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Editorial

Given all the bubble talk I thought it would be interesting to share a perspective and some data from a report I read this week. Morgan Stanley's report *Who is on the other side* addresses several topics including bubbles.

There have been countless bubbles throughout history. Bubbles are caused by our natural tendencies as humans and if we are still making decisions bubbles will continue to occur. The problem we face as investors is we know bubbles will occur but can't definitively identify a bubble until after it has popped.

Famed economist Eugene Fama described this conundrum:

I think most bubbles are twenty-twenty hindsight. Now after the fact you always find people who said before the fact that prices are too high. People are always saying that prices are too high. When they turn out to be right, we anoint them. When they turn out to be wrong, we ignore them. They are typically right and wrong about half the time.

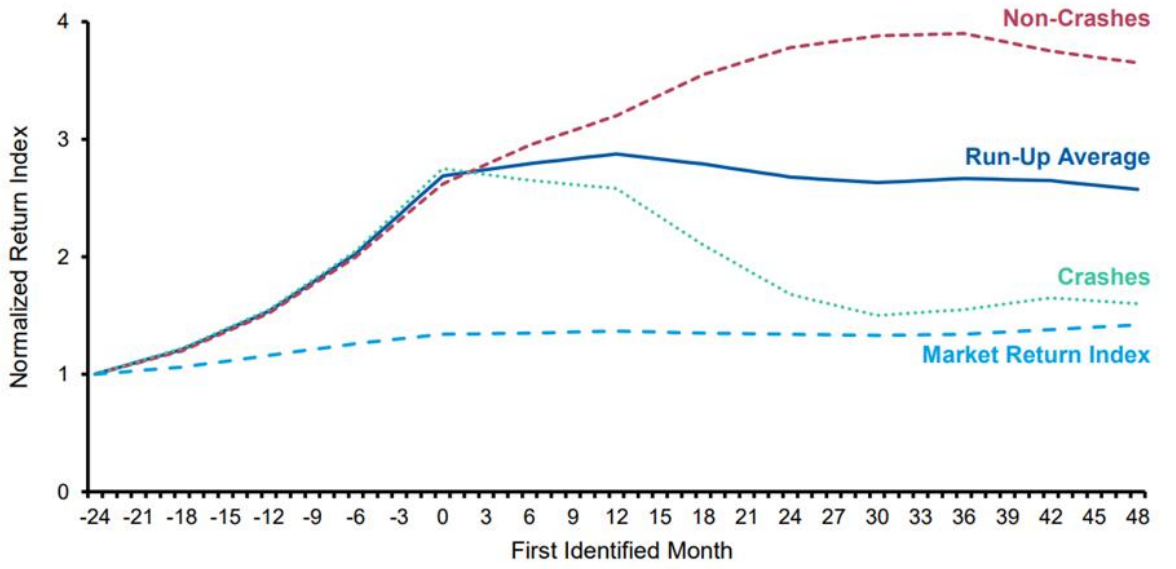
Fama didn't have the data when he made that statement, but three researchers named Robin Greenwood, Andrei Shleifer and Yang You looked at what happened after periods of high returns.

A period of high returns was defined as a portfolio of shares in an industry returning 100% or more on a relative or absolute basis over two years. To eliminate the impact of a bounce off substantial lows the study authors also stipulated the industry's absolute returns were 50% or more over the previous five years.

Between 1926 and 2014 there were 40 industries that meet their criteria in the US. Outside the US the researchers identified 107 scenarios between 1985 and 2014. Fama turned out to be right – in only half

of the 'bubbles' a crash occurred. The researchers defined a crash as a 40% fall at some point in the two years following the period of high returns.

Exhibit 13: The Return After a Run-Up Is Similar to the Market on Average



Source: Counterpoint Global based on Figure 1 from Robin Greenwood, Andrei Shleifer, and Yang You, "Bubbles for Fama," Journal of Financial Economics, Vol. 131, No. 1, January 2019, 24.

A normalised return index on the y-axis shows how an investment performs compared to a common starting point. As you can see the run-up average between the crash and non-crash outcomes looks similar to the overall market return index.

Talking about bubbles is one thing. Dramatically changing your portfolio is another. Incorrectly identify a bubble that doesn't happen and it could make a dramatic difference in your investment outcomes.

New rules for a new era

Index providers have rules stipulating when new companies can join an index. For instance, the S&P 500 rules require 12 months of seasoning before a new company is included. The purpose of this seasoning is to avoid the volatility that often accompanies an IPO and to avoid hype-driven inclusion in the index.

The S&P 500 index also requires companies to be profitable on a GAAP (Generally Accepted Accounting Principles) basis. This rule is designed to only include mature and high-quality companies.

In what is shaping up to be a massive year for IPOs the S&P 500 has a problem. The first giant IPO, SpaceX, doesn't meet the index criteria. Following a round of consultation which just ended Dow Jones S&P may let this new and wildly unprofitable company into the index.

If the S&P 500 caves they will follow the NASDAQ and FTSE indexes who have already changed their rules. And SpaceX is only the tip of the iceberg. The index providers are anticipating IPOs from Anthropic and OpenAI.

I know feigning outrage is in vogue. But I'm not a purist who thinks rules should never change. I don't really care what the index providers do although I do own some index products tracking the S&P 500.

But I do think it is telling when the rules are changed in a hype-driven market to include companies that embody that hype.

Passive investors aren't supposed to care about individual companies. Which is why I don't care what happens with SpaceX in the portion of my portfolio that tracks an index.

But maybe this will make some 'passive' investors happy. They can say they own SpaceX and talk about the synergies between rockets, mobile broadband, Twitter and AI.

Or maybe this strange conglomeration of businesses that people are desperate to own is a product of a time which will look foolish in retrospect.

Mark LaMonica

Also in this week's edition...

The government's tax proposal is supposed to help younger generations. **Lauchlan Mackinnon** explores the validity of these claims.

Shani Jayamanne sits down with **Abbey John** to learn the different ways you can minimise tax with a will.

Many investors are turning to AI to assist with investment decisions. **Larry Swedroe** doesn't think AI can help you pick winning funds… but he does think AI can help avoid the losers.

Ashely Owen is back and turning his attention to inflation. According to Ashley Boomers got lucky and the next generations won't be so fortunate.

The cost of financial advice continues to increase but expanded tax deductibility will increase affordability according to **Sarah Abood**.

Dr Joanne Earl returns with an update on her retirement.

Richard Holden argues the government has created the first ever productivity tax. He goes through the implications for young Australians.

This week's white paper is **Capital Group's** analysis of company dividends worldwide, as part of its broader Global Equity Study.

Curated by Mark LaMonica, Simonelle Mody and Leisa Bell

Are the government's CGT changes better for young investors?

Dr Lauchlan Mackinnon

One of the stated aims for the government's CGT changes was to improve generational inequality.

But will the changes be better for young investors?

To explore if young investors will benefit from the government's CGT changes, let's consider the case of a young person who wants to accumulate a deposit so that they can buy a home. We will explore how well off they are under each of the current and the new CGT arrangements.

In this example, they are on an income of a base salary of $150K a year, which increases each year with inflation, which we will take to be 3%.

They need to build up a home deposit and enough to pay any stamp duties. Let's say this amount required for their home deposit will be $250K in today's dollars, and that their goal is to accumulate this home deposit in 10 years. They will make contributions of $20K each year into their investments to work towards that goal.

Let's consider three scenarios for how they accumulate their home deposit:

1. They invest in a high growth ETF.

To represent this scenario we will imagine that they invest in the Betashares ETF NDQ, which tracks the NASDAQ 100. As I write, the 10-year historical growth for NDQ has been 21.33% per annum. In this scenario, we will assume that NDQ continues on a dream run and grows at 20% a year over the next 10 years.

For modelling purposes we will treat the entire 20% growth as capital growth, consistent with the Betashares total return methodology, which includes reinvested distributions. We will assume that the growth is consistent year on year without any volatility.

2. They invest in a high yield dividend ETF

Let's say that they invest in a high yield dividend ETF, such as Vanguard's VHY. The dividend yield is 5% a year each year which is reinvested, and the ETF market price grows at 5% a year.

The total return is therefore 10% a year. This is consistent with the 10-year average performance of VHY of a total return of 10.18% p.a. as of the time of writing this article.

3. They save the money in a bank account, at a 3% p.a. interest rate

They earn 3% p.a. on their capital, and they pay tax on the interest payments to the bank account.

How does this young person fare under the current CGT arrangements, compared to the new CGT arrangements? Indicative results are shown in the following table.

Illustrative modelling only. Stylised assumptions throughout. Actual returns, tax outcomes and portfolio values will vary. The purpose is to illustrate the structural effect of the CGT change, not to project a specific outcome.

Assumptions: Investor earns $150,000 in year 1, growing at 3% p.a. (~$196k by year 10) · $20,000 contributed per year · 10-year horizon · Target: $250,000 today = $336,000 nominal in year 10 · NDQ: 20% p.a. total return as pure capital growth (BetaShares 10-year actual); no annual distributions modelled · VHY: 5% p.a. capital growth + 5% dividend yield = ~10% total return (consistent with BetaShares VHY 10-year actual); 75% franking; after-tax dividends reinvested · Savings: 3% p.a. interest taxed as income annually; no CGT event · Cost base indexed per tranche: each annual contribution and reinvested dividend indexed to CPI from year of purchase to year of sale · CGT on full disposal in year 10; gain added to year-10 salary of ~$196,000

	NDQ growth ETF	VHY income ETF	Savings 3% account
Portfolio value — end of year 10	$623,000	$329,000	$220,000
Total contributions (nominal cost base)	$200,000	$256,000	$200,000
Indexed cost base (CPI-adjusted per tranche)	$236,000	$299,000	—
Nominal capital gain	$423,000	$73,000	No CGT event
Real capital gain (after indexation)	$387,000	$30,000	—
Income tax on distributions / interest (10 yrs)	$0	$17,100	$14,600
Before 1 July 2027 — 50% CGT discount on nominal gain			
Taxable gain (50% of nominal gain)	$211,500	$36,500	—
CGT payable	$99,400	$17,100	$0
Effective CGT rate on nominal gain	23.5%	23.5%	—
After-CGT portfolio value	**$524,000 ✓**	**$312,000 ×**	**$220,000 ×**
After 1 July 2027 — full real gain taxed at marginal rate			
Taxable gain (100% of real gain)	$387,000	$30,000	—
CGT payable	$181,800	$14,000	$0
Effective CGT rate on nominal gain	43.0%	19.2%	—
After-CGT portfolio value	**$441,000 ✓**	**$315,000 ×**	**$220,000 ×**
Change under the new method			
Change in CGT payable (new vs old)	+$82,400	−$3,100	$0
Change in after-tax wealth	−$82,400	+$3,100	—

✓ meets $336,000 nominal target · × falls short · VHY at 5% capital growth + 5% dividends reflects BetaShares VHY 10-year historical total return (~10% p.a.) · VHY real gain of $30,000 is positive because 5% capital growth exceeds 3% inflation — but below the 6% tipping point (2 × inflation), so the new indexed method still produces lower CGT than the old 50% discount · NDQ extra CGT of $82,400 reflects 20% growth well above the 6% tipping point — old 50% discount always better for high-growth assets · Despite the new method saving VHY investors $3,100 in CGT, NDQ after-CGT wealth ($441k) remains $126k higher than VHY ($315k) · All figures rounded to nearest $1,000

I have used AI as a research tool to perform calculations and produce visuals. If you are using this information to guide your own decisions you should consult a financial advisor, or perform these calculations yourself with your own specific information.

This investor clearly achieves a better outcome when investing in the high growth investment option. This is the case under either set of CGT tax arrangements – nothing has changed in that regard.

But if we focus on whether this young investor is better off under the new CGT arrangements or not, then in this example clearly they are not. If they invest in the high growth option, they are $82,400 worse off than under the current system. If they invest in the income option, they are $3,100 better off than under the current system. The investing approach that gives them the best outcome relative to their goals is hit hardest by the changes to the way CGT is calculated.

There is a more general pattern here. The higher the capital growth rate that their investment delivers – the higher the growth rate for the investment is above inflation – then the worse the new method of calculating CGT will be for them.

More specifically, if the growth rate for the asset is greater than twice the inflation rate, then as soon as they qualify for the CGT 50% discount (after the first year) then the investor will always be significantly better off under the old 50% discount method for calculating the CGT than they would be the proposed new indexed method. This is shown in the following table.

The underlying rule (at any inflation rate): the old 50% CGT discount always produces lower tax than the indexed real gain method when growth exceeds twice the inflation rate. This follows directly from the structure of the 50% discount — the tipping point is always exactly 2 × inflation, regardless of holding period, tax rate, or asset type.

GROWTH RATE CONDITION	INVESTOR'S OPTIMAL CGT METHOD	CROSSOVER POINT
Growth > 2 × inflation e.g. growth 10–20%+ at 3% inflation	Old 50% discount Always better, at every holding period	No crossover — old method always better for the investor
Inflation < growth < 2 × inflation e.g. growth 4–6% at 3% inflation	Depends on hold period Indexed method initially better; old 50% discount eventually better	Crossover exists — but may be very distant. The closer the growth rate is to the inflation rate, the later the crossover, potentially beyond any normal investment horizon.
Growth < inflation e.g. growth 1–2% at 3% inflation	New indexed method Always better — zero CGT due	No crossover — new indexed method always better. Real value of asset is declining; no real gain to tax.

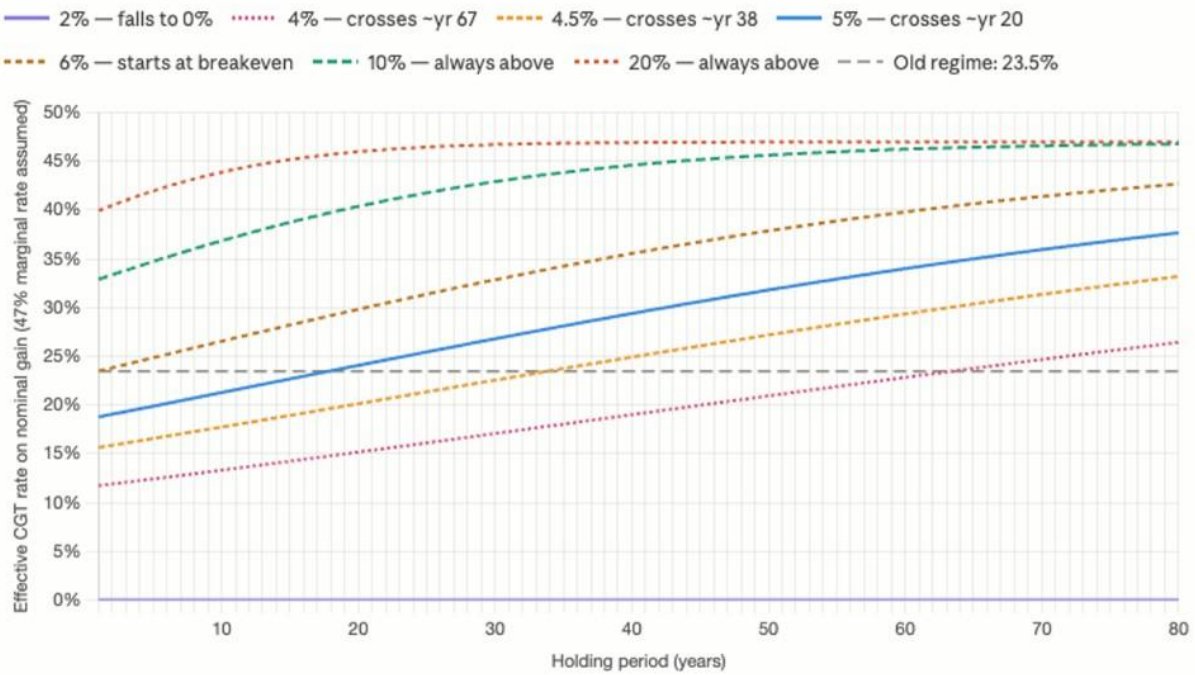
Tipping point formula: old 50% discount is better when growth > 2 × inflation. This holds from year 1 and at every holding period thereafter. At 3% inflation: tipping point = 6% growth. At 4% inflation: tipping point = 8% growth. At 2% inflation: tipping point = 4% growth. All analysis assumes the investor holds for more than 12 months and qualifies for the 50% CGT discount under the old method, and is at the top marginal tax rate (47% including Medicare levy).

If the growth rate is more than inflation but less than twice the inflation rate, the new indexing approach to calculating CGT will be better for the investor - until a crossover point is eventually reached and the old CGT 50% discount approach would deliver better outcomes for the investor.

These crossover points are illustrated in the following chart, produced to illustrate which CGT taxation method is better for an investor under the old and new proposed CGT methods when inflation is 3%. Please note again that this chart is for illustrative purposes only, and if you are using this to guide your

own decisions you should consult a financial advisor or do the calculations yourself with your own assumptions and in relation to your goals and circumstances.

Key rule: At 3% inflation, growth below 6% (= 2 × inflation) means the new indexed regime starts better — but all lines above inflation eventually cross the 23.5% breakeven and keep rising. The closer the growth rate is to inflation, the later the crossover — for 4% growth it is around year 67, well beyond any realistic investment horizon. Chart extended to 80 years to show all crossover points.



Growth rate	Year-1 effective rate	Crossover year	Practical implication
2.0% growth	0%	Never (no real gain)	Below inflation — real gain is zero, no CGT ever under new regime
4.0% growth	11.8%	~64 yrs	Crossover beyond most lifetimes — new regime practically always better
4.5% growth	15.7%	~34 yrs	Long-term hold needed before old regime becomes better
5.0% growth	18.8%	~18 yrs	Old regime better after ~20 years — relevant for long-term property investors
6.0% growth	23.5%	~1 yrs	Tipping point — regimes produce equal outcomes from year 1
10.0% growth	32.9%	~1 yrs	Old regime always better — typical for shares, diversified ETFs
20.0% growth	40.0%	~1 yrs	Old regime always better — high-growth assets, NDQ-style

Assumes lump-sum investment, cost base = $1, 3% annual CPI inflation, 47% marginal tax rate. Year-1 formula: ((growth − inflation) / growth) × 47%. Crossover year = first year where indexed effective rate exceeds 23.5%. All growth rates above inflation eventually cross — but for rates close to inflation the crossover is so distant it is practically irrelevant.

The crossover point is very sensitive to the investment rate. If the growth rate is close to twice the inflation rate, this crossover point might be reached within two or three decades; if the growth rate is close to the inflation rate, then the crossover point is unlikely to be reached during the lifetime of the investment and for assets with that growth rate the new indexed approach to calculating CGT will always be better.

Young investors are typically in the accumulation phase of investing, and typically seek high growth assets. The new CGT methods proposed are consistently skewed against the interests of young investors and are not the CGT assessment method that they would prefer or that would help them reach their goals.

The government will certainly collect more revenue from young investors under the CGT calculation method. It may even be a more economically “efficient” form of taxation.

The new CGT calculation method will raise more revenue for the government — $7 billion a year by Treasury's own projection. It may even be a more economically 'efficient' form of taxation. But it does not seem to do anything to help young investors get ahead. In fact, it would seem to have the opposite effect.

Dr Lauchlan Mackinnon is an independent researcher with interests in capitalism, vocation, and investing. He holds a Ph.D. in Economics and Philosophy from the University of Queensland.

How to minimise tax with a will

Shani Jayamanne

While Australia does not have an official inheritance tax, that doesn’t mean there won’t be tax bills and administrative delays depending upon how assets are passed on. In some cases, poor estate planning can cost beneficiaries hundreds of thousands of dollars.

The biggest misconception with estate planning is that it is purely about documenting your wishes. Proper estate planning documents wishes while providing options. I leaned on insights from estate planning lawyer Abbey John to understand how wills should be structured.

The cost of avoiding a will

The cost of avoiding a will can be significant. One of the clearest examples involves the family home. Under current tax rules, executors generally have two years from the date of death to sell a principal place of residence and retain a capital gains tax exemption.

John adds that delays are commonly caused by poorly drafted wills or the lack of a will. If you miss the two-year window entirely, there’s little to no chance to save the capital gains exemption.

Without a valid will, families may spend months determining who can act as administrator of the estate, potentially delaying the sale of assets and increasing legal and tax costs. When principal places of residence are held long-term the tax consequences may be significant.

John notes there is an appeal process for an exemption but this involves legal and administration fees that can otherwise be avoided. A successful appeal isn’t guaranteed and requires a strong, valid reason.

I’ve written a deep dive on what to do if you inherit a home here.

Testamentary trusts

Many simple wills merely divide assets without considering how beneficiaries will receive them, including the tax they will pay on sale or how to handle income generated by the asset. One way to divide assets and minimise the tax burden of the estate is a testamentary trust.

Testamentary discretionary trusts are powerful estate planning tools. These trusts are created through a will and only become active after death. Rather than beneficiaries receiving assets directly in their personal name, the inheritance is held within a trust structure.

John describes them as 'the most tax-advantageous and protective way to receive an inheritance.'

Benefits of a testamentary trust
Asset protection from creditors and bankruptcy
Greater flexibility over distributions
Potential tax savings through income splitting
Protection in family law disputes

Importantly, testamentary trusts allow distributions to minors to be taxed at adult tax rates rather than punitive minor tax rates. Under standard family trust rules, minors can typically only receive a small amount tax-free each year. Testamentary trusts allow minors to receive the adult tax-free threshold amount.

Income for the year	Tax rates
$0 – $416	Nil
$417 – $1,307	Nil plus 66% of the excess over $416
Over $1,307	45% of the total amount of the income that is not excepted income

Figure: Tax rates for residents who are under 18 for 2024–25 without a testamentary trust Source: ATO

With a testimonial trust families may be able to distribute income to children or grandchildren in a tax-effective way to help fund expenses such as education costs.

John charges around $1,100 for a simple will, while a will with a testamentary trust costs roughly $2,000. The trust itself sits dormant until death and does not create ongoing costs while the will-maker is alive. As a rough guide, she says estates of around $250,000 per beneficiary may justify the structure.

Testamentary trusts are not for everyone. They may not make sense for beneficiaries who permanently live overseas and are not Australian tax residents. They do not receive the benefits of structuring for tax minimisation. If the inheritance is relatively small, the ongoing accounting and tax return costs may outweigh potential benefits.

Structuring to get the most out of your super

Superannuation is often one of the most tax-sensitive assets in an estate because it does not automatically form part of your will. Instead, super is governed by the rules of the super fund and your binding death benefit nomination.

Binding death benefit nominations must be made to a valid dependent. If they are not a tax dependent, such as an adult child, they can face tax when inheriting super directly.

In some situations, directing super benefits to the estate instead of directly to adult children may reduce the overall tax burden. Nominating your Legal Personal Representative (LPR) on your binding death nomination form means that adult children will pay tax, minus the 2% Medicare Levy. On large estates, avoiding the Medicare levy is meaningful.

John adds that this strategy only works if the estate plan and binding death benefit nomination are properly aligned.

The biggest mistake with wills

DIY wills can make already emotional situations more complex. DIY or generic online wills are meant as a catch all for the general population and do not take your specific circumstances into account. Broad or general wording leaves the document up to interpretation. Estate planning language must be precise because executors rely entirely on the wording of the document when administrating an estate.

Any ambiguity can increase the risk of disputes and potentially expose executors to personal liabilities.

Three things to review

I finished my conversation with John by asking what are three things that each of us can do to improve the tax effectiveness of their estate plan. She believes the first place to start is a review. The second is assessing whether growing wealth means a simple will is no longer sufficient. The last is ensuring your binding death benefit nomination aligns with your estate plan.

Above all, don't avoid estate planning because it feels uncomfortable. Dealing with it now ensures that you have the best chances of your wishes being honoured and saves any potential conflict or confusion at an already emotional time.

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AI can't pick winning funds, but it can help you avoid losers

Larry Swedroe

In recent years, machine learning has been touted as a game changer for investment management. The authors of "Machine learning and fund characteristics help to select mutual funds with positive alpha," published in the December 2023 issue of the *Journal of Financial Economics*, claimed that machine-learning methods could identify long-only mutual fund portfolios earning significant out-of-sample annual alphas of 2.4% net of all costs. For believers in active management, this was the financial equivalent of the search for the Holy Grail.

What new research uncovered about machine learning

Two years later, a new set of researchers performed a replication analysis of the 2023 study for their own paper, "Does machine learning really help to select mutual funds with positive alpha?" These researchers found that the original results were driven by a coding error that inadvertently gave the algorithms access to future information—a classic case of look-ahead bias.

The error was technical but consequential. When constructing portfolio returns, the original code updated portfolio weights using next month's returns rather than the current month's returns, peeking into the future when making investment decisions, which is impossible in real-world investing. After correcting this error, the impressive outperformance vanished entirely. The annual returns dropped by 1.37 to 1.42 percentage points for the best performing algorithms, and none remained statistically significant. The authors also identified a survivorship bias in the original study.

What works in machine learning (and what doesn't)

The researchers didn't stop at identifying the error. They conducted a complete independent replication using fresh data from 1980 to 2024 and revealed several important insights.

First, machine learning cannot identify mutual fund portfolios that beat the market on a long-only basis. Whether using sophisticated techniques like random forests and gradient boosting or simpler linear models, none of the approaches generated statistically significant positive returns when investing only in top-predicted funds.

This finding held across:

- Different time periods (through 2024).
- Various forecasting horizons (12 to 36 months).
- Multiple risk-adjustment models.

However, machine learning proved effective at identifying funds likely to underperform.

The algorithms consistently identified bottom-decile portfolios that delivered significantly negative returns—around negative 2% to negative 3% annually. Both sophisticated machine learning methods and simple linear regression successfully flagged the worst performers.

When researchers constructed long-short portfolios (buying predicted winners, shorting predicted losers), they found annual returns of 3.00% to 3.05% that were statistically significant. However, virtually all of this performance came from the short side—avoiding the losers.

Linear models hold their own

Surprisingly, simple linear models (ordinary least squares and elastic net regression) performed just as well as—and sometimes better than—sophisticated non-linear machine learning methods over 12-month horizons.

The advantage of complex machine learning only emerged at longer forecasting horizons (36 months), where non-linear methods maintained their predictive power, while linear models lost statistical significance.

Their findings led the authors to conclude: "Our results suggest that ML adds value primarily through the consistent avoidance of poorly performing funds rather than by identifying long-only outperforming ones."

Key takeaways for investors

1. Beware the winner-picking fantasy

The dream of using artificial intelligence to systematically identify outperforming mutual funds remains elusive. Even with sophisticated algorithms and comprehensive data, generating consistent long-only outperformance above benchmark returns proved impossible.

2. The real value: Screening out underperformers

The practical application of machine learning in fund selection lies not in picking winners, but in avoiding losers. Algorithms can effectively flag funds exhibiting characteristics associated with future underperformance:

- Negative past alpha t-statistics
- Poor value-added metrics
- Unfavorable risk factor exposures

3. Simple may be better

For investors with 12-month horizons, sophisticated machine learning offers little advantage over simpler statistical approaches. Basic regression models using fund characteristics like past alpha, expense ratios, and factor loadings can be nearly as effective—and far more interpretable.

4. Time horizon considerations

For institutional investors with longer time horizons (more than three years), more sophisticated machine learning methods performed better, though they identified only future underperformers, not outperformers. The researchers found that non-linear techniques maintained their advantage over linear models only at 36-month forecasting horizons.

The bigger picture

This research serves as an important reminder that in finance, extraordinary claims require extraordinary evidence. The original findings were remarkable because they contradicted decades of empirical research showing that active fund management rarely beats the market after fees, and there has been no evidence of strategies that have successfully identified the few winners ahead of time—though many attempts have failed (such as active share).

The corrected analysis aligns with this body of evidence: On average, actively managed mutual funds underperform, and while some tools can help identify likely underperformers, the search for systematically superior performers remains unsuccessful.

Practical advice for investors

Rather than chasing the promise of machine-learning-selected outperformers, consider these evidence-based strategies:

1. Use screening tools to avoid red flags: Poor past performance, high expenses, unfavorable factor exposures, and young fund age are warning signs worth heeding.

2. Focus on costs: Because predicting winners is so difficult, minimizing expense ratios becomes even more critical to net returns.
3. Consider systematic (passive) alternatives: The difficulty of both identifying winning active managers and implementing effective active selection strategies strengthens the case for low-cost index funds and other systematic strategies such as those of Avantis, AQR, Bridgeway, and Dimensional.
4. Be skeptical of back-tests: This episode illustrates how easily coding errors or methodological choices can create illusory performance. Always look for independent replications and out-of-sample validation.

Machine learning isn't magic, even in the age of AI

While these tools offer some value in flagging funds to avoid, they haven't solved the fundamental challenge of active management: consistently identifying *future* outperformers.

For most investors, the lesson remains clear: Focus on controlling costs, maintaining diversification, and being deeply skeptical of anyone claiming to have discovered a systematic way to beat the market using active management strategies.

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.

This article was first published by Morningstar.com, and has been edited slightly for an Australian audience.

Inflation BIG picture: Boomers got lucky, next Gen not so much

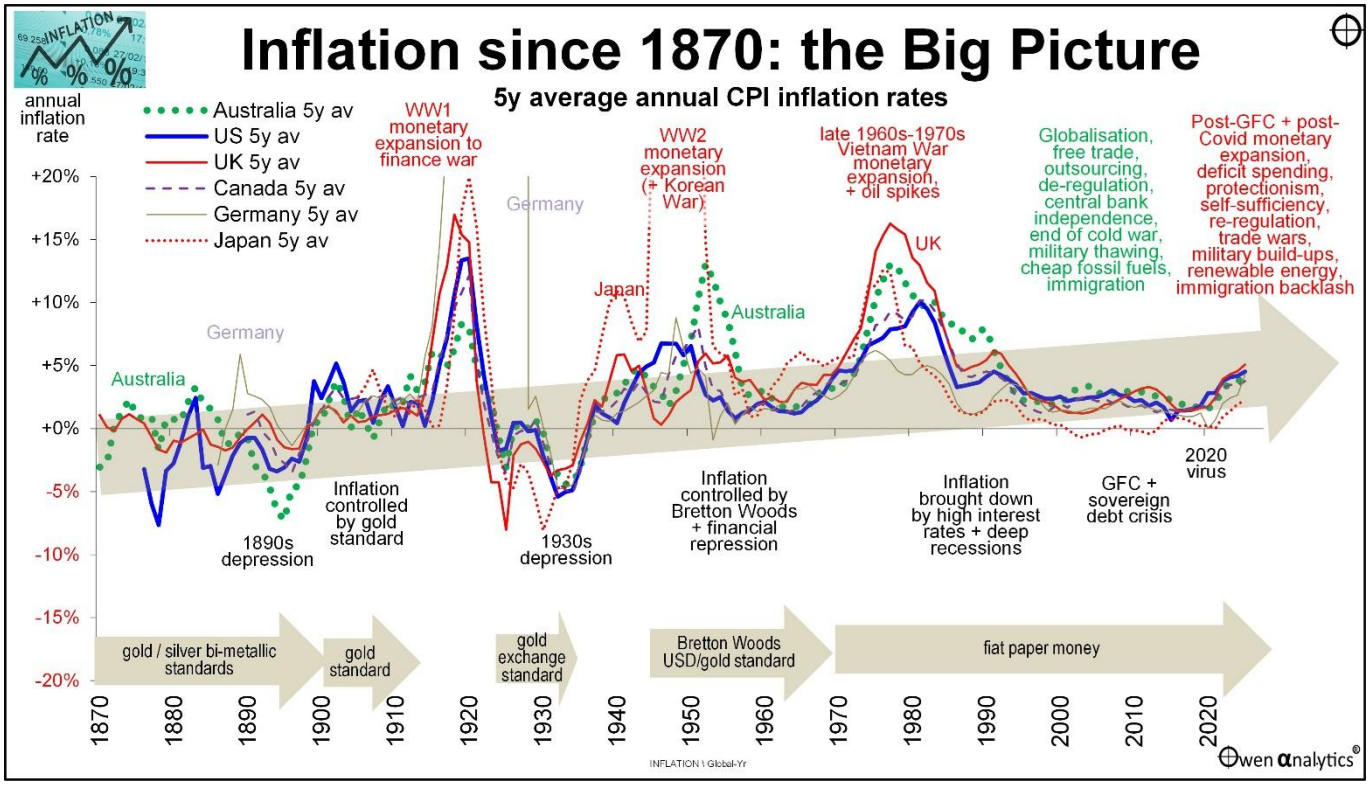
Ashley Owen

Here's my go-to chart on the BIG Picture on inflation over the past 150 years. Here we are talking about serious long-term investing.

Over the past few decades, I have advised (and mentored advisors for) serious long-term investors, including family offices, perpetual charities and endowments, where investment time frames are measured in generations, not just in decades and years.

But for mere mortals like me and ordinary investors and retirees, it is also useful to look at the big picture to understand where we are in the grand scheme of things, for an insight into where we may be heading.

Today's chart shows inflation rates in Australia and other major global markets since 1870. Here I have used five-year average inflation rates in each market in order to smooth over temporary effects like cyclical booms and busts, recessions and rebounds, and one-off impacts like the GFC, Covid, etc.



1 – Inflation is a global phenomenon

The first obvious stand-out is that inflation in all markets travel along similar paths. Each market is different of course due to local variations – like German hyperinflation in the early 1920s and Japanese hyperinflation in the late 1940s.

But, aside from local differences here and there, they all follow the same overall path. Why? Because capital markets are global.

Economic and monetary theory/ dogma/ fads are also global. We can see this clearly on the chart as the world shifted from one dominant theory to the next. Each monetary theory/ dogma/ fad-du-jour takes about a generation to be abandoned and replaced by the next.

We have just moved into a new phase, as explained below.

2 – Overall rising inflation over time

A second immediate observation is that there has been a persistent upward inflationary trend over the past 150 years covered by this chart.

This runs against academic finance theory, which does acknowledge and accept diversions from the mean, but it assumes reversion to some long-term average or mean level. From this chart it is clear that there is no long-term average level for inflation. On the contrary, there seems to be a long-term trend upward over time – over this 150-year medium-term time frame anyway.

3 – Multi-decade phases along the way

A third observation is that inflation appears to work in multi-decade phases – switching from long periods of rising and high inflation, to long periods of falling/low inflation, and back again.

Why? A combination of global geo-political structure and conditions, and economic/monetary theory phases.

4 – Military build-ups

We can see on the chart that the three periods of high inflation in the past 150 years were all driven by military build-ups and war-time spending. This has been the pattern throughout history in general, going back literally thousands of years. Governments have always resorted to inflationary money-printing to finance military build-ups and wars.

(I have studied dozens of repeats of this consistent pattern - since Dionysius (405 - 367 BC), the despotic and tyrannical ruler of Syracuse (Sicily) during the wars between the Corinthians, Athenians and Carthaginians for the control of Syracuse. Dionysius invented two great weapons of mass destruction – the catapult and money debasement. The catapult was used to great effect in destroying the Athenians, but his debasement of money in his own city to finance the war resulted in rising inflation, unrest and rebellion among his people, and led to his ultimate downfall. But that is another story for another day!)

5 – Now into the next rising inflation / interest rate phase

We have just enjoyed a wonderful multi-decade period of declining/low inflation since the early 1980s inflation-busting recessions in the US and UK (Australia was a decade late and only seriously tackled inflation in the 1990-91 recession).

That wonderful era of declining inflation and interest rates, which resulted in high real returns on shares and bonds, is now over.

Since the 2020-21 Covid stimulus spending sprees, the world is now into the next period of rising/high inflation.

Why? Because the recent disinflation era of declining inflation and interest rates did not happen by chance. It was the result of a set of ideas that were born out of failure of the post-WW2 policies that resulted in high inflation and stagnant growth from the late-1960s to late 1970s.

The problem now is that every one of the factors that drove lower inflation and interest rates in the recent disinflation cycle have now **ended and reversed, and are now driving inflation and interest rates higher**:

- Free trade with stable, low tariffs – now volatile, unpredictable tariff wars.
- Outsourcing to cheap labour countries – now ‘on-shoring’, ‘friend-shoring’ at higher cost.
- Specialisation in industries with comparative advantage – now national ‘self-sufficiency’.
- Globalisation – now trading blocs between strategic allies.
- ‘Just-in-time’ supply chains – now ‘just-in-case’ requiring higher inventories and working capital.
- Free movement of people – now increasingly xenophobic backlashes, restrictions.
- Free movement of ideas – now increasingly restricted, weaponised.
- ‘Rules-based’ international order – now volatile, power-based ‘law of the jungle’.
- ‘Peace dividend’ - lower military spending after fall of Soviet empire – now rising military spending everywhere.
- Central bank independence – now increasingly political and pressured to support government deficits/debt.

- De-regulation of financial markets – now re-regulation, rising costs of compliance, remediation.
- De-regulation labour markets – now re-regulation, rigidities, centralisation.
- Expansion of cheap fossil fuels lowering energy prices – now capital-intensive transition to 'renewables', more red/green/black tape/costs for new projects.
- Stable flow of cheap oil from petro-dollar middle east – now unstable, volatile.
- 'Balanced budgets over a cycle' – now endless government deficits and debts.
- Schumpeter's cleansing/renewing power of recessions and bankruptcies – now governments bail out everything.
- Small government mantra – is now big governments, interfering in anything and everything.
- Individual self-reliance – now cradle-to-grave universal welfare state.
- Free markets – now government subsidising political pet projects, 'strategic' industries, distorting/diverting capital.

This new economic orthodoxy driving inflation (and interest rates) higher will probably last a couple of decades or so until it too fails and is replaced by the next set of ideas, as in past cycles.

The counter view

Meanwhile, while each of the above factors drove inflation down in the last era and are now driving inflation upward in the current era, the 'ai' crowd insists that 'ai' will reduce the labour cost of everything to zero and therefore dramatically reduce the cost of all goods and services, driving CPI inflation down to near zero.

Which will it be? Who knows? Personally, I am in the higher inflation camp.

The 'so-what' for investors

Since inflation seems to work in long, multi-decade cycles, and is certainly not constant or random, we need to ensure that our investment strategies for long-term portfolios take into account the likely inflationary outlook from where we stand today. It would be unwise to merely assume that inflation and investment returns from the last few decades will continue into future decades, or that inflation will miraculously settle back to its long-term average and stay there forever.

The problem is that Boomers (through pure luck of birth) got rich during the golden post-1980s era of declining inflation and interest rates which boosted real returns on shares, bonds and real estate, and boosted their current retirement portfolios to where they are today.

All of those great-looking 10-year, 20-year and even 30-year historical returns from Super funds (and our own funds) will NOT be repeated in the future. They were boosted by tailwinds of declining and low inflation and interest rates. That era has not only ENDED but is now REVERSED into the current new era of RISING inflation and interest rates, which will depress future nominal and real returns.

Younger generations (born in 1990s-2000s, who are now early in their investing journeys) drew the short straw, just like the generation of investors born in the 1940s, 1880s, etc (ie 20 years before rising inflation cycles).

They face much lower nominal real returns from shares, bonds and real estate during their next couple of decades. (Mind you, many of the Boomers' kids and grandkids are benefiting in the form of inheritances and 'Bank of Mum and Dad').

Retirement planning?

How does this affect questions like 'How much do I need' and 'How much can I afford to spend'?

Calculations based on simply extrapolating the past three decades of great returns are probably going to turn out to be far too optimistic.

By the time you realise this, it may be too late to 'go back to work', or 'take on a new side-gig', or 'cut spending'. It would be prudent to assume that more capital is required per dollar of spending, and that the proportion of capital that you can safely afford to spend, is probably lower than the traditional calculations suggest.

(Personally, I have always based my plans on a minimum multiple of 25-30 times spending, ie max spend rate of 3-4% of investment fund. Just cautious I guess, as I have always focused on understanding drivers of returns rather than just extrapolating the past into the future.)

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.

Tax deductibility of financial advice improves affordability

Sarah Abood

The rapid decline in the number of financial planners in Australia over the past decade (from around 28,000 at the peak in early 2019 to just over 15,100 today) has been a huge factor in reducing the accessibility and affordability of financial advice. On top of this, the impact of increased regulation and red tape has made it more expensive for advisers to run their business, which also affects the cost of advice.

And of course, this is happening at a time when more Australians than ever would benefit from financial advice. The intergenerational wealth transfer, the rising cost of living, taxation reform and economic uncertainty, are all contributing to an environment where Australians need quality, professional financial advice in order to achieve financial wellbeing.

One simple step to make advice more affordable for more Australians has been to make more types of financial advice tax-deductible. Most ongoing financial advice is already deductible, but an important extension was finalised by the ATO in late 2024, confirming that some upfront advice can also be tax deductible.

In TD 2024/7, the ATO has confirmed that upfront financial advice fees are deductible to the extent they relate to tax advice.

The result is that more Australians should be able to deduct a larger portion of both their initial (as well as ongoing) financial advice fees.

What is deductible

The definition of tax (financial) advice can include all or part of the fee for superannuation advice about contributions such as salary sacrificing, advice around superannuation pension strategies, advice on whether or not certain insurance policies should be held inside or outside of super, gearing strategies, some estate planning advice and investment structuring for taxation purposes.

What Is deductible?

Fee Type	Deductibility	Key points
Initial Advice Fees	Likely to be partially deductible under s 25-5 Generally not deductible under s 8-1	*Tax (financial) advice* fees are generally deductible ATO regards these fees generally as capital in nature
Ongoing Advice Fees	Partially or fully deductible under s 8-1 and/or s 25-5	Based on whether the advice relates to investments generating assessable income or managing tax affairs

Note: Fees paid from superannuation funds are not deductible to the individual.

Source: FAAA

How the adviser determines what portion of the advice given relates to taxation advice is complex and must be evidence based. An example can help illustrate how this might work.

Let's look at the case of Leo, a pre-retiree in his 50s looking to retire in the near future and seeking advice from financial adviser Amy. The total initial advice fee paid by Leo (i.e. not his super fund) is $5,500.

Amy and Leo have an initial consultation of one and a half hours, during which they discuss a range of factors, including a general discussion about tax affairs.

After the meeting, Amy investigates and analyses Leo's existing investments and circumstances for half an hour which includes a CGT report and an examination of his contribution caps.

Overall, Amy breaks down each portion of time she spends on Leo's affairs and what part of that time is spent on tax (financial) advice. This includes 1.5 hours spent on strategy modelling, 2 hours spent on strategy development, 5.5 hours spent on writing the statement of advice and another hour-long meeting with the client to present the Statement of Advice.

In total, Amy assesses that $2,831 of the initial fee of $5,500 is tax deductible (51%).

If Leo is on a salary of $155,000 and a marginal tax rate of 37 cents in the dollar for income earned over $135,000, that tax deductibility represents a saving of $1,047 on his upfront advice fee, reducing the effective total fee to $4,453.

Affordability gains

In this example, the deductibility of certain portions of the financial advice fee is an effective 20% reduction in cost.

Our annual Value of Advice consumer research consistently shows that advised clients are much more confident about their financial affairs, with 96% in our most recent survey for 2025 saying that it has provided them with more value than it costs, and 93% reporting that their financial adviser has made them tangibly financially better off.

By reducing the overall effective cost of advice, the tax deductibility of some parts of the advice fee further improves affordability and allows more Australians to access financial advice.

So if you are a financial advice client, make sure you talk to your accountant and financial adviser about tax deductibility of any advice fees, when finalising your tax return for FY26!

Sarah Abood is the Chief Executive Officer at the Financial Advice Association Australia (FAAA).

Retirement in reality – 3 months in

Dr Joanne Earl

For those of you who have just connected, I retired 3 months ago from being a full-time academic after researching retirement planning for nearly 20 years. Now I am focusing on implementing my findings: for myself, for individuals and for organisations. As I promised when I retired, I am providing a month-by-month account of my findings from the other side. There are four things I'll focus on from this past month:

Travel

Back from the cruise and Vancouver. Still not convinced about how travels interact with retirement adjustment especially with two over-stuffed cases to be unpacked and a whole lot of admin to take care of that built up while I was away. A cramped, 14-hour bumpy plane ride back with stale sandwiches leads me to hypothesise a negative relationship between air travel and retirement adjustment. I can't fault the value of travel for catching up with people in person though. My travels to the US allowed me to catch up with Doug Hershey. Doug was the first academic to combine psychology and retirement planning. I consider him the original thought leader in the area and a great career mentor.

Vancouver, Queen Elizabeth Park- May 12th. Taken with my own camera.

Decision-making and prioritising

Doug himself retired about 5 years ago; he downsized and moved across America. So what's more interesting than reading this blog? Hearing about how Doug and his wife Ilda made a very considered decision about where to move for their retirement. Their decision-making process involved not only identifying criteria for their new location but weighting those criteria, and then assigning scores to each of the possible locations. They then multiplied scores on each of the criteria by the weightings to give each possible location a total score out of 100. They narrowed it down from about nine locations to their final destination using this process. Interesting, huh? I wonder how many people considering a tree change or sea change put in that much effort? Or are simply impressed by the house they saw on a real estate website. It is an idyllic spot but so much more - it's an ungated community with separate dwellings, a natural lake, forests, community garden, swimming pool, library, spa, health and fitness studios. Worth the extra decision-making effort, I'd say.

Time

You know that horrible feeling you get when your week seems too full to be manageable and how you'll never get it all done? Well, I'm finding it follows you into retirement and experiencing the residual effect of that already. It feels like everything is happening at once, but the difference is of course these things are not being executed inside or in addition to a normal 'work week' – these **are** the normal 'work week'. I'm probably talking about 14 hours of new activity. It's hard to fight the impulse to mentally calculate 60 hours + 14 hours. Still struggling to combine all my diaries on a single mobile device given limited access rights to some email addresses and usability issues of others. Any suggestions?

Health

I mentioned in my last post that one of the buckets I was trying to fill more was health. Maintaining a regular fitness schedule was easy on a cruise with a gym on board and regular fitness classes scheduled. It's a bit different when you return home and need to make more of an effort. One of the things I know from my research is the importance of implementation intention. This is where the more specific you can be about making a goal actionable - the better. So as soon as I got back, I scheduled some extra activities to try – Hot Yoga and a second HIIT class. Just to put you fully in the picture I previously attended a HIIT class on Mondays and a Yin Yoga class on Friday. Now I'm trying to fit something in every day and sometimes twice a day. Feels like a lot but I figure not everything will work for me, so I'll drop it later. I'll keep you posted on what did and didn't work for me.

So if you are looking for some advice this month, I would suggest booking in just two new activities this month using the implementation intention idea. Remember to include what, when, where, with who, book ahead and turn up. Just booking it in does not count.

Don't forget to visit my website at www.retirementdr.com.au. I'm offering free 30-minute meetings during June and July for anyone interested.

Joanne Earl is a Psychologist and Honorary Professor of Psychology and Retirement Planning. You can read more about Joanne's retirement journey via LinkedIn or visit her website: www.retirementdr.com.au.

Calculating the business cost of Australia's new 'productivity tax'

Richard Holden

A Productivity Tax exists when the interplay of different taxes means high productivity businesses pay a higher tax rate than low productivity businesses.

A high productivity business is a business that grows fast, at a speed above inflation; low productivity businesses grow more slowly, usually at or below the inflation rate. High-productivity businesses create more jobs and more economic activity. Low productivity businesses do the opposite, often shedding jobs over time.

In a profound oversight, a new economic analysis shows that the new business tax regime announced in the recent federal budget creates this exact situation. Two identical businesses, delivering the exact same service, one highly productive, the other unproductive, will now face vastly different effective capital gains tax rates.

As the example below shows, the high productivity businesses, the business that creates more jobs and more economic growth, will pay a vastly higher rate of capital gains tax on the sale of the business than a low productivity, low growth business.

How the 'productivity tax' works in practice

There are two industrial cleaning businesses started at the same time, by two different husband-and-wife teams. Both couples are in their early thirties.

Business 1 is a low productivity business. Business 2 is high productivity.

They both begin with an initial investment of $450,000. This is the life savings of both husband-and-wife teams. Both businesses generate $2,000,000 of revenue in their first year. Both have 4 employees, and both generate a profit of $150,000 in their first year.

Over the next five years, Business 1 – the low productivity business – grows at 3% a year, ends up generating a profit of a little over $300,000 in the 5th year, and is sold for 4 times that – around $1.2 million. It still employs 4 people. With inflation at 3% a year, **Business 1** has a taxable capital gain of $680,000. Under the new capital gains tax regime, they pay 47 cents on the dollar, or about $320,000 in CGT. That's an effective tax rate of 26.6% of the sale price.

Business 1: Low productivity business, with a growth rate of 3% p.a., inflation rate of 3% p.a. and initial investment of $450,000:

	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Revenues	$2,000,000	$2,060,000	$2,121,800	$2,185,454	$2,251,018
Fixed costs	$1,050,000	$1,050,000	$1,050,000	$1,050,000	$1,050,000
Variable costs	$800,000	$824,000	$848,720	$874,182	$900,407
Costs	**$1,850,000**	**$1,874,000**	**$1,898,720**	**$1,924,182**	**$1,950,407**
Profit	**$150,000**	**$186,000**	**$223,080**	**$261,272**	**$300,611**
Employees	4	4	4	4	4

Business 1: profit, capital gain and effective tax rate:

Cumulative profit (Years 1–5)	**$1,120,963**
Indexed investment	$521,673
Sale multiple	4x Year 5 profit
Sale price	$1,202,442
Capital Gain	**$680,769**
CGT @ 47%	**$319,961**
Net gain	**$360,808**
Effective tax rate	**26.6%**

Over the same five years, **Business 2** – the high productivity business – grows at 15% a year each year for 5 years. They end up employing 6 people. They also sell it for 4 times the year 5 profit of $1.05 million, or $4.2 million. They have a taxable capital gain of $3.67 million, pay $1.7 million in CGT, for an effective tax rate of 41.2% of the sale price.

Business 2: High productivity business, with a growth rate of 15% p.a., inflation rate of 3% p.a. and an initial investment of $450,000:

	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Revenues	$2,000,000	$2,300,000	$2,645,000	$3,041,750	$3,498,012
Fixed costs	$1,050,000	$1,050,000	$1,050,000	$1,050,000	$1,050,000
Variable costs	$800,000	$920,000	$1,058,000	$1,216,700	$1,399,205
Costs	**$1,850,000**	**$1,970,000**	**$2,108,000**	**$2,266,700**	**$2,449,205**
Profit	**$150,000**	**$330,000**	**$537,000**	**$775,050**	**$1,048,807**
Employees	4	4	5	6	6

Business 2: profit, capital gain and effective tax rate:

Cumulative profit (Years 1–5)	**$2,840,857**
Indexed investment	$521,673
Sale multiple	4x Year 5 profit
Sale price	$4,195,230
Capital Gain	**$3,673,557**
CGT @ 47%	**$1,726,572**
Net gain	**$1,946,985**
Effective tax rate	**41.2%**

Both businesses took a risk, grew a business, employed people, and paid tax, and both sold for the same multiple of profit. It's just that Business 2 was more productive.

In return for this high productivity the couple who started **Business 2** are punished with a capital gains tax rate more than 55% higher than the owners of **Business 1**.

In other words, the new tax system will now punish businesses more likely to create jobs and economic growth, and reward businesses more likely to shed jobs.

Summary comparison

Effective tax rate: Low Productivity	**26.6%**
Effective tax rate: High Productivity	41.2%
Tax multiple (High ÷ Low)	1.55x

This is the worst possible plan for a country in need of more jobs, and more economic growth. It's a Productivity Tax in the middle of a productivity crisis.

Unfortunately, that is the perverse logic of a Productivity Tax, they punish high productivity businesses for doing well, growing fast, and creating more jobs.

Young people will pay the biggest price for this profound policy error, because they will miss out on the jobs, growth, and prosperity that productive businesses create.

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