies is often blurred, many of the world’s largest companies control ubiquitous products or services where extremely large customer bases make it exceptionally difficult for new competitors to challenge, imputing massive pricing and market power. Additionally, this market power is global rather than domestic. Large US companies have done a very good job of stripping profit from the rest of the world, albeit owning shares in these companies has transferred a fair amount of the dramatic increase in asset value back to shareholders all around the world. Relatively small employee bases and few tangible assets have seen vast profits and minimal taxation given the difficulty of trapping tax in the same jurisdiction as revenue and the propensity of very small tax havens to relieve larger countries of tax revenues by offering vastly lower tax rates. To date, capital expenditures from these companies have been minimal. This is changing markedly as a result of AI, a business only tangentially related to the areas in which major technology companies have

made their historic profits. These technology behemoths are increasingly competing with each other. They are also competing in this race with China.

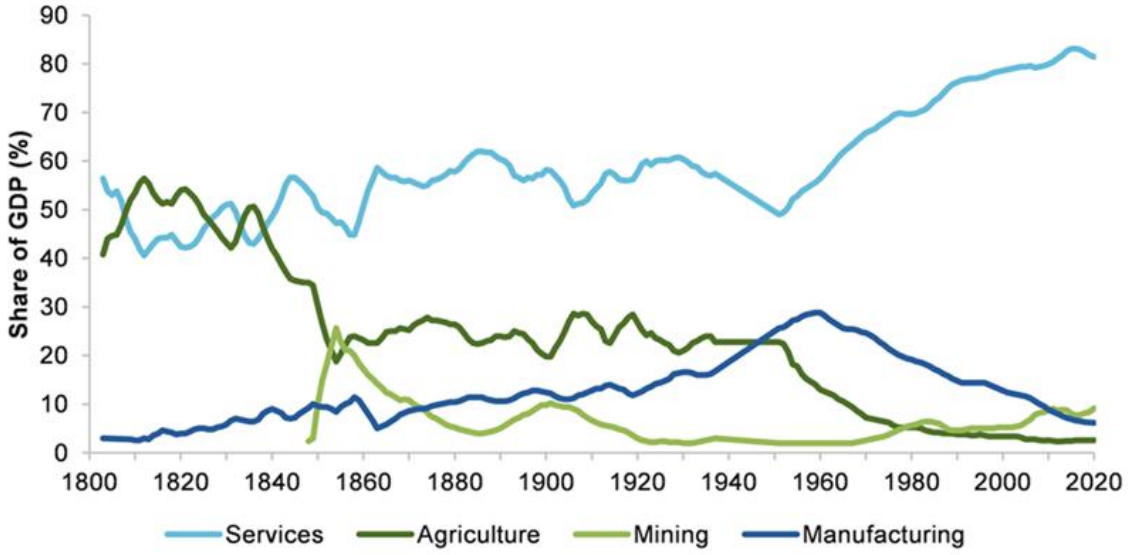
Chinese competition

Industries directly subject to competition from China have seen profits and return on capital erode materially over many years. Labour arbitrage, massive scale, lower safety, emission and pollution standards together with government subsidies are a headwind for even the most efficient companies. As is often quipped, when China enters a market the profit often disappears. In capitalist economies this creates a problem. When there is minimal profit and low returns, reinvestment disappears. Manufacturing and processing industries have largely disappeared while most retailers rely almost totally on Asian production. Western economies have gradually become ever more services and consumption reliant.

Monetary intervention

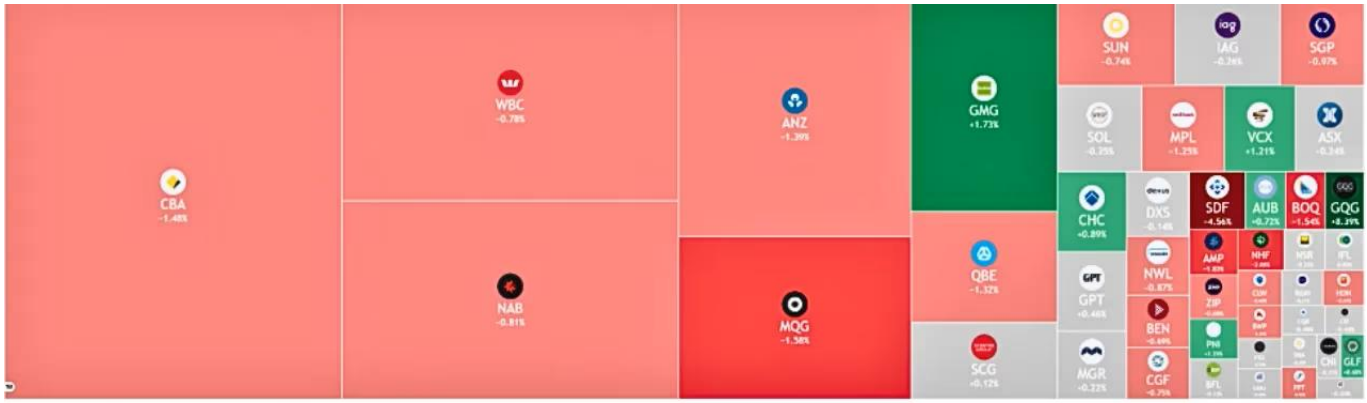
Keen to display the power of monetary intervention in 'smoothing' economic cycles and preventing any downturn, central bankers everywhere have ensured additional credit and easy monetary conditions have accompanied any sign of slowing. Low goods inflation which had nothing to do with Western economy productivity was the rationale for ever lower interest rates, while service economy inflation remained relatively high and was becoming an ever larger proportion of the economy. Credit was funnelled into consumption and housing inflation rather than improving the capital stock and infrastructure. 'Smoothing' cycles meant the tough times which normally promote cost shedding and efficiency gains together with the bankruptcies which normally cleanse weak performance and excessive leverage have been absent.

Against this backdrop, Australia has many similarities and some differences with the US and other Western economies. Listening recently to one of the always excellent podcasts of Joe Walker, Joe was talking to Greg Kaplan and Michael Brennan about the structure of the Australian economy and productivity decline. In thinking about the outlook for Australia and its companies relative to the rest of the world, it is crucial to understand the key differences. As Michael Brennan highlighted, there are three areas in which Australia is quite different. The first is mining. As has been highlighted in recent months, the extraction of raw materials on which the world relies is a small but crucial sector in the global economy. It is much larger in Australia, meaning commodity prices have an outsized influence. The second is financial services. A voracious appetite for housing debt and a large and non-government superannuation system result in a significantly oversized financial services sector relative to other economies. The third is construction. As a much higher immigration country than almost all Western counterparts, resulting in significantly higher population growth, construction is a much larger sector of the Australian economy. Agriculture is another sector in which Australia is disproportionately large (and incredibly productive), albeit one in which equity market exposure is limited. On the other side of the equation, manufacturing is a much smaller sector in Australia. While the abovementioned impact from China crushing profitability has been important for the world, its impact on Australia has been markedly narrower.



Source: Productivity Commission – 'Things you can't drop on your feet' – April 2021

Observing the market map of the domestic equity market starkly highlights these differentials, particularly in mining and financial services. The fate of these sectors will always have a disproportionate impact on returns for domestic equity investors.



Source: T7 Trading View. S&P/ASX200 as of 19/11/2025

Source: Schroders, LSEG. Data as of October 2025.

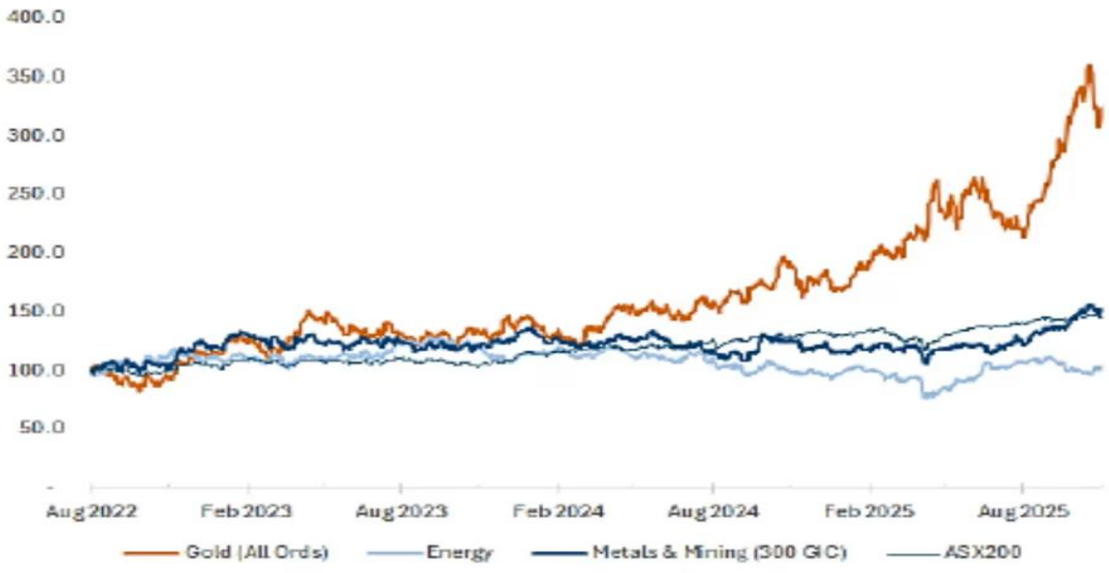
In looking at these sectors in turn:

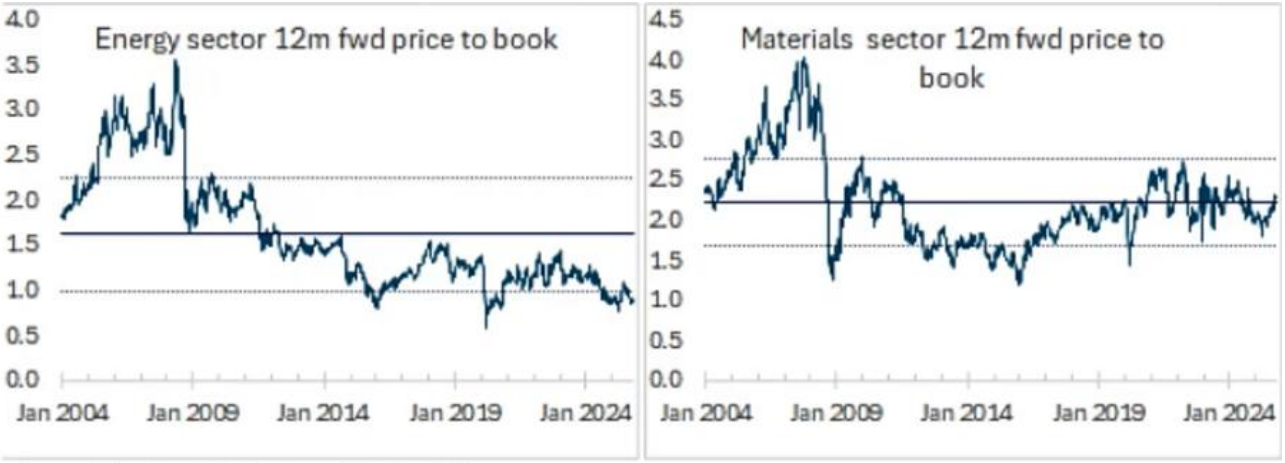
Financial services

Source: Schroders, LSEG. Data as of October 2025

Recent years have been good times for financial services, at least in equity performance terms. As the charts highlight, strong outperformance has been driven by expansion in PE and price to book multiples rather than strong earnings growth, leaving multiples very high versus history. While CBA and Macquarie contribute disproportionately to this position, and remain in our view, the most overvalued constituents, the rising tide has seen optimistic valuations permeate much of the sector. Revenue conditions have been polarised. While banks have seen increasing commoditisation and competitive conditions suppress revenue and profit growth, despite reasonable volume growth, insurers have enjoyed booming revenue conditions as rising construction and labour costs were passed on to consumers and large players chose to slowly shed market share and enjoy the easier gains through raising prices. We'd expect conditions are far more likely to become tougher for insurers over coming years. Banks sit at a crossroads and recent discussions with the incoming ANZ CEO, Nuno Matos, provide some interesting perspectives from an experienced banker with global perspective. Cost structures are bloated, technology and consulting companies have feasted on bank bureaucracy, mortgages from brokers don't make money and the exit of banks from wealth management after the Royal Commission was misguided. More of the same from the sector seems unlikely.

Resources and energy



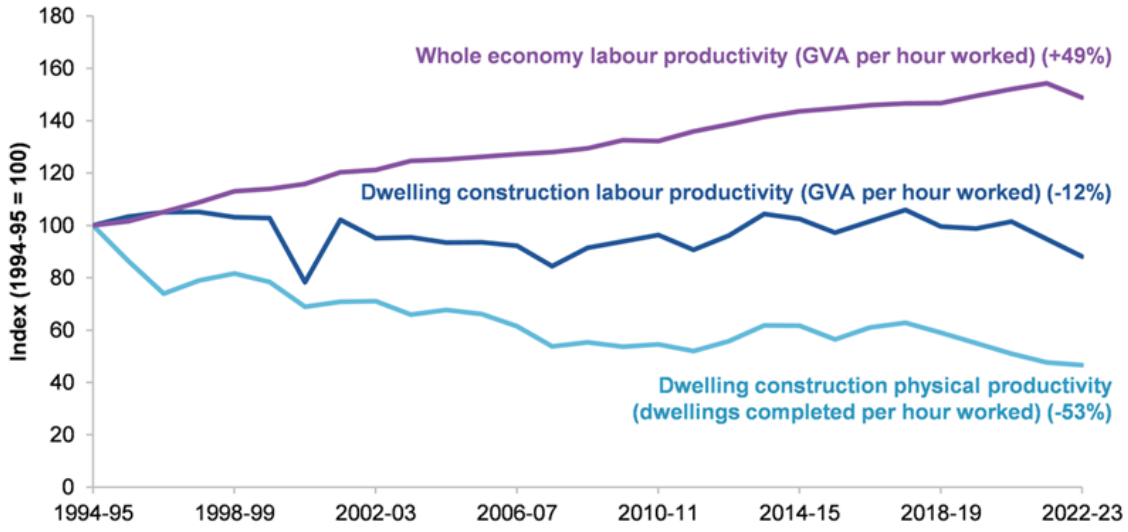


Source: Schroders, LSEG. Data as of October 2025.

The resource and energy picture is more nuanced. While the sector overall has performed largely in line with the broader market, gold has contributed the outperformance and energy is the other side of the equation. While more durable measures of value such as price to book leave the materials sector at around average levels and the energy sector near historic lows, gold is again providing upward impetus to valuations in the materials sector. While narratives around gold price performance remain abundant and almost universally positive (store of value, inflation hedge, protection against fiat money collapse, portfolio diversifier – it's got the lot), bottom-up valuation measures would urge more caution. Energy is perhaps the reverse. Plentiful supply, fading demand with decarbonisation, less than rational supply response from OPEC and producers – not much in the way of positive news. Bottom-up valuation again sends the reverse signal. Valuations near book value, little incentive to invest and increasing geopolitical tension would suggest endless negative momentum might eventually run out of gas (I'll be here all week)! While the picture across commodities is polarised, with gold and critical minerals flavour of the month, energy the reverse and iron ore, aluminium and many others somewhere in between, we remain very positive on stock selection opportunities and seemingly large valuation gaps in many areas.

Construction

While a major sector of the Australian economy, equity market exposures to the sector are disproportionately in owning real estate rather than building it, the economy remains inextricably linked to it. Our long-term concerns on the unsustainability of the sector remain, albeit acknowledging policy continues to defer the likely realisation of these concerns. Despite housing starts per capita well above nearly every other Western country, the prevailing narrative remains one of a 'supply' problem. As evidenced in NZ over recent times, where falling immigration has extinguished upward price pressure, the demand tension from very high immigration is far more likely to be the material driver in this equation. While our views on misguided immigration policy will obviously have no impact on the outcome of policy which seems to believe in government controlled population ageing outcomes, ever more extreme property prices will become ever more sensitive to changes in the immigration outcome, regardless of whether they are exogenous or endogenous. We remain vastly more concerned on price over volume. Construction material exposures seem unlikely to experience volume decline given poor construction productivity has seen the sector unable to keep pace with immigration fuelled demand for many years. The accumulated deficit should sustain a solid demand environment for many years, with any eventual adjustment more likely to be felt in land pricing.



Source: Productivity Commission – 'Housing productivity – Can we fix it?' – February 2025

Outside the disproportionately represented sectors of the economy, we'd observe a number of areas which offer opportunity for those inclined to wager that disequilibrium might not be the natural state of affairs. Possibly the best example is in the healthcare sector.

Source: Schroders, ABS, LSEG. Data as of October 2025.

If one is inclined to search for opportunity in the downtrodden, one needs look no further. Across private hospitals, pathology and pharmaceuticals, the list of former darlings in the doghouse is long. Distortions from COVID, doctor shortages, rampant cost escalation and competition from out of control NDIS spending are amongst the long list of reasons the sector is under both profit and equity market pressure. The private health insurance sector which serves little function beyond acting as an intermediary between community-rated premiums (code for being tax rather than insurance as the young and healthy subsidise the elderly) and healthcare providers, commands vastly more market capitalisation than the hospitals providing the service (currently about $13.4 billion for Medibank's 27% share of the private health insurance industry versus $7.2 billion for Ramsay Healthcare's similar market share in Australian private hospitals (we'll ignore the rest of the Ramsay business and assume it's worthless). CSL, Sonic Healthcare, Healius and Australian Clinical Labs have all had similar share price patterns. While the current margin squeeze may not abate in the short-term as the government

aggressively exacerbates cost inflation through NDIS spend and public sector wage inflation while simultaneously constraining healthcare outlays to others in an attempt to fund their own largesse, something will need to give in the longer term. We'd expect this is some combination of improved funding and foisting onto the user an increased share of healthcare funding. We see plenty of opportunity for the longer-term focused.

The landscape remains one of aggressive but still bifurcated valuations. In many cases we'd perceive it is not the best companies commanding the highest valuations. Short-term earnings growth and enticing narratives in areas such as defence, critical minerals and AI are being met with far greater fervour than business sustainability. Skewing portfolio holdings towards real economy businesses less susceptible to disruption and replete with far more underlying asset value can be accomplished whilst simultaneously paying far lower multiples. Just as the narratives around the urgent imperative to shift all business to the cloud for fear of being the last remaining dinosaur in Jurassic Park proved a wild exaggeration seeing far too many companies cede both profits and control over their own destiny to US technology giants, AI seems to call for cool heads and considered decision making rather than lemming behaviour and ludicrous forecasts. In markets in which efficiency is equated with speed, quantity of data collection and wild overreaction rather than considered thought, we believe the payoff for the latter is becoming greater.

Source: Datastream. As at 31 Oct 2025

Martin Conlon is Head of Australian Equities at Schroders, a sponsor of Firstlinks. This article does not contain and should not be taken as containing any financial product advice or financial product recommendations. It does not take into consideration your personal objectives, financial situation or needs.

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Dotcom on steroids Part II

GQG Research

In our previous GQG Research, *Dotcom on Steroids*, we explored the striking parallels between the current AI landscape and the euphoric rise—and subsequent fall—of the late 1990s technology, media, and telecommunications bubble. In this follow-up piece, we delve into OpenAI, and take a hard look at the numbers, narratives, and risks separating the technological marvel from the economic reality.

Scaling the heights, ignoring the cracks

On the surface, OpenAI may sound like a Mag 7 company in its early days—unprofitable, burning through cash, and a magnet to investors who think they have found the next pot of gold. Peel one layer or dare to bring out your calculator for a closer look, and OpenAI goes from being the world's "most valuable start-up" to what we believe is one of the most overvalued and overhyped companies in history.

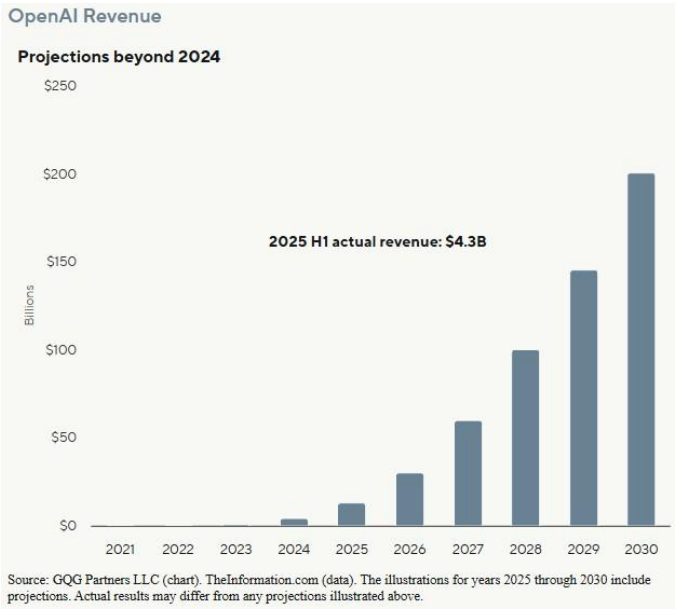
In our view, the company's financials are broken and unrealistic even if you lower the standards and look at them through the lens of a start-up with potentially revolutionary technology. OpenAI is more capital intensive than any other start-up we have seen, lacking the stickiness, the moat, and the network effect that have paved the way for other tech success stories. In addition, the disconnect between OpenAI's revenue and valuation is alarming by any historical standard. As a comparison, consider Amazon or Google in their earlier days: when these companies had a $500 billion valuation, their revenues were roughly 10x and 4x as large, respectively, in comparison to OpenAI's current run-rate revenue of ~$20 billion.[1]

As a long-only large cap manager investing in listed equities on behalf of its clients, most of the time we have the luxury of ignoring the less transparent world of private companies and some of their egregious valuations. So why is that different today? We are facing a unique situation where most of the large public players in tech are intertwined in a web of circular financing where money and deals flow through OpenAI. These relationships have direct implications for not just the large tech companies in our investable universe, but also many other companies in the S&P 500 in our view.

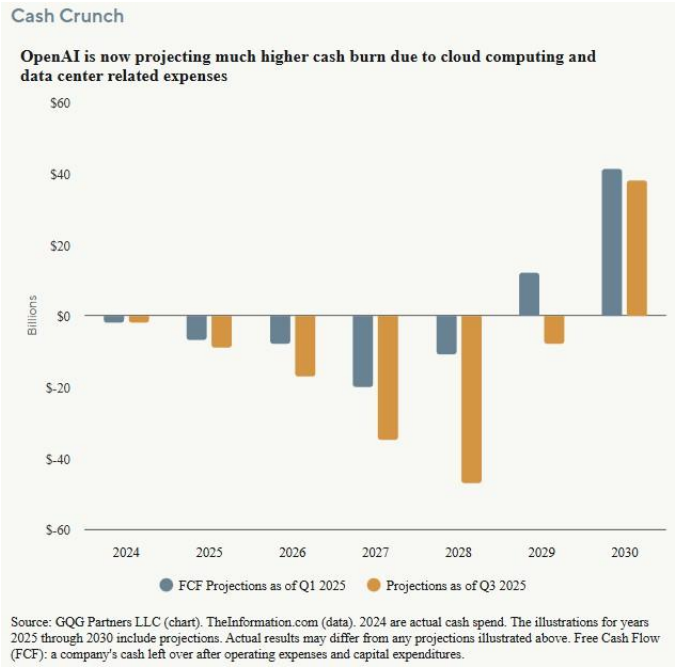
OpenAI is also playing a key role in driving the "hopes and dreams" factor, which we believe is helping to fuel this AI bubble. They believe Large Language Models (LLMs) will continue seeing meaningful step-function improvements toward this goal of Artificial General Intelligence (AGI), a notion a number of AI experts have started to pour cold water on.[2,3] In short, we see OpenAI as a capital-intensive business model that offers a product that faces meaningful risks of becoming a commodity. Yet, it continues to magically prop up valuations of its "partners" after each deal announcement.

Explosive growth, unprecedented spending

To give credit where it is due, OpenAI has firmly established itself as a leading innovator with its LLMs. Its market leadership is evidenced by rapid user adoption of their ChatGPT product which has swelled to over 800M weekly active participants and many large enterprise customers, in addition to revenue of billions of dollars, in the span of a few years.[4,5]



Source: GQG Partners LLC (chart). TheInformation.com (data). The illustrations for years 2025 through 2030 include projections. Actual results may differ from any projections illustrated above.



Source: GQG Partners LLC (chart). TheInformation.com (data). 2024 are actual cash spend. The illustrations for years 2025 through 2030 include projections. Actual results may differ from any projections illustrated above. Free Cash Flow (FCF): a company's cash left over after operating expenses and capital expenditures.

However, success is rarely free.

This explosive growth has been financed by record-breaking capital infusions and expenditures to build the infrastructure to support it.[6] This unprecedented level of spending is underwritten by market forecasts of what we view as extraordinary economic gains that may ultimately prove to be unsustainable. While these investments signal widespread enthusiasm, they obscure the structural challenges that threaten OpenAI's path to durable profitability. Despite the hype, the translation of this breakthrough technology into a resilient business is far from certain.

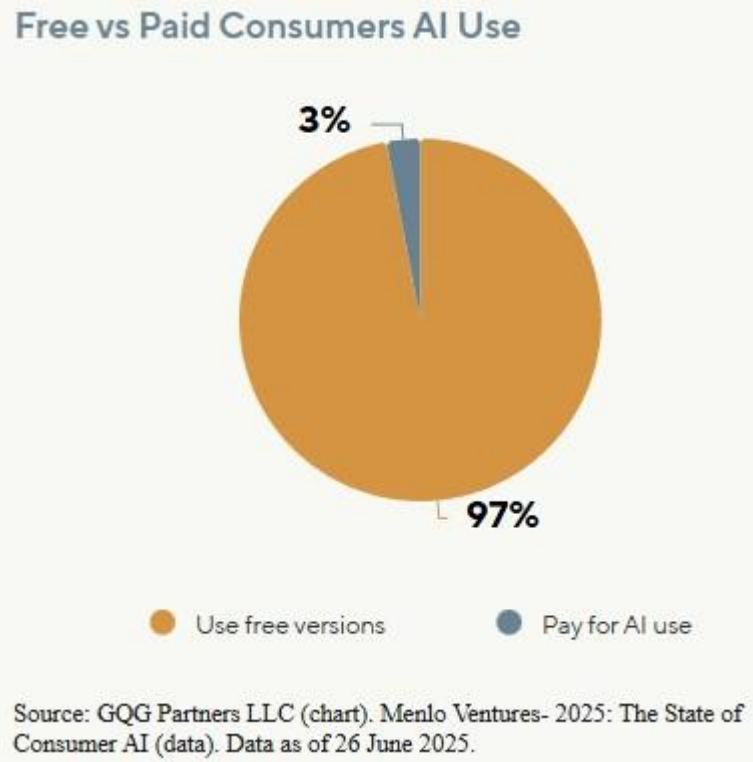
We will delve into OpenAI's dynamics from an economic and technology perspective to illustrate why we believe it fails the proverbial "smell test" given that most analysts seem to be ignoring the facts.

The myth of the metric

While impressive on the surface, high usage metrics (of which OpenAI has many to showcase) can often mask fundamental weaknesses in the quality of demand for a product and its ability to retain users. Specifically, a significant portion of OpenAI's current user engagement is largely driven by free-tier users using it for non-productive reasons.[7,8] This type of usage inflates activity metrics used for raising copious amounts of capital, but we believe it holds little signaling power for future revenue, making it a poor proxy for sustainable customer value. Not to mention that 90% of ChatGPT users are outside of the United States. Furthermore, we believe the translation of enterprise use into durable and sticky revenue is undermined by several key factors:

Persistent Reliability Gaps: LLMs continue to struggle with hallucinations.[9] Their lack of consistency erodes trust and makes it difficult for the models to be embedded in mission-critical, multistep applications or operations that generate recurring, high-value revenue.

Fragile Adoption and Low Switching Costs: The current user base is heavily weighted toward free-tier participants who have no financial commitment to the platform.[8] Even for paying enterprise customers, switching costs remain low for now. Currently, 28% of OpenAI's API usage flows through low-code platforms like Zapier, Bubble, and Retool.[5] These companies are model agnostic and can easily redirect workflows to better or more cost-effective models as they become available, including open-source models.



Source: GQG Partners LLC (chart). Menlo Ventures- 2025: The State of Consumer AI (data). Data as of 26 June 2025.

Questionable Performance Benchmarks: Extreme growth expectations are often justified by referencing the improving model performance on AI benchmarks.[10] However, this too gives us pause. Some studies are beginning to show how these models have "gamed" benchmark results by "memorizing" the questions rather than understanding the subject.[11] Beyond this technicality, the benchmarks create what we believe is a conceptual mismatch between what they measure and what enterprises value. They reward a model's breadth of capability, making it an impressive generalist, yet corporations tend to be structured around the reliability of specialist employees performing a certain set of tasks with consistency.

The cheaper it gets, the more you pay

Even if user engagements were a perfect proxy for value, the basic economics of generative AI present a challenge. While the cost per token has plummeted due to hardware and software innovations, the cost per query has not seen the same dramatic decrease.[12]

With the mainstream adoption of reasoning models, the economics of LLM usage have shifted dramatically.[13] Paying consumers are charged for each token the model takes as input and each token that the model outputs. It is important to note that users are charged more for tokens generated by the model than the tokens that are input. While the general cost per token has plummeted due to hardware enhancements, the number of tokens consumed per task has not.

An analysis by an AI gateway provider revealed an interesting trend: simple, single-turn queries, which constituted 80% of enterprise usage in early 2024, dropped to just 20% by year end. They were replaced by multi-step, complex workflows that drive up token consumption for each request, with most of them being the costlier output tokens.[14]

Will generative AI get sufficiently better from here?

It is not unusual for companies to invoke the promise of AGI when pressed on whether today's use cases justify the massive amount of AI infrastructure investment companies are making. What should be unsettling is that the notion of near-term AGI is increasingly challenged by researchers and operators

(including OpenAI founders themselves), with evidence of continued scaling and deployment realities pointing to a longer, harder road for advancement.[2]

But let us lower the standards a bit and put AGI to the side—can AI, as we know it today, meaningfully improve? Was GPT-5 materially better than its predecessor, and was its rate of improvement comparable to the step up from GPT-3 to GPT-4? A cursory glance at release cadence, benchmark deltas, sharply rising compute, and power requirements suggests step-function gains are becoming rarer and more expensive—an uncomfortable backdrop for valuations and hype that implicitly assume (need?) continued leaps.

Rising Costs, Shrinking Gains

Version	Release Date	Time Since Previous	Estimated Training Cost	Benchmark Improvement vs Prior
GPT-2	Feb 2019	~7 months	~$0.05 M	~+100% (vs GPT-1)
GPT-3	June 2020	~16 months	~$5 M	~+60%
GPT-4	Mar 2023	~33 months	~$100 M	~+40%
GPT-5	Aug 2025	~29 months	~$750 M	~+20%

Source: GQG Partners LLC (chart). Paul Kedrosky (data). Data as of 17 November 2025.

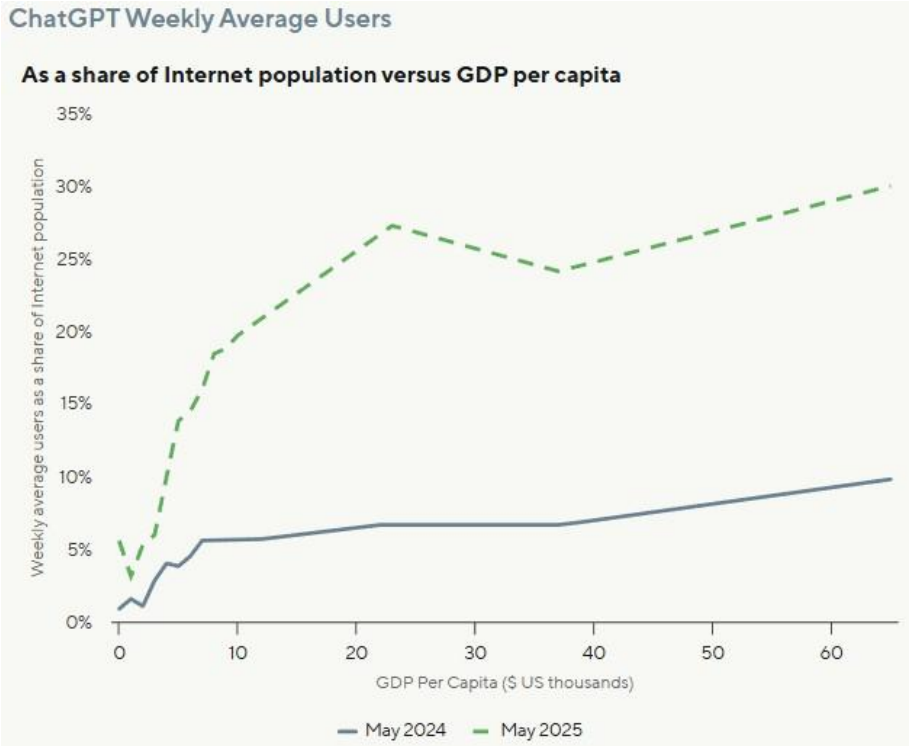
The uncomfortable truth is that this technology is running into hard constraints: the reservoir of high-quality human data is finite, returns to scale are slowing, and a recursive reliance on synthetic data risks degrading the signal. As a result, products like ChatGPT look a lot less like software with zero-marginal-cost scale and more like metered compute with rising variable inputs and operational choke points.

The illusion of scale

The unit economics of LLM providers do not seem to align with the high-margin, scalable models of successful Software-as-a-Service (SaaS) and marketplace companies. Unlike a SaaS model, the cost of adding a new LLM customer is not zero because the cost of compute for LLMs scales with the users, leading to an organic barrier to economies of scale that this business model can achieve. And unlike Uber, as an example, an LLM does not benefit from network effects in that the value of its service does not inherently improve as more users engage with it.

However, this flawed comparison appears to be driving a classic Venture Capital-subsidized “blitz-scaling” strategy that is now playing out globally. As shown in the graph, AI adoption has been unequal between geographies with varying GDP per capita. The lowest adoption rates can be seen in low GDP per capita countries, which tend to be more price sensitive, so providers seem to be using deeply subsidized pricing to capture users in these markets.

OpenAI, for instance, has introduced local plans in India, its biggest market after the US, at a fraction of the global price. Also in India, Perplexity, an AI-powered search engine, is bundling $20 per month subscriptions for free in mobile plans where telecom providers generate as little as $3 per month in revenue per user. It is difficult to rationalize how acquiring these highly price-sensitive users contributes to the future profitability that current valuations demand.



Source: GQG Partners LLC (chart). Empirical Research (data). "Internet population" uses 2023 estimates from the World Bank.

If growth within the consumer market relies on unsustainable subsidies, the hope for profitability must lie with enterprise adoption. This has been a comparatively bright spot, with enterprise spending on foundation models more than doubling in the first half of 2025. However, we believe this optimism is tempered by significant headwinds.

A few recent studies found that either companies remain in a perennial pilot phase for AI projects, or that most pilot programs for incorporating AI end up failing.[15,16] Furthermore, even successful adoption may yield only marginal gains. A recent study estimated AI's net impact on enterprise profit margins by 2030 at a mere 50-70 basis points.[17] While not immaterial, this margin uplift is expected to come primarily from job automation (which we think is becoming an increasingly questionable assumption[18]) and offset by the significant depreciation expenses of the required AI infrastructure (which is a known and unavoidable cost).

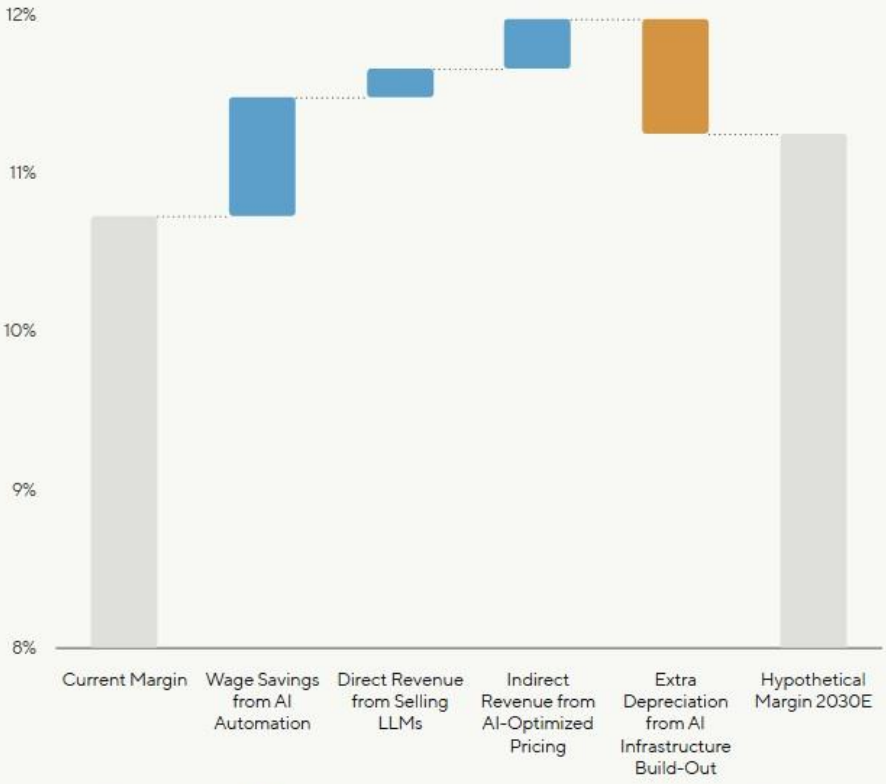
The hard financials make this picture even bleaker. In the first half of 2025, OpenAI generated $4.3 billion in revenue while posting a net loss of $13.5 billion and burning through $2.5 billion in cash. Despite this staggering burn rate, the company projects it will be profitable by 2030, with revenues soaring to $200 billion and gross margins over 60%.[19] This type of long-range, hockey-stick forecast for a business with such a murky path to profitability is eerily reminiscent of the dotcom era, where many companies extrapolated short-term hype into extreme future earnings that never materialized.[20]

For context, a $200 billion revenue target would exceed the 2024 sales of Nvidia, a company that operates as a near-monopoly with immense barriers to entry and is years ahead of its closest competitors, something we believe OpenAI can hardly claim considering how easily interchangeable frontier language models are.[21] To suggest that OpenAI—a company burning through cash by the billions amid fierce competition with seemingly no durable moat—will achieve a similar financial profile in just a few years seems less like a forecast and more like a work of speculative fiction in our view.

We believe there is another underappreciated risk: the intense competition for talent among the AI labs. OpenAI is on track to spend close to $6 billion on stock-based compensation in 2025 alone.[22] Since these are all based on the company's ~$500 billion valuation, even a modest slowdown could heighten the challenge of retaining key employees. However, despite the possible headwinds, OpenAI continues to raise its revenue expectations.

Large-Capitalization Stocks

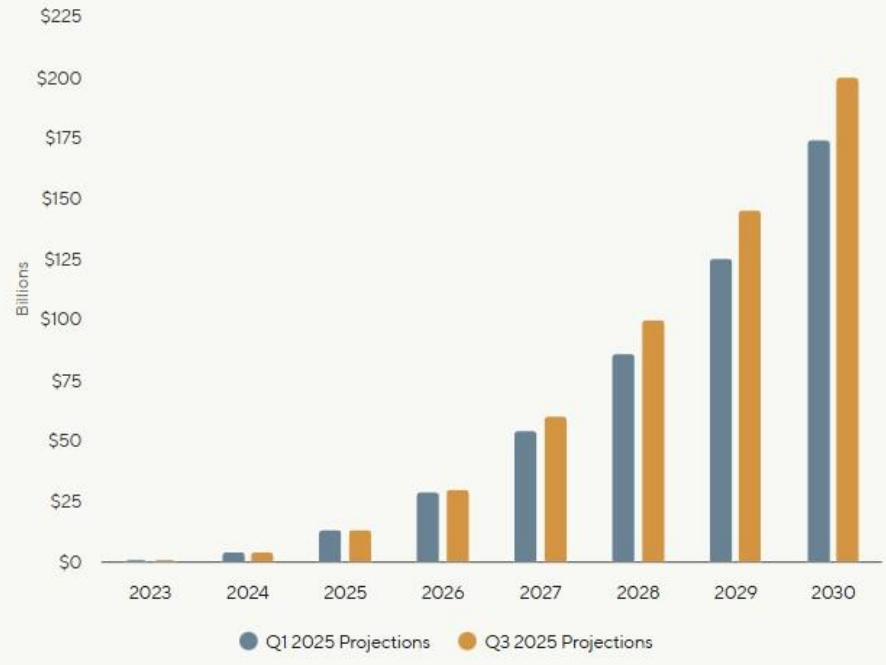
Estimated Impact of AI on Net Profit Margins 2025E through 2030E



Source: GQG Partners LLC (chart). Empirical Research Partners Analysis (data). Actual results may differ from any projections illustrated above. Data as of 30 September 2025.

Rising Revenue

OpenAI has increased its revenue projections, anticipating more from ChatGPT and new products, including monetizing people who use ChatGPT for free



Source: GQG Partners LLC (chart). TheInformation.com (data). Data as of 5 September 2025. 2023 and 2024 are actual revenue. The illustrations for years 2025 through 2030 include projections. Actual results may differ from any projections illustrated above.

This all leads back to one unavoidable consequence: the math seemingly does not work, and the capital-intensive nature of the business creates relentless liquidity pressure. Despite record-breaking revenue, OpenAI has raised over $40 billion this year, up from $6.6 billion in 2024, all in addition to revolving credit lines and infrastructure partnerships. To keep up their growth, arguably by subsidizing the cost of compute for users and maintaining their high-in-demand workforce, we think they will need to keep raising money at record-breaking rates.

Using a quick back-of-the-envelope calculation, taking the 136 million US private workforce at the going subscription rate of $20 per user per month yields less than $3 billion in revenues—and of course that is before discounts, usage caps, or reseller splits. To put this into perspective, Google raised just $26 million (~$60 million in today's terms) before becoming profitable, while Meta raised about $480 million (~$800 million today).[23,24] **By comparison, OpenAI is projected to burn through a staggering $115 billion before it even hopes to reach free cash flow profitability in 2030.[25] The scale of this capital consumption is without precedent.**

Immortal tech, mortal company

LLMs are not a bad asset, but the price being paid for a business with such immense capital costs, no obviously durable moat, and questionable unit economics may prove to be fatal. We believe the story to watch is not whether the technology is immortal (it most likely is), but whether the companies building it are.

This article is an abridged extract of GQG Partners' recent long-form article "Dotcom on Steroids Part II". You can read the full article here. This article contains general information only, does not contain any personal advice and does not consider any prospective investor's objectives, financial situation or needs. Before making any investment decision, you should seek expert, professional advice.

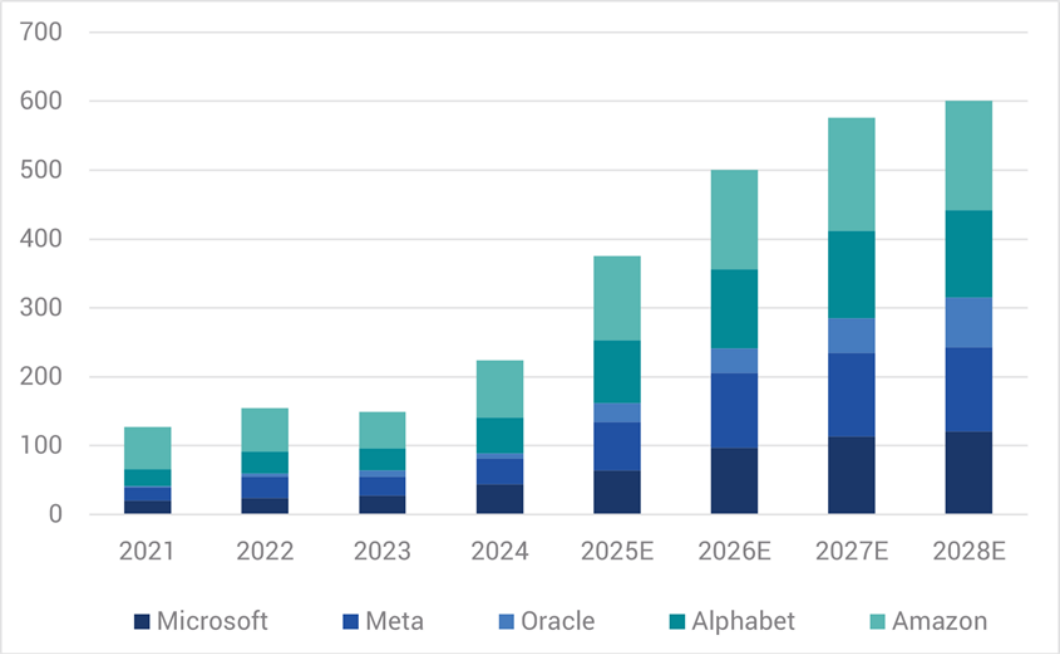
*For **End notes** and **Definitions**, see here.*

AI's debt binge draws European telco parallels

Phil Strano

Certainly 2025 will go down as yet another year dominated by the growth of the major technology companies, with AI themed investments headlining a surge in equity and debt capital market activity. Much of this activity is funding burgeoning AI capital expenditures with further significant growth expected in coming years as the major technology players make an almost 5x increase in combined capital outlays over the 7 years to 2028 (refer Chart 1).

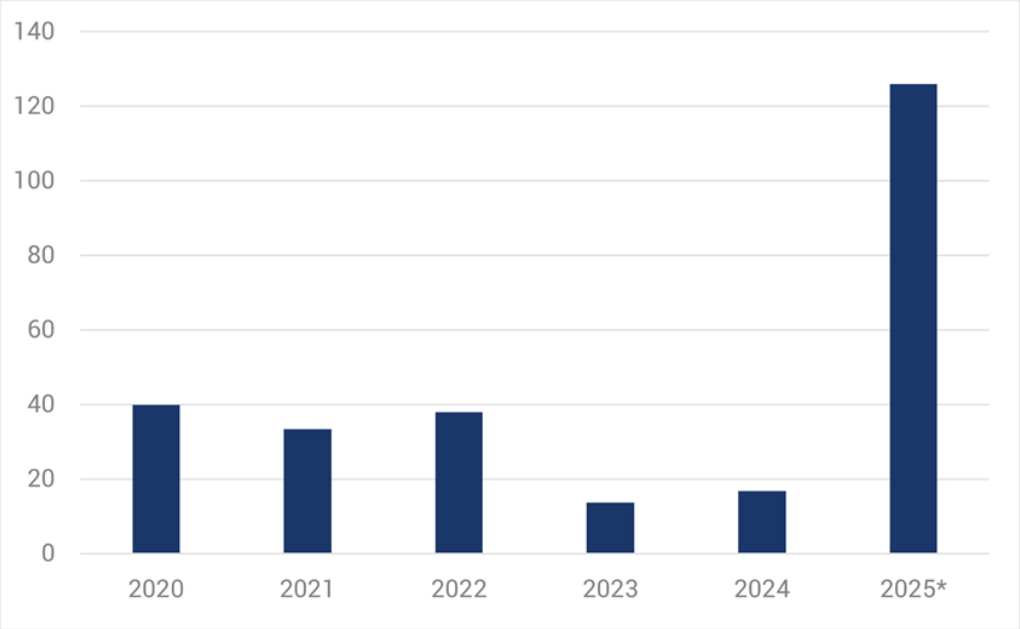
Chart 1. AI 'Hyperscalers' – Annual Capex Expenditures (Actuals and Estimates, $USbn)



Source: Bloomberg/Yarra, Nov 2025.

Aside from growth in capital expenditure fuelling equity prices and underpinning US economic growth, the major global technology players are increasingly turning to debt markets for funding. Mega debt deals this year are already many multiples of previous annual totals, with the prospect of much more debt issuance to come (refer Chart 2).

Chart 2. AI Tech Giants – Borrowings (Bonds and Loans, $USbn)

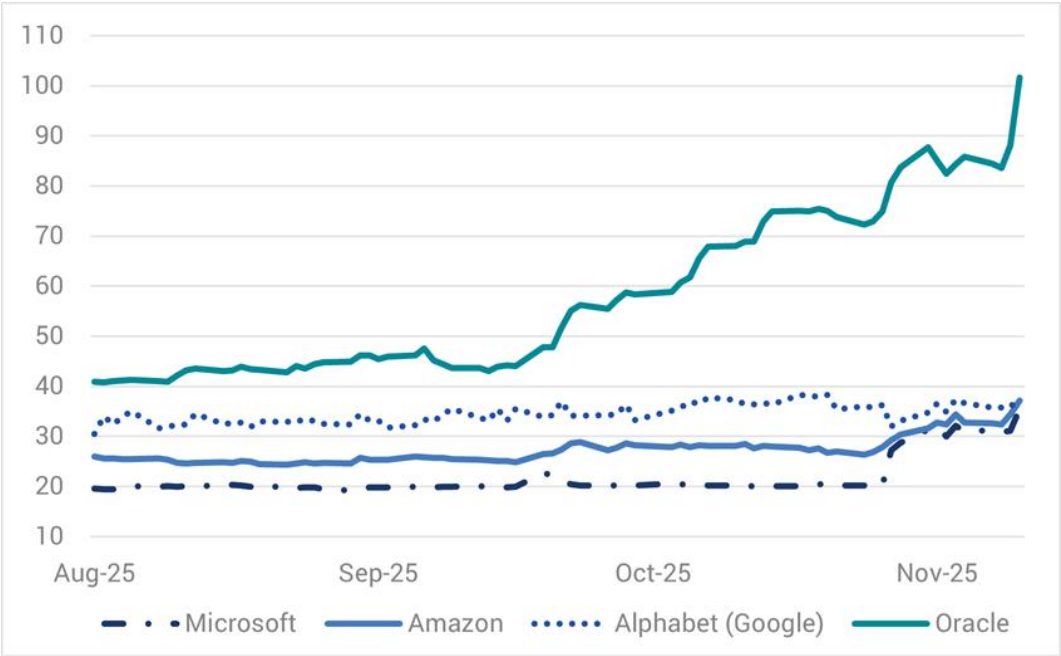


*Source: Bank of America/Yarra, Nov 2025. * New borrowings to Oct 2025.*

Renowned for their credit worthiness and strong cash flow generation, the AI hyperscalers appear very well placed to manage increased debt on their balance sheet. But everything, including even AI, has its limit. Given capital expenditures are expected to accelerate further over the outlook, we may very well reach the theoretical limits of debt funding in the years ahead without significant downgrades in credit quality, even for such illustrious names as Amazon, Google, Meta, and Microsoft etc.

To date, credit markets have absorbed large sums of new debt from AI companies, but higher Credit Default Swap (CDS) pricing is beginning to reflect some indigestion across the sector. This especially the case for triple B rated Oracle (refer Chart 3). Going forward, further debt capital issuance is likely to further pressure credit spreads.

Chart 3. CDS Spreads – US Technology Companies (bps)

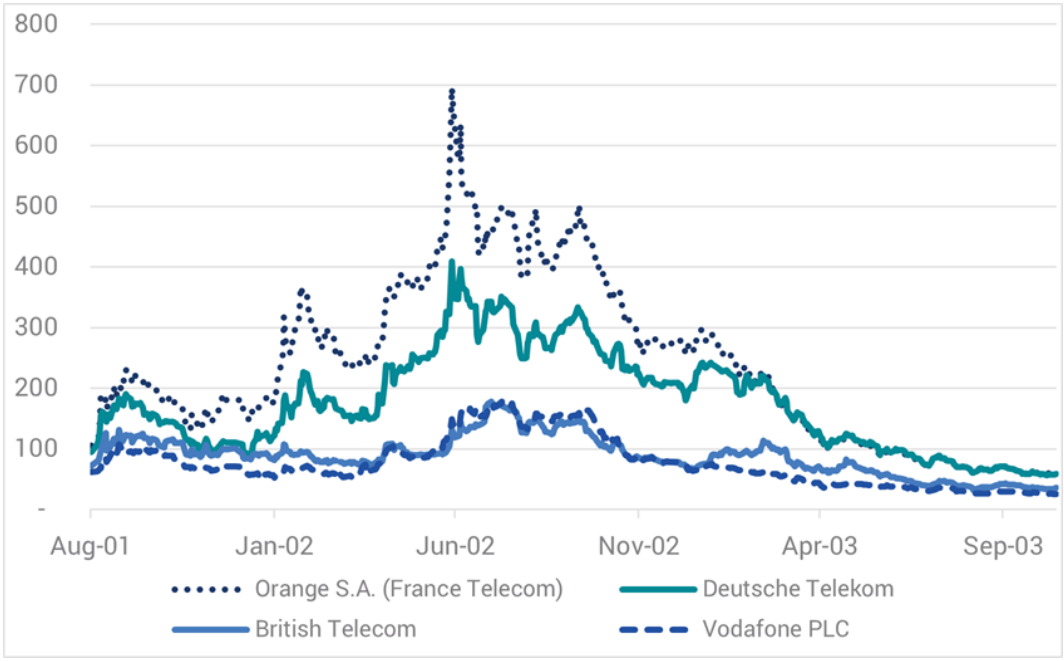


Source: Bloomberg/Yarra, Nov 2025.

For those of us in credit markets, major events can often be eerily similar to historical periods. From our perspective, highly rated AI companies increasingly tapping debt markets to fund burgeoning capital expenditures bears an uncanny resemblance to the early 2000s, where similarly rated European telcos (massively) overpaid for 3G spectrum licenses and associated infrastructure. In the second half of 2000, the likes of Deutsche Telekom (DT), Orange S.A. (France Telecom), British Telecom and Vodafone etc., used debt funding to pay European governments more than $US100 billion for 3G spectrum licenses on the lucrative early promise of the 'Internet of Things' (IOT) age.

As we now know, those roads to 3G riches were more potholed than expected, with associated debt issuance and lower-than-expected returns leading to significant negative credit migration and much higher credit spreads. For instance, the spreads of Credit Default Swap – insurance against default – for DT peaked at 400bps in 2002 (refer Chart 4) and its credit rating declined from a high of AA- in 2000 to a low of BBB+ in 2004. It still resides there some 20 years later.

Chart 4. CDS Spreads – CDS Spreads – European Telcos (bps)



Source: Bloomberg/Yarra, Nov 2025.

The history books confirm that credit investors incurred significant marked-to-market losses funding Europe's 3G capital expenditure binge in the 2000s, with a sense of Déjà vu now on the horizon for AI investors. While current credit quality – as assessed by S&P – for the likes of Meta (AA-), Amazon (AA), Alphabet (AA+) and Microsoft (AAA) is unquestionably pristine, if the past experience of the European telcos are anything to go by, their credit quality is unlikely to remain so. We believe the credit ratings of hyperscalers in the years ahead are likely to migrate down to single A and maybe even triple B categories.

Credit investors buying the bonds of hyperscalers should clearly be factoring in future credit migration risk into new issuance credit spreads, which for the most part does not appear to be occurring. For instance, Meta recently issued $US13bn (total) across 10 and 30-year tranches at Treasuries +78 and 98bps respectively. While you can debate whether the 10-year securities represent good value, we struggle to make any coherent argument in support of the relative value of the 30-year tranche, with any negative credit migration in the years ahead likely to lead to steep mark-to-market losses.

Phil Strano is Head of Australian Credit Research 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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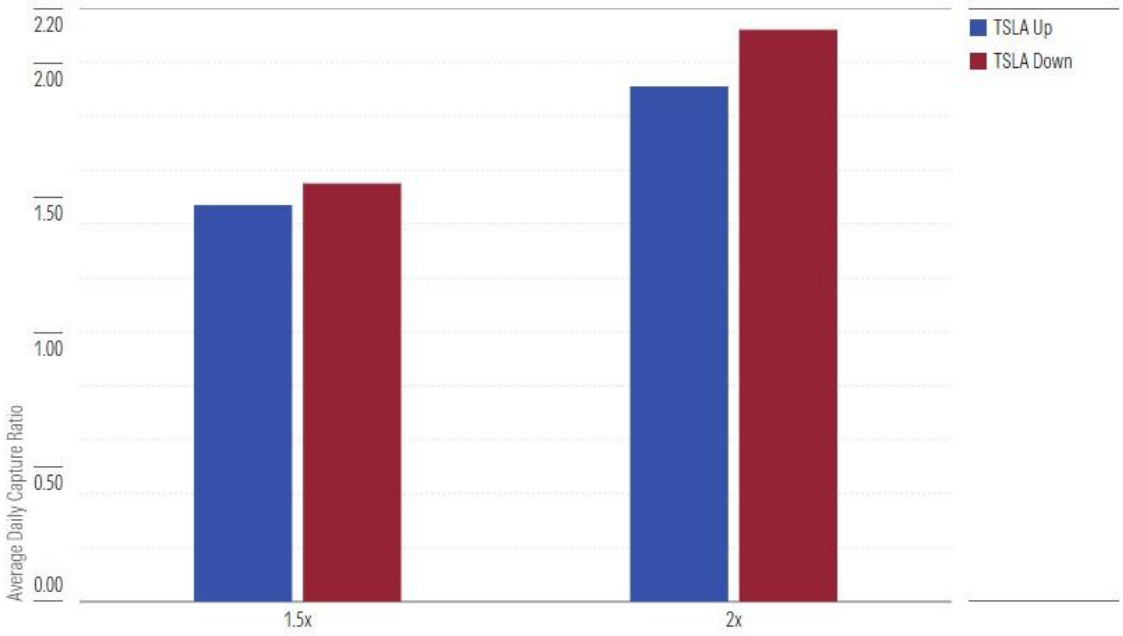
Leveraged single stock ETFs don't work as advertised

Jeffrey Ptak CFA

Direxion Daily TSLA Bull 2x Shares ETF TSLL in the US isn't something most investors would consider. It aims to deliver 2 times Tesla's TSLA return on a given day. That suits it more toward speculators betting on unpredictable changes in the electric car maker's stock price in a day.

But the math is the math: The ETF *should* deliver 2 times the stock's return each day before fees. It has not. Here's the Direxion ETF's average daily capture ratio—that is, Tesla's return divided by the ETF's return on an average day, broken down by whether TSLA had risen or fallen that day.

Direxion Daily TSLA Bull 2x Shares ETF: Average Since-inception Daily Capture Ratio Versus Tesla Stock

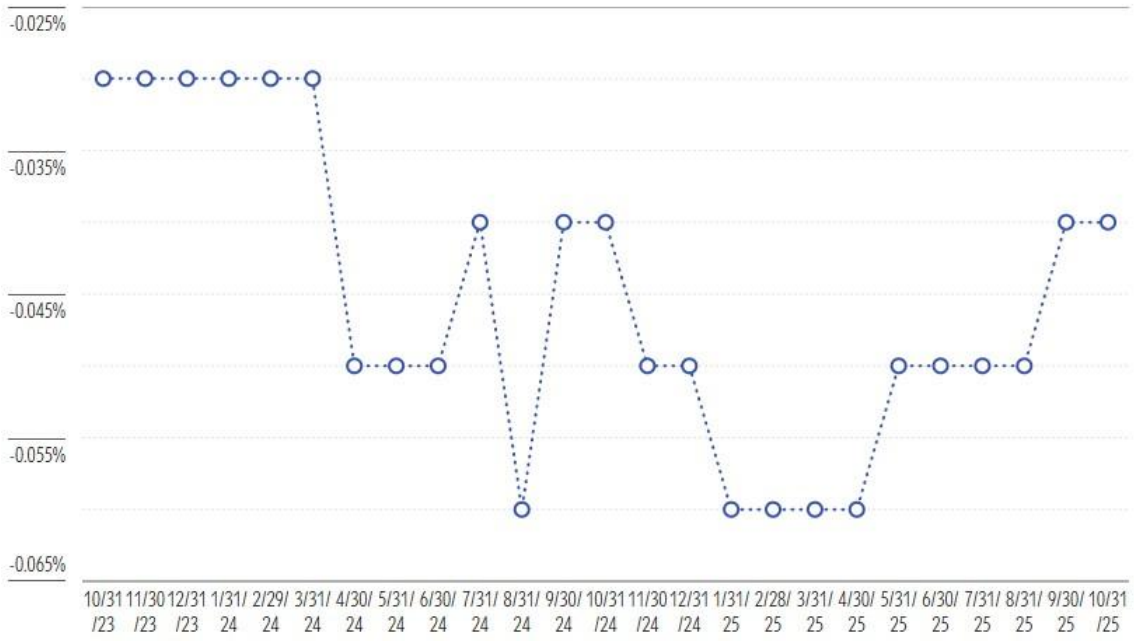


Source: Morningstar Direct, author's calculations. Data as of Oct. 24, 2025. Inception date: Aug. 8, 2022; from its Aug. 8, 2022 inception through April 1, 2024, the ETF targeted 1.5 times Tesla's daily return.).

On the average up day, the ETF delivered less than twice Tesla stock's return (and less than 1.5x when that was its target ratio earlier in its life), but on the average down day, it captured more than twice the stock's change. For instance, on June 23, 2025, Tesla's stock leapt 8.23% but the ETF rose only 16.42%, or 4 basis points shy of the 2x target. Then on July 1, 2025, Tesla fell 5.34% but the ETF sank 10.70%, which was 0.03% more than its target.

These were not isolated occurrences. Here is a time lapse of the past two years, in which I compare the Direxion ETF's daily return against the return suggested by its target at the time (either 1.5x or 2x). For simplicity, I've averaged the daily shortfalls for each month.

Direxion Daily TSLA Bull 2x Shares ETF: Average Daily Shortfall to Target, by Month



Source: Morningstar Direct, author's calculations. Data as of Oct. 24, 2025. Monthly average shown is arithmetic average of shortfall measured each trading day of that month. Shortfall on a trading day is derived by subtracting the target return (that is, 2 times Tesla's return) from the ETF's actual return that day.

On the average day, the ETF's return lagged the target return by 4 basis points, a shortfall that far exceeded the fee it levied on a given day (around one-fourth of a basis point, give or take). Over a full year, those daily shortfalls would compound to a nearly 10% annual drag on returns.

How much did that amount to in dollar terms? From the Direxion ETF's inception through Oct. 24, 2025, I estimate those daily shortfalls came to around $813 million in total. The ETF levied at least $70 million in cumulative fees over that span (based on the $43 million in total fees it reported in its filings from inception through April 30, 2025, and the $30 million or so I estimate it collected in the time since). So that would mean the ETF incurred nearly $740 million in frictional costs unexplained by standard management and other fees.

To put that figure in perspective, the ETF amassed around $4.9 billion in net income and gains over that span based on my estimates. Thus, the $740 million or so in forgone gains would have equated to around 14% of the dollar returns investors potentially could have earned had the ETF met its Tesla daily-return target.

Felt but not seen

The main culprit for the shortfall is financing costs. To obtain twice Tesla's daily return, the ETF enters "total return swaps" with counterparties, typically banks or market makers. Each counterparty pledges to deliver a multiple of Tesla's daily return, but to do so, it must borrow or otherwise use its balance sheet. To defray the associated costs, it charges a financing rate, consisting of a base component and a spread, both variable.

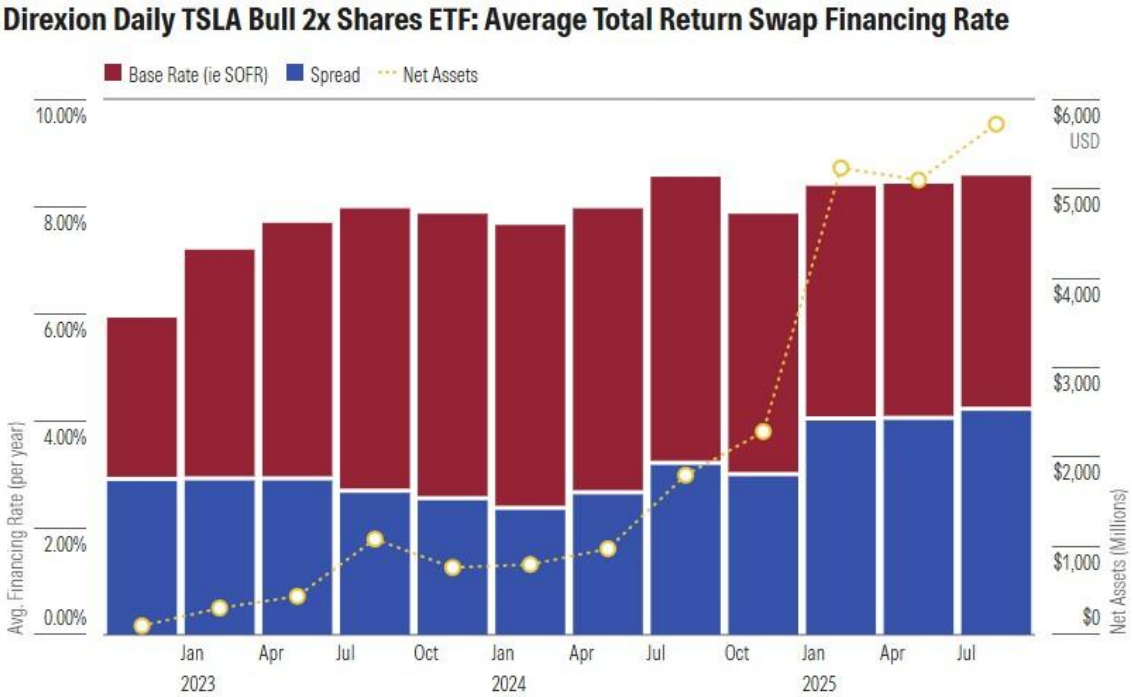
ETFs periodically disclose the swaps they've entered and their terms. Here's an example from the Direxion ETF's most recent report. Recently, the ETF was paying 8.66% all-in, on average (notionally weighted), for swap financing.

Direxion Daily TSLA Bull 2X Shares
Schedule of Investments (Unaudited)
July 31, 2025

Shares		Fair Value
COMMON STOCKS - 19.5%		
Transportation Equipment Manufacturing - 19.5%		
3,626,388	Tesla, Inc. [a]	$ 1,117,906,629
	TOTAL COMMON STOCKS (Cost $1,005,880,908)	$ 1,117,906,629
SHORT TERM INVESTMENTS - 90.9%		
2,240,832,426	Dreyfus Government Cash Management Institutional Shares, 4.20% [b]	$ 2,240,832,426
841,540,837	Dreyfus Treasury Securities Cash Management Institutional Shares, 4.13% [b]	841,540,837
557,039,697	Goldman Sachs Financial Square Government Fund Institutional Shares, 4.20% [b]	557,039,697
1,558,527,252	Goldman Sachs Financial Square Treasury Instruments Fund Institutional Shares, 4.14% [b]	1,558,527,252
	TOTAL SHORT TERM INVESTMENTS (Cost $5,197,940,212)	$ 5,197,940,212
	TOTAL INVESTMENTS (Cost $6,203,821,120) - 110.4% [c]	$ 6,315,846,841
	Liabilities in Excess of Other Assets - (10.4)%	(596,135,502)
	TOTAL NET ASSETS - 100.0%	$ 5,719,711,339

Percentages are stated as a percent of net assets.
The geographic location of all investments is United States unless otherwise indicated.
[a] Non-income producing security.
[b] Represents annualized seven-day yield at July 31, 2025.
[c] All or a portion of these securities have been segregated as collateral for swap contracts. Total value of securities segregated amounted to $4,423,092,854.

The ETF's average annual financing rate rose even as its assets grew. That's a function not only of rising short-term borrowing rates amid tighter Fed policy, but also widening spreads, as shown below.



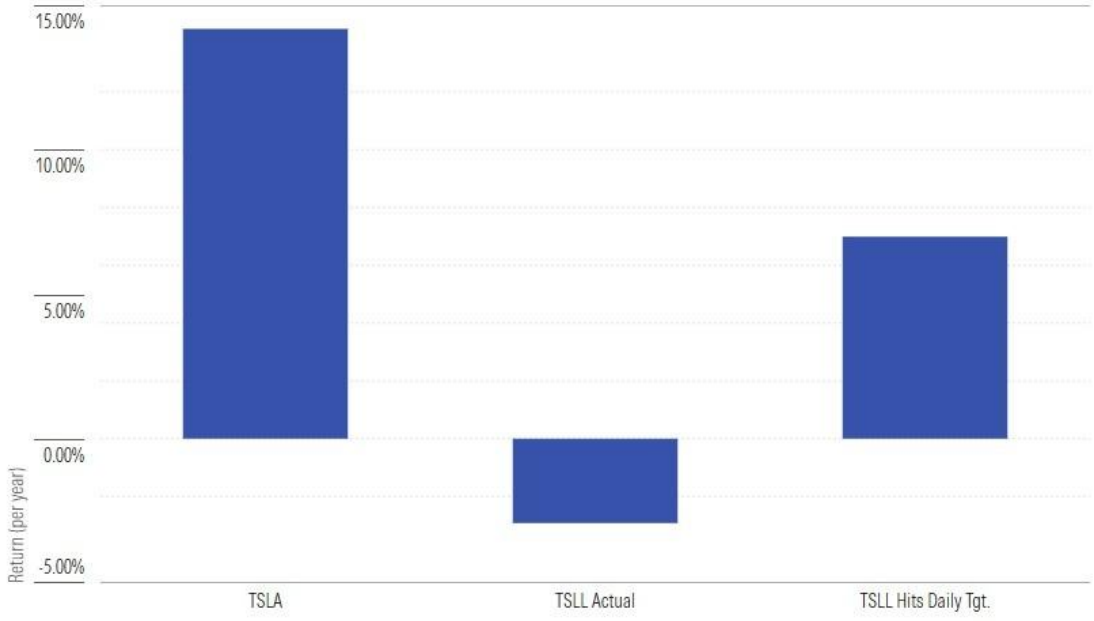
Source: Direxion ETFs periodic reports, author's calculations. Data as of July 31, 2025. Bars correspond to swap terms reported in Direxion periodic reports dated Oct. 31, Jan. 31, April 30, and July 31 of each fiscal year.

But you wouldn't know it judging from the ETF's expense ratio, which hovered in a narrow range since inception (between 0.95% and 1.08% based on prospectus disclosures). That's because these financing costs aren't bundled into the expense ratio. Instead, they're netted against the gains or losses on the swaps, similar to how brokerage commissions are backed out of returns. Thus, they're felt but not seen.

(Jason Zweig wrote about this topic in a recent column, and you can find some interesting research that Arizona State professor Hendrik Bessembinder published as well. I've also attempted to estimate some of these swap costs in a different article I wrote.)

Yet, they unquestionably drag on performance, largely explaining why the Direxion ETF hasn't been able to do its one job: deliver 2 times Tesla's daily return target. That's really brought home when you compare the ETF's actual since-inception annual returns against those of Tesla stock, as well as that of a hypothetical ETF that met its daily return target (that is, the leverage multiple times Tesla's return each day).

Comparing Direxion TSLA Actual Return to Tesla Stock and Hypothetical ETF That Hits Daily Target



Source: Morningstar Direct, author's calculations. Data as of Oct. 24, 2025.

The actual ETF's returns badly lagged Tesla's from inception through Oct. 24, 2025, which is to be expected. After all, leveraged daily ETFs aren't meant to be held for periods longer than a day due to volatility decay.

What's more surprising, though, is that the Direxion ETF's annual returns would have been nearly 10 percentage points higher than they were had it met its daily return target as advertised (around 9% after factoring in the ETF's fee). That would still lag Tesla, but it reinforces how much these frictions cost traders, even if they are an unavoidable part of executing the strategy.

More where that came from

This isn't an issue just for this Direxion ETF. To illustrate, here are the 10 largest leveraged single-stock ETFs by assets and how much of their reference stock's return they captured on an average up or down day since inception.

10 Largest Leveraged Single-Stock ETFs: Average Daily Capture Ratio by Whether Stock Rose or Fell

Name	Inception Date	Net Assets ($M)	Stock Rose	Stock Fell
Direxion Daily TSLA Bull 2X Shares	8/8/2022	7,532.70	1.91	2.12
GraniteShares 2x Long NVDA Daily ETF	12/12/2022	4,567.60	1.92	2.15
T-REX 2X Long MSTR Daily Target ETF	9/17/2024	1,057.80	1.84	2.20
GraniteShares 2x Long COIN Daily ETF	8/8/2022	914.70	1.93	2.14
GraniteShares 2x Long AMD Daily ETF	3/15/2024	826.10	1.92	1.87
GraniteShares 2x Long PLTR Daily ETF	9/4/2024	727.60	1.94	2.11
Defiance Daily Target 2X Lng MSTR ETF	8/14/2024	690.00	1.83	2.17
T-REX 2X Long NVIDIA Daily Target ETF	10/18/2023	629.20	1.82	2.14
Direxion Daily NVDA Bull 2X Shares	9/12/2023	627.30	1.94	2.15
Direxion Daily PLTR Bull 2X Shares	12/10/2024	551.60	1.92	2.07

Source: Morningstar Direct, author's calculations. Data as of Oct. 24, 2025. Average capture ratios based on ETF's daily returns from inception indicated through Oct. 24, 2025; red denotes underperformance of target; green indicates outperformance.

Every ETF but one captured less than its target on its reference stock's average up day and more than its target on the stock's average down day since inception. (I excluded data for ETFs that were on a 1.5x or 1.75x target before adopting a 2x target. The results were the same: They lagged their targets on up days and fell to deeper losses than the target on down days.)

(The lone ETF to capture less than its target on the average down day appears to be a fluke: GraniteShares 2x Long AMD Daily ETF AMDL inexplicably gained 10.3% on March 18, 2024, a day AMD AMD lost 0.2%, and then lost 18.6% the following day when AMD slid 4.8%. Excluding those two days, which came very early in the ETF's life, it would have captured 2.12 of AMD's return on the average losing day, exceeding its 2x target like every other ETF on the list.)

Big whiff

I estimate these shortfalls cost traders around $3.3 billion in returns from the ETFs' inceptions through Oct. 24, 2025. That figure excludes the roughly $230 million in fees these ETFs collected in aggregate over their lifetimes through Oct. 24, 2024 (those fees are netted against the income and gains shown).

Put another way, had these ETFs not whiffed the daily targets they advertised, traders would have reaped $13.4 billion in income and gains instead of the $10.1 billion they actually saw, with fees, financing costs, and other frictions eating away the difference.

10 Largest Leveraged Single-Stock ETFs: Since-Inception Income and Gains Versus Target Shortfalls

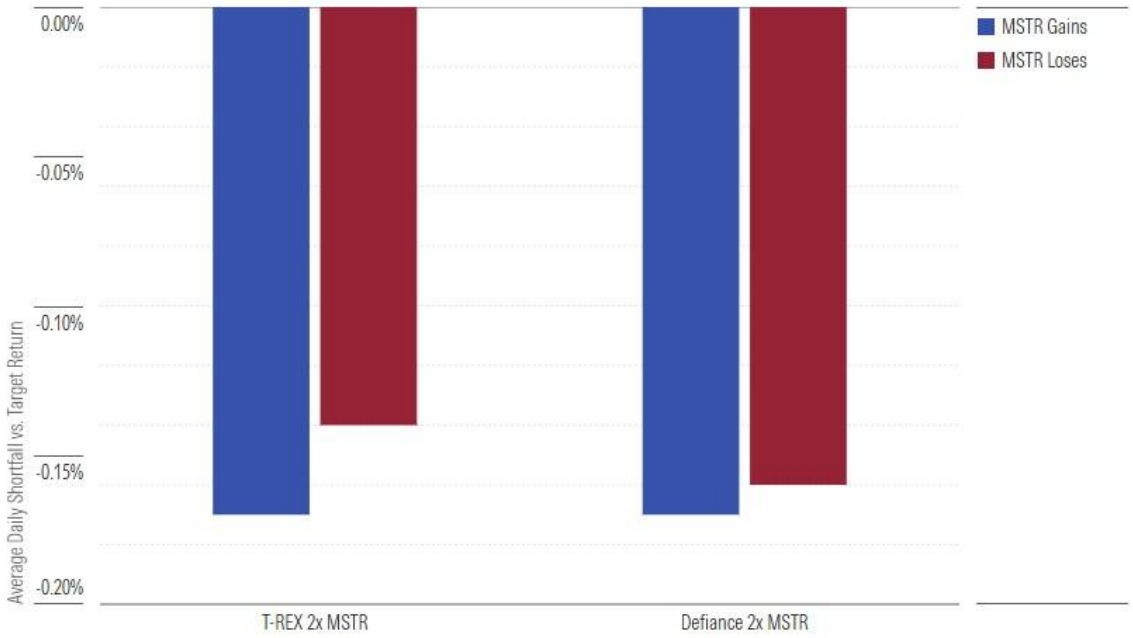
Source: Morningstar Direct, author's calculations. Data as of Oct. 24, 2025. Net income + Gains (Losses) is net of each ETF's fees; net income + gains (losses) cross-referenced against figures reported in periodic filings; author's estimates for period following most recent periodic report.

Poster children

A few of these ETFs stand out for the sheer amount they appear to have forgone in returns: Based on my estimates, T-Rex 2x Long MSTR Daily Target ETF MSTU looks to have incurred nearly $600 million in cumulative daily shortfalls to its target from its Sept. 17, 2024, inception through Oct. 24, 2025. Meanwhile, Defiance Daily Target 2x Long MSTR MSTX racked up almost $520 million in these shortfalls since launching on Aug. 14, 2024.

The T-Rex ETF lagged its target return by 17 basis points on the average up day and 14 basis points on the average down day, while the Defiance ETF fell shy by 17 basis points and 16 basis points, respectively.

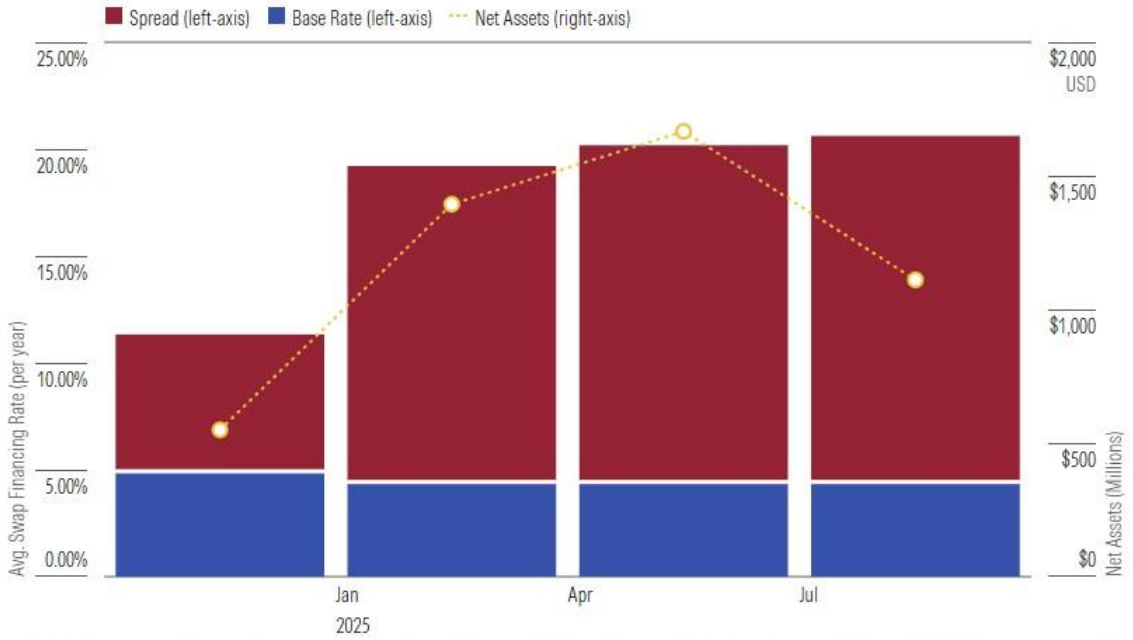
Leveraged MSTR ETFs: Average Daily Shortfall Versus Target Return



Source: Morningstar Direct, author's calculations. Data as of Oct. 24, 2025. Derived by averaging difference in each ETF's daily total return vs. its target return since inception. The Defiance ETF had a 1.75x daily target from inception through Oct. 29, 2024; During that period, its returns lagged its target by 0.08% on the average up day and 0.08% on the average down day.

What held these ETFs back? Swap financing costs that appear to have become more onerous as the ETFs' net assets swelled. For instance, here is a time lapse of the Defiance ETF's notionally weighted average financing costs based on disclosures in its periodic reports. As the ETF's assets climbed, its financing costs rose—diseconomies of scale.

Defiance Daily Target 2X Long MSTR ETF: Average Total Return Swap Financing Rate



Source: Defiance ETFs periodic filings. Data as of July 31, 2025. Defiance ETFs periodic reports; author's calculations. Data as of July 31, 2025. Bars correspond to swap terms reported in Direxion periodic reports dated Oct. 31, 2024, Jan. 31, 2025, April 30, 2025, and July 31, 2025.

What's notable is that the spreads on these swaps widened as the ETF grew, indicating the swap counterparties' hedging and balance-sheet costs mounted faster than assets rose. Thus, the ETF was recently paying more than 20% per year, all-in, to obtain swap exposure.

Conclusion

Daily single-stock leveraged ETFs don't deliver as advertised. They appear to routinely fall shy of their daily targets before fees, and those shortfalls have compounded to shortchange traders to the tune of billions in forgone gains. Moreover, given the nature of swap financing costs, it doesn't appear that these ETFs have been able to realize economies of scale as they've caught on with speculators. In several cases, I found that the financing costs became more onerous, further blunting the ETFs' ability to meet their daily return targets.

Jeffrey Ptak, CFA, is managing director for Morningstar Research Services LLC. The opinions expressed here are the author's. The author does not own shares in any securities mentioned in this article. This article is general information and does not consider the circumstances of any investor. Originally published by Morningstar and edited slightly to suit an Australian audience.