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Editorial

The economic impacts of the war in Iran continue to dominate headlines. Investors are following their typical playbook and rushing into the 'obvious' winners of the turmoil in the Middle East.

For instance, there are higher oil prices. Over the previous month the following energy companies have performed well:

- Exxon Mobil is up 12.44%
- Chevron is up 12.82%
- Shell is up 15.42%
- Santos is up 17.75%
- Woodside is up 18.51%

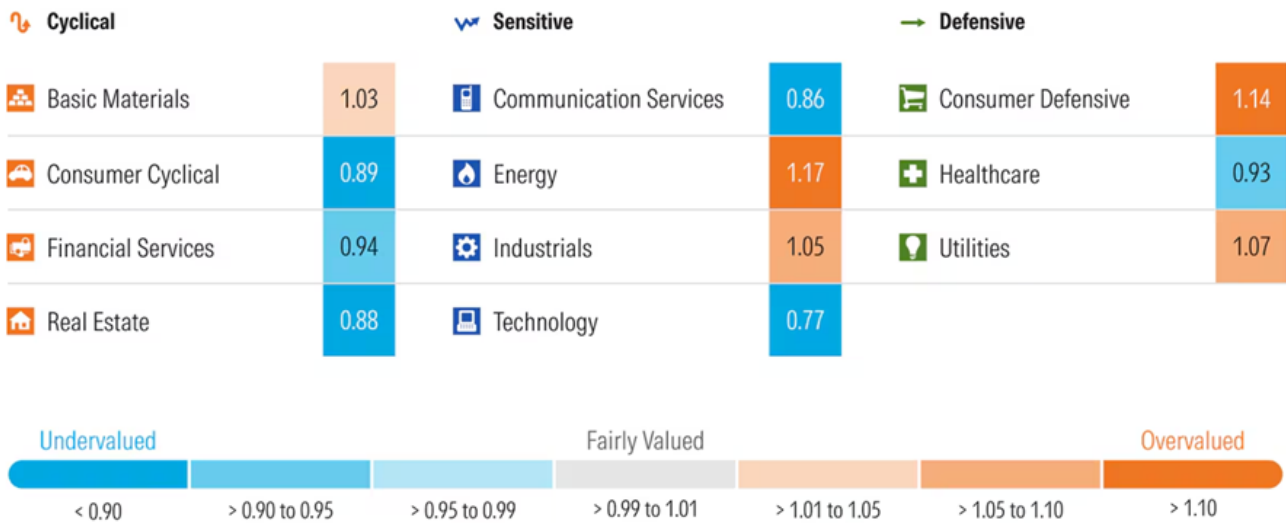
Yet investors viewing the market through the prism of the current challenges and opportunities arising from the geo-political mess we find ourselves are being short-sighted.

Long-term returns are driven by a mismatch between valuation and prices. The following chart shows the price to fair value on the US market according to our analysts.

The cheapest sectors are the ones most maligned in our current environment. The Technology and Communications sectors are being hit by fears about the impact of AI. Inflation concerns are driving weak performance in the Consumer Cyclical sector.

Those cheap valuations don't mean there aren't legitimate problems. AI is disrupting the previously strong moats of many leading companies in the software space. The longer the war goes on the greater supply chains are being impacted. As COVID demonstrated this can drive inflation which is difficult to reign back in.

Morningstar Price/Fair Value by Sector



Source: Morningstar Research Services, LLC. Data as of March 23, 2026.

Prevailing narratives may be true. But investors historically have overreacted to narratives on both the upside and downside. The constant drumbeat of headlines reinforces this tendency.

It is easy to invest using first order thinking – for example, oil is more expensive which is good for oil shares and bad for consumer spending. It is much harder to stay multiple steps ahead of our current situation.

What to do right now

Successful investors will focus on where the world will be in 10 years. That isn't easy but it beats trying to interpret each tweet out of the White House.

Remember that when investors are anxious and there is volatility they tend to make poor decisions. Much of the advice coming from the more sober commentators is to 'not panic.' This is well meaning and meant to be helpful.

But people generally don't panic. Instead, people rationalise their way into decisions that hurt their long-term interests. We describe investors as capitulating. Yet nobody would describe their own actions as capitulation. And that disconnect between how people see their actions and how they describe the actions of others matters.

Investor returns are influenced by the timing of buy and sell decisions. The gap between investment and investor returns is an indication of how poor we are at making decisions. Each poor decision is a point of failure. The cumulative impact was a 1.10% gap between investment returns and investor returns over the previous decade in Morningstar's latest *Mind the Gap* study. Collectively investors are not up to the challenge in the best of times.

Given this is an annual study, the size of the gap will fluctuate each time we run a new set of data. Over time we've noticed several patterns. The gap widens if there is more volatility. This is evident when different types of investments have different levels of volatility—say share ETFs and bond ETFs. The investor gap is bigger for share ETFs than bond ETFs. It is also evident when different periods of time have different levels of volatility.

For instance, in 2019 the gap was around 1%. In 2020 with turbulent markets in response to COVID the gap widened to close to 2%.

You are far more likely to make a mistake in times like this. Slow down your thinking and scrutinise each decision more than you normally would. It might just pay off in the long-run.

Mark LaMonica

Also in this week's edition...

From 1 July 2026, major superannuation caps will increase due to indexation. **Julie Steed** outlines the [rates and thresholds that are changing](#) and those that aren't.

Inflation continues to worry investors and policy makers. **Michael Collins** explores how central banks are [reconsidering inflation targets](#).

As data mining capabilities have increased and AI has advanced, investors have sought to identify factors that led to alpha or outperformance. **Larry Swedore** examines a study suggesting a new mindset is needed for investors looking to [generate superior returns](#).

Many investors believe a 'balanced' portfolio is the best of all possible worlds. But **Werner du Preez** believes [hidden concentration risk](#) may be lurking under the surface.

Investors are fleeing bonds given projections of higher inflation and a hawkish response by the RBA. **Phil Strano** sees some benefits for investors willing [lock in attractive rates of income](#).

The only thing that matters is the return that ends up in your pocket. **Emma Davidson** looks at [after-tax returns on LICs](#) and the opportunity for LIC providers to provide more return transparency for investors.

Jow Wiggins explores the [impact on decision making](#) from an "availability cascade" as investors lose sight of the long-term while their attention is focused on each successive short-term risk.

This week's white paper from the **World Gold Council** looks at the [role of gold in 2026](#) for Australian investors.

Curated by Mark Lamonica and Leisa Bell

Indexation implications – key changes to 2026/27 super thresholds

Julie Steed

The Australian Bureau of Statistics has released the average weekly ordinary time earnings (AWOTE) and consumer price index (CPI) figures which are used to determine key superannuation rates and thresholds that will apply from 1 July 2026. This article outlines the rates and thresholds that are changing and those that aren't. It also explains key considerations and opportunities in the lead up to 30 June 2026 and beyond.

Transfer balance cap

The transfer balance cap (TBC) limits the amount of superannuation that can be used to start a pension, where the investment returns are generally tax free. The TBC was introduced from 1 July 2017 at \$1.6 million and is indexed periodically to the CPI in \$100,000 increments.

From 1 July 2026 the transfer balance cap will increase from \$2 million to \$2.1 million.

Contributions

All key indexed thresholds that impact contribution planning will increase from 1 July 2026.

Total super balance

The value of the general transfer balance cap is used to determine the total super balance threshold which impacts eligibility for making non-concessional contributions and spouse contributions, as well as receiving Government co-contributions. This will increase to \$2.1 million from 1 July 2026.

When determining eligibility for contributions, the total super balance is measured at the previous 30 June, not at the time a contribution is made.

Concessional contributions

The concessional contributions cap is indexed to AWOTE in \$2,500 increments. The concessional contributions cap will increase to \$32,500 from 1 July 2026.

This also impacts the concessional contributions that can be made under the five-year catch-up concessional contribution rules by individuals who have a total super balance at the previous 30 June of less than \$500,000. The five-year catch-up total super balance threshold is not indexed.

Individuals who have a total super balance on 30 June 2026 below \$500,000 could have a potential a concessional contribution cap of up to \$175,000 in 2026/27. This includes the 2026/27 cap of \$32,500 and the maximum of \$27,500 for 2021/22, 2022/23, 2023/24, \$30,000 for 2024/25 and 2025/26.

Remember that the current year's concessional contribution cap is always used before applying any catch-up contributions.

From 1 July 2026, any unused concessional contributions from 2020/21 or earlier will no longer be available to use. This means that 2025/26 is the last year that individuals can use any unused concessional contribution cap from 2020/21.

Non-concessional contributions

The non-concessional contributions cap is calculated as four times the concessional contributions cap. From 1 July 2026 the non-concessional contributions cap will increase to \$130,000.

The two- and three-year bring forward limit also increase to \$260,000 and \$390,000 respectively from 1 July 2026.

The total super balance thresholds for determining eligibility to make non-concessional contributions will change, as outlined in the table below:

2025/26		2026/27	
TSB on 30 June 2025	NCC cap	TSB on 30 June 2026	NCC cap
< \$1.76m	\$360,000	< \$1.84m	\$390,000
\$1.76m < \$1.88m	\$240,000	\$1.84m < \$1.97m	\$260,000
\$1.88m < \$2.0m	\$120,000	\$1.97m < \$2.1m	\$130,000
\$2.0m +	Nil	\$2.1m +	Nil

Importantly, the two- or three-year bring forward maximum contribution is based on the non-concessional contributions cap at the time the two- or three-year bring forward is triggered. There is no benefit from indexation in 2026/27 for individuals who triggered a bring forward in 2024/25 or 2025/26.

Example

Oscar triggered the three-year bring forward in 2024/25 by making a \$150,000 non-concessional contribution. In 2024/25 the maximum three-year bring forward was \$360,000. Oscar can contribute a further \$180,000 prior to 30 June 2027 (subject to their total super balance). Oscar doesn't benefit from indexation of the non-concessional contributions cap during this time.

Thresholds not indexed

The \$500,000 threshold for accessing the five-year concessional catch-up contributions is not indexed. In addition, the \$300,000 total super balance threshold for determining eligibility for the work test exemption is not indexed.

Historic rates and thresholds

The table below summarises the history of the rates and thresholds:

Item	Indexed to	Since 1 July 2017	From 1 July 2021	From 1 July 2023	From 1 July 2024	From 1 July 2025	From 1 July 2026
Transfer balance cap	CPI	\$1,600,000	\$1,700,000	\$1,900,000	\$1,900,000	\$2,000,000	\$2,100,000
Total super balance	CPI	\$1,600,000	\$1,700,000	\$1,900,000	\$1,900,000	\$2,000,000	\$2,100,000
Concessional contribution cap	AWOTE	\$25,000	\$27,500	\$27,500	\$30,000	\$30,000	\$32,500
Non-concessional contribution cap	4 x CCC	\$100,000	\$110,000	\$110,000	\$120,000	\$120,000	\$130,000
Two-year bring forward		\$200,000	\$220,000	\$220,000	\$240,000	\$240,000	\$260,000
Three-year bring forward		\$300,000	\$330,000	\$330,000	\$360,000	\$360,000	\$390,000

Summary

The superannuation rules changed dramatically in 2017 and introduced a variety of thresholds that determine eligibility for certain tax concessions and the ability to make contributions. The indexation of the thresholds adds an additional layer of complexity from 1 July 2026. Understanding the additional complexities will assist individuals to maximise the opportunities available within super in both 2025/26 and 2026/27.

[Julie Steed](#) is a Senior Technical Services Manager at MLC TechConnect. This article provides general information only and does not consider the circumstances of any individual.

Central banks need higher inflation targets

Michael Collins

In 1971, an uncle of Don Brash, the governor of the Reserve Bank of New Zealand from 1988 to 2002, invested the proceeds from selling his fruit farm in 18-year government bonds yielding 5.4%. At that time, the uncle's NZ\$30,000 could buy 11 four-cylinder cars.

But when the bonds matured in 1989 the NZ\$30,000 could buy only one of those cars. Inflation, of course, had killed the bond investment's purchasing power.

Brash used this and other anecdotes to explain how the social injustices of inflation prompted the RBNZ to a world first in 1990 when New Zealand's inflation was 8%. That year the central bank and the government formalised an inflation target between 0% and 2%. The pact said the goal must be met by 1992.

The RBNZ's success in crushing inflation to below 2% in less than half the time prompted politicians the world over to gift central banks the autonomy to meet inflation targets of around 2%. – about 150 of the world's 200-odd central banks are judged to be depoliticised inflation fighters.

The move to 'independent' central banking ushered in decades of price stability (even if the coincidental rise of China and technological advancements helped). Such became their aura, central bankers epitomised the Davos ideal of a world run by the technocratic elite.

Those days are gone for the foreseeable future. The Israeli-US attack on Iran has sparked an inflation shock, foremost so far from higher energy prices, while impeding economic growth. The re-emergence of the 1970's curse of 'stagflation' will expose the social and political limits of monetary policy as an inflation-fighting tool.

Higher interest rates are an inadequate macro-economic weapon to control prices because they only target indebted businesses and consumers, notably mortgaged families in the case of the latter – about one-third of households in Australia.

If the object is to reduce demand to anchor the public's outlook for inflation and thus avoid a wages-price spiral, measures such as fiscal tightening are needed to spread the burden of taming inflation. Otherwise, interest rates need to rise to levels that cripple the indebted to achieve the same reduction in demand.

As the economic, political and social costs of primarily relying on monetary policy to combat inflation manifest, policymakers will seek other solutions. Part of the conundrum to solve is that monetary policy is innately political. Monetary settings including inflation goals must resolve the competing interests of debtors and creditors and savers and spenders. When inflation is elevated, the conflict of interests intensifies to a trade-off between the future jobless against reduced inflationary pain for others – essentially the question becomes how high might be an acceptable rate of unemployment.

One appealing solution might be to lift inflation targets so the blows to the indebted, employment levels and economic growth can be softer.

One way to do that would be to raise inflation targets to, say, 4%. In 2020, the Federal Reserve veered in this direction when it scrapped a 2% inflation ceiling for an average target of 2%. That meant the US central bank would let inflation exceed 2% "for some time" if it had undershot that figure. Such higher inflation targets would ease the monetary-policy squeeze and erode real debt burdens.

While many central banks only target low inflation, some including the Federal Reserve and the Reserve Bank of Australia have two main goals – tame inflation and full employment – that in conventional economics are mutually exclusive. A way to formalise this trade-off would be to target nominal gross domestic product.

Nominal GDP is the dollar value of an economy's output before it is adjusted for inflation to derive real GDP.

Economists suggest central banks target, say, 5% for nominal GDP, where the ideal outcome would be 2% inflation and 3% real GDP growth.

Among advantages, targeting nominal GDP implicitly contains 'forward guidance' and lowers the risk of boom-bust cycles by avoiding the rigidity whereby inflation close to 0% pressures central banks to cut rates even if the economy is thriving. The target better copes with shocks because it tolerates faster inflation when economies are struggling. Inflation, in theory, could reach 7% if the economy is shrinking 2% in real terms.

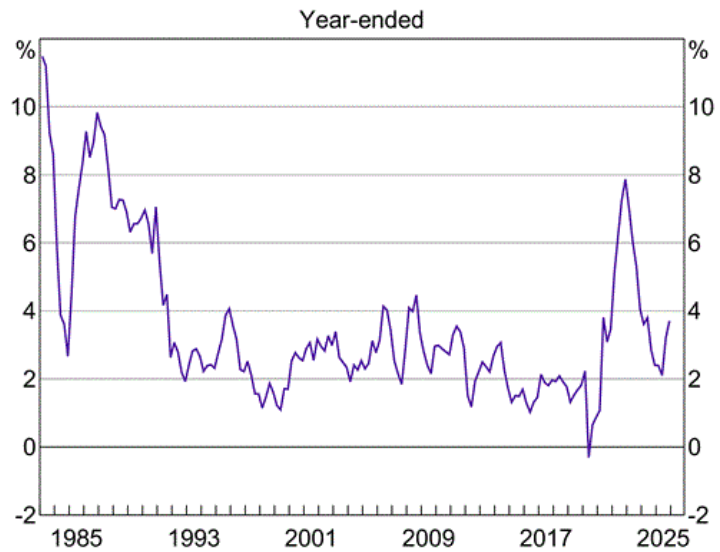
But the reverse applies too. Inflation above 5% demands shrinking real GDP, which is politically difficult to even articulate let alone implement (especially when high unemployment risks among other damage a housing crash that would threaten the banking system).

The threat of a surge in unemployment due to the energy, food and other price shocks (on top of any blows to

employment from the use of artificial intelligence) makes it likely that in coming times politicians will raise inflation targets in some way. If the coming hit to economic growth is severe enough, policymakers might even suspend inflation goals. Whatever happens, no gentle solution to today's inflationary shock looms.

Raising inflation targets has drawbacks, to be sure. Such moves unmoor inflation expectations as an inflation goal raised once can be lifted again. Targeting nominal GDP has additional disadvantages in that it's hard to explain to the public, and central banks might not allow inflation to rise too high even if the economy is contracting. Perhaps inflation targets might only need a little loosening as inflation is not headed towards double-digits as it did in the 1970s. The antics of President Donald Trump against the Fed might make it harder for the US central bank to raise its inflation target without looking like Trump's patsy. However the Fed tries to preserve its credibility (or not), policymakers know the public prioritise jobs over inflation-busting.

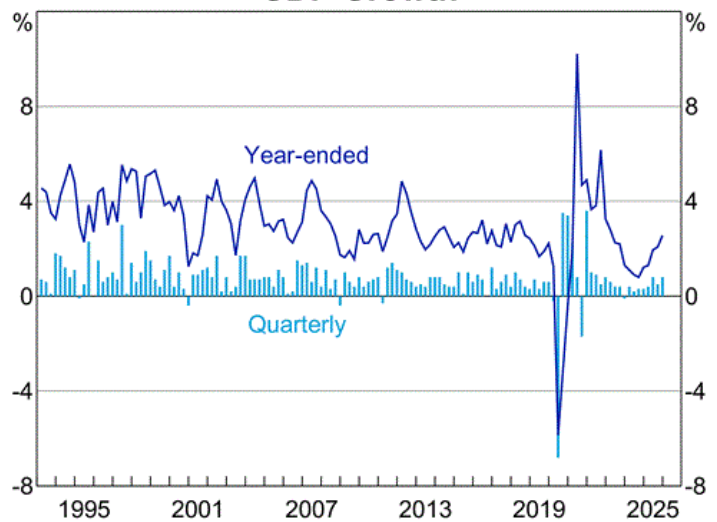
Consumer Price Inflation*



* Excludes interest charges prior to the September quarter 1998; adjusted for the tax changes of 1999–2000.

Sources: ABS; RBA.

GDP Growth



Source: ABS.

In the 1990s, inflation targets of 2% were the solution. Today's war-driven shocks, erratic US policymaking, high indebtedness and darkening economic outlook suggest more flexible inflation targets are needed.

Michael Collins is a freelance writer and editor, economist, and investment specialist. Republished with permission from the author's Substack newsletter [@denouementwatch](#).

The missing 30%: how LIC returns are understated, and why it matters

Emma Davidson

Recently, Firstlinks published an article comparing [the performance of LICs and ETFs](#). It concluded that LICs have generally underperformed their ETF peers over a range of timeframes.

That may be true in some cases.

But before we draw that conclusion, there is a more fundamental question that needs to be addressed: Are we measuring these vehicles properly in the first place?

Because if we are not comparing like with like, the conclusions that follow will be unreliable — and potentially misleading for investors.

More importantly, they may be obscuring something else entirely: that some LICs are not underperforming at all — they are outperforming, and the data simply isn't showing it.

The problem: an incomplete comparison

There is no shortage of data comparing LICs and ETFs. But much of it shares a common flaw: franking credits — a core component of LIC returns — are often excluded.

That might sound like a small technical detail. It is not.

Franking credits are a real economic benefit to investors. Excluding them is equivalent to leaving part of the return out of the equation.

The missing \$3

Let's take a simple example (which you can also view in [this explainer video](#)).

Assume two vehicles generate a 10% return from the same portfolio:

- The ETF distributes the full 10% to investors
- The LIC pays 30% tax, distributes 7%, and attaches 3% in franking credits

Yet many comparison tables present this as:

- ETF: 10%
- LIC: 7%

Conclusion: the LIC has underperformed.

But where did the other 3% go?

It hasn't disappeared. It has been paid to the Australian Tax Office (ATO) on behalf of the investor and returned as a tax credit with real value.

Comparing 10% to 7% in this context is not a like-for-like comparison. It is simply an incomplete one.

'Industry standard' — but not investor standard

It is often argued that this approach is standard practice. That is true when assessing manager performance before tax. But that is not how these comparisons are being used. They are being used to answer a much broader question: Which investment is better for investors?

For Australian investors, that is inherently an after-tax question. And any framework that excludes a material part of after-tax return will lead to distorted conclusions.

Why this matters

This is not just an academic debate.

The steady narrative that ETFs outperform LICs — often based on incomplete data — is influencing investor behaviour.

Over time, that shapes:

- Capital flows
- Product demand
- The future of the Listed Investment Company (LIC aka LIV) sector itself

If we measure things incorrectly, we will allocate capital incorrectly.

A call to action — and progress already underway

If the LIC sector wants to compete on a level playing field, it cannot rely on others to present its data accurately. It needs to take ownership of how returns are measured and communicated.

Encouragingly, this is not starting from scratch.

Industry bodies such as the [LISTED](#) are already working to improve transparency and consistency in how LIC performance is reported. That includes a focus on clearer, more comparable return metrics that better reflect what investors actually receive.

This is an important step forward. But it needs to go further.

At a minimum, the LIC industry must move toward publishing an **Adjusted NTA Return Series** which includes:

- Dividends
- Franking credits
- Capital management initiatives

Because if the data is not clearly available, others will fill the gap — and they may not do it properly.

And if we want investors to make better decisions, we need to give them better tools.

LISTED has the platform to lead this. Now is the moment for the sector to align behind a clear and consistent standard for reporting LIC returns.

What proper measurement looks like: GVF — a real-world example*

So far, the issue has been about incomplete measurement — specifically, the exclusion of franking credits. That is just one example of how comparisons can become distorted. It is not the only one — but it is a significant one.

Even if we move beyond it, another limitation remains: Many comparisons focus only on returns, and ignore the risk taken to achieve them.

To understand performance properly, we need to consider both.

Below is a table showing the annualised returns, volatility and corresponding [Sharpe Ratios](#) for a range of popular Australian investments — many of which were referenced in the original Firstlinks article.

Table 1: The last 11+ years** of popular Australian Investments

	Code	Annualised Return	Volatility	Sharpe Ratio
1	GVF	11%	7%	1.18
2	IVV	16%	12%	1.17
3	IOO	16%	12%	1.16
4	ACWI	13%	11%	1.02
5	VGS	13%	11%	0.98
6	MAQ	26%	29%	0.82
7	WES	16%	19%	0.73
8	SPBDAL Index	8%	9%	0.59
9	A200	11%	14%	0.58
10	VAS	10%	14%	0.56
11	IOZ	10%	14%	0.56
12	MVW	10%	14%	0.53
13	CBA	12%	20%	0.51
14	AQLT	8%	9%	0.47
15	BHP	13%	25%	0.45
16	CSL	10%	21%	0.40
17	WBC	9%	22%	0.33
18	XRO	13%	38%	0.27
19	TLS	7%	17%	0.27
20	WOW	5%	17%	0.17

Source: Author analysis. Please see [this link for all downloadable data and source references](#).

Note: Sharpe Ratio measures return per unit of risk (volatility). Higher values indicate more efficient, higher-quality returns.

The original analysis focused primarily on returns. But returns are only half the investment equation. The other half is the risk taken to achieve those returns.

Risk is most commonly measured using volatility. While it is sometimes suggested that retail investors do not understand volatility, that feels overstated. At a basic level, the concept is intuitive: The more volatile an investment, the more uncertain — and therefore riskier — the outcome.

No single metric perfectly captures risk. But measures such as the Sharpe Ratio or [Sortino Ratio](#) provides a useful way to assess the quality of returns, not just the magnitude.

Put simply: Higher Sharpe ratios indicate better returns for the level of risk taken.

What stands out is that GVF ranks at the top on a risk-adjusted basis.

It is worth noting that GVF is used here for a practical reason: it is one of the few LICs where we can confidently present a fully adjusted and internally consistent data set. The broader point is not about GVF specifically — it is about what becomes visible when returns are measured properly.

GVF is not a large, heavily marketed vehicle dominating flows or headlines. GVF is, by any measure, a relatively small and under-recognised LIC — and yet it is delivering the highest quality of returns in this comparison.

This is not because it generated the highest raw return. It is because it delivered the strongest, most consistent returns with lower volatility relative to those returns.

If a relatively small LIC like GVF can outperform many of the most widely held investments in Australia — when measured properly — it raises a much bigger question: How many other LICs are quietly delivering similar outcomes, but are being overlooked because the data is being presented incorrectly?

GVF is not an anomaly. It is simply a visible example of what happens when performance is measured on a complete, like-for-like basis.

Because for investors, the objective is not just to maximise returns — **it is to maximise returns per unit of risk.**

The bottom line

Franking credits are not a footnote. They are part of the return.

Until they are treated that way, investors will continue to be presented with an incomplete picture.

If we want better investment decisions, we need better data. And if we want better data, the LIC sector — led by initiatives like LISTED — needs to lead the charge.

** GVF is included as the LIC example in this analysis because we can ensure the completeness and consistency of the underlying data. The broader argument is not specific to GVF, and similar analysis across other LICs would be expected to produce more representative comparisons where equivalent data is available.*

GVF's investment strategy is built around identifying and investing in discounted listed investment vehicles (closed-end funds) globally and actively working to realise that value. Half the investment team

responsible for this strategy are based in London — widely regarded as the global centre for closed-end funds — and has extensive experience analysing these structures across different markets, regulatory regimes and corporate governance frameworks.

That background informs how returns are measured and presented here, with a focus on consistency, comparability and accurately reflecting investor outcomes. This approach has also been reviewed and agreed by the GVF Board, which includes experienced industry participants such as Chris Cuffe, Geoff Wilson and Jonathan Trollip.

A full breakdown of the data, methodology and sources used in this analysis is available [here](#).

** The period covers GVF's investment life as the author's preference, this being 1 July 2014 – 31 Jan 2026. The author has also looked at 1, 3, 5, 10-year data which can all be [found here](#). Also on the same page is where the data has been sourced and what assumptions have been made.

Emma Davidson is Head of Corporate Affairs at London-based Staude Capital, manager of the [Global Value Fund](#) (ASX:GVF). This article is the opinion of the writer and does not consider the circumstances of any individual.

Alpha isn't dead. You've just been measuring it wrong

Larry Swedroe

For decades, investors and academics have been locked in a hunt for alpha—the holy grail of risk-adjusted returns that can't be explained by known market factors. The quest has grown so frenzied it spawned what John Cochrane famously called the [factor zoo](#): a sprawling menagerie of hundreds of documented anomalies, each claiming to produce excess return. Yet, despite all this effort, alpha has been shrinking. Mutual fund alpha has declined, as has hedge fund alpha. The playbook that worked in 1993 looks considerably less potent today.

So, is alpha dead? Andrew Berkin and Christine Wang of Bridgeway Capital Management, authors of the study "[The Incredible Structural Alpha](#)," published in the Spring 2026 issue of *The Journal of Beta Investment Strategies*, believe the answer is an emphatic no. However, finding it requires a fundamentally different mindset.

Alpha: What did the authors examine?

Berkin and Wang set out to show that meaningful, persistent alpha is available not by discovering exotic new factors or mining ever-larger datasets but simply by being more thoughtful about constructing portfolios.

Their laboratory was the classic 5×5 grid of portfolios sorted by size and value—the same analytical framework that Fama and French used in their [landmark 1993 work](#). Using 60 years of US stock data (July 1963 through June 2023), they walked through four straightforward and easy-to-understand portfolio construction scenarios, measuring how each incremental design improvement affected both raw returns and risk-adjusted alpha.

The four levers they pulled were:

- 1. Deeper factor exposure:** Concentrating portfolios more tightly in the extremes of size and value (true small cap, truly cheap stocks), rather than broader splits.
- 2. Timely data and more frequent rebalancing:** Using the most current market cap available rather than stale year-old data and switching to quarterly accounting data when it becomes available.
- 3. Removing stocks with unwanted factor exposure:** Screening out the worst-momentum stocks from value portfolios to avoid the drag of stocks that are cheap but falling for good reason and junk from small caps.
- 4. Using multiple value metrics:** Combining four measures of value (book/price, sales/price, earnings/price, and cash flow/price) rather than relying on book/market alone.

What did they find?

The results are striking, and they build on each other.

- 1. Deeper exposure is worth it:** Starting with the baseline Fama-French approach (Scenario 1), the smallest and deepest value stocks returned over 16.0% annually across the 60-year period—while small-growth stocks returned just 3.65%. Even after adjusting for their known factor exposures, the smallest, deepest value corner of the market generated a statistically significant alpha of nearly 2% per year. The smallest growth corner, meanwhile, produced a statistically significant *negative* alpha of 6%. The implication: The nonlinearities at the extremes of the size and value spectrum are real, persistent, and economically large.
- 2. Fresh data changes everything (especially through the lens of momentum):** When the authors switched to quarterly data and current market cap (Scenario 2), something interesting happened. Returns for the deepest value portfolios actually *fell* slightly—but their measured alpha *rose sharply*, from 1.97% to 4.53% for the smallest deep-value portfolio. Why? Because more timely classification of stocks as “value” means you’re often catching stocks that have recently dropped in price—stocks with negative momentum. Those stocks carry a momentum headwind that suppresses returns but isn’t fully accounted for in simple alpha calculations. The alpha is real; the momentum drag is a separate, identifiable cost.
- 3. Removing the “cheap for a reason” boosts returns directly:** Screening out the worst quintile of momentum stocks (Scenario 3) produced higher returns across nearly all 25 portfolio squares—with the gains largest among smaller stocks, where momentum is the strongest. The smallest deep-value portfolio’s return rose to 17.85%. Notably, alpha itself barely moved (4.53% to 4.57%), but its statistical significance increased substantially, with the t-statistic rising from 4.54 to 5.96. The message is clear: Removing poor-momentum stocks raises returns through better factor exposure, not through some mysterious new source of alpha.
- 4. Multiple value metrics unlock the large-cap value premium:** This is perhaps the most practically important finding for many investors. It is well known that using only book/market as the value measure works poorly for large-cap stocks—the traditional high-minus-low-value premium mostly comes from smaller companies. But when the authors combined four value metrics (Scenario 4), the largest deep-

value portfolio's return jumped from 9.73% to 12.65% annually. The value premium was restored across all size segments.

The mechanism is transparent: Metrics like sales/price, earnings/price, and cash flow/price also capture profitability. Stocks that look cheap on these measures tend to have solid underlying businesses. Because the standard alpha model uses only book/market as its value factor, the extra returns from these other measures show up as alpha rather than factor compensation—which is exactly what the authors observe.

The structural size and value factors

Having demonstrated the benefits in portfolio terms, Berkin and Wang took the analysis one step further and constructed improved versions of the famous small minus big and HML factors themselves.

The results are sobering for fans of the conventional Fama-French factors—and encouraging for those willing to invest the effort in better construction:

- The standard SMB returned just 0.17% per month over the full 60-year period and was not statistically significant. The structural version returned 0.37% per month, rising to 0.44% per month when “cheap for a reason” low-value stocks were excluded from the small-cap side.
- The standard HML returned 0.29% per month. The structural version returned 0.33% per month.

The gap widens dramatically in the second half of the sample (1993–2023), when the conventional factors have struggled badly. The standard SMB averaged just 0.06% per month. The structural version earned 0.26%–0.33% per month. Similarly, standard HML earned just 0.13% per month in this period, while the structural version maintained 0.28% per month.

This is the paper's most important practical finding: When the conventional factors were weakening, thoughtful portfolio construction preserved most of their return premium.

Finally, their findings were basically unchanged in a robustness check using the Fama-French six-factor model.

Key takeaways for investors

1. Alpha from construction, not from new factors: The factor zoo is partly an illusion. Many apparent new anomalies may simply be capturing the structural alpha that already exists in well-known factors when they're properly constructed. Investors should be skeptical of claims that any new metric is truly distinct from size and value.

2. Go deeper, not broader: Concentrating in the true extremes of size and value—not the broadly defined “smaller half” or “high-30%”—produces meaningfully higher returns and alpha. Most mainstream indexes and many exchange-traded funds don't do this. Index funds cannot capture this structural alpha.

3. Pay attention to momentum interactions: A stock that looks cheap may be cheap for a reason. Screening out the worst-momentum stocks from value portfolios is a practical, disciplined way to improve returns without abandoning the value thesis. The momentum and value factors interact—ignoring that interaction leaves money on the table.

4. Use multiple value metrics, especially for large caps: Book/market alone is a poor value signal for large-cap companies. Combining it with earnings yield, sales yield, and cash flow yield produces a more robust value signal across the full market-cap spectrum, particularly in the large-cap space where book value has become a less reliable anchor.

5. Implementation is not a footnote: The authors are explicit that disciplined execution matters as much as smart factor design. Patient trading, broad stock-selection pools, position bounds, securities lending, and—critically—closing a fund before it grows too large to execute its strategy are all levers that can add or destroy the structural alpha that portfolio design creates. A beautifully designed strategy, poorly executed, will still underperform.

6. Fees matter, but less than you might think; design matters more: The authors note that structural alpha can amount to several percent annually—an order of magnitude larger than typical fee differences between funds. Investors fixated on minimizing basis points may be optimizing the wrong variable if they're ignoring the quality of portfolio construction.

7. The conventional factors aren't broken; they're just poorly measured: The well-documented weakness of size and value in recent decades is largely a story of how those factors are conventionally defined and measured. Structural improvements to construction preserve the premium substantially. The factors work. The definitions need updating.

8. AUM matters: As my September column "[The Hidden Costs of Passive Investing](#)" explains, large systematic managers attempt to reduce slippage by remaining flexible and limiting their participation in daily trading volume, typically to 1% to 3% of average daily volume. For smaller managers, or highly liquid large-cap stocks, this constraint is immaterial. However, for megafirms trading less liquid small-value securities, it creates a problem called *latency*—positions may take quarters, or even years, to build or unwind. The result is lower trading costs but also lower exposure to the factors with premiums.

The alpha bottom line

The search for alpha doesn't have to mean chasing increasingly exotic signals in increasingly crowded corners of financial markets. Berkin and Wang make a compelling case that the building blocks—size and value—still work, and work considerably better when handled with care.

The "incredible structural alpha" isn't magic. It comes from the disciplined application of things most sophisticated investors already know they should do: Concentrate on the true extremes of your target factors, keep your data current, avoid stocks with compounding headwinds, diversify your signal, and execute with precision. The paper's contribution is to quantify exactly how much each of those choices is worth—and the answer is: quite a lot.

For investors navigating a world where conventional factor premiums have compressed, that's a meaningful source of hope.

[Larry Swedroe](#) is a freelance writer and author. The views expressed here are the author's. For informational and educational purposes only and should not be construed as specific investment, accounting, legal, or tax advice. The author does not own shares in any of the securities mentioned in this article.

The diversification illusion: why 'balanced' portfolios may be exposed

Werner du Preez

Diversification is one of investing's oldest principles—and, arguably, one of its most misunderstood.

Most client portfolios today appear well diversified. They span regions, sectors, and often include multiple managers and strategies. On the surface, they look balanced.

But appearances can be misleading.

Look beneath the labels, and many portfolios are still driven by a relatively narrow set of underlying forces. That distinction—between how a portfolio looks and how it behaves—has become increasingly important.

When diversification fails, it tends to fail together

At its core, diversification is straightforward: combine exposures that behave differently, so that when one part of a portfolio struggles, another can help offset it.

In practice, that's becoming harder to achieve.

Global equity indices—now widely used as portfolio building blocks—have become increasingly concentrated. A significant portion of market capitalisation sits in a small group of US mega-cap companies, with a strong bias towards growth and technology.

By the end of 2025, the US made up roughly two-thirds of the MSCI All Country World Index, with the so-called AI-Eight (Nvidia, Microsoft, Amazon, Meta, Broadcom, Alphabet, Oracle and Palantir), alone representing close to 18.5% of the index. Other indices, such as the MSCI World or FTSE World Index, are even more concentrated.

But that concentration isn't always obvious in portfolios.

An investor may hold hundreds of securities through index funds and still find that outcomes are largely driven by the same factors: US growth, large-cap technology, and momentum.

The result is a portfolio that looks diversified but behaves more like a concentrated exposure.

The risk of unconscious concentration

Importantly, this is not typically a deliberate decision. It is structural.

Passive investing allocates capital in proportion to market size. As companies perform well, their weights increase, which further amplifies their influence on portfolio outcomes.

Over time, portfolios can become heavily exposed to a narrow part of the market—without any explicit intention to do so.

That would be less concerning if valuations were unremarkable. But today, much of this concentration sits in areas where valuations are elevated by historical standards.

Across a range of long-term measures, global equities are trading at levels that have, in the past, been associated with more modest forward returns.

In other words, portfolios may be most exposed at precisely the point they feel most comfortable.

Diversification in form versus diversification in function

For advisers, the key question is not how many holdings are in a portfolio, but how those holdings behave.

Owning multiple funds or strategies does not necessarily result in diversification if they are driven by the same underlying factors.

True diversification is about behaviour.

It involves combining exposures that respond differently to changes in economic conditions, market regimes, and investor sentiment—across geographies, sectors, currencies, and investment styles.

Without that, diversification can become largely cosmetic.

This distinction tends to matter most when conditions change. When leadership narrows—or begins to reverse—portfolios built on the same drivers often move together.

For advisers, this raises a practical consideration: diversification should be assessed not just by allocation, but by underlying drivers of return.

Looking beyond the obvious

Where, then, can genuine diversification be found?

Part of the answer may lie in looking beyond the areas that have performed best in recent years.

Non-US markets, for example, currently trade at more modest valuations relative to the US. While US shares trade on average at around 38 times earnings, developed markets ex-US and emerging markets change hands at roughly 20 and 16 times respectively. In many cases, they offer exposure to businesses with sound fundamentals that have simply fallen out of favour.

Balancing investment styles can also help. Growth has led markets for much of the past decade, but leadership between growth and value has historically moved in cycles.

Value-oriented opportunities, while less prominent in recent years, may provide differentiated outcomes if conditions shift.

Currencies are another, often overlooked, dimension. Exposure beyond the US dollar can introduce an additional source of return, which may behave differently from underlying equity markets.

Taken together, these exposures can broaden the drivers of return within a portfolio—but only if they are introduced deliberately rather than by default.

The role of active decisions

None of this suggests that passive investing has no role to play.

But it does highlight its limitations in the context of diversification.

Index strategies, by design, reflect the market as it exists today. They do not adjust for concentration or valuation risk.

Introducing deliberate, valuation-aware exposures—whether through active strategies or targeted allocations—can help broaden the drivers of return and reduce reliance on a single market narrative.

The key is not activity for its own sake, but intentional differentiation.

For advisers, the challenge is not simply to build portfolios that appear diversified, but to ensure they are.

Because diversification is not about owning more.

It is about owning differently.

And in practice, that difference tends to matter most when it is tested.

CTA

Explore how valuation-driven investing can improve portfolio diversification and resilience in today's concentrated markets in our latest white paper (for advisers):

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The case for staying the course in credit

Phil Strano

When we think about the current volatility, we are reminded of a prescient quote from Russian revolutionary and president Vladimir Lenin:

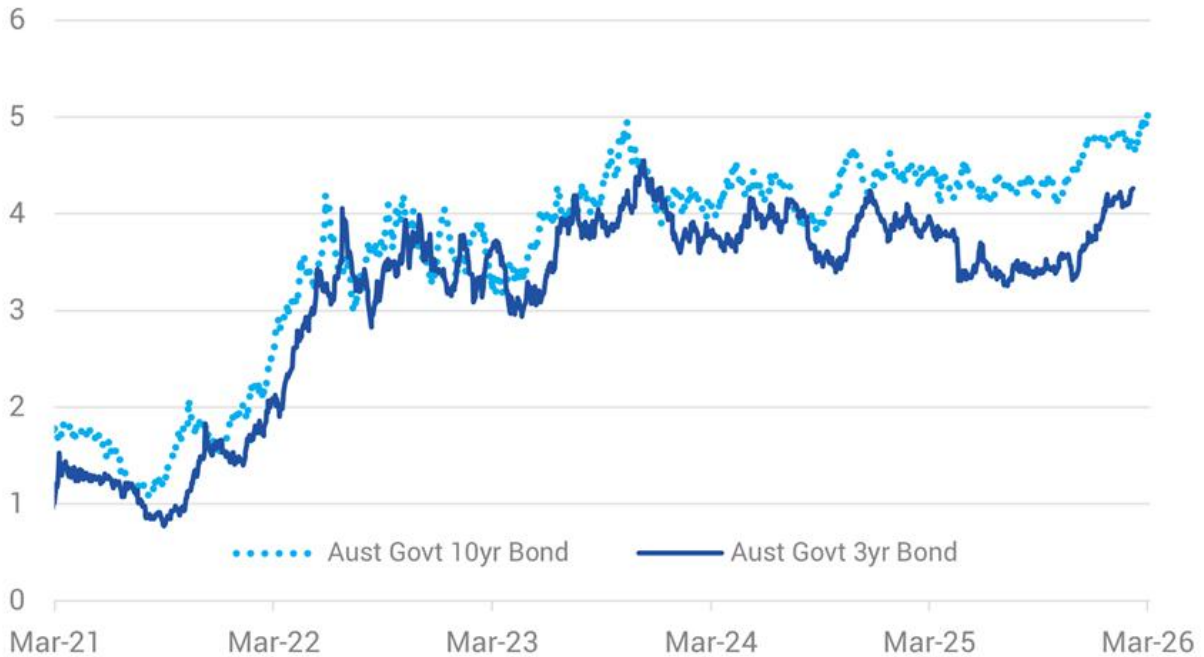
“There are decades where nothing happens and there are weeks where decades happen.”

Time will tell whether the Iran war is indeed one of these periods where decades happened.

As for markets domestically, higher oil prices have collided with sticky headline inflation and a hawkish central bank. Australian government bonds have sold-off aggressively in March, with 3 and 10-year bond yields now at ~4.8% and 5% respectively (refer Chart 1). Moreover, despite the Reserve Bank of

Australia (RBA) increasing the cash rate twice in February and March 2026 to 4.1%, interest rate markets as of 20 March were pricing in another ~70bps of tightening by the end of 2026 to 4.8% (i.e. close to another three 25bps increases in the RBA cash rate).

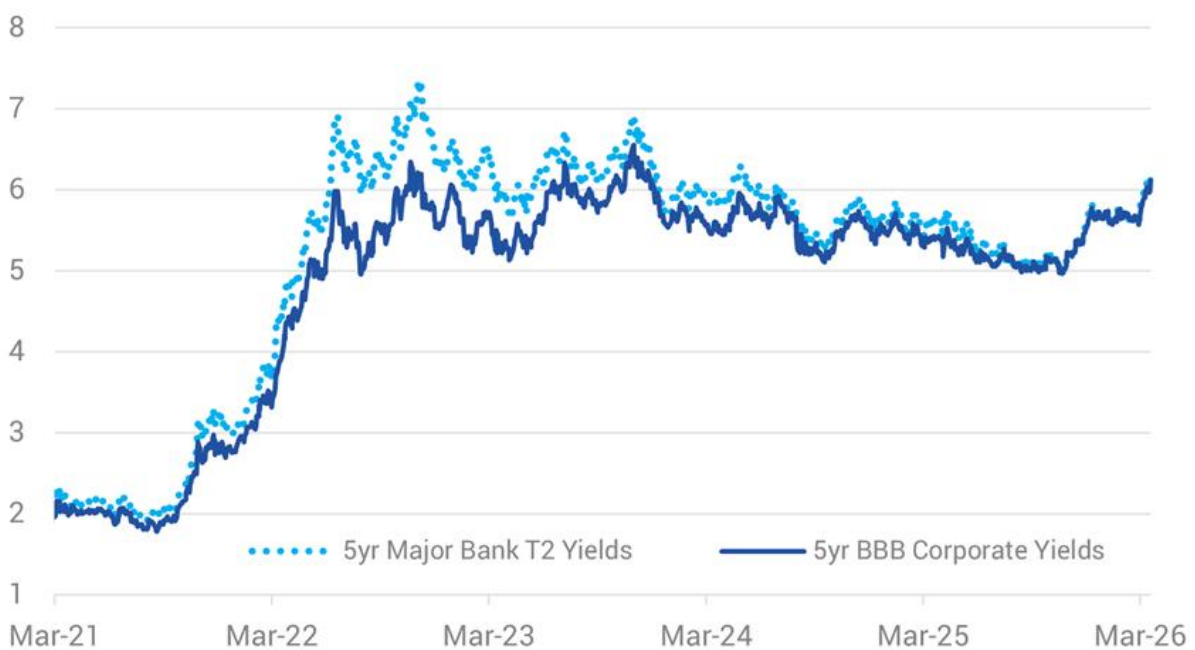
Chart 1: 3-year and 10-year Australian Government Bond Yields (%)



Source: Bloomberg, Mar 2026.

This higher rebasing of interest rates has a commensurate impact on corporate bond yields, with 5-year major bank T2 and triple B corporate yields now both back above 6% for the first time since late 2023 (refer Chart 2).

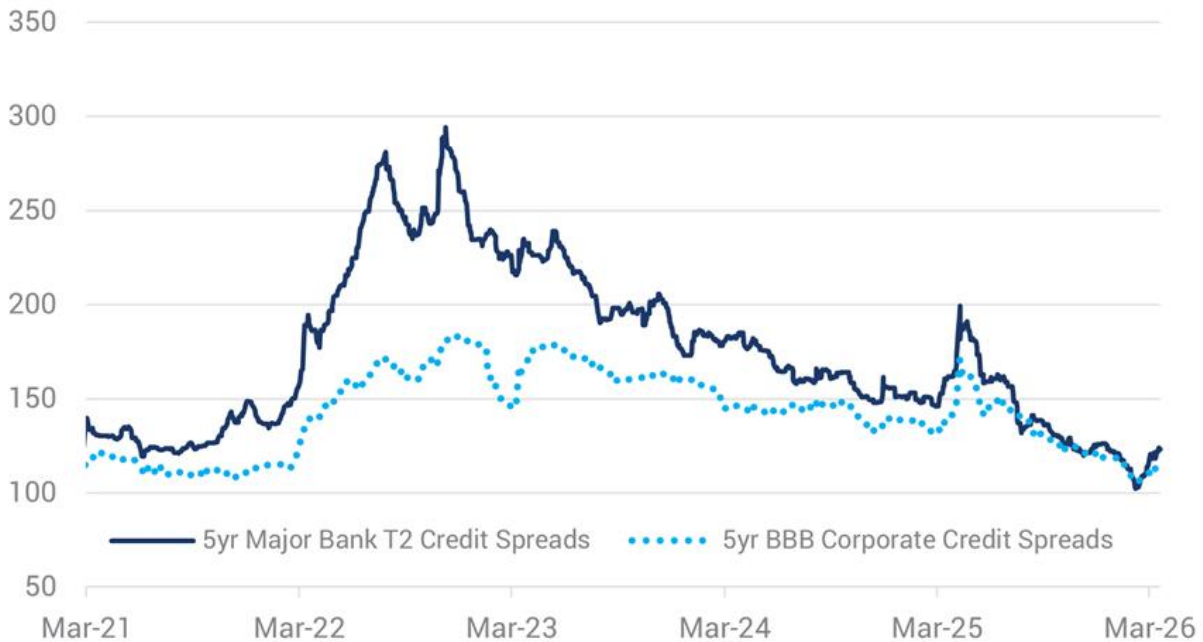
Chart 2: 5-year T2 and BBB Corporate Yields (%)



Source: NAB, Yarra Capital Management Mar 2026.

By contrast, the movement wider in investment grade (IG) credit spreads of ~20bps only takes us back to late 2025 levels (refer Chart 3). The orderly behaviour of IG credit thus far is testimony to the power of higher risk-free rates and outright yields (i.e. lessening the pressure on credit spreads to achieve investor return targets). Moreover, for the most part risk markets are still pricing in a speedier return to normalcy, enabling central banks such as the RBA to raise rates despite the heightened uncertainty.

Chart 3: 5-year T2 and BBB Corporate Bond Spreads (bps)



Source: NAB, Yarra Capital Management Mar 2026.

When uncertainty in markets is elevated, playing the averages over the medium term typically remains the best course of action. In many ways, what we've experienced in recent months, turbocharged by the Iran war, is a mini 2022 period with one important caveat. After the normalisation of bond yields in 2022, travel time to higher bond yields in 2026 was shorter and much less painful for interest rate duration positions.

From our perspective, while holding some duration has been reflected in performance in recent months, our focus has remained on taking advantage of higher outright yields and locking in attractive income. Portfolio running yields for the IG quality Yarra Enhanced and Higher Income funds are now well above 6% and approaching 7%, levels we last generated in 2023/24. Maintaining duration in portfolios at these elevated levels is advantageous for sustaining performance throughout the remainder of 2026.

In addition to higher bond yields, the rebuilding of more rate hikes in market pricing has significantly flattened the yield curve. The difference between the 3 and 10-year bonds is now under 30bps, down from a peak of ~120bps during the liberation day selloff in April 2025 (refer Chart 4). In this environment and if sustained, a flatter yield curve should result in a steeper credit curve with investors at the very least demanding increased term premiums in the current environment (i.e. higher credit spread compensation for longer dated securities).

Chart 4: Yield Curve – 3s10s (bps)



Source: Bloomberg, Mar 2026.

While credit spreads remain well behaved, if the current interest rate pricing is even half realised – i.e. reflective of some RBA future hikes – then a significant deflationary impulse for the Australian economy is likely. This is especially the case when combined with an appreciating \$A, much higher petrol prices, greater application of AI tools across the economy and a retreating public sector following a more austere May Federal budget. Resultant higher unemployment and much weaker economic growth is likely to reverse current interest rate settings through the course of 2026/27. Therefore, despite a small impact in recent months, maintaining interest rate duration in portfolios continues to make sense at current levels.

In an environment of much weaker growth and higher unemployment, rallying bond yields is likely to result in credit spreads moving wider, with the current calm in credit giving way to a further rebasing of spreads. Our focus remains on locking in favourable income and using duration and curve to protect the portfolio and strongly position us to take advantage of the transition in return composition, with credit spreads likely to comprise a greater proportion of future outright yields following a significant decline in risk free rates.

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. Both the Yarra [Enhanced Income](#) and [Higher Income](#) Funds are zero leverage funds, providing attractive yields.

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One risk after another

Joe Wiggins

At any given point in time, there is one major investment risk that becomes the focus of everyone's attention. Sometimes this will be a new and significant event (such as the war in Iran); other times it will be a risk that has lain dormant but suddenly becomes the thing to care about (like the recent AI/software company flare-up). The problem is not just that we almost always end up misjudging the impact of these risks, but that there is an incessant stream of them. Many investors seem to manage their portfolios from one risk to another, month by month, quarter by quarter. Suffice to say, this is probably not a strategy that can be successful over the long run.

As humans, we tend to judge risks by their availability – that is, we assess the severity and likelihood of a risk based on how prominent and emotive it is. It is easy to see the evolutionary benefit of this: if you worried a lot about very obvious threats, you probably had a better chance of survival.

While this focus on available risk may be a very effective human adaptation, it is incredibly unhelpful for most investors. There are two major problems. First, our tendency is to hugely exaggerate the risks we face at any given moment. This is particularly pertinent for long-term investors, as there are simply not many risks that are likely to matter in a predictable way over the horizons we care about. Second, given that we cannot know how any particular risk will unfold, it is incredibly difficult to do anything useful about it. What should we do? Get out of the market until the next risk comes along and then see how we feel?

The other issue with availability is that it creates a conveyor belt of risks, where one salient concern is in focus at any given point in time only for another one to come along the following month. Not only is the world far more complex and interconnected than this would suggest, but focusing on one particular risk means we are not considering many others.

For an investor, the next geopolitical risk feels far more vital than the risk of, say, trying to time your equity exposure or selling out of equities altogether. We are only wired to care about one of these – the thing that is front and centre right now, which is making us feel something.

We also tend to act as if the risk that currently has our rapt attention is far more important than whatever was on our minds six months ago, which we can barely remember. We struggle to imagine that we will be worrying about something else with similar intensity in a few months' time.

Although how some risks come into central focus is obvious – the current situation in Iran being a good example – others seem to become the topic everyone cares about out of the blue. It can be an underlying risk that everyone has known about for a long time suddenly starting to feel vital.

[Cass Sunstein and Timur Kuran](#) wrote about this idea and defined it as an “availability cascade”. This is the process by which belief about a risk becomes acute because it is visible and frequently repeated. The spread is driven primarily by informational and reputational factors, which are self-reinforcing.

How does this work? Imagine that during one balmy summer a diver is bitten by a shark off the coast of Cornwall. What happens next?

Informational cascade: News stories appear everywhere about dangers lurking in British waters. The incredibly remote risk of being the victim of a shark attack has not changed, but how we feel about it has.

Reputational cascade: You are taking your family to the beach in Cornwall. You know the risk of a shark attack from letting your children swim in the sea is virtually non-existent, but you also know what other people might think. Haven't you seen the news? Imagine the looks from the other parents as you lead your children into the water.

Availability isn't generally about imaginary risks; it is about real risks being overstated because of how aware of them we are.

We see this exact phenomenon all the time in financial markets – in the emergence of bubbles and in sporadic panics about certain risks. We are bombarded with what seems like information and feel compelled to react because everyone around us is.

It is almost certain that the advent of social media and 24-hour news has made these availability cascades more frequent and more impactful.

Managing an investment portfolio for the long term while reacting to each headline risk is not only exhausting but highly likely to lead to rash decisions and poor outcomes. There is no easy solution to this; the spectre of availability can make it costly to our reputation to ignore risks even when they are wildly exaggerated or imponderable.

For long-term investors, the risks to meeting our objectives are far more likely to stem from our reaction to headline risks than from the risks themselves.

Joe Wiggins is Director of Research at UK wealth manager, [St James's Place](#) and publisher of investment insights through a behavioural science lens at www.behaviouralinvestment.com. His book [The Intelligent Fund Investor](#) explores the beliefs and behaviours that lead investors astray, and shows how we can make better decisions.

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