Firstlinks
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Editorial

This is my last edition as Editor as I am leaving Firstlinks to become Commsec's Equity Market Strategist.

Morningstar's Director of Personal Finance, Mark LaMonica, will take over the role until a permanent replacement is found.

It's been a privilege to work at Firstlinks. I came here three-and-a-half years ago to help Graham Hand. He wanted to focus on writing and hand over editing and the administrative responsibilities of the newsletter. A year into coming on board, Graham became ill and my role changed. And it changed more permanently following Graham's passing.

It was a trying period. Not only with Graham but taking on the newsletter which he founded. After all, it was his baby and his audience.

I hope I have at least transitioned Firstlinks from being the founder-led newsletter that it was to what it is today.

Firstlinks remains as relevant as ever. In a world dominated by short-term thinking and marketing spiels, the newsletter stands out for its long-term, thoughtful approach to investing. Long may it continue.

Thank you to the readers, sponsors, and Morningstar for all your support.

If you'd like to stay in touch, please connect with me through LinkedIn or X.

Best wishes.

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In my article this week, the RBA rate rise dominates headlines, but Australia's inflation problem runs deeper. I look at some of the key myths behind our affordability crisis, what the real drivers are, and three ways to tackle the problem.

On the subject on inflation, **Ashley Owen** also runs through 125 years of data to reveal the destructive impact of inflation on our wealth and how even if the CPI returns to the RBA's 2-3% target range, it won't solve the problem for investors.

James Gruber

Also in this week's edition...

Tony Dillon says the new draft legislation for Division 296 is a step forward, yet it still feels like a wealth tax. The bigger question: has a chance for simpler, fairer super reform been missed?

Jon Kalkman believes many Australians mistakenly think their super is like a bank account when it's legally a trust - meaning you don't own the assets, the trustee does. He says proposed changes like Division 296 risk making you liable for tax on growth you don't actually control.

Investors fixate on tech giants, but much of the world market's 2025 gains came from other sectors. **VanEck's Anna Wu** thinks health care, gold miners, and nuclear energy may offer the next big investment opportunities.

When people think of infrastructure, they generally think of steady earnings and cashflows and, while true, it ignores something else they offer: dividends. In a world starved of yield, infrastructure's income prospects are attractive, according to **Magellan**.

Jeremy Grantham is a legend in the investment industry having correctly called out several bubbles including the 2000 tech wreck and the 2008 financial crisis. Now, he's targeting AI, believing that while it's the most impressive innovation in 100 years, the sector is in a bubble and a reality check is coming.

Lastly, in this week's whitepaper, **Fidelity International** examines the key themes that will shape markets in 2026.

Curated by James Gruber and Leisa Bell

3 ways to fix Australia's affordability crisis

James Gruber

The RBA has increased interest rates to tame inflation and there's no shortage of knee jerk reactions. About how it hurts homeowners (of course); about what the RBA will do next, even though almost no one forecast the rate rise a mere four months ago; and about how the government is or isn't to blame, depending on which side of politics you support.

A lot of the discussion seems short-sighted and fails to answer several key questions:

What are the real drivers behind our high inflation?

Why do many people feel worse off than the official consumer price index figures suggest?

How can we fix the affordability crisis?

What are the risks that this becomes a long-term issue rather than just a temporary one?

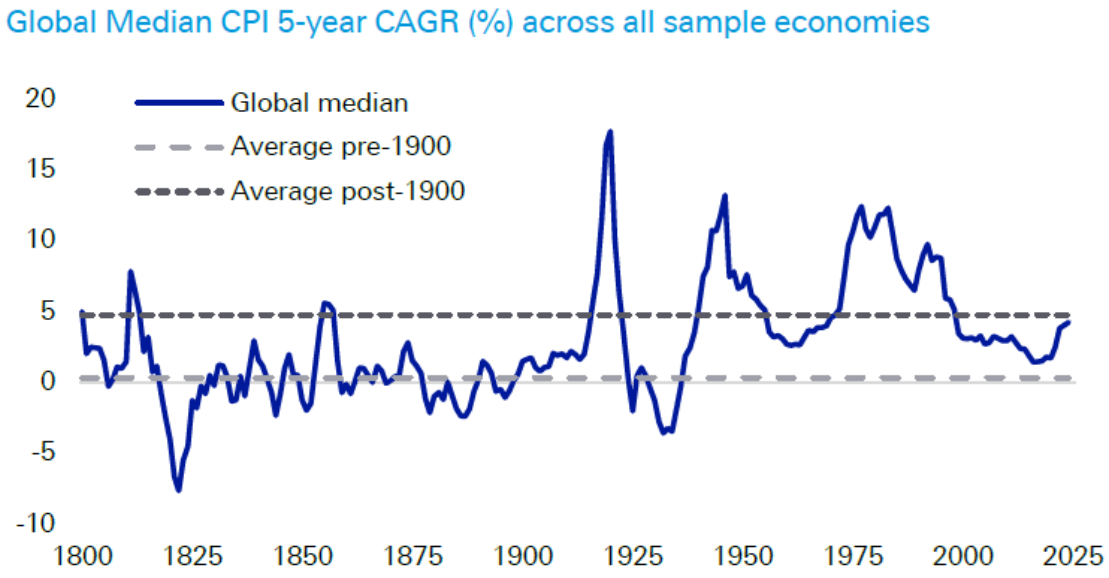
Here I'll attempt to answer those questions, so let's get to it.

We live in a structurally higher inflation world

I'm not sure about you but I look at the prices of lollies today and naturally compare them to the prices that I paid as a kid. It's hard to get my head around a lolly which cost me 20 cents as a child being priced at $2 now.

What most people don't realise is that the price hikes that they see on a day-to-day basis are part of a broader, global trend. Over the past century, and especially since the 1970s, we've lived in a structurally higher inflation world.

That's due to the world economy gradually loosening its ties to gold-based money, driven by shocks including the Great Depression, two World Wars, and the collapse of the Bretton Woods agreement.

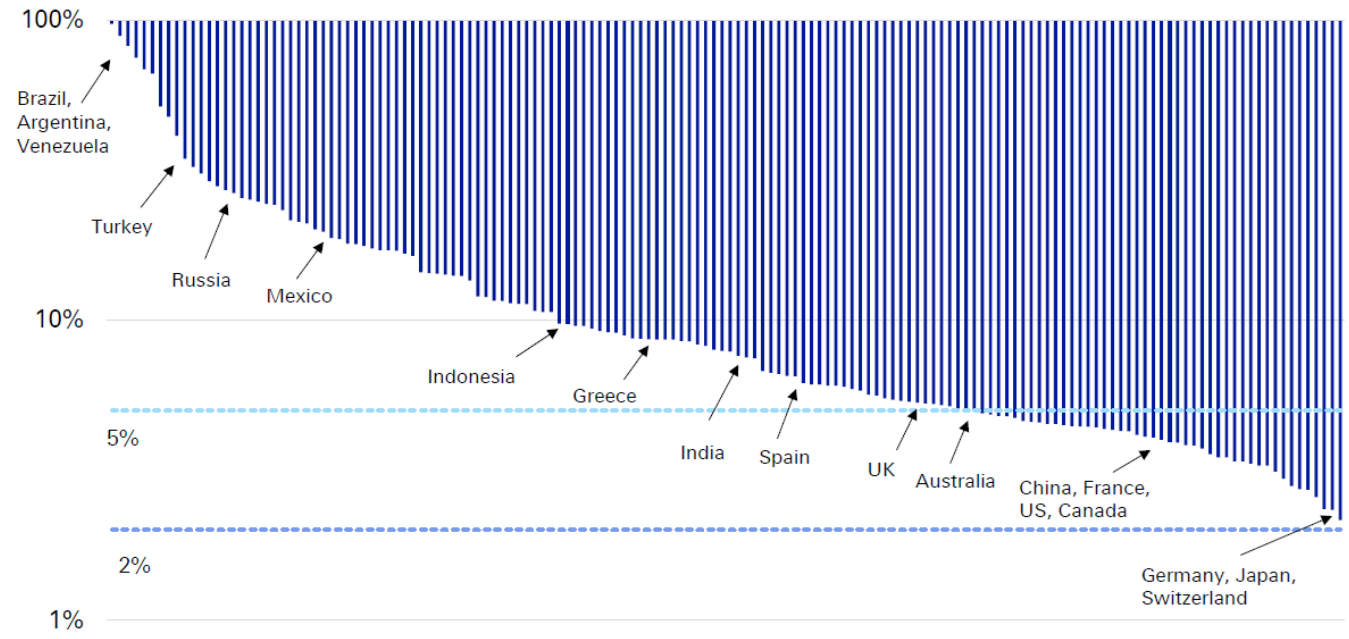


Source : Finaeon, Deutsche Bank. Note: through 2024.

It may surprise people that since the world went off the gold standard in 1971, inflation in Australia has averaged 5%. That's a big number – it means prices since then have doubled every 14 years or so. Which gives context to why my lolly prices have increased so much since my childhood.

The other thing that may surprise is that no country has managed to keep annual inflation below 2% since 1971. And only a handful of countries have kept annual inflation below 3% during that period.

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



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

This gives you context for the RBA's targeted inflation band of 2-3% and how achievable that may or may not be in the long-term.

So, while the media in Australia focus on inflation here, it really is a global issue.

That's not to diminish the fact that we do have higher inflation than many other developed countries right now and that there are idiosyncratic factors behind this.

Let's talk about housing

One key driver behind Australia's affordability problems is the high cost of housing. On some metrics, we have the world's most expensive homes.

Unbeknownst to most people, housing is largely excluded from official inflation figures. The Consumer Price Index (CPI) is considered a de-facto cost of living index and, though it includes rents, it excludes the cost of land and mortgage interest payments. Given that land accounts for 75% of housing values, it means a large chunk of house price rises aren't captured in the CPI.

Since 2000, the CPI has increased by 94%, but the median house price in capital cities has risen almost five-fold, from $200,000 to close to $1 million.

Even during 2025, the CPI increased 3.8%, while housing prices rose 12% in capital cities.

Index results as at 31st December 2025	Change in dwelling values				
	Month	Quarter	Annual	Total return	Median value
Sydney	-0.1%	0.8%	5.8%	9.0%	$1,280,613
Melbourne	-0.1%	0.8%	4.8%	8.5%	$827,117
Brisbane	1.6%	5.6%	14.5%	18.3%	$1,036,323
Adelaide	1.9%	5.1%	8.8%	12.7%	$902,249
Perth	1.9%	7.6%	15.9%	20.7%	$940,635
Hobart	0.9%	3.6%	6.8%	11.3%	$720,341
Darwin	1.6%	5.4%	18.9%	26.9%	$586,912
Canberra	0.2%	2.2%	4.9%	9.2%	$893,907
Combined capitals	**0.5%**	**2.7%**	**8.2%**	**11.8%**	**$991,331**
Combined regional	**1.0%**	**3.5%**	**9.7%**	**14.7%**	**$734,351**
National	**0.7%**	**2.9%**	**8.6%**	**12.4%**	**$901,257**

Source: Cotality

The CPI effectively ignores price changes in the single biggest purchase people are likely to make – a home. For the 37% of households that don't own a home though wish to, the CPI is an inadequate measure of changes in the cost of living. And most of that 37% are our younger people.

It's one of the reasons why many people feel costs are rising faster than the official inflation figures – because for them, they are.

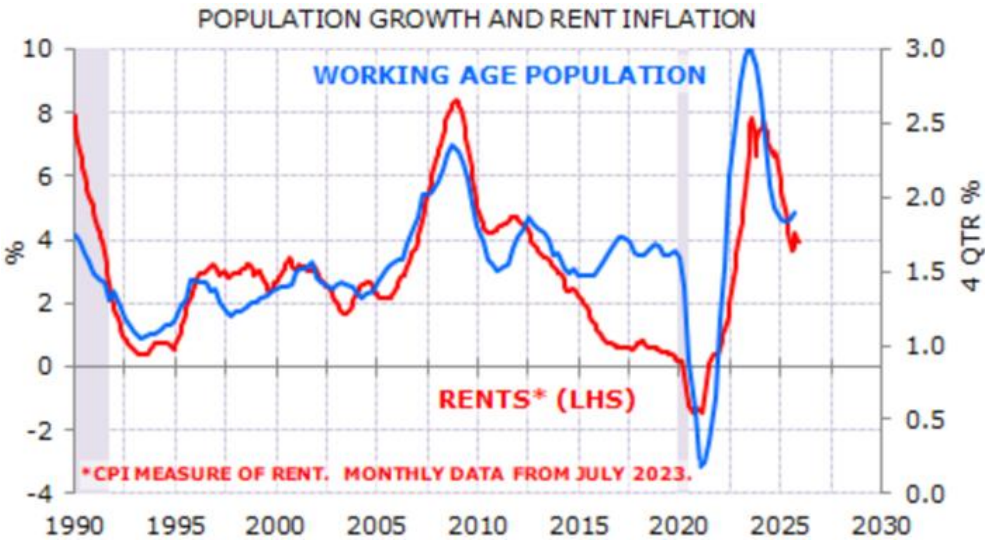
That's not to say that housing should be included in the CPI – there are good reasons why it isn't. It's just to acknowledge that the index doesn't fully capture the cost of living for a big part of the population.

Why isn't the "i" word mentioned?

Government spending has copped the blame for the recent inflation spike, especially from a certain financial newspaper. There's some justification for that as public spending blowouts have helped to push up demand for goods and services and crowded out more efficient private spending.

What hasn't been mentioned nearly enough, though, is the influence of immigration on higher inflation.

As economist Gerard Minack rightly points out, housing construction and rents are the two largest items in the CPI and they contributed to the rise in inflation in the second half of last year. And both are driven in part by population growth.



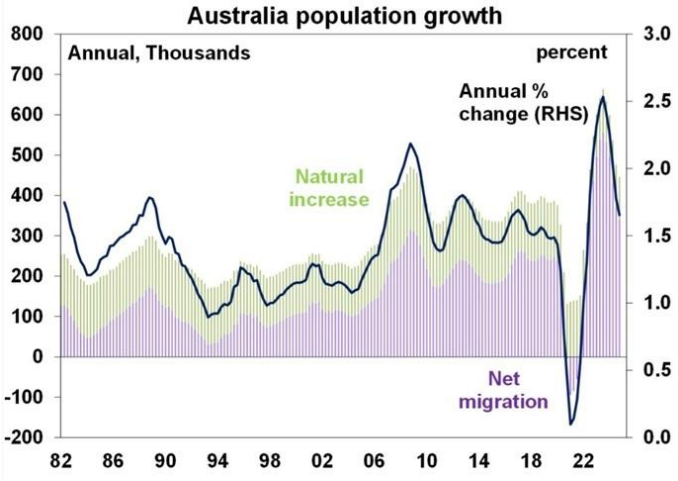
Source: Gerard Minack

From 1945 to 2005, Australia averaged net migration around 90,000 annually.

Since then, both major political parties have advocated a 'Big Australia' policy that's seen an unprecedented surge in our population.

The current Labor government has accelerated the migrant push, with net migration averaging 424,000 during its time in office.

There needs to be a mature discussion about the role that immigration has played in our cost of living crisis.



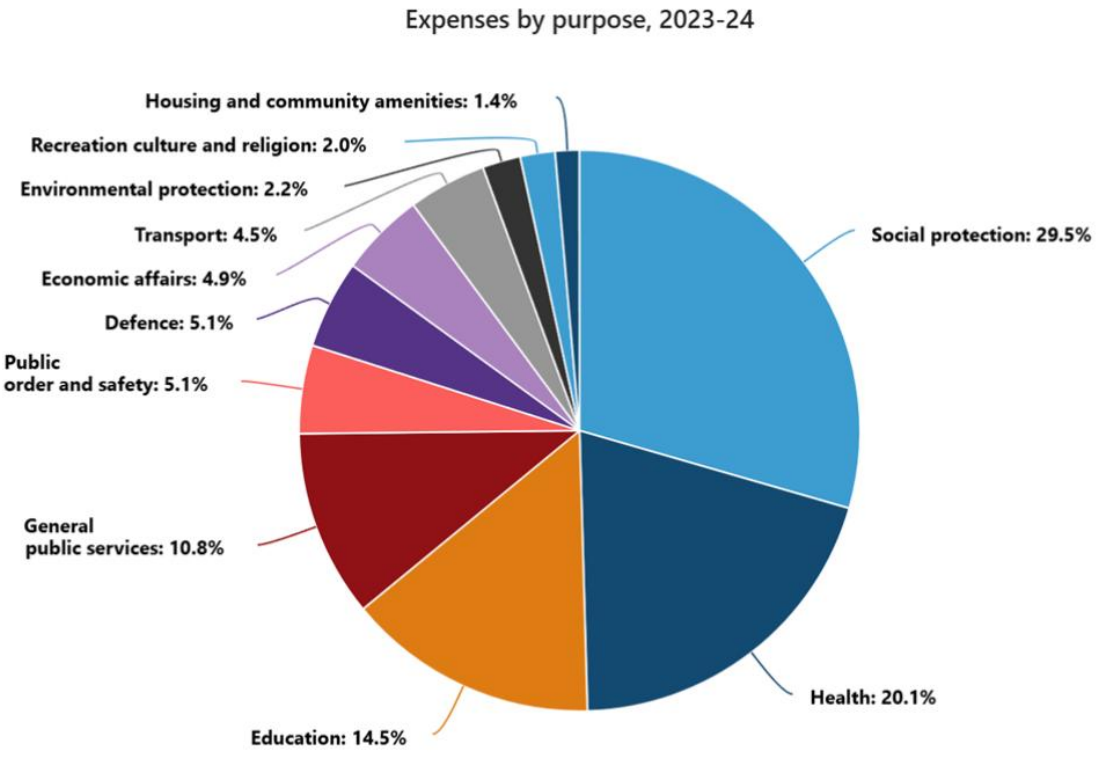
Yes, government spending isn't helping

As mentioned, there's little doubt that excessive government spending is playing some role in fuelling higher inflation. Government spending is now about 28% of GDP versus 21% a year ago.

Last financial year, federal government spending increased 8% after rising 9% the year before.

The problem for the current Labor government is that much of the spending appears structural rather than discretionary in nature.

Of the $758 billion in federal government spending, about 30% goes towards welfare, 20% to health, 15% to education, and 5% to defence.



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

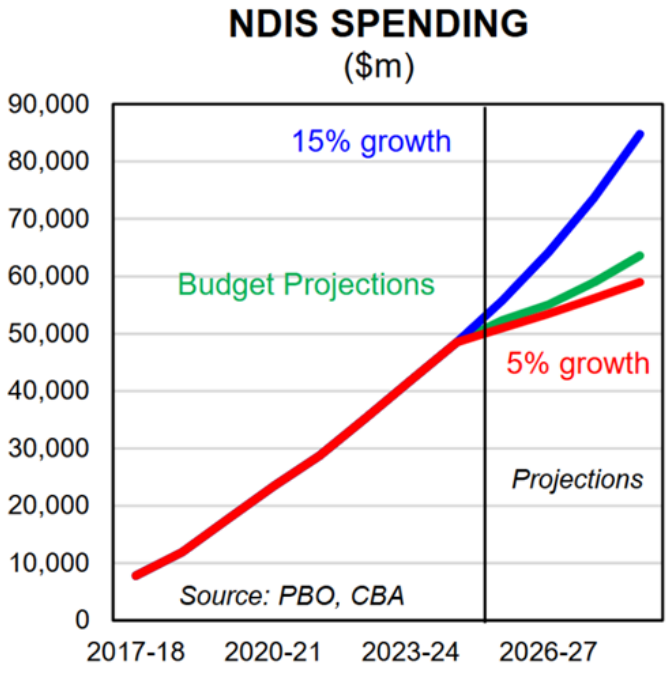
As Ben Walsh outlined in Firstlinks last week, defence spending will inevitably jump. Under pressure from the US to shoulder more of the defence burden, defence spending is projected to grow from $44.6

billion in 2026 to $56.2 billion by 2030 - a compound annual growth rate of 5.9%. As a percentage of GDP, this rises from 2.05% currently to 2.34% by 2032-33 under current government plans, with the opposition Coalition committed to reaching 3% of GDP within a decade. The US is pushing allies toward 3.5% of GDP.

Sources: SIPRI Military Expenditure Index and Australian government projections

The biggest issue for the government is growth in the National Disability Insurance Scheme (NDIS). It's gone from essentially nothing a decade ago to a $46 billion program now – about 6% of total government spending. And with forecast growth of close to 8% going forwards, that spending is on track to potentially double over the next 10 years.

Everybody, bar the government, seems to know that NDIS spending is out of control.



Over the Christmas break, I was speaking with a friend who is a chiropractor. He described how allied health businesses had restructured their practices to milk the most money from the NDIS program. He said some allied health services received little in NDIS funds, while others received quite a lot, and businesses had revamped services to make sure they raked in more NDIS money. He described the practice as widespread and very lucrative.

I believe him. I've personally worked with NDIS providers in recent years and have also witnessed rorting of the system.

Fixing our affordability problem

Curbing higher inflation involves addressing the issues that I've mentioned.

On housing, we obviously need to make it more affordable. In a recent article, 'A speech from the Prime Minister on fixing housing', I outlined a host of policies to tackle the problem. However, I thought that any individual policies weren't helpful without an overreaching goal and that the government should have a specific long target for house price growth – I suggested keeping them flat for the next decade.

Why aim for flat prices? Because if wages grew by 3% a year over the next 10 years, it meant houses would become more affordable for more people over time.

And this target would allow for a gradual adjustment in the housing market, without a big dip in prices.

In the article, I suggested a key, short-term fix to get house price growth down was to cut migration. I proposed reducing net overseas migration by half over the next 12 months. In my view, this would ease the pressure on rents, house prices, and inflation.

As evidence, I pointed to Canada which had clamped down on immigration over the past 18 months, and it's since had a meaningful impact on house prices and inflation.

Finally, the government must get serious about cutting spending by overhauling its NDIS program. Addressing widespread rorting of the scheme could wipe billions from government spending and ease inflationary pressure. If the government can't do this, then it needs to scrap the program and design a new one.

In sum, though we live in a structurally higher inflation world, Australia has particular issues that are making the problem worse. We need to aggressively deal with inflation lest we turn a temporary problem into a long-term one.

James Gruber is Editor at Firstlinks.

The Division 296 tax is still a quasi-wealth tax

Tony Dillon

While the latest Division 296 draft legislation may have dispensed with an unrealised capital gains tax component, it still has the whiff of a wealth tax about it. That's because the effective tax rate on earnings, including any realised capital gains, is tied to the Total Superannuation Balance (TSB) and not just the earned income itself.

Though technically not a wealth tax, because you actually have to earn income to be exposed to Div 296, the larger the TSB, the higher the effective tax rate on earnings, which makes it *feel like* a tax related to wealth.

Outside of super, two people with the same income pay the same tax regardless of net worth. Not so under Div 296.

For example, an SMSF with a $4 million balance would pay $18,750 tax on $100,000 income. While an $8 million fund would pay $24,375 tax on that income.

Acknowledging these are large balances, they serve to make a point. That Div 296 applies higher rates to larger balances, perhaps achieved via longer working lives or superior investment performance. Div 296 is effectively a balance-based tax with a retrospective feel.

A simpler alternative could've done the job

Yet the Div 296 link to wealth could have been avoided by instead setting up a progressive super income tax system, working the same way as the taxation of income outside super. Tax would be triggered solely by income, with marginal tax rates increasing with income. Such an approach would be more transparent, mainstream, simpler, and easier to sell than Div 296.

A progressive super tax schedule might look like the following:

Annual super earnings	Tax rate
Up to $150,000	15%
$150,001 - $200,000	25%
$200,001 - $500,000	30%
Above $500,000	40%

This schedule assumes a 'normal' earnings year of 5% on fund balance. The 15% rate up to a threshold of $150,000 is therefore anchored to 5% earned on a balance of $3 million, aligning with the Div 296 threshold below which earnings continue to be taxed at 15%. The 25% rate on $150,000 to $200,000 is a transition zone, then the 30% rate (the second tier Div 296 rate) up to $500,000 corresponds to a 5% return on balances up to $10 million. And the top marginal rate of 40% thereafter reflects the Div 296 effective upper bound.

Note: this progressive schedule applies to member balances in accumulation phase. Where a member also has a pension-phase component, a progressive super earnings tax can be accommodated by introducing a tax-free earnings threshold equivalent to the maximum pension balance. For example, a pension component capped at $2 million implies a tax-free earnings threshold of $100,000 when anchored to a 5% return (see Footnote for a pension phase schedule).

Let's compare total effective tax rates on earnings under the progressive schedule versus Division 296:

Scenario 1: Earnings rate 5%

Earnings rate	5.00%					
Balance	3,000,000	4,000,000	6,000,000	8,000,000	10,000,000	15,000,000
Earnings	150,000	200,000	300,000	400,000	500,000	750,000
Progressive tax rate	15.00%	17.50%	21.67%	23.75%	25.00%	30.00%
Div 296 tax rate	15.00%	18.75%	22.50%	24.38%	25.50%	30.33%

Example: $8 million balance, earnings $400,000.

- **Progressive** effective tax rate: 23.75% = ((150,000 x 15%) + (50,000 x 25%) + (200,000 x 30%)) / 400,000.
- **Div 296** effective tax rate: 24.38% = 15% x (1 + (8,000,000 - 3,000,000) / 8,000,000).

Scenario 1 shows a close alignment between effective progressive tax rates and Div 296 rates. But importantly, balances play no role under the progressive tax rate structure. Marginal tax rates progress according to earnings. The 15% tax rate still applies for ordinary outcomes expected on balances up to $3 million. Most accounts would never leave the 15% bracket, while higher earnings are targeted with higher tax rates. The tax rate would be determined purely by income, and not super balance accumulated to date.

Though the resulting tax rates are closely aligned in Scenario 1, to understand the flaws inherent in Div 296, we need to consider a poor earnings year.

Suppose the yearly earnings rate is only half that of a 'normal' year, at 2.5%:

Scenario 2: Earnings rate 2.5%

Earnings rate	**2.50%**					
Balance	3,000,000	4,000,000	6,000,000	8,000,000	10,000,000	15,000,000
Earnings	75,000	100,000	150,000	200,000	250,000	375,000
Progressive tax rate	15.00%	15.00%	15.00%	17.50%	20.00%	23.33%
Div 296 tax rate	15.00%	18.75%	22.50%	24.38%	25.50%	30.33%

Note, Scenario 2 Div 296 tax rates are unchanged from Scenario 1. That's because those rates are driven by account balances, not earnings amounts. But the progressive tax rates in Scenario 2 have dropped from Scenario 1, due to the lesser earnings amounts. Any alignment in tax rates has vanished.

We see here that Div 296 is aggressive at low earnings on high balances, but that the progressive based system is more forgiving on lower earnings (and more aggressive on higher earnings). This doesn't imply that the progressive system is too generous, rather that Div 296 imposes a higher tax rate on modest earnings when balances are large. That is, Div 296 is more onerous when returns are low relative to balances, but not when returns are strong.

Div 296 could therefore be seen to penalise more conservative portfolios. It's as if it assumes large balances will generate high earnings, and it will tax accordingly, even if those earnings don't eventuate.

So from a revenue perspective, 'normal' long-term return years should generate similar tax takes under both approaches. But in low return years, Div 296 will reap more revenue, while a progressive structure will collect more in high return years. Div 296 taxes regardless of performance, a progressive system is outcome-based.

In the end, Div 296 has the potential to penalise time and compounding. It is a complex tax, that uses existing savings as the basis for possibly higher tax rates.

Meanwhile, a progressive income-based tax structure avoids wealth-based proxies and debates around retrospectivity, and wealth taxes in general. It would be determined purely by income, and not balances accumulated to date. It would be administratively simpler and easier to explain, with no proportions of TSB above thresholds required. The messy design of Div 296 would be avoided.

Politics wins?

So what is the political motivation for Div 296 over a progressive tax system?

The political mood to address very large super balances is a core reason. It allows the government to argue that it is reining in 'excessive' tax concessions by taxing larger balances more. Even though on

average, a progressive earnings tax would also target high balances, higher tax rates driven by income renders a weaker 'excess balance' narrative.

And while the calculation method and magnitude of those concessions are debatable, what is not is the use of the super system as a tax-preferred environment to accumulate and shield wealth.

Div 296 also provides more predictable revenue, with effective tax rates more stable when a function of account balances rather than volatile earnings. Though this comes at the expense of fairness in outcomes.

Overall, both systems would likely drive similar long-term incentives and revenue. But the question remains whether a golden opportunity for simpler and fairer super tax reform has been missed.

Footnote

A progressive super tax schedule accommodating maximum pension account balance of $2 million:

Annual super earnings	Tax rate
Up to $100,000	0%
$100,001 - $150,000	15%
$150,001 - $200,000	25%
$200,001 - $500,000	30%
Above $500,000	40%

The $100,000 tax-free threshold reflects a capped $2 million pension balance, anchored to a 5% assumed return.

Corresponding comparison to Scenario 1: Earnings rate 5%

Earnings rate	5.00%					
Balance	3,000,000	4,000,000	6,000,000	8,000,000	10,000,000	15,000,000
Earnings	150,000	200,000	300,000	400,000	500,000	750,000
Progressive tax rate	5.00%	10.00%	16.67%	20.00%	22.00%	28.00%
Div 296 tax rate	5.00%	11.25%	17.50%	20.63%	22.50%	28.33%

Noting there is still strong alignment between progressive tax rates and Div 296 rates.

Example: $15 million balance, earnings $750,000.

- **Progressive** effective tax rate: 28.00% = ((100,000 x 0%) + (50,000 x 15%) + (50,000 x 25%) + (300,000 x 30%) + (250,000 x 40%)) / 750,000.
- **Div 296** effective tax rate: 28.33% = 15% x ((15,000,000 – 2,000,000) + (15,000,000 - 3,000,000) + 2/3 x (15,000,000 – 10,000,000)) / 15,000,000.

Tony Dillon is a freelance writer and former actuary. This article is general information and does not consider the circumstances of any investor.

Is it really 'your' super fund?

Jon Kalkman

Many people are encouraged to think that their super fund is much like a bank, where they deposit money, earn interest and draw the money out when they retire.

That is a mistake because super funds are nothing like banks. A super fund is structured as a trust. A trust is legal entity that means someone holds property or assets (e.g. money, shares or real estate) for the benefit of someone else. As I am not a lawyer, what follows is a layperson's understanding of the topic.

A primer on trusts

A trust is established when someone settles some assets under the care and control of someone who is appointed to manage the assets on behalf of and for the benefit of someone else. If I give you $1 million to care for my children while I undertake a hazardous mission, we have established a trust. I am the settlor, you are the trustee with a special responsibility, and my children are the beneficiaries of this arrangement. We will need to establish a trust deed which sets out the rules under which the trust will operate and what the trustee can and cannot do. This is a legal document, enforceable through the courts. Trust law goes back to the time of the Crusades.

As the trust is a separate legal entity, ownership becomes a really interesting question. Using the example above, I am no longer the owner of these assets as I have gifted them to the trust. My children don't own these assets either, because they are underage. The trustee doesn't own these assets because they are merely the custodians and managers of the assets on behalf of my children. To get around the problem, the trustee is considered the legal owner and must complete the tax return on behalf of the trust, but my children are the beneficial owners and collect the income and ultimately, the capital from this trust.

A good example is the way family trusts used to be a great place to hide assets when it came to the age pension. If you didn't own these assets, those assets couldn't be counted in the assets test and thus reduce your pension. The law was changed in 2002 to allow Centrelink to look inside a family trust. This law does not establish ownership but determines control of the fund and the source of these assets. If you control the assets in the trust or those assets came from you, all the assets in the trust are considered to be yours for the purposes of the assets test.

There are many different types of trusts. They are particularly useful in making provision for beneficiaries who cannot manage their own affairs, such as children with disabilities. Some trusts are established in your lifetime; others can be established in your will to take effect on your death. Nevertheless, all trusts follow the same principle: assets are managed on behalf of beneficiaries by a trustee.

All superannuation funds are a specific type of trust. That includes industry super funds and self-managed super funds. They all operate under the same superannuation law. Industry super funds are somewhat opaque in that regard as most people would have difficulty in identifying the trustee of their fund. With SMSFs, however, the issue is very real. The fund must have a trust deed and the decision to use personal trustees, or a company (corporate) trustee needs serious consideration.

Super funds are trusts

Because a super fund is legally structured as a trust, not a company or a bank, as a member, I am not an owner nor a shareholder. It means that I do not 'own' my wealth held in my super fund. It is merely held 'in trust' on my behalf as a beneficiary of the trust. Special laws were required to give the Family Court powers to split superannuation benefits in the case of divorce.

My status as a beneficiary, rather than an owner, has many implications. I do not elect trustees, and I cannot influence trustee decisions. Those assets do not become mine until released by the trustee. The distribution of my super benefits on my death is determined by the trustees, not by my will, because my will can only deal with the assets I actually own.

It also means that with a two-member SMSF, there needs to be special arrangements to ensure there is a trustee in place to make that distribution of super benefits on the death of the second member, otherwise there is no one with authority to operate the fund.

It is the fact that I do not own these assets that puts them beyond reach of creditors in the case of bankruptcy. In an SMSF, all members are trustees and all trustees are members but that does not change the legal relationship between members and the assets in the trust. One common mistake that SMSF trustees make is to regard the fund assets as their own so that they use the SMSF bank account for temporary personal loans. But they forget that any withdrawal from that bank account is a pension or lump sum payment from the fund and any deposit is a contribution governed by the contribution rules.

Most importantly, a super fund is a separate entity for tax purposes with its own tax file number (TFN). That is why, until now, ALL tax payable in superannuation on both contributions and fund earnings are paid by the fund, not the individual member. The proposed Division 296 tax changes, however, will mean that I, as a member, become responsible for the tax liability on the income and capital gains of another tax entity – the super fund.

Issues with the $3 million super tax

Div 296 is not a tax on super funds – it's an individual tax liability – but it's a tax based on the growth in assets that I do not own! I do not own the assets in my super fund held in a trust on my behalf. So how can I be held responsible for the tax on these assets?

How can I be responsible for the tax liability of another taxpayer?

Jon Kalkman is a former Director of the Australian Investors Association. This article is for general information purposes only and does not consider the circumstances of any investor. This article is based on an understanding of the rules at the time of writing and anyone considering changing their circumstances should consult a financial adviser.

Inflation is the biggest destroyer of wealth

Ashley Owen

Following two decades of 'low-inflation' in the 2000s and 2010s, inflation spiked up suddenly in 2021 after the Covid lockdowns unleashed a fiscal and monetary flood of cheap money. The 'return' of inflation in 2021 awakened a sudden resurgence in interest in the implications of inflation for investors.

Over the past couple of years, I have heard and read dozens of comments along the lines of: "Gee, we haven't had to worry about inflation for so long, but now it's back, we'd better take a look at inflation protection".

The problem is that most advisers and portfolios managers have only ever experienced the wonderful disinflation boom since the early 1990s – a period when declining inflation and interest rates boosted nominal and real returns from every asset class.

Great returns made every asset manager look good – even, and especially bond fund managers - but it was mostly just lucky timing.

That wonderful low-inflation era is now gone, and so are the great returns from every asset class that came with it.

Before 2021, there was a widely held belief (even by central bankers) that inflation had magically been 'solved', so we no longer needed to worry about it anymore.

If inflation does return to the target levels (2-3% range in Australia, 2% in the US) – that does NOT mean the problem has gone away.

Even 'low' inflation destroys wealth

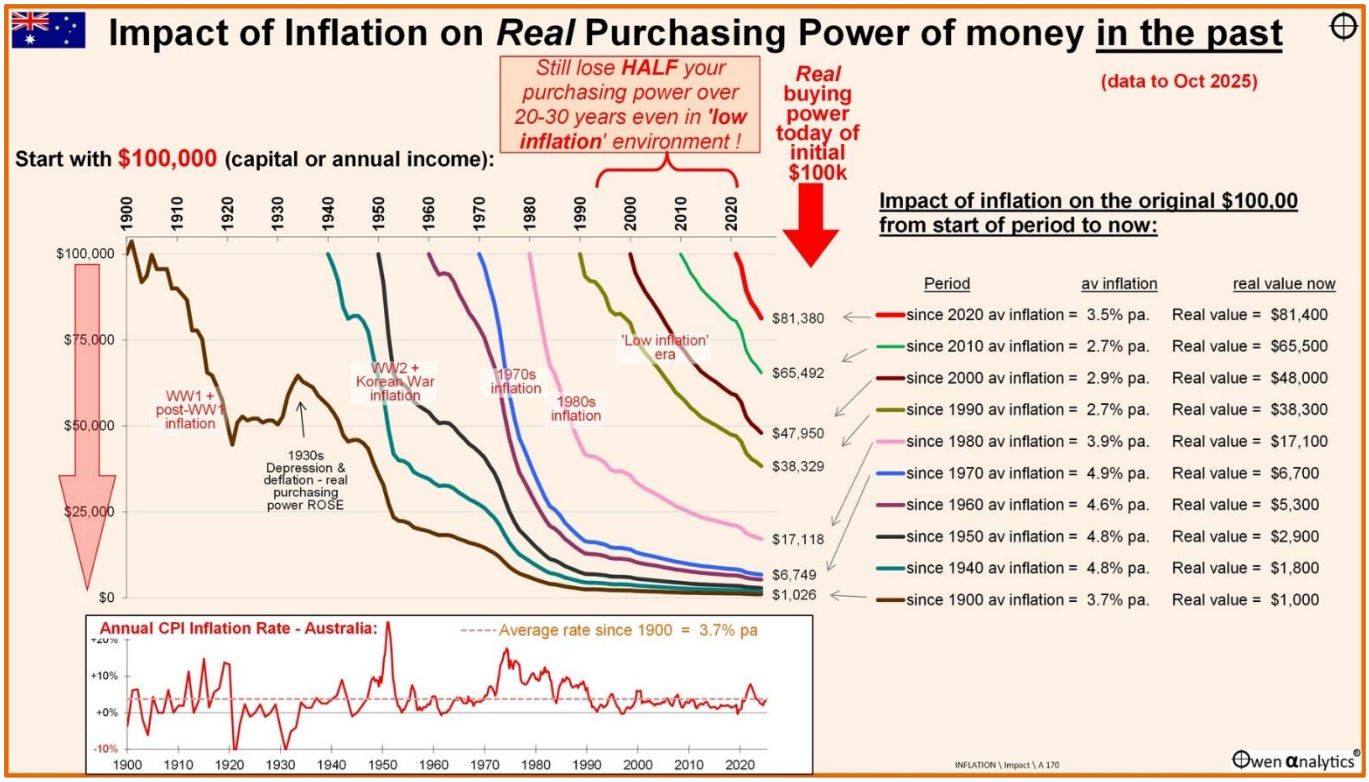
In reality, the wealth-destroying impacts of inflation never went away. Inflation has always been a silent, government-sponsored destroyer of the purchasing power of money, and therefore it critically important for investors, *even in so-called 'low inflation' years*.

This chart (next page) shows the impact of inflation in Australia on $100,000 in assets or income, from different starting points.

For example, take 1980 as a starting point (the pink curve near the middle of the chart). $100,000 of assets or income in 1980 was a lot of money at that time. Believe it or not, the median Sydney house price was just $69,000 in 1980! But $100,000 in 1980 dollars would have been whittled down to $17,000 in today's dollars due to the compounding effects of inflation.

Another way of looking at it is this: if you had $100,000 in paper dollars in 1980 and locked it in a safe, if you opened the safe today you still have that same $100,000 in paper money, but it would only buy $17,000 worth of today's goods and services. (Or, if you invested in bank term deposits in 1980 and you lived off the interest).

Inflation over the years since 1980 has eaten away 83% of its purchasing power.



With the 1980 'real' (ie after inflation) value line (pink line starting from 1980), we can see that the real purchasing power of $100,000 in 1980 decayed very quickly during the high inflation 1980s, but then the rate of value decay eased off (a less steep downward value decay curve) in recent decades.

The section at the bottom of the chart shows the annual CPI inflation rate in Australia since 1900. In the past 50 years, inflation was very high in the 1970s, then declined in the 1980s, and was relatively 'low' in the 2000s and 2010s decades.

Destructive impact during 'low inflation' years

The problem is that, even in the so-called 'low inflation' years, inflation still had a very serious destructive impact on wealth and incomes.

For me, the most remarkable feature of this chart is the fact that the value destruction curves are still steeply negative even during the so-called 'low inflation' years. Look at how steeply negative the lines are for money starting in 1990 (grey), 2000 (brown), and 2010 (green).

For example, $100,000 starting in 1990 has been eaten away to a purchasing power of just $38,000 today.

$100,000 starting in 2000 has been eaten away to a purchasing power of just $48,000 today.

Even in the ultra-low inflation post-GFC years, $100,000 starting in 2010 has been eaten away to a purchasing power of just $65,000 today. That's a big destruction of wealth and purchasing power in a relatively short period of time.

That's one third of our wealth and living standards gone – permanently destroyed – in the so-called 'low inflation era'.

2020s

In the current decade so far (up until October 2025), $100,000 at the start of 2020 has already lost 19% of its purchasing power, to just $81,000 today. We can see this in the short but very steep red value destruction curve to the right of the chart.

The downward slope of the 2020s wealth destruction curve is as steeply negative as the 1950s and 1980s wealth destruction curves on the chart.

The wealth-destroying effects of inflation *never went away*. Remember how central bankers dreamed about reviving inflation in the post-GFC years and in the Covid crisis - with their 'positive inflation targeting', zero interest rates, and their mad 'QE' (Quantitative Easing) money printing sprees. Likewise, governments with their free money hand-outs to anything that moved.

Well, they certainly succeeded in bringing back inflation (be careful what you wish for), and we are all paying for it now.

Unfortunately, even after more than half a decade after the Covid lockdown crisis, governments are still addicted to inflationary deficit-spending sprees.

And, for decades to come, our kids and grandkids will be paying for the debt that was borrowed by governments to fund the inflationary handouts. That's a double-whammy of wealth destruction governments and their central banks have handed our kids – thanks for the debt, and thanks for the inflation!

Compounding in reverse

We all know about the benefits of compounding on investments. Albert Einstein is attributed as saying: "Compound interest is the eighth wonder of the world. He who understands it, earns it ... he who doesn't ... pays it".

The destructive negative effect of inflation is *compounding in reverse* – Einstein's "he who doesn't [understand it] … pays it."

Long-term investors, especially those who are (or will in the future be) relying on their savings to fund their living expenses, are heavily exposed to inflation, even so-called 'low' inflation.

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

Picking the next sector winner

Anna Wu

In a recent email to his Wall Street Journal readers, Jason Zweig posed multiple-choice questions. The answers would provide investors with lessons.

The first started with a lead-in, asking readers to remember all those headlines about the US stock market being super concentrated in the 'Magnificent Seven', then he posed the question, "The S&P 500 returned 17.68% in 2025. What was the S&P 500's total return without the Mag 7?"

a. 10.36%
b. 1.36%
c. -1.36%
d. -10.36%

The answer is 10.36%. Well over 50% of the returns. The lesson Mr Zweig posits is that despite all the recent alarm about concentration, be wary of people wanting to sell you something riskier. This is the wrong lesson, investors should consider, rather, what sectors other than technology are driving the US share market's returns, and where else are opportunities. These could represent much more than 50% of the share it represented in 2025.[1]

Over the past three years, to the end of December 2025, global equities have delivered strong gains, with the S&P Global 1200 Index, a proxy for global developed markets, returning 23.16% per annum.[2]

Sector-level dispersion within the S&P Global 1200 has been considerable. Unsurprisingly, the information technology sector led with a 38.20% per annum return, followed by communication services 35.71%. Meanwhile, more defensive sectors were among the worst performers, with utilities gaining 12.80% per annum, followed by materials at 10.71% per year, then healthcare at 6.82%, energy at 6.77% and consumer staples at 5.97%[3]. (Note: The S&P Global 1200 Index is heavily exposed to US equities, with a 68% weight in the country as of 31 December 2025.)[4]

But the three-year numbers mask a recent trend. As we noted in our most recent quarterly viewpoint, over the three months to the end of December 2025, healthcare was the best-performing, and materials was the second best. Could it be that these sectors, in what was a positive market for global equities, helped drive the returns Mr Zweig highlighted above?

If momentum in these sectors continues, it will be important for investors to consider their approaches to them.

Materials (and energy and utilities)

The returns in the materials sector vary between sub-sectors, and within each of these sub-sectors, specialised skills are required to assess the materials being produced. This is where ETFs are useful tools for investors. Investors can cost-effectively invest in a basket of companies specialising in certain sub-sectors or industries.

Gold miners

A new year, and new queues in Sydney's Martin Place as investors seek the defensive characteristics of the world's oldest currency.

The latest ViewPoint highlighted why investors were lining up for gold during the last quarter of 2025, including highly valued share markets, excessive government spending, massive government debts and seemingly unchecked money creation. President Trump's military action in Venezuela stoked further geopolitical fears. It's little wonder some investors are on edge, driving demand for gold.

One of the beneficiaries of a rising gold price is the companies that mine it. Gold miners, as represented by the NYSE Arca Gold Miners Index (AUD), returned 139.81% over the 2025 calendar year. Should the price of gold rise further, so too could the price of gold mining companies. According to the ViewPoint, "We still think gold miners remain fundamentally undervalued relative to the metal itself. With all-in sustaining costs averaging around US$1,600/oz and current prices in excess of US$4,000/ oz, the result has been record margins across the industry. Miners are displaying improved capital discipline and stronger balance sheets, a key differentiator from previous cycles when high prices often led to overspending." Further, we think merger and acquisition activity in the sector will heat up.

Companies will be providing 2026 annual production and cost guidance when they report their 2025 fourth quarter results, starting at the end of February. The production cost sensitivity to the gold price appears, to us, to be well telegraphed. In our view, the gold miners sub-sector remains attractive. Even if the realised gold price doesn't offset the cost increases this year, gold mining companies' margins and free cash flow generation should be robust and remain above historical levels, at a time when their stocks still trade at historically low multiples.

Gold miners could be winners again in 2026.

Nuclear

One of the recent 'winners' within the global energy complex, capturing energy, utilities and mining companies has been nuclear. Demand for low carbon, efficient energy sources, primarily driven by the artificial intelligence sector, has resulted in a recent boom for uranium miners and nuclear energy infrastructure sectors. Some of the companies within the markets helped drive global equity markets in 2025 and this could continue into 2026.

Three key forces are currently powering the investment case for the nuclear energy ecosystem:

1. Increasing Electricity Demand: The International Energy Agency[5]projects that global electricity demand will increase by 3.7% in 2026, led by emerging economies such as China and India and powered by several trends, including:

- **Artificial Intelligence:** Advances in artificial intelligence and other data-heavy technologies are rapidly increasing the need for data centres and their associated power consumption.
- **Electric Vehicles:** Electric vehicle ownership is on the rise, along with a range of battery-powered machinery, all requiring electricity for charging.
- **Cryptocurrency:** The continued adoption of digital assets is adding to the world's growing power demand.
- **Climate/Heatwaves:** Intense heatwaves in many regions have contributed to this elevated electricity demand, straining local power grids.

2. Reliable, Clean Energy Source: Global efforts to reduce greenhouse gas emissions by building out renewable energy capacity have, by many accounts, fallen behind schedule. This has raised the profile of existing nuclear facilities and new construction as important components of the global energy transition.

- Nuclear energy has notably lower emissions compared to some renewable energy sources, and there are no limits on when nuclear facilities can generate power. Unlike wind and solar energy, which face the hurdles of calm winds and dark skies, nuclear energy can provide consistent and reliable power.

- Additionally, nuclear energy requires a fraction of the land compared to solar and wind, making it a compact and efficient source of electricity. For example, the average 1,000-megawatt nuclear plant in the United States needs about 1.3 square miles of land, compared to 31 times more land for solar and 173 times more land for wind.

3. Increased Regulatory Support[6]: An important tailwind for nuclear energy is the renewed support from many governments. Following the Fukushima nuclear accident in 2011, many countries deprioritised nuclear energy in favour of other sources. However, in recent years, many have reversed their stance or affirmed their commitment, recognising the critical importance of nuclear energy in the power mix:

- **United States:** The US has reversed course by choosing to extend the life of several nuclear power plants that were set to be decommissioned. Recently, the US Nuclear Regulatory Commission renewed the operating licenses at the North Anna Power Plant in Virginia, extending their operating lifetime by 20 years to nearly 2060. This trend is evident in many regions of the US.
  Legislative milestones such as the ADVANCE Act and the Inflation Reduction Act are providing critical support for nuclear technologies. The ADVANCE Act streamlines regulatory processes, fosters public-private partnerships, and accelerates innovation in small modular reactors (SMRs). Similarly, the Inflation Reduction Act bolsters nuclear energy's competitiveness by offering production tax credits, levelling the playing field with renewable sources like wind and solar.
- **Japan:** Despite Fukushima being fresh in their collective memory, Japanese leaders have begun taking steps toward expanding nuclear capacity. In late August, Prime Minister Fumio Kishida announced plans to hold a ministerial meeting to discuss measures needed to restart existing reactors at a Tokyo Electric Power Company facility.
- **China:** China has made significant, strategic investments in nuclear fusion. By some estimates, the Chinese government is spending around US$1.5 billion annually on fusion research, nearly twice that of the US.
- **Switzerland:** The Swiss Federal Council is set to reverse a 2017 voter-approved ban on the new construction of nuclear power plants.
- **India:** India's Department of Atomic Energy currently plans to deploy 50 small modular reactors in the country. They hope to create versions that can easily be deployed in older, non-nuclear power plants.
- **Norway:** Norway has entered into a memorandum of understanding with South Korea's DL Energy and DL E&C to explore the construction of a nuclear power plant at one of the country's oil refineries.

Health care

The recent improvement in returns, relative to the rest of the market, we think, reflects strengthening fundamentals in the health care sector. But taking a broad market capitalisation approach to global health care could leave investors with a long tail and potential concentration risks. Active managers make bets on who they think might be tomorrow's winners based on complex and risky factors such as drug trials, novel science and winning regulatory approvals. While others use a rules-based approach that targets companies that are attractively valued, while also targeting those that consistently deliver

growth. Such a GARP (growth at a reasonable price) approach has the potential to deliver greater rewards to investors over the longer term.

The MarketGrader Developed Markets (ex-Australia) Health Care Index, is calculated to select the 50 highest-rated health care companies across all developed markets outside of Australia, utilising MarketGrader's fundamentals-driven GARP framework. To put the index's selectivity into perspective, MarketGrader assesses 814 health care companies with a market cap of at least USD $500 million, representing its entire investable universe. Only 6% of eligible companies are selected.

Analysing the index's 50 constituents, 44 companies (88%) reported growth in trailing-twelve-month earnings per share (EPS) as at 31 December 2025, compared with a year earlier, with a median year-over-year growth rate of 20%. Importantly, this profit growth has been accompanied by solid top-line gains and meaningful margin expansion. Median quarterly revenue growth across the index was 8.2% versus the prior year, while median trailing-twelve-month revenue growth reached 8.7%. Median operating margins increased from 20.6% a year ago to 28.6%, and median net profit margins rose from 17% to 21.4% over the same period. Together, these results indicate broad-based operational improvement across the index's constituents.

A few constituents that delivered exceptional earnings growth are worth highlighting, including 3 companies that posted more than 300% gains in trailing-twelve-month EPS. They appear in Figure 1.

Figure 1. Companies in the MarketGrader Developed Markets (ex-Australia) Health Care Index with more than 300% last twelve months (LTM) EPS growth

Company	Country	LTM EPS Growth	LTM Revenue Growth
Incyte Corp.	United States	2098.0%	13.5%
Penumbra, Inc.	United States	1116.4%	11.7%
Globus Medical, Inc.	United States	315.7%	9.9%

Sources: FactSet & MarketGrader Research, 31 December 2025. This is not a recommendation to act.

The index's better known health care companies have also done well. For example, Eli Lilly & Co. (LLY-US) recorded trailing-twelve-month revenue growth of 76.0%, alongside continued margin expansion. Quarterly operating margins increased from 42.0% to 47.7%, while trailing-twelve-month margins improved from 37.8% to 44.4%. For a company of its scale, nearly US$1 trillion in market capitalisation with quarterly sales exceeding US$17 billion, these figures remain notable.

Johnson & Johnson (JNJ-US) also did well posting trailing-twelve-month revenue growth of 78.7%. Quarterly operating margin increased from 15.6% to 29.6%, and trailing-twelve-month operating margins rose from 23.5% to 25.8%, reflecting improved profitability across its diversified business lines.

Health care's strong end to 2025 could continue well into 2026, but selectivity will be key.

We think health care, gold miners, and those companies involved in nuclear energy production are well placed to contribute to the global share market's returns in 2026 and beyond.

Sources

[1] All the returns in US dollars. It is also worth noting that Australian investors tend to raise an eyebrow when US investors talk about concentration, noting that our own share market is more concentrated, and has been that way for some time.

[2] Source: Morningstar Direct. 31 December 2025. Past Performance is not a reliable guide to future performance. All figures are based on total returns, calculated in Australian dollars.
[3] Source: Morningstar Direct. 31 December 2025. Past Performance is not a reliable guide to future performance. All figures are based on total returns, calculated in Australian dollars. Indices used: S&P Global 1200 Communications Services Index, S&P Global 1200 Information Technology Index, S&P Global 1200 Utilities Index, S&P Global 1200 Materials Index, S&P Global 1200 Health Care Index, S&P Global 1200 Energy Index, S&P Global 1200 Consumer Staples Index.
[4] Source: S&P Global
[5] Electricity Mid-Year Update; IEA; July 2025.
[6] Global Nuclear News – 4w August; CLSA; September 2024.

Notes
'MarketGrader' and 'MarketGrader Developed Markets (ex-Australia) Health Care AUD Index' are trademarks of MarketGrader.com Corp. and have been licensed for use for certain purposes by VanEck. VanEck Global Healthcare Leaders ETF (HLTH) is based on the MarketGrader Developed Markets (ex-Australia) Health Care AUD Index, but is not sponsored, endorsed, sold or promoted by MarketGrader, and MarketGrader makes no representation regarding the advisability of investing in HLTH.

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What investors should expect when investing in infrastructure: yield

Magellan Infrastructure Investment Team

Dependable earnings growth is a core characteristic of the high-quality listed infrastructure companies in which we invest. Throughout past cycles we have seen consistent, solid returns. Given the earnings profile, operating models and potential for inflation protection that underpin these companies' assets, we expect this to continue. Moreover, we see sustained annual returns of CPI plus 5.0% over the investment cycle ahead for this asset class.

This expected return, of approximately 7.0%-8.0% annually, can be broken down into three key components: yield, inflation protection and capital growth. Yield is one of these building blocks and is unpacked in more detail below.

High-quality listed infrastructure companies provide consistent yield

In looking at historical data, high-quality infrastructure companies in our portfolio[1] delivered an average dividend yield of close to 4.0% over the past decade.

We've also seen that this yield moves in a tight range, through both up and down economic cycles. For example, in 2020, with the covid shock to the economy, and sizeable interest rate cuts, the average dividend yield for our portfolio[1] held in a range of 3.5%-4.5%.

Subsequently, in 2022-2023, when there was an inflation surge and sharp rises in interest rates, the average yield was maintained in this range. We see similar patterns in economic cycles further back in time. For example, in the global economic upswing in 2015-2016, which saw commodity prices rally, our portfolio again recorded an average dividend yield in the 3.5%-4.0% range.

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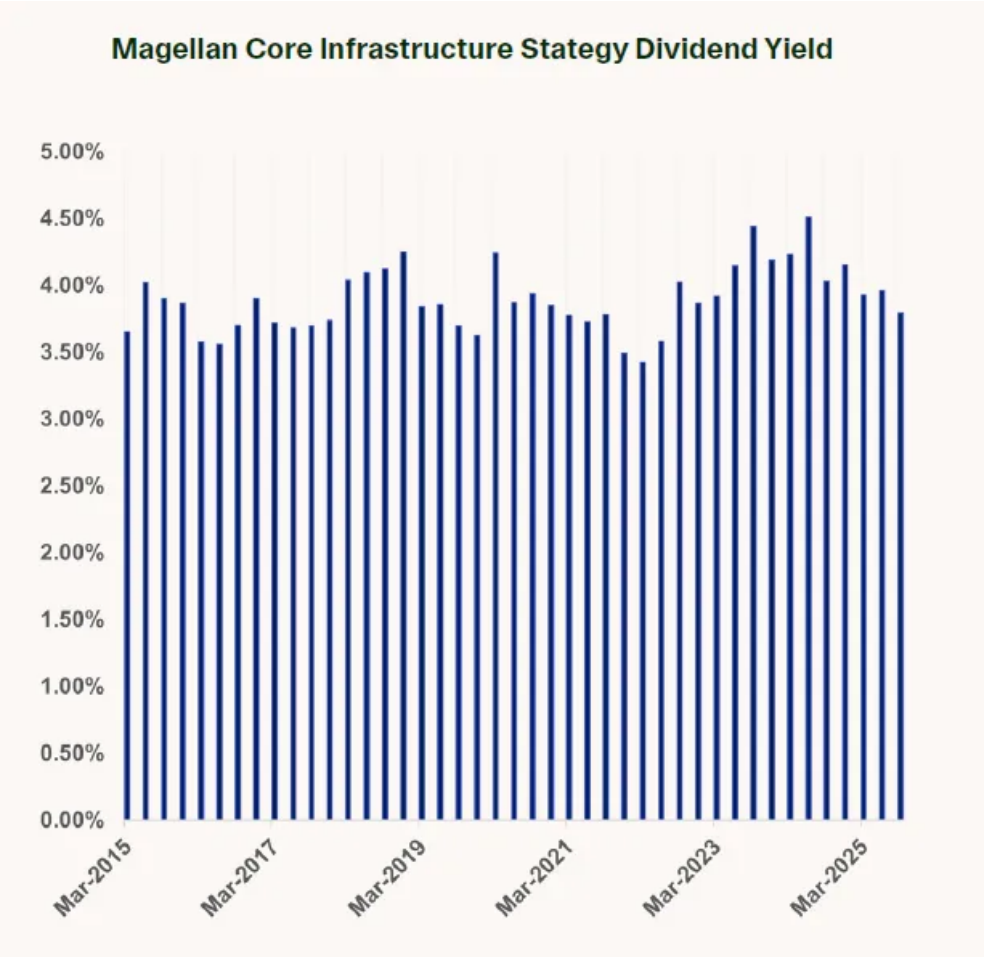

Source: Bloomberg. Magellan. The numerical information above is based on a representative portfolio. The representative portfolio is an account in the Global Core Infrastructure AUD Hedged Composite that closely reflects the portfolio management style of the strategy.

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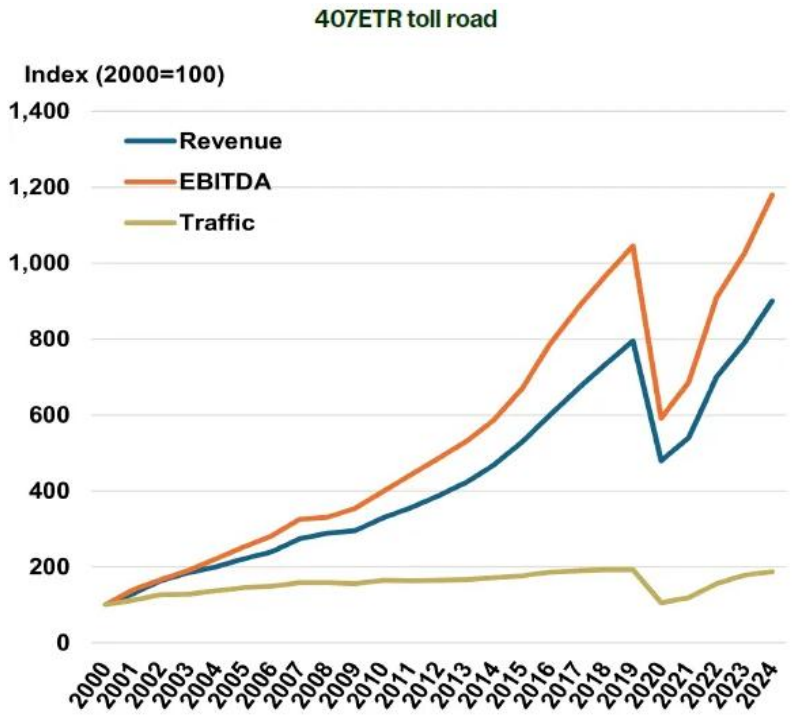
These examples highlight the stability of divided income yields to investors. The yield returned is consistent and largely unaffected by market cycles. Even in significant upswings and downdrafts, the yield does not deviate much from the long-term average of 4.0%. This is important, as it highlights the role of high-quality listed infrastructure as a diversifier in an investor's portfolio.

Stable businesses support stable dividends

Infrastructure companies can deliver consistent dividends because of the nature of their underlying assets. Fundamentally, infrastructure businesses provide essential services, which support predictable demand and income (for example, water services, or electricity). Earnings are typically secured in a regulated or non-competitive structure. For example, the Magellan Global Listed Infrastructure strategy invest in companies with the bulk of earnings (75% or more) sourced from high-quality infrastructure businesses that are predominantly natural monopolies or concession-driven businesses. Demand for the services these assets provide is typically stable. At the same time, many of these businesses have a regulated component to their earnings, which varies in its breadth but provides another parameter for certainty on earnings. This includes the regulated revenue allowance for utilities, regulated toll increases for toll road operators and regulated aero revenues for airports. As a result, these companies have a relatively stable cash flow profile.

To see what this looks like in practice, let's look at a few sub-sector examples. Toll roads illustrate this well, offering captive traffic flows and consistent revenue and earnings growth and reflecting operating leverage in their business model. The 407ETR toll road in Canada, owned by Ferrovial, is another example, shown in the chart below.

This road, like other high-quality toll road assets, captures the bulk of growth in traffic in its catchment. With the competing free road typically full at peak travel times, the toll road provides users with shorter transit times, with the added benefit that the concession allows for peak pricing and for different tolls for different segments based on demand.



Source: Magellan analysis of company data

Regulated utilities show a similar dynamic, with their earnings linked to the growth of their regulated asset base. These companies invest in new projects, with spending approved by their regulator, to meet growing power demand, improve asset resilience, or upgrade existing infrastructure. These companies then typically earn an agreed rate of return on this asset base – of around 9.0%-10% for US integrated power companies like Xcel Energy and WEC Energy.

High-quality airports (such as European airports including Aena) operate in regimes that entitle the operating company to earn predictable returns. This includes an entitlement to earn a fair rate of return on invested capital for aviation activities and provisions for minimum annual guarantees for commercial activities, such as retail.

Looking at these examples, we can see that well-defined infrastructure companies have the advantage of high barriers to entry, pricing power and a regulated operating environment. These conditions allow these companies to have stable revenue linked to their asset base rather than to the business cycle. Under this distinct model, infrastructure companies can then pay predictable distributions to investors.

Secular trends drive yield generation

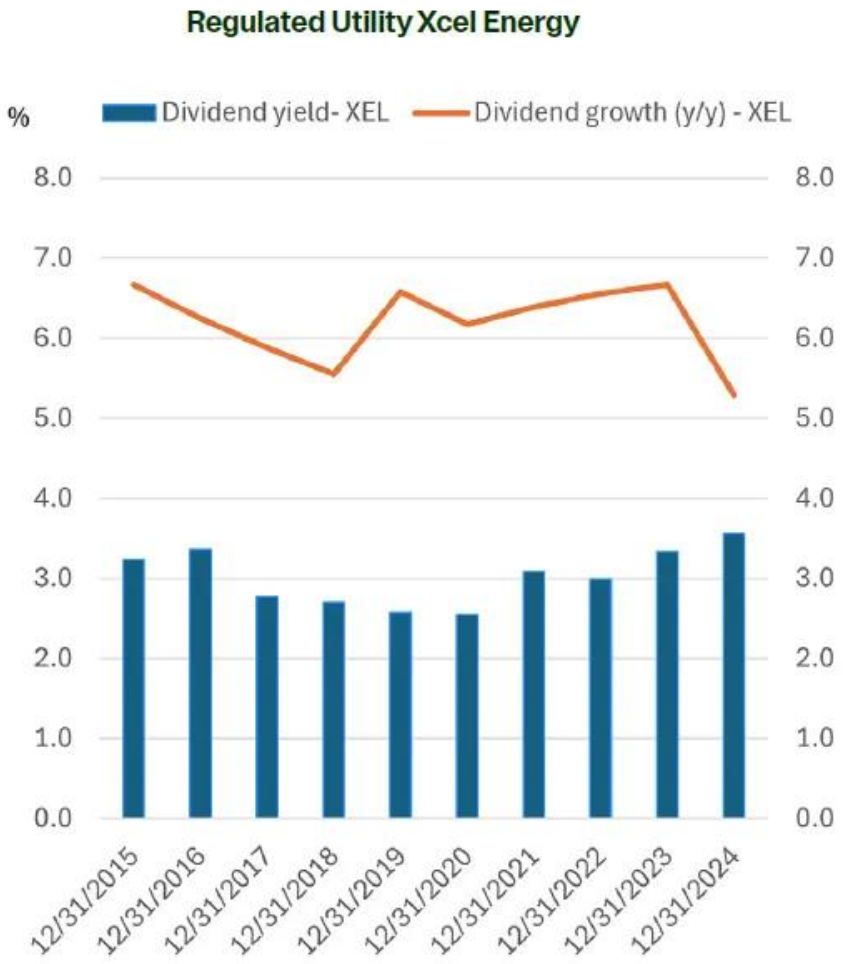
This is a snapshot of the translation of predictable demand and high-quality businesses into dividend yield at a point in time. Over time, there are clear catalysts for these companies to continue to generate yield, providing for durable returns to investors over an investment cycle.

In simple terms, steady growth in earnings over time can support higher dividends. The dividend yield can therefore comfortably hold ground for these companies, at around 4.0%. Major secular trends in the market at any given time can be linked directly to the ability of infrastructure companies to generate predictable earnings over the long term.

The rise of AI and ongoing demand for renewable energy generation are two such major trends. AI is expected to push electricity demand higher for years to come. That gives integrated utilities room to invest more, expand their asset base, and earn more on that capital. These allowable returns ultimately underpin dividends to investors. The resilience of renewable energy investment, reflecting improving cost competitiveness, also translates into greater capital investment for integrated utilities and transmission and distribution companies.

As these are regulated utilities, we see robust growth in capex again driving solid earnings growth over the longer term. Historically, this earnings growth has translated into dividend growth for investors (for example, with US regulated utilities typically recording 5.0-7.0% EPS growth, and similar dividend growth), which also helps to sustain dividend yield over time.

This is shown in the chart below for regulated utility Xcel Energy. The company demonstrates consistent dividend yield and dividend growth in the range of 5.0-7.0%, which is in line with its earnings growth over the last decade.



Source: Magellan analysis of company data

In addition, infrastructure businesses are highly cash generative, which supports dividend yield generation for investors over time. This is especially the case for transport infrastructure assets, which have often high levels of free cash flow. Management of these businesses can use the excess cash to maintain stable dividend yields to investors through special dividends and share repurchases, even in times of unfavourable stock price performance.

Durable yield and diversification benefits

We believe infrastructure investors can expect consistency in income over time, with some key drivers in place for self-sustainment. At around 3.5-4.5%, we view this to be an attractive income return and would highlight our expectations of limited deviations (up or down) from this dividend yield range. In fact, reflecting its business model and the nature of income streams, infrastructure is not typically seen by investors as the high-growth part of the portfolio. Rather, it plays the role of the consistent, slower-growing diversifier that can provide compounding and real capital growth over time. Infrastructure has also demonstrated outperformance in certain market environments.

We believe that high-quality listed infrastructure can be expected to provide a dividend yield of ~4.0%. This represents approximately 50%-60% of the CPI plus 5.0% return (7.0%-8.0% return) we would expect for the infrastructure asset class and underscores our confidence in achieving this outcome over the medium to long term.

Source

[1] Magellan Core Infrastructure Strategy (hedged and in AUD).

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Valuing AI: Extreme bubble, new golden era, or both

Jeremy Grantham

At GMO, we have always defined a bubble as a two-standard deviation divergence of the price of any asset class above its long-term real price trend. The U.S. stock market has now been in bubble territory for a prolonged period. Sooner or later, the bubble will burst, and the price will return to its historic level.

In our study of over 300 two-sigma bubbles across all asset classes for which we had good history, we identified a few genuine paradigm shifts in resources (why wouldn't there be, since all are finite?) including in oil after 1970, as well as in developing markets, such as India, as their economies became more capitalist. But in large, developed equity markets, two-sigma bubbles had always broken and retreated all the way to the pre-existing trend. We saw this play out in the U.S. equity market in 1929, 1972, and 2000, and in the U.S. housing market (a three-sigma bubble, the largest in any important U.S. asset class) in 2006.

But unlike every bubble before it, we have yet to see this from the December 2021 peak in the U.S. equity market, despite all the classic signs of a historic bubble top: crazy speculation, such as meme stocks, followed by a collapse of the most speculative stocks; and significant outperformance of quality stocks against the market. Yes, there was a handsome bear market in 2022 right on cue (-25% in the S&P 500, -35% in growth stocks, and almost -50% in the Magnificent 7), but this quite painful bear market was nipped in the bud, so to speak, by the introduction of ChatGPT in December 2022.

AI is a fast-moving and awe-inspiring invention that seems highly consequential—even world-changing—to almost everybody, myself included. It had an effect on what was then a deflating market of something like a multi-stage rocket. The rule from history is that great technological innovations lead to great bubbles. Especially when the technology is so obviously impressive—the science-fiction dream of a computer that can talk to you fluently, and that anyone with a phone can access anytime—that absolutely everybody will want to put their money in. This pattern of highly visible and self-evidently significant innovations leading to market euphoria, then to over-investment, and thus to severe market decline has repeated again and again throughout history, from railways to electricity to radio to the internet. AI is maybe the most visibly impressive innovation of the last 100 years, perhaps of a

magnitude equal to the railways of the 19th century. It should not be surprising that it appears to be moving through the same pattern both rapidly and powerfully.

AI is certainly still an immature technology. Possibly the biggest problem with current large language models (LLMs) is that their mistakes, or 'hallucinations', are so plausible. As we searched through the scientific literature on toxicity and fertility, they made up multiple reasonable-sounding studies with agreeable and convenient results, complete with realistic-looking citations, and mixed them in among real scientific papers. They make exactly the kind of errors that you would not catch at a casual glance, or indeed, errors you would prefer not to catch. But current LLMs are hopefully (hopefully for investors, certainly) just an opening phase in AI progress—just as in the past, similarly amazing innovations had bubbles and busts before reaching a maturity in which, after digging out of their earlier collapses, they often surpassed the wildest dreams of the early speculators. If AI can start to make advances in biotechnology, materials, and energy, or even to start improving itself, the future could be very interesting indeed.

As to what happens if (or when) AI becomes far more intelligent than us, the recent book, *If Anyone Builds It, Everyone Dies* (Yudkowsky and Soares 2025), is a chilling and very persuasive read. The authors' analogies and detailed examples serve as powerful reminders of our innate optimistic bias. And optimism is perhaps the most central and critical of our biases. It may indeed be that optimism has been a real help to our survival and success as a species. Now, however, with the last saber-toothed tiger long gone, our optimism causes us humans to have trouble with bubbles and financial crises, as well as other unpleasant but powerful developments, such as climate change and toxicity. When in doubt, we assume the best—despite history telling us repeatedly that things have turned out badly all too often. Over the whole of history, for example, more technologically advanced civilizations have crushed less advanced ones mercilessly and often casually, as if the damage was all incidental. And not just human history, but biological history too: no invasive species has yet made friendly allowances for other species. I'm sorry, Dave (as HAL said), I'm afraid that's the way it is.

On the other hand, in the last century or so, as we have advanced scientifically and culturally, we've come to value other groups, tribes, and even species, more and more. So there is a chance that an even more advanced intelligence than ours may follow us in this regard. As wishful thinkers, most of us will certainly expect that. But if we were much more intelligent, we would have done a much better job of dealing with long-term problems than we have so far. With just our intelligence and self-interest, we should have done a much better job than we have done so far of preserving our commons—clean air, clean water, fertile soil, and 2.1 healthy children per family. AIs may have some chance of concluding that it is we, the humans, who are the biggest danger to life on earth! And they would be quite justified in doing so.

But as far as risks like that go, markets very seldom even try to predict important change. In complete contrast, markets extrapolate today's conditions into the distant future. Thus, in a deep recession, the market's PE ratio is extremely low. Consider the December 1974 bear market bottom, at 7.5 times earnings. Not only were the then-current earnings crushed, but their predicted recovery—reflected by the PE—was remarkably slow despite a long history of quite rapid mean reversion to the contrary. Conversely, in economic booms with peak earnings, high PE ratios signal continued abnormally strong long-term economic growth. So in October 1929, wonderful earnings were multiplied by the then-record PE of 21 times, not matched until 1972, which had similar peak earnings. More recently, in March 2000,

we saw an all-time record PE of 35 times, multiplying record earnings once again. And here we are today, with investors extrapolating record earnings, continued rapid advances in AI technology, and a strong recent economy, discounting the future as if these conditions are guaranteed forever.

What is more likely, instead, is that when investor confidence sooner or later reaches its limits, the deflating of the AI bubble will lead to a major stumble for the economy, a plunge in profits, and a severe decline in valuations. For now, though, the key signs of a major bubble top—a collapse of the most speculative stocks, pronounced outperformance of quality stocks, and usually, a slowing of the rate of rise of the broad market—are not yet evident.

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